

World Economic and Financial Surveys

Regional Economic Outlook

Update

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

APR 19



Acknowledgments

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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.

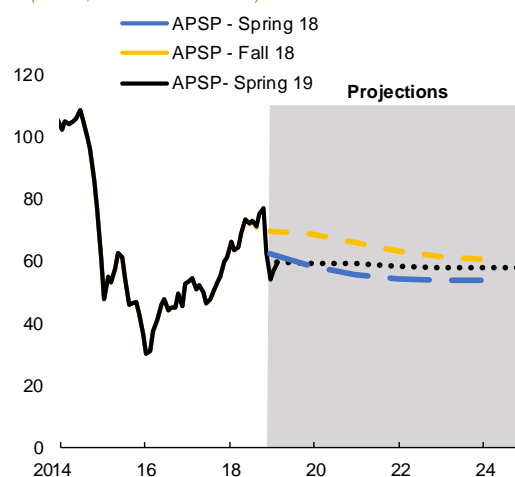
Weaker external demand, particularly from key trading partners (China, Europe, and Russia), represents a key challenge to countries across the Middle East and Central Asia. The recent **decline in oil prices** will also adversely impact oil-exporting countries. In October, prices peaked at over \$80 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

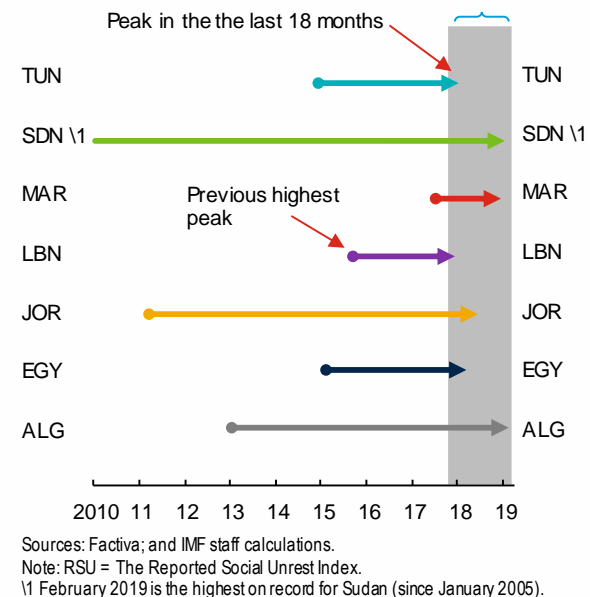
In the past 18 months, the new Reported Social Unrest Index (RSU) has hit multiyear highs in some countries in the Middle East and North Africa. Economic factors are often cited as a motive for protests and other forms of social unrest, and data bear out these concerns. Yet progress on these issues has 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.

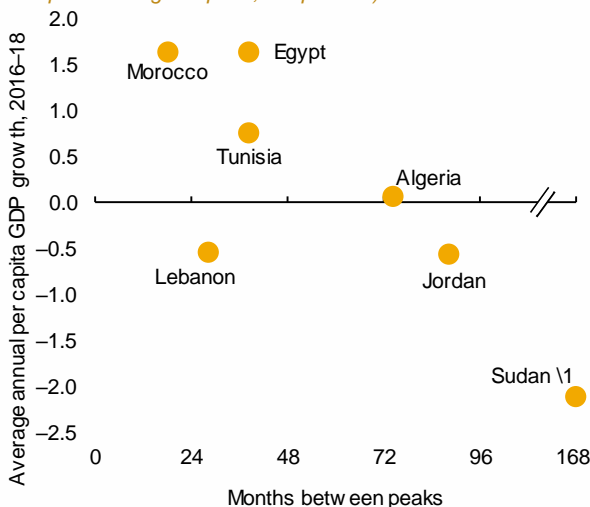
These motivations appear to be reflected in measures of economic opportunity. Many indicators of economic activity in these countries are disappointing and may partly explain protestors' concerns. Constrained access to credit is limiting opportunities for entrepreneurs and small businesses to grow and 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).

1. MENAP Oil-Exporting Countries: Feeling the Impact of Lower and More Volatile Oil Prices

Growth in oil exporters of the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region is projected to remain subdued relative to 2018 amid lower oil prices, restrained oil production, and slowing global growth. Policymakers will face the challenging task of resuming fiscal consolidation while sustaining growth in a more uncertain external environment, including bouts of oil price volatility that are likely to persist in the near term. Anchoring fiscal policy in a medium-term framework would help insulate economies from oil price volatility and gradually rebuild fiscal space; addressing structural weaknesses and tackling corruption, including better access to finance for small and medium enterprises (SMEs), will help diversify economies, create jobs, and promote higher and more inclusive growth.

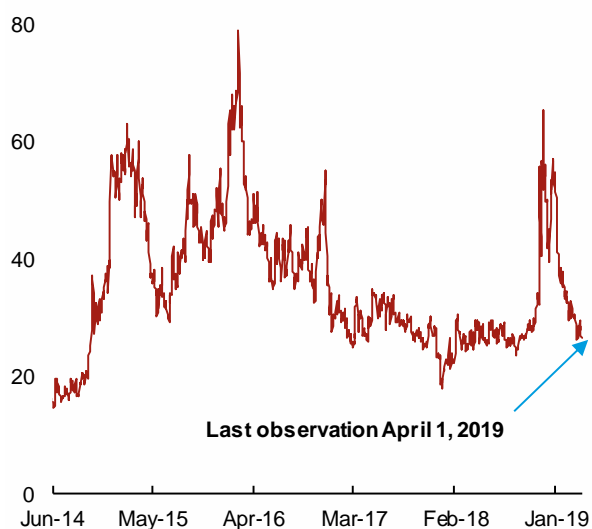
Adjusting to Volatile Oil Prices

Oil prices turned highly volatile at the end of last year. After increasing by nearly 30 percent in the first 10 months of 2018 to more than \$80 a barrel, oil prices declined sharply in the fourth quarter of 2018, and oil price volatility reached levels last seen during the 2014–15 commodity price shocks (Figure 1.1).

Renewed oil price volatility reflects supply disruptions, global growth concerns, technological changes, and geopolitical uncertainties. In particular, the reimposition of US sanctions on Iran, subsequent waivers, and a ramp-up in Saudi Arabia's oil production caused sharp fluctuations in global oil prices in the third quarter of 2018. These developments led to the December 2018 agreement at the 5th OPEC and non-OPEC Ministerial Meeting (OPEC+) to restrain production until at least June. Oil is now trading at about \$65 a barrel, just above this year's projected average (see the *Global Developments* section).

The combination of low oil prices, country-specific factors, and headwinds to non-oil growth from tighter domestic financial and monetary conditions has dampened the near-term growth outlook for MENAP oil exporters. And while higher oil prices led to visible

Figure 1.1.
CBOE Crude Oil Volatility
(Index)



Source: Bloomberg Finance L.P.

Note: The CBOE Crude Oil Volatility Index measures the market's expectation of 30-day volatility of crude oil prices. CBOE = Chicago Board Options Exchange.

improvements in current account and fiscal balances in 2018, gains will not be sustained given the modest oil price outlook.

Looking ahead, uncertainties related to global trade tensions, Iran sanctions, and the Organization of the Petroleum Exporting Countries' (OPEC's) production strategy and ability to respond to unforeseen supply shocks are factors likely to sustain large and persistent swings in oil prices. At the same time, slowing global growth and geopolitical tensions constitute key additional downside risks facing the region.

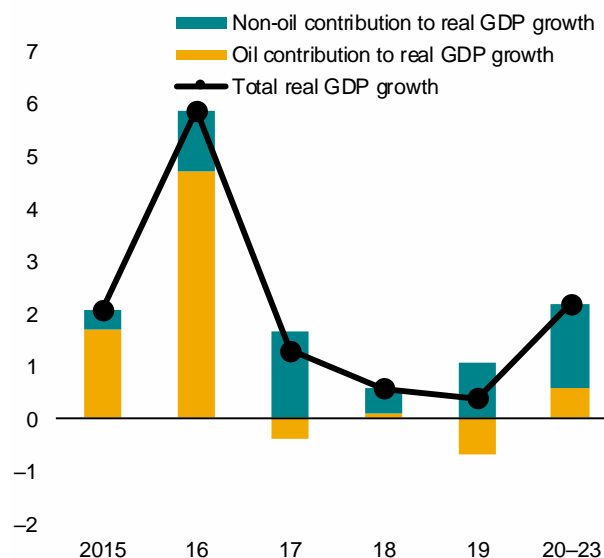
In this environment, policymakers face the challenging task of sustaining growth while resuming gradual fiscal consolidation at a time of greater external uncertainty. Recent fiscal adjustment efforts are welcome but have not yet achieved long-term sustainability given the low oil price outlook. Lower potential growth means that fiscal stimulus efforts could be counterproductive, unsustainable, and costly.

Moderate Growth

Growth in MENAP oil exporters is projected at 0.4 percent in 2019 (Figure 1.2). This mainly reflects a sharp decline in Iran's economic activity (of 6 percent), oil production cuts (in line with the December 2018 OPEC+ agreement) (Figure 1.3), and tighter domestic financial and monetary conditions in some countries.

