

# 1. Regional Developments and Economic Outlook: Building Resilience and Fostering Sustainable Growth<sup>1</sup>

*Across the Middle East and Central Asia (ME&CA), the combined effects of global headwinds, domestic challenges, and geopolitical risks weigh on economic momentum, and the outlook is highly uncertain. Growth is set to slow this year in the Middle East and North Africa (MENA) region, driven by lower oil production, tight policy settings in emerging market and middle-income economies (EM&MIs), the conflict in Sudan, and other country-specific factors. In the Caucasus and Central Asia (CCA), although migration, trade, and financial inflows following Russia's war in Ukraine continue to support economic activity, growth is set to moderate slightly this year. Looking ahead, economic activity in the MENA region is expected to improve in 2024 and 2025 as some factors weighing on growth this year gradually dissipate, including the temporary oil production cuts. But growth is expected to remain subdued over the forecast horizon amid persistent structural hurdles. In the CCA, economic growth is projected to slow next year and over the medium term as the boost to activity from real and financial inflows from Russia gradually fades and deep-seated structural challenges remain unsolved. Inflation is broadly easing, in line with globally declining price pressures, although country-specific factors—including buoyant wage growth in some CCA countries—and climate-related events continue to make their mark. Despite some improvement since April, the balance of risks to the outlook remains on the downside. In this context, expediting structural reforms is crucial to boost growth and strengthen resilience, while tight monetary and fiscal policies remain essential in several economies to durably bring down inflation and ensure public debt sustainability.*

## 1.1. A Global Slowdown amid Higher-for-Longer Interest Rates

A global slowdown is setting in, following resilient economic activity in the first quarter of this year driven by the reopening of China's economy, strong consumption in the United States, and robust service sector activity. High-frequency indicators for the second quarter point to additional weakening in manufacturing, softening services activity, and declining global trade growth. However, China's post-pandemic rebound is fading amid continued weakness in the real estate sector and exports. Even though financial stability concerns have receded in advanced economies, lending standards have tightened, curtailing the supply of credit. In this context, the October 2023 *World Economic Outlook* projects global growth to fall from 3.5 percent in 2022 to 3.0 percent in 2023 and 2.9 percent in 2024, driven primarily by a marked slowdown in advanced economies as tight monetary policy continues to bite.

Global headline inflation is receding, reflecting a moderation in fuel and non-fuel commodity prices. Still, core inflation is declining more gradually and remains above most central bank targets. In response, major central banks are expected to keep monetary policy tighter for longer. Global interest rate assumptions have thus been revised upward from the April 2023 *World Economic Outlook*, with the federal funds rate projected to peak at 5.4 percent by the end of 2023 and stay at that level until late 2024 (about 100 basis points higher than expected in April), thus keeping pressure on global financing conditions for longer than previously anticipated. Average petroleum spot prices are expected to moderate steadily (at \$80.5 and \$79.9 per barrel in 2023 and 2024, respectively), though they have been revised up (from \$73.1 and \$68.9 in April) as slowing global demand has only partially offset OPEC+ production cuts and additional voluntary cuts, primarily by Saudi Arabia. The

---

<sup>1</sup> Prepared by Azhin Abdulkarim, Vizhdan Boranova, Hasan Dudu, Filippo Gori (lead), and Gustavo Ramirez.

ongoing moderation in food commodity prices—projected to decline by 6.8 percent in 2023 and 1.9 percent in 2024—should help alleviate pressures on food prices worldwide (although international food prices remain about 40 percent above prepandemic levels).

## 1.2. MENA Region and Pakistan: A Complex Road Ahead

*Despite resilient domestic demand and strong tourism, several factors weigh on growth, including lower oil production in oil exporters, tight policy settings in EM&MIs, and the combination of lingering fragilities and new shocks in low-income countries (LICs)—such as the conflict in Sudan. Looking ahead, growth in the MENA region is expected to improve in 2024 as some of the factors weighing on current economic activity fade, but medium-term growth is projected at below its historical average amid persistent structural challenges. Headline inflation has started to come down in line with global trends, but country-specific factors—for example currency depreciations, import restrictions, and recurring droughts—continue to fuel inflationary pressures in some countries, lifting average inflation across the region.*

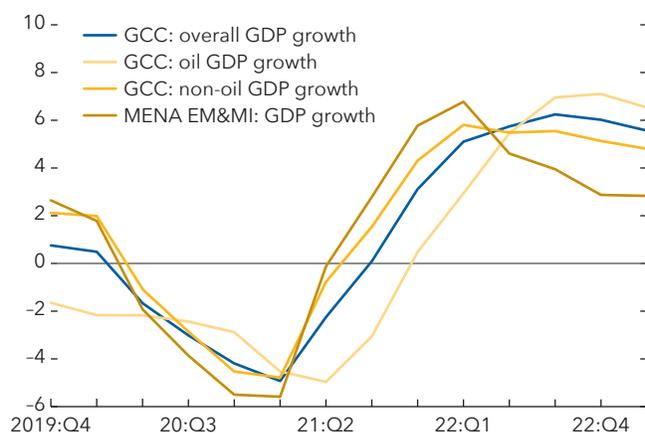
### Growth Is Easing amid Global Headwinds

Oil production cuts and country-specific factors have started to weigh on oil exporters. Oil GDP growth is slowing after three rounds of deep OPEC+ oil production cuts (October 2022, April 2023, June 2023) and additional temporary cuts by Saudi Arabia. For Gulf Cooperation Council (GCC) countries, crude oil production was cut considerably, driving a deceleration in oil GDP growth (Figure 1.1). Crucially, the slowdown of oil GDP has been

partially offset by continued strong non-oil GDP growth, driven by robust manufacturing activity (Oman, Qatar, Saudi Arabia, United Arab Emirates) and surging services (Bahrain, Oman, Saudi Arabia, United Arab Emirates). In Iraq, restrictions on foreign currency sales are constraining growth.

In the MENA region's EM&MIs and Pakistan, average growth is below that of oil exporters, held back by necessary tighter policy settings and several country-specific challenges. Notably, average real GDP growth remained lackluster at 3.1 percent in the first quarter of 2023 (below a historical average of 4 percent). Where growth strengthened in the first quarter, the uptick was supported by strong tourism flows (Morocco, Tunisia) and robust remittances (Morocco). In other countries, slowing growth reflects worsening macroeconomic conditions caused by the impact of foreign currency rationing (Egypt) and import restrictions (Egypt and Pakistan).

**Figure 1.1. MENA Region: Real GDP Growth**  
(Percent change, year-over-year; four-quarter moving simple averages)



Sources: Haver Analytics; and IMF staff calculations.

Note: Kuwait is excluded because of lack of recent data. EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; and MENA = Middle East and North Africa.

Meanwhile, economic conditions in the MENA region's fragile LICs have deteriorated as conflicts and climate-related shocks amplify underlying fragilities. The ongoing conflict in Sudan is damaging the country's infrastructure and compromising the provision of basic services while causing large migration flows (Box 1.1). In Yemen, the United Nations-mediated truce expired in 2022, and the country lacks financing to ensure sufficient food imports to fulfill basic needs. In Somalia, conflict

and severe drought have left much of the population internally displaced. By contrast, economic performance in non-fragile LICs is generally positive, with increased trade (Djibouti, following the peace agreement in Ethiopia) and robust services activity (Mauritania) supporting growth.

### Inflationary Pressures Are Receding but Remain Elevated in Some Countries

Inflation is easing in most oil-exporting countries in line with global trends. After continued interest rate hikes, headline and core inflation, measured on a month-to-month annualized basis, have now returned to prepandemic historical averages in several economies, particularly GCC countries. By contrast, inflation remains high in other oil exporters (Algeria, Iraq, Islamic Republic of Iran), driven by food components in Algeria and reflecting the broad-based effect of currency depreciations on prices in the Islamic Republic of Iran.

Headline and core inflation in most EM&MIs have also returned to near prepandemic historical averages of between 3 and 4 percent—helped by monetary policy tightening and lower global commodity prices. However, some countries continue to face high inflationary pressures (Figure 1.2). Monthly inflation remains well above historical levels in Egypt, Pakistan, and Tunisia. Moreover, as of July, year-over-year food inflation remains above 10 percent in Morocco and Tunisia and above 35 percent in Egypt and Pakistan, because of droughts (Morocco and Tunisia) and the lagged impact of exchange rate devaluations on import prices (Egypt and Pakistan).

