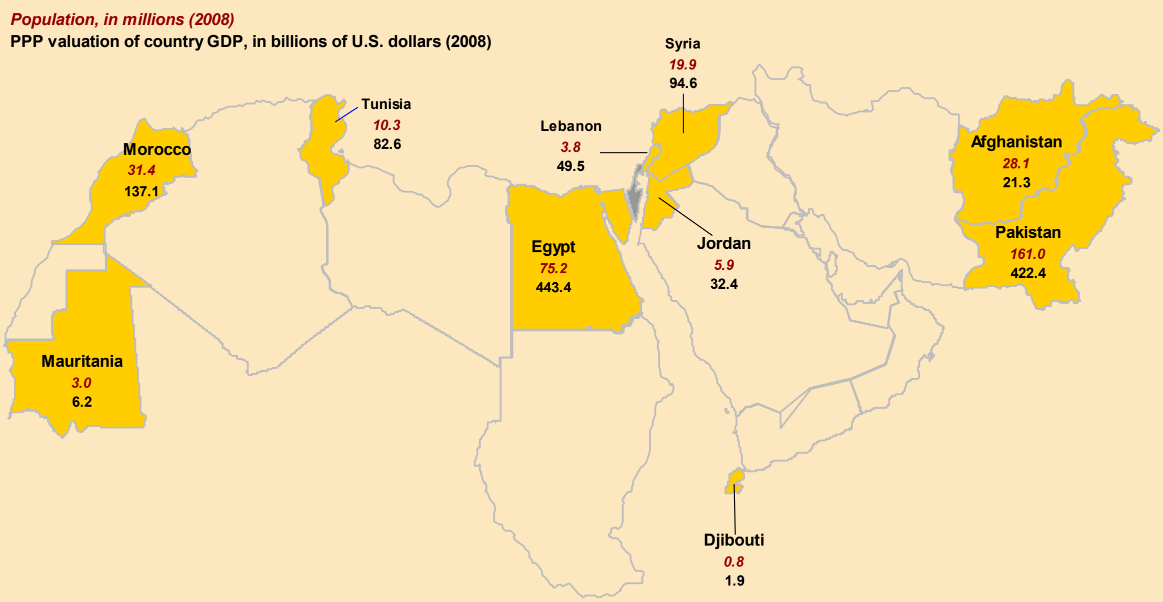
2. MENAP Oil Importers: Slow Recovery Ahead

The MENAP oil importers are a diverse group, encompassing both emerging and low-income economies. Many have seen significant slowdowns in the past year but, overall, these countries have escaped the substantial contractions experienced in other parts of the world. Supportive policy responses, a low degree of integration with international capital markets and manufacturing supply chains, and banking systems that had little exposure to structured financial products have contained the fallout. While the slowdown has been modest, this group of countries is also likely to experience a slow recovery. Limited external financing, little space for fiscal stimulus, a real appreciation of most domestic currencies, sluggish receipts from tourism and remittances, and higher energy prices will all continue to be a drag on growth for some time.

MENAP Oil-Importing Countries

MENAP oil importers are diverse in terms of geography, level of development, and integration with regional and global markets. Per capita income levels vary widely, as do poverty rates within the group. In economic terms, the group is dominated by Egypt and Pakistan (which account for 70 percent of nominal GDP among the group). Per capita GDP ranges from US$416 in Afghanistan to US$7,700 in Lebanon. Although more diverse in terms of economic structure than the MENAP oil exporters, the oil importers do share some common features—including close economic and trade ties with the GCC and Western Europe, fairly low levels of financial and industrial development, limited integration with world markets, and relatively high levels of public debt.



Sources: IMF, *Regional Economic Outlook* database; and Microsoft MapLand.

Note: The country names and borders on this map do not necessarily reflect the IMF's official position.

Economic Activity Is Picking Up Gradually

The MENAP oil importers are slowly starting to pull out of the economic downturn. While high-frequency economic data for these countries are sparse, some indicators suggest that activity has begun to turn upward. In Egypt, Morocco, and Pakistan (the three largest economies in the group), exports have recently increased, although values remain at lower levels than a year ago (Figure 2.1). Other indicators, such as industrial production, however, show that the recovery is still tentative.

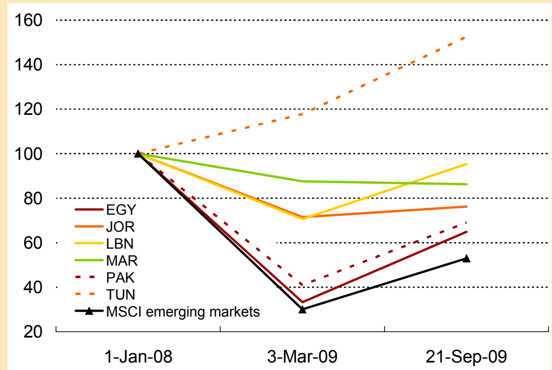
In comparison, the recovery in financial markets has been more robust. Stock markets in Egypt and Pakistan have almost doubled since their lows in early 2009 (Figure 2.2). Other countries in the group have seen smaller percentage increases this year, but also recorded more limited losses last year. Since the start of 2008, markets in the region have generally outperformed the emerging market average. Remarkably, Tunisia's index was hardly affected by the crisis and is now near its record high.

