

MENAP Oil-Importing Countries: Gradual but Uneven Economic Recovery

Economic Activity Trending Up

Since the onset of political transitions in 2011, MENAP oil importers have struggled to meet the public’s demands for higher living standards and better access to business opportunities and jobs. Recent reforms have helped preserve macroeconomic stability. Yet, unemployment remains high at 10 percent, especially among the young (25 percent). Thus, strengthening economic growth and making it more inclusive remains a high priority.

The recent pick-up in economic activity in some countries is a start. Growth averaged 3¾ percent in 2015, compared to 3 percent over 2011–14 (Figure 7). Lower oil prices, less drag from fiscal consolidation, and improved confidence owing to progress with recent reforms—including reforms to reduce fiscal deficits and improve the business environment (Morocco, Pakistan)—supported the recovery, helping to counteract the negative impact of rising security risks and spillovers from regional conflicts—including large inflows of refugees (Box 1) and trade disruptions—as well

as slower growth in the oil-exporting trading partners (the GCC).

In 2016–17, growth is expected to remain, on average, near 4 percent. Investment growth is gradually strengthening, mainly because recent subsidy reforms and lower oil prices have increased room for public infrastructure spending. Consumption is growing steadily, supported mainly by large public sector wage bills. Savings from lower oil prices—following energy subsidy reforms, most countries now pass through changes in global oil prices to domestic retail fuel prices (Figure 8)—are also supporting consumption, offsetting slowing remittances due to lower flows and currency appreciation against the euro. Continued security risks and spillovers from conflicts, meanwhile, still weigh on domestic demand.

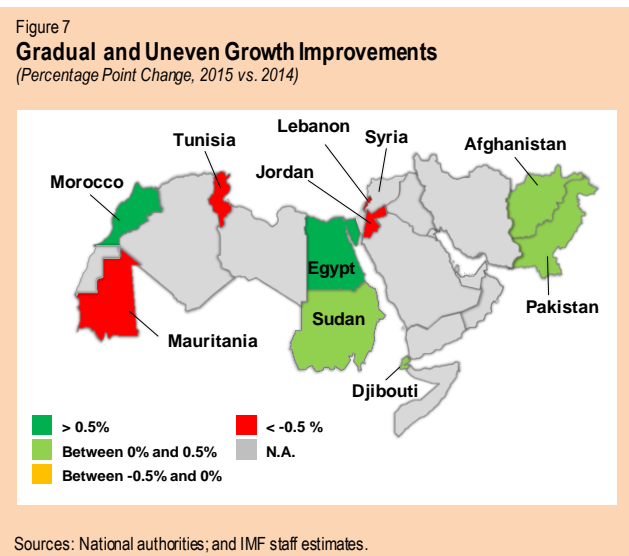
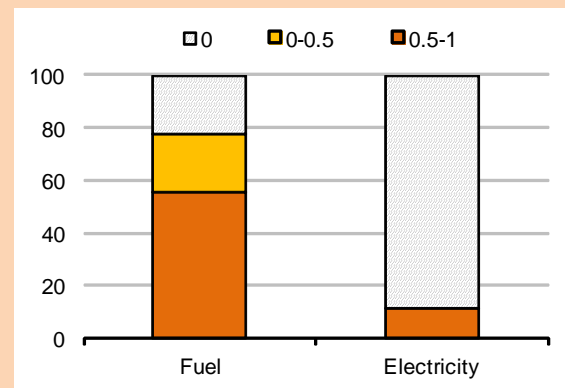


Figure 8
Oil Price Pass Through Higher for Fuel than Electricity 1/
(Proportion of Total Sample, Expected end-June 2016)



Sources: IMF staff estimates.
1/Pass-through period is defined as the oil price drop since Sept 2014 to end-June 2016

The pick-up in economic activity is proceeding unevenly. In 2015, Mauritania’s exports slowed due to lower iron ore prices and weaker demand from China. In Tunisia, heightened security threats hampered confidence and tourism. Spillovers from Syria’s conflict hurt confidence in Jordan and exacerbated the difficulties in

Lebanon from the domestic political impasse and lack of structural reforms. In Egypt, growth is being held back by concerns over security and rising external vulnerabilities (see below). Economic activity is also expected to slow in Morocco, reflecting lower agricultural production.

