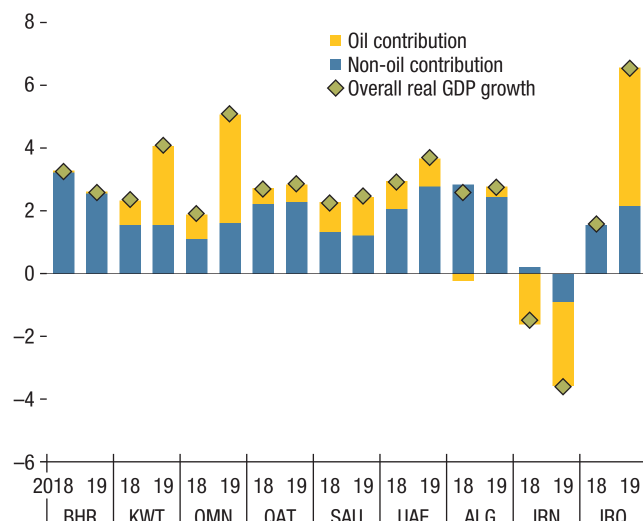
1. MENAP Oil-Exporting Countries: Higher Oil Prices Providing Temporary Support

Supported by higher oil prices, oil exporters in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region will experience visible improvements in external and fiscal balances in 2018–19. Non-oil activity is expected to continue its recovery, supported by a slower pace of fiscal consolidation, while oil production picks up where spare capacity is readily available. Risks remain skewed to the downside over the medium term. These include a faster-than-anticipated tightening of global financial conditions, escalating trade tensions that could affect global growth and put downward pressure on oil prices, geopolitical strains, and spillovers from regional conflicts. While a slower pace of fiscal consolidation may be justified in the short term, consolidation efforts should continue over the medium term. This will enable countries to mitigate the potential impact of shocks and ensure a sustainable use of hydrocarbon revenue. Continued structural reforms will facilitate private sector development and strengthen long-term resilience. Any delays on the structural reform agenda could curtail economic diversification and inclusion.

Recovery Underway

Oil prices continued to increase through the first half of 2018 and are now trading at about $75 a barrel, largely reflecting the collapse in Venezuela's production, unexpected outages in Canada and Libya, and the prospect of lower exports from Iran following US sanctions (see Global Developments). At the same time, production restrictions have been removed following the 4th OPEC and non-OPEC Ministerial Meeting (OPEC+) in June. Against this backdrop, economic activity in MENAP oil-exporting countries is expected to strengthen this year and next. Real GDP growth is projected at 1.4 percent in 2018 and 2 percent in 2019,

Figure 1.1. Real GDP Growth
(Percentage points)



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

up from 1.2 percent in 2017. This reflects a pickup in non-oil activity (except in Bahrain and Iran), underpinned by a slower pace of fiscal consolidation, as well as spillovers from higher oil output (especially in Saudi Arabia). Nonetheless, non-oil growth for MENAP oil exporters is projected to remain virtually unchanged this year and next compared with the 2.4 percent growth in 2017, mainly due to a drop in non-oil activity in Iran (Figure 1.1).

Projections in each subgroup are as follows:

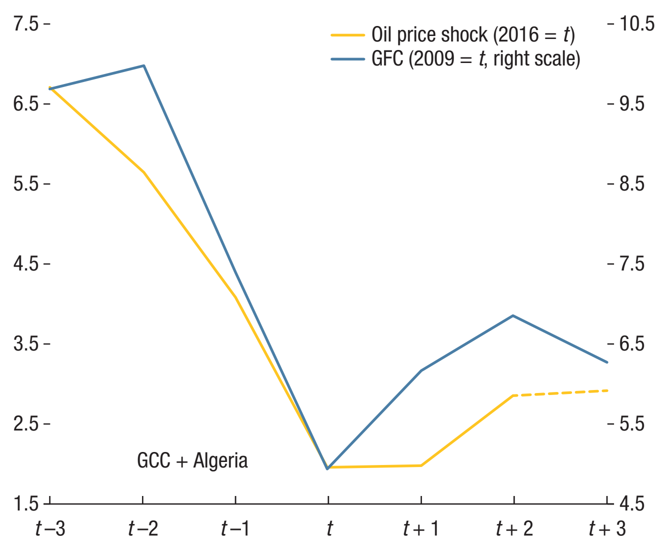
- Growth in the Gulf Cooperation Council countries (GCC) is expected to recover to 2.4 percent in 2018 and 3 percent in 2019, following a 0.4 percent contraction in 2017. This is mainly due to the implementation of public investment projects, including those consistent with the five-year development plan in Kuwait, infrastructure investment projects ahead of the FIFA 2022 World

Prepared by Juan Treviño (lead author) and Sebastian Herrador Guzman.

Cup in Qatar (where the effect of the rift with Saudi Arabia has been contained), and ongoing preparations for Expo 2020 in the United Arab Emirates (UAE). In Bahrain, the expected fiscal consolidation is projected to dampen non-oil activity, despite rising aluminum production capacity.

- Growth in non-GCC oil exporters is projected to slow to 0.3 percent in 2018, from 3 percent the previous year, and pick up modestly to 0.9 percent in 2019. This largely reflects the expected impact of the re-imposition of US sanctions on Iran, which is likely to reduce Iranian oil production and exports significantly over the next two years at least. In Algeria, higher public spending is expected to boost growth in 2018, but the planned fiscal contraction in the following years will likely result in a sharp slowdown in non-oil growth over the medium term. Iraq's growth is also projected to rebound in 2018–19, largely from continuing reconstruction efforts.
- In oil-exporting countries affected by conflict, growth performance has been mixed. While growth in Libya was strong in 2017, primarily driven by increased oil production, activity in Yemen contracted further. The outlook for these countries is expected to improve, but that is predicated on the assumption that the conflicts recede. Therefore, these projections remain highly uncertain and subject to security developments (see Box 1.1).

