APICORP Research

Economic Commentary

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A MENA Macroeconomic Perspective for the Period 2008-2012: Sustained Growth Amid Uncertainties [1]

1. Despite the world economy becoming more interdependent, multi-faceted risks have been felt by different countries and regions with varying degree of intensity and time-dependent effect. In the case of MENA, the region's exposure to external uncertainties seems reduced or not yet felt as it has continued to perform remarkably well. Macroeconomic fundamentals, which have greatly benefited from high oil prices, have remained generally strong. However, with looming downside risks and a challenging regional unemployment, the outlook deserves more careful consideration. This commentary aims at reviewing the macroeconomic outlook for the period 2008-2012. It first discusses the uncertainties and risks facing MENA before proceeding to highlight the global economic backdrop, then focusing on MENA various social and economic spheres. It concludes on the extent the region could weather key uncertainties and risks.

Key uncertainties and risks

2. Among the many uncertainty and risk factors a macroeconomic assessment of MENA must take into account, the direction of oil prices and the outlook for global financial markets are key. On the one hand, prospects for oil prices are currently extremely uncertain. Current steep upward price trends, which are neither desirable nor sustainable, are hardly extrapolable and corrections need to be assumed. Even more uncertain on the other hand, is the ongoing global financial crisis and the difficulty of anticipating its full impact. Both uncertainty and risk factors warrant some elaborations before proceeding further with macroeconomic projections.

3. As oil prices have continued to surge beyond any sensible analysts' forecast (at the time of writing US light sweet crude hit a new record above $96/bl) few economic forecasters are willing to look beyond 2008. Indeed, while it is relatively easy to conjecture on the medium term outlook of world oil demand, non-OPEC supply, inventory movements and OPEC's capacity to balance the market, other determining factors than these fundamentals are hardly as predictable or reliable. They include geopolitical tensions in key producing areas, hedging pressures and the associated speculative behaviours on the futures markets and the impact of monetary or currency policies, each of which can affect both the oil price direction and volatility. To the extent that higher oil prices increase the downside risk to the global economic outlook, the implied and desired assumption in this regard is a return to a moderate oil price range of US$60-70/bl nominal during the forecast period.

4. With regard to the ongoing financial crisis, it is worth reminding that it finds its origin in a serious deterioration in credit quality of the US sub-prime lending. Not only has the crisis spilled over to other segments within the US credit market but it has rapidly extended to the rest of the world through securitization and the explosion of complex credit instruments. The uncertainties about both the size of the resulting credit losses and the extent financial risks have been spreading through banks across the world has resulted in a lack of trust of financial counterparties. Ultimately, markets have had no choice but to re-price risk with likely lasting credit cost effects on both consumption and investment.

Global economic backdrop

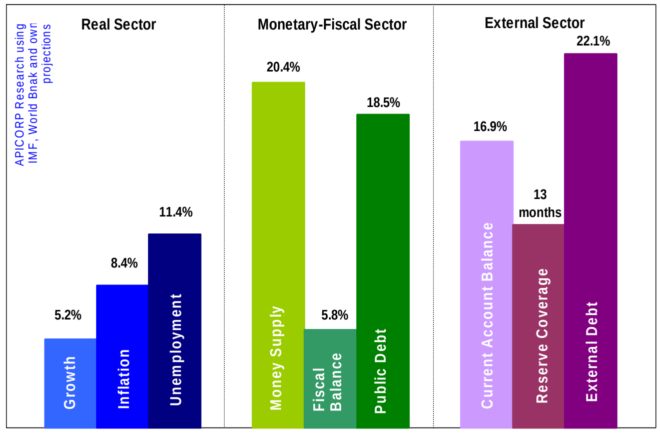
5. The global economic outlook, which appeared strong and sustainable until mid-2007, is now looking sluggish. Affected by the uncertainties and risks highlighted previously, world growth is projected to slow down from 5.2% in 2007 to 4.8% in 2008.[2] Additionally, although inflation has so far remained low at about 2% in advanced economies and contained at a little more than 5% in key emerging markets, rising inflationary pressures pose a further risk.

6. Obviously, the economic situation and outlook for key countries and regions are more contrasted. The US economy faces a serious risk of recession in the eventuality of persistently declining residential investment and reduced consumer spending. In this context, US output growth is expected to remain at 1.9% in 2008, at best. In Europe, domestic demand and investment have already felt the effect of exposure to the US sub-prime mortgage crisis as banks' lending has been curtailed and credit spreads widened. Euro zone growth and inflation are expected to decline from 2.5% in 2007 to 2.1% in 2008. In Japan, while deflation remains an issue, growth is expected to contract from 2% in 2007 to 1.7% in 2008.

