

Acknowledgments

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The analysis in this report was coordinated under the general supervision of Jihad Azour (Director of MCD). The project was directed by Taline Koranchelian (Deputy Director in MCD) and Ali Al-Eyd (Deputy Chief of MCD's Regional Studies Division). The primary contributors to this report were Selim Cakir, Atif Chaudry, and Matthew Gaertner, with additional contributions from Philip Barrett and Boaz Nandwa.

Marwa Alnasaa, Imen Benmohamed, Majdi Debbich, Najla F. Nakhle, Issouf Samake, and Mohammed Zaher reviewed the translations, in coordination with Yelena Eydinova.

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Global Developments: Implications for the Middle East and Central Asia Regions

Global growth is projected to slow this year to 3.3 percent, followed by a precarious recovery in 2020 (see the April 2019 *World Economic Outlook*). Prospects for growth have deteriorated over the past year, and the forecast for 2019 is over half a percentage point lower than projected one year ago. Although the magnitude of the expected slowdown is broadly similar worldwide, its drivers are varied and country-specific (see table). In Europe, disruption to automobile production in Germany, fiscal concerns, protests, and uncertainty about Brexit dampen the outlook. In China, growth is hindered by trade tensions and needed regulatory tightening to rein in shadow banking. And in Russia, lower oil prices and uncertainties from sanctions will likely reduce future growth.

	Real GDP Growth, 2018–24				
	2017	2018	2019	2020	2021–24
World	3.8	3.6	3.3	3.6	3.6
Euro Area	2.4	1.8	1.3	1.5	1.4
United States	2.2	2.9	2.3	1.9	1.6
China	6.8	6.6	6.3	6.1	5.7
Russia	1.6	2.3	1.6	1.7	1.6
MENAP	2.2	1.8	1.5	3.2	2.8
MENAP oil exporters	1.3	0.6	0.4	2.8	2.0
of which: non-oil GDP growth	2.5	1.2	2.1	2.9	2.6
MENAP oil importers	4.1	4.2	3.6	4.0	4.3
CCA	4.9	4.2	4.1	4.1	4.3
CCA oil and gas exporters	4.8	4.1	4.0	4.1	4.3
of which: non-oil GDP growth	2.9	3.9	3.9	3.9	4.1
CCA oil and gas importers	6.0	5.1	4.5	4.5	4.5

Sources: National authorities; and IMF staff calculations.

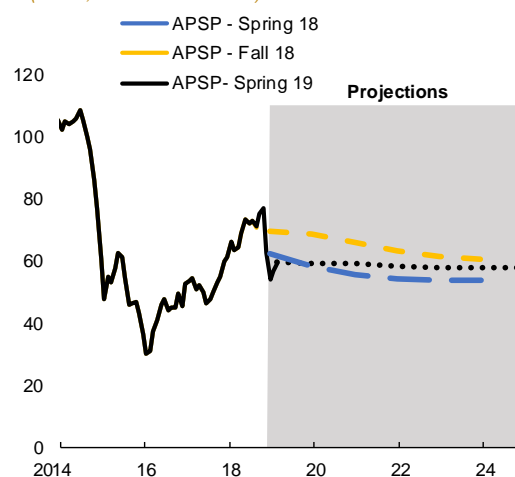
Weaker external demand, particularly from key trading partners (China, Europe, and Russia), represents a key challenge to countries across the Middle East and Central Asia. The recent **decline in oil prices** will also adversely impact oil-exporting countries. In October, prices peaked at over \$80 a barrel. And with supply disruptions in Iran, Libya, and Venezuela further increases seemed possible. Since then, oil prices have declined sharply because of weaker global growth, strong production in the United States, and temporary sanctions waivers for some Iranian oil exports. As a result, prices fell as low as \$50 a barrel in January, although they have recovered recently to nearer \$65 (see figure). At the same time, oil prices became increasingly volatile.

While over the very long term the outlook for oil is largely unchanged, prices are projected to remain lower than in the fall forecast for several years. The impact on output and fiscal positions is another common challenge for countries across the region, particularly for some oil exporters (Algeria, Bahrain, Oman).

The outlook for countries in the region is clouded by elevated levels of uncertainty. One source of uncertainty, and a third theme explored in the following chapters, is **exposure to external risks**.

Evolution of Oil Prices

(APSP, US dollars a barrel)



Sources: National authorities; and IMF staff calculations.

Note: APSP = average petroleum spot price. APSP is the average of UK Brent, Dubai Fateh, and West Texas Intermediate crude oil prices.

