

World Economic and Financial Surveys

Regional Economic Outlook

Update

**Middle East, North Africa,
Afghanistan, and Pakistan**

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Acknowledgments

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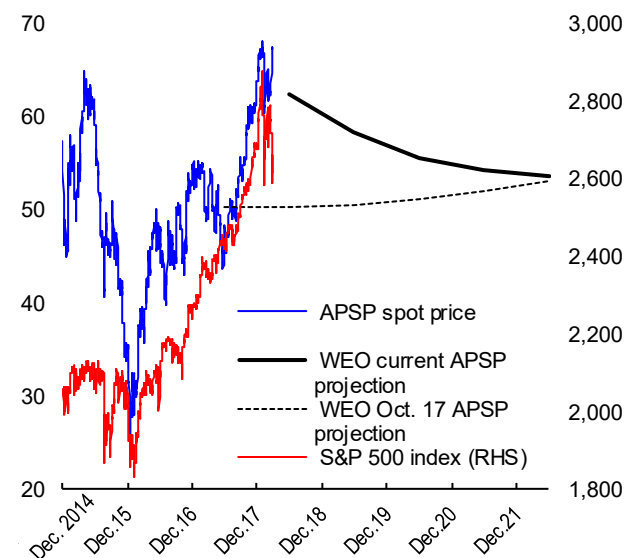
Global Developments: Implications for the Middle East, North Africa, Afghanistan and Pakistan Region¹

Global growth continued to strengthen in the second half of 2017 and is now estimated at 3.8 percent for the full year, the highest level since 2011 and 0.2 percentage point stronger than forecast in the October 2017 *World Economic Outlook* (see table). Growth is **projected to strengthen further to 3.9 percent in 2018 and in 2019**, also 0.2 percentage point higher than anticipated in October. Stronger prospects for the **euro area** should benefit the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region, especially oil importers, through higher exports. The region should also benefit from a marginal strengthening of the outlook for **China**, a key partner for the region. However, the global outlook also entails **higher global interest rates** as monetary policy continues to normalize in advanced economies. This could increase fiscal vulnerabilities and tighten credit conditions in the MENAP region, especially if the risk that global financial conditions tighten more than expected materializes.

Risks to the global outlook are broadly balanced in the near term, but are skewed to the downside over the medium term. In addition to the risk of tighter financial conditions, escalating import tariffs or a shift toward inward-looking policies could harm international trade, reduce global growth, and dampen commodity prices. And the region continues to be exposed to the risk of worsening geopolitical tensions and conflicts.

The outlook for **oil prices** remains highly uncertain, largely reflecting supply-side uncertainty. Oil prices grew strongly in the second half of 2017, rising above \$65 a barrel in January, supported by the improved global growth outlook, extension of the OPEC+ agreement (limiting oil production through the end of 2018), unplanned outages, and geopolitical tensions. More recently, with rapidly rising US shale production, the price of oil has edged down. In this context, while the oil price assumptions for 2018 and 2019 have been revised upward relative to the October 2017 *Regional Economic Outlook: Middle East and Central Asia* (see figure), the medium-term outlook for oil prices remains subdued.

APSP¹ Crude Oil and S&P 500 Index
(US dollars a barrel and stock price index)



Sources: Haver Analytics; and IMF staff calculations.

Note: APSP = average price of spot prices; RHS = right scale; WEO = IMF *World Economic Outlook*.

¹ The average of UK Brent, Dubai Fateh, and West Texas Intermediate crude oil prices.

Real GDP Growth, 2016–19

	2016	2017	2018	2019
World	3.2	3.8	3.9	3.9
MENAP	4.9	2.6	3.4	3.7
MENAP Oil Exporters	5.4	1.7	2.8	3.3
Of Which: Non-Oil GDP Growth	0.8	2.6	3.2	3.4
MENAP Oil Importers	3.7	4.2	4.7	4.6

Sources: National authorities; and IMF staff calculations.

Note: MENAP = Middle East, North Africa, Afghanistan, and Pakistan.

¹ See the April 2018 *World Economic Outlook*, *Global Financial Stability Report*, and *Fiscal Monitor* for a more comprehensive discussion of the global outlook.



MENAP Oil-Exporting Countries: Time to Accelerate Reforms

Economic growth in oil exporters in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) bottomed out in 2017 and is expected to accelerate in 2018–19. This largely reflects the continued recovery in non-oil activity as many countries are slowing the pace of fiscal consolidation in support of domestic demand. Risks to the outlook are skewed to the downside. These include the possibility of a sharp tightening of global financial conditions, growing trade tensions, and geopolitical strains—while the outlook for oil prices remains subdued and highly uncertain. If these risks materialize, they could trigger potentially significant fiscal and financing pressures for many countries in the region, affecting prospects for continued fiscal consolidation and economic recovery. Weak growth prospects over the medium term underscore the importance of accelerating planned structural reforms.

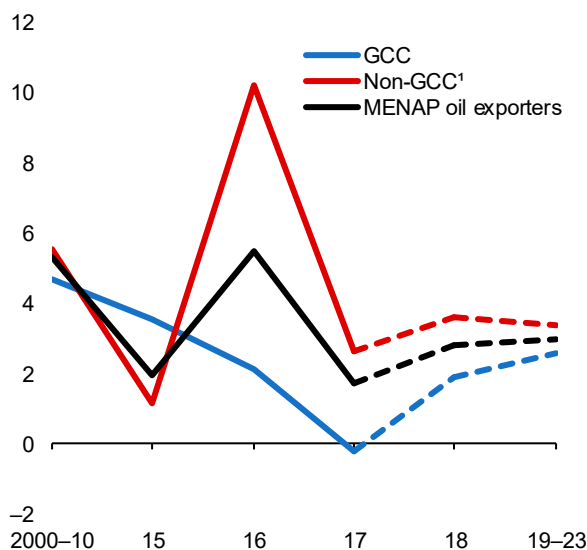
A Sharp Slowdown in 2017

In 2017, at 1.7 percent, growth in MENAP oil exporters was much weaker than the 5.4 percent outcome in 2016 (Figure 1.1). This significant slowing of economic activity reflects a deeper-than-expected slowdown in the Gulf Cooperation Council (GCC) countries relative to the forecast in the October 2017 *Regional Economic Outlook*. That slowdown was offset by stronger-than-

