

MIDDLE EAST and NORTH AFRICA



Growth in the Middle East and North Africa was stable in 2015, at 2.5 percent. Accelerating activity in most oil-importing countries more than offset a slowing in oil exporters. Growth is expected to jump to more than 5 percent in 2016 and 2017. This reflects an expected rapid growth pickup in the Islamic Republic of Iran, the largest developing economy in the region, as sanctions are suspended or removed under the Joint Comprehensive Plan of Action. The forecast also depends on a stabilization of oil prices, and measured improvement in security in some countries. The outlook remains subject to significant downside risks stemming from possible escalation of conflict, a further decline in oil prices, and social unrest. Key policy challenges are to reduce unsustainable fiscal deficits, particularly in oil-exporting countries, and to harness the potential of the working-age population.

Recent developments

Growth in developing countries in the Middle East and North Africa was unchanged in 2015, at 2.5 percent (Table 2.4.1). In most oil-exporting countries (Algeria, the Islamic Republic of Iran, and Libya), growth slowed, as oil production and investment fell with the steep decline in oil prices since mid-2014. The situation was worsened in Libya by ongoing conflict.¹ In Iraq, however, despite protracted conflict, expansion in the oil sector was sufficient to reverse an economic contraction in 2014.

In most oil-importing countries, growth strengthened in 2015, as lower oil prices provided support to demand and allowed reductions in fuel subsidies. Activity in Egypt and Morocco rebounded significantly, reflecting rising domestic consumption (Egypt) and a strong rebound in the agricultural sector (Morocco). Reconstruction

following the 2014 war supported growth in the West Bank and Gaza, while strong investment growth boosted activity in Djibouti. However, growth in Tunisia was held back by security concerns, and in Jordan and Lebanon by spillovers from the conflict in Syria. Subdued activity in Tunisia also reflected weak credit growth linked to a delay in recapitalization of ailing publicly-owned banks.

A potentially pivotal development was the international agreement, signed in July 2015, of the Joint Comprehensive Plan of Action for limitations on Iranian nuclear development. For their part, the five permanent members of the United Nations Security Council, plus Germany and the European Union, agreed to remove and, in the case of the United States, suspend, trade and finance sanctions on the Islamic Republic of Iran. The agreement opens the door for re-integration of the country into the global economy and the reinvigoration of its oil, natural gas, and automotive sectors. Sanctions could begin to be lifted in early 2016 if the International Atomic Energy Agency (IAEA) indicates the Iranian government has fulfilled its commitments under the pact. Renewed optimism about the potential of the Iranian economy has already generated a flurry of investment interest by foreign companies.

The toll of conflict in several countries in the region showed little sign of abating in 2015. The

Note: The author of this section is Dana Vorisek. Research assistance was provided by Qian Li.

¹This report covers low- and middle-income countries in the Middle East and North Africa region; Gulf Cooperation Council (GCC) countries are excluded. The developing countries are further divided into two groups, oil importers and oil exporters. Oil importers are Djibouti, the Arab Republic of Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic, Tunisia, and West Bank and Gaza. Oil exporters are Algeria, the Islamic Republic of Iran, Iraq, Libya, and the Republic of Yemen. Syria and the Republic of Yemen are excluded from regional growth forecasts due to data limitations.

number of people in the region who are internally displaced or who have left their home countries as a result of conflict is unprecedented. In Iraq, 3.6 million people were internally displaced as of December 2014. An estimated 4.8 million people have left Syria as migrants or refugees, while 7.6 million are internally displaced. The rising outflow of migrants from Syria, and to a lesser extent Iraq, moved to the forefront of the European Union's policy agenda in 2015. The average monthly number of first-time asylum seekers to the European Union more than doubled between 2013 and the first eight months of 2015, to more than 66,000 people. Nearly one-third of asylum seekers in July and August 2015 were from Syria, up from less than one-quarter during the same months in 2014 and roughly 10 percent in 2013. Separately, high-profile terrorist attacks aimed at tourists in Egypt and Tunisia in 2015 negatively affected tourism in those countries.

The economic impact of Syrians seeking to escape war has been very heavy for Lebanon and Jordan, which the United Nations High Commissioner indicates host 1.1 million and more than 630,000 Syrian refugees, respectively, as of November. The number of Syrian refugees in Lebanon and Jordan is equivalent to a respective 25 percent and 9 percent of the populations, putting severe strain on public service delivery and infrastructure. Another 1.9 million refugees from Syria are in Turkey.

For most oil-producing countries where conflict is entrenched, oil production has dropped. In Syria and the Republic of Yemen, oil production has all but collapsed. For Syria, the decline reflects disruptions from conflict as well as trade sanctions imposed by the European Union and the United States. In Libya, production has dropped by nearly 75 percent since 2010, from an average of 1.6 million barrels per day (mbd) to 0.4 mbd in 2015. In contrast, oil production in Iraq has steadily increased, despite the conflict (Figure 2.4.1), as the important oil fields are not in the immediate geographical vicinity of the territory now controlled or contested by the Islamic State of Iraq and the Levant (ISIL). Average oil production in Iraq, at approximately 4 mbd in 2015, is more than 65 percent higher than in 2010.

Oil prices are now below fiscal break-even levels (i.e., the levels that balance the government budget) in all oil-exporting countries in the Middle East and North Africa (IMF 2015g). Violent conflict, which has reduced oil revenues while necessitating increased spending on security, is further straining government budgets of oil exporters across the region. In Algeria and Iraq, fiscal deficits deteriorated by more than 10 percentage points of GDP between 2013 and 2015, and in Libya by 50 percentage points. In Iraq and Libya, budget deficits were financed in 2015 predominantly by borrowing from state-owned banks, the Development Fund for Iraq having been exhausted by 2014. The bank borrowing is putting liquidity under strain. Algeria continues to draw on a sovereign wealth fund.

For oil-importing countries, declining oil prices, together with falling food prices, have been generally beneficial, as they have reduced the cost of imports and, in Morocco and Lebanon, contributed to higher consumption growth. Declining oil and food prices have also kept inflation subdued (Figure 2.4.2). For some countries (Jordan and Morocco), the period of low oil prices has helped stabilize government debt. Nevertheless, fiscal deficits were 10 percent or more of GDP in Egypt and Djibouti in 2015, and above 7 percent in Lebanon.

In Egypt, Jordan, and Lebanon, real effective exchange rates (REERs) appreciated during 2015, weighing on export competitiveness. In Egypt, the appreciating REER reflects high inflation, which averaged 10.3 percent in the first ten months of 2015. The central bank carried out several nominal devaluations, and restricted access to foreign currency, in attempt to resolve a deepening foreign currency shortage. In Jordan and, in particular, Lebanon, whose currencies are pegged to the U.S. dollar, real appreciation mostly reflected the rise of the U.S. dollar against the euro, as inflation was negative through most of 2015. Among oil exporters, the currencies of Algeria, the Islamic Republic of Iran, and Libya have depreciated, partially offsetting the local-currency revenue loss from lower U.S.-dollar prices of oil exports (IMF 2015g). Although international sanctions on the Islamic Republic of

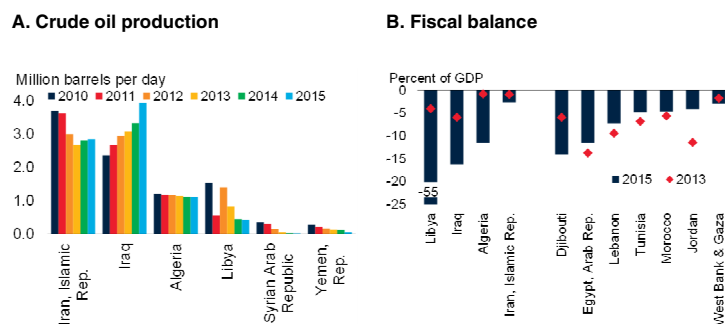
Iran contributed to an episode of extremely high inflation in 2012 and 2013, inflation has moderated more recently, despite a depreciating rial.

