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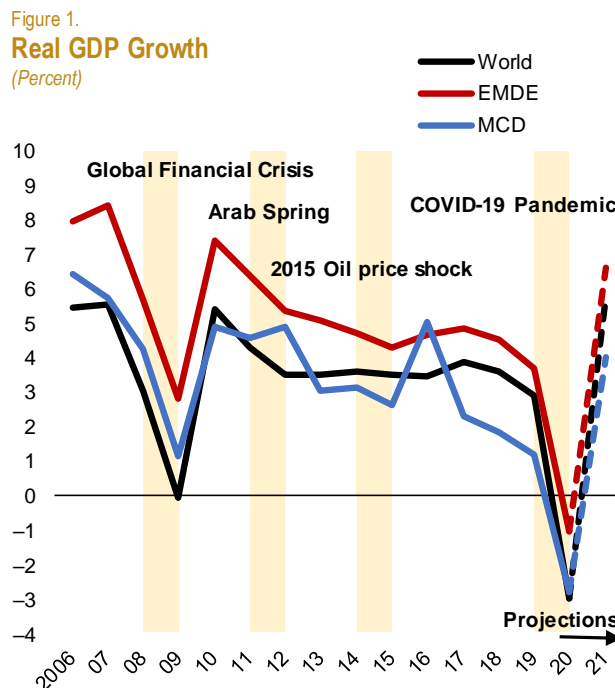
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Global Developments: Implications for the Middle East and Central Asia Regions

As the coronavirus (COVID-19) pandemic sweeps across the world, **growth in the Middle East and Central Asia region** is projected to fall from 1.2 percent in 2019 to -2.8 percent in 2020—lower than the growth rates during the 2008 global financial crisis and the 2015 oil price shock (Figure 1)—before rising to 4.0 percent in 2021, as threats from the virus recede and global policy efforts spur recovery. In line with the rest of the world, the regional forecast for 2020 has been significantly revised down from the October 2019 *World Economic Outlook* (5.7 percentage points lower), mainly reflecting the expected economic fallout from the pandemic that has spread to almost every country in the region, with Iran being one of the major epicenters.

Oil prices have fallen by about 50 percent since the COVID-19 outbreak (Figure 2), to the lowest point in more than 20 years after adjustments for inflation, as travel restrictions introduced by governments around the world have **reduced demand for oil**, and in the absence of a new production agreement among Organization of Petroleum Exporting Countries and other major oil producers (OPEC+). The subsequent production cut agreement by OPEC+ at the start of April, complemented by further production cuts by oil exporting G20 economies, could provide some support to oil prices, particularly if global demand increases.¹ Other commodity prices have fallen sharply too on **slowing global growth**. As Chapter 1 shows, decreases in oil prices are so large that fiscal and export revenues are expected to decline across all oil-exporting countries in the region, including those that might manage to gain market share from higher-cost producers. The lower oil and commodity receipts will erode policy space to address the crisis in some countries, put pressures on exchange rates and government budgets, and weaken external positions.

In addition to the devastating toll on human health, the **COVID-19 pandemic** is causing significant economic turmoil through simultaneous supply and demand shocks—plunging oil and commodity



Sources: National authorities; and IMF staff calculations.
Note: EMDE = emerging market and developing economies; and MCD = Middle East and Central Asia region.

This chapter was prepared by Ling Zhu, with research assistance provided by Oluremi Akin-Olugbade.

¹ Growth projections are based on data as of April 3, 2020 and therefore do not account for the OPEC+ agreement reached on April 9, 2020.

prices, dropping domestic and external demand, falling consumer confidence, tightening financial conditions, and disruption in production and global supply chains.

At the same time, restrictive containment measures introduced by governments in the region and fear of contagion are **weakening the region's consumer demand**, particularly in tourism, hospitality, and retail sectors (Azerbaijan, Bahrain, Georgia, United Arab Emirates). The largest impact is likely to be felt by small- and medium-sized enterprises (SMEs) due to their limited buffers. Moreover, given heavy employment in these service sectors, there could be significant second-round effects on domestic demand across the region if unemployment rises and wages and remittances fall.

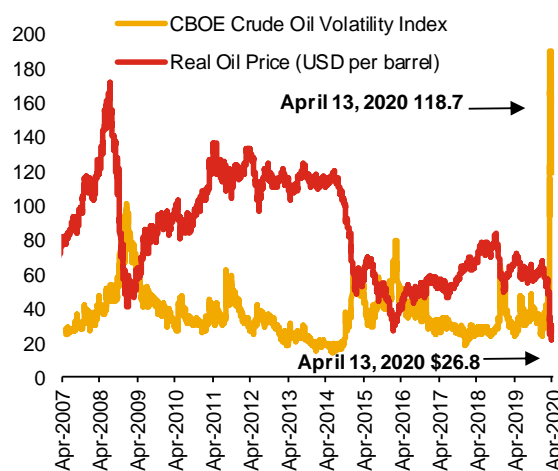
The region's other types of economic activities are being affected through **supply-side shocks**. With borders in the region being closed and supply chains interrupted, manufacturing production is being disrupted and investment plans put on hold. Moreover, these adverse shocks are being compounded by a **plunge in business and consumer confidence**, stemming from the region's elevated social and geopolitical tensions as well as significant uncertainty surrounding the duration and severity of the economic fallout from the pandemic.

Meanwhile, global **financial conditions** have tightened sharply, adding to the region's challenges. Equity markets are down by 20-30 percent since their peak in mid-February, with energy sectors being among the hardest hit, and global risk sentiment, measured by the Chicago Board Options Exchange volatility index (VIX), has nearly quadrupled to historic highs over the same period. Despite vigorous monetary policy easing and liquidity operations by major central banks, 10-year government bond yields and sovereign spreads have surged in many countries in the Middle East and Central Asia. High frequency data reveal that nearly \$5 billion of portfolio flows had left the region in the month of March. Such a tightening in financial conditions could prove to be a major challenge given the region's estimated \$35 billion in maturing external sovereign debt in 2020.

The outlook for the region is driven by a sizable economic fallout from the COVID-19 pandemic. While higher oil prices—for example from a faster recovery in global oil demand following the recent agreement on production cuts—can improve the region's outlook and is an upside, risks around the forecast, especially in the near term, are skewed to the downside, and highly dependent on the duration and severity of the pandemic:

- A more severe and protracted COVID-19 pandemic in the region or in its major trading partners could cause a prolonged production disruption, wider supply chain spillover, larger collapse in confidence and demand, and further deterioration in financial conditions. At the same time, banks and nonbank financial institutions, especially those that are not well-capitalized, could come under stress through exposures to the affected sectors and

Figure 2.
CBOE Crude Oil Volatility and Real Oil Prices
(Index and USD per barrel)



Source: Bloomberg Finance L.P.
Note: CBOE = Chicago Board Options Exchange; and rhs = right-hand scale. The CBOE Crude Oil Volatility Index measures the market's expectation of 30-day volatility of crude oil prices.

households. All these can lead to a more severe downturn in 2020 and weaker recovery in 2021. Moreover, a mishandling of the outbreak could elevate distrust in local governments, sowing seeds for further social unrest and adding to regional uncertainty.

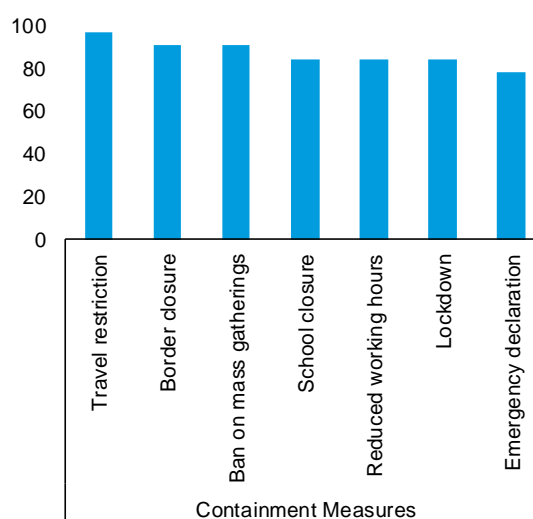
- A further deterioration of risk sentiment could sharply reduce capital flows to the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region, especially portfolio flows—which are highly sensitive to global risk sentiment. For example, if the VIX were to remain at its recent peak in March (at 83) for the rest of the year, portfolio flows to the MENAP region could fall by as much as \$100 billion (about 3 percent of GDP) (October 2019 *Regional Economic Outlook: Middle East and Central Asia*). This decline would exceed total portfolio inflows to the region in 2019. Such a sudden stop in capital flows could stem investment, put pressure on the balance of payments, and cause disorderly exchange rate adjustments, particularly in countries with few buffers and weak fundamentals.

Against this challenging background, the immediate priority for countries in the region is to **contain the spread of the virus**. Governments across the region have already started taking strong containment measures (Figure 3). For example, almost 80 percent of countries (25) in the region are under either a partial or a complete lockdown. In addition to containment measures, necessary health spending should be undertaken in all countries to ensure health systems are adequately prepared to meet the needs of populations, regardless of the available fiscal space.

As underscored in Chapter 2, these challenges can be especially daunting in the region’s fragile and conflict-affected states (Afghanistan, Iraq, Sudan, Yemen) or those facing large refugee inflows (Iran, Jordan, Lebanon, Pakistan), where the task of preparing their already stressed health systems for the COVID-19 outbreak could be further complicated by supply constraints—including from reduced imports—or high proximity risks and difficulty of social distancing in refugee camps. To help address these challenges, timely external medical and financial support from major economies and international organizations could prove to be necessary. In this context, the IMF has already provided debt relief to Yemen.

In addition, economic policy responses should be directed to prevent the COVID-19 pandemic from causing a protracted economic recession with lasting welfare losses to society through increased unemployment and bankruptcies. Countries are already using a mix of timely and targeted policies on hard-hit sectors and populations (Table 1), for example by providing cash transfers to the unemployed (Kazakhstan), and making concessional financing available to SMEs (Saudi Arabia).²

Figure 3
MCD Country Measures to Contain Spread of COVID-19
(Percent of MCD countries)



Source: National authorities.
Note: MCD = Middle East and Central Asia region. Information presented above is as of April 6, 2020.

² For details, please see the policy tracker on the IMF website: <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>.

In the period ahead, oil exporters facing major demand shocks and sharp declines in oil prices must guard against lasting damage to non-oil sectors. Given fragile growth and generally weak automatic stabilizers, governments may deliver temporary stimulus measures—once the pandemic becomes contained and economic activities are able to return to normal without risking further spread of the virus—to boost aggregate demand where policy space allows.

In other countries, particularly the region’s oil importers where fiscal space is constrained, governments could consider reorienting spending priorities, for example by reducing or delaying non-essential expenditures, or seeking external financing support or aid. The IMF is already providing financial support to Jordan, the Kyrgyz Republic, Pakistan, and Tunisia and debt relief from international creditors to Somalia, giving each country extra policy space to combat the pandemic. Additional financial support is planned for a broader group of countries, and the IMF continues to provide policy support to all its member countries.

