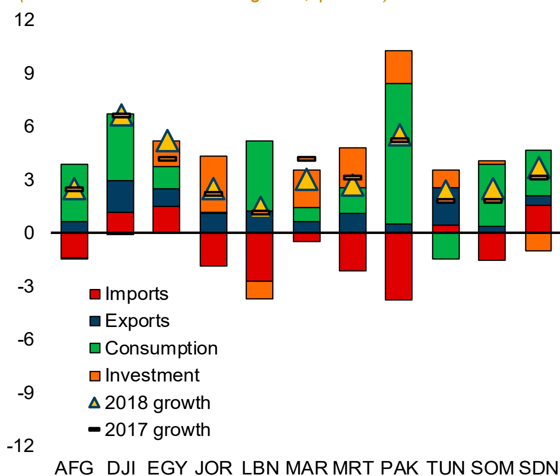
MENAP Oil-Importing Countries: Risks to the Recovery Persist

The growth recovery in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) oil-importing countries is set to continue in 2018, lifted by gains from ongoing reforms, improved domestic confidence in some countries, and a steady upswing in external demand. While the outlook remains broadly positive, with a moderate uptick in economic activity projected for 2019, it has softened for most countries relative to the forecast in the October 2017 Regional Economic Outlook*, and risks remain skewed to the downside. In addition, growth is expected to remain too low to provide enough jobs for the expanding labor force. Generating broad-based growth that benefits all will require an acceleration of structural reforms that improve the business climate and boost productivity. The need for sustained fiscal consolidation that protects much-needed social spending and investment while ensuring stability also persists.*

Growth Recovery Remains Fragile

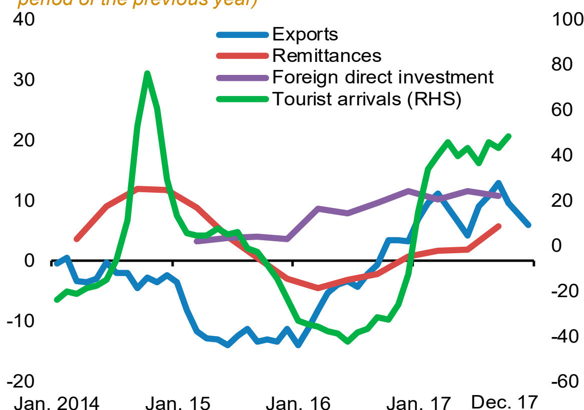
Regional growth is estimated to have reached 4.2 percent in 2017. It is projected to increase further to 4.7 percent this year and to 5 percent on average during 2019–23, with some countries experiencing appreciably faster growth (Figure 2.1). Further strengthening of the outlook for the euro area (see the *Global Developments* section) will continue to support economic activity through exports, remittances, foreign direct investment, and tourism (Figure 2.2). However, persistent conflicts and their regional spillovers, security concerns, weaker-than-anticipated public investment (Afghanistan, Jordan), delays in implementation or completion of structural reforms (Jordan, Morocco, Pakistan, Tunisia), and political and policy uncertainty (Lebanon, Pakistan) continue to weigh on growth. Overall, the outlook has softened slightly since the October 2017 *Regional Economic Outlook*.

Figure 2.1
Drivers of Growth, 2018: Exports and Investment Complement Consumption
(Contributions to real GDP growth, percent)



Sources: National authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes.

Figure 2.2
External Demand Supportive of Growth
(Three-month moving average, percent change over same period of the previous year)



Sources: National authorities; IMF, International Financial Statistics database; Haver Analytics; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. Tourist arrivals comprise EGY, JOR, and MAR. Exports comprise AFG, DJI, EGY, JOR, LBN, MRT, MAR, PAK, SDN, SYR, and TUN. Remittances comprise EGY, JOR, MAR, TUN, and PAK. Foreign Direct Investment comprises EGY, MAR, and PAK. Calculated as quarter over quarter change.

