

# IRAN



# ECONOMIC MONITOR

The Economy at a Crossroads

Spring 2021



**WORLD BANK GROUP**  
Middle East and North Africa Region



# Iran Economic Monitor

The Economy at a Crossroads

**Special Focus Topic:**  
Poverty and Inequality in Iran at the  
Outset of the COVID-19 Pandemic

Spring 2021 (Eighth edition)



Middle East and North Africa Region

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# ABBREVIATIONS AND ACRONYMS

Bbl	Barrel of oil	MEAF	(Iran's) Ministry of Economic Affairs and Finance
CAB	Current account balance	MoCLSW	(Iran's) Ministry of Cooperatives, Labor and Social Welfare
CMSF	Capital market stabilization fund	MoH	(Iran's) Ministry of Health
CBI	Central Bank of Iran	m/m	month-on-month
COVID-19	Corona Virus Disease 2019 (Novel Coronavirus)	NDFI	National Development Fund of Iran
CPI	Consumer price inflation; Consumer price index (Special Focus chapter)	NIMA	Unified system of foreign exchange transactions (Persian acronym)
ER	Exchange rate	OPEC	Organization of Petroleum Exporting Countries
GDP	Gross domestic product	PBO	Plan and Budget Organization
HIES	Household Income and Expenditure Survey	PMI	Purchasing Manager's Index
ICCIMA	Iran Chamber of Commerce, Industries, Mines & Agriculture	pp	Percentage point(s)
IEM	Iran Economic Monitor	PPP	Purchasing Power Parity
IPI	Industrial Production Index	RHS	Right-hand-side
IPO	Initial public offering	SCI	Statistical Centre of Iran
IMF	International Monetary Fund	SME	Small and medium-sized enterprise
IMF DOTS	International Monetary Fund's Direction of Trade Statistics database	SOE	State-owned enterprise
IRR	Iranian Rial	TEDPIX	Tehran Stock Exchange main index
kWh	Kilowatt-hour	TSE	Tehran Stock Exchange
LHS	Left-hand-side	US(A)	United States of America
Mbpd	Million barrels per day	US\$	United States Dollar
MBRI	Monetary and Banking Research Institute	WB WDI	World Bank World Development Indicators database
MENA	Middle East and North Africa	y/y	year-on-year



# PREFACE

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**T**he 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. Its coverage has ranged 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. The eighth issue of the IEM was prepared by Majid Kazemi (Economist, Task Team Leader, MTI) and Razieh Zahedi (Consultant, MTI) under the general guidance of Eric Le Borgne (Global Practice Manager, MTI) and

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# EXECUTIVE SUMMARY

**Iran's economy witnessed a modest recovery in the second half of 2020 following more than two years of economic recession.** A stronger performance in the industrial sector (including oil) in the first nine months of 2020/21<sup>1</sup> (9M-20/21) drove the gross domestic product (GDP) growth of 2.2 percent year-on-year (y/y) despite a contraction of services value added due to COVID-19 impact. Oil production according to secondary sources has reportedly recovered to 2.4 million barrels per day (mbpd) in April 2021 from a low of 2 mbpd in Q4-2019. The overall economic rebound, which started in Q2-20/21 and continued in the subsequent quarter, marks an end to two years of economic recession after the reintroduction of US sanctions in 2018 and the onset of COVID-19 in late 2019/20. However, the economy remains far from recovering from the accumulated contraction of recent years which left the economy at 90 percent of its previous peak in 2017/18. As a result, the per capita GDP gap between Iran and its income and regional comparator group of countries remains significantly larger than a decade ago.

**Restricted access to foreign exchange reserves and limited other external financing sources translated to pressures on the exchange rate and higher inflation in 2020/21.** Financial sanctions on the CBI and other financial institutions led to a sizable share of Iran's official reserves becoming either inaccessible or frozen in banks abroad which in turn complicated financing of the current account

deficit in 2020/21. These constraints together with inflationary expectations led to higher production costs and ultimately higher prices for consumers. Headline inflation hit a high of 36.4 percent in 2020/21. Like previous years, the higher inflation was felt hardest by lower income deciles as it eroded the real value of their savings and government cash transfers.

**The legacy of the previous years of economic shocks along with COVID-19 dominated government finances and led to a widening fiscal deficit in 2020/21.** Oil revenues fell to their lowest level in decades, through both export price and volume channels. According to the most recent cited data in 9M-20/21 (Apr–Sep 2020), only 16 percent of planned oil revenues for the year were realized during this period. Tax receipts, however, were buoyed in nominal terms by higher inflation and met the budget target except for indirect taxes which were impacted by the COVID-19 measures. Expenditures also increased in nominal terms due to higher wage bill, pensions, and COVID-19 expenditures (though the growth in real terms was offset by high inflation). This brought the fiscal deficit-to-GDP ratio to an estimated 6.3 percent in 2020/21 (a 2.6 pp increase). Faced with growing gross financing needs, the government continued to

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<sup>1</sup> The Iranian calendar year starts on March 21 of the Gregorian calendar year and ends on March 20 the following year.

expand domestic bond issuance (70 percent share of financing) in addition to sales of assets in the stock market (15 percent) and withdrawal from reserves (8 percent).

**The spread of new variants of COVID-19 led to yet another record surge in daily confirmed cases in 2020/21.** With over 2.7 million cases of infections and 76 thousand death as of May 15, 2021, Iran has experienced the deadliest outbreak in the Middle East and North Africa (MENA) region. A fourth wave started after the two weeks of the Iranian new year holidays (starting on March 21) which brought daily infections and deaths to their highest level on record. This placed an unprecedented burden on the health system and hospitals in some cities such as Tehran reached close to full capacity of intensive care units. The recent surge was also associated with a higher reported prevalence of the newer more dangerous variants of the virus while vaccination rollout remained sluggish.

**The COVID-19 pandemic further intensified economic pressures on the most vulnerable.** Using the latest household survey data, the Special Focus chapter of this issue of the Iran Economic Monitor (IEM) highlights the existing vulnerabilities of households in falling into poverty even before the pandemic hit. Multiple years of recession and high inflation have pushed a sizable proportion of the Iranian population closer to the poverty line. Per capita consumption fell by 5.6 percent in 2019/20. As a result, poverty continued to increase by 2 pp to 14.3 percent in 2019/20. Inequality measured by the Gini coefficient modestly improved in 2019/20 but this was hardly good news as both income and consumption fell and is likely to be temporary due to the subsequent disproportionate impact of COVID-19 on lower income households.

**Iran's economic outlook hinges on the evolution of the COVID-19 pandemic, the pace of global economic recovery, and the possibility of easing of US sanctions.** The recovery is projected to be slow, gradual, and likely non-linear due to the resurgence of new variants and containment measures, slow vaccination rollouts, and weak demand from regional trading partners. Non-oil GDP is projected to return to its pre-COVID-19 average while oil production is forecast to modestly bounce

back with higher demand. If US sanctions on Iran's economy are eased significantly, it could lead to substantially higher growths in both oil and non-oil sectors. However, insufficient investment in the oil sector constrains Iran's oil production capacity in the medium term, even in the absence of US sanctions. Furthermore, given the recent large global investment drive in renewable energy and other climate change mitigation measures, the long-term prospects for oil demand are uncertain.

**In the absence of a pickup in oil revenues, the fiscal deficit is projected to remain elevated over the medium term.** A slow economic recovery would translate into a similarly slow growth in non-oil revenues. Higher reliance on bond issuance, especially with shorter maturities, would increase interest payments and amortization costs. Further government debt issuance and sales of public assets could have negative spillovers to the stock market and place additional stress on the undercapitalized banking sector.

**Despite a moderate economic rebound, economic pressures on poor households will continue.** Inflation is forecast to decelerate but remain above 20 percent on average over the medium term due to cost push factors. With limited fiscal space to support the poor and high inflation, economic pressures on the poor are unlikely to subside, but a better targeting of cash transfers could free up resources for additional social protection measures.

**Risks to Iran's economic outlook relate to the recovery path from the pandemic and the prospects of geopolitical developments.** The pace of vaccination rollout, a resurgence in new cases such as those from new COVID-19 strains and subsequent lockdown measures could all weigh heavily on economic activity and prolong the acute phase of the crisis. The burden of further economic deterioration would be felt the most by the poor and vulnerable and increase poverty. Upside risks relate to a more rapid vaccination drive and sustained higher oil prices. If there is a breakthrough in nuclear negotiations, it could boost economic activity and improve Iran's fiscal and external balances. The outcome of the upcoming presidential elections (to be held in June 2021) will also be a crucial factor in the direction of

Iran's economy and the path of economic reforms over the next years.

**The economy is at a crossroads and urgently needs a recovery plan of comprehensive and coordinated macro-fiscal reforms.** Overcoming many of Iran's chronic economic challenges including high inflation calls for an overhaul of Iran's fiscal framework. A sustainable and inclusive growth model would require urgent reforms including in the areas of energy subsidies, pension system reforms, water scarcity management, and a comprehensive banking system restructuring. Growth-enhancing

reforms such as investment in green infrastructure, digital economy, and renewable energy can help lead the economy out of the pandemic and create much needed jobs. After the sharp contractions in recent years along with high unemployment, investment in infrastructure can boost the economy, create jobs, reduce emissions, and enhance trade. Greater focus on the digital economy can help catalyze economic diversification, by utilizing the full potential of Iran's highly educated and tech-savvy young population and transform the economy into a regional technology hub.





## چکیده‌ی مدیریتی

اقتصاد ایران به دنبال بیش از دو سال رکود اقتصادی، بهبودی نسبی را در نیمه دوم سال ۲۰۲۰ تجربه نمود. عملکرد قویتر بخش صنعت (که شامل بخش نفت نیز می‌گردد) در نه ماه نخست سال ۱۳۹۹، رشد ۲/۲ درصدی تولید ناخالص داخلی (GDP) نسبت به سال قبل را، با وجود کاهش در ارزش افزوده بخش خدمات به واسطه تأثیرات کووید ۱۹، به همراه داشت. تولید نفت بنا بر گزارش منابع ثانوی اوپک از ۲ میلیون بشکه در روز در سه ماهه آخر سال ۲۰۱۹ به ۲/۴ میلیون بشکه در آوریل ۲۰۲۱ افزایش پیدا کرده است. بهبود کلی اقتصادی، که از سه ماهه دوم ۱۳۹۹ آغاز و تا سه ماهه بعد ادامه یافت، را می‌توان نقطه پایان رکود اقتصادی دانست که پس از اعمال مجدد تحریم‌های امریکا در سال ۱۳۹۷ و شیوع کووید ۱۹ در اواخر سال ۱۳۹۸، آغاز گردیده بود. با این وجود، اقتصاد به واسطه رکود انباشته سال‌های اخیر و عملکردی برابر با ۹۰ درصد اوج آن در سال ۱۳۹۶، هنوز فاصله زیادی با بهبودی دارد. در نتیجه، شکاف سرانه‌ی تولید ناخالص داخلی بین ایران و هم‌تایان درآمدی و منطقه‌ای به طرز چشم‌گیری بیشتر از یک دهه گذشته می‌باشد.

دسترسی محدود به ذخایر ارزی و دیگر منابع خارجی تأمین مالی منجر به فشار بر نرخ ارز و تورم بالا در سال ۱۳۹۹ گردید. تحریم‌های مالی بر بانک مرکزی ایران و دیگر نهادهای مالی باعث شد که بخش بزرگی از ذخایر ارزی ایران غیر قابل دسترس شوند و یا در بانک‌ها بلوکه گردند، و تأمین مالی کسری حساب جاری را در سال ۱۳۹۹ مشکل‌تر ساخت. این محدودیت‌ها به همراه انتظارات تورمی منجر به بالا رفتن هزینه‌های تولید و در نهایت قیمت‌های بالاتر برای مصرف‌کنندگان گردید. در سال ۱۳۹۹، تورم تا ۳۶/۴ درصد اوج گرفت. مانند دیگر سال‌ها، تورم بالا بیشترین فشار را بر دهک‌های کم درآمد وارد نمود و باعث کاهش ارزش واقعی پس‌انداز و یارانه نقدی آن‌ها شد.

آثار شوک‌های اقتصادی سال‌های پیش، به همراه کووید ۱۹ تأثیر مهمی بر تأمین مالی دولت گذاشتند و به افزایش کسری بودجه در

۱۳۹۹ انجامیدند. درآمدهای نفتی به پایین‌ترین سطح خود در چند دهه اخیر رسید، هم به واسطه قیمت صادرات و هم به دلیل حجم تولید. بر اساس آخرین اطلاعات، در نه ماه نخست سال ۱۳۹۹، تنها ۱۶ درصد درآمدهای نفتی پیش‌بینی شده محقق گردیده است. درآمدهای مالیاتی اما به واسطه تورم بالا از لحاظ اسمی افزایش یافته و به اهداف بودجه دست یافتند، به استثنا مالیات‌های غیرمستقیم که تحت تأثیر اقدامات احتیاطی ناشی از کووید ۱۹ قرار گرفتند. هزینه‌های دولت نیز از لحاظ اسمی به خاطر افزایش دستمزدها، مستمری بازنشستگی و هزینه‌های مرتبط با کووید ۱۹ افزایش داشتند (اگر چه افزایش واقعی آن به واسطه تورم خنثی گردید). این مساله باعث شد که نسبت کسری بودجه به تولید ناخالص داخلی به سطحی حدود ۶/۳ درصد در سال ۱۳۹۹ (افزایش ۲/۶ واحد درصد) برسد. برای مقابله با نیازهای تأمین مالی داخلی، دولت میزان انتشار اوراق بدهی را افزایش داد (۷۰ درصد سهم تأمین مالی)، در کنار فروش دارایی‌ها در بازار بورس (۱۵ درصد) و برداشت از ذخایر (۸ درصد).

شیوع گونه‌های جدید کووید ۱۹ منجر به افزایش بی‌سابقه در آمار روزانه ابتلا در سال ۱۳۹۹ گردید. با تعداد بیش از ۲/۷ میلیون مورد ابتلا و ۷۶ هزار فوتی تا تاریخ ۲۵ اردیبهشت ۱۴۰۰، ایران مرگبارترین میزان شیوع در منطقه خاورمیانه و شمال آفریقا را تجربه کرده است. موج چهارم دو هفته پس از تعطیلات سال جدید در ایران آغاز گردید و میزان ابتلا و مرگ و میر را به بالاترین سطح رساند. این اتفاق فشار بی‌سابقه‌ای را بر روی بیمارستان‌ها و بخش درمان در برخی شهرها، از جمله تهران، وارد نموده و ظرفیت بخش‌های مراقبت‌های ویژه را نزدیک به حد اشباع رساند. این افزایش تا حدی نیز به واسطه شیوع بیشتر گونه‌های خطرناک تری از ویروس کرونا و روند کند واکسیناسیون می‌باشد.

