# MIDDLE EAST ECONOMIC OUTLOOK

Q3 2017

CAPITAL ECONOMICS

## Regional slowdown approaching a trough

- The slowdown in the Middle East and North Africa should bottom out in the second half of this year and growth is likely to strengthen in 2018-19. In the Gulf, the hit to headline GDP growth from OPEC-agreed oil output cuts will start to fade next year as policymakers resist calls for deeper cuts. Economic spillovers from the diplomatic spat between Qatar and regional powers should be limited, but ongoing austerity and higher interest rates will weigh on non-oil sectors. Outside of the Gulf, Egypt's economy should gradually strengthen as the recent inflation shock unwinds, monetary policy is loosened and fiscal consolidation slows. For the region as a whole, we expect growth to average around 2.5% in 2018-19, which is weaker than the consensus.

- The recent contraction in **Saudi Arabia's** economy looks set to deepen over the remainder of 2017. A rebound is likely next year but a resumption of austerity means that the Kingdom's economic performance will remain relatively subdued. (Page 4.)

- The **UAE's** economy will be the Gulf's top performer over the next few years. In contrast to its neighbours, fiscal policy will be less restrictive. The non-oil economy should also benefit from robust global growth and preparations for the 2020 World Expo. (Page 5.)

- The smaller Gulf countries are unlikely to fare as well. **Kuwait's** economy will stay sluggish. (Page 6.) And while the economic impact of **Qatar's** diplomatic spat with regional powers is likely to be limited, we retain our long-held view that growth there will be slower than most expect. (Page 7.) Fragile balance sheets mean **Bahrain** and **Oman** will remain the Gulf's weak spots. (Page 8.)

- Elsewhere, the worst is probably now over for **Egypt** and growth should pick up over the next couple of years. The big fall in the pound has happened, meaning that inflation will fall back and the central bank is likely to respond by cutting interest rates. Fiscal consolidation is also likely to ease. (Page 9.)

- Spillovers from the conflict in Syria will continue to weigh on growth in **Lebanon** and **Jordan**. (Page 10.) **Algeria's** adjustment to low oil prices is far from over and a further fall in the dinar, coupled with a big fiscal squeeze, means that the economy will struggle over the coming years. (Page 11.)

- **Morocco** is likely to be the region's top-performing economy. (Page 12.) Finally, **Tunisia's** recovery will remain slow-going. (Page 13.)


| North America | Europe | Asia-Pacific |
|---|---|---|
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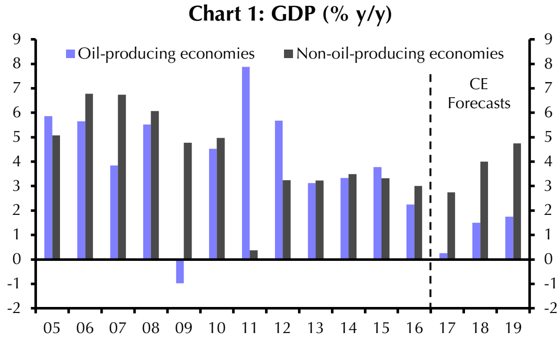
# Key Forecasts

**TABLE 1: REAL GDP & INFLATION**

| % y/y | | Share of MENA[1] | Share of World[1] | GDP 2016 | GDP 2017f | GDP 2018f | GDP 2019f | Inflation[2] 2016 | Inflation[2] 2017f | Inflation[2] 2018f | Inflation[2] 2019f |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Saudi Arabia | | 31.1 | 1.5 | 1.7 | -1.0 | 1.3 | 1.5 | 3.5 | 0.5 | 4.0 | 3.0 |
| Egypt | | 20.1 | 0.9 | 3.8 | 2.5 | 4.3 | 5.3 | 13.8 | 29.0 | 12.5 | 8.5 |
| UAE | | 11.9 | 0.6 | 3.0 | 2.0 | 3.0 | 3.3 | 1.6 | 1.8 | 3.0 | 3.0 |
| Algeria | | 10.9 | 0.5 | 3.5 | 1.0 | 0.8 | 1.5 | 6.4 | 6.5 | 8.0 | 6.0 |
| Qatar | | 5.9 | 0.3 | 2.2 | 1.3 | 2.5 | 2.8 | 2.8 | 0.5 | 2.0 | 2.0 |
| Kuwait | | 5.4 | 0.3 | 2.0 | 0.5 | 1.0 | 1.0 | 3.2 | 3.3 | 4.3 | 3.3 |
| Morocco | | 5.0 | 0.2 | 1.2 | 4.0 | 4.5 | 5.0 | 1.6 | 1.0 | 3.0 | 4.0 |
| Oman | | 3.3 | 0.2 | 2.0 | 0.5 | 1.0 | 1.0 | 1.1 | 1.5 | 2.5 | 1.8 |
| Tunisia | | 2.3 | 0.1 | 1.1 | 2.3 | 3.0 | 3.5 | 3.7 | 5.0 | 5.0 | 4.8 |
| Jordan | | 1.6 | 0.1 | 2.1 | 2.5 | 2.8 | 2.8 | -0.8 | 3.3 | 3.3 | 2.5 |
| Lebanon | | 1.5 | 0.1 | 1.0 | 1.3 | 1.5 | 1.8 | -0.8 | 2.5 | 1.0 | 0.5 |
| Bahrain | | 1.2 | 0.1 | 3.0 | 2.5 | 2.0 | 2.0 | 2.7 | 1.5 | 3.5 | 2.5 |
| **MENA** | | | 4.7 | 2.5 | 1.0 | 2.3 | 2.8 | 5.3 | 7.5 | 5.8 | 4.5 |
| **Oil Producing Economies** | | | 3.3 | 2.3 | 0.3 | 1.5 | 1.8 | 3.5 | 2.0 | 4.3 | 3.3 |
| **Non-oil Producing Economies** | | | 1.4 | 3.0 | 2.8 | 4.0 | 4.8 | 9.5 | 20.0 | 9.3 | 6.8 |
| **G4 Economies** | | | | | | | | | | | |
| US | | | 15.4 | 1.6 | 2.2 | 2.5 | 1.7 | 1.3 | 2.1 | 2.2 | 2.6 |
| China | Official | | 18.3 | 6.7 | 6.5 | 6.5 | 6.3 | 2.0 | 1.5 | 1.5 | 1.5 |
| | CAP[3] | | - | 5.1 | 6.0 | 5.0 | 4.5 | - | - | - | - |
| Euro-zone | | | 12.0 | 1.7 | 2.0 | 1.7 | 1.5 | 0.2 | 1.4 | 1.2 | 1.3 |

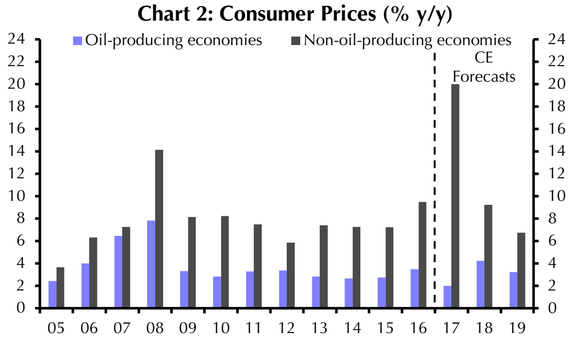
(1) %, 2016, in PPP terms. (2) All % y/y annual average. (3) Estimates based on our China Activity Proxy (CAP).

**Chart 1: GDP (% y/y)**




Sources – Thomson Reuters, CEIC, Capital Economics

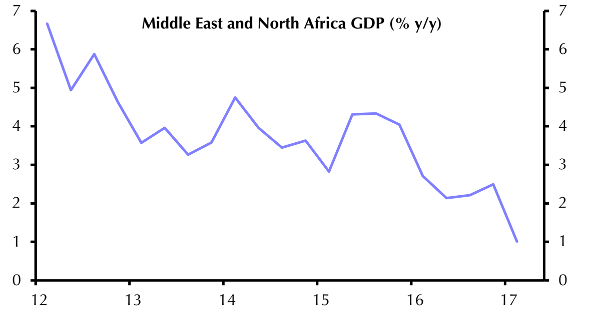
**Chart 2: Consumer Prices (% y/y)**



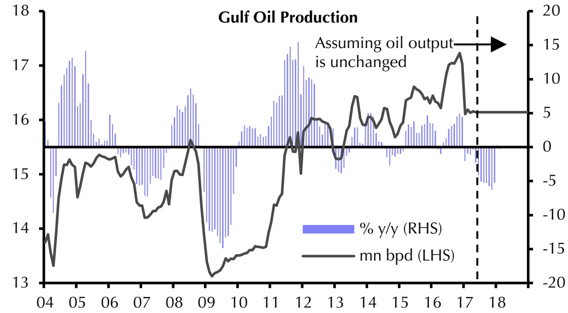

Sources – Thomson Reuters, CEIC, Capital Economics

# Overview

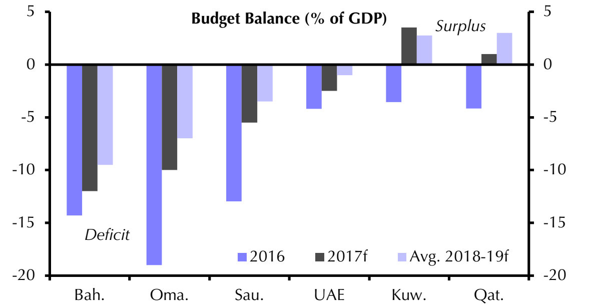
**The MENA economies have slowed sharply over the past couple of years, but growth should reach a trough soon.**



