UN-ESCWA

ESTIMATES AND FORECASTS FOR GDP GROWTH IN THE ESCWA REGION

2007-2008

UNITED NATIONS

Economic and Social Commission for Western Asia

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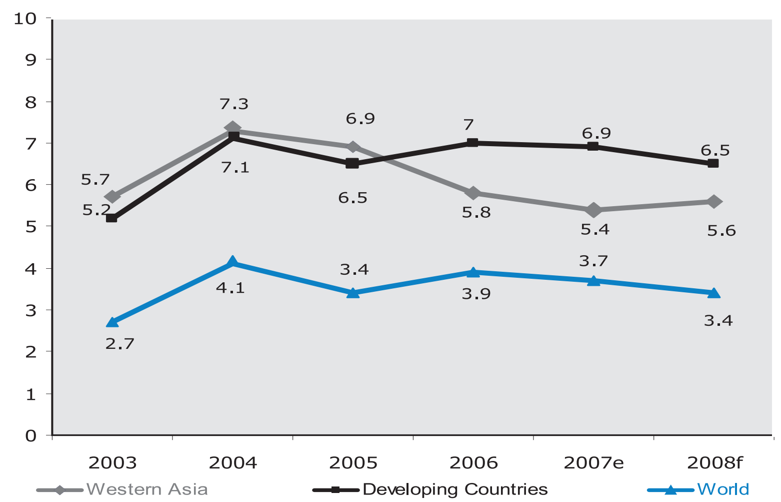
A. OVERVIEW

In 2007, the Economic and Social Commission for Western Asia (ESCWA) region registered its fifth consecutive year of robust growth in the wake of a continuous increase in oil prices and a supportive global macroeconomic environment. For the region as a whole, real growth of gross domestic product (GDP) was an estimated 5.4 per cent in 2007, which is significantly above the world average of 3.7 per cent, albeit below the projected average of 6.9 per cent for developing countries (see figure 1).[1] The region's strong economic expansion is likely to continue in 2008, with real GDP growth forecast at 5.6 per cent based on persistently high oil prices and strong domestic demand in most ESCWA member countries. Oil prices of the Organization of Petroleum Exporting Countries (OPEC) are expected to remain high and volatile throughout 2008 as a result of increasing global energy demand, low excess production capacities, refining bottlenecks and continuing concerns over supply disruptions caused by geopolitical conflicts.[2] The International Energy Agency (IEA) estimates that global demand for oil is set to increase by some 2 per cent in 2008 as the energy needs of fast-growing developing countries continue to expand at a rapid pace, especially those of China and India, while demand for oil products in the countries of the Organisation for Economic Co-operation and Development (OECD) remains stable.

Subsequent to substantial declines in the last quarter of 2006, oil prices followed a steady upward trend throughout 2007. The average monthly price of OPEC oil increased from $50.8 per barrel in January to $89.0 in November 2007. At the end of that month, crude oil prices were within the range of inflation-adjusted highs set in early 1980, before falling back modestly. As of mid-December 2007, the average yearly price for OPEC oil stood at $68.4, which corresponds to an increase of 12 per cent from 2006. While there are deep uncertainties concerning future trends in energy markets, oil prices are likely to remain at elevated levels in the short term. The baseline scenario that underlies GDP forecasts of the ESCWA region assumes that in the course of 2008, oil prices will decline modestly from current levels, thereby resulting in an average annual price of OPEC oil of $69.0.

1 Estimates and forecasts for GDP growth in the 13 ESCWA member countries, as well as regional and subregional averages, are provided in the annex.
2 Historically, the OPEC basket has been priced below the West Texas Intermediate (WTI) by an average of $2 to $4 per barrel, and below Brent by $1 to $2 per barrel. In 2007, average spreads widened substantially and the average annual price difference between WTI and OPEC oil was in the range of $6 to $8 per barrel.

Figure 1: Average Real GDP Growth by Region (in %)



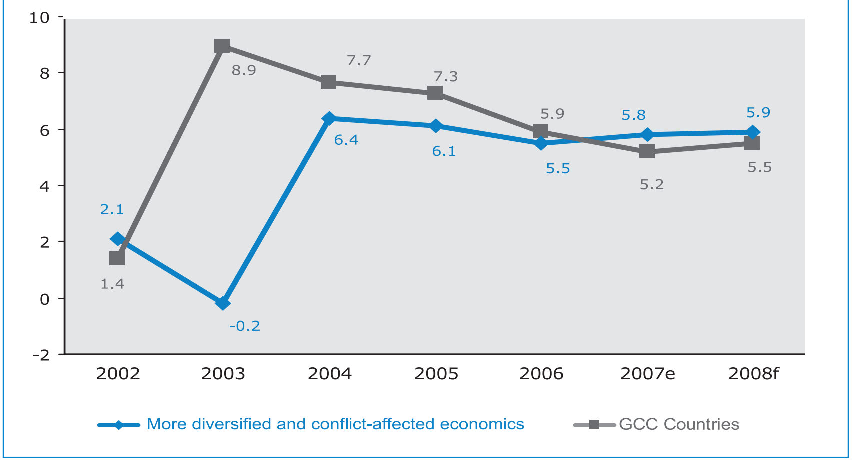
Sources: ESCWA, based on data by the Department of Economic and Social Affairs (DESA) and national statistical sources. 2007 figures are estimates, 2008 figures are forecasts

