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Times of economic crisis in the MENA region

Marek Dabrowski
Non-Resident Fellow at Bruegel, Professor at the Higher School of Economics in Moscow, Fellow at CASE – Center for Social and Economic Research
Marta Domínguez-Jiménez
Research Analyst, Bruegel

In the second half of the 2010s, the economic situation in the Middle East and North Africa (MENA)[1] deteriorated as a result of lower oil and other commodity prices, a new round of domestic political instability, continuous intra-regional conflicts, stalled economic and governance reforms and, finally, the COVID-19 pandemic. The deteriorating macroeconomic trends manifested themselves in slower growth rates (which in 2020 turned negative almost everywhere), worsening fiscal and external balances, increasing public debt and, in several cases, higher inflation. There has been no visible progress in resolving long-term structural and institutional challenges such as high unemployment, especially among youths, low female labour market participation, poor quality of education, costly and ineffective public sector activity, high military and security spending, high energy subsidies and others.[2] Our analysis will be divided into three parts: the macroeconomic situation before the COVID-19 pandemic; the direct and indirect impact of the pandemic on the MENA economy; and brief recommendations on anti-crisis policies and reforms.

THE MACROECONOMIC SITUATION IN THE PRE-PANDEMIC PERIOD

The growth of real GDP, which was slower after the global financial crisis of 2008-2009, further decelerated in the second half of the 2010s (see the first table on the next page). One may distinguish between two broad categories of countries: (i) those directly affected by high-intensity conflicts (Iraq, Libya, Syria and Yemen) and international sanctions (Iran), and (ii) the others. The first category experienced high growth volatility determined by the changing intensity of conflict and sanctions, and fluctuation in oil and natural gas prices (data for Syria is missing).

The second category is very heterogeneous: it includes both net oil exporters and importers, countries belonging to all income groups, countries that enjoy relative political stability and those suffering from internal political tensions and low-intensity conflicts. Nevertheless, with few exceptions (Djibouti, Egypt), growth rates were low and declining everywhere, in some cases (Sudan, Lebanon) already becoming negative before 2020.

As a result, due to high population growth rates, GDP per capita was either stagnating or declining long before the pandemic. This may not be an existential challenge for the high-income Gulf monarchies but it is certainly a challenge for a large group of lower-middle and low-income countries. The situation was particularly dramatic for the poorest countries like Somalia, Mauritania and Yemen.

73% Inflation in Sudan in 2018

Slow growth is also insufficient to generate enough jobs for the rapidly growing labour force and to eradicate poverty. This appears evident in the second table on the next page: little improvement if any has been recorded in total unemployment figures in low- and middle-income countries. High-income Gulf countries, which import a lot of labour from Asia and other MENA countries, are exceptions. Female and youth unemployment rates look even worse, with very few exceptions (Bahrain, Qatar and the UAE).

MENA REGION: A DECELERATING GDP

Annual growth of real GDP %, 2015-2020

Country	2015	2016	2017	2018	2019	2020[a]	2020[b]
Algeria	3.7	3.2	1.3	1.4	0.7	-5.2	
Bahrain	2.9	3.5	3.8	2.0	1.8	-3.6	
Djibouti	7.7	6.7	5.4	8.4	7.5	1.0	
Egypt	4.4	4.3	4.1	5.3	5.6	2.0	2.0
Iran	-1.6	12.5	3.7	-5.4	-7.6	-6.0	-6.0
Iraq	2.5	15.2	-2.5	-0.6	3.9	-4.7	
Jordan	2.6	2.1	2.1	1.9	2.0	-3.7	
Kuwait	0.6	2.9	-4.7	1.2	0.7	-1.1	
Lebanon	0.2	1.5	0.9	-1.9	-6.5	-12.0	
Libya	-13.0	-7.4	64.0	17.9	9.9	-58.7	
Mauritania	5.4	1.3	3.5	2.1	5.9	-2.0	
Morocco	4.6	1.0	4.2	3.0	2.2	-3.7	
Oman	4.7	4.9	0.3	1.8	0.5	-2.8	
Qatar	3.7	2.1	1.6	1.5	0.1	-4.3	
Saudi Arabia	4.1	1.7	-0.7	2.4	0.3	-2.3	-6.8
Somalia	3.5	2.9	1.4	2.8	2.9	-2.5	
Sudan	1.9	3.5	0.7	-2.3	-2.5	-7.2	
Tunisia	1.2	1.2	1.9	2.7	1.0	-4.3	
UAE	5.1	3.1	0.5	1.7	1.3	-3.5	
Yemen	-28.0	-9.4	-5.1	0.8	2.1	-3.0	

red font indicates IMF staff estimates or forecasts.

