

ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA (ESCWA)

**SURVEY OF ECONOMIC AND SOCIAL DEVELOPMENTS
IN THE ESCWA REGION
2008-2009**

SUMMARY

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Until the last quarter of 2008, ESCWA member countries exhibited steady economic expansion, boosted by higher-than-usual oil prices, save in conflict-affected areas. However, with the onset of the global financial crisis and the steep drop in oil prices, the growth prospects for 2009 are increasingly uncertain. Real gross domestic product (GDP) growth for 2009 is forecast to be around two per cent. On the economic side, the impact of the financial crisis has been recorded in four areas: plunging financial and real estate asset prices; the collapse of commodity prices, including energy, metal and food (although food prices remain relatively high and still hurt the poor); liquidity shortages, particularly in US dollars, in local and international money markets; and the rapid decline of export earnings. On the social side, the following issues may arise: declining effective incomes, particularly of the poor; rising unemployment; a potentially significant change in Gulf demographic structures due to migrant workers' returning home and possibly a decline in remittances; and a depletion of fiscal resources for social safety nets.

The main theme of the Survey this year is an exploration of the cyclical and structural policy alternatives available to the region to tackle the impact of the global financial crisis. For the purposes of this Summary, we will highlight the required fiscal, monetary and financial, trade and industrial policies required to deal with the global financial crisis. It is worth noting, however, that even before the crisis, the region as a whole was not expected to meet the Millennium Development Goals (MDGs) in view of the already inadequate structure of existing policies. On the economic side, industrialization and full-employment policies remained elusive goals. On the social side, there were some remarkable advances in health and education, but the regional starting point was quite low, and as for the 'development as freedom paradigm', the region was still far from realizing its developmental potential. Now that the crisis has arrived and notwithstanding the paucity of data, there is a need to remedy faulty policy in addition to gauging the inevitably baleful impact of the crisis on the poor.

Crisis or not, in a conflict-affected development context in which the rate of unemployment, a key measure of welfare and development, holds nearly steady at double-digit levels and responds poorly to fluctuations in growth rates, the impact of the crisis on the vast majority of the lower strata is likely to be only marginal, given their already dire condition. Financial crises erode a greater share of income from the globally-integrated rich than from the locally-disenfranchised poor. Still, if, in order to minimize financial losses, monetary policy undercuts the state's capacity to expand a fiscal stimulus meant to cushion the impact of the crisis on the poor, then the tenets of the social contract should best be re-examined. Already, a huge part of the region's savings do not get funnelled back into national or regional investment, implying that this leakage is underpinned by an articulation of various institutional arrangements that has long undermined the potential for development.

The ESCWA secretariat, in cooperation with the International Labour Organization (ILO) and the Government of the Syrian Arab Republic, held its "Regional High-level Consultative Forum on the Impact of the International Financial Crisis on ESCWA Member Countries: the Way Forward" in Damascus on 5-7 May 2009. The Forum participants discussed the impact of the international financial and economic crisis on ESCWA member countries and the national, regional and international responses to the crisis. The views of experts and of representatives of ESCWA member countries and regional and international organizations were all taken into account. On 7 May 2009 the Forum adopted the "Damascus Declaration on Responding to the International Financial Crisis in the ESCWA Region". This year's Survey will provide an in-depth analysis of a subset of the policy recommendations adopted by the Forum. The analysis will focus on the justification for the recommended policy and show how such a policy could lead to a more effective response that would guard against some of the negative effects of the crisis and/or create an opportunity for member countries to benefit from the crisis.

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I. RECENT ECONOMIC AND SOCIAL DEVELOPMENT TRENDS

A. THE GLOBAL CONTEXT

1. The expansion of the world economy came to an abrupt halt in the fourth quarter of 2008. Global recession, led by developed economies, continues to loom large in 2009. The credit crunch in financial markets in the United States and Western Europe since the summer of 2007 became a global financial crisis after the collapse of major financial institutions in the United States in September 2008. Due to surging counterparty risk among financial institutions, international money and capital markets were essentially frozen by the fourth quarter of the year. The financial crisis forced a shrinkage, through de-leveraging, of the balance sheet positions of financial sector entities and affected corporate and household sectors in developed countries. Balance-sheet adjustments have resulted in the downward revision of investment planning targets, corporate inventories, human resource allocations and consumption behaviour. The contraction of economic activities has led to a contraction of effective demand and to rising unemployment. Economies that rely on exports for growth have already experienced a significant decrease in export earnings. Weak prospects for global demand growth have led to deflation in commodity prices and shipping costs from their historical peak in the second quarter of 2008. A series of coordination efforts to cope with the financial crisis, made during the G-20 Summit meetings in November 2008 and April 2009, elaborated a vision of a new international financial architecture accompanied by coordinated fiscal stimulus action.

