Survey of Economic and Social Developments in the Arab Region

2022-2023

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Economic and Social Commission for Western Asia

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Preface

The Survey of Economic and Social Developments in the Arab Region is an annual flagship publication of the Economic and Social Commission for Western Asia (ESCWA). The publication is mandated by paragraph 173 of General Assembly resolution 35/56; paragraphs 2 to 4 of ESCWA resolution 270 (XXIV); and paragraphs 1 and 2 of ESCWA resolution 303 (XXVII). It seeks to contribute to efforts by member States to reform economic institutions and develop and implement policies based on principles of good governance in order to enable economic planning and policymaking in support of inclusive and sustainable development. The present 2022–2023 edition focuses on analysing the most recent socioeconomic developments from January 2022 to June 2023. The publication has two key objectives: to analyse routinely monitored economic and social variables in the Arab region in a global context (chapters 1 to 3), and to focus on inflation and exchange rate regimes in the Arab region (chapter 4).

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Policymakers and other stakeholders were consulted throughout the report's preparation. An external expert group meeting reviewed and validated the draft report on 26 September 2023. Participating experts comprised Ali Awdeh, Hatem Salah, Aljaz Kuncic, Raidan Al Saqqaf, Claudia Assmann and Samia Hamouda.

Executive summary

The global economic outlook for 2024 is moderately optimistic given the recovery of high-income and developed countries from the COVID-19 shock and the repercussions of the war in Ukraine. Commodity price inflation seems to be contained both in the United States of America and other developed countries. In contrast, developing economies, including Arab countries, are struggling with high interest rates, capital flight to developed countries and high borrowing costs. Many developing countries are also suffering from a surge in labour market informality, a growing gender gap, and uncertainty around natural resources and global food prices. Global tourism is expected to recover to its pre-pandemic levels in 2023. The global consumption of oil recovered to the December 2019 pre-COVID-19 level in June 2023.

With the stabilization of oil and gas prices at moderate levels in 2023 and before the war on Gaza, the gross domestic product (GDP) of the Arab region was expected to grow at a moderate pace of around 3.6 per cent in 2024, and at a faster pace of around 4.2 per cent in 2025. The rebound in tourism and the financial sector as well as expansionary infrastructure projects are the region's other main drivers of growth. However, the war on Gaza, which started in October 2023, is expected to slow down economic growth in the region in 2024. The three-month war scenario predicts that in 2024, GDP will grow by 3.3 per cent. Inflation reached 12.3 per cent in 2023, mainly as a result of the halting of the Black Sea Grain Initiative and the significant negative impact on the prices of essential food items imported by Arab countries. Inflation is expected to decline to around 7.5 and 6 per cent in 2024 and 2025, respectively, in both the pre-war and three-month war scenarios.

While a cut in oil production and a decrease in demand are expected to slow economic growth in Gulf Cooperation Council (GCC) countries, the expansion of non-hydrocarbon sectors, particularly the entertainment business, as well as the recovery of the tourism sector, a burgeoning services sector and numerous infrastructure projects will accelerate an upward climb in GDP. Growth is expected to reach 4.1 per cent on average during the 2023–2025 period. The decline in global oil prices coupled with generous subsidies and national support programmes are expected to negatively affect revenues, however, and create a fiscal deficit of around 2 per cent of GDP during the outlook period.

The increase in phosphate and gas production from Arab middle-income countries is expected to drive economic growth, with GDP predicted to rise by 3.7 per cent on average during the 2023–2025 period according to pre-war scenario. The risks, however, are skewed downward amid high inflation and financing costs on one hand, and the ongoing war on Gaza and its impact on neighbouring countries on the other. The three-month war scenario expects a slowdown in economic growth to around 3.3 per cent during the period 2023–2025, given the significant impact of the war on the tourism sector and on capital inflow in Egypt, Jordan and Lebanon, in addition to mounting fears of an escalation of the war into a regional conflict. Middle-income countries are expected to continue to have constrained fiscal space and to be significantly affected by fluctuations in commodity prices. Many have maintained costly food and energy subsidies. The fiscal deficit is expected to widen and reach 7.3 per cent in 2024 and 6.6 per cent in 2025. Debt levels are predicted to improve as a result of the better debt position of Egypt and changes in Lebanon.

The situation in Arab conflict-affected countries remains uncertain and is overshadowed by the war on Gaza, political divides and security concerns. GDP was expected to increase by 4.5 per cent on average during the period 2023–2025 in the pre-war scenario. The three-month war

scenario predicts that GDP will grow by 4.2 per cent in the same period. Conflict-affected countries will likely witness a deterioration in their fiscal position from 3.8 per cent of GDP in 2023 to 6.2 and 8 per cent in 2024 and 2025, respectively. The war on Gaza, with the severe level of violence against Palestinian civilians, is pushing the Gaza strip into dire economic and social conditions and has propagated to the whole State of Palestine. GDP in Palestine is expected to decline by 4.4 per cent during the period 2023–2025, while the massive number of casualties and injured in addition to the vast destruction will likely push the State of Palestine 10 to 15 years back.

The outlook for the Arab least developed countries is highly uncertain and gloomy, and is affected by the escalating conflict in the Sudan. GDP is expected to contract by 3.8 per cent on average during the 2023–2025 period. The least developed countries continue to face constrained fiscal space and challenging socioeconomic conditions. The fiscal deficit is expected to improve, however, from 3.2 per cent of GDP in 2023 to 2.6 and 2.3 per cent of GDP in 2024 and 2025, respectively.

One third of the region's population – 35.4 per cent – falls under the ESCWA poverty threshold, which is comparable to national poverty lines. The share is expected to decline sluggishly to 35.1 per cent by 2025. Arab middle-income countries could see their poverty rates gradually recovering from their height during the pandemic years, declining from 24.4 per cent in 2022 to an estimated 24.1 per cent by 2025. In the Arab low-income and conflict-affected countries, poverty rates have jumped from 56.7 and 45.5per cent in 2019, respectively, to 63.5 and 50.3 per cent in 2023. They are expected to further rise by 2025 to 63.7 and 50.4 per cent, respectively. The war on Gaza is threatening to push the entire population of the Gaza strip, around 2.3 million Palestinians, into multidimensional poverty, and that poverty will increase in Lebanon and Palestine. In high-income countries, poverty is projected to decline near monotonically from 11.4 per cent in 2019 to 10.3 per cent in 2023 and 9.7 per cent in 2025. These diverging poverty trends in the region go along with differing levels of inequality.

The Arab region continues to have the lowest global gender gap score among all world regions, at 0.62, implying a 0.38-point gap in 2023. This score indicates deep-rooted challenges, including sociocultural norms, policy barriers and labour market issues. The estimated time to bridge the gap is over 150 years.

In terms of women's education, the educational gap is around 4.6 per cent, displaying the region's commitment to achieving gender parity in education. In economic participation, the gender gap stands at 40.33 per cent in 2023, placing the region second to last in the world, just above Southern Asia and behind the global average of 60.1 per cent. The Arab region's female labour force participation rate is 19.89 per cent in 2023, a low number explained by a mix of cultural, legal and practical reasons. Societal norms often suggest that women should prioritize home responsibilities. In some countries, laws restrict where and how women can work. Additionally, the absence of practical support, like affordable childcare, is a major barrier.

Overall, the unemployment rate in the Arab region is estimated to be around 11.6 per cent in 2023 and is predicted to marginally decrease to 11.5 per cent by 2024. The female unemployment rate stands at 20.1 per cent, while the male rate is 8.19 per cent. The situation for youth is daunting, with the general youth unemployment rate at 26.4 per cent or around 22.2 per cent for men and 42 per cent for women.

Inflation is partly imported and partly endogenous, and has generated severe currency crises in some countries, such as Lebanon and the Syrian Arab Republic. Even though many countries in the Arab region have managed to keep inflation rates at low to moderate levels, six countries have recorded high rates in the past few years, namely, Egypt, Lebanon, the Sudan, the Syrian Arab Republic, Tunisia and Yemen.

Many drivers could explain the spike in inflation, including energy prices, government expenditures, exchange rate pass-through and the money supply. Based on variance decomposition, the main sources of inflation in the six Arab countries with high inflation rates are government expenditure, the money supply and the nominal effective exchange rate. Given the persistence of energy subsidies in some countries, the impact of fluctuations in energy prices was limited. Also, a certain inflation inertia is evident, where the current price level depends on the price level of the previous period, indicating a high degree of downward price stickiness.

Inflation affects everyone, including households and businesses. It erodes consumer purchasing power when wages are not indexed to changes in prices and has harmful

distributional effects on the most vulnerable communities. It accentuates poverty, increases the size of the informal sector and affects public finances.

Overall, the assessment shows that inflation continues to be a serious concern for the Arab region, notably for the six most affected countries. Containing the undesirable effects of high inflation should be among the leading priorities in monetary and fiscal policies in these countries, notably through reducing public expenditure and containing public debt. Coordinating fiscal and monetary policies is necessary during a disinflation process. Strengthening the independence of central banks is essential to enhancing the credibility of monetary policies. Finally, sustaining political stability is a key prerequisite for any successful policy.

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Abbreviations and explanatory notes

CAC Conflict-affected country

CPI Consumer price index

ESCWA Economic and Social Commission for Western Asia

FAO Food and Agriculture Organization

GCC Gulf Cooperation Council

GDP Gross domestic product

IDP Internally displaced person

ILO International Labour Organization

IMF International Monetary Fund

LDC Least developed country

MIC Middle-income country

NEER Nominal effective exchange rate

NEET Not in employment, education or training

OECD Organisation for Economic Co-operation and Development

OPEC Organization of Petroleum Exporting Countries

SVAR Structural vector autoregression

UNRWA United Nations Relief and Works Agency for Palestine Refugees in the Near East

The following country groupings are used in the present report. They were defined based on a combination of per capita income levels, geographical proximity, and similarities in economic and social characteristics and conditions. They include:

- GCC countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.
- Middle-income countries: Algeria, Egypt, Jordan, Lebanon, Morocco and Tunisia.
- Conflict-affected countries: Iraq, Libya, the State of Palestine, the Syrian Arab Republic and Yemen.
- Least developed countries: the Comoros, Djibouti, Mauritania, Somalia and the Sudan.

The global context and its implications for the Arab region

1

Key messages

After the tumultuous 2020–2022 period caused by the COVID-19 pandemic, the war in Ukraine and the great comeback of high inflation to the developed economies, 2023 brought a moderately optimistic outlook with slowly moderating inflation, decreases in commodity prices and the successful avoidance of crisis in European industries.

This has had, however, significant costs for middle-income economies and least developed countries. Interest rate hikes increased the cost of capital and triggered outflows to high-income economies. A deep reform of the international financial architecture is needed to distribute costs and benefits more evenly.

A food crisis was averted with the Black Sea Grain Export Initiative and higher-than-usual yields around the world. The El Niño-Southern Oscillation cycle, however, could bring unprecedented natural disasters and the return of high global food prices.

The resilience of advanced economies to a sudden halt in the flow of hydrocarbon exports from the Russian Federation, achieved through firm policy actions, behavioural changes and energy conservation measures, shows that the world is becoming increasingly independent from oil and gas. Prices are expected to decrease in the medium to long run, which calls for action by Arab oil exporters to accelerate the development of new growth models.

A. Global context

The global economy saw a difficult year in 2022. Growth was sluggish and inflation remarkable. Hopes for a post-pandemic recovery were dashed by the war in Ukraine and resultant disruptions in trade. Skyrocketing prices of grains and edible oils as well as hydrocarbons significantly affected the emerging economies. Nevertheless, these problems were by and large solved in the second half of the year by the Black Sea Grain Export Initiative as well as shifts in supply chains. As of 2023, the prices of food and hydrocarbons were already at pre-war levels. Inflation problems eased in developed economies as a result of tight monetary policy.

Two main challenges are threatening recovery prospects in 2024 and onwards. The first is the impact on developing countries of interest rate hikes and monetary tightening in developed countries. In a world of record-high debt, this policy approach can result in a broad wave of bankruptcies among financial institutions (as was already visible in the first half of 2023 in the bankruptcy of Silicon Valley Bank in the United States of America and the takeover of Credit Suisse brokered by the Swiss National Bank) and the Governments of developing countries. The second challenge is connected to climate change. El Niño conditions are developing in the Pacific with surface water temperatures that as at June 2023 were higher than ever recorded. It is expected that 2024 will be the hottest year on record, beating 2016. This could bring unprecedented droughts to Southern Africa, Central America and the Caribbean, and to food exporters such as Australia, Brazil and South Africa, causing an increase in the prices of agricultural commodities and threatening food security in the Arab region (box 1.1).[1] Nevertheless, while monetary policy tightening will strain debt sustainability in developing countries and agricultural prices may rise, it is not yet clear how fully these risks will materialize.

Table 1.1 Output growth and inflation in the main economies worldwide, 2021–2024 (Percentage)

	Real GDP				Inflation			
	2022	2023	2024	2025	2022	2023	2024	2025
World	3.1	2.3	2.5	4.1	9.8	7.7	4.9	4.1
Developed economies	2.7	1.0	1.2	3.3	7.8	4.8	2.4	2.1
United States of America	2.1	1.1	1.0	2.4	8.7	4.4	2.4	1.8
Japan	1.1	1.2	1.0	2.1	2.5	2.1	0.8	1.3
European Union	3.5	0.9	1.5	4.5	8.8	6.1	2.8	2.6
Euro area	3.2	1.3	1.4	3.5	9.4	6.5	6.0	5.4
Economies in transition	3.2	2.0	3.0	6.2	14.1	9.1	6.6	4.7
Russian Federation	-2.1	-0.6	1.4	1.9	13.8	8.2	6.2	4.1
Developing economies	3.9	4.2	4.2	5.2	12.8	12.2	8.9	7.1
Africa	3.8	3.3	3.8	4.4	18.4	17.4	12.6	10.8
East Asia	3.2	4.7	4.3	5.9	2.8	2.2	2.2	2.6
China	3.0	5.3	4.5	6.1	2.0	1.5	2.0	2.4
India	6.8	5.8	6.7	6.1	5.9	5.5	5.0	6.3
Latin America and the Caribbean	3.8	1.4	2.4	2.7	29.2	33.8	22.7	15.4
Least developed countries	4.3	2.9	4.9	6.1	26.0	15.0	10.1	9.8
World trade	5.1	2.3	3.7	4.2				
World output growth with purchasing power parity (PPP) weights	3.3	2.7	3.0	4.4				

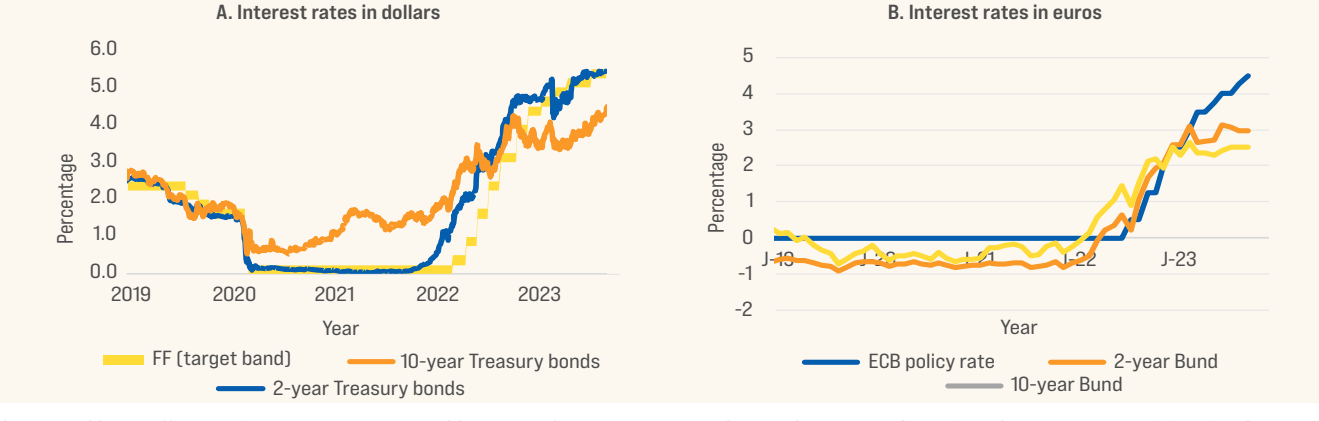
Source: **United** Nations Department of Economic and Social Affairs (UNDESA), 2023.

Against this background, growth in output is projected to remain subdued in 2023 and 2024 at 2.3 and 2.5 per cent, respectively, significantly below the midterm average of 3.1 per cent. The recovery will be minimal in the developed economies with projected gross domestic product (GDP) growth of 1 per cent in 2023 and 1.2 in 2024, driven mainly by tightening monetary policy that will curb investment. In the second half of 2023, these policies are expected to bear fruit and lower inflation towards targets. This process is expected to be faster in the United States as the Federal Reserve began its hike cycle earlier than the European Central Bank. Nevertheless, GDP growth is expected to amount to about 1.1 per cent in the United States, 1.2 per cent in Japan and 0.9 per cent in the European Union. The outlook in 2024 is expected to be slightly better with 1.2 per cent growth in developed economies: 1 per cent in the United States and Japan, and 1.4 per cent in the European Union. Full recovery is not expected in these countries before 2025 (table 1.1).

Although inflation in 2023 is already lower than in 2022 and is likely to further recede in 2024, it will probably remain at a heightened level for a few years to come. Globally, the consumer price index (CPI) is expected to reach 7.7 per cent in 2023 and 4.9 per cent in 2024, well above the medium-term average of 3.1 per cent. In the United States, the actions of the Federal Reserve will likely have an impact, with inflation predicted to be 4.4 per cent in 2023 and 2.4 per cent in 2024, before hitting the 2 per cent target in 2025. Disinflation in the euro area is expected to be slower due to less pronounced and delayed policy action by the European Central Bank, though it is expected to fall to 6.5 per cent in 2023 and 6 per cent in 2024. Inflation in Japan will remain low at 2.1 per cent in 2023 and 0.8 per cent in 2024. In these countries, disinflation will be driven mostly by the actions of the central banks, which will hamper the recovery of consumer demand.

The surge in interest rates in the developed economies will attract investment, leading to the strengthening of the dollar, euro and yen. The central banks in developing countries will face difficult choices – either they will increase their rates to halt capital outflow to developed countries, significantly diminishing the availability of funds for Governments and domestic borrowers, or they will allow their currencies to depreciate, which will increase the prices of imported goods and drive inflation. Due to governance difficulties, the latter seems more probable, so inflation is expected to remain quite high. This is especially relevant to Latin America and the Caribbean, where inflation is expected to reach 33.8 per cent in 2023 and 22.7 per cent in 2024. Similarly, it will remain high in Africa, at 17.4 per cent in 2023 and 12.6 per cent in 2024, especially in the western part of the continent at 19.4 and 16.3 per cent in 2023 and 2024, consecutively. China and India are expected to keep inflation low as they are not that import dependent, and their central banks have more influence on price levels. Inflation is expected to reach 1.5 and 2 per cent in China and 5.5 and 5 per cent in India in 2023 and 2024, respectively. It will remain elevated in the Asia region as a whole, however, with South Asia heading towards 11 per cent inflation in 2023 and 9.4 per cent in 2024, driven by the surge in demand and the inflow of tourists from a recovering China. Demand pressures in the countries of the Commonwealth of Independent States will be somewhat mitigated by sanctions on the Russian Federation and spillovers to neighbouring countries; inflation is expected to reach 9.2 per cent in 2023 and 6.7 per cent in 2024.

Figure 1.1 Interest rates in dollars and euros



Sources: ESCWA staff calculations based on the Board of Governors of the Federal Reserve System, Open Market Operations; ICE Benchmark Administration, 3-Month London Interbank Offered Rate; Federal Reserve Bank of St. Louis and the Deutsche Bundesbank database.

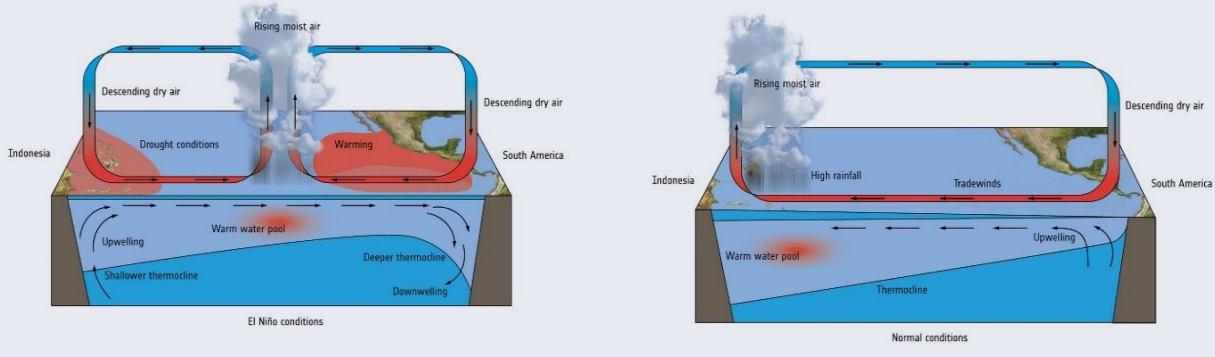
Note: ECB refers to European Central Bank.

Box 1.1 El Niño and its potential impact on the global recovery

According to the National Oceanic and Atmospheric Administration in the United States, the hottest 10 years in recorded history all fall within the last 13 years, with 2016 being the hottest – it saw global average temperatures increase by 1 degree Celsius above preindustrial levels. This record would have been broken since then without the occurrence of three consecutive La Niña episodes between 2020 and 2022. These countered the effects of human-caused climate change. Nonetheless, 2022 still managed to secure a solid second place on the list of hottest years, and 2023 is anticipated to be even hotter with an increase of 1.1 degrees Celsius, bringing the world dangerously closer to the 1.5-degree mark set in the 2015 Paris Agreement on climate change. Beyond that threshold, the impacts of catastrophic heat waves, disrupted ecosystems, flooding, drought, crop failures and species extinction become much harder for humanity to handle.

The El Niño-Southern Oscillation cycle is one of the most important factors influencing weather in Australia, South-Eastern Asia and the Americas over the next few years (figure 1A). During normal oceanic circulations, equatorial trade winds blow west, moving warm Pacific surface water away from the Americas towards Asia. This water is then replaced by a rise of cold water from the depths to the surface through a process called upwelling. These normal conditions are interrupted by two opposing climate patterns called El Niño (little boy) and La Niña (little girl), which together form the El Niño Southern Oscillation cycle. El Niño represents the warming phase of the cycle and is marked by an increase in ocean surface water across the Pacific, releasing more heat into the atmosphere and thus increasing global temperatures. La Niña forms the cooling phase of the cycle and tends to have global climate impacts opposite to those of El Niño. Both phases can significantly impact global weather, ecosystems and economies. These events occur every two to seven years, on average. They last typically between 9 and 12 months but can sometimes continue for years, with El Niño generally occurring more frequently than La Niña.

Figure 1A The impact of El Niño on the weather



Source: European Space Agency.

The arrival of a new El Niño in 2023 is expected to disrupt the global economy, which is already struggling to recover from COVID-19 and the war in Ukraine, and wreak havoc especially in the most vulnerable countries. Carbon emissions amplify the effects of naturally occurring climate phenomena and lead to accelerated climate change, setting the stage for the costliest El Niño to date. Previous El Niños weighed heavily on economies and caused spikes in global inflation as they directly impacted prices of oil and non-energy commodities. They also affected economic growth, especially in countries vulnerable to the phenomenon, such as Australia, Brazil, China and India. A Dartmouth University study concluded that the 1997–1998 El Niño led to a $5.7 trillion loss in GDP over the next five years.[a] The same model estimated that future El Niños may trim some $87 trillion from GDP by the end of the century. The risk is higher nearer the tropics and in the southern

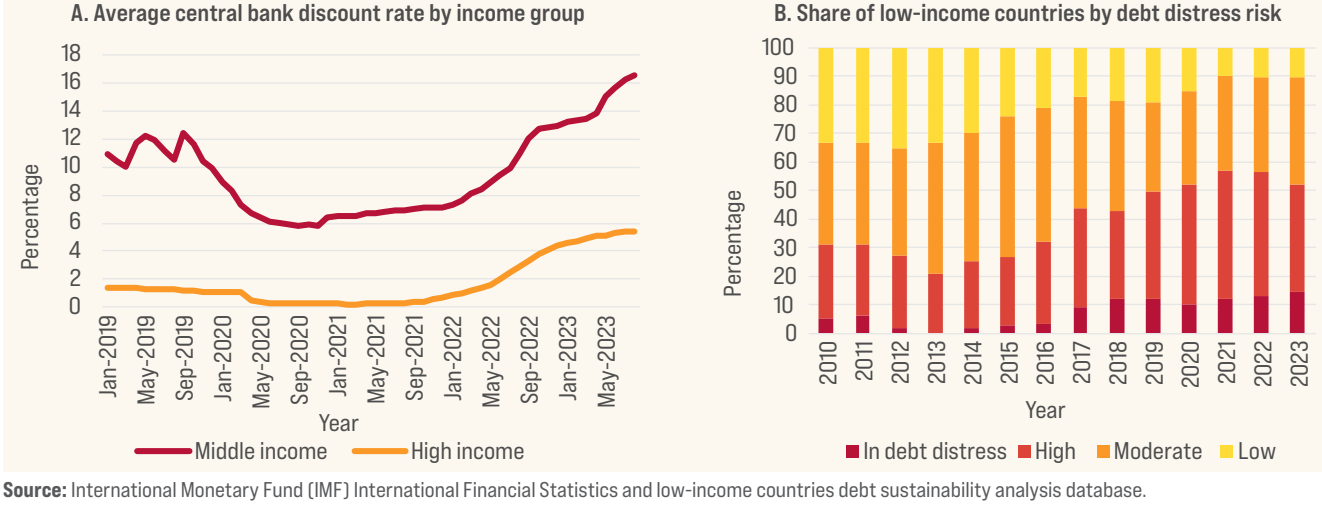
hemisphere. In Argentina and India, for example, El Niño could shave as much as half a percentage point off annual GDP growth.

The shift from La Niña could have severe macroeconomic repercussions. For example, reduced monsoons could affect rice, cotton, corn and soybean production in India. Potential droughts in parts of West and South Africa could hinder the production of cocoa and corn. The United States will witness a resurgence in winter storms despite the drop in the number of hurricanes. Drought could hit Brazil and Colombia, crimping coffee output, while Peru may see widespread flooding and a reduced anchovy catch. In Australia, severe droughts could instigate forest fires that would jeopardize the production of wheat and other crops. In Chile, heavy rains and floods will disrupt access to mines that supply 30 per cent of the world's copper, causing delays in production and a spike in the prices of electronics. In China, heatwaves will threaten livestock viability and stretch the power grid ever thinner, prompting officials to shut down power.

Even though it is not yet entirely known how strong the next El Niño cycle will be, it could have significant impacts on the global economy by prolonging droughts, exacerbating floods and producing more disastrous typhoons. On the other hand, as precipitation during the El Niño phase is usually higher, some agricultural areas may benefit as more rain is usually good for crops. One thing is certain: unprecedented climate change will bring even more uncertainty to the global economy over the next few decades.

[a] Dartmouth College, 2023.

Figure 1.2 Interest rates in different economies by income group and share of countries by debt distress status



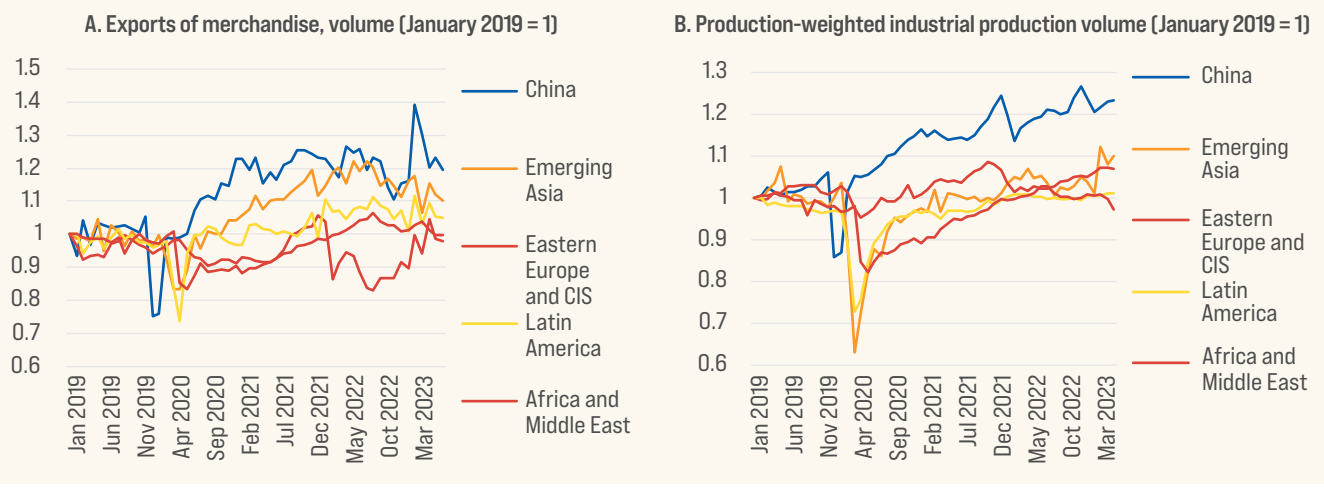
Source: International Monetary Fund (IMF) International Financial Statistics and low-income countries debt sustainability analysis database.

The first half of 2023 saw continued hikes in interest rates by the Federal Reserve in the United States. As inflation remained high, the bank kept raising rates, albeit at a slower pace than in 2022. Rates rose by a quarter percentage point in February, March and May (figure 1.1). The rate hike cycle was officially "paused" in June 2023, although the Federal Reserve continued to reduce its securities holdings. Furthermore, it issued statements that indicated that further hikes may be necessary to bring inflation back to the 2 per cent target. The future is still uncertain as the macroeconomic effects of previous hikes are not yet fully apparent. In contrast, in Europe, the European Central Bank hiked interest rates by 25 basis points in June, but it is expected to end its rate hikes around the middle of 2023 as inflation slows. Rapid decreases in the prices of commodities on international markets helped to ease inflation pressures in the first half of 2023, though it is still uncertain how these changes will translate into inflation expectations over the long run and whether they will help the central banks to bring inflation back to their targets.

The gap between interest rates in high- and middle-income countries not only remained significant in 2022 and 2023 but increased as fears of recession spread around the world (figure 1.2A). Furthermore, the reduction of inflation may be more difficult for the central banks of the less developed countries as they are perceived as less credible and inflation expectations are more difficult to re-anchor. Consequently, central banks may need to continue to increase interest rates, pushing labour market contraction to achieve their targets. As at August 2023, the policy rate equalled 118 per cent in Argentina, 13.25 per cent in Brazil, 13.25 in Colombia, 13 per cent in Hungary and 11.25 per cent in Mexico, dragging up government borrowing costs. Türkiye, which previously conducted an unconventional monetary policy, drastically changed its stance and increased the interest rate from 8.5 per cent to 25 per cent in just three months, between May and August 2023. As at the end of September 2023, government 10-year-bond yields equalled 49.7 per cent in Argentina, 11.8 per cent in Brazil, 24.9 per cent in Egypt, 12.9 per cent in the Russian Federation and 28.1 per cent in Türkiye. Therefore, even with no large increase from 2022, rates remain elevated, threatening the solvency of countries that already had problems before, such as Argentina, Egypt and Türkiye. The share of countries already in debt distress or at high risk of debt distress fell from 56 per cent in 2022 to 52 per cent in 2023, indicating that declining international commodities prices as well as the Debt Service Suspension Initiative brought some relief for oil-importing countries (figure 1.2B). The risks remain high, however, especially amid global uncertainty and further interest rate hikes in developed economies. More countries could face debt distress.

These developments have translated into disparities in labour market developments across the world. Labour markets in high-income countries have shown stronger-than-expected resilience to increases in interest rates, especially in the United States and the European Union, where they barely reacted to monetary policy tightening. Positive labour market data strongly contributed to the hawkish stance of the central banks. The picture in low- and middle-income economies is much worse, however. In high-income economies, unemployment is expected to touch 4.6 per cent in 2023, lower than the 2019 value of 4.8 per cent. In contrast, in Northern Africa, sub-Saharan Africa and the Arab States, unemployment is expected to reach 11.2, 6.3 and 9.3 per cent, notably above the pre-crisis levels of 10.9, 5.7 and 8.7 per cent, respectively. Labour markets in Asia are the main beneficiary of the global recovery, with unemployment expected to reach 7.8 per cent in Central and Western Asia and 5.5 per cent in Southern Asia, well below the pre-crisis values of 9.2 and 6.4 per cent, respectively. Other regions of the world are expected to reach pre-crisis levels of unemployment in 2023.

Figure 1.3 Merchandise trade



Source: ESCWA staff calculations based on the World Trade Monitor by the CPB Netherlands Bureau for Economic Policy Analysis.

Note: CIS refers to Commonwealth of Independent States.

