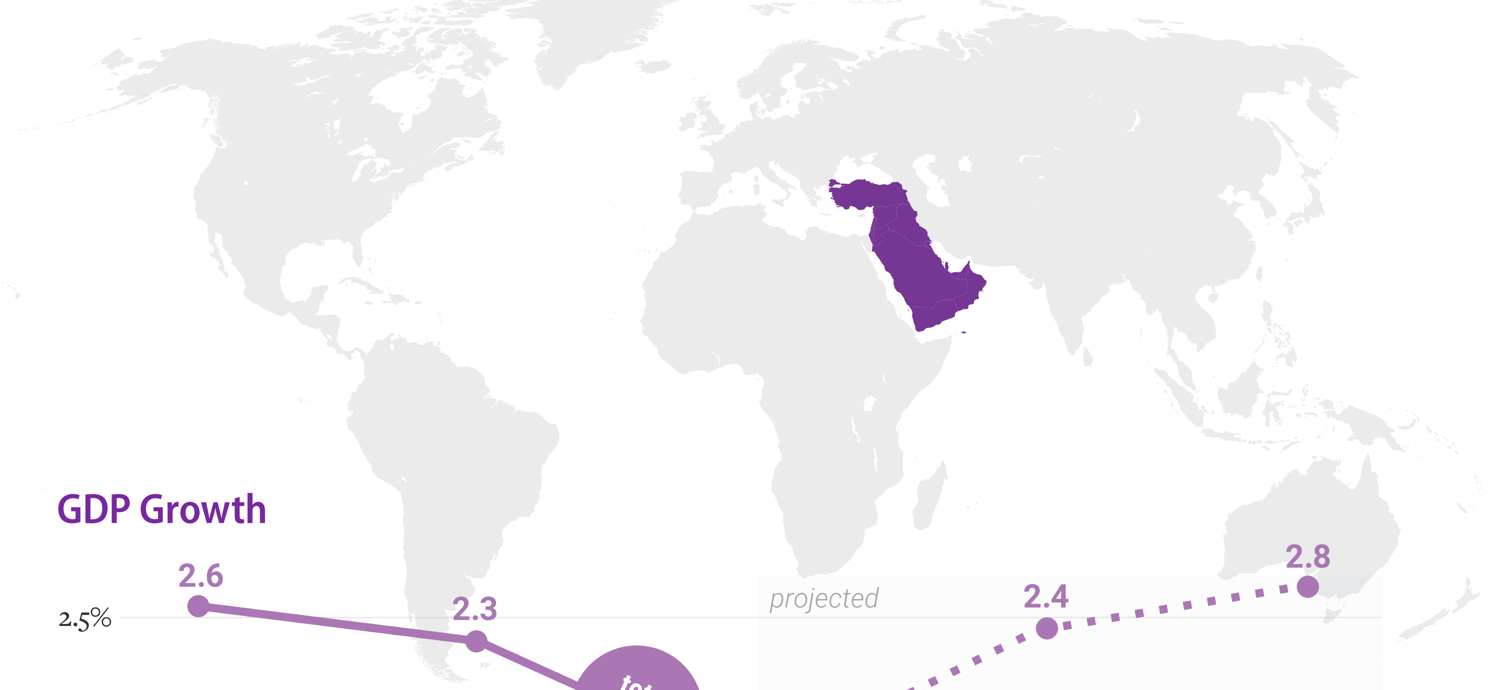
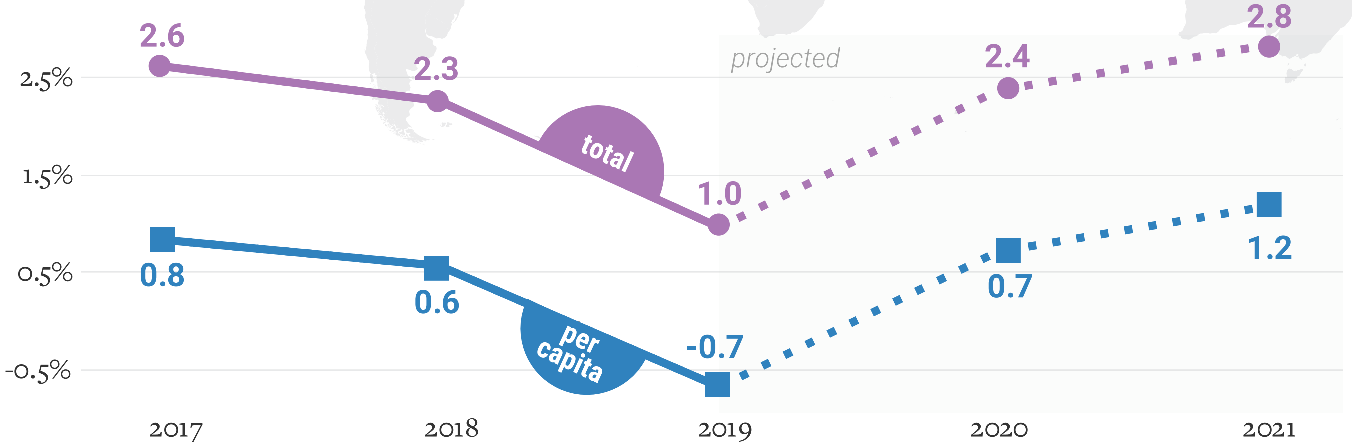
World Economic Situation and Prospects