Figure 1.2. Real Non-Oil GDP Growth
(Percent, weighted average by PPP GDP)



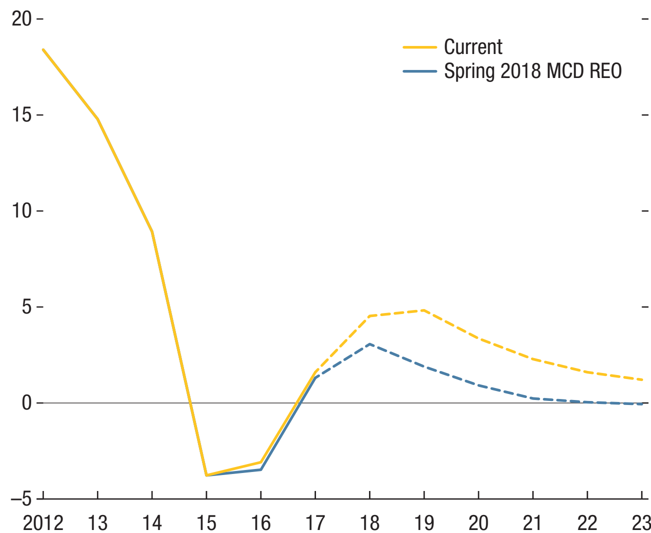
Sources: National authorities; and IMF staff calculations.
Note: GCC = Gulf Cooperation Council; GFC = global financial crisis; PPP = purchasing power parity. Dotted line represents projections.

Notwithstanding recent oil price developments and some increase in futures prices relative to the May 2018 *Regional Economic Outlook Update: Middle East and Central Asia*, markets continue to expect oil prices to peak in 2018 and then decline gradually to about $60 a barrel by 2023 (see Global Developments).

As the effect of higher oil prices fades, growth in MENAP oil exporters is projected to decelerate to an average of 2.3 percent in 2020–23, well below historical trends. Furthermore, while the impact of the shock to non-oil growth triggered by the 2014 drop in oil prices was of a magnitude broadly similar to the slowdown triggered by the global financial crisis, the projected recovery is anticipated to be weaker this time (Figure 1.2). As described in detail in the October 2009 *Regional Economic Outlook: Middle East and Central Asia*, MENAP oil exporters were affected by the 2009 global financial crisis by way of a 36 percent drop in oil prices, a contraction in the global economy, and a sudden drying up of capital flows. The pickup in oil prices of 28 percent in 2010 and 32 percent in 2011 is comparable to the 23 percent increase observed in 2017 and the 30 percent increase projected for 2018–19. However, global growth is anticipated to be weaker this time relative to the years following the 2009 crisis, as the global expansion has become more uneven and appears to have peaked in major economies, where slack is diminishing while capacity utilization is beginning to constrain supply (see Chapter 1 of the October 2018 *World Economic Outlook*).

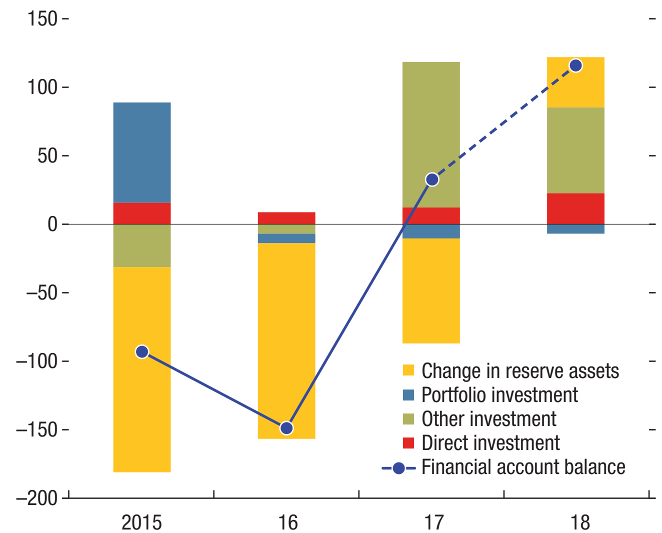
The growth outlook for MENAP oil exporters remains subject to significant uncertainty about the future path of oil prices. Potential spillovers

Figure 1.3. Current Account Balance in MENAP Oil Exporters
(Percent of GDP)



Source: IMF staff estimates.
Note: REO = *Regional Economic Outlook: Middle East and Central Asia*; MENAP = Middle East, North Africa, Afghanistan, and Pakistan. Dotted lines represent projections.

Figure 1.4. Balance of Payments: Financial Account Flows
(US billion, net lending (+) / net borrowing (–))



Sources: National authorities; and IMF staff calculations.
Note: Other investment includes currency and deposits, loans, trade credit and advances, other accounts receivable/payable, special drawing right allocations, other equity and insurance reserves, and standardized guarantees. Dotted lines represent projections.

associated with the re-imposition of sanctions on Iran and the persistence of geopolitical risks could create near-term upward pressures on oil prices. However, these factors, along with a further escalation of trade tensions, could reduce global demand, potentially depressing oil prices more than currently envisaged. Such developments could also have a negative impact on investor and consumer confidence throughout the region—in some countries exacerbated by possible contagion from recent developments in Turkey and other emerging markets—and act as a further impediment to growth.