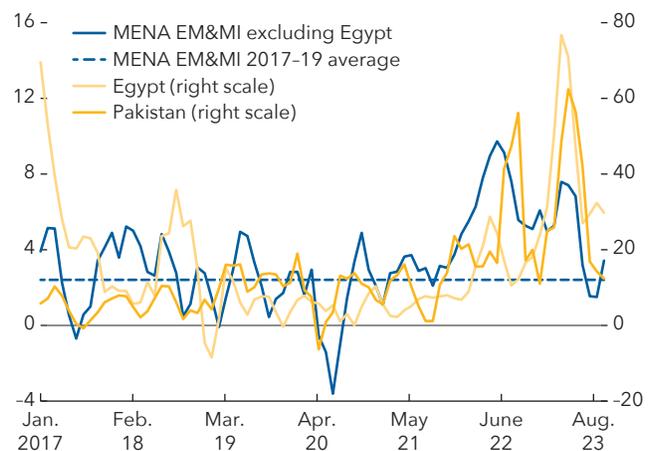
Though inflationary pressures vary markedly across LICs, food security remains a widespread concern. Inflation has eased in Djibouti and Mauritania since the beginning of 2023, reflecting favorable food price dynamics and the receding impact of past droughts (Mauritania). Nonetheless, inflation remains exceptionally high in Sudan because of the lingering effects of past climate-related shocks, low stocks of staples, and the ongoing conflict. Moreover, food insecurity remains pervasive despite some moderation in food prices in several LICs (Mauritania, Somalia, Yemen). As of July, more than 45 million people in Djibouti, Mauritania, Somalia, Sudan, and Yemen faced food insecurity—almost 50 percent of their combined populations.

### The Monetary Tightening Cycle Nears Its End, While Fiscal Positions Are Mixed

The pace of monetary policy tightening has slowed as price pressures have started to recede in several economies. Central banks in countries with currencies pegged to the US dollar (excluding Iraq) have followed the Federal Reserve, hiking policy rates by 100 basis points this year on average as of August 2023. Other central banks appear near the end of their monetary tightening cycle, with only some EM&MIs raising policy rates this year (Egypt, Morocco, Pakistan). Nevertheless, in a few economies, policy interest rates remain below model-based estimates of natural rates (Egypt, Pakistan, Tunisia; April 2023 *Regional Economic Outlook: Middle East and Central Asia*). Moreover, some oil exporters still face inflationary pressures (Algeria, Islamic Republic of Iran).

**Figure 1.2. MENA Region EM&MIs and Pakistan: Headline Inflation**

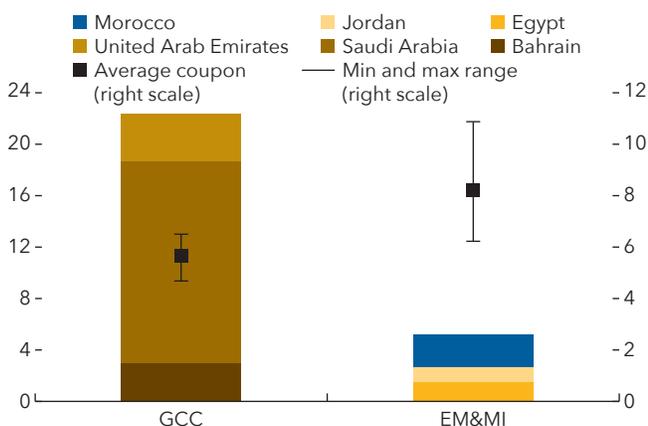
(Percent change, month-over-month, seasonally adjusted annualized rate)



Sources: Haver Analytics; IMF, Consumer Price Index database; national authorities; and IMF staff calculations.

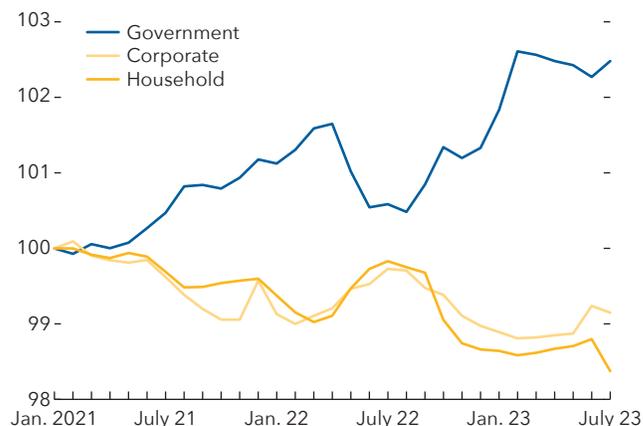
Note: EM&MI = emerging market and middle-income economy; MENA = Middle East and North Africa.

**Figure 1.3. International Bond Issuance in 2023**  
(Billions of US dollars, left scale; coupon rate for US dollar-denominated bonds, percent, right scale)



Sources: Bond Radar; and IMF staff calculations.  
Note: Issuances include Eurobonds and other international bond placements, such as sukuk. EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council.

**Figure 1.4. MENA Region EM&MIs and Pakistan: Share of Bank Credit by Sector**  
(Median index; January 2021 = 100)



Sources: IMF, Monetary and Financial Statistics database; and IMF staff calculations.  
Note: EM&MI = emerging market and middle-income economy; MENA = Middle East and North Africa.

To strengthen fiscal buffers further, non-oil primary balances (as a percentage of non-oil GDP) strengthened in most GCC countries last year (except for Saudi Arabia), while non-oil primary balances deteriorated in other oil exporters, reflecting higher public wages (Iraq, Libya) and subsidies (Algeria, Iraq, Libya). Most EM&MIs continued tightening their primary fiscal positions last year—amid high debt levels and elevated borrowing costs—despite the additional outlays associated with mitigating the cost-of-living crisis. For LICs, revenue mobilization has remained elusive, with fiscal revenues as a share of GDP at about 12 percent on average (about half the level of EM&MIs), down from about 18 percent 10 years ago, primarily because of revenue erosion in conflict-affected countries (Sudan, Yemen).

### Notable External Vulnerabilities Remain for Some EM&MIs

External funding conditions deteriorated for highly indebted countries. Following global financial turmoil in early March, foreign-currency sovereign bond spreads widened substantially in vulnerable EM&MIs (Egypt, Pakistan, Tunisia). By contrast, financing conditions moved broadly in line with global emerging markets for those with lower levels of debt (most GCC economies, Jordan, Morocco). While sovereign spreads have generally narrowed since last March's financial turmoil, as of August, they remain at distressed levels (more than 1,000 basis points) for Egypt, Pakistan, and Tunisia. In this context, some countries in the MENA region were able to access international financial markets during the first half of 2023 (Bahrain, Egypt, Jordan, Morocco, Saudi Arabia, United Arab Emirates) but at a relatively higher cost for more vulnerable emerging market economies (Figure 1.3). As such, amid limited external financing, EM&MIs continued to increase their reliance on domestic banks for public debt financing, further strengthening the already-elevated sovereign-bank nexus and reducing the pool of funding available to the private sector (Figure 1.4). In addition, after rebounding in the first two months of 2023, the global financial turmoil in March prompted a resurgence in capital outflows (in contrast to other emerging markets). But it was at a significantly slower pace than in 2022 (portfolio fund outflows from MENA and Pakistan totaled \$160 million in the second quarter of 2023, down from a record \$4.5 billion in outflows in 2022) (Figure 1.5).

Even so, external buffers improved for most EM&MIs during the first half of the year, partly because of strong tourism and remittance flows (Morocco, Tunisia) and support from bilateral and multilateral sources (Pakistan). Still, international reserve coverage is well below standard adequacy metrics, particularly for Egypt and Pakistan.

