MIDDLE EAST AND CENTRAL ASIA DEPARTMENT

Navigating Economic Challenges in the MENA Region: A conversation with Jihad Azour

Kuwait, January 2024

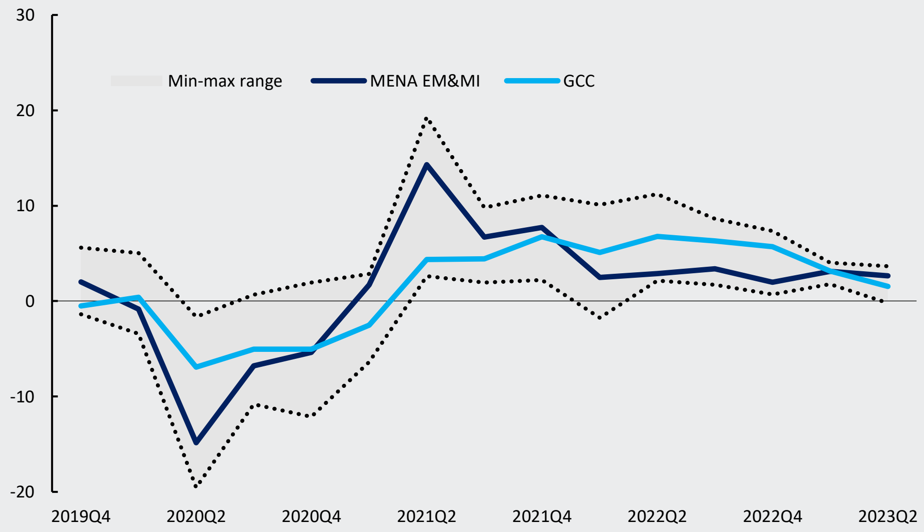
RECENT DEVELOPMENTS

Before the conflict, growth in MENA was slowing in 2023 amid declining inflation …

Growth has slowed across the region…

MENA EM&MI and GCC: Real GDP Growth

(Year-over-year percent change)

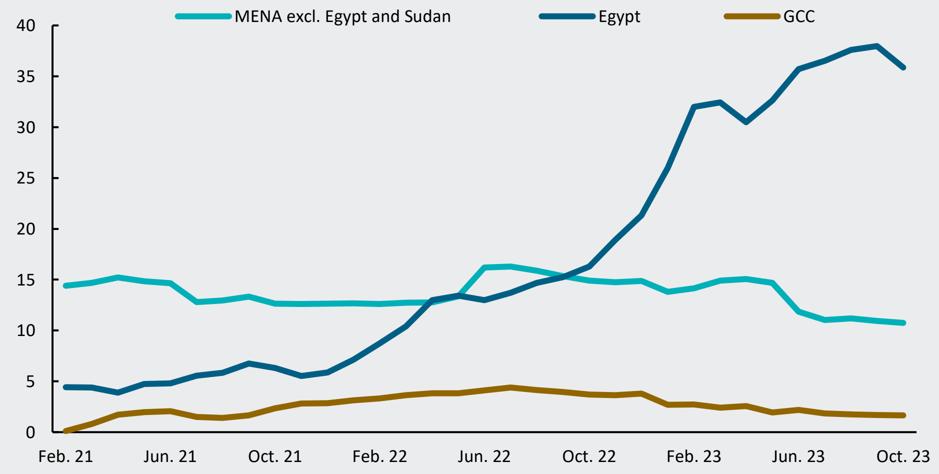


Sources: Haver Analytics; and IMF staff calculations.

…And inflation has declined, but remains high in some countries

MENA: Headline Inflation

(Percent change, year-over-year, weighted average)



Sources: Haver Analytics; national authorities; and IMF staff calculations.

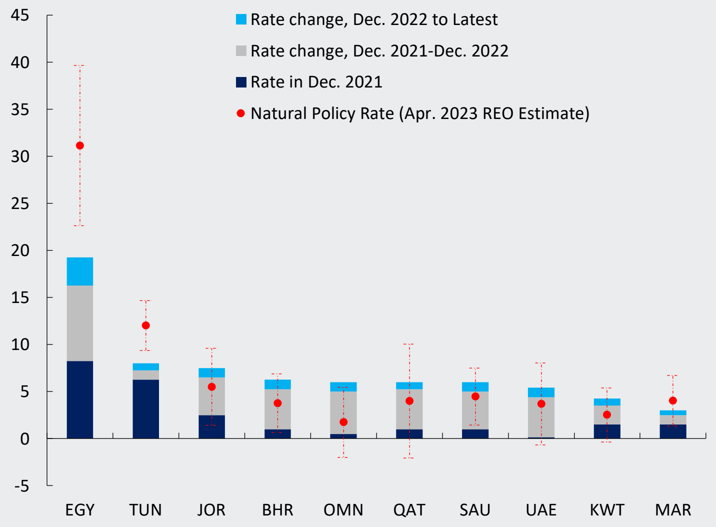
Financing conditions were generally tight

Policy rates continued to rise 2023, albeit at a slower pace

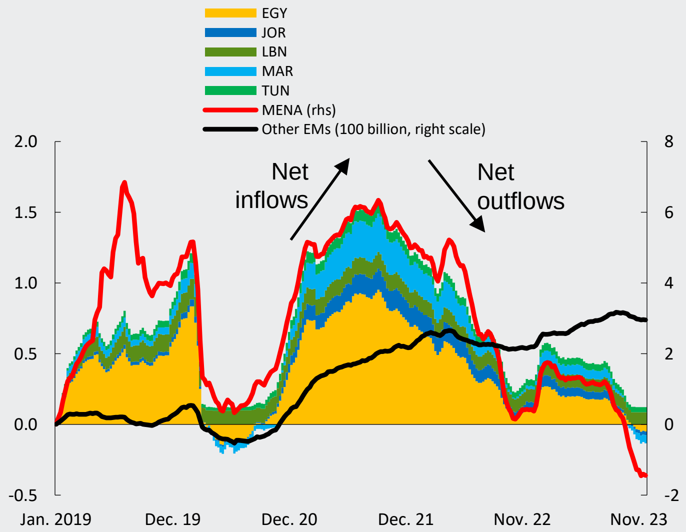
The global financial turmoil in March prompted a resurgence in capital outflows…