Low oil prices are also contributing to adjustments in external balances. Whereas all oil exporters in the Middle East and North Africa had current account surpluses in 2013, balances in all of these countries except the Islamic Republic of Iran had swung into deficit by 2015, particularly in Libya, Algeria, and Iraq. Algeria and Libya have been able to rely on official reserves, but these have been depleted rapidly since mid-2014. Although Lebanon's large current account deficit (21 percent of GDP in 2015) is a vulnerability, the country has been able to finance it in recent years, mainly through portfolio investment. Capital flows to Lebanon declined sharply in the first half of 2015, however, by 33 percent year over year. Inflows to other oil-importing countries (Egypt, Morocco) were up in 2015, mostly as a result of strengthening foreign direct investment (FDI). However, the pickup in FDI to Egypt has not been as strong as expected given pledges at an international economic development conference in March 2015.

Remittance flows to developing countries in the region are estimated to have expanded by 1.6 percent in 2015, a slower pace than in 2014 (World Bank 2015). Flows to Egypt, Jordan, and the Republic of Yemen rose, as inflows from GCC countries remained strong. Flows to Algeria, Morocco, and Tunisia, however, declined in U.S. dollar terms due to the depreciation of the euro, the currency in which 90 percent of remittance inflows are received. Remittances have represented a major source of foreign earnings for Lebanon and Jordan in recent years (16 percent and 10 percent of GDP in 2014, respectively, according to World Bank data). The inflows may have helped to smooth consumption in the weak growth environment (World Bank 2015n).

FIGURE 2.4.1 Oil production and fiscal balance

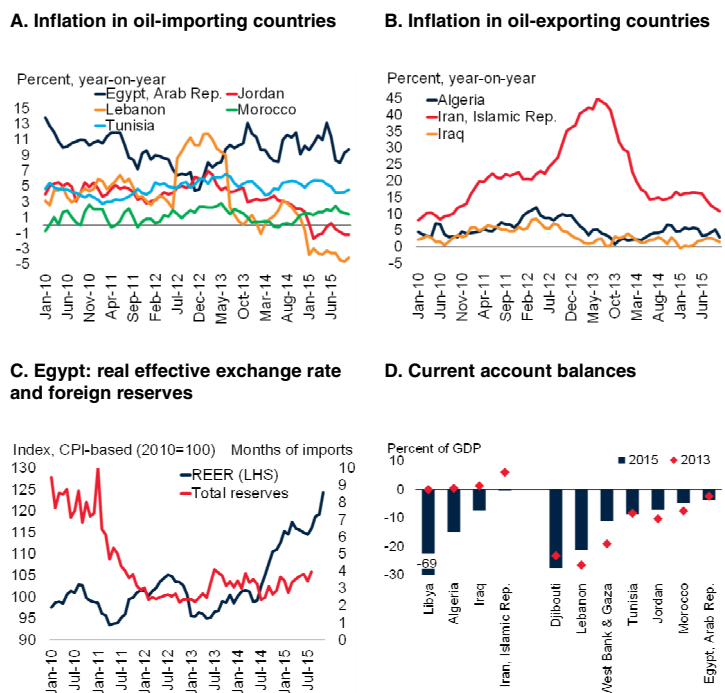
Crude oil production has declined in countries where conflict is entrenched except Iraq. Low oil prices and the direct and indirect costs of conflict are straining government budgets in oil-exporting countries in the Middle East and North Africa. Falling oil prices have helped improve fiscal balances in oil-importing countries.



Source: World Bank, International Energy Agency. A. Figure reflects average monthly production for each year; value for 2015 is the average for January to November.

FIGURE 2.4.2 Exchange rates, inflation, and current account balances

Low commodity prices have helped keep inflation subdued in oil-importing countries except Egypt, where rising prices are reflected in an appreciating real exchange rate. Low oil prices are contributing to adjustments in external balances, worsening deficits in oil-exporting countries and narrowing them in oil importers.



Source: World Bank, Haver Analytics. C. Foreign reserves include gold. On left axis, an increase denotes real appreciation.

Outlook

Despite low oil prices—assumed to be \$49 per barrel in 2016, broadly at 2015 levels—and several major conflicts, growth in developing countries in the Middle East and North Africa as a group is expected to rebound to 5.1 percent in 2016, and to 5.8 percent in 2017 (Table 2.4.2). The predominant reason for the improvement is an expected growth spurt in the Islamic Republic of Iran, the largest developing economy in the region, from 1.9 percent in 2015 to 5.8 in 2016 and 6.7 percent in 2017. The outlook also reflects slightly higher growth among other oil exporters, especially Iraq and Algeria, and a more modest medium-term improvement among oil importers, from 3.5 percent in 2015 to an average of 4 percent in 2016–18. The forecasts assume stabilization of oil prices and an improvement in the security situation in some countries.

Crude oil production in the Islamic Republic of Iran is expected to increase rapidly following the removal or suspension of sanctions, by an estimated 0.5–0.7 million barrels per day (mbd) in 2016 (World Bank 2015o), up from the 2015 level of 2.8 mbd. The potential increase in capital inflows in the post-sanctions environment could help expand exploitation of proven natural gas reserves, which are the largest in the world. The release of frozen Iranian assets currently overseas will also boost the economy. The ramping up of oil production over time, contingent upon significant infrastructure repair and investment, could help keep global oil supply high, and prices low, over the medium term.

A rebounding Iranian economy will affect neighboring countries within the Middle East and North Africa to varying degrees. A rapid rise in Iranian oil production would dampen growth prospects in oil-exporting countries and improve them in oil-importing countries (Ianchovichina, Devarajan, and Lakatos forthcoming). If pre-2010 -sanctions trade patterns are a guide, the export opportunities for other developing countries in the region from a rapidly growing Iranian economy may be limited, but perhaps greatest for Lebanon. Lebanese banks have already indicated that they

are interested in operating in the Islamic Republic of Iran.

Among other oil exporters, growth in Iraq and Algeria should be lifted in 2016 and 2017 by a recovery in the non-oil sector, in addition to continued oil sector growth. The baseline assumes that the impact of ISIL on Iraq's economy will slowly become more limited. In Libya, a UN-sponsored political agreement reached at the end of 2015 should allow oil production and GDP growth to recover.

Growth should also strengthen in most oil-importing countries. In Tunisia, growth should rise to 2.5 percent in 2016, predicated on a better security environment and progress on reforms. In Jordan, implementation of a new 10-year economic and social development plan is anticipated to lift confidence and push growth to 3.5 percent. The exceptions are Morocco and Egypt. In Morocco, growth is expected to revert to 2.7 percent in 2016, around the same as in 2014, as rainfall patterns reduce agricultural output from an exceptionally high level in 2015. In Egypt, growth is forecast to moderate to 3.8 percent in fiscal year 2015/16 as the tourism sector weakens following the October plane crash in the Sinai and a foreign currency shortage persists for at least part of the year. Growth in FY2016/17 should rise to 4.4 percent, driven by an uptick in investment. Rising growth in Egypt would have only a modest impact on the rest of the region, however (see Box 2.4.1).

