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Arab Countries in Transition:
An Update on Economic Outlook and Key Challenges

Prepared by the Staff of the International Monetary Fund

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I. REGIONAL ECONOMIC OUTLOOK AND KEY CHALLENGES

Despite uneven progress, there are early signs of improvement and macroeconomic stabilization in some Arab Countries in Transition (ACTs).[1] *However, persistently weak growth and subdued private investment amid heightened regional insecurity continue to weigh on the task of reducing unemployment. This calls for accelerated reform efforts by the authorities to achieve higher, more inclusive, and more private sector-led growth, supported by external partners. In addition, mobilizing affordable external financing could help boost well-implemented public investment and provide a short-term impetus to growth and employment, thereby stabilizing difficult socio-political conditions on the ground and providing space for deeper structural reforms.*

A. Background and Recent Developments

Macroeconomic stability has improved, but a fragile environment continues to discourage investment. Most ACTs have managed to achieve and maintain relative macroeconomic stability in 2013, financial sectors in most countries have remained stable, and several ACTs have made positive progress with their political transitions. At the same time, these and other positive changes in the external environment—notably, the easing of commodity prices and improved growth in trading partner countries—have been overshadowed by regional spillovers from the conflict in Syria and, in some cases, protracted political instability. Consequently, investor sentiment remains subdued.

Growth remains positive, but too weak to boost job creation. Average growth (excluding Libya) is estimated to have inched up to 2.8 percent in 2013 from 2½ percent in 2012 on account of a post-drought rebound of agriculture in Morocco, partial recovery of oil production in Yemen, and a rebound in construction in Jordan. Meanwhile, growth declined in Egypt and Tunisia, and a sharp drop in oil production precipitated a recession in Libya (-9 percent real GDP growth). Such a growth performance is far below what is needed to stem the rise in the number of unemployed, which climbed to 5.8 million[2] by the end of 2013—an increase of 1.5 million since end-2010.

Efforts to rebuild policy buffers have been mixed in 2013. Morocco and Jordan have achieved important milestones towards stronger macroeconomic frameworks by reducing budget deficits on the back of subsidy cuts and other fiscal reforms, including the establishment of more targeted safety nets. In addition, lower commodity prices and external assistance helped them to strengthen (Jordan) or stabilize (Morocco) the foreign reserves cover. By contrast, in Egypt, low receipts from tourism and other exports have kept the reserve cushion thin despite

[1] The ACTs are Egypt, Jordan, Libya, Morocco, Tunisia, and Yemen.

[2] For Egypt, Jordan, Tunisia, and Morocco.

substantial external aid; and the reduction in the budget deficit in 2013/14 was achieved only by sizeable grant assistance. In Libya and Yemen, political instability contributed to the decline in foreign reserves and widening budget deficits. Overall, average budget deficits in the ACTs remained elevated at 9 percent of GDP in 2013, and public debt continued to rise in most countries, reaching very high levels in Egypt and Jordan (approaching 90 percent of GDP).

B. Short-Term Outlook

Modest recovery will continue. In the absence of strong progress with the political transitions, a fast rebound of private investment appears improbable, and most ACTs will likely face another difficult year growing at only about 3 percent in 2014. Inflation is expected to remain relatively stable, while the current account and fiscal deficits will narrow at a slow pace. Public debt and unemployment rates are likely to climb in most countries, adding to the already high social tensions. Growth could strengthen to 4½ percent in 2015, provided political stability improves, external conditions continue to strengthen, and economic reforms accelerate. However, it will require more time and a strong track record of structural reforms to reach the growth rates of 6 or more percent needed to make a meaningful reduction in unemployment.[3]

Downside risks remain high. The Syrian crisis and continued violence and instability in other parts of the region could lead to a further increase in the number of refugees, and damage trade, confidence, and growth. Setbacks to the political transitions would further delay economic reforms and deter investment. Disruptions to energy supplies in Jordan, Libya, Yemen, and Egypt would take a toll on fiscal and external positions. The increased geopolitical risks in Eastern Europe could fuel commodity prices and impede trade. Unexpectedly rapid normalization of U.S. monetary policy and renewed bouts of risk aversion could renew financial pressures and cause abrupt adjustments in some emerging market economies. Finally, weaker growth in Europe could slow the recovery of exports and foreign inflows.

C. Short-Term Policy Issues

Rebuilding policy buffers and maintaining macroeconomic stability. Reducing budget deficits will remain essential to maintaining debt sustainability, ensuring adequate provision of public services, and avoiding further crowding out of the private sector. It will be important to build on the early progress achieved in some countries and continue with reallocating public expenditure toward capital investment, containing growth of the wage bill in line with productivity, and improving public finance management. Tax policy and administration reforms should aim to both shore up revenue and create a level playing field for the business community. At the same time, the authorities should strive to maintain financial sector stability and improve access to finance, rebuild external reserve buffers and facilitate external adjustment, while containing inflation by avoiding monetization of budget deficits.

[3] See new IMF paper, *Toward New Horizons: Arab Economic Transformation Amid Political Transitions*, forthcoming.

Escaping the unemployment trap. Notwithstanding some progress with political transitions, spillovers from regional crises as well as, in some countries, high social and political instability are weakening investor sentiment and feeding unemployment. Breaking this cycle will be crucial to preserving social cohesion and creating the political space for economic reforms. But with the private sector still largely on the sidelines, restoring confidence and reviving job creation will likely take longer than expected, leaving countries with increasing unemployment.

Increased job-creating public investment. One way to help achieve much-needed employment gains in the short term would entail boosting externally financed public investment in infrastructure and basic services. If successful, this approach would also facilitate deeper structural reforms and strengthen support for the political transitions. But it would also imply significant additional financial support and would need to be designed in a way that minimizes risks. Key elements of such a package[4] include: affordable and predictable external financing to preserve debt sustainability; continued fiscal consolidation to secure sound fiscal positions, accompanied by establishing safety nets for the poor; strong measures to remove the identified regulatory barriers to doing business; and improving adequate project selection and execution to overcome absorptive capacity constraints and target job creation in the private sector. Having these elements in place will require substantial donor support, credible commitments to reforms by the authorities, and significant capacity building assistance by external partners. Furthermore, efforts to maintain debt and fiscal sustainability would need to continue in the medium term.

