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MIDDLE EAST AND CENTRAL ASIA

Safeguarding Macroeconomic Stability amid Continued Uncertainty

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The Middle East and Central Asia *Regional Economic Outlook* is prepared each spring and fall by the IMF's Middle East and Central Asia Department (MCD). The report's analysis and projections form integral elements of the department's surveillance of economic developments and policies in member countries. It draws primarily on information gathered by MCD staff through consultations with member countries.

The analysis in this *Regional Economic Outlook* was coordinated under the general supervision of Jihad Azour (MCD Director). The project was directed by Taline Koranchelian (Deputy Director, MCD), S. Pelin Berkmen (Chief, MCD Regional Analytics and Strategy Division), Yasser Abdih (Deputy Chief, MCD Regional Analytics and Strategy Division), and Cesar Serra (Deputy Chief, MCD Regional Analytics and Strategy Division).

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Country Groupings

The *May 2023 Regional Economic Outlook (REO): Middle East and Central Asia* covers countries and territories in the Middle East and Central Asia Department (MCD) of the International Monetary Fund (IMF) referred to as ME&CA countries and territories. It provides a broad overview of recent economic developments and prospects and policy issues for the medium term. To facilitate the analysis, the 32 ME&CA countries and territories covered in this report are divided into three (nonoverlapping) groups, based on export earnings and level of development: (1) Oil Exporters (OE), (2) Emerging Market and Middle-Income Countries (EM&MI); and (3) Low-Income Developing Countries (LIC). Additional analytical and regional groups provide more granular breakdown for analysis and continuity. The country and analytical group acronyms and abbreviations used in some tables and figures are included in parentheses.

ME&CA OE include Algeria (ALG), Azerbaijan (AZE), Bahrain (BHR), the Islamic Republic of Iran (IRN), Iraq (IRQ), Kazakhstan (KAZ), Kuwait (KWT), Libya (LBY), Oman (OMN), Qatar (QAT), Saudi Arabia (SAU), Turkmenistan (TKM), and the United Arab Emirates (UAE).

ME&CA EM&MI include Armenia (ARM), Egypt (EGY), Georgia (GEO), Jordan (JOR), Lebanon (LBN), Morocco (MAR), Pakistan (PAK), Syrian Arab Republic (SYR), Tunisia (TUN), and the West Bank and Gaza (WBG).

ME&CA LIC include Afghanistan (AFG), Djibouti (DJI), the Kyrgyz Republic (KGZ), Mauritania (MRT), Somalia (SOM), Sudan (SDN), Tajikistan (TJK), Uzbekistan (UZB), and Yemen (YEM).

Caucasus and Central Asia (CCA) countries include Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.

CCA OE include Azerbaijan, Kazakhstan, and Turkmenistan.

CCA OI include Armenia, Georgia, the Kyrgyz Republic, Tajikistan, and Uzbekistan.

CCA EM&MI include Armenia and Georgia.

CCA LIC include the Kyrgyz Republic, Tajikistan, and Uzbekistan.

Middle East and North Africa (MENA) includes Algeria, Bahrain, Djibouti, Egypt, the Islamic Republic of Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, the Syrian Arab Republic, Tunisia, the United Arab Emirates, the West Bank and Gaza, and Yemen.

MENA OE include Algeria, Bahrain, the Islamic Republic of Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

MENA OI include Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Somalia, Sudan, the Syrian Arab Republic, Tunisia, the West Bank and Gaza, and Yemen.

MENA EM&MI include Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic, Tunisia, and the West Bank and Gaza.

MENA LIC include Djibouti, Mauritania, Somalia, Sudan, and Yemen.

MENAP includes MENA, Afghanistan, and Pakistan.

MENAP OI include MENA OI, Afghanistan, and Pakistan.

Arab World includes Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, the Syrian Arab Republic, Tunisia, the United Arab Emirates, the West Bank and Gaza, and Yemen.

Arab World OE include Algeria, Bahrain, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

The Gulf Cooperation Council (GCC) comprises Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

The **Non-GCC oil-exporting countries** are Algeria, the Islamic Republic of Iran, Iraq, and Libya.

North Africa countries include Algeria, Djibouti, Egypt, Libya, Mauritania, Morocco, Sudan, and Tunisia.

Fragile and conflict-affected states (FCS) include Afghanistan, Iraq, Lebanon, Libya, Somalia, Sudan, the Syrian Arab Republic, the West Bank and Gaza, and Yemen.

Conflict-affected countries include Afghanistan, Iraq, Somalia, the Syrian Arab Republic, and Yemen.

Assumptions and Conventions

A number of assumptions have been adopted for the projections presented in the *May 2023 Regional Economic Outlook: Middle East and Central Asia*. It has been assumed that established policies of national authorities will be maintained, that the price of oil[1] will average US$73.13 a barrel in 2023 and US$68.90 a barrel in 2024, and that the six-month London interbank offered rate (LIBOR) on US dollar deposits will average 5.4 percent in 2023 and 4.9 percent in 2024. These are, of course, working hypotheses rather than forecasts, and the uncertainties surrounding them add to the margin of error that would in any event be involved in the projections. The 2023 and 2024 data in the figures and tables are projections. These projections are based on statistical information available through late March 2023, unless otherwise noted.

The following conventions are used in this publication:

- In tables, ellipsis points (. . .) indicate "not available," and 0 or 0.0 indicates "zero" or "negligible." Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 2011–12 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2011/12) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY 2012).
- "Billion" means a thousand million; "trillion" means a thousand billion.
- "Basis points (bps)" refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

As used in this publication, the term "country" does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

The boundaries, colors, denominations, and any other information shown on the maps do not imply, on the part of the International Monetary Fund, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries.

[1] Simple average of prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate crude oil.

1. Regional Developments and Economic Outlook: Safeguarding Macroeconomic Stability amid Continued Uncertainty[1]

The economies of the Middle East and Central Asia (ME&CA) proved resilient in 2022, despite a series of global shocks. However, this year—and potentially next—growth is expected to slow in the Middle East and North Africa (MENA) as tight policies to fight inflation, reduce vulnerabilities, and rebuild buffers start to dent economic activity in many countries, and agreed oil production cuts curb growth in oil exporters. Inflation is projected to remain persistent.[2] The outlook for Caucasus and Central Asia (CCA) countries depends heavily on external factors, namely the impact of monetary tightening, growth in their main trading partners, the pace of private transfers, and inflows of migrants from Russia. Uncertainty is high, and risks to the baseline are tilted to the downside amid financial stability concerns—particularly in advanced economies amid contagion fears. Policy trade-offs are even more complex, and policymakers will need to calibrate the policy mix carefully to reduce core inflation without triggering financial stress and excessive tightening and continue to provide targeted fiscal support to vulnerable groups while preserving debt sustainability and financial stability. Tight monetary and fiscal policies across the region amid tight global financial conditions call for accelerating structural reforms to bolster potential growth and enhance resilience.

1.1. Uncertain Global Prospects amid Increased Financial Stability Risks

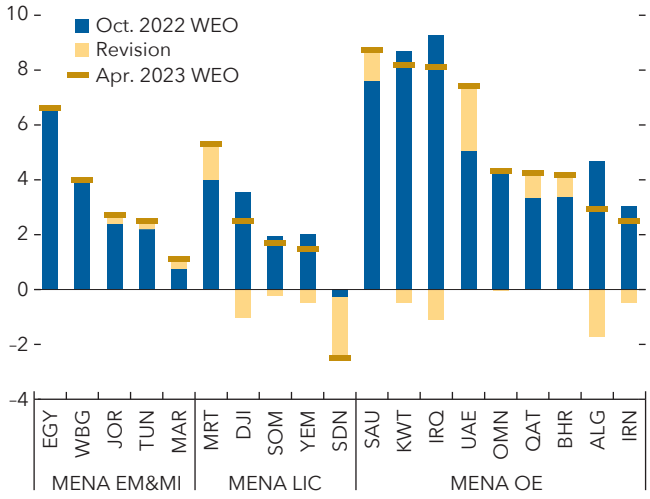
Global growth was resilient in the third quarter of 2022 but faded toward the end of the year. There were hints of stabilization in early 2023, but the outbreak of financial market turmoil triggered by stress in the banking sector in the United States and Europe in mid-March has cast a shadow on global prospects as financial stability risks have risen significantly (April 2023 *Global Financial Stability Report*). Although forceful actions by policymakers to stabilize the banking system appear to have contained systemic risks so far, global financial conditions tightened sharply in March, with credit spreads widening and equity prices falling, following an easing since October. In this context, and assuming that the ongoing financial sector turmoil is contained, the April 2023 *World Economic Outlook* projects that global growth will moderate from 3.4 percent in 2022 to 2.8 percent in 2023—an upward revision to the October forecasts to reflect unexpected resilience in advanced economies and China's faster-than-expected recovery in 2023—before accelerating slightly to 3.1 percent in 2024.

Despite some easing of headline inflation in the last months of 2022, core inflation has remained persistently high. The moderation in global inflation is partly attributable to declining commodity prices—particularly for energy—but also to the sharp and synchronized monetary policy tightening since last year, which has started to dampen demand and contain price pressures. Average petroleum spot prices are estimated at $74.20 per barrel in 2023 and $70 in 2024 (down from $85.50 and $80.20, respectively, in October 2022). Oil futures curves point to prices decreasing toward $62.70 by 2028. While food commodity prices are expected to decline by 4.9 percent in 2023 and 2.5 percent in 2024 (compared with October's forecast of declines of 5.8 and 2.0 percent, respectively), they are expected to remain well above pre-pandemic levels.

[1] Prepared by Olivier Bizimana (lead), Filippo Gori, Jeta Menkulasi (lead), and Sahra Sakha with excellent research assistance from Roy Randen and Subi Velkumar.

[2] This report does not include the April 2023 OPEC+ oil production cuts.

Figure 1.1. MENA: Real GDP Growth, 2022
(Percent change, year over year)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes. EM&MI = emerging market and middle-income economies; LIC = low-income country; MENA = Middle East and North Africa; OE = oil exporter; WEO = *World Economic Outlook*.

1.2. Middle East and North Africa and Pakistan: Muddling through amid Headwinds

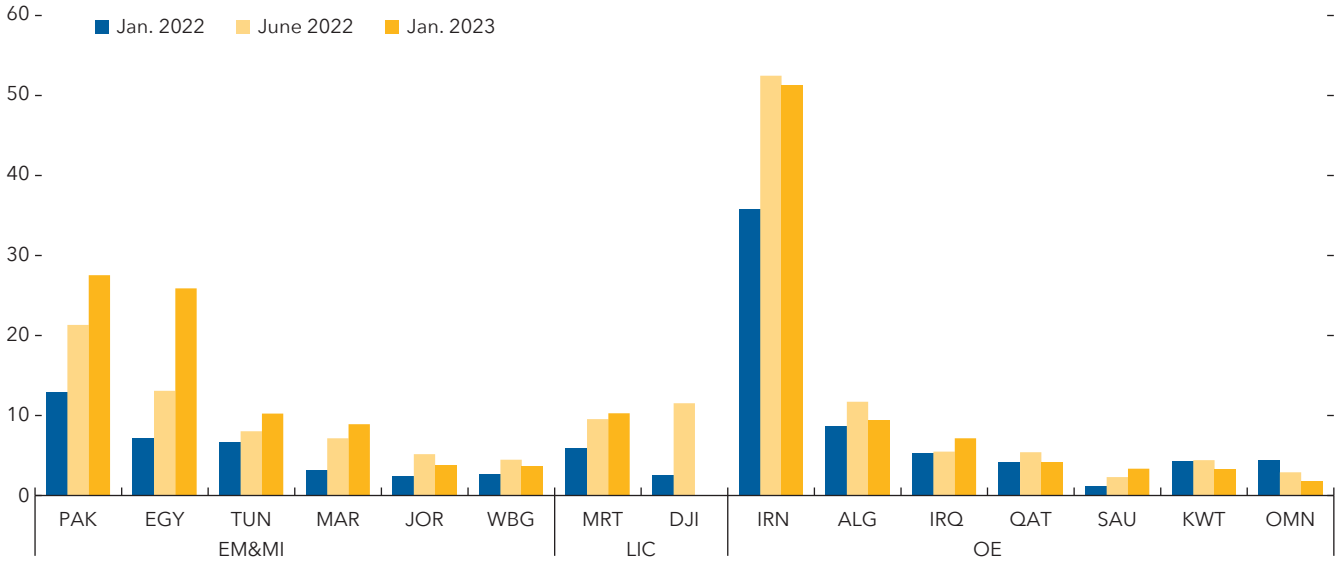
Economic activity proved resilient last year despite a large negative terms-of-trade shock, increased food insecurity, tight financing conditions and debt vulnerabilities in most emerging market and middle-income economies (EM&MIs), and high volatility in energy prices. However, the MENA economies and Pakistan are expected to go through a soft patch this year, reflecting tight policies in many countries to restore macroeconomic stability, OPEC+-related curbs in oil production, and the fallout from the recent deterioration in financial conditions. Macroeconomic instability and conflict will continue to pose challenges in low-income countries (LICs) and fragile and conflict-affected states (FCS) amid an ongoing cost-of-living crisis that is exacerbating food insecurity. Debt, financing needs, and inflation will remain high in the region's EM&MIs, reflecting the economic fallout from the pandemic and Russia's war in Ukraine.

Growth Surprised on the Upside amid Strong Domestic Demand

Real GDP growth in MENA has been upgraded for 2022 because of stronger-than-expected growth in many oil-exporting economies (Bahrain, Libya, Qatar, Saudi Arabia, the United Arab Emirates) and some oil importers (Jordan, Mauritania, Morocco, Tunisia; Figure 1.1). Real GDP in the region is estimated to have expanded by 5.3 percent in 2022 (an upward revision of 0.3 percentage point from October), up from 4.3 percent in 2021, reflecting the strong performance of oil exporters (especially Gulf Cooperation Council [GCC] economies) and Egypt and despite lackluster growth in other EM&MIs and most LICs. The acceleration in growth in 2022 was mainly due to strong domestic demand—notwithstanding the negative impact of higher prices on households' purchasing power and firms' production costs—and a strong rebound in oil production for oil exporters.

Several factors explain the relative strength of domestic demand. Tourism rebounded, and hotel occupancy rates recovered, surpassing their pre-pandemic levels in many countries (Jordan, Morocco, Qatar, Saudi Arabia). Remittance flows remained strong in mid-2022 in most EM&MIs (Egypt, Jordan, Morocco, Pakistan). Lending to the private sector (nonfinancial firms and households) continued to expand in real terms in some EM&MIs, with double-digit growth in some countries (approximately 10 percent in Egypt), partly reflecting the prevalence of subsidized lending initiatives in the second half of 2022. Labor market conditions stopped deteriorating in 2022, although structural factors, such as labor and product market rigidities (October 2021 *Regional Economic Outlook: Middle East and Central Asia*) hampered a meaningful recovery, especially in EM&MIs. Employment growth in EM&MIs remained lackluster in the second half (Jordan, Morocco, Tunisia) but continued to rise at a healthy pace in GCC countries (Bahrain, Oman, Saudi Arabia), partly reflecting rebounding migrant employment (Bahrain, Oman, Saudi Arabia). Unemployment rates inched up or remained broadly steady in most EM&MIs, staying above pre-pandemic levels in many countries in late 2022 (Jordan, Morocco, Tunisia).

Figure 1.2. MENA: Headline Inflation
(Percent change, year over year)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes. EM&MI = emerging market and middle-income economies; LIC = low-income country; OE = oil exporter.