Central banks should stand ready to provide liquidity to banks and nonbank financial institutions, particularly those lending to SMEs, while financial market regulators and supervisors could also encourage, on a temporary and time-bound basis, extensions of loan maturities while maintaining a regular assessment of the performance of these loans and the associated financial implications (April 2020 *Global Financial Stability Report*). As of April 7, seven central banks in the region, including those in Bahrain, Morocco, and the UAE, have injected about \$50 billion into their financial systems to support liquidity during the fight against COVID-19.

With weaker external demand and tighter financial conditions, many countries will face challenges on the external front. Countries with a flexible exchange rate and low inflation should allow some exchange rate adjustment to absorb part of the shock. As Chapter 3 points out, tighter monetary policies (and foreign exchange interventions) might be necessary to contain potential capital outflows and the inflationary impact of exchange rate movements, while macroprudential policies and temporary capital flow management could be considered to safeguard financial stability.

Table 1: Fiscal Measures in Response to COVID-19 Outbreak

	Additional Revenue Measures	Additional Expenditure Measures
Armenia		✓
Azerbaijan		✓
Bahrain	✓	✓
Egypt	✓	✓
Georgia	✓	✓
Iran	✓	✓
Iraq		✓
Kazakhstan	✓	✓
Kuwait	✓	✓
Libya		✓
Mauritania	✓	✓
Morocco	✓	✓
Pakistan	✓	✓
Saudi Arabia	✓	✓
Sudan		✓
Tunisia	✓	✓
U.A.E	✓	✓
Uzbekistan	✓	✓

Source: National authorities.

Note: Information presented above is as of April 6, 2020.

1. MENAP Oil-Exporting Countries: Coping with Multiple Shocks

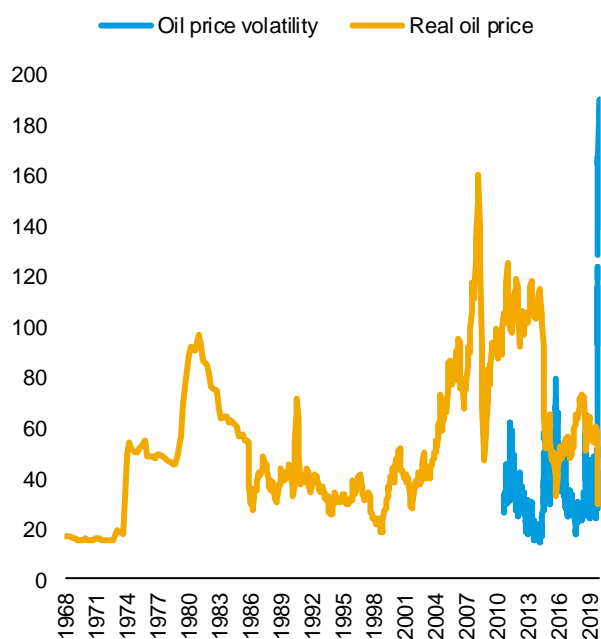
The outlook for the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) oil exporters has weakened significantly with the onset of the coronavirus disease (COVID-19) outbreak and sharp decline in oil prices.¹ Economies are expected to contract in 2020, while fiscal and external positions will come under significant pressure in many countries eroding policy space to deal with the crisis. Nevertheless, policies should continue to address the fallout from COVID-19. Spending on immediate healthcare should be given priority, while support to hard-hit sectors should be timely, temporary, and well-targeted, underpinned by central bank actions to ensure sufficient liquidity. Policies will result in higher near-term deficits. Once recoveries are well established, gradual fiscal consolidation should resume within the context of medium-term frameworks to meet future challenges, particularly from falling hydrocarbon revenue.

COVID-19 Outbreak: A Double Whammy

The COVID-19 pandemic is significantly affecting MENAP oil exporters. Nearly all countries in the region are affected by the spread of the virus, with some facing severe outbreaks. At the same time, a plunge in global oil prices is compounding strains on these economies, increasing challenges to combating the virus and preventing lasting economic damage. Beyond the devastating toll on human health, this combination of shocks is resulting in significant economic turmoil across the region.

Real GDP in MENAP oil exporters is projected to contract by 4.2 percent in 2020. This is a significant downward revision from the 2.1 percent growth projected in the *October 2019 Regional Economic Outlook for the Middle East and Central Asia* and reflects impacts through several key channels:

Figure 1.1
Real Oil Price and Oil Price Volatility
(2020 US\$ per barrel; Index)



Source: Bloomberg Finance LP.

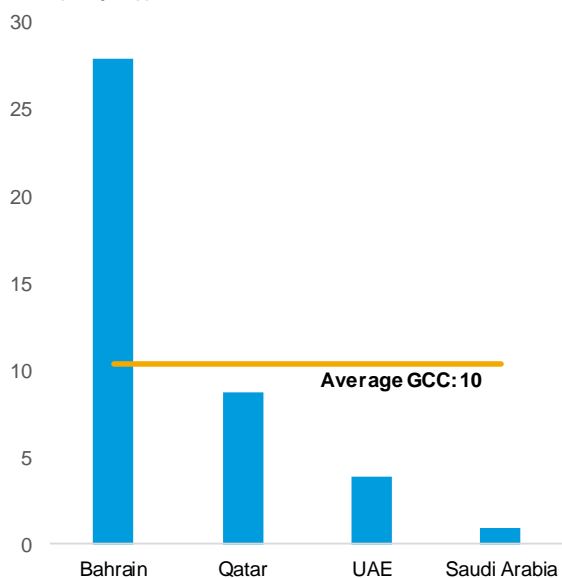
- *Spread of the virus and disruptions from containment measures.* The COVID-19 epidemic has been reported in all MENAP oil exporters. Iran has a particularly high concentration, with more than 50,000 cases and more than 3,000 fatalities and is a source of risk for ongoing virus infections throughout the region. Necessary containment measures to halt the spread of the virus have affected job-rich sectors across the region, with negative effects on confidence and non-oil activity.
- *Lower growth in trading partners.* Containment measures in major economies and key trading partners have significantly reduced global growth and demand for oil and other

Moussé Sow, Gazi Shbaikat, and Kate Nguyen prepared this chapter.

¹ MENAP oil exporters comprise Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Yemen.

Figure 1.2
Policy response to COVID-19
 (Percent of GDP)

1. Liquidity Support in MCD

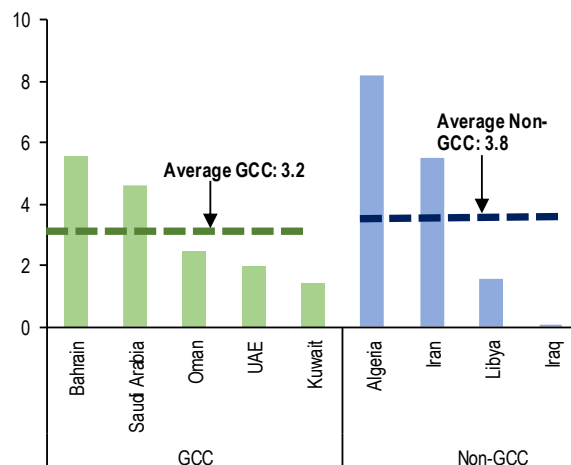


Sources: National authorities; and IMF staff calculations.
 Note: GCC = Gulf Cooperation Council; MCD = Middle East and Central Asia Department.

commodities (*Global Developments* and Box 1.1). This has resulted in lower trade and tourism flows and significant declines in global oil prices.

- Historic declines in oil prices.* The decline in global oil demand has been exacerbated by a large increase in oil supply, triggered by announced production increases in some major producers (Russia, Saudi Arabia, UAE) after the breakdown of the Organization of Petroleum Exporting Countries and other major oil producers (OPEC+) agreement in March. A subsequent production cut agreement by OPEC+ at the start of April, complemented by further production cuts by oil exporting G20 economies, could provide support to oil prices, particularly if global demand increases. Nevertheless, oil prices have tumbled by more than 60 percent since the beginning of this year, reaching \$26 per barrel by the end of March (Figure 1). Measured in real terms (adjusted for inflation), oil prices have not been this low since 2001. Oil prices at these levels could result in more than \$230 billion in lost annual revenue across MENAP oil exporters,

2. Fiscal Response to COVID-19



compared with October projections, placing significant strains on fiscal and external balances. For some countries (Algeria, Bahrain, Iraq, Oman), this could lead to a rapid depletion of buffers, particularly as spending pressures increase to combat the COVID-19 outbreak.

- Stiff headwinds from global financial markets.* Global financial conditions have tightened sharply despite substantial policy easing by major central banks (*April 2020 Global Financial Stability Report*). Cumulative portfolio inflows to MENAP oil exporters have declined by more than \$3.5 billion since the middle of February, despite a modest rebound at the start of April. External borrowing costs have risen, on average, by 279 basis points in the Gulf Cooperation Council (GCC) and by 942 basis points in Iraq over this period, widening further than similarly rated emerging economies. These conditions pose major challenges for those with existing funding pressures (Bahrain, Iraq, Oman) and could become a wider concern given the region's

estimated \$10 billion of maturing external sovereign debt this year.

Responding to the Crisis

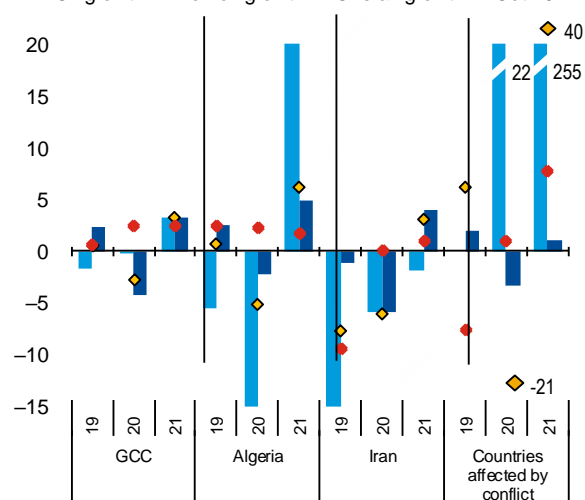
MENAP oil exporters have swiftly initiated broad policy actions to save lives, contain the spread of the pandemic, and support hard-hit sectors. Overall, announced fiscal measures average 3.2 percent of GDP (\$44 billion) across countries, and 3.8 percent of GDP (\$30.6 billion) in the GCC. Similarly, liquidity support amounts to about 2 percent of GDP (or about \$41 billion) in the GCC (Figure 1.2).