anticipated outcomes in non-GCC countries (Figure 1.2). Specifically,

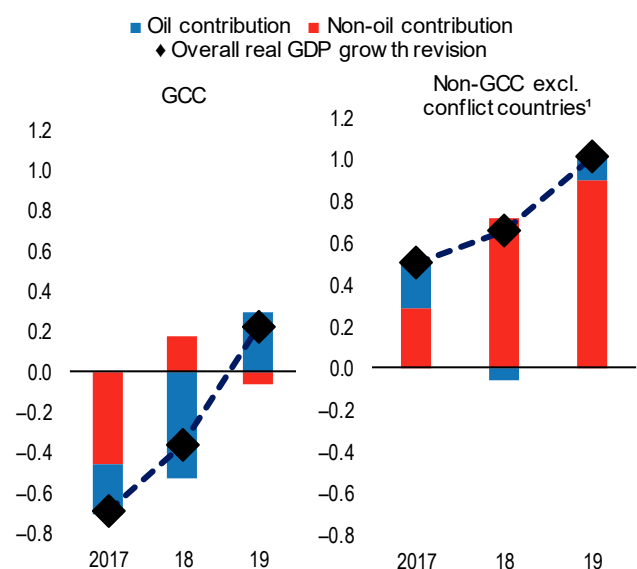
- In the **GCC**, overall GDP fell by 0.2 percent last year, with Saudi Arabia seeing its first economic contraction since 2009. This mostly reflected the effect of the OPEC+ oil production cuts, which more than offset the continued recovery in non-oil growth in most countries. In the United Arab Emirates

Figure 1.1
Real GDP Growth
(Percent, simple average across years)



Source: IMF staff calculations.
Note: GCC = Gulf Cooperation Council.
¹ Excludes Libya and Yemen.

Figure 1.2
Real GDP Growth Revisions since October 2017
(Percentage points)



Source: IMF staff calculations.
Note: GCC = Gulf Cooperation Council.
¹ Excludes Libya and Yemen.

and Qatar, where weak consumer and investor confidence dampened domestic demand, non-oil GDP growth in 2017 was softer than that of the previous year. In Bahrain, stronger non-oil growth—supported by GCC-funded projects and robust financial and hospitality sectors—more than offset weaker oil output.

- In *non-GCC* oil exporters (excluding Libya and Yemen), overall growth amounted to 2.6 percent in 2017. In Iran, growth decelerated significantly relative to 2016. Oil GDP growth in that country was much slower than in the previous year, more than offsetting the continued recovery in non-oil activity, which was supported by public investment. In Algeria and Iraq, weaker growth in oil GDP in the context of the OPEC+ agreement (and weaker-than-expected demand from Europe for Algerian-produced gas) was more than offset by a pickup in non-oil activity.
- In oil-exporting countries affected by *conflict*, growth outcomes were mixed. In Libya, stronger-than-expected growth was supported by increased oil production, which more than offset lower public spending. In Yemen, the economic contraction was much more pronounced than anticipated in October as the effects from the conflict continued.

Recovery in 2018–19 Driven by Opposing Forces

With growth estimated to have bottomed out in 2017, the overall outlook is little changed relative to October. Economic activity is projected to accelerate in 2018–19, but to remain low relative to pre-2014 levels over the medium term (Figure 1.1). Specifically, overall growth is projected at 2.8 percent this year and 3.3 percent in 2019 (versus 3.0 and 2.7 projected in October).

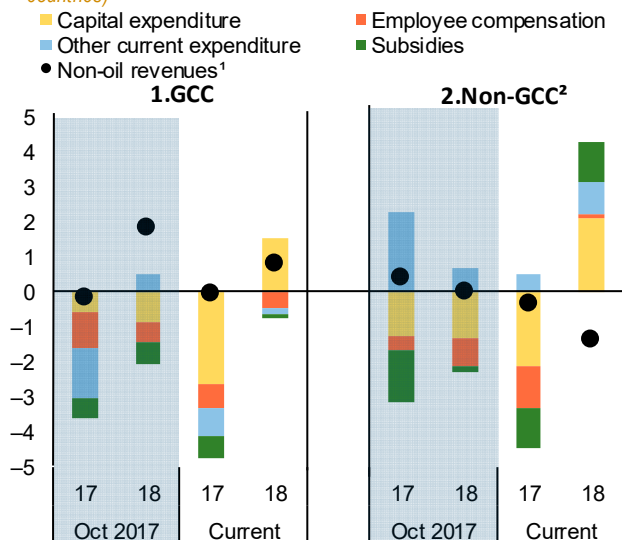
Non-oil GDP growth is expected to be 3.2 percent this year and 3.4 percent next, 0.7 and 0.4 percentage point higher, respectively, relative to October. These changes reflect two opposing forces (Figure 1.2):

- *Upward revisions to non-oil GDP growth for 2018 and 2019* relative to October forecasts in several countries: The deceleration in Bahrain is now projected to be more gradual (expected completion of investment projects). Meanwhile, the pickup is now anticipated to be faster in Saudi Arabia (partly from a slower pace of fiscal consolidation as described later in this update), Algeria (mostly increased public capital spending), and Iraq (reconstruction).
- *Downward revisions to oil GDP growth in 2018* in most GCC countries and Iraq relative to October: This revision is driven by lower oil production consistent with the extension of the OPEC+ agreement. For 2019, the deferred expiration of the agreement means that oil GDP growth will pick up faster than anticipated in October, especially in GCC countries.

Adjusting the Pace of Fiscal Consolidation

There has been some adjustment in the *pace of fiscal consolidation* among MENAP oil exporters (Figure 1.3). In 2017, fiscal adjustment in Saudi Arabia was less than initially indicated in the budget—higher expenditures were supported by higher-than-expected non-oil revenues. In Qatar, the availability of fiscal buffers allowed for more gradual fiscal consolidation than expected. Outside the GCC, fiscal consolidation efforts continued in 2017, especially in Iran and Iraq (in the context of the IMF-supported program).

Figure 1.3
Change in Expenditure and Non-Oil Revenues
(Percent of non-oil GDP, change from previous year, simple average across countries)



Source: IMF staff calculations.

¹ Gulf Cooperation Council (GCC) non-oil revenue series excludes Kuwait because of discontinuities in its series related to United Nations compensation payments.

² Includes Algeria, Iran, and Iraq.

Overall, MENAP oil exporters are expected to continue their fiscal consolidation efforts, although at a slower pace. However, large increases in expenditures are expected to generate significantly larger fiscal deficits in Algeria, where consolidation is expected to resume in 2019, and in Iran.

