EGYPT

Highlights

- **Growth has slowed amid rising inflation but the fiscal deficit has narrowed.** Fiscal reforms are anchored within a new IMF programme, and the current account deficit has remained broadly unchanged.
- **Reform progress in the past year was significant.** The exchange rate was liberalised and limits on foreign currency transfers scrapped; value-added tax (VAT) was introduced and the rate increased; several rounds of fuel, electricity and subsidy reforms were implemented; and there was progress on the industrial licensing, natural gas industry, investment and bankruptcy laws.
- **Foreign investment has increased amid rising confidence.** The approval of the IMF programme in November 2016 and the completion of the first review in July 2017, coupled with the strong reform momentum, have led to higher foreign direct and portfolio investments, increased remittances, and a heightened foreign appetite for domestic debt instruments and Eurobond issuances.

Key priorities for 2018

- **Continued fiscal consolidation, along with higher capital and social spending, is a priority.** The increase in VAT, continued energy subsidy reforms and wage restraint will reduce public debt over time and provide fiscal space for a strong social component to ease the burden of adjustment on the poor and vulnerable.
- **An immediate priority is to reduce inflation.** Inflation has reached record high levels in 2017 as a result of the currency depreciation following the liberalisation, VAT increases and subsidy cuts. As the currency starts stabilising and inflation expectations are guided by the central bank, inflation should ease.
- **Implementing and enacting executive regulations of approved laws should continue.** Legislative reforms to strengthen the business climate, attract investments, support private sector development, and promote growth are critical and should focus on, among other things, the investment law's executive regulations and investment map.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	3.3	2.9	4.4	4.3	4.1
Inflation (average)	6.9	10.1	11.0	10.2	23.5
Government balance/GDP	-12.9	-12.0	-11.4	-12.5	-10.9
Current account balance/GDP	-2.2	-0.9	-3.6	-6.0	-5.8
Net FDI/GDP [neg. sign = inflows]	-1.3	-1.4	-1.9	-2.1	-3.7
External debt/GDP	15.0	15.1	14.4	16.6	n.a.
Gross reserves/GDP	n.a.	5.5	6.1	9.0	n.a.
Credit to private sector/GDP	n.a.	25.4	25.7	25.6	n.a.

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Macroeconomic performance

Economic growth slowed and inflation sharply accelerated. Growth declined to 4.1 per cent in the fiscal year 2016-17, compared with 4.3 per cent the previous fiscal year. Meanwhile, private consumption continued to be the primary driver of growth despite eroded purchasing power as a result of inflation, and investment remained resilient. Net export performance picked up in the last two quarters following the liberalisation of the exchange rate, after being a significant drag on growth in the first two quarters. Unemployment decreased but remains elevated at 12.0 per cent in the second quarter of 2017 and youth unemployment is at 26.7 per cent. Inflation has risen, reaching 31.6 per cent year-on-year in September 2017, after having reached 33.0 per cent year-on-year in July 2017, its highest level in decades, fuelled by a new round of subsidy cuts implemented in late June.

The fiscal position improved but the deficit remains high. The fiscal deficit is estimated to have fallen to 10.9 per cent of GDP in the 2016-17 fiscal year, the lowest level in five years, down from 12.5 per cent of GDP in the previous fiscal year. The narrowing in deficit was driven by a contained wage bill and cuts in subsidies, coupled with a continued strong tax performance, especially with the introduction of value-added tax, despite increases in interest payments. The government also cleared its payment arrears to international oil companies in August 2017 from a peak of US$ 6.4 billion in 2012, which encouraged investment in the energy sector. Meanwhile, gross public debt rose to 98.4 per cent of GDP from 93.8 per cent in the previous fiscal year, with the ratio of external debt to total debt doubling to 21.8 per cent as a result of disbursements from the IMF and Eurobond issuances.

The external position remained broadly unchanged. The current account deficit increased in the third quarter of the 2016-17 fiscal year to 7.2 per cent of GDP compared with 7.0 per cent in the corresponding period the previous year, as the increase in exports and current transfers was offset by the increase in imports. The current account deficit is estimated to have declined marginally from 6.0 per cent to 5.8 per cent of GDP in 2016-17.

A new IMF programme is in place, boosting investor confidence. The programme is a three-year Extended Fund Facility of US$ 12 billion and was signed in November 2016. It was accompanied by an immediate liberalisation of the exchange rate. The first review of the programme was successfully completed in July 2017 and, coupled with strong reform momentum, boosted investor confidence. Foreign direct investment (FDI) in Egypt increased by 12.1 per cent year-on-year in the first three quarters of 2016-17, reaching 5.3 per cent of GDP compared with 3.7 per cent in the corresponding period of the previous fiscal year. Egypt attracted close to US$ 10 billion of foreign investment in domestic debt instruments in 2016-17 compared with US$ 1.1 billion the previous fiscal year. Remittances from Egyptians working abroad have also increased. International reserves have rebounded to pre-2011 levels, reaching a record high of US$ 36.5 billion in September 2017, and covering 6.1 months of imports, up from a critically low level of 3.1 months in June 2016.

Economic growth will pick up to 4.5 per cent in 2017-18, with the composition changing. High inflation will continue to adversely affect private consumption, but exports are expected to rise further. Construction will continue to be the main driver of growth, with various low-income housing projects and the construction of the new capital city. Growing confidence in the availability of foreign exchange and continued reform efforts should boost business sentiment and attract foreign investors, but significant downside risks remain, associated mainly with the adverse effect of high inflation on private sector consumption and investment, both domestic and foreign, and on competitiveness.

