CHAPTER 2

MIDDLE EAST & NORTH AFRICA

Following years of turmoil, some economies in the Middle East and North Africa appear to be stabilizing, although growth remains fragile and uneven. Growth in oil-importing countries was broadly flat in 2014, while activity in oil-exporting countries recovered slightly after contracting in 2013. Fiscal and external imbalances remain significant. Growth is expected to pick up gradually to 3.5 percent in 2017. Risks from regional turmoil and from the volatile price of oil are considerable; political transitions and security challenges persist. Measures to address long-standing structural challenges have been repeatedly delayed and high unemployment remains a key challenge. Lower oil prices offer an opportunity to remove the region's heavy energy subsidies both in oil-importing and oil-exporting countries alike.

Recent Developments

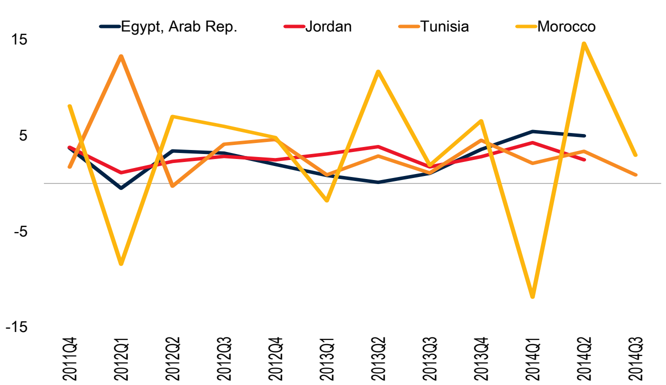
Growth in the developing countries of the Middle East and North Africa recovered in 2014 to 1.2 percent (Table 2.7).[1] The preceding year had been marked by domestic and regional turmoil, weak external demand, and stagnant activity. Improvements in confidence (Arab Republic of Egypt, Tunisia), manufacturing and exports (Egypt, Morocco), as well as a bottoming out of oil production, contributed to the pick-up in growth. This modest upturn, however, remains fragile, and output still languishes well below the region's potential. Structural reforms needed to spur growth, reduce unemployment and alleviate poverty remain unaddressed. While there has been progress on the political transition in Tunisia and greater stability in Egypt, others remain mired in tensions. Security challenges and/or resulting spillovers in several countries are a key source of instability, with security risks affecting an estimated 20 percent of regional GDP (Iraq, Jordan, Lebanon, Libya, Syrian Arab Republic, Republic of Yemen), and political transition affecting another 20 percent (Egypt, Tunisia). Fiscal and external accounts remain weak, even in countries that have received exceptional official support from the high-income Gulf Cooperation Council (GCC) countries.

In *oil-importing* developing countries, economic activity appears to be picking up (Figure 2.23) as a weak first quarter was followed by a rebound in the second and third quarters. Growth, on average, is estimated to have been flat at 2.6 percent in 2014. However, it has been fragile and uneven. Egypt especially benefited from greater stability and large-scale financial support from the

FIGURE 2.23 Oil importers, GDP growth

Growth has picked up in oil importers but is uneven.

Percent change, quarter-over-quarter, annualized rate

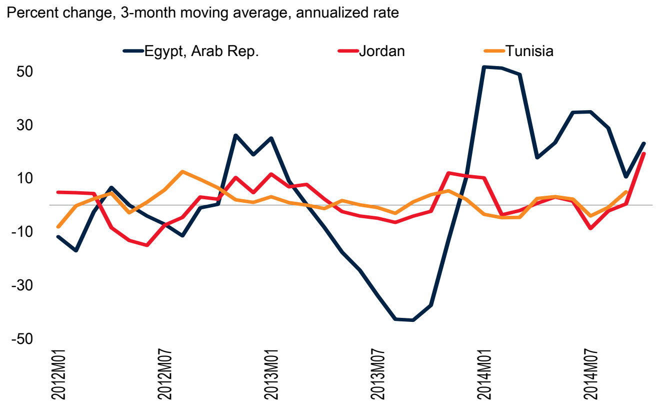


Sources: Haver Analytics and World Bank.
Note: Seasonally adjusted and annualized data.

