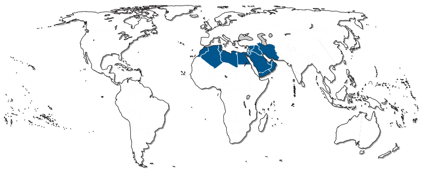
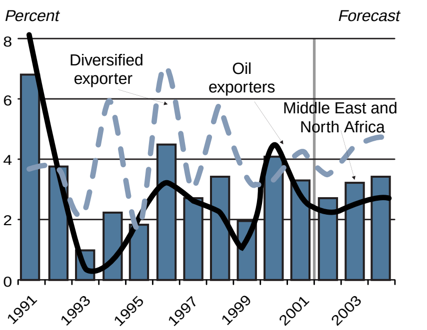


Middle East and North Africa

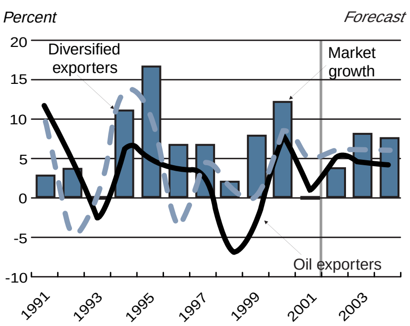
GNI per capita, 2000: $2,090

Gross domestic product growth, 1991–2004



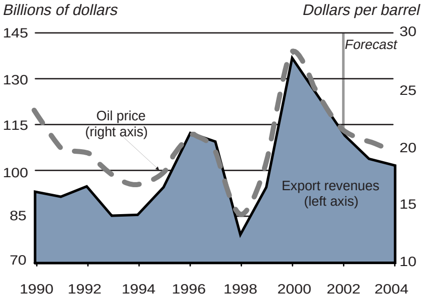
Source: World Bank Economic Policy and Prospects Group.

Export volume growth vis-à-vis export market growth, 1991–2004



Source: World Bank Economic Policy and Prospects Group.

World oil price and Middle East and North Africa oil producer exports, 1990–2004



Source: World Bank Economic Policy and Prospects Group.

Recent developments

Growth in the Middle East and North Africa (MENA) region slowed to 3.1 percent in 2001, following a 4.2 percent advance in 2000, which reflected high oil prices and booming global growth and trade. Oil prices and external demand for oil moderated sharply over the course of 2001, resulting in lower output growth, narrowing current account surpluses, and higher budget deficits among the oil-dominant economies of the region. At the same time, progressive weakening of economic activity in continental Europe—the dominant export market for countries of the Maghreb and several of the Mashreq—exacted a heavy toll on export performance. And these adverse trends were exacerbated for several countries by declines in tourism receipts and worker remittances because of heightened security concerns after September 11. This trend was most acute for the Arab Republic of Egypt, but it was also important for Morocco and Tunisia.

Oil exporters faced much less favorable terms of trade in 2001, as the world oil price fell to $24.40 per barrel from $28.20 in 2000 (a decline of 14 percent).[1] Several cutbacks in Organization for Petroleum Exporting Countries (OPEC) quotas were imposed to establish a floor under prices, especially later in the year as global activity fell sharply. In the real sector, hydrocarbons production and export volumes declined, leading to gross domestic product (GDP) outturns of 2.5 percent, down from 3.6 percent growth in 2000. The growth of incomes also moderated, and current account surpluses and fiscal balances—the latter of which eased recently with oil prices near $30 per barrel—were squeezed by the fall in oil-related revenues.

Despite the fall in oil prices and global demand, financial positions among the middle-income exporters of the region remained positive in 2001. Public debt was retired, foreign reserves rose, and public expenditures were relatively restrained. Algeria and the Islamic Republic of Iran have both channeled surplus oil revenues into oil stabilization funds. By the end of July 2001, Algeria had accumulated around $7 billion. The Islamic Republic of Iran accumulated around $6 billion by March 31, and this is expected to grow by a further $3.9 billion by March 2002. These surpluses will be used to smooth consumption if oil prices fall below a predetermined level, and in the case of the Islamic Republic of Iran, a portion will also be set aside for domestic lending.

