Macroeconomic Management in South-Med Transition Countries: What Happened and What Went Wrong?

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Motivation

- Political and social unrest in South-Med countries has led to deteriorating macroeconomic imbalances and lower growth
- Two macroeconomic policy choices:
  - Correct imbalances through austerity measures; or,
  - Partially correct imbalances to create some room for stimulating growth
- These chapters attempt to take stock of the economic consequences of the transition in 5 South-Med economies and to assess the fiscal and monetary policy responses to ameliorate their effects
  - What has been the impact of the transition on macroeconomic balances and short term economic growth?
  - Which approach did policy makers choose in response to these challenges?
  - And how effective were these adopted policies?

Outline

I. Economic consequences of the transition

   I. Macroeconomic balances

   II. Economic growth: actual and potential

II. Understanding and assessing the policy responses

   I. Fiscal response

   II. Monetary response

Five countries

Table 1: Key Economic Indicators of South-Med Countries, 2014

	Population, total	GNI per capita, Atlas method (current US $)	GNI per capita, PPP (current international $)	GDP per capita growth (annual %)
Algeria	38,934,334	5490	13880	1.73
Egypt	89,579,670	3210	10280	0.67
Jordan	6,607,000	5160	11910	-1.54
Morocco	33,921,203	3070	7290	1.07
Tunisia	10,996,600	4230	11020	1.63

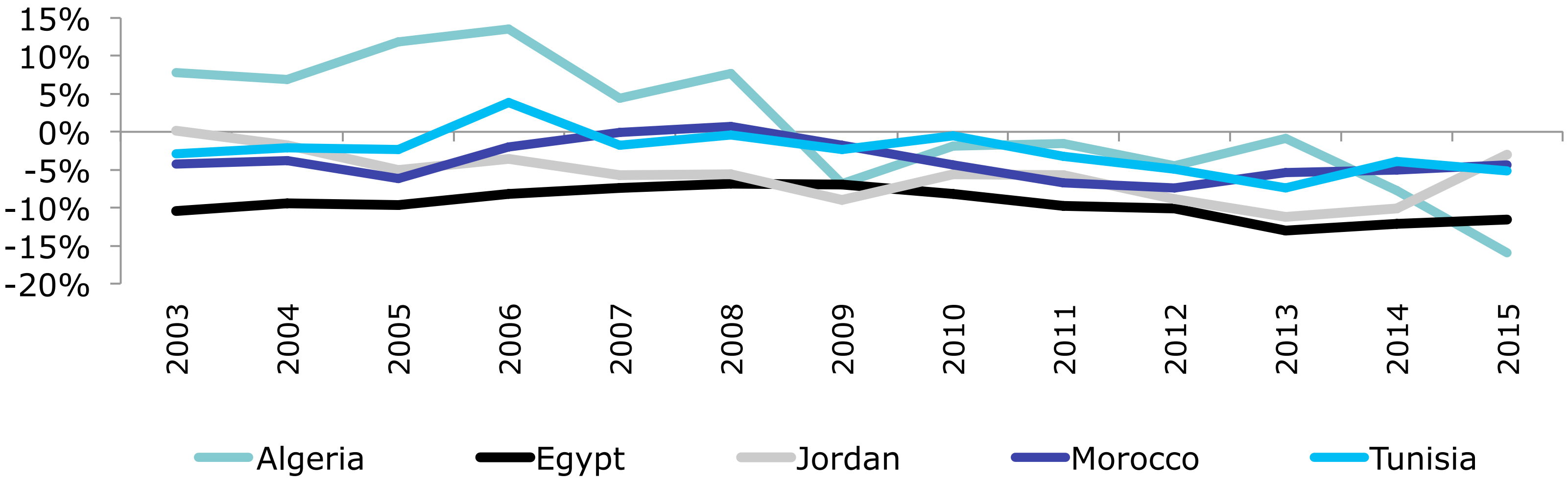
Source: World Development Indicators, World Bank

I. Economic Consequences of the Transition

1. Fiscal balances: fiscal deficits

- Post uprisings, South-Med countries experienced:
  - increased public expenditures to appease popular demands
  - Some also witnessed a decline in their fiscal revenues
- These developments exerted further strain on fiscal deficits:
  - Relative to 2010, all South-Med countries witnessed a deterioration in their budget deficits
  - Fiscal outcomes were worse for countries that suffered from high initial deficits prior to the uprisings

Figure 1: Fiscal deficits, central gov. (% of GDP)

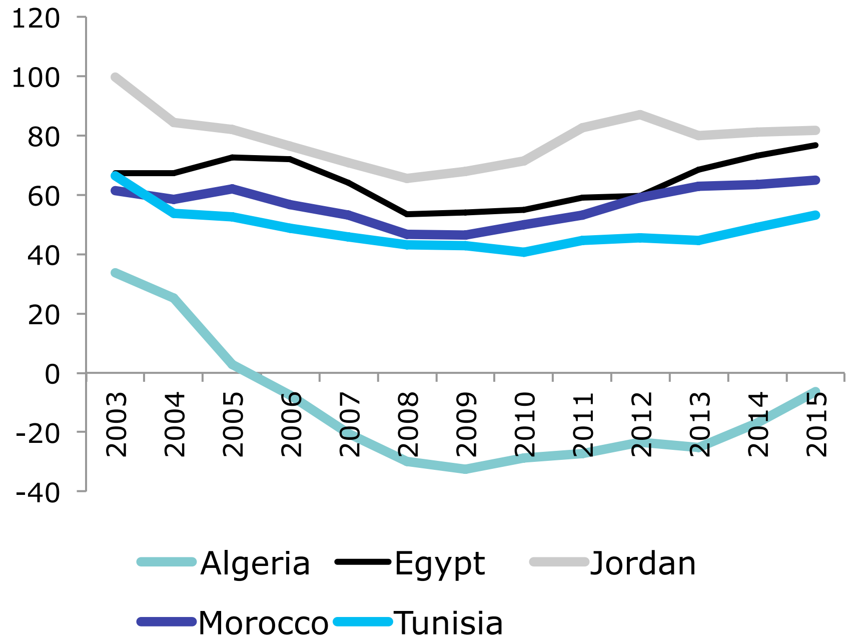


Source: IMF Article IV Consultation data.

