

WORLD BANK MIDDLE EAST AND NORTH AFRICA REGION
MENA ECONOMIC MONITOR

Towards a New Social Contract



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MENA ECONOMIC MONITOR

Towards a New Social Contract

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MENA ECONOMIC MONITOR

Towards a New Social Contract

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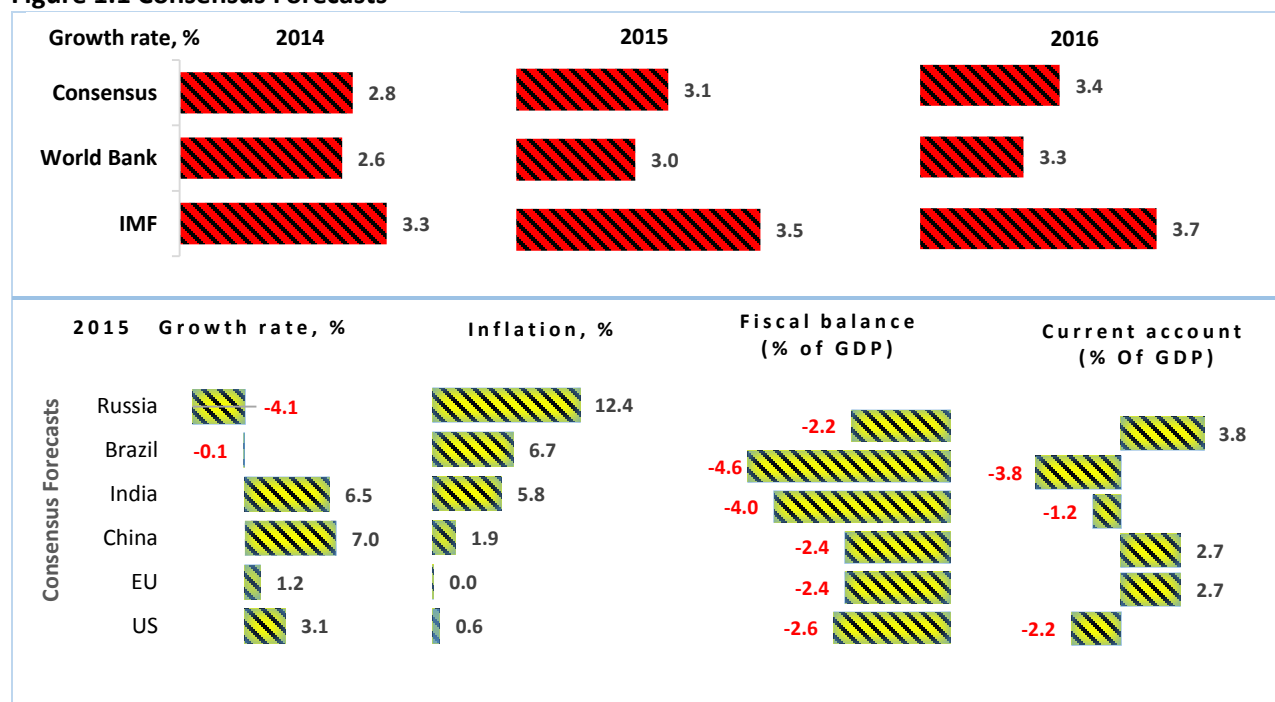
Recent Economic Developments and Prospects

The Global Outlook

The global economy will grow by between 3 and 3.5 percent this year, about half a percentage point higher than last year's 2.6 percent, and surpassing the average growth rate of 3.1 percent during 2000-08, prior to the financial crisis (Figure 1.1). Major forces behind the recent recovery are better-than-expected growth in the United States, United Kingdom, and some countries in the Euro area, and—most important—the sharp fall in international oil prices. Low oil prices have contributed in net terms to the global recovery, but the impact varies widely across countries, particularly between oil exporters and importers. Lower oil prices have increased oil importers' real GDP growth, improved trade balances and—to the extent that they subsidize fuel—eased their fiscal pressures. The magnitude of the gains, however, will depend on, among other factors, the share of oil imports in GDP. Oil exporters (including Russia) could see a sharp fall in their growth rates; their fiscal balances will deteriorate, with significant regional consequences (Mottaghi, 2015).

Next year, World GDP is estimated to grow by between 3.3 and 3.7 percent (Figure 1.1). Most international forecasters expect a continued recovery in the U.S., with a slower one in the Euro area in 2016. High-income countries of the G7 are likely to see growth of 2.3 percent in 2015 and 2016 and the Euro area by 1.2 and 1.6 percent in the same years. Growth in developing economies is expected to increase to 4.8 and 5.3 percent in 2015 and 2016, respectively. But risks continue to be on the downside.

Figure 1.1 Consensus Forecasts



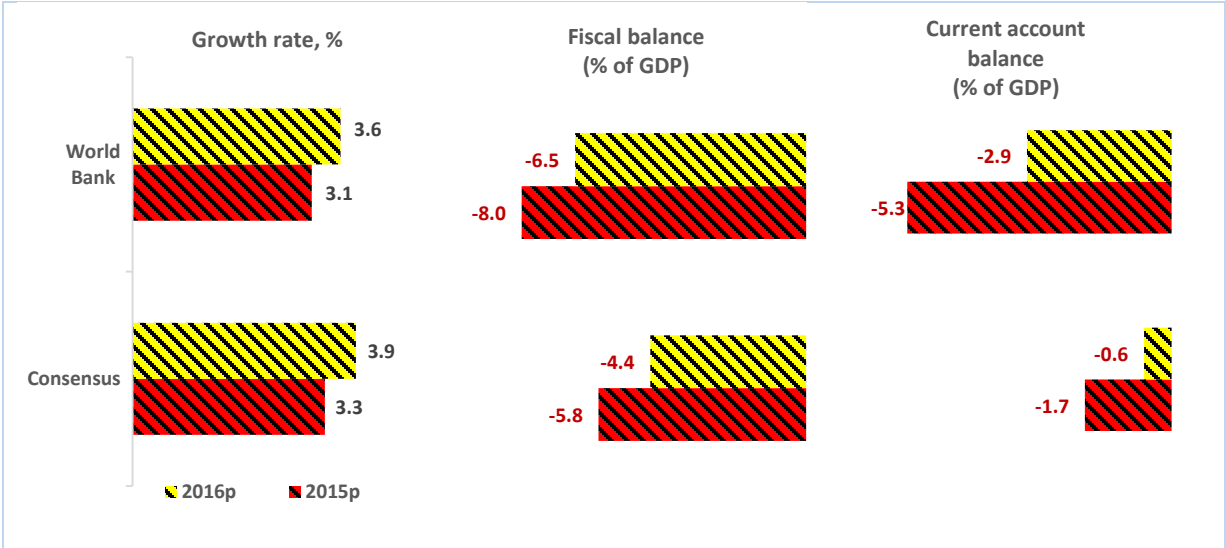
Source: World Bank, IMF and FocusEconomics March 2015. Note: Consensus forecasts is the average of economic indicators from international leading forecasters.

In the meantime, after falling by more than 60 percent since their peak in June 2014, oil prices (Brent crude) have been fluctuating at around \$50 per barrel in late March.¹ Oil prices are extremely volatile and notoriously difficult to predict, but the futures market points to a Brent crude price of about \$61 for delivery in December 2015, increasing to \$67 for December 2016. The pace of growth in oil prices is so slow that they are unlikely to revert to \$100 or above any time soon. Thanks to the weak economic recovery in the Euro area and moderate growth in China and India, demand is not growing fast enough to absorb the continued excess supply.

The Middle East and North Africa Regional Outlook

Whereas the global economy is set for a gradual pick up, economic prospects in the Middle East and North Africa (MENA) remain flat. Growth in MENA is expected to slow down in 2015 and range between 3.1 and 3.3 percent according to the World Bank and consensus forecasts respectively, and continue on the same path in 2016 (Figure 1.2). If the security situation in Libya improves and oil exports increase, the regional average could surge to 4 to 5 percent in 2016. The main reasons for the continued, sluggish growth are: prolonged conflict and political instability in Syria, Iraq, Libya and Yemen; low oil prices that are dragging down growth in oil exporters; and the slow pace of reforms that is standing in the way of a resumption of investment. The continuation of this situation will significantly hurt the overall unemployment rate, now standing at 12 percent, and poverty in the region. Fiscal deficits are mounting, leaving the region with a deficit of 8 percent of GDP in 2015, after 4 years of surpluses. At this point, the overall economic outlook for MENA remains tepid, though longer term forecasts, if the regional conflicts subside and necessary reforms are implemented, could be more optimistic.

Figure 1.2 World Bank and Consensus Forecasts for MENA



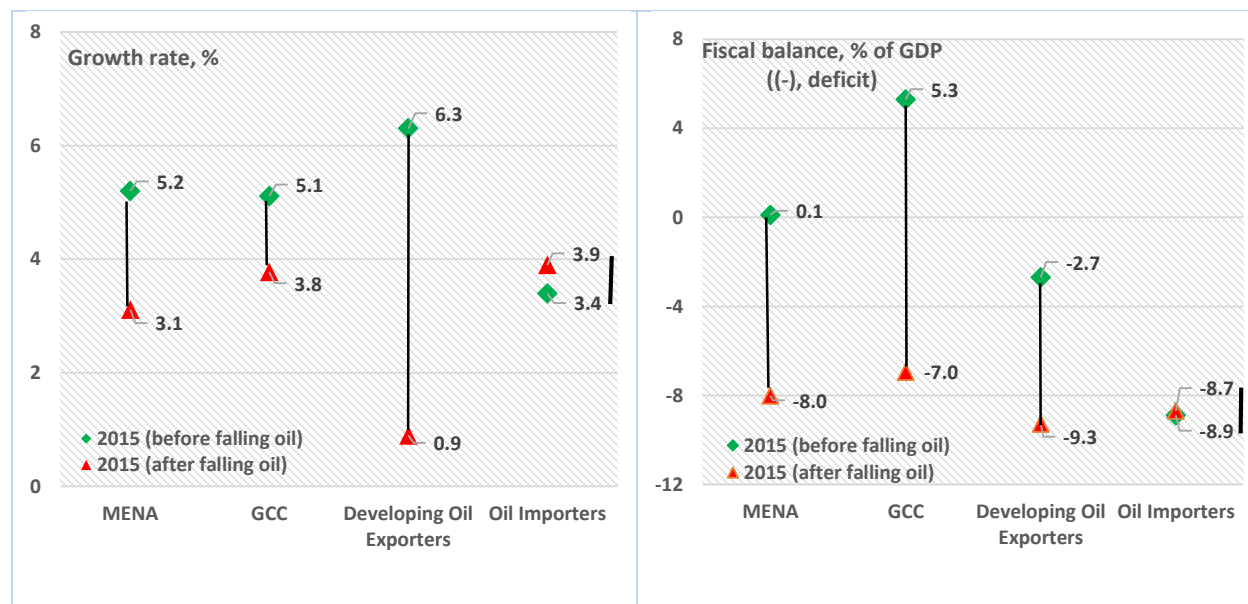
Source: World Bank and FocusEconomics (March 2015). Note: Consensus forecasts is the mean average of economic indicators from international leading forecasters.

¹ Oil prices (Brent crude) declined by \$2 and reached \$49 per barrel following the framework agreement reached between the P5+1 and Iran on April 2nd.

The group of oil exporters are estimated to grow by around 2.8 percent in 2015 with growth stagnating in developing oil exporters at less than 1 percent. Growth for the group of high-income Gulf Cooperation Council (GCC) oil exporters is estimated to range between 3.2 to 3.8 percent in 2015, predicted by the consensus forecasts and the World Bank respectively, about half a percentage point lower than last year (Figure 1.3 and Annex table). The World Bank estimates that growth in developing oil exporters in MENA, pinched by cheap oil, is expected to drop to 0.9 percent compared to 6.3 percent prior to the oil collapse (Figure 1.3, left panel). The impact on fiscal savings from the oil price collapse has outweighed the uptick in consumption due to a spending increase.

Growth in developing MENA countries as a whole will stay at 2 percent in 2015. While still low, this figure is about half a percentage point higher than the previous year, owing to better-than-expected growth in oil importers--estimated at 3.9 and 4.1 percent in 2015 and 2016, respectively, about one and a half percentage points higher than the previous year. Furthermore, fiscal deficits are expected to improve in the group of oil importers in 2015, partly due to the fiscal savings resulting from low oil prices (Figure 1.3, right panel).

Figure 1.3. Regional Economic Stance, Before and After Falling Oil Prices



Source: World Bank.

Economic growth in all MENA oil exporters is plummeting.² After surpassing 8 percent in 2011, growth in Saudi Arabia is set to decline to 4.6 percent in 2015 (Table 1.1). The World Bank has estimated that Gulf countries could lose about \$215 billion in oil revenues, equivalent to 14 percent of their combined GDP, in 2015. While Saudi Arabia, UAE, Kuwait and Qatar have managed to withstand the worst effects of low oil prices through their large reserves, Bahrain, and Oman have less of a cushion. Even those countries with large buffers are starting to feel the pressure on their fiscal balances. The large fiscal surplus in Saudi-

² Growth in Kuwait is expected to rise slightly in 2015 due to moderate increase in oil production and acceleration in growth of the non-oil sector.

Arabia is disappearing, leaving the country with double-digit fiscal deficits in 2015 and the following year, for the first time in a decade. Saudi Arabia and Kuwait continue their expansionary fiscal policies, financed partially by their large foreign assets. Abu Dhabi's sovereign wealth fund, believed to be worth \$800 billion, could cushion the impacts of low oil prices on its economy. But these remedies cannot last forever since fiscal deficits are rising. In December 2014 alone, alongside oil prices, Gulf stock markets plunged, losing \$16 billion in three weeks.

If oil prices remain low for a sustained period of time and the fiscal situation in the Gulf States deteriorates, it may slow growth in remittances outflows from GCC countries to the rest of the region, mainly Egypt, Yemen and Jordan (where they are a major source of income). Estimates by the World Bank show that while remittances are expected to increase, there may be a deceleration in growth rates. Aid flows from GCC to the rest of MENA may also decline as a result of low oil prices.

Among developing oil exporters, Iran's economic prospects are contingent on the timing of lifting of sanctions following a nuclear agreement framework that was reached in early April, as well as on fluctuations in oil prices. Under this agreement, which is expected to lead to a final deal by end of June, a comprehensive lifting of sanctions is envisaged. This could significantly boost economic activity and accelerate growth to an estimated 5 percent in 2016³, while improving Iranians' living conditions. Growth is estimated to continue on the same path for the following year. In this case, however, the Iranian economy will face a massive oil windfall, which if not managed carefully, could lead to an oil boom, an overvalued real exchange rate and a loss of competitiveness of the non-oil tradable sector, a major source of foreign revenues. It could also lead to an increase in unemployment in tradables, as the oil sector does not create many jobs. In the case of continued status quo, the Iranian economy is expected to slow down to 0.6 percent growth in 2015 with attendant consequences for unemployment, fiscal deficits and inflation. In this setting, the government has adopted a contractionary fiscal policy that is reflected in the new budget. Capital spending is prioritized, the rich are to be excluded from the current cash transfer system, and an increase in gas prices by 5 percent should keep the budget deficit at 3.4 percent for 2015 and 2016 respectively (Table 1.1).

Growth in Algeria is estimated to fall to half its rate in 2015, standing at 2.6 percent. The country is facing a doubling of its fiscal deficit (subsidies alone account for 18 percent of GDP) as a share of GDP in 2015 and a widening current account deficit from 4.2 percent of GDP in 2014 to 18.6 percent in 2015. Weakening economic activity has hit the unemployment rate, which is expected to increase from 9.8 percent in 2013 to 10.6 and 11 percent in 2015 and 2016 respectively.

For those countries already in conflict, Iraq -- Libya, Yemen, and Syria -- economic prospects are grim. The ISIS insurgency and large military expenditures have hit the Iraqi economy hard. Growth is expected to turn negative in 2015 following a contraction of 0.5 percent in 2014 due to the decline in economic activity in the areas occupied by ISIS. The fiscal deficit as a percentage of GDP is estimated to double and reach 10.6 percent due to high military expenses and the recent government decision to keep fuel subsidies

³ The P5+1 and Iran issued a joint statement on general points of agreement on April 2nd. All parties will continue negotiations aimed at achieving a comprehensive accord in June.

intact, together with low oil prices.⁴ Current spending is high with wages and subsidies, particularly for the power sector, constituting almost 70 percent of government expenses. The public sector accounts for more than 50 percent of Iraqi employment, leaving little room for investment spending. Public investments are declining and most capital investments are disrupted because of the fiscal shock.