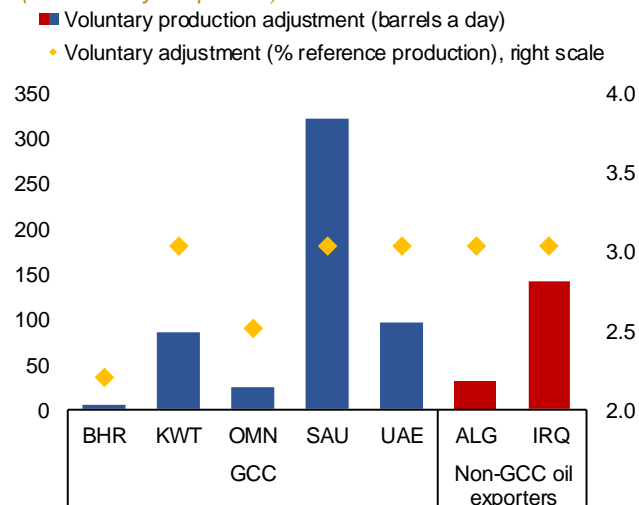
- Growth in Gulf Cooperation Council (GCC) countries is expected to improve slightly to 2.1 percent in 2019, up from 2 percent in 2018. Government spending and multiyear infrastructure plans will likely provide some support to economic activity in Kuwait and Saudi Arabia; Expo 2020-related spending in Dubai and Abu Dhabi's fiscal stimulus

Figure 1.2.
MENAPOE: Real GDP Growth
(Percent)



Sources: National authorities; and IMF staff calculations.
Note: MENAPOE = Middle East, North Africa, Afghanistan, and Pakistan oil exporters.

Figure 1.3.
OPEC: Voluntary Production Adjustments
(Barrels a day and percent)



Sources: Organization of the Petroleum Exporting Countries (OPEC); and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. GCC = Gulf Cooperation Council.

plan are expected to support near-term growth in the United Arab Emirates. In Qatar, the beginning of the Barzan Gas Project operations will underpin hydrocarbon production, but nonhydrocarbon growth is projected to moderate in 2019. Non-oil growth is also

expected to slow in Bahrain from planned fiscal consolidation under the authorities' fiscal balance program.

- Growth is set to contract by 1.7 percent in non-GCC oil exporters after contracting by 1.1 percent in 2018. This is mainly driven by developments in Iran, where the recession is expected to deepen, reducing projected growth by almost 10 percentage points during 2018–20. Algeria's growth is projected to be slightly higher in 2019, owing to a rebound in oil and gas production. Medium-term projections depend largely on the extent to which the necessary adjustment and reform package are implemented, which is now uncertain given recent political developments. Yemen will likely see a moderate improvement in its oil production despite the ongoing conflict. Iraq's growth will be supported by recovery from the conflict, a rise in fiscal spending, and a modest increase in oil production following agreement between the federal government and the Kurdistan

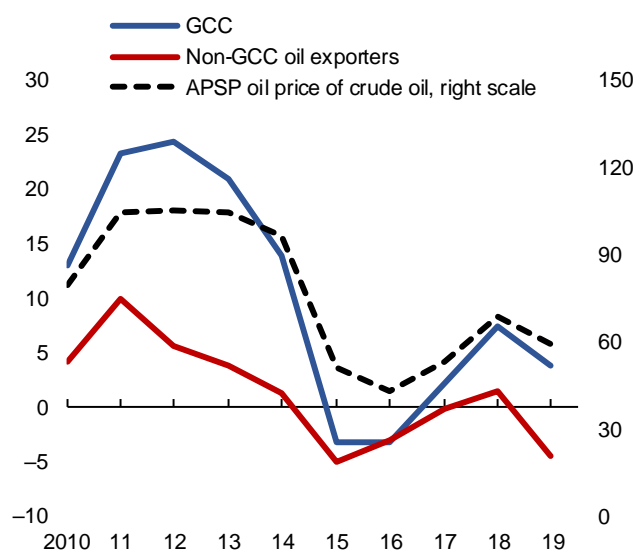
Regional Government on the terms of oil exports. Medium-term growth projections of non-GCC oil exporters assume that regional tensions will gradually dissipate. An escalation in tensions would pose a downside risk to the outlook.

Following a temporary rise last year, year-over-year inflation is expected to decline in 2019 as the impact of the introduction of value-added tax (VAT) (Saudi Arabia and United Arab Emirates) and exchange rate depreciation (Iran, Libya, Yemen) on inflation fades.

Lower projected oil prices will also weigh on current account balances, adding to pressures from OPEC+ production commitments and US sanctions against Iran. The region's current account balance is expected to drop from 5.3 percent of GDP in 2018 to 0.9 percent of GDP this year (Figure 1.4), pointing to increased risks in countries already facing weak external balances (Algeria, Bahrain, Oman) and emerging vulnerabilities in others (Iran, Iraq, Libya).

Figure 1.4.

Current Account Balance (Percent of GDP and US\$ 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. GCC = Gulf Cooperation Council.

Less-supportive global financial conditions in 2018 led to higher external sovereign borrowing costs, particularly in countries with weaker macroeconomic fundamentals (Bahrain, Oman). But recent policy guidance by the US Federal Reserve has resulted in notable easing of financial conditions (see the April 2019 *Global Financial Stability Report*). In addition, global bond index inclusion for GCC countries could bring some \$40 billion in flows over the next year or so, according to market analysts, as institutional investors rebalance their portfolios. This may temporarily mitigate rises in borrowing costs from regional uncertainties and oil price swings, reinforcing gains from the recent improvement in global financial conditions. It also presents an opportunity for additional borrowing, while other country-

specific factors, such as Bahrain’s planned fiscal consolidation and regional financial support, may provide more durable support for lower spreads.

Tighter Financial Conditions Weigh on Growth and Banks

Headwinds from tighter domestic financial and monetary conditions also act as a drag on non-oil growth in some countries. Increases in policy interest rates in the GCC, in line with US Federal Reserve monetary policy normalization, and declines in real estate (Qatar, United Arab Emirates) and equity (Dubai, Oman) prices have led to tighter domestic financial conditions, restraining non-oil activity (Box 1.1). Pressures from tighter global financial conditions led to net capital outflows in the region during the second half of 2018, contributing to lower domestic liquidity growth (Figure 1.5). Global easing of financial conditions in early 2019 is expected to reduce the impact of headwinds

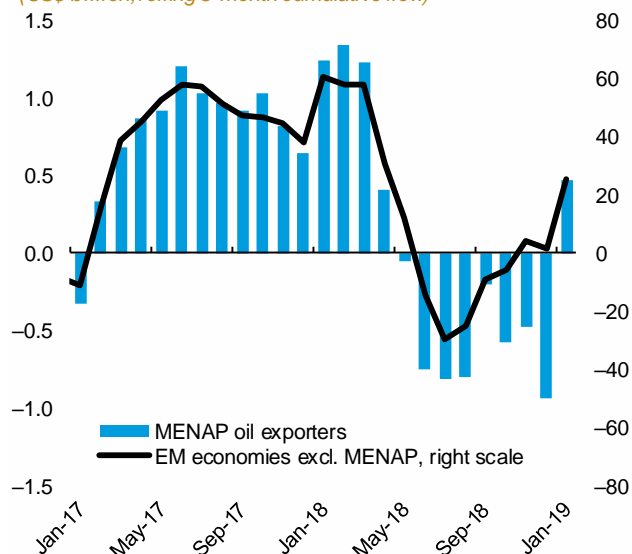
going forward as evidenced by the recent pickup in capital inflows.

With lower oil prices, higher interest rates, and weaker demand conditions, credit is expected to decline in most countries (Figure 1.6). Although banks in the region are generally stable, benefiting from high capitalization, falling liquidity could exacerbate mounting vulnerabilities in some. In particular, banks’ exposure to slowing real estate markets and weak non-oil growth could result in higher nonperforming loans in some countries (Bahrain, Oman, United Arab Emirates).

Fiscal Consolidation Slows

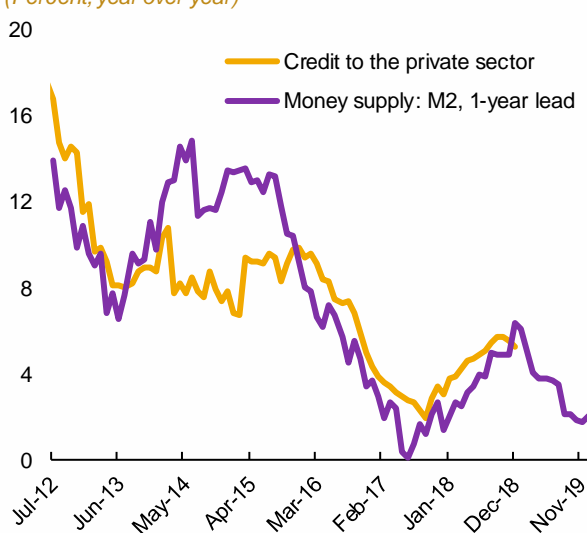
Fiscal consolidation in the region began in 2014, following the decline in oil prices, but slowed with the rebound in oil prices last year. Fiscal consolidation is projected to slow further this year despite lower projected oil prices, while fiscal expansion is expected in Algeria, Iraq, and Saudi Arabia (Figure 1.7). However, slower

Figure 1.5.
EPFR Flows to MENAP Oil Exporters and EM Economies
(US\$ billion, rolling 3-month cumulative flow)



Sources: Haver Analytics; and IMF staff calculations.
Note: EM = emerging market; EPFR = Emerging Portfolio Fund Research; MENAP = Middle East, North Africa, Afghanistan, and Pakistan.

Figure 1.6.
Money Supply M2 and Credit to the Private Sector Growth
(Percent, year over year)

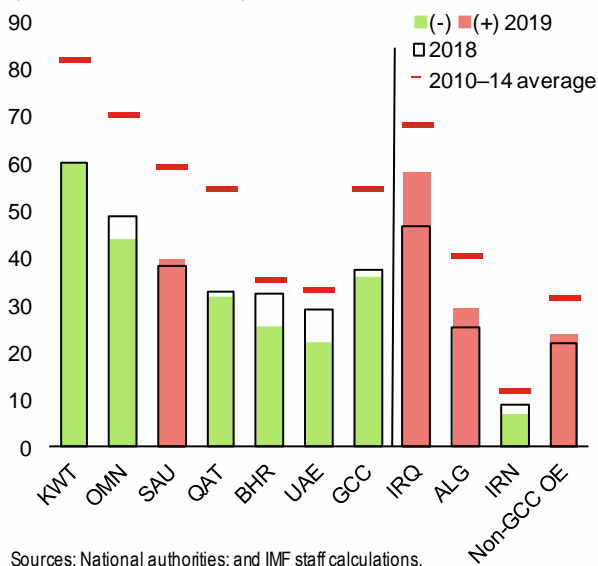


Sources: Haver Analytics; and IMF International Financial Statistics.
Note: The null hypothesis that M2 growth does not Granger causes credit to the private sector growth is rejected with p -value of 0.0003.

fiscal consolidation amid lower projected oil prices would heighten the near-term vulnerability of some countries with limited fiscal space, including from elevated public debt.

