



MENA Quarterly Economic Brief

Office of the Chief Economist

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Growth slowdown extends into 2013

HIGHLIGHTS

While the focus has been on the recent change in government in Egypt, five countries in the Middle East and North Africa Region, including Egypt, Tunisia, Lebanon, Jordan and Iran are facing a growth slowdown, rising fiscal deficits and debt, and high unemployment and inflation. Continued political turmoil in Egypt and spillovers from the civil war in Syria to Jordan and Lebanon threaten to make their economic situation worse. While easing political tensions in Tunisia and post-election improvements in Iran's international relations may help these countries, the overall macroeconomic outlook in all five countries for the rest of 2013 is grim.

- **Egypt.** Economic growth likely slid in the second half of 2012/13—before the arrival of the new government and financial support from Gulf countries—as data show signs of a slowdown in industrial production. After a sharp rebound in the third quarter of 2011/12, growth has been on a downward slide, falling by 2 percentage points in the first half of 2012/13 compared to the second half of the previous year, mainly as a result of lower investment. Annual growth is estimated to be around 2 percent in the fiscal year (ended in June 2013) marking the third consecutive year of sluggish growth.
- **Tunisia.** The economy recovered in 2012 as tourism related activities and FDI inflows rebounded, but the recovery lost momentum due to security concerns, following the assassination of a well-known political leader in Feb 2013. Real GDP growth fell to 2.6 percent in the first quarter of 2013, half the rate recorded in the same period in 2012. Recovery in the Euro area and Libya (Tunisia's main trading partners) as well as easing political tensions could accelerate growth in 2014.
- **Lebanon.** Growth has remained highly volatile due to the ongoing conflict in Syria. Lebanon's economy has grown between 1-3 percent over the past two years, significantly slower than the 7 percent and higher rates seen during the pre-crisis period. Political and economic spillovers from the Syrian crisis continue to dampen hope for recovery in tourism, real estate and wholesale trade (key drivers of growth). Growth is projected to remain around 2 percent in 2013.
- **Jordan.** Economic activity has remained weak due to turmoil in Egypt and spillovers from conflict in Syria. Security concerns have lowered investment flows, tourism and remittances while the government faces challenges dealing with widening twin deficits and Syrian refugees. Real GDP growth stood at 2.7 percent in 2012, about half the average growth rate recorded in the pre-crisis period. Growth is expected to pick up slightly in 2013 to above 3 percent but will remain subdued given the uncertainty about the Syrian conflict.
- **Iran.** The June presidential elections led to the victory of reformists-backed candidate Hassan Rouhani. The new government faces serious challenges dealing with a dire economy. Growth shrunk by 2 percent in 2012 as oil production declined sharply due to international sanctions. The currency has lost more than 70 percent of its value since March 2012 and the inflation rate surpassed 34 percent in the last quarter of 2012. Economic activity will remain sluggish in 2013, with prospects of gradual improvement as the new government takes over in August.

Prepared by Lili Mottaghi, with valuable comments from Manuela Ferro, Elena Ianchovichina and Christina Wood, under the guidance of Shanta Devarajan.

EGYPT

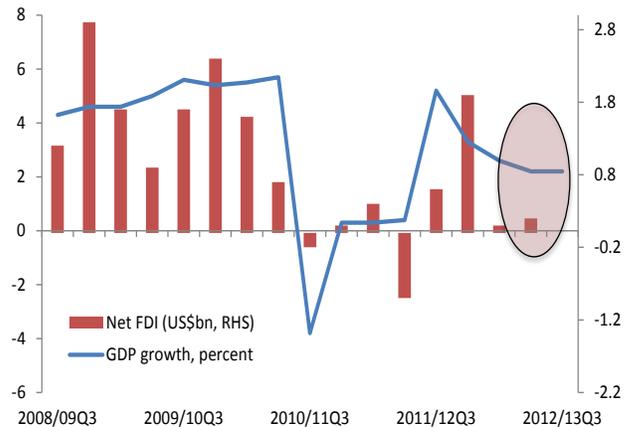
On July 3, 2013, following mass protests against President Morsi, the military intervened and removed him from office. A temporary government has been set up, and steps to set a date for new elections have been taken. Nevertheless, political turmoil and uncertainty continue to weigh heavily on the Egyptian economy. Growth that rebounded in the third quarter of 2011/12, slipped in the first half of 2012/13. Real GDP growth decelerated by 2 percentage points compared to the second half of the previous year.¹ The deceleration was triggered by a fall in domestic and foreign investment as political and economic policy uncertainty continued to keep investment decisions on hold. Data from the Central Bank show that total investment declined by more than 1 percent of GDP in the first half of 2012/13 compared with the same period the previous year. Foreign direct investment continued its downward spiral and inflows reached near zero in the second quarter of 2012/13. Consumption has been the main driver of growth since the revolution.

