Macroeconomic Aspects
Regional macroeconomic trends before the twin shock

The largest economies in the world have been hit hard by COVID-19 and the effects of subsequent containment measures. Being at the heart of global value chains, their woes have triggered a process of ‘supply-chain contagion’ affecting countries around the world – including in the Arab region, which has been doubly hit by COVID-19 and a simultaneous drop in oil prices.

This double shock occurred within a regional macroeconomic framework that was already in decline. Indeed, in the period 2017–2019, the average global real GDP growth of over 3 percent was outperformed only by the developing oil-importing countries, while oil-exporting and fragile countries’ real GDP grew well below the world average (see Figure 2.1). When growth is estimated in per-capita terms, the picture is even bleaker (see Figure 2.2). This suggests that the economic impact of the twin shock could cause lingering effects that may be far larger than those experienced in the recent past.

**Figure 2.1** Real GDP growth rate (2017–2019) (percentage)

<table>
<thead>
<tr>
<th>Year</th>
<th>World</th>
<th>Arab region</th>
<th>OECs</th>
<th>OIMICs</th>
<th>FCCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>3.9</td>
<td>2.9</td>
<td>1.2</td>
<td>1.9</td>
<td>-0.2</td>
</tr>
<tr>
<td>2018</td>
<td>3.6</td>
<td>1.9</td>
<td>1.9</td>
<td>0.6</td>
<td>0.4</td>
</tr>
<tr>
<td>2019</td>
<td>4.6</td>
<td>4.5</td>
<td>2.1</td>
<td>2.5</td>
<td></td>
</tr>
</tbody>
</table>

Source: authors’ elaboration based on data from the IMF’s WEO, April 2020.

**Figure 2.2** Regional real GDP per capita growth rates

Source: The World Bank, World Development Indicators (WDI) database.

The sectoral composition of regional GDP has historically seen a steady share of manufacturing at just above 10 percent, while the extractive industry has experienced significant volatility as a consequence of fluctuating prices for hydrocarbons and other commodities (see Figure 2.3). The regional economy heavily relies on services, very often basic services, which, on average, contribute to about half of the GDP while contributing to more than half of employment. As we will see later, in times of a pandemic, this may represent a vulnerable point.

Over the past decade, both GDP and fiscal revenues have shown larger swings relative to other regions in the world. Clearly, these swings are mainly influenced by fluctuations in the ‘oil-rich’ economies as well as by GCCs’ volatile performances. Indeed, fiscal revenues were around 28 percent of GDP in 2017, dropping from nearly 42 percent in 2012 – a drop aggravated by the 2014 plunge in oil prices.

In terms of foreign direct investment (FDI), it is widely understood that FDI into the countries of the Gulf Cooperation Council (GCC) – the largest regional recipient – has been mainly concentrated in the oil sector. However, FDI inflows were already falling before the pandemic, from a peak of over $94.8 billion in 2008 to $34.6 billion in 2018; as a percentage of GDP, average net FDI fell from 2.9 percent in 2008 to -0.5 percent in 2018. As a consequence of these two factors, only limited FDI has reached the non-oil tradable sectors in the past decade. Moreover, since most FDI has been going to capital-intensive sectors, it has had a limited effect on employment.

The region’s trade with Asia accounted for over half of the total trading value in 2018. Exports to the European Union accounted for 15.5 percent, while exports to the United States of America accounted for 5.5 percent. Arab intra-regional exports accounted for less than 10 percent of total Arab exports (see Figure 2.4).

The economic shock:
Key transmission channels

In the context of the structural macroeconomic weaknesses discussed, the region has been hard hit by an unprecedented, globally synchronized dual shock on both the supply and demand sides, as well as at both the macro and micro levels and across sectors.


What makes this situation particularly difficult to assess is that, unlike natural disasters, for example, its magnitude and impact cannot be estimated in the hours or days immediately following its occurrence. It will take months before the socioeconomic implications of this shock can be properly assessed. Indeed, forecasts made over the last few months have, at best, been quickly proven to only represent half of the story, and at worst, have been wildly inaccurate. Moreover, the propagation of this shock is not declining in its intensity as it continues to radiate from its epicentre – as is most often the case for natural disasters. Complex networks of propagation, rather than concentric circles, are a more appropriate representation of the spread of both the current health and socioeconomic shocks. Moreover, since pandemics involve human behaviour – influenced, as it is, by fear, lack of information and uncertainty – they are even harder to assess.\(^4\)

On the supply side, the economic fallout has included a reduction in the allocation of factors of production – labour and capital – and of intermediate inputs due to disruptions in production and transport resulting from social distancing and lockdown measures, with a consequent second-round effect of a drop in labour productivity that may endure long after the shock has subsided. In the period February–April 2020, the Markit PMI index – a closely watched measure of business conditions\(^5\) – has recorded its lowest levels ever across the largest world economies.

On the demand side, ‘first-round’ demand shocks resulting from sudden drops in household income are likely to propagate to the rest of the economy through Keynesian multipliers. Unlike recent epidemic shocks that tended to be short and sharp, today, the duration is less clear.\(^6\) This is likely to generate considerable uncertainty regarding the spread of the virus and the capacities of governments to manage the situation. Combined, these uncertainties will put further downward pressure on aggregate demand that is likely to hurt domestic investments and consumption. Indeed, the Keynesian multiplier effects are likely to be smaller if uncertainty and risk-aversion prevail across the population and the business community. The negative impacts of COVID-19 on domestic demand for non-tradable services is also likely to become substantial if it takes a long time to contain the infection.

