EGYPT

Highlights

- **Growth continued to accelerate and inflation declined to within the central bank's target.** GDP has been growing for five consecutive quarters and fiscal and external deficits are narrowing, anchored within the IMF-supported programme.
- **Reform progress since the end of 2016 was significant.** More recently, there was progress on the industrial licensing, natural gas industry, railway, investment, companies and bankruptcy laws. In addition, the government cut fuel, electricity, water and metro ticket subsidies.
- **Foreign interest increased in local investments and debt.** The approval of the IMF programme in November 2016, coupled with the strong reform momentum, led to higher foreign direct and portfolio investments, increased remittances, a build-up of reserves and increased creditworthiness.

Key priorities for 2019

- **There is a need to move forward with the IPO programme.** The sale of state assets would boost the capital market, increase efficiency and increase private ownership. There is a need to prioritise the sale of well-performing, bankable and profitable companies, to rebuild confidence and attract international investors, even from unconventional destinations.
- **Commitment to the current reform programme should continue.** To date, the economic reform programme has improved Egypt's overall macroeconomic position and its business climate. Further legislation and implementation are needed to strengthen the recovery, including land registration reform.
- **Maintaining meticulous debt management mechanisms is needed to ensure repayment sustainability.** The government's appetite for borrowing remains high, and commitment to the debt strategy implemented by the Ministry of Finance is crucial to reduce the level of public debt, currently at 92.5 per cent of GDP.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	2.9	4.4	4.3	4.2	5.3
Inflation (average)	10.1	11.0	10.2	23.5	20.9
Government balance/GDP	-12.0	-11.4	-12.5	-10.9	-9.8
Current account balance/GDP	-0.9	-3.6	-6.0	-6.1	-2.6
Net FDI/GDP [neg. sign = inflows]	-1.3	-1.9	-2.1	-3.1	-2.8
External debt/GDP	15.1	14.4	16.6	33.6	35.8
Gross reserves/GDP	4.7	4.9	7.9	16.1	n.a.
Credit to private sector/GDP	24.0	25.3	31.1	24.4	n.a.

* Data for Egypt corresponds to fiscal year, July to June, except for reserves and credit to the private sector.

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Macroeconomic performance

Growth continued to accelerate for the fifth consecutive quarter. It reached 5.3 per cent year-on-year in the second quarter of fiscal year 2017-18, and an estimated 5.3 per cent for the year, the highest rate in a decade. The acceleration was driven by manufacturing; trade; tourism and construction; and the recovery in mining. In per capita US dollar terms, GDP shrank in fiscal year 2016-17, as a result of the currency depreciation and sustained population growth, and increased by 5.0 per cent in fiscal year 2017-18. Unemployment declined for the seventh consecutive quarter but remained elevated at 9.9 per cent in the second quarter of 2018, and higher among the youth (24.8 per cent) and women (21.2 per cent). The continued moderation in the unemployment rate is due mainly to the bold reforms implemented in late 2016 and throughout 2017, which have boosted export-oriented businesses and improved the economic outlook. The government has also launched large construction projects that have generated many jobs.

Inflation declined from its record high level of 33.0 per cent in July 2017 to 16.0 per cent in September 2018. Meanwhile, in January 2018, the real interest rate turned positive for the first time in almost two years, and continued to increase, supported by the decline in inflation, despite the easing of monetary policy which started in February 2018.

Fiscal and external positions have improved. The government achieved its first primary budget surplus in 15 years of 0.2 per cent of GDP in fiscal year 2017-18, and the overall fiscal deficit narrowed to 9.8 per cent of GDP (slightly below the target of 9.0 per cent) from 10.9 per cent in fiscal year 2016-17. The narrowing in the deficit was driven by a contained wages bill and lower interest payments, coupled with a continued strong tax performance, despite increases in spending on subsidies and transfers. Gross public debt declined from 103 per cent of GDP in fiscal year 2016-17 to 92.5 per cent of GDP in fiscal year 2017-18. Meanwhile the current account deficit narrowed from 6.1 per cent of GDP in fiscal year 2016-17 to 2.8 per cent in fiscal year 2017-18, thanks to the strong pick-up in tourism receipts, exports (oil, non-oil), Suez Canal revenues, and private transfers, notably remittances, which more than offset increases in imports. In recent months, Egypt has stepped up external borrowing and shifted away from costly short-term domestic debt to rebuild foreign exchange reserves, and reduce crowding out of credit to the private sector. International reserves rebounded to surpass pre-2011 levels, reaching a record high of US$ 44.5 billion in September 2018, and covering close to 7 months of imports, up from a critically low level of 3.1 months in June 2016.

Strong economic growth is expected to continue in the short term. GDP is expected to grow at 5.5 per cent in fiscal year 2018-19 and by 5.8 per cent in fiscal year 2019-20, supported by a number of factors. These include the continued boost in confidence, recovery in tourism, an increase in foreign direct investment, improved competitiveness, continued strengthening of exports, the start of natural gas production from the Zohr field, the implementation of business environment reforms and prudent macroeconomic policies. In nominal dollar terms, GDP per capita will continue to grow in the short term. The main risks to the outlook arise from a slow-down in reforms, and increases in global oil prices which would delay fiscal consolidation. These risks are mitigated by the authorities' strong commitment to, and ownership of, the economic reform programme.