## MENA Region and Pakistan Outlook: A Slowdown amid Growing Challenges

Growth in the MENA region and Pakistan is projected to slow this year, driven by a few key factors, including extended oil production cuts in oil exporters, tight macroeconomic policies to safeguard macroeconomic stability and debt sustainability in EM&MIs, and heightened fragility from ongoing conflicts in LICs, particularly in Sudan. Notably, all country groups (oil exporters, EM&MIs, LICs) are projected to perform below the emerging market and developing economy average in the rest of the world. In addition, the region was recently hit by new shocks, including a devastating earthquake in Morocco and severe flooding in Libya that caused thousands of deaths and damaged infrastructure.<sup>2</sup>

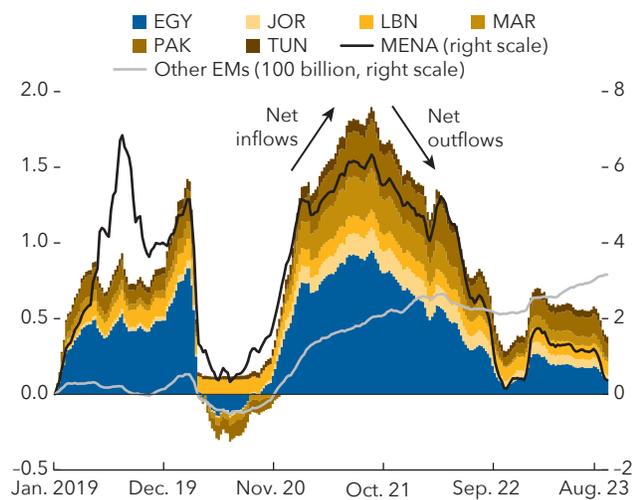
Looking ahead, as some of the factors weighing on growth in 2023 begin to dissipate, economic prospects are expected to rebound in 2024 and continue to improve in 2025. Yet persistent structural gaps and the decline in oil-related growth mean that for most countries, growth is projected to slow and remain modest and below its historical average over the medium term. In addition, large segments of the population face challenges finding jobs, including youth and women, while more than 100 million young people are expected to reach working age in the region in the next decade. Inflation is forecast to abate slowly with receding global price pressures, although large cross-country differences will persist.

### Oil Exporters: Growth is Slowing amid a Shift in Composition

Growth in oil exporters is projected to slow markedly this year to 2 percent (from 6.1 percent in 2022) before improving moderately to about 3.4 percent next year and setting at below 3 percent in the medium term—below its pre-pandemic historical average (Figure 1.6). Growth forecasts for 2023 are revised downward from April (by 1.1 percentage points), reflecting deeper than expected oil production cuts this year—including from unilateral cuts by Saudi Arabia—and the impact of foreign currency rationing on import-dependent sectors in Iraq. As such, non-oil activity is set to be the main growth driver in GCC countries in 2023 and subsequent years, supported by a moderate expansion in investment, while private consumption is set to remain subdued in relation to pre-pandemic historical trends. Nonetheless, despite ongoing efforts to diversify GCC economies away from oil, non-oil growth is projected to be insufficient to offset the decline in oil growth over the medium term, as productivity gaps in the non-oil sector persist (Chapter 2), posing challenges for job creation and inclusion (Figure 1.7).

Inflation dynamics are expected to continue easing, but price pressures will remain high in some non-GCC oil exporters. Across the MENA region's oil exporters, headline inflation is forecast to average 12.9 percent in 2023 (unchanged from 2022) and 9.4 percent in 2024. These elevated levels reflect persistent price pressures in some non-GCC countries because of ongoing fiscal expansions (Algeria) and the impact of sizable exchange rate depreciation (Islamic Republic of Iran).

**Figure 1.5. MENA Region EM&MIs and Pakistan: Net Cumulative Portfolio Inflows**  
(Billions of US dollars, cumulative flows since January 2019)

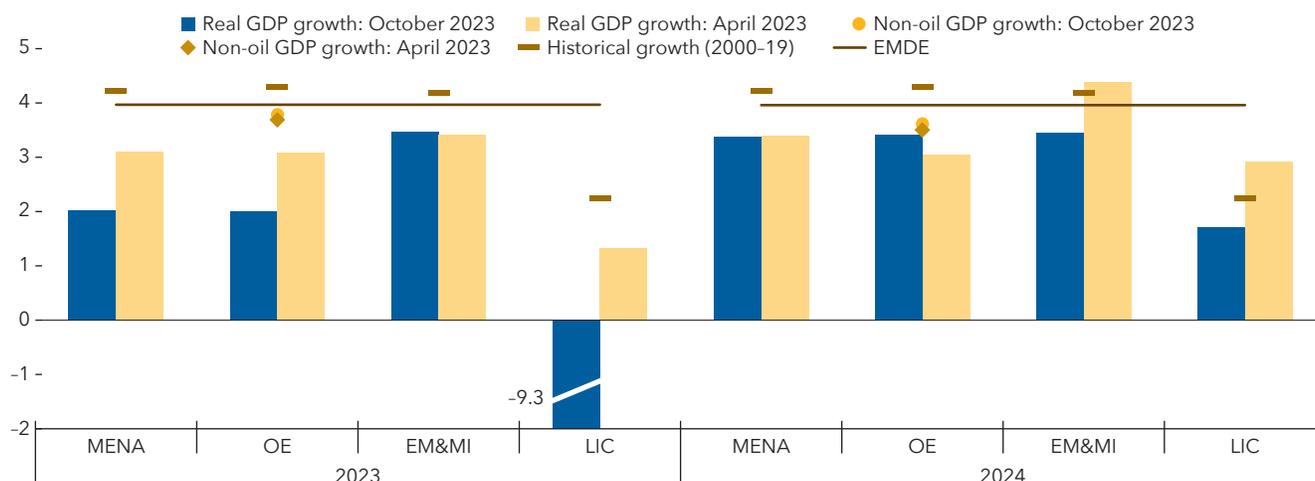


Sources: Haver Analytics; and IMF staff calculations.

Note: MENA includes flows to other MENA countries not displayed on the chart. Country abbreviations are International Organization for Standardization (ISO) country codes. EMs = emerging markets; EM&MI = emerging market and middle-income economy; MENA = Middle East and North Africa.

<sup>2</sup> Projections for Libya in this report do not include the impact of the disaster.

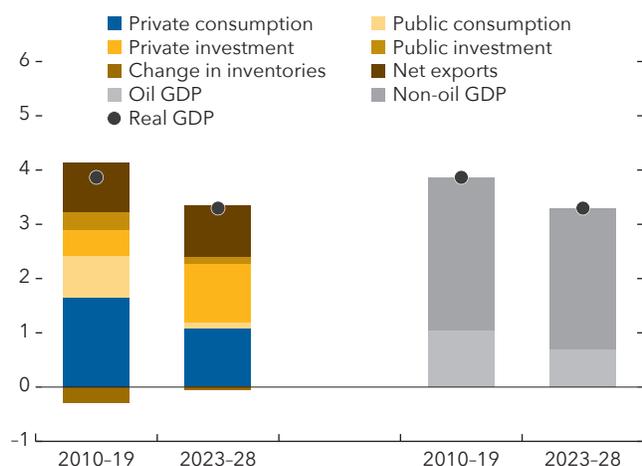
**Figure 1.6. Growth Projections**  
(Percent change, year-over-year)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: EM&MI = emerging market and middle-income economy; EMDE = emerging market and developing economy; LIC = low-income country; MENA = Middle East and North Africa; OE = oil exporter.

**Figure 1.7. GCC: Contributions to GDP Growth**  
(Percentage points, weighted averages)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Data for Kuwait are available starting 2011. GCC = Gulf Cooperation Council.

Lower oil production and oil prices will not only weigh on growth but also drive a marked decline in oil exporters' external positions. Current account surpluses are projected to almost halve from 14.6 percent of GDP in 2022 to 7.5 percent in 2023 and contract further to 6.7 percent of GDP in 2024. But they will remain in comfortable positions over the medium term (except for Iraq).