Fiscal deficits among oil-exporting countries, although still large in some cases, will begin to narrow in 2016. The improvement reflects fiscal consolidation following the oil price drop. Iraq's 2015 budget contained spending cuts (merging of some ministries, government job cuts, and reduction in construction spending) that will help shrink the deficit in 2016. The deficit will remain wide, however. Lending from official sources will fill a large financing gap. The Algerian government intends to reduce spending by 9 percent in 2016, with cuts in utility subsidies and infrastructure projects but not in health, education, or housing. The expected budget adjustments among oil exporters are, however, unlikely to be sufficient to

stabilize government debt in the absence of a significant rise in oil prices.

Fiscal deficits are expected to fall or remain broadly stable in oil-importing countries other than Djibouti. In Egypt, consolidation reflects lower energy subsidy spending and announced increases in electricity tariffs, among other things. In Lebanon, the expectation that the fiscal deficit will not fall substantially during the forecast period will contribute to a continued rise in government debt, already at approximately 145 percent of GDP at the end of 2015.

Current account deficits are expected to narrow in most countries in the region in 2016. With external financing conditions expected to tighten, however, some countries, such as Iraq, could have difficulty attracting enough foreign capital to finance their deficits. Oil-importing countries will continue to benefit from low oil prices over the medium term, while North African countries with deep trade ties with Europe (Algeria, Morocco, and Tunisia) may receive an export boost as the Euro Area economy improves (Figure 2.4.3). In the medium term, Tunisia's agricultural sector may also benefit from a deep and comprehensive free trade agreement with the European Union, on which negotiations began in October. Successfully boosting services exports, in particular through tourism, could contribute to further narrowing of current account deficits in several countries. Tourist arrivals are below pre-Arab-Spring levels across the region.

Risks

The growth outlook for the Middle East and North Africa is subject to several major and longstanding downside risks: economic spillovers from conflict; a renewed decline in oil prices; and the absence of progress in living conditions, which could reinvigorate social unrest. The Iran nuclear agreement could be an upside or a downside risk for the region: upside if economic recovery in the country is faster than in the baseline forecast following lifting of sanctions, and downside if the government's commitments are implemented more slowly than called for under the accord. Over the long term, the agreement does generate

broader risks to oil prices, depending on how fast new investment and technology can be mobilized to tap the Islamic Republic of Iran's oil and gas reserves.

The primary downside risk for the regional economy remains escalation or prolongation of conflict. In Iraq, Libya, Syria, and the Republic of Yemen, countries directly impacted by conflict, the loss of life, outward migration of skilled workers, destruction of infrastructure, and disruption of trade routes have significantly set back economic activity in recent years, and have slashed potential output. Conflict has also stalled regional trade integration that was in its infancy five years ago (Ianchovichina and Ivanic 2014). Spillovers from conflicts in the region could have ongoing impacts on neighboring countries beyond what has already occurred, through trade disruption, reduction in cross-border investment, evaporation of tourism, or an inability to manage pressure on public services from a large number of Syrian refugees. Lebanon and Jordan are particularly at risk in this regard.

Even in countries not facing large-scale conflict within their borders, security risk and political uncertainty have impacted consumer, business, and investor confidence. Egypt, for instance, had two new governments in the second half of 2015. Lebanon has been without a president since mid-2014. Terrorist attacks, such as those that targeted tourists in Egypt and Tunisia in 2015, would further damage the tourism sector. For Egypt, the contraction in foreign currency inflows that would accompany a shrinking tourism industry would not only negatively impact growth, but would exacerbate the existing foreign currency shortage.

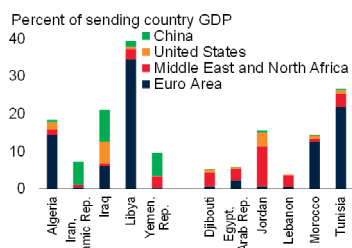
For oil exporters, another significant risk is potential additional downward movement in oil prices should global supply stay high for an extended period of time. This could stifle growth in economies highly dependent on oil revenues and exports (Libya, Iraq, Algeria) and put further pressure on already large fiscal and external imbalances.

Across the Middle East and North Africa, lack of improvement in labor markets and living conditions increases the risk of further social

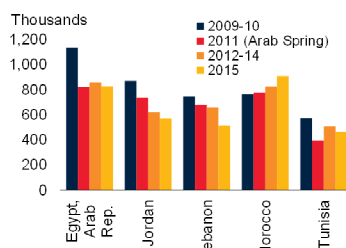
FIGURE 2.4.3 Trade

North African countries may experience a boost to growth through exports as Euro Area growth rises during the forecast period. Security risks weigh on the tourism industry in several countries, and tourism arrivals remain below pre-Arab-Spring levels.

A. Goods exports, 2014



B. Average monthly tourist arrivals

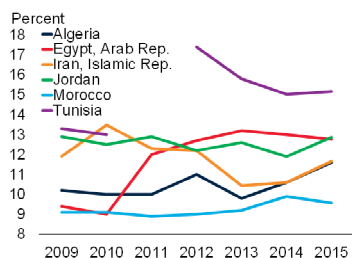


Source: IMF DOTS database, Haver Analytics, Lebanon Central Administration of Statistics, World Bank.
 B. Tourist arrivals for 2015 are the average of January-August for Egypt, January-September for Jordan, and January-October for Lebanon and Tunisia.

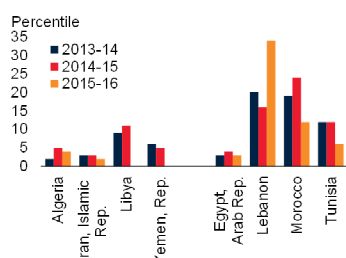
FIGURE 2.4.4 Labor market conditions

Unemployment rates in the Middle East and North Africa are high relative to other developing regions and higher than before the Arab Spring in some countries. Cross-country comparisons reveal poor labor market efficiency across the region.

A. Unemployment rate



B. Labor market efficiency



Source: World Bank, Haver Analytics, IMF, World Economic Forum Global Competitiveness Index.
 A. Unemployment rates shown for 2015 are the average of Q1-Q3 rates. Data for 2011 missing for Tunisia.
 B. Figure reflects percentile of individual country rankings among 135 countries ranked in 2015-16, 144 in 2014-15, and 148 in 2013-14. The labor market efficiency index includes 10 subcomponents: cooperation in labor-employer relations, hiring and firing practices, flexibility of wage determination, effect of taxation on incentives to work, redundancy costs, pay and productivity, reliance on professional management, country capacity to retain talent, country capacity to attract talent, and ratio of women to men in the labor force.

unrest. Unemployment rates, which have long been high relative to other developing regions, are above 2011 levels in Algeria, Egypt, Morocco, and Tunisia (Figure 2.4.4). Youth unemployment, at 32 percent in Jordan and 21 percent in Morocco, is more than double the overall unemployment rate. Employment growth is chronically weak or negative in countries with available data, and unemployment in the large informal sector is likely much higher than in the formal sector. A cross-country study of developing countries

including Egypt, Morocco, Tunisia, and Jordan found that the first three of these countries have significant gaps relative to other developing countries with regard not only to youth employment, but also the quantity and quality of education and skills mismatches (EBRD 2015a; Jelassi, Zeghal, and Malzy 2015).² Of the seven developing Middle East and North African countries assessed in the World Economic Forum’s Global Competitiveness Index, five scored worst in the labor market efficiency category in the 2015-16 index, and four of these countries (Algeria, Egypt, the Islamic Republic of Iran, and Tunisia) have been in the bottom decile of rankings of labor market efficiency for the past three years.

