

WORLD BANK MIDDLE EAST AND NORTH AFRICA REGION  
**MENA ECONOMIC MONITOR**

**Economic and Social Inclusion to  
Prevent Violent Extremism**



October 2016



WORLD BANK GROUP



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WORLD BANK MIDDLE EAST AND NORTH AFRICA REGION

## **MENA ECONOMIC MONITOR**

# **Economic and Social Inclusion to Prevent Violent Extremism**

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## Abbreviations

AQI	Al Qaeda in Iraq
CFR	Council on Foreign Relations
CNN	Cable News Network
CTC	Combating Terrorism Center
DFID	Department for International Development
e	Estimate
EIA	U.S. Energy Information Administration
ETA	Euskadi Ta Askatasuna (Basque's Fatherland and Liberty)
EIU	Economist Intelligence Unit
EU	European Union
f	Forecast
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GTD	Global Terrorism Database
HDI	Human Development Index
ILO	International Labor Organization
IMF	International Monetary Fund
ISIL	Islamic State in Iraq and the Levant
LTTE	Liberation Tigers of Tamil Eelam
MENA	Middle East and North Africa
NBC	National Broadcasting Company
NDR	Norddeutscher Rundfunk (German public radio and television broadcaster)
OCHA	United Nations Office for the Coordination of Humanitarian Affairs
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
SAMA	Saudi Arabian Monetary Agency
SL	Sendero Luminoso (Shining Path)
SOEs	State Owned Enterprises
UAE	United Arab Emirates
U.K.	United Kingdom
UNHCR	United Nations High Commissioner for Refugees
U.S.	United States
USAID	United States Agency for International Development
VAT	Value Added Tax
WDR	Westdeutscher Rundfunk (German public-broadcasting institution)

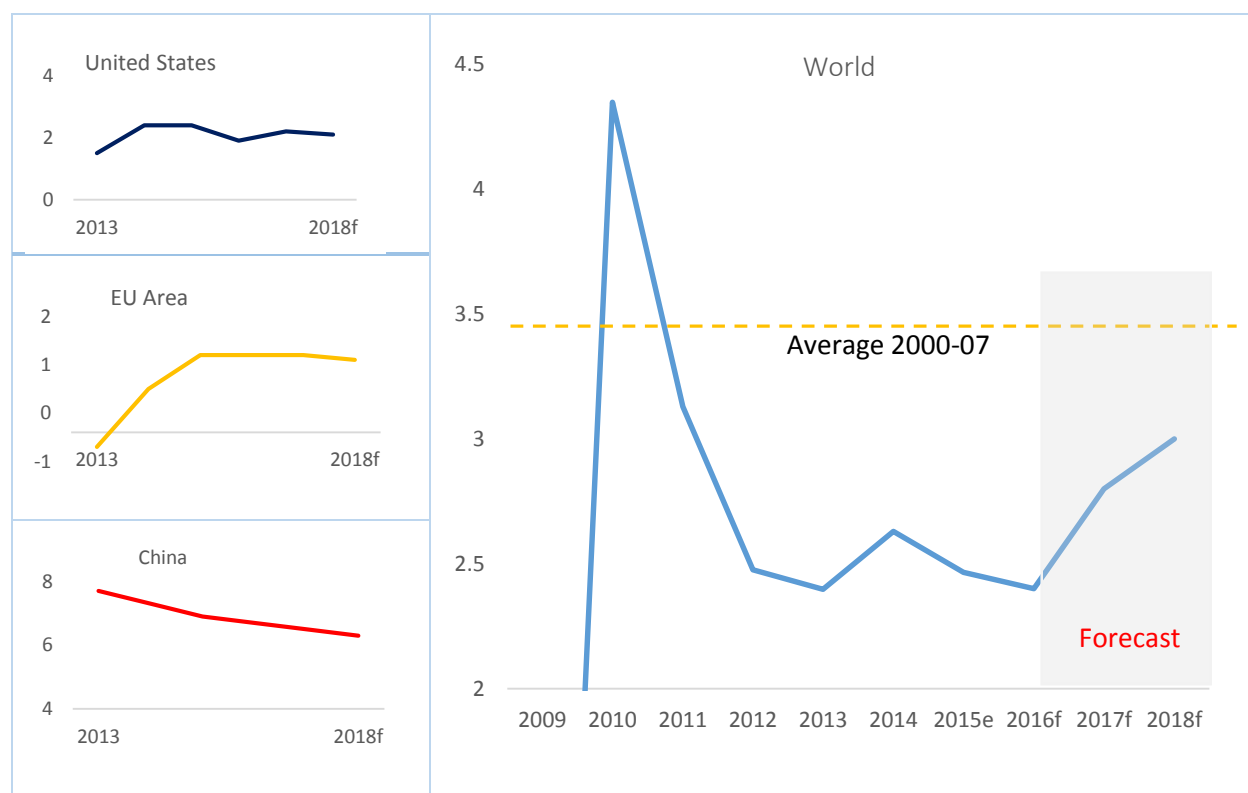


## Recent Economic Developments and Prospects

### Global Outlook

The global economy continues to disappoint, with growth in 2016 projected to remain at last year's 2.4 percent, half a percentage point below the January forecast. This year will be the fifth consecutive year with global growth below its long-term trend of 3.5 percent observed during 2000-07 (Figure 1.1). Many countries are plagued by recession, several others suffer from terrorist attacks and refugee crises, while some are mired in civil wars together with extremely uncertain commodity markets, especially oil. The result has been lower potential output and investment, and weaker demand across the globe. In advanced economies, real growth has remained uncomfortably low, almost one percentage point below the long term average of 2000 to 2007. Growth in the United States (U.S.), the European Union (EU) and Japan is expected to stay around 1.7 percent, half a percentage point slower than expected in January. Among them, growth in the United Kingdom (U.K.), already weak, is expected to fall in 2016 after the historic referendum of June 23, 2016 in favor of leaving the EU. The "Brexit effect"—likely through contraction in investment—is expected to hamper growth in the U.K. and EU in the medium term. Prospects for a rebound are dim, as both services and manufacturing confidence are deteriorating.

Figure 1.1 Real GDP Growth, percent



Source: World Bank.

The emerging markets have also been slowing down despite a decade of extremely fast growth. China's growth is gradually slowing, projected at 6.7 percent in 2016, down from 7.7 percent in 2013. Brazil and Russia are still in recession. All oil exporters are feeling the brunt of persistently low oil prices. Nigeria's and Angola's growth will fall below 1 percent in 2016 from almost 3 percent a year ago. Among Middle East oil exporters, growth in the GCC countries is expected to fall sharply with Saudi Arabia's declining to one percent in 2016 from above 3 percent last year.

The global outlook remains weak with growth expected to stay below the average of 2000-07 for the seventh year in a row. The World Bank projects it to hover around 2.8 percent in 2017, nearing 3 percent in 2018. The slight improvement with respect to 2016 is due to the better-than-expected performance among some advanced economies, particularly the United States which is expected to grow at 1.9 percent in 2018. Within developing countries, recessions in Russia and Brazil are expected to bottom out with growth turning positive starting in 2017. Oil markets are expected to remain over-supplied and, in the absence of a pick-up in demand, prices could remain around \$53-\$60 by the end of the decade.

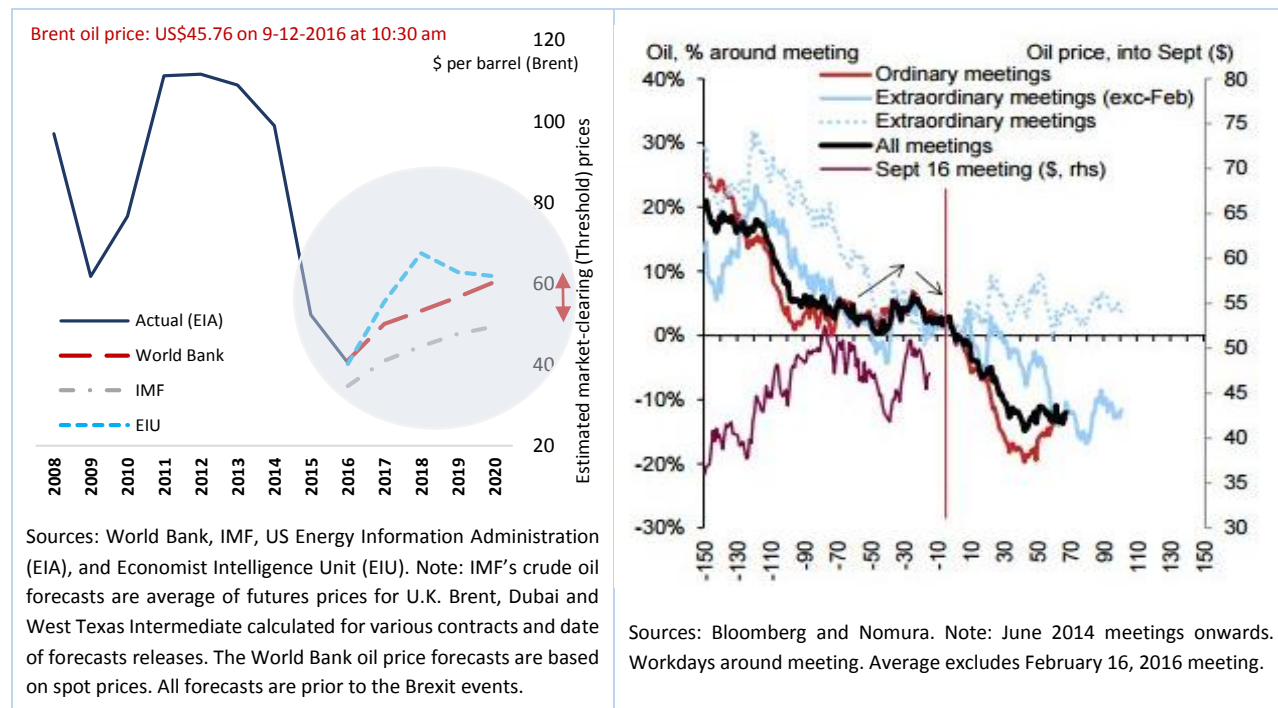
Risks to these projections are mostly on the downside, mainly geopolitical risks that could increase uncertainty, thus dampening investment and growth. Deceleration in major emerging market economies and rising private-sector indebtedness could increase vulnerability in some of these countries. Other major risk factors are a potential slowdown in the EU, particularly the U.K. in the aftermath of Brexit, and persistently low oil prices that could further destabilize the outlook for oil-exporting countries.

## Developments in the Oil Market

The oil market has entered a new normal of low oil prices. A World Bank study ([Devarajan and Mottaghi, 2016](#)) finds that oil markets are expected to work through their current oversupply and rebalance in early 2020 at market-clearing prices that are close to the marginal cost of US shale oil producers. Oil prices are likely to be in the range of \$53 - \$60 a barrel (Figure 1.2, Left panel) because global stockpiles are expected to remain well above historical averages; Iran, Kuwait, United Arab Emirates (UAE) and Iraq are increasing production; Russia and Saudi Arabia, among others, are producing at their highest levels since January 2016; and Libya has lifted restrictions on ports halted a few months ago, unlocking 300,000 barrels a day of supply. In August 2016, production of the Organization of the Petroleum Exporting Countries' (OPEC) crude oil increased by 40,000 barrels per day over July 2016, with Saudi Arabia's output reaching a record high. To lift prices, Russia and Saudi Arabia agreed to freeze oil output ahead of the September meeting of OPEC members and Iran agreed to cooperate on any decision that stabilizes the market. Expectations of a production cap led to a slight rebound of oil prices in early September but failed to lift prices as there is speculation that a consensus to cut production is hard to reach among the members. If the potential output cap deal fails, oil prices could fall further. Historical patterns

show that expectations ahead of OPEC meetings lift oil prices for a few weeks, but fail to hold prices up because members do not keep to their quotas (Figure 1.2, Right panel).

Figure 1.2. Evolution of Oil Prices



Countries that rely on oil for the lion's share of their export revenues are facing a major and long-standing terms of trade shock. In almost all cases, oil prices have remained well below the prices needed to balance their budgets, resulting in large fiscal and external account deficits. OPEC members' net oil export revenues in 2015 was \$404 billion, 46 percent lower than in the previous year, according to U.S. Energy Information Administration (EIA) estimates. Based on EIA price forecasts, OPEC revenue is expected to fall to \$341 billion in 2016 before rising to \$427 billion in 2017.

Among African oil exporters, Nigeria, which relies on oil for 70 percent of its fiscal revenues, needs a price of \$123 a barrel to balance the budget. The situation is even worse for those countries whose primary market for crude oil exports is the U.S., as the shale oil boom has wiped out their exports.<sup>1</sup> These countries, including Angola, Gabon and Nigeria, are facing a sharp drop in export revenues in addition to lower oil prices. The twin effect of lower oil prices and dropping demand from a major importer are reducing their fiscal space. In Latin America, Venezuela and

<sup>1</sup>Though oil is presumed as a commodity that is traded freely, constraints such as crude grade, structure of refineries in oil importers and market share could limit a country's trade prospects with the rest of the world, making them vulnerable to demand shocks.

Brazil have also been hit hard by the crash in commodity prices, pushing their economies into their deepest recession. Oil exporters in the Middle East and North Africa (MENA) region are facing the same problem. Libya and Algeria have been hit by lower oil prices and lower oil demand from the U.S., their major oil trading partner. Some of them have been drawing down their reserves and turning to capital markets. Estimates show that Libya lost two-thirds of its reserves between 2013 and 2016, equivalent to \$75 billion. Algeria lost \$86 billion, and Iraq \$29 billion during the same period.

## MENA Economies

This year appears to be one of the toughest for the region as MENA governments face serious policy challenges. The biggest for oil exporters is managing their finances and diversification strategies with oil below \$45 a barrel (Figure 1.3). Fiscal consolidation in a difficult sociopolitical environment and spillovers from conflicts is creating challenges for oil importers as well. Real GDP growth in MENA for 2016 is projected to fall to its lowest level since 2013, 2.3 percent, lower than last year's growth by half a percentage point and about one percentage point lower than predicted in April 2016.

MENA's weak growth performance is partially attributed to governments' taking austerity measures including cutting capital and current spending to counter lower fiscal revenues in the wake of cheap oil. For example, more than \$20 billion of projects may be canceled in Saudi Arabia this year. This comes at a time when ongoing conflict and war in Syria, Iraq, Libya and Yemen are ravaging these economies and the refugee crisis is draining fiscal space in neighboring countries. Furthermore, private-sector growth, a source of job creation, has been slowing down, making it difficult to absorb the large number of unemployed. The latest labor market data show that the unemployment rate has remained stubbornly high in Egypt, Iran, Iraq, Jordan, Morocco and Tunisia in 2016.

We expect regional growth to improve slightly to 3.1 and 3.5 percent over the next two years, as governments across the region undertake reforms and diversify their economies away from oil. The measures include eliminating fuel subsidies, reducing public-sector jobs and the wage bill, privatizing State Owned Enterprises (SOEs), and diversifying fiscal revenues away from oil through increasing direct and indirect taxes.<sup>2</sup> These reforms, if implemented, are expected to transform at least part of the [old social contract](#) and enhance the overall efficiency of their economies going forward. The regional fiscal deficit is expected to increase to 9.3 percent of GDP in 2016, up by half a percentage point from last year. The regional fiscal surplus of about \$63 billion in 2013 is expected to turn into a deficit of \$320 billion in 2016. All three sub-groups (GCC

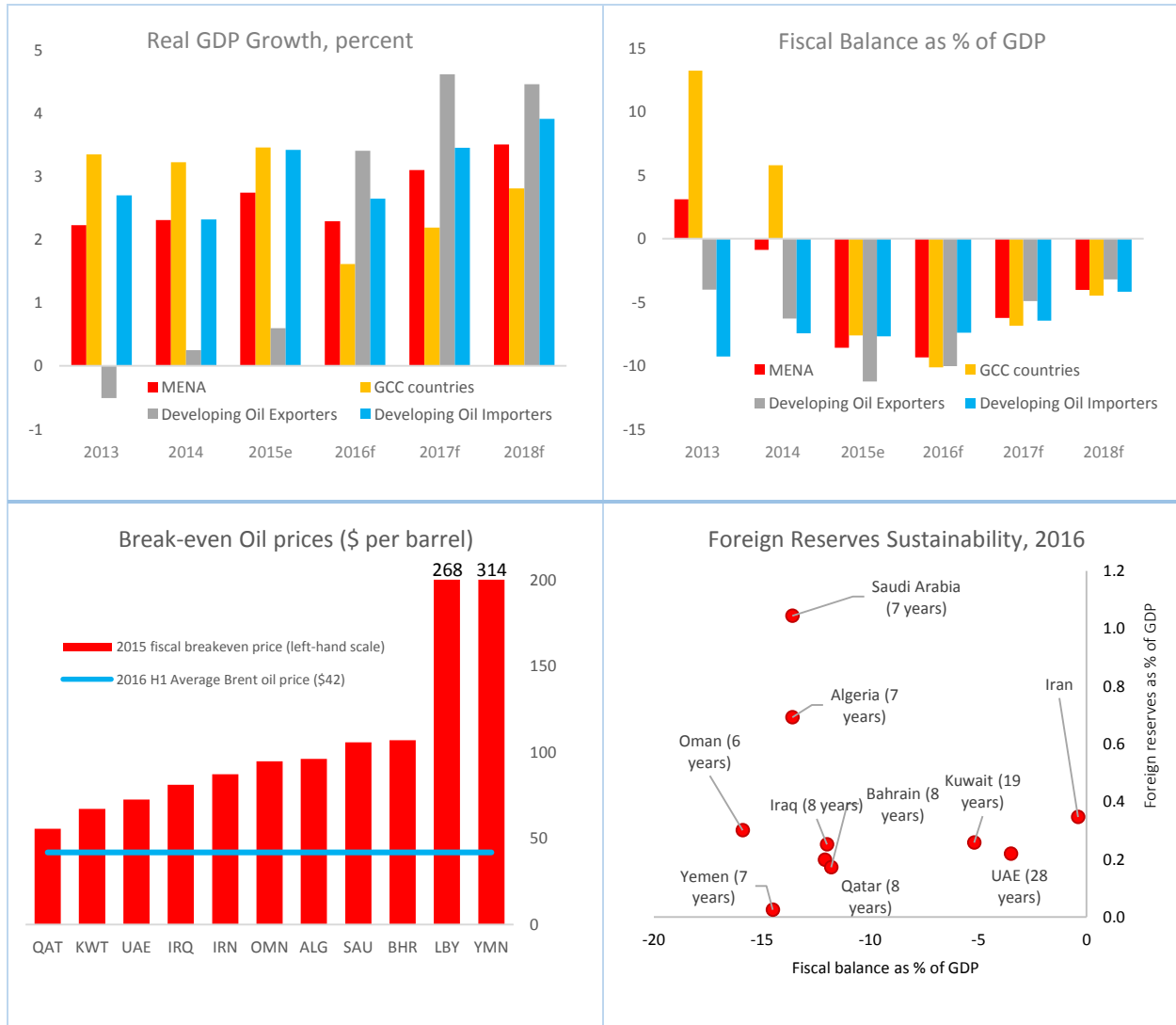
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<sup>2</sup> Saudi Arabia is planning to privatize its postal system by early 2017 and considering new income taxes on expatriates. The Kuwaiti government is considering privatization of non-oil production units of Kuwait Petroleum Corporation.



countries, developing oil exporters and oil importers) are expected to record significant deficits in 2016 and the next two years but with the prospects of reducing them going forward (Table 1.1 and Figure 1.3).

**Figure 1.3 MENA Macroeconomic Status**



Sources: World Bank and IMF. Note: e stands for estimate and f for forecast.

Growth in oil exporters in MENA is expected to remain subdued at 2.3 percent in 2016 due to a sharp drop in growth in the GCC countries (Table 1.1). If the September meeting of OPEC members fails to put a cap on production, oil prices will fall even further, worsening the situation. This time around, governments of oil exporters are treating the oil price decline as largely permanent and taking tough policy measures such as spending cuts, which have also lowered growth in the oil and non-oil sectors. Non-oil growth in Algeria and Oman is estimated to fall to 3.7 percent in 2016 compared to 5 and 7 percent respectively a year ago.

Table 1.1 Macroeconomic Outlook

	Real GDP Growth, percent						Fiscal Balance as % of GDP						Current Account Balance as % of GDP					
	2013	2014	2015e	2016f	2017f	2018f	2013	2014	2015e	2016f	2017f	2018f	2013	2014	2015e	2016f	2017f	2018f
<b>MENA</b>	<b>2.2</b>	<b>2.3</b>	<b>2.7</b>	<b>2.3</b>	<b>3.1</b>	<b>3.5</b>	<b>3.1</b>	<b>-0.9</b>	<b>-8.6</b>	<b>-9.3</b>	<b>-6.2</b>	<b>-4.0</b>	<b>9.0</b>	<b>4.4</b>	<b>-4.5</b>	<b>-6.2</b>	<b>-3.4</b>	<b>-0.9</b>
<b>Developing MENA</b>	<b>0.7</b>	<b>1.1</b>	<b>1.7</b>	<b>3.1</b>	<b>4.2</b>	<b>4.2</b>	<b>-6.0</b>	<b>-6.8</b>	<b>-9.4</b>	<b>-8.7</b>	<b>-5.7</b>	<b>-3.5</b>	<b>-2.3</b>	<b>-4.0</b>	<b>-6.6</b>	<b>-7.3</b>	<b>-4.8</b>	<b>-3.1</b>
<b>Oil Exporters</b>	<b>2.1</b>	<b>2.3</b>	<b>2.6</b>	<b>2.2</b>	<b>3.0</b>	<b>3.3</b>	<b>7.2</b>	<b>1.4</b>	<b>-8.9</b>	<b>-10.1</b>	<b>-6.1</b>	<b>-4.0</b>	<b>14.5</b>	<b>8.2</b>	<b>-3.6</b>	<b>-6.0</b>	<b>-2.2</b>	<b>0.1</b>
<b>GCC countries</b>	<b>3.3</b>	<b>3.2</b>	<b>3.5</b>	<b>1.6</b>	<b>2.2</b>	<b>2.8</b>	<b>13.2</b>	<b>5.8</b>	<b>-7.6</b>	<b>-10.1</b>	<b>-6.8</b>	<b>-4.5</b>	<b>21.6</b>	<b>13.7</b>	<b>-1.8</b>	<b>-5.0</b>	<b>-1.7</b>	<b>1.0</b>
Bahrain	5.4	4.5	2.9	2.0	1.8	2.1	-4.3	-3.3	-12.6	-12.1	-8.7	-5.3	7.8	3.3	-3.9	-5.1	-3.2	-0.2
Kuwait	1.1	0.5	1.8	2.0	2.4	2.6	35.1	18.0	-6.6	-5.2	0.5	2.7	39.9	33.2	7.5	1.6	8.3	11.2
Oman	4.4	2.5	5.7	2.5	2.9	3.4	-0.4	-3.6	-16.5	-15.9	-12.2	-10.0	6.6	5.2	-15.5	-20.0	-19.5	-16.0
Qatar	4.4	4.0	3.6	2.1	3.6	3.7	34.9	35.9	10.3	-12.1	-11.7	-8.9	30.4	24.0	8.4	-1.1	-5.6	-3.2
Saudi Arabia	2.7	3.6	3.4	1.0	1.6	2.5	5.8	-3.6	-15.2	-13.6	-9.3	-6.6	18.3	9.7	-8.3	-9.5	-3.4	0.6
UAE	4.7	3.1	3.8	2.3	2.5	3.0	10.4	5.0	-2.1	-3.5	-1.3	0.2	19.1	10.1	3.3	1.3	3.0	3.2
<b>Developing Oil Exporters</b>	<b>-0.5</b>	<b>0.3</b>	<b>0.6</b>	<b>3.4</b>	<b>4.6</b>	<b>4.5</b>	<b>-4.0</b>	<b>-6.3</b>	<b>-11.2</b>	<b>-10.0</b>	<b>-4.9</b>	<b>-3.2</b>	<b>2.3</b>	<b>-1.3</b>	<b>-6.6</b>	<b>-7.8</b>	<b>-3.0</b>	<b>-1.4</b>
Algeria	2.8	3.8	3.9	3.6	2.9	2.6	-0.4	-7.3	-16.2	-13.2	-9.7	-7.9	0.4	-4.4	-16.5	-14.3	-10.4	-8.0
Iran, Islamic Rep.	-1.9	3.0	0.6	4.3	4.6	4.5	-0.9	-1.2	-1.6	-0.4	0.5	1.1	6.3	3.8	2.3	2.6	3.4	4.1
Iraq	7.6	0.1	2.9	4.8	0.5	0.7	-5.8	-5.8	-13.5	-12.0	-6.8	-6.6	1.1	2.7	-6.1	-11.0	-5.4	-6.2
Libya	-13.6	-24.0	-8.9	-8.3	27.7	22.7	-4.0	-43.3	-77.1	-68.9	-35.3	-11.8	0.0	-46.1	-57.3	-61.1	-28.1	-7.6
Syrian Arab Republic	-20.6	-18.0	-15.8	1.7	...	...	-16.7	-19.3	-20.2	-18.2	...	...	-13.6	-19.0	-8.4	-9.9	...	...
Yemen, Rep	13.2	-11.3	-61.0	-59.8	...	...	-7.8	-8.0	-11.0	-14.5	...	...	-3.1	-1.7	-5.5	-6.1	...	...
<b>Developing Oil Importers</b>	<b>2.7</b>	<b>2.3</b>	<b>3.4</b>	<b>2.6</b>	<b>3.4</b>	<b>3.9</b>	<b>-9.3</b>	<b>-7.4</b>	<b>-7.7</b>	<b>-7.4</b>	<b>-6.4</b>	<b>-4.2</b>	<b>-7.5</b>	<b>-6.8</b>	<b>-6.7</b>	<b>-6.8</b>	<b>-6.5</b>	<b>-6.4</b>
Djibouti	5.0	6.0	6.5	6.5	7.0	7.0	-5.8	-12.1	-16.5	-11.6	-1.2	-3.0	-23.3	-25.6	-31.0	-25.8	-14.8	-14.5
Egypt, Arab Rep	2.1	2.2	4.2	3.8	4.0	4.7	-13.0	-12.2	-11.5	-12.1	-10.0	-8.9	-2.2	-0.9	-3.7	-5.4	-5.3	-4.9
Jordan	2.8	3.1	2.4	2.3	2.6	3.1	-14.2	-14.2	-6.9	-7.0	-6.7	-8.4	-10.4	-7.3	-9.0	-11.0	-9.8	-8.2
Lebanon	0.9	1.8	1.3	1.8	2.2	2.3	-9.5	-6.6	-8.2	-7.9	-8.6	-9.0	-25.9	-25.7	-17.3	-19.1	-19.7	-19.5
Morocco	4.5	2.6	4.5	1.5	3.4	3.5	-5.2	-4.9	-4.4	-3.5	-3.0	-2.8	-7.6	-5.7	-1.9	-1.5	-2.0	-2.4
Tunisia	2.3	2.3	0.8	2.0	3.0	3.7	-7.5	-4.3	-5.5	-4.6	-3.9	-3.7	-8.4	-9.1	-8.9	-7.7	-7.0	-6.2
West Bank & Gaza	2.2	-0.2	3.5	3.3	3.5	3.5	-1.7	-2.8	-5.1	-4.7	-3.0	-2.6	-14.4	-2.8	-5.1	-4.7	-3.0	-2.6

Source: World Bank. Notes: Regional averages may not be comparable across years due to missing data for Syria and Yemen for some years. Oman recently rebased its GDP starting 2011. Fiscal balances for Jordan, Tunisia, West Bank and Gaza and Yemen exclude grants.

**Table 1.2 GCC Oil Dependency**

	2000-05	2006-10	2011-14
<i>Oil export revenues as % of total exports of goods and services</i>			
<i>Bahrain</i>	58.7	60.5	65.1
<i>Kuwait</i>	82.7	80.5	87.6
<i>Oman</i>	76.9	69.4	64.3
<i>Qatar</i>	88.5	85.9	88.9
<i>Saudi Arabia</i>	83.4	88.1	83.0
<i>United Arab Emirates</i>	45.0	38.7	32.6
<i>Fiscal oil revenues as % of total fiscal revenues</i>			
<i>Bahrain</i>	71.7	82.2	87.2
<i>Kuwait</i>	72.7	79.2	83.6
<i>Oman</i>	83.4	83.4	88.7
<i>Qatar</i>	90.5	88.3	90.7
<i>Saudi Arabia</i>	82.8	88.3	90.3
<i>United Arab Emirates</i>	60.2	65.1	69.9
Source: IMF.			