United Nations
New York, 2020

Western Asia

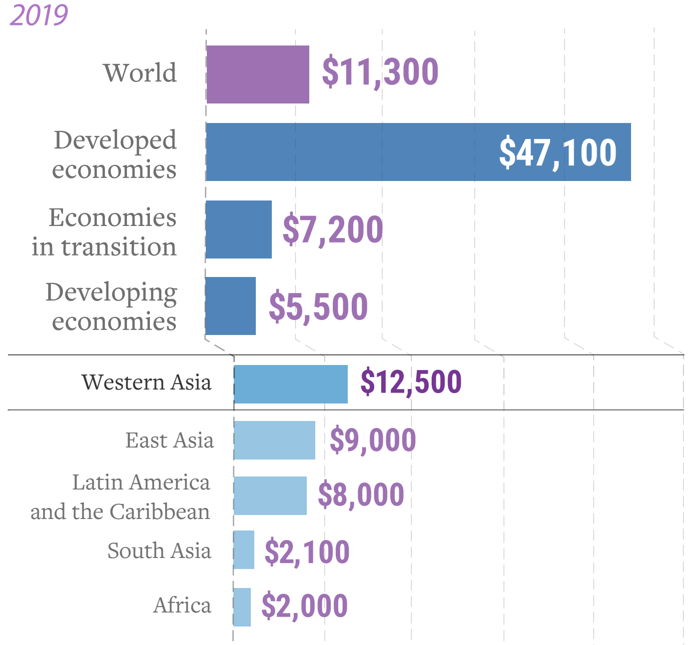


GDP Growth



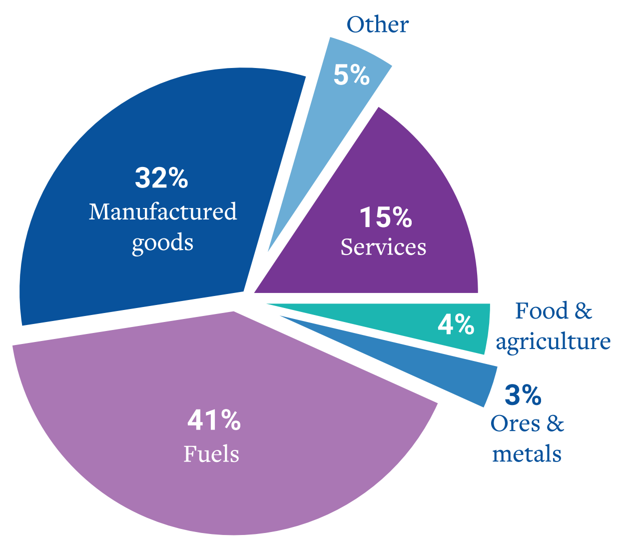
GDP per capita

2019



Export Structure

2018



Western Asia: growth fails to bounce back in the face of sluggish demand

- Demand for both energy and non-energy exports is weakening.
- A regional real estate slump is weighing on domestic demand.
- Economic prospects remain inextricably linked to geopolitical uncertainties.