Other indicators of living conditions are also weak. The United Nations Human Development Index, a composite measure of gross national income per capita, life expectancy, and schooling, shows less progress in Arab states in 2013 and 2014 than in any other developing region, and a decline in the index for Libya and Syria. Household surveys find that people in the Middle East were less satisfied in 2014 with their standard of living than they were in 2007, and that only 43 percent of people perceived their standard of living as improving in 2014, down from 58 percent in 2007 (Figure 2.4.5). These indicators suggest an increasing sense of disenfranchisement in the region. While the lack of progress in living conditions may be partly due to conflict, it is also self-reinforcing and has the potential to contribute to further social unrest, extremism, and violence.

Policy challenges

In view of their large budget deficits, there is a pressing need among oil exporters in the Middle East and North Africa for deeper cost-cutting and revenue-generating measures. In Algeria and Iraq, this means successful implementation of fiscal consolidation already planned. The urgency of fiscal adjustment in Iraq, Libya, and the Republic of Yemen, and to a somewhat lesser extent,

²An explanation of the variables included in these four categories and the statistical method for generating cross-country comparisons is given in EBRD (2015a).

Algeria, will become stronger in the medium term given that fiscal buffers are rapidly narrowing, financing needs are high, and borrowing capacity is weak (IMF 2015g). Furthermore, the decline in oil prices since mid-2014 is estimated to reflect a large permanent component (Husain et al. 2015), making the longstanding need for economic diversification in oil-exporting countries even more urgent.

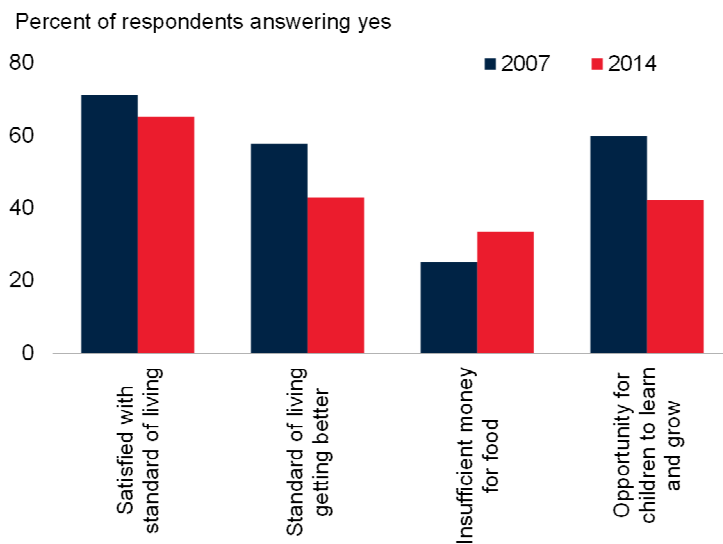
Fiscal adjustment can also be accelerated in oil-importing countries, notwithstanding subsidy reforms already undertaken (Egypt, Jordan, and Morocco). In Egypt, introduction of a second round of energy subsidy cuts and a value-added tax has stalled. The political impasse in Lebanon is holding back the reform agenda, and impedes the functioning of public services. In Tunisia, progress on energy subsidy reductions and other fiscal adjustments has lagged. Low oil prices could be used as an opportunity to advance fiscal reforms during the forecast period.

Central banks in the region also face challenges. The new governor of the Central Bank of Egypt will need to oversee a boosting of critically low levels of foreign reserves. Additional rounds of currency devaluation are likely, which means monetary policy will have to resist pressure on an inflation rate that is already high. Iranian policymakers have said they will make it a priority to reduce inflation, which may become an easier task as sanctions are loosened.

In the medium and long term, it is critical that developing countries the Middle East and North Africa reduce inequality of opportunity and foster more inclusive growth. Working-age population growth in the region is higher than in all other developing regions except Sub-Saharan Africa and will continue to be so over the next decade. From this demographic perspective, it is imperative that labor market and other policy adjustments begin now, and that there be a special emphasis on addressing shortcomings affecting youth. Reform efforts would be well placed in two broad areas: labor market policy and public sector accountability.

FIGURE 2.4.5 Perception of standard of living

Indicators of living conditions in the Middle East have declined in recent years, suggesting an increasing sense of disenfranchisement in the region that may contribute to future social unrest.



Source: Gallup World Poll 2014.

Note: Figure reflects responses to 1) "Are you satisfied or dissatisfied with your standard of living, all the things you can buy and do?", 2) "Right now, do you feel your standard of living is getting better?", 3) "Have there been times in the past 12 months when you did not have enough money to buy food that you and your family needed?", and 4) "Do most children in this country have the opportunity to learn and grow?" in nationally representative household surveys.

With respect to labor market policies, policymakers in the region should move forward with measures to remove supply-side constraints, such as improving the quality of education in some countries and implementing programs to better match labor force skills with those demanded by job markets. These efforts will need to be combined with the removal of constraints to competition and impediments to equality of opportunity among businesses, such as exclusive operating license requirements and trade barriers (Schiffbauer et al. 2015). Such measures in turn can be expected to improve labor demand. Removing rigidities in hiring, firing, and wage setting should also be a priority. To improve public sector accountability, particular effort should be made to curtail corruption, including by removing opportunities for rent-seeking among politically-connected people (World Bank 2015p).

TABLE 2.4.1 Middle East and North Africa forecast summary

(Annual percent change unless indicated otherwise)

(Percentage point difference from June 2015 projections)

	2013	2014	2015e	2016f	2017f	2018f	2015e	2016f	2017f
Developing MENA, GDP^a	0.6	2.5	2.5	5.1	5.8	5.1	0.1	1.4	2.0
(Average including countries with full national accounts and balance of payments data only) ^b									
Developing MENA, GDP^b	1.0	3.6	2.8	4.4	5.1	4.9	0.2	1.0	1.6
GDP per capita (U.S. dollars)	-0.9	1.7	1.0	2.8	3.5	3.5	-0.3	0.7	1.2
PPP GDP	0.9	3.6	2.8	4.5	5.2	5.0	0.1	1.1	1.6
Private consumption	2.5	2.5	2.7	3.1	3.3	3.3	-0.8	-0.5	-0.2
Public consumption	0.3	3.7	2.6	3.9	4.4	4.5	-1.2	1.0	1.5
Fixed investment	-0.1	8.3	4.9	7.3	8.8	7.9	2.0	0.6	4.8
Exports, GNFS ^c	-1.6	2.4	-0.4	7.0	7.5	8.3	-5.0	2.2	2.4
Imports, GNFS ^c	-1.2	2.0	1.3	4.5	4.9	5.1	-4.0	-1.6	-1.7
Net exports, contribution to growth	-0.1	0.0	-0.5	0.6	0.6	0.8	-0.1	1.2	1.4
Memo items: GDP									
Broader geographic region ^d	1.9	3.0	2.6	3.8	4.4	4.1	-0.5	0.2	0.6
High Income Oil Exporters ^e	3.1	3.5	2.7	2.7	3.0	3.0	-1.1	-0.8	-0.8
Developing Oil Exporters	-1.0	2.3	1.7	6.2	7.0	5.6	0.4	2.9	3.8
Developing Oil Importers	2.9	2.8	3.5	3.5	4.1	4.4	-0.4	-0.8	-0.5
Egypt, Arab Rep.	2.2	3.2	4.0	4.1	4.6	4.8	-0.3	-0.6	-0.2
<i>Fiscal Year Basis</i>	2.1	2.2	4.2	3.8	4.4	4.8	0.0	-0.7	-0.4
Iran, Islamic Rep.	-1.9	4.3	1.9	5.8	6.7	6.0	0.9	3.8	4.7
Algeria	2.8	3.8	2.8	3.9	4.0	3.8	0.2	0.0	0.0

