World Economic Situation and Prospects

2019

United Nations

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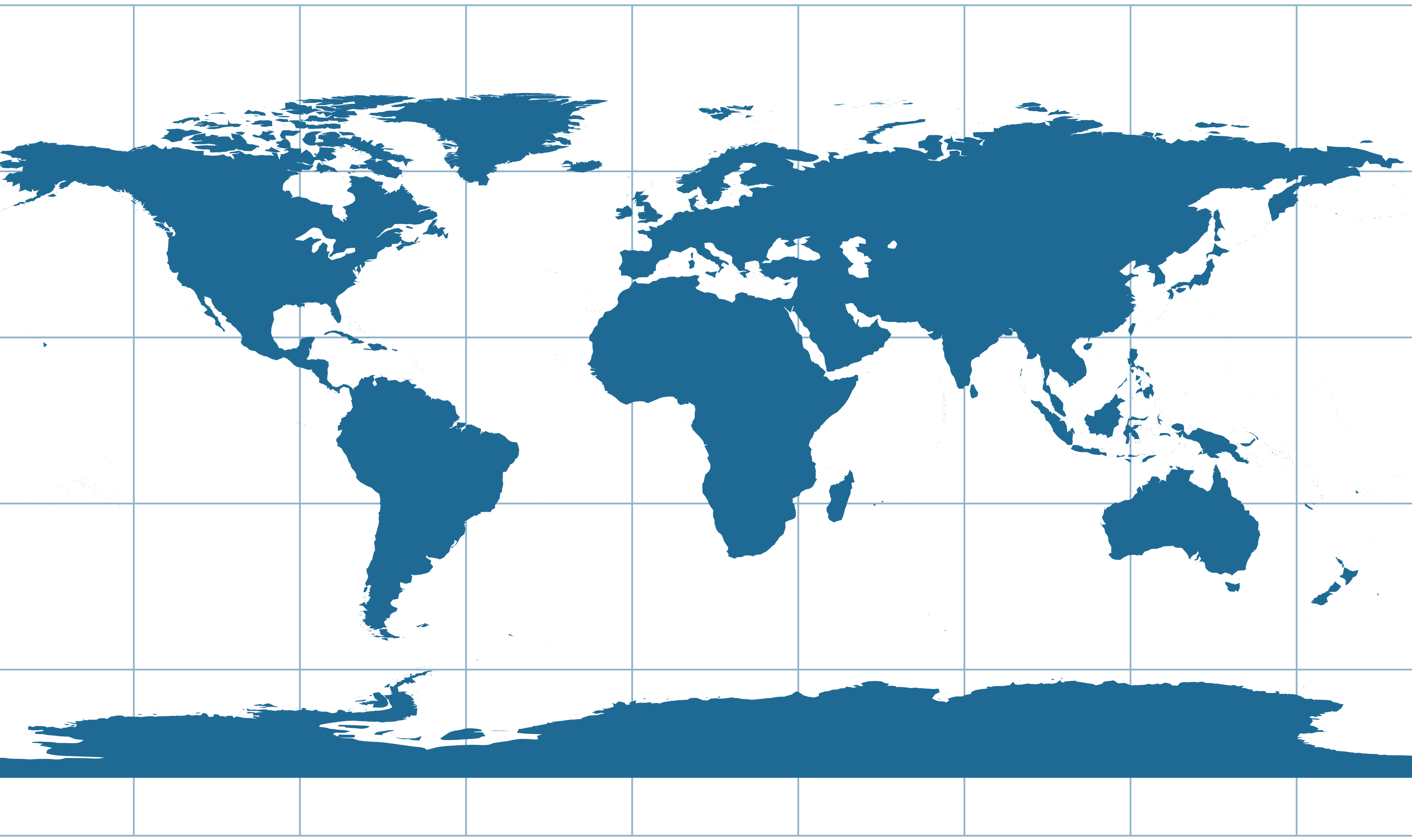
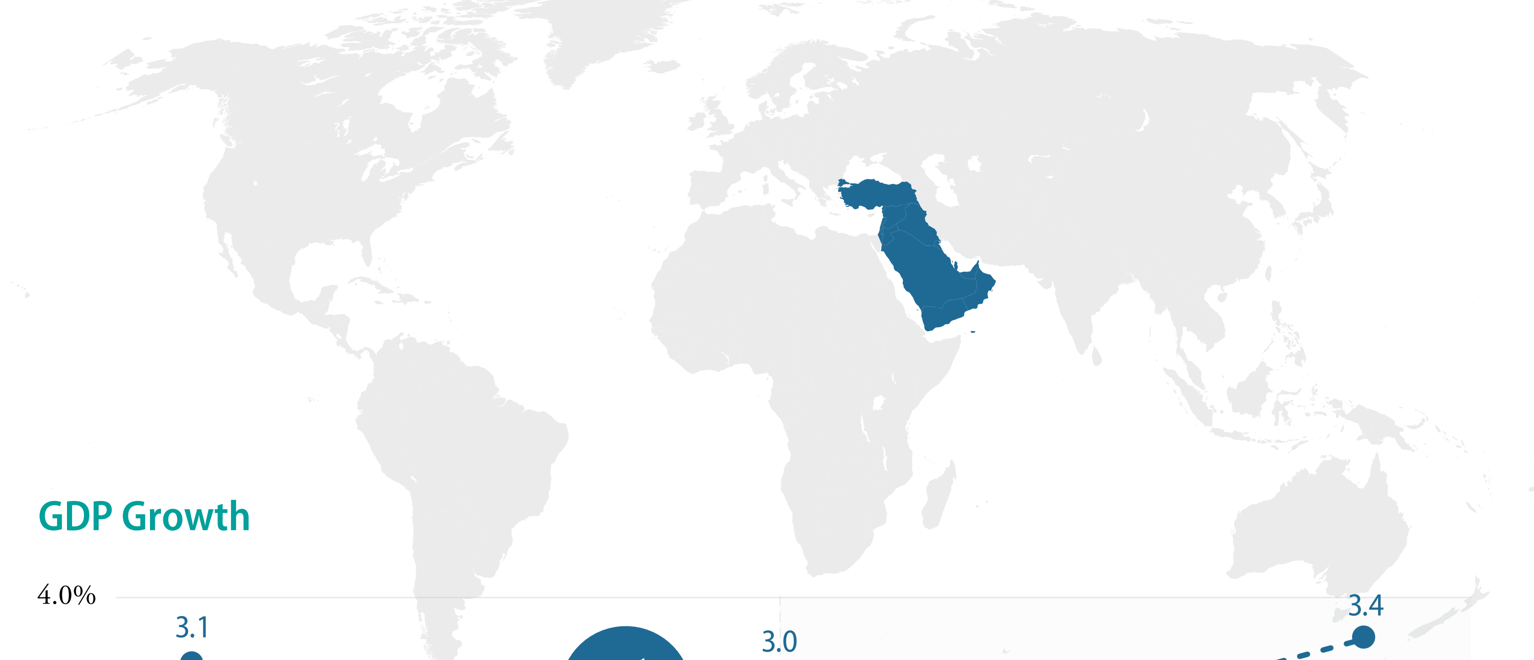
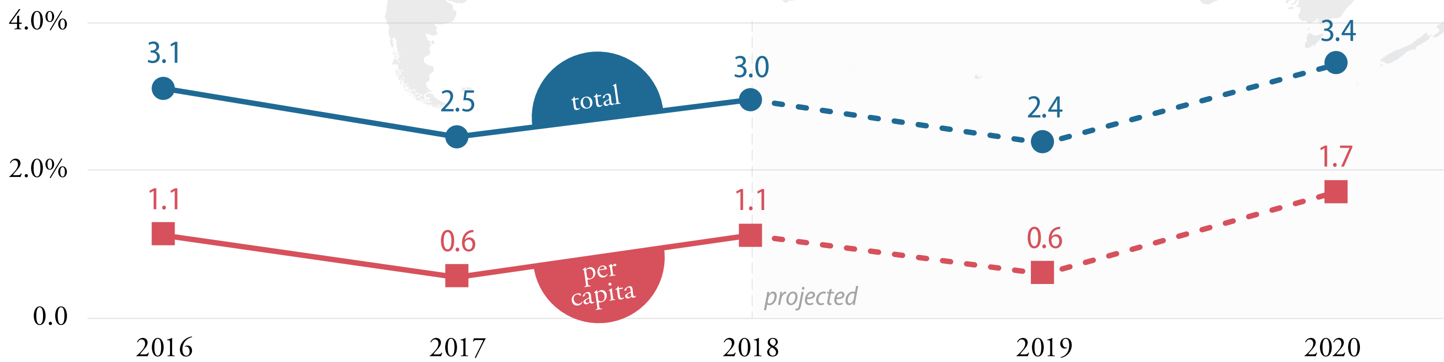


