# MENA's Debt: An Opportunity or a Trap?

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## Global Debt at Unprecedented Levels

In December 2020, global debt stood at $226 Trillion, a seemingly staggering number amounting to 256% of global GDP. In December 2021, global debt increased to $303 Trillion. It is the highest jump in debt level the world has experienced since WWII according to IMF calculations.[1] By all financial standards, the ratio poses a significant risk to global stability.

The global economic system has gone through a once-a-generation crisis with the Covid-19 lockdowns of 2020 and the beginning of 2021.

The financial response to Covid-19 was led by governments all over the world, with the US showing one of the most rapid and aggressive actions.

Global debt levels jumped by 28% overall. Governments' share was about 50% of this increase. This puts global levels of public debt at 40% of the total outstanding, a level not seen for 60 years.[2]

At the end of 2020, the global ratio of debt to GDP reached 97% with advanced economies (as defined by the World Bank and the IMF) at 120% and developing economies' ratio at 63%.[3] With the additional increases in 2021, government debt to GDP ratio is now most probably beyond 100%.

Within this context the Middle East and North Africa region – MENA – has traditionally had lower debt levels. Since the beginning of the 2000s, debt-to-GDP ratios in MENA were in the low 40 to low 50 percent levels on average. MENA oil exporters had very low debt ratios, below 20%, while MENA oil dependent countries had relatively higher ratios, around 60 to 70%.[4] Debt levels started increasing after the Arab Spring for some countries and after 2014 for the whole MENA region. The region's debt levels jumped significantly during the pandemic. From a level of 47.6% in 2019, they reached 56.4% by the end of 2020.[5] Compared to the global situation, MENA debt levels seem very low and the region's governments appear able to continue increasing borrowing to fund their responses to the Covid-19 pandemic and their budget spending plans.

External debt could be an opportunity the region can leverage, putting it at an advantage compared to other countries or regions in the world.

However, the overall ratio of debt in the region hides very different situations there.

This paper will discuss MENA's position in this global financial context and show how for many of its members, debt levels are becoming traps from which they are struggling to escape. We will attempt to show that even energy exporters face debt sustainability issues not yet reflected in the levels of the measurable ratios.

MENA's debt levels could put the region at risk of significant turmoil of the magnitude of the 2011 Arab Spring, unless the policies of debt management and

[1] IMF, MENA Regional Outlook, April 2021.
[2] IMF Blog, April 2022
[3] CSIS – Centre for Strategic International Studies, April 2022.
[4] World Economic Forum "4 ways the Middle East can become resilient in 2022." 18 January 2022 www.weforum.org/agenda/2022/01/4-ways-the-middle-east-mena-region-can-work-together-and-restore-trust/
[5] IMF MENA Regional Outlook, April 2021.

fiscal balances change quickly towards investment rather than consumption, to improve the credit worthiness of existing and future funding needs.

## Global Inflation Returns: The Rise of Interest Rates

With Russia's invasion of Ukraine on 24 February 2022, Europe is faced with war on the continent for the first time since WWII. The war's impact was initially thought to be mostly on the European Union's economy and security. However, its effects are turning into a global crisis that is being transmitted through global dependencies on food, energy and financial flows.

If there is one economic factor that reflects the impact of this dramatic event, it is inflation. In the years before Covid-19 and into the two years of lockdowns, the main concern was deflation. Moderate levels of inflation were often hoped for, especially by major central banks.

The combination of aggressive stimulus programmes to fight recession risks during lockdowns and the war breakout, resulted in a significant rise of inflationary tensions driven by energy and food prices. Consumer Price Indexes (CPI) in advanced economies have been above 6% since February 2022 and are rising. Even core CPI (excluding the energy and food prices) reached 4% because of rising labour market tensions. The trends are similar with even more intensity in developing and emerging markets, with the CPI reaching almost 12%.[6]

The buildup in inflationary pressures was closely watched by the two main central banks, the Federal Reserve (Fed), and the European Central Bank (ECB), throughout the Covid-19 period. The strong economic recovery following the end of confinements and the rollout of vaccines in the advanced economies, lead to the start of a cycle of interest hikes initiated by the US central bank, and soon followed by the ECB, albeit less aggressively. Along with the interest rate increases, came the "normalization" policies, where the Fed and the ECB both declared what is called the "tapering off" of their liquidity injections through the aggressive purchase of debt securities, to avoid deflation when interest rates were already at zero or below, and many segments of bond markets in Europe were trading at negative yields.

