

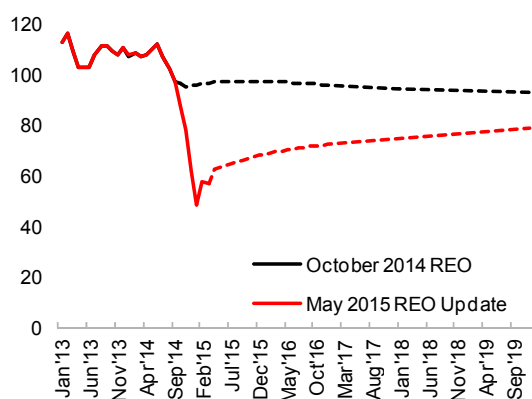
## MENAP Oil-Exporting Countries

### Lower Oil Prices Define Economic Outlook

Between July 2014 and April 2015, oil prices dropped by 50 percent. They are now expected to be \$58 per barrel in 2015 before rising gradually to \$74 per barrel by 2020, in response to a decline in oil investment and production and a pickup in oil demand as the global recovery strengthens. Importantly, a sizable part of the price decline is expected to persist—market expectations over the medium term have been revised down by almost 20 percent since last October (Figure 1).

**Figure 1.**  
**Brent Futures Curve**

(October 2014 REO versus May 2015 REO Update)



Source: IMF staff calculations.

### Government Spending and Rising Oil Production Support Growth

Growth in MENAP oil exporters reached 2.4 percent in 2014, slightly higher than in 2013, and mainly reflecting recovery in Iran and a pick-up in oil-related activity in Saudi Arabia. In 2015, growth is projected to remain unchanged, before rising to 3½ percent in 2016 as oil growth accelerates in Iraq and Libya. Although the oil price decline has reduced authorities' spending power, which has been the engine of the non-oil economy in recent years, the impact is to be appropriately cushioned by using the accumulated financial buffers where available, while gradually undertaking the needed fiscal adjustment over the medium term. As a result, growth will be stable this year, albeit 1½ pp lower than was projected last October.

- In the GCC countries, growth is forecast at 3.4 percent in 2015, revised downward since last October by 1 pp, mainly because of a slowdown in non-oil growth in response to lower oil prices. In Saudi Arabia, the growth forecast for 2015 is now 3 percent, down 1½ pp from last October, although half of this revision owes to the rebasing of real GDP data.
- Outside the GCC, growth has been revised down by 2 pp in 2015 to just above 1 percent, as oil production continues to be hampered by security disruptions (Libya, Yemen) and a challenging external environment (Iran). In Iraq, growth is expected to reach 1¼ percent in 2015 as the oil economy recovers, although the security situation and stagnating government spending will continue to weigh on non-oil activity.

### Inflationary Pressures Are Subdued

Inflation in MENAP oil exporters is projected to remain broadly unchanged in 2015. In the GCC, inflation is expected to decline by ½ pp to just above 2 percent because of strengthening currencies (pegged to the U.S. dollar) and declining food prices. Lower oil prices are unlikely to affect inflation significantly, because most countries use administered prices for fuel products. In countries with managed exchange rates (Algeria, Iran), currency depreciation may add to inflation pressures, while supporting non-oil exports.

### Two-Sided Risks

Uncertainty surrounding the projections has increased. Although most risks are two-sided, their balance is still tilted to the downside. The current oversupply in the global oil market suggests that GCC may face challenges in maintaining market share, with potential downside pressures on oil production. Government spending and hence nonoil activity may slow down by more than expected. However, a faster-than-expected recovery in oil prices would support government spending and nonoil growth. Overall, the risk of volatility in oil prices has risen, at least in the short term, because of complex interplays between traditional and shale oil production and geopolitical

risks. (For more details on oil market developments and outlook, see *Commodity Market Developments and Forecasts* in the April 2015 WEO, available at [www.imf.org](http://www.imf.org)).

Conflicts and geopolitical tensions further augment the risks. Oil production in countries affected by conflict (Libya, Iraq) may surprise either on the upside or downside. Following the release of the key parameters for a Joint Comprehensive Action Plan (JCPOA) between Iran and the P5+1 on April 2,<sup>1</sup> upside risks to oil production and exports have increased.