پاندمی کووید ۱۹ باعث افزایش فشار اقتصادی بر اقشار آسیب پذیر شده است. بخش تمرکز ویژه این شماره از ناظر اقتصادی ایران با استفاده

از جدیدترین اطلاعات بودجه خانوار نشان دهنده وجود آسیب پذیری در خانوارها و حرکت آن‌ها به سمت فقر حتی قبل از شروع پاندمی است. رکود مستمر در طول چند سال و تورم بالا، تعداد قابل توجهی از جمعیت ایران را به سمت خط فقر سوق داده است. میزان مصرف سرانه در سال ۱۳۹۸ به میزان ۵/۶ درصد کاهش داشت و در نتیجه فقر به میزان ۲ واحد درصد افزایش یافته و به ۱۴/۳ در سال ۱۳۹۸ رسیده است. نابرابری که توسط ضریب جینی اندازه گرفته می‌شود کمی بهبود را برای سال ۱۳۹۸ نشان می‌دهد، اما نمی‌توان به آن خوش‌بین بود چرا که درآمد و مصرف هر دو کاهش یافتند و احتمالاً به واسطه تأثیر نابرابر کووید ۱۹ بر خانوارهای کم درآمد، موقتی خواهد بود.

**چشم‌انداز اقتصادی ایران به تحولات پاندمی کووید ۱۹، آهنگ بهبود اقتصاد جهانی و احتمال کاهش تحریم‌های امریکا بستگی دارد.** به واسطه پیدایش گونه‌های جدید و نیاز به اقدامات کنترلی پاندمی، روند کند واکسیناسیون، و تقاضای ضعیف در میان شرکای تجاری منطقه‌ای، انتظار می‌رود که بهبود اقتصادی به کندی صورت پذیرد. پیش‌بینی می‌شود که تولید ناخالص داخلی غیر نفتی به میانگین زمان قبل از کووید ۱۹ باز گردد، هم‌چنین انتظار می‌رود که تولید نفت افزایش نسبی به دنبال بالا رفتن تقاضا را نشان دهد. اگر عمده تحریم‌های اقتصادی امریکا برداشته شوند، می‌توان رشد بسیار بالاتری را در هر دو بخش نفتی و غیر نفتی انتظار داشت. اما عدم سرمایه‌گذاری کافی در بخش نفتی در میان‌مدت ظرفیت تولید نفت ایران را محدود می‌سازد، حتی اگر تحریم‌های امریکا برداشته شوند. بعلاوه، با توجه به سرمایه‌گذاری‌های بزرگ اخیر جهانی در بخش انرژی‌های تجدید پذیر و دیگر اقدامات مرتبط با مقابله با تغییرات اقلیمی، چشم‌انداز دراز مدت تقاضا برای نفت نامشخص می‌باشد.

**پیش‌بینی می‌شود در صورت عدم افزایش درآمدهای نفتی، کسری بودجه در میان مدت در سطح بالایی باقی بماند.** آهنگ کند روند بهبودی نیز به معنای روند آهسته افزایش درآمدهای غیر نفتی خواهد بود. اتکای بالای دولت بر انتشار اوراق بدهی، بخصوص با سررسیدهای کوتاه مدت‌تر، منجر به بالاتر رفتن بهره پرداختی و بازپرداخت بدهی خواهد شد. بعلاوه، انتشار بدهی توسط دولت و فروش دارایی‌های عمومی می‌تواند باعث انتقال شوک بر بازار سهام شود و فشار بیشتری را بر بخش بانکی که از وضعیت نامناسب کفایت سرمایه رنج می‌برد، وارد سازد.

**علی‌رغم بهبود نسبی اقتصاد، فشار اقتصادی بر خانوارهای فقیر ادامه خواهد یافت.** پیش‌بینی می‌شود که میزان تورم کاهش یابد، ولی هم‌چنان به واسطه فشار هزینه‌ها به طور متوسط بالای ۲۰ درصد در میان مدت باشد. محدودیت مالی دولت برای حمایت از افراد فقیر و وجود تورم بالا به معنای ادامه فشار اقتصادی بر فقرا می‌باشد، ولی هدفمندی بهتر یارانه نقدی می‌تواند به آزاد شدن منابع بیشتر به منظور اقدامات حمایت اجتماعی گردد.

**ریسک چشم‌انداز اقتصادی ایران به روند بهبود شرایط پاندمی و آینده تحولات ژئوپولیتیک بستگی دارد.** سرعت واکسیناسیون، افزایش در تعداد مبتلایان به گونه‌های جدید و اقداماتی از قبیل تعطیلی مشاغل می‌توانند بر فعالیت‌های اقتصادی تأثیر منفی زیادی گذاشته و منجر به استمرار فاز حاد بحران گردند. فشار هر گونه تضعیف اقتصادی بیشتر توسط قشر فقیر و آسیب پذیر حس می‌گردد و افزایش فقر را به دنبال خواهد داشت. ریسک‌های دیگر به سرعت واکسیناسیون و استمرار در قیمت‌های بالای نفت بستگی دارند. پیشرفت در مذاکرات هسته‌ای می‌تواند باعث افزایش فعالیت‌های اقتصادی و بهبود تراز بودجه و خارجی ایران گردد. نتایج انتخابات آتی ریاست جمهوری نیز (که قرار است در خرداد ۱۴۰۰ برگزار گردد) عامل مهمی خواهد بود در تعیین جهت اقتصاد ایران و مسیر تحولات اقتصادی برای چند سال آینده.

**اقتصاد در مقطع حساسی است و نیازمند فوری برنامه‌ای جامع و اصلاحاتی هماهنگ در سطح کلان اقتصاد می‌باشد.** غلبه بر چالش‌های مزمین اقتصادی ایران، از جمله تورم بالا، تحولی اساسی در چارچوب بودجه را طلب می‌کند. مدلی برای رشد پایدار و فراگیر باید در برگیرنده اصلاحات در بخش‌هایی از قبیل یارانه انرژی، سیستم مستمری بازنشستگی، مدیریت کمبود آب، و تحولات ساختاری گسترده در بخش بانکی باشد. اصلاحات در بخش‌های محرک رشد از جمله سرمایه‌گذاری در زیرساخت‌های سبز، اقتصاد دیجیتال، و انرژی‌های تجدید پذیر می‌توانند اقتصاد را از دوران پاندمی عبور داده و به امر مهم اشتغال زایی کمک کنند. پس از رکودهای شدید سال‌های اخیر و نرخ بالای بیکاری، سرمایه‌گذاری در زیرساخت‌ها منجر به رونق اقتصادی گردیده و اشتغال‌زایی، کاهش گازهای آلاینده و افزایش تجارت را به همراه خواهد داشت. تمرکز بیشتر بر اقتصاد دیجیتال می‌تواند با استفاده از توان بالقوه جمعیت جوان بسیار تحصیل کرده و تکنولوژی آشنای کشور باعث تنوع اقتصادی گردد و اقتصاد را به یک قطب منطقه‌ای فناوری تبدیل نماید.



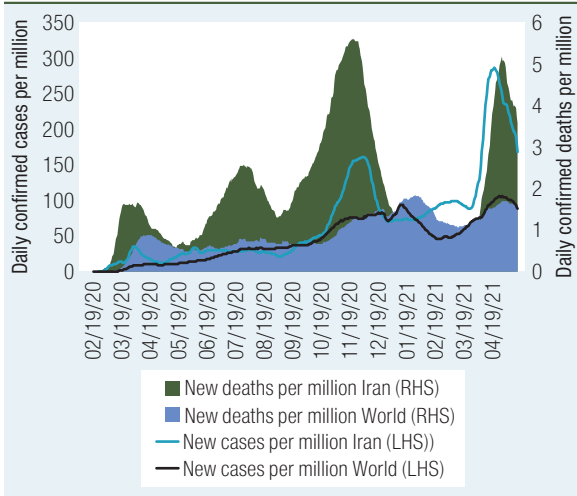
# RECENT ECONOMIC AND POLICY DEVELOPMENTS

## Introduction

Over the last decade, Iran’s growth performance has been volatile and jobless due to the role of the oil sector. Real GDP has declined to the same level of a decade ago and the country failed to benefit from growth opportunities such as periods of high oil prices (2010–2014) and a highly educated young population that could boost productivity. Job creation has fallen short of meeting labor supply, and despite a persistent low labor market participation rate (42 percent average), the rate of unemployment has been in the double digits. Unemployment has been especially high among the youth, female, and the highly educated (23.7, 15.6, and 14.2, respectively in 2020/21<sup>2</sup>). Despite some progress towards economic diversification, high public sector presence continues to inhibit job creation and capital formation by the private sector.

Iran is grappling with the impact of the COVID-19 health crisis. With over 2.7 million cases of infections and 76 thousand death as of May 15, 2021, Iran has experienced the deadliest outbreak in the Middle East and North Africa (MENA) region. Since the first confirmed cases in February 2020, the pandemic underwent four waves (Figure 1). Following

FIGURE 1 • Iran is Grappling with a Fourth COVID-19 Wave...



Source: Our World in Data.

the peak in daily cases of the third wave in November 2020, daily cases remained stable at the average level of 7–8 thousand new cases per day with a double-digit death rate after new containment measures,

<sup>2</sup> The Iranian calendar year starts on March 21 each year and ends on March 20 of the following year.

such as late-night curfews, were announced in November 2020. Since then, a fourth wave started after the two weeks of the Iranian new year holidays (starting on March 21) which brought daily infections and deaths to their highest levels on record. Intensive care units in major cities such as Tehran subsequently reached close to full capacity. In mid-April 2021, over 85 percent of cities were declared high-risk, and 65 percent were put on the highest virus risk level, and the country implemented more stringent containment measures and lockdown for two weeks which were further extended. The recent surge was also associated with a higher reported prevalence of the newer more dangerous variants of the virus while vaccination rollout remained sluggish (see Box 1).

**COVID-19 and years of economic sanctions amplify previous economic challenges.** The sharp decline in hydrocarbon revenues since 2019/20 combined with the economic and health costs of the

pandemic resulted in a large burden on government finances and amplified existing structural challenges. Inflation has remained high since 2018/19 (36 percent y/y on average). The pandemic severely affected jobs and incomes in many labor-intensive activities, including high-contact services and the informal sector.

## Output and Demand

**Iran's economy underwent a modest recovery in 2020/21 despite experiencing two-quarters of COVID-19 induced shock.** GDP recovery in Q2 and Q3-2020/21 was stronger than expected both in the oil and non-oil sectors, which grew by 15.3 percent and 3.1 percent y/y, respectively (Figure 2). The COVID-19 output loss was less pronounced than in other countries, partly due to a lower economic base

### BOX 1 COVID-19 VACCINE ROLLOUT IN IRAN

*As the epicenter of the Middle East's worst COVID-19 outbreak, more than 76 thousand Iranian lives have been lost and more than 2.7 million infections have been reported (as of May 15, 2021). The country started vaccination in mid-February 2021, however, only a small fraction of the population (less than 3 percent) has been vaccinated. Early in 2021, Iran secured 21 million doses of vaccine, and mass vaccination was due to start later using domestic and joint vaccine production. However, Iran finalized a purchase of 60 million doses of Sputnik V vaccine as well as 10 million doses of China's Sinopharm vaccine in mid-April.*

**Despite the ambitious initial vaccination targets, progress was slow and lagged other neighboring countries.** The government announced an expedited timeline for the national vaccination program<sup>a</sup> which aimed to vaccinate 60 million of Iran's 84 million population by the end of 2021, but this was pushed back by 1 quarter. To date, only 2.1 million people (2.5 percent of the population) have received at least one dose. Other countries in the region have been able to fully vaccinate a larger share of their population (UAE 39.2 percent, Turkey 13.0 percent, Qatar 29.1 percent and Azerbaijan 7.5 percent versus Pakistan 0.45 percent—as of May 15, 2021<sup>b</sup>).

**The prospects of widescale vaccination remain uncertain.** According to the authorities, Iran has put orders for over 86 million doses of various vaccines—16.8 million doses from the COVAX facility, 60 million doses from Russia, 10 million doses from China, and 500 thousand doses from India—but payments have faced hurdles due to constrained access to funds abroad due to sanctions. As of the publication of this report, Iran has received 4.6 million doses, including 2.1 million doses of AstraZeneca from the COVAX vaccination program, 1.65 million doses of China's Sinopharm, 720 thousand doses of Russia's Sputnik V, and 125 thousand doses of India's Bharat Biotech's Covaxin.<sup>c</sup> Vaccinations are free of charge for all Iranians.

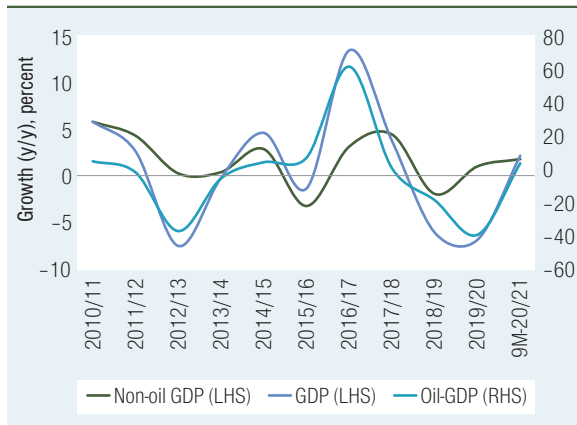
**Iran is working on multiple locally developed vaccines as well as two joint vaccine production projects.** At least 8 different domestic vaccine development projects by state-owned pharmaceutical, defense ministry, and universities are underway with half of them already in clinical trials stage. A joint vaccine development program in cooperation with Cuba, Cuban Soberana02, is in the third trial phase and is expected to be ready by June 2021. Iran is also planning to locally manufacture the Russian Sputnik V.

<sup>a</sup> According to the MoH vaccination program, in the first phase (Feb–March 2021), about 1.3 million front-line health workers and high-risk individuals were expected to receive vaccines. About 6 million people are planned to be vaccinated during the second phase (Apr–Jun 2021) including those over 65 years of age, and people with “special diseases”. In the third phase (Jul–Dec 2021), about 12 million people including people 55 to 64 years and people working in high exposure occupations and essential services are planned to be vaccinated. The fourth phase will be carried out in Jan–Mar, 2022 for the rest of the population.

<sup>b</sup> Johns Hopkins University

<sup>c</sup> Around 375,000 doses were initially ordered and expected to arrive in late March, but this did not materialize after India banned COVID-19 vaccine exports.

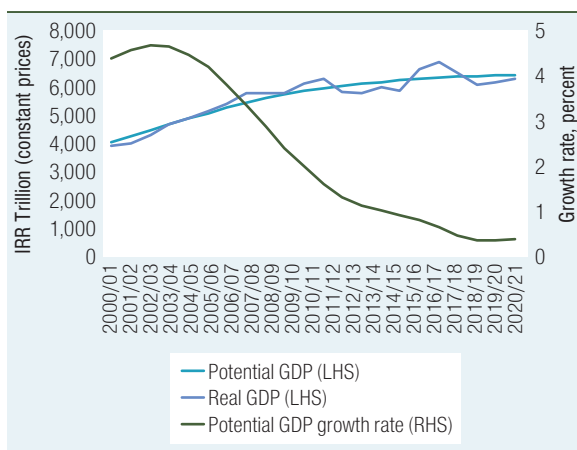
**FIGURE 2 • GDP Strongly Rebounded in Q2 and Q3-20/21**



Source: CBI and World Bank staff calculations.