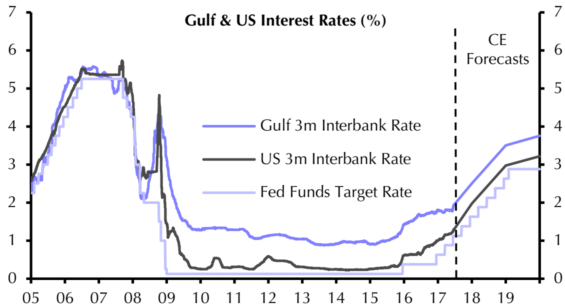

**In the Gulf, the drag on growth from OPEC-agreed oil output cuts will fade next year.**



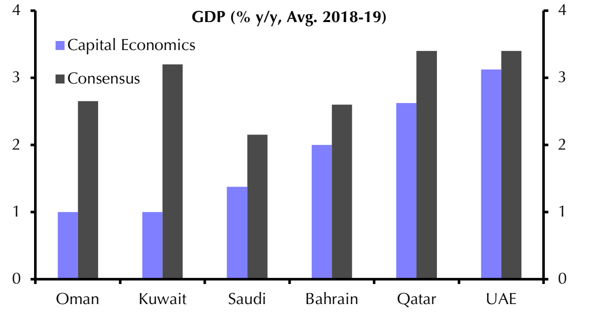

**But fiscal tightening looks set to continue, which will weigh on growth in non-oil sectors.**



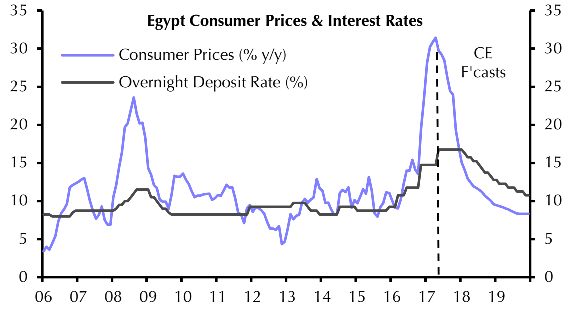

**Meanwhile, as the US Federal Reserve hikes rates, dollar pegs mean that local interest rates will have to follow suit.**



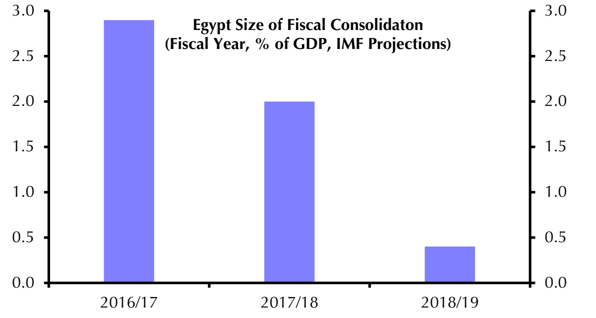

**Accordingly, while growth should recover in 2018-19, we expect it to be weaker than the consensus anticipates.**



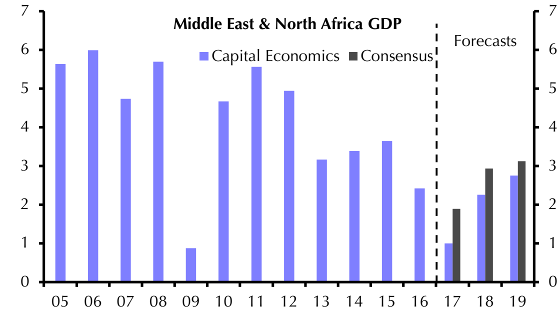

**Elsewhere, Egypt's economy should strengthen. Inflation will fall back, bringing interest rate cuts on to the agenda.**




**And given the progress made over the past twelve months, the pace of fiscal consolidation looks set to slow.**




**For the region as a whole, we expect growth to average 2.5% in 2018-19. Our forecasts lie below the consensus.**




Sources – Thomson Reuters, Bloomberg, CEIC, Capital Economics

# Saudi Arabia

*Economy to rebound in 2018-19, but growth to remain sluggish*

- Oil output cuts will cause Saudi Arabia's economy to contract this year and, while a recovery is likely in 2018-19, we expect it to be weaker than most anticipate.

- Recently-released latest official GDP data showed that the economy contracted by 0.5% y/y in Q1, down from growth of 2.2% y/y in Q4 of last year. (See Chart 1.)

- Growth was pulled down by oil production cuts. The recent extension of the OPEC deal means that this will remain a drag on the economy for the remainder of this year. However, officials are likely to resist calls for deeper cuts and so the hit to growth from the oil sector should fade in 2018.

- Austerity looks set to resume in 2018-19. A value-added tax is set to be introduced early next year which, combined with fresh subsidy cuts, will push up inflation, eroding incomes and dampening consumer spending.

- At the same time, the dollar peg means that local interest rates will need to rise in line with those in the US. (See Chart 2.) As a result, while we think that credit growth will reach a trough soon, it is likely to stay sluggish. The upshot is that the recent recovery in the non-oil sector will be slow-going.

- All told, we expect overall GDP to contract by 1.0% this year before growing by around 1.5% in 2018-19. (See Chart 3.) Our forecasts are below the consensus.

- Meanwhile, the elevation of Mohammed bin Salman to crown prince has raised hopes of a fresh impetus to push through his Vision 2030 reform plans. However, we think the programme will fall short of its lofty goals.

**Chart 1: GDP (% y/y)**

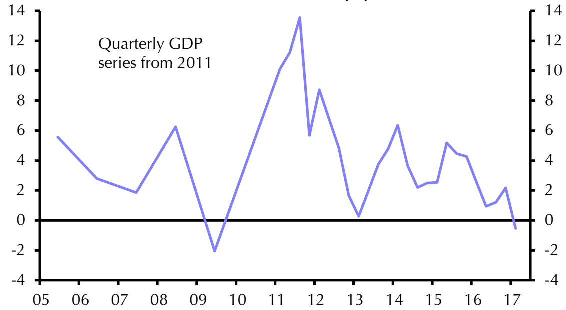



**Chart 2: 3m Interbank Interest Rate (%)**

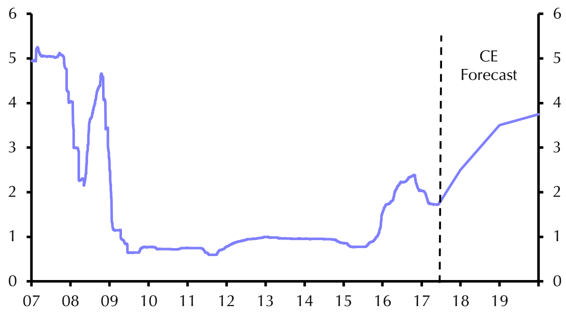



**Chart 3: GDP (% y/y)**

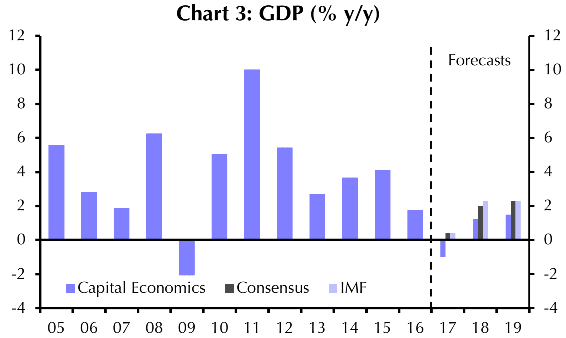



**TABLE 1: KEY FORECASTS** %y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 4.1 | 1.7 | -1.0 | 1.3 | 1.5 |
| Oil GDP | 5.3 | 3.8 | -3.8 | 0.5 | 0.5 |
| Non-oil GDP | 3.2 | 0.2 | 1.3 | 2.0 | 2.3 |
| CPI Inflation | 2.2 | 3.5 | 0.5 | 4.0 | 3.0 |
| Gen'l Gov't Bal(1) | -14.8 | -12.8 | -5.5 | -4.0 | -3.0 |
| Gen'l Gov't Debt(1) | 5.8 | 13.1 | 18.0 | 21.0 | 23.0 |
| Current Account(1) | -8.7 | -3.9 | 0.0 | 0.5 | 1.0 |

