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For ease of analysis and exposition, the region is divided into three main groups: the GCC oil exporters, developing oil exporters and oil importers. The first group contains the Gulf Cooperation Council (GCC) countries, namely, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates (UAE). The second group comprises the developing oil exporters such as Algeria, Islamic Republic of Iran, Iraq, Libya, Syrian Arab Republic, and Yemen. Oil importers include countries with strong GCC links (Djibouti, Jordan, and Lebanon) and those with strong EU links (Egypt, Morocco and Tunisia).
SUMMARY

Growth in MENA is rising but at a slower pace than average for other developing regions

MENA’s recovery has been driven by the global economic rebound and, to varying degrees, by domestic stimulus. Industrial production, which in MENA is dominated by oil, has nearly reached its pre-crisis peak, largely due to the strong recovery in emerging markets, especially Asia. However, the upturn has weakened in recent months because the global slowdown has arrived sooner and is occurring faster than previously anticipated, and there are serious concerns about the sustainability of the global recovery. In response, MENA governments have continued to stimulate their economies in 2010, and even those that did not use any type of fiscal stimulus in 2009 have started implementing fiscal measures in 2010.

The economic recovery in MENA has been much less vigorous than the recovery in countries that suffered sharp output contractions. Growth in MENA is expected to average 4 percent in 2010, an increase of slightly less than 2 percentage points over growth in 2009, and weak compared to increases of 5.6 percentage points in advanced economies and 4.5 percentage points in developing nations. The factors that helped MENA avoid severe recession – high public spending, state dominance and lack of integration with the global economy – are now slowing down the pace of MENA’s recovery. These factors are present to a different extent and have played a different role in the three major MENA groups of countries – the GCC oil exporters, the developing oil exporters and the oil importers – and their growth prospects vary accordingly.

The outlook for the GCC oil exporters is tied to the outlook for the global economy

In MENA, the well-integrated GCC countries were hardest hit by the global economic and financial crisis, but they recovered quickly as demand for oil picked up driven by the rapid recovery in emerging markets, and the financial sector stabilized. Economic growth has been constrained by anemic credit growth, which has started inching higher only recently, and by the fact that the four GCC members of OPEC have restrained output of crude oil to support oil prices, in the face of large stock overhang and rising non-OPEC supply. At present, nearly two thirds of OPEC ample spare capacity of 6 million barrels per day has been in Saudi Arabia. In 2010, economic growth of the GCC group is projected at 4.2 percent, and the expectation is that growth will accelerate to 5 percent in 2011 before declining to 4.8 percent in 2012.

The oil price rebound from the lows in 2009 has allowed GCC governments to maintain expansionary fiscal policies in 2010, while avoiding deterioration in their fiscal and current account positions. All GCC governments continued to stimulate their economies as the global economy started slowing down in the second quarter of 2010. Even Kuwait, which was the only GCC country without a fiscal stimulus in 2009 and suffered the worst recession in the region, started implementing a fiscal stimulus in the summer of 2010. The stimulus has supported these countries’ economic diversification strategies, and in the meantime is helping the revival of non-oil economic activities.
The sustainability of the recovery in GCC economies depends on developments in the rest of the world, and on the extent to which they affect oil markets. The outlook for the global economy and oil markets in the second half of 2010 remains uncertain, and a decline in oil prices cannot be ruled out. An economic slowdown will translate into weaker oil demand growth, while global oil supply is expected to be robust. According to World Bank’s most recent projections, the price of crude oil is expected to remain around $75 per barrel in the next three years, and support for further price increases based on demand and supply factors is expected to be weak due to robust non-OPEC production, high oil stocks and spare capacity. However, unanticipated shocks to supply and other factors including price speculation may lead to price spikes.

Tight credit conditions, particularly in interbank markets, pose another threat to the economic recovery in the GCC countries. With the exception of Qatar, credit growth to the private sector remains anemic due to the uncertainty arising from ongoing debt restructuring, and the spillovers from Dubai World (DW) events. Significant government support has enabled the market for large project and corporate finance to continue functioning, despite heightened risk aversion and uncertainty. When the GCC governments have not been directly present in bond markets, yields have been high.

Given the small export exposure to the EU, the debt problems in Europe are unlikely to alter significantly the economic growth prospects of the GCC countries unless these problems spread beyond Europe and affect global demand for oil. Recent developments suggest that the possibility of contagion has become a much less likely scenario. The recent spike in wheat prices – which nearly doubled in August from their lows in June – has caught the GCC countries unprepared, despite these countries’ dependence on wheat imports. However, the impact of the price spike on the GCC countries is expected to be small, and all GCC countries have fiscal space to respond to increases in the food import bill. However, in countries like Saudi Arabia, where inflationary pressures are a special problem, the recent wheat and other food price increases will remain a cause for concern.

The GCC countries have fiscal space to cushion the impact of a negative terms-of-trade shock but the systematic reliance on government spending poses a long term challenge. Some of the fiscal expansion will be self-terminating when projects get completed, but the medium-term burden of continued capital and current spending growth could increase the cost of capital for the private sector as public saving declines. Limited access to finance for small and medium enterprises (SMEs) and distortions in labor markets that discourage skill acquisition and entry into private sector also posed a threat to long-term growth of the GCC economies.

**Most developing oil exporters are vulnerable to oil price shocks and volatility**

Developing oil exporters such as Algeria, Iran, Iraq, Libya, Syria and Yemen felt the impact of the crisis, and later the recovery largely through the oil channel as their financial sectors are mostly state dominated, and not linked to global financial markets. Real growth of the developing oil exporters is projected to average 2.9 percent in 2010 – up by less than a percentage point from growth in 2009, and is expected to accelerate to 4.2 percent in 2011, and
3.9 percent in 2012. While stimulus has helped the recovery, the rebound has been weak as the OPEC members of the group had to limit their oil production in support of prices, and some developing oil exporters faced production-related problems limiting their oil output. In addition, some countries in the group backtracked in their reform efforts and passed laws that increased protection and the discriminatory treatment of firms.

Developing oil exporters are more vulnerable than GCC oil exporters to a sharp decline in oil prices as they have much more limited fiscal space than GCC oil exporters to respond to terms-of-trade shocks. Most developing oil exporters used some of their fiscal resources to cushion the impact of the crisis in 2009. Excessive volatility in oil prices has also become a major problem for this group of countries. Signaling the increasing use of oil as a mainstream asset and OPEC’s difficulties with supply management, volatility in oil markets has grown over time and is now much higher than the volatility of other commodity prices. Volatility of oil prices is expected to be present going forward implying that prudent macroeconomic management and oil revenue management have become more challenging and more important than ever before. Strategies aimed at diversifying the economic base and scaling up non-oil sources of growth will also help reduce the vulnerability of these countries to excessive oil price volatility. Iraq and Yemen are especially vulnerable to this volatility due to their limited fiscal space.

Some developing oil exporters are vulnerable to a food price shock stemming from the recent increases in wheat prices in response to droughts in a number of countries and the Russian wheat export ban. Yemen in particular stands out as the most vulnerable in the region. The cuts in estimated global production between May and August are projected to have raised wheat prices by 26 percent. This price increase is likely to have raised poverty in Yemen by slightly more than 0.3 percentage points, which represents an increase in the number of the poor by an estimated 80,000 people. Iraq also appears to be vulnerable although slightly less than Yemen due to sourcing a smaller share of its wheat consumption from abroad.

Developing oil exporters face deep structural issues that constrain long term growth. In response to the recent crisis, some countries in the group backtracked in their reform efforts and passed laws that increased protection that is already among the highest in the world, and the discriminatory treatment of firms, while others face production-related problems limiting their oil output. Due to the dominance of the state, these countries’ private sectors are small and face serious competitiveness issues, while their financial sectors have remained burdened by non-performing loans. The nonoil export performance of developing oil exporters has also been weak relative to potential, and in comparison with other countries.

Oil importers’ recovery depends on developments in key markets

Oil importers such as Egypt, Morocco, Tunisia, Lebanon, Jordan and Djibouti, weathered the effects of the global economic and financial crisis better than other MENA countries, but developments in Europe and still relatively anemic credit growth in some countries, are expected to have dampened growth in 2010, especially the growth of those with EU links. Lebanon has been the exception. Strong regional demand fueled by oil wealth and inflows of capital into
Lebanon’s real estate and banking sectors – considered a safe haven in times of crisis by the Lebanese Diaspora and some GCC nationals – has been driving the boom in its construction and trade sectors.

In 2010, real economic growth of oil importers is expected to average 4.9 percent and is unlikely to surpass growth in 2009. Assuming steady progress with structural reforms, oil importers’ growth after 2010 is expected to surpass pre-crisis levels in the 2000s, and average 5.3 percent in 2011 and 5.7 percent in 2012. Despite the challenges brought by the global economic and financial crisis, with a few exceptions, reforms have broadly remained on track, while in some cases oil importing countries have steamed ahead with reforms started prior to the crisis. In anticipation of a prolonged slowdown in the EU, most oil importers with strong EU links extended or implemented new fiscal stimulus.

Even though at present a smooth resolution of the fiscal issues in high-income Europe is the most likely scenario, oil importers with EU links are likely to face serious repercussions of the expected significant fiscal contraction in the heavily-indebted, high-income European countries (EU-5), and more broadly, the Euro zone. The effects would come through the balance of payments, reflecting the impacts on trade, remittances, and FDI flows. Oil importers with EU links have the greatest trade exposure to the highly-indebted countries in the Southern Euro Zone (SEZ), and the second highest trade exposure to the EU25, after ECA. In addition, two of the oil importers with EU links – Morocco and Tunisia – are much more dependent on the EU for their remittance flows than Egypt and the rest of the oil importers. How hard these countries are hit depends on the extent of the fiscal contraction in the EU, and how quickly MENA countries can shift sales to markets outside the EU.

