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Middle East Economies: Dim Light at the End of the Tunnel

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In mid-October 2020, the two main international financial institutions, the World Bank and the International Monetary Fund, updated their assessments regarding the implications of the coronavirus crisis for Middle East economies. Previous estimates were published in April this year; the update paints both a pessimistic picture and expectations of improvement, contingent on the discovery of medical solutions to the pandemic. Yet despite the hopes for improvement, estimates are that it will be several years before the economic effects of the crisis disappear.

Updated estimates by economists from the World Bank and the International Monetary Fund (IMF) point to the serious consequences of the coronavirus pandemic for Middle East economies, even more severe than what was predicted by these institutions in April 2020. The outlook for 2021 and estimates regarding the length of the recovery period from the crisis raise concerns of exacerbation of previously existing regional problems, as well as serious danger to the region's socio-economic stability.

Last month, World Bank economists revised their previous estimate, which already did not paint an auspicious picture. They now expect the regional economy to shrink by 5.2 percent in 2020, and estimate that the recovery in 2021, contingent upon finding medical solutions to the coronavirus pandemic, will be partial only. International Monetary Fund economists have also revised their estimates and expect regional GDP to fall by 4.1 percent in 2020 (compared with the 2.8 percent forecast of April). The accelerated increase in health care expenditure and the creation of safety nets for vulnerable populations have increased the regional states' deficits, and with them, their financial needs. World Bank economists estimate that regional public debt relative to GDP will increase from 45 percent in 2019 to 58 percent in 2022. (This rate is relatively low compared to other countries and regions around the world, as it includes oil-producing countries, most of which do not have large public debt relative to the GDP.) Most countries in the region have resorted to a basic set of measures, from exemptions of certain payments, deferral of tax payments and fees, reduction of interest rates, issuance of government bonds, transfers to low income populations, increased bank liquidity, reduced bank reserves, and encouragement of loan deferral. However, IMF economists note that the rate of emergency aid to the region's economies was only 2 percent of GDP, while in the rest of the world it reached 3 percent.

In the updated estimate, as in the previous one, economists point to the vulnerability of the economies of the oil and gas producing countries to a drastic fall in prices, which according to the OPEC agreements regarding output restrictions remained 40 percent lower than before the outbreak of the pandemic. Due to their high dependence on the price of oil and the fact that the oil industry is affected more than other industries, the producing countries suffered from a more severe economic contraction, which will reach 6.6 percent by 2020, compared to the region at large.

Bahrain is the main casualty among the oil producers, both due to the fall in oil prices and due to the paralyzed tourism industry – a sector in which the state invested heavily. While GDP will shrink by 5 percent this year, the surprising negative figure for Bahrain is the huge increase in public debt, estimated by World Bank economists at 130 percent of GDP – a figure more reminiscent of Lebanon than that of an oil producing country. In Saudi Arabia, Bahrain's immediate neighbor, GDP in 2020 will decrease by 5.4 percent, on the reasonable assumption that Saudi Arabia will maintain oil export restrictions. Growth in other industries will be hurt in part by the decision to hike up the VAT rate from 5 to 15 percent, in an effort to stem the consequences of the increase in health and welfare spending. In the United Arab Emirates, the slowdown in economic activity will continue as in other gas and oil producing countries, especially due to the postponement of Expo 2020, which was supposed to give a boost to the local economy. It is expected to shrink by 6.3 percent in 2020 and grow by 2.5 percent the following year, assuming that the event takes place in Dubai next year. The World Bank's economists presume that the Abraham Accords will also expand economic opportunities, as a result of commercial and technological cooperation between Israel and the UAE.

