

Levant: Structural woes accentuated

Florence Eid-Oakden, Ph.D., Chief Economist
Ghalia Al Bajali, Leila Lajevardi, Analysts

- Jordan has set a larger budget for 2021 than for 2020. This, along with the government's commitment to fulfilling IMF reforms, is expected to support recovery
- The outlook in Lebanon is not as promising. With government deadlocked, the solution to its political paralysis is now in the hands of the country's regional and international partners.
- Moving forward, for both Jordan and Lebanon, reforms targeting fiscal solvency and government transparency are more urgent than ever.

Jordan: Fiscal prudence reiterated

Following a deep GDP contraction of 5% in 2020, Jordan's growth is forecast to rebound by 3.4% this year. The IMF programme, along with continued government reform efforts, are expected to support the recovery.

- Success in containing the COVID-19 pandemic in 2020 is being challenged by the new wave of cases.
 - Up until September 2020, Jordan's infection and mortality rates were among the lowest globally. Since then, however, the number of infections started to surge.
 - This, along with the recent re-introduction of partial lockdown measures, is expected to slow the pace of recovery, at least for the first part of the year and until vaccine inoculation levels rise.
- Economic growth before the pandemic was already sluggish. In the 10 years prior to 2009, growth averaged 6.5%, but it then fell to 2.5% in the nine years after.
 - The bright spot is this year's growth forecast of 3.4%. If realised, it would be Jordan's highest annual expansion rate since 2010.
- The recently approved 2021 draft budget set government expenditure at USD 13.2B, a 6% YoY increase from 2020, with 65% budgeted to public payrolls and 15% for public debt servicing costs.
 - Capital expenditure is expected to increase by 25% YoY to reach USD 1.6B - the highest level since 2014.
- Public finances are expected to remain under pressure, however. Based on revenues of USD 11B, the government is budgeting for a deficit, excluding foreign grants, of USD 3.6B in 2021 (6.5% of GDP), compared with USD 3B in 2020.
 - The IMF is less optimistic, forecasting this year's deficit to narrow to 7.4% of GDP from 9.1% in 2020.
 - Our view is in line with the IMF, due to the tax relief measures introduced in March 2020, which are expected to continue to put pressure on revenue.
 - But, as tax relief is phased out, revenue is expected to recover slowly this year.
- Fiscal consolidation is expected to help rebuild buffers and arrest the rise in debt.

Table 1 - Jordan Macroeconomic Indicators¹

	2017	2018	2019	2020	2021f
Real GDP Growth (%)	2.1	1.9	2.0	-5.0	3.4
CPI Inflation (%)	3.3	4.5	0.7	-0.3	1.4
Fiscal Balance (% of GDP)	-3.3	-4.4	-6.1	-9.1	-7.4
C/A Balance (% of GDP)	-10.8	-7.0	-2.3	-6.8	-5.7
Total Gov't. Gross Debt (% of GDP)	77.3	76.3	79.3	88.4	88.8
Total Gross Extern'l Debt (% of GDP)	69.6	69.0	68.5	77.6	79.9
Gross Official Reserves (Mos. of Imports)	8.1	7.9	8.9	9.0	9.1
Nominal GDP (USD B)	40.8	42.3	43.8	42.7	44.9
Population (Millions)	9.4	9.7	10.1	10.2	10.3