2020[a]: April 2020 forecast; 2020[b]: June 2020 forecast

A RAPIDLY GROWING LABOUR FORCE, NOT ENOUGH JOBS

Unemployment total, female and youth (15-24), % of labor force, modelled ILO estimate, 2015-2019

	Total unemployment			Female unemployment			Youth unemployment		
Country	2015	2017	2019	2015	2017	2019	2015	2017	2019
Algeria	11.2	12.0	11.7	16.7	21.1	21.1	29.7	29.6	29.5
Bahrain	1.1	0.7	0.7	3.7	2.8	3.0	5.3	3.9	4.6
Djibouti	10.6	10.4	10.3	10.8	10.5	10.4	20.9	20.8	20.8
Egypt	13.1	11.7	10.8	24.9	23.1	22.1	34.3	32.9	31.1
Iraq	10.7	13.0	12.8	22.2	31.0	30.4	21.4	25.5	25.1
Qatar	0.2	0.1	0.1	0.9	0.6	0.4	0.6	0.5	0.4
Oman	3.6	3.0	2.7	13.2	12.4	11.9	15.0	13.4	13.2
Iran	11.1	12.1	11.4	19.5	19.9	18.6	25.9	28.0	27.4
Jordan	13.1	15.1	14.7	22.7	24.0	23.3	30.9	35.4	35.0
Lebanon	6.4	6.2	6.2	10.4	10.1	9.9	17.7	17.4	17.6
Kuwait	2.2	1.8	2.2	4.7	4.8	5.5	15.3	13.7	15.8
Mauritania	9.8	9.6	9.5	12.2	12.0	12.1	15.1	14.8	14.8
Morocco	9.5	9.2	9.0	10.4	10.7	10.4	20.9	22.3	22.1
Saudi Arabia	5.6	5.9	5.9	21.7	20.3	22.1	29.2	26.9	28.6
Somalia	11.6	11.4	11.4	11.4	11.1	11.1	17.5	17.1	17.0
Sudan	17.3	17.1	16.5	30.0	29.5	27.8	32.6	32.4	31.4
Tunisia	15.2	15.4	16.0	22.4	23.1	23.4	34.2	34.8	36.3
UAE	1.9	2.5	2.3	4.7	7.1	6.0	6.5	7.9	7.3
Yemen	13.4	13.2	12.9	25.3	25.5	24.9	24.6	24.4	24.0
MENA	10.1	10.2	9.8	18.2	18.6	18.1	27.0	27.4	26.9

Data: IMF World Economic Outlook database; World Bank's World Development Indicators

LEND AND BORROW

General government net lending/borrowing, % of GDP

Country	2015	2016	2017	2018	2019
Algeria	-15.3	-13.1	-6.6	-4.5	-5.1
Bahrain	-18.4	-17.6	-14.2	-11.9	-10.6
Djibouti	-15.4	-8.3	-4.5	-2.8	-0.8
Egypt	-10.9	-12.5	-10.4	-9.4	-7.4
Iran	-1.8	-2.3	-1.8	-1.9	-5.6
Iraq	-12.8	-13.9	-1.6	7.9	-0.8
Jordan	-8.5	-3.7	-3.6	-4.7	-6.1
Kuwait	5.6	0.3	6.3	9.0	4.8
Lebanon	-7.5	-8.9	-8.6	-11.3	-10.7
Mauritania	-2.4	0.1	0.5	3.4	2.8
Morocco	-4.2	-4.5	-3.5	-3.7	-4.1
Oman	-15.9	-21.3	-14.0	-7.9	-7.0
Qatar	4.5	-5.4	-2.9	5.2	4.1
Saudi Arabia	-15.8	-17.2	-9.2	-5.9	-4.5
Sudan	-3.8	-4.5	-6.5	-7.9	-10.8
Tunisia	-5.2	-6.2	-5.9	-4.6	-3.9
UAE	-3.4	-2.8	-2.0	2.0	-0.8
Yemen	-10.0	-9.2	-5.3	-6.7	-3.8

red font indicates IMF staff estimates or forecasts.