In 2007, average GDP growth in the countries of the Gulf Cooperation Council (GCC) was estimated at 5.2 per cent, which represents a modest drop from the 5.9 per cent in 2006 (see figure 2).[3] In 2008, GDP growth is expected to average 5.5 per cent, supported by continuing high oil revenues, increased public spending and a positive investment climate. However, the favourable macroeconomic picture has increasingly been clouded by rising inflation rates. As a result, local purchasing power has been eroded and the pressure on monetary authorities to reconsider exchange rate regimes increased. Following a decade of high price stability, inflation rates in the GCC countries started to rise in 2004, beginning primarily in the fast-growing economies of Qatar and the United Arab Emirates.[4] In the last quarter of 2007, inflation rates reached multi-year highs in all six GCC countries as domestic demand expanded strongly and money supply soared. At the same time, the United States dollar weakened sharply against major currencies, and the Federal Reserve Bank in

3 The GCC countries comprise Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.
4 The high price stability of the past was supported by, among other factors, national currencies pegged to the United States dollar. This peg currently exists in all GCC countries with the exception of Kuwait, which dropped its dollar peg in May 2007 and replaced it by a peg to a basket of undisclosed currencies.

the United States of America responded to the turmoil in international financial markets and the rising concerns about an impending recession by lowering key interest rates.

Figure 2: Real GDP Growth by Subregion (in %)



Source: ESCWA, based on national statistical sources.

As a result of the diverging economic trends of the United States and the Gulf subregion, a heated debate has developed among financial experts, economists and policymakers on whether the interests of the GCC countries can best be served by revaluating domestic currencies, switching to more flexible exchange rate regimes or maintaining the peg to the United States dollar.

In the more diversified and conflict-affected economies of the ESCWA region, average growth increased modestly from 5.5 per cent in 2006 to 5.8 per cent in 2007 (see figure 2). GDP growth in the five more diversified economies (MDEs) accelerated from 5.8 per cent to 6.0 per cent.[5] However, the relatively high subregional average masks substantial differences between individual countries. Based on record levels of foreign direct investment (FDI) and strong domestic demand, growth in Egypt

5 The more diversified economies (MDEs) of the ESCWA region comprise Egypt, Jordan, Lebanon, Syrian Arab Republic and Yemen. For the purpose of this analysis, Iraq and Palestine are treated separately as conflict-affected countries and territories.

continues to be robust; and overall macroeconomic conditions remain favourable in Jordan and the Syrian Arab Republic despite minor slowdowns in economic growth in 2007. By contrast, Lebanon and Yemen experienced another year of below-potential growth.

In Lebanon, the continuing deadlock between the Government and the main political opposition, combined with the unstable security situation, exerted a negative impact on domestic and foreign investment, private spending and tourist receipts. As a result, GDP growth in 2007 was an estimated 2 per cent, following zero per cent growth in 2006. In Yemen, high oil prices and new development assistance funds helped to support domestic demand and mitigate the impact of declining oil production. However, given high population growth rates, Yemen's expected GDP growth of 3.7 per cent in 2007 is well below the rate required to accelerate progress towards poverty reduction targets.

By and large, the growth pattern in MDEs is expected to remain unchanged in 2008, with average growth predicted to slow down to 5.8 per cent. While growth in Egypt is forecast to decelerate by approximately half a percentage point to 6.7 per cent, a slight economic recovery is anticipated in Lebanon, where real GDP is expected to expand by 3 per cent.

In Iraq and Palestine, economic developments in 2007 continued to be adversely affected by violence and high political uncertainty. Real GDP in Iraq is estimated to have grown by 6.1 per cent in the wake of increasing oil prices and expanding activities in the non-oil sector, which can be largely attributed to greater international welfare assistance. At the same time, inflation and unemployment rates dropped considerably. Based on the assumptions of prevailing high international oil prices and reduced violence, growth in Iraq is expected to accelerate to 7.5 per cent in 2008. In Palestine, lower foreign assistance and ongoing restrictions on the movement of goods, people and capital continued to reduce significantly economic activity during the first two quarters of 2007, with only a modest recovery in the third quarter. Assuming some progress on the political front, as well as increased flows of foreign assistance, real GDP growth in 2008 is projected to reach 4.5 per cent.

