1. Regional Developments and Economic Outlook: An Uneven Recovery amid High Uncertainty[1]

Uncertainty has become increasingly prevalent amid ongoing conflicts, shipping disruptions, and lower oil production. In turn, an uneven recovery is emerging, with growth this year at varying speeds across the Middle East and Central Asia (ME&CA). In the Middle East and North Africa (MENA), conflicts continue in several economies, providing stark reminders of their devastating human toll and long-term economic scarring. Some emerging market and middle-income countries (EM&MIs) face financing pressures and persistently high inflation. While some oil exporters continued with additional voluntary oil production cuts, they are strengthening nonhydrocarbon activity. In the Caucasus and Central Asia (CCA), growth momentum remains robust despite diminishing real and financial inflows related to the war in Ukraine, and hydrocarbon importers are generally growing faster than exporters due to stronger domestic demand. Across ME&CA, inflation is close to historical averages or targets for many economies and is projected to continue easing.

1.1. Global Backdrop: Disinflation amid Economic Resilience

Globally, economic activity has been resilient during the disinflation of the past two years. Even as monetary policies have tightened, favorable demand and supply developments have supported growth in several major economies, defying warnings of stagflation and a global recession. However, as inflation approaches target levels and central banks start easing monetary policy, tighter fiscal policies to curb debt levels are expected to weigh on growth.

Global growth, estimated at 3.2 percent in 2023, is projected to continue at the same pace in 2024 and 2025, surpassing the October 2023 *World Economic Outlook* projections for 2024 by 0.3 percentage point. However, at 3 percent, the medium-term forecast for global growth is the lowest in decades, partly reflecting persistent structural frictions preventing capital and labor from going to more productive firms and geoeconomic fragmentation. In addition, dimmer prospects for growth in China and other large emerging market economies are projected to weigh on prospects in trading partners.

Inflationary pressures are expected to ease steadily. Global headline inflation is projected to decline to an annual average of 5.9 percent in 2024 and 4.5 percent in 2025, with advanced economies returning to inflation targets before emerging market and developing economies. Meanwhile, the annual average oil price is forecast to drop by 2.5 percent in 2024 (to $78.61 per barrel) and 6.2 percent in 2025 (to $73.68 per barrel), while average prices for nonfuel commodities remain broadly stable.

1.2. MENA Region and Pakistan: No Break from Challenges

Economic activity in the MENA region and Pakistan is projected to strengthen from the weak outturn in 2023. Yet the forecast for 2024 has been revised down to 2.6 percent as conflicts,[2] tight policy settings in some economies, and lower hydrocarbon production continue to weigh on growth. Notably, the conflict in Gaza and Israel has

[1] Prepared by Steven Dang, Hasan Dudu, Rhea Gupta, Bashar Hlayhel, Thomas Kroen, Colombe Ladreit, Troy Matheson (lead), Borislava Mircheva (lead), Salem Mohamed Nechi, Subi Velkumar, and Qirui Zhang.

[2] Beyond West Bank and Gaza, six economies in MENA and Pakistan faced conflicts at the beginning of 2024. These are Iraq, Pakistan, Somalia, Sudan, Syria, and Yemen (Armed Conflict Location & Event Data Project [https://acleddata.com]). A country is considered to be in a conflict if at least 25 battle-related fatalities were recorded by the Armed Conflict Location & Event Data Project between January 1, 2024, and March 8, 2024 (data last updated March 8, 2024).

worsened an already challenging environment, and disruptions to shipping through the Red Sea have added to uncertainty.[3] Further ahead, growth is projected to strengthen as the impact of oil production cuts and conflicts gradually fade while remaining below historical averages over the medium term. Inflation continues to recede in line with global trends.

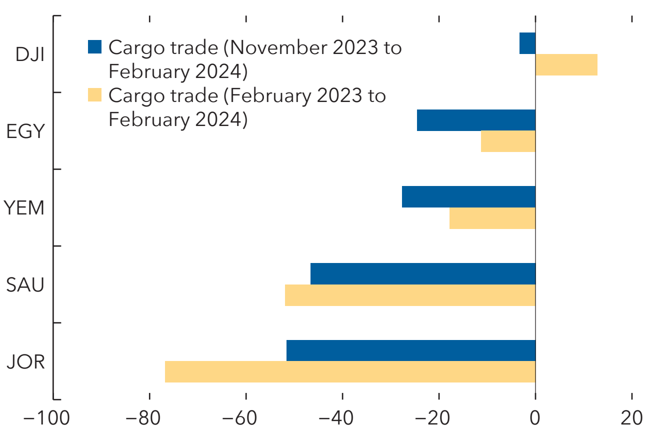
Recent Developments: Slower Growth amid Diverse Challenges

Among MENA EM&MIs, the impact of the conflict in Gaza and Israel is taking its toll on the most exposed economies. Beyond the devastating human toll, economic activity in Gaza has come to a standstill. As a result, real GDP in West Bank and Gaza is estimated to have contracted by more than 6 percent in 2023. As of March 15, 1.7 million people (75 percent of Gaza's population) had been internally displaced (UNOCHA 2024).

Moreover, security risks in the Red Sea continue to raise broader concerns about the impact of the conflict on trade and shipping costs, as 12–15 percent of global trade passes through the Suez Canal (UNCTAD 2024). Egypt's economy is particularly exposed to these disruptions, having received about 2.2 percent of GDP in annual balance-of-payment receipts—over $700 million per month—and 1.2 percent of GDP in fiscal revenue from Suez Canal dues in 2022/23. However, between the first drone attacks in the Bab el-Mandeb Strait in November and the end of February, trade through the Suez Canal dropped by more than half, from 38 million metric tons to 16 million metric tons.

The reduction in cargo trade volumes is also affecting other EM&MIs, with their Red Sea ports experiencing lower throughput (Figure 1.1). For example, by the end of February, Jordan's exports and imports through the Port of Aqaba had been cut nearly in half since the beginning of the disruptions in November, although some trade flows have since been redirected through other routes. In Saudi Arabia, port activity has decreased in Jeddah as the authorities shift traffic to the port of Dammam, located in the Persian Gulf.

Figure 1.1. Cargo Trade Volumes
(Percent change, seasonally adjusted, February 2024 versus November 2023, and February 2023)



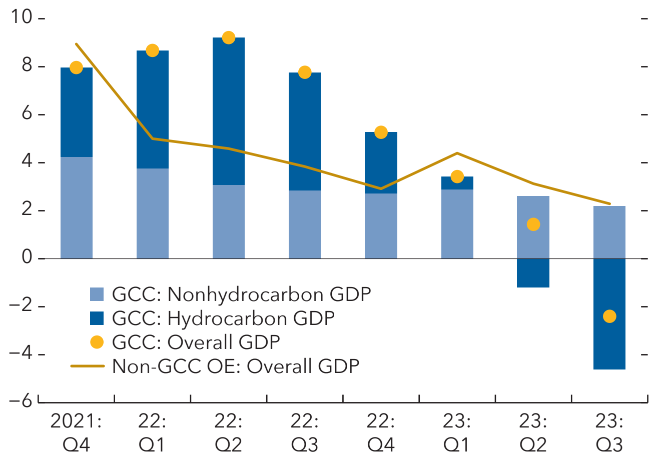
Sources: Portwatch; and IMF staff calculations.
Note: The data capture trade in goods. Data labels in the figure use International Organization for Standardization (ISO) country codes.

