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Arab Countries in Transition:
Economic Outlook and Key Challenges

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I. REGIONAL ECONOMIC OUTLOOK AND KEY CHALLENGES

The Arab Countries in Transition (ACTs) have had diverging trajectories over the past year and face an uncertain outlook.[1] *Improvements in the European economy, lower oil prices, and some progress on the policy front have provided tailwinds to growth, which is expected to pick up significantly in Egypt and Morocco. At the same time, unemployment remains high. Moreover, several of the ACTs have also suffered from intensifying and spreading conflicts that cause widespread human suffering and sizeable economic challenges. Libya and Yemen are directly affected, while spillovers from these conflicts and the civil wars in Iraq and Syria weigh on Jordan and Tunisia, as well as other countries in the region (e.g., Lebanon, Djibouti), Turkey and Europe. These spillovers come most prominently in the form of large refugee flows, deteriorating security, and pressures on economic infrastructures and labor markets. All these factors add urgency to the need in the Arab countries to strengthen economic resilience and address long-standing sources of inequity and exclusion. Coordinated and scaled-up support from the international community will be also critical in stabilizing conditions in the region, addressing the refugee crisis, and securing a more promising economic future for the ACTs in this challenging environment.*

A. Background and recent developments

Macroeconomic stability has been broadly maintained. Non-conflict ACTs experienced positive growth in 2014 and the first half of 2015, supported by some recovery in European partner countries, lower prices for oil and other commodities, and the early impact of reform efforts. Inflation was contained to below 5 percent in most countries except Egypt and Yemen. Budget positions and external current accounts also improved in many cases, which—for the first time since 2010—led to a reversal in the growth of central government deficits and strengthened reserve coverage. Successful bond issuances in Egypt, Morocco, and Tunisia were signs of improving confidence. At the same time unemployment has remained stubbornly high, especially among the youth and women.

Non-conflict Arab Countries in Transition: Selected Economic Indicators, 2011 - 2016[1]
(Percent of GDP, unless otherwise indicated)

			Estimated		Projections	
	2011	2012	2013	2014	2015	2016
GDP growth, percent[2]	2.1	2.5	2.6	2.3	4.0	4.0
CPI inflation, period average, percent[2]	8.7	6.2	7.3	6.3	8.4	7.9
Fiscal balance, central government	-6.3	-7.9	-9.0	-8.2	-6.2	-4.9
Total government debt, general government	61.1	65.9	70.4	73.2	74.4	74.0
Current account balance	-7.0	-9.2	-7.2	-5.5	-5.7	-5.0
Unemployment rate, percent	13.0	12.0	12.0	-	-	-
Youth unemployment rate, percent	31.9	30.1	30.6	-	-	-

Sources: ILO; national authorities; and IMF staff calculations.
[1]Comprises: Egypt, Jordan, Morocco, and Tunisia.
[2]Average, weighted by previous year's GDP (in PPP)

[1] The ACTs include Egypt, Jordan, Libya, Morocco, Tunisia, and Yemen.

Progress on structural reforms has been uneven and generally piecemeal. Most ACTs have made progress toward reforming their generalized energy subsidies to create space for better-targeted social protection and higher spending on infrastructure, healthcare, and education. At the same time, progress with efforts to rein in current spending, measures to strengthen revenues, and important structural reforms across a wide range of areas has been uneven. Often, these reforms have not been adequate for laying the foundations for higher and more inclusive growth. Policymakers have been emphasizing the difficult socio-political environment and capacity constraints as key challenges.

Violent conflicts have given rise to an increasingly challenging environment. Libya and Yemen (together with Iraq and Syria) have been experiencing high levels of violence that exact a heavy humanitarian toll and fuel political and social tensions. Their economies experienced sharp downturns (Yemen's GDP is estimated to have contracted by about 35 percent since October 2014), which have wiped out previous progress and from which it will take many years to recover. These conflicts have generated significant spillovers; for example, as of end-2014, the Syrian war alone produced more than four million officially recognized refugees, most of whom have so far been absorbed by neighboring countries including Jordan, Lebanon and Turkey. Tunisia is also hosting a large and increasing number of Libyans. While these inflows of people can add to demand and, over time, provide support to growth, they create significant immediate challenges for host countries: in Jordan, for example, the authorities estimate that Syrians living in the country exceed one fifth of the Jordanian population, giving rise to pressures on public infrastructure as well as labor and product markets. In addition, security and political stability have been affected negatively in many countries. For example, Tunisia's receipts from tourism, which accounted for 7 percent of GDP in 2014, are expected to decline by half in 2015 in the wake of the two terrorist attacks on the Bardo Museum and at Sousse.

B. Short-term outlook

Growth may pick up in some countries but will remain too low to foster enough job creation. In Egypt and Morocco, growth is expected to accelerate in 2015 to 4-5 percent, reflecting a pickup in investment for Egypt and a strong harvest in Morocco. However, the outlook for countries more affected by conflict, either directly (Libya, Yemen) or through spillovers (Jordan, Tunisia), is more subdued. More broadly, the projected average growth for the ACTs (excluding Libya and Yemen) of about 4 percent in 2015 and 2016 will still fall significantly short of the 6-7 percent growth rates needed, under current structural policies, to significantly lower unemployment and improve living conditions for the broader population. Weak domestic demand and softer commodity prices are expected to keep inflation low for most countries and reduce external pressures. Fiscal deficits would continue to narrow, except for Tunisia (reflecting increased security spending and outlays to offset the negative shock to tourism) and the countries in conflict. At the same time, given the build-up of spending in recent years, public debt levels will remain high, and elevated financing needs will continue to call for large flows from external official donors with a private sector still remaining mostly on the sidelines.

