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ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA (ESCWA)

**ESTIMATES AND FORECASTS FOR GDP GROWTH
IN THE ESCWA REGION
2006-2007**

(MAY 2007 FORECAST)

Overview

The Economic and Social Commission for Western Asia (ESCWA) region underwent a period of robust economic growth in 2006 driven by a strong global economy, high oil prices, and a thriving financial performance. Better investment opportunities have boosted capital inflows while oil revenues have led to an accumulation of liquidity, which in turn has been channelled into large investments. The short-term economic outlook for the ESCWA region as a whole remains favourable despite a moderate decline in real gross domestic product (GDP) growth from 5.6 per cent in 2006 to an expected 5.0 per cent in 2007. Average growth estimates and forecasts for the ESCWA region have been revised slightly downwards since the last quarter of 2006, mainly as a result of lower than expected growth figures for Saudi Arabia, which represents the region's largest economy and accounts for approximately 35 per cent of the total GDP of the region.

A benign global macroeconomic environment and continued high oil prices support the current economic expansion in the region that began in 2003. However, the positive economic prospects for 2007 rest on the assumption that such downside risks as disorderly adjustments of global imbalances or further escalations of violence in the region do not materialize. In addition, high average growth rates of above 5 per cent that have persisted since 2003 mask significant intraregional discrepancies between the countries of the Gulf Cooperation Council (GCC) and those categorized as more diversified economies (MDEs).

On the monetary side, inflation is fuelled by high liquidity and strong demand, particularly in oil rich countries with fixed exchange rates, as well as by accommodative monetary policies. In MDEs, high oil costs are increasingly translating into higher price levels, especially in Jordan and, to a lesser degree, in Egypt and Yemen. While the countries of the GCC are witnessing strong fiscal and current account surpluses, these are expected to decline in 2007 owing to slightly lower oil prices and higher import spending.

In 2006, growth in the GCC was 5.9 per cent, driven by a combination of high oil and non-oil prices, and by strong domestic demand. The subregion is expected to witness another year of solid economic growth given that all member countries have been performing well and have established proper financial environments and sound development strategies. While the oil sector continues to be a main driving force behind growth, non-oil sectors, particularly construction, also contribute substantially to the ongoing economic expansion.

On average, the MDEs of the ESCWA region are still performing below potential, with growth in 2007 estimated at 5.4 per cent compared to 5.1 per cent in 2006. Egypt, Jordan, the Syrian Arab Republic, and Yemen have maintained relatively stable rates of growth while the countries and territories in conflict continue to struggle. Specifically, the tense political stand-off in Lebanon, which followed the war by Israel in July-August 2006, continues to jeopardize the economy. In Palestine, the economic outlook is closely connected to the political and security conditions, which have seriously worsened in the course of 2006. By contrast, Iraq witnessed significant growth owing to higher oil prices and production levels despite the political unrest.

ECONOMIES OF THE ESCWA REGION: RATES OF ECONOMIC GROWTH, 2003-2007
(Annual percentage change)

Country or territory	Real GDP growth				
	2003	2004	2005	2006 ^{a/}	2007 ^{b/}
Bahrain	7.2	5.6	7.8	6.1	5.5
Kuwait	16.5	10.5	10.0	6.5	4.9
Oman	2.0	5.4	5.8	6.4	5.1
Qatar	3.5	20.8	6.1	7.0	7.4
Saudi Arabia	7.7	5.3	6.6	4.2	3.8
United Arab Emirates	11.9	9.7	8.2	8.9	6.0
GCC countries	8.9	7.7	7.3	5.9	4.8
Egypt	4.1	4.5	6.8	6.8	5.8
Iraq ^{c/}	-33.1	23.0	10.0	8.0	7.0
Jordan	4.2	8.4	7.2	6.0	5.3
Lebanon ^{d/}	3.0	5.0	0.0	-5.0	2.0
Palestine	8.5	2.0	4.9	-6.9	1.0
Syrian Arab Republic	1.1	8.6	4.5	5.0	5.6
Yemen	3.8	3.9	4.6	4.2	4.3
MDEs	-0.2	6.4	6.0	5.1	5.4
Total ESCWA region	5.7	7.3	6.9	5.6	5.0
Conflict affected economies ^{e/}	-13.9	11.4	4.6	0.4	4.2
ESCWA region without conflict affected economies	7.4	7.0	7.0	6.0	5.0