D. Medium-Term Challenges

Structural reforms to ignite private sector-led growth. Realizing the ACTs' vast potential for strong and sustainable private sector-led growth requires creating better conditions for the region's large labor force and economic opportunities for investors with enhanced business climates, deeper integration into global markets, better education and adequate training, improved access to finance, and appropriate social protection. Some of these reforms can have a very long lead time, and therefore should proceed without delay.[5]

[4] Detailed analysis of such an agenda was laid out in a separate report discussed at a meeting of senior officials and circulated to the Deauville Partners in December 2013. It suggests that additional investment of about $25 billion spread over a five-year horizon could create between 0.4 and 0.8 million jobs across the ACTs.

[5] A new IMF paper, *Toward New Horizons: Arab Economic Transformation Amid Political Transitions* discusses the multiple elements of the ACTs' medium-term reform agenda.

Good starting points. Emphasis on visible results could strengthen confidence in the authorities' dedication to the reform process. The examples in our earlier report[6] remain pertinent and feasible:

- Greater transparency of the budget process, public hiring and procurement, as well as project selection for public investment would help to demonstrate the authorities' commitment to accountability, while improving economic opportunities and raising efficiency of public spending.

- Safety nets for the most vulnerable groups could be strengthened by improving targeting of social assistance. To this end, costly generalized subsidies could be phased out to enable scaling up of means-tested social assistance. And mechanisms should be put in place to quickly and in a transparent manner identify and reach out to the members of society that are most in need.

- Initiation of a dialogue with the business community to identify and streamline the most cumbersome business regulations, including those affecting labor markets, would encourage investors.

- Fostering partnership with investors to reform vocational training and develop training programs, particularly for women and youth, could help tackle persistent unemployment while improving productivity. Improving education curricula so that graduates leave the formal schooling system with labor market-relevant skills would help the youth meet the challenges of future labor markets.

- Bankruptcy, provisioning, and collateral regulations for financial sectors could be strengthened, credit bureaus developed, and market infrastructure improved to reduce risk premia and to facilitate better access to credit. At the same time, countries need to decide on a strategy for public banks, and to provide a more enabling environment for private financial institutions, including those in the non-bank sector, such as micro finance.

- Alongside, the authorities should work to strengthen anti-monopoly regulations and institutions to facilitate market development and seek deepening integration into global markets to open up new business opportunities.

[6] See *Arab Countries in Transition: Economic Outlook and Key Challenges*, IMF report for the Deauville Partnership Ministerial Meeting, October 10, 2013. http://www.imf.org/external/np/pp/eng/2013/101013.pdf

E. Role of the International Community

Countries are in the drivers' seat. A national consensus on an economic vision for development is emerging, albeit slowly, in most countries. The development of such a consensus—and swift implementation of growth-promotion strategies through deep structural reforms and clear, realistic, and tangible policy commitments and objectives—will be critical to both enable the reforms and shore up investor and donor support.

Important role for external support. The ACTs' external partners should continue to support the economic transformations through actions in the following areas:

Arab Countries in Transition: Financing Needs[1]
(Billions of U.S. dollars)

	2011	Est. 2012	Projections 2013	2014	2015
Current account deficit (excl. official transfers)	26.4	34.1	26.7	33.7	34.3
External amortization	14.3	14.3	15.7	22.7	32.8
External gross financing needs[2]	**40.7**	**48.3**	**42.4**	**56.4**	**67.1**
Budget deficit (excl. grants)	38.6	48.3	55.4	57.3	53.5
Public external amortization	4.8	4.6	4.8	7.2	7.7
Fiscal financing needs[3]	**43.3**	**52.9**	**60.2**	**64.4**	**61.2**

Sources: National authorities; and IMF staff calculations.
[1]Comprises: Egypt, Jordan, Morocco, Tunisia, and Yemen. Libya does not face financing needs.
[2]Current account deficit, excluding grants, plus amortizartion.
[3]Budget deficit, excluding official grants, plus public external amortization.

- *Coordination.* Should the authorities, with sufficient external support, decide to substantially increase public investment in infrastructure and basic services to create more jobs in the short run, close coordination on the various elements of such a strategy among the international partners and the ACTs will be critical.

- *A concerted effort to increase external financial support.* External official disbursements since the onset of the Arab Spring (totaling around US$50 billion) have covered only a part of the transition countries' financing needs, notwithstanding significant contributions from the Gulf Cooperation Council (GCC) countries. As financing needs continue to climb, more financial support on affordable terms—and better linked to economic reforms— will be needed to smooth fiscal consolidation, and enable public investment. At the same time, countries will need to take action to reverse the rising trend in public debt over the medium term.

- *Facilitation of trade and FDI.* Deepening trade integration--most importantly with the EU as the region's key trading partner—including through tariff reduction, increased trade quotas, easier access for agricultural exports, and more active implementation of existing trade agreements, could help revitalize the export sectors.

- *Technical assistance.* To complete the reform process, the ACTs will need further technical assistance and capacity building in a number of areas, including public finance management, reform of social safety nets, civil service reforms, financial sector reforms to improve access to finance for small- and- medium-scale enterprises, tax and customs policy and administration, pension, education and other social sector reforms. The Deauville Partnership's Transition Fund (Box 1) is playing an important role in this regard.

F. IMF Engagement

Continued financial program support. Since the start of the Arab Awakening, the Fund has approved a total of about US$10 billion in financial support for the ACTs. The current programs with Jordan, Morocco, and Tunisia are on track. At the same time, we remain in discussions with Yemen on a new Extended Credit Facility, and stand ready to engage in program discussions with Egypt should the authorities request such support.

Active role in helping to mobilize additional financing for the ACTs. In response to calls from finance ministers at the October Deauville Partnership Meeting, staff teams from the IMF and the World Bank—in consultation with other IFIs—prepared a report on the feasibility of increasing externally-financed public investment in support of continuous reforms and job creation in the short term. Putting in place a platform for mobilizing such external financing—for example, country conferences—could help move this agenda forward.

Moving the analytical agenda and outreach in support of the ACTs' reforms. As discussed above, the Fund has just completed a comprehensive paper on "Arab Economic Transformation amid Political Transitions," aimed at informing the medium-term reform agendas of the ACTs; and will co-host, together with the government of Jordan and the Arab Fund for Economic and Social Development, a conference on "Building the Future: Jobs, Growth, and Fairness in the Arab World," in Amman in May. This conference will provide an opportunity for a regional policy dialogue among high-level policymakers, leading private and public sector executives, development partners, civil society representatives, and academics, on the main elements of economic visions for the ACTs, and will include lessons that can be drawn from similar episodes of fundamental economic transformation in other parts of the world.

