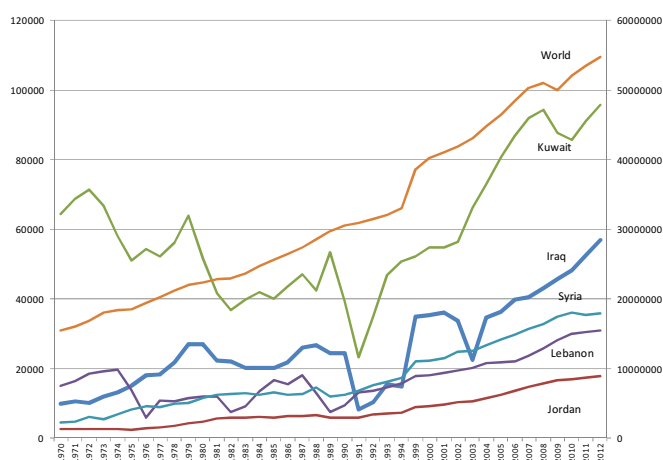


**Iraqi Crisis Situation Note:  
The impact on Jordanian, Lebanese, Syrian and Kuwaiti economies  
As of 1<sup>st</sup> of July 2014**

Channel 1 – Business Cycle Integration: Iraq's GDP is strongly correlated with Jordan's and Lebanon's in nominal, as well as in real, terms; that is to say Jordan's and Lebanon's GDP behave roughly like Iraq's (correlation coefficients of 0.88 and 0.87 respectively, table 1). Although interdependence does not imply causality, the three countries share close economic ties and a strong impact of the situation in Iraq is expectable in Jordan, Lebanon, Syria, and, to a lower extent, Kuwait.

Figure 1: GDP US Dollars at constant prices



The Kuwait business cycle was much less integrated with Syria, Lebanon or Iraq in the 70's and 80's. The increasing correlation observed since the 90's may be largely due to the strong dependence of Iraq, Kuwait and Syria economies to the oil sector.

Further, the correlation matrix does not show any interdependence between Kuwait and any other country from the sample real GDP per capita (table 1).

constant prices and constant exchange rates (2005) in millions, world right scale, other countries, left scale, sources: UNCTAD, ESCWA calculations

Table 1: Correlation coefficient matrix, various real GDP measures, 1995-2012

US Dollars at constant prices (2005) and constant exchange rates (2005) in millions						
	Iraq	Jordan	Kuwait	Lebanon	Syria	World
Iraq	1.00	0.88	0.80	0.87	0.89	0.90
Jordan	0.88	1.00	0.95	0.98	0.99	0.98
Kuwait	0.80	0.95	1.00	0.89	0.95	0.96
Lebanon	0.87	0.98	0.89	1.00	0.97	0.94
Syria	0.89	0.99	0.95	0.97	1.00	0.98
US Dollars at constant prices (2005) and constant exchange rates (2005) per capita						
	Iraq	Jordan	Kuwait	Lebanon	Syria	World
Iraq	1.00	0.61	-0.23	0.55	0.64	0.72
Jordan	0.61	1.00	0.31	0.62	0.95	0.97
Kuwait	-0.23	0.31	1.00	-0.32	0.27	0.22
Lebanon	0.55	0.62	-0.32	1.00	0.68	0.61
Syria	0.64	0.95	0.27	0.68	1.00	0.92

sources: UNCTAD, ESCWA calculations

Although the Kuwaiti population's standard of living seems to be, to some extent, immune from the crisis in Iraq and Syria, this is not the case in Jordan and Lebanon.

The correlation coefficients between Iraq on one side, Jordan, Lebanon and Syria real GDP per capita on the other are not dramatically high. However, the very nature of the problem – which is not mainly economic and its concomitance with the crisis in Syria – will imply very serious production disruptions and a likely permanent shift in trade partners and trade routes, as well as a rise in poverty levels.

The rest of the note provides an analysis of the potential impact of the Iraqi crisis on the Jordanian, Lebanese, Kuwaiti and Syrian economies through four main channels – trade, financial flows,

humanitarian situation, and business confidence – and further assesses the probability for a balance of payment crisis to develop in these countries.

