Egypt

Highlights

- **Growth has slowed amid foreign-currency shortages and a decline in natural gas production.** The subdued performance of the construction, manufacturing and natural gas sectors weighed on growth in the first three quarters of the 2022-23 fiscal year. Inflation surged to a record high and the exchange rate depreciated significantly, raising fiscal and external financing pressures.
- **The country has embarked on a programme to reduce the state's footprint in the economy and boost private investment.** The authorities published a State Ownership Policy to privatise state assets, amended the Competition Law to promote a level playing field, and enacted several regulatory reforms to attract foreign direct investment.
- **Egypt has raised its green ambitions.** Aiming to increase the contribution of renewables in the energy mix to 42 per cent by 2030 (from 31 per cent in 2021), the government launched a programme to decommission fossil-fuel plants and scale up renewable energy generation, while ensuring a just transition.

Key priorities for 2024

- **Addressing fiscal and external vulnerabilities is a top priority.** Following approval of an International Monetary Fund (IMF)-supported programme, progress has stalled amid increased fiscal and foreign-exchange pressures. Key requirements for macroeconomic stability include maintaining a flexible exchange-rate regime and ensuring fiscal and debt sustainability.
- **Progress on privatisation and structural reforms is essential for growth and investment.** Efforts have been made to strengthen competition and improve the business climate, but progress has been slow. Key priorities in the short term are to advance the country's state asset sales agenda and continue reforms to level the playing field and strengthen competitive neutrality.
- **Accelerating the green agenda is necessary to achieve Egypt's goal of becoming an energy hub.** The authorities should continue promoting investments in solar and wind energy, as well as infrastructure, to support the growth of the green hydrogen sector. This is especially important to ensure energy security and achieve Egypt's potential in light of declining natural gas production.

Main macroeconomic indicators[1] (per cent)

	2019	2020	2021	2022	2023 est.
GDP growth	5.5	3.6	3.3	6.6	4.1
Inflation (average)	13.9	5.7	4.5	8.5	24.1
Government balance/GDP	-7.5	-7.4	-6.8	-6.1	-6.0
Current account balance/GDP	-3.4	-2.9	-4.4	-3.5	-1.2
Net FDI/GDP [neg. sign = inflows]	-2.6	-1.9	-1.2	-1.9	-2.5
External debt/GDP	34.2	32.4	32.5	37.3	n.a.
Gross reserves/GDP	14.0	10.0	9.6	7.0	8.7
Credit to private sector/GDP	21.7	23.6	26.3	27.8	26.6

1. Data refer to fiscal year ending in June.

Macroeconomic developments and policy response

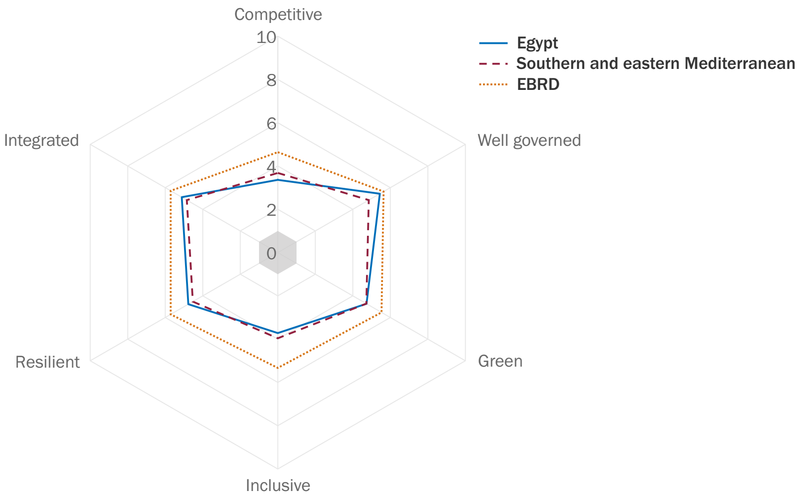
Growth slowed in the first three quarters of the 2022-23 fiscal year. Gross domestic product (GDP) grew by 4.1 per cent year on year in the first three quarters of the 2022-23 fiscal year (ending June 2023), down from 7.8 per cent in the same period of the 2021-22 fiscal year. Despite a recovery in revenues from the Suez Canal and from tourism, growth was weighed down by a deceleration in construction and manufacturing activity, as well as a contraction in gas production. Natural gas output is estimated to have declined by 10 per cent year on year in the first seven months of 2023, reaching a three-year low. Meanwhile, unemployment dropped slightly to 7.1 per cent in the first quarter of 2023, remaining at high levels among women (19.2 per cent) and in urban areas (10.3 per cent).

The authorities adopted several policies to control record-high inflation and mitigate its socioeconomic impacts. Egypt agreed to shift to a flexible exchange-rate regime as part of the IMF-supported programme, leading the central bank to devalue the pound multiple times since March 2022 (it has lost 50 per cent of its value against the US dollar since then). Inflation reached a record high of 38 per cent in September 2023. In response, the central bank has raised its key interest rates by a cumulative 1,100 basis points since April 2022. External financing risks and the uncertainty surrounding the exchange-rate regime have contributed to several international agencies downgrading Egypt's credit ratings since May 2022. Policies to mitigate the impact of inflation on citizens have included the launch of a new subsidised bread programme, as well as raising pensions, minimum wages for public and private employees, and the income-tax exemption threshold.

Fiscal pressures increased, driven by higher public spending, despite a narrower current account deficit and pick-up in foreign-exchange reserves. The fiscal deficit reached 6 per cent of GDP in the 2022-23 fiscal year. Higher spending on public investment, public wages, subsidies and social welfare, as well as inflation, higher interest rates and the currency's depreciation pushed up expenditures, although tax-collection revenues also rose. Gross public debt was an estimated 94.7 per cent of GDP in the 2022-23 fiscal year (up from 88.5 per cent in the 2021-22 fiscal year). Meanwhile, the current account deficit narrowed to an estimated 1.2 per cent of GDP by the end of the 2022-23 fiscal year, driven by higher tourism, Suez Canal revenues and a contraction in import demand due to foreign-currency shortages. Natural gas exports declined by 75.6 per cent year on year in April 2023, driven by the drop in global prices and decline in domestic production. Foreign-exchange reserves recovered slightly to reach US$ 35 billion (€33.2 billion) in September 2023, covering 5.5 months of imports.