In the first half of 2022, global trade recovered to and exceeded the pre-pandemic level. Sanctions on Russian oil that entered into force towards the end of 2022 then contributed to a fall in the volume of global trade in the first half of 2023. The World Trade Organization indicates that world trade volume is expected to rise by 1.7 per cent in 2023, before increasing by 3.2 per cent in 2024, owing to the rebound in GDP growth, mostly in emerging economies and least developed countries.[2] The value of trade is expected to surge even more due to the expected uptick in the prices of agricultural commodities. As is the case for other macroeconomic trends in 2023 to 2024, the main drivers of the volume of trade will be the course of the war in Ukraine and the extent of monetary policy tightening and its impact on the government budgets of emerging countries. Heavy sanctions and blockades by the Western coalition against the Russian Federation could significantly limit global trade. On the other hand, the possible ceasefire and reconstruction of Ukraine as well as structural changes in Europe to make its industry independent of Russian energy may intensify the inflow of goods and services to Europe and the Ukraine.

Trends in the growth of trade were similar across developing and developed economies in 2022 and 2023. Growth occurred everywhere except the Russian Federation and countries in the Commonwealth of Independent States, although it was marginal in Asia and the Pacific (figure 1.3A). In addition, the war in Ukraine and the decoupling of the United States–China relationship accelerated a trend dubbed "friend-shoring", in other words, integrating countries that share similar values into value chains. No increase in nearshoring was observed. Trade growth is expected to continue in all regions in line with the rebound of economic activity although it will be slightly faster in the services sector than in goods. Industrial production will remain stagnant in all major economies (figure 1.3B). The only exceptions are the Russian Federation and Ukraine, where developments heavily depend on the situation on the ground. The end of conflict and a peace treaty could bring massive resources to Ukraine; commencement of reconstruction activities should generate a trade boom in the region.

The economies of African commodity exporters should benefit from the recovery in China. Similarly, trade in the Arab region should increase in line with the embargo on oil produced by the Russian Federation and the substitution of energy commodities originating from that country with liquid natural gas and oil from Arab suppliers. Nevertheless, it has yet to be seen whether these commodities will be replaced by imports from other destinations or by renewable energy sources. The latter is likely to prevail in the medium to long run.

In 2023, global tourism is likely to fully recover to its pre-pandemic levels. This is especially true for the Middle East, where tourism saw 15 per cent growth in the first quarter of 2023. The Middle East was the first region to recover to pre-pandemic levels of tourist arrivals. Europe reached 90 per cent of the pre-pandemic level, a trend fuelled by strong intraregional demand. Africa and the Americas both managed to achieve 85 per cent, while for Asia and the Pacific, this figure stood at 54 per cent. In 2022, international tourism receipts passed the $1 trillion mark but still fell 36 per cent short of pre-pandemic levels in real terms. The summer season in 2023 in the Northern Hemisphere is likely to release huge pent-up demand, leading to recovery in particular in Europe and Asia and the Pacific.[3] Even though surveys conducted by the International Air Transport Agency indicate strong demand for air travel, the revenue passenger-kilometres in 2023 is expected to reach 88 per cent of 2019 levels, with full recovery envisaged only in 2024.[4]

These outlooks are subject to several downside risks. First, measures targeting inflation in developed economies are likely to succeed in curbing demand, leading to the substitution of distant travel with closer destinations and affecting countries receiving international tourists, in particular in the Arab region and Asia and the Pacific. Second, the potential increase in global oil prices and climate change measures could translate into a surge in airline operating costs, suppressing demand for overseas holidays. In addition, the airline industry is struggling to secure aircraft and spare parts amid global supply chain disruptions. Third, the global uncertainty surrounding the war in Ukraine could emanate to developed countries, prompting tourists to stay in their home countries. Nevertheless, as of mid-2023, the outlook remains positive.

B. Natural resource commodities

1. Oil

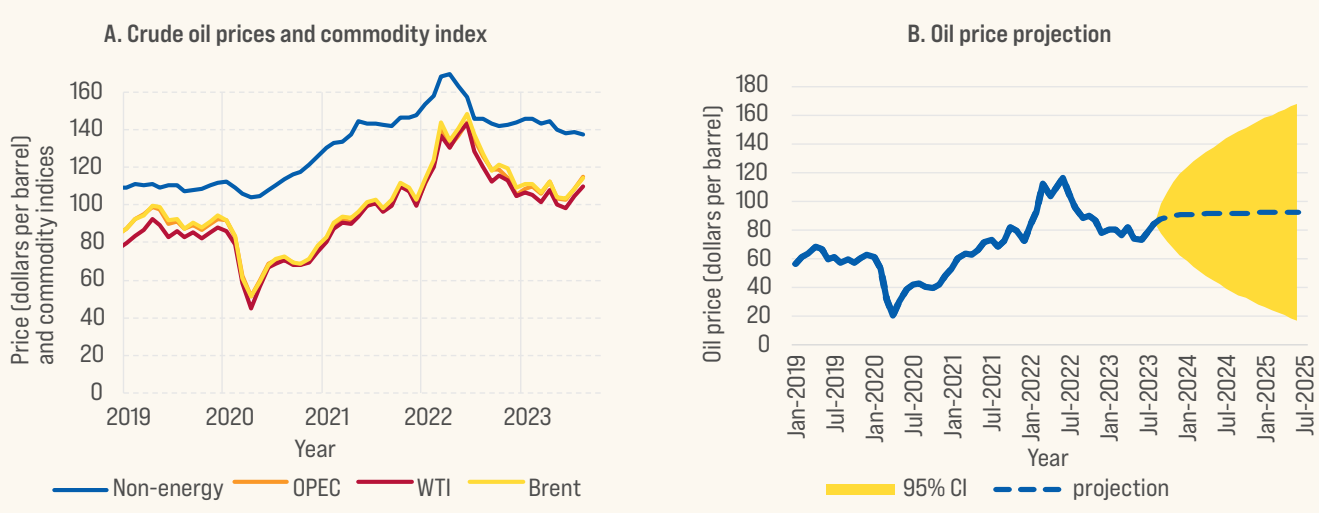
Following a tumultuous 2022, 2023 brought a stabilization in oil prices on the international market, and a slow but steady decline from about $80 per barrel in January to $75 in June. The price has since increased to around $90 per barrel in September owing mostly to production cuts in Saudi Arabia (figure 1.4A). The price is expected to stay at this level in 2024 and 2025 against global monetary tightening that curbs demand, the slower-than-expected recovery of China, an uncertain geopolitical situation and the development of climate policy (figure 1.4B). The market proved to be resilient to sanctions on Russian oil, introduced gradually in 2022. The prices of the basket for the Organization of Petroleum Exporting Countries (OPEC) did not react significantly.

The United States Energy Information Administration projects that global consumption of oil recovered to the December 2019 pre-COVID-19 levels only in June 2023, and slowly but steadily increased afterwards in line with the usual seasonal patterns. Overall, consumption is expected to rise to 102.7 million barrels per day in 2024, from 101 million barrels per day in 2023. Oil consumption is expected to slightly surpass the 2019 level in 2024. This rise will be driven mostly by the expected surge in the consumption of oil in China and other Asian countries as well as emerging economies. Consequently, while climate policies and economic stagnation will likely marginally depress oil consumption in the countries of the Organisation for Economic Co-operation and Development (OECD), they will not affect the consumption of petroleum in other economies, where the continuation of long-standing trends in oil consumption is expected. This is especially visible in China, where the COVID-19 recession did not significantly affect consumption and where, historically, it has climbed faster than in other regions of the world.

On the supply side, similar growth is expected with production, almost perfectly balancing the consumption increase in 2023 and 2024. In contrast to consumption, the main developments on the production side are expected in the OECD countries. While OPEC+ (OPEC, the Russian Federation and countries in the Commonwealth of Independent States) in June decided to extend production cuts through the end of 2023, the United States alone is responsible for almost 70 per cent of the global surge in production during the year. A continuing switch of oil production away from OPEC countries is envisaged, driven by increased crude oil production in the Permian shale region in Texas and New Mexico. In Canada, the development of oil sands production in Alberta is expected, which, together with the Trans Mountain Expansion project, scheduled to begin operations in late 2023, will unleash some production potential and allow oil exports to Asian markets. In Brazil, production is expected to grow by 0.3 million barrels per day due to the completion of several new floating production, storage and offloading projects, and increased production in existing offshore fields. Argentina and Guyana will also contribute to increased oil production from offshore fields and shale formation. In Europe, the completion of the Johan Sverdrup Phase 2 project added significant production capacity for Norway. Sanctions on the Russian Federation have been partially effective; current production by countries in the Commonwealth of Independent States is expected to reach the global market despite price caps and limitations in transport, but will likely remain stagnant in 2023 and 2024.[5]

Production in OPEC countries has been affected by production cuts. In July 2023, the Saudi Arabia output fell to 9 million barrels a day from 10 million in May, the biggest decline in years. In April 2023, OPEC+ countries announced total production cuts of around 3.7 million barrels per day. The greatest cuts announced are in the Russian Federation and Saudi Arabia (0.5 million barrels per day each), followed by Iraq (211,000 barrels per day), United Arab Emirates (144,000 barrels per day), Kuwait (118,000 barrels per day), Kazakhstan (78,000 barrels per day), Algeria (48,000 barrels per day) and Oman (40,000 barrels per day). OPEC countries plan no significant increases in production capacities.

Figure 1.4 Oil prices, 2015-2024



Source: ESCWA staff calculations based on the World Bank commodity prices database and the United States Energy Information Administration database.

Note: The oil price forecast is based on the vector error-correction model, including OPEC production, other suppliers' production, total oil consumption, the world industrial production index, oil price, CPI inflation in dollars and interest rates in the United States. WTI refers to West Texas Intermediate and CI refers to carbon intensity.

This equilibrium is reflected in forecasts of the price of oil, which is expected to remain relatively stable over 2023 and 2024 at $91.7 and $92.9 per barrel, respectively (figure 1.4B). This slight fall is the effect of the delicate balance between the demand and supply sides. As of 2024, pent-up demand for travel is expected to ease due to monetary policy tightening and the slowing of the global economy. Furthermore, transport demand could decrease as an increase in nearshoring and friend-shoring may overlap with the global macroeconomic situation. On the supply side, the significant technological developments and investment resulting from Western countries gaining independence from Russian oil, especially in Norway and the United States, are countering production cuts announced by OPEC+. In general, the situation on the oil and gas market following the war in Ukraine indicates that OECD countries, which consume 46 per cent of global oil, are increasingly oil self-sufficient. In 2010, they produced 47 per cent of the oil they consumed; in 2015, it was 58 per cent, and in 2022, it was 70 per cent. This trend will act as a stabilizer of the global oil market.

2. Natural gas and phosphates

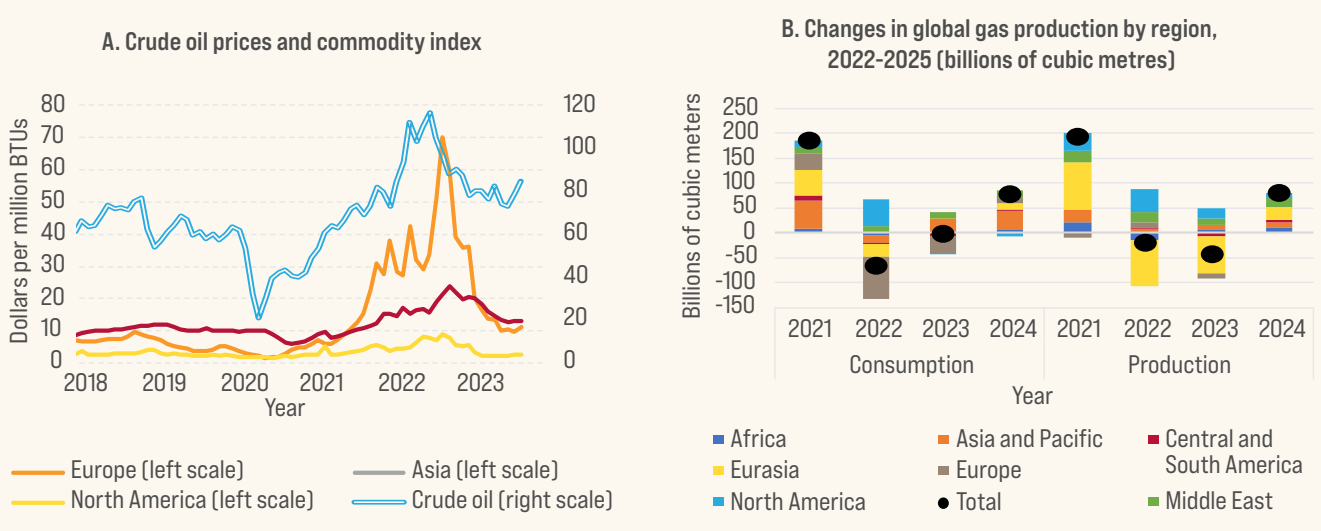
The trajectory of natural gas prices in the wake of the war in Ukraine proved the resilience of the European economy to energy shocks. After the initial surge in gas prices by 160 per cent between February and August 2022, many analysts and pundits predicted the fall of European industry, especially in Germany, where cheap gas from the Russian Federation was considered a cornerstone of industrial competitiveness. Nothing like this happened. Industrial production fell marginally, and companies quickly adapted to the new reality. In January 2023, natural gas prices in Europe were already at the pre-war level, and in May, they fell to $10 per million metric British thermal units (BTUs), the level last seen in June 2021 (figure 1.5A).

After the fall in consumption in 2022, induced by unprecedented consumption cuts in Europe, Eurasia and the Pacific, the demand for gas is expected to remain flat in 2023 (figure 1.5B). North America saw increased natural gas consumption during the 2022–2023 heating season, induced by an unusually harsh winter and the high prices of coal, which caused a switch to natural gas in electricity generation. Overall, gas demand in the United States in 2023 is expected to fall by 2.9 per cent, resulting from the expansion of renewable energy sources and the overall macroeconomic situation depressing the gas industry.

Timely policy action in Europe, inducing gas-saving measures in public buildings, fuel switches in rural households, the installation of heat pumps, efficiency gains and behavioural changes, accompanied an unusually mild winter, allowing for an unprecedented 16 per cent fall in demand in the

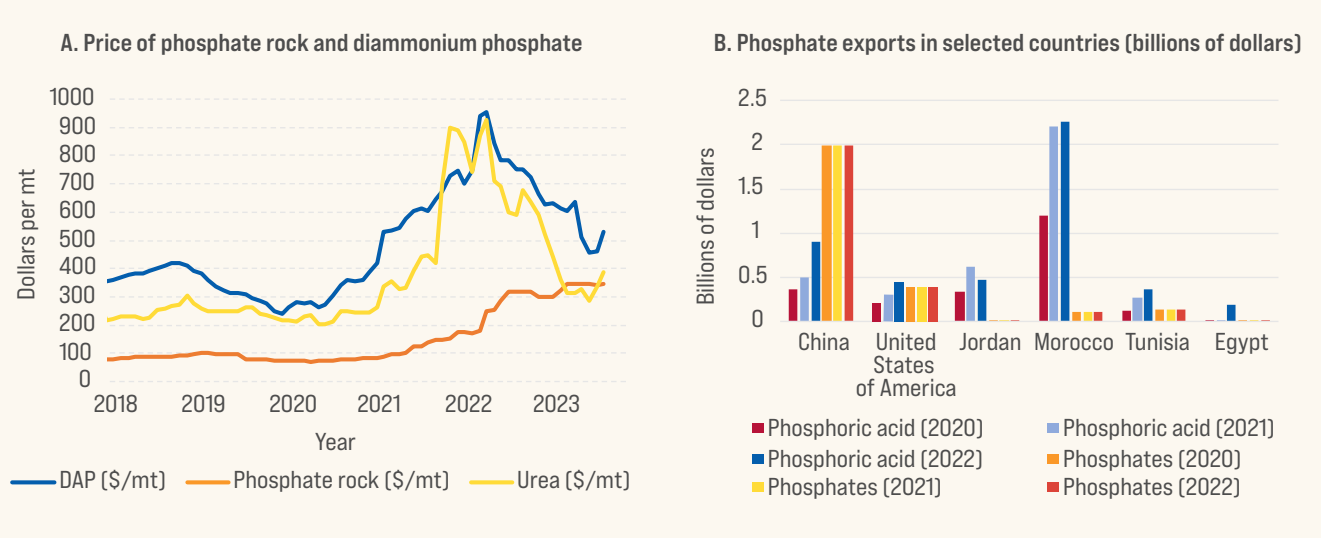
residential sector in the 2022–2023 winter season. Gas burned for electricity generation fell by 12 per cent due to lower electricity consumption and a switch to renewables. Industrial demand dropped by almost 20 per cent as prices induced fuel switching and reduced the operational rates of gas-intensive industries. On the supply side, liquid natural gas became the baseload supply for Europe, largely replacing gas pumped from the Russian Federation via pipelines. Supplies increased by over 25 per cent, reaching 94 billion cubic metres, fuelled by additional flows from Qatar and the United States. In addition, the pipeline supply from Azerbaijan increased by 15 per cent. Nevertheless, after an initial surge, demand for liquid natural gas in Europe is expected to remain flat for 2023. The switch towards renewable energy sources will further depress natural gas consumption, albeit at a slower pace than in 2022.

Figure 1.5 Natural gas prices



Source: ESCWA staff calculations based on the World Bank Commodity prices database and the International Trade Centre Trade Map.

Figure 1.6 Phosphate exports and prices



Sources: ESCWA staff calculations based on the International Trade Centre Trade Map and the World Bank commodity prices database.

Note: DAP refers to diammonium phosphate; mt refers to metric ton.

Gas consumption in Asia and the Pacific is satisfied mostly by liquid natural gas. Demand there has reacted to the surge in prices, prompting a 2 per cent fall in consumption in 2022 for power generation in China and India, which was further helped by a mild winter. In 2023, 3 per cent growth is expected, mostly due to the lifting of China's zero-COVID-19 policy and an assumption of the normalization of the weather. Similarly, gas consumption in Central and South America saw a small decline due to a fall in demand for electricity generation in Brazil following record droughts. Consumption is expected to stabilize in 2023. A 2 per cent surge in demand for gas in the Middle East is expected in 2023, driven by increased consumption in Saudi Arabia.

On the supply side, global gas production fell by 0.3 per cent in 2022 and is expected to further decrease by 1 per cent in 2023, with additional production in North America and the Middle East not able to fully counteract the fall in the supply from the Russian Federation. The surge in natural gas production in the United States, which accounted for 42 per cent of the overall increase in gas production in 2022 (or 38 billion cubic metres), is driven mostly by greater production from oil-driven shale plays, mainly in the Permian Basin. In 2023, an additional supply of 47 billion cubic metres is expected in line with conservative upstream spending, an escalation in costs and a decline in domestic demand. The other supplier of gas to Europe is the Middle East, with Egypt and Qatar supplementing exports of liquid natural gas from the United States. These producers are expected to ramp up production, with Egypt's two liquid natural gas facilities, Damietta and Idku, operating at full capacity and Qatar's North Field continuously expanding production.

The strains on the global fertilizer market eased off in the second half of 2022 and 2023 due to supply chain support by Governments and non-governmental organizations aimed at making sure that the war in Ukraine did not disrupt trade in fertilizers. The supply from the Russian Federation was barely disrupted by sanctions amid the rerouting of trade to such countries as Brazil and India. As a result, and given decreases in natural gas prices, the price of urea and diammonium phosphate by June 2023 had receded to levels last seen at the beginning of 2021, despite continuously high prices for phosphate rock (figure 1.6A).

Morocco is the world's largest phosphate producer, possessing around 70 per cent of global reserves (50 out of 71 billion tonnes), even though this position is likely to change soon given the recent discovery of huge phosphate reserves in Norway. The Moroccan giant OCP is ramping up production through a massive $13 billion Green Investment Programme launched in December 2022 and planned for 2023 to 2027. It aims to increase production capacity from the current 12 million tons of fertilizer to 20 million, and achieve full carbon neutrality by 2040. In Meskala, new mining of phosphate rock is planned in addition to the new fertilizer production complex in Mzinda. To reduce dependence on imported natural gas and ammonia, the programme is slated to ramp up production of green hydrogen through electrolysis and the use of renewable energy and green ammonia. It intends to develop desalination plants and boost photovoltaic capacity to produce renewable energy. In addition, research is being conducted on supplying elements for lithium iron phosphate batteries in line with global trends. The Saudi company Ma'aden awarded a contract to construct new fertilizer production plants in Wa'ad Al Shamal and Ras Al-Khair that are expected to produce up to 1.5 million metric tons of phosphate fertilizers. Overall, the export of phosphate fertilizers from the region is expected to further increase (figure 1.6B).

On the demand side, the consumption of fertilizers is predicted to surge by 4 per cent in 2023, while the demand for phosphorus is expected to increase by 5 per cent.[6] The main contributors to this growth are South Asia, where Pakistan is expected to recover consumption after the 2022 flood, and Latin America, with expanded consumption in light of El Niño. In Eastern Europe, demand is predicted to remain flat, with the recovery of fertilizer use in Ukraine offset by the decrease in the Russian Federation after winter losses and heavy rains during the planting season. Recovery in Africa is expected to be relatively moderate. The transition from La Niña to El Niño could cause droughts in northern Latin America, southern Africa, South-East Asia and Australia, leading to suppressed demand (box 1.1). Over the medium term, the growth of fertilizer use will slow in line with efficiency gains and government regulations. The development of lithium iron phosphate batteries and production of electric vehicles (Tesla is already using these batteries in its vehicles, and Hyundai and Toyota are expected to follow) will be additional sources of demand for phosphates over the medium run.

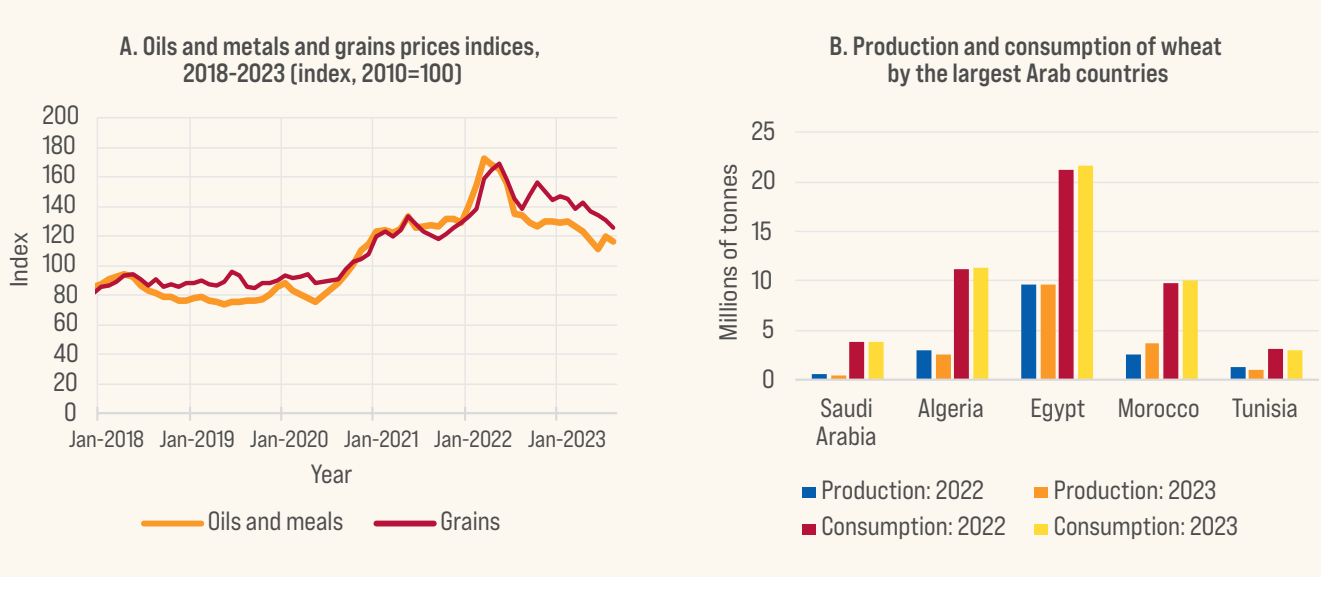
3. Food commodities

Despite the slowdown in the prices of food commodities and the successful aversion of a food crisis after the outbreak of the war in Ukraine, including through the Black Sea Grain Export Initiative, global prices of food commodities remain elevated (figure 1.7A). As the Arab region is one of the world's largest food importers, with many Governments subsidizing food products, global prices remain a concern (figure 1.7B).

In 2022, global wheat production passed the 800 million tonnes mark for the first time in history, leading to record high stocks. In 2023, production is expected to tighten although the world will remain adequately supplied with 777 million tonnes, the third largest output on record, as predicted by the Food and Agriculture Organization (FAO).[7] Most of the decline is expected in Australia and the Russian Federation, reflecting wet weather conditions during the 2022–2023 winter and the shortfalls in precipitation associated with the El Niño event. Smaller falls are predicted in other leading producers such as Kazakhstan and Ukraine due to the war affecting wheat plantings. The output of leading producers such as Canada, China, the European Union, India, Pakistan and the United States is expected to remain stable or even moderately increase. The harvest is expected to decrease in Northern Africa (including Algeria, Morocco and Tunisia) due to the persistent soil moisture deficit. These developments plus record global wheat stocks are likely to exert downward pressure on prices, leading to some easing of the pressure on government and household budgets in Arab food importers.

Like wheat, the prices of edible oils decreased from record highs in March 2023, reaching levels not observed since late 2020, following the decline of international prices for soybean, rapeseed and sunflower seeds. Global soybean production is expected to rebound in 2022 and 2023, following a contraction in the previous year driven by the recovery of harvests of soybean in Brazil, China, India and Paraguay. Rapeseed production is expected to reach a record-high harvest of 89 million tonnes, prompted by the recovery in output in Canada and the continuous expansion of production in Australia. Outputs of other key producers, including China, the European Union and India, are also expected to increase. In contrast, the global production of sunflower seed is expected to drop by 8 per cent in 2022 and 2023 amid lower production in Ukraine due to the war and a decline in the European Union due to unfavourable weather conditions. The only major producer to increase its crops is the Russian Federation. These developments, in line with expected further increases in 2023 and 2024, will exert further downward pressure on the prices of oils in the short and medium term.

Figure 1.7 Food imports and prices



Sources: World Bank commodity prices database; FAO, 2023.

C. Trade, financial interlinkages and financing conditions

In line with the stabilization of the situation in the war in Ukraine, resilience to the energy shock prompted by the Russian halt of gas exports to Europe and the relatively minor reactions of labour markets to increased interest rates, markets in advanced economies witnessed a relatively bullish environment in the first half of 2023. The S&P500 and DAX both gained 16 per cent; the French CAC40 index rose by 14.3 per cent. This came, however, after a weak 2022, when these indices lost 20, 14 and 10 per cent, respectively. Nevertheless, the French index reached its record in April 2023 and the DAX came close, showing the resilience of European economies. As the tightening cycle is almost over in Europe, and inflation has slightly receded without requiring a deep recession as in the 1980s, the prospects are moderately optimistic. The European economy proved resilient to the risk stemming from the sudden stop in the supply of Russian commodities, and the actions of the Federal Reserve and the European Central Bank managed to reduce inflation. Nevertheless, risks remain. Consumption receded over 2022 and 2023, and massive protests shook France in June 2023. Inflation is still elevated, and unexpected consequences of the war in Ukraine may still occur.

Of the Gulf Cooperation Council (GCC) stock exchanges, only the Dubai DFM Index noted growth comparable in magnitude to that observed in France and Germany, with a 13.7 per cent increase in the first half of 2023. The Bahrain index rose by 3.7 per cent over the same period, Oman by 2.1 per cent and the Saudi Tadawul by 9 per cent. Other stock exchange indices fell by around 6 per cent – Abu Dhabi by 6.4 per cent, Kuwait by 6.3 and Qatar by 5.8. These numbers are in stark contrast to 2022, when stock exchanges in GCC countries performed relatively well – Abu Dhabi rose by 20.6 per cent and Oman by 17.9 per cent. Bahrain, Dubai and Kuwait noted moderate growth of 5.3 per cent, 2.5 per cent and 8.3 per cent, respectively, while Qatar and the Saudi Tadawul fell by 6.8 per cent each. In contrast to the European economies, the short to medium term outlook for the GCC countries is moderately negative – the increased production of oil and gas by Canada and the United States, continued efficiency gains in line with climate policies and the rapid technological development of carbon neutral transport options do not leave much time for the GCC countries to diversify their economies. Over the long run, high oil prices seem unlikely. Oil exporters will not be able to sustain their lifestyles without jumpstarting other development engines.

The situation of Arab middle-income economies is much more positive. In the first half of 2023, the Egypt EGX30 Index rose by 18.1 per cent, the Moroccan MASI by 8 per cent and Tunisia's TUNIDEX by 10.6 per cent. In Egypt and Tunisia, growth came after a relatively robust 2022, clocking in at 25.6 and 16 per cent, respectively. In Morocco, there was a fall of 19.4 per cent amid catastrophic droughts. The Jordan ASI Index retreated moderately by 3.7 per cent in the first half of 2023 after an 18.9 per cent increase in 2022. These developments indicate that middle-income economies may be less resilient to global shocks than advanced economies. Dark clouds still hang above them. Egypt is on the verge of a solvency crisis; currency devaluation will significantly affect the affordability of imported goods and the welfare of households. The country is now undergoing a balance-of-payment crisis with significant inflation (37.4 per cent in August 2023) and a foreign exchange shortage. To alleviate these problems, the Government announced a huge privatization programme to sell stakes in 32 publicly owned companies by March 2024.

Similarly, Tunisia is facing a debt crisis amid increased borrowing costs. As of mid-2023, it is negotiating a reform programme and bailout package with the International Monetary Fund (IMF). Morocco is in substantively better shape, although a major drought and the catastrophic earthquake in Marrakech in September 2023 will continue to weigh on growth prospects into 2024. The outlook for Jordan is moderately positive amid prudent fiscal policy and an expected growth in remittances from the GCC countries. All middle-income countries will benefit from the pause in monetary policy tightening and possible cuts in interest rates in the advanced economies in 2024, and the inflow of tourists resulting from significant pent-up demand accrued over the COVID-19 pandemic.

The banking system in Lebanon remains frozen in a political vacuum, with a caretaker prime minister and no president as of late 2022. There is no solution in sight to cover $72 billion in losses in the banking sector, more than three times the size of GDP, given the divergent views of key stakeholders. They have proven reluctant to follow global best practices to restructure the sector and address losses upfront instead of calling on the State to bear responsibility. In Egypt, the vulnerability of the

financial system is rising due to the sovereign debt crisis, falling availability of hard currency and expected negative impact of the likely depreciation of the pound on bank capitalization. Furthermore, in case of a crisis, the Egyptian Government has limited room to act. As of mid-2023, Egyptian banks remained solvent despite the negative outlook.

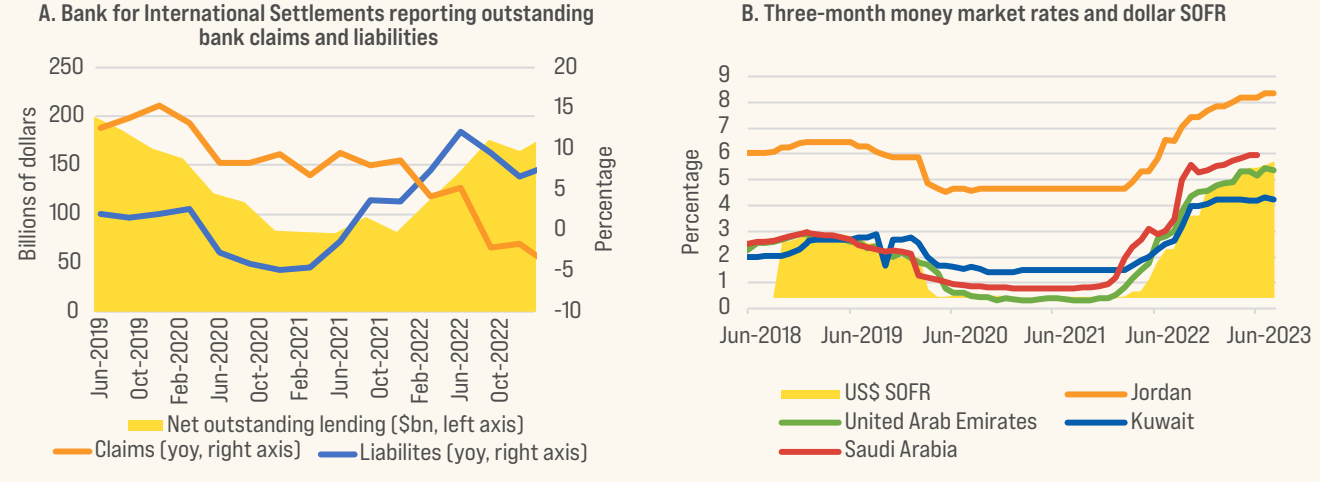
Tunisian banks are also exposed to government debt. Liquidity is tight and non-performing loans are at elevated levels. In addition, banks are subject to a default risk from State-owned enterprises. The Moroccan financial system remains resilient in a turbulent environment – in 2022, capital adequacy remained above the regulatory minimum despite the fall in profitability. The Central Bank of Jordan keeps managing to safeguard the stability of the Jordanian banking system with a firm reaction to global monetary policy tightening. As a result, the banking system remains healthy, with capital adequacy well above the regulatory minimum and decreases in non-performing loans.