Data: IMF World Economic Outlook database

Inflation remained on a one-digit level in most MENA countries except for Sudan, Iran, Egypt, Libya and Yemen where it was two-digit in all or part of the period of 2015-2019. In Sudan, it reached 73% in 2018.

The fiscal situation looks less good. In 2019, all MENA countries except for Kuwait, Mauritania and Qatar ran general government (GG) deficits (see table above). In three cases (Bahrain, Lebanon and Sudan) they exceeded 10% of GDP.

If one compares the fiscal balances in the second half of the 2010s with the ones from ten years earlier, the most striking difference concerns hydrocarbon producers (Algeria and Gulf countries). Once running fiscal surpluses and cumulating them in sovereign wealth funds, since 2014 they started spending massively. Limited increase in oil prices in 2017-2019 allowed them to reduce large fiscal deficits.

Among net oil importers, Egypt, Jordan, Tunisia and Lebanon have made little or no progress in fiscal consolidation even if the first three benefited from International Monetary Fund (IMF) programmes. Fiscal balances in Iraq and Yemen have been affected by a changing intensity of conflicts (there is no data for Libya and Syria). In Iran it has been determined by changes in oil prices and the international sanctions regime.

The deteriorating fiscal accounts unavoidably led to expansion of both gross and net public debt (see table on the next page). While the GG net debt statistics do not cover all analysed countries, they clearly show that since 2015 hydrocarbon producers have depleted their net fiscal reserves.

The GG gross debt-to-GDP ratio increased in most countries between 2015 and 2019, sometimes at a rapid pace. The group of highly indebted countries includes Sudan (over 200% of GDP in 2019), Lebanon (over 150% of GDP), Bahrain (over 100% of GDP), Jordan, Egypt, Mauritania and Tunisia (between 70 and 100% of GDP). The World Bank analysis estimated that 11 MENA countries were already on unsustainable fiscal paths in 2019 (before the pandemic hit). That is, their primary fiscal balances could not stabilise debt-to-GDP ratios.[3]

The situation in Lebanon spun out of control, leading to the country's sovereign default on 7 March 2020.[4] The tragic explosion in the Beirut harbour and the resignation of the government in August 2020 has delayed debt restructuring negotiations and the application for IMF assistance. Default and the lack of a swift anti-crisis response caused a substantial depreciation of the black-market exchange rate of the Lebanese pound an inflation shock.

IMPACT OF THE COVID-19 PANDEMIC

The development of the COVID-19 pandemic meant an additional negative shock to the already stagnant and fragile macroeconomic situation in the MENA region, including the effects of the health crisis and lockdown measures, the temporary interruption of supply chains, a dramatic decline in tourism revenue and labour remittances, and lower oil prices.

The pandemic's effects are hard to forecast but according to the IMF projection of April 2020 (see the first table on the previous page), GDP will fall in every single country in the region except Egypt and Djibouti. Furthermore, the IMF projection updated in June 2020 suggests that the GDP loss for the region in 2020 will be even larger than anticipated in April, for example in Saudi Arabia.

DEBT EXPANSION

Gross and net GG debt to GDP ratio, %

	GG gross debt					GG net debt				
Country	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
Algeria	8.7	20.5	27.3	38.3	46.1	-7.6	13.3	21.6	26.5	37.3
Bahrain	66.0	81.3	88.2	94.7	101.7					
Djibouti	39.9	45.7	47.9	48.0	47.4	38.0	43.7	46.0	47.0	46.4
Egypt	88.5	96.8	103.2	92.7	84.9	78.8	88.2	93.9	81.3	75.4
Iran	38.4	47.5	39.5	32.2	30.7	21.7	34.5	28.9	25.5	27.3
Iraq	56.9	64.3	58.9	49.3	51.1					
Jordan	92.4	93.8	94.3	94.4	94.6	84.9	86.5	88.0	89.7	90.1
Kuwait	4.7	10.0	20.7	14.7	15.2					
Lebanon	140.7	146.1	149.0	151.0	155.1	134.3	140.4	143.4	146.8	151.1
Mauritania	75.2	77.4	75.9	82.9	78.5	73.5	76.3	74.4	79.8	76.2
Morocco	63.7	64.9	65.1	65.0	65.3	63.1	64.4	64.7	64.7	65.0
Oman	15.5	32.7	46.4	53.4	59.9	-22.8	-1.0	13.4	32.2	39.0
Qatar	35.5	46.7	49.8	48.6	53.2					
Saudi Arabia	5.8	13.1	17.2	19.0	23.2	-35.9	-17.1	-7.7	-0.1	6.8
Sudan	92.2	128.4	159.2	212.1	207.0					
Tunisia	55.4	62.3	70.6	77.0	74.4					
UAE	18.7	20.2	20.0	19.1	20.1					
Yemen	65.5	79.6	84.3	64.8	56.3	64.5	78.5	83.3	64.1	55.8

red font indicates IMF staff estimates or forecasts.