Inflationary Pressures Remain Elevated Despite Tentative Signs of Plateauing for Oil Exporters

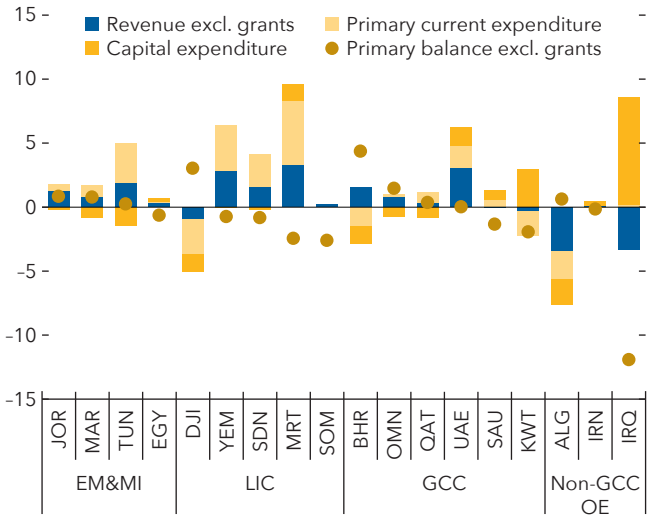
Headline inflation showed signs of peaking at the end of 2022, although it remains persistently high for EM&MIs and LICs (Figure 1.2). Headline and core inflation in many oil-exporting countries (Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi Arabia) remain relatively lower than elsewhere—as subsidies and caps on certain products, the strengthening of the US dollar (to which many of the countries peg their currencies), and limited share of food in the consumer price index basket have helped to offset imported inflationary pressures—and appear to have peaked in the last months of 2022. By contrast, headline inflation continued trending upward in most EM&MIs (Egypt, Morocco, Pakistan, and Tunisia, but not Jordan because of its peg to the US dollar and temporary fuel subsidies), partly reflecting the impact of past exchange rate depreciations and persistently elevated food prices, but also broadening price pressures (including on services) as underscored by the rise in core inflation amid loose monetary policy (Egypt, Pakistan, Tunisia).

Monetary Stances and Fiscal Positions Are Mixed

Central banks across the region continued to tighten policy through the end of 2022 in response to persistently high inflation and exchange rate pressures and to prevent inflation expectations from de-anchoring (Egypt, Mauritania, Morocco, Pakistan, Tunisia). In countries with currencies pegged to the US dollar (GCC economies, Jordan), central banks continued hiking policy rates broadly in line with the Federal Reserve, pushing real rates further into positive territory. For some MENA EM&MIs (including Egypt and Tunisia) and Pakistan, policy interest rates stood at levels below model-based estimates of natural rates, suggesting that monetary policy stances were still loose at the end of 2022 (see Chapter 2).

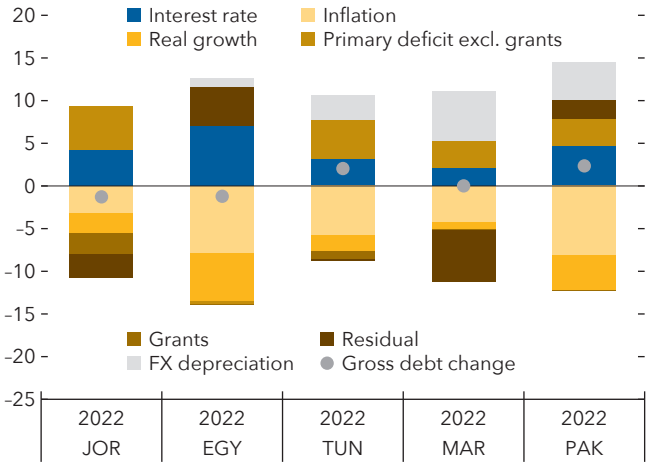
Fiscal positions in the region were mixed. For GCC countries, non-oil primary balances (as a percentage of non-oil GDP) remained broadly unchanged in 2022 relative to 2021 (Figure 1.3). Despite a substantial increase in oil revenues (about 4 percentage points of GDP on average), primary current expenditures remained broadly stable, indicating that most countries avoided procyclical spending (except for Kuwait and Saudi Arabia, entirely reflecting higher capital expenditures). By contrast, non-GCC oil exporters (Iraq, Libya) ran a procyclical fiscal policy as in the past, with a significant deterioration in the non-oil primary balance. Overall, oil exporters have

Figure 1.3. MENA: Change in Primary Balance Excluding Grants, 2021–22
(Percent of GDP; non-oil balances for oil exporters)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes. EM&MI = emerging market and middle-income economies; GCC = Gulf Cooperation Council; LIC = low-income country; OE = oil exporter.

Figure 1.4. MENA: Contributions to Changes in Gross Public Debt
(Percent of GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes. FX = foreign exchange.

increased their buffers, as evidenced by improved fiscal balances in 2022. Some countries repaid public debt (Kuwait, Oman), while others raised their international reserves or assets, including in their sovereign wealth funds. For oil importers, primary fiscal deficits (excluding grants) improved on average in most MENA EM&MIs (except for Egypt) in 2022 relative to 2021, reflecting higher tax revenues partly offset by the policy response to mitigate the impact of rising commodity prices, while interest expenses remained broadly stable (about 4 percent of GDP on average). By contrast, Pakistan undertook a sizable fiscal expansion. In LICs, primary fiscal positions deteriorated in most countries because of higher commodity prices.

Higher inflation was the main factor in containing public debt in most MENA EM&MIs and Pakistan in 2022 (Figure 1.4). Debt ratios declined slightly in Egypt and Jordan as higher nominal GDP growth more than offset interest costs. By contrast, public debt-to-GDP ratios continued to rise in Pakistan and Tunisia, reflecting the combination of still-large overall fiscal deficits and the impact of exchange rate depreciations, offsetting the eroding effect of high inflation.

Financial Sector Is Broadly Sound but Sovereign-Bank Nexus Has Tightened

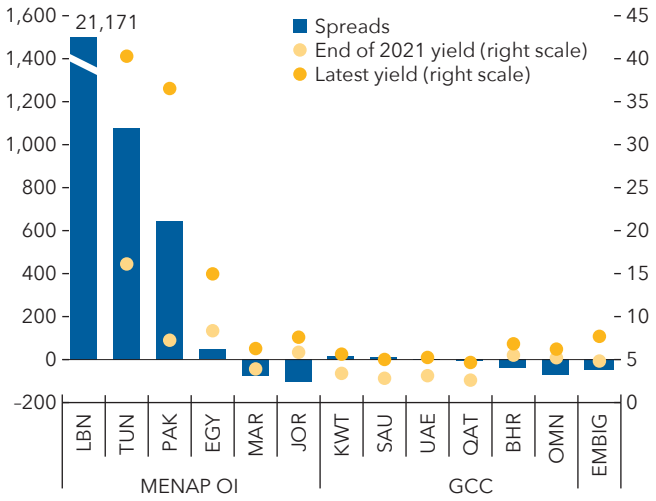
The banking sector in the MENA region has weathered the pandemic well partly because of the deployment of supportive measures. Following their unwinding, banks in the region have seen their profitability recover, with the median return on assets ranging between 1 percent and 1.4 percent as of the end of 2022, up from about 0.8 percent in 2020. Capitalization levels in both GCC and MENA EM&MIs have remained high (at 17 percent and 15.3 percent, respectively), well above regulatory minimums. Nonperforming loan ratios stood at 3.2 percent and 5.3 percent on average in the GCC and MENA EM&MIs, respectively, with a few emerging markets recording levels as high as 11.1 percent (mainly legacy nonperforming loans). Most banks in the region depend on customer deposits and long-term funding, with a few exceptions relying on wholesale funding and foreign depositors. However, structural vulnerabilities remain as the sovereign-bank nexus has tightened following the

public sector's increased reliance on domestic bank financing during the pandemic. The banking system's exposure to government bond holdings ranges from 6.8 percent to as high as 44 percent of total banking system assets.

Vulnerabilities Persist, Especially for EM&MIs, amid Challenging External Financing Conditions

External vulnerabilities remain elevated, especially in EM&MIs. Current account deficits for MENA EM&MIs deteriorated from 4.7 percent of GDP to about 5 percent of GDP on average in 2022. However, the widening in Pakistan was more marked (rising from 0.8 percent of GDP to 4.6 percent of GDP), reflecting rising import bills because of higher commodity prices. The relatively stable current account deficit in LICs (9 percent of GDP on average in 2022) reflects improvements in Sudan (because of a compression of imports), which was offset by deteriorations elsewhere. By contrast, oil exporters registered large current account surpluses amid high hydrocarbon prices.

Figure 1.5. MENA: Change in Spreads since October 2022 and Bond Yields
(Basis points [left scale]; percent [right scale])



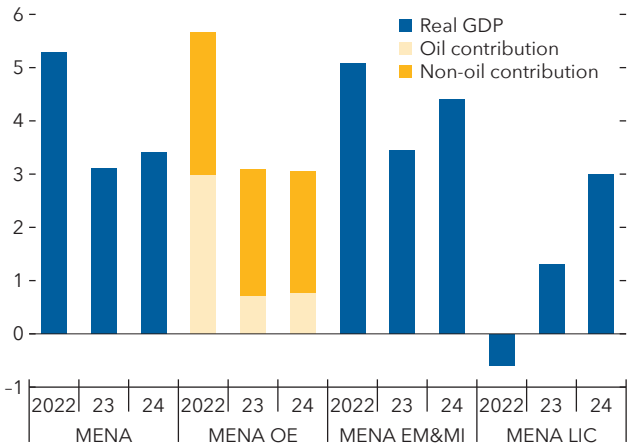
Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Government bond yields are calculated as the difference between EMBIG spreads and the 10-year US Treasury bond yield. Country abbreviations are International Organization for Standardization country codes. EMBIG = Emerging Market Bond Index Global; GCC = Gulf Cooperation Council; MENAP = Middle East, North Africa, Afghanistan, Pakistan; OI = oil importer.

The slight easing of financial pressures across the MENA region and Pakistan since October 2022 was reversed by the tightening of global financial conditions in March amid global banking turmoil. However, strong differentiation remains across the risk spectrum. Sovereign bond spreads have widened, and borrowing costs have increased sharply on net in many EM&MIs (Lebanon, Pakistan, Tunisia) relative to October 2022 (Figure 1.5). By contrast, despite a widening in the wake of the banking turmoil, spreads in Jordan and Morocco are still lower than in October 2022, in line with emerging markets more broadly. Overall, government bond yields across the region are higher than at the end of 2021 (by about 130 to 3,000 basis points). Capital flows had reversed even before the recent financial turmoil, with portfolio fund inflows to the MENA region and Pakistan reaching $1.2 billion in the first two months of 2023 (after a record $4.5 billion in outflows in 2022). Except for Morocco and Jordan, which issued $2.5 billion and $1.25 billion, respectively, the region's EM&MIs did not take advantage of the respite in the Eurobond market in early 2023 like other emerging market economies (see April 2023 *Global Financial Stability Report*). Egypt also issued $1.5 billion sukuks in late February. Pressures on exchange rates and international reserves remain significant, with sharp depreciations in some EM&MIs (Egypt, Pakistan) since October 2022. However, they have receded modestly in others (especially Morocco, which benefited from a two-year Flexible Credit Line arrangement in April).

MENA and Pakistan Outlook: Soft Patch amid Slow Disinflation

Growth prospects are set to weaken across the MENA region and Pakistan as tighter monetary and fiscal policies to safeguard macroeconomic stability dampen domestic demand in EM&MIs; heightened fragility, fiscal pressures, and persistently high inflation weigh on growth prospects and worsen living standards in LICs and FCS; and economic growth moderates in oil exporters because of lower oil production in line with the October OPEC+ agreement. As a result, growth in the MENA region is projected to decelerate from 5.3 percent in 2022 to 3.1 percent in 2023 before increasing slightly to 3.4 percent in 2024 (Figure 1.6). Meanwhile, inflation is projected to be more persistent in EM&MIs and LICs than previously expected. Yet with marginally decreasing (except for Egypt)

Figure 1.6. MENA: Real GDP Growth, 2022–24
(Percent change, year over year)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: EM&MI = emerging market and middle-income economies; LIC = low-income country; MENA = Middle East and North Africa; OE = oil exporter.

but still high debt levels and projected large gross public financing needs and current account deficits, fiscal and external vulnerabilities are expected to remain elevated in the region's EM&MIs.

Growth Shifting Gears in Oil-Exporting Economies

Real GDP growth for MENA oil exporters is expected to slow from 5.7 percent in 2022 to 3.1 percent in 2023 (and to broadly maintain that pace in 2024) as the main driver of growth in most oil exporters shifts to nonhydrocarbon activities, reflecting agreed oil production cuts. Non-oil GDP is forecast to expand at a healthy clip in 2023 (about 3.7 percent), broadly unchanged from 2022, as the positive momentum in the retail and service sectors (Kuwait, Saudi Arabia, United Arab Emirates) is sustained thanks to abundant liquidity, continued reform momentum, and rapid acceleration of private investment (Saudi Arabia), partially offsetting the impact of slow growth in major trading partners.

Activity in MENA Emerging Markets to Slow

Growth in MENA EM&MIs is projected to slow from 5.1 percent in 2022 to 3.4 percent in 2023. Growth in Egypt is forecast to decelerate from 6.6 percent in 2022 to 3.7 percent in 2023 because of tight financing conditions, past exchange rate depreciation, high inflation eroding households' purchasing power, and weak external demand growth. Similarly, Pakistan's growth rate is expected to slow materially from 6.0 percent in 2022 to 0.5 percent this year, reflecting challenging macroeconomic conditions, including damage from widespread flooding, broad-based inflationary pressures, and tighter monetary and financial conditions. By contrast, Morocco is set to grow faster this year, mainly because of a rebound in agricultural output following a severe drought in 2022; growth in the nonagricultural sector is forecast to remain weak. Activity in Jordan and Tunisia is projected to remain subdued this year and next, reflecting weakening growth in their main trading partners, spillovers from the economic fallout of the war in Ukraine, tighter external and domestic financial conditions, and restrictive fiscal policies. Growth in the region's EM&MIs is projected to gradually accelerate in 2024 (to 4.4 percent in MENA EM&MIs and 3.5 percent in Pakistan) and over the medium term as some of the headwinds dissipate, provided countries sustain implementation of policy and structural reforms, particularly under IMF-supported programs (Egypt, Pakistan).

Low-Income Countries Face Worsening Fragilities

GDP growth in MENA LICs is forecast to rebound from a contraction of 0.6 percent in 2022 to a modest 1.3 percent expansion in 2023 before accelerating to 3 percent in 2024 (still lagging the rest of the region). However, growth prospects are mixed across LICs, with economic activity being driven by country-specific idiosyncratic factors in some countries, such as debt distress in Djibouti and developments in the extractive sector and tight macro policies in Mauritania. For LICs already grappling with fragility, the outlook is dominated by macroeconomic instability—protracted conflict (Yemen), drought conditions (Somalia), and political crisis and lack of financing (Sudan). More broadly, the terms-of-trade shock, persistent drought, and the cost-of-living crisis have exacerbated food insecurity in fragile LICs and pushed more people into poverty. According to the United Nation's

Integrated Food Security Phase Classification, more than half of Yemen's population (about 19 million people) and one-third of Somalia's (about 6 million people) are estimated to have experienced acute food insecurity in 2022.

A Slow Disinflation Process

Inflationary pressures in the MENA region are expected to be more persistent than envisioned in October. Headline inflation is set to remain unchanged at 14.8 percent in 2023 (14.8 percent in 2022) and to decline to about 11 percent in 2024—an upward revision of about 2.5 percentage points for both years since October. The upward revisions for the region are driven primarily by EM&MIs, particularly Egypt and Tunisia, where inflation is expected to accelerate at a faster pace after further exchange rate depreciation in the former and price liberalization and subsidy reform in the latter. Similarly, in Pakistan, inflation is projected to more than double to about 27 percent this year, reflecting broadening price pressures. For oil exporters, inflation is forecast to remain low in most countries. In the GCC, headline inflation is expected to drop from 3.3 percent in 2022 to 2.9 percent in 2023 and 2.3 percent in 2024. While headline inflation for LICs is poised to moderate, it would remain at very high levels, declining from 83 percent in 2022 to about 46 percent in 2023 and 35 percent in 2024, mainly reflecting inflation above 100 percent in Sudan in 2022 and declining to about 70 percent in 2023. The disinflation projected across the region for 2024 is primarily attributable to lower commodity prices, easing supply chain disruptions, and slowing activity because of tighter fiscal and monetary policy stances (see Chapter 2).

