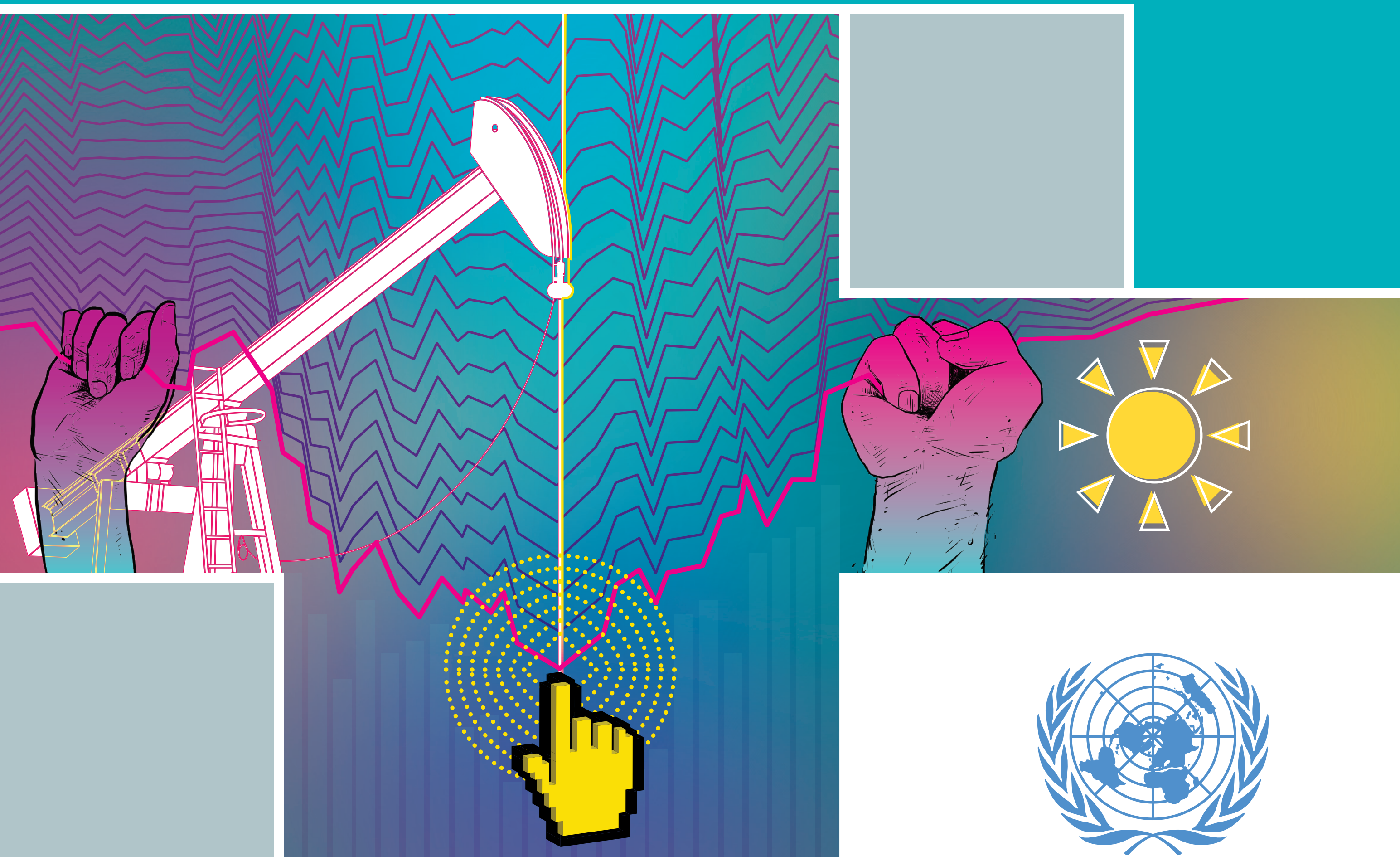
Survey of
Economic and Social Developments
in the ESCWA Region

2011-2012



ESCWA

United Nations Economic and Social Commission for Western Asia

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Preface

While the attention of the international community is focused on the political instability and social unrest, the socioeconomic situation in the Arab region is advancing. Economic and social issues in the region have often been highlighted as the underlying cause of the Arab Spring. The unemployment rate in the ESCWA region – which consists of Arab countries and Palestine - is one of the highest in the world. Looking back, we see that political frameworks, which suddenly became a target of political and social unrest during the Arab Spring, had once stood for people's aspiration for upward social mobility. In recent years, however, the younger generations' economic and social aspirations increasingly result in disappointment. Rigid social stratification made them unable to find upward social mobility when entering domestic labour markets. Wasta, which implies 'connections' in Arabic, was often cited as the most important factor in landing a decent job in times of such limited opportunity. If the Arab Spring stands for the Arab transition of economic and social affairs, it carries high hope for a new society which fulfils people's aspirations for upward social mobility. However, the Survey of Economic and Social Developments in the ESCWA Region 2011-2012 (hereinafter referred to as the Survey) found that the economic and social reality remains deeply uncertain.

It became apparent that the lack of upward social mobility disappointed a significant number of youth in the region. Social stratification forming within each domestic context defines the economic and social lives for the countries' populations. Upward social mobility can bring about a sense of equality among social classes. However, with this lack of upward social mobility, one would feel a strong sense of impoverishment even when living above the absolute poverty level. Even with a better education than their parents, most of the youth today in the region are forced to either compete for limited domestic job opportunities, which are often jobs in the informal sector for which they are highly overqualified, or to emigrate abroad. Emigration is considered as a last resort for youth to accelerate upward social mobility. However, this option is becoming less and less viable for the region's youth as the global financial and economic crisis of 2008-2009 hindered the job growth in crucial labour markets abroad.

The first chapter of the Survey presents an assessment and analysis of the cyclical elements of economic and social conditions in the global context, using the most up-to-date data. The chapter discusses how the ESCWA region's economic and social developments have been impacted by recent global socioeconomic events. Despite the slow recovery in the United States of America and the looming recession in Europe, the external economic environment has been favourable for the ESCWA region. This is mainly due to buoyant international commodity markets, including oil sector. In fact, both crude oil production and prices recorded historical highs from 2011 to early 2012. The region witnessed a considerable increase in oil revenues which could potentially earn the label 'oil boom'. In the past, such booms produced positive spillover effects from major oil exporters to the rest of the region. The booms of the past manifested themselves in intraregional flows of people, goods, services and funds. As oil prices grew from 2003 to 2008, more people in the region found jobs in the booming sectors within the region, more people travelled within the region for commerce and tourism purposes, and more regional investors directly and indirectly funded projects in the region. However, the present record level of oil revenue failed to produce a region-wide ‘boom’ in 2011-2012: the spillover effects were stalled by instability.

Why is the year 2011-2012 not likely to be recorded as an oil boom? To answer this underlying question, the second chapter of the Survey reviews the state of socioeconomic developments in the ESCWA region. the Survey found that growth in the gross domestic product (GDP) between major oil producers, namely Gulf Cooperation Council (GCC) countries and Iraq, and the rest of the ESCWA region appeared to diverge. The subdued intraregional tourism, foreign direct investment and foreign portfolio investment clearly failed to produce a positive, region-wide spillover effect. Considering the risk sensitivity of tourists and investors, as well as the extent of political and social unrest in some countries in the region, this observation may be taken as granted intuitively. In one way, the polarization in GDP growth performance in the ESCWA region is a result of the Arab Spring.

The Survey points out that this emerging polarization could indicate further scope for economic and social pressure in the region. GDP growth performance is one sphere of polarization which characterizes the economic and social structure of the ESCWA region. Various spheres of polarization existed even before the Arab Spring. The most striking, considering the employment situation in GCC countries, is that the high chronic unemployment rate, particularly of the female workforce, is common in the region. The standard of living between the employed and unemployed has widened. The positive spillover effect of the oil boom throughout the region, through the flows of people, goods, services and funds, was one of few hinges that prevented the region from being locked into extreme economic and social polarization. This last hinge is at risk of being broken down. If the region’s economic and social gravity points to further polarization, the organized and managed transition under the direction of the region’s policymakers would be more difficult.

Following the result of Egyptian presidential election in June 2012, Egypt’s stock prices surged; this fact indicates that the Arab Spring could bring about economic and social fruits. A sign of political stability alone will send a positive signal to financial markets, economic actors and their social interactions. However, markets could fail to react in a positive way in this transitional period because of its extreme risk sensitivities. In order to fill the gap of possible market failure, a relevant set of regional cooperation schemes may need to be articulated in order to prevent the region from further polarization and to seek further regional integration. Any leap towards regional integration may be difficult in the light of intensifying political and social unrest in some countries in the region at present. However, history shows that regional integration can be progressed for economic and social benefits in spite of frequent political divides that occur in the process. ESCWA is convinced that the snapshot of the region shown in the Survey points to the urgency to consider the Arab Spring as a positive thrust for completing the Arab transition through efforts for regional integration.

Contents

Abbreviations

AMF	Arab Monetary Fund
BHD	Bahraini dinar
CBE	Central Bank of Egypt
CBI	Central Bank of Iraq
CBJ	Central Bank of Jordan
CBOS	Central Bank of Sudan
CBS	Central Bank of Syria
CIS	Commonwealth of Independent States
CMI	Chiang Mai Initiative
CPI	Consumer price index
CRB	Commodity Research Bureau
DESA	Department of Economic and Social Affairs
ECB	European Central Bank
EIA	Energy Information Administration
EMU	European Monetary Union
ESCWA	Economic and Social Commission for Western Asia
ESM	European Stability Mechanism
FDI	Foreign direct investment
GCC	Gulf Cooperation Council
GDP	Gross domestic product
GRE	Government related entity
IFS	International Financial Statistics
ILO	International Labour Organization
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
LNG	Liquefied natural gas
MDE	More diversified economy
MDG	Millennium Development Goal
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
QE	Quantitative easing
SAIBOR	Saudi Arabia Interbank Offered Rate
SDG	Sudanese pound
SME	Small and medium enterprise
SWF	Sovereign wealth fund
SYP	Syrian pound
TRJ/CRB	Thomson Reuters/Jefferies CRB
WTI	West Texas Intermediate

CHAPTER I.

THE GLOBAL CONTEXT AND ITS IMPLICATIONS IN THE ESCWA REGION

I. THE GLOBAL CONTEXT AND ITS IMPLICATIONS IN THE ESCWA REGION

A. Global context

1. World economic developments in 2011-2012

The cautious optimism towards the state of world economy has been increasingly clouded by a series of recent economic events. The concern about a double-dip recession is growing. The world economy is now entering a difficult stage after an initial recovery period from the global recession of 2008-2009. The financial sector is still fragile as the value of assets remains stagnant. The subdued value of financial assets and real estate prevented the corporate and financial sectors from taking risks to expand their activities. Fiscal stimulus was the essential factor in having global demand buoyed for the initial economic recovery. However, with shrinking fiscal space, most Governments initiated fiscal consolidation to various extents by 2011, including fiscal austerity measures in several countries. The global consensus for active fiscal stimulus for economic recovery seen in 2009 was replaced by consensus for fiscal sustainability.

Sovereign debt distress in eurozone countries became one of the most notable economic events and continued to plague global economic sentiment. After months of political stalemate, eurozone area Governments took bold steps to reach an orderly sovereign debt workout arrangement for Greece, and European Union leaders also agreed to back a new fiscal compact treaty. Despite this, the eurozone crisis is still far from being settled and concerns about contagion to other larger economies in the eurozone remain. The credit rating for the United States' public debt obligations was downgraded in August 2011, which impacted financial markets worldwide enough to weaken market confidence. Moreover, the failure to reach agreement on the deficit reduction in November 2011 triggered automatic spending cuts of US$1.2 trillion to be spread over a ten-year period starting in 2013 in the United States.[1] During the same period, the level of Japan's public debt renewed its historical high for its reconstruction spending needs after the devastating earthquake of March 2011. Against this backdrop, the world gross domestic product is estimated to have increased by 2.7 per cent in 2011 compared to 4.1 per cent in 2010. The slowdown was most critical in developed countries, where the average growth margin became thin at 1.4 per cent in 2011 (see table 1).

The world gross domestic product is estimated to have increased by 2.7 per cent in 2011 compared to 4.1 per cent in 2010

Developing countries remained the main engine of growth, but their growth decelerated to reach 5.9 per cent in 2011. Growth in several major developing countries (Brazil, China, India, Russian Federation, South Africa and Turkey) is also slowing due to the tightening of domestic policy. This is partly due to a policy response: Brazil, China and India continued to carry out tighter monetary policies throughout 2011 amid accelerating inflation. In several sectors in developing countries, particularly in China, the wage rate has been rapidly increasing. The 'overheating' economies of major developing countries supported buoyant international commodity prices, including for energy, cereals and metals, in spite of the slow pace of economic recovery in developed countries.

The present commodity boom turned a double-edged sword for developing countries. Due to the hovering price of cereals, most developing countries experienced record high food prices. Though the prices peaked in the first half of 2011, prices remained high throughout the year. The 2011 annual food price index exceeded the 2010 annual index by 24 per cent.[2] Commodity exporters, such as oil exporting countries, could cope with the situation fiscally by utilizing increased export revenues. Meanwhile, commodity-importing countries could not cope with the situation through fiscal measures as their fiscal space had already been depleted. Though unpopular, subsidy reform on food and fuel products became a priority on policy agendas for many developing countries to maintain fiscal sustainability. As slower global growth prospects preclude immediate growth in export revenues for those resource-poor countries, the increasing import bills resulted in stagnation in the accumulation of foreign reserves.

Consequently, an increasing number of developing countries are facing tighter foreign exchange ceilings, which makes those countries more vulnerable to a balance-of-payment crisis. Although commodity-exporting countries could afford to cushion an adverse external economic environment for now, the extended dependency on commodity exports casts a shadow of uncertainty over their economic prospects amid the abrupt downward price adjustments taking place since May 2012.

The global outlook for 2012 is particularly gloomy and is characterized by significant downside risk. Slow growth, unresolved debt and deficit challenges in Europe, the United States and Japan erode market confidence. Optimistic assumptions forecast a global growth of 2.5 per cent in 2012. However, if the escalating European

Table 1. Growth and inflation 2009-2012: world and regional averages *(Percentage)*

	Real GDP growth rate				Consumer inflation rate			
	2009	2010	2011[a/]	2012[a/]	2009	2010	2011[b/]	2012[b/]
ESCWA region	1.5	5.7	5.1	3.8	4.3	4.8	5.4	6.4
World	-2.4	4.1	2.7	2.5				
Developed economies	-4.0	2.7	1.4	1.2	0.1	1.4	2.6	1.8
United States	-3.5	3.0	1.7	2.1	-0.3	1.6	3.0	2.1
European Union	-4.3	2.0	1.6	0.0	0.8	1.9	2.9	2.0
Japan	-6.3	4.4	-0.7	1.7	-1.4	-0.8	0.8	0.5
Economies in transition	-6.6	4.1	4.5	4.0	10.6	6.7	9.2	7.5
Developing economies	2.4	7.5	5.9	5.3	4.3	5.5	6.6	5.5
Africa	0.8	4.6	2.1	4.2	7.3	6.8	7.8	6.6
East and South Asia	5.2	8.8	6.9	6.3	2.9	5.0	6.2	5.0
Latin America and the Caribbean	-2.1	6.0	4.3	3.7	6.1	6.1	7.1	6.2

Sources: Figures for ESCWA region are calculations by ESCWA staff (see table 6 for details). Other figures are from the United Nations Department of Economic and Social Affairs publications World Economic Situation and Prospects 2012 (January 2012) and World Economic Situation and Prospects 2012. Update as of Mid-2012 (May 2012).
a/The Project LINK estimations as of May 2012.
b/The Project LINK estimations as of December 2011.

debt crisis and the weakness of the United States economy interact to create a downward spiral, the world economy could fall into a double-dip recession and global growth could fall to around 0.5 per cent.[3]

On the social front, global unemployment has remained high in 2011 at around 6 per cent (see table 2), and the rates are particularly high in some of the countries facing sovereign debt distress.[4] Youth unemployment soared globally, particularly in advanced countries; for example, it is estimated to be around 40 per cent in Spain. Youth unemployment is detrimental both in economic and social terms. At the individual level, the lack of economic opportunities creates psychological stress for the affected youth, which at the collective level represents potential for social unrest. Youth unemployment is extremely high in the various countries where social unrest took place, such as North Africa, Western Asia and some European countries (in particular the United Kingdom of Great Britain and Northern Ireland and Greece). The G20 meeting in Cannes, France, in November 2011 recognized the importance of employment generation and adopted the Cannes Action Plan for Growth and Jobs.

