



Middle East/Africa Fourth Quarter 2011 Economic Review

Fiscal vulnerability remains MEA region's main concern

According to the International Monetary Fund's (IMF) Regional Economic Outlook, **weakening global activity and further political uncertainty are the foremost risks that are likely to affect the Middle East and Africa (MEA) region's performance.** The IMF report notes that oil exporting nations of the MEA region have benefited from continued high energy prices and are slated to finish off 2011 clocking in a GDP growth of 5% before easing to 4% in 2012. However, these countries do face

At a Glance

- **South Africa:** According to Stats SA, South Africa's consumer price index (CPI) stood at 6.1% in November, lower than the market expectation of 6.2%.
- **Israel:** The Bank of Israel's monetary committee has left its key benchmark interest rate unchanged at 2.75% for January 2012.
- **Egypt:** According to a *Financial Times* report, the country's political unrest has cost the government \$14 billion in foreign currency reserves over the first ten months of 2011.
- **Morocco:** The Gulf Cooperation Council (GCC) has approved the setting up of a Gulf development fund worth \$5 billion, out of which \$2.5 billion would aid development projects in Morocco.
- **Jordan:** According to the Department of Statistics, Jordan's trade deficit jumped 18.8% to \$8.33 billion by the end of October 2011 mainly due to a 17.3% increase in imports.

a downside risk in the likelihood of fiscal and debt challenges in the developed nations that could adversely impact global activity and international oil prices.

In the case of oil importing nations, which include Morocco, Egypt and Jordan, the IMF report notes that high commodity prices have dented the financial reserves of these countries. While Egypt faces the threat of dwindling foreign currency reserves, Jordan is facing the most difficult year yet trying to battle widening trade deficits and swelling energy import bills. As the Euro-zone debt crisis impacted Morocco's exports to the European region, the Kingdom is keen on diversifying its export markets' reach.

Adding to the woes of these cash-strapped oil importing countries is a sharp decline in tourism revenues, which is a critical source of foreign currency. According to the Arab Tourism Organization, the Arab Spring uprising has cost the region's tourism sector over \$7 billion. With the political and economic transformation in the strife-hit countries still underway, the IMF expects the oil importing countries to register GDP growth below 2% in 2011.

Elsewhere, South Africa trudged along registering lower than expected GDP growth in the third quarter of 2011, due to declines in key economic sectors. Israel, though far removed from the Middle East's regional turbulences, is wary of a slowdown in light of waning domestic activity. In the wake of continued domestic as well as external pressures, the IMF's Regional Economic Outlook review anticipates the Middle East and North Africa region's real GDP to expand 4% in 2011. Regional inflation is expected to reach 10.2% for 2011 before narrowing to 7.7% in 2012. In the case of South Africa, restricted growth in advanced economies is expected to limit its GDP expansion to 3.5% in 2012.

South Africa: GDP growth lower than market expectation

The consumer price index (CPI) stood at 6.1% in November, which was lower than the market expectation of 6.2% as noted by Statistics South Africa (Stats SA). However, the CPI breached the Reserve Bank's target inflation range set between 3%-6%. An increase in the price of food and non-alcoholic beverages and transport, mainly due to a rise in petrol prices, were the key drivers of inflation. According to Nedbank economists, although the Reserve Bank has presently left its key interest rate unchanged at 5.5%, its future course of action would depend on the impact of the Euro-zone debt crisis on the domestic economy and inflation. Nedbank economists also noted that inflation is likely to continue rising in the coming months mainly due to higher food and administered prices.

Another issue burdening an already weak economy is a widening trade deficit. Yet encouragingly, South Africa's trade deficit in November decreased to \$981 million from around \$1.14 billion in October— the biggest trade gap in ten months, as noted by a *Bloomberg* report. A rise in exports mainly due to higher dispatches of chemicals and allied products helped ease the

trade gap. While overall exports rose 11.9% (month-on-month), imports climbed 8.1% on a monthly basis. However, the commerce ministry noted that the exports growth in November was the slowest in almost two years. Due to a slowdown in key market such as the United States and Europe, the ministry expects exports of around \$280 billion in 2011-2012 versus an earlier target of \$300 billion.