Data: IMF World Economic Outlook database

Oil producers were hit by the collapse of oil prices in March 2020, driven both by the fall in global demand and the breakdown of coordination between suppliers (the latter has been partially rebuilt in April 2020, somewhat stabilising prices on the low level).

The deep recession, lower GG revenue and higher expenditure will further deteriorate fiscal balances and debt-to-GDP levels, which may lead to more sovereign defaults in a near future.

At the end of February and early March 2020, the region was hit by broad capital flight; the IMF estimates around $6 to 8 billion of portfolio capital outflows, numbers which they concede may be even larger given the lack of official figures.[5] However, the magnitude of this shock was smaller than in other emerging markets, especially Latin America and the former Soviet Union.[6]

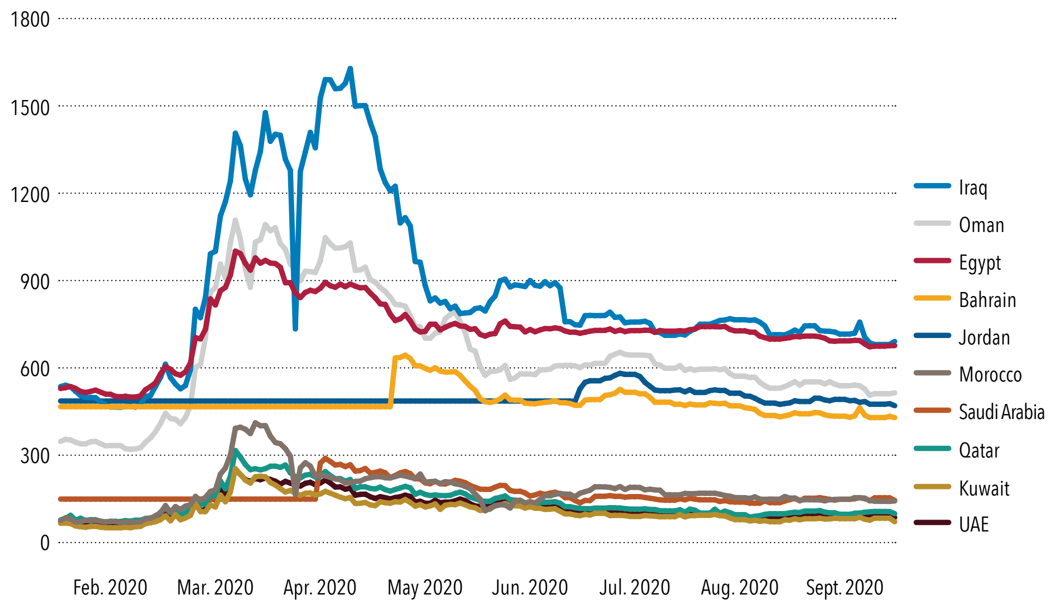
The first figure on the next page presents the spreads between the USD-denominated debt and US Treasuries in selected MENA countries.[7] It shows that, while spreads widened significantly in the first days of the crisis, market confidence has largely recovered in most cases, with spreads nearing their pre-COVID levels. This improvement in market sentiment is partially explained by the significant monetary and fiscal policy response in the developed world, which has loosened global financing conditions. Both countries with a high credit rating (oil producers) and lower credit-rated countries such as Egypt have managed to maintain market access, both with USD denominated and local currency bonds.