Policy efforts have appropriately focused on mitigation and containment, and targeted support to hard-hit households, sectors, and businesses. In particular:

- All countries affected by the spread of the virus have introduced varying degrees of domestic and international travel restrictions and quarantines to mitigate the immediate spread of the virus. In addition, most have introduced forms of virus containment strategies, including curfews; suspending religious gatherings; closures of schools, non-essential businesses, and public venues; and banning dining in restaurants. Some countries (Algeria, Saudi Arabia) have increased expenditure on health facilities and equipment.
- Support to the private sector and households affected by the virus and containment measures are broadly reflected through means to temporarily ease cash constraints, including direct cash transfers, suspension of rent and utilities payments, and loan modifications. In addition, government guarantees have been deployed (UAE) for small- and medium-enterprises (SMEs), and salaries of quarantined or ill migrant workers maintained (Qatar).
- Easier monetary policy, including interest rate cuts (Bahrain, Kuwait, Qatar, Saudi Arabia, and UAE) and lower reserve requirements (Algeria), and substantial liquidity support to

banks, particularly those lending to SMEs and hard-hit sectors (Bahrain, Qatar, Saudi Arabia, and UAE), have complemented fiscal-based measures. There has also been direct support to domestic equity markets (Qatar).

Figure 1.3
Real GDP Growth
 (Percent, weighted by PPP)
 ■ Oil growth ■ Non-oil growth ◆ Overall growth ● Oct 19 REO



Sources: National authorities; and IMF staff calculations.
 Note: Conflict countries include Iraq, Libya, and Yemen. GCC = Gulf Cooperation Council; PPP = purchasing power parity; REO = *Regional Economic Outlook*.

Drastic Decline in Economic Activity in 2020

The weak growth outlook in the MENAP oil exporters reflects the impacts of strong and broad-based containment measures and downward pressures from lower oil production in some countries (Figure 1.3). Uncertainty around these projections is high given the rapid global spread of COVID-19, the extent of its impact, and related policy responses.

- In GCC countries, growth is projected to contract by 2.7 percent in 2020. Non-oil activity is expected to be a major drag on the near-term outlook, contracting by 4.3 percent this year, a significant downward revision from the 2.3 percent growth projected in the *October 2019 Regional Economic Outlook for the Middle East and Central Asia*. The service, retail, hospitality

and tourism sectors have been particularly hard hit by the spread of COVID-19 and containment measures, raising challenges for those countries where these industries command a large share of output (Bahrain, Qatar, and UAE). Manufacturing has also slowed, and investment plans have been delayed across most of the region. Oil GDP is also expected to slow in 2020, contracting in all countries except for Kuwait, Saudi Arabia, and UAE. Overall, oil GDP is expected to contract by 0.3 percent, though overall oil production is set to fall further with the latest OPEC+ agreement, underscoring downside risks to oil GDP growth.²

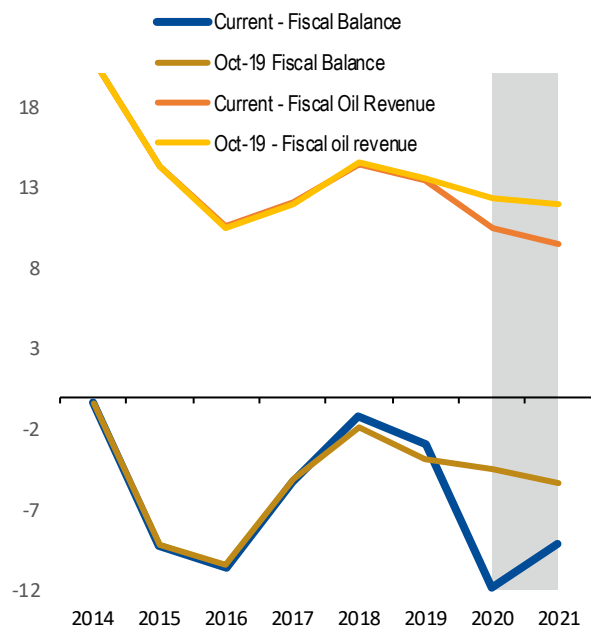
- Growth in non-GCC countries is also set to weaken, with both oil and non-oil GDP contracting markedly in 2020. Oil GDP is projected to contract by 5.9 percent, on lower

production, and non-oil GDP by 6 percent, on the widespread effects of the substantial coronavirus outbreak and containment measures. After a steep recession in 2019, Iran’s economy is expected to contract further, declining by 6 percent. Growth is projected to contract by 5.2 percent in Algeria, because of declining oil production capacity and loss of export market share, and by 4.7 percent in Iraq, where mass social protests are disrupting activity and oil production is projected to contract by 2 percent from ongoing security and supply chain constraints.

- Security and political conditions and economic performance have deteriorated further in Libya. The economy is expected to contract by more than 50 percent in 2020, reversing the recent strong recovery. Conflict will continue to be a major drag on growth in the Yemeni economy

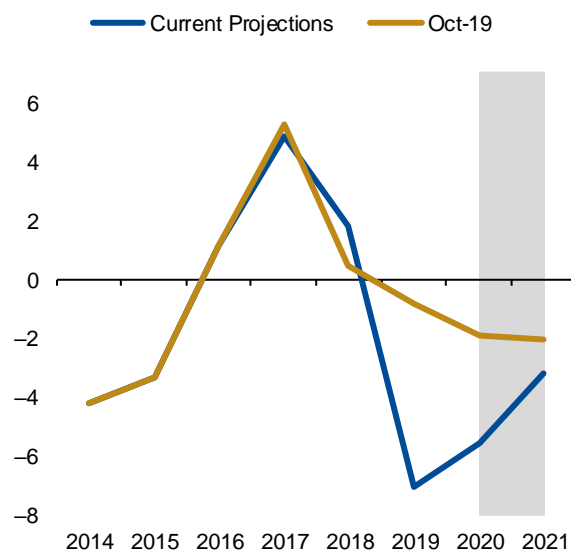
Figure 1.4
Fiscal Balances, Oil Revenue and Current Account Balance
(Percent of GDP)

1. Overall fiscal balances and Fiscal oil revenue



Sources: National authorities; and IMF staff calculations

2. Current Account Balance



Sources: National authorities; and IMF staff calculations.

² Growth projections are based on data as of April 3, 2020 and therefore do not account for the OPEC+ agreement reached on April 9, 2020.

as well, which is projected to contract by 3 percent.

Looking ahead, growth in the MENAP oil exporters is expected to rebound in 2021, reaching 4.7 percent. This reflects current projections of fading effects from the COVID-19 outbreak, gradual improvement in oil prices, and the benefits from sustained global policy easing.

Vulnerabilities on the Rise

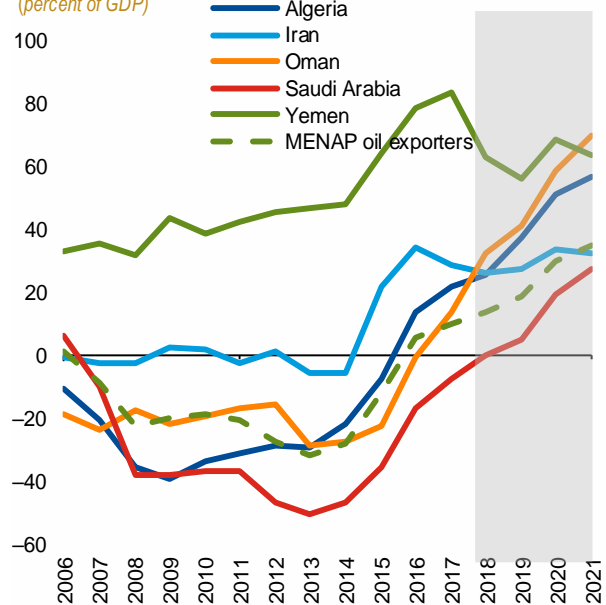
Lower growth and the sharp decline in oil prices are putting significant strains on fiscal and external positions in MENAP oil exporters. The fiscal deficit for the region is expected to deteriorate from 2.8 percent of GDP in 2019 to 10 percent of GDP in 2020, with about two-thirds of this decline (or 4.4 percent of GDP) resulting from crisis related spending and revenue measures (Figure 1.4). Countries with fiscal buffers (Kuwait, Qatar, Saudi Arabia, UAE) are better placed to accommodate rising deficits than those with limited space (Algeria, Bahrain, Iran, Iraq, and Oman).

Lower projected hydrocarbon revenue will also weigh on the region’s current account balance, which is expected to tip into a deficit of 5.8 percent of GDP in 2020 from a surplus of 2.7 percent of GDP in 2019. In the GCC, the current account will shift from a surplus of 5.6 percent of GDP in 2019 to a deficit of 3.1 percent of GDP this year (Figure 1.4).

The combination of weaker fiscal and external balances leaves MENAP oil exporters more vulnerable to downside risks, with limited space to combat the effects of the coronavirus. In particular:

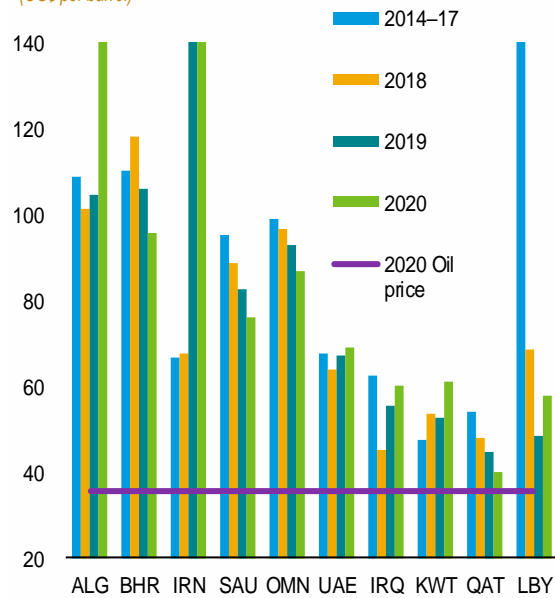
- *Buffers are depleting but they remain adequate for certain countries in the region.* Net debt (gross debt minus government deposits in the banking sector) has turned positive, reflecting increasing liabilities in particular for non-GCC countries

Figure 1.5
Net Public Debt
(percent of GDP)



Sources: National authorities; and IMF staff calculations.
Note: Net debt is calculated as gross debt minus financial assets. MENAP = Middle East, North Africa, Afghanistan, and Pakistan

Figure 1.6
Fiscal Breakeven Oil Prices
(US\$ per barrel)



Sources: National authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes.

in the region.³ The net debt for the region will stabilize at about 35 percent of GDP in 2021, but is expected to rise in the medium term. In some countries, however, gross and net debt will reach much higher levels, reflecting large financing needs (Algeria, Bahrain, Iraq, and Oman; Figure 1.5).

- *Higher breakeven oil prices.* Notwithstanding some improvement over the past two years, breakeven oil prices (oil prices needed to balance the budget) are much higher than current oil prices in all MENAP oil exporters, exceeding \$80 in some countries (Algeria, Bahrain, Iran, and Oman; Figure 1.6).
- *Rigid expenditure structures.* Large spending commitments, including public wage bills and pensions in some countries (Algeria, Iraq, Kuwait, and Oman), mounting interest payments (Bahrain, Iran, and Yemen), and other non-discretionary spending has left many countries in the region with rigid expenditure patterns and politically challenging policy choices to reduce these.