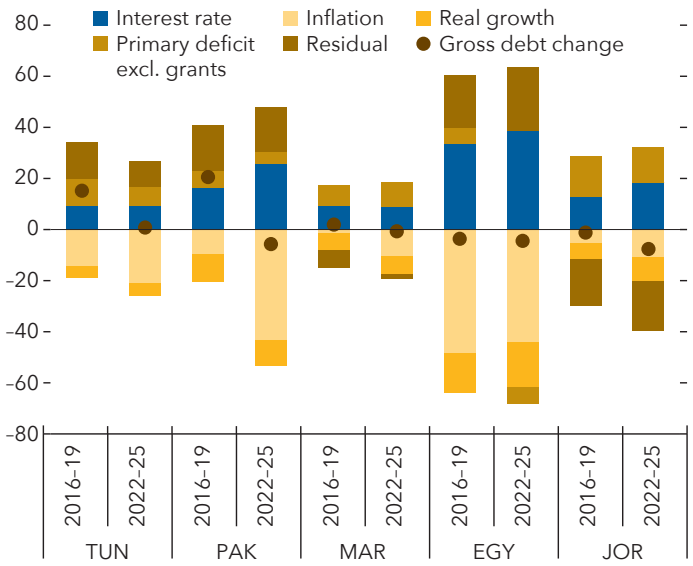
Elevated Fiscal and External Vulnerabilities for EM&MIs, Solid Buffers for Most Oil Exporters

Fiscal positions are expected to improve across the region over the next two years and the medium term as further consolidation measures are required to lower elevated public debt levels, especially in EM&MIs.

Most oil exporters are expected to continue consolidating their public finances. However, some countries will remain highly exposed to oil price volatility and may switch to overall fiscal deficits over the medium term as their breakeven fiscal prices are projected to be above the April 2023 *World Economic Outlook* oil price forecasts by 2025 (Algeria, Bahrain, Iraq).

MENA EM&MIs (especially Egypt, Jordan, and Tunisia) and Pakistan are expected to undertake meaningful fiscal consolidation, including subsidy reforms (Egypt, Morocco, Pakistan, Tunisia), with primary fiscal deficits projected to decline by about 3 percentage points of GDP on average between 2022 and 2025, in the context of IMF-supported programs for some countries (Egypt, Pakistan) or announced programs (Tunisia). However, tighter financial conditions will partly offset this fiscal effort, with interest expenses for EM&MIs projected to increase by about 1 percentage point of GDP on average over the same period. Overall, public debt-to-GDP ratios should decline in the medium term in most EM&MIs, further reflecting the erosion of the real value of public debt from persistent inflation (Egypt, Pakistan, Tunisia) and growth recovery (Figure 1.7).

Figure 1.7. MENA: Cumulative Contributions to Changes in Gross Public Debt
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes.

Public gross financing needs are forecast to decrease slightly from about $520 billion over 2021–22 to about $470 billion over 2023–24, reflecting lower primary deficits and relatively smaller domestic amortization that will offset higher interest payments. These still-high financing needs for EM&MIs are expected to be covered mainly through domestic bank financing (except in Tunisia); external financing should contribute a small portion (about 12 percent of total sources on average). The continued reliance on domestic financing will risk exacerbating the sovereign-bank nexus further, given the very high exposure of banks to sovereign debt in some MENA EM&MIs and Pakistan (more than 50 percent of bank assets at the end of 2022).

Oil exporters' current account surpluses are set to decline by about $250 billion (about 8 percentage points of GDP) between 2022 and 2024, reflecting lower hydrocarbon output and prices. Still, they will remain relatively large at about 4.7 percent of GDP in 2024. By contrast, lower commodity prices, rebounding tourism, resilient remittances, and fiscal consolidation are expected to narrow the current account deficits for MENA EM&MIs from 5.1 percent of GDP in 2022 to about 4 percent of GDP in 2024 on average. LICs' aggregate current account deficit is projected to widen from 9 percent of GDP in 2022 to about 11 percent of GDP in 2023, mainly reflecting a slump in Yemen's goods exports (following attacks on oil export facilities in October 2022) and normalization in Sudan's imports (after last year's compression).

External vulnerabilities remain elevated in the region's EM&MIs, underscored by large current account deficits and dwindling foreign exchange reserves in some countries in 2022. External financing needs for MENA EM&MIs and Pakistan are projected to stay large, though declining from about $132 billion in 2022 to $123 billion in 2023 (about 212 percent and 171 percent of gross international reserves, respectively). With many EM&MIs facing reduced access to international markets because of high public debt levels and other domestic vulnerabilities, GCC governments have stepped in to meet some of these external financing needs, including through direct budget and balance of payment supports, grants, loans, and foreign direct investment (Box 1.1).

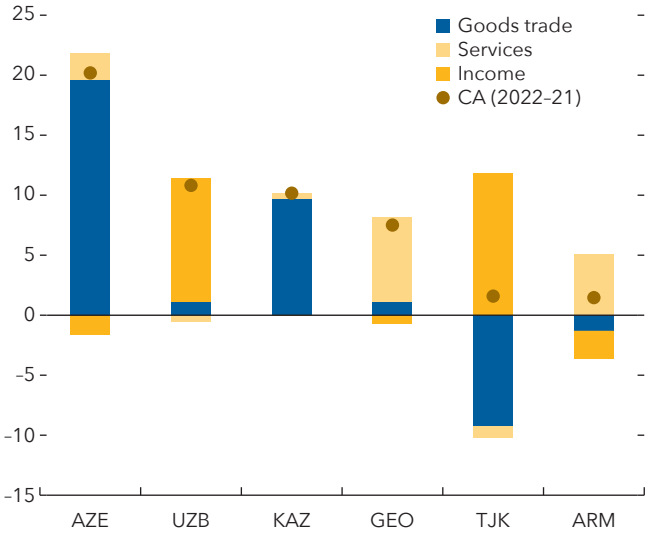
1.3. Caucasus and Central Asia: One Year into the War, Short-Term Benefits with Longer-Term Risks

Recent developments in CCA countries reflect two parallel currents: a continued post-pandemic rebound and spillovers from the war in Ukraine, including its impact on global commodity prices. A milder-than-expected contraction of the Russian economy and large inflows of income, capital, and migrants from Russia to neighboring countries and increased transit trade affected growth positively in 2022. Higher energy commodity prices contributed positively to oil-exporting countries' external balances. A better-than-expected harvest in Russia also contributed to sustained food imports, mitigating food security concerns. However, given their high share of food imports from Russia, the ruble appreciation has generated substantial imported food inflation in most CCA countries. Overall, inflation remained in the double digits because of elevated global commodity prices and wage pressures. Growth in 2023 is expected to slow as the spillovers of 2022 subside. Nonetheless, the war has introduced immense uncertainty to the economic outlook. Given the small relative size of recipient CCA economies, a reversal of inflows, worse-than-projected Russian growth, supply chain disruptions, or lower remittances could imply a negative shock to CCA economies down the road.

Positive Spillovers Drove Growth in 2022

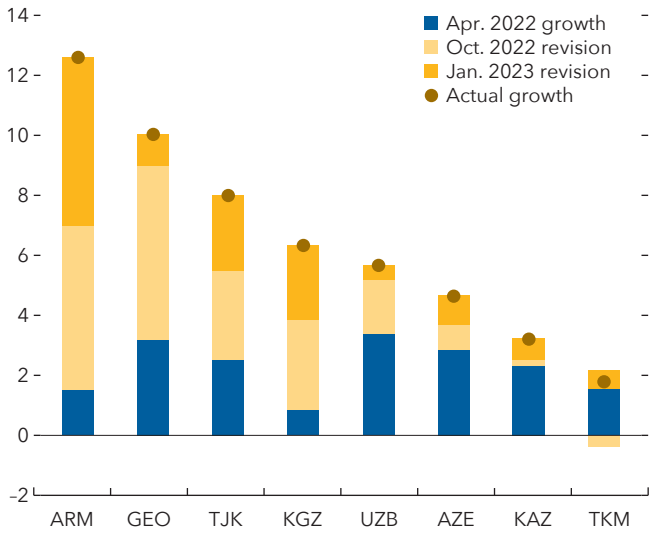
A sharp rise in private transfers from Russia and an influx of migrants from Russia supported services and boosted remittances in most CCA countries in 2022 (Box 1.2). Current account balances improved significantly across most CCA countries, reflecting a higher surplus in services (Armenia, Georgia) as tourism rebounded, higher income transfers in most oil importers, and higher oil prices in oil exporters (Azerbaijan, Kazakhstan; Figure 1.8). In response to large capital inflows from Russia, several recipient countries' banks increased liquid assets abroad

Figure 1.8. Current Account Components
(Percent of GDP; 2022:Q1–Q3 year-over-year change)



Sources: Haver Analytics; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes. CA = current account.

Figure 1.9. Real GDP Growth, 2022
(Percent change, year over year)



Source: IMF, World Economic Outlook database.
Note: Country abbreviations are International Organization for Standardization country codes.

rather than lending in foreign exchange domestically (Armenia, Georgia) to hedge against foreign exchange risks if sudden reversals were to occur. However, net foreign direct investment inflows rose across the region by about 1 percentage point of GDP on average from 2021, more than offsetting portfolio outflows.

CCA economies grew by 4.8 percent in 2022, with growth rates ranging from 12.6 percent in Armenia to 3.2 percent in Kazakhstan (reflecting oil production disruptions) and 1.8 percent in Turkmenistan (Figure 1.9). In most cases, growth was spurred by sharply higher private transfers and migrant inflows from Russia. A continued rebound in post-pandemic tourism (Armenia, Georgia) supported exports, whereas real wage growth (Armenia, Georgia, the Kyrgyz Republic, Uzbekistan) supported domestic demand. Robust growth led to a sharp reduction in unemployment rates in many countries, but unemployment remained high in Armenia, Georgia, and Uzbekistan partly for structural reasons.

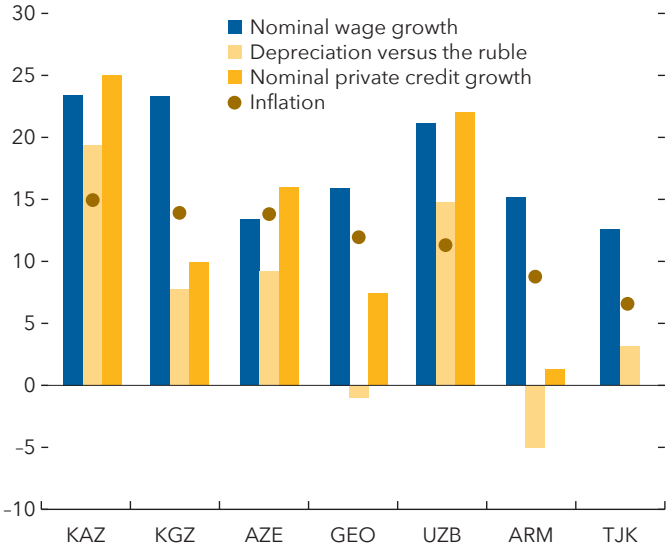
Inflation Easing in Some Countries but Persistent in Others

Since mid-2022, headline inflation has declined in Armenia, Georgia, and Tajikistan but continued rising in Kazakhstan and the Kyrgyz Republic and flattened in Uzbekistan. Inflation in Azerbaijan began to moderate slowly in September 2022 but remained in the double digits in early 2023.

While benefiting from the decline in global food and energy prices, the slowdown in inflation observed in Armenia and Georgia also reflects currency appreciation and moderate private credit growth as the transmission of tighter monetary policy and macroprudential measures started to take hold. However, core inflation is proving more persistent, reflecting strong domestic demand and rising rental prices because of migrant inflows. Similarly, the sharp disinflation in Tajikistan reflects currency appreciation, tight monetary policy, and other measures such as the release of strategic food reserves, a 3 percentage point reduction in the value-added tax rate, and strong domestic agricultural production.

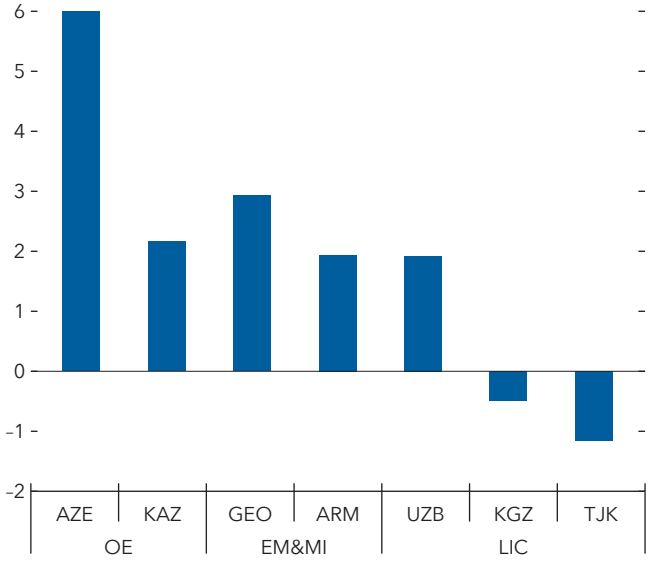
The continued rise in inflation in Kazakhstan and the Kyrgyz Republic and stubborn inflation in Azerbaijan is broad-based, with a significant imported inflation component, reflecting the high share of imports from Russia and 20–30 percent depreciation versus the ruble in 2022 (Figure 1.10). Other factors include rapid wage growth (Azerbaijan, Kazakhstan, the Kyrgyz Republic), demand pressures from migrants from Russia (the Kyrgyz

Figure 1.10. Wages, Credit, and Depreciation, 2022



Sources: Information Notice System database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes.

Figure 1.11. Change in Primary Balance, 2021–22
(Percent of GDP; non-oil balances for oil exporters)



Source: IMF, World Economic Outlook database.
Note: Country abbreviations are International Organization for Standardization country codes. EM&MI = emerging market and middle-income economies; LIC = low-income country; OE = oil exporter.

Republic), strong consumer lending despite substantial monetary tightening (Azerbaijan, Kazakhstan), and import supply-chain disruptions (Kazakhstan).

Wages are a key driver of CCA inflation dynamics. Nominal wage growth has surpassed inflation in most countries, pointing to potential price-wage spirals, which would increase inflation persistency and complicate monetary policy. Empirical estimates suggest that wage rises have a persistent impact on core inflation in CCA countries, with about a 50 percent pass-through peaking at 11 quarters following the shock, implying continued inflationary pressure.[3]

Fiscal and Monetary Policies Remain Tight

Primary fiscal positions improved significantly in 2022 in most CCA countries compared with 2021 (Figure 1.11), even while preserving essential expenditure. This improvement reflects revenue performance (Armenia, Georgia, Uzbekistan), higher non-oil revenues (Azerbaijan, Kazakhstan), and current expenditure restraint (Armenia, Kazakhstan). Exceptions include the Kyrgyz Republic and Tajikistan, where substantial loosening occurred because of a sharp increase in the wage bill, despite revenue improvements (the Kyrgyz Republic) and increases in current and capital expenditures (Tajikistan).

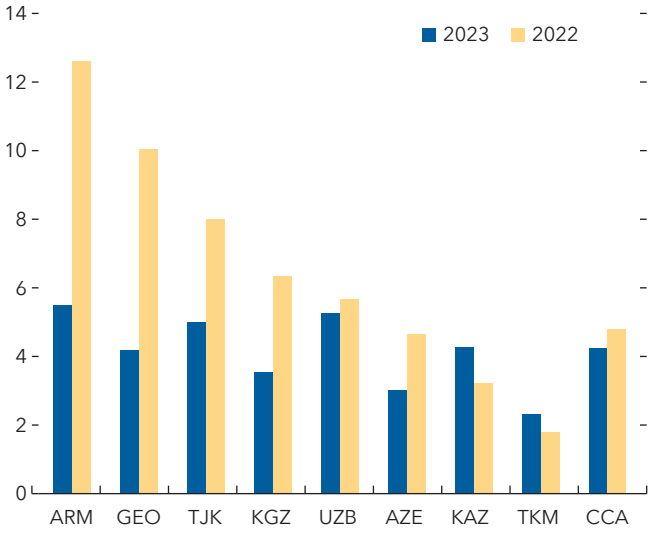
In response to continued inflationary pressures, Armenia, Azerbaijan, and Kazakhstan have tightened monetary policy further since August 2022 by raising policy rates. By contrast, the Kyrgyz Republic, Tajikistan, and Uzbekistan lowered rates—Tajikistan after a decline in inflation—and others remained on hold. The monetary stance is assessed to be appropriately tight or neutral in most CCA countries (Chapter 2).

[3] Staff estimates refer to a panel vector autoregression with two endogenous variables (wages and core consumer price index inflation) and one exogenous variable (employment). Identification is recursive with the following order: wages and core consumer price index. Countries included are Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, and Uzbekistan. The panel is unbalanced, and data start from 2015 at a quarterly frequency.

