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REGIONAL ECONOMIC OUTLOOK

MIDDLE EAST AND CENTRAL ASIA

An Uneven Recovery amid High Uncertainty

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

The analysis in this *Regional Economic Outlook* was coordinated under the general supervision of Jihad Azour (Director, Middle East and Central Asia Department). The project was directed by Taline Koranchelian (Deputy Director, Middle East and Central Asia Department), Lone Christiansen (Chief, Middle East and Central Asia Department Regional Analytics and Strategy Division), John Bluedorn (Deputy Chief, Middle East and Central Asia Department Regional Analytics and Strategy Division), and Cesar Serra (Deputy Chief, Middle East and Central Asia Department Regional Analytics and Strategy Division).

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Country Groupings

The April 2024 *Regional Economic Outlook: Middle East and Central Asia* covers countries and territories in the Middle East and Central Asia Department of the IMF, referred to as ME&CA countries and territories. It provides a broad overview of recent economic developments and prospects and policy issues for the medium term. To facilitate the analysis, the 32 ME&CA countries and territories covered in this report are divided into three (nonoverlapping) groups based on export earnings and level of development: (1) oil exporters (OEs), (2) emerging market and middle-income countries (EM&MIs); and (3) low-income developing countries (LICs). Additional analytical and regional groups provide a more granular breakdown for analysis and continuity. The country and analytical group acronyms and abbreviations used in some tables and figures are included in parentheses.

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

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

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

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

CCA OEs: Azerbaijan, Kazakhstan, Turkmenistan.

CCA oil importers (OIs): Armenia, Georgia, Kyrgyz Republic, Tajikistan, Uzbekistan.

CCA EM&MIs: Armenia, Georgia.

CCA LICs: Kyrgyz Republic, Tajikistan, Uzbekistan.

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

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

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

MENA EM&MIs: Egypt, Jordan, Lebanon, Morocco, Syrian Arab Republic, Tunisia, West Bank and Gaza.

MENA LICs: Djibouti, Mauritania, Somalia, Sudan, Yemen.

MENAP: MENA, Afghanistan, Pakistan.

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

Arab World OEs: Algeria, Bahrain, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates.

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

Non-GCC oil-exporting countries: Algeria, Iraq, Islamic Republic of Iran, Libya.

North Africa: Algeria, Djibouti, Egypt, Libya, Mauritania, Morocco, Sudan, Tunisia.

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

Conflict-affected states: Afghanistan, Iraq, Somalia, Sudan, Syrian Arab Republic, West Bank and Gaza, Yemen.

Assumptions and Conventions

Several assumptions have been adopted for the projections presented in the April 2024 *Regional Economic Outlook: Middle East and Central Asia*. It is assumed that the established policies of national authorities will be maintained, the price of oil[1] will average $78.61 a barrel in 2024 and $73.68 a barrel in 2025, and the three-month nominal yield on US Treasury bills will average 5.2 percent in 2024 and 4.1 percent in 2025. These are working hypotheses rather than forecasts, and the uncertainties surrounding them add to the margin of error that would, in any event, be involved in the projections. The 2024 and 2025 data in the figures and tables are projections. Unless otherwise noted, these projections are based on statistical information available through late March 2024.

This publication uses the following conventions:

- In tables, ellipsis points (. . .) indicate "not available," and 0 or 0.0 indicates "zero" or "negligible."
- Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 2019–20 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2019/20) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY 2020).
- "Billion" means a thousand million; "trillion" means a thousand billion.
- "Basis points (bps)" refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

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

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

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

Executive Summary

Resilience in the global economy and easing global inflationary pressures are positive developments for economies in the Middle East and Central Asia. Overall growth is projected to strengthen to 2.8 percent in 2024 (from 2.0 percent in 2023) and 4.2 percent in 2025.

In the Middle East and North Africa (MENA), there is no break from challenges. The conflict in Gaza and Israel has caused immense human suffering. In addition, Red Sea shipping disruptions and oil production cuts have added to existing vulnerabilities related to high debt levels and elevated borrowing costs. Accordingly, growth is projected to remain subdued, improving moderately to 2.7 percent in 2024 (from 1.9 percent in 2023). In 2025, growth is projected to strengthen to 4.2 percent as the impact of these temporary factors is assumed to fade gradually. Among Gulf Cooperation Council members, nonhydrocarbon activity is set to be the main contributor to growth as countries continue to pursue growth diversification plans. Meanwhile, MENA emerging market and middle-income countries face rising fiscal pressures, with elevated interest payments eroding efforts to strengthen fiscal positions. The conflict in Gaza and Israel is adding to uncertainty, with the duration and impact of the conflict remaining highly uncertain. In addition, conflicts are also adversely impacting activity in some fragile and low-income countries, though the tide may start to turn for a few economies, with economic conditions projected to improve in 2025 as growth-dampening factors gradually wane. On the positive side, monetary tightening cycles appear to have ended in most countries as inflation is approaching its historical average in many MENA economies, with inflation close to or even below average in one-third of economies.

The Caucasus and Central Asia region remains resilient to the war in Ukraine. Despite some moderation, growth is projected to remain robust at 3.9 percent in 2024 before picking up to 4.8 percent in 2025, owing in part to loosening macro policies, strong domestic demand, and idiosyncratic factors, such as oil production increases. Over the medium term, growth is expected to remain relatively stable among oil importers, supported by strong domestic demand, while plateauing hydrocarbon production is projected to weigh on growth in oil exporters. For the majority of Caucasus and Central Asia economies, inflation is below or close to targets, with most central banks easing monetary policy.

The outlook is subject to higher-than-usual uncertainty, and downside risks prevail. The conflict in Gaza and Israel remains a key downside risk for the MENA region, including the risk of further escalation or a protracted conflict. As Chapter 2 shows, conflict not only causes lasting human and social costs but can also lead to large and persistent output losses with potential spillovers to other countries. Moreover, changes in trade patterns as a result of conflicts could have knock-on effects on economic activity and fiscal revenue. Several global risks could also spill over to countries in the Middle East and Central Asia, including those related to geopolitical fragmentation. On the upside, higher-than-projected global growth would boost trade in the region, while a faster-than-expected resumption of interest rate cuts in major advanced economies could help reduce fiscal pressures and improve debt dynamics.

Policymakers face the difficult task of safeguarding macroeconomic stability and debt sustainability while navigating geopolitical challenges and improving medium-term growth prospects. **Monetary policy should remain vigilant**, being cautious of premature or excessive easing. Given the differences in public sector debt levels, **where debt levels are elevated, fiscal policy would need to help bring them down decisively**. That said, amid marked differences across countries, careful tailoring by country is essential. Amid heightened uncertainty, it is essential that countries **implement reforms to fortify their fundamentals, including by strengthening institutions** (Chapter 2). In addition, potential opportunities from new trade corridors can be seized by reducing long-standing trade barriers, diversifying products and markets, and improving infrastructure (Chapter 3).

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

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

1.1. Global Backdrop: Disinflation amid Economic Resilience

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

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

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

1.2. MENA Region and Pakistan: No Break from Challenges

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

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

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

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

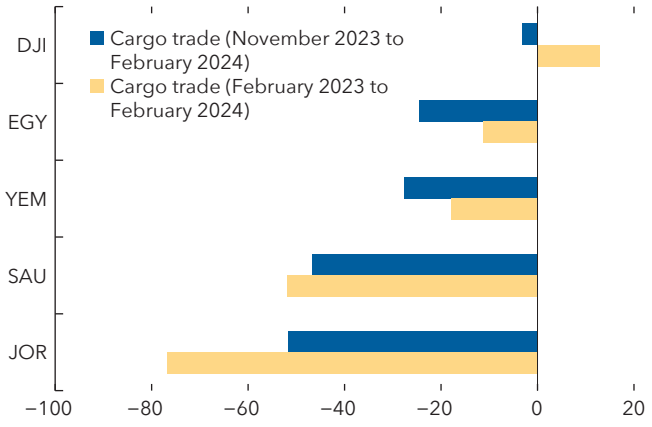
Recent Developments: Slower Growth amid Diverse Challenges

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

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

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

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



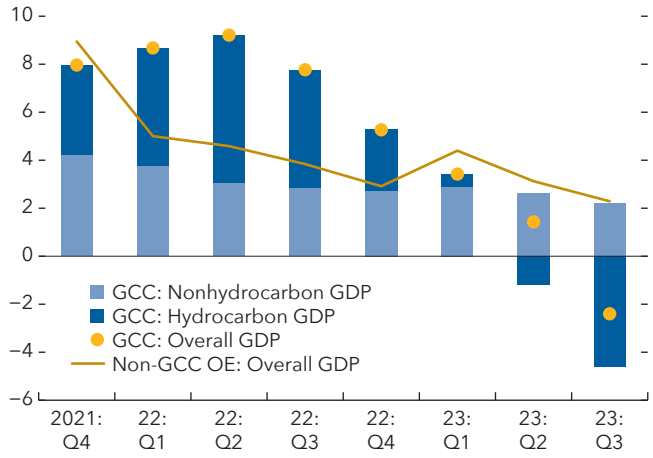
Sources: Portwatch; and IMF staff calculations.
Note: The data capture trade in goods. Data labels in the figure use International Organization for Standardization (ISO) country codes.

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

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

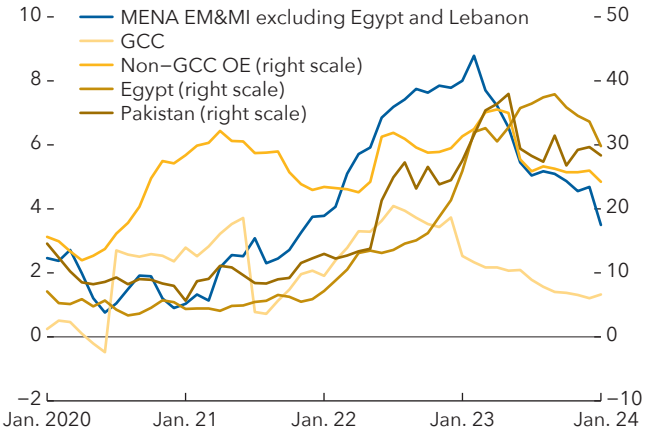
[3] See the January 2024 *Regional Economic Outlook Update: Middle East and Central Asia—Middle East and North Africa: Conflict Compounding Economic Challenges*.

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



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

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



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

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

Inflation on a Downward Path

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

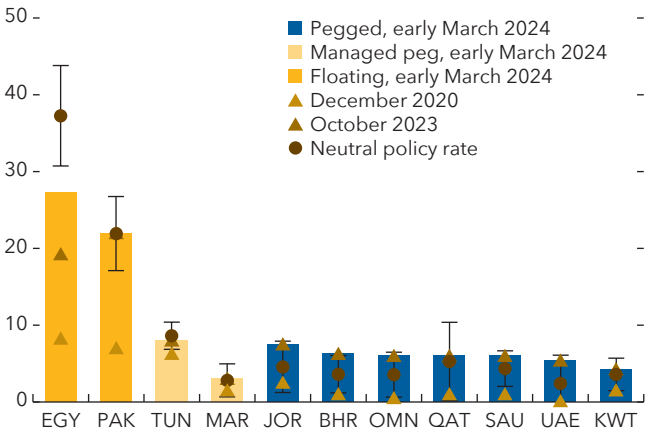
Nevertheless, inflation has remained persistently high in some economies. Notably, inflationary pressures have reflected food import shortages and accommodative fiscal and monetary policies in Algeria; foreign exchange shortages in Egypt; exchange rate depreciation and loose fiscal and monetary policies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

Monetary Tightening Cycles Have Broadly Ended, Fiscal Consolidation Continues

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

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

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

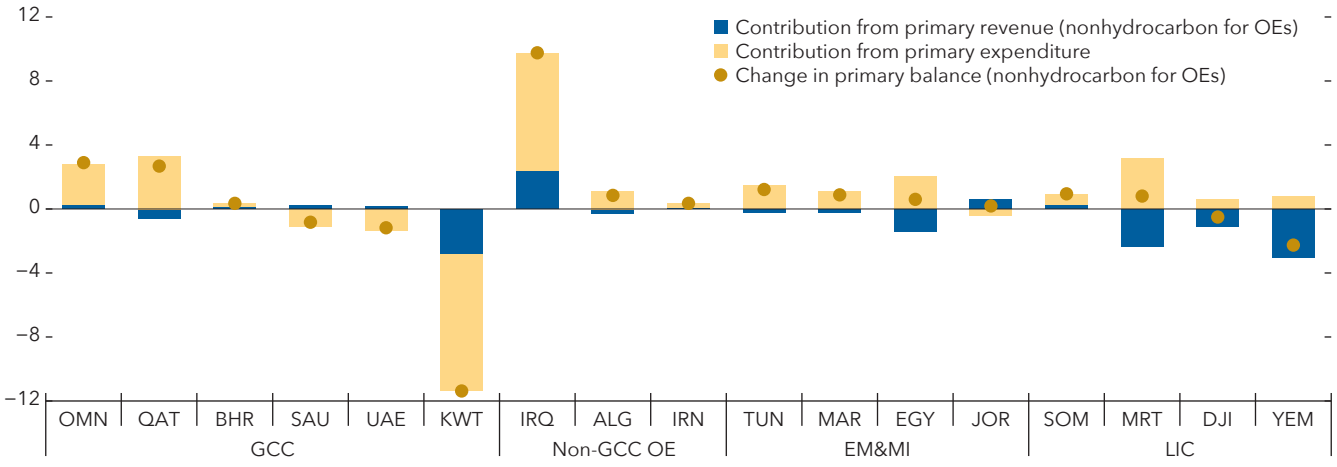


Sources: Haver Analytics; and IMF staff calculations.
Note: Range indicates one standard deviation of model-derived neutral policy rates. Data labels in the figure use International Organization for Standardization (ISO) country codes. MENA = Middle East and North Africa.

