Middle East and North Africa

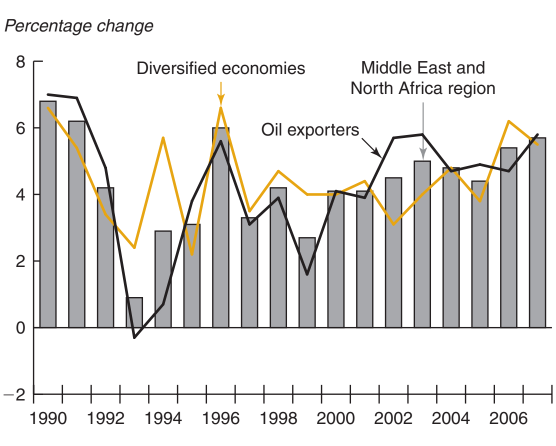
Recent developments

Growth in the developing countries of the Middle East and North Africa region found impetus in 2007 from both oil exporters and the more diversified economies of the region, which faced a generally favorable external environment during the first half of the year.[3] The region appears (to date) to have weathered the financial fallout stemming from the U.S. subprime mortgage and related turmoil, with little escalation in sovereign bond spreads and a recovery in equity markets following the initial shocks in summer 2007. GDP growth attained a 12-year high during 2007 of 5.7 percent, up from 5.4 percent in 2006, with gains among oil exporters ramping up sharply to 5.8 percent from 4.7 percent in 2006, offsetting a step-down among the diversified economies (due wholly to drought in Morocco) to 5.5 percent from a robust 6.2 percent during 2006 (figure A.11).

The region's growth advances have had significant spillovers for job creation, one of the greatest development challenges facing the region. The countries are at the absolute crest of a labor force growth surge, with labor force growth averaging 3.4 percent a year between 2002 and 2007. Yet in the midst of this burgeoning labor force, unemployment dropped from more than 15 percent in 2000 to 11 percent in 2007. Most of the region's new jobs have come from the private sector. This is a tremendously important development for a region in which job creation, especially for an increasingly educated population, has become the litmus test for economic performance.

The regional current account surplus eased moderately during the year from $79 billion in 2006 to $69 billion (or from 11.7 to 9.1 percent of GDP) as goods exports, remittances, and tourism receipts broadly underpinned revenue flows. Oil export revenues picked up by 6.7 percent to $130 billion, on the back of a 10.6 percent hike in the average global oil price to $71.10 per barrel. Production difficulties in Algeria and Iran, as well as restraints implied by quotas set by the Organization of Petroleum-Exporting Countries (OPEC), constrained export volumes and revenue growth from stronger performance. Goods exports from the diversified economies registered rapid nominal gains of 20 percent on strong demand from Europe, the United States (which had recently signed free trade agreements with several countries in the region), and emerging markets.

Figure A.11 Real GDP takes a step up, 1990–2007



Source: World Bank.

FDI inflows to developing countries in the region continued at a rapid 11 percent pace, amounting to a record $30.5 billion (largely originating in the economies of the Gulf Cooperation Council [GCC]) coming to support growth and provide financing for a larger number of countries in 2007. Inflation picked up across most countries in the region, however, tied to sharp escalation in food and fuel prices, and will continue to present a difficult challenge for policy makers. On balance 2007 was an exceptional year for growth, but the external environment and economic activity could potentially take a turn for the worse moving into 2008 (table A.10).