- *Trade tensions* between the United States and China may continue at length but could as easily come to a swift resolution (see the April 2019 *World Economic Outlook*). Irrespective of any near-term trade deal, ongoing disputes over trade and security will likely continue to impact the outlook for the region via supply chain disruptions and reduced investment.
- *Elevated oil price volatility* may continue in an uncertain global environment (see Chapter 1). This will weigh on fiscal and external balances of oil exporters. Oil importers may also be hurt, particularly through increased regional uncertainty and reduced and more variable remittances (Armenia, Tajikistan).
- *Global financial conditions* have eased recently but are likely to remain volatile, and market sentiment could change abruptly (see the April 2019 *Global Financial Stability Report*). If this happens, spreads could increase sharply, exposing countries to the risk of higher interest burdens (Bahrain, Egypt, Lebanon), revaluation of foreign debt (Kyrgyz Republic, Tajikistan), and financial sector stresses (Azerbaijan, Kazakhstan, Kyrgyz Republic).
- *Geopolitical risks* are high. Several countries in the region are either in or have recently emerged from conflict. And the impact and timing of major geopolitical developments—including tensions between India and Pakistan, large demonstrations and political uncertainty in Algeria, possible peace in Afghanistan, and sanctions on Iran—are not yet clear. Such uncertainty may increase investors' perception of risk for the whole region, leading to capital outflows and exchange rate pressure. And in turn, this may feed back into further oil price volatility and regional uncertainty.

These global and regional headwinds amplify the challenges faced by policymakers in their efforts to support growth. In several countries in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region, social tensions are rising in the context of lower growth and reform fatigue, threatening macroeconomic stability (see Box 1). Such tensions may also derail much-needed reforms, potentially spilling over into conflict and further regional uncertainty.

The high costs of policy inaction compound the urgency of addressing coming challenges. Policymakers throughout the Middle East and Central Asia should act now to deliver higher and more inclusive growth before conditions become more difficult.

- *In MENAP oil exporters*, procyclical fiscal policies have proved less supportive of growth in recent years, underscoring structural economic weaknesses. The combination of high fiscal break-even oil prices and a slower projected pace of fiscal consolidation leaves countries vulnerable to renewed oil price volatility and a weaker global economy. Anchoring fiscal policy in a medium-term framework would help insulate economies from oil price volatility and gradually rebuild fiscal space. Tackling corruption, improving small and medium enterprises' access to financing, and strengthening social safety nets will help diversify economies and promote higher and more inclusive growth.
- *In MENAP oil importers*, public debt burdens have increased significantly over the past decade, raising near-term vulnerabilities and limiting policy options to address persistent structural

weaknesses. Intensified growth-friendly fiscal consolidation is urgently needed to rebuild resilience and create space for structural reforms to lift medium-term growth, including by improving the business environment and governance, enhancing labor market flexibility, boosting regional integration, and strengthening market competition.

- *In the Caucasus and Central Asia*, the growth outlook remains stable, following recoveries from large external shocks in 2014–16. But unaddressed legacy challenges, including from weaknesses in some banking systems, and incomplete structural reforms are keeping growth well below its long-term potential. Overcoming these challenges has become more challenging and more urgent in the face of reduced global trade and possible future trade tensions. This requires action to complete financial sector repair, fully modernize monetary policy frameworks, and enhance the business environment, including by improving governance.

These challenges present policymakers throughout the Middle East and Central Asia with an opportunity to build richer, fairer societies. For example, low oil prices make the case for diversification more urgent, increased female labor force participation can revitalize moribund labor markets, and improved governance and reduced corruption could revive sluggish investment and make room for more social-protection-related spending. The opportunity to implement these changes will soon pass, though, underscoring the urgency for policymakers to act now.

Box 1. The Reported Social Unrest Index: A New Measure of Social Unrest in Countries of the Middle East and North Africa

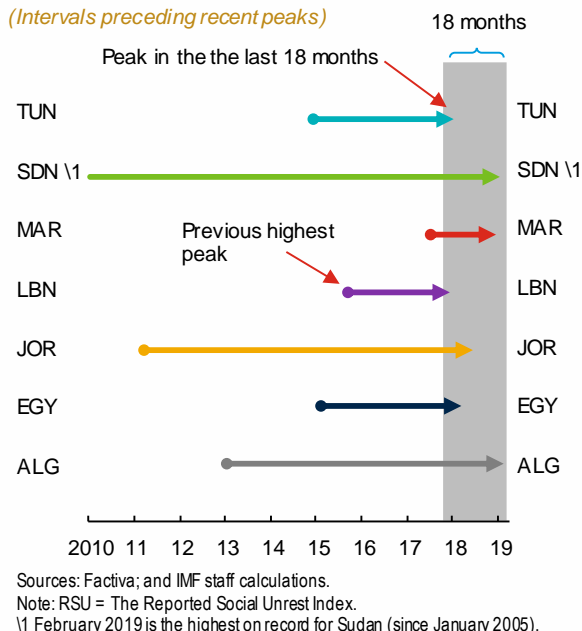
In the past 18 months, the new Reported Social Unrest Index (RSU) has hit multiyear highs in some countries in the Middle East and North Africa. Economic factors are often cited as a motive for protests and other forms of social unrest, and data bear out these concerns. Yet progress on these issues has been slow, and countries whose per capita growth has been lowest are also those that have seen the largest increases in relative social unrest. This underscores the urgency for policies that lower inflation and create fiscal space for investment and social spending, as well as for structural reforms aimed at lifting inclusive and job-creating growth.