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## **Jordan**

Channel 2 – Loss of exports: Iraq is the largest export destination of Jordan. Iraq absorbs 14 percent of Jordan's total exports, 34 percent of its food exports, 13 percent of its manufactured goods and 7 percent of its chemicals exports. Iraqi exports to Jordan have plummeted in 2013 as Jordan stopped importing crude oil from Iraq due to the security concerns. The first channel of impact is likely to be the loss of export earnings.

Channel 3 – Financial inflows: Due to the sizable Iraqi business community in Jordan, it is likely that Jordan has been benefiting as a safe haven for their financial resources. Rising tension and subdued business in Iraq may result in a decline of financial inflows from Iraq, which will likely be the second channel of impact.

Channel 4 – Refugees and overstretched hosting capacity: No substantial increase of Iraqi refugees to Jordan has been reported. Nevertheless, if the fighting continues, Jordan is likely to host a large number of refugees, adding to the 600,000 Syrian refugees who have already stretched Jordan's accommodating capacity in terms of finance and infrastructure.

Channel 5 – denting business confidence: The share prices at Amman Stock Exchange have been stable, but stagnating, compared to other countries in the region such as of Cairo Stock Exchange. The loss of business confidence may result in a decline in domestic demand. As net exports are likely to decline and the government maintains its austerity stance, the economic growth of Jordan, which was forecasted at 3.0 percent for 2013, will probably decelerate.

Balance of payments crisis unlikely: At present, however, the likelihood of a balance of payments crisis of Jordan is considered low. The reasoning is as follows:

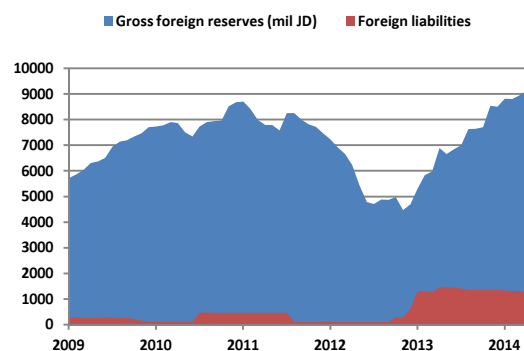
- a. The gross foreign reserves of the Central Bank of Jordan (CBJ) have sufficiently recovered from the rapid depletion in the first half of 2012. In April 2014, the amount stood at JD 9.1 billion (USD 12.9 billion), the highest in the country's history. The CBJ lowered policy interest rates (overnight deposit window rate and one-week repo rate) in June 24, after the Iraqi Crisis unfolded. It is a sign of confidence that the CBJ believes the Jordanian Dinar is defensible with moderately accelerating domestic demand.
- b. The total loss of export earnings from Iraq in the second half of 2014 could amount to JD 400 million. An increase of current account deficits of this magnitude can be financed by the use of foreign reserves without influencing the currency peg of Jordanian Dinar.
- c. The structural weakness in Jordan's balance of payments persists – a sizeable trade deficit is financed by the surpluses in service account, income account, current transfers (aid flows and workers' remittances), and financial inflows. Rapidly rising foreign reserves indicate that those financial flows have been more than sufficient to finance trade deficits.

d. As of 2013, the Jordanian government's gross domestic debt was 56.3 percent of GDP and external debt was 30.3 percent of GDP. The level has been rising but is still at a manageable level (i.e. under 100%). The shift from domestic debt to foreign debt issuances in financing Jordan's public debts may help in lowering the domestic cost of finance, which is vital to support Jordan's domestic industries at the time of crisis.