The alarming extent of youth unemployment called for a shift in social policy. A case-in-point is the United Kingdom, whose Government has set the principal goal of using social policy to improve social mobility.[5] Social mobility was defined by the Government as relating to "the degree to which the patterns of advantage and disadvantage in one generation are passed onto the next".[6] A lack of social mobility leads to the formation of fixed social classes over generations so that the social status of the preceding generation (namely, one's parents) determines the nature of one's economic and social lives. The increasing perception of unfairness, represented by social unrest in both developed and developing countries in 2011, could attribute to the lack of social mobility. With shrinking fiscal space, it is challenging for policymakers to implement effective social policy with a limited amount of economic resources. A new point of view, such as a social mobility-based perspective, is expected to identify effective scopes of policy intervention.

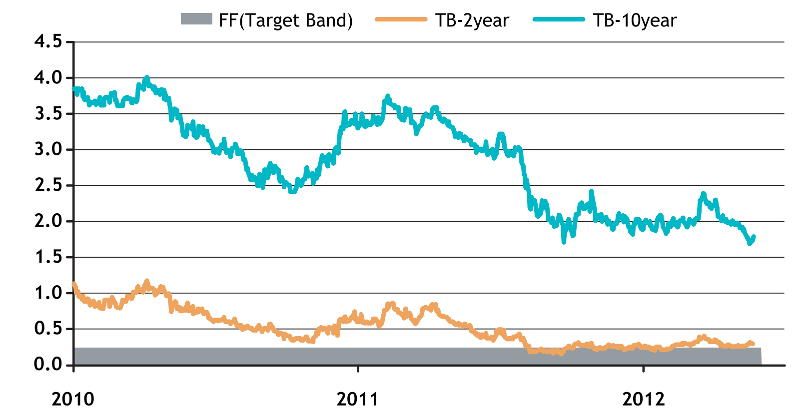
Table 2. Unemployment rates 2008-2012: world and regional averages *(Percentage)*

	2008	2009	2010	2011[a/]	2012[a/]
ESCWA region	9.3	9.8	9.3	10.3	11.4
World	5.6	6.2	6.1	6.0	6.0
Developed economies and the European Union	6.1	8.3	8.8	8.5	8.5
Central and Eastern Europe (non-European Union States) and the Commonwealth of Independent States	8.4	10.2	9.5	8.6	8.6
East Asia	4.2	4.3	4.1	4.1	4.1
South-East Asia and the Pacific	5.3	5.2	4.8	4.7	4.7
South Asia	3.7	3.9	3.9	3.8	3.8
Latin America and the Caribbean	6.6	7.7	7.2	7.2	7.2
Sub-Saharan Africa	8.1	8.2	8.2	8.2	8.2

Sources: Figures for ESCWA region are calculations by ESCWA staff (see box 3 in chapter 2 for details). Other world and regional averages are from table P1 (Unemployment 2007-11 rates) in the International Labour Organization publication Global Employment Trends 2012 (January 2012).
a/Preliminary estimates.

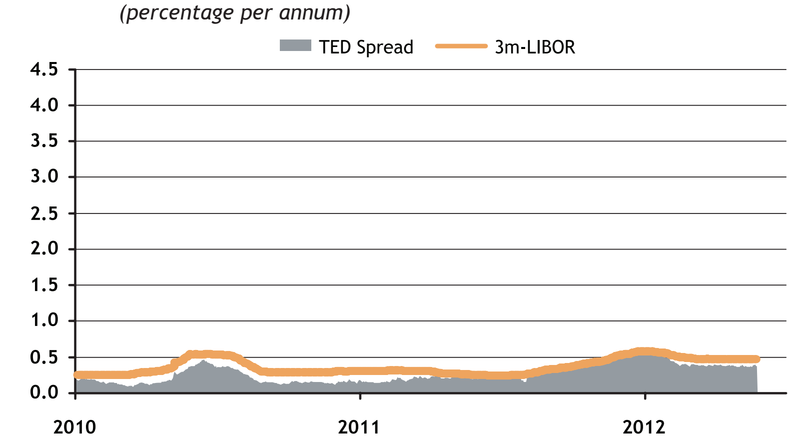
Figure I. Interest rates: United States dollar and euro 2010-2012

A. United States dollar *(percentage per annum)*



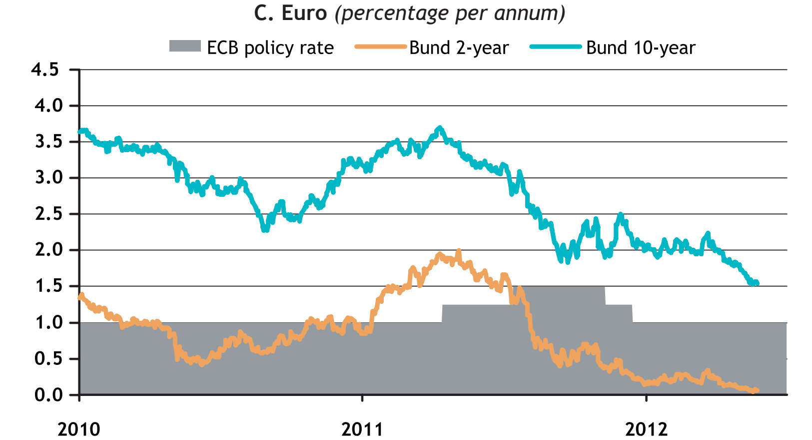
Source: Board of Governors of the Federal Reserve System, http://www.federalreserve.gov.

B. United States dollar three-month LIBOR and TED spread *(percentage per annum)*



Sources: Board of Governors of the Federal Reserve System, http://www.federalreserve.gov; British Bankers Association, http://www.bbalibor.com.

C. Euro *(percentage per annum)*



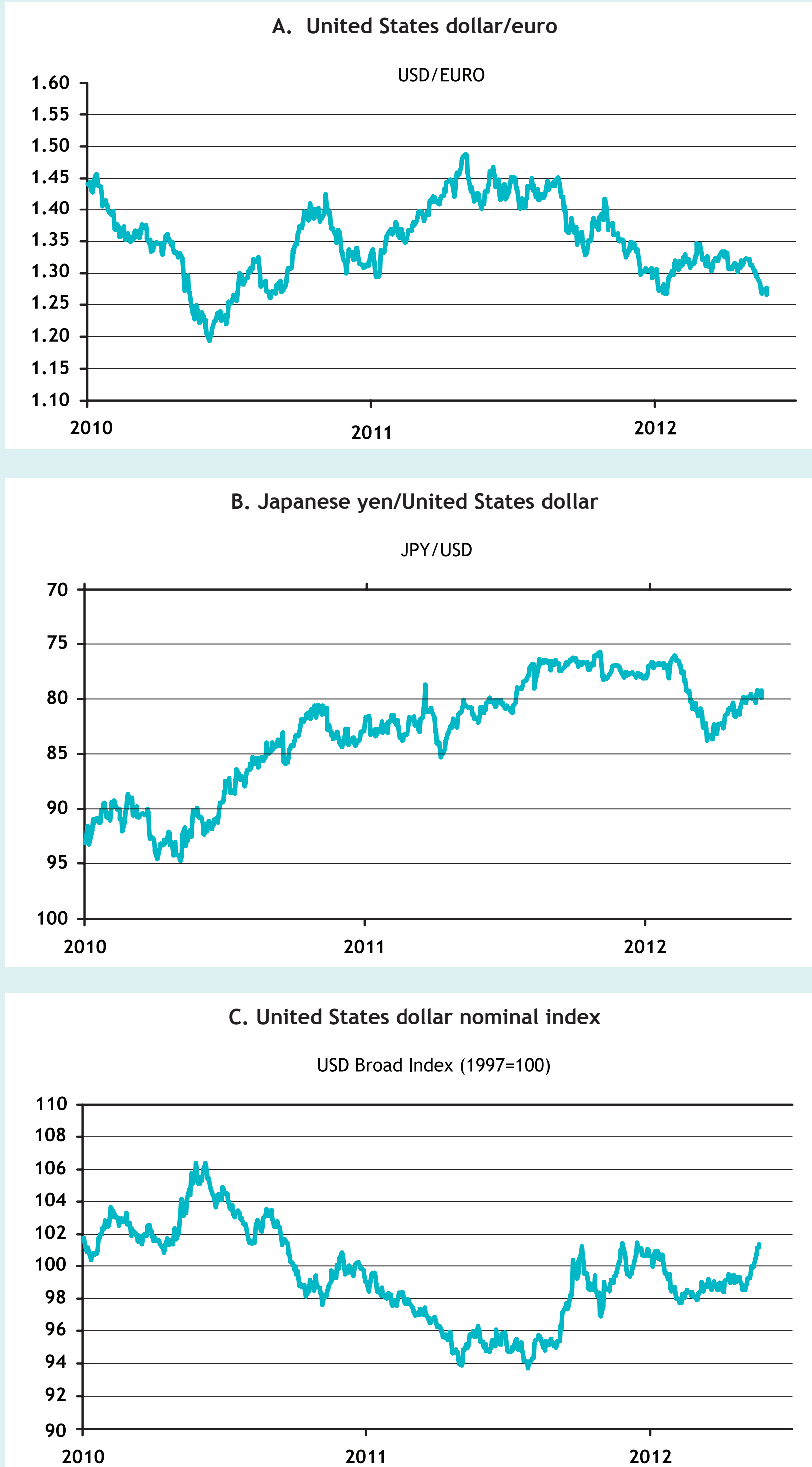
Source: Deutsche Bundesbank, http://www.bundesbank.de.

High food prices also have social implications. The purchasing power of the poor segments of society has been reduced even further because of their increased expenditure on food items. Instead of increasing food subsidies to safeguard the poor, an increasing number of developing countries have initiated subsidy reforms in order to maintain fiscal sustainability. Any reform measure can be politically sensitive or even difficult to implement. It became so crucial to develop 'pro-poor' subsidy reform to achieve seemingly contradicting policy objectives: protecting the poor while making fiscal policy sustainable.

The United States economy has been experiencing consistent recovery since the second quarter of 2009. The exports of goods and services in the second quarter of 2011 surpassed the pre-crisis level, while the level of imports has remained below the peak of the second quarter of 2008. The export price competitiveness of United States products has improved through the weakening United States dollars against other major currencies, except for the Japanese yen, since July 2010 (see figure II-B). The Federal Reserve Board maintained the level of the target range of 0 to 0.25 per cent of the federal funds rate since December 2008 (see figure I-A) and this will stay put until 2014. Meanwhile, the United States monetary authority's balance sheet remained heavily expanded through a series of asset purchase programmes and quantitative easing (QE) measures. The concern of inflation pushed up the 10-year yield of United States Treasury bonds (see figure I-A) in the first half of 2011, which receded towards the end of the year. The weak prospects for recovery and the demand for safe assets pushed down the yield to a record low by the first quarter of 2012. Although the TED spread [7] (see figure I-B) indicates United States dollar credit risk had receded substantially, the subdued asset prices, despite a rebound in stock price indices in the first quarter of 2012, caused a prolonged balance sheet adjustment in indebted economic sectors (financial, corporate and household). The ongoing deleveraging process is expected to contribute to the slow recovery with weak employment creation amid the increasing emphasis on fiscal sustainability in the political arena in the run-up to the upcoming presidential election. The United States economy is expected to grow by 2.1 per cent in 2012 (see table 1).

The economies of European Union countries are on the verge of double-dip recession. The issue of sovereign debt reorganization, particularly in Greece, has been dominating the regional policy agenda as it is testing the robustness of the European Monetary Union (EMU). If Greece leaves the EMU, it would have unknown economic consequences as the legal implications on euro-denominated sovereign and private debts are unclear. In spite of this mounting technical risk, the euro as a currency stayed resilient against the United States dollar, particularly in the first half of 2011 (see figure II-A). This partly reflected emerging optimism for the recovery of the European economy. The agreement that was reached among European Union policymakers in March 2011 was to establish the European Stability Mechanism by July 2012. This was seen as a permanent institutional arrangement to solve the sovereign debt problems in the eurozone area. As the priority was shifted, the European Central Bank raised its benchmark policy interest rates twice in the first half of 2011 (see figure I-C) because of inflation pressure on the eurozone area. The signs of optimism for economic recovery could be seen in several countries, particularly in Germany where the

Figure II. Foreign exchange rates of major world currencies 2010-2012



Source: Board of Governors of the Federal Reserve System, http://www.federalreserve.gov.

employment situation has been relatively better. Even though the value of real estate has plunged since 2008, a sign of recovery in that value could be seen in Germany and the United Kingdom. However, overall economic sentiment remained weak due to the ongoing deleveraging and associated balance sheet adjustments of the financial sector. Compared to the United States and the United Kingdom, financial sector's balance sheet adjustments have been slow in the eurozone area. The deteriorating balance sheet with non-performing assets in Spain's financial sector was revealed in the first half of 2012. This event forced European policymakers to work on effective measures to prevent it from becoming contagious. The economies of European Union countries are expected to mark a zero-growth on average in 2012.

Following a contraction of 0.7 per cent in 2011, the Japanese economy is expected to grow by 1.7 per cent in 2012. The Japanese economy, which had been the second largest in the world for more than three decades, fell to number three as China surpassed Japan in terms of nominal GDP in 2011. Japan's export competitiveness was further eroded by the strong Japanese yen, which was at a historical high against other major currencies (see figure II-B). The corporate profits of its major manufacturing exporters, including famous global brands, have declined significantly and the corporate sector's cost-saving efforts to outsource abroad have accelerated. The thin corporate profit base kept pushing down the wage level, contributing to the deflationary pressure on the entire Japanese economy. The Great East Japan Earthquake of March 2011 also impacted negatively on the Japanese economy owing to considerable casualties, loss of property and severed supply chains. The damages caused by the accident at the Fukushima Daiichi Nuclear Power Plant cast a dense shadow on economic sentiment and confidence. While executing prompt fiscal measures for reconstruction, Japanese policymakers were urged to consolidate mounting fiscal deficits. Public opinion is divided over the fiscal reform that would increase general sales tax, and political consensus will not emerge anytime soon.

Economies in transition, which include the economies of the Commonwealth of Independent States and South-Eastern Europe, are expected to grow by 4 per cent on average in 2012 (see table 1). This figure is skewed by the Russian Federation, the largest economy in the region, where the prompt recovery in GDP growth was spurred by the buoyant international commodity prices. The increased export revenues from natural resources and agricultural products were supposed to alleviate external constraints on domestic demand expansion for commodity exporters in the region, such as the Russian Federation and Central Asian countries. However, domestic demand was subdued partly because of the increasing repatriation of foreign investors as well as high consumer inflation. The region has experienced high consumer inflation even before the global financial crisis of 2008, and this inflationary trend continued throughout 2011. Commodity importers in the region experienced much slower recovery and the prospects for 2012 became increasingly uncertain in parallel with those of the European Union economies.

African economies are expected to grow by 4.2 per cent in 2012. Even after taking a hit in 2008-2009 from the global financial crisis, this region stayed on a consistent growth path since early last decade. Buoyant international commodity prices resulted in an increase in export revenues for resource rich countries, which brought about the traditional pattern of growth seen in the past commodity booms. However, what has been notable in the present trend is that the growth performance of crude oil importers superseded that of crude oil exporters. Access to external finance, through both foreign direct investment and portfolio investment, allowed the politically stable countries in the region to expand their domestic demand. Though it remains fragile, the region's economic potential is getting more attention from international investors. The slow but consistent improvement in development management capacities is expected to contribute to robust growth performance in coming years.

The growth of East and South Asia is projected to be 6.3 per cent in 2012, the fastest in comparison with other regions. Major economies in the region, particularly China and India, are remaining firm in their macroeconomic policy stance to cope with both external and domestic inflationary pressures in 2011. As for other regions, hovering international commodity prices caused a rapid rise in food prices. Moreover, the wage rates in several sectors of the economies, including those in China, have experienced quick growth. These inflationary sources are expected to become moderate in 2012 and the fiscal and monetary authorities in the region are to be given policy space for further growth. In fact, China and India started unwinding their tight monetary stances in the first half of 2012. Although the general economic sentiment in the region remains optimistic, the weakness remains widening economic inequalities.

The economies of Latin America and the Caribbean are estimated to grow by 3.7 per cent in 2012. Their pace of recovery from the global financial crisis of 2008-2009 has slowed down as the regional growth was on a decelerating trend (see table 1). Externally, this trend is in line with the stagnating pace of economic recovery at the global level. The United States remained the most significant trading partner of the region, particularly in the subregions of Central America and the Caribbean. Internally, it reflected the domestic demand growth of Brazil, the largest economy in the region, where policymakers were attempting to cool down the economy with tighter monetary policy measures against rapid inflation. As inflationary pressures recede, the region's monetary and fiscal authorities are expected to shift their macroeconomic priority from inflation to growth in 2012. However, the mounting uncertainty of the global economic environment, including volatile international commodity prices, caps the growth prospect of this region.

