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Middle East and North Africa regional prospects[5]

Recent developments

Thanks to oil revenues surging in 2006 and boosting government expenditure, growth in the developing countries of the Middle East and North Africa has reached its highest level in the past four years. Growth is estimated to have picked up by 0.5 percentage points to 4.9 percent in 2006 (table A.8), with developing-country oil exporters accelerating from 4.7 percent to 4.9 percent and oil importers from 4 percent to 5 percent. Growth in the oil sector itself was relatively modest, with oil and natural gas output volumes increasing by 1.9 percent.

Developing-country oil exporters seek with new government programs to create jobs for their rapidly growing labor force, but they face the challenge of ensuring competitiveness in non-energy sectors and avoiding permanent reliance on government support. Their challenge is much more complicated than that of high-income oil exporters, which are typically labor importers. The high-income regional oil exporters, such as Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates, are not part of the low- and middle-income grouping discussed in this appendix. The oil-importing countries are benefiting from the increased spending by oil exporters in the region, but their main challenge is to keep their fiscal balances under control. Energy subsidies, which increased with rising oil prices, have created fiscal strain and only recently some oil importers have started to adjust their policies.

Table A.8 Middle East and North Africa forecast summary

Annual percent change (unless otherwise indicated)

					Estimate	Forecast	
	1991–2000[a]	2003	2004	2005	2006	2007	2008
GDP at market prices (2000 US$)[b]	3.8	4.4	4.8	4.4	4.9	4.9	4.8
GDP per capita (units in US$)	1.9	2.7	3.0	2.6	3.1	3.0	3.1
PPP GDP[c]	3.9	4.6	4.8	4.4	5.2	4.9	4.9
Private consumption	3.5	3.7	6.3	4.8	5.0	5.0	6.5
Public consumption	3.6	3.1	2.8	6.2	9.2	5.3	5.2
Fixed investment	3.2	5.9	10.0	5.4	10.1	9.5	3.7
Exports, GNFS[d]	3.8	3.8	6.2	4.8	6.6	4.7	5.2
Imports, GNFS[d]	−0.9	3.8	12.9	7.2	12.5	8.7	7.2
Net exports, contribution to growth	−4.1	0.0	−1.9	−2.6	−4.4	−5.7	−6.4
Current account balance/GDP (%)	−0.5	0.0	2.5	6.6	6.8	3.6	2.3
GDP deflator (median, LCU)	7.7	4.4	6.9	14.5	8.7	4.1	4.8
Fiscal balance/GDP (%)	−4.3	−0.9	−2.4	−1.2	−0.4	0.1	0.1
Memo items: GDP							
MENA Geographic Region[e]	3.1	5.7	5.0	5.3	5.5	5.2	5.0
Resource poor-labor abundant[f]	4.8	4.0	4.8	4.0	5.0	5.1	5.3
Resource rich-labor abundant[g]	2.8	5.1	4.9	4.7	4.7	4.6	4.4
Resource rich-labor importing[h]	2.3	7.4	5.3	6.7	6.5	5.7	5.2
Algeria	1.8	6.8	5.2	5.3	3.0	4.5	4.3
Egypt, Arab Rep. of	4.4	3.1	4.2	4.9	5.8	5.6	5.8
Iran, Islamic Rep. of	2.9	5.0	5.1	4.4	5.8	5.0	4.7

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 U.S. dollars.
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, Iran, the Syrian Arab Republic, and the Republic of Yemen.
h. Bahrain, Kuwait, Oman, and Saudi Arabia.

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The surge in oil prices over the course of the year has boosted oil revenues of developing-country oil exporters in the region by 32 percent to $160 billion. For example, hydrocarbon revenues increased by more than 30 percent in Algeria, thanks to two new natural gas projects, while oil-related receipts rose by 33 percent in the Islamic Republic of Iran. In 2006 this helped to finance a surge in domestic demand and, because domestic production has not been able to keep up, increased import volumes. Overall domestic demand among regional oil exporters increased 7.9 percent, with government spending accounting for roughly half this increase. GDP growth was much less rapid at 4.9 percent because much of this demand was met by a 12.2 percent increase in imports compared with a 2.5 percent rise for exports.