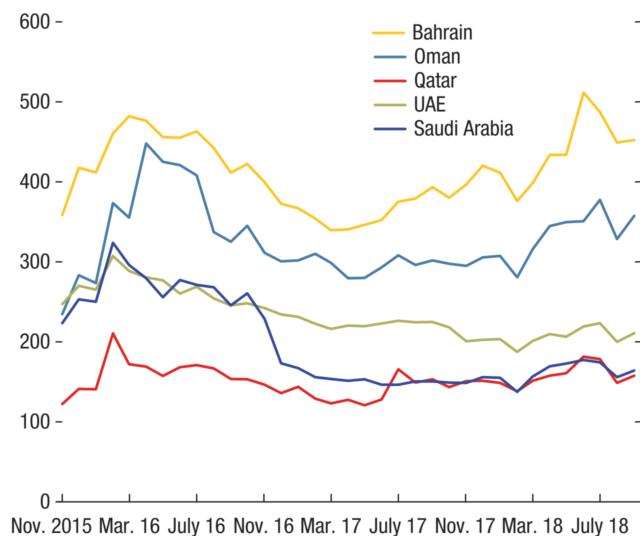
External Balances Improving

With oil prices having increased significantly since 2016, most MENAP oil exporters have seen tangible improvements in their external positions, although those positions remain weak in some countries (Algeria, Bahrain, Oman, Yemen). Oil exports have increased by about $260 billion during 2016–18—mostly due to price effects given the OPEC+ restrictions on production—and the current account balance is expected to shift from a deficit of $68 billion in 2016 to a surplus of $120 billion in 2018, an improvement of almost 8 points of GDP (Figure 1.3).

The financial account is also projected to improve further in 2018 (Figure 1.4). Many countries have tapped global financial markets this year—as of June 2018, MENAP oil exporters had issued sovereign debt worth $32 billion (of which $22 billion corresponds to Qatar and Saudi Arabia). Capital inflows following Saudi Arabia's inclusion in the MSCI Emerging Markets Index (March 2018) and the FTSE Russell Equity Indices (June 2018) are also supporting the improvement of its financial account. Against this backdrop, foreign exchange reserve accumulation has resumed in several countries, although coverage is low in some.

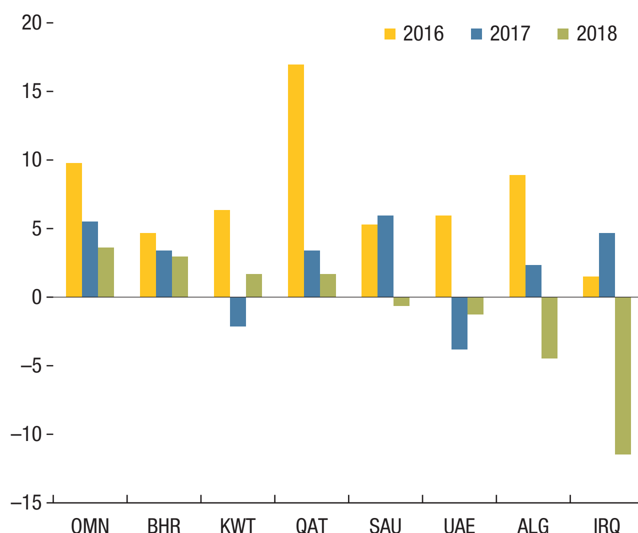
The recent tightening of financing conditions in emerging markets, however, has exposed vulnerabilities in MENAP oil exporters with weaker fundamentals, where sovereign spreads have widened (Figure 1.5). Rising regional

Figure 1.5. GCC Sovereign JPM MECI Spreads
(Basis points)



Source: Bloomberg Finance L.P.
Note: GCC = Gulf Cooperation Council; JPM MECI = JP Morgan Middle East Composite Index.

Figure 1.6. Change in Non-Oil Primary Fiscal Balance Relative to Previous Year
(Percentage points of non-oil GDP)



Source: IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes.

uncertainties from the re-imposition of sanctions on Iran have also dampened investor sentiment in some countries. With a large volume of non-sovereign international debt falling due by end-2019 ($135 billion), some countries are highly exposed to further tightening of financial conditions or higher risk aversion, which could lead to higher financing costs and capital flow reversals. This could hinder any further reserve accumulation and, in some countries, aggravate risks to external sustainability. Nevertheless, the inclusion of GCC countries in key emerging market bond indices will likely strengthen demand for GCC sovereign debt and mitigate some of these pressures (see Box 1.2).

Stronger Oil Revenues Providing Fiscal Space

With the recovery in oil prices and non-oil activity, combined in some countries with revenue mobilization measures (for example, the introduction of a value-added tax in Saudi Arabia and the UAE), fiscal balances are expected to improve notably across MENAP oil exporters. In several countries, including Saudi Arabia and the UAE, higher oil revenue has more than offset increases in public spending. The overall fiscal deficit for MENAP oil exporters is therefore projected to decline from 5.1 percent of GDP in 2017 to 1.6 percent in 2018 and 0.1 percent in 2019, and average 1.1 percent during 2020–23.

However, these trends mask differences in the fiscal stance across countries, as reflected by the change in the non-oil primary fiscal balance relative to non-oil GDP over time (Figure 1.6).

- In Saudi Arabia and the UAE, the available fiscal space provides the opportunity to temporarily adopt a modestly expansionary fiscal stance, consistent with the expected boost to non-oil activity. In Kuwait and Qatar, the fiscal stance is appropriately balanced, with the underlying fiscal position continuing to improve. In the coming years, however, each of these countries needs a further tightening of the fiscal position to ensure intergenerational equity (see Chapter 4).

- In Bahrain and Oman, spending restraint has contributed to notable improvements in the underlying fiscal positions. However, significant additional fiscal adjustment is still needed to maintain fiscal and external sustainability in these countries.
- Non-GCC oil exporters have adopted varying fiscal strategies. In Iraq, the fiscal stance is loose. In contrast, Algeria recently increased spending to boost economic activity, largely relying on monetary financing given limited fiscal savings, with a return to a steep fiscal consolidation planned from 2019 onward.

