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WHAT CAN MENA GOVERNMENTS EXPECT IN 2016?

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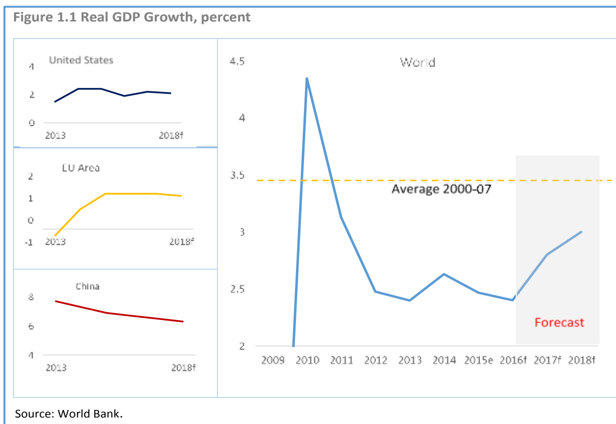
Introduction: This year will be the fifth consecutive year with global growth below its long-term trend of 3.5% observed during 2000-07, standing at last year's 2.4% (Figure 1.1). This is 0.5% below January's forecast. Many countries are plagued by recession, several others suffer from terrorist attacks and refugee crises, while some are mired in civil wars together with extremely uncertain commodity markets, especially oil. The result has been lower potential output and investment, and weaker global demand. In advanced economies, real growth remained uncomfortably low, almost 1% below the long term average from 2000 to 2007.

Figure 1.1 Real GDP Growth, percent



Source: World Bank.

Growth in the U.S., the EU and Japan is expected around 1.7%, 0.5% slower than expected in January. Already weak UK growth is expected to fall in 2016 via the "Brexit effect"– likely through investment contractions. This is expected to hamper medium term UK and EU growth. Prospects for a rebound are dim, as confidence in services and manufacturing is deteriorating. Emerging markets have also slowed despite a decade of fast growth. China's growth is projected at 6.7 % in 2016, down from 7.7 % in 2013. Brazil and Russia are still in recession. Oil exporters face by persistently low oil prices. Nigeria's and Angola's 2016 growth will fall below 1% from almost 3% last year. Among MENA oil exporters, growth in GCC countries is expected to fall sharply with Saudi Arabia's declining to 1% in 2016 from over 3 % last year.

The global outlook is expected to remain tepid in the short term and growth expected below 2000-07's average for the seventh year. The World Bank projects this 2.8% in 2017, nearing 3% in 2018. The slight improvement in 2016 is due to some advanced economies, particularly the U.S. expected to grow 1.9% in 2018. Recessions in Russia and Brazil are expected to bottom out with growth turning positive in 2017. Oil markets are expected to remain over-supplied and, in the absence of a pick-up in demand, prices could be around $53-$60 by the end of the decade.

Risks to these projections are mostly downside, mainly geopolitical risks that could heighten uncertainty and dampen investment and growth. Decelerations in major emerging market economies and rising private-sector indebtedness could increase vulnerability in some of these countries. Other major risk factors are a potential EU slowdown, particularly the U.K. after Brexit, and persistent low oil prices that could further destabilize the outlook for oil-exporters.

Oil Market Developments: The oil market has entered a new normal of low oil prices. A World

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Bank study (Devarajan and Mottaghi, 2016) finds that oil markets are expected to work through their current oversupply and rebalance in early 2020 at market-clearing prices close to the marginal cost of US shale oil producers. Oil prices are likely to be in the $53 - $60 a barrel range since global stockpiles are expected to remain well above historical averages. Iran, Kuwait, United Arab Emirates (UAE) and Iraq are increasing production. Russia and Saudi Arabia, among others, are producing at their highest levels since January 2016; and Libya has lifted restrictions on ports unlocking 300,000 barrels a day of supply. In August 2016, OPEC production of crude oil increased by 40,000 barrels per day over July 2016, with Saudi Arabia's output reaching a record high.

To lift prices, OPEC members agreed to freeze oil output at September meeting in Algiers to about 32.5 to 33 million barrels a day. This is about 0.7% to 2.2% below current output. Iran, Nigeria, and Libya is allowed to produce at its maximum level but members will wait for the November meeting to settle how the overall cut will be distributed among the members. Expectations of a production cap led to a slight rebound of oil prices to the tune of $3 a barrel (Brent crude) but failed to lift prices beyond that. The main reason lies in high inventories and uncertainties over whether a production freeze could affect world's oil supply, for example from Russia and Mexico. OPEC members control less than half of world oil production. If cap deal fails, oil prices could fall further and if holds, prices will not increase beyond $52 in the fourth quarter of 2016 according to UBS. Historical patterns show that OPEC agreements have failed to work because members do not adhere to their quotas and that Shale oil producers will enter the market by opening up idled wells and rigs when prices start to rise beyond $50 a barrel (See World Bank Study above). While the overall impact of the recent agreement on oil prices is left to be seen, we expect oil prices to settle around $53-$60 by end of decade when markets will rebalance.