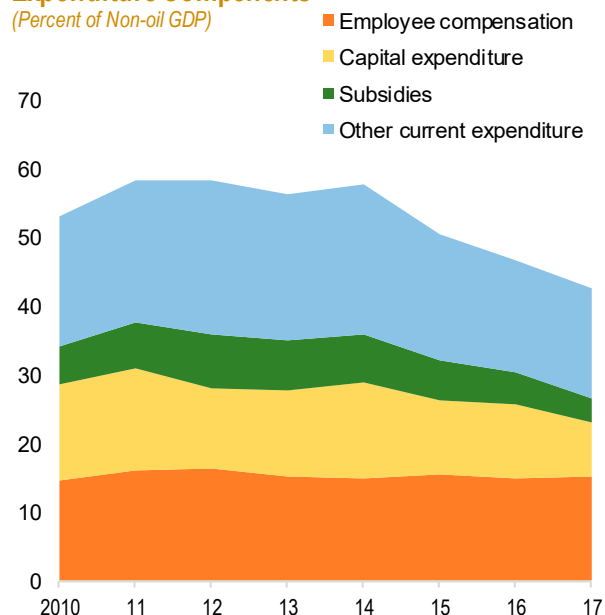
Fiscal consolidation efforts have targeted both revenue and expenditures. Recent revenue measures include the introduction (January 2018) of a value-added tax (VAT) in Saudi Arabia and the United Arab Emirates, with other GCC countries expected to introduce a VAT this year. Similarly, Iraq is expected to introduce sales and excise taxes on some goods and services in 2018. But countries could do more to mobilize non-oil revenues, with the implementation of the VAT in the remaining GCC countries a key priority.

On the expenditure side, improving the efficiency of public spending is also a priority. Public

investment efficiency indicators suggest that MENAP oil exporters perform better than emerging markets on average, but there is a substantial gap relative to advanced economies.

More efficient spending could be achieved by containing the large public wage bills that crowd out other critical components of public expenditure (Figure 1.4; Box 1.1). Measures taken so far (including temporary hiring freezes) may be difficult to sustain over time without additional structural reforms.

Figure 1.4
Expenditure Components
(Percent of Non-oil GDP)



Source: IMF staff calculations.

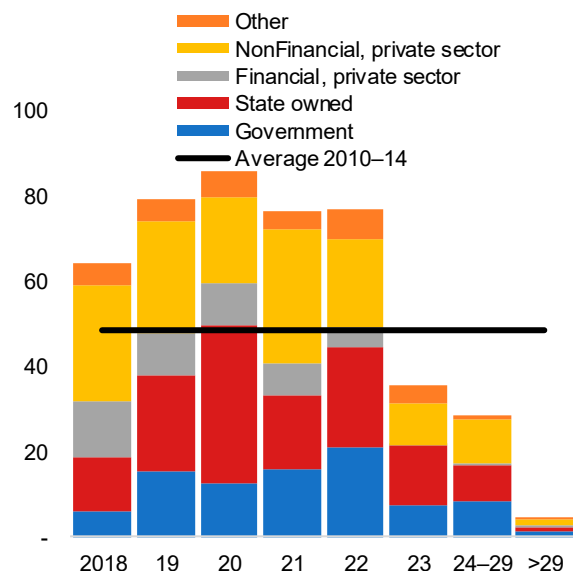
Other required reforms include further steps toward full elimination of energy subsidies, and changes to pension and social security systems—including revisions to retirement age and benefits. However, to mitigate the impact on the most vulnerable and to make such reforms equitable, they need to be accompanied by enhanced targeted social protection mechanisms and improvements in the delivery of and access to public services.

Potentially Large Fiscal and Financing Risks Could Emerge

Although public debt remains manageable for most MENAP oil exporters, the *rapid buildup of debt* in many of them is a cause for concern. Debt has increased by an average of 10 percentage points of GDP each year since 2013, with countries financing large fiscal deficits through a combination of drawdowns of buffers (where available) and increased domestic and foreign borrowing (see Chapter 1 of the October 2017 *Regional Economic Outlook: Middle East and Central Asia*). Looking ahead, several factors are likely to continue to drive debt upward in MENAP oil exporters. These include the slower pace of fiscal consolidation, weak growth prospects, and the possibility of higher financing costs given the expected monetary policy tightening in advanced economies.

Given anticipated financing needs—cumulative overall fiscal deficits are projected to be \$294 billion in 2018–22, while cumulative government debt amortizations amount to \$71 billion for the same horizon—countries are increasingly vulnerable to a sudden tightening of global financial conditions. For example, taking account of the gross financing needs for 2018, a 200 basis point increase in interest rates would add between 0.1 and 0.6 percent of GDP a year to interest payments in MENAP oil exporters, increasing existing fiscal challenges. An additional amount of \$312 billion of non-government-issued international debt (of which almost 40 percent corresponds to state-owned enterprises) is coming due over the next five years. Therefore, the fiscal impact could be larger if countries also experience a sudden stop in international market access that leads to a materialization of fiscal contingent liabilities (Figure 1.5).

Figure 1.5
Amortization Profile of International Debt¹
(Billions of US dollars, annual average)



Sources: Dealogic; and IMF staff calculations.
¹Includes bonds and syndicated loans.

Strong Banks yet Subdued Credit Growth

Despite the slowdown in economic activity in 2016–17, financial sectors have remained broadly resilient. However, *credit growth remains subdued in most countries*, partly reflecting weak consumer, government, and government-related enterprise spending, as well as reduced confidence (Figure 1.6). This has led to some policy measures to ease access to financing. In the United Arab Emirates, for example, the introduction of a credit registry has helped banks better manage credit risks. Other reforms have also been implemented. For example, in Saudi Arabia, capital market restrictions on foreign investors have been eased, and the loan-to-value ratio for first-time home buyers has been increased. While these reforms are not a direct consequence of weak credit growth, they may support a faster recovery. To improve confidence

Figure 1.6

Credit to the Private Sector*(Percent, end-of-period annual growth)*

Sources: Country authorities through Haver Analytics; IMF, International Financial Statistics database; and IMF staff calculations.

and promote credit, countries should also strengthen the legal rights of borrowers and lenders, and increase the availability of credit-related information. In Iran, the effect of rapid credit growth on non-oil activity has weakened as nonperforming loans (NPLs) continue to increase.

Interbank rates have continued to rise as monetary policy tightens in tandem with the United States, but sovereign spreads have narrowed as government cash constraints have eased with the higher oil price. Deposit growth remains slow, but has been broadly stable across the GCC. Although bank profitability has edged down due to compressed margins in several countries, NPLs do not appear to be a significant concern in many countries. While a large accumulation of government arrears has led to higher NPLs in Algeria, these are expected to decrease as arrears are cleared. However, in Iran and Iraq, banking systems continue to face numerous challenges, which will be the focus of

reforms expected to be implemented this year. **Financial markets** across the region were moderately affected by the recent wave of volatility in global asset markets. These movements suggest that the region is not insulated from global financial developments, and underscore the importance of improving prudential regulation and oversight.