Libya is in recession. In addition to the impact of cheap oil, the violent conflict has interrupted oil exports, a major source of government and external revenues. The economy is estimated to have contracted by 24 percent in 2014, following a contraction of about 14 percent in 2013. While there are signs that the political conflict is easing and two oil ports have reopened, a rapid recovery in crude oil supply is unlikely and growth will remain low in 2015. The budget deficit is estimated at more than 40 percent of GDP in 2014 and 2015. The major forces behind this alarming budget deficit are, in addition to lower revenues due to low oil prices, the existing wage bill and subsidies estimated at 70 percent of expenditure; capital spending has fallen to a fifth of its pre-revolutionary period. Libya is counting on its large foreign reserves, which have declined dramatically. Estimates by the Central Bank of Libya show that foreign reserves stood at \$85.5 billion in December 2014, a 40 percent decline from July 2013.

In Yemen, the conflict among multiple forces vying to rule the country have weighed heavily on the economy, bringing growth down to zero percent in 2014 from 4.8 percent the previous year. In addition to the political instability, economic activity is hampered by sabotage of oil fields and weak infrastructure, which have caused severe fuel shortages and power cuts. The economy is estimated to contract by 2.8 percent in 2015, with growing political and security risks. Oil exports are estimated to drop by 10 percent in 2015 on top of an 11 percent drop in 2014, to an average of 140 thousand barrels per day. The budget deficit rose to 8.7 percent of GDP in 2014 as subsidy reforms were reversed and the savings did not materialize. The trend is expected to continue in 2015. And in Syria, the civil war has caused a sharp drop in government revenues together with a hike in military spending, increasing the fiscal deficit significantly. While data are scarce, some forecasters estimate that the rate of economic contraction will slow down. The EIU, in particular, estimates a positive growth rate of about 2 percent in 2015, largely driven by major businesses' moving to more stable coastal areas of an expanded industrial zone. While exports have begun to increase for the first time since 2011, investment remains stalled due to continued violence and political instability.

Lower oil prices together with some policy reforms, notably in Egypt and Morocco, have helped the economies of oil importers recover, albeit slowly. In fact, this group of countries are helping to maintain MENA's overall growth at 3 percent. In Egypt, low oil prices have helped contain domestic inflationary pressures triggered by the subsidy reforms introduced in July 2014. Some estimates show that low oil prices could reduce the fiscal deficit by about 2 percent of GDP in 2016. At the Economic Development Conference in mid-March, Egypt raised about \$36.5 billion, with the Gulf countries pledging a package worth \$12.5 billion. All of these could help boost growth in the coming years, albeit with some delays if the pledges do not all materialize. Tourism and manufacturing posted double-digit growth in 2014. The

⁴ State-supplied gasoline is currently priced at Dinar 450 (\$0.387/liter) in Baghdad, compared with Dinar 1,000/liter in private filling stations.

Suez Canal, construction, and building also observed strong performance in 2014, which should continue in 2015. Growth is estimated to surpass 4 percent in 2016, approaching the growth rates observed in the pre-revolutionary period.

Economic recovery in Tunisia has been slow partly due to weak external demand from the Euro area's anemic economic stance and slowing domestic demand. The World Bank estimates a moderate increase in growth of about half a percentage point in 2015, to 2.6 percent and gradually reaching 3.4 percent the following year. This is likely to happen on the back of a moderate rebound in the manufacturing and tourism sectors (although the recent attack on the Bardo Museum has affected tourist arrivals⁵). Low oil prices together with fiscal consolidation have helped reduce the fiscal deficit from 6.8 percent in 2013 to 4.2 percent in 2016. This will help contain inflation to about 4 percent.

Jordan's and Lebanon's economies are recovering slowly but steadily, despite being buffeted by civil wars in neighboring countries. The Jordanian economy is expected to grow by more than 3 percent in 2015, slightly higher than the growth observed since 2010. This uptick in growth is mostly due to an increase in public investment following grants from the GCC, and a narrower trade deficit. In Lebanon, despite a domestic political deadlock and spillovers from the ISIS conflict, lower oil prices have helped economic activity pick up, although growth is estimated to remain at a low level of about 2.5 percent in 2015 and 2016. With a break in the political deadlock and some fiscal consolidation, a growth rebound, similar to that observed in the 2000s, is possible.

The Palestinian Territories, West Bank and Gaza, are still feeling the brunt of the 2014 Gaza war and the precarious political and security situation. After 7 years of continuous growth, the Palestinian economy contracted by 0.8 percent in 2014 with a sharp contraction of 15 percent in the Gazan economy. The Gaza war of July-August 2014, in addition to causing physical damage estimated at nearly \$2.5 billion, has had a severe impact on Gaza's economy (Box 1.1). The West Bank economy, on the other hand, experienced 4.4 percent growth that was largely driven by investments in construction. As a whole, the Palestinian economy is expected to grow by less than 1 percent in 2015. The pace of the reconstruction process in Gaza has been much slower than expected due to inadequate donor funding and Israeli restrictions on the import of construction materials into Gaza. Around 70,000 households continue to be internally displaced, which has created an extremely fragile environment that could lead to more conflict. Unemployment increased to 27 percent in 2014 -- 43 percent in Gaza and 17 percent in the West Bank. Particularly alarming is youth unemployment in Gaza which soared by about 60 percent in 2014. Preliminary estimates indicate that the poverty rate in Gaza increased from 28 percent in 2013 to 39 percent in 2014.

⁵ The Tunisian tourism ministry reported that around 3,000 bookings have been cancelled since the attack on the Bardo Museum on March 18, 2015. The tourism industry accounts for more than 12 percent of GDP.

Box 1.1 The Long-run Effects of Israeli Blockades and Military Assaults on Gaza

In 2005, a year before the election of Hamas and the imposition of a total trade blockade on Gaza by Israel, the GDP per capita in Gaza was the same as in the West Bank, \$1304, a level higher than many other developing countries and regions (Table B1). Over the next 7 years, particularly after 2007, GDP per capita in Gaza decreased by 2.3 percent a year, whereas in the West Bank it increased annually by 8.1 percent, and in other regions growth rates ranged between 2.2 and 10.8 percent, except in Yemen.

Since 2007, the people of Gaza have experienced a total trade blockade and three, destructive, military assaults, in 2008-9, 2012 and 2014. The damage to the Gazan economy of each of these events has been considerable. Using the West Bank (which was not subject to a blockade) as the counterfactual, and using various techniques for reconciling and smoothing the data, it can be seen that the gap in per-capita income between the West Bank and Gaza widened significantly after 2006. The gap widened even further after Operation Cast Lead, and continued to widen through 2012 (Figure B1). The smoothed trends show that in 2006, the year before Hamas took over Gaza, the estimated long-run GDP per capita in Gaza was 71.5 percent of that in the West Bank (Figure B1(b)). After 2006, the gap widened further. The chart shows the annual loss to the Gazan economy in terms of GDP per capita as a result of the Israeli blockade and the Israeli Operation Cast Lead late in 2008, as described by the vertical distance between the actual ratio (the blue line) and the counterfactual ratio (the red line). The estimated annual loss to Gazan GDP per capita from its potential level between 2006 and 2008 is 5 percent. After the Israeli military assault in 2008, this gap has widened to 8.3 percent reaching 15.2 percent in 2012. Between 2007 and 2012 the total loss amounted to 51.6 percent of potential GDP per capita. The results indicate that, in addition to the short-run damage they cause, temporary Israeli military assaults and blockades have persistent, destructive effects on the Gazan economy.

Table B1 GDP per capita in Gaza and Comparators (Constant 2005, USD)

	Gaza-Strip	West-Bank	Egypt	Yemen	Sub Saharan Africa	East Asia and Pacific (Developing)	MENA (Developing countries)	Middle Income countries
2005	1304	1304	1249	832	870	1623	2180	1938
2012	1097	2041	1560	729	1005	2855	2553	2729
Growth, %	-2.3	8.1	3.5	-1.8	2.2	10.8	2.4	5.8

Figure B1a. Real GDP per capita

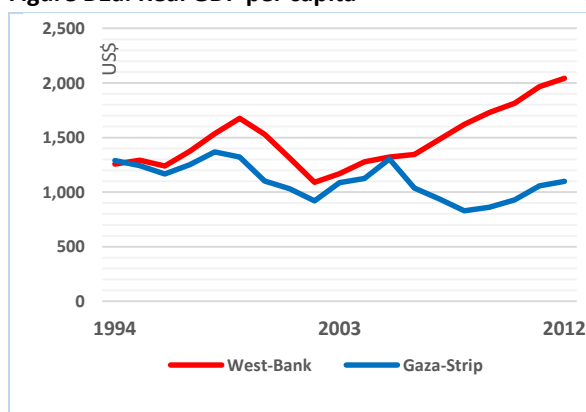
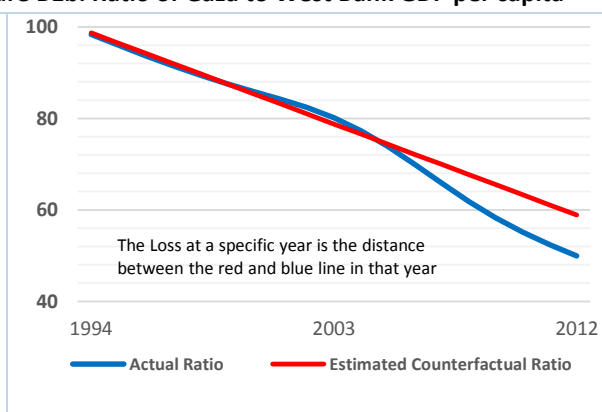


Figure B1b. Ratio of Gaza to West Bank GDP per capita



Source: Abu-Bader, S., 2015. The Effects of Israeli Blockades and Assaults on the Economy of Gaza. Mimeo, World Bank.

Table 1.1 Macroeconomic Outlook

	Real GDP Growth						Fiscal Balance						Current Account Balance					
	%						% of GDP						% of GDP					
	2011	2012	2013	2014e	2015p	2016p	2011	2012	2013	2014e	2015p	2016p	2011	2012	2013	2014e	2015p	2016p
MENA	4.8	5.8	2.9	3.2	3.1	5.2	3.9	5.9	2.7	0.3	-8.0	-6.5	13.0	12.3	9.1	5.8	-5.3	-2.9
Developing MENA	1.1	5.0	0.2	1.6	2.0	6.7	-3.6	-2.9	-6.2	-7.4	-9.1	-6.7	4.5	2.1	0.0	-3.1	-6.8	-4.0
Oil Exporters	5.2	6.3	2.8	3.3	2.8	5.3	6.4	8.9	5.5	2.5	-7.8	-6.0	16.8	16.2	12.4	8.0	-5.1	-2.3
High income MENA (GCC)	7.8	6.3	4.9	4.3	3.8	3.8	12.4	14.7	11.3	7.4	-7.0	-6.2	22.6	22.4	17.8	14.0	-3.8	-1.9
Bahrain	1.9	3.6	5.3	4.0	3.0	3.5	-0.1	-2.6	-3.8	-4.9	-11.9	-11.0	19.2	14.3	14.2	12.9	8.5	7.7
Kuwait	10.4	7.5	2.2	1.6	2.1	2.4	34.4	36.0	31.4	21.1	9.0	15.6	40.9	46.4	41.7	35.6	16.9	22.7
Oman	-1.1	7.1	3.9	4.1	3.7	3.6	7.5	2.5	4.2	-1.0	-16.7	-14.4	16.0	12.6	8.6	2.2	-10.0	-9.5
Qatar	13.0	6.2	6.1	5.9	3.0	3.7	15.4	16.8	14.2	9.7	6.5	0.4	38.9	33.2	25.8	21.2	2.3	5.5
Saudi Arabia	8.5	6.8	5.1	4.3	4.6	4.1	8.3	13.2	8.7	5.7	-16.2	-15.1	19.9	19.9	16.2	12.4	-11.8	-9.8
United Arab Emirates	4.9	4.8	5.2	4.7	3.1	4.0	9.3	9.9	7.2	5.7	-6.2	-4.4	12.2	12.4	7.4	5.7	-5.1	-4.0
Developing Oil Exporters	0.4	6.3	-1.3	1.1	0.9	8.1	-1.5	0.2	-3.7	-5.9	-9.3	-5.6	9.2	7.0	3.7	-2.0	-7.4	-3.0
Libya	-62.1	104.5	-13.6	-24.0	2.0	52.0	-15.4	27.8	-4.0	-43.5	-42.8	2.6	9.2	29.1	13.6	-32.8	-47.3	-1.0
Yemen	-12.7	2.4	4.8	0.0	-2.8	2.8	-5.7	-12.4	-7.8	-8.7	-6.5	-6.4	-2.8	-1.6	-2.9	-1.3	-0.8	-0.4
Algeria	2.8	3.3	2.8	4.1	2.6	3.9	-1.5	-5.0	-1.4	-6.8	-14.9	-11.6	9.9	6.0	0.4	-4.2	-18.6	-15.4
Iran	3.0	-6.6	-1.9	3.0	0.6	1.3	-1.4	-1.9	-2.2	-1.4	-3.4	-3.4	11.0	6.3	7.2	3.6	1.6	1.9
Iraq	10.2	10.3	4.2	-0.5	-1.0	5.5	4.7	4.1	-5.9	-4.9	-10.6	-6.0	12.0	6.7	2.1	-2.8	-8.3	-1.8
Syria	-3.4	-19.5	-20.6	0.5	1.9	...	-12.1	-17.0	-12.9	-10.7	-9.2	...	-14.7	-15.3	-12.6	-12.4	-12.4	...
Oil Importers	2.4	2.7	2.7	2.3	3.9	4.1	-8.5	-9.4	-11.0	-10.1	-8.7	-8.3	-6.1	-7.9	-7.0	-5.0	-6.0	-5.4
Egypt	1.8	2.2	2.1	2.2	4.3	4.3	-9.8	-10.6	-13.7	-12.8	-11.3	-10.5	-2.6	-3.1	-2.1	-0.8	-3.3	-3.1
Tunisia	-1.9	3.7	2.3	2.2	2.6	3.4	-3.3	-5.5	-6.8	-4.8	-4.5	-4.2	-7.4	-8.2	-8.4	-8.9	-8.5	-7.1
Djibouti	4.5	4.8	5.0	6.0	6.5	7.0	-0.7	-2.7	-5.9	-12.0	-14.1	-12.5	-14.1	-20.3	-23.3	-27.4	-27.7	-21.8
Jordan	2.6	2.7	3.0	3.1	3.5	3.9	-12.7	-10.5	-14.1	-13.5	-5.4	-5.1	-10.2	-15.2	-10.3	-7.1	-6.6	-5.2
Lebanon	2.0	2.2	0.9	2.0	2.5	2.5	-6.4	-8.7	-9.5	-7.0	-7.2	-10.1	-10.9	-22.7	-26.6	-22.2	-16.7	-16.1
Morocco	5.0	2.7	4.4	2.6	4.6	4.8	-6.7	-7.4	-5.4	-5.0	-4.5	-3.7	-8.0	-9.7	-7.6	-5.8	-5.0	-4.3
West Bank & Gaza	12.4	6.3	2.2	-0.8	0.9	4.3	-16.9	-15.1	-12.5	-12.1	-14.9	-13.8	-32.0	-23.1	-23.0	-27.7	-26.0	-27.8

Source: World Bank and Economist Intelligence Unit.