Jordan	2009	2010	2011	2012	2013
<b>Fiscal (million JD)</b>					
Domestic Revenues	4187.8	4261.1	4198.9	4726.9	5119.1
Foreign Grants	333.4	401.7	1215	327.3	639.1
Current Expenditures ( Commitment basis )	4586	4746.6	5739.5	6202.8	6050.4
Capital Expenditures	1444.5	961.4	1057.1	675.4	1015
Deficit / Surplus (Including Grants)	-1509.3	-1045.2	-1382.7	-1824	-1307.2
Deficit / Surplus (Excluding Grants))	-1842.7	-1446.9	-2597.7	-2151.3	-1946.3
<b>Fiscal indicators (In % of GDP)</b>					
Deficit / Surplus (Including Grants)	-8.9	-5.6	-6.8	-8.3	-5.5
Deficit / Surplus (Excluding Grants)	-10.9	-7.7	-12.7	-9.8	-8.2
Domestic Revenues	24.8	22.7	20.5	21.5	21.5
Current Expenditures	27.1	25.3	28.0	28.2	25.4
Capital Expenditures	8.5	5.1	5.2	3.1	4.3
<b>Public Debts (million JD)</b>					
Gross Domestic Debts	7,086	7,980	9,996	12,678	13,440
Gross Domestic Debts (% of GDP)	41.9	42.5	48.8	57.7	56.3
External public debts	3869	4610.8	4486.8	4932.4	7234.5
External public debts (% of GDP)	22.9	24.6	21.9	22.5	30.3
Long term loans	3766	3985.6	3871.9	4327.8	4936.2
Government bonds	0	532.5	532.5	532.5	2236.5
<b>Balance of Payments (million JD)</b>					
Exports (Goods)	4526.3	4990.1	5684.5	5599.5	5616.7
Imports (Goods)	8975.1	9813.9	11946.2	13086.1	13760.3
Trade balance (Goods)	-4448.8	-4823.8	-6261.7	-7486.6	-8143.6
Service account (Net)	616.6	926.2	896	1332.3	1265.7
Income account (Net)	266.6	-152.4	-187.8	-275.9	-240.4
Current transfer (Public, Net)	671.4	779.4	1431.9	1048.1	1620
Current transfer (Private, Net)	2463.9	2322.5	2376.4	2484.5	3455.2
Current account	-882.9	-1336.3	-2098.8	-3345.3	-2384.6
Current account (% of GDP)	-5.2	-7.1	-10.2	-15.2	-10.0
<b>Nominal GDP (million JD)</b>					
Nominal GDP (million JD)	16912.2	18762	20476.6	21965.5	23851.6
<b>Real GDP Growth rate (%)</b>					
Real GDP Growth rate (%)	5.5	2.3	2.6	2.7	2.8
<b>Consumer price inflation rate (%)</b>					
Consumer price inflation rate (%)	-0.7	5.0	4.4	4.8	5.6

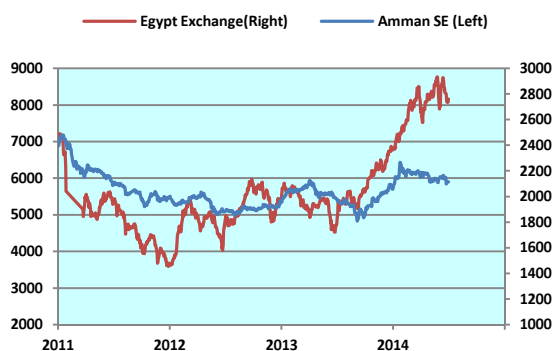
Source: Monthly Bulletin of Statistics, Central Bank of Jordan

Figure 2: Gross foreign reserves at CBJ: 2009-2014



Source: Central Bank of Jordan

Figure 3: Stock market index: Egypt and Jordan 2011-2014



Source: Amman Stock Exchange, Egyptian Exchange

## Lebanon

Channel 2 – Loss of exports: Iraq is one of the major export destinations of Lebanon, forming a 7 percent share of Lebanon's total exports in 2013. Conversely, Iraqi exports to Lebanon are at an extremely low level, only a 0.01 percent share of Lebanon's total imports in 2013. The first channel of impact is likely to be from the loss of export earnings, and it would hit Lebanon's industrial firms hardest as Iraq has been their traditional export destination.