Banks in GCC countries keep healthy balance sheets in line with the inflow of assets spurred by high oil prices in 2022; this boosted both private consumption and government spending. The ratings of these banks have remained stable and even improved in Saudi Arabia in the first half of 2023.

The net outstanding international position of Arab countries increased substantially in the first three quarters of 2022 in line with the surge in the prices of hydrocarbons (figure 1.8A). Rapid increases in liabilities and the moderate surge in claims in the first half and fall in the second half of 2022 led to a net regional position of $182 billion in the first quarter of 2023, the highest value since 2019. Saudi Arabia remained the biggest lender with a more than $121 billion net position, followed by Kuwait and Libya. Qatar was the largest borrower, although its net outstanding claims decreased over 2022 from $92 billion to $82 billon. Egypt was the second largest borrower, followed by Morocco, Oman and Bahrain, despite Egypt's reduction of net outstanding claims from $18 billion to $4 billion. Recent decreases in hydrocarbon prices in line with the pause in monetary policy tightening should lead to further declines in the Arab net outstanding international position over 2023 and 2024.

The first half of 2023 brought further tightening of financing conditions in the Arab economies in line with the trend in the United States, but the pace of hikes was smaller than in 2022 (figure 1.8B). Jordan managed to decrease its spread to the United States benchmark from 4.5 percentage points in mid-2022 to 3.1 percentage points in mid-2023, apparently reaching a plateau and leaving little probability of further increases in JODIBOR, with possible decreases in 2024. As historically observed, the money market rates in GCC countries co-moved with the United States benchmark, indicating that these economies are perceived as almost as safe as the United States. Recent improvement in the rating of Saudi banks confirms this view. As long as oil rents continue and their currencies are pegged, GCC countries should expect financing conditions similar to those of the United States.

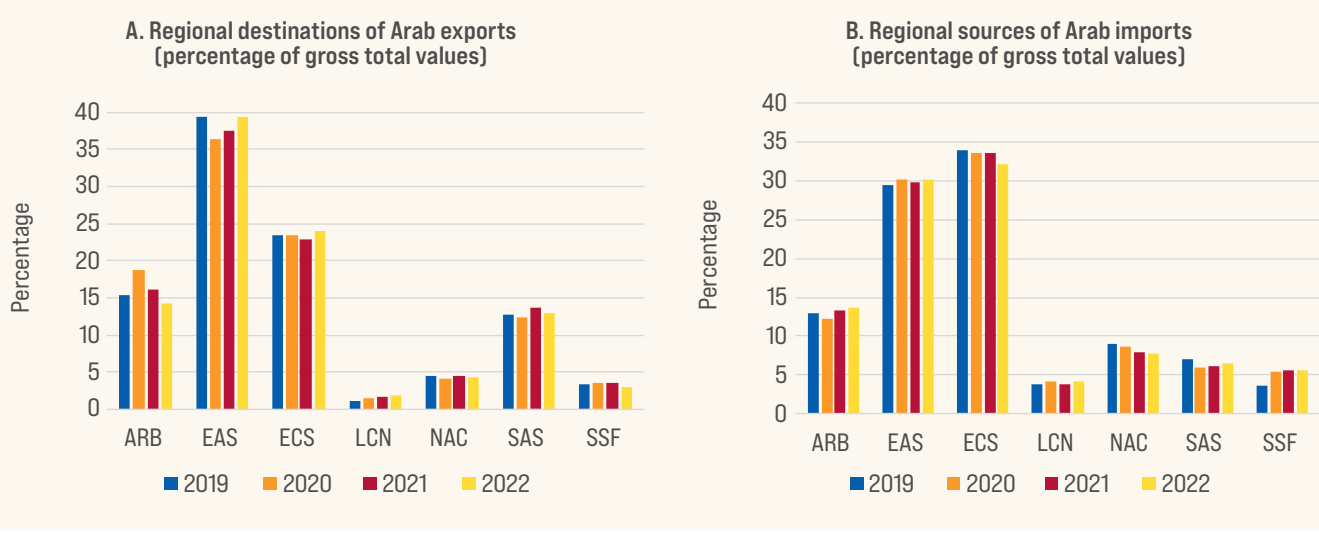
Figure 1.8 Global financial linkages in the Arab region



Sources: ESCWA staff calculations based on national statistical sources; the Arab Monetary Fund markets performance, stock market capitalization and financial markets database; and the Bank for International Settlements locational banking statistics database.

Note: SOFR indicates the secured overnight financing rate.

Figure 1.9 Global trade linkages in the Arab region



Source: IMF Direction of Trade Statistics.

Notes: ARB refers to Arab countries; EAS refers to East Asia and the Pacific; ECS refers to Europe and Central Asia; NAC refers to North America; LCN refers to Latin America and the Caribbean; SAS refers to South Asia; and SSF refers to sub-Saharan Africa.

Regional shifts in destinations for Arab exports in 2022 reflected the prices of hydrocarbons and their share in exports. Overall, exports rose by almost 28 per cent to $1.13 trillion, the highest value since 2012. The biggest regional recipient of additional exports was East Asia and the Pacific, with a $139 billion increase in 2022 compared to 2021. It was followed by Europe and South Asia with $86 billion and $35 billion increases, respectively. The structure of the destinations for Arab exports broadly returned to pre-pandemic levels, with the Arab regional share falling below 15 per cent, Asia and Pacific returning to almost 40 per cent, Europe and Central Asia passing the 24 per cent mark, and South Asia falling to 13 per cent. Trade within the Arab region increased by 17 per cent, far less than with other regions (excluding sub-Saharan Africa), indicating that the friend-shoring trend, in other words, including countries that share similar values in value chains, does not apply to Arab countries.

Sources of imports continued trends of the last decade. In particular, the share of Europe and Central Asia fell to 32 per cent, only 2 percentage points above the 30 per cent share of East Asia and Pacific. If this direction continues, 2024 may be the first year in history when the Arab region's imports from East Asia and Pacific will surpass those from Europe and Central Asia. Intraregional trade oscillates at around 13 per cent of the total, while other regions play minor roles as sources of imports, with an 8 per cent share for North America, 6 per cent for both South Asia and sub-Saharan Africa, and 4 per cent for Latin America and the Caribbean. Arab imports from Latin America rose by 22 per cent in 2022, a rate of increase far exceeding that seen for imports from other regions.

Contrary to some forecasts, the trade balances of Arab countries did not improve in 2023 as the price of oil receded to pre-war levels and supplies of liquid natural gas to Europe were provided mostly by the United States and to a lesser extent by Qatar. The Black Sea Grain Export Initiative proved to be effective, the food crisis was averted, and prices returned to pre-war levels (that were, however, elevated). The outlook for 2023 and 2024 is stable amid the increase in oil production in Canada and the United States, and sluggish growth in demand in China and the advanced economies. The prices of food staples should also remain stable as storages all over the world are full and production in 2023 and 2024 is expected to be maintained at sufficient levels. While Egypt, Lebanon and Tunisia are facing balance-of-payments crises that will continue to exert pressure on their trade balances, the GCC countries still benefit from their hydrocarbon reserves. Trends in 2022 and 2023 show that the world is becoming increasingly independent from their exports, however. Efforts to diversify their economies and improve competitiveness should be continued and strengthened in the medium and long run.

D. Concluding remarks

While high-income economies and the developed world have almost recovered from the COVID-19 crisis and proved resilient to the energy shock caused by the sudden stop of hydrocarbon imports from the Russian Federation, the developing economies, including Arab countries, are struggling to deal with long-term consequences such as a surge in labour market informality and a growing gender gap. Recovery from these problems is hindered by high interest rates required to return inflation to targets, which for developing economies has increased the cost of capital for companies and Governments. Consequently, while overall prospects for the world are stable to moderately optimistic, middle-income economies and least developed countries will continue to struggle with high borrowing costs and uncertainty around natural resources and global food prices.

Amid the repercussions of the war in Ukraine and the COVID-19 pandemic, international cooperation is especially important. There is room for intervention for international financial institutions and other international organizations, and donors and other supporters of international development. In his sixth policy brief,[8] the United Nations Secretary-General called for the reform of international financial infrastructure in line with this need.

A lesson for the Arab oil exporters is that advanced economies are increasingly independent from energy commodities. It is unlikely that prices of hydrocarbons will increase in the medium to long run, underlining that Arab oil exporters need to significantly accelerate new development models.

Regional socioeconomic trends

2

Key messages

The war on Gaza is expected to weigh on Arab economies. The three-month war scenario expects that these economies will grow at a slower pace compared with the pre-war scenario from 2023 to 2025, at an annual average of 3.6 per cent compared with 3.8 per cent, respectively.

While the cut in oil production and decreased demand are expected to slow economies in GCC countries, expansion in non-hydrocarbon sectors, particularly tourism, services and infrastructure projects, will accelerate GDP growth, which is expected to reach 4.1 per cent on average from 2023 to 2025.

Increased phosphate and gas production in Arab middle-income countries is expected to drive economic growth. However, GDP growth will be affected by the war on Gaza and the spillover effects on neighbouring countries. The three-month war scenario expects that GDP will grow by 3.3 per cent on average from 2023 to 2025 compared with 3.8 per cent in the pre-war scenario.

The situation in conflict-affected countries remains uncertain and is overshadowed by the war on Gaza, political divides and security concerns. The three-month war scenario expects that GDP will increase by 4.2 per cent on average from 2023 to 2025 compared with 4.6 per cent in the pre-war scenario.

The emerging conflict in the Sudan negatively affects the outlook for the Arab least developed countries. GDP for these countries is expected to contract by 4 per cent on average from 2023 to 2025.

A. Overview of Arab subregions

With the persistence of the war in Ukraine for the second consecutive year, economic uncertainty continues to prevail globally and in the Arab region. Uncertainty increased further in the Arab region with the eruption of the war on Gaza in October 2023, and with mounting fear that this war could expand in duration and geographical scope. Moreover, in July 2023, the Russian Federation stopped the Black Sea Grain Initiative, which allowed the export of Ukrainian grains to resume in July 2022. Future increases in global food prices are expected, putting further pressures on global prices and slowing global economic recovery following the COVID-19 pandemic. The expected increase in prices might prolong quantitative tightening policies by developed countries that began in 2022, decreasing the money supply and raising interest rates. This tightening policy will restrict liquidity in financial markets and will lead to a slowdown in economic growth as the global economy will not be operating at full capacity. Higher interest rates will increase borrowing costs and make it more challenging for developing countries, including Arab countries, to access financial markets, threatening debt sustainability even as these countries have not yet fully recovered from the repercussions of the pandemic and are struggling to make progress in achieving sustainable development goals. Additionally, higher interest rates are crowding out private investments, further slowing economic recovery in the Arab region. Interest rates have increased significantly from a low of 0.15 per cent in the United Arab Emirates at the beginning of 2022 to 4.5 per cent in a 12-month period, reaching up to 16.25 per cent in Egypt and 8 per cent in Tunisia (table 2.1).

With the stabilization of oil and gas prices at moderate levels in 2023, regional GDP was expected to grow at a moderate pace of around 3.6 per cent in 2024, accelerating to around 4.2 per cent in 2025 based on the pre-war scenario. Growth will likely stem from moderate economic expansion in oil-producing countries; phosphate and gas production; non-oil sectors, particularly the entertainment business, tourism and services; and infrastructure projects, despite the persistence of the economic crisis in some middle-income countries and political instability in other countries. However, as the war on Gaza has entered its third month, the impact of the war on the State of Palestine and neighbouring countries has become more significant. The three-month war scenario expects that GDP in the Arab region will grow by 3.3 per cent in 2024 and 4.2 per cent in 2025.

Table 2.1 Interest rates by country

	Beginning of 2022 (percentage)	Beginning of 2023 (percentage)
Bahrain	1	5.25
Egypt	8.25	16.25
Jordan	2.5	6.5
Kuwait	1.5	3.5
Mauritania	5	7
Morocco	1.5	2.5
Oman	0.15	4.5
Qatar	2.75	5.5
Saudi Arabia	1	5
Tunisia	6.25	8
United Arab Emirates	0.15	4.5

Source: Arab Monetary Fund, 2023.

Inflation reached 12.3 per cent in 2023 mainly as a result of the halting of the Black Sea Grain Initiative and the significantly negative impact on the prices of essential food items imported by Arab countries. Inflation is expected to decrease to 7.5 and 6 per cent in 2024 and 2025, respectively (table 2.2). Many countries are facing challenging political and economic circumstances that affect inflation rates, including socioeconomic crises and the depreciation of local currencies, in addition to tight financial conditions. To ease the burden of rising prices, several countries have either expanded their subsidies or implemented targeted assistance for vulnerable households.

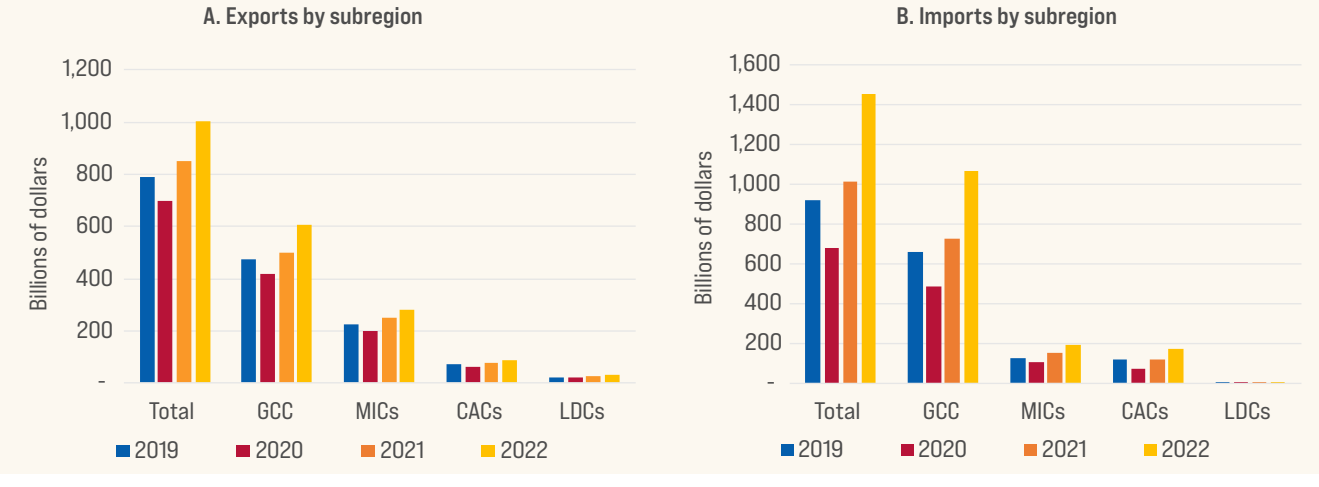
Table 2.2 GDP and inflation by subregion, 2023–2025

Real GDP growth rate (percentage per year)						
	Pre-war scenario			Three-month war scenario[a]		
	2023	2024	2025	2023	2024	2025
All Arab countries	3.4	3.6	4.2	3.2	3.3	4.2
GCC countries	4.3	3.8	4.2	4.3	3.8	4.2
Middle-income countries	3.2	3.7	4.4	2.5	3.1	4.3
Conflict-affected countries	5.2	3.7	4.7	4.5	3.3	4.7
Least developed countries	-12.5	-1.5	2.5	-12.5	-1.5	2.5
Consumer inflation rate (percentage per year)						
	Pre-war scenario			Three-month war scenario[a]		
	2023	2024	2025	2023	2024	2025
All Arab countries	12.3	7.5	6.0	12.3	7.4	5.9
GCC countries	3.0	2.6	3.2	3.0	2.6	3.2
Middle-income countries	26.7	15.4	10.7	26.5	15.2	10.6
Conflict-affected countries	9.7	6.0	4.8	9.6	5.8	4.7
Least developed countries	47.9	22.8	13.7	47.9	22.8	13.7

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

[a] ESCWA projections based on the World Economic Forecasting Model for 2023 and on the ESCWA-UNDP Expected Socio-Economic Impacts of the Gaza Crisis on Neighbouring Countries in the Arab States Region (forthcoming).

Figure 2.1 Exports and imports by subregion



Source: ESCWA staff calculations based on the IMF Direction of Trade Statistics.

Notes: MICs refers to middle-income countries, CACs to conflict-affected countries and LDCs to least developed countries.

The complete relaxation of COVID-19 restrictions in 2022 and the spike in global commodity prices, including for energy and food, led to a significant increase in Arab exports and imports. The former increased by 18 per cent and the latter by 43 per cent in 2022 (figures 2.1A and 2.1B). This trend is expected to continue during the 2023–2025 period, where exports are predicted to grow by an annual average of 5.6 per cent and imports by 4.1 per cent (table 2.3). The war on Gaza is likely to affect trade flows, particularly through an increase in trade costs resulting from higher insurance premiums. However, it is too early to estimate this impact, which depends on the length and scope of the war.

The fiscal position of Arab countries remains very challenging. While energy-producing countries benefited from higher energy prices in 2022, the situation changed in 2023 with the decrease in global energy prices. The fiscal deficit is expected to reach 4.1 per cent of GDP on average during the 2023–2025 period. The drop in energy prices in 2023 and elevated inflation rates will limit fiscal space and widen fiscal deficits across all Arab subregions. Countries that have either expanded coverage of subsidies or adopted targeted measures to mitigate the impacts of elevated inflation rates on vulnerable households could see further pressures on budgets and widening fiscal deficits.

The regional debt-to-GDP ratio is expected to decline from 46.8 per cent in 2023 to 45.8 per cent in 2025, driven by a decrease in debt levels in some middle-income and least developed countries with significant depreciations of local currencies (table 2.4). The war on Gaza will likely increase country risk, particularly for middle-income countries that neighbour the State of Palestine, and will likely increase the cost of borrowing.

Table 2.3 Real export and import growth rates by subregion

	Exports (percentage)			Imports (percentage)		
	2023	2024	2025	2023	2024	2025
All Arab countries	5.5	6.2	5.2	4.1	4.1	4.2
GCC countries	5.4	6.2	5.1	4.5	3.7	3.6
Middle-income countries	7.4	7.4	7.1	3.5	4.7	5.0
Conflict-affected countries	4.7	4.2	3.4	6.0	4.9	5.7
Least developed countries	-7.8	6.1	5.5	-4.1	5.3	4.1

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

Table 2.4 Fiscal deficit and debt as a percentage of GDP by subregion

	Fiscal balance (percentage)			Government debt (percentage)		
	2023	2024	2025	2023	2024	2025
All Arab countries	-4.0	-4.2	-4.0	46.8	46.1	45.8
GCC countries	-2.0	-2.1	-2.0	30.9	31.9	32.2
Middle-income countries	-7.6	-7.3	-6.6	71.1	67.4	64.9
Conflict-affected countries	-3.8	-6.2	-8.0	52.1	55.0	58.7
Least developed countries	-3.2	-2.6	-2.3	78.0	70.3	70.4

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

B. Gulf Cooperation Council countries

The GCC countries, like most developing countries, will be affected by global economic developments. The global recession has decreased demand for energy products and led to a drop in Brent crude oil prices from a high of $120 per barrel in June 2022 to around $71 per barrel in March 2023. The situation in the oil market improved slightly following the OPEC+ decision to cut production by 1.6 million barrels per day in April 2023 and the June decision to extend production cuts until the end of 2023. Since then, Brent crude oil prices have fluctuated significantly, reaching $85 per barrel in August 2023. Uncertainties in hydrocarbon markets are counterbalanced by the significant growth in non-energy sectors in the GCC countries. In 2023, GDP grew by 4.3 per cent, driven by growth in non-oil sectors of around 4.6 per cent[9] – particularly the entertainment business, a recovering tourism sector, an expanding services sector and numerous infrastructure projects. The war on Gaza is expected to have very limited impact on GCC countries given their distance from the conflict. This subregion is expected to grow at moderate levels in 2024 and 2025 of around 3.8 and 4.2 per cent, respectively. Inflation will likely remain relatively low at around 3 per cent during the 2023–2025 period as a result of persistent fuel subsidies (table 2.5).

The Saudi Arabia GDP is expected to grow by 5.1 per cent in 2023, 4.1 per cent in 2024 and 5.9 per cent in 2025. This positive outlook is driven by significant growth in non-oil sectors of around 4.6 per cent in 2023,[10] particularly increased investments though the Public Investment Fund. The fund's latest strategy indicated an intention to invest around $40 billion annually until 2025.[11] Growth has also come from private consumption, a significant expansion of the entertainment sector and positive tourism returns as the country has resumed religious tourism and promoted internal tourism. In addition, Saudi Arabia is expected to hold several major international and regional conferences, including hosting the Middle East and North Africa Climate Week in October 2023. An estimated 28 million tourists will likely visit the country in 2023, a figure 69 per cent higher than the previous year. Inflation rates are expected to remain low, ranging between 2.7 per cent in 2024 and 3.5 per cent in 2025.

Qatar will benefit from increased demand for gas following the war in Ukraine. It is continuing to expand its North Field to boost production and diversify its customer base. GDP is expected to rise by 5 per cent in 2023 and 3.7 and 3.5 per cent in 2024 and 2025, respectively. Inflation is predicted to remain at moderate levels, at around 2.9 per cent during the 2023–2025 period.

Oman will continue to expand its gas production and access new markets, taking advantage of increased demand as the war in Ukraine persists. The non-oil sector grew by 3.1 per cent in 2023, driven by increases in infrastructure projects and the recovery of tourism.[12] GDP is expected to grow by 3 per cent in 2023 and 2.6 and 4.7 per cent in 2024 and 2025, respectively. Inflation is expected to remain at moderate levels, ranging between 1.5 and 2.5 per cent between 2023 and 2025.

Table 2.5 GDP and inflation in GCC countries, 2023–2025

Real GDP growth rate (percentage per year)			
	2023	2024	2025
Bahrain	2.7	2.5	2.8
Kuwait	2.7	2.0	2.8
Oman	3.0	2.6	4.7
Qatar	5.0	3.7	3.5
Saudi Arabia	5.1	4.1	5.9
United Arab Emirates	3.5	4.0	5.9
GCC countries	4.3	3.8	4.2

Consumer inflation rate (percentage per year)			
	2023	2024	2025
Bahrain	1.8	2.0	2.5
Kuwait	3.0	2.3	2.6
Oman	1.5	1.8	2.5
Qatar	2.9	2.8	2.9
Saudi Arabia	2.8	2.7	3.5
United Arab Emirates	3.8	2.7	3.1
GCC countries	3.0	2.6	3.2

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

Bahrain will witness moderate growth, with the non-oil sector expected to expand by 3.5 per cent in 2023,[13] notably through tourism, services and infrastructure projects. GDP is projected to rise by 2.7 per cent in 2023, and 2.5 and 2.8 per cent in 2024 and 2025, respectively. Inflation rates are predicted to range between 1.8 and 2.5 per cent from 2023 to 2025.

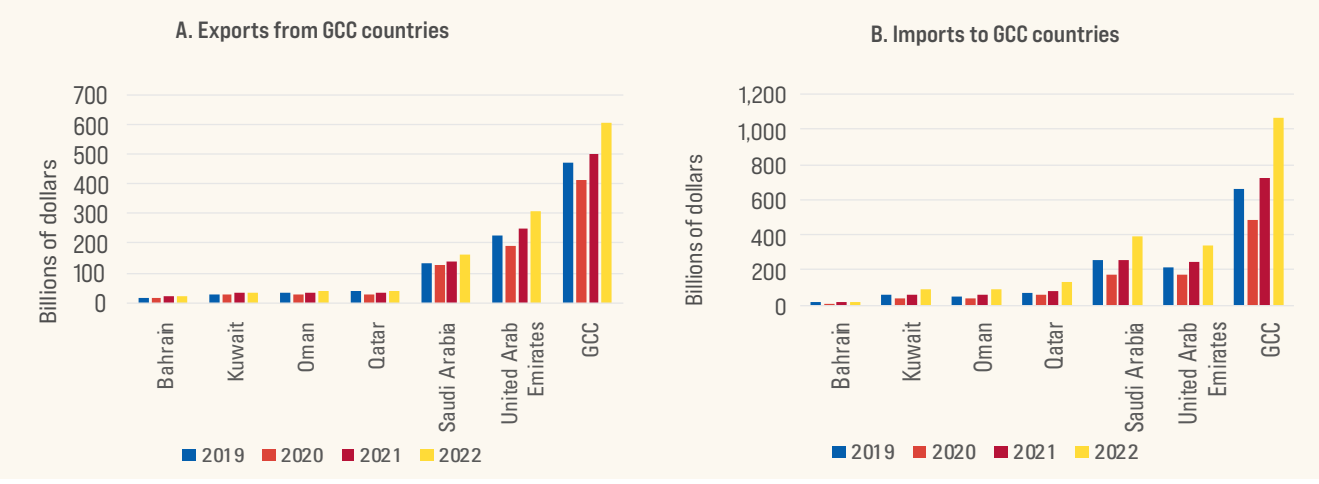
In Kuwait, growth rates are expected to be low between 2023 and 2025, affected by the OPEC+ oil production cuts and moderate oil price levels. Growth in the non-oil sector, however, at around 4.4 per cent,[14] could recover some losses from declining oil revenues. GDP is expected to grow by 2 per cent in 2024 and 2.8 per cent in 2025. Inflation rates are projected to be moderate, at around 2.3 and 2.6 per cent in 2024 and 2025, respectively.

Decreased oil production in 2023 will likely crimp economic growth in the United Arab Emirates although the slowdown was counterbalanced to some extent by expansion in the non-oil sector. It grew by around 4.8 per cent in 2023,[15] leading to a moderate overall growth rate of around 3.5 per cent. The tourism sector continued to play an important role, contributing to the services sector and increasing domestic consumption. In November 2023, the United Arab Emirates hosted the twenty-eighth Conference of the Parties on climate change, a major international event that increased demand and prices. Inflation in 2023 averaged 3.8 per cent. The outlook for 2024 to 2025 is more positive as GDP is expected to rise by 4 and 5.9 per cent, respectively, while inflation rates are predicted to be moderate at around 2.7 and 3.1 per cent, respectively.

Economic recovery in the GCC countries in 2022 was accompanied by significant economic growth, a recovery in domestic and global consumption, and increased commodity prices. As a result, exports and imports rose significantly in 2022, exceeding pre-COVID-19 levels. Exports increased by 20 per cent, reaching $603 billion, while imports climbed by 45 per cent, totalling $1,064 billion (figures 2.2A and 2.2B).

This trend is expected to continue in the 2023–2025 period (table 2.6). Exports are expected to grow by 5.6 per cent on average. Saudi Arabia could have the largest increase with 10 per cent growth between 2023 and 2024, and 8 per cent in 2025, resulting from an expected recovery in the oil market and increased domestic investments that are likely to boost exports. Oman and Qatar may also witness significant growth in exports due to expanded gas production and heightened demand for gas products. Bahrain, Kuwait and the United Arab Emirates could have moderate growth rates for their exports. Imports to the GCC are expected to grow by 4.5 per cent in 2023, and 3.7 and 3.6 per cent in 2024 and 2025, respectively. Projected growth in imports ranges between 2 per cent in Saudi Arabia and 7.4 per cent in Kuwait in 2023, and between 1.4 per cent in Oman and 5.9 per cent in Bahrain in 2025.

Figure 2.2 Exports and imports in GCC countries



Source: ESCWA staff calculations based on the IMF Direction of Trade Statistics.

Table 2.6 Real export and import growth rates in GCC countries, 2023–2025

	Exports (percentage)			Imports (percentage)		
	2023	2024	2025	2023	2024	2025
All Arab countries	**5.4**	**6.0**	**5.0**	**4.2**	**4.1**	**4.0**
Bahrain	2.9	3.8	3.9	6.1	5.3	5.9
Kuwait	1.4	4.9	4.1	7.4	3.2	2.7
Oman	5.2	5.6	7.1	6.0	2.5	1.4
Qatar	5.0	5.3	4.3	5.0	5.9	5.0
Saudi Arabia	10.0	10.0	8.0	2.0	2.0	2.0
United Arab Emirates	3.8	4.6	3.5	5.2	4.4	4.5
GCC countries	**5.4**	**6.2**	**5.1**	**4.5**	**3.7**	**3.6**

Source: Based on data from the United Nations Statistics Division and national sources for 2023.

The decline in global oil prices coupled with generous subsidies and national support programmes aimed at mitigating imported high inflation negatively affected revenues in the GCC countries and created a fiscal deficit in 2023, estimated at around 2 per cent of GDP (table 2.7). This deficit is expected to continue in 2024 and 2025, reaching 2.1 and 2 per cent of GDP, respectively. All GCC countries are expected to maintain the peg of their national currencies to the United States dollar and other major currencies. This could raise interest rates in line with rising rates in the United States and the euro area. A widening fiscal deficit coupled with climbing interest rates is expected to increase financing needs and costs, resulting in an increase in the debt-to-GDP ratio from 30.9 per cent of GDP in 2023 to 32.2 per cent in 2025.

Benefiting from greater demand for and production of gas, Qatar could widen its fiscal surplus from 2.8 per cent of GDP in 2023 to 3.2 per cent in 2025. Qatar still does not plan to introduce a value-added tax, part of the Common VAT Agreement among GCC countries. The debt-to-GDP ratio is expected to decline from 44.8 per cent of GDP in 2023 to around 41.6 per cent in 2025. Kuwait and the United Arab Emirates are predicted to maintain a fiscal surplus during the outlook period, but it will likely decline from an estimated 2.9 to 1.8 per cent of GDP in Kuwait and 1.1 to 0.6 per cent in the United Arab Emirates in 2023 and 2025, respectively. In the latter, a corporate tax law passed in late 2022 is expected to increase government revenues and diversify sources away from the energy sector. In Kuwait, debt levels are expected to

remain stable, at between 9.8 and 10.6 per cent of GDP from 2023 to 2025. In the United Arab Emirates, the fiscal surplus will be used to repay part of current debt, with the debt level expected to drop from 25.6 to 20.1 per cent of GDP over the same period.

Oman could also benefit from increased demand for gas and see an improved fiscal position from a deficit of 1.8 per cent of GDP in 2023 to only 0.9 per cent in 2025. An improved fiscal balance could go hand in hand with an improved debt position where the debt-to-GDP ratio could decrease from 56.7 per cent in 2023 to 51.8 per cent in 2025. In Bahrain, the fiscal deficit reached 12.2 per cent of GDP in 2023, driven by increased spending on infrastructure projects, but is predicted to decline to 6.6 per cent in 2025 following the expected recovery in global demand. Debt levels are expected to remain elevated, however, ranging between 133.5 per cent of GDP in 2023 and 137 per cent in 2025, signalling the need for debt consolidation. In Saudi Arabia, expansionary policy, increased public investments, the Citizen Account Programme to protect households from fluctuations in prices, and tax exemptions to foreign companies relocating to the country are expected to increase expenses and decrease revenues, widening the fiscal deficit. The deficit is projected to fluctuate at around 5.1 per cent of GDP from 2023 to 2025, while the debt-to-GDP ratio is expected to increase from 26.3 to 33 per cent of GDP.

Table 2.7 Fiscal deficit and debt as a percentage of GDP in GCC countries

	Fiscal balance (percentage)			Government debt (percentage)		
	2023	2024	2025	2023	2024	2025
Bahrain	-12.2	-10.1	-6.6	133.5	137.6	137.0
Kuwait	2.9	2.4	1.8	9.8	11.2	10.6
Oman	-1.8	-1.0	-0.9	56.7	55.0	51.8
Qatar	2.8	3.1	3.2	44.8	43.1	41.6
Saudi Arabia	-5.1	-5.5	-4.9	26.3	30.0	33.0
United Arab Emirates	1.1	1.1	0.6	25.6	22.7	20.1
GCC countries	**-2.0**	**-2.1**	**-2.0**	**30.9**	**31.9**	**32.2**

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

C. Middle-income countries

The economic performance of Arab middle-income countries improved significantly in the first three quarters of 2023 after a difficult 2022. While oil prices have stabilized at moderate levels, some uncertainty clouds the prices of essential food items after the halting of the Black Sea Grain Initiative. The war on Gaza will weigh significantly on this subregion, particularly on the economies of Egypt, Jordan and Lebanon given their proximity to the conflict. GDP was expected to grow by 3.2 per cent in 2023, 3.7 and 4.4 per cent in 2024 and 2025, respectively, driven by an expansion in gas and phosphate production and a good agricultural season in the pre-war scenario. However, as the war on Gaza has entered its third month, GDP is expected to grow at a slow pace of around 2.5 per cent in 2023, and of 3.1 and 4.3 per cent in 2024 and 2025, respectively, in the three-month war scenario. Inflation is projected to remain elevated at double-digit rates between 26.7 per cent in 2023 and 10.7 per cent in 2025 in both scenarios (table 2.8).

Egypt was expected to record the highest growth rate during the outlook period in the pre-war scenario, driven by increased gas production and demand from European countries,

stepped-up public investments, a recovery in tourism and resumption of Suez Canal activities at full capacity. In December 2022, Egypt received IMF approval for a 46-month arrangement under the Extended Fund Facility amounting to around $3 billion.[16] GDP was expected to increase by 3.5 per cent in 2023, and by 4 and 5.2 per cent in 2024 and 2025, respectively. However, given its proximity to Gaza, the tourism sector and foreign direct investment inflows to Egypt are expected to be affected by the ongoing war in neighbouring Gaza. The three-month scenario expects that GDP will grow at a slower pace at around 2.7 per cent in 2023, and at 3.1 and 5.2 per cent in 2024 and 2025, respectively. The depreciation of the local currency in addition to monetary tightening are exerting significant pressures on prices, however, and are expected to cause double-digit inflation of between 35.3 per cent in 2023 and 16.9 per cent in 2025.

