

## 2. Monetary Policy: Where Does the Middle East and Central Asia Stand?<sup>1</sup>

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

### 2.1. Introduction

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

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

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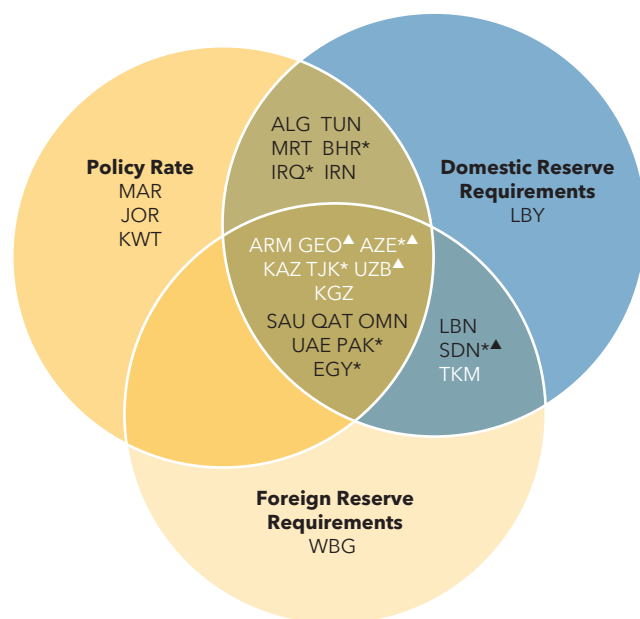
<sup>2</sup> Because of data limitations, this chapter does not cover some important aspects of monetary policy, including the inflation expectations channel of monetary policy. Also, the evolution of nominal and real wages and measures of labor market slack, which are important determinants of inflation,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

## 2.2. Monetary Policy Instruments and Recent Actions

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

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

**Figure 2.1. ME&CA Central Banks’ Instruments**

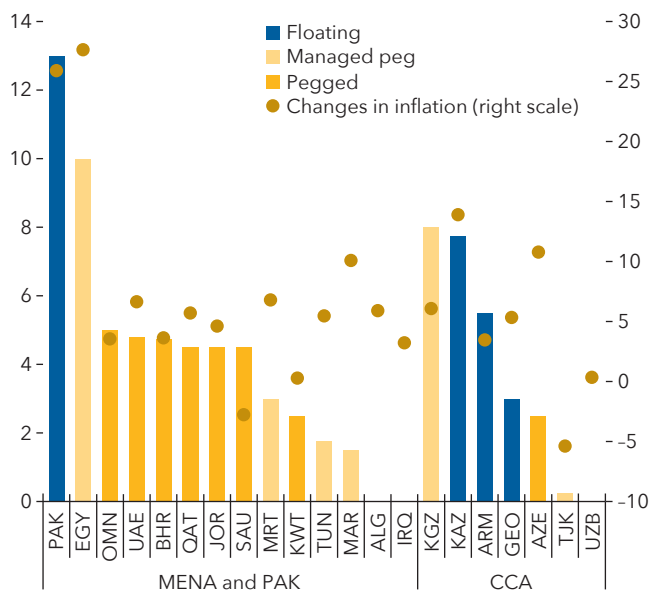


Source: IMF desk survey.

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

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

(Percent, January 2021 to latest)



Sources: Haver Analytics; and IMF staff calculations.

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

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

<sup>4</sup> Egypt’s decision to raise the required reserve ratio from 14 percent to 18 percent in September 2022 was for monetary policy purposes.

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

## 2.3. Assessing the Monetary Policy Stance

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

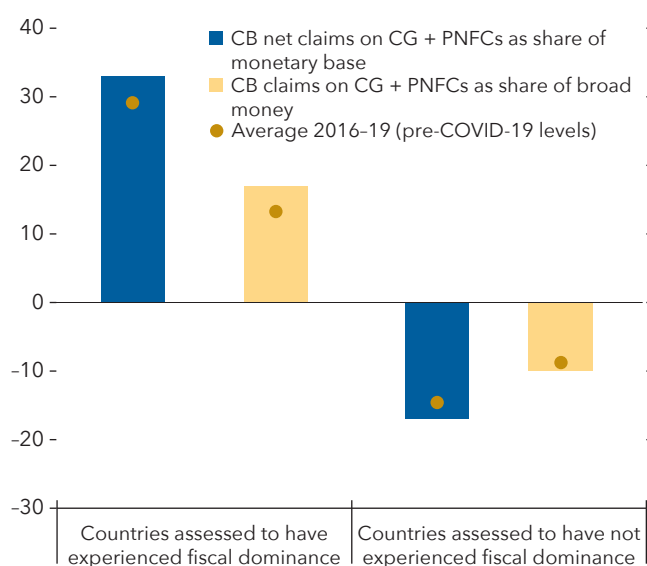
### What Is the Current Monetary Policy Stance?