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

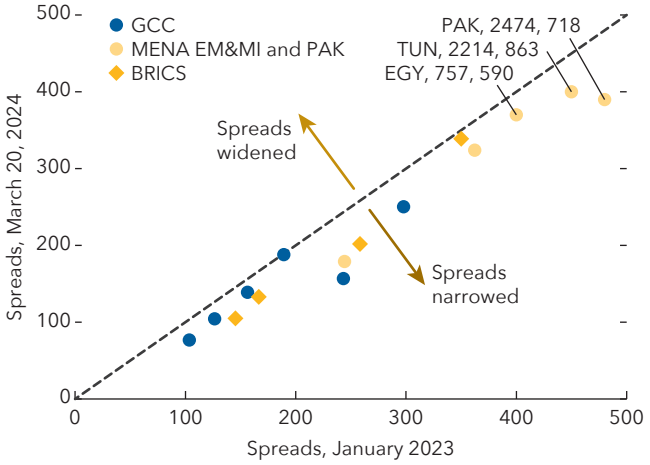
In terms of fiscal policy, EM&MIs continued to grapple with high borrowing costs, and oil production cuts weighed on revenues for several oil exporters in 2023. EM&MIs continued tightening their primary fiscal positions amid high debt levels and elevated borrowing costs. Yet debt ratios increased amid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

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



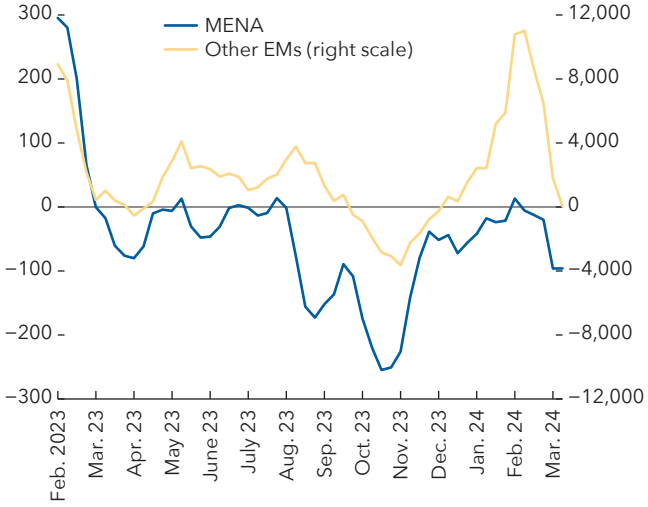
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: All data refer to the calendar years, except for the following countries, which refer to the fiscal years: Afghanistan (December 21 to December 20 from 2002 to 2020, and March 21 to March 20 thereafter), Islamic Republic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

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



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

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



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

Pockets of External Vulnerabilities Linger

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

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

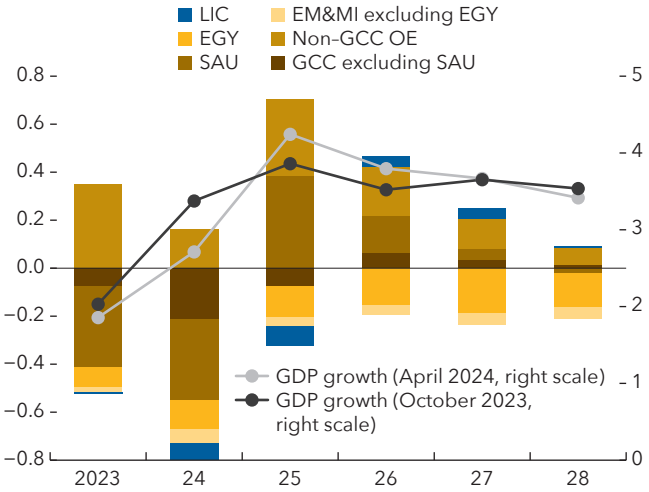
Outlook: An Uneven Recovery

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

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

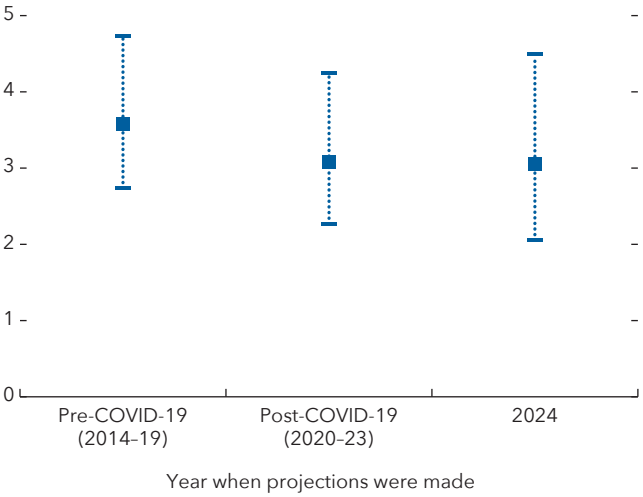
[5] The conflict in Gaza and Israel—and associated Red Sea trade disruptions—are assumed to remain at the current level of intensity and start easing after the first quarter of 2024, with the intensity gradually declining over the course of a year.

Figure 1.8. MENA Region: Contributions to Revisions in GDP Growth
(Percent change, year over year; percentage points for revisions)



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

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



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

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

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

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

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

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

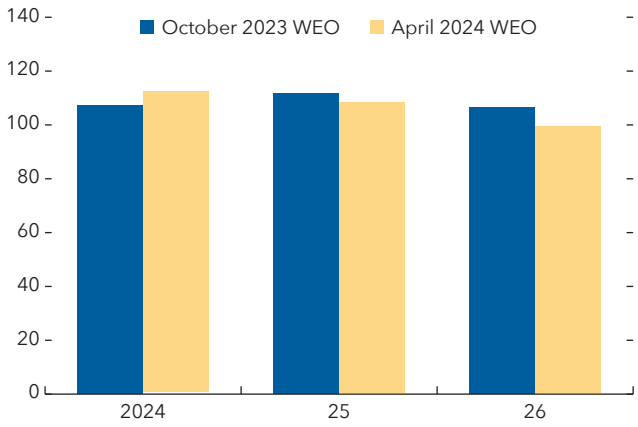
Further ahead, growth in MENA EM&MIs and Pakistan is projected to accelerate to nearly 4 percent in 2025 as constraints to growth this year (tight policies and country-specific events, including spillovers from conflict) begin to wane. Nonetheless, continued tight macroeconomic policies to tackle high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

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

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

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

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



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

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

LICs: Changing Tides

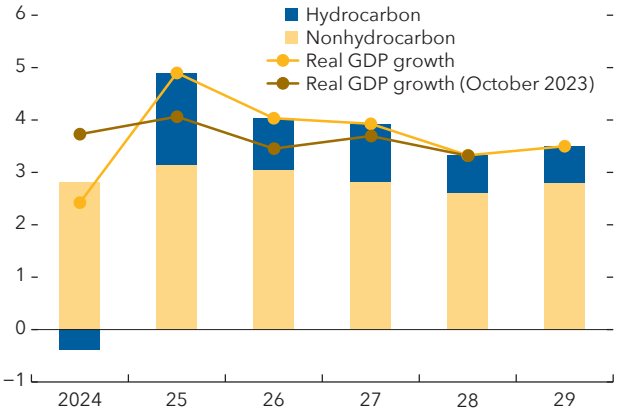
Economic activity in MENA's LICs is expected to contract by 1.4 percent in 2024. Yet this growth rate masks notably cross-country dispersion. Notably, the conflict in Sudan, and to a lesser extent Yemen, will weigh heavily on average growth this year. However, a rebound to 4.4 percent is projected in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

Oil Exporters: Nonhydrocarbon Activity Remains Strong

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

Figure 1.11. GCC: Contributions to Real GDP Growth

(Growth in percent change, year over year; contributions in percentage points)



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

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

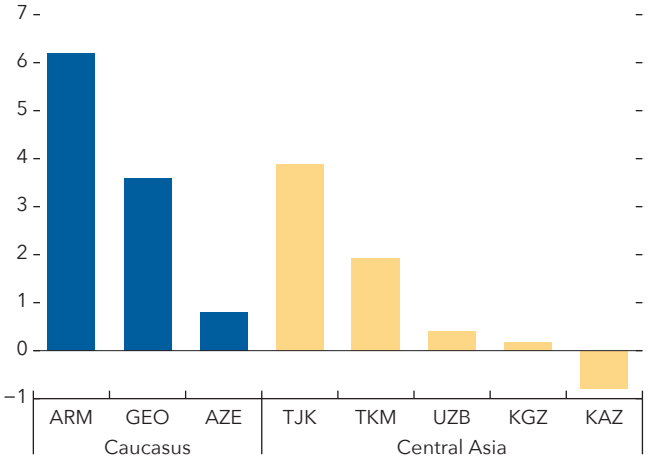
Inflation in all oil exporters is projected to continue declining in 2024 and 2025. However, in a few countries, inflation is expected to remain elevated due to strong domestic demand following expansionary policies amid robust oil revenues (Islamic Republic of Iran) and elevated food prices (Algeria).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

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

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

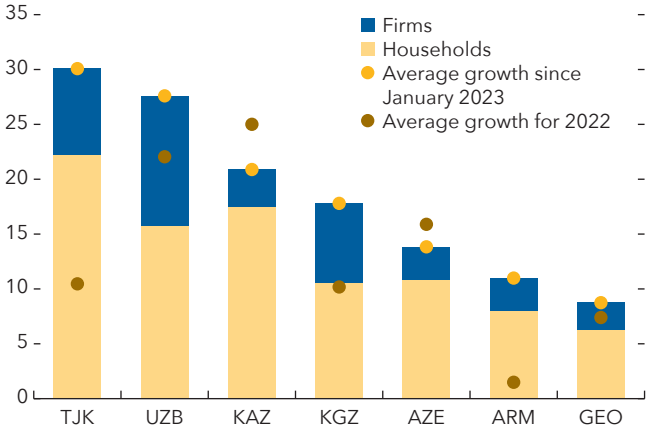
[8] Djibouti remains relatively isolated from the disruption in the Red Sea as its main port is located to the south of the Bab el-Mandeb Strait.

Figure 1.12. CCA: Revisions to Growth since the War in Ukraine
(Percentage points, 2022–23 average, current versus October 2021 REO)



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

Figure 1.13. CCA: Private Sector Credit Growth and Contributions
(Percentage points, year-over-year monthly growth, simple averages)



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

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

1.3. CCA: Continued Resilience

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

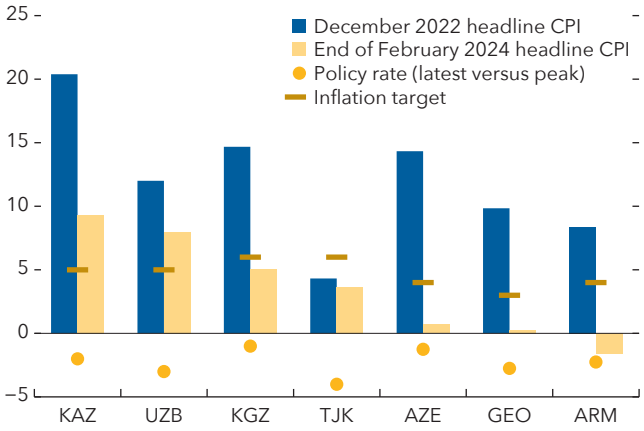
Recent Developments: Growth Has Slowed but Remains Robust

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

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

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

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



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

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

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

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

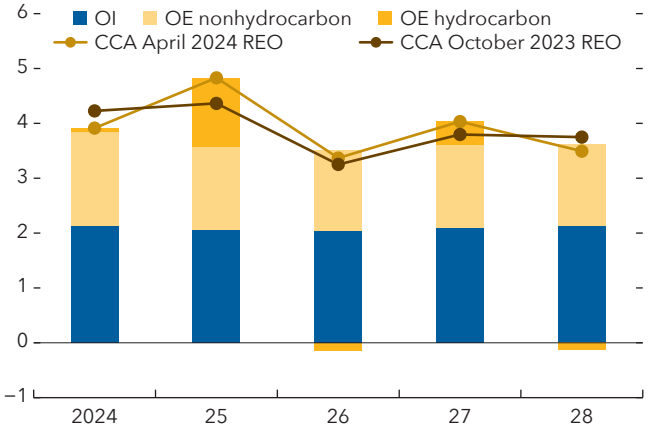
Similarly, current account balances deteriorated in most CCA countries (Armenia, Azerbaijan, Kazakhstan, Uzbekistan) in 2023, mainly driven by lower oil prices, strong domestic demand, and partial normalization of remittances. Nonetheless, despite volatility in commodity prices, oil exporters increased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

CCA Outlook: Stable Growth as Inflows Normalize

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

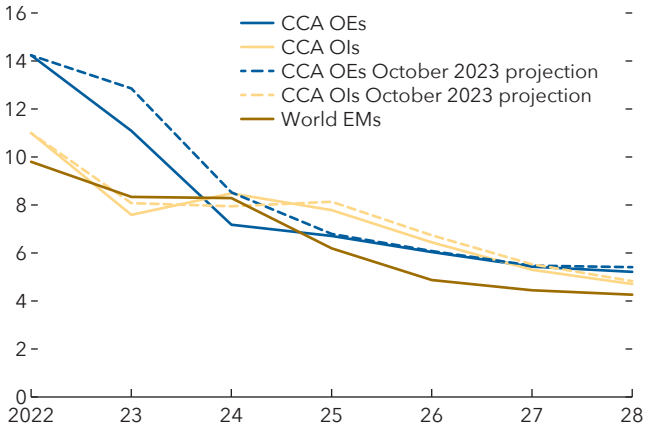
Over the medium term, growth is projected to moderate as spillovers related to the war in Ukraine (such as trade and financial inflows) gradually subside (Figure 1.15). Still, the pace of growth is expected to vary significantly between oil-importing and oil-exporting countries. For example, while medium-term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

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



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

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



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

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

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

1.4. Risks to the ME&CA Outlook

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

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

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

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

Risks specific to ME&CA could also materialize.

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

1.5. Balancing Policy Priorities in Uncertain Times

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

Monetary and Financial Policies: Maintain Focus on Price Stability

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

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

Where there is a lack of coordination between monetary and fiscal policy or where there is fiscal dominance, policymakers will need to address fiscal imbalances so that monetary policy can become a more effective tool to stabilize inflation, and more broadly to maintain central bank independence and preserve its balance sheet. Complementary reforms to deepen the financial sector could strengthen liquidity conditions and help spur investment and growth. In this context, all ME&CA economies can step up efforts to foster a deep and diversified

investor base and improve the management of state-owned banks (October 2023 *Regional Economic Outlook: Middle East and Central Asia*). Additionally, in the near term, sustained credit growth in many CCA countries warrants close supervision, even if banking sector financial soundness indicators remain comfortable, particularly as numerous countries have not activated macroprudential buffers.