…and spreads have widened for some countries, with significant differentiation

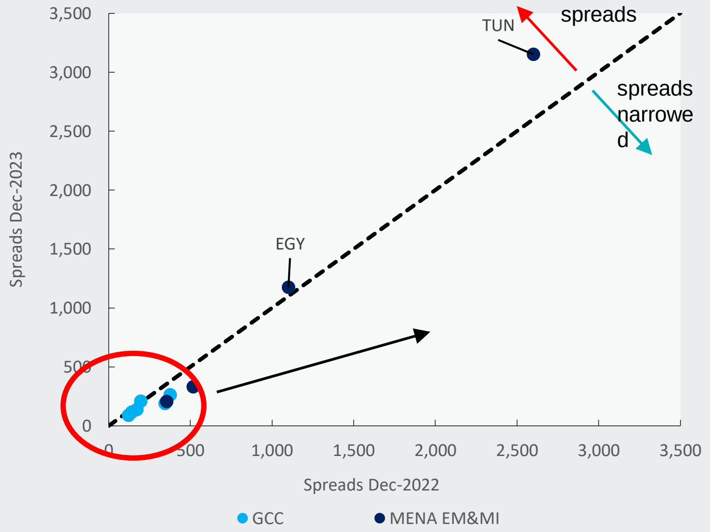
MENA: Policy Interest Rates
(Percent)



Portfolio Flows to MENA
(Billions of US dollars; cumulative flows since Jan. 2019)



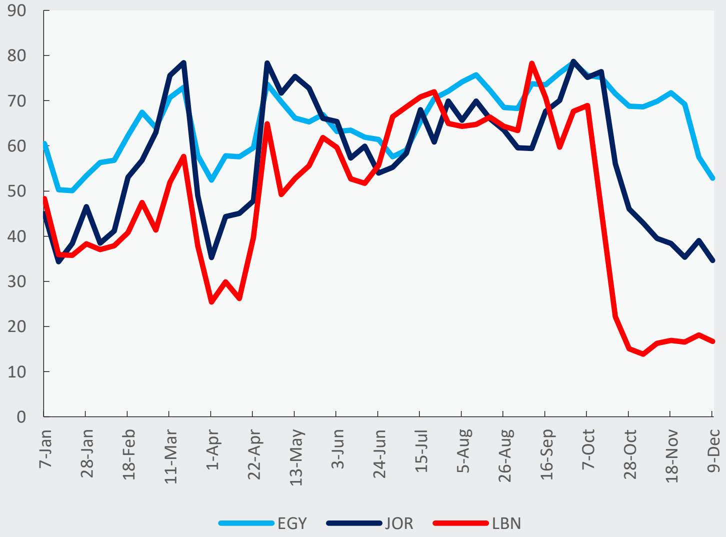
JP Morgan EMBIG Spreads
(basis points)



The conflict in Gaza has had adverse impact on neighboring economies, in particular, on their tourism sectors

Countries highly dependent on tourism could be at risk amid travel concerns

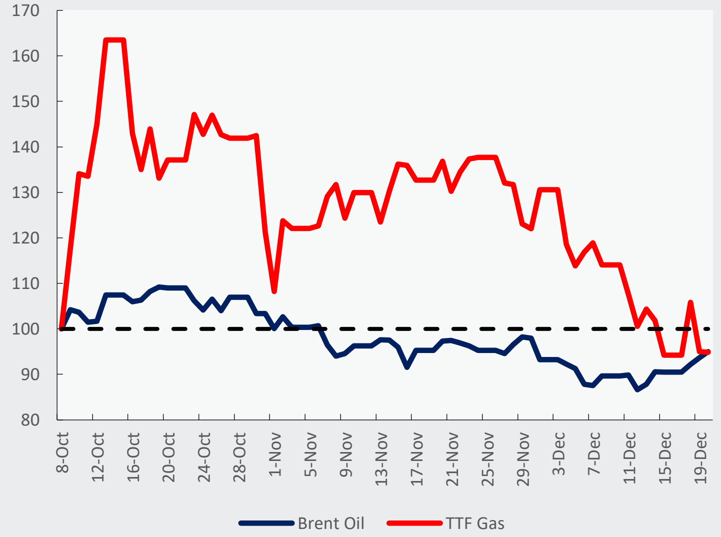
Hotel Occupancy Rates
(percent of services and goods exports)



Source: Smith Travel Research and IMF Staff Calculations

Oil and gas prices increased at the onset of the crisis but have since stabilized …

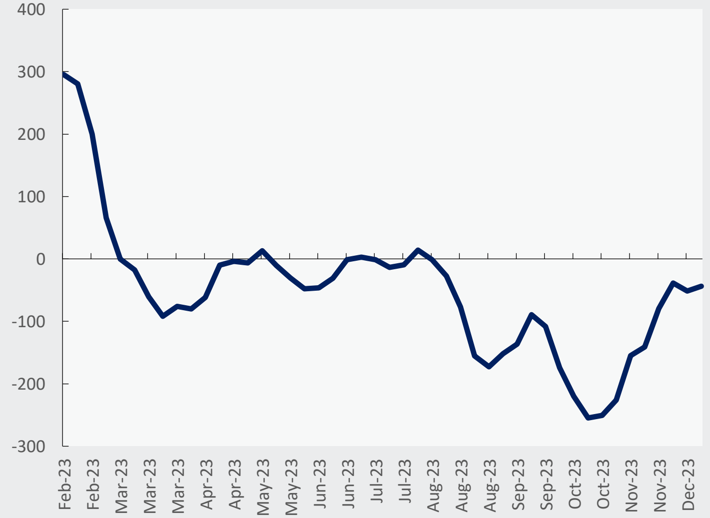
Oil and Gas Prices
(Index; Oct-6th, 2023 = 100)



Source: Bloomberg Finance L.P

…while capital outflows have reverted to pre-conflict levels

MENA Net Equity and Debt Portfolio Flows
(Million USD; 4-weeks moving average)



Source: Haver Analytics; EPFR; and IMF Staff Calculations

The full impact on Broader MENA is highly dependent on geopolitical developments and individual country resilience