Financial System Broadly Stable

After the pandemic and the unwinding of supportive measures, banks in the region have seen their profitability recover, with the median return on assets at 3.9 percent, up from 1.1 percent since 2020. Capitalization levels have remained high, with tier 1 capital ratios at 16.7 percent, 8.1 percentage points above regulatory minimum thresholds. Nonperforming loan ratios stood at 4.4 percent on average in 2022. Most banks in the region depend on customer deposits and long-term funding, which make up more than 90 percent of total funding. However, structural vulnerabilities remain because of comparatively lower levels of loan-loss provisioning, foreign exchange exposures, and currency mismatches amid still widespread though declining dollarization.

Figure 1.12. CCA: Real GDP Growth, 2022–23
(Percent change, year over year)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes.

Stronger Trade Links with Russia

Adapting to changes in trading routes and other logistical challenges since the start of the war in Ukraine has driven an increase in CCA trade with Russia (Box 1.2). Bilateral trade data suggest that the share of trade with Russia has increased for several CCA countries (Armenia, Georgia, Tajikistan, Uzbekistan), even after controlling for higher prices associated with Russian energy imports. Similarly, the share of trade with the Eurasian Economic Union has increased for some CCA members (Armenia, Kazakhstan, the Kyrgyz Republic).

CCA Outlook

A range of global and domestic factors—notably projected growth in main trading partners (including Russia) and private transfers and migrant inflows from Russia—shape the outlook for CCA countries. Other factors include faster monetary tightening in advanced economies, the lagged impact of domestic tightening, and the decline in global energy prices.

Growth Set to Moderate

Cross-border transfers and migrant inflows are expected to decelerate significantly in 2023 compared with 2022. As a result, lower remittances and services exports will drive a deterioration in the current account balances of EM&MIs and LICs (by an average of 1.5 and 3 percent of GDP, respectively). The decline in oil prices will weaken current account balances further for oil exporters by an average of 5.4 percent of GDP.

GDP growth is projected to decelerate to 4.2 percent in 2023 before a slight rebound to 4.5 percent in 2024. The deceleration in 2023, expected to be sharp in Armenia and Georgia, reflects the decline in the initial spillovers from the war in Ukraine (Figure 1.12). The projected slowdown in LICs reflects easing remittance flows amid slowing gold and agricultural production. Similarly, non-oil activity is projected to decelerate in oil exporters (Azerbaijan, Kazakhstan) as domestic demand cools. Nonetheless, overall growth in Kazakhstan is expected to accelerate to 4.3 percent from 3.2 percent in 2022 as oil production normalizes and the expansion of the Tengiz oil field becomes operational.

Sharper Disinflation for Emerging Markets and Persistent Inflation for Others

Inflation is projected to ease in 2023 and 2024, slowing to 11.8 percent and 8.5 percent from 13 percent in 2022, but the decline will be heterogeneous across countries. For CCA emerging markets, inflation is expected to decelerate sharply—to 6.4 and 4.0 percent in 2023 and 2024, respectively, from 10.5 percent in 2022—reflecting easing global commodity prices, the lagged impact of monetary tightening, and continued appreciation. Both Armenia and Georgia are expected to reach their inflation target by 2025. For LICs, inflation is set to remain at 11 percent in 2023 before declining to 9.3 percent in 2024 as persistent pressures in the Kyrgyz Republic and Uzbekistan (because of strong wage growth) offset lower inflation in Tajikistan. Inflation in oil exporters is set to ease only slowly—to 13 percent and 8.7 percent in 2023 and 2024, respectively, from 14.3 percent in 2022—as price pressures remain elevated in Kazakhstan, reflecting high wage growth.

Moderately Looser Fiscal Policy but Tight Monetary Policy

Fiscal policy, as measured by changes in primary balances (excluding grants), is expected to loosen modestly in 2023 for Armenia (higher capital spending) and Azerbaijan (lower non-oil revenues). The Kyrgyz Republic and Tajikistan will experience a more significant loosening of 1.6 and 1.8 percentage points of GDP, respectively, reflecting a higher wage bill and subsidies (the Kyrgyz Republic) and capital spending (Tajikistan) in addition to a decline in revenues (the Kyrgyz Republic). Meanwhile, Kazakhstan is expected to maintain a neutral position, whereas Georgia is forecast to consolidate further by 0.7 percentage point of GDP. Consolidation is set to resume in 2024 for most countries, and debt pressures are forecast to remain contained. Monetary policy is expected to remain tight in the region as countries continue to fight inflation.

1.4. ME&CA Outlook: Downside Risks Remain

The balance of risks to the outlook is skewed to the downside.

Global financial sector instabilities could intensify, and contagion take hold, affecting the region adversely through several channels. Financial sector instabilities in advanced economies could depress global growth and thus ME&CA's external demand, including by contributing to more volatile oil prices. Increased volatility in financial markets would add pressures to borrowing costs and exacerbate sovereign debt sustainability concerns in many MENA EM&MIs. Structural vulnerabilities in the financial sector, such as the tight sovereign-bank nexus, could exacerbate domestic financial stability risks, whereas impairment of the banks' ability to issue credit would weaken credit recovery.

Tighter-for-longer global financial conditions and debt distress risks. Further tightening of financial conditions could prompt investors to reassess debt sustainability in many MENA EM&MIs, pushing the most vulnerable economies to the brink of debt distress. This could spur a flight to safety and capital outflows, fueling exchange rate depreciation pressures and leading to financial stress. At the same time, the pass-through to domestic borrowing rates would weigh on credit to the private sector and growth, and ultimately raise fiscal pressures further.

An escalation of the war in Ukraine could lead to high volatility in commodity markets, shortages, and renewed price increases for energy, food, and fertilizers, fueling additional inflationary pressures across ME&CA.

More entrenched inflation expectations. Renewed commodity price pressures and supply-chain disruptions could fuel further headline inflation and spread to other goods and services, particularly in the region's EM&MIs and LICs, where inflation is already high. Persistently high core inflation and price-wage spirals could de-anchor inflation expectations, prompting more monetary policy tightening—further dampening economic activity and leading to a significant slowdown in growth and financial stress.

Climate change–related risks. The risks associated with climate change have increased significantly in the region, with changing weather patterns resulting in adverse weather events such as severe heat waves, droughts (North Africa), and floods (Pakistan, Sudan). Further climate-related events can have a meaningful impact on agricultural output and overall activity and worsen food security and poverty, especially in LICs and FCS (Anderson and others 2022; Duenwald and others 2022).

Food security and increased social tensions. MENA LICs and EM&MIs with limited fiscal space and a high dependency on energy and food imports remain vulnerable to further deteriorations in food security, including from renewed increases in food prices, persistent drought, and further disruptions to food supplies. This could stoke social tensions and weigh negatively on growth, especially in LICs and FCS, where food insecurity is already elevated.

For the CCA region, a sharper-than-forecast contraction of the Russian economy, a bad harvest, a reversal in foreign exchange inflows, and lengthy disruptions of the Caspian Pipeline Consortium pipeline and regional supply chains could hamper economic activity. However, the outlook is also subject to upside risks, including resilient and rising inflows to CCA economies. The continued influx of highly skilled migrants from Russia and foreign exchange could boost demand—potentially raising overheating risks in the near term—but also lift productivity growth across the CCA region. Changing regional trade patterns, and renewed efforts to diversify trade routes, present additional opportunities.

Delays and backtracking in reform implementation, especially in EM&MIs, could weaken growth prospects in the medium term, exacerbate ongoing scarring from the pandemic, and worsen vulnerabilities. Stalling reforms with respect to the state footprint in the economy would delay private sector development.

Deepening fragmentation could exacerbate these risks by leading to more restrictions on cross-border flows of labor and capital (April 2023 *Global Financial Stability Report*) and international payments, supply disruptions, rising input costs, and financial instability and could hamper multilateral efforts to address global economic challenges faced by the region's vulnerable emerging and developing market economies.

1.5. Policies

Because growth is expected to moderate while inflation pressures persist amid heightened uncertainty from global financial stress, striking the right balance of policies will be critical. Policymakers in the region should stay the course to safeguard macroeconomic stability through tight monetary and fiscal policies while being mindful of financial stability risks. At the same time, they should accelerate structural reforms to bolster potential growth and enhance resilience and inclusion.

Monetary Policy: Regaining Price Stability amid Continued Uncertainty

Inflation is estimated to have peaked in 2022 only for some countries, and it remains elevated in many countries. Even where disinflation has started, core inflation remains stubbornly high. While tight monetary policy stances continue to work through lags (Chapter 2), additional policy rate increases in advanced economies might lead to depreciation pressures. In this context, monetary policy should be driven by the following principles:

- In countries where inflationary pressures continue and the stance is loose, a tighter monetary policy should be considered (Egypt, Pakistan, Tunisia).
- Where the stance is tight or neutral and inflation has peaked, central banks should remain data dependent and not start loosening prematurely until there are clear signs that core inflation is on a downward trajectory.

Currently, communicating the policy direction is more critical than ever. Policymakers will need to focus on enhancing communication strategies and increasing the transparency of monetary operations, including the range of additional instruments (reserve requirements), to anchor market expectations. In addition, across

all countries, strengthening monetary policy frameworks and central bank independence will be critical to bolstering central bank credibility, activating the relatively weak bank lending channel, and, more broadly, effective policy transmission (Chapter 2). Reforms to deepen the financial sector should allow for a greater role of the policy rate as the key transmission instrument by strengthening the lending channel and relying less on exchange rate management.

Preserving Financial Stability

The region's banking sector weathered the pandemic well—profitability has recovered, and liquidity and capital buffers are high. But central banks should be mindful of financial stability risks amid heightened global financial stress and closely monitor financial system vulnerabilities that could arise from continued monetary tightening. Bank supervisors should ensure that banks have governance and risk management commensurate with their risk profile, including adequate supervisory capital and liquidity stress tests, while strengthening resolution regimes and crisis management frameworks.

Fiscal Policy: Prioritizing Targeted Support to the Vulnerable while Preserving Debt Sustainability, Building Buffers, and Supporting Monetary Policy

Elevated debt levels, support measures to address the cost-of-living crisis, and higher debt servicing costs imply a constrained fiscal space for many EM&MIs. Meanwhile, the forecast decline in oil prices will diminish revenues for oil exporters. In the near term, and where fiscal space permits, countries should prioritize targeted and temporary support, with cash transfers to protect the most vulnerable from still-high energy and food prices. Poorly targeted subsidies should be phased out gradually and social safety nets strengthened and expanded.

- Oil exporters should manage oil revenue carefully, avoid expanding current expenditures, and improve budget transparency. Fiscal efforts should address the challenges posed by climate change, the energy transition, and economic diversification by continuing non-oil revenue mobilization with reforms to increase the efficiency of tax collections and wage bill rationalization.
- Fiscal consolidation in EM&MIs should continue to be anchored on a downward debt path, supported by revenue mobilization (including removing tax exemptions) and expenditure containment measures such as refraining from untargeted subsidies and wage bill expansions. CCA countries need to maintain a prudent fiscal stance to build buffers, given the risk of a sudden reversal in war-related positive spillovers. Improving fiscal institutions—particularly budget process transparency—and adopting credible medium-term fiscal frameworks, including fiscal rules, can ease the burden of adjustment, facilitate access to external financing, and reduce fiscal vulnerabilities on a lasting basis (October 2019 *Regional Economic Outlook: Middle East and Central Asia*).
- The lack of fiscal space to protect the vulnerable in LICs and FCS demands of the international community's support and global cooperation to prevent a humanitarian crisis in many countries as acute food insecurity and poverty persist.

Structural Policies: Maximizing Potential Growth amid a Changing Geopolitical Landscape

The adoption of tight monetary and fiscal policies, though necessary, can weigh on growth. Therefore, it will be important for countries to pursue structural reforms that raise potential growth by bolstering private sector development and increasing the benefits from trade.

- Bolster private sector development reforms to maximize potential growth and attract much-needed investment and facilitate job creation. GCC countries are progressively investing in the MENA region and Pakistan in energy infrastructure, renewable energy, health care, and agriculture (Box 1.1). Although only a few countries have received investments to date, reforms to make the private sector more investment-friendly—for example,

reducing state-owned enterprises' outsize role in the economy, leveling the playing field across all economic agents, lifting red tape, and liberalizing the labor market—would improve investment prospects in these areas and foster employment.

- Rethink trade policy to improve resilience. Exposure to climate change with its impact on agriculture production and geopolitical fragmentation risks have highlighted the vulnerabilities of a non-diversified product and destination trade structure (IMF, forthcoming). In the CCA region, the dislocation of trade routes and supply chain disruptions that followed the war in Ukraine highlight the importance of continuing efforts that actively pursue partner diversification to strengthen resilience to future adverse shocks. A parallel effort should be made to reduce trade restrictions that prove distortive and exacerbate global price pressures.
- Ramp up diversification and decarbonization. Countries can invest public resources in renewable energy sources and climate-resilient infrastructure and enact measures that raise the effective carbon rate (including by phasing out subsidies). Cross-country cooperation can support the effectiveness of a country's climate policy, but international cooperation is crucial to address binding capacity and funding bottlenecks (Anderson and others 2022; Duenwald and others 2022).

IMF Support

The IMF remains a steadfast partner of ME&CA through policy advice, financing, and capacity development. Since January 2020, the IMF has approved $29.3 billion of new financing for ME&CA countries, including recent programs for Armenia (Stand-By Arrangement), Egypt (Extended Fund Facility), Mauritania (Extended Credit Facility and Extended Fund Facility), and Morocco (Flexible Credit Line). The IMF has also recently established the Resilience and Sustainability Trust to support low-income and vulnerable middle-income countries in addressing longer-term challenges, including climate change through the Resilience and Stability Facility. In addition, to help address the ongoing food crisis facing the IMF's most vulnerable members, the IMF has enhanced its emergency lending toolkit with the newly approved Food Shock Window that allows easier financial access for countries facing food-related balance of payment pressures. The IMF has also increased its presence in the field by expanding Resident Representative offices, reopening its Middle East Regional Technical Assistance Center, and setting up a new regional office in Riyadh, which will strengthen the partnership with the region. The upcoming IMF–World Bank Annual Meetings in Marrakech in the fall of this year will also provide a platform for wide-ranging policy discussions on challenges facing the region and the world.

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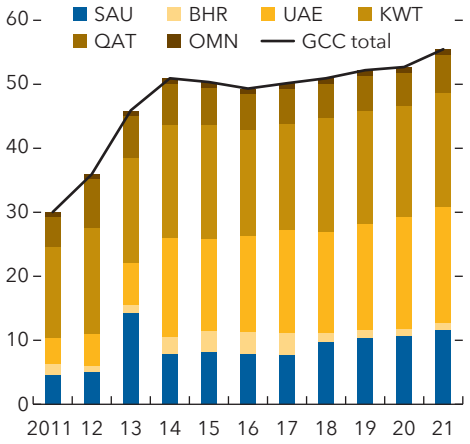
Box 1.1. The Growing Financial Footprint of the Gulf Cooperation Council in the Middle East and North Africa and Pakistan

Building on their long-standing history supporting the Middle East and North Africa (MENA) region and Pakistan, the Gulf Cooperation Council (GCC) countries have expanded and diversified their financial ties with the region in recent years through official financing (deposits and loans), investment, and remittances.

During 2018–22, GCC countries provided about $54 billion[1] in balance of payments and budget financing to MENA emerging market and middle-income economies (EM&MIs) and Pakistan, with additional support planned. They have also supported the region's low-income countries and fragile and conflict-affected states through debt relief, including under the G20 Debt Service Suspension Initiative and the Heavily Indebted Poor Countries Initiative. GCC debt relief to MENA countries (Djibouti, Mauritania, Somalia) and Pakistan totaled about $1.3 billion at the end of 2022. In response to higher international food prices, GCC members committed humanitarian support to countries facing food insecurity, including through a $10 billion package launched by the Arab Coordination Group. They have also expanded their financial support by contributing to multilateral institutions, including IMF loan facilities (Poverty Reduction and Growth Trust) and partnerships between the World Bank and GCC bilateral and multilateral financial institutions. As more financial support is channeled through or in collaboration with multilateral institutions, GCC financing is expected to support economic reforms in recipient countries.

