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ARAB STRATEGY FORUM

Global and Regional Economic Prospects and Policy Challenges

Prepared by Staff of the
INTERNATIONAL MONETARY FUND

ARAB STRATEGY FORUM

GLOBAL AND REGIONAL ECONOMIC PROSPECTS AND POLICY CHALLENGES

Introduction

Global economic growth will remain subdued in 2016, strengthening gradually in 2017 and beyond. The pickup in growth is expected to be driven by emerging markets, particularly distressed economies where conditions are projected to normalize, while growth in advanced economies is likely to remain subdued because weak productivity growth and demographics weigh on their medium-term prospects. The outlook is shaped by ongoing economic realignments, such as rebalancing in China and the adjustment of commodity exporters to a protracted decline in their terms of trade; as well as political and geopolitical factors, including political uncertainty, conflicts, and refugee crises. Risks are tilted to the downside and include, among other things, deepening political discord and inward-looking policies; stagnation in advanced economies; difficulties in China's transition; financial vulnerabilities in a few large emerging economies; and sizable uncertainties stemming from Brexit and U.S. electoral results.

Against this backdrop, Arab countries are confronting the escalation of conflicts in Iraq, Libya, Syria, and Yemen, as well as a steep drop in global oil prices since mid-2014. Uncertainties arising from conflicts are undermining confidence, while lower oil prices are taking a toll on fiscal and external positions of oil exporters. Oil importers are benefiting from lower oil prices, but declining remittances from oil exporters are partly offsetting these benefits. Despite significant policy adjustment, growth in the Arab world is expected to be modest this year, with little improvement expected in 2017. Deep structural transformations are needed to boost the role of the private sector and foster job creation.

The next section describes the outlook for the global economy, highlighting the risks surrounding the outlook, and policies that could foster a strong and durable recovery. Section III discusses the Arab economies and the key policy challenges they face going forward. Section IV concludes.

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GLOBAL ECONOMIC ENVIRONMENT[1]

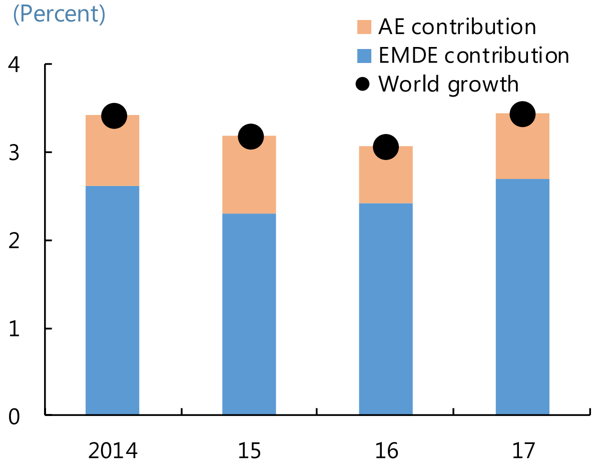
A. Recent Developments and Outlook

1. Global economic growth in 2016 is projected to slow to just over 3 percent this year (Table 1). The 2016 forecast reflects marked down prospects for advanced economies stemming from weaker-than-expected U.S. activity in the first half of the year, as well as the materialization of an important downside risk with the Brexit vote. Activity in emerging market and developing economies (EMDEs) is anticipated to have strengthened slightly in 2016—particularly in emerging Asia and stressed economies (for example, Brazil and Russia)—following five years of consecutive declines.

2. Next year global growth is projected to rise to 3.4 percent. This forecast envisages a further strengthening of economic activity in EMDEs over the medium term as these economies have become the engines for global growth (Figure 1), although the outlook for EMDEs is uneven and generally weaker than in the past. Prospects for advanced economies remain muted, given strengthening demographic headwinds and weakening productivity growth. More specifically:

- The subdued outlook for advanced economies reflects an expectation of continued soft investment growth in the U.S., persistent uncertainty about the long-term relationship between U.K. and E.U., and the dampening impact of aging and weak longer-term productivity trends. The U.S. economy is expected to regain some momentum, owing to a fading drag from inventories and a modest recovery in investment as the effect from lower energy prices and past dollar appreciation wanes. In Japan, economic activity is expected to pick up following a recent fiscal stimulus. A modest euro area recovery is anticipated to proceed at a slightly slower pace—weakening investor confidence on account of the uncertainty following Brexit will weigh on activity despite gains from lower oil prices and easy monetary policy.

Figure 1. Contributions to World Growth
(Percent)



Source: IMF World Economic Outlook.
Note: AE = Advanced Economies; EMDE = Emerging Markets and Developing Economies.

[1] This section draws from the October 2016 edition of the International Monetary Fund's World Economic Outlook, available at www.imf.org.

Table 1. Real GDP Growth

(Percent change)

