

## **1. Iran in the World Today**

Iran is the second largest economy in the Middle East and North Africa (MENA) region after Saudi Arabia, with an estimated Gross Domestic Product (GDP) in 2015 of US\$393.7 billion. It also has the second largest population of the region after Egypt, with an estimated 78.8 million people in 2015. Iran's economy is characterized by the hydrocarbon sector, agriculture and services sectors, and a noticeable state presence in manufacturing and financial services. Iran ranks second in the world in natural gas reserves and fourth in proven crude oil reserves. Economic activity and government revenues still depend to a large extent on oil revenues and therefore remain volatile.

## **2. Government of Iran's Vision for the Future and Its Reform Agenda**

Iranian authorities have adopted a comprehensive strategy encompassing market-based reforms as reflected in the government's 20-year vision document and the sixth five-year development plan for the 2021-2016 period. The plan is comprised of three pillars, namely, the development of a resilient economy, progress in science and technology, and the promotion of cultural excellence. On the economic front, the development plan envisages an annual economic growth rate of 8 percent and reforms of state-owned enterprises, the financial and banking sector, and the allocation and management of oil revenues among the main priorities of the government during the five-year period.

The Iranian government has implemented major reforms of its subsidy program on key staples such as petroleum products, water, electricity and bread, which has resulted in a moderate improvement in the efficiency of expenditures and economic activities. The overall indirect subsidies, which were estimated to be equivalent to 27 percent of GDP in 2008/2007 (approximately US\$77.2 billion), have been replaced by a direct cash transfer program to Iranian households. Domestic fuel prices have risen in parallel, thereby contributing toward reducing the deficit of the Targeted Subsidies Organization (TSO) (estimated at 0.3- percent of GDP in 2015). A second phase of subsidy reform is being considered which would involve a more gradual fuel price adjustment than previously envisaged and the greater targeting of cash transfers to low-income households.

## **3. Recent Economic Developments**

Following the economic recovery experienced in 2014\*, the Iranian economy is estimated to have advanced at an annual growth rate of only 0.5 percent during the 2015 Iranian calendar year (i.e., March 2015 - March 2016). This performance came in spite of the signing of the Joint Comprehensive Plan of Action (JCPOA) in July 2016 and the significant economic prospects it offered. Inflationary pressures on the economy continued to abate under the less accommodative monetary policy stance, with the Consumer Price Index falling to 12.6 percent per annum in January 2016, from a peak of 45.1



percent in October 2012. Despite this positive development, the fiscal balance of the central government deteriorated due to low oil prices, from a deficit of 1.2 percent of GDP in 2014 to a deficit of 2.7 percent of GDP in 2015. Similarly, Iran's current account surplus is estimated to have deteriorated from a surplus of 3.8 percent of GDP in 2014 to a surplus of 0.6 percent of GDP in 2015 due to the fall in oil exports.

Stimulating private sector growth and job creation is a continued focus for the government considering the number of workers who should enter the labor market in the coming years, including women and youth and the persistently high unemployment rate (11.7 percent). Tackling youth unemployment in particular is a pressing policy issue in line with the evolving demographic profile of the country, which is characterized by more than 60 percent of its population estimated to be under the age of 30 in 2013.

#### **4. Poverty Conditions**

Poverty is estimated to have fallen from 15 percent to 9 percent between 2009 and 2013, based on a US\$5.5 a day line in 2011 PPP (Iran has no official poverty line). This was likely due to the implementation of a universal cash transfer program in late 2010, which preceded the elimination of subsidies on energy and bread. The cash transfer program appears to have more than compensated for the likely increase in energy expenditures of less-well-off households thus contributing to positive consumption growth for the bottom 40 percent of the population. However, the recession years took their toll, with overall consumption growth between 2009 and 2013 being negative.

#### **5. Economic Outlook**

The January 2016 lifting of the nuclear-related sanctions will provide a short-term boost to Iran's economy. For the recovery to be sustained, longstanding structural reforms are needed. Due to the lifting of the sanctions and a more business-oriented environment, real GDP growth is projected to reach 4.3 percent and 4.8 percent in 2016 and 2017, respectively. On the production side, growth will be mainly driven by higher hydrocarbon production. On the expenditure side, consumption, investment and exports are expected to be the main drivers. Notwithstanding the narrowing of the output gap over the coming years, inflation is forecast to remain moderate, by Iran's standard. The lifting of sanctions, and in particular the positive impact this will have on the banking system, will significantly reduce international transaction costs. Strong capital inflows, including FDI and the repatriation of part of the frozen assets, could put upward pressure on the Iranian Rial which will help contain imported inflation. Fiscal policy, is projected to be slightly contractionary with the deficit projected to narrow to 1.8 and 1 percent in 2016 and 2017, respectively, mostly on account of improved oil revenues. Iran's current account position is expected to turn into a surplus in 2017, also primarily driven by rising oil exports.

\*The economic recovery came as a result of the partial lifting of sanctions under the interim Joint Plan of Action (JPOA) signed between Iran and the P1+5 (i.e., China, France, Germany, Russia, the United Kingdom and the United

States) in November 2013, and the related rise in consumer and business confidence. Under the terms of the JPOA, Iran agreed to curb the development of its nuclear program while the international community enacted a temporary and partial easing of sanctions on the country. These sanctions relief included the partial removal of constraints on Iran's oil exports, and the supply chain in key sectors of the economy—such as in the automobiles industry—and on international and domestic banks' international transactions, as well as partial access to Iran's frozen assets held abroad.

All references to calendar years herein designate the Iranian calendar year, which runs from March 21 to March 20 of the following year.

#### Outlook

Iran's economy is expected to grow at an annual average rate of %4.6 in -2016 2018. Over the medium term (2018-2017), investment is likely to play a much larger role in generating growth on the assumption that new investment deals currently being negotiated will materialize in 2017 and 2018, and financial linkages with the rest of the world will be restored.

Meanwhile, inflation is expected to ease into single digits (%8.6) in 2016 for the first time since 1990 as a result of lower commodity prices and easing import costs in the wake of lifting of the sanctions, but could edge higher in -2017 2018 if oil prices recover.

The fiscal balance is projected to improve by 1.2 pp (percentage point) to %0.4-of GDP in 2016 as a result of an expected surge in the volume of oil exports and a parallel increase in non-oil revenues, and to move into surplus in -2017 2018. The current account surplus should start improving in 2016 and reach %4.1 in 2018 as increased energy exports more than offset the rise in imports stemming from lower trade costs and increased domestic consumption.