IRAN ECONOMIC MONITOR

Sustaining Growth Amid Rising Geopolitical Tensions

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Iran Economic Monitor

Sustaining Growth Amid Rising Geopolitical Tensions

With a Special Focus
Recent Poverty and Inequality Trends in Iran (2020–2022)

Spring 2024

Middle East and North Africa Region

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ABBREVIATIONS AND ACRONYMS

CAB	Current account balance
CAR	Capital adequacy ratio
CBI	Central Bank of Iran
COVID-19	Corona Virus Disease 2019 (Novel Coronavirus)
CPI	Consumer price inflation
bbl	Barrel of crude oil
ER	Exchange rate
FATF	Financial Action Task Force
GDP	Gross domestic product
IEM	Iran Economic Monitor
IPI	Industrial Production Index
IRICA	Islamic Republic of Iran's Customs Administration
IRR	Iranian Rial
ITS	Information and telecommunication services
LHS	Left-hand-side
M0	Monetary Base
M2	Broad Money
mbpd	Million barrels per day
MENA	Middle East and North Africa
m/m	Month-on-month
mm	Millimeters
NDFI	National Development Fund of Iran
NIMA	Unified system of foreign exchange transactions (Persian acronym)
NPL	Non-performing loan
OPEC	Organization of Petroleum Exporting Countries
p.a.	Per annum
PBO	Plan and Budget Organization
pp	Percentage point
PRC	Parliament Research Center
RHS	Right-hand-side
q/q	Quarter-on-quarter
SCI	Statistical Centre of Iran
SCO	Shanghai Cooperation Organization
TEDPIX	Tehran Stock Exchange main index
TSE	Tehran Stock Exchange
US	United States of America
US$	United States Dollar
WAP	Working age population
y/y	Year-on-year

PREFACE

The Iran Economic Monitor (IEM) provides an update on key economic developments and policies. It examines these economic developments and policies in a longer-term and global context and assesses their implications for the outlook for the country. The IEM's coverage ranges from the macro-economy to financial markets to indicators of human welfare and development. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged on Iran.

The Iran Economic Monitor is a product of the World Bank's Global Practice for Macroeconomics, Trade and Investment (MTI) team within the Global Practice Group for Equitable Growth, Finance and Innovation (EFI). The eleventh issue of the IEM was prepared by Majid Kazemi (Economist, Task Team Leader, EMNMT) and Razieh Zahedi (Consultant, EMNMT) under the general guidance of Jean-Christophe Carret (Regional Director), Eric Le Borgne (Practice Manager, EMNMT), and Norbert Fiess (Lead economist, EMNDR). The special focus chapter on the recent poverty and inequality trends was prepared by Eiman Osman (Young Professional, EMNPV) and Erwin Knippenberg (Economist, EMNPV) under the supervision of Salman Zaidi (Practice Manager, EMNPV). The team is grateful to the Government of Iran and the United Nations Resident Coordinator Office in Iran for their contributions to this publication.

The findings, interpretations, and conclusions expressed in this Monitor are those of World Bank staff and do not necessarily reflect the views of the Executive Board of the World Bank or the governments they represent.

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EXECUTIVE SUMMARY

Iran's economy is growing for a fourth consecutive year aided by the recovery in the oil sector and despite ongoing economic sanctions. Real Gross Domestic Product (GDP) growth accelerated to 5 percent year-over-year (y/y) between April and December 2023, which corresponds with the first nine months of the Iranian year of 2023/24 (9M-23/24), driven by the oil sector and services. The oil sector, accounting for 8.6 percent of GDP in the period, expanded by 16.3 percent (y/y) fueled by a tighter global oil market and improved oil exports despite sanctions. The non-oil sector also grew by 3.5 percent (y/y), supported by domestic demand and exports to selected neighbors. However, economic imbalances from price and policy distortions, the economic cost of ongoing sanctions, and heightened geopolitical uncertainty weigh on prospects for sustainable and more broad-based growth.

The economic rebound has improved employment outcomes, but labor market challenges remain. In 2023/24 employment surpassed the pre-pandemic level, growing by 3.3 percent. This brought the unemployment rate to a record low of 8.1 percent. Over the last few years, the labor-intensive agricultural sector has suffered job losses due to drought and water shortages; the adverse labor market impact was offset by expansions in the industrial and service sectors. Despite a growing working-age population, only 41.3 percent of the working-age population participates in the labor market, with notably low female participation at 14.2 percent. The low economic participation rate is driven by lack of jobs, skills mismatch, and barriers to entry in certain professions. Unemployment rates vary across subgroups, with women, youth, and university graduates experiencing significantly higher unemployment rates. At the same time, the emigration of skilled workers creates labor shortages in various sectors, such as IT, teaching, nursing, and surgery. The looming demographic shift related to the aging of the population poses new challenges for the labor market, productive sectors, and the pensions and social protection system in the medium term.

Lower-than-planned government revenues in 2023/24 resulted in a reprioritization in expenditures. In 2023/24, only 73 percent of budgeted revenues are estimated to have been collected, primarily since only 55 percent of the planned oil revenues are estimated to have materialized. Besides ambitious export volumes envisioned in the budget, substantial discounts on Iranian oil export prices depressed oil revenues. In contrast, tax revenues reached 90 percent of their intended target, driven by direct tax revenues, particularly from income and corporate taxes, and despite a significant shortfall in import taxes due to limits on automobile imports. The revenue shortfall led the government to reduce expenditures. As assets sales and privatization fell significantly short of targets, to cover the budget deficit (estimated at 1.9 percent of GDP), the government resorted to financing from the National Development Fund and borrowing from the banking system.

A decline in oil prices and higher imports narrowed the current account surplus in 2023/24 despite an expansion in export volumes. Lower oil and petrochemicals prices led goods exports to edge down by 0.4 percent (y/y) in nominal terms in 9M-23/24. This, together with 10.9 percent (y/y) higher imports, more than halved the current account surplus to 1.6 percent of GDP (US$6.3 billion). This trend continued into the second half of the year, leading to non-oil trade deficit of about 4 percent of GDP (US$16.9 billion) in 2023/24. The greater concentration of trade to the top 3 key trading partners makes external accounts even more susceptible to terms of trade shocks and the demand of key partners. Recent efforts including membership in BRICS (the intergovernmental organization originally comprising Brazil, Russia, India, China and South Africa) and Shanghai Cooperation Organization (SCO) aim to promote trade but have had limited impact due to non-membership in Financial Action Task Force (FATF) and ongoing sanctions.

Consumer price inflation (CPI) remains elevated but closely impacted by inflationary expectations of geopolitical developments reflected in the exchange market. Headline and core CPI averaged 40.7 percent and 40.8 percent in 2023/24, respectively. High inflation has been primarily driven by food prices and housing costs. Lower global commodity prices, attempts towards tightening monetary policy, and moderating inflationary expectations from limited progress in negotiations with the US contributed to inflation easing from 55.5 percent (y/y) in April 2023 to 31 percent (y/y) in May 2024.

Recent trends in Iran show progress in reducing poverty and improving income inequality, driven by inclusive growth and supplemental cash transfers. Between 2020/21 and 2022/23, poverty rates as measured at US$6.85 a day decreased by 7.4 percentage points, from 29.1 percent to 21.9 percent. 6.1 million Iranians were lifted above the poverty line. Using the lower-middle income poverty line of US$3.65 a day, poverty declined from 6.1 percent to 3.8 percent. Inclusive consumption growth, driven by increased earnings from wages and self-employment in the non-oil sector contributed to the decline in poverty. Social programs, including cash transfers and pensions, played a significant role in poverty reduction. While the real value of regular cash-transfers has eroded with inflation, these have been supplemented with a series of top-ups since 2019. However, regional disparities persist, and poverty in rural areas remains more than twice as high as in urban areas.

GDP growth is forecast to moderate to an annual average of 2.8 percent during 2024/25 to 2026/27. Weaker global demand, sanctions, energy shortages, liquidity constraints, declining capital stock, and geopolitical tensions contribute to the growth outlook. GDP in 2024/25 is now forecast to grow at a more moderate rate due to the projected slower growth in government expenditures and the base effect of the larger oil GDP growth in 2023/24. While recent government plans to consolidate the budget in 2024/25 help to improve the fiscal outlook, fiscal pressures are forecast to persist, resulting in a fiscal deficit, compounded by off-budget expenditures. Inflation projections have also marginally improved but are still expected to remain above 30 percent annually, fueled by the government budget deficit financing operations and the impact of geopolitical tensions. The current account surplus is projected to gradually decrease, influenced by a projected decline in oil prices. Barriers to non-oil export promotion, including restricted access the international banking system and product markets for both sourcing intermediate material and as export destinations, lack of integration in supply chain networks, tariffs, and limited scope of export diversification constrain non-oil export growth potential.

The economic outlook is subject to significant risks related to economic, climate change, and geopolitical developments. A sharper than anticipated decline in global demand and oil prices would adversely affect economic growth and further limit the fiscal space needed for pro-growth and social protection measures. The growing concentration of trade with limited trading partners such as China, exposes the economy to fluctuations in these partners' economic prospects. More frequent extreme weather events threaten agricultural production and employment and pose a risk to food security and livelihoods. The intensification of economic sanctions, significantly impacting trade with neighbors and existing trade partners, would significantly weigh on growth and exports. Over the last year, risks to Iran's economy from the potential repercussions of the escalation of conflict in the Middle East have increased significantly. Scenario simulations of an expansion of the conflict in the Middle East, that would directly involve Iran, suggest it could lead to a 7 percent GDP contraction with significant impact on fiscal and external balances, even if the shock is limited in scope and restricted to 2024/25. Conversely, the removal or partial waiver of sanctions would significantly boost both oil and non-oil growth. Export diversification, improved economic integration, and inflow of foreign investments could help facilitate technology transfer and create new growth opportunities.

چکیده‌ی مدیریتی

اقتصاد ایران در راستای بهبود بخش نفت و با وجود تداوم تحریم‌های اقتصادی در حال رشد برای چهارمین سال پیاپی است. رشد واقعی تولید ناخالص داخلی در نه ماهه نخست سال 1402 (نسبت به مدت مشابه سال گذشته) به‌واسطه رشد بخش نفت و خدمات به 5 درصد رسید. بخش نفت که 8/6 درصد تولید ناخالص داخلی این دوره را تشکیل می‌دهد، به‌میزان 16/3 درصد (سال به سال) رشد یافته است که دلیل آن کاهش عرضه جهانی نفت و افزایش میزان صادرات نفت، با وجود تحریم، است. رشد سال به سال بخش غیرنفتی نیز بر اثر تقاضای داخلی و صادرات به برخی همسایگان به 3/5 درصد (سال به سال) رسیده است. البته ناترازی‌های اقتصادی ناشی از دخالت در قیمت‌گذاری و سیاست‌های اقتصادی، هزینه اقتصادی تداوم تحریم‌ها و تشدید نااطمینانی‌های ژئوپلتیکی باعث شده است ابهاماتی در زمینه چشم‌انداز رشد پایدار و گسترده ایجاد شود.

جهش اقتصادی سبب بهبود آمار اشتغال شده است ولی همچنان چالش‌هایی در بازار کار وجود دارد. سطح اشتغال در سال 1402 با رشد 3/3 درصدی، از سطح مربوط به دوره پیش از همه‌گیری پیشی گرفت. بدین‌ترتیب، نرخ بیکاری به رقم بی‌سابقه 8/1 درصد رسید. طی چند سال گذشته، بخش کشاورزی (با وابستگی بالا به نیروی کار) به دلیل خشکسالی و کمبود منابع آبی با افت فرصت‌های شغلی روبرو بوده است. این تأثیر نامطلوب بر بازار کار در اثر رشد بخش‌های صنعت و خدمات جبران شده است. با وجود رشد جمعیت در سن کار تنها 41/3 درصد افراد در سن کار در بازار کار حضور دارند. در این بین، نرخ مشارکت 14/2 درصدی زنان به میزان قابل توجهی پایین است. کاهش نرخ مشارکت اقتصادی ناشی از کمبود فرصت‌های شغلی، ناهمخوانی مهارت‌ها، و موانع ورود به مشاغل خاص است. نرخ بیکاری در زیرگروه‌های مختلف فرق می‌کند. نرخ بیکاری در بین زنان، جوانان و دانش‌آموختگان آموزش عالی بسیار بالاتر است. همچنین مهاجرت نیروی کار ماهر سبب کمبود نیروی کار در بخش‌های مختلف، مانند تکنولوژی اطلاعات، آموزش، پرستاری و جراحی شده است. تغییر ساختار جمعیتی ناشی از پیر شدن جمعیت در میان‌مدت سبب بروز چالش‌های جدیدی در بازار کار، بخش‌های مولد و نظام بازنشستگی و تأمین اجتماعی خواهد شد.

کاهش درآمدهای دولتی در مقایسه با سطح مورد انتظار در سال 1402 سبب تغییر در اولویت‌بندی هزینه‌ها شده است. طبق برآوردها، در سال 1402، فقط 73 درصد از درآمدهای بودجه‌ای محقق شده است. دلیل عمده این مسئله آن است که طبق برآوردها، فقط 55 درصد از درآمدهای مورد انتظار بخش نفت محقق شده است. علاوه بر پیش‌بینی درآمد صادراتی بلندپروازانه در سند بودجه، تخفیف‌های قابل توجه در قیمت نفت صادراتی ایران نیز سبب کاهش درآمدهای نفتی شده است. در مقابل، درآمدهای مالیاتی به 90 درصد هدف تعیین‌شده رسیده است. این دستاورد را می‌توان ناشی از درآمدهای مالیاتی مستقیم، به‌ویژه مالیات بر درآمد و مالیات بر شرکت‌ها دانست. البته رقم مالیات بر واردات، به دلیل محدودیت واردات خودرو، کاهش یافته است. کاهش درآمدها سبب شد که دولت مخارج خود را کاهش دهد. ازآنجاکه درآمد ناشی از فروش اموال و خصوصی‌سازی بسیار کمتر از اهداف تعیین شده بود، دولت برای جبران کسری بودجه (که در حدود 1/9 درصد تولید ناخالص داخلی تخمین زده می شود) به تأمین مالی از «صندوق توسعه ملی» و استقراض از نظام بانکی متوسل شد.

کاهش قیمت نفت و افزایش واردات سبب کاهش مازاد حساب جاری در سال 1402 با وجود افزایش حجم صادرات شد. در نه ماهه نخست سال 1402، کاهش قیمت نفت و فرآورده‌های پتروشیمی باعث کاهش جزیی ارزش اسمی صادرات کالاها به‌میزان 0/4 درصد (سال به سال) شد. این وضعیت در

کنار افزایش 10/9 درصدی (سال به سال) واردات در رقم مازاد حساب جاری را تقریباً نصف کرد و به 1/6 درصد تولید ناخالص داخلی (6/3 میلیارد دلار) رساند. این روند در نیمه دوم سال نیز ادامه یافت و سبب کاهش تجارت غیرنفتی به‌میزان 4 درصد تولید ناخالص داخلی (16/9 میلیارد دلار) در سال 1402 شد. با تمرکز بیشتر تجارت با 3 شریک تجاری اصلی، حساب‌های خارجی در برابر تکانه‌های تجاری و تقاضای شرکای اصلی آسیب‌پذیرتر می‌شود. اقدامات اخیر ازجمله عضویت در «بریکس» (سازمان چنددولتی با محوریت برزیل، روسیه، هند، چین و آفریقای جنوبی) و عضویت در «سازمان همکاری شانگهای» (SCO) با هدف تقویت تجارت صورت گرفت، ولی به دلیل عدم عضویت در «کارگروه اقدام مالی» (FATF) و تداوم تحریم‌ها تأثیر محدودی داشته‌اند.

نرخ تورم شاخص قیمت مصرف‌کننده همچنان بالاست ولی از انتظارات تورمی ناشی از تحولات ژئوپلتیک و بازار ارز تأثیر می‌پذیرد. میانگین نرخ تورم شاخص قیمت مصرف‌کننده کل و هسته در سال 1402 به‌ترتیب 40/7 و 40/8 بوده است. نرخ تورم بالا عمدتاً ناشی از افزایش قیمت مواد غذایی و هزینه اجاره مسکن بوده است. کاهش جهانی قیمت کالاها، تلاش برای اتخاذ سیاست پولی انقباضی و تعدیل انتظارات تورمی ناشی از پیشرفت محدود مذاکرات با آمریکا سبب کاهش نرخ تورم نقطه به نقطه از 55/5 درصد در فروردین 1402 به 31 درصد در اردیبهشت 1403 شد.

