USAID
Economic Analysis
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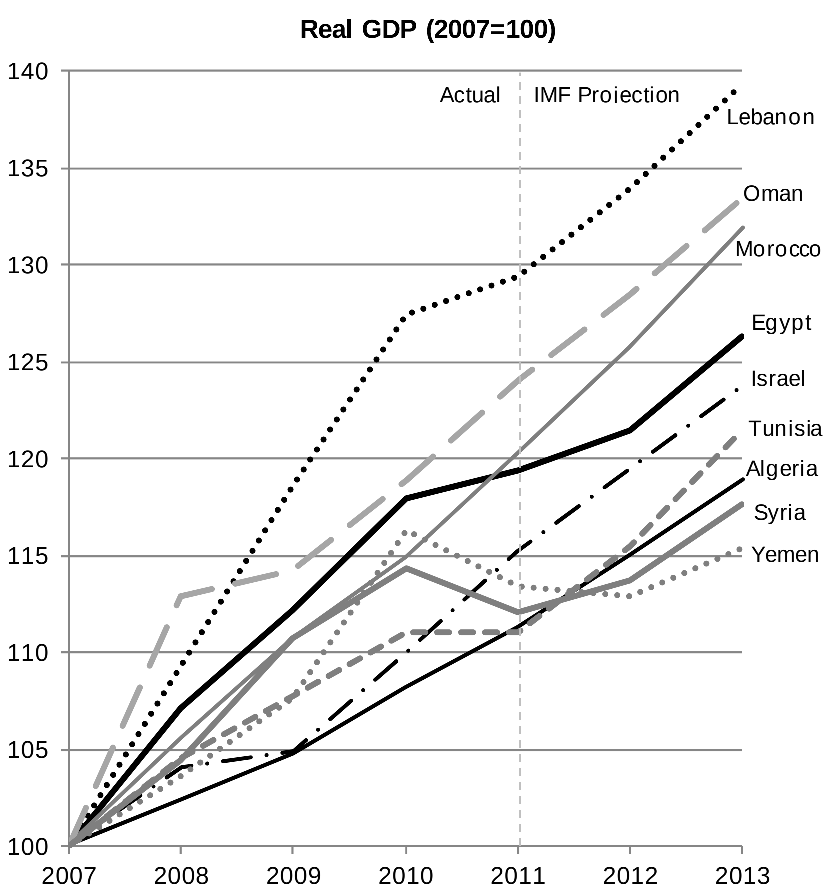
EADS Economic Trends Report

Middle East and North Africa

November 2011

Economic Overview

The Middle East and North Africa region (MENA) did not suffer as much as other regions from the impacts of the global financial crisis in 2008; however, MENA countries have also not experienced the sharp acceleration of growth that has buoyed other developing countries in 2010. The region faces challenges to short-term economic growth due to recent social unrest in several countries inflationary pressures, chronic unemployment, and weakness in the European market. On the other hand, political reforms could potentially lead to improved medium and long-term growth. Overall, MENA is expected to experience a modest increase in annual GDP growth from 3.8 percent in 2010 to 4.1 percent in 2011 and 4.2 percent in 2012.



SOURCE: IMF, *World Economic Outlook*, September 2011.

Countries experiencing protracted political turmoil will have slower growth as investment will be particularly adversely affected. Relatively brief political upheavals in Tunisia and Egypt are expected to dampen their short-term GDP growth in 2010 and 2011 as a result of disruptions to tourism, capital flows and financial markets; however, medium-term growth in these countries is forecasted to return to pre-crisis levels by 2012. Yemen and Syria have experienced negative GDP growth in 2011, -2.5 and -2.0 percent respectively, due to ongoing political unrest and violence. Even countries that are not currently experiencing protests will likely face negative spillover effects as is already being evidenced by widening credit default swaps and bond spreads across the region. Heightened risk aversion is contributing to a dramatic decline in Foreign Direct Investment (FDI) to the region, decreasing by half from $20 billion in 2010 to $10.7 billion in 2011. On the bright side, successful political transitions and reforms could potentially boost economic growth in the medium and long-term if they lead to greater accountability and transparency in governance, which would facilitate more effective use of resources and reduce unproductive rent-seeking behavior.

One of the major factors contributing to the political instability has been chronically high unemployment. The persistence of high unemployment rates, particularly in countries such as Tunisia, Egypt, and Syria, suggests that

Countries covered in this report include Algeria, Egypt, Israel, Lebanon, Libya (there is limited data on Libya due to the violent conflict and unpredictable situation), Morocco, Oman, Syria, Tunisia, West Bank/Gaza, and Yemen. Due to data limits, not all countries are represented in every graph or analytical section.

much of it may be structural, or related to skill mismatches, labor market rigidities, and high reservation wages. The IMF's World Economic Outlook (WEO) report suggests that tackling the region's unemployment will require strong, inclusive economic growth and reforms to improve labor market flexibility.

