Chapter 2

The Global Economic Environment and MENA's 2009–10 Prospects: Mitigating the Impact of Global Recession

Facing an Uncertain Global Economic Environment

If 2008 was a year of large swings in financial and economic indicators with little impact on MENA, 2009 will see the first global recession since World War II with serious impact in MENA countries. As discussed in Chapter 1, the global financial crisis had a muted impact on MENA's financial systems and little impact on the real economy in 2008; however, in early 2009, signs have emerged that the global recession is having an impact on the real economies across the region. Although current projections suggest that a global recovery could happen in 2010, these projections remains clouded with uncertainties. Even if the global economy starts recovering in 2010, the impact of the recession on human and physical capital may linger on and jeopardize growth prospects in some emerging market economies. It is therefore important to seek to mitigate the short-term impact of the crisis in MENA.

Section I of this chapter will review the main characteristics of the global economic environment that will have an important bearing on MENA economies in 2009–2010. The impact of the crisis on MENA's prospects for 2009–10 will be analyzed in section II. Section III will discuss policies that can be envisaged to mitigate the impact of the crisis on MENA economies in the short-term.

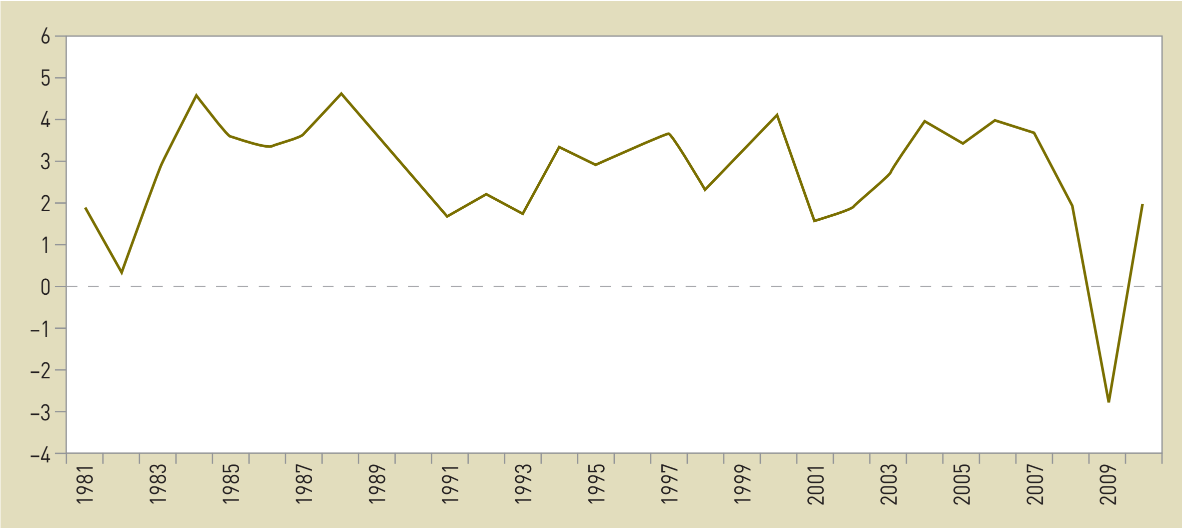
After a lackluster 1.9% global economic growth in 2008, the world economy is projected to shrink by 2.9% in 2009 before a weak recovery to 2.0% in 2010. (Figure 2.1). The recession that started in the second half of 2008 in advanced economies has been, and continues to be, rapidly spreading across the globe. Many developing countries which were initially decoupled from events in developed countries, have now joined the expanding list of economies forecast to contract in 2009. Out of 121 countries, the World Bank projects that 21 countries will experience negative growth in 2009—this compares with 5 countries in 2008.

Having by and large avoided the impact of the financial crisis on their financial systems as discussed in chapter 1, MENA countries face the prospects of seeing the global recession transmit to their real economy through various channels. The paragraphs that follow discuss possible global developments which may impinge on MENA's growth prospects in 2009 and 2010.

Oil prices are projected to be in the $55–63 bbl range in 2009–2010—levels that are above the breakeven point for most GCC oil producers but below breakeven point for some of MENA's non-GCC oil producers.[1] Several factors are

[1] The IMF estimates that the breakeven price is close to $57 per barrel for many MENA oil producers. Stark exceptions include

Figure 2.1: Global GDP growth rates: %, 1981–2010



Source: World Bank data.

likely to work to prevent oil prices from increasing significantly in 2009–2010. First, oil prices and global industrial production appear to be correlated and industrial production is projected to decline by another 12% in 2009.[2] (Figure 2.2). With depressed industrial production, demand for oil will remain low and oil prices are unlikely to increase markedly above current levels. Second, it is unlikely that speculation will be a strong factor in oil prices movements in the next couple of years. Recent additions to global oil production capacity—with Saudi Arabia's having increased its potential production capacity from 10.5 to 12.5 billion barrel per day—thanks to recent investments—along with excess production capacity that may have been created by recent production cuts by OPEC, will work to lull any speculative price increases, even in the face of possible isolated supply disruptions. Oil inventories in developed countries continue to be high—indicating a supply overhang.[3] Third, the securitization of commodities that contributed to oil price increases in 2003–08 is unlikely in the short-term, as capital markets remain depressed or recovering slowly from the doldrums of the 2008 crash. Moreover, tightening regulations in the aftermaths of the crisis and increased public intervention on global capital markets might work to limit the integration between finance and commodities. With lower prices (Figure 2.3) and weakened global demand, hydrocarbon export revenues—the mainstay of many MENA countries—is likely to decline sharply in 2009–10. However, current trends suggest that the price of oil will remain above breakeven level for most MENA oil producers.

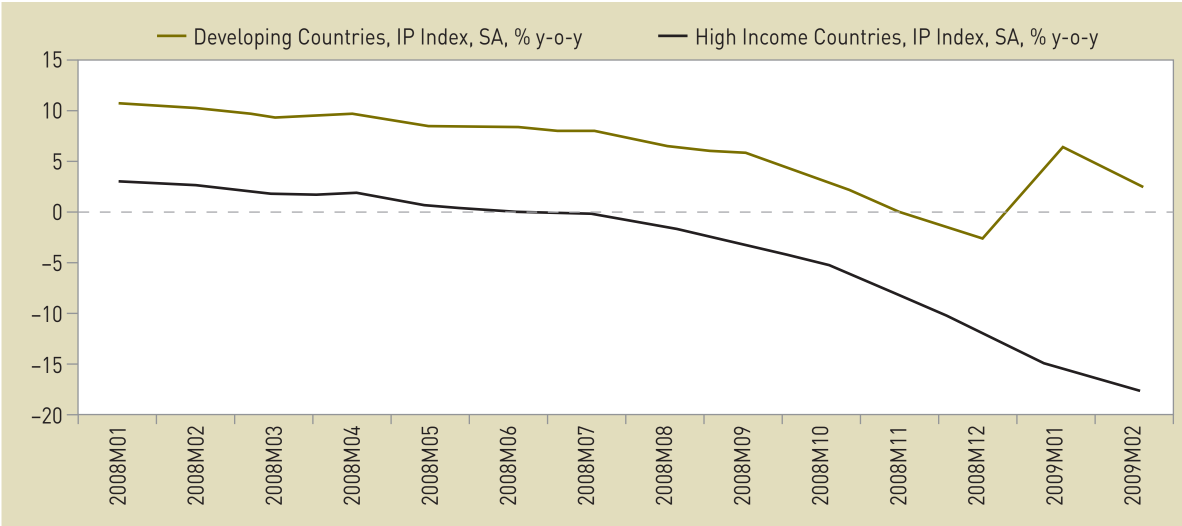
Global trade volume is projected to decline sharply by 9.7% in 2009, the first decline since 1982 and the biggest drop in 80 years (Figure 2.4).This sharp contraction in trade is likely to affect the MENA region in two major ways. First, the decline in global trade affects directly export of oil, oil-related products (such

Iraq and Iran with breakeven oil prices of $111 and $90 per barrel. Oil price at breakeven level is where a country would achieve fiscal balance. (see IMF, 2009a.)

[2] A study by Ewing and Thompson, 2007 shows that the crude oil prices are procyclical and lag industrial production by 1 month, as indicated by Hodrick-Prescott and Baxter-King or 2 months, as indicated by Christiano-Fitzgerald filters. Also a simple regression of the lagged oil prices (2 months) on the world industrial production done for the purpose of this chapter showed a strong positive relationship between these two variables for the period of 2005/01–2008/08 ($R^2 = 0.77$).

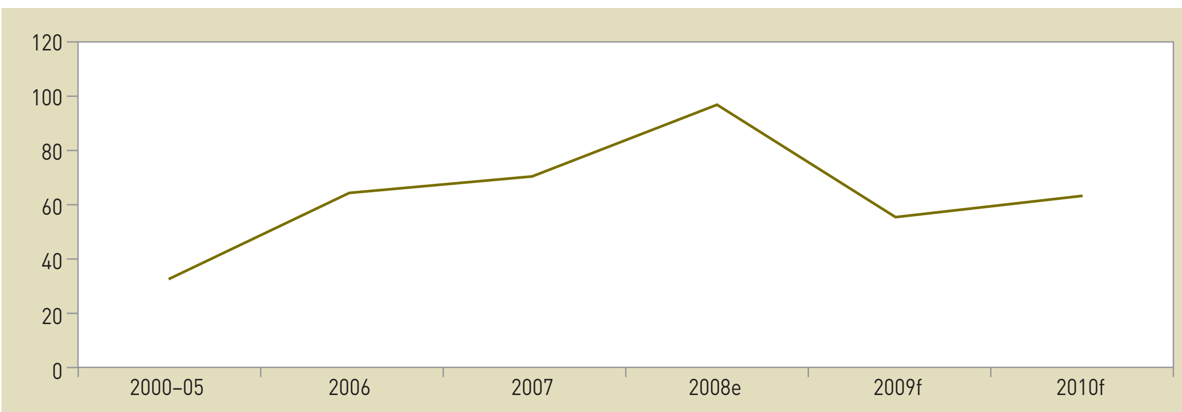
[3] In the long term, as the global economy recovers, it is possible that supply constraints may reappear unless new investments in oil or alternative source of energy take place.

Figure 2.2: Industrial production growth, % change, 2008/01–2009/02



Source: World Bank data.

Figure 2.3: Average oil prices, US$, 2000–2010



Source: World Bank data.
Note: Oil prices are in average of Brent, WTI and Dubai crude prices.

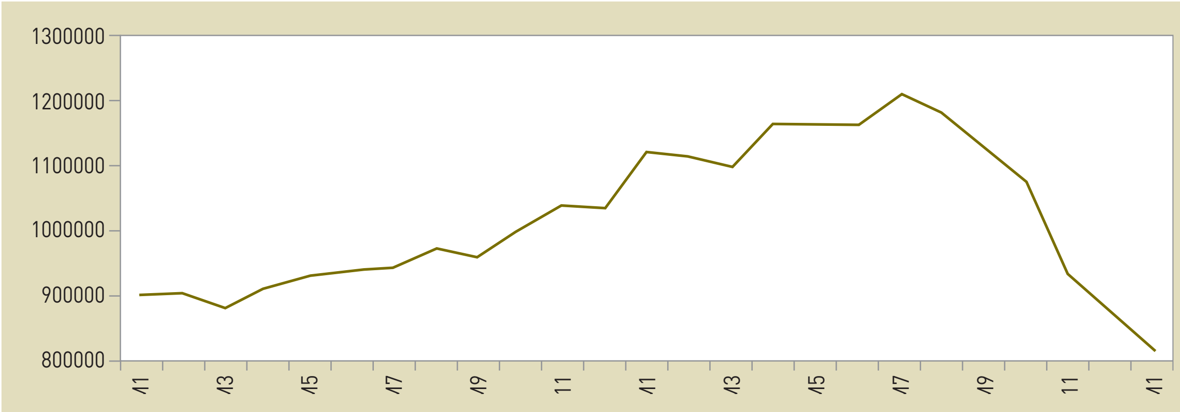
as petrochemicals), and manufactured goods (mostly garments) to Europe and OECD countries. In fact, the region's exports declined by 7% in the third quarter of 2008 when the recession was already affecting OECD countries. The second channel through which sluggish global trade will impact the MENA region is through lower trade related services—an important source of foreign exchange for countries like Egypt, Djibouti and the UAE.

MENA's Economic Prospects for 2009–10

Overview

Although the MENA region held up fairly well in 2008 and was able to brush off the first wave of impact of the global financial turmoil on national financial systems, it will experience serious impact on the real economy, households and

Figure 2.4: World export revenues, US$ million, 2007/01–2009/01



Source: World Bank data.

workers as the crisis has now mutated from a financial crisis to a globally synchronized recession. As reviewed in chapter 1, MENA is the only region that was able to avoid a decline in GDP growth in 2008 compared to the previous year. However, the region is projected to see a marked decline in its overall growth, with regional growth projected to decline sharply from 6.1% in 2008 to 2.2% in 2009 (figure 2.5). However, this sharp decline puts MENA in a relatively good position compared to some other developing regions—MENA's growth rate is comparable to developing country average of 2.1%. From the sectoral perspective, MENA's growth decline in 2009 and 2010 will be mostly led by a sharp contraction in the hydrocarbon sector across the region. From the demand perspective, public consumption remains relatively steady (helped by fiscal stimulus spending) while sharp falls in investment and exports drive down GDP growth (Table 2.1). MENA's growth rate is expected to rebound to 4% in 2010, but this rebound is expected to be less marked than in other regions. Growth resumption in 2010 is likely to be driven by expansion of investments at home, starting in GCC countries, as well as investments in, and exports to, other emerging and developing economies where the potential for incremental growth is the largest. In 2010, even if growth turns positive again, GDP growth will remain well below potential due to large spare capacity and necessary corrections in global consumption patterns.

Table 2.1: GDP growth by demand and contribution to growth, %: MENA, 2008–2010

Demand components	GDP	Private Concumption	Government Concumption	Gross Domestic Investment	Exports of Goods and Services	Imports of Goods and Services
2008e	6.1	6.2	10.2	7.9	6.3	11.2
2009f	2.2	1.8	8.0	0.8	–3.7	0.8
2010f	4.0	3.8	6.9	3.9	2.2	5.2
Contribution to Growth						
2008e	6.1	3.6	2.3	3.1	3.0	–5.9
2009f	2.2	1.6	2.0	0.7	–1.0	–1.0
2010f	4.0	2.4	1.8	1.7	1.2	–3.1

Source: World Bank data.