Elsewhere, in Tunisia, growth slowed to 0.4 percent in 2023 (from 2.6 percent in 2022) due to a drought-related decline in agricultural production and weak domestic demand. On the positive side, Morocco's economy outperformed expectations last year, with growth estimated at 3 percent (0.6 percentage point higher than October projections) due to strong domestic demand, which was supported by robust tourism receipts despite the September 2023 earthquake, fading adverse terms-of-trade effects, and a resurgence of agricultural production.

Conflicts are also weighing on economic conditions in some low-income countries (LICs), particularly Sudan and Yemen. Sudan is facing an escalating humanitarian crisis and substantial damage to its infrastructure, driven by a conflict that has displaced about 8.4 million people both inside and outside the country (UNHCR 2024). Sudan's real GDP is estimated to have contracted by almost 20 percent in 2023. Yemen also saw a contraction in output last year and continues to lack the financing to ensure sufficient food imports to meet basic needs. On a more positive note, higher-than-expected growth in Djibouti (at 7 percent) was supported by a resumption of construction and higher-than-expected gold production.

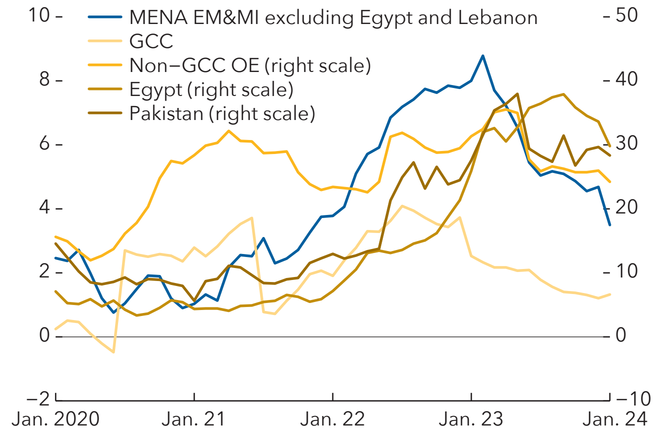
[3] See the January 2024 *Regional Economic Outlook Update: Middle East and Central Asia—Middle East and North Africa: Conflict Compounding Economic Challenges*.

Figure 1.2. MENA Region: Real GDP Growth
(Percent change, year over year; weighted averages)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: GCC = Gulf Cooperation Council; MENA = Middle East and North Africa; OE = oil exporters.

Figure 1.3. MENA Region EM&MIs and Pakistan: Headline Inflation
(Percent change, year over year)



Sources: Haver Analytics; IMF, Consumer Price Index database; national authorities; and IMF staff calculations.
Note: EM&MI = emerging market and middle-income economies; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa; OE = oil exporter.

Voluntary oil production decisions largely drove growth in MENA oil and gas producers in 2023. Notably, Gulf Cooperation Council (GCC) countries experienced a marked deceleration in hydrocarbon growth following several rounds of voluntary production cuts by some OPEC+ countries. Consequently, real GDP growth in the GCC slowed sharply (to 0.4 percent), despite robust nonhydrocarbon growth driven by continued benefits from reforms to diversify the economy, high domestic demand, and gross capital inflows. Activity in non-GCC oil exporters was broadly stable, with heterogeneity across countries reflecting higher oil exports (Islamic Republic of Iran, Libya) and fragility (Iraq) (Figure 1.2).

Inflation on a Downward Path

In line with global trends, inflation in many MENA economies started to ease in 2023, reflecting the impact of earlier monetary policy tightening and lower commodity prices (Figure 1.3). In turn, monthly sequential headline and core inflation in most oil exporters and EM&MIs have receded to levels close to historical averages.

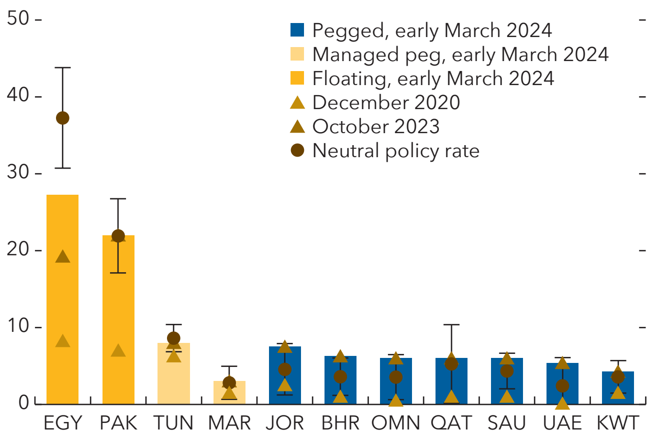
Nevertheless, inflation has remained persistently high in some economies. Notably, inflationary pressures have reflected food import shortages and accommodative fiscal and monetary policies in Algeria; foreign exchange shortages in Egypt; exchange rate depreciation and loose fiscal and monetary policies in the Islamic Republic of Iran; as well as necessary utility price adjustments, the impact of loose fiscal and monetary policies in fiscal year 2023, and a gas tariff increase in Pakistan. In Lebanon, inflation remains high, but the end of monetary financing, which forced a balanced budget and a stable exchange rate, has helped ease inflationary pressures since mid-2023. Among LICs, inflation rates continue to vary markedly—with Sudan experiencing particularly high levels—and food insecurity remains a widespread concern.

Monetary Tightening Cycles Have Broadly Ended, Fiscal Consolidation Continues

With inflation easing, monetary policy tightening has broadly halted. Only Egypt has raised its policy interest rate by 800 basis points since October 2023. However, despite earlier significant monetary policy tightening to bring down inflation, estimates of neutral interest rates suggest that some additional tightening may be needed in Egypt and Tunisia to contain inflation (Figure 1.4), though these estimates are subject to large error bands.[4]

[4] For details on the methodology used, see the April 2023 *Regional Economic Outlook: Middle East and Central Asia*.