Arab Countries in Transition: Financing Needs[1]

(Billions of U.S. dollars)

			Estimates		Projections	
	2011	2012	2013	2014	2015	2016
Current account deficit (excl. official transfers)	25.4	33.2	28.1	33.2	29.1	29.0
External amortization	13.1	13.8	13.9	20.0	22.7	18.3
External gross financing needs[2]	**38.5**	**47.0**	**41.9**	**53.2**	**51.8**	**47.3**
Budget deficit (excl. grants)	37.2	48.3	54.4	67.0	53.9	46.8
Public external amortization	8.6	6.2	9.7	8.7	14.5	12.9
Fiscal financing needs[3]	**45.7**	**54.6**	**64.1**	**75.7**	**68.4**	**59.7**

Sources: National authorities; and IMF staff calculations.
[1]Comprises: Egypt, Jordan, Morocco, Tunisia, and Yemen. Libya does not face financing needs.
[2]Current account deficit, excluding grants, plus amortization.
[3]Budget deficit, excluding official grants, plus public external amortization.

Risks have further tilted to the downside. Global growth is facing headwinds as a result of the demand slowdown in China, risks linked to the expected normalization of monetary policy in the United States, and increasing financial sector volatility. If these risks materialized, they would adversely weigh on ACT exports and financing conditions, and thus growth. Overvalued real exchange rates can also weigh on export performance. Persistently low oil prices could lead to lower remittances and donor support from oil-rich countries, while an increase in oil prices would lead to growing fiscal and external current account deficits. In addition, a continuation of the conflicts would further disrupt trade, strain public finances, reduce consumer and investor confidence, and affect reform appetite.

C. Short-term policy challenges

Consolidating macroeconomic stability. To increase resilience in this challenging environment, the ACTs need to continue making progress on two fronts:

- **Ensure fiscal sustainability, improve spending quality, and increase fairness.** To further strengthen fiscal positions, while containing the impact on growth, and over time reduce the debt burdens that are particularly high in Egypt and Jordan, countries should further advance with subsidy and safety nets reforms; re-orient and increase the efficiency of spending to investment in priority sectors including education, health, and infrastructure projects (e.g., in water management, energy and transportation); mobilize more domestic revenue while enhancing fairness by broadening tax bases and enhancing collection; and improve public financial management. These reforms would also help countries cope with some of the pressures from large refugee inflows, though this can be achieved only up to a point from domestic sources alone.

- **Strengthen the external sector.** To increase external resilience and further improve reserve coverage, particularly in cases with high current account deficits, some countries (Egypt, Morocco and Tunisia) could gradually allow more exchange rate flexibility while improving monetary transmission mechanisms through an expansion of interbank markets and other suitable reforms.

Escaping the unemployment trap. With private investors still largely on the sidelines, restoring confidence and reviving private sector-led job creation will take some time. In some countries, large inflows of refugee heighten the challenge. One way to boost employment in the short term would entail increasing externally financed public investment in infrastructure and basic services, while safeguarding debt sustainability. This approach would also provide space for deeper structural reforms through providing visible signs of progress to skeptical populations. Implementing this agenda would require substantial donor support, credible commitments to reforms by the authorities, strengthened public investment management processes, and significant capacity building assistance.

D. Medium-term challenges

Ensuring that growth is associated with strong job creation that benefits all. Many of the root causes of inequity and social tension that culminated in the Arab Spring have yet to be addressed. These include: high unemployment and unequal economic opportunities, particularly among the youth and women; a significant rural-urban divide in the level of access to basic services such as water, and a notable disadvantage for small businesses in access to credit and procurement contracts. Addressing these will also boost potential growth in the medium term, thus reducing the risk of these countries getting stuck in a low growth equilibrium.

Making growth more inclusive requires action in several areas. ACTs need to move toward economic models that encourage more private sector activity, more integration into the international economy, and more competition in support of continuous improvement in productivity. This transition should be achieved while providing adequate safeguards for the poor. The specific context of each country will provide guidance on prioritization and sequencing, but key elements of the reform agenda include:

- **Increase transparency and improving governance.** Improved transparency and governance in both the public and the private sectors are key to improving consumer and investor confidence. Most ACTs are already making early efforts to strengthen public financial management and increase budget transparency. These efforts need to be maintained and intensified. In addition, countries could consider making more use of online solutions for public services to minimize the scope for corruption and enhance the efficiency of service delivery; and invest in strengthening transparent enforcement of regulations to create a better level playing field for firms and individuals.

- **Strengthen business climates.** More efficient registration processes and better competition policies can help boost firm creation. Better insolvency regimes can reduce risks associated with entrepreneurship; and better credit information systems, collateral regimes, and corporate disclosure requirements can improve access to finance in particular for small- and medium-sized firms, which are typically not served by banking sectors.

- **Improve education, training, and labor market policies.** Countries should focus on: (i) reforming education and vocational training in collaboration with the private sector, so as to build skills that make workers employable; (ii) increasing incentives for private relative to public sector employment; (iii) developing targeted measures to enhance women participation; and (iv) strengthening incentives for firms in the informal economy to expand and eventually enter the formal sector. In addition, labor market regulations should be reviewed (especially to reduce disincentives for hiring) and better enforced.

E. Role of the international community

External support has become even more critical than before. The economic impact of the violent conflicts gives rise to substantial additional needs and makes it unlikely in many countries that private sector activity would pick-up significantly over the short term:

- **Scaled-up external financial support**. External official disbursements since the onset of the Arab Spring (totaling around US$97 billion, the dominant share of which came from Gulf Cooperation Council countries) have covered only part of the ACTs' financing gaps. Going forward, larger and more predictable financing will be critical to:
  - Support countries hosting large refugee populations;
  - Fund the reconstruction of economic infrastructure in Libya and Yemen;
  - Fund investment projects to accelerate ACT's growth potential; and
  - Facilitate a smooth budget and external adjustment by ACTs.
- **Facilitation of trade and FDI**. Further progress with trade agreements and trade regulation harmonization, and greater FDI will be needed to help build market-based recoveries and sustained growth for the ACTs. Progress in this area could provide a strong anchor for public confidence in the long-term sustainability of the economic transformations.
- **Capacity building assistance**. The reform process in the ACTs requires technical assistance and training from external partners. In this regard, the Deauville Partnership's Transition Fund has so far helped with 62 projects, totaling a volume of US$187.8 million as of September 2015. Other TA and training providers have also been active in the region, including the Middle East Regional Technical Assistance Center (METAC) that will soon also cover the Maghreb countries. It is essential that these are adequately funded to support the reform process in the ACTs.