In this context, several oil exporters are expected to continue consolidating their public finances to mitigate the fiscal impact of lower oil revenue and reduce budget sensitivity to oil price volatility. Planned consolidation efforts focus on rationalizing current expenditures to free up resources for priority spending, including on social safety nets and infrastructure (Bahrain, Oman, Qatar, Saudi Arabia), while also reducing the fiscal deficit in some (Bahrain, Qatar). As such non-oil fiscal balances (as a percentage of non-oil GDP) are expected on average to improve in 2023 by 5.5 percent and further to 1.8 percent in 2024. Conversely, an

increase in the wage bill (Kuwait, Iraq) and subsidies (United Arab Emirates) is expected to result in a worsening fiscal position in these economies this year.

### EM&MIs: Tighter Policies and Challenging External Conditions to Constrain Growth

Growth in the MENA region's EM&MIs is expected to slow to 3.5 percent this year (from 5.1 percent in 2022) amid tight macroeconomic policies, though with diverging trends across countries, reflecting country-specific factors. Developments in Jordan and Morocco are more favorable, with growth projected to remain stable (Jordan) or

accelerate (Morocco) because of strong tourism and exports (though subdued by historical standards) and the normalization of agricultural activity in Morocco as the impact of last year's drought fades. Conversely, growth in Egypt has decelerated in fiscal year 2023, reflecting the impact of foreign currency rationing on imports, production, and inflation, and the impact of elevated inflation on consumers' purchasing power. In the case of Pakistan, growth is estimated to have contracted during fiscal year 2023 because of severe damage from widespread flooding in the second half of 2022, broad-based inflationary pressures, and import curbs.

Further ahead, continued tight macroeconomic policies and persistent structural challenges are expected to hold back economic activity in several economies. Notably, while announced policy efforts, including on the structural reform agenda, are projected to gradually support growth, there are several challenges ahead. For example, gaps in economic opportunities for women and youth, fragmented social protection systems, and underdeveloped private sectors are expected to continue to put a damper on job creation.

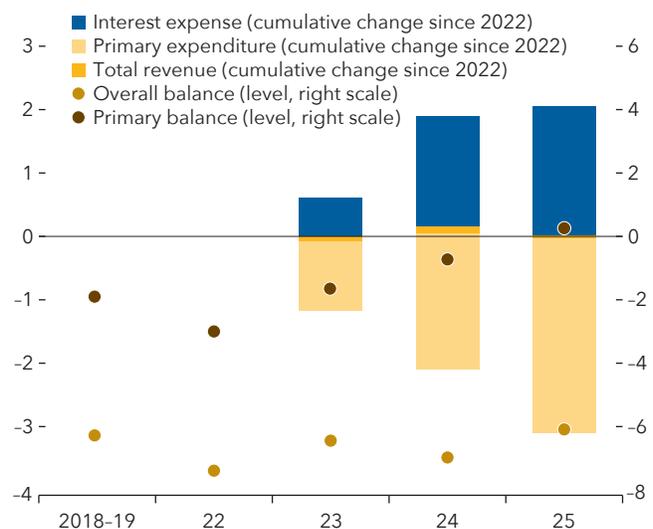
Inflationary pressures are poised to continue easing in most EM&MIs as the impact of monetary tightening takes hold. In Egypt, the lagged impact from exchange rate depreciations is set to keep pressuring domestic prices, with headline inflation peaking at 32.2 percent in 2024 but remaining in double digits through 2027. Inflation is forecast to peak in Pakistan in 2023, but it is foreseen to remain elevated in 2024. By contrast, price pressures in Jordan and Morocco are projected to continue declining, with inflation nearing prepandemic levels this year (Jordan) or next (Morocco).

Easing commodity prices and strong tourism activity are projected to benefit external balances in some EM&MIs. Overall, the current account deficit for EM&MIs is set to narrow from 5.2 percent of GDP in 2022 to 3.7 percent in 2023, reflecting robust tourism and resilient remittances, fiscal consolidation, and a partial reversal of the 2022 terms-of-trade shock. However, external financing needs will remain large, and reserve coverage is forecast to remain precarious in several countries, averaging about 70 percent of short-term external debt in Egypt, Pakistan, and Tunisia.

Primary fiscal balances are expected to improve in the MENA region's EM&MIs and Pakistan, reaching prepandemic levels this year, helped by expenditure rationalization (mostly on the back of lower subsidies and transfers). However, the overall fiscal balance is set to improve only by about 1 percent of GDP over 2023–24, reflecting a 2 percent of GDP increase in interest expenses, as higher interest rates put pressure on government debt-servicing costs (Figure 1.8). In this context, public debt-to-GDP ratios are projected to ease only gradually, from a peak of 90 percent in 2023 to 80 percent in 2025, primarily reflecting the erosion of the real value of public debt from still-elevated inflation in Egypt and Pakistan.

Elevated public sector gross financing needs are still a significant challenge for most MENA EM&MIs and Pakistan. Total financing needs over 2023–24 are projected at \$487 billion—an increase of about \$8 billion or 16 percentage points of fiscal revenues since April—reaching up to 38 and 21 percent of GDP by 2024 for Egypt and Pakistan, respectively (Figure 1.9).

**Figure 1.8. MENA Region EM&MIs and Pakistan: Overall and Primary Fiscal Balances**  
(Percent of GDP, simple averages)

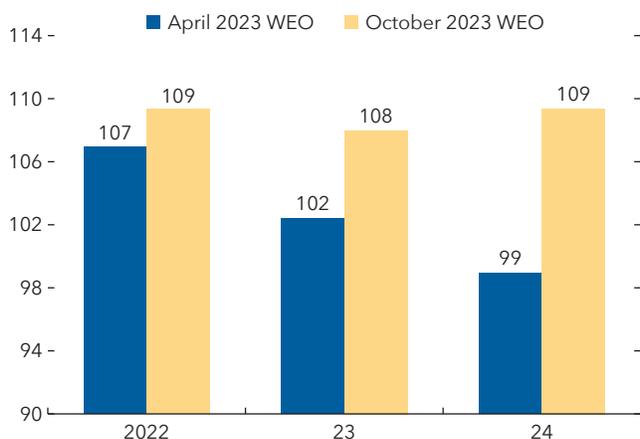


Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Overall and primary balances and total revenues exclude grants. EM&MI = emerging market and middle-income economy; MENA = Middle East and North Africa.

**Figure 1.9. MENA EM&MI and Pakistan: Public Gross Financing Needs**

(Percent of fiscal revenue, simple average)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: EM&MI = emerging market and middle-income economies; MENA = Middle East and North Africa; WEO = *World Economic Outlook*.

These would require domestic and external debt issuance of about \$175 billion and \$6 billion in excess of domestic and external debt amortization, respectively, over 2023-24, and thus would likely exacerbate further the sovereign-bank nexus in the region's EM&MIs.

### LICs: Difficulties Mount amid Crises and Depleted Policy Space

Economic activity in the MENA region's LICs is forecast to contract sharply this year (9.3 percent), following a mild contraction in 2022, greatly amplifying existing domestic challenges. However, these figures mask considerable heterogeneity across countries, as economic activity remains driven by country-specific, idiosyncratic factors that weigh particularly on fragile and conflict-affected LICs. The worsening crisis in Sudan will have a considerable impact on people and livelihoods—the conflict's impact on the economy is large, with GDP growth forecast to contract by more than 18 percent in 2023. Similarly, Yemen's economy

is projected to contract by 0.5 percent this year after the truce agreed to in 2022 expired without delivering tangible macroeconomic improvements for the country. Somalia's economy is forecast to grow by a moderate 2.8 percent in 2023 as drought conditions continue to weigh on the economy. Economic activity in other LICs is projected to remain robust. In Djibouti, GDP growth is forecast at 5 percent in 2023, boosted by the peace agreement in Ethiopia that has spurred port and border traffic. In Mauritania, economic growth is projected to decelerate as activity in the extractive and agriculture sectors moderates but remains at a healthy 4.5 percent.

LICs face multiple economic challenges over the medium term, particularly relating to their external positions. Financing needs will remain high because export revenues and remittances are insufficient to offset large import bills, resulting in current account deficits of more than 5 percent of GDP over 2027-28. In most countries, aid flows constitute a critical source of external and public financing, but LICs face declining official grants over the medium term and considerable gross financing needs amounting to about \$12 billion cumulative until 2028.