Sources – Thomson Reuters, CEIC, CE. (1) as % of GDP

# United Arab Emirates

## *Best-performing economy in the Gulf*

- The UAE's economy is likely to strengthen in 2018-19 and we expect it to be the Gulf's top performer over our forecast horizon.
- Weakness in the oil sector, on the back of OPEC-agreed output cuts, looks set to weigh on growth this year. (See Chart 1.)
- However, the economy should strengthen in 2018-19. For one thing, if we are right in expecting policymakers to resist calls for more aggressive action, the impact of oil output cuts will fade. At the same time, we expect the recovery in the non-oil economy to gather a bit of momentum.
- The UAE was ahead of the curve in tightening fiscal policy in response to the fall in oil prices and its balance sheet is amongst the strongest in the region. The current account will remain in surplus and the budget is likely to post only a modest deficit. (See Chart 2.) In any case, FX savings provide the authorities with a substantial buffer. Against this backdrop, fiscal policy will be much less restrictive compared with the other Gulf economies.
- The non-oil sector should also benefit from robust global growth, while construction activity will be boosted as preparations for the 2020 World Expo are stepped up.
- That said, there are a couple of factors which will hold back growth. Weakness in the rest of the GCC will weigh on the tourism sector. Meanwhile, monetary policy will tighten as local interest rates rise in line with those in the US, keeping credit growth subdued.
- Overall, we expect the UAE's economy to grow by 2.0% in 2017, before picking up to 3.0-3.3% in 2018-19. (See Chart 3.)

**Chart 1: Oil Production**

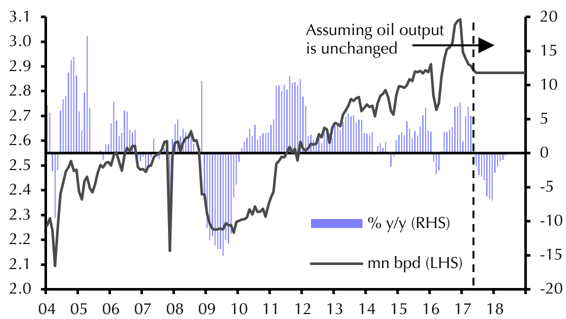



**Chart 2: Budget & Current Account Balances (% of GDP)**

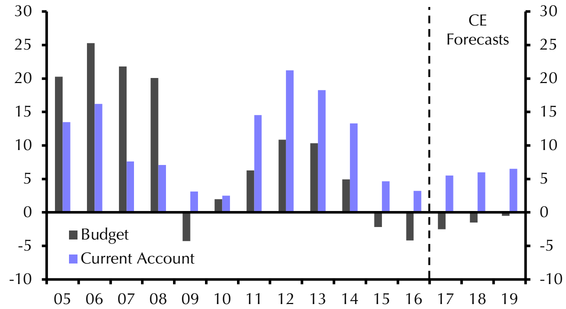



**Chart 3: GDP (% y/y)**

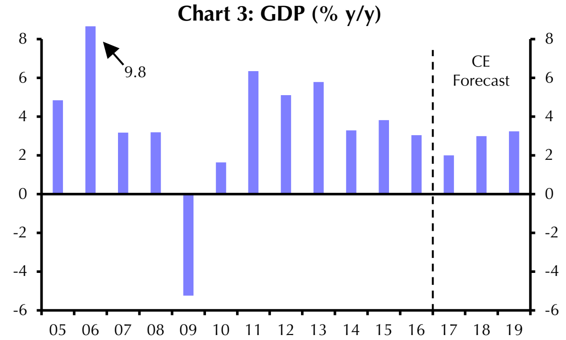



**TABLE 1: KEY FORECASTS** % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 3.8 | 3.0 | 2.0 | 3.0 | 3.3 |
| Oil GDP | 5.4 | 3.8 | -1.0 | 0.5 | 0.5 |
| Non-oil GDP | 3.2 | 2.7 | 3.5 | 4.0 | 4.5 |
| CPI Inflation | 4.1 | 1.6 | 1.8 | 3.0 | 3.0 |
| Gen'l Gov't Bal(1) | -2.2 | -4.2 | -2.5 | -1.5 | -0.5 |
| Current Account(1) | 4.7 | 3.2 | 5.5 | 6.0 | 6.5 |

Sources – Thomson Reuters, CEIC, CE. (1) as % of GDP

# Kuwait

*Growth to stay sluggish*

- Kuwait's economy should not be unduly troubled by low oil prices, but growth is likely to remain weak in 2017-19.

- Kuwait is by far the best placed of the Gulf economies to cope with a prolonged period of low oil prices. Current account and budget positions are likely to return to surplus this year. (See Chart 1.) Moreover, government debt is low and the country's FX savings amount to more than US$550bn, equal to around 500% of GDP. (See Chart 2.)

- Even so, we expect economic growth to remain sluggish. Fiscal policy is likely to be kept restrained. The government plans to limit growth in the public sector wage bill and push ahead with subsidy cuts. A corporation tax is to be introduced and Kuwait is set to bring in a value-added tax alongside the other Gulf countries by 2018, which will push up inflation and dampen consumer spending.

- Meanwhile, resistance from within the National Assembly, Kuwait's elected parliament, means that the government will struggle to push through its latest development plan. The plan is focussed on improving the dire business environment, which is the worst in the Gulf, and raising investment.

- Tight fiscal policy and slow progress on the development plan will keep growth in the non-oil sector subdued. At the same time, OPEC-agreed oil output cuts mean that the oil sector will act as a drag on the economy in 2017, although this should fade from next year.

- All told, we have pencilled in GDP growth of 0.5-1.0% in 2017-19. (See Chart 3.) These forecasts sit below the consensus.

**Chart 1: Current Account & Budget Balances (% of GDP)**

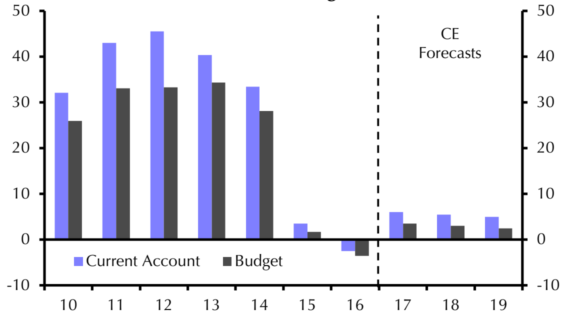



**Chart 2: Sov. Wealth Fund Assets and FX Reserves (% of GDP)**

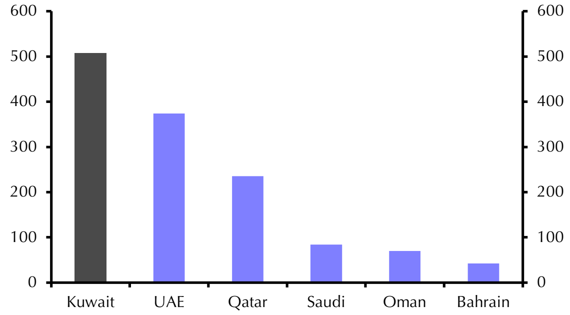



**Chart 3: GDP (% y/y)**

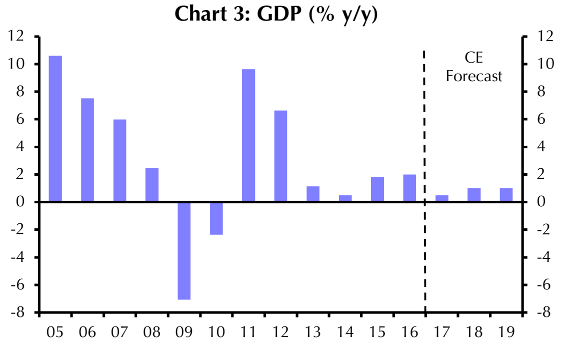



**TABLE 1: KEY FORECASTS** — % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 1.8 | 2.0 | 0.5 | 1.0 | 1.0 |
| Oil GDP | -1.7 | 2.2 | -0.7 | 0.5 | 0.5 |
| Non-oil GDP | 1.3 | 1.0 | 1.3 | 1.5 | 1.5 |
| CPI Inflation | 3.2 | 3.2 | 3.3 | 4.3 | 3.3 |
| Gen'l Gov't Bal(1) | 1.7 | -3.6 | 3.5 | 3.0 | 2.5 |
| Current Account(1) | 3.5 | -2.5 | 6.0 | 5.5 | 5.0 |

Sources – Thomson Reuters, CEIC, SWF Institute, CE. (1) as % of GDP

# Qatar

*Diplomatic spat to have limited impact, but growth to be weak*

- The recent diplomatic spat between Qatar and regional powers has cast a shadow over the economic outlook. While the economic impact of the crisis should be limited, we remain – as we were before the crisis erupted – more pessimistic than the consensus.

