

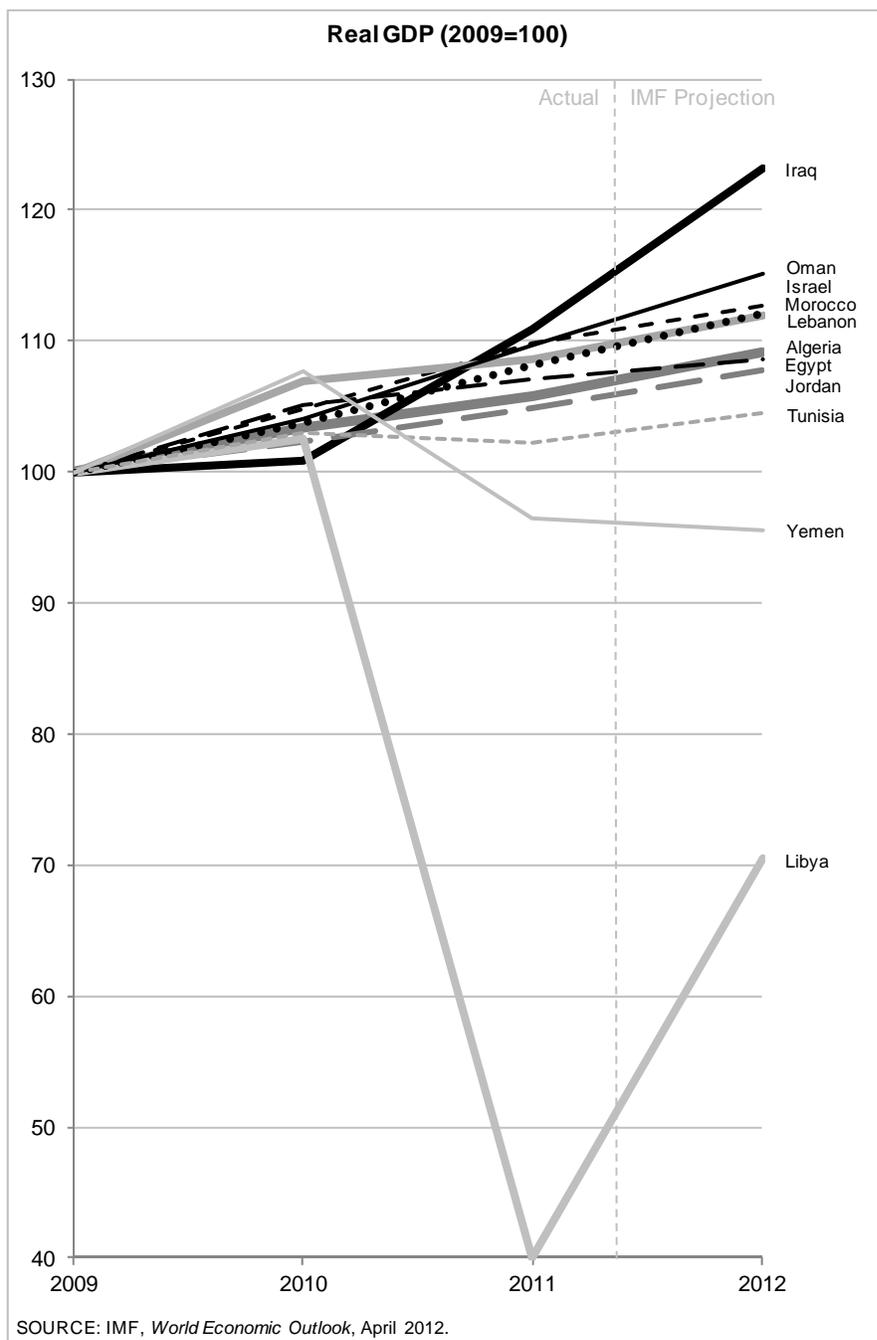


## Economic Overview

Real GDP growth for the Middle East and North Africa (MENA) region fell by half in 2011 from the 2010 pace. Faster growth is expected both this year and in 2013, but the pickup will be modest. Both the oil-exporting and oil-importing economies in the region are faced with sluggish growth rates.

For several of the oil-importing economies such as Egypt, Jordan, Morocco, and Tunisia, the texture and timing of the economic slump was broadly similar. In the first quarter of 2011, industrial production fell sharply. Both household and business confidence was hard hit the rest of the year, resulting in a fall off in consumption and investment. A jump in unemployment in Egypt from 9 percent to nearly 12 percent during the first six months of 2011 also undercut confidence in the economy.