2. During 2008, developing countries, including ESCWA member countries,¹ faced the impact of the global financial crisis in four stages: (a) plummeting financial and real estate asset prices; (b) the collapse of commodity prices, including energy, metal and food; (c) liquidity shortages, particularly in US dollars, in local and international money markets; and (d) rapidly

¹ The ESCWA region consists of two sub regions. The first comprises the members of the Gulf Cooperation Council (GCC): Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. The second includes all non-GCC member countries, henceforth defined as more diversified economies (MDEs): Egypt, Iraq, Jordan, Lebanon, the Occupied Palestinian Territories, the Syrian Arab Republic, the Sudan and Yemen.

declining export earnings. The repatriation of foreign funds started in the second quarter of 2008 in many emerging markets. This repatriation was a facet of international investment portfolio adjustments by risk-averse investors and their preference for safety and liquidity. This resulted in a gradual tightening of credit globally which reversed the trend of financial and real estate asset prices, including those of developing countries. As liquidity pressures grew, exporters and importers in developing countries found it increasingly difficult to obtain trade finance. Moreover, the rapid decline in effective demand at the global level reduced export earnings all round. Due to their limited exposure to the securitized financial products of developed countries, developing countries were initially believed to be insulated from the financial crisis. However, given linkages to global markets in goods, services and finance, contagion soon took hold, and the growth prospects for developing countries now face growing uncertainty.

3. The global financial crisis is anticipated to impact social development via four main channels and with varying time lags: (a) declining effective income, particularly for the poor; (b) rapidly rising unemployment; (c) change in the demographic structure due to migrant workers' returning home; and (d) threatened depletion of fiscal resources for social safety nets, including potentially a drop in remittances and official development assistance (ODA). Rapid food price inflation through 2007 and 2008 had already eroded the purchasing power of the poor, who spend a large proportion of their income on food. Despite international commodity price deflation since 2008, recent severe droughts in many agrarian parts of the world along with higher-than-average food prices (resulting in a higher import bill at a time of current account difficulties) are still causing serious concerns with respect to world food security. Lower growth prospects due to the financial crisis are likely to constrain the consumption demand of the world's poor. According to the International Labour Organization (ILO),² the number of unemployed in 2009 is projected to increase by between 18 and 51 million in comparison with 2007. The effect of unemployment will be more severe in

² International Labour Organization, Global Employment Trends, January 2009.

developing countries as most of them are in phases of demographic transition where high fertility rates co-exist with decreasing mortality rates. Moreover, chronic unemployment rates are typically high among younger cohorts and women. Therefore, more restricted employment generation is expected to delay the social transition to greater participation by youth and women in labour markets. Furthermore, the global financial crisis has strengthened nationalistic tendencies in favour of job protection measures, particularly in developed countries. The prospects for unemployed foreign workers are increasingly uncertain. Often they have to return to their home countries where jobs are scarce, Governments face contracting fiscal positions and fiscal austerity is shrinking allocations for social safety nets that guard against impoverishment.

4. Against this global backdrop, ESCWA member countries showed resilience in economic expansion up to the end of 2008. Growth prospects for 2009, however, appear increasingly uncertain. Except for those countries and territories that have suffered from military conflict and insecurity, business sentiment and consumer confidence in the region have been stably positive since 2002. Confidence has begun to erode due to the collapse in crude oil prices and regional financial and real estate asset prices. Lack of investor confidence and of comprehensive automatic stabilizers, such as unemployment insurance, combined with labour's already extremely low share of national income, represent real sources of concern for the region's economic growth prospects. Moreover, it is almost certain that the global financial crisis will have a significant impact on the region's social development and affect recent achievements in the way of reforms and institutional development. Greater economic and social uncertainty is weighing upon an already precarious general 'sense of security' shared by the ESCWA population.

B. OIL SECTOR DEVELOPMENT

5. According to the estimates of the Organization of Petroleum Exporting Countries (OPEC),³ total world demand for 2008 averaged 85.6 million barrels per day while total supply of crude oil averaged 85.8 million barrels per day. The demand for crude oil is estimated to have

decreased in 2008 by 0.3 million barrels per day over the previous year. The weak demand of Organisation of Economic Co-operation and Development (OECD) countries became apparent from the start of the year even as the expected demand growth from developing countries failed to materialize. Projecting weak real demand prospects, OPEC had maintained a reduced production quota from its peak in the last quarter of 2005. OPEC then decided to cut the quota further in October and December 2008 and gradually to decrease output by 4.2 million barrels per day. As the demand for crude oil is projected to weaken further in 2009, OPEC is likely to comply with its present production ceiling of 24.8 million barrels per day with the possibility of another reduction during the year. Due to their limited capacity to expand exploration and production, non-OPEC countries' crude oil production in 2009 is projected to remain at 2008 levels. Given the global situation, demand and supply of crude oil is expected to balance at around 81.5 million barrels per day in 2009, which is five per cent lower than the 2008 level.