Fiscal Policy: A Tailored Approach to Ensure Sustainability

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

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

Structural Policies: Maintain Momentum to Strengthen Resilience

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

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

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

Expanded IMF Support

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

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2. Fragile Foundations: The Lasting Economic Scars of Conflict[1]

The conflict in Gaza and Israel is another reminder of the recurring challenges related to conflicts in the Middle East and Central Asia (ME&CA). Conflicts cause immense human suffering across the ME&CA regions, with thousands of lives lost during the last decade and many more facing fragility and food insecurity. This chapter analyzes the economic effects of conflicts and their most salient channels, comparing ME&CA economies with those elsewhere over 1989 to 2022. The main findings point to marked adverse effects on near- and long-term economic performance, as well as higher inflation and lower consumption, investment, exports, and fiscal revenues. Moreover, these effects can become entrenched by damaging institutions and contributing to the fragility of conflict-affected economies. The negative economic impact of conflicts in ME&CA tends to be larger and more persistent than in the rest of the world. Specifically, after a severe conflict in an ME&CA country, per capita output is still about 10 percent lower on average after a decade. In other regions, this decline is less than 3 percent on average and recouped within five years. This likely reflects a mix of factors, including the average higher intensity of conflicts in the region, the adverse marginal effect of conflicts increasing with intensity, and the prevalence of exacerbating preexisting conditions, such as lower average institutional quality. Conflicts also tend to have greater negative impacts on bordering countries, with an immediate drop in output per capita of about 1.5 percent and a further drop of about 6 percent about a decade later (although estimated with a higher level of uncertainty).[2] Furthermore, when conflicts in bordering countries are nonstate-based, the adverse impact on output per capita is higher, at 10 percent seven years after the conflict onset.

2.1. Frequent and Intense Conflicts, with Devastating Human Toll

Since the early 1990s, ME&CA economies have been more frequently affected by violent conflicts (hereafter conflicts) than those in other regions, apart from sub-Saharan Africa. Conflicts—defined as episodes of organized and lethal violence between state or nonstate actors or against civilians—have risen sharply over the last decade, highlighting the relatively high prevalence of conflicts in the region (Figure 2.1, panel 1).[3] Within ME&CA, conflicts have been particularly prevalent in the geographic area encompassing the Middle East and North Africa, Afghanistan, and Pakistan (MENAP). The number of conflicts in MENAP nearly doubled in the mid-2010s, a rise surpassed only by sub-Saharan Africa. Moreover, conflicts in MENAP tend to last longer than those in other regions (Figure 2.1, panel 2).

Over the past decade, the nature of conflicts in ME&CA has changed. Civil wars and interstate conflicts (state-based conflicts) have become more frequent.[4] In MENAP, large-scale, nonstate-based conflicts (clashes between two nongovernmental armed groups) were the primary drivers of conflicts during the 2010s, accounting for

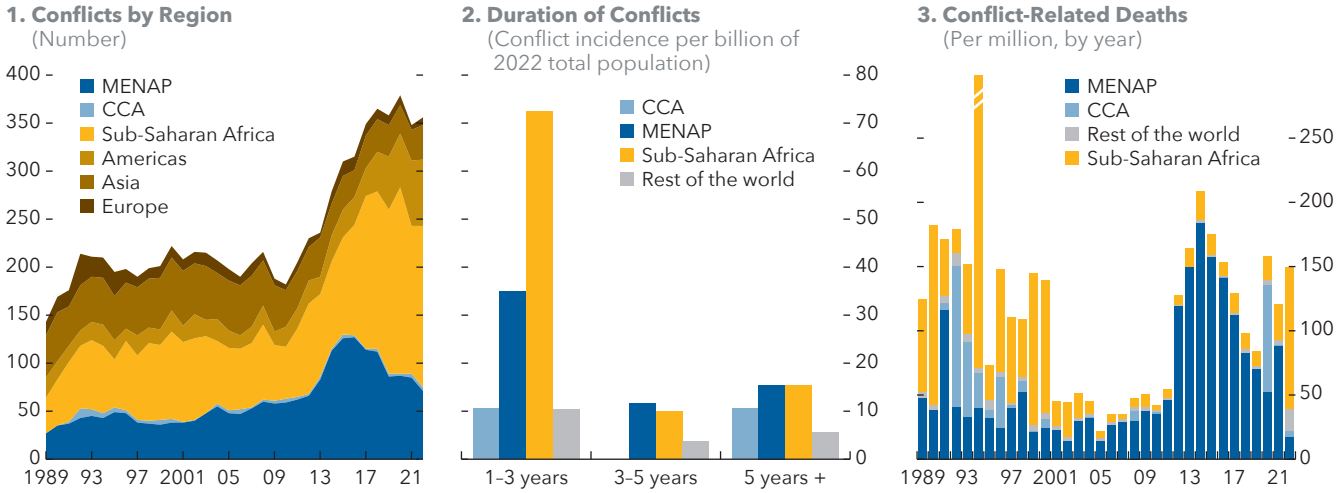
[1] The chapter was prepared by Diala Al Masri, Vizhdan Boranova, Steven Dang, Colombe Ladreit, Troy Matheson (co-lead), Borislava Mircheva (co-lead), Thomas Piontek, and Bozena Radzewicz-Bak.

[2] The terms impact and effect are used in the chapter for improved readability. Nevertheless, the estimated effects are associational and not necessarily causal.

[3] This chapter defines conflict as per the Uppsala Conflict Data Program's Georeferenced Events Database covering 1989–2022, which is the main data source. As such, conflicts are defined as incidents of organized and lethal violence between identifiable state or nonstate actors or against civilians. The data do not include criminal violence (such as homicides and gang violence) due to the challenge of attributing these incidents to specific identifiable and organized groups. See Uppsala Conflict Data Program (2022). Conflict-related deaths are aggregated by year and expressed per million residents to derive an intensity measure at yearly frequency. See Online Annex 2.1 for further details. As the conflict in Gaza and Israel began in October 2023, it is not included in the analysis.

[4] The Uppsala Conflict Data Program data distinguish between conflicts based on the involved actors. We consider two conflict types: state-based (involves lethal violence between two organized groups where at least one party is the government) and nonstate-based (occurs between two organized groups, neither of which is a government).

Figure 2.1. Conflicts, 1989–2022



Sources: IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: A conflict event is defined as an incident where organized and lethal violence involving state- or nonstate-based actors or against civilians occurs that results in at least 25 battle-related deaths in a calendar year. Panel 2 covers 273 conflicts with a duration of one or more years, occurring between 1989 and 2022, and in over 67 countries. The *y*-axis shows the number of conflicts per billion of 2022 regional population (conflict incidence) over the sample. The total sample covers 1,421 conflicts in 125 countries. For panel 3, in 1994 the conflict in Rwanda drives the significant jump in the category sub-Saharan Africa data to over 1,000, and the conflict in Ethiopia drives the jump in 2022. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

nearly two-thirds of conflicts by 2014–15. However, the proportion of state-based conflicts has since risen to about half of all conflicts, alongside a significant rise in deaths. Additionally, substate actors have emerged in many places, establishing parallel governments and economic entities. In contrast, countries in the Caucasus and Central Asia (CCA) were affected mainly by state-based conflicts during the sample period (1989–2022). Overall, the experiences across countries have varied markedly. Some conflict-affected states (Afghanistan, Iraq, Somalia, Sudan, Syria) have endured some form of conflict for most of the sample period, while other ME&CA economies have experienced more variation in the frequency and duration of conflicts, with most resolving within three years.

The human cost of conflicts has been devastating. For example, during the 2010s, conflict intensity in MENAP reached historical regional highs, with close to 100 deaths per million people occurring in the years following 2010 and peaking in 2014 following the onset of the Arab Uprisings (Figure 2.1, panel 3). Moreover, by the end of 2022, conflicts in a handful of ME&CA economies were responsible for more than 40 percent of the world's forcibly displaced population (about 47 million people), resulting in a substantial brain drain. The repercussions of such displacement extend beyond worsened living conditions for the displaced. Large and unanticipated movements of people resulted in economic and social strains on neighboring and host countries, affecting the provision of public services, employment, and wage levels (Rother and others 2016). For instance, 70 percent of refugees were considered poor, a number that rose to 90 percent when applying the poverty definitions of individual countries, putting strains on public resources.[5] Moreover, as legal and administrative barriers limit refugees' access to formal labor markets, it often pushes many into low-wage, unskilled jobs and informal employment.

Beyond the devastating human toll, conflicts in the region have also inflicted long-term societal impacts. Intense and protracted conflicts have disrupted human capital accumulation and social cohesion in many countries. Many conflict-affected economies have seen falling primary school enrollment rates, declining life expectancy,

[5] These statistics are based on a sample from a study of Syrian refugees residing in Jordan and Lebanon who registered by 2014 (Verme and others 2016).

and rising rates of undernourishment (Box 2.1). These negative outcomes are exacerbated by disruptions to basic services and food supplies, as well as economic hardship—all of which disproportionately impact the most vulnerable populations. The extent of these effects varies widely across the region, with some countries experiencing significant reductions in educational and health indicators, particularly during high-intensity and prolonged conflicts with high extent of population displacement (which can lead to a drastic drop in primary school enrollment, even reaching 30 percentage points,[6] and a severe fall in life expectancy by 10 percentage points in the second year of high-intensity conflicts). This evidence underscores the complex and lasting consequences of conflicts on human capital development and social cohesion.

Moreover, conflicts can cause substantial infrastructure damage, making postconflict reconstruction critical but costly. Conflicts typically result in the damage or destruction of physical assets and infrastructure, including residential and commercial buildings, roads, bridges, schools, and hospitals. Infrastructure for essential services like water, electricity, and sanitation is also often severely affected. For example, Rother and others (2016) indicate that the estimated cost of lost physical capital in Syria from the civil war is more than $130 billion (or about 230 percent of prewar GDP). Similarly, Rother and others (2016) cite media reports suggesting that infrastructure losses in Yemen due to the fighting in early 2015 exceeded $20 billion (or 50 percent of prewar GDP).

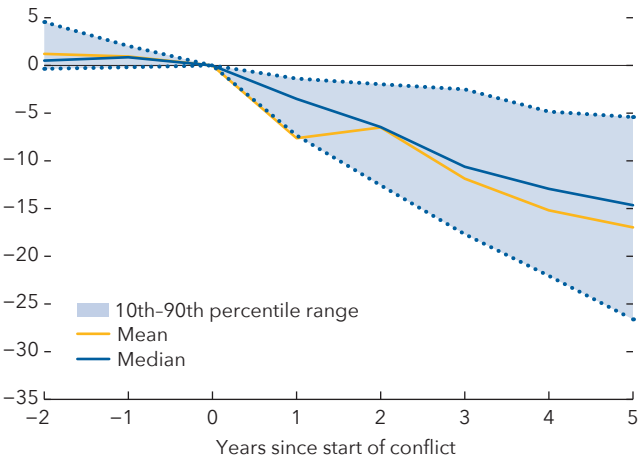
2.2. Persistently Lower Growth after Conflicts

On average, ME&CA economies have experienced markedly lower real GDP per capita than forecast before the onset of an acute and prolonged conflict. Although growth forecasts are inherently subject to uncertainty, observed data point to sizable economic losses. Compared to initial preconflict forecasts, actual real GDP per capita turned out nearly 5 percent lower (median) in the first year of an acute and prolonged conflict (Figure 2.2). As growth rates tended to remain stagnant or negative for an extended period after an acute and prolonged conflict episode started, the median difference in actual real GDP per capita versus preconflict forecasts widened to almost 15 percent after five years.

The empirical evidence suggests that the economic consequences of conflicts in ME&CA tend to be more severe and longer lasting than in other regions. Consistent with the forecast error analysis, dynamic responses—estimated using local projection methods—point to negative effects of conflicts on output that persist and build over time. Specifically, the onset of a high-intensity conflict is associated with a roughly 2 percent contraction in real GDP per capita during the first year, reaching a maximum drop exceeding –13 percent nine

Figure 2.2. ME&CA Region: The Effect of Acute and Prolonged Conflict Episodes on Real GDP per Capita

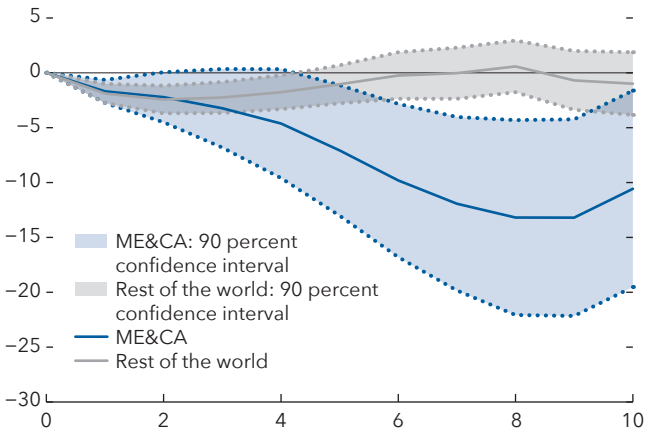
(Percent difference between actual and preconflict projection)



Sources: IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: Acute and prolonged conflict is defined as a conflict episode preceded by two or three years of relative peace (zero or less than 25 deaths in aggregate), episodes with greater than 25 deaths per year (acute) per country after onset, and three or more consecutive years (prolonged) of active conflict. For the preconflict *World Economic Outlook* forecast, the fall vintage preceding the year of the onset of identified conflict episodes was used. ME&CA = Middle East and Central Asia.