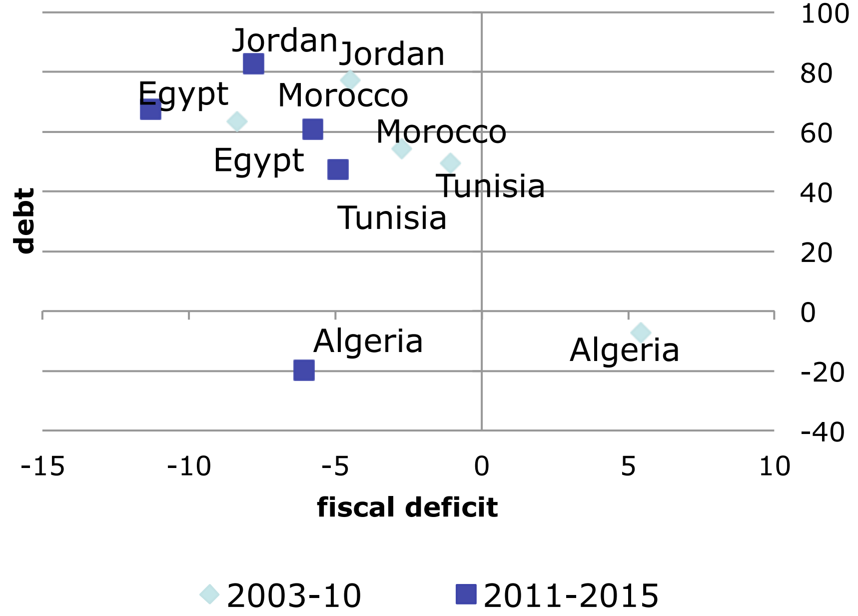
1. Fiscal balances: fiscal deficits and domestic debts

- The deterioration in fiscal balances and the decline in GDP led to the build up of government domestic debt which has risen considerably for all South-Med countries

Net domestic debt (% of GDP)



Net domestic debt and overall fiscal balance (% of GDP)

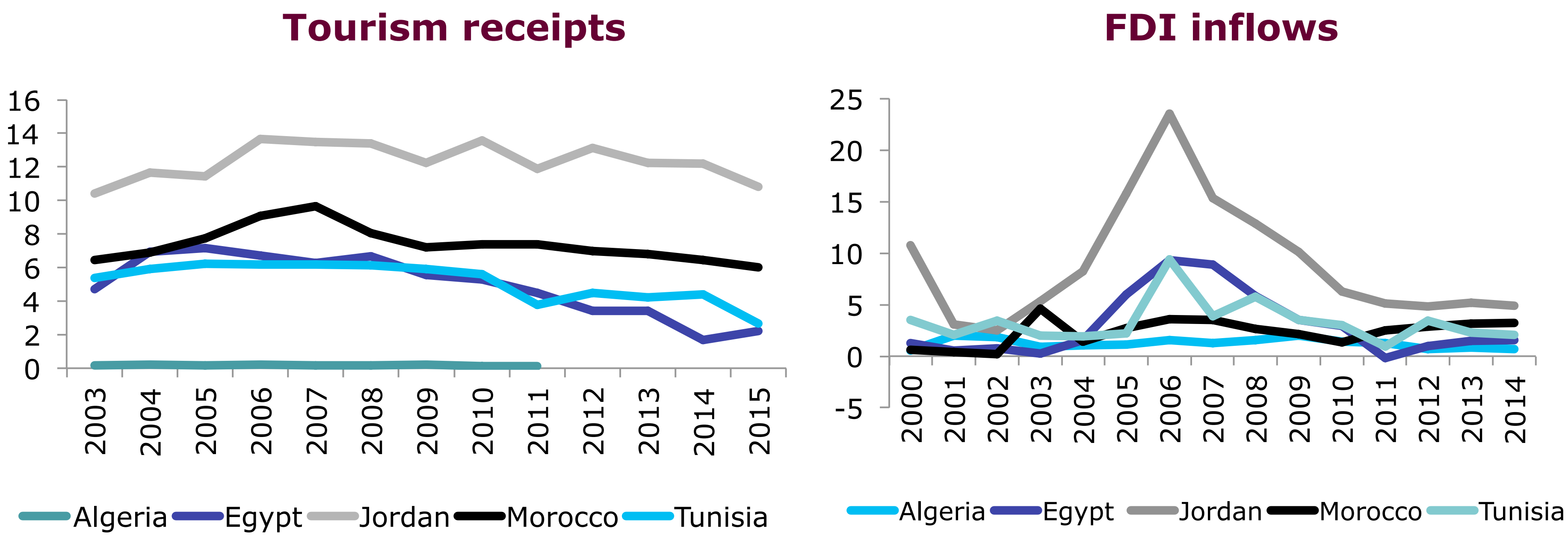


Source: IMF Article IV Consultation data.

1. External balances: capital flows

- Political instability triggered significant capital outflows:
  - Declining FDI inflows and tourism receipts

Figure 2: Tourism receipts and FDI inflows (% of GDP)



Source: data from national central banks and World Development Indicators, World Bank

1. External balances: current accounts and external debts

- Current accounts came under significant pressure as a result of declining tourism and in some cases growing trade deficits
- However, the ratios of external debt to GDP remained relatively modest between 2008 and 2015

Figure 3: Current accounts(% of GDP)