6. Crude oil prices surged in the first half of 2008 to a historical high and then declined to price levels not seen since early 2005. The OPEC Reference Basket (ORB) price marked a high of \$140.73 per barrel on 3 July 2008 and ended the year at \$35.58 per barrel. The surge of crude oil prices in 2008 was caused by financial speculation in crude oil futures. During the extraordinary price surge, decreasing real demand for fuel products, such as gasoline and heating oil, caused a substantial decline in refinery margins. In the second half of 2008, revised perceptions of world growth prospects, along with reduced crude oil demand and enhanced refining capacity, particularly in Asia, jointly acted to alleviate crude oil supply pressures. In early 2009, the ORB price was tending to stabilize in the range of \$40 to \$50 per barrel. However, major crude oil producers hope for a sustainable price of around \$70 per barrel to support investment in exploration, production and refining for the long run. Speculative forces still remain active in crude oil futures markets and together with economic uncertainty make the projection of volatile crude oil prices difficult. With this caveat, the average ORB price is projected to remain in the range of \$42.5 to \$52.5 per barrel in 2009.

7. The total crude oil production of ESCWA member countries is estimated to have stood at 20.2 million barrels per day on average in 2008,

³ OPEC Monthly Oil Market Report, March 2009.

up 3.6 per cent on the previous year. Gulf Cooperation Council (GCC) production is estimated to have totalled 16.0 million barrels per day whereas the estimate for other ESCWA crude-oil-producing countries, namely, Egypt, Iraq, the Sudan, the Syrian Arab Republic and Yemen, stands at 4.1 million barrels per day. In 2009, total crude oil production of ESCWA member countries is projected to be 17.5 million barrels per day. The significant reduction of production levels is due to prompt compliance with the OPEC quota by OPEC member countries in the ESCWA region. Moreover, with the exception of Iraq and the Sudan, the capacity constraint is expected to cause a moderate decline in the crude oil production of non-OPEC member countries in the region. The ESCWA region's gross oil export revenues in total are estimated to have stood at \$637.1 billion in 2008, an increase of 41.8 per cent from the previous year. However, due to weak price and production prospects, total gross oil export revenues are projected to be \$307.7 billion in 2009, down 51.7 per cent from 2008.

C. OUTPUT AND DEMAND

8. Average real gross domestic product (GDP) growth of ESCWA countries, which was 5.2 per cent in 2007, is estimated at 6.0 per cent for 2008 and is forecast to be 2.1 per cent in 2009 (see table). On the production side, surging international commodity prices in the first half of 2008 positively affected the region's energy and commodity-related sectors including crude oil production, oil refining, liquefied natural gas and petrochemical products. Wealth accumulated from previous periods, together with ongoing positive sentiment on the part of businesses, rentiers and well-off consumers, sustained expenditure and growth well into the year. The resulting domestic demand expansion contributed to the continuing rapid growth of the business services, communications, construction, financial services, tourism and transport sectors. However, the collapse of prices in commodities and petrochemical products in the second half of 2008 rapidly clouded business confidence. Moreover, the rapid decline of financial asset and real estate prices weakened the prospects for growth in domestic demand. Due to prompt action by the region's monetary authorities, the systemic risks to the region's financial sector were kept in check. However, as the region's commercial banks become more cautious in their lending activities,

credit growth in the private sector is projected to be substantially subdued.

9. Real GDP growth in the GCC countries is estimated to have averaged 5.7 per cent in 2008, after registering 4.5 per cent in 2007. Despite the fact that crude oil prices have rapidly declined since July 2008, GCC economies registered record oil export revenues in 2008 and another year of substantial fiscal surpluses. The sudden change in outlook of the world economy is due to the effect of the global financial crisis on business and consumer confidence in the region and increased uncertainty. Despite media reports of weak performances by the region's stock markets and real estate sector, the announcement of delays in megaprojects and the slowdown in real estate markets, a sizeable number of economic actors and policymakers in the GCC region considered the economic fundamentals to be sound. This was based on the already-accumulated surpluses and relative resilience of Gulf economies and reflected some modest success by GCC countries, despite the collapse in crude oil prices, in diversifying their economies. The degree of this diversification should not however be overestimated, since the economies of the GCC countries continue to depend greatly on oil revenues, and the structure of their economies is largely unchanged from what it was during the previous oil boom of the 1970s. The current income effect of oil revenues has been leveraged through international and domestic asset markets with the development of the financial sectors. Asset markets have linkages to the activities of non-oil economic sectors which are principally speculative in nature, particularly the real estate sector. While the non-oil sectors may have consistently added value to the GCC economies in recent years, their impact was less than proportionate as asset bubbles evaporated in 2008 with stock market adjustments. Although the income generated by the non-oil economic sectors had contributed to the consistent expansion of domestic demand since 2002, a major chunk of consumer demand was driven by the affluent, whose consumption fell off sharply with the onset of the crisis.

10. For 2009, GCC countries are forecast to experience a considerable decline in real GDP growth to an average of 1.1 per cent. This projected weakening, partly attributable to structural de-leveraging in the subregion's financial sector, is mainly due to prompt compliance with the sharp cut in the production

quotas of OPEC member countries in this subregion, namely Kuwait, Qatar, Saudi Arabia and the United Arab Emirates. Due to Governments' strong readiness to provide fiscal support, domestic demand in this subregion is not expected to shrink to the same degree. The main cause of the real GDP decline is the contraction in net exports. Specifically, Kuwait is projected to grow at 0.7 per cent, Saudi Arabia at 0.7 per cent and the United Arab Emirates at 0.5 per cent.