The GCC countries' reliance on oil has been increasing over the past decade, making it difficult to cope with the consequences of low oil prices (Table 1.2). Growth in the Gulf countries is expected to fall to 1.6 percent in 2016, less than half the rate seen in 2015 (Figure 1.3). All of the six countries in this group are projected to grow around 2 percent this year and the prospects for a rebound remain tepid unless necessary reforms are in place. Fiscal and external accounts deficits are expected to increase to 10.1 and 5 percent of GDP this year, equivalent to \$155.4 and \$77.1 billion respectively, but they could improve slightly over the projection period.

The economy of Saudi Arabia is expected to grow by 1 percent in 2016, much lower than was expected in April 2016. The fiscal deficit remains high and is expected to stay elevated in subsequent years. Growth in Qatar, the best performer in the sub-group, is expected to drop to 2.1 percent in 2016, much lower than previously forecast and half of the growth rate of last year. Qatar's fiscal surplus of the past two decades is expected to turn into deficit estimated at 12.1 percent of GDP in 2016 with the prospect of remaining high for the projection period (2017 and 18).

In response to low oil prices, all of these countries have tightened fiscal policy, used their foreign reserves and turned to debt markets to finance their twin deficits. GCC countries have been issuing about \$88 billion in sovereign bonds or government-related enterprise debt to plug the budget deficits left by falling oil prices. They are also looking into diversifying fiscal revenues away from oil by introducing a Value Added Tax (VAT) for the first time. The outlook is expected to improve slightly throughout the projection period (Table 1.1) as reforms and diversification measures come into effect, but still weak compared to the boom years prior to 2011.

Lower oil revenues and the slowdown in economic activity have lowered financial outflows. Data from the Saudi Arabian Monetary Agency (SAMA) showed that remittances outflow fell 19 percent in July 2016 compared to last year, the equivalent of \$640 million. Foreign transfers also declined by 35 percent compared to June 2016, from \$4.21 billion to \$2.74 billion, their lowest

level since February 2013. The decline in outflows to the rest of the region have seriously affected MENA oil importers' economies that receive these inflows.

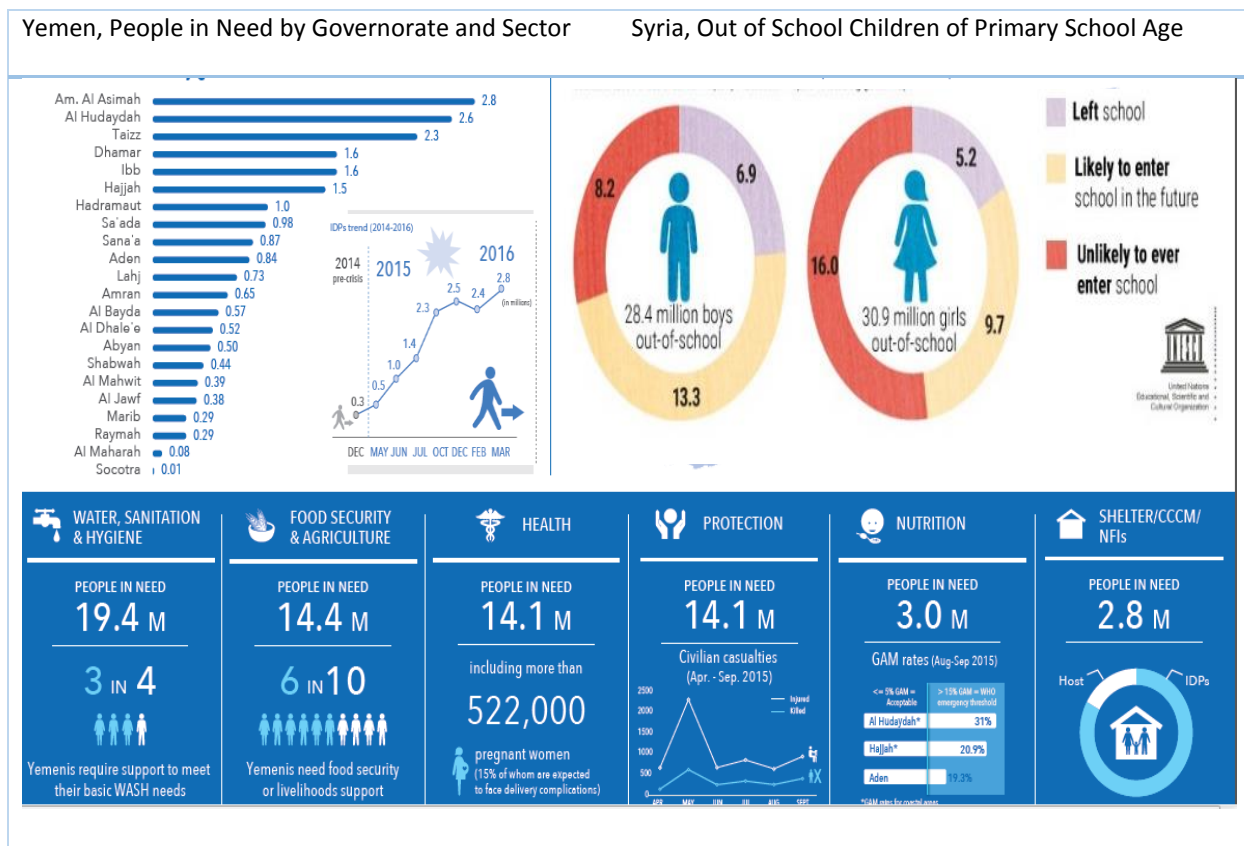
The outlook is slightly better but remains weak in developing oil importers. Oil importers were badly hit by terrorist attacks, spillovers from conflict in the region, and lower financial outflows from the Gulf countries. Growth is expected to fall to 2.6 percent in 2016 (from 3.4 percent last year) for the subgroup as a whole, before improving slightly to an average of 3.5 percent for the projection period. Fiscal and external account deficits are expected to remain stubbornly high throughout the projection period (Table 1.1). Among them, Egypt and Tunisia are facing lower tourism revenues, remittances and financial inflows together with tighter fiscal and monetary policy that will result in lower growth and higher inflation this year. The inflation rate in urban areas in Egypt reached 15.5 percent in August, a surge of nearly two percentage points over the previous month. There are expectations that the Egyptian pound will be depreciated further as the country faces a shortage of foreign currency, which could also accelerate inflation. And Morocco's economy, which relies heavily on the agriculture sector, will see growth weakening in 2016 to 1.5 percent compared to 4.5 percent last year. The agricultural sector poses the greatest risk to the Moroccan economy with estimated negative growth of 9.5 percent for this year due to a drought compared to a positive growth of about 2 percent in the non-agriculture sector. Growth in Jordan and Lebanon will remain subdued throughout the projection period as they struggle with the spillovers from the conflicts in neighboring Syria and Iraq and lower remittance inflows due to a sharp slowdown in GCC countries.

The economies of several developing oil exporters in the region are doubly hit by the slump in oil prices and civil wars. Average growth for the group of countries is expected to turn to 3.4 percent in 2016 from less than 1 percent last year, but this is solely due to expectations of Iran and Iraq producing more oil. These countries are facing major fiscal and external imbalances due to the high cost of war, low oil prices and a decline in trade. Growth in Iran will accelerate to 4.3 percent in 2016, four times the rate experienced last year, benefitting from the revival of oil output to pre-sanctions levels. Oil production in Iran has increased to 3.7 million barrels a day, doubling its level during the sanctions era.

The rest of the countries in this group (Syria, Iraq, Libya and Yemen) are mired in conflict and war with humanitarian and economic consequences. The Syrian war has ravaged the economy, output has shrunk between 50 to 60 percent, the Syrian Pound has lost 80 percent of value, the population has fallen by 23 percent, 12.4 million are displaced internally (7.6 million) and externally (4.8 million) since the start of the conflict, and education is on hold for many of the children living inside and outside of the country (Figure 1.4). The 18-month civil war in Yemen has resulted in 10,000 civilians killed, 2.8 million people displaced and most Yemenis suffering from shortages of food, water, sanitation and healthcare (Figure 1.4). Safety nets in Yemen have

been significantly weakened. It is estimated that more than 85 percent of Yemeni's are now living in poverty and the situation is getting worse. In addition to the humanitarian cost of the war, the World Bank estimates that Yemen's reconstruction will cost more than \$15 billion.

**Figure 1.4 Humanitarian Crisis in Syria and Yemen**



Sources: The UN Refugee Agency (UNHCR) and the United Nations Office for the Coordination of Humanitarian Affairs (OCHA).

It is clear that the disappointing performance of the MENA economies, and possibly the global economy, is partly due to the rise of terrorist attacks and spread of violent extremism. In the next section, we attempt to shed light on the underlying causes of this phenomenon by applying an economic perspective to the demand for and supply of violent extremists. Looking at a dataset on Daesh foreign recruits joining Daesh, we find that the factors most strongly associated with foreign individuals' joining Daesh have to do with a lack of economic and social inclusion in their country of residence. Promoting greater inclusion, therefore, could not only bring down the level of violent extremism, but it could improve economic performance in the MENA region.

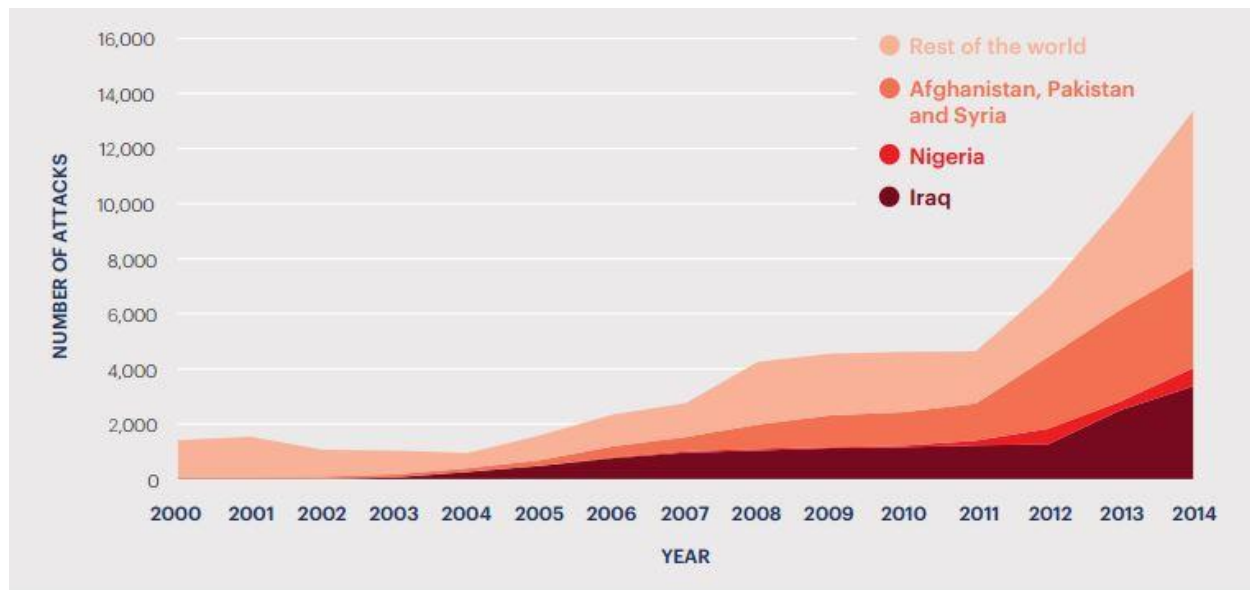
# Economic and Social Inclusion to Prevent Violent Extremism

## Introduction

Since 2000, the number of terrorist attacks worldwide has increased dramatically, with a sharp acceleration starting in 2011 (Figure 2.1). The attacks have also become increasingly concentrated. In 2014, 57 per cent of all attacks occurred in just five countries: Iraq, Pakistan, Afghanistan, Nigeria and Syria (Global Terrorism Index 2015). These attacks have had devastating effects not just on the lives of the victims and their families, but on the rest of the country and the region, as investment and tourism decline and economies fall into a low-growth trap. When terrorism by radicalized groups turns into violent extremism and full-fledged civil wars, the humanitarian effects become intolerable and the developmental impact long-lasting.

Bringing an end to civil wars and countering violent extremism are the highest priority for the MENA region. While much of the effort involves the security sector, an economic perspective can shed light on the underlying causes of violent extremism. In particular, as we show in this section, among the factors that lead people to leave their country and join radicalized groups is the lack of economic and social inclusion in their country of residence. These findings suggest economic and social policies that can help prevent the spread of violent extremism.

Figure 2.1 Terrorist Attacks, 2000-2014



Source: Global Terrorism Index (2015).

Before proceeding, we need to define terms. Terrorism is defined by Global Terrorism Database (GTD) as “the threatened or actual use of illegal force and violence by a non-state actor to attain a political, economic, religious, or social goal through fear, coercion, or intimidation.” On the other hand, the U.S. State Department defines terrorism as “[p]remeditated, politically

motivated violence perpetrated against noncombatant targets by subnational groups or clandestine agents. (As per 22 US Code § 2656f).” While the use of violence and a political motivation underlying such use are inherent to the term’s definition, what makes a use illegal or a target a noncombatant is largely left to interpretation, as illustrated in U.S. House of Representatives (1989). The difficulty in defining the term “terrorism” is epitomized by the persistence of the cliché “One man’s terrorist is another’s freedom fighter.”

Furthermore, since the first suicide attacks in recent history (Lebanon in the early 1980s and Sri Lanka in the late 1980s) and especially since the 9/11 attacks, the term radicalization has been closely associated with terrorism. Lewis (2013) argues that among the three factors necessary for successful suicide attacks, “willing individuals” is one of them alongside “organizations to train and use them, and a society willing to accept such acts in the name of a greater good.” The increased number of suicide bombing campaigns and the instrumental role of individual determination in the success of these campaigns has led to a coalescence of the concepts of terrorism and radicalization. The U.S. Agency for International Development (USAID) for example defines radicalization as the act of “[a]dvocating, engaging in, preparing or otherwise supporting ideologically motivated or justified violence to further social, economic and political objectives” (USAID 2011), hence allowing radicalization to comprise both the expression of extreme views and the actual exercise of violence. The U.K. Department for International Development (DFID) goes as far as equating radicalization with terrorism by defining the former as “the use of and facilitation of violence targeted on civilians as a means of rectifying grievances, real or perceived, which form the basis of increasingly strong exclusive group identities” (DFID 2013). This chapter, therefore, will henceforth use radicalization, violent extremism, and radicalization into violent extremism interchangeably (Borum 2011).

An economic perspective on radicalization involves acknowledging that there is demand for and supply of violent extremists and a marketplace where these two meet. In addition, the premise of an economic analysis of radicalization is that an individual decides to join a terrorist organization after weighing costs and benefits. Such costs and benefits are not solely financial; they could include family ties or loyalty to certain groups, for instance. The academic literature on personnel economics (see e.g. Lazear and Oyer 2012 for a review) provides two insights that are helpful in understanding the central role of radicalization in a terrorist group’s “business model”. First, the provision of non-monetary benefits such as a sense of mission is a substitute for monetary compensation, which is critical for cash-strapped organizations. Terrorist organizations rely on multiple sources of funding including donations and illegal activities (CFR 2006). In some cases, evidence shows that operations of terrorist groups are supported by limited activities such as the selling of counterfeit goods (Naim 2006). During the past few years, after the strengthening of financial regulations, Al-Qaeda recruits have been known to have to pay for their own training and supplies (CFR 2010), while commanders spoke of shortages of weapons

and food (Reuters 12 June 2009). Even the Islamic State in Iraq and the Levant (ISIL), among the richest terrorist groups in recent history (NBC 20 March 2015), is found to have relatively limited resources from what was once believed to be its main revenue source: oil (Do et al. 2016).

The second insight from personnel economics is that when there is little scope for external incentives (such as pay), workers' intrinsic motivation is instrumental for firm performance (Besley and Ghatak 2005; Prendergast 2007).<sup>3</sup> Since terrorist organizations require followers to engage in violent activities characterized by a low probability of survival (let alone suicide attacks) or support those who will do so, success hinges on individuals' being intrinsically dedicated to the organization's mission.

These observations lead to the following critical question: Given the demand by terrorist organizations for radicalized individuals, how can this demand be met? The main purpose of the analysis conducted herein is thus to look at the supply side of this market.

To address this question, we look at a specific organization that is largely associated with the word "radicalization", at least in the Western public discourse and media (CNN 7 October 2014, The Wall Street Journal 26 February 2015): the self-proclaimed Islamic State in Iraq and the Levant (ISIL), which we henceforth refer to by its Arabic acronym, Daesh. Admittedly, the phenomenon of violent extremism goes beyond one single organization and spans all continents and time periods. From Basque's Fatherland and Liberty (ETA) in Spain and the Shining Path (SL) in Peru, to the Liberation Tigers of Tamil Eelam (LTTE) in Sri Lanka, violent attacks on civilians have been perpetrated as a means to achieve political objectives. The focus on Daesh is nonetheless motivated by the impact of its activities on MENA economies. The analysis conducted in this report relies on a unique dataset on Daesh foreign recruits, which allows looking at the factors that could lead people from across the world to leave everything behind and join a terrorist organization. In particular, for the quantitative analysis conducted in this report, the multinational nature of Daesh's labor force uniquely allows us to identify country-level factors that lead some individuals to join the group. The analysis undertaken below, while restricted to Daesh, sheds light on the risk factors of radicalization turning into violent extremism in general, irrespective of the political motive underlying the subsequent use of violence.

To the extent that the choice of violent extremism by joining Daesh involves a cost-benefit analysis, the analytical framework proposed by Becker (1968) highlights the role of opportunity cost--what the individual could be earning otherwise--in influencing the decision to join a terrorist organization. Collier and Hoeffler (2004) adopt a similar framework to the empirical study of conflicts and alternatively talk about greed and grievance. In this report, we thus follow

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<sup>3</sup> Benabou and Tirole (2003), and Deci, Koestner, and Ryan (1999) theoretically and empirically document how extrinsic incentives can negatively affect workers' intrinsic motivation resulting in poorer performance.



a vast empirical literature on the proximate causes of civil war. However, instead of focusing on the onset of conflict or its intensity – typically measured by casualty counts— our outcome of interest relates to enrollment in a terrorist group. We look at whether, and to what extent, exclusion, broadly defined, is a main risk factor of radicalization. In particular, we investigate whether the lack of economic and social inclusion in their home country is a factor behind an individual’s decision to join Daesh. Such an exercise mirrors the analyses of socioeconomic risk factors of conflict such as Barron, Kaiser, and Pradhan (2009) on Indonesia, Mitra and Ray (2014) on India, Do and Iyer (2010) and Macours (2011) on Nepal, Abdel-Jelil and Do (2016) on the Syrian Arab Republic, while Duclos, Esteban, and Ray (2004), Fearon and Laitin (2003), Montalvo and Reynal-Querol (2005), Collier and Hoeffler (1998, 2004), Brunnschweiler and Bulte (2009) , among others, undertake cross-country comparisons instead (see Blattman and Miguel 2010 for a review).

To conduct our analyses, we combine a unique dataset on Daesh’s foreign recruits with country-level data from the recruits’ country of residence<sup>4</sup>. The Daesh foreign recruits database contains individual information for a subsample of the organization’s foreign workforce. Age, education, skills, self-reported knowledge of religious teachings, and country of residence are among the attributes included in the dataset. The country-level data includes macro indicators like GDP per capita, the Human Development Index (HDI), unemployment rates, population sizes, political rights along with subjective opinion data from surveys like the Arab Barometer, the Gallup World Poll and the World Values Survey.

We find that Daesh did not recruit its foreign workforce among the poor and less educated, but rather the opposite. Instead, the lack of economic inclusion seems to explain the extent of radicalization into violent extremism.

## Data and Methodology

### *Data on Daesh Foreign Recruits*

The data on Daesh foreign recruits comes from a leaked cache of the organization’s personnel records that was recently made available to researchers. The dataset has basic socio-economic information on 3,803 unique foreign recruits. CTC (2016) speculates that the data covers the period from early 2013 to late 2014 when Daesh used the name ISIL. The records provide information on a recruit’s country of residence, citizenship, marital status, skills, education status, previous jihadist experience, and knowledge of Sharia. A comparison of our data with comparable sources of information on Daesh foreign recruits finds that information available in alternative datasets are broadly consistent.

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<sup>4</sup> This section summarizes some of the results. For details and more analyses, see Do et al. (2016b)

### *Data from Opinion Surveys and other Controls*

To analyze Daesh foreign recruits' data at the macroeconomic level, we associate country-level attributes with each recruit's stated country of residence. We also use country averages from three nationally representative opinion surveys – Gallup World Poll, World Values Survey and Arab Barometer. The opinion surveys ask respondents about their basic values and beliefs, state of the world, current affairs and their opinion on society, religion, country and events. In addition, we use socio-economic variables such as GDP per capita, the Human Development Index (HDI), the Gini coefficient, unemployment rates, total population numbers, total Muslim population, distance to Syria, political rights, ethnic, religious and language fractionalization indices as controls.

### *Methodology*

As discussed, the main objective of the analysis is to understand the factors that have a bearing on the supply of Daesh foreign recruits. The country of residence is known for most individuals in the database, with the exception of 331 cases for which available information did not allow country-of-residence assignment. We can then look at the factors that explain whether any given country is the origin of at least one foreign recruit. This exercise will henceforth be referred to as the *extensive margin* analysis.

A natural extension is to then look at the *intensive margin*. In other words, we then consider countries that supply at least one Daesh recruit and identify the country-level characteristics that explain the differences between these countries in the *number* of foreign recruits supplied.

Since we are looking at the influence of many factors *simultaneously*, we will conduct multivariate regression analyses. In the main text we report graphically the influence of each variable of interest separately on either extensive or intensive margins.

## **Results**

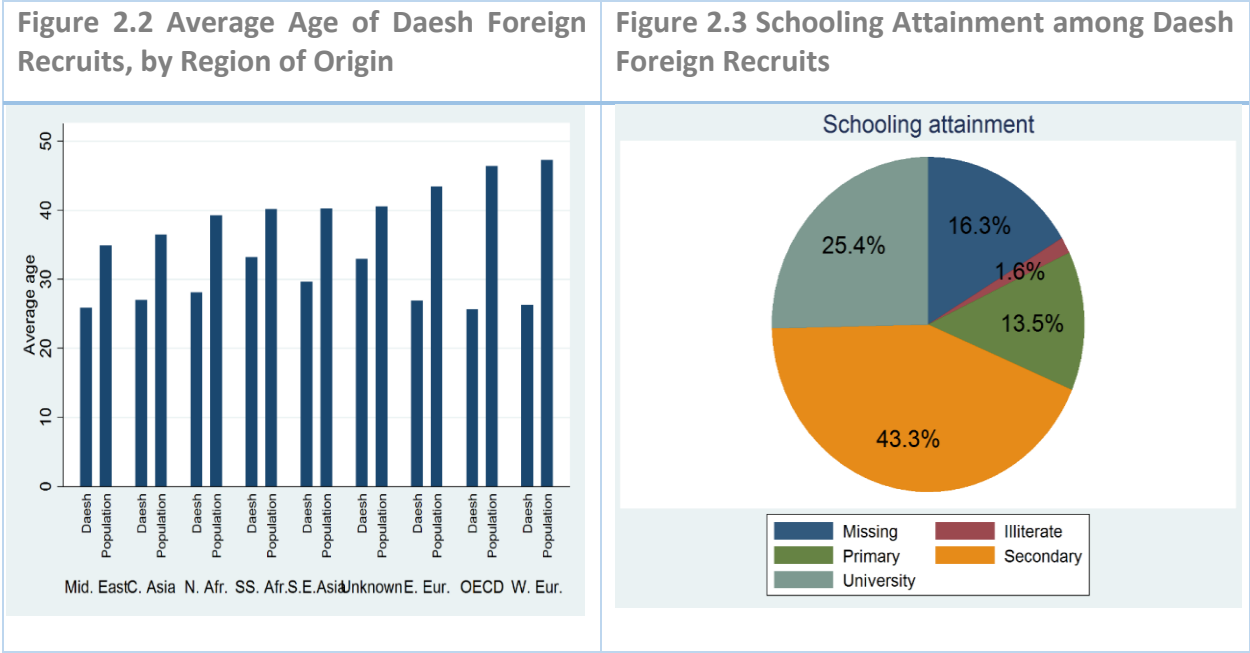
### *Who are Daesh's Foreign Recruits?*

A preliminary step to understanding *why* some individuals become radicalized is to have an idea of *who* they are. The tables and figures in this section describe individuals who travelled to Syria to join Daesh. Where are they coming from? What segments of a country's population are more likely to produce Daesh foreign recruits? Are there systematic socio-economic differences between foreign recruits coming from one part of the world versus another?

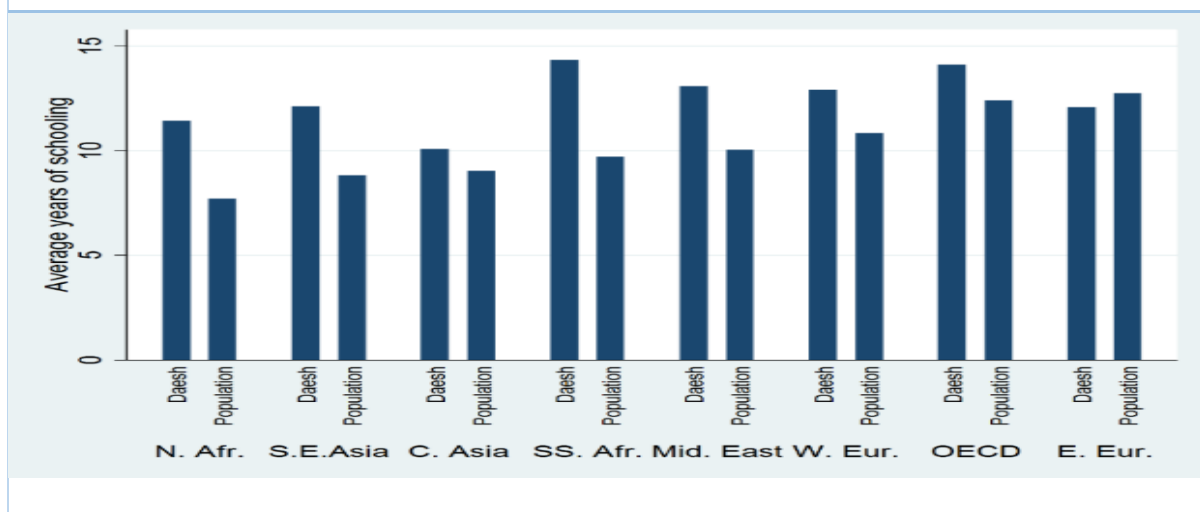
Daesh's recruits come from all continents across the globe. Saudi Arabia, Tunisia, Morocco, Turkey and Egypt are the top five countries supplying recruits to Daesh. Among the non-Muslim-majority countries, Russia, France, and Germany supply the largest numbers of Daesh's foreign workforce.

Looking at their individual characteristics, we find that the average foreign recruit in our data is 27.4 years old. The youngest recruits are from Libya (23.7 years of age on average) and the oldest are from Indonesia (33.5 years of age on average). Figure 2.2 shows that the average age of Daesh foreign recruits is not reflective of the demography in their region of origin: older regions do not produce older Daesh recruits.

Turning to Daesh recruits’ formal education, figure 2.3 shows that sixty-nine percent of recruits report at least a secondary education. Only fifteen percent left school before high school and less than two percent are illiterate. Figure 2.4 compares the reported schooling attainments among Daesh foreign recruits and the general population for ages 20-35 in each region of origin. Countries in Europe and in Central Asia, as well as other OECD member countries, produce Daesh recruits that exhibit similar levels of education to their compatriots. In contrast, foreign recruits from the Middle East, North Africa and South and East Asia are significantly more educated than what is typical in their region. We however leave open the possibility that recruits have been overestimating their education, and thus urge caution when interpreting these differences.



