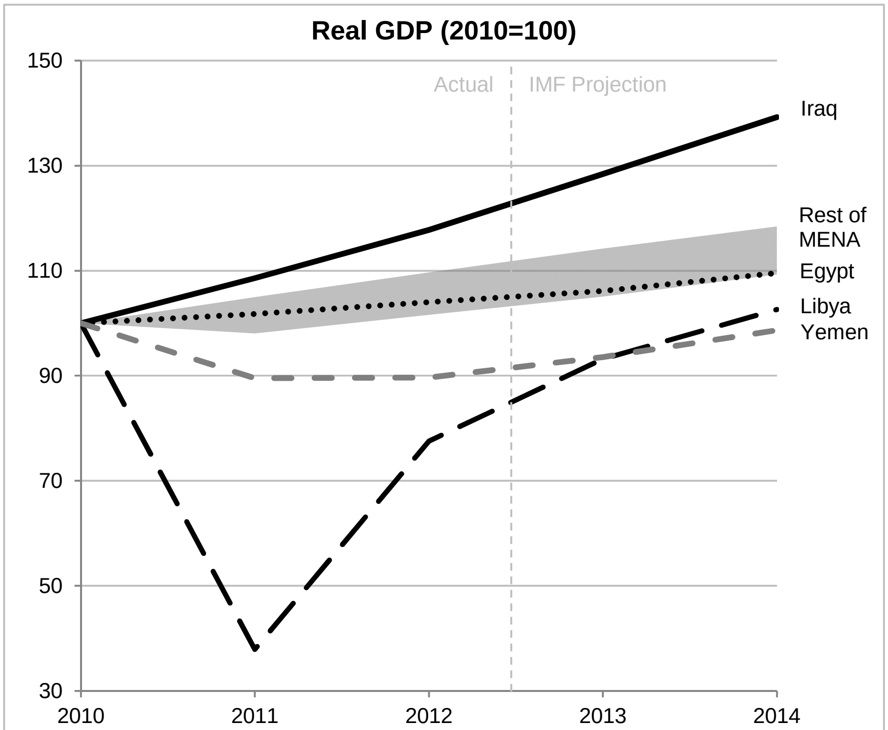
USAID
Economic Analysis
and Data Services

EADS Economic Trends Report

Middle East and North Africa

May 2013

Economic Overview



SOURCE: IMF, *World Economic Outlook*, April 2013.

The Middle East and North Africa (MENA) region real GDP growth increased in 2012 and slower economic growth is expected in 2013. Oil-exporter countries (Iraq, Libya, Yemen, Algeria, and Oman) grew faster than oil-importer countries (Egypt, Lebanon, Jordan, Tunisia, Syria, Israel, and Morocco) owing to the expansion in the Gulf Cooperation Council (GCC) countries and restoration of Libya's oil production. Because of uncertainty regarding Eurozone recovery and political stability in the MENA region, oil-importer countries still face slower growth in investment, reduced capital flow, financial market instability, and disruption in tourism.

The MENA region is still undergoing a political transformation that faces many economic challenges. Some Arab nations have changed their regimes (Tunisia, Egypt, Libya, and Yemen) while others are still undergoing political reform (Morocco and Jordan). On the bright side, successful political transitions and reforms could potentially boost economic growth in the medium and long-term if they lead to greater accountability and transparency in governance, which would facilitate more effective use of resources and reduce unproductive rent-seeking behavior. Oil-importing countries are expected to experience a modest increase in annual GDP growth from 1.9 percent in 2012 to 2.7 percent in 2013 and 3.7 percent in 2014.

The economy of Libya is fastest growing in the MENA region but it is still recovering from the civil war that overthrew the Gadhafi regime in 2011. Real GDP growth is improving faster than expected, primarily due to higher domestic crude oil production and export. The rebound in the oil sector will benefit the non-oil sector development, which hasn't seen any progress in 2012. Diversification of the economy is an important driver for GDP growth in Libya. Nonetheless the political uncertainty remains very high for the coming few years in determining the direction of the economic growth. If the security environment stabilizes, Libyan GDP is expected to recover to its pre-2011 level in 2014 and for investment to pick up.

Countries covered in this report include Algeria, Egypt, Iraq, Israel, Jordan, Lebanon, Libya, Morocco, Oman, Syria, Tunisia, West Bank/Gaza, and Yemen. Due to data limitations, not all countries are represented in every graph or analytical section.