Fiscal and current account balances will deteriorate sharply across the MENA region. Although the levels remain more comfortable than in other regions, the decline in MENA's fiscal and external accounts is sharper (Figure 2.5). Large fiscal space built in recent years is likely to vanish, or at least decline significantly, as MENA governments pay for subsidies and wage increases committed in 2008 in response to food and fuel crisis, and as they now turn their attention to additional fiscal stimuli in response to the financial crisis. Weaker economic activity and weaker fiscal revenues will make the situation even more difficult.

Inflation in many MENA countries is likely to be the silver lining of the global financial crisis in 2009–10, from being the major concern in developing countries in the first half of 2008. The inflation picture in MENA will improve as in other developing regions (Figure 2.5). The declining prices of global commodities including

Figure 2.5: Regional key macroeconomic indicators, 2008–2010

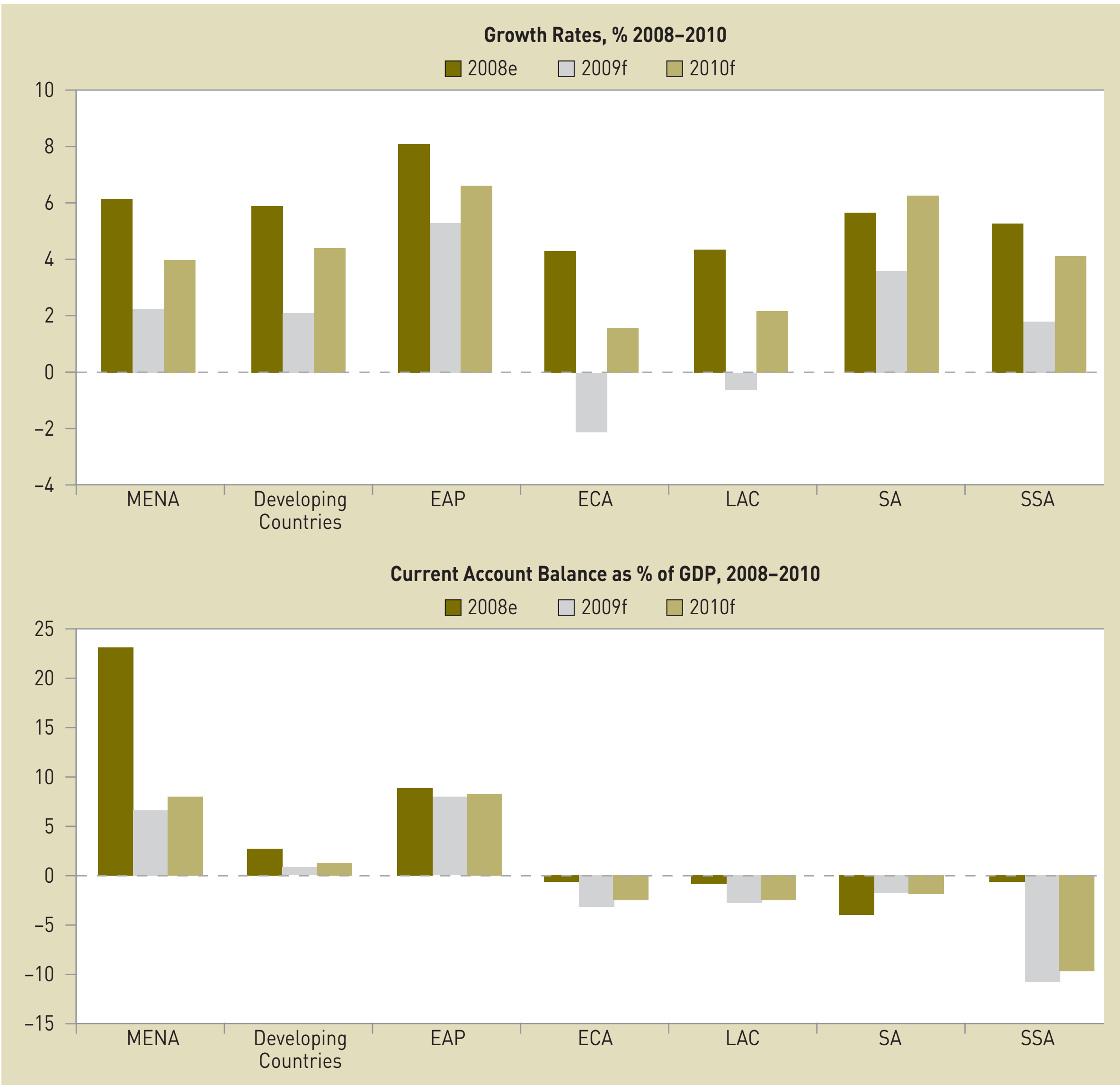


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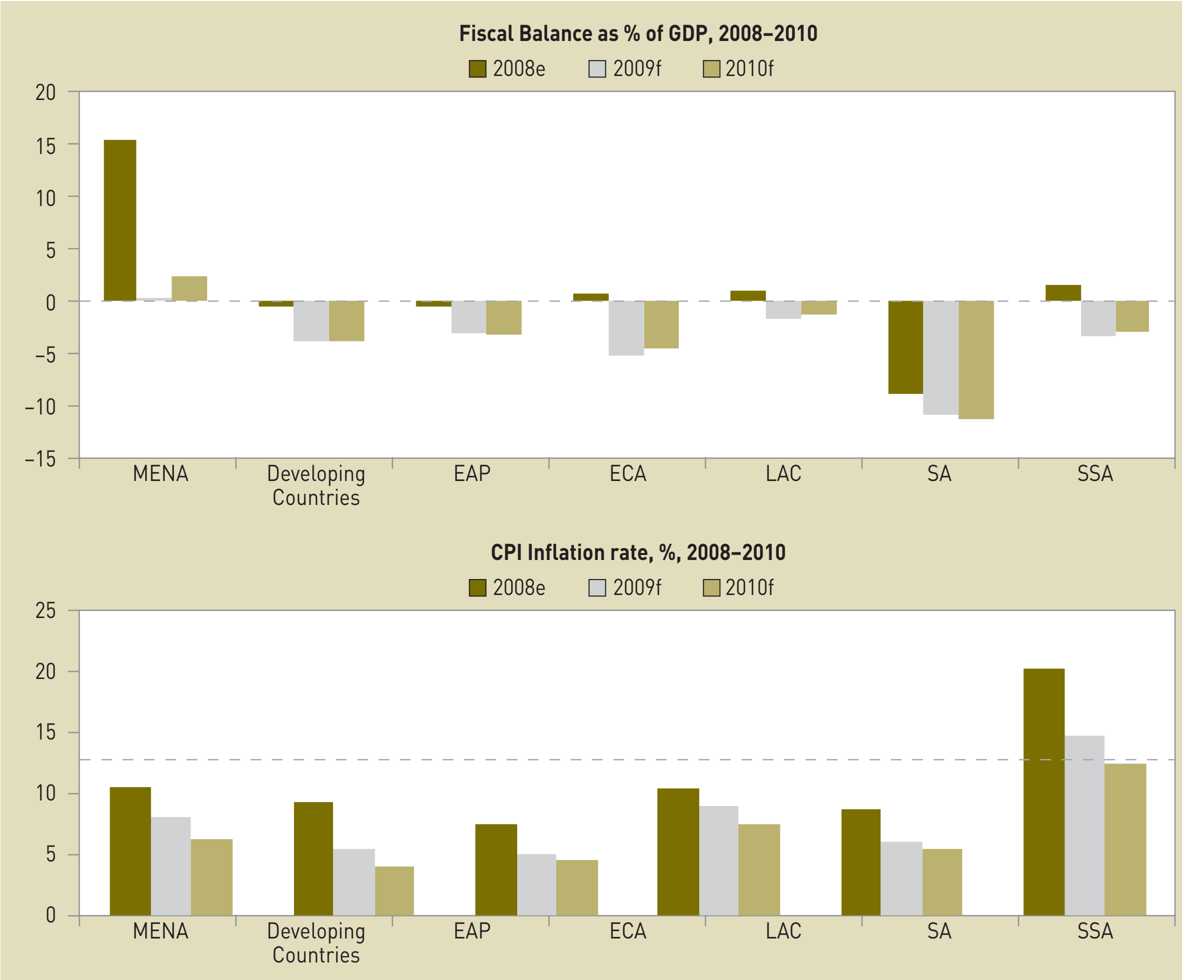
Figure 2.5: Regional key macroeconomic indicators, 2008–2010 (*continued*)



Source: World Bank data.

food, and the strengthening of the dollar vis-à-vis major international currencies, have contributed to lowering consumer price indices across MENA.

Despite a decline in inflation, households and workers are likely to feel the impact of the crisis sharply in 2009–2010. Data is not yet available to assess the social impact of the crisis across MENA. However, initial indications suggest that economic slowdown has caused a weakening in the region's already lackluster ability to create jobs and caused massive layoffs in some countries. In fact, the International Labor Organization (ILO) projects an increase in unemployment rate of about 25% in the Middle East and 13% in North Africa in 2009 compared to 2007. In many GCC countries, foreign workers suffered the most from job loss. The number of foreign workers in Kuwait for example dropped to 1.75 million at the end of 2008 from 1.77 million in 2007. About 90% of Dubai's workforce is foreign-born and most are in the country on work visas that are cancelled when their jobs are lost. In Egypt, employment growth has slowed down by 30% in Q2-FY09[4] compared to the Q2-FY08 which led to an increase in the unemployment rate to 8.8%[5]. In

[4] Fiscal year ends June 30.

[5] Ministry of Manpower and Migration. and Labor Force Sample Survey, CAPMAS.

Jordan, the unemployment rate reached 13.0% in Q2 2009, up from 12.1% in Q1 2009 and 12.5% in Q2 2008. On the positive side, in Saudi Arabia, the Cabinet approved two labor market liberalization measures. First, migrant laborers working in the public sector via contractors can now shift their work authorization to a new contractor without needing a new visa. Second, the Cabinet opened the professional and social sector services to nationals of any GCC country, implementing a long-standing GCC objective.

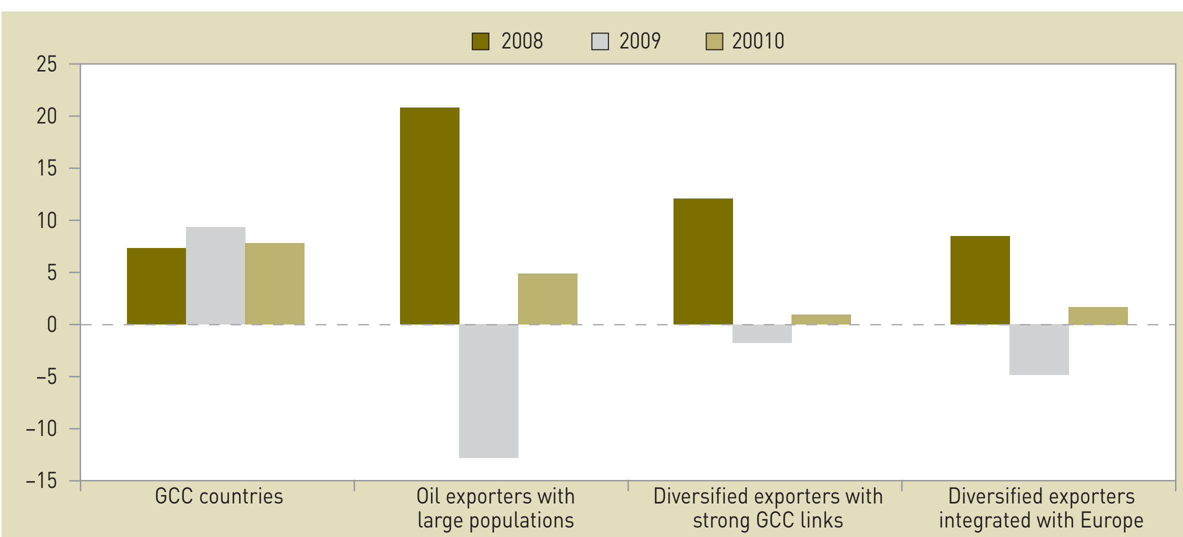
Tourism and remittances will not be able to sustain high GDP growth in MENA in 2009 and possibly 2010. Even though tourism has been somewhat resilient, it has not been immune and a decline is expected in 2009. International tourism arrivals declined by 2% in 2008 from an average growth rate of 7% in 2004–2007. Preliminary estimates by UNWTO indicate that international tourism arrivals will stagnate or even decline slightly (–2%) in 2009.[6] In MENA tourism receipts grew by only 10% in 2008, much slower than the growth of 45% in 2007. With global recession persisting and wealth effects settling in, MENA's tourism receipts are expected to contract about 3% in 2009. Apart from GCC countries which are expected to show positive albeit slower growth in tourism receipts in 2009 and 2010, the rest of the country groupings is likely to move to negative territories in 2009 but are expected to see some improvements in 2010.[7] (Figure 2.6)

Remittances have also been resilient so far but are projected to decline in 2009 before experiencing a mild recovery in 2010. Partly reflecting the deterioration in labor market conditions worldwide, remittances to developing countries began to fall in the last quarter of 2008, a trend that has continued into 2009. For 2009 as a whole they are expected to decline by 7.3% (Figure 2.7). In MENA, remittances grew in 2008 but at a slower pace of 8.6% than 17% during 2006–07; they proved resilient in 2008. However, they are likely to lose steam in the rest of the year and are projected to fall

[6] UNWTO, (2009), "World Tourism Barometer, Quick overview of Key Trendsî, Vol 7, No.1.