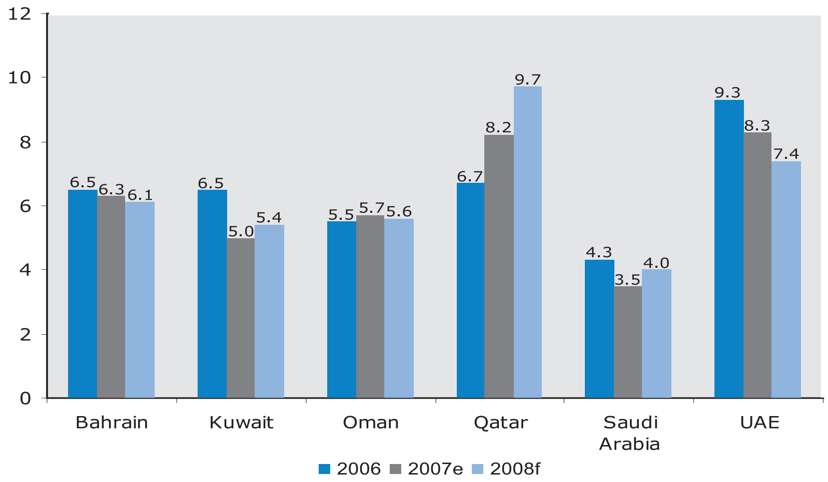
B. COUNTRIES OF THE GCC SUBREGION

In the GCC subregion, the economic recovery that began in 2003 continued during 2007, albeit at a slower pace than in previous years. Average real GDP growth in the subregion is estimated to have slowed from 5.9 per cent in 2006 to 5.2 per cent in 2007. Within the context of stable macroeconomic conditions, further increases in oil export revenues boosted domestic consumption demand and investment spending, thereby contributing to strong non-oil sector growth, particularly in construction, manufacturing, trade and financial services. The average yearly price of OPEC oil is expected to have increased by 12 per cent from 2006 to 2007, which more than offsets the estimated decline in total oil production of the GCC subregion at 3-5 per cent. Large public investment projects, for example in the oil and gas sector, infrastructure, real estate, metal industry, water and tourism, have supported GDP growth during recent years and, moreover, have increased future output capacities. In addition, institutional reforms have helped to stimulate private sector activities. The recent report by the World Bank, entitled Doing Business 2008, highlighted the positive reform efforts in Saudi Arabia, which improved its ranking on the ease of doing business index from 38 in 2006 to 23 in 2008.[6] The other three GCC countries covered in that report, namely, Kuwait, Oman and the United Arab Emirates, have equally made notable progress during recent years.

The economic prospects of the GCC subregion continue to be favourable. Average growth in 2008 is expected to accelerate to 5.5 per cent in the light of projected high oil prices and further increases in Government spending. Just as in 2007, Qatar and the United Arab Emirates are expected to record the highest growth rates in the subregion (see figure 3 and the annex). In Qatar, economic growth is forecast to accelerate from 8.2 per cent in 2007 to 9.7 per cent in 2008. A strong increase in public expenditures and higher oil and gas production, combined with considerable population growth, are expected to be major drivers of the ongoing economic expansion.

6 This index ranks a total of 178 countries. See the World Bank, Doing Business 2008, which is available at: http://www.doingbusiness.org/documents/DB-2008-overview.pdf.

Figure 3: Real GDP Growth Rates in the GCC Subregion (in %)

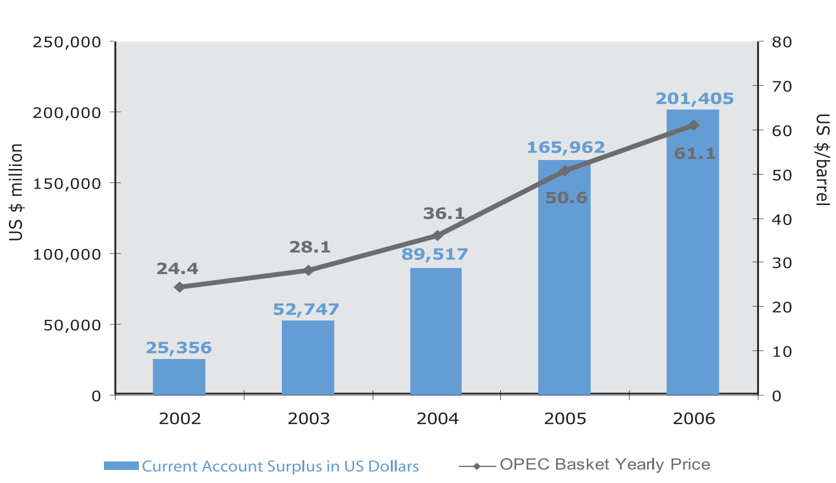


Source: ESCWA, based on national statistical sources.

The United Arab Emirates is set to experience a modest slowdown of growth in 2008, with real GDP projected at 7.4 per cent following estimated growth of 8.3 per cent in 2007. By contrast, growth in Saudi Arabia is expected to edge higher in 2008. Despite a strong performance of the non-oil sector, real GDP is estimated to have increased by only 3.5 per cent in 2007, which is well below the rates achieved during the period 2003-2006. That can be largely attributed to significant oil output cuts in the second half of 2006 and in February 2007, which resulted in a decrease by some 7 per cent of Saudi Arabia's daily production. Based on expectations of higher average oil output, increased private investment and strong Government spending, real GDP growth in Saudi Arabia is anticipated to increase to 4.0 per cent in 2008. In Bahrain, Kuwait and Qatar, the robust economic performance of recent years is likely to continue throughout 2008, with growth rates projected to emulate those achieved in 2007.

As a result of booming oil revenues, GCC countries have been running significantly high fiscal and current account surpluses over the past few years (see figure 4). According to national data, the combined current account surplus of the six GCC countries increased from $25.4 billion in 2002 (7.2 per cent of total GDP) to an estimated $201.4 billion in 2006 (42.8 per cent of GDP). In absolute terms, Saudi Arabia is by far the largest surplus country in the GCC subregion and accounted for 49 per cent of the total current account surplus in 2006, while Kuwait and the United Arab Emirates accounted for 25 per cent and 17 per cent, respectively. The current account to GDP ratios in 2006 ranged from 16.5 per cent in Bahrain to a staggering 86.9 per cent in Kuwait. It is expected that current account surpluses decreased slightly in 2007 as a result of lower oil exports from Saudi Arabia and increased spending on imports. In 2008, growth in import spending is expected to outpace export revenue growth, thereby resulting in a further modest decline of the total current account surplus of the GCC subregion.

Figure 4: OPEC Oil Prices and Current Account Surplus in the GCC Subregion



Sources: ESCWA, based on data by the Organization of Petroleum Exporting Countries (OPEC) and national statistical sources.