Risks

There is large uncertainty around the outlook and downside risks are significant:

- A deeper and more protracted spread of COVID-19 globally and in MENAP oil exporters, resulting in additional containment measures, would further weigh on demand, activity, confidence, and commodity prices and result in additional tightening in global financial conditions. As a result, there could be further dislocation in hard-hit sectors—including airlines, real estate, hotels, tourism, and retail, among others—resulting in a further weakening of non-oil growth in several GCC economies. This would put even greater strains on fiscal and

external balances and create additional financing risks for countries with low buffers and large financing needs. It would also create a highly challenging environment for low-income countries and those with weak health systems.

- Prolonged declines in oil prices could result from the combination of a wider COVID-19 outbreak and sustained higher oil supplies, if major producers increase production plans to gain market shares.
- Deepening conflict would dampen further confidence and investment across the region, preventing recovery from the COVID-19 pandemic.
- Finally, strains on MENAP oil exporters could increase if the recent trade agreement between the United States and China (Phase 1) leads to diversion of Chinese imports of crude oil and crude oil products from the region.

Policies Must Continue to Meet Crisis Needs

It is crucial that policies continue to mitigate the impacts of the COVID-19 outbreak. The immediate priority should remain on containing the spread of the virus and protecting people's lives, including by ensuring that health systems, essential services, and social safety nets are adequately prepared to meet the needs of the most vulnerable in society and affected populations, even in countries with more limited policy space and where larger fiscal deficits may arise.

Where policy space is available (Kuwait, Qatar, Saudi Arabia, UAE), governments should continue to pursue a mix of timely and targeted policies and liquidity support to hard-hit sectors and groups. These could include direct cash transfers; strengthening of existing social safety nets; targeted reductions in tariffs and excises on healthcare goods

³This measure does not include assets in sovereign wealth funds in the region, which remain very large despite a significant decline since 2014.

and services; temporary direct subsidies or deferred tax payments to vulnerable businesses to avoid sectoral dislocations (for example, SMEs or hospitality sectors); and expenditure-based incentives to firms (such as accelerated depreciations for investment) to support production of under-supplied goods and services. These and other measures, however, should be temporary to avoid creating lasting burdens on budgets.

For countries with more limited fiscal space, especially those with high debt or large financing needs (Bahrain, Iraq, Oman), scope to respond to the broader economic slowdown may be limited. However, where possible, room could be created within existing envelopes through reprioritizing and postponing non-essential spending; and rationalizing capital expenditure. Such policies should be part of a broader package of gradual medium-term fiscal consolidation with plans to rebuild buffers and ensure fiscal sustainability.

Central banks should stand ready to provide further liquidity to banks, particularly those lending to SMEs, while closely monitoring financial stability. This includes direct liquidity provision, maintaining or increasing credit lines, and providing guarantees to SMEs and state-owned enterprises. In addition, consideration could be given to temporary easing of prudential and regulatory measures, such as adjusting loan-to-deposit ratios, deferred loan payments, and allowing banks to use capital conservation buffers.

International support may be needed for those with limited policy space, including from ongoing conflict. The IMF is already supporting countries through emergency lending facilities and debt relief (for example, Yemen) and stands ready to serve its membership, including by continuing to coordinate and mobilize international support.

Beyond immediate crisis-related measures, economic policy responses should seek to prevent a protracted economic recession with lasting welfare losses to

society and ensure that enough stimulus is provided to help revive economic activity after the crisis. Governments with fiscal space could consider delivering temporary stimulus measures, including increased infrastructure spending, to boost aggregate demand where possible, although such measures would be more effective when economic activity resumes.

Ensuring Medium-Term Fiscal Sustainability

The current crisis has brought the region's vulnerability to oil price volatility into sharp focus and underscored the need for fiscal adjustment over the medium term. Once the virus pandemic abates and after all efforts are deployed to revive economic activity, country authorities should unwind temporary policy measures and resume gradual fiscal consolidation, anchored within revised medium-term fiscal frameworks, to meet pressing challenges from the expected peak in global oil demand (Mirzoev and others 2020) and demographic trends, including the ongoing rise in working age population (see October 2019 *Regional Economic Outlook for the Middle East and Central Asia*).⁴

⁴ Mirzoev, Tokhir N., Ling Zhu, Yang Yang, Andrea Pescatori, Akito Matsumoto, Tim Callen, and others. 2020. *The Future of Oil and Fiscal Sustainability in the GCC Region*. IMF

Departmental Paper 20/01, International Monetary Fund, Washington, DC.

MENAP Oil Exporters: Selected Economic Indicators

	Average	2017	2018	2019	Projections	
	2000–16				2020	2021
Real GDP Growth	4.8	1.2	0.1	-0.8	-4.2	4.7
<i>(Annual change; percent)</i>						
Algeria	3.7	1.3	1.4	0.7	-5.2	6.2
Bahrain	4.9	3.8	2.0	1.8	-3.6	3.0
Iran	3.7	3.7	-5.4	-7.6	-6.0	3.1
Iraq	...	-2.5	-0.6	3.9	-4.7	7.2
Kuwait	4.4	-4.7	1.2	0.7	-1.1	3.4
Libya	-1.6	64.0	17.9	9.9	-58.7	80.7
Oman	3.8	0.3	1.8	0.5	-2.8	3.0
Qatar	10.2	1.6	1.5	0.1	-4.3	5.0
Saudi Arabia	4.0	-0.7	2.4	0.3	-2.3	2.9
United Arab Emirates	4.8	0.5	1.7	1.3	-3.5	3.3
Yemen	0.3	-5.1	0.8	2.1	-3.0	6.1
Consumer Price Inflation	6.8	3.6	8.7	7.8	7.8	8.4
<i>(Year average; percent)</i>						
Algeria	3.9	5.6	4.3	2.0	3.5	3.7
Bahrain	1.8	1.4	2.1	1.0	2.6	2.5
Iran	16.9	9.6	31.2	41.1	34.2	33.5
Iraq	11.8	0.1	0.4	-0.2	0.8	1.0
Kuwait	3.2	1.5	0.6	1.1	0.5	2.3
Libya	7.1	28.0	-1.2	4.6	22.3	15.1
Oman	2.3	1.6	0.9	0.1	1.0	3.4
Qatar	4.1	0.5	0.2	-0.6	-1.2	2.4
Saudi Arabia	2.1	-0.9	2.5	-1.2	0.9	2.0
United Arab Emirates	4.0	2.0	3.1	-1.9	-1.0	1.5
Yemen	12.5	30.4	27.6	10.0	26.7	5.0
General Gov. Overall Fiscal Balance	4.7	-5.3	-1.2	-3.0	-11.8	-9.2
<i>(Percent of GDP)</i>						
Algeria ¹	0.8	-8.6	-6.9	-9.3	-20.0	-15.0
Bahrain ¹	-2.9	-14.2	-11.9	-10.6	-15.7	-11.9
Iran ²	1.0	-1.4	-2.1	-5.7	-9.9	-7.7
Iraq	...	-1.6	7.9	-0.8	-22.3	-14.7
Kuwait ¹	25.4	6.3	9.0	4.8	-11.3	-14.1
Libya	-9.0	-43.5	-0.2	8.8	-7.2	-19.1
Oman ¹	4.9	-14.0	-7.9	-7.0	-16.9	-14.8
Qatar	9.2	-2.9	5.2	4.1	5.2	1.4
Saudi Arabia	4.5	-9.2	-5.9	-4.5	-12.6	-9.0
United Arab Emirates ³	6.1	-2.0	2.0	-0.8	-11.1	-7.1
Yemen	-3.9	-5.3	-6.7	-3.8	-8.0	-8.1
Current Account Balance	10.7	1.8	5.9	2.7	-5.8	-4.5
<i>(Percent of GDP)</i>						
Algeria	8.1	-13.2	-9.6	-9.6	-18.3	-17.1
Bahrain	5.1	-4.5	-5.9	-2.9	-9.6	-7.3
Iran	4.5	3.8	2.1	-0.1	-4.1	-3.4
Iraq	...	1.8	6.9	-1.2	-21.7	-14.1
Kuwait	29.3	8.0	14.5	8.9	-10.2	-7.8
Libya	10.3	8.0	1.8	-0.3	-6.6	-8.3
Oman	5.8	-15.6	-5.5	-5.2	-14.2	-11.1
Qatar	18.7	3.8	8.7	2.4	-1.9	-1.8
Saudi Arabia	13.7	1.5	9.0	6.3	-3.1	-3.4
United Arab Emirates	9.8	7.3	10.0	7.4	1.5	4.1
Yemen	-0.6	-0.2	-1.4	-7.4	-2.8	-6.0

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

Note: Variables reported on a fiscal year basis for Iran (March 21/March 20).

¹Central government.

²Central government and National Development Fund including Targeted Subsidy Organization.

³Consolidated accounts of the federal government and the emirates Abu Dhabi, Dubai, and Sharjah.

2. MENAP Oil Importers: Weathering the Storm

Strong headwinds—the coronavirus disease (COVID-19) outbreak, tighter financial conditions, and weaker growth prospects in oil-producing countries—exacerbate secular challenges facing oil-importing countries in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region. The size, duration, and recovery pattern of the outbreak remain highly uncertain. Lower global oil prices provide some relief, but large macroeconomic imbalances constrain countries’ ability to tackle immediate challenges. Despite limited policy space and high public debt in many countries, emergency health spending to contain the outbreak and countercyclical policies should take precedence. Shielding affected people and firms with temporary targeted measures will need to be calibrated, cognizant of countries’ policy space.

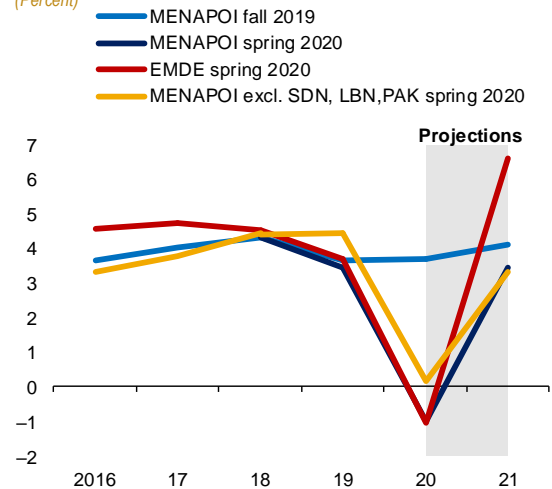
The Perfect Storm

The COVID-19 pandemic represents a clear threat to MENAP oil importers.¹ Besides the potentially large humanitarian impact, the long-lasting economic impact of the crisis—including via an increase in unemployment rates which stood on average at 9.5 percent in 2019—would worsen the already high unemployment in many countries. Although lower oil prices may provide some near-term support, weaker domestic activity, exacerbated by lower confidence and public debt vulnerabilities in some countries, could heighten risks to the outlook.

The onset of the pandemic has dramatically altered the outlook for 2020. Average growth in 2020 is expected to contract by 1.0 percent—4.5 percentage points below 2019 (Figure 2.1). In addition to the pandemic, this also reflects continued macroeconomic imbalances in Sudan, a temporary slowdown given stabilization policies

adopted in Pakistan, a sovereign default in Lebanon, and effects from slowing growth in key trading partners and countries sourcing remittances.

