**RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS**

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**Introduction:** This MENA K&L Quick Note summarizes the first section - “Recent Economic Developments and Prospects” - of a longer report entitled “MENA Economic Monitor: Towards a New Social Contract” and provides an overview of global and regional economic developments.

**The Global Outlook:** The global economy will grow 3 to 3.5% this year, 0.5% higher than last year’s 2.6%, and surpassing the average growth rate of 3.1% during 2000-08, before the financial crisis. Behind the recent recovery are better than expected growth in the U.S., the U.K., select Euro area countries, and—most important—the sharp fall in oil prices. Low oil prices have contributed in net terms to the global recovery, but the impact varies across countries, particularly between oil exporters and importers. Lower oil prices have contributed in net terms to the global recovery, but the impact varies across countries, particularly between oil exporters and importers. Lower oil prices have increased oil importers’ real GDP growth, improved trade balances and - to the extent that they subsidize fuel-eased fiscal pressures. The magnitude of the gains will depend on, among other factors, the share of oil imports in GDP. Oil exporters (including Russia) could see a sharp fall in growth deteriorating fiscal balances with significant regional consequences (Mottaghi, 2015).

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

The oil market is witnessing a sharp recession. After falling by more than 60% since their peak in June 2014, oil prices (Brent crude) were fluctuating at around $50 per barrel in late March. Oil prices are extremely volatile and notoriously difficult to predict, but the futures market points to a Brent crude price of about $61 for delivery in December 2015, increasing to $67 for December 2016. The pace of growth in oil prices is so slow and unlikely to hit $100 or above any time soon. Weak economic recovery in the Euro area and moderate growth in China and India, the demand to absorb continued excess supply.

**MENA Regional Outlook:** Low oil prices have significantly affected the economies of the oil exporters- accounting for 2/3 of the countries in the region. The rest of the countries, oil importers are benefitting from the low oil prices helping to keep the regional growth average between 3.1% and 3.3% according to the World Bank and Consensus Forecasts respectively (Figure 1). Economic growth in MENA is expected to continue on the same path in 2016. If the security situation in Libya improves and oil exports increase, the regional average could surge to 4% to 5% in 2016.

**Figure 1. World Bank and Consensus Forecasts for MENA**

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

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2 [www.focus-economics.com](http://www.focus-economics.com)
Several other reasons are behind the tepid growth in the region; prolonged conflict and political instability in Syria, Iraq, Libya and Yemen; and the slow pace of reforms that is standing in the way of a resumption of investment. The continuation of this situation will significantly hurt the overall unemployment rate, now standing at 12%, and poverty in the region. Fiscal deficits are also on the rise, leaving the region with a deficit of 8% of GDP in 2015, after 4 years of surpluses (Figure 2). At this point, the overall economic outlook for MENA remains tepid, though longer term forecasts, if the regional conflicts subside and necessary reforms are implemented, could be more optimistic.

Figure 2. Regional Economic Stance, Before and After Falling Oil Prices

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth Rate</th>
<th>Fiscal Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015 (before falling oil)</td>
<td>2.3%</td>
<td>-6.7%</td>
</tr>
<tr>
<td>2015 (after falling oil)</td>
<td>0.7%</td>
<td>-5.3%</td>
</tr>
<tr>
<td>GCC</td>
<td>2.6%</td>
<td>-4.5%</td>
</tr>
<tr>
<td>Developing Oil Importers</td>
<td>3.4%</td>
<td>-3.4%</td>
</tr>
</tbody>
</table>


**MENA’s Oil Exporters:** The group of oil exporters are estimated to grow by around 2.8% in 2015 with growth stagnating in developing oil exporters. Growth for the group of high-income Gulf Cooperation Council (GCC) oil exporters is estimated to range between 3.2 to 3.8% in 2015, predicted by Consensus Forecasts and the World Bank respectively, about 0.5% point lower than last year. The World Bank estimates that growth in developing oil exporters in MENA, pinched by cheap oil, is expected to drop to 0.9% compared to 6.3% prior to the oil collapse. The impact on fiscal savings from the oil price collapse has outweighed the uptick in consumption due to a spending increase.