[1]This chapter covers low- and middle-income countries of the Middle East and North Africa region while high-income Gulf Cooperation Council (GCC) countries are excluded. The developing countries are further divided into two groups; oil importers and oil exporters. Developing oil importers are: Djibouti, the Arab Republic of Egypt, Jordan, Lebanon, Morocco, Tunisia, and West Bank and Gaza. Developing oil exporters are: Algeria, the Islamic Republic of Iran, Iraq, Libya, the Syrian Arab Republic, and the Republic of Yemen.

FIGURE 2.24 Industrial production

Industrial production rebounded, especially in Egypt where it was supported by greater stability.



Sources: Haver Analytics and World Bank.

FIGURE 2.25 Oil production

Oil production has recovered but remains fragile given large security challenges.

Source: International Energy Agency.

GCC for investment programs. As a result, industrial production rebounded sharply (Figure 2.24) and the purchasing managers' indexes (PMIs) indicated marked improvements in confidence.

The recovery has been less robust in Tunisia, Jordan, and Lebanon. Tunisia's political transition accelerated in 2014, with the adoption of the new constitution and general elections, but external demand, tourism and investment have yet to recover. In Morocco, nonagricultural output remained buoyant, driven by private consumption and a surge in exports of manufactured goods (including cars and electrical items) and phosphates. In Lebanon, however, despite some acceleration, activity, exports, and sentiment remain depressed, reflecting spillovers from the conflict in Syria, and political uncertainty. Lebanon's PMI pointed to a contraction in business activity for the 16th consecutive month, with security issues weighing heavily on tourist arrivals, and harming domestic wholesale and hospitality industries.

In *oil-exporting* developing countries, output has stopped contracting but remains highly volatile. After contracting by 0.8 percent in 2013, activity rebounded slightly by 0.3 percent in 2014. Oil production was disrupted in the first half of 2014, but has stabilized at around 8 million barrels per day (mb/d)—25 percent below the pre–Arab Spring average (Figure 2.25). Security setbacks have affected production in Iraq, Libya, and the Republic of Yemen while sanctions have limited output in the Islamic Republic of Iran. The Islamic State of Iraq and Levant (ISIL) insurgency captured large swaths of territory in Iraq, disrupting production in the north of the country. Production in the country's larger oil fields in the south has not been affected. In fact, despite the insurgency, Iraq's production in 2014 increased, averaging 3.3 mb/d though November, up from 3.1 mb/d in 2013. Before the advance of ISIL, Iraq was expected to account for 60 percent of OPEC's additional capacity in the next five years. However, this may be set back by the unstable security situation. In Libya, oil output recovered in November to about 0.7 mb/d, up from 0.2 mb/d from the first half 2014 as the year-long blockade of the eastern oil export terminals has been lifted. However, political tensions have increased and the security situation has deteriorated as armed groups and two parliaments are vying for control of the country. The recovery remains tenuous as security risks persist.

Fiscal deficits have widened in the wake of the Arab Spring. In 2014, they reached 7.1 percent of regional GDP compared with 6 percent in 2013. Revenues were weak while expenditures on public sector wages and general subsidies—a large share of fiscal expenditures—have increased rapidly.

- Facing fiscal pressures and to sustain priority spending, *oil importers* have cut government investment and borrowed from domestic banks. Partly as a result of gradual subsidy reforms, fiscal deficits fell, on average, by 1 percentage point to 10 percent of GDP in 2014. These were partially funded by exceptional official financing from GCC countries (U.S. $22 billion).