But in general, the nature of slower growth rates varies among the economies, as well as among the policy options available to spur growth. Some MENA economies are more dependent on the European market than others, while only some MENA economies are oil exporters.



Middle East and North African economies included in this report are Algeria, Egypt, Iraq, Israel, Jordan, Lebanon, Libya, Morocco, Oman, Syria, Tunisia, West Bank/Gaza, and Yemen. Because of limitations on data, not all economies are included in every graph or narrative section.

Iraq's real GDP growth rates are hitting a double-digit pace, with the oil sector continuing to increase its output and the government's budget boosted by higher oil prices. Nearly every sector of the economy, including the oil sector, is suffering from weak infrastructure. In 2009, Iraq signed several "mega-deals" with major oil companies to build new production capacity. Three years later, a lot of work remains to be done in that sector. So long as investors are attracted by increased stability and revenues for the government are generated by firm oil prices, Iraq will be able to continue a rapid expansion for the next few years.

Lebanon had been the fastest growing economy in the region during 2008–2010, but recent trends are in line with the lackluster pattern in the region. In January 2011, the coalition government in Lebanon collapsed and the resulting political tensions quickly cut the pace of economic activity. By the end of 2011, some indicators pointed to faster growth, but many risks remain. The Lebanese economy also remains vulnerable to the political struggle in Syria. Tourism and trade have already been adversely affected.

Algeria's economy, by contrast, was only growing modestly from 2008 to 2010, but has since accelerated as higher oil prices improve the trade balance and boost fiscal revenues. Continued economic expansion during 2012–2013 is being supported by public infrastructure investment and capital spending in the oil sector. The biggest risk going forward for Algeria is the heavy reliance on high oil prices for fiscal stability. Given the large increases in public spending, the budget will remain in balance only so long as oil prices are at least as high as \$100 a barrel.

Since 2009, the Jordanian economy has decelerated and real GDP growth has been below 3 percent each year. The 2012 budget signals the intent of the government to rein in the fiscal deficit. Higher revenues will come from eliminating tax exemptions and raising taxes on luxury goods. Spending growth will be restrained by freezing public sector hiring, reforming subsidies, and cutting operational costs of ministries. The Jordanian government has been shielding the country from higher oil prices, but is expected to resume letting the higher prices pass through to consumers this year. The negative wealth effect of higher energy prices will further tame the economic expansion.

The economy of the West Bank/Gaza is also being stressed. Real GDP annual growth averaged 9 percent from 2008 to 2010, according to IMF staff estimates (*Staff Report*, March 21, 2012) but fell to below 6 percent in 2011. Unemployment remains high at 17 percent. The immediate prospects for a return to rapid expansion are clouded by liquidity constraints, fiscal consolidation, aid cutbacks, and a slower world economy.

In 2009, Oman overcame sluggish economic growth and has been one of the fastest growing economies in the region. Higher oil prices and increased government spending are boosting growth rates while well-capitalized Omani banks help shield the economy from any European debt crisis spillovers. Oil revenues keep the government's fiscal balance in surplus even as spending rises sharply. The Omani government has alleviated social tensions associated with unemployment by spending on job creation and higher education.

Israel's projected real GDP growth rate for 2012 has been downwardly revised recently by the IMF, the Bank of Israel, and private analysts. After two years of near 5 percent growth 2010–2011, the expansion in 2012 and 2013 will be not much more than half that pace. Israel's economy is under strain from slower world economic growth, particularly in Europe, given that exports are 40 percent of GDP and Europe is a key market for its high-tech products. Regional political instability also puts a strain on the economy by undermining investor and consumer confidence. As the IMF and others have noted, however, the policy framework for Israel remains sound and has been strengthened since the 2009 economic slowdown. New fiscal rules, adopted as part of the 2010 budget, impose discipline to keep external debt from reaching unsustainable levels. Banking regulations have been effective at keeping household loan losses at low levels and curbing concentration risk in commercial lending.

Morocco, like Israel, is dependent upon trade ties to the European market. A strong performance by the agricultural sector, increased tourism, a rebound in phosphates exports, and robust domestic consumption are keeping its real GDP growth rates among the highest in the region. Growth has brought down the unemployment rate in recent years, but it remains high—particularly for youth. The budget balance, however, is being strained as the Moroccan government increases spending targeted at offsetting higher oil and food prices. In the original budget for 2011, for example, spending on subsidies for food and fuel were planned as less than 3 percent of GDP but have turned out to be around 5 percent.