Source: ESCWA, based on computations of growth rates from real GDP figures at constant 2000 prices. The latter are taken from national sources and official figures as provided by answers to questionnaires of *National Accounts Bulletin of the ESCWA Region, No. 26*.

Notes: Data for country groups are weighted averages whereby weights for each year are based on GDP in 2000 constant prices.

a/ ESCWA estimates, February 2007.

b/ ESCWA projections, February 2007.

c/ Iraq rates are based on official sources, with the exception of 2005 and 2006, which are ESCWA estimates.

d/ The growth projection from February 2007 of 6.0 per cent has been revised downwards owing to updated information.

e/ This refers to the average of Iraq, Lebanon and Palestine.

I. COUNTRIES OF THE GCC

The countries of the GCC are expected to enjoy another year of strong growth in 2007 owing to persistently high oil and non-oil commodity prices and favourable liquidity conditions in financial markets. In addition, encouraging fiscal positions have led to significant increases in Government spending, particularly on infrastructure. Real GDP growth in GCC countries is expected to slow down from 5.9 per cent in 2006 to 4.8 per cent in 2007, as total oil revenues are projected to decrease by 10 per cent to 15 per cent.

In 2007, the average daily oil production of GCC countries and international oil prices are expected to be slightly below their 2006 levels. The Organization of the Petroleum Exporting Countries (OPEC) reference basket's yearly average rose from \$50.64 per barrel in 2005 to \$61.08 per barrel in 2006. In January 2007, the monthly average price dropped by nearly 13 per cent to \$50.73, before a period of cold weather in the United States and rising geopolitical concerns helped oil prices to rebound steadily. The OPEC basket averaged at \$64.36 in May 2007.

Against the backdrop of robust world economic growth, global oil demand in 2007 is forecast to be slightly higher than in 2006 and the average price of the OPEC reference basket is expected to remain at elevated levels throughout the year. In order to stabilize prices, OPEC has cut its crude oil production

considerably since the third quarter of 2006. By February 2007, the Organization had reduced daily crude oil output by 1.1 million barrels per day (mb/d), with Saudi Arabia accounting for more than half of this reduction. With non-OPEC supply expected to rise by 2 per cent to 3 per cent in 2007, the average oil production in the GCC is likely to be below the levels of 2005 and 2006, albeit with easing output constraints in the second half of the year as a result of higher investment in production capacities.

On the other hand, following the decision by Oman not to participate in the GCC single currency and the decision by Kuwait to de-peg its currency against the dollar, concerns have arisen about the future of the proposed GCC single currency to be launched in 2010. Officials in Oman announced that they would be unable to achieve the legislative and technical requirements by the expected date and considered their decision an attempt to keep monetary and fiscal policies unrestricted at the present time as part of efforts to generate higher GDP growth rates and, consequently, to facilitate tackling the unemployment problem. Moreover, Kuwait recently replaced the peg of the Kuwaiti dinar to the United States dollar with a peg to a basket of international currencies in order to fight imported inflationary pressure and to stabilize its currency.

On the monetary side, inflation rates increased throughout 2006 in most countries of the GCC, particularly Qatar and the United Arab Emirates, where surging housing costs have pushed up price levels. In 2007, inflationary pressures in these two countries are expected to decline gradually, mainly owing to an increase in the supply of housing. During the first five months of 2007 the negative trend in the stock market was reversed in most GCC countries. Complemented by rising oil prices and an increase in investor demand for financial assets, this helped the GCC countries to recover some of the losses of 2006. However, financial markets still remain vulnerable to setbacks, particularly if the overheating in the real estate sector continues. Consequently, it is likely that volatility in the more speculative markets of the region will continue to be high in the coming months.