**Developing MENA Countries:** Growth in developing MENA countries as a whole will stay at 2% in 2015. While still low, this figure is about 0.5% point higher than the previous year, owing to better-than-expected growth in oil importers—estimated at 3.9 and 4.1% in 2015 and 2016, respectively, about 1.5% points higher than last year. Furthermore, fiscal deficits are expected to improve in the group of oil importers in 2015, partly due to fiscal savings resulting from low oil prices.

**Economic Growth and the Gulf oil exporters:** Economic growth in the group of high income Gulf states is plummeting\(^3\). Growth in Saudi Arabia is set to decline to 4.6% in 2015, after a period of high growth. Fiscal deficits are mounting as cheap oil has severely affected oil revenues. The World Bank has estimated that Gulf countries could lose about $215 billion in oil revenues, equivalent to 14% of their combined GDP, in 2015. Saudi Arabia, UAE, Kuwait and Qatar have managed to withstand the worst effects of low oil prices through their large reserves, Bahrain, and Oman have less of a cushion. Even those countries with large buffers are starting to feel the pressure on their fiscal balances. The large fiscal surplus in Saudi Arabia is disappearing, leaving the country with double-digit fiscal deficits in 2015 and the following year, for the first time in a decade. Saudi Arabia and Kuwait continue their expansionary fiscal policies, financed partially by their large foreign assets. Abu Dhabi’s sovereign wealth fund, believed to be worth $800 billion, could cushion the impacts of low oil prices on its economy. But these remedies cannot last forever since fiscal deficits are rising. In December 2014 alone, alongside oil prices, Gulf stock markets plunged, losing $16 billion in three weeks.

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

**The Developing Oil Exporters:** Among developing oil exporters, Iran’s economic prospects are

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\(^3\) Growth in Kuwait is expected to rise slightly in 2015 due to moderate increase in oil production and acceleration in growth of the non-oil sector.
contingent on the timing of lifting of sanctions following a nuclear agreement framework that was reached in early April, as well as on fluctuations in oil prices. Under this agreement, which is expected to lead to a final deal by end of June, a comprehensive lifting of sanctions is envisaged. This could significantly boost economic activity and accelerate growth to an estimated 5% in 2016\(^4\), while improving Iranians’ living conditions. Growth is estimated to continue on the same path for the following year. In this case, however, the Iranian economy will face a massive oil windfall, which if not managed carefully, could lead to an oil boom, an over-valued real exchange rate and a loss of competitiveness of the non-oil tradable sector, a major source of foreign revenues. It could also lead to an increase in unemployment in tradables, as the oil sector does not create many jobs. In the case of continued status quo, the Iranian economy is expected to slow down to 0.6% growth in 2015 with attendant consequences for unemployment, fiscal deficits and inflation. In this setting, the government has adopted a contractionary fiscal policy that is reflected in the new budget. Capital spending is prioritized, the rich are to be excluded from the current cash transfer system, and an increase in gas prices by 5% should keep the budget deficit at 3.4% for 2015 and 2016 respectively.