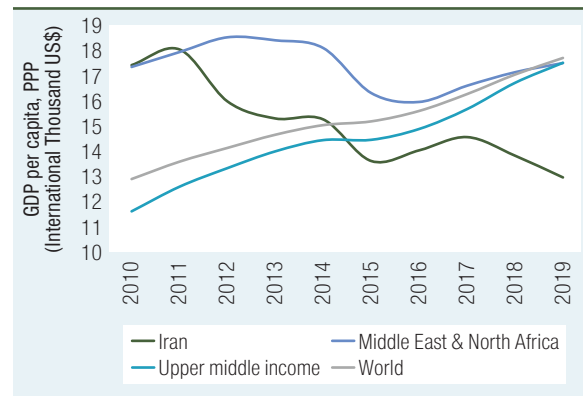
after the previous economic contraction. Real GDP contracted by 12 percent over the 2018/19–2019/20 period after US sanctions were reintroduced on the oil sector which shrank by half. The COVID-19 pandemic also had an impact towards the end of 2019/20 and contributed to the annual contraction. The economic contraction widened the gap between Iran and its income and regional peers (Figure 3). Over the last two decades, Iran’s potential GDP growth rate is estimated to have declined sharply from over 4 percent in the early 2000s to below 1 percent in recent years (Figure 4).

**FIGURE 4 • ...and Potential GDP Growth Rate Has Declined Sharply Over the Last Two Decades**



Source: CBI and World Bank staff calculations.  
Note: Potential GDP estimated using the HP filter.

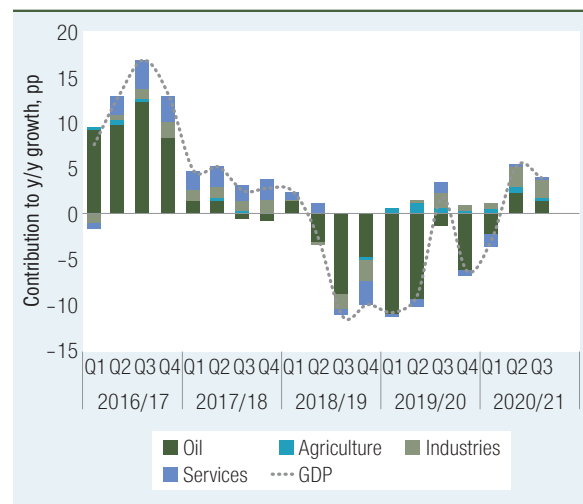
**FIGURE 3 • ... but Was Not Enough to Counter the Recent Diverging Welfare between Iran and Peer Groups...**



Source: World Bank WDI.

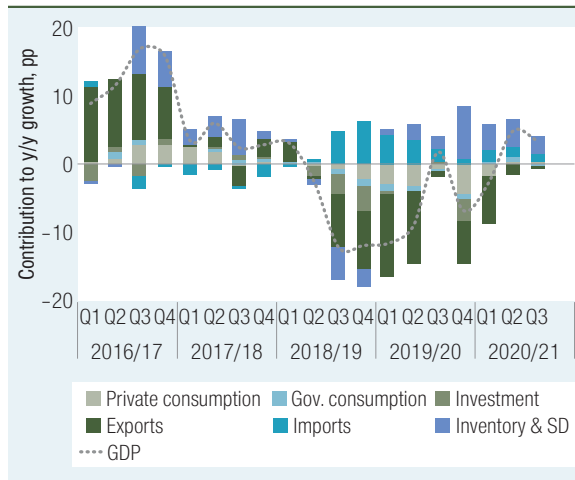
**While the economy has started to rebound in mid-2020, the recovery was uneven across sectors.** Economic activity in all sectors expanded in Q2 and Q3-20/21 (y/y) but at different rates (Figure 5). The recovery was led by a stronger than expected expansion in the oil industry (22.2 percent and 9.7 percent in Q2 and Q3-20/21, y/y), albeit from a low base, as well as growth in manufacturing value-added (7.9 percent and 7 percent in Q2 and Q3-20/21, y/y). The services sector growth remained subdued due to the ongoing impact of COVID-19 and the containment measures, while the agriculture sector

**FIGURE 5 • Industries Including Oil Strongly Rebounded...**



Source: CBI and World Bank staff calculations.

**FIGURE 6 • ...while Investment and Consumption Are Still Lagging**



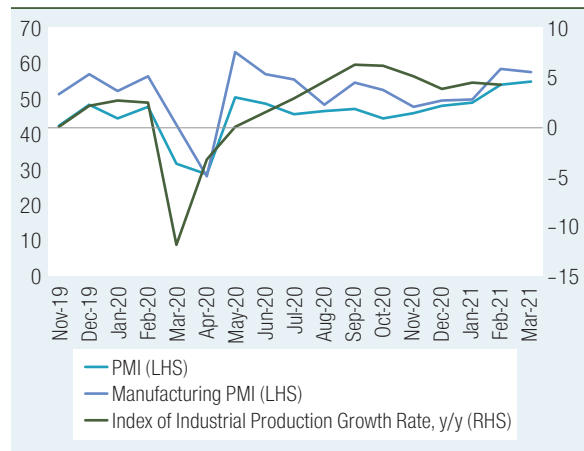
Source: CBI and World Bank staff calculations.

recorded 4.6 percent growth in 9M-20/21. GDP is now estimated to expand by 1.7 percent in 2020/21, driven by the industrial sectors (including oil).

**The recent recovery was primarily driven by the pickup in industries.** The oil sector shows signs of recovery after eight consecutive months of contraction. The pick-up could be attributed to higher anticipated orders<sup>3</sup> ahead of an expected recovery in global and domestic demand. The non-oil sector rebound was driven by the manufacturing sector as the local currency depreciation made domestic production more price competitive. The rial depreciated by a further 65 percent in 2020/21. The Industrial Production Index (IPI) of the selected industries in the stock market and Purchasing Manager’s Index (PMI) improvement also confirm a more favorable sentiment after a sharp decline in early 2020 (Figure 7).

**The main components of demand-side GDP including consumption and investment have yet to fully recover.** Imports and buildups in inventories led the growth in Q2 and Q3-20/21. After nine consecutive quarters of y/y contraction, private consumption and investment moderately grew in Q2 and Q3-20/21 but had a small contribution to growth (Figure 6). Exports and imports continued to decline, though at a slower pace than previous quarters. Since the return of US sanctions (2017/18–2019/20), the deterioration on the demand side was

**FIGURE 7 • PMI and the Industrial Production Index Picked Up after Reaching a Record Low in April 2020**



Source: ICCIMA and MBRI.

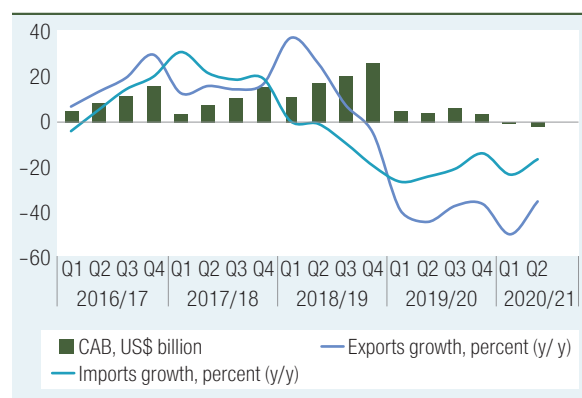
most pronounced in trade as exports and imports plunged by more than 39 percent and 56 percent, respectively. Private consumption also contracted by more than 10 percent in real terms leading to a per capita consumption falling by 12 percent. Over the same period, investment shrank by 17 percent with investment in machinery fell by 28 percent.

## External Sector

**The current account balance (CAB) turned negative in first half of 2020/21 as a drop in exports outweighed the decline in imports.** In the first half of 2020/21, oil and non-oil exports contracted by 47 percent and 22 percent, respectively, and imports dropped by 17 percent (y/y). The CAB registered US\$ 1.8 billion deficit and for the first time in the past fifteen years, turned negative in H1-20/21 (Figure 8). Import prohibition policy and the authorities’ expansion of the list of goods banned from imports and the rial’s depreciation were not enough to offset the full impact of a contraction in oil and non-oil exports.

<sup>3</sup> During the same period, total exports declined hence additional oil production was likely aimed at building inventories in anticipation of a stronger foreign demand, especially from China, and the possibility of a breakthrough in relaxation of oil sanctions.

**FIGURE 8 • The CAB Registered a Deficit in H1-20/21...**



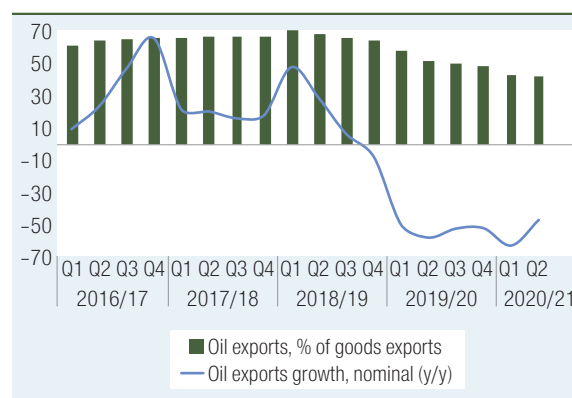
Source: CBI and World Bank staff calculations.

**Oil production and exports in H1-20/21 registered a record low in the last two decades, but some signs of recovery appeared in H2-20/21.** Based on OPEC data<sup>4</sup>, Iran's oil production in 2020 recorded a substantially low level of 1.98 mbpd even compared to that of 2019 (2.36 mbpd). Assuming similar levels of domestic consumption, this indicates that Iran's oil export volumes were likely well below their 2019 levels (0.651 mbpd)<sup>5</sup>. More recently, there are indications that oil production and exports started to pick up. The latest OPEC report puts Iran oil production at 2.32 mbpd in March 2021. According to media reports, in March 2021, China purchased about 1 mbpd at a discounted price from Iran<sup>6</sup>.

**The large trade shock due to the COVID-19 pandemic also impacted non-oil exports.** Total non-oil exports shrank by 17 percent (US\$ nominal terms) in 2020/21, however, the shock was distributed differently with different trade partners. Non-oil exports to Turkey fell by 50 percent, Iraq by 26 percent, and China and Afghanistan each by 7 percent in 2020/21 (Figure 10), while exports to the UAE edged up by 2 percent during the same period. Iran's main non-oil exporting items included gasoline, natural gas, polyethylene, and methanol.

**The continuation of import prohibitions led to a decline of total imports in 2020/21 by 12 percent.** Imports of goods in 2020/21 was about US\$38 billion, of which about 30 percent were essential goods (primarily corn, soybeans, rice, oil, and oilseeds) and the remainder consisted mainly

**FIGURE 9 • As Oil Export Revenues Hit a Two-Decade Low**



Source: CBI and World Bank staff calculations.

of intermediate goods (raw materials machinery and equipment). Import substitution and restrictions measures continued in 2020/21. Non-tariff import control policies, including the allocation of preferential exchange rates for essential goods, have proved challenging. While the government still provides preferential exchange rates for imports of essential goods, the allocated amount has reduced significantly from US\$30.5 million in 2018/19 to US\$10.5 million in 2020/21. This also reflects limited access to foreign exchange reserves due to financial sanctions.

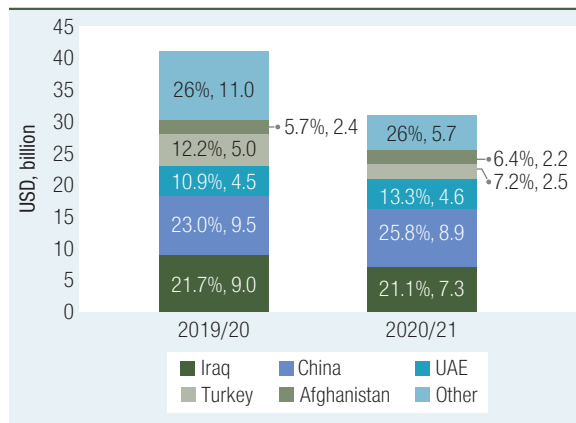
**Iran's main import partners remained the same in 2020/21, albeit trading at lower levels.** Iran continued to import goods from the same countries as before in 2020/21 (Figure 11). Trade restrictions and difficulties in accessing foreign reserves have led to a decline in imports. The total value of imports from the top import partners declined dramatically except for the UAE, which expanded by 8 percent. Imports from India plunged by 43 percent and those from Germany, Turkey, and China declined by about 13–14 percent in 2020/21. The US sanctions and the pandemic

<sup>4</sup> As reported by secondary sources.

<sup>5</sup> CBI and other official sources stopped publishing oil production and exports data after the return of US sanctions.

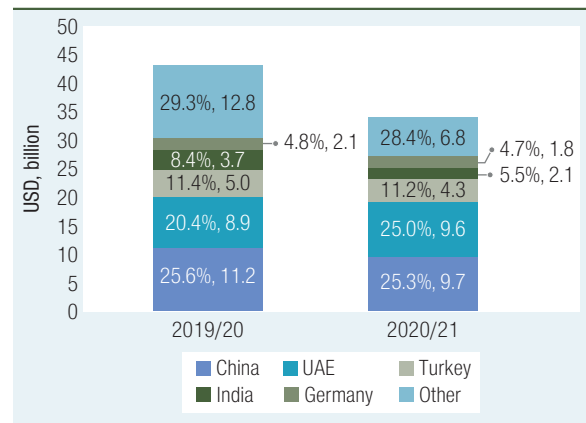
<sup>6</sup> <https://www.bloomberg.com/news/articles/2021-03-22/china-may-be-taking-rebranded-iran-oil-amid-increased-scrutiny>.

**FIGURE 10 • Non-Oil Exports Fell Sharply and Concentrated on Closer Neighbors...**



Source: IRICA and World Bank staff calculations.  
 Note: The first number represents the country's share (%) in total exports.

**FIGURE 11 • ...while the Origin of Imports Remained Unchanged**



Source: IRICA and World Bank staff calculations.  
 Note: The first number represents the country's share (%) in total imports.

increased the concentration in import partners as the top five import partners account for 72 percent of total import in the last two years, compared to a 58 percent share in 2017/18 to 2018/19.

**The CAB deterioration and increased economic uncertainty have added to existing challenges of accessing foreign exchange (FX) reserves abroad.** Despite deadlines set by CBI, repatriation of export proceeds by exporters was muted due to logistical challenges posed by sanctions and disincentives such as the price gap between parallel and NIMA market<sup>7</sup> rates and increasing uncertainty. These developments added to pressures on the rial in the parallel market (Figure 12). In response to these depreciation pressures, since mid-October 2020, the CBI intervened to stabilize the FX market. These interventions along with the recent negotiations to access foreign reserves with countries where funds have been blocked as well as positive market sentiment following the US elections and nuclear talks contributed to an appreciation of the rial in the parallel market by 23 percent (Oct 2020 to mid-May 2021).

## Monetary Policy and Prices

**The sharp depreciation of the rial and rapid growth in liquidity drove up inflation in 2020/21 (Figure 13).** Consumer price inflation (CPI)

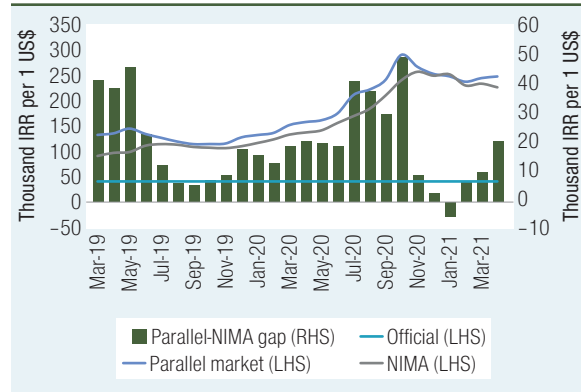
increased to 36.4 percent in 2020/21 (y/y) due to a combination of money supply growth, inflationary expectations, and higher cost-push factors. The latter was primarily driven by higher trade costs and a sharp depreciation of the rial (Figure 12). Over 2020/21, the rial depreciated more than 65 percent as the impact of COVID-19 added to geopolitical uncertainties and restricted access to export proceeds. In tandem with the ER trend, inflation steadily rose to 49.5 percent in April 2021 (y/y) and core inflation rose to 57.7 percent. The CBI missed its inflation target of 22 percent for the year after it started its inflation targeting policy and open market operations for the first time in May 2020. The main driver of the monetary base growth in M9-2020/21 was an increase in net foreign assets as the CBI could not fully sterilize external funds due to limited access to its foreign reserve. Based on this, the CBI was faced with the only option of printing against export proceeds and withdrawal from the National Development Fund of Iran (NDFI), including for the pandemic-related expenditures.