Following a collapse in global demand, oil prices have fallen sharply in 2020. Despite a slight correction in price, the recovery is expected to be slow (see Figure 2.5).

\(^4\) Baldwin and Mauro (eds.), 2020, op. cit.

\(^5\) The purchasing managers’ index\(^\text{TM} \text (PMI\textsuperscript{®})\) is derived from individual diffusion indices which measure changes in output, new orders, employment, suppliers’ delivery times and stocks of purchased goods. Scores above 50 signal an improvement in business conditions on the previous month, while scores below 50 show a deterioration.

\(^6\) Baldwin and Mauro (eds.), 2020, op. cit.
Hence, the region’s economies should be prepared for a prolonged low oil price environment. Combining this with the labour market dynamics in the region, it is expected domestic output could be subdued for some time, with the shock continuing to impact the labour market in the medium and long term.

Looking at some of the main transmission channels of the economic shock in the region, capital outflows have witnessed major increases since the onset of the pandemic, with emerging markets as a whole losing $83 billion in March, before recovering somewhat in April and May. It is projected that capital flows to the region will be significantly lower over the year 2020 compared to the relatively high levels of 2019. According to the Institute of International Finance (IIF), the largest drop is expected to be in portfolio investments, with equity investment inflows falling by as much as sixty percent and debt by about one third. FDI is also expected to drop by about one quarter compared to 2019.

Another important transmission channel in the region is represented by the tourism and hospitality industry. Plummeting international demand and an ongoing patchwork of international travel restrictions have led to significant decreases in revenue for countries such as, Bahrain, Egypt, Jordan, Saudi Arabia, Lebanon, Qatar, Tunisia, and the UAE, in which tourism constitutes an important economic sector. Recent estimates of GDP losses due to falling international tourism show that Morocco could lose 7 percent of its GDP, Egypt could lose 6 percent and the GCC could lose 3 percent, all in the intermediate scenario (assuming a fall in inbound tourism expenditure of two thirds for each country).  

Looking at overall trade trends, it is expected that global trade could fall by between 13 and 32 percent compared to 2019 volumes, although COVID-19 is likely to reinvigorate online activities in the retail, health and education sectors. Moreover, besides oil, other important commodities’ export receipts to the region are likely to fall, including crude potash, crude phosphate and fertilizer exports. In addition, as noted in the previous section, the prospects for export earnings rebounding after 2020 will largely depend on demand patterns emerging from the main trade partners of the region – i.e., the EU, China and the US.

To make things worse, shrinking OECD economies will inevitably lead to ODA decreases in absolute terms, even if donors reaffirm their ODA/GNI ratio commitments, and even after a full recovery is achieved, changes made to aid policies could outlast the current crisis and affect development funding for years to come.

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In sum, the expected economic impacts on the region so far could be transmitted through the following channels:

a. containment measures reducing labour mobility;

b. rising costs of doing business, and disruption of production networks and supply chains;

c. reductions in consumption and simultaneous shifts in consumer preferences, partly generated by changes in income and prices;

d. widening current account deficits and increasing external debt;

e. a freeze in domestic and foreign investment decisions;

f. reductions of remittance inflows;

g. a drop in ODA inflows;

h. a rise in the equity risk premiums of large companies;

i. increases in country risk premiums based on sudden exposure to vulnerabilities resulting from changing macroeconomic conditions; and

j. the inability of governments to maintain/increase expenditure and support key sectors.

As a result of the above – and with all the mentioned caveats – the IMF’s World Economic Outlook provides a useful first attempt at quantifying the macroeconomic effects of the lockdowns and falling oil prices. According to April’s revised IMF forecasts, (unweighted) economic growth in the Arab region is projected to fall from 1.8 percent in 2019 to -6.6 percent in 20209 – corresponding to a weighted average growth of -2.7 percent in 2020 – which would be worse than the recession during the 2008 global financial crisis and the 2014 oil price drop, with all countries in the region hovering in the negative quadrant this year (the only exceptions being Djibouti and Egypt, for the time being). When growth is estimated in per capita terms, the picture looks even bleaker, placing all countries in the negative quadrant.

However, the difficulty of performing economic forecasting in the present circumstances becomes apparent when we compare the IMF forecasts for the years 2020 and 2021 performed in April 2020, with the latest forecasts from the World Bank, performed in June 2020 – which are quite different from the former as reported in the graphs below, particularly in the case of Iraq, Kuwait, State of Palestine and Sudan.

9 The estimated weighted average regional growth for 2021 is 4.5%. Calculations do not include Lebanon (2021), Palestine and Syria (both years). The estimated weighted average regional growth rates are -2.7 percent and 4.5 percent for 2020 and 2021, respectively. Calculations do not include Lebanon (2021), Palestine and Syria (both years).
More worrying, although it is very difficult to foresee future economic dynamics from within this unique crisis, the economic recovery is unlikely to be V-shaped, with the region’s economies bouncing back in 2021; rather, for many economies in the region the recovery is likely to be U-shaped and in some cases – most notably oil-based and service-based economies – W-shaped or even L-shaped. This is because, on the one hand, nobody knows if there will be resurgent waves of infection, and if so, how long they will last before a vaccine is produced and is accessible to the whole population; while on the other hand, current
projections suggest that oil price may recover slowly—
gradually converging to $45 per barrel through 2022.10

Almost all countries in the region will undergo fiscal and
current account deficits in 2020, and over half of deficits will
run to double digits, particularly in oil exporting and fragile
countries. An important component driving down current
accounts in some countries — particularly the lower-
middle-income economies — will be the sizeable drop in
remittance inflows predicted in chapter 4 of this report.