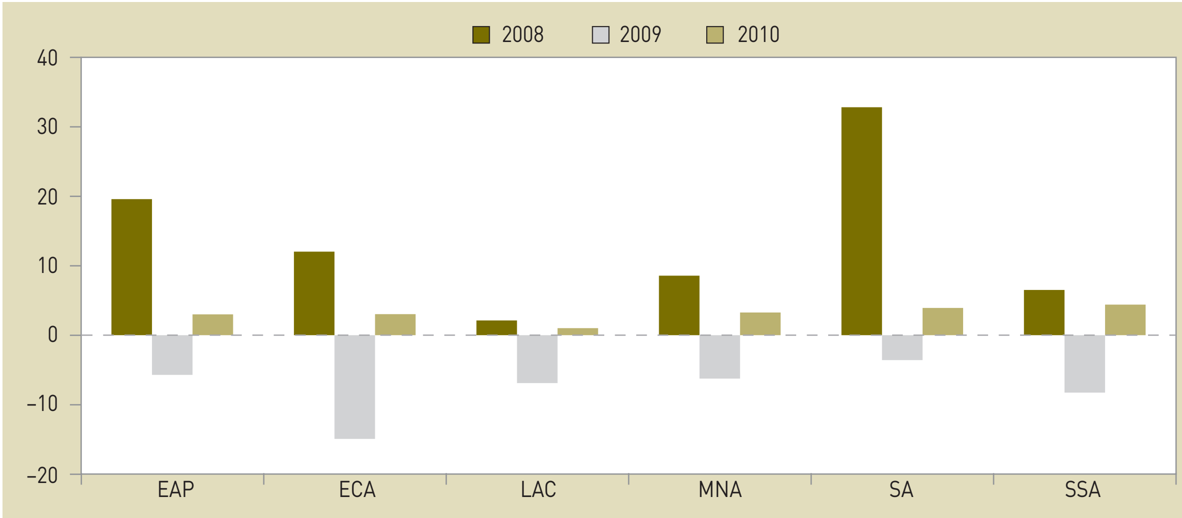
[7] Countries in the region are putting in effect policies to promote tourism demand. In Egypt for example a set of measures aimed at bolstering tourism such as exempting hotels from paying contributions to the country's tourism promotion authority, and cutting fees paid by charter flights were announced in early 2009.

Figure 2.6: Growth in tourism receipts: MENA country groupings, %, 2008–2010



Source: World Bank data.

Figure 2.7: Regional growth in remittances flows, %, 2008–2010



Source: World Bank data.

by 6.2% in 2009.[8] This rate of decline is one of the lowest across developing country groups. The resilience shown by remittances in MENA may be due to the fact that migrants continue to send remittances as long as they have a job (even if new migrants are not arriving) and migrants having lost their jobs return home with their stock of accumulated savings thus helping to compensate for reduced flows of remittances. If the global recession persists and deepens, it is expected that in 2009, these resilience factors will weaken and remittance levels could decline more sharply. In addition to being a recipient of remittances, MENA is also an important supplier of remittances. Thus MENA will not only suffer from decline in remittances but with lower oil prices and close to zero growth (in 2009 and expected low growth in 2010) in major remittance source countries among the Gulf countries (Saudi Arabia and UAE), MENA will generate much less remittances for regions like South and East Asia. It is projected that in 2009, remittances outflows from GCC countries will decline sharply by 9% compared to 37% growth in 2008.

Like for most emerging markets and developing countries, external financing conditions will remain tight for MENA in 2009 and possibly 2010. Global FDI flows are projected to fall sharply in 2009; and MENA will be directly affected.[9] FDI flows are low in MENA, and while their level is holding up, they are expected to decline slightly in 2010 as investors complete large projects that they started before the global financial crisis and could not easily interrupt without incurring large financial losses and now postpone, cancel or scale back new projects (figure 2.8). In fact, FDI has started declining in some MENA countries. In Egypt for example, FDI declined by 50% in early 2009 compared to the previous year. As in many developing regions, short-term capital flew out of MENA quite suddenly in 2008. The phenomenon was more apparent in GCC countries that had both attracted short-term flows and had open capital accounts. Several factors are likely to impede the return of short-term capital to MENA in the short-term. First, regional stock markets remain depressed. Second, expectations of currency depreciation in the GCC—a major factor behind short term inflows in GCC countries prior to September 2008—have subsided in the face

[8] World Bank 2008a.
[9] UNCTAD, 2009a.

Figure 2.8: FDI as a share in GDP, %, MENA country groupings, 2008–2010

Source: World Bank data.

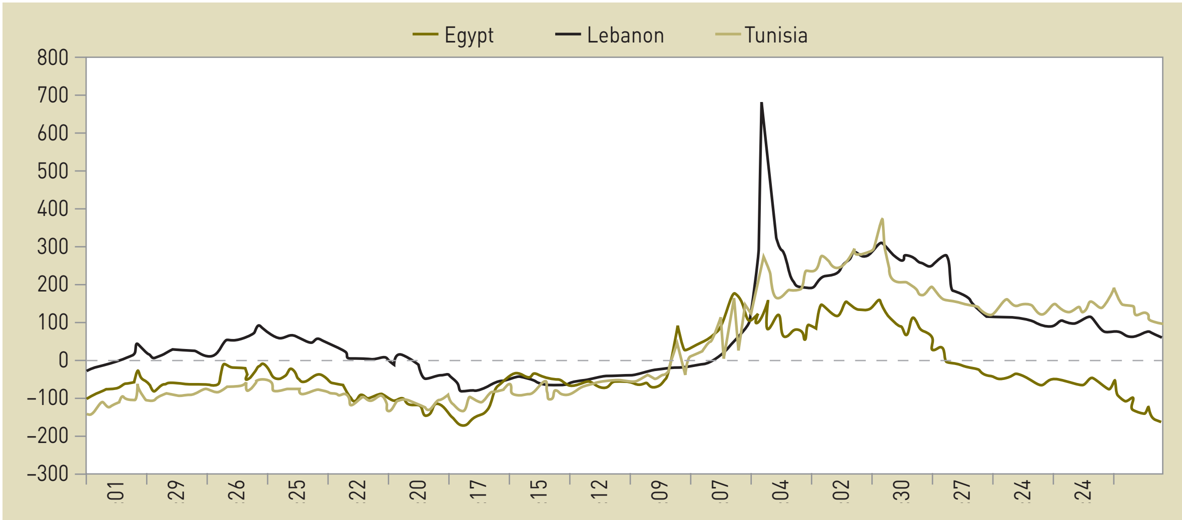
of lower inflation pressures. Finally, with lower oil price and wealth effect of declining stock market indices, there will be less complementary domestic capital to serve as magnet for short term foreign flows.

Although international bond markets have improved somewhat from the fourth quarter of 2008, conditions are likely to remain tight for MENA sovereign and corporate borrowers. With large stimulus packages to be financed in developed countries, there are fears that emerging market sovereign bonds will be crowded out by bonds issued by developed countries.[10] Nonetheless, emerging markets with market access can take advantage of declining interest and spreads in 2009: countries like Brazil, Colombia, The Philippines and Turkey were able to make large sovereign bond issues in January 2009. However, in 2008 and 2009, only three MENA countries—Lebanon, Qatar, and the UAE—have issued bonds on the international financial market. Although sovereign bond spreads have declined from their peaks reached in late 2008, they remain above mid-2008 levels. A second factor that may crowd out emerging market sovereign and corporates' access to the international bond market is the large issuance being made by large financial institutions with guarantee from their governments. Even so, an Abu Dhabi state-owned investment vehicle, Mubadala, successfully managed the first corporate bond issue in the GCC since September. The sale raised US$ 1.75 billion, with about two-thirds in 5 year bonds at about 400 basis points (bp) above US Treasuries and the remainder in 10 year bonds at a 460 bp premium. Corporate borrowing has remained tight since the beginning of the crisis, although there are signs of easing. For example, the Abu Dhabi International Petroleum Investment Corporation is expected to soon complete a US$3.5 billion syndicated loan which will be the first large scale syndicated loan in the region since the financial crisis deepened last September.

Finally, ODA is expected to decline somewhat in 2009, with the risks that this will impose

[10] In March, net foreign purchases of U.S. long-term U.S. securities were $ 56.6bn (up from $20.8bn in Feb and net sales in January and November) private foreign investors bought $30bn ($25.9bn in Feb) and foreign official institutions $26.4bn (reversal from net sales in Jan and Feb combined). Some European countries have borrowed abroad massively (Germany: USUS 2.3trn, the Netherlands: USUS 1.9trn, the UK: USUS 4.5trn). [Source: RGE Monitor, 5/18/2009].

Figure 2.9: Spreads basis points delta since Sep 15, 2008, 01/01/2007–04/20/2009



Source: World Bank data.

pro-cyclical forces in ODA dependent countries in MENA. ODA tends to be pro-cyclical with economic cycle in source countries. For example, ODA to LICs fell by 3% during crises in Nordic countries in early to mid-1990s. With today's global synchronized crisis, source countries are likely to reduce ODA at a time when recipient countries are also affected by the crisis and need ODA increases to implement counter-cyclical fiscal policies. Economies like Yemen, Djibouti, West Bank and Gaza will suffer if ODA levels are cut back.

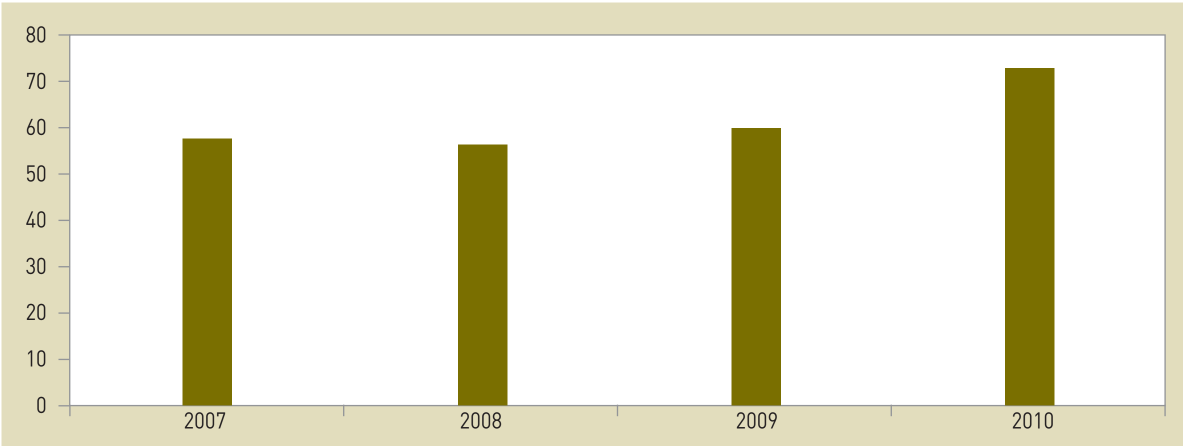
Prospects by country grouping

Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Qatar, Oman, Saudi Arabia, and UAE

As a group, GCC countries are poised to experience the sharpest growth contraction among MENA countries in 2009. Although the impact on growth in 2008 was limited, the sharp decline in oil prices since mid-2008 and continued depressed demand for oil on global markets are ushering in lower economic growth in 2009 and 2010 in virtually all GCC countries, with the exception of Qatar. In fact the two MENA countries projected to enter recession zone, Saudi Arabia and Kuwait, are among the GCC. For the GCC as a whole, growth is projected to decline from an average of 5.5% during 2004–08 to 1.1% and 4.2% in 2009 and 2010. However, with their significant financial reserves, GCC countries are likely to be able to maintain countercyclical fiscal stances and ride the storm comfortably if oil prices stay above $50 bbl throughout 2009 and 2010. While their fiscal revenues are projected to decline by 40% of GDP in 2009, expenditure is projected to remain at its 2008 level, leading to a sharp decline in fiscal balances, financed mostly with drawdown on past reserves.[11] Capital expenditures in particular are expected to be sustained at high levels. (Figure 2.10). Across the GCC, inflation is expected to ease to 7.6% and 4.7% in 2009 and 2010 from 11.4% in 2008, partly because of a drop in world commodity prices in 2009 and the stabilization of the US dollar—to which most GCC currencies are pegged—against the euro and other world currencies. External balance in GCC countries is expected to decline sharply to 13.2% and 16.7% of GDP respectively in 2009 and 2010 from its peak level of 33.6% in 2008, while their fiscal balance will deteriorate sharply from 26.6% of GDP in 2008 respectively to 5.3% and 7.2% of GDP in 2009 and 2010.

[11] Source; IMF, 2009c.

Figure 2.10: Capital expenditures: GCC, US$ billions, 2007–2010



Source: World Bank data.

Oil exporters with low oil revenue per capita – Algeria, Iran, Iraq, Libya, Syria, and Yemen

Although their public finances and external reserves will be stretched, oil exporting countries with large populations and social commitments relative to their hydrocarbon wealth will avoid recessionary growth in 2009 and 2010. Oil GDP will decline sharply but non-oil GDP will help maintain economic growth in positive territories. Real growth is projected to decline from an average of 5.6% in 2008 to 2.7% and 3.5% respectively in 2009 and 2010. With Iran's double digit inflation rate (23.5% in 2009) continuing into 2010, it is expected that the group's inflation will average 15.1% and 12.7% respectively in 2009 and 2010. Although, public finances will benefit from declining outlays for fuel subsidies on account of lower oil prices, countries in this group will see large swings in fiscal balances from a group average of 5.5% of GDP in 2008 to a projected negative 6.6% and negative 1.8% of GDP in 2009 and 2010. Large swings will also be observed in current account balances from an average of 22.7% of GDP in 2008 to 2.2% and 3% of GDP respectively in 2009 and 2010. While some countries are tightening up their fiscal stance due to lack of fiscal space and limited borrowing capacity (e.g. Iran), others are able to envisage counter-cyclical policies thanks to available reserves from previous years' oil revenues (e.g. Algeria).

Non-oil exporters reliant on financial flows from GCC or official development assistance from OECD – Djibouti, Jordan, Lebanon, WBG

Non-oil exporting countries with strong economic linkages with GCC countries (through remittances, FDI or tourism) and/or with strong dependency on foreign aid are seeing a stagnation of financial flows from GCC and face the challenge of mobilizing aid at a time when source countries are affected by the crisis. Countries in this group entered the crisis with generally weak macroeconomic frameworks characterized by high fiscal deficits, high debt levels, and tight external positions (see chapter 1). Their ability to conduct counter-cyclical policies will be dependent on fresh external flows or rollover of existing debt combined with a rationalization of expenditure patterns. Growth is projected to slow to 2.5 and 4.2% for the group in 2009 and 2010 compared with 6.1% in 2008. Inflation will ease to 5–6% from its high level of 12.5% in 2008. The group's average fiscal balance will remain negative in 2009 and 2010 (around negative 4 and 2.5% for both years), although it will show some improvement over 8.4% in 2008. The group's average current account balance will remain in negative territories but will improve over 2008 and reach negative 9.9% and 6.9% of GDP respectively in 2009 and 2010. The improvements in fiscal and external balances will be driven by contractionary policies in the absence of space for large fiscal stimuli.