**Similar to past cycles of high inflation, headline CPI was led by higher food and rental costs.** As in 2019/20, the CPI was led by price increases in essential goods and services (Figure 14).

<sup>7</sup> Launched in April 2018, NIMA is an FX auction system administered by the CBI for facilitating FX transactions between exporters and importers.



FIGURE 12 • The Rial has Depreciated Sharply...

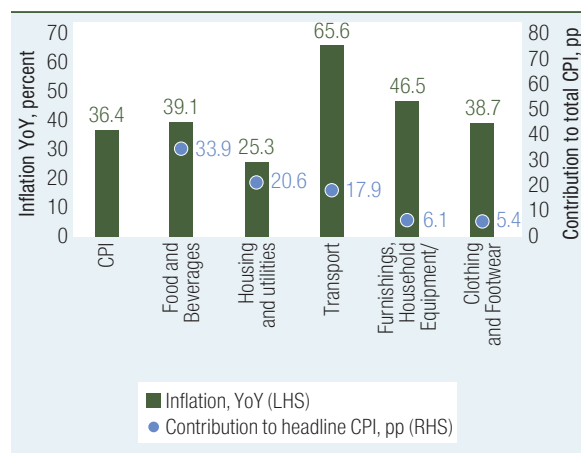


Source: CBI and World Bank staff calculations.  
 Note: NIMA, the Persian acronym for “integrated system of foreign exchange transactions”, is an FX auction system administered by the CBI for facilitating transactions between exporters and importers.

The rapid increase in the price of essential foods such as meat and poultry led to long lines in supermarkets for subsidized goods as the Iranian new year approached. High inflation for food and housing disproportionately affects the poor, as these items account for more than 75 percent of the consumption basket of the bottom 40 percent of the population, versus 51 percent for the highest decile as defined by the CBI.

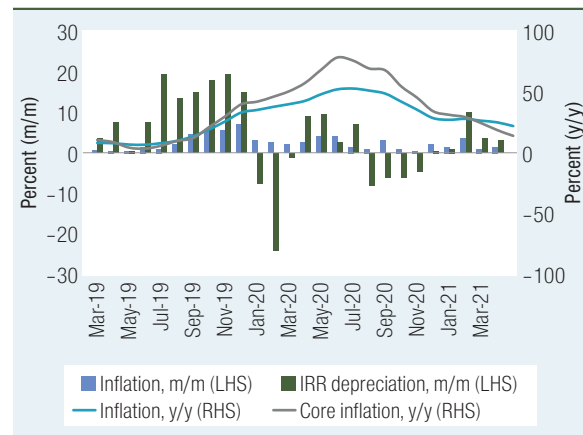
**Monetary aggregates continued to increase in a background of higher inflation and other constraints facing the banking sector.** Broad money (M2) growth accelerated in 2020/21 to 40.6

FIGURE 14 • Food and Beverages Were the Main Contributors to Inflation



Source: SCI and World Bank staff calculations.

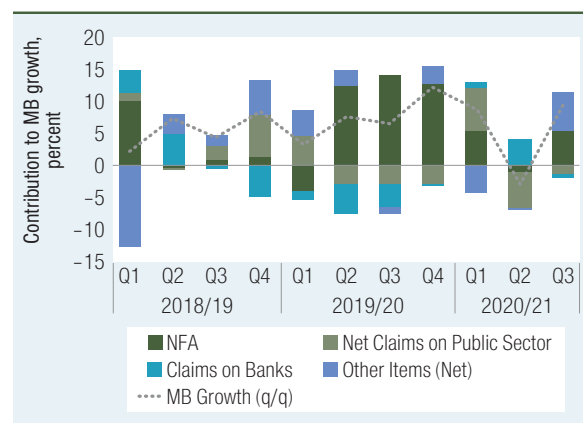
FIGURE 13 • ...leading to a Renewed Surge in Inflation



Source: CBI, SCI, and World Bank staff calculations.

percent driven by an expansion of the banking sector claims on the government and non-public sectors. This is in part due to the emergency COVID-19 loans (for which the reserve requirements were temporarily reduced) which contributed to a rapid rise in credit issued by the banking sector (8 pp increase as a share of GDP). However, high liquidity growth has been a chronic challenge in the banking sector over many years. The average growth rates of M2 and the monetary base (MB) in the last four decades were 28 percent and 22 percent, respectively. The banking sector faces deeper structural issues such as undercapitalization and other imbalances of their

FIGURE 15 • An Increase in the CBI’s Net Foreign Asset Was the Main Driver of the Monetary Base Growth...



Source: CBI and World Bank staff calculations.

balance sheets (e.g., accumulation of illiquid assets including non-performing loans and claims on government).

**The Tehran Stock Exchange Market (TSE) has experienced unprecedented fluctuations in 2020/21.** From early 2020/21, the TSE index jumped by more than 300 percent to its record high in early August but since then, it lost over 40 of its previous value (Figure 16). While the TSE was underperforming in previous years, its unprecedented rise had little fundamental support, and mainly driven the depreciation of the currency, inflationary expectations, and some TSE initiatives by the Government. The latter included a series of initial public offerings (IPOs) of state-owned enterprises (SOEs) and exchange-traded funds (ETFs). These measures along with lower banking deposit rates and curbs on FX sales led to a large influx of liquidity to the market and drove the index upwards in the initial stages. The market's bullish trend reversed in July 2020 after an increase in banking deposit rates and delays in other government IPOs and since November 2020, an easing of ER depreciation has also contributed to keeping the index stable.

**Following the sharp decline in the TSE index, authorities introduced several policies to support the capital market.** To shore up the stock market, the authorities announced the “3+7 capital market package”<sup>8</sup> in April 2021. Key elements of the package include allocation of additional funds to capital market stabilization fund (CMSF) from the NDFI and stock transfer taxes, lifting restrictions on banks and NDFI direct investment in TSE, tax exemptions or deferrals for listed companies' investment activities and share buybacks, and easing bank investment ring-fencing regulations. While some of these interventions can help TSE's stabilization in the short term, their potential inflationary impact and other ramification such as creating moral hazard problems and risky investment behaviors need to be considered.

**Despite the recent volatility of the TSE, the stock market provided the highest nominal return among other assets.** The TSE in 2020/21 with more than 150 percent return was higher than the yearly return in bank deposits, and investing in gold, FX, and

real estate, which are traditional investments to hedge against high inflation (Figure 17). In addition, both equity financing and debt financing through the stock market doubled in 2020/21.

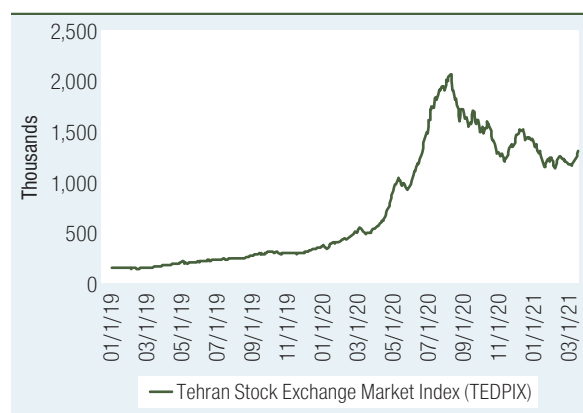
## Public Sector Finance

**The sharp decline in oil exports and COVID-19 placed unprecedented pressures on government finances.** The fiscal balance-to-GDP ratio reached 6.8 percent in 9M-20/21, as revenues fell to 8 percent of GDP. The government's share from oil revenues fell by more than 80 percent to reach less than 1 percent of GDP and tax revenues shrank in real terms 2020/21. Oil revenue's share in the budget fell to 3.4 percent, the lowest in recorded history (the previous low was 25 percent during the Iran-Iraq war in 1986/87), as only 16 percent of planned oil revenues were realized during 9M-20/21. However, overall tax revenues met the target based on the budget law in 2020/21 despite the economic contraction and narrowing of the tax base. This was mainly due to higher inflation and better collection, particularly from the wealth tax including stock exchange transaction tax. The indirect tax fell short of the budget target by about 20 percent in 2020/21 due to the impact

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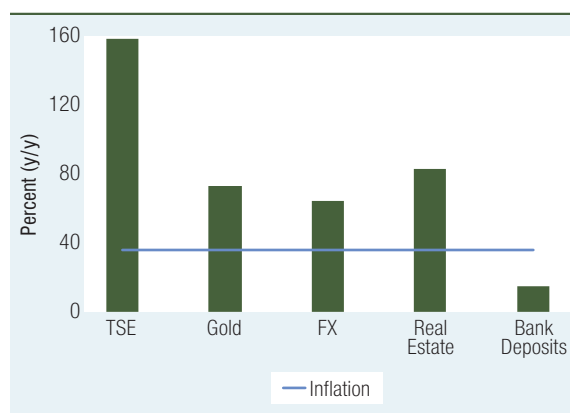
<sup>8</sup> The package consists of (i) allocating one percent of the NDFI resources to the CMSF; (ii) lifting restrictions on capital market financial institutions to use banking facilities; (iii) granting five-year residency for foreign investors in the stock market; (iv) allocating 80 percent of the stock transfer tax in 2021/22 to the CMSF's account; (v) tax exemption for companies that spend their accumulated profits on raising capital; (vi) allowing tax deferral for one year of 50 percent of purchasing their own or subsidiaries shares to support the market; (vii) extending the “law of removing barriers to production exemptions” to banks and credit institutions for three years, and allowing them to invest in the capital market; (viii) providing the possibility of NDFI investing in the capital market; (ix) allowing the CMSF and capital market development fund to issue up to IRR 200 Trillion of debt with government guarantees and allocate these sources to market protection policies; and (x) compensate the loss incurred by buyers of government's ETFs shares.

**FIGURE 16 • TSE Underwent a Large Fluctuation in 2020/21...**



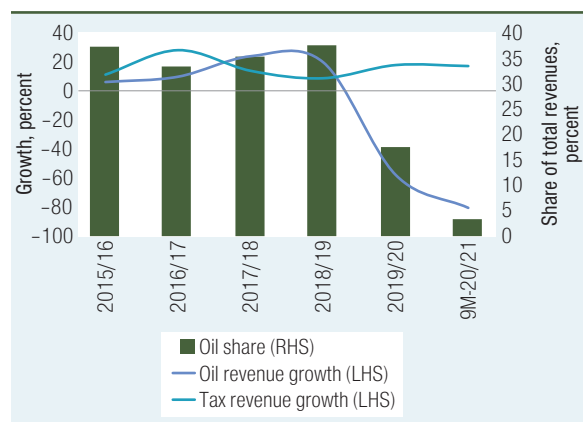
Source: TSE.

**FIGURE 17 • ... yet Provided the Highest Return among Other Assets in 2020/21**



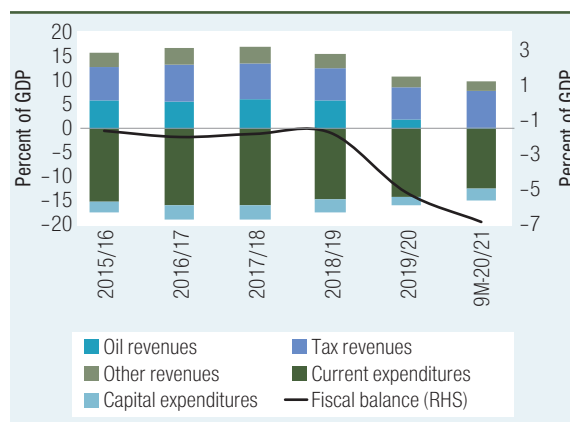
Source: TSE, CBI, and World Bank staff calculations.

**FIGURE 18 • Oil Revenues Have Fallen to Historic Lows while Taxes Grew Modestly...**



Source: CBI, PBO, and World Bank staff calculations.

**FIGURE 19 • ...Leading to a Widening Fiscal Deficit**



Source: CBI, PBO, and World Bank staff calculations.

of the pandemic on both import tax and sales and consumption tax.

**Higher current spending and COVID-19 related costs have led to an increase in government expenditures.** Expenditures in nominal terms grew faster in 2020/21 due to wage bill growth, pension payment adjustments, new unemployment payments, and additional transfers. In response to the pandemic, the government rolled out a number of new cash transfer programs and low interest loan packages to protect households and businesses (see Box 2). As a result of these higher costs and lower revenues, the fiscal deficit is estimated to have widened to over 6 percent of GDP in 2020/21.

However, the increase in expenditures was mainly offset by inflation, and as such, meant that the government expenditures only marginally increased in real terms.

**The government resorted to wide-scale bond issuance, sales of assets, and drawdowns on NDFI reserves for financing the deficit.** The government started selling SOE shares via the stock market and issued bonds through CBI auctions. The fiscal deficit in 9M-20/21 was primarily financed through bond issuance (70 percent), followed by sales of assets (15 percent) and withdrawals from strategic reserves (8 percent). Disposal of financial assets (mainly bond issuance) increased by over

## BOX 2 POLICY RESPONSES TO THE PANDEMIC

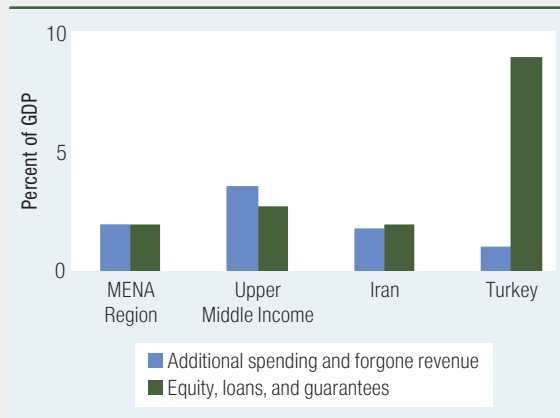
**Iran initiated several measures to counter the immediate economic impact of the COVID-19 crisis.** The government's initial rescue package was IRR 1000 Trillion (about 20 percent of budget, and 4 percent of GDP in 2020/21). A quarter of the package was allocated to cash transfers to households, the health sector, and the unemployment insurance fund, and the rest to provide low interest rate loans, through the banking system, to households and affected businesses. The NDFI was the financing source for the health sector and the unemployment insurance fund allocations. In addition to the initial package, in December 2020, the government announced another support package including four monthly cash transfers to vulnerable households (four bottom deciles) as well as additional low interest loans to households (about 0.5 percent of GDP). Other supporting measures included a moratorium on tax payments for a period of three months and relaxing the previous restrictions on trading the Justice Shares in the TSE, which potentially acted as a new income source for those in need. In addition, to protect the tenants, the government provided some subsidized loans to low-income tenants and imposed some caps on increasing rents as well as an extension of tenant agreements to three months after the pandemic.<sup>a</sup>

**Monetary policy was also leveraged as part of the pandemic response package.** To support bank facilities to vulnerable households and affected businesses, the CBI temporarily reduced the required reserves and provided foreign currency at the official preferential rate for imports of medicine, medical equipment, and essential goods. It also temporarily waived penalties on non-performing loans. Bank loan repayments were extended by three months at the end of the loan duration period. The CBI also intervened in the foreign exchange market to stabilize the rial.