In a broader perspective, current account balances for all major oil exporters of the region (including the high-income producers Kuwait and the United Arab Emirates) remained positive at $40 billion, albeit lower than the $59 billion surplus of 2000. Government deficits, which had shrunk to zero or gone into surplus in many countries, also deteriorated slightly, but with few financing problems. In the case of Saudi Arabia, despite public sector wage restraint, the 2002 budget foresees a deficit of some $6 to $7 billion, contrasted with a surplus of similar magnitude in 2000. A potential medium-term concern for oil exporters is appreciation of real exchange rates, which would tend to diminish the competitiveness of the nonhydrocarbon sectors and, for example, in the Islamic Republic of Iran, make the transition to a unified exchange rate more difficult.

Growth in the *diversified exporters*[2] in 2001, at 3.6 percent, was similar to 2000 outturns (3.7 percent), despite booming agricultural output in Morocco, following several years of severe drought, and stable growth in Jordan. Growth for this group, excluding Jordan and Morocco, registered deceleration of some 0.4 percentage points, as activity in most countries fell below trend rates of the 1990s. A substantial portion of the lower growth outturns can be accounted for by the deterioration of external factors such as export market growth, tourism, services receipts, and transfers. The dramatic slowing of economic activity in the Euro Area was exacerbated by the abrupt loss of confidence and rise of uncertainty in the industrial countries as well as the Middle Eastern and South Asian regions following September 11. This continues to affect aviation-passenger and freight-related insurance costs, tourism, and near-term prospects for privatization of aviation-related parastatals in the MENA region. These factors have contributed to a doubling of the current account deficit for the diversified exporters to more than $2 billion in 2001.

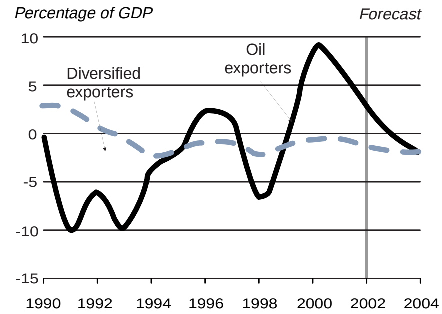
Internal difficulties, many of which were present in these countries prior to the downturn in global activity, were also responsible for the poorer growth performance in 2001 in several countries. Egypt is still dealing with the consequences of twin deficits in its fiscal and current accounts, with the current account deficit reaching 1.6 percent of GDP in 2000 and the fiscal deficit growing to more than 5 percent of GDP in 2001. An adverse investment climate, high real interest rates, and some uncertainty about the direction of the exchange rate have slowed GDP growth to under 3 percent in 2001. Similar adverse fiscal trends are affecting countries such as Morocco and Tunisia, and may broaden across the diversified exporters as external revenue shortfalls become more acute in the near term.

But some countercyclical policy action has been possible. Recent improved inflation performance in Egypt has allowed a full percentage point reduction in the central bank discount rate; and exchange rates have been falling relative to the dollar as well as the euro over the second half of 2001, in Egypt, Morocco, Tunisia, and the Republic of Yemen. These measures may help to mitigate the effects of the global slowdown to a modest degree; but given the importance of the European Union as an export market and principal source of remittance and tourism income, recovery there will be necessary for a return of more buoyant external conditions.