Annex Table: Consensus Forecasts

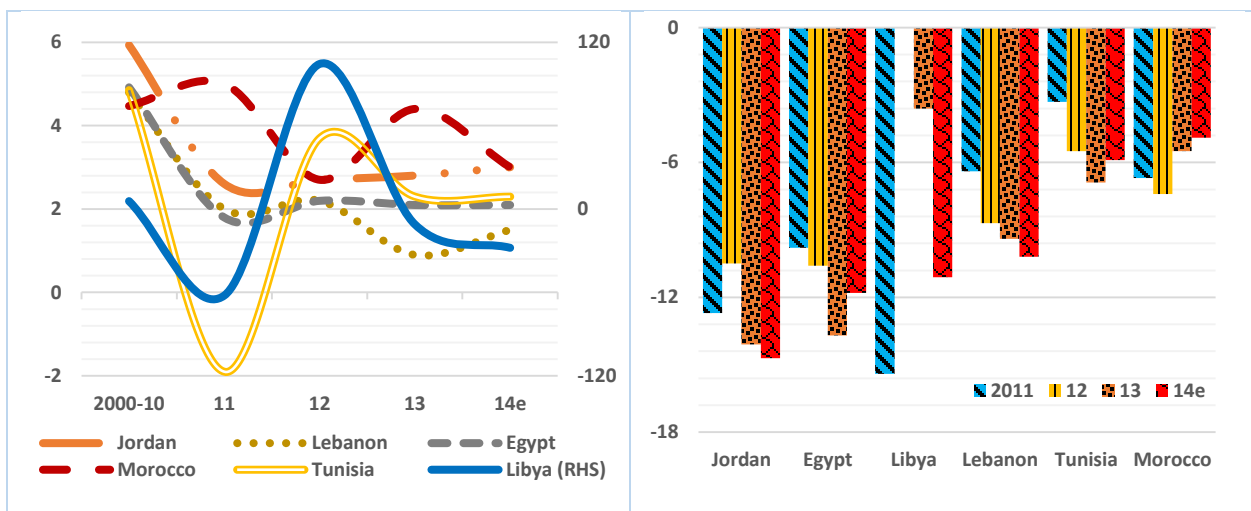
	Real GDP Growth %		Fiscal Balance % of GDP		Inflation %		Current Account % of GDP	
	2015	2016	2015	2016	2015	2016	2015	2016
MENA	3.3	3.9	-5.8	-4.4	3.5	3.8	-1.7	-0.6
GCC	3.2	3.6	-4.8	-2.6	2.6	3.0	1.7	3.9
Developing MENA	3.5	4.1	-7.1	-6.5	4.3	4.6	-5.2	-5.1
Developing oil exporters	3.2	4.3	-7.2	-6.4	4.4	4.9	-0.1	0.5
Developing oil importers	3.6	4.0	-7.1	-6.5	4.3	4.4	-6.2	-6.2
Algeria	3.0	3.1	-7.2	-6.4	4.3	4.2	...	...
Bahrain	2.8	3.1	-11.2	-8.4	2.4	2.7	-3.1	-1.9
Egypt	3.9	4.4	-11.1	-9.8	10.2	9.2	-1.7	-2.5
Iraq	3.4	5.5	...	...	4.5	5.6	-0.1	0.5
Jordan	3.6	3.9	-4.3	-3.9	2.6	3.2	-4.7	-4.5
Kuwait	2.1	2.6	4.9	5.3	2.9	3.2	12.4	16.9
Lebanon	2.2	2.9	-8.8	-8.7	2.6	3.2	-14.3	-14.5
Morocco	4.5	4.6	-4.2	-3.7	1.1	1.7	-3.1	-2.8
Oman	2.5	2.9	-11.0	-6.5	1.7	2.2	-7.5	-4.3
Qatar	5.9	6.1	5.0	3.5	3.4	3.7	8.4	8.3
Saudi Arabia	2.4	3.2	-12.4	-8.1	2.7	3.1	-3.7	0.2
Tunisia	3.	4.0	...	...	4.8	4.9	-7.2	-6.5
UAE	3.4	3.9	-4.1	-1.6	2.7	3.0	3.8	4.5

Source: FocusEconomics, March 2015.

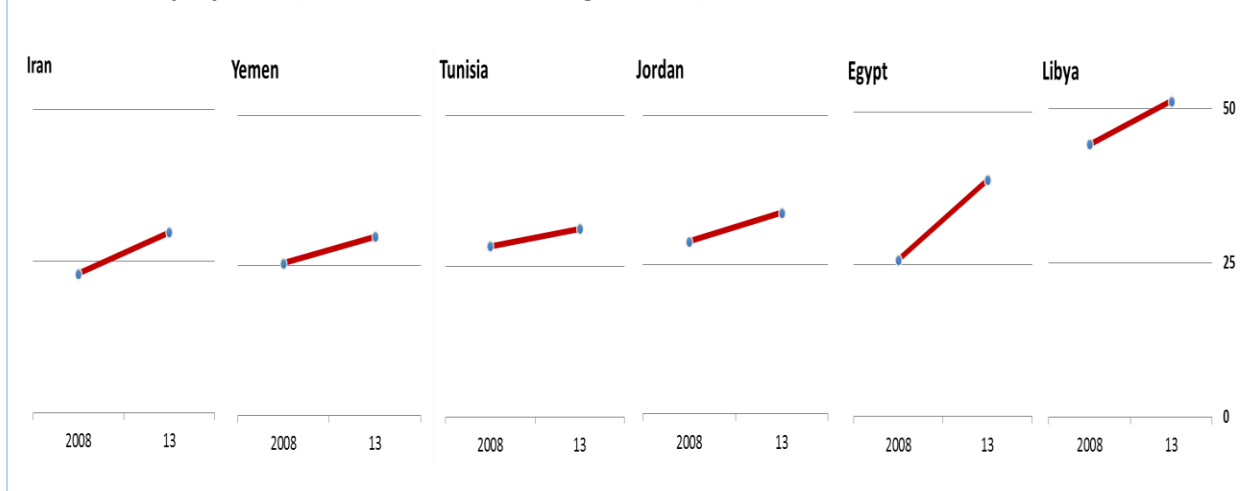
Towards a New Social Contract in the Middle East and North Africa

A snapshot of the Middle East and North Africa (MENA) today reveals a diverse and discouraging picture. Syria, Iraq, Libya and now Yemen are mired in violent conflicts that are devastating people’s lives, infrastructure and national economies, with spillovers to neighboring countries such as Lebanon, Jordan and Tunisia. The cost of the Syrian war and spread of the Islamic State alone have been estimated at \$35 billion in terms of lost output between mid-2011 and mid-2014 (Ianchovichina and Ivanic, 2014). The transition countries of Morocco, Tunisia, Egypt and Jordan are slowly but steadily reforming their economies, albeit in a context of anemic growth, high fiscal deficits and rising youth unemployment (Figure 2.1).

Figure 2.1 GDP Growth Rate (Percent)



Youth unemployment (% of total labor force ages 15-24)

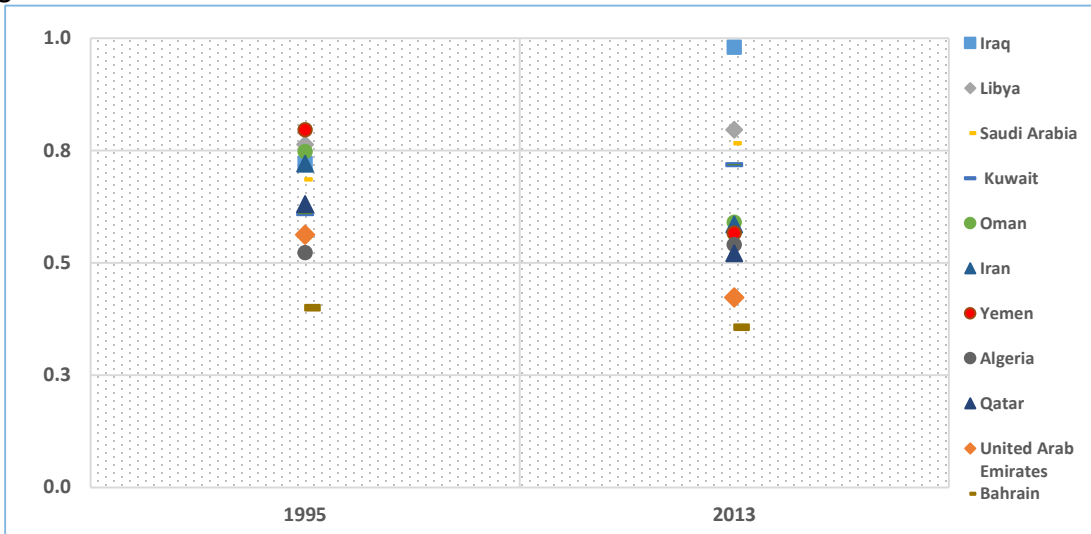


Source: World Bank.

Meanwhile, the resource-rich developing countries—Algeria, Iran and Iraq—have chronic problems of unemployment and lack of diversification, the latter being captured by the high concentration of exports

in a few commodities (Figure 2.2). The recent decline in oil prices is putting pressure on their budgets, as well as those of the high-income GCC countries, all of which are dominated by the public-sector wage bill.

Figure 2.2 Concentration Index



Source: UNCTAD. Note: Concentration index is the Herfindahl-Hirschmann index that ranges from 0 to 1. Close to 1 indicates more concentrated market. Number of products is based on SITC, Revision 3 commodity classification at 3-digit group level. This figure includes only those products that are greater than 100,000 dollars or more than 0.3 per cent of the country's or country group's total exports or imports. The maximum number of products is 261.

But a longer-term perspective—a movie rather than a snapshot—indicates a more homogeneous region and a more hopeful future. Despite their current differences, MENA countries have since independence been following more or less the same development model. The state would provide free health and education for all. Food and fuels were subsidized, to the tune of 10 percent of GDP recently. The public sector was the main formal-sector employer (Figure 2.3a). Perhaps in return for the state's largesse, citizen voice was limited. From internationally comparable data, all MENA countries were below the regression line connecting “voice and accountability” with per capita income (Figure 2.3b). Some people have described this development model as an “authoritarian bargain” (Yousef, 2004) or a social contract.

Figure 2.3a Employment Status (Latest available, Percent)

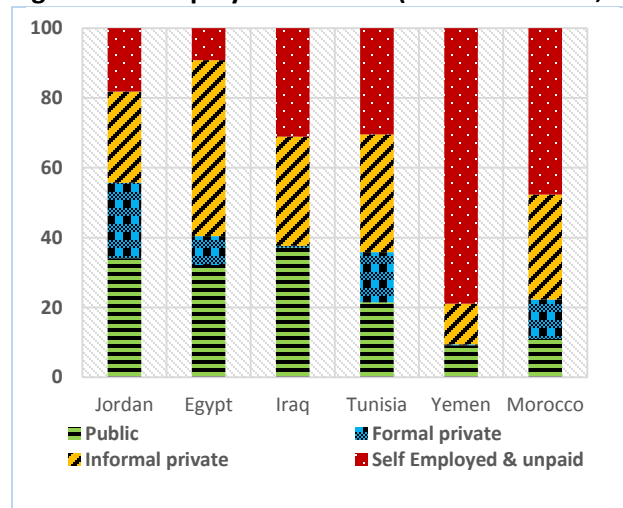
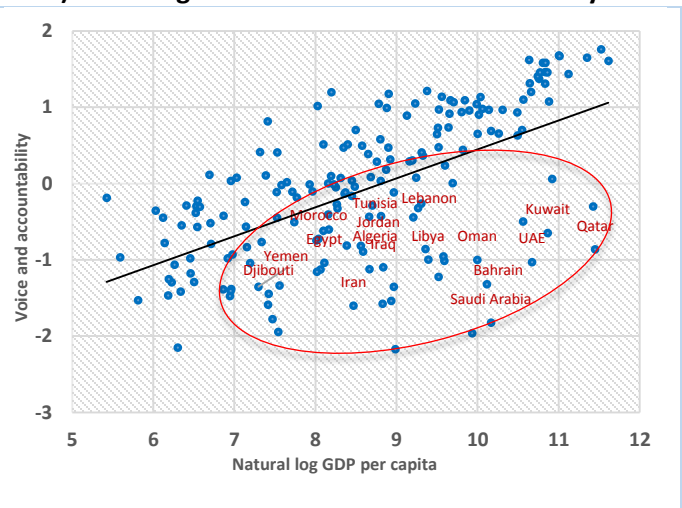


Figure 2.3b Voice and Accountability



Source: World Bank. Note: Governance estimates are measured on a scale from -2.5 to 2.5. Higher values correspond to better governance.

This common social contract delivered relatively successful results on both economic and social fronts. In the 2000s, economic growth averaged 4-5 percent a year⁶. Poverty rates were low and declining. Almost everyone completed primary school, and enrolment rates in secondary and tertiary education—especially for women—were high and rising (Figure 2.4a). MENA registered the fastest decline in infant mortality rates in the world (Figure 2.4b). Contrary to perceptions, inequality—as measured by conventional indicators such as the Gini coefficient—was lower than comparable countries elsewhere and either constant or declining (Figure 2.4c).

Figure 2.4a Female Years of Education

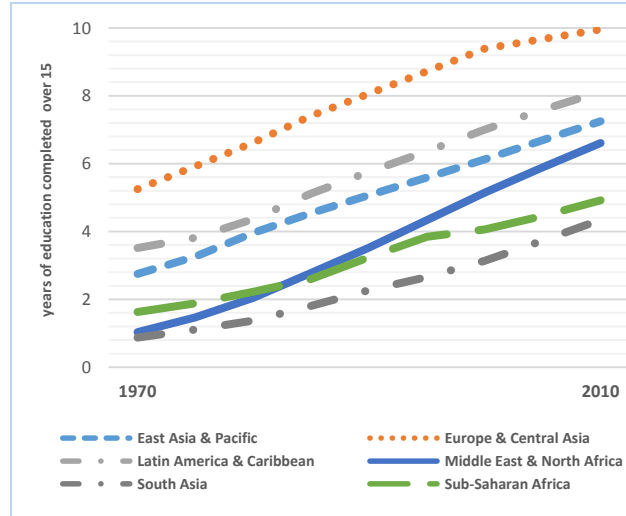
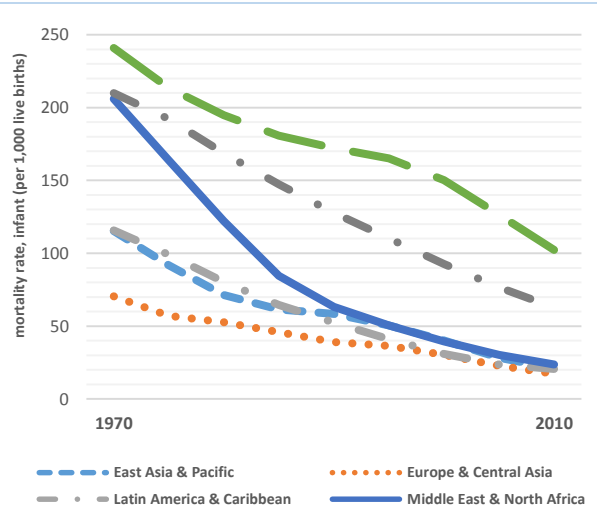
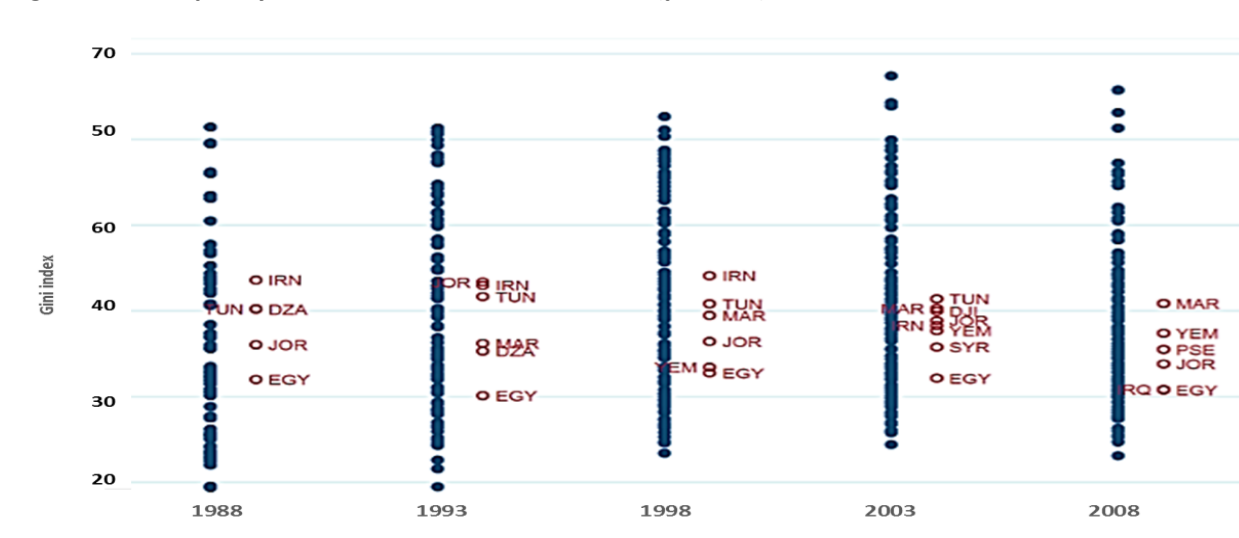


Figure 2.4b Infant Mortality Rate



Source: World Bank.