The substantial current account surpluses are matched by a net outflow of capital funds and a surge in international assets held by national central banks and Governments. In most GCC countries, a large part of the assets is transferred to so-called stabilization funds or sovereign wealth funds (SWFs), the latter of which includes the Abu Dhabi Investment Authority and the Kuwait Investment Authority. Globally, it is estimated that those oil investment funds hold approximately 20 per cent of the world's reserve stock. While estimates of the size of SWFs in the GCC subregion vary significantly, there is no doubt that those funds and the acquisitions they have recently undertaken have contributed towards increasing the weight of the GCC countries in the global economy.[7]

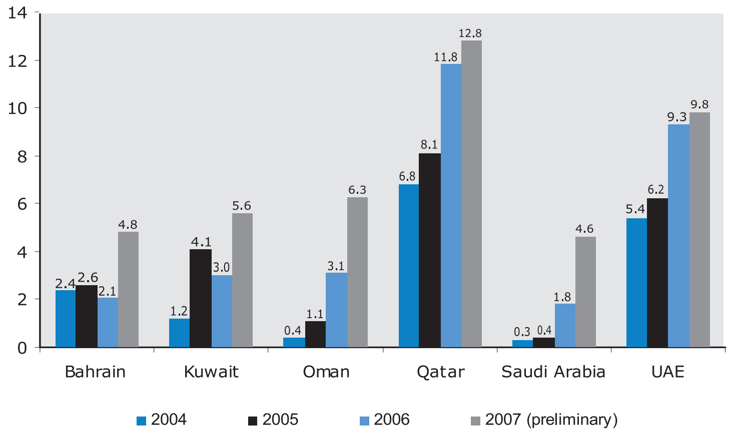
In addition to very sizeable current account surpluses, the GCC countries continue to record substantially high fiscal budget surpluses. In Kuwait, the budget surplus in the fiscal year 2006/07 was estimated at more than 30 per cent of GDP. Fiscal budgets in all the countries of that subregion are generally based on very conservative oil price projections. For example, the 2008 budget for Saudi Arabia assumes an average oil price of $45, which is almost 50 per cent below the current price. Those conservative price projections are aimed at preventing excessive Government spending, thereby drawing on lessons from previous oil booms. However, calls for further increases in public spending appear justified in view of the significant social and economic challenges across the subregion, including high unemployment and underemployment rates among young nationals and the need to diversify national export bases. Education, health, infrastructure and industrial development are among the sectors that need additional resources. Given the positive short-term outlook on growth and macroeconomic stability in the GCC subregion, national authorities must ensure that the benefits of the ongoing economic expansion are shared by all segments of society.

On the monetary side, abundant liquidity, strong consumption and investment demand, and a constant weakening of the United States dollar resulted in stronger inflationary pressures in 2007 (see figure 5). According to latest national data, consumer price inflation rates in all six GCC countries increased considerably throughout 2007 to reach multi-year highs in the last quarter. In Qatar and the United Arab Emirates, sharply rising housing costs and a rapid growth in credit to the private sector pushed inflation rates in 2007 to an estimated 12.8 per cent and 9.8 per cent, respectively. Given that the computations of the consumer price index (CPI) do not reflect fully the changing relative weights in expendi-

7 According to most estimates, total assets of those funds are valued at more than $1 trillion.

tures, actual inflation rates in both countries could be even higher. In Oman and Saudi Arabia, where CPI inflation in 2005 was 1 per cent or less, increased rental costs and strong price increases for food products yielded sharply higher inflation in 2007. In Kuwait and Bahrain, while price increases appeared more balanced, increases in rents and food prices also played a significant role in accelerating inflation. Sharp increases in housing costs and food products across the GCC subregion have led to an erosion of the purchasing power for large segments of society, especially those in the lower-income brackets. That group spends a relatively high share of total income on basic goods (rents, food and energy), whose prices have risen more markedly than average wages and salaries. Both private and public sector employees in all the GCC countries have recently demanded significant salary increases in order to meet rising costs of living. In several countries, that has resulted in sizeable pay increases, especially in the public sector. For example, salaries of federal Government employees in the United Arab Emirates are set to increase by 70 per cent in January 2008. Strong pressure on wages to catch up with the sharp price increases of most consumption goods will keep upward pressure on inflation rates in 2008.

Figure 5: Inflation Rates in the GCC Countries (in %)



Source: ESCWA, based on national statistical sources.

The combination of accelerating domestic inflation, a continuous weakening of the United States dollar against other major currencies and recent cuts in the Federal Reserve's benchmark rates has led to an intense policy debate on the appropriate monetary and exchange rate policies for the GCC countries. That debate is all the more relevant coming at a time when the Governments of Bahrain, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates have to decide whether to proceed with the plans of establishing a monetary union by 2010, following the decision by Oman in late 2006 to pull out of the single currency plan.

Currently, with the exception of Kuwait, all the GCC countries peg their national currencies to the United States dollar. As a result, monetary authorities in the GCC subregion face a serious policy challenge, namely: they can follow the latest moves by the Federal Reserve Bank in the United States and reduce benchmark interest rates at a time when strong economic growth and increasing inflation rates would instead require a tightening of monetary policy; or they can allow a widening spread between domestic and United States interest rates, thereby stimulating capital inflows and possibly further increasing the upward pressure on national currencies. In the light of that dilemma, a growing number of analysts and policy experts have suggested a move to more flexible exchange rate regimes such as replacing the dollar peg by a peg to a basket of goods. A less radical policy option would be a one-time revaluation of national currencies against the dollar. Given the rising concern of GCC authorities with regard to inflation, that alternative is increasingly being discussed, particularly in Saudi Arabia and the United Arab Emirates. However, fiscal and monetary authorities remain reluctant to such a move, given that it reduces the value of oil exports and foreign reserve assets and, moreover, that it further complicates monetary integration. They have repeatedly emphasized that the dollar pegs will remain in place, and that the current turbulences and speculations are only a temporary phenomenon.