External borrowing costs have started rising across
the region, posing major challenges for countries with
financing needs, including those below investment
grade (see Figure 2.9). According to the UN Secretary-
General’s report, the region’s fiscal revenue is forecasted
to record a loss of about $5 billion in import tariffs and
about $15 billion in other indirect taxes, including value
added tax and consumption taxes.11 This means that
responding to the crisis will increase fiscal deficits
that in many cases will exceed 10 percent and are
likely to be financed by increased borrowing and a
higher debt burden for many countries in the region,
particularly those lacking a prime sovereign rating.
Many of these countries already have a substantial
debt burden (see Figure 2.10), including external debt.

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10 According to the April edition of the World Bank’s Commodity Markets Outlook report, oil is expected to average $35 per barrel in 2020. The International Monetary Fund expects the global demand for oil to decrease by 29 million barrels per day (mbpd) in 2020.

More worrisome is that external debt as a share of the sum of merchandise exports, services and income receipts has exceeded 150 percent in the majority of the countries of the region since 2016 and — according to IIF projections — will rise further in 2020 (see Figure 2.11).

Indeed, an important transmission channel to monitor closely in the region will be the financial sector. As businesses and households borrow to finance the purchase of their durables or to invest, they count on incoming revenue to service their debt. If this double shock leads to a sudden halt to, or major reduction in, revenues, this could result in liquidity problems which may become solvency problems for many households and businesses, depending on the duration and depth of the shock as well as on the ability of the region’s economies to recover. Non-performing loans, however, will not show up immediately; rather, they will presumably emerge towards the end of the year as well as in 2021.

Estimates of GDP loss using night-time light satellite imagery

In the last two decades, data from outer space have been increasingly employed to produce alternative measures of GDP, as well as to assess the accuracy of official projections and facilitate evaluations of other multifaceted phenomena. Such tools have allowed economists to construct various proxies for macroeconomic indicators that cover periods and regions for which GDP data may not be available or reliable (due to natural disasters, conflict, etc.). The main advantages of these new techniques concern their potential to overcome problems of accessibility and reliance on near-real-time information.

The inversion in mean night-time light (NTL) between January and March of 2020 is evident in Figure 2.12, which refers to Egypt. Indeed, historical luminosity over the period 2014–2019 shows that the mean NTL in March is consistently higher than in January, while for the selected 2020 dates (i.e., pre- and post-COVID-19 outbreak), the opposite is true. While this is expected, the result may be driven by the choice of specific date range and must therefore be interpreted with caution. Furthermore, 2020 data is not yet available in a monthly format and is thus not perfectly comparable to 2014–2019 observations. Nonetheless, it is highly unlikely

Source: The Institute of International Finance (IIF) Economic Database. Sudan’s external debt as a share of exports of goods, services and income, has exceeded 800% since 2012 and is expected to reach 1,200% in 2020. It was eliminated from the graph to make the other countries’ data easier to read.

Figure 2.11 Total external debt (percentage of exports)
that the results are purely driven by data availability issues, since the day-to-day variability of NTL data is not sufficient to justify a drop of this significance.

This section is an early attempt to use alternative methods to provide new estimates of the macroeconomic impact of COVID-19 and the restrictive measures that have ensued. Following the econometric procedure retrieved from Giovannetti and Perra (2020) and proposed by Henderson et al. (2012), the adopted empirical strategy estimates the coefficients which measure the responsiveness of GDP variation to change in night-time light (NTL) satellite imagery on a selected pool of countries from the region.

The coefficients of the elasticities have been obtained from the following regression:

$$GDP_{it} = \alpha + \beta_1 \text{NightLights}_{it} + \beta_2 X_{it} + \lambda_t + \delta_i + \epsilon_{it}$$

where: $GDP_{it}$ is the natural logarithm of the GDP per capita for each country $i$ in year $t$; $\text{NightLights}_{it}$ is the natural logarithm of the average digital number, extracted from NOAA (2013), for country $i$ in year $t$;

### Table 2.1 Dependent variable: GDP

<table>
<thead>
<tr>
<th>OLS</th>
<th>Linear panel</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Night lights</td>
<td>0.305***</td>
</tr>
<tr>
<td></td>
<td>(0.037)</td>
</tr>
<tr>
<td>Squared NTL</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Night lights per capita</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity consumption per capita</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>9.337***</td>
</tr>
<tr>
<td></td>
<td>(0.056)</td>
</tr>
<tr>
<td>Observations</td>
<td>333</td>
</tr>
<tr>
<td>R-squared</td>
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<tr>
<td>Adjusted R-squared</td>
<td>0.169</td>
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<tr>
<td>F statistic</td>
<td>68.462***</td>
</tr>
<tr>
<td></td>
<td>(df = 1; 331)</td>
</tr>
</tbody>
</table>

Note: *p<0.1; **p<0.05; ***p<0.01.