Figure 2.4c Inequality in MENA and across the World (percent)

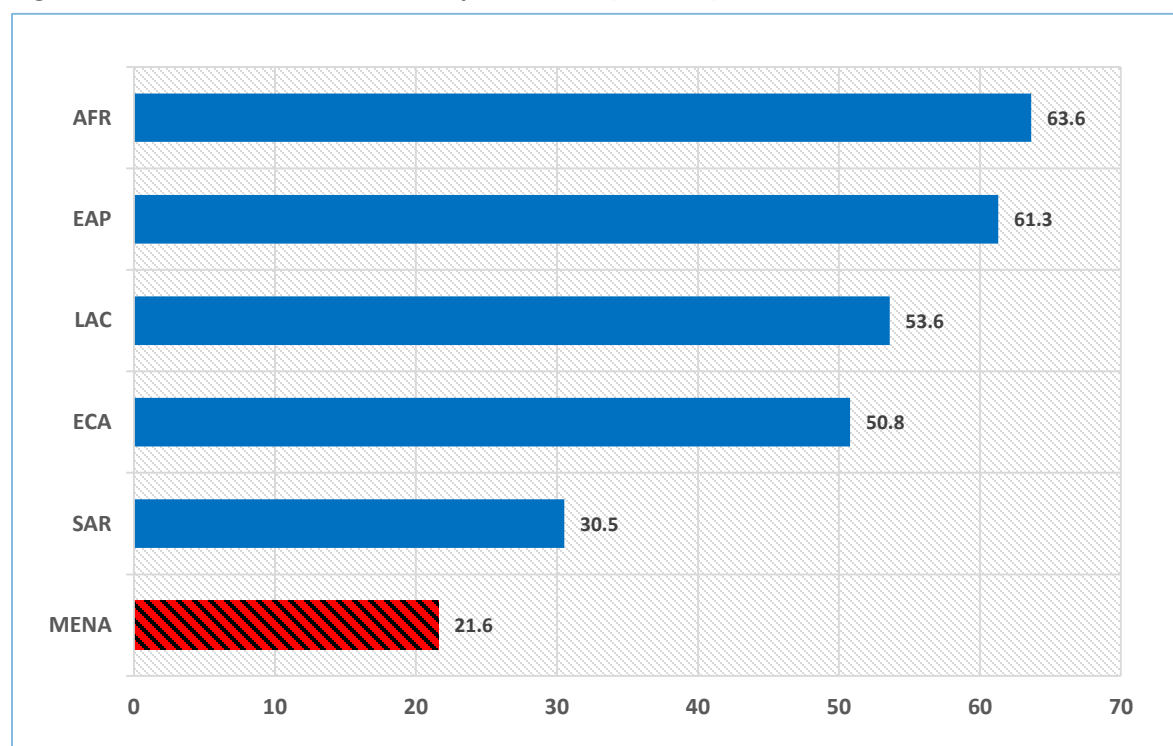


Source: Data used in Lakner and Milanovic, 2013). Note: DZA stands for Algeria, MAR for Morocco, and PSE for Palestine. The Gini coefficient is a number between 0 and 1, where 0 corresponds with perfect equality (where everyone has the same income) and 1 corresponds with perfect inequality (where one person has all the income—and everyone else has zero income).

⁶ To be sure, per-capita income growth was slower, and productivity growth quite weak (Schiffbauer et al., 2015).

Yet, by the late 2000s, there were signs that this development model, which had achieved so much, was beginning to fray. The combination of high subsidies and large public-sector wage bills was too much for government budgets to bear. Fiscal deficits started growing. To avoid their growing even higher, public-sector employment slowed down, and the public sector’s share in total employment started to decline. But the formal private sector did not grow fast enough to absorb the large number of educated young people entering the labor force. Unemployment rates rose to the highest levels in the developing world. Informal employment grew, dominated largely by men. In part because of the insecurity associated with the informal sector, women were discouraged from entering the labor force. MENA today has the lowest female labor force participation in the world (Figure 2.5).

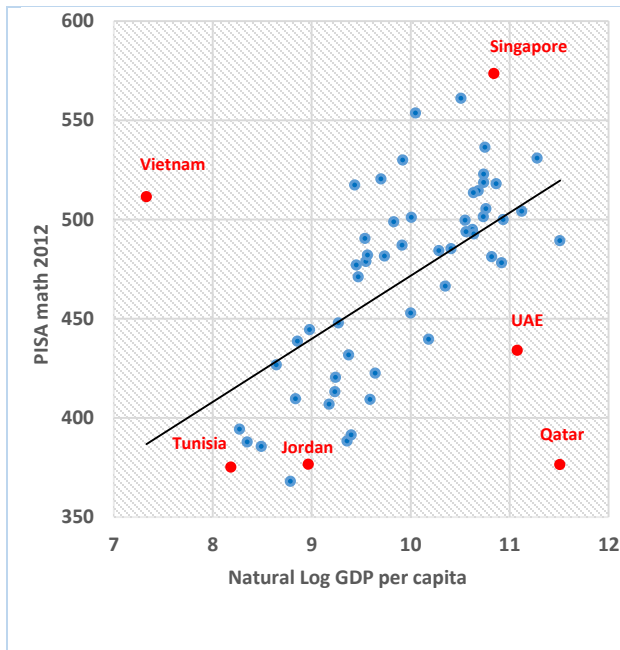
Figure 2.5 Female Labor Force Participation Rate (Percent)



Source: World Bank. Note: AFR: Sub Saharan Africa; EAP: East Asia and Pacific; LAC: Latin America and the Caribbean; ECA: Eastern Europe and Central Asia; and SAR: South Asia Region.

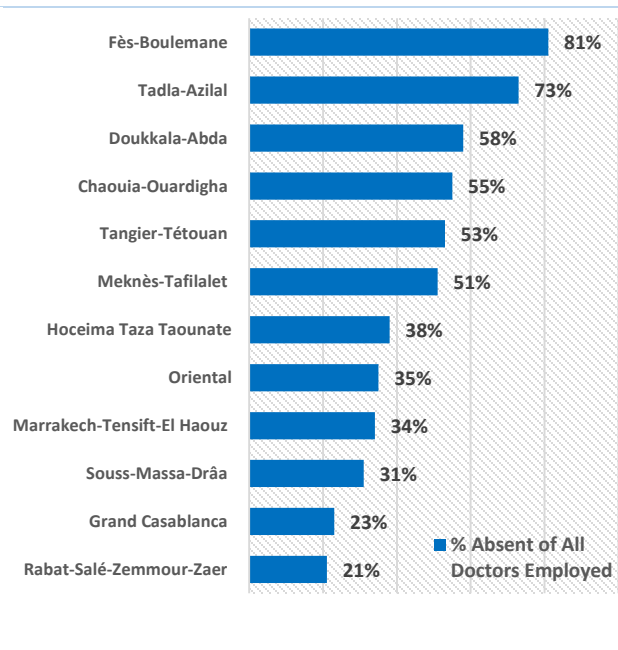
Meanwhile, although it continued to finance and provide health and education, the public system was falling short on two fronts--quality and equity. Secondary-school students, including those from high-income countries like Qatar and UAE, were scoring poorly in international standardized tests (Figure 2.6). In response to the low quality, people resorted to the private sector, which undermined equity. In Egypt, over 70 percent of the students used private tutoring (Dang and Rogers, 2008), leaving poor students, who could not afford it, at an even bigger disadvantage. With doctor absentee rates of 20-30 percent in public clinics in Egypt, Morocco and Yemen (Brixi et al., 2015), patients, desperate for care, resorted to private clinics, often paying exorbitant rates. As a woman in Egypt put it, “You can go to the private clinic and lose your money, or go to the public clinic and lose your life” (World Bank, 2013). Within countries, the quality of service delivery varied enormously, with the poorer areas being the most disadvantaged (Figure 2.7).

Figure 2.6 PISA Math Scores



Source: PISA, 2012.

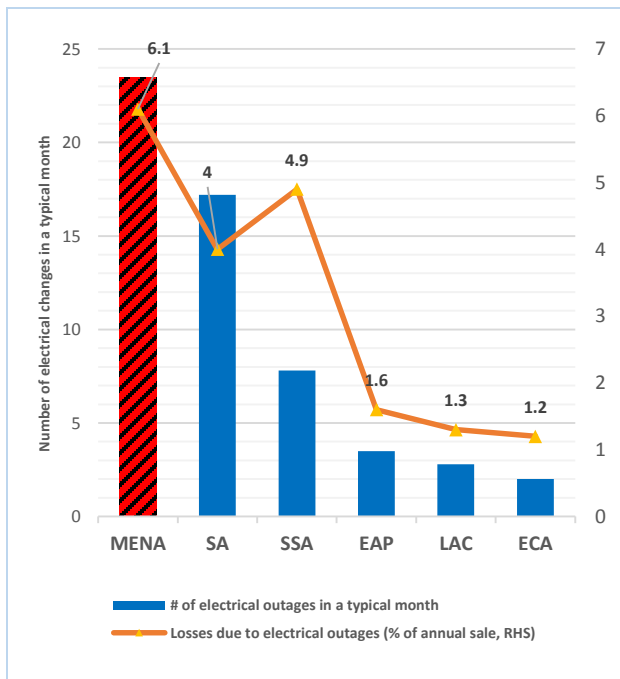
Figure 2.7 Doctor Absenteeism by District in Morocco



Source: Public Expenditure Tracking Survey Morocco 2013.

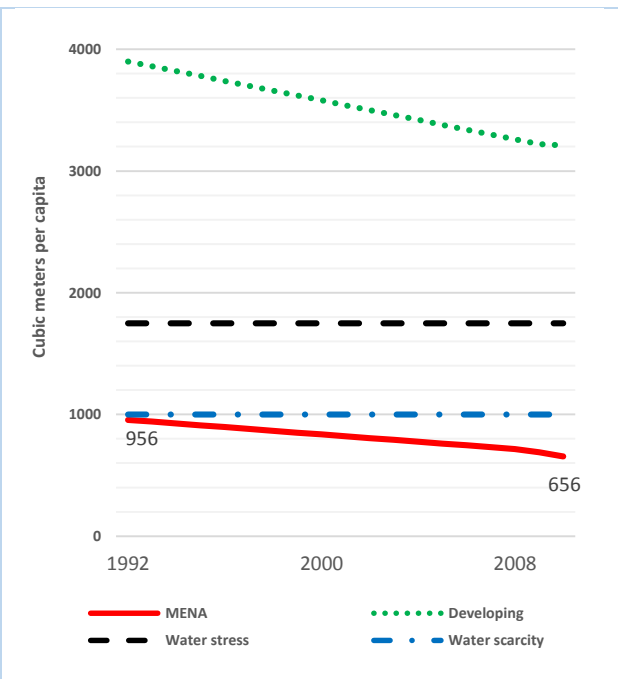
Infrastructure services, too, were deteriorating, with electricity blackouts increasingly commonplace, and renewable water resources dwindling at an alarming rate (Figure 2.8).

Figure 2.8 Electricity Outages



Source: World Bank.

Renewable Water Resources



Perhaps the clearest signs that the social contract was not delivering were the “Arab Spring” revolutions in Tunisia, Egypt, Libya and Yemen, which were followed by political protests in Bahrain, Morocco and Jordan. People took to the streets to demand jobs, better public services, and dignity. Even in countries that had not seen popular protests, such as Algeria, Kuwait and Saudi Arabia, similar concerns about unemployment and the quality of education were being raised in multiple forums.

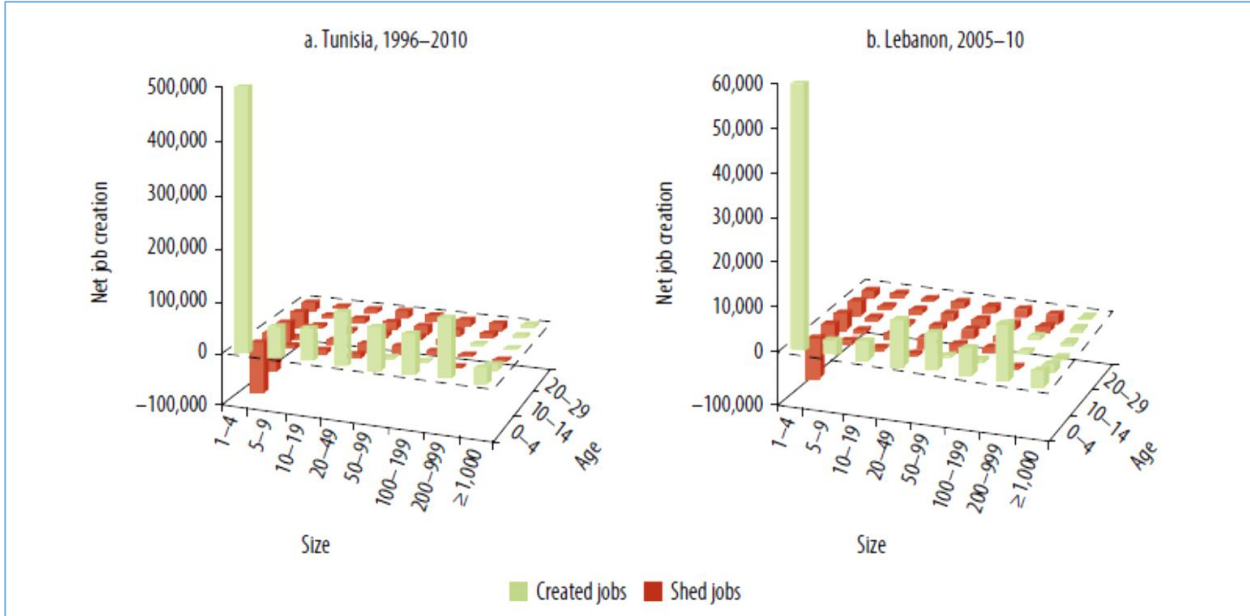
The aftermath of the Arab Spring has been so turbulent, and in some cases so violent, that the underlying problems remain. Investment and hence growth rates have slowed. Unemployment rates, especially for youth and females, have risen. And there is anecdotal evidence, such as the garbage not being picked up in Tunis that public services have deteriorated.

In order to propose solutions to these problems, it is important to better understand why the original social contract was reaching its limits. Why, when the public sector was cutting back, did the formal private sector not create enough jobs? Why are public services— that delivered so well the first generation of outcomes—failing with respect to quality and equity?

Private-sector Jobs

In MENA, as well as in high-growth economies, young firms and startups create the most jobs. Figure 2.9 below illustrates. Almost all net job creation in Lebanon and Tunisia was generated by young firms at their start-up period; i.e., in the first four years after they were established. For example, in Tunisia, micro-startups created 580,000 jobs between 1996 and 2010, accounting for 92 percent of all net job creation. In Lebanon small startups generated about 66,000 jobs between 2005 and 2010, accounting for 177 percent of net job creation. The second largest number of jobs (12,000) was created by young, large firms with 200–999 employees (Schiffbauer et al., 2015).

Figure 2.9 Net Job Creation, by Firm Size and Age



Source: Schiffbauer, et al, 2015.

The problem in MENA is twofold. First, not enough young firms are created. Not enough firms “die”, to make room for new firms to enter the market (Figure 2.10a). MENA has among the lowest rates of new firms entering the market (Figure 2.10b). Overall, the median age of firms is the highest in the developing world (Figure 2.10c).