Subsequent to substantial gains by the stock markets of the subregion in 2003 to 2005, several of those markets faced major corrections in 2006. In Saudi Arabia, the main market index dropped by more than 50 per cent during that year, while market indices in Qatar and in Dubai and Abu Dhabi in the United Arab Emirates slipped by 40-45 per cent. In 2007, equity markets in the GCC countries recovered from the poor performance of the previous year to record strong gains. Specifically, the Muscat Securities Index in Oman witnessed the highest gains in the subregion, with a growth of more than 60 per cent to reach an all-time high in late 2007. In Qatar, Saudi Arabia and the United Arab Emirates, where the losses in 2006 had been the most severe, stock markets regained some of the lost ground, albeit with valuations still below those prior to the corrections of 2006. Given the strong macroeconomic prospects for the subregion and price-earning ratios and other financial indicators that are close to international averages, the general outlook for GCC stock markets remains positive. However, comparatively small market sizes could lead to continuing high volatility. So far, the GCC subregion has not been seriously affected by the turmoil in the international credit market that was caused by the sub-prime mortgage crisis in the United States. Excess liquidity in the region, the timely intervention of central banks and increased preference of local investors to invest in local capital markets mitigated the negative impact of that financial crisis.

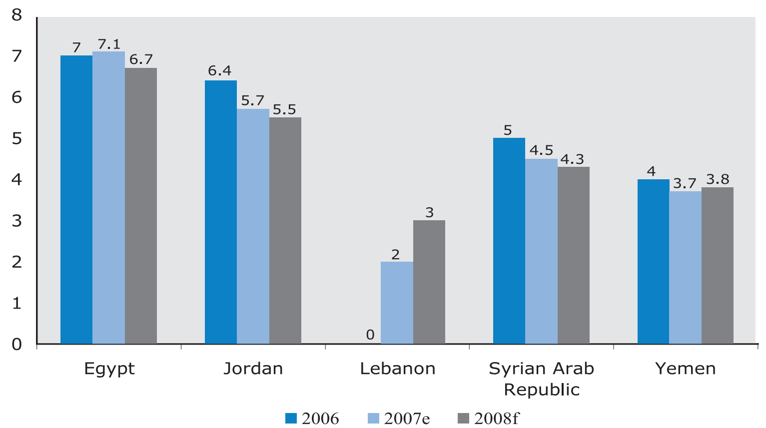
C. MORE DIVERSIFIED ECONOMIES

Average growth in the MDEs of the region is expected to have increased slightly from 5.8 per cent in 2006 to 6.0 per cent in 2007. By and large, the growth pattern in that subregion is expected to remain unchanged in 2008, with average growth forecast to slow down to 5.8 per cent. The relatively high subregional average masks substantial differences across individual countries (see figure 6).

1. EGYPT

Economic growth in Egypt continued to be strong, with real GDP expanding by an estimated 7.1 per cent in 2007. While the country's macroeconomic prospects remain largely favourable, growth is predicted to slow down to 6.7 per cent in 2008, owing partly to the expected downturn in the United States economy and slower investment growth.

Figure 6: Real GDP Growth Rates in the More Diversified Economies (in %)



Source: ESCWA, based on national statistical sources.

Note: For the purpose of this analysis, Iraq and Palestine are treated separately as conflict-affected countries and territories.

The robust and broad-based economic expansion of Egypt in 2007 was supported by strong domestic consumption and investment demand, and soaring FDI, in addition to high workers' remittances, tourism revenues and Suez Canal receipts. Moreover, fixed capital formation has become a major driver of growth, with the rising momentum of the economic reform process that was initiated in 2004. Recently, the World Bank identified Egypt as the world's top reformer in the period 2006-2007, with clear progress in several areas, including starting a business, registering property, obtaining credit and facilitating cross-border trade.[8] In July 2007, Egypt became the first Arab country to sign the OECD Declaration on International Investment and Multinational Enterprises aimed at providing a balanced framework in order to improve the international investment climate and to encourage the positive contributions multinational enterprises can make towards development. Over the fiscal year 2006/07, net inflows of FDI to Egypt increased by 82 per cent to reach $11.1 billion. The ratio of net FDI inflows to GDP, which registered a low of 0.5 per cent in the fiscal year 2003/04, rose to 8.5 per cent. The FDI increase in

8 The World Bank, Doing Business 2008, available at: http://www.doingbusiness.org/documents/DB-2008-overview.pdf.

2006/07 can be attributed to the establishment of new companies, capital expansions of companies already in operation, the sale of assets to non-residents and significantly higher inflows in the petroleum sector.

During the first nine months of 2007, all the main economic sectors registered robust growth, including, most prominently, transportation, tourism, Suez Canal receipts and construction. The manufacturing sector continued to perform strongly, while growth in the agricultural sector remained relatively weak. Growth rates in the oil and gas sectors slowed down considerably in the fiscal year 2006/2007; however, rising oil prices contributed to a significant increase in export revenues. Based on a strong expansion of non-oil exports, total merchandise export revenues rose by 19.3 per cent. Despite those gains, Egypt's trade deficit widened as merchandise imports increased by 24.3 per cent from fiscal year 2005/06 to 2006/07. However, the rise in the trade deficit was more than offset by a surge in services surplus and in net unrequited transfers. Additionally, the robust economic expansion led to a considerable decrease in the overall fiscal deficit as public revenues rose more than public expenditures. The total gross debt ratio of the Government fell from 107 per cent of GDP in June 2006 to less than 93 per cent in June 2007.

Annual consumer price inflation peaked in March 2007, at 12.8 per cent, owing partly to adjustments in administered fuel prices in 2006. Since then, CPI inflation and core inflation declined gradually in July 2007 reaching 8 and 6.6 per cent, respectively. However, given that further reductions of subsidies appear likely, inflation could remain relatively high in 2008.