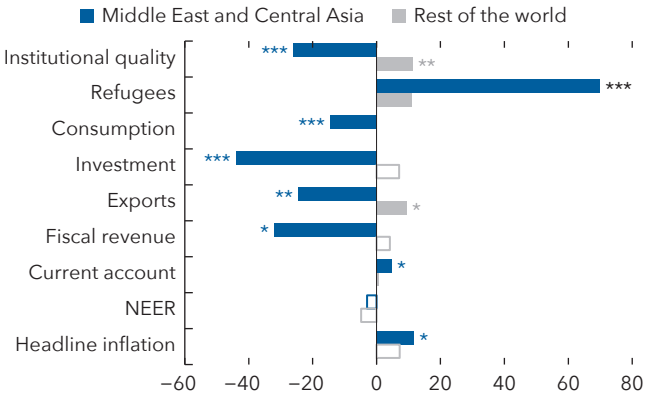
[6] For example, during the invasion of Kuwait from 1990 to 1991 and the Syrian Civil War between 2011 and 2013.

Figure 2.3. Impact of Conflict on Real GDP per Capita
(Percent)



Sources: IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: The shock occurs in year 1 and corresponds to an increase in conflict intensity to the 75th percentile of the world distribution. ME&CA = Middle East and Central Asia.

Figure 2.4. Economic Disruptions: Additional Variables
(Percent difference between year 7 and the year before the conflict onset)



Sources: International Country Risk Guide; IMF, World Economic Outlook database; UN Refugee Agency, Global Trends Report 2022; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: The figure shows the impact seven years after the shock, which corresponds to an increase in conflict intensity to the 75th percentile of the world distribution. ***, **, and * indicate statistical significance at the 1, 5, and 10 percent level, respectively. Empty bars indicate a lack of significance at the 10 percent level. Local projection results are available in Online Annex 2.2. All results are percent differences except for the current account balance as percentage of GDP, for which it is the percentage point difference. NEER = nominal effective exchange rate.

years after the shock (Figure 2.3).[7] No difference is observed in the loss of output per capita between state and nonstate conflicts, consistent with previous findings.[8] The economic impact of conflicts in MENAP is also statistically similar to CCA countries—although slightly less persistent among the latter group (see Online Annex Figure 2.4.5). In contrast, while the impact on output per capita for the average economy in the rest of the world is about –2.5 percent during the first years (similar to estimates for the average ME&CA economy), this effect dissipates after the fifth year.[9]

The more pronounced impact of conflicts in ME&CA compared to the rest of the world partly reflects differences in the impact across multiple channels and factors. Figure 2.4 plots the estimated dynamic response by economic channel or factor seven years after the onset of a high-intensity conflict. On average, there are signs of persistent disruption from conflict across most channels for ME&CA economies, while for the rest of the world there are typically not. Moreover, five main findings emerge (Figure 2.4):

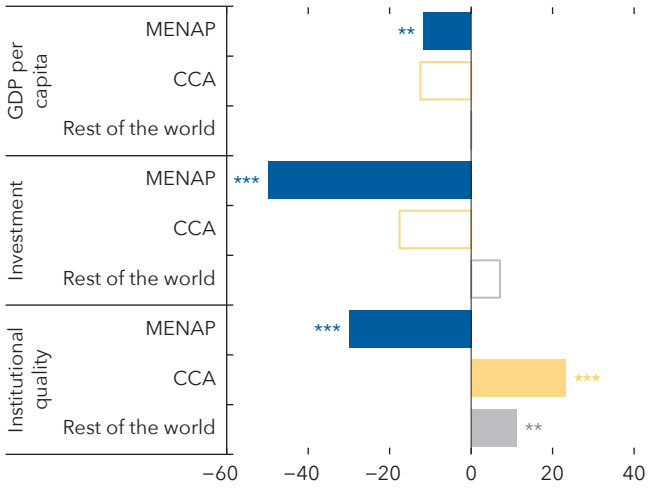
[7] A high-intensity conflict is defined as occurring when the conflict intensity (annual conflict-related deaths per million) is at the 75th percentile of the distribution of conflict intensity over the estimation sample.

[8] See the April 2019 *Regional Economic Outlook: Sub-Saharan Africa* and Fang and others (2020). Nonstate conflicts include civil conflicts. See Online Annex 2.3 for more details.

[9] The dynamic responses are robust to a variety of checks, including (1) the addition of a contemporaneous measure of the conflict shock for each horizon, as suggested by Teulings and Zubanov (2013), thereby controlling for future shocks and anticipation effects generated by the start of a conflict; and (2) dropping countries that have historically been affected by conflicts over a long time horizon (Afghanistan, Iraq, Libya, Somalia, Syria, Sudan, West Bank and Gaza, Yemen). See Online Annex 2.5 for more details.

- *Conflicts are associated with higher inflation and lower domestic demand*. The output per capita decline is accompanied by an increase in inflation and drops in consumption, investment, exports, and fiscal revenues for economies in ME&CA.[10] These outcomes likely stem from disruptions to the country's economic operations, heightened uncertainty, and a degradation of the state's operational capacity.
- *The substantial and enduring economic cost of conflicts in ME&CA is associated with significant reductions in investment and a deterioration of institutional quality*.[11] Specifically, these variables decline considerably more in ME&CA countries compared to the global average, with investment and institutional quality lower by 44 percent and 26 percent, respectively, seven years postshock. These declines are mainly driven by MENAP rather than by CCA countries, indicating more severe impacts in the former (Figure 2.5). Such declines typically signal poorer medium-term economic outlook through, for instance, forgone capital formation.
- *Conflicts tend to coincide with improvements in the current account balance*. These developments are not driven by import compression but an increase in the secondary income account (which points to more remittances during conflicts), together with increased foreign aid.[12] They are also associated with capital outflows, which may be symptomatic of heightened uncertainty and concern among foreign investors.[13]
- *Conflicts in ME&CA do not appear to affect the nominal effective exchange rate*. This seems to be driven by the prevalence of fixed exchange rate regimes in the region. The nominal effective exchange rate depreciates when analyzing only ME&CA economies with flexible exchange rates.[14]
- *Conflicts are often associated with large increases in refugee flows*. Figure 2.4 shows that seven years after a high-intensity conflict starts, the number of refugees from the conflict-affected economy is about 70 percent higher. Taken together with the findings described in Box 2.1, the implied fall in human capital and potential losses of prime-age workers would contribute to more persistent adverse economic effects, slow the pace of income convergence, and exacerbate poverty and inequality. Consequently, these factors can hinder

Figure 2.5. Economic Disruptions: Additional Variables
(Percent difference between year 7 and the year before the conflict onset)



Sources: International Country Risk Guide; IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: The figure shows the impact seven years after the shock, which corresponds to an increase in conflict intensity to the 75th percentile of the world distribution. ***, **, and * indicate statistical significance at the 1, 5, and 10 percent level, respectively. Empty bars indicate a lack of significance at the 10 percent level. Local projection results are available in Online Annex 2.4. All results are percent differences. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

[10] This is consistent with findings from the earlier literature (April 2019 *Regional Economic Outlook: Sub-Saharan Africa*; Fang and others 2020; Novta and Pugacheva 2021). The impact on fiscal revenues is negative and associated with decreases in social spending.

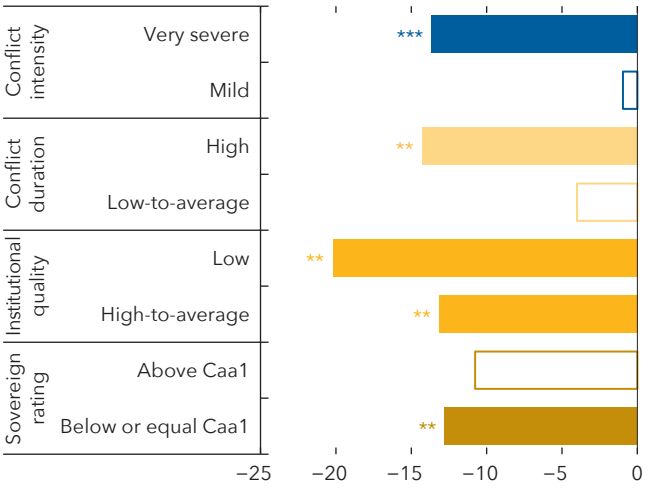
[11] Institutional quality is proxied by an indicator for the control of corruption (International Country Risk Guide). The results are qualitatively similar when looking at alternative proxy variables of institutional quality (including from the Worldwide Governance Indicators) such as measures of law and order, political stability, voice and accountability, government effectiveness, regulatory quality, and rule of law—see Online Annex Figures 2.2.11–2.2.16 for further details.

[12] While imports decrease following the onset of a conflict, they decline less than exports. We do not show the impact on imports due to space constraints.

[13] See also Online Annex Figure 2.2.17, showing an increase in the secondary income balance in ME&CA countries following the onset of a conflict and consistent with increases in remittances and aid flows.

[14] See Online Annex Figure 2.2.10. The exchange rate regime classification comes from Ilzetzki, Reinhart, and Rogoff (2019), with a flexible exchange rate regime coded by a score of 3 and above according to their coarse methodology.

Figure 2.6. Differential Impact on Real GDP per Capita According to Conflict Characteristics and Preexisting Economic Conditions
(Percent difference between year 7 and the year before the conflict onset)



Sources: Bloomberg Finance L.P.; International Country Risk Guide; IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: The figure shows the impact seven years after the shock and corresponds to an increase in conflict intensity to the 75th percentile of the world distribution, except for the conflict intensity case which uses a categorical variable (see Online Annex 2.4). ***, **, and * indicate statistical significance at the 1, 5, and 10 percent level, respectively. Empty bars indicate a lack of significance at the 10 percent level. Local projection results are available in Online Annex 2.4. We use sovereign ratings from Moody's and choose the threshold of Caa1 to ensure a sufficient sample size.

development efforts, widen the income gap, and increase economic and social disparities within and across countries.

What might account for the large and persistently more negative effects of conflicts in ME&CA? Part of the reason appears to be that the adverse marginal effects of conflict increase with the conflict intensity and duration. Combined with the greater incidence, higher typical intensity, and longer duration of conflicts in ME&CA, this translates into larger and more persistent impacts than seen elsewhere on average. When differentiating between mild and very severe conflicts, the analysis indicates that the latter accounts for the larger and more persistent reduction of output per capita estimated for ME&CA economies relative to other regions (Figure 2.6).[15] The same applies for longer duration conflicts.[16] Furthermore, there is evidence that preexisting country characteristics influence the economy's response to conflict.[17]

- ME&CA countries with lower institutional quality before a conflict tend to suffer larger output losses than other countries, exacerbating the likelihood of perpetuating negative feedback loops.[18] In addition, state and nonstate conflicts have a different associated effect on institutional quality. Specifically, nonstate conflicts tend to lead to larger drops in institutional quality compared to state-based conflicts (see Online Annex 2.3).
- *ME&CA countries with lower sovereign debt ratings tend to experience more pronounced output drops.*[19] Lower ratings could be associated with more persistent effects due to more constrained access to financing options essential for reconstruction efforts. With access to finance constrained, many of these countries may have to seek alternatives such as foreign aid or official financing, including through IMF-supported programs.

2.3. Adverse Spillovers to Other Countries from Conflicts

Conflicts may not only impact the countries directly involved but could also have spillover effects on other countries, with the impact varying depending on the channel of exposure. For instance, some countries could benefit from the emergence of new trade routes, stemming from trade divergence following the onset of a

[15] This is also in line with the greater incidence of more economically disruptive conflicts in MENAP compared to the CCA, as conflicts in the former are more likely to be severe. See Online Annex 2.4.

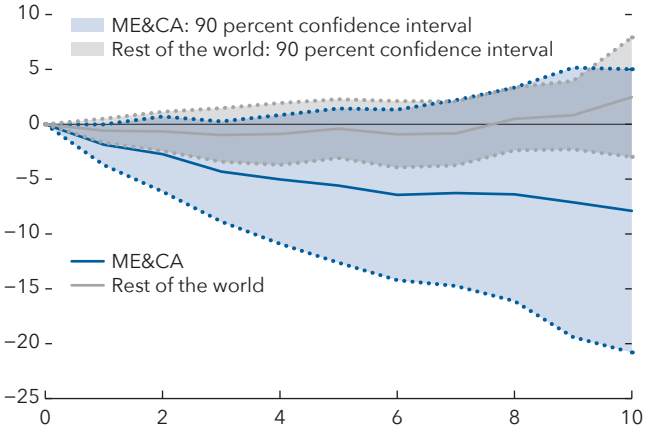
[16] Conflicts of very severe intensity are conflicts where the deaths-to-population ratio is in the top quartile of the world distribution, while conflict of mild intensity are conflicts where the deaths-to-population ratio is in the last quartile of the world distribution. See Online Annex 2.4 for more details. High duration is defined by a dummy if the duration is in the top quartile of the world distribution.

[17] Both results are partly driven by the fact that very severe intensity conflicts are more likely to take place in countries with low institutional quality or low sovereign debt rating, therefore highlighting potential endogeneity.

[18] Low institutional quality is defined by a dummy if the control of corruption as measured by the International Country Risk Guide is in the lowest quartile of the world distribution.

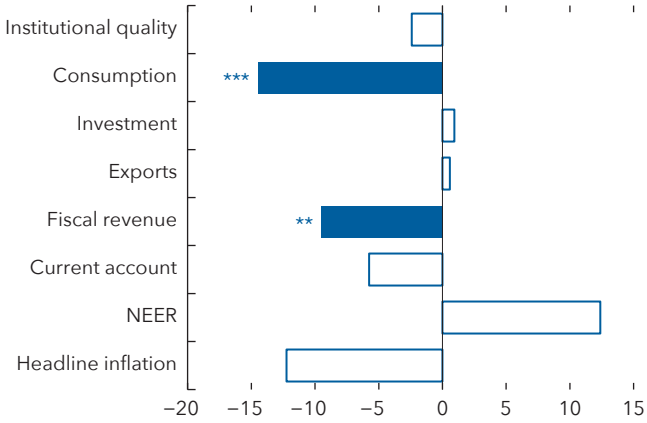
[19] This is based on Moody's sovereign debt ratings. The threshold of Caa1 is used to compare ME&CA countries with a low sovereign rating (below or equal to Caa1) to other ME&CA countries (with a sovereign rating above Caa1). This threshold was chosen instead of "investment grade" to ensure sufficient sample size in each bucket.