Egypt's political turmoil had a negative impact on the economy in 2011, especially on the tourism and non-oil sectors. GDP in 2012 had slightly increased and expected to continue growing in 2013. Egypt's large population, low wages, and strategic location serve as advantages for foreign investors over other countries in the region. Nervetheless, Egypt faces many challenges that it needs to overcome for its economy to fully recover and build confidence in its investors. The country has relatively high levels of bureaucracy and corruption as well. According to the World Bank's *Doing Business 2013* report, Egypt ranks 109 out of 185 countries and 10 out of 15 in the Arab region on the ease of doing business.

Iraq is the second fastest growing economy in the MENA region with real GDP forecast to grow by 10.6 percent in 2013, underpinned by the oil sector, the major growth driver of its economy. Iraq has the largest proven oil reserves and gas deposits in the world. Nonetheless, Iraq still has a poor security environment as well as new tensions between the Iraqi central government in Baghdad and the Kurdistan Regional Government. Also, political instability has been a barrier to diversification of the economy. According to World Bank's *Doing Business 2013* report, Iraq ranked 165th out of 185 on ease of doing business. The country was ranked among the last ten on the ease of starting a business (177), getting credit (176), and resolving insolvency (185). These constitute significant barriers to the economy's ability to attract investment into non-oil sectors.

Jordan is still undergoing slow GDP growth owing to the civil war taking place in neighboring Syria. In addition, the decrease in GDP growth is caused by the lack of foreign aid, decrease in FDI and tourism arrivals, and high energy prices. Real GDP growth in 2012 was 2.8 percent and forecast to increase slightly to 3.3 percent in 2013. The slight recovery is due to increase in investment from the GCC countries and a loan from the IMF. To improve Jordan's business environment and keep the fiscal and external balances on a sustainable path, it must continue its structural reform programs without affecting social stability.

Morocco's real GDP growth slowed down in 2012 largely due to repeated external shocks from the global crisis and commodity prices. In addition, the agricultural sector was hit with poor weather conditions which led the wheat crop production to decrease tremendously. However, the economy is expected to rebound and is forecast to grow 4.5 percent in 2013. Economic optimism is based on a forecast of lower global energy prices, a rebound of the infrastructure and agriculture sectors, and increased investments in export-oriented sectors by investors from the GCC countries. Furthermore, Morocco is expanding its trading with African partners by signing several trade agreements with Senegal, Ivory Cost and Gabon. In spite of the optimistic GDP forecast, Morocco's medium to long term economic state still highly depended on the economic progress in the Eurozone.

The economy of Lebanon was negatively impacted by the regional turmoil, especially in its neighboring country Syria which affected investment, trade, and tourism sectors. Real GDP growth was the second lowest in the MENA region and increased by only 1.5 percent in 2012. The Syrian civil war created a cautious environment for tourism and increased the costs for bilateral and transit trade. In addition, Lebanon is still absorbing a large influx of Syrian refugees (450,000 or the equivalent of 10.7 percent of the Lebanese population). GDP is forecast to increase to 2.0 percent in 2013 and to 4.0 percent in 2014 and 2015 as well. The positive outlook is related to the recent discovery of oil and gas resources in the Lebanese territorial waters. Then again, the security instability in the area is making international firms hesitant to carry out exploration work and investment in the hydrocarbon sector.

Yemen GDP grew by 0.1 percent in 2012, the slowest in the MENA region. Yemen faces many economic issues due to high unemployment rate, shortage of cultivated land, water scarcity, severe poverty, and high corruption. Moreover, the country is heavily reliant on the flow of remittances which decreased due to the economic slowdown, which put many Yemeni expatriates out of work. The economy is expected to grow by 4.4 percent in 2013 based on modest improvements in the security situation. The forecast growth is still below potential due to declining oil reserves and the fact that the country remains unattractive to foreign companies.

Algeria's GDP grew by 2.5 percent in 2012 mainly due to increase in the non-hydrocarbon sector revenues and good agriculture yields. Although the economy of Algeria still faces many challenges owing to slow hydrocarbon exports, the Eurozone financial crisis, rising in food prices, regional uncertainties, and the need for structural reform. Algeria's GDP is expected to slowly grow at 3.3 percent in 2013 supported by the recovery in the hydrocarbon sector.