2. Implications to the ESCWA region

The impact of these developments on the ESCWA region[8] varies from country to country depending on the country's degree of integration with Europe, United States and emerging growth centres in East and South Asia and Africa. In particular, those countries which have strong trade links with European Union countries, such as Egypt, Jordan, Lebanon and the Syrian Arab Republic, were adversely affected by the weak European demand for their export goods. Nonetheless, the ESCWA region's exports have increasingly shifted towards the East and South Asia from the traditional destination of European and American markets. Meanwhile, the geographical location of the ESCWA region as a connecting hub of Europe, East and South Asia and Africa, brought about a positive impact to the region. The United

The ESCWA region's exports have increasingly shifted towards East and South Asia from the traditional destination of European and American markets

Arab Emirates, which has established itself as a global transport and logistics hub, has benefited from the continuing growth of East and South Asia and Africa. Moreover, it should be noted that the region's increase in energy exports is to meet the growing demand from East and South Asia. As far as the ESCWA region's trade linkages are concerned, the negative impacts from both the weak European economies and the slow recovery of the United States were compensated by the positive impacts of the sustained growth in developing countries in 2011.

Another aspect that must be considered is the nexus between the region's energy exports and financial markets at both regional and global levels. There is still a consistent view regarding energy-exporting countries in the ESCWA region that the basic pattern of movement in those economies is simply the distribution and spending of oil export revenues. The events that followed the global financial crisis of 2008-2009 showed, however, that even in these major energy-exporting countries, the economic and financial pictures were more complicated than mere distribution and spending. Firstly, the correlation between oil export revenues and the growth in the region's financial assets, represented by the total value of market capitalization of the region's stock markets, broke down in early 2006 when the region's stock markets experienced the first downward adjustment (see figure III-A). In 2011, it switched directions: oil export revenues marked a historical high while the stock market performance stagnated. The implications of this division between oil export revenues and the stagnation of region's financial assets can be three-fold: (1) Continuing balance sheet adjustments in the region's finance and real estate sectors; (2) The concentration of funds in narrower scope of regional financial investments; and (3) Capital outflows abroad. Secondly, the major energy exporters of the ESCWA region, namely GCC countries, became leading global investors through sovereign wealth funds (SWFs) as well as the recipients of capital inflows. In net terms, these countries remained exporters of capital. However, more economic activities in these countries have become dependent on foreign capital inflows and it will remain this way unless a significant unwinding of SWF foreign assets takes place. A case-in-point is the United Arab Emirates, where the country depended significantly on the inflow of foreign savings to sustain their extremely high credit growth up until the first half of 2008.

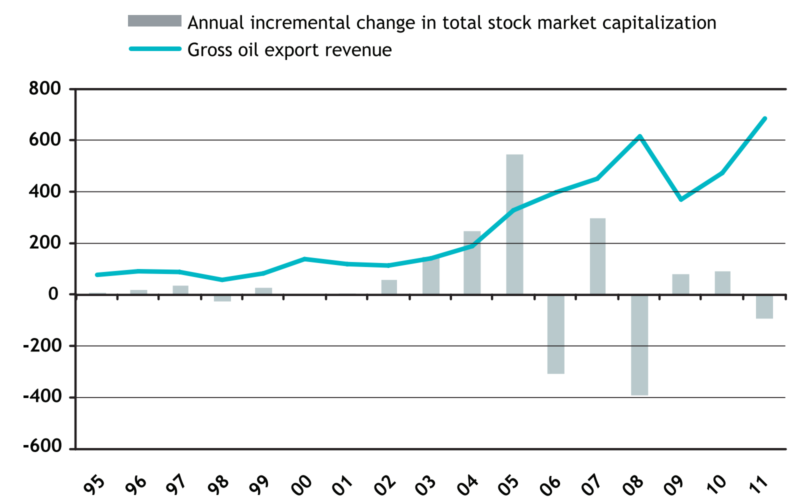
In 2011, oil export revenues marked a historical high while the stock market performance stagnated

Figure III-B shows the three-month interbank offered rates of the United States dollar and selected currencies from countries in the region, namely Jordan, Kuwait, Saudi Arabia and the United Arab Emirates. Up until the first half of 2008, the spread between the United States dollar London Interbank Offered Rate (LIBOR) and the rates of Kuwait, Saudi Arabia and the United Arab Emirates was very thin and at times negative. This indicated that the ample liquidity for credit expansion was available for those countries partly because of capital inflows. Since the second half of 2008, the spread between United States dollar LIBOR and the rates of Kuwait, Saudi Arabia, and the United Arab Emirates has widened. Among these three GCC countries, the spread was widest for the United Arab Emirates, reflecting a tighter liquidity condition. Therefore, even though the region marked historically high oil export revenues in 2011, it is envisaged that the cost of finance stayed relatively high partly because of subdued foreign capital inflow into the region. The subdued capital inflow to the region was more severely felt by net energy importers of the ESCWA region. Mostly due to domestic political events, foreign reserves were quickly depleted in Egypt, the Sudan and the Syrian Arab Republic in 2011. Meanwhile, Jordan and Lebanon experienced stagnated growth in foreign reserves accumulation. The spread between Jordan's three-month interbank offered rate and the United States dollar LIBOR has been increasing since the first half of 2011 (see figure III-B), indicating an even tighter liquidity situation in the country.

A number of external factors may be considered to have positive impacts on the ESCWA region's economic prospects. The region's geographical advantage is increasingly being recognized, particularly because it is a connecting hub between emerging growth centers – East and South Asia and Africa. Its role as a global centre of logistics and transportation is expected to be significant. On the other hand, the financing conditions remained tight. The funding cost in general rose above the world benchmark, and a trend of rising financing cost can be observed in energy-importers of the region.

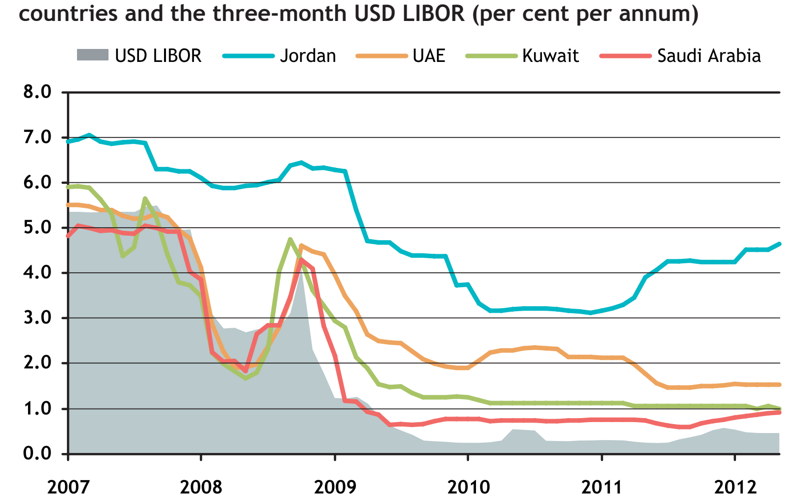
Figure III. Oil-financial markets nexus

A. Annual incremental changes in stock market capitalization and oil export revenues in total in the ESCWA region (US$ billion)



Sources: ESCWA staff compilation based on data from the Arab Monetary Fund on stock market capitalization; national sources for oil export revenues.

B. Three-month interbank offered rates of selected ESCWA member countries and the three-month USD LIBOR (per cent per annum)



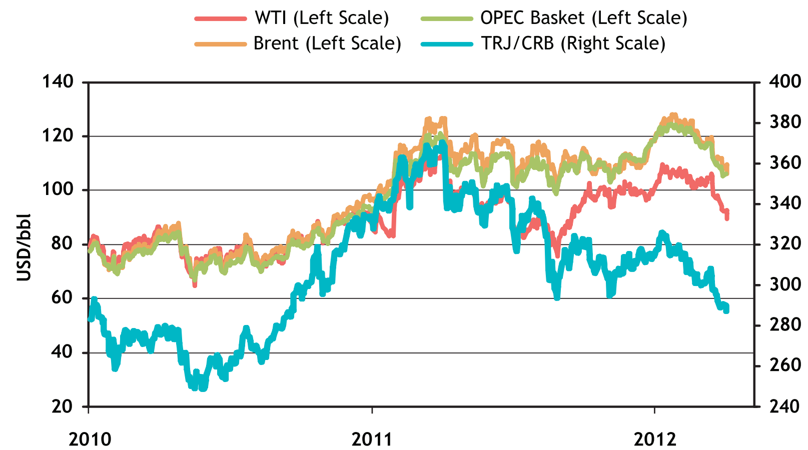
Sources: ESCWA staff compilation based on data from the British Bankers Association (USD LIBOR); Association of Banks in Jordan (Jordan); Central Bank of the United Arab Emirates (UAE); Central Bank of Kuwait (Kuwait); Saudi Arabian Monetary Agency (Saudi Arabia).

B. Oil sector development

The oil sector is, and will continue to be, essential in any analysis of the ESCWA region due to the large revenues stemming directly and indirectly from the sector. It represents a large share of exports for the majority of ESCWA member countries, including GCC countries as well as Iraq, the Sudan, the Syrian Arab Republic and Yemen. Meanwhile, Qatar has established itself as the largest exporter of liquefied natural gas (LNG) in the world. Egypt depends on crude oil exports to a much lesser extent, but was recently established as a major exporter of natural gas. Even energy-importing countries in the region, such as Jordan, Lebanon and Palestine, are also indirectly impacted by the oil sector developments because of the

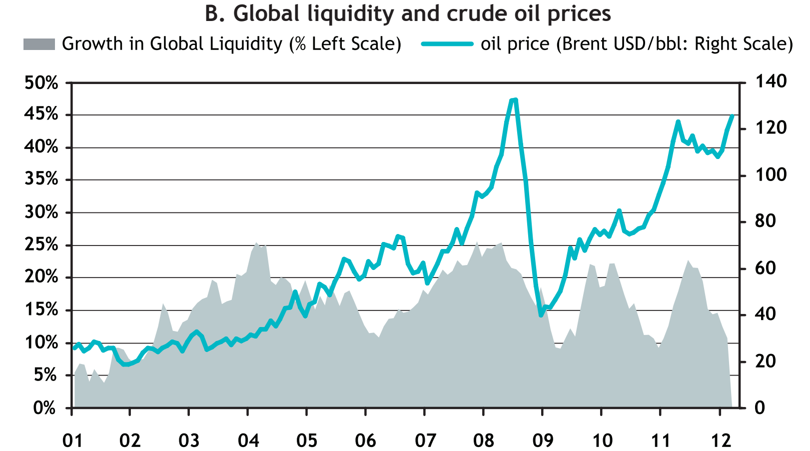
Figure IV. Oil prices

A. Crude oil prices and commodity index



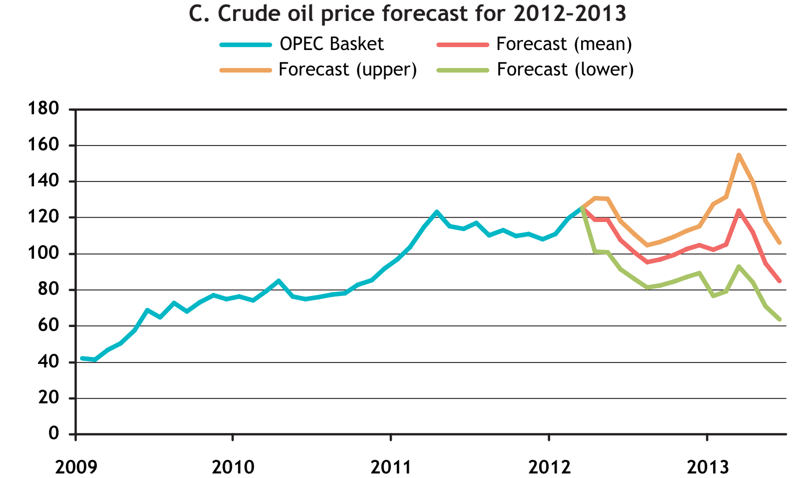
Sources: Energy Information Administration and the Commodity Research Bureau.

B. Global liquidity and crude oil prices



Sources: Federal Reserve Bank of St. Louis, International Monetary Fund/International Financial Statistics.

C. Crude oil price forecast for 2012-2013



Sources: OPEC and ESCWA staff forecast.

spillover effects of the intraregional flows of remittances, investments and tourism. Moreover, recent preliminary research activities of eastern Mediterranean shores indicate a potential for Lebanon and the Palestine to become natural gas producers in the future.

According to the estimation of the Organization of the Petroleum Exporting Countries (OPEC), the total world demand for crude oil in 2011 averaged at around 87.8 million barrels per day, while the total supply of crude oil averaged at 87.6 million barrels per day. Total world demand for crude oil increased by 0.8 million barrels per day from 2010 to 2011. Demand from the Organisation for Economic Co-operation and Development (OECD) countries contracted by almost 1 per cent, while demand from developing countries increased by around 2.4 per cent and demand from China increased by over 5 per cent.[9] The balance of supply and demand for 2011 remained unchanged from 2010 since both non-OPEC production and demand saw a similar downward adjustment, which left the demand for OPEC crude at 30 million barrels per day.

Since cutting its total production ceiling in December 2008 at 24.8 million barrels per day, the oil cartel amended the ceiling for the first time in December 2011 at 30 million barrels per day. Setting a total production ceiling without setting target for each member country implied that these agreements were not binding. These arrangements allowed OPEC member countries to increase their crude production to a historically high level. When the downward adjustment of crude oil prices took place in June 2012, Saudi Arabia called to increase crude oil production to stabilize the price in the range of US$80-US$100 per barrel. Speaking against this proposal, other oil exporting countries were divided as some members of OPEC insisted on a reduction in the production ceiling with a country-specific production quota. The rationale behind Saudi Arabia's opinion on the crude oil production is that a persisting excessively high price is likely to accelerate the use of alternative energy – which is not beneficial for oil exporters in the long run. Hence, it seems unlikely that OPEC member countries will decide on a significant reduction in crude oil production in 2012. The demand for OPEC crude is expected to be almost unchanged in 2012, as an increase in non-OPEC supply will match the increase in global demand.

The OPEC Reference Basket Price has hovered over the US$100 per barrel mark since February 2011 (see figure IV-A) and recorded its historical high at US$124.64 per barrel on 8 March 2012. The price stayed in the higher range despite weak economic data from major developed countries. The upward price trend was partly due to speculative activities in the crude oil future markets in parallel with other commodity futures. Figure IV-A shows that the representative index of commodity futures, the Thomson Reuters/Jefferies Commodity Research Bureau Index (TRJ/CRB index), has risen in parallel with crude oil prices in the first quarter of 2011. However, even after the TRJ/CRB index shifted to a downward trend since the second quarter of 2011, crude oil prices stayed buoyant until the second quarter of 2012. This deviation could attribute to a geopolitical risk premium amid fears of supply disruptions. The security situation in Libya which almost put halt to the crude production in one of the largest crude oil producers especially raised fears of supply disruption. Production in Libya was almost zero in the third quarter of 2011, but in February 2012 it was back at 1.2 million barrels per day, close to its pre-crisis level of 1.5 million barrels per day. South Sudan has temporarily shut down its export flow in 2012 due to a series of armed conflicts at the border area between South Sudan and the Sudan.

Table 3. **Crude oil price estimations and forecasts** *(OPEC Reference Basket: US$ per barrel)*

				Forecasted annual average for 2012		
	Minimum	Maximum	Annual Average	Lower	Median	Higher
2009	38.14	77.88	61.06			
2010	68.21	90.73	77.45			
2011	89.81	120.91	107.46			
2012				80.0	100.0	120.0

Source: OPEC for 2009-2011. Figures for 2012 are forecasts as of June 2012.

Crude oil prices in 2012 are forecasted to decline somewhat due to the expected economic stagnation in developed countries and decelerating growth in major developing countries (see figure IV-C and table 3). The geopolitical risk premium is likely to stay amid rising political and security tensions in major oil producing countries. To counteract the geopolitical risk premium, a stabilization factor may be moderate speculative activities in future markets. The growth in global liquidity, which is the sum of the monetary base of the United States and all other countries' foreign reserves, shows a declining trend following a series of major QE measures by monetary authorities in the United States and the United Kingdom (see figure IV-B). It is envisaged that more speculators will face a liquidity constraint in international commodity futures markets. In fact, the TRJ/CRB index has already been experiencing a declining trend. Considering these factors, it is projected that the crude oil price in the OPEC Reference Basket will be around US$100 per barrel, provided there is no dramatic shock to the world economy.