Higher demand for oil has benefited oil-exporting countries, including Algeria, Oman, and Libya. Disruptions to oil production in Libya due to the conflict are likely to push other OPEC oil suppliers to increase production in 2011. Meanwhile, higher food prices will negatively impact external balances for countries across the region and aggravate inflationary pressure.

Economic growth in West Bank/Gaza is expected to remain above 6 percent year-on-year for 2011–2013. However, the accuracy of this forecast depends largely on Israeli policies towards the territories. Growth in the territories is largely driven by household consumption, population growth and institutional reforms by the Palestinian Authority. However, high unemployment, dependence on foreign aid, and restrictions on the movement of goods and people by Israeli border control are major constraints to growth.

Uncertainty regarding recovery of Europe is another cloud hanging over the region as much of MENA's income depends on European trade, remittances and tourism. The uplifting rebound in trade and remittances from Europe in the beginning of 2010 has since stalled. Export demand from Europe has been volatile. While several countries have experienced declining export revenues in the first quarter of 2011 (Egypt, Lebanon, and Tunisia), others have benefitted from strong global demand for phosphates used in fertilizers (Morocco and Jordan). Remittances from Europe to the region increased by 6.5 percent in 2010, but are expected to increase only by 3.5 percent in 2011 with Tunisia expected to see a severe drop in remittance flows of -2.5 percent. Finally, tourism, a key driver of growth for Lebanon, Morocco, Tunisia, Jordan, and Egypt, has been hit hard by both the European economic difficulties and political instability. The dramatic decline in tourism will have significant negative second-round effects on growth as it is a labor-intensive industry that in recent years has attracted a great deal of investment, both domestically and from abroad.

World Bank Income Groups

Of the 10 MENA countries included in this report, the majority are in the Middle Income group by World Bank standards. Five (Algeria, Egypt, Morocco, Syria, and Tunisia) are Upper-Middle Income countries. Three (Lebanon, Libya, and Oman) are Lower-Middle Income countries. Finally, Israel is a High Income country and Yemen is a Low Income country.

Fiscal Policy

The pressure from troubled international markets and political turmoil at home has motivated MENA governments to pursue expansionary fiscal policies. A variety of initiatives have been implemented across the region to shield their populations from rising food and other commodity prices. Jordan and Tunisia are increasing food and fuel subsidies. Several economies, including Syria, Tunisia, and Yemen, are distributing more social transfers. Finally Egypt, Jordan, Morocco, and Yemen have begun expanding their civil service employment and salaries as well as enhancing other types of employment support. While many of the policies targeted at protecting the most vulnerable may have long-lasting positive impacts on supporting more inclusive economic growth, there is a risk that broad policies, such as expanding the civil service, will be very costly and less effective in the long-term. Oil-exporting economies experiencing a boon in revenues have more room to invest in infrastructure and social programs than the more constrained oil-importing countries struggling under heavy debt burdens. As a result, fiscal deficits in 2011 have narrowed slightly for oil-exporting countries (by 0.5 percent of GDP), but widened by more than 7 percent of GDP in 2011 for non-oil exporting countries given declining government revenues and increasing expenditures.

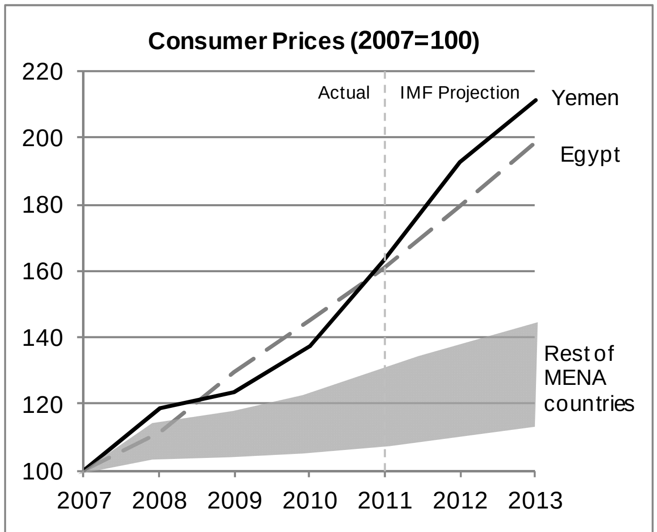
Monetary Policy

Countries across the MENA region will have to contend with inflationary pressures. In some countries such as Egypt and Yemen, inflation is expected to be further aggravated by depreciation in the exchange rate. The government of Morocco, on the other hand, is tightening monetary policy and subsidizing food and fuel prices in an effort to prevent prices from rising by double-digits. Algeria and Tunisia have also been effective in adopting policies, including subsidies and appropriate monetary policy, to safeguard domestic prices from rising due to increasing international food prices.