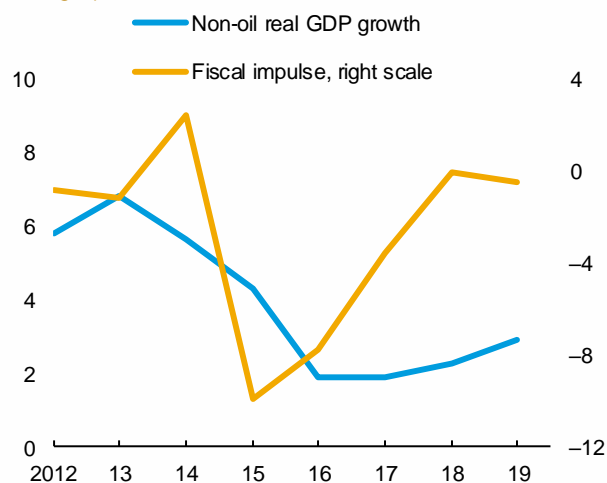
At the same time, there are signs that the relationship between government spending and growth has weakened in recent years, owing to the predominance of external shocks, and that potential growth is likely lower relative to the period of high oil prices, high investment, buoyant sentiment, and a stronger external environment (Figures 1.8–1.10). Meanwhile, fiscal break-even prices remain significantly above the current oil price trajectory, even though most countries have recently lowered these (Figure 1.11). This illustrates the significant medium-term fiscal challenges facing the region from lower projected oil prices, particularly for countries with sizable debt obligations (Figure 1.12).

Figure 1.7.
Non-Oil Fiscal Deficits
(Percent of non-oil GDP)



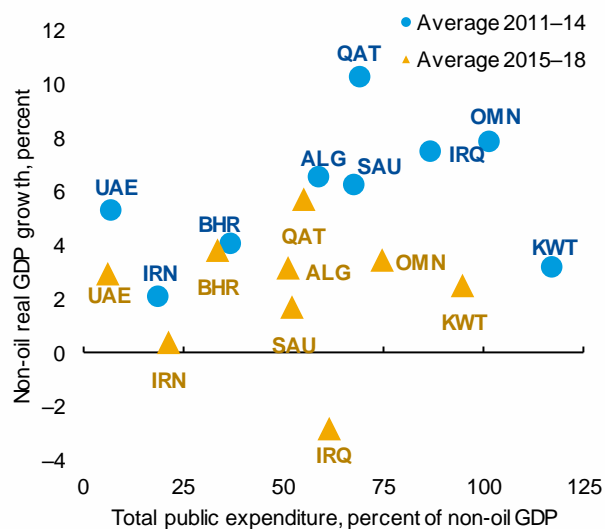
Sources: National authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization Standardization (ISO) country codes. For 2019, color is green if non-oil fiscal deficit is smaller than in 2018 and red if larger than 2018. GCC = Gulf Cooperation Council; Non-GCC OE = non-GCC oil exporters.

Figure 1.8.
GCC: Non-Oil Real GDP Growth and Fiscal Impulses
(Percent and percent of non-oil GDP, weighted averages)



Sources: National authorities; and IMF staff calculations.
Note: Fiscal impulse is calculated using the change in non-oil primary deficit to non-oil GDP ratio. Country-specific weights correspond to purchasing-power-parity-adjusted GDP. GCC = Gulf Cooperation Council.

Figure 1.9.
Non-Oil Real GDP Growth and Total Public Expenditure
(Percent and percent of non-oil GDP)

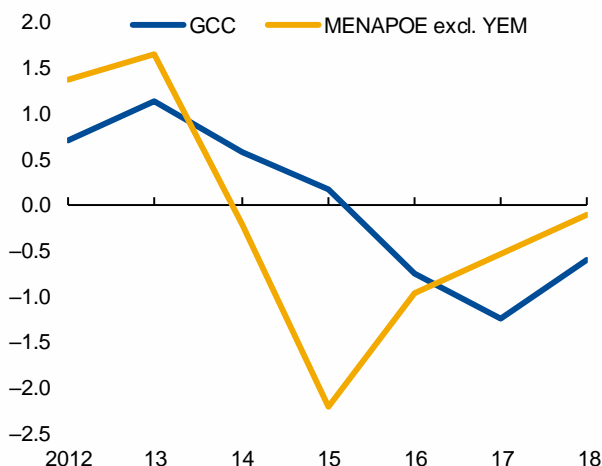


Sources: National authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes.

Figure 1.10.

Output Gap

(Cyclical component of non-oil real GDP growth, simple averages)



Sources: National authorities; and IMF staff calculations.
 Note: The output gaps are the cyclical components of non-oil real GDP growth over the period 2000–19. The cyclical components were calculated using the Hodrick-Prescott filter with a smoothing parameter of 100. GCC = Gulf Cooperation Council; MENAPOE = Middle East, North Africa, Afghanistan, and Pakistan oil exporters; YEM = Yemen.

Deeper Reforms Are Needed to Revive Growth

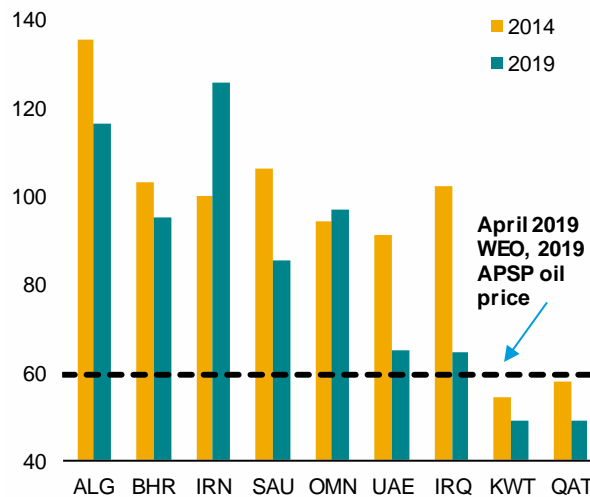
Facing a less certain outlook for oil prices, weaker external conditions, and stalled non-oil growth prospects, MENAP oil exporters must resume gradual fiscal adjustment to rebuild buffers, while deepening and broadening structural reforms to diversify economies and promote higher and more inclusive growth. This has gained more urgency given less effective growth outcomes from slower fiscal consolidation, and still-high unemployment, particularly among young people.

Resuming adjustment in underlying fiscal positions is needed until sustainable spending levels are achieved—and beyond, to rebuild fiscal space and insulate economies from oil price swings. The availability of fiscal space in 2014–15 allowed MENAP oil exporters to avoid sharper procyclical fiscal retrenchment after the collapse in oil prices.

Figure 1.11.

Fiscal Breakeven Oil Prices

(US\$ a barrel)

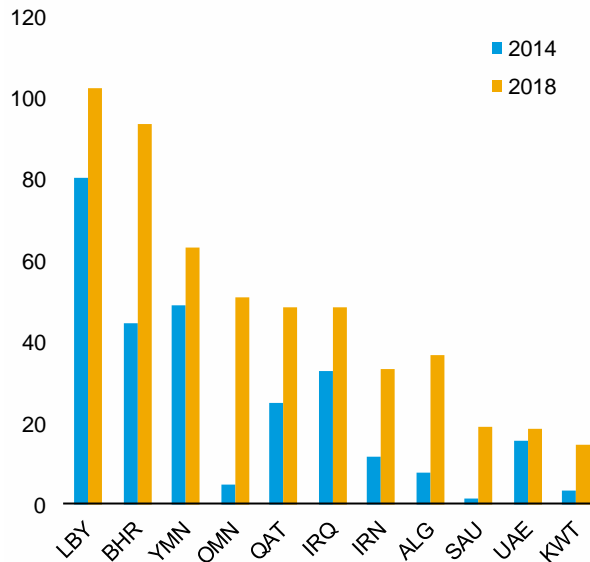


Sources: National authorities; and IMF staff calculations.
 Note: Country abbreviations are International Organization for Standardization (ISO) country codes. APSP = average petroleum spot price. APSP is the average of UK Brent, Dubai Fateh, and West Texas Intermediate crude oil prices. WEO = World Economic Outlook.

Figure 1.12.

Total General Government Debt

(Percent of GDP)



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

The size and pace of the adjustment should, however, depend on individual countries’ fiscal space and financing needs. Moreover, given that growth potential in many countries may now be

lower than during periods of sustained high oil prices, efforts to boost growth through fiscal stimulus, or a slower pace of consolidation, may be counterproductive, especially for countries with weak fundamentals (Bahrain, Oman).

To minimize potential short-term-growth impacts from necessary fiscal consolidation, the design of the adjustment strategy must be carefully considered. This means mixing expenditure consolidation with revenue reforms while reinforcing progress in areas such as VAT implementation and reducing public wage bills in some countries. In particular,

- *Revenue mobilization* efforts should continue. In this context, Oman's plan to introduce a VAT following Saudi Arabia, the United Arab Emirates, and Bahrain is welcome. Countries should also consider introducing direct taxes, such as on incomes, and property tax. Efforts to fight tax avoidance and evasion would help bolster revenue in the medium term.
- *Expenditure reforms* should focus on strengthening public investment management frameworks to ensure high-quality public investment, while seeking to further streamline public wage bills and subsidies and increasing social spending. In particular, countries with little fiscal space will need to place special emphasis on increasing the efficiency of spending and pay attention to the composition of spending. Measures to increase fiscal transparency and strengthen public financial management systems would support fiscal consolidation efforts.

