The Global Financial Crisis: Possible Transmission to the Real Economy in the Arab World

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The Global Picture

- The global financial crisis that started in the US in 2008 came on the heels of very high food and fuel prices that were already impacting many developing countries.
- The financial crisis has now become an economic crisis. Many developed countries are already in recession; every country in the world is being affected or is likely to be affected.
- Since reaching a peak of $147 per barrel in July 2007, oil prices have declined markedly. This has raised concerns in oil-exporting countries.
- At the same time, in non-oil exporting countries, the decline in oil prices, and the resulting decline in the price of food, have not resolved all problems.
- The Bank predicts that global GDP growth will slip from 2.5% in 2008 to 0.9% in 2009.
- Global trade volume is projected to decline in 2009 -- for the first time since 1982.
- Global poverty may have increased -- about 100 million people have been pushed into poverty, as a result of the accumulated impact of high food and fuel prices experienced in 2008.
- Recent estimates from the FAO show that the number of undernourished people increased from 848 million to 963 million between 2003–05 and 2008, largely owing to the food price crisis.
Outline of the Presentation

What does this new global picture mean for the Arab economies?

I. Financial Impact of the Global Financial Crisis on Arab economies
II. Potential Impact on the Real Economy
III. Policy Responses
IV. What Can the World Bank Group do to Help
I. Financial Impact of the Global Financial Crisis – GCC’s Capital Market

- Financial impacts of crisis on Arab countries have varied significantly
- Early impacts visible in countries with strong links to global financial markets
- Gulf countries first to see impact of crisis on their stock markets, starting in mid-2008 and accelerating after collapse of Lehman Brothers in mid-September 2008
- Impact on Gulf stock markets largely due to withdrawal of ST portfolio capital by global investors to balance portfolios in the face of losses in mature markets
- Despite credit dry out, banks in Gulf countries remained resilient
- Nonetheless, a bank and an investment house in Kuwait showed clear signs of vulnerability, as has Dubai’s luxury and commercial real estate sector
- Gulf countries have announced various rescue mechanisms to maintain liquidity and support the segments of their economies that have shown signs of vulnerability
- Sovereign Funds remain sound, although they may have taken some losses on their investments in global financial institutions

![Arab Stock Market index, 2007/01-2008/12](image)

| Estimated loss of Gulf Sovereign Funds due to the Economic downturn |
|----------------------|------------------|------------------|------------------|------------------|
| Abu Dhabi Investment Authority (ADIA)/Abu Dhabi Investment Council (ADIC) | 453 | 328 | -183 | 39 | -40% |
| Kuwait Investment Authority (KIA) | 262 | 228 | -94 | 57 | -36% |
| Qatar Investment Authority (QIA) | 65 | 58 | -27 | 28 | -41% |
| Saudi Arabian Monetary Agency (SAMA) + assets managed for other government institutions | 385 | 501 | -16 | 162 | -12% |
| Other GCC central banks | 116 | 84 | 0 | -33 | 0% |
| GCC Total | 1182 | 1200 | -350 | 273 | -27% |
| O Glo GCC “Big 4” | 1165 | 1116 | -350 | 306 | -30% |
| Memo: Norwegian Government Pension Fund–Global | 371 | 325 | 0 | -111 | 64 | -30% |

Source: World Bank data and national central Banks
Financial Impact of the Global Financial Crisis --- Capital Markets in Other Countries

- Fear triggered contagion, and stock markets in other Arab countries experienced a decline in their indices.
- Lebanon and Tunisia’s stock markets showed remarkable resilience.
- Across the Arab World, the banking sector has so far been little affected, mainly because of limited integration into global financial markets.

<table>
<thead>
<tr>
<th>Arab Stock markets</th>
<th>Jan-Nov Stock Index variation</th>
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<tbody>
<tr>
<td>COMPOSITE</td>
<td>-49%</td>
</tr>
<tr>
<td>ABU DHABI SECURITIES MARKET</td>
<td>-52%</td>
</tr>
<tr>
<td>AMMAN STOCK EXCHANGE</td>
<td>-31%</td>
</tr>
<tr>
<td>BAHRAIN STOCK EXCHANGE</td>
<td>-33%</td>
</tr>
<tr>
<td>BEIRUT STOCK EXCHANGE</td>
<td>-9%</td>
</tr>
<tr>
<td>CASABLANCA STOCK EXCHANGE</td>
<td>-31%</td>
</tr>
<tr>
<td>DOHA SECURITIES MARKET</td>
<td>-27%</td>
</tr>
<tr>
<td>DUBAI FINANCIAL MARKET</td>
<td>-55%</td>
</tr>
<tr>
<td>EGYPT CAPITAL MARKET</td>
<td>-56%</td>
</tr>
<tr>
<td>KUWAIT STOCK MARKET</td>
<td>-57%</td>
</tr>
<tr>
<td>MUSCAT SECURITIES MARKET</td>
<td>-57%</td>
</tr>
<tr>
<td>PALESTINE SECURITIES EXCHANGE</td>
<td>-20%</td>
</tr>
<tr>
<td>SAUDI STOCK MARKET</td>
<td>-56%</td>
</tr>
<tr>
<td>TUNIS STOCK EXCHANGE</td>
<td>9%</td>
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</tbody>
</table>

Source: Arab Monetary Fund
Financial Impact of the Global Financial Crisis -- Access to External Financing

