World Economic Situation and Prospects 2007

Western Asia

I - Introduction

With the 2003-6 boom still stimulated by oil revenues, wealth continued to spill over from the GCC economies. Boom conditions were prevalent until September 2006 whence oil prices dropped. Workers remittances from the Gulf expanded aggregate demand elsewhere and 2006 promised prosperity except for Iraq and Palestine and until more recently Lebanon. Arab trade and tourism were enhanced until the July-August war turmoil when tourists, refugees and expatriates fled through Lebanon's neighbours inducing short travel booms there. After six months of high growth estimated at 5 % annually in 2006, Lebanon's economy rejoined the depressed conflict-affected cluster. Reconstruction moved rapidly but that will not compensate for those human, economic and welfare losses incurred.

Polarised development continued with GCC growth further spurred by oil-market momentum while the conflict-affected cluster lost even more skilled people, investment, potential incomes, capital and welfare. In 2006, the GCC Six with small populations will acquire 90 % of total Western Asia's oil export revenues, while Iraq, Syria and Yemen obtain 10% only, though having significantly larger populations. Average Western Asia's per capita income in 2000 prices is 4610 US$ for 2006. However, the GCC cluster's average is 12653 US$ and the MDE's 1331 US$, only 10.5 % of the GCC average. Iraq and Yemen have the lowest per capita incomes of 690 US$ and 574 US$, respectively.

While unemployment and poverty rates remains high in the conflict affected cluster plus few others, GCC prosperity did not significantly ameliorate unemployment and poverty elsewhere. **Overall, official inflation rates have risen, impacted largely by cost-push factors, particularly escalating rental costs and depreciating US Dollar pegged currencies.**

Western Asia's (i.e. ESCWA region less Egypt) growth is forecast at 5.7 % for both 2006 and 2007 (Table 1). The GCC Cluster will grow at 6.3 % in 2006 as compared to 1.6 % in the MDE's, the latter slow-down attributable to Lebanon's (-3.5 %) GDP shrinkage. Palestine's economy will also shrink by (-0.8%) in 2006.However, 2007 promises to bring 4.6 % growth in the MDE cluster as Lebanon recovers while the GCC slows down to 5.8 % as oil prices decline.

TABLE 5. REAL GDP AND GROWTH RATES IN THE ESCWA REGION
AT CONSTANT 2000 PRICES, 2002-2006
(Millions of US dollars)

								Percentage change					
Country/area	2001	2002	2003	2004	2005	2006 a/	2007 b/	2002	2003	2004	2005	2006 a/	2007 b/
Bahrain	8,340	8,776	9,404	9,928	10,704	11,293	11,903	5.2	7.2	5.6	7.8	5.5	5.4
Kuwait	37,990	39,931	45,274	48,081	51,206	54,534	57,207	5.1	13.4	6.2	6.5	6.5	4.9
Oman	21,332	21,880	22,320	23,578	24,573	25,999	27,325	2.6	2.0	5.6	4.2	5.8	5.1
Qatar	18,563	19,926	21,091	22,884	24,967	26,714	28,691	7.3	5.9	8.5	9.1	7.0	7.4
Saudi Arabia	189,727	189,973	204,525	215,304	229,406	243,170	257,517	0.1	7.7	5.3	6.6	6.0	5.9
United Arab Emirates	71,730	73,322	82,040	89,990	97,360	103,981	110,220	2.2	11.9	9.7	8.2	6.8	6
GCC	347,681	353,808	384,654	409,765	438,216	465,691	492,862	1.8	8.7	6.5	6.9	6.3	5.8
Jordan	8,906	9,415	9,798	10,550	11,313	11,901	12,460	5.7	4.1	7.7	7.2	5.2	4.7
Lebanon	17,407	17,859	18,591	19,521	19,716	19,026	20,396	2.6	4.1	5.0	1.0	(3.5)	7.2
Syrian Arab Republic	20,546	21,760	22,002	22,450	23,461	24,118	24,793	5.9	1.1	2.0	4.5	2.8	2.8
Yemen	10,133	10,487	10,882	11,303	11,823	12,320	12,812	3.5	3.8	3.9	4.6	4.2	4
More diversified economies	56,991	59,521	61,274	63,825	66,313	67,365	70,462	4.4	2.9	4.2	3.9	1.6	4.6
ESCWA region c	404,672	413,329	445,928	473,590	504,529	533,056	563,324	2.1	7.9	6.2	6.5	5.7	5.7
Iraq	21,729	19,986	13,371	16,439	18,083	19,530	20,897	(8.0)	(33.1)	23.0	10.0	8.0	7
Palestine	3,852	3,708	4,023	4,103	4,304	4,270	4,312	(3.8)	8.5	2.0	4.9	(0.8)	1
Total ESCWA region d/	430,253	437,023	463,322	494,131	526,917	556,855	588,533	1.6	6.0	6.6	6.6	5.7	5.7