Real GDP Growth Rates, 2010	Developing Asia 9.5%	Latin America & Caribbean 6.1%	Sub-Saharan Africa 5.0%	**MENA 3.8%**

Inflation

Rising inflation is a major risk to MENA economies. Inflation is being stimulated by rising food and fuel prices as well as expansionary government fiscal and monetary policies. Oil prices are expected to remain high due to instability in key oil producing countries as well as rising global demand. Higher energy prices are also contributing to higher costs for producing food. MENA countries are highly dependent on imported food, particularly cereals, oils, and sugars. Since June 2010, wheat prices have risen 113 percent and maize by 109 percent. While rising international food prices are a major factor contributing to inflation, domestic factors also play a significant role. Domestic food inflation in MENA is further aggravated by inflexible procurement legislation, poor transportation infrastructure, inadequate stockpiling practices, and insufficient use of financial risk-hedging instruments—such as contracts and options—which protect the country against price shocks. Thus investment in domestic market infrastructure can help alleviate food inflation in many cases.



SOURCE: IMF, *World Economic Outlook*, September 2011.

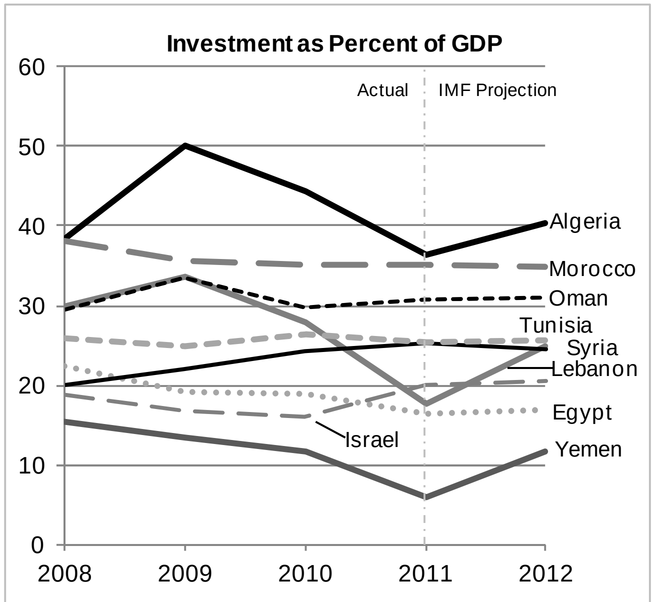
Egypt and Yemen are experiencing extraordinary rates of CPI growth, with expectations that prices will double from 2007 to 2013. For the MENA region, median inflation (year-on-year) rose from 4 percent in August 2010 to 5.1 percent in February 2011 and eased slightly to 4.5 percent by April 2011. High inflation is undermining purchasing power and consumer spending. In Israel, high prices for housing, food, gas, and other staple goods led to protests among students and the general population; the government responded with a package of long-term reforms to bring down prices and close social gaps.

Banking and Financial Sector

The outlook for banking sectors across MENA is shaky due to exposure to Europe and lingering political risks. In 2011, borrowing costs spiked amidst the uncertainty of the Arab Spring but have slowly declined. The main risk to banks in oil-exporting economies stems primarily from a greater potential drop in oil prices than is currently predicted. By contrast, the main risk in oil importing economies stems from ongoing political uncertainty. Tunisia had its ratings downgraded in 2010 as a result of risks related to its political transition. In contrast, Morocco had an upward revision of its ratings in 2010 due to the government's efforts to reduce debt. Several oil-importing economies are struggling with fiscal deficits and depend to a large degree on foreign financing to sustain domestic demand.

Investment

Investment-to-GDP ratios have been undermined both by the crisis in global markets as well as political instability. Investment declined in nearly all the countries in 2009 and 2010, but is expected to rebound in 2011. The ability to recover varies by country. According to IMF projections, in 2012 most countries will have an investment-to-GDP ratio below their 2008 level, with the exception of Algeria, Syria, Oman, and Israel. Economic growth in the MENA region is expected to be driven more by consumption and less by investment and exports as a result of the impact of political turmoil. Net private flows in 2011 are expected to drop by 83 percent to $4.1 billion from $28 billion in 2010, a fall equivalent to 2.1 percent of the region's GDP.