Output in the major sectors of the economy--manufacturing, construction, trade and tourism--has remained weak. Industrial production (mainly manufacturing, mining and utilities) that showed some signs of recovery during the second quarter of 2012/13 decelerated in the third quarter. On a positive note, tourism (and related activities), accounting for more than 13 percent of GDP, showed some signs of recovery as tourist arrivals increased by 20 percent in the first three months of 2013 (q/q). But arrivals are estimated to remain at about 11 million in 2013, well below the pre-revolution level of 14 million visitors.

The slowdown in economic activity led to a rise in the official unemployment rate, which

reached 13.2 percent in the first quarter of 2013, while unemployment among 20-24 year olds was 42 percent.

Real GDP growth has slowed down following a rebound in 2011/12Q3

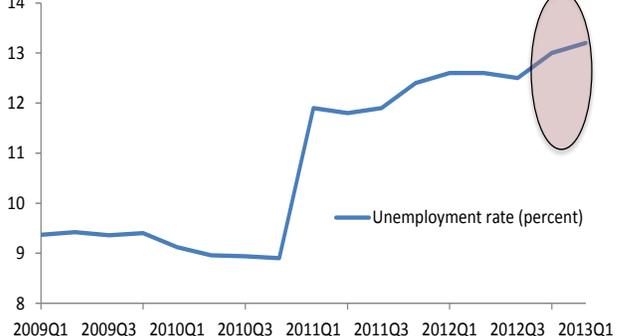


Source: Ministry of Planning. Data for 2010/11Q3 refer to the first three months of 2011 marking the revolution.

Quarterly industrial production remains sluggish



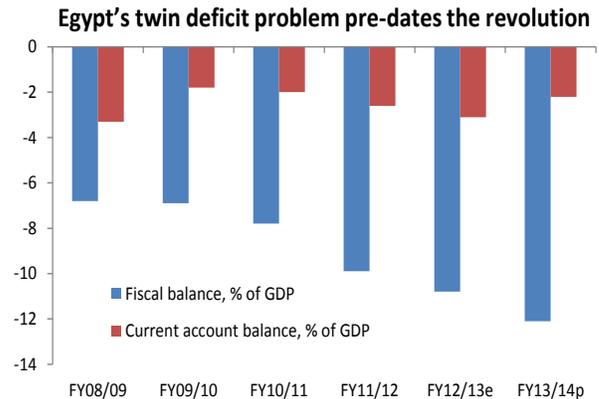
Quarterly unemployment rate rising



¹ Data are presented in Egypt’s fiscal year (July-June).

Egypt faces shrinking fiscal space as fiscal and external deficits are expected to remain elevated going forward. Financing needs are large, and have been accumulating over the past two years, but Egypt's twin deficit problem pre-dates the Arab Spring. Though Arab countries have been partially funding the balance of payments deficit--\$12 billion was pledged by Saudi Arabia, Kuwait and UAE following the recent change in government--financing needs have been primarily covered by drawing down international reserves (which reached less than 3 months of imports in May 2013) and building up domestic debt. Official data show that government domestic debt increased by 4 percent in the third quarter of 2012 relative to the second quarter of the same year and is estimated to reach a record high of 87 percent of GDP in 2013.