Figure 2.10a Entry and Exit Rates (as a Share of all Firms)

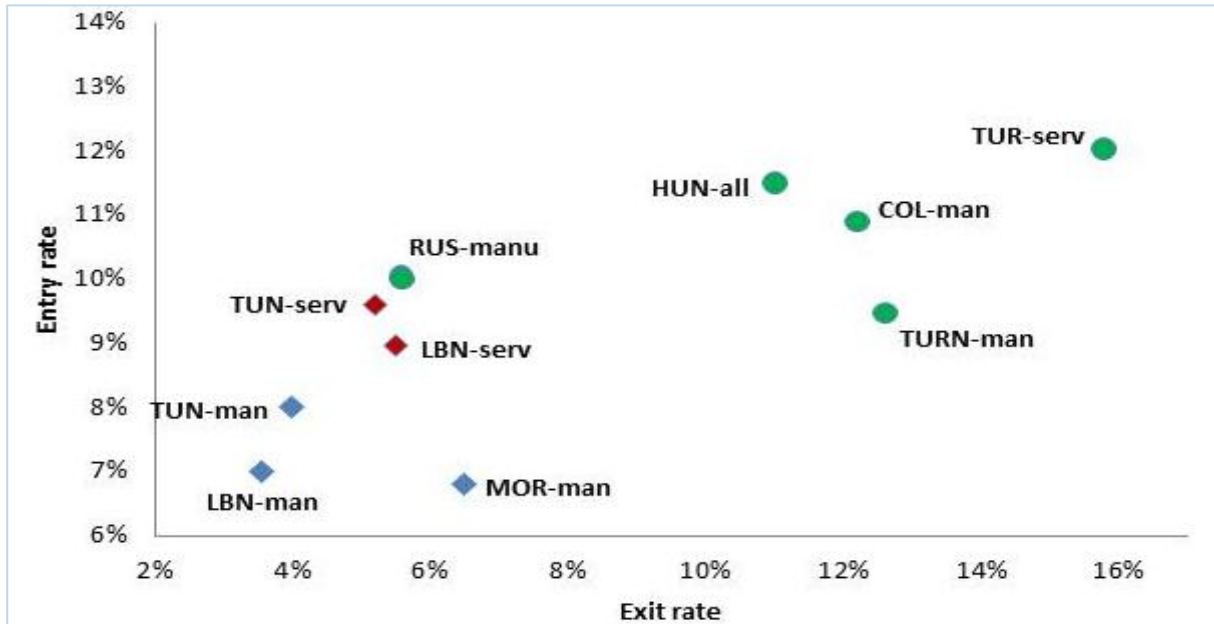


Figure 2.10b Entry Density of Formal Sector

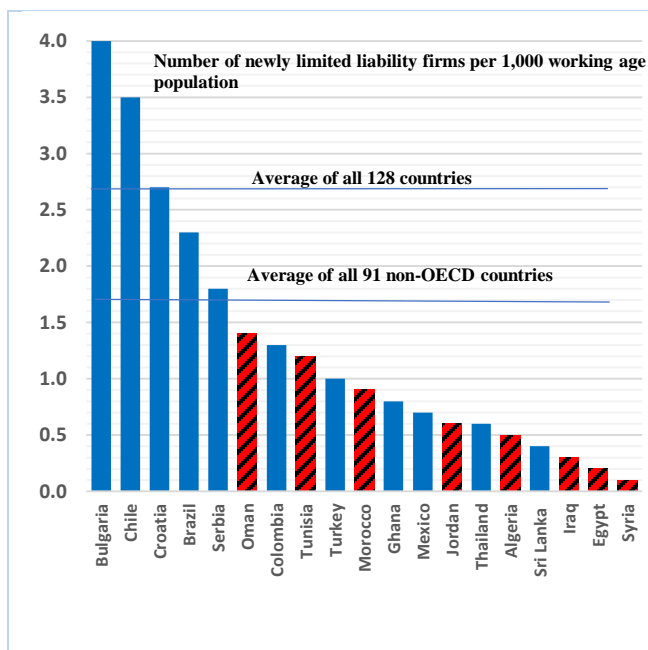
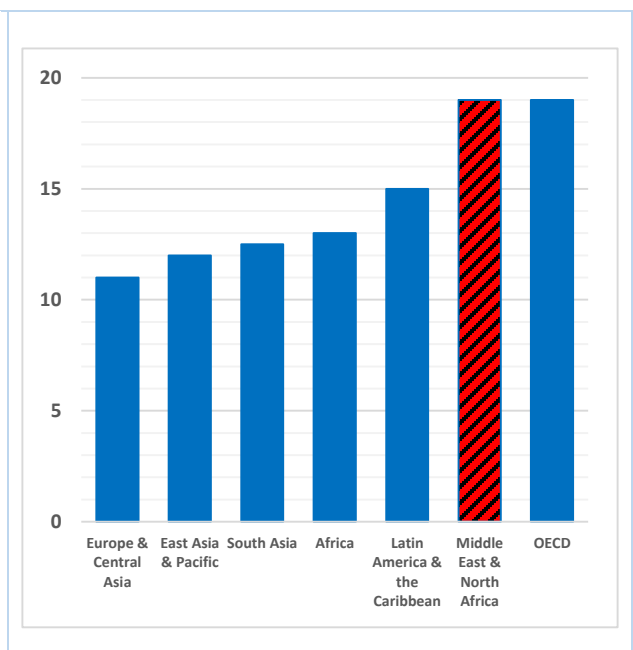


Figure 2.10c Median Age of Manufacturing Firms (years)



Source: Schiffbauer, Marc; et al., 2015.

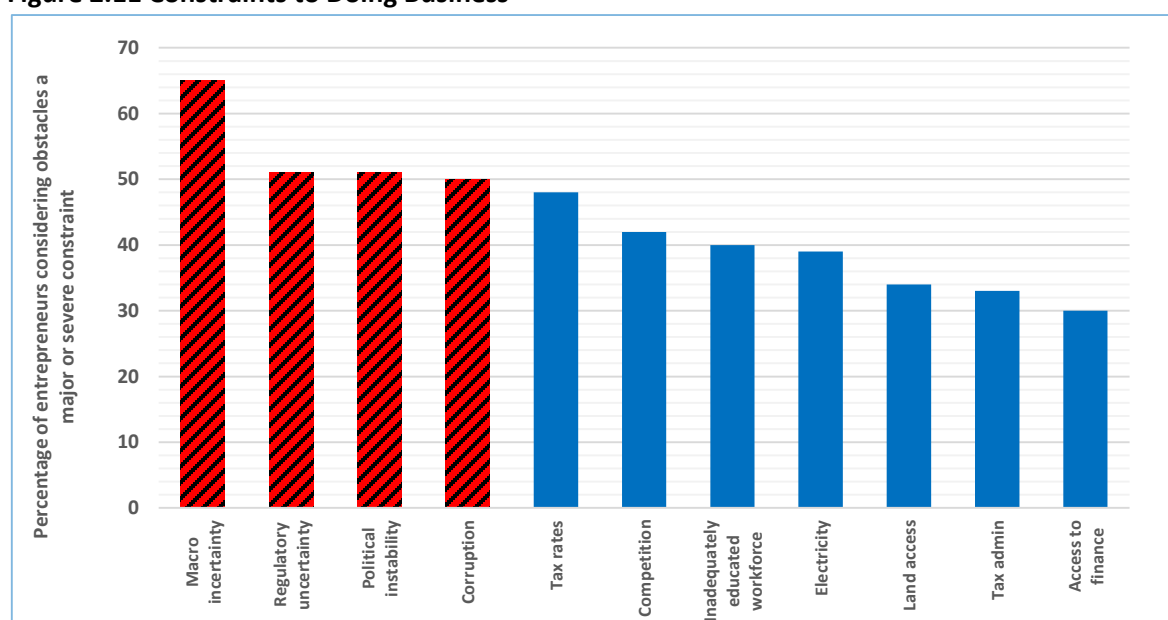
Second, most small enterprises stay small or die. In Morocco and Tunisia, only a tiny fraction of one-person, micro or small firms had grown to a higher-size category—in ten years (Table 2.1).

Tunisia – All Firms (status in year t+10)						Morocco – Manufacturing only (status in year t+10)				
Status in year t	Exited	1-person	Micro	Small	Large	Status in year t	Exited	Micro	Small	Large
1-person	30.8%	65.5%	3.4%	0.3%	0.0%					
Micro	19.0%	41.2%	37.0%	2.8%	0.1%	Micro	52.1%	36.5%	11.3%	0.1%
Small	14.8%	28.4%	14.0%	39.5%	3.3%	Small	44.6%	9.5%	41.2%	4.8%
Large	15.8%	23.3%	2.9%	15.2%	42.7%	Large	40.7%	0.6%	12.9%	45.9%

Source: Schiffbauer, et al., 2015.

Why are there so few young firms and why are they not growing? According to the enterprise surveys, the top four reasons include macroeconomic and regulatory uncertainty, political instability, and corruption (Figure 2.11). Interestingly, a constraint that is frequently mentioned in the popular literature—access to finance—does not rank in the top 10. The role of macroeconomic and political instability are well-known. For instance, Burger et al. (2015) show that instability skews foreign investment away from firms in manufacturing, which could create jobs and transfer technology, and towards real estate and extractive industry investments.

Figure 2.11 Constraints to Doing Business



Source: World Bank Enterprise Surveys 2006-2010.

As for regulatory uncertainty and corruption, there are many channels through which they impede firm and therefore job growth. Recent evidence on politically connected firms in Tunisia (under Ben Ali) and Egypt (under Mubarak) reveals that these firms received preferential treatment that included protection from domestic and foreign competition (Rijkers et al., 2014). As a result, the sectors with connected firms were not competitive, making it difficult for new firms to enter them. Sometimes, connected firms received construction permits faster; and they were inspected by tax officials less frequently. The dispersion of number of inspections is higher in sectors with connected firms, suggesting that unconnected firms that compete with connected firms received more inspections.

Not only was it difficult for new firms to enter sectors with connected firms, but—as a result of their monopoly power—the prices charged by these sectors, which in Tunisia included transport, telecommunications and banking, were so high that they made the exporting firms that bought these services uncompetitive. Since exporting is one way for firms to grow, this channel was effectively blocked in Tunisia.

There is also evidence that energy subsidies, which continue to be prevalent in most MENA countries, favored larger, older, capital-intensive firms (because these were also energy-intensive firms), again making it difficult for firms to grow and create jobs. That these subsidies also benefited politically connected firms may explain why they have been so difficult to remove.

Note that this combination of politically connected firms, monopolistic industries, and a large number of small firms stagnating is an equilibrium, in the sense that the system has no intrinsic impetus to change. Politicians and their business allies can continue to earn monopoly profits, while a large number of small firms stay small, and the private sector does not create many jobs.

Yet, the implications of this low-level equilibrium are huge. Young people, who have finished school, cannot find a job in the public sector or formal private sector. Those who can afford to, will wait for a public-sector job to open up, because the combination of salary, benefits and security make it attractive. This explains why so many of the unemployed are university graduates. The legacy of attractive public sector wages also bids up the reservation wage in the private sector, often making it harder for the private sector to be internationally competitive. A particular case is in the GCC countries, such as Kuwait, where 95 percent of Kuwaiti males are employed in the public sector, so that the private sector, in order to be competitive, hires expatriate workers.

Those who cannot afford to wait for an opening in the public sector join the informal sector, working at low wages with little security. The share of the labor force in the informal sector has grown substantially in the past decade to 67 percent (Angel-Urdinola and Tanabe, 2012). The insecurity (in many senses of the word) of the informal sector has deterred women from entering it. The result is that, without many options in the formal private or public sectors, a large number of women drop out of the labor force entirely. Inasmuch as most of these women are educated (and some highly educated), the tragedy is that their education is not being put to use.

While it is clear that the old social contract, where the government was the main employer, is broken, it is less clear whether government has been able to replace it with a new one, where government facilitates

a dynamic, private sector that creates jobs. To do so, governments will have to make major changes in their policies and practices towards the private sector. Among these changes, the most important will be to promote competition in domestic industries, so that young firms can grow and create productive jobs.

Quality Public Services

The second area where the social contract appears to have broken down is in delivering quality public services. Why has the quality of public services become so poor? The previous, top-down system could deliver on enrolment or prevention of childhood diseases because these were easy to measure and monitor, and required uniform inputs, such as teaching basic reading and writing, and immunization. Quality education and health care, especially if they are to respond to the global market, require more tailor-made approaches. Students want to learn different things. They learn at different speeds. Once childhood diseases have been eradicated, the population's health problems are non-communicable diseases such as diabetes, hypertension and cancer, which affect individuals idiosyncratically.

Addressing these second-generation issues of quality education and non-communicable diseases requires that the service provider—the teacher or the doctor—know about the student's or patient's individual needs, and be able and willing to respond to them. In short, they require that the service provider be accountable to the client ([World Bank, 2003](#)).

There is plenty of evidence that in MENA the accountability between service providers and citizens is not working, especially for poor people. Teacher absenteeism is as high as in low-income countries; doctor absenteeism is lowest in the capital city and highest in remote areas. Students get private tutoring because the public-school teacher is not teaching them what they want to learn (and poor students, who cannot afford to get the tutoring, lose out). The high share of doctors in private, or “dual”, practice is another example of the standard, publicly provided health system failing to deliver, especially to poor people.

When accountability is weak, services do not meet the needs of citizens who, in turn, begin to lose trust in government (Brixi et al., 2015). In the Arab Barometer survey, two-thirds of those surveyed said government performance in improving basic health services was “bad” or “very bad.” Citizens end up resorting to informal networks and informal payments, further eroding accountability in the public sector and norms of public service. And without citizen participation, it is very difficult for the state to rebuild these institutions.

The analysis extends to energy and water, where massive subsidies have led to deterioration in services (blackouts, etc.) and low agricultural productivity. Subsidies increase demand and, with lags in supply generation, shortages set in. Moreover, if the utility does not receive transfers from the government, it underspends on maintenance, deteriorating the grid further. Higher-income citizens opt out of the system and, as in Lebanon, use high-cost generators, whose suppliers then become a lobby against connecting to the grid. Significantly, subsidies make it difficult for consumers to hold service providers, such as utilities, accountable. Meanwhile, diesel subsidies have helped to deplete Yemen's water table (Devarajan, 2014). At the same time, raising prices (reducing subsidies) is seen as politically sensitive, especially if citizens have lost trust in government.

In short, public services are also in a low-level equilibrium, where, because of their inability to hold providers accountable, citizens are opting out of the public system, and moving towards market-based systems, such as private tutoring, private doctors, and power generators. And providers are supplying these services to supplement their public-sector incomes. The citizens' loss of trust in government is validated by the government's inability to serve them.

The advantage of a market-based system is that the consumer is able to hold the provider accountable (if the teacher is absent, he does not get paid). In the case of higher education, it may also permit a better match between skills needed in the labor market and what the students learn. The disadvantage is that it discriminates against poor people, who cannot afford to pay market prices. The key to reforming public services, therefore, lies in a system where the consumer or client can hold providers accountable, while ensuring that poor people can get access to the quality services that are typically enjoyed by the non-poor.

What is to be Done?

In this situation, what can be done? It is clear that the old social contract, although it delivered results in the past, is not suited to the needs of the current generation of citizens. The public sector can no longer be the main employer. The private sector has in some cases been captured by politically connected entities that resist domestic and international competition, even though these are necessary to create jobs. And public service delivery is not organized in a way that citizens, especially poor citizens, can hold providers accountable.

Moreover, because these are a series of low-level equilibria, incremental reforms in one area may not dislodge the system. For instance, if we improve education quality but job creation does not increase, we may remain stuck. What is needed therefore is a series of changes at all levels. This implies neither another revolution nor even "shock therapy". Rather, it suggests changes in the set of economic relationships between citizens and the state; in other words, a new social contract.

What would such a new social contract look like? First, instead of providing jobs in the public sector, the state promotes competition in the private sector and greater equality of opportunity for all entrepreneurs. Note that this shift signals a very different role for both the state and the private sector. Secondly, instead of providing free or subsidized, low-quality public services, the state replaces the subsidies with (targeted) cash transfers, with everybody paying market prices. In this way, poor people can afford to access the private services that only the non-poor currently consume. And public expenditures are used to finance public goods, such as infrastructure, and cash transfers (as above).