The IMF remains fully engaged. A three-year US$2.05 billion program with Jordan, which was successfully concluded in August 2015, has helped the country maintain stability and progress with key reforms in a difficult external environment. A two-year US$1.75 billion program with Tunisia agreed in mid-2013 has recently been extended to December 2015, while a three-year US$550 million program for Yemen agreed in 2014 is currently on hold due to the worsened security conditions. In July 2014, the Fund extended a second Precautionary and Liquidity Line of US$5 billion to Morocco that provides insurance for the economy in case of adverse external shocks. The Fund is also engaged in a fruitful dialogue with the Egyptian authorities on macroeconomic policies and structural reform needs; and maintains discussions with Libyan authorities on fiscal management and macroeconomic conditions. In addition, the Fund has embarked on an analytical program in support of the inclusive growth agenda; and continues to respond to capacity development needs, including through programs at METAC and the IMF—Middle East Center for Economics and Finance (CEF).

II. EGYPT

Egypt's long-term economic prospects have improved but vulnerabilities persist. The task ahead is to maintain macroeconomic stability and to continue to foster enabling conditions for strong and inclusive growth. This involves reducing external and fiscal deficits and deepening structural reforms, including by further reducing subsidies. Adequate external financing will also be important. The IMF and the Egyptian authorities are engaged in a fruitful dialogue on how to address Egypt's challenges.

Background. Parliamentary elections are scheduled for October and November 2015. The security situation has remained difficult although tensions are largely confined to the Northern Sinai region, with sporadic terrorist attacks in Cairo. At the same time, successes included the Egypt Economic Development Conference in March that gathered large pledges, notably in the energy sector; the issuance of a Eurobond in June; and the opening of the parallel Suez Canal in August. The recent discovery of a major gas deposit could improve Egypt's energy position and contribute positively to its economy in the medium term.

Recent developments. GDP growth rebounded to 4.2 percent in 2014/15 as policy efforts, along with a return of confidence, started to produce a turnaround in economic activity and investment. As a result, unemployment fell from 13.4 percent to 12.7 percent. Inflation has been on a declining trend in recent months. Despite the impressive fiscal adjustment in 2014/15, the budget deficit was still higher than the authorities' target, in part due to delays in implementing some revenue measures. Substantial financial disbursements from the GCC have helped to stabilize international reserves at a level equivalent to about three months of imports. Financial soundness indicators point to the continued resilience of the banking sector. However, companies report difficulty in getting access to foreign exchange.

Egypt: Selected Economic Indicators, 2010/11 - 2015/16

(Percent of GDP, unless otherwise indicated)

				Estimated		Proj.
	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
GDP growth, percent	1.8	2.2	2.1	2.2	4.2	4.3
CPI inflation, period average, percent	11.1	8.6	6.9	10.1	11.0	8.8
Budget balance	-9.8	-10.6	-13.7	-13.8	-11.7	-9.7
Current account balance, excl. grants	-2.9	-4.1	-2.7	-5.0	-4.7	-4.7
Fiscal financing needs, (excl. grants),US$ billion[1]	25.5	31.4	39.9	52.5	46.6	39.6
External financing needs (excl. grants), US$ billion[2]	11.9	15.6	12.1	23.5	25.7	25.1
Public debt	76.6	78.9	89.0	90.5	90.0	89.3
External debt	14.8	13.1	15.9	16.1	14.9	16.4
Reserves in months of imports	4.7	2.7	2.5	2.7	3.2	3.1

Sources: National authorities; and IMF staff calculations.

[1] Budget sector deficit, excluding official grants, plus public external amortization.

[2] Current account deficit, excluding grants, plus amortization.

Outlook. Growth is expected to trend towards 5 percent over the medium term and inflation to gradually decline. Egypt's potential output is expected to improve over time. Reforms announced by the authorities, including in particular planned elimination of most subsidies over the next five years (except LPG) and further measures to reduce the fiscal deficit over the medium term are expected to bear fruit. In the shorter term however, large investments are expected to increase imports, weighing on growth and widening the current account deficit. Inflation is projected to trend down in the medium term as fiscal consolidation kicks in. Financing needs are expected to remain large due to a continued current account deficit and scheduled debt repayments, despite expected improvements in tourism and FDI.

Risks. If the security situation worsens, tourism and FDI are likely to suffer, reducing growth. Possible setbacks in the economic reform agenda could also weaken growth and economic stability. Current account deficits are projected at around 4 percent of GDP over the medium term and adequate external flows will be needed to protect the reserves. On the upside, accelerating fiscal reforms and reducing administrative barriers to investment would help restore business confidence and encourage the return of private investors.

Short-term policy issues. Maintaining stability and reducing external and fiscal vulnerabilities are immediate policy priorities. Despite some nominal depreciation, the pound has appreciated significantly in real effective terms over the past year. A more flexible exchange rate would bring the currency closer to its market-clearing value in the near term. This will be important for preserving international reserves, supporting competiveness, and easing foreign exchange shortages. On the fiscal side, achieving the authorities' deficit target for 2015/16 would require quick implementation of reforms that have been delayed, including the next stages of subsidies reform, introduction of VAT and other tax measures. Looking forward, the authorities should aim at setting the public debt-to-GDP ratio on a declining path.

Reforms for inclusive growth. Growth has been low for several years, although there have been signs of recovery, and at 12.7 percent unemployment today is considerably higher than in 2009/10 (9.2 percent). Unemployment is particularly high among women and young people. The poverty rate increased from 21.6 percent in 2008/09 to 26.3 percent in 2012/13, and there are wide disparities between rural and urban governorates. Access to basic infrastructure and services has deteriorated, affecting education and health outcomes as evidenced, for example, by the reversal in the infant mortality trends since 2009 and the high illiteracy rate (26 percent). However, the authorities are making strong efforts to improve the situation, including through reduction in energy subsidies, investment in infrastructure, especially schools and hospitals, adoption of the microfinance law, amendments to laws on bankruptcy, competition and land use, and the enactment of regulations to support mobile payments. The new constitution has enshrined the role of education and health in social and economic development, by mandating the increase of public spending on these sectors to international levels. In FY 2014/15, the government's outlays on education and health exceeded the energy subsidy bill for the first time in many years, reflecting the policy shift toward reprioritizing expenditures and meeting social needs as well as declining international oil prices. Promoting the private sector would contribute to broad-based growth. This would require improving the business climate and restoring competitiveness. To reach these objectives, the government is focusing on streamlining burdensome regulations, improving access to finance, and modernizing insolvency and land laws. Increasing investment in human capital and infrastructure would also help boost economic activity and productivity, and provide more equal access to job and business opportunities for all.