Accelerating the Structural Reform Agenda

With growth prospects low relative to historical standards, it is **paramount to accelerate the structural reform agenda** and move to a new growth model that promotes diversification and private sector development. Labor market and education reforms that boost productivity and create opportunities for everyone will be critical. Some important steps have been taken, but more needs to be done. For instance, the United Arab Emirates continues to invest in education and innovation, while the recent introduction of a new corporate bankruptcy law will further improve the business environment. Meanwhile, Iran is developing programs to foster job creation for young individuals and women. Also, Bahrain has introduced a wage protection system and significant measures to increase job flexibility for expatriates. In Qatar, a visa-free entry program to stimulate tourism was recently announced, along with a new law that seeks to expand the protection of expatriate labor. But these reforms should also be underpinned by efforts to increase transparency and accountability, and by stronger institutions and governance. As recognized by policymakers in Marrakesh (Box 1.2), a commitment to the completion of these reforms will be instrumental in achieving higher and more inclusive growth.

Risks Remain Skewed to the Downside

Overall, the balance of risks remains skewed to the downside. There is high uncertainty surrounding the *outlook for oil prices* (see the *Global Developments* section). With each \$10 reduction in the price of oil leading to an instantaneous deterioration of 3 percentage points of GDP in the fiscal balance of MENAP oil exporters (excluding Libya and Yemen). In addition to the direct fiscal impact discussed, a *faster-than-expected tightening of financial conditions* could also trigger abrupt financial market and asset price corrections that put

pressure on the asset quality of banks. This could affect credit growth and slow economic activity in the region. Lower economic activity would also result if escalating import tariffs or a shift toward *inward-looking policies* disrupted global trade and investment, and resulted in lower oil prices. At the regional level, *conflicts and geopolitical risks* persist, and commitment to the implementation of key fiscal measures and structural reforms could weaken, considering the observed increase in oil prices. The continued commitment to fiscal consolidation, although at a slower pace, could, in contrast, boost investor confidence and result in stronger growth.

Box 1.1. Creating Fiscal Space: The Case for Reforming Public Sector Wage Bills in the Middle East, North Africa, Afghanistan, and Pakistan Region¹

Countries in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region need to promote higher and more inclusive growth, and create jobs for their young and rapidly growing populations (see Box 1.2). Yet many countries have seen dramatic reductions in the fiscal space available for public investment in infrastructure and human capital.

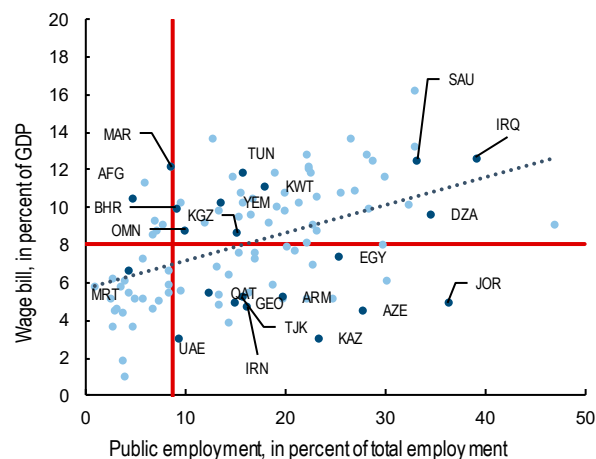
Historically, most countries in the region have used public employment and compensation policies to achieve multiple socioeconomic objectives, including employment and redistribution of wealth. As a result, public sector wage bills have grown large and public employment is high relative to global peers (Figure 1.1.1). Also, public sector compensation is above that in the private sector in many cases. For example, the gap between average public and private sector wages is about 200 percent in the Gulf Cooperation Council countries.

Despite high public wage bills, socioeconomic outcomes in the region remain below par. Unemployment has remained high, and overly generous public sector compensation has distorted labor markets. Government efficiency is lower than in peers, and the business and regulatory environment has stifled private sector activity; internationally comparable tests show education quality is weak, and access to and quality of public health care are mixed.

By complementing other reforms, such as energy subsidy reforms and fair taxation, public wage bill reforms can enable higher investment in infrastructure and social protection. This, together with improving the efficiency and quality of public service delivery and removing labor market distortions, can boost private sector growth and job creation—a more sustainable source of employment for the millions of youth entering the labor market each year.

Policymakers have already started to evaluate their public sector wage bills in the context of fiscal reforms. Some countries, including Algeria, Egypt, Iraq, Morocco, and Tunisia, have taken measures, such as wage and hiring freezes, to adjust public employment and compensation. International experience suggests, however, that the gains from such measures are difficult to maintain over the medium term.

Figure 1.1.1
Wage Bills and Public Sector Employment, 2005-16
(In percent, average)



Sources: IMF, World Economic Outlook database; country authorities; national labor force surveys; International Labour Organization data; and IMF staff model estimates.

Note: Data labels in this figure use International Organization for Standardization (ISO) country codes. Coverage (120 countries across the world) varies across periods. Red lines represent emerging market and developing economy weighted averages.

¹ This box was prepared by Gaëlle Pierre, based on Tamirisa, Duenwald, and others (2018).

Box 1.1 *(continued)*

To achieve lasting effects, countries need to implement deeper reforms. These reforms could (1) ensure that public employment and compensation policies are fiscally sustainable by identifying drivers of public wage bills and anchoring their growth in medium-term fiscal plans; (2) focus compensation and employment policies on providing public services effectively, efficiently, and equitably, by undertaking expenditure reviews and strengthening mechanisms for public service delivery; and (3) strengthen institutions and data, including control over bonuses and allowances, and linking compensation to performance.

The sequencing of public wage bill reforms should reflect country-specific circumstances and aim at building synergies with other policies. Particular attention should be paid to smoothing the transition through early social impact analyses and stronger social protection, and the private sector should be strengthened by taking steps to diversify the economy, bolster governance, and improve the business environment and the functioning of the labor market.