In 2019, Western Asia experienced a sharp decline in the rate of economic expansion owing to both sluggish domestic demand and weakening external demand, with average GDP growth estimated to have dropped to 1.0 per cent from 2.3 per cent in 2018. The slump in the real estate sector dampened both consumption and investment through a negative wealth effect. Energy-importing countries faced tightening fiscal and balance-of-payments constraints. For the member countries of the Cooperation Council for the Arab States of the Gulf (GCC),[6] the contribution of the energy sector to GDP growth is estimated to have been negligible. While oil prices have fallen from their latest peak in October 2018 (see chapter I), the level of crude oil production has barely changed since that time due to OPEC-led supply ceiling coordination. Non-energy exports have also faced weakening demand from Europe, South Asia and East Asia. Moreover, ongoing conflict and an unstable security situation in the Syrian Arab Republic and Yemen have suppressed the recovery in intraregional trade.

Economic prospects for Western Asia are clouded by oil price, real estate and geopolitical risks

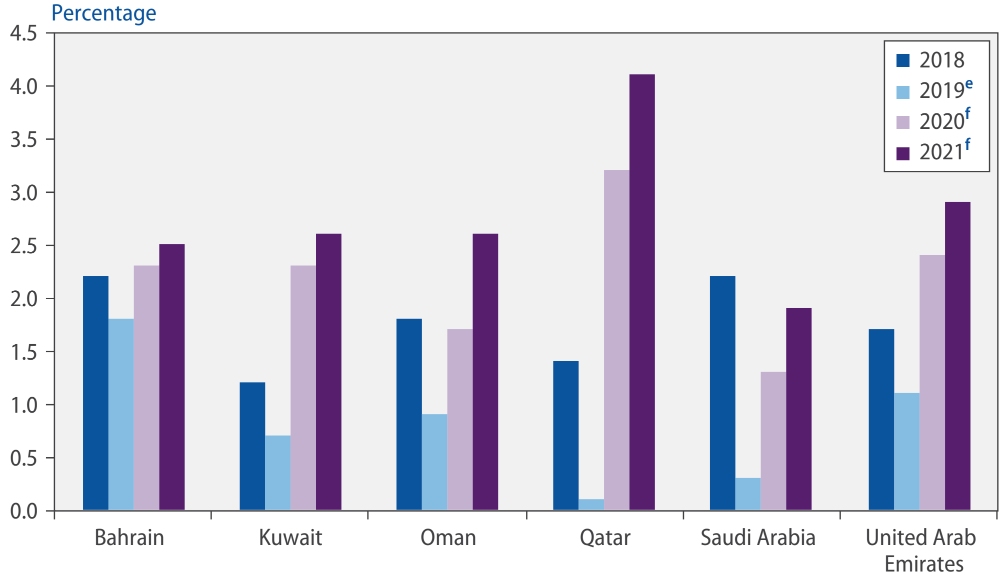
For the region as a whole, average GDP growth is forecast at 2.4 per cent in 2020 and 2.8 per cent in 2021. While weak external demand will continue to weigh on the region, recovering credit growth, a stabilization of the real estate sector, and ongoing economic reform are expected to support domestic demand growth. The main downside risks are a substantial decline in oil prices, further deterioration in the real estate sector, and the intensification of geopolitical risk events.

The contribution of the energy sector to growth in GCC economies was negligible in 2019

As a group, the GCC economies experienced a substantial slowdown in growth in 2019 (see figure III.15). As the OPEC-led agreement on the crude oil production ceiling was extended in July, production levels changed very little from the previous year in the GCC region—even in the non-OPEC member countries (Bahrain, Oman and Qatar). The region's exports of natural gas also stagnated; the global oversupply depressed natural gas prices, and the region's gas exporters (Oman, Qatar and the United Arab Emirates) lost market shares to emerging gas exporters. The contribution of the energy sector to economic growth in GCC countries was negligible in 2019, and domestic demand growth also slowed, mainly owing to declining real estate values. The slump in the real estate sector weighed on private investment and the consumption of durable goods. Consequently, the growth rate for broad money in the GCC economies stayed well below the peak reached in 2014. Capital inflows from South Asia, which sustained the growth of the non-energy sector in the recent past, also weakened. Nevertheless, the GCC economies are expected to experience a modest recovery during 2020 and 2021 as the real estate sector stabilizes. In Saudi Arabia and the United Arab Emirates, in particular, broad money growth is projected to recover in line with a moderately accelerating expansion of domestic demand. Ongoing reform efforts by the Governments to facilitate economic diversification should also contribute to the recovery.