- There are good reasons to think that the fallout from the spat will be marginal. Qatar's trade ties with its neighbours are small and there are unlikely to be severe disruptions to supplies of goods in and out of the country. Perhaps most importantly, Qatar's oil and gas shipments are still flowing. And the tightening of financial conditions has not been severe. (See Chart 1.)

- Meanwhile, Qatar is in a strong position to withstand any pressure on its currency. The current account posted a shortfall in 2017, but is likely to return to surplus in the coming years. (See Chart 2.) Moreover, the country has FX savings equal to 235% of GDP, so it should be able to cope with a period of capital flight.

- Even so, there are more fundamental reasons to be downbeat on Qatar's economic outlook. In particular, a period of deleveraging and tighter monetary conditions means that credit growth, a key driver of the economy over the past few years, will be weak.

- OPEC-agreed oil output cuts will cause output in the hydrocarbon sector to contract this year, although a rebound is likely in 2018 as the Barzan gas facility finally comes on stream.

- Bringing all of this together, our forecasts for growth of 2.5-2.8% in 2018-19 lie firmly at the bottom of the consensus range. (See Chart 3.)

**Chart 1: CE Qatar Financial Conditions Index**

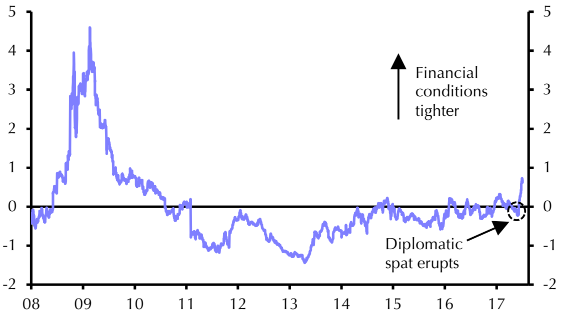



**Chart 2: Current Account & Budget Balances (% of GDP)**

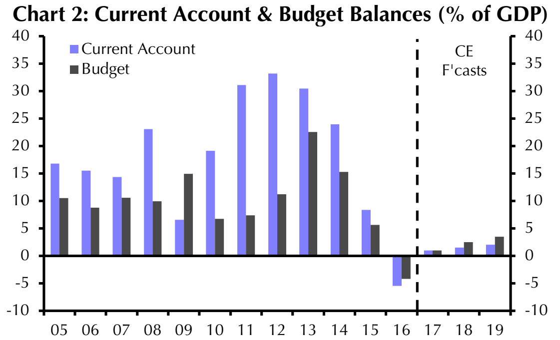



**Chart 3: GDP (% y/y)**

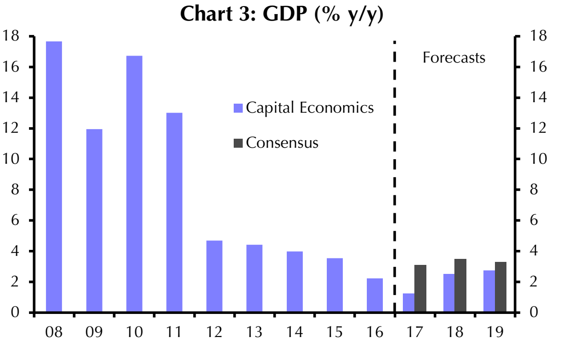



**Table 1: Key Forecasts** % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 3.6 | 2.2 | 1.3 | 2.5 | 2.8 |
| Oil GDP | -0.5 | -1.0 | -1.5 | 1.5 | 1.5 |
| Non-oil GDP | 8.2 | 5.6 | 4.0 | 3.5 | 3.8 |
| CPI Inflation | 1.7 | 2.8 | 0.5 | 2.0 | 2.0 |
| Gen'l Gov't Bal(1) | 5.6 | -4.2 | 1.0 | 2.5 | 3.5 |
| Current Account(1) | 8.4 | -5.5 | 1.0 | 1.5 | 2.0 |

Sources – Thomson Reuters, CEIC, CE. (1) as % of GDP

## Bahrain and Oman

*The Gulf's weak spots*

- Bahrain and Oman's balance sheets are the weakest in the GCC and, while currency devaluations should be avoided, fiscal austerity will need to be stepped up. We think growth will be weaker than most expect in 2017-19.

- Low oil prices have caused large twin budget and current account deficits to open up. (See Chart 1.) In addition, financial buffers are smaller than in the rest of the GCC – FX savings could fund current account deficits for no more than five years. Bahrain's debt-to-GDP ratio is the highest in the Gulf and Oman's has risen sharply. (See Chart 2.)

- If we are right in thinking that oil prices will only rise a little further – our end-2018 forecast for Brent is US$55pb, up from US$50pb at present – a big adjustment will be needed. Devaluation fears could re-emerge, although the rest of the Gulf would probably step in with financial support. After all, devaluations in Bahrain and/or Oman could ignite concerns about their own dollar pegs. That said, Gulf support is likely to be conditional on further austerity being implemented.

- All told, growth is likely to remain subdued for the foreseeable future. We have pencilled in growth of 2.0-2.5% in Bahrain and 0.5-1.0% in Oman. (See Chart 3.) Our forecasts lie below the consensus and the IMF.

- Worryingly, this bleak outlook comes against the backdrop of political uncertainty. In Bahrain, tensions are still rumbling between its Shia-majority population and Sunni leadership which could deter investment. Meanwhile, the poor health of Oman's Sultan Qaboos has brought the vague issue of succession onto the agenda there and may result in a period of policy paralysis.

**Chart 1: Current Account Balance (% of GDP)**

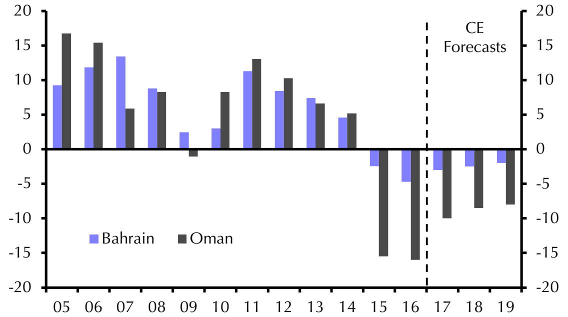



**Chart 2: General Government Debt (% of GDP)**

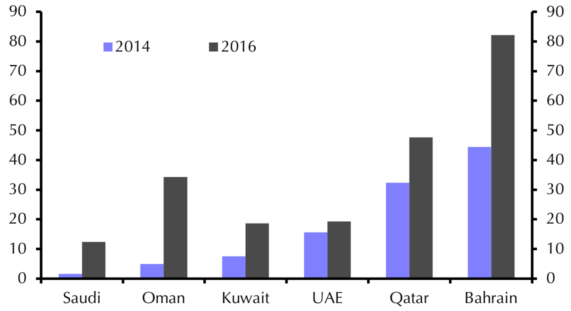



**Chart 3: GDP (% y/y)**

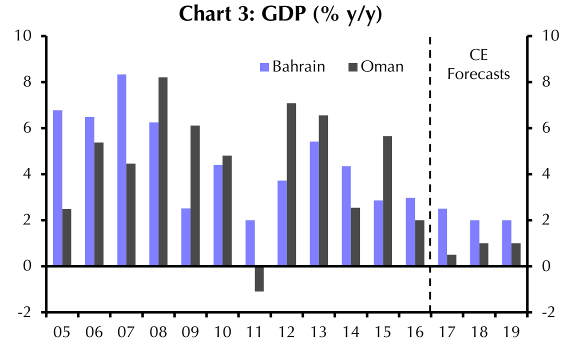



**TABLE 1: KEY FORECASTS** — % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| **Bahrain** | | | | | |
| GDP | 2.9 | 3.0 | 2.5 | 2.0 | 2.0 |
| CPI Inflation | 1.9 | 2.7 | 1.5 | 3.5 | 2.5 |
| Gen'l Gov't Bal(1) | -13.5 | -14.3 | -12.0 | -10.0 | -9.0 |
| **Oman** | | | | | |
| GDP | 5.7 | 2.0 | 0.5 | 1.0 | 1.0 |
| CPI Inflation | 0.3 | 1.1 | 1.5 | 2.5 | 1.8 |
| Gen'l Gov't Bal(1) | -15.1 | -19.0 | -10.0 | -8.0 | -6.0 |

Sources – Thomson Reuters, CEIC, CE. (1) as % of GDP

# Egypt

*Outlook starts to brighten*

- Egypt’s economy is probably now past the worst of its slowdown and the foundations are falling into place for a recovery in 2018-19.