15 We use a panel composed of the World Bank MENA region without Israel and Malta.
**Table 2.2** Alternative estimates of the economic impact of COVID-19 using NTL data in 2020

<table>
<thead>
<tr>
<th>Country</th>
<th>Scenario 1</th>
<th>Scenario 2</th>
<th>Scenario 3</th>
<th>(annual %)</th>
<th>IMF (annual %)</th>
<th>World Bank (annual %)</th>
<th>AfDB (annual %)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Middle Income countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jordan</td>
<td>-2.1 (-0.3)</td>
<td>-2 (-0.29)</td>
<td>-2.8 (-0.4)</td>
<td>-2.8/-2</td>
<td>-3.7</td>
<td>-3.5</td>
<td>na</td>
</tr>
<tr>
<td>Morocco</td>
<td>-1.92 (-0.305)</td>
<td>-1.87 (-0.297)</td>
<td>-2.6 (-0.405)</td>
<td>-2.6 /-1.9</td>
<td>-3.7</td>
<td>-4.0</td>
<td>-5.4</td>
</tr>
<tr>
<td>Tunisia</td>
<td>-2.54 (-0.41)</td>
<td>-2.48 (-0.4)</td>
<td>-3.41 (-0.55)</td>
<td>-3.4 /-2.5</td>
<td>-4.3</td>
<td>-4.0</td>
<td>-4.0</td>
</tr>
<tr>
<td><strong>Gulf countries</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Qatar</td>
<td>-1.14 (-0.17)</td>
<td>-1.13 (-0.16)</td>
<td>-1.54 (-0.23)</td>
<td>-1.5 /-1.1</td>
<td>-4.3</td>
<td>-3.5</td>
<td>na</td>
</tr>
<tr>
<td>UAE</td>
<td>-1.53 (-0.26)</td>
<td>-1.48 (-0.24)</td>
<td>-2.04 (-0.34)</td>
<td>-2 /-1.5</td>
<td>-3.5</td>
<td>-3.8</td>
<td>na</td>
</tr>
<tr>
<td><strong>FCCs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lebanon</td>
<td>-10.28 (-1.46)</td>
<td>-9.99 (-1.42)</td>
<td>-13.6 (-1.93)</td>
<td>-13.6 /-10</td>
<td>-12</td>
<td>-10.9</td>
<td>na</td>
</tr>
<tr>
<td>Syria</td>
<td>-6.65 (-1.09)</td>
<td>-6.47 (-1.06)</td>
<td>-8.84 (-1.459)</td>
<td>-8.8 /-6.5</td>
<td>na</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Libya</td>
<td>-2.2 (-0.32)</td>
<td>-2.1 (-0.31)</td>
<td>-2.92 (-0.43)</td>
<td>-2.9 /-2</td>
<td>-58.7</td>
<td>na</td>
<td>-43.7</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations based on satellite imagery from NASA Worldview (https://go.nasa.gov/3anYhwR). Note: The projections for the whole of 2020 have been calculated following this proportion: \( GDP_{\text{drop}} = \frac{\text{data range} \times \text{lockdown}}{365} \) (e.g. the dates chosen for Morocco are: 28/01/2020 and 26/03/2020, which means 366/58 = 6.3. Thus, by inspecting Scenario 1: -0.305\*6.3 = -1.92).

\( X_{it} \) is a vector of covariates, namely population density and electricity consumption per capita\(^{17}\), for country \( i \) in year \( t \), \( \lambda_t \) are year-specific fixed effects; \( \delta_i \) are country-specific fixed effects (FE); and \( \epsilon_{it} \) is a stochastic error term. The fixed effects regression has been employed to account for time-invariant unobserved heterogeneity, which could alter the estimated elasticities; in parallel, FE allows us to deal with potential measurement problems, due to the variation over time of the sensibility of satellite sensor settings, which may alter the comparisons of raw digital number of pixel luminosity.\(^{18}\) The elasticities that have been utilized in the analysis are those estimated below for the period 1992–2013.

The estimated elasticities of GDP to NTL have been employed to calculate observational estimates of GDP loss. Thus, the estimated GDP decrease has been extrapolated by multiplying the estimated elasticities, of GDP to NTL, in each different specification, by the registered drop in NTL, as in Henderson et al. (2012):

\[
\text{GDP}_{\text{loss}} = \hat{\epsilon}^* \text{NTL}_{\text{RAW}}
\]

This procedure allows these simulations to compare the estimated decrease in GDP with official projections provided by the IMF, the World Bank and the AfDB. These alternative estimates may be considered as a new testing tool to link spatial information with economic parameters, offering a different perspective on each country’s economic outlook and the geographical distribution of the impact of a shock throughout the countries’ territories.

Three different scenarios have been calculated depending on the regressions employed for the econometric estimation of the elasticities of GDP to NTL (see Table 2.2).\(^{19}\) These scenarios provide the estimated GDP loss for the whole of 2020, by assuming that the January–March decrease would be constant for the entire year. The observational GDP decrease for the two months under investigation is reported in brackets, while the column labelled Range reports the GDP decrease interval from the three scenarios under consideration.\(^{20}\) The assumption of constant trends is extremely strong and to some extent optimistic, thus the results must be interpreted with

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18 Henderson et al., 2012 Op. cit..

19 Scenario 1 corresponds to an OLS regression; Scenario 2 and Scenario 3 are FE regressions regressed on NTL per capita and electricity consumption per capita, respectively.

20 The estimates have been calculated focusing only on those regions that have experienced a drop in luminosity for the time range of the analysis.
a degree of caution. Indeed, compared to the official estimates of the IMF, WB and AfDB, the upper and lower bound of the estimated projections of the Range column appear to be slightly less negative, although consistent. This may be due to the fact that the time span of the analysis is too short to take into consideration the domino effect generated by the lockdown measures on the economy as a whole. In particular, they are not able to consider the economic repercussions of the slowdown in the global values chain, a global recession and the rise in debt levels experienced by these already fiscally constrained economies. Moreover, another reason for the less pessimistic estimates of GDP may stem from the fact that NTL properly reflects investments in physical capital and infrastructure, whereas they are less able to capture the value added generated by other types of industries – e.g. the service sector – that have been equally hit by the imposition of lockdown restrictions. However, the range of the estimates of GDP drop appear to be in line with the official forecasts for most of the countries. The only exceptions seem to be Libya and Egypt. For Libya these discrepancies do not alter confidence in the results, since its situation of protracted crisis is a crucial confounding driver of the economic and social crisis. Therefore, the estimated GDP drop calculated using this procedure may have only captured a small fraction of the devastating effects of the conflict. For Egypt, this could be due to the fact that the estimation of GDP using NTL may be driven by the results of specific areas that have experienced a strong decrease in emitted luminosity during the lockdown period.