Figure 1.4. MENA Region and Pakistan: Early March Policy Interest Rates
(Percent)

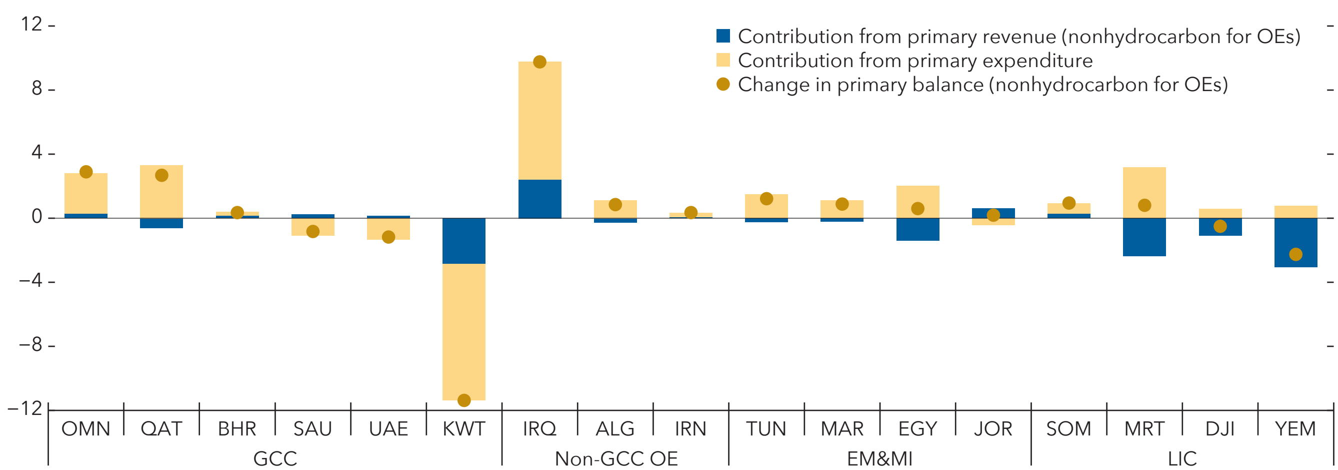


Sources: Haver Analytics; and IMF staff calculations.
Note: Range indicates one standard deviation of model-derived neutral policy rates. Data labels in the figure use International Organization for Standardization (ISO) country codes. MENA = Middle East and North Africa.

Meanwhile, central banks in countries with currencies pegged to the US dollar have maintained a tight monetary policy stance, mirroring the actions of the Federal Reserve, which has kept its policy interest rate unchanged since August 2023.

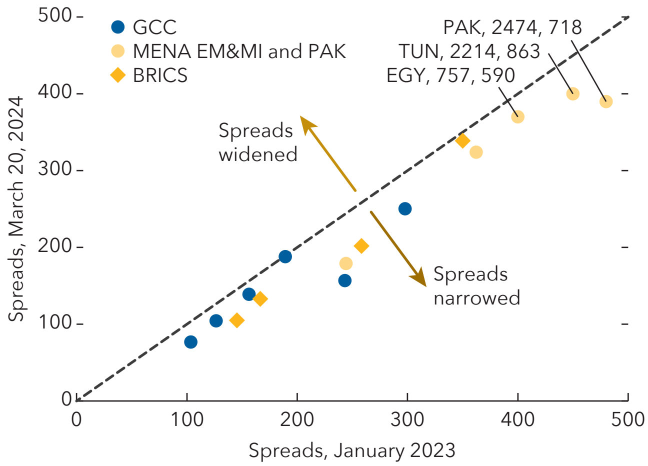
In terms of fiscal policy, EM&MIs continued to grapple with high borrowing costs, and oil production cuts weighed on revenues for several oil exporters in 2023. EM&MIs continued tightening their primary fiscal positions amid high debt levels and elevated borrowing costs. Yet debt ratios increased amid rising financing needs, including as expenditure consolidation was more than offset by a cyclical revenue decline. Among LICs, an improved fiscal position in Somalia was achieved, reflecting revenue overperformance supported by the implementation of higher customs duties and tax administration improvements. Meanwhile, in the GCC, fiscal outturns were mixed. While nonhydrocarbon primary balances as a share of nonhydrocarbon GDP improved for Bahrain, Oman, and Qatar, they deteriorated for Kuwait, Saudi Arabia, and the United Arab Emirates (Figure 1.5). Still, overall fiscal balances deteriorated in 2023 for most GCC economies due to lower oil revenues following oil production cuts and broadly stable oil prices. While overall balances also worsened among non-GCC oil exporters amid lower oil revenues, nonhydrocarbon primary balances are estimated to have generally improved.

Figure 1.5. Change in Primary Balances and Contributions (Excluding Grants), 2022–23
(Percent of GDP, percent nonhydrocarbon GDP for oil exporters)



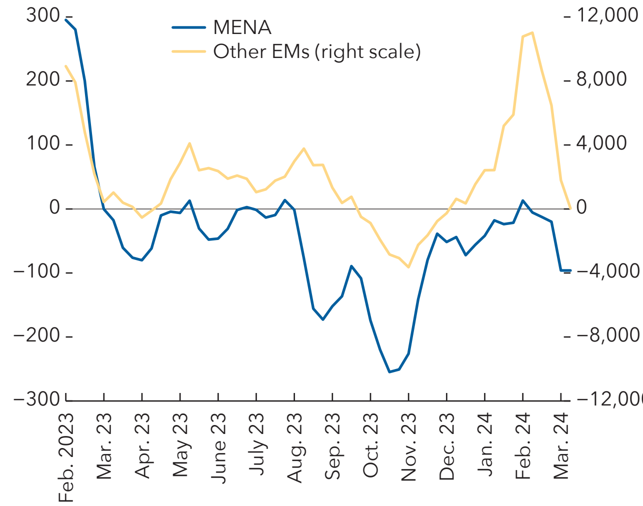
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: All data refer to the calendar years, except for the following countries, which refer to the fiscal years: Afghanistan (December 21 to December 20 from 2002 to 2020, and March 21 to March 20 thereafter), Islamic Republic of Iran (March 21 to March 20), and Egypt and Pakistan (July to June). Country abbreviations are International Organization for Standardization (ISO) country codes. EM&MI = emerging market and middle-income economies; GCC = Gulf Cooperation Council; LIC = low-income countries; OE = oil exporters.

Figure 1.6. J.P. Morgan EMBIG Spreads
(Basis points)



Source: Bloomberg Finance L.P.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. BRICS = Brazil, Russia, India, China, South Africa; EM&MI = emerging market and middle-income economies; EMBIG = Emerging Markets Bond Index Global; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa.

Figure 1.7. Net Equity and Debt Portfolio Flows
(Millions of US dollars; four-week moving average)



Sources: Haver Analytics; and IMF staff calculations.
Note: EMs = emerging markets; MENA = Middle East and North Africa.

Pockets of External Vulnerabilities Linger

Although current account balances narrowed in 2023, external vulnerabilities remained elevated, especially in EM&MIs and LICs. Current account deficits in MENA EM&MIs improved from 5.2 percent of GDP in 2022 to 3.0 percent in 2023, largely reflecting import compression (declining commodity prices and slowing domestic demand). For MENA LICs, the average current account deficit also improved, narrowing from 11.9 percent of GDP in 2022 to 8.9 percent in 2023, owing to narrower deficits in Mauritania (normalization of imported food and energy prices) and Sudan (collapse of external trade). At the same time, external buffers (reserves) improved for most EM&MIs in 2023 due to stronger tourism receipts and a reduced trade deficit from improvements in the terms of trade (Morocco, Tunisia). In contrast, Pakistan's external buffers deteriorated, mostly reflecting ongoing debt service, including Eurobond repayments.