III. JORDAN

The authorities have made good progress in reducing domestic and external imbalances. Still, public debt is high, and further fiscal consolidation is necessary to put it firmly on a downward path. There is also a need to move to reforms supporting higher and more inclusive growth. The last review under Jordan's Stand-By Arrangement with the IMF was completed in July, and the authorities have expressed an interest in a successor arrangement.

Background. Jordan experienced robust growth during 2000–09 (averaging about 6½ percent). It is among the most open economies in the Middle East; tourism receipts, remittances, FDI flows, and external grants play an important role. Jordan imports most of the hydrocarbon products and grains that it needs.

Recent developments. Despite major external shocks over the last three years, the authorities rebuilt reserves to an adequate level and implemented a large fiscal adjustment and energy sector reforms. Progress with structural reforms, however, was mixed, and growth was not insufficient to make a dent in very low employment ratios. More recently, economic growth dropped to 2 percent y-o-y in 2015Q1, largely because of flared up regional tensions taking a toll on exports and tourism (see below). Employment remains low, reflecting both a very low labor force participation (37 percent in 2015H1) and high unemployment (12½ percent in 2015H1). Headline inflation has turned negative (-0.6 percent y-o-y in July), from a sharp decline in fuel and transportation prices over the last 12 months; core inflation continued to gradually decline, to 3.3 percent y-o-y in July. Despite disruptions to trade routes, less tourism, and a hesitant investment sentiment, the current account deficit is gradually narrowing, helped by the decline in oil prices. Performance under the IMF-supported program was good in the run-up to the final review, with policies on track to meet their 2015 targets. The authorities have broadly stabilized public debt, but it remains high at about 90 percent of GDP at present. Against a backdrop of sluggish credit growth and a strong reserve position, the Central Bank of Jordan reduced its policy rate by 25 basis points in June to 2.50 percent. Net international reserves, at over 6 months of imports, continued to over-perform relative to program targets.

Short-term outlook. Supported by lower oil prices, growth is expected to pick up in the second half of the year, to an average of close to 3 percent in 2015 and to 3¾ percent in 2016; these projections are predicated on a recovery in investor sentiment and tourism. Inflation is expected to gradually increase over the coming year, to 2.5 percent y-o-y in 2016, as the impact of the fall in oil prices is waning. The external current account would continue to improve on account of continued public sector consolidation and savings from the energy import bill. On the back of continued adjustment by the central government and the electricity company (NEPCO), public debt would broadly stabilize in 2015 and start declining in 2016. Net international reserves would remain adequate.

Jordan: Selected Economic Indicators, 2011 - 2016
(Percent of GDP, unless otherwise indicated)

			Estimated		Projections	
	2011	2012	2013	2014	2015	2016
GDP growth, percent	2.6	2.7	2.8	3.1	2.9	3.7
CPI inflation, period average, percent	4.2	4.5	4.8	2.9	0.2	3.1
General government balance, excl. grants[1]	-11.7	-15.3	-12.4	-12.8	-7.2	-6.8
Current account balance, excl. grants	-17.3	-20.0	-17.1	-12.1	-10.9	-10.7
Public gross financing needs, (excl. grants),US$ billion	7.5	6.7	9.7	9.3	8.2	7.4
External financing needs (excl. grants), US$ billion	4.1	6.1	4.8	4.8	6.7	4.1
Public debt	70.7	81.8	86.7	89.0	90.0	86.6
External debt	23.7	24.1	30.0	31.9	34.5	33.3
Reserves in months of imports	5.0	2.3	4.9	6.7	6.8	6.5

Sources: National authorities; and IMF staff calculations.
[1] Includes NEPCO's losses.

Risks. Risks remain high. The most prominent relate to an escalation and/or lengthening of the conflicts in Syria and Iraq beyond 2016, which would further weigh on exports, tourism, investor confidence, and FDI. If additional refugees were to come in, there would also be further pressure on the fiscal accounts, infrastructure, and the quality of government services. Possible donor fatigue could jeopardize humanitarian assistance, hurting the fiscal and external accounts. Other risks include a loss of competitiveness in case of a further U.S. dollar appreciation, a sharp rebound in oil prices, and a prolonged slowdown in key emerging market economies. Finally, a domestic risk is a loss of momentum in reforms.

Short-term policy issues. Notwithstanding the significant progress over the last three years, continued public sector adjustment, both at the central government and energy sector levels, is needed to put Jordan's high debt firmly on a downward trend. This adjustment should be done in an equitable way, protecting the most vulnerable. At the central government level, there is a need to reduce the primary deficit while allowing for an increase in public investment. Focus should be on equity-enhancing tax reform and further expenditure savings, complemented by tax administration improvements, and public financial management reforms. On the energy front, implementing the strategy to return NEPCO to cost recovery will be crucial. To safeguard reserve buffers, monetary policy will remain focused on maintaining the attractiveness of the Jordanian dinar. Regarding the regional humanitarian crisis, Jordan cannot alone shoulder this burden; additional grants are needed to safeguard the country against risks.