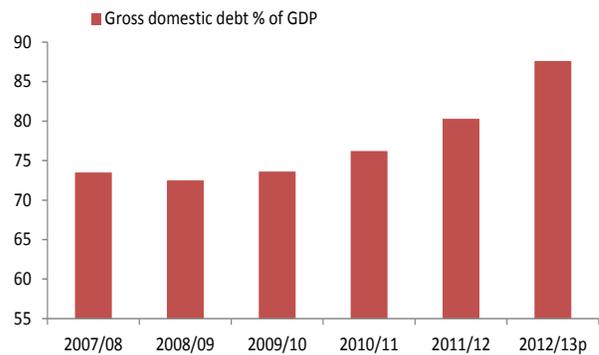
The Egyptian Pound (EGP) weakened against major currencies as the government relied more on domestic banks for financing its twin deficits. Official data show that, after the Central Bank's fifth auction in June, the Egyptian Pound (EGP) plunged again, reaching 7.03 Egyptian pounds to the US dollar in late June. The currency has fallen by 12 percent against the US dollar since the auctions were introduced in December. The EGP has been weakening even further in the parallel market as well as the forward market. These auctions, together with increasing Central Bank financing of the government, have kept inflation rates high. Monthly data produced by the Central Agency for Public Mobilization and Statistics (CAPMAS) show that the annual inflation rate increased to 9 percent in May 2013 (from 8.6 percent the previous year). The increase in inflation is comprised of increases in food and accommodation & food services items. Prior to the change in government, the IMF had projected the annual inflation rate to accelerate to 13.7 percent in the next fiscal year.



Foreign reserves and official exchange rate under pressure by large financing needs



Domestic debt is rising as government financing needs mount



Source: World Bank and Central Bank of Egypt.

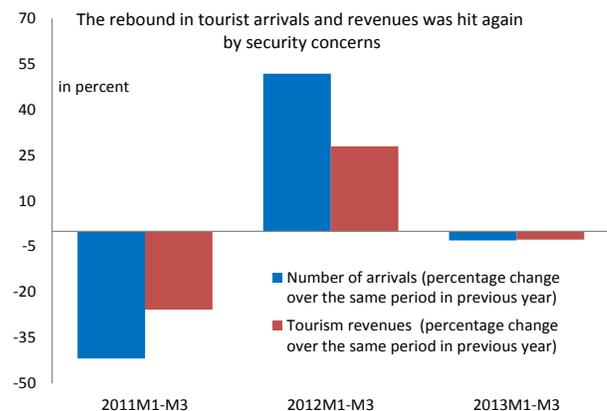
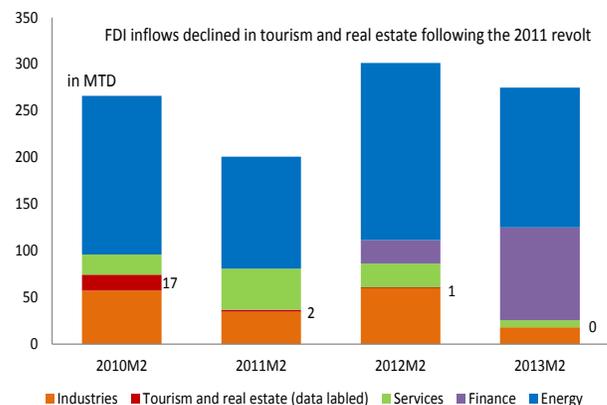
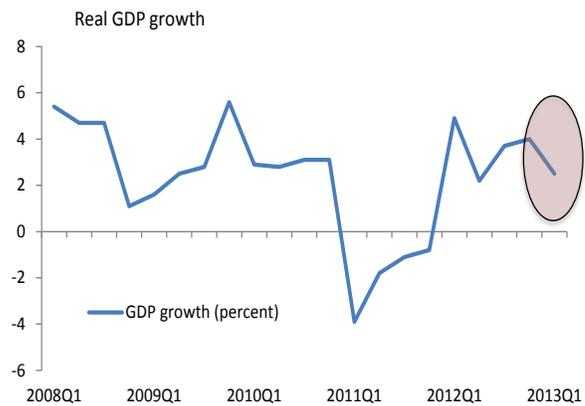
TUNISIA

The Tunisian economy rebounded in 2012. Growth turned positive in the first quarter of 2012 reaching 4.9 percent mainly due to the “base effect” following a contraction of 3.9 percent in the same period the previous year. The economy extended its recovery to the fourth quarter of 2012 on the back of a strong rebound in tourism related activities (accounting for more than 7 percent of GDP) and in the mining sector. Both sectors were hit hard during the revolution. On the demand side, growth was fueled by consumption resulting from a rise in government spending.