Overall, the rebound in output is likely to be gradual. Growth patterns vary, but for the MENAP oil importers as a group, real GDP is now projected to expand by 3.6 percent in 2009 and 3.8 percent in 2010 (Figure 2.3). With output and financial market conditions in Egypt and Lebanon outperforming expectations in recent months, these growth rates are slightly higher than those projected in the May REO. For most countries in the group, however, growth is expected to remain below precrisis levels for some time, and the pickup is projected to be slower than that of global activity as a whole.

Figure 2.2

Stocks Outshining MSCI Benchmark

(Stock market performance; index, Jan. 1, 2008 = 100)

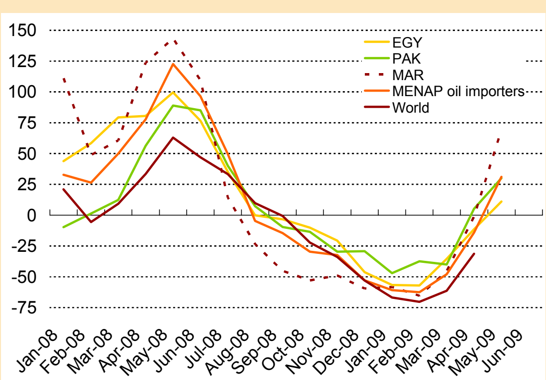


Source: Bloomberg.

Figure 2.1

Exports Rebounding

(Change in exports; annualized percent change of three-month moving average over previous three-month moving average)

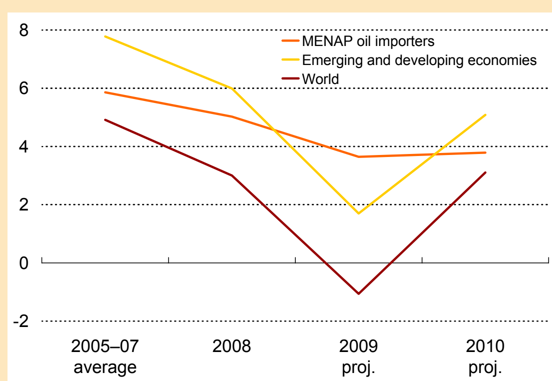


Source: IMF, *Direction of Trade Statistics*.

Figure 2.3

Economic Growth Slowed During the Crisis and Is Likely to Remain Relatively Subdued

(Real GDP growth; percent)



Sources: National authorities; and IMF staff estimates and projections.

Limited Links to Global Economy Provided Protection Against Downside Risks

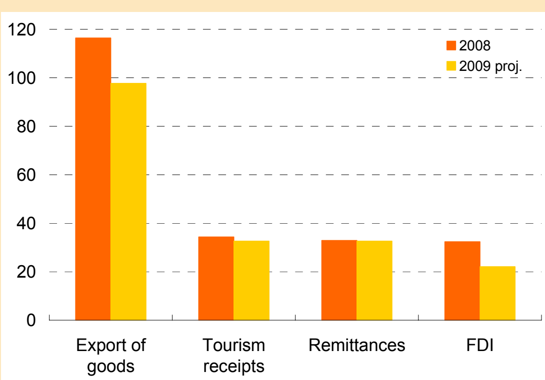
For the MENAP oil importers, the global crisis has manifested itself mainly in a reduction in receipts from abroad. Merchandise exports and foreign direct investment have been hardest hit and are, on average, projected to decline in 2009 by 16 percent and 32 percent, respectively (Figure 2.4). Tourism receipts and remittances have also declined, but not as much. In some cases, increased financial stress has also given rise to capital outflows, with international reserves dipping in Egypt as global tensions spiked in late 2008.

For the most part, however, the negative impact on the MENAP oil importers has been relatively modest. Capital outflows were manageable and are now reversing, and the loss of export earnings has been much less than those experienced in Asia. For example, demand for textiles—the major manufactured export item of several countries in the group—has slowed, but generally by substantially less than for many other products. During the first half of the year, European Union imports of textiles, clothing, and related products

Figure 2.4

Lower Receipts from Abroad

(MENAP oil importers: external receipts; billions of U.S. dollars)[1]



Sources: National authorities; and IMF staff estimates and projections.

[1] Excludes Afghanistan and Djibouti. Tourism receipts also exclude Pakistan.

fell by only 4 percent. In contrast, European Union total merchandise imports dropped by 24 percent over the same period, with petroleum products and heavy manufacturing registering the largest declines.

Receipts from tourism and remittances have varied considerably across countries. Available data indicate that, over the past year, remittances have fallen by 24 percent in Egypt, while both remittances and tourism contracted by about 12 percent in Morocco. In contrast, tourism has been stable or even growing in Jordan, Lebanon, Tunisia, and Syria, reflecting country-specific developments (such as recovery from last year's unrest in Lebanon and increased tourism from oil-exporting neighbors) as well as an apparent switch away from higher-cost destinations. In addition, remittances into Pakistan and Tunisia are reported to have increased, although this could also reflect misrecorded savings of workers returning to their home countries.