Figure 2.7. Impact of Conflict on Bordering Economies' GDP per Capita
(Percent)



Sources: CEPII database; IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: The impact estimates approximately correspond to the deaths per million associated with the 75th percentile of the world distribution for the own country analysis (see Online Annex 2.6 for details on the mapping). ME&CA = Middle East and Central Asia.

Figure 2.8. Impact of Conflict on Bordering Economies' Macroeconomic Indicators
(Percent difference between year 7 and the year before the conflict onset)



Sources: CEPII database; International Country Risk Guide; IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); and IMF staff calculations.
Note: The figure shows the impact seven years after the shock which approximately corresponds to the deaths per million associated with the 75th of the world distribution for the own country analysis. ***, **, and * indicate the statistical significance at the 1, 5, and 10 percent level, respectively. Empty bars indicate a lack of significance at the 10 percent level. The impact on the current account balance is in percentage point change. NEER = nominal effective exchange rate.

conflict, while others might suffer from a rise in uncertainty and increased fiscal pressures from refugee flows. When considering the impact of conflicts on bordering countries in our sample, ME&CA economies appear to experience a more adverse and prolonged impact compared to other regions (Figure 2.7).[20] For the group of ME&CA economies, conflicts in bordering countries are associated, on average, with an immediate drop in output per capita in neighbors of about 1.5 percent and a further drop of about 6 percent in output per capita about nine years after the initial conflict shock, albeit statistically insignificant. A similar pattern holds when considering spillovers via trade relationships (bilateral agreements or flows).[21] Zooming in to only the group of countries in the Middle East and North Africa, the spillover effect is large and statistically significant, with a decrease of about 10 percent five years after the conflict.

The characteristics of conflicts elsewhere and the recipient country's characteristics also influence the spillovers. When conflicts in bordering countries are nonstate-based, the adverse impact on output per capita is even larger and statistically significant, at 10 percent seven years after the conflict spillover shock. The impact of conflict spillover shocks is also more pronounced in countries with relatively lower institutional quality.[22] Countries with weaker institutions are estimated to have about 10 percent lower output per capita four years after a conflict spillover shock in bordering countries.[23]

Adverse economic effects from conflicts in bordering countries are also evident for other variables. Conflicts are associated with notable deteriorations in average domestic consumption and fiscal revenues (and an associated significant increase in public debt) of the bordering ME&CA countries (Figure 2.8). Although less statistically

[20] See Online Annex 2.6 for details on the construction of the conflict spillover shock. It is effectively a weighted average of conflict shocks elsewhere, with the specific bilateral weights varying depending on the exposure channel considered. For comparability in the dynamic responses, the conflict spillover shock is mapped to a percentile of its distribution that roughly corresponds to the own-country high-intensity conflict shock impulse's conflict-related deaths per million. For the bordering countries conflict spillover shock, this is a move to its 79th percentile.

[21] See Online Annex 2.6 for further details on the robustness of the findings to alternative spillover channels (weights).

[22] To proxy for institutional quality, we use the law-and-order quality and political risk rating in the country, and the estimate reported in the text refers to this measure (International Country Risk Guide).

[23] See Online Annex 2.6 for further details on effect differences by conflict spillover and country characteristics.

significant, the results also show economically meaningful adverse impacts on institutional quality and the current account balance. Nearby conflicts also increase refugee inflows into their neighbors in the immediate aftermath, with an increase of about 48 percent for ME&CA economies (and higher than what we observe for the bordering countries' conflict spillover shock in the rest of the world).[24]

2.4. Concluding Remarks

ME&CA is one of the most conflict-prone areas in the world. The duration and intensity of conflicts tend to be relatively high, resulting in significant long-term societal impacts. Moreover, the adverse impacts of conflicts on economic output and beyond for ME&CA economies are larger than those observed in the rest of the world. This disparity can be attributed not only to the severe intensity of conflicts and their nonlinear impacts, but also to preexisting conditions such as weaker institutions. Furthermore, conflicts in the region tend to produce more negative spillover effects for trading partner economies compared to other regions.

While this chapter focuses on the most salient channels through which conflicts can impact an economy, several other factors are likely also relevant. For example, conflicts may adversely impact financial stability when a prolonged conflict results in weaker financial sector performance and reduced ability by banks to sustain financial intermediation and payment systems, potentially leading to a greater risk of a systemic banking crisis. In addition, economies endowed with natural resources could face differing effects from a prolonged conflict (for example, depending on whether a substantial share of their natural resource revenue stream is lost). Moreover, higher oil prices (for example, from shipping or oil production disruptions) could imply an adverse supply shock to the global economy and jeopardize the global disinflation process. That said, recent history shows that oil price increases during conflicts in the Middle East do not persist. Oil price increases may be mitigated by regional oil producers tapping into spare capacity and other countries releasing strategic oil stocks to offset the shortfall.

Given the increased uncertainty associated with conflict, it is vital to make decisive progress to strengthen economic fundaments and institutions. Notably, the findings underscore the importance of strengthening institutions to help alleviate the adverse impact of conflicts. Sound macroeconomic policies, including building fiscal space to respond to urgent humanitarian and social needs, are essential. Moreover, in the case of systemic financial stress, the availability of crisis management measures, such as central bank emergency liquidity support, would be important. Last but not least, international and regional financial assistance needs to be calibrated to country-specific circumstances of fragility and conflict. In this regard, the IMF stands ready to assist its member economies and is stepping up its engagements with the most vulnerable members, including through its Strategy for Fragile and Conflict-Affected States (IMF 2022).

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[24] See Online Annex 2.6 for the details on refugee inflows.

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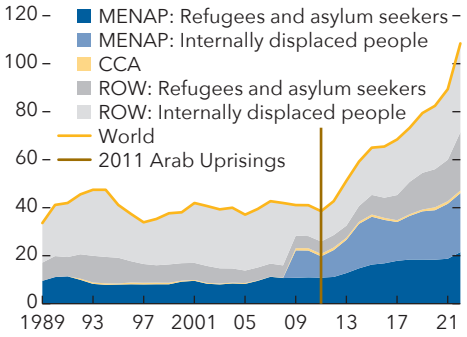
Box 2.1. Long-Term Societal Effects of Conflict

High-intensity and prolonged conflicts, particularly those leading to large-scale forced displacement, can severely disrupt human capital accumulation and social cohesion in the affected countries.

Box Figure 2.1.1. Forcibly Displaced People by Origin Country, 1989–2022
(Millions)



Sources: Internal Displacement Monitoring Center; UN High Commissioner for Refugees (UNHCR), Global Trends Report 2022; and IMF staff calculations.
Note: Forcibly displaced people include refugees under UNHCR mandate, asylum seekers, internally displaced people of concern to UNHCR, and other people in need of international protection. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; ROW = rest of the world.

By the end of 2022, the number of forcibly displaced people had surged to over 100 million worldwide, with the Middle East and Central Asia (ME&CA) accounting for over 40 percent (Box Figure 2.1.1). The aftermath of the 2011 Arab Uprisings led to a significant increase in forced displacement, with the region comprising slightly over 60 percent of the world's refugee population by 2014. Within ME&CA, only a few economies, including Afghanistan, Somalia, Sudan, Syria, West Bank and Gaza, and Yemen, make up the majority of the displaced population.

In addition, as skilled and educated individuals are more likely to leave to avoid violence, conflicts can also lead to a brain drain. This loss of talent in conflict countries could hinder postwar recovery and development.

Moreover, the cross-border flow of people has impacted recipient host economies. Notably, these economies have observed lower wages, increased demand for public services, and increased social spending (Rother and others 2016). As a considerable portion of the displaced population has remained within the region, this is adding to fiscal pressures in ME&CA.

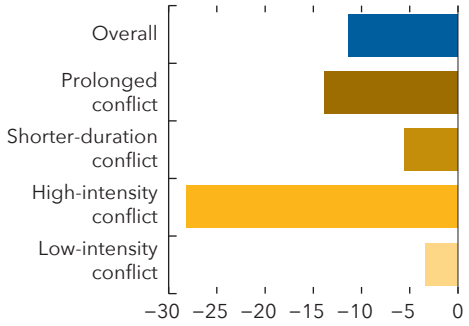
High-intensity and prolonged conflicts can have significant negative effects on educational attainment, skill development, and, consequently, future job prospects. Past conflicts in ME&CA have led to noticeably lower primary school enrollment rates. Compared to preconflict levels, these reductions are more severe during protracted conflicts—and even more so during high-intensity conflicts (Box Figure 2.1.2). The impact on primary school enrollment varies widely across ME&CA countries, yet the steepest cumulative decline in enrollment exceeded 30 percentage points by the conflict's second year. In general, the drop in school enrollments can be attributed to a combination of factors, including the destruction of school infrastructure, the use of schools as shelters for civilians, the displacement of communities, a shortage of qualified teachers, and heightened security concerns that deter student attendance. These factors collectively form barriers to education during wartime. The loss of family members and economic hardship can also result in more children entering the labor market, further diminishing their engagement in formal education.

Past armed conflicts in the region have also severely undermined health outcomes, leading to a decline in life expectancy (Box Figure 2.1.3). The reasons for this decline are multifaceted: directly through conflict-related fatalities and indirectly through the collapse of essential services like health care, water and sanitation systems, and food supply chains. This collapse has led to the spread of diseases, malnutrition, and even famine. The reduction in life expectancy was most acute in the early years of conflict. However,

Prepared by Bozena Radzewicz-Bak.

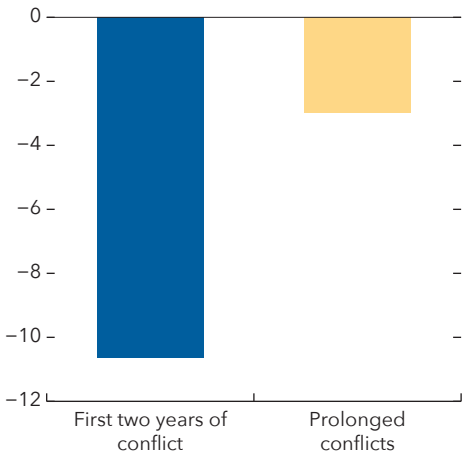
Box 2.1. *(continued)*

Box Figure 2.1.2. ME&CA Region: Primary School Enrollment in Prolonged versus Shorter Duration and High- versus Low-Intensity Conflicts
(Percentage points)



Sources: IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); World Bank, World Development Indicators; and IMF staff calculations.
Note: A prolonged conflict is defined as a conflict that lasts more than five years. ME&CA = Middle East and Central Asia.

Box Figure 2.1.3. ME&CA Region: Life Expectancy in Conflict Countries
(Percentage points)



Sources: IMF, World Economic Outlook database; Uppsala Georeferenced Event Database (v23.1); World Bank, World Development Indicators; and IMF staff calculations.
Note: A prolonged conflict is defined as a conflict that lasts more than five years. ME&CA = Middle East and Central Asia.

in prolonged conflicts, the negative impact on life expectancy tended to lessen, possibly due to some conflicts becoming less intense and more localized or the mitigating effects of humanitarian assistance and international support, which helped to improve health and living conditions in affected countries.

Intense and prolonged conflicts can also exacerbate rates of undernourishment, further compromising human capital formation. Data from past conflicts in ME&CA economies show that undernourishment rates tend to stay high even after conflicts have ended. Although there is considerable variation among economies, the average increase in undernourishment in those affected by conflict was nearly 14 percentage points, in contrast to a decrease in undernourishment observed in nonconflict countries over the same period. Conflicts disrupt food supply chains and local distribution networks, leading to higher food prices and shortages. When combined with the effects of displacement and economic hardship, this results in higher undernourishment rates, with the most severe impacts often borne by the most vulnerable groups, including children and the elderly.

3. Trade Patterns amid Shocks and a Changing Geoeconomic Landscape[1]

Amid rising trade restrictions globally, several shocks—Russia's war in Ukraine, the conflict in Gaza and Israel, and disruptions in the Red Sea—are altering trade patterns across the Caucasus and Central Asia (CCA) and the Middle East and North Africa (MENA). Since 2022, the CCA region has witnessed a notable uptick in overall trade activity, reflecting heightened transit trade and trade diversion. Some MENA countries have also seen shifts in trade patterns, particularly in energy products. More recently, tensions in the Red Sea have disrupted trade in several MENA countries. As the geoeconomic landscape evolves and uncertainties take hold, countries in the region could continue benefiting from an increase in trade flows or face trade and economic output losses, depending on the fragmentation scenarios considered. Amid this uncertainty, reducing risks and harnessing the gains from trade will require that countries reduce trade barriers, upgrade infrastructure, and strengthen regulatory frameworks. Meanwhile, mitigating disruptions from Red Sea tensions while building resilience to trade shocks could be achieved by diversifying shipping routes and, over the medium term, by developing alternative trade corridors and diversifying trade.

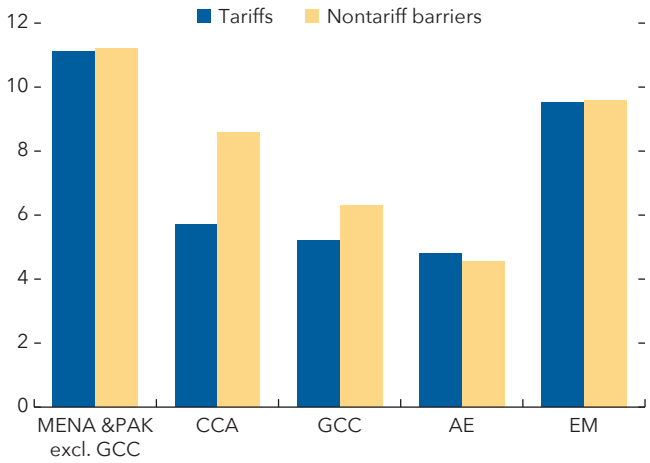
3.1. Shifting Trade Patterns

Countries across the CCA and MENA have experienced numerous shocks that have significantly reshaped their trade patterns in recent years. Following trade dislocation from the COVID-19 pandemic, Russia's war in Ukraine contributed to changes in regional trade dynamics, especially for CCA countries. More recently, security tensions in the Red Sea have raised broader concerns about their impact on shipping costs and trade. This has increased the risk of trade and supply chain disruptions, not only in the MENA region but also globally. Moreover, these shocks have occurred amid long-standing trade barriers (including high nontariff barriers), deficient infrastructure, and weak regulatory environments, limiting the CCA and MENA trade potential (Figures 3.1 and 3.2).