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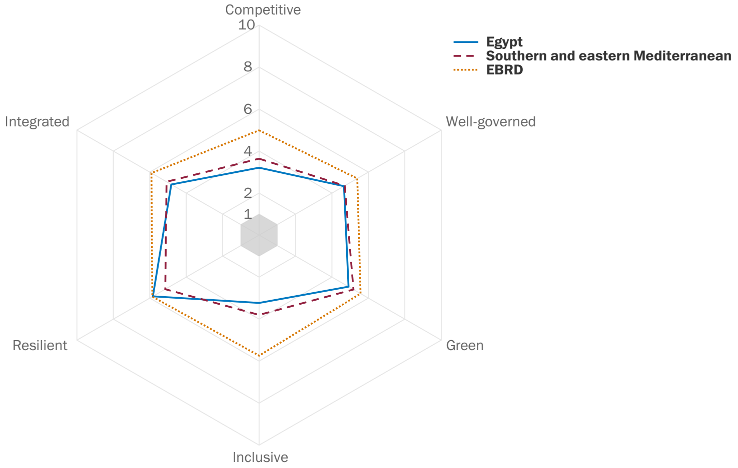
Assessment of transition qualities (1-10)



Major structural reform developments

The government performed several rounds of fuel and electricity subsidy reforms, and increased water and metro ticket prices. The Transport Ministry announced in May 2018 a new tariff scheme for the Cairo Metro that saw ticket prices more than triple in some instances and changed the pricing scheme to a tier system based on distance travelled. Ticket prices doubled under similar circumstances in March 2017. In the latest round of fuel subsidy reform in June 2018, the price for gasoline and diesel increased by 17.4 to 50.7 per cent and the price for a canister of gas for both households and for commercial purposes was raised by 66.7 per cent. Electricity prices increased in July 2018 on all consumption brackets by up to 42 per cent. In June 2018, the government raised piped water prices by up to 46.5 per cent as well as sewerage fees. Lastly, in July 2018, the government partially removed the subsidy on natural gas consumption for the household and business sectors. As a result, gas prices increased by up to 75 per cent.

Private sector participation in previously blocked sectors has been enabled. Two new pieces of legislation came into force in August 2017 and March 2018, respectively: the Natural Gas Act and the Railway Act. The former legislation allows private companies to import and trade natural gas, thus transforming the state from a monopoly distributor to a regulator. The Act also allows incentives to investment in the liquefied natural gas, petrochemicals, and fertiliser industries. Similarly, the latter law would allow private sector participation in developing, managing and operating railway projects.

A new bankruptcy law is in place. The new law was passed by parliament in January 2018. The Act effectively decriminalises bankruptcy by abolishing prison sentences and allows companies more time and options for restructuring by introducing mechanisms to help settle commercial disputes outside the courtroom and simplify bankruptcy proceedings. Special bankruptcy courts to arbitrate on these cases are now being formed.

The Investment Ministry issued amendments to the executive regulations of the Companies Act. The amendments are the most sweeping changes to the regulations of the Companies Act in 35 years, with 51 articles being amended. Amendments to the law allow the formation of single-shareholder limited liability companies and give measures of protection to companies against whistle-blowers.

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Social protection measures are under way. Resolutions to protect the most vulnerable groups were announced by the President in June 2018. The main measures are: an individual's share from a ration card increased from E£ 21 (US$ 1.20) to E£ 50 (US$ 2.80); a 15 per cent hike in the value of pensions for elderly citizens; increases in the allocations for the Ministry of Social Solidarity's conditional cash transfer programme "Takaful and Karama"; and a 7 per cent periodic bonus for public employees, as well as a 7 to 10 per cent rise in base salaries.

The Financial Regulatory Authority (FRA) announced the launch of a movable collateral assets registry. The launch took place in March 2018. The registry is expected to facilitate small and medium-sized enterprise funding and aid the government's financial inclusion efforts by allowing machines, patents and engineering designs to be used as collateral.

A new Leasing and Factoring Act is in place. The legislation, ratified by the President in August 2018, sets up a regulatory framework for factoring and leasing, having been amended by the FRA as part of its drive to improve access to finance for small businesses. Parliament also gave its final approval to the Public Contracts Act in July 2018. The legislation aims to decentralise and streamline tender procedures. Lastly, parliament approved amendments to the Government Accounting Act that legally enshrine the transition towards a cashless economy. The amendments make it mandatory for all government transactions to be electronic, and ban the use of paper cheques for transactions above a set threshold.

The authorities have announced plans to offer shares in state-owned assets in various sectors to promote competition, but implementation has been delayed. The objective of the initial public offering programme is to get state-owned enterprises (SOEs) outside the direct influence of bureaucrats and into the hands of investment professionals, bring private capital into public enterprises, ingrain more private sector management principles in SOEs, make SOEs more profit-oriented and reliant on key business indicators, and avoid "production for production's sake". In July 2018, the government listed the first five public companies: Alexandria Mineral Oils Company, Eastern Tobacco, Alexandria Container and Cargo Handling, Abou Kir Fertilizers and Heliopolis Housing.

Reforms to facilitate land ownership and remove barriers to trade are lagging behind. The investment law approved in 2017 did not resolve some of the difficulties facing investors in land acquisition procedures, despite considerably easing the process of establishing companies and obtaining licences. Moreover, in July 2018, parliament approved amendments to the Customs Act, to slash customs duties on capital goods and expand temporary exemptions for production inputs and packaging equipment, in addition to introducing provisions that aim to curb customs evasion. Meanwhile, an overhaul of the Act is yet to be presented to parliament, including measures to facilitate the flow of goods through Egypt's ports, including establishing a "white list" of importers who will benefit from expedited clearance of goods.

JORDAN

Highlights

- **The economic situation failed to improve significantly in 2017.** Growth was modest, unemployment remains high, and inflation increased as a result of new rounds of subsidy removals.
- **The pace of fiscal consolidation was slower than planned, but the current account deficit widened.** Moreover, public debt is increasing, reserves are declining, and the dinar is strengthening in real terms, undermining competitiveness.
- **Structural reforms progress has stalled.** Public unrest in mid-2018 saw the Cabinet dismissed and long-awaited amendments to the income tax law withdrawn.