United Nations
New York, 2019

Western Asia

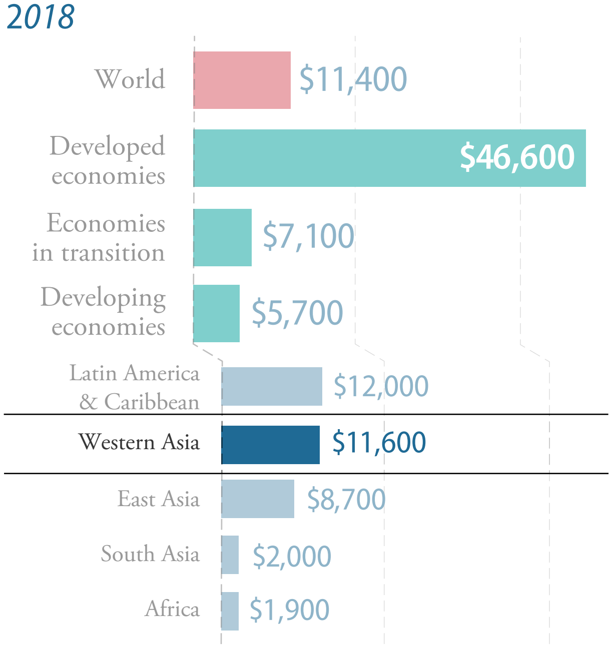


GDP Growth



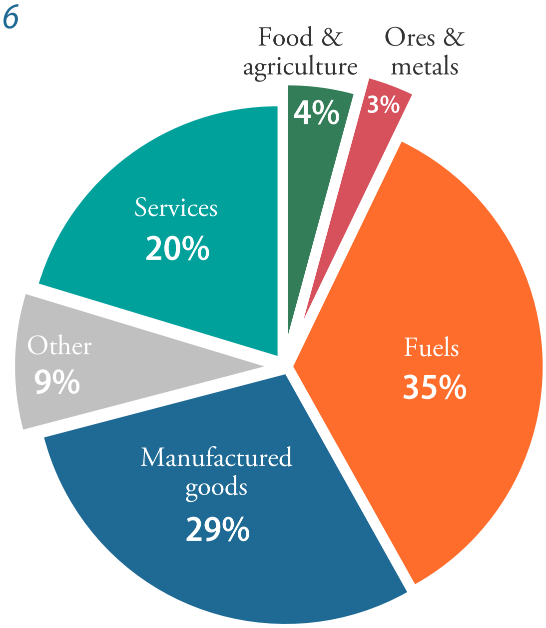
GDP per capita

2018



Exports structure

2016



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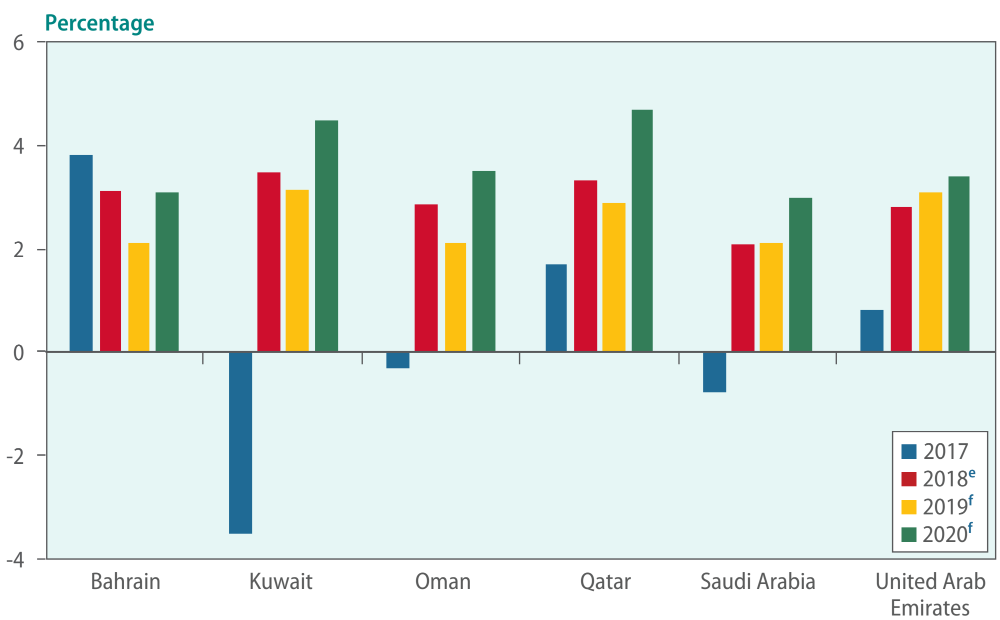
Western Asia: gradual recovery as oil markets improve

- Higher oil prices improve business sentiments
- Geopolitical tensions continue to impact economies
- The policy environment remains a challenge for ongoing fiscal reform

Western Asian economies saw a gradual recovery in economic growth in 2018 as the rebalancing of oil markets has positively impacted the region's major crude oil producers (see chap. I). Higher oil prices have not only contributed to fiscal balance improvements but also buoyed economic sentiment in the region's major crude oil producers, namely, the member countries of The Cooperation Council for the Arab States of the Gulf (GCC): Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. Moreover, the change in the Organization of the Petroleum Exporting Countries (OPEC) stance on the production ceiling in June 2018 has enabled the region's crude oil producers to moderately increase crude oil production over the previous year's level. On the other hand, growth in the energy-importing countries in the region (Jordan, Lebanon, and Turkey) has been mostly subdued, partly because of deteriorating terms of trade. Moreover, geopolitical uncertainty and high levels of public debt have negatively impacted these countries. The economic expansion in 2019 and 2020 is expected to be modest. Ongoing policy reforms and fiscal consolidation are expected to enhance macroeconomic resilience in energy-importing countries. The non-oil sector in GCC economies is projected to expand, deepening linkages to East and South Asian economies. However, the high reliance on hydrocarbon exports and geopolitical tensions weigh heavily on the region's growth prospects.