Box 1.2. An Action Plan for Inclusive Growth in the Middle East, North Africa, Afghanistan, and Pakistan Region ¹

The Middle East, North Africa, Afghanistan, and Pakistan region holds enormous promise, yet protracted regional conflicts, low commodity prices, weak productivity, and poor governance impede the region’s performance. Since 2011, regional growth has been three-fourths the previous decade’s average, a rate insufficient to significantly reduce unemployment. A staggering 25 percent of young people are jobless, and women are three times less likely than men to seek work. To take advantage of the global upswing, the region must accelerate reforms to spur growth and job creation, and harness the talent of its youth and women.

The “Opportunity for All” Conference in Morocco in January 2018 discussed how to identify new sources of growth and policy measures to make growth more inclusive and job-rich. Cohosted by the government of Morocco, the Arab Fund for Economic and Social Development, the Arab Monetary Fund, and the IMF, the conference brought together more than 400 representatives from the official and private sectors, youth, and civil society. Conference attendees agreed to a set of reform priorities, summarized as the *Marrakesh Call for Action*. This agreement calls on governments to “**ACT NOW**” to pursue actions that promote the following:

- **Accountability:** Increase transparency and strengthen institutions to improve governance, tackle corruption, and ensure responsibility for inclusive policies.
- **Competition:** Foster a more vibrant private sector through improved access to finance and a better business environment with fewer barriers and less red tape.
- **Technology and Trade:** Leverage technology and nurture trade to generate new sources of growth, create jobs, and foster prosperity.
- **No one left behind:** Build strong safety nets and strengthen legal rights to empower disadvantaged groups, including youth, women, rural populations, and refugees.
- **Opportunity:** Increase and improve the quality of social and investment spending and pursue fairer taxation to support growth, lift up citizens, and share the burden of reform more equitably.
- **Workers:** Invest in people and reform education to equip workers for the new economy.

The importance of the international financial community in this process was also recognized. More robust and inclusive growth is a shared responsibility and vitally important not only for the region, but also for the rest of the world. More external financing, preferably as grants, will be needed to support the region, particularly to help post-conflict countries and people displaced by war.

Looking ahead, meaningful reforms will be needed to operationalize the *Marrakesh Call for Action* and will require strong ownership of reforms and engagement by all parties. Conference participants recognized that, while some progress had been made in the past several years, much more remains to be done. The *Marrakesh Call for Action* will guide the IMF’s engagement with policymakers and other stakeholders in the region, as well as its analytical work. The IMF will work closely with its member countries, private sector civil society, and international financial institutions to help implement reforms in the region to raise growth and living standards, and generate a more prosperous future.

¹ This box was prepared by Peter Kunzel.

MENAP Oil-Importing Countries: Risks to the Recovery Persist

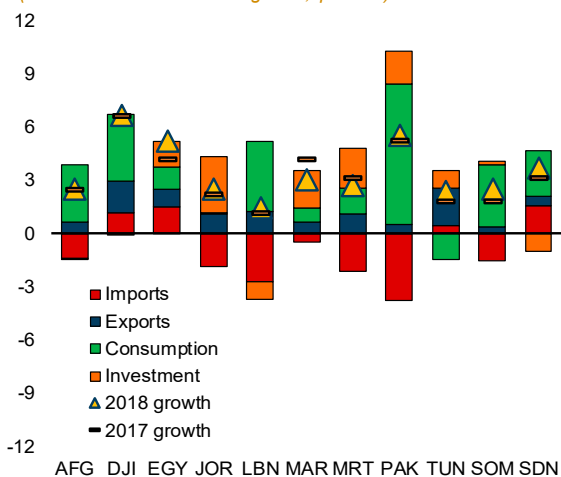
The growth recovery in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) oil-importing countries is set to continue in 2018, lifted by gains from ongoing reforms, improved domestic confidence in some countries, and a steady upswing in external demand. While the outlook remains broadly positive, with a moderate uptick in economic activity projected for 2019, it has softened for most countries relative to the forecast in the October 2017 Regional Economic Outlook, and risks remain skewed to the downside. In addition, growth is expected to remain too low to provide enough jobs for the expanding labor force. Generating broad-based growth that benefits all will require an acceleration of structural reforms that improve the business climate and boost productivity. The need for sustained fiscal consolidation that protects much-needed social spending and investment while ensuring stability also persists.

Growth Recovery Remains Fragile

Regional growth is estimated to have reached 4.2 percent in 2017. It is projected to increase further to 4.7 percent this year and to 5 percent on average during 2019–23, with some countries experiencing appreciably faster growth (Figure 2.1). Further strengthening of the outlook for the euro area (see the *Global Developments* section) will continue to support economic activity through exports, remittances, foreign

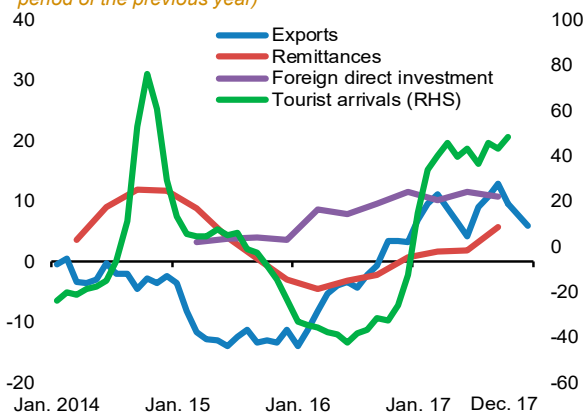
direct investment, and tourism (Figure 2.2). However, persistent conflicts and their regional spillovers, security concerns, weaker-than-anticipated public investment (Afghanistan, Jordan), delays in implementation or completion of structural reforms (Jordan, Morocco, Pakistan, Tunisia), and political and policy uncertainty (Lebanon, Pakistan) continue to weigh on growth. Overall, the outlook has softened slightly since the October 2017 *Regional Economic Outlook*.

Figure 2.1
Drivers of Growth, 2018: Exports and Investment Complement Consumption
(Contributions to real GDP growth, percent)



Sources: National authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes.

Figure 2.2
External Demand Supportive of Growth
(Three-month moving average, percent change over same period of the previous year)



Sources: National authorities; IMF, International Financial Statistics database; Haver Analytics; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. Tourist arrivals comprise EGY, JOR, and MAR. Exports comprise AFG, DJI, EGY, JOR, LBN, MRT, MAR, PAK, SDN, SYR, and TUN. Remittances comprise EGY, JOR, MAR, TUN, and PAK. Foreign Direct Investment comprises EGY, MAR, and PAK. Calculated as quarter over quarter change.