Key priorities for 2019

- **There is a need to create more employment opportunities.** The government should enhance the business climate to support the private sector's role in creating jobs. Key areas of reform that need to be tackled include: accessing credit, protecting minority investors, resolving insolvency, enforcing contracts and dealing with construction permits.
- **Further fiscal measures are needed.** Implementing the income tax law amendments and removing additional General Sales Tax (GST) and customs duties exemptions are vital steps for the economy to kick-start a recovery.
- **Social programmes targeting the most vulnerable segments of society should accompany structural reforms.** The government must ensure that the poor are well protected from the short-term economic impact of the reforms, through social welfare programmes that target family and children, housing, refugees and the host communities.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	3.1	2.4	2.0	2.0	2.2
Inflation (average)	2.9	-0.9	-0.8	3.3	4.5
Government balance/GDP	-2.3	-3.5	-3.2	-2.6	-2.9
Current account balance/GDP	-7.3	-9.1	-9.5	-10.6	-9.6
Net FDI/GDP [neg. sign = inflows]	-5.8	-4.3	-4.0	-4.1	-4.3
External debt/GDP	69.4	70.0	70.5	73.1	70.1
Gross reserves/GDP	39.3	37.7	33.3	30.6	38.8
Credit to private sector/GDP	73.0	72.8	77.6	81.9	n.a.

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Macroeconomic performance

The rate of growth in Jordan remained subdued in 2017 and the first half of 2018, at 2.0 per cent. This was below the average of 2.6 per cent recorded between 2010 and 2016, a period when the instability in Iraq and Syria and the presence of Syrian refugees – estimated at 1.6 million – had curbed growth. By comparison, average growth was 6.5 per cent between 2000 and 2009. In 2017, growth was driven by services, notably transportation and financial services. Tourism arrivals increased for the first time since 2010, by 7.8 per cent, signalling the best tourism season since the Arab uprising. The increase continued in the first four months of 2018, when arrivals grew by 4.9 per cent year-on-year. Labour market conditions deteriorated further; the unemployment rate continued to be high, reaching 18.7 per cent in the second quarter of 2018, and higher among women (26.8 per cent) and youth (35 per cent). The overall economic participation rate for women remains one of the lowest in the world, at 15.3 per cent.

Inflation has been increasing since the beginning of 2018. The inflation rate reached 5.7 per cent year-on-year in July 2018 as a result of energy and bread prices hikes, before declining to 4.4 per cent in September. In the 2018 budget, the government revised a range of General Sales Tax (GST) exemptions, part of the economic reforms planned by the government under the IMF-supported programme. Moreover, the arrival of Syrian refugees since 2011 has put pressure on services and increased prices on many goods, in addition to increases in housing prices. Real interest rates have been positive throughout the last five years (except for four months), as the fixed exchange rate remained an anchor for monetary policy.

The pace of fiscal consolidation was slower than expected, and the current account deficit widened. The central government's deficit declined to 2.6 per cent of GDP in 2017 from 3.2 per cent in 2016, reflecting stronger non-tax revenues and lower government consumption and subsidies, despite declining grants and lower tax revenues. But with continued Water Authority of Jordan losses, public debt remains elevated at 96.4 per cent of GDP as of the first quarter of 2018. The current account deficit reached 10.6 per cent of GDP in 2017, up from 9.5 per cent in 2016. Lower exports, grants and remittances (relative to GDP) and higher imports of goods were only partially offset by the increase in tourism receipts and the lower primary income deficit. International reserves have been decreasing since December 2017 and reached US$ 14 billion in May 2018, but they remain at comfortable levels, covering 7.1 months of imports.

A new US$ 2.5 billion economic support package to Jordan was promised by neighbouring Saudi Arabia, United Arab Emirates and Kuwait. In response to the public turmoil surrounding the amendments to the income tax law, a Gulf Cooperation Council (GCC)-Jordan summit was held in June. Assistance was promised to Jordan in the form of a central bank deposit, guarantees on loans from the World Bank, budgetary support, and financing for development projects.

The outlook remains broadly unchanged. Growth is expected to rise only modestly to 2.2 per cent in 2018 and 2.4 per cent in 2019, supported by stronger private consumption from the higher refugee population, the implementation of structural reforms, investment in the context of the government's programme to offer citizenship to foreign investors meeting certain requirements, and greater certainty and confidence stemming from fiscal consolidation. Moreover, exports will benefit from higher mining output, higher phosphate prices and the re-opening of the border with Syria and Iraq. Risks to the outlook include a slow-down – or reversal – in implementing reforms, an escalation of regional conflict and protracted conflict in Syria and Iraq (Jordan's main export markets), additional refugee inflows, tighter liquidity in the GCC, and a surge in the US dollar which would undermine competitiveness. On the upside, the involvement of Jordanian businesses in the reconstruction of Syria and Iraq would positively support growth.

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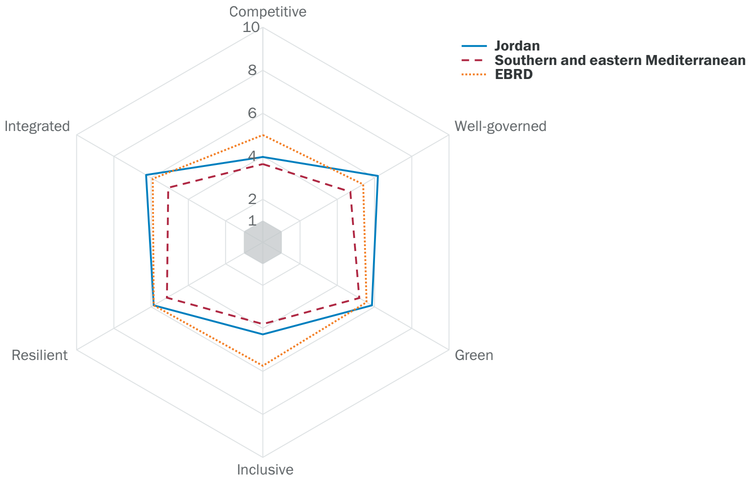
Assessment of transition qualities (1-10)



Major structural reform developments

The 2018 budget presented to parliament in November 2017 committed to removing remaining subsidies, including those on flour, which are the most politically sensitive. The authorities have also pledged social support to lower- and middle-income Jordanians to offset the impact of subsidies. The fiscal measures introduced included some tax changes and efforts to rationalise the public sector.