But the economic recovery lost momentum in the first quarter of 2013 as FDI inflows and tourism receipts were hit again by security concerns following the assassination of a political figure in February. Total FDI declined by 9 percent over the first two months of 2013, compared to the same period of 2012. Data published by the Foreign Investment Promotion Agency (FIPA) show that FDI inflows to the tourism and real estate sectors fell to near zero. FDI inflows also declined in the industrial and services sectors but less than in the other two sectors. On the positive side, FDI inflows to the finance sector almost tripled during this period.

The sharp rebound in tourism receipts in 2012 lost momentum in the first quarter of 2013, following the unrest. Data published by the National Office of Tunisian Tourism (ONTT) show a decline of 3 percent in total receipts in the first quarter of 2013, compared with the same period of the previous year. The number of tourist arrivals also decreased by 3 percent bringing the total down to 923,000 from 940,000. The decline was largely due to fewer visitors from Europe and Maghreb countries particularly Libya.

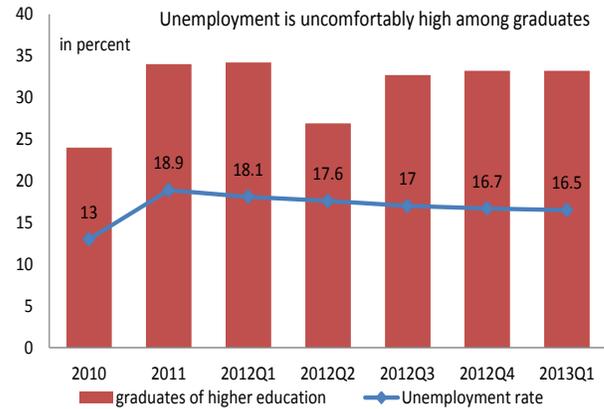
Growth recovery stalling due to political and economic policy uncertainty



Source: Central Bank of Tunisia

The unemployment rate in Tunisia was high even before the revolution, hovering around 13 percent. After the revolution and with weakened economic activity, unemployment increased sharply and reached 18.1 percent in the first quarter of 2012 due to slow tourism (tourism related activities provided 400,000 jobs, employing about 26 percent of workers) and the return of Tunisians from Libya. Unemployment rates have since been on a declining trend as these two factors have started to recede. The results of the National Survey on Population and Employment of the first quarter of 2013 show that unemployment was 16.5 percent in the first quarter of 2013, down 0.2 percentage points from the fourth quarter of 2012. Among graduates with higher education, the unemployment rate was 33.2 percent, with female graduates at 45 percent compared to 22.6 percent for their male counterparts.

Unemployment rates were high among graduates even before the revolution

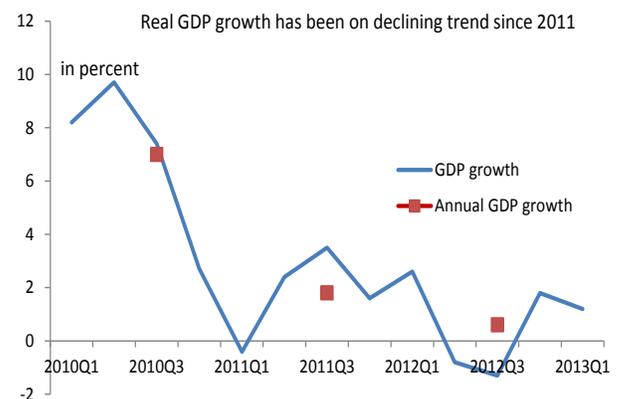


Source: National Institute of Statistics

LEBANON

Lebanon’s economy is entering its third consecutive year of sluggish growth as security risks arising from the ongoing Syrian conflict, interrupted real estate activity; slowed tourism receipts and disrupted trade routes have destabilized the economy. Real GDP decelerated sharply from 7 percent growth in 2010 to below 2 percent in 2011 and reached below 1 percent in 2012. The slowdown has continued in the first quarter of 2013 with quarter-on-quarter GDP growth declining to 1.2 percent from 2.6 percent in Q1 of 2012. The World Bank estimates annual growth to remain low, hovering around 2 percent in 2013, given the current security situation. Weak economic activity is expected to raise the unemployment rate above its already high level of 11 percent.