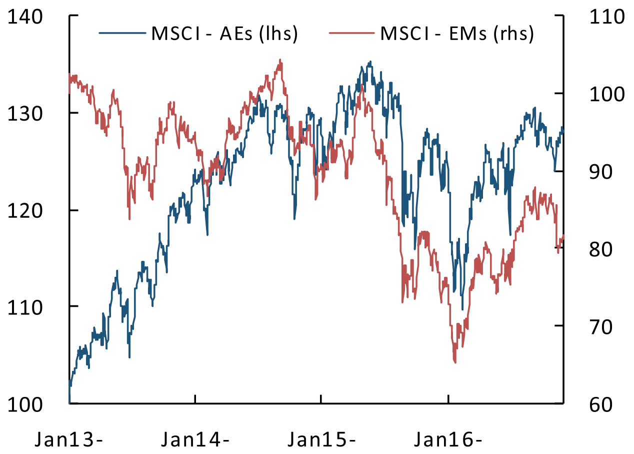
	Year over Year					
			Projections (from Oct. 2016)		Deviations (from Jul. 2016)	
	2014	2015	2016	2017	2016	2017
World 1/	**3.4**	**3.2**	**3.1**	**3.4**	**0.0**	**0.0**
Advanced Economies	1.9	2.1	1.6	1.8	-0.2	0.0
Euro area	1.1	2.0	1.7	1.5	0.1	0.1
Emerging market and developing countries 2/	4.6	4.0	4.2	4.6	0.1	0.0
Advanced G-20	1.8	1.9	1.5	1.8	-0.2	0.0
Emerging G-20	5.1	4.6	4.6	5.1	0.0	0.1
G-20 3/	3.6	3.4	3.2	3.6	-0.1	0.0
Argentina 4/	-2.5	2.5	-1.8	2.7	-0.3	0.6
Australia	2.7	2.4	2.9	2.7	0.1	-0.1
Brazil	0.1	-3.8	-3.3	0.5	0.0	0.0
Canada	2.5	1.1	1.2	1.9	-0.2	-0.2
China	7.3	6.9	6.6	6.2	0.0	0.0
France	0.6	1.3	1.3	1.3	-0.2	0.1
Germany	1.6	1.5	1.7	1.4	0.1	0.2
India 5/	7.2	7.6	7.6	7.6	0.2	0.2
Indonesia	5.0	4.8	4.9	5.3	0.0	0.0
Italy	-0.3	0.8	0.8	0.9	-0.1	-0.1
Japan	0.0	0.5	0.5	0.6	0.2	0.5
Korea	3.3	2.6	2.7	3.0	0.0	0.0
Mexico	2.2	2.5	2.1	2.3	-0.4	-0.3
Russia	0.7	-3.7	-0.8	1.1	0.4	0.1
Saudi Arabia	3.6	3.5	1.2	2.0	0.0	0.0
South Africa	1.6	1.3	0.1	0.8	0.0	-0.2
Turkey	3.0	4.0	3.3	3.0	-0.5	-0.2
United Kingdom	3.1	2.2	1.8	1.1	0.1	-0.2
United States	2.4	2.6	1.6	2.2	-0.6	-0.3
European Union	1.6	2.3	1.9	1.7	0.0	0.1

Source: IMF, *World Economic Outlook* October 2016.
1/ The quarterly estimates and projections account for 90 percent of the world purchasing-power-parity weights.
2/ The quarterly estimates and projections account for approximately 80 percent of the emerging market and developing countries.
3/ G-20 aggregations exclude European Union.
4/ The data for Argentina are officially reported data as revised in May 2014. On February 1, 2013, the IMF issued a declaration of censure, and in December 2013 called on Argentina to implement specified actions to address the quality of its official GDP data according to a specified timetable. On June 6, 2014, the Executive Board recognized the implementation of the specified actions it had called for by end-March 2014 and the initial steps taken by the Argentine authorities to remedy the inaccurate provision of data. The Executive Board will review this issue again as per the calendar specified in December 2013 and in line with the procedures set forth in the Fund's legal framework.
5/ For India, data and forecasts are presented on a fiscal year basis and GDP from 2011 onward is based on GDP at market prices with FY2011/12 as a base year.

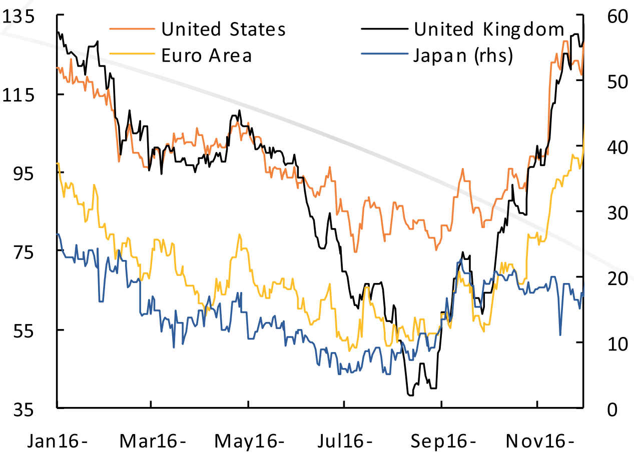
- Growth in EMDEs is anticipated to improve, but prospects differ across regions—with robust growth in emerging Asia, Brazil and Russia showing some signs of improvement, and sub-Saharan Africa experiencing a sharp slowdown. Owing to policy support in China, growth will continue to slow gradually as the economy transitions to a more balanced growth path. Growth in other emerging market and developing economies is expected to remain resilient. India's GDP will continue to expand at the fastest pace among major emerging economies, supported by large terms-of-trade gains, positive policy actions, structural reforms and improved confidence.

Figure 2. Equity Prices and Sovereign Bonds Yields

Equity Prices
(Index; January 100 =2013 ,1)



Sovereign Bond Yield Curves
(10-2 year spread, basis points)



Source: Bloomberg, L.P.
Notes: AEs stands for Advanced economies and EMs for Emerging Markets. lhs = left hand side, rhs = right hand side.
Last observation corresponds to November 2016 ,30.