In Algeria, growth declined from 5.3 percent in 2005 to 3 percent in 2006 due to slower hydrocarbon export volumes, stagnant oil production, delays in the implementation of a large government investment program, and a contraction of banking credit, including to the private sector, due to nonperforming loans. In Iran growth accelerated to 5.8 percent from 4.4 percent in 2005. In Oman, increased natural gas production contributed to a 6.5 percent increase in GDP, up from 4.8 percent in 2005. The imbalance in export and import volume growth meant that the current account balance of oil-exporting developing countries in the region improved by only $9 billion, reaching $50 billion or 11.4 percent of GDP.

Given heavy government involvement in the oil sector, high energy prices have greatly increased government revenues. While spending has increased by 20–35 percent as a result of several countries passing supplementary budgets, government fiscal balances in developing-country oil exporters have changed little from the 2.3 percent of GDP recorded in 2005, and they are estimated to equal 2.6 percent of GDP in 2006. While some of the additional spending is easily affordable at the moment, it might create tensions in the longer run if oil revenues come down. That is especially true for additional spending that is difficult to reverse and does little to increase productive capacity. The increased public-sector wages in Algeria, up by 20–25 percent, could be an example of such spending with less favorable effects in the longer run than in the short run.

In addition to current spending, a number of developing-country oil exporters have sought to use revenues to pay down debt—for instance, Algeria has paid off substantial amounts of external debt, which dropped from 47 percent of GDP in 2000 to 17 percent by 2005—or create funds from which future expenditures can be paid. Much of these funds were allocated to pro-development programs such as infrastructure development (for example, Algeria initiated a five-year, $90 billion program that would double outlays for infrastructure, housing, and rehabilitation investment).

Investments by high-income regional oil exporters have influenced oil-exporting and -importing developing countries.[6] A portion of their oil revenues is being recycled through FDI and equity investments within the region. Partly as a result, regional equity prices and real estate values increased substantially during 2005 and the first half of 2006, although as in many other developing regions there was a price correction in equity markets during the financial-market turbulence of May–June 2006.

These investments are becoming an important link between the diversified economies of the region and the resource-abundant countries. FDI flows from Gulf Cooperation Council (GCC) governments, private firms, and other entities are beginning to make a substantial impact on economic developments in both the Mashreq and Maghreb. Among recent examples of investment activity, FDI inflows into Jordan surged to $2 billion over January–August 2006, up from $750 million in the like period of 2005. A large proportion is being invested in real estate and tourism infrastructure. A Bahrain-based firm recently announced a $1.4 billion investment in Morocco, supporting tourism and related facilities—this in the wake of a $9 billion investment by the United Arab Emirates. And Egyptian projects and

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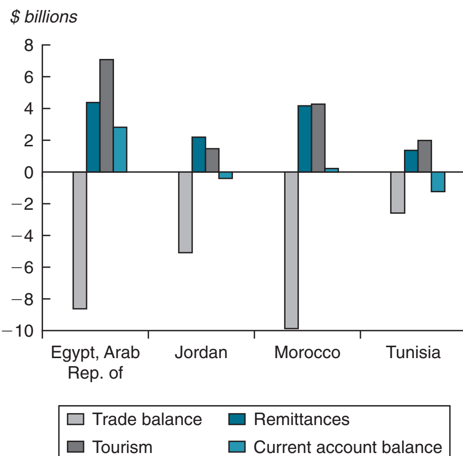
equity markets have attracted a good deal of capital from the GCC.

These foreign investments were one reason why growth among developing-country oil importers within the region also accelerated in 2006, moving from 4 percent in 2005 to an estimated 5 percent increase in 2006, despite rising oil prices. Other contributing factors were a rebound in growth following the severe drought in the Maghreb in 2005, stronger demand for the region's exports as European recovery firmed, and strong remittance and tourism flows from both the Euro Area and regional oil exporters (figure A.7). Private consumption in the oil-importing countries increased 4.5 percent in 2006, boosted by improved agricultural output and a 10.7 percent increase in government outlays. Household consumption surged 12 percent in Morocco and 5.5 percent in Jordan. Overall the increase in private consumption was responsible for four-fifths of the increase in oil importers' demand. Exports also surprised to the upside for several countries, in part as demand in the Euro Area rebounded. The Arab Republic of Egypt's exports were up 55 percent during the first half of 2006, and those for Morocco were up 20 percent in the wake of a foreign trade agreement with the United States in force as of January 2006.