The diversified economies. For the diversified, or resource-poor, labor-abundant economies, output growth slipped to 5.5 percent in 2007. With the exception of Morocco, however, GDP accelerated or equaled its 2006 pace in all other economies. Inflation continued to increase, rising from 5.3 percent in 2005 to 6.7 percent in 2007. This development occurred across the board but was more severe in the Arab Republic of Egypt, (9.9 percent), where food and fuels prices, as well as strong liquidity conditions, contributed. The group's industrial production picked up to a GDP-weighted 4.6 percent in 2007, with favorable performances in Tunisia (10 percent), Morocco (5 percent), Egypt (4 percent) and Jordan (4 percent). Fiscal balances deteriorated only moderately, coming to stand at deficit of 6 percent of GDP in 2007. And the groups' current account balance fell to modest deficit ($7.5 billion), with Egypt and Morocco registering small surplus positions. Aside from the GCC countries, the diversified group has been the prime focus of interest for FDI, with

Table A.10 Middle East and North Africa forecast summary
annual percentage change unless indicated otherwise

					Forecast		
Indicator	1999–2000[a]	2005	2006	2007	2008	2009	2010
GDP at market prices (2000 $)[b]	3.8	4.4	5.4	5.7	5.5	5.3	5.1
GDP per capita (units in $)	1.6	2.7	3.6	3.8	3.7	3.5	3.4
PPP GDP[c]	4.7	4.4	5.5	5.9	5.5	5.3	5.0
Private consumption	3.8	3.7	4.9	4.6	5.0	6.8	5.5
Public consumption	4.3	7.4	4.8	6.9	7.4	4.4	5.2
Fixed investment	3.3	2.6	14.4	22.5	14.6	9.1	9.2
Exports, GNFS[d]	4.4	11.1	4.9	3.8	−0.3	4.5	6.0
Imports, GNFS[d]	1.6	9.5	6.5	14.1	6.6	8.8	8.8
Net exports, contribution to growth	0.7	0.3	−0.6	−3.5	−2.5	−1.9	−1.6
Current account balance GDP (%)	−0.5	11.1	11.7	9.1	12.8	9.6	6.4
GDP deflator (median, LCU)	7.4	11.5	8.6	5.5	11.6	5.3	4.7
Fiscal balance/GDP (%)	3.5	3.7	2.5	−0.2	−1.2	−1.7	−1.8
Memorandum items: GDP							
MENA geographic region[e]	3.4	5.4	5.2	4.9	5.8	5.3	5.1
Resource poor, labor abundant[f]	4.2	3.8	6.2	5.5	6.2	6.1	5.9
Resource rich, labor abundant[g]	3.3	4.8	4.5	5.7	4.9	4.6	4.3
Resource rich, labor importing[h]	3.0	7.0	4.9	4.0	6.3	5.3	5.0
Egypt, Arab Rep. of	4.3	4.4	6.8	7.1	7.0	6.8	6.5
Iran, Islamic Rep. of	3.7	4.6	5.9	7.6	5.7	5.2	4.5
Algeria	1.7	5.1	1.8	3.0	3.5	3.5	4.0

Source: World Bank
a. Growth rates over intervals are compound averages; growth contributions, ratios, and the GDP deflator are averages.
b. GDP is measured in constant 2000 $.
c. GDP is measured at PPP exchange rates.
d. Exports and imports of goods and nonfactor services.
e. Geographic region includes high-income countries: Bahrain, Kuwait, and Saudi Arabia.
f. Egypt, Jordan, Lebanon, Morocco, and Tunisia.
g. Algeria, the Islamic Republic of Iran, Syria, and the Republic of Yemen.
h. Bahrain, Kuwait, Oman, and Saudi Arabia.

inflows equal to 10.5 percent of GDP in 2007, down slightly from the 10.9 percent results of 2006.

Output gains for the diversified group were driven by strong growth in domestic demand, particularly investment. Of the 5.5 percent GDP growth in 2007, absorption accounted for some 8.6 points of growth, offset by a 3.1 point negative contribution from net exports. Though export volumes registered a strong 12.6 percent gain in the year, imports grew still faster at 17 percent. GDP in Egypt jumped 7.1 percent in 2007, with growth broadly based, as non-oil-manufacturing and retail trade accounted for half of overall output gains. Reforms in Morocco and Tunisia, as well as in Egypt, are making headway in improving the business climate and increasing the competitiveness of the export sector. Egypt, Jordan, Morocco, and Tunisia signed a free trade agreement (the Agadir Agreement) to help promote trade within the region. For the diversified group, 2007 also marked a watershed for several countries in finance. Fitch Agency raised Egypt's issuer default rating to a positive outlook. And Morocco was awarded investment-grade status for its sovereign bonds and quickly raised €500 million ($685 million) at a low, 55 basis point spread above comparable European securities.