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

a. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars. Excludes Syria and Republic of Yemen due to data limitations.

b. Sub-region aggregate excludes Djibouti, Iraq, Libya, Republic of Yemen, Syria, and West Bank and Gaza, for which data limitations prevent the forecasting of GDP components.

c. Exports and imports of goods and non-factor services (GNFS).

d. Includes developing MENA and the following high-income countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

e. Includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

TABLE 2.4.2 Middle East and North Africa country forecasts^a

(Real GDP growth at market prices in percent, unless indicated otherwise)

(Percentage point difference from June 2015 projections)

	2013	2014	2015e	2016f	2017f	2018f	2015e	2016f	2017f
Algeria	2.8	3.8	2.8	3.9	4.0	3.8	0.2	0.0	0.0
Djibouti	5.0	6.0	6.5	7.0	7.1	7.0	0.0	0.0	0.0
Egypt, Arab Rep.	2.2	3.2	4.0	4.1	4.6	4.8	-0.3	-0.6	-0.2
<i>Fiscal Year Basis</i>	2.1	2.2	4.2	3.8	4.4	4.8	0.0	-0.7	-0.4
Iran, Islamic Rep.	-1.9	4.3	1.9	5.8	6.7	6.0	0.9	3.8	4.7
Iraq	4.2	-0.5	0.5	3.1	7.1	6.5	1.5	-2.4	1.2
Jordan	2.8	3.1	2.5	3.5	3.8	4.0	-1.0	-0.4	-0.2
Lebanon	3.0	2.0	2.0	2.5	2.5	3.0	-0.5	0.0	0.0
Libya	-13.7	-24.0	-5.2	35.7	27.6	8.4	-5.7	20.7	16.7
Morocco	4.7	2.4	4.7	2.7	4.0	4.0	0.1	-2.1	-1.0
Tunisia	2.9	2.7	0.5	2.5	3.3	4.5	-2.1	-0.9	-1.2
West Bank and Gaza	2.2	-0.4	2.9	3.9	3.7	3.7	2.0	-0.4	-0.4

	2013	2014	2015e	2016f	2017f	2018f	2015e	2016f	2017f
Recently transitioned to high-income economies^b									
Oman	3.9	2.9	3.7	3.2	3.0	2.5	0.0	-0.4	-0.5
Saudi Arabia	2.7	3.5	2.8	2.4	2.9	2.9	-1.8	-1.7	-1.4

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

a. Syria and Republic of Yemen are not forecast due to data limitations.

b. Based on the World Bank's country reclassification from 2004 to 2015.

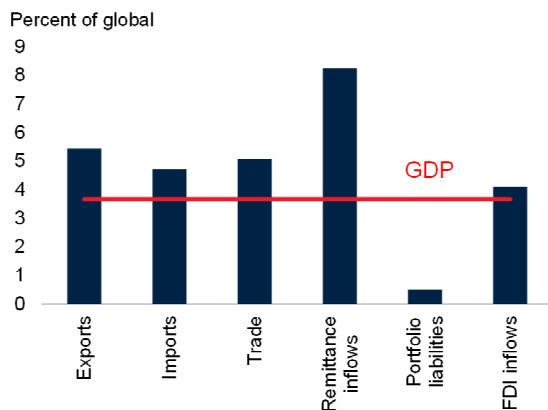
BOX 2.4.1 Regional integration and spillovers: Middle East and North Africa

Most of the external trade and financial ties of countries in the Middle East and North Africa (MENA) region are with countries outside the region. Trade and financial flows between MENA countries are modest. As a result, within-region growth spillovers even from the largest developing countries in the region—the Arab Republic of Egypt—are small. Spillovers from a large neighboring developing economy—Turkey—are also limited. In contrast, spillovers from G7 countries and GCC countries are considerably larger.

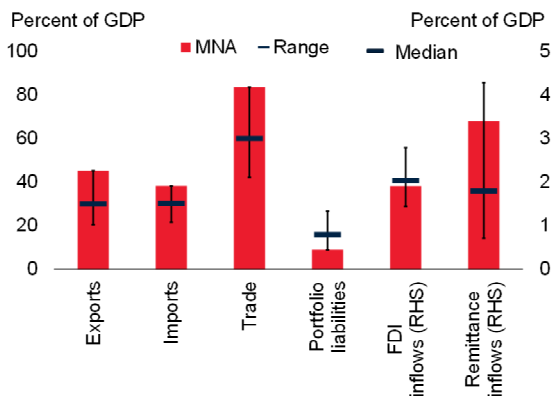
FIGURE 2.4.1.1 Cross-region comparison

The MENA region is one of the most open regions to global trade and remittances but receives limited financial flows by comparison with other developing regions.

A. MENA: Share of global activity, trade and finance, 2014



B. MENA: Trade and finance in regional comparison, 2014



Sources: IMF October 2015 World Economic Outlook, IMF International Financial Statistics, IMF Direction of Trade Statistics, UNCTAD FDI/TNC database, World Bank Remittance and Migration Database, World Bank World Development Indicators.

B. The red bar denotes exports, imports, trade, remittance inflows, portfolio liabilities and FDI inflows in percent of GDP on average across MENA countries. The vertical line denotes the range of averages for all six developing country regions.

Introduction

The MENA region is highly open to trade and remittance flows (Figure 2.4.1.1).¹ Trade accounts for more than 60 percent of GDP for both oil exporters and oil importers in the region. There has, however, been a decline in economic integration with the rest of the world since the global financial crisis. Trade as a percentage of GDP has declined (Figure 2.4.1.2). Political uncertainty and falling commodity prices have contributed to a sharp fall in foreign direct investment (FDI) inflows to below 2 percent of GDP, about 1 percentage point below the average for other regions and considerably below the high FDI inflows pre-crisis. Remittance receipts in oil-importing countries have recovered only modestly after dropping significantly during the crisis.

With anemic growth in advanced economies, the pattern of MENA's trade and remittances links has shifted. Trade with other emerging markets, especially the BRICS (Brazil, Russia, India, China, and South Africa), has increased threefold compared to 2000 (Figure 2.4.1.3). Within-region trade and remittance flows have increased, but remain low. In addition to direct economic ties, confidence shocks, related to the recent conflicts and security issues in the region may also affect the economies of neighboring countries and are of increasing concern to policymakers.