Growth is expected to pick up over the medium term. GDP is expected to grow by 4.8 per cent in the 2023-24 fiscal year, as external and fiscal vulnerabilities ease and recent reforms to boost private-sector growth start to pay off. Headwinds that might hold back growth include higher inflationary and currency pressures, tighter monetary conditions and potentially slower progress on the structural reforms necessary to empower the private sector. The recent decline in natural gas production and exports could present additional risks to the outlook.

Assessment of transition qualities (1-10)



Structural reform developments

The IMF approved a programme to support Egypt's economic reforms. The 46-month US$ 3 billion (around €2.9 billion) Extended Fund Facility was approved in December 2022, supporting a shift to a flexible exchange-rate regime, fiscal consolidation, debt sustainability and the implementation of structural reforms to encourage private-sector-led growth. The first review was scheduled for March 2023, but was delayed amid slow progress on the exchange-rate reform and privatisation programme. It is now expected to take place alongside the second review in autumn 2023.

Egypt embarked on a privatisation plan to reduce the state's footprint. A new State Ownership Policy was published in January 2023, aiming to increase the role of the private sector to 65 per cent and attract US$ 40 billion (€38 billion) in private investment by 2026. In February 2023 the government announced a plan to sell stakes in 32 state-owned enterprises (SOEs), which it later expanded to 35 SOEs in August 2023, either to strategic investors or through initial public offerings. Despite the slow progress, momentum started to pick up in the second half of the fiscal year, with the government announcing the sale of US$ 1.9 billion (€1.8 billion) in SOE stakes by July 2023 (almost meeting the announced US$ 2 billion target).

The government passed key regulatory reforms to improve the business climate and promote a level playing field. In line with the new State Ownership Policy, the government and the Egyptian Competition Authority (ECA) instituted several measures in late 2022 to promote fair competition. These included: (i) amending the Competition Law to empower the ECA to regulate mergers and acquisitions and prevent anti-competitive economic behaviour; (ii) issuing a new Competitive Neutrality Strategy; and (iii) establishing the High Committee for Competition Policy and Competitive Neutrality. The authorities also introduced another round of amendments to the public-private partnership (PPP) law in September 2022 to facilitate the process and improve communication on potential projects. Lastly, the central bank announced in November 2022 the discontinuation of subsidised lending schemes to limit credit-market distortions, in addition to cancelling the letters-of-credit requirement in December. These measures had been designed to ease pressure on foreign reserves, but had suppressed imports and created shortages in some products.

Measures to support the green economy transition are advancing. The authorities plan to generate 42 per cent of Egypt's electricity needs from renewables by 2030. To support this goal, the government launched the Country Platform for the Nexus on Water, Food and Energy (NWFE) on the sidelines of the COP27 climate conference, which was hosted in Egypt in November 2022. Under the NWFE's energy pillar, there are plans to decommission 5 GW of fossil-fuel capacity (9 per cent of Egypt's installed capacity) and replace it with 10 GW of private solar and wind energy by 2028, while ensuring a just transition. Moreover, in November 2022 the government launched the Sovereign Sustainable Financing Framework, an update of the 2020 Green Financing Framework, to expand green and sustainable financing by exploring the issuance of green, blue, social, sustainable and gender bonds. In parallel, Egypt is advancing the green hydrogen agenda to leverage its renewable energy potential and become a regional energy hub.

The central bank continues to promote financial efficiency and inclusion, including through digitalisation. In July 2023 a new reform programme was announced to enhance the efficiency of the financial sector, supported by a US$ 615 million (€583 million) loan from the Arab Monetary Fund. The programme aims to: (i) enhance the soundness and efficiency of the payment systems infrastructure; (ii) strengthen the supervisory and regulatory framework; (iii) enhance financial technologies and strengthen security; and (iv) improve financial inclusion and sustainability. In May 2023 the central bank launched the country's first payment service mobile application (Instapay) to promote financial inclusion, allowing users to instantly transfer funds from their bank accounts to any local bank account or digital wallet without additional fees.

The government embarked on a natural gas exploration programme to boost exports and improve energy security. In July 2023, in parallel to its green energy drive, the government announced a programme to mobilise US$ 1.8 billion (€1.7 billion) worth of investments to dig 35 new gas wells in the Nile Delta and Mediterranean. The government aims to increase oil and gas exports by 12 per cent in 2023 and an additional 15 per cent the following year, to reach US$ 24 billion (€23 billion) by 2024.

Jordan

Highlights

- **The economy posted steady growth in 2022 and the first half of 2023.** This was supported by a recovery in tourism and a broad-based improvement in non-service sectors. However, unemployment remains high, and rising food and energy prices are damping household demand.
- **Reforms under the government's 2033 Economic Modernisation Vision are advancing.** Recent progress includes regulatory reforms to promote investment and the adoption of measures to increase private-sector participation and foster competition, as well as to remove barriers to inclusive employment.
- **Jordan took steps to address barriers to youth and women's employment.** These include regulatory amendments to strengthen protection against workplace violence and harassment, as well as new incentives for employers to increase youth employment.

Key priorities for 2024

- **High unemployment and low female labour participation rates remain a constraint on inclusive growth.** Reforms to promote private investment, especially in labour-intensive sectors, will be key to creating jobs. Bold labour-sector reforms and addressing skills mismatches are vital to mitigating market rigidities and should be complemented by measures to promote entrepreneurship and innovation.
- **Solid progress on reforms is crucial to attract foreign investment and leverage private-sector participation**. Reforms are progressing under the Economic Modernisation Plan, but the authorities need to capitalise quickly on achievements, with effective implementation to attract foreign investment in and advance public-private partnerships (PPPs) on critical infrastructure projects.
- **Deeper structural reforms are needed to support debt sustainability.** In addition to revitalising growth and shoring up revenues, the authorities must address long-standing financial vulnerabilities in the water and energy sectors to safeguard fiscal reforms and improve private-sector access to services.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.0	-1.6	2.2	2.5	2.5
Inflation (average)	0.8	0.3	1.3	4.2	2.0
Government balance/GDP	-5.7	-8.6	-7.8	-7.3	-7.0
Current account balance/GDP	-1.7	-5.7	-8.2	-8.8	-7.6
Net FDI/GDP [neg. sign = inflows]	-2.8	-1.4	-1.6	-1.4	n.a.
External debt/GDP	82.6	79.5	82.6	86.9	n.a.
Gross reserves/GDP	32.6	54.8	57.8	52.7	n.a.
Credit to private sector/GDP	78.4	84.6	83.8	86.2	n.a.