روندهای اخیر ایران حاکی از پیشرفت در زمینه کاهش فقر و بهبود نابرابری درآمدی بر اثر رشد فراگیر و پرداخت یارانه نقدی، است. در فاصله سال‌های 1399 و 1401، نرخ فقر طبق معیار درآمد روزانه 6/85 دلار به‌میزان 7/4 واحد درصد کاهش یافته و از 29/1 درصد به 21/9 درصد رسیده است. یعنی 6/1 میلیون نفر از مردم ایران به بالای خطر فقر آمده‌اند. بر اساس خط فقر طبق معیار کشورهای با درآمد متوسطِ پایینِ 3/65 دلار در روز، نرخ فقر از 6/1 درصد به 3/8 درصد رسیده است. رشد کلی مصرف بر اثر افزایش درآمدهای ناشی از دستمزد و خوداشتغالی در بخش غیرنفتی، بر کاهش نرخ فقر تأثیرگذار بوده است. برنامه‌های اجتماعی، شامل یارانه‌ی نقدی و همسان سازی حقوق بازنشستگان نقش مهمی در کاهش فقر داشته است. با وجود کاهش ارزش واقعی یارانه نقدی بر اثر تورم، تعدادی پرداخت تکمیلی از سال 1398 آغاز شده است. البته نابرابری‌های منطقه‌ای همچنان وجود دارد و نرخ فقر در مناطق روستایی همچنان حدود دو برابر مناطق شهری است.

پیش‌بینی می‌شود که رشد تولید ناخالص داخلی در بازه 1403 تا 1405، به میانگین سالانه 2/8 درصد برسد. کاهش میزان تقاضای جهانی، تحریم‌ها، کمبود انرژی، محدودیت‌های نقدینگی، کاهش انباشت سرمایه و تنش‌های ژئوپلتیکی بر چشم‌انداز رشد اقتصادی تأثیر می‌گذارد. پیش‌بینی می‌شود که تولید ناخالص داخلی در سال 1403، به دلیل کاهش تخمینی رشد هزینه‌های دولت و کاهش تأثیر رشد تولید ناخالص داخلی نفتی در سال 1402 به نرخ متعادل‌تری برسد. با وجود برنامه‌های اخیر دولت برای بودجه انقباضی سال 1403 و بهبود چشم‌انداز بودجه‌ای، پیش‌بینی می‌شود که فشارهای بودجه‌ای همچنان پابرجا بماند و همراه با مخارج خارج از بودجه، کسری بودجه تداوم یابد. آمار برآورد تورم نیز بهبود اندکی را نشان می‌دهد ولی انتظار می‌رود که نرخ تورم بالای 30 درصد باقی بماند. تامین مالی کسری بودجه و تأثیر تنش‌های ژئوپلتیک بر این وضعیت تأثیرگذار خواهد بود. پیش‌بینی می‌شود که مازاد حساب جاری بر اثر کاهش تخمینی قیمت نفت، به‌تدریج کاهش یابد. موانع تقویت صادرات غیرنفتی شامل محدودیت دسترسی به شبکه بانکی بین‌المللی و بازارهای جهانی هم برای تأمین مواد اولیه و هم برای شناسایی مقاصد صادراتی، فقدان یکپارچگی در شبکه‌های زنجیره تأمین، تعرفه‌ها و گستره محدود تنوع صادراتی رشد صادرات غیرنفتی بالقوه را کاهش می‌دهد.

چشم‌انداز اقتصادی از مخاطرات مهم مربوط به اقتصاد، تغییرات اقلیمی و تحولات ژئوپلتیکی تأثیر می‌پذیرد. کاهش غیرمنتظره تقاضای جهانی و کاهش قیمت نفت بر رشد اقتصادی تأثیر منفی می‌گذارد و فضای بودجه‌ای مورد نیاز برای ایجاد رشد و اقدامات حمایت اجتماعی را محدود می‌کند. تمرکز روزافزون تجارت با شرکای تجاری معدود مانند چین، اقتصاد کشور را در معرض نوسانات ناشی از شرایط اقتصادی این شرکا قرار داده است. افزایش رویدادهای جوّی ناگوار بر تولید محصولات کشاورزی و اشتغال تأثیر منفی می‌گذارد و امنیت غذایی و معیشت مردم را تهدید می‌کند. شدت گرفتن تحریم‌های اقتصادی تأثیر چشمگیری بر تجارت با کشورهای همسایه و شرکای تجاری فعلی می‌گذارد و روند رشد اقتصادی و صادرات را مختل می‌کند. طی سال گذشته، مخاطرات تهدیدکننده اقتصاد ایران ناشی از احتمال تشدید درگیری‌ها در خاورمیانه افزایش چشمگیری یافته است. شبیه‌سازی سناریوهای گسترش جنگ در خاورمیانه که مستقیماً ایران را درگیر کند، می‌تواند منجر به کاهش 7 درصدی تولید ناخالص داخلی شود وتأثیر قابل توجهی بر تراز مالی دولت و تراز خارجی بگذارد؛ حتی اگر این تکانه محدود بوده و منحصر به سال 1403 باشد. از سوی دیگر، حذف کامل یا جزئی تحریم‌ها می‌تواند زمینه‌ساز افزایش چشمگیر رشد بخش نفتی و غیرنفتی باشد. متنوع‌سازی صادرات، تقویت همبستگی اقتصادی، و ورود سرمایه‌گذاری خارجی می‌تواند به تسهیل روند انتقال تکنولوژی و ایجاد فرصت‌های جدید برای رشد کمک کند.

1

RECENT ECONOMIC AND POLICY DEVELOPMENTS

Output and Demand

Iran's economy maintained a robust growth in the first nine months of 2023/24 (9M-23/24)[1], driven by both oil and non-oil sectors. Real gross domestic product (GDP) grew by 5 percent year-on-year (y/y) in 9M-23/24 (Apr-Dec 2023). Similar to the upward trend in 2022/23, the oil sector experienced a strong rebound of 16.3 percent (y/y), partly attributed to the tighter global oil market conditions and more relaxed implementation of US sanctions (Figure 1). The non-oil sector grew by 3.5 percent (y/y), primarily fueled by expansions in services and manufacturing. A moderate increase in rainfall combined with the government support, including an increase in guaranteed prices of wheat, helped agricultural production to grow marginally (Figure 2). However, despite the economic expansion over the last four years, Iran has yet to bridge the gap with its peer groups (Figure 3).

In 2023/24, oil production surged by 17.2 percent (y/y), reaching the highest level since the re-imposition of US sanctions in 2018.[2] Iran's exemption from OPEC+ production quotas and a tighter oil market have provided an opportunity for the expansion of its oil production. Iran recorded one of the highest increases in oil production among OPEC members in 2023, with average daily production rising by 300 thousand barrels to 2.855 million barrels per day (mbpd) (Figure 4). Oil production continued its upward trajectory reaching 3 mbpd in April 2024. As a result, Iran's share in OPEC production rose from 8.9 percent in January 2023 to over 12.1 percent in April 2024, making Iran as OPEC's third-largest oil producer. Despite this recovery, oil production remains well below the pre-sanctions high of an average of 3.8 mbpd in 2017 and the first half of 2018. Oil production expansion also faces limitations due to years of under-investment in the oil and gas sector leading to a declining capital stock.[3]

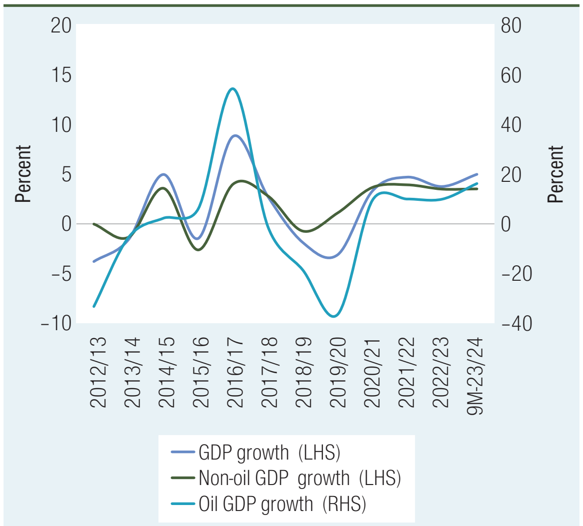
Despite energy shortages and an uncertain investment climate, non-oil industries experienced a moderate expansion. During 9M-23/24, non-oil

[1] The Iranian calendar year begins on March 21 and ends on March 20 of the following year.

[2] Oil production data as per OPEC's secondary sources. Official data on oil production and exports have not been published since the re-imposition of US sanctions in 2018.

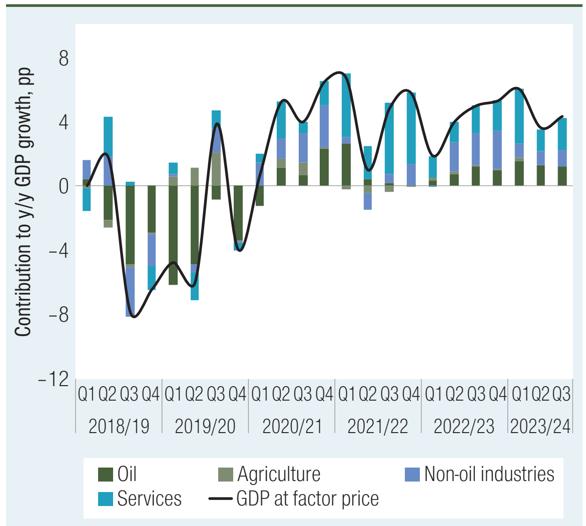
[3] Real net capital stock of the oil and gas sector in 2021/22 was 21.9 percent lower than its level a decade earlier.

FIGURE 1 • GDP Continued its Growth in 9M-23/24…



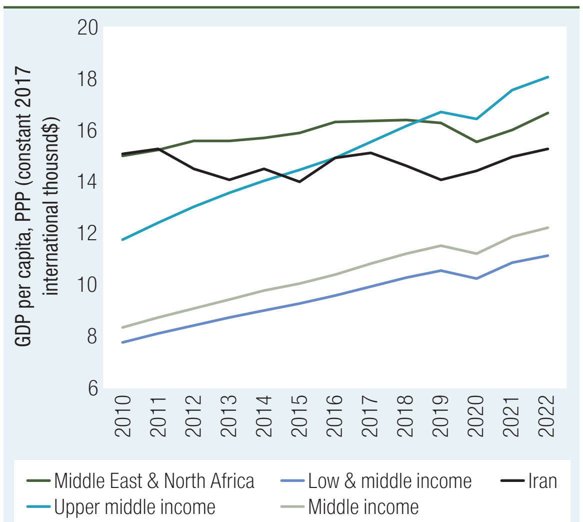
Source: Central Bank of Iran (CBI) and World Bank staff calculations.

FIGURE 2 • …Driven by the Expansion in the Oil Sector and Services



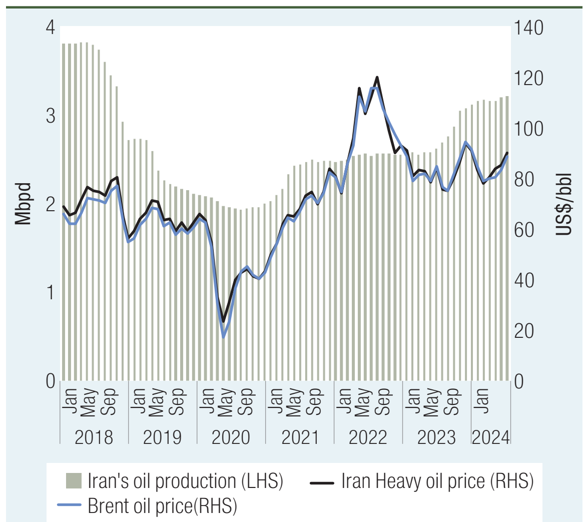
Source: CBI and World Bank staff calculations.

FIGURE 3 • The Income Gap between Iran and Peer Groups Widening Due to a Decade of Stagnation in Iran



Source: World Bank Open Data.

FIGURE 4 • Tight Oil Market and a More Relaxed Implementation of Sanctions Impacted the Country's Oil Production



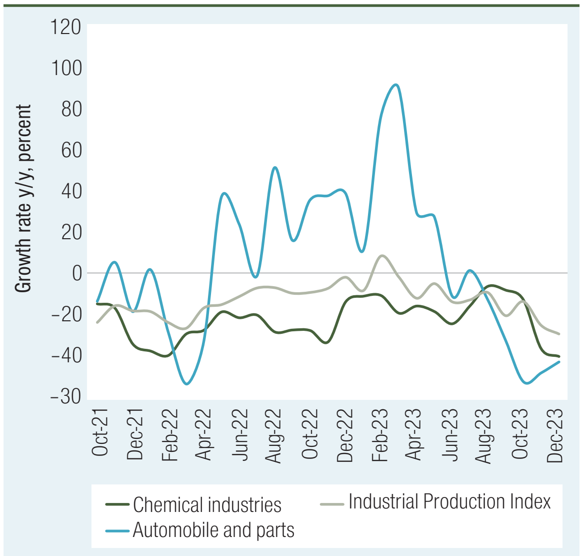
Source: OPEC and World Bank Commodity Price Data.

industries grew by 3.9 percent (y/y), driven primarily by a 4.2 percent y/y growth rate in the manufacturing sector. The construction sector also saw a more modest expansion of 3.1 percent y/y. Despite this growth, the industrial production index (IPI)[4] of selected industries in the stock market declined in the second half of 2023/24 (H2-23/24), primarily due to a slowdown in the automotive industry, which was the main driver of the IPI in the previous year (Figure 5).[5] Non-oil sector challenges persist, exacerbated by cash flow and working capital shortages, as well as the absence of

[4] The Parliament Research Center (PRC) publishes the IPI, covering over 302 industrial companies listed on the stock exchange that account for more than half of Iran's manufacturing production.

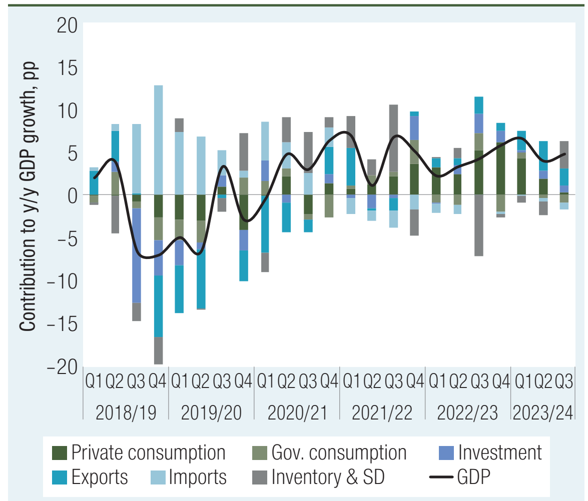
[5] Iranian automakers have faced persistent losses over the past five years. Three major car manufacturers in the country have collectively incurred cumulative

FIGURE 5 • ...and Manufacturing Production Growth Weakened



Source: Parliament Research Center (PRC).

FIGURE 6 • Consumption and Exports Were the Main Drivers of GDP Growth on the Demand Side in 9M-23/24



Source: CBI and World Bank staff calculations.
Note: SD refers to statistical discrepancy.

bank facilities and insufficient foreign exchange allocations. Supply chain disruptions for raw materials, along with decreased customer purchasing power and reduced domestic and export demand, have hindered scaling production. FX policy and other regulations have also impeded exports, while producers report a lack of skilled labor.

Challenges such as limited financing and escalating production costs have hindered the growth of the construction sector, which expanded by a modest 3.1 percent (y/y) in 9M-23/24. Growth was constrained partly due to a decrease in credit allocation to the sector, which fell to 5.6 percent of total banking credits in 2023/24.[6] Moreover, the prices of construction materials and land have skyrocketed by over 340 and 640 percent respectively over the past five years, leading to a decade-long recession with a 38 percent decline in the sector. The surge in housing prices has rendered homeownership unaffordable and driven up rental costs.[7] Despite government initiatives aimed at revitalizing the construction sector, such as the target of constructing one million affordable houses annually over four years, only about a quarter of this objective has been accomplished.[8] The sector challenges also reflect on the labor market as the labor-intensive sector contributes to over 10 percent to overall employment.

The agricultural sector exhibited a modest growth of 0.7 percent (y/y) in 9M-23/24, attributed to improved weather conditions. In the

losses of IRR 1740 trillion in 9M-23/24, averaging IRR 500 million per vehicle due to subsidized pricing. Iran Khodro reported losses of IRR 144 trillion and SAIPA of IRR 47 trillion in H1-23/24, compared to IRR 200 trillion and IRR 90 trillion in losses in 2022, respectively (Donya-e-eqtesad and Parliament Research Center). Despite heavy import tariffs and a ban on foreign automobile imports, restrictive pricing guidelines, obstacles in technology transfers, and corruption have resulted in low-quality and loss-making production.