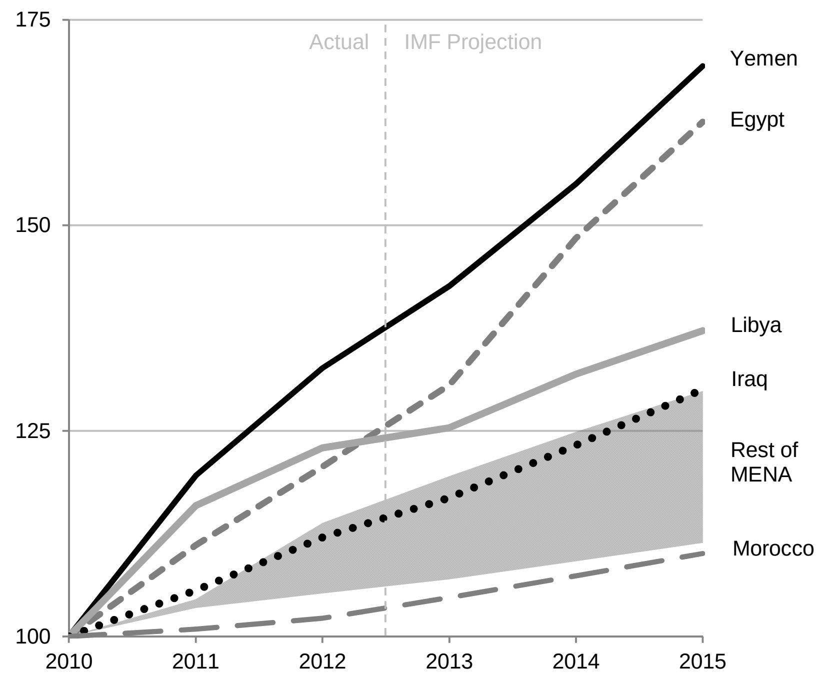
Israel's real GDP is projected to grow 3.6 percent in 2013 from 3.1 percent in 2012. Economic progress will be driven by a decrease in private consumption, declining imports, and an increase in fixed investment. The recent discovery of natural gas fields on its Mediterranean coast will increase domestic production and decrease energy import. Moreover, Israel was ranked 38 out of 185 countries in the World Bank's *Doing Business 2013* report. They scored better than all their neighboring countries in the region. However, regional political instability, mainly in Egypt and Syria, puts a strain on the economy by undermining investor and consumer confidence. Lastly, the Israel economy is under stress from slower Eurozone growth given that exports are 40 percent of GDP and Europe is a key market for its high-tech products.

The economy of the West Bank/Gaza is also being stressed. Real GDP annual growth averaged 11.0 percent in 2010 and 2011, according to IMF staff estimates (Staff Report, March 19, 2013) but fell to 6.0 percent in 2012 (January–September). The economy in West Bank/Gaza is weak due to the persistent Israeli restrictions on movement, aid cutbacks, and increasing political uncertainty internally and in the MENA region. Unemployment rose to 23.0 percent in the fourth quarter of 2012 and real GDP growth is forecast to grow to 5.0 percent in 2013. Growth in the territories is largely driven by household consumption, population growth, and institutional reforms by the Palestinian Authority.

Inflation

Despite an increase in international food prices, inflation remained steady in most of the MENA countries, mainly because of subsidy regimes for fuel and food and administered prices. The biggest exception is Yemen which is projected to have 11.0 percent inflation in 2013. Despite the double-digit annual price increase in Yemen, inflation has decreased from the previous years and is forecast to remain at a steady level. Yemeni high inflation in 2011 and 2012 were caused by frequent supply chain disruptions due to political conflict in southern regions of the country.

Consumer Prices (2010=100)



SOURCE: IMF, *World Economic Outlook*, April 2013.

In Egypt, inflation is projected to decrease to 8.2 percent in 2013 from 8.6 percent in 2012. Egypt is forecast to have the highest inflation rate in the MENA region in 2014 and 2015. Slow growth, fuel and food subsidy cuts, and subdued domestic demand are the primary reasons for increasing the rate of inflation. Furthermore, the Egyptian pound backsliding had a major role in increasing inflationary trend and caused prices to hike across all sectors.

In Jordan, inflation increased to 4.8 percent in 2012 and is expected to remain elevated to 5.9 percent in 2013 because of the civil war in neighboring Syria and fuel subsidy reform designed to reduce fiscal deficits. Lebanese inflation increased to 6.6 percent in 2012 and is forecast to rise to 6.7 percent in 2013. The flood of Syrian refugees into the country has increased rental housing prices, particularly on the border areas. In addition, commodity prices have increased globally and the Lebanese now have restricted access to cheaper products from Syria.