The ***outlook for Egypt has improved*** relative to the October 2017 forecast. In the context of its IMF-supported program, improving confidence is boosting private consumption and investment, adding to the increase in exports and tourism. Growth is projected to rise to 5.2 percent in FY2018 (from 4.2 percent last year) and accelerate further to 5.5 percent in FY2019, aided by an increase in gas production. Improved energy supply, investment related to the China-Pakistan Economic Corridor, and strong credit growth helped to raise ***Pakistan***'s growth to an estimated 5.6 percent in FY2018, from 5.3 last year. However, an increase in macroeconomic vulnerabilities and domestic policy slippages have weakened the outlook, with growth now projected to moderate to 4.7 percent in FY2019.

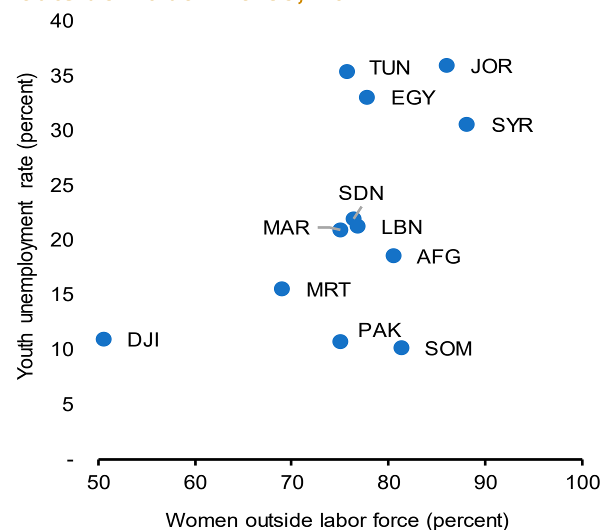
The ***growth outlooks for other countries are more modest***. Growth in Sudan is expected to advance to 3.7 percent this year from 3.2 percent in 2017, with stronger optimism, following the revocation of US trade and financial sanctions in October 2017, increasing domestic demand, and encouraging foreign investment flows. However, continued fiscal and external challenges are anticipated to cause growth to slow to 3.5 percent in 2019. A recovery in agriculture, manufactured exports, and tourism is expected to lift Tunisia's growth to 2.4 percent in 2018, from 1.9 percent in 2017, despite lower phosphate production. Growth is set to increase further to 2.9 percent in 2019. Growth in Jordan will increase slightly from 2.3 percent in 2017 to 2.5 percent in 2018, with a slight uptick to 2.7 percent in 2019. Growth is expected to be held back by ongoing delays in implementing structural reforms, a challenging regional environment, and limited scope for public investment given the constrained fiscal position. In both Mauritania and Morocco, growth will soften in 2018 to 2.7 and 3.1 percent (down from 3.2 percent and 4.2 percent in 2017), respectively, due to the impact of drought on agriculture. However, growth is anticipated to rebound in 2019 to 4.5 percent in Mauritania and 4 percent in Morocco.

Growth prospects for ***countries affected by conflict*** remain clouded. The ongoing impact of regional conflicts on confidence, trade, tourism, investment, and real estate will constrain the growth recovery in Lebanon, with growth projected to tick up to 1.5 percent in 2018, from 1.2 percent in 2017, then rise to 1.8 percent in 2019. Although it is improving, growth in Somalia and Afghanistan remains fragile as drought and ongoing security challenges continue to impede economic activity.

Growth Too Low to Create the Jobs Needed

At an average of 4.9 percent over 2018–22, growth rates remain too low to effectively reduce ***unemployment***, particularly for young people (Figure 2.3; Box 1.2). With the labor force expected to expand 2.2 percent a year over the next five years, MENAP oil importers would

Figure 2.3
Youth Unemployment Rate and Women outside Labor Force, 2017



Sources: World Bank, World Development Indicators; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes.

need sustained growth of 6.2 percent annually just to maintain unemployment at its current level of 10 percent.[1] Achieving higher growth will require an acceleration in ***structural reforms*** that allows the private sector to flourish and generate the required jobs. This is especially critical because the scale of countries' fiscal vulnerabilities means that the public sector does not have the capacity to absorb the new labor market entrants (see Box 1.1 in Chapter 1). However, upcoming elections (Lebanon, Mauritania, Pakistan, Tunisia) and a more challenging political environment could slow the reform process. Moreover, a high perception of corruption and lack of transparency (IMF, forthcoming) in several countries could not only affect macroeconomic outcomes directly, reducing investment and productivity, but could also heighten social tensions and hinder reform.