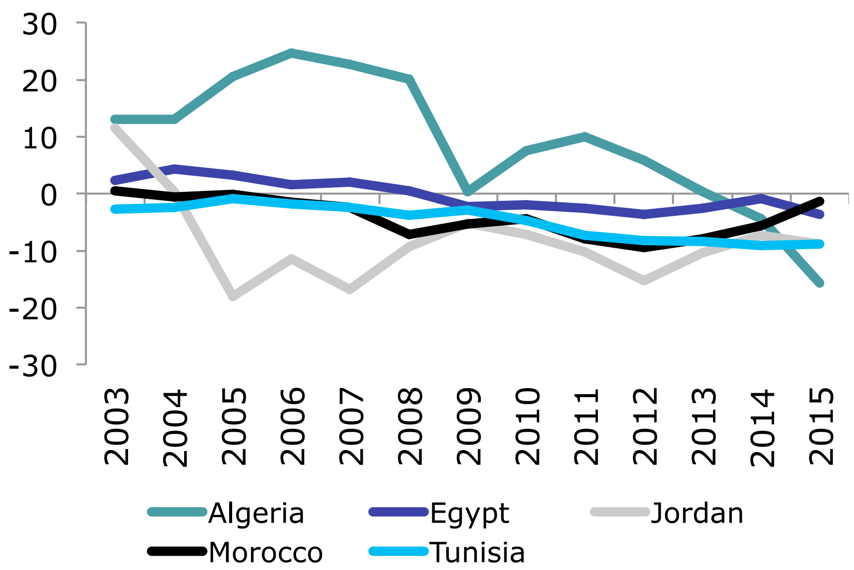
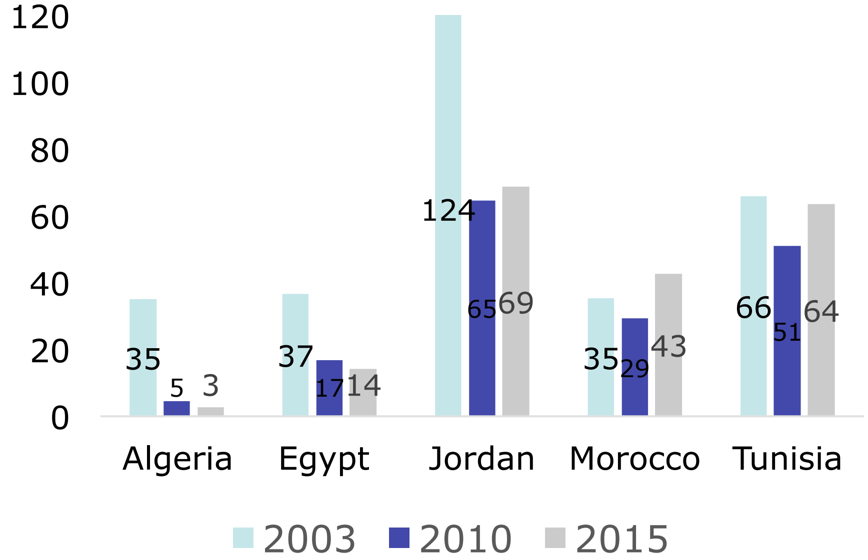


Figure 4: Total external debt (% of GDP)



Source: data from national central banks and World Development Indicators, World Bank

2. Economic growth Performance

- Post uprisings, South-Med actual growth performance has partly been the product of prevailing social and political tensions.
- However, this period also coincided with adverse global economic conditions and regional geopolitical conflicts.

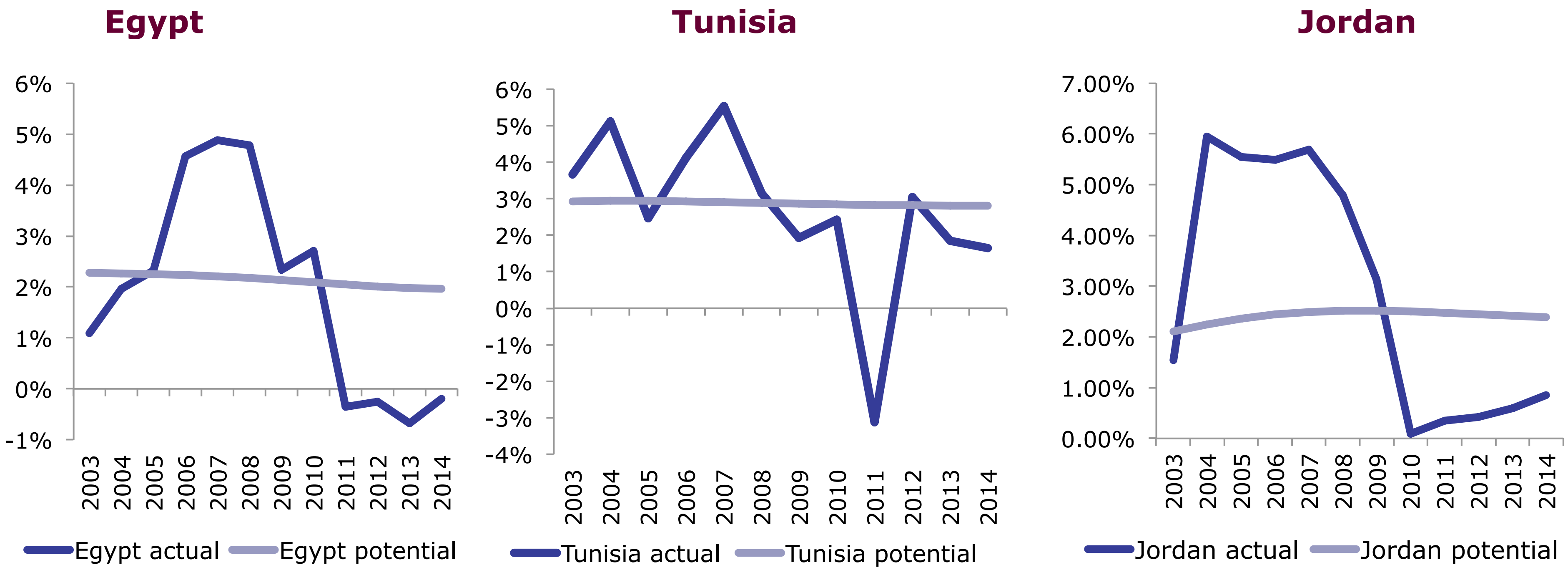
Table 2: Real GDP growth (%)

GDP growth					
	2003-2014	**2003-2008**	**2009-2010**	**2011**	**2012-2014**
Algeria	3.6	4.1	2.6	2.8	3.3
Egypt	4.2	5.5	4.9	1.8	2.2
Jordan	5.3	7.4	3.9	2.6	2.9
Morocco	4.5	5.0	4.2	5.2	3.4
Tunisia	3.7	5.3	2.9	-1.9	2.8
Average	4.2	5.5	3.7	2.1	2.9
Egypt and Tunisia	4.0	5.4	3.9	-0.1	2.5
GDP per capita growth					
Algeria	1.7	2.5	0.6	0.8	1.1
Egypt	2.0	3.3	2.6	-0.4	-0.4
Jordan	2.9	5.0	1.6	0.4	0.6
Morocco	3.4	4.0	2.9	4.1	2.3
Tunisia	2.7	4.1	2.2	-3.1	2.2
Average	2.5	3.8	2.0	0.4	1.2
Egypt and Tunisia	2.3	3.7	2.4	-1.7	0.9

2. Economic growth: realized vs. potential

- Egypt, Jordan and Tunisia are operating below their potential.
- There is a case for reigniting growth in short term. Yet, pre-crisis growth is not an appropriate target.