Sovereign spreads for global emerging markets have narrowed over the past year and are close to early 2023 levels for most MENA countries (Figure 1.6). However, they remain at distressed levels (more than 1,000 basis points) for Lebanon, Pakistan, and Tunisia. Meanwhile, in contrast to other emerging markets, the MENA region has largely experienced capital outflows since early 2023 (Figure 1.7). The region's EM&MIs have not issued Eurobonds since the first half of 2023 (except for Jordan), and this issuance came at a higher cost than for GCC countries (Bahrain, Saudi Arabia, United Arab Emirates). The continued reliance on domestic financing risks further exacerbating the sovereign-bank nexus, given the already-high exposure of banks to sovereign debt in some EM&MIs (notably Egypt and Pakistan).

Outlook: An Uneven Recovery

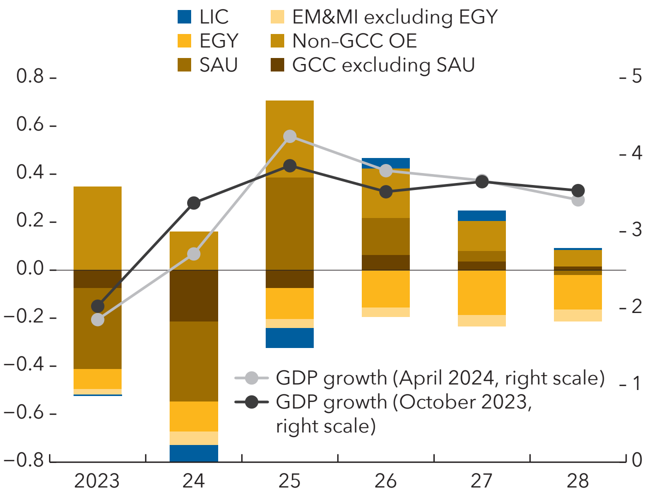
The growth outlook for the MENA region and Pakistan is characterized by an uneven recovery against a backdrop of armed conflicts, hydrocarbon dependence, and persistent structural challenges (Figure 1.8).

Near-term growth is projected to remain lackluster, improving only moderately to 2.6 percent in 2024 (from 1.6 percent in 2023)—a downgrade of 0.7 percentage point from the October 2023 *Regional Economic Outlook: Middle East and Central Asia*.[5] This downgrade mainly reflects additional voluntary oil production cuts (some

[5] The conflict in Gaza and Israel—and associated Red Sea trade disruptions—are assumed to remain at the current level of intensity and start easing after the first quarter of 2024, with the intensity gradually declining over the course of a year.

Figure 1.8. MENA Region: Contributions to Revisions in GDP Growth

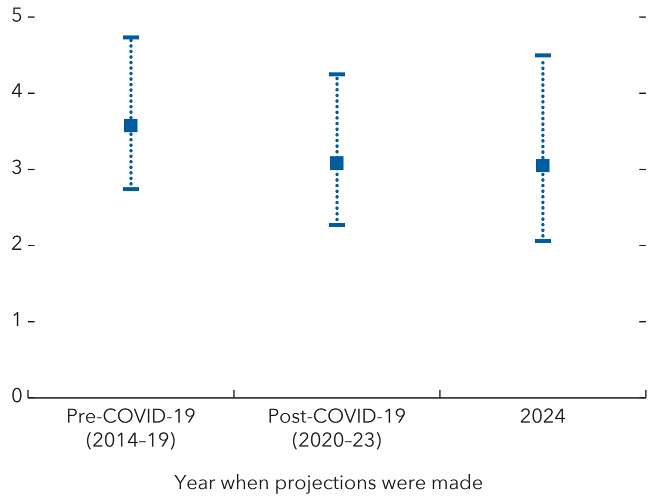
(Percent change, year over year; percentage points for revisions)



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

Figure 1.9. MENA and Pakistan: Medium-Term Growth Projections and Dispersion across Countries

(Percent)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: April *World Economic Outlook* five-year-ahead growth projections made between 2014 and 2024 (current). Range is the distance between the 75th and 25th percentiles of country projections. MENA = Middle East and North Africa.

GCC countries); reduced revenues due to lower hydrocarbon prices, which is expected to lead to lower fiscal spending (hydrocarbon exporters); the adverse impacts of conflicts (Sudan, West Bank and Gaza) and their spillovers, including disruptions in the Red Sea (Egypt); and still-tight monetary policy settings (GCC countries).

Growth in 2025 is projected to strengthen to 4.1 percent as some of the factors weighing on growth this year gradually fade. However, over the medium term, growth is projected to remain below historical averages in most countries, owing to persistent structural challenges, including continued financing pressures for some economies, and an ongoing deceleration in hydrocarbon growth. Growth prospects for some countries are also hampered by the prevalence of conflict in the region, which tends to have lasting adverse social and economic impacts (Chapter 2). Meanwhile, others could be impacted by trade diversion stemming from geopolitical developments and uncertainty (Chapter 3). Against this backdrop, medium-term growth projections have been gradually deteriorating over the past decade, with current projections showing more dispersion across countries (Figure 1.9).

EM&MIs and Pakistan: Slowing Growth, Rising Financing Needs Exacerbate Vulnerabilities

Growth in MENA EM&MIs is projected to slow to 2.8 percent this year (from 3.1 percent in 2023)—a downward revision of 0.7 percentage point from October. In Egypt, foreign exchange shortages held back economic activity until recent necessary macroeconomic policy adjustments were taken, while the situation in the Red Sea is expected to weigh on activity in the remainder of the fiscal year. As a result, growth in Egypt has been revised down by 0.6 percentage point since October to 3.0 percent in 2024.[6] Meanwhile, Jordan's robust economic fundamentals are expected to support stable growth. After contracting in 2023, growth in Pakistan is projected to rebound to 2.0 percent in 2024, supported by continuing positive base effects in the agriculture and textile sectors. Morocco's growth projection has been revised down by 0.5 percentage point since October to 3.1 percent, largely reflecting slowing domestic demand.

[6] Projections for Egypt refer to the fiscal year (July to June).

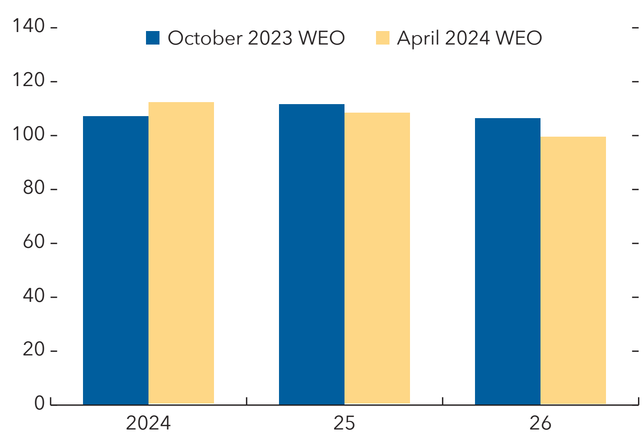
Further ahead, growth in MENA EM&MIs and Pakistan is projected to accelerate to nearly 4 percent in 2025 as constraints to growth this year (tight policies and country-specific events, including spillovers from conflict) begin to wane. Nonetheless, continued tight macroeconomic policies to tackle high levels of debt and inflation in some countries, coupled with persistent structural challenges, are expected to hold back medium-term economic activity, with growth remaining below historical averages in most economies.