Non-oil exporters with strong economic linkages with Eurozone and OECD – Egypt Morocco, and Tunisia

Non oil exporters with strong economic linkages with the Eurozone and OECD—Egypt Morocco, and Tunisia—entered the crisis with relatively good macroeconomic stance, although with already tight fiscal space. With real GDP growth rate averaging nearly 6.5% and inflation rate of 6.8% in 2008, this group of countries experienced the highest growth and lowest inflation rates among sub-groups of MENA countries. However, they started feeling the impacts of the crisis on their real economy as early as the last quarter of 2008 as the recession spread across Europe and other export markets. Growth is expected to decline to about 4% and inflation should be contained at about 5.2% and 4.3% in 2009 and 2010. Fiscal balance is projected to remain at the same level of 2008 of about 4% of GDP in 2009 and 2010. Current account deficit is expected to average at about 5% of GDP in 2009 and 2010. Countries in this group can build on their good track record of sound macroeconomic policies and structural reforms to mobilize financing needed to implement countercyclical policies.

Downside risks to the prospects

MENA's prospects for 2009–10 remain subject to significant downside risks that will test the endurance of countries and how they would fair in the face of a possible persistence or deepening of the crisis. Three such risks are worth highlighting. First, a deeper and more protracted global recession than currently envisaged or a delayed global recovery recession could continue to depress demand for MENA's exports of hydrocarbon and manufactures. Second, unchecked protectionist tendencies from trading partners or MENA countries could jeopardize MENA's contribution to global recovery through trade and affect MENA's growth and employment prospects in the short term. Third, a sharp or persistent deterioration in MENA's real economy could affect the financial sector through feedback loop effects.

Risk of prolonged global recession

Despite signs that the recession may be bottoming out in the US and some other OECD countries, signs also abound pointing to the possibility that the global economic crisis may become more protracted or deeper in the months ahead. So-called "green shoots" emerged in the U.S. toward the end of the first quarter of 2009 providing signs that the U.S. economy might be on the path to recovery. Manufacturing surveys suggested that as of the end of the first and the beginning of the second quarters of 2009, the manufacturing sector was contracting at slower rates in advanced economies than at the end of the fourth quarter of 2008. China's index showed signs of recovery. However, considering the large extent of wealth effects of big losses in the OECD banking sectors and excess capacity, the recent "green shoots" could well be short-lived. In April, the IMF estimated that, during the period 2007–10, banks and other financial institutions faced potential aggregate losses of $4.05 trillion in the value of their holdings as a result of the crisis[12]. Of that amount, $2.7 trillion is from loans and assets originating in the United States. That estimate is up from $2.2 trillion in the fund's interim report in January and $1.4 trillion last October. In the United States alone, banks reported $510 billion in write-downs by the end of 2008, and they face an additional $550 billion in 2009 and 2010. In the countries of the euro zone, banks reported just $154 billion in write-downs by the end of last year but still face $750 billion in projected write-downs. Such large projected write-downs could extend the credit squeeze faced by producers and consumers, thus delaying the recovery in the US and OECD countries.

The large investments in housing and manufacturing sectors around the world prior to the global financial crisis, especially in the high-income countries and emerging markets, now constitutes excess capacity and represents

[12] IMF, 2009d

another factor that could delay global recovery until 2010. Globally, investment grew at 3.8% during 2000–07 driven by growth prospects and driving growth—especially in MENA where investment growth reached 17% in 2007 and contributed 4% to growth. Growth in investment added to global supply capacity, which has now translated into excess capacity, and further dissuading investors from going into new ventures or expanding existing capacity. On the other hand, aggregate demand has been drastically reduced following massive loss of wealth and deleveraging in the financial sector that reduce funds for investments and consumption globally. This reduction in investment and consumption could lead to negative growth and deflation, possibly increasing the extent of the excess capacity in the short term, and delaying global recovery.[13]

Even if the recovery in the US and OECD occurs in 2009 or 2010, there are uncertainties as to whether recovery in emerging market economies, including the MENA region, will be synchronized with, or lag, US and OECD recovery. Indeed, just as the impact of the crisis in MENA lagged the impact in OECD and most other emerging market economies, it is possible that MENA's recovery also lag the US and OECD's. This risk would be greater if MENA governments' response to the crisis does not address some of the impediments to private sector activities and distortions in the use of public resources.

Risk of protectionist measures

Another risk clouding MENA's prospects is the temptation of trade protectionism around the world. With trade flows on the decline and countries under pressure to reestablish macroeconomic balances, ensure adequate supply to their domestic markets, and use tax payers resources to save the domestic economy and jobs, policy-makers might be under pressure to err on the side of protectionism. During the Great Depression in the 1930s, countries resorted to protectionist measures and implemented beggar-thy-neighbor policies such as competitive devaluations and trade restrictions to limit the impact of the crisis. This move made things worse. In responding to the current crisis, governments around the world have so far managed to avoid or limit such policies. However, protectionist tendencies are on the rise and a number of the policy measures adopted in 2008—in both developed and developing countries (including MENA), are akin to trade protection.

In developed countries, the group of G20 proposed a total of 78 trade measures, of which 66 measures involved trade restrictions. To date 47 trade-restricting measures have been put in effect in 17 countries of G20.[14] These include tariff increases, non tariff measures and subsidies. About a third of these measures are tariff increases. For example, Russia raised tariffs on used auto and Ecuador raised tariffs on more than 600 items. Non-tariff measures have also been taken by several countries. Argentina for example imposed non tariff measures on auto parts, textiles, and leather goods, China tightened its standards (which have slowed import entry), India banned Chinese toys, and EU announced new export subsidies on dairy product. Subsidies proposed for the auto industry have proliferated with total of $48 billion worldwide, with more than 92% ($42.7 billion) allocated in high-income countries. United Kingdom, China, Argentina, Brazil, Sweden and Italy have provided direct or indirect subsidies in addition to the US direct subsidy of $17.4 billion to its three national companies.[15] Moreover Australia has managed to support its car dealers, while South Korea and Portugal support their component suppliers.

Should current protectionist tendencies gain momentum, the impact on MENA economies would be detrimental. Early indications are that trade restrictive measures taken in 2008 will not be repeated in 2009. With inflationary pressure

[13] World Bank, 2009b

[14] World Bank, (2009), "Trade protection: Incipient but Worrisome Trends", Trade Note #37.

[15] In addition to the non tariff measures taken by US is the provision in the stimulus bill that "None of the funds appropriated or otherwise made available by this Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work unless all of the iron and steel used in the project is produced in the US." (Sec. 1110(a)).

Box 2.1: Example of measures that can limit MENA's contribution to global trade

In response to lobbying request from within the domestic steel industry, Egypt imposed a 10% import tariff on cold-rolled flat-tin sheets, on top of existing duties, to stabilize the local market price. This follows a similar move to put anti-dumping duties of LE500/ton on imports of white sugar, in addition to the existing 10% tariff, to protect the local sugar industry from "unfairly" priced imports. During 2008, rice suppliers registered with the General Authority for Supply were constrained to export only up to the amount they import subject also to an export tax of LE1000 a ton. This "export ban" has been extended until further notice. The Ministry is reviewing commitment to the Aghadir free trade agreement to decide whether to continue to allow Moroccan cars to enter Egypt duty free or not. In addition, the Prime Minister issued instructions to all government authorities prohibiting the import of any final goods that have local substitutes of similar specifications and quality.

Like some other oil exporters, Algeria has mandated that oil and gas projects (including their downstream revenues) must be at least 51% Algerian-owned. In December 2008, a directive from the prime minister's office extended this local ownership restriction to include all public projects. A new law passed in January 2009 stipulates that foreign investors cannot hold more than 49% of shares in new ventures. The rest must be held by local investors. The government has also mandated that public enterprises use local rather than foreign banks. This, however, does not apply to the private sector.

Source: MENA Staff

having eased, MENA governments will face no pressure to take trade restrictive measures. However, MENA could suffer from preferences given to domestic firms or to domestic contents as part of bailout packages in developed countries. On the export side, MENA exporters may find it more difficult to maintain shares in markets where importers are receiving government support and are required to favor domestic content. For example, the European Union's decision to reactivate export subsidies for butter, cheese and whole and skimmed milk powder to help European exporters better compete on the world market could harm MENA exports of dairy products to the EU.

In these dangerous times, it is important that MENA countries avoid measures that reinforce protectionist instincts which may have been initiated elsewhere (see section I). As one of the few regions expected to have positive growth in 2009, MENA will critically contribute to reducing the depth of the global recession and contribute to global recovery in 2009 or 2010. To preserve this contribution, MENA will need to play its full role in supporting global trade.

Risks of feedback loop from the real economy to the banking sector

With global recession working its way through the real economy in MENA countries, MENA's banking sector may face risks of feedback loop from the real economy. Having been spared by deep contagion from global financial markets, MENA's banking system may not avoid the impact of deterioration in the balance sheets of their customers in the real sector[16]. The global recession may induce an increase in non-performing loans, especially among companies in MENA's exporting sectors and tourism sector. Slowing export activity and falling real estate prices are also likely to be a risk particularly in Dubai (Box 2.2) and diversified economies in North Africa where banks' have large exposure either to real estate sector or trade-oriented manufacturing and services sectors. Internal weaknesses in the banks may also be magnified by—and magnify—the feedback loop form the real economy. For

[16] Moreover, since mark-to-market practices are virtually absent in the MENA region, the direct impact of the crisis on banks will likely be revealed with a lag, possibly between 2009 and 2010.

Box 2.2: United Arab Emirates: Recent developments in the real estate and financial sectors

The Colliers Home Price Index showed a 41% decline in home prices during the first quarter of 2009. This followed a decline of 8% in the last quarter of 2008 bringing prices roughly to their end-2007 levels. As 2007 had already seen several years of appreciation, analysts are concerned that further declines are in store. Recent financial results for property developers reflect the plunge in prices and cessation of new activity. Emaar and Nakheel (both of which have close links to the Dubai government) announced profits well below consensus expectations, but Abu Dhabi-based developers have also been badly affected. However, commercial banks have reported solid profits for the first quarter of 2009. This reflects their gains from the extensive liquidity operations of the Central Bank, which have lowered their funding costs. Nevertheless, analysts are concerned that indirect exposures to property have yet to play out.

Source: Collier International, MENA Region, Dubai, Q1, 2009.

example, derivative losses in a Kuwaiti bank is a warning that weaknesses in risk management need to be addressed in earnest in the banking system if the region is to mitigate the impact of any feedback loop effects that may be caused by shocks to bank clients in the real economy. Also, Kuwait's investment companies have suffered equity market losses and two have defaulted on debt payments in the last six months.

Policies to Mitigate the Impact of the Global Recession

Introduction

Although monetary policy was considered in many MENA countries as part of the toolbox to deal with high consumer prices and respond to the impact of the crisis on financial systems in 2008, its efficacy has been mixed thus far. Initial monetary policies in the second half of 2008 were somewhat constrained by currency pegs to the US dollar and other major OECD currencies, and by fear of inflation as commodity prices were still high. Inflation rates have come down markedly and prospects point to further declines, giving MENA authorities more room to relax monetary stance to stimulate domestic demand. Some countries have in fact done so in 2008 (see chapter 1). However, on the whole, the efficacy of monetary policy has been reduced because the crisis has eroded confidence in financial institutions among market participants. Also, with excess liquidity in the banking system in some countries—partly caused by the fact that many financial institutions are holding back lending due to weakened trust—lending rates are less responsive to monetary policy tools. In any event, going forward, authorities will rely less on monetary policy instruments to deal with the impact of the crisis as the crisis permeates the real economy.

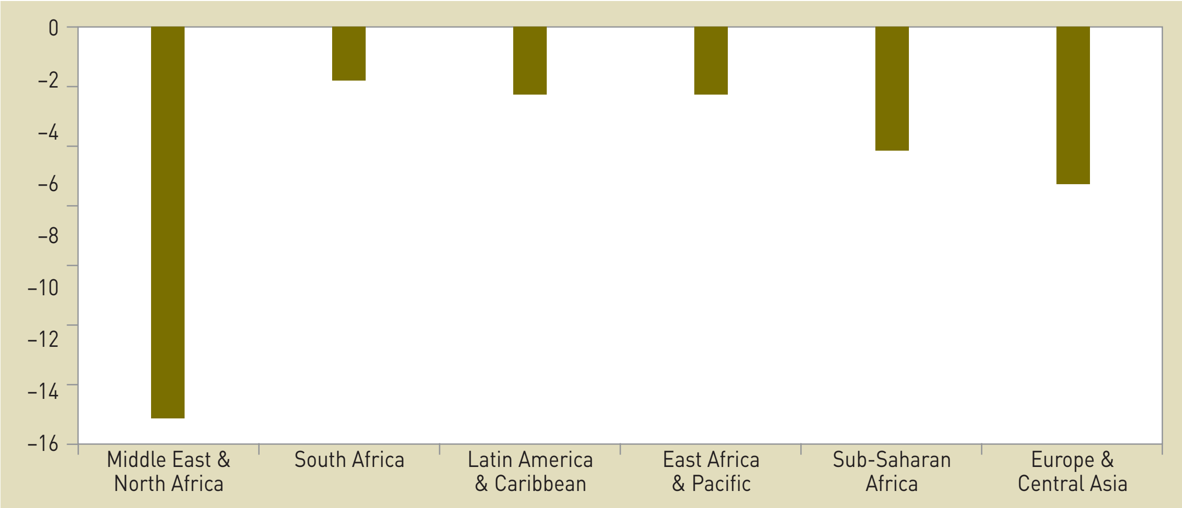
Starting with the last few months of 2008, attention has gradually shifted to fiscal policy across the region[17]. Fiscal policy responses to the global crisis have varied across the MENA region, reflecting the diversity of impacts and fiscal constraints. Going forward, efficacy of measures already taken and the adequacy of future measures will critically depend on: (i) remaining fiscal space or availability of financing and (ii) nature and content of the stimulus measures.