Qatar is projected to grow at 7.0 per cent, a rate well above the subregion's average. This is due to the advantage the country enjoys as a major global liquefied natural gas exporter. Non-OPEC members in the subregion, namely Bahrain and Oman, are projected to record moderate growth rates of 2.0 per cent and 1.5 per cent, respectively, based on moderate declines in crude oil production levels.

REAL GDP GROWTH AND CONSUMER INFLATION RATES, 2005-2009
(Annual percentage change)

Country/area	Real GDP growth rate					Consumer inflation rate				
	2005	2006	2007 ^{a/}	2008 ^{b/}	2009 ^{c/}	2005	2006	2007	2008 ^{b/}	2009 ^{c/}
Bahrain	7.9	6.5	8.1	6.3	2.0	2.6	2.1	3.3	3.5	3.5
Kuwait	11.4	6.3	4.6	6.1	0.7	4.1	3.1	5.5	10.4	5.7
Oman	6.0	7.2	6.1	6.0	1.5	1.9	3.4	5.9	12.4	6.0
Qatar	6.1	12.2	9.5	16.0	7.0	8.8	11.8	13.8	15.0	11.2
Saudi Arabia	5.6	3.2	3.4	4.2	0.7	0.7	2.2	4.1	9.9	4.5
United Arab Emirates	10.5	9.4	5.2	7.4	0.5	6.2	9.3	11.1	18.6	5.2
GCC countries ^{d/}	7.3	5.6	4.5	5.8	1.1	2.8	4.3	6.3	12.0	5.2
Egypt ^{e/}	6.8	7.1	7.2	6.5	4.5	4.9	7.6	9.5	17.1	9.7
Iraq	-0.7	6.2	5.0	8.9	5.0	37.0	53.2	30.8	2.7	5.0
Jordan	7.1	6.3	6.0	6.0	3.6	3.5	6.3	5.4	14.0	6.5
Lebanon	1.1	0.0	4.0	5.5	3.0	-2.6	1.5	6.7	11.7	5.7
Occupied Palestinian Territory	6.7	-8.3	0.6	-1.7	-1.0	3.5	3.8	2.7	9.8	5.2
The Sudan	8.6	11.3	10.0	8.5	4.2	8.4	7.2	8.0	15.0	11.0
Syrian Arab Republic	4.5	5.1	6.6	6.5	3.2	7.4	10.0	4.5	14.7	6.0
Yemen	5.8	4.5	4.7	4.5	2.0	11.8	10.8	7.9	19.0	12.7
MDEs ^{d/}	5.0	5.8	6.4	6.6	4.0	9.8	14.2	11.5	13.9	8.2
Total ESCWA region ^{d/}	6.5	5.7	5.2	6.1	2.1	5.3	7.9	8.2	12.7	6.3

Source: National sources unless otherwise stated.

a/ Estimated figures for Bahrain, Kuwait, Oman, Qatar and Iraq as of 15 March 2009.

b/ March 2009 estimates.

c/ March 2009 forecasts.

d/ Figures for country groups are weighted averages, where weights for each year are based on GDP in 2000 constant prices.

e/ GDP growth rate figures for Egypt refer to the country's July-to-June fiscal year.

11. GDP growth in the subregion of MDEs is estimated to have averaged 6.5 per cent in 2008, up slightly from 6.4 per cent in 2007. Despite precarious external balances due to weak current account positions, domestic demand continued to grow with firmly resilient capital account balances. Moreover, oil exporters in this subregion benefited from strong gross oil export revenues. During 2008, the MDEs saw increased

investment activity in the construction, telecommunications, financial and service sectors. Despite consistent industrial development efforts, the subregion has yet to establish for itself a sufficiently strong manufacturing base for export-led growth. On the other hand, the reduced reliance on manufacturing exports has effectively insulated the subregion from the impact of the rapid decline in global demand since the fourth

quarter of 2008. Also, the financial sector maintained sufficient monetary liquidity during the initial phase of the global financial crisis. Being underdeveloped in the areas of manufacturing and finance prevented a steep and abrupt fall in economic activity. Yet, from a development perspective, how much better had the region been more developed in these areas while still prudent in arranging its protection mechanisms.