More specific impacts in the three sub-regions

Oil-exporting countries

According to analysts, the oil-exporting countries are set to experience their worst recession in history. The most recent IMF forecasts suggest that this entire group of countries is set to be in negative territory, ranging from about -1 to about -5 percent. According to the Institute for International Finance (IIF), real GDP in the GCC subregion is estimated to contract by 4.4 percent in 2020 with oil GDP projected to contract by 5.3 percent and non-oil GDP by 3.8 percent. However, growth forecasts are expected

Figure 2.13 United Arab Emirates and Saudi Arabia PMIs

Source: Markit, 3 June 2020.

21 Using a simple ‘back of the envelope’ calculation to estimate the size of the income effect of an oil price drop – i.e. multiplying net oil exports as a share of GDP by the percentage point drop in the oil price – and based on last May’s average price, it is easy to see how the majority of oil-exporting countries in the region could experience a decline in GDP of over 10% in the first part of the year compared to 2019.

22 For example, in the June 2020 update, the IMF revised the growth forecast for KSA downward from -2.3% to -6.8%.
particularly in the service sectors, including the tourist and construction sectors, among others (see figure 2.14).

For all countries in the sub-region, significant current account pressure is expected, which, according to the latest IMF forecasts, is predicted to be particularly severe in Algeria (-18.3 percent) and Oman (-14.2 percent) as well as in Kuwait and the UAE which are set below -10 percent.

The IIF also forecasts a decline in hydrocarbon revenue in the sub-region from $326 billion in 2019 to $200 billion in 2020 and expects the aggregated fiscal deficit to widen drastically from 2.5 percent of GDP in 2019 to 10.3 percent in 2020, assuming an average oil price of $40 per barrel. For Algeria, Bahrain and Oman, the new oil price drop came while the countries were still grappling with the effects of the 2014 oil price shock, since which point each of these states has been running significant deficits. Moreover, countries such as Algeria, Kuwait and Oman spend a significant portion of their government budget on public wage bills, which for political-economy reasons can be difficult to reduce. In Bahrain, expenditure has increasingly shifted towards interest payments as the country struggles with mounting public debt. Debt as a share of GDP is projected to steadily increase in Bahrain and Oman. Conversely, Saudi Arabia, Kuwait, Qatar and the UAE, with large foreign assets, are better placed to accommodate large deficits.

![Dubai sector PMIs](image-url)

**Source:** Markit, 11 May 2020.

This negative outlook has been supported by high-frequency data such as headline purchasing managers’ indices (PMIs) in Saudi Arabia, the UAE and Qatar, which declined to less than 45 in April, the lowest level since the surveys began in 2009 (see Figure 2.13).

Sector-based PMIs confirm that the shock will be felt to be revised downward. This negative outlook has been supported by high-frequency data such as headline purchasing managers’ indices (PMIs) in Saudi Arabia, the UAE and Qatar, which declined to less than 45 in April, the lowest level since the surveys began in 2009 (see Figure 2.13).

![Fiscal breakeven oil price (past and projections) (in USD/barrel)](image-url)

**Source:** Elaboration based on IMF data.

**Note:** Although Iraq and Libya are reported in the FCC category, for the purposes of comparison they are also included in this chart.
Also, as a result of fiscal consolidation and new VAT receipts, lower fiscal breakeven oil prices are estimated for Saudi Arabia and Qatar in 2020 compared to 2019. Yet, at the same time, Algeria is expected to record an historical spike in breakeven price (see Figure 2.15).

According to IIF projections, oil exporting countries will witness the largest capital flights from the region in 2020, largely due to a sharp decline in foreign portfolio investments. Saudi Arabia tops the list at $17 billion, mostly in equity. Bahrain, the UAE, Qatar and Oman are also projected to lose foreign capital in the order of $5–6 billion each, mostly due to declines in foreign debt portfolio investments. FDI will not be affected as much, however, as flows are expected to remain relatively stable compared to 2019 – except for the UAE and Oman.

### Oil-importing middle-income countries

In these countries, the economic impact of the shock is likely to be propagated mainly across their service sector and through some financial transmission channels including lower remittances, ODA and FDI flows, both extra- and intra-regional.

These economies are heavily reliant on services, including tourism; therefore, the impact of the twin shock may be particularly long-lasting, as so many people have been unable or unwilling to use services such as restaurants and cinemas, or to travel, and are unlikely to “make-up” that demand once the situation returns to relative normality.

The more open, developing oil-importing economies are seeing a reduction in the export of goods and services upon which they depend to a relatively large degree. Significant current account pressure is expected through lower non-commodity exports, including particularly Moroccan and Tunisian exports to the EU, which will add to the contraction of domestic demand. Secondly, many other commodity prices have also dropped in response to lower global economic growth, which is likely to impact the exports of Jordan and Morocco, for example, because they are major phosphate and potash exporters – both commodities that have dropped in price.