Figure III.25
GDP growth prospects of GCC countries



Source: UN/DESA.
Note: **e** = estimate, **f** = forecast.

The growth of GCC economies rebounded

The growth of GCC economies rebounded in 2018 from the weak growth performance in the previous year (figure III.25). The OPEC-led crude oil production ceiling resulted in a 4.5 per cent decline in crude oil production in GCC countries over the period between 2016 and 2017. Although domestic demand continued to expand consistently, the negative contribution of the oil sector halted the overall economic expansion in 2017. Economic growth rebounded in 2018 as both the oil and non-oil sectors positively contributed to growth. In addition to a modest increase in crude oil production, higher oil prices have improved business sentiment and stabilized financial and real estate markets. Ongoing reform measures to promote non-oil sectors also contributed to positive business sentiment. The efforts to diversify fiscal revenues, most notably through the introduction of the VAT, continued to improve fiscal frameworks and institutions. GCC economies are forecast to maintain steady growth over 2019 and 2020 as business sentiment is expected to remain mildly positive. Some acceleration may take place for large infrastructure projects such as World Expo 2020.

The recent decline in oil revenues has compelled the Government of Iraq to take fiscal consolidation efforts. Consequently, the reduction in public investment outweighed a pickup in non-oil economic activities. Moreover, inadequate public service provision, such as electricity, caused social unrest in the first half of 2018. With the formation of the new Government, public investment and public service provision are expected to strengthen. The Iraqi economy is estimated to have grown by 2.4 per cent in 2018 and forecast to grow by 2.3 per cent in 2019.