Proposed tax changes have encountered major opposition. In June 2018, major demonstrations took place in the country to protest against the new income tax law, which followed adjustments to the sales tax and subsidy system. The law allows for a larger tax base, since it is estimated that over 90 per cent of Jordanians do not pay income tax. The bill aims to reduce the income tax thresholds for individuals and families towards international standards, and increase the taxation of other sources of income. In addition, it unifies the corporate income tax rates for non-bank corporations, and aligns this unified rate with the maximum personal income tax rate. Tax revenues were expected to increase by around 1.1 per cent of GDP, a 7.0 per cent increase compared with 2017. The bill followed adjustments which had been made to the sales tax and subsidy system. These included raising levies on food and consumer items by unifying the general sales tax to 16 per cent, removing exemptions on many basic goods, and ending subsidies on bread on the basis that the majority of the subsidy was spent on refugees and foreign workers, thus not benefiting Jordanian nationals.

Measures to attract foreign investors have been introduced. In February 2018 the Cabinet approved a programme opening the way for foreign investors to apply for Jordanian citizenship. The initiative was based on a number of investment options to attract individuals with substantial resources to invest in Jordan, thereby reviving economic growth and reducing reliance on foreign aid in the medium term. These include making a zero-interest deposit at the Central Bank of Jordan (CBJ) of US$ 1.5 million for five years, buying Treasury bonds for no less than 10 years (US$ 1.5 million, at an interest rate to be decided by the CBJ), buying securities from an active investment portfolio (US$ 1.5 million), investing US$ 1 million in small and medium-sized enterprises (SMEs) for at least five years, investing US$ 2 million in any location in Jordan, or US$ 1.5 million if the project is registered in a governorate other than Amman, provided that it creates at least 20 job opportunities and remains operational for at least three years. Investors could also buy and retain property for a minimum of 10 years. The Jordan Investment Commission (JIC) received more than 50 applications from Iraqi, Lebanese, Syrian, Palestinian and Yemeni nationals. The decision is likely to create tension among some groups living in Jordan. Finally, pro-employment reforms have been implemented, including the reduction of the cost of formalisation of workers.

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Some improvements in the transport sector are already under way, but more needs to be done. The Bus Rapid Transit (BRT) system for Amman is due for completion by 2020, and there are plans to extend it to link Amman and the nearby city of Zarqa. Jordan has had some success in improving key transport-related infrastructure, notably with the completion of the upgrade and expansion of Queen Alia International Airport (QAIA) in Amman – a successful public-private partnership example – and the relocation of the Aqaba port in southern Jordan. However, the large increase in refugee immigration in recent years has added to urban transportation woes, and the transport sector's needs are complex. Given the current financial situation, Jordan will need the support of external donors and investors to move forward with such projects.

LEBANON

Highlights

- **Lebanon has remained in a protracted period of low growth since 2011.** Since the start of the Syrian conflict, growth averaged 1.7 per cent, compared with 5.6 per cent in the decade before. The fiscal and external positions are deteriorating further.
- **The Capital Investment Programme (CIP) was adopted by the Cabinet and presented at the Paris IV conference.** The total cost of the phases of the programme until 2025 is estimated at US$ 17.3 billion and over one-third of the first phase has the potential to be fulfilled by the private sector.
- **Reforms progressed in 2017 in some areas, but lag behind in others.** Completed reforms in 2017 and early 2018 included passing the public-private partnership (PPP) law, new decrees regulating oil and gas exploration, new licences for a consortium of three international oil companies to start exploratory drilling, and adoption of a new electoral law.

Key priorities for 2019

- **A sustained and balanced fiscal adjustment is essential.** Without further adjustment, Lebanon's public debt burden, already among the highest in the world (relative to size of the economy) will continue to rise, adding to existing vulnerabilities and ultimately crowding out essential public spending.
- **Lebanon's infrastructure deficit needs to be addressed.** The current situation is the result of protracted under-investment and is exacerbated by the refugee presence. Slow internet speeds are a major burden for firm operations and growth, and strengthening infrastructure would help the development of the knowledge economy.
- **There is a critical need for electricity reform.** The electricity sector has been identified as the most pressing bottleneck for doing business and for competitiveness. Reforming this sector has been long-delayed, resulting in large fiscal costs.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	2.0	0.2	1.7	1.5	1.1
Inflation (average)	1.1	-3.8	-0.8	4.5	6.5
Government balance/GDP	-6.3	-7.9	-9.6	-6.0	-9.7
Current account balance/GDP	-23.9	-16.7	-20.5	-22.8	-25.6
Net FDI/GDP [neg. sign = inflows]	-3.4	-1.8	0.0	-4.3	-4.0
External debt/GDP	167.5	168.4	182.6	182.4	183.3
Gross reserves/GDP	76.9	73.6	78.1	75.0	63.3
Credit to private sector/GDP	143.8	147.4	147.1	n.a.	n.a.

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Macroeconomic performance

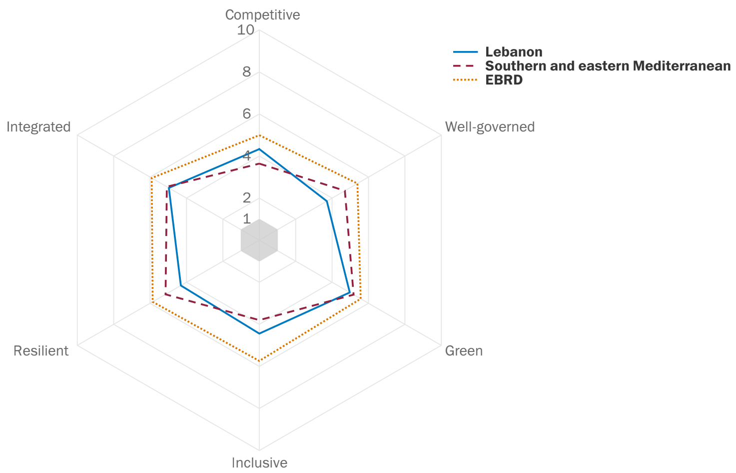
The economy remains in a protracted period of low growth. GDP growth averaged 1.7 per cent in 2011-17, compared with 5.6 per cent in the decade before, due to declining investment and exports and subdued private consumption and tourism. This is a result of political and security conditions, both domestic and regional, which affected traditional growth drivers – tourism, real estate and construction. The economy grew by 1.5 per cent in 2017, driven mainly by private consumption – sustained by remittances from the Lebanese diaspora – and exports. In per capita terms, GDP has been increasing at a mere 0.2 per cent per year on average since 2010, compared with 8.4 per cent in the six years before the Syrian crisis.