Figure 5: Actual and potential growth



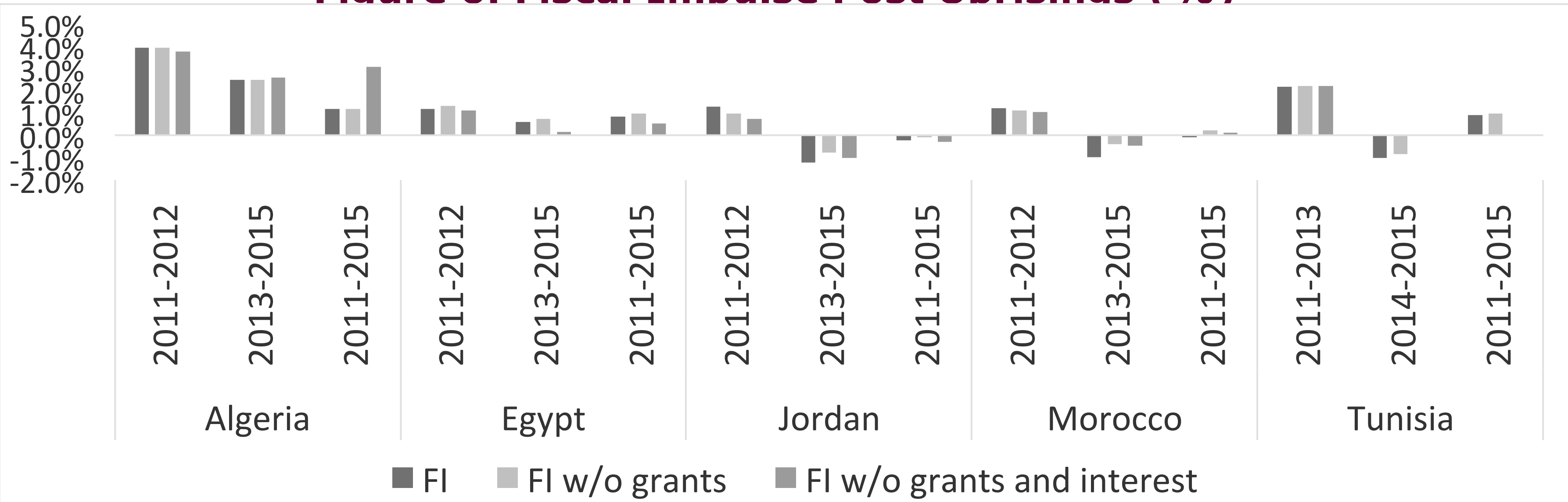
Source: calculated by the authors based on WEO data

II. Understanding and Assessing the Policy Responses

1. Understanding fiscal response: stance

- Governments in South-Med economies adopted an expansionary fiscal policy during the early years of the uprising (2011-2012) (positive FI):
  - Followed by a reversal of these policies starting 2013 or later (negative FI).
  - In Egypt and to a lesser extent Tunisia, grants enabled this expansionary stance.
- Shifting objectives of fiscal policy:
  - Appeasing popular demands was prioritized over fiscal sustainability in 2011-2012
  - However, the latter becoming inevitable eventually
  - Moreover, restoring growth was never a formal goal of fiscal expansions

Figure 6: Fiscal Impulse Post Uprisings (%)

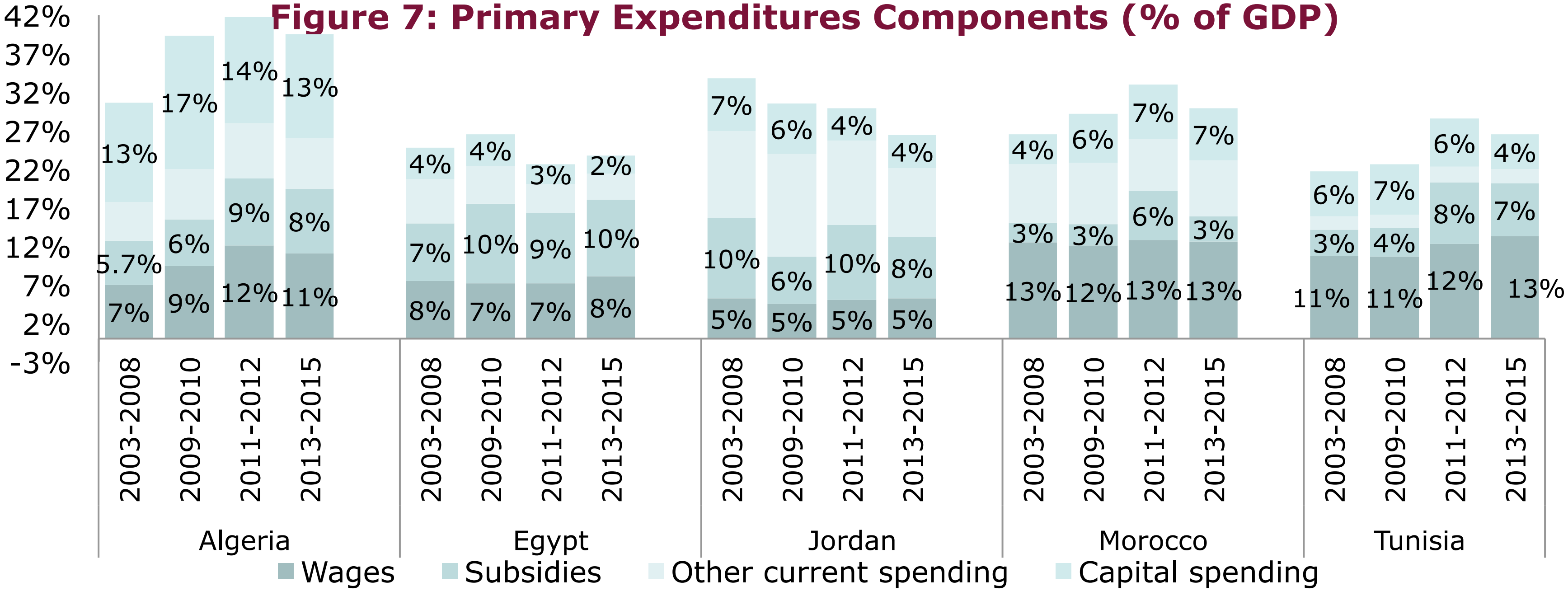


Source: authors' calculations based on IMF article IV data

1. Understanding fiscal response:composition of spending

- ***Current spending expansions*** (wages and subsidies) were used to appease mounting unrest in 2011-2012.
- In all countries except Morocco, capital spending cuts partly financed those expansions.
- ***Consolidation became inevitable eventually***, primarily through subsidy cuts and in some countries through further capital spending cuts (Egypt and Tunisia).