**The allocated resources were financed through government securities, the NDFI, and privatization proceeds.** Due to the fall in oil revenues, the fiscal supports were mainly through the below-the-line measures (i.e., those that do not affect primarily balances but debt) according to the latest fiscal data indicates. About Euro 1 billion from the resources of the NDFI were allocated to deal with the effects of the coronavirus outbreak. Out of this amount, according to the PBO's report, as of Feb 2021, Euro 770 million was allocated to the ministry of health (89 percent), the unemployment insurance fund (9.8 percent), and the armed force (1 percent).

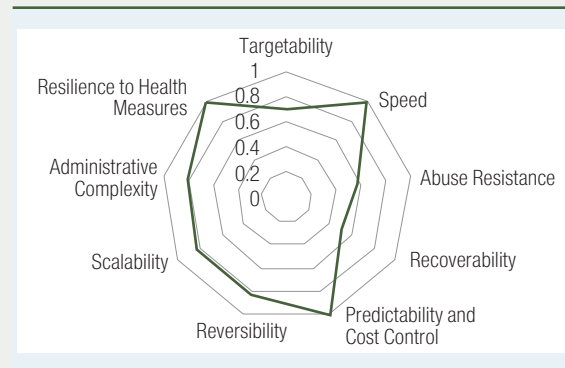
**Iran's policy response was comparable to that of MENA and the upper middle income counterparts.** The response included loans and guarantees (1.8 percent of GDP) and to the health sector and unemployment insurance fund (1 percent of GDP) as well as about 1 percent of GDP in cash transfer (above-the-line-measures). The World Bank assessment of fiscal policy measures for more than 200 countries shows that Iran's response in terms of speed, predictability, cost control, and resilience to health measures ranks favorably among other countries but has a low rank in terms of scalability, abuse resistance, and reversibility.<sup>b</sup>

**FIGURE B2.1 • Governments All Over the World Deployed Unprecedented Fiscal Support to Face the Pandemic...**



Source: Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic, IMF and World Bank staff calculations.

**FIGURE B2.2 • Iran Average Performance of Fiscal Policy Dimensions (policy assessment scores)**



Source: A Review of Fiscal Policy Responses to COVID-19, WBG.  
 Note: Scores show the share of policies meeting each criterion. 0 indicates not meeting the criteria. The policies were scored objectively, without consideration of the country context.

<sup>a</sup> The government COVID-19 response packages complement existing social protection programs including the Targeted Subsidy Reform Plan cash transfers (cover about 78 million people since 2010), Livelihood Support cash transfers (cover about 60 million since the November 2019 gasoline price increase), occasional transfers (e.g., for Ramadhan) as well as other public social assistance plans of Behzisti Organization and Imam Khomeini Relief Foundation (Komite Emdad) which focus on the most vulnerable households and people with disabilities.

<sup>b</sup> The assessment is based on whether the governments met the criteria across nine dimensions, including targetability, speed, abuse resistance, affordability, predictability and cost control, scalability, reversibility, administrative complexity, and feasibility considering social distancing and contagion risks. The assessment does not consider fiscal space, implementation capacity, pre-existing spending and coverage gaps, and the cost of the policy in the determination of the appropriateness of a fiscal policy.

TABLE 1 • The 2021/22 Budget is Expansionary on All Components

	2020/21 Law (IRR billion)	2021/22 Law (IRR billion)	2021/22 Law (US\$ billion) <sup>a</sup>	Growth (%) (relative to 2020/21 Law)
<b>Total Revenues</b>	<b>3,962,886</b>	<b>8,504,460</b>	<b>73.95</b>	<b>114.60</b>
<b>Current Revenues</b>	<b>2,887,991</b>	<b>4,548,990</b>	<b>39.6</b>	<b>57.5</b>
Tax Revenues	2,038,535	3,327,789	28.9	63.2
Direct Taxes	871,006	1,805,888	15.7	107.3
Indirect Taxes	1,167,530	1,521,901	13.2	30.4
Other Revenues	849,456	1,221,201	10.6	43.8
<b>Disposal of Non-Financial Assets</b>	<b>1,074,895</b>	<b>3,955,470</b>	<b>34.4</b>	<b>268.0</b>
Oil	569,436	1,992,720	17.3	249.9
Others	505,459	1,962,750	17.1	288.3
<b>Total Expenditures</b>	<b>5,240,136</b>	<b>10,951,809</b>	<b>95.2</b>	<b>109.0</b>
<b>Current Expenditures</b>	<b>4,360,316</b>	<b>9,189,164</b>	<b>79.9</b>	<b>110.7</b>
<b>Development Expenditures</b>	<b>879,821</b>	<b>1,762,645</b>	<b>15.3</b>	<b>100.3</b>
<b>Operational Balance</b>	<b>-1,472,324</b>	<b>-4,640,174</b>	<b>-40.3</b>	<b>215.2</b>
<b>Budget Balance</b>	<b>-1,277,250</b>	<b>-2,447,349</b>	<b>-21.3</b>	<b>91.6</b>
<b>Disposal of Financial Assets</b>	<b>1,747,250</b>	<b>4,274,480</b>	<b>37.2</b>	<b>144.6</b>
<b>Acquisition of Financial Assets</b>	<b>470,000</b>	<b>1,827,400</b>	<b>15.9</b>	<b>288.8</b>
<b>Net Disposal of Financial Assets</b>	<b>1,277,250</b>	<b>2,447,080</b>	<b>21.3</b>	<b>91.6</b>
<b>Government General Resources</b>	<b>5,710,136</b>	<b>12,779,209</b>	<b>111.1</b>	<b>123.8</b>

Source: PBO and World Bank staff calculations.

Note: <sup>a</sup> Converted using the budget proposal's ER of 115,000 IRR/US\$.

100 percent in 2020/21. Financing through the TSE—a combination of bond issuance and sales of SOE shares—in 9M-20/21 was four times the size of these financing operations of 2019/20.

**Following a prolonged review in the Parliament, the 2021/22 budget law was approved in the last days of 2020/21.** The 2021/22 budget law proposes an expansionary budget of about 58 percent compared to that of the previous year budget which could expand by 124 percent if revenues meet the first six-month target. The bill assumes an ambitious oil export volume of 2.3 mbpd, far exceed the realized oil exports in 2020/21, and an oil price of US\$40/bbl. The oil revenue fiscal rule is adjusted to keep the share of NDFI from the first 1 mbpd of oil export proceeds at 20 percent but increase to 38 percent for exports beyond this amount. The implicit ER assumed in the Bill is 115,000 IRR/US\$, substantially

higher than the current official ER of 42,000 IRR/US\$. The public sector wages and pensions are to increase by 25 percent—both imply real wage cuts given last year's inflation and current inflation projections for this year. The government proposes a smaller allocation of US\$ 8 billion (down from US\$ 10.5 billion in 2020/21) at the subsidized rate of 42,000 IRR/USD for the importation of essential goods and medicine.<sup>9</sup>

**To improve electricity consumption, the government introduced a series of price adjustments.** Following widescale outages during the peak consumption in the summer, electricity tariffs

<sup>9</sup> As part of the draft budget, the government requested discretion for scrapping the allocated ER subsidy in 2021/22 and allocate the resources to further social protection measures and capital expenditures.

## BOX 3 THE NEW GOVERNMENT SECURITY ISSUANCE

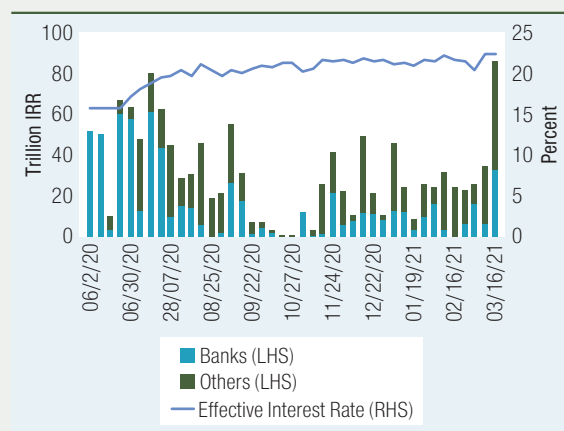
Faced with an unprecedented budget deficit, the government turned to domestic financing sources and embarked on large-scale bond issuance. The Central bank of Iran (CBI) started holding auctions on behalf of the Ministry of Finance in the primary market for the first time in June 2020. The process has helped the government to partly finance the deficit.

**During June 2020 to April 2021, about IRR 1,300 trillion (about 4 percent of GDP), of government debt securities, were purchased by market participants (Figure B3.1).** The bonds were mostly with maturities of 1–4 years with bi-annual payments. Figure B3.2 shows the maturity dates of issued securities. The bonds' maturity profile indicates the servicing and rollover costs in the coming years and highlights the need for a consolidated medium-term debt strategy.

**The more favorable demand in the initial phase of issuance changed in recent months.** While early issuances hovered around cut-off market interest rates of 15 percent, the government was slow in accepting asked prices at the time. After overall economic conditions worsened and prospects for alternative financing sources dimmed, the government increased the rates to 22 percent in the last two auctions in March 2021, closer to the CBI's interest ceiling corridor. To ease the pressure, the CBI has intervened and bought bonds through open market operation to provide liquidity to market participants and maintain its interest rate corridor (the upper limit is CBI's lending rate to banks and the lower limit is the deposit rate on banks' deposits with the CBI).

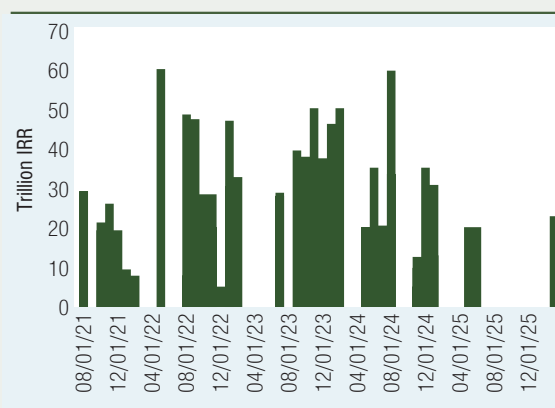
**Debt issuance should be part of a comprehensive medium-term debt strategy (MTDS).** Such a strategy should consider macroeconomic constraints and the level of development of the different components of the domestic financial market. The MTDS would support the development of the domestic debt market and facilitate a transparent approach to domestic borrowing and avoid volatility in the market, particularly where the market depth is low and is in the early stages of development.

FIGURE B3.1 • Government Securities Weekly Auctions



Source: CBI, and MEAF.

FIGURE B3.2 • Maturities of Government Securities



Source: CBI and World Bank staff calculations.

Note: The calculated figures do not include interest payments.

for commercial and residential users were increased. Residential electricity tariffs have increased by 7 percent on average (considerably below inflation). Residential high-consumption users (consuming more than 300 kWh per month) faced a 23 percent increase and low consumption households (consuming less than 80 kWh per month) were incentivized by free electricity. Cryptocurrency miners faced double electricity tariffs, as the electricity outages were partly attributed to their mining activities. Furthermore, in March 2020, the Parliament quadrupled the average

price of electricity for some industries (including steel, aluminum, copper, basic metals, metal minerals, and refineries and petrochemical units). While the electricity tariff increase can help cover part of the supply costs, they remain well below inflation and thus have a small effect on electricity companies' (mainly SOEs) balance sheets.

**In an attempt to remedy the housing shortage and soaring rent prices, the government levied taxes on vacant homes.** House prices rose rapidly in Iran (e.g., about 80 percent in Tehran in

2020/21) and rents faced a sharp increase (e.g., 40 percent increase in 9M-20/21 (y/y)). To control prices, the government imposed taxes on vacant properties. The tax rate will be higher (double) for empty real estate properties under corporations' ownership and the rate will increase if the house remains empty for more years. In addition, the government provided some subsidized rental assistance loans to low-income tenants and imposed caps on rent increases.

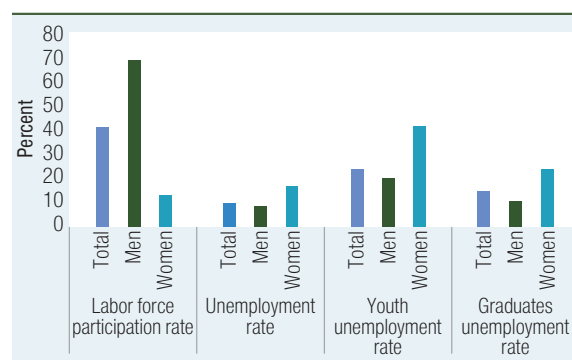
## Labor Market and Jobs

**The worsening of the economic situation contributed to a deterioration of employment and labor force participation in 2020/21.** Despite an additional 0.7 million people entering the working-age population over the past year, the active population declined by about 1.4 million as hope for finding jobs faded. In 2020/21, over a million jobs were lost mainly due to the pandemic, especially in the service sector (accounting for 75 percent of job losses). Women bore the brunt of job losses accounting for 60 percent of net job losses. However, because of this decline in participation, the unemployment rate dropped to 9.6 percent in 2020/21 (1 pp decline), the lowest rate during the last two decades.

**The economic recession and the pandemic have had a disproportionate gender labor market impact.** The labor force participation rate declined by 2.8 pp to 41.3 in 2020/21, mainly driven by a reduction in the female participation rate. The female participation rate has fallen to a low rate of 13.9 percent, far below the world and MENA averages (47 and 20 percent, respectively). Even with a much lower participation rate, the female unemployment rate is twice as large as males (15.6 percent compared to that of men by 8.4 percent). The gender gap is even wider among the youth and educated. The female youth unemployment rate is 36 percent, much lower than the rate of their male counterparts (21.2 percent). Furthermore, 22.8 percent of women with university degrees are unemployed while this number is 10.4 percent for male graduates (Figure 20).<sup>10</sup>

**Iran's labor market challenges are structural issues that have been amplified by the recent**

**FIGURE 20 • Labor Market Gender Gaps Remain High (Q4-20/21)**



Source: SCL.

**years of recession.** Over the last decades, even with an exceptionally low participation rate (averaged 42 percent), the unemployment rate has consistently been in the double digits while underemployment was also high at 10 percent on average. The unemployment rates are disproportionately worse for females, youth, and the educated population with an average of 23.6, 26.4, and 14.1 percent, respectively over the past decade. GDP growth has been relatively jobless meaning that the country failed to provide enough job opportunities to its highly educated young population. Faced with limited job opportunities, the large cohort of Iranians born in the 1980s had previously postponed entry through continued education and training. Due to long-term structural issues in the labor market, many job seekers are either reluctant to enter the job market or exited as they lost hopes for finding jobs. Even during the last period of a moderate increase in labor market indicators (2014/15 to 2019/20), the majority of the created jobs were self-employed and in small enterprises of less than 4 employees in the service sector which was quickly reversed due to the pandemic (see Behnia et al. 2021).