Trade Diversion Reshaping Trade

One of the key implications of the war in Ukraine for CCA countries has been a shift in the direction of their trade flows. In 2022, the CCA's share in EU, Russian, and US nonhydrocarbon exports increased by 25, 22, and 53 percent, respectively. In addition, the CCA's share in their nonhydrocarbon imports rose by 47, 43, and 27 percent, respectively. Meanwhile, Russia's shares in EU and US nonhydrocarbon exports and imports

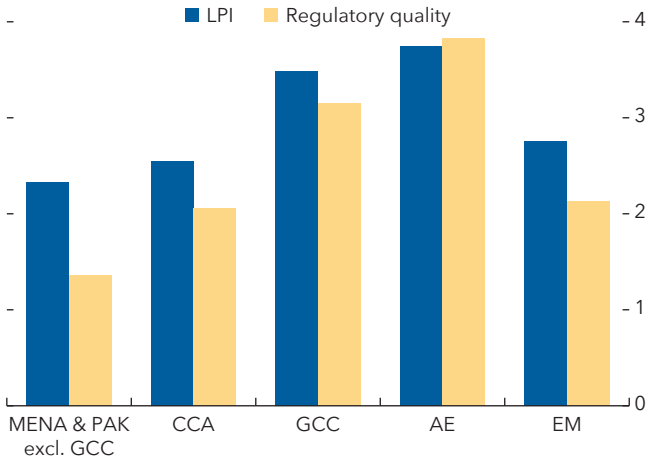
Figure 3.1. Tariff and Nontariff Barriers
(Tariffs in percent; nontariff barriers as index values)



Sources: Fraser Institute Economic Freedom Index; World Bank, World Development Indicators; and IMF staff calculations.
Note: Tariff data correspond to 2022; nontariff data correspond to 2021. Nontariff barriers have been rescaled to show index values between 0 and 20 (higher values are associated with higher barriers). AE = advanced economies; CCA = Caucasus and Central Asia; EM = emerging markets; GCC = Gulf Cooperation Council; MENA & PAK = Middle East and North Africa and Pakistan.

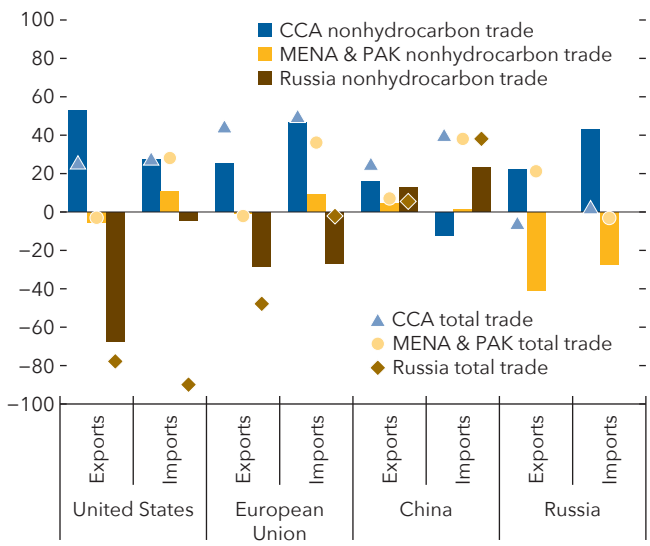
[1] Prepared by Apostolos Apostolou (co-lead), Hasan Dudu, Filippo Gori (co-lead), Alejandro Hajdenberg, Thomas Kroen, Fei Liu, Salem Mohamed Nechi, Subi Velkumar, and Qirui Zhang.

Figure 3.2. Logistics Performance and Regulatory Quality
(Index)



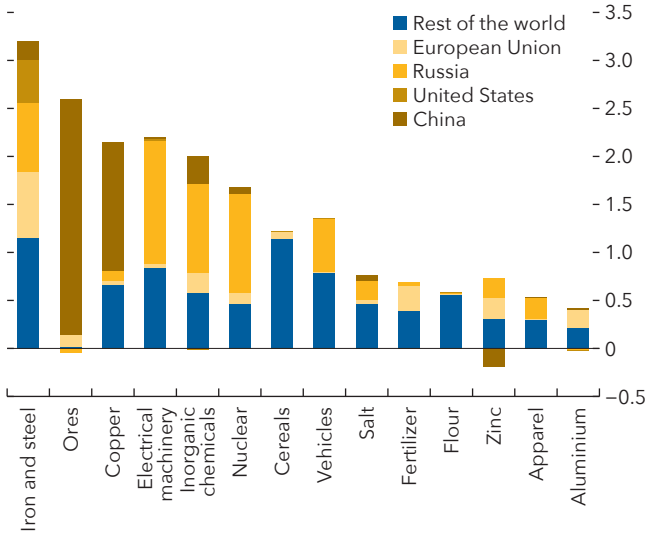
Sources: World Bank, Logistics Performance Index; and World Bank, Worldwide Governance Indicators database.
Note: Regulatory quality is rescaled as an index ranging from 0 to 5 (higher values are associated with better regulatory quality). The Logistics Performance Index (LPI) is also reported as an index, rated from very low (1) to very high (5). The LPI includes measures of infrastructure quality, customs performance, logistics quality, and logistics efficiency. AE = advanced economies; CCA = Caucasus and Central Asia; EM = emerging markets; GCC = Gulf Cooperation Council; MENA & PAK = Middle East and North Africa and Pakistan.

Figure 3.3. Trade Shares with Partner Countries, 2021–22
(Percentage change)



Sources: CEPII BACI database; and IMF staff calculations.
Note: Percent change in the share of CCA, MENA and Pakistan, and Russia in exports and imports from/to selected trading partners between 2021 and 2022. CCA = Caucasus and Central Asia; MENA & PAK = Middle East and North Africa and Pakistan.

Figure 3.4. CCA: Exports by Product Group
(Value change in billions of US dollars, 2022 versus 2019–21 average)

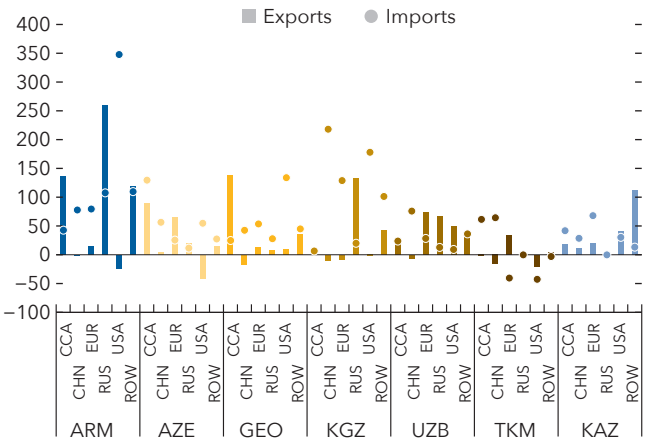


Sources: UN Comtrade; and IMF staff calculations.
Note: Excludes Tajikistan given data limitations. CCA = Caucasus and Central Asia.

declined markedly (Figure 3.3). The CCA region also increased its share in China's nonhydrocarbon exports, reflecting some reorientation of trade with greater traffic through the Middle Corridor, where transported volumes have risen sharply (Box 3.1). Hence, trade diversion to the CCA region entailed a noticeable increase in imports from and exports to major trading partners and across a wide range of product categories (especially in extractive industries and manufacturing, such as iron and steel, electrical machinery, chemicals, and vehicles)—a trend that continued in 2023 and contributed to the expansion of both overall and intraregional trade linkages, particularly for Armenia, Georgia, and the Kyrgyz Republic (Figures 3.4 and 3.5).

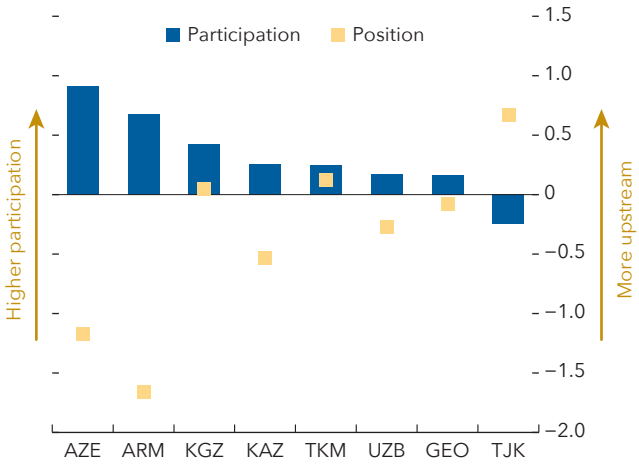
The CCA region's footprint in global value chains has also expanded. Specifically, participation in global value chains—that is, the share of exports that is part of a multistage trade process—has increased in all CCA countries (except Tajikistan). At the same time, several CCA countries (Armenia, Azerbaijan, Georgia, Kazakhstan, Uzbekistan) have increased their use of foreign inputs in their production and exports, surpassing the volume of their exports used in the production of other countries' exports (Figure 3.6).

Figure 3.5. CCA: Exports and Imports by Trading Partner
(Percentage change, 2022–23 average versus 2021)



Sources: UN Comtrade; and IMF staff calculations.
Note: Excludes Tajikistan given data limitations. Kyrgyz Republic: Data do not include gold exports, which declined sharply for reasons not related to the war. Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; ROW = rest of the world.

Figure 3.6. CCA: Deepened Involvement in Global Value Chains
(Change in index values, 2021–22)



Sources: EORA MRIO database; and IMF staff calculations.
Note: Both indices are calculated following Aslam, Novta, and Bastos (2017), based on manufacturing trade excluding extractive sector. Increasing participation implies greater integration with global value chains. Increasing position implies more upstream exports. Country abbreviations are International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia.

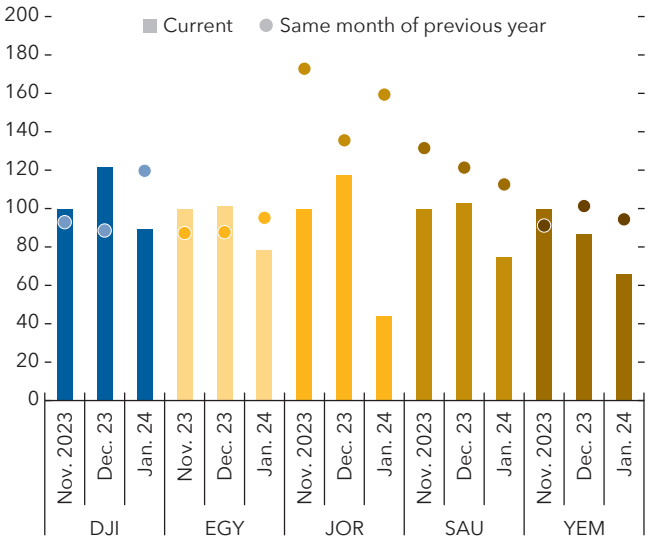
In MENA, shifting trade patterns were seen mainly among oil exporters and for hydrocarbon exports, as the European Union substituted some of its Russian-supplied oil and gas. MENA's share of EU hydrocarbon imports increased from 2.3 percent in the first quarter of 2022 to 5.8 percent in the fourth quarter of 2023 (with most gains for Algeria and Saudi Arabia).

Red Sea Security Tensions Disrupting Trade in MENA

Recent security tensions in the Red Sea have disrupted maritime trade through the region. With about 15 percent of global trade and 30 percent of global container trade transiting through the Suez Canal before the onset of the conflict, the Red Sea is a crucial pathway for global maritime trade. However, starting in November 2023, attacks on commercial vessels traversing the Bab el-Mandeb Strait have raised security concerns for shipping routes and caused a sharp rise in maritime insurance premiums. Consequently, from the onset of the conflict in Gaza and Israel until March 2024, the cost of shipping a standard 40-foot container from China to the Mediterranean Sea has soared from about $1,000 to over $4,000.

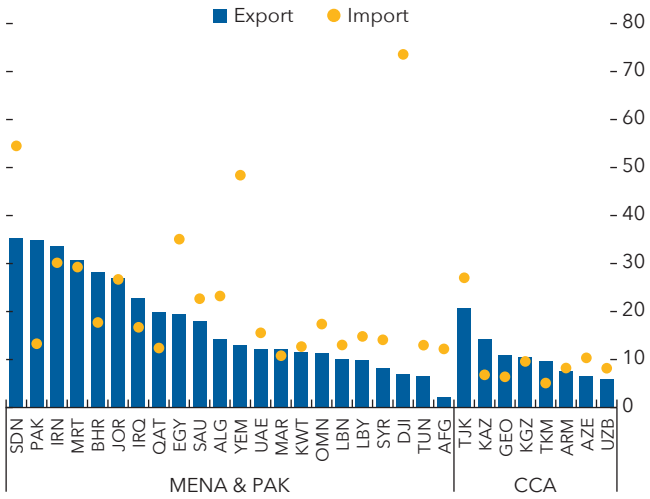
These security concerns have also affected regional trade. Trade through the Suez Canal dropped dramatically, declining by over 50 percent between November 2023 and the end of February 2024. Additionally, cargo trade volumes in some MENA countries, particularly those reliant on Red Sea ports, contracted during this timeframe, reflecting the varied exposure to maritime trade through the Bab el-Mandeb Strait (Figures 3.7 and 3.8). For example, the throughput of Jordan's Port of Aqaba fell by nearly half between November and the end of February, prompting the rerouting of some trade through land transport routes. In Saudi Arabia, Jeddah's port activity has decreased as the authorities have partly diverted trade flows to the port of Dammam in the Persian Gulf. Going forward, prolonged tensions in the Bab el-Mandeb Strait could have a deeper negative impact on trade and output, especially for countries bordering the Red Sea (Box 3.2).

Figure 3.7. Cargo Trade Volume
(November 2023 = 100)



Sources: PortWatch; and IMF staff calculations.
Note: Data capture trade in goods. Labels correspond to International Organization for Standardization (ISO) country codes.