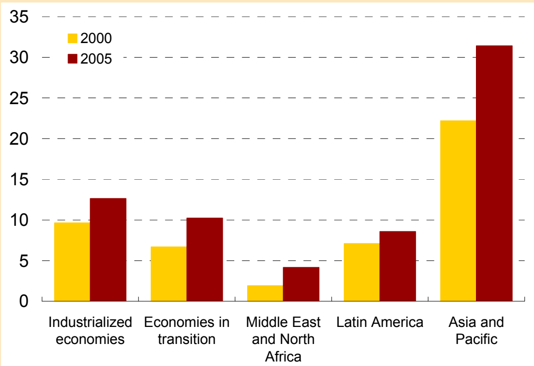
In most of these countries, a smaller import bill has offset the decline in export receipts as lower oil prices and the drop in foreign direct investment have contributed to marked reductions in the price and volume of goods purchased abroad. This has helped reduce pressure on the balance of payments and has allowed reserves to increase.

The largely muted impact of the crisis on the MENAP oil importers reflects their low level of international integration. Perhaps nowhere is this more apparent than in their limited engagement in advanced manufacturing (Figure 2.5). This sector relies on a highly specialized and intricate supply chain that spans the globe—a very efficient mode of production, but one that is also highly vulnerable to disruption at all stages. In addition, much of the sector's output consists of capital goods and machinery for which demand tends to be cyclical. These characteristics have rendered the sector among those most affected by the global crisis. Its minor role in the MENAP region helps explain why these economies have been relatively unharmed by the global crisis, as illustrated by the correlation between the share of advanced manufacturing in GDP and the magnitude of the slowdown (Figure 2.6).

Figure 2.5

Little Advanced Manufacturing . . .

(Share of advanced manufacturing value added in GDP; percent)



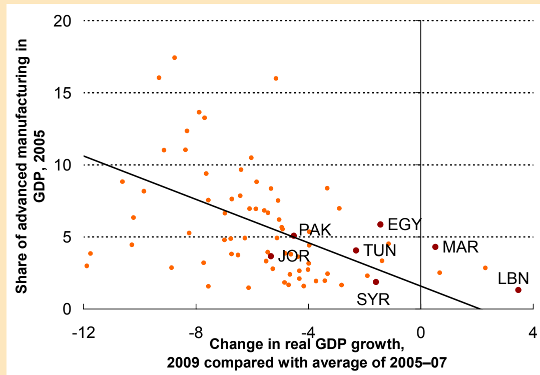
Sources: UNIDO database; and IMF staff calculations.

Note: Advanced manufacturing is high- and medium-technology manufacturing as defined in the UNIDO *Industrial Development Report*, 2009.

Figure 2.6

. . . Has Provided Protection from the Downturn . . .

(Share of advanced manufacturing in GDP and projected change in growth; percent)



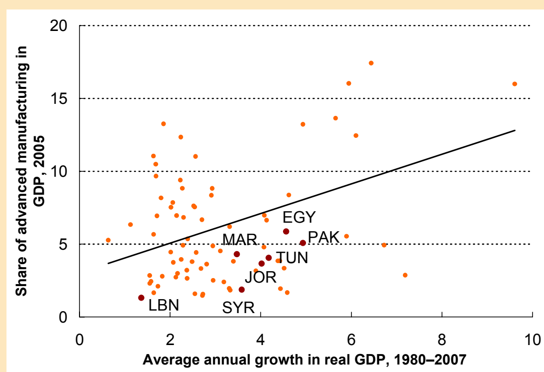
Sources: UNIDO database; *World Economic Outlook*; and IMF staff calculations.

In Lebanon—where advanced manufacturing plays only a minor role—the impact of the global crisis has been particularly mild. In contrast, Egypt, Pakistan, and Tunisia are more engaged in advanced manufacturing and are projected to experience larger reductions in economic activity. Of all the oil importers, Jordan is likely to see the largest reduction in growth, largely on account of the contraction of its financial services sector. In general, while limited integration with the global manufacturing supply chain has helped insulate the MENAP oil importers from the downturn, it has also come at the cost of lower value added in production and slower economic growth (Figure 2.7).

Figure 2.7

. . . but at a Long-Term Cost

(Share of advanced manufacturing in GDP and average historical growth; percent)



Sources: UNIDO database; *World Economic Outlook*; and IMF staff calculations.