Dealing with shrinking fiscal space

Although many MENA countries entered the crisis with respectable fiscal space, the region is seeing the largest decline in fiscal position among developing regions, mainly due to sharply lower oil revenues compared to 2008 (Figure 2.11). Moreover, on the expenditure side, budgets are lumbered by expensive and often poorly targeted social programs and large civil service wage bills, and on the revenue side, governments face declining intake due to less buoyant income tax

[17] A global survey of World Bank economists for 66 countries (mostly middle income countries) in early 2009 found that 44 percent had plans for a fiscal stimulus (World Bank (2009j).

Figure 2.11: Projected deterioration in fiscal balance, % of GDP, (changes) in 2008–2009



Source: World Bank data.

revenues. If and when economic recovery occurs, automatic stabilizers might kick in and some components of revenues (such as oil revenues and income taxes) may increase whereas some components of expenditures such as employment benefits (in the case of Maghreb countries) may decline. However, automatic stabilizers are less effective in MENA than in OECD countries. To be prudent, MENA countries should take safeguards fiscal measures to increase revenues or reduce expenditures in order to reduce the non-discretionary deficit, if economic recovery does not occur as fast or as robustly as expected.

However, fiscal deficit is not a sufficient metric to get an accurate picture of fiscal space. To get a more accurate picture of fiscal space, it is useful to also take into account the level of debt. The lower initial deficit and debt condition, the larger fiscal space is available to the governments. In fact creating fiscal space is constrained by the amount of public debt and deficits as well as the size and nature of private sector debt. The latter will impose constraints on fiscal space because during boom times the private sector may have over leveraged itself, and finds it difficult to repay debts during the downturn. Governments may intervene and bail out banks and nonfinancial firms in distress. Thus booms in private credit or elevated levels of private debt should be factored in as the likely location of contingent liabilities that will constrain fiscal space if they are realized. If private sector liabilities are in foreign currencies, countries with larger foreign exchange reserves will be better positioned. In Brazil, for example where the public sector through rapid accumulation of foreign reserves had become a net creditor in hard currency, the government announced that the private sector will be allowed to access official reserves to repay debts.

Using the levels of fiscal deficit and public debt to assess fiscal space shows that MENA countries are quite diverse. (table 2.2) Half of GCC countries—Qatar, Oman and the UAE—have comfortable fiscal space. Bahrain, Saudi Arabia, and Kuwait have some fiscal space but they might be constrained by a moderate fiscal deficit in the case of Kuwait and a limited fiscal surplus in Saudi Arabia and Bahrain. Going forward, they will need to use their remaining fiscal moderately.

All other oil exporters, except Iraq (Algeria, Iran, Libya and Syria) have some fiscal space that needs to be managed carefully going forward.[18]

[18] Despite a zero budget deficit, Iraq has no fiscal space due to an already high level of debt.

Table 2.2: Fiscal space projections: MENA country groupings: 2009

	Fiscal Balance as % of GDP	Government Debt as % of GDP
	2009f	2009f
GCC countries		
Bahrain	1.8	26.0
Kuwait	-2.7	7.5
Oman	11.9	5.0
Qatar	13.5	6.0
Saudi Arabia	1.5	15.6
United Arab Emirates	13.5	10.8
Oil exporters with large populations		
Algeria	-11.5	8.7
Iran, Islamic Republic of	-5.2	14.6
Iraq	0.0	137.0
Libya	-9.8	0.0
Syrian Arab Republic	-5.5	32.6
Diversified exporters with strong GCC links		
Djibouti	-3.4	47.7
Jordan	-3.4	65.9
Lebanon	-4.4	161.9
Yemen	-2.0	39.9
Diversified exporters integrated with Europe		
Egypt	-5.6	73.8
Morocco	-3.1	47.8
Tunisia	-3.1	48.4

Source: World Bank and IMF data, and World Bank staff estimates

Fiscal balance ---->	*Larger than 2% of GDP*	*-2% to + 2% of GDP*	*Less than -2% of GDP*
Government Debt ----->	*0 to 30% of GDP*	*30% to 80% of GDP*	*Larger than 80% of GDP*

Thanks to high oil revenues in the recent past, they have been able to maintain a low level of debt; and although they are all expected to run a fiscal deficit in 2009, they have some space to increase the level of public debt in hopes that oil prices will not fall below levels that jeopardize their governments' ability to accumulate surpluses and repay debt. However, countries where debt issuance can be constrained by other factors than the debt level may not be able to increase public debt and will be constrained in their ability to implement pro-cyclical fiscal policies. Also, countries with declining oil production (e.g. Yemen, Syria) should refrain for increasing their debt to GDP ratio as their repayment capacity may be constrained going forward.

Among non-oil exporters, with a debt to GDP ratio among the highest in the world and a fiscal deficit of more than 4%, Lebanon has no fiscal space. Other than rolling over existing debt, it will be difficult for Lebanon to issue new debt to finance a stimulus plan. Jordan and Djibouti have no fiscal space either; they also suffer from a high fiscal deficit although with a much lower debt to GDP ratio than Lebanon. Morocco and Tunisia have some fiscal space thanks to moderate levels of public debt. With a higher fiscal deficit and debt ratio, Egypt has no fiscal space and will find it difficult to finance additional stimulus spending in 2009–2010 over and above the package already announced by the authorities.

The quality of fiscal and debt management policies and institutions are also important factors in assessing the desirability of temporary fiscal deficit as a crisis response measure. Not all countries in need of external financing for their fiscal stimulus packages have the institutional capacity to implement largely scaled up public expenditure programs. Effectiveness of policies will depend on institutions for fiscal policy making and implementation. For example, can policy-makers reverse temporary deficit-building measures into deficit-reducing ones later on, correct errors mid-course, or spend discretionary fiscal stimulus funding for social or infrastructure efficiently? In many instances, the answers to these assessment questions are not unequivocally positive. In some countries where the quality of current social spending is wanting, it may be necessary to accept some contraction of the public expenditure programs while restructuring them to make them sound and high-impact.

With falling fiscal revenues in almost all the countries in the region and with tightening external financing conditions, domestic public debt can be an interesting alternative for financing fiscal stimulus packages. In fact domestic public debt is already an important share of total public debt in MENA where 50% of public debt is domestic, compared to 30% in sub-Saharan Africa[19]. Many MENA countries have issued domestic bonds since mid-2008. As conditions remain tight on international bond markets, domestic markets may remain the best option for many MENA countries. However, MENA will need to carefully manage the risks associated with domestic debt issuance to finance crisis response. First, the public sector should avoid crowding-out the private sector at a time when the private sector is already facing difficulty raising funds from banks or corporate markets. Second, in some countries such as Lebanon where the cost of servicing domestic debt is already high, the government should avoid adding to that cost. Third, the effectiveness of domestic debt as a source of stimulus financing can be stifled by the Ricardian equivalence whereby taxpayers, seeing today's new debt as a cause for tax increases tomorrow, save an amount equivalent to today's new debt to face tomorrow's tax increases. By doing this, taxpayers cause public spending to substitute for, rather than adding to, private spending and therefore defeat the purpose of the stimulus. To get around the Ricardian equivalence, domestic debt issuance should finance revenue-generating investments (e.g. through cost-recovery) or activities that add to future growth of the overall economy (e.g. public investments that crowd in private investment) as such activities would add to government revenues without having to increase tax rates.

What fiscal stimulus packages for MENA?

As the impact of the crisis on the real economy deepens in MENA, the attention currently received by fiscal stimulus packages will need to turn to composition of stimulus packages and capacity to implement them effectively. Most fiscal stimulus packages imply increasing government consumption of goods and services, government transfers and/or public investment so as to offset a fall in other components of aggregate demand. As discussed in Favaro et. al, fiscal stimulus packages are effective if they result in production of goods and services valuable to the consumer via employing labor and capital that are idle as a result of the recession. At the other extreme, fiscal stimulus packages may be ineffective if the increase in government spending goes to the production of goods and services of zero value to the consumer and do not affect net employment.[20] They may be ineffective also if they result in an equivalent decline of private investment or consumption as discussed in the previous section.

In designing their stimulus packages, countries in MENA should seek to include at least the following three components: measures that can stimulate investment and remove bottlenecks

[19] Source: World Bank, (2009j).

[20] See Edgardo Favaro, Leonardo Garrido and Tihomir Stucka for a discussion of Egypt's fiscal stimulus package.

to future growth, measures that provide needed safety nets to the poor and vulnerable through a rationalization of existing subsidy programs, and measures that support private sector's economic activity and trade in the short term. Attention should also be paid to coordinating fiscal stimuli across MENA countries so that stimuli can be mutually reinforcing.

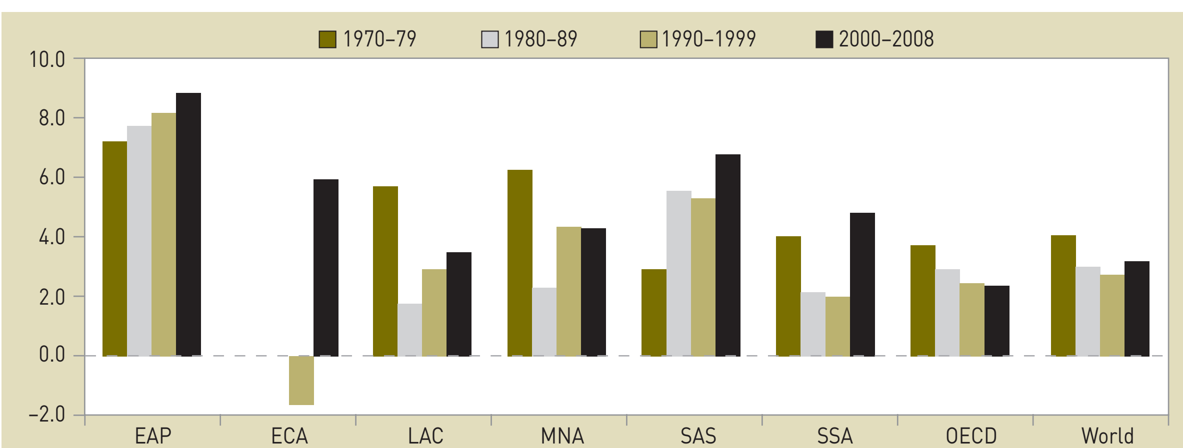
Removing Bottlenecks to Growth

To benefit from global recovery once the crisis is over, MENA countries will need to use the crisis as an opportunity to remove infrastructure bottlenecks and institutional constraints that have suppressed regional growth for decades. MENA's pre-crisis growth rate has been respectable but not stellar when compared to other developing regions. For example, during 2000–08, MENA was the second slowest growing of all developing regions with a growth rate of 4.3% (Figure 2.12). The region's growth rate was identical in the 1990s and even lower in the 1980s, in contrast to the fast growth of the 1970s which the region has been unable to replicate since. Despite its abundant natural resources and a strategic geographical location, MENA's growth potential has been subdued; lack of modern infrastructure to raise the region's competitiveness and fully take advantage of the growing global manufacturing and services trade is one of the reasons for this.

Reliable data for the investment needs in the MENA region are not available but estimates show that more than $300 billion of investment will be needed in MENA over the next 10 years in order to meet infrastructure capital demands.[21] Among the countries in the region, GCC countries infrastructure needs are the highest. Despite high profile investments in some GCC cities, GCC countries as a group are in dire need of modernizing their infrastructure. It is estimated that between 1998 and 2007, about 20% of GCC 's total GDP was invested, compared with 39% and 30% in China and South Korea respectively. Given the large needs and low level of investment to date, care should be taken not to cut too sharply MENA's investment rates as a result of the crisis. Lessons from past crises indicate that this is a risk to bear in mind in governments' responses to the crisis. In Argentina for example, the crises of the late 1980s and of 2001–02 elicited deep declines in fixed investment which resulted in Argentina's investment-GDP ratio standing some 7.8 points below trend in 2002. And during the East Asia crisis, Thailand, the country initially at the focus of the disruption, saw investment (in real estate as well as in services and manufacturing) drop by an astounding 18% per year between 1996 and 1999.

[21] OECD, (2006), Initiative on Governance and Investment for Development, MENA Workshop on Public-Private Partnerships for Infrastructure Financing, Organized in Istanbul, Turkey.

Figure 2.12: Regional average growth rates: 1970–2008



Source: World Bank data.

Recognizing the infrastructure challenge, some GCC countries have committed to maintaining high levels of spending to stimulate their economy and provide competitive infrastructure. For example in Saudi Arabia, capital spending is budgeted to leap 36% to US$60 billion in 2009, and the country's medium-term investment program totals US$400 billion over the next five years. Qatar and Bahrain have announced ambitious investment plans. Despite the heavy impact of the crisis, Dubai appears to be well positioned to take advantage of a global rebound—although it is unlikely to regain the pre-crisis level of enthusiasm—helped by a high level of investment and a conducive business environment.

The role of the private sector in infrastructure should be actively encouraged as part of MENA's crisis response framework. This is particularly important given the limited fiscal space faced by many MENA governments. In the past 15 years, a country like Egypt has taken slow but steady steps towards strengthening the role of markets in the allocation of resources. These policy changes have yielded a high return in terms of growth and employment, showing that changes are possible. Tunisia has also had some success in private sector-led growth. But even in Egypt and Tunisia, and more so in most other MENA countries, much remains to be done to create a leveled playing field for all investors, domestic and foreign, public and private (chapter 3). In the post crisis era, countries with adequate infrastructure and conducive business environment will have a particular edge over other countries as investors are likely to look for profit opportunities while taking minimal risks in order to make up for the losses of the crisis period.

Using subsidies effectively to mitigate the impact of the crisis on vulnerable groups and stimulate investment especially in small and medium enterprises

Historically, MENA countries have maintained high levels of subsidies and social spending that tie up a significant share of public resources that rarely benefit the social groups or sectors for which they are intended. In the majority of countries, all fuels and electricity are subsidized. Subsidies represent on average 7.1% of GDP and over 20% of government spending in MENA countries for which data is available.[22] In most MENA countries, high social spending is seen as part of the social contract, or as a mechanism to redistribute natural resource wealth. Some of the subsidy programs were either introduced to address spikes in commodity and were thus deemed to be temporary or as a safety net to support the poor. Across the region, these programs have persisted even when commodity prices declined. Programs created as safety nets for the poor and vulnerable have tended to benefit the wealthy as well and perhaps more than the poor in some cases. For example, in Morocco, the richest 20% of the population receives more than 31% of subsidies on fuel and liquefied gas while the poorest 20% received less than 10%.