With the recent developments in wheat markets, the risk of a food price hike has become a threat to all oil importers. Egypt and Morocco have the largest estimated monthly imports, and therefore face the largest increases in the import bill as a percent of monthly foreign reserves. Stimulus has helped oil importers weather the crisis and support the recovery, but many of them are now squeezed for fiscal space which represents a key source of long-term vulnerability. With a few exceptions, reforms have broadly remained on track, giving these countries an opportunity to continue the process of transforming their economies, upgrading their technological capabilities and improving their competitiveness.
I. MENA is recovering at a slower pace than average for other developing regions

The Middle East and North Africa (MENA) region is recovering from the global financial and economic crisis along with the global economy and with all the attendant uncertainties. MENA was affected by the financial and economic crisis but to a much smaller extent than developed economies and developing regions outside Asia. The economic recovery in MENA has also been much less vigorous than the recovery in countries that suffered sharp output contractions (Figure 1). The factors that helped MENA avoid severe recession – high public spending, state dominance and lack of integration with the global economy – now seem to be constraining the growth recovery. Growth in MENA is expected to average 4 percent in 2010, an increase of slightly less than 2 percentage points over growth in 2009, and weak compared to increases of 5.6 percentage points in advanced economies and 4.5 percentage points in developing nations on average (Figure 2). MENA’s output growth in 2011 and 2012 is expected to return to the average growth rates observed in the 2000s, prior to the economic and financial crisis.

Figure 1. Growth outlook (real GDP growth rates in percent)

![Growth outlook chart](source: World Bank, Global Economic Prospects 2010 and MNSED.)

In the near term growth would be driven by consumption and investment expansion, and a recovery in exports (Table 1). Government consumption is expected to remain an important driver of growth in MENA although the extent to which individual governments will be able to stimulate their economies will depend on the degree of fiscal space available. Given the uncertainty about the economic prospects of the global economy, it is difficult to forecast the extent to which exports would contribute to growth in MENA going forward and the extent to which private consumption and investment will pick up pace. It is important to recognize that the outlook by country will differ depending on initial conditions and the linkages to the global economy through the financial, oil, and the balance-of-payments channels.
So far MENA’s recovery was driven by the global economic rebound and, to varying degrees, by domestic stimulus

In MENA, the well-integrated GCC countries were hardest hit by the global economic and financial crisis, but they recovered quickly as demand for oil picked up, driven by the rapid recovery in emerging markets, most notably Asia, and the GCC financial sector stabilized. In 2010 growth is projected at 4.2 percent – a strong comeback from near zero growth in 2009 (Figure 3), and the expectation is that growth will accelerate to 5 percent in 2011 before declining to 4.8 percent in 2012.

GCC governments responded quickly with monetary and fiscal stimuli, and their accumulated reserves and other assets enabled them to prevent a deeper deceleration in growth, and support a rebound in growth. However, economic growth has been constrained by anemic credit growth, which has started inching higher only recently, and by the fact that the four GCC members of OPEC have restrained output of crude oil to support oil prices, in the face of large stock overhang and rising non-OPEC supply. At present, nearly two thirds of OPEC ample spare capacity of 6 million barrels per day has been in Saudi Arabia.
Governments facilitated the recovery and the return to stability by using monetary easing, including lower reserve requirements of banks, liquidity support from central banks or governments, government guarantees on deposits and debt, capital injections and, in Qatar, asset purchases.¹ The fiscal stimulus aimed to help the recovery, but also to enhance long-term growth prospects, mainly through capital expenditures concentrated on infrastructure investments. For example, ongoing large fiscal spending by Abu Dhabi has supported its long-term diversification strategy.

**Figure 3. MENA’s annual real growth performance before, during, and after the crisis²**

![Graph showing MENA's annual real growth performance](image)

Source: National agencies and World Bank staff estimates (e) for 2010, and projections (p) for 2011 and 2012.

The GCC recovery has had a positive impact on other MENA countries, and more broadly, on the global economy, mainly through increased outflows of remittances and capital flows.³ Remittance outflows from GCC countries remained resilient during the crisis and continued to grow in 2009, albeit at a smaller pace than the one registered during the pre-crisis period. The investment programs part of the GCC governments’ fiscal stimulus tended to be labor intensive, although most entailed use of imported labor, and therefore stimulated the economies of countries supplying migrants, e.g. those in developing MENA and South Asia.

Developing oil exporters such as Algeria, Iran, Iraq, Libya, Syria and Yemen also felt the impact of the crisis, and later the recovery largely through the oil channel as their financial sectors are mostly state dominated, and not linked to global financial markets. The strong rebound in oil prices during the past 12 months, improved the fiscal and growth outlooks for this country group (Figure 3) highly dependent on oil (Figure 4). Real growth is projected to be 2.9 percent in 2010, up from 2.1 percent in 2009, and accelerate to 4.2 percent in 2011, and 3.9 percent in 2012. Public spending of developing oil exporters is typically pro-cyclical, but during the recent crisis

¹ These share common elements with the support measures introduced in the US, EU and Eastern Europe.
² See statistical appendix for country-specific macroeconomic information.
³ The GCC states are an important source of remittances, and increasingly foreign investments. These countries generate more than 10 percent of global annual remittance flows, while their estimated accumulated reserves and assets in sovereign wealth funds exceed US$1.5 trillion.
governments in a number of these countries responded with counter-cyclical fiscal policies, in addition to monetary easing and financial sector support measures. Monetary easing measures included lower reserve requirements in Algeria, Iran, and Syria, interest rate reductions in Syria and drawdown of reserves in Algeria, while financial sector measures covered government guarantees on deposits, liquidity support and asset purchases. Debt relief measures were adopted in Algeria, where they benefited mostly farmers and SOEs, and in Syria.

**Figure 4. Sources of external revenue, 2008**

![Diagram showing sources of external revenue](source.png)

Source: COMTRADE data and IMF. Note: Other oil exporters are developing oil exporters in MENA. Oil importers are MENA’s oil importing countries.

While stimulus helped the rebound, some of the countries in the group backtracked in their reform efforts and passed laws that increased protection and discriminatory treatment of firms. For example, unlike other governments which eased liquidity constraints in 2009, Algeria’s government passed a supplementary budget law which banned credit to consumers, except for mortgages, as well as supplier credits to finance imports - only letters of credit may now be used. The law aims to protect consumers from excessive debt and restrain importation of durable consumer goods. The measures form part of a package of regulatory reform measures passed in 2009 in favor of domestic over foreign operators, including minimum local ownership of 51 percent on foreign investment, and policies to restrict imports to encourage domestic production. The law included a 400% increase in the cap on government guarantees for SMEs loans.

The extent to which governments were able to use fiscal stimulus depended on their fiscal space (Table 2). Unlike the GCC countries, developing oil exporters implemented their stimulus mainly through increases in current expenditures, especially subsidies and transfers, but also public wages, and therefore could hurt, not enhance their long-term growth prospects. In Algeria, the fiscal stimulus involved increases of 25 percent in transfers and social subsidies, including

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4 Indeed, only one of the 6 developing oil exporters (Syria) increased capital spending by 40% in 2009 relative to 2008.
milk and wheat subsidies, and housing support. While a portion of this spending, such as aid to students from poor families or those living in remote areas, targeted the poor, some of it supported special groups. For example, a new public investment fund was created to invest in SMEs created by young Algerian entrepreneurs, subsidies for down payment and interest were extended to low-income households and tax exemptions were granted to homeowners renting housing to low-income families, but also mortgages were granted to public servants at a subsidized interest rate of one percent.

Table 2. MENA countries’ fiscal space in 2008

<table>
<thead>
<tr>
<th>Oil exporters</th>
<th>Fiscal Balance as % of GDP</th>
<th>Current account Balance as % of GDP</th>
<th>Government Debt as % of GDP</th>
<th>Reserves in months of imports</th>
<th>Reserves (including SWF) in months of imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>GCC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bahrain</td>
<td>4.9</td>
<td>10.6</td>
<td>15.2</td>
<td>2.2</td>
<td>13.6</td>
</tr>
<tr>
<td>Kuwait</td>
<td>19.9</td>
<td>40.7</td>
<td>5.3</td>
<td>6.3</td>
<td>86.6</td>
</tr>
<tr>
<td>Oman</td>
<td>13.9</td>
<td>9.1</td>
<td>5.0</td>
<td>5.5</td>
<td>6.4</td>
</tr>
<tr>
<td>Qatar</td>
<td>10.9</td>
<td>33.0</td>
<td>15.0</td>
<td>3.8</td>
<td>23.1</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>32.5</td>
<td>27.8</td>
<td>13.3</td>
<td>27.4</td>
<td>45.4</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>20.4</td>
<td>8.5</td>
<td>15.1</td>
<td>13.6</td>
<td>16.7</td>
</tr>
<tr>
<td>Developing Oil exporters</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Algeria</td>
<td>7.7</td>
<td>20.2</td>
<td>8.2</td>
<td>34.5</td>
<td>45.1</td>
</tr>
<tr>
<td>Iran, Islamic Republic of</td>
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<td>7.2</td>
<td>16.1</td>
<td>8.0</td>
<td>9.2</td>
</tr>
<tr>
<td>Iraq</td>
<td>-3.3</td>
<td>12.8</td>
<td>108.5</td>
<td>14.6</td>
<td></td>
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<tr>
<td>Libya</td>
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<td>40.7</td>
<td>0.0</td>
<td>42.6</td>
<td>65.7</td>
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<tr>
<td>Syrian Arab Republic</td>
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<td>-1.9</td>
<td>30.2</td>
<td>9.4</td>
<td></td>
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<tr>
<td>Yemen</td>
<td>-4.5</td>
<td>-7.6</td>
<td>36.4</td>
<td>7.5</td>
<td></td>
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<tr>
<td>Oil importers</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Oil importers with GCC links</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Djibouti</td>
<td>1.3</td>
<td>-27.6</td>
<td>60.2</td>
<td>3.0</td>
<td></td>
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<tr>
<td>Jordan</td>
<td>-8.8</td>
<td>-9.6</td>
<td>62.3</td>
<td>5.6</td>
<td></td>
</tr>
<tr>
<td>Lebanon</td>
<td>-8.8</td>
<td>-19.8</td>
<td>157.1</td>
<td>18.7</td>
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<tr>
<td>Oil importers with EU links</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Egypt</td>
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<td>76.6</td>
<td>6.6</td>
<td></td>
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<tr>
<td>Morocco</td>
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<td>47.2</td>
<td>6.3</td>
<td></td>
</tr>
<tr>
<td>Tunisia</td>
<td>-1.0</td>
<td>-5.8</td>
<td>47.5</td>
<td>4.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: World Bank data. Government debt and SWF data are from IMF