Social unrest is increasing in some countries in the Middle East and North Africa. The RSU has increased recently following a steady decline during 2015–16, although political factors (such as the political regime) and the degree of freedom of the press could affect individual country results (Figure 1).¹ The RSU has hit multiyear highs in nearly all countries.

Figure 1
The Reported Social Unrest Index
 (Index, 12-month moving average)



Figure 2
Peaks in the RSU Index in the Last 18 Months
 (Intervals preceding recent peaks)



Prepared by Philip Barrett and Jorge de León Miranda.

¹The RSU—prepared by the authors—calculates the share of articles in major news sources that include key terms relating to protests, demonstrations, and other forms of social unrest. The current version includes Algeria, Egypt, Jordan, Lebanon, Morocco, Tunisia, and Sudan and will be expanded further in the future. The index, which covers January 2005 to February 2019, increases sharply during major episodes of social unrest. Although data availability means that the headline index uses English-language media, the results hold using Arabic and French sources. Key patterns are also robust to different search terms and sources. Trends in usage, data constraints, and concerns about bias mean social media are excluded. See the online annex for details on the methodology.

This trend is shown in Figure 2, which plots the interval between the RSU peak over the past 18 months and the last time the index was higher. Longer intervals mean reported protests are high relative to the recent past. Indeed, recent protests have hit an all-time record in Sudan. In contrast, shorter intervals in Morocco, Lebanon, and Egypt indicate, for different reasons, fewer reported expressions of social discontent than in the recent past.

Discontent over economic conditions seems to be a motivation for unrest. While many factors contribute to unrest, reports often highlight discontent over economic conditions and management, such as joblessness, limited opportunities, corruption, and poor public services.

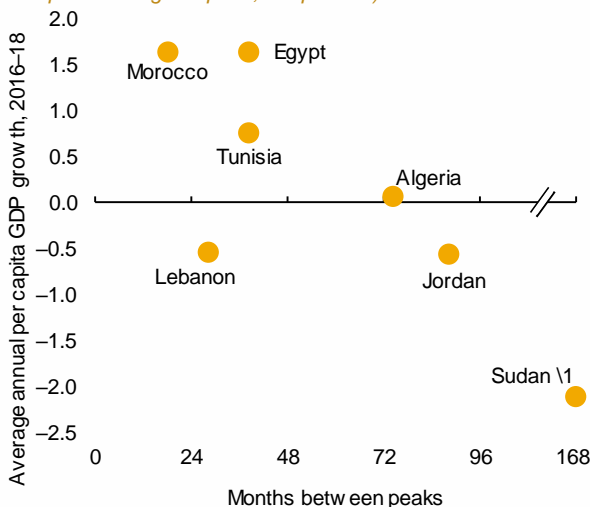
These motivations appear to be reflected in measures of economic opportunity. Many indicators of economic activity in these countries are disappointing and may partly explain protestors' concerns. Constrained access to credit is limiting opportunities for entrepreneurs and small businesses to grow and create jobs. Large and inefficient public sectors crowd out private activity. Social spending, such as on health and education, is often low relative to peers (see Chapter 2, Figure 2.7). And indicators of a business-friendly legal system—such as the time it takes to resolve insolvency or enforce contracts—are weak.

Moreover, progress toward higher and more inclusive growth has been limited in recent years. Progress has been weak on many issues related to economic outcomes and management. For example, unemployment has remained stubbornly high across the region—particularly in oil importers (see Chapter 2, Figure 2.1). Similarly, control of corruption—as measured by the World Governance Indicators—has barely changed. And, in line with people's reported concerns, recent RSU highs are largest relative to the past in countries with the lowest rates of per capita GDP growth in the past few years (Figure 3). While this association is not evidence of a causal link, given that other noneconomic factors may also contribute to social unrest, it signals that the role of economic forces in social unrest cannot be discounted.

Increased social unrest underscores the urgency for structural reforms that create inclusive and job-rich growth. As highlighted elsewhere in this *Regional Economic Outlook Update*, addressing citizens' concerns requires improving infrastructure and access to health care and education, strengthening governance and public services, tackling corruption, and expanding access to credit, with the aim of fostering private-sector-led growth, creating jobs, and strengthening social safety nets. Despite some progress, more decisive efforts are needed, particularly on governance and product market reform. Sustained growth requires macroeconomic stability. This underscores the difficult trade-off policymakers face between rebuilding fiscal buffers and addressing medium-term growth challenges. Although modest growth and social unrest can make pursuing reforms challenging, delayed implementation risks less favorable medium-term outcomes.

Figure 3
The RSU and per Capita GDP Growth

(Months between latest highest value of the RSU and previous highest peak, and percent)



Sources: Factiva; national authorities; and IMF staff calculations.

Note: RSU = The Reported Social Unrest Index.

¹ February is the highest on record for Sudan (since 2005).