Macroeconomic developments and policy response

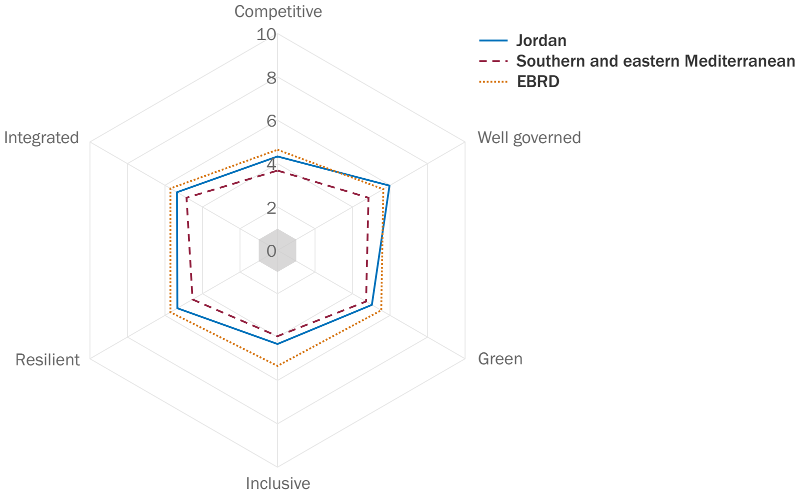
Economic growth was robust in 2022 and the recovery of underperforming sectors accelerated in the first half of 2023. Gross domestic product (GDP) grew 2.5 per cent in 2022, reflecting a broad-based recovery in most sectors. The pace of growth picked up to 2.7 per cent year on year in the first half of 2023 on the back of improved performance in the agricultural, construction and transport sectors. The rebound in tourism continued to gather pace, and tourism receipts in 2023 so far have surpassed pre-pandemic levels. Nonetheless, unemployment remained high in the second quarter of 2023, at 22.3 per cent, and even higher for women (26.7 per cent) and youth (43.7 per cent). Meanwhile, inflation eased to 1.2 per cent in September 2023 from a peak of 5.4 per cent in September 2022. However, the population continues to face elevated food and energy prices as a result of global inflation in 2023.

Fiscal discipline has been accompanied by rising domestic interest rates, but public debt remains high. In 2022 climbing energy prices were mitigated by reductions in fuel taxes. However, a lack of fiscal space meant that these broad-based subsidies were phased out and replaced with targeted support for the poorest households in 2023. Likewise, subsidies on food commodities remained limited to basic bread. In tandem, rising interest rates globally, particularly in the United States of America, have led to simultaneous rate hikes in Jordan to maintain the currency peg. The Central Bank of Jordan has raised its main rate four times in 2023 – to 7.5 per cent as at the end of September. Meanwhile, the general government fiscal deficit narrowed from 7.8 at the end of 2021 to 7.3 per cent of GDP at the end of 2022, despite sizeable energy subsidy spending, thanks to greater revenue mobilisation and expenditure efficiency. The move from universal to targeted subsidies is expected to help the government control public spending in 2023. General government debt, which stood at more than 114 per cent of GDP (including guarantees) at the end of 2022, is expected to decline slowly as the fiscal deficit continues to narrow. Rising financing costs on both external and domestic debt are expected to boost the debt-servicing burden in the medium term, but access to international debt markets remains comfortable, with Jordan successfully issuing US$ 1.25 billion (€1.19 billion) of Eurobonds in April 2023 at relatively low rates.

Rising commodity prices widened Jordan's current account deficit in 2022, but lucrative mineral exports are compensating in part. The current account deficit grew from 8.2 per cent to 8.8 per cent of GDP in 2022, as imports rose by almost a third due to lofty global oil and food prices. The effect on the overall trade balance was mitigated by a doubling in exports of goods and services, driven by rising phosphate and potash prices and a recovery in tourism. Lower commodity prices in the first half of 2023 have eased external pressures and the trade deficit narrowed, but medium-term trends remain uncertain, with risks of additional supply shocks looming and the pay-off from mineral exports sensitive to global conditions. Meanwhile, foreign-exchange reserves remained at comfortable levels and edged up to US$ 17.3 billion (€16.4 billion) in September 2023, covering around 7.6 months of imports.

Growth is expected to remain relatively stable in the short term, but significant uncertainty remains. GDP growth is projected at 2.5 per cent in 2023 and 2024, supported by a continued recovery in tourism and robust growth in non-service sectors. However, Jordan remains vulnerable to rising energy and food prices, as well as global supply-chain disruptions, thanks to its high import dependency. Tightening global and domestic monetary conditions also entail downward risks and could mute private-sector growth. In the long term, growth potential remains modest in the absence of strong drivers. Progress on transformative structural reforms is, therefore, all the more crucial.

Assessment of transition qualities (1-10)



Structural reform developments

Jordan continues to implement reforms under its International Monetary Fund (IMF)-supported programme. The four-year Extended Funds Facility, approved by the IMF Board in March 2020, remains on track, with the sixth review completed in June 2023. The authorities have met all programme targets so far, including closing tax loopholes, widening the tax base and maintaining stable foreign-currency reserves. These reforms have contributed greatly to macroeconomic stability, even during the challenging global circumstances of recent years, although Jordan has also benefited from programme flexibility and augmented financing to address rising prices. However, progress on deeper fiscal and structural reforms remains critical to preserving stability in the medium and long term, including on key emerging roadmaps for ensuring financial sustainability in the energy and water sectors.

The government launched its Economic Modernisation Vision, a comprehensive 10-year plan aimed at ensuring inclusive and sustainable growth. Work is ongoing under the Executive Programme for 2023-25, which lays the groundwork for envisaged reforms, including regulatory amendments and sectoral strategies. The Vision targets a doubling of GDP growth rates and stimulating job creation, driven mainly by private investment, especially foreign direct investment.

Parliament approved a new investment law, supported by the launch of an investment promotion strategy. Investment Environment Law 21 was passed in November 2022 and came into effect in January 2023. It provides for equal treatment between Jordanian and non-Jordanian investors and expands the number of sectors benefiting from incentives. The law also facilitates the employment of foreign labour on jobs requiring specialised skills up to 25 per cent of total employees, or up to 40 per cent if qualified Jordanian labour is not available. The new Investment Promotion Strategy 2023-26, approved by the cabinet in May 2023, identifies priority sectors, including information and communications technology (ICT), logistics, chemicals, mining, healthcare and real estate, and aims to streamline communication, registration and licensing processes for investors through a specialised electronic platform.