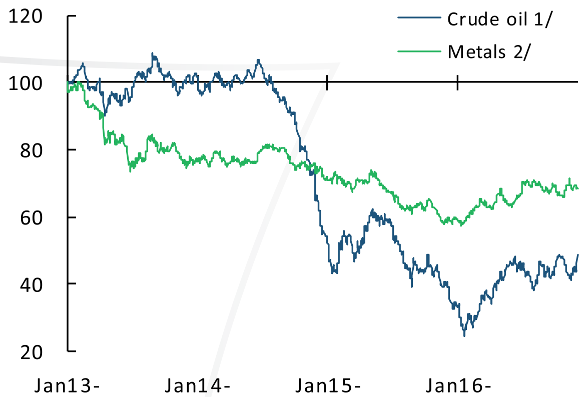
B. Risks to the Outlook

3. Both economic and non-economic factors threaten this forecast. First, political discord and inward-looking policies—fueled by weak growth bypassing low-income earners—could inhibit international cooperation and disrupt trade and financial flows, leading to increased volatility and slower growth in the U.S. and elsewhere. Second, there is a risk of stagnation among advanced economies, particularly where balance sheets remain impaired. Finally, there are sizable uncertainties surrounding the ultimate outcome of Brexit. In this context, risks related to credit and monetary and financial conditions, as well as risk appetite, have risen. Uncertainties around policy positions in advanced economies—particularly on financial regulation and international trade—amid a fraying consensus about the benefits of cross-border integration, could ultimately lead to unsustainable policies, weighing on global growth and exacerbating financial market volatility (Figure 2).

4. Other risks may also influence the global outlook. In particular, risks pertaining to China's rebalancing and associated spillovers remain, even though a recent stimulus has improved short-term sentiment since the beginning of this year. Without decisive progress in addressing debt and governance issues, China's transition could become bumpier than anticipated, with important implications particularly for commodity markets (Figure 3). Also, while financial conditions among emerging markets have continued to improve, economies with large financial vulnerabilities—high corporate debt, declining profitability, weak bank balance sheets—and limited policy buffers remain exposed to sudden shifts in investor sentiment.

5. Finally, a gamut of noneconomic factors could also influence the outlook in some regions. One of the biggest challenges is the spread and intensification of conflicts in the Middle East and North Africa, and, related to this, an unprecedented refugee crisis (see Arab Countries section below). Other risks include drought in eastern and southern Africa, and epidemics in the western hemisphere and south east Asia. If these factors were to intensify, they could collectively take a large toll on market sentiment, hurting demand and activity.

Figure 3. Commodity Prices
(January 100 =2013 ,1)

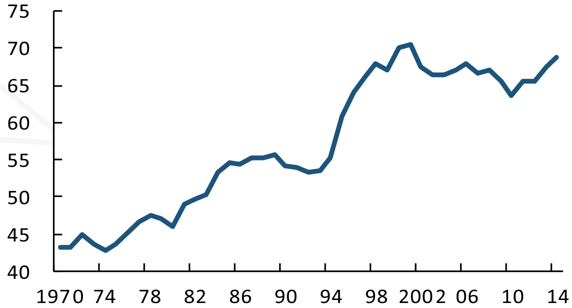


Source: Bloomberg, L.P.
1/ Simple average of three spot prices; U.K. Brent, West Texas Intermediate, and Dubai Fateh.
2/ Simple average aluminium, copper, gold, and silver spot prices.
Note: Last observation corresponds to November 2016 ,30.

C. Policies to Lift Potential Output and Support Inclusive Growth

6. The still weak and precarious nature of the global recovery, and the threats it faces, call for a comprehensive policy approach. Policy priorities differ across individual economies depending on their specific objectives. A common theme, though, is that urgent policy action is needed on multiple fronts to head off repeated growth disappointments and combat damaging perceptions that policies are ineffective in boosting growth, and that the rewards accrue only to those at the higher end of the income distribution.

Figure 4. United States: Household Income Gap
(Thousands of 2005 U.S. dollars)



Source: IMF staff calculations based on Alichi A., K. Kantenga, and S. Solé, "Income Polarization in the United States," IMF WP/121/16, January, 2016.

Note: Household income gap is defined by the diference between the high-income household (households with more than 150 percent of median income) and the low-income households (households with less than 50 percent of median income).

7. Overstretched monetary policy in many countries should be supported with fiscal policy—where space allows—and structural reforms. Where fiscal space is limited, there is scope to change the composition of spending and revenues in a way that supports near-term growth and future productive capacity. Space can be created if policy is based on consistent frameworks that credibly communicate how policy will be used to attain short-term goals in the context of clearly articulated medium-term objectives. These policy frameworks should include measures that mitigate any adverse effects of economic change on income distribution (Figure 4), educational investments that provide people with adaptable skills as well as better social insurance mechanisms that enhance resilience for all.

8. In advanced economies where output gaps are negative and inflation expectations are below target, monetary policy must steer an accommodative course. Further monetary policy loosening through unconventional tools can help lift inflation expectations, lower borrowing costs, and facilitate orderly market conditions. However, fiscal support remains essential for lifting growth momentum. It should be calibrated to the available policy space—supported by credible medium-term consolidation plans—and oriented toward policies that are conducive to lifting potential growth prospects and protect the vulnerable. This includes reforming labor taxes and social benefits to foster labor force participation, and boost investment in infrastructure and human capital.

9. Policies in EMDEs should aim at maintaining convergence to higher income ranges and strengthening resilience. The former requires the implementation of structural reforms that facilitate technology diffusion and job creation, and enhancing the quality of human capital through adequate investment in education and health care. Strengthening resilience requires avoiding excessive fiscal and monetary tightening that could otherwise prevent a sustained recovery among distressed economies. More broadly, to reduce repercussions from potential global financial distress, EMDEs should contain currency and balance sheet mismatches and, where possible, allow for increased exchange rate flexibility. Countries with large fiscal imbalances should continue to adjust their public finances in a growth-friendly fashion.

