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IMF Regional Economic Outlook for the Middle East and Central Asia Sees Continued Positive Near-Term Economic Outlook, but the Region Faces Challenges to Sustain Ongoing Transformation and Reduce Unemployment.

The International Monetary Fund (IMF) today released the October 2007 *Regional Economic Outlook: Middle East and Central Asia (REO)*. Mr. Mohsin Khan, Director of the IMF's Middle East and Central Asia Department, highlighted the report's main findings:

"The Middle East and Central Asia region is undergoing a remarkable transformation, driven by rapid GDP growth, which is set to outpace global growth for the eighth year in a row. Helped by continuing high oil and non-oil commodity prices, and despite increased uncertainties in global financial markets, growth in the region is projected to stay in the 6–7 percent range in 2008. All parts of the region are doing well, with growth in the Caucasus and Central Asia projected to be especially strong at 11 percent, the fourth year of double-digit growth. Unemployment remains a big concern, however, especially in the Maghreb countries,[1] where more moderate growth of 5–6 percent is expected.

"But inflation is on the rise in many countries. Fueled by strong demand growth, large external inflows, and generally accommodative monetary policies, average inflation in the region has picked up to 8–9 percent. For oil exporters, the increase has been particularly sharp, to nearly 10 percent in 2007, from 7 percent in 2006. In the context of pegged or heavily managed exchange rates, higher inflation is resulting in significant real exchange rate appreciation in many countries, as would be expected in response to rising oil prices. With no major changes in the policy stance envisaged, inflation is likely to ease only slightly in 2008.

"As oil producers have ramped up their spending, saving in the region has declined. With imports of investment and consumer goods increasing rapidly, oil exporters' current account surplus has dropped to about 17 percent of GDP, from 21 percent in 2006, even though oil prices remain at record highs. Higher private and public sector spending has contributed to this. In the Gulf Cooperation Council (GCC) countries,[2] investment spending plans amount to at least $800 billion over the next five years, with major projects in the oil and gas sectors (funded largely by national oil companies), infrastructure (mainly under public-private partnerships), and real estate (financed primarily by the private sector).

“However, governments in oil-exporting countries, which receive a large share of oil revenues, continue to manage their resources prudently by running sizable fiscal surpluses, only a little below the peaks recorded in 2005–06. Their saving from fiscal oil revenue is projected at about 42 percent in 2007–08, down from about 45 percent in 2005–06.

“The recent global credit market turmoil has so far left the region’s capital markets largely unscathed. Following the sharp equity market correction in 2006, most markets have stabilized or partially recovered their losses. The pace of initial public offerings (IPOs) has eased, but sukuk (Islamic bonds) issuance continues to grow. Signs of stress have, however, been evident in a tightening of liquidity and a widening of bond spreads of banks that have borrowed heavily from abroad, notably in Kazakhstan.

“While the outlook remains positive, downside risks from the global economy have increased. If the credit crunch continues, growth in developed economies could slow sharply, with substantial spillovers to other parts of the world. Further spikes in oil or food prices would add to inflationary pressures and pose a dilemma for policymakers attempting to forestall an economic slowdown. Such a scenario would test the region’s resilience, which has been strengthened in recent years by sound macroeconomic policies, huge increases in official reserves and other foreign assets, and reductions in debt.

“Against this more uncertain background, the region faces important policy challenges to sustain its transformation and make greater headway in reducing poverty and unemployment. Chief among these are managing large foreign exchange inflows, solidifying fiscal and external sustainability in some countries, developing the financial sector, and promoting economic diversification, especially by creating conditions for a dynamic private sector.

“Historically high foreign exchange inflows in recent years have been a critical factor underlying the region’s greatly improved performance. The challenge now is to maintain this progress, while limiting the inflation that has accompanied it. Oil exporters should continue with their spending plans, which are comfortably affordable and will still allow them to build their defenses—in the form of net foreign assets—against possible external shocks, including oil price declines. With pegged exchange rates in many of these countries, open and flexible goods and labor markets, as well as expanding absorptive capacity, are the best means to limit inflation. For non-oil exporters, tighter fiscal policies and, where currencies are not pegged, less resistance to nominal exchange rate appreciation would be helpful.

“Medium-term fiscal and external sustainability remains elusive in a few countries. In these countries, and in oil exporters facing declining oil revenues, fiscal reforms are a priority. Efforts to broaden tax bases and improve tax administration, complemented by spending restraint and elimination of subsidies, will help to set debt on a downward path while leaving more room for government spending to fight poverty.

“Financial sector reforms are a priority for all countries in the region. The agenda is different in each country, but includes steps to strengthen banking sector soundness, enhance competition, and deepen financial markets.

“Diversification is particularly important for countries facing rapidly declining oil reserves, and those that are vulnerable to fluctuating commodity prices. It will require further progress on a wide range of structural reforms to improve the business environment, boost productivity in the noncommodity sector, and encourage a dynamic private sector. The current strong macroeconomic environment provides an excellent opportunity to address these issues."

The full text of the October 2007 *Regional Economic Outlook: Middle East and Central Asia* can be found on the IMF's website, www.imf.org.

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[1]The Maghreb countries comprise Algeria, Libya, Mauritania, Morocco, and Tunisia.

[2]GCC countries comprise Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (U.A.E.).