The total crude oil production of the ESCWA region is estimated at 20.4 million barrels per day on average in 2011, which is an increase on the 18.6 million barrels per day in 2010 (see table 4). The total crude oil production is projected to increase further in 2012 before decreasing moderately in 2013. However, crude oil production in the Sudan, the Syrian Arab Republic and Yemen is forecasted to decrease significantly in 2012. Crude oil production in the Syrian Arab Republic is expected to decrease by 40.5 per cent in 2012; this is due to the increasing constraints on production operations as well as economic sanctions on oil exports. Yemen's production is projected to decline by 20.1 per cent in 2012. The available data for the first three months of 2012 already indicate a considerable decline in crude oil production in the country. In both Yemen and the Syrian Arab Republic, persisting attacks on oil installations have been reported. The Sudan's crude oil production is projected to decline by 61.7 per cent 2012; the country lost 75 per cent of its crude oil reserves due to the secession of South Sudan. The potential crude production capacity of the Sudan is estimated to stay within 25 per cent of its peak production level for the next few years. The unstable security situation along its border with South Sudan is a risk factor for the Sudan's crude oil production. In fact, the conflict in this area caused a disruption of crude oil production in the Heglig region in April 2012.

Table 4. **Oil production in the ESCWA region 2008-2013** *(Thousands of barrels per day)*

Country	2008	2009	2010	2011[a/]	2012[b/]	2013[b/]	Percentage change	
							2011/12	2012/13
Bahrain[c/]	185	182	180	182	182	185	0.2	1.6
Kuwait[d/]	2 676	2 262	2 312	2 660	2 950	2 800	10.9	-5.1
Oman	757	813	865	885	890	895	0.6	0.6
Qatar	843	733	733	734	740	730	0.8	-1.4
Saudi Arabia[d/]	9 198	8 184	8 166	9 311	9 750	9 300	4.7	-4.6
United Arab Emirates	2 572	2 242	2 324	2 565	2 650	2 550	3.3	-3.8
GCC countries	**16 231**	**14 415**	**14 580**	**16 337**	**17 162**	**16 460**	**5.1**	**-4.1**
Egypt	523	523	534	505	520	530	3.0	1.9
Iraq	2 281	2 336	2 358	2 653	2 750	2 800	3.7	1.8
The Sudan	462	475	462	281	103	110	-63.4	6.8
Syrian Arab Republic	377	377	386	370	220	200	-40.5	-9.1
Yemen	286	283	265	225	190	220	-20.1	22.2
More diversified economies	**3 928**	**3 995**	**4 005**	**3 914**	**3 773**	**3 860**	**-6.5**	**2.3**
ESCWA region	**20 159**	**18 410**	**18 585**	**20 371**	**20 935**	**20 320**	**2.8**	**-2.9**

Source: Table 3.7 of OPEC's 2011 Annual Statistical Bulletin 2010-2011 with the exception of Oman and the Sudan. For Oman, Issue 1, Vol. 39 of the Central Bank of Oman's 2012 Quarterly Statistical Bulletin was used. For the Sudan, various issues of the Central Bank of Sudan's Annual Reports were used.
a/ESCWA staff estimates based on official and other sources as of June 2012.
b/ESCWA staff projections as of June 2012.
c/Including the share of Abu Safah field.
d/Figures include share of production from the Neutral Zone.

The ESCWA region's gross oil export revenues in total are estimated to stand at a record high of US$686.1 billion in 2011 (see table 5). Forecasts indicate that this will decline by 10.1 per cent to US$616.5 in 2012 with a median crude oil price (OPEC Reference Basket price) of US$100 per barrel. The near-capacity production with the highest average price of crude oil brought about a significant increase in oil export revenues to the ESCWA region. The Sudan and the Syrian Arab Republic are estimated to have experienced a decline in oil export revenues in 2011, which reflect the decrease in their crude oil production and exports. Economic sanctions by the European Union and the United States on the Syrian Arab Republic made the country's crude oil exports virtually impossible. The European Union implemented an oil embargo since the fourth quarter of 2011 and the United States' sanctions against the country made oil-related trade finance extremely difficult.

The region witnessed a considerable increase in oil export revenue. The period of 2011-2012 could potentially be labelled an 'oil boom'. The most recent boom period, from 2003 to 2008, was felt not only by the major oil exporting countries but also in the rest of the region. The oil boom was a source of positive regional spillover effects through intraregional flows of people, goods, services and funds. However, the historically high oil revenue failed to produce a region-wide sense of 'boom' in 2011-2012. Why is 2011-2012 not likely to be recorded as an oil boom? To answer this underlying question, the next chapter reviews the state of socioeconomic developments in the ESCWA region.

Table 5. **Gross oil export revenues in the ESCWA region 2008-2013** *(Billions of US$)*

Oil exporting countries	2008	2009	2010	2011[a/]	2012[b/]	2013[b/]	Percentage change	
							2011/12	2012/13
Bahrain[c/]	13.8	8.9	11.5	15.2	12.0	10.7	-21.2	-10.8
Kuwait	82.7	48.9	61.8	96.7	89.0	82.0	-8.0	-7.9
Oman	24.5	15.5	22.2	27.9	23.0	21.0	-17.6	-8.7
Qatar	25.8	14.1	20.4	26.0	22.0	20.5	-15.4	-6.8
Saudi Arabia	281.0	163.1	215.2	311.0	284.0	280.0	-8.7	-1.4
United Arab Emirates	85.4	54.1	60.1	90.6	86.0	82.0	-5.1	-4.7
GCC countries	**513.2**	**304.6**	**391.1**	**567.5**	**516.0**	**496.2**	**-9.1**	**-3.8**
Egypt	14.4	11.0	10.7	13.4	11.5	11.0	-14.5	-4.3
Iraq	61.8	39.0	51.5	87.0	80.0	82.0	-8.0	2.5
The Sudan	11.1	7.1	9.7	7.8	3.0	4.2	-61.7	40.0
Syrian Arab Republic	6.2	4.3	4.6	2.5	--	--	--	--
Yemen	7.7	4.4	6.3	7.9	6.0	7.5	-23.6	25.0
More diversified economies	**101.3**	**65.9**	**82.7**	**118.6**	**100.5**	**104.7**	**-15.3**	**4.2**
ESCWA region	**614.5**	**370.5**	**473.8**	**686.1**	**616.5**	**600.9**	**-10.1**	**-2.5**

Source: Balance-of-payments data from central banks/monetary authorities.
a/ESCWA staff estimates based on official and other sources as of June 2012.
b/ESCWA staff projections as of June 2012.
c/Including the share of Abu Safah field.

CHAPTER II.

SOCIOECONOMIC TRENDS AND DEVELOPMENTS IN THE ESCWA REGION

II. SOCIOECONOMIC TRENDS AND DEVELOPMENTS IN THE ESCWA REGION

A. Economic situation and prospects

Since late 2010, the ESCWA region has been coloured by a series of political and social events known as the Arab Spring. Social unrest and political transitions were witnessed in several ESCWA member countries. A political transition often requires an institutional reconstruction with economic implications. However, even those countries on the path towards political transition, namely Egypt and Yemen, had not yet been engaged in institutional reconstructions. The incomplete political transitions and institutional reconstructions leave space for further social unrest in the region. The perceived instability in political and social situations caused stagnation in the intraregional flow of funds and tourism, vital channels for energy-importing countries to benefit from an oil boom. The weakened spillover channels between GCC countries and more diversified economies (MDEs) resulted in a divergence in GDP growth rates among ESCWA member countries.

Table 6. **Real GDP growth rate and consumer inflation rate 2009-2012**
(Annual percentage change)

Country/Area	Real GDP growth rate				Consumer inflation rate			
	2009	2010	2011[a/]	2012[b/]	2009	2010	2011[a/]	2012[b/]
Bahrain	3.1	4.5	2.2	3.5	2.3	2.0	-0.4	3.0
Kuwait	-7.8	11.4	5.0	5.5	4.0	4.0	4.8	4.0
Oman	3.9	5.0	4.5	4.0	4.2	3.2	4.1	3.5
Qatar	12.0	16.6	14.1	7.0	-4.7	-2.4	1.9	2.0
Saudi Arabia	0.1	4.6	6.8	4.5	5.1	5.3	5.8	4.0
United Arab Emirates	-1.6	1.4	4.2	3.5	1.6	0.9	0.9	2.0
GCC countries[c/]	-0.2	5.6	6.3	4.5	3.4	3.5	3.7	3.4
Egypt[d/]	4.7	5.1	1.8	1.6	11.8	11.1	10.1	11.0
Iraq	9.3	10.2	9.6	10.5	-2.8	2.4	5.6	5.0
Jordan	2.1	3.4	3.2	3.2	-0.6	5.0	4.4	4.5
Lebanon	8.5	7.0	2.0	2.5	1.2	4.1	4.9	5.0
Palestine	7.4	9.8	9.9	5.0	2.8	3.8	2.9	4.0
The Sudan	5.9	5.2	-1.0	0.0	13.2	12.8	18.1	25.0
Syrian Arab Republic	5.9	3.2	-2.0	-5.5	2.8	4.4	4.7	28.0
Yemen	4.3	7.8	-2.5	1.0	5.4	11.1	19.4	22.5
MDEs[c/]	5.8	6.0	2.6	2.4	6.9	8.2	9.0	12.1
MDEs excluding Iraq[c/]	5.3	5.3	0.8	0.6	8.2	9.2	10.5	15.5
Total ESCWA region[c/]	1.5	5.7	5.1	3.8	4.3	4.8	5.4	6.4

Source: National sources and forecasts by ESCWA staff.
a/Preliminary figures as of June 2012.
b/Forecasts as of June 2012. For the Sudan, the forecast was made on a rescaled GDP estimation to take account of the secession of South Sudan.
c/Figures for country groups are weighted averages, where weights for each year are based on GDP at 2005 exchange rates.
d/Figures for Egypt are for the fiscal year starting in July and ending the following June.

While GCC countries experienced an increase in average GDP growth rate at 6.3 per cent in 2011, the average GDP growth rate for MDEs excluding Iraq is estimated to stand at 0.8 per cent

The average real GDP growth for 2011 for the ESCWA region (see table 6) is estimated to be 5.1 per cent, compared to 5.7 per cent in 2010. While GCC countries experienced an increase in average GDP growth rate at 6.3 per cent in 2011, the average GDP growth rate for MDEs excluding Iraq is estimated to stand at 0.8 per cent. This diverging trend is projected to continue over 2012. The forecast for the entire ESCWA region in 2012 is at 3.8 per cent.

Regarding consumer price inflation (see table 6), the ESCWA region experienced a slight increase to 5.4 per cent in 2011 compared to 4.8 per cent in 2010 as global commodity prices increased. Many countries in the region used subsidies to mitigate the pass-through from global prices to domestic consumer prices. Despite this, inflation in GCC countries was expected to have increased from 3.5 per cent in 2010 to 3.7 per cent in 2011, while inflation in the MDEs increased from 8.2 per cent to 9.0 per cent, mainly driven by high inflation in Egypt, the Sudan and Yemen. The region's trend in consumer inflation was characterized by rapidly rising commodity prices, including food items, and subdued housing-related items. The surplus of newly-built housing and commercial estates in GCC countries, with the exception of Saudi Arabia, weakened housing rents and pushed down the general price level. For Egypt, the Sudan and Yemen, the rapid depletion of foreign reserves became a contributing factor for accelerated consumer inflation. The outlook for inflation is uncertain as a global slowdown can lower inflationary pressure, while recent salary increases may create second-round inflationary pressure in GCC countries. The strength of the US dollar is deflationary for most countries in the region and it is expected to strengthen further as the European economy struggles to contain the sovereign debt crisis. Oil and food prices are expected to remain high, but the price level is projected to fall moderately in 2012, which would reduce some of the inflationary pressure. Considering these factors, the projection of the consumer inflation rate in 2012 was 3.4 per cent for the GCC and 12.1 per cent for the MDEs. Consumer inflation in the MDEs will remain high particularly in Egypt, the Sudan, the Syrian Arab Republic and Yemen because of their deteriorating foreign exchange situations.

In Saudi Arabia, the non-oil sector is estimated to have grown by around 5 per cent in 2011, which is among the highest growth rates in decades

The GCC countries benefited from oil prices above US$100 per barrel on average throughout 2011, and grew by an estimated 6.3 per cent in 2011, up from 5.6 per cent in 2010. Kuwait, Saudi Arabia and the United Arab Emirates also benefitted from higher oil production benefited to compensate for the disruption in Libyan oil production. The social movement did not strongly affect the economic performance of these countries, as high oil prices made it possible to maintain the fiscal expansion and support household incomes and private consumption during this time. The exception to this is Bahrain, whose reputation as a stable financial hub has been dented following the social unrest in 2011. Key financial and tourism sectors have suffered and as a result growth dropped from 4.5 per cent in 2010 to around 2.5 per cent in 2011. Growth in the GCC countries is mainly driven by the oil sector, but the emerging non-oil sector is increasingly contributing to growth in a few countries. In Saudi Arabia, the non-oil sector is estimated to have grown by around 5 per cent in 2011, which is among the highest growth rates in decades. Moreover, Saudi Arabia's real estate sector remained robust in contrast with other GCC countries, resulting in a strong increase in domestic demand. The Kingdom's growth rate is expected to be at 4.5 per cent in 2012. Exports from both the oil and non-oil sectors in Saudi Arabia should remain resilient as they are increasingly being destined for East and South Asia, where growth should remain firm.

On the other hand, the economic performance of the MDEs was adversely affected by the social unrest and growth fell from 6.0 per cent in 2010 to an expected 2.6 per cent in 2011. Iraq benefiled from the growing crude oil production capacity (see table 4) and achieved a record growth rate of 9.6 per cent in 2011. Excluding Iraq, the average growth rate for the MDEs was a meagre 0.8 per cent. This was mainly driven by the situation in the Syrian Arab Republic and Yemen, but the political unrest also affected neighbouring countries. In particular, growth in Lebanon decelerated drastically, from 7 per cent in 2010 to an expected 2 per cent in 2011. Egypt was riddled with political uncertainty in 2011 and growth was reduced to around 1 per cent. In the MDEs overall, the financial and external environment worsened with substantial declines in capital inflows. This has had an adverse impact on growth, and has also contributed to the widening of the current account deficits in Egypt, Jordan, Lebanon and the Syrian Arab Republic. In these four countries, the political turmoil has severely impacted the tourism industry, which is vital for these economies.

GDP growth in Palestine is mainly due to the Gaza Strip's extremely low base figure, primarily owing to the acceleration of resumed construction works following the loosened Israeli blockage in 2010.[10] Data from the Palestinian Central Bureau of Statistics shows that the Gaza Strip has grown by 23 per cent in 2011, following a 19.5 per cent growth in 2010. It should be noted that the Gaza Strip has experienced considerable loss in terms of physical capital in the periods from 2000 to 2002 and 2006 to 2008 due to Israeli military incursions; it recorded a 20.1 per cent contraction in 2006 alone. Despite seemingly impressive growth figures, the economy of Palestine has yet to emerge from stagnation. The Israeli-imposed restriction measures on economic and human flows in and out of Palestine, partially through blockades, are obstacles to its economic and social development.

Growth in Lebanon decelerated drastically, from 7 per cent in 2010 to an expected 2 per cent in 2011

The outlook for the ESCWA region in 2012 remains uncertain. The situation in the Syrian Arab Republic is expected to remain highly volatile, which may affect the risk perception of regional economic actors considerably. Political uncertainty is still present in other countries in the region, particularly Egypt and Yemen. The region is also vulnerable to a global downturn which could impact oil prices as well as reduce the demand for non-oil exports from the region. Despite weaker prospects than those of 2011, the OPEC Basket Reference price is expected to remain around US$100 per barrel on yearly average in 2012. Hence, the oil sector is still likely to buoy the GDP growth of oil-exporting countries. Considering these factors, the GCC countries are projected to grow by 4.5 per cent on average in 2012, and the MDEs by 2.4 per cent. Excluding Iraq, which is expected to achieve double-digit growth rates, the GDPs of MDEs are expected to grow by 0.6 per cent. This estimate must be taken with caution as it may be subject to significant downside risk depending on developments in the political and security situation. The Syrian economy is projected to experience a severe contraction of 5.5 per cent, and Lebanon will continue to be affected by the ongoing crisis in the Syrian Arab Republic, especially the tourism

The outlook for the ESCWA region in 2012 remains uncertain. The situation in the Syrian Arab Republic is expected to remain highly volatile, which may affect the risk perception of regional economic actors considerably. Political uncertainty is still present in other countries in the region, particularly Egypt and Yemen sector. But the maintained level of inflows of funds from the GCC countries will allow growth to increase from 2 per cent in 2011 to 2.5 per cent in 2012. In Qatar, the era of double-digit real GDP growth rate is probably over, but it will continue to boast the highest rates among the GCC countries due to the ongoing expansion of LNG production, infrastructure projects and continued fiscal expansion. Saudi Arabia, the largest economy in the ESCWA region, is expected to show robust growth at 4.5 per cent with the consistent expansion of its domestic demand and non-oil sector.