10. With weak prospects for global growth and limited policy space in a number of countries, multilateral actions acquire even greater relevance to sustain global improvements in living standards. Continued multilateral effort is needed on several fronts, including financial regulatory reform, trade, and the global financial safety net, to help countries become less vulnerable to cross-border contagion and unanticipated economic and noneconomic shocks.

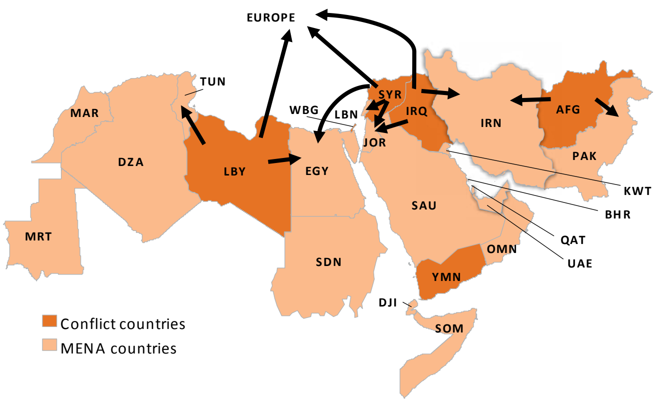
ARAB COUNTRIES[2]

11. Conflicts are one of the biggest challenges the Arab world is facing. Uncertainties arising from conflicts in Iraq, Libya, Syria, and Yemen (Figure 5, left panel) are weakening confidence as violent, non-state groups, such as ISIL, become significant political and military actors, holding large areas of territory. Conflicts have fundamentally changed the region's physical, economic, and social landscape. They are directly affecting some 90 million people, with severe humanitarian, security, and economic concerns impacting many more across the region. The overall number of people living in the Middle East and North African (MENA) countries with full-fledged conflicts or substantial security risks now amounts to almost 150 million.[3]

12. Conflicts are also causing significant economic damage, with activity in the affected countries shrinking considerably, and with much weaker and highly uncertain longer-term growth prospects (Figure 5, right panel). This outlook is predicated on an easing of those conflicts. In Iraq, for example, despite the recent reduction in ISIL-held territories, the medium-term outlook for oil production has been revised down to reflect lower investments in a difficult budget environment and continued security challenges. Similarly, the recognition by the international community of the Government of National Accord in Libya is yet to translate into improved economic prospects. And a resolution of the conflict in Yemen remains elusive despite ongoing talks.

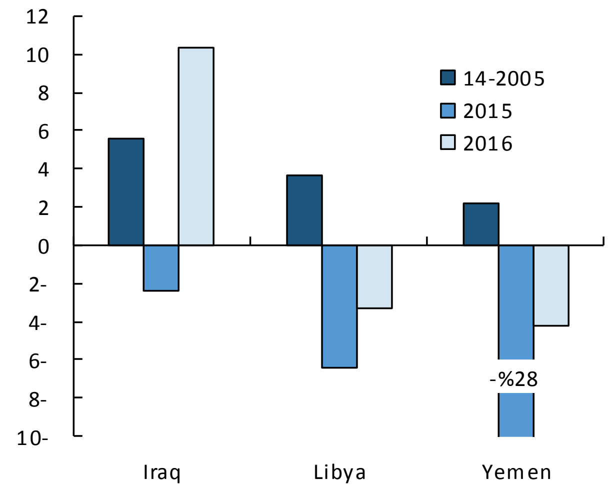
Figure 5. Conflicts and Refugees in the MENA Region

Spillovers from Conflicts



Sources: IMF Regional Economic Outlook database; and Microsoft Map Land.
Note: The country names and borders on this map do not necessarily reflect the IMF's official position. Arrows indicate the direction of spillovers from recent conflicts.

Real GDP Growth in Countries Affected by Conflicts
(Percent)



Source: IMF staff calculations.

[2] This section draws from the October 2016 edition of the International Monetary Fund's Middle East and Central Asia Regional Economic Outlook, available at www.imf.org.
[3] The Middle East and North African (MENA) countries include Afghanistan, Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Pakistan, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates, and Yemen.

13. Largely owing to these conflicts, the region is facing a refugee crisis not seen since the end of World War II. Today, 10 million refugees registered by UN Refugee Agency are from MENA, making up over 60 percent of the world's total. About 6 million of the refugees are displaced in another country of the MENA region and 20 million people in the region have become internally displaced. Populations remaining in conflict countries have experienced rising poverty, as well as deteriorating health and education services.

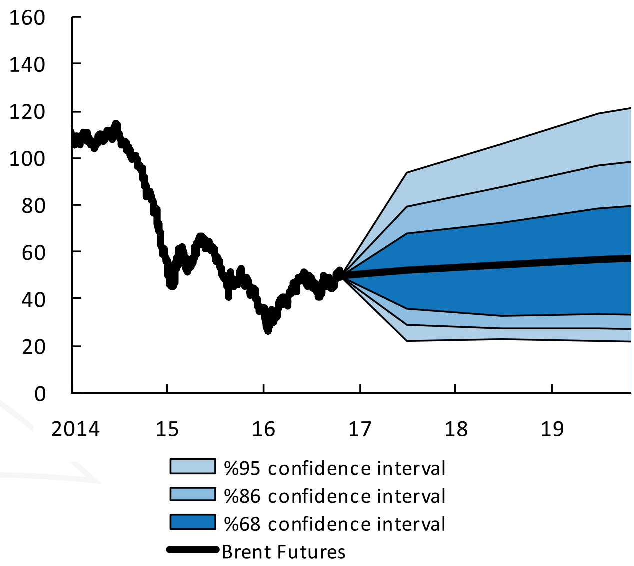
14. The immediate priorities for countries in conflict are to protect human life, keep economic and social institutions operational, and stabilize macroeconomic and financial activities. However, the challenges of stabilizing and rebuilding these countries, and resettling refugees and displaced persons are not the sole responsibility of the region. These are global issues that demand a global response. The international community needs to embark on a concerted effort to help refugees while intensifying its support to stabilize the affected countries. Efforts should also focus on the provision of additional financing to the countries in the region hosting large numbers of refugees.