Figure A.7 Tourism and remittance flows offset trade shortfalls in 2005



Sources: World Bank; national agencies; IMF.

Morocco experienced the largest acceleration in GDP growth, shifting from a weak drought-influenced 1.7 percent advance in 2005 to 7 percent in 2006. In Egypt, vibrant exports, tourism, remittance receipts, and government spending underpinned a solid 5.8 percent increase in economic activity. Growth picked up by 1 percentage point in Tunisia, coming in at an estimated 5.3 percent in 2006, while growth in Jordan remained strong at 6.3 percent, buoyed by investment in real estate and tourism projects largely financed from high-income regional oil exporters. Political uncertainty and then war in Lebanon is estimated to have provoked a 5.5 percent fall in GDP during 2006, although some observers suggest that the loss might have been as high as 10 percent. The United Nations Development Programme (UNDP) places costs of infrastructure and other damages at more than $15 billion.

The surge in oil revenues and government spending among oil exporters has yet to generate substantial inflationary pressures, with the notable exception of the Islamic Republic of Iran, where inflation exceeds 10 percent. However, rapidly rising credit and external flows have pushed inflation up in a number of countries, including Egypt, Morocco, Oman, and Tunisia. Moreover, regional stock and housing markets have appreciated enormously. While local markets lost as much as 25–33 percent of their value in the May–June 2006 market correction, valuations remain high and there is a concern that private-sector balance sheets are becoming over-leveraged. Regional equity markets have since bottomed out, but remain some 10 percent below "precrisis" levels.

Rising crude oil prices in the first eight months of the year contributed to a deterioration in the current accounts of oil importers, whose aggregate deficit rose from 1.3 percent of GDP in 2005 to an estimated 2.1 percent of GDP in 2006. At the same time, higher oil prices weighed on fiscal balances as several oil-importing countries—among them Egypt,

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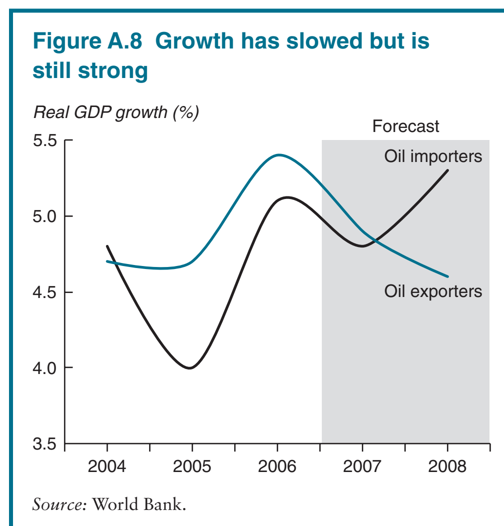
Jordan, Morocco, and Tunisia—did not fully pass through the price hikes to consumers. More recently, Jordan reduced subsidy expenditures by 60 percent in the second quarter of 2006 to rein in the fiscal deficit, which hit 4.6 percent of GDP in 2005. Egypt has taken steps that reduced the consolidated government deficit from 9.1 percent in fiscal 2005 to 6.5 percent, while in Tunisia the government raised petrol prices 5 percent in July.

Medium-term outlook

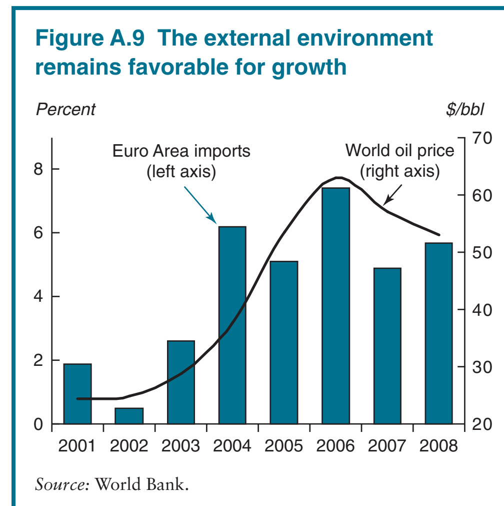
Growth among developing countries in the Middle East and North Africa is projected to remain broadly stable, easing from 4.9 percent in 2006 to 4.8 percent in 2008, reflecting a modest slowdown among oil exporters (from 4.9 to 4.5 percent). Oil importers are expected to register 5.1 percent growth in 2007, followed by 5.3 percent gains in 2008 (figure A.8). These projections are predicated on a further but gradual decline in oil prices from $57 per barrel in the fourth quarter of 2006 to an average of $53 in 2008, low long-term interest rates, continued strong growth among developing countries (notably China), a moderate slowdown in European growth, and a somewhat more pronounced growth cycle in the United States characterized by significant slowing in 2007 and a pickup in 2008 (figure A.9).