12. For 2009, the MDE subregion is projected to mark a moderate average growth rate of 4 per cent. A weakened capital account position is expected, and the risk of balance-of-payments difficulties remains. However, due to the solid position of foreign reserves at central banks in the subregion, this risk is expected to remain relatively low. Declining consumer price inflation has helped to support domestic demand only moderately, because labour earns an unusually small share of total income. Business and consumer confidence is projected to be relatively stable in spite of the increasing uncertainty about chronic structural issues, such as unemployment, since much economic activity is associated with rents rather than any dynamic rise in productivity. For Iraq and the Sudan, the impact of investment activity on their growth potential is expected to continue along with improving stability in these countries. Iraq is projected to grow at 5 per cent and the Sudan at 4.2 per cent. Estimates for Egypt, Jordan, Lebanon and the Syrian Arab Republic mainly reflect their weakened capital account positions, while taking into account the strong position of foreign reserves at their respective central banks. Export earnings in both goods and services are expected to decline in 2009, but the capital account position should be sufficient to cover the weak current account position during the year. Domestic demand growth in both countries is expected to face certain constraints leading to moderate growth in real GDP. Egypt is projected to grow at 4.5 per cent, Jordan at 3.6 per cent, Lebanon at 3.0 per cent, and the Syrian Arab Republic at 3.2 per cent. A rapid decline in gross oil export revenues is expected to affect Yemen's growth prospects. However, the deteriorating current account position is likely to be covered by accumulated central bank foreign reserves and international support. Moderate growth in domestic demand is projected to lead Yemen's GDP growth to the 2 per cent level in 2009.

13. Recently revised official figures confirm that the Occupied Palestinian Territories continue

to experience depressed economic activity. Physical blockades, continuing insecurity and hostilities have imposed a severe constraint on the Territories' economic activities. Unpredictable flows in international development aid have precluded fiscal efforts at reconstruction and development. Moreover, the intensity of Israeli military actions in the Gaza Strip over 22 days from December 2008 to January 2009 caused devastating destruction to human and physical capital. In 2009, the Occupied Palestinian Territories are projected to register their second year of negative economic growth at the rate of -1 per cent.

D. COSTS AND PRICES

14. Average consumer price inflation in the ESCWA region is estimated for 2008 at 12.7 per cent, compared with 8.2 per cent in 2007. Due to consistent growth in domestic demand, the ESCWA region had already been under mounting inflationary pressure at a time when international commodity prices, including energy, metal and food items, started surging at an alarming rate over 2007 and 2008. The extraordinary hike in international grain prices was immediately passed through to prices of food items. For the previous few years, consistently rising rental prices of business and residential properties had been observed in parallel with the rising value of property assets. The rising price of construction materials further inflated the nominal value of newly-built properties and associated rental prices. For non-oil-exporting countries, the hike in crude oil prices passed through to higher transport costs. Consumer price inflation peaked in the second half of 2008. However, even as commodity prices in international markets rapidly declined, food prices in the region generally remained well above their long-term trendlines. This high-end stickiness in food prices was due to market segmentation, wholesalers' overpricing their inventories and a resilience in the price levels of processed foods. Property rental prices veered downwards in the region in the fourth quarter of 2008. The growth of private sector wages, particularly in the GCC countries, also flattened out amidst the increasingly uncertain employment situation. By the end of 2008, inflation pressure on ESCWA member countries had substantially tapered off.

15. The 2009 forecast for the consumer price inflation rate of the ESCWA region is 6.3 per cent, reflecting the expected slowdown in

domestic demand growth, except in Qatar where growth is projected to be well above average. However, due to structural differences, the region is not expected to experience deflation as may be the concern for some developed countries. The world supply-demand balance for grains is projected to be stable in 2009. However, severe droughts were experienced in several agrarian parts of the ESCWA region in the period up to February 2009, and the supply situation may remain fragile, subject to several other risk factors. Moreover, the speculative funds which contributed to the violently volatile movements of international grain prices in commodity futures markets in 2008 may renew their purchasing interest depending on developments in the credit and other financial markets.

E. EXTERNAL SECTOR

16. Despite the collapse of crude oil prices in the second half of 2008, the ESCWA region's external sector performance remained strong on average for the year. The total current account surplus of GCC countries is estimated at \$236 billion for 2008, up from \$195 billion in 2007. The total current account surplus of the MDEs is estimated for 2008 at \$22 billion, up from \$6 billion in 2007. Egypt, Jordan, Lebanon, the Sudan and Yemen are estimated to have recorded current account deficits in 2008, mainly due to the rising prices of commodity imports and declining exports towards the end of the year. However, the deterioration of current account positions was offset by strong capital account positions. At the end of February 2009, the import-cover ratio of foreign reserves was estimated at 8.8 months for Egypt and at 8.5 months for Jordan, based on the net reserves position. The ratio is estimated at 21.4 months for Lebanon and 16.3 months for Yemen, based on the gross reserves position. Net exports from the region are projected to decline considerably in 2009. Exports of commodity-related goods and products such as crude oil, petrochemicals and other chemical products are projected to decrease. Exports of apparel products from Egypt and Jordan's qualifying industrial zones (QIZs) are expected to decline despite their price competitiveness in the United States. Meanwhile, the moderate growth in domestic demand is expected to sustain import levels in real terms. Egypt, Jordan, Lebanon, Oman, the Sudan, the Syrian Arab Republic, the United Arab Emirates and Yemen are forecast to have current account deficits.