In 2023, Morocco had a good agricultural season after a year of low productivity caused by severe droughts. It benefited significantly from increased demand for phosphates. These positive developments were countered by the devastating earthquake that hit the country in September 2023, killing more than 2,900 persons, injuring more than 5,500 and causing massive destruction.[17] In 2023, GDP grew by around 2.7 per cent. It is expected to grow by 4.2 and 4.3 per cent in 2024 and 2025, respectively. Inflation is projected to remain at moderate levels of around 4.8 per cent in 2023, and 3.8 and 2.9 per cent in 2024 and 2025, respectively. Preliminary estimates suggest that the earthquake could cost around 8 per cent of GDP,[18] although humanitarian and international aid started flowing into the country in the wake of the event, mitigating a significant share of economic losses.

In Lebanon, the outlook was positive in 2023 driven by strong tourism and an inflow of remittances, which revived domestic consumption. However, the situation was overshadowed by uncertainty with the eruption of the war on Gaza and Israeli aggressions in southern Lebanon in the fourth quarter of the year. GDP was expected to grow by around 1.2 per cent in 2023 in the pre-war scenario but is likely to contract by 3 per cent in the three-month war scenario as a result of a significant drop in tourism in the fourth quarter. Since the first half of October 2023, many airlines have suspended their flights to Beirut, and many countries have advised their citizens against travelling to Lebanon. In addition, the national air-carrier has cut its flights in and out of Beirut by a third for at least two months, discouraging Lebanese expatriates from visiting the country. Meanwhile, the country continues to suffer from a lack of basic services, the deterioration of infrastructure and the prevalence of multiple exchange rates – the revised official exchange rate of 15,000 Lebanese pounds (LBP) per dollar, the customs rate of LBP 86,000 per dollar, the Sayrafa rate at around LBP 85,500 per dollar in September 2023, and black-market rates that reached LBP 140,000 per dollar and then decreased to around LBP 89,600 per dollar in September. The absence of reforms in addition to the reluctance to elect a president and fill other key positions like the Governor of the Central Bank have worsened the situation. In 2024 and 2025, GDP was expected to increase by 1.3 and 2.2 per cent, respectively. However, the three-month war scenario estimates that GDP will contract by a further 0.9 per cent in 2024 and will grow by 1.9 per cent in 2025. This outlook in the three-month war scenario is subject to change, positively if the war in Gaza ends soon, if the political bottleneck is resolved, and if reforms facilitating the IMF programme are enforced, but negatively if the war persists longer and if escalations in Lebanon expand beyond the south of the country. Inflation continues to weigh on the economy at a time when prices are soaring, the national currency is deteriorating and a cash dollarized economy is prevalent. Inflation reached 117.4 per cent in 2023 and is expected to fall to 45.8 and 11.9 per cent in 2024 and 2025, respectively.

Algeria may be affected by oil production cuts and moderate oil prices but may benefit from increased demand for gas by European countries and growth in the non-hydrocarbon sector. GDP is expected to grow by moderate levels of around 3.4 per cent in 2023, 3.2 per cent in 2024 and 2.6 per cent in 2025. Inflation is predicted to be moderate, ranging between 6.5 in 2023 and 5.4 per cent in 2025.

In Jordan, GDP was expected to grow modestly by 2.2 per cent in 2023, 2.5 and 3.3 per cent in 2024 and 2025, respectively, in the pre-war scenario, driven by recovery in tourism and increased revenues from phosphate production. However, the war on Gaza will affect the tourism sector – there has been many tours and ticket cancellations in the last quarter of 2023 – and the inflow of foreign direct investments. The three-month war scenario expects that GDP will not grow in 2023, will grow by 0.3 per cent in 2024 and by 2.7 per cent in 2024. Inflation rates are expected to be moderate at 3.7 per cent in 2023, and 2.9 and 3.4 per cent in 2024 and 2025, respectively.

In Tunisia, GDP growth is expected to increase by 2.5 per cent in 2023, 4.5 and 5.5 per cent in 2024 and 2025, respectively, subject to the enforcement of structural reforms that facilitate the adoption of an IMF programme. Inflation rates are expected to remain elevated, ranging from 9.1 in 2023 to 8 per cent in 2025.

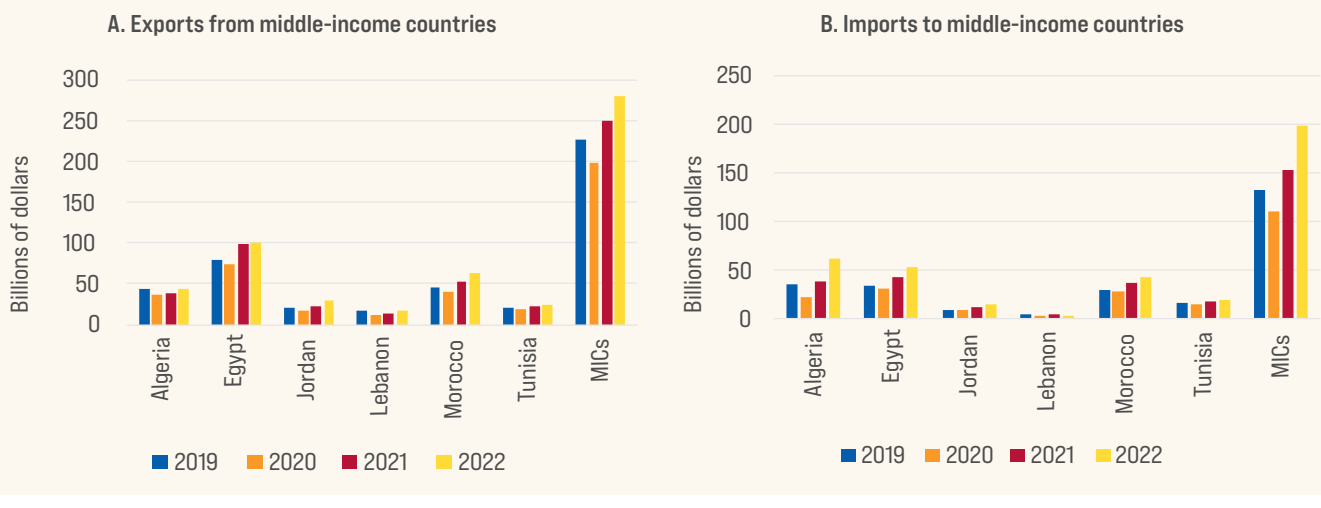
Table 2.8 GDP and inflation in middle-income countries, 2023–2025

Real GDP growth rate (percentage per year)						
	Pre-war scenario			Three-month war scenario[a]		
	2023	2024	2025	2023	2024	2025
Algeria	3.4	3.2	2.6	3.4	3.2	2.6
Egypt	3.5	4.0	5.2	2.7	4.2	4.3
Jordan	2.2	2.5	3.3	0.0	0.3	2.7
Lebanon	1.2	1.3	2.2	-3.0	-0.9	1.9
Morocco	2.7	4.2	4.3	2.7	4.2	4.3
Tunisia	2.5	4.5	5.5	2.5	4.5	5.5
Arab middle-income countries	**3.2**	**3.7**	**4.4**	**2.5**	**3.1**	**4.3**
Consumer inflation rate (percentage per year)						
	Pre-war scenario			Three-month war scenario[a]		
	2023	2024	2023	2024	2023	2024
Algeria	6.5	6.0	5.4	6.5	6.0	5.4
Egypt	35.3	21.7	16.9	35.2	21.5	16.8
Jordan	3.7	2.9	3.4	3.5	2.5	3.1
Lebanon	117.4	45.8	11.9	116.1	45.0	11.6
Morocco	4.8	3.8	2.9	4.8	3.8	2.9
Tunisia	9.1	8.1	8.0	9.1	8.1	8.0
Arab middle-income countries	**26.7**	**15.7**	**10.7**	**26.5**	**15.2**	**10.6**

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

[a] ESCWA projections based on the World Economic Forecasting Model for 2023 and based on the ESCWA-UNDP Expected Socio-Economic Impacts of the Gaza Crisis on Neighbouring Countries in the Arab States Region (forthcoming).

Figure 2.3 Exports and imports in middle-income countries



Source: ESCWA staff calculations based on the IMF Direction of Trade Statistics.

Table 2.9 Real export and import growth rates in middle-income countries, 2023–2025

	Exports			Imports		
	2023	2024	2025	2023	2024	2025
All Arab countries	**5.5**	**6.2**	**5.2**	**4.1**	**4.1**	**4.2**
Algeria	3.0	4.3	4.0	2.0	2.7	3.0
Morocco	5.5	8.9	11.2	3.0	5.7	6.0
Tunisia	5.6	3.3	3.5	2.5	2.1	0.2
Egypt	12.0	10.0	8.0	5.0	5.0	5.0
Jordan	5.9	4.7	4.9	0.4	1.0	1.6
Lebanon	3.0	4.0	5.7	5.0	5.2	8.2
Arab middle-income countries	**7.4**	**7.4**	**7.1**	**3.5**	**4.7**	**5.0**

Source: Based on data from the United Nations Statistics Division and national sources.

Exports and imports significantly increased in 2022 in middle-income countries. Exports rose by 12 per cent in 2022, reaching $280 billion, driven by a significant jump in phosphate exports from Jordan and Morocco (figure 2.3A). Imports climbed by 29 per cent, reaching $199 billion due to a large increase in Algeria (figure 2.3B).

In 2023, exports increased by around 7.4 per cent on the back of a 12 per cent increase from Egypt, mainly gas and phosphate exports, coupled with enhanced demand for cheaper Egyptian products as a result of currency depreciation. This trend is expected to continue, with exports predicted to increase by 7.4 in 2024 and 7.1 per cent in 2025. Imports are projected to increase by 3.5 per cent in 2023, and by 4.8 per cent on average from 2024 to 2025, based on a significant increase in Lebanon (table 2.9). Exports and imports from this subregion are subject to uncertainty as the war on Gaza is increasing transport costs, particularly through the Arabian Gulf following the rise of insurance premiums.

Arab middle-income countries are expected to continue facing constrained fiscal space and fluctuations in commodity prices. To lessen the impact of the latter, many countries have maintained food and energy subsidies, and several have expanded social safety net coverage. In 2023, the fiscal deficit reached 7.6 per cent of GDP. It is expected to top 7.3 per cent in 2024 and 6.6 per cent in 2025. Debt levels are projected to improve as a result of the better debt position of Egypt and changes in Lebanon. The debt-to-GDP ratio is expected to decline from 71 per cent in 2023 to around 65 per cent in 2025 (table 2.10). However, with the war on Gaza and the uncertainties surrounding neighbouring Egypt, Jordan and Lebanon, country risks in these countries are increasing and the cost of borrowing is likely to rise.

Egypt is predicted to witness a deterioration in its fiscal position. The depreciation of the local currency in addition to increased public investments, expanded food and energy subsidies, and greater coverage of vulnerable households by the Takaful and Karama Cash Transfer will widen fiscal deficits. The deficit is expected to reach 8.6 per cent of GDP in 2023, 8.1 per cent in 2024 and 6.9 per cent in 2025. Local currency depreciation will likely have a positive impact on debt levels, particularly on outstanding debts in the local currency. The debt-to-GDP ratio is expected to decline from 79 per cent in 2023 to around 66 per cent in 2025. Egypt joined an IMF programme and received $3 billion as part of a 46-month arrangement under the Extended Fund Facility; it also issued $1.5 billion worth of sukuk bonds in 2023.

In Morocco, the Government maintained its food and energy subsidies and expanded subsidies for transportation in order to control costs. It increased humanitarian spending in the wake of its devastating earthquake. These policies will likely put additional pressure on the budget and widen the fiscal deficit. The latter is expected to reach 6.2 per cent of GDP in 2023, and 5.5 and 5 per cent in 2024 and 2025, respectively. Morocco received $5 billion from the IMF as part of a two-year Flexible Credit Line Arrangement for crisis prevention, in addition to significant financial support following the earthquake. Debt levels are expected to increase from 56.7 per cent of GDP in 2023 to around 58.7 per cent in 2025.

Table 2.10 Fiscal deficit and debt as a percentage of GDP in middle-income countries

	Fiscal balance (percentage)			Government debt (percentage)		
	2023	2024	2025	2023	2024	2025
Algeria	-5.6	-7.0	-8.0	57.5	60.6	63.4
Morocco	-6.2	-5.5	-5.0	56.7	58.0	58.7
Tunisia	-8.6	-7.4	-6.4	84.8	81.7	77.7
Egypt	-8.6	-8.1	-6.9	79.0	71.1	65.7
Jordan	-9.3	-7.7	-4.9	99.0	101.2	99.8
Lebanon	-5.7	-3.8	-3.7	28.0	19.6	15.5
Arab middle-income countries	**-7.6**	**-7.3**	**-6.6**	**71.1**	**67.4**	**64.9**

Source: ESCWA projections based on the World Economic Forecasting Model 2023.

In Tunisia, the fiscal deficit is expected to rise to 8.6 per cent of GDP in 2023 and to range between 7.4 and 6.4 per cent in 2024 and 2025, respectively. Depreciation of the national currency is projected to affect debt denominated in the local currency. The debt-to-GDP ratio is expected to decrease from around 85 per cent in 2023 to around 78 per cent in 2025. Delays in adopting structural reforms present a risk of debt distress.

In Algeria, the Government has increased public wages and strengthened food subsidies. These policies, in addition to a drop in hydrocarbon revenues, have pressured the fiscal position, which moved from a surplus to a 5.6 per cent deficit as a percentage of GDP in 2023. This deficit is expected to widen in 2024 and 2025, reaching 7 and 8 per cent of GDP, respectively. The debt-to GDP ratio is projected to increase from 58 per cent in 2023 to around 63 per cent in 2025.

Fluctuations in energy and food prices are expected to widen the fiscal deficit in Jordan, which is projected to reach 9.3 per cent of GDP in 2023 before decreasing to 7.7 per cent in 2024 and 4.9 per cent in 2025 as commodity prices stabilize. Debt levels are expected to increase and fluctuate at around 100 per cent of GDP during the 2023–2025 period.

In Lebanon, the political deadlock is putting public investment projects on hold. Government spending is very limited, covering basic items, including civil service salaries and subsidies of critical products like selected medicines and cash transfers to vulnerable households, which are covered through an additional loan from the World Bank as part of the Emergency Crisis and COVID-19 Response Social Safety Net Project. The fiscal deficit remained around 5.7 per cent of GDP in 2023 and is expected to decline to 3.8 and 3.7 per cent in 2024 and 2025, respectively. Debt levels are expected to diminish as a result of the significant depreciation of the national currency and the decrease in the value of debts denominated in the local currency. The debt-to-GDP ratio is expected to drop from 34 to 27 per cent between 2023 and 2025.

D. Conflict-affected countries

The situation in conflict-affected Arab countries remains uncertain, overshadowed by the war or Gaza, political divides and security concerns. Political mediation promises to break the status quo and to broker some consensus among conflicting parties. This could translate into higher growth rates during the outlook period, except in Palestine. GDP was expected to increase by 5.2 per cent in 2023 and by 3.7 and 4.7 per cent in 2024 and 2025, respectively, in the pre-war scenario. However, the war on Gaza will havea significant impact on the State of Palestine and very limited impact on the other countries in this subregion due to their distance from the conflict. The three-month war scenario predicts that GDP

will grow by 4.5 per cent in 2023, and by 3.3 and 4.7 per cent in 2024 and 2025, respectively. Inflation is projected to decline from a high of 9.7 per cent in 2023 to 6 and 4.8 per cent in 2024 and 2025, respectively (table 2.11).

Political disagreement continues to cloud the economic outlook in Libya. National elections have been postponed several times since 2021. Intense floods that hit coastal areas in September 2023 caused immense damages, with the bursting of the Mansour and Derna dams killing more than 4,250 people and resulting in over 8,500 missing people amid massive destruction and displacement.[19] With the flow of financial assistance, and in the absence of an impact on oil production, which resumed earlier in 2023, GDP is expected to grow by 16.4 per cent following a severe economic contraction in 2022, and then to increase by 6.1 and 6.8 per cent in 2024 and 2025, respectively. Inflation is projected to remain low, ranging between 3.5 and 2.5 per cent from 2023 to 2025. The halting of the Black Sea Grain Initiative and the expected increase in global food prices might affect the inflation outlook.

In Iraq, GDP is expected to grow at moderate levels as a result of oil production cuts and moderate price levels. GDP growth is predicted to range from 3.4 per cent in 2023 to 4.3 per cent in 2025. Inflation is expected to reach 6 per cent in 2023 as a result of higher food prices, and to decrease to 3.7 and 3.6 per cent in 2024 and 2025, respectively.

In Yemen, the ceasefire agreement reached earlier this year between conflicting parties will have a positive impact on the economic outlook. In 2023, GDP is expected to witness minor growth at 0.4 per cent, followed by a strong recovery of 4 and 3.2 per cent in 2024 and 2025, respectively. Inflation rates are expected to decrease from 20 per cent in 2023 to 9.5 per cent in 2024 and 5.7 per cent in 2025.

In Palestine, and prior to the eruption of the war on Gaza, GDP was expected to grow by 3.2 per cent in 2023 and 2.6 per cent from 2024 to 2025, while inflation was estimated to be around 3.1 per cent on average during the 2023–2025 period. However, this outlook is reversed by Israeli aggressions and excessive violence, particularly since 7 October 2023. The war on Gaza has caused the death of at least 18,205 persons between 7 October and 12 December 2023, 70 per cent of whom are children and women, in addition to at least 50,100 injured[20]. This war is pushing the Gaza strip into dire economic and social conditions and has propagated to the whole State of Palestine. If the war lasts for three months, GDP is expected to decline by 9.6 per cent in 2023 and 5.7 per cent in 2024, and to grow modestly by 2 per cent in 2025. The drop in GDP is expected to be due to a reduction in trade and capital inflows, halting of investments and productivity, higher production costs including for transport, and greater overall insecurity, and will have lasting negative effects on potential output and productivity for years to come, especially with the destruction of the health and education sectors. Total investment is expected to decline between 15 and 44 per cent, exports between 13 and 28 per cent, and imports between 4 and 14 per cent.[21] The war and the massive number of casualties and injured in addition to the vast destruction in housing and infrastructure will likely push the State of Palestine 10 to 15 years back.[22]

The Syrian Arab Republic had a difficult year in 2023 as two devastating earthquakes in February hit the northern and western parts of the country. Despite these challenges, GDP is expected to increase by 2.9 per cent in 2023, 3.8 per cent in 2024, then to grow at a faster of 7.2 per cent pace in 2025. Inflation rates are expected to remain elevated but to follow a decreasing path from 30.2 per cent in 2024 to 20 per cent in 2025.

Table 2.11 GDP and inflation in conflict-affected countries, 2023–2025

Real GDP growth rate (percentage per year)						
	Pre-war scenario			The three-month war scenario[a]		
	2023	2024	2025	2023	2024	2025
Yemen	0.4	4.0	3.2	0.4	4.0	3.2
Libya	16.4	6.1	6.8	16.4	6.1	6.8
Iraq	3.4	3.1	4.3	3.4	3.1	4.3

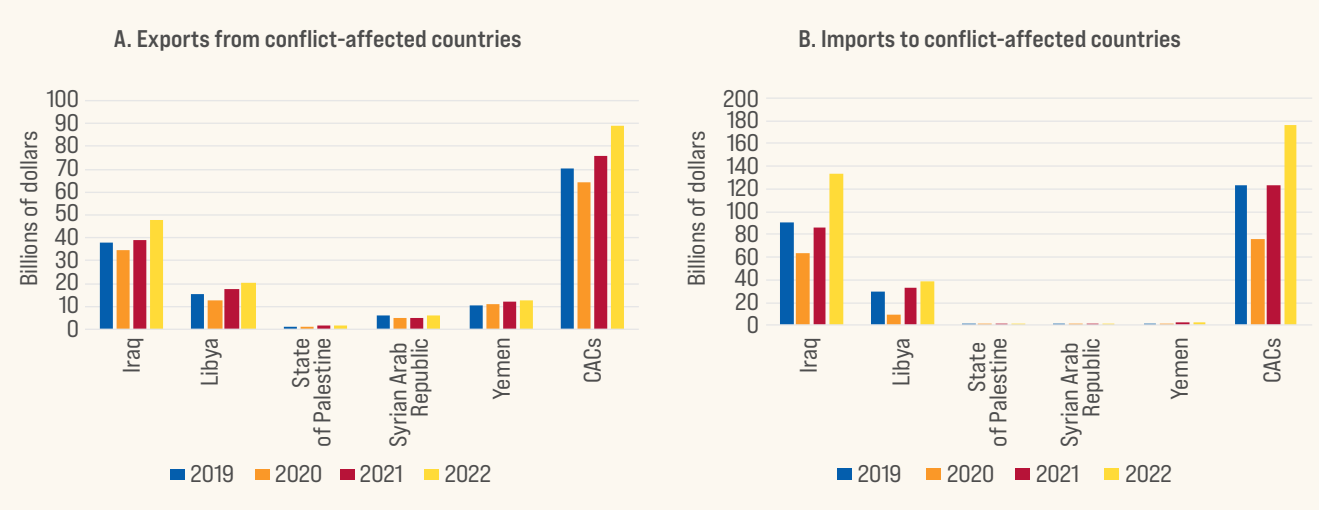
State of Palestine	3.2	2.6	2.6	**-9.6**	**-5.7**	**2.0**
Syrian Arab Republic	2.9	3.8	7.2	2.9	3.8	7.2
Arab conflict-affected countries	**5.2**	**3.7**	**4.7**	**4.5**	**3.3**	**4.7**

Consumer inflation rate (percentage per year)						
	Pre-war scenario			Three-month war scenario[a]		
	2023	**2024**	**2025**	**2023**	**2024**	**2025**
Yemen	19.9	9.5	5.7	19.9	9.5	5.7
Libya	3.5	2.6	2.5	3.5	2.6	2.5
Iraq	6.0	3.7	3.6	6.0	3.7	3.6
State of Palestine	3.4	2.8	3.1	1.0	0.4	2.1
Syrian Arab Republic	44.5	30.2	20.0	44.5	30.2	20.0
Arab conflict-affected countries	**9.7**	**6.0**	**4.8**	**9.6**	**5.8**	**4.7**

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

[a] ESCWA projections based on the World Economic Forecasting Model for 2023 and based on the ESCWA-UNDP Expected Socio-Economic Impacts of the Gaza Crisis on Neighbouring Countries in the Arab States Region (forthcoming).

Figure 2.4 Exports and imports in conflict-affected countries



Source: ESCWA staff calculations based on the IMF Direction of Trade Statistics.

Note: CACs refers to conflict-affected countries.

Exports from conflict-affected countries improved significantly in 2022, increasing by 18 per cent, reaching $89 billion as a result of greater oil exports from Iraq and Libya (figure 2.4A). Imports increased even more, by around 43 per cent, reaching $177 billion due to higher import bills following the increase in commodity prices (figure 2.4B).

Exports are expected to grow by 4.1 per cent on average during the 2023–2025 period as several conflict-affected countries are expected to resume economic activities and ties with neighbouring countries. Imports are projected to grow by 5.5 per cent on average to secure goods needed for reconstruction and recovery (table 2.12).

Table 2.12 Real export and import growth rates in conflict-affected countries, 2023–2025

	Exports (percentage)			Imports (percentage)		
	2023	2024	2025	2023	2024	2025
All Arab countries	**5.4**	**6.0**	**5.0**	**4.2**	**4.1**	**4.0**
Yemen	9.2	7.5	8.0	5.0	2.8	2.3
Libya	3.7	3.1	3.1	5.8	5.0	5.0
Iraq	5.0	4.4	3.1	5.0	4.4	3.1
State of Palestine	NA	4.4	5.7	NA	4.4	5.7
Syrian Arab Republic	5.0	5.2	8.2	5.0	5.2	8.2
Arab conflict-affected countries	**4.7**	**4.2**	**3.4**	**6.0**	**4.9**	**5.7**

Source: Data from the United Nations Statistics Division and national sources.

Table 2.13 Fiscal deficit and debt as a percentage of GDP in conflict-affected countries

	Fiscal balance (percentage)			Government debt (percentage)		
	2023	2024	2025	2023	2024	2025
Yemen	-21.0	-24.1	-25.3	72.3	86.1	103.4
Libya	2.3	-3.6	-8.7	NA	NA	NA
Iraq	-3.5	-5.0	-6.1	54.2	55.7	58.1
State of Palestine	NA	NA	NA	NA	NA	NA
Syrian Arab Republic	-1.2	-3.4	-3.3	3.1	5.8	7.9
Arab conflict-affected countries	**-3.8**	**-6.2**	**-8.0**	**52.1**	**55.0**	**58.7**

Source: ESCWA projections based on the World Economic Forecasting Model.

Conflict-affected countries are expected to witness a deterioration in their fiscal position, reaching a deficit worth 3.8 per cent of GDP in 2023, and 6.2 and 8 per cent in 2024 and 2025, respectively. This large increase is mainly due to a widening fiscal deficit in individual countries, expected in 2025 to reach 8.7 per cent of GDP in Libya, 6.1 per cent in Iraq, 25.3 per cent in Yemen and 3.3 per cent in the Syrian Arab Republic. Libya and Yemen are projected to increase their spending to finance reconstruction, while Iraq is maintaining costly fuel and food subsidies to mitigate the impacts of fluctuating global commodity prices on vulnerable communities. The fiscal position of the State of Palestine is expected to worsen. Revenues collected by Israel on behalf of and transferred to the Palestinian Authority (representing around 64 per cent of total revenues in 2022) are expected to be reduced or halted, which will affect debt payments and risk of causing debt default.[23]

The debt-to-GDP ratio is expected to increase in conflict-affected countries from around 52 per cent in 2023 to 58.7 per cent in 2025. In Yemen, debt levels are predicted to increase significantly to finance reconstruction; the debt-to-GDP ratio could reach 103.4 per cent in 2025. In Iraq, it may reach 58.1 per cent. The ratio is expected to increase to 7.9 per cent in the Syrian Arab Republic in 2025, given uncertainty regarding the persistence of economic sanctions under the Caesar Act adopted by the United States (table 2.13).

E. Least developed countries

The outlook for the Arab least developed countries is highly uncertain and gloomy, and is affected by the escalating conflict in the Sudan. GDP is expected to contract by 12.5 per cent in 2023 and 1.5 per cent in 2024, and then to grow by 2.5 per cent in 2025. Inflation rates are projected to be elevated, reaching 48 per cent in 2023 before declining to 22.8 per cent in 2024 and 13.7 per cent in 2025 (table 2.14).

The Sudan is undergoing a civil conflict that started in April 2023, further aggravating dire socioeconomic conditions and generating a humanitarian crisis. The conflict has disrupted production, agricultural activities and exports, and generated a wave of refugees and internally displaced people. GDP is expected to contract by around 15.7 per cent in 2023 and 3.4 per cent in 2024 should the conflict endure until then, before growing by 2.1 per cent in 2025. Prices are expected to soar. Imports have been severely affected by conflict, and the country relies heavily on imported food and medicines. Inflation rates are expected to reach 55.5 per cent in 2023, 26 per cent in 2024 and 15.3 per cent in 2025.

Mauritania is expected to grow by 4.9 per cent in 2023, 9 per cent in 2024 and 4.8 per cent in 2025 based on significant growth in the extractives sector, particularly iron ore and gold. Inflation will reach moderate levels and will fluctuate between 6.4 per cent in 2023 and 5.7 per cent in 2025.

GDP in Comoros is expected to grow by 2.8 per cent in 2023 and 2.9 per cent in 2024 to 2025, while inflation rates are expected to be around 5.4 per cent on average during the 2023–2025 period.

In Djibouti, GDP is expected to grow by 3.1 per cent in 2023, 5.5 per cent in 2024 and 4.5 per cent in 2025, driven by peace in Ethiopia and the resumption of economic activities, while inflation rates are projected to be around 3.9 per cent during the 2023–2025 period.

In Somalia, GDP is expected to grow by 2.5 per cent in 2023, 3.2 per cent in 2024 and 3 per cent in 2025. Inflation is predicted to be 5 per cent on average during the 2023–2025 period.

Table 2.14 GDP and inflation in least developed countries, 2023–2025

Real GDP growth rate (percentage per year)			
	2023	**2024**	**2025**
Comoros	2.8	2.9	2.9
Djibouti	3.1	5.5	4.5
Mauritania	4.9	9.0	4.8
Somalia	2.5	3.2	3.0
Sudan	-15.7	-3.4	2.1
Arab least developed countries	**-12.5**	**-1.5**	**2.5**
Consumer inflation rate (percentage per year)			
	2023	**2024**	**2025**
Comoros	6.8	5.1	4.4
Djibouti	4.0	3.9	3.7
Mauritania	6.4	6.2	5.7
Somalia	6.5	4.3	4.1
Sudan	55.5	26.0	15.3
Arab least developed countries	**47.9**	**22.8**	**13.7**

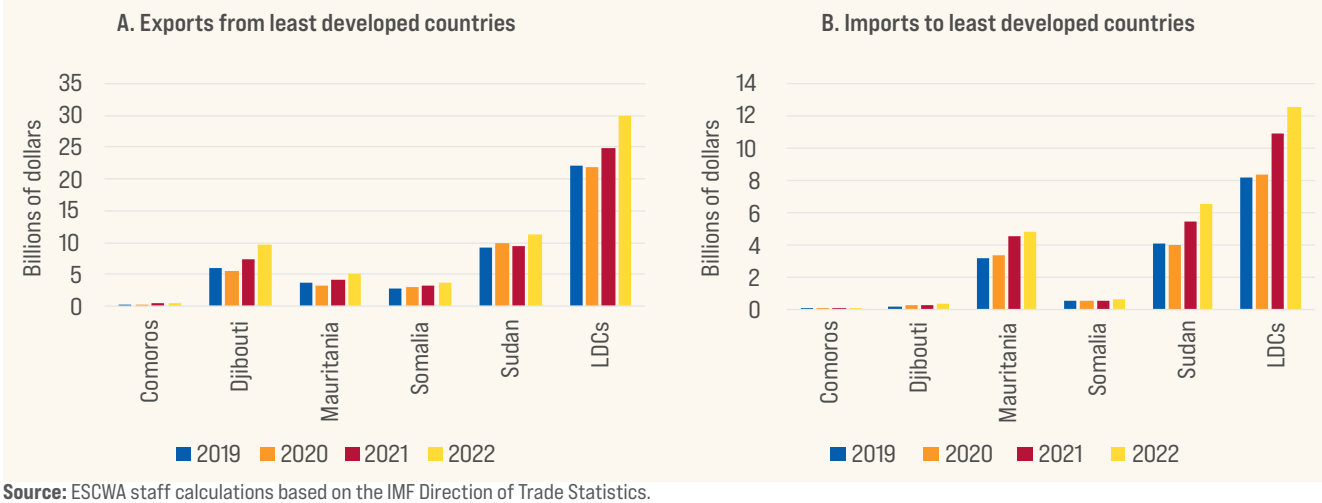
Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

Exports from the least developed countries increased by 21 per cent in 2022, reaching $30 billion, while imports rose by 15 per cent to $13 billion (figures 2.5A and 2.5B). Both were driven by significant growth in trade in Mauritania and the Sudan. The escalating conflict in the Sudan, however, is expected to affect trade growth in the least developed countries. Exports are projected to contract by 7.8 per cent in 2023, caused by a 30 per cent decline in exports from the Sudan, before later edging up by 5.5 per cent in 2025. Similarly, imports are expected to contract by 4.1 per cent in 2023, following a 30 per cent decline in the Sudan, before increasing by 4.1 per cent in 2025 (table 2.15).

The least developed countries continue to face constrained fiscal space and challenging socioeconomic conditions. The fiscal deficit is expected to increase and reach 3.2 per cent of GDP in 2023, with projections of 2.6 and 2.3 per cent in 2024 and 2025, respectively. The debt-to-GDP ratio is expected to decline from 78 per cent in 2023 to around 70 per cent in 2025, mainly driven by a decrease in debt levels in the Sudan (table 2.16).

The fiscal situation in the Sudan is very challenging. The local currency has depreciated significantly, and the ongoing conflict is diminishing revenue collection. The fiscal position is expected to worsen, with the fiscal deficit projected to reach 3.3 per cent of GDP in 2023 and to improve slightly to 2.7 per cent in 2024 and 2.4 per cent in 2025 should the conflict end early in 2024. Given the depreciation in the local currency, debt levels are expected to decrease from 83.4 per cent of GDP in 2023 to around 75 per cent in 2024 and 2025.

Figure 2.5 Exports and imports in least developed countries



Source: ESCWA staff calculations based on the IMF Direction of Trade Statistics.

Note: LDCs refers to least developed countries.