Overall, MENAP oil exporters should seek to insulate spending from oil price developments and avoid a return to procyclical fiscal policies of the past that create undue volatility in

economic activity. Anchoring fiscal policy in a strong medium-term fiscal framework with a clear objective (such as a debt ratio, an intermediary target based on the non-oil primary balance, or a multiyear budgeting rule) would help resist spending pressures and vulnerabilities that could emerge from sustained bouts of oil price volatility. It would also increase the scope for a growth-friendly path for consolidation. Moreover, ensuring a more sustainable fiscal framework would support improvements in current account balances, particularly since oil prices are unlikely to rise in the near term.

In parallel, and in light of the modest oil price outlook, countries should intensify efforts to diversify economies away from hydrocarbon dependence. State-led growth models, which tend to favor large public enterprises and crowd out private sector credit, have not delivered the broad-based and sustainable growth to create more jobs and make economies more inclusive. An enhanced private-sector-driven growth engine is therefore needed to achieve better outcomes for all and would help spur domestic investment and attract more nonhydrocarbon foreign investment. Ensuring these outcomes will be crucial for securing employment opportunities for the rapidly growing labor force, particularly in the GCC, where IMF staff calculations suggest the region will need about 1 million new jobs a year for at least the next five years to absorb new entrants (Purfield and others 2018).

To this end, countries should focus on improving the quality of education, reforming labor markets, and integrating nationals into private employment, while maintaining competitiveness. Greater efforts are also needed to improve the business environment in some countries, including by putting in place legal frameworks that ensure adequate and

predictable protection mechanisms for dispute prevention and resolution, and further liberalizing foreign ownership regulations.

Governance weaknesses in the region call for urgent engagement on corruption and governance issues. For instance, implementing anti-bribery and integrity measures in public governance, including by addressing conflicts of interest, would support countries' anti-corruption efforts, and also help reduce the fiscal costs of corruption (see the April 2019 *Fiscal Monitor*).

Particular focus on fostering the development and increasing the productivity of SMEs would help deliver much-needed job creation. SMEs, which account for more than 90 percent of businesses and are a major source of job creation, still contribute relatively little to economies in terms of output and employment (see Blancher and others 2019; Stepanyan and others, forthcoming).

Although most countries in the region have recognized the importance of SME development, reforms lack a comprehensive approach and are at varying stages of advancement. Some countries have adopted dedicated SME strategies or laws (Bahrain, United Arab Emirates), while others have

incorporated SMEs into broader strategies or national development plans (Algeria, Qatar, Saudi Arabia). Thus, a more holistic and concerted approach includes:

- *Increasing access to financing* by ensuring availability of adequate funding adapted to SME needs, providing a supporting framework for enhanced credit information and bank competition, and developing capital markets to broaden access to new sources of financing (see Ben Ltaifa and others 2018).
- *Enhancing human capital and physical infrastructure* through efficient expenditures on education, technology, and key infrastructure, such as broadband, to increase SMEs' capacity and access to high-quality factors of production.
- *Delivering a more favorable business environment* by establishing robust legal, regulatory, and taxation frameworks, as well as ensuring a level playing field for SMEs to face fair competition. Improved governance, including in tax administration and public procurement, and a reduced role of the public sector as a competitor in the economy, would also help.

Box 1.1. Financial and Monetary Conditions Indices in GCC Countries

Analyzing information about financial conditions will be essential if Gulf Cooperation Council (GCC) countries are to better assess the state of the economy to inform policy decisions. A well-designed financial and monetary conditions index (FMCI) could serve as an early indicator of future non-oil economic activity.

There are several challenges to building an FMCI for GCC countries. The lack of timely data reduces the variables that could be included. House price data are available only for Qatar and the United Arab Emirates. Absence of data on inflation expectations makes it difficult to determine inflation-adjusted real returns. A monthly industrial production index is not available to assess the predictive power of the FMCI against a high-frequency activity indicator. Dubai's quarterly GDP figures end in 2017, and quarterly GDP is not available for Oman. Bond markets are not liquid enough yet to incorporate changes in the yield curve or the term spread into the FMCI.

Therefore, our FMCI for GCC countries includes the following:

- Money growth, M2 (year over year), as a measure of liquidity
- Stock market (year over year) as equity prices impact household wealth
- Real policy rate—the latest annual inflation rate is used as a proxy for inflation expectations to calculate the real policy rate of GCC central banks
- Real effective exchange rate—appreciation in the real effective exchange rate represents tightening in the FMCI, whereas depreciation represents loosening
- House prices (Qatar, United Arab Emirates)

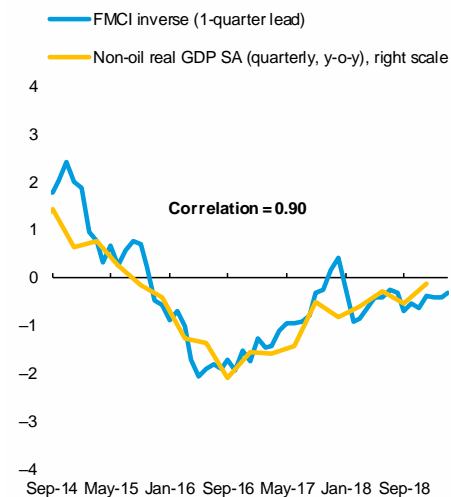
Variables with the highest volatility are given the lowest weight. The series is standardized by subtracting the FMCI's mean and dividing by its standard deviation. Accordingly, an FMCI value above (below) zero implies a tightening (loosening) in the financial conditions. As a gauge of activity, the FMCI is used and employed as an early indicator of non-oil GDP growth.

The model shows that loosening (tightening) in the FMCI is followed by an increase (decrease) in non-oil activity with a one-quarter lag, where quarterly GDP is available. The correlation between the FMCI as an early indicator and non-oil GDP growth is particularly strong in Saudi Arabia and Qatar. The tightening in the FMCI (reversed in Figure 1.1.1), which started in late 2017, has continued and is likely to be a drag on non-oil growth in early 2019 as well.

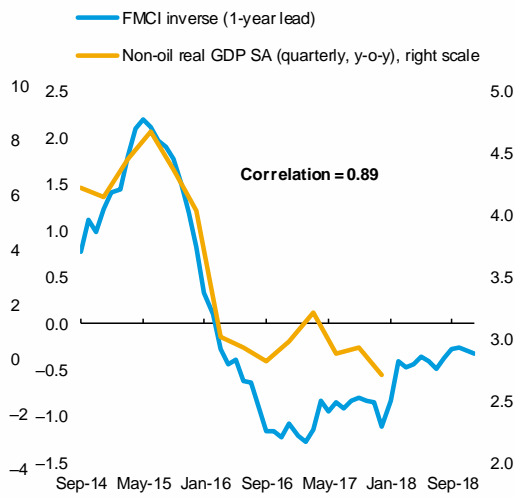
The main drivers of tightening in financial and monetary conditions have been higher policy rates, declines in real estate (Qatar, United Arab Emirates) and equity prices (Bahrain, Dubai, Oman), and a slowdown in liquidity growth driven in part by capital outflows.

Figure 1.1.1.
Financial Conditions Indices and Quarterly Non-Oil GDP Year-over-Year Growth Rates
(Correlations, last observation December 2018)

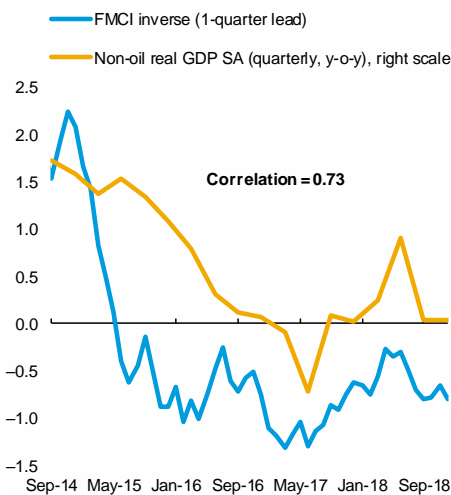
1. Saudi Arabia



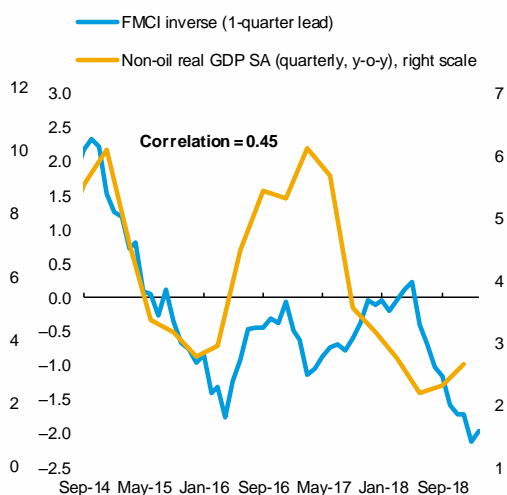
2. UAE: Dubai



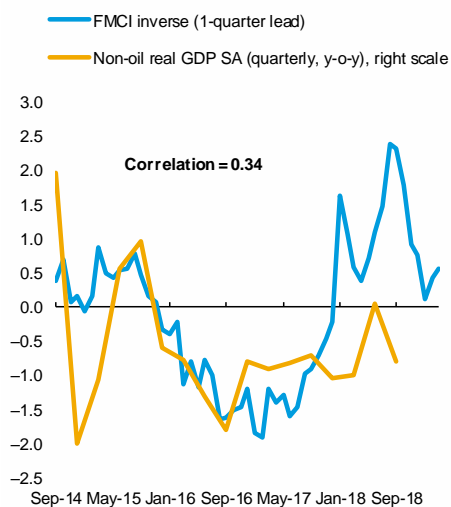
3. Qatar



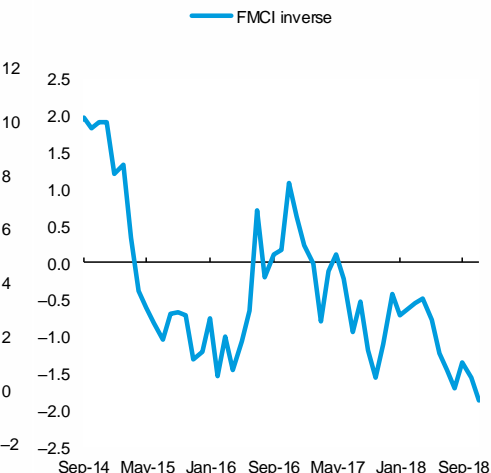
4. Bahrain



5. Kuwait



6. Oman



Sources: Haver Analytics, national authorities, and IMF staff calculations.
 Note: FMCI = Financial and Monetary Conditions Index; SA = seasonally adjusted; y-o-y = year over year.