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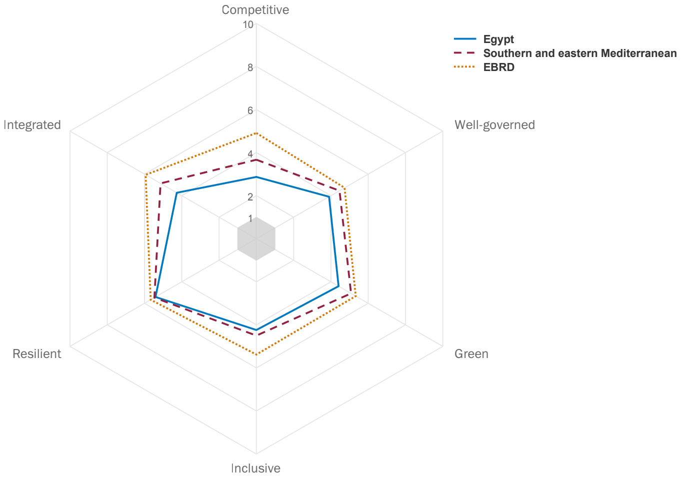
Assessment of transition qualities (1-10)



Major structural reform developments

The central bank has implemented several bold reforms. To reduce inflation and absorb excess liquidity, the central bank increased its policy interest rate three times since November 2016; 300 basis points in November followed by 200 basis points each in May and July 2017. Inflation reached record high levels, posing a risk to macroeconomic stability and hurting the poor. The liberalisation of the exchange rate regime in November 2016 was a critical step towards restoring confidence in the economy and eliminating foreign exchange shortages. Moreover, in June 2017, the central bank scrapped limits on currency transfers abroad, signalling the easing of the foreign currency shortage, which had strangled the economy and eroded international reserves and was a major concern for foreign investors who were unable to repatriate profits.

Reforms in the energy market have advanced. The government performed several rounds of fuel and electricity subsidy reforms, the latest of which were in June 2017, where the prices of diesel and 80-octane petrol increased by 55.0 per cent, 92-octane went up by 43.0 per cent, and 95-octane rose by 5.6 per cent. The price of a canister of liquefied petroleum gas was doubled, but it remains the most heavily subsidised energy product. Moreover, the act deregulating the natural gas industry was issued and published in August 2017. The act opens the door for private sector participation in importing and trading natural gas, a move that could help end supply shortages which have hampered businesses. It also transforms the state from the monopoly manager of the distribution network into a regulator, by setting up a natural gas regulatory authority charged with licensing and devising a plan to open the gas market to competition. The strategy to settle outstanding arrears to international oil companies has already contributed to major investment pledges by two British companies, BP and BG Group, as well as Eni of Italy, which operates the Zohr gas field, the largest discovered field in the Mediterranean, potentially large enough to meet Egypt's entire domestic needs for a decade and allow for the resumption of natural gas exports.

Value-added tax (VAT) and a stamp tax on capital market transactions have been introduced. The VAT came into force in September 2016 at a rate of 13 per cent. The rate was increased in July 2017 to 14 per cent, strengthening fiscal consolidation. In the same month the authorities also introduced a new stamp tax on capital market transactions. This is a 0.125 per cent levy imposed on both sides of any capital market transaction that gradually rises to 0.175 per cent by its third year.

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A new investment law has been approved. Parliament approved the new law in May 2017, and the cabinet signed off on the executive regulations in August 2017. The new law will ease the process of establishing companies and obtaining licences considerably but does not resolve some of the difficulties facing investors in land acquisition procedures. As a result, although the law is an improvement on earlier versions, it is likely to undergo future revisions. Moreover, weak institutional capacity and the influence of powerful interest groups within government may pose implementation risks.

Procedures to establish a business are being simplified. A new industrial licensing law was approved by parliament in March 2017 and signed by the president in May, followed by the announcement of the executive regulations in August. The new law aims to combat bureaucracy and reduce the waiting time for new projects. Investors have long complained of lengthy processes for obtaining approvals, with Egypt ranked 128th in the World Bank's *Doing Business 2018* report, partly because of difficulties obtaining permits and licences. With the new law the waiting period for 80 per cent of industries will be reduced to one week or less, while the remaining 20 per cent, deemed more critical due to their higher risks to health, environment, safety or security, will require about one month.

Social protection measures are under way. Resolutions to protect the most vulnerable groups were announced by the president in June 2017. The main measures are: (i) increase the monetary support per capita on ration cards by 140 per cent; (ii) increase the insurance pensions by 15 per cent for 10 million pensioners; (iii) increase the value of monetary support to the 8 million beneficiaries of the two targeted social safety net cash transfer programmes which provide monthly income called *Takaful* ("solidarity" – an incentive-based system related to school attendance and making use of maternal and child health care services) and *Karama* ("dignity" – targeting the poor, the elderly and people with severe disabilities who are unable to work); (iv) approve a periodic bonus for those addressed by the Civil Service Law of 7 per cent and approve an exceptional inflation premium of 7 per cent; (v) approve a periodic bonus for those who are not addressed by the Civil Service Law of 10 per cent and an exceptional inflation premium of 10 per cent; and (vi) stop the tax on agricultural land for three years to ease the tax burden on the sector. Moreover, the school meals programme for children, which provides a daily meal and aims to address malnutrition among children in poor families and decrease the numbers of those students dropping out, has been expanded to include all public schools.

Meanwhile, some important reforms are delayed. The authorities have announced plans to offer shares in state-owned assets in the financial and energy sectors to promote competition but implementation has been delayed. The new bankruptcy law, approved by the cabinet in January 2017, is yet to be passed by parliament at the start of its autumn legislative term.

JORDAN

Highlights

- **Growth continued to decline in 2016.** It dropped to 2 per cent in 2016, which reflects the slow-down in agriculture, construction and mining, although a slight upturn is evident in the first half of 2017. Unemployment rose sharply to 18 per cent in the first half of 2017, its highest level in 25 years.
- **The pace of fiscal consolidation was strong, although slower than initially envisaged.** This is due to weaker nominal growth and tax revenues and refugee-related spending pressures. Moreover, the composition of expenditures has worsened, and public debt increased, also the result of continued Water Authority of Jordan (WAJ) losses.
- **Structural reform continued.** Key developments include: the adoption of the electricity tariff adjustment mechanism and the action plan to reduce the water sector's losses; the elimination of general sales tax (GST) and customs duty exemptions on a large number of products; the compilation of credit reports by the credit bureau to assess borrower creditworthiness; and the launching of the new "one-procedure one-form" registration process and standardised business classifications.