MENA governments buoyed by high oil prices of the past decade (2000-10) embarked on a vast but untargeted social program including food and fuel subsidies, public sector jobs, free health and education and handouts in return for muted citizen voice and limited accountability. With oil prices falling, the picture has changed dramatically. MENA countries dependent on oil for most of their exports are facing a major and long-standing terms of trade shock. In almost all cases, oil prices have remained well below the prices needed to balance budgets, resulting in large fiscal and external account deficits. OPEC members' net oil export revenues in 2015 was $404 billion, 46 % lower than in 2014 according to U.S. Energy Information Administration (EIA) estimates. Based on EIA price forecasts, OPEC revenue is expected to fall to $341 billion in 2016 before rising to $427 billion in 2017.

In Africa, Nigeria, which relies on oil for 70% of its fiscal revenues, needs a price of $123 a barrel to balance the budget. The situation is even worse for those countries whose primary market for crude oil exports is the U.S., as the shale oil boom has wiped out their exports.[2] These include Angola, Gabon and Nigeria, all facing a sharp drop in exports in addition to lower oil prices. The twin effect of lower oil prices and dropping demand from a major importer are reducing their fiscal space. In Latin America, Venezuela and Brazil have also been hit hard by the crash in commodity prices, pushing their economies into their deepest recession. Oil exporters in the MENA region are facing the same problem. Libya and Algeria have been hit by lower oil prices and lower oil demand from the U.S., their major oil trading partner. Some of them have been drawing down their reserves and turning to capital markets. Estimates show that Libya lost two-thirds of its reserves between 2013 and 2016, equivalent to $75 billion. Algeria lost $86 billion, and Iraq $29 billion during the same period.

MENA Economies in 2016 and beyond: This year appears to be one of the toughest as MENA governments face serious policy challenges. The biggest for oil exporters is managing their

[2] Though oil is presumed as a commodity that is traded freely, constraints such as crude grade, structure of refineries in oil importers and market share could limit a country's trade prospects with the rest of the world, making them vulnerable to demand shocks.

finances and diversification strategies with oil below $45 a barrel. Fiscal consolidation in a difficult sociopolitical environment and spillovers from conflicts is also creating challenges for oil importers. Real 2016 GDP growth in MENA is projected to fall to its lowest level since 2013, 2.3%, lower than last year's growth by 0.5% and about 1% lower than predicted in April 2016.

MENA's weak growth is partly due to austerity measures such as cutting capital and current spending to counter lower fiscal revenues from cheap oil. Over $20 billion in projects may be canceled in Saudi Arabia in 2016. Ongoing conflicts in Syria, Iraq, Libya and Yemen are ravaging these economies while refugees drain fiscal space in neighboring countries. Also, private-sector growth has been slowing down, preventing absorption of the large of number of unemployed. The latest labor market data show that 2016's unemployment rate remains high in Egypt, Iran, Iraq, Jordan, Morocco and Tunisia.

We expect regional growth to improve to 3.1 and 3.5% in the next two years, as governments' reform and diversify away from oil. The measures include eliminating fuel subsidies, reducing public-sector jobs and wage bills, privatizing State Owned Enterprises, and diversifying fiscal revenues away from oil through higher direct and indirect taxes.[3] These reforms are expected to transform at least part of the old social contract and enhance economic efficiency. The 2016 regional fiscal deficit is expected to increase to 9.3% of GDP, up 0.5% from 2015. The 2013 regional fiscal surplus of $63 billion is expected to become 2016's deficit of $320 billion. GCC countries, developing oil exporters and oil importers are expected to face significant deficits in 2016-2018 but with prospects of reducing them afterwards.

Growth in MENA oil exporters is expected to remain subdued at 2.3% in 2016 due to a sharp drop in GCC growth. If OPEC's September meeting fails to cap production, oil prices will fall further. Oil exporting governments are now treating the price decline as permanent and taking tough measures including spending cuts, lowering growth in the non-oil sectors. Non-oil growth in Algeria and Oman is down to 3.7% in 2016 compared to 2015's 5 and 7% respectively.

GCC reliance on oil has increased over the past decade, making it difficult to cope with low oil prices (Table 1.2). In 2016 GCC growth is expected to fall to 1.6%, less than half the 2015 rate. GCC countries are projected to grow around 2% this year and rebound prospects are weak unless reforms occur. Fiscal and external account 2014 deficits are expected to increase to 10.1 and 5% of GDP, equivalent to $155.4 and $77.1 billion respectively, but they could improve slightly over the projection period.