To be sure, these changes cannot, need not, and probably should not happen overnight. Nor do they apply in the same way to all countries. Countries in conflict will need to resolve the conflict first. At the same time, a strategy of "security at all costs" has its limits—the country may end up in another low-level equilibrium of security with low growth. The transition countries have to modulate changes to accommodate the political forces that may otherwise destabilize the country. In some of these countries too, security and stability may be the short-run priorities. But the need to address the inexorable demands

for jobs and better public services will remain paramount. Finally, the oil-rich countries have a cushion in their reserves, so they can plan the changes with a longer time horizon.

Getting there will not be easy. Many vested interests in the status quo will resist the change. As mentioned above, citizen trust is limited. Reform champions will have to build coalitions for change. But the people of the region are demanding jobs and better service delivery; they are demanding change. And the Arab Spring taught us that they want their voices to be heard.

The old social contract has served its purpose. It is hard to see how the MENA region can solve its long-standing problems without a new social contract. Inasmuch as MENA countries have shown that, with the old social contract, they were able to deliver substantial progress to their citizens, they can do the same with the new social contract.

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Country Notes

Algeria

Economic prospects have worsened in Algeria following the crash of oil prices in the second half of 2014.

With the price of oil, Algeria's main export, projected to average only \$US 53 per barrel in 2015 (down from \$US100 in 2014), real GDP growth is projected to decline to 2.6 percent in 2015 from 4.1 percent in 2014. The fiscal deficit rose to 6.8 percent of GDP in 2014 and is projected to more than double to about 14.9 percent of GDP in 2015. The current account deficit is also expected to grow from 4.2 percent of GDP in 2014 to an estimated 18.6 percent, of GDP in 2015. Weak growth performance has already pushed up the unemployment rate from 9.8 percent in 2013 to 10.6 percent in 2014.

The situation is made more difficult by declining trends in hydrocarbon output, exports and revenues.

Hydrocarbon production has been on a downward path since 2006 due to a lack of investment in upgrading existing fields and exploiting new discoveries, in part due to security concerns and in part to an unattractive business environment. Exports have suffered also because domestic energy consumption has continued to rise.

A clear policy response has not yet emerged. While the authorities have floated the idea of cutting subsidies in basic goods (sugar, cooking oil, milk, and petroleum products) and utilities (electricity, gas and water), which reportedly may cost the state as much as 18 percent of GDP, none of these steps has been taken yet. And while fresh public sector hiring is to be postponed, statements have also been made that this may not apply to sectors of "socioeconomic importance." Furthermore, while the government has insisted that it intends to maintain its ambitious five-year economic plan for the 2015-19 period, which includes large investments in roads, housing, and water and energy infrastructure, capital expenditure in 2015 is now projected to rise by only 4 percent (down from over 30 percent year-on-year growth considered in the 2015 government budget). On the external front, in an effort to reduce import demand, import licenses have been tightened and the dinar depreciated by about 10 percent against the dollar. This move may be insufficient as about half of Algerian imports are paid in euros and the euro has recently depreciated by 30 percent against the dollar. Meanwhile, longer term structural challenges, such as improving governance and the business climate to create private sector jobs, remain largely unaddressed.

Downside risks prevail in the present outlook. The key downside economic risks include an extended decline in energy prices and further weakness in European growth. On the political side, internal social pressures could mount, particularly if youth unemployment problems are not resolved. In addition, important security risks remain associated with the active presence of radical factions and the threat they pose to oil operations in Algeria.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	2.8	4.1	2.6
Inflation Rate (%)	3.3	2.9	4.0
Fiscal Balance (% of GDP)	-1.4	-6.8	-14.9
Current Account Balance (% of GDP)	0.4	-4.2	-18.6

Bahrain

Economic growth slowed to 4 percent in 2014 while fiscal pressures continued. After growing by 5.3 percent in 2013, Bahrain's economy decelerated to about 4 percent in 2014, largely due to weak investment sentiment. It is continuing to diversify its economy as construction, manufacturing, transport and tourism and related services expand. The fiscal deficit rose in 2014, in part because oil-revenues constitute 85 percent of total revenues and prices have been falling since June 2014. The fiscal break-even price of oil for Bahrain (i.e., the price at which the budget is balanced) has crept up to US\$125 per barrel. Fiscal pressures have also risen due to increased subsidies and public sector wages since 2010. As a consequence, the public debt has increased from 8 percent of GDP in 2008 to over 45 percent by 2014. Moreover, the plan to increase diesel prices was suspended following objections by members of parliament in December 2013.

The current account stayed in surplus despite falling oil prices. Oil and refined petroleum products accounted for 73 percent of Bahrain's total goods exports in 2013. In general, the composition and share of products has not changed since 2000, although the volume of diesel and fuel oil has declined. The BOP current account remains strong with an estimated surplus of 14.2 percent of GDP in 2013 and slightly lower (12.9 percent) in 2014.

Bahrain's banking system is sound and, for the moment, foreign investor confidence remains strong. Bank mergers, encouraged by the Central Bank of Bahrain, have continued, leading to fewer banks, with more diversified assets and stronger capital bases. As a sovereign, Bahrain continues to access foreign credit; nevertheless, the 6 percent yield on recent and anticipated dollar bond issuance is reflective of political risk.

Going forward, the economic outlook is characterized by moderate growth and higher public debt, with average annual inflation projected to be subdued in 2015 and over the medium term. On the negative side, Bahrain is running out of domestically-produced natural gas and soon may need to import gas at market prices—which could reduce the profitability and competitiveness of its energy-intensive industries, such as aluminum, and manufacturing. The immediate challenges are to correct the fiscal imbalances and stabilize the government debt. Fiscal sustainability requires a phasing out of subsidies for the well-off and controlling for the growth in current spending while diversifying the sources of fiscal revenue, including through an introduction of corporate income tax and value added tax.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	5.3	4.0	3.5
Inflation Rate (%)	3.3	2.5	2.0
Fiscal Balance (% of GDP)	-3.8	-4.9	-11.9
Current Account Balance (% of GDP)	14.2	12.9	8.5

Djibouti

Economic growth in Djibouti accelerated in 2014 while the current account deteriorated. Growth reached 6 percent in 2014, up from 5 percent in 2013, driven mainly by port-related activities, such as transit trade with Ethiopia and transshipment activities featuring large FDI inflows as well as a surge in public investment. Meanwhile, the external position deteriorated due to high imports arising from ongoing infrastructure projects. The current account deficit reached 33 percent of GDP in 2014, increasing from 23.7 percent of GDP in 2013 and 18.4 percent of GDP in 2012.

Newly contracted debts are exacerbating fiscal and external debt sustainability pressures. In November 2013 the government contracted two non-concessional loans to finance two major water and railway investment projects. These loans have a combined value equivalent to 60 percent of GDP and their repayment will severely restrict fiscal space. Construction of the Djibouti segment of the railway is already underway but the institutional arrangements for managing the project are not clear. Delays in sub-project implementation will also be costly to the budget. Moreover domestic revenues are expected to fall as a percentage of GDP in 2016–19 compared with 2013–15 because growth will not be accompanied by a significant increase in fiscal revenues since the activities driving growth are mostly tax-exempt.

The decision to cancel the MIGA-guaranteed concession of the main port facility poses risks to investor confidence and growth. On July 2014 the government announced that it had cancelled the concession of its main container terminal to Dubai Port World. While Dubai Port World is continuing to operate the terminal during the arbitration phase, the commercial dispute has increased business uncertainty. This may ultimately affect the perceived quality of the business environment, reduce investor confidence in Djibouti and undermine the economic progress achieved in previous years that was underpinned in large measure by high investments in port activities.

The medium-term outlook is favorable but significant risks persist. Aggregate investment is projected to rise from 26 percent of GDP in 2010–13 to 52 percent in 2014–16 (with public investment rising from 11 percent to 25 percent of GDP). This should support real GDP growth of around 6.8 percent per year. Risks to growth and macroeconomic stability include: delays in the construction and management of the new infrastructures; adverse economic or security developments in neighboring areas; domestic social and political instability; degradation in the fiscal and debt situation and delays in the implementation of a new ECF program with the IMF. Also, as already mentioned, the commercial dispute with Dubai Port World could affect the flow of foreign investment.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	5.0	6.0	6.5
Inflation Rate (%)	2.5	3.0	3.0
Fiscal Balance (% of GDP)	-5.9	-12.0	-14.1
Current Account Balance (% of GDP)	-23.3	-27.4	-27.7

Egypt

Egypt's economic performance is improving as political and security tensions have abated somewhat.

Preliminary data for the first half of 2015 show an acceleration of growth to 5.3 percent, compared to 1.2 percent in the same period last year. The recent spike in economic activity reflects in part an ongoing recovery in tourism and manufacturing. On the demand side, growth benefited from resilient consumption and government stimulus spending, supported by large financial inflows from the GCC countries. It is expected that real growth will rise to 4.3 percent in FY15, almost double the rate achieved in FY13 and FY14. Unemployment is still high but with signs of improvement going into FY15 when the rate is expected to decline to 12.7 percent.

The underlying fiscal stance has improved, thanks to subsidy and tax reforms. In July 2014, the government introduced bold reforms including the reduction of energy subsidies and the enactment of new or additional taxes on real estate, capital gains, dividends, alcoholic beverages and cigarettes. At the same time, budget allocations to health, education, social safety nets and infrastructure increased. The budget deficit declined to 12.8 percent of GDP in FY14 and is expected to decline further to 11.3 percent in FY15. This will put the government debt ratio at 94 percent of GDP by end FY15, down from 95.5 percent in end-FY14. The IMF conducted its Article IV consultation in November 2014, and the final report generally commended the authorities' medium-term plans while highlighting potential implementation risks and the persistence of a large external financing gap.

The external account is stabilizing but reserves continue to be uncomfortably low. The balance of payments was in surplus during the first quarter of FY15 driven by strong remittances, rebounding tourism, and higher foreign direct investment (with flows rising year on year by 138 percent). Recently, the repayment of US\$3 billion of Qatari deposits and US\$2.8 billion of oil companies' arrears added pressures on reserves, which reached US\$15.5 billion by end-February 2015. Reserves are expected to reach US\$17 billion by end FY15, in part supported by an additional support package pledged by the Gulf countries in the Egypt Economic Development Conference, held in mid-March 2015. The official exchange rate depreciated in January 2015 by 7 percent shrinking the parallel market premium from 8 percent to 2 percent.

Sustaining the economic recovery will require continued improvements in security as well as attention to economic reforms. The security situation, while improved relative to previous years, continues to feature sporadic small-scale protests and terrorist attacks. Near-term strategy appears highly dependent on mega-projects and government spending. This carries much uncertainty given the high level of prevailing fiscal deficits and public debt. Meanwhile, business sector reforms needed to stimulate private investment have not been clearly articulated yet. These will be critical to medium term prospects.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	2.1	2.2	4.3
Inflation Rate (%)	6.9	10.1	11.0
Fiscal Balance (% of GDP)	-13.7	-12.8	-11.3
Current Account Balance (% of GDP)	-2.1	-0.8	-3.3

Iran

The Iranian economy rebounded from recession in 2014. Despite the sharp fall in the price of oil, Iran's real GDP grew by an estimated 3.0 percent compared to a contraction of -1.7 percent in 2013. This was due to the temporary and partial easing of sanctions imposed on Iran's oil exports, on the supply chain in key sectors of the economy—such as in the automobiles industry—and on the transactions of international and domestic banks as well as the rise in consumer and business confidence that a comprehensive nuclear agreement is within reach.

The fiscal position is sound despite low oil prices. Government revenue shortfalls due to lower oil prices during the current Iranian calendar year (i.e., March 2014-March 2015) will be partly offset by stronger-than-expected revenues generated in the first half of the year. The combination of a higher-than-projected price of crude sold by Iran (which averaged US\$105-110 per barrel and exceeded the price of US\$100 per barrel assumed in the Budget) as well as increased export volume (which was 5 percent higher than predicted in the Budget) explain this outcome. As a result, despite the recent decline in oil prices, the fiscal deficit, which was estimated at 1 percent of GDP in the Budget, will remain contained at about 1.4 percent of GDP in 2014-15. Meanwhile, Iran's current account surplus is estimated to have declined from a surplus of 7.2 percent of GDP in 2013 to 3.6 percent in 2014.

The near-term outlook calls for slower growth. Low oil prices will affect the economy much more in 2015 than was the case in 2014. The baseline scenario suggests that growth will decelerate to 0.6 percent in 2015 based on the assumption that the oil sector would grow by only 1.0 percent in 2015, down from 2.5 percent in 2014, and the non-oil sector will actually decline by 2.7 percent, compared to an expansion of 7.3 percent in 2014.

However, much depends on whether a nuclear agreement is finalized in 2015 and how regional tensions are resolved. Iran has huge oil and gas resources as well as general economic potential that has not been fully utilized in recent years due to international sanctions. These sanctions could be removed if a nuclear agreement is achieved per ongoing negotiations. If so, that would provide a huge boost to Iran's economic prospects. At the same time, the ongoing conflicts in Syria and Iraq will also determine how economic prospects change.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	-1.9	3.0	0.6
Inflation Rate (%)	34.7	15.8	17.3
Fiscal Balance (% of GDP)	-2.2	-1.4	-3.4
Current Account Balance (% of GDP)	28.0	14.6	6.2

Iraq

Economic growth declined in 2014 due to multiple shocks. During 2014, Iraq was affected adversely both by the continuing Islamic State (IS) insurgency and the sharp decline in the price of oil, the country's main source of public revenues. Real GDP contracted by 0.5 percent. The non-oil sectors of the economy were also affected by the prevailing insecurity which caused the destruction of infrastructure, impeded access to fuel and electricity, destroyed business confidence, and disrupted internal trade and transport. Non-oil GDP growth declined by 5.2 percent in 2014.

The current account balance worsened during 2014 while the fiscal deficit stayed high. The current account balance deteriorated from a surplus of 2.1 percent of GDP in 2013 to a deficit of 2.8 percent in 2014 mostly due to falling oil prices. Reserves declined from over US\$78 billion at end-2013 to about US\$65 billion at end-2014. Iraq operated without an approved budget for 2014. Instead, spending was funded on the basis of 2013 actual disbursements plus *ad hoc* additional commitments approved by the Cabinet. As the year progressed, security spending took precedence over all other discretionary items, which were frozen. By year end, the fiscal deficit amounted to 5 percent of GDP, lower than in 2013 but still quite high.

Near term prospects are challenging. The ongoing insurgency will keep disrupting economic activity and diverting resources which could have been spent on poverty and development objectives to military ones. Meanwhile, high dependence on oil revenues renders the economy vulnerable to low oil prices. Based on these two factors, we expect real GDP to decline further by 1 percent in 2015. We expect the current account deficit to grow considerably larger, reaching 8.3 percent of GDP, and the fiscal deficit to more than double to 10.6 percent of GDP.

In addition to economic and security challenges, Iraq also faces a humanitarian crisis. As a result of the ongoing conflict with the insurgent IS group, 17,073 Iraqis died and 23,126 were injured in 2014—the highest levels since 2006. In addition, 2.1 million persons have been displaced and some 250,000 Syrian refugees have flooded into the country. All this poses a major humanitarian crisis which the Government is hard pressed to meet. The standard of living has deteriorated and a noticeable share of the population has fallen into poverty or is vulnerable to falling into poverty.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	4.2	-0.5	-1.0
Inflation Rate (%)	1.9	2.2	3.0
Fiscal Balance (% of GDP)	-5.9	-4.9	-10.6
Current Account Balance (% of GDP)	2.1	-2.8	-8.3

Jordan

Jordan's economy continues to grow slowly amidst regional tensions. These tensions include conflict in Syria which has sent more than 620,000 refugees into Jordan and the fight against the Islamic State (IS) which recently claimed the life of a Jordanian pilot. Jordan's real GDP grew by 3.1 percent in 2014, up 30 basis points over 2013. Growth was led by construction, wholesale and retail trade, and a recovery in the mining and quarrying sector. Demand side highlights include higher public investments, mostly due to grants from the Gulf Cooperation Council, and a narrower trade deficit through the third quarter of 2014. Unemployment declined to 11.9 percent in 2014, mostly due to a drop in the labor force participation rate, while inflation fell to 2.8 percent, mostly due to lower oil prices.