6 The six GCC members include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

Figure III.15
GDP growth prospects for GCC countries



Source: UN DESA.
Note: e = estimate; f = forecast.

Iraq is benefiting from growing oil revenues, with economic growth estimated at 3.2 per cent for 2019 and forecast at 4.8 per cent for 2020. The 2019 budget was expansionary, with a 27 per cent increase in spending over the 2018 budget. However, insufficient public service provision and a lack of social cohesion have resulted in growing social unrest, including frequent street demonstrations.

Jordan has managed to sustain domestic demand growth against its balance-of-payments constraints by increasing exports and foreign capital inflows. However, the speed of expansion is insufficient to provide an appreciable boost to per capita income levels, which have declined significantly due to the influx of refugees from the Syrian Arab Republic; real per capita GDP in 2019 was 10 per cent below the level prevailing in 2010. Following GDP growth of 1.9 per cent in 2019, a modest acceleration to 2.2 per cent is expected in 2020 as ongoing reforms are implemented in line with the provisions of the recently launched London Initiative (United Kingdom Cabinet Office, 2019).

Balance-of-payments constraints have tightened in Lebanon

Unlike Jordan, Lebanon experienced a tightening of balance-of-payments constraints as foreign capital inflows continued to dwindle. The central bank ran down its foreign reserves by $4 billion over the first seven months of 2019 to alleviate these constraints. However, the pressure on the Lebanese pound mounted due to a severe shortage in United States dollar liquidity. Deteriorating economic sentiment resulted in widespread social unrest towards the end of 2019. The economic prospects for 2020 are highly uncertain, as much will depend on the stabilization of the sociopolitical situation.

Despite the continuing armed conflict in parts of the Syrian Arab Republic, the economy expanded by an estimated 10.1 per cent in 2019 as a result of increased reconstruction activity. Growth is forecast to decline to 3.7 per cent in 2020 as the momentum of reconstruction slows. The country continues to face balance-of-payments constraints, as it has become more import-dependent under economic sanctions. The Syrian pound saw a significant depreciation in 2019 in the parallel market.

Macroeconomic and humanitarian conditions remain dire in Yemen

In early 2019, the United Nations Office for the Coordination of Humanitarian Affairs (2019) stated that the humanitarian crisis in Yemen was the worst in the world.

Throughout the year, the macroeconomic and humanitarian situations remained dire as the armed conflict continued. Severe damage to the country's food supply capacity has caused widespread food insecurity. In aggregate terms, the country's economy is projected to expand at a moderate pace, with growth increasing from 1.2 per cent in 2019 to 3.6 per cent in 2020 as Yemen reaps the benefits of the recent resumption of crude oil exports. However, while this may create some fiscal space, it does not imply an improvement of economic welfare.

The economy of the State of Palestine continues to be negatively affected by political tensions and instability. Economic growth accelerated moderately to 1.4 per cent in 2019 as a two-year contraction of the economy in the Gaza Strip came to an end. The economy in the West Bank continues to grow, but the pace remains slow. Overall, the Palestinian economy is forecast to expand by 2.6 per cent in 2020.

In Israel, economic expansion slowed as the result of a precautionary measure undertaken by the central bank to manage the economy, which was showing signs of overheating. Nevertheless, the value of financial and real estate assets grew over the year, providing support for domestic demand. Exports also showed robust growth. The Israeli economy is estimated to have grown by 3.1 per cent in 2019 and is forecast to grow at a similar pace in 2020.

Turkey recovers from recession

Turkey spent the year recovering from a recession, achieving growth estimated at 0.4 per cent in 2019 after registering two consecutive quarterly declines in GDP in the second half of 2018 as the economy adjusted to a steep depreciation of the Turkish lira. While the pace of recovery in industrial production remains slow, declining imports have eased pressures on the Turkish lira. For 2020, a moderate recovery in domestic demand growth is expected, but the recovery in manufacturing exports is projected to be slow as demand from the European Union remains weak. Balance-of-payments constraints will effectively limit real GDP growth to 2.4 per cent in 2020.