Moreover, while these countries benefit from lower import payments for oil and gas products, they will also see a lower inflow of remittances from oil-exporting countries, which are a main source of foreign exchange receipts. Therefore, according to the IMF, countries such as Morocco and Tunisia are expected to run significant current account deficits this year, hovering around 7.8 and 7.5 percent of GDP, respectively. Countries with a flexible exchange rate such as Egypt might be able to absorb part of the current shock by devaluing. However, these countries may also need to be better equipped against the risk of a dry-out of hard currencies exposing depreciation of their national currencies.

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23 The oil price at which the fiscal balance is zero.
Finally, as these economies have historically run significant deficits – which will be aggravated in 2020 – and are also forecasted to shrink, debt-to-GDP ratios are likely to rise significantly as of this year. This will happen most notably in Egypt, Morocco and Tunisia – where the debt-to-GDP ratio is expected to rise and approach 80 percent – while in Jordan it is projected to be over the psychological threshold of 100 percent. Presumably, the relief provided by the lower oil price on the fiscal balance of these economies is expected to be limited, given that they have already taken concrete steps to reduce energy subsidies in the recent past.

External borrowing to fund the larger government deficits is expected to be increasingly difficult for countries in this sub-regional category, which are facing large outflows of portfolio investments. Egypt is projected to witness the largest capital outflow in this group, with a decline in its foreign debt portfolio.
investment of over $9.5 billion in 2020 according to IIF projections.

As a result, some of these countries may face higher interest rates or other difficulties accessing the international financial market.

**Fragile and crisis-affected countries**

These countries tend to have a relatively high demand-side exposure to shocks, with consumption being the main transmission channel of the twin shock, rather than supply. This is the group for which the macroeconomic impact is set to be disproportionally higher through its growth, fiscal and current account declinations, among other aspects. Moreover, while these are the countries in which the most investment will be needed to cope with the twin shock, they are also the ones with the least financial resources.

By way of an example, even the wealthiest of countries in this group – Lebanon – recorded another

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**Figure 2.19**  Lebanon PMI (left) and employment index (right)

![PMI and Employment Index](image_url)

*Source: Markit, 3 June 2020.*

**Figure 2.20**  Summary of FCCs macroeconomic data (%)

![Macroeconomic Data](image_url)

*Source: elaboration from IMF April 2020 forecasts.*
sizeable deterioration of its business conditions during May; the latest Lebanon PMI reported a score of 37.2 (although up from an historical low of 30.9 in April) driven by a further marked reduction in new business opportunities, with businesses hesitant to place orders amid uncertainty during the COVID-19 outbreak and the developing currency crisis (see Figure 2.19).

According to the IMF, in 2020, double-digit inflation is expected in some fragile countries, such as Sudan, Lebanon and Libya, where there is early evidence that purchase prices are increasing fast. In Sudan for instance, the prices of various staple foods have increased to record highs in March following a further devaluation of the country’s currency (FAO, 2020). Food prices have been skyrocketing in Syria as well. Inflation is also likely to be driven by currency devaluation in some of these countries due to a sudden drop in their supply of hard currencies provided through remittances. In Lebanon, for example, in June, the Lebanese pound precipitously depreciated against the US dollar in the parallel market, crossing the 9,000 LP mark on the black market.

Moreover, public debt-to-GDP ratio risks reaching unsustainably high levels, such as in the cases of Lebanon and Sudan with 151 and 212 percent of GDP, respectively. Both Lebanon and Sudan also have sizable external debts.

Policy review in the three subregions

Government responses

The historical challenge facing governments is dual and specular: on the one hand, they aim to flatten the infection curve domestically by imposing social distancing and investing in the healthcare system (see Figure 2.21). However, flattening the curve may steepen the economic recession curve, unless tailored economic policies are put in place and implemented well. Therefore, in the economic realm too, the challenge will be to flatten the recession curve.

![Figure 2.21 The infection and economic recession: Potential trade-off](source: Images taken from Gourinchas, P.-O., Flattening the pandemic and recession curves, VOXEU CEPR, 3 June 2020 (https://voxeu.org/article/flattening-pandemic-and-recession-curves)).

This multi-faceted crisis will require carefully coordinated monetary, fiscal, social, health and other sector policy responses. Governments in the region, like many other governments around the world, have tried to adopt immediate support measures to help the population and the business sector to cope with the crisis. Monetary policy interventions have often been complemented by fiscal stimulus packages. In most cases, fiscal policies have sought to enhance the capacities of national health systems to tackle the pandemic, but they have also

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25 The official rate is at 1500 LP/USD.
covered support measures to mitigate income losses for various vulnerable segments of society and to sustain businesses. Deferred tax and loan payments and concessional loans – in some cases, interest-free – have been among the major policy measures implemented to support businesses and particularly SMEs. In some Arab countries, however, the effectiveness of monetary and fiscal policies may be limited due to weaker financial markets, sizeable informal economies, limited fiscal space and capacity to provide targeted support.

To summarize, the most common measures adopted so far include:

**Fiscal response**

**Support to the population:**

a. Pay bonus for health care workers.

b. Cash pay-out to some population groups, particularly those considered vulnerable.

c. Suspension of payments for utility bills.

d. Tax deductions, freeze, reductions

**Support to businesses:**

a. Subsidized short-term employment schemes.

b. Sector-specific financial support for tourism, accommodation and aviation.

c. Broad-based financial help for businesses, including absentee payroll.

d. Financial support for workers.

e. Reduction in profit tax and low interest loans for SMEs.

f. Targeted bank liquidity provision conditioned on bank lending to SMEs.

g. Liquidity support to banks.

h. Suspension of employers’ payments of social security.

i. Tax deductions, freeze, reductions.

j. Supply chain diversification.