BROADER IMPACT

GCC	MAGHREB COUNTRIES	FRAGILE AND CONFLICT STATES

Tourism

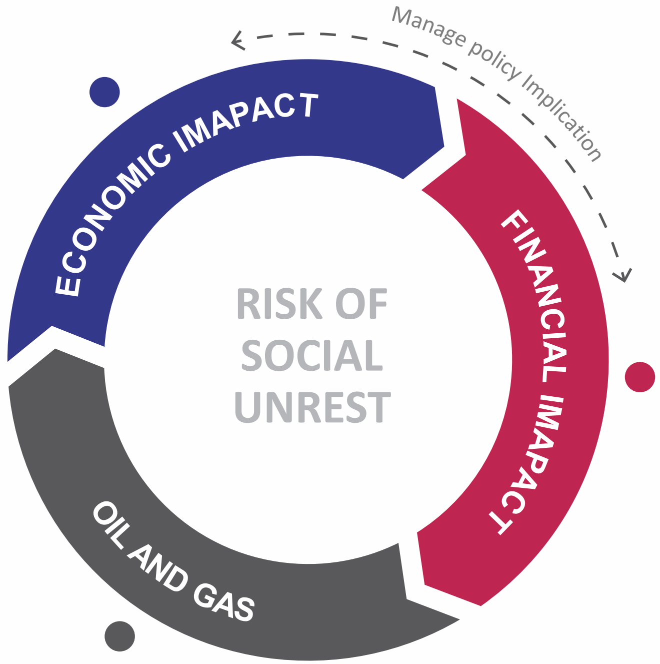
- So far, no evidence of falling tourism beyond Egypt, Jordan, and Lebanon. Tourism accounted for between 5 to 20 percent of GDP across countries in the region prior to the pandemic

Trade

- No reported disruption in trade or substantial increase in transportation cost

Investments

- No major development since the outbreak of the crisis.



Financial Markets and Sovereign Borrowing

- Sovereign spreads increased in Jordan (+120 bps), Lebanon(+3205 bps) and Iraq (+258 bps).
- CDS spreads have also slightly raised across all countries.
- Egypt issued 1bn USD-equivalent in CNY and JPY local currency bonds in the past month

Forex Markets

- FX markets in the region have been broadly stable after an initial decline at the onset of the conflict.

Oil and Gas Markets

- Spot Brent prices peaked 12 days after the start of the conflict to $92 a barrel, while falling to about $87 a barrel
- Suspension of gas production in the Tamar field has minor impact on international prices (0.5 percent of global production)

Potential risk of disruption – Magnitude will depend on the duration and scale of supply disruptions. Given the large spare capacity and ample strategic reserves (42 percent of world’s oil exports and 13 percent of world’s natural gas exports) disruptions could be short-lived.

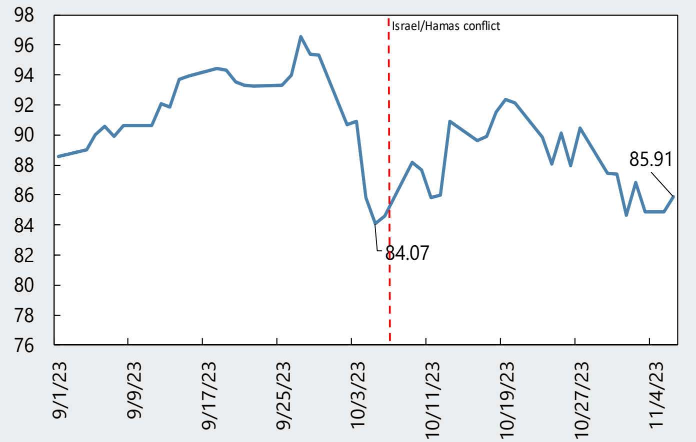
The impact on oil markets is limited so far, but several channels could operate in case of escalation

Oil prices have fallen back to pre-conflict levels

Supply can be affected by several incidences (sanctions, Strait of Hormuz tensions, or attacks on oil facilities, etc.)

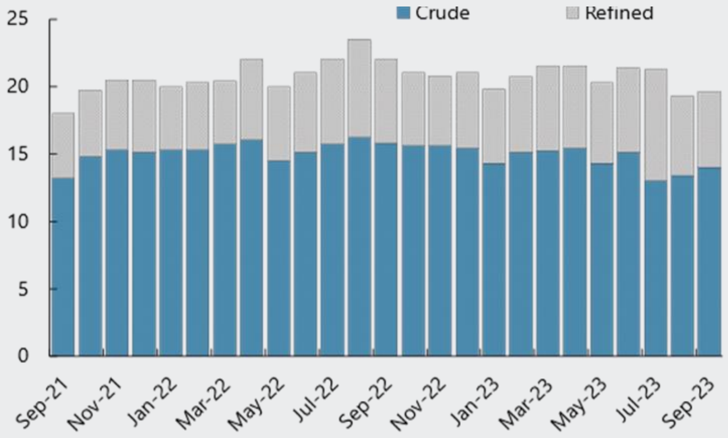
But the region has large spare capacity to offset a temporary shortfall

Brent Oil Price
(USD per barrel, 1st month future)



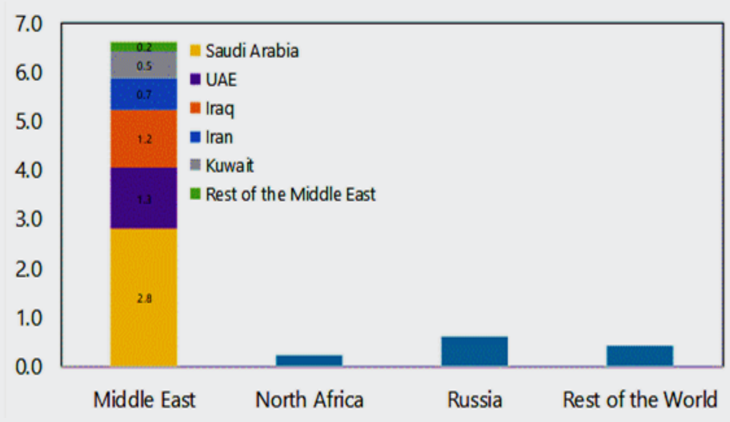
Source: Bloomberg

Oil Passing Through the Strait of Hormuz
(Daily, million barrels)