Figure 2.1.
Real GDP Growth
(Percent)



Sources: National authorities; and IMF staff calculations.
Note: EMDE = emerging market and developing economies; MENAPOI = Middle East, North Africa, Afghanistan, and Pakistan oil importers.
Country abbreviations are International Organization for Standardization country codes.

- The projected global contraction and the resulting dramatic decline in global demand have already led to large drops in international commodity prices, affecting food and non-oil commodity exporters (Afghanistan, Jordan, Mauritania, Morocco, Pakistan, Tunisia).
- Additional demand and supply shocks—through trade, tourism, remittances, tighter global financial conditions, and spillovers on domestic credit conditions, along with confinement measures—would severely curtail trade (Djibouti, Egypt, Mauritania, Pakistan, Tunisia) and net tourism credit

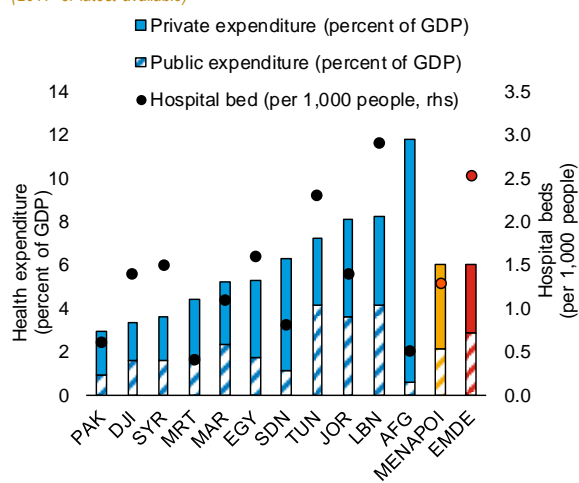
This chapter was prepared by Maximiliano Appendino and Nicolas End with research assistance by Oluremi Akin-Olugbade.

¹ MENAP oil importers (MENAPOI) comprise Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syria, and Tunisia.

(Egypt, Jordan, Lebanon, Morocco, Tunisia) in the region, affecting domestic production and businesses. Furthermore, most MENAP oil importers rely heavily on imports to serve their domestic demand and exports (imports represent 57 percent of GDP versus 47 for emerging market and developing economies [EMDEs]), which, added to the generalized disruptions in global trade, could put available domestic supply at risk.

- These challenges will be particularly daunting for countries with weaker health care infrastructures (Afghanistan, Mauritania, Pakistan, and Sudan; Figure 2.2).

Figure 2.2. **Health Expenditure and Infrastructure** (2017 or latest available)



Sources: World Health Organization; and IMF staff calculations. Note: EMDE = emerging market and developing economies; MENAPOI = Middle East, North Africa, Afghanistan, and Pakistan oil importers; rhs = right-hand scale. Country abbreviations are International Organization for Standardization country codes. Private and public health expenditure data are as of 2017, and hospital beds data is as of 2015, or latest data from 2000–14 where 2015 is not available.

Possible disruptions in the supply of consumption goods and currency depreciations could push domestic prices upward. Lower oil prices may help reduce MENAP oil importers’ fiscal and external imbalances, but reduced capital and remittance flows from oil-extracting countries may also affect the impact on economic activity. In 2014, when oil prices halved, MENAP oil importers improved their fiscal balances by an average of 0.6 percent of GDP and their current accounts by 0.9 percent of GDP, but remittances and foreign direct investment decreased by 0.3

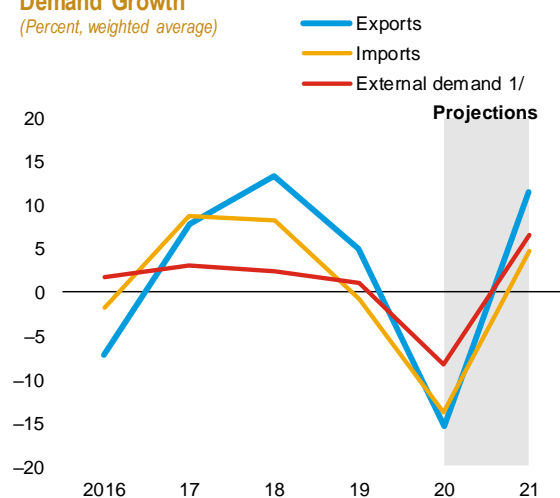
and 1.0 percent of GDP, respectively, and growth ended only marginally higher.

Fiscal expansion is expected in all countries as the fight against the virus and its economic effects is scaled up. MENAPOIs’ fiscal deficit is expected to increase on average to 8.5 percent of GDP because of the impact of lower growth on tax revenues in most countries and scaled-up spending, which would not be compensated by savings in subsidy accruing from lower international commodity prices and an increase in tax revenue in some countries (Jordan, Pakistan).

These challenges arise as growth remained weak in 2019 across most MENAP oil importers, reflecting large, accumulated macroeconomic imbalances (Lebanon, Pakistan, Sudan), persistent structural weaknesses (Tunisia), or adverse agricultural shocks (Sudan). Exceptions were those that benefited from buoyant commodity extraction (Egypt, Mauritania) and higher external demand (Djibouti, Egypt).

Current account balances are expected to improve in 2020 despite lower tourism receipts and remittance flows, with the average deficit shrinking to 4.9 percent of GDP (Figure 2.3).

Figure 2.3. **MENAPOI: Import, Export, and External Demand Growth** (Percent, weighted average)

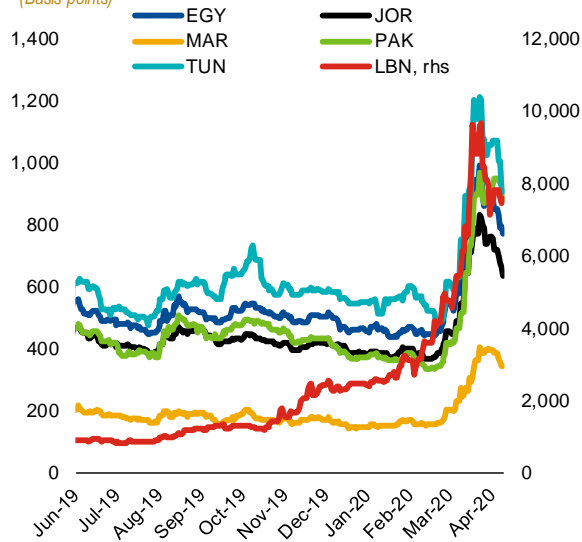


Sources: National authorities; and IMF staff calculations. Note: MENAPOI = Middle East, North Africa, Afghanistan, and Pakistan oil importers; rhs = right-hand scale. 1. The weighted average of real GDP growth of export destination countries.

Figure 2.4.

Sovereign Spreads

(Basis points)



Source: Bloomberg Finance L.P.
 Note: rhs = right-hand scale. Country abbreviations are International Organization for Standardization country codes.

However, financing for this lower deficit may prove difficult in the context of the sharpest portfolio flow reversal on record for emerging markets. This may increase pressure on some countries' foreign reserves and exchange rates. Substantial bond and equity outflows—\$380 million by end of March—have already been observed, with sovereign spreads deteriorating (Figure 2.4). In some countries, financing needs may increase reliance on domestic financial markets and crowd out private credit. Furthermore, increase social unrest in some countries (Lebanon and Sudan, Figure 2.5) constrain policymakers further.

Fragile and conflict-affected states remain particularly vulnerable because sanitary and economic conditions in these states may be conducive to a rapid spread of the pandemic.² Conflict, capacity constraints, and deficient health systems could impede adequate policy responses to the current challenge. Likewise, refugees are dramatically exposed to the fallout of the

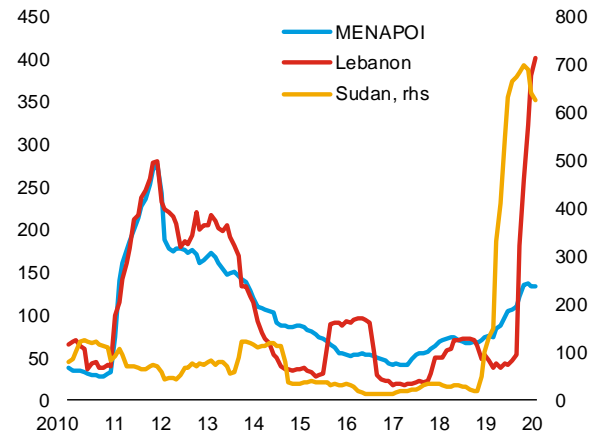
² Fragile states among MENAPOI include Afghanistan, Djibouti, Lebanon, Somalia, Sudan, and Syria.

COVID-19 pandemic—calling for strong support from the international community (Box 2.1).

Figure 2.5.

Reported Social Unrest Index¹

(Index, average 2010–20 = 100, 12-month moving average)



Sources: Factiva; and IMF staff calculations.
 Note: MENAPOI = Middle East, North Africa, Afghanistan, and Pakistan oil importers; rhs = right-hand scale.

1. The Reported Social Unrest Index calculates the share of articles in major news sources that include key terms relating to protests, demonstrations, and other forms of social unrest.

Flying in Turbulent Skies

The authorities in the MENAP oil importers region have reacted proactively to addressing the pandemic. Many countries rapidly declared national emergencies, with all of them restricting domestic and international mobility to different degrees, closing schools, reducing working hours (except for Djibouti and Lebanon), and banning mass gatherings to prevent the spread of the virus. Many have begun increasing their health-related expenditure, deploying financing and supply to their health systems with a focus on immediate needs; this represents an average cost of 0.4 percent of GDP.

Additionally, many countries have increased transfers and subsidies for targeted households (Egypt, Morocco, Pakistan, Tunisia) using existing social protection programs. Others have used cash transfers to unemployed and self-employed workers (Egypt, Pakistan, Tunisia). Assistance to affected firms in the tourism or exporting sectors

(Egypt, Jordan) and to small- and medium-sized enterprises (Morocco, Tunisia) has been granted through guaranteed and subsidized lending, and through tax exemptions (Egypt, Pakistan) and deferrals (Morocco). Including health costs, responses in the MENAP oil importers region to the current pandemic is thus expected to increase fiscal deficits by an average of about 1.5 percent of GDP, ranging from above 2 percent of GDP (in Egypt and Morocco) to 0.2 percent of GDP in countries with less room to maneuver (Sudan).

Some countries have reduced their monetary policy rates (Pakistan, Jordan, Tunisia) with cuts ranging from 25 basis points (Morocco) to 300 basis points (Egypt), while others have facilitated credit to small and medium firms (Egypt, Morocco, Tunisia) and intervened in capital markets (Egypt, Morocco).

In the current circumstances, the immediate priority should indeed be to save lives, protect the most vulnerable, and safeguard critical economic sectors, including through outright support to the financial sector, as needed. Fiscal policy should accommodate urgent spending needs, particularly to support emergency services and enhance health care infrastructures. Given weak health care capabilities in some countries (Afghanistan, Mauritania, Pakistan, Sudan) and reliance on private expenditure of health care in some others, scaling up health expenditure (including for migrants and refugees) is needed urgently.