In 2006, Saudi Arabia enjoyed yet another year of strong economic growth, albeit at a lower than expected rate. The significant reduction of crude oil production in Saudi Arabia was the main factor behind the lower than expected GDP growth of 4.2 per cent in 2006. Indeed, growth is highly linked to the oil sector given that revenues from oil exports amount to 90 per cent of total Saudi export earnings and to more than 50 per cent of total GDP. Based on the latest 2007 oil market projections, the GDP growth forecast for Saudi Arabia has been revised downwards to 3.8 per cent, as oil production between August 2006 and March 2007 fell from 9.5 to 8.6 mb/d. However, growth in such non-oil sectors as manufacturing, construction, trade and financial services is likely to remain strong in 2007, boosted by an improved business climate and strong fiscal stimulus. As such, growth in non-oil sectors is expected to yield a rise in imports.

The economic outlook for the other countries of the GCC continues to be positive. GDP growth is supported by high Government spending, strong private consumption and increased foreign investment in new projects, particularly in the areas of infrastructure, tourism, and energy production. As a result of a strong expansion of import spending, the current account surpluses of GCC countries are expected to narrow in 2007, albeit remaining wide by historical standards.

The United Arab Emirates has enjoyed impressive economic growth over the past years and was classified as the most competitive Arab economy by the World Economic Forum. The economic expansion in that country, which reached 8.9 per cent in 2006, is buoyed by high foreign direct investment (FDI) and a strong tourism sector. The country has emerged as one of the world's most attractive destinations for FDI activities, of which 29.5 per cent was in processing industries, water, and the electricity sector in 2006. The tourism sector, in turn, recorded an increase in revenues of some 23 per cent in 2006. The economy has generated substantial savings during the past years and the total trade volume reached 145.8 per cent of GDP in 2006. Real GDP growth in 2007 is expected to slow down to 6 per cent, mainly owing to a modest decline in oil production and an expected appreciation of the real exchange rate.

Qatar has achieved strong economic growth over the past years with an estimated rate of 7 per cent in 2006. The oil and gas sector has witnessed growth of 29 per cent with rising oil prices and a surge in natural

gas production, thereby increasing the sector's contribution to GDP to 62 per cent. In 2007, an expansion in oil production will most likely offset the expected slight decrease in average oil prices, resulting in higher revenues. Strong public and private spending is expected to contribute to a modest acceleration in the growth rate of real GDP to 7.4 per cent. While per capita income reached a record high in 2006, placing Qatar among the wealthiest countries in the world, inflation increased to 11.8 per cent, which represents a major jump from the 8.8 per cent recorded in 2005.

In Kuwait, real GDP growth is expected to decline to 4.9 per cent, from 6.5 per cent in 2006, in response to a marginal contraction in oil export volume. On the monetary front, Kuwait abandoned the dinar's peg to the dollar in May 2007 and, instead, linked it to a basket of currencies in order to curb inflation resulting from the dollar's fall against other major currencies. This shift infringes an agreement among countries of the GCC to peg their currencies to the dollar in preparation of the monetary union projected for 2010. According to officials in Kuwait, the inflation rate reached 5.1 per cent in the first quarter of 2007, compared to 3.2 per cent in 2006.

In Oman, economic projections for 2007 remain positive and substantiated by strong domestic demand. Owing to an expected decline in oil output and a rise in imports as a result of higher domestic consumption, real GDP growth is expected to drop from 6.4 per cent in 2006 to 5.1 per cent in 2007.

The economic performance of Bahrain in 2006 benefited from large-scale construction activities triggered by excess liquidity from high oil and aluminum revenues. The surge in the real estate sector and the strong performance of that country's financial sector contributed to real GDP growth of 6.1 per cent in 2006. As in all the countries of the subregion, benign global and regional economic conditions coupled with a positive investment climate are expected to further support the ongoing economic boom. Based on the assumptions of slightly lower oil prices and increased spending on imports, a growth rate of 5.5 per cent is forecast for 2007.