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

For those countries already in conflict, Iraq -- Libya, Yemen, and Syria -- economic prospects are grim. The ISIS insurgency and large military expenditures have hit the Iraqi economy hard. Growth is expected to turn negative in 2015 following a contraction of 0.5% in 2014 due to the decline in economic activity in the areas occupied by ISIS. The fiscal deficit as a %age of GDP is estimated to double and reach 10.6% due to high military expenses and the recent government decision to keep fuel subsidies intact, together with low oil prices\(^5\). Current spending is high with wages and subsidies, particularly for the power sector, constituting almost 70% of government expenses. The public sector accounts for more than 50% of Iraqi employment, leaving little room for investment spending. Public investments are declining and most capital investments are disrupted because of the fiscal shock. Libya is in recession. In addition to the impact of cheap oil, the violent conflict has interrupted oil exports, a major source of government and external revenues. The economy is estimated to have contracted by 24% in 2014, following a contraction of about 14% in 2013. While there are signs that the political conflict is easing and two oil ports have reopened, a rapid recovery in crude oil supply is unlikely and growth will remain low in 2015. The budget deficit is estimated at more than 40% of GDP in 2014 and 2015. The major forces behind this alarming budget deficit are, in addition to lower revenues due to low oil prices, the existing wage bill and subsidies estimated at 70% of expenditure; capital spending has fallen to a fifth of its pre-revolutionary period. Libya is counting on its large foreign reserves, which have declined dramatically. Estimates by the Central Bank of Libya show that foreign reserves stood at $85.5 billion in December 2014, a 40% decline from July 2013.

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

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\(^4\) The P5+1 and Iran issued a joint statement on general points of agreement on April 2nd. All parties will continue negotiations aimed at achieving a comprehensive accord in June.

\(^5\) State-supplied gasoline is currently priced at Dinar 450 ($0.387/liter) in Baghdad, compared with Dinar 1,000/liter in private filling stations.
stable coastal areas of an expanded industrial zone. While exports have begun to increase for the first time since 2011, investment remains stalled due to continued violence and political instability.

**MENA Oil Importers**: Lower oil prices together with some policy reforms, notably in Egypt and Morocco, have helped the economies of oil importers recover, albeit slowly. In fact, this group of countries are helping to maintain MENA’s overall growth at 3%. In Egypt, low oil prices have helped contain domestic inflationary pressures triggered by the subsidy reforms introduced in July 2014. Some estimates show that low oil prices could reduce the fiscal deficit by about 2% of GDP in 2016. At the Economic Development Conference in mid-March, Egypt raised about $36.5 billion, with the Gulf countries pledging a package worth $12.5 billion. All of these could help boost growth in the coming years, albeit with some delays if the pledges do not all materialize. Tourism and manufacturing posted double-digit growth in 2014. The Suez Canal and construction also saw strong growth in 2014, which should continue in 2015. Growth is estimated to surpass 4% in 2016, close to growth rates observed in the pre-revolutionary period.

Economic recovery in Tunisia has been slow partly due to weak external demand from the Euro area’s anemic economic stance and slowing domestic demand. The World Bank estimates a moderate increase in growth of about 0.5% in 2015, to 2.6% and gradually reaching 3.4% the following year. This is likely to happen on the back of a moderate rebound in the manufacturing and tourism sectors (although the recent attack on the Bardo Museum has affected tourist arrivals). Low oil prices together with fiscal consolidation have helped reduce the fiscal deficit from 6.8% in 2013 to 4.2% in 2015, close to growth rates observed in the pre-revolutionary period.

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

**The Palestinian Territories**: West Bank and Gaza, are still feeling the brunt of the 2014 Gaza war and a precarious political and security situation. After 7 years of continuous growth, the Palestinian economy contracted by 0.8% in 2014 with a sharp contraction of 15% in Gaza. The West Bank economy, on the other hand, experienced 4.4% growth, largely driven by investments in construction. As a whole, the Palestinian economy is expected to grow by less than 1% in 2015. The pace of the reconstruction process in Gaza has been much slower than expected due to inadequate donor funding and Israeli restrictions on import of construction materials into Gaza. Around 70,000 households continue to be internally displaced, which has created an extremely fragile environment that could lead to more conflict. Unemployment is on the rise from 27% in 2014 to 43% in Gaza and 17% in the West Bank. Particularly alarming is youth unemployment in Gaza which soared to 60% in 2014. Preliminary estimates indicate that the poverty rate in Gaza increased from 28% in 2013 to 39% in 2014.

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