15. A second key challenge is the slump in oil prices, and the expectation that they will remain low over the medium term (Figure 6). Oil prices are the key driver of the outlook for the Arab world, particularly oil exporters given their high dependence on hydrocarbon budget revenues and exports. After hitting a ten-year low in January 2016, oil prices have staged a partial recovery, supported by lower output from high-cost oil fields and supply disruptions in Nigeria and Canada. This increase has eased fiscal pressures in Arab oil exporters, but it does not fundamentally change the outlook that oil prices will remain below $60 in the coming years.

16. Considerable uncertainty surrounds the oil price outlook, resulting from risks to global growth, oil supply outages, outcomes of the OPEC meetings, ongoing consolidation and efficiency gains in the U.S. shale oil industry, and the role of non-OPEC oil producers. If prices were to rise, high-cost producers would have an incentive to enter the market, boosting global supply and moderating the price increase. If new entrants gain market share, low-cost producers may step up production to maintain their market share by crowding out high-cost producers yet keeping prices low.

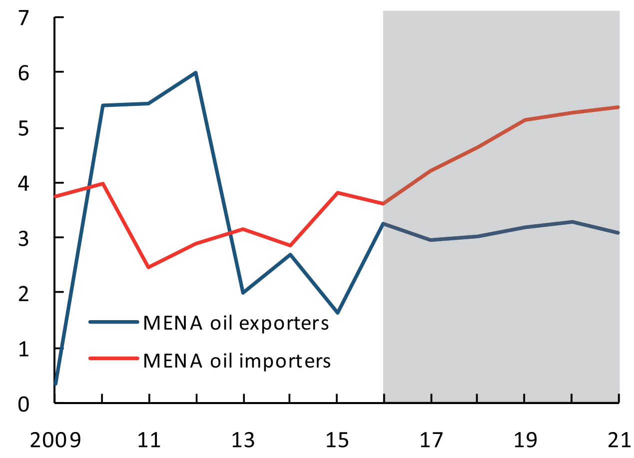
17. Other factors also have bearing on the outlook for Arab countries. The recent increase in uncertainty about policies in some advanced economies could translate into trade and financial flow disruptions leading to a significant slowdown in global growth, a further reduction in commodity prices, and increased financial market volatility. China's rebalancing toward a model where consumption and services, rather than public investment and exports, drive growth may also have implications for Arab countries. While it could imply lower demand for oil and further downward pressures on the price of that commodity, it could offer Arab countries an opportunity to diversify their exports and create much needed jobs.

Figure 6. Brent Crude Oil Price
(U.S. dollars per barrel)



Sources: Bloomberg L.P., IEA, and IMF staff calculations from October 2016 WEO.

Figure 7. Real GDP Growth in MENA
(Percent)



Source: IMF staff calculations.
Notes: Grey area denotes projections. MENA stands for Middle East and North African countries.

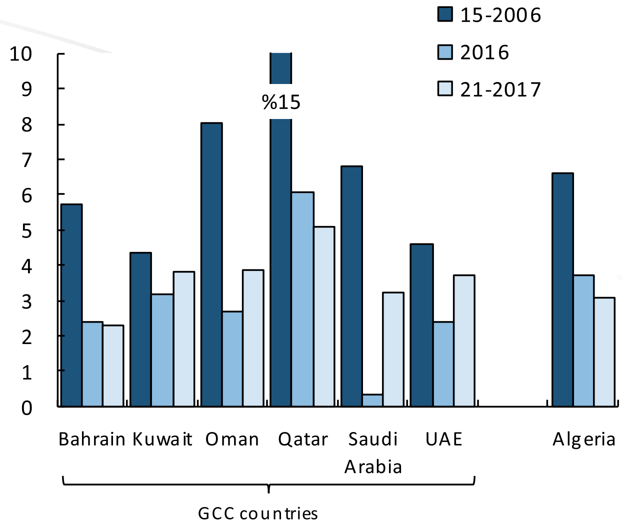
18. Against this backdrop, economic activity is expected to remain subdued (Figure 7). Growth in MENA oil exporters is projected to recover from 1.6 percent last year to around 3 percent in 2016-17. Growth in MENA oil importers is set to moderate to 3.6 percent this year and, assuming continued progress in reforms, should strengthen to 4.2 percent in 2017.

A. Arab Oil Exporters

19. With oil prices anticipated to recover only moderately, economic growth in Arab oil-exporting countries is projected to remain weak in the coming years. Amid significant fiscal retrenchment, economic activity in the Gulf Cooperation Council (GCC) countries is projected to slow this year—despite continued expansion in hydrocarbon output. Non-oil growth is anticipated to dip from 3.8 percent last year to 1.8 percent in 2016. Next year, it is forecast to pick up to 3 percent as the pace of fiscal consolidation eases. Over the medium term, non-oil growth should reach about 3.5 percent on average, still well below the 7 percent average in 2006–15 (Figure 8). In Algeria, the overall growth slowdown in 2016 will be countered by higher natural gas output, but non-oil growth will remain well below historical norms over the medium term.