Key priorities for 2018

- **Continued fiscal consolidation is needed.** The main reforms should: broaden the tax base through amending the income tax law and removing additional GST and customs duties exemptions; tackle tax evasion and strengthen tax compliance, while containing non-priority current expenditures and wage bill growth, better targeting transfers, and preserving social and capital expenditures.
- **Much-needed legislative reforms to improve the business environment should be prioritised.** These include submitting to parliament the draft inspection law, enacting the secured lending and insolvency laws, and ratifying amendments to the insurance and deposit insurance laws.
- **Reforms to strengthen inclusive growth should continue.** The government's strategy consists of three measures: (i) facilitating access to finance; (ii) active labour market policies and reforms; and (iii) improving the business environment and governance. These reforms should be complemented by the implementation of the Jordan Compact initiative to create jobs for Jordanians and Syrian refugees in special economic zones.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	2.8	3.1	2.4	2.0	2.3
Inflation (average)	4.8	2.9	-0.9	-0.8	3.3
Government balance/GDP	-5.5	-2.3	-3.5	-3.2	-2.5
Current account balance/GDP	-10.4	-7.3	-9.1	-9.5	-8.4
Net FDI/GDP [neg. sign = inflows]	-5.3	-5.8	-4.3	-4.0	-3.8
External debt/GDP	30.3	69.4	70.0	70.5	n.a.
Gross reserves/GDP	35.7	39.3	37.7	33.3	n.a.
Credit to private sector/GDP	76.3	73.0	72.8	77.6	n.a.

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Macroeconomic performance

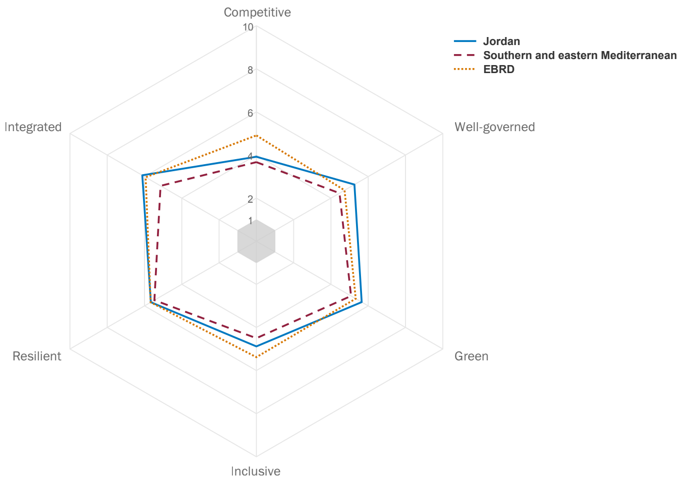
The decline in growth, which started in 2014, continued in 2016. GDP growth fell from 3.1 per cent to 2.0 per cent between 2014 and 2016. This deterioration was driven by slowing agriculture and construction, and contracting mining activity, which shrank by 12.1 per cent in 2016 due to temporary shutdowns in production. Transportation and financial services were the main positive drivers of growth. During the first half of 2017, growth recorded 2.1 per cent year-on-year, with strong rebounds in mining and agriculture, despite the continued decline in construction. Data for the first eight months of 2017 show a recovery in tourism, increasing 8.1 per cent relative to the same period in 2016. Labour market conditions deteriorated further; the unemployment rate rose sharply to 18 per cent in the first half of 2017, its highest level in 25 years, partially reflecting some methodological changes. Female and youth unemployment rates are double the overall rate.

The pace of fiscal consolidation was strong, but slower than planned. The central government's deficit declined to 3.2 per cent of GDP in 2016 from 3.5 per cent in 2015, reflecting stronger non-tax revenues and flat expenditures, despite declining grants. Nevertheless, the composition of expenditures worsened, with lower capital expenditures offsetting higher defence and security spending. Moreover, the decline in the deficit was lower than envisaged, owing in part to weaker nominal growth, continued refugee-related spending pressures, and limited success in increasing tax revenues. As a result, and with continued Water Authority of Jordan (WAJ) losses, public debt reached 95.1 per cent of GDP at the end of 2016.

The current account deficit widened and reserves declined. A decline in energy imports as a result of lower oil prices and the National Electric Power Company's (NEPCO) shift to liquefied natural gas as its primary energy source were counterbalanced by lower exports, tourism receipts, grants and remittances. As a result, the current account deficit reached 9.5 per cent of GDP in 2016, slightly higher than the 9.1 per cent deficit in 2015. International reserves declined in August 2017 to US$ 13.2 billion but remained at comfortable levels, at 6.9 months of imports.

The outlook remains broadly unchanged. Growth is expected to remain low at 2.3 per cent in 2017, as regional turmoil continues to weigh on tourism and investment, and following lower-than-expected 2016 growth and lower reserves. In 2018 growth will pick up slightly to 2.5 per cent, supported by the implementation of structural reforms and fiscal consolidation. The outlook is subject to considerable risks from additional refugee inflows and a surge in the US dollar undermining Jordan's competitiveness. Moreover, any slippages in implementing reforms under the IMF-supported programme would undermine prospects for a strong rebound in economic performance.

Assessment of transition qualities (1-10)



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Major structural reform developments

The credit bureau has expanded its activities. The bureau had started operating in January 2016 to help expedite credit decisions, notably for small and medium-sized enterprises (SMEs), which make up about 95 per cent of the corporate sector. It has been receiving data since October 2016 from banks, as well as from other financial institutions such as insurance and leasing companies, microfinance institutions, public utilities and telecommunications companies. It has started compiling credit reports to assess borrower creditworthiness and expediting credit risk assessment decisions for borrowers. The bureau should be able to assign credit scores to borrowers by early 2018 after compiling three years of historical data.

The electricity tariff adjustment mechanism and the action plan to reduce the water sector's losses were adopted. The authorities published in December 2016 the final version of a study on cross-subsidisation and options for electricity tariff reform. Based on the findings of the study, a new automatic tariff adjustment mechanism was adopted in October 2016 and came into effect on 1 January 2017. The mechanism considers the system's overall costs, including power plants, NEPCO and distributors, and shelters NEPCO from oil price fluctuations, helps its operational cost recovery and reduces its vulnerability to exogenous shocks. The authorities also reduced cross-subsidies by lowering tariffs on high-end consumers. At the same time, an updated action plan on ways to reduce the water sector's losses was adopted by the government and published in April 2017.