Beyond this, measures should be targeted to address the nature and persistence of the shock, particularly in countries with limited policy space, such policies should be contemplated only to restart the recovery phase when the outbreak subsides.

Temporary tax reliefs and subsidies may be needed to avoid sectoral dislocations, and targeted expenditure-based incentives, such as accelerated depreciations for investment, may boost the production of undersupplied goods and services. Absent adequate social safety nets, social programs will also have to be expanded to protect

the most vulnerable. Targeted cash transfers, wage subsidies, and temporary tax relief could help ensure that vulnerable households and small and medium firms can weather this temporary shock, even though the administrative capacity of MENAPOI countries to implement means-tested or temporary programs is weak. These measures should ideally be offset by postponing nonessential spending whenever possible, though with urgent spending needs met even if such offsetting measures are not available. Where fiscal space may not exist, countries may need to seek assistance from donors.

Possible losses on their credit portfolios to corporates and households may necessitate measures to aid the financial sector. Temporary and targeted financial support measures may be needed to address liquidity pressures caused by the COVID-19 outbreak, even if it involves contingent fiscal liabilities, but loan classification and provisioning rules should continue to be fully applied to preserve the credibility of the financial system. Supervisors could issue guidelines to banks supporting a prudent, constructive easing of loan terms and conditions for affected borrowers and the temporary and transparent regulatory implications (if any), while remaining cognizant of risks in countries with already large stranded financial assets (Tunisia), a banking stress (Lebanon), or weak supervisory capacities.

Countries with high inflation (Tunisia, Sudan) or low international reserves (Tunisia) may be unable to accommodate the shock with monetary policy. Conversely, they may have to tighten their monetary policy stance to avoid disorderly exchange rate adjustments, surging inflation, and financial stability implications, given the rapid tightening of global financial conditions. Macroprudential policies and temporary capital outflow restrictions could play complementary roles if they are adequately evaluated to react to near-crisis situations.

External Support Critical

A globally coordinated response to the COVID-19 pandemic is essential to transition away from the shock. Given the limited fiscal space in many countries, with large needs adding to about \$170 billion in 2020, external financing will be critical in helping governments effectively contain the adverse implications of the virus on households and firms. The IMF, other international financial organizations, and the international community have a large role to play to assist the MENAP oil importers.

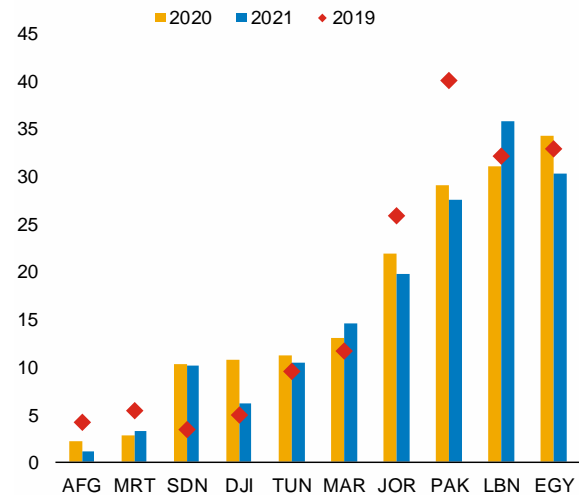
The IMF has responded swiftly. Morocco has chosen to draw on its Precautionary Liquidity Line to help manage needs from the current shock. In March, the IMF Executive Board approved a new arrangement under the Extended Fund Facility for Jordan and an Extended Fund Facility and Extended Credit Facility for Somalia, after the latter successfully reached the Heavily Indebted Poor Country decision point. In April, it granted Pakistan and Tunisia financial support under its Rapid Financing Instrument. Several other countries' requests for IMF financing are under way.

Repairs After the Storm

When the pandemic has subsided, MENAPOI will find their policy space has shrunk further, with limited policy options. The current shock is likely to result in weaker economic fundamentals and higher public and external debt vulnerabilities. Some countries may even face an increasing number of weather-related shocks induced by climate change, as already observed. Restoring growth in this environment may require financing beyond the sizable \$170 billion currently envisioned for 2021, adding to the already large financing needs that some governments face (Figure 2.6). Policies would thus need to be calibrated to facilitate a recovery while restoring macroeconomic stability over the medium term. This challenging environment would require

support, including from the international community.

Figure 2.6.
Public Gross Financing Needs
(Percent of GDP)



Sources: National authorities; and IMF staff calculations.
Note: Country abbreviations are International Organization for Standardization country codes.

Box 2.1. A Decade into the Syrian Refugee Crisis

The Syrian conflict is now in its tenth year. About 6 million Syrians—nearly one-quarter of the population—have been forced to leave the country and 7 million to relocate internally, making Syria the largest displacement crisis in recent times.

Lebanon hosts 1 million registered refugees, and Jordan hosts 0.7 million (about one-tenth and one-third of their pre-crisis populations, respectively), delivering critical global public good. However, the size of such inflows has exacerbated social and economic tensions. Refugees have also arrived in the context of already large fiscal and external imbalances: Jordan has been stabilizing its economy with a series of IMF-supported programs since 2012, while Lebanon has been accumulating unsustainable debts, leading to the recent decisions to impose capital controls and restructure public debt.

The COVID-19 pandemic brings about a new layer of vulnerability for refugees and their hosts that needs urgent palliative response. Refugees in camps or substandard housing have insufficient means to contain contagion risks, and even though theoretically able to access local health care services, they are unable to do so because health care facilities are either already overstretched (Jordan) or expensive (Lebanon; see Figure 2.1). Moreover, most refugees work in the informal sector with little access to credit or emergency funds, which makes them especially vulnerable to the economic impact of pandemic (Errighi and Griesse 2016).¹

Host governments need to ensure their access to health care and shield them from the economic fallout. To this end, they would require foreign grant support and concessional financing to achieve these humanitarian objectives. More broadly, once the pandemic is under control, they should resume the developmental approach to the refugee crisis with the support of the international community (World Bank 2017).² Allowing refugees to integrate into domestic markets, reach self-reliance, secure livelihood, and maintain marketable skills will ultimately foster rather than deter return (Harild and others 2015; Koser and Kuschminder 2015).^{3,4}

1/ Errighi, Lorenza and Jörn Griesse. 2016. “The Syrian Refugee Crisis: Labour Market Implications in Jordan and Lebanon” European Economy Discussion Paper 029, Luxembourg, European Commission.

2/ World Bank. 2017. *Forcibly Displaced: Toward a Development Approach Supporting Refugees, the Internally Displaced, and Their Hosts*. Washington, DC: World Bank.

3/ Harild, Niels, Asger Christensen, and Roger Zetter. 2015. “Sustainable Refugee Return: Triggers, Constraints, and Lessons on Addressing the Development Challenges of Forced Displacement.” Global Program on Forced Displacement Issue Note Series Report 99618, World Bank, Washington, DC.

4/ Koser, Khalid & Katie Kuschminder. 2015. “Comparative Research on the Assisted Voluntary Return and Reintegration of Migrants.” Geneva: International Organization for Migration.

MENAP Oil Importers: Selected Economic Indicators

	Average 2000–16	2017	2018	2019	Projections	
					2020	2021
Real GDP Growth	4.2	4.0	4.3	3.5	-1.0	2.5
<i>(Annual change; percent)</i>						
Afghanistan	...	2.9	2.7	3.0	-3.0	4.5
Djibouti	4.4	5.4	8.4	7.5	1.0	8.5
Egypt	4.3	4.1	5.3	5.6	2.0	2.8
Jordan	4.7	2.1	1.9	2.0	-3.7	3.7
Lebanon	4.5	0.9	-1.9	-6.5	-12.0	...
Mauritania	3.5	3.5	2.1	5.9	-2.0	4.2
Morocco	4.3	4.2	3.0	2.2	-3.7	4.8
Pakistan	4.3	5.2	5.5	3.3	-1.5	2.0
Somalia	2.6	1.4	2.8	2.9	-2.5	2.9
Sudan ¹	3.0	0.7	-2.3	-2.5	-7.2	-3.0
Syria ²	4.3	...	...	...	...	...
Tunisia	3.3	1.9	2.7	1.0	-4.3	4.1
West Bank and Gaza ³	4.4	1.4	1.2	0.9	-5.0	6.5
Consumer Price Inflation	3.7	12.7	12.3	8.1	9.4	9.4
<i>(Year average; percent)</i>						
Afghanistan	...	5.0	0.6	2.3	4.7	4.5
Djibouti	1.1	0.6	0.1	3.3	2.9	2.8
Egypt	0.6	24.6	19.9	8.3	4.9	7.2
Jordan	3.3	3.3	4.5	0.3	0.2	1.6
Lebanon	2.3	4.5	4.6	2.9	17.0	...
Mauritania	5.3	2.3	3.1	2.3	3.9	4.5
Morocco	1.6	0.8	1.9	0.0	0.3	1.3
Pakistan	8.1	4.1	3.9	6.7	11.1	8.0
Somalia	...	...	...	...	...	...
Sudan ¹	16.4	32.4	63.3	51.0	81.3	91.1
Syria ²	4.9	...	...	...	...	...
Tunisia	3.7	5.3	7.3	6.7	6.2	4.9
West Bank and Gaza ³	2.6	0.2	-0.2	1.6	0.1	1.3
General Gov. Overall Fiscal Balance	-5.8	-6.7	-6.9	-7.3	-8.5	-7.0
<i>(Percent of GDP)</i>						
Afghanistan ⁴	...	-0.6	1.5	-1.0	-4.0	-2.0
Djibouti	-3.0	-4.5	-2.8	-0.8	-2.7	-1.7
Egypt	-8.5	-10.6	-9.5	-7.4	-7.7	-6.9
Jordan ⁵	-6.2	-3.3	-4.4	-6.1	-6.7	-5.7
Lebanon ⁴	-8.4	-8.6	-11.3	-10.7	-15.3	...
Mauritania ^{4,6}	-11.9	0.0	2.5	2.1	-3.3	-0.7
Morocco ⁴	-4.2	-3.5	-3.7	-4.1	-7.1	-4.5
Pakistan ⁷	-4.7	-5.8	-6.4	-8.8	-9.2	-6.5
Somalia	...	...	...	...	...	...
Sudan ¹	-2.3	-6.5	-7.9	-10.8	-16.9	-20.6
Syria ²	...	...	...	...	...	...
Tunisia ⁸	-3.3	-5.9	-4.6	-3.9	-4.3	-2.5
West Bank and Gaza ³	-18.2	-7.3	-6.6	-7.4	-10.7	-8.1
Current Account Balance	-2.4	-6.7	-6.4	-5.4	-4.9	-4.4
<i>(Percent of GDP)</i>						
Afghanistan	...	7.1	13.0	8.6	4.9	5.8
Djibouti	5.4	-4.8	18.0	24.7	-0.8	0.2
Egypt	-0.6	-6.1	-2.4	-3.6	-4.3	-4.5
Jordan	-6.6	-10.8	-7.0	-2.8	-5.8	-5.3
Lebanon	-19.4	-26.5	-26.7	-20.6	-12.6	...
Mauritania	-11.3	-10.0	-13.8	-10.6	-17.3	-17.4
Morocco	-3.4	-3.4	-5.3	-4.1	-7.8	-4.3
Pakistan	-1.3	-4.1	-6.3	-5.0	-1.7	-2.4
Somalia	-9.9	-9.7	-10.3	-13.7	-11.4	-11.2
Sudan ¹	-7.6	-10.1	-13.0	-14.9	-15.2	-11.8
Syria ²	-0.4	...	...	...	...	...
Tunisia	-5.8	-10.2	-11.2	-8.8	-7.5	-8.1
West Bank and Gaza ³	-16.7	-13.2	-13.1	-10.7	-11.7	-11.0

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

Note: Variables reported on a fiscal year basis for Afghanistan (March 21/March 20) until 2011, and December 21/December 20 thereafter, and Egypt and Pakistan (July/June), except inflation.