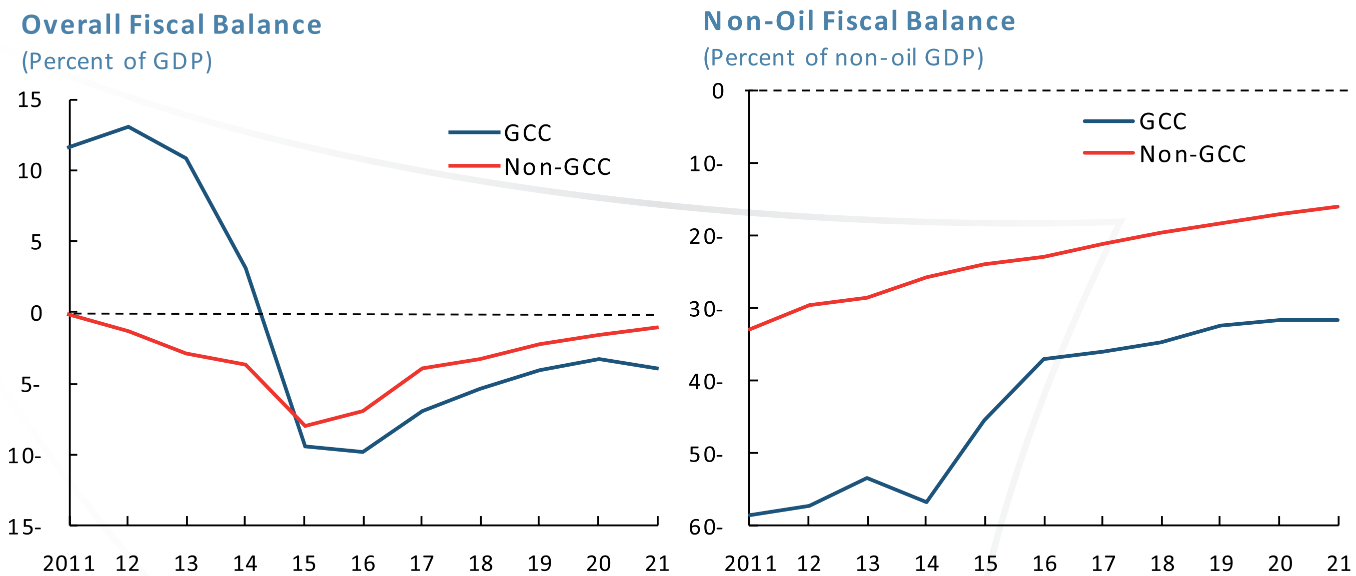
20. In spite of the recent firming of oil prices and the adoption of significant consolidation measures, projected fiscal deficits for Arab oil exporters are anticipated to remain large (Figure 9). Taking into account announced fiscal policy measures, all countries are expected to register fiscal deficits this year, and most are projected to remain in deficit even by 2021. To help address the large budget deficits, many

Figure 8. Real Non-oil GDP Growth
(Percent)



Sources: National authorities; and IMF staff calculations.

Figure 9. Fiscal Balance



Source: IMF staff calculations.

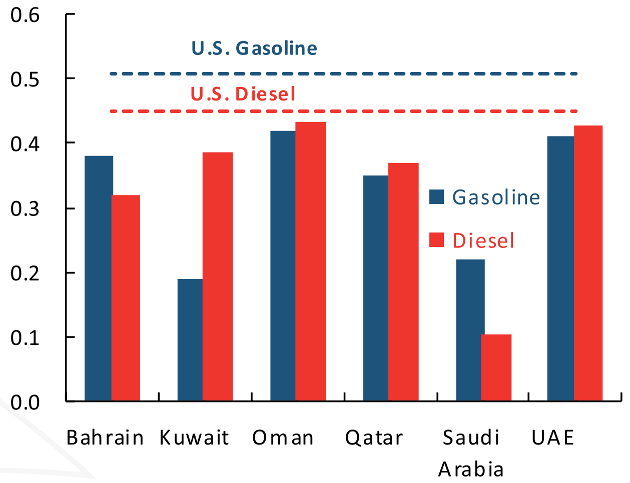
Notes: The GCC (Gulf Cooperation Council) countries include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates; The Non-GCC oil-exporting countries group Algeria, Iran, Iraq, and Yemen.

countries have implemented a mix of spending cuts and revenue-increasing measures. In particular, they have demonstrated resolve in addressing the politically difficult issue of low domestic fuel prices. GCC countries have implemented energy price reforms, with fuel prices rising since mid-2014—average prices for diesel and gasoline have edged toward international benchmarks in most cases (Figure 10). Some countries have taken a step further and implemented automatic pricing mechanisms. Others have introduced measures to rein in the public sector wage bill, including hiring freezes and streamlining benefits. Also, GCC countries are planning to introduce a value-added tax, having already raised some fees, charges, and excises. Thanks to these measures, cumulative fiscal deficits during 2016–21 are forecast to be about $765 billion, down from last April's projection of $1.1 trillion. Despite this progress, most oil exporters still face the challenge of achieving the significant medium-term fiscal adjustment their economies need. As fiscal tightening proceeds, policymakers are likely to face headwinds from increasingly rigid public expenditures, and limited scope for drawing down financial assets.