The Public-Private Partnerships Law has been amended. The amendment, adopted in July 2023, aims to streamline and expedite processes and establish a dedicated PPP unit under the Ministry of Investment. This should minimise overlap between various governmental bodies, enable efficient budget allocation, and optimise pipeline formulation and project implementation.

The government took steps to foster competition. Amendments to the Competition Law of 2004 were passed in March 2023 and are designed to combat monopolistic practices. They include articles to improve the definition of market concentration and increase violation penalties.

Legal reforms aim to boost youth employment and female labour-market participation. Changes to the law, adopted in March 2023, include greater protection against sexual harassment and violence in the workplace, as well as lifting restrictions on women's employment in certain sectors. The Social Security Law was also amended to lower employer contributions to social security for young hires, in order to encourage youth employment.

Work is ongoing under the Public Sector Modernisation Plan 2022-25 to support economic reforms. Key pillars include the digitalisation of government services and the introduction of a new human resource strategy for 2023-27. The modernisation plan aims to improve governance and transparency, centralise strategic planning and policymaking, and empower public-sector officials to take decisions in a manner that speeds up processes and improves the quality of services.

Lebanon

Highlights

- **Lebanon's recovery is being held back by political inaction and an impasse on key reforms.** The currency has continued to depreciate, with multiple exchange rates still in place, while inflation is soaring, pushing the poverty rate above 80 per cent of the population.
- **Rising global prices have put added pressure on the external accounts, while Lebanon remains locked out of international markets.** The current account deficit remains large, despite some relief from rising tourism revenues and remittances, and the government is still unable to access international financial markets.
- **Parliament has failed to elect a new president, paralysing other branches of government and holding back progress on reforms.** As a result, there has been no progress on key preconditions to an International Monetary Fund (IMF) programme, including restructuring of banking-sector debt and electricity-sector reforms.

Key priorities for 2024

- **Meeting the reforms required for an IMF-supported stabilisation and structural reform programme remains the most immediate priority.** An agreement with the IMF would help rebuild credibility as to reform commitment and provide access to necessary external financing. Urgent progress is, therefore, necessary on electing a president and forming a government, in addition to comprehensive bank restructuring and regulatory reform.
- **Establishing comprehensive social safety nets has become even more pressing as the population suffers from rising prices for essential products and services.** Wider coverage and improving the transparency of targeted subsidies are critical to addressing the deepening rate of poverty. Given its severe financing constraints, the government will need to attract donor assistance and gradually build robust support networks.
- **Progress on energy-sector reforms, including on the legislative side, is necessary to unlock the financing needed to develop sectoral capacity.** Stronger commitment to greener energy production and improved efficiency will greatly help to address severe shortages and limit import dependence.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	-6.9	-25.9	-10.0	0.0	0.0
Inflation (average)	2.9	84.3	150.6	183.8	229.0
Government balance/GDP	-10.6	-4.1	1.2	-5.2	-6.9
Current account balance/GDP	-27.9	-15.7	-17.3	-29.0	-12.5
Net FDI/GDP [neg. sign = inflows]	-3.4	-5.3	-2.1	n.a.	n.a.
External debt/GDP	201.0	135.0	392.0	391.0	n.a.
Gross reserves/GDP	48.1	72.2	48.6	58.6	n.a.
Credit to private sector/GDP	88.3	54.3	n.a.	n.a.	n.a.

Macroeconomic developments and policy response

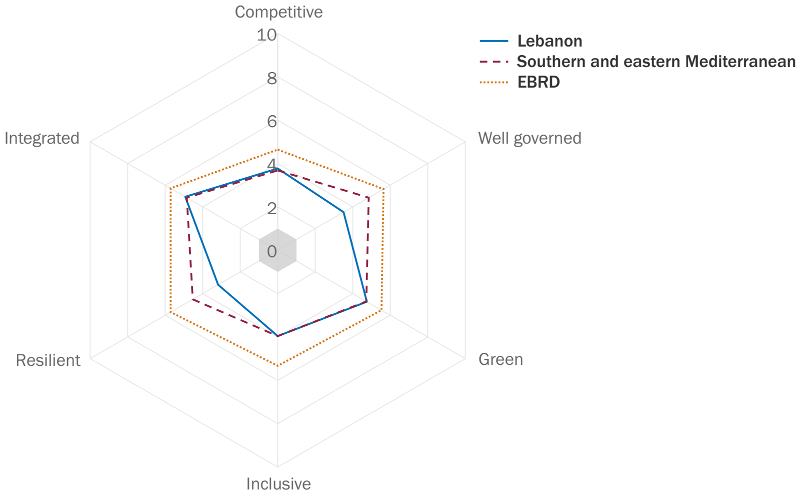
Political deadlock is still holding back economic recovery, and the population's living conditions are dire. The economy is estimated to have recorded zero growth in 2022 after two years of deep recession (a 10 per cent contraction in gross domestic product [GDP] in 2021, on top of a decline of 25.9 per cent in 2020). The resulting surge in the cash economy and informal sector has further deprived the state of highly needed fiscal revenues, underpinning the overall deterioration of macroeconomic fundamentals. Throughout most of 2023, Lebanon has seen little progress on reforms, as the lack of a functioning government has stalled progress and left the country unable to access international donor support. The black-market exchange rate deteriorated further in the first half of 2023 to a peak of LBP 134,800 per US dollar, despite improvements in the inflow of fresh dollars, before stabilising at around LBP 89,700 per dollar at the end of October (compared with an official rate of LBP 15,000 per dollar). This fuelled even higher inflation, which reached 208 per cent in September 2023. The prolonged crisis continues to threaten the livelihoods of most households; the International Labour Organization estimated the unemployment rate at 29.6 per cent in January 2022, with more than 80 per cent of the population estimated to be living in poverty at the end of 2021. Elevated prices for food and energy have placed more pressure on vulnerable households, with only limited targeted support available to those most in need.