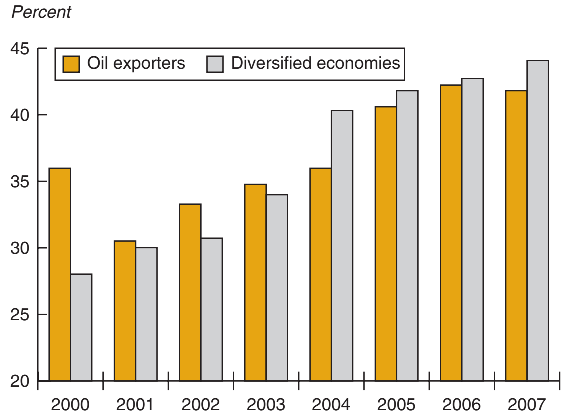
The developing oil exporters. Because of capacity constraints or management of crude oil output to keep production in line with OPEC quotas, cuts in production amounted to 4.3 percent for all resource-rich economies in the region in 2007 (including the high-income exporters). Reductions in output ranged from 11.7 percent in the Republic of Yemen to 8.4 percent in Kuwait to 4.9 percent in Saudi Arabia to 0.7 percent in Algeria. These reductions carried important implications for growth, through public sector revenues and spending, as well as through management and disposition of the fiscal surplus.

Growth among the developing oil exporters—or resource-rich, labor-abundant economies—of the region stepped up from 4.7 percent in 2006 to 5.8 percent in 2007. Output gains in Algeria were constrained by a fall in hydrocarbon output, with GDP advancing just 1.8 percent in 2006 and 3 percent in 2007. Following a massive 40 percent surge in oil and gas output in 2004, production tailed off to decline by 2007, but non-hydrocarbon activity expanded by a strong 6 percent in 2007. A major government investment initiative has started belatedly and is slated to expend more than $22 billion over the next years on housing, transport, and agriculture. This initiative is now boosting job growth in construction and related sectors and underpinning strong household spending. In the Islamic Republic of Iran, growth stepped up to 7.6 percent from 5.9 percent in 2006. The main driver was major fiscal expansion over 2006 and 2007, seen in the movement from a budget surplus in 2005 to a budget deficit equal to 11.9 percent of GDP by the end of 2007.

Exports of merchandise from the region amounted to $285 billion in 2007, of which $130 billion came from oil and related products. This represents a 9.6 percent advance on 2006, with oil gaining 6.7 percent and non-oil exports growing at a robust 15 percent. Higher oil prices account for the full upswing in export receipts in the year, while a pickup in shipments of manufactured goods helped underpin export gains for the diversified group. Adding services exports (largely tourism at $20 billion) and remittances receipts ($29 billion) to goods exports, current account revenues as a share of GDP moved up to a record 45.1 percent for the diversified economies in 2007, from 28 percent in 2000 (figure A.12). In contrast, revenues for the oil-exporting countries diminished relative to GDP, reflecting declines in hydrocarbon output and other production difficulties.

Egypt and Morocco have enjoyed the strongest growth in tourism revenues over the past years, in part as investment in improved tourism infrastructure is increasingly in place (much tied to FDI from the Gulf countries) and as economic growth in Europe gained firmer footing. Egypt's efforts to diversify its tourism base, appealing to residents of the GCC, as well as to new markets in Central Europe and the former Soviet Union, have paid handsome dividends. During Egypt's fiscal 2007, tourist arrivals grew by 12.6 percent, with earnings up 14 percent to $8.2 billion (6.5 percent of GDP). In Morocco tourism receipts advanced 22 percent in 2007, to reach $7.2 billion (almost 10 percent of GDP).