On the positive side, inflation is projected to continue easing in most EM&MIs. Specifically, price pressures in Jordan and Morocco are projected to remain low, with inflation settling below 3 percent this year and over the medium term. Inflation is projected to decline gradually in Egypt as foreign exchange shortages ease and monetary tightening takes hold. Tunisia is expected to face continued elevated inflation over the projection horizon, albeit in single digits, amid sizable fiscal financing needs, increased recourse to monetary financing, and persistent product market policy distortions.

Although easing oil prices are reducing import costs, the uptick in domestic demand—and hence imports—this year is expected to result in a deterioration of current account balances in most EM&MIs and Pakistan. The current account deficit for MENA EM&MIs is set to widen from 3.0 percent of GDP in 2023 to 6.3 percent in 2024, or by about $20 billion. Additionally, sluggish export receipts are further weighing on external balances in some economies (Egypt).

Despite efforts to strengthen fiscal buffers, public sector debt ratios are projected to remain elevated this year amid mounting interest expenses. Specifically, primary fiscal balances are projected to improve in EM&MIs over the next several years, helped by expenditure rationalization (Jordan, Morocco) and revenue mobilization (Egypt, Jordan). However, the overall fiscal deficit for EM&MIs is set to rise to 8.2 percent of GDP in 2024 (from 5.4 percent in 2023), reflecting a sizable increase in interest expenses. Consequently, public sector debt-to-GDP ratios are projected to remain at above 90 percent in 2024 before gradually declining over the medium term, helped by divestment (Egypt), continued fiscal consolidation (Egypt, Jordan, Morocco), and favorable interest-growth differentials.

Figure 1.10. MENA Region EM&MIs and Pakistan: Public Gross Financing Needs
(Percent of fiscal revenue, simple average)



Sources: IMF, Middle East and Central Asia Department Regional Economic Outlook database; IMF, World Economic Outlook database; and IMF staff calculations.
Note: All data refer to the calendar years, except for Egypt and Pakistan which refer to fiscal years (July to June). EM&MIs = emerging market and middle-income economies; MENA = Middle East and North Africa; WEO = *World Economic Outlook*.

In turn, public sector gross financing needs will remain a significant challenge for most EM&MIs and Pakistan. Public gross financing needs over 2024 are projected to rise to nearly 115 percent of fiscal revenues ($261.3 billion), an increase of about 5.6 percentage points compared to the IMF's October projections (Figure 1.10). While some frontier economies in other regions of the world have been able to access international markets, access for highly indebted countries in MENA continues to appear limited in the short term, and in several countries high financing needs will likely be covered mostly through domestic bank financing, further exacerbating sovereign-bank linkages and hampering private credit provision. Nevertheless, the $35 billion investment deal between the Abu Dhabi Development Holding Company and Egypt would help ease the country's near-term financial pressures and reduce dependence on the local financial system. The deal will provide $24 billion in new financing to develop the Ras El Hekma region and will also convert an existing dollar-denominated deposit at Egypt's Central Bank of about $11 billion into an Egyptian pound–denominated one for investments across Egypt.

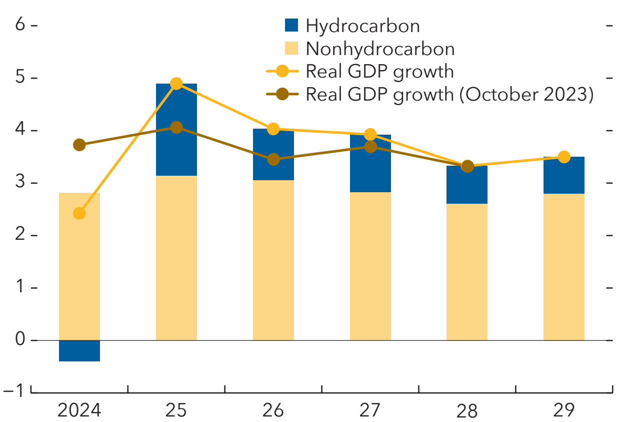
LICs: Changing Tides

Economic activity in MENA's LICs is expected to contract by 1.4 percent in 2024. Yet this growth rate masks notably cross-country dispersion. Notably, the conflict in Sudan, and to a lesser extent Yemen, will weigh heavily on average growth this year. However, a rebound to 4.4 percent is projected in 2025, contingent upon a stabilization of the crisis in Sudan[7] and a resumption of economic growth in Yemen. Djibouti[8] is expected to sustain robust growth in 2024, supported by strong port-related and construction activity following the peace agreement in Ethiopia. Similarly, Mauritania's growth outlook remains positive, driven by the continued expansion of its extractive sector with large-scale projects. Nonetheless, all LICs will continue to grapple with challenges over the medium term amid persistent external and fiscal deficits.

Oil Exporters: Nonhydrocarbon Activity Remains Strong

Among GCC countries, nonhydrocarbon activity is projected to remain the main contributor to growth in the years ahead. The voluntary oil production cuts—most notably by Saudi Arabia—are expected to continue to put a temporary damper on growth this year. Hence, growth for GCC members has been revised down by 1.3 percentage points since October and is now projected to rise to a moderate 2.4 percent in 2024. That said, ambitious plans to diversify economies are expected to reduce dependence on relatively volatile hydrocarbon production and bolster stability, rendering nonhydrocarbon activity the main driver of growth going forward (Oman, Saudi Arabia, United Arab Emirates). In turn, growth in the GCC is projected to rise to 4.9 percent in 2025 (amid the pickup in hydrocarbon production) before settling at about 3.5 percent over the medium term (Figure 1.11).

Figure 1.11. GCC: Contributions to Real GDP Growth
(Growth in percent change, year over year; contributions in percentage points)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: GCC = Gulf Cooperation Council.

For non-GCC oil exporters, growth has been revised up to 3.3 percent in 2024—an upgrade of 0.3 percentage point from October. This upward revision mainly reflects higher-than-projected oil production in the Islamic Republic of Iran and Libya and an increase in public spending in Algeria. After remaining relatively stable over 2024–25, growth in non-GCC oil exporters is expected to gradually decline to 2.3 percent over the medium term, mainly driven by a decline in hydrocarbon growth due to capacity constraints (Islamic Republic of Iran, Libya).

Inflation in all oil exporters is projected to continue declining in 2024 and 2025. However, in a few countries, inflation is expected to remain elevated due to strong domestic demand following expansionary policies amid robust oil revenues (Islamic Republic of Iran) and elevated food prices (Algeria). Overall, inflation is projected to decline to 10.7 percent in 2024 and gradually moderate to about 7.5 percent over the medium term.