<table>
<thead>
<tr>
<th>Fiscal balance</th>
<th>Current account balance</th>
<th>Government Debt</th>
<th>International reserves in months of imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Larger than 2% of GDP</td>
<td>-2% to +2% of GDP</td>
<td>Less than -2% of GDP</td>
<td>More than 6 months</td>
</tr>
<tr>
<td>Larger than 3% of GDP</td>
<td>-3% to +3% of GDP</td>
<td>Less than -3% of GDP</td>
<td>Between 3-6 months</td>
</tr>
<tr>
<td>0 to 30% of GDP</td>
<td>30% to 80% of GDP</td>
<td>Larger than 80% of GDP</td>
<td>Less than 3 months</td>
</tr>
</tbody>
</table>

In Syria, the stimulus was a mix of spending measures and tax cuts. The government increased wages by 23 percent and implemented measures to compensate for rising fuel prices and mitigate the impacts of drought. Tax incentives included tax breaks for farmers and tax incentives to encourage companies to contribute to strategic objectives such as locating production in remote areas, creating jobs and participating in initial public offerings. Syria also increased investment spending by 40 percent in nominal terms in 2009.

Yemen had limited fiscal space and provided few interventions. Social security interventions for the most vulnerable were implemented with financing from the Crisis Response Facility provided by the World Bank. In Iraq, where the fall in oil prices severely affected public
finances, the World Bank provided financial support through a development policy loan, working closely with the IMF.

Oil importers such as Egypt, Morocco, Tunisia, Lebanon, Jordan and Djibouti, were least affected by the global economic and financial crisis, but growth in 2010 is expected to average 4.9 percent and is unlikely to surpass growth in 2009 (Figure 3), largely due to the weak growth expected in developed markets, and the fact that growth is expected to moderate from relatively high levels in Lebanon and Djibouti. Assuming steady progress with structural reforms, oil importers’ growth in 2010 is expected to surpass pre-crisis levels in the 2000s, and average 5.3 percent in 2011 and 5.7 percent in 2012. Despite the challenges brought by the global economic and financial crisis, with a few exceptions, reforms have broadly remained on track, while in some cases countries have steamed ahead with reforms started prior to the crisis. Examples of such reforms include pension and social welfare reform in Egypt and trade liberalization and economic integration in Tunisia.

Fiscal policy of oil importers with EU links has been expansionary, as countries launched various measures to stimulate demand, and in some cases the private sector. In addition to easing liquidity constraints on banks and firms, so far the response has focused on mitigating the short-term impact of the crisis on the real economy, although some measures including tax cuts and investment expenditure would promote sustained growth. In Tunisia and Morocco, fiscal stimulus through increased current expenditures included measures to support private consumption, in the form of public sector wage increases, and measures to help SMEs cope with the decline of external demand, including guarantees of working capital loans, easing of regulation, and debt rescheduling facilities. Assistance to firms, irrespective of size, was provided in Egypt through transfers supporting exporters, industrial zones in the Delta region, and logistic areas for internal trade.

Stimulus through capital expenditure increases went into job-creating infrastructure investments in Egypt and Tunisia. In addition, Egypt increased investments in rural and social sectors. A range of tax measures were introduced in Egypt, including cuts in customs duties on selected industrial inputs and capital goods, temporary suspension of the sales tax on selected capital goods, introduction of import tariffs on steel, and imposition of anti-dumping duties on sugar to protect domestic production.

The economies of oil importers with strong GCC links such as Lebanon, Jordan and Djibouti were relatively unaffected by the crisis and managed to grow at a robust pace of 6.5 percent per year in 2009. Growth slowed down substantially only in Jordan, where it fell from 7.6 percent in

5 For example, Egypt halted the energy subsidy reform. It adopted a one-year freeze of the energy subsidy phase-out plan for non-intensive industrial users, and extended the freeze for another six months to June 2010.
6 Liquidity support was pursued in Tunisia and Morocco, while government deposits in the banking sector were increased in Egypt. Monetary easing, particularly reduction in reserve requirements, was pursued by all three countries. Interest rates were lowered in Tunisia and Egypt, and international reserves declined in Egypt.
2008 to 2.3 percent in 2009. This sharp slowdown prompted the authorities to respond with a combination of financial, monetary and fiscal measures, the latter reflecting a mix of tax cuts and spending increases. Financial measures included full guarantees provided on all bank deposits, initially through the end of 2009 and subsequently extended through the end of 2010; the provision of guarantees for private sector borrowing, targeting listed industrial and real estate companies with sound credit record facing temporary difficulties obtaining financing; and a scale back of operations to soak up liquidity by the Central Bank of Jordan. Monetary measures included lower reserve requirements and interest rates, and an increase in international reserves.

To mitigate the impact of the crisis on the poor, the government of Jordan used largely a combination of tax cuts and exemptions, and capital spending increases that are likely to enhance the country’s growth prospects. Jordan increased public investment by 52 percent between 2008 and 2009 in order to tackle infrastructure bottlenecks in the road and water sectors, and granted tax relief for a number of sectors. The government granted tax exemptions to the tourism sector, extended tax exemptions on some imported construction materials in response to signs of contraction in key sectors, full exemptions from income taxes in the agriculture sector and for households with income up to a certain level, corporate tax exemptions or reductions in a number of sectors. Jordan used subsidies sparingly extending a subsidy only on gas cylinders used for cooking.

Djibouti and Lebanon registered only minor declines in growth during the same period, with both economies growing at 5 and 8 percent, respectively, in 2009. Lebanon grew at a much faster pace than other oil importers with GCC links, reflecting a post-conflict recovery boom aided by strength in certain sectors – tourism and real estate – and vibrant private investment. Policy interventions in Lebanon helped fuel the post-conflict recovery boom, but strained further the fiscal outlook. Public sector wages increased, and a daily compensation fee was introduced for low-income public school students. Other policies were introduced to ensure access to finance, including subsidized interest rates extended to all sectors, except construction and trade, and strengthen macroeconomic fundamentals such as an increase in international reserves.

**MENA labor markets remained relatively unscathed by the crisis but impacts differed between countries**

Even though economic recovery has been under way, global unemployment has been lagging behind and the specter of a *jobless recovery* has been observed in many countries. Globally, unemployment is estimated to have continued to rise in 2010 with an increase of more than 30

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7 The proposed scheme covers 35 percent of the value of the loan, requires security of at least 125 percent of the financing value and targets projects that are more than 25 percent complete.

8 These included full exemption from income taxes of income arising from the agriculture sector, as well as for households with income up to JD24,000; full exemption from corporate tax for agribusinesses, for the first JD75,000 in income; and corporate tax reduction for industrial companies (from 15 to 14 percent), for trade and tourism companies (from 25 to 14 percent), and for financial and telecommunications companies (from 35 to 30 percent).
million since 2007 (Figure 5). Three-quarters of this increase in the number of unemployed people has occurred in the advanced economies and the remainder among developing economies. Within the advanced countries, the problem is particularly severe in Spain, where the rate increased by nearly 10 percentage points, and the United States which has seen the highest increase in the number of unemployed. Among developing economies, China and Russia had the largest increases in the number of unemployed (Figure 6). The export sectors were hardest hit in terms of jobs, and informal employment expanded implying that the number of workers with little or no social protection increased.

**Figure 5. Global unemployment and real growth**

Source: World Bank data and ILO. Note: Data for 2010 is a forecast.

**Figure 6. Changes in number of unemployed, 2007-09 (in millions)**

Source: IMF, World Economic Outlook.

The economic crisis triggered dramatic reductions in activity in sectors that had expanded substantially during the upswing and were at the center of the crisis – such as financial services, real estate and construction. In response, many advanced economies put in place mechanisms to stimulate labor demand including direct job subsidies, wage subsidies or reductions in payroll
taxes targeting specific groups in the labor force that are most vulnerable to joblessness such as the long-term unemployed and the youth.

**Job losses in the GCC countries were steep but affected mainly expatriate workers, not nationals**

Job losses in the GCC countries were steep because of their high exposure to credit financing and global markets. Labor markets were hardest hit in the UAE (Figure 7), most notably Dubai, where the labor-intensive real estate sector contracted sharply. Recent analysis based on labor surveys of professionals shows that a total of 10% of professional jobs in the Gulf were cut down over the 12-month period up to August 2009. Small firms registered steeper job losses (14 percent) than larger firms (8 percent). Moves by some GCC governments to restrict termination of Gulf nationals have helped secure their jobs in the short run. However, with termination not an option, some employers have become more cautious in hiring nationals.

The job cuts have disrupted the lives of many expatriates as they typically lack social security or unemployment benefits, and most are required by local immigration laws to depart within 30 days of termination. With new vacancies few and extremely competitive, many have relocated from Dubai to Abu Dhabi, and other GCC countries or have returned home. Across the region, some firms took advantage of the greater supply of candidates to get rid of under-performing employees, and to replace them with higher-skilled professionals who had previously been either unavailable or unaffordable. It is estimated that in 2010 further job cuts are likely, albeit at a slower pace than one witnessed over the past 12 months.