This box addresses the following two questions:

- How open is the MENA region to global and regional trade and financial flows?
- How large are the potential intra-regional spillovers from one of the region's largest developing countries,

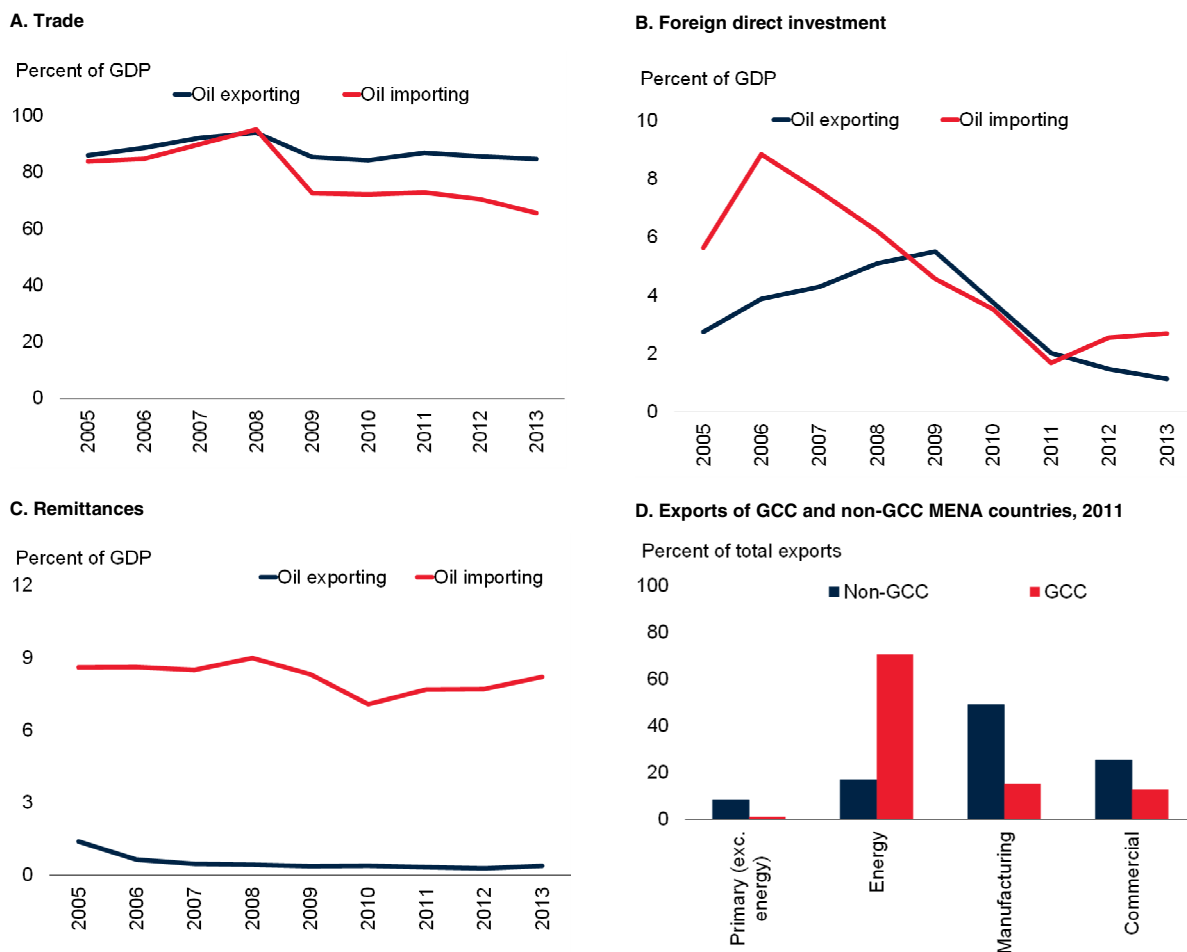
Note: This box was prepared by Ergys Islamaj and Jesper Hanson.

¹Unless otherwise specified, the MENA region is defined to include oil-exporting countries (Algeria, Bahrain, the Islamic Republic of Iran, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates and the Republic of Yemen) and oil-importing countries (Djibouti, Egypt, Israel, Jordan, Lebanon, Morocco, Tunisia and West Bank and Gaza). GCC stands for Gulf Cooperation Council countries. For the purposes of this box, Israel is also included as a recipient country of shocks (although it is not part of the World Bank's definition of the geographic region) since it has substantial trade ties to some other countries in the region.

BOX 2.4.1 Regional integration and spillovers: Middle East and North Africa (continued)

FIGURE 2.4.1.2 Trade, FDI, and remittances

The MENA region is highly open to trade and remittances despite a decrease since 2008. FDI inflows have fallen steeply in both oil exporters and importers, partly as a result of political uncertainty and falling commodity prices.



Sources: World Bank World Development Indicators; IMF Balance of Payments Statistics; World Bank Export Value Added Database.
 Notes: A., B. and C. Trade is defined as the sum of exports and imports. Oil-exporting countries include Algeria, Bahrain, Iraq, Islamic Republic of Iran, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates and Yemen. Oil-importing countries include Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia and West Bank and Gaza. Data unavailable for Islamic Republic of Iran, Iraq, Libya, Qatar, and the United Arab Emirates. Lines show sums of all countries in each sample.
 D. GCC countries include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates; non-GCC countries include Algeria, Djibouti, Egypt, Islamic Republic of Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Tunisia, West Bank and Gaza, the Republic of Yemen. Data is unavailable for Algeria, Djibouti, Iraq, Jordan, Lebanon, Libya West Bank and Gaza, Yemen. Bars show unweighted averages.

Egypt, and from one of its largest neighboring developing countries, Turkey?

The empirical results suggest that the region is predominantly vulnerable to growth shocks originating from outside the region. Growth shocks from developing countries inside the region have negligible spillovers on other MENA countries. Potential spillovers from Gulf Cooperation Council (GCC) countries could be significantly larger, although data limitations prevent a

formal estimation. Other types of shocks—for example, of a political, security or financial nature—may also generate important spillovers that are not captured in the econometric analysis.

How open is the MENA region to global and regional trade and financial flows?

Trade and financial ties with countries outside the region far outweigh those within the region (Figure 2.4.1.3). On

BOX 2.4.1 Regional integration and spillovers: Middle East and North Africa (continued)

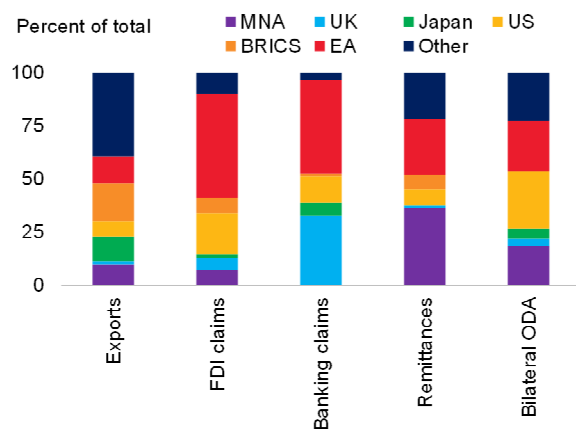
average across the MENA region during 2011-14, the United States, the Euro Area, and Japan combined accounted for 31 percent of exports, 69 percent of inward FDI, and 62 percent of banking claims on countries in the

MENA region. This average masks considerable cross-country heterogeneity, however. For many MENA countries, the Euro Area and the United States together account for more than 50 percent of export revenues and

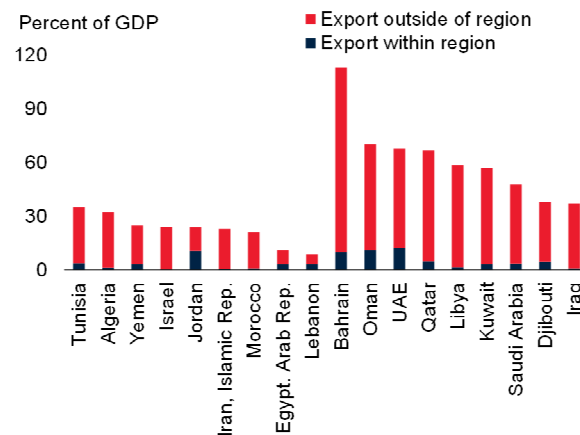
FIGURE 2.4.1.3 Openness inside and outside the region

The main economic partners of MENA countries are outside the region, although within-region remittance and official development assistance flows are important. Since 2000, ties with the United States and the Euro Area have weakened while those within the region and the BRICS countries have strengthened.