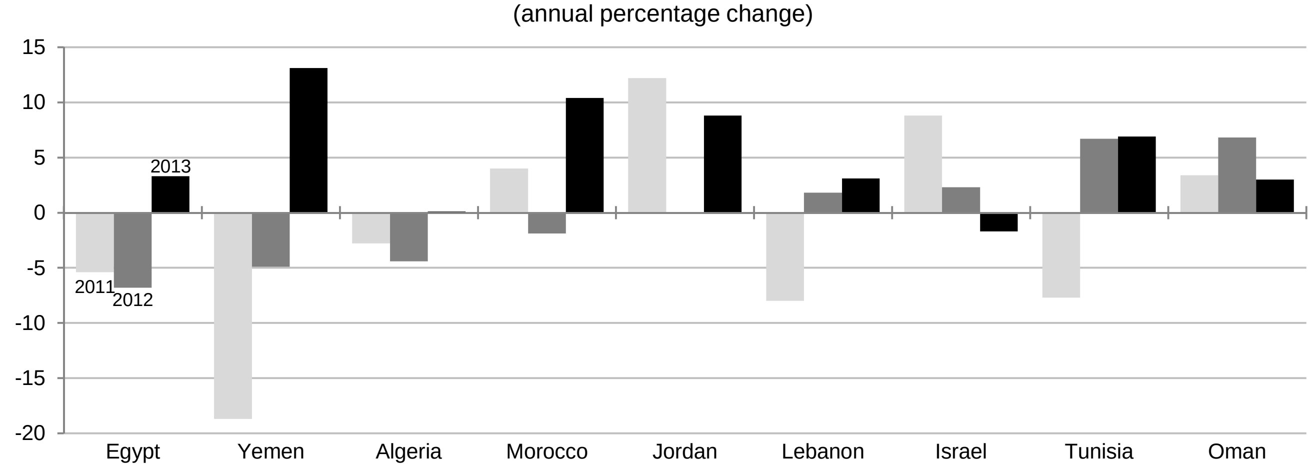
Inflation increased slightly in the West Bank because of the price rise in petroleum products and food in 2012. In Gaza itself, inflation has remained at less than 1.0 percent due to the high supply of consumer goods from the time of the relaxation of restrictions in mid-2010. Combined inflation for West Bank/Gaza, is expected to remain steady at 2.8 percent in 2013. Israel is still achieving a low inflation rate because of the strength of the new Israeli Shekel and the slowing of domestic demand. The former has shrunk prices of imported goods and the latter decreased price pressure on the demand side. Israeli inflation is expected to stay low at 1.7 percent in 2013.

In other economies in the region, price pressures are quite modest. In Morocco, inflation remained low at around 1.3 percent in 2012. The rise in the supply of food grain imports and poor local harvest didn't raise inflation since food subsidies kept it low. In Oman, inflation was mild at around 3.0 percent a year and monetary policy has been able to support continued economic growth. IMF staff estimate the forecast to be steady despite the recent decision by the Omani government to increase the monthly minimum salary of Omani private sector workers by 62.5 percent.

Trade

Exports volume of goods and services in the MENA region were negatively affected in 2012 by low euro zone economic growth, increased regional insecurity, and a decrease in energy subsidies. However, with the exception of Israel, all countries in the MENA region are expecting a positive outlook for 2013. In Israel, annual percentage change of exports of goods and services are expected to decrease to 1.7 percent in 2013 because of the slow economic growth of some of their major trade partners such as Italy and France. In the IMF staff report released on March 19, 2013 (*Recent Experience and Prospects of the Economy of the West Bank and Gaza*), exports of goods and services in West Bank/Gaza are projected to be relatively low but with steady growth in 2013 through 2016.

Export Volume of Goods and Services, 2011–2013
(annual percentage change)



SOURCE: IMF, *World Economic Outlook,* April 2013.
NOTE: 2013 values are projections.

Trade conditions remained highly favorable for Oman due to elevated global commodity prices which led to higher hydrocarbon production. Omani exports are projected to remain very strong due to expansion to the East, especially increasing oil exports to China and non-oil exports to India. Libyan export has recovered because of the higher oil production though non-oil exports are still weak.