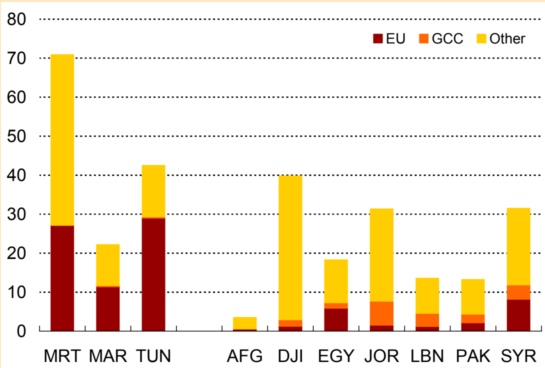
Aside from these general patterns, varied developments reflect the diverse nature of the region. Countries in the Maghreb (Mauritania, Morocco, and Tunisia) have been more exposed to the slowdown in the European Union—their main trading partner and most important source of remittances (Figure 2.8). In Morocco, however, an exceptional agricultural harvest is expected to mitigate the impact of the global economic slowdown on overall output, while Tunisia is benefiting from a major gas field coming on line.

Further to the east, countries in the Mashreq (Egypt, Jordan, Lebanon, and Syria) are more closely linked to the GCC, where increased government spending has helped sustain demand and, to some extent, has provided neighboring countries with a buffer against the downturn (see Chapter 1).

Figure 2.8

Trade Patterns Differ

(Direction of merchandise exports, 2008; percent of GDP)



Source: IMF, *Direction of Trade Statistics*.

In Pakistan, the economic slowdown began before the global crisis—a consequence of preexisting macroeconomic imbalances and a deteriorated security situation.

Some have seen hardly any impact from the crisis, as is the case for Afghanistan and Mauritania, whose exports are small or based on primary products and where there are few trade and financial linkages with the rest of the world. Djibouti's economy, too, is bucking the trend by continuing to grow at a healthy pace spurred by a number of large foreign direct investment projects in construction and port services.

Limited Exposure to International Capital Markets Curbs Fallout

While the global financial crisis also rippled through to local stock markets and sovereign bond spreads, the negative impact on regional output has been relatively small (Box 2.1).

Across the MENAP oil importers, no major financial institutions have failed. In addition, except in Pakistan, credit growth has remained positive, in line with the muted deceleration in output. These countries' mainly bank-based financial systems are well capitalized and avoided significant exposure to U.S. subprime or other structured securities. Moreover, reinforcing confidence, Jordan instituted a blanket guarantee on bank deposits, while Egypt reiterated an existing blanket guarantee.

Historically, the volume of external financing has been relatively insignificant across the region. While the oil importers enjoyed increasing capital inflows in the run-up to the global crisis, the total value of external bond issuance was relatively low. Since 2007, Lebanon has been the only country to issue external bonds, many of which have been locally purchased (Figure 2.9).

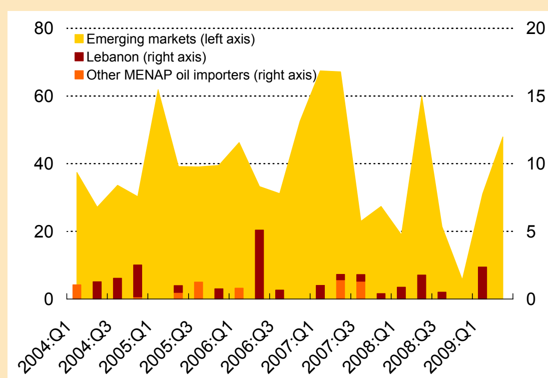
Although emerging market bond issuance is recovering from a near-standstill at end-2008, none of the countries in the group—except probably Lebanon—plan to tap international bond markets over the coming year. Dominated by Egyptian—and to lesser extent Pakistani—borrowers, cross-border bank lending to these countries has been similarly small in scale and has yet to resume in earnest (Figure 2.10).

While access to international capital markets remains limited, the cost of external borrowing has declined in recent months. In line with developments in other emerging markets, the interest rate spread over U.S. treasuries on sovereign borrowing jumped sharply in late 2008, reaching as much as 20 percentage points in Pakistan for a short period. However, these

Figure 2.9

Low Issuance of External Bonds . . .

(Emerging market bond issuances; billions of U.S. dollars)



Source: Dealogic.

Box 2.1

Spillovers from the Global Crisis

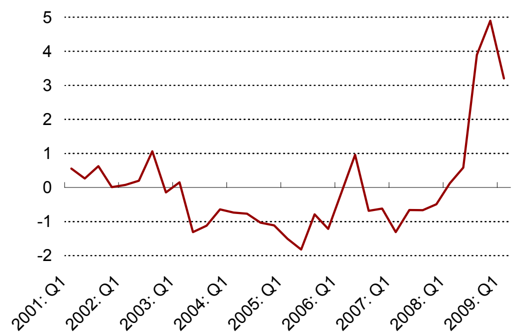
Financial markets in the MENAP oil-importing countries experienced significant spillovers from the global financial crisis. Financial stress, as measured by a normalized index of exchange rate market pressure and four market-based price indicators (sovereign bond spreads, banking sector β, stock market returns, and stock market volatility) with equal weights, spiked in late 2008. The increase was mostly driven by a sharp decline in stock market prices, increased stock market volatility, and increased sovereign bond spreads. Financial stress has subsequently declined but remains elevated compared to last year.