7. By contract to the low growth and low inflation in the advanced economies, other emerging market and developing countries are expected to continue to show stronger growth but relatively higher inflation. In Sub-Saharan Africa, growth is projected to increase from 6.1% in 2007 to 6.8% in 2008 and inflation to remain at 6.7%. Due to the negative impact of its external trade link with the USA, Latin America may well contract from 5.0% in 2007 to 4.3% in 2008 with inflation at 5.8%. Asia's overall economic outlook remains positive thanks to the twin engine: China and India, whose 2008 respective growths are projected to 10.0% and 8.4% with respective inflations of 3.9% and 4.4%. Russia's output growth is expected to slow to 6.5% and inflation contained at 7.5% in 2008. Finally, MENA region is expected to continue to grow strongly at 5.9% in 2007 and 2008 with inflation remaining relatively high at 8.6%.

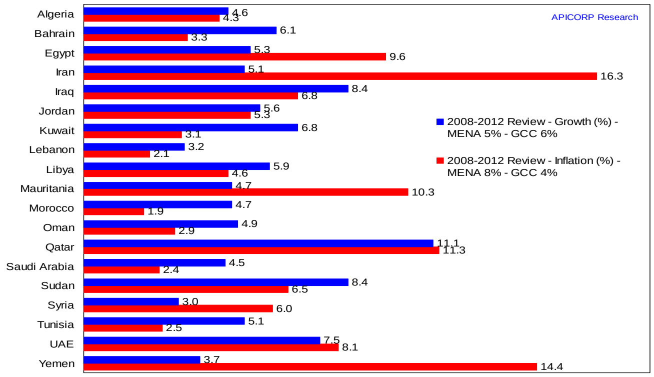
MENA medium-term perspective

8. Taking a longer-term perspective, a snapshot of the MENA macroeconomic outlook for period 2008-2012 is tentatively provided in the Figure below. It summarizes the analysis of three interrelated spheres of the economy: the real sector, the monetary and fiscal sector and the external sector.



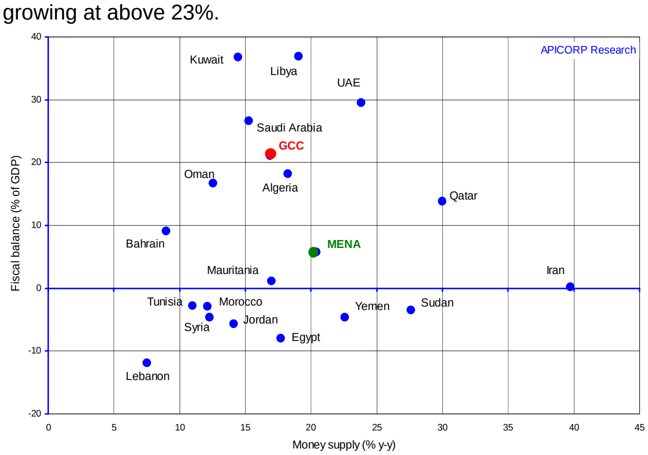
9. Over the period 2008-2012 the region's aggregate output is expected to grow at a sustained 5.2% annual rate, and experience a relatively high inflation at 8.4%. The key underlining factors of this anticipated remarkable growth performance are, by-and-large, sustained high oil prices, favorable economic policies and regulations and an improved business environment. In the GCC area, growth is additionally attributable to vigorous infrastructure and capital expenditures. As a result, the GCC area will continue to expand more robustly resulting in an output growing at 5.7% and a more contained inflation of 3.6%.

[1] This commentary has been prepared by Wichai Turongpun with input and feedback from Ali Aissaoui.
[2] Figures for the period 2003-2008 are from IMF literature (October 2007). Projections beyond 2008 are based on APICORP Research assumptions.



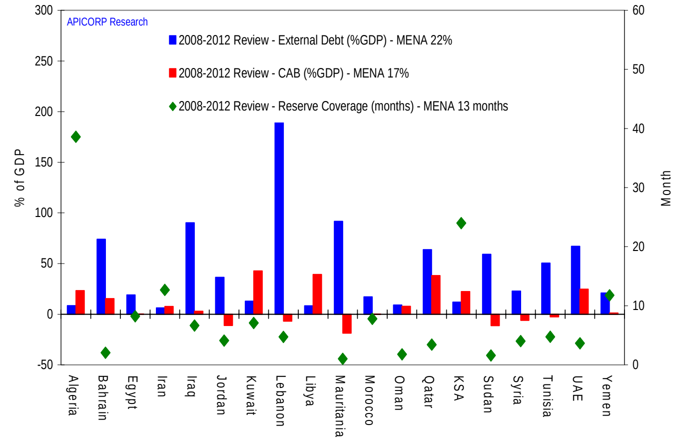
10. Notwithstanding these favorable prospects, under-employment and unemployment - the latter trending towards 11.4% for the whole region - will remain high with notable country variations reflecting demographic factors and the degree of economic diversification. In the oil-producing countries, the major structural problem is the highly productive petroleum sector. As long as this sector remains the main economic engine, growth alone will not be enough to make a dent.

