Introduction: In 2013, MENA regional growth is expected to slow to 3.8% from 6.1% in 2012. Growth deceleration into 2013 reflects a return to more sustainable growth in oil exporting countries, which reached 7.4% in 2012. Egypt’s growth is expected to weaken relative to 2012, but in other oil importing countries economic activity is expected to expand faster than in 2012.

This outlook is subject to a variety of risks. Political instability, policy uncertainty, and weakened macroeconomic fundamentals are the key challenges facing developing MENA countries. Slow growth in Europe poses additional problems, especially for Morocco and Tunisia.

Growing macro imbalances in oil importers present serious risks. Libya aside, fiscal deficits have worsened significantly since 2010 in the remaining transition economies (Egypt, Tunisia, and Yemen), due to rising expenditures on wages and subsidies, and a large public sector. Current account positions are deteriorating, government debt as a share of GDP increased by 4-12 percentage points, and international reserves are under pressure.

The already difficult employment situation has worsened in the post-revolutionary period. In Egypt and Tunisia unemployment rates increased by 4 percentage points compared to those prevailing before the Arab Spring. The transition has disproportionately hit the employment creating sectors. In Egypt, manufacturing, construction, and tourism-related services have been most affected.

The main challenge now is generating the economic and political confidence that will renew spending by investors, tourists, and consumers.

Political Context: The regionally varied process of political change continued into 2013. Violence in Syria escalated, with spillover effects to the countries in the Mashreq area. Violent incidents near the border with Syria have increased Lebanon’s sectarian tensions, damaging political stability and growth. In Jordan, the influx of Syrian refugees has put a strain on resources.

Security in Yemen is fragile, but progress has been made in reforming the security institutions and the six-month national dialogue is ongoing. A new constitution is to be drawn and preparations made for presidential and parliamentary elections. Tunisia’s deepening political instability has delayed the

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2 This note refers to two main groups of MENA countries: oil exporters and oil importers. The oil exporters refer to the GCC oil exporters - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates, and the developing oil exporters - Algeria, Iran, Iraq, Libya, Syria, and Yemen. The oil importers are Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, and the Palestinian territories.
constitution and the next national elections. The schedule to prepare the Libyan constitution has slipped, but the interim government is working to improve security and public institutions’ capacity. Politics in Egypt remains highly fragmented, following the referendum on the new Constitution in December 2012. The Constitution was approved by a small majority, but with low voter turnout. Challenges to the election law will likely delay the Parliamentary elections to the second half of the year.

Changes since the Arab Spring: Macro-economic fundamentals have worsened in the developing MENA countries since the onset of Arab Spring transitions. Despite recoveries in 2012, growth for the year was below the average growth observed in 2000-10 in all countries, except in Libya where the sharp 2012 rebound offset a similar drop in the previous year (Figure 1). Political instability, sectarian divisions, and unrest took their toll on economic activity and investment. Weakness in the global economy, and the EU in particular, made the situation worse for Tunisia and Morocco due to their close ties with the EU. Jordan and Lebanon experienced spillovers from Syria, hurting growth.

In Egypt, tourism-related sectors, such as the hospitality industry, air transport, and retail trade, were particularly hard-hit, and so were manufacturing and construction. In 2010, these sectors jointly contributed over 40% of total value-added and employed around 43% of the labor force. Agriculture – the largest employer and third largest sector – also contributed to the growth slowdown. Indeed, all sectors other than the Suez Canal declined between 2010 and 2012.

Since the Arab Spring, the employment situation in Egypt and Tunisia has worsened. Job creation slowed and unemployment rose in tandem with the slowdown in output growth. Officially, the Egyptian unemployment rate in the last quarter of 2012 was 13%, up more than 4 percentage points from 2010. Tunisia presents a similar picture, with the unemployment rate increasing by just less than 4 percentage points between 2010 and 2012. According to recent data, the poverty rate in Egypt rose from 22.0% in 2008/09 to 25.2% in 2010/11. It has likely increased further since.

Public works in infrastructure offer one way to support job creation relatively quickly. According to a World Bank study on infrastructure and employment creation in MENA (Estache et al. 2012), the region could generate 2.5 million jobs by meeting annual infrastructure needs. However, many countries with fiscal constraints have trimmed the

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investment portion of their budgets, expanding recurrent expenditures to fund increases in subsidies, pensions, and public wages. In Morocco, for the first time, the government spent more on subsidies (6.6 percent of GDP) than on public investment (5.8 percent of GDP).