Figure 7: Primary Expenditures Components (% of GDP)



Source: authors calculations based on IMF article IV data

1. Understanding fiscal response: consolidation at different paces

- Early consolidation in Jordan and Morocco: 2012
- Tunisia's fiscal consolidation: 2013
- Egypt's delayed fiscal consolidation: 2016

Table 3: IMF programs in South-Med countries

Country	Date	Program	Size	Duration
Jordan	Aug 2012	Stand-By-Arrangement (SBA)	SDR 1.364 billion (US$2 billion)	3 years
	Aug 2016	Extended Fund Facility (EFF)	SDR 514.65 million (US$723 million)	3 years
Morocco	Aug 2012	Precautionary and Liquidity Line (PLL)	SDR 4,117.4 million (US$6.21 billion)	2 years
	July 2014	Precautionary and Liquidity Line (PLL)	SDR 3.2351 billion (US$5 billion)	2 years
	July 2016	Precautionary and Liquidity Line (PLL)	SDR 2.504 billion (US$3.47 billion	2 years
Tunisia	June 2013	Stand-By-Arrangement (SBA)	SDR 1.146 billion (US$1.74 billion)	2 years, 7 months extension
	April 2016	Extended Arrangement under Extended Facility Fund	SDR 2.04 billion (US$2.9 billion)	4 years
Egypt	Nov 2016	Extended Fund Facility (EFF)	SDR 8.5966 billion (US$12 billion)	3 years

Source: IMF

1. Understanding fiscal response: consolidation at different paces

The decision to consolidate and the pace of fiscal adjustment depended on:

- **the severity of social/political unrest**
  - Jordan's and Morocco's contained unrest permitted fiscal consolidation relatively quickly
  - Prolonged unrest in Egypt and Tunisia complicated IMF program negotiations.

- **Fiscal initial conditions**
  - Weak initial conditions in Jordan and Morocco quickly eroded fiscal space and vice versa in Tunisia

- **Access to foreign grants**
  - access to external finance (from GCC and other countries) helped relax Egypt's budget constraint and financed fiscal expansions in 2014.

1. Assessing fiscal response: fiscal imbalances and crowding out

- Primary balances have deteriorated and most countries accumulated significant debt
- Large deficits were financed through extensive bank borrowing, crowding out private credit

Figure 8: Primary deficits, excluding grants

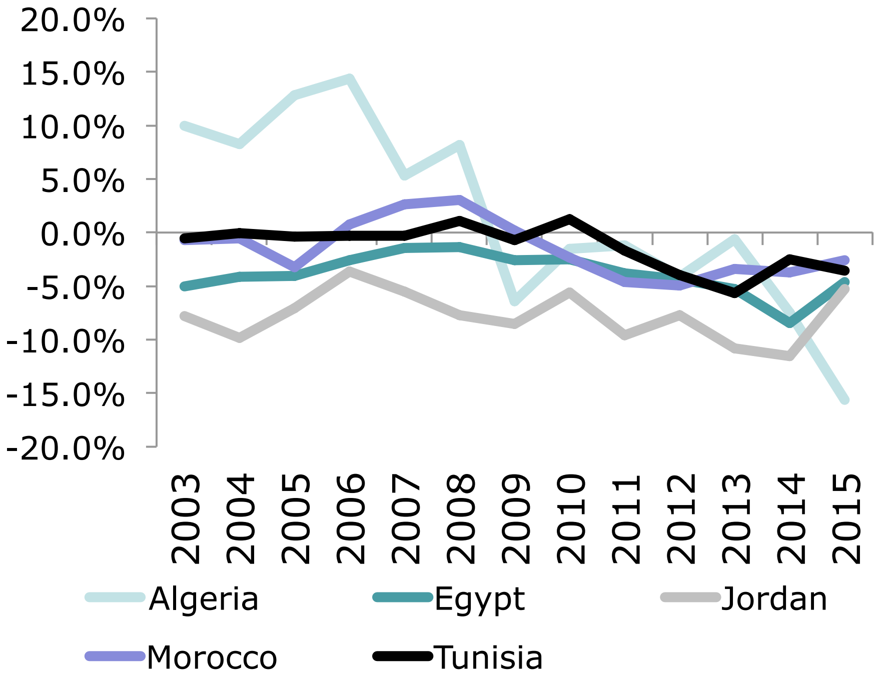
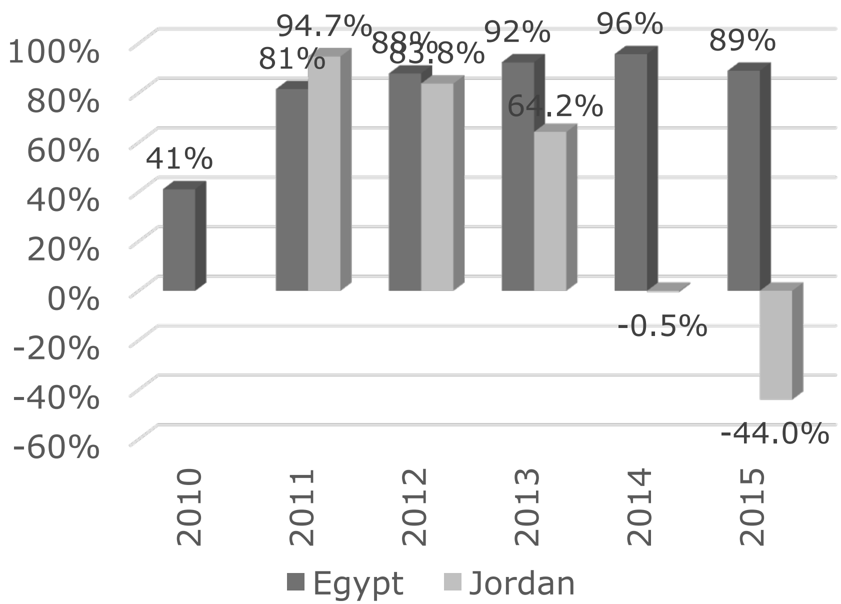


Figure 9: Bank Financing of the Deficit



Source: authors' calculations based on IMF article IV data

1. Assessing fiscal response: growth

- Fiscal expansions were not designed to permanently boost investment and job-creating growth, but rather to accommodate social discontent.
- Growth remains below pre-crisis levels and below potential.
- Fiscal policy was mostly pro-cyclical, particularly capital spending.