**Figure 2.4 Schooling Attainment among Daesh Foreign Recruits aged 20-35, by Region of Origin**



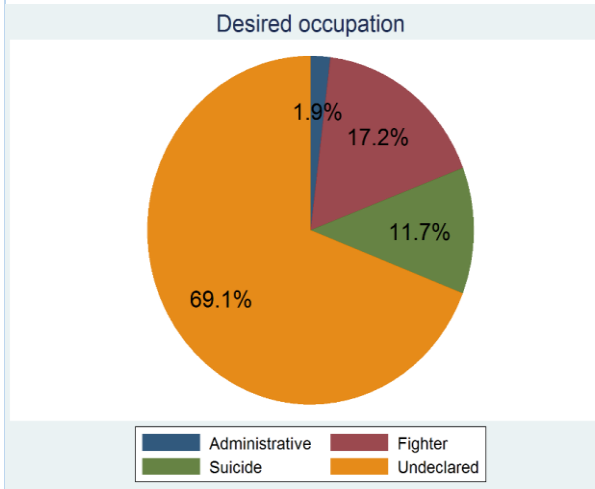
During their interview, of the thirty percent of Daesh recruits who declare their preference, 1.9 percent prefer to work in administrative positions, 17.2 percent as fighters, and 11.7 percent in suicide operations (Figure 2.5). Figures 2.6 and 2.7 present the characteristics of recruits who report each specific aspiration, excluding individuals who declared none. Aspiring administrators are relatively more represented among Sub-Saharan African and South and East Asian countries. Fighters are most common in Eastern Europe and non-European OECD countries. North Africa, Sub-Saharan Africa, the Middle East and Central Asia produce the largest proportions of suicide fighters.

The proportions of administrators but also of suicide fighters increase with education. Recruits who reported not working or being in the military before joining Daesh are the most prone to choosing “suicide fighter” as their preferred option.

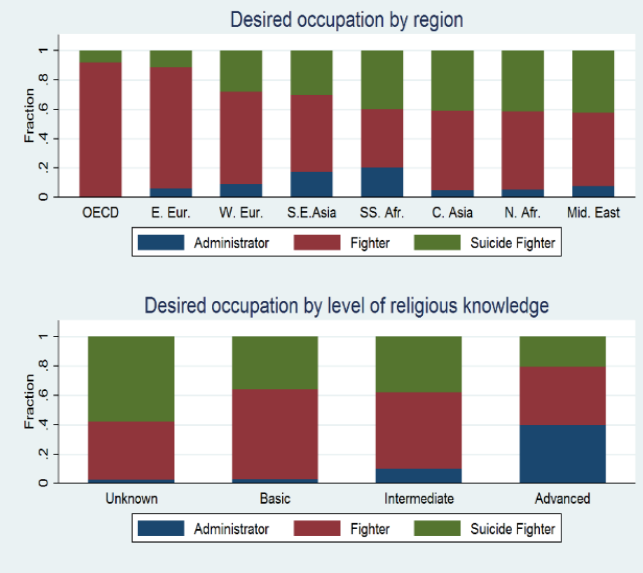
These descriptive results shed new light on debates in the literature on the determinants of violent extremism, but also open new avenues. Existing studies have either resorted to small samples to study individuals involved in acts of violence (e.g. Hegghammer 2006, Jenkins 2011), or exploited larger, representative samples but then had to focus on expressions of radical opinions (e.g. Bhatia and Ghanem 2016, Kiendrebeogo and Ianchovichina 2016) rather than actual commitment to the use of violence. In contrast, we are able to describe a large sample of individuals who have acted on their radical beliefs. An important finding is that these individuals are far from being uneducated or illiterate. Most claim to have attended secondary school and a large fraction have gone on to study at university. Notably, Daesh recruits from Africa, South and East Asia and the Middle East are significantly more educated than individuals from their cohort

in their region of origin. The vast majority of them declared having an occupation before joining the organization.

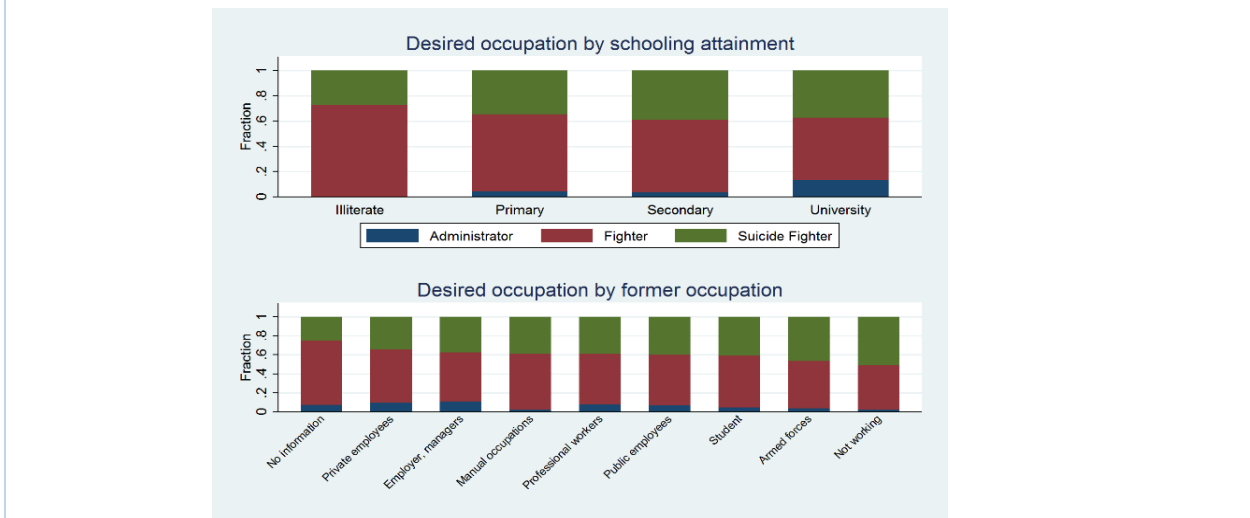
**Figure 2.5 Desired Role Stated by Daesh Foreign Recruits**



**Figure 2.6 Desired Role Stated by Daesh Foreign Recruits, by Region of Origin and by Level of Religious Knowledge**



**Figure 2.7 Desired Role Stated by Daesh Foreign Recruits, by Schooling Attainment and by Former Occupation**



Our data are also unique in showing that Daesh recruits travel to Syria with diverse aspirations: some of them want to help administer the organization, others are willing, or desire, to end their life at its service. Others simply want to fight. As shown above, these aspirations correlate with

very different characteristics, which further suggests the heterogeneity of motives that underlies the concept of radicalization.

### *The Determinants of Radicalization into Violent Extremism*

The first question we address is: What drives the likelihood that a country will be supplying extremist recruits to Daesh? Can we identify some variables that capture various dimensions of exclusion --- economic, social, or political --- that affect the propensity of a country to have some of its citizens join the terrorist group?

Before addressing radicalization per se, we look at demographic and geographic variables that capture more “mechanical” factors linking country characteristics and Daesh membership. We expect countries with larger populations, and larger Muslim populations, to be more likely, *ceteris paribus*, to have at least one of its residents join the extremist group. Along the same lines, everything else remaining constant, larger distances to Syria are expected to increase the cost of travelling there, hence lowering the propensity of radicalized individuals to end up joining Daesh’s foreign recruits.

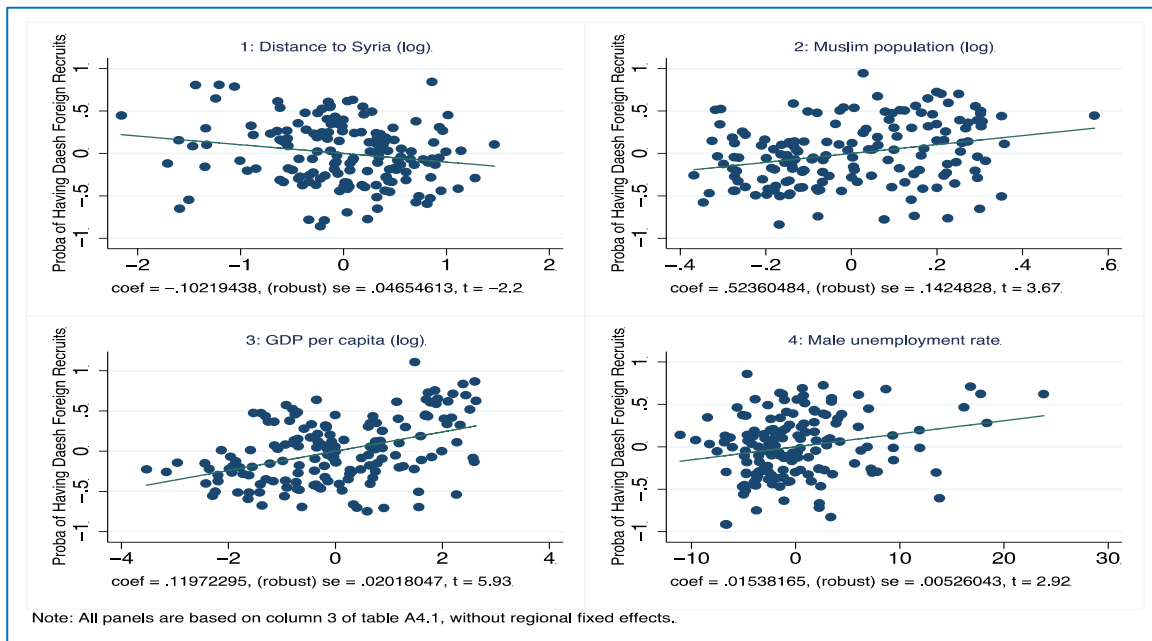
Economic development variables, such as a country’s per capita GDP, have an ambiguous influence on an individual’s propensity to join the radical group. While wealthier people have more to lose (a higher opportunity cost) by risking their lives, they are also more likely to have the means to afford their trip to Syria and Iraq. On the other hand, indicators of economic inclusion or lack thereof ---such as unemployment rates--- should predict higher rates of radicalization as economic exclusion might both generate more grievances and be associated with a lower opportunity cost of joining Daesh.

Figure 2.8 panels 1-4 shows the association between determinants of radicalization and the propensity for that country to supply Daesh recruits. Panels 2.8.1 and 2.8.2 confirm our initial hypothesis that larger distances make it costlier for would-be Daesh recruits to actually make it to Syria (panel 2.8.1). Looking at overall economic development, we find that wealthier countries as measured by their per capita GDP, are more likely to be supplying foreign recruits for the terrorist group (panel 2.8.3). Similar patterns are found when using the Human Development Index as a proxy for economic development. This result is consistent with a number of other studies that come to a similar conclusion: poverty is *not* a driver of radicalization into violent extremism (see for example Abadie 2006, Krueger and Maleckova 2003). Looking at measures of economic inclusion however, panel 2.8.4 shows a strong association between a country’s male unemployment rate and the propensity of that country to supply Daesh foreign recruits. This result echoes the findings of Bhatia and Ghanem (2016) who show, using opinion polls for a sample of eight Arab countries, that unemployment among the educated leads to a greater probability to hold radical ideas. Similarly, Kiendrebeogo and Ianchovichina (2016) draw on

information on attitudes toward extreme violence from 27 developing countries around the world and find an association between radical views and unemployment or economic hardship.

Furthermore, we fail to detect any robust correlation between the propensity to be a supplier of Daesh recruits and measures of socio-economic diversity such as the Gini coefficient, which measures income inequality, and various measures of fractionalization that capture a country's ethnic, linguistic, or religious diversity.

**Figure 2.8 Propensity of Supplying Daesh Foreign Recruits: Demographic, Geographic and Economic Determinants**



## Conclusion

The analysis of Daesh personnel files has allowed shedding some light on radicalization and its determinants. To the extent that the findings presented here apply more generally, we can draw a few conclusions. While terrorism is not associated with poverty and low levels of education, the lack of inclusion seems to be a risk factor of radicalization into violent extremism. Moreover, unemployment certainly has explanatory power. Policies that promote job creation, therefore, not only benefit young people seeking jobs, but may help thwart the spread of violent extremism and its attendant effects on national and regional economic growth.

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# Country Notes

# ALGERIA

*In the first half of 2016, Algeria's economy grew at 3.6 percent compared to 3.9 percent in 2015. The sharp drop in oil prices was compensated by an increase in hydrocarbon production and a high level of public spending. Inflation and unemployment rose and double-digit fiscal and external current deficits deepened. Over the next two or three years, growth is expected to decelerate as the government implements fiscal consolidation measures.*

## Recent developments

Despite a sharp decline in oil prices and unfavorable weather, Algeria was able to maintain respectable economic growth in 2015 and in the first semester of 2016. In 2015, growth picked up to 3.9 percent due to the first increase of hydrocarbon output in a decade and a stable non-hydrocarbon growth despite the economy being hit by a falling oil price. During the first half of 2016, Algeria sustained fairly strong growth of 3.6 percent (yoy), underpinned by ongoing hydrocarbon production recovering which mitigated slower non-hydrocarbon growth. Hydrocarbon production grew at 3.2 percent during the first semester of 2016 up from -0.8 percent in the same period of 2015. Non-hydrocarbon output eased to 3.8 percent from 5.1 percent in the first semester of 2015. This slowdown was led by a weaker growth in agriculture (due to poor weather), in water and energy, and in other industries. On the demand side, government consumption increased its contribution to growth in 2015 and during the first half of 2016, while the contribution of private consumption and investment declined, see figure 1.

Sustained growth has been achieved at the cost of a widening fiscal deficit, which more than doubled to 16.2 percent in 2015 as the government delayed fiscal consolidation. The deficit widened further in the first semester of 2016, as the government had difficulty implementing the fiscal measures contemplated in the 2016 Budget

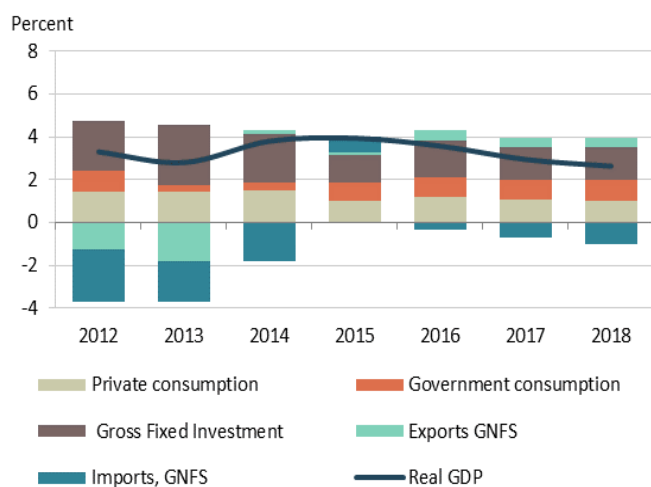
law. The latter calls for a 9 percent cut in expenditure (mostly investment) and a 4 percent increase in tax revenue, based on a 36 percent hike in gasoline prices and higher taxes on electricity and on car registrations. The budget also empowers finance authorities to approve further cuts if oil prices fall lower than its average oil price assumption, and to engage in external borrowing if needed. However, in Q1 2016, government spending skyrocketed (up roughly 60 percent yoy), indicating difficulties in implementing fiscal consolidation.

The current account deficit remained stable at 16.5 percent of GDP in 2015 but worsened during the first semester of 2016. The value of imports decreased by 11.8 percent in 2015 and 8.7 percent (yoy) in Q1 2016, too little to compensate for the 42.3 percent and 36.6 percent (yoy) fall in exports in 2015 and in Q1 2016 respectively. In 2016, new import licenses were introduced to further curb the current account deficit.

Despite tight monetary policy, inflation rose to 4.8 percent in 2015, in part reflecting pass-through from a roughly 20 percent nominal depreciation of the dinar, aimed at correcting the external imbalance. In the H1 2016, monetary authorities allowed the dinar to further depreciate as the authorities tried to avoid a sharp drop in foreign exchange reserves and maintain reserves at US\$100 million or above. The depreciation of the dinar should keep inflation pressures high, with inflation projected at 5.9 percent in 2016.

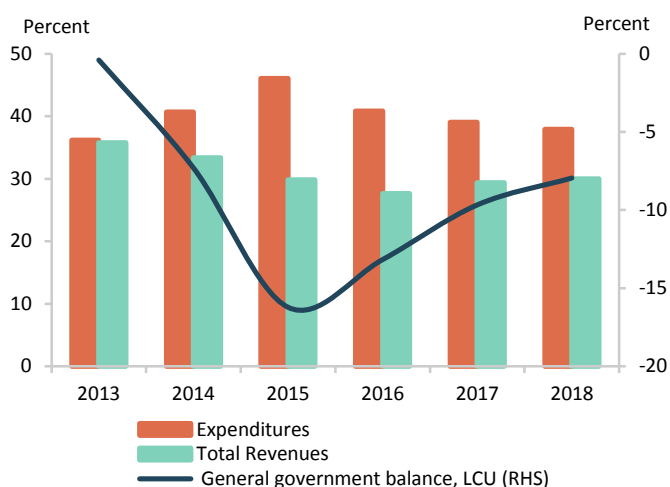
Persistently high youth unemployment hampered poverty and inequality reduc-

**FIGURE 1 Algeria / Contributions to annual GDP growth**



Sources: IMF and World Bank Staff estimates and projections.

**FIGURE 2 Algeria / Fiscal position**



Sources: IMF and World Bank Staff estimates and projections.

tion. In 2015, unemployment rose to double digits (11.2 percent), has not significantly changed in the first half of 2016 and is acute among women (16.6 percent) and youth (29.9 percent). The poor rely heavily on subsistence agriculture for income generation. In urban areas, informal jobs are predominant among the poor. The formal sector is dominated by civil servants and employees of state-owned enterprises.

## Outlook

Real GDP growth is expected to slow to 3.6 percent in 2016 and to ease further to 2.6 percent in 2018. In 2017 and 2018, a substantial increase in hydrocarbon output, as new oil wells start to produce, will mitigate the negative effect of the projected oil price decline on the real non-oil sectors. High unemployment is expected to weigh on household spending. The baseline assumes that the government will make some progress in fiscal consolidation. Still, the fiscal deficit is expected to remain large at about 13.2 percent of GDP in 2016 (albeit gradually, narrowing to 8.0 percent in 2018) as low oil prices weigh on fiscal receipts. With fiscal savings (Fonds de Régulation des Recettes, FRR) depleted, the deficit is expected to be financed by the issuance of new debts with the debt

-to-GDP ratio projected to rise from 13.6 percent of GDP in 2016 to 25.1 percent in 2018. The current account deficit is projected to slightly narrow from 15.5 percent of GDP in 2016 to 10.4 percent in 2018.

## Risks and challenges

This outlook is subject to at least two key downside risks: oil price volatility and social discontent. Reliance on hydrocarbon revenues makes Algeria still highly vulnerable to volatility in global oil prices in the face of substantial global oil inventories, and weaker than anticipated recovery in demand. A fall in oil prices may also impact investment in the hydrocarbon sector. Mounting social discontent from government spending cuts, tax hikes and high youth unemployment levels also pose a risk. The political will and national consensus to rationalize inefficient, inequitable and costly subsidies is emerging, but such reform requires improved safety nets, a cash transfer system reaching the needy, a solid media campaign facing opposition during its implementation, and, a stronger statistical system that allows monitoring of households' living conditions more frequently. None of these accompanying measures are, or expected to be, in place in the short run.

**TABLE 1** Algeria / Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	2.8	3.8	3.9	3.6	2.9	2.6
Private Consumption	5.0	4.4	3.3	4.1	3.5	3.5
Government Consumption	0.8	1.1	2.6	2.7	2.8	2.8
Gross Fixed Capital Investment	8.6	6.4	3.0	4.7	4.3	4.3
Exports, Goods and Services	-5.7	0.2	0.5	1.9	1.5	1.7
Imports, Goods and Services	10.0	8.6	-3.3	1.6	3.6	5.1
<b>Real GDP growth, at constant factor prices</b>	2.3	4.0	4.5	4.2	3.4	3.1
Agriculture	8.2	2.5	7.6	4.8	4.9	4.5
Industry	2.3	3.4	4.1	4.5	3.2	3.2
Services	-0.3	5.6	3.7	3.4	3.0	2.4
<b>Inflation (Consumer Price Index)</b>	3.3	2.9	4.8	5.9	4.8	4.3
<b>Current Account Balance (% of GDP)</b>	0.4	-4.4	-16.5	-15.5	-14.3	-10.4
<b>Fiscal Balance (% of GDP)</b>	-0.4	-7.3	-16.2	-13.2	-9.7	-7.9
<b>Debt (% of GDP)</b>	7.7	8.0	9.2	13.6	18.1	25.1
<b>Primary Balance (% of GDP)</b>	-0.1	-7.0	-15.9	-12.8	-9.2	-7.4

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.

# BAHRAIN

*Growth continues to slow and the fiscal deficit remains wide. The BOP current account has moved into deficit and international reserves have declined. Despite the significant fiscal consolidation efforts taken by the authorities, Bahrain is the most vulnerable GCC country in the face of low oil and bauxite prices due to its limited savings and high debt levels, leaving it exposed to financing risks.*

## Recent developments

Cheap oil continues to test the resilience of Bahrain's fiscal accounts. Bahrain maintained an expansionary fiscal stance since 2009 resulting in general government deficits. However, the situation has worsened in 2015 with a decline in oil revenues by about 10 percent of GDP and a general fiscal deficit estimated at 12.6 percent of GDP (from 3.3 percent in 2014). Bahrain suffered a decline in fiscal revenues by about 10 percent of GDP in 2015 as a result of decreasing oil prices.

Bahrain has taken significant fiscal consolidation measures. Revenue enhancing measures such as higher tobacco and alcohol taxes and government services fees were introduced over the past year. A cost-cutting program entailed the raising of petrol prices by up to 60 percent in January 2016 (likely to create savings worth US\$148.4 million), the gradual phasing-in of price increases for electricity, water, diesel and kerosene subsidies by 2019, an increase and unification of natural gas prices for industrial users, and the removal of meat subsidies. Lower oil prices are forcing the government to cut back on capital spending since restraining current spending may exacerbate domestic political tensions. A new law is proposed to privatize several state-owned businesses to help curb the deficit.

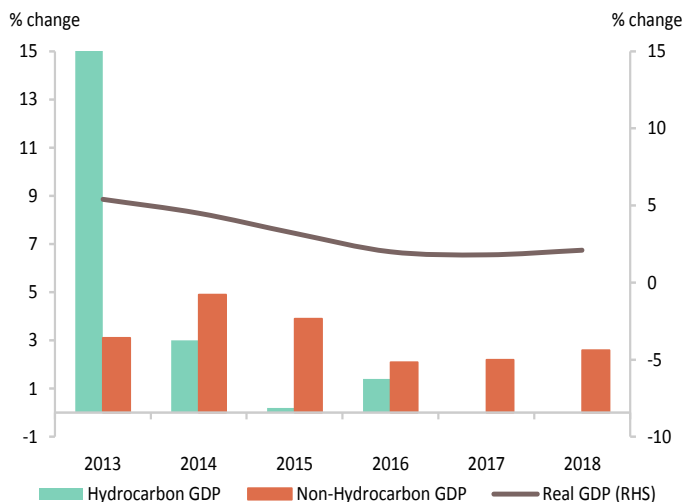
The efforts to mitigate fiscal risks weighed on growth. In 2015, Bahrain's economy grew by 2.9 percent. This reflects a decrease in non-oil GDP growth from 4.9

percent in 2014 to 3.9 percent despite the resilience in services sectors like hotels and restaurants. Hydrocarbon GDP remained flat in 2015. Inflation was subdued at an average rate of 1.8 percent in 2015 reflecting lower international food prices and appreciation in the US dollar. The current account surplus turned into a deficit of 3.9 percent of GDP in 2015. Reserves declined to 2.6 months of imports. Unemployment fell to 3.1 percent in September 2015, from 3.8 percent at end-2014.

The 2016 indicators so far confirm the persistence of fiscal imbalances and deteriorating trends. In the first half of 2016, Bahrain's project pipeline continued to expand thanks to the funds from other GCC countries like UAE and Kuwait. Oil production increased by 12.4 percent y-o-y in the first quarter of 2016. However, non-oil performance was constrained by fiscal austerity measures, which continued to weaken private consumption and investor confidence. With a public debt to GDP ratio estimated to exceed 60 percent in 2016, and weakening outlook, the S&P downgraded Bahrain's sovereign rating to BB/B but with a stable outlook in February. A day before this rating cut, Bahrain issued an additional US\$750 million of existing bonds, but had to cancel the debt sale following the rating downgrade. The sale was reopened but reduced to US\$600 million with higher borrowing costs.

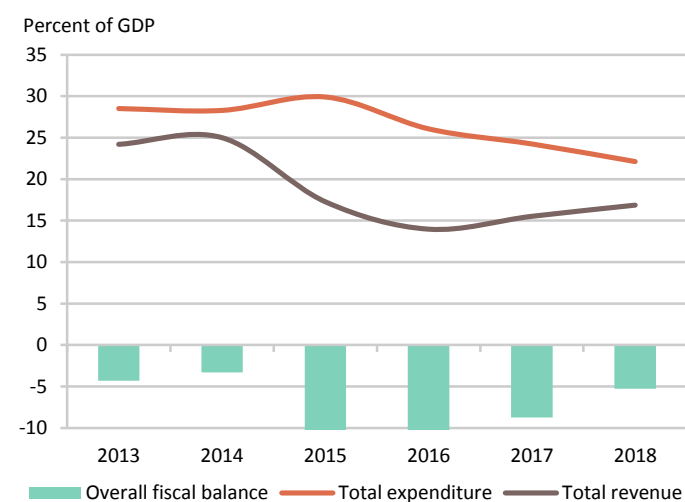
Little comprehensive welfare analysis is available due to restricted access to household survey data, limited capacity and the sensitivities involved. Among Bahraini nationals, labor force participation is low, and people work predominantly in the

**FIGURE 1 Bahrain / Growth in GDP and its components**



Sources: Bahraini Authorities, World Bank and IMF staff estimates.

**FIGURE 2 Bahrain / General government operations (in percent of GDP)**



Sources: Bahraini Authorities, World Bank and IMF staff estimates.

public sector, where wages are high and productivity low. Immigrant workers constitute about a half of the resident population and command much lower incomes. Key government welfare policies, public employment and subsidies, are becoming less affordable amid an ongoing fiscal consolidation. As the national population is being increasingly affected, Bahrain stands to gain from upgrading its capacity for living standard measurement and social policy design in order to mitigate the impact as well as make the adjustment more palatable and less costly, including fiscally. A new household survey fielded in 2015 is an opportunity for a more comprehensive welfare analysis.

## Outlook

Economic growth is expected to decline in the forecast period. Real GDP growth projections have been revised downwards to 2.0 and 1.8 percent in 2016 and 2017 respectively, as continuing low oil prices depress private and government consumption. Some infrastructure investments are also likely to be put on hold. In

addition, the high oil production in the first quarter of 2016 is not likely to continue after the withdrawal of the international oil companies from the Awali oil-field in May.

Average inflation is expected to increase to 3.4 percent in 2016 reflecting subsidy reform and will remain above 3 percent in the medium term. The current account deficit will widen to 5.1 percent of GDP in 2016 and gradually fade away as oil prices recover and global demand for aluminum rises in following years. International reserves are expected to follow a declining trend (to 2.4 months of imports in 2016).

## Risks and challenges

Real GDP growth is expected to slow further and fiscal and external balances are expected to remain under pressure in 2016 due to continued low oil prices. Despite efforts to diversify and boost non-oil fiscal revenues, hydrocarbons account for about 80 percent of government revenues in Bahrain. In addition, subsidies still absorb more than 20 percent of the fiscal budget. The fiscal break-even price for Bahrain is

estimated at US\$110 per barrel in 2016, the highest amongst the GCC. Thus, Bahrain is expected to continue to run significant general fiscal deficits in the forecast period, 2.1 percent of GDP in 2016. Government debt is forecast to increase from 47.8 percent of GDP in 2015 to 62.1 percent in 2016, breaching the 60 percent debt-to-GDP stability criterion imposed by the Gulf Monetary Union convergence criteria.