Geopolitical tensions and terms-of-trade deterioration impact Jordan, Lebanon and Turkey

Geopolitical tensions continue to negatively impact the economies of Jordan, Lebanon and Turkey. Moreover, rising energy prices caused terms-of-trade deterioration in those countries, resulting in tightening of balance of payment conditions. Robust growth in the mining sector and a pickup in tourism drove moderate growth in Jordan. However, fiscal austerity measures have weakened domestic demand growth. Ongoing reform is projected to stabilize the Jordanian economy over 2019 and 2020. Jordan is estimated to have grown by 2.1 per cent in 2018 and forecast to grow by 2.3 per cent in 2019.

Stagnant intraregional trade, a decelerating inflow of both workers' remittances and foreign investments negatively impacted Lebanon's economy in 2018. Business sentiment deteriorated with stagnation in the real estate sector. Lebanon faces the challenge of tackling rapidly rising public debt, and the fiscal stance is expected to remain tight for 2019 and 2020. However, the acceleration of economic reconstruction activities in the Syrian Arab Republic is projected to impact the Lebanese economy positively. Lebanon is estimated to have grown by 0.9 per cent in 2018 and forecast to grow by 1.7 per cent in 2019.

The Turkish economy decelerated in 2018 amid a sharp depreciation of the national currency and rising inflation. Despite resilient performance of the manufacturing sector, business sentiment has weakened in tandem with a stagnating real estate market. The currency devaluation is expected to positively impact Turkey's export growth while the domestic demand remains weak due to high inflation and tighter credit conditions. Turkey is estimated to have grown by 3.5 per cent in 2018 and forecast to grow by 1.7 per cent in 2019.

Yemen's economy contracts amid dire humanitarian conditions

While the humanitarian crisis in Yemen continues, its economy continued to contract in 2018 by 2.5 per cent. Ongoing armed conflict and political divisions in public institutions hampered economic activities. Yemen resumed its oil exports in August 2018 for the first time since 2015. However, the amount remained insufficient to make a positive impact. The economy is forecast to grow modestly by an estimated 1.9 per cent in 2019 as a slow recovery of the oil sector is projected. Despite this growth prospect, the population continues to face severe food insecurity as the agriculture sector was heavily damaged by armed conflict.

The Syrian economy has improved significantly as the intensity of conflict has eased. After five years of continuous contraction, the economy resumed expansion in 2017. While the stable exchange rate and monetary conditions stabilized economic conditions, increasing reconstruction activities contributed to the substantial recovery. Syria's economy is estimated to grow by 10.1 per cent in 2018 and forecast to grow by 11.3 per cent in 2019.

The economy of Palestine has been impacted by political tensions and instability. Industrial production declined while the economy was sustained by demand growth based on international aid and private sector transfers. The Palestinian economy is estimated to have contracted by 0.8 per cent in 2018 and forecast to grow by 1.3 per cent in 2019.

Robust economic growth continues in Israel

Robust economic expansion continued in Israel, supported by both strong external and domestic demand growth. While overheating domestic demand and upward pressure on wages have created inflationary pressures, consumer price inflation remained low in 2018. Weakening house prices are likely to lead to a gradual deceleration in domestic demand growth over 2019. The Israeli economy is estimated to have grown by 3.5 per cent in 2018 and forecast to grow by 3.2 per cent in 2019.

Mixed prospects in inflation

Inflationary pressures in GCC countries remained weak in 2018 except for Saudi Arabia and the United Arab Emirates where the introduction of the VAT impacted the price levels. Consumer price inflation for Iraq is also projected to remain low in 2018. This trend for GCC countries and Iraq is forecast to continue over 2019. The tax reform measures and rising energy prices resulted in rising price levels in Jordan and Lebanon. The inflation rate is forecast to decline in 2019 amid stabilizing energy prices in both Jordan and Lebanon. Due to the stable exchange rate, the high inflation rate in Syria is estimated to have come down to 4.3 per cent in 2018. However, as the economy is under severe foreign-exchange constraints, the rapid growth in reconstruction activities is forecast to push up inflation to 13.6 per cent in 2019. Yemen continues to face strong inflationary pressures that stem from the general shortage of supplies as well as monetary financing of a growing fiscal deficit, which is forecast to continue in 2019. Consumer price inflation in Turkey is estimated to be 16.1 per cent in 2018 due to the exchange-rate pass-through from a severe devaluation of the national currency. Despite a tight monetary stance, consumer price inflation is forecast to be high, at 10.2 per cent in 2019 as the impact of exchange-rate pass-through remains. Consumer price inflation is forecast to stay low in Israel through appreciation of the national currency and modest deceleration in domestic demand expansion.