The authorities continued with labour market reforms to strengthen job prospects. A bylaw on flexible working hours was issued by Royal Decree in March 2017, and implementation guidelines are being prepared in the second half of 2017 by the Ministry of Labour in consultation with other stakeholders. To promote female employment, the authorities require large companies to provide childcare facilities within their premises. Most recently, they have submitted to parliament amendments to the labour law to allow companies to pool their resources and set up joint nurseries, while increasing penalties for companies not complying with the law, and have started establishing new nurseries in the special economic zones.

A decree establishing a central Public Investment Management (PIM) unit at the Ministry of Planning and International Cooperation was adopted in June 2016. The government is already managing all investments according to standards set by the new PIM framework adopted in 2015 to strengthen the design, assessment, prioritisation and implementation of public investment and public-private partnership projects. Moreover, in May 2017 the government conducted a comprehensive Public Investment Management Assessment (PIMA), to ensure that public investment spending was well assessed and efficient enough to promote growth while minimising future risks to the budget, given the limited fiscal space.

Reforms to strengthen the business environment have advanced. Recent efforts have focused on reducing the cost of starting and operating a business. The authorities addressed shortcomings in the investment-window procedures by automating and integrating the services provided by Jordan Investment Commission to make it fully operational by the end of June 2017. The authorities have also launched the new "one-procedure one-form" registration process and standardised business classifications to eliminate all duplicate procedures and introduce a fast track approval mechanism. Jordan is ranked 103rd out of 190 countries in the *Doing Business 2018* report, ahead of the Middle East and North Africa average and of Egypt and Lebanon, but behind Morocco and Tunisia. The areas where Jordan is ranked the lowest are getting credit (159th), and protecting minority investors and resolving insolvency (146th).

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The authorities conducted a medium-term debt management strategy (MTDS) analysis. Based on the findings of the analysis, the debt management strategy for 2016-20 covering the central government and its agencies, including NEPCO and WAJ, was prepared and published in September 2016. An action plan to build capacity in the middle and front offices of the Public Debt Directorate (PDD) was prepared ahead of schedule. The authorities started in January 2017 to publish the central government indicative bond issuance plan for 2017 to enhance transparency, communication and predictability. A quarterly financing plan for the central government and its agencies was prepared to ensure that the issuance schedules of the central government and public agencies are coordinated in a way that improves overall borrowing terms, lengthens the average maturity of debt, improves the debt profile of the central government and its agencies, and reduces total public debt over the medium term.

The removal of GST and customs duties exemptions was less ambitious than initially envisaged. Revenues from these measures amounted to 0.4 per cent of GDP instead of the planned 1.1 per cent of GDP, as many non-basic goods and services remain exempt. GST exemptions generally contribute to lower efficiency and revenue with limited offsetting benefits.

Several much-needed laws have been delayed. Delays included are submitting to parliament the draft inspection law, enacting the secured lending and insolvency laws, and amendments to the income tax, insurance, and deposit insurance laws. In addition, the publication of a study assessing the key issues and challenges to promote financial inclusion has not yet been completed.

LEBANON

Highlights

- **The macroeconomic position is challenging as a result of the political situation and regional instability.** Growth remained low in 2016 at an estimated 1 per cent, fiscal performance deteriorated and the external position remains difficult.
- **The debt burden in Lebanon is among the highest in the world.** This puts a strain on public finances as interest payments account for half of revenues, leaving limited space for capital and social spending.
- **Policy-making improved and reforms progressed after the resolution of the political deadlock.** Once the new government was appointed in December 2016, reforms advanced, including decrees regulating oil and gas exploration (approved by the Cabinet in January 2017), and an electricity reform plan and draft 2017 budget in March 2017.

Key priorities for 2018

- **A sustained and balanced fiscal adjustment is essential.** Without further adjustment, Lebanon's public debt burden 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 operation and growth, and strengthening infrastructure would help the development of a 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 implications.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	2.50	2.0	0.8	1.0	2.3
Inflation (average)	4.8	1.9	-3.7	-0.8	3.6
Government balance/GDP	-9.0	-6.3	-7.6	-9.3	-9.9
Current account balance/GDP	-26.7	-26.4	-18.7	-18.6	-18.0
Net FDI/GDP [neg. sign = inflows]	-1.6	-3.5	-3.5	-4.6	-4.5
External debt/GDP	170.4	175.0	175.8	183.9	n.a.
Gross reserves/GDP	73.7	78.0	74.3	84.6	n.a.
Credit to private sector/GDP	136.9	143.8	147.4	147.1	n.a.

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Macroeconomic performance

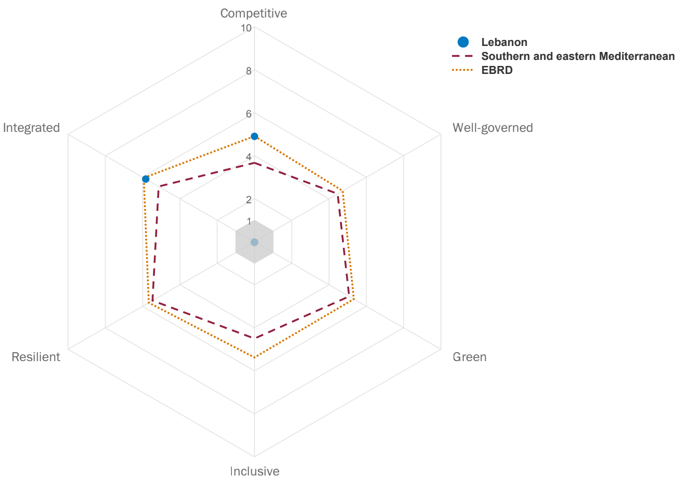
Growth remains sluggish. The economy grew by just 1 per cent in 2016, the same rate as in 2015. Lebanon has been in a protracted period of low growth since the start of the Syrian conflict in 2011 and the collapse of Syria's economy. In 2016, tourism, real estate and construction, traditionally the main drivers of growth, continued to be weak, reflecting regional insecurity and the political situation in Lebanon. In 2017, growth is still subdued despite positive political developments, as external imbalances remain wide.