Given the existing social tensions and in light of government plans to cut subsidies, the economy remains vulnerable to civil unrest as well as regional tensions, in the forecast period. Tourism and financial services activity could dampen as a result of the slowdown in the region. Delays in implementing fiscal consolidation or a further decline in oil prices could trigger additional sovereign rating downgrades making access to external financing harder and intensifying pressure on reserves and the peg.

**TABLE 1 Bahrain / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	5.4	4.5	2.9	2.0	1.8	2.1
Private Consumption	4.7	3.0	2.8	1.6	1.7	2.5
Government Consumption	4.2	2.9	-0.2	-3.5	-0.9	2.1
Gross Fixed Capital Investment	-13.7	0.9	4.0	4.4	2.8	2.9
Exports, Goods and Services	8.9	0.4	2.3	2.7	2.6	3.0
Imports, Goods and Services	0.8	-6.2	1.1	1.5	2.0	3.8
<b>Inflation (Consumer Price Index)</b>	3.3	2.7	1.8	3.4	3.5	3.6
<b>Current Account Balance (% of GDP)</b>	7.8	3.3	-3.9	-5.1	-3.2	-0.2
<b>Fiscal Balance (% of GDP)</b>	-4.3	-3.3	-12.6	-12.1	-8.7	-5.3
<b>Primary Balance (% of GDP)</b>	-2.8	-1.6	-10.8	-9.9	-5.9	-2.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.



# DJIBOUTI

*Economic growth remains strong in 2016, fueled mainly by port and transport-related activities. Although fiscal and external positions are improving from 2015, debt and fiscal sustainability risks remain. With more than a fifth of the population unemployed, reforms that make growth more inclusive with job creation are critical. The statistical system needs to be strengthened for more accurate and timely monitoring.*

## Recent developments

GDP growth is projected at 6.5 percent in 2016, similar to 2015 and a modest acceleration compared to 6 percent in 2014. The growth pace has been maintained by construction, transport, and port-related capital-intensive activities. The inflation rate is projected at 3.5 percent in 2016, up from 2.1 percent in 2015, spurred by strong demand for housing and services.

The primary fiscal deficit is projected to decline to 10 percent of GDP in 2016 from 15.5 percent of GDP in 2015, given the softening of capital expenditures as the projects for port development and railway construction to link Addis-Ababa (Ethiopia) to the Djiboutian ports of Tadjoura and Doraleh near completion, and spending in late 2015 related to the presidential election of early 2016 ended. The current account deficit is projected to narrow to an estimated 23.4 percent of GDP in 2016 from 29.2 percent of GDP in 2015 as capital imports slow. FDI is expected to remain stable at 8.5 percent of GDP in 2016. Foreign exchange reserves remain strong, sufficient for broad money and currency board coverage. The REER is projected to further appreciate by 6.1 percent in 2016, reflecting the combined effects of supply side constraints and the pickup in inflation (high consumer prices). The banking sector remains weak with deteriorating loan portfolio of commercial banks and rising nonperforming loans (NPLs). The ratio of NPLs to total loans increased to over 22 percent in June 2015

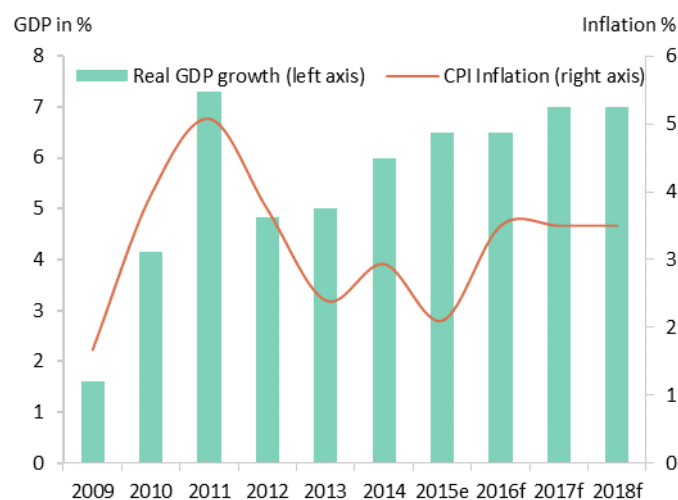
from 16.5 percent in June 2014.

The lack of a strong statistical system, in particular poverty monitoring system, remains a key concern in Djibouti. Whereas there were two household surveys conducted in 2012 and 2013, they are not strictly comparable and exclude a significant proportion of the vulnerable population such as nomads and those living in “temporary structures” (about 25-30 percent of the population according to the 2009 census). The unemployment rate declined to 22 percent in 2015 (38 percent if discouraged workers are included) from just under 50 percent in 2012.

## Outlook

The medium-term outlook remains favorable with the expectation that the ongoing capital investments will generate revenues, accompanied by rents from foreign military bases. Growth could reach 7 percent in 2017-2019, before decelerating to 6 percent by 2020. The fiscal position should gradually improve, narrowing to low single digits in 2017-18, on the assumption that current investments will create new production and export capacity, that spending is rationalized, and that fiscal reforms to increase revenues and reduce fuel subsidies are implemented effectively. The current account deficit is projected to decline to 14.5 percent of GDP by 2018, with a gradual pick up in exports while construction and related imports soften as the infrastructure projects near completion. FDI inflows and capital transfers

**FIGURE 1 Djibouti / Growth and inflation**



Sources: Djibouti Government and World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

should continue to finance the deficit. Reserves are expected to continue to guarantee adequate currency board and import coverage (of well over four months of imports), thus allowing the peg of the exchange rate at 177.72 Djiboutian Franc per 1US\$ to be sustained. Inflation is projected to remain at 3.5 percent in 2017-2018 as demand in the housing and services sectors remains strong.

As growth is mainly driven by infrastructure investments, its impact on job creation and poverty reduction is expected to be limited. The government is currently implementing a program to promote employment opportunities, improve nutrition practices, and provide transfers to reduce poverty among the most vulnerable groups. Political harmonization and social unification are key to ensure political and social stability. To ensure macro-economic stability, the government needs to engage in reforms to rationalize spending and effectively implement fiscal reforms to im-

prove the business environment and increase domestic resource mobilization. Labor market reforms to better match labor supply and demand, and economic diversification towards light manufacturing and agricultural sectors with potential for jobs creation, are imperative to address the country's growing unemployment and poverty issues.

for debt servicing. In addition, failure to effectively implement fiscal reforms could further deteriorate the business environment and weaken growth. Social instability and discontent as well as security issues on the Red Sea could also slow economic activity and growth.

## Risks and challenges

Growth and macroeconomic stability remain subject to high risks, considering global uncertainties and internal macro-imbalances. Djibouti is vulnerable to uncertainties and disturbances in the global economy given its heavy reliance on trade transit and transshipments. Djibouti's own internal macroeconomic imbalances could hinder growth if the debt-financed infrastructure projects are not efficiently managed to generate sufficient revenues

**TABLE 1 Djibouti / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015 e	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	5	6	6.5	6.5	7	7
Private Consumption	-1.8	-10.1	-1.9	17.6	62.6	24.3
Government Consumption	8.8	33.4	15.7	8.8	-15	-1.8
Gross Fixed Capital Investment	44.2	8.8	21	2.1	-31	-15
Exports, Goods and Services	6.1	5.4	17.6	6.8	6.5	8.3
Imports, Goods and Services	9.2	11.9	28.9	0.5	-11.5	2.6
<b>Inflation (CPI, period average)</b>	2.4	2.9	2.1	3.5	3.5	3.5
<b>Current Account Balance (% of GDP)</b>	-23.3	-25.6	-31	-25.8	-14.8	-14.5
<b>Financial and Capital Account (% of GDP)</b>	..	..	..	..	..	..
Net Foreign Direct Investment (% of GDP)	19.7	9.1	8.6	8.5	9.7	9.8
<b>Fiscal Balance (% of GDP)</b>	-5.8	-12.15	-16.5	-11.6	-1.2	-3
<b>Debt (% of GDP)</b>	42.4	44.8	55.5	63.6	61.3	58.4
<b>Primary Balance (% of GDP)</b>	-5.5	-11.8	-15.5	-10.1	0.4	-1.4

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

# EGYPT

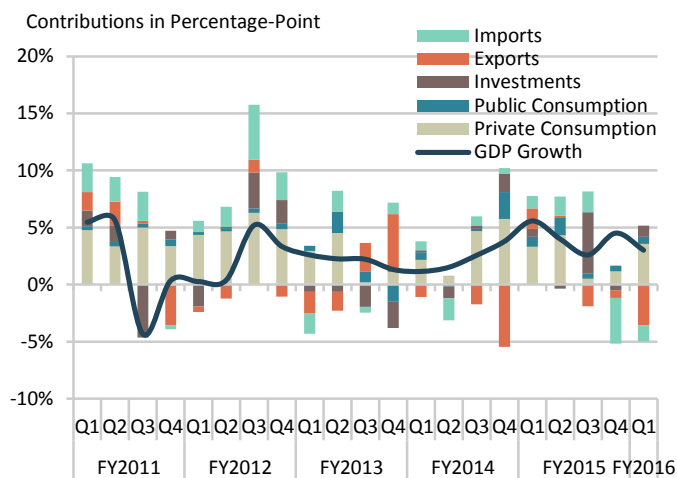
*Egypt's nascent recovery faded in FY16, owing to the foreign exchange crunch, a drop in tourism, and an unfavorable external environment. The government seeks to implement measures that will address the ongoing macro-imbalances (especially in the external and fiscal accounts), introduce structural reforms to improve the business environment, and redirect resources towards social programs. This would be supported by a 3-year Extended-Fund Facility (for which a Staff-Level Agreement was reached in August and is pending IMF Board approval).*

## Recent developments

Egypt's growth was 4.3 percent in 9M-FY16, in line with the previous year, and double the rate during FY11-14, but still below potential. Real growth in Egypt continues to be below potential and is constrained by shortages in hard currency, an overvalued exchange rate, and sluggish growth in Europe (Egypt's main trading partner), as well as the lower international oil prices that adversely impacted the Gulf (primary source of remittances). Additionally, key sectors continued to post negative growth, particularly 'oil and gas extractives' (as the sector suffers from underinvestment and arrears), and 'tourism' (which has deteriorated further since end-October 2015 when Russia and the UK banned travel to Egypt). Social conditions continue to be a concern. Unemployment remains elevated at 12.5 percent in H2-FY16, with rates higher among the youth and women. Furthermore, the recent spike in inflation (reaching a seven-year high of 15.5 percent in August 2016)—in part due to the March 2016 devaluation—is expected to have increased poverty due to the increase in price of items with high import content, especially food. In June, the government sought to protect the population from the impact of price increases by raising the value of food smart cards from LE15 to LE18 per person (88.6 percent of the population has food smart cards.) Following delays in the implementation of important fiscal reforms, Egypt is set to

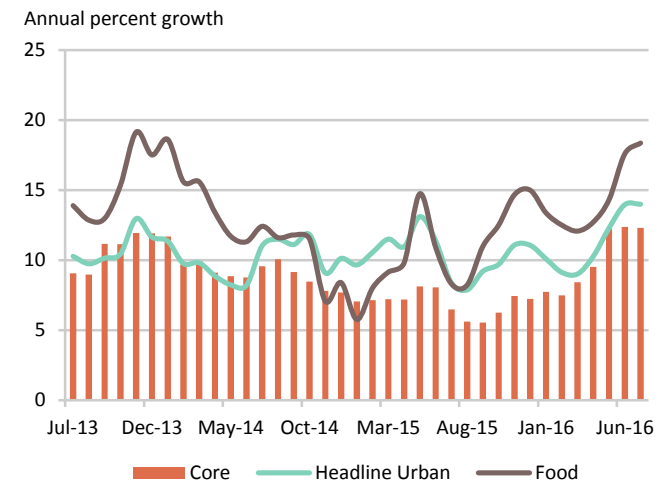
resume its fiscal consolidation plan. In FY16, the fiscal deficit increased to an estimated 12 percent of GDP from 11.5 percent of GDP the year before. Energy subsidy reform announced in early-FY15 was only 'partially' implemented in FY16, along with measures to curb the growth in the civil servants' wages, whereas other key reforms were on hold. Important fiscal reforms are expected in FY17: The government has already raised the electricity tariffs by 35 percent (on average) for households, commercial and industrial users in early-August, and the State budget includes other major fiscal reforms, including introduction of a VAT (approved at end-August 2016) in addition to efforts to raise revenues from existing taxes by improving tax collection. Meanwhile, the Central Bank of Egypt (CBE) started to tighten monetary policy through key policy rate hikes, but liquidity conditions continue to be loose. The CBE raised its key policy rates twice (by a cumulative 250 basis points, reaching an 8-year high of 12 percent, on average) since the exchange rate was last allowed to depreciate in mid-March, in order to curb the inflationary pressures and alleviate further downward pressure on the currency. However, the parallel exchange rate continued to surge (40 percent weaker than the official rate at end-August), and liquidity growth continued to be strong, driven mainly by the perpetual credit extended to the government. Egypt and the IMF have reached a Staff-Level Agreement on a three-year \$12 billion Extended Fund Facility (EFF). The agreement was signed on August 11, 2016,

**FIGURE 1 Arab Republic of Egypt / Real GDP growth, demand-side, FY2011-FY2016**



Sources: Authors' calculations based on Ministry of Planning data.

**FIGURE 2 Arab Republic of Egypt / Inflation rates, July 2013 – July 2016**



Sources: Central Bank of Egypt.

and is subject to obtaining adequate financing assurances and approval by the IMF's Executive Board. The government aims to implement reforms on three main fronts: (1) exchange rate liberalization; (2) fiscal consolidation, and (3) structural reforms to boost growth and reduce unemployment. The program also aims to strengthen the social safety nets to better protect the poor and vulnerable groups.

## Outlook

GDP is expected to grow by 3.8 percent in FY16, slightly lower than the 4.2 percent growth achieved in FY15, before rebounding gradually thereafter. Growth in FY16 is expected to be entirely driven by domestic demand as consumption remains resilient and public investments crowd-in the private sector. Net exports, on the other hand, continue to be a drag on growth due to the shortages in hard currency and an overvalued real exchange rate. Over the medium term, growth is expected to pick up as economic reforms progress and

key sectors recover.

The fiscal deficit is expected to narrow over the medium term, assuming the government implements the envisaged fiscal consolidation measures. On the external front, Egypt's accounts are likely to worsen in FY16 due to the sharp decline in tourism and lower transfers before recovering slowly afterwards, provided that the CBE continues to ease restrictions on foreign exchange and re-aligns the exchange rate. Current conditions do not appear conducive to significant poverty reduction. While recent efforts to better target food subsidies and to implement the constitutional commitments to increase spending on health and education should help alleviate poverty, higher energy prices and the new VAT could lead to higher inflation in the short term with a negative impact on the poor. The gradual expansion of programs like Takaful and Karama and geographically-targeted programs such as the "Economic Development for Inclusive and Sustainable Growth in Upper Egypt" hold promise for poverty-reduction in the future.

## Risks and challenges

The Egyptian economy faces three main challenges: (1) resolving the major macroeconomic imbalances (including exchange rate re-alignment and fiscal consolidation); (2) bringing down the high poverty rate and closing the spatial disparities in health and education outcomes; and (3) jumpstarting growth through implementing structural reforms. Reforms envisaged under the IMF's EFF hold promise to restore macroeconomic stability, but the contractionary and inflationary impacts associated with some measures (such as the energy price adjustments) will have to be mitigated by policies aimed at improving the business environment and strengthening safety nets to better protect the poor. Meanwhile, public expenditure restructuring and governance reforms are crucial to ensure better service-delivery, especially in lagging regions.

**TABLE 1 Arab Republic of Egypt / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	2.1	2.2	4.2	3.8	4.0	4.2
Private Consumption	2.8	4.1	3.6	4.0	3.0	3.0
Government Consumption	3.9	6.6	7.0	3.5	1.1	3.7
Gross Fixed Capital Investment	-8.7	1.5	8.7	4.1	11.2	12.5
Exports, Goods and Services	5.6	-11.9	-0.5	-5.0	5.0	6.5
Imports, Goods and Services	0.5	0.2	0.4	-1.0	4.0	6.5
<b>Real GDP growth, at constant factor prices</b>	2.1	2.2	3.1	2.8	4.0	4.3
Agriculture	3.0	3.0	3.0	3.3	3.0	3.0
Industry	0.6	1.5	1.0	1.7	3.5	4.0
Services	3.1	2.6	4.7	3.4	4.6	4.8
<b>Inflation (Consumer Price Index)</b>	6.9	10.1	10.9	10.2	17.0	13.0
<b>Current Account Balance (% of GDP)</b>	-2.2	-0.9	-3.7	-5.4	-5.3	-4.9
<b>Financial and Capital Account (% of GDP)</b>	3.4	1.7	5.4	4.7	2.4	4.8
<b>Fiscal Balance (% of GDP)</b>	-13.0	-12.2	-11.5	-12.1	-10.0	-8.9

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.

# IRAN

Following moderate growth in 2015 related to uncertainties regarding implementation of the Joint Comprehensive Plan of Action (JCPOA), the Iranian economy is projected to grow at an average rate of 4.5 percent during 2016-18 as the benefits of the removal of sanctions materialize. The medium-term prospects depend on a sustained reform agenda and increased integration with the global economy.

## Recent developments

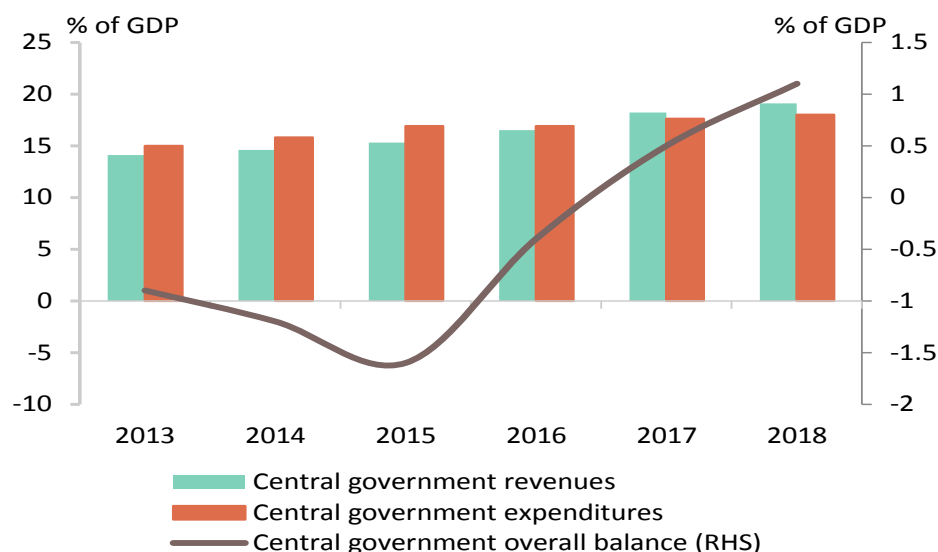
Growth is estimated to have moderated to 0.6 percent in 2015 (March 2015 - March 2016), from 3 percent in 2014, in the run-up to the implementation of the JCPOA (January 2016). Since January, Iran is likely to have benefitted from an improvement in business and consumer confidence under the reform-oriented Rouhani government and as suggested by emerging preliminary agreements with foreign companies preparing to ramp up investments in the country. There are early indicators of a pick-up in economic activity, with an estimated 4.4 percent growth in the first quarter of 2016 (March-June), albeit primarily driven by the oil sector. In parallel with the weak growth performance in 2015, the unemployment rate rose by 0.5 percentage point to 11.3 percent, partly driven by an increase in the labor force participation rate, which reached 38.2 percent in 2015, up from 37.2 percent in 2014. The structural imbalances in the labor market continue to be a challenge with sharp differences along the gender, age, and spatial dimensions. Inflationary pressures continued to abate and year-on-year consumer price inflation came down from a high of 34.7 percent in 2013 to 11.9 percent in 2015 and further to 9.2 percent in June 2016. Still, the CBI's lending rates remained almost unchanged, following the maximum deposit rate cut from 20 percent to 18 percent in October 2015 leading to fairly restrictive real policy rates.

On the fiscal side, the central government deficit is estimated to have deteriorated by 0.4 percentage points to 1.6 percent of GDP in 2015, with the rise in revenue being more than offset by the concomitant increase in expenditures, particularly current spending. Iran's current account surplus also weakened from a surplus of 3.8 percent of GDP in 2014 to an estimated 2.3 percent of GDP in 2015, with a decline in non-oil exports being only partially offset by a fall in imports.

## Outlook

Iran's economy is expected to grow at an annual average rate of 4.6 percent in 2016-18. Over the medium term (2017-2018), investment is likely to play a much larger role in generating growth on the assumption that new investment deals currently being negotiated will materialize in 2017 and 2018, and financial linkages with the rest of the world will be restored. Meanwhile, inflation is expected to ease into single digits (8.6 percent) in 2016 for the first time since 1990 as a result of lower commodity prices and easing import costs in the wake of lifting of the sanctions, but could edge higher in 2017-2018 if oil prices recover. The fiscal balance is projected to improve by 1.2 pp (percentage point) to -0.4 percent of GDP in 2016 as a result of an expected surge in the volume of oil exports and a parallel increase in non-oil revenues, and to move into surplus in 2017-2018. The current account surplus should

**FIGURE 1 Islamic Republic of Iran / Central Government Operations (% of GDP)**



start improving in 2016 and reach 4.1 percent in 2018 as increased energy exports more than offset the rise in imports stemming from lower trade costs and increased domestic consumption.

## Risks and challenges

Iran's expected strong growth path is conditional on significant improvements in trade and investment linkages. Thus, a slower than anticipated implementation of the JCPOA may negatively affect this outlook. Also, Iran's dependence on the energy sector leaves it highly exposed to swings in gas and oil prices. Another major risk to the outlook is the potential outcome of the presidential elections scheduled for June, 2017.

Continued commitment to implementation of significant structural reforms including of state-owned enterprises, of the financial sector and the management of oil revenues will play a crucial role in securing domestic and foreign investments alike. Finally, in the event of elevated geopolitical risks, the Iranian economy may be hit mainly through the trade channel. Better access to the extensive micro data and deeper analysis will be essential to accurately assess poverty and inequality trends.

**TABLE 1 Islamic Republic of Iran /** Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	-1.9	4.3	1.7	4.6	5.2	4.8
Private Consumption	-9.3	3.1	3.9	2.4	3.2	3.0
Government Consumption	1.6	2.7	-8.9	-1.3	9.1	8.5
Gross Fixed Capital Investment	-6.9	3.5	-1.0	2.8	7.7	6.9
Exports, Goods and Services	0.0	12.0	6.3	22.7	17.5	12.0
Imports, Goods and Services	-18.7	-5.7	-5.6	18.2	23.6	14.6
<b>Real GDP growth, at constant factor prices</b>	-1.8	3.0	0.6	4.3	4.8	4.5
Agriculture	4.8	3.8	3.0	3.5	4.1	6.7
Industry	-4.7	4.9	4.2	6.5	6.7	4.8
Services	-0.6	1.7	-2.0	2.9	3.5	4.0
<b>Inflation (Consumer Price Index)</b>	34.7	15.6	11.9	8.6	10.4	9.1
<b>Current Account Balance (% of GDP)</b>	6.3	3.8	2.3	2.6	3.4	4.1
<b>Fiscal Balance (% of GDP)</b>	-0.9	-1.2	-1.6	-0.4	0.5	1.1
<b>Debt (% of GDP)</b>	1.6	1.3	0.9	0.7	0.5	0.4
<b>Primary Balance (% of GDP)</b>	-0.9	-1.1	-1.5	-0.4	0.6	1.1

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.

# IRAQ

*The double shock of ISIS insurgency and fall in oil prices have negatively impacted the economy since mid-2014. The non-oil economy contracted deeply because of the war against ISIS and the ongoing fiscal consolidation. The authorities have responded with a mix of fiscal adjustment, financing, and structural reforms to stabilize the economy, protect social spending and public service delivery. Higher oil production, investments, implementation of structural reforms and IMF program, and an improvement in security would support growth in 2016.*

## Recent developments

The double shock has severely dented growth, diverted resources away from productive investment, and increased poverty, vulnerability and unemployment. Private consumption and investment remain subdued due to an unstable security and political situation and a poor business environment. The non-oil economy contracted by almost 14 percent in 2015 following a 5 percent fall in 2014. After slowing to 0.1 percent in 2014, Iraq's economy grew by 2.9 percent in 2015 on the back of a 19 percent increase in oil production, as the vast majority of Iraq's oil fields are beyond ISIS' reach. The inflation rate remained low at 1.4 percent in 2015, with the government subsidizing electricity, food and fuel, but was likely underestimated in ISIS-occupied areas.

The shocks have also deteriorated the country's fiscal and external balances. The overall fiscal deficit rose to about 14 percent of GDP in 2015, despite significant fiscal consolidation efforts. The deficit was mainly financed by T-bills and loans from state-owned banks (in part rediscounted by the central bank) and by two loans of US\$1.2 billion each by the IMF and the World Bank. The current account has also turned into a deficit of 6 percent of GDP in 2015, reflecting a 41 percent reduction in oil export revenues. Given Iraq's severe challenges and substantial financing needs, the IMF approved a three-year Stand-By Arrangement in July 2016 for US\$5.34 billion. On July 20, 2016, a donor

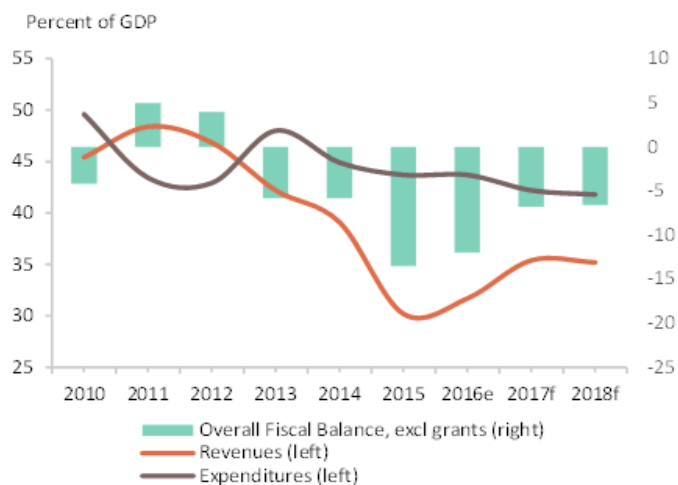
conference co-hosted by the US Government pledged a total of US\$2.1 billion for 2016-2018, with the aim of securing financial support for Iraq's humanitarian crisis. Following a long-running dispute, the federal government and the Kurdistan Regional Government have resumed discussions on fiscal transfers, which would help KRG address its growing fiscal crisis. Long-standing structural vulnerabilities have been exacerbated by the ongoing violence and economic and social disruption.

Jobs were not providing a pathway out of poverty even before the crisis. Iraq has one of the lowest employment-to-population ratios in the region, even among men, and the 2014 crisis has led to an estimated reduction in employment by 800,000 jobs. Last April, the government launched a new poverty targeting program based on proxy-means testing to improve the efficiency of its social security network.

## Outlook

The Iraqi economic outlook is highly uncertain as military attacks by ISIS have undermined confidence, while the fall in oil prices saps the economy, government finances, and the external position. Given the planned investments in oil production, overall real GDP growth is expected to reach 4.8 percent in 2016, but the non-oil economy will continue to contract as a result of the conflict and fiscal consolidation. Low oil prices in 2016 (expected to average US\$35.5 per barrel compared to US\$45 assumed in the 2016 budget) and increased humanitarian and military

**FIGURE 1 Republic of Iraq / Fiscal accounts (percent of GDP)**



Sources: Ministry of Finance; and World Bank staff projections.

spending would keep the overall fiscal deficit large at 12 percent of GDP and increase the current account deficit to 11 percent of GDP. In light of the difficulty of implementing additional fiscal consolidation in 2016–17, fiscal and current account deficits are expected to be financed by an increase in indirect monetary financing by the Central Bank of Iraq (CBI), additional drawdown of foreign exchange reserves, and domestic and external borrowing. Total public debt would increase to about 70 percent of GDP in 2016 from 56 percent of GDP 2015. In light of the successful offensive that Iraq continues to make against ISIS, and under much improved security conditions, growth is expected to pick up in 2016, and non-oil sector growth is projected to recover to 0.2 percent in 2017, assuming the implementation of structural reform to diversify the economy and support private sector development.