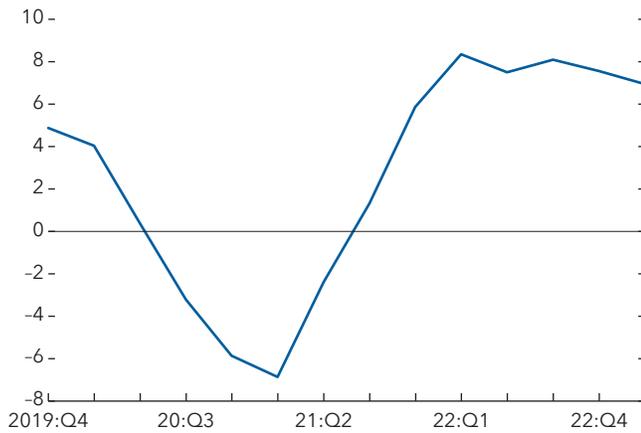
## 1.3. Caucasus and Central Asia: Growth Momentum Remains

*Economic growth in the CCA is expected to decelerate moderately in 2023 and next year, as migration, financial inflows, and trade with Russia gradually normalize. Over the medium term, economic activity is projected to grow at a slower pace and remain well below its prepandemic historical average as long-standing structural challenges continue to hold back growth. While price dynamics are diverging across countries, inflation is projected to ease more quickly than previously expected in 2023 but remain persistent in 2024 in some countries, reflecting continued wage pressures.*

### Economic Activity Remains Strong in Several Countries

Strong transit trade, inward migration, and tourism continue to support growth in the region, even amid some moderation in a few economies. Migrant flows, net money transfers, and nonresident deposits—though abating from 2022 peaks—have remained well above pre-war levels in most countries, and continued transit trade has supported a strong expansion of exports. Tourism growth has also remained robust, and in some countries,

**Figure 1.10. CCA: Real GDP Growth**  
(Percent change, year-over-year; simple average)



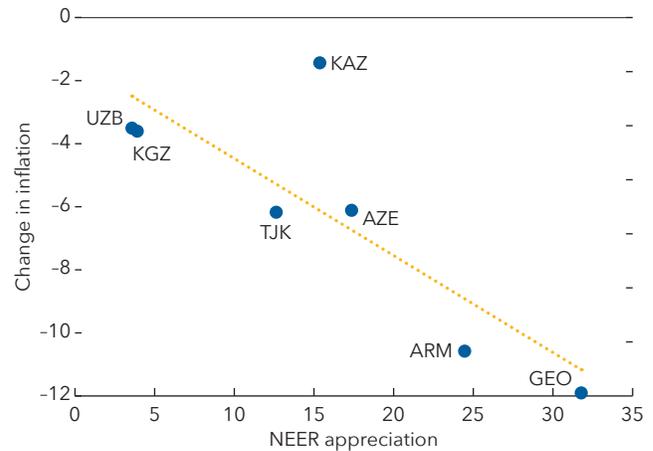
Sources: Haver Analytics; national authorities; and IMF staff calculations.  
Note: Simple average for Armenia, Azerbaijan, Georgia, Kazakhstan, and Kyrgyz Republic. CCA = Caucasus and Central Asia.

tourist arrivals have surpassed prepandemic levels (Armenia, Georgia). Moreover, expansions in retail sales and communication services—industries with growth above prepandemic levels—have resulted in robust domestic demand (Armenia, Georgia, Kazakhstan). Economic activity still showed signs of slowing in some CCA countries in the first quarter of 2023, as production constraints in extractive industries held back growth in Azerbaijan, and an easing of remittance flows and weaker gold and agricultural production weighed on activity in the Kyrgyz Republic (Figure 1.10).

However, external buffers have improved in most CCA countries thanks to high international oil and gas prices for oil exporters, large trade surpluses in services (Armenia, Georgia), continued private transfers from Russia, and strong remittance flows. Consequently, reserve accumulation has continued in 2023, and domestic currencies have appreciated (especially in Armenia and Georgia) because of sizable inflows relative to the size of the domestic economy.

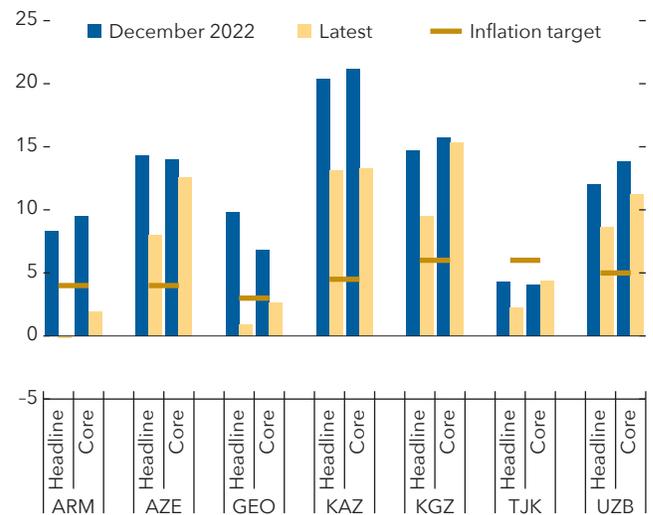
Despite still-robust growth, headline and core inflation have eased, helped by base effects, declines in international food and energy prices, earlier monetary policy tightening, and tighter fiscal positions in some countries. The disinflation process has been particularly fast where currencies appreciated strongly vis-à-vis trading partners (Armenia, Georgia), highlighting the exchange rate channel’s importance in domestic price dynamics (Figure 1.11). Notably, inflation has fallen below central bank targets in Armenia and Georgia and administered prices have contained inflation in Tajikistan (Figure 1.12).

**Figure 1.11. Inflation Changes and Currency Appreciation since June 2022**  
(Percent)



Sources: Haver Analytics; national authorities; and IMF staff calculations.  
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. NEER = nominal effective exchange rate.

**Figure 1.12. CCA: Inflation**  
(Percent change, year-over-year)



Sources: Haver Analytics; national authorities; and IMF staff calculations.  
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia.

**Figure 1.13. House Prices**  
(Index, January 2022 = 100)



Source: Haver Analytics; national authorities; and IMF staff calculations.

Note: House prices in Armenia are proxied by the average price per square meter of multiapartment buildings in Yerevan. House prices in Georgia are interpolated from quarterly data. House prices in Kazakhstan are proxied by a price index for existing new housing.

However, inflation remains elevated in several countries and core inflation has proved stickier than headline. Strong demand in the services sector and strong wage growth in some countries has prevented a faster disinflation process in Azerbaijan, Kazakhstan, the Kyrgyz Republic, and Uzbekistan.

Slowing inflation has prompted some CCA central banks to begin loosening monetary policy, supporting an easing of financial conditions. Armenia, Georgia, Kazakhstan, and Tajikistan have reduced their policy rates by 50, 75, 25, and 300 basis points, respectively, since the beginning of the year. Combined with an expansion in monetary aggregates (Armenia, Georgia, Kyrgyz Republic) and local currency appreciation, the resulting easing of financial conditions has supported a steady (though small in magnitude) increase in credit to the private sector (Azerbaijan, Kyrgyz Republic, Tajikistan). At the same time, housing prices have risen in Armenia, Georgia, and Kazakhstan since the first quarter of 2022 (Figure 1.13).

## CCA Outlook: Moderating but Still Robust Growth

Near-term prospects in the CCA are broadly positive. Overall, GDP growth in the CCA is projected to moderate to 4.6 percent in 2023 and decline further to 4.2 percent in 2024. This reflects an upward revision of 0.3 percentage point for 2023 relative to April amid a more persistent positive impact on growth from real and financial flows to the region (Armenia, Georgia, Tajikistan, Uzbekistan). However, country-specific factors and challenges are expected to result in divergent growth trends across countries this year. For example, growth in Armenia and Georgia is set to decelerate from last year's double-digit surge in activity, and economic activity in CCA LICs is softening on a continued decline in remittance flows and weaker gold and agricultural production (Kyrgyz Republic, Tajikistan, Uzbekistan).