The normalization of U.S. monetary policy is expected to tighten financial and monetary conditions in the region, especially in the GCC, although the pass-through tends to be slow and partial. For countries that are highly dependent on foreign funding (Bahrain, Oman, Yemen), financing and rollover risks may rise.

### Lower Oil Prices Erode Long-Standing External and Fiscal Surpluses

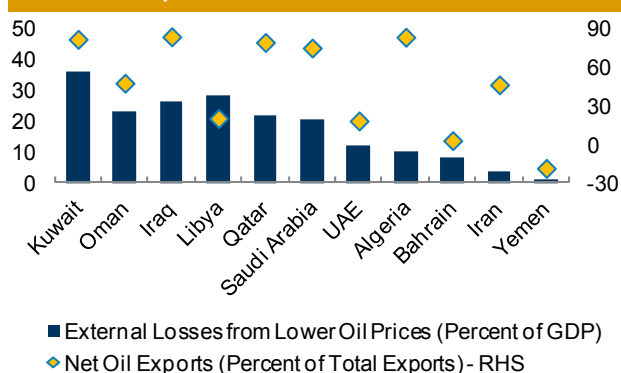
Under the current oil price assumptions, the fall in anticipated oil export earnings in 2015 is \$287 billion (21 percent of GDP) in the GCC and \$90 billion (11 percent of GDP) in the non-GCC countries (Figure 2). The oil price decline will turn the longstanding current account surplus of MENAP oil exporters into a deficit of \$22 billion (1 percent of GDP) in 2015.

Surpluses are expected to return gradually over the medium term, reaching 3¼ percent of GDP by 2020, as a result of both higher oil prices and projected fiscal consolidation (Figure 3).

<sup>1</sup> P5+1 are the five permanent members of the UN Security Council and Germany. The key parameters are expected to serve as the basis for a final JCPOA to be completed by end-June, 2015, which aims for commitments regarding Iran's nuclear program in exchange for economic sanctions relief. Projections presented in this REO Update do not incorporate the impact of sanctions relief on the economy, as details of these are yet to be agreed.

Fiscal balances are also severely affected by lower oil prices. In the GCC, a combined budget surplus for 2014 of \$76 billion (4½ percent of GDP) is expected to turn into deficit of \$113 billion (8 percent of GDP)

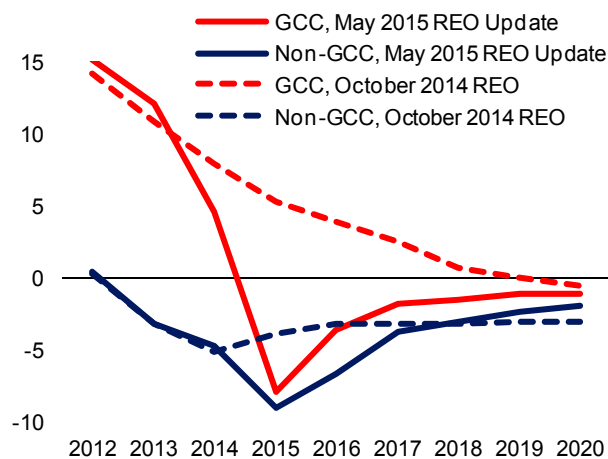
**Figure 2.**  
Drop in Oil Export Revenue from Lower Oil Prices, 2015



Sources: National authorities; and IMF staff calculations.  
Note: External losses are calculated as the projected difference in the U.S. dollar value of net oil exports in 2015, using the 2015 oil price assumptions in the May 2015 and October 2014 WEOs, and the volume of net oil exports in the latter, with adjustments for country-specific factors.

in 2015, narrowing only partly over the medium term to 1 percent of GDP (Figure 3). Non-GCC countries already posted a fiscal deficit in 2014 (4¾ percent of GDP), which is expected to widen to 9 percent of GDP in 2015, before stabilizing at 2½ percent of GDP in the medium term.