Capacity development assistance. The Fund has continued to respond to the region's capacity development needs, including through the program pursued by the IMF-Middle East Regional Technical Assistance Center and our joint training institute in Kuwait. In some cases, concerns over security conditions have affected the delivery of the program. Nevertheless, last year, we implemented a total of 60 technical assistance projects, covering areas such as tax policy and administration, financial sector supervision, monetary policy, and public finance management. In addition, we held over three dozen training events and activities for participants from the ACTs, including courses for Parliamentarians and Journalists dealing with economic policy issues. The Fund stands ready to scale up our capacity development program in response to the authorities' requests.

Box 1. The Middle East and North Africa Transition Fund

The Middle East and North Africa (MENA) Transition Fund (TF), with an envisaged endowment of US $250 million, was established in December 2012 by the Deauville Partnership as a joint venture among the G-8 countries, Gulf partner countries, Turkey, and Denmark, and IFIs. Its objective is to support the ACTs in formulating policies and programs and implementing reforms to bring about sustainable, inclusive growth over the medium-term, while strengthening transparency and accountability in governance.

The TF's Steering Committee has so far approved 43 projects for all ACTs. They cover such areas as support to micro, small, and medium enterprises (Egypt, Jordan, Libya, Morocco, Yemen), energy sector reform (Egypt, Tunisia), access to water (Jordan), targeted social assistance (Jordan, Tunisia), labor market policies (Jordan), public-private partnerships (Tunisia), private sector development (Libya, Tunisia), civil society dialogue (Yemen), leadership development and governance (Libya, Morocco, Tunisia, Yemen), regional integration through trade and transport (Egypt, Jordan, Morocco, Tunisia) and affordable housing (Morocco, Tunisia).

Over the past 15 months, the TF has evolved into a key vehicle for support of the ACTs' capacity-building efforts in the areas of structural reform identified in the main text. It is particularly suited for this role: it was designed to be rapid, flexible, and responsive in providing grant support for technical cooperation; and it facilitates coordination and prioritization across donors and the ACTs governments. Perhaps most importantly, the TF can stay involved long enough to help with the implementation of reforms, not only with their design.

TF projects have focused in particular on the following priorities in response to the countries' key development needs and should continue to do so:

Building strong institutions to help establish improved accountability and governance. Specific efforts are expected to focus on reforms in the areas of public financial management (budgeting, budget execution and cash management, and reporting), public procurement (transparency in awards, increased competition, improved public service delivery and better public funds management), and financial sector strengthening (banking supervision and financial sector stability and capital market development). Strengthening the quality of statistics could become another key component of this work program.

Promoting trade integration. Specific efforts could focus on measures that produce immediate effects, to bridge the time until the ACTs reach or upgrade free trade agreements with their major trading partners.

Helping policies become more equitable and inclusive. Specific efforts could concentrate on reducing untargeted subsidies to create room for targeted social safety nets and on putting in place more efficient and fairer tax systems to ease distortions, improve revenue administration, and thus increase growth prospects.

Lowering the cost of doing business. This agenda would require focus, inter alia, on removing impediments to entry and exit and streamlining business regulations.

The impact of the TF on the ACTs' reform efforts depends on the quality of its project pipeline, as well as on its capacity to meet strong project demand with adequate financial resources. Over the past year, $140.5 million has been committed. There is clearly strong demand from the ACTs, which represents ample opportunity for donors to engage. Efforts will continue to be made to generate sufficient funds to respond to demand.

II. Egypt

Financial support from the Gulf countries has provided a breathing space, but Egypt faces a difficult combination of persistently low growth, a high budget deficit and external vulnerabilities. Economic activity continues to be adversely affected by political and social tensions. Fiscal stimulus and the confidence effects from progress in the political roadmap have been offset by the escalation of violence and the resulting drop in tourism and foreign direct investment. Action is needed to address the imbalances and vulnerabilities stemming from high budget deficits, inflation and low reserves, and to create the conditions for strong and inclusive growth and job creation. The Fund remains in close contact with the authorities and provides technical assistance on the introduction of a value-added tax.

Background. The political roadmap is advancing, with the adoption in January 2014 of a new constitution and the recent enactment of the law for the presidential elections. These steps will pave the way for presidential and parliamentary elections over the next few months. The interim cabinet was reshuffled in late February. The political landscape remains polarized, with unrest and occasional terrorist incidents.

Recent developments. Business confidence is recovering, but the economic situation remains troubled. Financial conditions have eased: the stock market index has rallied more than 70 percent since July 2013, and yields on government debt have fallen. However, despite two stimulus packages of a combined 3 percent of GDP, both real GDP and private investment growth have been weak due to a further fall in tourism receipts, a decline in energy production, and frequent power outages. The unemployment rate has inched up again to reach 13.4 percent in 2013Q4, while Inflation has remained in double digits and the poverty rate has increased to 26.3 percent. The budget deficit has receded thanks to official grants, but remains elevated, creating an unsustainable debt dynamic. An agreement has been reached for the clearance of external arrears (about US$ 6.3 billion) of the public oil company (EGPC) to foreign partners, and an initial payment of US$ 1.5 billion was made in December 2013. However, a major international energy company has declared force majeure on LNG shipments from Egypt—citing increased diversion of gas for domestic uses by the government as rendering it unable to fulfill its export contracts. This may adversely affect investment in the energy sector. The government continues to rely heavily on bank financing, thereby increasing banks' exposure to the sovereign and crowding out the private sector. Excluding grants, the external position has weakened significantly as traditional sources of foreign currency (mainly tourism and FDI) have come under pressure. Balance of payments pressures are also reflected in the existence of a parallel exchange market. Substantial financial disbursements and in-kind grants (oil and LNG shipments) from partner countries (Kuwait, Saudi Arabia, and the United Arab Emirates) have prevented a drop in international reserves, which stand at just below three months of imports.