Table 2.15 Real export and import growth rates in least developed countries, 2023–2025

	Exports (percentage)			Imports (percentage)		
	2023	2024	2025	2023	2024	2025
All Arab countries	**5.4**	**6.0**	**5.0**	**4.2**	**4.1**	**4.0**
Comoros	9.1	10.1	7.6	10.0	8.0	7.0
Djibouti	8.3	8.7	5.9	4.7	4.5	3.5
Mauritania	3.3	4.1	5.9	3.3	4.1	5.9
Somalia	7.9	4.9	3.9	7.9	4.9	3.9
Sudan	-30.0	3.3	5.4	-30.0	3.3	5.4
Arab least developed countries	**-7.8**	**6.1**	**5.5**	**-4.1**	**5.3**	**4.1**

Source: Based on data from the United Nations Statistics Division and national sources.

Table 2.16 Fiscal deficit and debt as a percentage of GDP in least developed countries

	Fiscal balance (percentage)			Government debt (percentage)		
	2023	2024	2025	2023	2024	2025
Comoros	-3.9	-3.8	-4.1	31.6	33.3	35.5
Djibouti	-1.8	-2.3	-1.5	45.1	43.5	41.6
Mauritania	-2.0	-1.9	-1.9	47.6	44.7	45.0
Somalia	NA	NA	NA	NA	NA	NA
Sudan	-3.3	-2.7	-2.4	83.4	75.3	75.6
Arab least developed countries	**-3.2**	**-2.6**	**-2.3**	**78.0**	**70.3**	**70.4**

Source: ESCWA projections based on the World Economic Forecasting Model.

In Mauritania, the fiscal deficit is expected to be stable at around 2 per cent of GDP during the 2023–2025 period, while the debt-to-GDP ratio is projected to decrease from 47.6 per cent in 2023 to around 45 per cent in 2025. In 2023, Mauritania received IMF approval for $86.9 million for a 42-month arrangement under the Extended Fund Facility.

In Djibouti, the fiscal deficit is expected to reach 1.8 per cent of GDP in 2023, 2.3 per cent in 2024 and around 1.5 per cent in 2025, while the debt-to-GDP ratio is projected to drop from 45.1 per cent in 2023 to 41.6 per cent in 2025.

In the Comoros, the fiscal deficit is expected to increase from 3.9 per cent of GDP in 2023 to 4.1 per cent in 2025, while the debt-to-GDP ratio is predicted to increase from 31.6 to 35.5 per cent over the same period.

F. Concluding remarks

The outlook for the Arab region in highly uncertain. It depends on several factors, including the ongoing war on Gaza, the future of the war in Ukraine, and related repercussions such as fluctuations in energy prices and the resumption of grain exports from countries in conflict. The outlook also depends on lasting truces and ceasefire agreements among several conflicting parties, policymaking and measures to rebuild fragmented institutions, efforts to end political deadlocks, economic and social reforms, international aid to support reconstruction and recovery, and the sustainable reconciliation of conflicting parties.

Climate change adds another element of uncertainty. The repercussions are increasingly visible in the region, which struggles with recurrent heat waves, droughts and flooding, and more frequent natural disasters. These are threatening food, water and energy security along with livelihoods. Addressing climate change is essential for developed and developing countries alike globally, including Arab countries.

Social developments and gender dynamics

3

Key messages

Poverty is projected to decline sluggishly in the Arab region over the coming years, reaching 35.1 per cent by 2025. In middle-income countries, poverty rates are expected to resume a downward trend, declining from 24.4 per cent in 2022 to an estimated 24.1 per cent by 2025. In the low-income and conflict-affected countries, poverty rates have jumped from 56.7 and 45.5 per cent in 2019, respectively, to 63.5 and 50.3 per cent in 2023. They are expected to further rise by 2025 to 63.7 and 50.4 per cent, respectively. In high-income countries, poverty is projected to decline near monotonically from 11.4 per cent in 2019 to 10.3 per cent in 2023 and 9.7 per cent in 2025.

According to the 2023 Global Gender Gap Index, the Arab region's average score remains static. It has the world's most significant disparities in gender equality.

Striking gender disparities persist in labour force participation. While female labour force participation is estimated to be as low as 19.88 per cent, compared to the global average of 47.15 per cent, male labour force participation is around 70.38 per cent, close to the global average of 72.36 per cent.

Unemployment rates are expected to remain elevated in the region at around 11.6 per cent in 2023 and 11.5 per cent in 2024.

A. Poverty and inequality

The Economic and Social Commission for Western Asia (ESCWA) projections of economic growth and its trickle down to households[24] indicate that from 2023 to 2025, the Arab region will continue on an uneven path of recovery from the pandemic, subject to diverging experiences across distinct country income groups. This is due to the evolving situation in commodity and energy markets in the wake of the outbreak of the war in Ukraine, and the war on Gaza and a resurgence of conflict in other parts of the region.[25] Based on poverty thresholds[26] comparable to national poverty lines, the region has witnessed a rise in poverty compared to pre-pandemic years, from 31.5 per cent in 2019 to 35.4 per cent in 2023. Poverty is projected to abate marginally in 2024 to 2025, to 35.1 per cent in 2025 (table 3.1).

Poverty trends have diverged markedly among country groups, according to income level and equity of distribution. Arab high-income countries have the lowest levels of poverty, at 10.3 per cent in 2023, and are further poised to see their poverty rates decline to 9.7 per cent by 2025. Middle-income countries have seen their poverty levels deteriorate from the pandemic years, rising from 22.4 per cent in 2019 to 25.0 per cent in 2023, and declining to 24.1 per cent in 2025. In the Arab low-income and conflict-affected countries, poverty has also increased, from 56.7 and 45.5 per cent in 2019 to an estimated 63.5 and 50.3 per cent in 2023. In these countries, poverty is expected to further tick up in 2025 to 63.7 and 50.4 per cent, respectively.

The war on Gaza is threatening to drive the entire population of the Gaza strip – around 2.3 million Palestinians – into multidimensional poverty, requiring basic necessities for survival.[27] Furthermore, the aggressions on southern Lebanon, the significant damage incurred to cultivated land, in addition to the large number of internally displaced, are likely to increase poverty in Lebanon and other neighbouring countries.

While inequality trends cannot be assessed without careful, up-to-date household budget surveys, ESCWA projections show that Arab countries have for the most part modest degrees of income inequality. Gini coefficients generally range from 26 to 37 per cent. Only a handful of countries have Gini scores in the forties. Middle-income countries as a group typically have lower income inequality, with an average national Gini of 30.7, while the least developed and conflict-affected countries have an average Gini of 32.0–33.8 and the high-income countries a score of 37.0.

These stylized facts paint a picture of divergent fortunes across the region. Middle-income countries have for the most part enjoyed modest inequality, and their poverty rates have partially recovered from the shocks of the pandemic. Recovery efforts have been less significant in the least developed and conflict-affected countries, where poverty rates have remained elevated or even continue to go up.

Table 3.1 Poverty rates and Gini indices of inequality in the Arab region

	Poverty rate (percentage of total population)				Gini (percentage)
	2019	2023	2024	2025	2023
Low-income countries	56.7	63.5	63.8	63.7	33.8[a]

Middle-income countries	22.4	25.0	24.6	24.1	30.7[a]
High-income countries (nationals)	11.4	10.3	10.0	9.7	37.0[a]
Conflict-affected countries	45.5	50.3	50.5	50.4	32.0[a]
Arab countries	31.5	35.4	35.3	35.1	32.0[a]

Source: ESCWA, 2024. Based on the ESCWA Money Metric Poverty Assist Tool (https://moneymetrics.unescwa.org/) and ESCWA poverty lines (https://www.unescwa.org/publications/counting-world-poor-engel-law).

a Population-weighted mean national Gini indices are shown, notably disregarding between-country inequality. Lebanon, Libya and the State of Palestine are missing given a lack of recent distributional data.

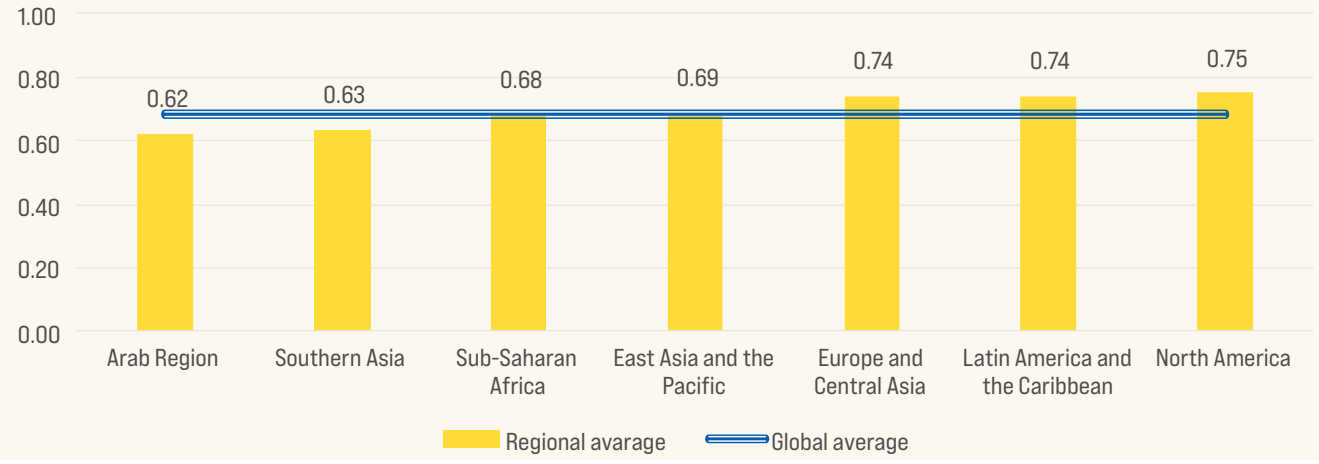
b Country groupings are as per the 2022 World Bank country income classification. Low-income countries include: Somalia, the Sudan, the Syrian Arab Republic and Yemen. Middle-income countries include: Algeria, Comoros, Djibouti, Egypt, Iraq, Jordan, Mauritania, Morocco and Tunisia. High-income countries are: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates. Conflict-affected countries are: Iraq, Somalia, the Sudan, the Syrian Arab Republic and Yemen.

B. Gender equality

The journey towards gender equality in the Arab region confronts persistent hurdles, as is evident in the 2023 data. Despite some advancements, the 2023 Global Gender Gap Index reveals a stark reality: the region's average score remains static at 0.62, the same as the previous year, leaving a substantial 0.38-point gap. The region lags the global average of 0.68, leaving it with the most significant disparities in gender equality worldwide (figure 3.1). The majority of Arab countries unfortunately fall at the lower end of the global ranking, showcasing the broad scale and depth of gender gaps in the region. Given the current pace of progress, the sobering estimate is that it may take over 150 years to close the gap. This underlines the urgency of accelerated and sustained efforts in the region to enhance gender equality as a critical dimension of social and economic development.

The United Arab Emirates maintains its position as the region's top performer on gender equality, although its rank has slightly dropped to 0.712. Lebanon, previously ranking higher, has seen a decrease in its score to 0.628, causing it to slip to rank 132 globally. Algeria, Oman and Morocco are the three worst-performing countries in the region, with ranks of 144, 139 and 136, respectively. Bahrain, the Comoros and Kuwait have seen the most significant progress with increased scores. Algeria, Egypt and Lebanon have experienced the most significant declines, illustrating the mixed progress in the region.

Figure 3.1 Global Gender Gap Index scores by region, 2023



Source: ESCWA calculations based on the World Economic Forum Global Gender Gap Index 2007-2023.
Note: Regional average scores were weighted by population using population data from the World Bank's World Development Indicators database.

Figure 3.2 The gender gap in educational attainment, 2007-2023

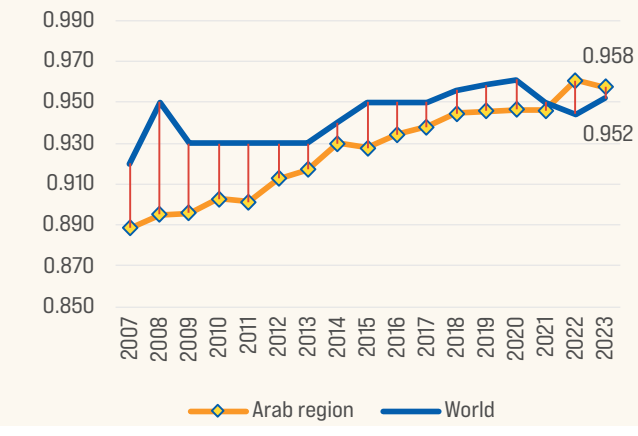


Figure 3.3 The gender gap in health and survival, 2007-2023

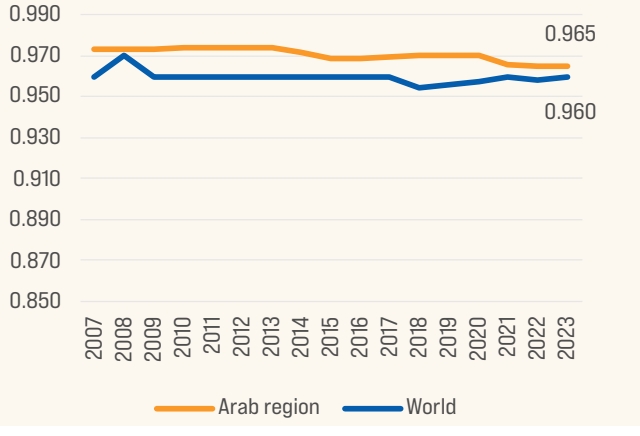


Figure 3.4 The gender gap in economic participation, 2007–2023

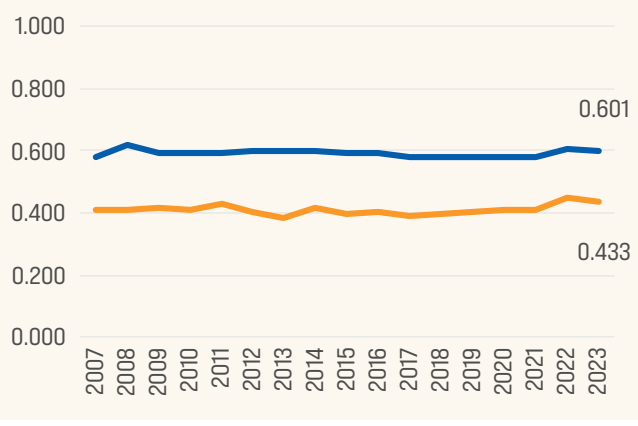
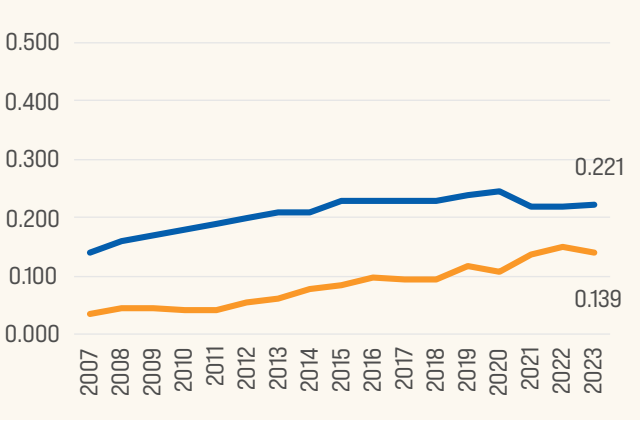


Figure 3.5 The gender gap in political participation, 2007–2023



Source: ESCWA calculations based on the World Economic Forum Global Gender Gap Index 2007-2023.
Note: Regional average scores were weighted by population using population data from the World Bank's World Development Indicators database.

1. Women's education

The Arab region has made impressive strides towards closing the gender gap in education over the past 16 years, with only 4.6 percentage points remaining to close the disparity in the educational attainment subindex of the Global Gender Gap Index. In 2007, the region's educational attainment subindex was 0.889, which progressively rose to a peak of 0.961 in 2022 before experiencing a marginal dip to 0.958 in 2023. These numbers have surpassed global averages consistently since 2021 (figure 3.2), indicating firm commitment to gender parity in education. Of the 13 Arab countries included in the Global Gender Gap Index in 2012, only the Comoros and Egypt had a score lower than 0.95. Female literacy has increased by more than 13 per cent in the last 15 years, although the literacy rate remains slightly higher among young men than among young women.[28]

These scores must be scrutinized in a broader socioeconomic context, considering disparities among countries and socioeconomic groups, and lasting barriers to education, particularly for marginalized and conflict-affected populations. Continued attention is needed to consolidate gains and improve the quality of education and its relevance to the labour market (box 3.1).

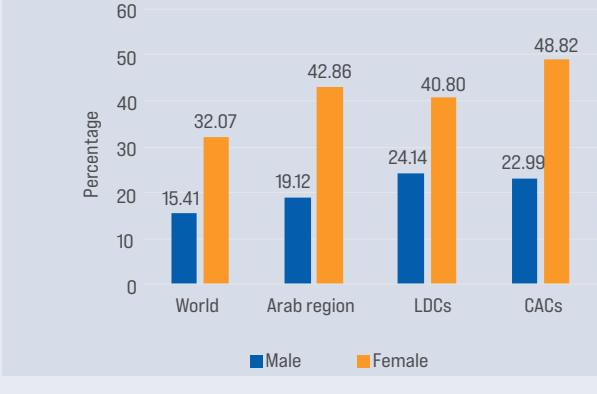
Box 3.1 A hidden crisis: dissecting the impact of high rates of women not in education, employment or training

Despite the region's significant progress in closing the education attainment gender gap, a high number of young people (aged 15 to 24), particularly women, are not in education, employment or any type of training (NEET). The total NEET rate in the region is a concerning 30.7 per cent. A clear gap exists between men and women, with 19.1 per cent of men and a high 42.9 per cent of women falling into this category (figure 3A). This difference highlights the larger problem of gender inequality in the Arab region, where women face more obstacles to finding jobs or getting an education and training.

The problem is even more severe in conflict-affected and least developed countries, where the social and economic situation is already difficult. In these fragile environments, female NEET rates average 48.8 per cent and 40.8 per cent, respectively. In Yemen, an enormous 69.3 per cent of women are not in employment, education or training (figure 3B).

High NEET rates have deep socioeconomic impacts. They indicate that a large number of young people, particularly women, are not contributing to the economy or developing their own skills and potential. This lack of involvement in work or education can deepen poverty and social inequality. And the gap between men and women is likely to grow even wider. Women without access to jobs or desired education are less likely to gain capacities and experiences to help reduce disparities. Over time, this could lead to an even bigger gender divide, one that threatens the region's social harmony and economic growth.

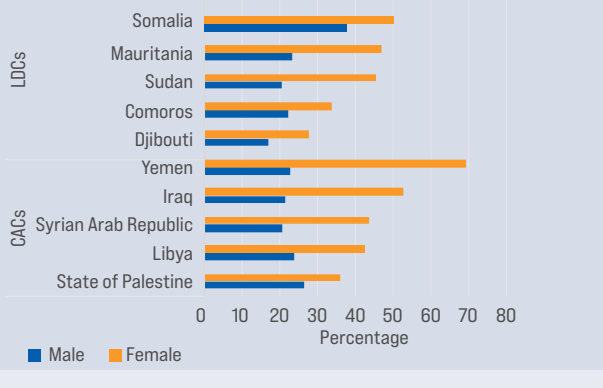
Figure 3A The proportion of young people not in education, employment or training, 2022



Source: ESCWA calculations based on ILO modelled estimates.

Source: ILO modelled estimates.

Figure 3B The proportion of young people not in education, employment or training in the least developed and conflict-affected countries, 2022



Source: ILO modelled estimates.

2. Health and survival

The health and survival subindex of the Global Gender Gap Index paints an optimistic picture of the Arab region's strides toward gender parity in health outcomes. The region has consistently maintained a score above the global average, moving from 0.973 in 2007 to 0.965 in 2023 (figure 3.3). This progression suggests a strong commitment to improving and maintaining women's health and well-being. Yet the region faces some persistent health disparities. Significant hurdles still arise from the limited integration of maternal and neonatal health, sexual and reproductive health, and mental health services in health systems. Moreover, health services remain largely fragmented and supply driven, with an emphasis on curative rather than preventative measures. To maintain and improve its scores, the region needs to systematically overhaul health-care systems so they promote integrated and preventative care, and address cultural and structural barriers impacting women's health.

3. Women's economic empowerment

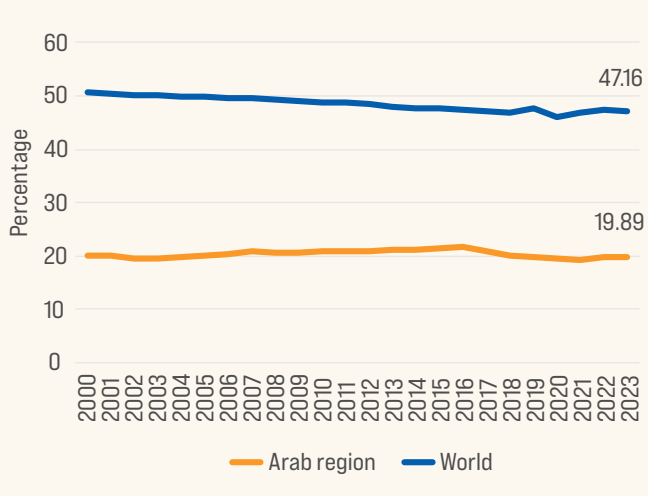
In 15 years, the Arab region only made 2.3 percentage points of progress in closing its gender gap in economic participation. In 2023, the gap held at 40.33 per cent, indicating a remaining shortfall of almost three fifths. The region is considered the second to last after Southern Asia. It is consistently below the world average economic participation gap of 60.1 per cent (figure 3.4).

In labour force participation, the Arab region presents a unique and complex picture. As of 2023, data reveal a female labour force participation rate of 19.89 per cent, a figure that underscores the significant gender disparity in economic participation. The rate for women in the region has long been a subject of concern, fluctuating between 19.2 and 20.8 per cent over the past two decades. This relatively constant and low rate underscores a stark reality: for every five women in the Arab region, only one is actively participating in the economy (figure 3.6).

The situation is even more alarming when considering the labour force participation rate among young people aged 15 to 24, which stands at a mere 10.93 per cent. This is not only the lowest rate among all world regions but is also one of the lowest rates ever recorded in the region and globally (figure 3.7).

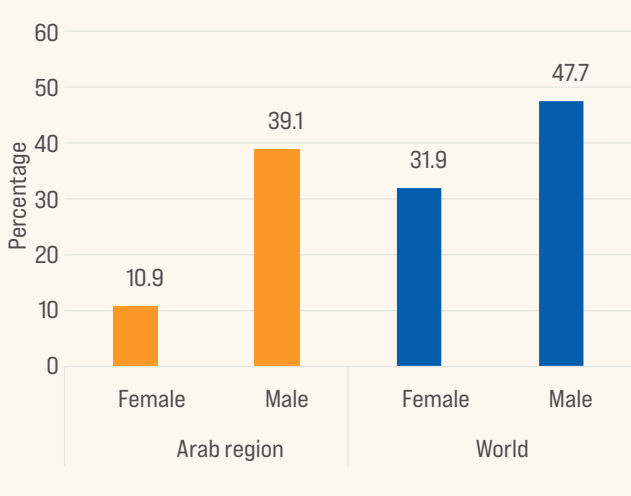
Low female labour force participation stems from deeply entrenched societal norms, legal and institutional barriers, and economic factors. Traditional gender roles often relegate women to household duties, while men are perceived as the primary breadwinners. Legal restrictions in some countries, such as Qatar, Saudi Arabia and the United Arab Emirates, limit women's ability to work in certain sectors. A lack of affordable childcare and family-friendly workplace policies further exacerbate the issue.

Figure 3.6 Female labour force participation rates in the Arab region, 2000-2023



Source: ILO modelled estimates, 2023.

Figure 3.7 Male and female labour force participation rates, 2022



Source: ILO modelled estimates.

Insufficient female participation in the economy is not merely a matter of gender equity; it is a significant economic constraint on the region reaching its potential. The underutilization of women's skills and talents represents a substantial loss of economic opportunity. Arab women striving to participate in the economy face a daunting array of challenges and barriers. The scarcity of female role models in leadership positions underscores the magnitude of the challenge; only 5 per cent of firms in the region have women top managers.[29]

4. Political participation

Women's engagement in the political sphere in the Arab region fell slightly between 2022 and 2023, with the mean representation of women in parliaments receding from 18.1 per cent to 17.9 per cent. This minor regression masks divergent patterns unfolding within distinctive geopolitical contexts. Despite the region registering the lowest metrics for female political participation on a global scale, observable incremental progress is evident in the development of women's political empowerment. Over 15 years, the disparity in political participation has gradually widened from 0.03 to approximately 0.14 in 2023, yet with some improvement in 2022 and 2023 (figure 3.5), indicating a tenuous shift towards a more gender-balanced political landscape within the Arab world.

Of the 22 Arab countries, 12 have introduced quotas for women legislators in a single or lower house (table 3.2). The number of seats held by women fell by 22 from 2022 to 2023, when it totalled 669 seats. This significant drop was mainly caused by the Tunisian election in December 2022, where a political sea change led to a disconcerting contraction in women's representation.

The United Arab Emirates has taken a decisive stride towards gender parity in governance, with women now occupying 50 per cent of parliamentary seats, a noteworthy achievement stemming from the enactment of mandatory quotas. In Bahrain, the November 2022 elections catalysed a modest yet symbolic elevation in female representation – the number rose from six to eight, a victory even more remarkable given that it transpired without a quota system. The legislative landscape in Kuwait exhibits a striking disparity after the 2023 elections, where a paltry 1 seat out of 50 is held by a woman, underscoring the implications of the absence of a mandated gender quota.

In Djibouti, the electoral events of February 2023 did not shift the dial on female representation, leaving the ratio of women parliamentarians unaltered at the level of the quota. In Mauritania, a combination of a reinvigorated election cycle and a novel incentive-driven election law triggered a rise in the number of female parliamentarians from 31 to 41 in 2023.

Table 3.2 Women in national parliaments

Country	As at July 2022				As at July 2023			
	Lower or single house				Lower or single house			
	Elections	Number of seats[a]	Number of women	Percentage of women	Elections	Number of seats[a]	Number of women	Percentage of women
Algeria[a]	June 2021	407	33	8.1	June 2021	407	32	7.9
Bahrain	November 2018	40	6	15.0	November 2022	40	8	20.0
Comoros	January 2020	24	4	16.7	January 2020	24	4	16.7
Djibouti[a]	February 2018	65	17	26.2	February 2023	65	17	26.2
Egypt[a]	October 2020	592	164	27.7	October 2020	592	163	27.5
Iraq[a]	October 2021	329	95	28.9	October 2021	329	95	28.9

Jordan[a]	November 2020	130	16	12.3	November 2020	130	16	12.3
Kuwait	December 2020	62	1	1.6	May 2023	50	1	2.0
Lebanon	May 2022	128	8	6.3	May 2022	128	8	6.3
Libya[a]	June 2014	170	28	16.5	June 2014	170	28	16.5
Mauritania[a]	September 2018	153	31	20.3	May 2023	176	41	23.3
Morocco[a]	September 2021	395	95	24.1	September 2021	395	96	24.3
Oman	October 2019	86	2	2.3	October 2019	86	2	2.3
State of Palestine[a]	-	-	-	-	-	-	-	-
Qatar	October 2021	45	2	4.4	October 2021	45	2	4.4
Saudi Arabia[a]	October 2020	151	30	19.9	October 2020	151	30	19.9
Somalia	November 2021	274	54	19.7	November 2021	274	54	19.7
Sudan[a]	-	-	-	-	-	-	-	-
Syrian Arab Republic	July 2020	250	28	11.2	July 2020	250	27	10.8
Tunisia	October 2019	217	57	26.3	December 2022	154	25	16.2
United Arab Emirates[a]	October 2019	40	20	50.0	October 2019	40	20	50.0
Yemen	April 2003	250	0	0.0	April 2003	245	0	0.0

Source: Inter-Parliamentary Union Database, 2023.

[a] Refers to the country having a quota reserving a number or share of seats for women in parliament.

C. Labour force

The persistent complexities of the Arab region's labour market present a formidable challenge that reverberates across the socioeconomic landscape. The region grapples with an unsettling paradox: growing youth populations and alarmingly high unemployment rates, particularly among young people and women. This disquieting reality, underscored by an intense disconnect between the skills offered by the workforce and the evolving demands of employers, casts a long shadow over the region's economic prospects. Substantial investment in human capital as a critical catalyst for enhancing education and training remains an urgent concern. The future of the Arab labour market depends on navigating these multifaceted challenges.

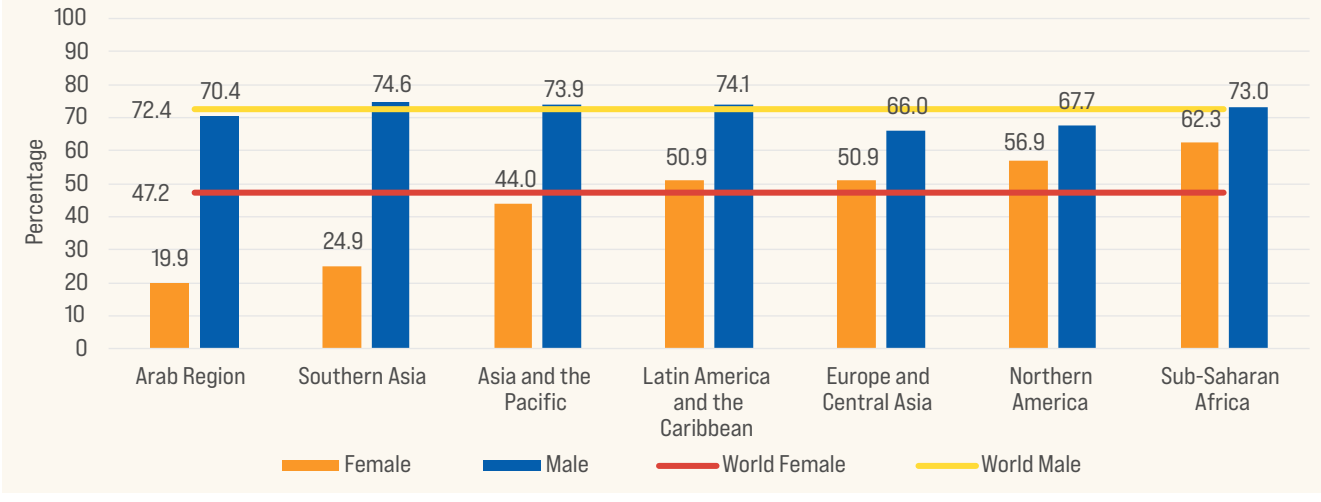
1. Labour force participation

In 2023, the Arab region has striking disparities in labour force participation rates between men and women. The female labour force participation rate languishes at a very low 19.88 per cent, compared to the global average of 47.15 per cent (figure 3.8). This significant disparity underscores a crucial

gender divide, indicative of the systemic underutilization of female skills and talents in the economy (Box 3.2). On the other hand, the male labour force participation rate remains robust at 70.38 per cent. It parallels the global average of 72.36 per cent.

For younger people, the challenges are even more evident. Young women (aged 15 to 24) have a labour force participation rate of just 10.93 per cent in 2023,[30] substantially below the international average of 31.9 per cent. This indicates a severe underrepresentation and a stifling of the potential of a significant proportion of the population. The labour force participation rate of young Arab males of the same age is an estimated 39 per cent in 2023, falling slightly short of the global average of 47.6 per cent.[31]

Figure 3.8 Female and male labour force participation rates, regional averages, 2023



Source: ILO modelled estimates, 2023.

Box 3.2 World Values Survey insights: dissecting gender roles and beliefs in the Arab region

The World Values Survey is a globally recognized research project that delves into the intricacies of people's values, beliefs and changes over time, and how they impact societal structures and political systems. Conducted by a network of international social scientists since 1981, it has generated insights into national cultures through surveys conducted in nearly 100 countries. Seven Arab countries – Egypt, Iraq, Jordan, Lebanon, Libya, Morocco and Tunisia – participated in the seventh wave of the survey (2017–2022), providing rich insights into the region's gender-related values and beliefs. The survey allows the exploration of the persistence of traditional gender norms, the challenges faced in achieving gender equality and the potential impact on women's empowerment.

The data indicate a prevailing cultural norm in the Arab region favouring traditional gender roles, where men are primary earners and women are caregivers. This perspective, while varying in degree, is pervasive across the region and points towards deeply rooted societal beliefs. Such views can have significant implications for gender equality, limiting women's opportunities for professional and personal development and reinforcing gender disparities, while also restricting economic growth by diminishing women's potential in the workforce.