Figure A.8 Growth has slowed but is still strong



Source: World Bank.

Figure A.9 The external environment remains favorable for growth



Source: World Bank.

The modest slowdown projected among oil exporters reflects plans to reduce oil production in an effort to support prices. Robust government spending will keep domestic markets tight and import growth strong. Already non-oil-sector capacity constraints are becoming more binding and inflation is rising. Over the projection period, domestic demand is anticipated to increase by 6.5 percent on average, fueled by high (though declining) oil revenues. Increasingly, this demand will be met by imports, which are projected to rise by more than 8.5 percent per year (versus less than 3 percent for exports), and as a result GDP growth will slow.

Given the continued strength of domestic demand in the oil-exporting countries, inflationary pressures are projected to intensify and real exchange rates are likely to appreciate. Both factors will keep import demand strong, while a projected moderate decline in oil prices will reduce export revenues. As a result, developing-country oil exporters' current account surpluses are projected to decline from about 11.4 percent of GDP in 2006 to about 5.3 percent in 2008.

Prospects for the diversified oil-importing developing countries are expected to be shaped by first a fall and then an increase in exports to the Euro Area and the United States, and strong capital and remittance inflows. Fiscal

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consolidation as governments pursue efforts to narrow deficits from high-single digits to more sustainable levels may dampen growth modestly in Jordan and Morocco. Overall, growth is projected to rise moderately from 5 percent in 2006 to 5.1 percent in 2007, as Lebanon's 5.5 percent growth falloff of 2006 is recouped, helping to offset an easing in the postdrought growth rebound in the Maghreb countries. By 2008, these two effects are expected to have worn off and growth should pick up once more to 5.3 percent.

Risks and policy challenges

The future price of oil has important potential implications for the prospects of countries—both oil exporters and oil importers—in the region. In the baseline forecast oil prices are assumed to decline gradually toward a long-term price of $53 in 2008, but a scenario where prices rise as they did last year (or even rise by much more owing to a supply shock) or decline even more quickly cannot be ruled out. Higher prices would likely accentuate the tensions currently visible in oil-exporters, leading

Table A.9 Middle East and North Africa country forecasts

Annual percent change (unless otherwise indicated)

					Estimate	Forecast	
	1991–2000[a]	2003	2004	2005	2006	2007	2008
Algeria							
GDP at market prices (2000 US$)[b]	1.8	6.8	5.2	5.3	3.0	4.5	4.3
Current account balance/GDP (%)	3.3	13.0	13.1	21.2	24.2	17.5	15.8
Egypt, Arab Rep. of							
GDP at market prices (2000 US$)[b]	4.4	3.1	4.2	4.9	5.8	5.6	5.8
Current account balance/GDP (%)	0.9	4.5	4.3	3.3	1.7	1.5	−0.7
Iran, Islamic Rep. of							
GDP at market prices (2000 US$)[b]	2.9	5.0	5.1	4.4	5.8	5.0	4.7
Current account balance/GDP (%)	1.2	−7.8	0.9	7.5	5.6	2.2	2.0
Jordan							
GDP at market prices (2000 US$)[b]	4.9	4.1	8.4	7.3	6.3	5.0	5.0
Current account balance/GDP (%)	−4.3	11.6	−0.2	−18.2	−21.6	−20.3	−16.2
Lebanon							
GDP at market prices (2000 US$)[b]		4.9	6.3	1.0	−5.5	4.5	2.9
Current account balance/GDP (%)		−27.5	−23.7	−21.7	−21.5	−23.1	−23.5
Morocco							
GDP at market prices (2000 US$)[b]	1.6	5.5	4.2	1.7	7.0	3.5	4.5
Current account balance/GDP (%)	−1.4	3.5	1.9	2.4	1.2	0.7	0.9
Oman							
GDP at market prices (2000 US$)[b]	4.0	1.3	3.1	4.8	6.5	5.5	5.0
Current account balance/GDP (%)	−3.7	4.0	2.2	14.6	25.2	19.1	14.4
Syrian Arab Republic							
GDP at market prices (2000 US$)[b]	4.1	1.1	3.9	5.1	4.0	3.7	3.5
Current account balance/GDP (%)	1.0	3.4	1.1	−4.0	−2.5	−4.9	−6.7
Tunisia							
GDP at market prices (2000 US$)[b]	4.3	5.6	6.0	4.2	5.3	5.6	6.0
Current account balance/GDP (%)	−4.3	−2.9	−1.7	−1.1	−1.2	−1.4	−1.2
Yemen, Republic of							
GDP at market prices (2000 US$)[b]	5.3	3.1	2.6	3.8	3.9	2.5	3.0
Current account balance/GDP (%)	−4.3	1.4	2.0	5.0	−4.9	−8.4	−11.5