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

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

**Figure 2.3. Central Banks' Net Claims on Central Government and Claims on Public Nonfinancial Corporations**

(Percent, 2020-21 average)



Sources: IMF, International Financial Statistics database; and IMF staff calculations.

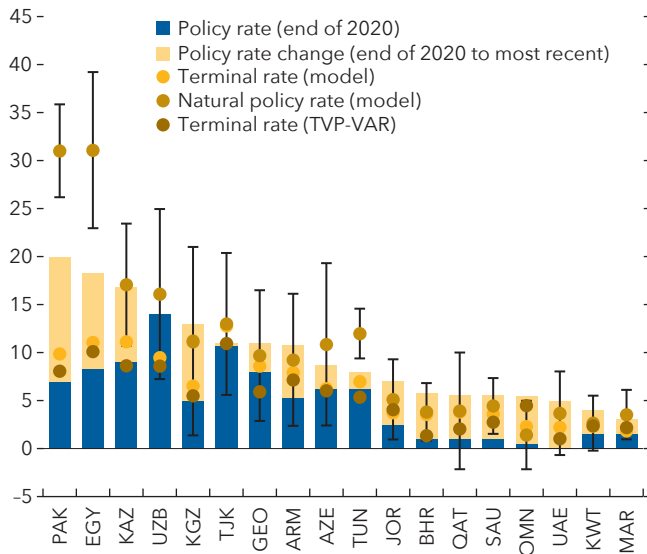
Note: The classification of the countries that experienced fiscal dominance and those that did not is based on IMF country teams' assessment. See Online Annex 1 for details. CB = central bank; CG = central government; PNFCs = public nonfinancial corporations.

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

<sup>6</sup> The uncertainty surrounding natural rate estimates has implications for the conduct of monetary policy. See Online Annex 2 for a discussion.

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

**Figure 2.4. Nominal Policy Interest Rates**  
(Percent)



Source: IMF staff calculations.

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

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

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

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

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

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

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

<sup>8</sup> See Online Annex 2 for model details and estimation results.

<sup>9</sup> See the section titled “The Monetary Policy Transmission Mechanism in ME&CA” for estimated impacts on inflation from higher policy rates.

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

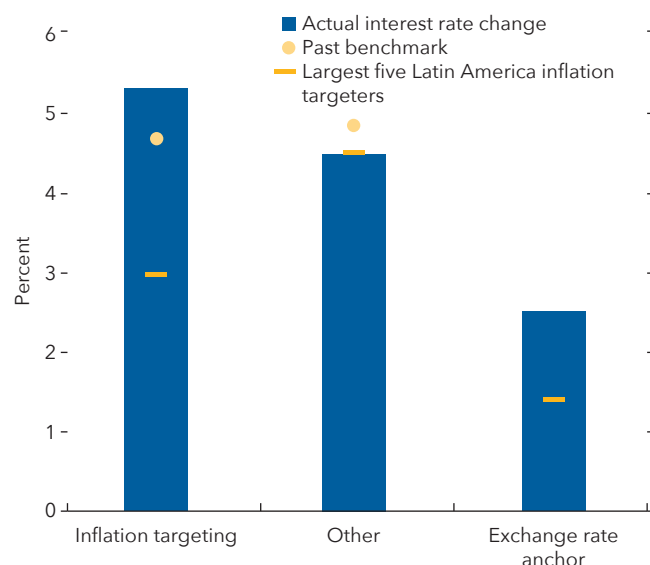
## How Have Financial Conditions Changed?