Reforms for inclusive growth. The key obstacles to inclusive growth are weaknesses in the business environment, labor markets, and institutions. For example, Jordan's scores on business climate indicators are low, particularly on investor protection, contract enforcement, and access to finance. Unemployment is chronically high, particularly among the youth, and female's labor force participation is among the lowest worldwide. The authorities are taking steps to address these weaknesses. They have passed several laws to improve the business climate—including the laws on investment and public-private partnerships—and have taken steps to improve access to finance, including through: mobilizing donor support for SME finance; drafting a secured lending law and revisiting the bankruptcy/insolvency law; and licensing a credit bureau. In collaboration with the ILO, they are also conducting a review of their National Employment Strategy (NES), to make it more effective in addressing labor market challenges. There were also improvements in public institutions, including the adoption of a new public investment framework and the establishment of a public-private partnership unit in the ministry of finance. Going forward, Jordan needs to accelerate its structural reform agenda. This includes (1) expediting cabinet approval of the PPP by-laws and parliament approval of the secure lending and bankruptcy/insolvency laws; (2) adopting an action plan with a concrete timeline for the NES; (3) prioritizing public investment toward maximizing its impact on growth and unemployment; and (4) working on making tangible progress toward transparency and accountability.

IV. LIBYA

Continued conflict is bringing Libya a step closer to fragmentation, with serious consequences for the economy, public finances and official reserves. The most important priorities are to end the conflict, restore rule of law and the unity of the state, and establish transparent and accountable mechanisms for managing Libya's resources. There is also an urgent need to control current spending and improve the quality of the budget process. Over time, creating space for investment in broad growth requires streamlining general subsidies and limiting public sector employment. The Fund maintains a dialogue with both governments, but its ability to provide policy advice and capacity building has been affected significantly by the worsened security.

Background. Clashes between rival militias since the summer of 2014 have cost hundreds of lives and displaced over 250,000 Libyans. The fall of Tripoli to militias and the move of the elected parliament to Tobruk have left the country with two competing authorities. The fighting has caused widespread damage to public and private property, and infrastructure; and it has precipitated power, water, fuel and food shortages in Tripoli and across the country. Insecurity and lawlessness are hampering the delivery of cash to commercial banks across Libya, further undermining economic activity. Outside the largest cities most affected by the fighting, the situation is marginally better. However, some modest, albeit tentative, progress seems to be emerging from the UN-sponsored peace talks.

Recent economic developments. The ongoing blockade of Libya's oil facilities by rival militias and the continuous infightings have steadily reduced the country's oil output to less than 400,000 barrels per day (bpd), from about 1.7 million bpd in peaceful times. As a result, GDP contracted by an estimated 24 percent in 2014. Prices remained largely unaffected due to predominance of imports in the consumer basket. The large fiscal and trade balances of 2012 turned into deficits, including as a result of the sharp drop in international oil prices. The government accounts are expected to post a deficit of about 80 percent of GDP in 2015 with the current account deficit exceeding 60 percent of GDP. The twin deficits will take a toll on official reserves, which are expected to decline by about US$25-30 billion in 2015 to about 31 months of imports by year's end.

Short-term outlook. The departure of most international oil company personnel in recent months and the reduction of maintenance and capital investment is expected to hurt economic activity this year and in the near-to-medium term. GDP is projected to drop by another 6 percent this year and to grow by only 2 percent in 2016. Under baseline projections, the shortfall in oil revenue will weigh on the fiscal deficit, which will remain large at over 60 percent of GDP and result in a further decline in official reserves to less than 20 months of imports. Government spending is also expected to decline due to security constraints**,** and be limited to salaries and subsidies. The projected deficit is expected to be financed from the central bank. Inflation, broad money and credit to the economy are expected to remain broadly at their current levels due to the slowdown in government spending and non-oil economic activity.

Libya: Selected Economic and Financial Indicators, 2012-15

(Percent of GDP, unless otherwise indicated)

		Est.		Proj.	
	2012	2013	2014	2015	2016
GDP growth, percent	104.5	-13.6	-24.0	-6.1	2.0
CPI inflation period average, percent	6.1	2.6	2.8	8.0	9.2
General government balance, excl. grants	27.8	-4.0	-43.5	-79.1	-63.4
Current account balance, excl grants	29.1	13.6	-30.1	-62.2	-49.1
Fiscal financing needs (excl. grants), US$ billion[1]	0.0	4.0	43.5	79.1	63.4
External financing needs (excl. grants), US$ billion[2]	0.0	0.0	30.1	62.2	49.1
Public debt	…	…	…	…	
External debt	6.8	8.5	13.5	18.8	20.6
Reserves in months of imports	39.8	50.7	43.3	30.8	18.9

Sources: National authorities; and IMF staff calculations.

[1]Budget deficit, excluding grants, plus public external amortization.

[2]Current account deficit, excluding grants, plus amortization.

Risks. The worsened security situation places Libya's resources, including official reserves and oil revenues, at great risk. A few oil facilities remain at the mercy of un-accountable militias. Should the conflict deteriorate further leading to state failure or fragmentation, the economic consequences will be severe for Libya and its neighbors.

Short-term policy issues. The main priority is to bring the ongoing conflict to an end. The continued deterioration of the fiscal outlook adds urgency to the need to contain current spending and improve the quality of the budget process. Public expenditure should be reoriented from wages and subsidies to service delivery and institution building and investment. Improving public finance management, with a focus on enhancing transparency and efficiency of public spending, is necessary to restore both fiscal sustainability and trust in government. It is also necessary to continue to strengthen central bank independence and build capacity at the central bank to improve the management of reserves and facilitate the development of the financial sector as a leading driver for private sector growth.

Reforms for inclusive growth. To move away from total dependency on oil, to a sustainable and inclusive path, it would be necessary to create the conditions for diversified, private-sector led growth. Despite the political and security turmoil, important steps have been made to restrain current spending and create space for investment in infrastructure. A number of important energy and transport projects were completed in 2013 in difficult circumstances. Going forward, efforts should focus on enhancing the business environment, upgrading the skills of the workforce through better education and training, fostering financial intermediation, and investment in physical, regulatory and institutional infrastructure, including in the context of a decentralized, local framework.

V. Morocco

Macroeconomic indicators have continued to improve and the outlook for growth, inflation, fiscal deficit and the external current account is favorable, while still subject to significant risks. Policy priorities include increasing fiscal and external buffers while moving ahead with reforms to boost competitiveness, growth, employment and inclusion. The IMF approved in July 2014 a second two-year arrangement under its Precautionary and Liquidity Line (PLL), which supports the authorities' economic reform program and provides insurance against external risks.