Box Figure 1.1.1. MENA and Pakistan: Inward Direct Investment Position
(Billions of US dollars)



Source: IMF, Coordinated Direct Investment Survey.
Note: Country abbreviations are International Organization for Standardization country codes. GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

In addition to official financing, GCC countries have significantly increased their foreign direct investment (FDI) into MENA economies and Pakistan over the past decade, estimated at $55 billion in 2021 (about 1.6 percent of GDP), an increase of 85 percent since 2011 (Box Figure 1.1.1).[2] GCC investment is spread across most EM&MIs of the region, but Morocco has received the lion's share, totaling $13 billion in 2021. Quarterly data suggest that the upward momentum of FDI continued in early 2022. The increase in inward FDI from the GCC supports private investment, productivity, and growth in recipient countries and, in some cases, helps meet external financing needs, contributing to shared regional macroeconomic stability.

The strong expansion in economic activity across the GCC, mainly because of higher oil prices, has boosted labor demand, supporting higher-income and employment opportunities, including for migrant workers. As a result, inward remittances in countries with strong ties to the GCC (Egypt, Jordan, Pakistan, and, to some extent, Lebanon) rose in 2021 and remained high in the first half of 2022 (Box Figure 1.1.2). These trends, which in some cases also reflect robust flows from other major remittances-sending

Prepared by the Gulf Cooperation Council division, Olivier Bizimana, and Sahra Sakha.

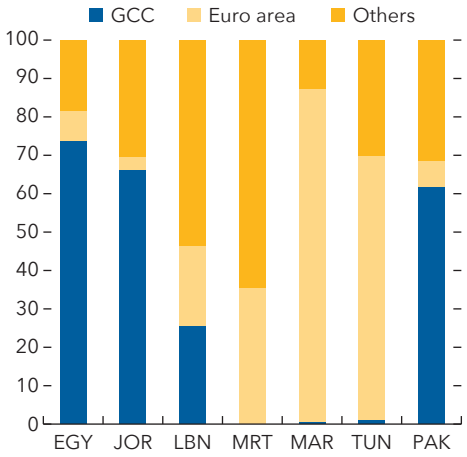
[1] These numbers are from a survey of IMF country teams and are likely an underestimate of the actual support given limited information available to IMF staff.

[2] These figures reflect total FDI from GCC countries, including flows from GCC countries to other GCC countries.

Box 1.1. *(continued)*

regions (Europe), have helped to alleviate pressure on the external accounts and the cost-of-living crisis affecting many households in MENA EM&MIs and low-income countries, supporting consumption growth and economic activity.

Box Figure 1.1.2. MENA and Pakistan: Remittances: Main Sources and Recipients, 2021
(Share in total inflows, percentage)



Sources: IMF, Coordinated Portfolio Investment Survey.
Note: Country abbreviations are International Organization for Standardization country codes. GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

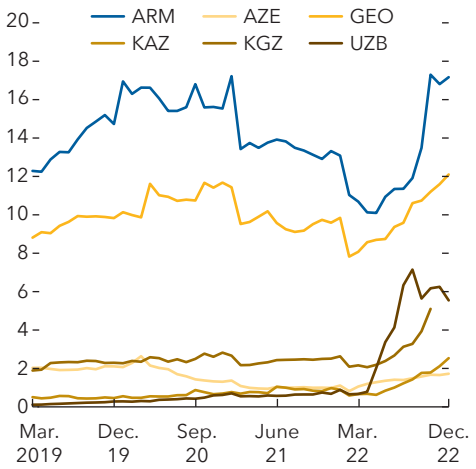
Box 1.2. Unexpected Spillovers from the War in Ukraine amid Heightened Risks

Over the past two decades, Russia and Caucasus and Central Asia (CCA) countries have experienced synchronous growth, mainly reflecting their strong trade and financial ties. Nonetheless, Russia's contraction in 2022 did not drive a downturn in economic growth in CCA economies. Instead, most CCA countries experienced a substantial boost from unexpected positive externalities. Understanding the nature and durability of these spillovers is important to assess potential risks and inform future policy.

Private inflows rose significantly. Net money transfers from Russia to Armenia, Georgia, and Azerbaijan increased more than fivefold year over year in 2022, reaching 17, 8, and 3 percent of GDP, respectively. Tajikistan and Uzbekistan also saw a doubling of net remittances, with the increase ranging from 13 to 23 percent of GDP. By contrast, net remittances inflows to the Kyrgyz Republic, historically dependent on migrant workers' remittances from Russia, declined by about 6 percentage points of GDP in 2022. The scale of these inflows is macro-critical for some countries, and uncertainty over their future size and pace constitutes a risk.

Given their size, the channeling of private transfers via the banking system also has financial stability implications and will require close monitoring. Nonresident deposits have increased by 4 to 8 percentage points of GDP in Armenia, Georgia, and Uzbekistan, reaching 6 to 18 percent of GDP and similar values as a percent of total banking system assets (Box Figure 1.2.1). So far, banks have followed a prudent approach by boosting liquidity buffers and hedging against a potential flight risk rather than intermediating these funds into domestic lending.

Box Figure 1.2.1. CCA: Nonresident Deposits
(Share of GDP)



Sources: IMF, Integrated Monetary Database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes.

War-related immigrant inflows, while boosting demand, have increased price pressures in rental and property markets. Migrants from Russia relocating to CCA countries (mainly Armenia, Georgia, Kazakhstan, and Uzbekistan) range between 50,000 and 150,000, comprising up to 5 percent of the host country's population. This has strained rental markets in Georgia and Kazakhstan, with rental prices rising by more than 20 percent year over year in real terms by the end of 2022, raising pressures in already high-inflation environments.

Sanctions against Russia and the dislocation of trade routes have created complex incentives, resulting in closer ties between Russia and some CCA countries (Armenia, Georgia, Tajikistan, and Uzbekistan; Box Figure 1.2.2). The share of Kyrgyz Republic exports to Russia has doubled, rising from 14 percent of total exports in 2021 to 34 percent in the first nine months of 2022. Sanctions have destabilized traditional trade (rail) routes between China and the European Union, diverting trade routes away from Russia toward neighboring countries. This

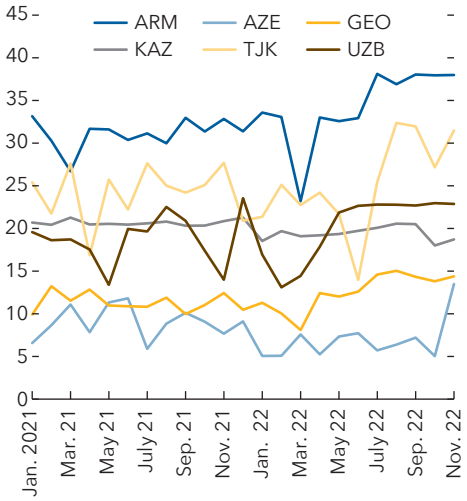
Prepared by Jeta Menkulasi.

Box 1.2. *(continued)*

reconfiguration implies increased transit trade (Armenia, Georgia, the Kyrgyz Republic). Growing trade with Russia exposes CCA countries to a potential worsening of the war and a sharper Russian contraction and deeper sanctions.

Box Figure 1.2.2. CCA: Trade with Russia

(Percent of total trade, three-month moving average)



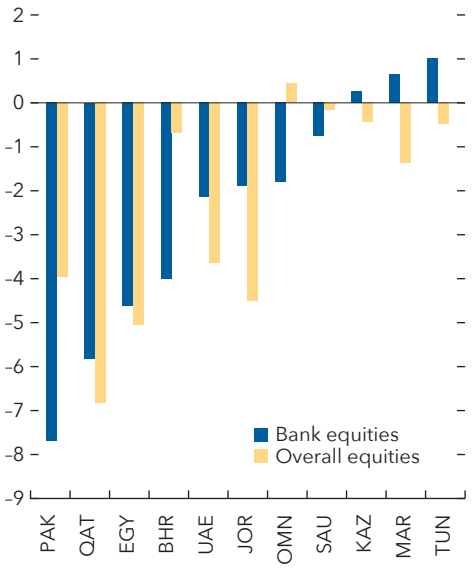
Source: IMF, Direction of Trade Statistics.
Note: Trade shares are total exports and imports with Russia as a percent of total exports and imports with the world. Country abbreviations are International Organization for Standardization country codes.

Box 1.3. The Impact of Global Financial Turmoil on the Middle East and Central Asia

Countries in the Middle East and Central Asia (ME&CA) have been affected by the turbulence in global financial markets and increased policy uncertainty, although direct exposure to US and European banks is limited. Further bouts of financial turbulence would reinforce strains, particularly in countries with large debt burdens.

Transmission channels of contagion are varied. While direct spillovers to ME&CA banks have been marginal, reflecting no direct exposure to Silicon Valley Bank and only a limited one to Credit Suisse, there is uncertainty over potential capital losses given the prevalence of hold-to-maturity portfolios. However, such a risk is mitigated by the large reliance of ME&CA banks, with a few exceptions, on customer deposits and long-term funding, including sizable government deposits (particularly in Gulf Cooperation Council countries). ME&CA economies could be indirectly impacted through a deeper deceleration of global economic growth from tighter global lending standards and its impact on oil price volatility.

Box Figure 1.3.1. Equity Markets
(Index points; percent change since SVB's collapse)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Data refers to March 15, 2023. Country abbreviations are International Organization for Standardization country codes. SVB = Silicon Valley Bank.

So far, financial markets in the region have moved in line with global trends, though countries with large debt burdens have seen a larger impact. Equity markets have declined across most of the region, with Egypt, Jordan, Oman, Pakistan, and Qatar experiencing the largest declines. Bank equities were most affected in Egypt, Gulf Cooperation Council financial hubs, and Pakistan (Box Figure 1.3.1). Bond spreads widened significantly for Pakistan, Tunisia, and to a lesser extent in Egypt, and currencies have broadly gained on US dollar weakness, while some Central Asian currencies (Kazakhstan, the Kyrgyz Republic) have weakened with the Russian ruble.

Further stress could test ME&CA countries. Additional bouts of global financial market turbulence would strain private and public sector funding, especially in countries with large debt burdens. Capital flow reversals, including the inability to access external markets, would increase the reliance of the public sector on domestic bank financing, further exacerbating bank-sovereign interlinkages. Banking systems could face liquidity risks as financial conditions tighten further, forcing asset sales that could result in bank capital losses and undercapitalization in some cases. Lending to firms and households would decline, eroding assets quality, dragging down growth, and further straining bank capital. In highly dollarized economies, such as in the Caucasus and Central Asia, capital outflows and weaker currencies could result in heightened credit risk and balance sheet strains. Lastly, sustained oil price volatility could weigh on oil exporters' external and fiscal balances and undermine financial market conditions, and prolonged global policy uncertainty could drag consumer and investor sentiment and ultimately depress economic activity.

Prepared by Bashar Hlayhel, Thomas Kroen, and Roy Randen.

2. Monetary Policy: Where Does the Middle East and Central Asia Stand?[1]

The monetary policy response of Middle East and Central Asian (ME&CA) countries to the 2021–22 surge in inflation has varied widely. The current stance is appropriately tight or neutral for many countries using a policy rate, but it needs further tightening in others. The response to the latest inflation shock has been in line with or, in some cases, even more forceful than during previous inflation episodes. Nevertheless, in several countries monetary policy implementation continues to be undermined by a lack of coordination with fiscal policy or fiscal dominance. Monetary policy transmission in countries with floating or managed exchange rate regimes is stronger than in those with a peg, it operates mainly through the exchange rate channel, and the credit channel is relatively weak. Even countries that have responded appropriately would benefit from strengthening monetary policy frameworks and fostering financial development. Activating additional transmission channels would enhance central bankers' ability to fight inflation while reducing their economic costs. In addition, greater exchange rate flexibility and the use of macroprudential policies could help strengthen monetary policy effectiveness. In countries where state-owned banks play an important role in financial intermediation, policymakers should also reduce their quasi-monetary and quasi-fiscal activities to improve transmission.

2.1. Introduction

Restoring price stability remains a key policy challenge for ME&CA countries. Inflation surged over the past two years, reflecting a combination of demand and supply factors, including a rise in food prices and disruptions to global supply chains (April 2022 *Regional Economic Outlook: Middle East and Central Asia*). Inflation may have peaked in several countries (see Chapter 1), but food and energy prices are still high relative to their pre-pandemic levels, inflation is above target in most countries that have a target, and core inflation remains stubbornly elevated.

This chapter assesses what central banks should do next to restore or maintain price stability. Central banks have responded to rising inflation with a series of monetary policy actions, including increasing policy interest rates. Whether this tightening was sufficient to control inflation depends on various factors, including how the increase in nominal rates has translated into increases in real rates, the level of the natural rate of interest, monetary policy transmission lags, and the effectiveness of monetary transmission. Furthermore, the appropriateness of the monetary policy stance depends on factors beyond policy interest rates (for example, on financial conditions more broadly, including longer-term interest rates and net capital inflows). Several standard methods are used to assess the monetary policy stance and estimate its impact on inflation, the strength of its main transmission channels, and the lags with which monetary policy operates.[2]

[1] Prepared by Will Abel, Mohamed Belkhir, Vizhdan Boranova, Rodrigo García-Verdu (lead), Filippo Gori, Bashar Hlayhel, Thomas Kroen, Troy Matheson (lead), and Christine Richmond, with excellent research assistance from Azhin Abdulkarim.

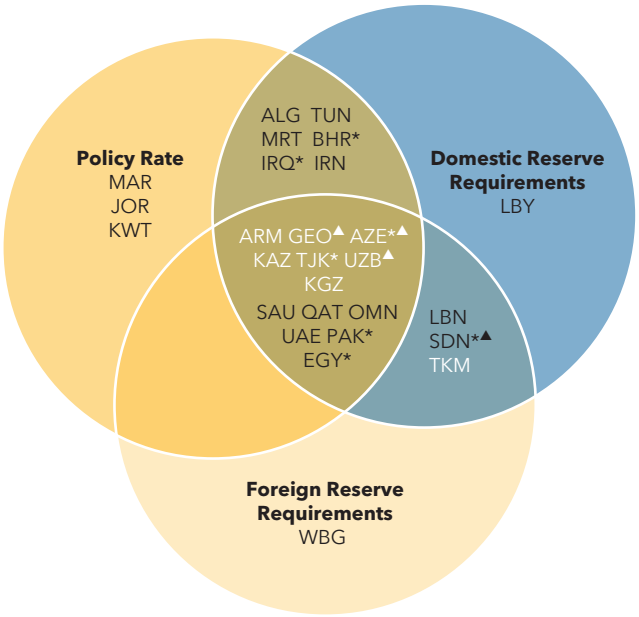
[2] Because of data limitations, this chapter does not cover some important aspects of monetary policy, including the inflation expectations channel of monetary policy. Also, the evolution of nominal and real wages and measures of labor market slack, which are important determinants of inflation, are not analyzed.