The fiscal situation is increasingly challenging. The fiscal deficit remained large in 2017, as subsidies to the electricity company – Electricité du Liban (EdL) – increased due to rising oil prices, and interest payments continued to increase, accounting for half of revenues and crowding out more productive forms of spending. At the same time, one-off revenues from taxing higher bank profits prevented the deficit from widening further. Meanwhile, public debt, the third highest in the world (relative to GDP), is now close to 150 per cent of GDP.

The external situation has worsened. The current account deficit widened to over 20 per cent of GDP in 2017 owing to the impact of regional conflict on key trading partners and routes, and the economy remains largely dependent on remittances (which account for 13.4 per cent of GDP) and deposits from non-residents (14.6 per cent of GDP). Reserves remain comfortable at over US$ 43 billion, covering around 14 months of imports and providing stability to the economy.

Growth is expected to rebound but remain subdued. GDP is forecast to grow at 1.1 per cent in 2018 and a range of 1.5 to 1.9 per cent in 2019 depending on the recovery in the construction and financial sectors, and the extent of reconstruction in Syria. Meanwhile, sizeable vulnerabilities and risks remain, including from internal political uncertainty, regional turmoil and increased spending pressures.

Assessment of transition qualities (1-10)



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Major structural reform developments

A new budget has been passed, the first for many years. The resolution of the political deadlock paved the way for the passage of the first budget since 2005, as well as the country's first parliamentary elections in nine years. In March 2017, Cabinet approved a draft 2017 budget, and in October 2017 it passed through parliament. In March 2018, parliament approved the 2018 budget, a few days before the CEDRE donor conference in Paris. The 2018 budget included a commitment to reduce current spending by 20 per cent, although this commitment did not materialise when executing the budget. Also, the Cabinet adopted a new electoral law based on proportional representation, which governed the recent parliamentary elections in May 2018.

The Capital Investment Programme (CIP) was approved by the Cabinet in March 2018. The total cost of the government's ambitious plan during the first two phases of the programme (2018-21 and 2022-25) is estimated at US$ 17.3 billion. The first phase is estimated at US$ 10.8 billion (including expropriation costs), of which around 38 per cent has the potential to be financed fully from private investment in cycle 1. The programme is expected to be an effective tool to help reinforce Lebanon's depleted infrastructure, thereby supporting a boost in economic growth.

The Public-Private Partnership (PPP) law has been ratified. The law, adopted in August 2017, introduced a new legal regime for PPP projects in Lebanon, to improve transparency, competitiveness and accountability standards. The PPP law grants the renamed High Council for Privatization and Partnerships (HCPP) the power to assess and evaluate potential PPP projects. Nevertheless, the PPP law includes certain gaps that remain to be bridged. For example, there are no clear criteria on what projects should be implemented as PPPs instead of traditional public procurement, the role of the Ministry of Finance is limited, the institutional set-up for PPPs appears complicated and geared toward the promotion of PPPs, without appropriate risk management, and the dispute resolution mechanism is insufficient.

The government has already begun to address some of the key factors that have caused delays in project start-up. All loans approved by lenders as of the end of 2017 have been signed or approved for signing by the Cabinet, and parliament ratified about US$ 400 million of loans over the past year. With regards to counterpart funds for projects for which foreign loans have already been provided, the government decided, in consultation with the central bank, to issue bonds worth US$ 700 million for the financing of land acquisition and other counterpart funds required, although this has not materialised to date.

Parliament approved a set of regulations to jump-start the oil and gas sector. The petroleum-income tax law—a necessity to complete the Lebanese petroleum fiscal regime—was enacted in October 2017, two years after it was first drafted. Four other important laws in this sector are currently at the initial stages of the parliamentary process. They cover the establishment of a petroleum asset-management department, a sovereign wealth fund and a national oil company, as well as prospects for onshore exploration. In addition, last year's Right of Access to Information Law, the Petroleum Transparency Law—which is reaching the final stages in parliament committees – and the plan to join the Extractive Industries Transparency Initiative should all contribute to greater transparency in the sector.

Concrete measures have been taken to solve the solid waste crisis. The Cabinet decided in January 2018 on measures to resolve the crisis including: the expansion of landfill facilities, the construction of a composting plant and upgrading of sorting plans, and the construction of waste to energy plants. At the same time, responsibility for solid waste management will be decentralised to municipalities. A Framework Law setting forth the mechanism for developing solid waste strategies and plans is currently under final consideration by parliament.

The public consultation process is being enhanced amid concerns about wage policy. A Socio-Economic Council has been reinstated in January 2018 after it was first formed in 2000. The Council serves as a consultative body on economic and social policy and is tasked with creating an efficient space for dialogue between the main actors of the public and private sector and contributes to the public governance in Lebanon. The Cabinet also passed the public sector's salary scale bill, which had been held up for years, although its uneven implementation has sparked ongoing protests, in addition to having a large fiscal cost, with insufficient revenue measures to finance it, and causing the ballooning of pension payments.

MOROCCO

Highlights

- **Growth has slowed in the first half of 2018 due to a drop in agricultural output.** Fiscal consolidation continued and the fiscal deficit narrowed, but public debt remained above 60 per cent of GDP at the end of 2017.
- **Morocco's car industry is growing.** Affordable labour, political stability, access to the European market and a series of tax incentives have attracted European carmakers since 2012, and the industry is now the major source of exports.
- **Structural reforms have advanced, albeit with some delays.** The transition to a more flexible exchange rate regime and to inflation targeting, originally planned for 2017, started in January 2018.