17. The exchange rates of ESCWA member country currencies remained stable in 2008. The GCC countries, with the exception of Kuwait, kept their currencies pegged to the US dollar. Jordan and Lebanon also maintained a US dollar peg. Kuwait kept its currency pegged to a basket of foreign currencies and the Syrian Arab Republic remained pegged to the Special Drawing Right (SDR). Among countries that had adopted a US dollar currency peg, restricted monetary policy became a focus of policy debates. Calls for foreign exchange regime reforms, including a de-pegging and/or revaluation of national currencies against the US dollar intensified as the dollar fell. Appreciation pressures increased, particularly for GCC countries, during the first quarter of 2008. Speculative inflows of foreign funds, anticipating revaluation of regional currencies, caused a surge in liquidity. As the US dollar strengthened and the region's policymakers renewed their commitment to existing foreign exchange regimes, speculative flows subsided. As foreseen in the previous issue of the Survey, the repatriation of speculative foreign funds caused a violent swing in liquidity, particularly in Kuwait and the United Arab Emirates. GCC countries are expected to maintain the present foreign exchange regime for 2009. The GCC Summit in December 2008 confirmed the target date for the GCC currency union as January 2010, with plans to further discuss details in the course of 2009. As the financial crisis has unfolded in international capital and money markets, the monetary authorities of MDEs have started to take a cautious approach to their foreign exchange-rate policy. Egypt, the Sudan and Yemen have allowed a gradual devaluation of their national currencies against the US dollar. In the first quarter of 2009, Iraq suspended the gradual appreciation of its national currency against the US dollar, a measure that had been in effect since November 2006. Jordan, Lebanon and the Syrian Arab Republic have all announced their intention to maintain their foreign exchange-rate regimes as a policy to protect their economies from the impact of the global financial crisis.

F. SOCIAL DYNAMICS

18. As elsewhere, the global financial crisis could have a direct and negative impact on social conditions in the ESCWA region. Up-to-date data do not yet exist for accurate stocktaking. However, whatever the outcome of the crisis, the region as a whole is not expected to meet the MDGs in view of the already faulty structure of existing policies. The prolongation of the current

crisis may not only exacerbate social conditions, but also narrow the space available for social expression, the exercise of human rights, in particular gender equality, and peaceful development. Some aspects of the crisis can already be discerned. On the demographic side, for example, the economic boom leading up to 2008 in the GCC countries had expanded their foreign workforce. Now, trickles of reverse migration are taking place. Still, the demographic composition remains complex. For 2007, the population growth rate stood at 8.2 per cent in Bahrain, 6.8 per cent in Kuwait, 6.4 per cent in Oman, 17.7 per cent in Qatar, 2.4 per cent in Saudi Arabia and 6.1 per cent in the United Arab Emirates. The ESCWA region, including the GCC countries, is still at a phase of demographic transition where a low mortality rate and a high fertility rate co-exist. However, with the exception of Saudi Arabia, the rapid population growth in the GCC countries has mainly been caused by the influx of foreign workers rather than any change in fertility and death rates. In 2007, the share of foreign nationals in the total population was estimated at 49 per cent in Bahrain, 69 per cent in Kuwait, 29 per cent in Oman, 27 per cent in Saudi Arabia and 80 per cent in the United Arab Emirates. In the same year, the share of foreign nationals in the 15+ population age group stood at 81 per cent in Qatar. Media reports from Kuwait and the United Arab Emirates suggest that foreign workers have started leaving for home after being laid off in these countries. The large relative size of the working-age population, partly due to the demographic transition and partly due to the immigration of foreign workers, is potentially beneficial for development since it may provide what has been dubbed a demographic window of opportunity. However, when employment opportunities grow scarce, positive opportunities turn into their opposites, and the sensitive topic of 'balance of population' between nationals and foreign workers begins again, as in the past, to dominate national debates.

19. As of the first quarter of 2009, no significant number of return migrants has been reported in MDEs which are home to a substantial number of migrant workers in the GCC countries, North America and Europe and which depend on remittances to partly redress balance-of-payments shortfalls. If the economic impact of the global financial crisis persists, there will be an increasing number of returning migrants and, in view of the scarcity of employment opportunities in MDEs, already chronic unemployment could worsen. The

ILO estimated the unemployment rate for the Middle East at 9.4 per cent and for North Africa at 10.3 per cent for 2008.⁴ The unemployment rate of these two regions has shown signs of improvement in recent years but is still higher than in other regions of the world. The anticipated deterioration in employment conditions led the League of Arab States, at its first Arab Economic, Social and Development Summit in January 2009, to designate 2010-2020 as the "Arab decade for employment and reducing poverty by half". However, in the absence of redistributive initiatives redressing the income gap and an emphasis on development via increased diversification and industrialization, the future is unlikely to hold out much prospect of either employment creation or poverty reduction.