Egypt: Selected Economic Indicators, 2010/11 - 2014/15

(Percent of GDP, unless otherwise indicated)

				Projections	
	2010/11	2011/12	2012/13	2013/14	2014/15
GDP growth, percent	1.8	2.2	2.1	2.3	4.1
CPI inflation, period average, percent	11.1	8.6	6.9	10.7	11.2
Budget sector balance	-9.8	-10.6	-13.7	-11.5	-11.4
Current account balance, excl. grants	-2.9	-4.1	-2.4	-5.1	-4.9
Fiscal financing needs, (excl. grants),US$	25.4	31.2	39.9	43.5	41.8
External financing needs (excl. grants), US	11.9	15.6	11.6	27.2	38.4
Public debt	76.6	78.9	89.2	91.3	92.7
External debt	14.8	13.1	14.5	16.4	18.5
Reserves in months of imports	4.7	2.7	2.4	2.4	2.4

Sources: National authorities; and IMF staff calculations.

[1]Budget sector deficit, excluding official grants, plus public external amortization.

[2]Current account deficit, excluding grants, plus amortizartion.

Short-term outlook. The government has recently announced a second stimulus package of 1.5 percent of GDP, consisting mainly of additional social and investment spending after an earlier stimulus in the second half of 2013 of approximately the same amount. However, low execution levels and disruptions in the energy and tourism sectors will likely hold back economic activity; we expect growth in FY2013/14 to be broadly the same as in FY2012/13. Additional financial support will be needed to help Egypt meet its financing needs during FY 2014/15 and over the medium term. The budget deficit will remain high, unless the authorities move ahead quickly with plans to reform subsidies and implement other fiscal measures. Inflation will remain at 10--12 percent, reflecting wage increases, supply bottlenecks, and continued money expansion.

Risks. Delayed implementation of the political roadmap and persistence of violence continue to be the main risks. Recent events in Ukraine—a major wheat provider to Egypt—and the effects of international political tensions on oil and gas prices could lead to higher commodity prices, placing additional pressures on the fiscal and external positions. On the other hand, resolution of political uncertainty and significant economic adjustment efforts could restore confidence and accelerate the return of private investors.

Short-term policy issues. Under current policies, Egypt will continue to face significant financing needs. Macroeconomic adjustment and structural reforms are needed to put public debt on a sustainable path and create the conditions for high and inclusive growth. The immediate priorities are to strengthen the underlying fiscal position (excluding grants), build up international reserves, and contain inflation. Reorienting budgetary resources towards infrastructure, education, and health, as well as enhancing implementation capacity in the public sector, will be important to improve growth prospects. Subsidy reform is essential to achieve a credible medium-term fiscal framework and restore confidence in fiscal solvency. Improving the transparency of public-private partnerships and better public investment planning would help foster more private investment while minimizing associated fiscal risks. Removing the restrictions to price discovery and eliminating backlogs in the foreign exchange market would help preserve competitiveness of the economy and address external imbalances.

Medium-term challenges. The medium-term priorities should be achieving higher and more inclusive growth while rebuilding fiscal and external buffers. Streamlining regulations and improving access to financing could help unleash private investment. At the same time, addressing impediments in the electricity and transport sectors would help boost economic activity and provide more equal access to jobs and business opportunities for all segments of society. Bringing the budget balance back on a sustainable path is also essential: this requires regaining control of public expenditures, including reforming energy subsidies and containing the wage bill, mobilizing additional revenue, reducing contingent liabilities, and developing a well-targeted social safety net. Additional external financial support will help smooth fiscal consolidation and could contribute to job creation in the short run, through well-targeted public investment. Potential areas for more technical assistance from Egypt's external partners include: public finance management; subsidies and social safety nets; civil service reform; access to finance for small- and medium-sized enterprises (SMEs); and mobile banking.

III. JORDAN

Jordan's economy has been facing large exogenous shocks in recent years. These shocks include regional unrest, especially in Syria, and energy supply problems. In this difficult external context, the authorities' reform program aims at correcting domestic and external imbalances through fiscal and energy policies, while fostering higher and more inclusive growth to address the persistently high unemployment. This program is broadly on track, with growth gradually picking up. The second review under Jordan's Stand-by Arrangement with the IMF was completed in November, and the third and fourth reviews could be considered by the Board in the coming weeks.

Background. Jordan experienced strong growth during 2000–09 (averaging about 6½ percent), which tapered off to 2-3 percent in recent years, largely because of the global downturn and regional factors. The economy is among the most open in the Middle East, with high tourism receipts, remittances, foreign direct investment, and grants. Jordan is highly energy dependent. Although the authorities have implemented structural reforms to develop the private sector, unemployment remains persistently high, averaging 13.7 percent over the past decade. Unemployment is particularly high among the youth (with an unemployment rate of 31 percent), and among women (with a rate of 22 percent). Political reform has been gradually progressing. The election law was amended in 2012, to move toward a multi-party political system. The parliament elected in January 2013 is now playing a more visible role.

Jordan: Selected Economic Indicators, 2011 - 2014

(Percent of GDP, unless otherwise indicated)

			Projections		
	2011	2012	2013	2014	2015
GDP growth, percent	2.6	2.7	3.3	3.5	4.0
CPI inflation, period average, percent	4.4	4.6	5.5	3.0	2.4
General government balance, excl. grants[1]	-16.6	-15.4	-14.6	-12.7	-9.4
Current account balance, excl. grants	-19.0	-22.1	-19.0	-16.1	-12.9
Fiscal financing needs, (excl. grants),US$ billion[2]	5.3	5.3	5.6	5.2	5.2
External financing needs (excl. grants), US$ billion[3]	6.0	7.6	7.1	6.4	6.6
Public debt	70.7	80.2	87.7	91.3	93.0
External debt	21.9	22.5	24.5	26.0	25.2
Reserves in months of imports	5.1	2.4	5.3	5.7	5.8

Sources: National authorities; and IMF staff calculations.

[1]Starting in 2013, the government balance includes direct transfers to NEPCO.

[2]Budget deficit, excluding official grants, plus public external amortization.

[3]Current account deficit, excluding grants, plus amortizartion.