The combined effect is a global decrease in liquidity and rise in bond yields and a significant rise in the US$ exchange rate.[7]

These trends had an extremely negative impact on all emerging markets and developing countries. All bond yields increased, with debts labelled in US$ adding an additional cost to an already heavy debt burden. Credit spreads increased in most countries reflecting their increased financial risks.

A particularly worrying sign is the increased number of distressed sovereign issuers and the share of the debt in distressed or even default territory – as defined by the IMF – with spreads above 1,000 bps. They reached 20% of the total in the spring of 2022, a level not seen since the 2008 global financial crisis.[8]

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Within a list of 46 "least developed countries" (LDCs), which are closely followed by the United Nations' Trade and Development branch (UNCTAD), the debt burdens have been rising at a worrying pace for more than 10 years. They usually rely on exports to access financing. Their debt service tripled in 10 years as they entered the Covid-19 pandemic, reaching 13% of exports. The trend continued to rise in 2020 and 2021, reaching more than $50B at the end of 2021, putting the weight of the burden at above 15% of exports.

From a debt sustainability level, which the UN estimates to be at a threshold of 10% for LDCs, at least 15 of them are in distressed debt conditions and an

[6] IMF World Economic Outlook, April 2022.
[7] Global Financial Stability Report, April 2022.
[8] Global Financial Stability report, April 2022.

additional 15 to 16 of them are expected to enter distressed debt conditions in 2022.[9]

This is not limited to LDCs. In middle – and low-income countries, a category in which many MENA countries find themselves, the external debt servicing has reached 16% of total government spending.[10]

Furthermore, the "advanced economies" (AEs) category harbours significant risks. Within the EU for example, a country like Italy, with a 134% debt-to-GDP ratio before the pandemic, ended 2021 at a ratio of 155%. The debt tension is reflected in the 10-year government bond yield that has risen from 1% in 2019 to 4.25% recently.[11] The risk to Italy's debt sustainability within the Eurozone is very serious.

A global debt crisis might have already started.

## Can MENA Debt Levels Allow It to Sail through the Stormy Weather ahead?

The year 2019 saw relatively weak growth in the region, at around 1.2%. The impact of the pandemic in 2020 was severe, with a negative growth of 3.1% to 3.6%, depending on various calculations.[12] The recovery in 2021 was strong with real GDP growth at 3.3%, continuing into 2022 with forecasts of even faster economic activity of 5.5%.

External debt growth slowed in 2019 for the MENA region to a rate of less than 5%. It increased again in 2020 towards 8.5 to 9%.[13]

Compared to all other regions, net debt increases for the MENA region in 2020 were the smallest in the world at approximately $20 billion.[14] Increases were very significant at almost all other regions with the most significant rises in debt inventory in Latin America with almost $80 billion, followed by East Asia, Europe and Africa.

Given the relatively lower levels of overall government debt in MENA discussed above, it seems that the impact of the pandemic has been relatively limited. The region seems to have been able to sail through a threatening global crisis.

The recovery of economic activity pushed inflation up from a low average of 1.5 to 2% towards levels of 4.5% in the first months of 2022.[15] Although only slightly better than price indexes in the EU or the US, this, nevertheless, reflects a very strong recovery of demand.

While the regional aggregate numbers can paint a relatively favourable picture, the different countries in the region face divergent needs of more funding, deterioration of debt value, mounting costs for servicing existing inventory and a rapidly decreasing access to new debt

Oil and gas prices play a significant, but not exclusive, role in overall recovery. They have a positive impact in MENA when their prices rise. High oil and gas prices translate as a good thing for MENA debt. The initial impact of the pandemic drove energy prices down well into the summer of 2020. From a stabilized level of $70 a barrel, oil reached a low of about $18.5 in the middle of the confinements in April 2020. Gas prices were stable at around $1.7 to $1.8 MMBtu.[16]

By the last quarter of 2021, the vaccine rollouts triggered the economic recovery. Oil and gas prices immediately recovered, oil reaching $60 per barrel by the end of 2021, and gas reaching $3.60, following a peak in the autumn at $6.56.

These were not the only factors pushing inflation, but they were important ones. Other important indica-

[9] Soaring debt burden jeopardizes recovery of least developed countries. UNCTAD 2022. https://unctad.org/topic/least-developed-countries/chart-march-2022

[10] Centre for Strategic and International Studies, April 2022.