Further, several factors might contribute to mitigating the impact of the crisis in Syria and Iraq on Lebanon:

- Lebanon is one of the countries that exports the least in the world as it is specialized in services exports which should not suffer much from the situation
- Lebanon has successfully redirected its trade to the ports of Beirut, Masnaa, and Tripoli (Figure 4). Nevertheless, higher transportation costs will erode Lebanese products' competitiveness.
- The effect of scarcity and market size: Since the crisis in Syria began, fuel re-exports to Syria surged and Lebanon became a net food exporter to Syria while it had always been a net food importer (Figure 5). The impact of the Iraqi crisis from this channel deserves attention.

Figure 4: Proportion of Exports and Imports redirected through alternative routes

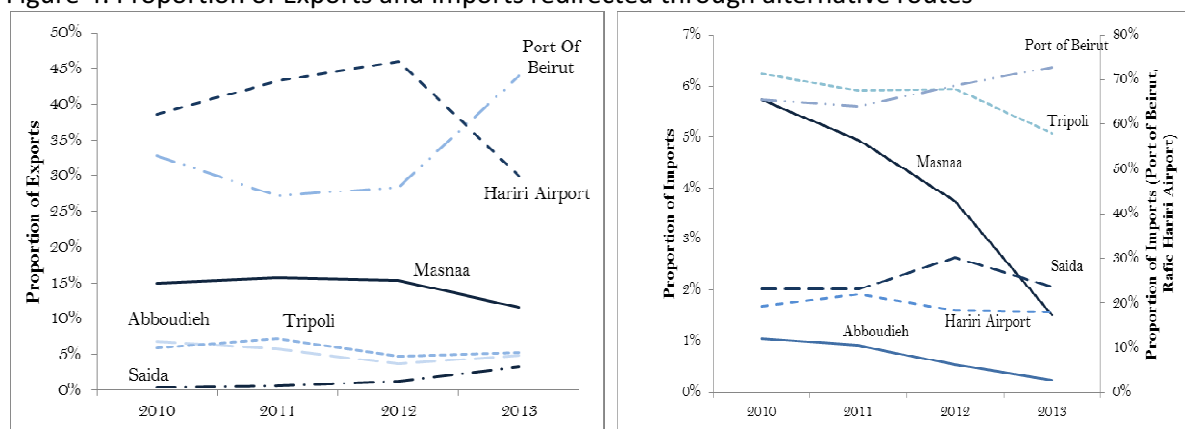
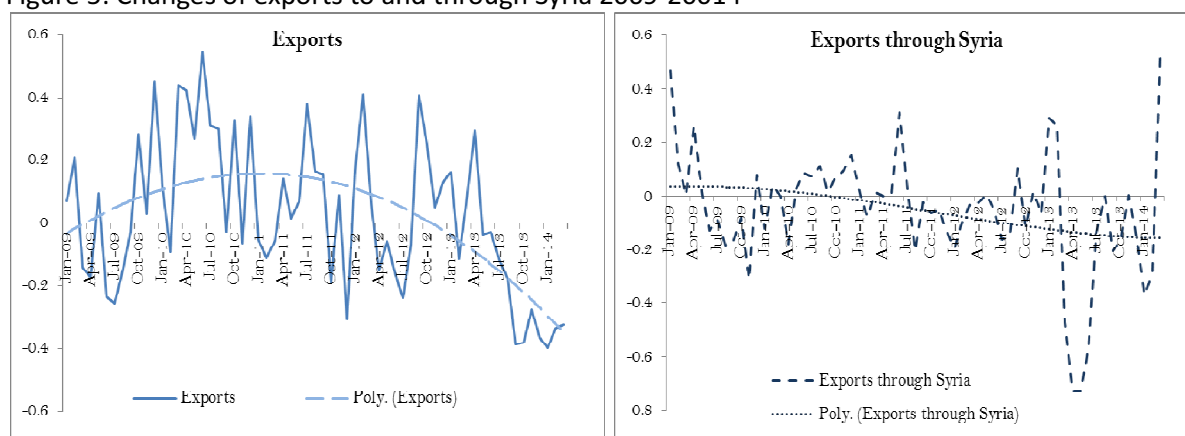


Figure 5: Changes of exports to and through Syria 2009-20014



Sources: Lebanese Customs, International Monetary Fund and Cali, M., (2014), 'The trade impact of the Syrian war on Lebanon', The World Bank, working paper, mimeo

**Channel 3 – Financial inflows:** Due to a lack of major Iraqi business presence in Lebanon, unlike the case in Jordan, financial flows between Lebanon and Iraq are considered minor. There will be little impact from this channel.