- Debt sustainability risks have increased as debt is forecast to reach nearly 90% of GDP in 2021, a 1% YoY increase.
- This is much higher than the current median of 60% of GDP for similar BB-rated sovereigns.
- In an effort to reduce debt to 80% of GDP by 2025, and in line with the IMF's recommendations, the authorities will implement gradual fiscal consolidation of 4% of GDP over the coming three years.
 - This includes 0.7% of GDP in 2021 and 1.1% of GDP each year until 2024.
 - Fiscal consolidation will be anchored by broadening tax base reforms and tightening the preferential tax regime, along with rationalising current spending.
 - Tax revenue is expected to reach USD 8.3B in FY 2021, an increase of around 60% compared with FY 2020 estimates.
- Despite this, downside risks such as rising unemployment and the slump in tourism revenue will continue to weigh heavily on the pace of the recovery this year.
 - The pre-pandemic unemployment rate, which hovered around 19%, has risen to a record high of 24%, with youth unemployment at 40%.
 - If economic output levels and business activity remain weak this year, the new elevated unemployment rates could likely persist.
- Additionally, with tourism essentially shut for a while longer, the damage of the sector presents a tail risk to unemployment growth.
 - The tourism sector, which contributes roughly 15% of GDP, is a major employer - employing 55K people - and is a major source of FX.
 - But with tourist arrivals expected to remain far below 2019 levels, when they reached a six-year high of 5.4 million, this shortfall will be a drag on employment growth and the overall economy.

Accelerating economic reform and expanding measures to prevent corruption and increase transparency are at the top of the government's 2021 agenda.

- The Central Bank of Jordan and the Ministry of Digital Economy and Entrepreneurship plan to digitise the government payment system.
- The Minister of Digital Economy and Entrepreneurship, Ahmad Hanandeh, announced that, once the tender process is complete on March 14, the ministry will work with local

¹ Arabia Monitor; IMF.

companies to build a comprehensive management system for payment collections.

- This follows the end of direct cash payments to government institutions and payments to citizens in 2020.
- Since then, payments, along with subsidies and the National Aid Fund to beneficiaries, have been processed through online bank accounts and digital payments.
- Meanwhile, Prime Minister Bisher al-Khasawneh earlier this week carried out his first cabinet reshuffle since taking office in October 2020 to accelerate IMF reforms and restore public trust over the handling of the pandemic.
 - The 28-member cabinet has six new ministers, including new ministers of interior and justice after both incumbents were forced to resign for violating COVID-19 restrictions.
 - Mazen Al Faraya replaced Samir Mobeideen as the Ministry of Interior, while Ahmad Ziyadat, as the Minister of Justice, replaces Bassam Talhouni.
- Cabinet reshuffles are not new in Jordan. But the recent change comes at a critical time as further delays in implementing economic reforms pose a risk to fiscal sustainability.
 - The preceding government, under Prime Minister Omar Al Razzaz, featured the appointment of 52 ministers and carried out five cabinet reshuffles during his tenure of little more than two years.

Lebanon: A perfect storm

Lebanon's economy continues to go from bad to worse. The government deadlock and renewed protests are weakening the country's capacity to convince international and regional donor communities to unlock aid commitments.

- Following a 25% GDP contraction in 2020, Lebanon's two-year crisis shows no signs of ending this year.
 - Deteriorating economic conditions and subdued productivity have exacerbated the currency crisis as the Lebanese pound plunged to a new low.
 - The pound has dropped 20% since the end of 2020, trading on the parallel market for LBP 10,000 to the USD. The currency is now 85% below the country's official exchange rate.
 - Inflation is surging and is expected to remain elevated. In 2020, annual inflation reached 85.5% - the highest level since the aftermath of the Lebanese Civil war - up from 2.9% in 2019.
- Over 33% of the population were living below the poverty line in late 2019. The crisis and pandemic-related lockdown have increased this to almost 50% of the population, with 22% in extreme poverty.
 - If virus cases continue to increase, and no financial plan is implemented, these figures are bound to rise further.
- The judicial charges faced by the governor of the central bank, Banque du Liban, Riad Salameh, both at home and in Switzerland, have further delayed prospects of receiving IMF aid and donor support. Things could move in a different direction if Salameh steps down.