2.2. Monetary Policy Instruments and Recent Actions

Policy interest rates and reserve requirements are the main monetary policy instruments in the region.[3] Two-thirds of ME&CA central banks use a policy rate to signal their monetary policy stance, while nearly three-quarters of central banks use reserve requirements on domestic currency liabilities as an instrument of monetary policy and slightly more than half use them on foreign currency liabilities. However, countries vary in their instrument mix and use (Figure 2.1). Most central banks raised policy rates over the past two years, although by varying degrees (Figure 2.2). While most central banks kept reserve requirement rates unchanged relative to their averages in the first half of 2021, during 2021–22, seven raised reserve requirement rates on domestic currency liabilities and four on foreign currency liabilities. However, in most instances, these changes reflected the unwinding of COVID-19-related measures.[4]

In addition to raising policy rates and reserve requirements, over the past two years, most of the region's central banks have acted to mop up excess liquidity, including by issuing their own securities, selling government securities, engaging in reverse repurchase agreements, and intervening in foreign exchange markets by selling foreign currency (Online Annex 1). However, they have made limited use of macroprudential tools (about half of central bank actions were related to unwinding pandemic-related measures). On the communications front, almost two-thirds of central banks publish a communiqué after a monetary policy decision, while only a few provide forward guidance on interest rates. Lack of coordination between monetary and fiscal policies

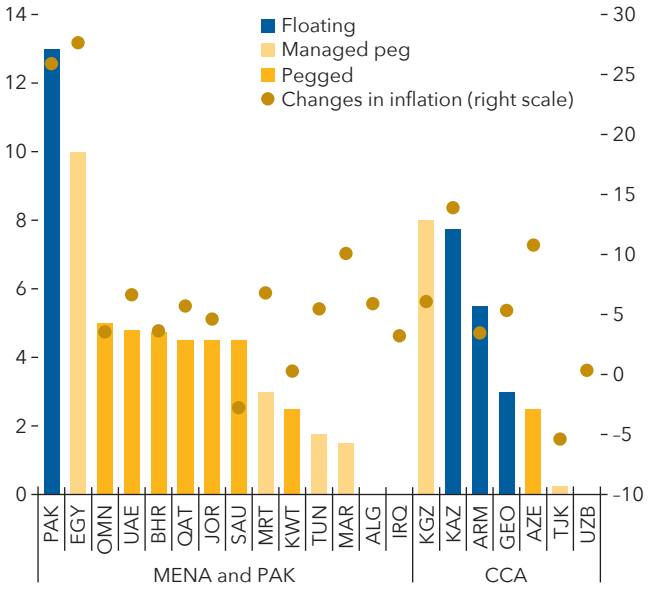
Figure 2.1. ME&CA Central Banks' Instruments



Source: IMF desk survey.
Note: Country names in black font are Middle East and North Africa, and Pakistan; country names in white font are Caucasus and Central Asia. Countries with a * increased their domestic currency reserve requirements and with a ▲ increased their foreign currency reserve requirements since January 2021. Country abbreviations are International Organization for Standardization (ISO) country codes. ME&CA = Middle East and Central Asia.

Figure 2.2. ME&CA: Change in Policy Interest Rates and Inflation

(Percent, January 2021 to latest)



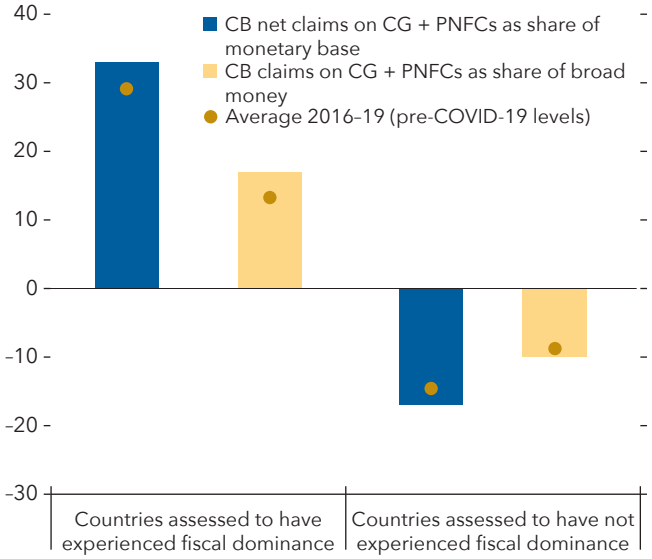
Sources: Haver Analytics; and IMF staff calculations.
Note: Data on policy rates are as of March 31, 2023. Data on inflation are as of February 2023 except for Bahrain (January 2023) and Tajikistan and United Arab Emirates (December 2022). Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucusus and Central Asia; MENA and PAK = Middle East and North Africa, and Pakistan; ME&CA = Middle East and Central Asia.

[3] See Poghosyan and others (forthcoming) for a more complete characterization of monetary policy frameworks in the Caucasus and Central Asia, including the legal and accountability framework of central banks in the region.

[4] Egypt's decision to raise the required reserve ratio from 14 percent to 18 percent in September 2022 was for monetary policy purposes.

and fiscal dominance hamper monetary policy effectiveness.[5] These are present in about half of ME&CA countries, resulting in an inconsistent policy mix likely to thwart central bank efforts to control inflation. Moreover, the incidence of fiscal dominance has increased in several countries over the past two years, reflecting the pandemic, Russia's war in Ukraine, and tighter external financing (Figure 2.3; Online Annex 1).

Figure 2.3. Central Banks' Net Claims on Central Government and Claims on Public Nonfinancial Corporations
(Percent, 2020–21 average)



Sources: IMF, International Financial Statistics database; and IMF staff calculations.
Note: The classification of the countries that experienced fiscal dominance and those that did not is based on IMF country teams' assessment. See Online Annex 1 for details. CB = central bank; CG = central government; PNFCs = public nonfinancial corporations.

2.3. Assessing the Monetary Policy Stance

This section assesses whether current monetary policy stances in ME&CA are tight or loose relative to two benchmarks and whether monetary policy actions (including higher policy interest rates) and external conditions have translated into tighter domestic financial conditions. First, estimates of natural rates in ME&CA countries were compared with the current policy rate using two different methods. Next, an assessment was made of how the current monetary policy stance compares with that implied by a flexible monetary policy rule that can fit different monetary and exchange rate frameworks. Finally, the section presents the results of an estimation of a financial conditions index (FCI) for ME&CA.

What Is the Current Monetary Policy Stance?

Central banks across the region have tightened monetary policy using a variety of instruments, the most important of which is raising policy interest rates. But are these rates above or below levels consistent with stable economic growth and inflation—that is, their "natural" levels? Or do they need to rise further to stabilize inflation?

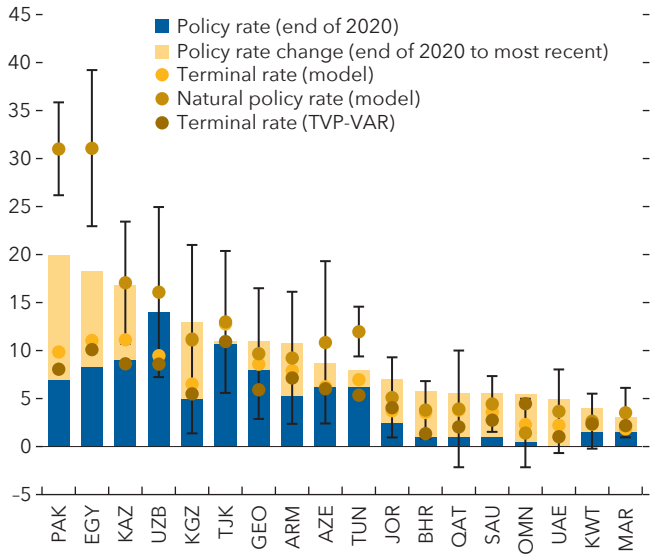
Natural rates are useful to gauge the monetary policy stance, but their estimates are subject to significant uncertainty.[6] The natural rate refers to the interest rate that neither stimulates nor contracts the economy and is consistent with output at potential and stable inflation. However, natural rates are notoriously difficult to measure in real time because they are unobservable, differ across countries, and are subject to short-term volatility. This chapter defines two different measures of natural rates: a short-term rate and a long-term rate. The short-term rate—the natural policy rate—is defined as the real natural rate plus one-year-ahead inflation expectations from World Economic Outlook databases; this indicates where nominal rates should be to stabilize inflation in the short term.[7] The long-term rate—the terminal rate—is defined as the real natural rate plus five-year-ahead inflation expectations from World Economic Outlook databases; this is an estimate of where nominal rates will eventually converge when inflation is at its long-term desired level. Natural rates are estimated using two methods: a small

[5] Fiscal dominance is defined as subordination to fiscal policy of monetary policy and its primary goal of maintaining price stability, generally with the objective of contributing to financing the fiscal deficit. It may be difficult to measure, depending on the form it takes. See Online Annex 1 for a discussion on some of the forms it can take.

[6] The uncertainty surrounding natural rate estimates has implications for the conduct of monetary policy. See Online Annex 2 for a discussion.

[7] In other words, it is the policy rate required to prevent changes in real interest rates. Monetary policy is contractionary or tight when the policy rate is higher than the natural policy rate and expansionary or easy when the policy rate is lower than the natural policy rate.

Figure 2.4. Nominal Policy Interest Rates
(Percent)



Source: IMF staff calculations.
Note: The ranges around the natural policy rate estimates reflect one standard deviation confidence intervals based on the estimated model and one-year-ahead inflation forecast errors from World Economic Outlook databases. Country abbreviations are International Organization for Standardization (ISO) country codes. The cutoff date for the policy rate changes is March 31, 2023. TVP-VAR = time-varying parameter vector autoregressions.

semistructural open economy model that jointly estimates natural rates, potential output, and the equilibrium exchange rate; and a time-varying parameter vector autoregression.[8]

Point estimates of natural policy rates suggest that the monetary policy stance was appropriately tight or neutral in many countries in early 2023. However, monetary policy remains loose (policy interest rate below natural policy rates) and may need to be tightened further to stabilize inflation in some countries (Egypt, Pakistan, Tunisia; Figure 2.4).[9] Once short-term inflation pressures are contained, policy interest rates—currently well above estimates of terminal rates—will eventually converge to lower levels.

How Does Recent Monetary Policy Tightening Compare with Peers and Earlier Responses?

The analysis in the previous section sought to determine whether current policy interest rates are above their natural levels and thus disinflationary. This section focuses on assessing the reaction of central banks to price pressures to characterize how monetary policy has tightened with respect to coincident and expected price dynamics.

To do so, the policy reaction of ME&CA central banks was benchmarked using a historical and cross-country comparison. Simple reactive interest rate rules were identified using two different monetary policy reaction benchmarks—the monetary policy reaction of ME&CA countries over the last two decades as estimated by a monetary policy rule, and the corresponding reaction of a subset of emerging market central banks that engaged in the early and relatively successful adoption of inflation-targeting regimes—the emerging market and developing economy (EMDE) benchmark (see Online Annex 3).

The exercise shows positive monetary rule residuals since 2021 for countries with an inflation-targeting regime and conventional peggers,[10] suggesting that these countries increased policy interest rates more than when facing previous shocks of comparable magnitude (Figure 2.5). In countries with an inflation-targeting monetary policy framework (all in the Caucasus and Central Asia), the rise in policy interest rates was also consistent with the EMDE benchmark. This suggests that their monetary policy response to the recent inflation surge was consistent with a steadfast commitment to fighting inflation pressures; it also reflects improvements in their monetary policy frameworks relative to the past. Conversely, countries with other monetary frameworks (Egypt, Tunisia) increased interest rates consistent with their historical norms and less than the EMDE benchmark, suggesting that they are less reactive to inflation developments than other peers, likely because the trade-offs in these countries between higher interest rates and debt sustainability are critical.

[8] See Online Annex 2 for model details and estimation results.

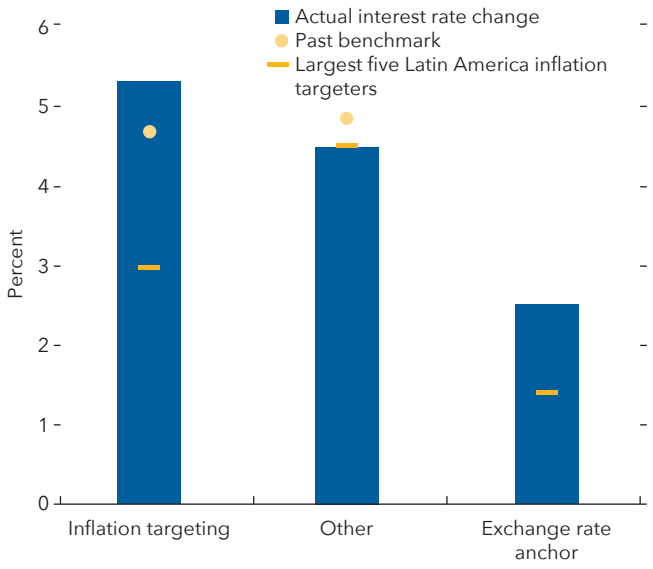
[9] See the section titled "The Monetary Policy Transmission Mechanism in ME&CA" for estimated impacts on inflation from higher policy rates.

[10] For countries with a conventional peg exchange rate framework, changes in interest rates reflect the uncovered interest rate parity condition (see Online Annex 3 for more details).

How Have Financial Conditions Changed?

The previous subsections documented that in ME&CA countries, the current monetary policy stance—measured by policy interest rates—is tight or neutral for many countries but loose for others and that the rise in policy interest rates since 2021 has been approximately consistent with domestic and international benchmarks. This section complements the analysis by characterizing the evolution of domestic financial conditions at a time when rises in policy interest rates and other tightening measures, including reserve requirements, have coincided with a period of large capital inflows (for example, Caucasus and Central Asia countries) or asset price appreciation (for example, Gulf Cooperation Council countries). This analysis is important to determine the extent to which monetary policy tightening has transmitted to financial conditions, which have an impact on demand and ultimately on prices.[11] To do so, a monthly nominal FCI was estimated for 14 ME&CA countries using indicators that provide a comprehensive measure of financial conditions in money, debt, and equity markets and from conditions stemming from external factors (see Online Annex 4).

Figure 2.5. Difference between Actual and Rule-Based Policy Interest Rate Changes
(2021:Q1–22:Q4)



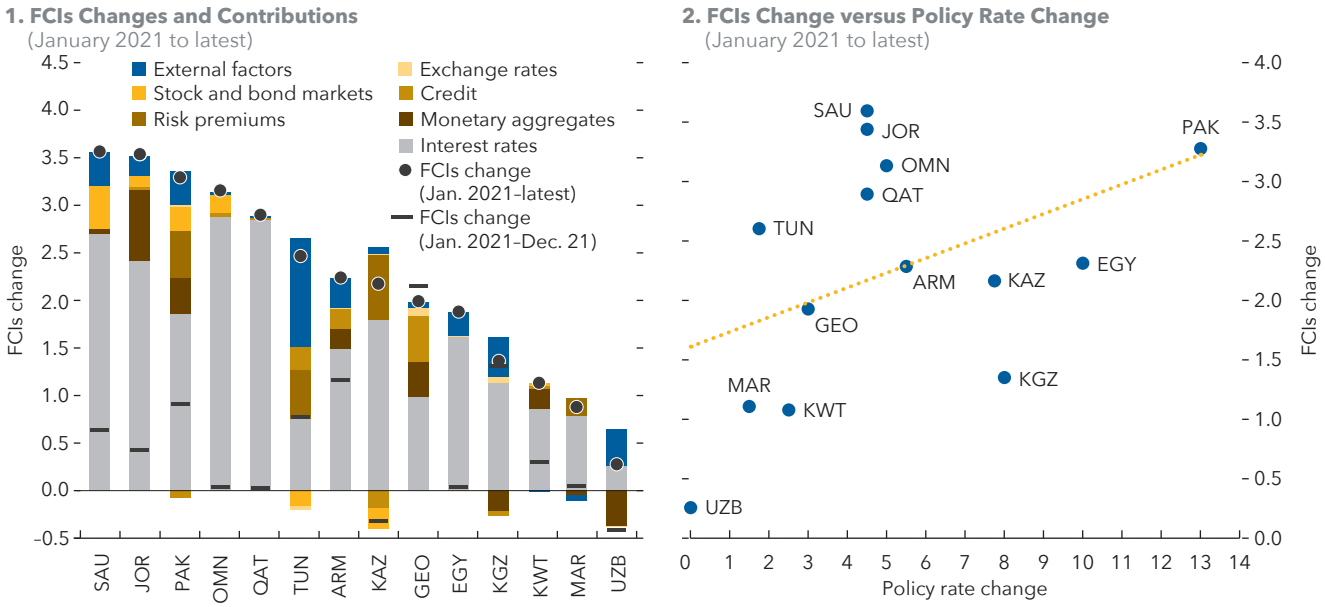
Source: IMF staff calculations.
Note: Bars represent actual changes in interest rates from the first quarter of 2021 through the fourth quarter of 2022. Other marks represent predicted changes from two benchmark monetary policy reaction functions estimated for (1) individual countries (horizontal bars) and (2) the five largest Latin American economies with an inflation-targeting monetary policy framework (Brazil, Chile, Colombia, Mexico, Peru). We call this the emerging market and developing economy benchmark. Countries considered in the analysis are Egypt and Tunisia (other); Armenia, Georgia, and Kazakhstan (inflation targeting); and Bahrain, Jordan, Kuwait, Morocco, Oman, Qatar, and Saudi Arabia (exchange rate anchor).

Financial conditions in some advanced economies have eased somewhat in recent months, but they remain tight in ME&CA relative to two years ago. Nevertheless, financial conditions have tightened in recent weeks following bank stress episodes in a few advanced economies. The results show that the FCI co-moves positively with policy interest rates and that financial conditions have tightened across ME&CA since the end of 2021, although with significant heterogeneity across countries, driven mainly by a sharp rise in overall interest rates and changing global factors (Figure 2.6, panel 1).