Countries of the region that do not produce gas and oil share a similar outlook, but the causes are somewhat different. Egypt, which still falls in the consumer category despite being a gas and oil producer, lost 2.7 million jobs due to the coronavirus crisis, and unemployment rose to 9.6 percent (according to the official figure, which presumably is much lower than the real situation). Government debt will rise from 90.2 percent of GDP in 2019 to 93.8 percent at the end of 2020. Egypt took an unusual step when it dropped government debt to insurance funds and thus lowered the public debt ratio relative to GDP. Egypt also deviates from the regional picture, as it expects positive growth of 3.5 percent in 2020 (although this is a decline compared to estimated growth in 2019) and 2.2 percent in 2021. Given the almost full shut-down of the tourism industry across the region and the sharp decline in remittances of Egyptian workers abroad, this is a less negative picture than might have been expected.

Lebanon has gained global media coverage, having won the dubious title of the first country in history to declare insolvency, and following the explosion in the Beirut port, which caused the deaths of hundreds of people as well as widespread destruction in the port area. Lebanese GDP is liable to fall by 19.2 percent in 2020 and another 13.2 percent in the coming year.

The second wave of the coronavirus has also hit the Palestinian population and economy, and the situation has been exacerbated by the ongoing delay in the transfer of tax monies from Israel to the PA. After three years of minor economic growth at a rate of 2 percent annually, the pandemic will worsen the economic slowdown and Palestinian GDP will shrink by 8 percent in 2021. Nearly a third of the Palestinian population already lives below the poverty line.

The forecasts of the economists for the recovery process are both cautious and reserved. Their analyses indicate the consequences of the damage to employment in the tourism industry in Jordan, Lebanon, Morocco, and Egypt, which will not entirely dissipate even with the return to normal economic activity. Economists argue that the risk of company insolvency is double than what was estimated before the crisis, which will make it difficult for companies in certain industries to raise credit. The financial sector of the countries in the region commands special attention, as it is fundamental to the ability of governments to maintain a level of socio-economic stability. IMF economists point to the deterioration of the banking system in Bahrain, Oman, and the United Arab Emirates, due to the decline in profitability and stability caused by lower interest rates, changes in liquidity ratios, and a decline in the value of government bonds held by banks. The World Bank’s economists, who examined a series of assumptions, estimated possible cumulative damage of $190 billion against total regional financial assets. Their conclusion is that governments will be forced to find a balance between the need to deploy a socio-economic safety net and maintain financial stability. The potential ensuing action item is to exercise restraint in all matters relating to subsidies, grants, and other relief to the needy. The accompanying implications are a slowdown in the process of emerging from the crisis and an increasing number of people living below the poverty line.

The IMF and World Bank recommend continuing the effort to preserve jobs, ensure the liquidity of small and medium-sized businesses and households, and protect more vulnerable populations. According to the economists, the "lockdown-reopen" policy causes a decline in productivity, an increase in unemployment, and an increasing difficulty for small and medium-sized businesses to finance their continued activity. To address the fiscal pressures, the recommendations are to improve and streamline tax collection, make taxation as progressive as possible, gradually reduce fuel subsidies, and in the short term, reduce expenditures on unnecessary budget items.

Israel has a clear interest in the consequences of the economic situation for the stability of the region's countries, and especially its immediate neighbors. The reports of the international economic institutions show that the governments of Egypt and Jordan are in control of the situation and are dealing with the healthcare and economic pressures reasonably well. Indeed, the election campaign and the change of government in Jordan did not provoke any political unrest.

On the other hand, the economic situations in Lebanon and the Palestinian Authority, in juxtaposition to ongoing political developments, indicate high volatility, both internally and in relations with Israel. In these two fronts, Israel has the ability to influence political-economic stability in the immediate and medium terms, and must consider the use and timing of levers of influence. Arranging the transfer of tax money to the Palestinian Authority is imperative to strengthen its stability, and should be part of preparations to emerge from the current crisis in the Israeli and Palestinian economies in all that is related to labor and trade. The crisis in Lebanon, on the one hand, increases the potential for a security confrontation, even if unplanned, but on the other hand it offers an opportunity for political-economic arrangement, which can help reduce the risk of dangerous and unnecessary friction.