Background. Regional and local elections took place on September 4, 2015. The Justice and Development Party (PJD) won most seats in regional councils (25 percent of the total) and control of major cities, including Casablanca, Rabat, and Fez. The Party of Authenticity and Modernity (PAM) registered strong scores in local councils (21 percent of the seats). National parliamentary elections are scheduled for 2016.

Recent developments. In the first quarter of 2015, growth rose to 4.1 percent year-on-year, boosted by a strong agricultural output and a gradual acceleration of activity in other sectors. Inflation remained low (1.7 percent in August). Unemployment in the second quarter of 2015 declined to 8.7 percent from 9.9 percent at end-2014. The authorities are targeting in 2015 a further reduction in the fiscal deficit to 4.3 percent of GDP from 4.9 percent of GDP in 2014 and budget execution through July 2015 remains broadly consistent with this target. The trade balance has continued to improve through August 2015 driven largely by a lower energy bill. A successor two-year PLL arrangement with the IMF was approved in July 2014. Its lower access-level than the first arrangement (US$5.0 billion against US$6.2 billion for the first PLL) reflects lower international risks and signals the strengthening of the economy's resilience. As before, the authorities do not intend to draw upon resources available under the PLL, unless Morocco experiences actual BOP needs due to a significant deterioration in external conditions.

Short-term outlook. Growth is expected to be close to 5 percent in 2015, bumped up by exceptional cereal production and a gradual acceleration of activity in other sectors, but to decelerate in 2016, as cereal production returns back to normal. Inflation is projected to remain low at about 1.5 percent in 2015. The current account deficit should continue to improve as a result of lower global energy prices, and the rapid developments of exports from newly developed sectors.

Morocco: Selected Economic Indicators, 2011 - 2016

(Percent of GDP, unless otherwise indicated)

			Estimated		Projections	
	2011	2012	2013	2014	2015	2016
GDP growth, percent	5.2	3.0	4.7	2.4	4.9	3.7
CPI inflation, period average, percent	0.9	1.3	1.9	0.4	1.5	2.0
General government balance, excl. grants	-6.7	-7.3	-5.8	-6.4	-5.7	-4.5
Current account balance, excl. grants	-8.2	-9.8	-8.6	-6.9	-3.7	-2.4
Fiscal financing needs, (excl. grants),US$ billion[1]	7.7	8.1	7.2	8.1	6.7	5.7
External financing needs (excl. grants), US$ billion[2]	9.8	11.2	11.2	9.5	5.4	4.4
Public debt	52.5	58.3	61.5	63.4	63.8	64.1
External debt[3]	26.1	28.5	29.2	32.7	32.3	32.1
Reserves in months of imports	5.3	4.3	4.7	5.9	6.0	6.2

Sources: National authorities; and IMF staff calculations.

[1] Budget deficit, excluding official grants, plus public external amortization. Assumes full domestic rollover.

[2] Current account deficit, excluding grants, plus amortization.

[3] Includes external publicly guaranteed debt.

Risks. Significant risks remain. A slower-than-expected growth in advanced country trading partners would lower growth, export, FDI and remittances. A renewed surge in oil prices could rapidly widen the current account. A sharp increase in global financial market volatility would affect directly and indirectly the current (via its impact on global growth) and financial accounts. Parliamentary elections in 2016 could delay reforms in a volatile regional environment.

Short-term policy issues. The authorities aim to consolidate recent gains and ensure continued macroeconomic stability by increasing fiscal and external buffers while moving ahead with reforms to boost competitiveness, growth and employment. In particular, the authorities' plan for fiscal consolidation strikes an appropriate balance among those objectives and is supported by reforms (tax, subsidies, pension, and new organic budget law) that will strengthen the fiscal framework and reduce fiscal risks.

Reforms for inclusive growth. Despite relatively robust growth over the past three decades, employment and labor force participation rates have not increased substantially and remain low compared to other emerging markets. While the unemployment rate declined from more than 13 percent in 2000 to 8.7 percent in June 2015, it remains relatively high and is particularly elevated amongst the youth (20.5 percent), notably in urban areas (38.6 percent). Poverty has decreased considerably over the past decade thanks in large part to strong economic growth. Over the period, about 1.7 million people have moved out of poverty and the poverty rate has decreased by more than 40 percent. Still, inequality in access to health services remains high, as does gender inequality. Going forward, the authorities need to continue to advance their structural reform agenda including measures to improve competitiveness, achieve higher potential growth and reduce unemployment. Such reforms include measures to improve the business environment, access to finance, governance and the judicial system. A new national strategy for employment, designed in consultation with social partners and business representatives, was adopted in February 2015. It aims to enhance human capital by promoting reforms of the education and vocation training systems; ameliorate the governance and functioning of the job markets, including by improving existing employment support programs, and increase the responsiveness of employment to growth. Other initiatives such as the National Initiative for Human Development and education and health programs for the poorest will continue to help improve conditions for the poor and vulnerable groups. In addition, fiscal policies aimed at reducing spending on generalized subsidies will continue to help create space for investment and social spending to reduce income inequality, while recently-initiated decentralization reforms may also help to reduce disparities amongst regions.

VI. Tunisia

Tunisia has successfully maintained macroeconomic stability during the political transition but headwinds from increased security threats and social tensions are challenging the country's recent resilience. Policy priorities to address high external imbalances, high youth unemployment, and significant regional disparities include improving budget composition, reducing banking sector vulnerabilities, increasing exchange rate flexibility, and advancing reforms to improve the business climate. The IMF has supported Tunisia's economy through a Stand-By Arrangement, which is expected to conclude in December 2015. The Tunisian authorities have expressed their desire for continued IMF support through a successor arrangement.

Background. Over the past four years, Tunisia adopted a new constitution and successfully completed its democratic transformation with free and fair elections. During this process, the country experienced significant uncertainty, social unrest, and attacks by armed militants. Throughout, it has successfully preserved macroeconomic stability in the face of a difficult international economic environment and increased regional turmoil. The tragic terror attacks in Sousse and at the Bardo Museum are severely hurting tourism and investor confidence, and may shift the government's limited resources to security issues and delay policy implementation. At the same time, Tunisia's broad-based coalition provides the opportunity to push ahead on reform implementation, which will also benefit from increased policy space provided by the decline in international oil prices and a recovering Europe.