**Figure 7. Job cuts by country and sector in GCC, 2009**

<table>
<thead>
<tr>
<th>Sector</th>
<th>United Arab Emirates</th>
<th>Bahrain</th>
<th>Kuwait</th>
<th>Qatar</th>
<th>Saudi Arabia</th>
<th>Oman</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>7%</td>
<td>8%</td>
<td>10%</td>
<td>10%</td>
<td>11%</td>
<td>12%</td>
</tr>
<tr>
<td>Health care</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>12%</td>
</tr>
<tr>
<td>Oil &amp; gas</td>
<td>10%</td>
<td></td>
<td>12%</td>
<td></td>
<td></td>
<td>13%</td>
</tr>
<tr>
<td>Construction</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>12%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telecom &amp; IT</td>
<td>12%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banking</td>
<td>13%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real estate</td>
<td>15%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Survey based on GulfTalent.com

---

Survey data show that, among expatriates living in Dubai, the percentage who work in Abu Dhabi has tripled over the last year from 1% to 3%. Most of those who relocated from Dubai to Abu Dhabi are high-income professionals.
The impact of the crisis on oil importers’ labor markets was mild

The impact of the crisis on the labor markets in Egypt and Jordan was mild, according to recent analyses, based on a unique set of labor force surveys conducted in the two countries before and after the crisis. In Egypt, opposite to expectations, there was a mild decline in unemployment (Figure 8), combined with a slight increase in both labor force participation and employment-to-population ratios during the period from 2006 to 2009. This decline in unemployment was observed in rural and urban areas, and affected both men and women. Additionally, the effects of the crisis on hours worked, informality of employment and sectoral labor shifts have been minimal. However, the crisis-related decline in real earnings growth and, hence in the wage bill growth have been substantial (Figure 9). The young, old, unskilled and female workers were more likely to be vulnerable than other groups in the workforce.

Figure 8. The crisis did not affect aggregate employment in Egypt

![Graph showing labor force participation and unemployment rate](source: Population Council (2010)).

Figure 9. Crisis-related decline in real earnings and wages growth in Egypt

![Graph showing percentage change in wages and employment growth](source: Population Council (2010)).

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10 The real wage bill is defined as the product of total employment and median real earnings.
The crisis slowed down employment growth in Jordan (Figure 10), but changes in labor force participation, employment and unemployment were small in magnitude. Unlike Egypt, the segments of the labor force hit hardest by the crisis included those with tertiary levels of education or above. Indeed, men with tertiary degrees were the only group that experienced increases in unemployment rates following the crisis. People in urban areas suffered more from the crisis than those in rural areas. Among men, older workers tended to be somewhat more negatively affected than younger ones, whereas among women, the middle-aged group was the worst affected.

Figure 10. Output and employment growth in Jordan

Source: Population Council (2010).

Unemployment remains on an upward trend in Tunisia, although the measures adopted by the government during the crisis to support distressed firms helped contain the impact of the economic slowdown on employment. To achieve Tunisia’s medium-term objectives of boosting employment-generating growth and lowering unemployment, the authorities are developing an export promotion strategy that seeks to diversify target markets and products. The authorities have also identified a number of reforms of labor market policies, the education system, and public employment services that will serve to facilitate labor mobility and reduce mismatches between demand and supply in the labor market. The implementation of these reforms will be supported by several World Bank Development Policy Loans.

II. MENA’s recovery is proceeding in an uncertain global economic context

The Middle East and North Africa (MENA) region is recovering in an uncertain global environment. Industrial production, which in MENA is dominated by oil, has nearly returned to its pre-crisis peak (Figure 11), largely due to the strong recovery in emerging markets, especially Asia (Figure 12). However, the upturn has been weaker than expected because the global

---

11 The government of Tunisia signed a preferential trade agreement with the West African Economic and Monetary Union, and is currently negotiating free trade agreements with the Central African Economic and Monetary Community. Bilateral negotiations with the European Union are also under way to extend the FTA beyond industrial products to services, agricultural products, and processed food.
slowdown has arrived sooner, and is occurring faster than previously expected. The pace of recovery has decelerated as the impact of rebound factors, including inventory restocking and government stimuli, have faded. Industrial production growth rates have declined, with almost all of the decrease occurring in developing countries.

**Figure 11. Industrial production** (percent difference from pre-crisis peak to June 2010)

![Industrial production chart](image)

Source: World Bank based on data from Datastream.

**Figure 12. Industrial production, seasonally adjusted year-on-year real growth rates**

![Industrial production growth chart](image)

Source: World Bank based on data from Datastream.

Persistently high unemployment rates, weak housing data, anemic credit growth, especially to SMEs in the US, and a deceleration of growth in developing countries (Figure 12), notably China, have added to concerns about the sustainability of the global recovery. Credit growth in China continues to moderate and is approaching pre-crisis rates, but credit growth in other emerging markets is picking up pace (Figure 13). It increased steadily in Latin America and Caribbean (LAC) since end-2009, and it turned positive even in Eastern Europe and Central Asia.
(ECA) in the second quarter of 2010. In developed countries, large firms have had good access to corporate debt markets but credit growth remains anemic in the US.

Credit growth in MENA has slowed down but the rates at which credit is expanding remain higher than in other emerging markets. However, GCC countries other than fast-growing Qatar are exceptions. Credit growth in these countries slowed down rapidly in response to the crisis and has started inching higher only recently. And unlike in April, when the recovery appeared to be proceeding in a V-shaped fashion, recent data indicates that a second dip in economic activity remains a possibility (Figure 14).

**Figure 13. Credit growth (YoY, in percent)**

![Credit Growth Graph](image)

Source: Datastream.

**Figure 14. V-shaped recovery may turn into a W-shaped one (real GDP, % change quarter-on-quarter)**

![V-shaped Recovery Graph](image)

Source: IMF

Growth in global trade volumes has decelerated (Figure 15 and Figure 16) as developing countries, adjusted the pace of importing goods from the rest of the world, likely in response to
the end to inventory re-stocking. However, import demand of high income countries appears to be reviving after recent lows, in line with the increase in domestic demand in the US and EU. It is unclear, however, whether the strength in US domestic demand will continue with the help of further stimulus given the fact that the pace of slowdown in initial unemployment claims has reduced significantly since the beginning of the year. The persistent lack of jobs growth constrains consumer spending, which is a major driver of US output growth on the expenditure side.

Figure 15. Import growth, seasonally adjusted year-on-year in volumes

![Figure 15. Import growth, seasonally adjusted year-on-year in volumes](image)

Source: World Bank, DECPG.

Figure 16. Export growth, seasonally adjusted year-on-year basis in volumes

![Figure 16. Export growth, seasonally adjusted year-on-year basis in volumes](image)

Source: World Bank, DECPG.

Strong external demand for European, and especially German capital goods and motor vehicles, has been supported by the depreciation of the euro against the dollar and other currencies since
the start of the year. The surge in exports strengthened considerably the growth outlook in the EU in the second quarter of 2010, while the opposite was the case in the US, where imports surged in response to strong domestic final demand. In Japan, the strong contribution of exports to growth in the first quarter of this year is likely to have moderated substantially in the second quarter due to the appreciation of the yen against the dollar and the weakened import demand in China and elsewhere.

Financial market volatility reflects the unusually uncertain global outlook

Financial markets have been unsettled since the end of April when equity markets reached their peak during the last 12-month period. Sentiments changed often based on news about the global recovery, Europe’s debt problems, the passage of new financial reform legislation and fiscal austerity measures in a number of developed economies. The move of many European governments toward fiscal austerity, combined with well-publicized outcomes of stress tests on the largest European banks, appeared to have increased confidence and is expected to be helpful to medium-term growth in the euro area. Indeed, EU confidence surveys were sharply up in July. But the shift in market sentiment has not been dramatic and sovereign default remains a concern in Europe as the real test for the European banking sector will be the expected refinancing of 1.6 trillion euro-denominated debt by 2012.

Figure 17. Sovereign 5-year CDS spreads (bps)

![Sovereign 5-year CDS spreads (bps)](image)

Source: Bloomberg and DECPG, World Bank.

Financial markets reflected the debt difficulties in Europe with a pullback in equity markets worldwide, a widening of sovereign CDS and bond spreads for some countries (Figure 17), and

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12 In July, however, the US trade deficit contracted sharply as export of airplanes surged and imports fell across the board.

13 The EU stress test covered 91 European banks and focused on how they would cope with another economic downturn and losses on trading portfolios of government bonds. Results revealed that seven EU banks, including a group of five Spanish unlisted savings banks, Germany’s Hypo Real Estate and the Agricultural Bank of Greece, failed the test.
corporate bond and CDS spreads in Europe. European interbank lending rates diverged to their highest levels since their inception as stress built up in the Euro zone banking system. Investors reduced their tolerance for risk and channeled funds into US treasuries and gold – assets traditionally perceived as safe havens. Since then equity markets have recovered some of the recent losses (Figure 18), but in most regions they remain below levels prevailing in the first quarter of 2010 and volatility remains high.

**Figure 18. Financial markets reflected concerns about events in Europe**

GCC stock markets, which are more globally integrated than markets in other MENA countries, have followed global trends, while non-GCC stock markets reacted less to these global developments (Figure 18). Tunisia’s stock index continued its climb, proving for yet another time its resilience during difficult times. This performance, attributed to good fundamentals and strong demand for equity by domestic investors, is less impressive when compared with other non-MENA emerging countries.

MENA’s risk premiums and CDS spreads have declined somewhat and are below those for ECA, but remain higher than those in East Asia and Latin America, even when Iraq is excluded.

Source: Datastream.
(Figure 18). This is because many countries in the region, especially oil importers with EU links, are dependent on European markets where uncertainty about future growth prospects remains high. In addition, a few countries – most notably Lebanon – have limited fiscal space, and remain sensitive to negative shocks which push their credit spreads higher than those of their peers.

Further movements in the markets will depend on evidence that private sector growth in consumption and investment has started to pick up globally. Despite a sharp decline in global corporate default rates, and the possibility for further declines in the short term, serious concerns remain about the ability of companies, especially those in Europe, to refinance a large stock of leveraged loans due for repayment in the next few years.