Source: Vortexa

World Crude Oil Production Spare Capacity
(Million barrels per day, as of Oct 2023)



Source: Bloomberg LP; and IMF staff calculations

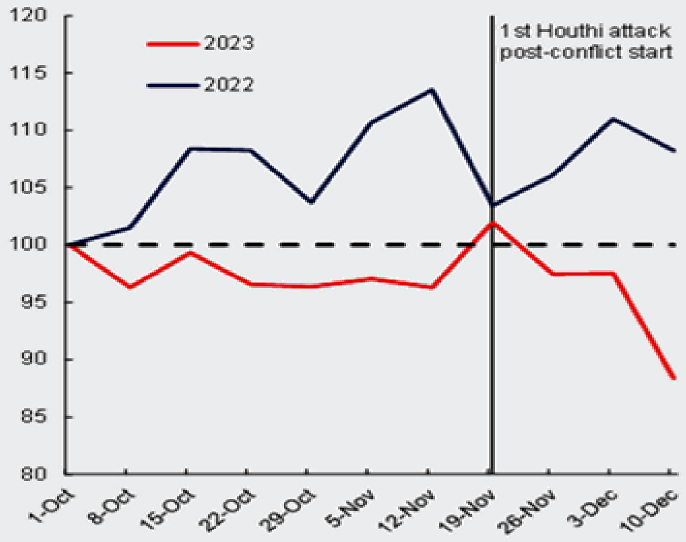
Prolonged disruptions to trade in the Red Sea could significantly impact several Middle East economies and global trade

Oil prices have fallen back to pre-conflict levels

Security situation in the Red Sea poses risks to global supply chains and commodity trade

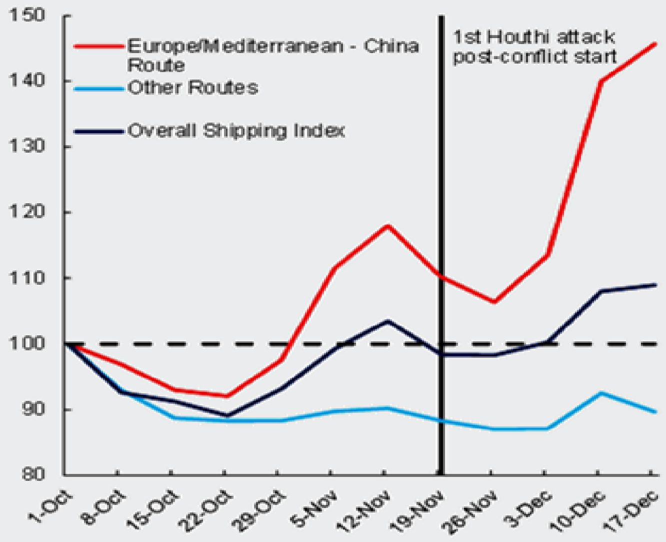
Red Sea serves as a vital route for international trade and the transportation of hydrocarbons, and other essential commodities

Suez Canal Trade Volumes
(Index)



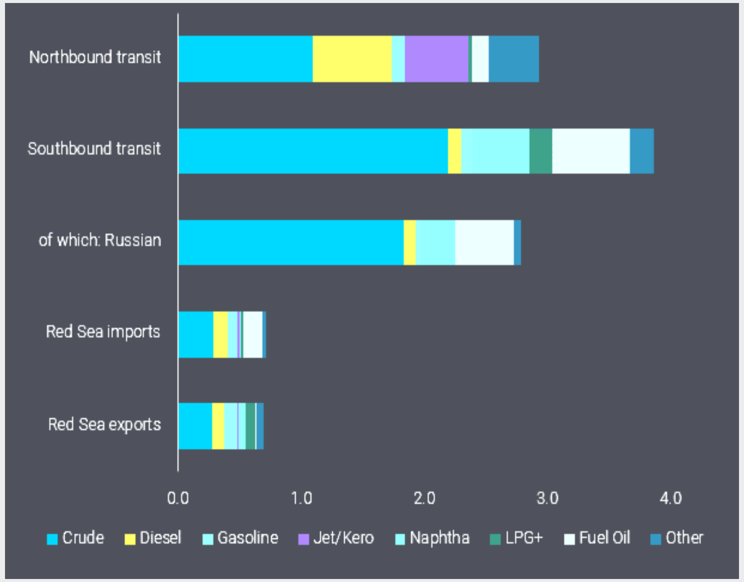
Source: Portwatch and IMF staff calculations.
Note: Post-conflict start refers to the start of the conflict in Gaza and Israel in October 2023.

Freight Container Prices
(Index)



Source: Bloomberg Finance L.P and IMF staff calculations.
Note: Post-conflict start refers to the start of the conflict in Gaza and Israel in October 2023.

Overview Red Sea/Bab el Mandeb oil transit volumes
(mbd, 2023 average)



Source: Haver Analytics; EPFR; and IMF Staff Calculations

OUTLOOK AND RISKS

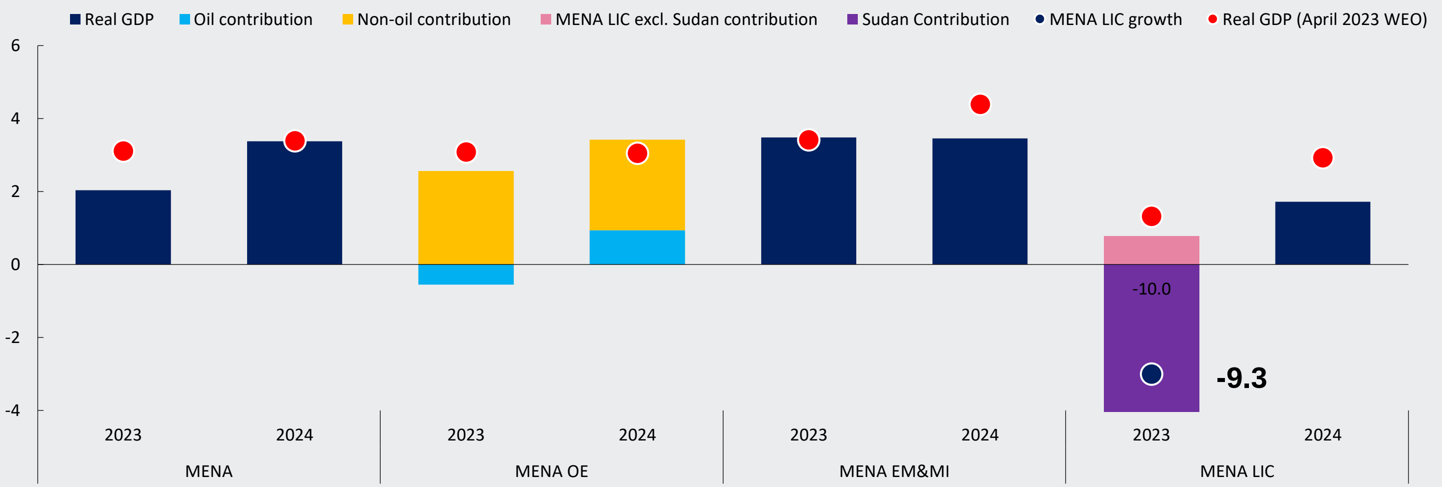
MENA Growth is expected to strengthen in 2024 and inflation to decline amid uncertainty and risks of spillovers