## Political Upheavals and Economic Growth

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No economy was more whipsawed by the Arab Spring than Libya. During its conflict, oil production fell from an average 1.8 million barrels per day (bpd) in 2010 to only 22,000 bpd in July 2011. The IMF estimates that the economy contracted by around 60 percent in 2011. The departures of expatriate workers, disruptions to banking activity, limited access to foreign exchange, and destruction of infrastructure all contributed to the severe downsizing of the economy.

Tunisia's economic sectors reacted to the political turmoil in distinct ways. The mining and refining industries were hit hard. The country's main refinery was essentially shut down for most of 2011 and the sharp decline in phosphates mining damaged downstream chemical industries. By contrast, the demand for textiles and electrical goods was resilient. Export growth in those sectors cushioned the blow to the economy from declines elsewhere.

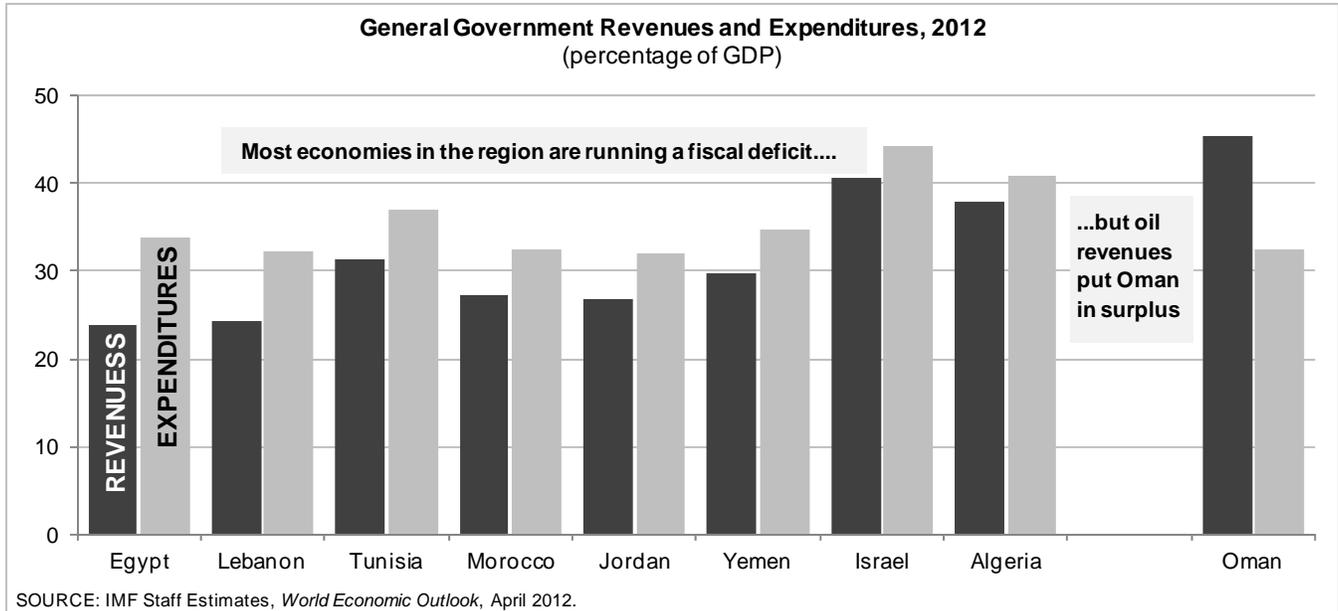
Egypt's political upheaval in 2011 had an immediate impact on the economy, cutting the real GDP growth rate by more than half and ending several years of relatively strong expansion. Given the size of the disruption to the economy during the first quarter of 2011, it is perhaps surprising that Egypt's economy managed to expand by nearly 2 percent in 2011. But the economic situation is also borne out in other indicators. Unemployment rates have been over 12 percent, the highest level since 1992. International credit ratings agencies have lowered Egypt's credit ratings multiple times in the past year, essentially pushing the country out of access to international bond markets.