The *outlook for Egypt has improved* relative to the October 2017 forecast. In the context of its IMF-supported program, improving confidence is boosting private consumption and investment, adding to the increase in exports and tourism. Growth is projected to rise to 5.2 percent in FY2018 (from 4.2 percent last year) and accelerate further to 5.5 percent in FY2019, aided by an increase in gas production. Improved energy supply, investment related to the China-Pakistan Economic Corridor, and strong credit growth helped to raise *Pakistan's* growth to an estimated 5.6 percent in FY2018, from 5.3 last year. However, an increase in macroeconomic vulnerabilities and domestic policy slippages have weakened the outlook, with growth now projected to moderate to 4.7 percent in FY2019.

The *growth outlooks for other countries are more modest*. Growth in Sudan is expected to advance to 3.7 percent this year from 3.2 percent in 2017, with stronger optimism, following the revocation of US trade and financial sanctions in October 2017, increasing domestic demand, and encouraging foreign investment flows. However, continued fiscal and external challenges are anticipated to cause growth to slow to 3.5 percent in 2019. A recovery in agriculture, manufactured exports, and tourism is expected to lift Tunisia's growth to 2.4 percent in 2018, from 1.9 percent in 2017, despite lower phosphate production. Growth is set to increase further to 2.9 percent in 2019. Growth in Jordan will increase slightly from 2.3 percent in 2017 to 2.5 percent in 2018, with a slight uptick to 2.7 percent in 2019. Growth is expected to be held back by ongoing delays in implementing structural reforms, a challenging regional environment, and limited scope for public investment given the constrained fiscal position. In both Mauritania and Morocco, growth will soften in 2018 to 2.7 and 3.1 percent (down from 3.2 percent and 4.2 percent in 2017), respectively, due to the impact of drought on

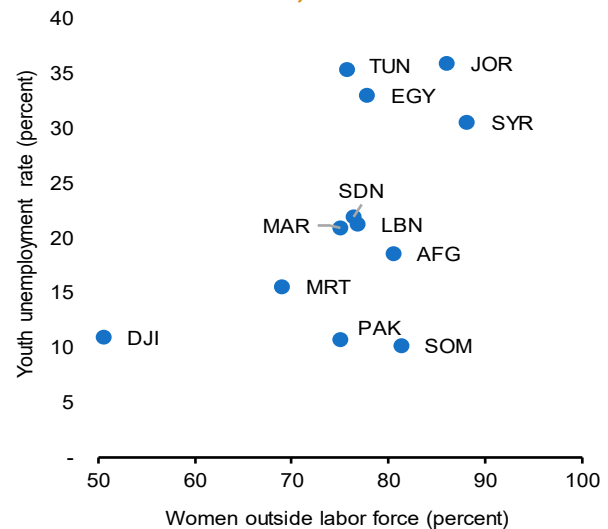
agriculture. However, growth is anticipated to rebound in 2019 to 4.5 percent in Mauritania and 4 percent in Morocco.

Growth prospects for *countries affected by conflict* remain clouded. The ongoing impact of regional conflicts on confidence, trade, tourism, investment, and real estate will constrain the growth recovery in Lebanon, with growth projected to tick up to 1.5 percent in 2018, from 1.2 percent in 2017, then rise to 1.8 percent in 2019. Although it is improving, growth in Somalia and Afghanistan remains fragile as drought and ongoing security challenges continue to impede economic activity.

Growth Too Low to Create the Jobs Needed

At an average of 4.9 percent over 2018–22, growth rates remain too low to effectively reduce *unemployment*, particularly for young people (Figure 2.3; Box 1.2). With the labor force expected to expand 2.2 percent a year over the

Figure 2.3
Youth Unemployment Rate and Women outside Labor Force, 2017



Sources: World Bank, World Development Indicators; and IMF staff calculations. Note: Country abbreviations are International Organization for Standardization (ISO) country codes.

next five years, MENAP oil importers would

need sustained growth of 6.2 percent annually just to maintain unemployment at its current level of 10 percent.¹ Achieving higher growth will require an acceleration in *structural reforms* that allows the private sector to flourish and generate the required jobs. This is especially critical because the scale of countries' fiscal vulnerabilities means that the public sector does not have the capacity to absorb the new labor market entrants (see Box 1.1 in Chapter 1). However, upcoming elections (Lebanon, Mauritania, Pakistan, Tunisia) and a more challenging political environment could slow the reform process. Moreover, a high perception of corruption and lack of transparency (IMF, forthcoming) in several countries could not only affect macroeconomic outcomes directly, reducing investment and productivity, but could also heighten social tensions and hinder reform.

Countries in the region are slowly taking steps to improve *governance and transparency*. For instance, Sudan has appointed external auditors to review public policies. Afghanistan enacted legislation to criminalize acts of corruption, and anti-corruption laws are being operationalized in Morocco, Tunisia, and Somalia. Additional efforts are also being made to bolster the *business environment*, with Pakistan recently strengthening its bankruptcy framework.

But, as recent *discussions in Morocco* highlighted (Box 1.2), more remains to be done to improve accountability, foster a more vibrant private sector, and ensure access to opportunities for all.

External and Fiscal Positions Improving, but Fiscal Vulnerabilities Remain

Following three years of decline, *exports* of MENAP oil-importing countries *grew* by 6.4 percent in 2017 and are projected to accelerate by 8.4 percent in 2018 and 8.6 percent in 2019. This largely reflects improved external demand, greater exchange rate flexibility (Egypt, Pakistan, Tunisia), gains in competitiveness (Morocco, Tunisia), and a pickup in the prices of phosphates (Morocco, Tunisia), metals (Mauritania), and cotton (Pakistan). In contrast, despite the impact of higher oil prices relative to 2017, *import growth is projected to slow* to 4.8 percent in 2018 (from 6.8 percent in 2017) and remain broadly steady around 5.5 percent over the medium term. This import compression partly reflects an anticipated slowdown in capital imports for infrastructure projects (Djibouti, Mauritania, Pakistan). The region's current account deficit is, therefore, projected to narrow from 6.5 percent of GDP in 2017 to 6.2 percent in 2018, and further to 5.7 percent in 2019. Nevertheless, these gains are less than what could have been achieved if oil prices had remained at levels expected in October.