II. THE MORE DIVERSIFIED ECONOMIES

In 2006, average economic growth in the MDEs of the region remained below potential owing mainly to the recent escalation of violence in several countries and territories. On the positive side, economic growth in Egypt and Jordan continued to be strong, particularly as a result of robust domestic consumption and investment demand. Assuming that the security situation in the Middle East does not deteriorate, real GDP growth in this cluster is projected to accelerate from 5.1 per cent in 2006 to 5.4 per cent in 2007.

Egypt registered strong economic growth in 2006 across both oil and non-oil sectors, supported by economic policy reforms that target FDI, exports, and local investments. Overall, the economy expanded at a rate of 6.8 per cent. Growth was boosted by a cutback in personal income taxes, a booming tourism sector and an improved business environment. In 2007, growth is likely to slow down slightly to 5.8 per cent, partly as a result of interest rate hikes that are expected to curb inflationary pressures. The slow down is also likely to be brought about by a weakening of the external balance position due to expected stronger growth in imports.

The growth rate in Jordan reached 6 per cent in 2006 in real terms, owing mainly to high domestic demand that stems from major investment initiatives and high remittances from the Gulf countries. The country's construction and real estate sectors are prospering and have witnessed a growth estimated at 11.1 per cent owing to demand from Iraqi expatriates and a growing number of foreign firms setting up headquarters in Jordan. Moreover, the manufacturing sector grew by 10.6 per cent, partly due to strong growth in the textile sector, while the transport and telecommunications sectors expanded by 6.7 per cent. In 2007, GDP growth is projected at 5.3 per cent fuelled by high investments, both foreign and domestic, especially in the tourism sector, and by strong private consumption partly driven by remittances. On the monetary front, the rise in oil prices in recent years has been increasingly passed through to consumers, especially following the removal of fuel subsidies.

The Syrian Arab Republic and Yemen face the massive challenge of gradually dwindling oil reserves and the related adjustment of fiscal policies. The current economic expansion of the Syrian Arab Republic, where real GDP growth reached 5 per cent in 2006, is mainly based on increased domestic demand boosted by the large influx of Iraqi expatriates. Furthermore, while the economy is benefiting from a strong performance of the tourism sector and from new foreign investment activities, the price of food, real estate, and consumption fuel have risen notably.

Economic growth in Yemen is forecast at 4.3 per cent for 2007, which represents no change from 2006, and continues to fall short of the target set by the Government. While the economy is attracting highly promising investments, especially in the energy, minerals and transportation sectors, there is a need for more comprehensive economic reforms aimed at increasing competitiveness and at further diversifying the structure of the economy. The current account deficit is expected to rise owing to increased imports, especially in the energy sector.

III. IRAQ, LEBANON AND PALESTINE

Lebanon and Palestine suffered severe declines in economic activity in 2006, while the lack of security in Iraq has resulted in lower than expected oil production and weak growth in the non-oil sector. Lebanon's economic recovery from the impact of the war in July-August 2006 will depend on the resolution of the domestic political tension that is currently afflicting that country. In Palestine, the macroeconomic outlook for 2007 depends, above all, on the political situation, particularly in the light of the internecine conflicts between Palestinians and of Israel's obstruction of movement of people and goods within and between the occupied Palestinian territories and the neighbouring countries. In Iraq, short-term economic prospects depend mainly on the development of the security situation, which affects growth in both the oil and non-oil sector.