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

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

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

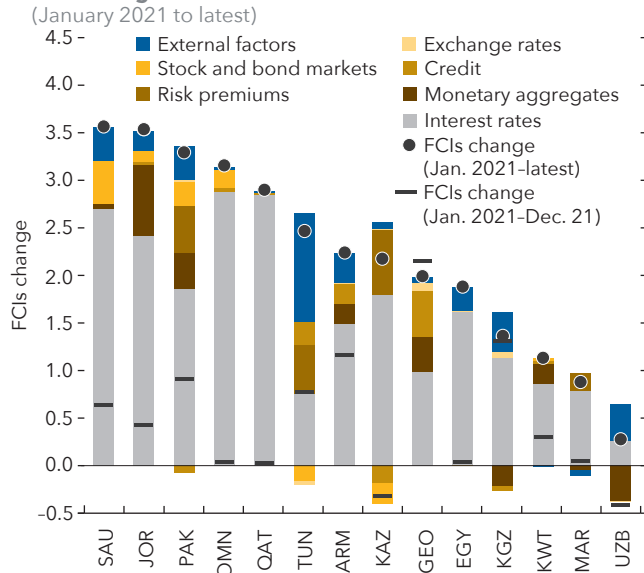
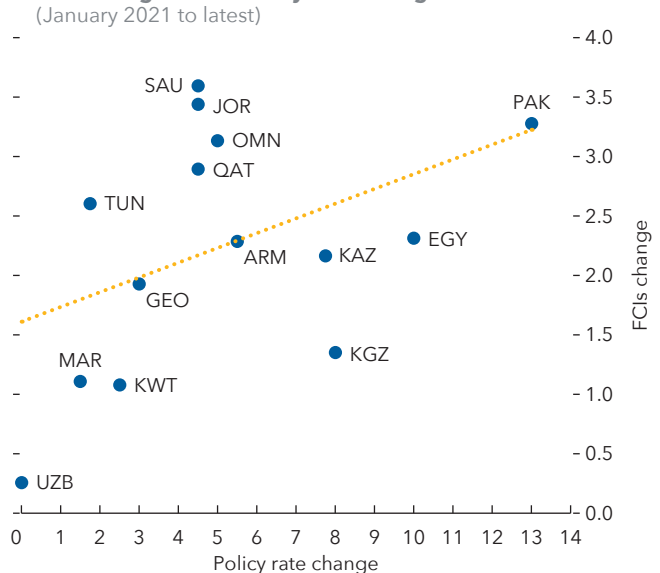
**Figure 2.5. Difference between Actual and Rule-Based Policy Interest Rate Changes (2021:Q1-22:Q4)**



Source: IMF staff calculations.

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

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

**Figure 2.6. ME&CA: Financial Conditions Indices****1. FCIs Changes and Contributions****2. FCIs Change versus Policy Rate Change**

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

## 2.4. The Monetary Policy Transmission Mechanism in ME&CA

### How Does Monetary Policy Tightening Reduce Inflation?

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

### Is the Exchange Rate Channel Functioning?

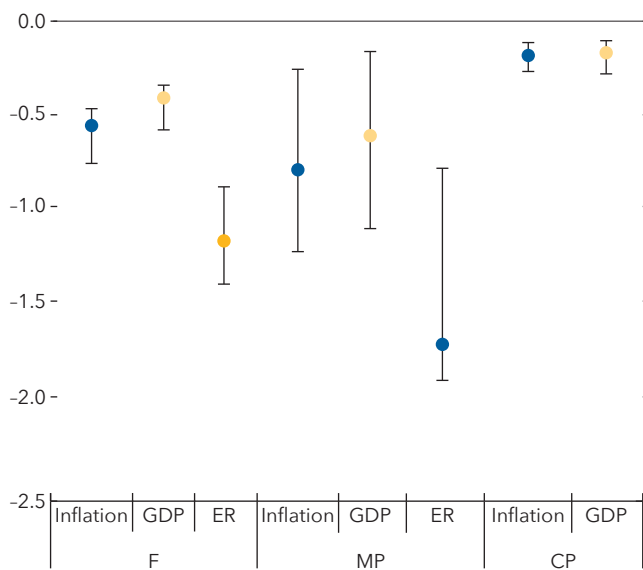
A surprise increase in interest rates should attract capital into a country, causing the exchange rate to appreciate. This appreciation should subsequently raise the cost of exports (to the extent that they are priced in the local currency) and lower the cost of imports, leading to declines in output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

<sup>12</sup> Estimates in this section are based on the model described in Online Annex 2. See Online Annex 7 for results based on structural vector autoregressions.

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



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



Source: IMF staff calculations.