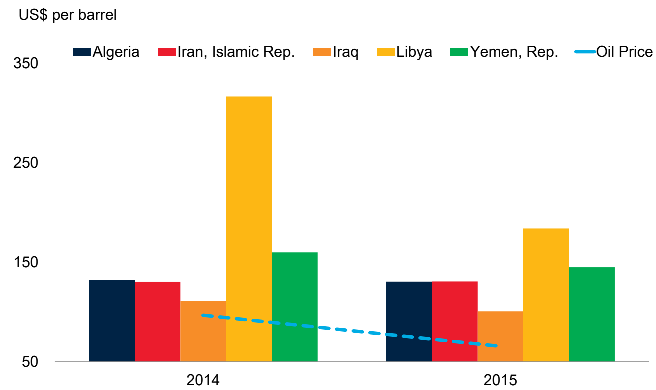
- In virtually all *oil exporters*, fiscal deficits have emerged or widened as production declined or was disrupted in the first half of 2014, with some recovery in the second half. Especially in the last quarter of 2014, oil prices fell sharply and below fiscal break-even points (the prices at which budgets would be balanced) for most developing oil exporters (Figure 2.26). The fiscal deterioration was most acute in Libya and the Republic of Yemen as internal strife curtailed oil output and revenues compared to 2013.

Gross capital flows to the region slowed in 2014, as a sharp rise in bank lending only partially offset weak bond and equity flows. Four countries (Jordan, Lebanon, Morocco, and Tunisia) have been able to raise funds in international bond markets, although bond issuance from Jordan and Tunisia had to be guaranteed by the U.S. government and the Japan Bank of International Cooperation while Morocco benefited indirectly from having an active IMF program. Many of the region's economies lack access to international capital markets because of geopolitical risk and economic uncertainty. However, there are signs of a nascent increase in investor interest in Egypt, as the economy is recovering and as increased support from GCC countries has helped ease foreign-exchange shortages. Overall, however, net FDI remains well below pre-Arab Spring inflows and is projected to recover to those levels only late in the forecast period.

Remittances to the region increased in 2014 by about 3 percent. After the sharp fall in 2013, remittance flows to Egypt stabilized in 2014, in part because of heavy interest in purchasing investment certificates for the expansion of the Suez Canal available to Egyptian citizens only. Egyptian and Tunisian migrant workers began to return from Libya in 2014 as the security situation deteriorated, but in smaller numbers than in 2011.

FIGURE 2.26 Oil producers' fiscal breakeven prices

Oil exporters in the region are under fiscal pressure because of volatile production and weak oil prices.



Source: IMF.
Note: Oil price is the average of West Texas Intermediate, Dubai, and Brent. Libya's fiscal break-even price spiked in 2014 because of output disruptions.

Outlook

Growth in the developing countries of the region is projected to pick up gradually to 3.5 percent in 2017, helped by a rebound in oil production among oil exporters and a modest recovery among oil importing economies. Egypt, Jordan, and, to lesser extent, Lebanon and Tunisia, appear to be entering a steady recovery from a period of heightened volatility and uncertainty (Table 2.8). Other countries in the region, such as Iraq, Libya, and, the Republic of Yemen continue to be affected adversely by security challenges.

In the baseline scenario, only limited improvement is expected in the political uncertainty and lack of security that has plagued the region for the past four years. As a result, although growth is expected to pick up, the recovery is not sufficient to make deep inroads into spare capacity and unemployment. The region needs to create 4 million jobs per year to keep the unemployment rate from rising (World Bank, 2014i). Historically, the region created jobs near this rate only when growth was in excess of 5 percent (World Bank, 2014i).

- Among *oil exporters*, growth is expected to firm to about 3.1 percent by 2017 as some improvements in security allow an increase in oil output. The baseline outlook for the Islamic Republic of Iran assumes a partial easing of the sanctions in line with steps taken to date. Following their sharp decline in 2014, oil prices are expected to remain soft in 2015 but rise modestly in the medium term. In turn, this will steady fiscal positions and support domestic demand.

- Among *oil importers*, the baseline outlook is for a gradual improvement in growth driven by increasing investment. Aggregate growth for the subregion is expected to pick up to about 4.1 percent by 2017, close to but still below the historical average. Consumption will be underpinned by large public outlays on wages and increased remittances. A reduction in and improved targeting of general subsidies will make room for increased public investment.

Risks

The outlook is subject to significant downside risks that are mostly internal to the region.