Figure 3.8. Exports and Imports Transiting through the Bab el-Mandeb Strait
(Percent of total merchandise exports/imports, 2022)



Source: Verschuur and Hall (forthcoming).
Note: Labels correspond to International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; MENA & PAK = Middle East and North Africa and Pakistan.

Rising Trade Restrictions

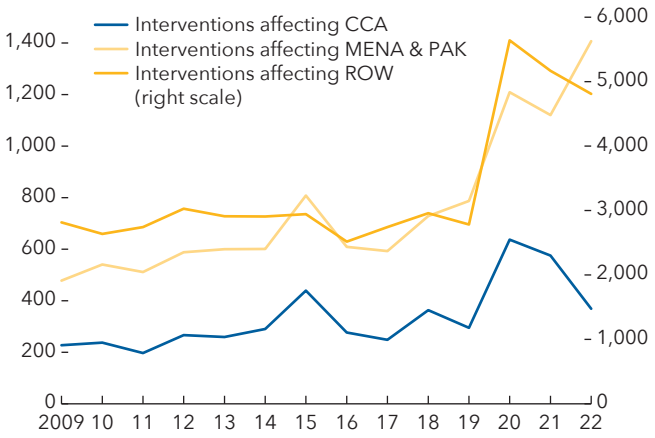
Globally, policymakers have become more receptive to implementing trade barriers, which are increasingly impeding the free flow of trade. A series of protectionist trade measures between China and the United States since 2018 preceded a broader trend of increased trade barriers between nations (Aiyar and others 2023). Moreover, trade dislocation from the COVID-19 pandemic, Russia's war in Ukraine, and tensions in the Red Sea has exacerbated challenges from rising geoeconomic fragmentation. In this context, trade interventions have increased globally by 70 percent since 2019. The average number of trade interventions affecting countries in the Middle East and Central Asia (ME&CA) has nearly doubled during the same period, with restrictions varying across countries (Figures 3.9 and 3.10).

3.2. Assessing the Impact of Geoeconomic Fragmentation on ME&CA

Amid ongoing changes to trade patterns and trade restrictions, three illustrative scenarios point to potential trade and economic output gains and losses in ME&CA countries from rising geoeconomic fragmentation.[2] Scenario 1 would entail the European Union and the United States ceasing all trade with Russia while trade between other countries proceeds as normal.[3] Scenarios 2 and 3 illustrate the separation of the world into three blocs—a Western bloc, an Eastern bloc, and a neutral bloc, with trade halted between the Western and Eastern blocs but the neutral bloc continuing to trade with any country. In scenario 2, ME&CA countries are assumed to remain in the neutral bloc. In scenario 3, ME&CA countries would align into the three blocs based on their votes in the 77th UN General Assembly Session during 2022–23 (see Online Annex 3.1 for details).

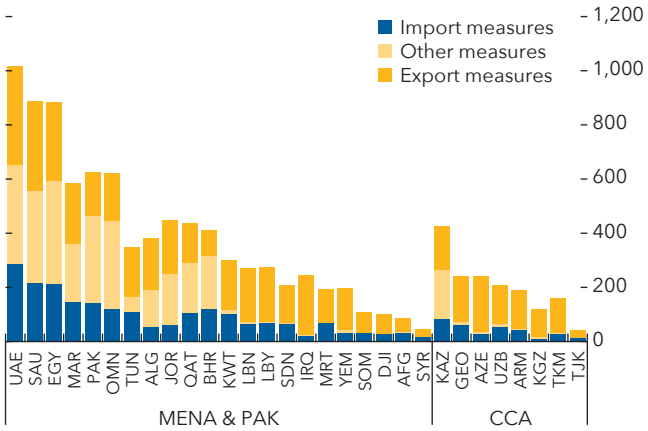
[2] These scenarios are assessed based on a structural bilateral gravity model using data for 185 countries from 2012–19. The focus is on the pre-COVID-19 years to remove any potential impact of COVID-19-related trade disruptions from the gravity equation estimation.
[3] In line with the "strategic decoupling" scenario in Bolhuis, Chen, and Kett (2023).

Figure 3.9. Trends in Trade Interventions
(Number)



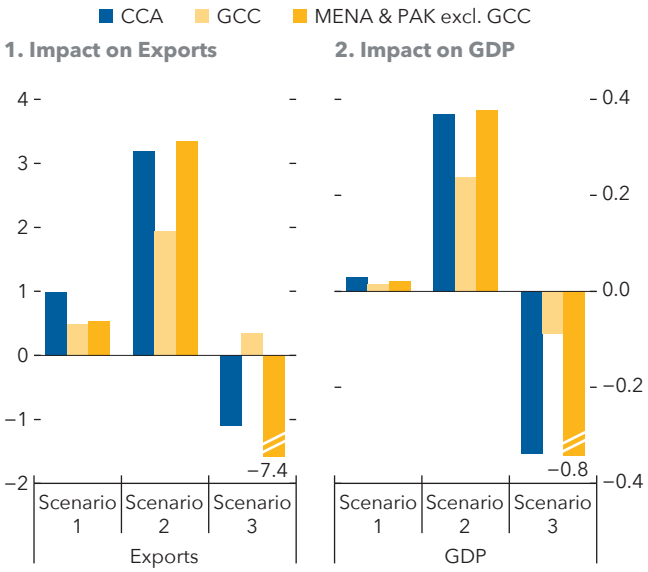
Sources: Global Trade Alert database; and IMF staff calculations.
Note: Trade interventions are defined as those that discriminate against foreign commercial interests. The main categories of interventions include export and import policy instruments, subsidies and state aid, and trade defense instruments. CCA = Caucasus and Central Asia; MENA & PAK = Middle East, North Africa, and Pakistan; ROW = rest of the world.

Figure 3.10. ME&CA: New Trade Interventions
(Number, 2020–22)



Sources: Global Trade Alert database; and IMF staff calculations.
Note: Other measures include anti-circumvention, anti-dumping, anti-subsidy, restrictions to public procurement, special safeguards, and measures not elsewhere specified. Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; ME&CA = Middle East and Central Asia; MENA & PAK = Middle East, North Africa, and Pakistan.

Figure 3.11. Baseline Impact on Exports and GDP
(Percent)



Sources: CEPII Gravity data set; and IMF staff calculations.
Note: CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENA & PAK = Middle East and North Africa and Pakistan.

Economic Losses Possible

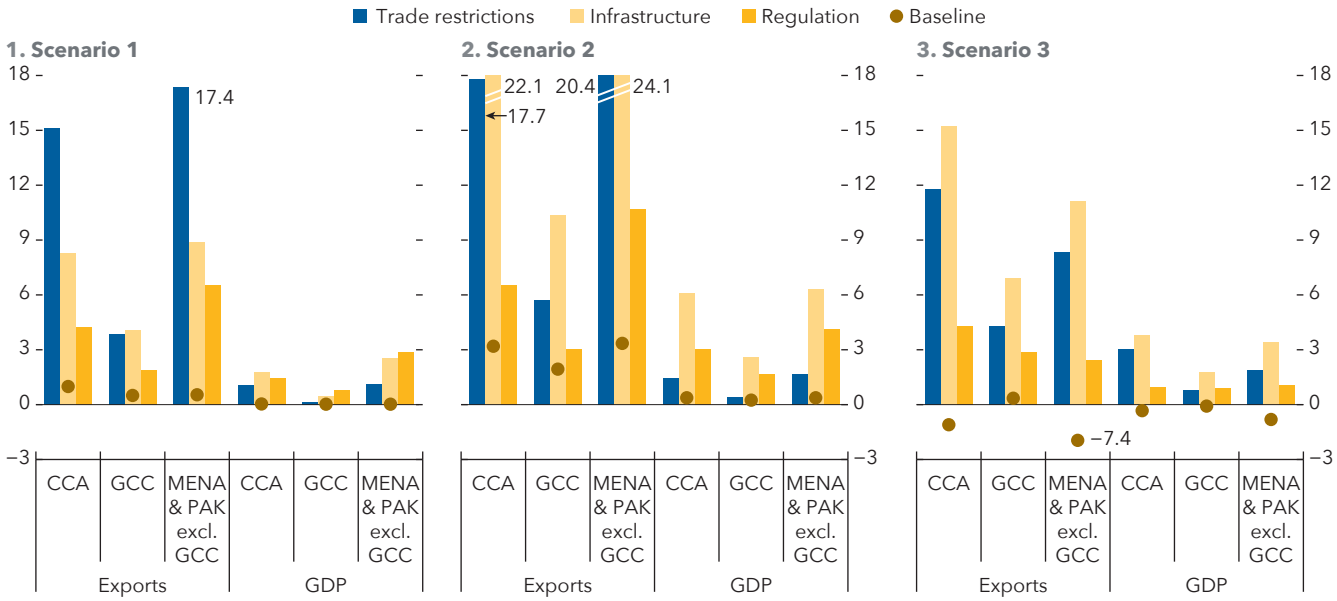
The net effect on trade and output across these scenarios depends on two opposing forces. On the one hand, the loss of trade partners would lead to reduced trade, adversely affecting economic output. On the other hand, trade diversion would occur due to fragmentation, redirecting trade flows toward countries that can trade.

Under scenario 1, ME&CA countries could continue to see expanded trade opportunities as trade diversion originating from a more targeted rise in trade restrictions could boost trade flows (Figure 3.11). Trade diversion and price effects in commodity markets generate positive, albeit modest, impacts on output, primarily in CCA countries.[4]

Under scenario 2, by remaining neutral, ME&CA countries could serve as intermediaries for trade between blocs with strained trade relations, contributing to trade and output gains above those illustrated under scenario 1. Across ME&CA, exports would increase by 2–3 percent while economic output would rise by up to 0.4 percent.

[4] The structural gravity model only incorporates direct trade between an exporter and an importer but not trade that is intermediated through a third country in a fragmentation scenario. Hence, results may represent a lower bound for countries that may emerge as trade intermediaries in a fragmentation scenario.

Figure 3.12. Trade and Output Gains from Policy Actions



Sources: CEPII Gravity data set; and IMF staff calculations.
Note: CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENA & PAK = Middle East and North Africa and Pakistan.

Under scenario 3, with the hypothetical configuration of blocs driven by UN voting, several ME&CA countries would experience losses, with a resultant drop in exports for the CCA (–1.1 percent) and for non–Gulf Cooperation Council (GCC) countries within the MENA and Pakistan group (–7.4 percent), and a mild decline in output. GCC countries would be less impacted under scenario 3, as they are better positioned to benefit from trade diversion due to their lower tariffs and nontariff barriers compared to other country groups.

Policy Actions Can Expand Trade Gains and Prevent Losses

Policy actions that curb long-standing barriers,[5] such as reducing trade restrictions,[6] easing regulatory constraints, and upgrading infrastructure investment,[7] can facilitate trade and income gains under scenario 1 and 2 (Figure 3.12) or mitigate the adverse impact under scenario 3.[8]

Under scenario 1, lowering the trade restriction gap with advanced economies could boost exports by 14 percent for CCA countries and by more than 15 percent for the group containing non-GCC MENA countries and Pakistan relative to the baseline (that is, without such policy action). Upgrading infrastructure could enable ME&CA economies to increase exports by about 7 percent in the CCA and 8 percent in non-GCC MENA countries and Pakistan, driven by improved intra- and interregional trade flows. Moreover, improving the regulatory environment could lead to a more than 3 percent increase in exports for the CCA and around 6 percent increase for non-GCC MENA countries and Pakistan. These export gains under various policy actions could also translate into higher annual output in the CCA (between 1 and 2 percent) and among non-GCC MENA countries and Pakistan (between 1 and 3 percent).[9]

[5] Calibrated to achieve a 20 percent reduction in the gap of such factors between ME&CA countries and advanced economies.

[6] Based on a composite index of tariff and nontariff barriers.

[7] Infrastructure is proxied by the World Bank's Logistics Performance Index, which is a composite measure of countries' physical infrastructure, customs performance, logistics quality, and logistics efficiency.

[8] While the structural gravity model provides a tractable framework for policy analysis in a multicountry setting, the results rely on the implicit assumption that the structural parameters of each economy would be invariant to different degrees of geoeconomic fragmentation and could thus be captured by the gravity model estimated using historical data (see Online Annex 3.2 for details).

[9] These gains have two components: higher trade through better infrastructure and higher domestic output through better infrastructure. In the results, GDP changes are reported excluding the direct impact of better infrastructure on domestic production.

Similarly, under scenario 2, reducing trade barriers would increase exports by more than 17 percent for CCA countries, more than 20 percent for non-GCC MENA countries and Pakistan, and 6 percent for GCC countries. Moreover, export gains related to an upgrade in infrastructure would reach 6, 22, and 24 percent in GCC, CCA, and non-GCC MENA countries and Pakistan, respectively, and 6, 3, and 11 percent following improvements in the regulatory environment, respectively. The additional gains in exports from policy actions also translate into extra output gains (0.4 to 6.3 percent), especially for CCA and non-GCC MENA countries and Pakistan.

Under scenario 3, policy actions can help prevent economic losses over the medium term and improve trade and output outcomes, though the improvements are generally less pronounced than those observed in scenarios 1 and 2 (Figure 3.12). By reducing trade restrictions, the CCA and the non-GCC MENA and Pakistan groups could see their exports rise by more than 11 percent and about 8 percent, respectively—effectively eliminating any output losses due to fragmentation under the baseline results. Furthermore, upgrading infrastructure would similarly boost both exports and output across the region. Improving regulatory quality also leads to export and output gains and reverses the adverse effects experienced by the CCA and the non-GCC MENA and Pakistan group without policy actions under scenario 3.

3.3. Policy Response

The empirical results emphasize the need for decisive and targeted policy actions to boost trade prospects and counteract the adverse potential impacts of trade shocks and increased fragmentation. It is essential that these measures are calibrated to address both immediate and longer-term challenges.

In the short term, policies prioritizing trade facilitation measures and improving "soft" infrastructure, such as digital technology and customs management, would help consolidate ongoing shifts in trade patterns into stronger trade and GDP gains. Reforms should aim to reduce nontariff barriers by improving customs efficiency, including by expanding the use of digital technology, simplifying import and export license processes, and tackling other technical barriers at the border.