2. JORDAN

While Jordan's economic recovery continues to be solid and broad based, GDP growth is estimated to have slowed from 6.4 per cent in 2006 to 5.7 per cent in 2007. Anticipating a substantial downturn in the United States economy and lower global growth, Jordan's real GDP is expected to expand by 5.5 per cent in 2008. The average annual inflation rate fell from 6.3 per cent in January-August 2006 to 5.7 per cent over the same period in 2007. The boom in real estate and construction, which has been fuelled by the influx of Iraqi expatriates and foreign firms establishing bases in Jordan, slowed down to some extent during 2007, thereby reducing the upward pressure on prices. Given expectations of slower domestic demand growth and of stabilizing international commodity prices, inflationary pressures are likely to ease further in 2008.

Growth in 2007 was supported by strong increases in private investment demand and public expenditures. Total investment rose by 16.2 per cent during the first nine months of 2007 compared to the same period in 2006. The main share of domestic and foreign investment spending was directed to the industrial sector, particularly cement and equipment industries, pharmaceuticals and foodstuff. By contrast, investment in agricultural projects remained significantly low and accounted for a mere 0.7 per cent of total investment spending. Public expenditures increased by 8.8 per cent in the first seven months of 2007 compared to the same period in 2006, thereby providing a strong stimulus to growth. However, the increase stems exclusively from higher current expenditures, including defence and security, employees' compensations and interest payments, whereas capital expenditures stagnated.

Most sectors in the national economy continued to expand at a robust pace in 2007. Finance and insurance, construction, and transport and communication recorded particularly high growth rates during the first nine months of the year. By contrast, manufacturing activity increased only slightly, while the agricultural sector witnessed a contraction. The trend of weak growth or stagnation in manufacturing and agriculture is a potential source of concern for the authorities given Jordan's high unemployment rate, particularly among young women. In March 2007, the total unemployment rate was estimated at 14.3 per cent, which represents a rise from 2006 and is only slightly below the level that prevailed before the economic expansion.

3. LEBANON

Lebanon suffered severe declines in economic activity in the second half of 2006 as a result of the Israeli war on Lebanon in July and August of that year, as well as the subsequent political tensions in the country. Despite prevailing adverse political and security conditions and insignificant growth in the first half of 2007, the country is expected to register positive growth of 2 per cent over the year. In parallel, inflationary pressures eased to some extent in the course of 2007. The annual increase in consumer prices is expected to have fallen from 5.6 per cent in 2006 to approximately 4 per cent in 2007. The sluggish growth recovery can be primarily attributed to declines in FDI, private spending and tourist receipts arising from the adverse political and security conditions. In fact, the number of tourists in the first half of 2007 dropped by 34.7 per cent from the corresponding period of the previous year. To some extent, that contractionary environment was offset by increased public sector activities as post-war reconstruction efforts intensified.

Moreover, the contractionary environment led to a further widening of the trade and current account deficits. Lebanon has long been characterized by substantial trade deficits, which are largely counterbalanced by net foreign income earnings, including capital inflows, remittances from Lebanese expatriates and service earnings, particularly from tourism. In the first seven months of 2007, the trade deficit expanded by 17.3 per cent as imports grew at a much higher rate than exports. Gross capital inflows during the first seven months decreased by 8.5 per cent compared to the corresponding period of the previous year. As such, additional transfers and services could not offset the deepening trade deficit. The fiscal performance also reflected the ongoing political crisis as the fiscal deficit accounted for 28 per cent of total expenditures in the first eight months of 2007 and gross public debt increased further. However, on the positive side, public revenue increases outpaced spending increases in the first eight months of 2007. Total public revenues were 18.4 per cent higher than in the same period of the previous year, reaching $3,967 million, whereas total public expenditures rose by 13.2 per cent to $5,511 million. A large part of the rise in public expenditures can be attributed to an increase by 45.6 per cent of transfers to the State-owned electricity company and a significant increase in debt service, which accounted for 37.8 per cent of total expenditure in the first eight months of 2007. Gross public debt amounted to $40.57 billion by the end of September 2007, 50.5 per cent of which was denominated in foreign currencies. Consequently, the ratio of gross public debt continued to increase from 177.8 per cent of GDP at the end of 2006 to 178.7 per cent at the end of the third quarter of 2007.

Lebanon's growth potential can only be realized in a stable political and security environment. While political tensions could ease in 2008, following the election of a new president, it seems unlikely that the political bottleneck will subdue completely. Accordingly, assuming some improvements on the political front, Lebanon's real GDP is forecast to expand by 3 per cent in 2008.

4. SYRIAN ARAB REPUBLIC

Despite gradually declining oil production, the Syrian Arab Republic is experiencing a period of robust economic growth. Owing to a strong performance of the non-oil sector, real GDP growth is expected to decrease only slightly from 5.0 per cent in 2006 to 4.5 per cent in 2007 and 4.3 per cent in 2008. The service sector, particularly trade, finance and insurance, social and personal services, and tourism, continues to be the main driver of growth, benefiting considerably from the economic boom in the GCC countries and from the large influx of Iraqi expatriates over recent years. Government reforms in a number of areas, including fiscal policy, financial intermediation and trade liberalization, have contributed to an improved business climate and have stimulated domestic and foreign investment activities. At the same time, the increase of oil prices during 2007 largely offset the negative impact of declining crude production. In fact, during the first eight months of 2007, total national production of crude oil decreased by merely 3 per cent compared to the respective period in 2006, thereby indicating a lower-than-expected decline.