**Channel 4 – Refugees and overstretched hosting capacity:** No substantial increase of Iraqi refugees to Lebanon has been reported. The number is unlikely to increase as it is difficult for the Iraqis to cross over Syria to reach Lebanon.

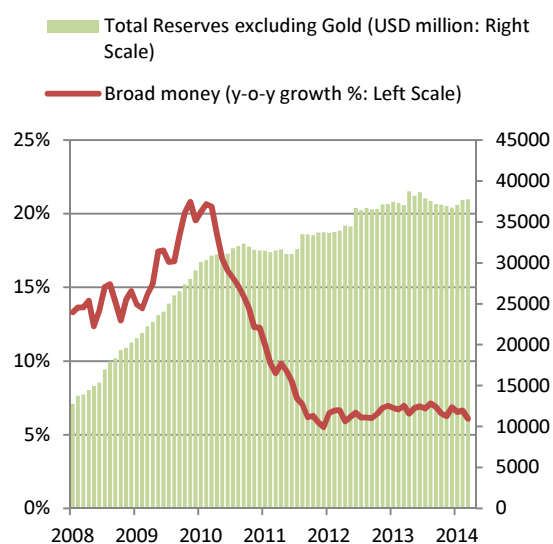
**Channel 5 – Denting business confidence:** The Lebanese economy has already been hit by the Syrian crisis and domestic demand has been weak since 2011. Broad money growth has stagnated despite the efforts of Banque du Liban to expand credit via a series of stimulus packages. The crisis in Syria and Iraq has been visibly impacting the security situation in Lebanon: A series of bombing incidents in June will prevent much-awaited tourists from GCC countries from vacationing in Lebanon in the summer of 2014. The security situation is erasing the optimistic sentiment regarding Lebanese economic prospects.

**Balance of payments crisis unlikely:** At present, however, the extremely high level of foreign reserves means the likelihood of a balance of a payments crisis in Lebanon is extremely low. The speed of accumulation has stagnated but there is no sign of depletion despite continuing current account deficits.

Lebanese trade with Iraq in 2013 (USD million)		Imports	Exports
1	Live animals; animal products	0.701	5.914
2	Vegetable products	0.585	10.953
3	Animal or vegetable fats and oils	0	0.35
4	<b>Prepared foodstuffs; beverages, tobacco</b>	1.026	<b>51.436</b>
5	Mineral products	0	0.542
6	<b>Products of the chemical or allied industries</b>	<b>0</b>	<b>39.913</b>
7	Plastics and articles thereof; rubber	0.025	9.728
8	Raw hides and skins, leather, furskins	0	0.136
9	Wood and articles of wood; wood charcoal; cork	0	6.466
10	<b>Pulp of wood; paper and paperboard</b>	0.023	<b>27.528</b>
11	Textiles and textile articles	0	4.414
12	Footwear, umbrellas, artificial flowers	0	0.453
13	Articles of stone, plaster, cement, glass	0	1.71
14	Pearls, precious stones and metals	0	0.34
15	Base metals and articles of base metal	0	6.354
16	<b>Machinery; electrical instruments</b>	<b>0.044</b>	<b>91.679</b>
17	Vehicles, aircraft, vessels, transport equipment	0.002	5.606
18	Optical, photographic, medical, musical instruments	0	1.125
20	Miscellaneous manufactured articles	0	7.084
21	Works of art, collectors' pieces and antiques	0.008	0.533
Total		2.414	272.264