$6 to 8 billion Regional portfolio capital outflows (IMF estimate, early 2020)

Depreciation of MENA currencies was modest (except the Lebanese pound) and they largely recovered (sometimes even with a positive margin) after the initial fall in March - April 2020 (see second figure on the next page). However, it should be noted that most MENA currencies are pegged to the USD and no data are available on changes in the international reserves of MENA central banks

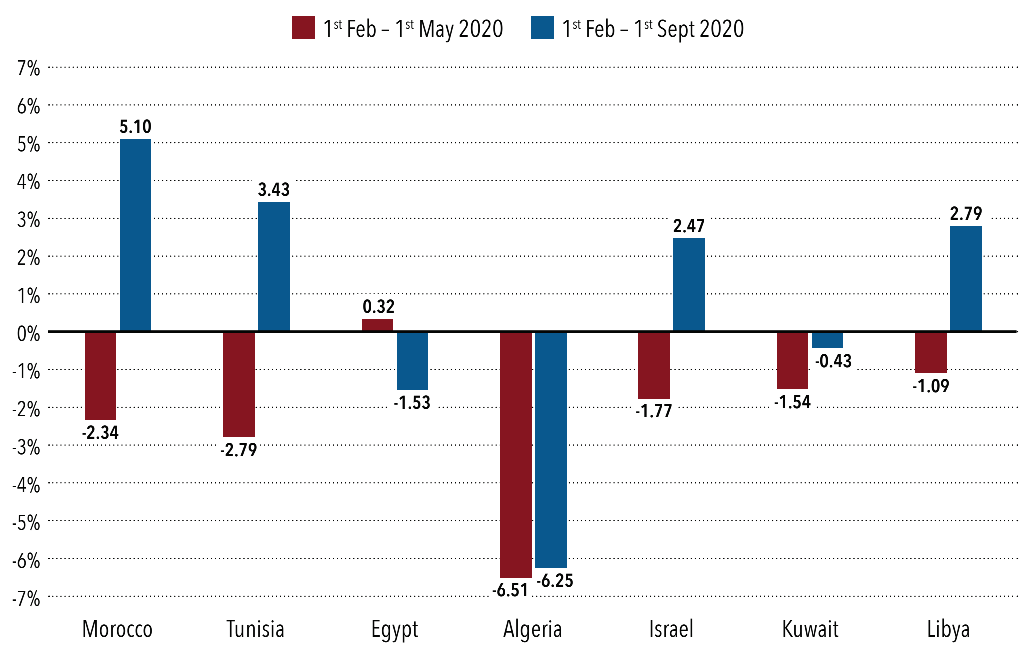
BACK TO PRE-COVID-19 LEVELS

Spread between the sovereign dollar-denominated debt and UST, basis points, Feb. – Sept. 2020



DEPRECIATION AND RECOVERY

Change in value of MENA currencies against the USD, February-September 2020



Data: Bloomberg

in the analysed period. Furthermore, not all MENA currencies are fully convertible.

CHALLENGES AND REFORM PRIORITIES

Dealing with the health emergency is the immediate and most important challenge in the MENA region. Some countries face shortages in medical capacity as well as other related services (e.g., sanitation). The most fragile countries have around 17 million internally displaced persons and close to 3 million refugees, which puts them in a more precarious situation.[8]

Uncertainty will prevail in the coming months. Subsequent waves of the pandemic and the associated containment measures may be an important obstacle to recovery. Hardships and increasing poverty may provoke social unrest in the already politically fragile states.

Reform in the region has been slow in recent years, and since the pandemic started, the priority has shifted towards managing the health and economic shock. In this regard, multilateral assistance has played a significant role, with the IMF at the centre. For example, Egypt, Jordan and Tunisia have received emergency assistance under the Rapid Financing Instrument, while Djibouti and Mauritania have benefited from the Rapid Credit Facility (which includes concessional terms of its servicing). Neither of these instruments include ex-post conditionality. Therefore, it is less likely they will pave the way towards structural reforms (which progressed slowly under the "standard" IMF assistance programs). Morocco has drawn from its precautionary credit line, while the IMF-supported programme in Jordan has been modified and a new Stand-By Arrangement with Egypt was approved.[9]

11 MENA countries that before the pandemic were already on an unsustainable fiscal path

Following recovery, the focus should shift towards rebuilding fiscal buffers, lowering debt and raising international reserves. State-Owned Enterprises (SOE) liabilities present an additional source of vulnerability. For hydrocarbon dependent countries, economic diversification should be a priority, in light of the oil price collapse and the expected progress in "greening" the global economy.

Other structural and institutional obstacles to sustainable, more balanced and socially just economic growth include, among others, bureaucratic barriers to business activity, corruption, poor governance, outdated regulations, trade protectionism, restrictions to foreign investment, limited currency convertibility, underdeveloped infrastructure, poor quality of public services (especially education), social exclusion, and others. They should be removed by comprehensive reform programmes with the support of international donors.

Resolving regional conflicts could also help the economic and social agenda by offering a substantial peace dividend.