Source: ESCWA based on national sources and official figures.

a/ ESCWA estimates, October 2006.

b/ ESCWA projections, October 2006.

c/ Excluding Palestine and Iraq and Egypt.

d/ Excluding Egypt

II – <u>Boom undermined by declining oil prices</u> - Boom prevailed in the GCC cluster until September 2006 as oil prices reached a peak of 78 US$ per barrel. Several 1st quarter stock market crashes, however, had tempered speculative activity. Seasonal and other factors coalesced in September and beyond to significantly reduce oil revenues. Grave instability in Iraq, Palestine and then war in Lebanon undermined those three economies. Nominal oil export revenues for 2006 will reach US$ 401 billion, a 25.4% rise over 2005. However, as oil prices and exports decline in 2007, oil revenues will shrink by 14.9 % to 341.5 US$ billion.

Declining oil exports will ameliorate the current boom in 2007 as GCC growth rates slow down, amongst other oil producers. However, lagged increases in investment and public expenditure may cancel-out some of the impact of the 2006-7 oil revenue declines.

As the boom spilled over to the MDEs since 2003 through trade, tourism, migration and business linkages, the anticipated deceleration in 2007 will percolate as well.

III- <u>2006 boom overshot its course</u>

The 2006 boom was over-stimulated by speculation and political uncertainty. Oil futures trading induced prices to overshoot during perceived shortages and/or periods of war and tensions until hostilities ended in Lebanon. Oil price expectations reversed course by autumn declining rapidly by mid-October. The boom's locomotive, thus, risks losing steam. Earlier in the year financial market crashes will have compounded this prospective marginal deceleration. Those two negative influences were, however, countered by public expenditure increases. **In addition, budgeting for public revenues in oil exporting countries continues to use conservative oil price assumptions, thus generating built-in ex-post surpluses over planned expenditure.**

IV - Demand Spillovers

Post 2001 travel restrictions induced GCC travellers towards the region. Tourist expenditure boomed during 2004-5. 2006 promised to be another boom year until the summer war. Quarter to quarter, Jordan's travel receipts rose by 16.1 % in the second quarter of 2006. Workers remittances also remained buoyant at about **51% of total Jordanian exports for 2005 and the first half of 2006.** GCC prosperity fostered employment and incomes in Yemen where Workers remittances reached 1.312 billion US $ in 2005 or 20.5 % of total exports. However, after the War tourists were diverted with refugees to safer destinations and employment conditions worsened in the disaster affected cluster, including Lebanon, while Jordan and possibly Syria may have benefited from diverted tourists and rising demand for housing by expatriates.

V – Inflation outlook for 2006

Accumulation of foreign reserves partially sterilised excess liquidity while investment funds channelled surpluses abroad. Lagging public expenditure responses continued to reduce liquidity below potential as surpluses were being accumulated in most GCC countries, except Kuwait. Indeed, the Saudi budgetary surplus is estimated to have doubled from 28.5 billion US$ in 2005 to 57.143 billion in 2006. Inflationary expectations are still strong due to rising public expenditure and high liquidity with financial market crashes tempering 2005's speculative fervour. Cost-push rental increases remain significant in Qatar, the UAE, Saudi Arabia and Jordan. Dollar pegs contribute to rising import prices. Overall, estimated inflation rates in the GCC cluster rose from 2.9 % in 2005 to 5.4 % in 2006***. In the MDEs, the corresponding rates were 4.5 % and 7.5 %. At 52%, Iraq scored the highest 2006 inflation despite an IMF Stabilization package, followed by Yemen (15.5 %), the UAE (9%) and Qatar (8.2%). Western Asia's inflation is estimated at 7.4 % for 2006 having risen from 4.3 % in 2005 (Table 2).***