20. Reform measures aimed at social development in the region recorded certain advances in 2008. In the budget formation for the fiscal year covering 2008, the fiscal priorities of the region's Governments included education and health. This trend has continued in fiscal 2009, in parallel with economic stimulus packages to cope with the global financial crisis. Labour market reform has been ongoing in GCC countries, including a review of the sponsorship system governing foreign workers and of their status in general, the proposal of minimum wage guidelines for nationals and proposals for labour law reforms. Against severe consumer price inflation in 2008, wage adjustments have been made in several countries of the region, including in Jordan in the form of a revised minimum wage and in Lebanon in the form of revised public sector wages. These steps do not, however, meet even the minimum requirements for addressing this issue and the absence of autonomous labour organizations throughout the region allows wage gains to take the form of charity as opposed to rights. Jordan is planning to establish an unemployment fund within the country's Social Security Corporation in 2009. Despite Governments' professed fiscal priorities, the concern remains that the anticipated deterioration of fiscal positions may result, particularly in the MDEs, in declines in Government spending on social development. Clearly, a prolongation of the global recession along with depressed oil prices could lead to outcomes similar to those experienced after the collapse of oil prices in the 1980s.

⁴ ILO, Global Employment Trends, January 2009.

21. Developments with respect to gender equality continue to gain attention in the ESCWA region, reflecting the increasing number of women who complete higher education but are unable to participate in the labour market due to cyclical patterns characteristic of a rent economy that already short-changes the entire labour force. The female unemployment rate in the region remains substantially higher than that for males. According to ILO estimates, female unemployment was 13.3 per cent in the Middle East and 15.9 per cent in North Africa⁵ in 2008 versus male unemployment at 8.2 per cent and 8.1 per cent, respectively. It is feared that the anticipated deterioration of employment conditions in the region, due to the global financial crisis, will have adverse effects which will be disproportionately higher for female jobseekers.

G. POLICY DEVELOPMENTS

22. Policymakers in the region faced a growing dilemma in 2008 as consumer price inflation soared and unemployment rates remained stubbornly high. Fiscal expansion was sought in order to achieve development targets even as monetary authorities tightened their monetary stance with the declared intention of alleviating inflationary pressures. With the exception of Egypt where a floating exchange-rate regime was adopted, monetary authorities in the region faced a restricted policy space that was subject to the stability of foreign exchange rates. Nevertheless, liquidity management by monetary authorities in the region, particularly Kuwait and the United Arab Emirates, effectively tightened their monetary stance. As a result, the balance sheets of central banks in Kuwait and the United Arab Emirates contracted from the second to the third quarter of 2008. In the face of the global financial crisis, monetary authorities in the region have now reversed their policy from one of monetary tightening to one of monetary easing. A series of interest rate reductions has been observed in the region since October 2008, together with a reduction in commercial banks' reserve requirements and the provision of additional credit facilities – a reversal in monetary stance which has brought with it a gradual decrease in inter-bank money market rates which had shot up in September 2008. Several countries in the region, namely, Egypt, Jordan, and Qatar, have been more

cautious in their monetary easing. In addition to monetary easing, policy measures to cope with the global financial crisis in the region have included in most cases fiscal and institutional support for the financial sector. Kuwait, Qatar and the United Arab Emirates have taken measures to enhance the commercial banks' balance sheets. Jordan, Kuwait, Saudi Arabia and the United Arab Emirates have all announced that they will guarantee bank deposits.

23. The fiscal response to the global financial crisis has varied among ESCWA member countries. For fiscal year 2009, an expansionary fiscal stance is sought in those GCC countries which have accumulated sizeable fiscal surpluses since 2002. According to GCC national budgets, infrastructure investment, health and education, and social provisions are emphasized. The fiscal stance has become more cautious in the MDE subregion due to a revised outlook and public debt constraints. Rapidly-declining oil revenues have forced Iraq, the Sudan and Yemen to consider fiscal austerity measures. Across the region, further weakening of revenue prospects could lead to declining Government budgetary spending. With the importance of fiscal stimulus being much emphasized lately, to safeguard global stability and economic growth in the aftermath of the financial crisis, the MDEs may require additional international support in order to avoid contractionary postures.

H. PROSPECTS

24. The ESCWA region on average is projected to grow by 2.1 per cent in real GDP in 2009, with the consumer inflation rate declining to 6.3 per cent. The region's growth rate is expected to be the lowest since 2002. While inflationary pressures have diminished since 2008, the level of consumer inflation is projected to remain above that of 2005. Despite the severe downward adjustments in the prices of crude oil, commodity-related products, financial assets and real estate, a moderate growth in domestic demand is forecast for 2009. However, the examples of Japan and the United States show that there could be a time lag of 18 to 24 months before a downward asset price adjustment shows up in the real economy. On the other hand, such a juxtaposition is perhaps unwarranted, since regionally it could take less time. Since the region's real estate and stock market asset prices peaked in the second quarter of 2008, sentiments about near-term growth prospects in the region have remained mixed. A

⁵ ILO, Global Employment Trends, January 2009.

case in point is the emergence of disparate views on the availability of credit in the first quarter of 2009. While central banks and commercial banks in the region claimed that sufficient liquidity was available, the business sector reported facing tight credit conditions. Commercial banks in the region became increasingly risk-averse and tightened their lending practices. The lack of sufficiently profitable projects, given the risk factors, led to an increase in liquidity within the banking sector. Meanwhile, the business sector faced an increasingly difficult credit situation. The time lag observed in Japan and the United States suggests that the resilience of business sector confidence in the ESCWA region may continue well into 2009. However, with looming uncertainty about economic conditions external to the ESCWA region, such as crude oil prices and global recession, the risk of economic contraction in the region in 2010 remains.