## Risks and challenges

Significant challenges remain from a possible escalation of the conflict, further fall in oil prices, worsening of domestic political tensions, shortfall in oil production, and poor policy implementation. This situation threatens to weaken growth, worsen the external position, and increase pressure on public finances, which depend predominantly on oil export revenues. A failure to narrow fiscal and external deficits and a rapid build-up in government debt would divert more resources away from productive investment and further reduce foreign exchange reserves and the economy's resilience to shocks. Immediate challenges are to manage fiscal spending pressures while protecting the poor, and restoring and improving basic public services, especially in the liberated areas. However, the fiscal consolidation efforts, especially the highly sensitive trimming of the wage bill, could also exacerbate existing fragility. Poverty is expected to increase unless growth and security are restored. Popula-

tion displacement and postponement of spending on socio-economic infrastructure will further hinder the Government's ability to deliver services.

**TABLE 1 Republic of Iraq / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 e	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	7.6	0.1	2.9	4.8	0.5	0.7
Private Consumption	5.2	-2.1	-2.4	2.4	2.4	5.7
Government Consumption	20.7	5.9	-61.8	39.2	2.6	6.1
Gross Fixed Capital Investment	85.7	24.0	-10.1	-14.3	-5.7	15.7
Exports, Goods and Services	2.9	-13.0	26.0	22.0	12.5	1.0
Imports, Goods and Services	25.0	-3.0	-15.0	3.0	22.0	19.0
<b>Real GDP growth, at constant factor prices</b>	7.6	0.1	2.9	4.8	0.5	0.7
Agriculture	12.2	-2.0	-22.3	-20.5	0.0	7.0
Industry	8.1	-3.6	12.6	20.5	0.7	0.0
Services	6.2	-3.6	-18.9	-3.3	0.1	1.4
<b>Prices:</b>						
Inflation	1.9	2.2	1.4	2.0	2.0	2.0
<b>Current Account Balance (% of GDP)</b>	1.1	2.7	-6.1	-11.0	-5.4	-6.2
<b>Financial and Capital Account (% of GDP)</b>	..	..	..	..	..	..
Net Foreign Direct Investment (% of GDP)	13.4	10.5	6.9	1.7	1.8	1.9
<b>Fiscal Balance (% of GDP)</b>	-5.8	-5.8	-13.5	-12.0	-6.8	-6.6
<b>Debt (% of GDP)</b>	31.2	32.6	55.9	69.6	70.0	72.5
<b>Primary Balance (% of GDP)</b>	-4.8	-5.1	-12.2	-9.2	-4.2	-3.3

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

Note: f = forecast.

\*Currently, the country does not report the poverty at ppp terms.



# JORDAN

*Jordan's economic growth has been subdued in the last year as spillovers from regional instability take a toll with unemployment reaching a recent high. Nevertheless, growth is projected to average 2.7 percent over 2016-2018 on the back of implementation of the Jordan Compact and planned reforms to stimulate the labor market and improve the business climate. A new IMF program supports related reforms and containment of the fiscal deficit.*

## Recent developments

Jordan has been managing spillovers from the Syrian crisis including closure of trade routes with Iraq and Syria and hosting more than 656,000 registered Syrian refugees. While the Jordanian economy has held up with growth generated from a number of sectors, it has been losing momentum. Growth of 2.3 percent in Q1-2016 was an improvement compared to 2.0 percent in Q1-2015. 'Finance and insurance services', 'transport, storage and communications', and 'electricity and water' were the largest contributors to growth that quarter, while 'mining and quarrying' was a drag. However, growth in Q1-2016 continued to decline on a seasonally adjusted basis. Unemployment reached a high of 14.8 percent in Q2-2016 with over one third (34.8 percent) of the youth unemployed. Ahead of Parliamentary elections (September 20, 2016), the King established an Economic Policies Council to identify measures to stimulate the economy.

Prices (CPI) contracted by 1.3 percent on a period average basis for the first seven months of 2016 (7M-2016), driven by lower prices of transport, fuel, and food. Monetary policy action has been unchanged since the last rate cuts in July 2015.

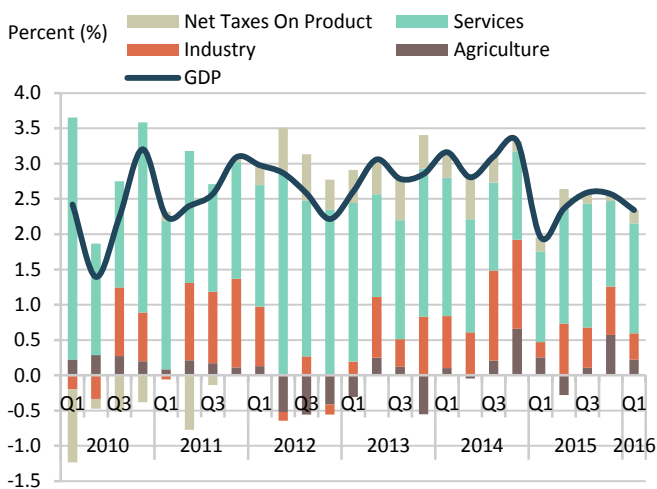
Jordan's fiscal deficit widened by 30 percent in H1-2016 largely due to contracting grants. While the national electricity company reached cost recovery in 2015 (aided by low international oil prices), the Water Authority of Jordan (WAJ) has

an increasing deficit. WAJ's government-guaranteed borrowing adds pressure to Jordan's debt stock, already high at 93.4 percent of GDP end-2015. A three-year US\$732 million arrangement under the IMF's Extended Fund Facility approved in August 2016 focuses on fiscal consolidation towards a reduction of the debt-to-GDP ratio to 77 percent by 2021. The program also highlights a structural reform agenda to stimulate growth. This agreement is expected to unlock grants and concessional financing for Jordan from donors in line with commitments made under the Jordan Compact.

Pressures abound on the current account due to slower tourism and remittances, closed land routes, and pricing pressures on potash exports. Travel receipts contracted by 3.6 percent in H1-2016, while exports of goods fell by 5.6 percent in 5M-2016 (with exports to Iraq down 47 percent). While continued low oil prices compared to H2-2015 helped reduce Jordan's import bills (20.5 percent cut in energy imports in 5M-2016), pressure on the current account stems from reduced remittances (-4.3 percent in H1-2016). Such pressures have affected Jordan's gross international reserves, which decreased by 11 percent to US\$12.5 billion (7.2 months of imports) by end-July 2016 compared to end-2015.

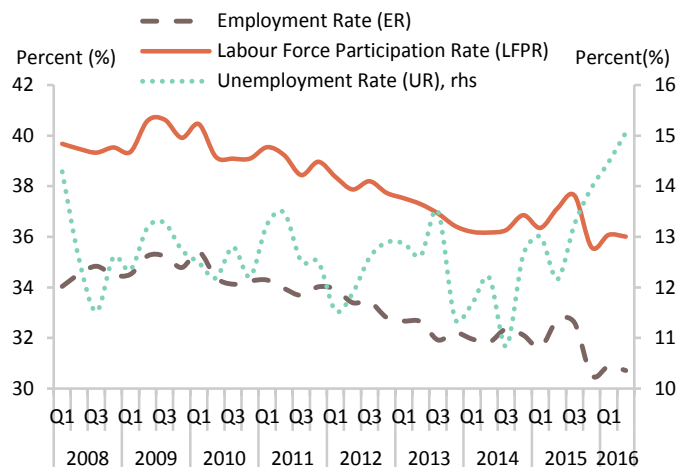
Jordan has begun implementing its commitments under the Jordan Compact, starting with the granting of work permits to Syrian refugees. In parallel, the European Union (EU) has relaxed its Rule of Origin (ROO) requirements to Jordan for specific product categories for 10

**FIGURE 1 Jordan / Supply side contribution to real GDP growth (yoy)**



Sources: Central Bank of Jordan and World Bank staff calculations.

**FIGURE 2 Jordan / Labor market dynamics**



Sources: Department of Statistics and World Bank staff calculations.

years. This is expected to spur investment in Jordan, job creation (for both Jordanians and Syrian refugees), and exports to the EU.

## Outlook

Jordan's economic growth is expected to remain flat at 2.3 percent in 2016 and improve in the medium term to 3.1 percent in 2018, closer to but still below Jordan's potential. The outlook assumes no further deterioration of security spillovers in and around Jordan. Further, confidence in the macroeconomic framework is forecasted to strengthen due to the IMF agreement. The primary fiscal balance is projected to move into surplus in 2017, coinciding with a reversal in the hitherto increasing

gross debt-to-GDP ratio. Pressures on the external account are expected to subside as of 2017 with a pick-up in exports and investment due to diversification efforts and the opportunities afforded by the EU's ROO relaxation and energy supply diversification plans, as well as stabilization of remittances and travel receipts. Despite expectations of higher oil prices and resulting higher energy imports, the current account deficit is expected to narrow from 2017. The next round of HEIS necessary to estimate poverty is expected to be implemented in 2017/18.

## Risks and challenges

The outlook is subject to downside risk. Higher frequency of security incidents are

materializing in and around Jordan, exposing vulnerabilities and could further influence consumer and investor confidence. Containing the fiscal deficit and implementing the new IMF program in a timely way will be challenging given the size of adjustment and scope of structural reforms envisaged. In parallel, the implementation of planned reforms related to the labor market, improving the investment climate and unlocking access to finance are vital to stimulate economic activity and improve welfare. Finally, Jordan's external position would face further pressure if expected grants and concessional financing do not materialize.

**TABLE 1 Jordan / Macro outlook indicators<sup>a</sup>**

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	2.8	3.1	2.4	2.3	2.6	3.1
Private Consumption	3.7	-2.6	6.6	5.3	-0.6	0.0
Government Consumption	-1.1	6.5	1.7	6.3	4.3	1.1
Gross Fixed Capital Investment	7.2	2.1	-11.6	2.5	4.9	5.9
Exports, Goods and Services	2.6	7.5	-9.5	-5.4	6.6	6.5
Imports, Goods and Services	4.3	-0.9	-8.3	2.7	1.6	1.4
<b>Real GDP growth, at constant factor prices</b>	2.8	3.2	2.6	1.9	2.8	3.2
Agriculture	-3.5	7.6	5.0	1.0	1.5	2.0
Industry	2.3	3.9	2.2	2.3	2.6	3.0
Services	3.3	2.7	2.6	1.8	3.0	3.3
<b>Inflation (Consumer Price Index)</b>	4.8	2.9	-0.9	-0.5	2.8	2.9
<b>Current Account Balance (% of GDP)</b>	-10.4	-7.3	-9.0	-11.0	-9.8	-8.2
<b>Financial and Capital Account (% of GDP)</b>	7.6	3.6	6.2	3.7	4.3	3.4
Net Foreign Direct Investment (% of GDP)	5.3	5.4	3.7	3.3	3.7	3.7
<b>Fiscal Balance (% of GDP)<sup>b</sup></b>	-11.5	-9.3	-3.6	-3.5	-2.4	-0.3
<b>Debt (% of GDP)<sup>c</sup></b>	86.7	89.0	93.4	94.6	93.9	90.4
<b>Primary Balance (% of GDP)<sup>b</sup></b>	-8.4	-5.7	-0.1	-0.1	1.1	3.2

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

Notes: f = forecast.

(a) Jordan has not released poverty estimates since 2010 due to issues with data quality for the 2013/14 Household Expenditure and Income Survey (HEIS).

(b) Includes fiscal gap of 15% of GDP in 2017 and 3.3% of GDP in 2018.

(c) Government and guaranteed gross debt. Includes NEPCO and WAJ estimated borrowing for 2016-2018.

# KUWAIT

*Growth was resilient in 2015 as rising output in the non-oil sector more than offset a contraction in the oil sector. Financial buffers remain large, but fiscal flow positions have sharply deteriorated, prompting fuel subsidy reform. Major infrastructure projects should continue to support growth in the near to medium term. Key challenges include the need to anchor fiscal sustainability, improve natural resource wealth management and economic diversification. Poverty is not an issue for Kuwaiti citizens.*

## Recent developments

Provisional GDP data released mid-year show growth accelerating to 1.8 percent in 2015, despite headwinds from global commodity prices. Activity was supported by public infrastructure spending, which boosted investment and supported consumption. Factor cost GDP data, however, show a contraction of 0.3 percent, as a 1.7 percent contraction in the oil sector offset growth of 1.3 in the non-oil sector. Growth for 2014 was also revised upwards, from -1.6 percent to +0.5 percent, mainly due to a strong showing in the non-oil sector.

Incoming data suggest the economy is improving further. Oil production has rebounded following a strike by oil workers in April, and consumer confidence has lifted. Bank lending rose by a healthy 8 percent (y/y) in H1 2016, led by rising household borrowing. Lending to non-bank financial companies has stabilized, suggesting a 5-year period of deleveraging is coming to a close. Real estate prices and transaction volumes lost momentum, but this reflects a welcome cooling of the property market after prices doubled between 2009 and 2015. Infrastructure spending is helping ease banking sector liquidity as growth in government deposits has picked up. Three-month interbank rates currently stand at 1.5 percent, down from nearly 1.8 at end-2015.

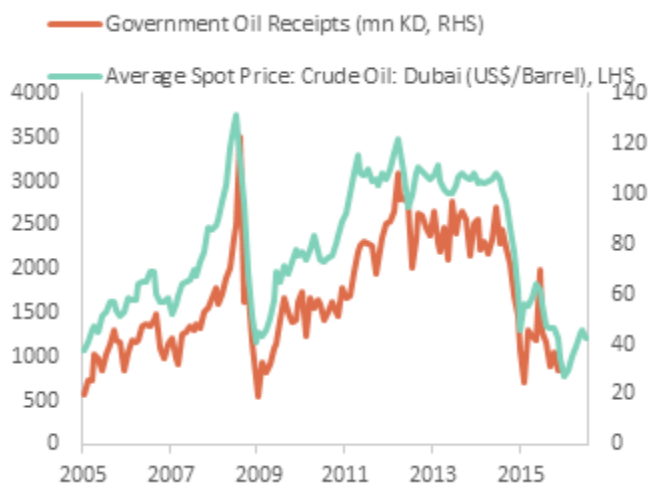
Fiscal buffers and external positions remain strong and supportive of Kuwait's currency peg, backed by an SWF estimat-

ed at US\$600 billion as well as low debt levels. The CA surplus narrowed significantly from over 30 percent of GDP in 2014, but remained substantial at 7.5 percent of GDP in 2015. The trade balance shrank to a 13-year low in Q1 2016, as further weakness weighed on export receipts, and also remained in surplus.

Still, fiscal pressures have increased. Oil receipts, which have historically accounted for 80 percent of total government revenues, have fallen to a third of their 2013 levels. Consequently, the government ran a deficit (excluding investment income)—the first in more than a decade—of about KD 6.9 billion (or 20 percent of GDP) in FY15/16, financed by a combination of drawdowns from the General Reserve Fund and domestic debt issuance. The FY16/17 budget projects a larger shortfall of 26 percent of GDP although, conservative budget assumptions for oil (US\$35/bbl) suggest actual outturns may be better.

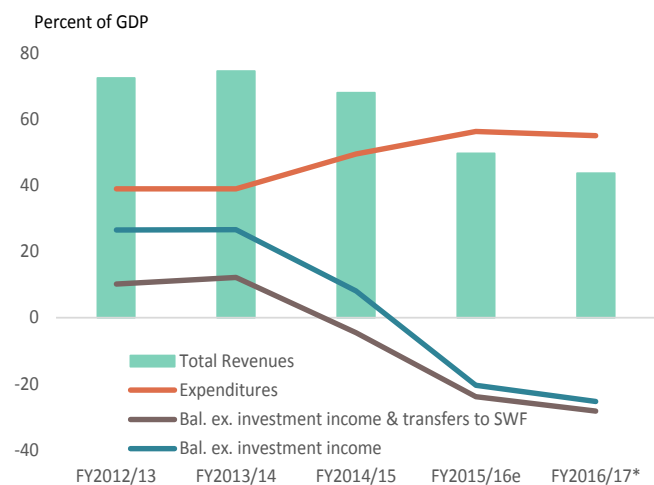
Reforms are gaining momentum. In March 2016, the government approved a reform plan focused on cutting the fiscal deficit in addition to other structural reforms. In September, gasoline prices were partially deregulated: energy subsidies cost about 1.3 percent of GDP. Some savings should be recouped from the reform. Parliament has also approved electricity and water tariff hikes to take effect in 2017, which are expected to generate savings of 1 percent of GDP. A corporate income tax and a value added tax (VAT) are also planned alongside privatization of state-owned oil services companies. Finally, under the 2015-19 Development Plan,

**FIGURE 1 Kuwait / Public sector oil receipts and oil prices**



Sources: Ministry of Finance, IMF, World Bank Staff estimates.

**FIGURE 2 Kuwait / Kuwait public sector finances**



Sources: Ministry of Finance, IMF, World Bank Staff estimates.

\* Budget projections

the government has accelerated efforts to implement major infrastructure projects. These are critical for laying the foundations for a post-oil economy, and for raising hydro-carbon output in the near to medium term.

The labor force participation rate for Kuwaiti nationals is 45 percent - of these 80 percent work for the public sector. In contrast, immigrants, who make up two-thirds of the population, constitute the bulk of lower-income residents. Additional concerns for immigrant workers include unpaid or delayed wages, difficult working conditions and fear of a crackdown. Finally, *Bidoons*, or unrecognized, stateless Arab population, are ineligible for most public benefits and services.

## Outlook

Growth is expected to rise to 2.0 percent in 2016, firming to 2.6 percent in 2018. Activity should be supported by rising oil output (due to recent discoveries, improved production efficiencies, and as production from the Neutral Zone oilfield resumes in 2017). After years of stalled projects and delays, investment outlook has turned positive. The 2015/19 Development Plan also includes at least 8 major Public Pri-

vate Partnership projects, which should support growth in the non-oil sector.

Public finances should remain under pressure as fiscal breakeven oil price, estimated at close to US\$70/barrel, exceed current oil prices by a large margin. However, fiscal and current account positions should gradually strengthen in line with a modest recovery in oil prices and output. The baseline assumes gradual implementation of spending and revenue reforms including the implementation of a VAT in 2018.

## Risks and challenges

External risks include spillovers from geo-political tensions and conflict, a supply overhang in global oil markets that keeps oil prices depressed, and global financial volatility. On the upside, the rebalancing in global oil markets is progressing, and oil prices could recover faster than anticipated. Domestic risks include project delays, parliamentary gridlock that impedes reforms, and ruling family rivalries that increase political uncertainty. The government's extremely strong fiscal cushion could reduce incentives to undertake politically difficult fiscal reforms. The banking sector, although well capitalized,

has high levels of exposure to the real estate sector.

Longer-term challenges relate to Kuwait's dependence on the hydro-carbon sector. A poor business environment and large public sector have hampered the development of the private non-oil sector. In addition, global anti-climate-change efforts are gaining urgency and likely to induce a shift towards less carbon-intensive technologies and greater energy efficiency. These challenges put a premium on policies that strengthen the management of Kuwait's natural resource wealth, preserve (and build) intergenerational equity, diversify the economy and create jobs.

**TABLE 2 Kuwait / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	1.1	0.5	1.8	2.0	2.4	2.6
Private Consumption	4.9	4.9	2.4	2.0	2.4	2.4
Government Consumption	6.6	-0.8	-0.5	0.6	1.0	1.0
Gross Fixed Capital Investment	8.9	4.6	13.0	8.0	8.0	7.0
Exports, Goods and Services	-4.0	1.4	1.0	2.0	2.5	3.0
Imports, Goods and Services	-0.1	8.0	5.1	5.0	5.0	5.0
<b>Real GDP growth, at constant factor prices</b>	0.8	1.0	-0.3	1.2	2.1	2.4
Agriculture	0.8	7.5	4.2	2.0	2.0	2.0
Industry	-1.3	-0.5	-1.7	2.0	2.4	2.4
Services	4.5	3.3	1.9	-0.1	1.5	2.3
<b>Inflation (Private Consumption Deflator)</b>	2.7	2.9	3.2	3.0	3.0	3.0
<b>Current Account Balance (% of GDP)</b>	39.9	33.2	5.1	1.6	8.3	11.2
<b>Financial and Capital Account (% of GDP)</b>	43.9	38.3	9.9	33.6	22.8	15.9
Net Foreign Direct Investment (% of GDP)	8.7	7.8	4.5	4.6	4.3	4.1
<b>Fiscal Balance (% of GDP)<sup>a</sup></b>	35.1	18.0	-6.6	-5.2	0.5	2.7
<b>Primary Balance (% of GDP)</b>	35.2	18.1	-6.2	-4.9	0.9	2.6

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.

(a) Fiscal deficit is on general government basis, including transfers to SWF and investment income.

# LEBANON

Despite improved security conditions, Lebanon continues to be subject to regional tensions and domestic political dysfunctionality. The protracted Syrian crisis is markedly increasing the country's vulnerabilities and remains an impediment to a recovery of growth. For the fourth year, Lebanon remains the largest host (on a per capita basis) for displaced Syrians. In 2016, a stronger real estate sector as well as a continued increase in tourist arrivals are expected to lead to a small pickup in economic activity, which nonetheless would persist to be sluggish.

## Recent developments

Weighed down by government spending and the construction sector, real GDP growth in 2015 decelerated to an estimated 1.3 percent compared to 1.8 percent in 2014. This is despite an increase in tourist arrivals (the overwhelming majority of whom have been Lebanese expatriates) and continued, albeit slower, expansion in private lending as the Banque du Liban (BdL) renewed its stimulus package in the amount of US\$1 billion. The real estate sector, on the other hand, acted as a drag, with registration fees and cement deliveries contracting in 2015 by 9.4 percent and 8.6 percent, respectively.

Fiscally, a 3.5 percentage points (pp) of GDP decline in revenues was partially offset by lower transfers to Electricite du Liban (EdL), driven by cheaper oil prices, but the overall fiscal deficit widened by 1.6 pp of GDP to 8.2 percent of GDP. The fall in revenues reflected the absence of one-off measures that boosted revenues in 2014 (e.g., payment of telecom arrears). Nonetheless, the government was able to register a primary surplus in 2015 amounting to 1.3 percent of GDP. On the external account, a broad contraction in imports is estimated to have induced a 8.5 pp of GDP narrowing of the current account deficit, which nevertheless remained elevated at 17.3 percent of GDP. The narrowing current account deficit, however, was more than offset by lower capital inflows adversely affecting the net foreign asset position of the country. As a

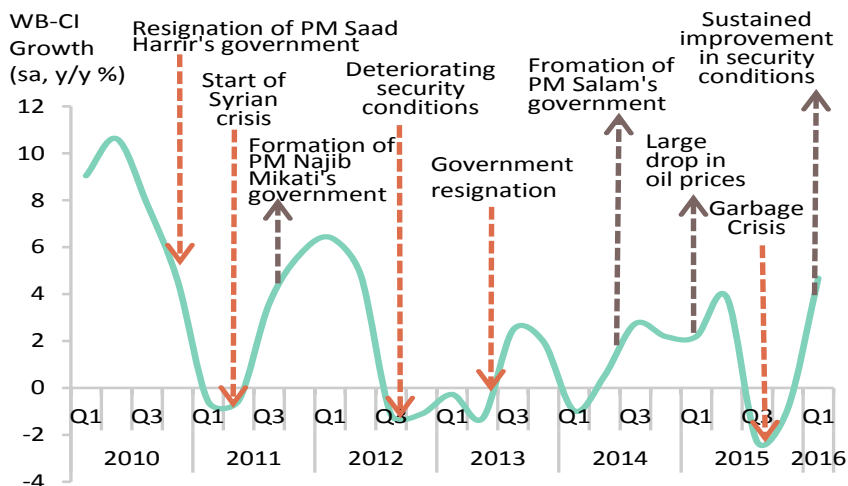
result, foreign exchange reserves at BdL declined by 5.4 percent to US\$30.6 billion by end-2015 (equivalent to 12 months of imports).

## Outlook

A stronger real estate sector as well as a continued increase in tourist arrivals are expected to lead to a small pickup in economic activity in 2016, which nonetheless would persist to be sluggish and below potential. Lebanon's economic prospects over the medium term are highly affected by geopolitical and security conditions, and those remain decidedly volatile. Projections assume that the Syrian war persists and that spillovers into Lebanon, while significant, remain contained. Based on this, we forecast growth over the medium term at 2.5 percent annually. Reaching pre-crisis rates is contingent on the resolution of the Syrian war in a manner that does not compromise the structure and stability of Lebanon, as well as on the resumption of the domestic political process.

Assuming oil prices will not fall much further, the benefits for Lebanon of cheap energy are likely to have plateaued in 2015 via (i) higher private consumption: an increase in the real purchasing power of consumers; (ii) stronger fiscal balance: smaller transfers to EdL; and (iii) improved balance of payments: less costly energy imports. However, even if oil prices do not increase, negative consequences could still materialize as fiscal buffers in

**FIGURE 1 Lebanon /** Volatile economic activity reflects frequent shocks.



Sources: World Bank staff calculations based on a World Bank designed coincident indicator of the Lebanese economy.

the GCC countries erode and spending cuts ensue, signs of which are emerging, leading to a deceleration of remittances to Lebanon. This will impart further strain on the balance of payments.

Work to understand the impact of the influx of Syrian refugees on the host community is underway. The World Bank and the Central Administration of Statistics are also working on improving data quality in a future household budget survey, which is planned in 2017.

## Risks and challenges

Spillovers from the war in Syria remains the principal challenge. Domestically, creeping political paralysis rendered the three main branches of government either vacant (the Presidency, since April 2014), idle (Parliament) or ineffective (Government). As a result, the population is increasingly bearing the consequences of failed governance via a marked deteri-

oration of government services, such as electricity, water supply and a visually powerful garbage crisis that has left piles of trash uncollected on the streets.

Lebanon is vulnerable to a further slowdown in net foreign asset accumulation in the face of persistent and sizable fiscal and current account deficits. To the extent that global financial and economic conditions, such as a slowdown in the GCC countries, induce a further reduction in capital inflows, Lebanon could be exposed to balance of payments risks. However, foreign exchange reserves remain at a comfortable level, a sizable interest rate gap attracts depositors and bond holders, especially when compared to stubbornly depressed global rates, and a captured depositor base provides much needed resiliency in the face of successive security and political shocks.

One of the key challenges to improving empirically-informed policy is to strengthen the data and analytical base of the government. An improved data system would better inform understanding

of the micro-implications of the crisis and build capacity in the Central Administration of Statistics for poverty measurement and monitoring.

**TABLE 1 Lebanon** / Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	0.9	1.8	1.3	1.8	2.2	2.3
Private Consumption	-1.3	-1.9	7.1	4.5	-0.9	0.8
Government Consumption	23.2	2.0	-0.3	1.9	2.2	0.6
Gross Fixed Capital Investment	1.0	5.5	-8.6	12.7	3.5	3.5
Exports, Goods and Services	-0.5	3.2	-2.3	1.4	3.2	3.7
Imports, Goods and Services	-1.2	-1.5	1.2	15.5	-1.0	1.0
<b>Real GDP growth, at constant factor prices</b>	1.3	2.4	2.4	1.8	2.2	2.3
Agriculture	7.0	4.5	0.6	7.1	2.5	-0.2
Industry	3.7	11.0	0.7	-7.5	4.1	2.7
Services	0.6	0.6	2.9	3.4	1.8	2.4
<b>Inflation (Consumer Price Index)</b>	2.7	1.2	-3.7	-1.5	2.0	3.0
<b>Current Account Balance (% of GDP)</b>	-25.9	-25.7	-17.3	-19.1	-19.7	-19.5
<b>Financial and Capital Account (% of GDP)</b>	3.6	3.1	3.9	2.1	2.8	3.0
Net Foreign Direct Investment (% of GDP)	1.7	3.7	3.7	3.6	3.7	3.7
<b>Fiscal Balance (% of GDP)</b>	-9.5	-6.6	-8.2	-7.9	-8.6	-9.0
<b>Debt (% of GDP)</b>	143.1	145.6	149.4	148.7	155.5	158.4
<b>Primary Balance (% of GDP)</b>	-0.9	2.6	1.3	1.8	1.4	1.5

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.