Fiscal performance deteriorated in 2016. The fiscal deficit reached 8.1 per cent of GDP in 2016, up from 7.4 per cent of GDP in 2015, as a result of several factors. On the positive side, transfers to Electricité du Liban (EdL) decreased as a result of the global drop in oil prices, and tax revenues were stronger supported by higher excise tax collection, a steady increase in income and property taxes, and higher treasury receipts. However, interest payments, hospital spending and capital expenditures also increased, as did transfers to municipalities. Moreover, wages for military personnel represented two-thirds of the total wage bill as the deterioration in the security situation at the borders led to the hiring of additional troops. Interest payments consumed around 48 per cent of total revenues, the highest level since 2007, crowding out more productive forms of public expenditures. The large number of Syrian refugees, representing almost one-third of the total population, is placing further pressure on the economy's public finances and infrastructure, straining local communities, and adding to poverty and unemployment. Gross debt increased to 143.4 per cent of GDP, the third-highest level in the world, as a result of persistent fiscal deficits and moderate growth.

The external position remains challenging. The current account deficit is estimated to have widened to 18.9 per cent of GDP in 2016 from 16.3 per cent in 2015, owing to the impact of regional conflict on key trading partners and routes. Exports of goods and services declined in 2016, partly offset by decreases in imports. Remittances from the large diaspora increased by 9.0 per cent in 2016 to 7.5 per cent of GDP and supported growth through private consumption, which constitutes around 90.0 per cent of GDP. Gross remittances, which also include non-resident deposits, reached 14.6 per cent of GDP in 2016, with remittance flows from the Gulf Cooperation Council (GCC) accounting for almost 25.0 per cent of the total. The reliance on GCC countries for remittances and trade mitigates the growth benefit from lower oil prices to the extent that GCC countries' growth and fiscal accounts are affected by lower oil prices. Net foreign direct investment (FDI) increased to 3.8 per cent of GDP from 3.4 per cent in 2015, while net portfolio investment increased five-fold to reach 5.1 per cent of GDP. As a result, international reserves have remained high and stable and amounted to US$ 40.2 billion as of May 2017, over 14 months of imports, bolstering confidence in the peg and the financial system despite weak public finances.

Growth is expected to rebound but remains subdued at 2.3 per cent. A recovery in the construction and financial sectors, thanks to renewed political stability and the continuation of reforms, is expected to boost confidence, increase inflows and help debt dynamics. Meanwhile, sizeable vulnerabilities and risks remain, including from regional turmoil and increased spending pressures.

Assessment of transition qualities (1-10)



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Major structural reform developments

Lebanon's economy suffers from a number of structural weaknesses. In 2017, The World Economic Forum ranked Lebanon 101st out of 138 countries in its Competitiveness Ranking, due to poor macroeconomic conditions, infrastructure and electricity, and institutions. Corruption, government instability and inadequate infrastructure were identified as the most problematic factors for doing business. The World Bank's *Doing Business 2018* report ranked Lebanon 133rd out of 190 countries, down from 126th in the 2017 report. According to the assessment, the lack of investment in infrastructure has eroded the country's competitiveness.

Progress was made in setting up public-private partnerships in the energy sector. The electricity sector remains a key bottleneck to improved competitiveness and a large drain and source of uncertainty on the budget because of ageing infrastructure, unpaid consumption and low tariffs. Efforts to reform the national electricity company, Electricité du Liban (EdL), have been hindered for years. A chronic electricity crisis has existed since the end of the Civil War in 1990, with successive governments failing to make large investments to improve the ailing sector and its outdated infrastructure. The electricity reform plan announced in March 2017 calls for the lease of power barges aimed at improving power supply in the summer.

Decrees regulating oil and gas exploration have been approved. In January 2017, the cabinet approved decrees that would allow the start of offshore oil and gas exploration, by setting out both the exploration blocks that it will offer and the terms and conditions for exploration and production agreements. Lebanon is the last country in the eastern Mediterranean region to explore its hydrocarbon reserves, which are shared with Cyprus, Israel and Egypt. After passing a hydrocarbon law in 2010, Lebanon fell behind neighbouring countries in exploring the Levant Basin owing to internal political strife. The authorities in Lebanon expect to open five new offshore gas blocks for exploration in 2017. The government is now pushing to receive bids by mid-September to speed up the process.

Efforts to reform taxes and public sector wage scales face legal barriers. In July 2017, parliament passed a series of laws to raise taxes and ensure funding for the long-awaited new public-sector wage scale. Parliament voted to approve 38 separate measures to provide the funding for increased public-sector salaries and an 85 per-cent increase in public-sector pensions, to be delivered over three years. The changes included a tax on bank profits, a fine on those encroaching on public maritime properties, and a new fee on foreigners entering the country, among others. The package was supposed to pave the way for parliament to ratify the country's first budget since 2005. However, in August, the constitutional council suspended the implementation of the law, and in September it annulled the law in its entirety. It is worth noting that the passage of a new wage scale has been delayed for five years and the latest revenue measures to be passed were a decade ago.

Spending plans are still formulated ad hoc but progress is being made in improving the situation. Political deadlock has resulted in parliament not formally approving a budget for the past 12 years, with spending plans formulated on an ad hoc basis. In March the cabinet approved the 2017 draft budget, and parliament approved it during an extraordinary session in October and is set to begin drafting the 2018 budget. Parliamentary ratification of an annual budget going forward would improve the transparency and predictability of public finances, allow further reforms and facilitate donor funding. The World Bank recently agreed to new loans and grants for two separate road projects totalling more than US$ 400 million, conditional on Lebanon passing a budget. The absence of an approved budget continued to impede the formulation and implementation of debt-stabilising reforms. While the agreement on a budget within the cabinet raises the prospect of one now being passed by parliament, its likely impact is unclear and the associated delays increase fiscal risks.