Figure 10: Fiscal impulse and growth rates

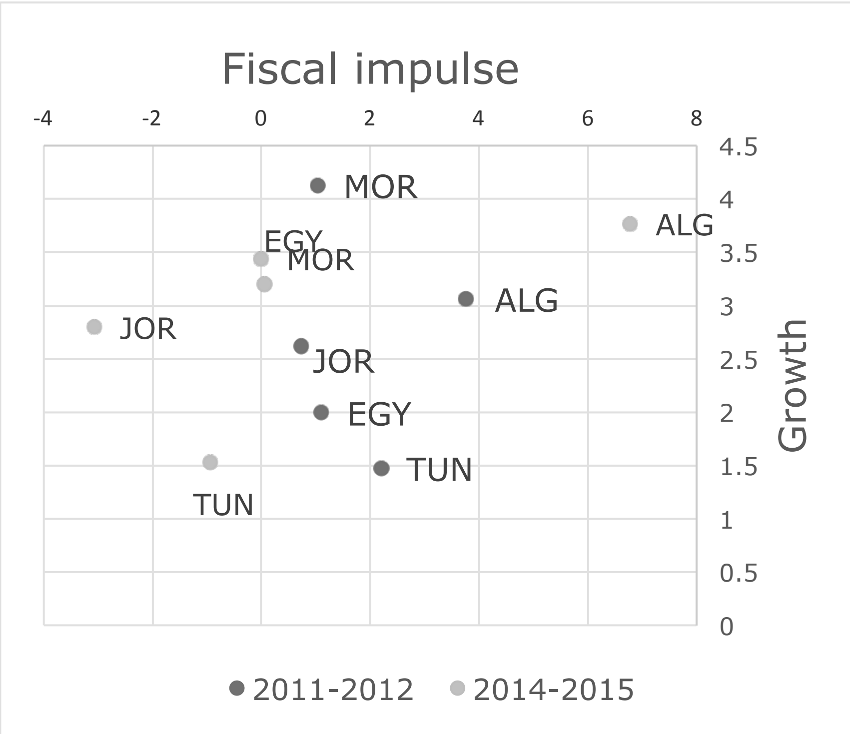
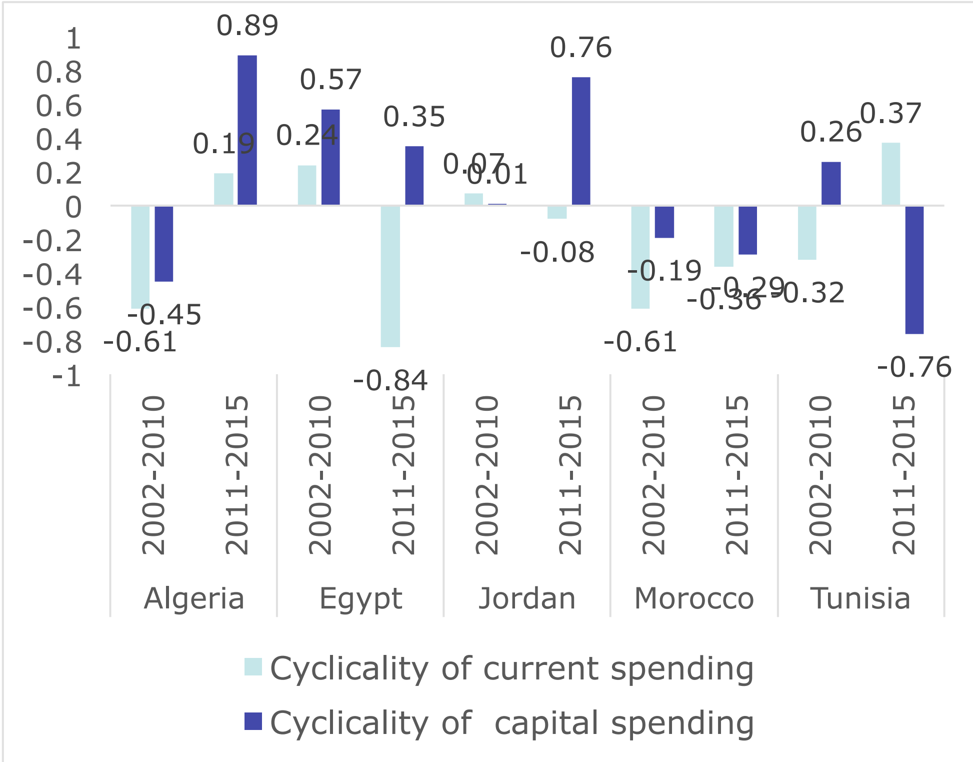


Figure 11: Cyclicality of fiscal policy



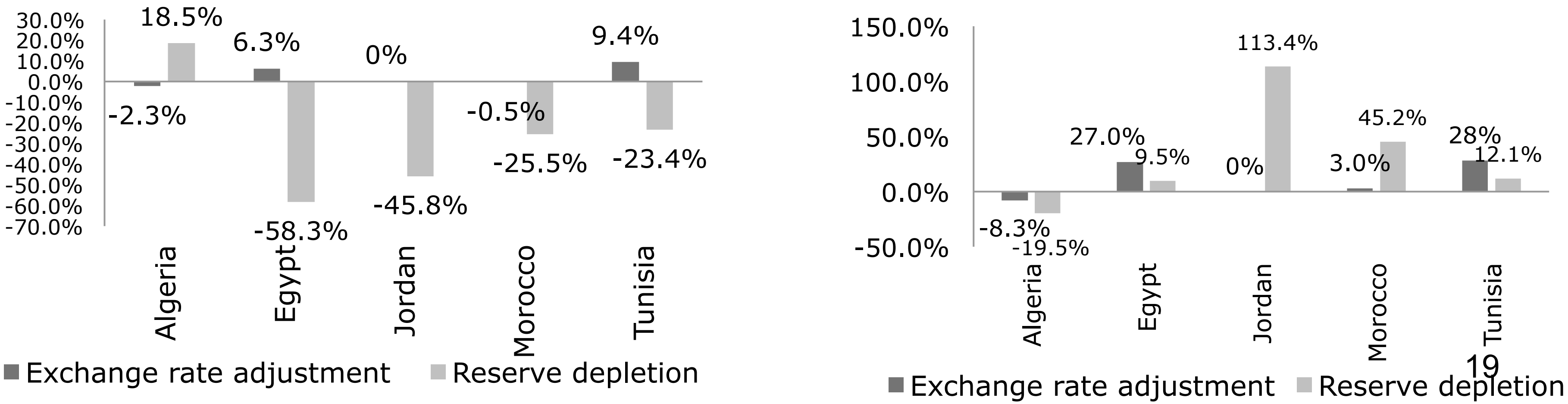
Source: authors' calculations based on on WDI, WEO and IMF article IV data