Fiscal Reforms Should Continue

Despite their varying fiscal stances, all MENAP oil exporters confront similar medium-term fiscal challenges. Given the high dependence on oil revenue—average fiscal break-even prices in 2020–23 are projected to be above the current oil price levels (except in Iraq, Kuwait, Qatar, Saudi Arabia, and the UAE)—fiscal balances remain vulnerable to oil price movements. Also, despite recent adjustment efforts, the gap between the actual non-oil fiscal balance and the balance consistent with the long-term income expected to be generated by oil revenue remains significant in many countries (see Figure 4.2 in Chapter 4). Thus, further consolidation over the medium term will help secure intergenerational equity and maintain fiscal sustainability while supporting economic activity. In addition, further consolidation would ensure that fiscal policy remains consistent with maintaining external sustainability, especially in countries with fixed exchange rates.

The current environment of temporarily high oil prices also provides an opportunity for countries to rebuild buffers. The potential threats to the global outlook, including rising trade tensions, could put additional downward pressures on oil prices (see below). Therefore, countries should further strengthen their fiscal frameworks to create space in the event policy support is needed.

Given that fiscal multipliers associated with capital expenditure in the region are estimated to be larger than current expenditure (Fouejieu, Rodriguez, and Shahid 2018), reducing less-productive current spending could provide space to preserve critical public investment and make the desired fiscal consolidation more growth-friendly (see Chapter 4). In this context, countries should tackle current expenditure rigidities, including public wage bills and subsidies, while safeguarding social safety nets. In parallel, efforts are needed to improve the efficiency of public spending, focusing on high-return public investments.[1]

Mobilizing non-oil revenues would also reduce reliance on commodity-related revenues and strengthen fiscal resilience. To this end, tax policy frameworks should continue to be broadened. The implementation of the value-added tax in Saudi Arabia and the UAE is welcome and should proceed in the remaining GCC countries. Other taxes, some of which are already operational in some countries, should also be considered. These include the income tax (especially corporate and eventually also personal), property tax, and excise duties where not already implemented (see Chapter 4).

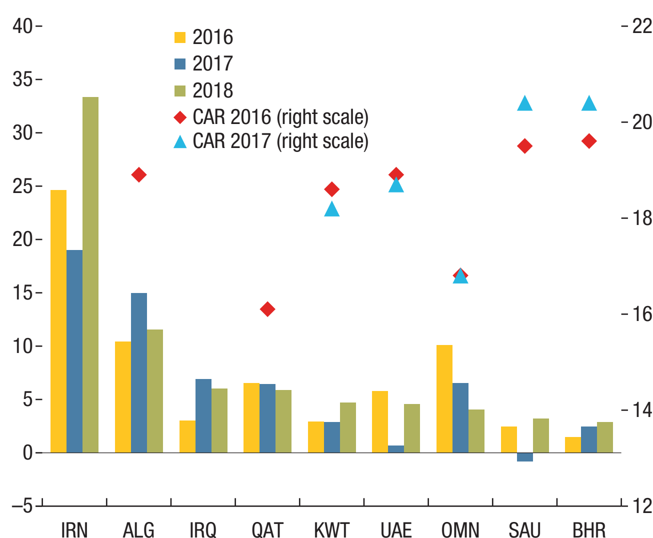
Private Sector Credit Remains Tepid

Higher oil prices have also improved liquidity conditions for banks. Nevertheless, private sector credit growth remains generally subdued (Figure 1.7), largely reflecting weak demand given the nascent economic recovery, and a weak real estate market in several GCC countries. In Bahrain, growth in corporates' demand for credit is weak given that major investment projects are financed by GCC funds. In Oman, demand for credit in the construction sector has weakened, partly reflecting the effects of fiscal consolidation. In Qatar, where real estate lending represents a large share of loans, credit growth remains weak,

[1]The literature on the magnitude of fiscal multipliers is generally mixed (Ilzetzki, Mendoza, and Vegh 2011), and several factors may affect the composition of public spending.

Figure 1.7. Bank Credit to the Private Sector and Capital Adequacy Ratios

(Percent, average annual growth, and percent of risk-weighted assets)



Sources: National authorities through Haver Analytics, IMF, International Financial Statistics database; and IMF staff calculations.
Note: CAR = capital adequacy ratio. Country abbreviations are International Organization for Standardization (ISO) country codes.

in part because of the downward trend in real estate prices. In Saudi Arabia, lower credit to the construction sector has more than offset stronger mortgage lending. In addition, policy rates in the GCC have risen in line with increases in the United States' federal funds rate, resulting in higher interest rates that could have also affected the demand for credit.

Among non-GCC economies, monetization of the fiscal deficit in Algeria implied substantial liquidity injections that provided a boost in 2017 to both private and public sector credit. In Iran, continued central bank liquidity injections to address liquidity and interest rate pressures have supported private sector credit. In Iraq, the weak banking sector and the prevalence of a parallel exchange rate market have hampered healthy financing to the private sector.

Credit growth is anticipated to pick up gradually over the next two years in most countries as the economic recovery continues. Accordingly, policies that support growth are likely to strengthen credit demand. In parallel, structural challenges that hamper financial sector development and inclusion should also be addressed. Lending to small and medium enterprises should be encouraged, supported by the development of further regulations (including bankruptcy laws and corporate governance practices) and effective supervision, to strengthen lender and borrower rights and lending practices.