11. MENA monetary policies which, until recently, have largely been accommodative, have shown a temporary sign of tightening as growth in money supply has decreased from 22.6% in 2007 to 16.4% in 2008. However, congruent with the region's relatively well-contained inflation, this trend is expected to be reversed for the review period with money supply picking up again to 20.4%, Furthermore, as shown in the Figure below, Qatar, the UAE, Iran and Sudan are expected to experience an even looser monetary policy with money supply growing at above 23%.



12. Interest rates have shown little change in many countries in the region. In countries whose currency is pegged to the US dollar, as is the case of the GCC area (excluding now Kuwait), interest rates have mirrored the US Federal Reserve fund rates. While it is hard to predict future movements, it is worth noting that a long period of moderate rates amid accommodative domestic policy has contributed to credit expansion, thereby boosting investment and growth. Importantly also, monetary authorities of key open economies in the region have played a critical role in providing liquidity to the market to stem any financial disturbances from the global sphere.

13. Fiscal balances have a mixed record. The region's overall balance, which showed a surplus of 7.0% in 2006, is expected to remain at 6.1% in 2008. In the review period 2008-2012, MENA average fiscal balance will remain in large surplus at 5.8% of GDP. Obviously, while fiscal balance in the GCC area is expected to exhibit a much larger surplus of 21.1% of GDP, thanks to higher petroleum tax revenues (see Figure above), fiscal deficits will continue to be felt by the oil-importing economies within the region, not to mention war-torn Iraq and other unstable areas.



14. The region's fiscal policy stance has generally been supportive of the economy. Many high-fiscal-surplus MENA countries, of which Saudi Arabia, Kuwait and to some extent Algeria, have been able to foster economic growth through increased public spending aimed at infrastructure development and capacity expansion. Furthermore, oil-exporting countries have used part of their budget surpluses to reduce public debt as a percentage of GDP. As a result, the region's debt stock dropped to 18.5% for MENA as a whole and 7.0% for the GCC area. Yet, countries experiencing unstable environments have developed unsustainable debt levels. Their current debt ratios of more than 90% of GDP could deteriorate further in the medium term.

15. MENA as a whole and, a fortiori, the petroleum-exporting economies, have emerged as net savers thanks to sustained large surpluses in their aggregate current accounts. Record surpluses of more than 40% of GDP are registered in Kuwait and Libya. The region's overall balance, which reached 18% of GDP in 2006, is expected to slightly decline to 17% in response to import growth derived from public spending, with the notable case of Saudi Arabia's balance decreasing from 30% of GDP in 2005 to 22%in 2012. Furthermore, as with public debt, external debt in MENA has been declining from 30% of GDP in 2004 to 26% of GDP in 2007, and is projected to continuingly slide resulting in an external debt stock of 22.1% in the review period. Finally, despite inflated import costs and volume, central banks' aggregate reserves are expected to remain strong with an overall 13-month coverage of merchandise imports.

Concluding remarks

16. Record high oil prices remain a serious downside risk to the global economy and, as a result, to both world petroleum demand and the demand for MENA petroleum. Therefore, MENA region should be better off if prices settle at sensible levels. An equally serious risk is the still unfolding global financial turmoil, which MENA should be able to withstand. As indicated by most indexes, MENA stock markets appear to have barely felt the contagion.[3] Trends in the loan market are also relatively positive. According to a survey conducted by S&P (summer 2007), the exposure of Gulf banks (the largest banks it rates in the GCC) is generally limited. These banks have indeed been less exposed to structured products than their Western counterparts and, as a result, are less vulnerable to a domino effect. Furthermore, although project finance markets have generally taken steps to curb risk exposure, the attitude of the international banks involved in the region contrasts with that of the domestic and regional lenders. The latter, whose rating has recently been upgraded, are expected to play more significant roles, notwithstanding postponement of some debt issues until confidence is restored in the international capital market. Finally, even in the eventuality that capital investment inflows slightly retrench, the regional outlook will remain positive as growth is most likely to be sustained over the medium-term.

[3] Stock indexes in the region have shown a low impulse response to S&P500 during the peak turbulence period of August to October 2007.