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

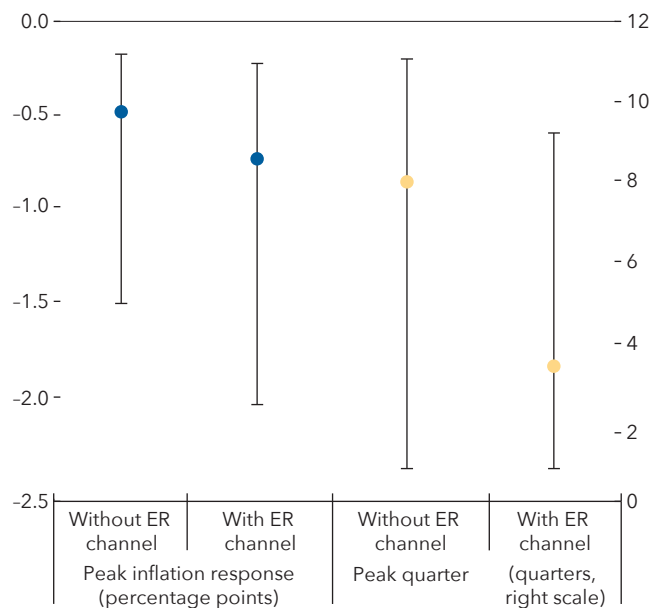
analysis is consistent with the exchange rate being a key channel for magnifying the effect of monetary policy on inflation in the region. In a structural vector autoregression framework, estimates show that on average, 40 percent of the peak impact on inflation from monetary policy shocks is driven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

### Is the Bank Lending Channel Functioning?

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

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

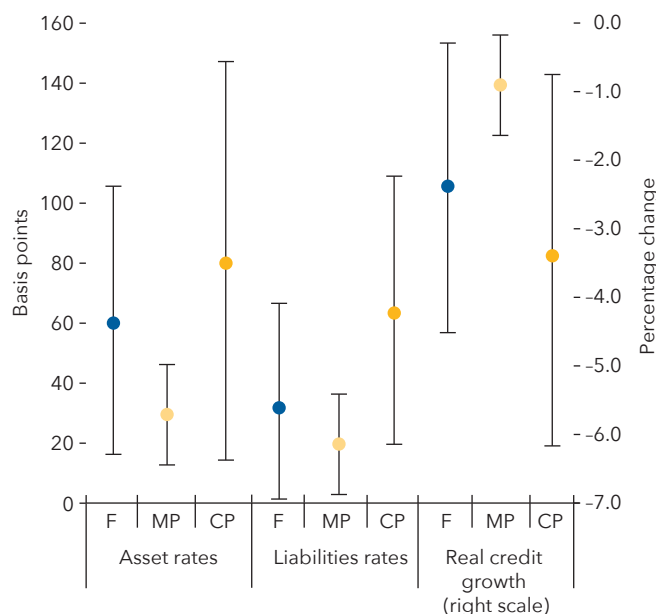
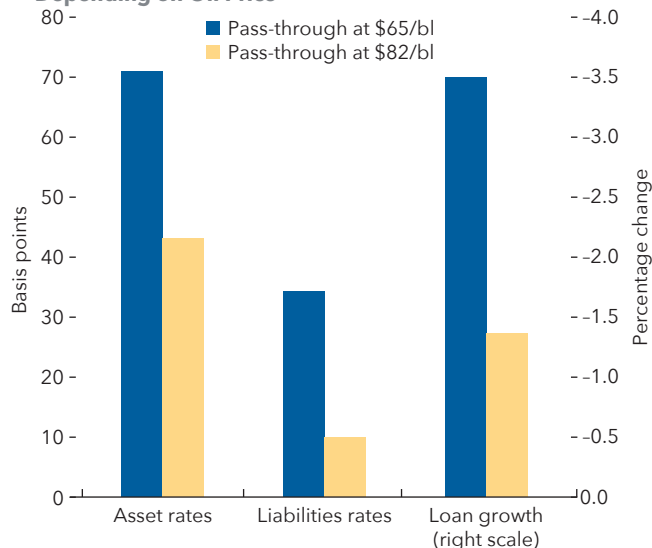
**Figure 2.8. Peak Effect of a 100 bps Contractionary Monetary Policy Shock on Inflation in ME&CA Countries**  
(Percentage points)



Source: IMF staff calculations.

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

<sup>14</sup> The sample of peggers consists of Azerbaijan, Bahrain, Jordan, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

**Figure 2.9. Impact of Monetary Policy Tightening on Effective Interest Rates and Credit Growth****1. Maximum Impulse Responses to a 100 bps Monetary Policy Shock****2. Oil-Exporting ER Peggers: Response of Interest Rates and Credit Growth to a 100 bps Monetary Policy Shock, Depending on Oil Price**

Source: IMF staff calculations.