The improvement of secured transactions and the development of credit information systems (credit bureaus) would also help improve lending and borrowing. Fintech and financial education, as well as programs that target women and the young—whose participation gaps are large—would promote greater access to finance and inclusion. Deepening domestic financial markets, including corporate bond markets, would also support the economic diversification strategy by creating new sources and channels for private sector access to capital.

Short-Term Risks Are Balanced, but Skewed to the Downside Beyond

Relative to the May 2018 *Regional Economic Outlook Update: Middle East and Central Asia*, risks to the outlook have improved in the short term, largely reflecting the recovery in global oil prices, but remain skewed to the downside over the medium term. In some countries, including Kuwait, Saudi Arabia, and the UAE, the positive effect on investor confidence from higher oil prices could improve the outlook in the short term. Also, the projected payoff of reforms implemented to date in some countries (especially Qatar, Saudi Arabia, and the UAE) could be higher than anticipated.

However, there is a tangible risk that the commitment to implement key fiscal measures and structural reforms will weaken amid higher oil prices. Also, any delays to reforms that would facilitate a greater role for the private sector in the economy—for example, through privatization in Qatar, Saudi Arabia, and the UAE—could curtail economic diversification efforts.

In addition, the overall uncertainty surrounding the future path of oil prices and the risk of downward pressures from escalating trade tensions remain significant sources of vulnerability for MENAP oil exporters. Similarly, an abrupt change in global risk appetite, including from trade tensions, faster than expected monetary policy tightening in the United States, or spillovers from volatility and policy uncertainty in some emerging market economies, represents another downside risk.

At the regional level, ongoing conflicts and geopolitical risks persist, including potential spillovers from the re-imposition of sanctions on Iran. These factors could exert upward pressure on oil prices in the near term but could be offset by losses in investor and consumer confidence.

Addressing Labor Market Distortions and Improving the Business Environment

The medium-term growth outlook appears less positive when placed in historical perspective, as illustrated above. In addition, the temporary nature of the oil price surge and the rising risks to the global economy make it more urgent to continue efforts to diversify the economy and create private sector jobs for the growing population (Purfield and others 2018)—IMF staff calculations suggest that the GCC will need to create about 1 million new jobs a year for at least the next five years to absorb new entrants into the labor market. While fiscal measures continue, including the tax policy reforms discussed earlier (Saudi Arabia and the UAE), energy subsidy reforms (Algeria, the GCC, Iran), and efforts to contain the public wage bill (Kuwait, Oman), more impetus is needed on the structural reform agenda, which has focused on job creation and inclusive growth (Purfield and others 2018).

Considering the need to reduce commodity dependence and promote economic diversification, two areas deserve special attention: *labor market* reforms and improving the *business environment*.

A number of countries have undertaken reforms that aim to address *labor market* distortions—for example, by leveling incentives between expatriates and nationals—and to reduce employment in the public sector (where more than 25 percent of the labor force in the GCC and Algeria work, well above the 9 percent in emerging market and developing economies).

In addition, countries have acted to support job creation for nationals, for instance by developing programs that encourage greater female and youth employment (Bahrain, Saudi Arabia). Reforms to soften hiring conditions for expatriates have also been implemented, including immigration regulations (self-sponsorship in Bahrain), and changes to visa requirements (Qatar granting residence to foreign workers and Saudi Arabia through visa amnesty). Nevertheless, a few countries have tightened restrictions on foreign workers (Oman, Kuwait). This could generate costly adjustments to employers, with differentiated effects on productivity across sectors. In the short term, such measures could negatively affect economic activity by restricting access to labor. In the long term, this could create distortions in labor costs that reduce competitiveness.

Therefore, strengthening the skills of nationals by investing in education and training should be prioritized, while efforts to increase the mobility of expatriates and promote female and youth participation should continue, accompanied by changes to public sector wages and benefits (Tamirisa and Duenwald 2018). This would create the appropriate incentives for nationals to compete for private sector jobs, while also ensuring they have the skills to be competitive.

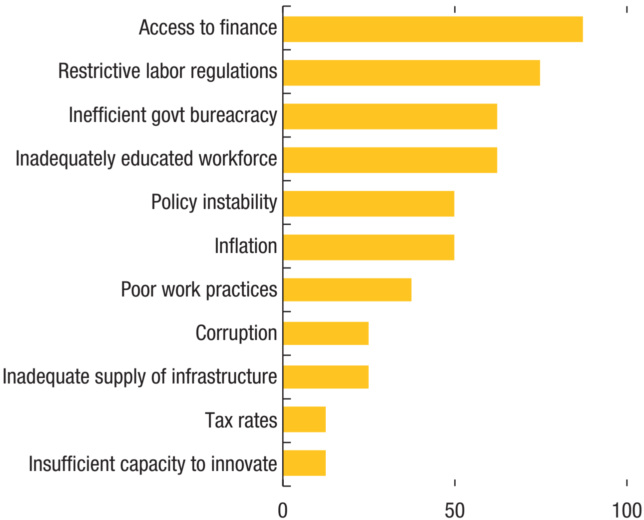
Progress is also being made, especially in the GCC, in improving the *business environment* and encouraging private sector development. Bahrain, Kuwait, Qatar, Saudi Arabia, and the UAE are in the process of implementing policies to ease the time and cost of starting a business by introducing one-stop registration, and, in some cases, using e-government technologies. Other reforms include streamlining customs procedures

(Saudi Arabia), enacting new laws to support small and medium-size enterprises (Algeria), developing and strengthening public-private partnership frameworks (Algeria, Kuwait, Qatar), and improving the bankruptcy framework (UAE).

To further improve the business environment (Figure 1.8), GCC countries need to ease access to finance. In this context, developing domestic capital markets as an alternative and complementary source of funding could prove beneficial. Non-GCC oil exporters need to make progress in several areas, including improving government effectiveness, transparency, and accountability, streamlining regulations, and reducing corruption and barriers to entry. These actions would ensure stronger and more inclusive long-term growth.