Yemen's economy has been in decline for the past few years, even though the IMF is projecting a modest gain in 2013. Unlike the other oil-exporters in the region, Yemen has not been able to benefit from high oil prices and the nascent production of liquefied natural gas has yet to boost economic growth. Yemen's known oil reserves are dwindling rapidly and a transition to a post-hydrocarbon economy has barely begun. Infrastructure is of poor quality, groundwater supplies are being depleted, and the government's institutional capacity is weak.

Syria's economy is strained by its political conflict. Although GDP data are not available from the IMF, the *International Country Risk Guide* estimated that the Syrian economy contracted by several percentage points in 2011. European trade sanctions curbed the economy last year and new trade sanctions from the Arab League will further squeeze it. Sabotage to oil pipelines contributed to daily oil production falling by around 40 percent during 2011. Any potential stimulus from the rapid expansion of public spending is being offset by those negative factors.

The most salient factor in assessing the economic outlook for the MENA region remains how the many political upheavals settle over time. As the recent *Global Economic Prospects* (January 2012) noted about many economies in the region, "A failure to achieve political and macroeconomic stability would extend uncertainties, keeping investment and economic activity at low levels for several countries, potentially for an extended period of time."

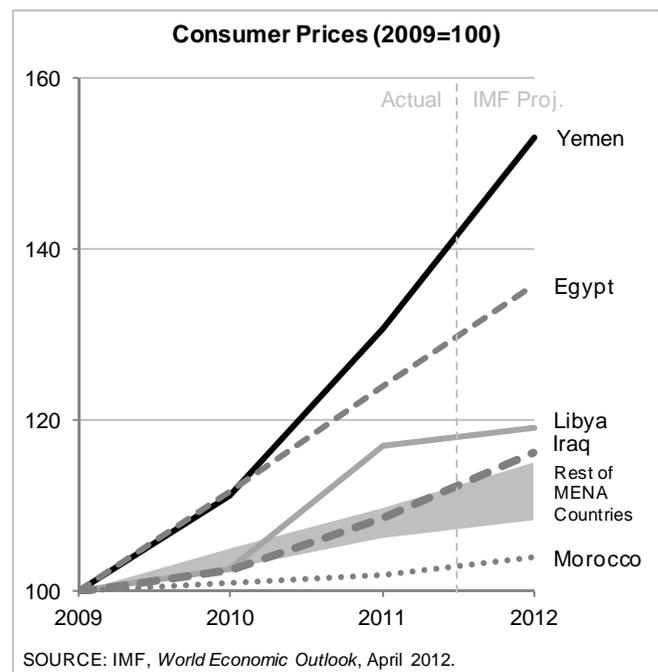
In confronting low levels of economic activity, not all governments will have the same scope for policy flexibility. As the graph on fiscal balances indicates, some economies are already running large deficits in need of consolidation. Oman’s oil-driven surplus puts it in the best shape, but Israel and Algeria also are in a relatively strong fiscal position. By contrast, Egypt and Lebanon are the most constricted with respect to options for policy flexibility.



## Inflation

For most of the MENA region, inflation is currently not a major issue, ranging from 2–5 percent at an annual rate. The biggest exceptions are Yemen and Egypt, both of which are in periods of double-digit annual price increases. Inflation in Iraq, as the economy expands rapidly, is beginning to move above regional norms. The IMF projects that inflation in Iraq will be 7 percent in 2012, still below the 10 percent projected for Egypt and 17 percent for Yemen.

Price pressures are not completely absent elsewhere in the region. In Jordan, inflation was held below 5 percent in 2011 partly by a government policy of not completely passing through international oil price increases to domestic consumers. There will be price hikes in 2012 for energy as the government, in response to the need to tighten its fiscal stance, reduces the subsidies which had kept prices low. The Central Bank of Jordan, however, has demonstrated its ability to manage monetary policy and is disciplined by the policy of maintaining an effective peg of the Jordanian dinar to the U.S. dollar.



Algeria also used subsidies to shield the domestic population from some food price hikes in 2011, keeping overall inflation around 4 percent. There is a risk of food supplied locally rising in price during 2012 and civil servant pay raises could also nudge inflation higher.

In other economies in the region, price pressures are genuinely modest. In Tunisia, inflation eased to below 4 percent in 2011 and would have fallen more sharply in the absence of higher food and energy prices. In Morocco, favorable local harvests in 2011 pushed food prices down and the overall inflation rate remains below 2 percent. In Oman, inflation has been steady at around 4 percent a year and monetary policy has been able to support continued economic growth.