2. Understanding monetary response: reserve depletion

- The uprisings led to a drop in foreign exchange earnings and short-term capital outflows that put significant pressure on the nominal exchange rate
- Yet, because all South-Med central banks are exchange rate targeters, at least in *de facto* terms, monetary authorities were reluctant to let the exchange rate adjust.
- Initial response focused too much on depletion of reserve buffers and not enough on exchange rate flexibility.
- Egypt and Tunisia have combined both limited exchange rate flexibility and reserve depletion which could not be sustained for a longer period.

Figure 12: Change in nominal exchange rates and reserve depletion

Panel a: 2012 relative to 2010 | **Panel b: 2015 relative to 2012**



Source: data from national central banks

2. Understanding monetary response: policy rates and reserve requirements

- Central Banks in South-Med oscillated between accommodative and restrictive stances
- Post uprisings, most CBs in South-Med countries opted for monetary easing through reductions in reserve requirements

Figure 13: Policy rates, 2010-2016 (%)

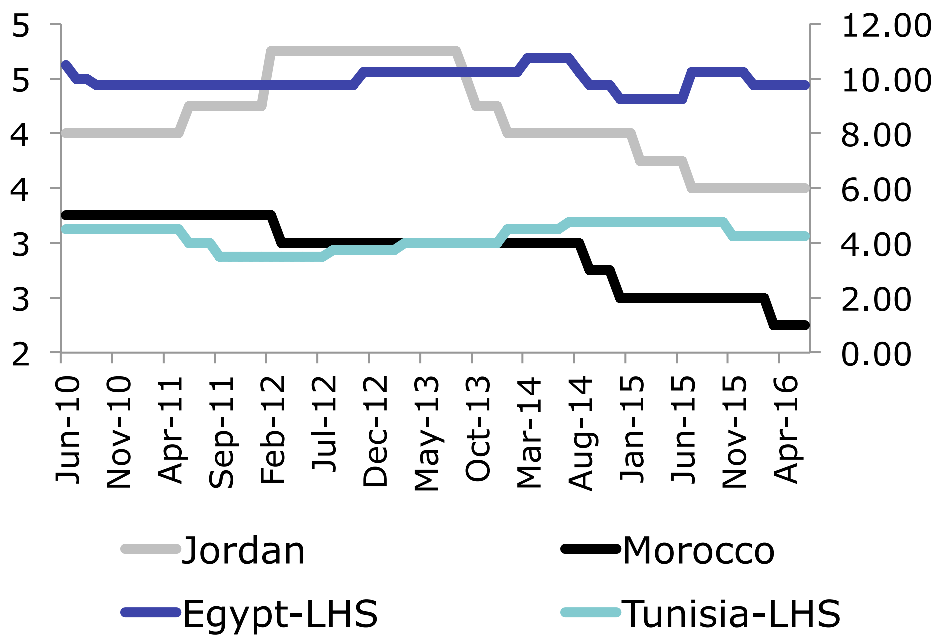


Table 4: Reserve requirements (%)

	Algeria	Egypt	Jordan	Morocco	Tunisia
2010	8.0	14	7.00	6.00	12.50
2011	9.0	14	7.00	6.00	2.00
2012	11.0	10	7.00	6.00	2.00
2013	12.0	10	7.00	4.00	1.00
2014	12.0	10	7.00	2.00	1.00
2015	12.0	10	7.00	2.00	1.00
2016	12.0	10	7.00	4.00	1.00

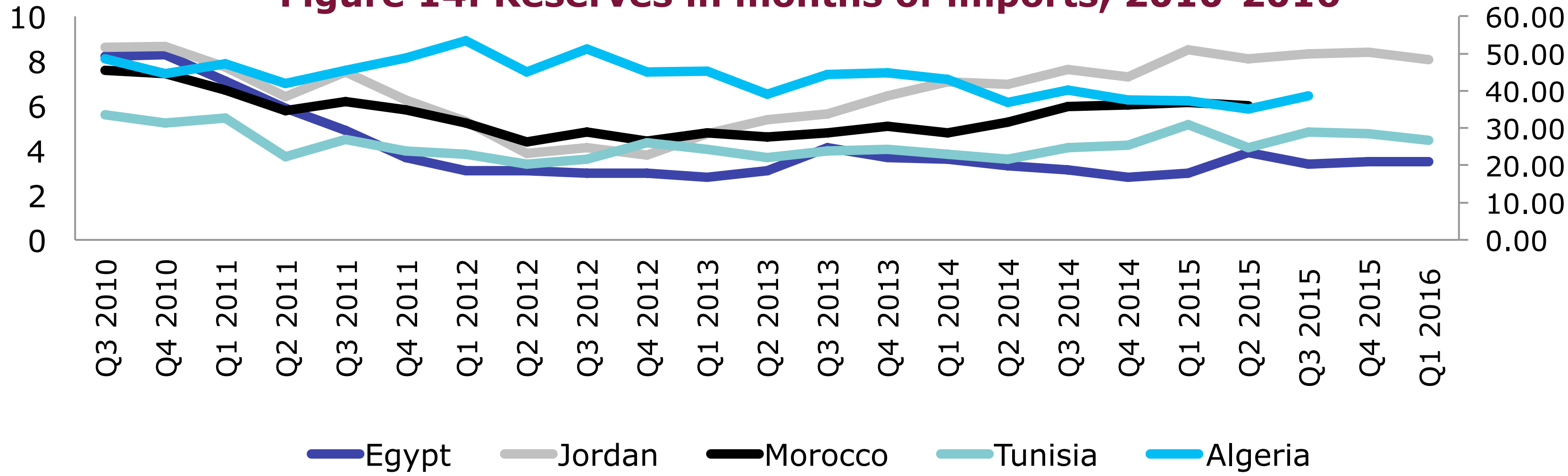
Source: data from national central banks