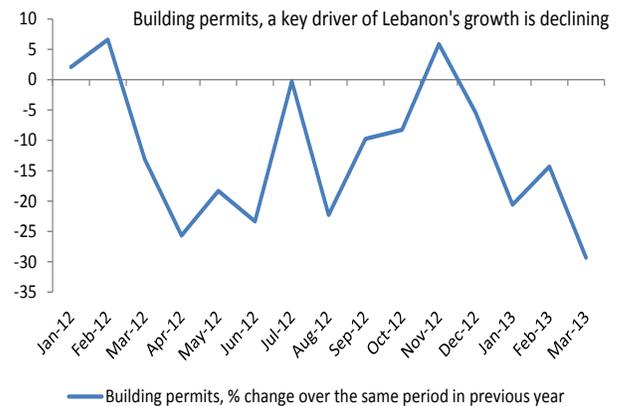
Ongoing conflict in Syria dashes hope for a growth recovery in Lebanon for 2013



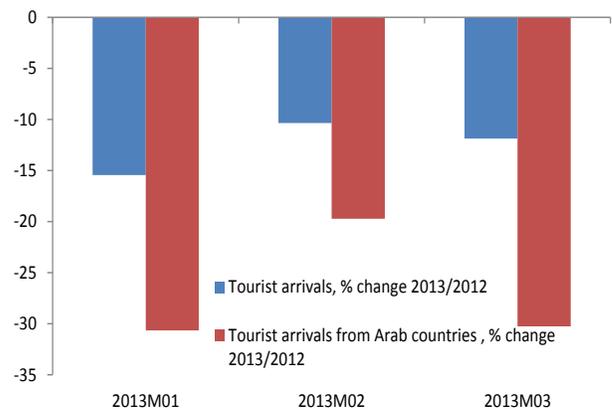
Source: Institute of International Finance

The real estate sector, accounting for 13 percent of GDP, has contracted sharply since the beginning of 2011. The slowdown in the property market has been extended to the first quarter of 2013 as demand from foreigners, particularly those from Arab countries, has not yet shown signs of recovery. Due to weaker demand, the number of new building permits issued declined by 27 percent q/q in the first quarter of 2013. The tourism sector is still weak due to security concerns. The number of tourist arrivals reached its lowest level since 2008 totaling 274 thousands in the first quarter of 2013, a decline of 12.5 percent compared with the same period in the previous year, largely as a result of a sharp fall in visitors from Arab countries. The number of tourists from GCC countries, accounting for more than half of the tourists, declined sharply as governments warned citizens against travelling to Lebanon due to security reasons.

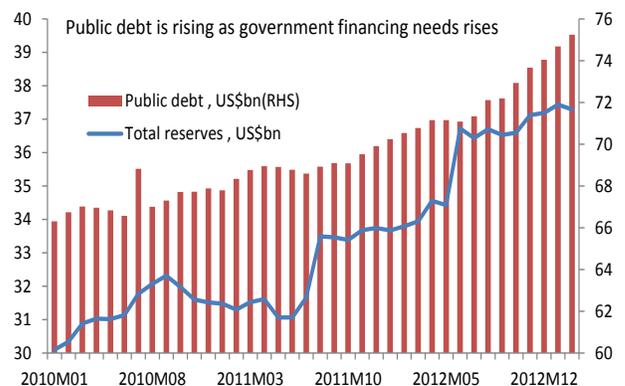
Weak economic activity combined with a widening fiscal deficit has further constrained the government's fiscal space. The fiscal deficit as a percent of GDP has almost doubled since 2011 and is estimated to widen to 9.2 percent of GDP in 2013 (from 5.7 in 2011) due to implementation of a large fiscal stimulus - including a sizable rise in wages and salaries - that has been in place since 2012. The government's large financing needs have translated into higher public debt, which escalated from US\$70 bn in January 2012 to over US\$75 bn in December 2012. The pace of increase in public debt accelerated in the first quarter of 2013 compared to the same period in the previous year, suggesting an upward trend for the rest of the year. On the positive side, the Central Bank has been maintaining large international reserves (covering more than 17 months of imports) which could be used as a buffer during a downturn.