Source: World Bank.

Note: 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 U.S. dollars.

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to stronger domestic demand that would be offset by even higher imports—and as a result only limited additional GDP growth. Inflationary pressures and a tendency for flexible exchange rates to appreciate would accentuate, while current account balances could be expected to improve. For oil importers the effects would be more complex. To the extent that they benefit from additional leakages in the form of exports and FDI, their growth rates might actually pick up, even as government deficits and current account balances deteriorate. In the case of weaker oil prices, domestic demand among oil exporters would weaken, but the GDP impact would be less severe because import demand would also likely weaken. Lower oil prices would result in reduced government and foreign currency revenues, resulting in deterioration in both government and current account balances.

The possibility of increased political tension is a further risk for the region. Events in Lebanon illustrate how serious an economic impact even a short-lived conflict can have. Even an increase in uncertainty can generate significant global impacts if it affects financial market confidence, interest rates, and investment intentions.

On the positive side, a number of countries in the region have made substantial efforts at reforms: Egypt, Tunisia, and among oil-exporting countries, Algeria and Oman. A number are enjoying the benefits in the form of increasing FDI, more vibrant private sector activity, and broader reductions in the "cost of doing business." And to the extent that oil-financed government investment projects succeed in improving potential supply, these too could have long-term benefits.

South Asia regional prospects

Recent developments

GDP for the region is estimated to have expanded at a very rapid 8.2 percent pace in 2006, marking the fourth consecutive year that regional GDP has advanced by more than 7.5 percent (table A.10). A group of factors have contributed to this trend, including progress in promoting private sector–led growth, improved macro management, and greater integration. Loose monetary and fiscal policies and strong remittance inflows also played a role, providing a boost to domestic demand, while the reimposition of restrictions on Chinese exports of textiles and clothing, combined with strong external demand, kept export growth strong. Throughout much of the region, supply was unable to keep up with demand, resulting in rising inflation and rapidly growing imports. As a result, despite very strong export growth, net exports actually reduced GDP growth by 1.7 percentage points. Growth in some of the smaller countries of the region has been supported by strong remittance inflows as well as recoveries from natural disasters (including the December 2004 tsunami in Sri Lanka and the Maldives, and floods in Bangladesh).

India, the largest economy in the region, led the way with GDP expanding by an estimated 8.7 percent in 2006—backed by nonagricultural growth in excess of 10 percent. Very low real interest rates combined with an improved business climate and rising household savings have enabled higher investment rates, helping to sustain stronger growth. Elsewhere in the region, growth was less rapid but nevertheless robust at 6.5 percent. Output in Pakistan is estimated to have slowed from 7.8 to 6.6 percent, following a return to more normal agricultural production in the wake of a bumper harvest in 2005. In Bangladesh, growth rebounded owing to stronger remittance inflows and the waning impact on agricultural output and incomes from last year's floods, and by vibrant services and manufacturing sector output. Economic activity in Nepal slowed because of the intensified conflict, a weather- related decline in agricultural production, and a trend decline in clothing exports. In Sri Lanka growth picked up to an estimated 7 percent, thanks to a good harvest, post-tsunami recovery, and reconstruction activity (including tourism, despite increased political uncertainty). Bhutan's GDP