6 The allocation of housing loans below the specified limit has led to some banks being penalized. Moreover, high mortgage costs and cumbersome procedures for obtaining housing loans are additional demand side constraints.

7 The average price of real estate in Tehran has surged 14-fold over the past six years. In 2022/23, the cost of renting constituted 51 percent of average expenditure, up from 47.9 percent in the previous year. According to a study by the Statistical Center of Iran (SCI), the average waiting time for urban households to own a residential unit was 34.5 years in 2017/18, but it has risen to 47.7 years in 2021/22. Despite extended discussions regarding the taxation of vacant properties, no progress has been made on this front.

8 Tasnim.

hydrological year 2022/23 (October 2022-September 2023), Iran experienced a 4 percent increase in rainfall, although it remained below the long-term average by 14 percent. A 15 percent y/y decline in rainfall during October 2023 to March 2024 (25 percent decline to the long-term average), also indicates that the country could be entering its fourth year of drought, highlighting the nationwide water crisis. Dam inflows have decreased by 12 percent compared to the previous water year, while dam outflows have grown by 21 percent, resulting in a decline in dam capacity, indicating dams have reached less than half capacity.[9] Years of drought have created conditions where occasional heavy rainfall led to floods due to the land's reduced capacity to absorb moisture. The sector faces challenges like water scarcity, extreme weather events, and high production costs, endangering food security.

The service sector grew by 4 percent (y/y) in 9M-23/24, primarily driven by the IT and gig economy. Over the past six years, the information and telecommunication services (ITS) sector has emerged as a key driver in the service sector, consistently maintaining an average annual real growth rate of 24 percent. However, this sector faces challenges related to a shortage of high-skilled labor and digital infrastructure limitations including the speed and stability of the internet.[10] The ITS sector growth decelerated to its lowest rate in six years, in part due to a more restrictive regulatory climate and disruptions to internet access after the street protests in 2022/23.

On the expenditure side, exports and private consumption were the main drivers of GDP growth in 9M-23/24. The private sector saw substantial growth, expanding by 4.2 percent (y/y), following a robust 8.7 percent expansion in the previous year. The expansion in private consumption can be attributed to demand for inflation hedging through the purchase of durable goods due to negative real interest rates, heightened uncertainty, and rising inflationary expectations. Government consumption contracted by 1.6 percent, due to unrealized government revenue. Exports significantly expanded by 17.9 percent (y/y) in 9M-23/24. Investment grew by 4.5 percent, driven by a strong expansion in machinery investment and a moderate increase in construction sector activity, while foreign investment remains low at 1 percent of GDP. In recent years, overall gross fixed capital formation has matched depreciation costs, with some sectors experiencing coverage below the depreciation cost. This trend raises concerns about potential adverse implications for future growth and development.

Labor Market and Jobs

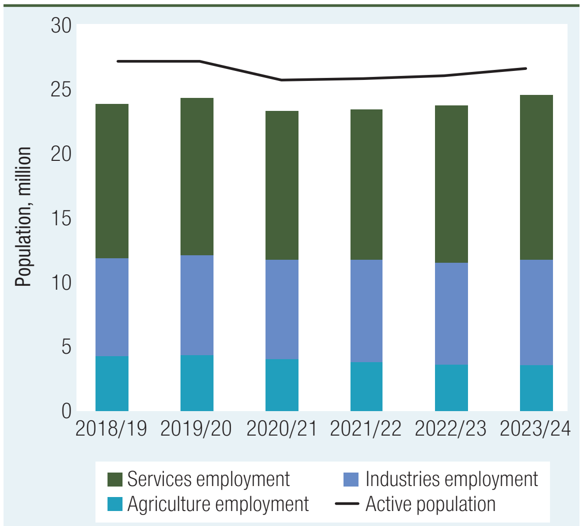
In line with the growth dynamics, employment is recovering to pre-pandemic levels. In 2023/24, total employment grew by 3.3 percent, to reach 37.9 percent of the working age population (Figure 7). Over the last four years, most of the job creation was due to expansions in the industrial and services sectors, which experienced employment growth rates of 6.3 percent and 4 percent, respectively. However, the agriculture sector employment declined by 18 percent (equivalent to 0.8 million jobs) due to drought and water shortages leading to migration to urban areas.

The unemployment rate registered a record low, but labor market challenges remain. In 2023/24, the labor force participation rate slightly improved by 0.4 percent point and the unemployment rate reached a record low of 8.1 percent. A record low unemployment rate was also driven by a reduction in the economically active population, as many long-term unemployed individuals stopped seeking work being discouraged from finding jobs (Figure 8). The working-age population has grown

9 Iran Water Resource Management Company, weekly reports.

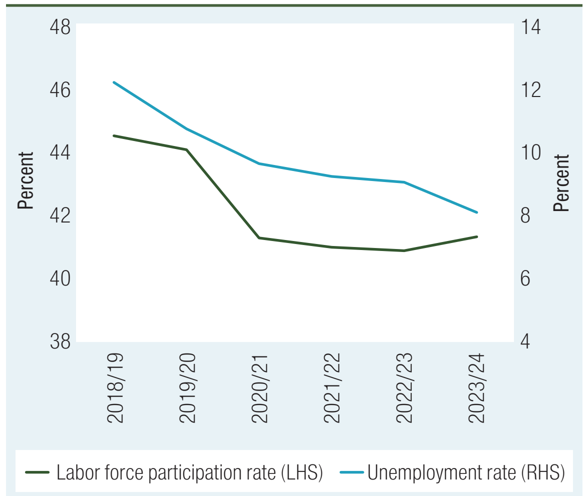
10 In November 2023, Iran's median mobile internet speed was recorded at 31.82 Mbps and fixed internet speed at 12.76 Mbps, while global medians were 48.61 Mbps for mobile and 90.21 Mbps for fixed internet, with Iran holding the 75th position in median mobile internet speed and slipping to 154th place for median fixed internet speed. According to the Electronic Commerce Association report, a global index measuring internet access factors in 70 countries in 2023 revealed that Iran ranks third worst, following China and Myanmar, in terms of free internet access.

FIGURE 7 • Employment Reached the Highest Level after the Pandemic



Source: Statistical Center of Iran (SCI) and World Bank staff calculations.

FIGURE 8 • The Unemployment Rate Reached a Record Low, but Labor Force Participation Remained Low

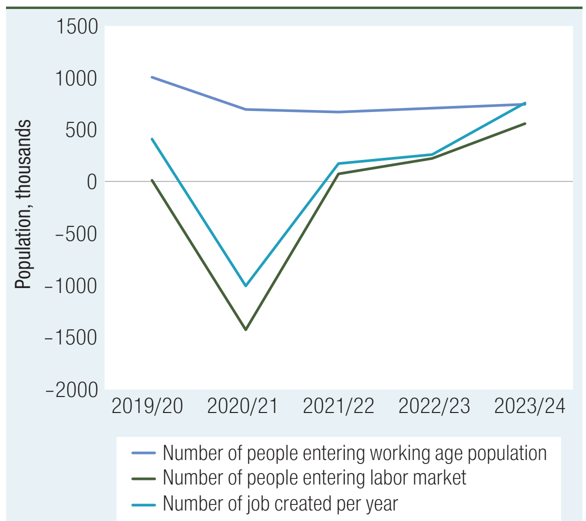


Source: SCI and World Bank staff calculations.

by 2.9 million people, while the active population has decreased by 0.5 million individuals compared to the pre-COVID era in 2019/20.[11] In fact, in 2023/24, only 41.3 percent of the working age population participated in the market, which is 2.8 percentage points below the pre-pandemic level. In addition, unemployment varies significantly among different subgroups, with male unemployment at a record low of 6.6 percent in 2023/24, compared to 15 percent for females, 21.2 percent for youth, and 11.8 percent for university graduates. The pandemic exacerbated pre-existing gender disparities, with its disproportionate impact on women. In 2023/24, male employment was 3.2 percent higher than pre-crisis levels, whereas female employment was lower by 9.6 percent. Underemployment decreased by 1.3 pp (y/y) but remains high at 8.1 percent in 2023/24, further underscoring the demand for jobs.

The labor market faces significant challenges, including low labor force participation and inadequate job creation. These issues are primarily attributed to insufficient jobs for its growing working-age population (Figure 9), especially for women, youth, and university graduates. These challenges carry economic and social costs, including reduced productivity, slower economic growth, and increased poverty and inequality. The lack of jobs has also contributed to the increasing emigration of skilled workers. In recent years, Iran has witnessed a significant surge in emigration, with the

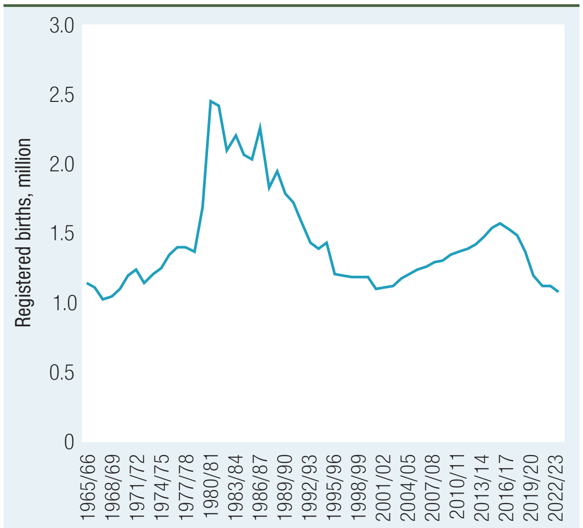
FIGURE 9 • Job Creation Has Remained Insufficient



Source: SCI and World Bank staff calculations.

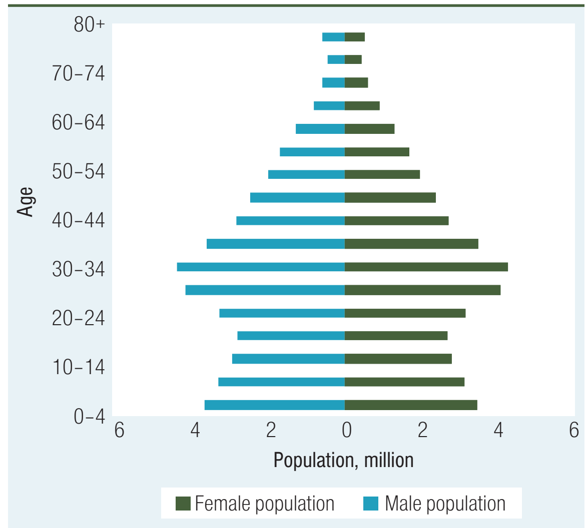
[11] The growth of the working-age population has been uneven in Iran, with urban areas experiencing an increase of 2.3 million, while rural areas have seen a decline of 0.2 million. This suggests a trend of migration from rural to urban areas.

FIGURE 10 • The Birth Rate Has Dropped Significantly…



Source: SCI and World Bank staff calculations.

FIGURE 11 • …leading to a Shift in the Age Structure



Source: SCI and World Bank staff calculations.

Iran Migration Outlook report showing a doubling of Iranian migrants over three decades.[12] This trend, driven by financial pressures and a desire for opportunities abroad, has led to approximately one million Iranians migrating to the countries in the south of the Persian Gulf seeking better job opportunities. However, this presents challenges for Iranian employers, as skilled workers engage in unrecognized remote work abroad. Addressing the root causes of emigration and implementing effective policies to bolster economic stability domestically will be vital in shaping Iran's future trajectory.

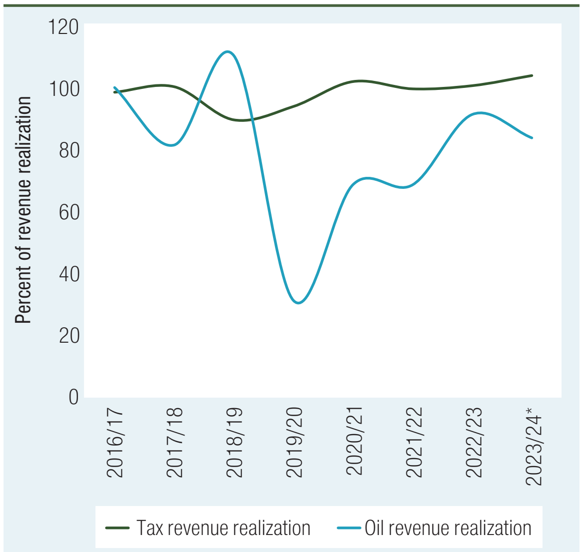
Iran is confronting the emerging challenge of an aging population, impacting social welfare, pensions, healthcare, labor force shortages, dissaving, and old-age income security. Rapid changes in the age structure, characterized by a significant decline in the birth rate, highlight new challenges ahead (Figure 10). Despite recent government initiatives aimed at boosting population growth through financial incentives and restrictions on abortion, total fertility rate is reported to have reached a record low of 1.6 in 2023 compared to 6.5 in the 1980s.[13] Additionally, the approaching retirement of the baby boom generation from the 1980s compounds the challenges (Figure 11).[14] Addressing these changing demographics requires a comprehensive approach that considers the specific needs arising from the altered age structure, and fosters stability, prosperity, and profound transformations in social security and healthcare systems to support an older population more than three times its current size in coming years.

12 Gallop polling in 2023 shows 61 percent of Iranians facing financial strain due to inflation, prompting a concerning trend. Over one-fourth are open to permanent migration, doubling since 2014. Among younger Iranians aged 15 to 29, 43 percent express willingness to relocate permanently, reflecting Iran's socio-economic challenges and the need for policies supporting economic stability domestically.

13 Statement by the Head of the Department of International Specialized Agencies of the Ministry of Foreign Affairs of the Islamic Republic of Iran at the fifty-seventh session of the UN Commission on Population and Development (April-May 2024).

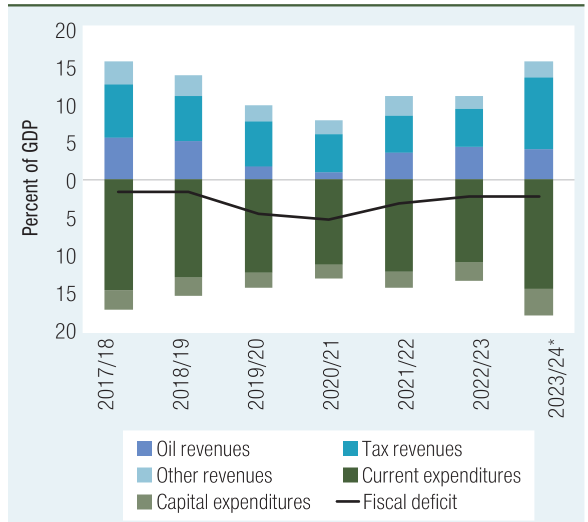
14 Economic challenges accompanying these demographic shifts include a shrinking workforce, escalating healthcare expenditures, and changes in consumption patterns. On the social front, there is an urgent need to explore the impact on family structures, caregiving responsibilities, and intergenerational dynamics. Additionally, the rising demand for geriatric healthcare services and long-term care facilities must be addressed. A holistic strategy is essential to navigate these complex challenges and ensure the well-being of the population in the face of demographic transformations.

FIGURE 12 • Oil Revenues Failed to Meet the Budget Target in 2023/24...



Source: CBI, MoF, Parliament Research Center (PRC), and World Bank staff calculations.
Note: 2023/24 oil revenues are annualized 7M-23/24 data.

FIGURE 13 • …the Government Reduced Expenditures to Narrow the Fiscal Deficit as a Share of GDP



Source: CBI, MoF, and World Bank staff calculations.
Note: *2023/24 data are annualized 7M-23/24 data except for tax revenues which is actual expenditures for the period.

Public Sector Finance[15]

The government faced some revenue shortfalls in 2023/24 as only an estimated 72.6 percent of planned revenues materialized. Despite higher oil export volumes, oil revenues in 2023/24 are estimated to have fallen significantly short, meeting half of their budget target, based on an assumed 1.5 million barrels per day of oil exports at US$85 per barrel (Figure 12). This shortfall was mainly due to heavily discounted oil export prices and overambitious oil export budget targets. Consequently, the government partly reduced spending to control the deficit.[16] The budget deficit is estimated to have stabilized at 1.9 percent of GDP in 2023/24 as a result.

Since 2018, budgetary tax revenues have consistently met targets, in part aided by higher inflation, but overall revenues still fell short. In 2023/24, tax revenues grew significantly by 51.7 percent in nominal terms. This surge was primarily driven by a robust expansion in direct tax collections, which exceeded the target by 9 percent despite an 18.8 percent shortfall in wealth taxes. Corporate tax contributed significantly to direct tax revenues, accounting for approximately two-thirds, followed by income tax at 26 percent and wealth tax at 8 percent. Indirect taxes, consisting of sales and consumption taxes and import taxes also experienced a notable increase, growing by 35.6 percent, albeit achieving 71.6 percent of the planned budget target. However, the government's efforts to raise revenue through the sale of government assets fell well short of its ambitious target, achieving only 10 percent of the planned target in 7M-23/24.