Key priorities for 2019

- **Conditions for private sector investment should improve.** Adopting a clear strategy to promote investments is essential, targeting both local and foreign companies. In addition, appointing all the members of the Competition Council should be a priority in order for it to start functioning.
- **Diversifying the country's economic activity is essential.** The current reliance on agriculture often results in macroeconomic volatility. Morocco should use its proximity to Europe and explore more export opportunities.
- **Policy interventions are needed to lessen the socioeconomic divide between rural and urban communities.** Health, unemployment and poverty are major sources of insecurity for citizens and should be addressed by the government through decentralisation, promoting access to services, and promoting sustainability in agriculture and infrastructure.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	2.7	4.5	1.1	4.1	3.0
Inflation (average)	0.4	1.6	1.6	0.8	2.4
Government balance/GDP	-5.2	-4.5	-4.2	-3.5	-3.2
Current account balance/GDP	-6.0	-2.2	-4.2	-3.6	-4.3
Net FDI/GDP [neg. sign = inflows]	-2.8	-2.6	-1.5	-1.6	-1.7
External debt/GDP	33.3	33.9	34.6	33.5	34.6
Gross reserves/GDP	19.8	22.8	25.0	23.0	23.3
Credit to private sector/GDP	83.9	80.2	81.3	82.1	n.a.

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Macroeconomic performance

The economy is slowing in 2018. GDP grew by 2.8 per cent in the first half of 2018, down from 4.0 per cent in the same period in 2017. Falling agricultural output was the main factor behind the lower growth rate. Nevertheless, total economic production grew, aided by a 3.1 per cent growth in the non-agricultural sector in the same period. In per capita dollar terms, GDP continued to grow steadily by 1.4 per cent on average per year, but Morocco remains a lower-middle-income country. In the first quarter of 2018 the unemployment rate decreased to 10.5 per cent, from 10.7 per cent a year earlier.

Fiscal consolidation continued. The fiscal deficit narrowed to 3.5 per cent of GDP in 2017 – down from 4.2 per cent in 2016 – thanks to stronger tax revenues and a contained wage bill combined with lower public investment, and despite weaker non-tax revenues and grants and higher spending on subsidies and transfers. This trend continued in the first quarter of 2018 due to a 2.4 per cent drop in total spending, despite lower tax revenues. Meanwhile, public debt marginally decreased to 64.5 per cent of GDP at the end of 2017, the lowest by regional standards.

Inflation has accelerated during 2018. The inflation rate rose to 2.7 per cent in April, the highest level since 2013, before easing to 1.7 per cent in August. The acceleration was driven by the impact of the review of the consumer price index (CPI) basket structure in March as well as significant increases in volatile food and regulated prices. The central bank's decision to keep interest rates unchanged since March 2016 at 2.25 per cent led real interest rates to turn negative between March and June 2018, before edging positive again to 0.5 per cent in August.

The current account deficit declined to 3.6 per cent of GDP in 2017, down from 4.2 per cent in 2016. This was due to increased exports following Europe's strong economic recovery, increases in remittances and higher grants from the Gulf Cooperation Council. Moreover, the number of foreign tourists arriving in Morocco increased by 10 per cent year-on-year in the first seven months of 2018, partially due to the alleviation of visa requirements for Chinese citizens which started in mid-2016, allowing a 90-day stay on entry. On the capital account, foreign direct investment also rose slightly to 1.6 per cent of GDP, from 1.5 per cent in 2016, and was highly concentrated in the automotive sector; it remains lower than its historical levels, but better than Morocco's peers.

Growth is expected to slow in 2018. The current forecast is 3.0 per cent GDP growth in 2018, influenced by the negative base effect following favourable weather conditions for agriculture in 2017. In 2019 growth is forecast to rise to 3.5 per cent, supported by a number of factors, including the continued recovery in tourist arrivals, an increase in foreign direct investment, greater competitiveness from the move to a more flexible exchange rate regime, a rebound in services and manufacturing, stronger export growth – especially in the automotive and aeronautics industries-, and expanded mining capacity. The sustained growth is predicated on continuing reforms to improve the business environment and boost productivity, and diversifying the economy away from agriculture. Downside risks include delays in implementing reform, possible declines in the prices of phosphates, wheat and vegetables, weak growth in trading partners, and the vulnerability of agricultural activity to weather and price developments.

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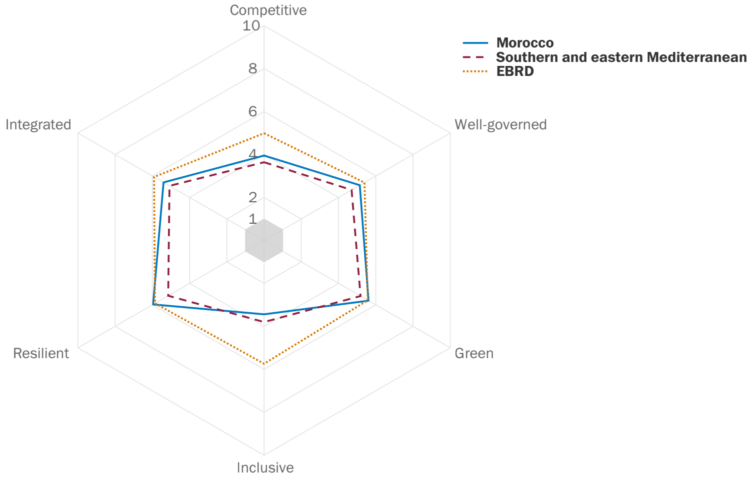
Assessment of transition qualities (1-10)



Major structural reform developments

A new central bank law has been introduced. The new law passed in July 2018, having been approved by the government a year earlier. The law will enhance the central bank's independent status and improve communication between the central bank and the Ministry of Finance, with the aim of bringing about a more harmonious monetary policy.

The central bank adopted a more flexible exchange rate. From January 2018 the dirham has been allowed to fluctuate within a 5.0 per cent band (±2.5 per cent), much higher than the former 0.3 per cent band. This move comes as part of the government's monetary policy reform aimed at improving the competitiveness of the economy and is in line with the IMF programme.