Table 1.2 GCC Oil Dependency

	2000-05	2006-10	2011-14
Oil export revenues as % of total exports of goods and services			
Bahrain	58.7	60.5	65.1
Kuwait	82.7	80.5	87.6
Oman	76.9	69.4	64.3
Qatar	88.5	85.9	88.9
Saudi Arabia	83.4	88.1	83.0
United Arab Emirates	45.0	38.7	32.6
Fiscal oil revenues as % of total fiscal revenues			
Bahrain	71.7	82.2	87.2
Kuwait	72.7	79.2	83.6
Oman	83.4	83.4	88.7
Qatar	90.5	88.3	90.7
Saudi Arabia	82.8	88.3	90.3
United Arab Emirates	60.2	65.1	69.9

Source: IMF.

Saudi Arabia's economy is expected to grow at 1% in 2016, much lower than expected in April 2016. The fiscal deficit remains high and is expected to stay elevated in later years. Qatar's 2016 growth, the GCC's best performer, is expected to drop to 2.1%, lower than forecast earlier and half the growth rate of last year while its two decades long fiscal surplus is expected to become a deficit estimated at 12.1% of GDP in 2016 with the prospect of remaining high in 2017 and 2018.

Responding to low oil prices GCC countries tightened fiscal policy, used foreign reserves and utilized debt markets to finance deficits. They

[3] Saudi Arabia is planning to privatize its postal system by early 2017 and considering new income taxes on expatriates. The Kuwaiti government is considering privatization of non-oil production units of Kuwait Petroleum Corporation.

have issued $88 billion in sovereign bonds or government-related enterprise debt to plug budget deficits. They are looking to diversify fiscal revenues away from oil through a Value Added Tax. The outlook is expected to improve slightly in the projected period as reforms and diversification measures are taken but still weak compared to the pre-2001 boom era.

Lower oil revenues and the slowdown in economic activity have lowered GCC financial outflows. Data from the Saudi Arabian Monetary Agency (SAMA) shows remittances fell 19% in July 2016 compared to 2015 i.e. $640 million. Foreign transfers declined by 35% compared to June 2016, from $4.21 billion to $2.74 billion, their lowest level since February 2013. The decline in outflows to the region have seriously affected receiving MENA oil importers.

The outlook is better but still weak in developing oil importers who were hit by terrorism, conflict spillovers, and lower GCC financial outflows. Growth is expected at 2.6% in 2016 (3.4% last year) before improving to 3.5% on average for the projection period. Fiscal and external account deficits are expected to remain high. Egypt and Tunisia face lower tourism revenues, remittances and financial inflows with tighter fiscal and monetary policies with less growth and higher inflation this year. Egypt's urban inflation was 15.5% in August, up 2% over July. There are expectations that the Egyptian pound will be further depreciated due to foreign currency shortages, which could accelerate inflation. Morocco's heavily agriculture reliant economy, will see 2016 growth weakening to 1.5% compared to 4.5% last year. The agricultural sector poses the greatest risk to the Moroccan economy with estimated negative growth of 9.5% this year due to drought versus positive growth of 2% in other sectors. Growth in Jordan and Lebanon will be subdued throughout the projection period due to spillovers from conflicts in Syria and Iraq and lower remittances given a sharp GCC slowdown.

The economies of several developing oil exporters in the region are doubly hit by the slump in oil prices and conflict. Average growth for the group is expected to turn to 3.4% in 2016 from below 1% last year, solely due to expectations of Iran and Iraq producing more oil. These countries face major fiscal and external imbalances due to the high cost of war, low oil prices and trade declines. Iranian 2016 growth will be 4.3%, four times last year's, due to oil output reaching pre-sanctions levels. Iranian oil production increased to 3.7 million barrels a day, doubling its sanctions era level.

In this group Syria, Iraq, Libya and Yemen are mired in conflict. Syria's war has ravaged the economy, output has shrunk 50-60%, the Syrian Pound has lost 80% of its value, population has fallen by 23%, 12.4 million are displaced – including 7.6 million internally and 4.8 million externally. Education is on hold for many children inside and outside the country. The 18-month civil war in Yemen has resulted in 10,000 civilians killed, 2.8 million people displaced and most Yemenis suffering from shortages of food, water, sanitation and healthcare. Safety nets in Yemen have significantly deteriorated. It is estimated that more than 85% of Yemenis are living in poverty and the situation is worsening. In addition to humanitarian costs, the World Bank estimates that reconstruction will cost over $15 billion.

All in all, if MENA economies could take advantage of the opportunity provided by low oil prices to implement reforms that are planned, it could improve economic performance in the region.

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