The relationship between increases in policy interest rates and tighter financial conditions is positive but dispersed across the region (Figure 2.6, panel 2). A widely diverse reaction of financial conditions to changes in policy interest rates partially reflects ME&CA central banks' use of different instruments to tame recent inflation pressures. However, it is also consistent with relatively large heterogeneity in the monetary transmission channel, including the magnitude and timing of interest rate pass-through.

[11] The impact of financial conditions on inflation is determined by various factors, including market structure and price frameworks (including the presence of administrative prices or price subsidies). The overall impact of interest rates on prices is covered in the next section on monetary policy transmission channels.

Figure 2.6. ME&CA: Financial Conditions Indices



Sources: Bloomberg Finance L.P.; Haver Analytics; IMF, International Financial Statistics database; national authorities; and IMF staff calculations.
Note: Data on policy rates are as of March 31, 2023. The latest data point for FCIs is December 2022 except for Egypt and Morocco (January 2023), Tunisia and Uzbekistan (February 2023), and the Kyrgyz Republic (October 2022). Country abbreviations are International Organization for Standardization (ISO) country codes. FCIs = financial conditions indices; ME&CA = Middle East and Central Asia.

2.4. The Monetary Policy Transmission Mechanism in ME&CA

How Does Monetary Policy Tightening Reduce Inflation?

Monetary policy tightening reduces inflation and output, although with heterogeneity across exchange rate regimes.[12] Figure 2.7 reports estimates of the peak impact of monetary policy tightening on inflation and real GDP, with countries grouped according to their exchange rate regime. The estimated effects are the largest in countries with floating exchange rates and managed pegs, while the responses are more muted for countries with pegged exchange rates, suggesting that the exchange rate channel might be key for the transmission of monetary policy for countries in the sample.[13] Looking across countries, peak effects on quarterly inflation occur between one and three quarters after a monetary shock, with inflation eventually reaching half of the peak impact about four to 11 quarters after the shock (for year-over-year inflation, these lags are about four to six quarters and six to 13 quarters, respectively).

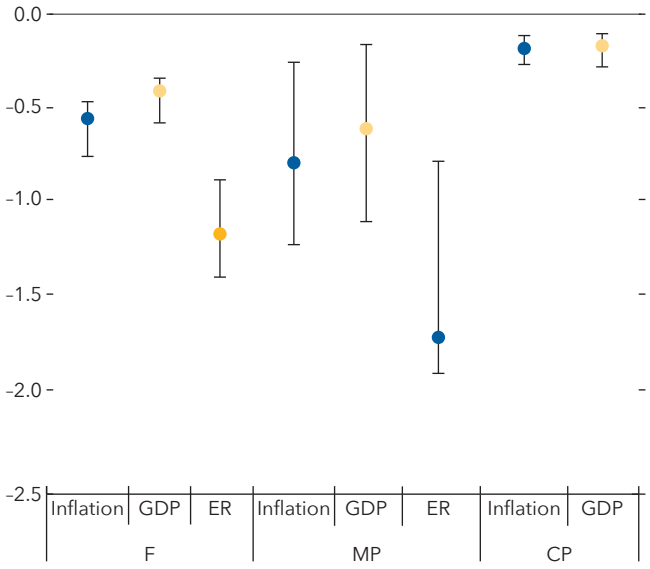
Is the Exchange Rate Channel Functioning?

A surprise increase in interest rates should attract capital into a country, causing the exchange rate to appreciate. This appreciation should subsequently raise the cost of exports (to the extent that they are priced in the local currency) and lower the cost of imports, leading to declines in output and inflation. Following a surprise monetary policy tightening, a large appreciation of the nominal exchange rate was observed for all countries in the sample, and this appreciation occurs within the same quarter as the tightening (Figure 2.7). For countries with a floating or managed exchange rate, the analysis found that a 100 basis point monetary policy shock leads to an appreciation in the nominal exchange rate of almost 2 percent on an annualized basis. Additional

[12] Estimates in this section are based on the model described in Online Annex 2. See Online Annex 7 for results based on structural vector autoregressions.

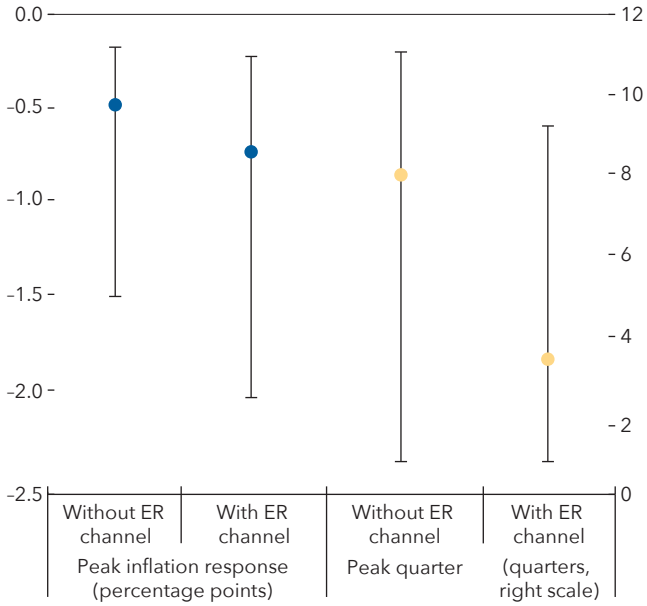
[13] The relatively low impact of interest rates on inflation among currency peggers may also reflect a prevalence of price subsidies in these countries over the sample period examined. For an analysis of the evolution of price subsidies in the Middle East and North Africa region, see the October 2022 *Regional Economic Outlook: Middle East and Central Asia*.

Figure 2.7. Peak Effect of a 100 bps Contractionary Monetary Policy Shock on Inflation, Real GDP, and the Exchange Rate in ME&CA Countries
(Percentage points)



Source: IMF staff calculations.
Note: Circles represent the median peaks, and the error bars show the ranges across countries. Inflation is quarter-over-quarter annualized percentage rates. Real GDP and exchange rates are in percent. Note that for CP, the monetary tighening is a 100 basis point increase in foreign interest rates with an equivalent increase in domestic rates. bps = basis points; CP = conventional pegger; ER = exchange rate; F = floater; ME&CA = Middle East and Central Asia; MP = managed pegger.

Figure 2.8. Peak Effect of a 100 bps Contractionary Monetary Policy Shock on Inflation in ME&CA Countries
(Percentage points)



Source: IMF staff calculations.
Note: The figure shows the peak effect of a 100 basis point contractionary MP shock on quarter-over-quarter inflation in countries with a statistically significant response of inflation, estimated using Jordà's (2005) local projections method. Circles represent the median peaks, and the error bars show the ranges across countries. "Without ER channel" points to the impulse response of inflation when the exchange rate channel is muted. "With ER channel" measures the inflation response when the nominal effective exchange rate appreciates by one standard deviation simultaneously with a monetary policy tightening. bps = basis points; ER = exchange rate; ME&CA = Middle East and Central Asia.

analysis is consistent with the exchange rate being a key channel for magnifying the effect of monetary policy on inflation in the region. In a structural vector autoregression framework, estimates show that on average, 40 percent of the peak impact on inflation from monetary policy shocks is driven by the exchange rate (see Online Annex 7). Similarly, local projection estimates, based on Jordà (2005), suggest that in countries with flexible or managed exchange rate regimes, inflation tends to decline by a larger magnitude when the exchange rate also appreciates following a contractionary monetary policy shock (Figure 2.8). Transmission lags also tend to be shorter under the amplifying effect of the exchange rate.

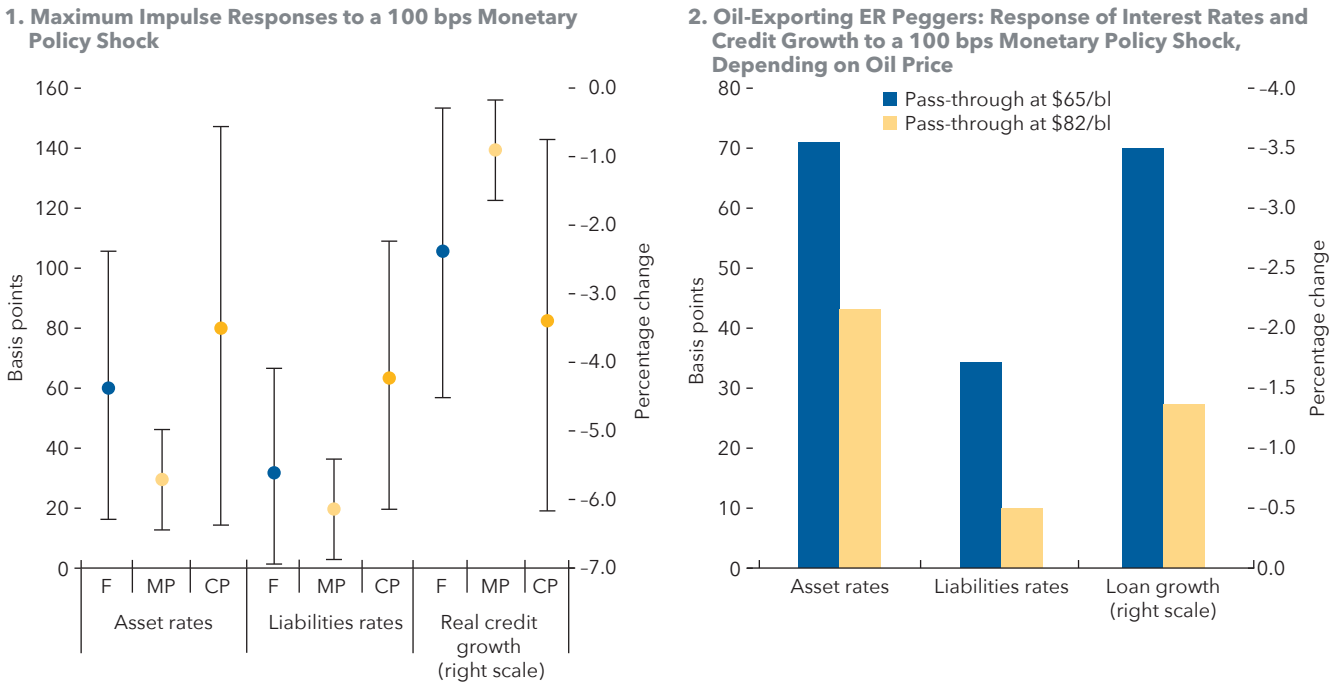
Is the Bank Lending Channel Functioning?

The pass-through of monetary policy tightening to bank lending and deposit rates and credit provision were estimated using local projection methods with quarterly bank-level data for a panel of countries in the region. For countries with pegged exchange rates, the pass-through of US monetary policy was considered; for managed peggers and exchange rate floaters, the impact of an increase in the policy interest rate was estimated.

In countries with fixed exchange rates, at the peak, a 100 basis point US monetary tightening leads to 81 basis points higher asset rates (a proxy for effective lending rates), 66 basis points higher liability rates (a proxy for effective deposit rates), and a reduction of 3.2 percent in real credit growth (Figure 2.9, panel 1).[14] Yet the trans-

[14] The sample of peggers consists of Azerbaijan, Bahrain, Jordan, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

Figure 2.9. Impact of Monetary Policy Tightening on Effective Interest Rates and Credit Growth



Source: IMF staff calculations.
Notes: Panel 1 shows peak response from local projection estimation for country groups, sorted by exchange rate regime. Panel 2 shows how the peak response in exchange rate peggers depends on the level of the oil price. According to the World Economic Outlook database, $65 is the current medium-term projection for the oil price; $82 was the prevailing oil price in the week of January 18, 2023. bl = barrel; bps = basis points; CP = conventional pegger; ER = exchange rate; F = floater; MP = managed pegger.

mission of higher US policy rates into domestic banks' asset and liability rates operates with sizable lags. In the year following a 100 basis point tightening, asset and liability rates rise by approximately 30 basis points on average. The peak responses are reached after eight to 10 quarters (see Online Annex 6).[15]

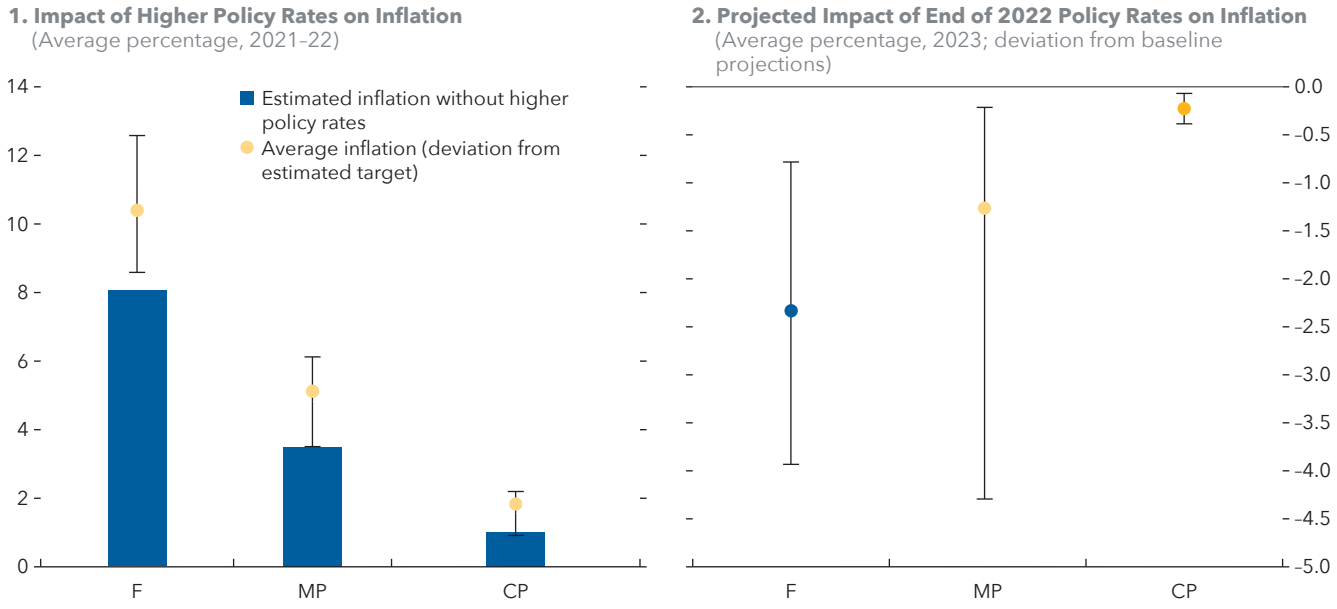
In this context, the level of the oil price is a critical determinant of monetary transmission in oil-exporting countries. When liquidity is ample because of high oil revenues, the transmission of US monetary policy into domestic financial conditions is dampened. Quantitatively, the pass-through of a 100 basis point US interest rate rise into domestic asset and liability rates is more than 20 basis points stronger at an oil price of $65 per barrel (consistent with medium-term projections) compared with an $82 oil price (the prevailing price in the week of January 18, 2023; Figure 2.9, panel 2). Higher oil prices also attenuate the pass-through into real credit growth. With oil prices expected to revert to their 2019 levels over the next five years, spillovers from US monetary policy will likely strengthen, increasing the need for macroprudential buffers.

Monetary policy transmission to bank asset and liability rates is weaker on average in countries with a managed peg or floating exchange rate regime,[16] partly reflecting their lower level of financial development compared with ME&CA peggers and emerging markets in general, largely due to the high level of development among Gulf Cooperation Council countries. Asset and liability rate pass-through peaks at 60 and 34 basis points for floaters (28 and 22 basis points for managed peggers), respectively, for a 100 basis point rise in the policy interest rate; the response of credit growth is economically small and statistically insignificant for all countries except for Pakistan. There is significant heterogeneity across the region, with pass-through stronger in countries

[15] Such long lags reflect the use of effective asset and liability rates instead of marginal interest rates.

[16] The sample of managed peggers based on the 2021 *Annual Report on Exchange Arrangements and Exchange Restrictions* consists of Egypt, Morocco, and Tunisia. Since then, Egypt has de jure transitioned to a floating exchange rate arrangement. The sample of floaters consists of Armenia, Georgia, Kazakhstan, and Pakistan.