Recent developments. Despite a challenging environment, the macroeconomic situation remains broadly stable. Growth increased by about 3 percent in 2013, driven by sustained activity in financial services, telecommunications, and construction. Year-on-year inflation dropped to just above 3 percent, as the impact of the fuel price liberalization in late 2012 subsided. After resuming in late 2013, gas inflows from Egypt were once again interrupted in January. This, together with a growing number of Syrian refugees in Jordan (over 590,000 as of mid-March, according to the United Nations), puts pressure on fiscal and external accounts. Nonetheless, the authorities' IMF-supported program has stayed broadly on track. Regular increases in electricity tariffs for most economic sectors, the latest in January, are reducing the electricity company's (NEPCO) losses. The Central Bank of Jordan (CBJ) has restored trust and rebuilt its international reserves buffer to about six months of imports as of March 2014. This was helped by a significant reduction in the current account deficit (from lower energy imports, sizeable grants from the GCC, and private transfers), and the successful issuance of two U.S. dollar-denominated domestic bond and a U.S. guaranteed Eurobond.

Short-term outlook. Supported by an increase in government capital spending, real GDP growth is expected to increase further, to about 3½ percent in 2014. Year-on-year Inflation is expected to decline to about 2½ percent by end-2014. The external current account is expected to continue its improvement, which will allow the CBJ to maintain a strong reserve position. Most of the decline in the combined public deficit will come from NEPCO in 2014 and the central government budget structure is improving with revenue measures helping to finance higher capital spending and transfers to the health fund (to cover services provided to Syrian refugees). Public debt is likely to increase further from an already very high level, which calls for more concessionality in external financial assistance.

Risks. Jordan is heavily exposed to spillovers from Syria, and an escalation of the civil war could lead to a further inflow of refugees, adding to the pressure on public finances. Regional uncertainties could also affect FDI and private sector confidence. Furthermore, continued disruption in gas supplies from Egypt would weaken the current account and increase NEPCO losses (by as much as 2 percent of GDP in 2014). Other risks stem from lower growth and global spillovers (such as an increase in U.S. interest rates).

Short-term policy issues. Steadfast implementation of reforms is needed to keep the fiscal and external balances on a sustainable path. On the fiscal front, consolidation will remain gradual in order to prevent jeopardizing growth prospects. Tax reform, including the new income tax law and a reduction in tax incentives, should be the main driver of fiscal consolidation in 2015, in order to recover some of the loss in revenue since 2008. It should be accompanied by strengthened tax administration and reforms to improve the prioritization of investment projects and the targeting of cash transfers. On the energy front, returning NEPCO to cost recovery requires the annual announced electricity tariff increases and the completion, by mid-2015, of a liquefied natural gas terminal in Aqaba. Monetary policy will continue to balance maintaining the attractiveness of the Jordanian dinar with supporting economic activity. External partners should provide additional grants to help alleviate fiscal and macroeconomic pressures, including high outlays for Syrian refugees.

Medium-term challenges. To return public debt to a downward trend, fiscal consolidation should continue through tax and expenditure reforms. NEPCO's return to cost recovery is also essential. The burden of reforms on vulnerable groups needs to be minimized through well-targeted social assistance and creation of quality jobs. In parallel, fostering high and more inclusive growth will require implementing structural reforms aimed at upgrading the business environment and enhancing access to finance, while improving labor market skills through education and training reforms and strengthening public institutions. This agenda offers opportunities for possible technical assistance, including in the areas of tax administration and public financial management.

IV. LIBYA

Security conditions continue to deteriorate as political and sectarian tensions deepen and the legitimacy of the state is eroded. Attacks have kept hydrocarbon output at less than one-third of capacity since mid-2013, resulting in an alarming decline in GDP and widening fiscal and current account deficits. The negative outlook is exacerbated by runaway public spending, especially on wages and subsidies. The IMF is working with the authorities to develop emergency measures aimed at slowing the depletion of reserves; as well as a comprehensive technical assistance program, the delivery of which, however, suffers from the deteriorating security environment.

Background. Restoration of hydrocarbon output underpinned economic recovery after the 2011 revolution, resulting in a doubling of real GDP in 2012. Consumer price inflation fell while fiscal and current account balances moved to surplus. Since the summer of 2013, however, attacks on oil production and export facilities have reduced output to a trickle, undoing the achievements of the previous year. Deepening hydrocarbon dependency, combined with growing current spending, exacerbate the impact of output disruptions on Libya's economy.

Libya: Selected Economic Indicators, 2011 - 2015

(Percent of GDP, unless otherwise indicated)

			Projections		
	2011	2012	2013	2014	2015
GDP growth, percent	-62.1	104.5	-9.4	-7.8	29.8
CPI inflation, period average, percent	15.9	6.1	2.6	4.8	6.3
General government balance, excl. grants	-9.2	25.9	-1.3	-30.4	-18.8
Current account balance, excl. grants	9.1	35.4	-2.8	-27.7	-16.7
Fiscal financing needs, (excl. grants),US$ billion[1]	…	…	…	…	…
External financing needs (excl. grants), US$ billion[2]	…	…	…	…	…
Public debt	0.0	0.0	0.0	0.0	0.0
External debt	16.1	6.8	8.2	9.5	6.6
Reserves in months of imports of imports	41.1	38.0	39.3	27.3	19.7

Sources: National authorities; and IMF staff calculations.

[1]Budget deficit, excluding official grants, plus public external amortization.

[2]Current account deficit, excluding grants, plus amortizartion.

Recent developments. The decline of hydrocarbon output from 1.45 million bpd in 2012 to 1 million bpd in 2013 has reverberated throughout the economy. GDP contracted by over 9 percent with the fiscal and current accounts registering 1 percent and 3 percent of GDP deficits, respectively. Inflation remained subdued at 2.6 percent on average for 2013. Nevertheless, pressures and bottlenecks arising from the political and security environment could increase inflation..

Short-term outlook. Escalating political and security turmoil has reduced the forecast for 2014 hydrocarbon output to 0.6 million bpd, a decline of 40 percent from 2013. GDP is expected to contract further by 8 percent with a current account deficit of 17 percent. Government revenues could fall by 45 percent from the 2013 level, leading to a fiscal deficit in excess of 30 percent of GDP. Current spending, which grew from 40 percent of GDP in 2012 to 60 percent in 2013, is a major contributor to the deterioration of the fiscal outlook. Libya has significant reserves to help weather the crisis in the short term. At the end of 2013, combined international reserves at the Central Bank and the Libyan Investment Authority (LIA) were estimated at 180 percent of GDP. The drawdown of reserves is expected to accelerate from one percent of GDP in 2013 to 30 percent of GDP in 2014. Unemployment is likely to remain broadly unchanged, with limited public sector recruitment and stagnation in private sector hiring.