Weak domestic demand has subdued inflationary pressure in the region

In terms of consumer price dynamics, inflationary pressures in the region remain generally subdued. Saudi Arabia and the United Arab Emirates even experienced deflation in 2019, reflecting weak domestic demand. A significant drop in the price of housing-related items pulled down general price levels in GCC economies. Weak domestic demand also contributed to low inflation in Iraq and Jordan in 2019, whereas tightening balance-of-payments constraints created inflationary pressures in Lebanon, the Syrian Arab Republic and Yemen to varying extents. The consumer price inflation rate in Turkey remains high relative to most of the region, but inflation has receded from the recent peak in September 2018 driven by the depreciation of the Turkish lira. For 2020, consumer price inflation rates are forecast to remain generally low in the region, but the expected recovery in domestic demand will create mild inflationary pressure. Tighter balance-of-payments constraints are expected to contribute to higher inflationary pressures in Lebanon, the Syrian Arab Republic, Turkey and Yemen.

Fiscal stances appear cautious

In 2019, following the shift in the monetary policy of the United States, central banks in Bahrain, Jordan, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates loosened their monetary stances. The Bank of Israel is expected to shift to an accommodative stance in 2020. After a series of policy rate cuts in 2019, the Central Bank of the Republic of Turkey is expected to maintain its policy interest rate in 2020. On the fiscal side, caution prevailed in 2019, and this trend is forecast to continue in 2020. Governments in the GCC countries refrained from activating significant stimulus measures despite a recovery in oil revenues. This cautious stance is accompanied by efforts towards revenue diversification, exemplified by the recent introduction of the VAT in Saudi Arabia and the United Arab

Box III.4

Policy simulations of alternative energy subsidy reforms: strategies towards macroeconomic sustainability in the Arab region

Many Arab countries, including both oil exporters and oil importers, rely on high energy subsidies to maintain low domestic energy prices; these subsidies amount to $117 billion in the Arab region, accounting for more than one fourth of the global total of $436 billion. The costliness of energy subsidies raises concerns about the sustainability of macroeconomic development trajectories in many Arab countries. In particular, the severe fluctuations in global oil prices over the past several years have revealed structural fiscal deficit challenges in many countries. Macroeconomic management is further complicated by the persistent geopolitical tensions in the region.

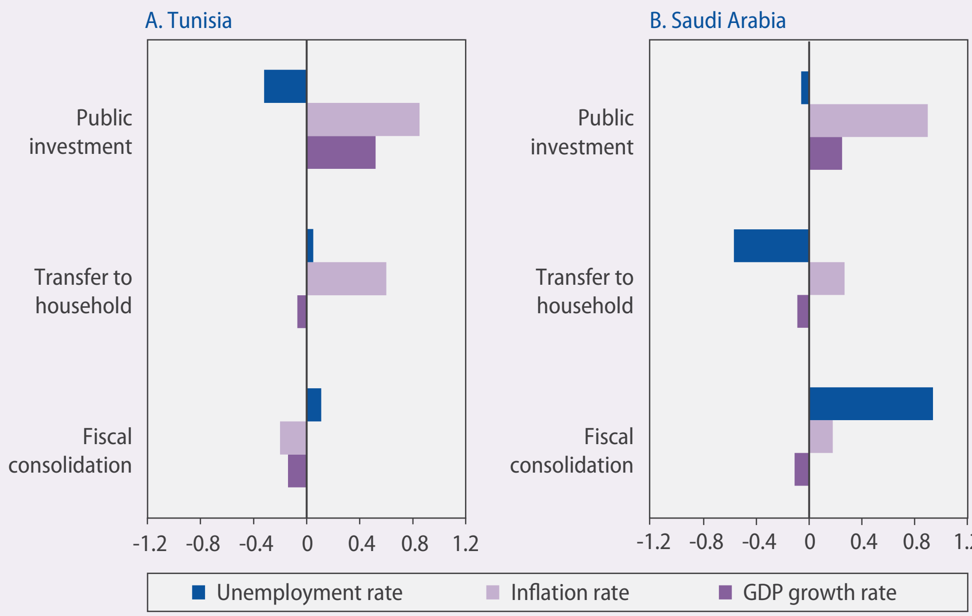
In response to these concerns, many Arab countries have identified the reform of their existing energy subsidy systems as an urgent policy priority in order to balance the trade-off between stable energy prices in an environment of fluctuating oil prices and maintaining fiscal sustainability. A computable general equilibrium (CGE) model offers an empirical approach motivated by a renewed emphasis by Arab policymakers on the macroeconomic implications of energy subsidy reforms. The CGE model is designed to evaluate the effects of three hypothetical reform scenarios based on case studies of two countries—Tunisia (an oil importer) and Saudi Arabia (an oil exporter). Within this framework, the "savings" from the withdrawal of energy subsidies are (a) used to fund additional public investment programmes; (b) transferred to households as a lump sum; or (c) directed towards the reduction of the fiscal deficit. The results of the simulations, based on a 10 per cent increase in energy prices, are compared with the initially set business as usual (BAU) scenario for the period 2018-2023 (see box figure III.4.1).