- The global financial crisis had immediate impact on access to external financing worldwide. Borrowing spreads increased for emerging market sovereign and corporate borrowers.
- Arab countries were no exceptions to this.
- However, Arab countries have been far less severely affected by the credit crunch.
- With generally good balance of payments positions coming into the crisis, or with alternative sources of financing for their large current account deficits, such as remittances, FDI or foreign aid, Arab countries were able to avoid going to the market in the latter part of 2008.
II. Potential Impact on the Real Economy

- Overall, most Arab countries have not been highly vulnerable to the financial impact of the crisis so far.
- However, the impact on the real economy is still unfolding, and can be significant in many countries.
- Governments with fiscal space going into the crisis will be in a stronger position to respond to the impact of the crisis on the real economy and households. However, going into the crisis, many Arab countries were running a fiscal deficit.
Potential Impact on the Real Economy

- Most Arab countries are already experiencing decline in export growth as a result of global economic downturn and/or lower oil prices.
- However, economic impact of global slowdown will vary, depending upon initial fiscal and external account positions, as well as the degree of economic integration with highly impacted regions.
- To discuss the potential economic impact, useful to group countries into four categories according to the main channels of transmission:
  - Group 1: Countries with strong linkages with Europe in trade and tourism.
  - Group 2: Oil exporters with large populations and social needs but with less financial surpluses than GCC countries.
  - Group 3: Countries with strong linkages with GCC through remittances, FDI and tourism.
  - Group 4: Oil exporters with large financial capacity and small populations.

Source: World Bank data
Group 1: Morocco, Tunisia, and to some extent Egypt

- These countries have the strongest economic links to Europe, through trade in goods trade as well as through tourism
- They will feel the greatest economic impact through the depressed European demand for imports and tourism
- They will also receive less FDI from Europe
- The Euro Zone effect will compound other relatively less important channels through which these countries might be impacted
- These impacts will directly be felt in the SMEs sector, on employment and household income
- Public finances and the domestic banking sector will be impacted in a second round

Exports to EU, as a share of total exports, 2002-2006

Source: World Bank data
Group 2: Algeria, Libya, Iraq, Syria, Sudan

- Although oil exporters with significant oil revenues, these countries have large populations and large social commitments, making it difficult to adjust expenditures in a downturn.
- And unlike the oil exporting Gulf countries, these countries enter the crisis with weak fiscal positions to start with.
- The crisis is likely to precipitate a decline in the trade surplus.
- Fiscal challenges are likely, as governments struggle to meet long-term social challenges such as unemployment.
- Households and jobs will be affected through reduced social and infrastructure spending.

Source: World Bank data
Group 3: Lebanon, Jordan, Yemen and to some extent Egypt (again), Djibouti, Somalia, Comoros, and Mauritania

- These countries have the strongest financial links to Gulf economies or are dependant on foreign aid, or both
- They entered the crisis in the weakest position, both in terms of fiscal and external balances
- Rapidly descending oil prices or sustained low oil prices make these countries very vulnerable to declines in remittances and FDI from the GCC
- The persistence of the global economic crisis will also make them vulnerable to a decline in foreign aid
- Household and government budgets are likely to be impacted simultaneously
- Social pressures are likely to emerge with the return of migrant workers

Source: World Bank data
Group 4: GCC countries
Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates

- These countries entered crisis in exceptionally strong positions, giving them a significant cushion against the global downturn
- They are in the best position region-wide to absorb the economic shocks
- The greatest impacts will come in the form of lower oil prices, which remains the single most important determinant of economic performance
- Steadily declining oil prices would force them to draw down reserves and cut down on investments. Significantly lower oil prices could cause a reversal of economic performance as has been the case in past oil shocks. But this is a distant scenario
- Impact will be seen first on public finances and employment for foreign workers

Source: World Bank data
III. Policy Responses

- GCC countries intervened early to support their banking systems and stock markets
- They did so by easing monetary policy, securing the banking system’s liabilities (including through deposit guarantees), and by injecting fresh capital where necessary
- Saudi Arabia has announced an investment spending plan and provided capital to Saudi Credit Bank to secure credits to low income households
- Egypt has announced a fiscal stimulus package geared toward job-creating infrastructure investment
- Jordan has guaranteed deposits in domestic banks and announced a fiscal stimulus package
- Tunisia has announced measures to support domestic SMEs and employment
- Policy responses and fiscal stimuli should pay closer attention to safety nets
- The crisis is an opportunity for restructuring poorly targeted safety net programs in order to free up resources for the poor as well as those who are deeply affected by the crisis
IV. What Can the World Bank Group Do to Help?

- IBRD lending envelope has been expanded to respond to financing needs from our clients: $100 million over next 3 years, representing a tripling of normal levels. This stretch has been possible using the IBRD’s capital.
- IDA 15 envelope of $42 million for next 3 years will be frontloaded if needed by IDA clients affected by the crisis.
- IFC has introduced or scaled up 4 instruments to help deal with the crisis:
  - Trade finance
  - Bank recapitalization
  - Infrastructure Fund
  - Technical assistance to SMEs
- MIGA will use its guarantee facility to help secure FDI to our client countries.
- In addition to financing, we will remain close to our clients to gain a good understanding of the crisis’ implications for each country.
- We will use our knowledge products (ESWs, TA, including fee-based analytical and advisory activities) to support our client countries in their efforts to review scenarios and policy options, design crisis response policies, and implement reforms in these critical times.