MOROCCO

Highlights

- **Growth remained sluggish in 2016.** The economy remains sensitive to volatile agricultural output, and non-agricultural activity has been subdued. Fiscal and current account deficits are above 4 per cent of GDP but reserve coverage has strengthened in the past year.
- **The six-month political gridlock, which started in October 2016, ended with the appointment of a new coalition government.** The coalition is broader and more fragmented, which may slow policy-making. However, policy priorities do not differ from those of the previous administration, implying a continuation of sound policies and strong reforms.
- **Important fiscal and public sector reforms are advancing.** In the past year pension system and civil service reforms have continued, the implementation of the organic budget law (OBL) came into effect, steps to address risks related to state-owned enterprises were taken, and the authorities implemented tax reforms.

Key priorities for 2018

- **Fiscal policy reforms should continue.** The focus should be on continuing fiscal consolidation and decentralisation, civil service reform and strengthening the oversight of state-owned enterprises.
- **Financial policy framework reforms would make the financial sector more resilient.** Critical measures include adopting the central bank law, continuing to implement the joint IMF-World Bank Financial Sector Assessment Program recommendations, and moving towards a more flexible exchange rate regime.
- **Further measures are needed to improve the business climate and enhance competitiveness.** Access to finance would be improved by enacting the draft law on collateral and aligning the insolvency regime with international best practices. It is also important to make the Competition Council operational by appointing all its members, and to implement the recently adopted national strategy to fight corruption.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	4.5	2.7	4.5	1.2	4.2
Inflation (average)	1.9	0.4	1.6	1.6	1.2
Government balance/GDP	-5.6	-5.2	-4.5	-4.1	-3.5
Current account balance/GDP	-7.6	-6.0	-2.2	-4.4	-4.0
Net FDI/GDP [neg. sign = inflows]	-2.8	-2.8	-2.6	-1.6	-1.6
External debt/GDP	29.3	33.3	33.9	34.6	n.a.
Gross reserves/GDP	17.1	19.8	22.8	24.9	n.a.
Credit to private sector/GDP	84.3	83.9	80.2	81.3	n.a.

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Macroeconomic performance

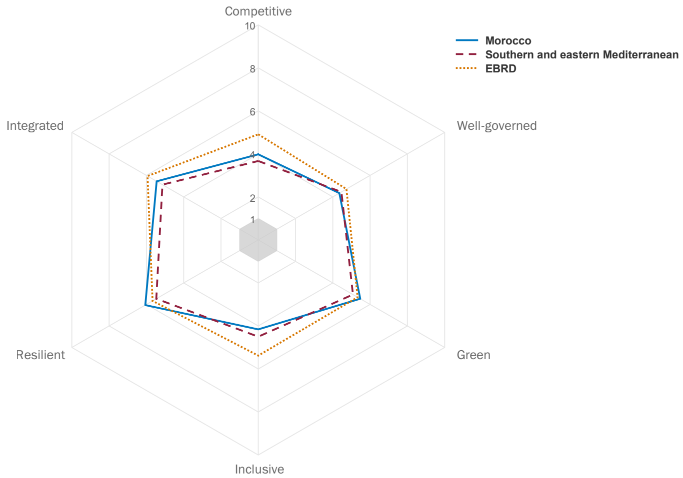
Growth slowed significantly in 2016 but picked up in the first half of 2017. GDP growth declined to 1.2 per cent in 2016, from 4.5 per cent in 2015, due to a sharp slow-down in agriculture and subdued non-agricultural activity. The 12.8 per cent contraction in agriculture was due both to a drought and a negative base effect following record agricultural production in 2015. The disappointing 2.7 per cent growth in non-agriculture was due to slowing industry. In the first three quarters of 2017 growth picked up to 3.9 per cent, driven by the rebound in agriculture. The unemployment rate increased to 9.3 per cent in the second quarter of 2017 from 9.1 per cent in the same quarter of 2016, while youth unemployment increased to 22.5 per cent in 2016.

Fiscal developments were positive, although less favourable than envisaged. For 2016, the deficit was 4.1 per cent of GDP, down from 4.5 per cent in 2015, but higher than the authorities' objective of 3.5 per cent. This was primarily due to a revenue shortfall related to lower-than-expected growth and to accelerated VAT reimbursements (to ease SME financing constraints), while increased capital spending (to support growth) was offset by lower current spending. For the first half of 2017, fiscal performance improved and the deficit narrowed to 1.2 per cent of GDP, compared with 2.4 per cent in the same period of 2016, due to strong tax revenue performance.

The external position remained strong in 2016, as international reserves increased. The current account deficit widened to 4.4 per cent of GDP in 2016, from 2.2 per cent in 2015, and by more than expected. This was due to stronger capital equipment and food imports, and to the impact of lower phosphate prices that offset strong export growth in emerging sectors such as automobiles. In the first half of 2017 the deficit increased further to 7.3 per cent of GDP compared with 4.8 per cent in the same period of 2016. Meanwhile, steady foreign direct investment inflows, international bond issuances and trade credit supported the capital account. As a result, international reserves reached 6.3 months of imports at the end of 2016 and 5.9 months of imports in September 2017.

Growth is expected to rebound to 4.2 per cent in 2017. This reflects the pick-up in agricultural output, but is subject to steadfast reform implementation, including agricultural sector modernisation and reforms to improve the business climate and boost productivity. The outlook remains subject to downside risks, including from social unrest, weak growth in Morocco's main trading partners, geopolitical risks and global policy uncertainty.

Assessment of transition qualities (1-10)



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Major structural reform developments

Pension system and civil service reforms have continued. Parliament passed draft laws to reform the pension system run by the Moroccan Pension Fund (CMR) in July 2016 and gradual implementation began in September 2016. This reform gradually raises the retirement age, increases the rate of employer and employee contributions, and introduces new rules for calculating benefits. It will extend the sustainability of the pension system managed by the CMR and lower the deficit of the system. Moreover, to keep the public payroll below 10.5 per cent of GDP over the medium term, several reforms have been pursued, including the recent introduction of contractual employment and increased personnel mobility across ministries.