While removing entrenched subsidies is not an easy task, and while there is no ideal time to do so, the time may be ripe for governments in MENA to rationalize their expensive subsidy programs. First, the argument can be made that the global financial crisis strengthens the case for restructuring poorly targeted safety net programs and other social programs in order to free up resources to finance critical social programs and job creation that benefit the poor and those who are deeply or directly affected by the crisis. Simulations show that elimination of energy subsidies would generate US$46 billion welfare gain for the world (0.1% of GDP), of which US$12 billion for MENA (0.005% of GDP), and US$33 billion for non-MENA, and a reduction in energy use in the MENA region (up to 13.2% in Morocco and in 46% in Iran). Second, as fuel and food prices have come down somewhat, restructuring of subsidy program will not represent an inordinate increases in household expenditure for wealthy households who may have to forgo formerly received subsidies. Finally, in some countries, subsidies have created heavy reliance on imports, public companies, rent-seeking situations, corruption and smuggling which in turn have stifled competition and private sector development. The need to spur private sector activity and growth

[22] Source: World Bank, MENA data.

should be an important component of any stimulus package for economic recovery. Removing these "institutional bottlenecks" is yet another reason for rationalizing subsidies in MENA.

It should however be noted that in some cases, price subsidies, especially food subsidies, do reach the poor and play an important role in their livelihood. Therefore subsidies should be rationalized with care so as to maintain—and perhaps—increase benefits to the poor. The impact on vulnerable groups can be lessened if subsidies are reformed in a progressive fashion, cutting unnecessary subsidies that benefit the wealthy while maintaining or even increasing subsidies that benefit the poor and vulnerable. This seems to be the guiding principle behind ongoing efforts at reforming subsidies and introducing new social programs in a number of MENA countries (Box 2.3).

Box 2.3: Examples of social programs being introduced in MENA

Safety nets in Syria consist mainly of subsidized prices on food and other commodities, although this is changing rapidly. Gasoline and diesel prices were increased in May and again in December 2008, and coupons were issued for limited purchase of diesel at subsidized prices for all families to ease the transition. While current public safety nets are limited, it is expected that remaining energy subsidies will be phased out, replaced by a targeted cash transfer program. The program would initially target the poorest 15% of the population, and is expected to be launched by the Ministry of Social Affairs and Labor in 2009. Informal assistance from family members and from nongovernmental charities remains a significant safety net for the poor.

In Morocco, the government implemented better-targeted social programs to enhance the efficiency of social spending while fighting poverty and improving the welfare of the population. To this effect, two important social programs were launched in 2008. The first concerns a health insurance coverage scheme for the poor and vulnerable (RAMED), and the second involves a Conditional Cash Transfer program. Both of these programs and other similar ones would improve social protection coverage of the population and hence help set the conditions for progressively phasing out the inefficient current universal subsidy system.

In Iran, where energy subsidies exceeded 20% of GDP in 2007/08, the government submitted a bill to reduce energy subsidies in December 2008. The parliament rejected the proposal on the grounds that ending energy subsidies, particularly during this time of economic crisis and high inflation, would only serve to stoke inflationary pressures.

In Iraq, for the past several years, policy makers have made increasingly more public statements about the need for reform of the PDS. As a first step to reform the un-targeted Public Distribution System (PDS), the authorities announced that eligibility of better-off families will be restricted as of mid-2009. Although the PDS is an effective safety net, this goal is accomplished in a highly inefficient manner, costing about US$ 6.30 to transfer US$ 1 worth of food to a poor person. Any phasing out of the PDS is scheduled to take place as authorities set up a cash-based targeted safety net. However, there is little popular support for targeting or moving to a cash-based safety net.

In Egypt, a plan to liberalize trade in subsidized flour used in the production of subsidized bread has been adopted. The objective is to eliminate the waste and leakage of both subsidized wheat and flour, and to create more competition in the market. The Holding company for Milling will undertake the purchase of wheat and will sell it to the Minister of Social Solidarity at market prices, which will tender the milling of the wheat. The General Authority for Supply and Commodities (GASC) will continue to import wheat from abroad to maintain a strategic stock for at least four months and will make the wheat available for mills wishing to participate in the tender process to mill the wheat at market prices. Moreover, bread will continue to be subsidized and sold at LE0.05/loaf, with subsidies reaching LE15 billion in the state budget (almost 1.5% of FY09 GDP). The plan will be implemented in four phases over two years, starting with 20% of the subsidized flour quotas. However, it is not clear, at this point, whether the new system could lead to savings in subsidies on wheat due to efficiency gains.

Beyond subsidies, countries are considering other social spending for rationalization. Although not all the efforts are directly related to the global financial crisis, lessons from previous crises suggest that in restructuring social spending, countries should favor projects that can act as automatic stabilizers such as means-tested social benefit programs whose extension will occur naturally and should be financed during downturns as more people fall below the eligibility threshold, and this will reverse as the economy recovers. Similarly, public work programs with below market wages can act as automatic stabilizers. Aspects of Egypt's fiscal stimulus package geared toward job-creating infrastructure investment fall in this category. Introducing new conditional cash transfers is not appealing in the midst of the crisis as eligibility criteria and thresholds may have been affected by the crisis making it difficult to accurately define the beneficiaries. The implementation of Morocco's recent plans to introduce a conditional cash transfer, though based on international best practice, may need to be timed to take into account the crisis.

Labor market interventions to support employment and earnings (e.g. payroll tax holidays and wage subsidies) may be appropriate if the crisis is short-lived but may not be fiscally sustainable if the crisis is prolonged. They may also be difficult to remove in the upturn due to risk of capture. In Morocco, the recovery plan focuses on three labor-intensive exporting sectors that employ between 300,000 and 400,000 employees: textiles, automotive components, and leather and footwear products. The ultimate objective of the government's recovery plan is to preserve jobs in these activities. The recovery plan provides guarantees for up to 65% for working capital loans; extends insurance risk coverage for exports; eases regulations that relate to imports covered by the temporary admission scheme; provides additional training and logistics in partnership with business associations; and covers the employers' contributions to social security in eligible cases (that is, provided the firms retain their employees and can show a 20% loss). While some measures in the Morocco package may be beneficial in the post-crisis era (easing of import regulations and partnership with business associations), some other components will need to be phased out when the crisis is over lest they become a burden on public finances. Tunisia has announced similar measures to support domestic SMEs and employment.

ANNEX

Country Prospects

Gulf Cooperation Council, GCC countries

Bahrain. Real GDP growth is projected to decline from 6.1% in 2008 to 2.6% in 2009 followed by 4% in 2010. Demand for Bahrain's exports of goods and services, is likely to come under pressure in 2009 as the global economic downturn and lower oil prices hurt regional growth. Current account surplus of the past few years is projected to turn into a deficit of 5.4% and 4.8% of GDP in 2009 and 2010. The global financial turmoil poses risks to Bahrain's economy, particularly since the banking sector, the largest contributor to GDP, could see a decline in activity if international banks were to reduce their presence in Bahrain. Inflation is projected to slow slightly to an average of 3% in 2009 and 2010. In the short run, the Bahraini government's economic policy will focus on shoring up growth given the global economic downturn. The government plans a strong fiscal expansion in 2009 and 2010 despite falling oil revenues. Fiscal surplus is projected to decline from 8% of GDP in 2008 to 1.8% of GDP in 2009 but increase to 9% of GDP in 2010. Because it does not have a large resource endowment, Bahrain did not experience the extent of windfall seen elsewhere in the GCC in 2007–08 and its budget comes under pressure more quickly when oil prices weaken: oil revenue still accounts for about 75% of total fiscal revenue. The fall in oil prices will give more urgency to efforts to diversify fiscal revenue, which will possibly include the introduction of value-added tax (VAT) and increases in electricity and water tariffs, visa fees and the levy on expatriate workers. The government also seeks greater private-sector participation in the economy, but progress is slow as the global economic downturn is causing a fall in foreign direct investment flows. The agenda here includes promoting efficiency in the performance of core government functions, reducing the footprint of government through privatization and pension reform, improving the targeting of subsidies and transfers, and encouraging best practice in managing state-owned enterprises. Nevertheless, growth prospects can be grounded in the resilience of Saudi Arabia and Bahrain's role as the flexible niche hub for the Saudi economy. The integration between the economies is extremely high, and the determination of Saudi Arabia to keep focused on its long-term investment agenda means that there is a potentially lucrative project finance pipeline in which Bahrain can be a player.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	6.1	2.6	4.0
Inflation Rate (%)	3.5	3.0	3.0
Fiscal Balance (% of GDP)	8.0	1.8	9.0
Current Account Balance (% of GDP)	32.3	–5.4	–4.8

Source: World Bank data

Kuwait. Growth is projected to decline from 5.2% in 2008 to negative 1.2% in 2009 driven by a sharp contraction in oil GDP of about 5%.[23] Kuwait's ability to increase its growth prospects for 2010 will depend on the global environment—notably oil prices—but also on the complex interaction between the domestic political

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	5.2	–1.2	2.4
Inflation Rate (%)	5.4	4.2	4.0
Fiscal Balance (% of GDP)	25.7	–2.7	3.3
Current Account Balance (% of GDP)	48.2	19.6	31.6

Source: World Bank data

[23] IMF, World Economic Outlook, 2009

situation and the ability to design and implement policies. Inflation is expected to ease down to about 4.2% in 2009 and 2010. Current account balance is projected to drop by more than 50% from its high level of 48.2% of GDP in 2008, reaching 19.6% and 31.6% of GDP respectively in 2009 and 2010. Fiscal balance is expected to deteriorate to negative territories from a surplus of 25.7% of GDP in 2008 to negative 2.7% of GDP in 2009 before turning positive to 3.3% of GDP. The government has relied mainly on aggressive monetary policy measures to mitigate the impact of the crisis, but this model is now under strain. In addition to Central Bank easing, the Kuwait Investment Authority is making local stock exchange investments to support the market (and thus the local institutions linked to it). The Central Bank has also managed modest depreciation of the Kuwaiti Dinar to the point where the exchange rate against the dollar is now almost exactly where it was when Kuwait abandoned the dollar peg in 2007. The financial sector stabilization package, enacted by decree in March, concentrates on refinancing about $17 billion of Investment Company debts invested in now sharply depreciated financial assets. Under the package, 50 percent of any new loans extended to the investment companies by domestic banks will be guaranteed if it goes to refinance domestic debt and 25 percent if it goes to refinance foreign debt. The size of the package may not be sufficient given the still-emerging debt restructuring situations in the financial sector. Moreover, the package fails to quarantine bad debt and risks contaminating the fairly healthy commercial banking sector with the bad debts of the weaker investment funds. In the short-term, Kuwait has several margins of adjustment for dealing with the global economic crisis. Large financial wealth had been seen as one beneficial side effect of Kuwait's limited strategy of focusing on oil extraction, while limiting its attention to development ventures internally. However, the big capital losses of the Kuwait Investment Authority (the country's sovereign fund) over the last year have raised questions over this strategy.

Oman. Real GDP growth is expected to slow from 6.2% in 2008 to 3–4% in 2009 and 2010. Non-oil growth should remain at 4% which will help to counterbalance a contraction in the oil sector. With the slowdown in global and regional growth, Oman's tourism industry which is an important driver for the service sector will face a difficult year ahead. Current account surplus of recent years is projected to turn into deficits of 14–20% of GDP in 2009 and 2010. Inflation is contained by the government's extensive subsidy system, which holds in check the prices of a range of core goods and services which will also continue to weigh on public finances. It is projected that inflation will remain around its current level of 6% in 2009 but with oil and non-oil commodity prices falling sharply, it is expected that inflation will fall to 2% in 2010. Fiscal balance is projected to remain at around 12% of GDP in 2009 and 2010. The government has also announced an increase in spending by 11% in response to the economic slowdown. With net foreign assets estimated at 50% of GDP, the economy has saved prudently in recent years, which will give it a robust budgetary cushion for the next few years. However, existing challenges will be accentuated if the global crisis does not unwind over 2009–2010; the country would have a lower ability to run countercyclical policies than most other Gulf countries, given its lower revenue base. Oman's resource extraction costs are much higher than in its GCC neighbors (due to difficult geology) and oil prices projected at $55–63/barrel will not permit the windfall saving of recent years when set against the highly capital-intensive mode of development. Well aware of this fact, policymakers have long welcomed private sector involvement in the upstream energy sector and through judicious use of partnerships and joint ventures have built significant local capacity in the energy sector. However, it is likely that more diversified sources of funding for investments will have to be found, focused for example on financial sector deepening and privatization.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	6.2	3.0	3.8
Inflation Rate (%)	6.0	6.7	2.0
Fiscal Balance (% of GDP)	12.7	11.9	11.2
Current Account Balance (% of GDP)	16.3	–14.2	–19.7

Source: World Bank data

Qatar. Qatar looks set to be unique in maintaining strong growth in 2009 among GCC countries. Real GDP growth is projected to increase to 18.2% in 2009, up from 16.4% in 2008. Growth is expected to be sustained at 16.2% in 2010. This reflects the coming on stream of new liquefied natural gas (LNG) facilities in the world's largest LNG exporter. The economy was less exposed than others in the GCC to the global economic crisis. LNG sales are mostly determined by long-term contracts which preset prices and quantities (although a spot market is emerging), and the main customers in East Asia remain committed to gas imports. Although Doha has seen a building boom, many of the new towers are for relocated government ministries for which the appetite remains solid. Furthermore, Qatar avoided the speculative trade in unfinished apartments, which was a feature of the Dubai property boom. Qatar's inflation rate is the highest among GCC countries with rent and food prices being major contributors. Inflation is projected to fall to 10% in 2009 from 15.1% in 2008 due to the pass through of declining international food prices and slower increase in domestic rents. On the fiscal side, Qatar will maintain a surplus of 13–15% of GDP in 2009 and 2010, similar to levels of the past few years. Qatar has maintained high current account surplus in the past few years peaking at 37.1% of GDP in 2008 and is projected to continue the same trend except in 2009 where the current account balance will decline to 12.4% of GDP. In 2010 it is projected that the external account balance will strengthen and reach 30.7% of GDP. Although LNG is the engine of growth in Qatar, oil production (at about 0.85 million barrels per day) remains an important "cash cow" for the economy. Nevertheless, Qatar is feeling some effects from the global crisis. The severe regional stock market plunge has almost certainly caused big losses for investment firms, with consequent exposure risk for the commercial banking sector. In a pre-emptive move, QIA announced in October in 2008 that it would purchase phased 5% stakes in all local banks, and the government said that it would purchase the investment and real estate portfolios of commercial banks. Overall, the government is confident that Qatar can capitalize on the crisis, especially in terms of its regional ambitions. Plans to make Doha a hub for education, healthcare, and financial services are being kept on track, and ample liquidity is available from hydrocarbon revenues to keep the private sector engaged. Even highly ambitious projects like the "Friendship Causeway" to Bahrain are reportedly on schedule. However, revisions in international financial regulation may require some adjustments to the ambitious plan of Qatar as a global Financial Centre.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	16.4	18.2	16.2
Inflation Rate (%)	15.1	10.0	6.0
Fiscal Balance (% of GDP)	11.5	13.5	14.7
Current Account Balance (% of GDP)	37.1	12.4	30.7