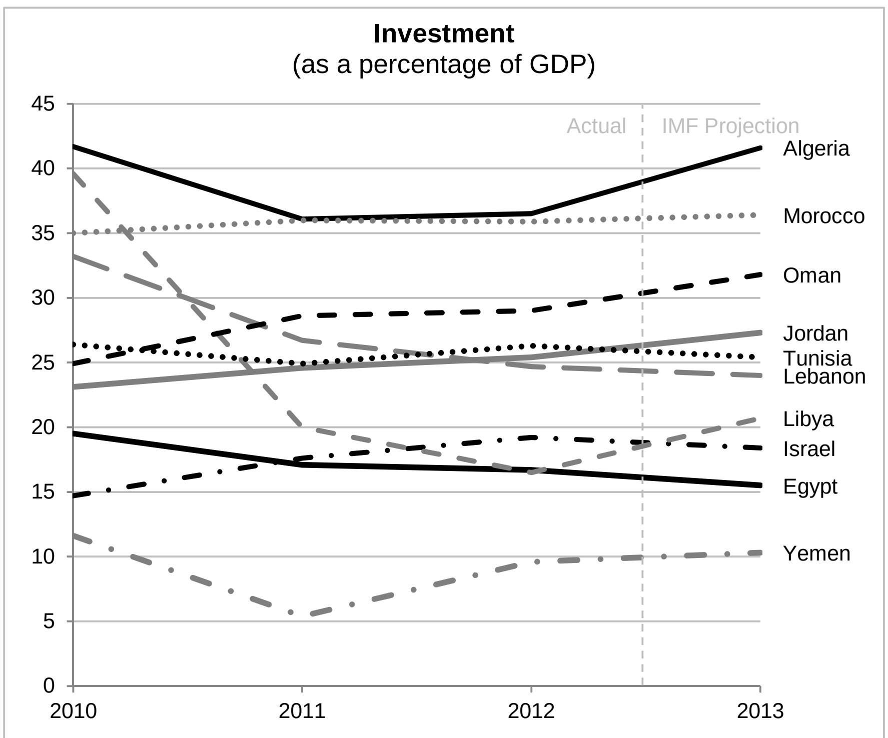
Civil war in Syria has disrupted trade rail network and supply chain in the Levant region. Because of this disruption, Jordanian exports decreased to Syria, Iraq, and Lebanon in 2012. Moreover, the decrease in the energy subsidy has increased the costs of production for Jordanian manufacturers which reduced their competitiveness. Nonetheless, exports of goods and services are projected to increase in 2013 because of expanding the export market in the GCC countries, particularly in the pharmaceutical products. Lebanon was also hit by the turmoil in its neighboring country Syria in 2012. But despite the political instability in the region, Lebanon is expected to have a slight increase in its exports in 2013.

In Egypt, exports of goods and services decreased in 2012, as a result of ongoing weaker petroleum demand from its major European trade partners and also due to occasional political instability. Exports are expected to increase in 2013 owing to the devaluation in the Egyptian pound. In Tunisia, exports had increased in 2012 but it remains uncertain due to continued strikes and civil unrest which are keeping production at a low level. Exports are forecast to increase in 2013 but that depends on the economic growth in the euro zone.

Investment

Investment in the MENA region has been affected by the political upheaval in many Arab countries, economic problems in its euro zone neighbor, and the lack of investment funding. Despite these difficulties, some of the Arabic countries have shown improvement in investment levels.

Investment in Tunisia increased in 2012 to 26.3 percent of GDP from 24.9 percent in 2011. Despite this slight improvement, investors remain cautious until after the parliamentary and presidential elections have taken place in June 2013. In addition to the economic reform, Tunisia is preparing a new investment code to improve the investment climate in the country. Investors are following a wait-and-see approach for the results of any improvement in investment legislation.



SOURCE: IMF, *World Economic Outlook*, April 2013.

Algeria continues to be in the lead in the MENA region when it comes to investment as percentage of GDP with 36.5 in 2012 and a projected increase to 41.6 in 2013. Nevertheless, Heritage Foundation's 2013 index on business freedom ranked Algeria as a repressed economy and it is ranked 14 out of 15 in the MENA region. Some of the challenges that Algeria's investment sector faces are widespread corruption, bureaucratic hurdles, and lack of access to financial services.