Fanning the trade gap was also a loss in the value of the Rand currency against the U.S. dollar, which inflated import costs. According to a *Bloomberg* report, the Rand lost 19% against the dollar in 2011.

What's more, according to the National Treasury, **South Africa's budget deficit stood at \$3.53 billion in November.** While revenues amounted to around \$52.8 billion in the April-November period, expenditures came in higher at \$70.4 billion. The Treasury in its three-year fiscal program noted that the nation's budget deficit for fiscal year 2011-2012 would account for 5.5% of GDP primarily due to lower revenues, before decreasing to 4.5% of GDP in 2013-2014.

According to Stats SA, South Africa's economy expanded 1.4% in the third quarter of 2011, lower than the market expected growth of 1.8%. The anemic performance was mainly due to a contraction in the agriculture, mining and manufacturing sectors, which account for around 25% of the economy. According to a *Financial Times* report, while the decline in the agriculture sector was challenging to estimate, the mining sector plunged 17.4% (annualized) and the manufacturing sector tumbled 1.9% (quarter-on-quarter) failing to recover from the aftermath of the strike season.

Yet, it is not all doom and gloom as the retail and wholesale trade sectors posted improved performances. As noted by Stats SA, the wholesale trade sales (seasonally adjusted) for the third quarter of 2011 rose 1.9%, while retail trade sales grew 6.3%, mirroring the support from consumer spending. Stats SA also reported a 14.2% jump in motor trade sales in the third quarter of 2011, thanks to an increase in fuel and new vehicles sales. Still, Standard Bank economists are wary of the downside risks in the retail sector and expect lackluster domestic and global economic conditions coupled with pricing pressures to stymie growth in both the retail and wholesale sectors.

Elsewhere, the unemployment rate eased slightly to 25% in the third quarter of 2011 from 25.7% in the second quarter, according to Stats SA. While the formal and agricultural sectors added jobs, job losses continued in the informal sector and private households as well. A *Reuters* report noted that South Africa's economy needed 7% GDP growth to have a visible impact on the country's jobless rate. **According to finance minister Pravin Gordhan, it would be difficult to achieve the target of creating 5 million jobs by 2020, given the present economic situation.** South Africa has added a total of 343,000 jobs in the past year, according to the Stats SA report.

In light of sluggish global economic conditions, the International Monetary Fund has cut South Africa's GDP growth to 3.0% for 2011 from an earlier estimate of 3.5%. This was also in line with the National Treasury's revised growth estimates of 3.1% for 2011, down from 3.4%.

Israel: Growing concerns of a slowdown

The Bank of Israel's monetary committee has left its key benchmark interest rate unchanged at 2.75% for January 2012, in a bid to support the economy and while maintaining inflation within the bank's target range of 1%-3%. What's more, according to the central bank, economists' 12-month inflation expectation has slipped to 2.2% from an earlier estimate of 2.3%. A Central Bureau of Statistics (CBS) report noted a 2.6% increase in consumer prices in November from a year ago, which was the lowest rise in a year.

Still, the widening trade deficit remains a concern. According to a CBS report, Israel's foreign trade deficit was \$1.9 billion in November 2011 compared to \$530.5 million a year ago. However, the trend data over the period September –November mirrored a 6.3% (annualized) rise in imports versus a 13.9% (annualized) increase in the export of goods. The CBS report noted that a weaker Israeli shekel influenced the import and export transactions. In the case of exports, the trend data point to a 19% jump in exports by high technology industries versus a 37.4% drop in exports of electronic components. Exports of high technology industries account for 47% of total manufacturing exports. On the imports front, while imports of raw materials decreased 1.5%, the import of machinery and equipment (constituting 75% of investment imports) jumped 22% in the September-November 2011 period. Fuel imports over the January-November 2011 period pointed to a rise of 28.4% versus a year ago.

Israel's budget deficit continues to increase. According to the Ministry of Finance, due to a tax short fall of around \$926.9 million in 2011, the budget deficit is expected to account for 3.4%-3.5% of GDP. This is 0.5% above the deficit target. The finance ministry has also expressed its concern over a tax revenues shortfall stemming from the impact of the global economic slowdown on the domestic economy.