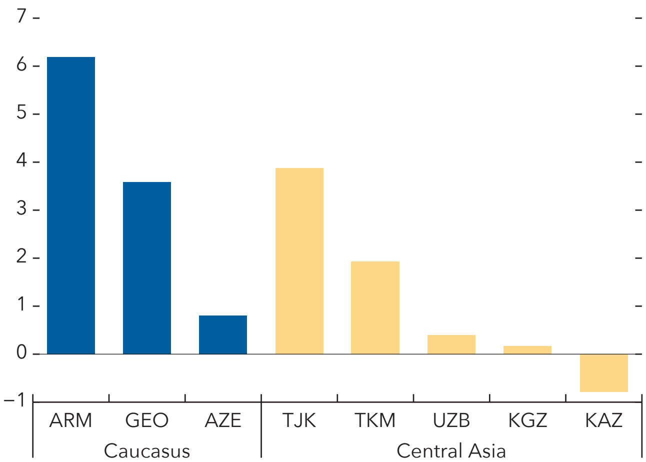
Overall fiscal surpluses are projected to narrow among GCC members that rely on public finances for their economic diversification (Kuwait, Qatar, United Arab Emirates), due to moderating hydrocarbon prices. That said, some hydrocarbon exporters are expected to continue consolidating their public finances, reduce their hydrocarbon exposure, and support diversification efforts (Bahrain, Oman, Qatar, Saudi Arabia). Beyond 2024,

[7] Projections for Sudan are premised on the war ending in mid-2024 and on reengagement with the international community.

[8] Djibouti remains relatively isolated from the disruption in the Red Sea as its main port is located to the south of the Bab el-Mandeb Strait.

Figure 1.12. CCA: Revisions to Growth since the War in Ukraine

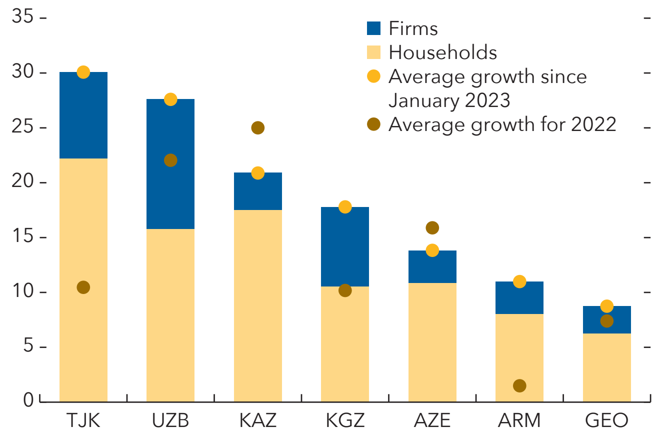
(Percentage points, 2022–23 average, current versus October 2021 REO)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: The figure shows the difference between projections of real GDP growth rates published in the October 2021 *Regional Economic Outlook: Middle East and Central Asia* (REO) and actual figures recorded in the April 2024 REO. Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia.

Figure 1.13. CCA: Private Sector Credit Growth and Contributions

(Percentage points, year-over-year monthly growth, simple averages)



Sources: IMF, Monetary and Financial Statistics database; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia.

nonhydrocarbon fiscal deficits as a percentage of nonhydrocarbon GDP are expected to generally improve across MENA oil exporters. Alongside, lower oil production and hydrocarbon prices are expected to drive a persistent decline in the external positions over the medium term.

1.3. CCA: Continued Resilience

Economic growth in the CCA is projected to remain robust, decelerating slightly over the medium term as trade, financial, and tourism spillovers related to Russia's war in Ukraine continue to fade. Price pressures have moderated in several countries, allowing central banks to proceed with monetary easing.

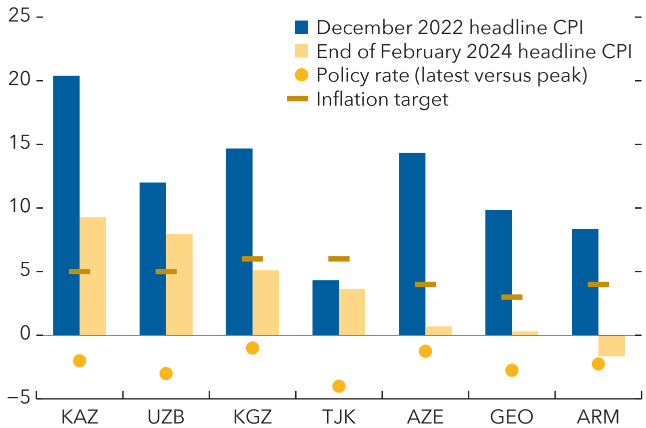
Recent Developments: Growth Has Slowed but Remains Robust

Growth in the CCA region exceeded expectations again in 2023, showing continued resilience to the war in Ukraine. The region saw robust growth of 4.9 percent, surpassing even preconflict forecasts (Figure 1.12). Notably, Armenia, Georgia, and Tajikistan performed particularly well. Several countries continued to benefit from increased migrant flows (Armenia, Georgia), trade (Georgia, Kyrgyz Republic), tourism (Armenia), and remittances from Russia (Tajikistan). These inflows, combined with additional financial flows and strong domestic demand, have fueled an expansion of credit, especially household credit (Figure 1.13), albeit from a low base.

However, growth has been uneven across the region, and some countries have fared less well. A 3 percent contraction of the hydrocarbon sector negatively impacted growth in Azerbaijan, while tepid investment and consumption contributed to markedly slower growth in Turkmenistan.

Inflation continued to moderate in line with global trends, yet the pace of disinflation varied across the region, reflecting domestic economic conditions, policy frameworks, and external factors. Inflation fell in Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, and Turkmenistan amid exchange rate appreciations

Figure 1.14. CCA: Headline Inflation and Change in Policy Rate
(Percent change, year over year)



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

(Armenia, Georgia, Kazakhstan, Turkmenistan), earlier monetary policy tightening, and a sharp decline in commodity prices (Figure 1.14). However, inflation remained above central bank targets in Kazakhstan and Uzbekistan due to strong domestic demand and persistently high inflation expectations (Kazakhstan, Uzbekistan) and energy price reforms (Kazakhstan).

Lower inflation in most CCA economies has allowed central banks to begin or continue easing monetary policy earlier than in many major advanced economies. Notably, only the Kyrgyz Republic's central bank kept its policy interest rate on hold in 2023.

Despite continued inflows, fiscal balances deteriorated in several CCA countries. On average, fiscal balances deteriorated to –1.3 percent of GDP in 2023 (after recording a surplus of 0.5 percent in 2022). This deterioration was largely due to lower oil and gas revenues among oil-exporting economies and a fiscal expansion in Uzbekistan (public sector wage hikes, social spending, and energy subsidies). Nonetheless, public sector debt ratios remained broadly stable in 2023 at under 20 percent of GDP, on average, among CCA oil and gas exporters and about 40 percent of GDP for oil and gas importers, on average, significantly lower than those in MENA EM&MIs.