External positions are weakening because of slowing exports and remittances but are being supported by lower energy import bills. Exports of goods are declining—mainly to the euro area and China (35 percent and 5 percent of the region’s exports, respectively) (Figure 9). Against a backdrop of stable demand from the region’s main export markets, this reflects an erosion of cost-competitiveness (evidenced by appreciating real exchange rates), which, along with heightened security concerns, has also reduced tourist receipts from the euro area. Declining remittances add to these pressures. In

projected 5¼ percent of GDP deficit in 2016, reserve coverage is at 3 months of imports. Against this backdrop, the depreciation of the currency, by 13 percent against the U.S. dollar in March 2016, is a welcome development. In Sudan, limited access to external financing and de-risking by international banks have complicated the policy adjustment and kept international reserves low.

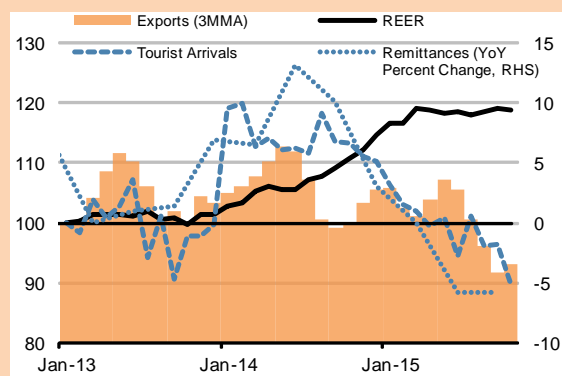
Sharply Declining Inflation

Continuing a sharp decline that began in mid-2014, inflation is projected to fall to 6 percent this year—a 1 percentage point drop from last year and a 3½ percentage point decline since 2014. Among other factors, lower food and energy prices (where pass-through has been allowed) and currency appreciation against the main import partners—China and the euro area (15 and 25 percent of imports, respectively)—are the main drivers. Continued energy subsidy phase-outs (including in electricity), monetization of fiscal deficits, and, in some cases, exchange rate depreciation are preventing a faster decline in inflation.

Downside Risks Dominate

The economic outlook is subject to significant downside risks. A worsening in security conditions or social tensions, reform fatigue, or increased spillovers from regional conflicts could derail policy implementation and weaken economic activity. Downside external risks have also risen since last October. Tighter and more volatile global financial conditions—arising from movement in the U.S. interest rate and recent turbulence in global financial markets—could raise external borrowing costs, feed into domestic interest rates, and slow capital inflows. Weaker growth in China could reduce infrastructure financing (Egypt, Pakistan) and put further pressures on commodity prices—weakening international reserves in commodity exporters (especially Mauritania). Weaker growth in the GCC could dampen remittances, tourism, exports, investment, and official financial

Figure 9
Declining Exports, Tourism, and Remittances
(Index Values, Jan2010 = 100)



Sources: National authorities; Bloomberg, LP; and IMF staff calculations.
Note: Exports and remittances are measured in U.S. dollars. Exports are expressed in constant January 2010 exchange rates.

2016, the region’s current account deficit is projected to remain unchanged for a third straight year (at 4½ percent of GDP). Yet the drop in imports (mainly energy products), supported by stable financial flows, is set to raise reserve coverage by 1 month of imports to 6¼.

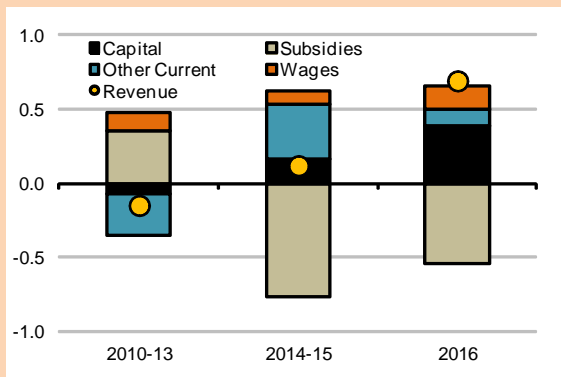
In some cases, international reserve coverage is very low. In Egypt, where the current account is worsening from near balance in 2014 to a

support. Weaker growth in the euro area and/or emerging markets would have similar effects. On the upside, a faster improvement in domestic confidence in response to ongoing reforms may bolster growth.