**The outlook for GCC countries is tied to the outlook for the global economy**

The sustainability of the recovery in GCC economies (Figure 3) depends on developments in the rest of the world, and on the extent to which they affect oil markets. Current oil prices are around $80 per barrel and the average for the year up to beginning of September stood at around $77 per barrel – an increase of 24 percent over the 2009 average price of $62 per barrel (Figure 20). China has been a key driver of oil demand, accounting for 30-40 percent of the projected incremental increase in oil consumption. China’s crude oil imports grew at a fast pace reflecting overall rapid economic growth, plans to add 280 million barrels of strategic petroleum reserves by 2011 and a sizable refining expansion program.

**Figure 20. Crude oil average spot price (current US$ per barrel)**

![Crude oil average spot price](image)

Source: World Bank, DECPG.

While prices are expected to average $75 per barrel in real terms in the next few years, support for further price increase based on demand and supply factors is expected to be weak. Following production cuts to support prices, OPEC’s space capacity has nearly reached 2002 levels when
oil prices were $25 per barrel, inventories in developed economies are high, and oil demand is expected to grow in the medium term only slowly, while non-OPEC output continues to rise modestly.

The positive terms-of-trade shock from the oil price rebound has allowed GCC governments to maintain expansionary fiscal policies while maintaining or improving fiscal and current account positions (Figure 21 and Figure 22). All GCC governments continued to stimulate their economies as the global economy started slowing down in the second quarter of 2010. Even Kuwait, which was the only GCC country without a fiscal stimulus in 2009 and suffered the worst recession in the region, started implementing a fiscal stimulus in the summer of this year.\footnote{See statistical annex for a complete set of macroeconomic indicators by country in MENA region.}

**Figure 21. MENA fiscal outlook (percent of GDP)**

![Chart showing MENA fiscal outlook](chart1)

Source: National agencies and World Bank staff estimates (e) for 2010, and projections (p) for 2011 and 2012.

**Figure 22. MENA current account positions (percent of GDP)**

![Chart showing MENA current account positions](chart2)

Private consumption in all GCC countries was stimulated by increases in current spending and freezes on cuts of public sector employment and subsidies. All GCC governments continued to stimulate investment through direct capital spending, and in some cases through guarantees on private financing. The stimulus supports these countries’ economic diversification strategies, and in the meantime is helping the revival of non-oil economic activities. Saudi Arabia continued to implement its $400 billion public investment stimulus program. Abu Dhabi stimulus spending has encouraged investment and consumption. Despite rapid growth in Qatar, the government continued spending on projects and revived private investment by extending large-scale government financing or implicit guarantees.

Saudi Arabia’s stimulus spending supported non-oil sector growth in the country, and more broadly the global recovery because of its large size and high import content. In UAE re-export trade held up much better than expected due to steady regional growth and strong growth in Asia. Growth in most non-oil sectors in Kuwait remained depressed although consumption and Iraq-related logistics fared considerably better. Steady export-led recovery in Bahrain’s downstream energy-related sectors, including aluminum and petrochemicals, and government-driven construction have been the major sources of economic growth. In Qatar, LNG has been the key driver of growth, while in Oman the main non-oil source of growth has been construction which benefitted from government spending.

A number of risks cloud GCC countries’ growth prospects. The outlook for the global economy and oil markets in the second half of 2010 remains uncertain, and a decline in oil prices cannot be ruled out. An economic slowdown will translate into a weaker growth in oil demand, while global oil supply is expected to be robust and stocks are expected to remain relatively high. Thus, fundamental support for the oil market is expected to be weak in the absence of unexpected disruptions to supply. The GCC countries have fiscal space to cushion the impact of a negative terms-of-trade shock but the systematic reliance on government spending has risks. Some of the fiscal expansion will be self-terminating when projects get completed, but the medium-term burden of continued capital and current spending growth could increase the cost of capital for the private sector as public saving declines. In some countries, it would be difficult to cut public spending due to political consideration.

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15 Saudi Arabia’s fiscal package is the largest as a share of GDP of any G-20 country.
16 However, prices might find support because of the increasing use of crude oil and other commodities as assets.
It is also unclear to what extent private sector growth would pick up when public sector spending declines. In the UAE, there is a huge overhang of partly completed property developments, some stalled for two years and the property price slump shows no sign of easing. In order to revive the construction sector, the emirate of Dubai put substantial new funds into Nakheel – its flagship property developer, and paid trade creditors. It is too soon to say whether these measures have had the desired effect. Furthermore, Abu Dhabi’s property market has not remained immune to the effects of the crisis and has entered a downturn with a lag. In Qatar, where the property market, especially for commercial real estate, is oversupplied, and the banking sector has had significant exposure to domestic property loans, the construction sector is expected to grow at a slow pace in the coming years. More importantly, the outlook for the LNG market has been weakened significantly given developments in the US and EU LNG markets.

Box 1. The Dubai World debt restructuring

The Dubai World (DW) restructuring is close to completion on terms very similar to those outlined in the April 2010 Regional Economic Update. A formal offer was made to creditors in July 2010, with the terms outlined by the companies in March 2010 providing the basis for negotiations. As was clear when the terms were announced, DW’s property development subsidiary Nakheel has been separated from the rest of the DW restructuring and is proceeding on a parallel track. Nakheel has indicated that it is close to final agreement with its bank creditors on a 5-year extension of its loans. The extension would be at an interest rate that is 4 percentage points above the relevant interbank rate. This rate is significantly better than the one DW is offering its creditors. Nevertheless, Nakheel’s bonds coming due in future years are yielding around 15 percent, well above the rate on the restructured bank facilities.

From the perspective of the Dubai government, Nakheel is essential to restarting stalled construction activity in the emirate, and so funds have been provided to enable it to redeem sukuk as it comes due and to re-engage with its trade creditors. The latter group is receiving cash payments (totaling US$680 million so far) equal to 40 percent of outstanding obligations, with the remaining 60 percent to be settled by a sukuk whose terms will be finalized shortly. Notably, Nakheel has been making these payments without having final agreement on its restructuring package, indicating an objective of keeping activity flowing as smoothly as possible.

As for DW, virtually all creditors accepted its proposal by the deadline of September 10, 2010. Although the terms of the DW offer are not as severe as some initial predictions, due to the extension of maturities at below commercial interest rates they represent a substantial haircut in net present value terms (on the order of 25 percent). There were indications during the summer that some creditors were balking at these terms, leading the company to reiterate its option to force a deal via the special insolvency tribunal established in Dubai International Financial Center (DIFC) last year. As the creditors became convinced that no better deal was possible, DW’s offer was able to go through.

Source: Compiled by World Bank, MNSED.
Tight credit conditions, particularly in interbank markets, pose another threat to the economic recovery in the GCC countries. With the exception of Qatar, credit growth to the private sector remains anemic (Figure 23) due to the uncertainty arising from ongoing debt restructuring, and the spillovers from Dubai World (DW) events (see Box 1). The DW case has highlighted the complexity of out-of-court debt restructurings in the context of GCC countries’ lack of experience with modern insolvency procedures, the central role of government-related enterprises, and the complicated financing mix of many companies, including Islamic finance and working capital funded from purchaser deposits.

Nonetheless, DW would be a relatively quick restructuring by GCC standards, where some cases have taken 2 years to resolve. The direct engagement of the emirate’s government via the Dubai Financial Support Fund has been a major reason for the relatively quick progress made with this restructuring (Table 3). The government has been able to use a mixture of persuasion and authority to move things along. It has promised new funds for viable entities and the prospect for financial institutions’ continued engagement with the Dubai business model, but has reserved the right to move the restructuring to a special insolvency tribunal in the Dubai International Financial Center\(^\text{17}\) if a consensual restructuring could not be reached.

**Figure 23. Credit growth in GCC**

![Credit Growth Chart](image.png)

Source: Datastream.

Not all parties to the GCC debt restructuring have been satisfied. Some creditors have found themselves in particularly weak positions as a result of this process. Creditor bargaining power has varied with the type of obligation. The creditors in the weakest position vis-à-vis distressed debtors have been lenders at the holding company level and purchasers of yet-to-be-delivered assets. Lenders to the holding company level of a corporate entity have been vulnerable to the

\(^{17}\) The DIFC tribunal was created specifically for DW and there has been no indication that the government intends broadening its scope to other “Dubai Inc.” debt distress situations, such as that of Dubai Holding.
problem of co-mingled finances and lack of clarity about which assets they could pursue in the event of default, whereas subsidiary companies typically offer clearer outcomes in both respects.

A further complication is evident in the case of the Saad and al-Gosaibi groups in Saudi Arabia, where the holding companies were managing financial operations in Bahrain and creditors of the latter are thus forced to pursue cross-border claims. The experience of purchasers of off-plan Dubai property has made clear their lack of recourse when things go wrong. These investors have been faced with the conundrum of whether to provide further funds into a distressed entity in order to get its developments closer to completion. On the other hand, secured lenders and asset-based financiers (as in Islamic finance) have been in a somewhat stronger position, although the unraveling of various claims on specific assets could also pose difficulties.