[11] Trading Economics. https://tradingeconomics.com/italy/government-bond-yield

[12] World Bank database https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2020&locations=ZQ&start=2000

[13] World Bank debt report, 2021 second edition.

[14] World Bank debt report, 2022 first edition.

[15] IMF MENA Regional Economic Outlook. April 2022.

[16] One of the standard units in the global market: MMBtu: Million Metric British Thermal units.

tions of the disruption and the paradigm impact of the pandemic are reflected by the extreme changes in shipping prices globally, the cost of which multiplied by four to eight times.[17]

As tensions with Russia started to take a serious turn with the shadow of war rising tall in the first weeks of 2022, oil quickly reached $81 as early as mid-January, and towered above $120 in March. Gas reached almost $5 up from $3.56, and the market disruptions are severe as prices touched almost $9.50 a few days ago and are now back at $6.50 today.

All these price changes should translate into a positive impact on MENA finance and debt. After a very negative impact on fiscal balances, reaching –9.5% of GDP and an estimated –3.3% of GDP in 2021, the expectations are very positive for 2022 with a positive balance of 3% and a forecast for 2023 of about +1.4 to +1.5%.

The negative impact of current accounts was much less severe in 2020 reaching a low of –1.5% of GDP net balance. Current accounts have swung even more rapidly into positive ground with an estimate of +3.3% and very strong expectation of +8.3% of GDP and a forecast of +6.5% of GDP, respectively in 2022 and 2023.

Strong economic recovery, along with an apparently less severe inflation level, combined with rapid improvements of fiscal deficits following the Covid-19 support programmes throughout the region, and strong and strengthened current account balances due to rising energy prices globally caused by the combined effects of global recovery in 2021 and the war in Europe since February 2022, all point towards a positive impact on existing debt levels and future borrowing capabilities in the region. The MENA region could become attractive relative to other regions, which are struggling with their existing level of liabilities in a globally stressed debt environment.

An apparently positive MENA picture hides extremely different situations. While the regional aggregate numbers can paint a relatively favourable picture, the different countries in the region face divergent needs of more funding, deterioration of debt value, mounting costs for servicing existing inventory and a rapidly decreasing access to new debt.

## Diverging Realities

The recovery of economic activity is very uneven across the region. While the overall recovery in 2021 was around 3.5% and expectation over 5% in 2022, many countries are struggling to recover pre-pandemic levels of activity, and the GDP forecasts in 2022 are lower.

Countries like Algeria, Morocco, Tunisia or Turkey are seeing their growth rate decrease after having seen much deeper recessions in 2010 than the average for MENA of –3.5%. Tunisia, for example, saw its GDP plunge by more than 8%. Its activity is faltering in 2022. Algeria's GDP fell by 5% in 2020 and it did not recover fully in 2021, when it registered 3.9% real GDP growth. And activity this year is slower, despite favourable energy prices, and its economy is expected to falter going into 2023. Turkey has seen its growth prospects for 2022 downgraded by the IMF in April to 2.7%. Morocco's real GDP growth is not expected to grow faster than 1.1% in 2022, much lower than the MENA average. Even exceptions like Iran, which has been less impacted according to its own reports, with growth remaining positive in 2020 contrary to other countries, will not outperform the region's real GDP average in 2021 and 2022.[18]

Similarly, the region's inflation rate hides very divergent levels, with gulf countries' CPI, while rising rapidly from deflation levels mid-2020, remaining at about 2% at the beginning of the Ukraine war, and the rest of the region experiencing much steeper levels, rising from 4% during 2020 to 10% in early 2022. This is putting pressure on all countries of the region with a flexible exchange rate to either accept national currencies' fall in value or tighten their monetary policies and raise interest rates. This is what is happening with the hike in interest rates in many countries like Tunisia and Egypt. Turkey, which has persisted with low interest rates, has paid the price with punishing inflation rates. However, with economic conditions already tense, central banks in MENA have much more limited options, and cannot increase rates too aggressively. In countries that have pegged their currencies to the $US, their options

[17] See shipping price indexes like the Harpex price index, a container ship price benchmark, and the Baltic Dry index, a price benchmark for commodities and food transport.
[18] World Bank report: "Reality Check: Forecasting growth in MENA." April 2022.

are a bit better, but with the Fed continuing to hike interest rates, they will also come under pressure to follow the trend.[19]

In the context of the ongoing global monetary tightening initiated by the Federal Reserve Bank, for many emerging markets and specific countries in the region this translates into a rise in their debt service payments and an increase in the cost of existing external debt.[20] In both cases, the effect on economic activity will be negative, resulting in slower growth. This will feed back into further financial instability and bodes negatively for present and future debt prospects.[21]

## MENA Debt Sustainability in Question?

### *Deteriorating Debt Prices*

The tightening of liquidity is reflected by increased credit spreads in the region. While the global context has led to deteriorating credit spreads, impacting all emerging and developing countries, MENA spreads deteriorated faster than the overall average. This is an important signal of the region's particular external debt fragility.