**Monetary and macro-financial responses**

a. Cut interest policy rates (which were not close to zero, unlike in many western countries).

b. Relaxed capital provisioning and reserve requirements for the banking sector.

c. Quantitative easing.

Some countries – such as Iraq, Jordan, Lebanon and Morocco – introduced new charity relief mechanisms to support vulnerable groups by encouraging solidarity in society.

Central banks across the region continue to provide liquidity to the banking sector, which remains the key component of the financial system in the region and the most probable source of their exposure during the crisis. This is likely to translate into increased contingent liabilities for relevant government budgets in the medium-term.

Overall, the extents of the stimulus packages launched by governments have been heterogeneous across the region, with some GCC countries putting in place unprecedented packages amounting to more than 10 percent of GDP, while many LDCs and FCCs have been unable to fund packages in excess of a few decimal points of GDP. Many countries have stepped up transfers and subsidies to households and SMEs. However, several governments were caught unprepared given their limited capacity to target the neediest, which is likely to trigger further frustration and resentment across their populations.

Currency depreciation and some form of capital control can be expected in some countries in the near future.

In Table 2.3 below, we report the main categories of economic policy support, including their average size at the regional and global levels. One can easily see that the region has put in place smaller fiscal stimuli and used relatively fewer policy instruments but has had more room to reduce interest rates compared to the rest of the world.

When it comes to trade, inconsistent measures have been adopted in the region. Indeed, while on the one hand, export and tariff barriers have been widely adopted, on the other hand, trade facilitation measures have also been enacted. Overall, in the past few months, Arab governments have adopted 58 trade-related measures in merchandise trade – including those dealing with market access; reduction of tariffs; sanitary and phyto-sanitary measures; technical barriers to trade measures; bans on exportation of medical supplies; and restrictions of exports of foodstuffs – and three measures in trade in services (see Figure 2.22).

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26 For a more detailed review of the policy measures see Annex III.

Regardless of the economic policies adopted, clear, well-thought-out and transparent government communication about the measures being implemented would help a great deal in their effectiveness and economic impact, particularly in a prolonged extension of the pandemic.

Oil-exporting countries’ responses

The response of these countries has been quite articulate, with a range of fiscal and macro financial policy initiatives, coupled with plans to cut or delay non-essential spending. For example, Oman announced that it will reduce spending in the 2020 budget by 10 percent (about 5 percent of GDP); Saudi Arabia intends to reduce spending in non-priority areas by about 2 percent of GDP, and Algeria has announced its intention to lower current spending by 30 percent and cut the import bill by at least 6 percent of GDP.

Using the database prepared and regularly updated by Elgin et al. (2020), one can see that these countries have used interest rate cuts and macro-financial measures, in particular, to tackle the twin crises. On top of these measures, Qatar has also put in place an expansionary fiscal stimulus package (see Table 2.4).

Oil-importing middle-income countries’ responses

As is well known, developing oil-importers have few resources, poor infrastructure and high underemployment and unemployment. Yet the savings afforded to governments from the fall in oil prices and drop in demand for heavily state-subsidized fuel could help to widen social safety nets during this crucial time.

As is to be expected, the adoption of various policy measures has been more limited compared to the oil-exporters and the rest of the world (see Table 2.5).

In an attempt to alleviate some of these pressures in the short term, Egypt, Jordan and Tunisia, upon their
### Table 2.4  Policy measures adopted in the OEC sub-region

<table>
<thead>
<tr>
<th>Country</th>
<th>Fiscal policy stimulus (%)</th>
<th>Interest rate cut (%)</th>
<th>Reserve requirements (% cut)</th>
<th>Macro-financial package (% of GDP)</th>
<th>Other monetary measures dummy</th>
<th>BoP measure (dummy)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>-2.2**</td>
<td>14.3</td>
<td>40.0</td>
<td>0.0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Bahrain</td>
<td>5.5</td>
<td>52.3</td>
<td>40.0</td>
<td>28.0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Kuwait</td>
<td>1.4</td>
<td>45.5</td>
<td>19.2</td>
<td>0.0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Oman</td>
<td>-5.0**</td>
<td>60.0</td>
<td>50.0</td>
<td>26.2</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Qatar</td>
<td>13.0</td>
<td>43.7</td>
<td>0.0</td>
<td>1.5</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>-2.8**</td>
<td>63.5</td>
<td>0.0</td>
<td>4.0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>2.0</td>
<td>62.5</td>
<td>50.0</td>
<td>7.8</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td><strong>SUB-REGION AVERAGE</strong></td>
<td>1.7</td>
<td>48.8</td>
<td>28.5</td>
<td>9.6</td>
<td>100%</td>
<td>14%</td>
</tr>
<tr>
<td><strong>REST OF THE WORLD AVERAGE</strong>*</td>
<td>4.8</td>
<td>19.9</td>
<td>20.1</td>
<td>3.6</td>
<td>95%</td>
<td>28%</td>
</tr>
</tbody>
</table>

**Source:** dataset from Elgin et al. (2020), updated 6 June 2020.

**Notes:** **fiscal policy stimulus to GDP ratios for Algeria and Saudi Arabia encompass the increase in spending on health and other areas, as well as the announced reduction of spending on non-priority areas. For Oman, the ratio refers to the reduction of spending by 10% in the 2020 budget; *average calculated without the Arab countries.