Movements in stock index returns during the second half of 2008—one of the main contributors to the increase in financial stress—can largely be attributed to developments in global financial markets, as shown by very large comovements (more than two standard deviations) of stock index returns for Egypt, Jordan, Lebanon, and Morocco with the S&P500. This contrasts with the September 2001 crisis, during which only small comovements were apparent. There were also substantial comovements between sovereign bond spreads, although of smaller magnitude.

Figure 1

Financial Stress in the MENAP Region

(Index)



Source: IMF staff calculations.

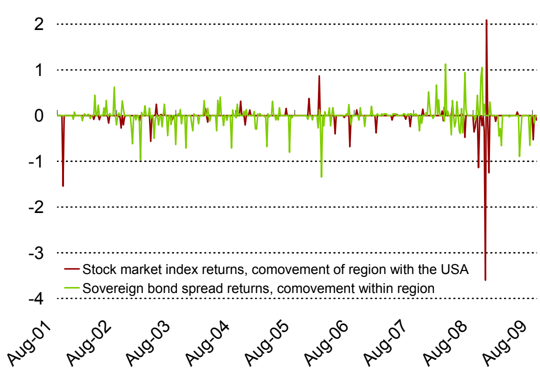
Note: Figure covers Egypt, Jordan, Lebanon, Morocco, Pakistan, and Tunisia.

A decomposition of real GDP growth shows that stress in the financial sector had a relatively small, albeit statistically significant, effect on growth in the MENAP region. The spillovers to the real economy were mostly from a contraction of output in advanced economy trading partners and other factors, and to a smaller extent via greater financial stress. Country-specific analysis for Tunisia indicates that trade and tourism are the most important transmission channels, and that the impact of a shock in Europe takes several quarters to materialize fully.

Figure 2

Comovements of Financial Assets

(Standard deviations)



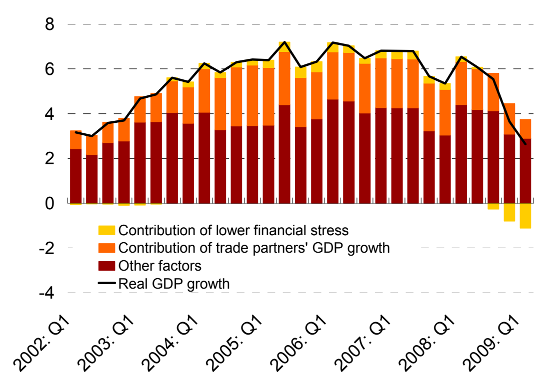
Source: IMF staff calculations.

Note: Figure covers Egypt, Lebanon, Morocco, and (in the case of stock market comovements) Jordan.

Figure 3

Decomposition of Regional Real GDP Growth

(Percent: year-on-year)



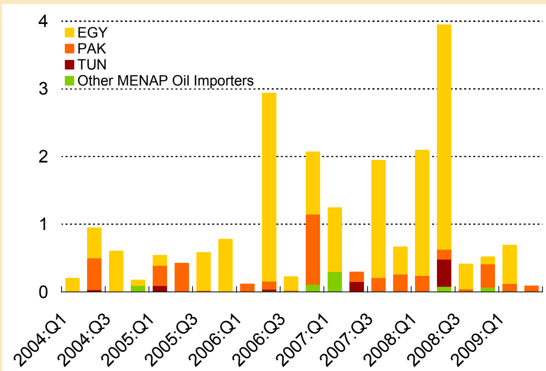
Source: IMF staff calculations.

Note: Figure covers Egypt, Jordan, Morocco, Pakistan, and Tunisia.

Figure 2.10

. . . and Little Cross-Border Bank Lending

(Cross-border loans to MENAP oil importers; billions of U.S. dollars)



Source: Dealogic.

spreads remain elevated at between 70 basis points in Egypt and 625 basis points in Pakistan. And, with the exception of Lebanon, even the governments that were accessing international markets prior to the crisis are now relying entirely on domestic or official sources to finance their deficits, which are projected to range from about 2 percent of GDP in Morocco to some 8 percent of GDP in Egypt.

The switch to local financing in these countries appears to have taken place seamlessly, in sharp contrast to what has occurred in some other emerging markets, where sudden stops of capital inflows have had severe consequences. This is not surprising, given the MENAP oil importers' limited dependence on external private financing and, in many cases, relatively deep local debt markets. At the same time, as private credit growth has slowed, the relative ease with which most governments in the group have been able to finance fiscal deficits at home may reflect reduced competition for loanable funds. If fiscal balances do not improve as the global and regional recovery progresses, interest rates are likely to rise with greater private sector demand for capital. Given ambitious plans for bond issuance in industrial countries, the future cost of capital is also likely to go up with the anticipated increase in U.S. treasury yields.

Policy Responses Are Constrained

The MENAP oil importers have responded to the slowdown with a range of fiscal and monetary measures (Table 2.1).