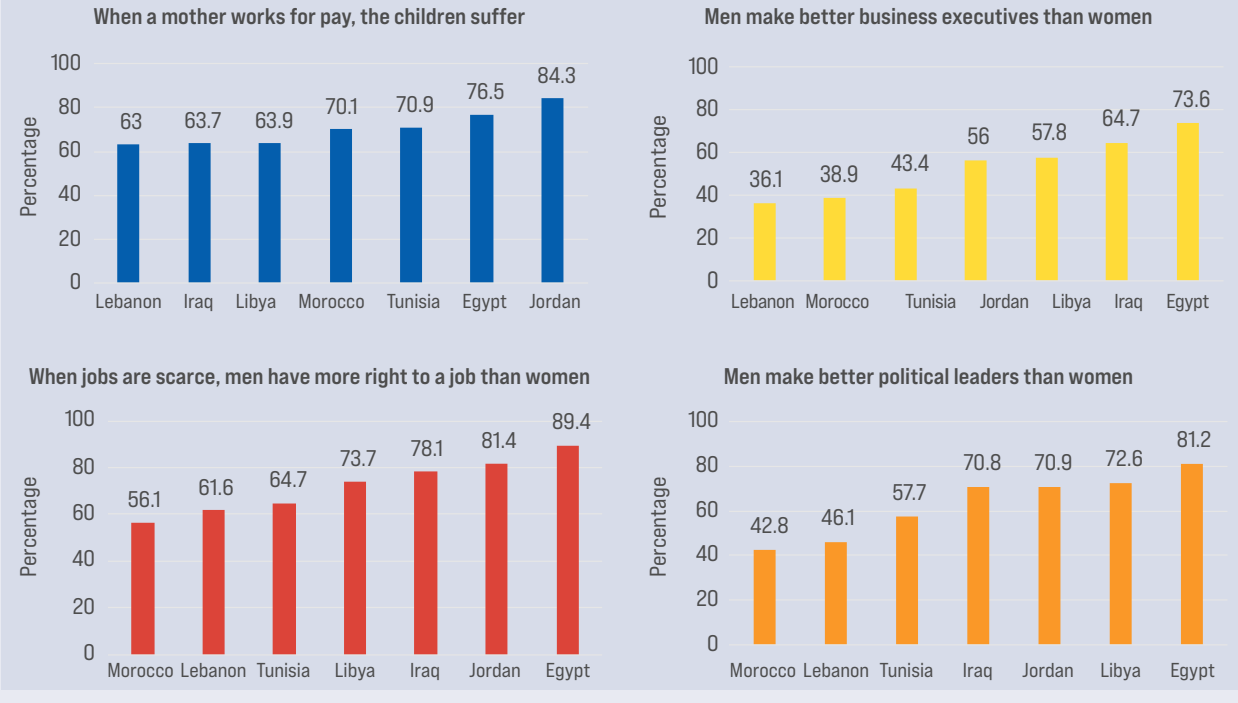
Selected indicators from the survey are integral to understanding gender roles and equality in the region. They encompass beliefs about working mothers, male superiority in business and political leadership, and gender-based job entitlement during scarcity. Each indicator sheds light on societal attitudes and helps gauge progress or regression in gender equality (figure 3C).

Analysis of survey data reveals a prevailing belief that when mothers work for pay, children suffer. The agreement rate ranges from 63 per cent in Iraq and Lebanon to a high of 84.3 per cent in Jordan, indicating a pervasive perception that a woman's primary role should be at home, caring for children. This belief can limit women's participation in the workforce and solidify traditional gender roles.

The belief in male superiority in business and political leadership is prevalent. Agreement with the notion that men are better business executives ranges from 36.1 per cent in Lebanon to a striking 73.6 per cent in Egypt. The belief in male political superiority ranges from 42.8 per cent in Morocco to 81.2 per cent in Egypt. These values echo patriarchal norms, perpetuating the glass ceiling effect and hindering women's progress in assuming leadership roles.

The conviction that men have more rights to a job than women when jobs are scarce further indicates entrenched gender inequality. Agreement with this notion reached 56.1 per cent in Morocco and an alarming 89.4 per cent in Egypt, further evidence that traditional gender roles where men are the primary earners continue to prevail.

Figure 3C Agreement in Arab countries on selected indicators from the World Values Survey, seventh wave, 2017-2022



Source: World Values Survey, seventh wave.

Source: World Values Survey, seventh wave, 2017-2022.

2. Informal employment

The prevalence of informality in the regional labour market presents a formidable challenge to economic development, with significant social implications. In 2022, the region's informal employment rate was 64.3 per cent, with a higher incidence among males of 66.2 per cent and a slightly lower rate for females of 55.7 per cent.[32] These figures underscore the pervasive nature of informal employment, often typified by substandard working conditions, diminished productivity and insufficient remuneration.

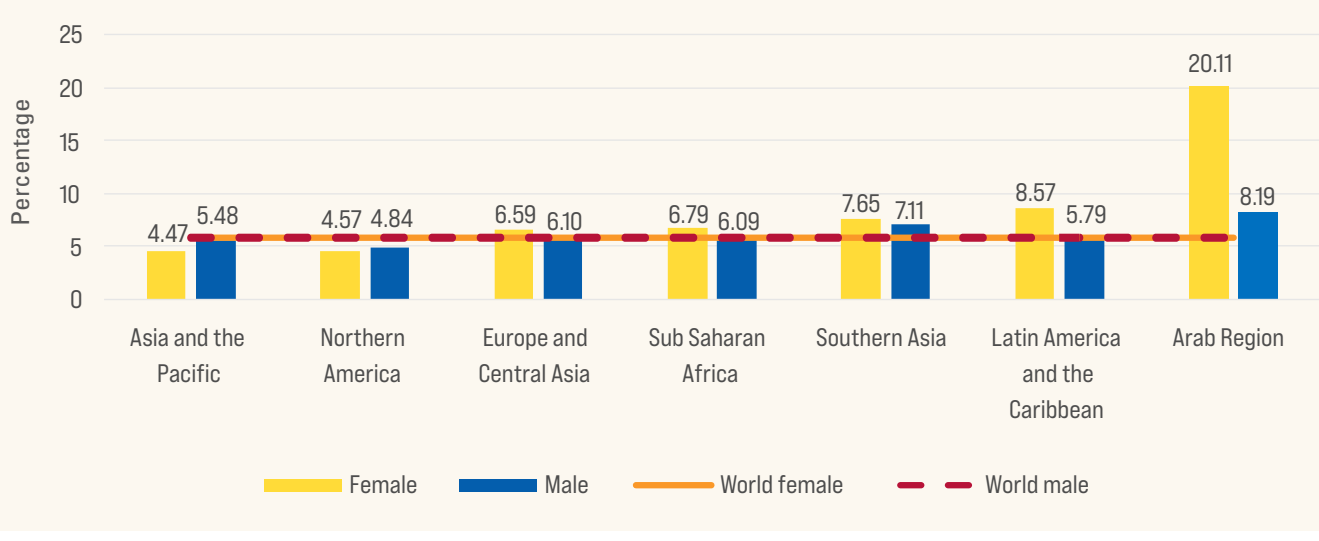
The social challenges associated with informality are manifold. Informal workers often face income inequality and an increased risk of poverty due to lower earnings and a lack of access to benefits. Job insecurity is prevalent, with irregular hours, uncertain income and the risk of sudden job loss. The absence of social protection measures leaves these workers vulnerable to shocks such as illness, injury or economic downturns. Poor working conditions are common, including long hours, unsafe environments, and a lack of access to training and career development opportunities. Informal workers may also have limited access to housing, education and health-care services, which are often tied to formal employment. Social exclusion is another consequence, as informal workers are marginalized and lack representation in decision-making processes.[33] Informality can exacerbate gender inequality by disproportionately clustering women in precarious and low-paid jobs, and contribute to child labour, as informal sectors often have less oversight and regulation.

3. Unemployment

Alarming unemployment levels in the Arab region are particularly acute among women (figure 3.9). The female unemployment rate in 2023 reached a regional high of 20.1 per cent, significantly outpacing the global average of 5.8 per cent. The male unemployment rate is 8.19 per cent, the highest rate globally and far above the global average of 5.7 per cent. The spectre of unemployment looms ominously large over the region's youth. International Labour Organization (ILO) modelled estimates indicate that unemployment among youths (aged 15 to 24) is a distressing 26.4 per cent, 22.2 per cent for male youths and 42 per cent for female youths. Both figures substantially exceed global averages, underscoring the urgent need to enhance youth employment prospects and mitigate the potential ramifications for social stability and economic prosperity.[34]

High unemployment rates largely stem from a confluence of demographic, economic, educational and sociopolitical factors. The region's significant "youth bulge", with a large proportion of the population under age 30, puts immense pressure on the job market as more young people enter the workforce each year. Economic stagnation, exacerbated by low oil prices, escalating conflicts and civil unrest, hampers job creation. A mismatch between job seekers' skills and employers' needs arises from deficiencies in education and training systems. Small and medium enterprises, which are crucial for job creation, face challenges such as limited access to finance and regulatory barriers that curtail their growth. Additionally, gender inequality results in low labour force participation rates among women. Addressing these multifaceted challenges calls for comprehensive policies that promote economic growth, enhance the quality of education and training, support the development of small and medium enterprises, and foster gender equality in the labour market (box 3.3).

Figure 3.9 Female and male unemployment rates, regional averages, 2023



Source: ILO modelled estimates, 2022.

Box 3.3 The ESCWA Skills Monitor: unveiling labour market dynamics in the Arab region

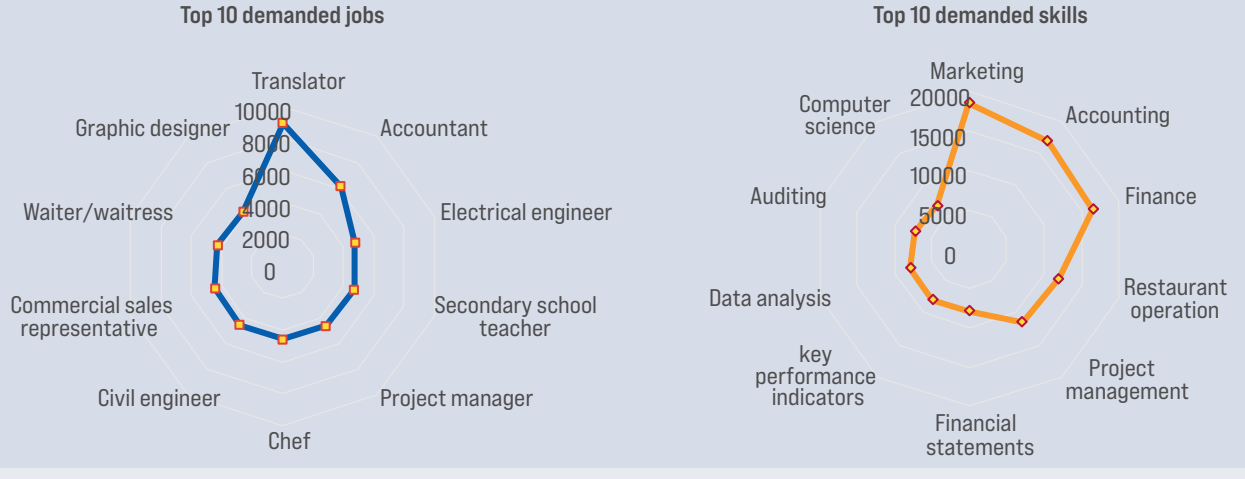
Launched by ESCWA, the Skills Monitor is a ground-breaking initiative that capitalizes on big data and machine learning to develop comprehensive understanding of the Arab region's labour market dynamics. Extracting real-time data from over 100 regional online job posting platforms, the initiative is equipped to observe and forecast job demand, evaluate the relevancy of a spectrum of skills and anticipate future employment trajectories. From January to June 2023, the Skills Monitor scrutinized 367,799 online job postings.

Analysis based on data compiled in the first two quarters of 2023 unveils a notable imbalance in labour market demand. The service and sales sectors saw surges in job demand, with jobs as translators, accountants, teachers, chefs, waiters, graphic designers and sales managers among the majority of the top 10 most sought positions (figure 3D). Demand continued to prevail for mechanical and electrical engineers.

The most coveted skills were in marketing, accounting, finance and restaurant operation. Although computer science and data analysis ranked among the top 10 most demanded skills, the region may be lagging in the Fourth Industrial Revolution. According to the World Economic Forum's Future of Jobs 2023 report, analytical thinking, creative thinking, artificial intelligence (AI) and big data will dominate global skills demand by 2027. Notably, skills most needed in the era of the AI revolution encompass those related to cloud computing, AI, sales leadership, analysis, translation, mobile app development, people management, video production, audio production, user experience (UX) design, search engine optimization and search engine marketing (SEO/SEM) and blockchain, among others.[a] This notable divergence between regional and global demand points to the importance of reskilling and aligning with evolving markets as many traditional jobs may potentially be lost.

An additional revelation is the gender bias in the many job postings that explicitly specify a preference for male candidates. Further, the data demonstrate a significant discrepancy between the percentage of job vacancies aimed at women versus those targeting men, across various levels. For example, at the entry level, only 24.5 per cent of job postings target women, compared to 35.5 per cent seeking men. This disparity widens to a stark contrast at the senior level, where only 18 per cent of vacancies target women versus a considerable 57 per cent aimed at men (figures 3E and 3F).

Figure 3D Most demanded jobs and skills in the first two quarters of 2023



Source: ESCWA Skills Monitor, 2023 data.

Note: Based on 367,799 online job postings analysed between January and June 2023.

These findings underscore ongoing gender discrimination in the labour market. It is imperative to rectify this imbalance and champion equal opportunities for both women and men, striving for a more diverse and balanced workforce. Gender discrimination otherwise will continue to exacerbate women's already high unemployment gap and low labour force participation rates.

Figure 3E Demanded seniority level by gender marker, 2023 (Percentage)

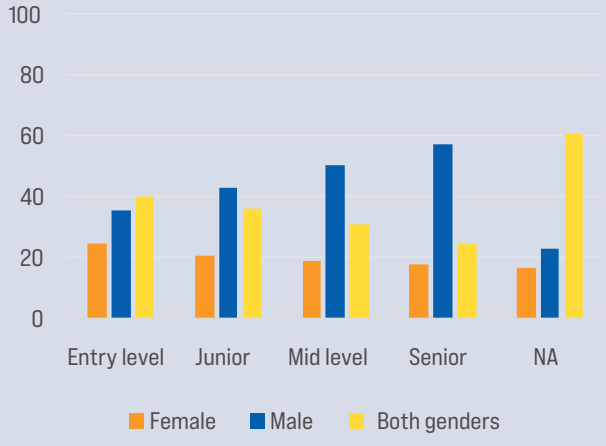
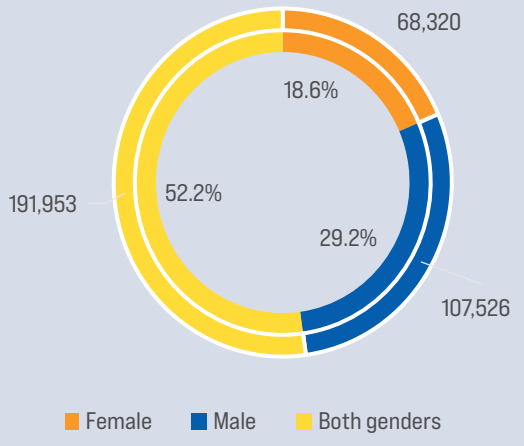


Figure 3F Job description by gender marker, 2023 (Percentage)



Source: ESCWA Skills Monitor, 2023 data.

Note: Based on 367,799 online job postings analysed between January and June 2023.

Source: ESCWA Skills Monitor, 2023 data.

[a] Birt, 2023.

4. Unemployment projections

The Arab region is anticipated to continue facing a high unemployment rate, with projections indicating a persistently elevated level. The overall regional rate is expected to be 11.6 per cent in 2023, among the highest rates globally. It is projected to decrease slightly to 11.5 per cent in 2024 (table 3.3).

The least developed countries face significant challenges in generating sufficient employment opportunities, resulting in a high unemployment rate of 17.1 per cent in 2023. There is a projected decline to 16.4 per cent in 2024, however. In conflict-affected countries, ongoing strife hinders economic diversification, restricting sufficient employment opportunities. The projected unemployment rate of 16.5 per cent in 2023 is expected to increase to 16.9 per cent in 2024.

Middle-income countries demonstrate comparatively better performance on unemployment. The projected rate for 2023 is 10.8 per cent, expected to decline gradually to 10.5 per cent in 2024. The GCC subregion exhibits the lowest unemployment rates in the region, with an expected 2023 unemployment rate of 5.1 per cent, slightly increasing to 5.4 per cent in 2024. The GCC countries have achieved job creation success by actively implementing national visions, structural reforms and economic diversification strategies. These efforts have facilitated growth in the private sector, attracted foreign investments and enhanced labour market efficiency.

Table 3.3 ESCWA unemployment rate projections, 2023–2024 (Percentage)

	2023	2024
Total Arab countries	**11.6**	**11.5**
Bahrain	1.0	0.6
Kuwait	2.9	4.0
Oman	4.3	4.1
Qatar	0.1	0.2
Saudi Arabia	5.1	5.2
United Arab Emirates	3.2	3.3
GCC countries	**5.1**	**5.4**
Algeria	15.3	15.9
Egypt	6.1	6.3
Jordan	21.9	21.0
Lebanon	28.4	27.6
Morocco	12.9	13.8
Tunisia	16.1	15.7
Middle-income countries	**10.8**	**10.5**
Yemen	12.6	13.1
Libya	19.7	19.5
Iraq	16.3	17.0
State of Palestine[a]	22.1	20.6
Syrian Arab Republic	21.5	21.3
Conflict-affected countries	**16.5**	**16.9**
Comoros	6.6	7.2
Djibouti	26.0	25.9
Mauritania	10.4	10.2
Somalia	19.2	19.1
Sudan	20.6	20.7
Least developed countries	**17.1**	**16.4**

Source: ESCWA projections based on the World Economic Forecasting Model.

a Figures for the State of Palestine do not account for the October 2023 war in Gaza.

Lebanon faces significant obstacles to socioeconomic development, primarily due to the prolonged crisis plaguing the country over the past four years. The COVID-19 pandemic and the devastating Beirut Port explosion in 2020 further exacerbated the situation. A challenging business environment makes it difficult for companies to operate efficiently, which in turn, hampers job creation and contributes to brain drain and youth emigration as Lebanese seek better opportunities elsewhere. The unemployment rate was approximately 29.6 per cent in 2022. Although projections indicate a slight decrease to 28.4 per cent in 2023 and 27.6 per cent in 2024, this is mainly due to a brain drain shrinking the labour force, not actual economic recovery.

Saudi Arabia has adopted an economic diversification strategy comprising various structural changes aimed at promoting the growth of the private sector, encouraging investment and tourism, attracting foreign capital and increasing exports across multiple industries. Notably, the Government has secured agreements amounting to $2.7

billion[35] to establish four investment funds dedicated to developing commercial, tourism and residential projects. These comprehensive reforms and strategies to stimulate investment and growth are projected to generate job opportunities and drive a decline in unemployment rates. In 2021, the unemployment rate in Saudi Arabia was 6.62 per cent, which subsequently decreased to 5.59 per cent in 2022. Projections indicate a further decline, reaching 5.1 per cent[36] in 2023 and 5.2 per cent in 2024.

In alignment with its national vision for 2030, Qatar has implemented structural reforms to bolster investment, with a particular focus on green financing and digitalization. Notable initiatives include the establishment of a sovereign financing framework by the Ministry of Finance; the creation of a dedicated department within the Qatar Central Bank to formulate environmental, social and governance policies; and partnerships forged by the investment promotion agency to expedite digital transformation and foster technological innovation through foreign direct investment. These strategic measures and reforms are expected to fuel economic growth, attract more investments and generate additional job prospects. Qatar exhibited a remarkably low unemployment rate of 0.1 per cent[37] in 2022; projections indicate that this rate will remain stable at 0.1 per cent in 2023 and rise modestly to 0.2 per cent in 2024.

The Palestinian economy remains exposed to significant vulnerabilities against a backdrop of sociopolitical instability. According to ILO data, in 2022, the national unemployment rate was 24.4 per cent, with projections indicating a gradual decline to 22.1 per cent in 2023 and further improvement to 20.6 per cent in 2024. However, following the eruption of the war on Gaza, unemployment rates are expected to increase significantly, and ESCWA estimates that in the Gaza strip, unemployment rate will reach at least 64 per cent,[38] while the unemployment rate in the West Bank is expected to increase.

Tunisia has encounte red a period of economic fragility following the onset of the pandemic, with a persistently sluggish performance. The Tunisian economy faced numerous barriers that hindered its progress such as the cumbersome regulations governing investment, trade and licenses, along with limited access to finance and an expanding public administration, causing the economy to struggle in generating sufficient job opportunities.[39] The unemployment rate in Tunisia was 15.2 per cent in 2022, with a slight increase to 16.1 per cent[40] in 2023. It is projected to reach 15.7 per cent in 2024. Addressing these high rates necessitates comprehensive measures to revive economic growth and restore confidence in the job market.

Box 3.4 The socioeconomic implications of water and food scarcity in the Arab region

In the Arab region, the intertwined challenges of ecology and climate are most evident when it comes to water and food security. A severe scarcity of clean drinking water plagues several countries, a situation that is even more alarming in the region's least developed countries, where access to essential drinking water hovers at just 60 per cent, and essential sanitation services reach only 40 per cent of people. This scarcity is echoed in dire food security numbers, with 116 million people being food insecure and 43 million undernourished, figures that skyrocket in conflict-affected areas. Complicating matters further is a contrasting health crisis: obesity. A staggering 115 million people in the region are obese, a phenomenon most prevalent in the GCC and middle-income countries.

The socioeconomic ramifications of these intertwined challenges are broad and complex. The scarcity of water and food not only threatens public health but also has a domino effect on agriculture and industry, leading to unemployment and economic downturns. This lack of resources hits marginalized communities the hardest, deepening existing social inequalities. Elevated levels of food insecurity and malnutrition, especially in conflict zones, perpetuate a cycle of poverty that hampers both social and economic advancement. At the same time, the obesity crisis in wealthier nations imposes a different but equally troubling strain on health-care systems. Collectively, these factors reveal a region in the tight grip of severe socioeconomic setbacks, primarily fuelled by environmental and climate challenges.

Source: ESCWA, 2020.

Egypt has positioned itself as a regional leader in implementing the 2030 Agenda through its sustainable development strategy, Vision 2030.[41] Challenges persist in the labour market, however, including a high reliance on informal and daily wage labour, especially in agriculture. Refugees in Egypt face difficulties in securing decent employment, often leading to informal sector jobs with low wages and long working hours. Egypt's unemployment rate was 7.2 per cent in 2022. It is projected to decline to 6.1 per cent in 2023 and then tip up to 6.3 per cent in 2024. Vision 2030 emphasizes empowering and protecting women as a crucial element of sustainable development. It sets a target to increase the female labour force participation rate to 35 per cent.[42]

The Sudan is currently embroiled in the conflict that began in April 2023. This is expected to further worsen the Sudanese economy, limit job opportunities, and accelerate brain drain and youth emigration. Urgent, comprehensive reforms and an immediate end to the conflict are necessary to address these concerns. The unemployment rate remains high and is projected to reach 20.6 per cent in 2023 and 20.7 per cent in 2024.

5. Internal displacement in the Arab region

The Arab region in 2023 faces numerous challenges related to internally displaced persons (IDPs), each shaped by a complex blend of factors such as armed conflict, natural disasters and economic hardships. The scale of internal displacement has escalated notably after the second quarter of 2023, with a majority of adverse events transpiring after July. The socioeconomic repercussions of these displacements are substantial and varied. Local labour markets face disruption, and infrastructure is stressed as communities grapple with the influx of displaced persons. In the Sudan, large-scale displacement has not only disturbed internal stability but also triggered significant outward migration. Yemen's displacement crisis is closely tied to its ongoing conflict, impacting both the economy and safety. Iraq is in a state of instability for IDPs, exhibiting both signs of hope and despair. Lebanon's geopolitical tensions further complicate the issue, while Morocco's natural disaster-induced displacement presents unique challenges in hard-to-reach mountainous areas. These scenarios often exacerbate existing social divisions, fostering a competitive environment for already scarce resources.

In Libya, the catastrophic Storm Daniel centred around the coastal city of Derna, which led to unprecedented flooding, displacing 43,421 individuals in September 2023.[43] This added to the 125,802 persons already displaced in Libya until April 2023.[44] The Sudan witnessed a massive displacement of 4,570,541 individuals (or 911,531 households) due to armed clashes, predominantly (68.44 per cent) in the capital, al-Khartoum. Additionally, 1,256,436 Sudanese migrated to neighbouring countries such as Chad, Egypt and Libya.[45] Iraq hosted 1,157,115 individual IDPs as at April 2023 but also saw 154,068 returnees, primarily in Mosul, Sinjar and Al-Ba'aj districts.[46] The IDP situation in Yemen includes 28,296 individuals (4,716 households) displaced in 2023, with 54 per cent attributing their displacement to economic reasons and the remaining 46 per cent to safety and security concerns. Morocco has 145,695 displaced individuals due to the 6.8-magnitude earthquake in September 2023.[47] Lebanon recorded 55,183 IDPs from 8 to 28 November 2023, due to Israeli aggressions on southern Lebanon.[48]

The humanitarian situation in Gaza deteriorated significantly in October 2023, marked by an alarming rise in the number of IDPs. Predominantly seeking refuge in schools operated by the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA), the IDPs sought shelter amid escalating conflict and heavy airstrikes. By 22 October 2023, UNRWA data revealed that at least 42 per cent (164,756) of all housing units in Gaza had either been destroyed or damaged since the onset of hostilities, contributing to mass displacement. Over 566,000 individuals were now seeking shelter in 148 UNRWA-designated emergency shelters, facing increasingly dire conditions.[49]

Given the scale and complexity of internal displacement in the Arab region, an urgent need for multi-pronged, coordinated strategies has arisen. These strategies should address both the unique and common challenges faced by each country, encompassing immediate humanitarian needs, economic resilience and social integration. Regional collaborations could be the linchpin in navigating this complex landscape, advocating for tailored and effective policy interventions. There is also an urgent need for humanitarian intervention in Gaza to alleviate the suffering of its beleaguered population and to work towards a durable solution to prevent the recurrence of such devastating crises in the future.

Assessing inflation policies in Arab countries

4

Key messages

- Inflation in Arab countries is partly imported due to exogenous factors, and partly endogenous, and has generated currency crises in some cases.
- Six Arab countries had high inflation rates in the past few years, namely, Egypt, Lebanon, the Sudan, the Syrian Arab Republic, Tunisia and Yemen.
- Based on variance decomposition, there are three main sources of inflation in the six Arab countries with high inflation rates: government expenditure, the money supply and nominal effective exchange rates (NEER).
- Coordinating different policies, including fiscal and monetary policies, is necessary during disinflation.
- Strengthening the independence of central banks is essential to enhancing the credibility of monetary policies.

A. Introduction

Arab countries are exposed to different shocks emanating from the openness of their economies and integration with the global financial system. In 2021 and 2022, they experienced accelerating inflation due to a number of factors, including supply chain disruptions resulting from the COVID-19 pandemic and the war in Ukraine, rising global energy and food prices, climbing interest rates, the pass-through of exchange rate depreciation on import prices, and the mismatch between supply and demand.

Sovereign debt levels remain high in many countries, representing a risk to economic recovery. The average debt-to-GDP ratio was over 84 per cent in 2022. In most countries, government spending and budget deficits rose alongside sovereign debt levels in 2021 and 2022, which affected prices and contributed to accelerating inflation. In fact, the increase in public spending augments the risk of excessive recourse to monetization to cover that spending, which leads to an even higher inflation rate. Higher inflation then makes it more likely that the monetary financing of government expenditure will continue and further accelerate inflation.

B. Inflation drivers: theoretical and empirical aspects

1. High inflation in Arab countries

The COVID-19 pandemic and the war in Ukraine were major shocks for several Arab countries with already difficult macroeconomic situations, particularly oil-importing countries, which suffered from high inflation and the depreciation of the NEER. Inflation did not follow the same path in all Arab countries. While several have managed to maintain low to moderate inflation rates since 2019, six countries have suffered from high inflation since 2020, namely Egypt, the Syrian Arab Republic, Tunisia and Yemen. Lebanon and the Sudan have struggled with very high inflation, which occurs when the 12-month inflation rate rises above 100 per cent and the cumulative inflation rate exceeds 100 per cent for three consecutive years (table 4.1).[50]

Although inflation in these countries has many economic causes, an unstable political context characterized by diverse social demands has played a significant role in the deterioration of public finances, the monetization of public deficits and the acceleration of inflation. The political context has also weakened institutions, rendering them unable to prevent the disorganization of distribution channels and limit price increases due to the imperfect matching of supply and demand. Both security and energy shocks have sapped investor confidence and negatively impacted domestic currency value, with a direct effect on prices.

In March 2023, inflation remained very high in Egypt. The annual urban consumer inflation rate was up by 32.7 per cent year-on-year. In 2022, Egypt had a series of currency devaluations that escalated prices and are likely to keep inflation high in 2023.

Very high inflation in Lebanon continued for the thirty-fifth straight month in April 2023, when triple-digit inflation reached a record 269 per cent. Inflation acceleration is affecting almost all consumer sectors, including food, transport, clothing, housing and utilities. Inflation is driven by a dramatic depreciation of the Lebanese pound, reflecting a lack of confidence in the financial system, large increases in the money supply, and the complex interplay of Banque du Liban circulars that have given rise to multiple exchange rates and speculative arbitrage. At the same time, a collapse in budget revenues has forced a drastic reduction in public spending and led to monetary financing of government expenditure, further fuelling inflation.

The Sudan has suffered from very high inflation since 2013. Inflation eased from 359.1 per cent in 2021 to 139 per cent in 2022 due largely to unifying exchange rates and reducing monetization of the fiscal deficit. The Central Bank adopted monetary base targeting, reducing growth in the money supply to 48 per cent in 2022 compared with 153 per cent in 2021. The political crisis, armed conflict between military forces and the persistence of the war in Ukraine, however, led to deterioration in the economic situation and a staggering loss in purchasing power in 2023.

Caught in a deep political crisis, the Syrian Arab Republic faces spiralling domestic inflation due to the devaluation of its national currency. This pushed the inflation rate to 78 per cent in 2021 and 66 per cent in 2022, and increased food prices by over 90 per cent. The global rise in food and fuel prices contributed to this acceleration in inflation and left a larger part of the population in a precarious situation, unable to cover subsistence needs.

In Tunisia, inflation rates have remained at moderate levels, but the national currency has undergone significant depreciation. Prices of food and energy have risen significantly. Since December 2022, the country has contended with double-digit inflation.

The political crisis in Yemen constitutes a risk to the country's macroeconomic position and poses challenges to achieving overall stability. Despite the recent decline in global food and fuel prices, domestic prices remain high, with food inflation averaging 45 per cent in 2022. The authorities have preserved a weekly foreign exchange auction system to finance essential imports at market exchange rates. This will constrain inflation and support exchange rate stability through the absorption of liquidity. The exchange rate and price stability depend on external aid to alleviate financing pressures and reduce monetary financing.

Table 4.1 Inflation rates (Percentage)

	2019	2020	2021	2022	2023[a]	2024[a]
Egypt	9.38	5.07	5.21	13.74	35.31	21.75
Lebanon	2.89	84.30	150.70	183.76	117.38	45.82
Sudan	51.00	153.60	359.80	164.12	55.53	26.00
Syrian Arab Republic	13.40	116.40	81.90	63.16	44.54	30.15
Tunisia	6.72	5.63	5.71	8.30	9.05	8.09
Yemen	12.01	23.10	45.69	42.60	19.92	9.55

Source: ESCWA projections based on the World Economic Forecasting Model for 2023.

[a] indicates forecasts.

2. Assessing the drivers of inflation

The following econometric analysis assesses the different sources of inflation in Arab countries that have experienced price spikes. It uses a combination of different economic approaches, given the complexity of inflation dynamics.

a. Some theoretical perspectives

Inflation has many causes and theories. The two main theories relate inflation to, first, increased aggregate demand (demand-pull inflation) and, second, to increased production costs (cost-push inflation).

Demand-pull inflation occurs when there is too much total spending in the economy compared to the amount of goods and services available. This excess demand can happen after the Government increases spending, or if consumption, investment or exports go up for other reasons. Under this theory, inflation is caused by aggregate demand growing faster than what aggregate supply can accommodate.

The theory of cost-push inflation relates to situations where prices increase because the costs of making goods and providing services increase. Increased production costs are mainly driven by increases in wages. This occurs when the demand for labour exceeds supply. Other factors that drive up costs relate to the costs of borrowing money, paying taxes and buying goods from other countries.

It is difficult to distinguish between the various determinants of inflation, whether cost- or demand-driven. This suggests that there are some interactions between these determinants, or that price movements involve different drivers of inflation. Nevertheless, inflation has six major dimensions: energy prices, trade openness and capital accounts, imported inflation, government spending, the exchange rate pass-through and the money supply.

Energy prices (exogenous shock): The price of energy is often considered an exogenous shock for net importers of natural resources. It is assumed that energy prices are subject to strong temporary variations, and an increase in their price will spread widely to the prices of other goods. Higher energy prices increase production costs and amplify inflationary pressures.

Trade openness and the role of capital accounts: Trade openness is anticipated to impact domestic inflation through two channels: trade and the capital account. This impact is driven by a couple of mechanisms. First, it reduces costs due to heightened market competition, and second, it enhances factor productivity, thereby reducing overall costs and prices. Conversely, the openness of capital accounts prompts enhancements in the economic structure, encompassing monetary policies focused on monetary stability, greater fiscal responsibility and the increased credibility of the central bank.