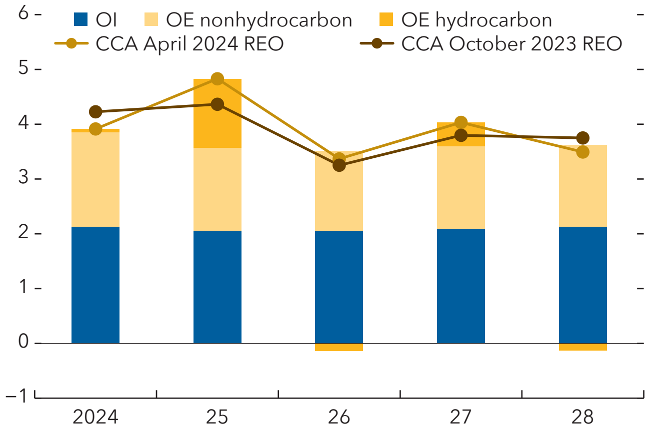
Similarly, current account balances deteriorated in most CCA countries (Armenia, Azerbaijan, Kazakhstan, Uzbekistan) in 2023, mainly driven by lower oil prices, strong domestic demand, and partial normalization of remittances. Nonetheless, despite volatility in commodity prices, oil exporters increased their stock of international reserves. In the case of Kazakhstan, this was mainly due to a valuation effect.

CCA Outlook: Stable Growth as Inflows Normalize

Following the strong performance in 2023, growth in the CCA is projected to moderate to 3.9 percent this year (a downward revision of 0.3 percentage point from October) before accelerating to 4.8 percent in 2025 (an upgrade of 0.4 percentage point). These revisions mainly reflect developments in Kazakhstan, where production increases from the Tengiz oil field were pushed back to 2025. Accordingly, growth in Kazakhstan is projected to slow to 3.1 percent in 2024 before a temporary but notable pickup to 5.6 percent in 2025. Meanwhile, nonhydrocarbon growth in oil-exporting economies is projected to remain robust (3.6 percent) in 2024. For oil-importing economies, growth in 2024 is projected to moderate to 5.4 percent from 6.5 percent in 2023, with growth declining across all countries except the Kyrgyz Republic.

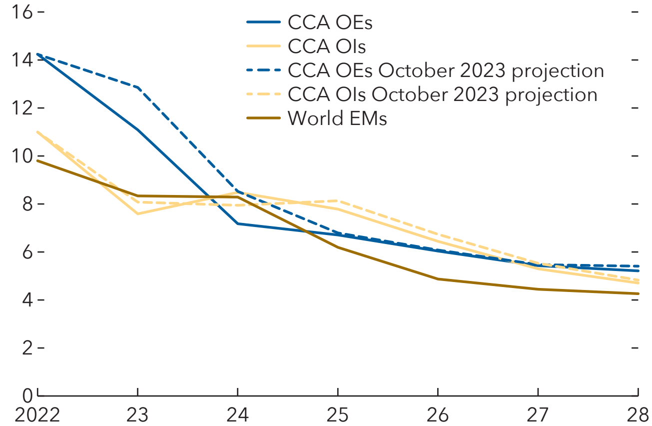
Over the medium term, growth is projected to moderate as spillovers related to the war in Ukraine (such as trade and financial inflows) gradually subside (Figure 1.15). Still, the pace of growth is expected to vary significantly between oil-importing and oil-exporting countries. For example, while medium-term growth in oil importers is projected to maintain a steady pace of about 5 percent, fluctuations in hydrocarbon growth in Kazakhstan will continue to impact overall growth in oil exporters (Figure 1.16). Furthermore, some countries may continue to benefit from recent changes in trade patterns stemming from the war in Ukraine and sanctions on Russia (Chapter 3).

Figure 1.15. CCA: Growth and Contributions
(Percentage change, year over year; percentage points for contributions)



Source: IMF, World Economic Outlook database.
Note: CCA = Caucasus and Central Asia; OE = oil exporters; OI = oil importers; REO = *Regional Economic Outlook: Middle East and Central Asia*.

Figure 1.16. CCA: Headline Inflation
(Percent change, year over year)



Sources: National authorities; and IMF staff estimates and projections.
Note: CCA = Caucasus and Central Asia; EMs = emerging markets; OE = oil exporters; OI = oil importers.

Alongside, inflation in CCA oil and gas exporters is projected to moderate further in 2024, to an average of 7.2 percent, driven primarily by developments in Azerbaijan and Kazakhstan. In contrast, for oil-importing countries, average inflation is expected to rise to 8.5 percent (from 7.6 percent in 2023—despite a drop in inflation in the Kyrgyz Republic), in part reflecting base effects from a stabilization in commodity prices after the sharp declines of 2023. Over the medium term, inflation across the region is projected to gradually normalize, mirroring trends in emerging markets elsewhere (Figure 1.16).

Public sector debt is projected to remain at manageable levels. Specifically, relatively low debt and interest expenses combined with high and stable nominal GDP growth are supporting stable or declining debt levels in most countries over the medium term. Still, a projected increase of 10 percentage points in Kazakhstan's debt ratio over the forecast horizon, as the authorities are planning to increase the assets of the sovereign wealth fund, is pushing up the region's overall debt-to-GDP ratio from about 25 percent of GDP in 2024 to just below 30 percent in 2029.[9]

1.4. Risks to the ME&CA Outlook

The balance of risks remains tilted to the downside and uncertainty has risen markedly since October 2023, and disproportionately so in MENA. The conflict in Gaza and Israel remains geographically contained, but its duration and scope for escalation continue to be highly uncertain. Disruptions in the Red Sea highlight the unpredictability of the conflict's potential spillovers. Additional downside risks include persistent inflation and financial stress, disruptive fiscal adjustment and debt distress, the potential worsening of geoeconomic conditions, an abrupt global slowdown (including China's recovery faltering), and recurrent climate shocks.

Several global risks could spill over to ME&CA economies. An increase in sovereign borrowing costs would have a negative impact on countries with high financing needs and debt, particularly MENA EM&MIs. An abrupt global slowdown, potentially starting in China and Europe, could negatively impact ME&CA through reduced trade. In addition, a global slowdown would reduce energy demand, weighing on the outlook for oil-exporting

[9] Kazakhstan's higher gross public debt would be somewhat offset by accumulation of assets in the sovereign wealth fund (National Fund of the Republic of Kazakhstan).

economies. Finally, ME&CA's vulnerability to climate-related events leaves economies exposed to recurrent shocks. On the upside, higher-than-projected global growth would support trade, while a faster-than-expected resumption of interest rate cuts in major advanced economies would help reduce fiscal pressures and improve debt dynamics.

Risks specific to ME&CA could also materialize.