Risks. The combination of hydrocarbon output disruptions and runaway spending could deplete Libya's financial reserves in less than five years. Prolonged production disruptions could degrade Libya's output infrastructure. Turmoil is likely to further weaken the state and its institutions, and exacerbate shortages of basic services, particularly law and order. Trust in government could erode further in the context of political and sectarian polarization as well as weakening state institutions, to create a vicious circle of declining legitimacy and effectiveness.

Short-term policy issues. The rapid deterioration of the fiscal outlook adds urgency to the need to contain current spending and improve the quality of the budget process. Fund staff is working with the authorities to develop emergency measures aimed at containing the growth of wages and subsidies and focusing capital spending on priority areas. Strengthening public finance management, with a focus on enhancing transparency, accountability, and the efficiency of public investment, is necessary to restore both fiscal sustainability and trust in government. It is also necessary to continue to build capacity at the central bank to improve the management of public wealth and facilitate the development of the financial sector as a key driver for private sector-led growth. Working closely with the authorities, Fund staff developed a comprehensive program of technical assistance to address these issues; however, the uncertain security environment is hampering implementation.

Medium-term challenges. A restoration of security is a precondition for a growth in economic activity. For Libya to move away from dependency on oil to a sustainable path, it would be necessary to create the conditions for diversified, private sector-led growth. This will require, among others, enhancing the business environment, upgrading the skills of the workforce through better education and training, fostering financial intermediation, and investing in physical, regulatory, and institutional infrastructure. Libya would benefit from a substantial increase in capacity building-assistance from the international community.

V. Morocco

Economic conditions improved in 2013, supported by appropriate policy actions. The fiscal and current account deficits declined significantly from their 2012 heights, helped by the authorities' initiatives to reduce fiscal and external vulnerabilities. In particular, the authorities implemented measures to reduce the cost of subsidies and shield the budget from international oil price fluctuations, while extending social support to the most vulnerable of the population. Economic activity is expected to slow down in 2014, as agricultural production returns to normal levels after an exceptional 2013 harvest. Unemployment levels, particularly for the youth, will remain at uncomfortably high levels. Inflation has continued to be low. The third and last review under the IMF's Precautionary and Liquidity Line (PLL) arrangement was completed in January 2014. The authorities do not intend to draw on PLL resources unless Morocco experiences severe balance-of-payments needs resulting from a significant deterioration in external conditions.

Background. After the adoption of a new constitution in July 2011 and subsequent elections, a coalition government, headed by the Justice and Development Party, took office in January 2012. After the resignation of ministers from the main junior party, Itsiqlal in July 2013, a new coalition government was formed in October 2013 with the National Rally of Independents replacing Itsiqlal. The challenge for the authorities remains to sustain difficult reforms in a context of high expectations and an unfavorable external environment.

Recent developments. Overall growth picked up in 2013 and is expected to have reached 4.5 percent. This performance was driven by an exceptionally strong harvest, while non-agricultural activity slowed down, reflecting the impact of weak activity in Europe, Morocco's main economic partner. The unemployment rate remained stable around 9 percent, with youth unemployment remaining elevated at 19.3 percent. The fiscal deficit declined substantially from 7.3 percent of GDP in 2012 to 5.4 percent of GDP, thanks to a reduction in the wage bill (by 0.5 percent of GDP) and subsidies (by 2 percent of GDP) and despite the impact on revenue of the slowdown in non-agricultural activity. The decrease in subsidies was due to the introduction of a partial indexation mechanism for domestic prices of some petroleum products in September, as well as to lower international prices. In January 2014, the authorities removed subsidies on gasoline and industrial fuel and reduced the per-unit subsidy of diesel, and announced further reductions for the remainder of the year. Although the weak demand from the Euro area continued to weigh on exports, the current account improved in 2013 owing to lower fuel and food imports. International reserves have stabilized above four months of imports.

Morocco: Selected Economic Indicators, 2011 - 2015

(Percent of GDP, unless otherwise indicated)

			Projections		
	2011	2012	2013	2014	2015
GDP growth, percent	5.0	2.7	4.5	3.9	4.9
CPI inflation, period average, percent	0.9	1.3	1.9	2.5	2.5
Central government balance, excl. grants	-6.9	-7.4	-6.1	-6.1	-5.3
Current account balance, excl. grants	-8.4	-10.0	-8.0	-7.7	-6.8
Fiscal financing needs, (excl. grants),US$ billion[1]	7.7	8.0	7.4	8.0	7.7
External financing needs (excl. grants), US$ billion[2]	9.8	11.2	10.3	10.8	10.6
Public debt	54.4	60.2	61.9	62.7	62.5
External debt[3]	25.1	29.8	30.9	31.5	31.6
Reserves in months of imports	5.0	4.2	4.0	4.3	4.3

Sources: National authorities; and IMF staff calculations.

[1]Budget deficit, excluding official grants, plus public external amortization (central government).

[2]Current account deficit, excluding grants, plus amortizartion.

[3]Includes external publicly guaranteed debt.

Short-term outlook. Growth is expected to fall below 4 percent in 2014 as agriculture production returns to normal levels following a bumper crop in 2013. Non-agricultural activity, which slowed in 2013, is expected to pick up, pulled by the recovery in Europe. Inflation is projected around 2½ percent in 2014-15, notwithstanding recent increases in the prices of some energy products. The current account deficit is expected to contract further as a result of the reduction in the fiscal deficit, lower global energy prices, and exports from newly developed sectors (e.g., car and aeronautics industries) resulting from recent foreign investments.

Risks. A protracted period of slower growth in trading partners from advanced economies, especially in the euro area, could affect growth and the balance of payments. A surge in global financial market volatility, related to the exit from unconventional monetary policies in large advanced economies, could limit access to international capital markets, even though Morocco's reliance on foreign financing is moderate. Pressing social demands may slow implementation of the necessary reforms. On the upside, a better-than-expected agriculture production would have a positive impact on growth and the current account.