<sup>10</sup> This significant gender gap in labor market outcomes has also been impacted by policies limiting female employment such as gender quotas in the public sector employment and university students in specific majors. Women entering the labor force after the imposition of these quotas face fewer labor market and educational opportunities and are less likely to be employed. See Moeeni and Tanaka (2020).





# OUTLOOK AND RISKS

## Outlook

**Iran's economic outlook hinges on the evolution of the COVID-19 pandemic, the pace of global economic recovery, and the possibility of sanctions relief.** The recovery is projected to be slow and gradual due to the resurgence of new variants and containment measures, slow vaccination rollouts, and weak demand from regional trading partners. Non-oil GDP is projected to return to its pre-pandemic average while oil production is forecast to modestly bounce back with higher demand. If US sanctions on Iran's economy are removed, this could lead to substantially higher growths in both oil and non-oil sectors. However, insufficient investment<sup>11</sup> in the oil sector constrains Iran's oil production capacity in the medium term, even in the absence of US sanctions. Furthermore, given the recent large global investments in renewable energy and other climate change mitigation measures the long-term prospects for oil demand are uncertain.

**In the absence of a pickup in oil revenues, the fiscal deficit is projected to remain high over the medium term.** A slow economic recovery would translate into similarly slow growth in non-oil revenues. Higher reliance on bond issuance, especially with

shorter maturities, would increase interest payments and amortization costs. Further government debt issuance and sales of public assets could have negative spillovers to the stock market and place additional stress on the undercapitalized banking sector.

**Despite a moderate economic rebound, economic pressures on poor households will continue.** Inflation is forecast to decelerate but remain above 20 percent on average over the medium term. With limited fiscal space to support the poor and high inflation, economic pressures on the poor are unlikely to subside, but a better targeting of cash transfers could free up resources for additional social protection measures.<sup>12</sup>

<sup>11</sup> Iran and China signed a strategic 25-year agreement in March 2021. The "Comprehensive Strategic Partnership" aims to expand political, economic, and cultural cooperation between the two countries. The agreement could help Iran's external account financing and reverse the recent years' decline in investment rates.

<sup>12</sup> Mahmoodzadeh et al. (2019) show that in 2019/20, the total amount of explicit subsidies (including budget and off-budget items) and hidden subsidies are equal to IRR 8900 Trillion which is almost 2.2 times of the budget. In addition, the government-guaranteed facilities are estimated to be IRR 720 Trillion. Thus, the subsidy paid

## Risks and Opportunities

**Risks to Iran's economic outlook relate to the recovery path from the pandemic and the prospects of geopolitical developments.** The pace of vaccination (purchase and distribution), a resurgence in the number of cases such as those from new COVID-19 strains, and subsequent lockdown measures could weigh down on economic activity and prolong the acute phase of the crisis. The burden of further economic deterioration would be felt the most by the poor and vulnerable and increase poverty. Upside risks relate to a faster than expected vaccination drive and sustained higher oil prices. If there is a breakthrough in the ongoing nuclear negotiations, US sanctions relief, could significantly boost economic activity and improve Iran's fiscal balance. The outcome of the upcoming presidential elections (due to be held in June 2021) will also be a crucial factor in the direction of Iran's economy and the path of economic reforms.

**The continuation of current monetary reforms can help control inflationary pressures and improve banking sector health.** Recently, the central bank embarked on several fundamental reforms to improve monetary policy, including the introduction of inflation targeting. The CBI also held weekly auctions for government securities, enabling the government to finance about 70 percent of the 2019/20 budget deficit. Partly due to limited access to its reserves, the CBI's intervention in the foreign exchange market was also subdued. Despite an ambitious inflation target (22 percent) and a lack of fully developed monetary institutions and regulations, the new monetary policy approach helped the CBI to resist pressures to accommodate fiscal needs and transfer pressures to the banking sector. The monetary

authorities can build on these positive experiences and shift towards indirect interventions and improve the health and the depth of the financial sector. Achieving the inflation target requires independence of the central bank, reducing fiscal dominance, unifying the multiple exchange rates, and shifting to a more flexible exchange rate regime (see Mazarei, 2019; Zahedi and Azadi, 2018).

**The economy urgently needs a recovery plan through comprehensive and coordinated macro-fiscal reforms.** Overcoming many of Iran's chronic economic challenges including high inflation calls for an overhaul of Iran's fiscal framework. A sustainable and inclusive growth model would require urgent reforms including in the areas of energy subsidies, pension system reforms, water scarcity management, and comprehensive banking system restructuring. Growth-enhancing reforms such as investment in green infrastructure, digital economy, and renewable energy can help lead the economy out of the pandemic and create much-needed jobs. After the sharp contractions in recent years along with high unemployment, investment in infrastructure such as railroads can boost the economy, create jobs, reduce emissions, and enhance trade. Greater focus on the digital economy could help catalyze diversification by, utilizing the full potential of Iran's highly educated and tech-savvy young population and transform the economy into a regional tech hub.

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for each individual is estimated to be 20 times the current monthly cash transfer. These numbers indicate that better and more effective allocation of these resources can improve the well-being of the vulnerable population.

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TABLE 2 • Iran: Selected Economic and Financial Indicators, 2018/19-2023/24

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Act.	Act.	Est.	Proj.	Proj.	Proj.
<b>Real sector</b>	(annual percentage change, unless otherwise stated)					
Real GDP at factor cost	-5.4	-6.5	1.6	2.1	2.2	2.3
Real GDP per capita	-7.2	-7.9	0.5	1.0	1.1	1.2
Real non-oil GDP	-1.8	1.1	1.4	1.7	1.8	1.8
Total crude oil production (million barrels/day)	3.6	2.4	2.4	2.5	2.7	2.8
Crude oil, average price (US\$/bbl)	68.3	61.4	41.3	56.0	60.0	61.0
Agriculture	-0.9	8.8	4.0	4.0	4.2	4.2
Industry	-11.0	-15.9	4.3	2.9	3.3	3.7
Services	-0.7	-0.5	-0.7	1.2	1.0	0.8
<b>Money and prices</b>						
CPI Inflation (p.a.)	31.1	41.3	36.9	29.3	21.7	18.9
Monetary base (MB)	24.2	32.8	28.9	n/a	n/a	n/a
Broad money (M2)	23.1	31.3	40.6	n/a	n/a	n/a
Banking system credit	40.4	39.9	47.9	n/a	n/a	n/a
Nominal interest rate (percent)	19.7	18.9	17.5	n/a	n/a	n/a
Nominal exchange rate, parallel market (IRR/USD)	103,378	129,185	227,792	n/a	n/a	n/a
	(percent of GDP, unless otherwise stated)					
<b>Investment &amp; saving</b>						
Gross capital formation	34.7	35.1	40.7	41.0	40.8	41.1
Gross national savings	40.6	35.7	39.9	41.8	41.9	42.4
<b>Government finance</b>						
Total revenues	15.4	11.2	8.6	8.7	8.8	9.0
Tax revenues	6.7	5.8	5.9	6.0	5.9	6.1
Direct taxes	3.4	3.4	3.4	3.4	3.3	3.3
Indirect taxes	3.3	2.4	2.5	2.6	2.6	2.8
Total expenditures	17.0	14.9	14.9	15.4	15.8	16.0
Current expenditures	14.5	12.5	12.6	12.6	12.4	12.4
Primary Balance	-1.3	-3.0	-5.3	-5.2	-5.0	-4.9
Net lending/borrowing (overall balance)	-1.6	-3.7	-6.3	-6.7	-7.0	-7.0
Government Debt	38.5	47.9	50.3	52.1	54.7	57.4
<b>External sector</b>						
Current account	5.9	0.6	-0.8	0.8	1.1	1.3
Net exports	5.5	0.5	-0.7	-0.6	-0.5	-0.4
Export of goods and services	22.7	12.1	7.2	6.9	7.1	7.5

(continued on next page)

TABLE 2 • Iran: Selected Economic and Financial Indicators, 2018/19-2023/24 (continued)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Act.	Act.	Est.	Proj.	Proj.	Proj.
Import of goods and services	17.1	11.6	7.9	7.5	7.6	7.9
<b>Population and labor market</b>						
Population (million)	82.08	83.08	84.04	84.97	85.87	86.74
Participation rate (percent)	44.5	44.1	41.3	n/a	n/a	n/a
Unemployment rate (percent)	12.2	10.7	9.6	n/a	n/a	n/a
<b>Memorandum Items:</b>						
Nominal GDP (IRR Billion)	19,128,840	24,412,570	33,058,141	43,935,200	54,872,887	66,859,113

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



# SPECIAL FOCUS ON POVERTY AND INEQUALITY IN IRAN AT THE OUTSET OF THE COVID-19 PANDEMIC<sup>13</sup>

**T**his chapter updates monetary poverty estimates presented in previous Iran Economic Monitor reports using the latest official data covering the period of March 2019 to March 2020. Poverty is measured using the international poverty line of USD 5.5 (2011 purchasing power parity (PPP)). It shows that the pandemic struck when many households, especially those at the bottom of the welfare distribution, were already struggling with the economic downturn and high inflation of recent years.

## Introduction

**From a historic perspective, there was an apparent disconnect between poverty trends and macro-economic performance in Iran.** For instance, poverty

continued to fall, despite large drops in GDP growth in 2009/10<sup>14</sup> and 2012/13, and to increase after 2013/14 when the overall GDP growth trend was small but positive (Figure 21). Two factors have been important to explain this apparent disconnect.<sup>15</sup> First, government

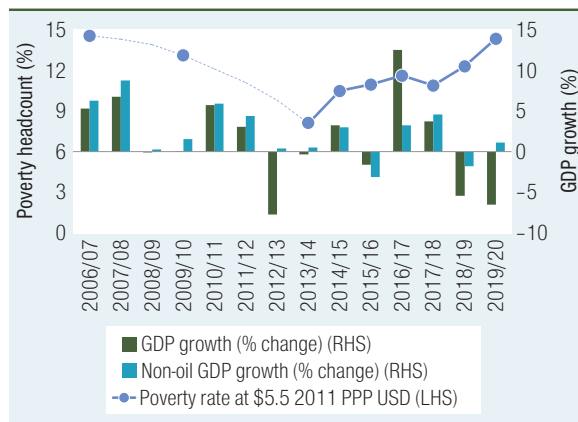
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<sup>13</sup> This section is a product of the Poverty and Equity Global Practice. It has been written by Laura Rodriguez (Young Professional) and Mohammad Mostafavi-Dehzoeei (Consultant). Federica Alfani (Consultant) provided inputs for the box on COVID-19 and Inequality.

<sup>14</sup> As in the rest of this report, numbers on Iran in this note are based on the Persian calendar which bridges two years in the Gregorian calendar, starting and ending in March.

<sup>15</sup> Other potential explanations include a lagged impact of growth and the lack of a 'trickle-down' of aggregate growth to the poorer households of a country.

**FIGURE 21 • GDP (total and non-oil) Growth Rates and Poverty Headcount Rates (consumption per capita) at USD 5.5 2011 PPP**



Source: World Bank calculations based on HEIS and Central Bank of Iran.

policies have helped to counterbalance some of the downturns, for example, in 2010 when a near universal cash transfer was introduced to alleviate the impacts of the removal of residential energy subsidies (Salehi-Isfahani et al., 2015; Hayati et al., 2018). Second, other macroeconomic indicators, particularly high inflation, have had a disproportionate impact on the fates of the poor. A high inflation period in 2013, and most recently since 2018, have disproportionately affected poorer households, halving the real value of social assistance transfers between 2012/13 and 2016/17 (Hayati et al., 2018) and raising the cost of their consumption basket (Rodriguez and Atamanov, 2021).

**In recent years, before the COVID-19 pandemic, Iran was amidst economic uncertainty and shocks. These macroeconomic trends raise concerns about the welfare of Iranians and their ability to withstand the shock of the pandemic.** Iran has been in an economic downturn since the reintroduction of US sanctions in 2018: the growth rate in GDP per capita was -7.0 percent in 2018/19 and -7.7 percent in 2019/20, while inflation spiraled with the sharp currency depreciation. Meanwhile, poverty has been rising (Figure 21). During the last year, although some economic recovery is expected (GDP growth is expected to be 1.7), the global pandemic continued to fuel inflation; the consumer price index (CPI) reached its highest month-to-month increase in almost 2 years in October 2020.

The latest release of official data from the Household Expenditure and Income Survey (HEIS) 2019/20, collected just before the pandemic began, presents an opportunity to analyze the situation and vulnerabilities of Iranian households at the outset of this crisis.

## Poverty and Inequality Trends in Iran 2018/19-2019/20

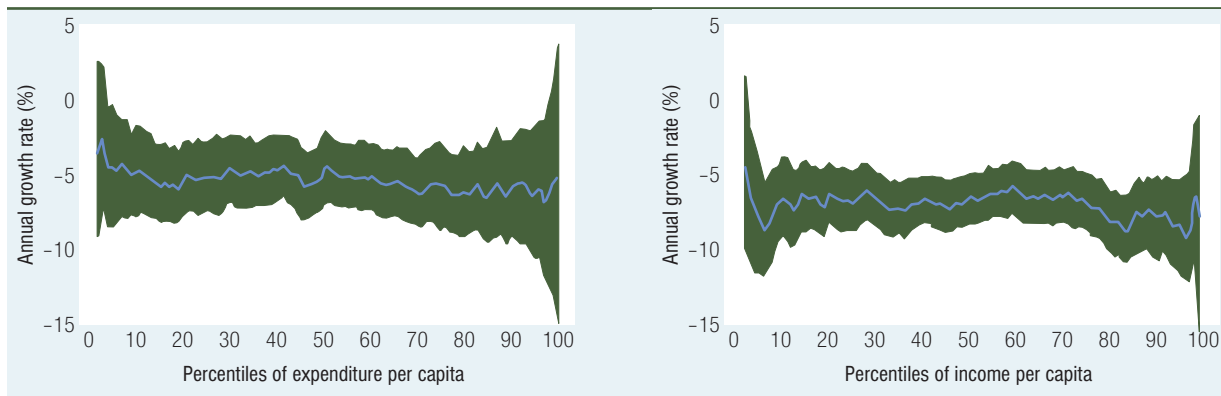
**Before the COVID-19 pandemic, households were already feeling the economic downturn; on average, consumption per capita fell by -5.6 percent between 2018/19 and 2019/20.** Growth incidence curves (GIC) in Figure 22 show how much real household consumption or income per capita changed from one year to the next across the population distribution, from the poorest to the richest percentile. In the two previous years, the bottom 40 percent of the population experienced the slowest growth (2017/18) or lost the most when consumption fell for all households (2018/19) (World Bank, 2020a). In 2019/20, the overall negative consumption growth trend persisted (on average, per capita consumption fell by 5.6 percent), but this time the fall was felt more evenly across all households, with a larger drop for the top 60 percent of the population (-5.7 percent compared to -5.0 percent for the bottom 40 percent of the population). The pattern is similar when looking at incomes instead of consumption; there was a negative income growth rate across the distribution (on average -7.7 percent), but the bottom 40 percent were affected slightly less than the richer income groups (-7.0 and -7.9 percent, respectively).