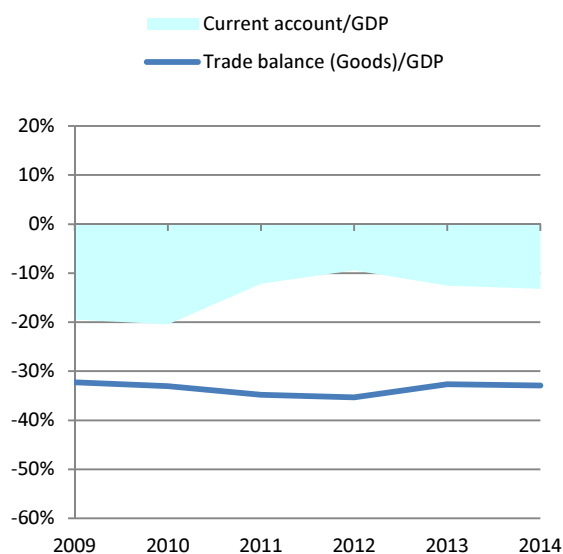
Source: Lebanese Customs

Figure 6: Lebanon: Foreign reserves and broad money growth 2008-2014



Source: IMF/IFS

Figure 7: Lebanon: Balance of Payments 2009-2014



Source: Banque du Liban

Note: 2013 and 2014 are ESCWA staff estimates

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## Kuwait

Channel 2 – Loss of exports: Iraq is an extremely minor trading partner with Kuwait. Anecdotal evidence suggests the size of bilateral trade is USD 2.5 billion, but latest official statistics (available for 2012) indicate a much lower level (USD 87.5 million exports of which USD 84.4 million are re-exports; USD 0.1 million imports). Therefore there will be no influence through this channel on the Kuwaiti economy.

Channel 3 – Financial inflows: Kuwait is a country with a substantial level of fiscal surplus and current account surplus. As a result, in terms of macroeconomic balance, there will be no financial impact.

Channel 4 – Refugees and overstretched hosting capacity: Kuwait does not host a large number of refugees and is unlikely to serve as a major evacuation destination for Iraqis; the impact of this channel is unlikely.

Channel 5 – Denting business confidence: Recently rising property prices, as well as hovering crude oil prices, have revitalized business confidence in Kuwait. The implementation of mega public projects is often delayed by political disputes within the Kuwaiti government; however, this is independent of the situation in Iraq. Therefore, no impact through this channel is anticipated.

Balance of payments crisis unlikely: Considering Kuwait's financial position, a balance of payments crisis is highly unlikely.

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### Kuwaiti trade with Iraq in 2012 (USD million)

Exports	Re-exports	Domestic exports	Imports
87.5	84.4	3.1	0.1

Source: Foreign trade Annual Bulletin, Kuwait Central Statistics Bureau

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## Syria

Channel 2 – Loss of exports: It is difficult to estimate the magnitude of impact through this channel as no relevant official statistics have been released since 2011. However, IMF's Direction of Trade Database, which estimates bilateral trade figures from customs data of various countries, indicates growing trade between the two countries after the Syrian Crisis. Traditionally, agriculture goods were the major export items from Syria, but trade structure under the crisis may have changed; anecdotal evidence suggests Iraq remains a major export destination for both sides – the government and opposition.

The latest development of the crisis in Iraq has resulted in the end of the prevailing agreement that allowed Syria to import crude oil from Iraq. This fact will have a highly detrimental impact on the Syrian economy. Not only does this cause further production disruption but even if the country successfully finds another source of crude oil imports, it will encounter difficulties in paying the bill as Iraqi crude oil was being imported at a discounted price.

A continuing crisis situation in Iraq may thus affect the level of US Dollar liquidity (or US Dollar cash) on both sides of political line and potentially serve as a destabilizing factor for the Syrian Pound which maintains its credibility in government-controlled and opposition areas.