For Tunisia, the simulations reveal that among the three policy options, increasing public investment has the most positive impact on growth and unemployment, increasing economic growth by 0.52 percentage points and reducing unemployment by 0.32 percentage points. The fiscal consolidation option produces the least favourable outcome, reducing growth by 0.14 percentage points and increas-

Figure III.4.1

Results of the CGE modelling assessment

Percentage point change against BAU scenario



Source: Author's own elaboration on the basis of UNESCWA (2019).

(*continued*)

Box III.4 (*continued*)

ing the unemployment rate by 0.11 percentage points, while the policy option of the transfer to households has a relatively moderate impact, leading to a decrease in growth by 0.07 percentage points and a 0.05 percentage point increase in the unemployment rate. The impact on domestic price dynamics appears to be highest when the option of public investment is selected.

Similar modelling results are observed for Saudi Arabia, with a few exceptions—the most noteworthy being that the allocation of the fiscal space arising from an energy subsidy reform involving lump-sum transfers to households is the best alternative for reducing unemployment. It is worth noting that as part of its Vision 2030 initiative, Saudi Arabia is implementing a cash transfer scheme called the Citizen Account Program to support increased household employment, especially for economically vulnerable segments of the population. This policy is also designed to contribute to improving access to education and social services for such groups.

Although higher energy prices from subsidy reforms negatively impact economic growth as higher inflation squeezes real income, the reforms are expected to eventually improve the fiscal balance in both countries. In the short term, the gradual removal of the energy subsidy would lead to lower financing needs. A long-term implementation strategy needs to address the heterogeneous effects of the reforms on the economy. If the improvement in the fiscal balance is channelled towards increasing public spending in growth-enhancing sectors, the potential exists to generate inclusive growth for the economy, though at the expense of higher inflation.

To direct increased fiscal spending towards achieving not only growth but growth that is inclusive, policymakers have to focus on several additional issues, including, first and foremost, ensuring that public spending promotes the diversification of the economy away from excessive reliance on activities relating to resource extraction. For example, supporting small and medium-sized enterprises through the provision of tax advantages or government grants creates a broader base of economic activity that benefits broader sections of the population (in terms of income level, gender, geographic location and other criteria). Economic and investment policies have to be accompanied by dedicated socioeconomic policies specifically aimed at increasing income levels among the poor and promoting gender equality in employment; examples in this regard include improving access to education and implementing wage assistance programmes.

A final key consideration is the environmental impact of subsidy reforms. Phasing out subsidies and charging the real price of energy would contribute to reducing emissions and the wasteful consumption of energy resources and would release financial resources that could be invested in green technologies. Concrete steps must be taken to explore the development experiences of Arab countries and policy options that can contribute to balancing the economic, social and environmental dimensions of sustainable development.

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Emirates. As oil prices are forecast to remain weak, fiscal stances are expected to remain relatively tight in GCC countries, and the same is true for other economies in the region, especially Jordan, Lebanon, the Syrian Arab Republic and Yemen.

Unemployment remains high

The unemployment rate remains high in the region. The leading cause of social unrest, as witnessed in Iraq and Lebanon in 2019, is the lack of decent employment opportunities. Unemployment in Jordan reached 19.2 per cent in the second quarter of 2019—the highest rate since 1993. The employment situation deteriorated rapidly in Turkey as the seasonally adjusted unemployment rate surged to 13.9 per cent in July 2019, up from 10.8 per cent a year earlier. In Saudi Arabia, the unemployment rate edged down to 12.3 per cent in the second quarter of 2019 from 12.7 per cent at the end of 2018. The gender gap in employment opportunities persists, with female unemployment remaining significantly higher than male unemployment. In the second quarter of 2019, the female unemployment rate stood at 27.2 per cent in Jordan and 31.1 per cent in Saudi Arabia.