Violence in Syria could escalate and spill over to other countries (mainly Iraq, Jordan, and Lebanon). More than 3 million Syrian refugees are hosted in the neighboring countries, with officially registered refugees in Lebanon and Jordan amounting to about 25 percent and 10 percent of local populations. Actual numbers are likely to be even higher. In Iraq, the number of internally displaced persons because of ISIL's advance has reached 2 million in 2014 or 6 percent of the population. Social as well as external and fiscal pressures are high for these countries and could be exacerbated further should the civil war in Syria and its spillover to Iraq intensify. Setbacks in political transitions or an escalation of violence in Egypt, Iraq, Libya, Tunisia, and the Republic of Yemen would undermine confidence and delay necessary structural reforms as well as reduce oil output. On the upside, restoration of political stability and policy certainty that leads to sustained attention to structural reforms could substantially boost confidence and return growth to the long-run potential.

Debt rollover and refinancing risks are rising. Countries in political transition have benefited from large official financing from the Gulf economies. While these are expected to continue, the associated debt will become increasingly burdensome and presents a rollover risk for recipient countries. Public debt levels have increased in oil-importing countries from 73 to 88 percent of GDP during 2011–14. They may be approaching unsustainable levels as debt servicing costs account for an ever larger share of the expenditures.

External risks are also tilted to the downside. A weaker-than-expected recovery in the Euro Area could reduce exports, tourism, remittances, and capital flows in North Africa. In addition, sharply tightening or persistently volatile global financial conditions could raise risk premia for developing countries, raising borrowing costs and at the same time lowering FDI.

A sharper- or longer-than-projected decline in oil prices could lead to a significant deterioration in external and fiscal accounts of oil-exporting countries (although benefiting, more vulnerable, oil importers). This could be triggered by a return to the market of some 1.5 mb/d of idle capacity in the Islamic Republic of Iran and Libya, at a time of a surging unconventional North American production and moderating demand in Europe and Asia. A permanent 10 percent oil price drop could cut GDP growth by 0.8–2.5 percentage points in the developing oil exporters of the region in the first year (World Bank, 2013b; Berument, Ceylan, and Dogan, 2010). Current account balances would deteriorate by 1.8 percent of GDP and fiscal balances would weaken by 1.0 percent of GDP (World Bank, 2013a). While this would benefit oil importers in the region, the impact would be limited. Their growth would improve by 0.3 percentage point on average, while current and fiscal accounts would improve by 0.3 percent and 0.1 percent of GDP, respectively (World Bank, 2013a).

Conversely, a sharp rise in geopolitical risk could disrupt oil supplies leading to a temporary oil price spike. Iraq is poised for a material increase in output in the forecast period, but the deteriorating security situation could spread to core production facilities so far unaffected. Intensifying turmoil in Libya could further disrupt oil production and exports, while deteriorating prospects for an international agreement with Iran could result in tighter sanctions that dent oil exports even further.

Policy Challenges

Since 2011, many developing countries of the region have been in political turmoil, in some cases associated with conflict, which has disrupted economic activity. Economies have stagnated, with growth averaging a mere 0.8 percent per year, a sharp slowdown compared to the average of 4.4 percent during the previous decade. Measures to address long-standing structural challenges, which predate the Arab Spring uprisings, have been repeatedly delayed. There has been progress on the political transition in Tunisia and greater stability in Egypt; however, Iraq, Libya, Syria, and the Republic of Yemen remain mired in internal strife.

Aside from the need to improve security and ease political tensions, the region faces a long list of economic challenges—slow growth, high unemployment, poor service delivery, barriers to competition, unequal access to economic opportunity (IMF, 2014a). Unless credible reform programs are implemented to tackle long-overdue structural problems, growth will remain weak and insufficient to reduce unemployment, the region's key economic challenge (Chapter 1 includes a discussion of structural reform priorities).

Subsidies in the region are large and inefficient. Historically, energy subsidies have been used to shield the population from price swings (in oil importers) or to share oil revenues (in oil exporters), but there is growing evidence that they are disproportionally benefiting the well-off segments of the population, while adding to both fiscal and current account pressures (IMF, 2014b). Large energy subsidies carry high fiscal cost and dampen growth, tilt production and FDI towards energy- and capital-intensive activities (World Bank, 2013b AfDB, 2014), discourage employment, contribute to higher road traffic volumes (and hence accidents and fatalities), lower air quality and encourage water-intense agriculture (World Bank, 2014j). Consequently, reform of the region's high energy subsidies should be a priority.