The policy environment remains challenging

For the fiscal year covering 2018, GCC countries are expected to reduce budgetary deficits substantially. Although the improvement in fiscal positions is mostly attributed to increasing oil revenues from higher oil prices, the extensive efforts of fiscal consolidation—including subsidy reforms, revenue mobilization, and the introduction of the VAT—are forecast to positively impact the GCC countries' economic diversification strategy over the long term. Even though the impact of the VAT is modest regarding revenue increases, it is expected to improve the accounting system and business transparency. On the monetary side, the tightening monetary stance of the United States resulted in rising funding costs in the region as GCC countries, Iraq, Jordan and Lebanon sought a stable exchange rate of respective national currencies against the US dollar. Most of the central banks in the countries raised policy rates in tandem with the ongoing cycle of United States interest rate hikes. Moreover, the fast appreciation of the US dollar raised its funding costs in international capital markets for the region's borrowers. Although policy measures are in place to lessen liquidity pressures, which will enhance central banks' ability to supply credit to the private sector, the generally tightening monetary stance is expected to weaken domestic demand growth over 2019 and 2020.

Gradual social evolution continues amid grave challenges

Social evolution in the region was reflected in developments in Saudi Arabia, where women were allowed to obtain drivers' licenses in June 2018. Despite this indication of movement towards gender equality, the progress remains gradual. The Western Asia region witnessed remarkable progress in educational attainment for females over the last two decades, but the region on average is projected to experience only a modest increase in female labour force participation over 2019 and 2020. Moreover, the prolonged armed conflict caused a large-scale displacement of the population in Iraq, Syria and Yemen, resulting in a fragmented labour market for both the public and private sectors. The situation impeded policymakers' ability to intervene effectively and create job opportunities, particularly for women. As the labour market failed to recover, a significant gap between males and females is forecast to continue in the region's conflict-affected countries throughout 2019 and 2020.

Box III.5

Exploring exchange-rate misalignment in Arab countries[a]

Factors influencing the choice of exchange-rate regime vary across countries in the Arab region. About two thirds of Arab countries have a rigid exchange rate (i.e., currency board or conventional peg), while the remaining third operate more supple regimes by floating their currency and allowing for at least some flexibility in the exchange rate (table III.5.1). In effect, these choices are essentially concerned, inter alia, with the following: the degree of capital mobility; trade share with main partners; independency of monetary policy; flexibility and sustainability of fiscal policy; and the extent to which wages are sticky. However, the optimal choice of exchange-rate regime for a country is often widely debated.

In this context, assessing misalignment has been placed at the centre of academic and policy debate. A real exchange-rate misalignment refers to situations where the real exchange rate deviates from its long-run equilibrium path. Using an unbalanced data set for the period 2008–2016, Edwards' (1994) modelling specification is adopted to assess the degree of misalignment in five Arab countries with variables including real exchange rate, investment, government consumption, economic openness and terms of trade.

a This box draws on ESCWA, 2018.

Table III.5.1

Exchange-rate arrangements in Arab countries

	Rigid exchange rate				Supple exchange rate				Other
		Conventional peg							
Country	Currency board	USD	EUR	Composite	Stabilized arrangement	Crawl-like arrangement	Floating	Free floating	Other arrangement
Bahrain		■							
Kuwait				■					
Oman		■							
Qatar		■							
Saudi Arabia		■							
United Arab Emirates		■							
Egypt							■		
Iraq		■							
Jordan		■							
Lebanon					■				
Syrian Arab Republic									■
Algeria									■
Libya				■					
Morocco				■					
Tunisia						■			
Comoros			■						
Djibouti	■								
Mauritania						■			
Somalia								■	
Sudan					■				
Yemen					■				
Total	1	7	1	3	3	2	1	1	2