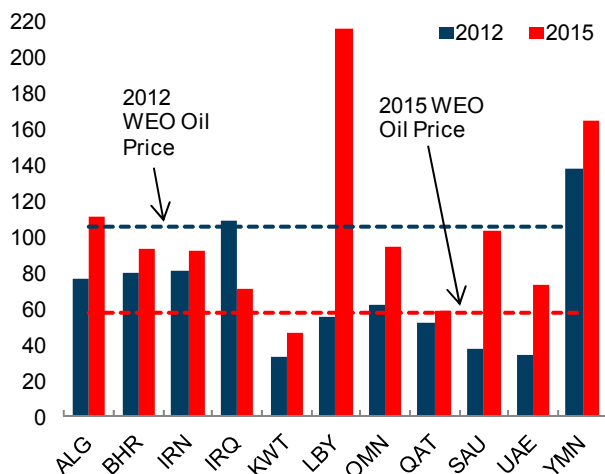
**Figure 3.**  
Fiscal Balance, 2012-20  
(Percent of GDP)



Sources: National authorities; and IMF staff calculations.

A sharp rise in spending in recent years has made budgets vulnerable to lower oil prices. Most countries in the region cannot balance their budgets when oil prices approach \$60 per barrel (Figure 4).

**Figure 4.**  
Fiscal Breakeven Oil Prices, 2012 and 2015  
(U.S. dollars per barrel)



Sources: National authorities; and IMF staff calculations.

A permanent decline in oil prices reduces the real income of oil exporters and requires fiscal consolidation plans to be brought forward. Non-oil fiscal balances are expected to improve by 2½ pp of non-oil GDP in 2015, driven by Kuwait, Oman, Iraq, and Libya. In the GCC, large buffers and available financing allow the adjustment to be gradual (Table 3 in the January 2015 REO Update). However, most GCC countries have not yet announced specific consolidation plans (Table 1).

Outside the GCC, where both oil revenue losses and fiscal buffers are smaller (Figure 2), non-oil balances are expected to improve by 2¾ pp of non-oil GDP in 2015, a revision of 1½ pp since last October. In Libya, capital spending is curtailed because of difficult security conditions. A moderately looser fiscal position in Iran (by 1 percent in 2015) reflects lower oil prices and planned increases in capital spending.

### Opportunities for Fiscal Reform

Because government spending is a key driver of non-oil growth, fiscal consolidation should be done in a growth-friendly manner. This can be achieved by

limiting spending overruns and slowing the growth of public wage bills and other current expenditures and ensuring the productivity of capital spending.

**Table 1. Announced Fiscal Measures in MENAP Oil Exporters**  
(as of end-March 2015)

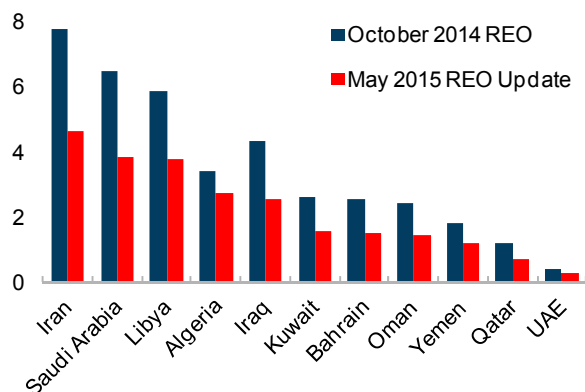
GCC	
Bahrain	Authorities announced increase in natural gas prices for industrial users (+11%) and employee medical insurance fees (paid by employers) in early 2015.
Kuwait	The 2015/16 budget projects an 18% cut in public spending, capital spending to be shielded.
Oman	The 2015 budget includes reduction in defense spending, capital spending shielded.
Qatar	No major announced policy response. Qatar continues its policy of restraining current expenditures.
Saudi Arabia	A large fiscal spending package worth around 4 percent of GDP was announced in Feb 2015.
UAE	No major announced policy response. UAE continues its path of gradual fiscal consolidation.
Non-GCC	
Algeria	Public sector hiring freeze was announced.
Iran	The 2015/16 budget aims to limit drop in oil revenue by: (i) increasing the share of oil exports that goes to the budget, (ii) depreciating the official exchange rate (by 10%).
Iraq	The 2015 budget includes increases in non-oil taxes and aims to contain spending (e.g., savings on civil servant wages).
Libya	No major policy response announced.
Yemen	Large decline in energy subsidies planned for 2015H1. Increase in Social Welfare Fund transfers to poor by 50% (Dec 2014). Progress in implementation will depend on security situation.