The fiscal deficit declined modestly but public debt remains high. The overall fiscal deficit (excluding grants) narrowed by 0.6 points to an estimated 13.5 percent of GDP respectively in 2014. This was driven by a (mostly) cyclical improvement in revenue collection and restrained spending. Gross public debt increased to 88.6 percent of GDP by end-November 2014. The recently approved 2015 budget (consistent with the IMF SBA) and reshuffled cabinet (March 2) augur well for continued fiscal consolidation as key policy makers (e.g., prime minister and minister of finance) remain unchanged.

The current account deficit narrowed significantly. The current account is estimated to have narrowed from 10.3 to 7.1 percent of GDP between 2013 and 2014 due to higher travel and government receipts. The trade deficit (on CIF basis) widened by 1.3 percent largely due to a 9.2 percent rise in energy imports to offset the disruption in (cheap) gas supplies from Egypt. Security incidents in Iraq, Jordan's largest export partner, had an adverse impact.

Momentum exists for near term growth acceleration though regional security presents downside risks. Real GDP growth is forecast at 3.5 percent in 2015 due to carry over effects, a lower oil price and investment projects notably in energy. The debt-to-GDP ratio is expected to be reduced given the growth pick-up and continued fiscal consolidation. Risks include exacerbation of the Syrian and Iraqi crises and the IS threat. Oil prices carry both a positive and negative risk. Persistently low oil prices in the medium term could reduce GCC grants and remittances while higher prices would affect growth and macroeconomic balances adversely.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	2.8	3.1	3.5
Inflation Rate (%)	5.6	2.8	1.0
Fiscal Balance (excl. grants) (% of GDP)	-14.1	-13.5	-5.4
Current Account Balance (% of GDP)	-10.3	-7.1	-5.7

Kuwait

The economy grew modestly in 2014 as oil prices fell sharply. Falling oil prices (since June 2014) and flat oil production kept overall real GDP growth at 1.6 percent. The non-oil sector grew by 3.5 percent in 2014, driven by domestic consumption and some pickup in government capital spending and private investment. In keeping with low oil and commodity prices worldwide, the inflation rate stayed low at about 3.1 percent in 2014.

Despite weak oil prices, the fiscal and external position remained strong. A fiscal surplus of 21.1 percent of GDP is estimated for 2014 down from about 31.4 percent in 2013. Wages and salaries constitute 50 percent of total expenditure in the FY2014/15 budget. Total spending is projected to rise by 9 percent between 2013 and 2014, reflecting both increased current (by 7 percent) and capital expenditures (by 15 percent). The current account surplus is estimated to have remained high at about 35.6 percent of GDP in 2014.

The near-term economic outlook is positive. Non-oil GDP growth in Kuwait is expected to accelerate to 4 percent in 2015, and is projected to further increase gradually to 4.5–5 percent in the medium term in the baseline scenario, on the strength of public spending in infrastructure and the oil sector, private investment, and consumption. Inflation is projected to fall to 2.4 percent in 2015. A moderate increase in oil production is expected to further support overall growth. The external current account and fiscal surpluses are projected to remain high over the medium term, but on a declining trajectory, amid rising government spending and continuously low oil prices.

High current spending poses a downside risk. The breakeven oil price—the price needed to balance the budget at current expenditure levels—has risen over the past few years and is currently estimated at US\$75. While large reserves accumulated in previous years will allow the government to smooth public spending in the medium term, in the event of a sustained oil price drop, this would come at the cost of lower savings for future generations. Some steps have been taken recently to contain current spending. The cabinet has decided to increase diesel and kerosene prices from 55 fils per liter to 170 fils per liter (with potential saving of 0.5 percent of GDP). Some allowances for Kuwaitis travelling for healthcare abroad have been trimmed. A proposal to reduce electricity subsidies is to be considered by the cabinet soon. This could generate revenues of about 1 percent of GDP each year and a reduction in power usage by 20 percent.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	2.2	1.6	2.1
Inflation Rate (%)	2.4	3.1	2.4
Fiscal Balance (% of GDP)	31.4	21.1	9.0
Current Account Balance (% of GDP)	41.7	35.6	16.9

Lebanon

Lebanon continues to be highly exposed to regional turmoil. The border with Syria remains menacing as coordinated attacks by ISIS and Al Nusra are frequently launched from bases in Syria. While the influx of Syrian refugees decelerated significantly in 2014 after the Lebanese government imposed entry restrictions, Lebanon continues to host around 1.18 million UNHCR-registered refugees from Syria amounting to 26 percent of the population. Partly as a consequence of the regional turmoil, Lebanon has also been in a state of domestic political paralysis as symbolized by the failure to reach agreement on a new president since May 2014.

Economic activity picked up in 2014 albeit from a low level and macroeconomic balances improved.

Stronger economic performance and lower oil prices pushed real GDP growth to an estimated 2.0 percent in 2014, compared to 0.9 percent in 2013. The fiscal deficit declined to an estimated 7 percent of GDP with the primary balance reverting to a surplus after two years in deficit. Declining imports led to an improvement in the current account balance though the overall level is still high at 22.2 percent of GDP.

Near term prospects are mixed. On the positive side, security conditions within Lebanon's border have improved so far in 2015 and a dialogue has been launched between opposing political parties. This is likely to have a positive impact on consumer and investor confidence. In addition, oil prices are expected to stay low and this will help improve the country's current account balance. Overall, we expect real GDP to grow by 2.5 percent in 2015, up slightly from 2014. We also expect the current account deficit to narrow further to 16.7 percent of GDP. We expect the fiscal deficit to stay roughly constant at 7.2 percent of GDP as reduced transfers to Electricite du Liban from falling oil prices are likely to be offset by higher debt servicing due to rising interest rates.

On the negative side, it is hard to predict how regional turmoil will evolve beyond Lebanon's borders. And, on the economic side, with reasonable prospects for Fed tightening this year, Lebanon is likely to follow suit and raise domestic interest rates to maintain the margin on USD and LBP deposits in Lebanon. This will negatively impact lending to the private sector and raise Lebanon's debt service costs, as new debt will need to be contracted at higher interest rates given the short average debt maturity of the current portfolio and the ongoing large gross financing needs

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	0.9	2.0	2.5
Inflation Rate (%)	2.7	1.9	2.2
Fiscal Balance (% of GDP)	-9.5	-7.0	-7.2
Current Account Balance (% of GDP)	-26.6	-22.2	-16.7

Libya

Ongoing armed strife reduced oil output and drove the economy into deeper recession in 2014. A series of strikes and security breaches at oil production sites led to a drop in oil production from 1 million barrels per day in 2013 to an average of 0.5 million in 2014. The ongoing strife has severely disrupted other economic activities as well. As a result, GDP is estimated to have contracted by 24 percent in 2014, following a 13.6 percent drop recorded in 2013.

The collapse of economic activity is putting enormous strain on the budget. Revenues dropped by 61 percent in 2014 reflecting mostly low oil tax revenues but also a halving of the normal level of revenues from other sectors. On the spending side, while capital expenditures declined sharply, current expenditures (comprising mostly salaries and consumer subsidies) remained high. Consequently, the fiscal deficit in 2014 climbed to an estimated 43.5 percent of GDP, the highest ever recorded.

The current account deficit has grown substantially as oil exports have fallen. The crisis that developed in the oil sector since mid-2013 took a toll on exports, while consumption driven imports remained high. The high current account surplus recorded in 2012 (29 percent of GDP) was more than halved in 2013 and has since proceeded to turn into a huge deficit of 32.8 percent of GDP in 2014. To finance the deficit, the Central Bank drew US\$24.8 billion from its reserves, which fell to US\$83 billion by end- 2014.

Near term prospects are highly dependent on how the political and security situation evolves. At the moment, the country is divided between rival armed groups. Until the armed conflict dies down, a return to normal economic activity based on the country's enormous oil potential is not possible. We expect weak economic growth in 2015, based on oil production staying at the 2014 level of 0.5 million bpd and some rebound of non-oil economic activity. However, both public finances and the balance of payments are projected to continue running high deficits due to low global oil prices and low oil exports.

Over the medium term, political stabilization and economic reform could release substantial growth potential. In the event of a conflict resolution by the second half of 2015 and a rapid resumption of oil production, the growth rate could jump in 2016 and beyond. Both the budget and current account balances will significantly improve, eventually turning into surpluses, allowing foreign reserves to stabilize around US\$65 billion during 2015-2017. Within this context, the implementation of economic policy reforms aimed at private sector development and job creation could boost Libya's economic performance significantly over the medium term.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	-13.6	-24.0	2.0
Inflation Rate (%)	2.6	2.8	2.2
Fiscal Balance (% of GDP)	-4.0	-43.5	-42.8
Current Account Balance (% of GDP)	13.6	--32.8	-47.3

Morocco

Morocco's economic performance was below potential in 2014. Economic growth decelerated from 4.4 percent in 2013 to 2.6 percent as a result of declining agricultural output due to insufficient rainfall and lackluster performance outside agriculture, especially in manufacturing. Unemployment rose to almost 10 percent and reached close to 40 percent and 20 percent among the urban young and educated, respectively.

Despite the weak economy, macroeconomic balances improved due to policy measures. Measures initiated in 2013 to reduce fuel subsidies and cut selected recurrent expenditures were continued in 2014. As a result, the budget deficit decreased from 5.4 percent of GDP in 2013 to 5 percent. Consistent with the fiscal tightening, the current account deficit shrunk to an estimated 5.8 percent of GDP from a peak of 9.7 percent of GDP in 2012. On the capital account side, financial inflows were buoyed by relatively high foreign direct investment, corporate and sovereign bond issuances, support from the Gulf Cooperation Council (GCC), and financial assistance from development partners, including the World Bank Group. At more than US\$20 billion, foreign exchange reserves recovered to their 2011 level.

Near term prospects are promising. This year, real GDP growth is expected to recover to 4.6 percent due to good rainfall and the sharp decline in international oil prices. The 2015 Budget Law confirmed the Government's resolution to solidify the tax base, rein in expenditures and launch the reforms of the pension system, and the recent adoption of the Organic Budget Law should enhance central and local governments' budget design and implementation for better public service delivery and efficiency over the medium term. To improve further the investment climate, the Government announced its intention to proceed with justice reform, improve access to financing, especially for the SMEs, and address access to land constraints. Assuming full implementation of these reforms, including the commitment to reduce the budget deficit to 3 percent of GDP by 2017, growth should pick up to around 5 percent over the medium term, with inflation kept below 2 percent.

Morocco's external position is also expected to strengthen over the medium term. The emergence of new growth drivers in higher value-added export industries (such as car manufacturing and aeronautics) and the expansion of Moroccan companies in Western Africa are potentially creating the conditions for Morocco to become a regional hub for trade and investment between Europe and Sub-Saharan Africa. External financing requirements constitute a moderate concern in the medium term, given the relatively low external debt, financial support from the GCC countries, and access to international markets. Any remaining financing gap would be filled by tapping international markets given Morocco's investment grade ratings. The IMF's Precautionary and Liquidity Line (PLL) in the amount of US\$5 billion will continue to serve as insurance against external shocks until mid-2016.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	4.4	2.6	4.6
Inflation Rate (%)	1.9	0.4	0.8
Fiscal Balance (% of GDP)	-5.4	-5.0	-4.5
Current Account Balance (% of GDP)	-7.6	-5.8	-5.0

Oman

Oman's economy continued to expand in 2014 as government spending offset the effect of falling oil prices. Real GDP grew by an estimated 4.1 percent, slightly above the rate achieved in 2013. While the oil sector weakened, the non-oil sector grew by an estimated 6.5 percent, driven mainly by petrochemicals, large-scale infrastructure projects (airport, port, water systems, roads, housing and tourism), social infrastructure (health and education), and financial services. Lower revenues (due to lower oil prices) and higher spending pushed fiscal balances into deficit in 2014 (-1 percent of GDP). The current account balance was in surplus of 2.2 percent of GDP, down considerably from 8.6 percent in 2013. Inflation was contained at 2.2 percent.

Capital spending plans may have to be revisited as fiscal constraints tighten. The 8th Five-Year Development Plan currently under implementation featured high rates of capital spending of about 10 percent of GDP a year over 2011-2015. Despite this occurring in tandem with higher current spending, buoyant revenue growth from high oil prices helped to contain the impact on public debt. With fiscal constraints tightening as oil prices have dropped, the planned rate of spending may have to be re-examined both in 2015 and under the next Plan which is currently being prepared.

Lack of jobs for youth is the chief economic and social concern. Census data suggest that total unemployment reached 24.4 percent in 2010. The working age population is growing at over 3 percent a year. To absorb new labor force entrants and significantly reduce unemployment, the economy will have to generate some 45,000 new positions for Omanis each year, a pace that has only been reached in the past by hiring into the public sector. However, this is not a sustainable option for the future, both for its fiscal impact and its low contribution to national productivity.

The short-term macroeconomic outlook depends on oil prices and public spending. Our central forecast is that real GDP will grow by 3.7 percent while the fiscal and current account balances will deteriorate sharply. The 2015 budget envisages a deficit of 8 percent of GDP due mainly to the steep fall in oil revenues. However, if public spending continues at recent rates, the budget deficit could reach 17 percent of GDP. The current account deficit could rise to 10 percent of GDP unless measures are taken to restrain growth in imports which are largely determined by public and private spending. The inflation outlook remains moderate but inflationary pressures might emerge due to higher wages and aggregate demand.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	3.9	4.1	3.7
Inflation Rate (%)	3.1	2.2	1.5
Fiscal Balance (% of GDP)	4.2	-1.0	-16.7
Current Account Balance (% of GDP)	8.6	2.2	-10.0

Palestinian Territories

More than 6 months after the Gaza war, the political and security situation in the Palestinian territories remains precarious. The pace of the reconstruction process in Gaza has been much slower than expected due to inadequate donor funding and the Israeli restrictions on importing construction material into Gaza. The ongoing rift between Hamas and Fatah has also hindered efforts to rebuild Gaza. So far, the two Palestinian parties have not agreed on governance arrangements in Gaza, and the Palestinian Authority (PA) is yet to station its officials at the border crossings with Israel and Egypt as agreed in the ceasefire. Peace talks with Israel have completely stalled.

After 7 years of continuous growth, the Palestinian economy contracted in 2014. The Gaza war of July-August 2014 caused physical damage estimated at nearly USD2.8 billion and led to a contraction of nearly 15 percent in Gaza's real GDP. Consequently, despite growth of 4.4 percent in the West Bank economy, the overall Palestinian economy contracted by about 1 percent in 2014. Given that population growth in the Palestinian territories is 3 percent, real GDP per capita contracted by about 2 percent. Unemployment, already high, increased even further (by 2 points) to 27 percent in 2014: 43 percent in Gaza and 17 percent in the West Bank. Preliminary estimates suggest that poverty in Gaza increased from 28 percent in 2013 to 39 percent in 2014.

The Government of Israel's (GoI) decision to withhold Palestinian taxes has triggered a fiscal crisis. The recurrent deficit (before grants) was reduced by about 1 percentage point of GDP in 2014 as a result of strong revenue performance. However, in early 2015, the GoI decided to withhold customs and VAT duties it collects on behalf of the PA after the latter submitted an application to become a member in the International Criminal Court (ICC). Since this affected as much as 70 percent of its revenues, the PA has resorted to cash rationing, paying only 60 percent of staff salaries, delaying expenditures and increasing its stock of arrears to the private sector and the pension fund.

Near term prospects are poor. The overall real GDP growth rate is projected at 0.9 percent in 2014. The economy of the West Bank is expected to contract by 1.8 percent due to the fiscal and liquidity squeeze brought about by the Israeli decision to withhold Palestinian taxes. The economy of Gaza is expected to grow by 10 percent as economic activity recovers and the reconstruction process accelerates. However, downside risks remain significant. First, if donor pledges for Gaza do not materialize, the pace of reconstruction will be slower than expected. Second, while the expectation is that Israel will resume the payment of Palestinian taxes by May/June, this is by no means certain and further delays in the payment of these revenues could lead to an even larger contraction in the West Bank.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	2.2	-0.8	0.9
Inflation Rate (%)	1.7	1.7	2.0
Fiscal Balance (% of GDP before external support)	-12.5	-12.1	-14.9
Current Account Balance (% of GDP)	-16.2	-13.0	

Qatar

The economy grew strongly in 2014 despite falling hydrocarbon prices. Qatar managed to maintain GDP growth of about 6 percent in 2014, a level comparable to the previous year, largely because of high levels of public and private spending. The rate of economic expansion is expected to decline to 3 percent in 2015 due to sharply lower oil prices and oil-indexed LNG prices. However, the large public investment program, a generally expansionary fiscal policy, and population growth will continue to drive domestic demand and non-hydrocarbon sector growth over the medium term. Services are projected to contribute heavily to GDP growth over the next few years, as are manufacturing and construction, while the hydrocarbon sector's contribution may well be negative.