Figure A.12 Current account revenues as share of GDP, 2000–07



Sources: World Bank, IMF and National Agencies.

Gross remittance inflows to recipient countries in the Middle East and North Africa increased 9 percent in 2007 to $28.5 billion. This increase comes on the heels of an 11 percent jump during 2006. Morocco has maintained its first place in "league standings," with remittances advancing 25 percent to $6.7 billion in 2007, in part reflecting the continuation of stronger economic activity in the Euro Area. Egypt stands as the second-largest recipient, with remittances amounting to $6.3 billion in 2007, also up 25 percent over 2006 levels.

Capital flows. Net debt flows to the region rebounded to $8.4 billion in 2007, following negative levels in 2006. Both bank and bond flows to the region increased, with bank loans showing strong gains in 2007, reaching $5.4 billion from −$0.9 billion in 2006. Net equity flows (FDI and portfolio equity) picked up fairly sharply in the year to $32.6 billion, growth of 10.5 percent following the large-scale gains of 2006. FDI flows to the region increased to $31 billion in 2007 from $27 billion the previous year. While resource-related investment in the region is on the rise—particularly in Algeria, investment in other sectors such as banking, manufacturing, real estate, tourism, and transportation is also increasing. In addition to European countries, the main investors in the region

Table A.11 Net capital flows to Middle East and North Africa
$ billions

Indicator	1999	2000	2001	2002	2003	2004	2005	2006	2007p
Current account balance	3.1	22.4	12.1	7.8	23.7	39.1	64.6	79.3	69.3
as % of GDP	0.8	5.8	3.0	1.9	5.3	7.7	11.1	11.7	9.1
Net equity flows	3.5	5.1	4.2	4.4	8.4	8.0	17.0	29.5	32.6
Net FDI inflows	2.8	4.8	4.2	4.9	8.2	7.1	14.4	27.5	30.5
Net portfolio equity inflows	0.7	0.2	0.0	−0.6	0.2	0.9	2.6	2.0	2.1
Net debt flows	−3.0	−3.8	−0.3	1.3	0.3	4.0	−1.1	−12.5	8.4
Official creditors	−2.5	−2.7	−1.1	−2.5	−2.4	−4.0	−3.7	−11.6	1.3
World Bank	0.2	−0.3	−0.1	−0.3	−0.3	−0.6	0.0	−0.8	1.0
IMF	0.0	−0.2	−0.1	−0.3	−0.6	−0.5	−0.7	−0.2	−0.1
Other official	−2.8	−2.2	−0.9	−1.9	−1.6	−2.9	−3.0	−10.6	0.4
Private creditors	−0.5	−1.1	0.8	3.8	2.8	8.0	2.6	−0.9	7.1
Net medium- and long-term debt flows	−1.5	0.8	3.8	4.5	0.2	2.6	2.5	−1.5	6.2
Bonds	1.4	1.2	4.4	5.0	0.7	3.3	2.3	0.6	2.7
Banks	−1.8	0.2	−0.4	−0.5	−1.2	−0.6	1.2	−0.9	5.4
Other private	−1.1	−0.6	−0.2	0.0	0.7	−0.1	−1.0	−1.2	−1.9
Net short-term debt flows	1.0	−1.9	−3.0	−0.7	2.5	5.4	0.1	0.6	0.9
Balancing item[a]	−4.7	−18.8	−6.6	−1.5	−10.4	−36.8	−59.2	−59.3	−66.9
Change in reserves (− = increase)	1.2	−4.8	−9.5	−12.0	−22.0	−14.3	−21.3	−37.0	−43.4
Memorandum item									
Worker's remittances	11.8	12.1	14.3	14.9	19.9	22.6	23.6	26.1	28.5

Source: World Bank.
Note: p = projected.
a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

also include Gulf countries as well as a few developing Asian economies (China, India and Malaysia). Egypt continues to receive the largest FDI flows within the region with $7.5 billion in 2007, mainly in the oil sector as well as in manufacturing, real estate, and tourism. But the amount was lower than the $10 billion Egypt received in 2006, which FDI was supported by resource-related investments and privatization in the banking sector (table A.11).