Multiple exchange rates persist, amid a dire fiscal and public debt situation. Banque du Liban (BDL) announced a new official exchange rate of LBP 15,000 per US dollar in February 2023. The gap to the black-market rate remains significant, however; the BDL's most widely used Sayrafa platform rate stood at LBP 85,500 per dollar at the end of August 2023. Steps have been taken to end Sayrafa, unify the exchange rate and move to an electronic FX trading platform, as announced by the new BDL leadership team in August. Meanwhile, the fiscal deficit is estimated to have widened due to severe revenue shortfalls, reflecting distorted exchange-rate pricing for taxes and customs, as well as eroded collection capacity. The diminishing real salaries of public-sector employees have resulted in high numbers of resignations and increased absenteeism, further undermining the country's already weakened public administration capacity. Public debt stood at 282 per cent of GDP at the end of 2022 and is forecast to be around 250 per cent by end of 2023.

The current account deficit peaked in 2022 and the population's access to basic goods remains precarious. The deficit is estimated to have exceeded 29 per cent of GDP in 2022, but is expected to ease in 2023, helped by increasing tourism receipts and rising remittances from Lebanese nationals abroad. Access to wheat imports have remained largely secure in 2023, owing to a US$ 150 million (around €142 million) World Bank loan to help stabilise bread prices. However, fuel prices continue to change based on availability, exchange-rate fluctuations and global prices, while access to electricity in some areas is limited to two hours a day, increasing the population's dependence on private generators. Regional agreements to supply Lebanon with energy remain on hold pending progress on electricity reforms, including the gas import agreement signed by Egypt, Syria and Lebanon in July 2022 and the agreement signed with Jordan to import electricity in January 2022. The fuel supply deal with Iraq was extended for another year in the middle of 2023.

The outlook remains highly uncertain, and any recovery depends on the speed of government formation and agreement on an IMF deal. The economy is expected to see zero growth again in 2023, amid political inaction and stalled reforms. A return to growth is possible in 2024 – provisionally forecast at 3 per cent – conditional on an IMF-supported programme being successfully implemented by a reform-minded government, which would also allow negotiations to resume with international partners.

Assessment of transition qualities (1-10)



Structural reform developments

Lebanon has made little progress on the prerequisites to the IMF staff-level agreement reached in April 2022. The proposed IMF programme would be a 46-month US$ 3 billion (around €2.8 billion) Extended Fund Arrangement. Discussions with the IMF have been on hold, with no progress on forming a new government since May 2022 or electing a new president since October 2022. In its June 2023 Article IV consultation, the IMF identified gaps in the draft banking secrecy and capital controls laws (both are programme prerequisites), which are still being discussed in parliament. Political support for the draft banking resolution law, necessary for financial-sector restructuring, has also been limited. Delays in adopting the 2022 draft budget law, and now the 2023 budget law, also point to political and capacity constraints that are hindering the implementation of crucial fiscal reforms.

Consensus on the proposed economic recovery plan and subsequent bank restructuring is still out of reach. The plan, approved by the cabinet in May 2022, introduces sweeping banking-sector restructuring, including for the BDL. Banking-sector losses are estimated at roughly US$ 70 billion (€66 billion), and reforms are likely to result in large haircuts on deposits over US$ 100,000 (around €94,000). The plan initially received pushback from the Association of Banks in Lebanon (ABL) regarding the distribution of losses and continues to face political opposition.

The much-awaited central bank forensic audit findings have finally come to light. The audit was concluded in August 2023 after numerous delays. The findings provide evidence of misconduct and financial mismanagement, including the disguising of substantial losses incurred by the BDL. They also highlight gaps in governance, risk management, transparency and accountability. An interim management team for the BDL was appointed in August 2023. The interim management team announced its intention to gradually stop financing the state budget, phase out the Sayrafa platform and liberalise the exchange rate, all of which signal a new approach to monetary policy and central bank independence, though it remains to be seen whether it will get the necessary political support.

Electricity reform remains stuck. More than a year after cabinet approval, the government's electricity reform plan remains stuck in parliament, blocking international support and energy imports from neighbouring countries. The plan should involve the creation and operationalisation of an electricity regulatory authority, for which management hiring is facing delays. Other elements include a comprehensive audit of the state power company, Electricité du Liban (EDL), and tariff adjustment. EDL increased its electricity prices in November 2022 for the first time since the 1990s, but further revisions to the tariff structure are likely to be needed.

International donor support has been much more limited recently, with the exception of crisis-response financing from the World Bank. The World Bank approved financing worth a total of US$ 500 million (around €470 million) so far in 2023 for agricultural sector support and social safety nets, building on previous emergency and Covid-19 response funding.

Morocco

Highlights

- **Growth recovered in 2023, but will potentially be affected by the severe earthquake of September 2023.** Following the acute drought of 2022, better weather conditions and easing inflation led to faster growth in the first half of 2023 and to some reduction in unemployment rates. An earthquake (measuring 6.8 on the Richter scale) in September caused the loss of thousands of lives, as well as widespread destruction in and around Marrakech and the Atlas mountains.
- **Steps have been taken to mitigate the effects of inflation, but public finances remain sound.** The government raised the minimum wage and extended a range of subsidies and tax exemptions to stabilise prices, but the fiscal deficit narrowed and public debt remains contained.
- **Reforms have been adopted to address water scarcity, improve food security and support private investment.** The country's water and electricity company launched a new investment programme for water infrastructure, and the government enacted a new legal framework to enable independent power producers (IPPs) to sell and export renewable energy.

Key priorities for 2024

- **Diversifying the economy remains a top priority.** This includes promoting innovation, boosting private investment in export-oriented industrial sectors and exploring new export markets. In addition, continued efforts to improve the business environment and promote private investment are essential.
- **Investing in agricultural resilience is vital to mitigate climate risk.** Morocco needs to adopt a long-term plan to address climate challenges (notably the impacts of drought). This includes investing in water storage, wastewater treatment and alternative water sources, as well as strengthening value-chain resilience.
- **Continued investment in renewables and infrastructure is important for the country to become an energy hub.** Capitalising on renewable energy resources and leveraging the private sector could enhance energy security and reduce import dependence. Moreover, investing in infrastructure, including in electricity interconnections, green hydrogen and its derivatives, could boost exports and provide immense opportunities in the long run.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.9	-7.2	8.0	1.3	3.1
Inflation (average)	0.2	0.7	1.4	6.6	6.3
Government balance/GDP	-3.6	-7.1	-6.0	-5.2	-4.9
Current account balance/GDP	-3.4	-1.2	-2.3	-3.5	-3.1
Net FDI/GDP [neg. sign = inflows]	-0.6	-0.8	-1.2	-1.5	-1.4
External debt/GDP	42.5	50.8	47.4	50.9	n.a.
Gross reserves/GDP	20.5	29.7	25.1	24.7	n.a.
Credit to private sector/GDP	58.9	66.2	62.4	64.2	n.a.