Short-term policy issues. Ensuring macroeconomic stability by continuing to rebuild fiscal and external buffers and moving ahead with difficult but necessary reforms remains crucial. In particular, the authorities' fiscal consolidation plan needs to be followed through, by further containing the wage bill and reducing subsidies. The costly universal subsidies should be gradually replaced with well-targeted social programs. Reforms to strengthen the fiscal framework are at a key stage as a draft organic budget law (OBL) makes its way through Parliament. The OBL should reflect international best practice, while enshrining recently introduced important measures related to investment appropriations and wage policy. Effective communication will be important to adhere to the medium-term fiscal path and explain to citizens the benefits of the planned reforms. The reform of the pension system is urgently needed to ensure its viability and preserve fiscal sustainability.

Medium-term challenges. Promoting stronger, more inclusive growth and higher employment is the key challenge. Ensuring macroeconomic stability is the necessary foundation. To improve competitiveness, raise potential growth, and reduce unemployment, there is also a need to accelerate structural reforms aimed at further improving the business climate and economic governance by enhancing transparency, accountability, and the rule of law; strengthening the judiciary; making the tax system more supportive of competitiveness and more equitable; facilitating access to credit; and enhancing the quality of education. Morocco would also benefit from moving toward a more flexible exchange rate regime to enhance external competitiveness and strengthen the economy's ability to absorb shocks. This agenda presents substantial opportunities for further capacity building assistance by Morocco's external partners, particularly in the areas of taxation, the budget monitoring process, as well as in further strengthening the monetary policy framework and exchange rate management.

VI. TUNISIA

The authorities have managed to preserve macroeconomic stability despite a political crisis and a difficult international context. However, external and fiscal imbalances remain elevated, and growth is not high enough to meet the population's social aspirations and make a significant dent in high unemployment. Immediate priorities are to control the budget and external deficits, reduce banking sector vulnerabilities, and generate more rapid and inclusive growth that can create jobs and reduce inequality. The IMF continues to support Tunisia through a two-year Stand-By Arrangement, approved in June 2013, which aims at preserving short-term macroeconomic stability and foster higher job-intensive growth while protecting the most vulnerable segments of the population.

Background. After a political stalemate that paralyzed the country for most of 2013, the political transition is moving forward with the approval of a new constitution and the formation of a technocratic government in January 2014. These positive events are expected to improve the political and social climate, and to lead to renewed confidence in the economy. New presidential and legislative elections are expected by the end of the year. In view of the authorities' firm commitment to advance on the reform agenda, IMF staff and the Tunisian authorities reached an agreement on the third review under Tunisia's IMF-supported program, which will be submitted for approval by the IMF Executive Board in the coming weeks. However, the economic situation remains fragile, with growth that is too low to meet the population's high social aspirations, and continued strikes and calls for salary increases.

Recent developments The recovery of the Tunisian economy remains timid, with real growth estimated at 2.6 percent in 2013, driven mainly by public and private services. Headline inflation declined to 5.5 percent at end-February 2014. The current account deficit widened to 8.4 percent of GDP in 2013, as a result of weak exports of phosphates and low tourism revenues. On the fiscal front, the deficit declined in 2013 to 4.5 percent of GDP (on a cash basis, excluding grants) from 5 percent of GDP in 2012, thanks primarily to deferring cash payments to 2014 and a significant under-execution of investment spending, linked to absorptive capacity constraints.

Tunisia: Selected Economic Indicators, 2011 - 2015[1]

(Percent of GDP, unless otherwise indicated)

			Projections		
	2011	2012	2013	2014	2015
GDP growth, percent	-1.9	3.7	2.6	2.8	4.2
CPI inflation, period average, percent	3.5	5.6	6.1	5.5	5.0
General government balance, excl. grants	-3.4	-5.7	-6.1	-6.8	-4.4
Current account balance	-7.4	-8.7	-8.4	-7.2	-6.3
Fiscal financing needs, (excl. grants),US$ billion[2]	3.0	3.8	3.9	4.1	2.8
External financing needs (excl. grants), US$ billion[3]	10.7	11.1	11.8	10.5	9.4
Public debt	44.5	44.5	44.7	50.9	52.6
External debt	48.0	53.8	53.9	57.3	59.8
Reserves in months of imports	3.4	4.0	3.5	3.9	4.3

Sources: National authorities; and IMF staff calculations.

[1]Figures may differ from WEO data as they reflect updates by recent missions.

[2]Budget deficit, excluding official grants, plus public external amortization.

[3]Current account deficit, excluding grants, plus amortizartion.

Short-term outlook. Investor confidence has improved with the recent political developments, but risks to the political transition as well as security concerns persist. In addition, growth in Tunisia's trading partners is still subdued. Against this background, economic growth for 2014 has been revised down to 2.8 percent. Inflation is likely to remain stable, owing to a negative output gap, moderation in the rise in food prices and the implementation of prudent monetary policy. Tunisia's current account deficit would be reduced slightly to a still-elevated 7.2 percent of GDP, expected to be financed mostly by official external financing flows. Gross official reserves increased and stood at close to four months of imports at end-2013. For 2014, the payment of deferred expenditures will weigh on the budget deficit (on a cash basis), which will widen to 8.6 percent of GDP.

Risks. Short-term risks to the outlook remain significant, particularly in case of a lengthy political transition period, heightened security tensions, or a worsening of the economic outlook for Tunisia's main trading partners. Tourism activity is still negatively impacted by regional and domestic security concerns, despite heightened government efforts. Any delays in the political calendar would also weigh on economic policy and reform implementation, thus weakening economic activity and delaying job creation. A shortfall in expected external financing or loss of market access would add to financing needs. A weaker economic outlook in Europe and other trading partners, or higher commodity prices, would add another drag on growth and the external and fiscal positions.

Short-term policy issues. The most immediate challenge is to maintain macroeconomic stability while moving ahead with its pro-growth reform agenda in a still-difficult political environment. Fiscal policy will need to be geared towards preserving external stability and safeguarding debt sustainability. Controlling the wage bill and gradually replacing energy subsidies with a better-targeted social safety net are priorities for creating the necessary fiscal space to increase capital investments and social spending. The implementation of a tight monetary policy and a more flexible exchange rate policy are also essential to preserve macroeconomic stability, improve Tunisia's price competitiveness, and rebuild foreign exchange buffers. Reducing the banking sector's increasing vulnerabilities, particularly for public banks, is also an immediate priority. It is important that Tunisia's external partners follow through with their commitments for timely and affordable financial support.