- The effects of last year’s 50% drop in the Egyptian pound against the US dollar have continued to filter through into the wider economy. In particular, inflation has soared, eroding real incomes and dampening consumer spending. A deep fiscal squeeze has acted as a further drag on growth.

- The worst is probably now over for the economy. The big adjustment in the pound has happened and, as a result, inflation will drop back over the next 12-18 months. The next move in interest rates will be down, albeit not until the turn of this year. (See Chart 1.)

- A weaker pound has boosted competitiveness which should support stronger export growth and dampen import demand. This, combined with the start of operations at the “supergiant” Zohr gas field, will help to rein in the wide current account deficit. (See Chart 2.) Meanwhile, a weaker pound and ongoing economic reforms should attract more foreign investors back to the country. A stronger external position will allow disruptive FX restrictions to be scaled back.

- Fiscal policy will continue to be tightened in order to rein in the large budget deficit and bring down the public debt-to-GDP ratio. A rise in the VAT rate and further subsidy cuts are on the cards. But the progress made over the past year means that there should be scope for the pace of austerity to ease.

- All told, we expect the Egyptian economy to accelerate in 2018-19 (see Chart 3) and our forecasts are a touch above the consensus.

**Chart 1: Consumer Prices & Interest Rates**

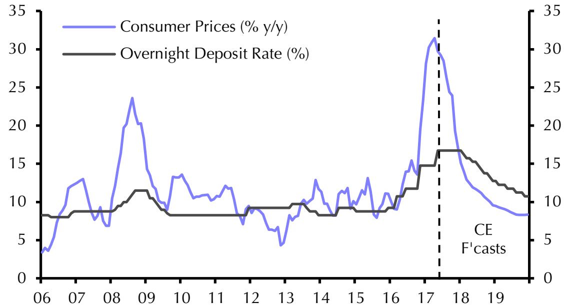



**Chart 2: Current Account Balance (% of GDP)**

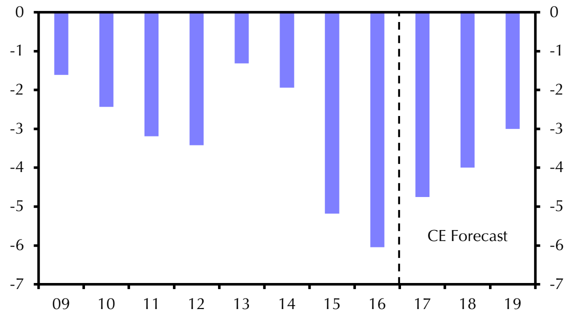



**Chart 3: GDP (% y/y)**

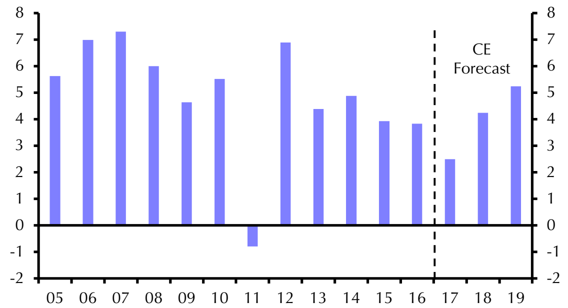



**TABLE 1: KEY FORECASTS** %y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 3.9 | 3.8 | 2.5 | 4.3 | 5.3 |
| CPI Inflation | 10.4 | 13.8 | 29.0 | 12.5 | 8.5 |
| Unemp. Rate (%) | 12.8 | 12.4 | 12.5 | 12.0 | 11.5 |
| | | | | | |
| Gen’l Gov’t Bal[1, 2] | -11.4 | -12.5 | -13.0 | -8.0 | -6.0 |
| Gen’l Gov’t Debt[1, 2] | 88.4 | 97.0 | 91.0 | 80.0 | 75.0 |
| Current Account[1] | -5.2 | -6.0 | -4.8 | -4.0 | -3.0 |
| | | | | | |
| Interest Rate %[3] | 9.25 | 14.75 | 16.25 | 12.75 | 10.75 |
| EGP/USD[3] | 7.83 | 18.13 | 18.00 | 19.00 | 20.00 |

Sources – Thomson Reuters, CEIC, CE. (1) % of GDP. (2) Fiscal Year. (3) End period.

# Lebanon and Jordan

*Syrian conflict, Gulf weakness to keep growth subdued*

- The ongoing conflict in Syria will continue to cast a dark shadow over Jordan and Lebanon and we expect growth in both economies to remain sluggish in 2017-19.

- Growth in Lebanon and Jordan has been weak for a number of years as the conflict in neighbouring Syria has weighed on exports, deterred investment and heightened security concerns. Tourism sectors have suffered particularly badly. This picture is unlikely to improve any time soon.

- Both countries are also exposed to weak growth in the Gulf via trade ties (see Chart 1) and a reliance on official financing, capital inflows and remittances from these countries. As a result, current account deficits will remain large. (See Chart 2.) That said, Jordan's IMF deal and Lebanon's large FX reserves provide the authorities with substantial buffers.

- In return for IMF support, Jordan will be required to tighten fiscal policy. Fiscal policy will be kept tight in Lebanon too, although we doubt that the government will make great strides in dealing with the dire public finances.

- Perhaps the bigger risk for Lebanon is a fresh deterioration in relations with the Gulf. Saudi Arabia and its allies have taken a harsher line with those countries perceived to have close ties with Iran – factions of the Lebanese government are backed by Tehran. In a worst-case scenario, Lebanon may face measures, such as financial restrictions, that could undermine the sustainability of the dollar peg.

- All told, we expect growth in Lebanon and Jordan to remain sluggish over the next few years. (See Chart 3.) Our forecasts lie below the consensus.

**Chart 1: Exports to the Gulf (2016, % of GDP)**

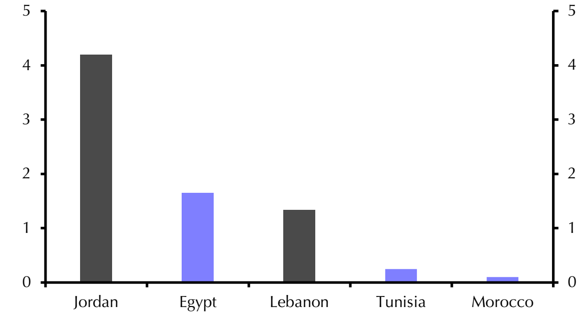



**Chart 2: Current Account Balance (% of GDP)**

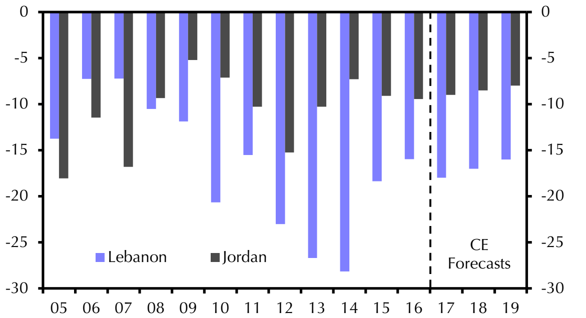



**Chart 3: GDP (% y/y)**

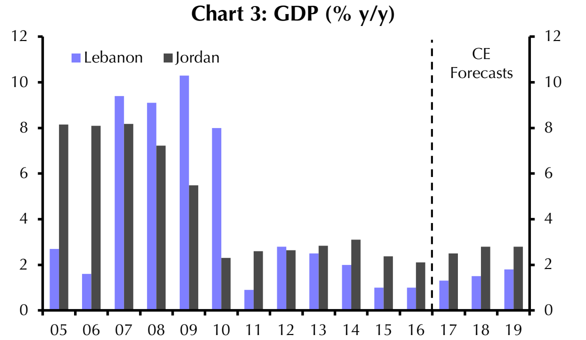



**TABLE 1: KEY FORECASTS** % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| **Lebanon** | | | | | |
| GDP | 1.0 | 1.0 | 1.3 | 1.5 | 1.8 |
| CPI Inflation | -3.7 | -0.8 | 2.5 | 1.0 | 0.5 |
| Gen'l Gov't Bal(1) | -7.4 | -8.1 | -8.0 | -7.5 | -7.0 |
| **Jordan** | | | | | |
| GDP | 2.4 | 2.1 | 2.5 | 2.8 | 2.8 |
| CPI Inflation | -0.9 | -0.8 | 3.3 | 3.3 | 2.5 |
| Gen'l Gov't Bal(1) | -4.1 | -3.4 | -3.0 | -2.5 | -2.0 |

Source – Thomson Reuters, CEIC, CE. (1) as % of GDP

# Algeria

## *Growth to be much weaker than most expect*

- Algeria's adjustment to low oil prices is far from over. Further falls in the dinar, coupled with a big fiscal squeeze, mean that the economy will struggle in 2017-19.