25. As economic growth prospects for 2009 and 2010 appear to be increasingly weak in the ESCWA region, the role of the public sector in assisting the course of economic development is expected to expand. As the crisis started with the credit crunch and de-leveraging in the financial sector of the United States and Western Europe, the region's monetary authorities have turned

to supporting the financial system. Since September 2008, the ESCWA region's monetary authorities have successfully defended the banking systems in their respective countries with prompt policy responses. Further monetary stimulus, if unaccompanied by fiscal stimulus, is unlikely to have much lasting impact on the real economy, especially if the banks are not persuaded to become more involved in industrial development finance. De facto, the present steps are a form of insurance of private banking by the state sector. However, had the present measures been taken in concert at the regional level, these channels alone could have represented a commitment and public insurance for long-term loans committed to regional development over the long run. This alone would have attenuated the risks that regional banks face in committing themselves fully to regional industrial development. The fiscal stance among ESCWA member countries has varied significantly. Efforts at the national level must be strengthened to avoid fiscal contraction in economic and social spending, including economic infrastructure, social protection, social safety nets, employment, education and health. Additional global and regional cooperation is urged in order to enhance the prospects for national economic growth.

II. RESPONDING TO THE INTERNATIONAL FINANCIAL CRISIS

26. The ESCWA secretariat in cooperation with ILO and the Government of the Syrian Arab Republic, held its "Regional High-level Consultative Forum on the Impacts of the International Financial Crisis on ESCWA Member Countries: the Way Forward" in Damascus on 5-7 May 2009. The Forum participants discussed the impact of the international financial and economic crisis on ESCWA member countries and the national, regional and international responses to the crisis. The views of experts and of representatives of ESCWA member countries and of regional and international organizations were all taken into account. On 7 May 2009 the Forum adopted the "Damascus Declaration on Responding to the International Financial Crisis in the ESCWA Region".

27. The Forum requested ESCWA member countries to undertake several actions and adopt appropriate policies to respond more effectively to

the crisis. In general, member countries were requested to take active measures to offset the repercussions of the crisis on their economies and, in particular, to mitigate its impact on economic growth, development and employment. The measures taken will depend on whether a country is oil-exporting, has a more diversified economy, is a least developed country or is under occupation.

28. The ESCWA member countries were requested in particular to adopt sustainable expansionary fiscal policies to boost domestic demand and shorten the period of low economic growth. Fiscal stimuli in ESCWA member countries should meet key development goals, and be coordinated and implemented in cooperation with the private sector and civil society. Such policies should be targeted primarily towards infrastructure, agriculture, industry, health, education, environment and social protection mechanisms.

29. ESCWA member countries were further requested to take measures to ensure greater cooperation with and support for the private sector, particularly in the real economy, with a special focus on small and medium-sized enterprises and the banking sector in those member countries facing capital reversal and liquidity crises.

30. Member countries were requested to encourage national, regional and international funds to provide increased liquidity to those among them facing liquidity crises. Such funds are required to strengthen the response to the crisis through measures that provide long-term financing for low- and medium-income countries in the region in order to enable them to meet the MDGs. Sovereign wealth funds in the ESCWA region were encouraged to increase their investment in the real economy of the region, in particular in those member countries with a comparative advantage in agriculture and industry.

31. The Forum requested member countries to promote greater regional integration, particularly in monetary and financial affairs, and to coordinate stimulus policies in order to improve the effectiveness of their response to the crisis. Member countries were also requested to enhance the efficiency of regulatory frameworks in the financial sector to better serve the real economy.

32. Oil exporting countries in the region were requested to pursue diversification vigorously in order to reduce dependency on the oil sector, by diversifying exports and investing in technology and infrastructure, thus expanding employment opportunities.

33. The Forum requested the member countries to facilitate intraregional flows of trade in goods and services, people and capital to enhance regional integration among them. They were further urged to promote South-South cooperation as part of the promotion of economic and technical cooperation between developing countries.

34. Member countries were requested to take proactive steps towards ensuring more active participation of developing countries, in particular those in the ESCWA region, in managing the global economy. The current crisis has demonstrated the need for reform and, in particular, for a more representative, legitimate and thus effective management of the global economy. This cannot be achieved without the active participation of developing countries in global economic decision-making mechanisms.

35. On the social side, the member countries were called upon to strengthen employment and social protection policies in the interest of ensuring decent work for all, including employment services, active labour market policies, unemployment insurance, sustainable and adequate pension policies, and complementary cash transfer programmes.

36. This year's Survey will provide an in-depth analysis of a subset of the policy recommendations adopted by the Forum. The analysis will focus on the justification for the recommended policy and show how such a policy could lead to a more effective response that would guard against some of the negative effects of the crisis and/or create an opportunity for member countries to benefit from the crisis.