Among oil and gas exporters, economic momentum is projected to decelerate in Azerbaijan and remain subdued in Turkmenistan, reflecting persistent capacity constraints in hydrocarbon production and deep-seated structural challenges. By contrast, growth in Kazakhstan is expected to rebound this year, supported by strong domestic demand and increased oil production (because of easing operational constraints affecting the Caspian Pipeline Consortium and the Tengiz oil field expansion).

Economic activity in the CCA is generally forecast to decelerate over the medium term as inflows from Russia dissipate, growth in extractive sectors slows, and structural gaps persist, holding back productivity, including related to limited diversification of economic structures and international trade patterns (Box 1.2), governance challenges, and lack of competition (Gigineishvili and others 2023). In this context, average medium-term growth in the region is projected to decline below its pre-pandemic historical average (Figure 1.14).

External positions are projected to weaken as private transfers and trade from Russia gradually normalize. Azerbaijan and Kazakhstan are forecast to experience sharp current account deteriorations, reflecting lower export revenues and strong imports. Moreover, Azerbaijan is expected to continue to experience production constraints related to structural (oil) and capacity (gas) challenges.

Meanwhile, disinflation is projected to continue. Reflecting sharp declines in inflation in Armenia and Georgia, inflation is projected to ease to 11 percent on average in 2023 (0.8 percentage point faster than projected in April). Although strong wage growth in Kazakhstan, the Kyrgyz Republic, and Uzbekistan underpins more persistent price pressures, headline inflation in the CCA is still projected to moderate to 8.3 percent in 2024.

Public-sector debt is at manageable levels. Still, overall fiscal positions are forecast to worsen by 1.5 percent of GDP on average across the CCA in 2023 and remain broadly unchanged in 2024. Notably, expenditure increases are projected in Kazakhstan (though these will be largely offset by strong non-oil revenues), the Kyrgyz Republic (subsidies and the wage bill), and Azerbaijan and Tajikistan (capital expenditure). By contrast, Georgia is set to maintain a gradual consolidation path, supported by strong revenue and fiscal restraint.

## 1.4. Risks to the ME&CA Outlook

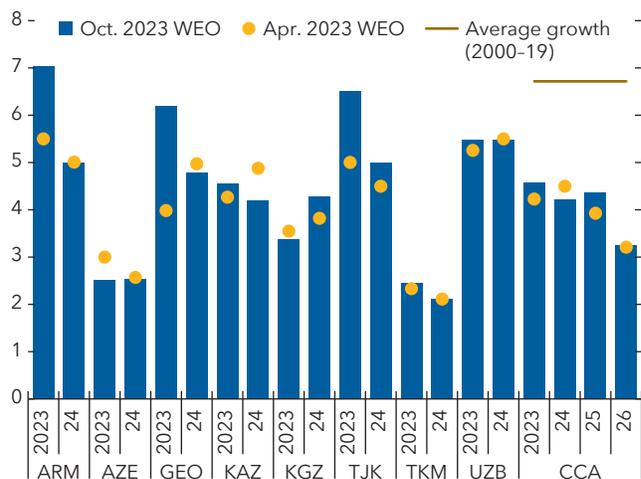
*The balance of risks to the outlook in ME&CA has improved since the April 2023 World Economic Outlook, but it remains tilted to the downside.*

The materialization of several upside risks could help lift growth prospects in ME&CA. A faster-than-anticipated global decline in inflation would reduce the extent of central banks' necessary interest rate hikes, allowing for an easing of global financing conditions and an attendant decline in borrowing costs in ME&CA. Moreover, lower-than-expected food prices would help reduce fiscal costs, alleviating food insecurity especially in LICs. Stronger-than-projected global growth (for example, because of additional stimulus measures in China), would reignite global trade and help strengthen external demand for ME&CA exports. A continued influx of migrants and foreign exchange to the CCA could boost demand.

Yet, several downside risks cloud the outlook. A larger-than-expected slowdown in China or advanced economies would depress external demand and worsen the region's economic prospects, reducing tourism and curtailing exports, including amid China's importance in global commodity demand. Moreover, an escalation of the war in Ukraine could put renewed pressure on food (for example, because of the suspension of the Black Sea Grain Initiative), fuel, and fertilizer prices, thus reigniting inflationary pressures and worsening food insecurity, with the potential differential effect on inflation across countries determined by their import or export dependence. The realization of climate-related shocks—especially amid changing El Niño patterns—could result in local or regional persistent drought conditions and floods, affecting physical infrastructure, agriculture output, and food prices.

Region-specific downside risks could also materialize:

**Figure 1.14. Real GDP Growth**  
(Percent change, year-over-year)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; WEO = World Economic Outlook.

- Tighter global financial conditions and deeper spillovers from regional conflicts could pose risks amid challenging financing conditions for MENA region EM&MIs. Tighter-for-longer global financial conditions could prompt investors to reassess lending to highly indebted EM&MIs, worsening debt dynamics and heightening risks of debt distress. Attendant fiscal tensions could spill over to the private sector through sovereign-bank link (Chapter 3). Separately, a deterioration of the crisis in Sudan could accelerate migration flows and add to social and economic costs in Egypt (Box 1.1).
- A possible worsening of geoeconomic conditions related to Russia's war in Ukraine could adversely impact financial flows, remittances, trade, and economic activity, and lead to the introduction of secondary sanctions. In addition, a conflict escalation could cause new disruptions to regional trade infrastructure and linkages, including maritime routes and oil pipelines, thereby hampering trade and economic activity for oil and gas exporters and importers alike.

Limited progress in implementing structural reforms, including under IMF-supported programs, would weigh on medium-term prospects further and undermine the region's resilience to shocks given long-standing structural gaps (Chapter 2). Chronically limited job creation, high unemployment rates, and a heavy reliance on volatile commodity markets expose ME&CA to downside risks. These structural deficiencies hinder the region's ability to attract foreign investment, foster innovation, and create the competitive and dynamic business environment necessary to increase the economy's resilience to shocks.

## 1.5. Policies: Building Resilience while Safeguarding Macro Stability

*In the context of subdued growth prospects, accelerating efforts to foster structural economic change is essential to enhancing potential growth and inclusion, hastening economic diversification, and increasing resilience to shocks. This is all the more important as persistent inflationary pressures and depleted fiscal and external buffers in several ME&CA countries call for continued tight macroeconomic policies to re-establish price stability and ensure fiscal and external sustainability.*

### Structural Policies: Transforming the Economy to Be Ready for Tomorrow

Expediting the implementation of comprehensive structural reforms is critical to solving the deep-seated economic challenges holding back growth in ME&CA, especially when many countries will need to maintain tight macroeconomic policies (Chapter 2).

- Strengthening governance would be instrumental to fostering an economic environment that promotes private investment. Reforms to improve government effectiveness and the rule of law can be particularly impactful by strengthening efficiency and predictability for private sector participants. This is particularly relevant as most ME&CA countries fall far behind the global frontier on multiple governance indicators. Moreover, countries need to ensure a level playing field between public and private firms to develop the private sector. This requires reducing the dominant role of state-owned enterprises, streamlining or eliminating burdensome government regulations, enhancing financial inclusion (especially of small and medium-sized enterprises), and improving general governance.
- ME&CA countries would benefit from fostering financial development (for example, by strengthening regulatory and supervisory frameworks, enforcing property rights and creditor rights, and enhancing banking competition, transparency, and information sharing; Gigineishvili and others 2023) and improving productivity by investing in infrastructure, including transportation and information and communication technologies.
- Promoting digitalization would be essential as it is a tool to improve both inclusion and efficiency. Notably, increased digitalization can help provide the young and women with new job opportunities associated with remote working, online learning, digital finance, and e-commerce.

- Amid low female labor force participation in the MENA region, several countries would also need to reduce barriers to women's participation in economic life, including by removing the legal and policy barriers that weaken the link between women's education and employment outcomes (Cardarelli, Vera-Martín, and Lall 2022).

However, identifying an appropriate set of structural reforms is not enough to maximize growth. Sequencing and packaging structural reforms matter for their overall economic growth dividend (Chapter 2). For example, “first-generation” reforms—governance, regulatory quality, and external sector reforms—can have a positive impact on the returns from subsequent reforms. Similarly, credit market and labor market reforms can have a substantial effect on output once countries implement first-generation reforms.