Macroeconomic developments and policy response

Following a slowdown in 2022, growth picked up in 2023. Gross domestic product (GDP) growth decelerated to 1.3 per cent in 2022, driven by a drought-induced contraction in the agricultural sector (the wheat harvest fell by 69 per cent), a slowdown in non-agricultural activities and rising inflation, which damped household demand. In the first half of 2023, growth recovered to 3.4 per cent year on year, as inflation eased, domestic demand recovered, and the agricultural and non-agricultural sectors expanded. Unemployment decreased slightly to 12.4 per cent in the second quarter of 2023, but remains higher among women (17 per cent), youth (33.6 per cent) and in urban areas (16.3 per cent).

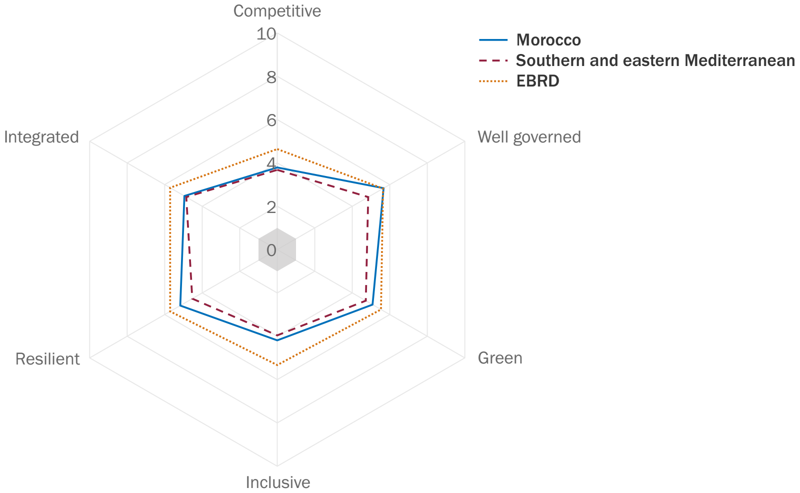
An earthquake in September 2023 caused the loss of more than 3,000 lives and widespread destruction. The devastation and the subsequent reconstruction spending will strongly affect the country's macroeconomic performance in the coming year. The epicentre of the earthquake was in the Atlas Mountains near Marrakech. It caused physical damage to both historical buildings and essential infrastructure, demolishing entire villages. Given the affected region's moderate contribution to GDP, the immediate impact on national output is likely to be modest. The government announced a reconstruction plan amounting to MAD 120 billion (around €11 billion, or 8 per cent of GDP) over five years, which is likely to boost GDP and could help mitigate regional disparities, as many of the affected villages are remote and disadvantaged. The plan would significantly increase financing needs, already estimated at 15 per cent of GDP for 2023.

The government adopted several measures to mitigate the impact of inflation. Annual inflation eased to 4.9 per cent in September 2023 from a peak of 10.1 per cent in February 2023 after the central bank raised interest rates by a cumulative 150 basis points from October 2022. The government extended a range of subsidies to stabilise the prices of butane gas and other basic commodities and to help specific sectors facing higher fuel prices. In 2023 the government confirmed that it would maintain those subsidised electricity prices and announced the removal of value-added tax on agricultural inputs. Moreover, it recently announced a plan to amend the 2023 budget law, increasing spending by US$ 1 billion (€0.95 billion) to address drought and inflation challenges.

The fiscal position remains strong, although external imbalances increased in 2022. The budget deficit narrowed to 5.2 per cent of GDP in 2022 and is expected to shrink further to 4.9 per cent of GDP in 2023 on the back of improved tax collection and higher non-tax revenues. Public debt remained sustainable at 69 per cent of GDP. Still, the current account deficit widened to 3.5 per cent of GDP in 2022 on the back of a larger trade deficit, due to a doubling of energy imports and a rise in grain imports amid a poor harvest and higher prices. Meanwhile, exports of automotive, textile, agriculture and fertiliser products expanded, benefitting from higher global prices. The current account deficit is expected to narrow to 3.1 per cent of GDP in 2023 as energy prices ease, weather conditions improve, and tourism and remittances pick up. Foreign reserves declined to US$ 32.2 billion (€30.5 billion) at the end of 2022, but recovered slightly to US$ 35.5 billion (€33.7 billion) in August 2023, covering around 5.8 months of imports.

Growth is expected to continue to recover in the short term, with some downside risks. The economy is forecast to grow by 3.1 per cent in 2023 and remain stable at around 3 per cent growth in 2024. This will be driven by improved agricultural production as weather conditions improve, a continued recovery in tourism, easing inflation and a relative pick-up in domestic and external demand as European markets recover. These forecasts do not incorporate the effects of the earthquake, as the likely impact on overall economic activity remains difficult to gauge at this stage. In addition, Morocco's high dependence on energy imports and seasonal agricultural production make the country vulnerable to global instability and climate risks.

Assessment of transition qualities (1-10)



Structural reform developments

A new International Monetary Fund programme should mitigate potential financing risks and accelerate reform. The country's two-year US$ 5 billion (around €4.7 billion) Flexible Credit Line was approved in April 2023. It is designed to build up the country's external buffers and provide insurance against risks, enabling the authorities to create the necessary policy space for and accelerate the implementation of a comprehensive reform agenda. The programme is expected to catalyse the country's New Model of Development 2021-35, which aims to enhance governance, human capital, inclusion, sustainability and regional leadership.

Morocco continues to address the increasing challenges of water scarcity and food insecurity. Capitalising on the National Drinking Water Supply and Irrigation Programme (PNAEPI) 2020-27, in May 2023 the government increased the programme's budget allocation to US$ 14.3 billion (€13.6 billion) from an initial investment of US$ 11.5 billion (€10.9 billion). The PNAEPI aims to scale up investments in the water sector, strengthen the supply of drinking water and irrigation, and build resilience against climate risks. The additional investment would accelerate the construction of dams, connect various water basins (raising Morocco's freshwater storage capacity), increase the share of reused treated wastewater and speed up the transition to alternative water sources (the government has embarked on an ambitious desalinated seawater programme). Moreover, in June 2023 the government signed a framework agreement worth US$ 1 billion (€0.95 billion) with agricultural sector professionals to reduce the impact of drought on agriculture and strengthen resilience.