21. Countries will need to diversify sources of financing for their deficits. Options include drawdown of financial assets, and issuance of debt, both domestic and foreign. While domestic debt issuance has many benefits, including a generally more stable investor base and an absence of any currency risk, it is constrained by the extent of financial development. Foreign financing—such as debt issuance—appears appropriate given favorable international financing conditions, but risks of borrowing in foreign currency must be carefully managed. Some countries have pursued this option. In particular, Bahrain, Oman, Qatar, Saudi Arabia, and the United Arab Emirates have issued bonds and/or obtained syndicated loans in international markets this year for a combined $30 billion.

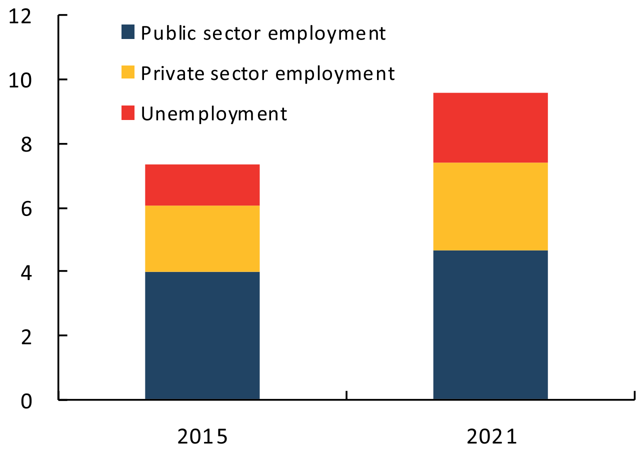
22. In light of the new oil market realities and the downsizing of the public sector, countries need to accelerate structural reforms to diversify their economies away from hydrocarbons. To reduce the dampening effect of fiscal consolidation on growth, countries should phase in additional deficit-reducing measures gradually, while embedding in a well-defined, medium-term fiscal framework to strengthen credibility. Boosting the role of the private sector must also be a priority to create jobs for the rapidly growing labor force in Arab oil exporters. Measures to improve the business environment and to diversify and expand the role of the private sector are also needed. Labor market policies deserve special attention, with the young facing the biggest challenge, given the expected slowdown in public sector hiring that has traditionally been the employer of first resort for nationals (Figure 11). Training programs can help make

Figure 10. Prices of Energy Products in the GCC
(U.S. dollars per liter)



Source: U.S. Departmeent of Energy (EIA)
Note: Values reflect the average January–July 2016 or the latest available data.

Figure 11. Projected Employment in the GCC
(Millions of nationals)



Source: IMF staff calculations.

growth more inclusive and alleviate social pressures. Narrowing the gap between public and private sector wages would also make private sector employment more attractive for nationals.

23. Most oil exporters have formulated strategic development plans, including Saudi Arabia's recent Vision 2030. These plans typically anticipate that several strategic sectors—such as logistics, tourism, energy, financial services, health care, and manufacturing—will help generate the much-needed private sector jobs and become the main driver of growth. However, these plans need to be developed into actionable measures, sequenced, and implemented.

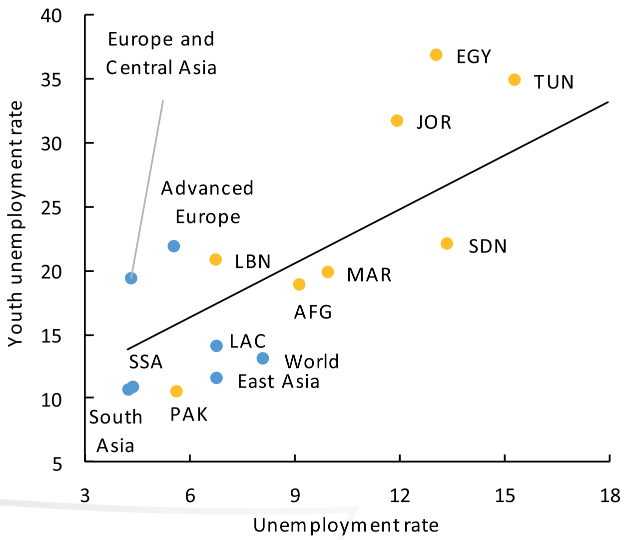
B. Arab Oil Importers

24. Macroeconomic stabilization has advanced in Arab oil importers since 2010, owing to significant progress in reforms and the implementation of sound policies. Lower fiscal deficits, in part owing to energy subsidy reforms, and improvements in sovereign credit ratings have helped to slow the rate of debt accumulation and improved international reserves positions. Inflation has generally declined and financial stability has also improved, with well-capitalized, liquid, and profitable banks. Amid a gradual recovery in the euro area, lower oil prices and improved confidence in these economies, real GDP growth is projected to reach 3.6 percent this year, and 4.2 percent in 2017 (Figure 7). These projections are supported by gradually strengthening public infrastructure spending—financed by channeling savings from energy subsidy reforms and lower oil prices—and steady consumption growth, underpinned by large public wage bills as remittances from GCC countries continue to weaken.

25. Nevertheless, growth remains weak and fragile. Consumer confidence and spending have been supported by the pass-through of lower oil prices, although a partial recovery in oil prices is expected to erode these gains somewhat. Also, external activity has been subdued because of weak external demand and low competitiveness. Exports and tourism have declined sharply in recent months, in part owing to slowing growth in the GCC. Spillovers from regional conflicts also continue to hold back economic activity. Challenging security conditions—including recent terrorist attacks in Egypt and Tunisia—hamper confidence and hurt trade and tourism, while accommodating growing numbers of refugees

Figure 12. Unemployment and Youth Unemployment

(Latest available, percent)



Source: IMF staff calculations based on ILO data.
Notes: Youth unemployment covers persons aged 15 to 24 years.
SSA stands for Sub-Saharian Africa.