- In Egypt, the government stepped up expenditure (mainly on infrastructure) by about 1 percent of GDP in 2008/09 and provided further easing in 2009/10. In addition, the central bank has cut policy rates six times since the beginning of 2009 and reiterated its 100 percent guarantee on local bank deposits.
- In Jordan, the 2009 budget envisages a substantial increase in capital spending and some tax cuts, financed mostly by savings from lower fuel and food subsidies. Interest rates have been cut by 150 basis points since late 2008, and required reserves have been reduced from 10 percent to 7 percent. A temporary blanket guarantee on bank deposits was issued in October 2008.
- In Morocco, the authorities intend to boost public investment by ½ of one percent of GDP and to proceed with plans to lower income taxes and to increase wages at the lower end. The key policy rate has been reduced by 25 basis points and required reserves have been reduced from 15 percent to 10 percent since the start of 2009.

Table 2.1

MENAP Oil Importers: Policy Responses to the Crisis

Country	Monetary Easing	Deposit Guarantees	Liquidity/ Prudential	Fiscal Stimulus	Stock Market Intervention
Egypt	✓	Reiterated		✓	
Jordan	✓	✓	✓		
Lebanon			✓		
Morocco	✓	Already exists	✓	✓	
Pakistan	✓		✓		✓
Syria			✓	✓	
Tunisia	✓		✓	✓	✓

Sources: National authorities; and IMF staff assessments.

- In Pakistan, the 2009/10 budget provides for an easing of 1.2 percent to 1.5 percent of GDP compared with the earlier program. Interest rates were cut by 100 basis points in April and again in August by the same amount.

- In Tunisia, the authorities introduced in several steps fiscal measures totaling about 1.4 percent of GDP in 2009, involving an acceleration of investment projects and support to affected export sectors and their domestic suppliers. Earlier, the required reserve ratio was lowered from 10 percent to 7½ percent, and the key policy rate was reduced by 75 basis points.

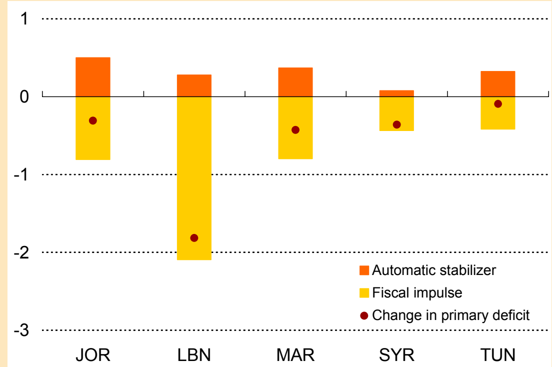
Despite this range of countercyclical measures, overall fiscal policy packages have tended to be procyclical. Based on a measure of fiscal impulses (Appendix), Morocco and Tunisia have been providing a substantial discretionary stimulus in 2009, on the order of 2 percent to 4½ percent of GDP, while most other countries appear to have maintained or tightened their fiscal policy stance. In 2010, however, the move toward greater fiscal tightening is projected to become more pronounced, with all countries shown in Figure 2.11 having to withdraw fiscal stimulus despite output falling further below potential. These results are in line with historical data, which suggest that the MENAP oil importers have generally had to pursue procyclical fiscal policies, even during recessions.

There are several plausible explanations for the seemingly reserved fiscal responses to the current slowdown. In almost all oil importers, high debt levels impose a major constraint on the size of deficits that can be sustained (Figure 2.12). With limited room for more debt and with revenue dropping as a result of the slowdown, most countries are having to cut expenditure. Reduced access to external financing may also be playing a role. Moreover, for major aid recipients, such as Djibouti and Jordan, tight spending could reflect an anticipated reduction in official development assistance. In several other countries, including Egypt and Morocco, fiscal developments are heavily influenced by changes in energy subsidies that move in line with the international price of oil.

Figure 2.11

Procyclical Fiscal Impulses

(Change in non-oil primary fiscal deficit, 2010; percent of non-oil GDP)



Sources: National authorities; and IMF staff estimates and projections.

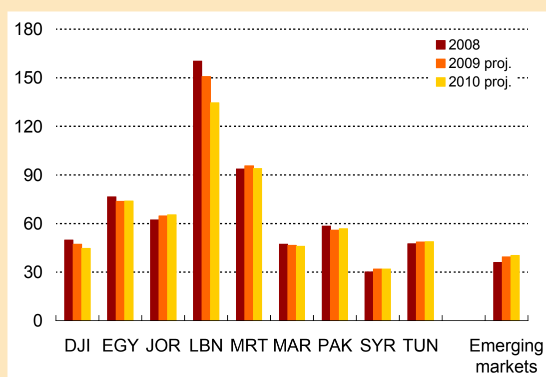
Note: Excludes countries where fiscal years differ from calendar years.

In contrast to the fiscal response, monetary stimulus is more uniform. With GDP growth below potential, inflation has receded sharply, helping create space for monetary easing (Figure 2.13). Accordingly, in many countries, including Jordan, Morocco, and Tunisia, the authorities have lowered reserve requirements substantially. Reductions in policy rates have generally been more cautious and to a large extent dictated by exchange rate

Figure 2.12

High Debt Burden

(Government debt; percent of GDP)



Sources: National authorities; and IMF staff estimates and projections.