Table 3. Debt Restructurings in the GCC, 2008-2010

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Initiated</th>
<th>Amount</th>
<th>Current Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuwait Finance &amp; Investment Co.</td>
<td>Kuwait</td>
<td>2008 (early)</td>
<td>$0.5 bn</td>
<td>Concluded June 2010</td>
</tr>
<tr>
<td>Global Investment House</td>
<td>Kuwait</td>
<td>Dec-08</td>
<td>$1.7 bn</td>
<td>Creditor agreement obtained Dec 2009</td>
</tr>
<tr>
<td>Investment Dar</td>
<td>Kuwait</td>
<td>Jan-09</td>
<td>$3.5 bn</td>
<td>Creditor agreement (tentative) obtained Dec 2009. Some litigation continues. Restructuring terms will have to be approved by court since the company is in court protection.</td>
</tr>
<tr>
<td>Gulf Invest</td>
<td>Kuwait</td>
<td>Apr-10</td>
<td>$0.05 bn</td>
<td>Loan guarantee called from UAE bank.</td>
</tr>
<tr>
<td>International Investment Group</td>
<td>Kuwait</td>
<td>Apr-10</td>
<td>$0.2 bn</td>
<td>Ongoing “business review”; sukuk being dissolved; 2nd missed payment in July.</td>
</tr>
<tr>
<td>Dubai Holding plus subsidiaries</td>
<td>UAE</td>
<td>May-10</td>
<td>$1-3 bn</td>
<td>Loan extensions sought at holding company and subsidiary level. No formal default.</td>
</tr>
<tr>
<td>National Central Cooling</td>
<td>UAE</td>
<td>Apr-10</td>
<td>$1 bn</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Dubai World</td>
<td>UAE</td>
<td>Nov-09</td>
<td>$26 bn</td>
<td>Virtually all creditors accepted offer in September 2010. Finalization expected shortly.</td>
</tr>
<tr>
<td>Nakheel</td>
<td>UAE</td>
<td>Nov-09</td>
<td>$10 bn</td>
<td>On parallel track to the above but with larger sukuk and trade credit elements.</td>
</tr>
<tr>
<td>Blue City</td>
<td>Oman</td>
<td>NA</td>
<td>$0.6 bn</td>
<td>Project not viable as originally conceived; bonds bought at 33% discount by an Abu Dhabi fund (June 2010)</td>
</tr>
<tr>
<td>Gulf Finance House</td>
<td>Bahrain/Kuwait</td>
<td>Feb-10</td>
<td>$0.3 bn</td>
<td>Rollover granted but strains continue. No formal restructuring request.</td>
</tr>
</tbody>
</table>

Source: Staff compilation from media reports.

Significant government support has enabled the market for large project and corporate finance to continue functioning, despite heightened risk aversion and uncertainty. Although private sector bank credit availability remains tight throughout the GCC, GCC firms have been able to conduct large funding operations. In Saudi Arabia, major financing has been carried out by key government-related enterprises such as the petrochemicals giant Sabic and the electric utility Saudi Electric, while the government has also been a direct lender to both of these companies and to other large projects with mixed public and private participation. In Qatar, the central government and a unit of the sovereign wealth fund have raised billions of dollars through bond
issues. The bonds provide a safe asset for risk-averse banks, and the funds allow the government to play a more direct role as a financier of major projects, especially in real estate, at a time when other players withdrew. The government of Bahrain has also used bond sales to support macroeconomic stimulus efforts.

When the government has not been directly present in bond markets, yields have been high. Three significant bond issues without a government guarantee have seen near double-digit yields, and other potential issues have been postponed in the wake of market uncertainties which were particularly pronounced during the height of concerns about Greece’s debt crisis. Nevertheless, two UAE banks have successfully tapped the Malaysian sukuk market at attractive yields, but these banks benefit from their implicit government backing. For many other borrowers, all indications are that conditions are very tight.

DW restructuring has had a long-lasting effect on the market for GCC sukuk. The amount of GCC sukuk issuance has declined from 2009 levels. Furthermore, yields on new issues have been high, at around 10 percent, and yield spreads on existing securities over the LIBOR benchmark have not returned to their November 2009 levels prior to the first DW announcement, and are higher than East Asian sukuk spreads. GCC sukuk spreads are about 120 basis points above their November level, while GCC conventional spreads are about 30 basis points lower than their November level, and global sukuk spreads are about 30 basis points above their November level (Figure 24).

The state of the sukuk market is not surprising because the DW debt standstill crystallized concerns about two aspects of sukuk financing in the GCC: (i) the lack of clarity about procedures in the event of a default, and (ii) the use of real estate as the underlying asset in sukuk transactions. Sukuk markets have been illiquid prior to the defaults and became more illiquid since then as spreads widened. Clarity on asset recovery in the event of default could boost activity in sukuk trading and lower yields.

As is to be expected, tighter supervision of banks and other financial institutions is a key outgrowth of the crisis, even though GCC financial sectors came through the crisis relatively well. GCC banks were well positioned in terms of liquidity and capital adequacy in the run-up to the crisis. Nevertheless, central banks are placing increased emphasis on stability in sources of funding. For example, the Central Bank of the UAE is placing heightened emphasis on a long-standing prudential rule requiring that, for each bank, the ratio of loans and advances to stable resources equals one. The Central Bank of Kuwait, which had taken a relatively hands-off approach to investment companies prior to the crisis, is now directly monitoring their leverage,

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18 Stable resources consist of free capital and reserves, interbank deposits with a remaining maturity of more than six months and 85 percent of customer deposits. This rule is currently binding for several UAE banks.
liquidity, and external borrowing. And the Central Bank of Bahrain has imposed limits on real estate lending as a proportion of banks’ total lending portfolio.

**Figure 24. Spreads over LIBOR on Global (SKBI) and GCC sukuk (GSKI) and GCC conventional bonds (SKBI)**

![Graph showing spreads over LIBOR](image)

Source: HSBC/Nasdaq Dubai Indices

Other than through financial markets, the debt problems in Europe are unlikely to alter significantly economic growth prospects of the GCC countries. A very small share of GCC exports goes to EU25 (Figure 25). Given the dominance of hydrocarbon exports in total merchandise exports and GDP, growth in the GCC economies will depend mostly on how the debt problem in Europe evolves, whether it spreads beyond Europe and slows down the global recovery and global demand for oil. Recent developments suggest that the possibility of contagion has become a much less likely scenario.

**Figure 25. Exposure to EU markets for merchandise goods**

![Graph showing exposure to EU markets](image)

Data source: WDI, World Bank and Comtrade.
The recent spike in wheat prices – which nearly doubled in August 2010 from their lows in June 2010 – has caught the GCC countries in the early stages of implementing food security strategies in the wake of the 2008 food price shock. Wheat reserve levels in all GCC countries except Saudi Arabia are low, at less than one month of consumption, and these countries are highly dependent on wheat imports (Table 4). According to most recent data, the GCC countries import 87 percent of their wheat consumption with all but Saudi Arabia producing no wheat domestically and relying 100 percent on imports.

The impact of the price spike on the GCC countries is expected to be negligible (Table 4). An increase of 50 percent in the price of wheat is estimated to increase the import bill by just 0.05 percent of GDP in the GCC countries. And although wheat price increases might transmit to other products, at the macro-level all GCC countries still have fiscal space to respond to increases in the food import bill (Table 5). Food price increases, however, might stoke inflationary pressures. In 2007-08 rises in wheat prices led to a rise in overall food inflation, which outpaced overall inflation. In countries like Saudi Arabia where inflationary pressures are a special problem, the recent wheat price increases will be a further cause for concern.

Table 4. Impact of a wheat price hike in GCC oil exporters

<table>
<thead>
<tr>
<th>Country</th>
<th>Net Imports (% of Consumption)</th>
<th>Wheat reserves (months)</th>
<th>Change in import bill due to a 50% increase in wheat prices (% of GDP)</th>
<th>Change in import bill due to a 50% increase in wheat prices (% of foreign reserves)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>100</td>
<td>0</td>
<td>0.05</td>
<td>n/a</td>
</tr>
<tr>
<td>Kuwait</td>
<td>100</td>
<td>0</td>
<td>0.02</td>
<td>1.12</td>
</tr>
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<td>Oman</td>
<td>100</td>
<td>0</td>
<td>0.06</td>
<td>1.41</td>
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<tr>
<td>Saudi Arabia</td>
<td>81</td>
<td>11</td>
<td>0.06</td>
<td>1.68</td>
</tr>
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<td>United Arab Emirates</td>
<td>100</td>
<td>0</td>
<td>0.05</td>
<td>n/a</td>
</tr>
<tr>
<td>GCC oil exporters</td>
<td>87</td>
<td>8</td>
<td>0.05</td>
<td>n/a</td>
</tr>
</tbody>
</table>

Source: Staff calculations based on USDA and World Bank data for 2009 GDP in ‘000s and 2008 monthly foreign reserves data.

Figure 26. US Wheat prices

The recent surge in wheat prices is unlikely to lead to a repeat of the 2007-08 food crisis. The current price shock is much smaller in magnitude than the one experienced in 2007-08 (Figure 26). This year, the world wheat crop is expected to be the third highest on record and wheat stock-to-use ratios remain well above their 30-year low, registered in 2007-08. However, the wheat market might remain sensitive to future events. Small disturbances might be amplified if stocks are drawn down this year to compensate for production disturbances in Russia and elsewhere. Price speculation, potential stockholding and other psychological responses could also have an impact on wheat prices.

Most developing oil exporters are vulnerable to oil price shocks and volatility

Developing oil exporters are expected to have benefited from increases in oil exports and oil prices in 2010 (Figure 3). Fiscal and current account balances are expected to improve (Figure 21 and Figure 22) due to an increase in oil revenue in 2010 compared to 2009. Developing oil exporters however are vulnerable to a sharp decline in oil prices. They have much more limited fiscal space than GCC oil exporters to respond to terms-of-trade shocks. Most developing oil exporters have used some of their fiscal resources to cushion the impact of the crisis in 2009 (Table 2 and Table 5).
Excessive volatility in oil prices is a major problem for these oil exporters. Oil prices dropped $20 per barrel in May 2010, before recovering to trade back close to OPEC’s target range of $75-$80 per barrel. Signaling the increasing use of oil as a mainstream asset and OPEC’s difficulties with supply management, volatility in oil markets has grown over time and is now much higher than the volatility of other commodity prices (Figure 27). Volatility of oil prices is expected to be present going forward implying that prudent macroeconomic management and oil revenue management have become more challenging and more important than ever before. Strategies aimed at diversifying the economic base and scaling up non-oil sources of growth will also help reduce the vulnerability of these countries to excessive oil price volatility.