Medium-term challenges. Generating higher and more inclusive growth to absorb high unemployment and reduce social and economic disparities across regions remains the key economic challenge for Tunisia. A stronger banking sector and a deeper domestic financial market will be important to finance the investment activities in this respect. Additionally, reforms should focus on: (i) a more transparent and competitive environment for doing business through the new investment code, competition law, bankruptcy law, and trade facilitation measures; (ii) strengthening public investment execution; (iii) accelerating progress towards better-targeted social safety nets to protect the most vulnerable from the impact of reforms; (iv) fiscal measures to create a more level playing field for investors in the onshore and offshore sectors, strengthening revenue collection, improving equity, and raising transparency; (v) enhancing the functioning of the labor market; and (vi) improving the governance of public enterprises. This agenda offers ample opportunities to increase capacity-building support by external partners.

VII. YEMEN

Yemen has made some progress towards restoring macroeconomic stability, but needs to boost growth, generate more jobs, and reduce poverty. To this end, Yemen needs to re-orient public spending towards pro-growth pro-poor outlays, and to reduce the fiscal deficit in order to contain pressures on inflation and foreign exchange reserves. The fledgling recovery remains fragile against the background of persistent political uncertainty, a frail security environment, and lagging economic reforms. Available domestic financing is very limited, and additional donor financing for the budget will be crucial to support economic reforms and to halt a further decline in the already low infrastructure investment. The IMF provided financial support through the Rapid Credit Facility in 2012. Staff remains in close dialogue with the authorities on economic policy challenges, including those related to the move to a federal structure of the state.

Background. Yemen experienced a serious political crisis in 2011 that resulted in a decline in economic activity. A political agreement brokered by the GCC enabled the formation of a national unity government in December 2011 and the election of a new president in February 2012. The national dialogue was concluded in early 2014, with an agreement to move to a six-region federal state. Next steps in the transition include drafting the new constitution, which will determine the degree of autonomy granted to the regions, and preparing the elections, which have been postponed to February 2015.

Recent developments. Real GDP growth improved somewhat helped by a partial recovery in oil output, while non-hydrocarbon growth stayed at 4 percent. Inflation edged up slightly to 11 percent. The fiscal deficit (excluding grants) narrowed in 2013, although this was achieved through a reduction in much-needed capital spending and in general fuel subsidies. The latter reflected a harder budget constraint, the full-year effects of 2012 diesel price adjustments, and possibly an improvement in governance following the unification of the wholesale price of diesel in 2013. The fiscal deficit was largely financed through issuance of government securities, including sukuks, while external financing to the budget was very low. Public debt continued to climb. Broad money growth moderated to 12.5 percent, while credit to the private sector accelerated to 39 percent. Notwithstanding this acceleration, private credit growth averaged about 5 percent over the past three years; much lower than nominal GDP growth. At the same time, bank credit to the government continued to rise, reaching about 44 percent of total bank assets, one of the highest ratios in the region. The external current account deficit widened to about 2.7 percent of GDP, and foreign exchange reserves declined moderately to US$4.8 billion (about 4.5 months of imports), helped by the pension funds' sales of foreign currency deposits to purchase treasury bonds. The exchange rate remained stable.

Yemen: Selected Economic Indicators, 2011 - 2015[1]
(Percent of GDP, unless otherwise indicated)

			Projections		
	2011	2012	2013	2014	2015
GDP growth, percent	-12.71	2.39	4.40	5.08	4.44
CPI inflation, period average, percent	19.54	9.89	11.12	10.36	9.76
General government balance, excl. grants	-5.63	-12.55	-8.00	-7.75	-7.62
Current account balance, excl. grants	-6.37	-7.55	-3.41	-2.76	-3.94
Fiscal financing needs, (excl. grants),US$ billion[2]	2.07	4.58	3.32	3.67	3.80
External financing needs (excl. grants), US$ billion[3]	2.31	2.83	1.53	1.52	2.14
Public debt	45.18	48.04	49.95	51.42	53.38
External debt	18.36	17.80	15.90	14.96	15.32
Reserves in months of imports	3.82	5.64	4.63	3.81	3.87

Sources: National authorities; and IMF staff calculations.
[1]Figures may differ from WEO data as they reflect updates by recent missions.
[2]Budget deficit, excluding official grants, plus public external amortization.
[3]Current account deficit, excluding grants, plus amortizartion.

Short-term outlook. The 2014 fiscal deficit (excluding grants) is projected at 7¾ percent of GDP, assuming further improvement in tax collection and continued expenditure restraint. Capital expenditures are projected to remain low. The scope for a further reduction in energy subsidies without price adjustments is minimal. The financing of the deficit is increasingly a challenge. Absent an increase in external donor financing in support of economic reforms, budget implementation will likely result in a decline in investment, growth, and foreign reserves.

Risks. The main downside risks include a potential increase in sabotage to oil production and exports, a weakening of fiscal or monetary policies and/or worsening in the political and security situation related particularly to the remaining steps in the political transition. Other risks stem from the prospective move to fiscal federalism, which would need to be carefully designed and supported by adequate institution and capacity building to avoid a weakening in fiscal discipline and an unchecked contracting of public debt. On the upside, Yemen could benefit from an acceleration of donor disbursements in support of economic reforms and an extension of the recently renegotiated LNG price to all its export contracts.

Short-term policy issues. Priorities include strengthening fiscal and external sustainability, and promoting high and inclusive growth. A gradual re-orientation of the budget will be required: improving tax compliance, containing the wage bill (by measures that include eliminating ghost workers and double-dippers), and gradually reducing fuel subsidies while increasing targeted social transfers and public investment—including through enhanced project coordination and implementation. Any compensation to the South or other region should be financed by external grants or offset by fiscal measures. There is also scope for improving financial intermediation and strengthening bank supervision.

Medium-term challenges. The key medium-term challenge is to achieve high growth and job creation, diversify the production and export structure, and reduce public debt. In addition to the critical fiscal reforms described above, a new challenge is to adapt the fiscal structure of the government to the needs of the new federal state structure that is in the making. There is also a need to address inefficiencies in oil refining and marketing, electricity generation, and state enterprises in general. An improved business environment, and continued prudent monetary policy, will also be critical for the financing of job-creating private sector investment, including SMEs. In addition, further improvements are needed in governance and transparency. Implementing this agenda requires additional external budget support and further technical assistance by Yemen's external partners, in areas that include public financial management, financial and capital market development, monetary operations, banking supervision, payment systems, economic and financial statistics, and judicial reforms.