Some economies are achieving low inflation rates and improving their capacity to manage the economy. Israel's central bank legislation from 2010, according to an IMF report, "now stipulates price stability as the primary objective of monetary policy, and has strengthened the Bol's autonomy, transparency, and governance."

In West Bank/Gaza, IMF Staff estimate that the annual inflation rate was about 3 percent in both 2010 and 2011. In Gaza itself, greater availability of consumer goods in 2011 caused a small deflation in the overall price level. The combined 3 percent inflation rate includes a higher inflation rate in the West Bank.

## Investment

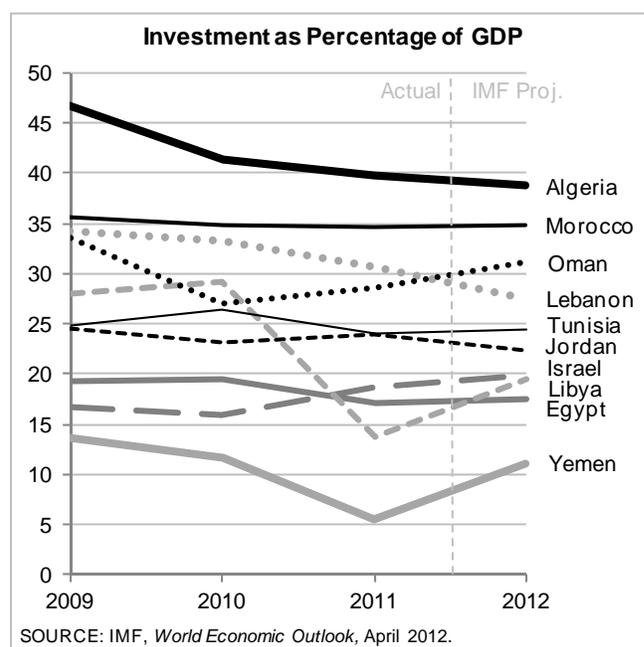
A general impact of the political upheaval in the MENA region has been a blow to investor confidence, at least in the short run. For most economies, the investment ratio (investment as a percentage of total GDP) was either down or flat in 2011. Although national accounts data are not available for either Libya or Syria for 2011, investment activity is estimated to have fallen sharply. Data are also not available for Iraq, but investment probably increased in 2011 and would be projected to do so in 2012.

Among those countries with data, a downturn in investment was particularly noticeable in Egypt, Tunisia, and Yemen. The biggest exception to the trend was in Oman, where investment spending relative to GDP was up notably. Omani banks, relatively insulated from any euro zone tribulations, are able to keep lending growing apace.

In Algeria, the lower investment ratio in 2011 and 2012 still leave it with the highest in the MENA region. One support to investment now is an ambitious Public Investment Program (PIP) for expanded infrastructure (2010–2014).

In Tunisia, the drop off in investment spending was concentrated in the oil and phosphates sectors, but it was large enough to offset consumption gains. As a result, overall GDP contracted in 2011.

The euro zone is an important export market for many MENA economies, so economic problems in Europe will feed back to less investment in MENA through the trade channel. But the financial channel is less significant for