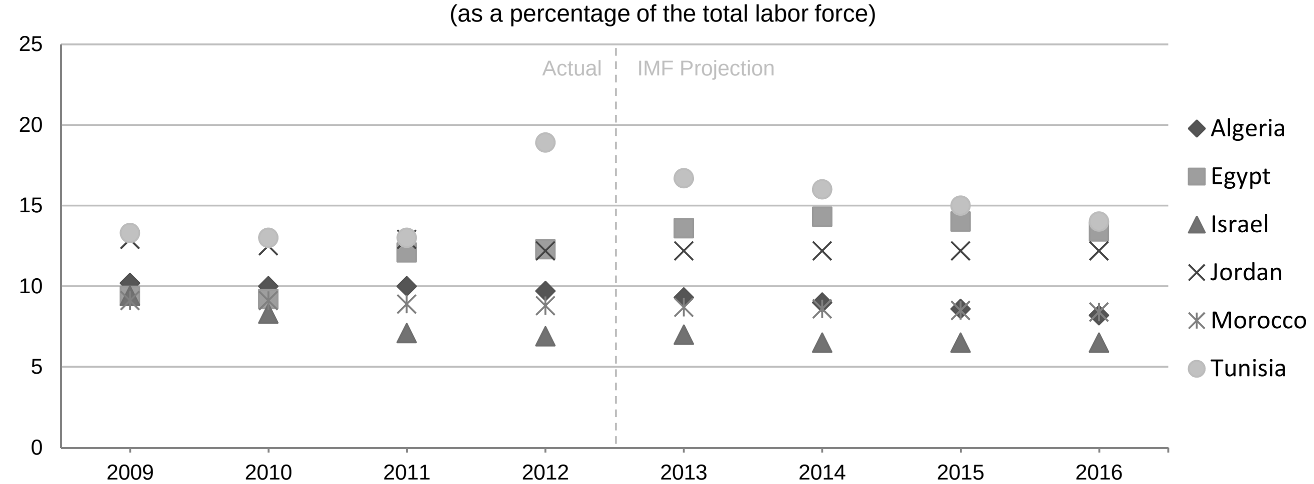
In Egypt, many investors are questioning the security situation in the post-Mubarak era. Investor's lack of confidence was reinforced after the delay in the start of the country's US$4.8 billion Stand-By Arrangement (SBA) with the IMF. Egypt's political and economic uncertainty led to a decrease in investment as percentage of GDP to 16.7 percent in 2012 from 17.1 percent in 2011. Investment is forecast to decrease further in 2013 to 15.5 percent of GDP, primarily as a result of the continuation of the social unrest and economic policy uncertainty.

Yemen's investment recovered in 2012 to 9.6 percent of GDP. Despite the slight improvement, the country still ranks very poor on the ease of doing business (118 out of 185) according to the *Doing Business 2013* report. Its poor score is due to lack of security to protect investors, difficulty in getting electricity, and a corrupt tax system. Similarly, Jordan had a slight increase in its investment in 2012 mainly from the recovered GCC countries. Also, investment as percent of GDP is forecast to increase to 27.3 in 2013 from 25.4 in 2012 as new development projects are expected in the renewable energy sector.

Unemployment

High unemployment, especially for youth, contributed to the political instability in the MENA region. The persistence of high rates suggests that much of it may be structural or related to skill mismatches, labor market rigidities, and high reservation wages. More recently, the unemployment rates were affected by political instability resulting from the Arab Spring which decreased tourism activities and investments.

Unemployment Rate
(as a percentage of the total labor force)



SOURCE: IMF, *World Economic Outlook*, April 2013.

In Egypt, unemployment is forecast to increase to 13.6 percent in 2013 and 14.3 percent in 2014 because of rapid population growth, urbanization, and complicated labor policies in the public sector. Israel's unemployment rate is forecast to decrease in the upcoming years owing to increase in fixed investment on the recent discovery of gas fields. Jordanian government put a temporarily halt on permits for the recruitment of foreign workers in April 2013 as a move to decrease its high unemployment rate. Government might have difficulties persuading Jordanian workers in taking jobs that foreigners filled. The move is politically popular especially after the rise of the Syrian refugees in the country but the effect of the move on the decrease of unemployment rate might be very minimal.

IMF analysis (*Finance and Development*, a quarterly publication of the IMF) suggests that tackling the region's unemployment will require improvement in policies that encourage youth and female employment, educational system reform to align it with the private sector needs, and reforming public sector's labor market hiring and compensation policies.

Additional Information

For questions or more information, please contact the author, Georges Fadel, at gfadel@devtechsys.com.

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

Sources used in compiling this report include the semi-annual *World Economic Outlook* from the International Monetary Fund (http://www.imf.org/), the *Global Economic Prospects* and *Doing Business* reports from the World Bank (http://www.worldbank.org/), the UNDP *Human Development Report 2013* (http://hdr.undp.org/en/reports/global/hdr2013/), and Business Monitor International Business Forecast Reports (http://www.businessmonitor.com/).