Table 2 - Lebanon Macroeconomic Indicators²

	2017	2018	2019	2020
Real GDP Growth (%)	0.9	-1.9	-6.5	-25.0
CPI Inflation (%)	4.5	4.6	2.9	18.7
Fiscal Balance (% of GDP)	-8.6	-11.3	-10.7	-16.5
C/A Balance (% of GDP)	-26.5	-26.7	-20.6	-12.6
Total Gov't. Gross Debt (% of GDP)	149.7	154.9	172.2	183.6
Total Gross Extr'n'l Debt (% of GDP)	190.3	192.8	196.3	186.6
Gross Official Reserves Ex. Gold (Mos. of Imports)	14.6	14.4	20.5	16.0
Nominal GDP (USD B)	53.1	55.0	52.7	53.9
Population (Millions)	6.8	6.8	6.8	6.8

- The charges against Salameh do not come as a shock, but we remain sceptical that they will turn into anything substantial.
- This is because any large-scale corruption in Lebanon is "by agreement" and permeates the system in ways that involve multiple parties at a time.
- Meanwhile, government formation, by Lebanese standards, is taking the expected time -- long! Although, admittedly, one would have liked to see a more rapid pace given the gravity of the situation on the ground.
 - The French initiative, which accelerated momentum in the autumn of 2020, has drifted.
 - On its own, the initiative did not look like it would yield fruit given that most countries remained preoccupied with the pandemic, the change in US administrations, and the desired resumption of talks on Iran's nuclear dossier.
- Now that the contours of all of this are emerging and the international community has somewhat found its footing, Lebanon could benefit from renewed diplomatic bandwidth regionally and internationally to help shepherd government formation along and buttress the efforts from the French initiative.
 - This is the way things have worked in the past, while the "revolutionary movements" of 2019 have called for the opposite in every possible way.
 - So inertia reigns strong in the Lebanese system.
- Domestic players are also piling on the pressure for the government to react swiftly and calling out government mismanagement including from the caretaker Prime Minister Hassan Diab and Maronite Patriarch Boutros Al-Rai.
 - President Michel Aoun and Prime Minister Designate Saad Al-Hariri are unlikely to react to domestic appeals and will remain at loggerheads on the make-up of the new government's cabinet until the deadlock is brokered away externally.
- Ultimately, the key to Lebanon's political apparatus is not in the hands of technocrats nor with popular movements on the street. It is with Lebanon's regional and international partners, as only they hold the necessary sway with its deeply rooted political factions.
- Protests are likely to ebb and flow in size and momentum over Q2 of 2021, with instability remaining a fixture in the country until a government is formed.

² Arabia Monitor; IMF.

Disclaimer

© Arabia Monitor 2021

This is a publication of Arabia Monitor Limited (AM Ltd) and is protected by international copyright laws and is for the subscriber's use only. This publication may not be distributed or reproduced in any form without written permission.

The information contained herein does not constitute an offer or solicitation to sell any security or fund to or by anyone in any jurisdictions, nor should it be regarded as a contractual document. Under no circumstances should the information provided on this publication be considered as investment advice, or as a sufficient basis on which to make investment decisions. The information contained herein has been gathered by AM Ltd from sources deemed reliable as of the date of publication, but no warranty of accuracy or completeness is given. AM Ltd is not responsible for and provides no guarantee with respect to any of the information provided herein or through the use of any hypertext link.

Arabia Monitor is an independent research firm specializing in economic and market studies on the Middle East & North African region, which we view as the new emerging market. Our forward-looking perspective allows us to place recent developments in the region within a broader context and a long-term view. Our analysis is based on the macroeconomic and financial balance sheet of Arab countries to deliver unique strategy insights and forecasts to businesses across a wide range of sectors.

Arabia Advisors specialises in portfolio strategy and private placements. It works with firms, family offices and government related organisations that are looking to streamline, re-balance or diversify their asset portfolios. Based in the UAE as an off-shore company, Arabia Advisors services a regional and international client base with interest in the Arab countries.

Arabia Monitor
Aston House | Cornwall Avenue | London N3 1LF
Tel +44 203 239 4518
info@arabiamonitor.com
www.arabiamonitor.com