Israel's GDP expanded at an annualized rate of 3.4% in the third quarter of 2011, beating a Reuter's poll economic growth estimate of 2.6%, as noted by a CBS report. However, growth was marginally lower than an economic expansion of 3.5% earlier in the second quarter. According to a *Reuters* report, the economic expansion in the period July – September was driven by a 13% jump in fixed asset investments and a 3.2% rise in government spending. Private spending clocked in a slower growth of 0.9%.

Meanwhile, the unemployment rate in Israel fell to an all-time low of 5% in October, despite slowing economic activity as reported by the CBS. Yet, the report noted that the unemployment rate has responded to economic activity at its slowest pace. In fact, an Economic and Financial Review by Bank Hapoalim, indicated that the rate of increase in the number of payrolls is not

sufficient to sustain the unemployment rate at its present low level. Hence, the jobless rate is expected to rise in the coming months, and according to the Bank of Israel, will likely reach 6.4% in the last quarter of 2012 compared to 5.6% in the third quarter of 2011.

Encouragingly, the consumer confidence index of Bank Hapoalim and TNS, which averaged around the 132.1 level over the third quarter, increased to a level of 135.1 in October. This rise was driven by a wave of optimism following the release of the Israeli soldier Gilad Shalit, who was held in captivity by Hamas militants for five years. The other factor that boosted consumer confidence was an uptick in the Tel Aviv 25 Index, which managed to gain some lost ground in the month of October by rising 6%. In the third quarter, the Tel Aviv 25 Index had fallen 11.9% versus an increase of 15.4% in the comparable period a year ago, a Bank Hapoalim report noted.

The Bank of Israel expects Israel's GDP to expand 4.8% in 2011. However, the GDP growth forecast for 2012 has been revised downwards to 2.8% from an earlier estimate of 3.2% in September, mirroring the weakening global condition due to the Euro-debt crisis.

Egypt: Egypt's foremost elections get underway

Egypt's citizens cast their first vote in the wake of their foremost parliamentary elections, since the downfall of the Mubarak regime. However, in the run up to the elections, the nation was gripped with fresh protests, leading to the dramatic resignation of Prime Minister Essam Sharaf and the entire Egyptian cabinet. The demonstrators poured into the episodic Tahrir Square calling for an end of the rule of the Supreme Council of the Armed Forces (SACF), headed by Mubarak-era defense minister Mohammed Hussein Tantawi, who had taken control following the ouster of Hosni Mubarak. These protests dubbed as the "second revolution" were a public outcry against the interim military rule and the need for a civilian-led government to handhold Egypt's transition to democracy. The final phase of voting is expected to be completed in March 2012.

In addition to a vulnerable political situation, the nation's fiscal state teeters precariously as well. **The drying up of financial reserves is the foremost cause for concern, with Egypt's budget deficit threatening to account for 11.7% of GDP in 2011, as noted by the ministerial committee.** According to a *Financial Times* report, the country's political unrest has cost the government \$14 billion in foreign currency reserves over the first ten months of 2011. The report noted that the net international reserves in December 2010, prior to the uprising, had stood at \$36 billion.

What's more, the level of liquid reserves, comprised of convertible foreign currencies such as securities, cash and deposits, is falling at a faster rate compared to the net international reserves. According to data released by the Central Bank of Egypt (CBE), liquid reserves were estimated to be \$16.8 billion at the end of September 2011, down from \$30.9 billion in December 2010.

The report noted that the present level of reserves would narrowly cover three months of imports – considered a minimum- and the forecasted external financing needs for 2012.

According to a *Financial Times* report, dwindling reserves are likely to affect the Egyptian pound as well. The Egyptian pound has held steady amidst the 10-month period of political upheaval, thanks to central bank's intervention in supporting the currency using its U.S. dollars. However, it remains to be seen if the bank would be in a position to continue managing the Egyptian pound in light of deteriorating reserves. According to a *Financial Times* report, the Egyptian currency has thus far fallen by over 3% since January 2011, trading at 6 Egyptian pounds to 1 U.S. dollar. Adding to the woes has also been a rise in the yields of government bonds, as noted by a *Bloomberg* report.