Some progress has been made, despite the political opposition to rising prices of basic goods and services. Efforts are underway in Egypt, the Islamic Republic of Iran, Jordan, Morocco, Tunisia, and the Republic of Yemen to reform fuel and energy subsidies, which amount to 5 percent of GDP in Tunisia, about 9 percent in Egypt and the Republic of Yemen, and 11 percent in Libya. Egypt has started to reform energy subsidies by raising electricity and fuel prices, which, together with revenue measures, should lower the fiscal deficit from 14 percent of GDP in the fiscal year ending June 2013, to 11 percent of GDP in two years. In the Republic of Yemen, fuel subsidies were removed in July 2014, but were partially restored in wake of significant political and even armed opposition. Nevertheless, the net reduction in untargeted subsidies remains substantial. Earlier efforts in Jordan, Morocco, and Tunisia are also beginning to reduce deficits. Recent declines in oil prices offer an opportunity to remove the region's heavy energy subsidies in oil-importing and oil-exporting countries alike.

TABLE 2.7 Middle East and North Africa forecast summary

(Annual percent change unless indicated otherwise)

	00-10[a]	2011	2012	2013	2014e	2015f	2016f	2017f
GDP at market prices, geographic region[b, c]	4.6	3.2	3.3	2.3	3.0	3.3	3.6	3.9
GDP at market prices, developing countries[c]	4.4	-0.1	1.4	0.5	1.2	2.5	3.0	3.5
(Average including countries with full national accounts and balance of payments data only)[d]								
GDP at market prices, developing countries[c,d]	4.7	2.7	-1.1	0.9	2.3	2.5	2.7	3.3
GDP per capita (units in US$)	3.1	1.1	-2.6	-0.5	0.8	1.1	1.4	2.0
PPP GDP[e]	4.7	2.6	-1.0	1.0	2.3	2.6	2.8	3.4
Private consumption	4.5	3.4	2.8	2.7	2.7	3.2	3.4	3.5
Public consumption	3.5	4.0	4.0	-0.4	3.3	2.2	2.3	3.2
Fixed investment	7.0	1.9	-0.5	-1.8	-2.0	3.0	2.9	4.3
Exports, GNFS[f]	5.1	-1.7	-7.1	0.3	3.6	4.6	4.7	4.9
Imports, GNFS[f]	8.1	1.2	4.4	-3.3	4.1	5.7	5.7	5.9
Net exports, contribution to growth	-0.5	-0.9	-3.4	1.1	-0.3	-0.5	-0.5	-0.6
Current account balance (percent of GDP)	3.8	4.4	1.3	0.6	-1.0	-4.3	-4.1	-3.9
Consumer prices (annual average)[g]	7.1	11.9	14.4	18.6	10.3	...	...	...
Fiscal balance (percent of GDP)[h]	0.1	-4.0	-3.8	-6.0	-7.1	-6.1	-5.3	-4.4
Memo items: GDP								
Developing countries, ex. Libya	4.4	3.1	-0.6	1.1	2.0	2.5	2.9	3.4
High-income oil exporters[i]	4.8	7.0	5.4	4.1	4.7	4.1	4.2	4.3
Developing oil exporters	4.2	-1.7	0.5	-0.8	0.3	1.8	2.4	3.1
Developing oil importers	4.9	2.6	2.6	2.6	2.6	3.6	3.8	4.1
Egypt	4.8	2.0	2.2	2.1	2.9	3.6	3.9	4.0
Fiscal year basis	4.8	1.8	2.2	2.1	2.2	3.5	3.8	4.0
Iran	5.0	3.9	-6.6	-1.9	1.5	0.9	1.0	2.2
Algeria	3.9	2.8	3.3	2.8	3.0	3.3	3.5	3.5

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

a. Growth rates over intervals are compound weighted averages; average growth contributions, ratios and deflators are calculated as simple averages of the annual weighted averages for the region.

b. Geographic region includes the following high-income countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

c. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.

d. Sub-region aggregate excludes Djibouti, Iraq, Libya, Syria and West Bank and Gaza, for which data limitations prevent the forecasting of GDP components or balance of payments details.

e. GDP measured at PPP exchange rates.

f. Exports and imports of goods and non factor services (GNFS).

g. Latest observation for 2014 is Sepember.

h. Includes all developing countries, except Syria for which data is not available.

i. High-income oil exporting countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates.