MENAP Region: Selected Economic Indicators, 2000–20

(Percent of GDP, unless otherwise indicated)

	Average	2016	2017	2018	Projections	
	2000–15				2019	2020
MENAP¹						
Real GDP (annual growth)	4.6	5.2	2.2	1.8	1.5	3.2
<i>of which non-oil growth</i>	5.7	2.3	3.1	2.3	2.7	3.3
Current Account Balance	8.2	-3.9	-0.6	2.3	-0.9	-0.7
Overall Fiscal Balance	2.9	-9.5	-5.5	-3.1	-4.9	-4.0
Inflation (year average; percent)	6.5	5.1	7.0	9.6	9.5	9.0
MENAP oil exporters						
Real GDP (annual growth)	4.8	5.9	1.3	0.6	0.4	2.8
<i>of which non-oil growth</i>	6.2	1.6	2.5	1.2	2.1	2.9
Current Account Balance	11.6	-3.1	1.6	5.3	0.9	1.0
Overall Fiscal Balance	5.7	-10.4	-5.1	-1.9	-4.2	-3.1
Inflation (year average; percent)	6.9	4.0	3.6	9.2	9.0	8.8
MENAP oil exporters excl. conflict countries						
Real GDP (annual growth)	4.2	5.3	1.0	0.4	0.0	2.0
<i>of which non-oil growth</i>	5.9	2.3	2.7	0.9	1.7	2.6
Current Account Balance	12.1	-2.5	1.5	5.5	1.7	1.6
Overall Fiscal Balance	6.2	-9.2	-4.9	-2.5	-4.0	-2.9
Inflation (year average; percent)	6.8	4.5	3.5	9.8	9.6	9.6
Of which: Gulf Cooperation Council (GCC)						
Real GDP (annual growth)	4.8	2.3	-0.3	2.0	2.1	2.8
<i>of which non-oil growth</i>	6.7	1.9	1.9	2.3	2.9	3.3
Current Account Balance	15.3	-2.8	2.5	7.3	3.9	3.4
Overall Fiscal Balance	8.6	-10.7	-5.5	-1.7	-3.1	-2.2
Inflation (year average; percent)	2.7	2.1	0.2	2.1	0.4	2.4
MENAP oil importers						
Real GDP (annual growth)	4.3	3.7	4.1	4.2	3.6	4.0
Current Account Balance	-2.2	-5.6	-6.7	-6.5	-6.1	-5.3
Overall Fiscal Balance	-5.6	-7.2	-6.5	-6.7	-6.8	-6.5
Inflation (year average; percent)	6.0	7.5	14.4	10.4	10.5	9.5
MENA¹						
Real GDP (annual growth)	4.6	5.3	1.8	1.4	1.3	3.2
<i>of which non-oil growth</i>	5.8	2.0	2.8	1.9	2.6	3.3
Current Account Balance	8.8	-4.2	-0.3	3.1	-0.5	-0.4
Overall Fiscal Balance	3.6	-10.0	-5.5	-2.8	-4.7	-3.6
Inflation (year average; percent)	6.3	5.4	7.4	10.5	9.8	9.3
Arab World						
Real GDP (annual growth)	5.0	3.6	1.4	2.6	2.8	3.8
<i>of which non-oil growth</i>	6.2	1.8	2.4	3.0	3.5	3.8
Current Account Balance	9.8	-5.6	-1.0	2.9	-0.6	-0.4
Overall Fiscal Balance	4.0	-11.4	-6.2	-2.6	-4.8	-3.5
Inflation (year average; percent)	3.9	4.5	6.9	6.2	4.9	5.5

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

¹2011–20 data exclude Syrian Arab Republic.

Notes: Data refer to the fiscal year for the following countries: Afghanistan (March 21/March 20) until 2011, and December 21/December 20 thereafter, Iran (March 21/March 20), and Egypt and Pakistan (July/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 importers: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syria, and Tunisia.

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.

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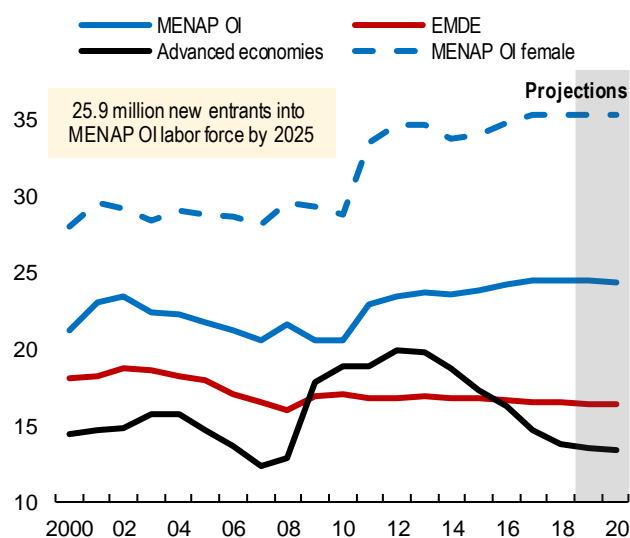
2. MENAP Oil-Importing Countries: Managing Vulnerabilities When the Economic Outlook Is Uncertain

Growth in oil importers of the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region is projected to remain relatively modest, constrained by persistent structural rigidities. Elevated public debt in many countries limits the fiscal space needed for critical social and infrastructure spending and leaves economies vulnerable to less favorable financial conditions. The outlook remains clouded by mounting global trade tensions and financial market uncertainty. Social tensions are rising in many countries as unemployment remains high and socioeconomic conditions worsen. Continued growth-friendly fiscal consolidation is needed to rebuild buffers and enhance resilience, along with intensified structural and governance reforms to improve competitiveness, boost private investment, and generate jobs. Increased regional integration will also help support medium-term growth.

How to Balance Near-Term Vulnerabilities and Medium-Term Challenges

Real GDP growth in MENAP oil importers is projected to remain moderate in 2019, reflecting the weaker external environment as well as domestic factors. Although growth is expected to pick up slightly over the medium term, it remains constrained by persistent structural rigidities in many countries and is too low to effectively reduce unemployment as demographic pressures rise. Unemployment remains particularly high among young people (24.4 percent in 2018) and females (18.9 percent in 2018) in the region, while female labor force participation also remains very low (26 percent in 2018) (Figure 2.1). Social tensions have been building in many countries across the region (see Box 2.1) as fiscal consolidation efforts, together with limited progress on structural reforms, have weighed on socioeconomic conditions.

Figure 2.1.
Youth Unemployment Rate
(Percent of labor force)



Sources: International Labour Organization: Key Indicators of the Labour Market; and IMF staff calculations.

Note: EMDE = emerging market and developing economies. MENAP OI = Middle East, North Africa, Afghanistan, and Pakistan oil importers.

At the same time, public debt has increased significantly over the past decade, constraining policy options to address these challenges. Near

term risks from elevated debt levels are worsened by a less favorable growth outlook and more volatile global financial conditions, particularly as a large amount of foreign currency debt matures over the next years. Policymakers increasingly face a trade-off between rebuilding buffers to strengthen resilience to near-term risks, as debt dynamics become less favorable, and addressing growth challenges.

Modest and Uneven Growth Continues

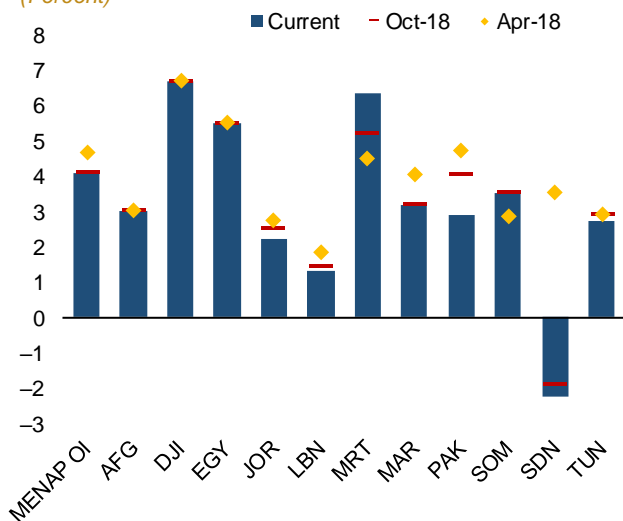
Masking considerable variation across the region, real GDP growth in MENAP oil importers is expected to slow from 4.2 percent in 2018 to 3.6 percent in 2019, before rebounding to 4.3 percent during 2020–23 (Figure 2.2). Weaker growth in Pakistan is pulling down the regional aggregate growth rate this year, with large macroeconomic imbalances and ongoing policy adjustment challenges expected to slow Pakistan’s growth from 5.2 percent in 2018 to 2.9 percent in 2019. Regional growth prospects also continue to

be constrained by low private investment and delays in reforms to address persistent structural impediments to private sector development.

Growth projections have been steadily revised down in several countries (Jordan, Lebanon, Morocco, Pakistan, Sudan) amid a weaker external environment. Regional growth for 2019 was projected at 4.0 percent in the October 2018 *Regional Economic Outlook*, compared with the current projection of 3.6 percent.