Multiple reforms are under way to support competition, investment and renewable energy. The new investment charter, passed in December 2022, aims to make the country a hub for investments from abroad. It offers investment support systems in the form of subsidies or grants for investment projects carried out in key regions and sectors, and boosts investment in small and medium-sized enterprises (SMEs). This was complemented in early 2023 by legislation amending existing laws on renewable energy and the regulation of the electricity sector, so that IPPs can: (1) produce energy for their own consumption, (2) sell surplus energy from renewable sources to other consumers by connecting to the national grid, and (3) export renewable electricity through national electricity grid interconnections. However, further clarification is required from the National Electricity Regulation Agency on tariffs and conditions for feeding electricity into the network while preserving grid stability. In addition, the Moroccan Competition Council, which oversees the country's antitrust regime, has become more active over the past year, especially in the field of merger control. Reforms to ensure the smooth handling of cases include a simplified filing form for no-issue transactions and the introduction of a filing fee, with an optional expedited process for an additional fee.

The government introduced a new programme to support industrial innovation. Launched in September 2022, the innovation programme plans to invest US$ 30 million (around €28.5 million) over 2023-25 to promote research and innovation by industrial SMEs. The programme aims to support at least 100 qualified projects by supporting: (1) the development of patents (by contributing 80 per cent of the patent process costs), (2) innovation, research and development of new products or processes in the design-to-prototype phase (by contributing 60 per cent of the costs of inputs and services), and (3) the industrialisation of products and processes in the pilot phase (by contributing 30 per cent of investment costs).

Efforts are being made to unify corporate tax rates and promote investment. The Finance Law 2023 introduced a four-year, phased reform aimed at promoting convergence to a unified corporate tax rate from the current multi-rate system (depending on profits, sector and location). By 2026 the regime will comprise a tax rate of 20 per cent for standard companies, 35 per cent for companies with profits of at least MAD 100 million (around €9 million) and 40 per cent for financial institutions. The reform would particularly benefit medium-sized firms (with profits between MAD 1 million [€90,000] and MAD 100 million [€9 million]) and industrial companies (with profits of less than MAD 100 million [€9 million]), which would benefit from a gradual reduction in their tax rate by 2026. This is expected to improve tax revenues, as lower rates should encourage formalisation and widen the tax base, while simplifying the system and improving incentives and resource allocation.

Tunisia

Highlights

- **The economic situation has deteriorated and agreement on an International Monetary Fund (IMF) programme has been delayed again.** Growth slowed in 2022 and into the first half of 2023, as fiscal pressures and external vulnerabilities remained high and sovereign ratings continued to worsen.
- **Tunisia entered a long-term partnership with the World Bank to support growth and create jobs.** The new agreement will capitalise on the country's National Development Plan, offering annual financing of US$ 400-500 million (around €380-470 million) over a period of five years.
- **Steps have been taken to improve food security, enhance financial inclusion and liberalise the foreign-exchange rate.** These include an emergency programme to enhance self-sufficiency in the cereal sector, expanded access to electronic payments, the removal of some foreign-currency restrictions and the announcement of plans to replace some subsidies with targeted cash benefits.

Key priorities for 2024

- **Fiscal consolidation is essential to alleviate the pressure on the country's strained public finances.** This will require continued efforts to enhance revenue collection, but also to reduce the large public-sector wage bill, lower subsidies on various products (including fuel) and move towards more targeted support systems.
- **Accelerating the green transition and improving agricultural output are top priorities.** Scaling up renewables, including by promoting private investment and strengthening the regulatory framework, could improve energy resilience. Moreover, enhancing productivity and stability in the grain value chains and addressing climate risks are necessary to mitigate food shortages.
- **Improving the business environment and reforming state-owned enterprises (SOEs) are necessary to promote growth and job creation.** Reducing the state's footprint in the economy and reforming SOEs, including by advancing the new SOE law, strengthening operational efficiency and eliminating foreign-exchange restrictions are essential to boosting overall competitiveness.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	1.6	-8.8	4.3	2.4	1.9
Inflation (average)	6.7	5.6	5.7	8.3	9.4
Government balance/GDP	-3.4	-9.4	-7.7	-7.6	-7.7
Current account balance/GDP	-7.8	-5.9	-6.0	-8.6	-5.8
Net FDI/GDP [neg. sign = inflows]	-1.9	-1.4	-1.1	-1.4	-1.4
External debt/GDP	90.9	94.9	90.6	91.3	n.a.
Gross reserves/GDP	17.8	21.4	18.6	17.0	n.a.
Credit to private sector/GDP	68.6	72.9	69.8	n.a.	n.a.

Macroeconomic developments and policy response

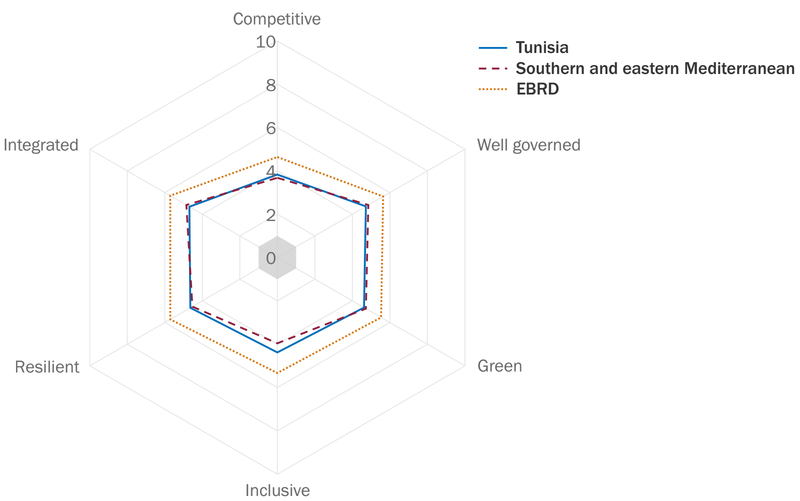
Growth slowed in 2022 and continued to do so into 2023, although the economy showed some resilience to extremely challenging conditions. Gross domestic product (GDP) grew 2.4 per cent in 2022 and just 1.2 per cent year on the year in the first half of 2023. The restrictive business environment, high inflation and social unrest all continued to weigh on economic activity. While the tourism, financial services and industrial sectors expanded, the slowdown in growth was driven by contractions in agriculture (drought impacted agricultural output) and mining (phosphate production dropped). Unemployment declined slightly to 15.6 per cent in the second quarter of 2023, remaining higher among women (21.1 per cent), youth (38.1 per cent) and graduates (23.7 per cent).