2. Assessing monetary response: Exchange rate management

Egypt and Tunisia

- Policy mix was tight and costly in terms of reserve depletion
  - By mid-2016, the currencies of Egypt and Tunisia had lost half of their 2010 values; and,
  - Around half and a third of the stock of reserves respectively, well below safe levels
- Central banks provided short-term management (arbitrary and sizable reserve depletion and unsustainable access to external finance) to a permanent shock
- Currency devaluations never brought exchange rate to a value consistent with long-run fundamentals and led to the emergence of a black market in Egypt

Figure 14: Reserves in months of imports, 2010-2016



Source: data from national central banks

2. Assessing monetary response: negative real interest rates and inflation

- Negative interest rates in Egypt and Tunisia have maintained a de facto accommodative monetary policy stance:
  - Fueled credit growth
  - Sustained inflationary pressures; and,
  - Overall impeded the effectiveness of monetary policy
- Monetary policy has been pro-cyclical in real terms

Figure 15: Real interest rates (%)

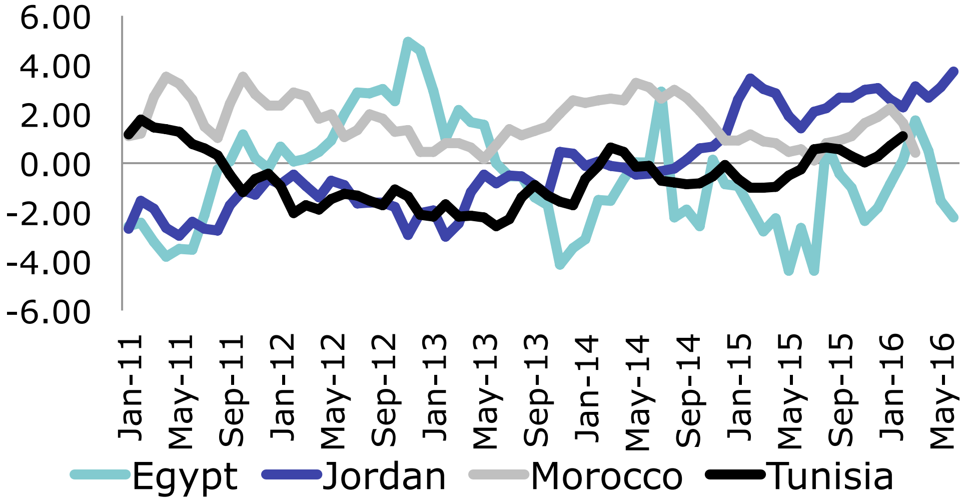
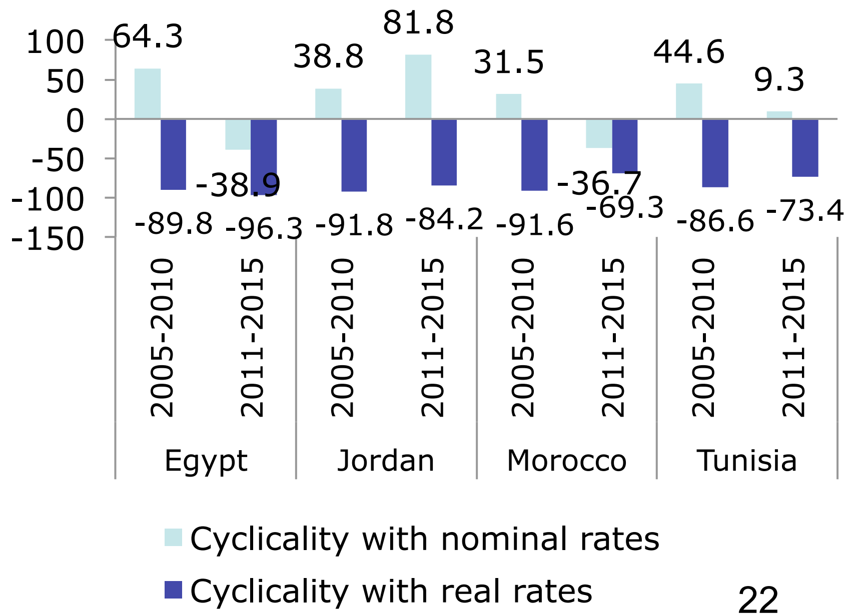


Figure 6: Inflation cyclicality



Source: Calculated by the authors based on data from national central banks and World Development Indicators, World Bank.

2. Fiscal monetary coordination

Monetary policy does not seem to have provided the required easing during fiscal adjustment in Jordan and Morocco.

Table 5: Fiscal policy response and changes in policy rates

	Egypt		**Jordan**		**Morocco**		**Tunisia**	
Year	FI	Change in policy rates	FI	Change in policy rates	FI	Change in policy rates	FI	Change in policy rates
2008	0.39	1.75	4.94	-0.75	0.63	0.25	-0.82	0.00
2009	1.08	-1.50	-0.44	-1.50	2.77	-0.25	1.58	-0.75
2010	-0.34	-0.75	-2.72	-0.50	2.15	0.00	-1.88	0.00
2011	0.70	0.00	4.48	0.25	2.26	0.00	2.03	-1.00
2012	1.51	1.00	-3.01	1.75	-0.18	-0.25	2.83	0.25
2013	0.35	0.50	3.09	-0.50	-1.45	0.00	1.73	0.25
2014	3.25	-1.50	0.39	-0.75	0.34	-0.50	-2.88	0.75
2015	-3.15	0.50	-6.53	-1.25	-0.36	0.00	1.00	-0.50

Source: FI calculated by the authors based on fiscal data extracted from IMF Article IV Consultation central government budget tables and policy rates data from national central banks

Conclusions

- South-Med economies managed to preserve macroeconomic stability despite a turbulent socio-political context and regional conflict
- Initial conditions matter.
- Most South-Med countries are currently operating below capacity given that their actual growth is below potential
- Therefore, there is scope for macroeconomic policy (fiscal policy mainly):
  - To raise aggregate demand; and
  - To boost short term economic growth.
- Fiscal policy was used to maintain social peace (in some countries more than others) and not growth, though at the expense of fiscal sustainability
- With the fall in forex earnings, monetary policy response was too costly and ineffective in Egypt and Tunisia