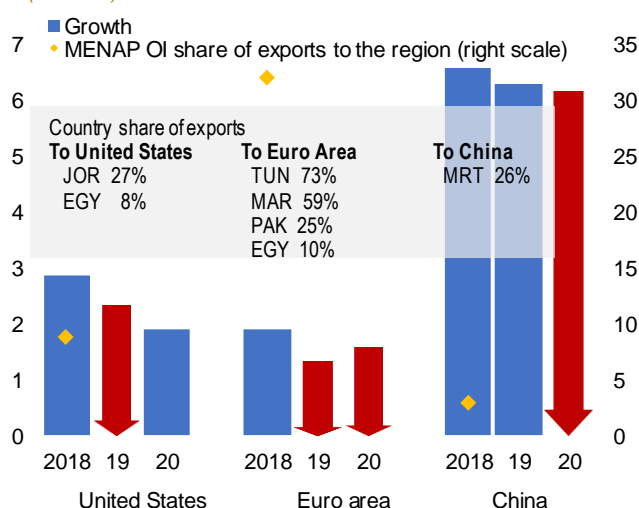
Risks also remain to the downside, with global trade tensions casting a cloud over the growth outlook in key trading partners and raising the prospect of investors’ increased risk aversion toward emerging markets. In particular, the MENAP oil importers’ large share of exports to China, the European Union, and the United States exposes these countries (for example, Jordan, Mauritania, Morocco, Pakistan, and Tunisia) to downside risks from weaker growth. Heavy reliance on tourism also exposes some countries (Egypt, Jordan) to risks from slower global growth (Figure 2.3).

Figure 2.2. 2019 Real GDP Growth across MENAP Oil Importers (Percent)



Sources: National authorities; and IMF staff calculations. Note: Country abbreviations are International Organization for Standardization (ISO) country codes. MENAP OI = Middle East, Central Asia, Afghanistan, and Pakistan oil importers.

Figure 2.3. Global and Regional Growth and MENAP Oil Exports Shares to the Regions (Percent)



Sources: IMF, Direction of Trade database; World Economic Outlook database; and IMF staff calculations. Note: Red arrows denote downward revision from October 2018 *Regional Economic Outlook: Middle East and Central Asia*. Country abbreviations are International Organization for Standardization (ISO) country codes.

Uncertainty related to ongoing conflicts and security concerns also poses a downside risk to the outlook. Regional uncertainty (Afghanistan, Jordan, Lebanon, Somalia, Syria), security concerns, weaker-than-anticipated public

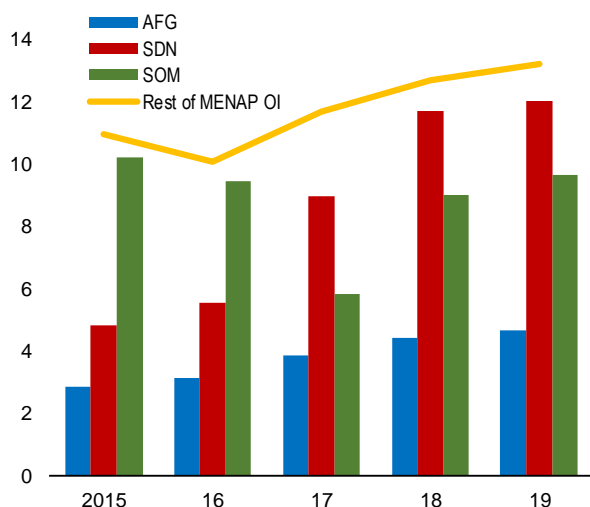
investment, and large external imbalances (Lebanon, Pakistan, Sudan) are expected to weigh on the medium-term growth outlook (See Box 2.1).

Box 2.1 Growth in Low-Income Oil Importers in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) Region

Low-income MENAP oil importers remain under stress from persistent conflict and poverty (Afghanistan, Somalia, Sudan, Syria, West Bank and Gaza). Security-related vulnerabilities pose an even greater risk to some of these countries than the global slowdown, as trade accounts for a comparatively smaller portion of total GDP for these countries than in the other MENAP oil importers (see Figure 2.1.1). Remittances, however, comprise a significant portion of GDP for some low-income countries (for example, Somalia), which exacerbates risks from global developments.

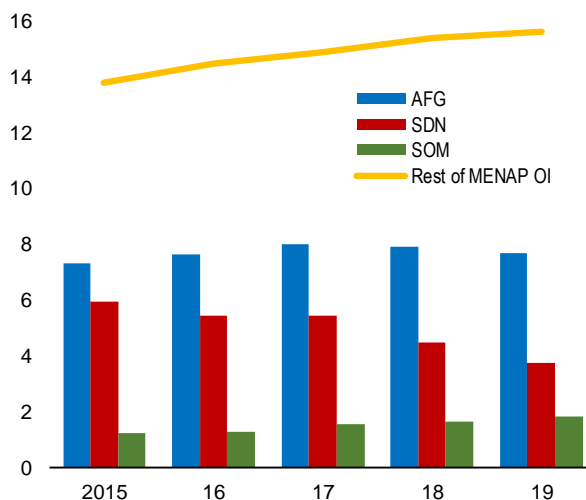
Fiscal policy remains constrained by weak revenue mobilization, despite some improvements in tax collection (see Figure 2.1.2). Countries rely heavily on external assistance, and the need to spend on basic public services limits the scope for expenditures on social safety nets and infrastructure investment. In addition, the financial sector remains at a very early stage of development. Credit to the private sector is very low, because the financial sector lacks the capacity to extend credit and finance investment, which is further compounded by high risk premiums during conflict. These vulnerabilities, coupled with higher population growth, capacity constraints, and security concerns, pose an even greater risk of social tensions. Moreover, the displacement of populations puts stress on neighboring countries faced with the challenge of absorbing refugees from conflict areas (for example, Jordan and Lebanon).

Figure 2.1.1.
Exports of Goods
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. MENAP OI = Middle East, Central Asia, Afghanistan, and Pakistan oil importers.

Figure 2.1.2.
Tax Revenues
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. MENAP OI = Middle East, Central Asia, Afghanistan, and Pakistan oil importers.

Lower Oil Prices Help, but External Vulnerabilities Persist

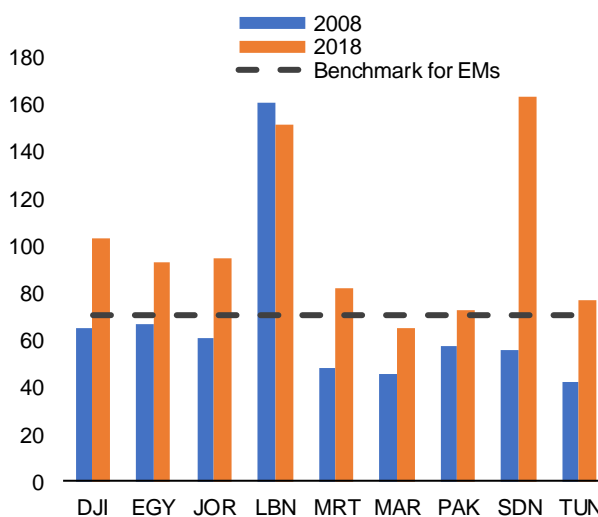
The regional current account deficit is expected to decline from 6.5 percent of GDP in 2018 to 5.9 and 5.2 percent in 2019 and 2020, respectively, as lower oil prices help improve oil importers' terms of trade. However, although current account deficits in Egypt and Morocco are projected to narrow to about 2 percent of GDP by 2020, external deficits remain sizable elsewhere in the region. With oil prices likely to remain volatile in the context of continued geopolitical tensions (see Chapter 1), the durability of the terms-of-trade improvement is uncertain.

Regional export growth is expected to slow to 7 percent in 2019 and 6.5 percent in 2020 largely due to weaker demand in key trading partners. While export growth is expected to remain strong in Egypt (continued recovery from an earlier shock in tourism and new production of natural gas)—and pick up in Jordan (tourism and improved access to markets from the opening of key borders and trade agreements with the European Union) and Mauritania (higher iron ore and gold exports)—exports are projected to slow elsewhere in the region. The escalation of trade tensions poses an additional downside risk to all countries in the region. Moreover, while remittances help to provide a buffer for current account deficits in many countries (Morocco, Pakistan, Somalia), there is a downside risk of a slowdown in remittance-originating countries, most of which are in Europe or the Gulf Cooperation Council.

Elevated Public Debt Increases Risks and Limits Fiscal Space

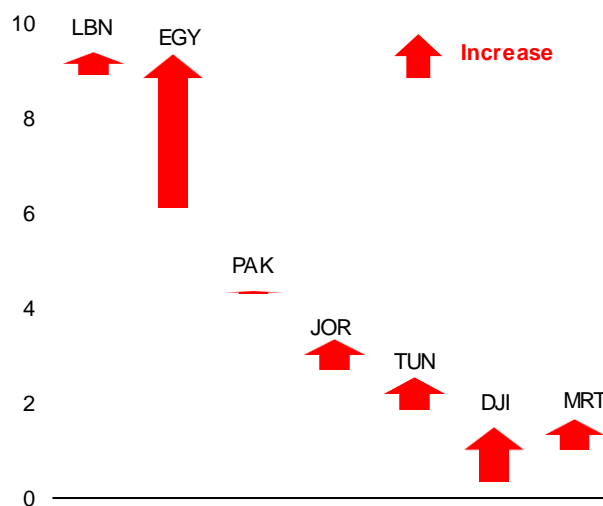
Although countries in the region have taken steps to consolidate fiscal positions in recent years, public debt ratios have increased considerably

Figure 2.4.
Gross Government Debt
(Percent of GDP)



Sources: National authorities, IMF, Regional Economic Outlook database; and IMF staff calculations.
Note: Djibouti and Mauritania data include public and publicly guaranteed debt. Country abbreviations are International Organization for Standardization (ISO) country codes. EM = emerging market economies.