Recent developments. The growth momentum waned in early 2015, as real GDP growth averaged 1.2 percent (y-o-y) for the first semester as activity in the manufacturing, tourism, and mining sectors slowed significantly. Inflation has been declining, reaching 4.2 percent (y-o-y) at end August 2015 following lower food and beverage prices. External imbalances remain high, although exceptional olive oil exports and declining energy imports helped compensate the drop in tourism receipts in H1 2015, thereby narrowing the current account deficit at 4.6 percent of GDP in the first half of the year (from 5.3 percent of GDP in H1 2014). On the fiscal front, weak budget composition— through under-execution of capital spending, which led to record low levels of public investment of 4.2 percent of GDP in 2014— contributed to a lower overall fiscal deficit in 2014 despite a higher wage bill, which represents close to 12.7 percent of GDP in 2014. Banking system vulnerabilities remain high, with NPLs above 15 percent of total loans and an overall solvency ratio that stood at 9.5 percent as of March 2015, but will continue to improve following the recent recapitalization of two public banks.

Short-term outlook. Growth is projected to slow down to 1 percent for 2015 (revised down from 3 percent) reflecting the weak performance in H1 2015, work stoppages in the phosphate sector, and the sharp decline in tourism. Inflation is expected to remain contained at 4.4 percent (y-o-y) at end 2015, helped by low food and energy prices. The current account deficit is expected to narrow only marginally to 8.5 percent of GDP in 2015, as the drop in tourism revenues and low phosphate exports offset gains seen earlier in the year from the net impact of lower energy prices and exceptional olive oil exports. Reserves are expected to remain above four months of imports helped by higher World Bank disbursements and renewed international market access. Relief measures to alleviate the short-term economic impact of the Sousse attack are expected to increase the structural fiscal deficit in 2015—i.e., fiscal balance corrected for cyclical fluctuation and excluding banking recapitalization costs— by 0.3 percent of GDP. The increasing deficit also reflected an increase in the wage bill to 13.3

percent of GDP, which was judged necessary by the authorities to reduce social tensions and act as a countercyclical policy that will boost demand.

Tunisia: Selected Economic Indicators, 2011 - 2016[1]

(Percent of GDP, unless otherwise indicated)

			Estimated		Projections	
	2011	2012	2013	2014	2015	2016
GDP growth, percent	-1.9	3.7	2.3	2.3	1.0	3.0
CPI inflation, period average, percent	3.5	5.1	5.8	4.9	5.0	4.0
General government balance, excl. grants	-3.5	-5.7	-6.2	-4.1	-6.0	-4.3
Current account balance (excluding grants)	-8.0	-8.8	-9.1	-9.7	-8.9	-7.2
Fiscal financing needs, (excl. grants),US$ billion[2]	3.0	3.8	3.9	2.6	3.2	2.4
External financing needs (excl. grants), US$ billion[3]	10.7	11.2	12.0	12.9	11.4	10.6
Public debt	44.5	44.5	44.3	50.0	54.0	56.3
External debt	48.0	53.8	54.1	56.2	64.4	67.5
Reserves in months of imports	3.4	3.9	3.4	3.9	4.3	4.6

Sources: National authorities; and IMF staff calculations.

[1]Figures may differ from WEO data as they reflect updates by recent missions.

[2]Budget deficit, excluding official grants, plus public external amortization.

[3]Current account deficit, excluding grants, plus amortization.

Risks. Economic confidence in Tunisia will continue to hinge on improvements in the security situation with the terrorist threats and spillovers from the Libya crisis, including refugee inflows, representing a key challenge. Tunisia's economic outlook is also vulnerable to a protracted period of slower global growth—particularly from Europe—and surges in global financial volatility. An upsurge in political instability or social tensions—including through union pressures for further wage hikes—could worsen the composition of the fiscal adjustment or delay structural reforms, exacerbating existing vulnerabilities and lowering the growth potential.

Short-term policy issues. The most immediate challenge is to maintain macroeconomic stability in a context marked by increased security threats, high social demands, and weaker growth. A return to fiscal consolidation in 2016 will help reduce financing constraints and contain external imbalances. A prudent monetary policy and greater exchange rate flexibility, and completing banking reforms are also essential to reduce external vulnerabilities and rebuild foreign exchange buffers.

Reforms for Inclusive Growth. The government's five year economic vision, which is expected to be finalized ahead of a March 2016 international donor conference, aims at promoting stronger and more inclusive growth. High unemployment, particularly among the youth (35 percent) and women (22.2 percent, twice the average for men) as of June 2015, low female labor force participation (26.1 percent vs. 69.2 percent for men as of March 2015), and social and economic disparities across regions are the key challenges for generating inclusive growth in Tunisia. Important steps have been initiated to address these issues: (i) energy subsidies have been reduced; (ii) a tax reform strategy that promotes more equity and transparency is being finalized; (iii) the public bank recapitalization process in line with sound international practices has been launched; (iv) a new competition law has been adopted. Additional reforms should focus on: (i) improving the composition of the budget through containing the wage bill and creating space for higher capital and social spending; (ii) accelerating banking reforms, which will contribute to deepening financial intermediation; (iii) creating a more transparent and competitive business climate through a revamped investment code, strengthening the bankruptcy framework, and trade facilitation measures; (iv) enhancing the functioning of the labor market; and (v) improving the governance of public enterprises. This agenda offers opportunities to deepen technical assistance, including in the areas of banking, revenue administration, public financial management and expenditure policy.

VII. Yemen

The escalation of conflict is having a major impact on economic activity, with a deterioration in exports, reserves, and inflation, as well as growing exchange rate pressures. Post-conflict priorities will be to restore public services, ensure an efficient and transparent procurement process to facilitate the delivery of much-needed aid, and rebuild infrastructure. A three-year Extended Credit Facility agreed in 2014 to support efforts to improve the structure of public expenditure, strengthen social protection, and facilitate private sector-led growth aimed at poverty reduction and job creation has been put on hold as a result of the deterioration in the security situation.