Figure 1.8. Challenges to Doing Business in MENAP Oil Exporters excl. Conflict Countries

(Percent of countries identifying the constraint among the top five)



Source: World Economic Forum, *Global Competitiveness Report 2017–18* (Executive Opinion Surveys).

Box 1.1. Conflict in the Middle East and Central Asia: Costs and Economic Policy Priorities

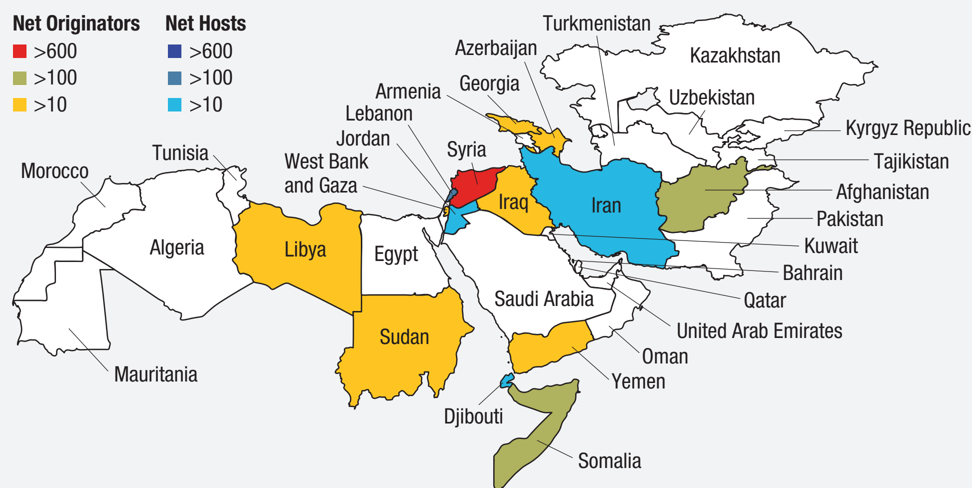
Violent conflict in the Middle East and Central Asia imposes vast humanitarian and economic costs (Rother and others 2016).[1] While the direct effects are concentrated in just a few countries—Afghanistan, Iraq, Syria, and Yemen accounted for more than 90 percent of conflict deaths in the region in 2017—the indirect effects spill across the region.[2]

One aspect of this has been the very large flows of refugees across the region (Figure 1.1.1) and further afield, especially Europe. Host countries often face a significant strain in accommodating large numbers of displaced people. For instance, data from United Nations High Commissioner for Refugees imply that refugees in Jordan and Lebanon accounted for about 7 and 16 percent of their respective populations in 2017. Violence itself can also spill over into nearby countries. For example, instability in eastern Lebanon is largely a result of conflict in neighboring Syria. The impact of these spillovers on trade and investor confidence also takes a toll.

The unpredictability of conflict presents a further challenge, as former safe havens can quickly become violent. For instance, Syria once offered a sanctuary to Iraqis fleeing sectarian violence following the invasion of 2003 and by 2007 more than 1.5 million Iraqi refugees were living in Syria. Since 2015, the roles have reversed; there are almost no Iraqi refugees in Syria, but nearly a quarter million Syrians have sought refuge in Iraq.

Figure 1.1.1. Net Refugees and Internally Displaced Persons, 2017

(IDPs and originated refugees minus hosted refugees, per 1,000 residents)



Sources: UNHCR, the UN Refugee Agency; and IMF staff calculations.

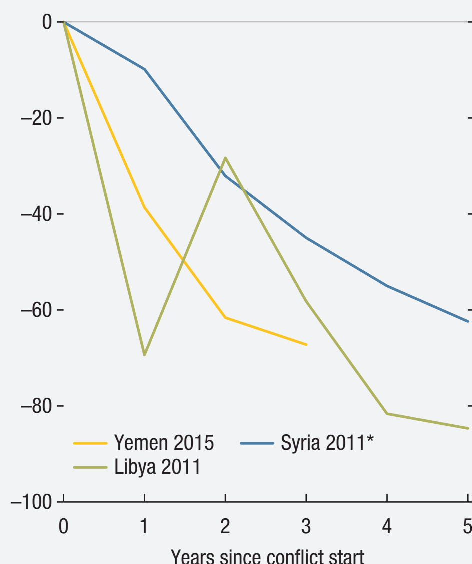
Prepared by Philip Barrett.

[1]The region accounts for 10 of 36 countries on the World Bank's Harmonized List of Fragile Situations, and 12 of 25 entries on the Council on Foreign Relations' list of global conflicts.

[2]Based on fatalities reported in the commonly used Uppsala Conflict Data Program (UCDP). Data from another standard data set, the Armed Conflict Location & Event Data Project, coincide with the UCDP. Data from the UCDP also suggest that the region accounted for more than three-quarters of conflict deaths worldwide in 2017.

Box 1.1 *(continued)*

Figure 1.1.2. Output Relative to Regional Comparators
(Percent of GDP)



Sources: National authorities; and IMF staff calculations.
Note: Conflict onset in legend corresponds to year 1. Syrian data are estimates.