Countries in the region are slowly taking steps to improve ***governance and transparency***. For instance, Sudan has appointed external auditors to review public policies. Afghanistan enacted legislation to criminalize acts of corruption, and anti-corruption laws are being operationalized in Morocco, Tunisia, and Somalia. Additional efforts are also being made to bolster the ***business environment***, with Pakistan recently strengthening its bankruptcy framework.

But, as recent ***discussions in Morocco*** highlighted (Box 1.2), more remains to be done to improve accountability, foster a more vibrant private sector, and ensure access to opportunities for all.

External and Fiscal Positions Improving, but Fiscal Vulnerabilities Remain

Following three years of decline, ***exports*** of MENAP oil-importing countries ***grew*** by 6.4 percent in 2017 and are projected to accelerate by 8.4 percent in 2018 and 8.6 percent in 2019. This largely reflects improved external demand, greater exchange rate flexibility (Egypt, Pakistan, Tunisia), gains in competitiveness (Morocco, Tunisia), and a pickup in the prices of phosphates (Morocco, Tunisia), metals (Mauritania), and cotton (Pakistan). In contrast, despite the impact of higher oil prices relative to 2017, ***import growth is projected to slow*** to 4.8 percent in 2018 (from 6.8 percent in 2017) and remain broadly steady around 5.5 percent over the medium term. This import compression partly reflects an anticipated slowdown in capital imports for infrastructure projects (Djibouti, Mauritania, Pakistan). The region's current account deficit is, therefore, projected to narrow from 6.5 percent of GDP in 2017 to 6.2 percent in 2018, and further to 5.7 percent in 2019. Nevertheless, these gains are less than what could have been achieved if oil prices had remained at levels expected in October.

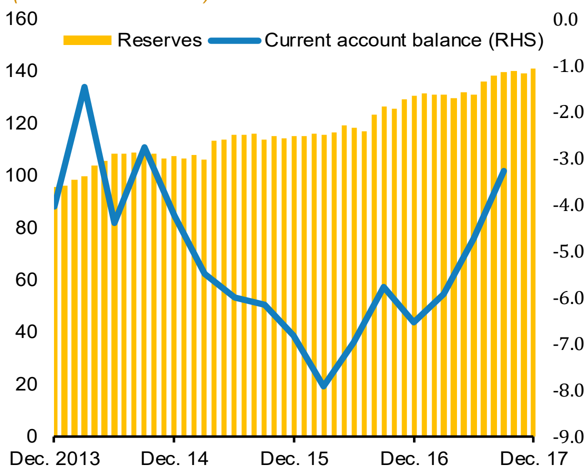
Increased ***capital inflows*** (Egypt, Morocco), including from international bond issues (Egypt, Jordan, Tunisia) and grants from foreign governments (Afghanistan, Somalia) have complemented the impact of stronger external demand, ***helping bolster reserves*** across most MENAP oil-importing countries (Figure 2.4). At the regional level, subsidy reforms, reduced capital spending, and stepped-up revenue mobilization are helping sustain an improvement

[1] Elasticity of GDP growth to employment used for MENAP oil importers is 0.39 (Crivelli, Furceri, and Toujas-Bernate 2012).

in the ***fiscal position*** from a deficit of 6.8 percent of GDP in 2016 to 6.5 percent in 2017 and 5.9 percent in 2018. Additional fiscal adjustment is expected (Figure 2.5) through efforts to raise or unify value-added tax rates (Egypt), eliminate or reduce exemptions (Jordan, Morocco), address loopholes, strengthen administration, and reform income and corporate tax systems (Jordan, Morocco). Under the IMF-supported programs in Egypt and Tunisia, further growth-friendly and socially conscious adjustment of more than 2 and 0.7 percentage points of GDP, respectively, is anticipated to be achieved by raising taxes and instituting further measures to reduce subsidies, while maintaining a floor on social spending.