¹Data for 2011 exclude South Sudan after July 9. Data for 2012 and onward pertain to the current Sudan.

²2011–20 data exclude Syria.

³West Bank and Gaza is not a member of the IMF and is not included in any of the aggregates.

⁴Central government. For Lebanon, includes transfers to electricity company.

⁵Overall fiscal balance includes the transfers to the electricity company NEPCO until the end of 2014. From 2015 transfers were stopped.

⁶Includes oil revenue transferred to the oil fund.

⁷Including grants.

⁸Includes bank recapitalization costs and arrears payments.

3. Caucasus and Central Asia: Confronting a Global Challenge

The onset of the coronavirus disease (COVID-19) pandemic and a sharp fall in oil prices after the breakdown of the Organization of Petroleum Exporting Countries and other major oil producers (OPEC+) coalition have tipped the Caucasus and Central Asia (CCA) region into a recession, expected to be worse than during the 2008 global financial crisis and the 2014–16 shock. This has undercut a generally robust performance since 2017, driven partly by generally strengthened macroeconomic frameworks and buffers. Notwithstanding the uncertainties regarding the pace and depth of the pandemic and the ensuing humanitarian, economic, and financial consequences, the outlook faces significant downside risks. In the near term, policies should be targeted to contain the human and economic tolls of the COVID-19 pandemic and to limit its fallout.

Immediate Global Challenges

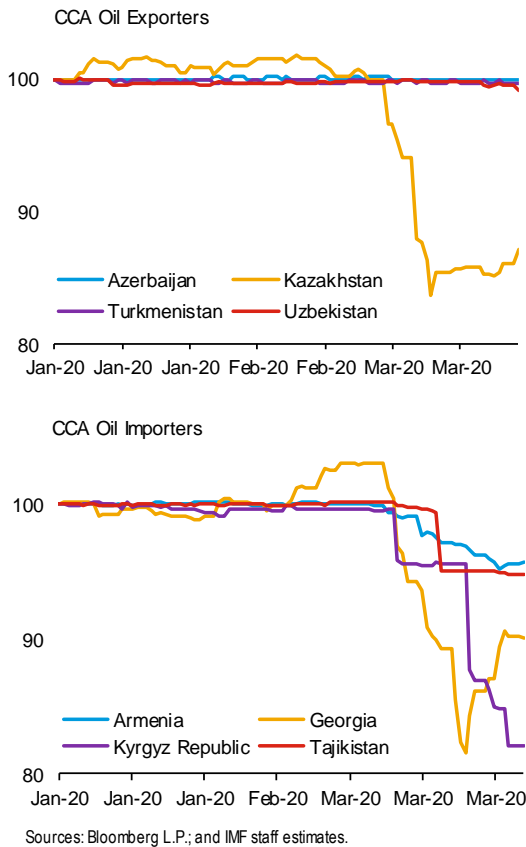
The economic outlook for the CCA region is expected to be markedly worse than during the global financial crisis and the 2014–16 shock, amidst containment and mitigation measures already undertaken. The CCA region is projected to contract by 1.7 percent of GDP in 2020, a downward revision of more than 6 percentage points of GDP since the October 2019 *Regional Economic Outlook: Middle East and Central Asia*.

The current conjuncture is a multifaceted crisis. First and foremost, it is a *domestic health crisis*, with an urgent need for critical containment and mitigation measures. The pandemic and lockdowns also bring *demand and terms of trade shocks* as well as a *supply shock*, including via disrupted supply chains. The parallel *tightening of financial conditions* exacerbates circumstances facing the CCA. These developments present substantial headwinds to the regional outlook:

- Most significantly, the decline in global oil demand has been compounded by the recent breakdown in the OPEC+ agreement and subsequent decisions by Saudi Arabia and others to ramp up production of oil. The resulting large decline of more than 50 percent in the price of oil since January—combined with declines in prices of other commodities—will most strongly affect CCA oil exporters. Oil and gas exports were 20–35 percent of GDP in 2019 in Azerbaijan, Kazakhstan, and Turkmenistan. More than 80 percent of Turkmenistan’s exports are oriented toward China, which together with Italy remains a significant export destination for Azerbaijan and Kazakhstan. While CCA oil importers are expected to benefit from a lower oil price, demand shocks—lower remittances from Russia—may mute some of the positive impact.
- Import volumes from affected trading partners are also large for both CCA oil exporters and oil importers. About 35 percent of imports to the Kyrgyz Republic come from China. More than 40 percent of Uzbekistan’s imports are drawn from affected trading partners in Asia and Europe. Supply disruptions have also been observed, reducing import-related tax revenue and causing domestic price spikes (Kyrgyz Republic, Tajikistan).
- A global slowdown in tourism would further constrain growth, particularly in countries where inbound tourism expenditure constitutes a high percentage of GDP or exports (Armenia, Georgia, Kyrgyz Republic).
- While international reserves and debt ratios were assessed as broadly adequate and sustainable pre-pandemic, sharp declines in commodity prices

and anticipated drops in remittances—given, among others, the expected slowdown in Russia—have put pressure on local currencies (Figure 3.1) and sovereign spreads. Some flexible currencies such as the Kazakh tenge and the Georgian lari have depreciated to historic lows, in line with emerging markets. While the Kyrgyz som and the Tajik somoni have lost some value, other managed currencies have generally remained stable due to demand for dollars being absorbed through either increased foreign exchange auctions or rationing. In parallel, sovereign spreads have spiked significantly from their lows in mid-February, with increases (above 400 basis points) in Azerbaijan, Georgia, and Tajikistan, broadly in line with emerging markets

Figure 3.1. **Currency Exchange Rates**
(Index, January 2020 = 100)

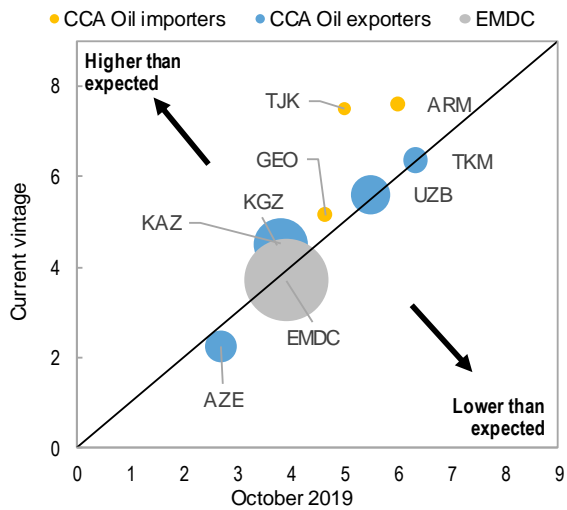


but raising debt service and refinancing costs and further constraining fiscal space.

These improvements in macroeconomic frameworks since the external shock of 2014–16 had

smoothed the management of the crisis across most countries in the CCA. Enhancements in fiscal transparency and public financial management, the introduction of fiscal rules, and greater exchange rate flexibility and modernization of monetary policy frameworks had enhanced macroeconomic stability and provided buffers. Growth in CCA was resilient in 2019: at 4.8 percent, output grew faster than expected in the October 2019 *Regional Economic Outlook: Middle East and Central Asia*, and above the

Figure 3.2. **Real GDP Growth in 2019**
(Percent)

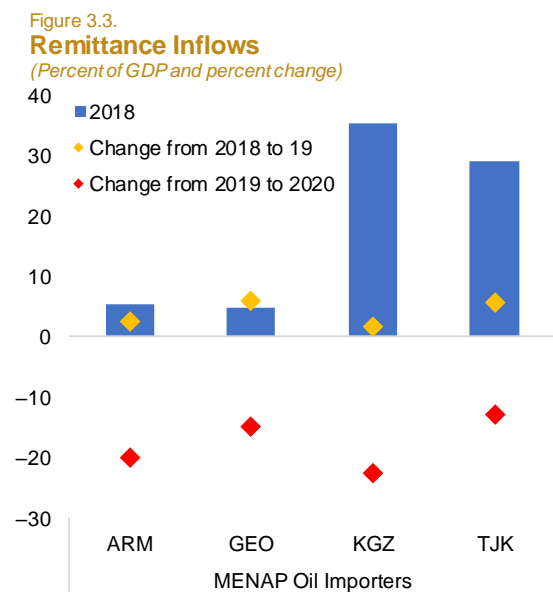


average for emerging markets and developing countries (EMDCs; Figure 3.2).

Darker Skies Ahead

Adverse impacts of the multiple shocks are expected to drive most countries in the CCA region into a recession. While CCA oil exporters are projected to contract by 0.8 percent due to supply disruptions and a decline in export demand, mostly in oil, CCA oil importers are expected to be hit harder, with growth shrinking by more than 8 percentage points to –2.2 percent. This is mainly driven by sharply lower exports, tourism, and remittances receipts (see

Figure 3.3) as well as decelerating credit to the private sector.

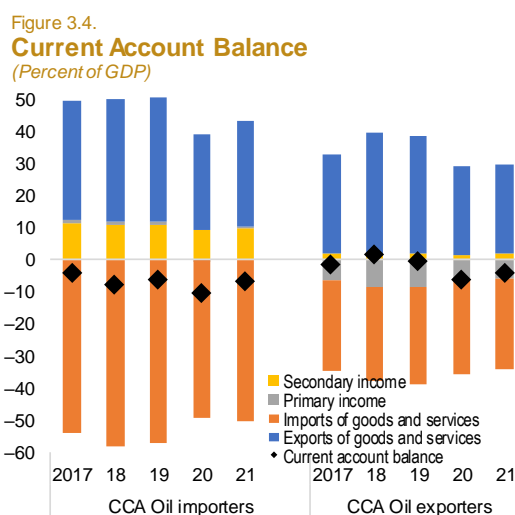


Sources: Country authorities; and IMF staff calculations.
Note: ARM = Armenia; GEO = Georgia; KGZ = Kyrgyz Republic; MENAP = Middle East, North Africa, Afghanistan, and Pakistan; TJK = Tajikistan.