Tourists from Arab countries declined the most as Syria conflict continues



Government debt is rising together with international reserves while growth stalls



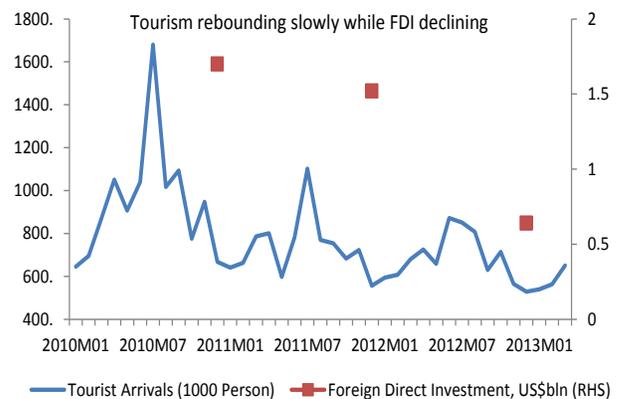
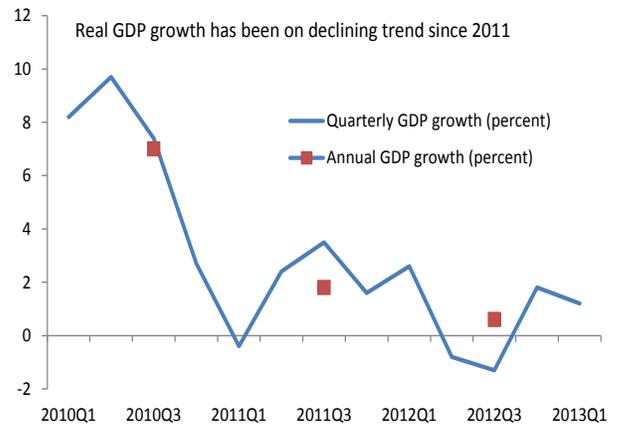
Source: Ministry of Finance, Banque du Liban, Central Administration of Statistics, Association of Banks in Lebanon.

JORDAN

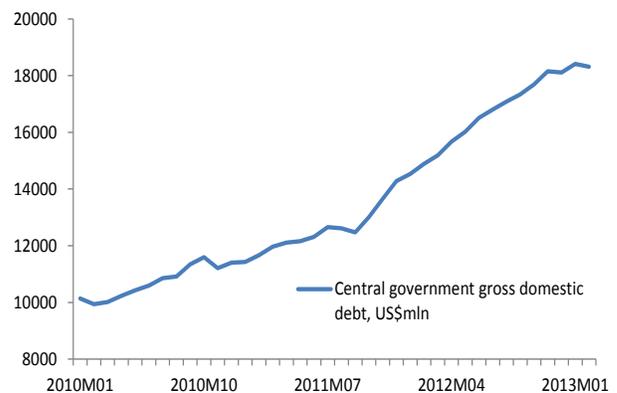
In Jordan, spillovers from turmoil in Syria and cutbacks in energy exports from Egypt have dramatically slowed economic activity. GDP growth was 1 percent lower (q/q) in the last quarter of 2012 compared to the same period the previous year. The slowdown in GDP was a result of contraction in the construction sector as well as a sharp decline in value added in the agriculture and mining sectors due in part to the disruption of transportation through Syria. Official data for the first three months of 2013 show GDP growth has picked up to 2.6 percent from 2.2 percent in the fourth quarter of the previous year. The economy is expected to expand by about 3 percent in 2013, in particular due to a large number of Syrian refugees contributing to consumption. But it remains well below the robust growth registered over the past decade. Private and public consumption have remained the main demand-side drivers of growth over the past three years.