- The Algerian economy held up better than expected last year. The non-hydrocarbon sector struggled under the weight of fiscal austerity and the impact of earlier falls in the dinar, but growth was supported by a rebound in the hydrocarbon sector. (See Chart 1.)

- We doubt that this robust performance will last for much longer. For one thing, the hydrocarbon sector is set to weaken as oil production is cut in line with the OPEC deal and the boost from the In Amenas gas plant's return to full capacity fades.

- Meanwhile, the country's twin budget and current account deficits remain large. (See Chart 2.) The authorities have been forced to burn through their FX reserves and a fresh devaluation of the dinar now seems likely. We expect the currency to fall 25% against its euro-dollar basket by end-2018.

- A weaker dinar will raise the local currency value of the government's oil revenues and help to narrow the budget deficit. But the government has made clear that more austerity is on the cards. Fresh subsidy cuts and a range of tax hikes, coupled with currency weakness, will keep inflation high and household spending under pressure.

- All told, we think GDP growth will remain below 2% over the coming years. (See Chart 3.) Our forecasts are weaker than IMF and consensus expectations.

**Chart 1: GDP by Sector (% y/y)**

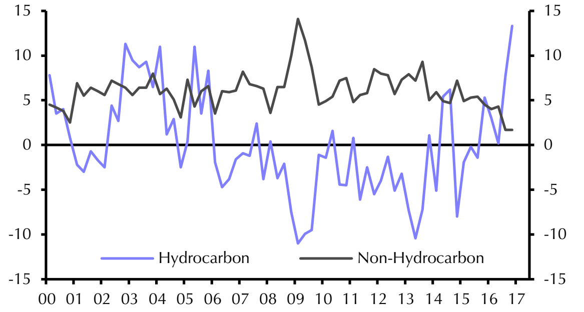



**Chart 2: Budget and Current Account Balances (% of GDP)**

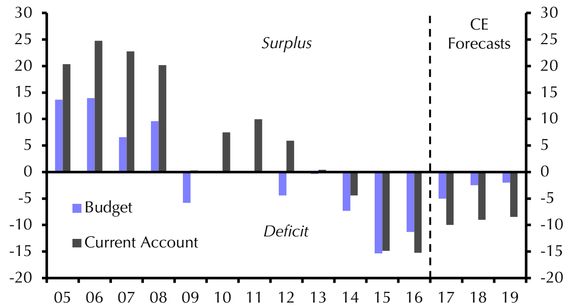



**Chart 3: GDP (% y/y)**

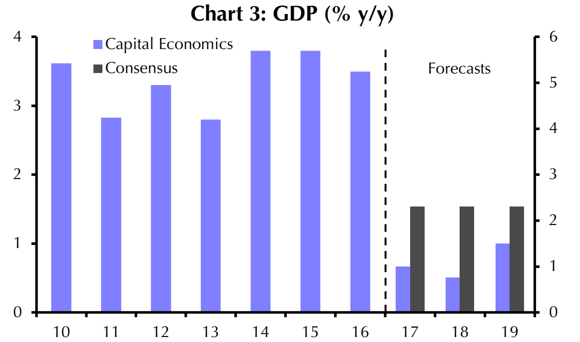



**TABLE 1: KEY FORECASTS** % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 3.8 | 3.5 | 1.0 | 0.8 | 1.5 |
| Unemp. Rate % | 11.2 | 10.6 | 11.0 | 11.5 | 11.5 |
| CPI Inflation | 4.8 | 6.4 | 6.5 | 8.0 | 6.0 |
| Gen'l Gov't Bal(1) | -15.4 | -11.3 | -5.0 | -2.5 | -2.0 |
| Gen'l Gov't Debt(1) | 8.8 | 20.4 | 23.5 | 22.5 | 21.5 |
| Current Account(1) | -14.9 | -15.3 | -10.0 | -9.0 | -8.0 |

Sources – Thomson Reuters, CEIC, CE . (1) as % of GDP

# Morocco

## *Growth to rebound as drought impact fades*

- Morocco's economy has rebounded from last year's drought-related slump and we expect it to be the region's best-performing economy over our forecast horizon. A move to a more flexible exchange rate regime is likely to result in the dirham strengthening against the euro.

- Morocco's economy expanded by 3.8% y/y in Q1. This was up from 1.2% over 2016 as a whole, as more favourable weather conditions supported a rebound in the agricultural sector from last year's drought-related slump. Stronger agricultural output also means that last year's jump in food imports should unwind.

- While we expect growth in the euro-zone, Morocco's largest trading partner, to soften over the next couple of years, ongoing investments into the manufacturing sector, will support stronger export growth.

- Meanwhile, twin budget and current account deficits have narrowed sharply over the past five years. (See Chart 2.) Accordingly, there is little need for a fresh round of aggressive fiscal consolidation.

- Moreover, a stronger external position means the impending move to a flexible exchange rate is likely to see the dirham strengthen against the euro – we have pencilled in a rise to 10.0/€ by the end of this year, from around 10.9/€ at present.

- All told, we expect GDP growth of 4.0-5.0% in 2017-19. These forecasts are above-consensus and would make Morocco the region's best-performing economy. (See Chart 3.)

**Chart 1: GDP by Sector (% y/y)**

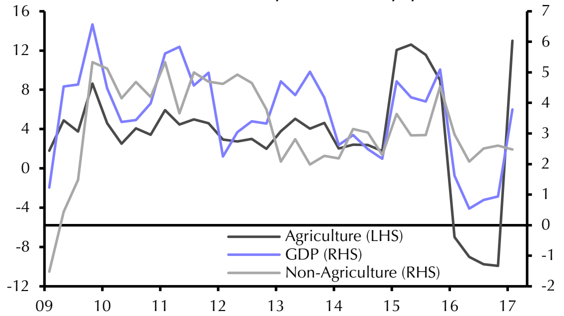



**Chart 2: Budget & Current Account Balances (% of GDP)**

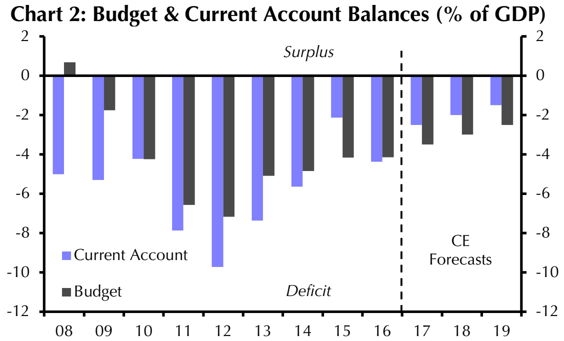



**Chart 3: GDP (% y/y)**

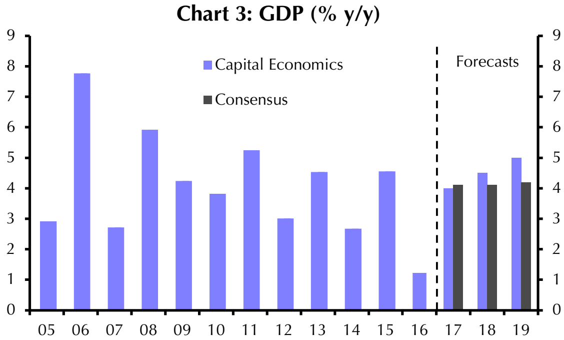



**Table 1: Key Forecasts** % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 4.5 | 1.2 | 4.0 | 4.5 | 5.0 |
| Unemp. Rate % | 9.7 | 9.4 | 9.3 | 9.0 | 8.5 |
| CPI Inflation | 1.5 | 1.6 | 1.0 | 3.0 | 4.0 |
| Gen'l Gov't Bal(1) | -4.2 | -4.1 | -3.5 | -3.0 | -2.5 |
| Gen'l Gov't Debt(1) | 64.1 | 64.5 | 65.0 | 63.5 | 61.0 |
| Current Account(1) | -2.1 | -4.4 | -2.5 | -2.0 | -1.5 |

Sources – Thomson Reuters, CEIC, World Bank, CE . (1) as % of GDP

# Tunisia

*Modest recovery set to continue*

- Tunisia's economy strengthened at the start of this year and we expect the recovery to continue over the coming quarters. But growth will remain sluggish at no more than 3.5%.

- GDP expanded by 2.1% y/y in Q1, up from 1.2% y/y in Q4 of last year. The agricultural sector rebounded from last year's drought, but the rest of the economy failed to gather momentum.