Fiscal measures to mitigate the impacts of soaring inflation strained public finances to the limit. Rising commodity prices have severely affected the Tunisian economy, which relies heavily on food and energy imports. Inflation reached 9 per cent year on year in September 2023, slightly below the 30-year high of 10.4 per cent recorded in February. In response to inflationary pressures in 2022 and 2023, the central bank has raised interest rates by a cumulative 175 basis points since May 2022. The government almost doubled subsidies on electricity and basic commodities in 2022, although fuel prices were increased five times in 2022. Minimum wages rose, but the government and unions reached agreement on a longer-term plan to contain the public-sector wage bill (which accounts for over 40 per cent of expenditures). Although tax revenues increased on the back of better tax enforcement, the budget deficit and public debt remained high in 2022, at 7.6 per cent and 80 per cent of GDP, respectively. The fiscal deficit is projected to increase to 7.7 per cent of GDP in 2023 (from an initial budget target of 5.2 per cent), mostly driven by elevated subsidies (due to delayed fiscal reforms and adjustments to the fuel, electricity and gas tariffs) and lower expected tax revenues (on the back of slower economic activity).

External vulnerabilities increased in 2022 and the country was subject to downgrades by ratings agencies, but the situation has stabilised in 2023. The current account deficit increased to 8.6 per cent of GDP in 2022, mostly driven by a widening trade deficit, despite the recovery in tourism and remittances. The current account gap is projected to narrow to 5.8 per cent of GDP in 2023, supported by improvements in tourism, remittances and the trade balance (the latter narrowed by 28 per cent in the first three quarters of 2023). Since March 2022, Moody's Investors Service and the Fitch Ratings agency have downgraded Tunisia's sovereign ratings twice, as the country has experienced pressure in servicing its sizeable external debt. Foreign reserves recovered slightly to US$ 8.4 billion (€8 billion) in October 2023, but cover just 3.8 months of imports.

Domestic and foreign vulnerabilities will continue to weigh on the short-term economic outlook. Growth is forecast at 1.9 per cent in 2023, held back by limited fiscal space, a lack of access to external financing, the restrictive business environment and delays in implementing the structural reforms necessary to empower the private sector. Economic growth should pick up slightly to 2.5 per cent in 2024 if an IMF-supported programme is agreed and reform momentum picks up. Nonetheless, the country's high dependence on tourism, climate risks, reliance on imports and domestic opposition to the necessary reforms will continue to pose major risks to the outlook.

Assessment of transition qualities (1-10)



Structural reform developments

Progress stalled on the IMF-supported programme, blocking other donor support and exacerbating financing constraints. A staff-level agreement (SLA) for a US$ 1.9 billion (around €1.8 billion) IMF Extended Fund Facility was reached in October 2022, but has not yet been signed. The programme would aim to restore external and fiscal stability, lower the public-sector wage bill, review fuel subsidies and tackle inefficiencies in SOEs. The SLA came after the authorities and labour unions reached a milestone agreement on the cornerstones of key reform measures (SOEs and public-sector wage bill). However, amid concerns about the impact on living standards, the government is currently working on a revised reform plan to resubmit to the IMF.

Support from the World Bank and European Union (EU) has been secured. In June 2023 the World Bank announced a new Country Partnership Framework (CPF) 2023-27 to support Tunisia's development plan, by creating quality jobs in the private sector, strengthening human capital, reducing carbon emissions and building resilience to climate change. The programme builds on Tunisia's National Development Plan 2023-25, which aims to boost employment and achieve sustainable and inclusive growth. The government is also planning to strengthen infrastructure for targeted cash transfers (including a digital platform), in line with moving from blanket subsidies to more targeted support schemes. The EU will provide up to €900 million to support the struggling Tunisian economy and an extra €150 million to support the budget, once the IMF programme has been approved. In parallel, the EU will provide support for border management to help the country curb migration.

Progress advanced on the Tunisia-Italy interconnector (ELMED) project. Momentum picked up on implementing the high-voltage direct current interconnector project, with the feasibility study phase completed in 2022 and the procurement phase started in May 2023. The project secured €307 million from the EU in 2022 and US$ 268 million (€254 million) from the World Bank in June 2023 (under the new CPF) to build the necessary infrastructure. Launched in 2019 by the two countries' electricity grid operators, Société Tunisienne de l'Electricité et du Gaz (STEG) and Terna, ELMED aims to link their electricity systems using submarine cables to expand opportunities for the exchange of renewable energy between North Africa and Europe.

Tunisia embarked on a new a programme to improve food security. The Emergency Food Security Support Project in Tunisia (PAUSAT) 2022-26 is designed to enhance food security and self-sufficiency by strengthening resilience to climate and external shocks. The programme is a coordinated effort between development partners, with total financing of US$ 530 million (around €500 million) from the European Bank for Reconstruction and Development, the World Bank, the African Development Bank, the European Investment Bank and the EU. Its key objectives include: (1) increasing cereal production by providing agricultural inputs, (2) providing emergency cereal supplies to avoid shortages and support food security and (3) supporting digitalisation, capacity building and value-chain reforms.

The government is reviewing a new law to gradually liberalise the exchange rate. New regulations are under review to modernise the exchange-rate system and facilitate access to foreign currency. Under the new law, investors and Tunisian firms would be able to open foreign-currency accounts, enabling them to invest, purchase assets and pay any necessary expenses abroad. Moreover, the new law would allow foreign investors to maintain permanent non-resident status, regardless of their duration of stay, enabling them to avoid restrictions applicable to residents. While this is only a first step, the government has reiterated the ultimate objective of gradually reaching full liberalisation of the exchange rate.

The central bank continues to promote financial inclusion by digitising utility payments. With the aim of improving financial inclusion and transparency, the central bank launched a new digital platform in November 2022, allowing citizens to pay their bills online or through mobile applications for no additional fee. The central bank has an overarching objective of promoting financial inclusion by increasing the digitalisation and de-cashing of the economy. The total value of electronic transactions in Tunisia grew by 25 per cent on the year in 2022.