Source: World Bank data

Saudi Arabia. While the largest economy in the GCC and the MENA region was able to avoid the financial and property sector turmoil afflicting the UAE, Kuwait and some other emerging market economy, the combined effects of lower oil prices and production cuts will be sharp reductions in economic growth and fiscal and trade surpluses in Saudi Arabia in the 2009–10. Saudi Arabia will see recession in 2009. GDP growth rate is projected to contract by negative 0.9% in 2009 before recovering to 3% in 2010. Inflation is projected to ease to 5.7% and 3.5% respectively in 2009 and 2010 from 9.9% in 2008. The loss of fiscal revenue due to oil price movements is

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	4.6	-0.9	3.0
Inflation Rate (%)	9.9	5.7	3.5
Fiscal Balance (% of GDP)	30.4	1.5	4.5
Current Account Balance (% of GDP)	35.5	16.2	26.4

Source: World Bank data

projected to be 27% of GDP in 2009.[24] The fiscal balance is projected to deteriorate from 30.4% of GDP to less than 2% and 4.5% in 2009 and 2010. On the external side, the surplus of about 35.5% of GDP in 2008 is projected to decline to 16.2% but will improve to 26.4% of GDP in 2010. The wealth effect caused by large losses on the stock markets and uncertainty regarding short term prospects have caused consumers to cut down consumption of certain luxury goods (e.g. cars). This wealth effect may persist throughout 2009 and possibly 2010, stifling growth prospects. In fact, recently, The Saudi Arabia Basic Industries Company (SABIC), the largest traded company in Saudi Arabia, surprised the stock market with a big loss in the first quarter of 2009. The company was hurt by poor performance in its US operations (the former GE Plastics) and by sharply declining petrochemical product prices. Luckily, thanks to, Saudi Arabia is in a position to provide a sizeable fiscal stimulus thanks to its large international reserves accumulated in past years and its cautious approach to overseas investment of oil wealth—largely US Treasury instruments rather than in global equity as other sovereign funds. Thus the Saudi government has announced an important fiscal stimulus for 2009–2010 amounting to a total of 9–10% of GDP—the largest among G20 countries. Government's focus is to maintain the level of investment in the economy and keep large projects (such as railways) on track so as not to jeopardize long-term growth potentials. Public financing is used to make up for the project finance vacuum left by the departure of many large international banks hitherto providing financing to local projects. Recently, the impact of two corporate debt distress situations in Saudi Arabia has spread around the GCC. It is generally considered that banks in Bahrain, the UAE, and Saudi Arabia have a combined exposure to these two companies that could run into billions of dollars.

United Arab Emirates (UAE). The UAE will experience the sharpest growth slowdown of any MENA economy in 2009. Growth is projected to decline from 7.4% in 2008 to 0.3% in 2009. UAE is expected to have the lowest inflation rate among GCC countries in 2009, with inflation projected to ease from its high level of

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	7.4	0.3	3.3
Inflation Rate (%)	11.5	2.0	3.1
Fiscal Balance (% of GDP)	23.6	11.2	8.0
Current Account Balance (% of GDP)	17.5	8.1	–5.3

Source: World Bank data

11.5% in 2008 to 2–3% in 2009 and 2010. The fiscal surplus of the past few years is projected to shrink to 11.2% and 8.0% of GDP in 2009 and 2010. External balance will halve to 8.1% in 2009 and is projected to lower to negative 5.3 percent of GDP in 2010 as the impact of the sharp decline in economic activity in Dubai is likely to persist and stimulus spending helps sustain imports. In fact, with the diversity of situations across the constituent Emirates, the UAE faces a challenging situation in the short term. The UAE is experiencing the most complex manifestation of the global economic crisis among the GCC countries. While the volatility in oil prices and their associated effect is common to the GCC, the UAE also features emerging market-type vulnerabilities overlaid with an embryonic system of intergovernmental fiscal relations. Critical to understanding the crisis dynamic in the UAE is that it is an oil-rich economy which relied heavily on external financing for its non-oil growth. After the sharp collapse in the real estate property market as well as in the financial market in Dubai, the main short term challenge is to manage the impact of the global recession on Dubai in an environment where lower oil prices may constrain Abu Dhabi's rescue capacity. Abu Dhabi has provided much needed support to help stabilize the financial system across the Emirates and especially Dubai. Abu Dhabi has also issued bonds worth $10 billion and used the proceeds to help Dubai remain current on its debt service and guaranteed an additional $10 billion bonds. On a consolidated basis, the scale of the financial crisis in the UAE is manageable; the issue is the institutional capacity to do so. Given the UAE's GDP of $250

[24] Source: IMF, (2009), Regional economic Outlook, Middle East and Central Asia

billion, even an outright fiscal loss of $25 billion on Dubai projects (which is in the range of publicly cited cost estimates) would be 10 percent of GDP—difficult, but similar to financial crisis costs in other countries. And assets of sovereign wealth funds provide a huge buffer for coping with such costs. Beyond the concerns over the short-term impact of the crisis, Dubai is likely to emphasize its fundamental strengths in logistics, light manufacturing, and as a safe haven for funds and investors from Iran and South Asia. As the crisis has highlighted weaknesses in the financial sector (such as a lack of diversity in products and reliance on volatile sources of funding), correcting these are likely to be high priorities for policymakers in the short-term.

Oil exporters with low oil revenue per capita – Algeria, Iran, Iraq, Libya, Syria, and Yemen

Algeria. GDP growth is expected to reach 2.2% in 2009 and 3.5% in 2010, supported by a 6% growth in non-hydrocarbon output in 2009. Inflation is projected at 3.5%, assuming a favorable harvest. The overall fiscal balance will turn negative for the first time since 1999, with a deficit of 11.5% and a small surplus of 1.8% of GDP respectively in 2009 and 2010. This deficit would be financed by significantly drawing down the oil stabilization fund. The recession in Europe and the decline in oil revenues pose significant risks. The projected decline in oil prices coupled with high imports induced by the public investment program would reduce the current account surplus to 6.3% and 1.4% of GDP in 2009 and 2010, from 24.2% in 2008. Nevertheless, the international reserve coverage would still remain at more than two years of imports. In the absence of substantial improvements in productivity and the business climate, non-hydrocarbon output is unlikely to be an engine of growth in the short term. But growth in 2010 could be higher than projected if decisive actions are taken to promote private sector development and economic diversification.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	3.0	2.2	3.5
Inflation Rate (%)	4.0	3.5	3.0
Fiscal Balance (% of GDP)	8.3	–11.5	1.8
Current Account Balance (% of GDP)	24.2	6.3	1.4

Source: World Bank data

Iran. Growth is projected to slow down from 6.9% in 2008 to about 2.5% and 3% in 2009 and 2010. Iran is adjusting to low oil prices by reducing public expenditures. This has become even more necessary since Parliament refused to allow a reduction in subsidies (which represent up to 18% of GDP). A cut of US$ 6.4 billion is projected in capital expenditures (44% reduction) and US$ 2.1 billion in current expenditures (5% reduction) in addition to cuts of 8.6% of GDP in current expenditures and 1.7% of GDP in capital expenditures between fiscal year 2008/09 and 2009/10.[25] Tax revenues are budgeted to fall by 1.8% of GDP, reflecting an expected slowdown in economic activity; while oil revenues are expected to fall by 5.6% of GDP. With low oil prices and contractionary budget for the fiscal year 2009/10 and after several years of positive balance, fiscal balance will turn negative at around 5–6% of GDP in 2009 and 2010. Inflation is expected to remain high at 23.5% and 20% in 2009 and 2010, a continuation of the past trend mostly due to an expansionary credit policy and a significant, albeit recently reduced, fiscal spending. Owing to the lower oil receipts, current account balance is projected to fall sharply from 20.6% of GDP in 2008 to 4–5% of GDP in 2009 and 2010.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	6.9	2.5	3.0
Inflation Rate (%)	22.5	23.5	20.0
Fiscal Balance (% of GDP)	0.7	–5.2	–6.0
Current Account Balance (% of GDP)	20.6	4.1	4.9

Source: World Bank data

[25] Iranian fiscal year ending March 20.

Iraq. Oil production and export volumes are projected to increase by 2.5 mbpd and 2.0 mbpd, respectively in 2009 and 2010. This increase is mostly due to the recent security gains in Iraq. However, due to lower oil prices, 2009 oil revenues are expected to be about 25% lower than the outturn in 2008. This implies an equivalent loss of government revenues and is having a major impact on fiscal plans. The difficult financing outlook and lack of savings from past years limit the scope for counter-cyclical fiscal policies. The Government has announced it will cut recurrent and capital spending in a supplementary budget if oil prices remain low in order to contain fiscal balance at zero percent of GDP in 2009 and 2010. As a result of a severe drought, total wheat production is expected to decline in 2009 by 27%. The combination of lower oil revenue and poor performance of agriculture will be a lower GDP growth. Iraq's economy is projected to grow by about 6.9 and 6.7% in 2009 and 2010 while inflation should be contained at 6%. The current account surplus of 26.7% of GDP in 2008 is expected to turn into a deficit of about 5.8% of GDP in 2009 before improving to 3.4% of GDP in 2010. Continued recovery of non-oil activity and increase of production and export volumes are expected to play a role in the recovery. However, short-term economic prospects critically hinge on the security situation and the political reconciliation process.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	9.8	6.9	6.7
Inflation Rate (%)	6.8	6.0	6.0
Fiscal Balance (% of GDP)	0.0	0.0	0.0
Current Account Balance (% of GDP)	26.7	−5.8	3.4

Source: World Bank data

Libya. Although less robust than in recent years, Libya's economic outlook for 2009–10 remains solid. Real GDP growth is expected to slow to 2.9% and 4.8% respectively in 2009 and 2010, with hydrocarbon growth turning negative. Current account balance in 2009 and 2010 will be significantly lower than in 2008 but will nevertheless remain positive, at 8.7% of GDP in 2009, with improvement to 11.9% expected in 2010. The reduced price of oil may imply some adjustments to the public investment program. Fiscal balance will turn negative in 2009 for the first time since 1996, falling from a surplus of 22.8% percent of GDP in 2008 to a deficit of 9.8% of GDP in 2009. Some improvement is expected in 2010. Inflation should be contained at 0.9% in 2009 and 2010 with the international prices stabilizing and money growth slowing. International reserves will maintain healthy levels, equivalent to about 40 months of imports.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	6.3	2.9	4.8
Inflation Rate (%)	0.9	0.9	0.9
Fiscal Balance (% of GDP)	22.8	−9.8	−0.2
Current Account Balance (% of GDP)	39.2	8.7	11.9

Source: World Bank data

Syria. Declining global output and trade as well as the ongoing drought could have a significant impact on Syria in 2009. The external demand shock has been compounded by a domestic supply shock, namely, a severe drought that is entering its third year, with severe impact on agricultural output. The global downturn is expected to decelerate the recent growth in tourism and foreign direct investment, and to reduce remittances from expatriate workers as job losses mount in the GCC countries and other "labor-importing" countries. Growth is projected to decline to 3% and 3.5% respectively in 2009

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	5.2	3.0	3.5
Inflation Rate (%)	14.5	8.5	5.0
Fiscal Balance (% of GDP)	−5.3	−5.5	−2.3
Current Account Balance (% of GDP)	1.1	−9.6	−9.0

Source: World Bank data

and 2010. Inflation is projected to ease respectively to 8.5% and 5% from its high level of 14.5% in 2008. Fiscal pressures are expected to arise as well despite the authorities' commitment to fiscal discipline. Fiscal deficit will remain at 5.5% of GDP and 2.3% of GDP in 2009 and decrease to 2% in 2010. Export earnings are expected to decline substantially reflecting falling oil and agricultural prices. Current account balance is expected to turn negative from surplus of 1.1% of GDP in 2008 to negative 9.6% and 9% of GDP in 2009 and 2010. Going forward, Syria faces the challenges of developing its non-hydrocarbon sources of growth. After peaking at 650,000 bpd in 1995, crude oil production has plummeted to about 380,000 bpd in 2007. With declining output and rising consumer demand for petroleum products, Syria's overall oil balance turned negative in 2007. Oil production is expected to decline further over the coming years, reaching a plateau of about 300,000 bpd by 2025 and eventually depleting recoverable reserves by 2030. Further progress in economic reforms and continued efforts to diversify Syria's production and exports are necessary.