Channel 3 – Financial inflows: Anecdotal evidence suggests significant financial flows from Iraq to Syria exist, supporting Syria's need for foreign exchange. Foreign exchange has become substantially scarce since the imposition of sanctions by the European Union in October 2011. Anecdotal evidence suggests that Iraq is exporting around 40,000 bpd (average) crude oil to Syrian refinery facilities in Baniyas and Homs, which not only supports essential fuel needs in Syria, but also releases scarce financial resources as a result of fuel purchasing. To measure the impact of this channel, the exchange rates of Syrian Pound/US Dollar and Iraqi Dinar/US Dollar should be monitored. The Iraqi Dinar once depreciated against the US Dollar in 2012 as Syrians bought up US Dollar cash in the Iraqi market. If hidden financial flows are suspended, this will be reflected in the value of the Iraqi Dinar as Syrian demand for US Dollar in the Iraqi market would surge once again.

Channel 4 – Refugees and overstretched hosting capacity: It is unlikely that Iraqi refugees will evacuate to Syria, and as such impact through this channel is unlikely.

Channel 5 – Denting business confidence: Due to the stabilized value of the Syrian Pound, a certain confidence was regained in the government-controlled area, but the sentiment remains extremely fragile. The trading volume at Damascus Stock Exchange has recovered recently, reflecting this subtle recovery in business confidence. Several calls were made by the government to invite the evacuated Syrian business community to return to Syria in the first half of 2014, but investment has been ongoing in limited areas (such as Tartous and Latakia). Further security events which deteriorate the economic status quo – which would result in another spike of foreign currency against Syrian Pounds – may sink the remaining Syrian business completely.

Balance of payments crisis likely: There already exists a Syrian balance of payments crisis situation but further deterioration is possible.

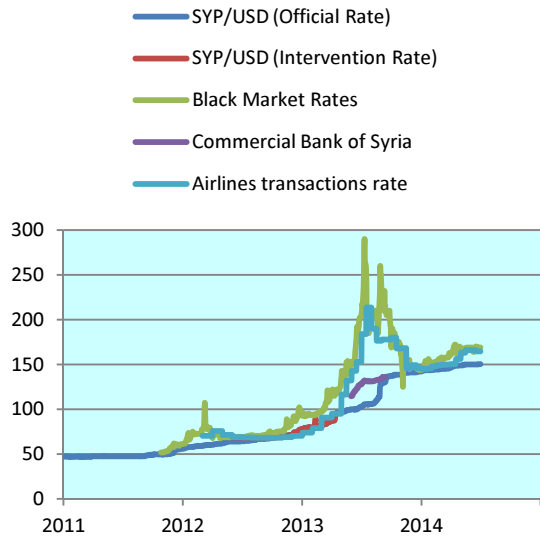
Syrian trade with Iraq; 2009-2013 (USD million)

	2009	2010	2011	2012	2013
Syrian exports to Iraq	3,559	4,662	6,014	6,391	6,331
Syrian imports from Iraq	675	884	1,140	1,211	1,200

Source: DOTS/IMF

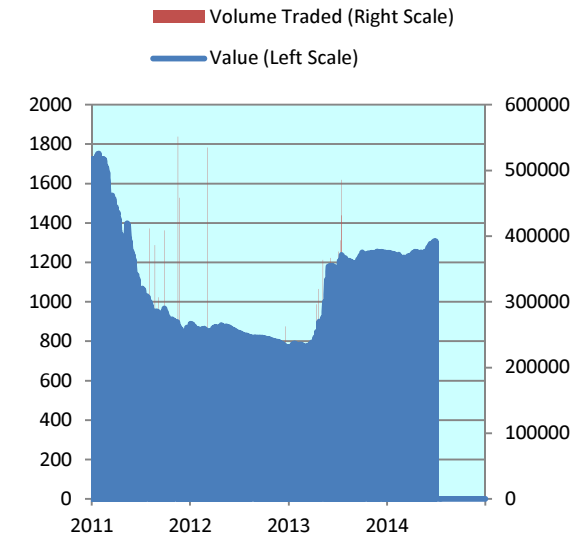


### Syria: Exchange rate



Source: Central Bank of Syria

### Damascus Stock Exchange



Source: Damascus Stock Exchange