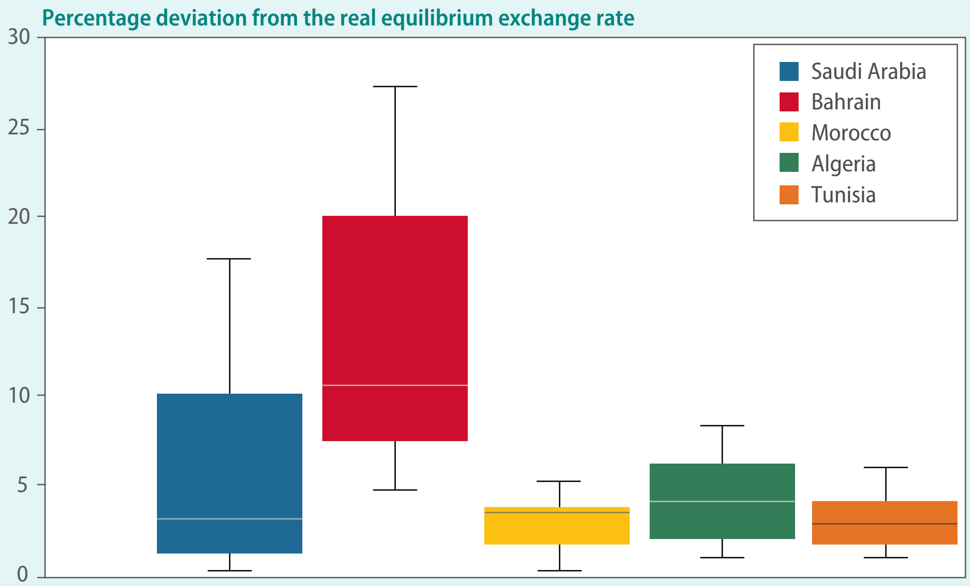
Source: IMF (2017), table 2, pp. 6-8.

(*continued*)

Box III.5 (*continued*)

Our empirical estimates of real exchange-rate misalignments show that there have been substantial misalignments in oil-exporting countries over this period (figure III.5.1). Bahrain and Saudi Arabia exhibit episodes of high levels of exchange-rate misalignment (above 15 per cent of deviation of the real exchange rate from its equilibrium level), which presents risks of distortion in relative prices and macroeconomic imbalances. On the other hand, our empirical evidence shows that in Morocco, the exchange rate appears to have only minor deviations, remaining close to its equilibrium level (less than 5 per cent deviation over the sample period). Since oil is the chief commodity in Bahrain and Saudi Arabia, the estimated high level of misalignment is mainly due to the impacts of swings in world oil prices on their currency valuations. In recent years, the decline in oil and commodity prices, growing fiscal imbalances, and geopolitical tensions have inspired reflections in many Arab countries on the most appropriate exchange-rate regime and triggered reforms concerning the way the exchange rate is managed.

Figure III.5.1
Modelling results on exchange-rate misalignment in Arab countries



Source: ESCWA (2018).
Note: Figure illustrates the average deviation of the real exchange rate from real equilibrium exchange rate over the sample period 2008–2016, where the whiskers illustrate the range of misalignment over the entire period.

Mindful of misalignment testing, ten Arab countries have recently made adjustments to their exchange-rate regime. In particular, Egypt has opted for a hard landing policy by instantly adopting a floating exchange-rate system since November 2016. With the adoption of a floating exchange-rate regime, Egypt put forward an active monetary policy in order to reduce the high and persistent current account deficit, in addition to devaluing the currency. In a different approach, Morocco is opting for a soft-landing transition and implemented in 2018 the first step towards a long-term adoption of the floating regime, taking advantage of its relatively high-quality credit rating and solid economic performance.

Although switching to the appropriate exchange-rate regime allows a country to strengthen its competitiveness and promotes economic resilience, the transition requires a careful approach. In the case of Egypt, exchange-rate shocks have had immediate and high impacts on inflation, whereas Morocco may also face costs associated with losing the country's nominal anchor, in exchange for a more appropriate exchange-rate regime.

Transitioning from one form of exchange-rate regime to another has the potential to introduce greater stability in real exchange rates and reduce misalignments. However, policymakers should carefully consider the design and pace of transition to also preserve short-term macroeconomic stability. Modernization of monetary policy, including central bank reforms and gradual progress towards a transparent policy framework, could be a crucial aspect of reform efforts.

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