# LIBYA

*The Libyan economy is near collapse as political stalemate and civil conflict prevent it from fully exploiting its sole natural resource: oil. With oil production just a fifth of potential, revenues have plummeted, pushing fiscal and current account deficits to record highs. With the dinar rapidly losing value, inflation has accelerated, further eroding real incomes. In addition to near-term challenges of macroeconomic and social/political stability, medium-term challenges include rebuilding infrastructure and economic diversification for job creation and inclusive growth.*

## Recent developments

Political stalemate continues to prevent the country from realizing its growth potential. Oil production is estimated to have declined for the fourth consecutive year in 2016. Indeed, Libya just managed to produce an average 0.335 million barrels per day (bpd) over the first half of 2016 (a fifth of potential), almost 20 percent less than that produced in 2015-H1. As a result, the economy has remained mired in recession since 2013, with GDP shrinking by an estimated 8.3 percent in 2016. GDP per capita fell by almost two-thirds of its pre-revolution level, to US\$ 4,458.

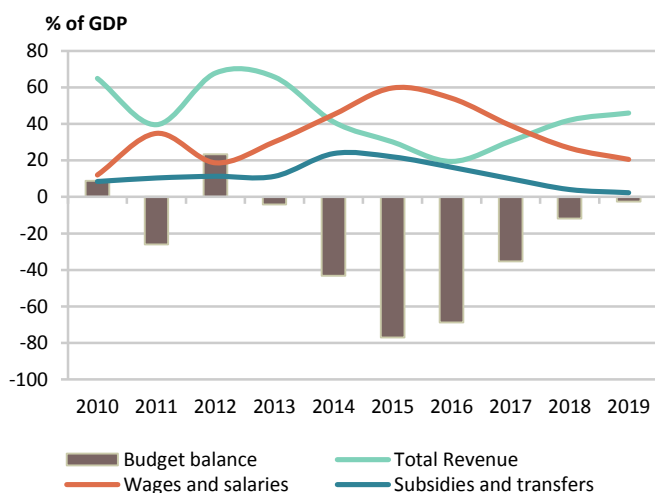
Inflationary pressures remained high over the first half of 2016 leading to substantial loss in real purchasing power of the population, especially given rising basic food prices. Lack of funds to pay due subsidies to importers and distributors of basic food since October 2015 translated into a de facto removal of subsidies to food. As a consequence, shortages in the supply of food emerged and the black markets prospered, which led prices of food to increase by 31 percent in 2016-H1. Headline inflation jumped to 24 percent over the same period. It is estimated that inflation will average 20 percent during 2016.

Ongoing political strife, low oil production and prices have hit public finances hard. Revenues from the hydrocarbon sector plummeted to the lowest amount on record at just LYD 3.2 billion during the first 7 months of 2016, amounting to

only a tenth of revenues that accrued over the same period last year. For 2016 as a whole, total revenues are estimated to reach LYD 8 billion, just sufficient to cover projected subsidy outlays for 2016. Spending on subsidies declined by 25.4 percent thanks to lower imported fuel prices and the removal of food subsidies. Wages also fell by 8.7 percent reflecting efforts to remove duplicate payments from government payrolls through extending and enforcing the use of the national identification number. However, outlays on wages (61 percent of GDP) and subsidies (18.4 percent of GDP) remain very high. Capital expenditure fell to a seventh of the pre-revolution amount. Overall, the budget deficit remained very high at 69 percent of GDP. The deficit was financed mainly through borrowing from the Central Bank of Libya and to a lesser extent from commercial banks. While the central government was a net lender before the revolution, domestic debt has since quickly increased to reach a high 110 percent of GDP in 2016.

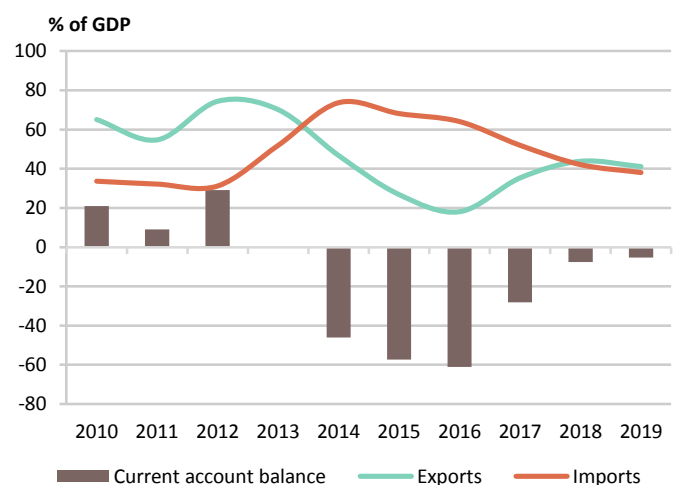
The balance of payments is also suffering from the ongoing political deadlock, exacerbated by low oil prices. Libya is only exporting 0.2 million bpd of oil this year, which is less than the sixth of potential. Hit further by declining oil prices, revenues from hydrocarbon exports are estimated to fall by a third in 2016, representing only 7 percent of the 2012 export revenues. Although declining, consumption-driven imports remained high. Against this backdrop, the current account deficit is projected to deteriorate this year to an estimated 61 percent of GDP, the third

**FIGURE 1 Libya / Public finances, in % of GDP**



Sources: Government of Libya and World Bank staff estimates.

**FIGURE 2 Libya / External accounts, in % of GDP**



Sources: Government of Libya and World Bank staff estimates.

deficit in a row. To finance these deficits, net foreign reserves are rapidly being depleted. They were halved from US\$107.6 billion in 2013 to an estimated US\$43 billion by end-2016. The official exchange rate of the Libyan Dinar (LYD) against the US\$ has been stable around its SDR peg, while the LYD in the parallel market lost 73 percent of its value due to weak macroeconomic fundamentals and foreign exchange restrictions.

## Outlook

The outlook hinges on the assumption that the Libya's House of Representatives will endorse a new government of national accord by the end of 2016, which will be able to start restoring security and launching programs to rebuild the economic and social infrastructures, especially oil facilities and terminals. In the baseline scenario, production of oil is projected to progressively improve to around 0.6 million bpd by end-2017. On this basis, GDP is projected to increase 28 percent. However, the twin deficits will remain as revenues from oil and will not be sufficient to cover budget expenditures and consumption-driven imports. This should keep the budget deficit at about 35 percent of GDP and the current account deficit at 28 per-

cent of GDP in 2017. However, downside risks to this scenario remain high as the political uncertainties may prevail.

Over the medium term, it is expected that oil production will progressively increase without reaching full capacity before 2020 due to the time necessary to restore the heavily damaged oil infrastructure. In this context, growth is projected to rebound at around 23 percent in 2018. Both the fiscal and current account balances will significantly improve, with the budget and the balance of payments running surpluses expected from 2020 onwards. Foreign reserves will average around US\$26 billion during 2017-2019, representing the equivalent of 13 months of imports.

Unless immediate and target action is taken to address the humanitarian crisis, the situation is unlikely to improve. The situation in Libya is such that simply relying on a slightly improved macro outlook is unlikely to bring about significant change. The country needs humanitarian aid and specific programs to address the destruction and lack of basic services that a large part of the population faces.

## Risks and challenges

Immediate challenges are to achieve macrostability while restoring and im-

proving basic public services. Current expenditures need to be brought under control, in particular the wage bill and subsidies. Over the medium term, the country needs broader and deeper structural reforms, inter alia by improving tax revenues, enhancing the management of public financial and human resources, launching civil service reform, and promoting the development and diversification of the private sector for job creation. Inclusive growth will require not only substantial increases in investments on key basic services to rebuild human capital, but also interventions targeted to the poor and the bottom 40 percent to restore the welfare of the population.

**TABLE 1** Libya / Macro outlook indicators

(annual percent change unless indicated otherwise)

	2012	2013	2014	2015e	2016e	2017f	2018f
<b>GDP, at constant market prices</b>	104.5	-13.6	-24.0	-8.9	-8.3	27.7	22.7
Private consumption	110.7	-8.5	-1.4	-14.9	-0.7	2.6	2.8
Government consumption	13.4	116.8	6.6	-19.4	-11.6	-1.5	-0.2
Gross fixed capital investment	54.3	56.9	-15.5	-24.6	-8.0	23.6	21.5
Exports, goods & services	218.1	-23.8	-54.6	-21.9	-18.1	112.4	44.6
Imports, goods & services	123.3	37.6	-8.2	-28.7	-3.5	8.7	4.8
<b>GDP, at constant market prices</b>	104.5	-13.6	-24.0	-8.9	-8.3	27.7	22.7
Hydrocarbon	211.4	-31.6	-53.7	-15.8	-19.2	76.3	54.6
Non-hydrocarbon	43.7	8.7	-1.0	-6.5	-5.0	15.0	10.0
<b>Inflation (Consumer Price Index)</b>	6.1	2.6	2.4	9.8	20.0	3.0	2.7
<b>Current account balance (% of GDP)</b>	29.1	0.0	-46.1	-57.3	-61.1	-28.1	-7.6
<b>Fiscal balance (% of GDP)</b>	23.4	-4.0	-43.3	-77.1	-68.9	-35.3	-11.8

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

Note: e = estimate; f = forecast.



# MOROCCO

Poor harvests have weighed on growth during 2016, but activity is expected to rebound in 2017. Thanks to sustained fiscal consolidation since 2013 and the fall in oil prices, the twin deficits have declined and exchange reserves increased. Over the medium term, promoting stronger private-sector led growth and job creation, narrowing inequalities and increasing shared prosperity remain paramount challenges.

## Recent developments

After a good performance in 2015, the economy is decelerating in 2016. Economic activity slowed to 1.4 percent in the second quarter (vs. 4.2 percent during the same period last year), as a result of a 12.1 percent contraction in agricultural production, while growth outside the agriculture sector remained sluggish at around 2.5 percent. Inflation has remained muted at under 2 percent reflecting prudent monetary policy and the fall in international commodity prices.

While the overall unemployment rate has hovered around 9 percent in recent years, the rate among urban youth is much higher and reached 38.8 percent in June 2016.

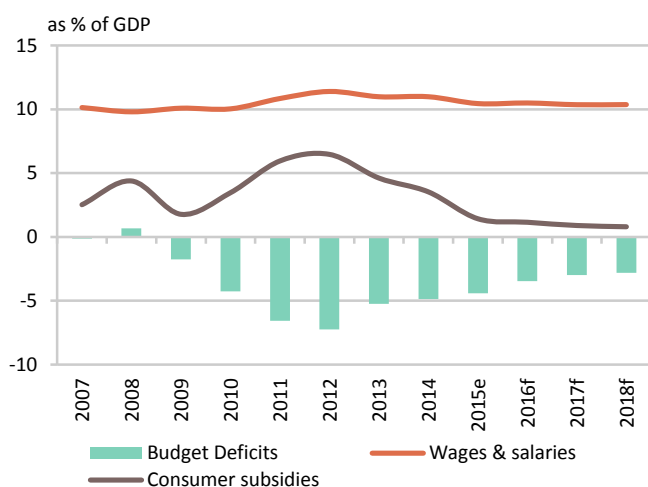
With the successful liberalization of petroleum prices (gasoline and diesel) and other fiscal consolidation efforts since 2013, Morocco's fiscal deficit has been on a downward path and the external current account has improved significantly. Based on performance since the beginning of the year, Morocco is expected to reduce its fiscal deficit to 3.5 percent of GDP in 2016. This would be the result of strong revenue performance and the continued reduction in consumption subsidies. Yet, achieving the end-year fiscal target still depends on further reining in expenditure, especially transfers to public enterprises. Morocco should be able to stabilize the central government debt at around 64 percent of GDP. On the external front, the trade deficit deteriorated by 7 percent during 2016-H1. Higher exports from Morocco's new

industries, especially automobiles, could not compensate the rise in wheat and intermediate goods imports. Also, phosphate exports have sharply declined. Tourist receipts and workers' remittances remained important sources of income and were growing at 3.3 percent and 3.9 percent at end-June 2016, respectively. In contrast, after several years of good performance, FDI inflows have decreased by 11.2 percent during the first half of 2016. Overall, Morocco's international reserves continued to increase and reached US\$24.9 billion or the equivalent of 7.3 months of imports at end-June 2016.

## Outlook

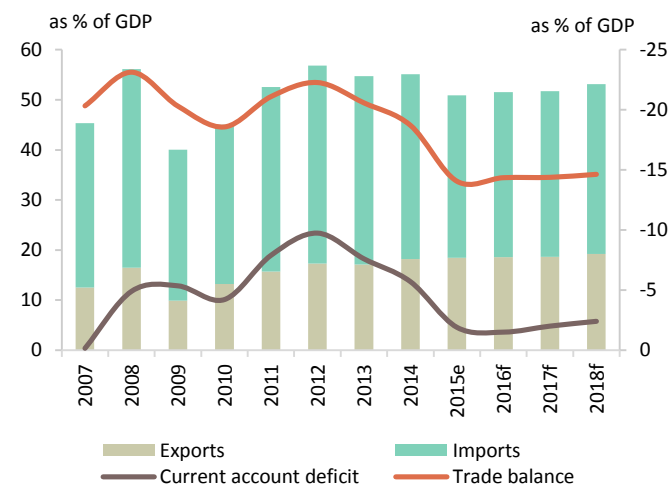
In the short term, Morocco's GDP growth should slow down to 1.5 percent in 2016 as the full impact of the fall 2015 drought unwinds. Agricultural GDP is projected to contract by 9.5 percent in 2016 before rebounding by 8.9 percent in 2017. Non-agricultural GDP growth is expected to hover around 3 percent in the absence of more decisive structural reforms. In line with the government's commitment, the fiscal deficit should be further reduced to 3 percent of GDP in 2017, which should also feature an enhanced central and local Governments' budget design and implementation for better public service delivery and efficiency consistent with the new Organic Budget Law. The current account deficit is projected to narrow further to 1.5 percent of GDP in 2016 as international oil prices remain low. External financing re-

**FIGURE 1 Morocco / Budget deficits are mostly determined by consumer subsidies**



Sources: World Bank.

**FIGURE 2 Morocco / External position**



Sources: World Bank.

quirements will remain a moderate concern, given the relatively low external debt, financial support from the GCC countries, and Morocco's investment grade ratings on international markets. In July 2016, the IMF approved a new two-year arrangement for Morocco under the Precautionary and Liquidity Line, which will continue to serve as insurance against external shocks.

Over the medium term, Morocco should be able to accelerate its economic growth while maintaining macroeconomic stability. The strong performance of the newly developed industries (automobile, aeronautics and electronics) and the expansion of Moroccan companies in Western Africa are potentially creating the conditions for Morocco to boost its position in global value chains. However, economic prospects and the consolidation of its macroeconomic stability gains over the medium term depend on the pursuit of sound macroeconomic policies and the deepening of structural reforms aiming at accelerating productivity gains, reducing youth unemployment, increasing female labor force participation, and reducing further poverty and inequalities. Assuming the full implementation of a comprehensive reform agenda following the autumn 2016 parliamentary elections, growth could accelerate toward 4 percent over the medium term, with inflation kept

around 2 percent.

The spatial inequalities are likely to persist in the absence of targeted policies that address the multitude of challenges faced in the lagging regions of the country.

## Risks and challenges

Increasing the economy's competitiveness, boosting growth and employment, strengthening fiscal buffers and leveraging the political stability constitute the key challenges for Morocco. Notwithstanding Morocco's relatively strong economic performance in the MENA region in recent years, the economy has remained structurally oriented toward nontradable activities (such as construction, public works, and low value-added services) and a volatile, weakly productive rain-fed agriculture. Given this orientation, Morocco has made little productivity gains over the past two decades despite high levels of investment. Investment efforts—dominated by publicly funded large infrastructure projects—have not yet triggered a growth takeoff. Morocco has yet to secure the productivity and competitiveness gains needed to further integrate into world markets. This requires further efforts to strengthen public governance, improve the business envi-

ronment and investment climate, and increase human capital. Meanwhile, greater exchange rate flexibility would help the economy absorb shocks (including those related to lower growth in the euro area and Brexit uncertainty) and support the economic diversification. The recently launched National Strategy for Employment, aimed at creating 200,000 new jobs annually and reduce unemployment to 3.9 percent in ten years, will require no less ambitious reforms to ensure a well-functioning labor market conducive to private sector job creation.

**TABLE 1 Morocco / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	4.5	2.6	4.5	1.5	3.4	3.5
Private Consumption	3.2	3.6	2.4	2.6	3.7	3.7
Government Consumption	4.2	1.8	1.9	2.7	4.1	4.0
Gross Fixed Capital Investment	-0.5	-2.1	1.5	1.5	1.9	2.0
Exports, Goods and Services	0.0	8.4	6.0	5.0	5.9	5.9
Imports, Goods and Services	-0.1	3.3	-3.1	6.4	4.9	4.7
<b>Real GDP growth, at constant factor prices</b>	3.8	1.8	3.4	0.0	3.4	2.8
Agriculture	17.8	-2.3	13.0	-9.5	8.9	2.5
Industry	0.6	3.1	2.8	3.0	3.2	3.5
Services	1.9	2.3	1.2	1.4	2.1	2.6
<b>Inflation (Consumer Price Index)</b>	1.9	0.4	1.6	1.5	2.0	2.0
<b>Current Account Balance (% of GDP)</b>	-7.6	-5.7	-1.9	-1.5	-2.0	-2.4
<b>Fiscal Balance (% of GDP)</b>	-5.2	-4.9	-4.4	-3.5	-3.0	-2.8
<b>Debt (% of GDP)</b>	61.7	63.4	64.1	64.6	64.2	63.6
<b>Primary Balance (% of GDP)</b>	-2.6	-2.1	-1.5	-0.5	0.0	-0.4

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.

# OMAN

*Slower economic growth estimated in 2016 is a reflection of lower oil sector investment coupled with the knock-on effects of lower public spending. Significant fiscal consolidation efforts have led to fiscal savings, but the deficit remains high. Low oil prices have also widened the current account deficit despite higher export volume. Oman continues to resort to its reserves and to borrowing. The projected uptick in oil prices and expansion of the non-oil economy will improve the macroeconomic outlook.*

## Recent developments

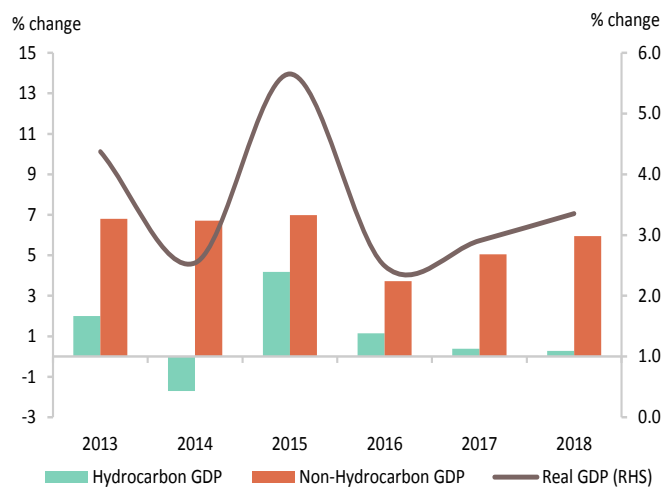
Real GDP growth in Oman is estimated to slow to 2.5 percent in 2016 from 5.7 percent in 2015, according to recently rebased data. Higher growth in 2015 was due to record oil production levels. But lower oil sector investment in 2016 is expected to slow hydrocarbon GDP growth to 1.1 percent from 4 percent in 2015. Non-hydrocarbon GDP growth is estimated to drop to 4 percent in 2016 from 7 percent in 2015 as public spending declines with knock-on effects on investment and consumption. The current account balance turned into a deficit of 15.5 percent of GDP in 2015 and is expected to widen to 20 percent of GDP in 2016 despite higher export volumes. The Central Bank policy rate remained unchanged, but interbank lending rates continue to inch upwards. Inflation is estimated to increase from 0.1 percent in 2015 to 0.9 percent in 2016 reflecting the fuel price hike early this year. Fiscal consolidation efforts are projected to slightly narrow the fiscal deficit in 2016 to 15.9 percent from the record high level of 16.5 percent of GDP in 2015 (17.2 percent excluding grants). Fuel subsidy reform, cuts in defense and capital spending and wages and benefits were the main levers of consolidation. While oil and gas revenue fell by 20 percent in 2016, non-hydrocarbon revenue is estimated to increase on the back of higher customs and investment income. To finance the deficit Oman borrowed US\$1 billion from a consortium of banks in January and issued its

first sovereign bond since 1997 worth US\$2.5 billion in June. The government plans to tap US\$1.5 billion of Oman's general reserves and further borrow US\$5-10 billion from the international debt markets in 2016.

The government's policy directions reflect a continued focus on fiscal consolidation and diversification. Sultan Qaboos approved an economic diversification program that uses Malaysia's economic transformation model, and that supports sectors such as logistics, manufacturing and tourism. Reforms began in 2015 with the doubling of gas prices for industrial users, increasing diesel and petrol prices by up to 33 percent, designating an office for speeding up the process for issuing licenses, containing wage bill growth, and removing some tax exemptions. Also, the liberalization of the aviation sector reflects a policy shift away from protectionism. Natural gas projects will be a priority to cater for the increased power demand expected to result from diversification. Other reforms expected to be implemented in the forecast period include higher corporate income tax, a GCC-wide VAT, a move towards a fully cost-reflective tariff for large industrial consumers of electricity, and increasing excises and fees for government services.

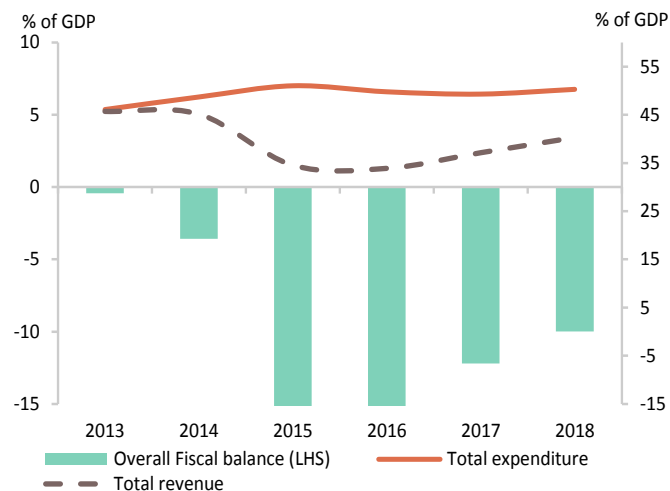
The main social concerns include the lack of jobs for the youth and, to some extent, regional disparities. ILO estimates youth unemployment in Oman at 20 percent, a pressing problem in a country where almost 40 percent of the population is less than 25 years old. Young Omanis typically wait three years to find a job—partly re-

**FIGURE 1 Oman / Real annual GDP growth**



Sources: Omani authorities, World Bank staff estimates.

**FIGURE 2 Oman / General government operations (in percent of GDP)**



Sources: Omani authorities, World Bank staff estimates.

flecting their strong preference for public sector jobs, where pay is higher and working hours are shorter. Oman will have to generate 45,000 jobs annually to address the problem, and the ongoing effort to replace expatriates with Omanis (so-called 'Omanization' policy) will be insufficient without an improvement in the environment for private sector job creation.

## Outlook

Overall real GDP growth is projected to slightly recover over the medium term, reaching 3.4 percent by 2018, as a gradual recovery of oil prices improves confidence and encourages private sector investment. This will be further supported by the new foreign ownership law and liberalization in aviation. Oman is expected to focus its infrastructure investment in tourism and logistics. Continued fiscal austerity measures and revenue mobilization, combined with higher oil prices, will allow the budget deficit to further narrow to 10 percent of GDP in 2018. But with further bond issuances in the pipeline, debt is likely to rise dramatically. Trade and investment opportunities with Iran are expected to increase as the sanctions are lifted. The current account deficit is pro-

jected to remain high at 19.5 percent in 2017 but should narrow as oil prices rise, non-oil exports grow, and the gas pipeline with Iran increases LNG exports. Cost push pressures from rising global food prices and subsidy reform are expected to increase inflation to 2.8 percent by 2018. Oman is expected to maintain its peg to the US dollar.

## Risks and challenges

Continued and gradual reform is needed to maintain fiscal and external sustainability, and to support the peg over the long term. Authorities will need to monitor emerging risks affecting the resilience of Oman's financial sector. In addition, with the Omani population growing at 4 percent annually, job creation is a major challenge. In the medium term Oman may need to adopt policies to mitigate the impact on the population of the declining oil revenues brought by low prices and a relatively short oil horizon. Efficiencies could be gained by moving away from universal subsidies to more targeted transfers. A review of existing social programs and an upgrade of capacity to measure and analyze welfare would be necessary.

Social and political obstacles to cutting expenditure remain; intensifying the need for increasing non-oil revenues. Thus successful implementation of the planned diversification reforms under the 9<sup>th</sup> development plan is critical to sustaining growth and securing employment opportunities. Key areas of risk facing the Omani economy include further oil price shocks and possible rate hikes by the Fed. Moreover a continued slowdown in China, Oman's main trading partner, would add to downside risks.

**TABLE 1 Oman / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015 f	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	4.4	2.5	5.7	2.5	2.9	3.4
Private Consumption	-6.9	5.6	2.9	2.7	2.8	3.2
Government Consumption	17.6	9.6	0.8	0.6	0.9	1.3
Gross Fixed Capital Investment	6.1	0.8	2.5	2.1	2.3	2.8
Exports, Goods and Services	12.5	-2.1	-9.4	3.0	4.0	4.2
Imports, Goods and Services	18.7	-9.8	-3.2	-2.3	-1.0	1.1
<b>Prices</b>						
Inflation (Consumer Price Index)	1.2	1.0	0.1	0.9	2.5	2.8
<b>Current Account Balance (% of GDP)</b>	6.6	5.2	-15.5	-20.0	-19.5	-16.0
<b>Fiscal Balance (% of GDP)</b>	-0.4	-3.6	-16.5	-15.9	-12.2	-10.0
	..	..	..	..	..	..
	..	..	..	..	..	..

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice. Notes: f = forecast. In annual percent change unless indicated otherwise.

# PALESTINIAN TERRITORIES

Recovering slowly from the 2014 recession, the Palestinian economy is estimated to have expanded by 8 percent in Q1 2016 due to transitory factors, mainly an uptick in Gaza reconstruction. At 27 percent, unemployment continues to be stubbornly high. Given the ongoing constraints to economic competitiveness, medium-term growth is projected at 3.5 percent. Lower than expected aid and the possibility of further conflict pose downside risks to growth and employment.

## Recent developments

After a recession in 2014 following the Gaza war, economic activity has picked up in the Palestinian territories. Real GDP growth for West Bank and Gaza as a whole reached 3.5 percent in 2015 and 8 percent in the first quarter of 2016. Growth was mainly driven by a rebound in Gaza where the economy is estimated to have expanded by 21 percent in the first quarter of 2016 due to an upsurge in reconstruction activity. The West Bank economy expanded by 4.2 percent in the first quarter of 2016, and growth was concentrated in services and household consumption financed by bank loans.

At 27 percent, the unemployment rate in the Palestinian territories remains stubbornly high. The overall figure masks wide regional differences with unemployment in Gaza, at 42 percent, more than twice as high as that in the West Bank at 18 percent. Youth unemployment continues to be a major concern in the Palestinian territories, particularly in Gaza where more than half of those aged between 15 and 29 are out of work.

The inflation rate remains very low averaging 0.2 percent in the period between January and June 2016. The Israeli Sheqel is the main currency in circulation in the Palestinian territories, and hence inflation has been kept low by deflation in Israel and a fall in global fuel and food prices.