Several developing oil exporters including Iraq and Yemen are especially vulnerable to this volatility due to their limited fiscal space (Table 5). In Yemen, where the government obtains 60 percent of fiscal revenue from oil exports and distribution, and fiscal and current account deficits were above 10 percent as a share of GDP in 2009, the goal of the government is to reduce the fiscal deficit by containing current expenditures and slashing energy subsidies, but to protect investment and priority spending. Development spending, including social transfers to the poorest households and basic education and health, are projected to increase in order to compensate the poor and vulnerable for the increase in domestic energy prices as a consequence of the energy subsidy cuts, and sustain the progress towards meeting the Millennium Development Goals (MDGs). To accelerate non-oil growth and employment opportunities, the government has put in place an incentive system for private investment in line with international best practice.

**Figure 27. Commodity volatility (measured as standard deviations in monthly prices)**

Source: Staff calculations based on World Bank data.

In Iraq, the government has aimed to contain current expenditures while protecting priority public investments, and to commit to a medium-term-oriented approach to oil revenue
management. Despite these efforts Iraq’s fiscal deficit is expected to decline only modestly and remain close to 12 percent of GDP in 2010. Agriculture is the second engine of growth in Iraq but since 2002 its contribution has eroded as infrastructure and productivity have deteriorated significantly. In addition, oil price risks are compounded by political risks in Iraq. A prolonged political vacuum or the formation of a government that excludes part of the electorate could result in a worsening of the security situation. This could also put at risk the development of new oil fields by international oil companies, which could limit projected increases in oil production, and can put at risk the growth outlook presented here.

Syria’s economy is much less vulnerable to oil price shocks than the economies of other developing oil exporters. Syria is a lot less dependent on oil exports than other developing oil exporters, and a substantial share of its non-oil exports go to the GCC, and other countries. Syria’s oil production and revenues have declined rapidly in recent years. At its peak in 2001-04 oil contributed 70 percent of total exports and approximately 50 percent of fiscal revenue. By 2008 Syria turned into a net oil importer due in part to rapidly-growing domestic demand. Given expectations that Syria’s recoverable oil reserves will be depleted by 2030, Syria has started diversifying its economic base. Its non-oil exports grew rapidly in the 2000s but so did imports of goods and services. The government is taking measures to boost exports further and tighten its fiscal stance in 2010 compared to 2009, although fiscal and current account deficits are expected to persist in the near term.

Algeria’s outlook depends on the global economic outlook and developments in oil markets, but the economy is much less vulnerable to oil price shocks compared to other developing oil exporters. Algeria is using its fiscal space to launch an ambitious public investment program over the next 4 years. This investment stimulus is $100 billion larger than its 2005-09 plan and intends to diversify the economy, promote private investment and reduce unemployment. So far the stimulus has had a positive impact on the construction, infrastructure and energy sectors. However, manufactures remain uncompetitive due to the poor investment climate and restrictive policies toward FDI.

Some developing oil exporters are also vulnerable to a food price shock stemming from the recent increases in wheat prices in response to declines in production due to droughts in a number of countries and the Russian wheat export ban. Yemen in particular stands out as the most vulnerable in the region (Table 6). It is one of the poorest countries in MENA, relies on wheat imports to meet 82 percent of its consumption, has reserves that would cover less than a month of its average monthly wheat consumption and has a weak fiscal position. A 50 percent increase in the wheat price would translate into an estimated increase in the import bill of nearly 1 percent of GDP or more than 20 percent of foreign reserves. The cuts in estimated global production between May and August are projected to have raised the domestic wheat price in Yemen by 26.1 percent. This price increase is likely to have raised poverty in Yemen by slightly more than 0.3 percentage points (Figure 28), which represents an increase in the number of the poor by an estimated 80,000 people. Because wheat production in Yemen is limited and its sales
among the poor represent less than 0.5 percent of their income, the poverty impact of higher wheat prices is dominated by the rising costs to the poor consumers who spend on average 12.5 percent of their income on wheat and wheat-related products.

**Figure 28. Some potential poverty impacts of a wheat price spike**

Source: Staff estimations, World Bank. Note: Simulations of poverty impacts in response to wheat price changes due to the decline in world wheat production over different periods and the impacts of embargoes by Russia, Kazakhstan and Ukraine. The assumption is that only half of the increase in the price would be transmitted to the domestic markets of each country.

**Table 6. Impact of a wheat price hike in developing oil exporters**

<table>
<thead>
<tr>
<th>Country</th>
<th>Net Imports (% of Consumption)</th>
<th>Wheat reserves (months)</th>
<th>Change in import bill due to a 50% increase in wheat prices (% of GDP)</th>
<th>Change in import bill due to a 50% increase in wheat prices (% of foreign reserves)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>57</td>
<td>3</td>
<td>0.4</td>
<td>..</td>
</tr>
<tr>
<td>Iran</td>
<td>9</td>
<td>2</td>
<td>0</td>
<td>..</td>
</tr>
<tr>
<td>Iraq</td>
<td>65</td>
<td>1</td>
<td>0.6</td>
<td>10</td>
</tr>
<tr>
<td>Syria</td>
<td>38</td>
<td>10</td>
<td>0.4</td>
<td>..</td>
</tr>
<tr>
<td>Yemen</td>
<td>82</td>
<td>0</td>
<td>0.9</td>
<td>20</td>
</tr>
<tr>
<td>Developing oil exporters</td>
<td>37</td>
<td>3</td>
<td>0.2</td>
<td>..</td>
</tr>
</tbody>
</table>

Source: Staff calculations based on USDA and World Bank data for 2009 GDP in ‘000s and 2008 monthly foreign reserves data.

Iraq also appears to be vulnerable although slightly less than Yemen largely due to sourcing a smaller share of its wheat consumption from abroad (Table 6). Algeria reacted to the Russian wheat export ban by purchasing extra wheat on the spot market. The impact of a 50 percent price hike on its import bill would however be very small. Syria seems to be most prepared to face the jump in wheat prices as its wheat reserves can cover 10 months of consumption. In addition,
Syria is far less dependent on wheat imports than other developing oil exports. Iran is not vulnerable as it imports only a tiny share of its annual consumption of wheat.

**Figure 29. Non-oil merchandise exports to EU25**

Data source: WDI, World Bank and Comtrade.

**Figure 30. Non-oil merchandise exports to Southern Euro Zone**

Data source: WDI, World Bank and Comtrade.

A possible future slowdown in Europe, triggered by fiscal compression in the highly indebted parts of the EU and combined with financial sector instability, is expected to have marginal effect on developing oil exporters as their shares in non-oil exports to the EU25 and the Southern Euro Zone

are small and their financial sectors are not exposed to global financial markets (Figure 29 and Figure 30). Only one country – Algeria – appears to be highly exposed to the EU25 through trade. Its exports to the EU25 account for more than 50 percent of its merchandise exports. This high exposure is due mostly to oil exports, which can easily be redirected to other markets. Among developing oil exporters, Syria is the country with the highest non-oil trade exposure to the EU25 market. Still with a non-oil export share to the EU25 of around 8 percent, the impact on Syria’s economy is expected to be small.

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19 Southern Euro Zone includes Portugal, Italy, Greece and Spain.
Oil importers’ recovery depends on developments in key markets

Oil importers weathered the effects of the global economic and financial crisis better than other MENA countries, but developments in Europe and still relatively anemic credit growth in some countries (Figure 31), are expected to have dampened growth in 2010, especially the growth of those countries with strong links to EU markets (Figure 3). Even though at present a smooth resolution of the fiscal issues in high-income Europe is the most likely scenario, oil importers with strong EU links are likely to face serious repercussions of the expected significant fiscal contraction in the heavily-indebted high-income European countries (EU-5), and the expected slow growth in the EU. The effects would come through the balance of payments, reflecting the impacts on trade, remittances and FDI flows.

Figure 31. Credit growth in oil importers

[Diagram showing credit growth in oil importers]

Source: Datastream.

Oil importers with EU links have the greatest trade exposure to the highly-indebted countries in the Southern Euro Zone (SEZ) and the second highest trade exposure to the EU25, after ECA (Figure 29 and Figure 30). The share of these countries’ exports to the SEZ exceeds ECA’s share to the SEZ by such a wide margin that even these countries’ lower openness does not diminish the impact of this exposure on income. In this group of countries, Tunisia is the most vulnerable to shocks in the EU25 and the SEZ (Figure 29), followed by Morocco and Egypt. How hard these countries are hit depends on the extent of the fiscal contraction in the EU, and how quickly they can shift sales to markets outside the EU.

In addition, two of the oil importers with EU links – Morocco and Tunisia – are much more dependent on the EU for their remittance flows than Egypt and the rest of the oil importers. According to data for 2000, 72 percent of Morocco’s emigrants and 75 percent of Tunisia’s

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20 These include Portugal, Italy, Island, Greece and Spain.
migrants were located in the EU27, compared to just 10 percent for Egypt’s. Demand for migrants in the GCC countries is expected to grow at a much faster pace than that in the EU as the GCC countries have fiscal space and long-term investment plans that will fuel demand for imported labor, while fiscal space in EU is extremely limited and many large EU members have plans for large fiscal contractions. According to the IMF fiscal consolidations in the range of 9.2 and 4.8 percent of GDP, respectively, are needed in Greece and Italy to reduce the debt burdens in these countries to 60 percent of GDP.

In general, the oil importers are a lot less likely to be affected through the financial channel as their financial sectors are much less integrated into the EU and global financial markets than ECA’s financial sector. Indeed according to a recent report prepared by the Arab Monetary Fund and the World Bank, a sizable share of capital flows in MENA is intra-regional suggesting that the MENA countries have a buffer insulating them to some degree from turmoil in global markets, as opposed to other regions that experienced sudden stops due to flow reversals from the developed world.

In anticipation of a prolonged slowdown in the EU, most oil importers with strong EU links extended or implemented new fiscal stimulus. Tunisia has chosen to maintain its expansionary fiscal policy to support growth and delay fiscal consolidation until at least 2011, as well as initiate additional reforms aimed at improving the business climate and foster foreign investment. The government remains vigilant of the situation in the Euro Zone and has set aside in the budget an unallocated expenditure cushion of around 1.5 percent of GDP that could be used if the situation prevailing in European partner countries worsens in the second half of 2010.