TABLE. RATES OF INFLATION IN THE ESCWA REGION, 2002-2005

(Percentage)

Country/area	2003	2004	2005	2006 a/
Bahrain	1.59	2.35	2.59	1.60
Kuwait	0.98	1.26	4.21	3.74
Oman	-0.31	0.41	1.90	2.87
Qatar b/	2.26	6.80	8.81	8.19
Saudi Arabia	0.61	0.30	0.71	4.46
UAE	3.12	5.04	6.20	9.00
GCC Countries	1.25	1.87	2.91	5.43
Jordan	1.60	3.35	3.52	4.20
Lebanon	3.04	1.66	-2.63	7.00
Syria	4.81	4.59	7.20	5.60
Yemen	10.83	12.51	11.82	15.50
More diversified economies	4.83	4.90	4.50	7.48
ESCWA Region c/	1.74	2.28	3.12	5.70
Iraq	33.62	26.97	36.96	51.97
Palestine	4.40	3.05	3.48	3.55
Total ESCWA Region d/	2.69	3.11	4.28	7.37

a/ 2006 estimates are based on official preliminary figures.

b/ based on first half 2006 CPI compared to first half 2005 CPI. It is likely that this figure is under-estimated if they do not reflect the changing relative weight of expenditures of rent, fuel and energy.

c/ Weighted average, where weights are based on GDP in constant 2000 prices.

d/ Excluding Egypt

Lagged public expenditure increases have tempered the boom-bust cycles of aggregate demand maintaining price level increases as output and incomes were stabilized. Yet, severe asset price shocks were noted. The Qatar Securities Market Index dropped by 26.5 % in the second half of 2006 compared to end 2005 while the Saudi index dropped by 18.7%, Abu Dhabi's by 29.2 % and Dubai's by 25.4 %. Private perceptions of wealth (compared to 2003), and especially in real estate, continue to prop-up expenditure and demand for credit, both of which stimulate prices. Only Bahrain's and Muscat's stock markets appeared stable while Beirut's shot up by 42.4 % during the first half of 2006 as investors were fleeing crashing Gulf assets. Speculative fervour, especially in real estate, stimulated by high liquidity has been significant and an element in cost-push inflation.

VI - <u>Unemployment</u> – Persistent region-wide growth since 2003 has only marginally dented high rates of unemployment. Rapid population and labour force growth, an increasing female participation rate and significant migration to the GCC caused excess labour supplies there. Public employment remains over-saturated allowing few degrees of freedom for expansion there. New employment creation is increasingly reliant on a cost-sensitive private sector. Political crises, wars, population displacements and turbulence have strongly impacted employment in some highly vulnerable economies, such as Iraq, Lebanon and Palestine.

Rising economic growth, which pervaded over the past 2-3 years, did not make a major dent in the intra-regional rate of unemployment. High labour force growth in several countries, including Jordan contributed to a minor dent in "official" unemployment rates which were reduced from 14.8 % in 2005 to 14.4 % in 2006. In 2004, Syria's unemployment rate rose from 10.8 % in 2003 to 12.6 % while Iraq and Palestine remained the two countries with the highest rates at 26.8% and 26.8 %, respectively. Yemen's unemployment remains high as the informal sector prevails. Wage-segmented labour markets reduce substitutability of domestic for imported labour in several countries, especially in the GCC cluster while mass pauperisation in countries in conflict diminishes capacities to grow, invest and employ. Layoffs appear to be rising in Lebanon as its hitherto vibrant tourism sector was hard-hit by the war. Reconstruction, on the other hand, will yield greater employment opportunities for 1-2 years.

For a region where high unemployment pervades, only a "Marshall Plan" for spreading investment with employment to the poorer countries can absorb excess labour. This plan should raise rates of investment and train the poor, especially youth and women. It should also finance SME development, micro-enterprises, deprived regions, and fund technology research for appropriate innovations. Without that, greater equity and democratic reform, the turbulent politics of high unemployment and social exclusion will continue to exact a heavy toll.

ANNEX