MENA growth is expected to slow down this year, before a slight improvement next year

Inflation is set to peak in 2023 in most MENA countries and decline thereafter, but differences persist

MENA: Real GDP Growth

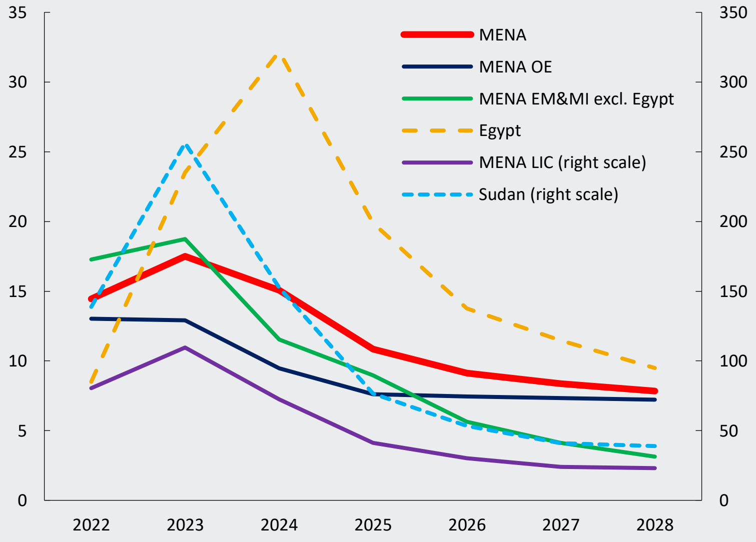
(Percent change, year-over-year)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

MENA: Headline Inflation

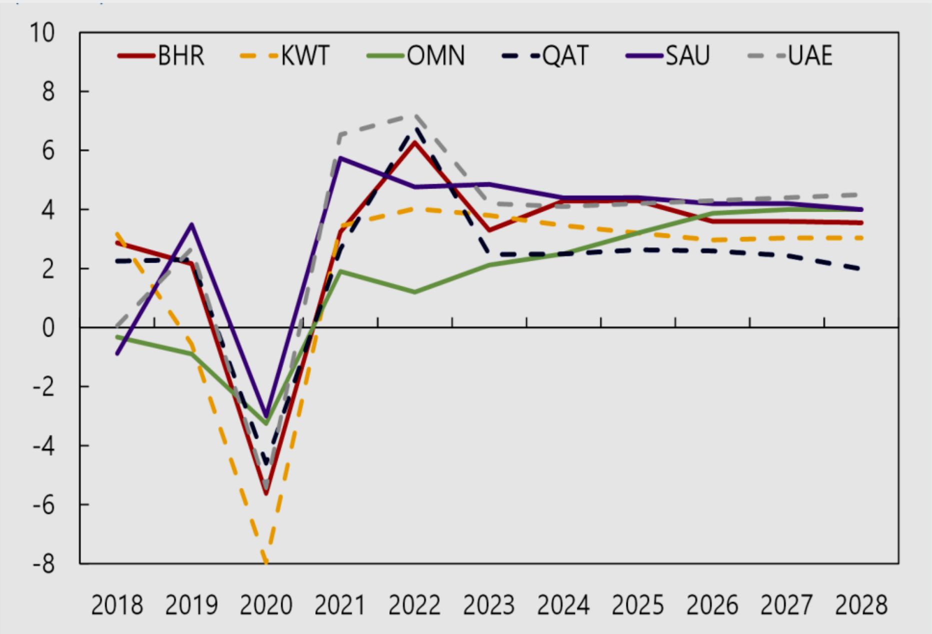
(Year-over-year percent change, weighted averages)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

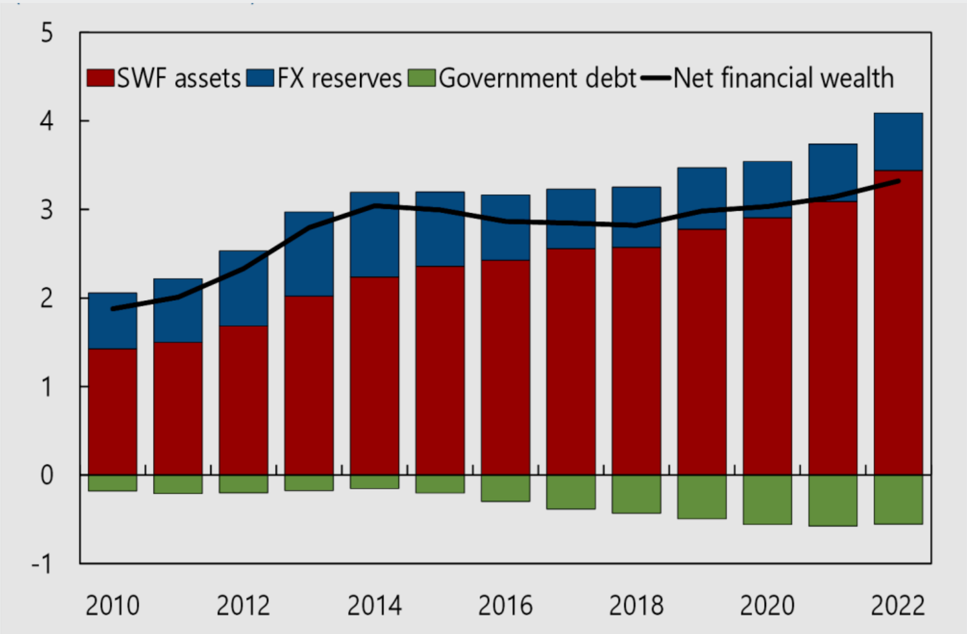
GCC short-term outlook is positive, given robust non-hydrocarbon growth and high Public net financial wealth

GCC Real Non-Hydrocarbon GDP Growth (Percent)



Sources: National authorities and IMF staff projections.