Yemen. Yemen faces a number of economic and political uncertainties in 2009–10. External sources of concern include depressed oil prices, plunging growth rates in the Gulf countries, and instability in the Horn of Africa. The ongoing crisis is expected to reduce the flow of foreign investment, both to the hydrocarbon and non-hydrocarbon sectors. Non-hydrocarbon investment flows, coming mostly from the Gulf in the past, have tended to concentrate in tourism, real estate, and some manufacturing industries. They are likely to be affected by lower oil revenues and slow growth in the Gulf. The current crisis could also reduce remittances coming from Gulf countries. Despite these odds, the overall growth rate will rise to 7.7% in 2009 and 5% in 2010 from 4% in 2008, owing to a one-off impact of the coming on-stream of a liquefied natural gas (LNG) plant. The performance of the non-hydrocarbon sector, the main source of employment, will slow to about 4%. As an early sign of slower growth in economic activity in 2009, the customs authority have reported a noticeable decline in customs revenue in the first two months of the year, reflecting lower import prices and lower volumes. Monetary data available for the first two months of the year show a decline in credit to the private sector. The fiscal deficit will remain at 2% of GDP in 2009 and 2010. Lower inflation will be among the positive developments, with the CPI falling to 5.5% in 2009 and 2010. Current account deficit will increase to 11.1% of GDP in 2009 from 6.5% of GDP in 2008 before seeing some improvement in 2010 to 6% of GDP. Disbursement of pledges made at the Consultative Group meeting in London in 2006 has been slow, amounting to less than 6% of pledges by the end of February 2009. The pace of disbursement may be affected by the global economic crisis. Yemen's short to medium term prospects reinforce the need to tackle the structural weaknesses of the economy, particularly fostering non-oil growth led by the private sector.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	4.0	7.7	5.0
Inflation Rate (%)	8.5	5.5	5.5
Fiscal Balance (% of GDP)	−3.0	−2.0	−2.0
Current Account Balance (% of GDP)	6.5	−11.1	−6.0

Source: World Bank data

Non-oil exporters reliant on financial flows from GCC or official development assistance from OECD – Djibouti, Jordan, Lebanon, West Bank and Gaza

Djibouti. The economy is expected to grow at rates of 5–5.5% over the next two years, compared with 5.8% in 2008. Inflation is expected to fall to 5.4 in 2009 as world oil and food prices continue to fall. Fiscal deficit is projected to reach 3.4% of GDP in 2009 and 2010 due to lower grants, higher investments, and military expenditures related to the border conflict with Eritrea. Improvements in tax administration, including the introduction of the VAT and the rationalization of exemptions in the Free Trade Zone in 2009, should increase tax revenue and

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	5.8	5.0	5.5
Inflation Rate (%)	12.0	5.4	4.0
Fiscal Balance (% of GDP)	–3.4	–3.4	–3.4
Current Account Balance (% of GDP)	–6.7	–5.0	–3.4

Source: World Bank data

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	5.5	2.5	3.5
Inflation Rate (%)	14.9	2.0	10.0
Fiscal Balance (% of GDP)	–9.9	–3.4	–2.6
Current Account Balance (% of GDP)	–27.5	–9.6	–9.5

Source: World Bank data

improve fiscal outlook beyond 2010. Current account deficit will continue throughout 2009 and 2010 albeit lower than the levels in 2008. It is projected that the current account deficit will reach 5% and 3.4% of GDP respectively in 2009 and 2010. Traditional exports should continue rising in 2009–2010, following the expansion of port activities, cattle processing facilities and salt extraction. This will help to reduce the trade deficit in 2009, further supported by reduced international food and oil prices and a fall in FDI-related imports. FDI has been high at about 23% and 30% of GDP in 2007 in 2008, but is expected to decline to levels of around 20% of GDP in the medium-term as ongoing investments are completed and others are cancelled or postponed. The construction of the second container terminal in Doraleh by Dubai World has been delayed to 2010 as well as the construction of a new refinery and pipeline. Due to Djibouti's small size, investment projects are limited in number and large projects have a high economic importance. This in turn means that a withdrawal of such investments is associated with high economic risks. However, recent investments in tourism, alternative energy, and the Free Zone will continue to support growth as will a projected increase in earnings from port services.

Jordan. Economic activity is expected to slow significantly, with growth rate slipping to 2.5% and 3.5% respectively in 2009 and 2010 in line with expected lower foreign capital flows, exports and remittances, and domestic private investment. One early indication is the industrial production index which decreased by 6.8% in January 2009. Jordan has limited room for fiscal stimulus; and fiscal space has been eroded further in 2008 as a result of generous compensation to public sector employees to mitigate the impact of higher fuel and food prices. Fiscal deficit is projected to decline from 9.9% of GDP in 2008 to about 3% on average in 2009 and 2010. Recognizing the lack of fiscal space, the Government plans to increase public capital spending in 2009 only to the extent that it can be financed from expected savings and lower spending on fuel and food subsidies (the timing may be opportune since prices have declined). Jordan also has a high dependence on current transfers and capital inflows; and there remain key risks related to financing of the current account deficit, which is estimated to reach 9.6% and 9.5% of GDP in 2009 and 2010 from a high deficit of 27.5% of GDP in 2008. If financing dries up over and above what is currently projected, the resulting squeeze would contract economic activity and worsen already high unemployment. To compensate for limited scope for fiscal stimulus, the government has sought to support economic activity by relaxing monetary policy. The Central Bank has loosened monetary policy by scaling back operations to soak up liquidity, reducing a key policy interest rate (so far by 50 bps) and reducing reserve requirements (from 10 to 9% of total deposits). Inflation is projected to ease to 2% from its high level of 14.9% in 2008 but could pick up in 2010 if liquidity in the banking system remains high. The possible loss of jobs held by Jordanian workers in GCC countries can compound the pressures on an already difficult job market at home return—unemployment rate has reached 13.0 percent in Q2 2009, up from 12.1 percent in Q1 2009 and 12.5 percent in Q2 2008.

Lebanon. Despite a resilient banking sector, Lebanon's real economy will be impacted in 2009 largely through economic slowdown in neighboring Gulf oil exporters. Economic growth is expected to slow from 6.5% in 2008 to 2.5% and 4.5% respectively in 2009 and 2010 in line with expected reduction in regional demand and

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	6.5	2.5	4.5
Inflation Rate (%)	10.7	8.5	5.0
Fiscal Balance (% of GDP)	−7.7	−4.4	−2.5
Current Account Balance (% of GDP)	−19.3	−10.4	−5.2

Source: World Bank data

slowdown in inflows of remittances and foreign direct investment from GCC countries. Inflation is projected to ease to 8.5% in 2009 and lower to 5% in 2010 following a double digit rate in 2008. Current account deficit is projected at around 10.4% of GDP in 2009 and 5.2% in 2010. Fiscal deficit is projected to decline respectively to 4.4% and 2.5% in 2009 and 2010 from 7.7% of GDP in 2008. But public debt is expected to remain very high, close to its 2008 level of 162%. Moreover, interest payments on public debt absorb 45% of government revenues and the exposure of commercial banks to public debt is very high (over 55% of the US$47 billion stock of public debt was held by commercial banks as of end-2008). Lebanon has very limited room for a fiscal stimulus or countercyclical fiscal spending, unless inefficient subsidies to the electricity company are rationalized to free up resources for much needed safety nets and infrastructure investments. In the absence of fiscal space, the authorities have focused on monetary policy to manage the impact of the global crisis, with some success so far. The central bank has recently announced plans to facilitate lending by banks through the provision of subsidized facilities and by reducing reserves requirements on deposits.

West Bank and Gaza. The optimistic scenario is for West Bank and Gaza's economy to grow at 5% and 6.5% respectively in 2009 and 2010.[26] This would begin a recovery of per capita GDP. The fiscal deficit is projected to worsen to 35.7% of GDP in 2009 and improve marginally in 2010 to 22.7%, a level close to the 2008 level. The current account deficit is projected to follow a similar pattern—worsening sharply to 39.7% of GDP in 2009 and recovering to the 2008 level in 2010. All of the growth in 2009 is assumed to come from the West Bank, while Gaza continues to stagnate. Reaching the projected 5% growth rate requires that the peace process be consolidated to restore investor confidence. The 2009 budget calls for about $1.65 billion in external aid, with as much as $1.15 billion designated for budget support and $50 billon allocated to development expenditures. However, it may be difficult to redirect that much external aid from recurrent expenses to development expenditures. With real wages for government employees declining and the private sector not expanding quickly, the Palestinian Authority will be under pressure to both increase the public work force and increase their wages. Currently, the 2009 draft budget calls for a 6% increase in the wage bill, with 4% coming from a general wage rise to offset the rising cost of living and another 2% to account for additional hiring in the health and education sectors.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	2.0	5.0	6.5
Inflation Rate (%)	7.0	4.0	3.0
Fiscal Balance (% of GDP)	23.3	−35.7	−22.7
Current Account Balance (% of GDP)	−27.2	−39.7	−29.3

Source: IMF data

Non-oil exporters with strong economic linkages with Eurozone and OECD – Egypt Morocco, and Tunisia

Egypt. The rapid deterioration in the global economic outlook weakens nearly all key drivers of Egypt's balance of payment and economic activity in fiscal year 2009. Tourism revenues are expected to fall by 8% (in fact, revenues of

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	7.2	3.8	4.2
Inflation Rate (%)	11.7	8.5	7.3
Fiscal Balance (% of GDP)	−7.6	−5.6	−4.7
Current Account Balance (% of GDP)	−6.7	−6.3	−6.3

Source: World Bank data

[26] IMF, 2009b

Egyptian hotels have reportedly declined by 30 to 40 percent in the past nine months due to the global economic crisis). Suez Canal revenues are expected to fall by 10–15%, due to falling traffic, with a larger drop in fiscal year 2010 if tariff reductions take place.[27] Worker remittances will also fall by 5–10% (to US$ 7.5 billion in fiscal year 2009 and US$ 6.8 billion in fiscal year 2010) following the growth slowdown in GCC (which originates around half of Egypt's worker remittances). Net merchandise exports will fall by 20–25% on the back of the recession in Europe and the US in 2009. Net hydrocarbons exports are expected to rise due to steady prices of natural gas—which represents most of Egypt's hydrocarbon exports—while hydrocarbon imports are bought at or close to spot prices. Yet, this will not likely compensate for the sizable loss in net non-oil merchandise exports leading to a larger trade deficit as a ratio to GDP despite lower non-oil merchandise import growth. Tighter global credit conditions and increased investor aversion should lead to a fall in FDI inflows by almost 40% (to US$8.5 billion in fiscal year 2009 and US$7.7 billion in 2010). Against these negative trends, the current account is expected to post a deficit of 6.3% of GDP in fiscal years 2009 and 2010. Against this backdrop, GDP growth is projected at 3.8% in 2009 and 4.2% in 2010. This growth rate is too low to absorb the 600–700 thousand annual cohorts of new entrants in the labor market. Together with the potential return of expatriate Egyptians, particularly from GCC states, this might lead to increasing unemployment. On the positive side, inflation is expected to fall to 8.5% in 2009 and 7.3% in 2010 due to base effects, falling international commodity prices and weakening domestic demand. Egypt has announced a fiscal stimulus. However, given the country's tight fiscal space, the main challenges in the short term remain the ability of the government to implement expansionary policies without impairing long-run fiscal stability. It is expected that increase in spending will be partially financed by savings on the cost of food subsidies. Fiscal deficit is projected to remain at around 5.6% and 4.7% of GDP in 2009 and 2010. Compared to the last downturn, Egypt's economic fundamentals place it in a better position to weather shocks including a large consumer base (formal or informal sector), unleveraged financial sector with only 41% of the total credit extended to the private sector; a relatively diversified economy with available opportunities in most sectors; comfortable level of net international reserves (US$32.2 billion in end-March 2009, projected at US$35.5 billion by the end of FY09 and US$37.2 billion in FY10) to be drawn upon as the current account deteriorates.

Morocco. An unexpected outstanding 2009 harvest brought about by good rains and targeted sectoral fiscal stimulus actions are expected to moderate the impact of the global recession on the Moroccan economy. Economic growth is expected to weaken to 5% and 3% respectively in 2009 and 2010, lower than the 5.6% growth rate in 2008. Inflation should be contained around 3.5% in 2009, mainly determined by imported food inflation, and remain subdued around 2.5% in 2010. Unemployment is expected to moderately deteriorate in 2009 to around 11% from 10% in 2008, and progressively improve as growth strengthens. Fiscal deficit is projected to increase to 3.1% and 2.8% of GDP in 2009 and 2010 as the authorities provide incentives to firms for job creation and exports and step up social spending to boost safety nets.[28] Although the trade deficit should remain at the same level as in 2008 (around 22% of GDP), with falling imported commodity prices compensating for lower exports, the current account is expected

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	5.6	5.0	3.0
Inflation Rate (%)	3.9	3.5	2.5
Fiscal Balance (% of GDP)	−0.1	−3.1	−2.8
Current Account Balance (% of GDP)	−5.4	−2.5	−2.9

Source: World Bank data

[27] In an attempt to encourage more traffic, the Suez Canal Authority has temporarily lowered its fees for dry cargo vessels while keeping its transit fees for 2009 unchanged.

[28] Here the fiscal data differs from the national fiscal data since it does not include in the budget the Hassan II fund and it does include privatization receipts.

to remain in deficit, at 2.5% and 3% of GDP in 2009 and 2010 due to a drop in tourism receipts and workers' remittances. With moderate FDIs flows and loans, foreign reserves are expected to remain at comfortable level.

Tunisia. Tunisia's real GDP growth is expected to weaken to 3% and 4% respectively in 2009 and 2010, following a slowdown in 2008 (with 2008 growth estimated at 4.5% against 6.3% in 2007). Agricultural sector growth is expected to pick up in 2009, following a sluggish performance in 2008. The slowdown in economic growth in 2009 will be caused by moderating growth in export-oriented manufacturing industries such as electrical and mechanical engineering and information technology industries, due to both increased competition and weaker demand from the EU. The global slowdown will also depress tourism activity. Domestic demand, especially private consumption and public investment will thus be the main drivers of growth. The major infrastructure projects that are expected to boost growth include a new airport, a new refinery, and the Tunis-Medjes-Beja-Boussalem highway. It is expected that the fiscal deficit will remain at about 3% for both 2009 and 2010. Despite the strong public investment program and fiscal incentives provided to small and medium enterprises affected by export declines as well as support to firms that create jobs. In fact, the Government has extended for another six months the measures approved in December 2008 in support of firms that have experienced a sharp decline in exports. These measures consist mostly of subsidies of the employer's cost of social security and the cost of export insurance. External financing will be constrained by tight conditions on sovereign bond markets but Tunisia hopes to tap multilateral sources of financing. With the global commodity prices falling and then stabilizing, and with domestic demand likely to weaken, inflation is expected to ease to 3.5% and 3% in 2009 and 2010. Current account deficit will reach 4.8% and 3.6% of GDP respectively in 2009 and 2010. In contrast with recent years during which the economy has attracted significant FDI, especially from the Gulf Arab countries and the UK (hydrocarbons), FDI inflows will be highly vulnerable in 2009–2010 to the impact of the global credit crunch.

Key Economic Indicators	2008e	2009f	2010f
Real GDP Growth (%)	4.5	3.0	4.0
Inflation Rate (%)	4.7	3.5	3.0
Fiscal Balance (% of GDP)	−3.0	−3.1	−3.0
Current Account Balance (% of GDP)	−5.4	−4.8	−3.6

Source: World Bank data