In 2006, Lebanon suffered a severe contraction of 5 per cent of GDP as a result of the war in July and August. While the direct costs of the war were estimated at \$2.8 billion, the indirect costs were significantly higher. These indirect costs arose from the two-month long sea and air blockade, the lost working days during the war period, the drop in confidence in future economic prospects, and the fear of further conflict and escalating political tensions. While all the sectors were severely affected, the drop in tourism was the most significant. The national tourism sector, which contributes some 10-12 per cent to GDP and has strong linkages with the rest of the economy, is estimated to have lost approximately one million tourists in 2006. On the other hand, mounting pressures on the financial sector and the economy at large were effectively absorbed by the central bank owing to the country's international reserves of \$12 billion, and to soft loans from Saudi Arabia and Kuwait amounting to \$1.5 billion.

While Lebanon's economy was expected to recover from the impact of the war in July-August 2006, the ongoing political tensions in the country hamper the implementation of any serious reform programme and depress economic activity at large. Consequently, the growth forecasts for 2007 have been revised downwards, from 6 per cent to 2 per cent. At the end of 2006 and in early 2007, there were a number of encouraging signs for the Lebanese economy. At the Paris III donor conference, which was held in January 2007, the Government presented a comprehensive plan for economic reform, for which it received some \$7.6 billion in financial aid and soft loans from the international community. Remittances from Lebanese expatriates, at an estimated \$5 billion in 2006, were expected to maintain their upward trend; the scale of ongoing construction activity was reflecting a friendly investor sentiment; and there was hope that the tourism sector would recover from its 2006 slump. However, the recent political setbacks and impasses have given way to less optimistic expectations about the country's economic prospects for 2007. The number of tourists declined by almost 36 per cent in the first two months of 2007 compared to the corresponding period of 2006. In the medium term, large budget deficits and mounting public debt will remain a major concern for the Lebanese authorities, with the public debt approaching 200 per cent of GDP and the fiscal deficit amounting to 15.2 per cent of GDP. It is hoped that a rigorous reform package, much stressed upon by the Paris III conference, can provide the desired reduction of public debt.

In Iraq, owing to frequent acts of sabotage and to technical problems, crude oil production in 2006 was limited to 1.9 mb/d, falling significantly short of the Government's target level of 2.5 mb/d. The continuing conflict and attacks over oil fields have stalled operations and the implementation of maintenance and capacity upgrading and enhancing projects. In the first quarter of 2007, oil production remained at its 2006 level. However, assuming that in the second half of 2007 the security situation improves to some extent, a real GDP growth rate of 7 per cent can be achieved.

Export earnings are expected to remain significantly high in 2007 given that oil prices are not expected to change notably from their high levels of 2006. If violence continues, it would be difficult to reach the targeted level for oil production and, moreover, it could prove impossible to realize the desired growth in non-oil sectors. Additionally, adverse security conditions inhibit entrepreneurs from investing and impose a severe constraint on the ability of the Government to expand its investments in physical and human capital. According to the Economist Intelligence Unit, Iraq registered an estimated fiscal surplus of \$5.6 billion in 2006, which is equivalent to 13.8 per cent of GDP, because security prompted restrictions on Government spending. Failure to boost economic activity in the non-oil sectors resulted in jobless growth for Iraq. Unemployment in Iraq, excluding the three governorates in the Kurdish regions of the country, was an estimated 26.8 per cent in the first quarter of 2004. According to some observers, the unemployment rate is now estimated at around 48 per cent, thereby creating a mass of impoverished Iraqis. A recent study by the World Food Programme (WFP) on food security in Iraq revealed that 54 per cent of the Iraqi population of 16 governorates, excluding Dohuk and Erbil, are spending less than \$1 per person per day, of which 15 per cent are spending less than \$0.50 per person per day.

Authorities are planning to reopen many of Iraq's old State-owned businesses in order to absorb some of the unemployed. Equally, the Ministry of Agriculture has unveiled a three-year development plan under which it hopes to create 3 million jobs mostly in the southern and central parts of the country. It is hoped that the new plan will boost agricultural production and be able to meet 21 per cent of the country's food needs. Conditions in the Kurdish regions of Iraq stand in sharp contrast to the central and southern regions. Specifically, the Kurdish north is witnessing an economic boom that has largely been triggered by high construction activity, especially in the real estate sector, an increase in the number of hotels and a very significant increase in the number of new companies.