While the general outlook for the Syrian economy remains largely positive, national authorities face several major policy challenges. Most prominently, the fiscal deficit has steadily increased during recent years and is estimated to have surpassed 5 per cent of GDP in 2006, mainly as a result of the soaring cost of fuel and other subsidies. Given that fiscal revenues from oil production, which currently account for 20-30 per cent of total revenues, are expected to decrease further, authorities face the need to strengthen other revenue sources.[9] At present, it seems unlikely that a value added tax (VAT) will be introduced in the short term, thereby implying that there is little room for significant increases in expenditures. Rising inflation rates have been another area of concern for monetary and fiscal authorities. In the wake of the massive influx of Iraqi expatriates, demand for housing and basic commodities has led to an increase in the inflation rate from 1 per cent in 2002 to 10 per cent in 2006. However,

9 Subsequent to rescheduling its debt with the Russian Federation in 2005, the country's public debt level has declined considerably and now appears relatively moderate.

slower expansion of domestic credit to the private sector and the abandonment of the exchange rate peg to the United States dollar are likely to have resulted in lower inflationary pressures in 2007.

5. YEMEN

GDP growth in Yemen continues to be below potential, especially in the light of the country's high population growth rate, which is estimated at some 3 per cent per annum.[10] Despite favourable global economic conditions and robust growth in the neighbouring GCC, real output is estimated to have increased by only 3.7 per cent in 2007, following 4.0 per cent growth in 2006. For 2008, growth is predicted at 3.8 per cent, based on the assumption of a modest increase in the average annual price of oil.

While economic activity in 2007 was stimulated by higher-than-expected oil prices and increased public expenditures, the decline in oil production, estimated at 4-6 per cent, constrained both GDP growth and fiscal revenues. Domestic consumption and investment demand were also supported by higher workers' remittances and a substantial inflow of development assistance from bilateral and multilateral sources as agreed upon at the Conference of International Donors, which was held in London in November 2006. Given that Yemen's oil production has been declining constantly since 2001, short- and medium-term growth prospects depend on the discovery and exploitation of new oil and gas fields, and on successful economic diversification. The latter is all the more important in the light of significantly high unemployment and underemployment rates, particularly among youth. Growth in the non-oil sector, estimated at 5-6 per cent in 2007, continued to be constrained by a number of factors, including security concerns; lack of sufficient investment in productive capacities; and weaknesses in the institutional and regulatory environment, despite significant progress in those areas over the past few years. Overcoming those constraints requires a strong commitment by the Government in order to continue the ongoing reform process aimed at, among other objectives, strengthening private sector investment and reducing the dependency of the fiscal budget on oil revenues. Given lower-than-expected oil income and political and administrative difficulties in accruing additional tax revenues, Yemen's fiscal deficit is expected to widen substantially over the coming years.

10 According to United Nations estimates and projections, Yemen had a fertility rate of 6.02 in 2005.

After inflation exceeded 20 per cent in 2006, pressures eased to some extent in the first half of 2007, owing partly to a success by the Central Bank in absorbing part of the excess liquidity. However, given the highly dollarized nature of the Yemeni economy, the Central Bank lacks the instruments to control money supply effectively. With increasing pressures to public sector wages substantially raise, inflation is expected to remain at an elevated level in 2008.

D. CONFLICT-AFFECTED COUNTRIES AND TERRITORIES

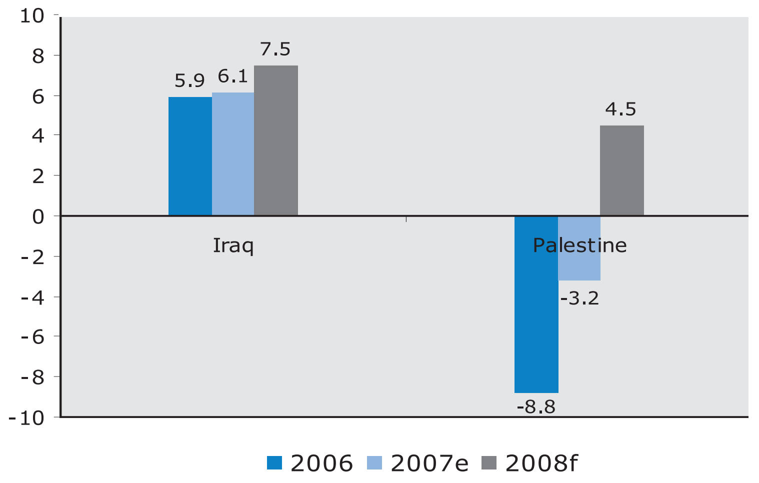
1. IRAQ

In 2007, Iraq's GDP is estimated to have increased by 6.1 per cent (see figure 7). Value added in non-oil activities is likely to have registered considerable growth, owing mostly to substantial disbursements in aid and large FDI, including for example, in the mobile phone sector. By contrast, expected improvements in the oil sector did not materialize in the light of further deteriorations of the security situation during the first half of 2007. Based on the assumptions of high international oil prices and a prevailing trend of reduced violence, GDP growth in Iraq is predicted to accelerate to 7.5 per cent in 2008.

International oil firms remain reluctant to expand their presence owing to security concerns. Current production levels are estimated at some 2 million barrels per day (bpd), compared to a pre-war output of 2.5 million bpd.

Moreover, most refineries are working well below their maximum capacity, owing to a lack of maintenance and sabotage. Consequently, refinery capacity limits currently compel Iraq to import refined products from Iran for domestic use. An expansion of oil production is largely dependent on enhanced foreign investment, which requires improved security conditions and greater political stability. A much debated oil legislation designed to bring in more international firms remains highly controversial; however, it could result in greater oil proceeds if promulgated.