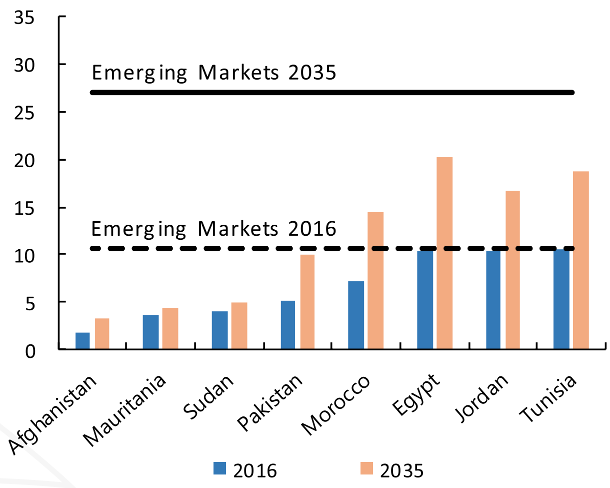
(Jordan, Lebanon, Tunisia) adds to pressures on infrastructure, health, and education services. Moreover, despite significant progress in recent years, structural impediments to growth persist, including insufficient transportation and telecommunications infrastructure and shortages of electricity, fuel, and water.

26. While growth has picked up significantly, medium-term prospects remain insufficient to tangibly increase living standards and reduce unemployment (Figure 12). Under baseline assumptions—that is, with medium-term growth projections of slightly more than 5 percent—unemployment, currently at 11 percent, is anticipated to decline only to 8 percent by 2021. The low sensitivity of unemployment to growth suggests that unemployment is mostly structural and due, in particular, to mismatches in job skills. Amid weak productivity growth and slow capital accumulation, this suggests that potential growth is likely to remain weak. As a result, per capita income would continue falling behind other EMDEs (Figure 13).

27. Notwithstanding recent improvements, achieving fiscal sustainability while supporting economic activity remains a priority. Carefully designed and clearly communicated medium-term plans can help sustain an easier fiscal stance in the near term without exerting upward pressure on borrowing rates. On the revenue side, efforts to reduce exemptions and loopholes and improve tax administration should continue. There is little scope for increased spending given the weakness of state revenues, large public wage bills, and high debt service— especially in Egypt, Jordan, and Lebanon, where debt ranges between 90 percent of GDP and 145 percent of GDP. However, subsidy and revenue reforms are expected to reduce fiscal deficits in most Arab oil importers, potentially generating space for growth-enhancing investments and well-targeted social spending (Figure 14).

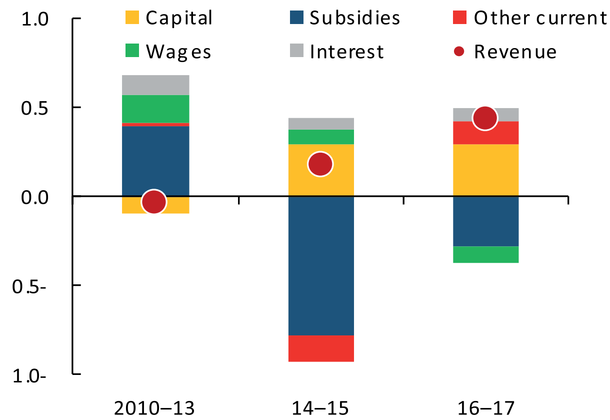
28. The fiscal policy constraints underscore the need for further structural reforms. Most oil importers have already made important steps to improve productivity and job creation. However, there is a need to generate stronger and more inclusive growth that yields sufficient benefits for the general population. Arab oil importers should focus on accelerating reforms especially in the areas of business, trade, and labor—it is of particular importance implementing policies to enhance the employability of job seekers, more aptly connect workers and jobs, and to promote job creation and labor force participation. Growth will also need to be made more inclusive, to allow the broader population to enjoy the benefits of higher living standards. Finally, particular efforts must be made to foster female labor participation to boost benefits from greater diversity.

Figure 13. Income per Capita
(In Thousands PPP U.S. Dollars)



Source: IMF staff calculations.
Note: The growth rate assumed for 2022-35 is the average growth rate in 2017-21.

Figure 14. Subsidy Reforms Create Space for Growth-Enhancing Social Spending
(Percentage of GDP, Change from Prior Year)



Source: IMF staff calculations.

CONCLUDING REMARKS

29. The global economy is expected to expand by about 3 percent this year and further 3.4 percent in 2017. The projected recovery reflects an improvement in the outlook among emerging market and developing economies, as well as the U.S. economy regaining some momentum. However, risks, mostly to the downside, abound. They stem primarily from greater policy uncertainty and an increased likelihood of inward-oriented policies in some advanced economies, and also from slower-than-expected growth in China where rebalancing continues and the intensification of conflicts and geopolitical risks. Amid weak prospects for global growth and limited policy space in a number of countries, the mitigation of these risks requires strengthening international cooperation including on financial regulation, trade, and the global financial safety net.

30. In this setting, Arab countries continue to face exceptional challenges. To mitigate the impact of adverse shocks and strengthen growth prospects, many countries have made significant progress in implementing much needed reforms. Notwithstanding this remarkable, and in some cases unprecedented progress, much remains to be done. Arab countries need to continue to strengthen their fiscal positions while moving ahead with structural reforms that reduce commodity dependence and promote diversification. These actions will foster private sector development and create much needed jobs, ultimately achieving more sustained and inclusive growth and unleashing the enormous creative potential of the Arab world.

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