GCC Public Net Financial Wealth
(Trillions of 2018 US$)



Sources: National authorities and IMF staff estimates.

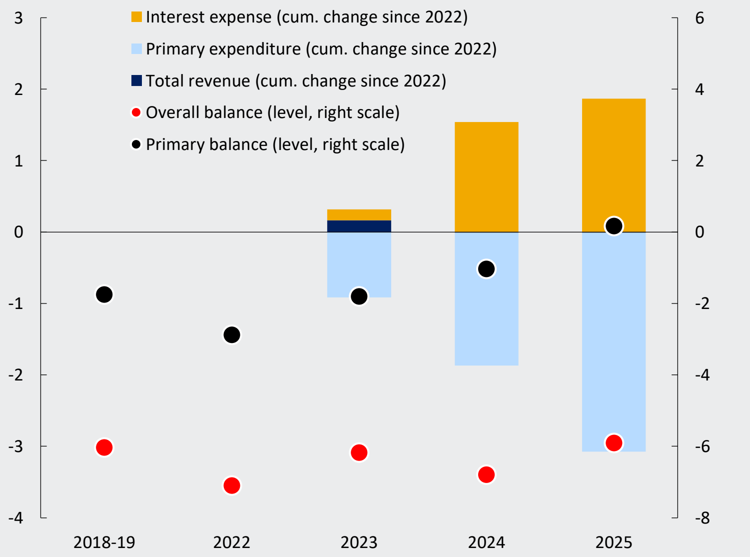
Elevated debt levels pose financing challenges in MENA EM&MIs

Sizable consolidation amid limited policy space

Financing needs have increased…

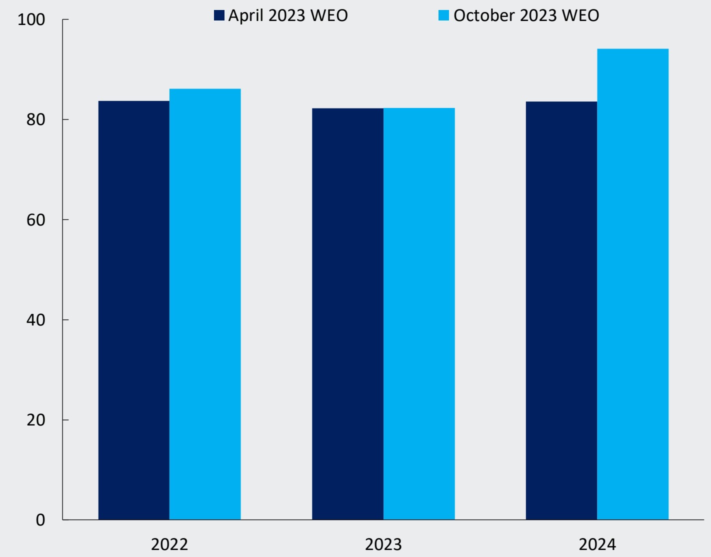
…and rising interest rate expenditures are exacerbating debt pressures

MENA EM&MI: Overall and Primary Fiscal Balances
(Percent of GDP)



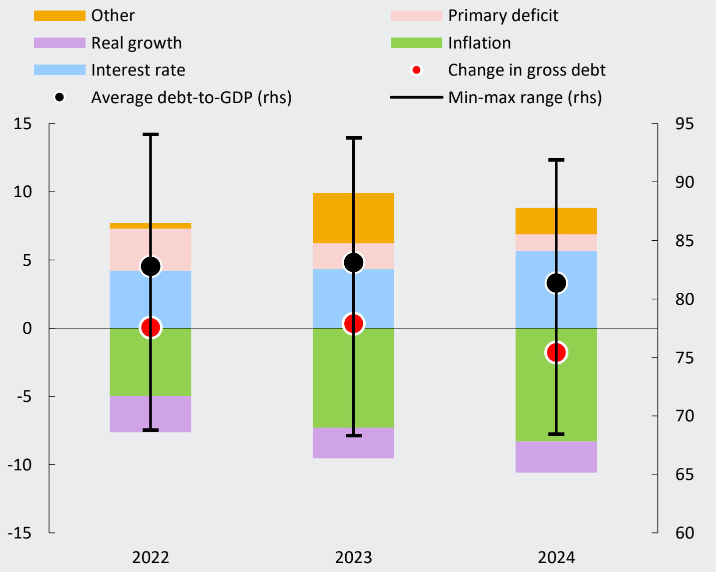
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Overall and primary balances and total revenues exclude grants.

MENA EM&MI: Gross Financing Needs
(Percent of fiscal revenues; simple averages)



Sources: IMF, *MCD REO*; and IMF staff calculations.
Note: MENA EM&MI include Egypt, Jordan, Morocco, and Tunisia.