Gross capital flows from international capital markets and FDI

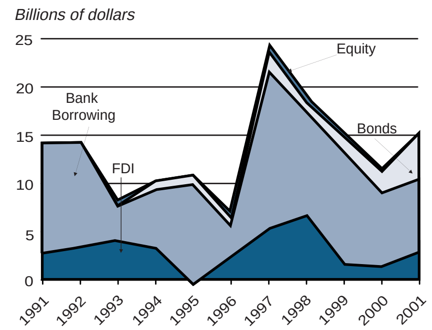
Gross capital flows from international markets (bonds, bank lending, and equity placement) to the Middle East and North Africa rose during 2001, by $2.7 billion (an increase of 26 percent), fully offsetting the drop-off in flows that occurred in 2000. Commercial bank financing continues to dominate flows to the region and increased by some $165 million in the year to reach $7.7 billion. The increase, in a year that bank financing to other developing regions was falling, reflects the unique characteristics of oil-exporting economies. Egypt, the Islamic Republic of Iran, Oman, and Saudi Arabia remain the principal recipients of bank financing. Bond issuance jumped by $2.9 billion in the year to $5.3 billion, as those countries with access to the markets at present—Egypt, Lebanon, Morocco, and Tunisia—stepped up issuance as opportunities arose. Lebanon garnered some $3.1 billion in Eurobond issues, Egypt some $1.5 billion, and Tunisia $460 million in the year. Although tensions regarding the war on terrorism led to an increase in mar-

Current account balances, 1990–2004



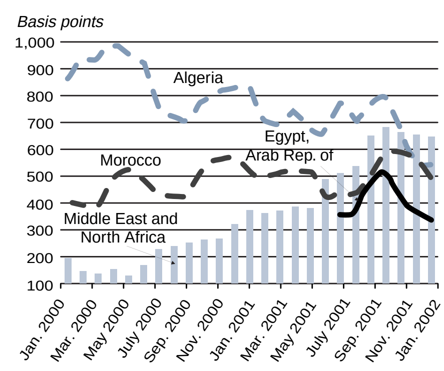
Source: World Bank Economic Policy and Prospects Group.

Composition of gross market flows plus foreign direct investment, 1991–2001



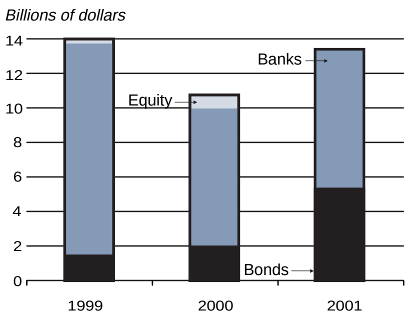
Source: World Bank Economic Policy and Prospects Group.

Emerging market bond spreads in the Middle East and North Africa region and selected countries, 2000–02



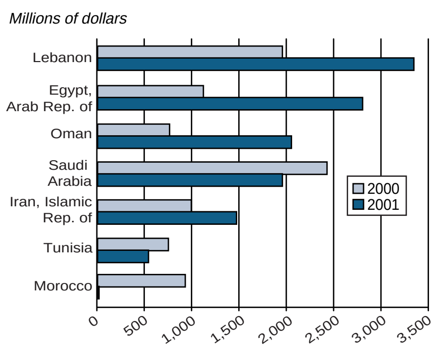
Note: Regional spread is dominated by weight of Lebanon in terms of outstanding international bond issuance.
Source: J.P. Morgan/Chase.

Gross capital market flow commitments to the Middle East and North Africa region, 1999–2001



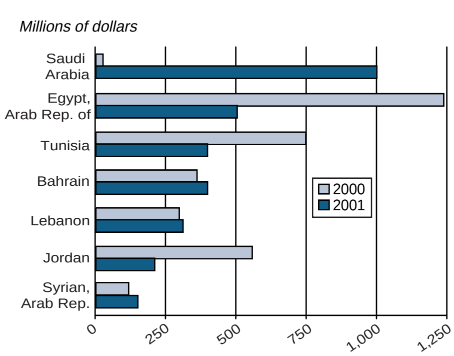
Source: Euromoney and the World Bank Economic Policy and Prospects Group.