B. External balances

The total current account surplus in the ESCWA region is estimated at US$312 billion for 2011, a sharp increase from the US$131 billion of the previous year. This is mainly due to the buoyant energy-related exports. However, the weak current account balance became a source of macroeconomic concerns in several MDE countries. For more than a decade, the weak current account balance has not been a threat to the growth performance even for those countries in the region with current account deficits. The

Box 1. Arab Spring and immediate economic consequences

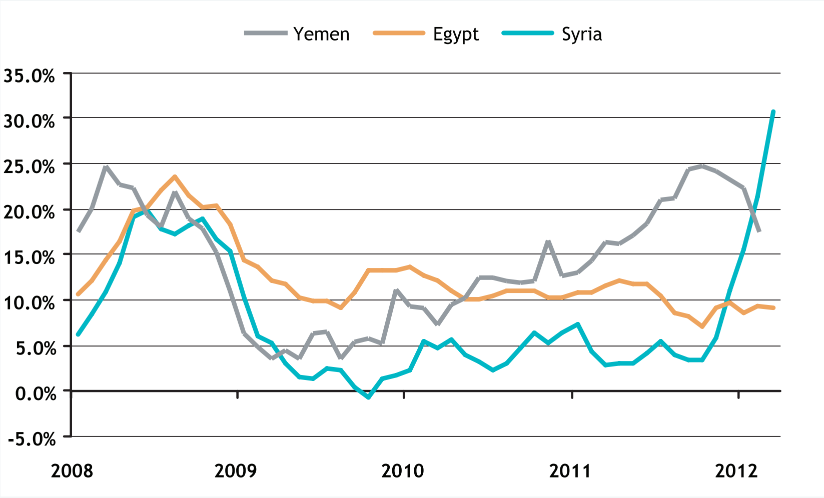
Egyptian stock prices surged sharply following the result of Egypt's presidential election in June 2012. The market welcomed the political stability and sentiment went bullish for the first time since January 2011. This is envisaged to be the first sign of the economic fruits of the Arab Spring at long last. During the passing transitional period of political uncertainty, the country witnessed a dwindling level of foreign reserves due to the significant capital outflows as well as stagnating export activities. According to the Central Bank of Egypt (CBE), reserves fell on average by around US$2 billion a month from October 2011 to January 2012. In February and March 2012, the drain on Egypt's foreign reserves showed signs of abating as the reserves fell by around US$600 million to reach US$15.2 billion by the end of March. This has given Egypt some time to secure additional foreign funding and authorities some room of manoeuvre. However, the situation remains critical as the reserves now cover just over three months worth of imports, the lower threshold level for foreign reserves. Meanwhile, the CBE sought a gradual depreciation of the Egyptian pound. The pressure on the Egyptian pound not only stemmed from general strains in Egypt's balance of payments, but also from a decade of high inflation against a backdrop of a relatively strong nominal exchange rate regime that has eroded Egypt's international price competitiveness. The two policy scenarios concerning the tight foreign reserve situation are: a further orderly devaluation by the CBE under a credible stabilization programme; or a disorderly devaluation stemming from confusing macroeconomic policy and coordination failure. If not properly managed, the situation could trigger a balance-of-payment crisis. However, if more stable political and social prospects are ensured, Egypt would be in an advantageous position to rebuild its foreign reserves to achieve solid growth potential in manufacturing and services export in the long run. It is for this well-received economic potential of the country that external donors have shown their support. Several Arab countries, notably Saudi Arabia, have already disbursed their aid packages. Moreover, Egypt is currently negotiating with the International Monetary Fund (IMF), which pledged its support for Egypt's new administration.

Continuing political and social unrest cast a deep shadow on economic prospects in the Syrian Arab Republic. Social unrest and security instability since March 2011 caused substantial breakdowns in domestic logistical chains. Also, as economic sanctions from the United States, the European Union and the League of Arab States came into effect, the country's crude oil export, so crucial for the Syrian economy, was made effectively impossible to carry out. Losing the major source of foreign exchange earnings, the scarcity of foreign currencies started to cause a gradual depreciation of the Syrian pound (SYP), first in the black markets. Between February and December 2011, the black market rate fell by around 50 per cent, while the official rate of the Syrian pound depreciated by around 20 per cent. The Central Bank of Syria succeeded in stabilizing the value of the national currency by setting an official intervention rate. As of the end of June 2012, the intervention (selling) rate stood at SYP 68.6 per US$1. In June 2011, the official exchange (selling) rate was at SYP 47.5 per US$1. The fear of scarcity amplified the inflationary pressure. In fact, economic sanctions made it difficult for the Syrian Arab Republic to import non-sanctioned items, including deterioration of current account positions was offset by the strong capital account positions. In 2011, this support channel was severed. All MDEs with exception of Iraq are estimated to have experienced current account deficits in 2011.

The total current account surplus of GCC countries is estimated at US$316 billion in 2011, which has increased from the US$140 billion of the previous year. The strong energy export revenues surpassed the resilient and constant growth of domestic demand (see figure V). However, the continuing weak global asset markets contributed to weak income account surpluses in spite of highlighted activities of SWFs. Net trade in services is estimated to stay negative in GCC countries, with exception of Bahrain. The outflows in current transfers that include remittances of foreign workers from the subregion are estimated to have increased moderately in 2011. For 2011, the current account balance in terms of nominal GDP is estimated at 12.7 per cent in surplus for Bahrain, 45.3 per cent in surplus for Kuwait, 13.4 per cent in

essential goods such as grains, as the access to trade finance was blocked. Despite the Syrian Government's effort to stabilize the prices of essential goods, the general price level started surging in December 2011. The year-on-year consumer inflation rate stood at 30.8 per cent in March 2012 (see figure in this box). Due to a relatively high-level of self-sufficiency in agricultural goods and fuel products, the sanctions-induced foreign exchange restriction will not cause a sudden economic collapse. While closures of a considerable number of business and halted commercial activities were reported, the domestic banking system was reported to be functioning resiliently. However, for the majority of the population in the Syrian Arab Republic, the sense of economic insecurity has been growing in addition to the rapidly deteriorating general security situation due to increasingly intense armed conflicts within the country.

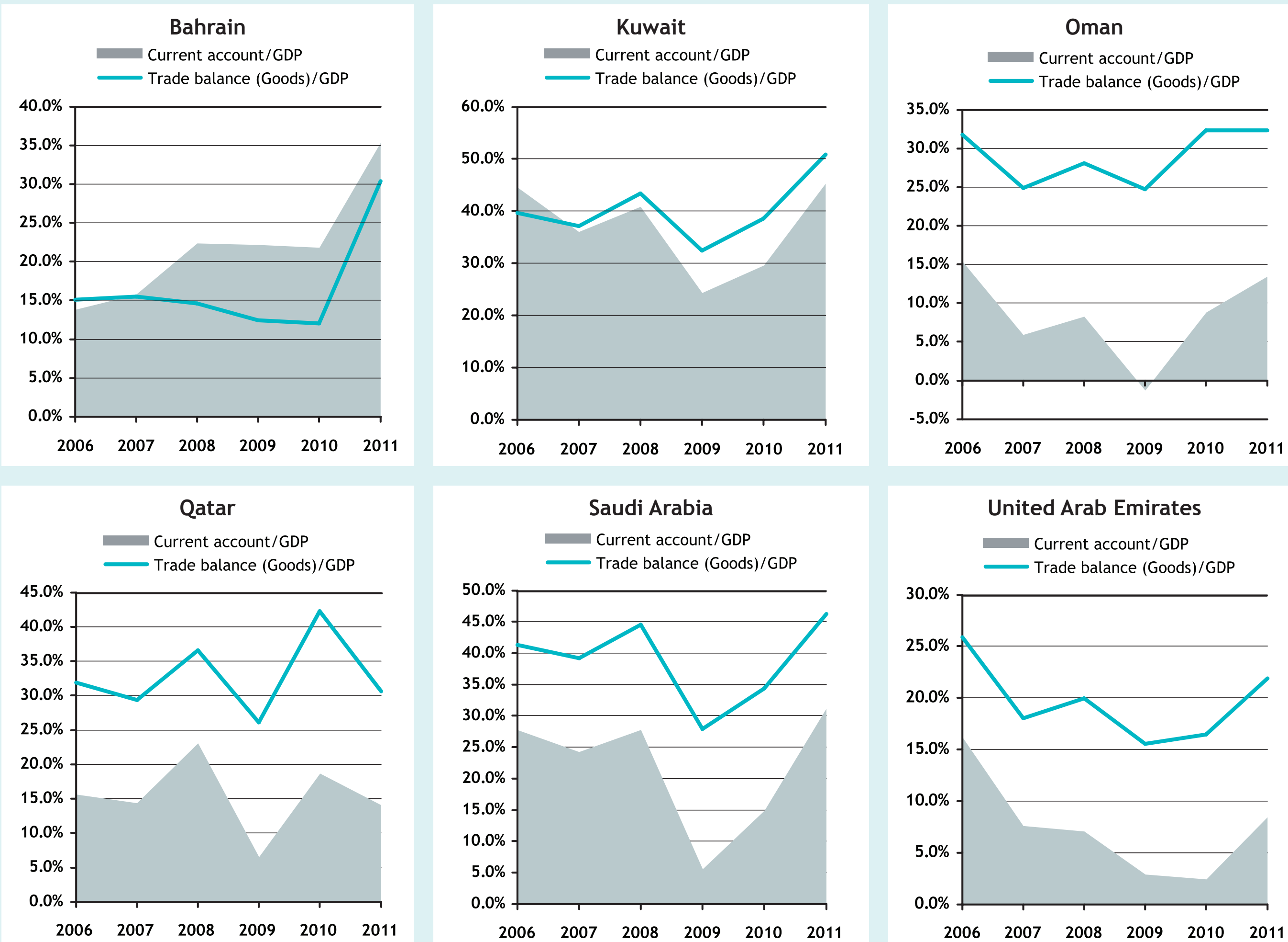
Consumer inflation rates: Egypt, the Syrian Arab Republic, Yemen 2008-2012



Sources: Central Bank of Egypt, Central Bureau of Statistics (Syrian Arab Republic), Central Bank of Yemen (Yemen).

With the inauguration of a new president in February 2012, the political transition of Yemen marked significant progress. However, the general security situation of the country has not improved due to armed conflicts within the country. Energy export revenues, mainly of crude oil and LNG, remained a crucial source of the country's fiscal revenue and foreign exchange earnings. However, from 2011 to the first half of 2012, LNG and oil pipelines were continuously under attack by armed groups. The unstable economic situation has made a smooth economic and social transition difficult. Historically, the level of consumer inflation in Yemen was high compared to other countries in the region, but since 2010 it has hovered over the 10 per cent mark (see figure in this box). Several signs of stability were observed in the 'peaked-out' inflation trend and relatively stable foreign exchange rates. International support was sought to complete the transition. Major donors, including GCC countries and multilateral aid agencies, are scheduled to hold a donor conference in September 2012. In the meantime, the Yemeni Government has been preparing a transitional programme for stabilization and development in 2012–2014.

Figure V. Trade balance and current account balance 2006-2011: GCC countries



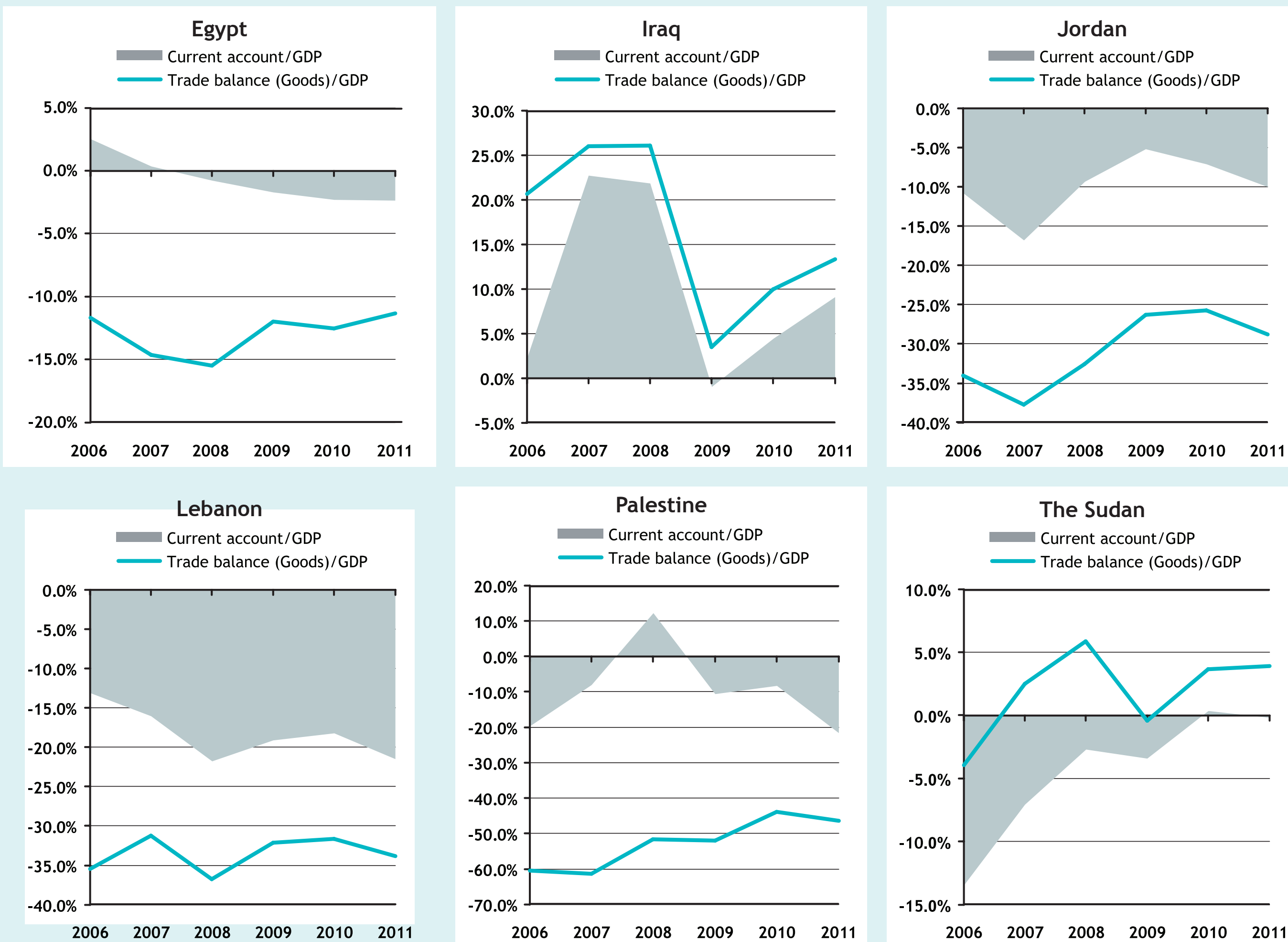
Source: ESCWA staff calculation based on national sources.

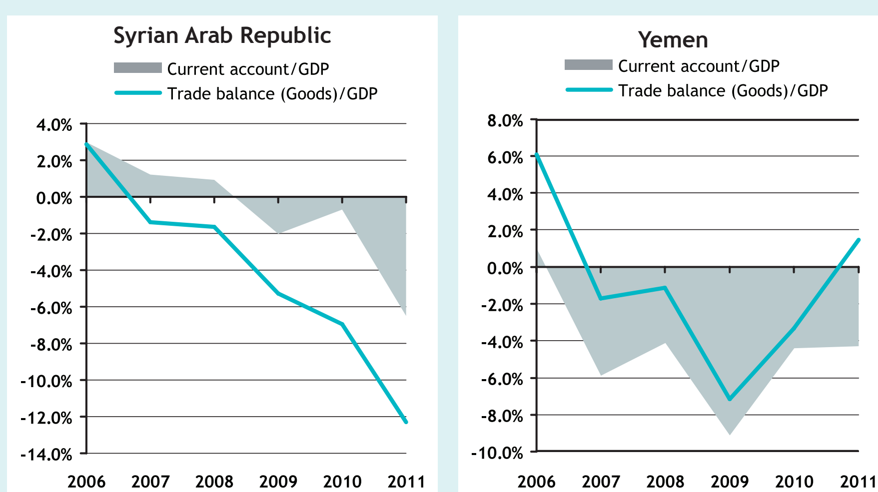
surplus for Oman, 14.1 per cent in surplus for Qatar, 31.2 per cent in surplus for Saudi Arabia, and 8.5 per cent in surplus for the United Arab Emirates.