Figure 2.5.
Government Interest Expenditure
(Change from average 2010–14 to 2018, percent of GDP)



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

over the past decade, rising by 20 percent of GDP on average since 2008. Most MENAP oil-importing countries are well above the emerging

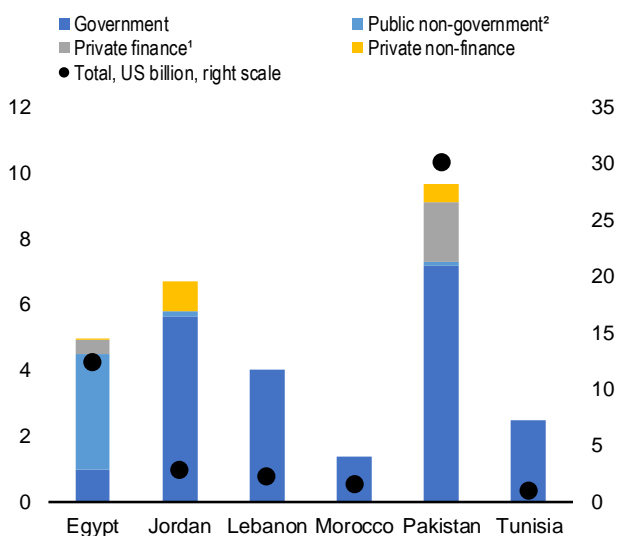
market threshold for public debt,¹ exceeding 80 percent of GDP in Egypt, Jordan, Lebanon, and Sudan (Figure 2.4). Increased borrowing has meant higher interest expenditures, constraining fiscal space and crowding out other high-priority spending (Figure 2.5). In addition, many countries have large foreign currency debt—some \$27 billion—set to mature in the next two years, leaving them more exposed to slower growth prospects and financial market volatility (Figure 2.6). Although immediate pressures on financial flows have abated in recent months, global financial conditions remain uncertain and are likely to be much less supportive than during the past several years.

This presents an increasingly difficult choice for policymakers as they weigh rebuilding buffers to strengthen resilience to near-term risks against addressing challenges to growth. High public debt limits options for fiscal policy to help offset the impact of weaker external demand on near-term growth and leaves little fiscal space to upgrade

infrastructure, invest in health and education, and build a sustainable safety net—all of which are essential to supporting medium-term growth and alleviating social tensions.

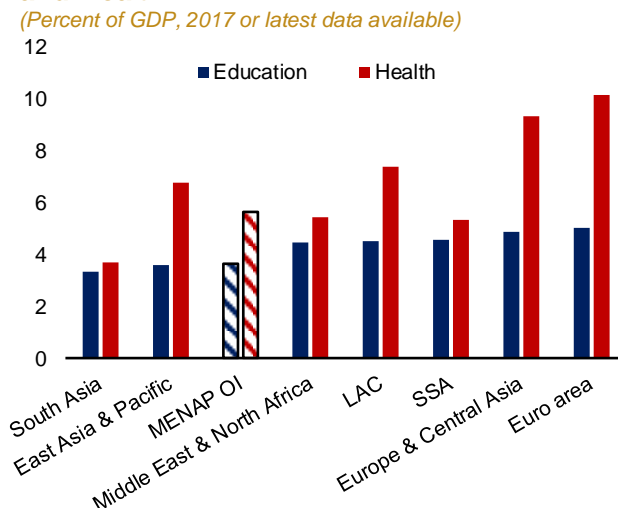
Fiscal consolidation efforts will need to intensify to rebuild buffers but should be appropriately calibrated to focus on growth-friendly fiscal adjustment. Countries should look to improve the efficiency of public spending by rationalizing recurrent expenditures to preserve space for capital and social spending. Adequate public spending on health, education, and the social safety net could help alleviate social tensions (Figure 2.7). Targeted social transfers should replace subsidies, which benefit some segments of the population disproportionately (for example, fuel subsidies in Sudan and Tunisia and cross-electricity subsidies in Jordan), while restructuring state-owned enterprises (Egypt, Pakistan) would also make for more efficient spending. In countries where the level of tax collection is low (Afghanistan, Pakistan, Sudan), there is also

Figure 2.6. External Debt Maturing in 2019–20 (Percent of 2018 GDP, unless specified otherwise)



Sources: Dealogic, National authorities; and IMF staff calculations.
¹Both private and public finance for Egypt.
²Includes the Central Bank of Egypt.

Figure 2.7. Government Expenditure on Education and Health (Percent of GDP, 2017 or latest data available)



Sources: United Nations Educational, Scientific, and Cultural Organization (UNESCO) Institute for Statistics; World Health Organization, Global Health Expenditure database; and IMF staff calculations.
 Note: LAC = Latin America and Caribbean, MENAP OI = Middle East, Central Asia, Afghanistan, and Pakistan oil importers, SSA = sub-Saharan Africa.

¹ The IMF’s Public Debt Sustainability Analysis in Market Access Countries considers emerging market countries to be

at higher risk of debt distress where public debt exceeds 70 percent of GDP.

considerable room to improve revenue mobilization, including by eliminating distortionary exemptions; taxing the richer segments of the population, such as by introducing property and wealth taxes; broadening the tax base; and reducing informality.

There is also clear scope to improve the effectiveness and efficiency of public institutions, which will enhance tax collection and the quality of expenditure. Budget transparency in the region is low relative to other emerging market economies, which underscores the importance of initiatives to reduce corruption and increase public trust in fiscal institutions. Expanding the use of technology can also help increase tax compliance and improve the effectiveness and governance of fiscal institutions (IMF 2017a). To maximize these benefits there is a need to develop institutional capacity, facilitate access to digital services, and address privacy and cybersecurity concerns.

Limited Monetary Space despite Modest Inflation Pressure

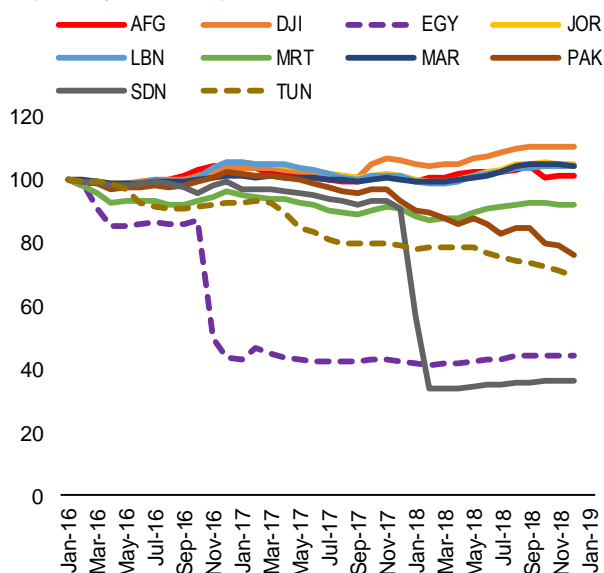
Regional inflation is projected to pick up slightly to 11.3 percent in 2019, primarily due to higher inflation in Egypt (fuel subsidy reform) and Pakistan (weaker exchange rate). On the whole, inflation is expected to remain broadly stable, helped by declining energy prices, with most countries in the region projected at single-digit inflation (below 3 percent for Afghanistan, Jordan, Lebanon, and Morocco).

While monetary authorities in the region have largely maintained a broadly neutral policy stance (except for tighter stances in Egypt, Pakistan, and Tunisia), scope for more supportive monetary policy varies. There is little role for monetary policy in countries following a peg or currency board arrangement (Djibouti, Jordan, Lebanon). Limited exchange rate flexibility constrains scope

for monetary policy and puts a heavier burden on fiscal policy. Countries with more flexible exchange rates are better able to absorb external shocks and safeguard external competitiveness. Exchange rate movements give policymakers an adjustment tool where fiscal and conventional monetary policy is constrained (Figure 2.8). Large discrete adjustments in the exchange rate as pressures build are more disruptive than flexibility over time.

To enhance resilience, authorities should also continue to strengthen banking sectors, including by enhancing regulatory and supervisory frameworks and insolvency regimes. When growth and financial conditions are less favorable, banking sector fragility can emerge and risks further aggravating fiscal pressure. More effort is also needed in many countries (Sudan, Tunisia) to strengthen frameworks against money laundering and the financing of terrorism to guard against losing correspondent banking relationships.

Figure 2.8.
NEER Index
(January 2016 = 100)



Sources: IMF, International Notice System database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. NEER = nominal effective exchange rate.

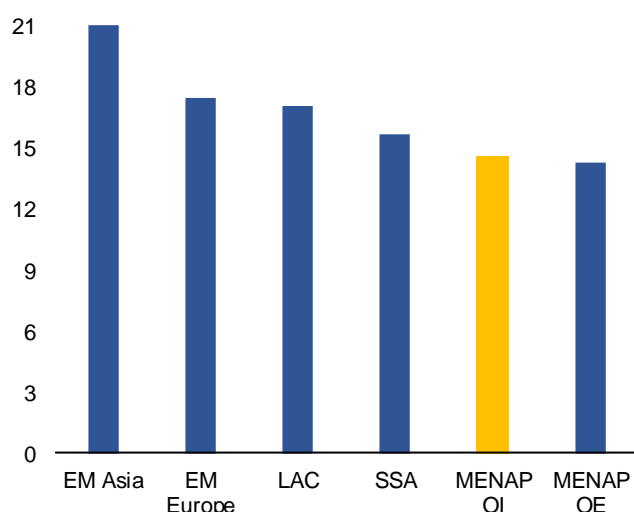
Focus on Structural Reforms to Improve Growth Prospects

Limited fiscal and monetary space heightens the importance of structural reforms to improve medium-term growth prospects, enable private sector job creation, and enhance inclusion. Private investment across the region remains comparatively low; creating an environment more conducive to private investment will require improving infrastructure and education, strengthening governance and institutions, and expanding access to credit (Figure 2.9).

In the context of a more difficult external environment and emerging social tensions, there can be reluctance to pursue structural reforms that will not have an immediate growth impact. However, it is essential to make progress on reforms before conditions become more difficult. Social divisions will continue to intensify if medium-term challenges are left unaddressed, raising the risk of a more disorderly adjustment.