- We expect the economy to continue its slow recovery in 2018-19. In particular, the improvement in the security situation should support a recovery in the tourism sector, a key source of foreign currency earnings.

- Nonetheless, the current account deficit is likely to remain wide. (See Chart 1.) An IMF deal and financial support from other partners should keep strains in the balance of payments contained. In return for financing, though, the Fund has insisted that the authorities push ahead with economic reforms.

- Fiscal consolidation looks set to continue and the authorities have loosened their grip on the dinar. The currency has fallen by more than 10% against the euro in recent months and we expect it to reach 3.00/€ by end-2017, from 2.75/€ at present. (See Chart 2.) In the near-term, inflation looks set to rise, eroding real incomes and dampening consumer spending.

- All told, we have pencilled in GDP growth of 2.3% this year and 3.0% in 2018, before picking up to around 3.5% in 2019. (See Chart 3.) These forecasts are roughly in line with the consensus, which has moved towards our downbeat view in recent months.

**Chart 1: Budget & Current Account Balances (% of GDP)**

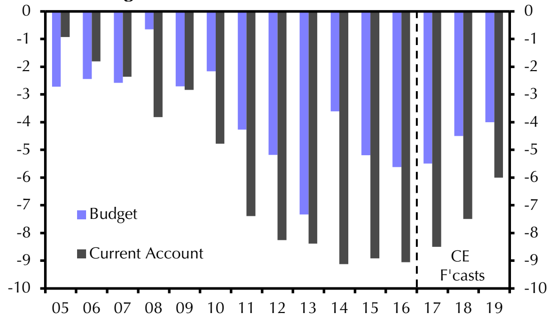



**Chart 2: Tunisian Dinar (vs. €, Inverted)**

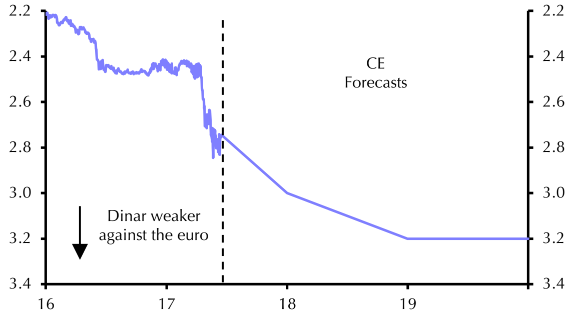



**Chart 3: GDP (% y/y)**

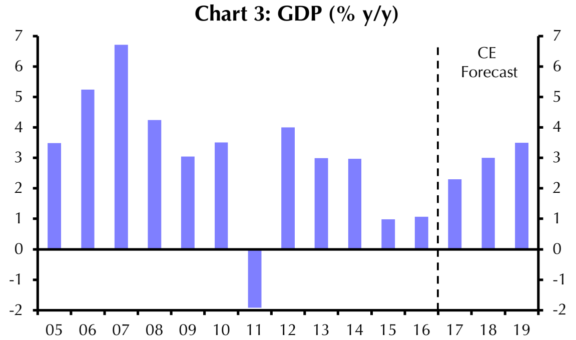



**Table 1: Key Forecasts** — % y/y unless stated

| | 2015 | 2016 | 2017f | 2018f | 2019f |
|---|---|---|---|---|---|
| GDP | 1.0 | 1.1 | 2.3 | 3.0 | 3.5 |
| Unemp. Rate % | 15.5 | 15.5 | 15.0 | 14.5 | 14.5 |
| CPI Inflation | 4.7 | 3.7 | 5.0 | 5.0 | 4.8 |
| Gen'l Gov't Bal(1) | -5.0 | -5.5 | -5.5 | -4.5 | -4.0 |
| Gen'l Gov't Debt(1) | 57.0 | 60.5 | 62.0 | 62.0 | 61.5 |
| Current Account(1) | -9.0 | -9.0 | -8.5 | -7.5 | -6.0 |

Sources – Thomson Reuters, CEIC, CE. (1) as % of GDP

# Financial Markets

*Equities to struggle, dollar bond yields up*

- Equities have struggled so far this year, and we think they will probably tread water over the next twelve to eighteen months. Interest rates and dollar bond yields are likely to rise in much of the region.

- The MSCI Arabian Markets equity index is up 0.7% year-to-date, underperforming stocks elsewhere in the emerging world. (See Chart 1.) An impending inclusion into MSCI's benchmark EM index will provide a boost to foreign inflows into Saudi Arabia's equity market. However, we think some of the optimism may be overdone and oil prices are likely to remain the key driver of the Tadawul and other stock markets in the Gulf. On the basis of our oil price forecasts, equities are unlikely to make much headway. (See Chart 2.)

- Meanwhile, Egyptian stocks should be supported by improved investor sentiment towards the country, although stretched valuations are likely to limit any gains. (See overleaf for our full market forecasts.)

- Dollar pegs in the Gulf should remain intact. As a result, interbank interest rates will have to follow those in the US up (see Chart 3), while higher US Treasury yields will push up dollar bond yields. The recent narrowing of spreads has probably gone a bit too far and, with the Fed likely to tighten policy more aggressively than the markets anticipate, we expect spreads to widen a touch in the coming years.

- Elsewhere, the big adjustment in the Egyptian pound has probably now happened. (See Chart 4.) The Moroccan dirham is likely to strengthen against the euro when the authorities shift to a more flexible exchange rate later this year. In contrast, the Tunisian and Algerian dinars probably have further to fall.

**Chart 1: MSCI Arabian Markets & MSCI Emerging Markets (1st Jan. 2017 = 100)**

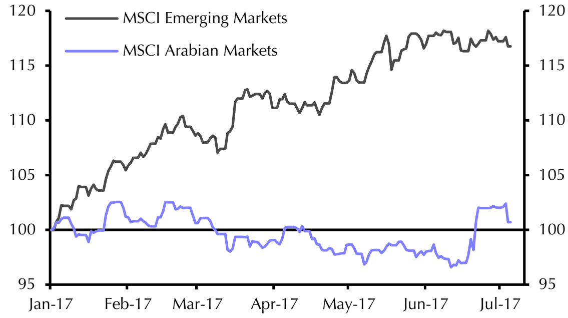



**Chart 2: MSCI GCC & Brent Oil Price**

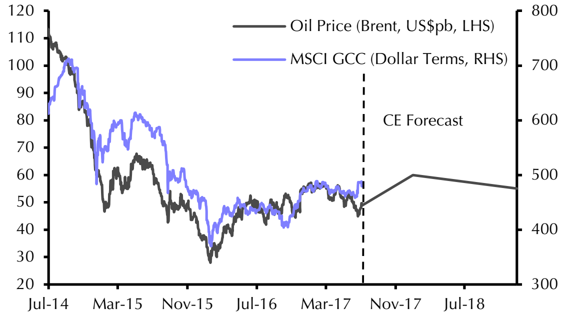



**Chart 3: Gulf & US Interest Rates**

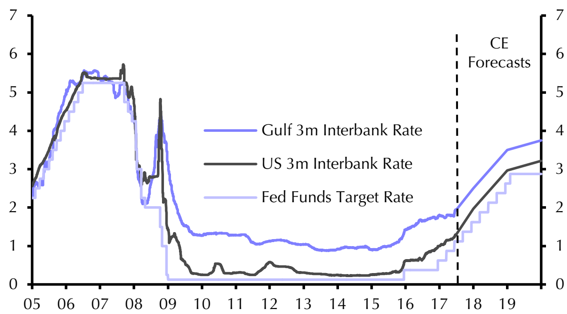
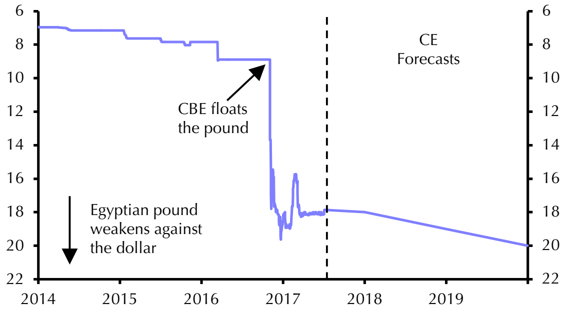



**Chart 4: Egyptian Pound (vs. US$)**




Sources – Thomson Reuters, Bloomberg, Capital Economics

# Market Forecasts

### Table 1: FX Rates

| Currency | | Latest (5th Jul.) | End 2017 | End 2018 | End 2019 |
|---|---|---|---|---|---|
| Saudi Arabia/$ | SAR | 3.75 | 3.75 | 3.75 | 3.75 |
| Egypt/$ | EGP | 17.83 | 18.00 | 19.00 | 20.00 |
| UAE/$ | AED | 3.67 | 3.67 | 3.67 | 3.67 |
| Qatar/$ | QAR | 3.64 | 3.64 | 3.64 | 3.64 |
| Kuwait/$ | KWD | 0.30 | 0.30 | 0.30 | 0.30 |
| Morocco/€ | MAD | 11.00 | 10.00 | 9.80 | 9.80 |
| Tunisia/€ | TND | 2.78 | 3.00 | 3.20 | 3.20 |
| Euro-zone/$ | EUR | 1.13 | 1.10 | 1.15 | 1.20 |
| US | USD | - | - | - | - |
| Japan/$ | JPY | 113 | 120 | 120 | 115 |