The total current account balance of the MDEs is estimated at a deficit of US$4 billion. The margin of deficit was narrowed from US$9.3 billion of the previous year. This figure is highly affected by increasing oil exports in Iraq and Yemen. With exception of Iraq, MDEs experienced deficits in both trade and current accounts in 2011 (see figure VI). The current account balance in terms of nominal GDP is estimated at 2.4 per cent in deficit for Egypt, 9.1 per cent in surplus for Iraq, 10.0 per cent in deficit for Jordan, 21.5 per cent in deficit for Lebanon, 21.6 per cent in deficit for Palestine, 0.2 per cent in deficit for the Sudan, 6.0 per cent in deficit for the Syrian Arab Republic, and 4.3 per cent in deficit for Yemen.

It was noted that several MDE countries were under a moderate foreign exchange constraint. This provided rationale for tightening domestic demand. A case-in-point is Jordan where both

Figure VI. Trade balance and current account balance 2006-2011: MDEs





Source: ESCWA staff calculation based on national sources. Figures for 2011 are projections by ESCWA staff. Figures for Lebanon are estimations by ESCWA staff.

monetary and fiscal policies were tightened. It serves not only for the fiscal sustainability of the country but also for avoiding balance-of-payment crises. Considering the high level of accumulated foreign reserves, Jordan and Lebanon are likely to have moderate constraints with their balance-of-payments in 2012. Meanwhile, the Sudan, the Syrian Arab Republic and Yemen are facing serious balance-of-payments problems, which is likely to continue as long as the political and security situations are not stabilized in respective countries.

With exception of the Sudan and the Syrian Arab Republic, the nominal exchange rates of ESCWA member countries have stayed stable from 2011 to early 2012. GCC countries, with exception of Kuwait, have kept their foreign exchange rate regime with the United States dollar peg. Jordan and Lebanon also continued to peg their national currencies to the United States dollar. Kuwait continued to peg its national currency to the basket of foreign currencies. Since a series of economic sanctions were implemented by the United States and the European Union, the Syrian pound (SYP) was consistently under devaluation pressure. For the last few years, the rate was effectively fixed at SYP45 per US$1. In the first quarter of 2012, anecdotal evidence indicated that the rate hit SYP100 per US$1 in the black markets. The Central Bank of Syria attempted to stabilize foreign exchange transactions by creating an 'intervention rate'. As of the end of June 2012, the intervention rate stood at SYP68 per US$1. The Sudanese pound (SDG) also suffered despite the Central Bank of Sudan maintaining an official exchange rate fixed at SDG2.6702 per US$1 until June 2012. The divergence between the official rate and that of the black markets widened as a result (see box 2).

Intensifying political instability and social unrest affected the capital flows in the ESCWA region, especially the inflows of foreign direct investments (FDI). It is estimated that the gross total of FDI inflows to the ESCWA region dropped by 40.5 per cent to US$34.3 billion in 2011 from US$57.6 billion in the previous year.[11] The subdued trend is projected to continue as the political and social situation deters investors from looking into potentially attractive projects in the region. According to the estimation of United Nations Conference on Trade and Development

Box 2. **Economic challenges for the Sudan after the secession of South Sudan**

The peaceful secession of South Sudan on 9 July 2011 should be marked as an exceptional political achievement by all of the stakeholders in the Sudan and South Sudan. After decades of civil war, this historical settlement was supposed to open the door for new economic and social development opportunities for both the Sudan and South Sudan. More economic resources are supposed to be released for development purposes upon the formal cessation of hostility. Both countries could open up a corridor for subregional commerce and trade between East and North Africa. However, both faced difficulties in adjusting to the new economic reality. Particularly for the Sudan, which lost around 75 per cent of its oil reserves to South Sudan, the secession brought an economic shock. As oil had accounted for half of its Government revenue and 90 per cent of export revenue before the breakup, the new economic picture of the Sudan requires urgent diversification. The oil loss resulted in a decline in foreign reserves and a depreciation of the currency. Official quotations from the Central Bank of Sudan show that it jumped from SDG2.6702 per US$1 to SDG4.4200 per US$1 in June 2012, while the private bank rate stood at SDG5.3 per US$1. This contributed to mounting inflationary pressure. Year-on-year consumer inflation rate stood at 28.6 per cent in April 2012. Regarding foreign debt, the Sudan agreed to the so-called zero-option: the Sudan will take on the entire debt burden after the secession. This made the Sudan one of the highest indebted least developed countries in the world with debt levels way above the most commonly used thresholds for debt sustainability. This also creates a significant constraint on fiscal policy and the ability of the country to pursue the much needed diversification agenda. In its budget for 2012, the Government announced a set of austerity measures, which include: the reorganization of federal and regional government structures; the reduction of government officials; and the phase-out of fuel subsidies. Cutting the fuel subsidies and the associated increase in transportation fares was a difficult and unpopular political decision, but as of the end of June 2012, the Sudanese Government decidedly stuck with the austerity decision amid popular protests against the measures.

(UNCTAD), FDI inflows to Bahrain, Iraq, Kuwait, Palestine and the United Arab Emirates increased. FDI inflows to the United Arab Emirates increased from US$5.5 billion in 2010 to US$7.7 billion in 2011, and FDI inflows to Bahrain also significantly increased from US$0.15 billion in 2010 to US$0.78 billion in 2011. For other ESCWA member countries, FDI inflows were stagnated. Egypt is one of the countries that experienced the most serious drop in FDI in 2011. FDI inflows to Egypt in 2011 were recorded as negative due to divestments. It stood at minus US$0.48 billion in 2011, compared to US$6.3 billion in 2010.[12] The Syrian Arab Republic and Yemen also marked a significant decrease in FDI inflows for their domestic political instability and social unrest. FDI inflows to Jordan and Lebanon have shown a decreasing trend, partly affected by political and social instability in the Syrian Arab Republic. In spite of its political stability and resilient economic condition, FDI inflows to Saudi Arabia decreased in 2011 to US$16.4 billion from US$28.1 billion in 2010. This can be interpreted as the end of initial investment boom by foreign firms following Saudi Arabia's accession to the World Trade Organization in 2005. Saudi Arabia remained the largest FDI destination in the ESCWA region in 2011.

C. Economic policy developments

Recent developments and trends are creating a number of macroeconomic challenges for policymakers in the ESCWA region, yet they have limited policy instruments at their disposal. As most countries in the region have a fixed or managed exchange rate, the effectiveness and role of monetary policy are restricted as it is tied to the policy of the United States Federal Reserve. Fiscal policy is therefore the main tool in addressing macroeconomic challenges, but it is facing increasing constraints in the non-oil exporting countries as fiscal space is running out. In response to the global financial crisis in 2008-2009, most ESCWA member countries successfully introduced counter-cyclical fiscal policy to mitigate the impact of the global downturn. If a global recession returns in 2012, the capacity to implement such strategies will be even more limited due to already strained fiscal resources.

The GCC countries continued their fiscal expansion in 2011, as they introduced discretionary social spending in order to stem the fear of contagion of political unrest. Measures for increasing public sector employment to provide jobs to youth as well as for providing hand-outs and increased salaries were implemented. Bahrain, the only GCC country strongly affected by social unrest, introduced a number of social spending measures, such as a 1,000 Bahraini dinar (US$2,600) hand-out per household and the introduction of a cost of living subsidy.[13] In the GCC as a whole, social spending came out on top of the already expansionary fiscal policy pushing the diversification agenda through large infrastructure projects as well as spending on education and health. Despite this large increase, GCC countries expect to post healthy surpluses given the high crude oil prices. However, fiscal breakeven oil prices have increased to record levels in recent years, which signal a source of vulnerability in the case of a fall in oil prices. Breakeven oil prices vary among GCC countries and range between US$40 per barrel and US$100 per barrel.[14]

In 2012, public spending in the GCC is expected to slow down to around 6 per

Fiscal policy is the main tool in addressing macroeconomic challenges, but it is facing increasing constraints in the non-oil exporting countries as fiscal space is running out

Saudi Arabia remained the largest FDI destination in the ESCWA region in 2011 cent, the lowest rate of increase in several years. However, fiscal policy will remain expansionary in most countries. In Oman, the budget announced in January 2012 confirms this view, as the Government outlined its plans for spending on education, healthcare and the creation of 36,000 new government jobs. Bahrain is also expected to continue its loose fiscal policy, as the policies introduced in 2011 are difficult to roll back in the short term. There are some indications of a slight shift in priorities for government spending in Bahrain, as a larger share will be directed towards infrastructure rather than simple cash handouts. Since the global financial crisis, there has been a reappraisal of large infrastructure projects in the United Arab Emirates, along with a prudent prioritization of activities. In January 2012, Abu Dhabi's Executive Council approved a development programme including several large-scale projects such as the Khalifa Port and Industrial Zone, the Abu Dhabi International Airport, as well as housing and health-care projects. In Kuwait and Saudi Arabia, the combination of a tense political situation and ample fiscal space will ensure loose fiscal policy in 2012.

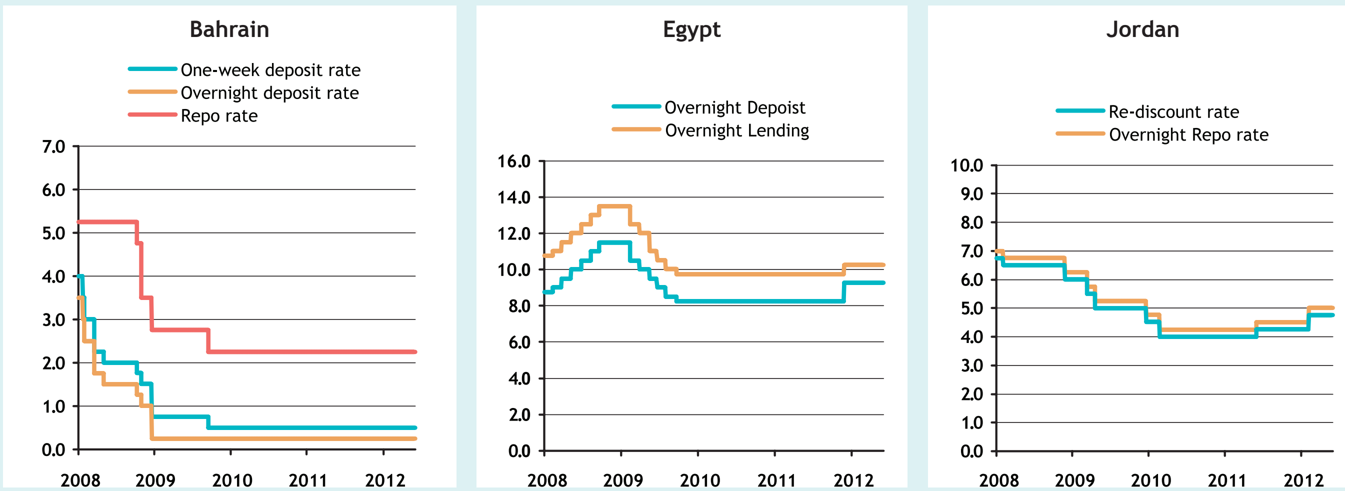
While the GCC countries have the fiscal space for continued expansion, the MDEs are more constrained in terms of fiscal policy. However, most of these countries also responded to the political tension stirred up by the social movement by increasing spending on subsidies, public sector wages and social benefits

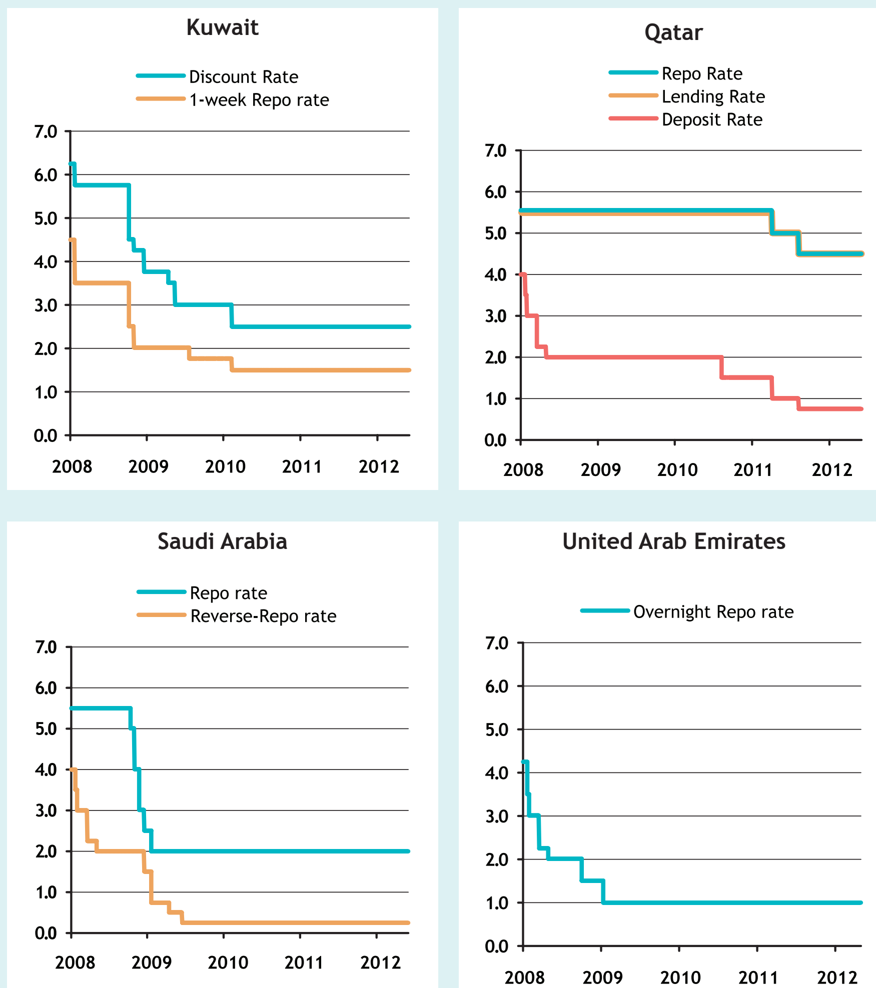
Most countries have been running consecutive and large fiscal deficits, which have led to an increase in debt levels, in particular Jordan and Lebanon

While the GCC countries have the fiscal space for continued expansion, the MDEs are more constrained in terms of fiscal policy. However, most of these countries also responded to the political tension stirred up by the social movement by increasing spending on subsidies, public sector wages and social benefits. This is not only problematic as most countries are running out of fiscal resources, but it might also have a detrimental long-term effect if the increased discretionary social spending comes at the expense of productive investments. Lower investment might have an adverse impact on the long term growth trajectory. Most countries have been running consecutive and large fiscal deficits, which have led to an increase in debt levels, in particular in Jordan and Lebanon.