**As a consequence of high inflation and economic contraction, poverty continued to rise.** As incomes and consumption fell, the poverty rate (at the international poverty line of USD 5.5 in 2011 PPP)<sup>16</sup>

<sup>16</sup> The poverty measurement in this chapter follows the methodology of previous Iran Economic Monitor reports and well-established international standards. In the absence of an official poverty line, the poverty threshold is the international upper middle-class poverty line of USD 5.5 PPP per day. The chapter uses both household consumption and household income (expressed per

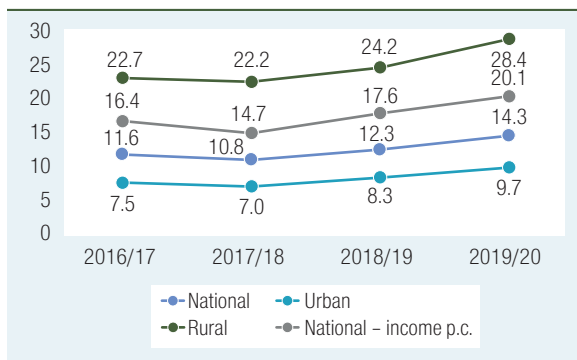


**FIGURE 22** • Anonymous Growth Incidence Curves 2018/19-2019/20  
Growth Rates of Annualized Real Expenditure (a) and Real Income (b) Per Capita by Percentiles (%)



Source: Authors' calculations based on HEIS 2018/19 and 2019/20.

**FIGURE 23** • Headcount Poverty Rates (consumption per capita) at USD 5.5 2011 PPP National and by Rural/Urban Areas, 2016/17-2019/20

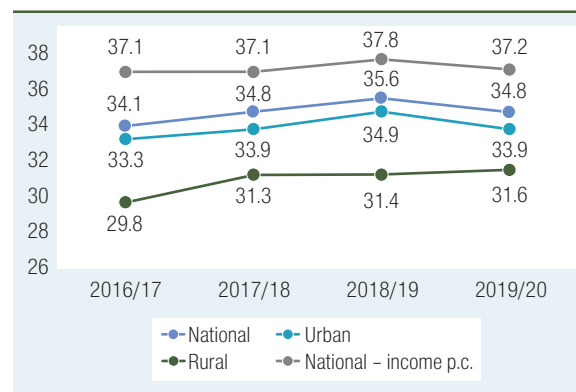


Source: Authors' calculations based on HEIS 2016/17-2019/20.

rose from 12.3 in 2018/19 to 14.3 in 2019/20, when measured by the consumption per capita measure, and from 17.6 to 20.1, when measured by the income per capita measure (Figure 23). Urban and rural poverty followed similar trajectories, although rural poverty remains considerably higher and rose faster. Urban poverty stood at 9.7 percent in 2019/20, compared to 28.4 in rural areas.

**The recent increase in inequality staled in 2019/20, but this is hardly good news.** Inequality measured by the Gini index had also been increasing since 2016/17, but the rise staled in 2019/20 when there was a slight reversal to the 2017/18 level (Figure 24). Despite the halt in urban areas, inequality

**FIGURE 24** • Gini Index (consumption per capita) National and by Rural/Urban Areas, 2016/17-2019/20

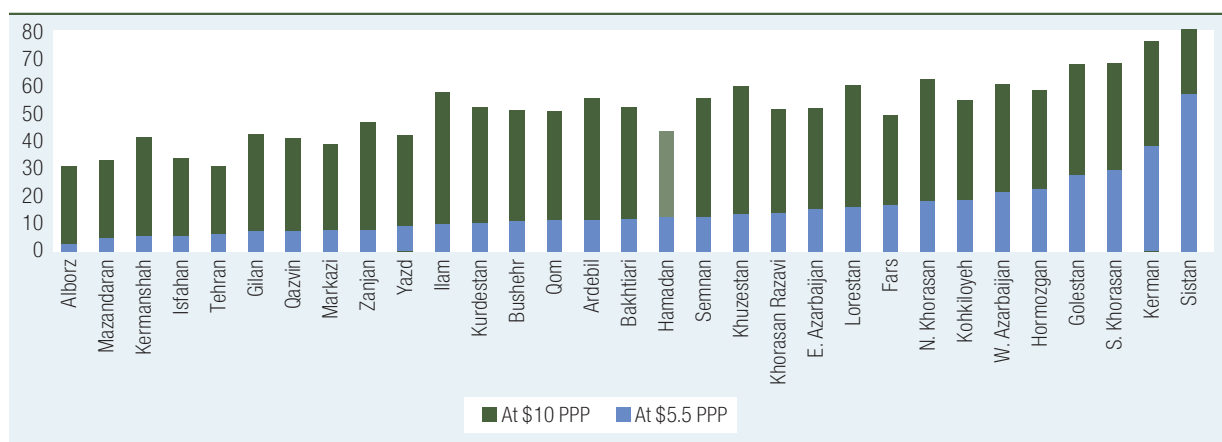


Source: Authors' calculations based on HEIS 2016/17-2019/20.

within rural areas continued to rise modestly in 2019/20. The small drop in national inequality is not a positive development. Firstly, as seen in the GIC earlier, the drop occurred because incomes and

person) to measure welfare or living standards. It follows standard procedures to construct the aggregates and implement price adjustments to ensure comparability within survey years and across them (Deaton and Zaidi, 2002; Haughton and Khandker, 2009). In the absence of a nationally defined poverty line, the minimum level below which a person is considered to be poor, the chapter presents figures based on the international upper middle-class line of USD 5.50 expressed in 2011 Purchasing Power Parity (PPP) terms (Jolliffe and Prydz, 2016).

FIGURE 25 • Headcount Poverty Rates (consumption per capita) at USD 5 and USD 10 2011 PPP by Province, 2019/20



Source: Authors' calculations based on HEIS 2019/20.

consumption fell faster for the top of the distribution, rather than because they grew faster for the bottom. Secondly, it is unlikely that this reduction in inequality will continue. Simulation analysis of the impacts of the COVID-19 pandemic and inflation in Iran point to rising inequality in 2020/21, given the disproportionate affectation of incomes for informal workers in services and high-contact jobs, who are concentrated among the poorest deciles (Box 1).

**National poverty numbers hide large within-country variations.** Rural areas and the Southeast<sup>17</sup> have a much higher incidence of poverty. The poor in Iran are located primarily in rural areas; in all the regions, the rural poverty rates are significantly higher than those in urban areas (Figure 28). Poverty is also heavily concentrated in the Southeast provinces of the country; the two with the highest poverty rates are located there: close to two-thirds of the people in Sistan and Baluchestan are poor, and the same is true for 40 percent of the population in Kerman (Figure 25). Meanwhile, poverty is 6 percent in the capital Tehran, and below 5 percent in the least poor provinces of Alborz, Mazandaran and Kermanshah.

**The welfare of the poor and vulnerable is closely tied to developments in labor incomes, the fall of which accounted for more than half of the increase in poverty between 2018/19–2019/20.** One way to better understand the underlying factors behind observed changes in poverty and inequality is to decompose them into

changes in the various income sources (Azevedo, Sanfelice and Nguyen, 2012).<sup>18</sup> Total income consists of labor income, cash and other transfers, pensions, and other incomes (property income and income from products sold from home).<sup>19</sup> The main contributors to poverty changes are the same as in previous years (see World Bank, 2020a). The fall in labor incomes accounted for 1.5 of the 2.5 percentage points total increase in poverty between 2018/19 and 2019/20 (Figure 26). The continued erosion in the real value of cash transfers was the second-largest contributor to the poverty increase. This seemingly counterintuitive effect of cash transfers on poverty can be explained by their declining real value due to high inflation<sup>20</sup> and because any change in these transfers affects

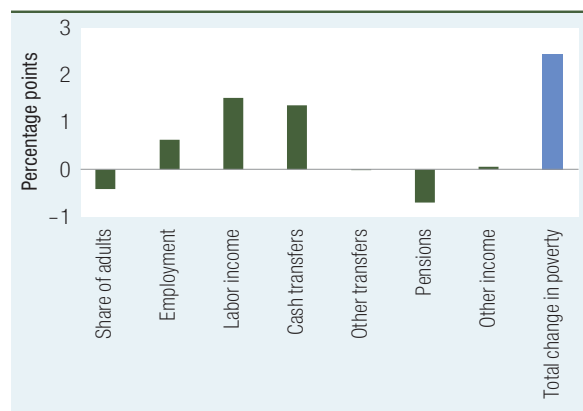
<sup>17</sup> Provinces are grouped into regions. See note in Figure 28 Headcount poverty rates (consumption per capita) at USD 5.5 2011 PPP by region, 2019/20.

<sup>18</sup> The exercise is conducted using income poverty and inequality. Although the indices are higher than consumption-based ones, the trends are qualitatively similar.

<sup>19</sup> The income aggregate is spatially deflated to account for the difference in prices across different areas. A weighted spatial deflator was constructed by combining rent and food deflators. Shares of rent in the total welfare aggregate were used to construct a weighted deflator for each household.

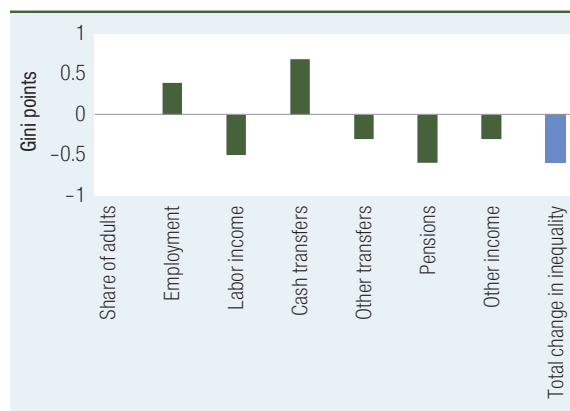
<sup>20</sup> The nominal amount of transfers was kept constant from 2018/19 to 2019/20.

**FIGURE 26 • Sources of Income Poverty Changes (USD 5.5 2011 PPP poverty line), 2018/19-2019/20 (percentage points)**



Source: Authors' calculations based on HEIS 2018/19 and 2019/20.

**FIGURE 27 • Sources of Income Inequality Changes (Gini coefficient), 2018/19-2019/20 (percentage points)**



Source: Authors' calculations based on HEIS 2016/17–2019/20.

the poor disproportionately more, as they comprise a larger share of their household income.

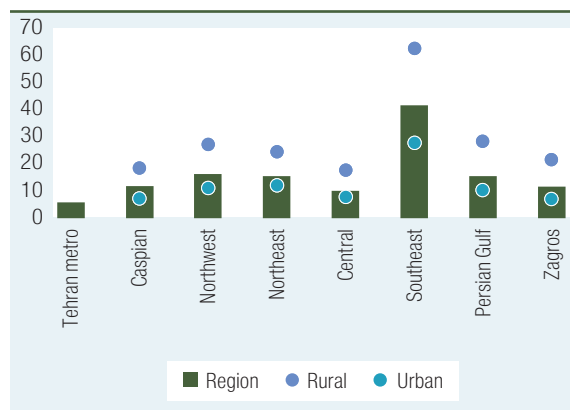
**Pensions and labor income were the main contributors to the small decline in inequality.**

Although only a small share of poor Iranians received some pension (2.7 percent in the bottom quintile), this source of income was among the few that slightly rose in 2019/20 (1.2% on average and 3.6% for the bottom 40 percent), contributing to a decline in inequality. In contrast, the negative contribution of labor income to the inequality was not because these incomes grew, but because their decline was slightly larger for the top 60 percent of the population compared to the bottom 40 percent. The inequality increasing effect of cash transfers is again explained by the erosion of their real value due to inflation, which was more pronounced for the poor.

**Despite relatively moderate poverty levels for an upper-middle income country, many Iranians were living closely above the poverty line at the outset of the pandemic.**

Figure 29 shows the distribution of the rural and urban populations ranked by household consumption per capita. The bulk of the population, especially the rural one, lived with a consumption level close to the poverty line of USD 5.5 (2011 PPP), as indicated by the mode of the distribution being near this value. Most of the urban population was concentrated above the poverty line but still below USD 10 (2011 PPP), sometimes

**FIGURE 28 • Headcount Poverty Rates (consumption per capita) at USD 5.5 2011 PPP by Region, 2019/20**



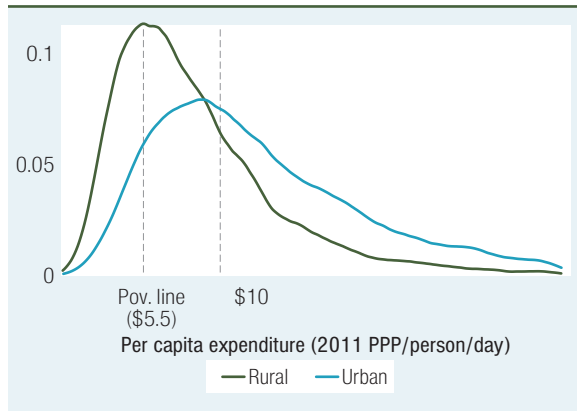
Source: Authors' calculations based on HEIS 2019/20.

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 and Baluchestan, Yazd); Persian Gulf (Khuzestan, Bushehr, Hormozgan); Zagros (Kermanshah, Kurdistan, Hamadan, Bakhtiari, Lorestan, Ilam, Kohkiluyeh).

considered a threshold for a global middle-class line (e.g., Lopez-Calva and Ortiz-Juarez, 2014).

**Consequently, there was a sizeable group of vulnerable households in an insecure economic situation.** It is useful to divide the population into quintiles according to their welfare level (consumption per capita) to examine the characteristics of the different segments. The poor are in the bottom quintile, while

**FIGURE 29 • Distribution of Consumption Per Capita (USD 2011 PPP) by Rural and Urban Areas, 2019/20**



Source: Authors' calculations based on HEIS 2019/20.  
 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 and Baluchestan, Yazd); Persian Gulf (Khuzestan, Bushehr, Hormozgan); Zagros (Kermanshah, Kurdistan, Hamadan, Bakhtiari, Lorestan, Ilam, Kohkiluyeh).

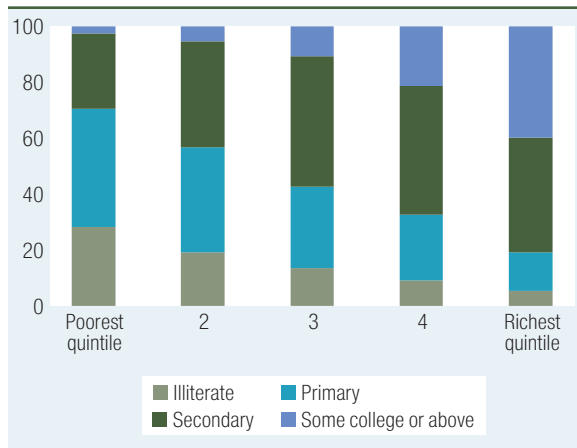
those above the poverty line but potentially vulnerable to shocks are in the second quintile. In 2019/20, their median consumption per capita per day was USD 7.6 (2011 PPP), only marginally above that of the poorest quintile (USD 4.8 in 2011 PPP) and the poverty line (USD 5.5 in 2011 PPP). The composition of their household income was similar to that of the poor, with a large share derived from employment or transfers (Figure B4.3),

both sources significantly affected by the pandemic and high inflation. But the vulnerable relied more on self-employment, which represented a third of their income (compared to a fifth of the poor's income), than on government cash transfers, which represented 10 percent of their income (compared to 20 percent among the poor), making them more at risk of income losses during the pandemic and less likely to benefit from government assistance. Lower educated households were more likely to be among the poor and vulnerable alike (Figure 30). Female-headed and larger households with more dependents were common among the poor but less so among the vulnerable (Figure 31).