Qatar's fiscal and external positions remained comfortable in 2014, although downward pressure is expected in 2015 as low oil and gas prices reduce government revenues and exports. Qatar recorded a fiscal surplus of 9.7 percent of GDP and a current account surplus of 21.2 percent in 2014. As oil and related gas prices are projected to remain low in 2015, Qatar is revising its capital investment plans to ease pressure on the budget. However fiscal policy is still expected to be expansionary as the government races to meet its FIFA World Cup 2022 preparation schedule. Consequently, the fiscal balance is projected to drop to 6.5 percent of GDP while the current account records a low rate of 2.3 percent for the first time in many years. Qatar continues to maintain a steady exchange rate pegged to the US dollar and pressure for revaluation is unlikely. Its cushion of foreign reserves declined to 13.8 billion USD (6 percent of GDP) in 2014 and is expected to stabilize around that level.

Medium-term prospects in the gas market are unclear due to the expansionary trend of global supply. This trend encompasses higher production of shale gas in Europe and the United States as well as higher LNG exports from Australia, Russia, Canada and other producers. At the same time, geopolitical considerations could make Qatar's access to additional gas sources from the North field questionable, should its current fields prove insufficient. However, the Ukraine crisis is only the latest of a series of major shocks that have boosted the economics of LNG and particularly for incumbent players like Qatar.

Qatar has announced measures to ensure better treatment of expatriate workers. An international outcry over the treatment of expatriate workers involved in the preparations for the FIFA 2022 World Cup in Qatar has galvanized government action to reform labor policies. In May 2014 Qatar announced reforms to its sponsorship system (to allow expatriate workers flexibility to switch between employers) and to ensure wage payments and occupational health. The reforms have yet to be enshrined in national legislation and implementation timelines and enforcement mechanisms have yet to be announced.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	6.1	5.9	3.0
Inflation Rate (%)	3.1	3.0	2.5
Fiscal Balance (% of GDP)	14.2	9.7	6.5
Current Account Balance (% of GDP)	25.8	21.2	2.3

Saudi Arabia

Saudi Arabia's growth weakened in 2014 in line with sharply lower oil prices during the year. Real GDP growth slowed to 4.3 percent in 2014, much below the 5.1 percent registered in 2013 and 6.8 percent recorded in 2012. This was not surprising as economic performance in Saudi Arabia is much affected by the price of oil which plunged by more than 50 percent since June 2014. However, the overall economy is well-placed to cope as close to \$786 billion dollars of reserves have been accumulated in recent years (when oil prices were high) and the government is in a comfortable position to engage in counter-cyclical fiscal spending. Inflation (year-on-year) stood at 3 percent in 2014, a little lower than the level of 2013.

The 2015 budget aims to stimulate the non-hydrocarbon sector and boost social spending. Education and health remained the focus of government spending accounting for 38 percent of total spending. The 2015 budget envisages a reduction of investment spending by 13 percent compared to 2014 budget. Despite this decline, investment spending will still be 81 percent higher than its level five years ago. Due to the fall in oil prices and to the increase in wages and social benefits, the 2015 budget is forecast to have a deficit of more than 16 percent of GDP compared with a fiscal surplus of 6 percent in 2014. The current account balance is expected to behave in similar fashion by moving to a deficit of 11.8 percent of GDP in 2015 from a surplus of 12.4 percent in 2014.

Longer term challenges include generating adequate jobs for nationals. According to the latest labor force survey by the Ministry of Labor, unemployment among Saudis declined slightly to 11 percent in 2014 from 11.5 in 2013. While improving, the level of unemployment is still considered very high and is higher still among such groups as youth and women. To combat unemployment, the government has been actively implementing education and skills measures as well as a quota-enforcement scheme called Nitaqat and an unemployment assistance scheme called Hafez. However, other measures such as the award of salary bonuses to public sector employees work at cross-purposes to the employment objective.

The outlook remains broadly positive despite weak oil prices. GDP is expected to grow by 4.6 percent in 2015 despite weak oil prices because of counter-cyclical spending. Furthermore, a smooth leadership transition has taken place recently. Crown Prince Salman ascended the throne upon the death of King Abdullah and quickly appointed a new leadership team. The general impression is that while the leaders have changed the thrust of economic policy will remain unchanged. Of course, the economic outlook also depends on how regional security matters play out.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	5.1	4.3	4.6
Inflation Rate (%)	3.5	3.0	3.2
Fiscal Balance (% of GDP)	8.7	5.7	-16.2
Current Account Balance (% of GDP)	16.2	12.4	-11.8

Syria*

The humanitarian impact of Syria's civil war worsened in 2014. The estimated death toll has exceeded 220,000 people (UN); 840,000 were injured and many more held in custody. Half the Syrian population has been forced to leave their homes (7.6 million internally displaced, 3.8 million refugees, and more than 1.5 million non-refugee migrants). More than 12.2 million in Syria are in need of humanitarian aid, including 5.6 million children (UNOCHA, Syrian Center for Policy Research-SCPR). Lack of access to health care and scarcity of medicine have led to a catastrophic health situation. Poor food availability and quality and successive cuts in subsidies on bread has exacerbated nutritional deprivation. An estimated 25 percent of schools were not operational by Q3-2014. Unemployment was estimated at 58 percent and overall poverty incidence at 83 percent at end-2014 (SCPR).

Available estimates of growth are wildly divergent. SCPR and ESCWA project that economic contraction significantly slowed in 2014 to -9.9 and -14.3 percent respectively, bringing GDP to 38 percent (SCPR) or 48 percent of 2010 GDP (ESCWA). EIU, on the other hand, projects that the economy bottomed out, with growth averaging a modest 0.5 percent, driven by the economy's adjustment to the military stalemate and the considerable migration of businesses to more stable coastal areas. The EIU estimates growth of 1.9 percent in 2015 and 2016, whereas ESCWA projects a 2015 growth rate of -4.7 percent, bringing Syrian GDP to a mere quarter of the 2015 GDP projected by the IMF before the crisis.

The crippling civil war has caused a drop in government revenues and a spike in spending. ESCWA estimates a 2013 budget deficit of -26.3 percent of GDP. EIU estimates a deficit of -12.9 percent in 2013 and projects deficits of -10.7 percent and -9.2 percent of GDP in 2014 and 2015. SCPR estimates a deficit close to 20 percent during 2013 and 2014 and almost doubles its estimates to 35.7 percent and 40.5 percent after adding off-budget subsidies. SCPR projects foreign debt increased tenfold from 7 percent of GDP in 2010 to 71 percent at end-2014, whereas domestic debt increased from 16 to 76 percent of GDP. This implies a total debt of 147 percent of GDP by end-2014. Meanwhile EIU estimates external debt in 2014 at a much lower 40 percent of GDP.

Large current account deficits persist and the currency has depreciated. Depressed export revenue caused by the impact of the conflict (declining output and international sanctions), and declining international reserves have caused a significant depreciation of the Syrian pound from 47 pounds per USD in March 2011 to an estimated 176 pounds per USD at end-2014 (EIU).. Continued reliance on imports to satisfy food and fuel needs, weak exports, and absent tourism (Syria's second largest source of foreign exchange pre-crisis) will result in the persistence of a high current account deficit of over 12 percent in 2015 (EIU).

** The World Bank has no independent data or estimates on Syria for the period after 2010. The information on the country context and all figures referred to in the text are based on data from the following sources: United Nations (UN), United Nations Office for the Coordination of Humanitarian Affairs (UNOCHA), United Nations Security Council (UNSC), Syrian Center for Policy Research (SCPR), the United Nations Economic and Social Commission for Western Asia (ESCWA), the Economist Intelligence Unit (EIU), and the Syrian Central Bureau of Statistics (CBS).*

Tunisia

Economic performance stayed weak in 2014. Real GDP grew by only 2.3 percent, matching the subdued performance of 2013. On the production side, a short-lived rebound in mining and continued expansion in the services and administrative sectors were offset by declining activity in the extractive industries and stagnating manufacturing. Industrial production has steadily decelerated after its 2012 rebound and grew by only 0.2 percent in 2014. Overall, the recovery in external demand is slow, reflecting the weak economic recovery in the EU, while domestic demand is increasingly affected by tighter macroeconomic policies, notably translating into slowing public and private consumption. Inflation declined to 5.5 percent in 2014 as food and energy prices decelerated. Unemployment remained high, hovering between 15 and 16 percent.

The current account deficit widened despite weak domestic demand and exchange rate depreciation. The trade balance deteriorated markedly (to 16 percent of GDP) as exports grew slowly (+2.6 percent) and the import bill rose sharply (+6.3 percent), the latter driven by a worsening energy balance (expressed in domestic currency). This drove the current account deficit to an estimated 9 percent of GDP. Security concerns had an adverse impact on tourism and FDI, with tourism receipts growing only by 1.7 percent during the year, and FDI not recovering from its 2013 downturn. The exchange rate depreciated by 15 percent vs. the US\$ and 5 percent vs. the Euro in 2014. Reduced interventions helped preserve somewhat the level of reserves in 2014 at US\$7.7 billion, after a drawdown of a 1 billion US\$ in 2013.

The fiscal balance improved due to lower spending on subsidies and better revenue performance. The fiscal deficit declined from 5.9 percent in 2013 to 4.3 percent in 2014. Capital spending was kept at only 4.8 percent of GDP, subsidies at 7.2 percent and the wage bill at 12.7 percent, the last-mentioned only marginally exceeding the target of 12.6 percent agreed with the IMF. Tax revenues outperformed expectations due to improved collection administration but also one-off tax measures that will not be sustained in 2015. Foreign financing fell short of expectations but was compensated by a smaller deficit than programmed and additional recourse to domestic financing. In early 2015, the Government raised financing on the Eurodollar market by floating a 10 year US\$1bn bond (priced at 5.875 percent), without any guarantee.

Medium term prospects are mixed. On the positive side, broad adherence to the ongoing transition by the major political parties should boost domestic and foreign investor confidence as should low energy prices. On the negative side, security tensions remain high both within the country and in neighboring Libya while Europe is mired in anemic growth. Overall, we expect real GDP to grow by about 2.6 percent in 2015 based on a moderate rebound in manufacturing and the agro-food sector.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	2.3	2.2	2.6
Inflation Rate (%)	5.7	5.5	5.0
Fiscal Balance (% of GDP)	-5.9	-4.3	-4.1
Current Account Balance (% of GDP)	-8.4	-8.9	-8.5

United Arab Emirates

Despite falling oil prices, the UAE economy performed well in 2014 as non-oil sectors grew strongly. Overall, the economy expanded by 4.7 percent even though oil prices fell by almost 50 percent after mid-year. Such resilience was due to the fact that non-oil growth, especially in the services sector, continued to accelerate. The real estate market, which had hindered growth since the 2009 crisis, has mostly recovered albeit unevenly as Dubai has done better than Abu Dhabi.

Internal and external balance positions remained in surplus. The progressive unwinding of the stimulus initiated in response to the 2009 crisis led to a surplus of 5.7 percent of GDP in the fiscal account in 2014. This is expected to shift to deficit in 2015. Likewise, the external current account recorded a surplus of 5.7 percent of GDP in 2014 but is expected to run a deficit in 2015 as the demand for imports continues while overall export revenues slacken due to low oil prices. Gross foreign inflows to the banking sector also remained steady, reflecting the UAE's perceived safe-haven status.

Dubai's successful debt restructuring of government-related enterprises (GREs) was tested as some extended repayments came due. The common element to the restructurings was extensions of bank debt maturities, with terms depending on creditor priority (i.e. secured creditors got better terms than unsecured). Cash to meet immediate GRE needs was supplied by a US\$20 billion loan backed by Abu Dhabi in 2009 (half of the money was on the balance sheet of the Central Bank, the other half with two commercial banks). This loan was due for repayment this year, but has now been extended to 2019 with an interest rate of 1 percent (in contrast to 4 percent on the original loan).

Abu Dhabi is generally focused on completion of existing initiatives. The tourism/culture megaprojects remain on their revised track, and various sovereign development entities continue their mix of strategic investments at home (e.g., Masdar solar) and abroad (European and East Asian energy and finance). The government has struggled to maintain a fully arms-length relationship from public commercial companies: Etihad (the airline) and Etisalat (telecom) were both revealed to be in receipt of large, and apparently one-off, financial transfers.

Medium term growth will come largely from public spending and the non-oil sector. Growth in tourism, real estate, construction, and services is likely to strengthen further in 2015. The non-oil economy is projected to expand by over 4 percent per annum in the coming years on the back of Dubai's strong core services sectors and Abu Dhabi's diversification efforts. The still-uncertain global economic and financial environment could pose external risks to this favorable outlook, although the UAE's sizeable foreign assets provides a buffer. The debt overhang may limit growth in bank lending.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	5.2	4.7	3.1
Inflation Rate (%)	2.5	2.1	1.0
Fiscal Balance (% of GDP)	7.2	5.7	-6.2
Current Account Balance (% of GDP)	7.4	5.7	-5.1

Yemen

Yemen's economy deteriorated sharply in 2014 due to political turmoil. The key political event of the year was the progressive take-over of the government and the capital city of Sana'a starting in September 2014 by the Houthi rebel group from the northern part of the country. Presently, military and administrative control in Yemen is divided between two main groups, one around Sana'a under the Houthis and the other around Aden under elements opposed to them. In addition to this conflict, numerous other skirmishes took place during the year involving other groups as well. Indeed, throughout the year, there was repeated sabotage of oil pipelines and facilities which led in turn to fuel shortages and power outages. One consequence of this extended turmoil and insecurity was the collapse of economic growth from 4.8 percent in 2013 to only about 0.3 percent in 2014. This bodes ill for the alleviation of poverty in the country which, at 54 percent, is among the highest in the world. Indeed, given the prevailing circumstances, there is a risk of even greater political and economic deterioration in 2015.

Fiscal performance reflected the growth collapse. The fiscal deficit (before grants) increased to 8.7 percent of GDP in 2014, compared to 7.8 percent of GDP in 2013, due mainly to a decline in tax and nontax revenues. Tax collection was hindered by the slowdown in economic activity as well as by the general insecurity. Savings from the fuel subsidy reform initiated in July were limited due to late implementation and also because the subsidies were partially restored by the government under pressure from the Houthis. Mobilizing domestic financing proved difficult—net domestic financing to the Government amounted to about 2.6 percent of GDP compared to 7.2 percent of GDP in 2013—due to tight liquidity conditions in the economy and the reluctance of Islamic banks to purchase more sukuk at the prevailing yield of 10 percent. To keep expenditure within the available financing envelope, the government had to reduce capital expenditures and accumulate arrears. The overall fiscal deficit estimate (inclusive of grants) stood at 5.2 percent of GDP in 2014, compared to 6.9 percent in 2013.

Current account performance would have been much worse without Saudi grants. Yemen is a small net exporter of oil and so falling oil prices reduced foreign exchange inflow on this account. Capital outflows also increased, mainly from oil companies. On the positive side, remittances remained stable and large Saudi grants totaling about US\$1.2 billion were received. This helped improve the current account deficit from 2.9 percent of GDP in 2013 to 1.3 percent of GDP in 2014. Gross foreign exchange reserves declined by about US\$800 million to reach US\$4.1 billion at the end of 2014, but remained broadly adequate covering four months of imports. Despite the decline of international reserves, the nominal exchange rate has remained stable since July 2012, at 214.9 Yemeni Rials per US dollar.

Key Economic Indicators

	2013	2014e	2015f
Real GDP Growth (%)	4.8	0.3	-2.8
Inflation Rate (%)	11.0	9.0	11.4
Fiscal Balance (% of GDP)	-7.8	-8.7	-7.7
Current Account Balance (% of GDP)	-2.9	-1.3	-6.1

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