Fiscal Positions Improving Yet Still Vulnerable

Concerted fiscal efforts, together with lower oil prices, have reduced fiscal deficits. The region’s average deficit is expected to fall to 6½ percent of GDP in 2016 from a 2013 peak of 9½ percent. This improvement is mainly due to subsidy reforms (Figure 10). Where reforms are yet to be completed (Egypt, Sudan, Tunisia), low oil prices have reduced energy subsidy bills. In some cases, low oil prices have also improved the balance sheets of state-owned enterprises (SOEs)—especially in electricity (Jordan, Pakistan)—reducing their borrowing from the banking system and arrears. To lower the adverse impact of fiscal consolidation on growth and stimulate job creation, some savings from lower energy subsidies are being channeled toward infrastructure, health, and education spending, as well as targeted social assistance and wage bills (Egypt, Morocco, Pakistan, Tunisia).

Figure 10
Changes in Government Spending and Revenues
(Percent of GDP, Change from Prior Year)



Sources: National authorities; and IMF staff estimates.

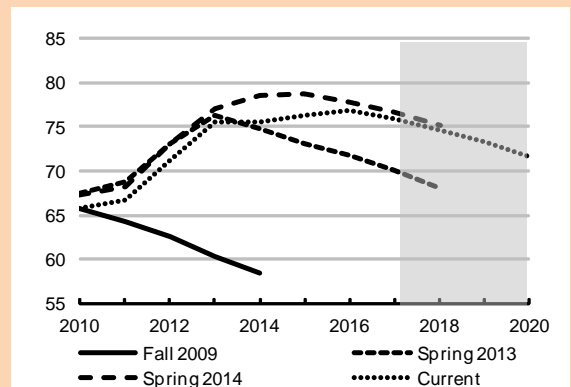
Against a backdrop of high spending pressures and downside risks to growth, maintaining progress with fiscal consolidation is a challenge.

Spending pressures are mounting with the need to address social tensions and the rising costs of basic public services, in part owing to growing numbers of refugees (Jordan, Lebanon). Tax revenues are suffering from lower ad valorem fuel tax revenues (Jordan) and weak collection.

This year, revenues are expected to rise with the elimination of exemptions (Pakistan), a reduction in tax loopholes, income tax reforms (Jordan), higher excises, and strengthened administration. Many of these revenue reforms, however, are yet to be implemented and unexpected shocks or lower growth could undermine these efforts. Financial assistance from GCC countries is also expected to slow in line with their economies.

Despite recent stabilization, public debt ratios remain high, especially in Egypt, Jordan, and Lebanon where they range between 90 and 145 percent of GDP (Figure 11). These large ratios undermine investor confidence, particularly in a volatile global financial market environment, raising debt servicing costs and financing needs. High public sector loan concentrations, absent deeper financial markets, could pose risks to the stability of the banking sector, which has remained liquid, capitalized, and profitable, despite a recent rise in non-performing loans stemming from weak economic activity.

Figure 11
Public Debt: Is It Finally Poised to Decline?
(Percent of GDP)



Sources: National authorities; and IMF staff estimates.

To put debt on a sustainable path, continued fiscal consolidation is needed. Revenue measures

targeting the higher income segments of the population and more efficient tax collection—such as moving to a technology-based system—can advance fiscal consolidation with a smaller impact on growth than spending measures. Low oil prices provide an opportunity to complete on-budget energy subsidy reforms and reduce the losses of energy SOEs by advancing automatic pricing. The current sociopolitical environment makes shrinking large public wage bills difficult, but they could be contained through civil service and pension reforms that free resources for basic services and infrastructure, stimulating private sector growth and creating several times the job opportunities that can be found in the public sector. Improved financial management can raise efficiency. Where vulnerabilities are high, fiscal gains should be saved to build buffers against future adverse shocks. Where buffers are already strong, part of the gains could be used to increase growth-enhancing spending, which would also create jobs. Greater exchange rate flexibility

would support fiscal consolidation by partly absorbing external shocks and would improve external positions by strengthening competitiveness.

Creating Jobs and Raising Living Standards

Besides macroeconomic stability, much higher, and more inclusive, economic growth is needed to create jobs and improve living standards. Targeted structural reforms are key to boosting growth.¹ The cost of doing business, as well as supply-side bottlenecks—which hold back productivity—can be reduced through better protection of investor rights, more efficient and better quality infrastructure, and regulatory reform. Raising labor market efficiency and matching education to private sector needs are both critical to reducing unemployment and increasing worker productivity. Greater coverage of credit bureaus would facilitate access to finance. And increased trade openness can enable countries to join job-creating global manufacturing supply chains.

¹ See Mitra and others (2016) “*Avoiding the New Mediocre: Raising Long-Term Growth in the Middle East and Central Asia*,” available at www.imf.org.