Critically, climate change-related shocks threaten growth prospects across ME&CA and represent a key source of socioeconomic risk. Effective climate change adaptation requires including climate risks and policies in all relevant policy frameworks and structural reform agendas; adopting measures that help boost climate resilience—notably social measures (such as social protection, health care, and education) and infrastructure investments (Duenwald and others 2022)—and promoting a balanced policy mix to support climate mitigation and more sustainable growth (April 2023 *Fiscal Monitor*). In addition, oil exporters should make the transition toward more diverse and greener sources of energy generation. Eliminating energy subsidies is an important first step. The geographic location and dependence on agriculture of many LICs and fragile and conflict-affected states (FCS) expose them to climate change disproportionately. Notably, droughts increase hunger from already elevated levels, calling for scaling up climate-resilient infrastructure investment (Jaramillo and others 2023).

### Monetary and Financial Policies: Bringing Inflation Down Durably While Maintaining Financial Stability

Monetary policy should remain focused on price stability. Consistent with prevailing policy frameworks, exchange rate flexibility can help cushion the impact of shocks. In all economies, clearly communicating policy intentions is essential to support stability. As such, countries in the region could benefit from strengthening monetary policy frameworks and increasing the transparency of monetary policy operations. Ensuring central bank independence is critical for the monetary policy effectiveness (April 2023 *Regional Economic Outlook: Middle East and Central Asia*).

- In countries with a flexible exchange rate and persistent inflationary pressures, monetary policy should remain tight and follow a data-dependent approach. Most EM&MIs would need to maintain a tight policy stance and remain vigilant until signals of sustained disinflation are well-established. In some economies where inflation is high, this may require more monetary policy tightening (Egypt, Pakistan, Tunisia).
- In countries where inflation has returned to or is near inflation targets and underlying inflationary pressures have abated, monetary easing can proceed in countries where growth is lackluster. But in countries where demand is still strong, it should be done cautiously to prevent re-igniting price pressures. This is particularly relevant in some CCA economies (Armenia, Georgia). Paying due attention to any risks of a reversal of inflation developments will be essential.
- In countries with a fixed exchange rate (GCC, Jordan), any policy interest rate change should be made in accordance with their frameworks.

Additionally, reforms to deepen the financial sector would strengthen liquidity conditions and help spur investment and growth. In some GCC countries, policies to guard against unexpected liquidity stress related to foreign liabilities would help ensure financial sector stability, while countries in the CCA would benefit from macroprudential policies and tools that incentivize de-dollarization and enhance corporate and bank risk management. All ME&CA countries should step up efforts to foster a deep and diversified investor base and improve the

management of state-owned banks—particularly in countries where these entities dominate the marketplace (MENA region, Pakistan)—by building adequate buffers, providing clear and well-defined mandates, and aligning supervisory tools such as stress tests (Chapter 3).

### Fiscal Policy: Strengthening Resilience and Rebuilding Buffers

Amid marked differences in fiscal space and varying dependence on global developments across ME&CA, carefully tailoring policy actions to local conditions will be essential. In all economies, it is essential to ensure that social protection systems have sufficient reach and provide equal access to basic services. Additionally, social spending should be targeted toward the most vulnerable segments of the population, avoiding generalized increases in wages, subsidies, and transfers.

MENA oil exporters would benefit from avoiding procyclical spending. Amid volatile oil prices and a high dependence on global economic developments, boosting fiscal buffers further would help ensure resilience. Moreover, oil exporters would benefit from diversifying away from their current dependence on oil fiscal revenue, strengthening fiscal risk management, and implementing credible medium-term fiscal frameworks. To support longer-term economic resilience, public investments should target the development of non-oil sectors and address the challenges associated with climate change.

In the MENA region's EM&MIs, policymakers will need to strengthen fiscal balances further and bring down public-sector debt levels decisively. Given elevated debt-to-GDP ratios and related debt-servicing costs, EM&MIs should continue consolidating their public finances, mainly by containing current spending on wages and subsidies, and in some cases through additional revenue mobilization (including by removing tax exemptions). Moreover, credible medium-term fiscal frameworks would reinforce these efforts and build a track record of fiscal discipline. For example, the publication by Moroccan authorities of a three-year budget plan as part of the annual budget starting from 2023 represents an important step toward a stronger institutional fiscal framework, as publishing a credible, realistic, and consistent medium-term fiscal plan could reassure markets about the authorities' commitment to fiscal discipline. In addition, for all economies, considering ways to mitigate fiscal risks from state-owned enterprises will be important.

In the MENA region's LICs and FCS, ensuring stability while easing food insecurity remains a priority. Where present, resolving ongoing conflicts is a prerequisite for improving living standards and growth. Where financing constraints prevent progress toward the Sustainable Development Goals, strong efforts are needed to mobilize domestic fiscal revenues. Amid persistent droughts and devastating food insecurity, any spending aimed at supporting livelihoods should target the most pressing social needs (such as acute food insecurity). Support from the international community is essential in this regard because it would help mitigate ongoing humanitarian crises.

Fiscal risks are prevalent in low- and middle-income countries in the MENA region and include those associated with macroeconomic shocks (commodity price volatility), public-sector guarantees (including to state-owned enterprises), and natural disasters, among other shocks (Boukezia and others 2023). To mitigate these risks, country authorities would benefit from developing fiscal risk management frameworks, including building the capacity to identify and assess sources of fiscal risks and their budgetary impact. To this end, countries should collect regular, timely, and comprehensive fiscal data covering the entire public sector, along with other macroeconomic data to facilitate the adoption of fiscal risk mitigation measures.

Amid the uncertainty surrounding the medium-term outlook, CCA countries should maintain a prudent fiscal stance to build buffers and reduce vulnerabilities. Fiscal structural reforms—such as increasing budget transparency and adopting credible medium-term fiscal frameworks anchored in fiscal rules—will reinforce these efforts and help facilitate access to external financing.

## IMF Support Has Expanded

The IMF remains dedicated to supporting the region by offering policy advice, fostering capacity development, and providing financial assistance. The World Bank-IMF Annual Meetings in Marrakech, Morocco, provide a platform for wide-ranging policy discussions on challenges facing the region and the global economy. Since the onset of the pandemic, the IMF has provided \$34 billion in new financing to 15 countries in ME&CA. Over the last year, IMF programs were approved for Armenia (Stand-By Arrangement), Egypt (Extended Fund Facility), Mauritania (Extended Credit Facility and Extended Fund Facility), Morocco (Flexible Credit Line, Resilience and Sustainability Facility), and Pakistan (Stand-By Arrangement). Since 2020, the IMF has also provided about \$6 billion in emergency financing and enhanced its emergency financing facilities to address the pressing food crisis confronting the Fund's most vulnerable members. This includes establishing a Food Shock Window that allows easier access to financial assistance for countries facing balance-of-payments pressures related to food and fertilizers. Moreover, the IMF created the Resilience and Sustainability Trust to support low-income and vulnerable middle-income countries in addressing longer-term challenges, including climate change. The recent approval of a Resilience and Sustainability Facility with Morocco amounting to about \$1.3 billion is the first in ME&CA. The IMF has also increased its local presence in the region by expanding Resident Representative offices, reopening its Middle East Regional Technical Assistance Center, opening its Caucasus, Central Asia, and Mongolia Regional Capacity Development Center, and setting up a new regional office in Riyadh, Saudi Arabia, which will strengthen the IMF's partnership with the region.