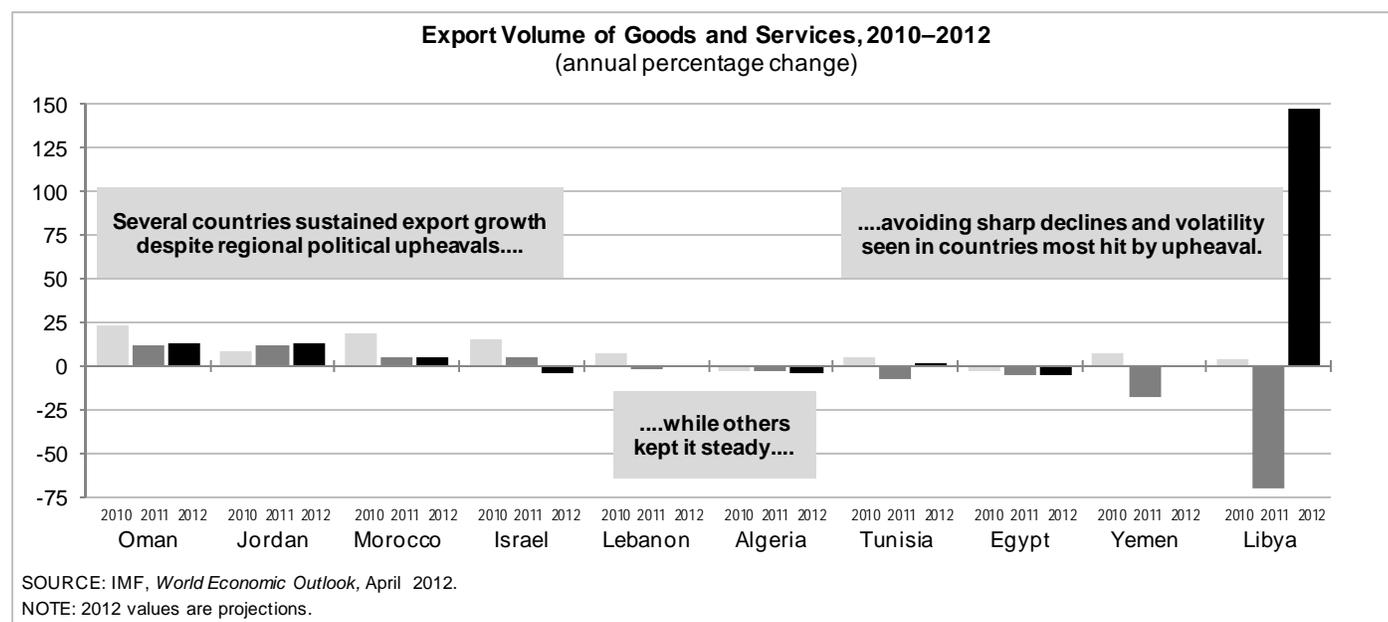
MENA economies. In most of them, modest inflation and accommodative monetary policies will continue to facilitate credit growth to support investment.

## Trade

Political upheaval and regional insecurity dampened trade flows in the MENA region during 2011 as energy and manufactured goods supply was cut and inbound tourism was discouraged. But the weakness in trade was not a consistent pattern across countries.

Trade conditions remained highly favorable for Oman due to an expanding oil sector. In the cases of Jordan and Morocco, exports were boosted by strong global demand for phosphates and fertilizer.

For Tunisia, the volume of exports in textiles and electrical products rose in 2011, partially offsetting the fall in mineral and petroleum products shipments. But a decline in worker remittances (Tunisian migrants returned from Libya) and tourism added to the weakening of the external position. The current account deficit in Tunisia widened by around two percentage points of GDP during 2011, to nearly 7 percent. Conditions are more favorable for 2012, but a strong rebound in export earnings is not likely.



With respect to manufactured goods, Tunisia, Morocco, and Egypt are all heavily dependent on the European market. Jordan, by contrast, is more reliant on exports to the United States under an FTA signed more than a decade ago. As the euro zone financial difficulties continue, countries more reliant on Europe are more vulnerable to a downturn.

Although data on exports for Libya are not available from the IMF's *World Economic Outlook* for 2011 or 2012, the IMF staff estimated that exports were only \$19 billion in 2011, down from \$49 billion in 2012. Lack of access to foreign exchange put the squeeze on imports in 2011, albeit on a smaller scale than exports. The current account remained in surplus for year, but was much smaller relative to GDP.

In West Bank/Gaza, exports to Israel have declined over the past several years as restrictions on trade reflect increased security concerns. In the IMF staff report released March 21, 2012 (*Recent Experience and Prospects of the Economy of the West Bank and Gaza*), exports of goods and services are projected to be relatively steady in 2012 and then increase notably in both 2013 and 2014.

#### Additional Information

For questions or more information, please contact the author, Michael Shea, at [mshea@devtechsys.com](mailto:mshea@devtechsys.com).

For country-specific data and additional information about the countries covered in this report, please visit the EADS Country Portal at [http://esdb.eads.usaidallnet.gov/query/do?\\_program=/eads/esdb/countryPortal](http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal).

Sources used in compiling this report include the semi-annual *World Economic Outlook* (April 2012) and the *Fiscal Monitor: Balancing: Fiscal Policy Risks* (April 2012) from the International Monetary Fund (<http://www.imf.org/>), the *Global Economic Prospects* from the World Bank (<http://www.worldbank.org/>), and specific country documents from the IMF ([www.imf.org](http://www.imf.org/)). The Syria estimate from the International Country Risk Guide is from a PRS Group report on February 24, 2012 (<http://blog.prsgroup.com/>).