The influence of imported inflation: An extensive literature stresses the predominant effect of global inflation on domestic inflation.[51] When the prices of imported goods increase because of global inflation, this also affects domestic inflation, since imported goods are used as inputs or consumed by local producers and consumers. As a result, the costs of production and consumption increase, leading to a persistent rise in domestic prices. This effect is pronounced for Arab countries since they rely heavily on imported raw materials and products.

The contribution of government expenditures to inflation: Domestic price dynamics are likely to be influenced by cyclical regulatory policies that aim to boost economic activity and reduce unemployment through a larger budget deficit. In this case, the idea is to exploit a negative relationship between inflation and unemployment through the monetization of public deficit.

Another key factor is the exchange rate pass-through since a depreciation in the NEER will likely increase prices. Lastly, according to monetary theory, a higher monetary base can cause more inflation, hence the impact of the money supply on inflation.

b. Decomposition of inflation and its volatility

The diverse factors influencing inflation trends require paying attention to all variables that could influence movements in the general price level. The following discussion identifies the various drivers of inflation in Arab countries that have experienced high rates of inflation. Given that these drivers are interrelated and depend on the economic policy adopted (monetary, fiscal, trade and industrial), it is useful to apply a structural vector autoregression (SVAR)-type model. This model helps to capture the responses of system variables to identified (given) structural shocks; assess the average share of a given structural shock in the dynamics (variation) of the variables using the forecast error variance decomposition; and assess the cumulative share of a given shock in the dynamics of each model variable over a period of time, using historical decompositions. The variance in inflation can be decomposed to provide an appropriate framework for the contribution of different inflation components to fluctuations in the CPI.

For the following analysis of the six countries with high rates of inflation, all variables were expressed in natural logarithms. Unit root tests were performed for level and first differences. The optimal number of lags was also tested. Lagrange multiplier tests for residual vector autoregression serial correlation and tests for residual vector autoregression normality were carried out. Finally, the long-run SVAR specification was estimated.

1. The case of Egypt

A recurrence of double-digit inflation began in 2022 in Egypt and is expected to reach 35 per cent in 2023. Figure 4.1 illustrates the dynamics of inflation and growth in the NEER, indicating a co-movement from 2019 to 2022. During this period, the national currency followed a managed devaluation reflecting the monetary authorities' commitment to maintaining a competitive advantage. The rapid rise in inflation has been accompanied by a considerable depreciation of the NEER, from 40 per cent in 2022 against an appreciation of 7 per cent in 2021.

Figure 4.2 shows the co-movement between the CPI and the price of a barrel of oil. Estimates suggest that energy prices are making only a minor contribution to the acceleration in inflation (table 4.2). Public energy subsidies have served as a buffer against fluctuations in energy prices.

Figure 4.1 Nominal effective exchange rate and inflation trends in Egypt

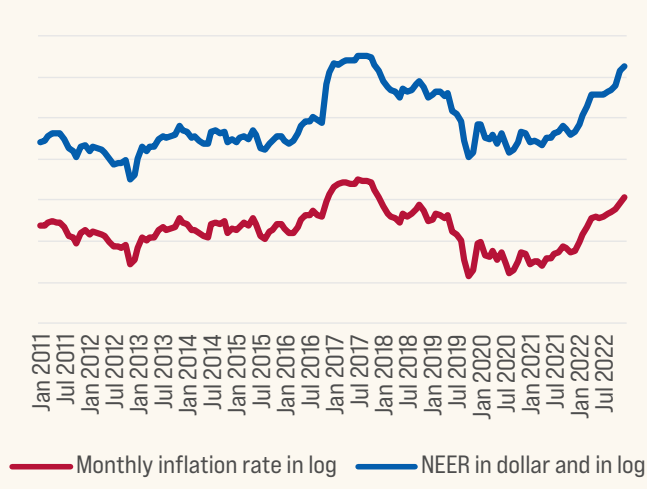
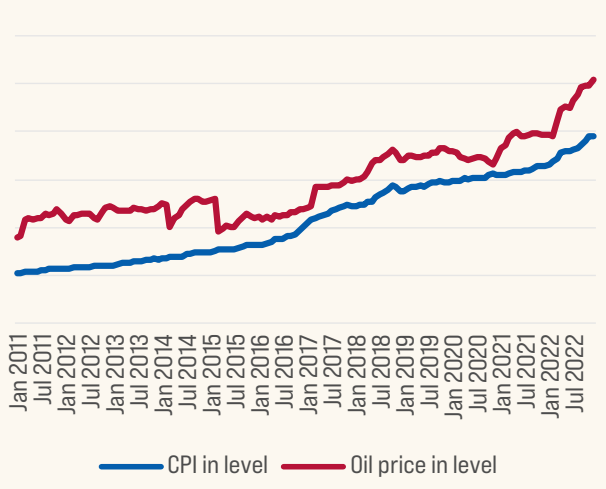


Figure 4.2 Inflation and oil price trends in Egypt



Source: ESCWA calculations.

Table 4.2 Decomposition of inflation variance in Egypt

	Three months (percentage)	Six months (percentage)	One year (percentage)	Two years (percentage)
Government expenditure	2.97	6.07	6.12	6.12
Money supply (M2)[a]	3.56	3.45	3.45	3.45
NEER	30.43	29.53	29.51	29.51
Import price index	5.75	5.93	5.95	5.95
International energy prices (price of a barrel of oil)	1.88	1.83	1.83	1.83
CPI	55.38	53.16	53.11	53.11

Source: ESCWA calculations.

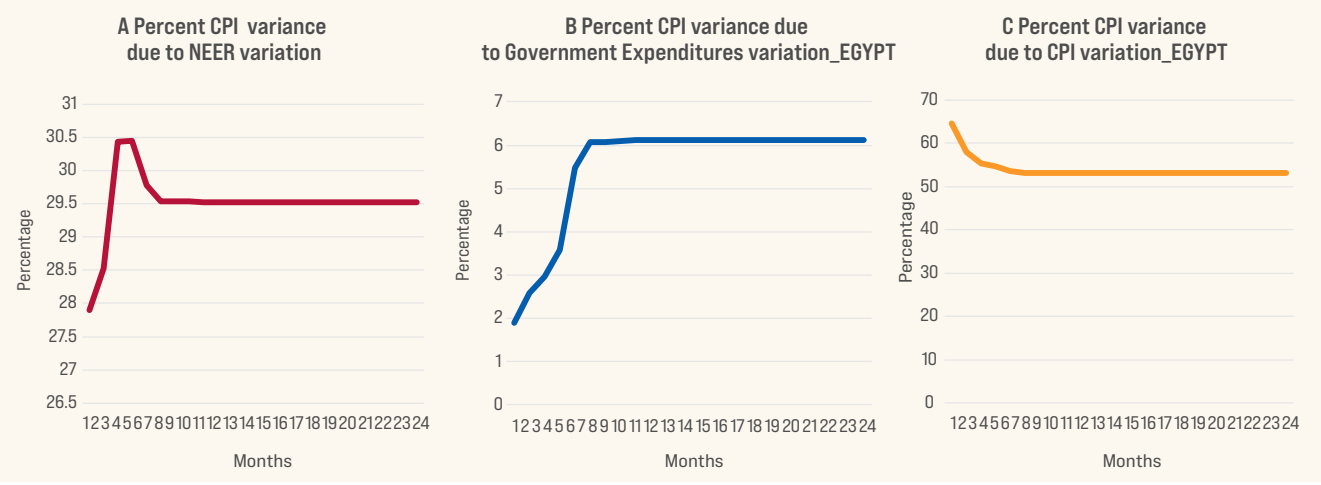
[a] M2 is a measure of the money supply that includes cash, checking deposits and other types of deposits that are readily convertible to cash.

The variance decomposition shows three main sources of inflation in Egypt (table 4.2). Over a 24-month time horizon, there is evidence of the importance of the NEER (29.5 per cent), public spending (6.12 per cent) and imported inflation (6 per cent). A form of inertia in inflation that occurs when the current price level depends on the price level of the previous period also contributes to inflation (53.1 per cent). Due to rigidities, what initially appears as a temporary price increase becomes permanent and structural.

Figures 4.3A, 4.3B and 4.3C show the reaction delays of the price level to changes in some sources of inflation in Egypt. The price level is affected rapidly at three months by changes in the NEER, but public spending takes longer to affect inflation at around six months. Figure 4.3C shows that inflationary inertia has tended to decrease but remains high.

Egypt's inflation dynamics seem partly associated with the nature of the floating exchange rate regime it has adopted. This regime is less flexible, with Egypt effectively maintaining an exchange rate anchored to the dollar fluctuation.

Figure 4.3 Reaction delays of the price levels to main sources of inflation in Egypt



Source: ESCWA calculations.

Figure 4.4 Nominal effective exchange rate and inflation trends in Lebanon

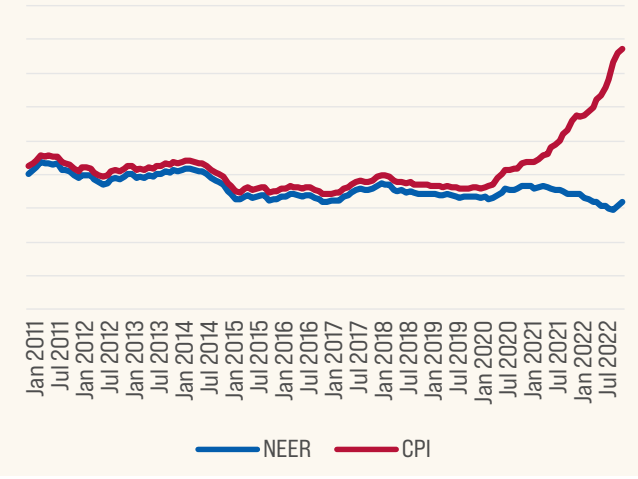
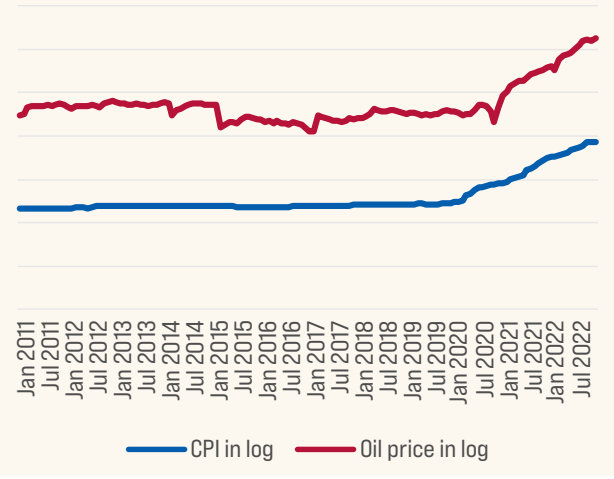


Figure 4.5 Oil price and inflation in trends in Lebanon



Source: ESCWA calculations.

2. The case of Lebanon

The evolution of inflation is very interesting to analyse in Lebanon. According to figure 4.4, there is no correlation between inflation and NEER trends in Lebanon. This might seem counterintuitive in a country affected by very high inflation. But the country context and the atypical Lebanese foreign exchange market with its multiple exchange rates must be considered. In addition to the revised official exchange rate of LBP 15,000 per dollar, other rates include the customs dollar exchange rate of LBP 86,000 per dollar to pay for customs fees for imported goods, the Sayrafa rate at around LBP 85,500 per dollar used by commercial banks and foreign exchange dealers, and the informal black-market rate of around LBP 89,600 per dollar as at September 2023.

This context explains the disconnection between the official exchange rate (for which a statistical series is available) and inflation acceleration (figure 4.4). Figure 4.5 illustrates the dynamics of inflation and the price of a barrel of oil in Lebanon, showing co-movement between the two variables from February 2021 to 2022.

The variance decomposition indicates the main sources of inflation in Lebanon (table 4.3). Over a 24-month time horizon, these comprise government expenditures (36.96 per cent), imported inflation (28.27 per cent), international energy prices (10.21 per cent) and the money supply (9.87 per cent). The modest contribution of the NEER (3.08 per cent) is due to the specifications of the estimated model, which considers only the official exchange rate and does not reflect the market value of the Lebanese lira (up to December 2022, the official exchange rate was LBP 1,507 per dollar). Similarly, the estimation does not cover the 2023 period and the decision to sharply devalue the national currency to a new official rate of LBP 15,000 per dollar. The results in table 4.3 should be treated with a degree of caution. In general, government expenditure, imported inflation and money creation processes have contributed strongly to accelerated inflation.

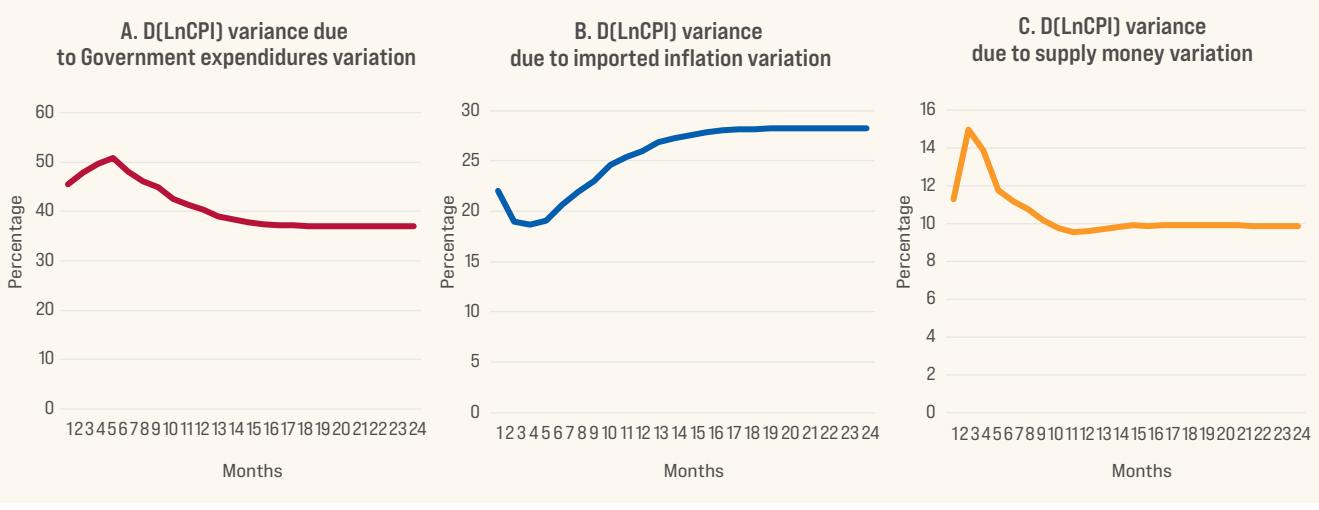
Figures 4.6A and 4.6C show the delays in the reaction of the price level to changes in major sources of inflation in Lebanon. The price level responds instantly (one month) to any changes in the money supply, represented by M2. Public spending contributes gradually to increasing inflation at six months. Inflation shows no form of inertia, which seems to be specific to the case of Lebanon. In other words, inflation is less dependent on past inflation, with a contribution of only 11.58 per cent, as shown in figure 4.6B. This indicates that current inflation trends react more to expected inflation than to previous inflation. In addition, current inflation is increasingly dependent on inflation anticipation. To protect themselves against very high inflation, economic agents will set prices on the basis of inflation expectations.

Table 4.3 Decomposition of inflation variance in Lebanon

	Three months (percentage)	Six months (percentage)	One year (age)	Two years (percentage)
Government expenditure	49.65	46.06	38.31	36.96
Money supply (M2)	13.87	10.72	9.79	9.87
NEER	5.68	3.92	3.16	3.08
International energy prices (price of a barrel of oil)	2.52	6.63	9.52	10.21
Import price index	18.62	21.95	27.24	28.27
CPI	9.65	10.70	11.95	11.58

Source: ESCWA calculations.

Figure 4.6 Reaction delays of the price levels to main sources of inflation in Lebanon



Source: ESCWA calculations.

Earlier in 2023, the Lebanese monetary authority described the new official exchange rate as a step towards unifying the wide range of rates that have emerged since 2019. In parallel, and with the collapse of the Lebanese currency, the price inflation rate reached a new record, with an increase of 366 per cent between March 2022 and March 2023. This very high inflation could be attributed to the rising cost of energy, which climbed by 2,068 per cent during the same period. Food prices rose by triple digits, or 320.3 per cent, due to a decision to "dollarize" commodity prices in response to requests from retailers and importers.

3. The case of Yemen

Analysis of inflation in Yemen focuses on areas controlled by the internationally recognized Government. The exchange rate is a key determinant of food prices due to a high dependence on imports. As shown in figure 4.7, inflation and the NEER follow a similar trajectory, although inflation is increasing more rapidly. The NEER shows a relatively long-term trend of stability in the local exchange market. The 4 per cent currency depreciation announced by the monetary authority in January 2023 to address gaps in government revenue, however, affected inflation in general and food price inflation in particular. Figure 4.8 shows the co-movement of inflation and fuel prices over time, indicating that the price of energy is one of the main drivers of inflation. The NEER is the other driver.

The variance decomposition over a 24-month period shows the roles of the international price of energy, the money supply, imported inflation and the NEER in driving inflation, with respective contributions of 22.19 per cent, 8.47 per cent, 8.20 per cent and 4.94 per cent (table 4.4). The money supply, represented by M2, makes a significant contribution, having reached a record level in June 2023 of 11,218 million Yemeni riyals compared to 7,273 million Yemeni riyals in June 2022, an increase of 55 per cent. As in other countries, previous inflation contributes greatly to current inflation at 55.4 per cent due to inertia in price formation. The high contribution of international oil prices is confirmed by practical experience, where weak oil production affects domestic prices. In addition, limited export capacity and declining international aid have spurred a shortage of foreign exchange that has affected the NEER and domestic prices.

Figure 4.7 Nominal exchange rate and inflation trends in Yemen

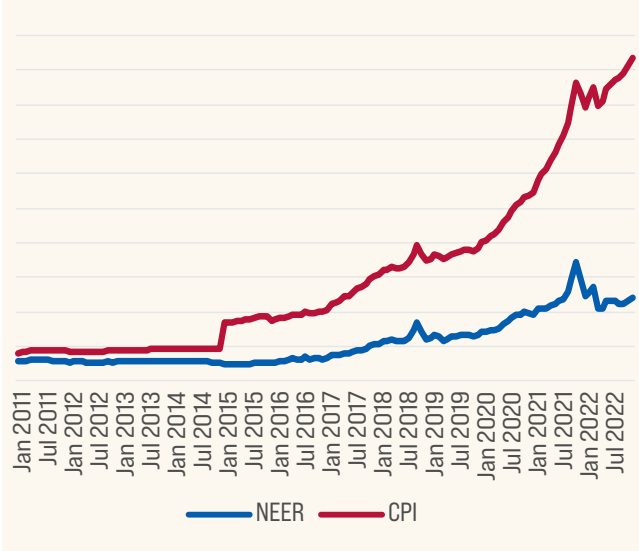
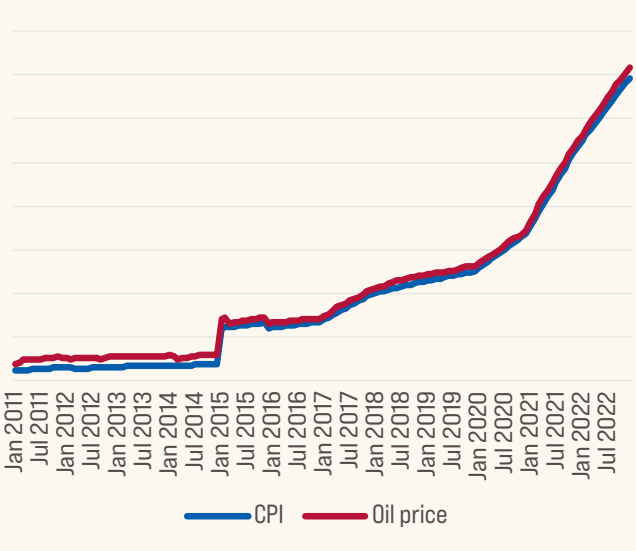


Figure 4.8 Oil price and consumer price index trends in Yemen



Source: ESCWA calculations

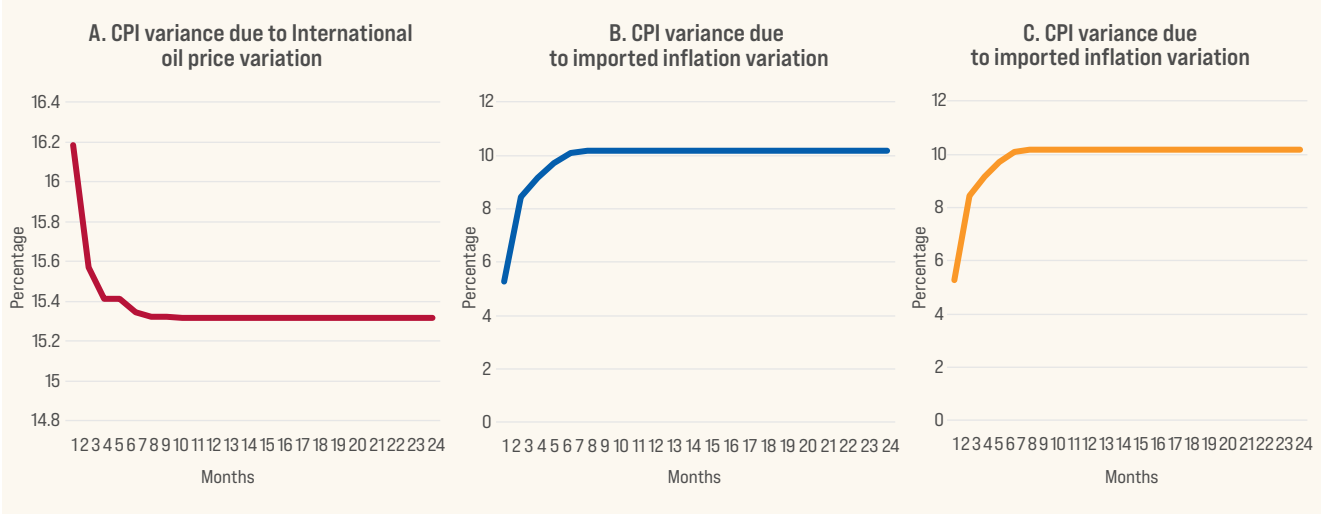
Figures 4.9A, 4.9B and 4.9C show the price adjustment dynamics in each change in the main inflation drivers in Yemen. The price level responds instantly (one month) to any change in international oil prices. Price level reacts with a lag (five months) to changes in the money supply and also to changes in imported inflation. Finally, the NEER gradually contributes to rising inflation (five months).

Table 4.4 Decomposition of inflation variance in Yemen

	Three months (percentage)	Six months (percentage)	One year (percentage)	Two years (percentage)
Government expenditure	0.70	0.77	0.77	0.77
Money supply (M2)	8.60	8.47	8.47	8.47
NEER	4.33	4.92	4.94	4.94
Import price index	7.83	8.20	8.20	8.20
International energy prices (price of a barrel of oil)	22.33	22.19	22.19	22.19
CPI	56.18	55.41	55.40	55.40

Source: ESCWA calculations.

Figure 4.9 Reaction delays of the price levels to main sources of inflation in Yemen



Source: ESCWA calculations.

4. The case of the Sudan

Figure 4.10 illustrates the dynamics of inflation and the NEER in the Sudan, showing a co-movement from 2017 to 2022. The depreciation of the domestic currency appears to be faster and stronger than that of the CPI. The depreciation of the NEER has been accompanied by a fairly fast rise in inflation. Figure 4.11 shows the same trend in the joint evolution of inflation and energy prices, with a partial co-movement between CPI and the price of a barrel of oil.

Figure 4.10 Nominal effective exchange rate and inflation trends in the Sudan

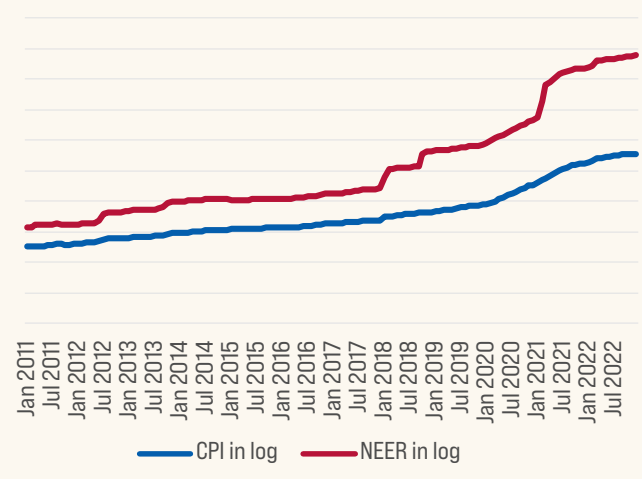
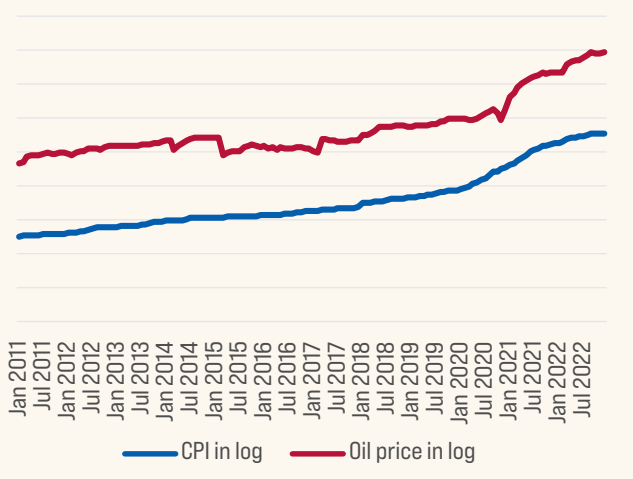
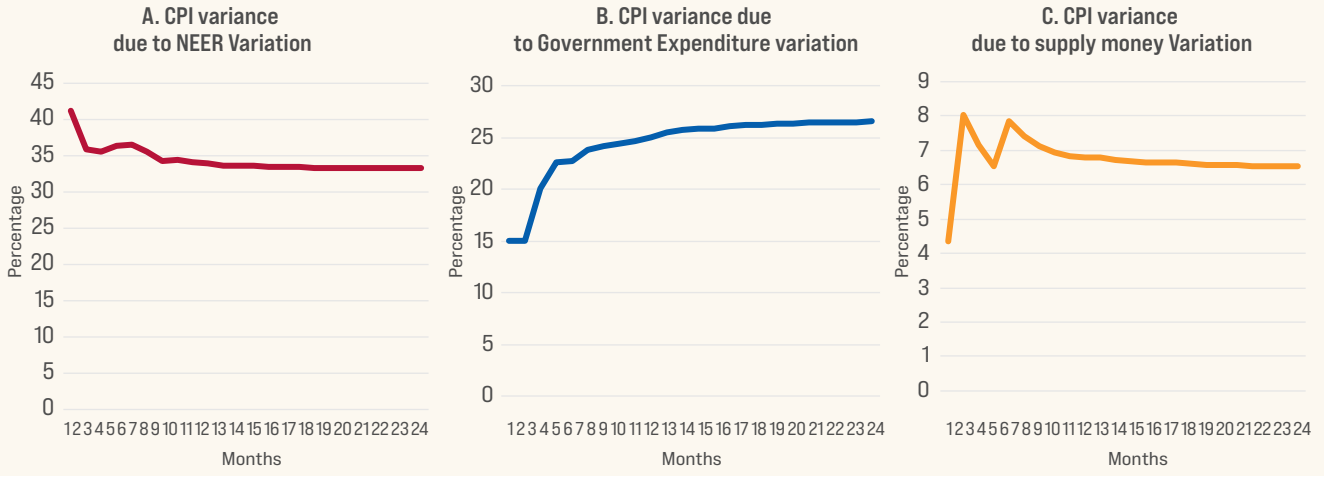


Figure 4.11 Oil price and inflation trends in the Sudan



Source: ESCWA calculations.

Figure 4.12 Reaction delays of the price levels to main sources of inflation in the Sudan



Source: ESCWA calculations.

Table 4.5 Decomposition of inflation variance in the Sudan

	Three months (percentage)	Six months (percentage)	One year (percentage)	Two years (percentage)
Government expenditure	20.13	23.78	25.70	26.55
Money supply (M2)	7.16	7.41	6.71	6.53
NEER	35.51	35.64	33.62	33.26
Import price index	7.72	6.51%	6.47	6.11
International energy prices (price of a barrel of oil)	0.31	0.71	0.99	0.94
CPI	29.15	25.93	26.48	26.59%

Source: ESCWA calculations.

The NEER, government expenditure, money supply and imported inflation constitute the four drivers of inflation in the Sudan, making respective contributions of 33.26 per cent, 26.55 per cent, 6.53 per cent and 6.11 per cent (table 4.5). The NEER and government expenditure seem to contribute more to increased inflation. Nevertheless, imported inflation and the money supply contribute equally to rising inflation. Current inflation is slightly influenced by past inflation, indicating a low degree of inflation inertia (26.59 per cent), as is also observed in high-inflation countries such as Lebanon.

Figures 4.12A, 4.12B and 4.12C show response times to a change in the main drivers of inflation. The CPI reacts immediately to changes in the NEER, but the degree of adjustment is less important after eight months. The effect of the NEER tends to be stable and permanent. There is approximately the same reaction of prices to any change in government expenditure. The degree of adjustment is more important after four months when the CPI reacts immediately to money supply.

5. The case of the Syrian Arab Republic

The Syrian pound has undergone significant depreciation since 2020, which affected the inflation rate. There is a strong correlation and co-movement in the evolution of these two variables, but the exchange rate pass-through is not total and price movements partially incorporate exchange rate variations (figure 4.13). Figure 4.14 illustrates the dynamics of inflation and price of a barrel of oil, showing a perfect co-movement between the two. The global economic situation in 2023 is uncertain and could push commodity prices even higher, negatively affecting inflation in the Syrian Arab Republic as a food and energy importer.

Due to the unavailability of sufficient statistical data, the estimated model does not include the money supply as an inflation driver. Estimates should be interpreted with caution but suggest that imported inflation (12.01 per cent), government expenditures (7.62 per cent) and the NEER (84 per cent) constitute the three main drivers of inflation in the Syrian Arab Republic over a 24-month horizon (table 4.6). With a contribution of only 0.27 per cent over the same period, international energy prices appear to be a relatively marginal factor. As in other Arab countries that are net importers of oil, this result is due to high expenditure on energy subsidies. Similarly, current inflation is strongly affected by previous inflation over the 24-month horizon.

Figure 4.13 Consumer price index and nominal effective exchange rate trends in the Syrian Arab Republic

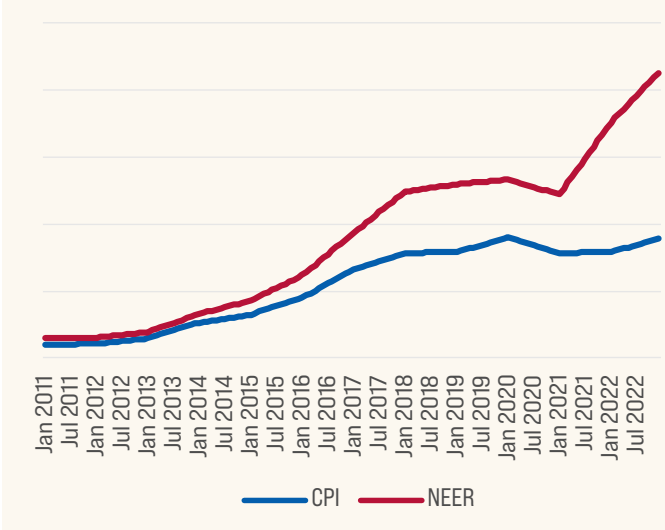
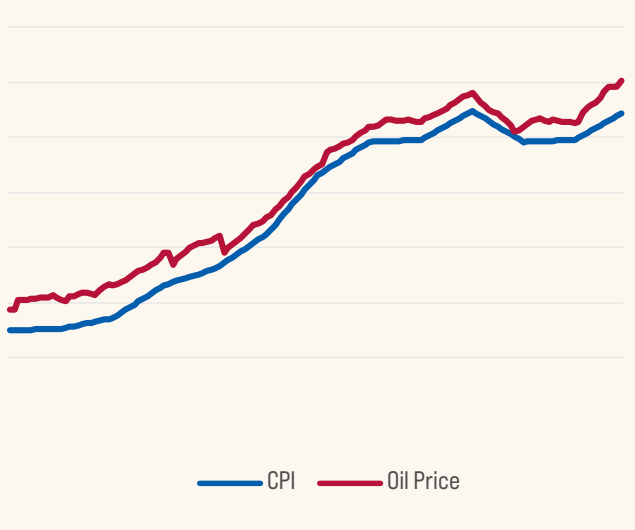


Figure 4.14 Consumer price index and oil price trends in the Syrian Arab Republic



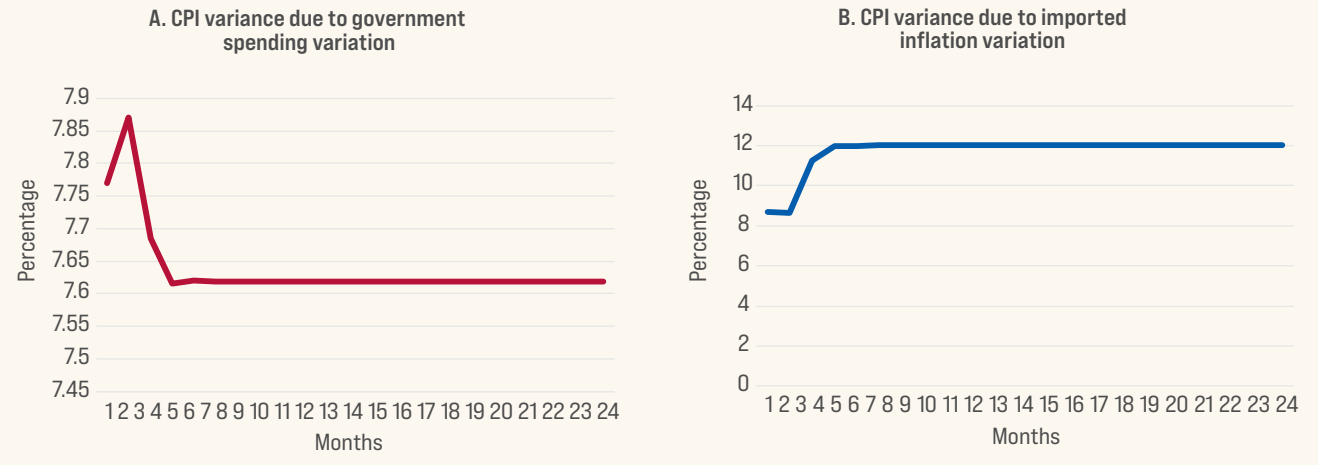
Source: ESCWA calculations.