TABLE 2.8 **Middle East and North Africa country forecast**

(Real GDP growth at market prices in percent and current account balance in percent of GDP, unless indicated otherwise)

	00-10[a]	2011	2012	2013	2014e	2015f	2016f	2017f
Algeria								
GDP	3.9	2.8	3.3	2.8	3.0	3.3	3.5	3.5
Current account balance	13.3	10.0	6.1	0.5	-3.3	-9.1	-9.3	-9.5
Djibouti								
GDP	3.9	4.5	4.8	5.0	5.5	5.5	6.0	6.0
Current account balance	..	-14.1	-18.4	-23.7	-33.0	-36.6	-40.6	-47.4
Egypt, Arab Rep.								
GDP	4.8	2.0	2.2	2.1	2.9	3.6	3.9	4.0
Fiscal year basis	4.8	1.8	2.2	2.1	2.2	3.5	3.8	4.0
Current account balance	0.8	-2.6	-3.9	-2.7	-0.9	-1.7	-1.8	-2.0
Iran, Islamic Rep.								
GDP	5.0	3.9	-6.6	-1.9	1.5	0.9	1.0	2.2
Current account balance	6.3	11.0	6.6	7.5	3.6	-2.6	-2.2	-1.9
Iraq								
GDP	-0.4	10.2	10.3	4.2	-2.7	0.9	7.0	5.9
Current account balance	..	12.0	6.7	-0.8	2.0	-5.3	-2.2	-1.5
Jordan								
GDP	6.3	2.6	2.7	2.8	3.0	3.4	3.9	4.0
Current account balance	-4.6	-10.2	-15.2	-10.0	-11.3	-9.4	-7.9	-6.0
Lebanon								
GDP	5.9	2.0	2.2	0.9	1.5	2.0	3.4	3.6
Current account balance	-17.1	-10.9	-8.1	-8.5	-8.3	-8.0	-7.3	-7.1
Libya								
GDP	4.3	-62.1	104.5	-13.7	-21.8	4.3	4.4	6.5
Current account balance	..	9.2	29.1	-3.5	-24.3	-12.5	-11.2	-9.8
Morocco								
GDP	4.9	5.0	2.7	4.4	3.0	4.6	4.0	4.5
Current account balance	0.1	-8.0	-9.7	-7.6	-5.9	-4.2	-3.6	-2.9
Tunisia								
GDP	4.4	-0.5	4.7	2.5	2.3	2.7	3.5	4.0
Current account balance	-3.0	-7.4	-8.2	-8.4	-9.1	-8.6	-7.3	-6.6
Yemen, Rep.								
GDP	3.0	-12.7	2.4	4.8	1.9	3.7	3.8	5.2
Current account balance	0.4	-3.2	-1.9	-3.3	-3.6	-6.5	-6.1	-5.5
West Bank and Gaza								
GDP	3.3	12.2	5.9	1.9	-3.7	4.4	4.0	4.0
Current account balance	..	-32.0	-36.4	-29.1	-37.5	-39.7	-36.9	-34.1

	00-10[a]	2011	2012	2013	2014e	2015f	2016f	2017f
***Recently transitioned to high-income economies*[b]**								
Oman								
GDP	4.9	4.5	5.0	5.1	4.4	5.0	3.9	4.0
Current account balance	8.5	15.3	11.4	9.2	3.0	-4.9	-5.9	-7.9
Saudi Arabia								
GDP	5.4	8.6	5.8	4.0	5.2	4.1	4.4	4.6
Current account balance	15.0	23.7	22.4	18.4	12.8	2.4	-2.4	-2.3

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time. Data for Syria are excluded due to uncertain political situation.

a. GDP growth rates over intervals are compound average; current account balance shares are simple averages over the period.

b. The recently high-income countries are based on World Bank's country reclassification from 2004 to 2014.