### Table 2.5  Policy measures adopted in the OIMIC sub-region

<table>
<thead>
<tr>
<th>Country</th>
<th>Fiscal policy stimulus (%)</th>
<th>Interest rate cut (%)</th>
<th>Reserve requirements (% cut)</th>
<th>Macro-financial package (% of GDP)</th>
<th>Other monetary measures dummy</th>
<th>BoP measure (dummy)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Djibouti</td>
<td>2.4</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Egypt</td>
<td>1.8</td>
<td>23.5</td>
<td>0.0</td>
<td>2.2</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Jordan</td>
<td>0.5</td>
<td>37.5</td>
<td>28.6</td>
<td>1.7</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Morocco</td>
<td>2.7</td>
<td>11.1</td>
<td>0.0</td>
<td>0.0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Tunisia</td>
<td>1.8</td>
<td>12.9</td>
<td>0.0</td>
<td>1.0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td><strong>SUB-REGION AVERAGE</strong></td>
<td>1.8</td>
<td>17.0</td>
<td>5.7</td>
<td>1.0</td>
<td>100%</td>
<td>20%</td>
</tr>
<tr>
<td><strong>REST OF THE WORLD AVERAGE</strong>*</td>
<td>4.8</td>
<td>19.9</td>
<td>20.1</td>
<td>3.6</td>
<td>95%</td>
<td>28%</td>
</tr>
</tbody>
</table>

**Source:** dataset from Elgin et al. (2020), updated 6 June 2020.

**Note:** *average calculated without the Arab countries.

### Table 2.6  Policy measures adopted in the FCC sub-region

<table>
<thead>
<tr>
<th>Country</th>
<th>Fiscal policy stimulus (%)</th>
<th>Interest rate cut (%)</th>
<th>Reserve requirements (% cut)</th>
<th>Macro-financial package (% of GDP)</th>
<th>Other monetary measures dummy</th>
<th>BoP measure (dummy)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iraq</td>
<td>0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>1.0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Lebanon</td>
<td>1.9</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Libya</td>
<td>1.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Sudan</td>
<td>7.2</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Yemen</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td><strong>SUB-REGION AVERAGE</strong></td>
<td>2.4</td>
<td>0.0</td>
<td>0.0</td>
<td>0.2</td>
<td>33%</td>
<td>17%</td>
</tr>
<tr>
<td><strong>REST OF THE WORLD AVERAGE</strong>*</td>
<td>4.8</td>
<td>19.9</td>
<td>20.1</td>
<td>3.6</td>
<td>95%</td>
<td>28%</td>
</tr>
</tbody>
</table>

**Source:** dataset from Elgin et al. (2020), updated 6 June 2020.

**Note:** *average calculated without the Arab countries.
request, received financial assistance from the IMF under the Rapid Financing Instrument (RDFI) scheme. Other Arab countries such as Djibouti received other assistance including debt service relief.

**Fragile and crisis-affected countries’ responses**

This country group has adopted heterogeneous policy measures; Sudan, with the help of the donor community, has adopted a sizeable fiscal stimulus package, while other countries put in place very limited measures, if at all, as in the case of Yemen (see Table 2.6).
Policy Recommendations

Fiscal policy has a wide spectrum and while an excessive dispersion of its measures could dilute the impact, a high concentration of these measures may risk missing important segments of the business community and the population. Important trade-offs are at play in a context of limited fiscal space and the careful design and implementation of fiscal interventions is of the utmost importance.

Additional government spending should be first directed at the health sector to prevent and contain the propagation of virus and treat patients.

With regard to fiscal policy, options include providing households with temporary support to shield them from income losses caused by work shutdowns and layoffs.

A reallocation of governments’ budgets will be most likely needed in many countries, including the rationalisation of current expenditures through a thorough review and re-purposing of existing public sector spending.

Expanding temporary liquidity buffers for firms can also be helpful to avoid debt accumulation. This should be conducted while monitoring market dynamics across the different sectors to avoid excessive liquidity that might pose inflationary pressures.

Reducing temporarily fixed charges and taxes would also ease the pressure on firms and households most affected by the shock.

In case of emergency, an injection of hard currencies could be created by using swap agreements in close coordination with central banks.

As we will see in the final part of this report, the twin crises can also present an opportunity to pursue reinvigorated national discussions and development plans that promote the investment of scarce budgetary resources in high-growth areas that would allow to diversify the economies in the region.

The present crisis can also provide an opportunity to enhance regional integration. On the economic policy front, if countries announced coordinated policy support, confidence effects across the region would compound the effect of these policies.
With regard to trade-related measures:

a. Adoption of practical measures to minimize the impact of disruption of the supply chain among Arab countries is a necessity, taking into account the composition of merchandise trade and the economic structure of their economies. The integrity and viability of the supply chain is essential to secure populations’ access to necessary medicines, medical supplies, personal protection equipment, foods and other necessities.

b. Responding to uncertainty in the global market, Arab countries must diversify their international supply chains instead of relying exclusively on one large supply chain. In this regard, fostering the development of Free Zones into regional hubs could promote the establishment of regional supply chains, closer to the distribution of manufactured goods and merchandise.

c. Arab countries must act collectively and adopt common policies to deepen regional integration. In this regard, the removal of unnecessary non-tariff measures and acceleration of facilitation of trade and investment is imperative. This should be accompanied by a new governance framework of regional cooperation in economic development and trade.

It is also recommended that regional programmes in trade facilitation, and the adoption of digitalization in the provision of public services, both be accelerated. Capitalizing on the potential of new technologies, attention should also be given to the supply of services through digital means.