The fiscal outlook for the MDEs will continue to be marked by high social spending, as most of the policies adopted in 2011 are politically difficult to reverse in the short term. There are now increasing concerns about the sustainability of debt, and plans of fiscal reform are being discussed in several countries. Jordan revealed a three-year fiscal reform agenda that plans to reduce the deficit to 3.5 per cent of GDP by 2014 by removing tax exemptions, reducing spending and reforming the subsidy system. However, the fear of social unrest forced the Government to temporary abandon its plans. In Yemen, disruptions in oil production and increased public sector wages widened the fiscal deficit in 2011. Given the priority to achieve political stability, efforts to rein in public spending will probably be deferred until 2013. In Egypt, there is still uncertainty about the future direction of economic policy, and the Government has issued conflicting statements about fiscal policy, first saying that the deficit will widen, and then saying it will stick to the budget plan. Deficits are also widening in Lebanon and the Syrian Arab Republic; the latter in particular will experience large increases due to European Union sanctions on oil revenue and the economic standstill. The Sudan is in a unique situation, as it lost about 50 per cent of government revenue following the secession of South Sudan. The country has embarked on a major adjustment of fiscal policy including large spending cuts, with the bulk of cuts in development spending and federal transfers to States. This is feared to have adverse impacts on poverty reduction and progress towards achieving the Millennium Development Goals. Despite the fiscal

Figure VII. Policy interest rates 2008-2012: selected ESCWA member countries



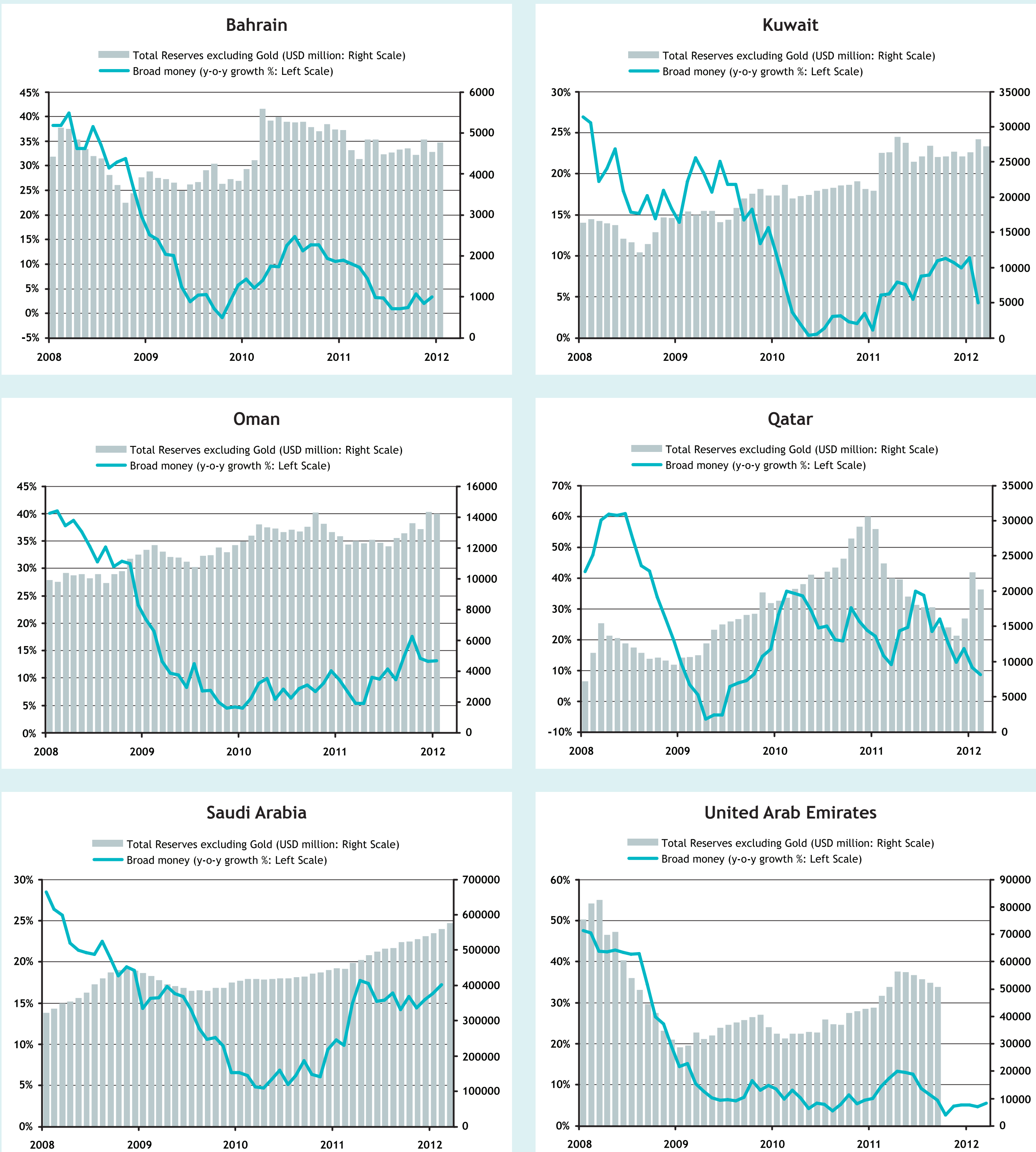


Sources: Central Bank of Bahrain, Central Bank of Egypt, Central Bank of Jordan, Central Bank of Kuwait, Qatar Central Bank, Saudi Arabia Monetary Agency and the Central Bank of the United Arab Emirates.

austerity, the fiscal deficit as a share of GDP is expected to double in 2012. Iraq is the exception in the MDEs, as higher oil prices and production increased government revenue. Iraq's 2012 budget includes a 20 per cent increase in total expenditure.

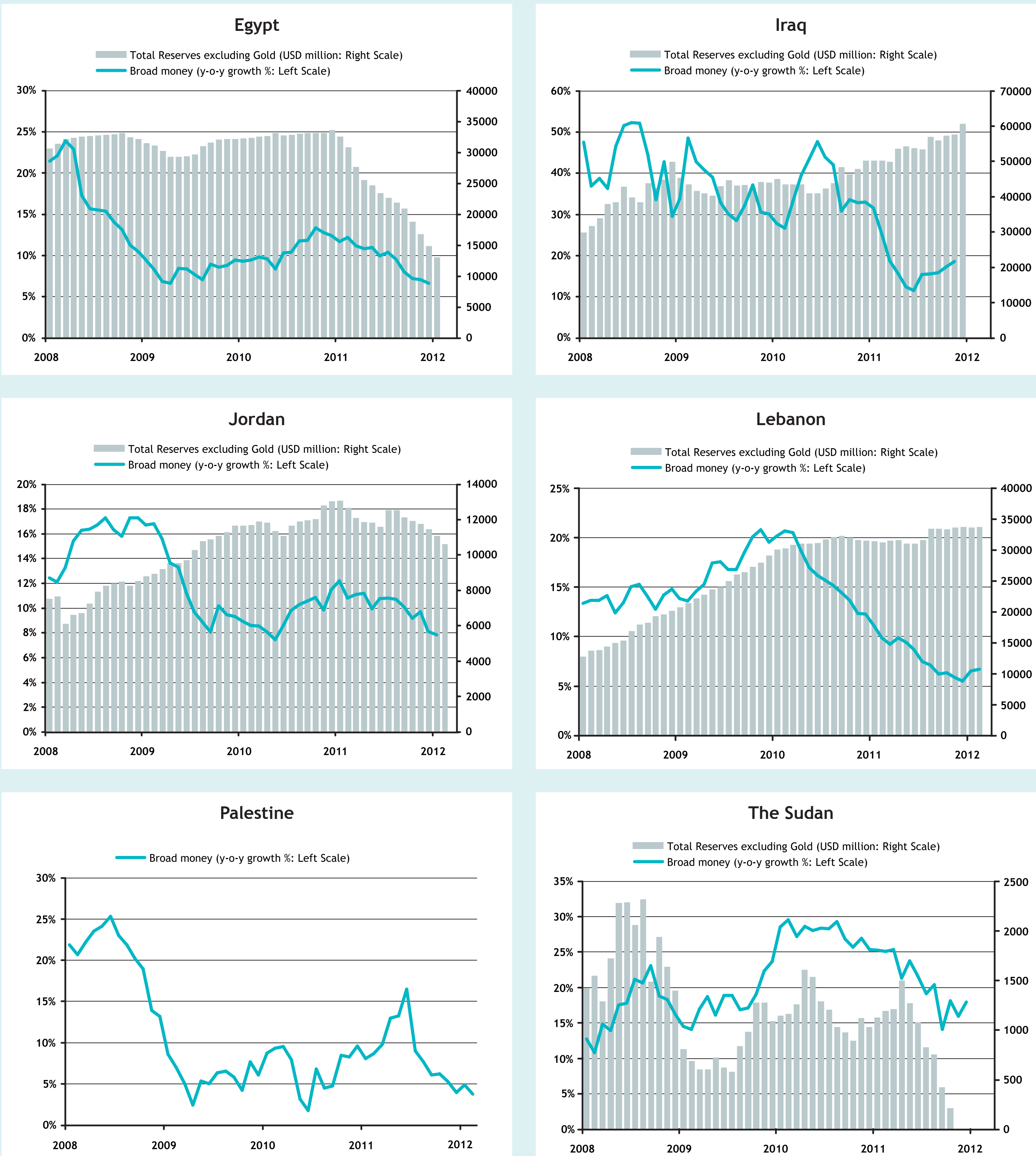
Monetary policy in the GCC has remained relatively unchanged in 2011 (see figure VII). The Central Bank of Kuwait made no changes to its official policy rate at 2.5 per cent, but appeared to be less aggressive in its demands on banks to take additional provisions. Money supply in Kuwait increased throughout 2011 to keep the system liquid and put downward pressure on interest rates. The Central Bank of Oman made no change in the official lending rate, which has remained unchanged at 2 per cent since 2009. In Qatar, the authorities have in recent years implemented measures to tighten bank supervision and strengthen financial stability. In 2011, the Qatar Central Bank cut its deposit rate from 1.5 per cent to 0.75 per cent in a bid to stimulate credit to the private sector.

Figure VIII. Monetary indicators 2008-2012: GCC countries



Sources: ESCWA staff calculation based on IMF's International Financial Statistics and national sources.

Figure IX. Monetary indicators 2008-2012: MDEs



Sources: ESCWA staff calculation based on IMF's International Financial Statistics and national sources.

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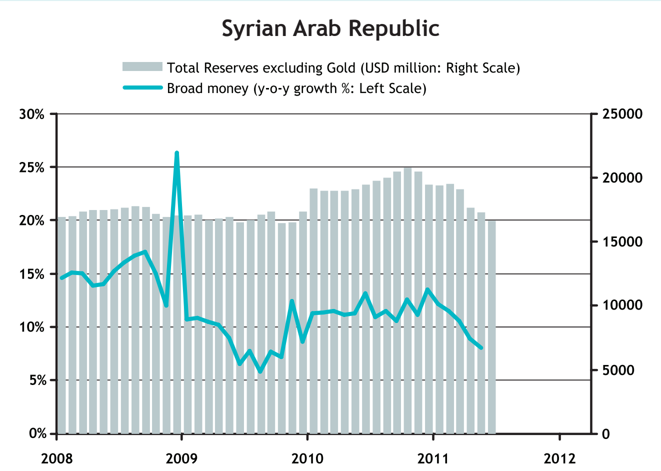
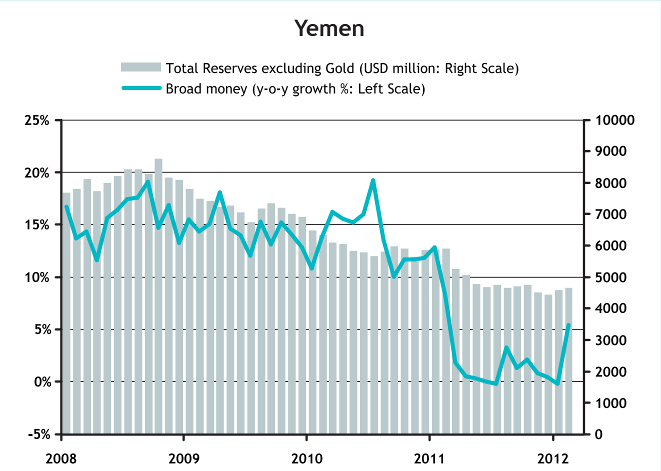
Figure IX. Monetary indicators 2008-2012: MDEs





Sources: ESCWA staff calculation based on IMF's International Financial Statistics and national sources.

In Saudi Arabia, monetaryconditions have improved since the beginning of 2011 as liquidity, bank lending and deposit growth are all increasing. The spread between the Saudi Arabia Interbank Offered Rate (SAIBOR) and the LIBOR narrowed in the second half of 2011 (see figure III-B), reflecting the more liquid relative position of the Saudi banking system. The United Arab Emirates experienced a surge in liquidity in the beginning of 2011 as it was regarded as a safe haven during the unrest in the Arab world, and the Central Bank of the United Arab Emirates has maintained its repo rate at 1 per cent.

Monetary policy in the MDEs also witnessed small changes in 2011 as most of the countries are heavily dollarized and tied to the monetary policy in the United States. However, in November 2011 the CBE increased interest rates for the first time since 2008. This was to support the Egyptian pound and boost local currency deposits. With the downward pressure on the Egyptian pound it is expected that the CBE will raise interest rate further in 2012, which might have detrimental effect on economic growth. In Jordan, the Central Bank of Jordan increased policy interest rates in May 2011 due to inflationary pressure, but further rises are not expected in 2012. In the Syrian Arab Republic, fears about a run on the Syrian pound, as mentioned above, forced authorities to take action, and the Central Bank of Syria imposed restrictions on foreign-currency transactions and abandoned the peg to the IMF's special drawing rights. Currently there is a multi-tier exchange-rate system in place, with an official exchange rate, an official intervention rate, a private bank rate and a black-market rate. The Central Bank of Iraq conducted an active monetary policy as a response to declines in inflation by reducing its policy rate.

Figure VIII shows the year-on-year growth of broad money stock and the level of foreign reserves in GCC countries[15] from 2008 to the first quarter of 2011. The broad money growth showed a recovering trend in Oman, Qatar and Saudi Arabia, while that of Bahrain, Kuwait and the United Arab Emirates showed stagnation. Qatar's and Saudi Arabia's money growth was robust compared to other GCC countries, though the rate remained below the pre-crisis level of 2008. As GCC countries' national currencies are pegged to United States dollar with exception of Kuwait, whose currency is pegged to a foreign currency basket, a low growth in money stock with growing foreign reserves implies either a sterilization policy by the monetary authority or a weak credit demand. In either case, it is reasonably envisaged that balance sheet adjustments in financial and corporate sectors were in place in Kuwait and the United Arab Emirates in 2011. In fact, the restructuring of corporate debts in a small number of investment firms in Kuwait and government related entities in the emirate of Dubai in the United Arab Emirates continued. However, the likelihood of a technical default for legal reasons, which was focused in "Dubai Shock" of 2009, became remote.

Figure IX shows the year-on-year growth of broad money stock and the level of foreign reserves in the MDEs from 2008 to the first quarter of 2012. With exception of Iraq, foreign reserves accumulation has stagnated in MDE countries. Rapid depletion was seen in Egypt, the Sudan and the Syrian Arab Republic, and a gradual decline was observed in Jordan and Yemen. Lebanon's growth in foreign reserves turned flat. Meanwhile, the growth of broad money stock was in declining trend in all MDEs, though Iraq maintained a high level of monetary growth. The situation suggests the cautious stance of the MDEs' banking systems and the likelihood of 'crowding out' by increasing government borrowings. The financial sector in the MDEs remains relatively underdeveloped. Loans-to-deposit ratios are below unity in most countries, which demonstrates the existence of a case which can be categorized as excess liquidity. However, this excess liquidity does not mean the availability of funds to the private corporate sector. In most cases, the financial sector holds government bonds which are deemed safe compared to loan assets of the private sector. This type of financial sector without depth and width is creating a challenging environment for the private sector and especially small and medium enterprises (SMEs). Since financial intermediation is heavily based on resolving information problems, banks find it more convenient to fund large businesses. Therefore, in the absence of an inclusive financial infrastructure, small firms find it more difficult to access finance in comparison with large firms. It has been a consensus in the region that SMEs lie at the core of private sector development and are essential for job creation. Given the unemployment problem in the region, there is a strong need for a more vibrant and robust SMEs that can drive private sector growth and job creation. Lack of access to finance therefore poses serious constraints on the ability to deal with the unemployment problem. Hence, there is a pressing need for an overarching national strategy for financial inclusion in the region, which in particular should aim to ensure SMEs' access to finance.

D. Social dynamics

The widespread political and social unrest in the ESCWA region known as the Arab Spring was not a reaction to a single decisive change in economic and social lives. Rather, it was decades of accumulated social problems and political exclusion that led people to the streets to protest. Ever-increasing economic burden from the global food price hike and stagnating economic prospects were crucial igniting factors. However, the motivation

The calls for dignity, freedom and social equity demonstrate that the political economy of exclusion is no longer tenable

for social unrest is beyond economic cost-benefit calculations. The calls for dignity, freedom and social equity demonstrate that the political economy of exclusion is no longer tenable. Even if the movements are of a complex nature and the underlying causes, as well as the demands of the people, differ from country to country, there are similarities, and issues related to unemployment, poverty and inequality have been highlighted in most countries. The social movements in the ESCWA region were mainly carrying an internal political agenda arguing that the first step should be political change which could then act as a catalyst for improvement in the socioeconomic situation.