Principal capital market participants, 2000 and 2001



Source: World Bank Economic Policy and Prospects Group.

Principal foreign direct investment recipients, 2000 and 2001



Source: World Bank Economic Policy and Prospects Group.

ket spreads toward 700 basis points, the situation eased somewhat in late 2001 and early 2002, and spreads for the region showed some improvement, falling by 250 basis points for Algeria, 150 points for Egypt, and 90 points for Morocco. However, spreads for Lebanon remain high as public debt continued to increase to very high levels. A general easing of investor risk aversion may be a welcome development moving into 2002, as signs of recovery in economic activity in the United States and East Asia have become clearer, and availability of finance is improving (liquidity in the industrial countries has risen substantially in a lower interest rate environment).

Portfolio equity issuance, traditionally small in the region, was virtually nil in 2001, as it fell to $7 million from $375 million in 2000, and from a recent peak of $720 million in 1997. This was in- line with the large decline in equity placement worldwide, which fell 75 percent in 2001, as stock markets around the world responded to declines in earnings and profitability. On balance, market-based flows to the region proved fairly resilient in the face of deteriorating global (and local) conditions.

FDI flows into the region increased, particularly to oil-exporting countries. FDI rose from $1.2 billion in 2000 to $2.6 billion in 2001. For the first time in three years, Saudi Arabia experienced net positive inflows of $1 billion, as limited foreign participation in hydrocarbon projects was approved. But many of the diversified exporters, such as Egypt and Jordan, experienced considerable falloffs in FDI, as current global conditions suggest that the prospects for privatization-related FDI, particularly in telecommunications and aviation, will be considerably dampened through the medium term, remaining well below 1997–98 levels.

Prospects

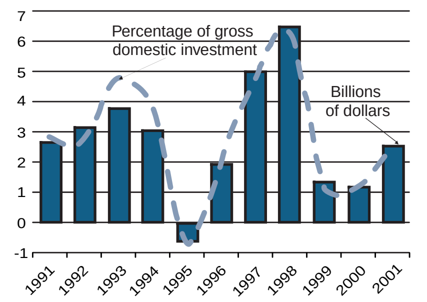
Given difficult conditions in the external environment, near-term prospects appear muted: growth recovery in the European Union is likely to lag behind that of North America and East Asia; underlying demand for hydrocarbons will require some time to reach 1999–2000 levels, and uncertainty associated with the war on terrorism will likely remain a dampening factor for regional dynamism. GDP growth is anticipated to fall to 2.7 percent in 2002, while recovery over the 2003–04 period may be protracted relative to other developing regions, rising to an average of 3.3 percent.

The slowdown in external demand will continue to affect the Middle East and North Africa well into 2002. Average oil prices have fallen below $20 per barrel early in the year, eroding the large current account surpluses and oil revenue boosts seen recently by governments in oil-exporting countries. Cuts in oil production quotas in OPEC countries will also reduce GDP growth prospects for some oil-exporting countries, although this will be balanced in countries such as the Islamic Republic of Iran and Algeria, which have large investment programs in the hydrocarbons sector. As a result, GDP growth among the oil exporters is likely to soften in 2002 to 2.2 percent, while the aggregate current account surplus may fall from $40 billion in 2001 (9.9 percent of GDP) to $6 billion (1.5 percent).

Lower export volumes, services income, and tourism receipts will continue to constrain growth in the diversified exporters, and current account deficits are likely to worsen in 2002. GDP growth in the year is anticipated to weaken to 3.1 percent, as Moroccan growth falls from post-drought highs in 2001. Tunisia and Jordan will benefit from the expected upturn in global activity in late 2002 and as the impacts of September 11 on tourism fade, although the intifada in the West Bank and Gaza may persist and cause more acute concerns for tourism in the Levant. The weak economic situation in Egypt has led the government to consider a range of policies to improve the business climate, including capital market reforms and independence for the central bank. Tax reforms, to ease the corporate tax burden and encourage compliance, are also being considered.