Figure 2.10. Estimated Impacts of Higher Policy Rates



Source: IMF staff calculations.
Note: Counterfactual analysis based on small structural model (see Online Annex 2). Panel 1 shows the reduction in average inflation over 2021 and 2022 from the increase in policy interest rates between the end of 2020 and the end of 2022. The counterfactual scenario assumes that all interest and exchange rates are unchanged over this period. Panel 2 shows estimated inflation responses to the monetary policy stance at the end of 2022 (policy rates less terminal rates). Circles represent the median impacts across countries, and the error bars show the cross-country range of estimates. CP = conventional pegger; F = floater; MP = managed pegger.

with a smaller footprint of state-owned banks (see Online Annex 6). These results suggest that the banking sector may be playing only a limited role in monetary transmission to the real economy for exchange rate floaters and managed peggers in the region on average, particularly for countries where state-owned banks are dominant.

Putting It Together: Where to Next?

Inflation rates have been relatively high since 2021, but inflation could have been notably higher if central banks had not increased policy interest rates. The analysis suggests that interest rate increases since 2020 have acted to reduce inflation for all countries examined, with larger inflation reductions among countries with greater exchange rate flexibility (Armenia, Georgia, Kazakhstan, Pakistan; Figure 2.10, panel 1). However, inflation has continued to rise in Egypt, Pakistan, and Tunisia, with the comparison of current policy interest rates relative to natural policy rate estimates suggesting that further interest rate increases are needed to stabilize inflation (see subsection titled "What Is the Current Monetary Policy Stance?").

The high level of policy interest rates relative to terminal rates at the end of 2022 can be expected to continue putting downward pressure on inflation throughout 2023 (Figure 2.10, panel 2). The extent to which policy rates need adjustment in the short term will be determined by the evolution of inflation and inflation expectations, considering the impact of past policy changes and domestic and global economic conditions.

2.5. Policy Recommendations

Headline inflation appears to have peaked in 2022, but core inflation remains stubbornly high in many countries. Although monetary policy actions taken since 2020 have been broadly appropriate and helped curb inflation for the majority of countries using a policy rate, other countries still need to tighten further, and risks remain for all countries as policymakers search for clear signs of an inflection point amid heightened uncertainty.

Where to next? Heightened uncertainty requires close vigilance. Calibrating and communicating monetary policy in a data-dependent manner will be essential to prevent inflation expectations from becoming de-anchored. Specifically:

- Where the policy stance is tight or neutral, and inflation appears to have peaked (for example, Armenia and Georgia), central banks should remain data dependent and not start loosening until there are clear signs that core inflation is on a downward trajectory.
- Countries with a currency peg should continue following US monetary policy and consider the use of additional macroprudential policies (for example, lower loan-to-value and debt-to-income ratios) in case of significant asset price appreciation or if financial conditions remain loose or loosen.
- Where the policy stance is loose and inflationary pressures persist, tighter monetary policy should be considered to stabilize inflation and inflation expectations (for example, in Egypt, Pakistan, and Tunisia).
- Where there is a lack of coordination between monetary and fiscal policy or where there is fiscal dominance, policymakers will need to address fiscal imbalances so that monetary policy can become an effective tool to stabilize inflation. Until then, monetary policy will need to be tightened more than if fiscal policy were acting in coordination.
- Where high oil prices dampen the bank-lending channel (energy exporters), the policy rate will need to be complemented with other monetary or macroprudential tools.
- Across the region, and in countries that will tighten monetary policy further in particular, central banks should be mindful of financial stability risks and closely monitor financial system vulnerabilities that could arise from increasing interest rates.

In parallel, further efforts are needed to improve monetary policy frameworks and monetary policy transmission in the region. Given that inflation expectations data are not available in most countries in ME&CA, policymakers need to develop surveys of inflation expectations. The strong estimated response of inflation to monetary policy shocks and the short time lag with which it responds in countries with a floating or managed exchange rate—and the bank-level data evidence that the lending channel is weak—suggest that the exchange rate is a key transmission channel for many countries.

- Strengthening the lending channel would also require developing the financial sector, including by promoting well-functioning and highly liquid interbank markets for reserves and secondary markets for government securities with a broad range of maturities, and by promoting measures to de-dollarize those financial systems with a high degree of dollarization. This would subsequently facilitate greater exchange rate flexibility, allowing the exchange rate to act as a shock absorber to better isolate economies from shocks and improve the efficiency of monetary policy.
- All countries could benefit from closer coordination of monetary policy with financial and fiscal policies. For example, state-owned commercial banks should operate on a level playing field with private banks, and the use of state-owned banks for monetary or fiscal purposes should be avoided (for example, through phasing out quasi-fiscal activities and subsidized lending).
- The use of macroprudential measures in countries with fixed exchange rate regimes can help strengthen the link between changes in the policy rate and financial conditions, which is particularly important now for Caucasus and Central Asia countries that are experiencing large capital inflows and for Gulf Cooperation Council countries that are experiencing rapid asset price appreciation (for example, in equity or housing markets).

- Monetary policy frameworks should be improved by enhancing central bank communications and increasing the transparency of monetary operations and foreign exchange interventions.

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ME&CA: Selected Economic Indicators, 2000–24

(Percent of GDP, unless otherwise indicated)

	Average 2000–19	2020	2021	2022	Projections 2023	2024
ME&CA[1,2]						
Real GDP (annual growth)	4.5	–2.7	4.6	5.3	2.9	3.5
of which non-oil growth	5.3	–2.7	5.3	4.5	3.2	3.7
Current Account Balance	5.8	–3.0	3.3	7.5	3.6	2.1
Overall Fiscal Balance	1.4	–7.9	–2.5	1.4	–1.5	–2.2
Inflation (year average; percent)	7.2	10.4	12.8	14.3	15.9	12.0
ME&CA oil exporters						
Real GDP (annual growth)	4.5	–3.9	4.7	5.4	3.2	3.2
of which non-oil growth	5.6	–3.7	5.8	4.0	3.7	3.5
Current Account Balance	8.9	–2.8	6.5	12.5	6.5	4.3
Overall Fiscal Balance	3.3	–8.5	–1.0	4.3	0.2	–0.6
Inflation (year average; percent)	6.7	8.7	11.0	13.6	12.1	8.7
ME&CA emerging market and middle-income countries[1]						
Real GDP (annual growth)	4.2	–0.8	4.6	5.6	2.4	4.1
Current Account Balance	–3.6	–3.1	–3.5	–4.8	–3.5	–3.5
Overall Fiscal Balance	–5.4	–7.3	–6.3	–6.2	–6.6	–7.2
Inflation (year average; percent)	7.1	8.2	7.8	11.5	21.5	17.1
ME&CA low-income developing countries[2]						
Real GDP (annual growth)	4.4	–1.4	4.3	3.1	3.5	4.3
Current Account Balance	1.0	–5.1	–6.8	–4.8	–6.8	–6.4
Overall Fiscal Balance	–2.0	–3.8	–2.8	–2.7	–2.7	–2.5
Inflation (year average; percent)	13.9	38.9	67.0	38.1	24.7	19.4

Sources: National authorities; and IMF staff calculations and projections.

[1] 2011–24 data exclude Syrian Arab Republic.

[2] 2021–24 data exclude Afghanistan.

Notes: Data refer to the fiscal year for the following countries: Afghanistan (March 21/March 20) until 2011, and December 21/December 20 thereafter, the Islamic Republic of Iran (March 21/March 20), and Egypt and Pakistan (July/June).

The 32 ME&CA countries and territories are divided into three (nonoverlapping) groups, based on export earnings and level of development: (1) Oil Exporters

(ME&CA OE), (2) Emerging Market and Middle-Income Countries (ME&CA EM&MI); and (3) Low-Income Developing Countries (ME&CA LIC).

ME&CA OE include Algeria, Azerbaijan, Bahrain, the Islamic Republic of Iran, Iraq, Kazakhstan, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Turkmenistan, and the United Arab Emirates.

ME&CA EM&MI include Armenia, Egypt, Georgia, Jordan, Lebanon, Morocco, Pakistan, the Syrian Arab Republic, Tunisia, and the West Bank and Gaza.

ME&CA LIC include Afghanistan, Djibouti, the Kyrgyz Republic, Mauritania, Somalia, Sudan, Tajikistan, Uzbekistan; and Yemen.

MENA: Selected Economic Indicators, 2000–24

(Percent of GDP, unless otherwise indicated)

	Average 2000–19	2020	2021	2022	Projections 2023	2024
MENA[1]						
Real GDP (annual growth)	4.2	–3.1	4.3	5.3	3.1	3.4
of which non-oil growth	5.2	–3.0	5.2	4.0	3.6	3.7
Current Account Balance	6.8	–3.3	4.2	9.0	4.5	2.7
Overall Fiscal Balance	1.6	–8.4	–2.0	2.5	–1.0	–1.7
Inflation (year average; percent)	7.1	10.9	13.9	14.8	14.8	11.1
MENA oil exporters						
Real GDP (annual growth)	4.3	–4.1	4.7	5.7	3.1	3.0
of which non-oil growth	5.5	–3.9	5.9	3.8	3.7	3.5
Current Account Balance	9.6	–2.9	7.2	13.0	6.9	4.6
Overall Fiscal Balance	3.3	–8.9	–0.8	4.6	0.4	–0.5
Inflation (year average; percent)	6.6	9.0	11.3	13.5	12.0	8.7
MENA emerging market and middle-income countries[1]						
Real GDP (annual growth)	4.1	–0.5	3.6	5.1	3.4	4.4
Current Account Balance	–4.0	–3.7	–4.7	–5.1	–4.1	–4.1
Overall Fiscal Balance	–5.8	–7.4	–6.6	–5.6	–6.9	–7.1
Inflation (year average; percent)	7.1	6.8	7.1	11.2	19.1	14.9
MENA low-income developing countries						
Real GDP (annual growth)	2.2	–4.1	0.6	–0.6	1.3	2.9
Current Account Balance	–3.5	–12.0	–8.4	–8.8	–10.5	–9.8
Overall Fiscal Balance	–3.2	–3.8	–0.2	–1.7	–2.1	–1.8
Inflation (year average; percent)	17.1	92.1	175.9	83.2	45.9	35.0
MENA excl. conflict-affected countries						
Real GDP (annual growth)	4.3	–2.7	3.9	5.6	2.9	3.3
of which non-oil growth	5.3	–2.7	5.2	4.2	3.4	3.6
Current Account Balance	6.8	–3.2	4.3	9.1	4.6	2.7
Overall Fiscal Balance	1.6	–8.2	–2.2	2.5	–1.1	–1.8
Inflation (year average; percent)	7.1	10.9	14.1	14.9	15.0	11.2
MENA excl. fragile states and conflict-affected countries						
Real GDP (annual growth)	3.9	–1.7	3.9	5.7	2.9	3.3
of which non-oil growth	5.1	–1.4	4.5	4.5	3.5	3.6
Current Account Balance	7.6	–2.3	4.4	9.5	4.9	3.4
Overall Fiscal Balance	1.9	–7.9	–2.4	2.3	–0.9	–1.5
Inflation (year average; percent)	6.8	8.4	9.6	12.6	13.9	10.7

	Average 2000–19	2020	2021	2022	Projections 2023	2024
MENAP[1,2]						
Real GDP (annual growth)	4.3	–2.8	4.5	5.4	2.7	3.4
of which non-oil growth	5.2	–2.7	5.3	4.3	3.1	3.7
Current Account Balance	6.4	–3.0	3.8	7.8	3.9	2.3
Overall Fiscal Balance	1.3	–8.2	–2.4	1.6	–1.5	–2.3
Inflation (year average; percent)	7.1	10.8	13.2	14.4	16.4	12.5
Gulf Cooperation Council						
Real GDP (annual growth)	4.2	–4.7	3.5	7.7	2.9	3.3
of which non-oil growth	5.9	–4.1	5.2	4.9	4.2	3.9
Current Account Balance	12.8	–1.1	8.6	15.2	8.6	6.5
Overall Fiscal Balance	6.0	–8.0	0.0	6.0	2.4	1.6
Inflation (year average; percent)	2.3	1.3	2.2	3.3	2.9	2.3
Arab World[1]						
Real GDP (annual growth)	4.5	–4.5	4.2	5.9	3.3	3.7
of which non-oil growth	5.5	–4.2	5.4	4.4	3.9	4.0
Current Account Balance	7.4	–3.5	4.3	9.4	4.8	2.8
Overall Fiscal Balance	2.4	–8.6	–1.8	3.1	–0.5	–1.2
Inflation (year average; percent)	4.8	6.1	9.1	8.9	9.9	7.7
Arab World oil exporters						
Real GDP (annual growth)	4.7	–6.5	4.7	6.7	3.4	3.4
of which non-oil growth	6.0	–6.1	6.4	4.2	4.2	3.9
Current Account Balance	11.3	–3.2	7.7	14.0	7.6	5.0
Overall Fiscal Balance	4.8	–9.2	–0.3	5.7	1.2	0.3
Inflation (year average; percent)	3.0	1.3	3.2	4.2	3.9	2.8

Sources: National authorities; and IMF staff calculations and projections.

[1] 2011–24 data exclude Syrian Arab Republic.

[2] 2021–24 data exclude Afghanistan.

Notes: Data refer to the fiscal year for the following countries: Afghanistan (March 21/March 20) until 2011, and December 21/December 20 thereafter, the Islamic Republic of Iran (March 21/March 20), and Egypt and Pakistan (July/June).

MENA: Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syrian Arab Republic, Tunisia, United Arab Emirates, West Bank and Gaza, and Yemen.

MENA oil exporters: Algeria, Bahrain, the Islamic Republic of Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

MENA emerging market and middle-income countries: Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic, Tunisia, and the West Bank and Gaza.

MENA low-income developing countries: Djibouti, Mauritania, Somalia, Sudan, and Yemen.

MENA excl. fragile states and conflict-affected countries: Algeria, Bahrain, Egypt, the Islamic Republic of Iran, Jordan, Kuwait, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, and the United Arab Emirates.

MENAP: MENA, Afghanistan, and Pakistan.

Gulf Cooperation Council: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

Arab World oil exporters: Algeria, Bahrain, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

CCA: Selected Economic Indicators, 2000–24

(Percent of GDP, unless otherwise indicated)

	Average 2000–19	2020	2021	2022	Projections 2023	2024
CCA						
Real GDP (annual growth)	6.7	–2.1	5.6	4.8	4.2	4.5
Current Account Balance	–0.2	–3.0	–0.6	5.8	1.1	0.5
Overall Fiscal Balance	2.0	–5.4	–3.0	0.1	–1.6	–1.4
Inflation (year average; percent)	8.9	7.4	9.6	13.0	11.8	8.5
CCA oil and gas exporters						
Real GDP (annual growth)	7.0	–3.0	4.5	3.3	3.8	4.1
of which non-oil growth	7.0	–2.1	5.3	5.2	3.4	3.2
Current Account Balance	0.2	–2.4	1.5	8.6	3.1	2.5
Overall Fiscal Balance	2.6	–5.6	–2.3	1.4	–1.1	–0.8
Inflation (year average; percent)	7.7	5.9	9.2	14.3	13.0	8.7
CCA emerging market and middle-income countries						
Real GDP (annual growth)	5.9	–6.9	8.5	11.1	4.6	5.0
Current Account Balance	–9.1	–8.6	–7.5	–1.7	–3.0	–3.8
Overall Fiscal Balance	–1.7	–6.9	–4.6	–1.9	–2.1	–1.9
Inflation (year average; percent)	4.3	3.5	8.6	10.5	6.4	4.0
CCA low-income developing countries						
Real GDP (annual growth)	6.4	1.2	7.3	6.0	5.1	5.2
Current Account Balance	1.0	–3.0	–5.5	–1.1	–4.0	–4.1
Overall Fiscal Balance	0.0	–4.3	–5.0	–3.6	–3.1	–3.1
Inflation (year average; percent)	13.0	11.7	10.7	11.1	11.0	9.3

Sources: National authorities; and IMF staff calculations and projections.
CCA oil and gas exporters: Azerbaijan, Kazakhstan, and Turkmenistan.
CCA emerging market and middle-income countries: Armenia and Georgia.
CCA low-income developing countries: the Kyrgyz Republic, Tajikistan, and Uzbekistan.