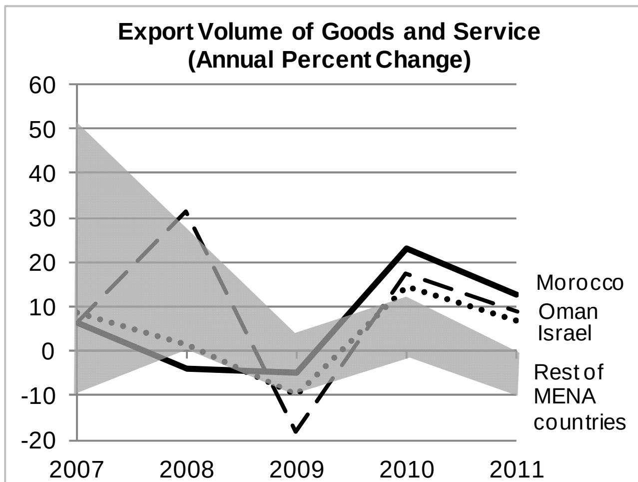
SOURCE: IMF, *World Economic Outlook*, September 2011.

As private investment flows dry up, government expenditures are rising in some countries. In Algeria, the government is investing in building new houses while in Tunisia public infrastructure projects are focused on the telecommunications sector.

Looking forward, security, stability, and improved governance are key to encourage a return of investment.

Trade

Oil exporters that have not been affected by political turmoil are benefitting from windfall revenues as oil prices have risen almost 50 percent from June 2010 to April 2011. However, high food prices are negatively impacting terms of trade for most MENA countries who are net food importers. Nearly half of MENA's domestic wheat consumption was imported in 2010. The increase in the import bill of oil importers attributed to higher food prices is estimated to be 1.2 percent of GDP for 2010.



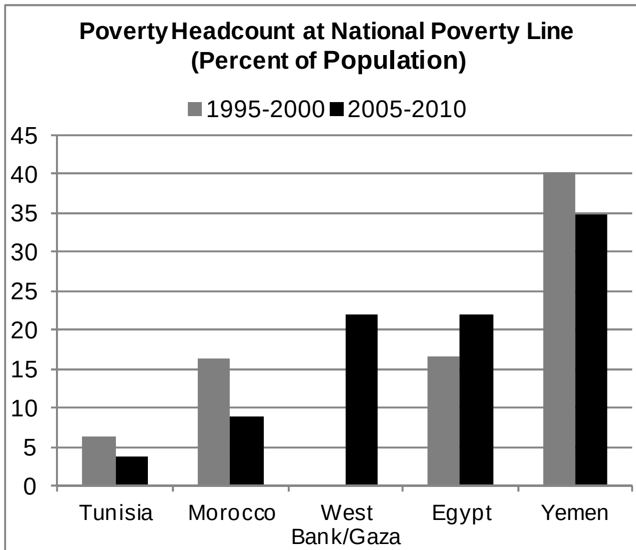
SOURCE: IMF, *World Economic Outlook*, September 2011.
NOTE: 2011 values are projections.

Most MENA countries have experienced highly volatile export volumes over the past three years. Countries suffering from political violence will see sharp declines in exports in 2011, including Egypt, Tunisia, Yemen, and Syria. On the other hand, Morocco, Oman, and Israel have regained or surpassed their pre-crisis export growth rates, after a sharp decline in 2009 related to the global crisis.

Poverty Reduction

Poverty is relatively low in MENA—17 percent of the region's population lived below $2-a-day in 2005, similar to the percent living in poverty in Latin America and the Caribbean (LAC) and lower than in East Asia. However, the speed at which poverty rates have been declining has been slower than other regions and has not kept up with population growth rates. As a result, the total number of people living in poverty has not declined since 1990. The global financial crisis has slowed progress on poverty reduction and is expected to push an additional 2.6 million people into poverty by 2011.

While Tunisia and Yemen have seen a slight decrease in their poverty rates, it remains extremely high in Yemen. Egypt has seen an increase in the amount of people living in poverty over the past ten years, reaching a level equal to the West Bank/Gaza, a territory that has not benefited from the strong GDP growth and increasing oil revenues witnessed in Egypt over the past decade.



SOURCE: World Bank, *World Development Indicators*, 2011.
NOTE: Data is for the most recent year with data available in date range.

Progress on Human Development

Most MENA countries are classified as "Medium" or "Low" development in the 2010 Human Development Report with the exception of Libya and Israel, which are classified as "High" and "Very High," respectively. From 2009 to 2010, Libya, Algeria, and Yemen improved their ranking while Israel fell one place.

Additional Information

For country-specific data and additional information about the countries covered in this report, please visit the EADS Country Portal at http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal.

Sources used in compiling this report include the semi-annual World Economic Outlook from the International Monetary Fund (http://www.imf.org/) and the Global Economic Prospects from the World Bank (http://www.worldbank.org/).