Implementation of the 2015 OBL started in 2016 and steps to reform the governance of state-owned enterprises (SOEs) have advanced. The OBL was adopted in 2015 and took effect in 2016, with most of its provisions implemented. The provision establishing the limiting nature of personnel appropriations to limit the risks of exceeding those appropriations entered into force on 1 January 2017, and the regulatory measure limiting the carry-forward of investment appropriations was renewed, pending the introduction of the relevant OBL provisions on 1 January 2018. A draft law to strengthen the governance and auditing of public enterprises and establishments in order to further improve their performance was submitted to the General Secretariat of the Government in 2017, with a view to finalising and submitting it to the Government Council. The authorities have also taken steps to address potential SOE-related fiscal risks, for which specific provisions are missing from the OBL.

The authorities are implementing tax reforms. The reforms are in line with recommendations from the 2013 national tax conference. Key measures implemented since then include: the taxation of self-employed and liberal professions; the introduction of corporate tax brackets in the 2016 budget, rather than a unique 30 per cent corporate income tax rate; the introduction of VAT deductions in some agro-industrial inputs; and improvements to the VAT refund system. Revisions were also introduced on excise tax rates, and the social contribution for the public sector increased in September 2016 with the implementation of the new pension law. Lastly, the government has simplified various administrative procedures related to compliance and settlement of tax disputes.

Plans to introduce greater exchange rate flexibility and inflation targeting have been delayed. While the central bank had plans to gradually introduce a floating exchange rate starting in the second half of the year, it is now unclear when this will take place. Currently, the dirham is pegged to a two-currency basket weighted 60 per cent to the euro and 40 per cent to the US dollar. By delaying, the government may be missing a good opportunity, given the current strong economic health due to the improvement in fiscal and external buffers, the resilience of the financial sector, the alignment of the exchange rate with fundamentals, and the gradual diversification of the economy.

The business environment has improved but some reforms are lagging. Efforts have been made recently to simplify administrative procedures (such as for customs transactions, property rights and enterprise creation), and to reduce payment delays from the public to the private sector. Morocco's 2018 World Bank Doing Business ranking remained broadly the same at 69, against 68 in 2017, but an improvement compared with 75 in 2016. However, other key reforms are lagging, including the appointment of all members of the Competition Council (which would make it operational), and determined implementation of the recently adopted national strategy to fight corruption.

TUNISIA

Highlights

- **Growth remained weak in 2016 but has picked up in 2017.** GDP grew by just 1 per cent in 2016 and, coupled with policy slippages, this caused the fiscal deficit to widen to 6.1 per cent of GDP and the debt to increase to 61.9 per cent of GDP.
- **The dinar has depreciated sharply.** The most volatile episodes occurred between July and November 2016 (around 10 per cent depreciation) and in May 2017 (12.8 per cent drop), when the interbank market froze due to political uncertainties and strong demand for foreign exchange for energy importers. The depreciation resulted in rising inflationary pressures, higher debt and a widening in the trade deficit.
- **Structural reform performance has improved.** The authorities have: made important progress in restructuring public banks; adopted a new tax strategy; established the Large Taxpayers Unit; adopted a revised strategy to reform the civil service; published the implementation decrees relating to the laws on competition, public-private partnerships (PPPs) and the investment code; and continued with energy subsidy reforms.

Key priorities for 2018

- **Outstanding legislative reforms should be adopted.** These include the laws on lending rates, bank inspections, and the organic budget law; performance contracts for the five largest state-owned enterprises; the functional reviews of key ministries; the creation of the high anti-corruption authority; and the compilation of the databank on vulnerable households.
- **Removing the discrimination against public banks in managing non-performing loan (NPL) portfolios should be a priority.** The recent restructuring plans of public banks now hinge on these banks improving their ability to resolve their legacy NPLs. And the required legislative changes need to be implemented swiftly, as high NPLs contribute to inadequate access to finance.
- **Sound macroeconomic, fiscal and monetary policies should be implemented to complement progress on structural reforms.** Contractionary monetary policies should be taken to support the depreciating dinar and mitigate rising inflation. The removal of entrepreneurship constraints, a more competitive business environment for exporting firms, and import-substitution should be implemented to create jobs at home, and growth-enhancing and social spending should be prioritised, especially within a limited fiscal space.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	2.3	2.3	1.1	1.0	2.2
Inflation (average)	5.8	4.9	4.9	3.7	4.5
Government balance/GDP	-6.9	-5.0	-4.8	-6.1	-5.9
Current account balance/GDP	-8.4	-9.1	-8.9	-8.8	-8.7
Net FDI/GDP [neg. sign = inflows]	-2.3	-2.2	-2.2	-1.7	-2.5
External debt/GDP	58.8	63.7	68.5	74.7	n.a.
Gross reserves/GDP	16.9	17.6	17.8	15.4	n.a.
Credit to private sector/GDP	68.1	69.3	70.1	72.2	n.a.

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Macroeconomic performance

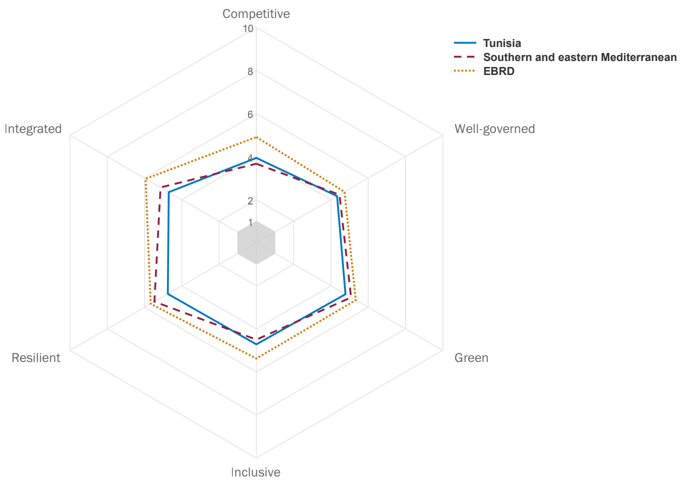
Growth remained weak in 2016. The rate of GDP growth declined slightly to 1.0 per cent from 1.1 per cent in 2015, driven by contractions in mining and agriculture, and slow growth in manufacturing and tourism. However, growth picked up to 1.9 per cent year-on-year in the first half of 2017, supported by a rebound in agriculture, and strong growth in tourism and phosphates production. Unemployment remained elevated at 15.3 per cent in the second quarter of 2017, with youth and female unemployment rates running at double this level.