Table 4.6 Decomposition of inflation variance in the Syrian Arab Republic

	Three months (percentage)	Six months (percentage)	One year (age)	Two years (percentage)
Government expenditure	7.68	7.61	7.62	7.62
Money supply (M2)	--	--	--	--
NEER	3.83	3.84	3.84	3.84
import price index	11.24	12.00	12.01	12.01
International energy prices (price of a barrel of oil)	0.24	0.27	0.27	0.27
CPI	76.99	76.26	76.25	76.25

Source: ESCWA calculations.

Figure 4.15 Reaction delays of the price levels to main sources of inflation in the Syrian Arab Republic



Source: ESCWA calculations.

In terms of response times to changes in inflation drivers, CPI instantly responds to shifts in government expenditure, in less than one month. Imported inflation takes four months to impact CPI (figures 4.15A and 4.15B).

6. The case of Tunisia

Since 2011, the Tunisian dinar has been continuously depreciating (figure 4.16), which has had an impact on the inflation rate. There is a strong correlation in the evolution of these two variables, with a full pass-through of the exchange rate, in which NEER fluctuations are incorporated in the movement of prices. On the other hand, figure 4.17 shows the dynamics of the inflation rate and the price of a barrel of oil. Public expenditure on energy subsidies has largely mitigated the impact of global oil price increases on domestic price levels. These subsidies significantly increase government expenditures.

Figure 4.18 shows that the real and effective exchange rate started to appreciate from 2019. This contributed to Tunisia's non-price competitiveness. The current account gap and the related overvaluation of the real and effective exchange rate are mainly caused by a fiscal deficit. According to econometric estimates, however, government expenditure, the money supply, the NEER and imported inflation are the four main drivers of inflation in Tunisia, with respective contributions, over a 24-month period, of 12.02 per cent, 7.50 per cent, 7.32 per cent and 5.56 per cent (table 4.7). Current inflation is strongly affected by previous inflation, indicating high inflation inertia, as observed in several Arab countries. International energy prices do not have an impact on price increases, according to the econometric estimation, since energy subsidies mitigate the impact on domestic prices of volatility in energy prices in the international market. Since inflation in Tunisia is influenced by multiple factors, a multidimensional approach must be adopted to limit inflation.

Figure 4.16 Consumer price index and nominal effective exchange rate trends in Tunisia

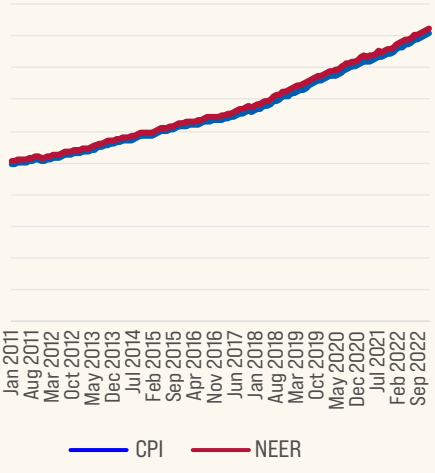


Figure 4.17 Consumer price index and oil price trends in Tunisia

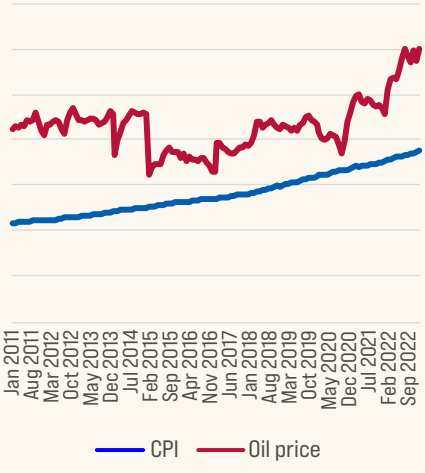
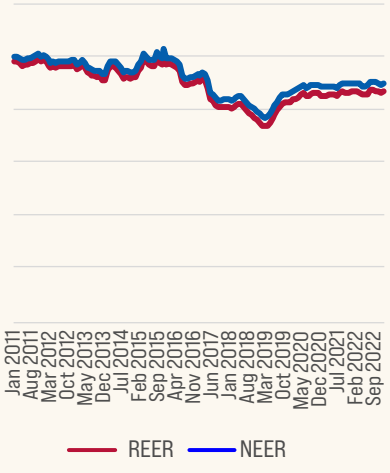
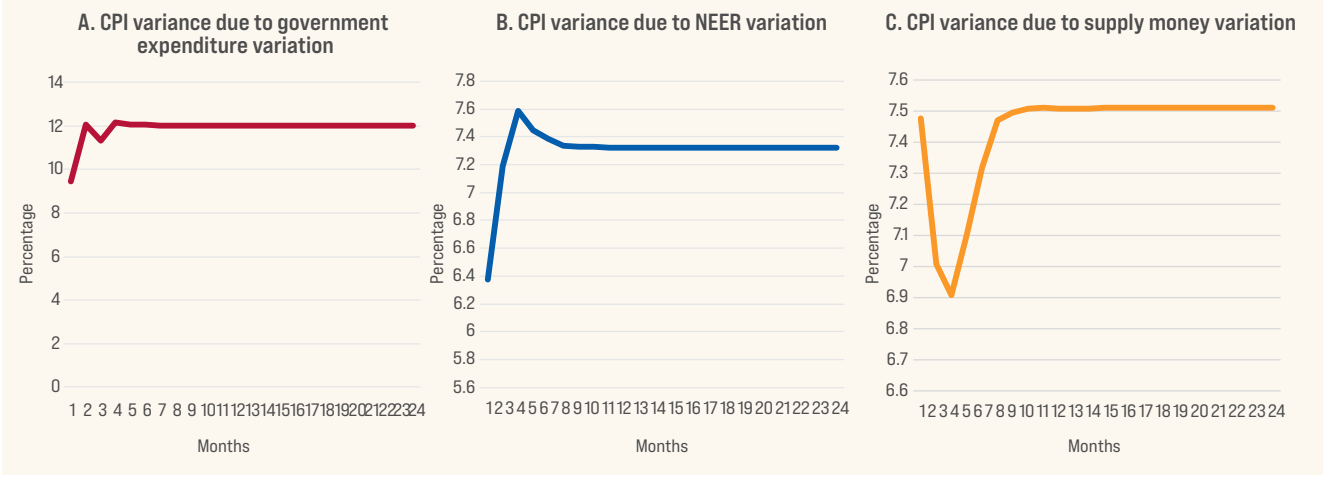


Figure 4.18 Real and nominal exchange rate trends in Tunisia



Source: ESCWA calculations.

Figure 4.19 Reaction delays of the price levels to main sources of inflation in Tunisia



Source: ESCWA calculations.

Table 4.7 Decomposition of inflation variance in Tunisia

	Three months (percentage)	Six months (percentage)	One year (percentage)	Two years (percentage)
Government expenditure	11.32	12.04	12.02	12.02
Money supply (M2)	6.90	7.47	7.50	7.50
NEER	7.58	7.34	7.32	7.32
Import price index	5.56	5.57	5.56	5.56
International energy prices (price of a barrel of oil)	0.68	1.01	1.10	1.10
CPI	67.93	66.55	66.47	66.47

Source: ESCWA calculations.

Figures 4.19A, 4.19B and 4.19C illustrate the inflation response times to a change in inflation drivers. CPI instantly responds to changes in government expenditure and the money supply, within three months. CPI reacts slowly to changes in the NEER, within six months. International energy prices (the price of a barrel of oil) and imported inflation also impact inflation, slightly, with six-months delays.

7. Summary of results

Table 4.8 shows the main inflation drivers of high inflation in the six selected countries over a 24-month period. Government expenditure represents the most significant driver. It makes the highest contribution in Lebanon at 36.96 per cent, followed by the Sudan at 26.55 per cent and Tunisia at 12.02 per cent. The second largest driver is the money supply. It makes the highest contribution in Lebanon at 9.87 per cent, followed by Yemen and Tunisia at 8.47 and at 7.50 per cent, respectively. The contribution is lower in the Sudan at 6.53 per cent.

The NEER is a source of inflation in most countries but to a lesser degree. It makes the highest contribution in the Sudan at 33.26 per cent, followed by Egypt at 29.51 per cent. In Tunisia, the contribution is relatively low at 7.32 per cent. In some countries, such as Egypt and Tunisia, changes in international oil prices are not a significant source of inflation. This is easily explained by the level of public expenditure on energy subsidies in these countries. Changes in international oil prices made the highest contribution to inflation in Yemen at 22.19 per cent, followed by the Syrian Arab Republic at 12.01 per cent and Lebanon at 10.21 per cent.

Inflation inertia is significant in most high-inflation countries, except for Lebanon at 11.58 per cent and, to a lesser extent, the Sudan at 26.59 per cent. The Syrian Arab Republic shows the highest inflation inertia at 76.25 per cent, followed by Tunisia at 66.47 per cent, Egypt at 53.11 per cent and Yemen at 55.40 per cent.

In sum, for the six Arab countries with high inflation rates, the main sources of inflation are government expenditure, money supply and NEER. A certain inflation inertia is evident and indicates a high degree of downward price stickiness. Implementation of effective disinflation policies should consider the determinants of the most relevant inflation drivers in each country, as analysed above.

Table 4.8 Decomposition of inflation variance: a summary of the main results over a 24-month horizon

	Egypt	Tunisia	Lebanon	Sudan	Syrian Arab Republic	Yemen	Average for Arab countries
Government expenditure	6.12%	12.02%	36.96%	26.55%	7.62%	--	17.85%
Money supply (M2)	--	7.50%	9.87%	6.53%	--	8.47%	7.97%
NEER	29.51%	7.32%	--	33.26%	--	4.94%	23.36%
International energy prices (price of a barrel of oil)	--	--	10.21%	6.11%	12.01%	22.19%	9.44%
Import price index	--	--	28.27%	--	--	8.20%	28.27%
CPI	53.11%	66.47%	11.58%	26.59%	76.25%	55.40%	46.80%
Number of inflation drivers	2	3	4	4	2	4	3

Source: ESCWA calculations.

C. Disinflation policies

Inflation is an important macroeconomic indicator. It affects all economic actors, households and enterprises. In addition, it can erode consumer purchasing power when wages are not indexed to changes in prices. It has more harmful distributional effects on the most vulnerable communities. Inflation stems from several causes, which may be cumulative,

including an overall increase in production costs, rapid increases in demand, significant money creation or a lack of competition. While the current rise in inflation was initially driven by the sudden upturn in aggregate demand following the COVID-19 health crisis, other causes have included increased production costs following the rise in energy prices after the outbreak of the war in Ukraine.

Table 4.9 provides an overview of the types of policies applied to contain inflation in oil-importing Arab countries since February 2022, with a view to achieving disinflation.[52] The table lists policies targeting domestic product markets through changes to consumer subsidies, indirect taxes (or specific commodity taxes), import duties, price controls and the application of product-specific exchange rates aimed at reducing the cost of certain imports. It also presents amendments made to social protection policies, which are intended to provide direct support for trade without altering the functioning of national product markets. It thus includes a qualitative summary of policies that can reduce inflation. It should also be noted that over the same period, Egypt, Jordan, Lebanon and Tunisia increased regulated prices and reduced subsidies, despite high inflation.

Table 4.9 does not include traditional macroeconomic policies such as raising key interest rates, which are used to curb inflation by supporting the domestic currency or reducing aggregate domestic demand. If inflation is above the target, central banks raise their prime rates to maintain credibility. The challenge in using a restrictive monetary policy to combat inflation is that it results every time in lower investment and weak growth. Using a New Keynesian monetary model with rational expectations shows that interest rates should fall during an episode of disinflation, a prediction that contrasts with observed monetary policy.[53]

The pre-announced crawling band exchange rate system is a very powerful means of disinflationary policy, taming the inflationary expectations of economic agents by offering them a directly observable nominal anchor.[54] Such an exchange rate system can have the advantage of eliminating devaluation uncertainty, provided it can win the confidence of economic agents.

During a disinflation process, the main question is whether monetary policy is credible. One essential element is the independence of the central bank. Both institutionally and financially, its autonomy needs to be strengthened in Arab countries to play its role, notably in conducting monetary policy and managing the exchange rate.

Close coordination of fiscal and monetary policies, a policy mix compatible with the objective of disinflation, is a necessary condition for disinflation. Precarious public finances are a concern since the financing of budget deficits by money creation contributes to inflationary inertia among private agents.

Table 4.9 Changes in product market and social transfer policies in Arab countries with an inflation spike since February 2022

	Product market interventions					Targeted social protection		
	Increased food and fuel subsidies	Introducing new price controls	Trade regulations	Product-specific exchange rate	Subsidy reduction	Cash transfers	Utility and financial support	Improved targeting
Egypt	x	x	x		x	x	x	
Lebanon				x	x	x	x	
Syrian Arab Republic			x	x	x			x
Tunisia	x	x	x		x			
Yemen			x		x		x	

Source: Gatti, Lederman, Islam and others, 2023.

D. The undesirable social consequences of disinflation policies

Inflation has multiple consequences. It accentuates poverty and inequality, increases the size of the informal sector and affects public finances.

1. Disinflation and poverty

Inflation is widely regarded as a regressive phenomenon, particularly when surging food and energy prices are significant drivers.[55] Figure 4.20 shows a positive relationship between inflation and poverty levels by country, based on the average values of inflation and the poverty ratio over a recent period. This explains why Lebanon has an average poverty rate that is close to 0 and inflation of around 5 per cent over the period considered. Poverty rates have been positively related to inflation in cross-country data.[56]

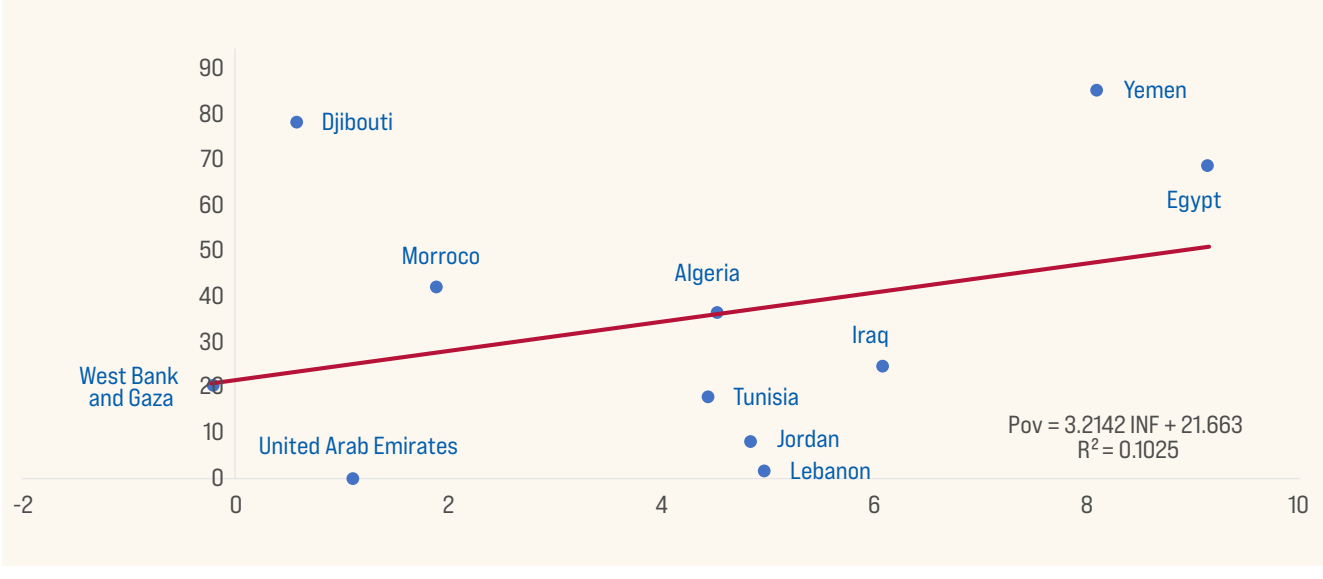
Based on these statistical correlations, a policy of disinflation is likely to induce a more inclusive economic process and mitigate the undesirable effects on poverty in Arab countries severely affected by high inflation. Egypt and Yemen, where poverty and inflation rates are the highest, would be the first to benefit from a disinflation policy. The same conclusion would likely be drawn if statistics were available for the Sudan and the Syrian Arab Republic.

Compared with Jordan, Lebanon and Tunisia, the "inclusion" gains from a disinflation policy would be lower in Morocco, where inflation is low and poverty is high. It needs to advance rural social inclusion through greater financial inclusion and improvement in basic infrastructure affecting human development, such as electricity, education, water and transport.

2. Disinflation and the informal sector

Some economists posit that inflation can affect the size of the informal sector, where prices increase at a moderate pace compared to those in the formal sector. Amid rampant double-digit inflation, people tend to buy cheaper goods, especially when the formal and informal sectors are in competition. The following figure shows a positive correlation between the size of the informal sector and the level of inflation. In other words, higher inflation levels are associated with a larger informal sector.[57]

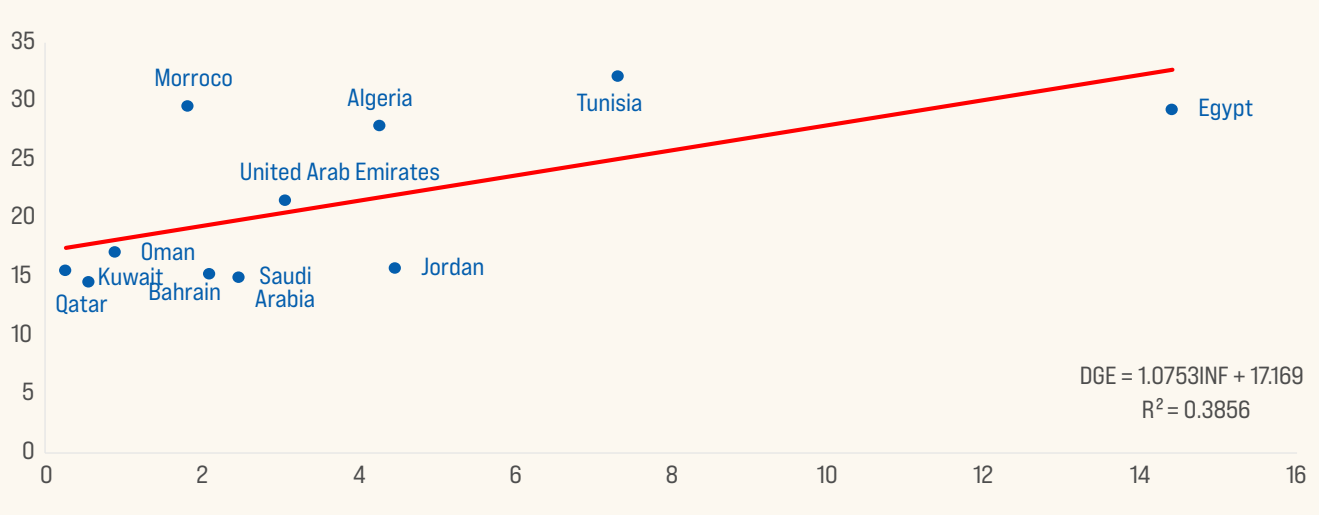
Figure 4.20 Inflation and poverty ratio by country



Sources: IMF database, ESCWA calculations.

Note: Poverty headcount ratio at $6.85 a day (2017 PPP), percentage of population.

Figure 4.21 Inflation and the informal sector



Sources: IMF database, ESCWA calculations.

3. Disinflation and budget deficits

Disinflation is likely to mitigate budget deficits since the loss in revenues due to lower inflation is offset by gains from lower interest charges on public debt. An improved fiscal situation in turn helps to stabilize the balance of payments.

As the budget deficit recovers, the balance of payments improves. The link between the budget deficit and the balance-of-payments deficit is explained in particular by the savings-investment approach to the current account.[58]

The starting point for this approach is an equation defining national income at date t:

$$Y_t = C_t + I_t + G_t + X_t - M_t \quad (1)$$

where Y, C, I, G, X and M denote national income, private consumption, investment, public spending, exports and imports, respectively. By introducing tax revenues (T), equation (1) can be rewritten as follows:

$$X_t - M_t = Y_t - C_t - T_t - I_t + T_t - G_t \quad (2)$$

By defining the current account balance as $BOC_t = X_t - M_t$, excluding transfers; the budget balance as $S_t = T_t - G_t$; and private savings as $E_t = Y_t - C_t - T_t$, we arrive at the following equation:

$$BOC_t = E_t - I_t + S_t \quad (3)$$

Equation (3) shows that improvement in the budget deficit due to disinflation contributes to improvement in the current account balance. Disinflation reduces the budget deficit as the loss of the income is counterbalanced by lower interest charges on public debt. This reduction in the budget deficit in turn reduces the current account deficit.

Faced with insufficient household savings, the external account deficit necessarily widens. To prevent the current account from slipping, it is therefore essential to shrink public consumption. In the long term, it seems advisable to sharply reduce the budget deficit and continue the structural reform of public finances.

4. Disinflation and the sacrifice ratio

The sacrifice ratio helps to measure the cost of disinflation. It is defined as the total loss in GDP due to disinflation, expressed as the output gap, divided by the fall in inflation.

The method commonly used to assess the costs associated with disinflation consists of estimating a Phillips curve and calculating the corresponding sacrifice ratios. The non-parametric approach, inspired by the work of Ball (1994), is based on the identification of disinflation episodes. The sacrifice ratio of a given disinflation episode is defined as the ratio of cumulative growth losses to a total reduction in trend

inflation over the duration of the episode. Ball assumes that trend inflation at period t is equal to the ninth-order moving average, in other words, the average over the four quarters before and after date t.

To mark periods of disinflation, we first identify the "peaks" and "troughs" of trend inflation. A peak is a quarter in which core inflation is higher than in the four preceding quarters and the four following quarters. The symmetrical opposite is a trough. A disinflation episode begins with a peak in inflation and ends with a trough.

The following calculation of the sacrifice ratio for the sampled Arab countries that experienced a peak in inflation follows Ball. It defines trend inflation as the nine-quarter centred moving average of the raw inflation series. A disinflation episode is a period beginning with a peak in inflation and ending with a trough, during which core inflation falls by at least 1.5 points. Furthermore, only sacrifice ratios matching a rise in interest rates are considered. No causality test is performed. The calculation of the loss in growth of the disinflation episode is based on the following three assumptions:

- Growth (respectively unemployment): the potential level at the start of the episode.
- Growth (respectively unemployment) has returned to its potential level four quarters after the end of the disinflation episode.
- Between these two dates, growth increases in a log-linear fashion.

The sacrifice ratio can be interpreted as the cost of a disinflation episode (between a peak and a trough) in terms of growth or unemployment points. If disinflation accelerates, the economy will return more quickly to its potential level and the sacrifice ratio will therefore fall.

The numerator of the sacrifice ratio is the loss in cumulative growth between the start date of the disinflation period t_i and the end date of this period plus four quarters t_f+4. The denominator is the change in inflation between the start and end dates of the disinflation episode:

$$RS = \frac{\sum_{t=t_i}^{t_f+4} y_t - y_t^*}{\pi_{t_f} - \pi_{t_i}}$$

For all Arab countries that experienced a peak in inflation, output data are only available at an annual frequency. Annual inflation data were used to calculate trend inflation to identify episodes of disinflation.

Figures 4.22A, 4.22B and 4.22C on trend inflation, calculated on the basis of the third-order moving average, identify disinflation episodes for each of three countries, Egypt, Morocco and Tunisia. Morocco was chosen for comparison with Egypt and Tunisia. The period is fairly long, stretching from 2000 to 2021. In Morocco, only one disinflation episode was detected, dating from 2008, which is almost certainly due to data frequency.

Figure 4.22 Inflation trends

Sources: IMF database, ESCWA calculations.

Table 4.10 Disinflation annual data

Country	Episode	Length in years	Initial inflation	Change in inflation	Sacrifice ratio
Egypt	2018–2021	4	19.24	5.47	0.35
Morocco	2008–2011	4	3.01	0.95	0.5
Tunisia	2014–2016	3	4.85	4.23	2.43

Source: IMF database, ESCWA calculations.

Table 4.10 summarizes the result of the sacrifice ratio for Egypt, Morocco and Tunisia during different episodes of disinflation. Disinflation is a decrease in the rate of inflation or the general level of prices in an economy. The sacrifice ratio measures the percentage of output (or GDP) lost for each 1 per cent reduction in inflation. A lower sacrifice ratio means that the economy can reduce inflation with less cost in terms of output and employment.

For Egypt and Morocco, the value of the sacrifice ratio is relatively low, compared with the average value for OECD countries calculated by Ball (1994), which stands at 0.8 for an annual frequency. It seems that annual data underestimate the loss of output, as these data smooth out production.

Egypt had a disinflation episode from 2018 to 2021, lasting four years. The initial inflation rate was 19.24 per cent, which decreased by 5.47 percentage points to 13.77 per cent. The sacrifice ratio was 0.35, which means that Egypt lost 0.35 per cent of output for each 1 percentage point reduction in inflation. This relatively low sacrifice ratio indicates that Egypt was able to lower its inflation rate with a small cost in terms of output.

Morocco had a disinflation episode from 2008 to 2011, lasting four years. The initial inflation rate was 3.01 per cent, falling by 0.95 percentage points to 2.06 per cent. The sacrifice ratio was 0.5, which means that Morocco lost 0.5 per cent of output for each 1 percentage point reduction in inflation. This is a moderate sacrifice ratio, implying that Morocco faced some cost in terms of output to reduce its inflation rate.

Tunisia had a disinflation episode from 2014 to 2016, lasting three years. The initial inflation rate was 4.85 per cent, which declined by 4.23 percentage points to 0.62 per cent. The sacrifice ratio was 2.43, which means that Tunisia lost 2.43 per cent of output for each 1 percentage point reduction in inflation. This is a very high sacrifice ratio; Tunisia suffered a large cost in terms of output to reduce its inflation rate.

These sacrifice ratios suggest that the social consequences of anti-inflationary policy will differ from one Arab country to another due to structural specificities. Findings from selected countries show that Tunisia would be most affected by a disinflation policy. Egypt, on the other hand, would be the least affected. Although Morocco has managed to keep inflation under control, compared to Egypt and Tunisia, the cost of disinflation is higher in Morocco than in Egypt. This is an unexpected result that should be interpreted with caution in view of the frequency of statistical data collection.

Finally, estimates of the sacrifice ratio show that the cost of disinflation policy in the three countries studied ranges from 0.35 to 2.43, compared with OECD countries, where the sacrifice ratio ranges from 1.83 to 3.3. Overall, the cost of disinflation is very low in Egypt and Morocco but relatively high in Tunisia.

E. Conclusion and recommendations

Discussion of accelerated inflation in Arab countries highlights how their economic openness can make them vulnerable to global uncertainties and fluctuations in global financial conditions. Such vulnerabilities can give rise to escalating inflation rates, increasing financial costs, exchange rate volatility and even food crises. They contribute in particular to a persistent upward trajectory in inflation rates in several countries reliant on oil imports.

The six countries with high inflation rates, notably Egypt, Lebanon, the Sudan, the Syrian Arab Republic, Tunisia and Yemen, have three main drivers of inflation: government expenditure, money supply and NEER. The implementation of an effective disinflation policy should consider the most relevant inflation drivers in each country. A country that fails to maintain fiscal discipline and recurrently resorts to monetizing its public deficit, for instance, runs the risk of experiencing high inflation. Using an exchange rate regime mechanism can be efficient when a sound macroeconomic policy is in place and the political environment remains stable. During a disinflation process, critical concerns are the credibility of monetary policy and the independence of the central bank, which may need to be reinforced both institutionally and financially.

A disinflation policy is likely to be inclusive and to mitigate some inflationary effects, notably on the poor. Egypt and Yemen, with both high poverty and inflation rates, stand to be the primary beneficiaries of such an approach, along with the Sudan and the Syrian Arab Republic. Compared with Jordan, Lebanon and Tunisia, Morocco would see relatively limited benefits from a disinflation policy in terms of inclusion, since inflation is low and poverty is high.

Sacrifice ratios show that the social effects of an anti-inflationary policy will differ among Arab countries due to their economic structures. Among the sampled countries, Tunisia would likely experience the most pronounced impact from a disinflation policy, while Egypt would be less affected. Surprisingly, even though Morocco has effectively maintained low inflation rates compared to Egypt and Tunisia, the associated cost of disinflation in Morocco appears to be higher than in Egypt. This unexpected finding should be interpreted cautiously, considering the frequency and methodology of statistical data collection.

Overall, inflation continues to be a serious concern for the Arab region, notably in the six countries with high inflation rates over the past three years. They have been unable to bring inflation and budget deficits under control and to reduce their large external imbalances. Frequent exogenous shocks stemming from political and security contexts have had a detrimental effect on both domestic production and inflation. The economies of Iraq, the Sudan, the Syrian Arab Republic and Yemen have been severely affected by high uncertainty. Containing the undesirable effects of high inflation should be among the top priorities of these countries. In that regard, policymakers may consider the following:

- Optimizing public finance expenditures and reducing public debt can be attained notably by controlling the size of the public wage bill, reducing subsidies and avoiding an increase in debt services.
- Enhancing the autonomy of decision-making on monetary policies entails strengthening central bank independence in many Arab countries as this is crucial to achieving monetary stability and controlling inflation within a range of 3 to 3.5 per cent. Central banks should be encouraged to exercise operational autonomy in setting key interest rates and ensuring that their actions remain insulated from political-electoral cycles. Governments must control budget deficits that lead to inflationary pressure, which might compromise monetary stability and put excessive pressure on central banks.
- Adopting fully flexible exchange rate regimes may not be a wise option for mitigating inflation. For some countries, it is imperative to transition towards a pegged exchange rate system with some degree of flexibility in exchange rate management. This transition should aim to reduce external imbalances, improve export price competitiveness and stabilize inflation. Such regimes have typically demonstrated a significant level of exchange rate stability. Achieving fiscal consolidation requires improved expenditure control, an independent monetary policy and the resolution of political conflicts.
- Rising inflation is adversely affecting vulnerable households, especially those with significant expenditures on food. A disinflationary policy with fiscal consolidation should protect low-income people from the rising costs of food and energy. Achieving this requires a proficient mechanism to identify vulnerable populations eligible for aid and support.
- Reducing indirect taxes on some goods and applying preferential exchange rates for basic commodities are also essential steps, notably in periods of crisis. Furthermore, subsidies need to be better targeted to vulnerable groups by more clearly identifying them. Cash transfers should be used to support the purchasing power of lower-income groups, thereby mitigating the undesirable effects of disinflationary policy. Well-designed, competently implemented and efficient social safety net programmes are another recommended consideration.

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The 2022-2023 edition of the Survey of Economic and Social Developments in the Arab Region presents the economic recovery path at the global and regional levels following the COVID-19 pandemic and the war in Ukraine. A lot of uncertainties cloud the outlook as developed countries face increasing risks of falling in a recession and are resorting to increase interest rates to mitigate rising inflation, while developing countries are suffering from increasing borrowing costs, high inflation and uncertainties about energy and food prices. In addition to that, some Arab countries are facing depreciation of local currencies, repercussions of natural disasters, war and occupation, political instability and structural economic challenges. In terms of social developments, the Arab region continues to face significant challenges including widespread poverty, high unemployment and large gender gap.

The thematic chapter of this year's survey focuses on inflation in Arab countries and examines the sources of inflation in six countries that have recorded high inflation rates in the past few years, namely Egypt, Lebanon, the Sudan, the Syrian Arab Republic, Tunisia and Yemen. It also presents the different disinflation policies available and provides some recommendations on the way forward.

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