Figure 7 : Real GDP Growth Rates in Conflict-Affected Countries and Territories (in %)



Source: ESCWA, based on national statistical sources.

In the non-oil sector, growth based on natural resources and manufacturing activities is set to be partly dependent on aid and demand generated by the Government aimed at raising capacity use. Moreover, trade and investment relations with neighbouring countries are determined by the security situation, with border closures having detrimental effects. That is exemplified by the obstruction of trade that stemmed from border closures between Iraq and Iran in September 2007.

In addition to hampering economic activity, border closures, political uncertainty and sectarian violence have enhanced inflationary pressures as they constrain the supply of consumption and investment goods. However, in the course of 2007, the Central Bank succeeded in lowering inflation significantly. In September 2007, the annual price increase was estimated at 17 per cent, compared to almost 65 per cent reached at the end of 2006.

The national budget for 2008 is expected to register a modest increase, owing to higher-than-expected oil prices in 2007. Boosting capital expenditure and equipping the armed forces, which accounts for a third of the budget, are anticipated to remain areas of high priority. Recently, there has been a surge in expenditures by local governments against the backdrop of provincial reconstruction efforts and job creation activities. Despite those efforts, unemployment remains rampant, and estimates suggest that as much as 40 per cent of the labour force is unemployed.

2. PALESTINE

Based on estimates available for the first two quarters of 2007, Palestine's real GDP is anticipated to decline by 3.2 per cent for that year. That can be attributed to a myriad of factors, including stagnating manufacturing activity; minimal agricultural value added, which was lower than in any of the past three years; and reduced issuance of construction licences, which was down compared to previous years. Moreover, border closures and road blocks continue to have an adverse impact on businesses, both in terms of sales and acquisition of raw material inputs. The banking sector is also suffering, particularly in the light of closures of banks in the Gaza Strip owing to continuing restrictions of their activities by Israel. The poor economic situation is reflected in rising levels of unemployment, which is estimated at 26 per cent. As a result, poverty rates have increased dramatically over the past years. In the second quarter of 2006, the total poverty rate was estimated at 36.9 per cent, based on an expenditure and consumption survey conducted by the Palestinian Central Bureau of Statistics (PCBS). Estimates of income poverty rates are even higher. The United Nations Development Programme (UNDP) estimates that in 2007, 70 per cent of households in Gaza and 56 per cent of households in the West Bank lived below the (income) poverty line. The rise in bank credit, which was up 2.3 per cent in June 2007 on the previous year, can be solely attributed to donor funding that had circumvented the Palestinian Authority in 2006 for political reasons. Foreign aid, which has hovered at one-quarter of GDP in recent years, therefore represents the main stabilizing source of demand and employment.

Following peace talks between Palestinian and Israeli authorities in December 2007, Palestine received $7.4 billion in global donor pledges for the next three years. With the resumption of coordinated aid efforts, real GDP is anticipated to grow by 4.5 per cent in 2008. However, uncertainty continues to cloud prospects for stabilization, and the Palestinian economy remains highly volatile and susceptible to closure. Indeed, continued structural deficiencies of the economy are associated with occupation, isolation and aid dependence. Consequently, annual changes in GDP reflect varying levels of capacity use in this war-torn economy, rather than growth in the strictest sense. In addition, the absence of effective border-crossing regimes diminishes the likelihood that unemployment levels will show any significant decline in the near future. A noticeable impact on unemployment is set to require rapid short-term recovery and increased demand and steady growth over an extended period. Indeed, while donor aid is a necessary factor for recovery, it cannot lead to sustainable development if it is not accompanied by enhanced movement of people, goods and capital across the West Bank and Gaza Strip.

TABLE 1: REAL GDP GROWTH RATES IN THE ESCWA REGION (in %)

Country/area	2002	2003	2004	2005	2006 a/	2007 a/	2008 b/
Bahrain	5.2	7.2	5.6	7.8	6.5	6.3	6.1
Kuwait	3.0	16.5	10.5	10.0	6.5	5.0	5.4
Oman	2.6	2.0	5.4	5.8	5.5	5.7	5.6
Qatar	7.1	3.5	20.8	6.1	6.7	8.2	9.7
Saudi Arabia	0.1	7.7	5.3	6.6	4.3	3.5	4.0
United Arab Emirates	2.2	11.9	9.7	8.2	9.3	8.3	7.4
GCC	1.4	8.9	7.7	7.3	5.9	5.2	5.5
Egypt	3.2	4.1	4.5	6.8	7.0	7.1	6.7
Jordan	5.8	4.2	8.4	7.2	6.4	5.7	5.5
Lebanon	2.6	3.0	5.0	1.0	0.1	2.0	3.0
Syrian Arab Republic	5.9	1.1	8.6	4.5	5.0	4.5	4.3
Yemen	3.5	3.8	3.9	4.6	4.0	3.7	3.8
More diversified economies	3.7	3.6	5.3	5.8	5.8	6.0	5.8
Iraq	-8.0	-33.1	23.0	10.0	5.9	6.1	7.5
Palestine	-3.8	8.5	2.0	4.9	-8.8	-3.2	4.5
Conflict affected economies	-7.4	-26.6	18.1	9.0	3.1	4.5	7.0
More diversified and conflict affected economies	2.1	-0.2	6.4	6.1	5.5	5.8	5.9
Western Asia region	1.6	5.7	7.3	6.9	5.8	5.4	5.6

Source: ESCWA based on national sources and official figures.

a/ ESCWA estimates, October 2007. b/ ESCWA projections, October 2007.

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