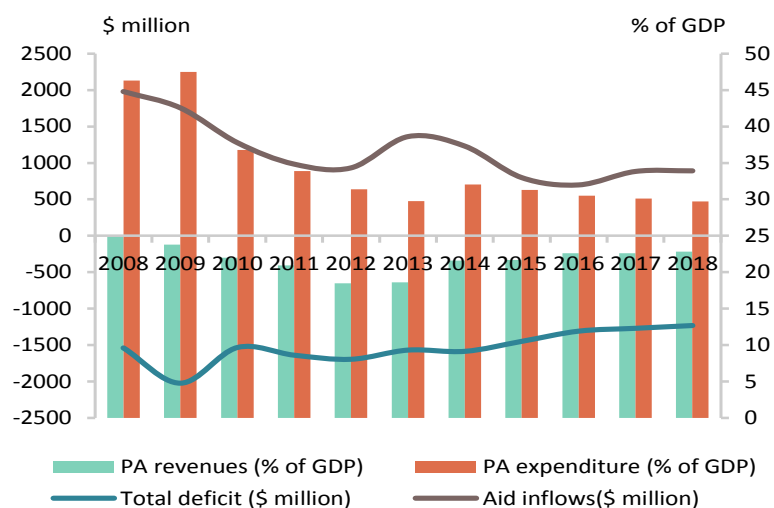
The Palestinian Authority's (PA) fiscal situation remains difficult despite an impressive revenue performance so far in 2016. Public revenues grew by 24 percent in the

first half of 2016 on account of frontloaded domestic taxes and one-off revenue transfers by the Government of Israel (GoI). This offset the higher than budgeted growth in expenditures, driven by unexpected wage increases for teachers and engineers, and led to a 23 percent drop in the deficit in the first half of 2016 (year-on-year). In parallel, aid to the PA treasury declined by 28 percent, resulting in a US\$205 million financing gap and further arrears accumulation. The external current account deficit (excluding official transfers) is estimated to have widened by 4 percentage points in 2015 to reach 22 percent of GDP. This is due to an increase in the trade deficit to 41 percent of GDP, as a result of a rise in non-Israeli imports. On the other hand, imports from Israel, the Palestinian territories' main trading partner, saw a decline in 2015 due to lower fuel prices and a growing trend among Palestinian consumers to substitute products imported from Israel by those from other countries. Exports remained low and stagnant at around 18 percent of GDP in 2015.

## Outlook

The recent pickup in growth was driven by Gaza reconstruction and is not sustainable without efforts to improve economic competitiveness. Therefore, the economic outlook for the Palestinian territories remains worrying. Assuming that the current restrictions remain in place and that the security situation stays relatively calm, the real GDP growth rate

**FIGURE 1** Palestinian territories / Estimates and outlook: Public finances



Sources: Palestinian MoF and staff estimates.

of the Palestinian economy in 2016 is projected at 3.3 percent: 2.7 percent in the West Bank and 5.5 percent in Gaza. In the medium term, real GDP growth could hover around 3.5 percent. This sluggish growth implies a stagnation in real per capita income and an increase in unemployment.

The fiscal deficit (before grants) is projected to decline to 10 percent of GDP (US\$1.3 billion) in 2016. At the same time, foreign aid in 2016 could fall to under US\$700 million, leaving a financing gap in excess of US\$600 million (4.7 percent of GDP). The PA plans to implement measures to reduce this gap, but those will not be enough to fully close it. Unless donor aid is significantly stepped up, the gap will be mostly financed through arrears to the private sector and the pension fund since borrowing from local banks is very close to the maximum limit set by the Palestinian Monetary Authority. On the external side, the cur-

rent account deficit (excluding official transfers) is expected to slightly decline to 21 percent of GDP in 2016 due to a decline in imports.

## Risks and challenges

Lack of progress in the Israeli-Palestinian peace process and the ongoing constraints to economic competitiveness continue to stand in the way of a sustainable economic recovery in the Palestinian territories and downside risks to growth and employment remain significant. First, despite some progress in recent months, setbacks to the reconstruction process in Gaza are possible. The resumption of armed conflict cannot be ruled out and if this happens, the Gaza economy is expected to slip back into recession. Second, the outcome in the West Bank may be worse than expected if the decline in do-

nor support exceeds current projections. Also, if tensions erupt again throughout the West Bank, they will result in elevated security risks that may negatively impact economic activity and poverty.

**TABLE 1** Palestinian territories / Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	2.2	-0.2	3.5	3.3	3.5	3.5
Private Consumption	-4.0	3.5	4.6	4.0	5.0	5.0
Government Consumption	-1.6	3.7	2.9	4.0	4.0	4.0
Gross Fixed Capital Investment	17.7	-4.4	9.9	-6.1	-13.9	-8.4
Exports, Goods and Services	3.3	1.2	11.1	-5.3	5.6	4.0
Imports, Goods and Services	-1.7	3.5	9.0	-2.1	-0.6	2.1
<b>Real GDP growth, at constant factor prices</b>	2.4	-2.3	3.1	3.3	3.5	3.5
Agriculture	-8.6	-7.6	-11.4	0.5	1.4	1.0
Industry	6.1	-13.8	1.4	1.4	4.0	4.0
Services	1.7	3.1	4.7	4.1	3.4	3.5
<b>Inflation (Consumer Price Index)</b>	1.7	1.7	1.6	1.3	1.3	1.9
<b>Current Account Balance (% of GDP)</b>	-14.4	-9.6	-16.0	-15.6	-13.2	-12.6
<b>Financial and Capital Account (% of GDP)</b>	12.5	6.6	14.8	15.5	13.1	12.4
Net Foreign Direct Investment (% of GDP)	1.8	-0.2	-0.5	1.2	0.1	0.1
<b>Fiscal Balance (% of GDP)</b>	-1.7	-2.8	-5.1	-4.7	-3.0	-2.6
<b>Poverty rate (\$3.1/day PPP terms)<sup>a,b,c</sup></b>	0.6	0.7	0.6	0.6	0.6	0.6
<b>Poverty rate (\$5.5/day PPP terms)<sup>a,b,c</sup></b>	7.0	7.8	7.6	7.4	7.3	7.2

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

Notes: e = estimate, f = forecast.

(a) Calculations based on 2009-PECS.

(b) Projection using neutral distribution (2009) with pass-through = 0.7 based on GDP per capita constant in constant LCU.

# QATAR

*Growth has slowed further in Qatar. Both current account and fiscal balances are projected to have shifted into deficits during 2016, for the first in decades. In light of the uncertain medium-term outlook for the gas sector later this decade and beyond, the development of the non-hydrocarbon sector is critical.*

## Recent developments

Like its GCC neighbors, Qatar appears to be entering a period of slower growth. GDP growth eased to 3.6 percent in 2015 (from 4.2 percent in 2014), with output in the hydrocarbon sector broadly flat. Growth in the latter has fallen sharply since 2012 in line with stagnating production, in large measure due to a self-imposed moratorium on additional output from the North Field. More recently, the oil price slump has also taken a toll. Nominal GDP fell 20 percent in 2015, due to deteriorating terms of trade, while non-hydrocarbon sector growth slowed to 7.6 percent (vs. 11 percent in 2014) on weaker consumer confidence, fiscal adjustment and tighter banking sector liquidity. Large fiscal and current account surpluses have vanished. Hydrocarbon revenues account for some 90 percent of fiscal receipts and the bulk of export earnings. With low oil prices persisting, the current account surplus has narrowed sharply, from over 30 percent of GDP in 2011-12 to 8 percent in 2015.

With fiscal revenues falling sharply amid continued fiscal outlays related to the staging of the 2022 World Cup, the general government fiscal balance has shifted into deficit and is projected to reach 12.1 percent in 2016. Policy shifts to prioritize capital spending on projects deemed critical to economic diversification and the World Cup were reflected in the shelving of major “non-essential” projects (notably the US\$6.4 billion Al-Karaana petrochem-

icals complex in 2015). It is estimated that government spending on new construction and transport contracts fell by 92 percent (y/y) in Q1 2016.

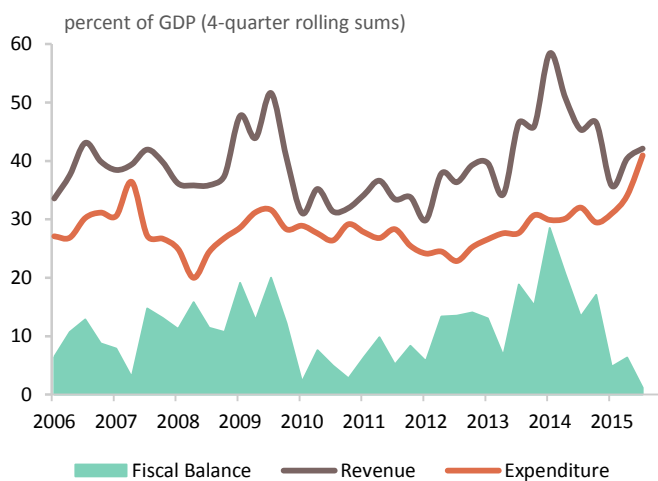
The government has begun to rationalize subsidies, allowing fuel prices to more closely track global prices. It is also developing new revenue sources, including through planning for a value added tax. Large buffers are anchoring confidence amid rising debt issuance. Qatar’s SWF is estimated to hold US\$256 billion in assets. Instead of drawing upon the SWF to fund the fiscal deficit, the government has issued QR 4.6 billion and US\$9 billion in debt markets thus far in 2016. Indications are that no new money has been allocated to the SWF this year, with new investments to be funded through asset sales or dividend income.

By and large, though, fiscal policy tends to be pro-cyclical in Qatar with the country needing fiscal frameworks to insulate the budget from commodity price volatility. The country could benefit from cross-governmental planning, coordination, and public investment management of non-hydrocarbon projects

Monetary policy remains accommodative but banking liquidity is tight. The central bank chose not to mirror the US Fed’s policy rate hike in December 2015. But with further tightening by the Fed likely, it will eventually need to follow suit given the currency peg. Banking sector solvency indicators and capital buffers remain healthy; however both deposit and credit growth have slowed.

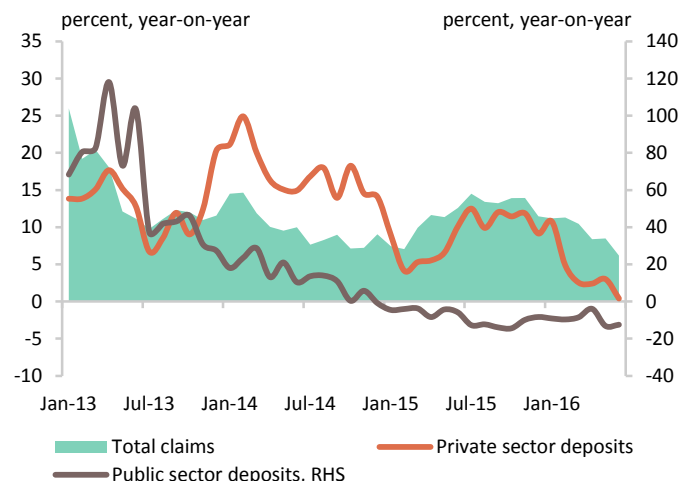
Living standard monitoring and analysis should contribute to better design of social

**FIGURE 1 Qatar / Fiscal indicators**



Sources: Central Bank of Qatar, World Bank.

**FIGURE 2 Qatar / Commercial banks, lending and deposit growth**



Sources: Central Bank of Qatar, World Bank.

policies, including their targeting, especially in light of the recent rise in utility tariffs and the elimination of subsidies.

## Risks and challenges

### Outlook

Qatar is projected to continue growing at a moderate pace. Qatar is in the second year of a US\$200 billion infrastructure upgrade ahead of hosting the World Cup, which should support activity, particularly in construction, transport and services. GDP growth is projected at 2.1 percent in 2016, and should gradually rise 3.7 percent in 2018. Natural gas production has plateaued, and is expected to decline. However, the 1.4 billion cubic feet per day Barzan gas project – the last project approved before the North Field moratorium – is set for start in 2016 with full output expected in 2017. This should offset some of the anticipated production decline.

Fiscal and CA balances should gradually improve. As gas production increases and oil prices recover, export earnings should recover. The CA deficit will stay elevated during the forecast period, reflecting FIFA related capital imports before gradually narrowing to 3.2 percent of GDP in 2018. The fiscal deficit will narrow, also helped by savings in current expenditures and subsidy reforms, but is expected to remain large at close to 9 percent in 2018 (general government basis).

Key downside risks include depressed global oil and gas prices, which lead to a slower-than-expected improvement in fiscal balances at a time when the GCC region as a whole is tapping international investors for funds to finance fiscal shortfalls. Room to cut capital spending is limited given contractual obligations regarding FIFA.

Other risks include volatility in global financial markets, or regional instability that disrupts oil and gas production and/or capital inflows. Over the medium term, growing competition and the emergence of a global spot market in gas prices could pose a challenge to Qatar's dominance in global LNG markets.

In light of the uncertain medium-term outlook for the gas sector later this decade and beyond, the development of the non-hydrocarbon sector is of even greater importance. Qatar's investment-driven growth strategy over the past decade has yet to deliver benefits in terms of greater productivity growth, even as bottlenecks have been visible in the form of overheating pressures, congestion and pollution, and demographic imbalances. To diversify Qatar will have to raise the productivity of its investment, in both human and physical capital, and undertake structural reforms to improve the business environment.

**TABLE 1** Qatar / Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	4.4	4.0	3.6	2.1	3.6	3.7
Private Consumption	8.8	8.0	7.9	3.5	3.8	4.0
Government Consumption	24.1	8.9	1.1	-8.9	1.0	1.0
Gross Fixed Capital Investment	6.4	11.3	1.3	9.3	10.4	9.7
Exports, Goods and Services	1.3	0.4	-1.4	1.5	2.5	3.0
Imports, Goods and Services	8.7	6.4	-9.2	3.0	6.5	6.5
<b>Real GDP growth, at constant factor prices</b>	4.4	4.0	3.6	2.0	3.5	3.7
Agriculture	5.9	25.0	8.5	3.9	6.4	6.4
Industry	2.2	1.9	1.7	1.7	2.0	1.9
Services	10.3	9.3	7.8	2.7	6.9	7.5
<b>Inflation (Consumer Price Index)</b>	3.1	3.1	1.9	0.0	0.0	0.0
<b>Current Account Balance (% of GDP)</b>	30.4	24.0	8.4	-1.1	-5.6	-3.2
<b>Financial and Capital Account (% of GDP)</b>	-27.7	-19.7	17.1	30.0	26.8	17.1
Net Foreign Direct Investment (% of GDP)	-4.5	-2.8	-3.6	-3.8	-3.8	-3.6
<b>Fiscal Balance (% of GDP)*</b>	34.9	35.9	10.3	-12.1	-11.7	-8.9
<b>Primary Balance (% of GDP)</b>	37.5	38.0	11.9	-10.1	-9.2	-6.3

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast. \* General Government basis



# SAUDI ARABIA

## Recent developments

*Cheap oil continues to test the economic resilience of the Kingdom of Saudi Arabia (KSA). In the first half of 2016, the authorities switched gears from an ad hoc approach to a medium- and long-term strategy to counter the growing challenges posed by the new reality of oil markets. With unfolding fiscal consolidation efforts, tradeoffs between fiscal sustainability and public spending driven growth will manifest themselves in favor of the former.*

Low oil prices continue to threaten growth and fiscal sustainability in the Kingdom of Saudi Arabia (KSA). Despite a recent recovery, at US\$45 per barrel as of July 2016, prices remain 60 percent below their peak in June 2014. With hydrocarbons accounting for about 80 percent of fiscal revenues and more than 40 percent of GDP (Figure 1), the KSA remains vulnerable to subdued prices.

The Government of the Kingdom of Saudi Arabia (GoKSA) initially responded to the oil price slump with a counter-cyclical reflex: oil output was increased from 9.7 million barrels per day (bpd) in 2014 to 10.1 million bpd in 2015, and fiscal expenditure cuts were contained at 2.5 percentage points of GDP. However, despite keeping growth at 3.4 percent in 2015, with sharply decreasing revenues, this approach triggered a twin-deficit: a fiscal deficit estimated at 15.2 percent of GDP and a current account deficit estimated at 8.3 percent of GDP. Deficits were largely financed by using SAMA's reserves, which dropped from USD 727 billion in 2014 to USD 612 billion (106 percent of GDP) by the end of 2015.

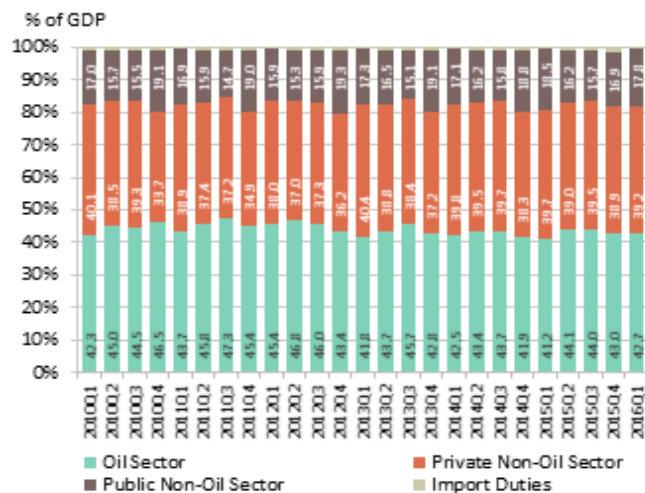
Concerned with the potentially protracted nature of these deficits, the authorities moved to consolidate the medium-term fiscal outlook. Initial measures included a 2.5 percent tax on undeveloped land, US\$23 airport fee for foreigners, and increases in fuel, gas and water prices. In addition, a 5 percent Value Added Tax

(VAT) and additional taxes on tobacco and soft drinks, have been announced, but implementation may take time. The major shift in policies, however, came with the announcement of Vision 2030 and the National Transformation Plan (NTP) in the second quarter of 2016.

The Vision aims to revamp the scope of public investments, raise the private sector's share in the economy, and rationalize government expenditures. Key reforms include an ambitious subsidy reform program; increased transparency and government efficiency; partnerships with private investors to localize renewable energy and industrial equipment sectors. An IPO of about 5 percent of ARAMCO – KSA's oil company with an estimated value at US\$2 trillion, is also planned. The NTP aims to fulfill the Vision 2030 objectives by: (i) identifying strategic objectives and targets for participating agencies; (ii) translating the objectives to initiatives with implementation plans and feasibility studies; and (iii) promoting joint action for a number of national priorities. The actionable implications of this framework involve a number of strategic objectives assigned to individual entities. Progress in each of these objectives will be monitored by a set of indicators and associated targets until 2020.

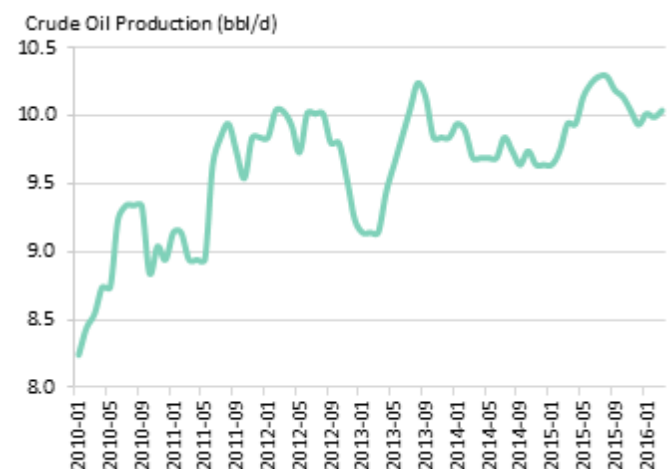
Monetary policy remains constrained by the peg to the US dollar. While the peg provides stability and predictability, it has also led to about 40 percent real appreciation in KSA's effective exchange rate against major trading partners since July 2008.

**FIGURE 1 Saudi Arabia / Institutional composition of the GDP (Constant Prices)**



Sources: KSA General Authority for Statistics.

**FIGURE 2 Saudi Arabia / Crude oil production in the KSA**



Sources: US Energy Information Administration.

Although the NTP should have significant implication for welfare of Kingdom's citizens, the plan does not include a direct focus on these issues. Further improvements in welfare measurement and analysis capacity would contribute to better design of policies to mitigate the impact of the ongoing fiscal consolidation on the well-being of the national population.

## Outlook

With fiscal consolidation progressing, amid weakening investor and consumer sentiment, both government and private consumption are expected to slow in 2016. Based on Q1 performance (Figure 2), oil production is unlikely to fully offset these losses. Overall, growth is projected to slow to 1.0 percent in 2016 and to accelerate gradually to 1.6 percent and 2.5 percent in 2017 and 2018, respectively.

On the external side, the current account is projected to remain in the red, at 9.5 percent of GDP in 2016. Going forward, export prices should recover gradually in 2017 and 2018. With slower recovery in imports, the current account should revert to small surpluses from 2018 onwards.

The fiscal outlook is stable in the short

term with large reserves held by SAMA. However, with US\$43 average oil price in 2016 (the latest World Bank projections) current fiscal measures are insufficient, and the fiscal deficit is projected to remain at 13.6 percent of GDP. Efforts to raise non-oil revenues will likely yield some (albeit modest) savings and expenditure cuts will occur gradually, focusing primarily on the capital budget. These measures are projected to gradually reduce the overall fiscal deficit-to-GDP ratio.

Inflation should be restrained by fiscal contraction on the demand side, but be supported by hikes in utility prices. Social indicators may deteriorate along with fiscal consolidation and lower incomes, but data to assess the risks and vulnerabilities are not available.

## Risks and challenges

With significant dependency on hydrocarbons, the Kingdom's economic outlook is remarkably sensitive to oil price movements. Although fiscal deficits are not likely to pose serious sustainability challenges in the short term, they will lead to erosion of accumulated reserves and increases in the public debt (the authorities are likely to rely on both

methods to avoid any sharp movements in either indicator) over the medium term.

The National Transformation Plan provides an important vehicle for maintaining fiscal sustainability and promoting diversification. However, in the absence of an overarching medium-term macroeconomic and fiscal framework, the reforms may remain partial and uncoordinated across various implementing agencies.

**TABLE 1 Saudi Arabia /** Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	2.7	3.6	3.4	1.0	1.6	2.5
Private Consumption	3.2	6.1	4.0	1.8	2.5	3.5
Government Consumption	11.1	12.0	3.9	-1.1	1.8	1.8
Gross Fixed Capital Investment	5.6	7.5	4.5	0.7	2.6	4.5
Exports, Goods and Services	0.2	1.7	3.0	2.1	0.9	1.8
Imports, Goods and Services	3.7	11.3	5.2	1.5	2.5	3.8
<b>Real GDP growth, at constant factor prices</b>	2.7	3.5	3.4	1.0	1.6	2.5
Agriculture	1.9	1.8	1.1	-0.2	-0.1	0.2
Industry	0.2	2.7	3.8	0.4	0.8	1.4
Services	6.5	4.7	2.9	1.9	2.9	4.0
<b>Inflation (Consumer Price Index)</b>	3.5	2.7	2.2	4.3	4.1	4.2
<b>Current Account Balance (% of GDP)</b>	18.3	9.7	-8.3	-9.5	-3.4	0.6
<b>Fiscal Balance (% of GDP)</b>	5.8	-3.6	-15.2	-13.6	-9.5	-6.6
<b>Primary Balance (% of GDP)</b>	6.0	-3.5	-14.8	-13.2	-8.1	-6.5

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.

# SYRIA

*Syria has experienced devastating conflict since 2011, which has resulted in a tragic human and socioeconomic situation. Violence continues to disrupt the production and distribution of goods and services, and impedes economic activity. Physical harm, poor nutrition and health services, unemployment, poverty, and the breakdown of public service delivery will continue to weigh heavily on the population. The medium-term macroeconomic prospects hinge on containing the war and ultimately finding a political resolution to the conflict.*

## Recent developments

The proliferation of the violent conflict in Syria over the past six years has taken a heavy toll on life of the Syrian people and is resulting in a large outflow of refugees. The estimated death toll has exceeded 250,000 people (as per the UN); a recent report by the Syrian Center for Policy Research (SCPR) put the death toll at 470,000, with 1.2 million injured and many more displaced. In addition, 1.1 million asylum applications were filed by Syrians in Europe from 2011 through June 2016. The United Nations High Commissioner for Refugees (UNHCR), estimated that half of the Syrian population has been forcibly displaced, with an estimated 7.6 million internally displaced persons (IDPs) and 4.8 million registered refugees (UNHCR, 2016).

The conflict has significantly damaged the country's public and private assets including health, education, energy, water and sanitation, agriculture, transportation, housing and other infrastructure. The World Bank Damage and Needs Assessment (DNA) report (conducted for six governorate capitals namely, Aleppo; Dar'a; Hama; Homs; Idlib; and Latakia) estimated the total damages for the six cities range between US\$5.9 to 7.2 billion (as of March 2016). The SCPR estimated that, for the whole country, the destruction of physical infrastructure amounted to US\$75 billion and the UN estimated that investments of US\$150-200 billion will be needed to bring Syrian GDP back

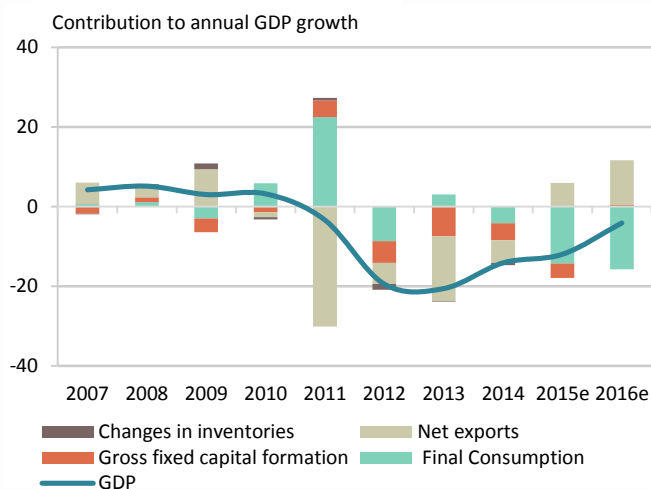
to pre-conflict levels.

The conflict has had severe macroeconomic implications. Real GDP contracted sharply in 2012-15, including some 12 percent in 2015. After increasing by nearly 90 percent in 2013, inflation eased but remained high at nearly 30 percent in 2014-15. The severe decline in oil receipts since the second half of 2012 and disruptions of trade due to the conflict has put pressure on the balance of payments and the exchange rate. Revenues from oil exports decreased from US\$4.7 billion in 2011 to an estimated US\$0.14 billion in 2015 as most of Syria's oil fields are outside government control. The current account deficit reached 19 percent of GDP in 2014 but declined markedly to 8 percent of GDP in 2015. International reserves declined from US\$20 billion at end-2010 to US\$1.1 billion at end-2015, while the Syrian pound depreciated from 47 pounds per USD in 2010 to 517 pounds per USD at end-August 2016. The overall fiscal deficit increased sharply, reaching 20 percent of GDP in 2015, with revenues falling to an all-time low of below 7 percent of GDP during 2014-15 due to a collapse of oil and tax revenues. In response, the government cut spending, including on wages and salaries, but this was not enough to offset the fall in revenues and higher military spending.

## Outlook

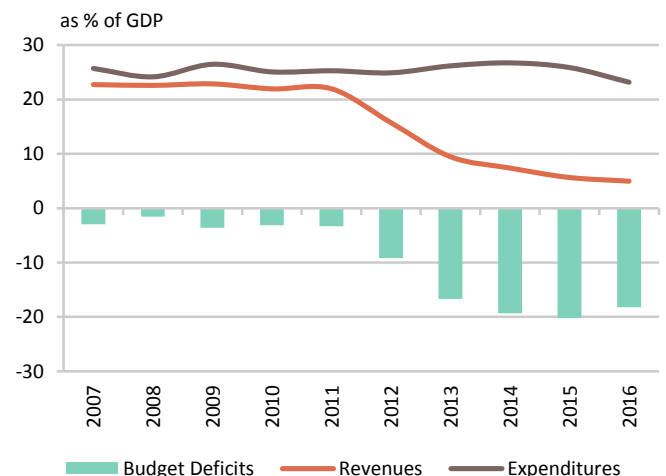
Macroeconomic and poverty projections are complicated by the uncertainty about

**FIGURE 1 Syrian Arab Republic / Contribution to annual GDP growth**



Sources: World Bank estimates.