**Pre-pandemic, poverty had been steadily rising in Iran and many households who were not necessarily poor were also struggling. The COVID-19 pandemic will substantially raise poverty and amplify disparities in the country. In this context, the need to support the most vulnerable Iranians is significant.**

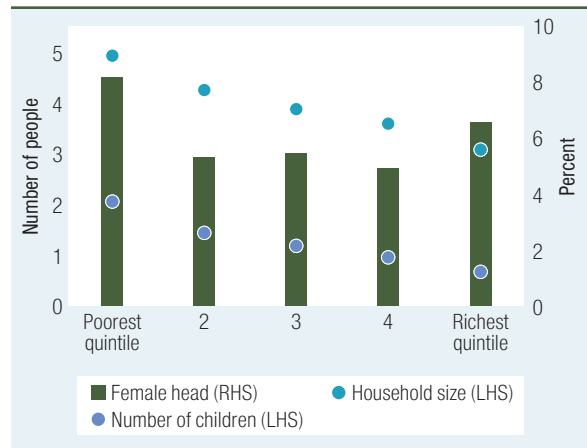
The latest official household survey data from the 2019/20 HEIS shows that the pandemic struck when many households were already struggling with the economic downturn and cost of living increases of recent years. While the extent of the impacts will not be fully known until new data collected during and after the pandemic becomes available, the outlook is bleak. With many Iranians already living closely above the poverty line and vulnerable to income fluctuations and shocks, poverty is expected

**FIGURE 30 • Head of Household's Level of Education by Quintile, 2019/20**



Source: Authors' calculations based on HEIS 2019/20.

**FIGURE 31 • Female Headed Households and Household Size by Quintile, 2019/20**



Source: Authors' calculations based on HEIS 2019/20.

## BOX 4 COVID-19 AND INEQUALITY IN THE MIDDLE EAST AND NORTH AFRICA (MENA) AND IRAN

**The socioeconomic effects of the COVID-19 pandemic are unprecedented.** Beyond the average impact, what has received less attention is that its consequences are borne unequally. Across the globe, the negative effects are being disproportionately borne by those who, pre-pandemic, were already disadvantaged and vulnerable (Hill and Narayan, 2020; Oxfam International, 2021). This Box focuses on the inequality effects of COVID-19 in the Middle East and North Africa (MENA) region and in Iran specifically.

**The number of poor in the MENA region is estimated to increase by at least 3 million people.** The COVID-19 outbreak exacerbated a series of problems that characterized the region before the crisis, such as high shares of inactivity especially among the youth, inequality in education, high levels of informality, and large gaps in economic opportunities for women. The pandemic is the fourth crisis to hit the region in the past decade, after the Arab uprisings, the 2014–2016 decline in oil prices, and the 2019 resurgence of protests in countries that had escaped the first wave in 2010–2011 (Yahya, 2020). It deserves special consideration, because of its overall impact, and particularly because of its distributional consequences. Rising inequality reduces the scope for a rapid recovery as inequality is detrimental to economic growth (Madsen et al., 2018). Moreover, the perception that the better off navigate the pandemic relatively unscathed while the most vulnerable are left coping with the brunt of its impact, deepens societal stresses. It reinforces the need to invest in restoring social contracts, which in the region were already being challenged by low levels of trust in public institutions and high levels of life dissatisfaction.

**There are two main reasons why inequality increases due to COVID-19.** First, the health of poor and vulnerable citizens is affected more by the virus as they have greater exposure, are more likely to have underlying health conditions and fewer treatment options. Poor households across the region tend to be larger, multigenerational, and poor people are more likely to be engaged in the informal sector and in activities with intensive human interaction (food preparation, transport, construction), all risk factors for COVID-19.

Second, the economic effects of COVID-19 affect the poor and vulnerable disproportionately too. Many statistical agencies started collecting data to assess the socioeconomic impacts of COVID-19 on households. The case of Tunisia, where five rounds of a phone survey were implemented between April and October 2020, is illustrative. Poor and vulnerable households were more likely to report a deterioration in welfare relative to the month before the interview (Alfani et al., 2021). The probability of a respondent declaring a worsening in living standards was positively correlated with a lower education level and with being younger, as well as with not being employed, being self-employed, or a contributing family worker at the time of the survey (compared to someone working as a civil servant) (Figure B4.1). A private sector employee receiving a partial salary, or no salary at all, also had a higher probability of reporting lower living standards than a civil servant receiving a full salary (38.5 and 19.5 percent, respectively). Similarly, respondents employed as non-wage workers with lower than usual, or no business income at all, had a higher likelihood (29.5 percent) of experiencing lower living standards, compared to a civil servant receiving a full salary. Households that were wealthier before the pandemic had a lower likelihood of reporting a deterioration in living standards than those in the lowest consumption quintile. The insights from Tunisia are typical for other countries in the region. Across MENA, poorer households are more likely to lose their income due to COVID-19 as they are disproportionately engaged in activities that shut down due to quarantining and other public health measures.

**Those same phone surveys demonstrate that mitigation measures are limited in scope and insufficient to avoid significant increases in poverty.** Relatively few households benefited from cash transfer programs, largely because many are informally employed and therefore outside the existing benefit schemes (Figure B4.2). Even the most extensive transfer systems only reached 25 percent of the poor. Therefore, the fraction of households reporting to be food insecure has reached dramatic levels. In Palestine, as many as 42 percent of households reported consuming less food, 26 percent in Djibouti and 16 percent in Tunisia. In Iraq, almost half the households implemented at least one negative coping strategy (such as the sale of assets) to make sure the family has enough to eat. The exception may have been Morocco, which rapidly scaled up cash transfer programs to reach 5.2 million people (about 20 percent of the working age population) who had lost their jobs in the informal sector and requested government assistance (Lopez-Acevedo, 2021).

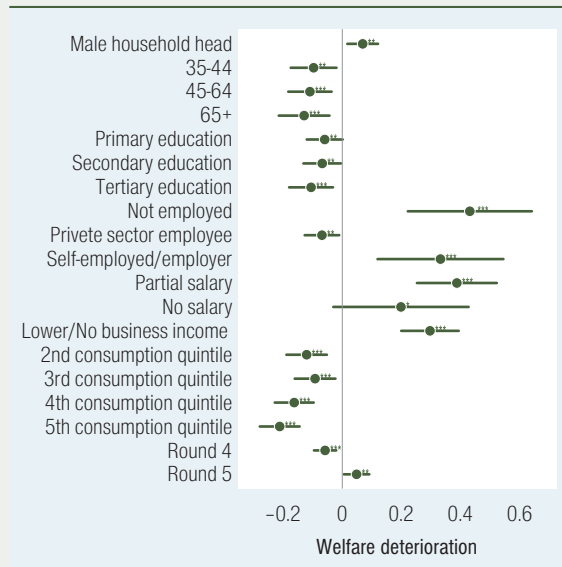
### Evidence of the impact of COVID-19 on inequality in Iran

**In Iran, the pandemic also had different impacts on households across the welfare distribution and in different regions of the country.** In the absence of real-time data, a microsimulation analysis conducted using recent household survey data (Rodriguez and Atamanov, 2021) helps to shed light on the unequal impacts of the pandemic and high inflation in the country. The analysis shows that not only poverty will substantially rise, by up to 21 percentage points, as a combined result of the fall in household incomes and inflation through the pandemic, but also, since Iranians in the bottom of the welfare distribution are disproportionately affected, inequality measured by the Gini index will also rise by 2 points as a result.

**The high inflationary trend that the country was experiencing since mid-2018 continued and intensified in 2020 in parallel to the pandemic.** By October 2020, the average household consumption basket was 1.3 times more expensive than at the beginning of the year, but not everyone was equally affected by rising living costs. The degree to which purchasing power declines with inflation depends on the items that households consume and on spatial variations in price increases. For instance, food items had the highest price increases, and these rising food costs have deeper implications for the poor, who in Iran spend as much as 46 percent of their budget on these items. This

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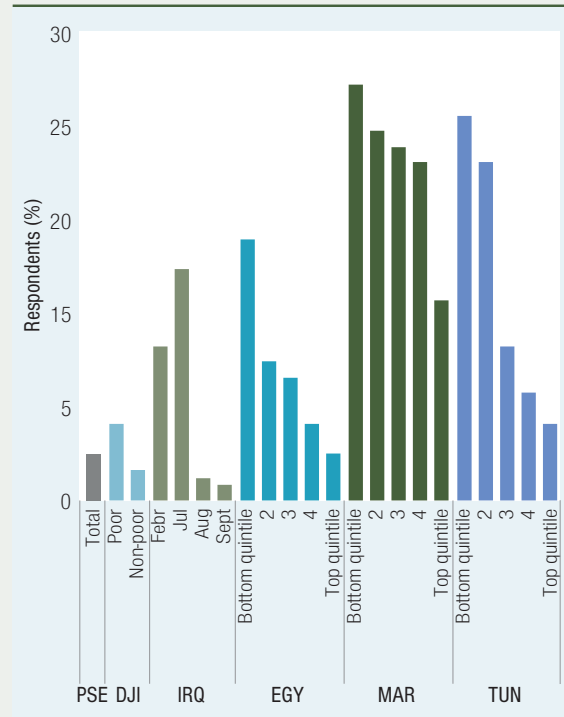
**FIGURE B4.1 • Probability of Declaring a Deterioration in Living Standards Compared to the Month Before the Interview, Tunisia**



Estimation coefficients of a linear probability model. Reference categories: 15–34; no education; public sector employee; full salary, business income as usual or more than usual; Quintile 1; Round 3.

Source: Alfani et al., 2021. Estimation based on data from the Enquête téléphonique auprès des ménages pour étudier et suivre l'impact du COVID19 sur le quotidien des Tunisiens, Institut national de la statistique (INS) and World Bank.

**FIGURE B4.2 • Respondents to High Frequency Surveys Receiving Support from Public Cash Transfer Programs Following COVID-19, MENA**



Source: World Bank, 2020c.

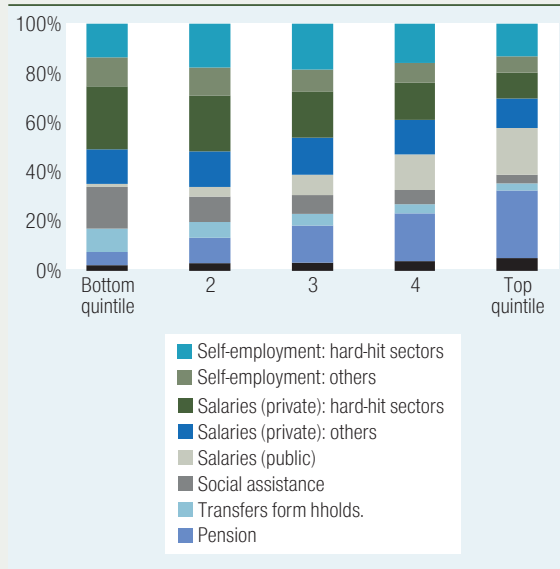
explains why the cost of the consumption basket rose more for households in the bottom consumption decile, especially in rural areas and in the poorer provinces of South Khorasan and Sistan and Baluchestan.

**Pre-pandemic income patterns also indicate a greater vulnerability of poorer households to earning losses arising from restrictions to work or reduced working hours.** Households in the lower half of the welfare distribution derive a greater share of their income from wages and self-employment in sectors that are more vulnerable to lay-offs or income reductions during the pandemic, such as construction, retail, transport, hotels and restaurants, communications, real estate, administrative and support activities and entertainment and art ('hard-hit sectors' in Figure B4.3). The poorest also derive up to a quarter of their income from social transfers, which in Iran have lost much of their real value in recent years because of high inflation. They were also more likely to receive private transfers from other households. While these transfers typically increase during crises to help cushion shocks, they are less likely to be a source of consumption smoothing during the COVID-19 pandemic as sending households across the country and the world also experience economic disruptions. Richer households, in contrast, are more likely to work in sectors more isolated from income shocks, including the public sector, and to receive pensions, both sources of income that are less volatile during hard times. Because of these differences in household income composition, the labor income and private transfers losses during the pandemic are estimated to result in a reduction in total household income of between 15 to 17 percent for households in the bottom half of the welfare distribution, and between 10 to 14 percent for those in the top half (Rodriguez and Atamanov, 2021).

**The recovery path from the pandemic is also likely to be uneven.** Poor and vulnerable people will continue to experience the effects of prolonged income shocks and diminished job opportunities. Those who lose their jobs or are out of the labor force will struggle to (re)enter the job market; the longer people are out of a job, the harder this will be. In Iran, as in other neighboring Mashreq countries (World Bank, 2020b), the very low female labor force participation and employment, even among younger women (Figure B4.4), is likely to be exacerbated by the COVID-19 pandemic. The weaker labor demand will add to pre-existing barriers for women to obtain gainful employment, such as those related to social norms, legal constraints, access to childcare and safe transportation.

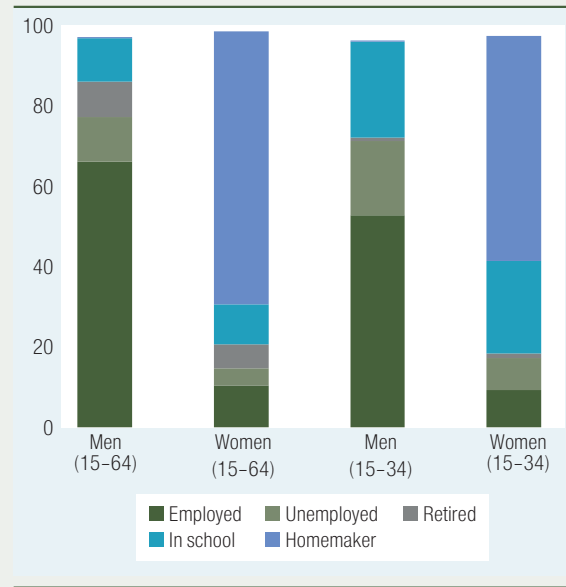
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FIGURE B4.3 • Household Income Sources by Consumption Per Capita Quintile, Iran



Authors' calculations based on HEIS 2019/20.

FIGURE B4.4 • Labor Force Status by Gender and Age, Iran



Authors' calculations based on HEIS 2019/20.

**The rising inequality has consequences for planning the post-COVID period.** Building back better will require to offer the poorest and most vulnerable the opportunity to regain what they have lost. Labor market, social protection, health and education policies will need to be (re) considered through a lens of equity and inclusion and considering how they can be designed in such a way that productivity and welfare are improved in a progressive way. This would allow to make up for the large losses that have been experienced, and help build the foundations for a stronger, more inclusive social contract.

to further increase as a consequence of the COVID-19 shocks which will heighten already strained household finances.<sup>21</sup> Additional cash transfers and social protection measures adopted in 2020/21 can partially offset the economic strain on the most vulnerable households but will remain insufficient in view of the country's larger structural challenges.

<sup>21</sup> Estimations from a microsimulation model suggest poverty will rise by close to 20 percentage points as a combined result of high inflation and income losses associated with the economic shock of the COVID-19 pandemic (Rodriguez and Atamanov, 2021).

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