- The conflict in Gaza and Israel is a key downside risk for the MENA region, particularly the risk of further escalation or a protracted conflict and disruptions to trade and shipping. In a scenario where the conflict escalates, neighboring economies would be impacted by reduced tourism, continued trade disruptions, and possible inflows of refugees. Moreover, prolonged disruptions in the Red Sea would continue to impact trade volumes and shipping costs, with an amplified impact on Egypt, through the reduction in Suez Canal receipts.
- For CCA economies, the main downside risks stem from geopolitical and geoeconomic developments. A slowdown in major trading partners could adversely weigh on remittances and trade. Additionally, geoeconomic conditions related to Russia's war in Ukraine could worsen, with potential ramifications for economies in the region, including through changing trade patterns.
- Across the region, for countries that are relying on monetary financing through the central bank to finance their fiscal deficits (Iraq, Tunisia), a resurgence of inflation could materialize.
- In all countries, failure to make sufficient progress on implementing structural reforms (for example, related to state-owned enterprises, governance, privatization, energy subsidies, and trade restrictions) to overcome long-standing structural deficiencies (such as persistently high unemployment rates, weak productivity growth, a large state footprint, and a heavy reliance on commodities) risks jeopardizing medium-term growth prospects.

1.5. Balancing Policy Priorities in Uncertain Times

Amid a multitude of challenges and heightened uncertainty, particularly for MENA and Pakistan, the appropriate policies will depend on country-specific challenges. In conflict-affected countries, prudent crisis management and precautionary policies to offset the impact will be critical. For CCA economies, policies should leverage recent windfall gains related to trade and financial flows to boost medium- and long-term growth.

Monetary and Financial Policies: Maintain Focus on Price Stability

Price stability should remain the focus of monetary policy in all ME&CA economies. Against the backdrop of slowing inflation and heightened risks, clear communication of the policy intentions is essential to support stability. As such, countries should continue to strengthen monetary policy frameworks and increase the transparency of monetary policy operations while also ensuring central bank independence, which is critical for monetary policy effectiveness (April 2023 *Regional Economic Outlook: Middle East and Central Asia*).

- Where inflationary pressures persist, monetary policy should remain tight and follow a data-dependent approach (Egypt, Kazakhstan, Pakistan, Tunisia, Uzbekistan), while closely monitoring risks of a reversal of inflation developments.
- Where inflation is at or below target, such as in some CCA countries, gradual monetary easing could be considered. If inflation moderates faster than expected, countries should carefully monitor developments and stand ready to ease monetary policy sooner if conditions allow.

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 a more effective tool to stabilize inflation, and more broadly to maintain central bank independence and preserve its balance sheet. Complementary reforms to deepen the financial sector could strengthen liquidity conditions and help spur investment and growth. In this context, all ME&CA economies can step up efforts to foster a deep and diversified investor base and improve the management of state-owned banks (October 2023 *Regional Economic Outlook: Middle East and Central Asia*). Additionally, in the near term, sustained credit growth in many CCA countries warrants close supervision, even if banking sector financial soundness indicators remain comfortable, particularly as numerous countries have not activated macroprudential buffers.

Fiscal Policy: A Tailored Approach to Ensure Sustainability

Given the marked differences in fiscal space across ME&CA, fiscal policy should be tailored to country needs. All countries would benefit from strengthening fiscal risk management, including implementing or bolstering existing medium-term fiscal frameworks to improve transparency and credibility. At the same time, it remains essential for social protection systems and spending to be preserved and targeted to reach the poor and most vulnerable.

- MENA EM&MIs will need to strengthen their fiscal positions to reduce debt decisively. Given elevated debt ratios and financing needs, countries should continue to consolidate their public finances, including by containing current spending on wages and subsidies and mobilizing additional revenue, and by streamlining tax exemptions.
- CCA countries should maintain a prudent fiscal stance to preserve buffers and reduce vulnerabilities. Fiscal structural reforms (such as increasing budget transparency and adopting or strengthening credible medium-term fiscal frameworks anchored in fiscal rules) can support these actions and help facilitate access to external financing.
- Meanwhile, against the backdrop of lower oil prices and production, commodity exporters should preserve fiscal buffers to foster resilience while ensuring intergenerational equity and sustainability. Public investment should target the development of nonhydrocarbon sectors and revenue diversification and aim to address climate-related challenges. In this context, where relevant, policymakers should actively consider eliminating energy subsidies.
- Strengthening medium-term fiscal frameworks will reinforce all countries' efforts by building a more credible track record of fiscal discipline. Authorities should also consider ways to mitigate fiscal risks from state-owned enterprises. For countries with high debt levels, active debt management policies and proactive asset and liability management is needed to reduce mounting interest expenses. Domestic revenue mobilization would further strengthen fiscal balances.

Structural Policies: Maintain Momentum to Strengthen Resilience

Structural reforms are essential to lift longer-term growth prospects and can also help support near-term economic activity, especially where tight macroeconomic policies need to be maintained.

- Strengthening governance, including of the central bank by preserving their independence, can be particularly valuable in many ME&CA economies and would be instrumental in fostering an economic environment that promotes private investment. Improving government effectiveness and the rule of law can be particularly impactful (October 2023 *Regional Economic Outlook: Middle East and Central Asia*). Moreover, strong institutions not only boost investor confidence but also foster resilience to the repercussions of conflict (Chapter 2). As such, implementing structural reforms aimed at improving institutional quality will be imperative.
- In the context of geoeconomic uncertainty, ME&CA countries need to step up policy reforms to reduce long-standing and increasing trade barriers, diversify products and markets, and seize the opportunities provided by new trade corridors. Upgrading infrastructure and regulatory environments and increasing participation in global value chains would further support these objectives (Chapter 3).
- To maintain momentum and build on the spillovers related to Russia's war in Ukraine, CCA economies can accelerate their structural reform agenda to boost growth in both the medium and long term.

- For LICs and fragile states in MENA, improving food security remains a priority amid persistent droughts and other climate-related shocks. Policies aimed at addressing climate change challenges would be vital. In addition, support from the international community is essential to meet the most pressing social needs and mitigate ongoing humanitarian crises. Resolving ongoing conflicts remains a prerequisite to improving living standards and growth.

Expanded IMF Support

The IMF's commitment to the region is steadfast. The institution stands ready to provide policy advice, technical assistance, and financing to ME&CA countries to help cushion against shocks and ease any necessary adjustment. Since early 2020, the IMF has provided more than $40 billion in financing to ME&CA countries. Of this and since the beginning of 2023, the IMF has provided more than $16 billion in financing to seven countries. This financing includes an Extended Fund Facility arrangement for Jordan, a Resilience and Sustainability Facility for Mauritania (to address climate-related challenges), an Extended Credit Facility for Somalia following the Completion Point under the enhanced Heavily Indebted Poor Countries Initiative, and the Executive Board approval of the first and second reviews under the Extended Fund Facility for Egypt, which included an augmentation of IMF support from $3 billion to about $8 billion. The IMF has also continued to support its membership with about 350 technical assistance and capacity development projects in 30 countries. The IMF also maintains a local presence through its Resident Representative offices; the Middle East Regional Technical Assistance Center; the Caucasus, Central Asia, and Mongolia Regional Capacity Development Center; and a new regional office in Riyadh, Saudi Arabia—all of which strengthen the IMF's partnership with ME&CA members.

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