Sugar subsidies are being reduced. As part of the 2018 budget the government announced the progressive removal of sugar subsidies by 2019, saving an estimated 0.3 per cent of GDP. The government has reiterated 2020 as the target date to replace across-the-board subsidies on all remaining products with a targeted compensation mechanism, which at this stage remains fragmented across different social transfer programmes. The shift to a unified transfer programme will be based on the implementation of a national population register, a centralised social register and the assignment of a unique identification number to all nationals to better target transfers.

Morocco and the European Union (EU) have initialled a new fisheries agreement. The agreement was initialled in July 2018 after three months of negotiations, five days after the expiry of the precedent agreement. The new agreement should come into force by the end of 2018. It allows EU vessels to access the Moroccan fishing zone. The level of mandatory landings and fishing categories will remain unchanged.

The Moroccan government announced tax breaks to new industrial firms. In July 2018 the government announced exemptions from corporate tax for five years for firms established after June 2017. The measure covers 24 sectors, including manufacturing, food, textiles and pharmaceuticals, and aims to encourage investment, especially in the slowly growing, non-agricultural sector.

CONTINUES

Morocco continued to develop its economic and political ties with sub-Saharan Africa. In June 2018 the Moroccan and Nigerian governments signed a joint declaration detailing the next steps for the finalisation of a 5,660 km gas pipeline project launched in 2016. Morocco has been expanding its political and economic influence in sub-Saharan Africa over the past decade. The presence of Moroccan firms in this area is growing; a local subsidiary of a Moroccan renewable energy company will soon start to build the first photovoltaic solar plant in Côte d'Ivoire, an opportunity to expand to a market where solar power could prove a valuable tool in mass electrification.

Morocco's car industry is growing. Since Renault's investment in 2012, the sector, which was non-existent in the 2000s, has benefited from affordable labour, political stability, access to the European market, and a series of tax incentives. In July PSA Peugeot-Citroën announced a new production line in Morocco, set to produce up to 90,000 cars by 2020. The car production industry has been strengthening in recent years, with automotive exports now outstripping phosphates, historically the major source of foreign exchange.

Several obstacles continue to hinder Morocco's business environment. These include shortages of highly skilled labour and inefficient bureaucracy, which continue to slow the pace of project implementation. Moreover, regional disparities and non-inclusive economic growth risk are exacerbating social tensions, including over-high levels of unemployment.

TUNISIA

Highlights

- **Growth is slowly picking up.** The economy grew 2.7 per cent in the first half of 2018, up nearly a percentage point on 2017 growth, on the back of agriculture, agribusiness, food production, manufacturing, in addition to tourism and financial services.
- **Inflation has reached its highest level in decades.** In mid-2018, inflation reached 7.8 per cent, the highest level in more than 26 years, because of the depreciation in the dinar, the VAT rate increase in January 2018, and several rounds of subsidy removals.
- **Some reforms have passed amid domestic tensions.** The law to allow public banks to write off non-performing loans (NPLs) was passed and the Tunisia Investment Authority and the Strategic Investment Council were formed, but other key reforms have been delayed.

Key priorities for 2019

- **Increasing the employability of the youth is essential.** There is a need to create a better link between education and vocational training and the skills needed by employers. Moreover, policies are needed to encourage women to increase their participation in the labour market.
- **Further economic reforms should be prioritised.** The authorities should focus on modernising monetary policy, completing energy subsidy reforms, introducing anti-corruption mechanisms, and completing a census on the vulnerable segments of society to improve targeted social safety nets.
- **The business environment for the private sector needs to improve.** Top priorities to encourage private sector activity and job creation include accelerating the opening of the renewable energy sector to the private sector, developing public-private partnerships (PPPs) for infrastructure, and gradually facilitating access to foreign currencies for Tunisian companies for their internationalisation and expansion.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	2.3	1.1	1.0	1.9	2.8
Inflation (average)	4.9	4.9	3.7	5.3	8.1
Government balance/GDP	-5.0	-4.8	-6.1	-6.1	-5.2
Current account balance/GDP	-9.1	-8.9	-8.8	-10.3	-9.6
Net FDI/GDP [neg. sign = inflows]	-2.2	-2.2	-1.5	-2.0	-2.0
External debt/GDP	63.7	68.5	74.7	83.8	82.6
Gross reserves/GDP	17.6	17.8	15.4	14.2	15.3
Credit to private sector/GDP	69.3	70.1	72.2	74.7	n.a.

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Macroeconomic performance

The economy is picking up in 2018. Real GDP growth accelerated to 2.7 per cent year-on-year in the first half of 2018 from 1.8 per cent in the same period of 2017, the fastest growth since 2014. Growth was driven by the rebound in agriculture, notably olive oil and dates, which reached record highs amid favourable weather conditions. The rebound in agriculture in turn supported agribusiness and food production industries, and consequently manufacturing. Services – mainly tourism and banking – continued to support growth, while non-manufacturing industries contracted, due to a decline in oil and gas extraction, construction and mining. Unemployment remained high at 15.4 per cent in the first quarter of 2018, and higher among women. Due to rapid population growth, GDP per capita has been declining since 2009 by 2.4 per cent per year on average, and the country has been reclassified by the World Bank as a lower middle income country since June 2016.

Inflation has been elevated, necessitating central bank policy tightening. The inflation rate peaked at 7.8 per cent in June, the highest level since 1991, before moderating slightly to 7.5 per cent in July and August. The dinar's depreciation, the VAT rate increase in January 2018, and the increase in prices of certain products (for example, fuel, tobacco and telecommunications) have all contributed to rising prices. As a result, real interest rates have been negative for all but two out of the 19 months since December 2016. In March 2018, the central bank raised its benchmark interest rate by 75 basis points for the first time in almost a year, in an attempt to tame the inflationary pressures. Another rate hike, of an unprecedented 100 basis points, followed in June 2018.