MENA EM&MI: Contributions to Changes in Gross Public Debt-to-GDP Ratios
(Percentage points)

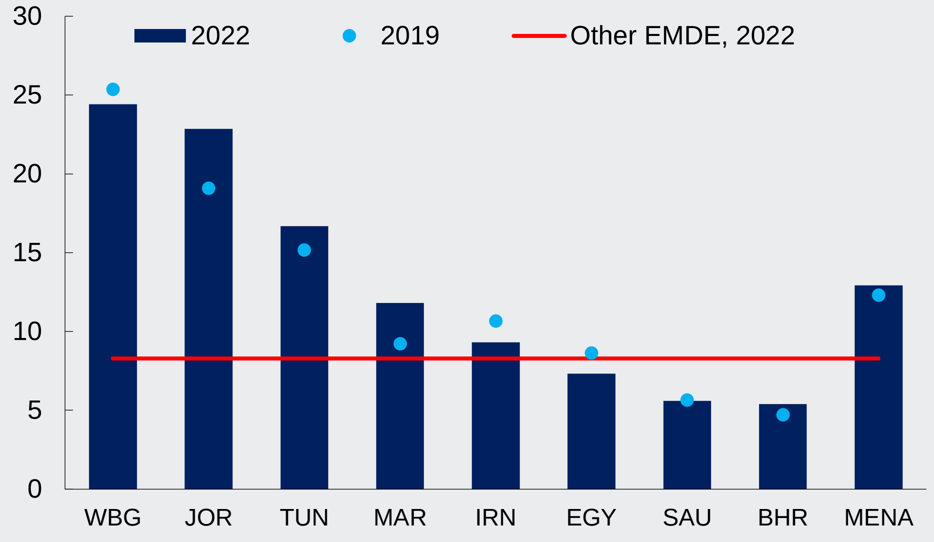


Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: "Other" includes contributions from the exchange rate, grants, and other flows.

In addition, long-standing challenges persist, leading to high unemployment and subdued productivity

Long-standing labor market challenges

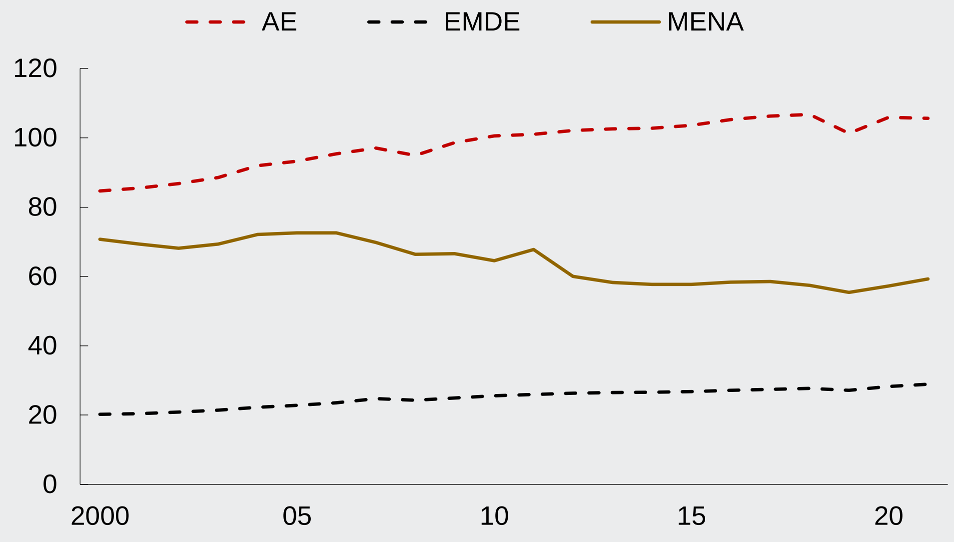
MENA: Unemployment Rate
(Percent)



Source: IMF, World Economic Outlook; and IMF staff calculations.

Limited progress on implementing structural reforms weighs on productivity

MENA: Labor Productivity
(GDP per person employed, thousands)

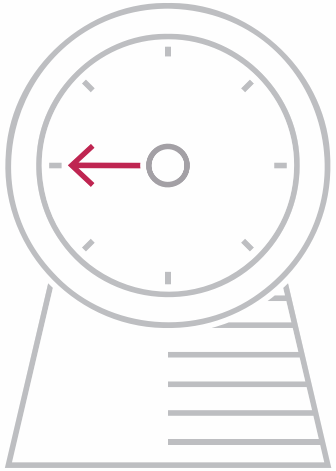


Source: World Bank, World Development Indicators, ILOSTAT; and IMF staff calculations.

The balance of risks remains tilted to the downside

DOWNSIDE RISKS

- Deeper slowdown in China
- Escalation of conflict in Gaza and Israel
- Tighter-for-longer global financial conditions and debt distress risks
- Deterioration of the crisis in Sudan
- Worsening of geoeconomic conditions
- Recurrent climate shocks



UPSIDE RISKS

- Stronger-than-projected global growth
- Faster-than-anticipated decline in inflation

POLICY PRIORITIES

Policymakers must accelerate structural reforms to enhance growth, inclusion, and resilience to shocks, while deploying macro policies to safeguard stability

Crisis Response

Where the economic impact is acute, prudent crisis management and precautionary policies will be critical; elsewhere, it is key to not lose sight of the reform agenda

→ **Stability**

Structural Policies

- Improve governance & level the playing field
- Improve social protections
- Invest in education & digitalization
- De-carbonization, while ensuring energy security

→ **Recovery**

Macro & Conjunctural Policies

- Monetary policy: remain focused on ensuring price stability
- Fiscal policy: EM&MIs to continue consolidation; Oil exporters to improve fiscal buffers; all countries to strengthen medium-term frameworks
- LICs/FCS to maintain or reestablish stability, mitigate food insecurity & seek international assistance

→ **Resilience**

Structural reforms offer a way to build resilience and bolster growth both in the near and longer terms

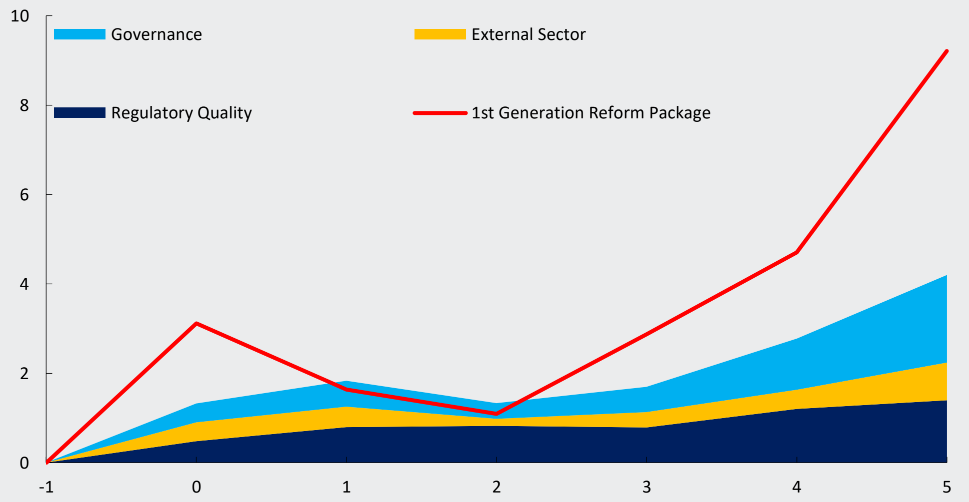
Structural reforms can lift output significantly, even when growth is low and policy space is limited…