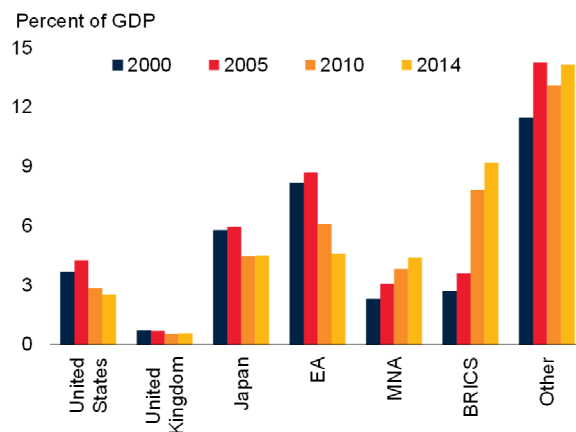
A. Trade, investment, remittances, and official development assistance in MNA region, average 2011-14



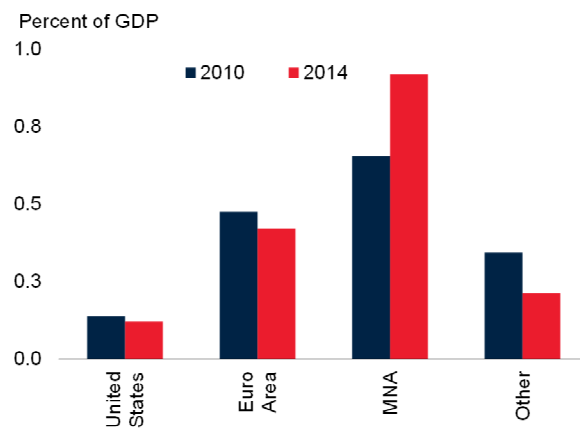
B. Trade within and outside the region, average 2011-14



C. Evolution of trade within and outside the region



D. Remittance Inflows



Source: IMF Direction of Trade Statistics (DOTS); IMF Coordinated Direct Investment Survey (CDIS); Bank for International Settlement (BIS) Consolidated Banking Statistics; World Bank Remittances and Migration database and WB country economists' estimates; OECD.
 Notes: BRICS = Brazil, Russia, India, China, and South Africa; EA = Euro Area. Also see abbreviations above.
 A. ODA = Official Development Assistance. Latest available data: 2014 for trade, remittances, BIS-reporting banks' consolidated foreign claims; 2013 for foreign direct investment and official development assistance. FDI claims from CDIS not available for China, and replaced with BBVA data. Data provided for Algeria, Bahrain, Djibouti, Egypt, Iraq, Islamic Republic of Iran, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, United Arab Emirates, West Bank and Gaza, and the Republic of Yemen. Within-region FDI reported only for Kuwait. Within-region ODA includes Kuwait, Saudi Arabia and the United Arab Emirates.
 B. Includes Algeria, Bahrain, the Arab republic of Egypt, the Islamic Republic of Iran, Jordan, Kuwait, Morocco, Oman, Qatar, Tunisia, Lebanon, Saudi Arabia, the United Arab Emirates, and Yemen.

BOX 2.4.1 Regional integration and spillovers: Middle East and North Africa (continued)

FDI inflows. The openness of the region to global trade and finance is reflected in spillovers of global shocks to financial market activity. For example, equity returns in the MENA region move strongly with U.S. and European equity markets (Khalifa, Hammoudeh and Otranto 2013; Balli et al. 2015).²

Within-region remittance and official development assistance (ODA) flows remain significant and potentially constitute important channels for within-region spillovers. In contrast, within-region trade and financial links are modest by comparison with other regions. Given the proximity to the EU, one of the world's largest trading blocs, MENA countries trade predominantly with countries outside the region. Nevertheless, since they continue to face trade barriers in the EU, MENA countries trade more with each other than would be expected based on the size of their economies and transport cost (Freund and Jaud 2015). Limited within-region trade links also partly reflect close similarities in the export base of many energy-exporting countries in the MENA region.

Bilateral trade and official assistance flows from GCC to some oil importing countries have grown, but remain modest on average, with considerable heterogeneity. Since 2000, trade within the region has doubled, to an average of 4 percent of GDP. Remittances from GCC to other MENA countries have risen by one third, to 0.9 percent of GDP. Official development assistance from GCC countries to Egypt, Jordan and the Republic of Yemen increased from near-zero in 2000 to 2.7, 1.7, and 0.6 percent, respectively, of recipient government revenues during the 2011-2013 period. Since the Dubai World debt restructuring and the Arab Spring uprisings, comovement of GDP among MENA countries has increased somewhat (IMF 2013).

Two channels are particularly likely to generate within-region spillovers:

- *Remittances.* Remittance inflows ranged from 5 percent of GDP in Tunisia to close to 11 percent of GDP in Jordan during 2011-2014. More than three-fifths of these remittances were from GCC countries. While large remittances increase the risk of transmission of

negative shocks in GCC source countries to other countries in the region (IMF 2014d), remittances also help smooth consumption against unexpected variations in output in recipient countries (Balli, Basher and Louis 2013; World Bank 2015q; Abdih et al. 2012; IMF 2014d).

- *Official development assistance.* ODA from GCC to other oil-importing MENA countries was scaled up during the financial crisis of 2008 and the Arab Spring. It has remained high since then. GCC countries have provided or pledged loans and grants to Egypt, Jordan, Morocco, Tunisia and Yemen to finance infrastructure investment, balance of payments deficits, and commodity imports (Rouis 2013). ODA from Kuwait, Saudi Arabia and UAE represents more than 18 percent of total aid to the region, ranging from 4 percent of total ODA for Morocco to 72 percent of total ODA for Egypt. Historically, GCC aid to other MENA countries has varied with oil revenues (Talani 2014, Rouis et. al. 2010). The revenue losses associated with falling oil prices in GCC countries may make GCC assistance to the region less forthcoming.

Disruptions in trade and finance and displacements of large parts of the population during conflicts in parts of the region can also generate significant spillover effects to neighboring countries. These could be both positive and negative. Disruption of trade routes and trade disintegration lowers potential output. Migrants can occupy jobs previously held by low-skilled workers in the host country (Del Caprio and Wagner 2015). However, the domestic demand generated by large numbers of migrants or government expenditures related to migrants could stimulate activity. The net effect has been estimated to be positive for Lebanon—reflecting the large share of the migrant population—but negative or mixed for Turkey, Egypt and Jordan (Ianchovichina and Ivanic 2014, Cali et al. 2015, Del Caprio and Wagner 2015).

How large are the potential intra-regional spillovers from one of the region's largest economies, Egypt, and from one of its largest neighboring countries, Turkey?

Several countries in the MENA region have stronger ties with other MENA economies than others: the GCC countries and Egypt. Trade links are similarly sizeable with Turkey, one of the largest economies neighboring the MENA region.

²Khalifa et al. (2013) finds significant spillovers from U.S. equity markets to Saudi Arabia and UAE equity indices, while Balli et al. (2015) document spillovers from U.S. equity markets to all GCC countries and from European equity markets to Qatar and Oman.

BOX 2.4.1 Regional integration and spillovers: Middle East and North Africa (continued)

- GCC countries account for more than half of remittance inflows to Jordan and Egypt (50 and 60 respectively).
- Egypt and Turkey are sizeable export markets for Jordan, Lebanon, Morocco and Tunisia.
- Turkey remains an important trading partner for Egypt and the Islamic Republic of Iran. Anecdotal and survey data suggest sizeable informal trade between the Islamic Republic of Iran and other countries in the region.