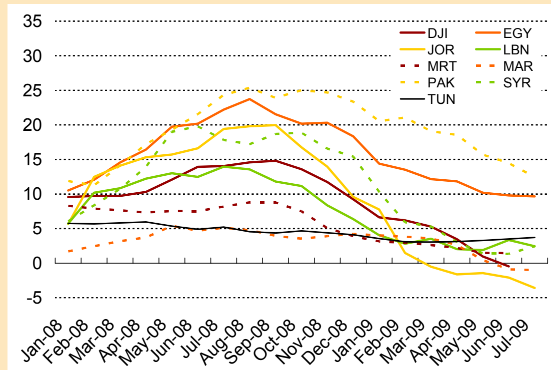
considerations, with most MENAP oil importers targeting a steady nominal exchange rate, vis-à-vis the U.S. dollar, the euro, or a basket of currencies. Looking forward, further rate cuts will need to be contemplated carefully, given exchange rate arrangements, reserve positions, and still-high rates of inflation in many countries—near or in the double digits in Egypt and Pakistan—and rising commodity prices in world markets.

Movements among the major reserve currencies—in particular the sharp appreciation of the U.S. dollar relative to the euro in late 2008—have led to considerable variation in effective (trade-weighted) exchange rates, and several of the MENAP oil importers have experienced sizable nominal effective appreciation (Figure 2.14). Moreover, despite recent moderation of price pressures, the majority of countries are still suffering a higher rate of inflation than are their trading partners. That has resulted in further appreciation of the real effective exchange rate and has hurt competitiveness, although in some cases it may have represented a move back toward fundamentals.

Figure 2.13

Attenuating Price Pressures

(Consumer price inflation; average; percent: year-on-year)



Source: IMF, Information Notice System.

Domestic Consumption Will Be Main Driver of Recovery

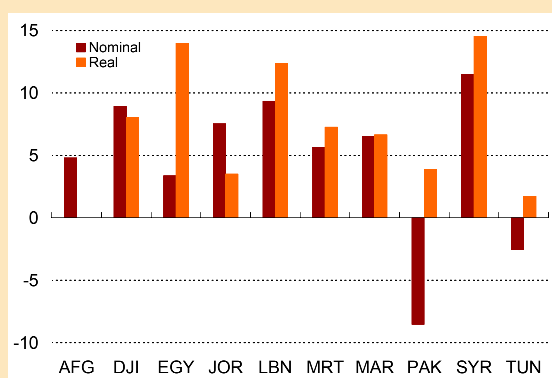
Domestic—rather than foreign—demand is projected to pull the oil importers' economies slowly forward (Figure 2.15). Tight government expenditures in most countries will be limiting the pace of growth. On the external side, the appreciation in real exchange rates in most countries, along with slow growth in partner economies, will work against an export-led recovery. Remittances are not likely to recover quickly either, with many workers having returned home after losing their jobs abroad and unemployment projected to rise in OECD countries in 2010. A sluggish global recovery will also hold back a rebound in tourism and foreign direct investment. Moreover, the impact of recent adverse developments in advanced economies may be felt with a lag (Box 2.1). Rising energy costs could also dampen the recovery, although some MENAP oil importers will be partly shielded by domestic hydrocarbon production and close economic ties to the oil-exporting GCC countries (Egypt and Syria).

Despite robust consumption growth, imports are set to fall by more than exports in 2009 and may recover more slowly. Much of the drop in imports is associated with reduced investment—a key factor behind muted growth prospects. Driven by lower foreign direct investment, gross capital formation is projected to decline by 1½ percent of GDP in 2009 and fall further in 2010 (Figure 2.16). As a result, the

Figure 2.14

Currencies Mostly Appreciating

(Effective exchange rates; percent change: July 2008 to July 2009; upward movement indicates appreciation)

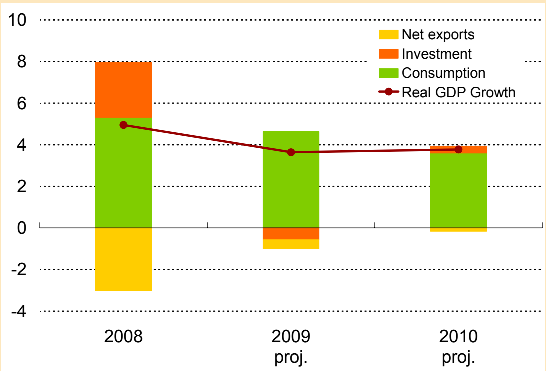


Source: IMF, Information Notice System.

Figure 2.15

Consumption Will Drive Growth

(MENAP oil importers: real GDP contribution; percent)[1]



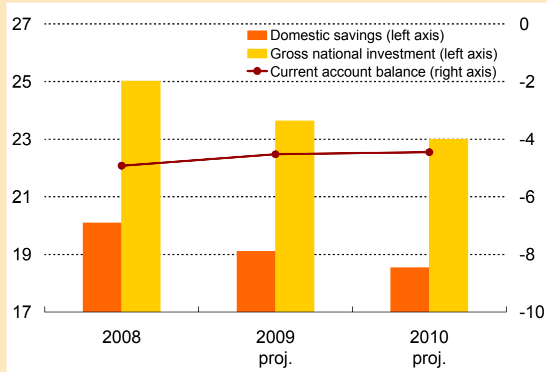
Sources: National authorities; and IMF staff estimates and projections.

