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Iran's Battered Economy

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On 19 February 2020, Iran's first confirmed COVID-19 cases were reported in the city of Qom. The announcement was delayed in order to prevent people from being discouraged to vote in parliamentary elections on 21 February. The Chinese connection seems to be a key reason behind the outbreak and spread of the virus. The Iranian epicenter of COVID-19, Qom, the Shia holy city, had a strong Chinese presence; from the construction of high-speed rail and subway infrastructures to an estimated seven hundred Chinese seminarians studying theology there. The spiritual leader of Iran's Sunni community suggested that Chinese students at Qom's Al-Mustafa International University, an international Shiʿa seminary involved in propagating the political ideology of the Islamic Republic, were the source of the virus in Iran.

In June 2019, Iran had announced visa-free entry for Chinese nationals, which boosted Chinese tourism. Crucially, when Iran's neighbors had halted their China flights by early March of 2020, Mahan Air—affiliated with the Islamic Revolutionary Guard Corps (IRGC)— continued operating between Iran and several Chinese cities. Given the desire to re-orientate Iran's trade towards China, the Chinese COVID connection became a very sensitive issue for the Iranian leadership.[1]

Following the outbreak, the government introduced measures to limit the spread of the virus, including stopping flights from China, closing schools, malls and markets. It also closed key religious sites, and banned cultural and religious gatherings. On 25 March, President Rouhani announced a partial lockdown, closing businesses and government offices for two weeks and banning travel between different cities. In March and April, the purchasing managers' index (PMI: an indicator of the state of business) collapsed.

On 8 April, concern about this collapse resulted in the government ordering a step-by-step reopening of those businesses that it considered to be at low or average risk in terms of spreading the virus. On 27 April, Iran reopened all international borders to revive regional trade, and in mid-May mosques and schools reopened. On 26 May all the remaining restrictions of businesses and major religious sites were eased. While the PMI in May and June suggested that industries had started to recover, in July it registered a 6.4 percent contraction.[2]

Iran is now facing a "second wave" of virus cases with a shortage of medical personnel and hospital beds. The government has instituted mandatory mask-wearing and announced new restrictions in Tehran in July, all schools and universities, restaurants, cafes, cultural facilities and beauty salons were closed and a third of government employees in Tehran were ordered to work from home. In early August, President Rouhani said that the state of emergency designed to contain the pandemic will remain in place at least until the end of January 2021.[3]

In April, the government allocated extra funding for the health sector (equal to 2 percent of GDP); cash transfers to vulnerable households (worth 0.3 percent of GDP); support to the unemployment insurance fund (0.3 percent of GDP); and subsidized loans for businesses affected by the pandemic and vulnerable households (4.4 percent of GDP). In addition, it announced a moratorium on tax payments for a period of three months (6 percent of GDP). Issuing $1.1 billion of bonds, the National Development Fund and privatization proceeds will provide part of the financing.[4]

On 15 April, the government embarked on its biggest-ever initial public offering, selling its residual shares in 18 companies, including 12 percent share of Social Welfare Fund (SHASTA), the largest public company, to generate income as it struggles with the economic consequences of COVID-19 and U.S. sanctions. The estimated privatization proceeds are at around 165 trillion rials (0.6 percent of GDP) from banks and insurance companies and 70 trillion rials (0.2 percent of GDP) from SHASTA. The total is equal to about $3.6 billion. In August the government announced that shares of four state-owned oil refineries would be sold to the public.[5]

The Central Bank of Iran has announced the allocation of funds to import medicine; agreed with commercial banks that they postpone by three months the repayment of loans due in February 2020; offered temporary penalty waivers for customers with non-performing loans; and expanded contactless payments and increased the limits for bank transactions in order to reduce the circulation of banknotes and the exchange of debit cards.

Since March 2020, the rial has fallen by nearly 70 percent and reached 260,000 to the dollar. Three years ago, before the United States pulled out of the 2015 nuclear deal and re-imposed sanctions, the rial traded at 32,000 to the dollar. The Central Bank of Iran has injected around $3 billion into the foreign exchange market to stabilize the rial's exchange rate. In mid-July alone, it injected $920 million into the foreign exchange market to boost the country's currency against the U.S. dollar. As a result of these interventions, the rial rose temporarily and then fell again.