Here again, there are very wide differences within the region. Credit spreads of GCC countries remained mostly stable since the war in Ukraine started, and, in many cases, decreased slightly against a very negative global background, while other MENA countries, including other oil exporters experienced a sharp widening of their spreads. The deterioration of MENA spreads was four to five times greater than those of emerging markets.[22]

The deterioration of credit spreads started before the Ukraine war, as inflation tensions started rising following the recovery from the Covid-19 pandemic. Between mid-2021 and January 2022, all spreads on MENA credit increased at higher rates than the median global increase,[23] with the exception of Kuwait and Saudi Arabia. Some changes are very significant, with Egypt's spread rising by 47%, and Turkey and Tunisia by more than 35%. Even the spread of Abu Dhabi increased, albeit by 5%.[24]

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The overall average of the relative value of MENA debt is high, making the region one of the worst default risks globally, second only to the Latin America region.

To make things worse, many countries of the region are at or beyond their default risk threshold, which means they are in default probability territory, with Turkey and Tunisia both beyond their threshold levels, Egypt having crossed into high risk levels at the beginning of 2022.

### *The Weight of Subsidies on Debt*

Most MENA countries have high levels of food dependency ratios. Their import dependency varies between an already significant 40% for countries like Iran or Egypt, a full 100% for countries like Jordan, Lebanon and Kuwait, and with large countries like Algeria, Yemen and Saudi Arabia at very high ratios of between 65 and 80%.[25]

The added effects of shipping costs, Covid-19 disruption and the war between Ukraine and Russia, the world's main cereal suppliers, have resulted in a sharp spike in food prices. Wheat prices rose from a

[19] IMF MENA Regional Economic Outlook, April 2022.
[20] IMF MENA Regional Economic Outlook, Annex, 2 April 2022.
[21] IMF MENA Regional Economic Outlook; "Changing Tides." April 2022.
[22] IMF MENA Regional Economic Outlook, April 2022.
[23] Damodaran, Aswath. "Country Risk: Determinants, Measures and Implications – the 2021 Edition." *SSRN*, 6 July 2021, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3879109.
[24] Ibid.
[25] "New UN Food Outlook Report: World's Most Vulnerable Are Paying More for Less Food." *Food and Agriculture Organization*, www.fao.org/newsroom/detail/new-un-food-outlook-report-world-s-most-vulnerable-are-paying-more-for-less-food/en.

level of $4.50 to $5.0/Bu,[26] to more than $12.0/Bu by February 2022, and have remained at these levels, currently trading at between $10.0 and $11.0. Soybeans, another important food commodity, experienced the same price changes, more than doubling in value from mid-2020, when they were trading at roughly $9.0/Bu, rising to almost $17.0/Bu and remaining very high, currently trading at $17.5%. Moreover, the import dependency of MENA countries is almost exclusively linked to both Ukraine and Russia, compounding the effect of the crisis. These price tensions carry a dominant weight in inflation at consumer level. They influence about 30% of the CPI in GCC countries and 50% in all other MENA countries.

The rise in energy prices described above have similar effects on the region's economies. MENA has the highest level of energy subsidies in the world. On its own it represents half the global energy subsidy cost. This has an impact not only on oil importing countries in the region, but also on oil exporting countries, through the negative financial balances they generate in their current accounts. Their impact is more damaging, as prices in the energy markets rise. Additionally, they tend to increase domestic consumption, with many of the GCC countries being the top global consumers of oil and gas per capita.[27]

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The effects of energy and food prices have significant indirect effects on debt ratios through subsidies. They compensate for the effects of price fluctuations and protect the purchasing power of consumers in the region. The higher the prices, the more negative the impact of subsidies on fiscal balances.

The subsidies impact could amount to a cost that accounts for 1% of the region's overall GDP. Energy subsidies alone are estimated to represent $22 billion of additional fiscal spending.[28]

The indirect but significant effect of current account balances creates additional difficulties to servicing existing debt and hinders the ability to raise new external debt.