The fiscal deficit remained unchanged in 2017 but the current account deficit has widened. Stronger revenues from corporate income tax, VAT and oil, combined with lower public investment, were offset by lower subsidies and income tax revenue, yielding a fiscal deficit of 6.1 per cent of GDP, the same as in 2016. Meanwhile, public spending on wages remained high at 14.6 per cent of GDP, among the highest ratios in the world. Public debt has continued its upward trend since 2010 and reached 69.9 per cent of GDP in 2017. On the external side, the current account deficit widened to 10.3 per cent of GDP in 2017 from 8.8 per cent of GDP in 2016, the first time the economy has recorded a double-digit deficit since 1984. The widening was led by the increase in imports of goods, despite the pick-up in exports of goods (agricultural, food and energy) and in tourism receipts. Meanwhile, the dinar continued to depreciate in relation to the euro, and as of May 2018, it had lost one-quarter of its value compared with 2016. The expanding current account deficit, exacerbated by the rising international prices of oil and the slowly recovering tourism inflows, has been eroding foreign reserves, which continued to decline, covering less than three months of imports in August 2018.

Growth is expected to increase gradually. GDP is forecast to rise by 2.8 per cent in 2018 and gradually pick up to 3.0 per cent in 2019, driven by a continued recovery in tourism and investment, stronger growth in major export markets in Europe, and the implementation of structural reforms. Risks stem from the 2019 election-related uncertainties and the possibility that socioeconomic protests will disrupt production in the phosphate and hydrocarbon sectors. The depreciation of the dinar and the reintroduction of a mechanism that adjusts fuel prices in line with fluctuations both in currencies and in international oil prices may further raise inflationary pressures. Furthermore, a faster-than-anticipated normalisation of monetary policy in the United States of America could lead to a stronger US dollar and amplify debt vulnerabilities, given that two-thirds of public debt is denominated in foreign currency.

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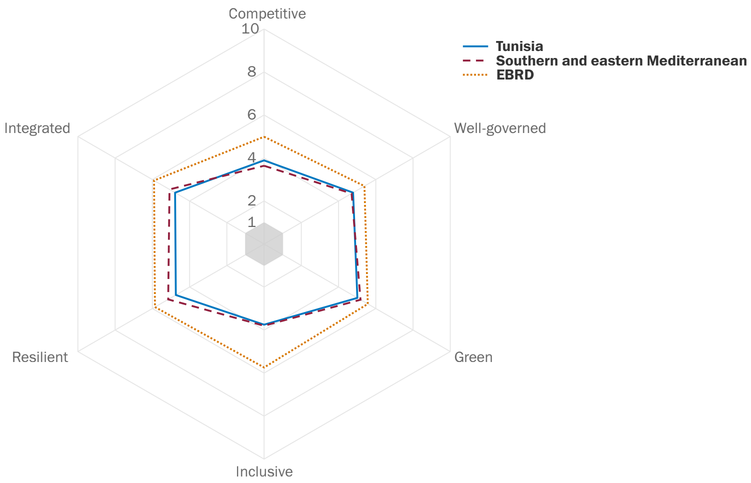
Assessment of transition qualities (1-10)



Major structural reform developments

New fiscal measures are in place. In December 2017, parliament passed the 2018 budget which included a package of fiscal measures to cut the budget deficit. MPs approved new articles, including the enlargement of the 35 per cent corporate tax rate scope to include car dealership activities, shopping centres and franchises. Another article stipulates the simplification of conditions for granting tax benefits in terms of reinvestment of revenues and profits in the subscription of the companies' capital. The 2018 budget also raises customs taxes on some imported products to cut the trade deficit. The parliament approved a rise of 1 percentage point in value-added tax and imposed a new 1 per cent social security tax on employees and firms. Taxes on bank profits will rise from 35 to 40 per cent. The 2018 budget also limited new recruitment into the civil service to graduates of state training schools. Consistent with the civil service reform strategy, hiring will be capped below 3,000 civil servants for 2018.

Foreign investment rules have been liberalised. In June 2018, the government announced that foreign investors would be allowed to acquire property in foreign currency. Tunisia continues to impose restrictions on foreign land and property buying, including a ban on purchasing agricultural land or social housing, but has amended the legislation for foreign investors in order to stimulate investments. The authorities also established a one-stop shop for large investors and adopted a restricted list of eight sectors that remain subject to investment authorisations, while freeing all other sectors from prior approval.

New agencies are being established. During the past year the government established the Tunisian Investment Authority, the Strategic Investment Council and the High Anti-Corruption and Good Governance Authority (HACGGA). The new Investment Law has now entered into force, with the Tunisia Investment Authority close to becoming fully operational. The HACGGA will become functional once its board members are appointed by parliament following consultations among political parties. Moreover, the General Committee on Taxation, Public Accounts and Collections was created in December 2017, tasked with combating tax fraud and smuggling. This committee was set up following the merger between the General Directorate of Taxes and the General Directorate of Public Accounting and Collections.

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Non-performing loans are being tackled. In February 2018 the Council of Ministers passed a new legal framework to facilitate the resolution of non-performing loans (NPLs) in public banks. Parliament voted the new framework into law in May 2018. The law allows public banks to write-off and resolve NPLs in the same way as private banks. Before this amendment, NPLs were disproportionately concentrated in public sector banks, mostly in the tourism industry. As of the end of 2017, NPLs were 13.9 per cent and higher in public banks, which until recently faced legal discrimination in managing NPLs portfolios, thus constraining growth and access to finance.

A new initiative is encouraging entrepreneurship. In April 2018, parliament passed the Start-up Act to incentivise local entrepreneurs to initiate and operate their ventures. As part of the government's 'Digital Tunisia 2020' plan, the new act aims to increase the number of Tunisian start-up companies, primarily in the tech industry, with the aim of boosting innovation and the country's international competitiveness. One of the major advantages of this legislation is the appeal to the youth, thus tackling one of Tunisia's lingering economic problems of youth unemployment.

The government is targeting assistance to vulnerable groups. In January 2018, the government announced a US$ 70 million package for poor and vulnerable families. This support, which became effective in April 2018, includes a 20 per cent increase in the cash transfer amount, as well as an increase in the minimum pensions of retirees.