**Fiscal Vulnerability:** Fiscal vulnerability increased throughout the region, reflecting the impact of growth decelerations on government revenues and increases in public spending in response to political upheavals. Government deficits widened substantially: in the case of Yemen by as much as 6% of GDP (Figure 2).

![Figure 2. Growing macroeconomic imbalances](image)

Increases in other post-revolutionary economies were smaller, but sizable. Government debt grew as a share of GDP in most MENA developing countries. In Egypt, the government has relied increasingly on short-term domestic debt instruments and its interest payment obligations rose by 33% in the second half of 2012, compared to the same period in the previous fiscal year. Egypt’s access to external markets has diminished significantly as credit agencies lowered its credit ratings. In late December 2012, Standard & Poor’s cut Egypt’s long-term credit rating to the same level as Greece. Egypt’s sovereign interest bond spreads skyrocketed to nearly 700 basis points over US Treasuries. Jordan’s debt grew at the fastest pace among developing countries in the region during the period 2010-12, adding 12 percentage points to its debt-to-GDP ratio. In Egypt and Morocco, government debt increased sharply as well, rising by nearly 7 percentage points in the two years since 2010.

**External Positions:** External positions have worsened across developing MENA since 2011 (Figure 2) as net exports and investment flows declined (Figure 3). The drop was dramatic in Egypt, though estimates suggest that in 2012 FDI in Egypt may have recovered somewhat. Lebanon’s external position saw an improvement due to increased capital inflows, driven by widening domestic-international spreads. Yemen’s current account deficit narrowed as well due to a US$2 billion Saudi grant. Consequently, gross reserves increased to US$ 5.6 billion, equivalent to slightly less than 6 months of imports, up from 4 months in 2011. This support built confidence and strengthened the currency, narrowing the wide gap between official and black-market rates.

![Figure 3. FDI flows (US$ bn)](image)

Currencies have weakened across oil importing North Africa despite drawing down on foreign exchange reserves. Foreign reserves dropped, especially in Egypt, but less in other oil importing countries (Figure 4). The drop in Egypt occurred despite balance of payments support from Qatar (US$2.5 billion) and Turkey (US$0.5 billion). At less than 3 months of imports and half in illiquid form, reserves are critically low. The Egyptian pound has...
depreciated by 10% against the US$ since December 2012, when the central bank introduced foreign exchange auctions and a black market emerged in response to rationing and new regulations. Adding to economic stress are shortages of fuel and certain foods and products, rising differences between official and black market prices, and increased dollarization. Recently announced loans from Qatar (US$3 billion) and Libya (US$2 billion) could provide temporary relief.

**Figure 4. International Reserves**

![International Reserves, US$ bn](image)

Source: IMF.

**Economic outlook:** In 2013, regional growth is expected to slow to 3.8% from 6.1% in 2012 when the region started recovering from the political turmoil of 2011. The growth deceleration into 2013 largely reflects a return to more sustainable growth in oil exporting countries, which grew at a very high pace in 2012 because of strong oil prices and production, and a sharp rebound in Libya, after the 2011 production collapse. Recovery is expected to strengthen in Yemen, assuming that the national dialogue produces a stable government, capable of forging ahead with reforms and project implementation.

Uncertainty shrouds the outlook in many developing MENA countries, but risks are elevated in Egypt. The economy contracted by 2.6% q/q in the last quarter of 2012, dragged down by agriculture which contracted by 26% q/q. In FY13, Egypt will complete its third year of near zero growth in per capita terms. Lack of progress will disappoint millions of Egyptians, especially the poor, who were frustrated with the economy even before the Arab Spring when growth was robust. Verme (2013) shows that, on average, household welfare in Egypt did not improve in real terms between 2000 and 2008, despite high economic growth. There was a sharp rise in inequality aversion (measured by the proportion of people who think that incomes should be more equal) across almost all income groups and a decline in self-reported income and status.

Growth in other oil importers is expected to accelerate relative to 2012 so long as political transitions proceed smoothly and progress is made with fiscal consolidation and other reforms. Developments in Europe will impact Morocco and Tunisia. Twin deficits will have to be addressed decisively in order to avert further macroeconomic deterioration, improve confidence, and stimulate the private sector. Meanwhile, post-revolutionary oil importing MENA countries remain dependent on external financing from official sources.

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