Medium-term outlook

A number of factors are likely to shape the profile for growth for the developing economies of the Middle East and North Africa region. In the external environment, demand from the United States primarily but also from Europe and Japan, is expected to slow markedly in 2008. Yet, this development is likely to be accompanied by continued rapid escalation in global oil prices to average $108/bbl in 2008, diminishing to a still-high $99/bbl by 2010. This is tied to strong demand in emerging markets, shortfalls in non-OPEC supply and restraint exercised by OPEC itself. Growth in the region is viewed to ease gradually from a peak of 5.7 percent in 2007 to 5.1 percent by 2010, largely as hydrocarbon output- and non-oil GDP gains among the oil exporters, particularly the Islamic Republic of Iran, diminish. At the same time, oil export revenues will be boosted by higher global prices, carrying the current account balance for oil-dominant economies to $132 billion in 2008 from $77 billion during 2007, increasing sharply to 21.3 percent of GDP from 15.6 percent, before easing to 10.5 percent by 2010.

The Islamic Republic of Iran's GDP growth is expected to fall from the strong 7.6 percent pace of 2007 to 5.7 percent in 2008, and to 4.5 percent by 2010, despite continued strong fiscal expansion. Most of the surge in spending will lead to exceptionally rapid import gains, and not to increased domestic production, while advances in export volumes are anticipated to be meager. Continued work to supplement hydrocarbon output in Algeria, with implementation of the government's infrastructure plan, should underpin investment and consumption and carry GDP growth back to a 4 percent range (table A.12).

For the diversified group, rebounds in Morocco to 5.5 percent growth from the depths of drought and in Lebanon to 3.5 percent, are key to the 2008 outlook, tending to offset modest easing across the remainder of the group tied to increasingly adverse conditions in the external

Table A.12 Middle East and North Africa country forecasts
annual percentage change unless indicated otherwise

					Forecast		
Country/indicator	1991–2000[a]	2005	2006	2007	2008	2009	2010
Algeria							
GDP at market prices (2000 $)[b]	1.7	5.1	1.8	3.0	3.5	3.5	4.0
Current account bal/GDP (%)	3.2	20.4	23.1	19.4	25.7	22.0	18.1
Egypt, Arab Rep.							
GDP at market prices (2000 $)[b]	4.3	4.4	6.8	7.1	7.0	6.8	6.5
Current account bal/GDP (%)	0.9	2.3	2.6	−0.3	0.6	1.3	1.5
Iran, Islamic Rep.							
GDP at market prices (2000 $)[b]	3.7	4.6	5.9	7.6	5.7	5.2	4.5
Current account bal/GDP (%)	1.2	19.8	19.5	19.7	25.1	17.7	10.5
Jordan							
GDP at market prices (2000 $)[b]	5.1	7.1	6.3	6.3	5.8	6.0	6.0
Current account bal/GDP (%)	−4.3	−18.2	−14.7	−19.5	−30.2	−24.4	−18.9
Lebanon							
GDP at market prices (2000 $)[b]	7.2	1.0	0.0	1.0	3.5	4.5	5.0
Current account bal/GDP (%)	—	−12.2	−5.5	−5.2	−11.4	−10.5	−9.0
Morocco							
GDP at market prices (2000 $)[b]	2.2	2.4	8.0	2.3	5.5	4.5	4.5
Current account bal/GDP (%)	−1.4	2.0	3.1	−3.2	−8.5	−5.6	−2.5
Oman							
GDP at market prices (2000 $)[b]	4.6	5.6	7.0	6.9	5.0	4.8	5.0
Current account bal/GDP (%)	−3.7	13.9	12.1	3.7	11.7	9.5	6.2
Syrian Arab Republic							
GDP at market prices (2000 $)[b]	5.1	4.5	5.1	3.9	4.0	4.8	4.6
Current account bal/GDP (%)	1.0	1.0	2.7	−0.7	3.0	1.1	−0.9
Tunisia							
GDP at market prices (2000 $)[b]	4.7	4.0	5.3	6.3	5.8	6.2	6.0
Current account bal/GDP (%)	−4.3	−1.1	−2.1	−2.0	−3.4	−1.5	0.3
Yemen, Rep.							
GDP at market prices (2000 $)[b]	5.5	5.6	3.2	3.1	4.2	4.0	4.0
Current account bal/GDP (%)	−4.3	3.7	1.0	−5.1	−2.7	−3.9	−5.4