U.S. sanctions have almost completely dried up Iran's oil export revenues and seriously hurt non-oil exports. The government has been withdrawing money from its foreign currency reserves, which according to the International Monetary Fund will decline by $19 billion this year, to $85 billion. In 2021 the IMF forecasts a further $16 billion decrease of reserves to $69 billion.[6]

Nine months ago, *Iqtisadi* noted that Iran was under severe internal and external pressure. Economic pressures had pushed the government to increase petrol prices and this resulted in riots and many deaths. During the last decade, the economy has barely grown and income per capita has fallen by an annual average of one percent.[7] Since then, the COVID-19 crisis has made matters much worse. On the basis of Iranian official data, on 14 September 2020, it had recorded almost 400,000 cases and over 23,000 deaths, the 12th largest number of cases and the 11th largest number of deaths worldwide.[8]

In the three fiscal years, 2018/19 to 2020/21 Iran's national income is expected to decline by 20 percent and national income per capita by 23 percent.[9] This has been the result of underlying structural problems, as well as sanctions that have badly affected its oil industry and the COVID-19 crisis.

Table 1 shows how economic indicators have deteriorated. In 2016/17 economic growth accelerated as a result of the easing of sanctions. While positive growth continued in 2017/18, it was much slower. Agricultural production was influenced by economic policy and water-shortages that are becoming ever more serious, but wheat production rose to an all-time peak of 16.8 million tons in 2019. The most noticeable change was in the industrial sector that is heavily reliant on imports. Much of Iranian industry consists of the sub-assembly of products using foreign inputs. The dramatic decline in output estimated in 2018/19-2020 of over 25 percent included a fall in automobile production from 1.4 million in 2017 to 860,000 in the year to March 2020.[10]

Public and personal services, also experienced slower growth. All the main economic aggregates – private and public consumption, investment, exports and imports declined. According to the 2019/20 estimates, all experienced negative growth.

Table 1: Macro-economic indicators, 2016/17-2019/20 (percent change)

	2016/17	2017/18	2018/19 estimate	2019/20 estimate
GDP	12.5	3.7	-4.4	-7.3
Agriculture	4.2	3.2	1.5	2.1
Industry	24.7	3.0	-9. 5	-16.5
Services	3.7	4.5	0.2	0.5
Private consumption	3.8	2.5	-2.2	-6.1
Government consumption	3.7	3.9	4.5	-2.4
Investment	-3.7	1.4	-5.5	-2.0
Exports	41.3	1.8	-13.6	-30.4
Imports	6.1	13.4	-38.3	-26.0
Inflation (end year)	11.8	8.3	47.5	22.0
Current account balance (% GDP)	3.9	3.5	5.3	-0.4
Fiscal balance (% GDP)	-1.9	-1.8	-1.4	-5.4

Source: World Bank, Iran Economic Monitor, Spring 2020.

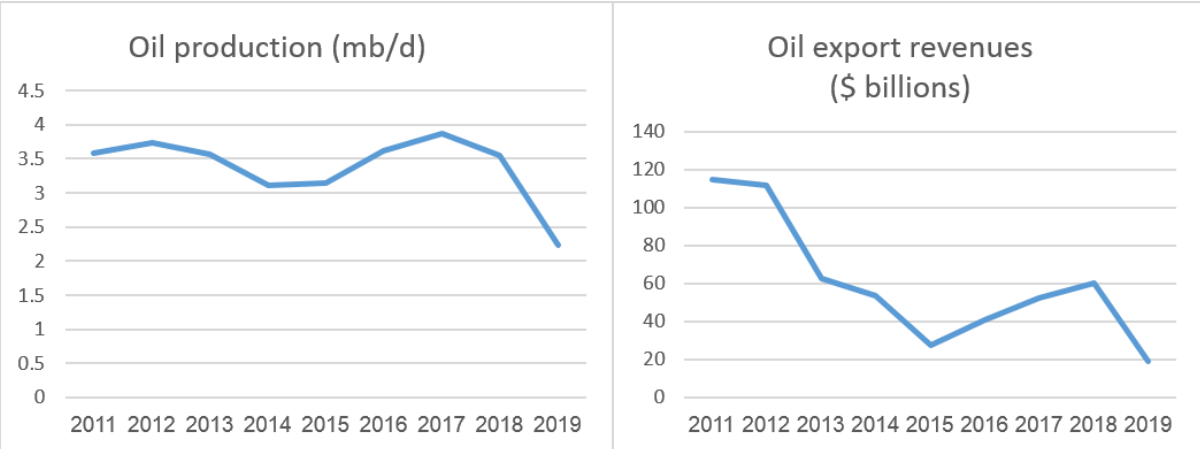
Although the rate of inflation fell in 2018/19 compared with the previous year, it has accelerated this year. The consumer price index in the year to August 21, (the end of the fifth Iranian month), increased by 25.8 percent compared with the corresponding period of the last fiscal year, according to data released by the Statistical Center of Iran.[11]