In response to declining revenues, the government reduced expenditures and relied on its strategic reserves to finance the deficit. In the first seven months of 2023/24, 80 percent of government expenditures for the period were executed. Current expenditures were driven by rising wage bills and adjustments to pensions driven by high inflation and other transfers (see Box 1) (Figure 13). The net balance associated with the subsidy program, not

15 Latest official fiscal data available is for 2022/23. The information reported for subsequent years is primarily based on reports and interviews of authorities reported in the media. Tax revenue data for 2023/24 was shared by the authorities.

16 Based on the most recent data available, the realized capital expenditure was 21 percent of their total year budget target in 4M-23/24.

directly included in the budgetary central government accounts, add to these fiscal pressures.[17] Efforts to finance the deficit through the sale of government assets fell well short of its ambitious target. Even with full realization of government-issued bonds, the government still faced challenges in servicing its existing debt and financing the budget deficit. This led to the utilization of the National Development Fund of Iran (NDFI) and borrowing from the banking system to cover the remaining budget deficit as privatization proceeds also fell short.

The 2024/25 budget law reflects a more prudent fiscal stance with more restrained expenditures and less ambitious revenue projections. The total budget is planned to grow by 23 percent in nominal terms, significantly below the projected inflation rate of 35.3 percent, indicating a contractionary fiscal policy stance. Total revenues are projected to increase by 25.6 percent, with oil revenues based on an assumption of 1.35 mbpd of exports and a price of US$71/bbl.[18] Non-oil revenues are planned to grow by 40.4 percent, mainly through higher taxes. Total expenditures will rise by 21 percent, driven by current expenditures domi-

[17] Article 14 of the annual budget stipulates key ceilings for the targeted subsidy program, including expected revenues from sales of energy products, cash transfers, support for government energy sector entities, and initiatives aimed at curbing fuel consumption. The total allocation for the 2023/24 amounted to approximately 5 percent of the GDP. In practice, the plan's budget has often been in deficit. For instance, in 4M-23/24, 81 percent of approved expenditures were utilized, while revenue realization stood at only 53 percent.

[18] Foreign currency revenues and expenditures are now all denominated in euros instead of dollars. The implicit exchange rate in the budget is IRR310,000/Euro (equivalent to IRR285,000/US$—the new subsidized rate for imports of essential items), while the parallel exchange rate is around IRR580,000/US$.

BOX 1 RECENT SUBSIDY AND TRANSFER MEASURES

Amid external shocks and persistent inflation, the Government of Iran has implemented various policies to support the most vulnerable households. These measures include subsidized food and energy prices, the subsidized exchange rate for the import of essential goods, cash transfers (3.1 percent of GDP in 9M-23/24), healthcare and social security transfers, and public sector wage and pension increases. While these efforts have improved welfare, they have been largely ad-hoc and under-targeted, undermining their sustainability. Their significant fiscal cost has reinforced vulnerabilities, including via higher inflation due to deficit financing. Furthermore, these measures have contributed to over-consumption and misallocation of funds.[a]

Cash transfers have provided robust support for the welfare of the poor (see the special focus chapter), albeit with a significant fiscal cost. The shift from broad subsidies to targeted cash transfers, along with subsequent adjustments to the social protection programs, reflects the government's efforts to support vulnerable populations while grappling with economic challenges. High inflation eroded the value of cash transfers, the poor have increasingly depended on earnings from employment and self-employment, and more recently additional top-ups. These top-ups were initially introduced in 2019 when the government launched the Livelihood Support cash transfers to compensate for the gasoline price increase (Figure 38). The program was bolstered by the COVID-19 relief package in 2020 and further supported in 2022 to offset the elimination of exchange rate subsidies. These additional top-ups have served as a crucial safety net for vulnerable households, significantly contributing to the decline in poverty, particularly in 2022.

A series of recent initiatives, including the phase out of the exchange rate subsidy and consolidation of cash transfers aim to improve the efficiency and sustainability of social policy. Following the reimposition of US sanctions in 2018, the government established a subsidized exchange rate for imports of essential goods and medicine, initially set at IRR42,000/US$. Subsequently, facing a surge in the free-market rate and limited foreign currency reserves, the government first narrowed the list of items and services benefiting from the preferred exchange rate. Ultimately, limited access to international reserves abroad, large demand, and other implementation challenges such as misallocation of funds, undermined the maintenance of the preferred rate. This then led to the elimination of the policy and the consolidation of all subsidies into a single monthly payment.[b] Under the new cash transfer scheme introduced in June 2022, individuals in the first to third deciles receive IRR4 million (US$14), while those in the fourth to ninth deciles receive IRR3 million (US$10.5) monthly, benefiting approximately 78 million people out of the total population of 85 million. However, due to fluctuations in the exchange rates, the government reinstated another subsidized exchange rate six months later, setting it at IRR285,000/US$.

The government adjusted subsidies in September 2023, particularly targeting lower-income groups through electronic vouchers ("Kala Barg" plan). Initially envisioned to cover only the first three income deciles, the plan now encompasses the seven deciles, benefiting approximately 61 million people or about 75 percent of the population. Beneficiaries receive IRR1.2 million (US$4.2) monthly subsidy upon

(continued on next page)

BOX 1 RECENT SUBSIDY AND TRANSFER MEASURES *(continued)*

purchasing IRR2 million (US$7) worth of essential items from a specified basket, ensuring vital nutrients. Initial estimates suggest that more than 27 million people have registered for the Kala Barg plan.

In February 2024, the government also introduced a temporary "Fajraneh" plan providing a temporary top-up to the Kala Barg plan. The plan was designed to run from February to April 2024, aiming to increase the consumption subsidies to IRR2.2 million (US$7.7) for households for the first to seven deciles, with no spending requirement to receive the additional incentive subsidy. According to the Minister of Cooperatives, Labor, and Social Welfare, the Fajraneh Plan has benefited 52 million individuals, representing 87 percent of the targeted population, with usage varying across income deciles.[c]

Recent attempts towards streamlining of transfers are necessary steps for improving the effectiveness and sustainability of the transfer system. The consolidation of different initiatives and improved design of new measures, such as their time bound characteristic and more targeted nature, can help improve their impact and reduce their administrative burden. These initiatives, if broadened and deepened, including through strengthened targeting and incorporation of automatic adjustment mechanisms, could help provide a fairer distribution and create fiscal space for other pro-growth interventions. Extending the reform initiative as part of a broader reform package that includes other policy interventions can help build a stronger case for such reforms and help manage their political economy dimension.

[a] For example, the resulting significant rise in domestic petroleum consumption and limited production capacity, has led to a decrease in exports, affecting revenue generation under Article 14.

[b] In 2011, Iran embarked on an ambitious reform plan (Targeted Subsidies Reform), aiming to significantly reduce extensive indirect subsidies on energy products and replace them with universal cash transfers to the population (about 78 million people at the time). However, this policy faltered in implementation. Instead of aligning gasoline prices with international standards, the government fixed them at a higher Rial level, which, coupled with rial's depreciation and a surge in global oil price, nullified the intended reforms within two years. Additionally, the direct cash transfer program, implemented alongside energy subsidies reform, saw its effectiveness wane over time due to a lack of inflation adjustment. The policy raised fiscal pressures which in turn further fueled inflation. Furthermore, the diminishing value of cash transfers over time, dropping from approximately US$45 in 2009 to under US$1 in 2023, led to public resistance to similar changes as witnessed with social grievances following the increase in gasoline prices in 2019.

[c] In addition, under the supplementary scheme, known as the "Children's Food Security Program," each child under the age of 5 in households in the first 5 income deciles are entitled to receive IRR10 million, and IRR6 million in deciles six and seven. This is aimed at ensuring families have access to the necessary protein, vitamins, and energy for their children's well-being.

TABLE 1 • The Budget Law for 2024/25 Signals a Tighter Fiscal Stance

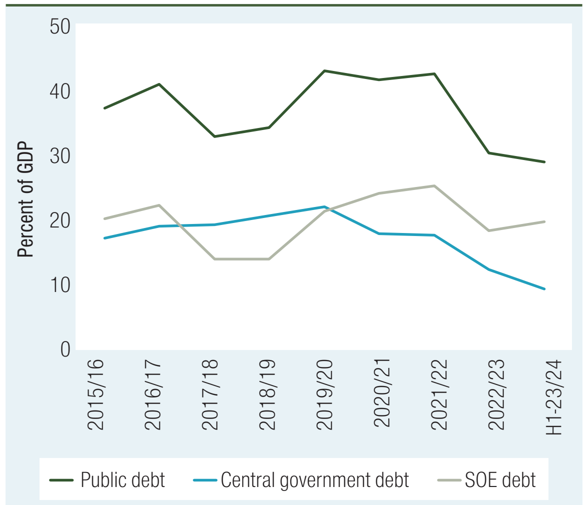
	2023/24-Budget Law		2024/25-Budget Law			
	(IRR Trillion)	Percent of GDP	(IRR Trillion)	Percent of GDP	(US$ billion)[a]	Growth (%)
Total revenues	**17,863**	**12.3**	**22,429**	**11.4**	**78.7**	**25.6**
Current revenues	**10,541**	**7.2**	**15,983**	**8.2**	**56.1**	**51.6**
Tax revenues	8,945	6.1	13,645	7.0	47.9	52.6
Other revenues	1,596	1.1	2,338	1.2	8.2	46.5
Disposal of non-financial assets	**7,322**	**5.0**	**6,446**	**3.3**	**22.6**	**−12.0**
Total expenditures	**18,838**	**12.9**	**22,787**	**11.6**	**80.0**	**21.0**
Current expenditures	15,088	10.4	18,787	9.6	65.9	24.5
Capital expenditures	3,750	2.6	4,000	2.0	14.0	6.7
Operational balance	−4,547	−3.1	−2,804	−1.4	−9.8	−38.3
Budget balance	**−975**	**−0.7**	**−359**	**−0.2**	**−1.3**	**−63.2**
Disposal of financial assets	2,960	2.0	3,192	1.6	11.2	7.8
Acquisition of financial assets	1,985	1.4	2,833	1.4	9.9	42.7
Net disposal of financial assets	**975**	**0.7**	**359**	**0.2**	**1.3**	**−63.2**
Government general resources	**20,823**	**14.3**	**25,620**	**13.1**	**89.9**	**23.0**
Targeted subsidy resources	**6,598**	**4.5**	**7,588**	**3.9**	**26.6**	**15.0**

Source: Parliament and World Bank staff calculations.
Note: [a] Converted using the implicit exchange rate of IRR285,000 /USD.

nated by the wage bill and pension expenditures, while investment expenditures are to grow by 6.7 percent. As a result, the planned deficit of the operational balance is expected to be curbed significantly by 38.3 percent, reducing the overall budget deficit to almost a third of the previous year's planned budget. Almost all issued debt will be rolled over with new issuances and the remainder of financing needs are to be met with proceeds from privatization. The budget for targeted subsidy programs is to increase by 15 percent while aiming to eliminate subsidies for top income deciles.[19]

Over the last two years, public debt as a percentage of GDP declined to 29 percent in H1-23/24 due to high nominal GDP growth and negative real interest rates.[20] However, government debt to the NDFI, primarily in dollar terms, is not included in these figures. The estimated debt to the NDFI is around US$100 billion, equivalent to about 30 percent of GDP. This debt has grown substantially due to a decline in government oil proceeds following US sanctions, with only 20 percent of oil revenue allocated to the NDFI instead of the intended 40 percent. Government-backed foreign currency denominated loans also remain unpaid, partly due to exchange rate fluctuations. Withdrawals from the NDFI for special permissions, such as COVID-19 relief and natural disasters, have impacted the fund's financial health. Total external debt in Iran remains small at 1.9 percent of GDP in 2022/23, which shelters the economy from the direct impact of exchange rate fluctuations and global interest rate spikes.

FIGURE 14 • High Inflation and Improved Oil Revenue Enabled the Government to Partially Settle its Domestic Debt in 2022/23



Source: Ministry of Economic Affairs and Finance (MoF) and World Bank staff calculations.
Note: Public debt is the sum of central government and SOE debt. This does not include liabilities to the NDFI.

Monetary Policy and Prices

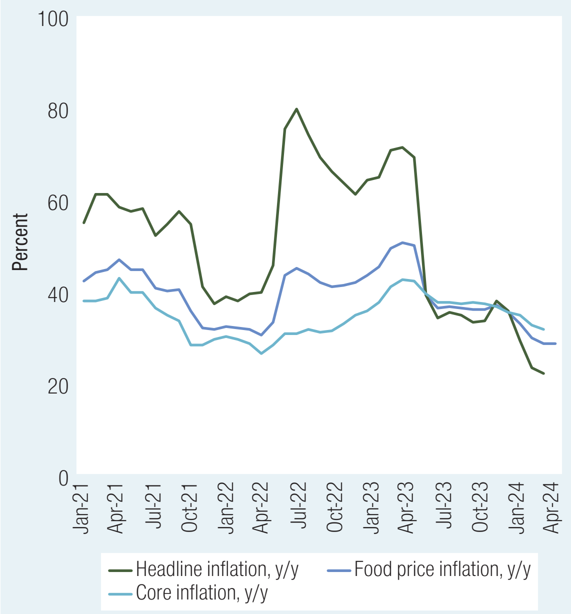
Despite a moderating trend, consumer price inflation (CPI) remained above 40 percent for the fifth consecutive year in 2023/24. Since the changes in exchange rate subsidies announced in June 2022[21] and the subsequent surge in inflation, inflation has eased gradually, declining from 55.5 percent (y/y) in April 2023 to 31 percent (y/y) in May 2024 (Figure 15). This trend was supported by recent monetary policy tightening (see below) and stabilization of the rial following some partial progress in negotiations with the US and news about unfreezing of funds abroad (Figure 16). The headline and core inflation reached 40.7 percent and 40.8 percent in 2023/24, respectively. High inflation is primarily attributed to food price inflation, contributing to approximately one third of the overall inflation rate, followed closely by housing costs (Figure 17). Higher inflation disproportionately affects lower-income households as food and housing account for around 80 percent of their consumption

19 The budget underwent several revisions in the parliament. The changes proposed included raising the minimum wage and public sector salaries, adding provisions for housing sector funds, and reducing the subsidized exchange rate allocation for imports. Furthermore, several adjustments to the tax system were proposed, including revising taxation for mining companies, which were previously exempt from taxes, as well as raising the tax exemption threshold for businesses in the upcoming year. Additionally, a proposed Personal Income Tax (PIT) bill, centered on taxing total income, is set to be implemented in the future. Retirees are anticipated to receive 90 percent of the salaries of active employees within the next three years, reaching the threshold by the end of the third year.

20 The Ministry of Finance initiated a program for the consolidation of public debt data in 2015 through the establishment of a dedicated unit. However, there remain discrepancies in estimates of public arrears between the Ministry of Finance, the pension funds, and banks.

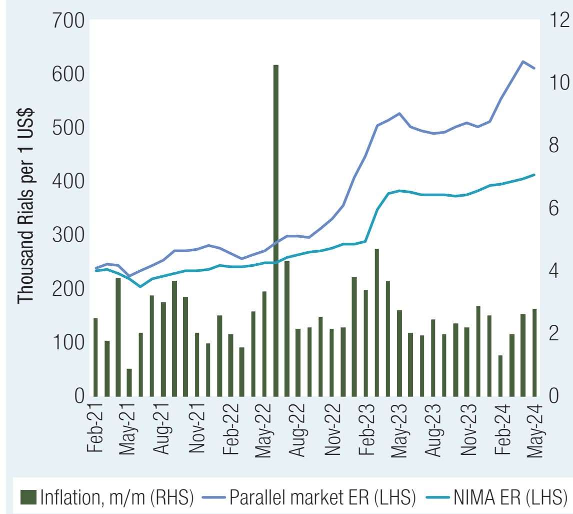
21 See Iran Economic Monitor, Spring/Summer 2023.

FIGURE 15 • Inflation Decelerated in 2023/24…



Source: SCI and World Bank staff calculations.

FIGURE 16 • …as the Rial Stabilized Relative to the Previous Year



Source: SCI, CBI, media and World Bank staff calculations.
Note: NIMA, the Persian acronym for "integrated system of foreign exchange transactions", is a foreign exchange auction system administered by the CBI for facilitating foreign currency exchange between exporters and importers.

basket. Partial progress in nuclear negotiations and efforts to tighten monetary policy have contributed to this trend. In a similar trend, producer price inflation also eased to 32.6 percent in 2023/24, the lowest rate in over five years.