ME&CA: Output Effects of Reforms after 5 Years
(Percent)

Source: IMF, World Economic Outlook, World Bank, Fraser Institute, and IMF staff calculations.
Note: The blue bars reflect average impacts following major historic reforms (2 standard deviations) and the red lines are 95 percent confidence intervals.

…and strategic packaging of reforms can further amplify their benefits

ME&CA: Output Effects of First-Generation Reform Package
(Percent)



Sources: IMF, World Economic Outlook, World Bank, Fraser Institute, and IMF staff calculations.
Notes: The scale of the x-axis is years, where t=0 is the first year of the reforms are implemented. The red lines denote the response to a major historical first-generation reform package—defined as the sum of one-third of a major historical reform (two standard deviations) on its three components. The stacked areas denote the responses to one-third of a major historical reform (two standard deviations) on the three components of the first-generation reform package, namely governance, trade, and product market, when implemented individually.

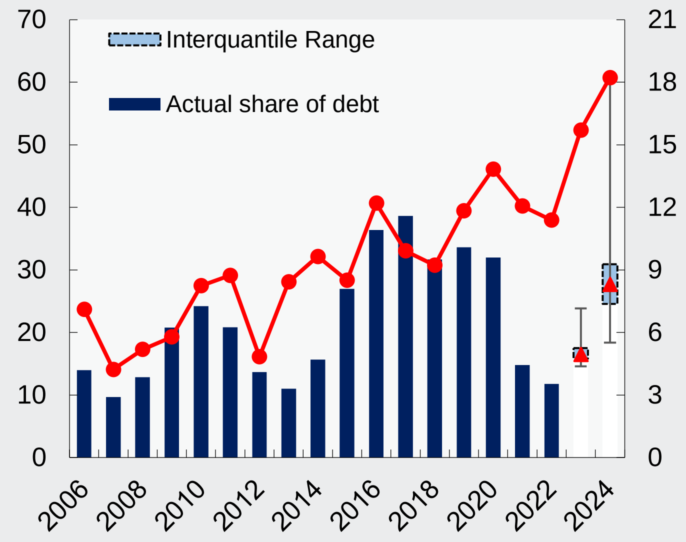
Higher-for-longer interest rates call for strong policies to preserve financial stability and enhance growth potential

Debt at risk of default could double in the corporate sector…

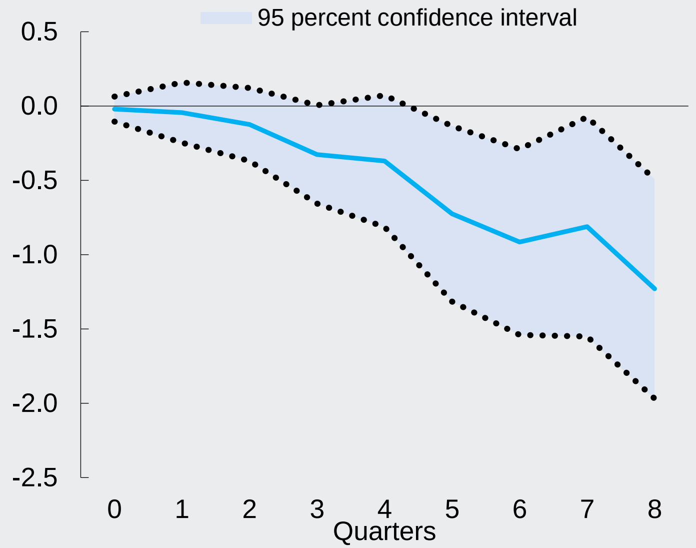
…and some banks could face losses, hampering credit provision…

…and weighing on output

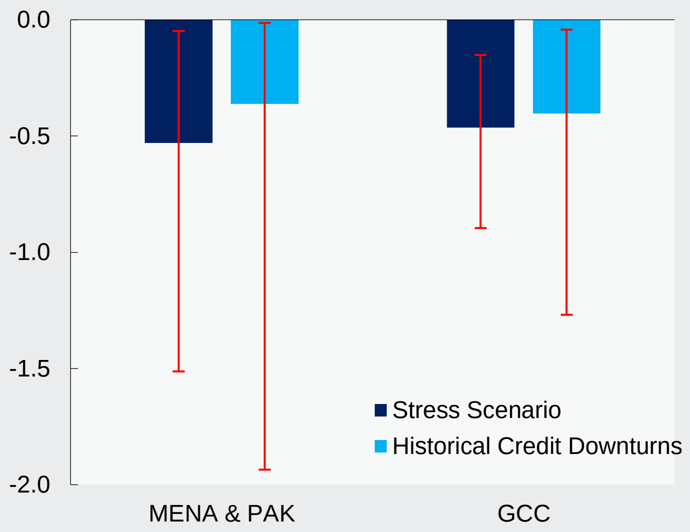
Total Debt Held by Zombie Firms
(Percent of total)



Effect of 1 Percentage Point Lower Capital Ratio on Real Credit
(Percent)



Effect of Real Credit Contraction on Real Output
(Percent)



Sources: S&P Capital IQ; and IMF Staff Calculations
Notes: Data for 2023 and 2024 are simulation results. Zombie firms are defined as firms with an ICR below 2.5 and borrow at a rate lower than the top rated firms.

Sources: Fitch Connect; and IMF staff calculations.

Sources: International Financial Statistics; and IMF staff calculations. The output losses displayed reflect the median and 95th percentile of losses across countries in each subregion for a stress scenario (dark blue bars) and historical downturns (light blue bars). The confidence intervals around these estimates are displayed in red.

THANK YOU