In addition to its human cost, conflict also has substantial economic effects. To illustrate the potential scale of economic cost, Figure 1.1.2 shows the gap between the actual evolution of GDP and what it would have been if the country grew in line with regional peers for three recent conflicts.[3,4]

All three countries saw large relative declines in output following the start of conflict.[5] This is consistent with cross-country studies of the cost of conflict, such as Rother and others (2016), World Bank (2017), and Box 1.1 of the April 2017 *World Economic Outlook*.[6] However, the speed and extent of the impact varies substantially, potentially reflecting a variety of country-specific factors, including the severity and duration of the conflict. It also suggests that the structure of the economy explains much of the variation in the responses. The deeper declines in Libya and Yemen compared to Syria are largely due to reduced oil production, which is highly sensitive to conflict (for example, production or export may be impossible in an insecure environment), and which represented a large share of pre-conflict economic activity.[7]

Given the inherent uncertainty in measuring the cost of conflict, other measures of economic loss are also relevant. Government revenues are one such measure. For instance, in Libya, declines in oil production have deprived the government of an essential revenue stream (estimated at close to $50 billion during 2012–16 or about 90 percent of 2012 revenues). And the length and severity of the Afghanistan conflict are estimated to have reduced cumulative government revenues by about $3 billion (about 17 percent of GDP) since 2005.[8] Looking ahead, reconstruction efforts in conflict-affected countries are likely to be a source of further costs.

The extent and duration of conflict are beyond the control of economic policymakers. Nevertheless, steps can be taken to mitigate economic harm during conflict and promote recovery once peace arrives. Three general priorities stand out: (1) protecting institutions from becoming inoperative or corrupt; (2) prioritizing public

[3]For example, the value of –60 for Yemen in year 2 means that the country would have produced 60 percent more output in the second year of the conflict if it had grown at the same rate as other MENAP oil exporters.

[4]The comparison set for a given country is the relevant sub-regional grouping—MENAP oil exporters for Libya and Yemen, and oil importers for Syria—minus the country itself. Comparing to regional peers is a simple way to control for other external shocks that may occur simultaneously, such as fluctuations in global oil price or world demand.

[5]Two major conflicts in the region cannot be analyzed in this way: Afghanistan, because of absent pre-conflict data; and Iraq, where the removal of sanctions on oil sales following the 2003 invasion caused a rapid re-orientation of the economy towards oil exports, undermining the validity of comparison with other countries.

[6]For example, World Bank (2017) use a sophisticated economic model to estimate cumulative GDP losses in Syria of $226 billion. The equivalent statistic of about $200 billion implied by Figure 1.1.2 is very close.

[7]Post-2011 events in Libya are sometimes considered as two separate (albeit related) conflicts: a revolution in 2011, and civil war from 2014. This is reflected in the partial rebound in Libyan GDP in 2012 (year 2 of Figure 1.1.2). But as this recovery still entails an output loss of nearly 30 percent both episodes are treated here as one conflict.

[8]See Barrett (2018) for further details.

Box 1.1 *(continued)*

spending to protect human life, limiting fiscal deficits to preserve macroeconomic stability, and preserving economic potential; and (3) stabilizing macroeconomic and financial developments through effective monetary and exchange rate policy (see the October 2016 *Regional Economic Outlook: Middle East and Central Asia*). In Libya, for example, this means: keeping the National Oil Corporation as one entity; unifying the central bank and the finance ministries; devaluing the exchange rate; and replacing huge fuel subsidies with cash transfers. And in the case of Yemen, there is an urgent need for donors to support food imports and facilitate payments of public salaries and cash transfers.

The IMF supports these economic objectives by providing policy advice and technical assistance to help stabilize and preserve institutions (see the April 2017 *Regional Economic Outlook Update: Middle East and Central Asia*). In addition, it provides financing support (Afghanistan, Iraq) and helps mobilize additional resources from donors and other international financial institutions (Iraq, Somalia, West Bank and Gaza). The IMF can also facilitate the transition to recovery by coordinating with donors and other international organizations. Recognizing the economic costs for neighboring countries, the IMF similarly plays a role in mobilizing international donor support (Jordan) and has tailored IMF arrangements to take into account the impact of refuges and the internally displaced (Iraq, Jordan).

Box 1.2. The Impact of Including Gulf Cooperation Council Countries in the Global Diversified Emerging Market Bond Index

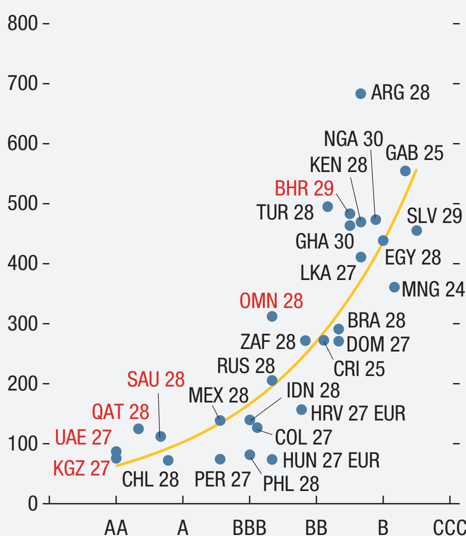
JP Morgan's expected inclusion of Bahrain, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates in its Global Diversified Emerging Market Bond Index (EMBI-GD) in September 2018 represents an important opportunity for these Gulf Cooperation Council (GCC) economies to mitigate risks relating to changes in global financial conditions.[1]

Although some GCC countries are already included in other bond indices, their contributions are small, and the scope for inclusion is limited by countries' relatively high credit ratings. For instance, GCC issuers represent less than 5 percent of the Bloomberg Barclay's Global Aggregate Index. In contrast, the move to include them in the EMBI-GD adds roughly $150 billion to the index, according to market estimates. This reflects the $127 billion issued by GCC sovereigns in 2014–17 plus the $32 billion issued in 2018.