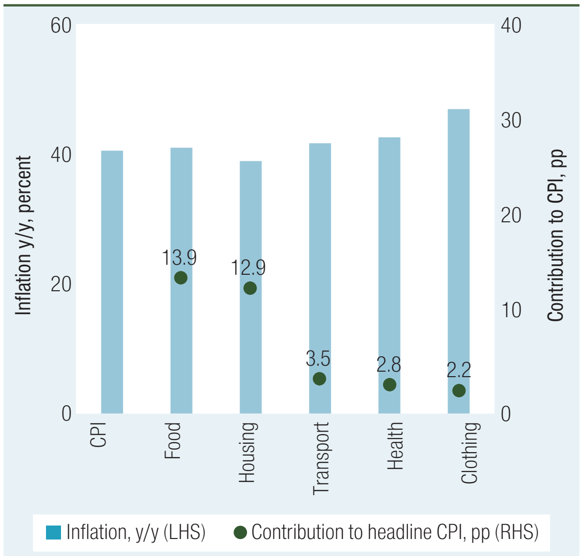
The rial has undergone a period of relative stability in part by reinstating a new preferred exchange rate for essential goods but the parallel market remains impacted by expectations. Six months after the elimination of the subsidized exchange rate in May 2022 (initially pegged to the dollar at IRR42,000/US$ following the reimposition of US sanctions in 2018), the CBI introduced a new fixed rate of IRR285,000/US$ for the import of essential goods in December 2022 (see Box 1). The inclination to maintain a fixed exchange rate by direct intervention in the market, while keeping the market for exports and imports at low levels, has widened the gap with the parallel market. The parallel market exchange rate continues to reflect supply and demand conditions and market sentiments, which after months of relative stability surged by 19.3 percent between during January to May 2024 in line with rising geopolitical tensions and the upcoming US elections.

To curb inflation and stabilize the economy, the central bank implemented various measures. These measures include restricting bank balance sheet growth to a range of 1.5 to 2.5 percent, increasing reserve requirements for riskier banks, and raising deposit and interbank interest rates. As a result, broad money (M2) growth has decelerated to 24.3 percent in 2023/24, down from 31.1 in 2022/23 (Figure 18). Base money (M0) growth also declined to 28.1 percent in 2023/24, down from 42.3 in 2022/23 (Figure 19). However, these constraints on banks, along with government budget deficit financing and directive lending initiatives, have led to increased borrowing from CBI. High restrictions on banks have also led to a decline in the relative credit allocated to different sectors (Figure 20).[22]

The banking system continues to face structural challenges and imbalances. The banking sector grapples with high levels of non-performing loans (NPLs) and insufficient capital, over 70 percent of banks fail to meet the capital adequacy ratio

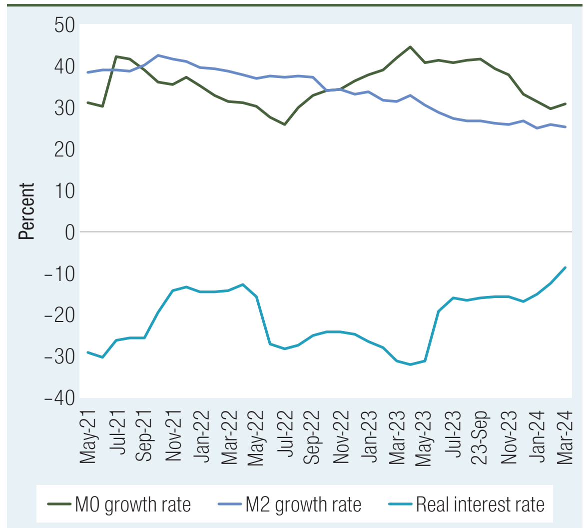
[22] Liquidity constraints in the market, along with fluctuations in the exchange rate due to elevated inflationary expectations after the outbreak of conflict in the Middle East, led to the issuance of a special depositary with a high interest rate in January 2024. This resulted in the average interest rate of Islamic Treasury Bills (Akhza) reaching a historical high of 31 percent.

FIGURE 17 • Food Prices and Housing Expenditures Were the Main Driving Force of Inflation in 2023/24



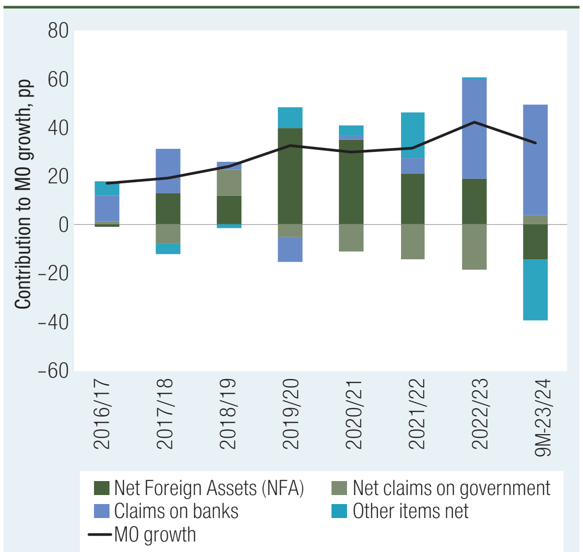
Source: SCI and World Bank staff calculations.

FIGURE 18 • Monetary Base and Liquidity Growth have Decelerated and the Negative Real Interest Rate Moderated



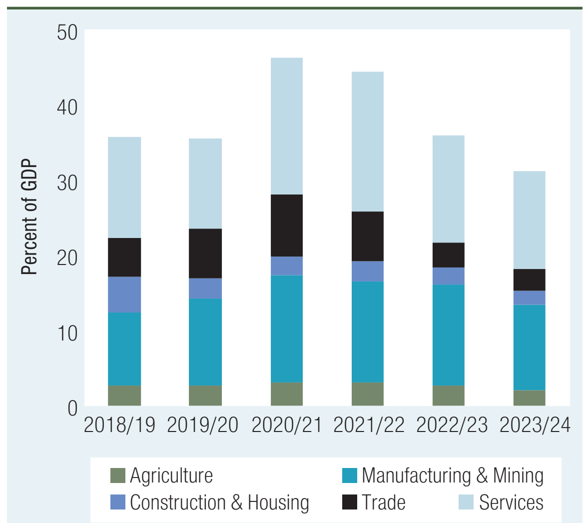
Source: CBI and World Bank staff calculations.

FIGURE 19 • M0 Growth Was Driven by Rising Net Claims on Government in 9M-23/24



Source: CBI and World Bank staff calculations.

FIGURE 20 • Tighter Monetary Policy Led Credit Allocated to the Real Economy to Decline as a Share of GDP in 2023/24

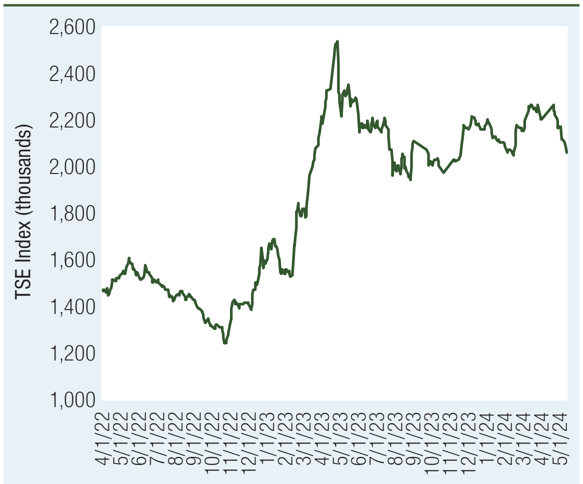


Source: CBI and World Bank staff calculations.

(CAR) requirements and nearly half of them have a negative CAR.[23] This poses a risk of bankruptcy, exacerbated by increased provision of directed credit by the government. NPL accumulation and capital inadequacy heighten the risk of bank failure, threatening financial stability. While the central bank implements measures to mitigate risks, liquidity shortages persist,

[23] The reported average non-performing loan (NPL) ratio was 16.2 percent in 2021/22. However, this figure does not include rollover loans, a significant portion of outstanding loans. High NPLs in Iran stem from factors such as inadequate credit risk assessment, non-financial loan criteria, moral hazard in government-guaranteed projects, and poor central bank supervision.

FIGURE 21 • The Stock Market Started Strongly in 2023/24, Before Stagnating Again with Reemerging Market Uncertainties



Source: Tehran Stock Exchange (TSE).

leading to withdrawal limits and higher deposit rates. This restricts credit allocation. Resolving these issues requires comprehensive solutions.[24]

The Iranian stock market in 2023/24 began the year with considerable strength, driven by improved expectations before being impacted by rising market uncertainty with rising geopolitical tensions. Initially, the market experienced a significant rebound, primarily due to rising inflationary expectations, depreciation of the rial, and bullish market sentiment. The re-escalation of security risks with the conflict in the Middle East again weighed on market sentiment in the second half of 2023 (Figure 21). In response, the government injected IRR10 trillion (about US$17 million) from the National Development Fund of Iran into the stock market "Capital Market Stabilization Fund".[25] However, such interventions alone may not be sufficient to maintain investor confidence in the long run. The market's performance and firm profitability more broadly are also impacted by price controls, the role of public sector, and economic sanctions.

External Sector

The decline in oil prices and higher imports narrowed the current account balance (CAB) in 2023/24. Despite an expansion in oil and non-oil export volumes, a decline in the oil product prices led total goods exports edged down by 0.4 percent (nominal, y/y) while imports expanded by 10.9 percent (nominal, y/y) in 9M-23/24, leading to more than halving of the current account surplus to 1.6 percent of GDP (US$6.3 billion). Despite only edging up by 0.1 percent y/y, oil exports share in total exports reached 57.1 percent in 9M-23/24, the highest share since the reimposition of US sanctions in 2018. Services trade, skewed towards imports, also rebounded by over 19.6 percent (y/y) (Figure 22). The current account surplus was more than offset by the net capital account deficit (US$20.2 billion), registering a 24.8 percent increase in net capital outflows in line with the deficit of the last 8 years (Figure 23).[26]

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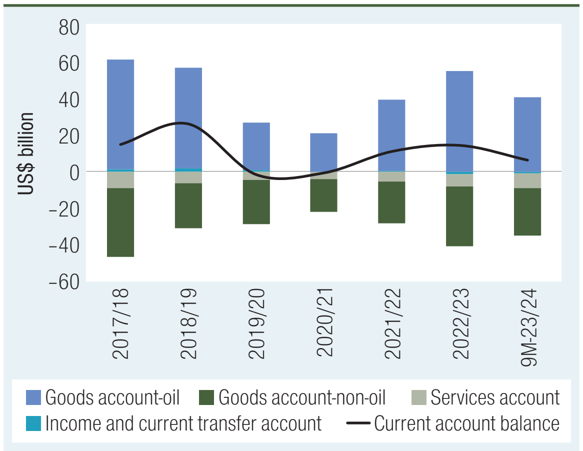
[24] The Central Bank's program aims to revitalize and reform underperforming banks in two phases. The first phase focuses on revitalization, organization, and reform, while the second phase involves halting operations and dissolving the financial institution if desired results are not achieved. Currently, a reform program has been presented to eight banks, with ongoing monitoring and constraints implementation to address imbalance issues. Among them, three credit institutions are slated for dissolution, with two already completed and the third set to dissolve soon as part of the banking network's imbalance resolution program.

[25] The Capital Market Stabilization Fund was established in 2015 and later operationalized in 2017 with the aim of (1) maintaining conditions for fair market competition, (2) preventing and/or containing market downturn contagion during periods of economic and financial crisis, (3) implementation of government policies in periods of crisis, and (4) protecting micro investors. The fund can intervene in the stock market through direct asset trade and benefits from exemptions, including from taxes and trade commission fees. The main investors of the fund are the Securities and Exchange Organization of Iran and the NDFI (IRNA).

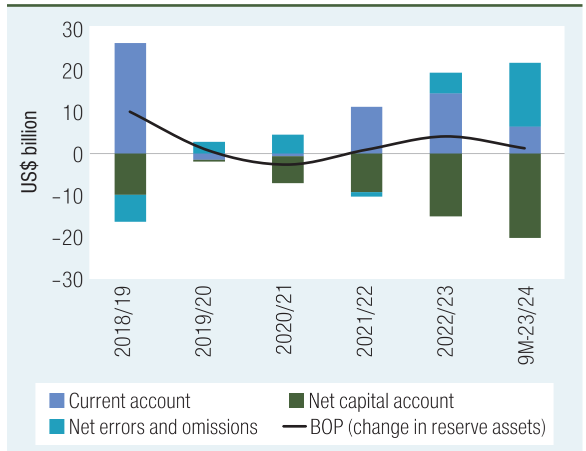
[26] Over the past seven years, Iran's capital account balance has experienced consecutive deficits, which can be attributed in part to significant capital flight caused by economic uncertainty in the country. This trend indicates a lack of confidence in the Iranian economy and its investment opportunities, which has led investors to seek out more stable and predictable investment options abroad. Addressing the underlying causes of economic uncertainty in Iran, such as inflation, sanctions, and political instability, will be essential to reversing this trend and attracting much-needed investment to the country.

FIGURE 22 • The CAB Contracted Due to a Decline in Oil and Oil Product Prices and Higher Imports…



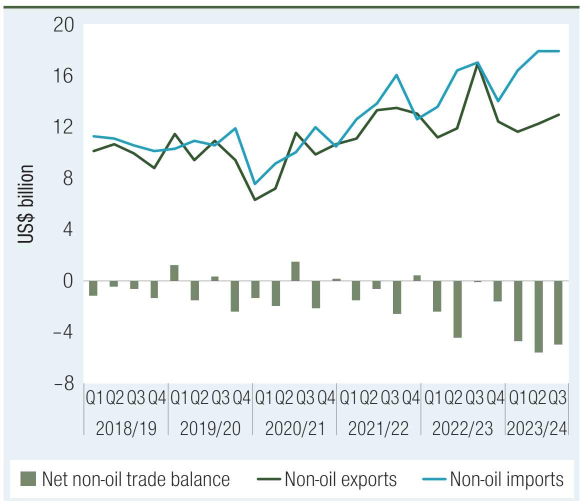
Source: CBI and World Bank staff calculations.

FIGURE 23 • …while the Capital Account Registered a Larger Deficit in 9M-23/24



Source: CBI and World Bank staff calculations.

FIGURE 24 • Lower Non-Oil Export Prices Have Widened the Non-Oil Trade Deficit



Source: Islamic Republic of Iran's Customs Administration (IRICA) and World Bank staff calculations.

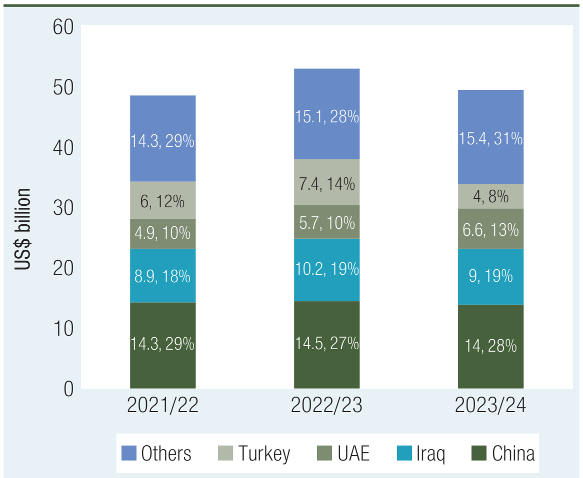
Lower oil prices also contributed to a larger non-oil trade deficit in 2023/24. Import growth of 6.7 percent compared to a decline in non-oil exports of 8.6 percent, led to a widening of the non-oil trade deficit to about 4 percent of GDP (US$16.9 billion) (Figure 24). Prices were the main driver of trade dynamics as the total volume of exports and imports expanded by 9.8 percent and 4.4 percent, respectively. Major non-oil exports comprise oil products, while key imported items include cereals and cell phones.

The high oil content of non-crude oil exports and limited processing of other exports present a challenge to further export diversification and value-added generation. More than 50 percent of Iran's non-oil exports in 2023/24 consisted of petrochemical products and gas condensates. As a result, recent lower oil prices also impacted non-crude oil exports. More generally, Iran's non-oil exports mainly comprise raw and semi-finished goods, yielding lower value-added returns and increasing vulnerability to commodity price fluctuations.

Economic sanctions have concentrated trade flows further. Iran's top three trading partners in non-oil exports and imports accounted for 60 percent and 70 percent, respectively, highlighting a high level of trade concentration and susceptibility to shocks from these key partners (China, Iraq, UAE and Turkey) (Figure 25 and Figure 26). Approximately 10 key trade partners contribute to roughly 85 percent of Iran's non-oil exports, while the shares of other nations in these exports are relatively insignificant.