Despite the liberal import policy, the slowly appreciating Iraqi dinar and the high unemployment rate, inflation has gained additional momentum. If the increased inflation rate is left unattended, it could become an additional risk to economic and social stability. The consumer price index increased by 64.8 per cent in 2006, while it was 37.1 per cent higher in February 2007 than in February 2006, reflecting a substantial decline in prices over the month of January 2007. Owing to the large weight of foodstuff in Iraq's consumer price index, at 63.2 per cent, escalating food prices are believed to be the primary cause for the hike in the consumer price index. Nevertheless, the reduction in fuel subsidies, the increase in transport costs and the shortage of basic items, including gas and petrol, are believed to have contributed directly and indirectly to the ongoing price trajectory.

The economic outlook for Palestine remains comparatively bleak. Preliminary results by the Palestinian Central Bureau of Statistics (PCBS) for 2006 show that real GDP declined by 1.3 per cent between the second and first quarter, followed by a further decline of 8.9 per cent in the third quarter. Based on this trend and on other indicators, the drop in GDP in 2006 from its level in 2005 was an estimated 6.9 per cent. However, GDP is expected to experience a modest recovery of 1 per cent in 2007. Many factors that caused the sharp decline in 2006 are likely to continue to impose constraints on the economy in 2007.

Moreover, national and international private investments will be driven away in 2007, thereby adversely affecting business activity as was the case in 2006, if the current combination of afflictions persist. Israeli attacks on the Palestinian territories, the closures and roadblocks imposed by Israel, the ongoing

construction of the cement security barrier in the West Bank, and the internecine and factional violence between Palestinians severely restrict economic activity.

The severe contraction in budgetary resources will continue to curtail Government investment and consumption expenditure in 2007, albeit possibly to a lesser degree than in 2006. Budget resources were estimated by the International Monetary Fund to have fallen by one-third between 2005 and 2006, and there are no indications that a significant improvement will take place in 2007. The drop in budget resources in 2006 was instigated by the international boycott of aid (freezing of assistance pledges by donors) following the victory by Hamas in the election and its subsequent formation of Government, and to the Israeli withholding of clearance revenue/taxes collected on behalf of the Palestinian Government. It is expected, however, that 2007 will witness some relaxation of the restrictions on aid flows to the territories.

The expectation of a 1 per cent increase in GDP in 2007 is not based on the prospects of a structural improvement in the Israeli attitude towards the occupied territories; rather it rests mainly on the following: (a) that private consumption is expected to be higher in 2007 owing to some salary and services payments channelled through the Palestinian Authority; and (b) that some funds for humanitarian assistance will flow from the United Arab Emirates, from some non-governmental organizations and as a result of the pledges made by donors at the Stockholm Donor Conference on the Humanitarian Situation in the Palestinian Territories (1 September 2006), which amounted to US\$ 500 million. This modest increase in GDP reflects the failure of a comprehensive recovery of investment activities and of Government expenditures. Keeping in mind that a large part of Government expenditures directly or indirectly finances health, education, and other social services, there is a need to underscore the dire consequences that this fall in investment and Government expenditures would have on the physical and human capital and, consequently, on the long-term economic and social development of Palestine.

Employment has been hard hit by the prevailing economic conditions. According to a survey on the labour force by PCBS, the proportion of unemployed persons in Palestine reached 21.6 per cent in the first quarter of 2007, which represented a modest decrease from 22 per cent in the fourth quarter of 2006. Wide disparities remained between unemployment rates in the West Bank and the Gaza Strip. In the first quarter of 2007, the unemployment rate in the West Bank stood at 17.3 per cent, while it was 30.4 per cent in the Gaza Strip. According to the International Labour Organization, this widespread unemployment and the drop by 40 per cent in per capita income between 1999 and 2006 resulted in a rise by 26 per cent in the number of households living below the poverty line. In 2006, some 76 per cent of Palestinian households were believed to be living below the poverty line.