Background. The political and security situation has deteriorated significantly since early 2015. Following the expansion of military operations by the Houthis, the coalition forces launched a military campaign on March 26 in support of the government of President Hadi. This followed unsuccessful UN peace talks to find a political solution to the crisis. Coalition forces have recently regained control over Aden and continue to make territorial gains. President Hadi and Vice President and Prime Minister Bahah have recently returned to Aden. The humanitarian situation is dire with 21 million people estimated to be in need of assistance and six million deemed severely food insecure. Damage to infrastructure is also reported to be substantial. The Internal Displacement Monitoring Center estimates there are over 1,439,000 internally displaced people in Yemen.

Recent developments. Following a broadly satisfactory performance under the ECF, the macroeconomic situation started weakening in late 2014 due to the worsening of the political and security situation. Growth in 2014 is estimated to have stagnated due in part to the sabotage of oil pipelines and the further drop in investment. Inflation declined to 8 percent and the exchange rate remained stable. Reserves coverage was adequate at about 5.8 months of imports, thanks to prudent financial policies and a large grant from Saudi Arabia. Notwithstanding the decline in oil revenue, the fiscal deficit narrowed to about 4 percent of GDP, reflecting both progress in the implementation of reforms as well as a forced fiscal adjustment in the form of under-execution of spending in the last quarter of the year due to lack of financing. Preliminary data for the first half of 2015 point to significant contraction of economic activity, mounting inflationary pressures due to severe shortages of food and fuel, exchange rate pressures, declining reserves, and, as financing dried up, increased government borrowing from the central bank despite the substantial under-execution of fiscal spending. Unemployment remains high (17.4 percent as of end-2013, the most recent available data).

Short-term outlook. The outlook will largely depend on the duration of the conflict, as the difficult political situation and armed conflict continue to weigh on economic prospects. The economy is projected to contract sharply in 2015 as a result of economic activity disruption and the virtual stop of oil production and exports. Inflation is expected to remain high and international reserves coverage to drop well below 3 months of imports. Assuming a cessation of conflict by end 2015, a recovery of economic activity can be envisaged to start within a year in tandem with humanitarian relief and provision of public services. The fiscal and external positions are also expected to improve, assuming sufficient support from the international donor community and recovery of hydrocarbon production and exports. Donor support will be critical, including for budget support to help reduce financing pressures and the crowding out of private sector credit in the post conflict period. Ensuring adequate donor and domestic coordination as well as an efficient and transparent procurement framework would be essential to facilitate the flow and implementation of external assistance. Resuming key pro-growth pro-poor reforms will be essential to bring about sustained growth, job creation, and poverty alleviation.

Yemen: Selected Economic Indicators, 2011 - 2016[1]

(Percent of GDP, unless otherwise indicated)

			Estimated		Projections	
	2011	2012	2013	2014	2015	2016
GDP growth, percent	-12.7	2.4	4.8	-0.2	-28.1	11.6
CPI inflation, period average, percent	19.5	9.9	11.0	8.2	30.0	15.0
General government balance, excl. grants	-5.7	-12.4	-7.8	-6.8	-9.7	-10.1
Current account balance, excl. grants	-5.4	-7.9	-4.0	-5.2	-6.5	-6.5
Fiscal financing needs, (excl. grants),US$ billion[2]	2.0	4.6	3.3	3.2	3.7	4.6
External financing needs (excl. grants), US$ billion[3]	2.0	3.0	1.8	2.5	2.6	3.0
Public debt	45.7	47.3	48.2	48.7	67.0	60.6
External debt	18.6	17.4	15.2	14.3	18.1	15.9
Reserves in months of imports	3.7	5.5	4.8	5.8	2.6	1.3

Sources: National authorities; and IMF staff calculations.

[1]Figures may differ from WEO data as they reflect updates by recent missions.

[2]Budget deficit, excluding official grants, plus public external amortization. Financing needs do not include a portion for reconstruction of damaged infrastructure

[3]Current account deficit, excluding grants, plus amortization. Financing needs do not include a portion for reconstruction of damaged infrastructure

Risks. The two main downside risks are the protraction of the conflict and the continued decline in oil prices. Another key risk could be difficulty in generating post-conflict reform momentum. Delays in restoring government and financial services could also hinder efforts to restart the economy and private sector investment. On the upside, a faster resolution of the conflict, strong support by donors, and higher international oil prices would improve the overall outlook.

Post-conflict priorities. The immediate priority is to contain and begin reversing the adverse humanitarian and economic effects of the conflict. It is crucial to restart the economy and restore key public services and government functions. This will facilitate rebuilding infrastructure as well as rehabilitating oil facilities. Coordination of donor reconstruction support will be critical. Economic policies going forward should build on pre-conflict achievements and target improving tax collection, wage bill containment, removal of ghost workers and developing a capital spending plan in line with reconstruction needs and available financing. A fuller assessment of the post conflict economic situation will be necessary to estimate reconstruction, technical assistance and capacity building needs and to put together an appropriate macroeconomic framework and adequate reform program.

Reforms for inclusive growth. Beyond post-conflict reconstruction, Yemen's medium and long-term challenges are to achieve and sustain higher inclusive growth, generate adequate job opportunities, address high poverty and inequality, reduce disparities in access to services, diversify production and export structure, and strengthen institutions. In addition to fiscal reforms to reorient the budget to pro-growth pro-poor spending, there is a need to rehabilitate the hydrocarbon sector and improve its regulatory framework, encourage FDI, and increase compliance of large tax payers. Putting public finances on a sustainable footing will allow a much-needed further increase in Social Welfare Fund transfers to the poor and vulnerable groups. Reforming the civil service would help reduce corruption and enhance public service provision, efficiency, and fairness. Improving the business environment and financial intermediation will also be critical for spurring private sector investment to support growth and job creation. Improvements are also needed in governance and transparency. This agenda requires further capacity building and well-coordinated technical assistance by external partners.