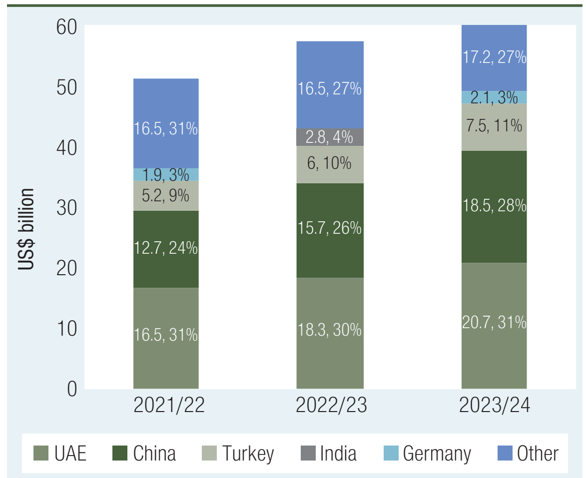
The government has pursued several initiatives to diversify trade partners, with limited impact due to its non-membership in FATF and ongoing sanctions. Despite this, leveraging its geopolitical position could offer benefits as a gateway and transit point for regional economic coopera-

FIGURE 25 • China Remains the Top Importer of Iran's Non-Oil Exports...



Source: IRICA and World Bank staff calculations.

FIGURE 26 • ...while More than Half of Imports are Sourced from the UAE and China



Source: IRICA and World Bank staff calculations.

tion agreements such as BRICS and the Shanghai Cooperation Organization (SCO). Membership in BRICS could offer partial benefits, including potential access to financial resources contingent on the provision of financial resources in the currencies of member countries.[27] Acceptance of FATF conventions and efforts to alleviate sanctions could facilitate economic integration in regional and international agreements, thereby accelerating Iran's economic development and optimizing economic opportunities. Positioned strategically as a key transportation route, Iran holds significance in the East-West corridor supporting the Belt and Road Initiative and the North-South Transportation Corridor, requiring further development of customs facilities, infrastructure, logistics, and other prerequisites for attracting foreign investment.

The limited growth in non-oil trade and increased concentration reflects the dual impact of US sanctions and trade policy. Sanctions have imposed constraints due to banking and financial restrictions, limiting trade scope and technology transfers, increasing trade costs, and impacting competitiveness. High tariff and non-tariff barriers have also negatively impacted productivity and innovation. Additionally, exchange rate (ER) policy plays a crucial role**.** When oil revenues are high, ER policy mainly focuses on stabilizing the nominal ER to provide a nominal anchor to control inflation expectations. However, in combination with strong long-term M2 growth and persistent inflation, this leads to a decline in the real exchange rate (i.e., effective exchange rate overvaluation), negatively affecting net exports. Conversely, in times of low oil prices or intensification of sanctions, the central bank's reduced control over the foreign exchange market results in currency depreciation, often marked by spikes.[28]

27 BRICS, an intergovernmental organization consisting of Brazil, Russia, India, China, and South Africa, originated in 2010 with the inclusion of South Africa into its precursor, BRIC. At the 15th BRICS Summit in August 2023, it declared the invitation of Argentina, Egypt, Ethiopia, Iran, Saudi Arabia, and the United Arab Emirates to join the organization.

28 On the import side, heavily depreciated exchange rates lead to the allocation of subsidized rates, depleting the central bank's limited foreign reserves and demonstrating limited efficacy in preventing inflation. Regarding exports, challenges such as increased costs due to imported raw materials and sanctions on banking transactions, unfavorable business conditions, and government policies restricting exports collectively undermine the country's commercial competitiveness, hindering efforts to enhance export capabilities.

2

OUTLOOK, RISKS, AND OPPORTUNITIES

GDP growth is forecast to maintain a modest pace in the medium term. GDP in 2024/25 is now forecast to grow at a more moderate rate due to the projected slower growth in government expenditures and the base effect of larger than anticipated growth in 2023/24. The initial boost in oil production and exports in 2023/24 is projected to significantly moderate in subsequent years with weaker global demand, including China's economic slowdown; this will also spillover into the non-oil sector. Non-oil GDP is expected to remain constrained due to sanctions, energy shortages, liquidity constraints, underinvestment, and economic uncertainty. Domestic consumption is forecast to weaken as the purchasing power of households is expected to continue to decline with prolonged high inflation.

Despite plans to consolidate the budget in 2024/25, fiscal pressures are forecast to persist, leading to a fiscal deficit that is further compounded by off-budget expenditures. The fiscal deficit is projected to average around 2.3 percent of GDP throughout the projected period (2024/25–2026/27), due to rising expenditures and limited growth in oil revenue. Increased government expenditures, particularly for pension payments and transfers to mitigate high inflation and rising living costs, are expected to gradually widen the fiscal deficit.

High inflation and sluggish job creation are expected to negatively impact households' welfare. While subdued inflationary expectations and reduced currency pressures would alleviate inflationary pressures, a growing budget deficit is forecast to keep inflation above 30 percent in the medium term. The challenge of job creation persists across various sectors, hindered by economic volatility, insufficient non-oil growth and labor market rigidities. The private sector will continue to grapple with macroeconomic uncertainties and an uncertain investment climate, factors that are anticipated to reduce household welfare and disposable income. While government transfers can provide some relief, they come at a fiscal cost that may exacerbate inflationary pressures and reduce the fiscal space needed for pro-growth investments.

Poverty is projected to decrease, albeit at a slower pace. Poverty at the US$6.85 line is expected to drop by a further 3 percentage points over the next three years, but poverty at the US$3.65 percentage line will decrease only slightly. Building on the last two years of inclusive growth by improving the effectiveness of social protection measures will help ensure the trend of poverty reduction continues. Further consolidation of cash transfers and enhanced targeting of transfers would help improve their effect on reducing inequality and manage their fiscal cost.

The current account surplus is forecast to gradually narrow, reaching 2.2 percent of GDP by 2026/27. This decline is primarily attributed to a projected decline in oil prices linked to subdued global demand and more specifically China's economic slowdown, as well as the expiry of OPEC+ production cuts in 2024. Iran's exports, both oil and non-oil, will also be impacted by lower energy prices and intensified competition from other major exporters in key international markets.

Risks and Opportunities

Risks to the economic outlook arise from global oil market dynamics, climate change, economic sanctions, and the conflict in the Middle East. A decline in oil prices resulting from reduced global demand would adversely affect economic prospects. Growing economic ties with China makes the economy susceptible to fluctuations in China's economy. More frequent extreme weather events threaten agricultural production and employment, posing risks to food security and livelihoods. Intensified economic sanctions, especially impacting trade with neighboring and existing trade partners, would significantly weigh on growth. A potential expansion of the conflict in the Middle East that would directly involve Iran would have profound implications for the economy and the region (see Box 2). Conversely, the removal or partial waiver of sanctions would significantly boost both oil and non-oil growth. Enhanced economic integration and investments with neighboring countries could generate new growth opportunities.

BOX 2 SCENARIO IMPACT OF THE RECENT CONFLICT IN THE MIDDLE EAST ON IRAN'S ECONOMY

The recent regional security ramifications of the conflict in the Middle East centered in Gaza have heightened economic risks for Iran. The consequences of a full-scale war would be profound for Iran, considering the country's current situation, amplified by existing challenges and ongoing economic sanctions. This box provides a scenario of the potential impact of conflict materializing in 2024/25. The actual consequences would depend on the scale, duration, and specific developments during the conflict.

Table B2.1 presents an initial assessment of the economic consequences of the conflict relying on the downside oil scenario of the recent World Bank Commodity Market Outlook[a] and a specific scenario of shock to Iran's economy. The baseline scenario considers a minimal impact of the conflict on Iran's economy, presuming no direct involvement from Iran. The downside scenario assumes an extended conflict with Iran's direct involvement, resulting in a substantial disruption to Iran's oil export volumes, an increase in oil prices but with heavier discounts, and a negative shock to the non-oil sector.

Depending on the scale of the conflict for Iran, the negative impact on GDP growth can be as high as 10 percentage points in 2024/25, primarily through the oil shock channel. Additionally, conflict would disrupt economic activities, leading to reduced production, decreased consumer spending, and diminished investments due to heightened uncertainties. Furthermore, physical and human capital damages would impede the recovery of economic activities in the post-conflict period. The resulting depreciation of the domestic currency would also fuel an inflationary spiral.

In the downside scenario, the fiscal account would be heavily strained with the budget deficit estimated to exceed 6.2 percent of GDP in 2024/25. This would be driven by a 22 percent decline in oil revenues, reduced tax revenues stemming from economic disruptions in trade, and infrastructure damage. In addition, Iran's government may need to allocate a significant portion of its budget to fund defense and security measures, diverting resources from other critical sectors.

On the external account, the conflict would indicate a substantial impact, with reduced oil and non-oil exports causing the current account to fall into a projected deficit of 2.6 percent of GDP in 2024/25. Iran's oil exports could face severe repercussions from an expanded conflict, although this may be partly offset by the impact on oil prices. Additionally, intensified sanctions and disruptions in trade routes, consequently affecting supply chains, could lead to delays and increased costs for businesses, impacting both imports and exports.

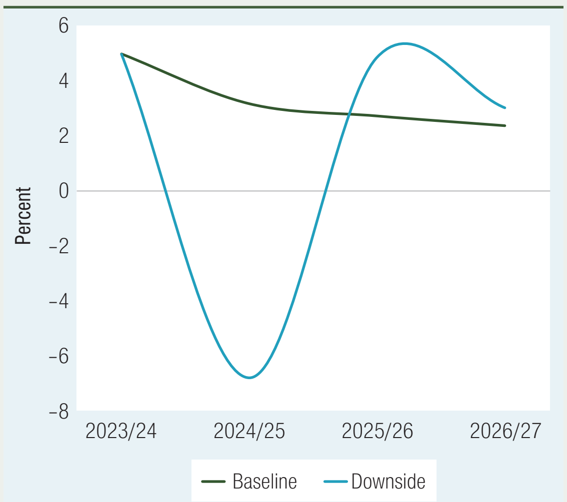
(continued on next page)

BOX 2 SCENARIO IMPACT OF THE RECENT CONFLICT IN THE MIDDLE EAST ON IRAN'S ECONOMY *(cont.)*

TABLE B2.1 • The Impact of Gaza Conflict on Iran's Economy under Difference Scenarios

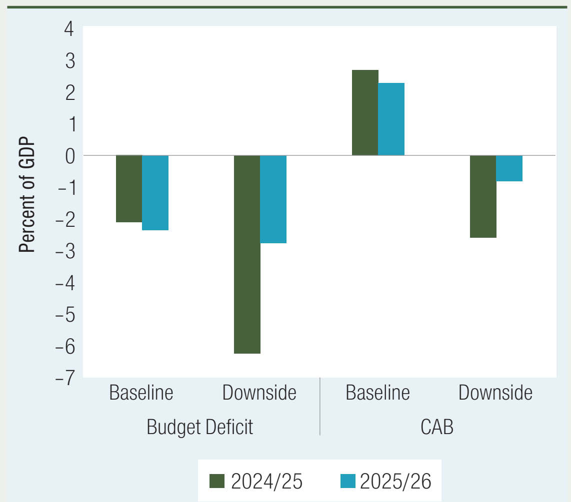
	2024/25		2025/26	
	Baseline	Downside	Baseline	Downside
	(Percentage change unless otherwise noted)			
Oil Price (US$/bbl)	**81.0**	**157.0**	**78.0**	**78.0**
Oil Exports (mbpd)	**1.3**	**0.5**	**1.4**	**1.0**
Oil GDP	5.0	−22.1	5.0	17.0
Non-oil GDP	3.0	−5.3	2.5	3.3
GDP	**3.2**	**-6.9**	**2.7**	**4.9**
Budget Deficit (Percent of GDP)	**-2.1**	**-6.2**	**-2.3**	**-2.7**
CAB (Percent of GDP)	**2.7**	**-2.6**	**2.3**	**-0.8**
CPI Inflation	**35.3**	**58.0**	**32.0**	**43.4**

FIGURE B2.1 • The Impact of the Conflict on GDP Growth Could Be Significant



Source: World Bank staff calculations.

FIGURE B2.2 • …and Would Reflect on the Budget Deficit and CAB



Source: World Bank staff calculations.

[a] The CMO evaluated the Middle East tension based on four scenarios: a baseline scenario with very limited impact of the war, a low disruption scenario with a 0.5–2 million barrels per day (mbpd) decline in global oil supply and a 3–13 percent increase in oil prices, a medium disruption scenario with a 3–5 mbpd decline in global oil supply and a 21–35 percent increase in oil prices, and a large disruption scenario with a projected 6–8 mbpd disruption in oil supply and a 50–75 percent increase in oil prices.

TABLE 2 • Iran: Selected Economic and Financial Indicators, 2020/21-2026/27

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.
Real sector	(Annual percentage change, unless otherwise stated)						
Real GDP at market prices	3.3	4.7	3.8	5.0	3.2	2.7	2.4
Real GDP at factor cost	4.1	4.4	4.0	5.0	3.2	2.7	2.4
Real GDP per capita	2.5	4.0	3.0	4.2	2.5	2.1	1.8
Real non–oil GDP	3.6	3.9	3.5	3.8	3.0	2.5	2.2
Real oil GDP	9.6	10.1	10.0	17.1	5.0	5.0	5.0
Total crude oil production (mbpd)	2.0	2.5	2.6	3.0	3.2	3.3	3.5
(GDP supply side components)							
Agriculture	3.2	–2.6	1.1	1.0	0.9	0.8	0.8
Industry (including oil)	7.8	3.2	7.4	8.8	4.9	3.7	3.7
Services	2.2	6.5	2.7	3.4	2.6	2.3	2.0
(GDP demand side components)							
Private consumption	0.5	3.9	8.7	3.3	2.4	2.1	1.8
Government consumption	–0.9	8.3	–3.6	0.5	1.9	2.1	2.2
Gross fixed capital formation	3.2	0.0	6.7	5.9	4.4	4.2	3.1
Exports, goods and services	–12.8	5.2	8.2	15.4	7.1	5.2	5.2
Imports, goods and services	–29.7	24.1	7.5	1.6	1.8	2.1	2.1
Money and prices							
Oil price (US$/bbl)	61	41	99.8	82.6	81.0	78.0	77.0
CPI Inflation (p.a.)	47.1	46.2	46.5	40.7	35.3	32.0	30.5
Monetary base (MB)	30.1	31.6	42.3	28.1	n/a	n/a	n/a
Broad money (M2)	40.6	39	31.1	24.3	n/a	n/a	n/a
Banking system credit	94.8	56.3	49.9	52.9	n/a	n/a	n/a
Nominal interest rate (percent)	17.5	19.6	21.2	23.6	n/a	n/a	n/a
Nominal exchange rate, parallel market (IRR/US$)	228,872	259,476	334,103	516,731	n/a	n/a	n/a
	(Percent of GDP, unless otherwise stated)						
Investment & saving							
Gross capital formation	42.2	39.5	38.0	36.4	35.3	34.8	34.2
Gross national savings	42	42.6	41.4	39.3	38.0	37.1	36.4
Government finance							
Total revenues	7.8	11.0	11.7	11.8	11.8	11.8	11.9
Tax revenues	5.1	4.9	5.1	5.2	5.2	5.3	5.3
Total expenditures	13	14.2	13.6	13.7	13.9	14.1	14.3
Current expenditures	11.1	12.1	10.6	11.0	11.2	11.4	11.6

(continued on next page)

TABLE 2 • Iran: Selected Economic and Financial Indicators, 2020/21-2026/27 *(continued)*

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.
Net lending/borrowing (overall balance)	−5.2	−3.2	−2.2	−1.9	−2.1	−2.3	−2.4
External sector							
Current account balance	−0.3	3.1	3.4	2.9	2.7	2.3	2.2
Population and labor market							
Population (million)	83.4	84.1	84.7	85.3	85.9	86.5	86.6
Participation rate (percent)	41.3	40.9	40.9	41.3	n/a	n/a	n/a
Unemployment rate (percent)	9.6	9.2	9.0	8.1	n/a	n/a	n/a
Memorandum Items:							
Nominal GDP (IRR Trillion)	40,791	66,775	104,350	145,559	195,935	258,979	339,963

Source: Iranian authorities and World Bank staff estimates and projections.