Increased *capital inflows* (Egypt, Morocco), including from international bond issues (Egypt, Jordan, Tunisia) and grants from foreign governments (Afghanistan, Somalia) have complemented the impact of stronger external demand, *helping bolster reserves* across most MENAP oil-importing countries (Figure 2.4). At the regional level, subsidy reforms, reduced capital spending, and stepped-up revenue mobilization are helping sustain an improvement

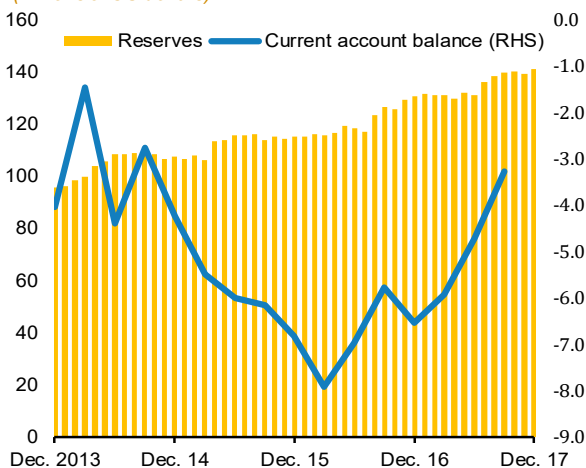
¹ Elasticity of GDP growth to employment used for MENAP oil importers is 0.39 (Crivelli, Furceri, and Toujas-Bernate 2012).

in the *fiscal position* from a deficit of 6.8 percent of GDP in 2016 to 6.5 percent in 2017 and 5.9 percent in 2018. Additional fiscal adjustment is expected (Figure 2.5) through efforts to raise or unify value-added tax rates (Egypt), eliminate or reduce exemptions (Jordan, Morocco), address loopholes, strengthen administration, and reform income and corporate tax systems (Jordan, Morocco). Under the IMF-supported programs in

Egypt and Tunisia, further growth-friendly and socially conscious adjustment of more than 2 and 0.7 percentage points of GDP, respectively, is anticipated to be achieved by raising taxes and instituting further measures to reduce subsidies, while maintaining a floor on social spending.

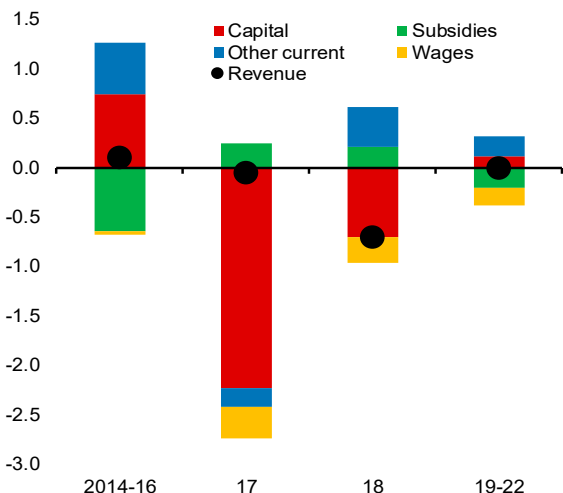
However, *public debt levels remain elevated*, exceeding 80 percent of GDP in several countries (Egypt, Lebanon, Sudan; Figure 2.6). Such large debt stocks represent a significant burden on the economy. Debt service crowds out growth-enhancing expenditures—for instance, interest payments are, on average, between 5 and 10 percent of GDP for Egypt and Lebanon. The large debt stocks also add to external vulnerabilities given the large share of external debt. This burden will increase since financing costs are likely to rise in line with the expected tightening of monetary policy in advanced economies, especially in MENAP countries where deficits remain high (Egypt, Lebanon) and where the short-term debt to be refinanced is large (Egypt). This highlights the importance of continued efforts to reduce debt.

Figure 2.4
Central Bank Reserves and Current Account Balance
(Billions of US dollars)



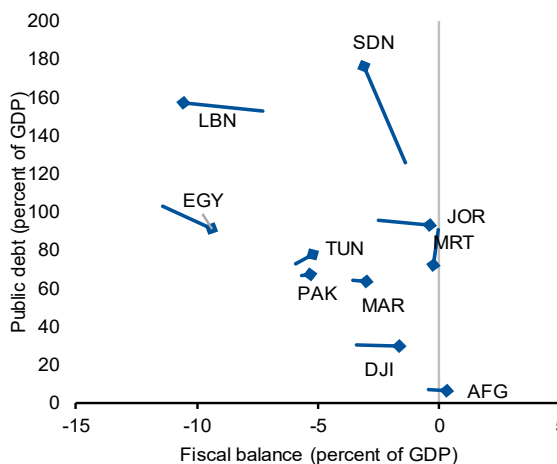
Sources: National authorities, IMF, International Financial Statistics database; and IMF staff calculations.
 Note: RHS = right scale. Reserves comprise AFG, EGY, JOR, LBN, MAR, and PAK. Current account balance comprises EGY, JOR, and TUN.

Figure 2.5
Changes in Government Spending and Revenues
(Percent of GDP, change from prior year, simple averages)



Sources: National authorities; and IMF staff calculations.

Figure 2.6
Narrowing Fiscal Deficits, 2017 and 2018
(Overall fiscal balance and public debt, percent of GDP)



Sources: National authorities; and IMF staff calculations.
 Note: Country abbreviations are International Organization for Standardization (ISO) country codes. Diamond corresponds to 2018; beginning of the arrow to 2017.

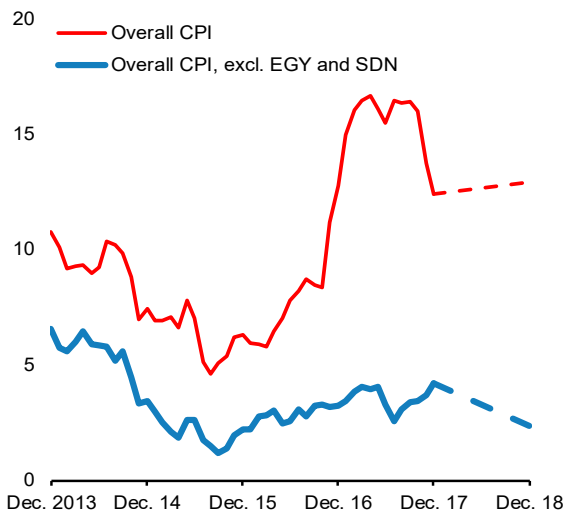
Inflation Pressure Is Easing, and Financial Sectors Remain Resilient

Inflation pressure in the region has abated, with *inflation broadly stable* at about 12 percent. This largely reflects the receding impact of one-off factors in Egypt and Sudan and, in some cases, monetary tightening (Jordan, Tunisia) or a decline in food prices (Morocco, Pakistan; Figure 2.7).

From a legacy of high, but declining levels of nonperforming loans, banking sectors have generally remained stable, liquid, and adequately capitalized. *Private credit growth remains relatively buoyant*, with developments largely unchanged compared with those described in the October 2017 *Regional Economic Outlook*. Several countries (Egypt, Lebanon, Jordan, Pakistan) are beginning to embrace financial technology (“fintech”) to increase financial inclusion.