### Table 2: Equity Markets

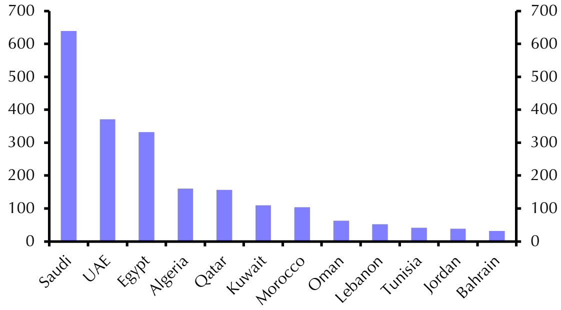
| Equity Market | | Latest (5th Jul.) | End 2017 | End 2018 | End 2019 |
|---|---|---|---|---|---|
| Saudi Arabia | TASI | 7,263 | 7,500 | 7,750 | 8,000 |
| Egypt | EGX30 | 13,343 | 13,500 | 14,500 | 13,000 |
| Abu Dhabi | ADI | 4,413 | 4,750 | 5,000 | 5,000 |
| Dubai | DFMGI | 3,417 | 3,750 | 4,000 | 4,000 |
| Qatar | QSE | 8,929 | 9,000 | 9,250 | 9,500 |
| Kuwait | KWSE | 6,670 | 6,750 | 6,800 | 6,900 |
| Morocco | MADEX | 9,878 | 10,000 | 10,500 | 11,000 |
| Tunisia | TUNINDEX | 6,118 | 6,250 | 6,500 | 6,750 |
| Germany | DAX 30 | 12,451 | 13,500 | 14,000 | 12,500 |
| US | S&P 500 | 2,429 | 2,400 | 2,400 | 2,050 |
| Japan | Nikkei 225 | 20,082 | 21,500 | 21,500 | 18,750 |

### Table 3: Government Bond Yields (%)

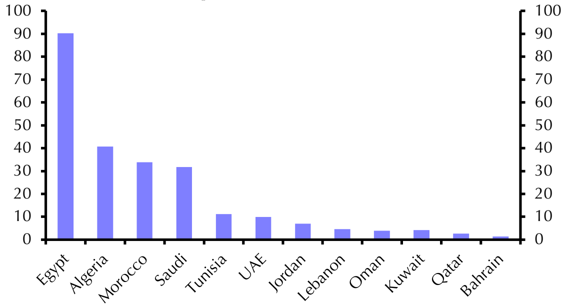
| | | Latest (5th Jul.) | End 2017 | End 2018 | End 2019 |
|---|---|---|---|---|---|
| Saudi Arabia | 2026 Dollar | 3.41 | 4.00 | 4.75 | 4.25 |
| Egypt | 10yr Local Currency | 18.36 | 18.00 | 17.00 | 15.00 |
| | EMBI | 6.65 | 7.25 | 7.50 | 7.00 |
| UAE (Abu Dhabi) | 2026 Dollar | 2.92 | 3.50 | 4.25 | 3.75 |
| Qatar | 2026 Dollar | 3.15 | 3.75 | 4.50 | 4.00 |
| Kuwait | 2027 Dollar | 3.22 | 3.75 | 4.50 | 4.00 |
| Morocco | 2022 Dollar | 3.27 | 4.00 | 4.50 | 4.25 |
| Tunisia | 2025 Dollar | 6.39 | 7.00 | 7.50 | 7.25 |
| Germany | 10yr Local Currency | 0.49 | 0.75 | 1.50 | 2.00 |
| US | 10yr Local Currency | 2.35 | 3.00 | 3.50 | 3.00 |
| Japan | 10yr Local Currency | 0.09 | 0.00 | 0.00 | 0.00 |

# Background Charts

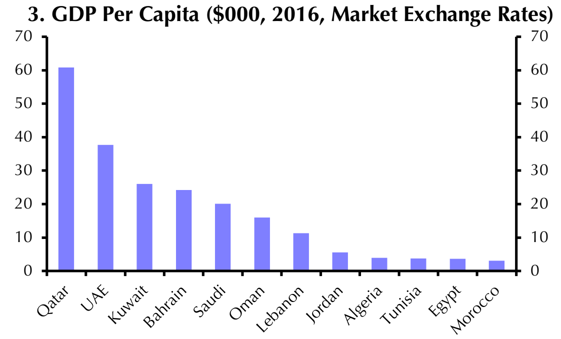
1. GDP ($bn, 2016, Market Exchange Rates)



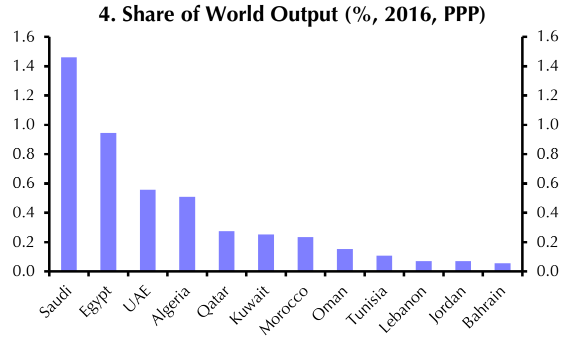

2. Population (Millions, 2016)



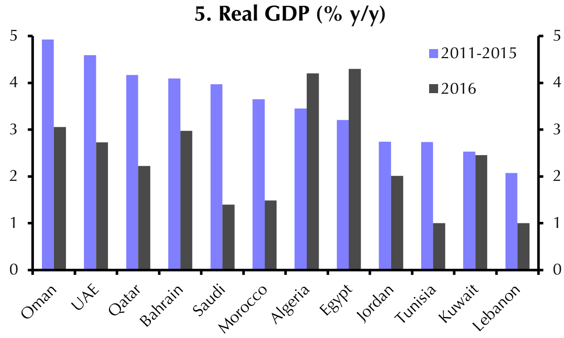

3. GDP Per Capita ($000, 2016, Market Exchange Rates)



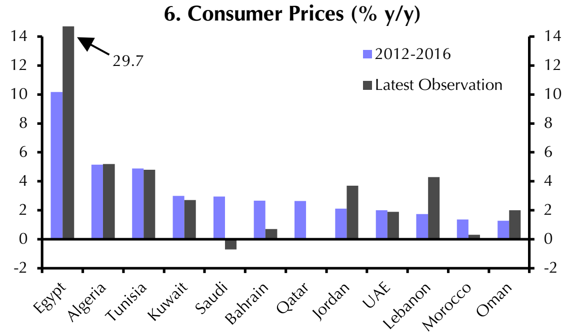

4. Share of World Output (%, 2016, PPP)



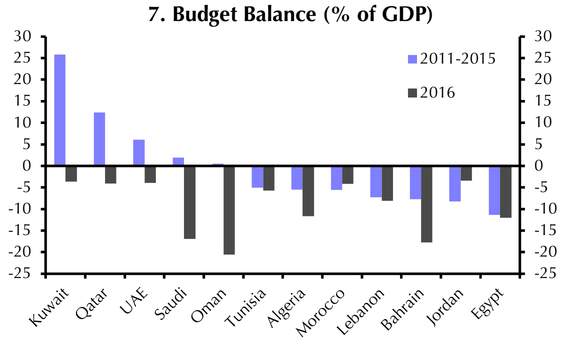

5. Real GDP (% y/y)



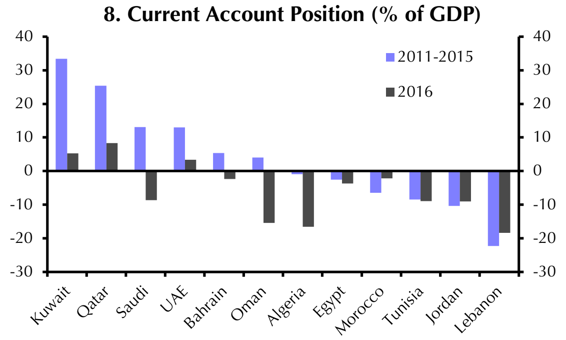

6. Consumer Prices (% y/y)




7. Budget Balance (% of GDP)




8. Current Account Position (% of GDP)




Sources – IMF, CEIC, Thomson Reuters, Capital Economics