Source: World Bank
Notes: Growth and current account figures presented here are World Bank projections and may differ from targets contained in other Bank documents. Djibouti, Iraq, Libya, and the West Bank and Gaza are not forecast owing to data limitations.
a. Growth rates over intervals are compound averages; growth contributions, ratios, and the GDP deflator are averages.
b. GDP is measured in constant 2000 $.

environment—and supporting a fillip in growth to 6.2 percent in the year. Beyond 2008, GDP advances are anticipated to average 6 percent, as investment-led growth appears increasingly well established in Egypt, and activity there should remain within a 6.5-to-7 percent range in the next years. Growth in Jordan and Tunisia near 6 percent is also likely, grounded in services exports and increasingly in investment and construction funded by FDI. And a stronger profile of growth emerges in Lebanon as economic conditions gradually improve.

Risks and uncertainties

Rising food prices represent a growing vulnerability and risk for the region, especially in the context of poorly targeted safety nets. The sharp rise in both oil and food prices have spotlighted the region's heavy subsidization of prices within the domestic market, which particularly threatens fiscal positions for resource-poor economies.

The Middle East and North Africa region is particularly vulnerable to a food price crisis, given the poverty within the region. At the aggregate, the region suffers from low levels of poverty, with only 1.5 percent of the population living on less than $1 a day (World Bank 2007). However, there is tremendous disparity across countries in the region and within countries in the region. While there is virtually no poverty in some of the oil-exporting nations of the GCC, in the Republic of Yemen, more than a third of the population lives below the poverty line. Within countries, poverty exists in deep pockets, most often in rural areas. In addition, the degree of poverty vulnerability is very high in the region, with large numbers of people living just barely above the poverty line. For example, only 3 percent of Egyptians live below $1 a day, but some 43 percent live on less than $2 a day; in the Republic of Yemen, 10 percent of the population lives on less than $1 a day, but a full 45 percent of the population lives on less than $2 a day. Overall, while less than 2 percent of the region's population lives on less than $1 a day, some 20 percent lives on less than $2 a day. With such deep clustering of large proportions of the population around the poverty line, rising global food prices represent a serious risk to wide-scale poverty in the Middle East and North Africa.

Markets for manufactures and services may suffer a more pronounced slowdown linked to the ripple effects of financial difficulties already present in the United States and the Euro Area. Moreover, should a significant credit crunch occur, slowing growth across developed as well as developing countries, demand for crude oil and refined petroleum products could decline quite abruptly, leading to a sharp falloff in price, with attendant effects for revenues and growth.

For the region's oil exporters, management of the hydrocarbon windfalls of the last years remains a continuing challenge. And with oil prices anticipated to remain at quite elevated levels through 2010, the risk of overheating domestic demand, with potentially inflationary consequences, looms as an overarching threat. Judicious use of oil stabilization funds to counter such trends and to offer a cushion for future growth should be a priority, as should prudent disposition of surplus funds across asset classes. Moreover, domestic reform efforts may stand at some risk against the background of abundant liquidity and rapid growth. On the other hand, should oil prices take a sudden and sustained downturn, economies may find adjustment to be a difficult transition.