Overall, with GCC sovereign bonds accounting for some 15 percent of total emerging market bonds outstanding, inclusion in the EMBI-GD index could lead to a significant increase in demand for GCC sovereign bond issues. Market estimates indicate passive investment by index-tracking funds could amount to $30 billion to $45 billion of new demand, or about 30 percent of the value of outstanding GCC sovereign issuance. This would lead to a decline in sovereign spreads relative to international benchmarks, reducing the premium they pay relative to similar or lower rated issuers (Figure 1.2.1). For instance, this could amount to up to 30 basis points for Qatar.

Figure 1.2.1. Sovereign Spreads vs. Rating

(Basis points; maturity years in data labels)



Source: Bloomberg Finance L.P.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes.

This passive demand would further ease access to global financial markets and likely lower funding costs, including for corporates. With international bond issuance by corporates also significant—about $40 billion from 2014 to the first half of 2018 (Dealogic)—securing a reduction in financing costs could result in higher private investment and stronger and more broad-based economic growth. Easing access to global financial markets would help ease the impact of tightening global financial conditions and provide an important channel to mitigate the risk of further bouts of financial market volatility.

Prepared by Juan Treviño.
[1]EMBI-GD is a widely tracked US dollar-denominated sovereign bond index. Oman is already a member of this index.

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MENAP Oil Exporters: Selected Economic Indicators

	Average 2000–14	2015	2016	2017	Projections 2018	2019
Real GDP Growth	**5.0**	**2.0**	**5.8**	**1.2**	**1.4**	**2.0**
(Annual change; percent)						
Algeria	3.7	3.7	3.2	1.4	2.5	2.7
Bahrain	5.1	2.9	3.5	3.8	3.2	2.6
Iran	3.5	−1.6	12.5	3.7	−1.5	−3.6
Iraq	. . .	2.5	13.1	−2.1	1.5	6.5
Kuwait	4.8	−1.0	2.2	−3.3	2.3	4.1
Libya	−5.3	−13.0	−7.4	64.0	10.9	10.8
Oman	3.7	4.7	5.0	−0.9	1.9	5.0
Qatar	11.2	3.7	2.1	1.6	2.7	2.8
Saudi Arabia	4.1	4.1	1.7	−0.9	2.2	2.4
United Arab Emirates	4.9	5.1	3.0	0.8	2.9	3.7
Yemen[1]	2.9	−16.7	−13.6	−5.9	−2.6	14.7
Consumer Price Inflation	**7.1**	**4.7**	**4.0**	**3.6**	**9.8**	**9.9**
(Year average; percent)						
Algeria	3.7	4.8	6.4	5.6	6.5	6.7
Bahrain	1.7	1.8	2.8	1.4	3.0	4.8
Iran	17.8	11.9	9.1	9.6	29.6	34.1
Iraq	14.0	1.4	0.5	0.1	2.0	2.0
Kuwait	3.2	3.7	3.5	1.5	0.8	3.0
Libya	4.9	9.8	25.9	28.5	28.1	17.9
Oman	2.5	0.1	1.1	1.6	1.5	3.2
Qatar	4.3	1.8	2.7	0.4	3.7	3.5
Saudi Arabia	2.2	1.3	2.0	−0.9	2.6	2.0
United Arab Emirates	4.1	4.1	1.6	2.0	3.5	1.9
Yemen[1]	11.3	12.0	−12.6	24.7	41.8	20.0
General Gov. Overall Fiscal Balance	**6.7**	**−9.2**	**−10.4**	**−5.1**	**−1.6**	**−0.1**
(Percent of GDP)						
Algeria[2]	2.9	−15.7	−13.4	−8.9	−7.0	−5.6
Bahrain[2]	−0.9	−18.4	−17.6	−14.3	−8.9	−8.2
Iran[3]	1.4	−1.8	−2.3	−1.4	−3.2	−4.2
Iraq	. . .	−12.8	−14.3	−1.6	5.6	3.8
Kuwait[2]	28.4	5.6	0.6	6.6	11.6	12.0
Libya	6.0	−131.0	−113.3	−43.0	−25.1	−26.9
Oman[2]	8.0	−15.9	−21.2	−12.9	−2.0	0.8
Qatar	10.6	5.4	−4.7	−1.6	3.6	10.5
Saudi Arabia	7.3	−15.8	−17.2	−9.3	−4.6	−1.7
United Arab Emirates[4]	7.3	−3.4	−2.0	−1.6	0.6	1.3
Yemen[1]	−3.1	−8.7	−8.9	−4.7	−10.7	−4.5
Current Account Balance	**12.6**	**−3.8**	**−3.1**	**1.6**	**4.7**	**4.8**
(Percent of GDP)						
Algeria	11.4	−16.4	−16.5	−13.2	−9.0	−7.9
Bahrain	6.3	−2.4	−4.6	−4.5	−2.5	−2.3
Iran	4.8	0.3	4.0	2.2	1.3	0.3
Iraq	. . .	−6.5	−7.8	2.3	6.9	3.1
Kuwait	33.3	3.5	−4.6	5.9	11.3	11.0
Libya	16.9	−54.4	−24.7	8.4	1.5	2.9
Oman	8.9	−15.9	−18.7	−15.2	−3.3	−0.5
Qatar	21.0	8.5	−5.5	3.8	4.8	6.6
Saudi Arabia	16.3	−8.7	−3.7	2.2	8.4	8.8
United Arab Emirates	10.6	4.9	3.7	6.9	7.2	7.5
Yemen[1]	−0.1	−6.2	−5.1	−4.0	−9.3	−7.4

Sources: National authorities; and IMF staff estimates and projections.
Note: Variables reported on a fiscal year basis for Iran (March 21/March 20).
[1]2018 projection is based on assumption that conflict ends in 2019.
[2]Central government.
[3]Central government and National Development Fund including Targeted Subsidy Organization.
[4]Consolidated accounts of the federal government and the emirates Abu Dhabi, Dubai, and Sharjah.