Tourism, worker remittances and FDI inflows have been hit by the regional turmoil and cuts in energy from Egypt, from whom Jordan imports 95 percent of its energy. Data from the Department of Statistics show that buying fuel from other countries to replace Egyptian gas has inflated the import bill. Tourist arrivals have declined by 7 percent in the first quarter of 2013 compared to the same period in 2012 and declined by 21 percent compared to Q1 2010. Workers remittances have also declined by 3 and 9 percent in the last quarter of 2012 compared to the same periods in 2011 and 2010, respectively. Foreign direct investment has more than halved since 2011 reaching less than half a billion dollars in 2012. The current account deficit has widened in 2012 to 18 percent of GDP from 7 percent in 2010.

Quarterly GDP growth slows down in 2013Q1



Central government's public debt rising

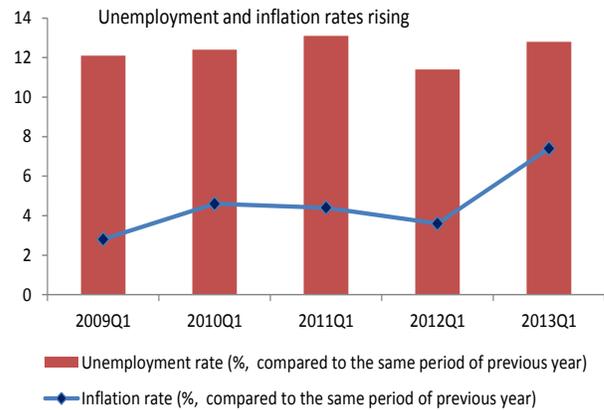


Source: Central Bank of Jordan

As a result of lower than expected grants and rising spending for hosting Syrian refugees, pressures are mounting on the government budget. Jordan's large financing needs have further pushed up public debt. Recent data from the Central Bank show that public debt has increased by more than 60 percent in the years following the Arab Spring. The public debt to GDP ratio has been rising following the regional turmoil, reaching 80 percent in 2012, and is expected to surpass this figure in 2013.

Weakening economic activity and financial pressures increased unemployment and inflation, respectively, in the first quarter of 2013. Inflation doubled to 7.4 percent during this period compared to the 3.6 percent registered in the first quarter of 2012. Inflationary pressures came as a result of the sharp increase in the prices of fuel and transportation, which reflected more expensive fuels and the reform the energy subsidy system in November 2012. The unemployment rate rose to 12.8 percent in the first quarter of 2013, compared to 11.4 percent in the same quarter of 2012. The increase was greater among females, whose unemployment rate increased from 18 to 20.5 percent over the same period.

Slowdown in economic activity resulted in higher unemployment and inflation rates in 2013Q1

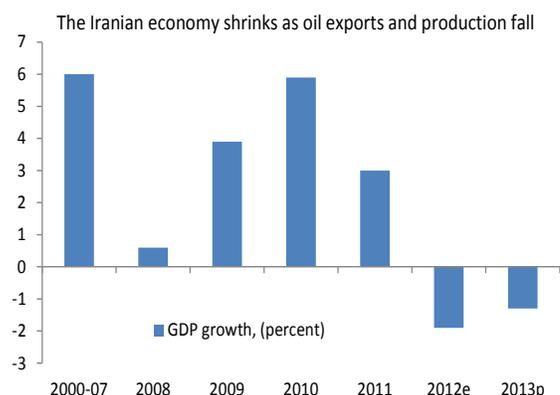


Source: Central Bank of Jordan

IRAN

The presidential elections of June 14th led to the victory of Hassan Rouhani, the only reformists-backed candidate. He will take up office in August, replacing hardliner Mahmoud Ahmadinejad. The president-elect has called for reaching out to the international community and easing tensions over its nuclear program. The new government, however, faces enormous challenges as it inherits a dire economy. Growth contracted by an estimated 2 percent in 2012 as oil exports (the major source of output and revenue) and production fell sharply.