Sources: National authorities and IMF staff.

Reducing generalized energy subsidies—which remain large despite lower oil prices (Figure 5)—while increasing targeted social subsidies, would also help raise government revenues and discourage inefficient use of energy. Delaying such reforms will most likely require a more abrupt and costly adjustment in the future. Most countries have already initiated reforms to their subsidy systems (Table 2).

Lower oil prices underscore the benefits of reducing countries' dependence on oil. Increasing the efficiency of capital expenditure by prioritizing and raising oversight and transparency of projects, improving tax administration, and increasing non-oil revenue collection would complement efforts to contain spending.

**Figure 5.**  
**Pre-Tax Fuel Subsidies Are Still High<sup>1</sup>**  
(Percent of GDP)



Sources: National authorities; and IMF staff calculations.  
<sup>1</sup>Size of subsidy bill is estimated using 2013 data. Calculations are based on a price-gap analysis following IMF Board Paper (SM/13/29) and MCD Departmental Paper (14/3).

### Banks Are Sound but Face Higher Risks

The oil price decline has affected financial markets in MENAP oil exporters. Equity prices have declined, and volatility has risen. Real estate markets are showing signs of cooling.

GCC banks are expected to remain sound despite the sharp decline in oil prices and slowing loan growth, because they have strong initial financial positions. They will also be supported by continuing government infrastructure investment—albeit at a lower pace—which drives nonoil growth, bank credit, and profitability. Liquidity could tighten as oil-related bank deposits decline, and NPLs could rise. However, banks are well positioned to absorb the shocks.

By contrast, non-GCC banks are more vulnerable. Iran’s banking system is already exhibiting systemwide stress, on the back of high NPLs, because of a weaker economic environment and the withdrawal of correspondent banks in response to sanctions. In Yemen, large exposures to the government, against the backdrop of a weak fiscal position, declining oil revenues, and the escalating conflict has raised systemic risks. In Iraq, the deteriorating political and economic environment is exerting pressure on an already weak banking system.

Table 2. Subsidy-related Reform Measures In MENAP Oil Exporters	
<b>GCC</b>	
Bahrain	Authorities announced increase in natural gas prices for industrial users (+11%) and employee medical insurance fees (paid by employers) in early 2015.
Kuwait	In Jan-15, government raised diesel and kerosene prices (+50%) and instituted monthly price review mechanism.
Oman	No reform measures recently announced.
Qatar	Diesel prices up in May-14 by 50%. Starting to improve desalination technologies and awareness of sustainable energy use.
Saudi Arabia	No reform measures recently announced.
UAE	Gasoline price highest in GCC (still below int'l levels). Abu Dhabi increased water (+170%) and electricity (+40%) tariffs in Jan-15.
<b>Non-GCC</b>	
Algeria	Authorities published cost of implicit subsidies in budget for first time in 2014.
Iran	Fuel prices were increased in Mar/Apr-14 by about 30 percent. Similar increase is possible in 2015.
Iraq	No reform measures recently announced.
Libya	Two initiatives being piloted: (i) use of national ID to eliminate duplication, (ii) reduce number of subsidized food items.
Yemen	Increase in gasoline, diesel, and kerosene prices in 2014 by 20%, 50%, and 100%, respectively. Automatic fuel price adjustment mechanism planned for first half of 2015.

Sources: National authorities and IMF staff.

### Diversification Is More Urgently Needed

New realities of the global oil market make more urgent the need to move away from the past growth models based on oil-driven government spending and sharing of oil wealth through subsidies and public employment for nationals. These models have led to low productivity growth and are not delivering adequately on jobs and diversification.<sup>2</sup>

A new model is needed where economic growth and job creation are driven by a diversified private sector. Creating incentives for private entrepreneurship in the tradable goods sectors, improving the match between education and skills required by the private sector, and increasing private employment of nationals would go a long way toward achieving the diversification goals.

<sup>2</sup> The contribution of productivity to potential growth was 2 pp lower in MENAP oil exporters than in other emerging market and developing countries during 2008–2014 (see Annex I of the October 2014 REO).