The social movement has demonstrated a promising trend over the past year in terms of the social and political engagement of the Arab people. The increased participation of youth in social and political dialogue is especially promising for the future of the region. Today, the region's youth have inspired youth worldwide; the 'Occupy Wall Street' and '99 per cent' movements in the United States and Europe often make reference to the influence of Arab youth. It is also worth noting that there has been a remarkable level of participation by women in the social movement in Egypt, Jordan, the Syrian Arab Republic, and perhaps in particular in Yemen. Awarding the Noble Peace Prize to the Yemeni activist Tawakkul Karman gave recognition to the crucial role of women in the social movement. It is important that the central role of women in the protests is also reflected in discussions following the revolutions. The region must take this opportunity to transfer the voice of women from the streets to establishing political positions and concrete actions.

Among the most critical social development challenges in the ESCWA region is high unemployment. In the ESCWA staff estimate (box 3), the unemployment rate in the ESCWA region on average is among the highest in the world (see table 2), and is estimated to stand at 10.3 per cent in 2011 (see table in box 3). However, these figures alone mask the large gender disparities. Table 7 demonstrates the differences in selected ESCWA member countries for the latest years in which such data are available. It can envisage that the considerably high unemployed female population exists in GCC and MDE countries. The issue of female employment was well-recognized in Saudi Arabia in recent years as the number of women with higher academic qualifications has grown rapidly. The Government of Saudi Arabia introduced the Hafiz (incentive) programme in 2011, which includes unemployment benefits of SAR2,000 per month, to assist the nationals' job seeking activities.[16] It was reported that two-thirds of the beneficiaries of this programme are women.

Youth unemployment is a particular challenge in the region. An additional challenge in the labour market is the informal sector. As the informal sector is not clearly defined, it is difficult to measure its extent, but anecdotal evidence suggests that it plays a significant role in the ESCWA region. It accounts for around one-third of the GDP in Egypt, Jordan, Lebanon, the Syrian Arab Republic and Yemen. This implies that a large share of the population is excluded from most forms of social protection.

Labour markets in the GCC countries vary from those in the rest of the region due to their reliance on expatriate labour. Unemployment rates are often not comparable as the large foreign labour force skews the statistics and unemployment among nationals is probably much higher than what aggregate statistics show (see table 7). Despite relatively strong job creation in the region, unemployment rates for youth have been increasing. Given the young and rapidly growing population in the GCC countries, job creation for nationals is a key issue that must be addressed. Governments in these countries have responded to this challenge by creating additional jobs in the public sector, but although this is currently affordable, it is not a viable long term strategy. These countries have also adopted so-called 'nationalization' policies aiming to replace expatriate labour with nationals. However, in the long term, economic diversification must be the core strategy to provide more jobs for national youth.

Table 7. **Unemployment in selected ESCWA member countries: total and by gender** *(Percentage)*

Country	Total	Male	Female
Egypt (2009)	9.4	5.2	22.9
Jordan (2011)	12.9	11.0	21.2
Palestine (2011)	20.9	19.2	28.4
Saudi Arabia (nationals: 2009)	10.5	6.9	28.4
Saudi Arabia (non-nationals: 2009)	0.3	0.3	0.7
Syrian Arab Republic (2010)	8.4	5.7	22.5
United Arab Emirates (nationals: 2009)	14.0	7.8	28.1
United Arab Emirates (non-nationals: 2009)	2.8	1.8	7.0
Yemen (2008)	15.0	11.5	40.9

Source: 7th Edition of the ILO's Key Indicators of the Labour Market for Egypt, the Syrian Arab Republic and Yemen; Jordanian Department of Statistics press release for Jordan; table 18 of the Palestinian Central Bureau of Statistics' 2011 Labour Force Survey for Palestine; table 18.15 of the Saudi Arabian Monetary Agency's 2011 Annual Report for Saudi Arabia; table 39 of the United Arab Emirates' National Bureau of Statistics' Labor Force 2009 for the United Arab Emirates.

Box 3. **Estimation of the regional unemployment rate**

As discussed on the preceding pages, there is a slowdown in economic growth in all non-oil producing countries, and estimations show that these countries grew by a meagre 0.8 per cent in 2011 and that growth will be similarly weak in 2012. This will of course have social implications, as low growth will spillover to the labour market by reducing employment creation.

Anecdotal evidence already shows that unemployment is on the rise in the region, but timely and up-to-date social data are lagging. In the Survey, an estimation of unemployment dynamics was conducted in order to capture an early indication of the impact of the current economic slowdown on unemployment. The estimation was of a two-step process: determining the growth forecast and the growth-employment elasticity. The base data used were from the 6th edition of the ILO's Key Indicator of the Labour Market research tool (KILMnet). The estimation assumes no changes to the labour force participation rate in the projection period. It calculates growth-employment

Unemployment estimation in the ESCWA region 2008-2012

	2008	2009	2010	2011	2012
Bahrain	5.2	5.4	5.2	5.8	5.9
Kuwait	2.0	2.1	2.1	2.3	2.3
Oman	7.1	8.3	8.5	8.9	9.4
Qatar	0.5	0.9	0.9	0.9	0.9
Saudi Arabia	6.4	6.7	7.4	6.1	6.9
United Arab Emirates	4.0	4.2	5.0	4.1	3.5
GCC average	5.1	5.4	6.0	5.1	5.4
Egypt	8.7	9.5	8.5	9.0	9.7
Iraq	16.7	17.8	17.1	16.7	16.0
Jordan	12.4	12.5	12.0	11.5	11.1
Lebanon	8.7	8.7	8.6	9.5	10.3
Palestine	26.0	24.3	22.1	19.7	19.9
The Sudan	8.6	8.9	9.4	11.8	13.8
Syrian Arab Republic	8.2	8.2	9.4	13.9	20.4
Yemen	14.9	14.9	10.8	15.6	17.3
MDE average	10.5	11.1	10.3	11.8	13.2
ESCWA average	9.3	9.8	9.3	10.3	11.4

Source: ESCWA staff estimation based on data from ILO's KILMnet and the United Nations' World Population Prospects: the 2010 Revision. Averages are weighted averages using the size of the labour force.

Continued

Box 3. **Estimation of the regional unemployment rate**

elasticity for each country/territory based on the period 2007-2009. (For some countries a longer time period is used to smooth strong business cycles). Employment is then projected using these sets of elasticity and the growth forecasts to estimate the employment in the projection period. Unemployment rates are then calculated as the difference between the number of people in the labour force and the projected employment numbers, divided by the labour force population. Here we present some rough estimates of the unemployment in the region. These estimations must be evaluated carefully, but they give some hints to the degree of the impact.

In the GCC countries, the labour market has its own specific characteristics given the high share of migrant workers. Given the strong linkages between growth and immigration to these countries, it is difficult to make accurate projections. However, estimations show that unemployment in the GCC countries is stable in most of the countries, with the exception of a small increase in Bahrain and Oman.

In the MDEs, the unemployment situation, which was severe before the global economic crisis and the Arab Spring, is expected to have deteriorated in 2011. In these countries, estimations show that unemployment rates increased from 10.3 per cent in 2010 to 11.8 per cent in 2011 on average. The increase was largest in countries affected by internal turmoil such as the Sudan, the Syrian Arab Republic and Yemen. Given the weak growth forecasts for 2012, the unemployment situation is expected to deteriorate further in 2012. The unemployment rates will increase from 11.8 per cent in 2011 to 13.2 per cent in 2012 on average. In particular, in the Syrian Arab Republic, the internal instability and weak growth will increase unemployment to around 20 per cent. In all other MDEs, unemployment rates will be in double digits, with the exception of Egypt where they are estimated to be 9.7 per cent.

Before the Arab Spring, unemployment rates in the ESCWA region were already among the highest in the world. This high unemployment, especially among youth, was cited as among the reasons for the Arab Spring. However, estimations show that increasing unemployment rates is also a result of the Arab Spring, at least in the short run. Countries such as Yemen and the Syrian Arab Republic experienced an almost doubling of their unemployment rates. The unemployment rates in Egypt have also been on an upward trend since 2010.

In many ESCWA member countries, it is a challenge to respond to the short-term employment demands of the people. In the past, it has been obvious that ESCWA member countries have not been able to create the jobs needed to meet the needs of an increasing labour force. Addressing the unemployment challenge must be considered a top priority in the post-Arab Spring context in order to foster stability in the region. Policymakers must take both the necessary short- and long-term steps to promote employment creation.

Poverty and inequality are also widespread in the ESCWA region, but they are often not reflected in most indicators. Using a US$1 or US$2 per day poverty line is not applicable in most countries in the region, so the region should develop alternative ways to measure poverty. Poverty rates in Yemen and the Sudan are high at around 50 per cent according to the national poverty lines. In the other MDEs poverty is also considerable and varies between 20 to 40 per cent, while poverty has special manifestations in the GCC countries that should be addressed.[17] Indicators of inequality, such as the Gini coefficient, indicate moderate levels of income inequality in most ESCWA member countries. However, these results are controversial due to the measurement method and to the fact that it does not coincide with the glaring manifestations of rising inequality in many countries in the region.[18] Regional disparities are also highly present in the region. This is particularly apparent in access to public services, electricity and water, which differs between rural and urban areas. This fuels inequalities and the potential for increased rural-to-urban migration, as well as the challenge of social dislocation.

Unemployment, poverty and inequality are not newly emerging problems, but they have become more serious in recent years due to pressure from globalization coupled with ineffective domestic social and economic policies. The social movement and political protests succeeded in bringing these issues to the top of the agenda. Several countries adopted policies as a response to the protests, such as increased unemployment benefits, wages and housing allowances, as well as increased public employment. However, these discretionary social policies are not sufficient to tackle the root cause of the social discontent. There is a need for comprehensive social policy which will bring upward social mobility. Socioeconomic development has not received sufficient attention at this transformative stage where the focus has been mainly on political reform. In the light of experience in several countries in the region, this excessive focus on political reform may mask the urgency of socioeconomic transition. Without substantive socioeconomic dialogue within the transitional bodies, the discussion digressed into a traditional election competition and ideological debate. The ESCWA region needs to establish a social dialogue to articulate a new approach to development based on inclusion, equality and participation. There is a need to move away from the pattern of economic growth that has failed to create sufficient decent employment. The promotion of economic diversification and competitiveness must be developed in parallel with an integrated social policy in order to synchronize policymaking with a long-term development vision.

CHAPTER III.

CONCLUDING REMARKS

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The global context that surrounds the ESCWA region is a mixture of positive and negative developments. Indeed a number of external factors may be considered to have positive impacts on the ESCWA region's economic prospects. For example, the region's central location between emerging growing centers – East and South Asia and Africa – will likely be an advantage for the coming year. However, this factor is yet to be sufficiently robust to move the region away from its energy-export dependency. Recent oil sector developments in the ESCWA region set a resiliently positive sentiment on the region's economic prospects, particularly of GCC countries. It also has masked the elements of pessimism due to a series of political and social unrest in the ESCWA region, particularly in Bahrain, Egypt, the Sudan, the Syrian Arab Republic and Yemen. It should be noted, however, that the optimistic prospects in the oil sector have not been translated into a perception of an 'oil boom'. GDP growth performance between major oil producers, namely GCC countries and Iraq, and the rest of the ESCWA region appeared to diverge. The subdued intraregional tourism, foreign direct investment and foreign portfolio investment clearly failed to produce a positive region-wide spillover effect.

By the end of the first half of 2012, the global economic outlook became increasingly uncertain given the looming recession and policy crisis in the eurozone area over sovereign and private debts. Political agreements to resolve tangled institutional arrangements regarding the single currency are proving elusive. Potential negative impacts resulting from Greece's exit from the single currency are difficult to calculate. The slow recovery of the United States and less-than-expected growth performance of developing economies also cast a shadow of uncertainty. Compared to 2008-2009, when there was a consensus for fiscal stimulus to get the world out of crisis, the fiscal space for active policy implementations is limited for the majority of countries, particularly developed countries. Major developing countries, such as Brazil, China and India, changed their policy stances in the first half of 2012 by shifting from tightening to easing. However, the impact of this policy change in developing countries has yet to be realized. Over recent years, ESCWA member countries have put forth efforts in economic diversification and there are several promising cases. Nevertheless, the ESCWA region's economic prospects became more reliant on oil sector development. The stagnation in global demand growth and the associated plunge in oil prices remain a contingency. This fundamental downside risk for the ESCWA region cannot be ruled out in the present global economic circumstances.

The ESCWA region has already reduced its exposure to international capital markets. Inflow of foreign funds, at times excessive before 2008, has already decreased significantly. The region's relative cost of funding has already risen against that of United States dollar. In the meantime, the rising risk perception within the ESCWA region subdued intraregional flows of funds and people. More signs of vulnerability to balance-of-payments crises have appeared in the MDEs. In fact, Egypt, the Sudan, the Syrian Arab Republic and Yemen are in extraordinary situations to varying degrees against which their respective monetary authority had to take measures. The vulnerability increased in Jordan and Lebanon as their accumulation of foreign reserves slowed down. Immediately after the global financial crisis of 2008, a balance-of-payments crisis has not been observed in most of the countries, which was a marked difference from the previous financial crisis in Asia in 1997 and Mexico in 1995. Due to the limited fiscal space and already exhausted monetary measures in developed countries, next global financial shock, if it takes place, may likely cause balance-of-payments crises in developing countries, including the MDEs of ESCWA region. In order to cope with such a contingency, an effective framework for regional cooperation is vital. After the Asian financial crisis, East and South Asian countries have set up a web of bilateral swap agreements under the Chiang Mai Initiative (CMI). This web of bilateral agreements has evolved over the last decade into a multilateral setting in 2010.

The ESCWA region does not lack regional initiatives through Arab organizations. Moreover, numerous bilateral initiatives have been observed. Saudi Arabia implemented a bilateral financial support package to Egypt in the second quarter of 2012, which reversed the trend of foreign reserves depletion. At its summit in December 2011, the GCC decided to establish a US$5 billion fund for direct fiscal support to Jordan and Morocco. GCC countries also form the core of the 'Friends of Yemen' donor coordination mechanism. However, the region lacks thrust for building up a bottom-up regional cooperation scheme like the CMI is for East and South Asia. The uncertain political and social situations mask the potential value and benefit of regional cooperation. At this politically difficult time, the challenge for policymakers in the region rests on their creativity to weave bilateral trust into an effective multilateral setting for the region's economic and social developments.

If the region's economic and social development is geared toward polarization, the organized and managed transition under the guidance of the region's policymakers would be more difficult. It is high time for the region's policymakers to articulate a regional cooperation framework for Arab regional integration. Economic and social policies can be more effective by using regional leverage to tackle pressing issues. ESCWA is convinced that regional integration is an answer to the Arab Spring. Regional integration enables policymakers in the region to take on the wave of the Arab Spring to facilitate the constructive transition of the economic and social lives of the people. Regional integration can set a bridge over political divides. One of the crucial purposes of ESCWA is to promote and support Arab regional integration. ESCWA is scheduled to follow up on the issue through a series of forthcoming publications, including the Arab Regional Integration Report and the Arab Economic Outlook. ESCWA will continue to serve as a catalyst for massing region's ideals and ideas for the Arab economic and social transition.

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6. Ibid., p.11.
7. TED spread is the spread between three-month LIBOR and three-month United States Treasury Bill interest rates. TED spread is a measure of liquidity as it indicates a relative borrowing cost of private entities to the United States Treasury. Historically it has stood at around 50 basis points (0.5 percentage points). The higher TED spread implies a shortage in United States dollar liquidity in the private sector as the funding cost of the United States dollar in the international money market rises more than that of United States Treasury.
8. The ESCWA region consists of two subregions: the countries of the Gulf Cooperation Council (GCC), namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; and the more diversified economies (MDEs), namely Egypt, Iraq, Jordan, Lebanon, Palestine, the Sudan, the Syrian Arab Republic and Yemen.
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The 2011-2012 Survey assesses the most recent economic and social developments in the Economic and Social Commission for Western Asia (ESCWA) region using data that became available by the second quarter of 2012. It found that differences in growth in gross domestic product (GDP) between major oil producers and the rest of the ESCWA region seemed to diverge. Oil export revenues in the Gulf Cooperation Council (GCC) countries marked an all-time high. However, subdued intraregional tourism, foreign direct investment and foreign portfolio investment clearly failed to produce the positive spillover of oil revenues throughout the region. The Survey emphasizes that this growth polarization deepens already uncertain prospects of economic and social development, noting that the unemployment rate in the region remains the highest in the world. The Survey concludes that harnessing 'regional leverage' by developing regional cooperation frameworks for regional Arab integration is crucial in tackling pressing issues to achieve a constructive economic and social transition.

ESCWA

United Nations House, Riad El Solh Square
P.O. Box: 11-8575, Beirut, LEBANON
Tel.: +961 1 981301; Fax: +961 1 981510
www.escwa.un.org

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