## References

---

- Boukezia, Racheeda, Jacques Charaoui, Jonas Frank, Mahmoud Harb, Maximilien Queyranne, Nathalie Reyes, Patrick F. Ryan, and Alexander F. Tieman. 2023. "Managing Fiscal Risks in the Middle East and North Africa." IMF Departmental Paper 23/005. International Monetary Fund, Washington, DC.
- Cardarelli Roberto, Mercedes Vera-Martín, and Subir Lall, eds. 2022. *Promoting Inclusive Growth in the Middle East and North Africa: Challenges and Opportunities in a Post-Pandemic World*. Washington, DC: International Monetary Fund.
- Duenwald, Christoph, Yassir Abdih, Kerstin Gerling, Vahram Stepanyan, Lamiae Agoumi, Abdullah Al-Hassan, Gareth Anderson and others. 2022. "Feeling the Heat: Adapting to Climate Change in the Middle East and Central Asia." IMF Departmental Paper 22/008. International Monetary Fund, Washington, DC.
- Gigineishvili, Nikoloz, Iulia Ruxandra Teodoru, Narek Karapetyan, Yulia Ustyugova, Jean van Houtte, Jiri Jonas, Wei Shi, and others. 2023. "Paving the Way to a More Resilient, Inclusive, and Greener Economies in the Caucasus and Central Asia." IMF Departmental Paper 23/004, International Monetary Fund, Washington, DC.
- Jaramillo, Laura, Aliona Cebotari, Yoro Diallo, Rhea Gupta, Yugo Koshima, Chandana Kularatne, Daniel Jeong Dae Lee, and others. 2023. "Climate Challenges in Fragile and Conflict Affected States." IMF Staff Climate Note 23/001. International Monetary Fund, Washington, DC.
- United Nations High Commissioner for Refugees (UNHCR). 2023. *Sudan Emergency Regional Refugee Response Plan: May–October (Six Months), Revised June 2023*. Geneva.

### Box 1.1. The Conflict in Sudan: Migration Consequences for North Africa

The conflict in Sudan is rapidly worsening the country's humanitarian crisis, which has been ongoing for more than two decades. Economic and social conditions have deteriorated since 2021, with currency depreciation driving a dramatic rise in inflation and worsening food insecurity. At the start of 2023, almost 16 million people—one-third of the population—needed humanitarian assistance, and 11 million people were acutely food insecure. However, since the conflict intensified in April, the United Nations estimates that the number of people in Sudan needing humanitarian assistance has increased by a staggering 10 million. This jump partly reflects a 20 percent increase in food prices between March and June, reducing access to sufficient and safe food, and pushing more than 20.3 million (42 percent of country's population) to high levels of acute food insecurity, according to the Food and Agriculture Organization.

The crisis in Sudan is expected to generate large flows of displaced persons in Africa. The United Nations High Commissioner for Refugees (UNHCR) reported that more than 5.3 million had been displaced as of September. Of these, about 1.2 million have left the country. Chad and Egypt have received the most internationally displaced refugees (412,000 and 317,000, respectively); other neighboring countries

received around 70,000 refugees. Additionally, about 250,000 refugees from South Sudan are expected to leave Sudan to return to their home country.

The economic costs for countries impacted by this displacement are substantial. The UNHCR estimates the total cost of the response across the five countries receiving refugees at \$1 billion through December 2023. By September, \$266 million had been funded (Box Figure 1.1.1).

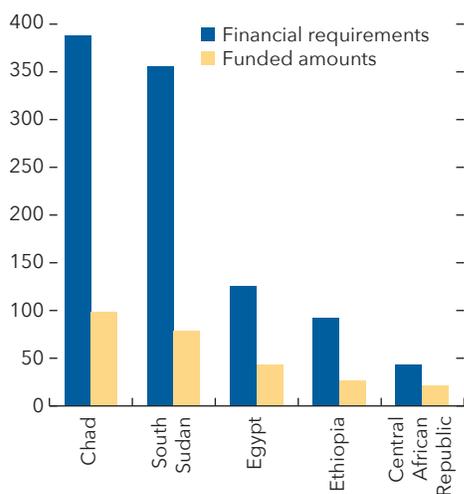
According to the United Nations Office for the Coordination of Humanitarian Affairs, the current crisis has also increased the cost of Sudan's overall humanitarian response plan by an estimated \$750 million, raising it to \$2.6 billion. As of September, donors had funded about \$900 million, about one-third of the response funds needed.

The impact of the conflict in Sudan could be long-lasting. Sudan's infrastructure and human capital are incurring significant losses, that could take years to rebuild. A weakened Sudanese economy would negatively affect neighboring countries and North Africa more broadly over the medium term. To prevent these

consequences, donor countries, both internationally and in the region, should contribute to relief efforts for refugees and continue to use all their capacity to end the conflict as soon as possible.

**Box Figure 1.1.1. Refugee Response: Financial Requirements and Funded Amounts**

(Millions of US dollars)



Sources: UNHCR (2023); and IMF staff calculations.

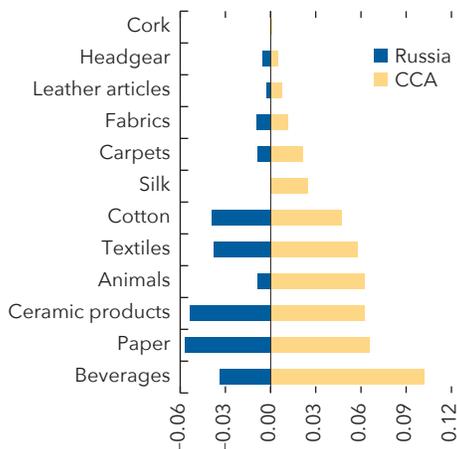
### Box 1.2. Changing Trade Patterns in the Caucasus and Central Asia

Since the start of the war in Ukraine, trade patterns in the Caucasus and Central Asia (CCA) have changed. Despite possible errors and omissions in trade statistics,<sup>1</sup> the data show that trade flows between Russia and several CCA countries have increased for product categories including iron and steel, machinery, chemicals, agriculture products, and energy. Overall, the Kyrgyz Republic’s share of exports to Russia has tripled (increasing from 14 percent of total exports in 2021 to 44 percent in 2022), while Armenia’s exports to Russia almost doubled (from 27 percent in 2021 to 45 percent in 2022). The increase in Uzbekistan’s exports to Russia was significantly smaller—only 5 percentage points (from 12 percent in 2021 to 17 percent in 2022)—as exports to the European Union and the rest of the world increased significantly. By contrast, the share of exports to Russia from Azerbaijan, Georgia, and Kazakhstan declined slightly.

In parallel, most CCA countries have stepped up their exports to the rest of the world, expanding the region’s overall footprint in global trade. In relative terms, most countries in the CCA (excluding Armenia and the Kyrgyz Republic) increased their non-energy export share to trading partners other than Russia in 2022. This rise was primarily in agriculture products, food, and raw materials (especially metals), and corresponds to the product categories in which Russian exports have declined the most since the war started (Box Figure 1.2.1). From a geographical standpoint, exports to the European Union, the United States, China, and the rest of the world surged, suggesting a broad-based geographical widening of CCA trade links (Box Figure 1.2.2).

**Box Figure 1.2.1. CCA Exports to the Rest of the World**

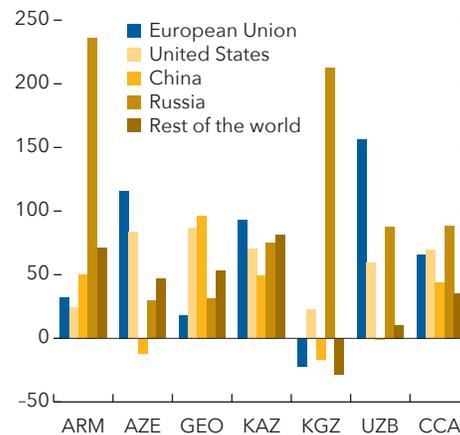
(Change in billions of US dollars, 2022 versus 2019-21 average)



Sources: United Nations Comtrade; and IMF staff calculations.  
 Note: Includes all CCA countries except Tajikistan and Turkmenistan because of lack of data.  
 CCA = Caucasus and Central Asia.

**Box Figure 1.2.2. CCA Exports by Trading Partner**

(Percentage change, 2022 versus 2019-21 average)



Sources: United Nations Comtrade; and IMF staff calculations.  
 Note: All CCA countries except for Tajikistan and Turkmenistan because of lack of data. Data for the Kyrgyz Republic do not include gold exports, which declined sharply because of non-war-related reasons. Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia.

Prepared by Hasan Dudu.

<sup>1</sup> Official trade statistics may not accurately reflect trade within the Eurasian Customs Union and, therefore, among Armenia, Kazakhstan, the Kyrgyz Republic, and Russia. For example, available data for the Kyrgyz Republic are based on sporadic surveys of exporters and vehicles crossing the border.