Elsewhere, the nation's unemployment rate rose to a 10-year high of 11.9% in the third quarter of 2011, noted by Central Agency for Public Mobilisation and Statistics (CAPMAS). Egypt's annual inflation rate increased to 9.1% in November, after falling continuously for four consecutive months, mainly due rising food prices according to a report by the Central Bank of Egypt. With falling reserves and a higher inflation, the central bank hiked its overnight deposit rate for the first time after a span of three years, by 100 basis points to 9.25% and its overnight lending rate by 50 basis points to 10.25%.

On a positive note, Suez Canal revenues, a critical source of foreign currency alongside tourism, rose 5.5% year-on-year to \$435.5 million in November, the Suez Canal Authority reported. However, revenues in October were higher at \$447.9 million. According to official statistics, tourist arrivals jumped 23.2% in the third quarter of 2011 versus a 35.4% drop in the second quarter. Yet, the tourism sector is expected to end 2011 on a rather lackluster note. Revenues are anticipated to fall 30%-35% to around \$9 billion due to the overall impact of the Arab Spring uprisings, as noted by the tourism ministry. In an effort to enhance tourism revenues, the tourism ministry is keen on launching marketing campaigns in Europe, the Gulf, Americas, South-east Asia and China.

Morocco: GDP growth to ease in Q3 2011

According to Morocco's planning authority report, the Kingdom's economic growth is likely to slow to an annualized rate of 4.1% in the third quarter. The High Planning Commission (HCP) mentioned that the slowdown was primarily due to declines in the non-agricultural sectors, in particular mining and tourism. The country's economy had expanded 5% in the first quarter of 2011 and 4.2% in the second.

The HCP report noted that the mining sector's value-add is expected to be 2% in the third quarter compared to 2.3% in the second quarter and 14% in the first quarter. Morocco is among the most sought after tourism destinations in Africa, with tourism constituting almost 20% of the country's GDP and accounting for around 17% of employment in the industry, as noted by a

Moroccan online-based media report. With the region **engulfed by political instability and uncertainty in the European Union, the HCP expects a 1.8% (quarter-on-quarter) fall in value from the tourism sector in third quarter.** The European Union is one of Morocco's key sources of tourists.

Elsewhere, a tight supply chain for phosphates is expected to continue into 2012, according to the Kingdom's finance and economy ministry. Consequently, **Morocco, one of the world's largest holders of phosphate reserves, expects prices of phosphates and its by-products to remain strong in the coming months.** Encouragingly, phosphate rock prices stood at \$197.5 per ton in September, after rising 41% from January to July, as noted by the ministry. What's more, exports of phosphates and its by-products jumped 34% to \$4.3 billion in the first nine months of 2011 over the year-ago period. According to the ministry, although the export volumes of phosphate rock tumbled 7% in the January-September period, the value of the commodity surged 42% thanks to firming prices. In addition, export volumes of phosphate by-products increased 7% resulting in a 32% jump in value on the back of favorable prices.

The government of Morocco aims to diversify its export market to achieve long-term economic goals. The foreign trade ministry has identified West Africa and Central Africa as potential export markets. Morocco's exports to Europe, its largest exports market, stood at 63% in August 2011 versus 75% in 2007, as noted by the foreign trade ministry.

Encouragingly, the country's consumer prices continued to retreat, sliding at a year-on-year rate of 1.1% for a second month in a row in October, thanks to a steep fall in food prices, as noted by a HCP report. The consumer price index had reached a year-high of 2.2% in August due to a surge in food and education costs, before easing to 0.8% in September. The HCP anticipates inflation will touch 1.1% by the end of 2011, with core inflation rising to 1.4% due to an increase in domestic food prices in line with global market trends. Morocco's Statistics Office reported an unemployment rate of 9.1% in the third quarter compared to 8.7% in the earlier quarter of 2011, mainly due to a fall in construction activity. While the urban unemployment rate stood at 13.5%, rural jobless rate was 4.1%.

Elsewhere, the Gulf Cooperation Council (GCC) approved the setting up of a Gulf development fund worth \$5 billion, with \$2.5 billion slated to support development projects in Morocco.