To enhance resilience, the authorities need to continue to strengthen *regulatory and supervisory frameworks* (Djibouti, Mauritania),

Figure 2.7
Inflation
(Annual percent change)



Sources: National authorities; and IMF staff calculations.
Note: Overall CPI comprises EGY, JOR, LBN, MAR, PAK, SDN, TUN. CPI = consumer price index.

insolvency and bankruptcy regimes (Egypt, Jordan, Morocco, Tunisia), and in some cases deposit insurance arrangements (Egypt, Pakistan). Country authorities also need to remain alert and ready to adapt their frameworks to new sources of risk, including as the reach of fintech expands. Further, countries need to reinforce their anti-money laundering and combating the financing of terrorism frameworks. This will help bring them in line with international standards (Afghanistan, Somalia, Sudan) to ensure that the private sectors maintain their current access to finance.

Risks Remain Tilted to the Downside

Overall, *risks* remain tilted to the downside:

- A further deterioration of regional conflicts or security conditions, intensification of domestic social tensions, or reform fatigue could derail the implementation of policy and reforms and weaken economic activity.
- The outlook for oil prices anticipates a rise to above \$60 a barrel in 2018–19, a 20 percent increase over 2017. A further increase in oil prices could undermine consumption, increase fiscal pressures, and worsen external imbalances in most countries. For instance, a \$10 increase in oil prices relative to the baseline would lead to a worsening in the current account balance by 1 percentage point of GDP across MENAP oil importers.
- Tighter and more volatile global financial conditions could increase borrowing costs further for MENAP oil importers, adding to existing fiscal sustainability concerns, weighing on bank balance sheets, and undermining private sector activity. Such tightening could be particularly challenging for countries facing significant financing

needs in the near term. For example, taking into account the gross financing needs for 2018, a 200 basis point increase in interest rates relative to the baseline would raise financing costs for Lebanon, Egypt, and Pakistan by 0.9, 0.8, and 0.7 percentage point of GDP, respectively. In addition, tightening of global financial conditions could precipitate capital outflows from the region that would put pressure on external positions and exchange rates.

- Escalating import tariffs or a shift toward more inward-looking policies could reduce global trade or affect commodity prices, removing some of the support being provided by external demand.

However, there also remains the potential for upside risk in those countries that would benefit if activity in key trading partners turned out stronger than expected.

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MENAP Region: Selected Economic Indicators, 2000–19

(Percent of GDP, unless otherwise indicated)

	Average 2000–14	2015	2016	2017	Projections	
					2018	2019
MENAP¹						
Real GDP (annual growth)	4.8	2.5	4.9	2.6	3.4	3.7
<i>of which non-oil growth</i>	5.9	1.6	1.9	3.2	3.6	3.9
Current Account Balance	8.8	-4.0	-4.2	-0.9	0.5	-0.3
Overall Fiscal Balance	3.5	-8.6	-9.4	-5.6	-4.4	-3.5
Inflation (year average; percent)	7.1	5.6	4.7	6.3	8.2	6.8
MENAP oil exporters						
Real GDP (annual growth)	5.0	1.9	5.4	1.7	2.8	3.3
<i>of which non-oil growth</i>	6.6	0.3	0.8	2.6	3.2	3.4
Current Account Balance	12.6	-3.8	-3.6	1.2	3.0	1.8
Overall Fiscal Balance	6.7	-9.2	-10.6	-5.2	-3.8	-2.8
Inflation (year average; percent)	7.1	5.1	4.0	3.4	6.3	5.5
MENAP oil exporters, excluding conflict countries						
Real GDP (annual growth)	4.3	2.2	5.2	1.3	2.6	3.0
<i>of which non-oil growth</i>	6.2	1.9	2.1	2.5	3.1	3.2
Current Account Balance	13.1	-3.1	-2.9	1.3	3.6	2.5
Overall Fiscal Balance	7.2	-7.8	-9.2	-4.9	-3.5	-2.3
Inflation (year average; percent)	6.9	4.9	4.5	3.6	6.5	5.7
Of which: Gulf Cooperation Council (GCC)						
Real GDP (annual growth)	4.9	3.6	2.1	-0.2	1.9	2.6
<i>of which non-oil growth</i>	6.9	3.5	1.6	1.8	2.7	2.7
Current Account Balance	16.5	-2.4	-3.4	2.1	4.3	3.1
Overall Fiscal Balance	9.7	-8.4	-10.8	-5.5	-3.4	-1.9
Inflation (year average; percent)	2.8	2.0	2.1	0.2	3.6	2.5
MENAP oil importers						
Real GDP (annual growth)	4.3	3.8	3.7	4.2	4.7	4.6
Current Account Balance	-2.2	-4.4	-5.7	-6.5	-6.2	-5.7
Overall Fiscal Balance	-5.6	-7.2	-6.8	-6.5	-5.9	-5.2
Inflation (year average; percent)	7.6	6.8	6.2	12.4	12.2	9.5
MENA¹						
Real GDP (annual growth)	4.8	2.4	4.9	2.2	3.2	3.6
<i>of which non-oil growth</i>	6.1	1.3	1.5	2.9	3.3	3.8
Current Account Balance	9.5	-4.4	-4.6	-0.6	1.1	0.2
Overall Fiscal Balance	4.2	-8.9	-10.0	-5.6	-4.3	-3.3
Inflation (year average; percent)	7.0	5.8	4.9	6.6	8.7	7.1
Arab World						
Real GDP (annual growth)	5.1	3.2	3.1	1.7	3.0	3.5
<i>of which non-oil growth</i>	6.4	2.3	1.1	2.6	3.2	3.7
Current Account Balance	10.6	-5.1	-6.1	-1.4	0.2	-0.7
Overall Fiscal Balance	4.7	-10.1	-11.3	-6.2	-4.8	-3.3
Inflation (year average; percent)	4.7	4.6	4.0	5.8	7.9	6.0

Sources: National authorities; and IMF staff calculations and projections.

¹2011–19 data exclude Syrian Arab Republic.

Notes: Data refer to the fiscal year for the following countries: Afghanistan (March 21 to March 20) until 2011, and December 21 to December 20 thereafter, Iran (March 21 to March 20), and Egypt and Pakistan (July to June).

MENAP oil exporters: Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Yemen.

GCC countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

MENAP oil exporters excl. conflict countries: Algeria, Bahrain, Iran, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

MENAP oil importers: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syria, and Arab World: Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, and Yemen.