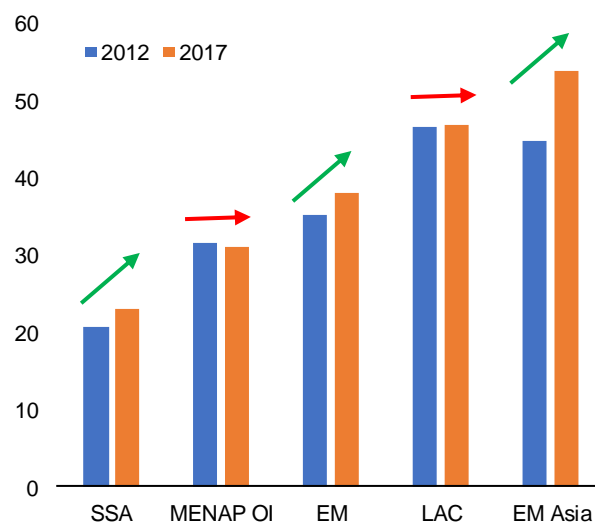
Improving access to credit: Credit to the private sector remains low in MENAP oil importers, constrained in part by an underdeveloped banking system that is unable to effectively intermediate domestic savings for productive investment in many countries (Figure 2.10). Banks tend to cater primarily to large, well-established companies; small and medium enterprises, mortgages, and consumer financing represent only a limited portion of their business (Figure 2.11). This reflects in part deficiencies in legal and institutional frameworks related to property rights, contract enforcement, credit information, the insolvency framework, and collateral enforcement that discourage banks from lending in these areas. The cumbersome property registration process in many countries also remains a fundamental obstacle to development of the mortgage market. Broader financial sector development would support private sector investment. Improving small and medium enterprises' access to credit would also encourage them to move into the

Figure 2.9.
Private Investment Ratios by Regions
(2000–18 average, percent of GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: EM Asia = emerging Asia; EM Europe = emerging Europe; LAC = Latin America and Caribbean; MENAP OE = Middle East, North Africa, Afghanistan, and Pakistan oil exporters; MENAP OI = Middle East, North Africa, Afghanistan, and Pakistan oil importers; SSA = sub-Saharan Africa.

Figure 2.10.
Banking Credit to Private Sector
(Percent of GDP)

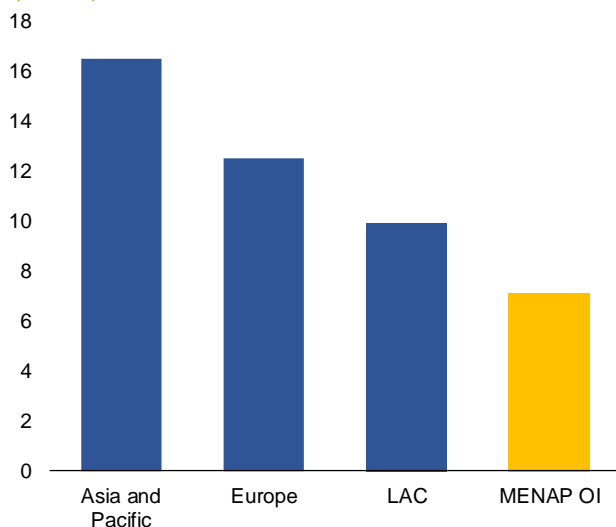


Sources: IMF, International Financial Statistics database; and IMF staff calculations.
Note: EM = emerging market economies; EM Asia = emerging Asia; LAC = Latin America and Caribbean; MENAP OI = Middle East, North Africa, Afghanistan, and Pakistan oil importers; SSA = sub-Saharan Africa.

Figure 2.11.

SME Lending as Share of Total Bank Lending by Region, 2016

(Percent)



Sources: IMF, Financial Access Survey, and IMF staff calculations.
 Note: LAC = Latin America and Caribbean; MENAP OI = Middle East, North Africa, Afghanistan, and Pakistan oil importers; SME = small and medium-sized enterprise.

formal sector, reducing the level of informality in the economy and helping to expand the tax base (see Blancher and others 2019; Stepanyan and others, forthcoming).

- Improving the business environment and governance:** Several countries have passed legislation that makes it easier to open and operate businesses (Egypt, Jordan, Morocco, Tunisia) (October 2018 *Regional Economic Outlook*). In addition, recognizing that corruption can impede the pace of reform, cost of doing business, and private investment (IMF 2017b), some countries are focusing on reducing corruption through legislative reform (Afghanistan, Egypt, Mauritania, Tunisia) (October 2018 *Regional Economic Outlook*). Benefits of reducing corruption include less revenue leakage, more efficient public spending, and higher-quality public education and infrastructure (see the April 2019 *Fiscal Monitor*). However, more decisive efforts are needed to strengthen good governance and improve the effectiveness of the anti-
- corruption and anti-money-laundering frameworks in the region.
- Skilled labor force and labor market reforms:** Skills shortages and mismatches, coupled with inefficient labor markets, carry significant productivity costs and limit firms' ability to compete effectively and generate employment. Educational attainment and learning outcomes in MENAP oil importers remain low relative to other emerging market economies. More efficient spending on education that caters to the skills needed in the workforce would help boost productivity as well as generate more inclusive and equitable growth. In addition, reforming regulations to enhance labor market flexibility can improve dynamism and facilitate private sector development. The cost of labor also needs adjustment (for example, expensive employee contributions in Jordan) to improve employment outcomes.
- Product market reforms and market competition:** A more competitive business environment in which the state plays a less prominent role will improve total factor productivity and direct capital toward more productive sectors. Administered prices, electricity and fuel subsidies (Jordan, Lebanon, Sudan, Tunisia), and inefficient state-owned enterprises (Pakistan, Tunisia) suppress competition and divert resources to less productive areas.
- Regional integration:** IMF analysis suggests that greater integration in the Maghreb region countries would create a regional market of almost 100 million people with an average income of about \$4,000 per capita in nominal terms (IMF 2019). Maghreb integration could contribute to raising growth in each Maghreb country by 1 percentage point on average over the long term.

MENAP Region: Selected Economic Indicators, 2000–20

(Percent of GDP, unless otherwise indicated)

	Average	2016	2017	2018	Projections	
	2000–15				2019	2020
MENAP¹						
Real GDP (annual growth)	4.6	5.2	2.2	1.8	1.5	3.2
<i>of which non-oil growth</i>	5.7	2.3	3.1	2.3	2.7	3.3
Current Account Balance	8.2	-3.9	-0.6	2.3	-0.9	-0.7
Overall Fiscal Balance	2.9	-9.5	-5.5	-3.1	-4.9	-4.0
Inflation (year average; percent)	6.5	5.1	7.0	9.6	9.5	9.0
MENAP oil exporters						
Real GDP (annual growth)	4.8	5.9	1.3	0.6	0.4	2.8
<i>of which non-oil growth</i>	6.2	1.6	2.5	1.2	2.1	2.9
Current Account Balance	11.6	-3.1	1.6	5.3	0.9	1.0
Overall Fiscal Balance	5.7	-10.4	-5.1	-1.9	-4.2	-3.1
Inflation (year average; percent)	6.9	4.0	3.6	9.2	9.0	8.8
MENAP oil exporters excl. conflict countries						
Real GDP (annual growth)	4.2	5.3	1.0	0.4	0.0	2.0
<i>of which non-oil growth</i>	5.9	2.3	2.7	0.9	1.7	2.6
Current Account Balance	12.1	-2.5	1.5	5.5	1.7	1.6
Overall Fiscal Balance	6.2	-9.2	-4.9	-2.5	-4.0	-2.9
Inflation (year average; percent)	6.8	4.5	3.5	9.8	9.6	9.6
Of which: Gulf Cooperation Council (GCC)						
Real GDP (annual growth)	4.8	2.3	-0.3	2.0	2.1	2.8
<i>of which non-oil growth</i>	6.7	1.9	1.9	2.3	2.9	3.3
Current Account Balance	15.3	-2.8	2.5	7.3	3.9	3.4
Overall Fiscal Balance	8.6	-10.7	-5.5	-1.7	-3.1	-2.2
Inflation (year average; percent)	2.7	2.1	0.2	2.1	0.4	2.4
MENAP oil importers						
Real GDP (annual growth)	4.3	3.7	4.1	4.2	3.6	4.0
Current Account Balance	-2.2	-5.6	-6.7	-6.5	-6.1	-5.3
Overall Fiscal Balance	-5.6	-7.2	-6.5	-6.7	-6.8	-6.5
Inflation (year average; percent)	6.0	7.5	14.4	10.4	10.5	9.5
MENA¹						
Real GDP (annual growth)	4.6	5.3	1.8	1.4	1.3	3.2
<i>of which non-oil growth</i>	5.8	2.0	2.8	1.9	2.6	3.3
Current Account Balance	8.8	-4.2	-0.3	3.1	-0.5	-0.4
Overall Fiscal Balance	3.6	-10.0	-5.5	-2.8	-4.7	-3.6
Inflation (year average; percent)	6.3	5.4	7.4	10.5	9.8	9.3
Arab World						
Real GDP (annual growth)	5.0	3.6	1.4	2.6	2.8	3.8
<i>of which non-oil growth</i>	6.2	1.8	2.4	3.0	3.5	3.8
Current Account Balance	9.8	-5.6	-1.0	2.9	-0.6	-0.4
Overall Fiscal Balance	4.0	-11.4	-6.2	-2.6	-4.8	-3.5
Inflation (year average; percent)	3.9	4.5	6.9	6.2	4.9	5.5

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

¹2011–20 data exclude Syrian Arab Republic.

Notes: Data refer to the fiscal year for the following countries: Afghanistan (March 21/March 20) until 2011, and December 21/December 20 thereafter, Iran (March 21/March 20), and Egypt and Pakistan (July/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 importers: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syria, and Tunisia.

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.

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