On the political front, the Justice and Development Party (PJD) won the most number of seats in Morocco's Arab Spring elections, and is expected to form a coalition government. PJD's secretary general, Abdelilah Benkirane, was appointed as the country's Prime Minister by King Mohamed VI. The polls are a part of the reform process initiated by King Mohamed VI, under the new constitution adopted earlier in July 2011.

The finance ministry expects Morocco's economy to expand 5% in 2011. The Kingdom had registered a 4% GDP growth to around \$95 billion in 2010. The central bank expects Morocco's budget deficit to account for 5%-5.5% of the GDP in 2011.

Jordan: Toughest year yet

According to the Hashemite Kingdom's minister of finance Mohammad Abu Hammour, the year 2011 has been an extremely challenging one for Jordan, primarily due to weakening key economic indicators. In particular, the energy sector is Jordan's greatest cause for concern. Disruption of natural gas supplies from Egypt, due to sabotage attacks on the Arab Gas Pipeline, has forced the Kingdom to resort to heavier and more expensive fuel. What's more, this has resulted in a whopping four-fold rise in electricity generation costs compounding the financial deficit of the state-owned National Electric Power Company (NEPCO), as noted by the finance ministry. The minister of finance expects NEPCO's financial deficit to reach \$1.55 billion by 2011-end.

Jordan's economy has been burdened further by a ballooning energy imports bill. Jordan imports 98% of its energy needs and according to government sources, the Kingdom's energy import bill is anticipated to touch \$4.94 billion or 16% of the estimated GDP for 2011.

According to data released by the Department of Statistics (DoS), Jordan's energy bill surged to \$3.81 billion by the end of September this year, compared to a \$2.26 billion in the comparable period in 2010. The energy bill accounted for 28.5% of Jordan's total imports of \$13.4 billion by September-end. What's more, problems related to the Kingdom's energy supply have deepened public debt, as noted by the finance ministry. Public debt accounted for 57.1% of the GDP by the end of October and according to the finance minister, Jordan's debt-to-GDP ratio is expected to tip over the legal limit of 60% and reach 65% by 2011-end. To bring down the debt to safe levels, the finance minister is looking to issue bonds to the international markets in 2012.

Widening trade deficits remain a concern. Jordan's trade deficit jumped 18.8% to \$8.33 billion by the end of October 2011 mainly due to a 17.3% increase in imports, as noted by the DoS. The Kingdom's key trading partners included member countries of the Greater Arab Free Trade Agreement (GAFTA), the North American Free Trade Agreement (NAFTA) and other non-Arab Asian and European nations. According to the DoS report, Jordan's imports from the Gulf Cooperation Council (GCC) member countries totaled \$4.23 billion versus exports worth \$1.1 billion.

As in the case of Morocco, the GCC has set aside \$2.5 billion out of the \$5-billion worth Gulf development fund to enhance development projects in the Hashemite Kingdom. Other grants and agreements to enhance the budget and other developmental projects in the cash-strapped Kingdom include a \$135.2 million agreement between Jordan and the European Union and \$660 million in aid from the United States.

Meanwhile, regional turbulence has managed to take a big bite out of tourism sector revenues, which is a critical component of the economy. According to the Tourism Board,

revenues from this sector declined 11% to \$1.12 billion in the first eight months of 2011, a trend which is expected to continue in the near future. The Tourism Board also noted a decline in the country's medical tourism, which is also a main revenue draw for the Kingdom.

The DoS reported a 4.6% increase in Jordan's consumer price index (CPI) for the period January-October 2011, over the comparable period a year ago. This rise in inflation was driven by an increase in the price of transport, rents, meat and poultry, education, and clothes and shoes. **What's more, the nation's unemployment rate stood at 13.1% in the third quarter of 2011, as noted by a Middle East North Africa region media report.** While the jobless rate among women was 22.4%, the male unemployment rate touched 11.1%.

A government circular has stresses the importance of continuing with economic and fiscal reforms in the coming year. It also mentioned the government's desire to obtain alternative finances to lower borrowing costs. Jordan's budget deficit ceiling has been fixed at 5.6% of an estimated GDP of \$31.4 billion for 2012. 

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