Growth shrunk as oil production declined sharply

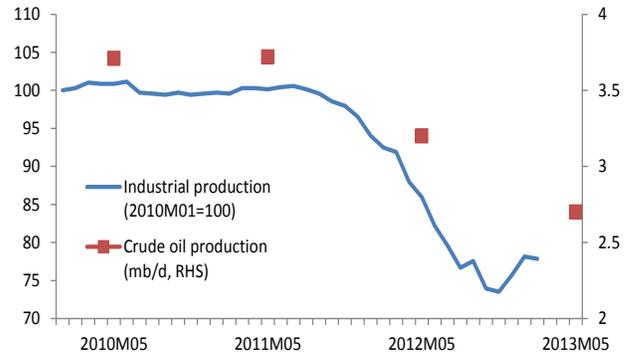


The contraction is largely a result of the US/EU sanctions which primarily targeted the energy sector and the country's ability to access the international financial system. Crude oil production and exports, which accounted for more than 70 percent of the GDP and fiscal revenue, reached record lows. The IEA estimates that Iran's net oil export receipts have declined from US\$95bln in 2011 to US\$64bln in 2012, or 25 percent in one year. Economic growth is expected to remain sluggish in 2013 but with prospects of gradual improvement as the new government takes over in August. Growth has remained substantially below the average of 6 percent recorded over the period of 2000-2007.

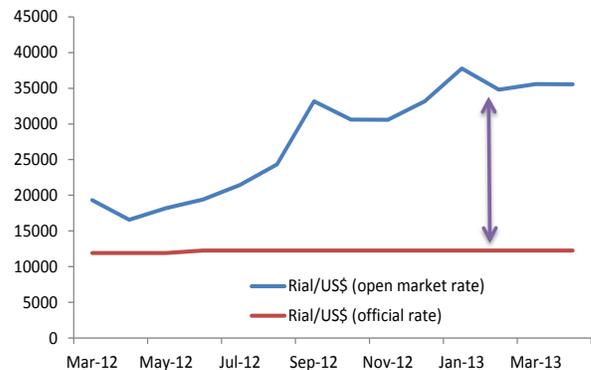
The loss of hard currency and exclusion from the international banking system have disrupted trade, creating a multiple exchange rate system. Before July 6, 2013, the official exchange rate was allocated only to imports of essential goods. Non-essential goods were imported through a dual exchange rate system prevailing in parallel markets (trading and open markets). While the trading rate is determined by the Central Bank, the open market rate is set by demand and supply. Since March 2012, the Rial has lost more than 70 percent of its value in the open market. Foreign reserves were drawn down by 10 percent in 2012 compared to 2011 and are expected to drop by another 5 percent in 2013, albeit remaining at comfortable levels of about 12 months of imports.

Rising financial pressures have resulted in soaring inflation and unemployment. Official data show that inflation has been on the rise since the first quarter of 2012 surpassing 34 percent in the last quarter of 2012. Inflation is expected to remain high at about 32 percent in 2013. Unemployment has increased substantially due to the anemic growth in 2012. Official data put the unemployment rate at 15.5 percent in 2012, an increase of 5 percent compared to 2010 level. The youth unemployment rate is estimated at 25 percent.

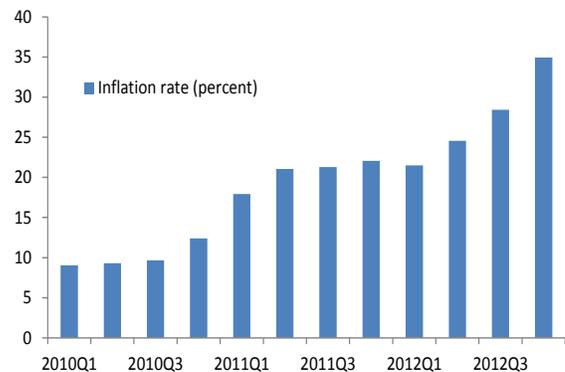
Production fell precipitously in 2012



The domestic currency plummeted in value in the open market



Quarterly inflation rate soaring



Source: Official sources, IMF and IEA.