The country faces serious housing shortages and the costs of construction has been pushed up as a result of the devaluation of the Iranian riyal on the free market by over 50 percent since the beginning of 2020. This was also true of the most important exchange rate, which is rarely cited, the so-called NIMA exchange, a centralized electronic system established by the Central Bank of Iran in 2018 to streamline the purchase and sale of foreign exchange by Iranian companies.[12] As a result, the Tehran housing price index increased by 46.4 percent in the year to July 21. The metropolitan area of Teheran has a population exceeding 15 million (18 percent of Iran's population).[13]

One of the worst consequences of the pattern of negative economic growth has been high unemployment. In 2019, unemployment was estimated at 13.6 percent (3.8 million) and in 2020 it is forecast at 16.3 percent (4.6 million). Like other countries in the Middle East, unemployment rates among the young are even higher. In 2019, the rate among females aged 15-24 percent it was 41.9 percent and among males aged 15-24 years was 23.4 percent.[14]

Oil is Iran's leading sector. Chart 1 shows the decline in oil production since 2017 and the fall in oil export revenues since 2011. Oil export revenues recovered with the easing of sanctions in 2016 by the Obama administration but were hit by their renewal in 2018.

Chart 1: Oil production and export revenues, 2011-2019



Source: OPEC

The loss of oil export revenues has affected the balance of payments, reducing the foreign currency earnings that Iran needs to pay for its imports. It has also reduced government revenues. In 2011/12, 51 percent of government revenues came from the oil sector; by 2018/19 they had fallen to 38 percent.[15] Iran's balance of payments has been affected by the fall in oil export revenues on the military.

Despite budget pressures, a nine percent real increase in military spending has been reported this year, with the Islamic Revolutionary Guard Corps receiving the main part of the rise.[16] This is an indication of the importance of the Guards to the regime.

In April 2020, a report released by the Iranian Parliament's Research Center stated that the COVID-19 pandemic would accelerate inflation and that the government's expectations for non-petroleum-based GDP growth during the same period would not be met due to sanctions re-imposed by the US and COVID-19 and falling domestic consumption of goods and services. As a result, GDP would fall by between 7.5—11 percent, resulting in the loss of 2.8—6.4 million jobs. The report concluded that uncertainty along with economic stagnation or decline would cause many businesses to collapse and increased poverty. The main external challenge comes from US sanctions, which hit private businesses by severing international financial links. These have constrained both exports of finished products and imports of necessary raw materials and machinery, impeded access to required software, and blocked online services. The incompetence of Iranian policymakers and lack of flexibility and engagement in supporting the private sector, massive bureaucracy, and corruption were also cited in the report as factors causing economic damage.

In April 2020, Iran requested an emergency loan of $5 billion from the IMF, the first such request since the revolution forty-one years ago. This was to be used in the fight against the pandemic. Funds would be earmarked for purchasing food, medicine, medical equipment, and other health-related goods and services. The recent scandal involving about $4.8 billion missing in government's funds coupled with US hostility have made it unlikely that Iran will receive the funds.[17]

While few businesses have financially benefited from the pandemic due to involvement in import, manufacturing and distribution of medicine, medical consumables and equipment, others in consumer products, general commerce, tourism, knowledge-based companies and technical startups, transportation, and hospitality sectors have incurred losses estimated at least $2 billion per month.[18]

Iran has sought to try to mitigate the economic effect of sanctions. Supreme Leader Khamenei publicly has called for the development of a "resistance" or "resilient" economy that is less dependent on imports and foreign investment with a special focus on the participation of the lower- and middle-income classes in the process of wealth creation. At the heart of the strategy were issues such as the promotion of a knowledge-based economy, increased efficiency, and subsidy reform, in addition to comprehensive reform of the financial systems, export promotion, and increased domestic value creation. During the past 10 years, Iran has promoted sales of petrochemicals and non-oil products. Sanctions compelled Iranian manufacturers to increase domestic production of goods as substitutes for imports.

The unfavorable developments that have been examined here pose severe challenges to the Iranian regime but the conclusion drawn in Iqtisadi nine months ago, that**,** forty years after the revolution, the regime's grip on power appears unshaken, remains true. Increased repression and the pandemic have made opposition to the regime even harder.

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