Subsidies are one significant reason for the deterioration of credit spreads for the region and the rise in debt costs.

## Conclusion: MENA Debt Brought into Question, When It Might Need More of It

MENA's debt level seems to be lower than other regions in the world. It represents very different situations within the region. In the context of a global return of inflation, which has triggered a strong response from the major central banks and a rise in interest rates, the MENA region has apparently been in a better position relative to other regions in the world.

The Russia-Ukraine war has caused dramatic increases in energy prices. This has strengthened the financial and economic prospects of oil exporters. The overall impact on the external debt of the region should be beneficial.

However, some of the expected positive effects are mitigated by the global rise in inflation, and the accompanying restrictive monetary policies and interest rate hikes, which are having a negative impact on the servicing of the debt and the value of the inventory of external liabilities.

This inflation is down to the aggressive stance taken by the US Federal Reserve, which is pushing the US currency higher and increasing the weight of currency denominated debts.

The conflict in Europe has created a global food supply shortage, as the two countries involved in the conflict are dominant exporters, causing a devastating impact on international prices. While this affects all countries, the impact on MENA is particularly severe, given the food dependency ratios of most of the countries in the region.

The combination of those elements has had very negative consequences on MENA's external debt,

[26] Unit of 1 wheat or soybean Bu= 0.27 metric ton.
[27] Our World in Data. https://ourworldindata.org/grapher/per-capita-energy-use
[28] IMF blog: MENA Commodity importers hit by higher prices. 24 May 2022.

as shown by financial flows. The region received the smallest amounts of new international flows in 2020, and that was almost exclusively through international institutions like the IMF. It saw outflows from the private sector and negligible amounts from bond investors compared to all other regions in the world.[29]
While 2021 saw a strong recovery of foreign direct investments (FDIs),[30] the MENA region, with the exception of Saudi Arabia, did not even benefit from apparent favourable financial and economic developments. The UAE was another exception here, but there the expectations for 2023 are for flat inflows.[31]
Credit spreads show that the sustainability of external debt for the region is in question. Debt default in Lebanon is driving the country towards a failed state status, through one of the most spectacular and deepest financial crises in history, made worse by the combination of a currency devaluation, a foreign debt default and a full banking crisis. Tunisia is heading in the same direction. Egypt might become the "Argentina" of the Middle East for the IMF. All these trends contribute to weakening the debt suitability of the region in general.

The current levels of debt for the region, which seem low, become actually very high. The potentially improved economic conditions in the current context, which some countries could benefit from, will not translate into a significant increase in the capacity for new debt. These benefits appear to be fragile and are based on short-term, exceptional circumstances.

Current events are revealing longer and more structural weaknesses, which have not been addressed since the Arab Spring in 2011.

High and increasing unemployment, especially among youth, the impact of rapidly expanding populations, has been addressed with increased subsidies. But the structural reforms needed to change the economic fundamentals that will foster more sustainable economic activity and potentially more stable social contracts are being avoided.

The region is the most water stressed in the world.[32] Additionally, it is already experiencing the effects of rising temperatures, with many countries, especially Algeria and Iraq, feeling the impact of two additional degrees.[33]

MENA is in urgent need of more funding, not less. As its financial sustainability deteriorates, it needs more debt, not less, so that it can invest in the crucially needed energy transition and economic diversification, through aggressive reforms of existing subsidy and taxation systems.

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Within a highly stressed global debt environment, it is no longer possible to avoid the difficult choices required to confront these challenges. All MENA countries are being forced to switch from consumption-driven economies to production-oriented ones. Time has run out.

[29] WB debt report 2022 Edition 1.
[30] UNCTAD Investment trends report. Jan. 2022
[31] Nasser, Saidi & Associates. Weekly Economic Insights. https://nassersaidi.com/2022/06/17/weekly-insights-17-jun-2022-will-central-bank-aggressive-monetary-tightening-disrupt-the-global-tourism-recovery/
[32] United Nations Water Global Water map. www.unwater.org/water-facts/scarcity/
[33] Wehrey, Frederic; and Fawal, Ninar. "Cascading Climate Effects in the Middle East and North Africa: Adapting through Inclusive Governance." *Carnegie Endowment for International Peace*, 24 Feb. 2022, https://carnegieendowment.org/2022/02/24/cascading-climate-effects-in-middle-east-and-north-africa-adapting-through-inclusive-governance-pub-86510.