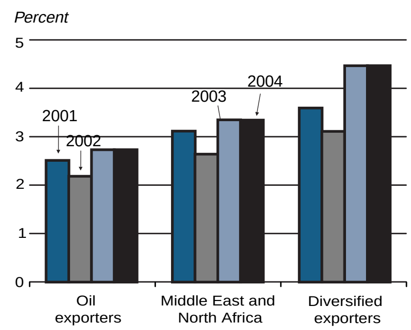
The rebound of the global economy in late 2002 into 2003 should help to stabilize growth in the region. There may be some upside potential for oil prices, but this will most likely be negated by higher non-OPEC supply, potentially implying a further deterioration of fiscal deficits and current account balances of oil exporters from the positive balances seen in recent years. However, given the recovery of foreign exchange reserves, the resources available to countries such as the Islamic Republic of Iran and Algeria in their oil stabilization funds, as well as the lower levels of foreign debt achieved in recent years, oil exporters should have little problem in financing deficits. Improvement in external conditions should also be a boost to the diversified exporters, particularly Jordan and Tunisia, where export volumes have exceeded export market growth in 2001. Conditions in Egypt point to continued domestic weakness into 2003, as the government is likely to lower the fiscal deficit while the economy is growing much more slowly than during the late 1990s. Moroccan growth is heavily reliant on weather conditions but will also be affected by low prices for its commodity exports, and Morocco faces the challenge of increasing the competitiveness of its manufacturing sector as it implements the next stages of its European Union Association Agreement.

Foreign direct investment, 1991–2001



Source: World Bank Economic Policy and Prospects Group.

GDP growth, 2001–2004



Source: World Bank Economic Policy and Prospects Group.

Middle East and North Africa forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	3.2	2.0	4.2	3.1	2.7	3.3	3.3
Consumption per capita	0.4	0.5	1.7	1.4	1.0	0.8	0.9
GDP per capita	1.0	0.1	2.2	1.2	0.7	1.4	1.3
Population	2.2	1.9	2.0	1.9	1.9	1.9	1.9
Gross domestic investment/GDP[a]	21.2	21.5	21.7	22.1	22.4	22.6	22.8
Inflation[b]	5.3	5.7	3.8	3.8	3.4	3.3	3.1
Central government budget balance/GDP	–1.2	–1.2	–1.0	–0.5	–0.9	–1.1	–1.4
Export market growth[c]	7.2	8.2	12.9	0.1	2.2	7.9	7.4
Export volume[d]	4.9	4.0	7.4	2.1	3.0	5.2	4.7
Terms of trade/GDP[e]	0.5	5.3	8.8	–2.5	–3.7	0.1	–1.7
Current account/GDP	–1.7	1.4	7.6	5.5	0.7	0.9	–0.9
Memo items							
GDP growth: oil exporters	2.5	0.2	3.6	2.5	2.2	2.8	2.8
Diversified exporters	4.0	3.6	3.7	3.6	3.1	4.4	4.4

a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services.
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.

On balance, growth for the diversified exporters during 2003–04 is projected to pick up to 4.4 percent; that for the oil-dominant economies to 2.8 percent, yielding an overall regional growth rate of 3.3 percent. Against a background of continued rapid population growth, this implies per capita income growth of about 1.5 percent over the period, suggesting continued difficulties in mitigating unemployment among the region's increasing, and increasingly youthful, work force.

Notes

1. Low- and middle-income oil-dominant countries in the MENA region reported here, supported by available data, are Bahrain, the Islamic Republic of Iran, Oman, Saudi Arabia, and the Republic of Yemen. High-income oil exporters include Kuwait and the United Arab Emirates; insufficient data are available for Qatar.

2. The group of diversified exporters of the region comprises Egypt, Jordan, Morocco, the Syrian Arab Republic, and Tunisia.