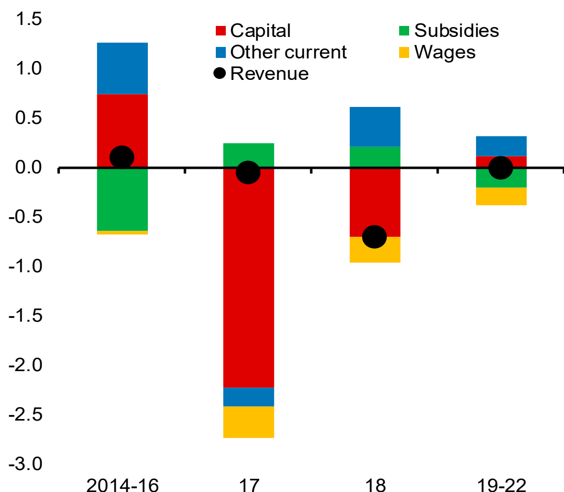
However, ***public debt levels remain elevated***, exceeding 80 percent of GDP in several countries (Egypt, Lebanon, Sudan; Figure 2.6). Such large debt stocks represent a significant burden on the economy. Debt service crowds out growth-enhancing expenditures—for instance, interest payments are, on average, between 5 and 10 percent of GDP for Egypt and Lebanon. The large debt stocks also add to external vulnerabilities given the large share of external debt. This burden will increase since financing costs are likely to rise in line with the expected tightening of monetary policy in advanced economies, especially in MENAP countries where deficits remain high (Egypt, Lebanon) and where the short-term debt to be refinanced is large (Egypt). This highlights the importance of continued efforts to reduce debt.

Figure 2.4
Central Bank Reserves and Current Account Balance
(Billions of US dollars)



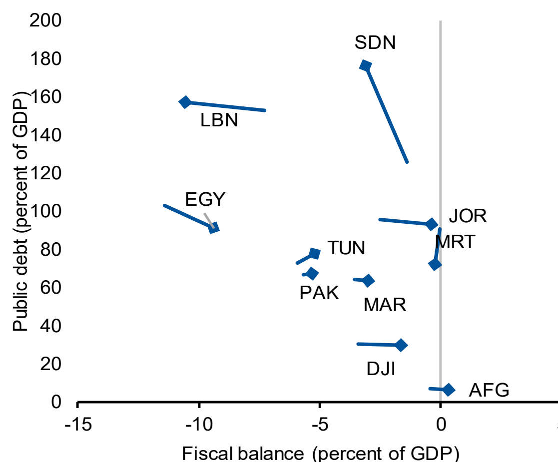
Sources: National authorities, IMF, International Financial Statistics database; and IMF staff calculations.
Note: RHS = right scale. Reserves comprise AFG, EGY, JOR, LBN, MAR, and PAK. Current account balance comprises EGY, JOR, and TUN.

Figure 2.5
Changes in Government Spending and Revenues
(Percent of GDP, change from prior year, simple averages)



Sources: National authorities; and IMF staff calculations.

Figure 2.6
Narrowing Fiscal Deficits, 2017 and 2018
(Overall fiscal balance and public debt, percent of GDP)



Sources: National authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. Diamond corresponds to 2018; begining of the arrow to 2017.