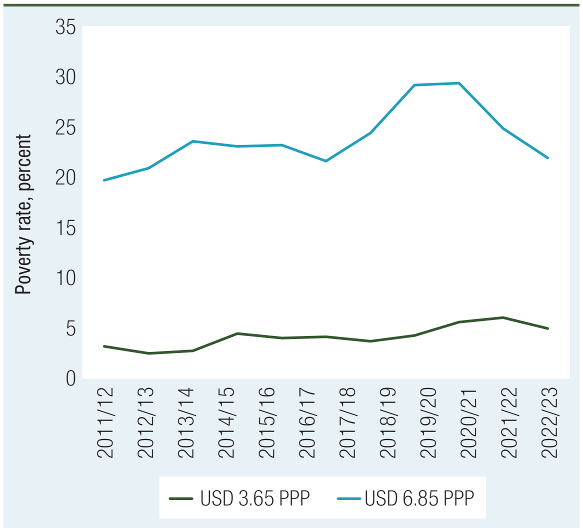
SPECIAL FOCUS: RECENT POVERTY AND INEQUALITY TRENDS IN IRAN 2020/21-2022/23

Recent trends in Iran show progress in reducing poverty and improving income inequality. Between 2020/21 and 2022/23, poverty rates as measured at US$6.85 a day decreased by 7.4 percentage points, lifting approximately 6.1 million Iranians above the poverty line.[29] Using the lower-middle income poverty line of US$3.65 a day, poverty declined from 6.05 percent to 3.8 percent. Income inequality also improved slightly, declining from 35.8 to 34.8, as measured by the Gini index. Inclusive consumption growth, driven by increased earnings from wages and self-employment, contributed to the decline in poverty levels. Social programs, including temporary cash transfers and pensions, played a significant role in poverty reduction, particularly in 2022/23. However, regional disparities persist, with rural areas and the Southeast region experiencing higher poverty rates compared to urban centers.

This Special Focus builds on the World Bank's latest Iran Poverty Diagnostic: Poverty and Shared Prosperity , which covered 2011/12 to 2020/21 (World Bank, 2023). The report documented a significant rise in poverty during this period. Earnings volatility was a key factor influencing poverty with social protection programs providing essential support during times of economic downturn. However, the diminishing real value of social transfers, especially for the lower-income deciles, forced a greater dependence on wages and self-

[29] The welfare estimates are calculated using the recent guidelines in the updated methodological note for poverty measurement for Iran. This methodology takes into account spatial and temporal price differences, inflation, and other relevant factors to ensure accurate welfare comparisons. For more detailed information on the methodology, please refer to Box 1 in the document.

FIGURE 27 • Poverty Rates, 2012/13-2022/23



Source: WBG updated poverty estimates.

employment, which did not keep pace with escalating needs. During this period, an additional 9.5 million fell into poverty—set at US$6.85 per day in 2017 purchasing power parity terms—and the poverty rate rose from 19.7 percent in 2011 to 29.1 percent in 2020. Iran is the only country in the Middle East and North Africa region that collects high quality household budget survey data on an annual basis and makes them publicly available. With more recent household survey data now available, the team has extended the time series analysis for Iran to also include 2020–2022, a period during which Iran's economy has seen a resurgence in growth and corresponding poverty reduction.

Poverty and Inequality in Iran for 2020/21-2022/23

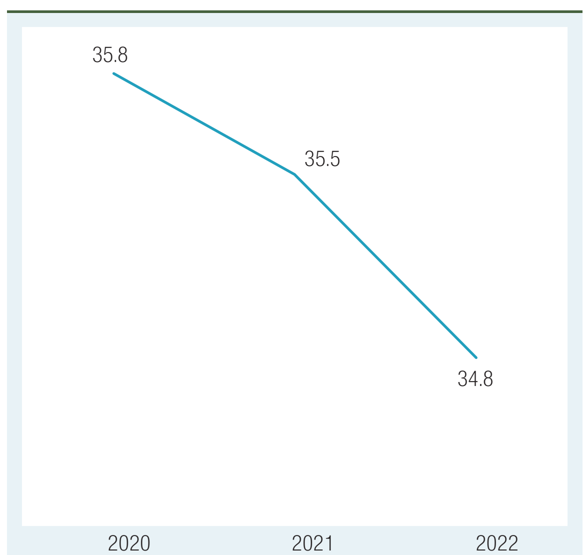
New household survey data reveal notable reductions in poverty levels. The economic rebound in 2020/21–2022/23 has led to a significant decline in poverty (Figure 27). Poverty in 2022/23 was 21.9 percent, nearing levels seen in 2018/19.

Figure 27 Poverty rates, 2012/13–2022/23 and Figure 28 highlight the significant shift in poverty rates and income inequality over this period. By the end of 2022, the percentage of individuals living below the upper-middle income country poverty threshold of US$6.85 per day had decreased by a cumulative 7.4 percentage points, with approximately 6.1 million Iranians rising above the poverty line. For the lower-middle income poverty line of US$3.65, there was a modest decline of 2.25 percentage points over two years, which equates to about 0.8 million Iranians

FIGURE 28 • Headcount Poverty Rates at US$3.65 and US$6.85 2017 PPP National

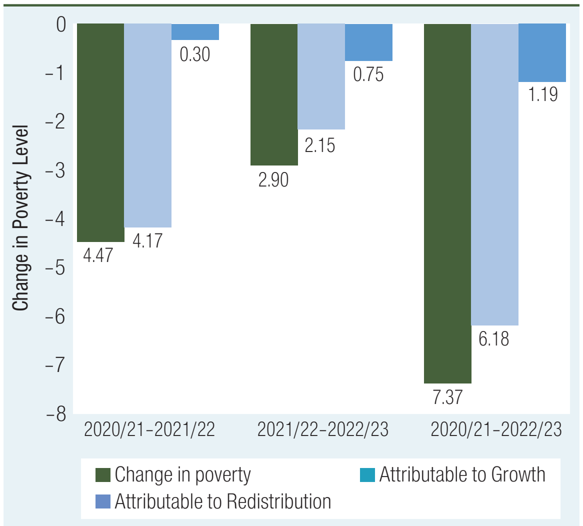
Source: World Bank staff estimates based on HIES 2020/21–2022/23.

FIGURE 29 • GINI Index, National, 2020/21-2022/23



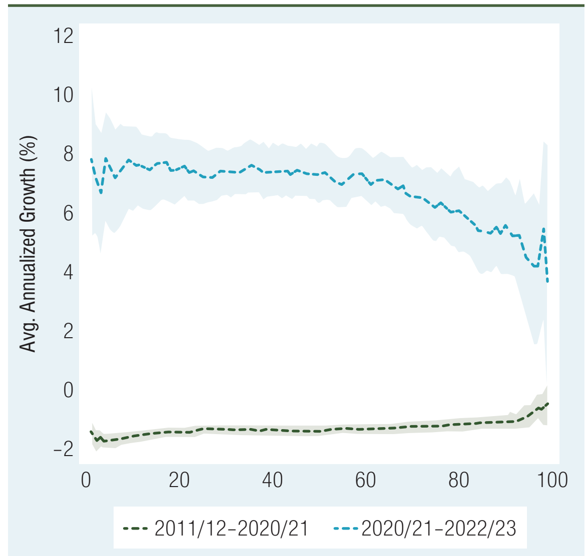
Source: World Bank staff estimates based on HIES 2020/21–2022/23.

FIGURE 30 • Growth and Redistribution Effects on Poverty Reduction, 2020/21-2022/23



Source: World Bank staff estimates based on HIES 2020/21–2022/23.
Note: A growth incidence curve shows the annualized change in consumption for all households, from the poorest to the richest. A flat slope means that households all experience the same rate of consumption change. A downward slope means that poor households increase their consumption more rapidly than rich households or decrease it at a lower rate, and vice versa.

FIGURE 31 • Growth Incidence Curves 2011/12-2020/21 and 2020/21-2022/23



Source: World Bank staff estimates based on HIES 2020/21–2022/23.
Note: A growth incidence curve shows the annualized change in consumption for all households, from the poorest to the richest. A flat slope means that households all experience the same rate of consumption change. A downward slope means that poor households increase their consumption more rapidly than rich households or decrease it at a lower rate, and vice versa.

escaping poverty.[30] Income inequality, as measured by the Gini index, also declined from 35.8 to 34.8. This is a slight improvement compared to the previous decade, which saw a marginal rise in income inequality, with the Gini index increasing from 35.5 in 2011 to 36.7 in 2020.

The recent dynamics of poverty were driven primarily by inclusive consumption growth. Between 2020 and 2022, the decrease in poverty levels in Iran was largely due to a significant uptick in consumption growth (Figure 30). Income redistribution from the richest to the poorest contributed only marginally to poverty reduction. Growth incidence curves, illustrated in Figure 31, display the real per capita expenditure growth rates across the entire population distribution for two key periods: 2011–2020 and 2020–2022. From 2011 to 2020 the poorest segments of the population were hit hardest during recessions and gained the least during periods of economic growth (World Bank 2023),[31] this pattern shifted in the subsequent period from 2020 to 2022. In this latter period, the entire population experienced positive consumption growth, but the increase in consumption for the top 60 percent was outpaced by that of the bottom 40 percent. This was primarily due to a proportionally larger increase in consumption among the poorest deciles. Such shifts in per capita consumption across the distribution align with a trend towards reduced inequality within the country.

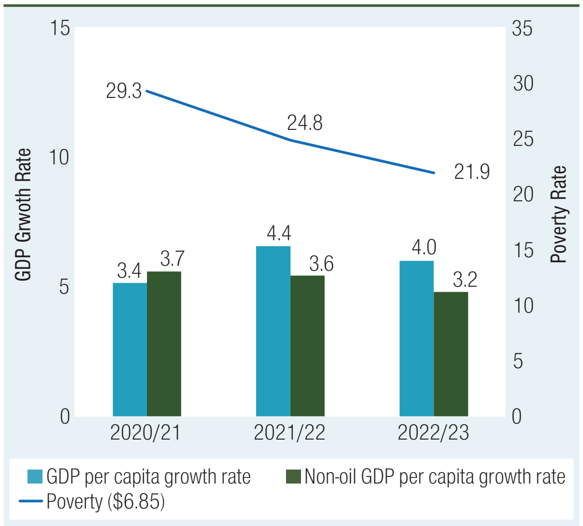
Explaining Welfare Changes from 2020/21 to 2022/23

Iran's macroeconomic trends and poverty levels have been closely aligned in recent years. As illustrated in Figure 32, there is a correlation between the real GDP growth rates (including both oil and non-oil sectors) and the poverty rates, using the $6.85 2017

30 In 2021 Iran was reclassified from an upper-middle income to a lower-middle income country. For the purposes of comparability, this report includes poverty estimates for both country groupings.

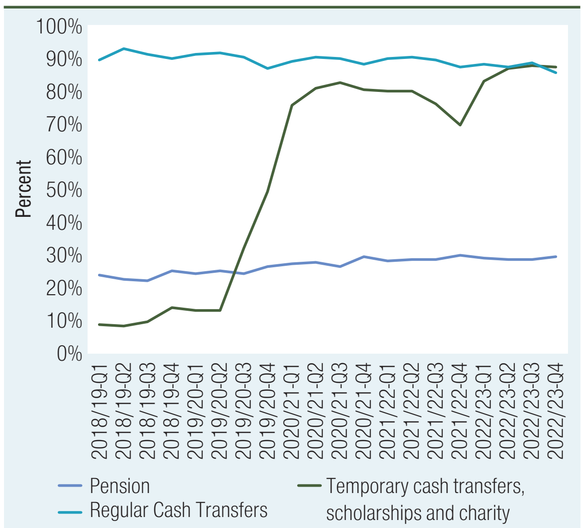
31 Poverty numbers in this note are different from the 2023 Iran Poverty Assessment; here we used Purchasing Power Parity (PPP) of the Gregorian year (January-December), while the Poverty Assessment used PPP of Persian year (April–March).

FIGURE 32 • GDP Growth Rates and Poverty Rates in Iran, 2020-2022



Source: World Bank staff estimates based on HIES 2020/21–2022/23.

FIGURE 33 • Evolution of Social Transfers, 2018/19-2022/23



Source: Author's calculations based on HIES 2020/21–2022/23.
[a] For reporting purposes, the Statistics Center of Iran (SCI) has a standalone category for recording regular cash-transfers; and records one-time top-ups to its cash transfer under a separate category that includes 'welfare, scholarships, and charity". This is evidenced by the surge in recipients of such payments starting in 2019, when the first top-ups were provided.

PPP benchmark for poverty. Notably, there was a significant reduction in poverty during 2021/22, which corresponded with a 4.4 percent increase in real GDP per capita. This trend of declining poverty continued into 2022/23, a period that saw a 4 percent rise in real GDP per capita and a 3.2 percent growth in the non-oil GDP, further underscoring the positive impact of economic growth on poverty reduction in Iran.

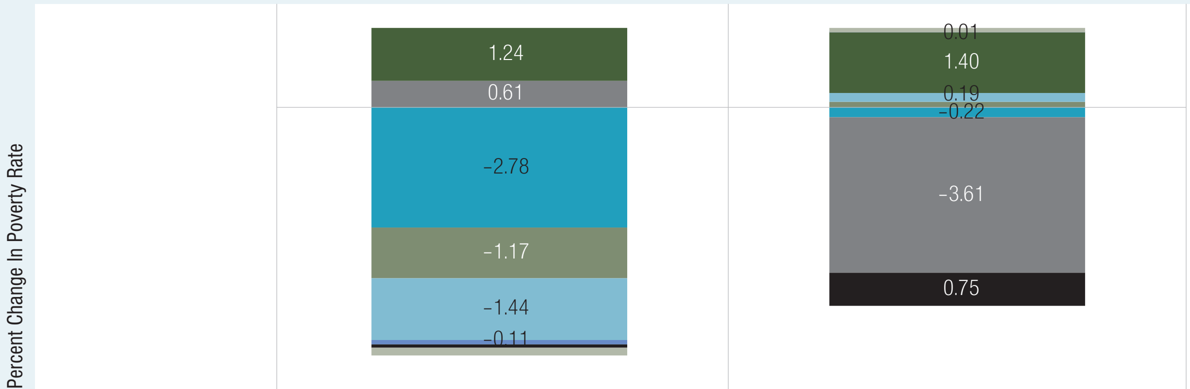
Increase in earnings from wages, self-employment, and a surge in one-time social transfers, are contributors to the recent decline in poverty levels. As confirmed in the recent poverty diagnosis for Iran, income volatility is a key determinant of poverty fluctuations. The drop in poverty from 2020 to 2021 is primarily attributed to the increased earnings from wages, self-employment, and pensions (Figure 34 Decomposition of the drivers of poverty, 2020/21–2022/23).In the following period of 2021–2022, cash transfer top-ups were the main factor to push poverty down. These additional transfers account for a 3.6 percentage point decrease in poverty; without them, the poverty rate would barely have budged. This observed increase in the data likely reflects the additional cash top-up the government paid to poor Iranian households. This measure was taken to cushion the effects of discontinuing the "preferred" exchange rate of IRR42,000/US$, which was previously used to stabilize import costs for essential goods, including food items, medicine, and medical equipment.

Spatial Disparities

Despite the decline in poverty, there are significant disparities that continue to exist within the country. Rural regions and the Southeast of Iran experience a disproportionately high prevalence of poverty. The majority of Iran's impoverished population resides in rural areas, where poverty rates are markedly higher than in urban centers, as shown in Figure 35. While more than one-third of the rural population is classified as poor in 2022/23, the area has experienced a substantial decline in poverty, with an 11-percentage point decrease between 2020/21 to 2022/23. In urban areas, poverty has also decreased, with a 6-percentage point drop during the same period. In terms of income inequality, urban regions have observed a downward trend, suggesting a slight improvement. In contrast, rural areas have seen a slight uptick in inequality.