A sufficiently long time series of quarterly data is available to estimate growth spillovers only from Egypt and Turkey to several non-GCC economies in the MENA region. A Bayesian structural vector autoregression (VAR) model is estimated, using data for 1998Q1-2015Q2. The variables are: G7 average growth; JPMorgan's Emerging Market Bond Index; growth in the shock source countries (Egypt and Turkey); trade-weighted commodity prices; and growth and real effective exchange rates of the countries subject to the external shock. Figure 2.4.1.4 shows the cumulative response after four quarters of recipient-country growth to a 1 percentage point decline in growth in Egypt or Turkey.³

Growth spillovers from Egypt and Turkey appear to be modest, and, in most cases, not statistically different from zero, reflecting limited within-region ties.⁴ A 1 percentage point drop in Turkey's growth is associated with small or statistically insignificant growth effects across the region.⁵ A 1 percentage point decline in growth in Egypt is associated with a 0.16 percentage point decline in growth in Jordan and a 0.15 percentage point decrease in growth

³Quarterly GDP data are available from IMF's International Financial Statistics, Haver and Bloomberg for 1998Q1-2014Q4. Countries for which there were considerable differences amongst the three sources were dropped. The resulting unbalanced panel included Egypt, Islamic Republic of Iran, Jordan, Morocco and Tunisia. For Lebanon, quarterly energy production data was used as a proxy for output. For Egypt, the data starts in 2002Q2 and for Tunisia in 2000Q2.

⁴The results in Figure 2.4.4 include four lags. They are robust to alternative specifications: different Cholesky ordering, Bayesian priors, decay in the lag structure, correlation across variable lags, and number of lags.

⁵Shocks in Turkey seem to be inversely correlated with growth in Tunisia. This may reflect competition in key export sectors, especially tourism: when tourist arrivals to Tunisia declined during 2005-13, those to Turkey increased as tourists shifted their destinations during bouts of political uncertainty. Tourism has been a significant channel for the transmission of spillovers in Mediterranean countries (Canova and Dallari 2013). As expected, the estimated spillovers are smaller if the period after the Arab Spring (starting 2010Q4) is excluded.

in Tunisia by the end of the first year. A decline in growth in Egypt does not appear to have significant effects elsewhere. The correlation between shocks to Egypt's growth and growth in Jordan and Tunisia reflect trade and remittances ties between these countries, as well as proximity in the case of Tunisia. In a similar regression using Islamic Republic of Iran as source country of the shock, estimates suggest a negligible effect of a slowdown on Israel, Jordan, Morocco and Tunisia.⁶

Growth spillovers from outside the region are larger in magnitude than those within the region, but mostly insignificant, with the exception of Morocco. A 1 percentage point decline in G7 growth is associated with an average 1 percentage point decline in growth in countries in the MENA region.⁷

These results are broadly comparable to the few available studies by other authors. Using a global VAR, Cashin, Mohaddes and Raissi (2012) show that growth shocks from Europe and the United States have a modest, but negative effect on the output growth of countries like Egypt, Jordan, Morocco and Tunisia.⁸ Behar and Espinosa-Bowen (2014) suggest that non-oil trade in MENA countries would decline considerably following shocks to growth in Europe and the global economy.

Conclusion

The MENA region is highly open, but with fewer within-region ties than other regions. As a result, spillovers from the larger developing countries in the region and from neighboring Turkey are modest.

Although not estimated explicitly for lack of comparable data, spillovers from GCC countries to the rest of MENA region are likely to be significantly larger than spillovers from Egypt and Turkey, given large remittance and ODA flows from GCC to non-GCC countries in the region

⁶The response of the non-GCC MENA countries' average growth rate to a one percentage point decline in Turkey and Egypt is also near-zero. Because of the higher volatility of industrial production (IP), measured spillovers from industrial production are somewhat larger: a 1 percentage point decline in IP growth in Egypt and Turkey is associated with 0.15 and 0.2 percentage point decline in growth in the other countries.

⁷Spillovers from a decline in G7 growth to electricity production growth in Lebanon could be sizable (shown on the right axis of Figure 2.4.1.4). Those to Egypt are not statistically significantly different from zero after 4 quarters.

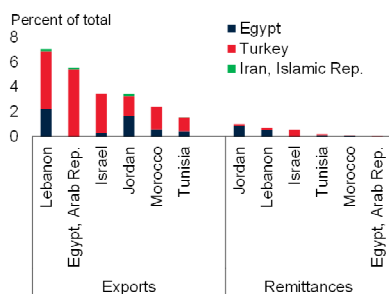
⁸They find that the cumulative effect after four quarters of a 1 percentage point decline in growth in Europe is not statistically significantly from zero or on the order of 0.1-0.2.

BOX 2.4.1 Regional integration and spillovers: Middle East and North Africa (continued)

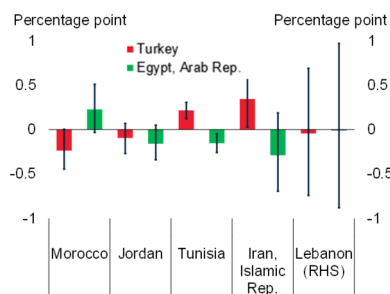
FIGURE 2.4.1.4 Spillovers from Egypt and Turkey

Output spillovers between non-GCC MENA countries have been modest, reflecting the predominance of trade and financial ties of non-GCC MENA countries to economies outside the region.

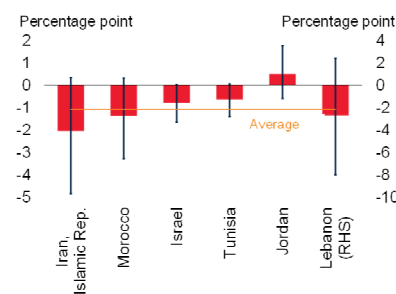
A. Trade ties



B. Response to a 1 percentage point decline in Turkey's and Egypt's GDP growth



C. Response to a 1 percentage point decline in G7 growth



Source: World Bank staff estimates.

Notes: B and C. Cumulative response of each country's growth after 1 year to a 1 percentage point decline in growth rates of Egypt, Turkey and World GDP, respectively. World GDP refers to average GDP growth in G7 countries. Energy production data used for Lebanon. Quarterly GDP data for Tunisia and Egypt are available from 2000Q2 and 2002Q2, respectively. All other series are available from 1998Q1. Bayesian VARs include Arab Spring dummies for Tunisia (2010Q4-2011Q4) and Egypt (2011Q1-Q4), financial crises dummy (2008Q2-2009Q2), a dummy for Turkey's financial crises (2001Q1), a dummy for conflict in Lebanon (2006Q1-Q4) and dummies for droughts in Morocco (2002, 2003, 2006 and 2012). Horizontal line represents MENA average response. Vertical lines show a one standard deviation confidence band. Solid bars represent medians and the error bands represent 33-66 percent confidence bands. Lebanon shown on the right axis.

(Cashin, Mohaddes and Raissi 2012, IMF 2012c). GCC economies may also have a significant effect on developing MENA countries through their investments in infrastructure, such as airlines, telecom and multi-country railway projects, as well as banking and financial ties (World Bank 2014b).

In addition, spillovers from political uncertainty, security concerns or spreading violence could also be sizeable.

Going forward, more stability in the MENA region will not only allow countries to benefit from deepening trade and finance, but will also alleviate some of the fiscal burden associated with creating infrastructure to help people displaced by conflicts. Continued turmoil will derail efforts to tackle problems of corruption, and prolong necessary reforms in the labor markets (World Bank 2015f).

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