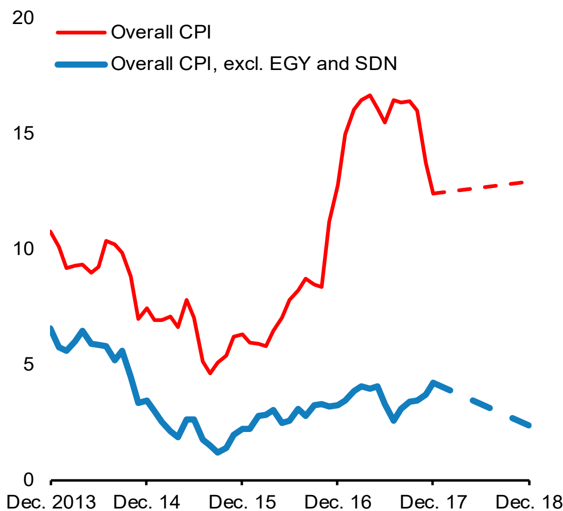
Inflation Pressure Is Easing, and Financial Sectors Remain Resilient

Inflation pressure in the region has abated, with ***inflation broadly stable*** at about 12 percent. This largely reflects the receding impact of one-off factors in Egypt and Sudan and, in some cases, monetary tightening (Jordan, Tunisia) or a decline in food prices (Morocco, Pakistan; Figure 2.7).

From a legacy of high, but declining levels of nonperforming loans, banking sectors have generally remained stable, liquid, and adequately capitalized. ***Private credit growth remains relatively buoyant***, with developments largely unchanged compared with those described in the October 2017 *Regional Economic Outlook*. Several countries (Egypt, Lebanon, Jordan, Pakistan) are beginning to embrace financial technology ("fintech") to increase financial inclusion.

To enhance resilience, the authorities need to continue to strengthen ***regulatory and supervisory frameworks*** (Djibouti, Mauritania), insolvency and bankruptcy regimes (Egypt, Jordan, Morocco, Tunisia), and in some cases deposit insurance arrangements (Egypt, Pakistan). Country authorities also need to remain alert and ready to adapt their frameworks to new sources of risk, including as the reach of fintech expands. Further, countries need to reinforce their anti–money laundering and combating the financing of terrorism frameworks. This will help bring them in line with international standards (Afghanistan, Somalia, Sudan) to ensure that the private sectors maintain their current access to finance.

Figure 2.7
Inflation
(Annual percent change)



Sources: National authorities; and IMF staff calculations.
Note: Overall CPI comprises EGY, JOR, LBN, MAR, PAK, SDN, TUN. CPI = consumer price index.

Risks Remain Tilted to the Downside

Overall, ***risks*** remain tilted to the downside:

- A further deterioration of regional conflicts or security conditions, intensification of domestic social tensions, or reform fatigue could derail the implementation of policy and reforms and weaken economic activity.

- The outlook for oil prices anticipates a rise to above $60 a barrel in 2018–19, a 20 percent increase over 2017. A further increase in oil prices could undermine consumption, increase fiscal pressures, and worsen external imbalances in most countries. For instance, a $10 increase in oil prices relative to the baseline would lead to a worsening in the current account balance by 1 percentage point of GDP across MENAP oil importers.

- Tighter and more volatile global financial conditions could increase borrowing costs further for MENAP oil importers, adding to existing fiscal sustainability concerns, weighing on bank balance sheets, and undermining private sector activity. Such tightening could be particularly challenging for countries facing significant financing

needs in the near term. For example, taking into account the gross financing needs for 2018, a 200 basis point increase in interest rates relative to the baseline would raise financing costs for Lebanon, Egypt, and Pakistan by 0.9, 0.8, and 0.7 percentage point of GDP, respectively. In addition, tightening of global financial conditions could precipitate capital outflows from the region that would put pressure on external positions and exchange rates.

- Escalating import tariffs or a shift toward more inward-looking policies could reduce global trade or affect commodity prices, removing some of the support being provided by external demand.

However, there also remains the potential for upside risk in those countries that would benefit if activity in key trading partners turned out stronger than expected.