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

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

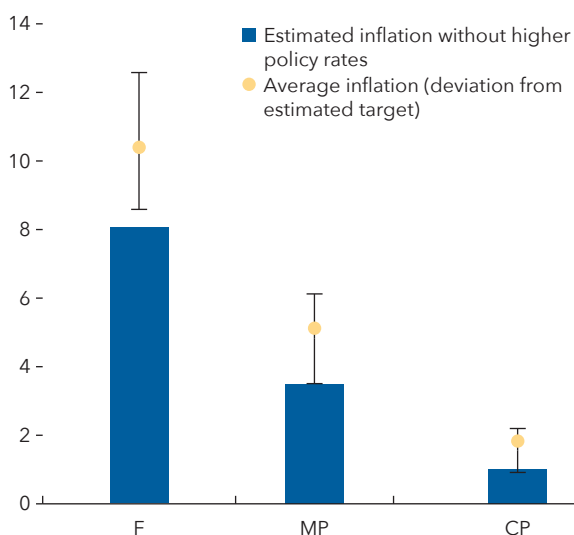
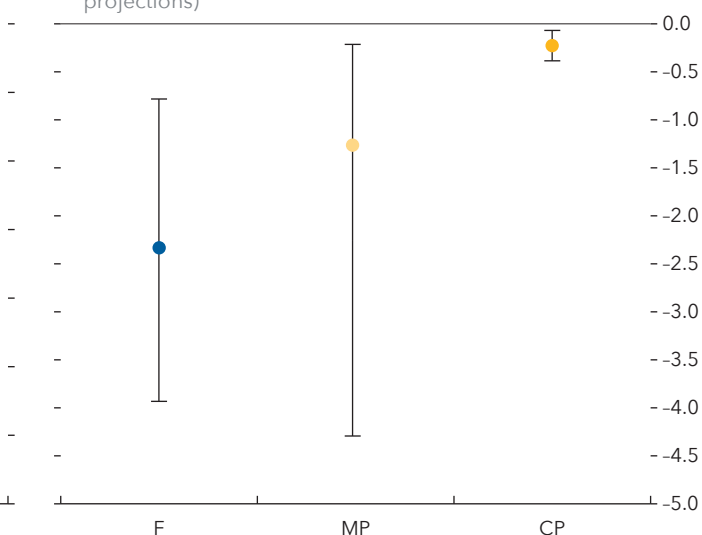
In this context, the level of the oil price is a critical determinant of monetary transmission in oil-exporting countries. When liquidity is ample because of high oil revenues, the transmission of US monetary policy into domestic financial conditions is dampened. Quantitatively, the pass-through of a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

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

<sup>15</sup> Such long lags reflect the use of effective asset and liability rates instead of marginal interest rates.

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



**Figure 2.10. Estimated Impacts of Higher Policy Rates****1. Impact of Higher Policy Rates on Inflation**  
(Average percentage, 2021-22)**2. Projected Impact of End of 2022 Policy Rates on Inflation**  
(Average percentage, 2023; deviation from baseline projections)

Source: IMF staff calculations.

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

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

### Putting It Together: Where to Next?

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

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

## 2.5. Policy Recommendations

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

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

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

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

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

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

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**ME&CA: Selected Economic Indicators, 2000-24**

(Percent of GDP, unless otherwise indicated)

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

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

<sup>1</sup> 2011-24 data exclude Syrian Arab Republic.<sup>2</sup> 2021-24 data exclude Afghanistan.

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

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

(ME&amp;CA OE), (2) Emerging Market and Middle-Income Countries (ME&amp;CA EM&amp;MI); and (3) Low-Income Developing Countries (ME&amp;CA LIC). ME&amp;CA OE include Algeria, Azerbaijan, Bahrain, the Islamic Republic of Iran, Iraq, Kazakhstan, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Turkmenistan, and the United Arab Emirates.

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

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

**MENA: Selected Economic Indicators, 2000-24***(Percent of GDP, unless otherwise indicated)*

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

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

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

<sup>1</sup> 2011-24 data exclude Syrian Arab Republic.

<sup>2</sup> 2021-24 data exclude Afghanistan.

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

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

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

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

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

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

MENAP: MENA, Afghanistan, and Pakistan.

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

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

**CCA: Selected Economic Indicators, 2000-24***(Percent of GDP, unless otherwise indicated)*

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

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

CCA oil and gas exporters: Azerbaijan, Kazakhstan, and Turkmenistan.

CCA emerging market and middle-income countries: Armenia and Georgia.

CCA low-income developing countries: the Kyrgyz Republic, Tajikistan, and Uzbekistan.