External positions could worsen across the region, given the large exposure of CCA economies to countries hardest hit by the COVID-19 pandemic (see Figure 3.4). The current account deficit among CCA oil exporters could decline further to 6.7 percent of GDP in 2020, led by a sharp fall in exports (including those of commodities), with effects most pronounced in Azerbaijan, Kazakhstan and Uzbekistan. Mirroring the decline in domestic demand, import growth would also drop. A worsening of the current account deficit among CCA oil importers—to 10.5 percent in 2020—reflects lower remittances and contractions in growth rates of both exports and imports. Overall, CCA oil importers’ exports would contract by 29.4 percent while imports would shrink by 19.9 percent; in both cases, magnitudes for Georgia and Kyrgyz Republic are higher, given the larger services share in GDP and their regional role as ports for trade with China, respectively.

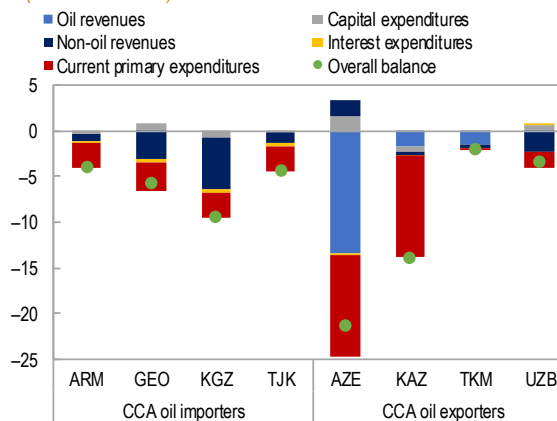
A further worsening of the fiscal balance is envisaged amid lower commodities prices, slower activity, and additional health and social measures (see Figure 3.5). Higher urgent expenditures associated with the COVID-19 pandemic across much of the region, combined with a substantially

lower revenue (3.4 percent of GDP decrease) could further worsen fiscal balances and yield, in some case, significant additional financing needs.



Sources: Country authorities; and Fund staff calculations.
Note: The primary income account shows income flows between residents and nonresidents. Primary income captures returns for the provision of labor and financial assets (from direct investment, portfolio investment, other investment, and reserve assets) and renting of natural resources. The secondary income account shows current transfers between residents and nonresidents, including workers’ remittances. CCA = Caucasus and Central Asia.

Figure 3.5. Change in Overall Fiscal Balance, 2020 versus 2019
(Percent of GDP)



Source: IMF, World Economic Outlook database.
Note: An increase (decrease) in revenue contributes positively (negatively) to the fiscal position. An increase (decrease) in expenditure contributes negatively (positively) to the change in fiscal position. ARM = Armenia; AZE = Azerbaijan; CCA = Caucasus and Central Asia region; GEO = Georgia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; TJK = Tajikistan; TKM = Turkmenistan; UZB = Uzbekistan.

While financial systems in the region have remained stable so far, vulnerabilities exist in the current conjuncture. For instance, the recent rise in retail and mortgage credit growth has been accompanied by relaxed lending standards and subsidized and directed lending (Azerbaijan, Kazakhstan,

Kyrgyz Republic). An asset quality review of the 14 largest banks in Kazakhstan revealed capital needs in four. Resolution and restructuring remain on the agenda in the Kyrgyz Republic and Tajikistan. The Azeri authorities recently extended a deposit guarantee, which was to expire in March, until December. However, in the current environment, nonperforming loans are likely to increase, and liquidity pressures could build up. Banks could come under pressure, giving rise to calls on state and central bank support. Some central banks in the region are already considering forbearance for certain types of borrowers (households and small- and medium-sized enterprises [SMEs]).

Under the baseline, with no protracted outbreaks, medium-term growth is projected to rebound and stabilize. However, downside risks dominate this outlook, and a worsening of the pandemic remains an immediate and large risk. A more prolonged global slowdown could further weaken global demand and lower commodity prices, affecting CCA oil exporters. A longer period of low commodity prices could lead to external and fiscal pressures, including via secondary effects on trade and remittances from a slowdown in Russia. A tightening of global financial conditions could result in disorderly market conditions in countries reliant on external financing with liquidity constraints, possibly giving rise to solvency problems. An economic rebound would, consequently, become more challenging.

Responding to Immediate Shocks

Countries have been responding to the COVID-19 pandemic and oil price shock with a variety of policy measures:

- Most countries have banned travel, closed borders, and adopted social distancing measures and lockdowns.
- The Kyrgyz Republic and Tajikistan have raised their policy rates by 75 and 50 basis points, respectively, amid concerns about food price increases. Kazakhstan increased its policy rate by

about 275 basis points before letting the tenge float.

- Kazakhstan has announced a large fiscal support package, including both expenditure and revenue measures covering health, households and SMEs equivalent to 9 percent of GDP. Armenia has also rolled out a fiscal package estimated at 3.5 percent of GDP, covering mainly health expenditure. Azerbaijan, Georgia and Uzbekistan also have announced fiscal packages of 1–3 percent of GDP, including to address the indirect economic impact of pandemic.
- Armenia is considering a 24–36-month subsidized loan program for households and SMEs. Georgia has loosened some previously tightened macroprudential measures. So far, no country has reported a resort to capital flow management measures.

Overall, countries have generally communicated well, accommodated exchange rate pressures, and planned for additional health-related spending. However, more may be needed as the pandemic intensifies in the region.

In the near term, responding to the human and economic tolls of the COVID-19 pandemic and limiting its fallout remain priorities. Targeted fiscal and financial support measures are most suitable for addressing some of the most acute pandemic-related problems. Countries affected by the virus should make direct, urgent fiscal spending to alleviate capacity constraints in health services and contain the spread. These may include mitigation measures such as the provision of temporary health facilities to quarantine and treat those affected. Authorities could also consider tax and revenue administration measures to facilitate imports of medicines, personal protective equipment, medical supplies, and related goods.

Additionally, targeted social spending (cash transfers to the poorest households, especially those affected by a decline in remittances and loss of employment) as well as temporary subsidies or deferred tax payments to the hardest hit firms (such as SMEs and

the hospitality sector) should be instituted. A few countries have the fiscal space (Azerbaijan, Kazakhstan, Uzbekistan) to consider such measures without reallocating existing plans. Such deviations from planned budgets should be clearly communicated as temporary efforts to address the immediate challenge. However, in general, the magnitude needed for the response, especially where fiscal space might be limited, would require concerted international support to help create temporary policy space in addition to the careful reorientation of expenditure priorities.

Monetary and exchange rate policies will play a critical and complementary role to play to counter impacts of pandemic-induced demand and terms of trade shocks. Therefore, in countries with flexible exchange rates, credible monetary frameworks, low inflation, and relatively moderate currency mismatches (like Armenia, Georgia and Kazakhstan), exchange rates could act as shock absorbers. However, in countries with less credible monetary frameworks, poorly anchored inflation, and large unhedged balance sheet exposures, monetary policy tightening may be advisable to avoid capital outflow pressures that could lead to disorderly exchange rate movements, spiraling inflation and contractionary effects. Monetary policy

may not be the first line of defense to respond to capital outflows in all situations. Given concerns about capital movements, foreign exchange interventions and capital flow management measures, combined with macroprudential policies could also be deployed to safeguard financial stability in the event of extreme external systemic stability pressure. However, such measures should be transparent and temporary, and not substitute for needed macroeconomic adjustment.

Additionally, authorities should ensure an adequate supply of liquidity and collateralized emergency funding schemes for banks to help support affected firms.

The IMF is supporting CCA countries with policy advice and financial support to help create space for additional measures. In that context, Kyrgyz Republic became the first member country to access resources (\$120 million) under the IMF's Rapid Financial Instrument-Rapid Credit Financing in the post-pandemic environment. Additional countries in the region have also requested IMF financing. In this endeavor, the IMF is also coordinating closely with other international and regional financial institutions to ensure full support to its members.

CCA: Selected Economic Indicators

	Average 2000–16	2017	2018	2019	Projections	
					2020	2021
Real GDP Growth	7.4	4.0	4.3	4.8	-1.0	4.7
<i>(Annual change; percent)</i>						
Armenia	6.6	7.5	5.2	7.6	-1.5	4.8
Azerbaijan	9.5	0.2	1.5	2.3	-2.2	0.7
Georgia	5.5	4.8	4.8	5.1	-4.0	3.0
Kazakhstan	6.9	4.1	4.1	4.5	-2.5	4.1
Kyrgyz Republic	4.4	4.7	3.5	4.5	-4.0	8.0
Tajikistan	7.7	7.1	7.3	7.5	1.0	5.5
Turkmenistan	9.7	6.5	6.2	6.3	1.8	6.4
Uzbekistan	6.8	4.5	5.4	5.6	1.8	7.0
Consumer Price Inflation	9.1	9.4	8.3	6.8	7.7	6.9
<i>(Year average; percent)</i>						
Armenia	3.8	1.0	2.4	1.4	0.8	2.0
Azerbaijan	6.3	12.8	2.3	2.6	3.3	3.2
Georgia	5.1	6.0	2.6	4.9	4.6	3.7
Kazakhstan	8.6	7.4	6.0	5.2	6.9	6.8
Kyrgyz Republic	8.0	3.2	1.5	1.1	10.6	7.2
Tajikistan	12.5	7.3	3.8	7.8	8.1	6.9
Turkmenistan	5.6	8.0	13.3	5.1	8.0	6.0
Uzbekistan	13.8	13.9	17.5	14.5	12.6	10.6
General Gov. Overall Fiscal Balance	1.6	-2.8	2.0	0.6	-5.6	-3.1
<i>(Percent of GDP)</i>						
Armenia ¹	-3.4	-4.8	-1.8	-1.0	-5.0	-2.5
Azerbaijan ¹	5.9	-1.4	5.5	8.4	-12.8	-9.7
Georgia	-2.0	-2.7	-2.3	-2.0	-7.8	-3.8
Kazakhstan	2.1	-4.3	2.5	-0.6	-5.3	-2.7
Kyrgyz Republic	-4.0	-3.7	-0.6	-0.1	-9.6	-6.4
Tajikistan	-2.9	-6.0	-2.8	-2.1	-6.4	-3.0
Turkmenistan ²	2.4	-2.8	-0.2	-0.3	-2.3	-0.5
Uzbekistan	0.5	1.6	2.1	0.0	-3.3	-1.3
Current Account Balance	0.2	-2.3	0.2	-1.6	-7.2	-5.0
<i>(Percent of GDP)</i>						
Armenia	-8.1	-3.0	-9.4	-8.2	-8.6	-7.2
Azerbaijan	7.7	4.1	12.8	9.2	-8.2	-3.7
Georgia	-10.8	-8.1	-6.8	-5.1	-10.5	-6.9
Kazakhstan	-1.1	-3.1	-0.1	-3.6	-6.8	-5.5
Kyrgyz Republic	-5.7	-6.2	-12.1	-9.1	-16.6	-11.0
Tajikistan	-9.0	2.2	-5.0	-3.3	-7.7	-4.5
Turkmenistan	-10.0	-10.4	5.5	5.1	-1.4	-0.4
Uzbekistan	4.0	2.5	-7.1	-5.6	-9.4	-6.4

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

¹Central government.²State government.