**FIGURE 2 Syrian Arab Republic / Budget deficits accelerated due to the conflict**



Sources: World Bank estimates.

the duration and severity of the conflict. Nevertheless, real GDP is estimated to continue to contract in 2016 by around 4 percent on account of a worsening of the conflict in key centers of economic activity such as Aleppo and as oil and gas production and non-oil economic activity continue to suffer from the conflict. Inflation is likely to remain very high at around 25 percent in 2016, because of continued exchange rate depreciation, trade disruptions, and shortages. Current account and fiscal deficits are also projected to remain large, broadly around the levels of 2015. Medium-term macroeconomic prospects hinge on containing the war and finding a political resolution to the conflict, and rebuilding the damaged infrastructure and social capital.

## Risks and challenges

The key challenges are clearly to end the conflict and restore basic public services along with other measures to address the humanitarian crisis. Syria will also eventually need to move towards some degree of macroeconomic stability and create the conditions for renewed growth. The international community will have a key role to play in a post-conflict environment.

**TABLE 1 Syrian Arab Republic /** Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f
<b>Real GDP growth, at constant market prices</b>	-20.6	-18.0	-15.8	1.7
Private Consumption	14.4	-10.7	-26.1	0.0
Government Consumption	-18.5	-10.0	-3.3	0.0
Gross Fixed Capital Investment	-34.4	-27.1	-26.4	10.2
Exports, Goods and Services	-55.5	-9.3	-11.8	1.7
Imports, Goods and Services	-46.8	10.1	-30.4	2.7
<b>Real GDP growth, at constant factor prices</b>	-20.2	-17.5	-15.3	2.8
Agriculture	-35.0	-20.0	-15.0	7.7
Industry	-8.3	-9.8	-27.2	-0.2
Services	-20.0	-20.0	-10.0	2.8
<b>Inflation (Private Consumption Deflator)</b>	19.4	24.9	48.0	40.0
<b>Current Account Balance (% of GDP)</b>	-7.0	-7.7	-4.6	-3.1
<b>Fiscal Balance (% of GDP)</b>	0.0	0.0	0.0	0.0
<b>Debt (% of GDP)</b>	0.1	0.1	0.1	0.1
<b>Primary Balance (% of GDP)</b>	0.0	0.0	0.0	0.0

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice. and Poverty Global Practice.  
Note: f = forecast.

# TUNISIA

Five years after the Revolution, Tunisia's economic performance remains weak, with growth too low to make a significant dent on unemployment, poverty and inequality amid widening fiscal and current account deficits. The Tunisian President's recent call for a unity government has been supported by most political parties and civil society and followed by the formation of a new government in late August 2016. This initiative is intended to ease political bottlenecks and provide impetus to the much needed reforms to strengthen security, improve the business environment and restart growth.

## Recent developments

The Tunisian economy slowed markedly in 2015: growth reached a mere 0.8 percent (versus 2.3 percent in both 2013 and 2014), with notable declines in manufacturing, mining (oil, gas, and phosphate industries) and tourism following two terrorists attacks targeting tourists. Data for the first half of 2016 indicate some moderate improvement of economic conditions. The economy expanded in Q1 and Q2 2016 at 1.0 and 1.4 percent (year-on-year, yoy), respectively. This modest uptick in growth reflected improved performance within manufacturing industries and non-tradable sectors, which grew by 2.0 percent and 3.3 percent (yoy) in H1 2016 while agriculture and fisheries, and non-manufacturing industries contracted by 2.8 percent and 0.8 percent, and value-added in tradable services remained flat. Importantly, imports of machinery and equipment, and raw products rose by 10 percent, as an improving security environment supported investment sentiment.

Notwithstanding this improvement, a number of indicators point to a still fragile and modest economic recovery in 2016. Industrial production fell by 0.3 percent in H1 2016, led by production declines in the agro-food, energy, and rubber and plastics industries. Furthermore, tourist arrivals fell by 25 percent in H1-2016. The significant trade deficit, combined with the deterioration of the capital and financial accounts, is eroding the country's foreign reserve buffer and leading to a deprecia-

tion of the Tunisian dinar. In June 2016, foreign reserves were estimated at USD 6.5 billion, amounting to a mere 3.5 months of imports.

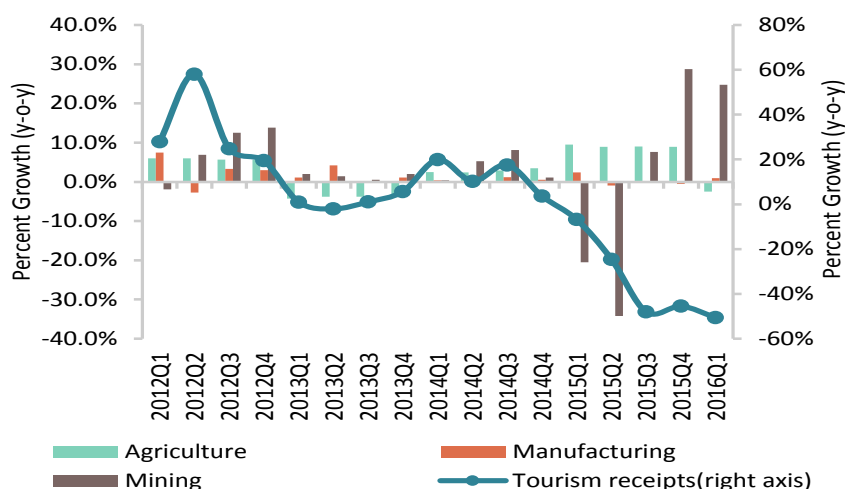
The unemployment rate remains high at 15.4 percent, particularly for women (22.6 percent), university graduates (31.2 percent) and the youth (31.8 percent), while inflation is subdued (4 percent) as monetary policy remains prudent.

The Tunisian President recently proposed the formation of a national unity government to tackle the security, economic and social challenges facing Tunisia, and called for the participation of all political parties and civil society groups (worker unions, business organizations and other civil society). A short document, "The Carthage Agreement" outlining the priorities of the new government to be formed, was drafted and signed by most stakeholders. A new cabinet was formed and endorsed by Parliament in late August 2016 and is expected to try to unlock the political bottlenecks to reforms and give new impetus to the much needed and urgent measures to strengthen security, improve the business environment and restart growth.

## Outlook

The economy is projected to expand modestly by 2.0 percent in 2016 driven by rising public consumption (up 10.1 percent) as negotiated wage increases are enacted, and investment (up 4.5 percent). In the medium term, economic growth is project-

**FIGURE 1 Tunisia / Sectoral value added and tourism receipts growth (y-o-y)**



Sources: National Institute of Statistics, Central Bank of Tunisia, and Staff calculations.

ed to pick up to 3.0 and 3.7 percent in 2017 and 2018 respectively in a scenario that would combine the acceleration of structural reforms, the improvement of security at the national and regional level (most notably a start of normalization in Libya), greater social stability, and a moderate increase in external demand.

Lower fiscal revenues in H1 2016 were compensated by the sale of 4G licenses and the transfers of excess money held by the Central Bank of Tunisia. But energy subsidies and net transfers to the State oil refining company have increased by 0.1 percentage points of GDP. Moreover about 0.6 percent of GDP were transferred to the State pension fund, which is structurally in deficit, to cover its liquidity needs. Overall the data for the first half of the year indicate that the fiscal deficit could be 1 percentage point of GDP higher than initially budgeted (4.6 percent of GDP) if no compensatory measures are implemented to keep the structural deficit below 4 percent (benchmark of the new IMF Extended Fund Facility). In the medium term, reining in the public wage bill and expanding the tax base are critical for fiscal sustainability and to create the space for more investment spending.

On the external side, the current account deficit is projected to drop to 7.7 percent of GDP in 2016, with the decline in im-

ports partially offset by the fall in exports. In the medium term the current account is likely to benefit from the gradual recovery of remittances and services trade and would decline gradually toward 6.4 percent of GDP in 2017-18.

trade unions. Slow progress on such reforms is a key risk in the baseline.

## Risks and challenges

The main risks to the economic outlook remain the high level of youth unemployment and social unrest, as well as the security situation domestically and in the region. While the government is deploying resources to improve the security situation, reforms to stimulate private sector growth and job creation are needed to counter these risks. This would include, most notably: (i) adopting and implementing regulations to provide strong signals to investors that improve conditions for market access, and to move towards a level playing field in all sectors; (ii) developing and implementing a comprehensive strategy on civil service reform and SOE reform; (iii) improving governance, including fighting against corruption and elite capture; and (iv) establishing a dialogue aimed at tackling and resolving sources of social unrests, particularly with

**TABLE 2 Tunisia /** Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	2.3	2.3	0.8	2.0	3.0	3.7
Private Consumption	4.2	1.8	2.3	1.1	2.3	3.1
Government Consumption	6.2	4.2	8.8	10.1	-2.0	3.9
Gross Fixed Capital Investment	-3.8	1.2	-4.5	4.5	5.0	7.0
Exports, Goods and Services	3.5	3.9	-6.8	1.6	5.5	6.1
Imports, Goods and Services	4.9	2.2	-3.2	3.5	2.1	4.7
<b>Real GDP growth, at constant factor prices</b>	2.6	2.3	0.6	1.5	2.5	3.2
Agriculture	-4.0	2.8	9.0	3.2	3.2	3.2
Industry	-0.2	-1.1	-1.6	-6.3	-3.2	-0.8
Services	5.0	3.8	0.5	4.6	4.6	4.6
<b>Inflation (Consumer Price Index)</b>	5.8	4.9	4.9	3.9	3.9	3.8
<b>Current Account Balance (% of GDP)</b>	-8.4	-9.1	-8.9	-7.7	-7.0	-6.2
<b>Fiscal Balance (% of GDP)</b>	-7.5	-4.3	-5.5	-4.6	-3.9	-3.7
<b>Debt (% of GDP)</b>	44.5	49.0	53.2	54.6	54.5	53.1
<b>Primary Balance (% of GDP)</b>	-5.7	-2.5	-3.6	-2.5	-1.8	-1.8

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

Notes: e = estimate, f = forecast.

(a) Calculations based on 2010-NSHBCSL.

(b) Projection using neutral distribution (2010) with pass-through = 1 based on GDP per capita constant in constant LCU.

# UNITED ARAB EMIRATES

*As low oil prices have persisted, the economy has slowed further, with growth projected at 2.3 percent in 2016 (down from 4.7 percent in 2013). Despite significant reforms, the fiscal deficit has widened and external balances deteriorated. However as projected oil prices trend upwards and production rises, growth is expected to pick up in the medium term. Tight fiscal policy will hold back government expenditure growth while simultaneously developing new revenue sources, thereby reversing the fiscal deficit.*

## Recent developments

The UAE's economy continues to slow down as a result of low oil prices and fiscal consolidation weighing on non-oil growth. Overall real GDP growth is estimated at 2.3 percent in 2016, a significant drop from the pre-2014 oil shock average of 5 percent (2010-14). Austerity measures weakened business and consumer confidence and slower growth in credit to the private sector. This is expected to result in lower non-oil growth estimated at 2.4 percent in 2016. Hydrocarbon GDP growth is also expected to slow down to 2 percent in 2016 from an estimated 4.6 percent in 2015. The average rate of inflation is estimated to ease to 3.3 percent in 2016 from 4.1 percent in 2015.

Sustained low oil prices have led fiscal and external balances to deteriorate, despite significant fiscal consolidation efforts. Authorities have managed some fiscal consolidation by raising electricity and water tariffs, removing fuel subsidies and scaling back capital transfers to Government Related Entities (GREs). Abu Dhabi reduced reliance on government deposits and issued a US\$5 billion Euro-bond in April. Despite these measures, the drop in hydrocarbon revenues has pushed the fiscal balance down from a comfortable surplus of 10.4 percent of GDP in 2013 to an estimated deficit of 2.1 percent in 2015 and 3.5 percent in 2016. The Abu Dhabi and Dubai sovereign wealth funds have recorded lower returns (3 percent y-o-y fall in 2015 net profits) resulting from

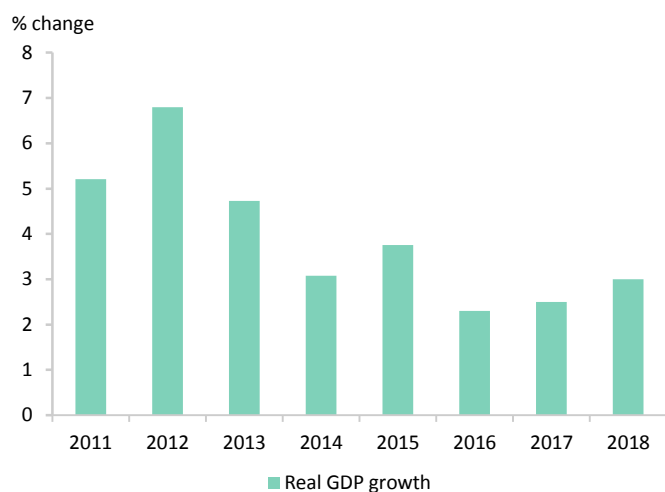
global volatility. The current account surplus also fell from 19.1 percent of GDP in 2013 to 3.3 percent in 2015 and an estimated 1.3 percent of GDP in 2016.

Monetary policy is tightening, as is liquidity in the banking system. The central bank raised its policy rate by 25 basis points in December in response to the US Federal Reserve rate increase and is expected to continue mirroring the Fed's rate movements. Reduced government deposits are resulting in lower liquidity in the banking sector with deposit growth decelerating to 1.8 percent y-o-y at end-March 2016. A recent Credit Sentiment Survey revealed that banks are increasingly unwilling to lend, especially to SME's.

Dubai's property market continues to soften but does not pose a systemic risk. Average real estate residential prices fell by 11 percent in 2015. Increased supply and weakening demand amidst financial tightening resulting from low oil prices have led to office rents falling by up to 10 percent in Q1 2016. Nevertheless, continued demand in established free-zone developments is sustaining non-oil growth and the real estate loan portfolio remains resilient.

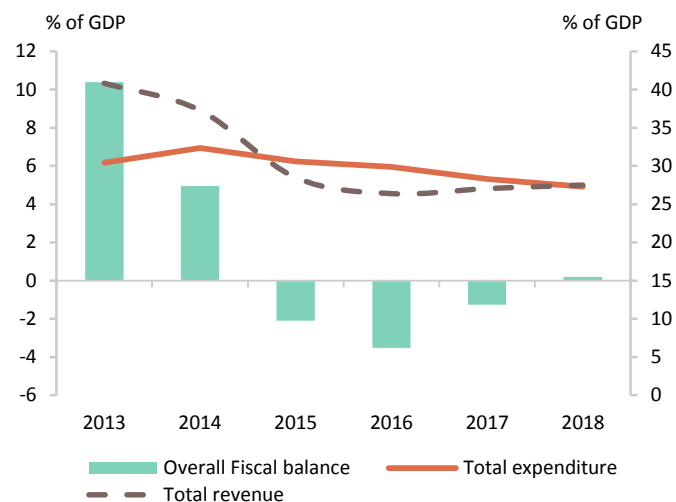
The UAE is yet to fully develop its capacity for a comprehensive measurement and analysis of household welfare across its seven Emirates. Each Emirate has an independent statistics agency, and while the federal-level statistical bureau was established in 2009, the harmonization of methods and statistical agendas for a country-level welfare measurement is yet to be accomplished.

**FIGURE 1 United Arab Emirates / GDP growth rate (percent per annum)**



Sources: UAE authorities and World Bank Staff estimates.

**FIGURE 2 United Arab Emirates / Government operations (as share of GDP)**



Sources: UAE authorities and World Bank staff estimates.

## Outlook

Growth is expected to slowly recover, reaching 3 percent in 2018. Oil production is expected to rise due to investments in oilfield development. Non-oil growth is also projected to rebound (i) as the expected improvement in oil prices and its positive effects on confidence and financial conditions dampen the effects of fiscal consolidation; (ii) as megaproject implementation ramps up ahead of Dubai's hosting of Expo 2020; and (iii) as the lifting of sanctions on Iran translates into increased trade. Fiscal and external balances are expected to improve over the medium term; with a reversal of the fiscal deficit expected and a rebound in the current account surplus to 3.2 percent of GDP by 2018.

Progress in economic diversification, large buffers and safe-haven status have strengthened the resilience of the economy. The UAE is expected to implement a GCC-wide value added tax (VAT) by 2018, and is considering increasing excise taxes and introducing corporate tax. Despite pressures key investment areas will be maintained, as evident by the recently announced nuclear energy project. Abu Dhabi's aerospace manufacturing has se-

cured contracts with Airbus and Boeing, underscoring its commitment to diversification. New bankruptcy and investment laws are also being prepared with a potential positive impact on investment. In addition, as anxiety looms over the impact of UK's decision to leave the EU, according to a survey of financial investment professionals Dubai's competitiveness as a financial hub is not expected to be affected.

## Risks and challenges

However, macro-financial risks are increasing; the financial management of GRE's megaprojects on the domestic side, and further sustained drop in oil prices on the external side. In an environment of low oil prices, macro-financial risks could be exacerbated by declining liquidity in the banking system, increased volatility in the stock markets, and disruptive declines in the real estate sector. Further, imprudent management of Dubai's megaprojects could be a source of macro-financial risks for its GREs, its banks, and ultimately the government. In this context, the recent hike in interest rates in the US could lead to a tightening of financial markets and increase the costs of financing. Structural reforms are needed to support

the move towards a knowledge based economy as envisaged by Vision 2021. Easing SME access to finance and innovation financing should be a priority. Reforming labor admissions policies is key for private sector job creation since under the current sponsorship system expatriate labor mobility is limited leading to large-scale importation of expatriate workers, wages below marginal productivity and lower incentives to upgrade skills. This in turn negatively affects productivity, technology choice, and contributes to making nationals uncompetitive in the private sector.

**TABLE 1 United Arab Emirates / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
<b>Real GDP growth, at constant market prices</b>	4.7	3.1	3.8	2.3	2.5	3.0
Private Consumption	-1.6	25.3	-12.0	2.1	2.4	3.2
Government Consumption	23.2	5.8	16.6	-0.9	-0.5	2.5
Gross Fixed Capital Investment	11.5	8.3	10.6	3.0	4.5	9.5
Exports, Goods and Services	5.1	0.2	3.4	1.3	2.5	4.0
Imports, Goods and Services	6.5	12.3	-1.2	1.7	3.0	3.2
<b>Real GDP growth, at constant factor prices</b>	4.7	3.1	3.8	2.2	2.1	3.8
Agriculture	-0.5	1.9	3.1	0.5	0.1	0.2
Industry	1.1	1.6	4.6	1.1	1.8	3.1
Services	7.4	4.1	3.2	2.9	2.3	4.3
<b>Inflation (Consumer Price Index)</b>	1.1	2.3	4.1	3.3	2.8	3.1
<b>Current Account Balance (% of GDP)</b>	19.1	10.1	3.3	1.3	3.0	3.2
<b>Fiscal Balance (% of GDP)</b>	10.4	5.0	-2.1	-3.5	-1.3	0.2

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.  
Note: f = forecast.



# YEMEN

*The ongoing conflict has caused a dramatic deterioration in the country's economic and social situation. With the disruption of oil production and other economic activities, output has contracted sharply, inflation has been on the rise since 2015, and international reserves are below two months of crisis-subdued imports. The conflict has led to a catastrophic humanitarian situation, with an increasing toll of civilian deaths and casualties, massive displacement of people, destruction of infrastructure, and acute food shortage.*

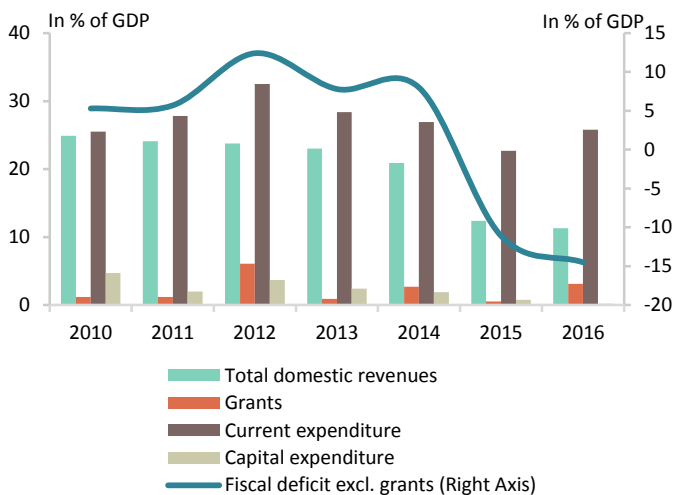
## Recent developments

The economy has contracted sharply. Official reporting suggests that Yemen's GDP contracted by approximately 28 percent in 2015. The broadened conflict since March 2015 has led to widespread disruptions of economic activities and infrastructure. Oil and gas exports have come to a halt. Some limited gas production has been maintained for domestic consumption. Imports have also contracted, though not critical food and energy imports. Annual inflation reached around 40 percent in 2015. Public finances are under severe stress. The fiscal deficit reached around 11 percent of GDP in 2015. Many development partners suspended their engagement, including the World Bank, and moved instead to emergency and relief operations. The World Bank obtained Board approval in July for an emergency operation for critical support implemented through the UNDP and executed via the Social Fund for Development (SFD). Tax revenues depend largely on nonhydrocarbon tax revenues that reached about 10 percent of GDP in 2015, slightly less than the wage bill (11 percent of GDP). The government suspended many public expenditure obligations while servicing mainly wages and interest payment obligations (around 8 percent of GDP). All premiums on wages were cut, and public investment has come to a complete stop.

Foreign reserves are running at less than US\$0.8 billion, less than 2 months of conflict-reduced import demand. The nominal exchange rate was devalued by 23 percent in March 2016. Since then, the Central Bank of Yemen (CBY) has serviced only wheat and rice imports at the devalued official rate of 250 Yemeni Riyal per US dollar. CBY has stopped servicing external credit obligations except to IDA and the IMF (status August 2016). Meanwhile, the government's reliance on central bank financing of the fiscal deficit has increased the domestic debt stock by about 40 percentage points since end 2014.

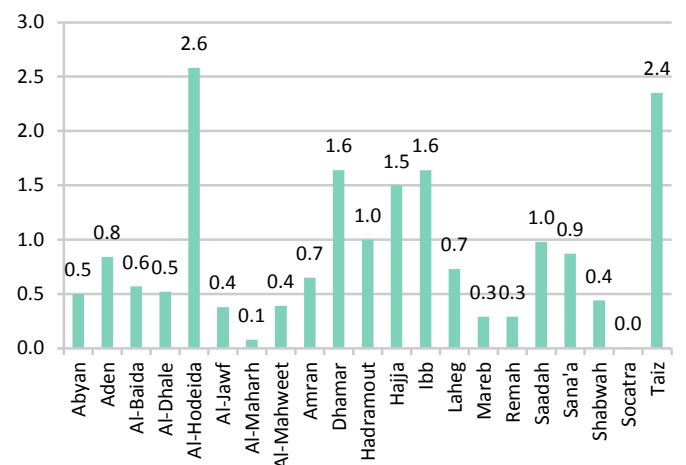
The protracted conflict in Yemen is inflicting a heavy toll on the population. UN-OCHA reports that by June 2016, 6500 people had been killed with an additional 31,400 injured. These numbers are likely to have gone up further in light of the resumption of full-blown hostilities in August. The humanitarian situation is dire. Destruction of infrastructure, disruption of trade, commerce and supplies as well as the displacement of people (about 3 million) has put stress on markets for essential commodities, including food. The latest Integrated Food Security Phase Classification (IPC) analysis suggests that half of the Yemeni population may be facing food shortages. Concurrent difficulties in accessing clean water and sanitation as well as healthcare are likely to cause a sharp uptick in malnutrition, especially among young children.

**FIGURE 1 Yemen Arab Republic / Yemen: Public finances, in % of GDP**



Sources: Yemen Statistical Organization, IMF and staff estimates.

**FIGURE 2 Yemen Arab Republic / Number of people in need of urgent humanitarian assistance, by governorate**



Sources: OCHA Humanitarian Bulletin, March 1, 2016.

## Outlook

Economic and social prospects in 2016 and beyond will depend critically on rapid improvements on the political and security fronts. Real GDP is projected to contract further in 2016 by some 4 percent, while inflation would decline to single digits. Fiscal and external current account deficits are likely to edge even higher. It is possible that foreign financing could resume in the 4<sup>th</sup> quarter based on a peace settlement.

## Risks and challenges

Restoring peace and political stability is critical for beginning reconstruction and addressing the country's deep-rooted governance, institutional, economic, social, and environmental challenges (including rapid depletion of ground water). Providing relief and basic humanitarian assistance is needed to the many suffering from the conflict in the short term. Even in a post-conflict period, the country will depend more than ever on foreign assis-

tance and donor support to recover and rebuild confidence, including in its institutions.

**TABLE 1 Yemen Arab Republic / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2011	2012	2013	2014	2015
<b>National Income and Prices</b>					
(Change in percent, unless otherwise indicated)					
Nominal GDP, market prices (billions of YR)	6,480.5	6,785.8	8,462.7	9,289.3	8,108.6
Real GDP growth (in %)	-12.7	2.4	4.8	-0.2	-28.1
Hydrocarbon	-14.5	-11.5	13.2	-11.3	-61.0
Nonhydrocarbon sectors	-12.5	4.0	4.0	1.0	-25.0
CPI (period average)	19.5	9.9	11.0	8.2	39.4
Hydrocarbon production (in thousand barrels per day)	364	322	365	324	126
Crude Oil	197	155	175	156	59
LNG (oil equivalent)	167	167	190	167	67
<b>Central Government Finances</b>					
(In percent of GDP)					
Revenue and Grants	25.3	29.9	23.9	23.6	12.9
of which hydrocarbon revenue	16.5	14.1	12.8	10.6	2.9
of which grants	1.2	6.1	0.9	2.7	0.5
Expenditure and net lending	29.8	36.2	30.8	27.8	23.5
Current, of which:	27.8	32.5	28.4	26.9	23.5
wages and salaries	10.0	11.1	10.2	10.1	11.3
subsidies	8.1	9.3	7.2	5.6	0.7
Capital	2.0	3.7	2.4	1.8	0.8
Overall fiscal balance (incl. grants)	-4.5	-6.3	-6.9	-4.1	-10.6
Overall fiscal balance (excl. grants)	-5.7	-12.4	-7.8	-8.0	-11.1
Primary non-oil fiscal balance (cash)	-16.7	-15.0	-14.3	-10.4	-6.0
<b>External Sector</b>					
(In millions of U.S. dollars, unless otherwise indicated)					
Exports, f.o.b., (goods & services)	9,929	8,802	9,036	9,287	3,864
of which hydrocarbon (oil and gas)	7,731	6,332	6,537	6,774	2,440
of which nonhydrocarbon	931	1,017	1,102	1,132	501
of which services	1,267	1,453	1,398	1,390	923
Imports, f.o.b., (goods & services)	-10,708	-12,921	-12,186	-12,257	-8,485
of which services					
Current account balance (in percent of GDP)	-3.0	-1.7	-3.1	-1.7	-5.5
<b>Reserves</b>					
Central Bank own gross reserves (billions US\$ end-period)	4.0	5.6	4.9	4.1	1.5
Central Bank own gross reserves (in months of imports)	3.7	5.5	4.7	5.7	2.0
<b>External Debt</b>					
External debt (in billions YR)	1,300	1,321	1,322	1,325	1,258
External debt (in percent of GDP)	18.6	17.4	15.2	14.3	15.5
<b>Exchange Rate</b>					
Exchange rate (per US\$, period average)	213.8	214.9	214.9	214.9	214.9
<b>Memo Items</b>					
Nominal GDP in billion US\$	32.7	35.3	40.4	43.2	37.7
Population (in millions)	24.2	24.9	25.5	26.2	26.8
Nominal per capita GDP (US\$)	1,350	1,419	1,583	1,651	1,406

Source: GOY, MoF, Central Bank of Yemen, IMF and staff calculations.



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WORLD BANK MIDDLE EAST AND NORTH AFRICA REGION

MENA ECONOMIC MONITOR, OCTOBER 2016

## **Economic and Social Inclusion to Prevent Violent Extremism**

<http://www.worldbank.org/en/region/mena/publication/mena-economic-monitor>