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MENAP Region: Selected Economic Indicators, 2000–19

(Percent of GDP, unless otherwise indicated)

	Average 2000–14	2015	2016	2017	Projections 2018	2019
MENAP[1]						
Real GDP (annual growth)	4.8	2.5	4.9	2.6	3.4	3.7
of which non-oil growth	5.9	1.6	1.9	3.2	3.6	3.9
Current Account Balance	8.8	-4.0	-4.2	-0.9	0.5	-0.3
Overall Fiscal Balance	3.5	-8.6	-9.4	-5.6	-4.4	-3.5
Inflation (year average; percent)	7.1	5.6	4.7	6.3	8.2	6.8
MENAP oil exporters						
Real GDP (annual growth)	5.0	1.9	5.4	1.7	2.8	3.3
of which non-oil growth	6.6	0.3	0.8	2.6	3.2	3.4
Current Account Balance	12.6	-3.8	-3.6	1.2	3.0	1.8
Overall Fiscal Balance	6.7	-9.2	-10.6	-5.2	-3.8	-2.8
Inflation (year average; percent)	7.1	5.1	4.0	3.4	6.3	5.5
MENAP oil exporters, excluding conflict countries						
Real GDP (annual growth)	4.3	2.2	5.2	1.3	2.6	3.0
of which non-oil growth	6.2	1.9	2.1	2.5	3.1	3.2
Current Account Balance	13.1	-3.1	-2.9	1.3	3.6	2.5
Overall Fiscal Balance	7.2	-7.8	-9.2	-4.9	-3.5	-2.3
Inflation (year average; percent)	6.9	4.9	4.5	3.6	6.5	5.7
***Of which:* Gulf Cooperation Council (GCC)**						
Real GDP (annual growth)	4.9	3.6	2.1	-0.2	1.9	2.6
of which non-oil growth	6.9	3.5	1.6	1.8	2.7	2.7
Current Account Balance	16.5	-2.4	-3.4	2.1	4.3	3.1
Overall Fiscal Balance	9.7	-8.4	-10.8	-5.5	-3.4	-1.9
Inflation (year average; percent)	2.8	2.0	2.1	0.2	3.6	2.5
MENAP oil importers						
Real GDP (annual growth)	4.3	3.8	3.7	4.2	4.7	4.6
Current Account Balance	-2.2	-4.4	-5.7	-6.5	-6.2	-5.7
Overall Fiscal Balance	-5.6	-7.2	-6.8	-6.5	-5.9	-5.2
Inflation (year average; percent)	7.6	6.8	6.2	12.4	12.2	9.5
MENA[1]						
Real GDP (annual growth)	4.8	2.4	4.9	2.2	3.2	3.6
of which non-oil growth	6.1	1.3	1.5	2.9	3.3	3.8
Current Account Balance	9.5	-4.4	-4.6	-0.6	1.1	0.2
Overall Fiscal Balance	4.2	-8.9	-10.0	-5.6	-4.3	-3.3
Inflation (year average; percent)	7.0	5.8	4.9	6.6	8.7	7.1
Arab World						
Real GDP (annual growth)	5.1	3.2	3.1	1.7	3.0	3.5
of which non-oil growth	6.4	2.3	1.1	2.6	3.2	3.7
Current Account Balance	10.6	-5.1	-6.1	-1.4	0.2	-0.7
Overall Fiscal Balance	4.7	-10.1	-11.3	-6.2	-4.8	-3.3
Inflation (year average; percent)	4.7	4.6	4.0	5.8	7.9	6.0

Sources: National authorities; and IMF staff calculations and projections.

[1]2011–19 data exclude Syrian Arab Republic.

Notes: Data refer to the fiscal year for the follow ing countries: Afghanistan (March 21 to March 20) until 2011, and December 21 to December 20 thereafter, Iran (March 21 to March 20), and Egypt and Pakistan (July to June).

MENAP oil exporters: Algeria, Bahrain, Iran, Iraq, Kuw ait, Libya, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Yemen.

GCC countries: Bahrain, Kuw ait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

MENAP oil exporters excl. conflict countries: Algeria, Bahrain, Iran, Kuw ait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

MENAP oil importers: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syria, and

Arab World: Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuw ait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates, and Yemen.