The government of Morocco implemented several measures to help affected firms cope with the decline of external demand well before recent months, but in June 2010 the government decided to extend the implementation of the stimulus package until the end of 2010. The support costs 0.2 percent of GDP and includes a number of measures, including the provision of guarantees on working capital loans; finance for promotion campaigns and market surveys; debt rescheduling; insurance coverage for exports; training and logistics in partnerships with business associations; removal of some types of import restrictions; and public contribution to the payment of social insurance by employers in eligible categories. Specific programs have been designed for firms operating in Morocco’s tourism sector and for the remittances and investments of Moroccan workers residing abroad. As of June 2010, 443 firms requested social insurance relief, 129 firms benefited from loan guarantees, 134 benefited from training. The majority of firms that sought these types of support operate in the textile industry, while the remaining are in automotive

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22 In Egypt, the fiscal deficit is expected to have widened due to the economic slowdown and the fiscal stimulus implemented by the government of Egypt during the past fiscal year from July 2009 to March 2010. Although the stimulus package adds up to 1.5 percent of GDP, 40 percent of it was spent in the fourth quarter of the fiscal year. At the time this report was written the government had no plans for additional fiscal stimulus packages. Furthermore, the government plans fiscal measures aimed at reducing the fiscal deficit to 3 percent of GDP over the next 5 years.
equipment and electronics sectors. In addition, the government continues to extend tax relief, wage increases and social expenditures for selected groups.

These measures, along with a much higher public investment program kept domestic demand high, but those expenses related to Morocco’s food and fuel subsidy system constitute a key macroeconomic risk in the event of an unexpected increase of oil and food prices. With the recent draughts in a number of countries and the wheat export ban in Russia, the risk of a food price hike has become a reality for all oil importers, and memories of violent protests during 2007-08 have come to the fore. All oil importing countries are vulnerable to the effects of a sharp increase in wheat prices. Egypt, Jordan and Lebanon rely heavily on wheat imports, especially from Russia, and the grain harvests in Morocco and Tunisia are expected to be smaller this year compared to last year. To head this off Egypt – the world’s biggest importer of wheat, as well as Tunisia and Jordan, reacted quickly by buying extra wheat on the spot market at higher prices than those prevailing before the ban announcement. Egypt and Morocco have the largest estimated monthly imports, and therefore face the largest increases in the import bill as a percent of monthly foreign reserves (Table 7).

Table 7. Impact of a wheat price hike in oil importers

<table>
<thead>
<tr>
<th></th>
<th>Net Imports Wheat reserves</th>
<th>Change in import bill due to a 50% increase in wheat prices</th>
<th>Change in import bill due to a 50% increase in wheat prices</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(% of Consumption)</td>
<td>(months)</td>
<td>(% of GDP)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(% of foreign reserves)</td>
</tr>
<tr>
<td>Egypt</td>
<td>51</td>
<td>3</td>
<td>0.5</td>
</tr>
<tr>
<td>Morocco</td>
<td>42</td>
<td>2</td>
<td>0.4</td>
</tr>
<tr>
<td>Tunisia</td>
<td>56</td>
<td>4</td>
<td>0.4</td>
</tr>
<tr>
<td>Jordan</td>
<td>93</td>
<td>4</td>
<td>0.4</td>
</tr>
<tr>
<td>Lebanon</td>
<td>83</td>
<td>0</td>
<td>0.1</td>
</tr>
<tr>
<td>Oil importers</td>
<td>51</td>
<td>3</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Source: Staff calculations based on USDA and World Bank data for 2009 GDP in ‘000s and 2008 monthly foreign reserves data.

Strong domestic demand supported growth in all oil importers. In Egypt economic activity in 2010 is expected to average 5.1 percent, driven by private consumption and investment, on the demand side, and strong expansions in construction, services and non-oil manufacturing, on the supply side. By contrast, Morocco and Tunisia – the two economies most heavily dependent on trade and remittances from Europe – are expected to grow at a much slower pace than Egypt and other oil importers. On the demand side, growth in Morocco is expected to be driven by expansion of consumption and private investment, as the rebound in exports will not offset the surge in imports. On the supply side, growth is expected to be driven by an expansion of industry and services, while agricultural output is expected to have contracted following an exceptionally successful year. In Tunisia, internal demand is driving the recovery too as import growth has

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23 See statistical appendix for country-specific macroeconomic information.
outstripped export growth due to a strong inflow of imports of capital and intermediate goods. Manufacturing output expanded, while most services expanded only modestly.

The growth outlook for oil importers with GCC links continues to be strong largely because of the high expected growth in Lebanon, where credit to the private sector grew at the highest pace among oil importing economies (Figure 31). Strong regional demand fueled by oil wealth and inflows of capital into Lebanon’s real estate and banking sectors – considered a safe haven in times of crisis by the Lebanese Diaspora and some GCC nationals – has been driving the boom in the construction and trade sectors. Sectors producing tradable goods and high value-added services however remained weak due to structural bottlenecks in infrastructure, and the loss in competitiveness associated with the continued real exchange rate appreciation (Figure 32), driven by the massive inflows of financial resources into the Lebanese economy.

**Figure 32. Ridrik’s real undervaluation index for Lebanon**

Management of large financial inflows has been one of Lebanon’s key macroeconomic challenges. In 2009, deposits in the banking sector increased by 23 percent – an increase equivalent to 54 percent of GDP, and by 4.5 percent between December of 2009 and June of 2010. In addition to the appeal of Lebanon as a safe haven, the country has attracted financial resources by offering large spreads between interest rates on deposits in Lebanese banks and international rates. The spreads widened substantially in the course of the financial crisis, but in 2010 have narrowed down. The Central Bank of Lebanon has already initiated a new interest rate policy aiming to gradually reduce the spread on depositor’s rates between Lebanon and the international market. The spread has already declined by 81 basis points between October 2009 and June 2010. This was a key factor behind the deceleration of foreign inflows and of deposits in the first half of 2010.

Limited fiscal space, defined by large twin deficits and government debt above 145 percent of GDP, is a key source of long-term vulnerability. It constrains the ability of the government to
respond to unexpected adverse shock, including the one related to the recent wheat price spike. Most importantly, over the long-run, a failure to implement structural reforms aimed at increasing the competitiveness of the economy and addressing the fiscal risks could erode further the country’s growth outlook and debt servicing capacity.

Annual growth in Jordan is expected to increase relative to 2009 but remains far below its pre-crisis level as credit to the private sector expanded at the lowest pace among the oil importing countries in the region (Figure 31). Jordan continues to rely on remittances and financial flows from the GCC countries, but its exports have become a lot more dependent on the US and Asian markets and a lot less dependent on the EU and the GCC (Figure 33).

The government has decided to tackle Jordan’s main source of vulnerability – its limited fiscal space, by tightening the fiscal policy stance in 2010 and adopting measures to rationalize government consumption by downsizing current spending and capital spending. At the same time the government has taken measures to stimulate investment and economic activity. These measures include income tax exemptions on export activities, reduction in land and property registration fees, and the provision of public lands for production, tourism and services projects.

Figure 33. Jordan has made a dramatic shift in export destinations

Source: COMTRADE data.

Hoping to encourage lending to the private sector, the government has started providing guarantees to SME’s borrowing for productive projects. The government has also approved a new debt strategy emphasizing further reliance on external borrowing in order to reduce any potential crowding out effects of government borrowing. For this purpose, the government has announced the first Eurobond issuance in the history of Jordan. This issuance is expected to serve as a benchmark for future operations.

A pronounced global economic slowdown in the second half of the year is the key near term threat to Jordan’s outlook. Export growth could slow down as a result of a more rapid global economic slowdown, while negative developments in the Gulf countries, including in their financial sectors, may lead to a drop in remittances and capital inflows. If financing dries up further, the contraction of real GDP and the increase in unemployment would be more
pronounced than over the coming year since Jordan has limited fiscal space to extend additional stimulus. Weakening political support for the medium term reform agenda adopted by the government is also a risk that the government will need to take into account as it decides to balance the need for stimulus with the need to improve its fiscal stance.

The main secondary effect of the crisis in Djibouti was the significant slowdown in FDI flows as a consequence of the financial difficulties in Dubai. Transport and port-related activities were areas of strength, but growth is expected to decelerate to 4.5 percent in 2010 on weakness in agriculture and manufacturing. With limited fiscal space – including very small reserves – the government has not extended any fiscal stimulus this year. Instead, the government adopted a fiscal stability plan in addition to a multiyear payment schedule to partly cover domestic payment arrears accumulated in 2009.
<table>
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<td><strong>Oil Exporters</strong></td>
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<td>GCC Oil Exporters</td>
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<tr>
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<td>-8.7</td>
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<td>4.0</td>
<td>32.5</td>
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<td>13.4</td>
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<td>13.4</td>
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</tr>
<tr>
<td><strong>Developing Oil Exporters</strong></td>
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</tr>
<tr>
<td>Algeria</td>
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<td>2.1</td>
<td>2.9</td>
<td>4.1</td>
<td>-3.9</td>
<td>-1.5</td>
<td>0.3</td>
<td>1.5</td>
<td>13.7</td>
<td>-0.4</td>
</tr>
<tr>
<td>Iran, Islamic Republic of Iraq</td>
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<td>1.4</td>
<td>1.5</td>
<td>7.7</td>
<td>-6.6</td>
<td>-8.0</td>
<td>-7.0</td>
<td>-3.4</td>
<td>20.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Iraq</td>
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<td>4.2</td>
<td>1.6</td>
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<td>-14.2</td>
<td>-12.2</td>
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<td>-25.7</td>
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<td>Libya</td>
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<td>2.1</td>
<td>5.4</td>
<td>246</td>
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<td>Syrian Arab Republic</td>
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<td>5.0</td>
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Source: World Bank data