The fiscal situation worsened in 2016. Lower-than-expected growth and policy slippages caused the fiscal deficit to widen to 6.1 per cent of GDP in 2016 from 4.8 per cent of GDP in 2015. The shortfall in revenues was due also to weaknesses in revenue collection. Meanwhile, the public sector wage bill grew to 14.6 per cent of GDP in 2016 from 13.7 per cent in 2015, among the highest in the world. As a result of the higher deficit, the dinar's depreciation and a reclassification of post office deposits as central government debt, public debt stood at 61.9 per cent of GDP at the end of 2016, up from 55.4 per cent in 2015, with most of it foreign debt.

The external position remained broadly unchanged but reserves are at low levels. The current account deficit was 8.8 per cent of GDP in 2016, almost the same as 2015, as the decrease in exports and current receipts was offset by lower imports of goods. Foreign direct investment declined to 1.7 per cent of GDP in 2016, the lowest since 2011. Meanwhile, a worsening trade deficit eroded gross international reserves, which declined to US$ 5.8 billion at the end of August 2017, covering only 3.3 months of imports.

Growth will recover gradually. Growth is expected to rise in 2017 to 2.2 per cent, but the still-modest rate reflects delays in implementing structural reforms and low private investment. The impact of tax revenue rises and monetary tightening would be mitigated through the recovery of phosphates and tourism, higher public investment and wage increases. Sizeable risks remain; on the domestic side, the fragile socio-political environment, especially in the run-up to the local elections in December 2017, may adversely affect confidence and possibly delay reforms. On the external front, continued conflict in neighbouring Libya and the wider region could affect Tunisia through immigration flows, confidence shocks and weaker social cohesion.

Assessment of transition qualities (1-10)



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Major structural reform developments

The authorities have made important progress in restructuring public banks. Following the recapitalisation in 2015 and management changes in 2016 of the three public banks, performance contracts were completed in early 2017. These developments constitute a major step in strengthening the resilience of the financial sector and improving credit availability in the economy. Meanwhile, the viability of the banks' restructuring plans now hinges on these banks improving their ability to resolve their legacy NPLs, but the required legislative changes are seriously delayed.

The authorities have finalised the first implementation decrees of the banking law. The law, adopted in 2016, fell short of good international practices, mainly on the resolution framework, due to constraints of the guarantee fund to finance transactions, creditor hierarchy in liquidation, and government presence in the resolution committee. Secondary legislation was approved in August 2016 to address some of the weaknesses in the banking law regarding the bank resolution framework. Key measures include the adoption of a government decree to implement the framework of the Bank Deposit Guarantee Fund that includes a least cost-test for resolution (with an exception for systemic cases), and adoption of a bylaw of the Resolution Committee providing a short time-frame to determine resolution measures for systemic cases to achieve financial sector stability.

Major fiscal reforms were completed. The Council of Ministers adopted in early May 2016 a strategy to broaden the VAT base by reducing exemptions; rationalising VAT rates (from three to two); introducing a more progressive personal income tax, including through fewer deductions and a significantly higher tax threshold; reducing further the dichotomy between the offshore and onshore corporate tax rates by 2018; and increasing the tax on dividends. The strategy was presented in May 2017 to the signatories of the Pacte de Carthage, the government's road map for the timely prioritisation of reforms signed by nine parties, the Tunisian Confederation of Industry, Trade, and Handicrafts (UTICA), the Tunisian General Labour Union (UGTT) and the Tunisian Union of Agriculture and Fisheries (UTAP). The authorities have also adopted the decree for the establishment of a modern Large Taxpayers Unit (LTU) that assumes formal responsibility for the major tax and enforcement functions, as well as setting up an implementation timetable that will be guided and monitored by a task force.

The government has adopted a revised strategy to reform the civil service. This strategy, adopted in April 2017, aims to improve the provision of public services and reduce the civil service wage bill to about 12 per cent of GDP in 2020. The strategy mandates no further wage increases unless economic growth substantially exceeds the baseline projections and unless the wage bill reduction path can be maintained as envisaged. It also contains a restrictive recruitment policy that will enforce a limited replacement rate for departing employees, and voluntary departure programmes, which would mainly rely on negotiated departures rather than early retirements.

Business environment reforms are being implemented. In September 2016 the authorities published the implementation decrees relating to the laws on competition, PPPs and the investment code. The new investment law, adopted by the parliament in September 2016, provides more clarity to the investment framework, including equal treatment of domestic and foreign investors and the separation between fiscal and financial incentives in line with international best practices. Parliament also adopted the law on whistleblowers in April 2017, enabling the creation of a legal framework underpinning the civic duty to report wrongdoing.

The authorities continued with energy subsidy reforms. The government increased administered fuel prices in July 2017 to reduce inefficient energy subsidies. It also applied the automatic adjustment mechanism (monthly) for the three main fuels starting in July, and revised electricity tariffs in the 2017 budget to include an increase in the prices of electricity (5 per cent) and gas (7 per cent), while keeping the social tariffs unchanged.

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Important reforms are delayed. Despite the inspections of five banks being completed in May 2017, inspections for two other banks were delayed, essentially due to a lack of staff within banking supervision. The signature of performance contracts for the five public enterprises (Tunisair, the electricity and gas companies STEG and STIR, the Office des Céréales, and the national Régie des Tabacs) is also delayed, with work at an advanced stage for four of them and an interim contract signed for Tunisair. Following the government's request, delayed parliamentary discussions on the Organic Budget Law, the law creating the high anti-corruption authority, and the law on the excessive lending rate will be accelerated, after which they will be published in the official gazette.