This disparity is particularly pronounced in the Southeastern provinces, where poverty

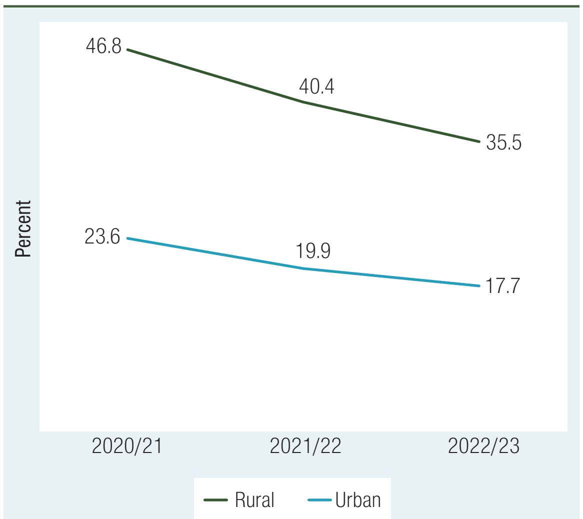
FIGURE 34 • Decomposition of the Drivers of Poverty, 2020/21-2022/23



	2020/21–2021/22	2021/22–2022/23
Remittances	−0.16	0.09
Assets	−0.08	−0.75
Own Production	−0.11	0.01
Regular Cash Transfers	1.24	1.40
Pension	−1.44	0.19
Temporary Cash Transfers, Scholarships and Charity	0.61	−3.61
Self employed	−1.17	0.14
Wage	−2.78	−0.22

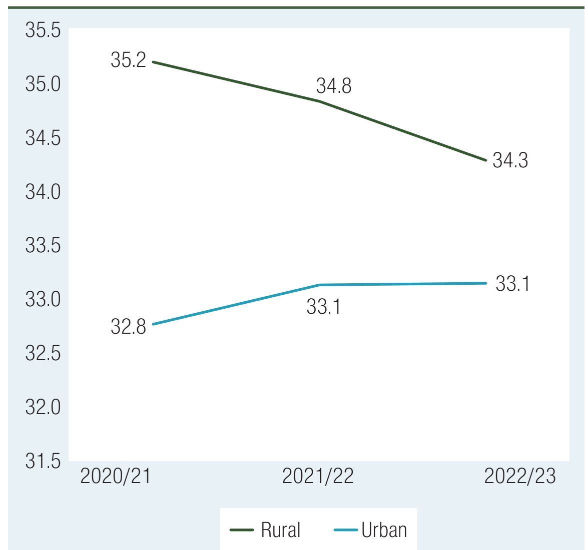
Source: Author's calculations based on HIES 2020/21–2022/23.
Note: results derived from Shapely decomposition as recommended by (Azevedo, Sanfelice and Nguyen, 2012).

FIGURE 35 • Headcount Poverty Rates at US$6.85 2017 PPP, by Rural/urban Areas, 2020/21-2022/23



Source: Author's calculations based on HIES 2020/21–2022/23.

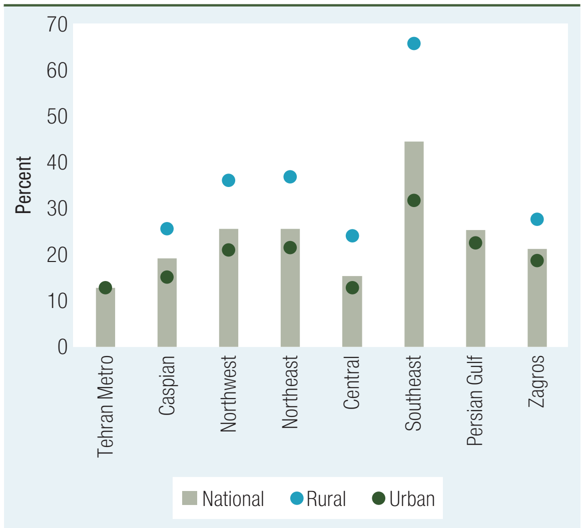
FIGURE 36 • GINI Index, by Rural/urban Areas, 2020/21-2022/23



Source: Author's calculations based on HIES 2020/21–2022/23.

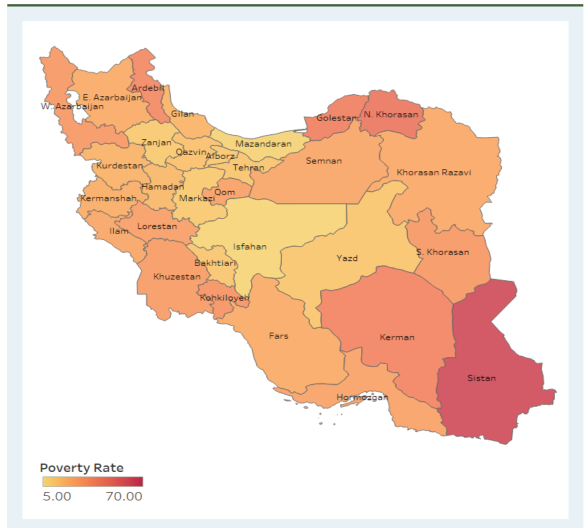
is deeply entrenched. Sistan and Baluchestan, for example, have the highest poverty rates, with nearly two-thirds of its residents living in poverty in 2022. Although this represents a decrease from the 70 percent recorded in 2020, the current rate remains alarmingly high and substantially exceeds the national average. Similarly in Kerman, where 40 percent of the population is poor. In contrast, the poverty rate is

FIGURE 37 • Headcount Poverty Rates at US$6.85 2017 PPP, by Region and Rural/urban Areas, 2022/23



Source: World Bank staff estimates based on HIES 2022/23.
Note: Provinces are grouped in the following regions: Tehran metro (Urban parts of Tehran and Alborz); Caspian (Golestan, Gilan, Mazandaran); Northwest (East and West Azarbaijan, Zanjan, Ardebil); Northeast (Khorasan Razavi, Semnan, North and South Khorasan); Central (Rural parts of Tehran and Alborz, Qom, Qazvin, Markazi, Fars, Isfahan); Southeast (Kerman, Sistan , Yazd); Persian Gulf (Khuzestan, Bushehr, Hormozgan); Zagros (Kermanshah, Kurdestan, Hamadan, Bakhtiari, Lorestan, Ilam, Kohkiloyeh).

FIGURE 38 • Headcount Poverty Rates at US$6.85 2017 PPP, by Province, 2022/23



Source: World Bank staff estimates based on HIES 2022/23.
Note: Provinces are grouped in the following regions: Tehran metro (Urban parts of Tehran and Alborz); Caspian (Golestan, Gilan, Mazandaran); Northwest (East and West Azarbaijan, Zanjan, Ardebil); Northeast (Khorasan Razavi, Semnan, North and South Khorasan); Central (Rural parts of Tehran and Alborz, Qom, Qazvin, Markazi, Fars, Isfahan); Southeast (Kerman, Sistan , Yazd); Persian Gulf (Khuzestan, Bushehr, Hormozgan); Zagros (Kermanshah, Kurdestan, Hamadan, Bakhtiari, Lorestan, Ilam, Kohkiloyeh).

13 percent in Tehran, the capital, and below 8 percent in the least poor provinces of Isfahan, Mazandaran, and Markazi. From 2020 to 2022, nearly all provinces saw a reduction in poverty rates, with the exception of Ardebil province, which experienced a slight increase of approximately 3 percentage points.

Role of Social Programs

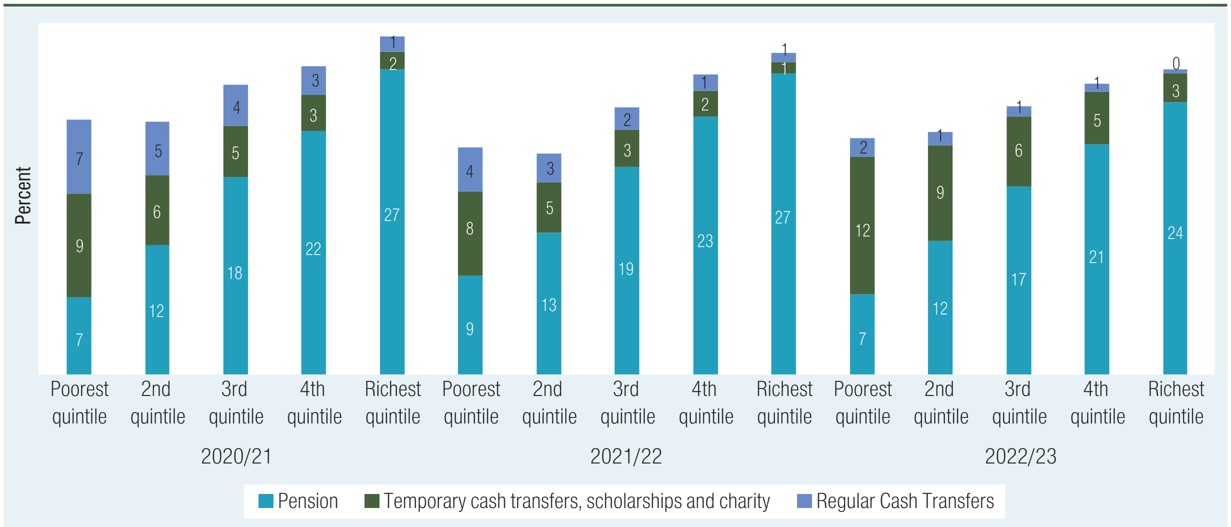
Iran's social welfare system has seen a significant transformation. The 2011 Targeted Subsidy Reform was a pivotal change, transitioning from broad subsidies to targeted cash transfers, which initially helped reduce poverty. However, the program's effectiveness was challenged by persistent sanctions and rising inflation, which diminished the purchasing power of the cash transfers[32]. In response, the government adjusted the program to better target those in need, particularly with the Livelihood Support cash transfers introduced alongside the 2019[33] gasoline subsidy cuts. The social safety net in Iran, which includes cash transfers and a pension system, has proven resilient, adapting to maintain support for the population. This adaptability was further evidenced during the COVID-19 pandemic when the government rolled out a substantial rescue package to bolster households and businesses. (World Bank, 2023)

The Iranian government has sustained its efforts to provide additional cash-transfer top-ups. The household survey delineates three categories of social transfers: regular cash transfers, pensions, and a miscellaneous group that encompasses temporary cash transfers, scholarships, and charitable contributions. The temporary cash top-ups, initiated in

32 The value of the cash transfer is estimated to be of US$6 per person in 2019, a fall from an equivalent of US$40 in 2011, according to UNICEF.

33 This additional payment was directed at the lowest 70 percent of households by income. Families with only one member were granted a monthly sum of 555,000 rials, equivalent to roughly US$20 in terms of purchasing power parity. For households with more than one member, the amount increased incrementally, with a cap at families of five members. (World Bank, 2023).

FIGURE 39 • Composition of Household Income from Social Transfers, by Quintile



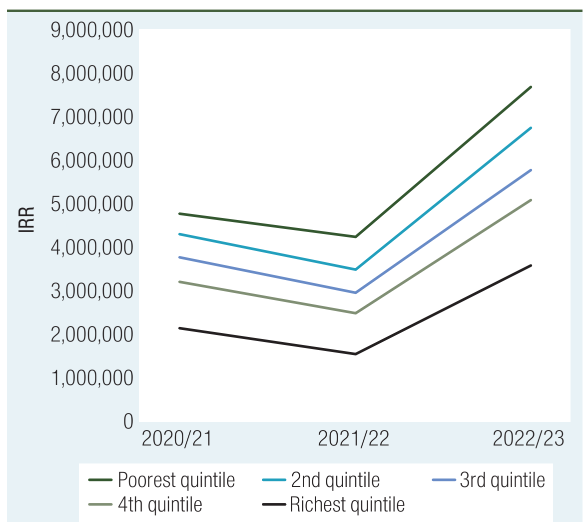
Source: Author's calculations based on HIES 2022/23.

2019 to mitigate the impact of escalating gas prices, were rapidly expanded to most of the population, with 87 percent of households reporting receipt in 2022/23. Pension receipt has remained stable from 2020/21 to 2022/23, while the uptake of regular cash transfers has been consistently high, albeit with a marginal decline in 2022/23, but their real value has continued to erode with inflation.

Regarding the utilization of social programs, wealthier households predominantly depend on pensions, whereas poorer ones lean on cash transfers. The upper two consumption quintiles are more reliant on pensions, which are adjusted for inflation, thus preserving their purchasing power (World Bank, 2023). Conversely, the lower two quintiles are more dependent on cash transfers. Notably, in 2022, an increased number of poor households relied on temporary cash transfers, significantly contributing to poverty decline that year.

The top-up transfer values experienced an upsurge in 2022/23. Although there was a nominal decline in the additional top-up due to inflation in the 2021/22 period, the subsequent year saw the amount nearly double. This increase was in line with the government's compensatory payments following the removal of the "preferred" exchange rate. In the wake of the US sanctions reinstated in 2018, the Iranian government established a "preferred" exchange rate of IRR42,000 (4,200 toman) per US$ for imports of basic goods such as wheat and medicine, which was significantly lower than the free-market rate ranging from IRR120,000 to IRR300,000. Facing foreign currency shortages, in 2022 the government discontinued the "preferred" rate for certain food items and instead provided cash top-ups to alleviate potential welfare losses. The government projected that this measure would result in a savings of 9 billion dollars.

FIGURE 40 • Value of Cash Top-Up, 2020/21-2022/23



Source: World Bank staff estimates based on HIES 2022/23.

BOX 3 UPDATED METHODOLOGY FOR IRAN POVERTY MEASUREMENT

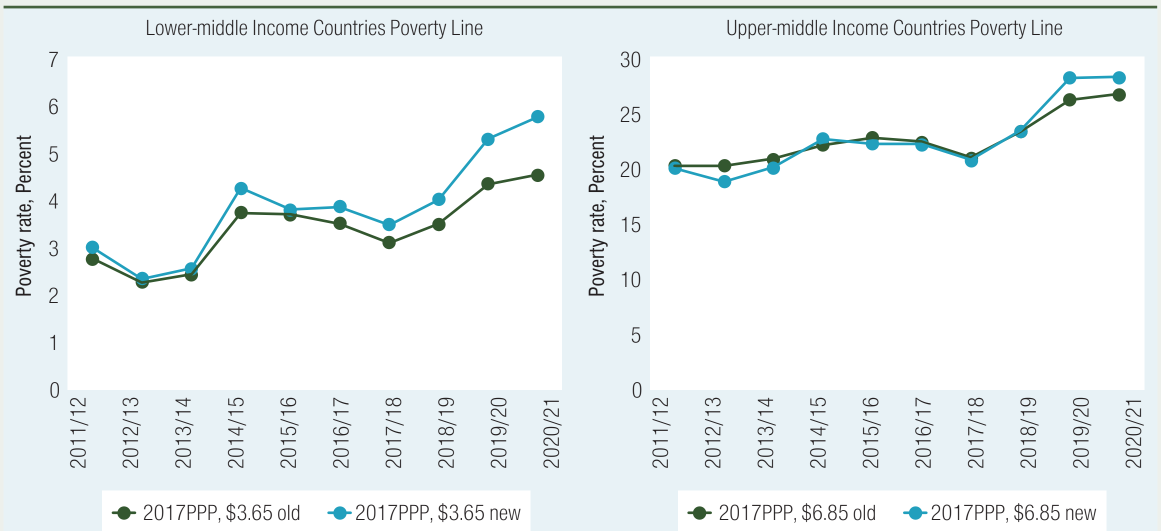
The poverty numbers in this note are different from those reported in previous IEMs. In previous notes, poverty was measured using the upper-middle-income international poverty line of US$5.50, expressed in terms of 2011 Purchasing Power Parity (PPP).

The updated methodology by Amendola et al. (2023a) is based on the World Bank's 2022 Guidelines for constructing consumption aggregates.[a] Welfare is estimated using household expenditure per capita, which is adjusted for inflation to account for price differences over time and across various regions. The poverty threshold, which is the minimum income level below which an individual is considered poor, is determined using two international benchmarks: the lower-middle-income poverty line at US$3.65 and the upper-middle-income poverty line at US$6.85, both expressed in terms of Purchasing Power Parity (PPP).[b] Population sampling weights, included in the raw data made publicly available by SCI, ensure the poverty estimates are representative at the national, urban/rural and provincial level.

The methodology followed four principles of comprehensiveness, relevance, representativeness, and market price valuation. It included all monetary expenditures on goods and services consumed, excluding expenditures for financial assets, loan repayments, and infrequent and exceptional expenditures. Health expenditures were included in the aggregate. It also involved a harmonization and validation process to ensure comparability over time and transparency in the inclusion or exclusion choices made for each elementary consumption item. Durable goods were mostly excluded due to the lack of information necessary for the computation of consumption flow estimates, with some semi-durables being included in the aggregate (example includes desktop fans, mobile air conditioners, and electric iron). The methodology maintained a conservative approach with extreme values. Outliers were found to not significantly affect poverty estimates and inequality trends, and thus were not trimmed.

Spatial and temporal deflators were applied to account for differences in price levels. The methodology involved adjusting for spatial and temporal price differences, using sampling weights and price deflation to correct for inflation and ensure accurate welfare comparisons. One significant change was the revision of the spatial deflation approach, moving from a multiple index approach to a single index deflator. Overall, the new consumption aggregate followed similar trend patterns as the previous one, with the difference in levels being driven by the inclusion of health expenditure. (Amendola, et al., 2023).

FIGURE B3.1 • Comparison of Poverty Trends at Lower and Upper Middle Income Poverty Line, 2011/12-2020/21



Source: Amendola, et al. (2023).

[a] As detailed by Mancini and Vecchi (2022).

[b] Starting 2021, the World Bank has classified Iran as a lower-middle income country. To account for the new classification, both lines will be used simultaneously.

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