[1] Excludes Afghanistan and Jordan.

Figure 2.16

Lower Investment Is Behind Narrowing of External Current Account Deficits

(MENAP oil importers: savings and investment balances; percent of GDP)



Sources: National authorities; and IMF staff estimates and projections.

average current account deficit in this group of countries is projected to narrow to 4½ percent of GDP in 2009–10, half a percentage point of GDP lower than in 2008.

Downside Risks Linger

The region is projected to return to higher growth by 2011. If the global recovery fails to take hold, however, continued strong headwinds could prove problematic. Few, if any, countries in the group are in a position to provide stimulus for an extended period. Continued anemic growth could therefore have more serious consequences, including for poverty and social stability. Sharply higher oil prices would also be a concern for the countries with no hydrocarbon resources of their own.

An extended slowdown would test the strength of local financial systems, especially if coupled with another bout of global stress and increased risk aversion. The percentage of nonperforming bank loans has dropped over the past several years but still remains high in many countries (Table 2.2). A delayed recovery would hurt businesses and put further pressure on loan quality, potentially eroding confidence in the banking sector.

Over the medium to longer term, public debt sustainability is a concern for many of the MENAP oil importers. Thus far, ample financing has been available, mainly from domestic sources. However, continued large government deficits would be difficult to fund, in particular if global interest rates increase sharply. Large government financing needs would also tend to crowd out the local private sector, reducing growth prospects and, ultimately, the tax base.

Future Policy: A Delicate Balance

As the crisis recedes, policymakers need to start shifting attention from maintaining demand to improving the productive capacity of their economies. As the recovery is not yet entrenched, however, it is still too early to stop providing stimulus. At the same time, maintaining high fiscal deficits is becoming increasingly burdensome and global interest rates are likely to increase, constraining the scope for expansionary policies.

Monetary policy should be cautiously accommodative. Receding inflation and weak economic activity are providing greater space for interest rate cuts. Any step toward monetary easing would need to be carefully examined, however, particularly in those countries where the rate of inflation has been slow to come down. For countries that are not on a fixed exchange rate peg, additional exchange rate flexibility could also help offset the slowdown.

Fiscal policy will need to strike a balance between supporting domestic activity and reducing vulnerabilities. Countercyclical measures have been appropriate for those countries that were hard hit by the global crisis. At the same time, it is important to maintain focus on debt sustainability and other long-standing impediments to sustained economic growth. The net outcome for the MENAP oil importers has generally been a pause in the recent trend of debt reduction, rather than outright fiscal expansion. In light of the incipient recovery, countries should prepare to resume fiscal consolidation as soon as conditions permit.

Reforms to place public finances on a sounder footing would also help cement the road to higher growth. Improved tax collection and administration, especially in countries where revenue is low or declining relative to GDP, would generate more room for needed spending, build confidence, and make the economies less crisis-prone. To this end, revenue mobilization measures are needed in almost all countries. This includes the introduction of a value-added tax in Egypt, Pakistan, and Syria. To improve the efficiency of spending and reduce fiscal risks, widespread subsidies could be scaled back and funds redirected into infrastructure or more targeted social protection—Egypt, Pakistan, Jordan, and Syria are taking important steps in this direction.

Financial sector supervision requires continued attention, as amply underscored by the global crisis. High levels of nonperforming loans call for corrective action and corresponding provisioning. To better assess and prepare for potential vulnerabilities, banks should adopt more systematic and comprehensive stress testing and develop appropriate contingency plans.

Table 2.2

Banking Indicators Show Signs of Improvement and Some Challenges

(Financial soundness indicators; percent)

	Capital Adequacy Ratio		Ratio of Nonperforming to Total Loans	
	2007	Latest	2007	Latest
Afghanistan	14.6	…	0.9	1.5
Djibouti	8.1	8.5	17.8	16.5
Egypt	14.8	14.7	19.3	14.8
Jordan	20.8	17.6	4.1	4.2
Lebanon	12.5	11.4	10.1	7.2
Mauritania	28.2	31.5	…	27.2
Morocco	10.6	11.2	7.9	6.0
Pakistan	13.2	12.2	7.2	11.5
Syria	12.9	…	5.3	…
Tunisia	11.6	11.7	17.6	15.5

Sources: National authorities; and IMF staff calculations.

Medium Term: A Larger Role for the Private Sector

While the crisis has highlighted more immediate needs, countries should be careful not to lose the momentum on structural reforms, especially those that deal with the problem of protracted unemployment. To support this goal, the creation of an environment more conducive to private business should remain an overarching priority. This may involve broadening privatization programs and liberalizing the energy sector. While limited openness and lack of competition may have shielded regional oil importers from the risks associated with the global economic downturn, these countries' lack of international integration also implies forgone opportunities to boost economic growth and employment over the longer term.

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