Over the medium term, policies to reduce infrastructure gaps and enhance regulatory quality, such as reducing infrastructure bottlenecks and harmonizing and streamlining regulatory requirements, would also boost trade, help mitigate the impact of trade shocks, and curb the adverse impact of geoeconomic fragmentation, including by facilitating regional linkages and connectivity (for example, by developing alternative trade corridors). Further integration into global value chains could help countries bolster competitiveness and contribute to higher income per capita (Raei, Ignatenko, and Mircheva 2019).

In MENA countries, efforts to improve supply chain management, prepare for alternative sources of supply in most affected sectors, seek alternate shipping routes, and assess air freight capacity needs could help mitigate the disruptions related to ongoing tensions in the Red Sea. Over the medium term, increasing MENA countries' resilience to trade disruptions requires moving forward with investments in transportation infrastructure to strengthen and expand regional linkages and connectivity, including by developing innovative sea-land routes. Cultivating a more diversified trade profile—spanning partners, products, and routes—would further enhance resilience.

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Box 3.1. The Middle Corridor

The Middle Corridor, also known as the Trans-Caspian International Transport Route, is a multimodal[1] network connecting China and Europe, offering significant potential for the Caucasus and Central Asia region's development. The corridor runs through Kazakhstan, the Caspian Sea, Azerbaijan, and Georgia, and on to Europe through Türkiye or the Black Sea. The Middle Corridor provides an alternative transit route to sea transportation and the Northern Corridor[2] (the overland east-west route across Russia[3]) for trade between China and Europe. The route was strengthened by the opening of the Trans-Kazakhstan railroad in 2014 and the Baku-Tbilisi-Kars railway in 2017. Since the onset of Russia's war in Ukraine, the volumes transported through the Middle Corridor have grown substantially, rising from 600,000 tons in 2021 to 2.7 million tons in 2023. While accounting for only a small share of overall trade between China and Europe, the Middle Corridor offers important potential for the Caucasus and Central Asia region's development and integration into global supply chains.

However, several actions are needed to overcome challenges related to developing the Middle Corridor as a viable route. Recent studies identified high transport costs and long and unpredictable transit times as key shortcomings (EBRD 2023; OECD 2023; World Bank 2023). As such, measures are needed to streamline procedures at border crossings to reduce delays, enhance automation through the digitalization of transport documents, and harmonize regulatory requirements, permits, and tariffs across Middle Corridor countries. Significant infrastructure improvements are also needed, including expediting transshipments along the route, expanding the fleet at the Caspian Sea, developing railway capacity, and improving the road network. Cooperation among the countries involved and beneficial conditions to attract private sector involvement are crucial for achieving these goals. To this end, several regional initiatives already exist. For example, in 2022, Azerbaijan, Georgia, Kazakhstan, and Türkiye signed the Roadmap for 2022–27 to accelerate the development of the Middle Corridor.

Prepared by Alejandro Hajdenberg and Fei Liu.

[1] Involving road, railway, and sea links.

[2] See OECD/ITF (2022).

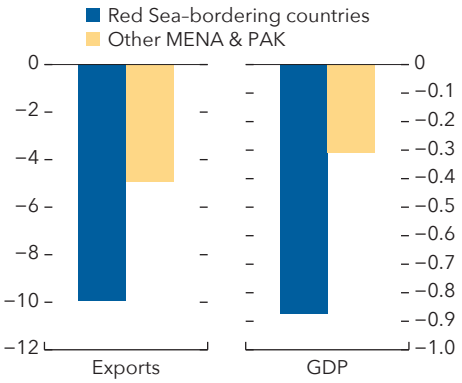
[3] Volumes transported through the Northern Corridor dropped by over 60 percent in 2023 compared to 2021, according to the Eurasian Rail Alliance Index.

Box 3.2. MENA: Uneven Trade Losses from Prolonged Red Sea Tensions

Amid the ongoing changes to trade patterns related to the security concerns in the Red Sea, an illustrative scenario points to notable trade losses for highly exposed economies in the event of prolonged disruptions. The scenario assumes the current level of disruptions in maritime trade continues through the end of 2024. In turn, it simulates the impact of an increase in trade costs by 1 percent of freight value for trade traversing the Red Sea (equivalent to a full-year rise in maritime insurance premiums at the level observed as of mid-March 2024 for vessels traveling through the Red Sea). This shock is then scaled by each Middle East and North Africa (MENA) country's dependence on this shipping route, measured by the share of their trade via the Bab el-Mandeb Strait. Results from the analysis illustrate an uneven impact across MENA countries. For countries bordering the Red Sea (Egypt, Jordan, Saudi Arabia, Sudan, Yemen), exports are estimated to decline by 10 percent on average.

For the rest of MENA, the decline in exports is about half of the decline seen for the previous group, reflecting a generally lower share of trade exposed to the ongoing disruptions in maritime traffic. The ensuing negative impact on economic activity is estimated at about 1 percent for economies bordering the Red Sea and 0.3 percent for other MENA countries and Pakistan (Box Figure 3.2.1).

Box Figure 3.2.1. Estimated Impact of Prolonged Red Sea Disruptions on MENA and Pakistan
(Percent change)



Sources: CEPII Gravity data set; and IMF staff calculations.
Note: The scenario assumes the current level of disruptions in maritime trade through the Red Sea continues through the end of 2024. The chart displays one-year impacts. Red Sea–bordering countries include Egypt, Jordan, Saudi Arabia, Sudan, and Yemen. MENA & PAK = Middle East and North Africa and Pakistan.

Prepared by Thomas Kroen and Salem Mohamed Nechi.

ME&CA: Selected Economic Indicators, 2000–25

(Percent of GDP, unless otherwise indicated)

	Average 2000–20	2021	2022	2023	Projections 2024	2025
ME&CA[1,2]						
Real GDP (percent change, year over year)	4.1	4.5	5.3	2.0	2.8	4.2
Current Account Balance	5.3	3.4	8.4	4.0	1.8	1.4
Overall Fiscal Balance	0.7	–2.3	2.4	–0.3	–2.0	–1.7
Inflation (percent change, year over year)	7.4	12.7	13.9	16.7	15.5	11.8
ME&CA Oil and Gas Exporters						
Real GDP (percent change, year over year)	4.1	4.6	5.4	2.1	2.9	4.4
of which nonhydrocarbon growth	5.1	4.8	4.6	3.9	3.6	3.9
Current Account Balance	8.4	6.8	13.8	6.6	4.1	3.2
Overall Fiscal Balance	2.7	–0.7	5.6	1.6	–0.3	–0.2
Inflation (percent change, year over year)	6.9	10.9	13.1	11.5	10.3	9.0
ME&CA Oil and Gas Importers[1,2]						
Real GDP (percent change, year over year)	4.0	4.3	5.2	1.7	2.6	4.0
Current Account Balance	–2.8	–4.1	–5.3	–3.1	–4.9	–3.8
Overall Fiscal Balance	–4.8	–5.8	–5.7	–5.6	–7.0	–6.1
Inflation (percent change, year over year)	8.5	15.5	15.2	25.3	24.4	16.3
ME&CA Emerging Market and Middle-Income Countries[1]						
Real GDP (percent change, year over year)	4.0	4.6	5.7	2.1	2.6	3.8
Current Account Balance	–3.4	–3.6	–4.9	–2.3	–4.5	–3.1
Overall Fiscal Balance	–5.3	–6.3	–6.3	–5.9	–7.6	–6.7
Inflation (percent change, year over year)	7.1	7.8	11.5	24.2	23.5	15.9
ME&CA Low-Income Developing Countries[2]						
Real GDP (percent change, year over year)	4.1	2.5	2.4	–0.2	2.7	4.9
Current Account Balance	0.8	–7.3	–7.5	–7.9	–7.3	–7.2
Overall Fiscal Balance	–2.1	–2.6	–2.7	–3.9	–3.3	–2.8
Inflation(percent change, year over year)	15.0	60.0	35.1	31.8	29.9	18.5

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

[1] 2011–25 data exclude Syrian Arab Republic. ME&CA emerging market and middle-income countries include Armenia, Egypt, Georgia, Jordan, Lebanon, Morocco, Pakistan, Syrian Arab Republic, Tunisia, and West Bank and Gaza.

[2] Afghanistan is excluded from real GDP growth, overall fiscal balance, and inflation data for 2023–25, and current account balance data for 2021–25. ME&CA low-income developing countries includes Afghanistan, Djibouti, Kyrgyz Republic, Mauritania, Somalia, Sudan, Tajikistan, Uzbekistan, and Yemen.

Note: Data refer to the fiscal year for the following countries: Afghanistan (March 21/March 20 until 2011, and December 21/December 20 thereafter), Islamic Republic of Iran (March 21/March 20), and Egypt and Pakistan (July/June). The 32 Middle East and Central Asia (ME&CA) countries and territories are divided into three (nonoverlapping) groups, based on export earnings and level of development: (1) oil exporters, (2) emerging market and middle-income countries, and (3) low-income developing countries. ME&CA oil exporters: Algeria, Azerbaijan, Bahrain, Islamic Republic of Iran, Iraq, Kazakhstan, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Turkmenistan, and United Arab Emirates. ME&CA oil importers: Afghanistan, Armenia, Djibouti, Egypt, Georgia, Jordan, Kyrgyz Republic, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syrian Arab Republic, Tajikistan, Tunisia, Uzbekistan, West Bank and Gaza, and Yemen. ME&CA emerging market and middle-income countries: Armenia, Egypt, Georgia, Jordan, Lebanon, Morocco, Pakistan, Syrian Arab Republic, Tunisia, and West Bank and Gaza. ME&CA low-income developing countries: Afghanistan, Djibouti, Kyrgyz Republic, Mauritania, Somalia, Sudan, Tajikistan, Uzbekistan, and Yemen.

MENA: Selected Economic Indicators, 2000–25

(Percent of GDP, unless otherwise indicated)

	Average 2000–20	2021	2022	2023	Projections 2024	2025
MENA[1]						
Real GDP (percent change, year over year)	3.9	4.3	5.2	1.9	2.7	4.2
Current Account Balance	6.4	4.2	10.0	5.3	2.7	2.1
Overall Fiscal Balance	1.1	–1.8	3.6	0.5	–1.5	–1.1
Inflation (percent change, year over year)	7.4	13.8	14.3	16.0	15.4	12.4
MENA Oil and Gas Exporters						
Real GDP (percent change, year over year)	3.9	4.7	5.6	1.9	2.9	4.4
of which nonhydrocarbon growth	4.9	4.8	4.4	3.9	3.6	4.0
Current Account Balance	9.0	7.2	14.3	7.4	4.8	3.6
Overall Fiscal Balance	2.7	–0.5	6.0	1.9	–0.1	0.0
Inflation (percent change, year over year)	6.8	11.2	12.9	11.6	10.7	9.4
MENA Oil and Gas Importers[1]						
Real GDP (percent change, year over year)	3.7	3.3	4.5	1.8	2.4	4.0
Current Account Balance	–4.0	–5.3	–5.9	–3.6	–6.8	–4.9
Overall Fiscal Balance	–5.6	–6.0	–5.4	–5.2	–7.6	–6.3
Inflation (percent change, year over year)	8.8	20.6	17.9	27.4	28.0	20.3
MENA Emerging Market and Middle-Income Countries[1]						
Real GDP (percent change, year over year)	4.0	3.7	5.1	3.1	2.8	3.9
Current Account Balance	–4.0	–4.8	–5.2	–3.0	–6.3	–4.1
Overall Fiscal Balance	–5.9	–6.6	–5.7	–5.4	–8.2	–6.8
Inflation (percent change, year over year)	7.1	7.0	11.1	22.6	24.0	18.6
MENA Low-Income Developing Countries						
Real GDP (percent change, year over year)	1.9	0.5	–0.4	–9.6	–1.4	4.4
Current Account Balance	–3.8	–9.2	–11.9	–8.9	–11.2	–11.8
Overall Fiscal Balance	–3.1	–0.3	–2.1	–2.9	–2.4	–2.2
Inflation (percent change, year over year)	20.4	171.7	80.7	75.0	69.0	35.9
Gulf Cooperation Council						
Real GDP (percent change, year over year)	3.9	4.3	7.0	0.4	2.4	4.9
of which nonhydrocarbon growth	5.3	5.4	5.3	3.8	3.6	4.5
Current Account Balance	12.4	8.7	15.9	9.0	6.3	5.0
Overall Fiscal Balance	5.2	0.2	7.6	3.4	2.3	2.7
Inflation (percent change, year over year)	2.2	2.2	3.3	2.2	2.2	2.1

	Average 2000–20	2021	2022	2023	Projections 2024	2025
Arab World[1]						
Real GDP (percent change, year over year)	4.1	4.2	5.5	1.3	2.6	4.5
Current Account Balance	7.0	4.3	10.6	5.4	2.6	2.0
Overall Fiscal Balance	1.7	–1.7	4.3	0.8	–1.3	–0.8
Inflation (percent change, year over year)	4.9	9.0	8.8	11.2	11.2	8.6
Arab World Oil and Gas Exporters						
Real GDP (percent change, year over year)	4.2	4.7	6.1	1.0	2.7	4.8
of which nonhydrocarbon growth	5.3	5.1	4.7	3.9	3.6	4.3
Current Account Balance	10.6	7.7	15.6	7.9	5.0	3.7
Overall Fiscal Balance	4.0	–0.2	7.2	2.5	0.4	0.6
Inflation (percent change, year over year)	3.0	3.2	4.3	3.4	3.1	2.8

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

[1] 2011–25 data exclude Syrian Arab Republic.

Note: Data refer to the fiscal year for the following countries: Afghanistan (March 21/March 20 until 2011, and December 21/December 20 thereafter), Islamic Republic of Iran (March 21/March 20), and Egypt and Pakistan (July/June). Middle East and North Africa (MENA): Algeria, Bahrain, Djibouti, Egypt, Islamic Republic of 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, Islamic Republic of Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and United Arab Emirates. MENA emerging market and middle-income countries: Egypt, Jordan, Lebanon, Morocco, Syrian Arab Republic, Tunisia, and West Bank and Gaza. MENA low-income developing countries: Djibouti, Mauritania, Somalia, Sudan, and Yemen. MENA excluding conflict-affected states: Algeria, Bahrain, Djibouti, Egypt, Islamic Republic of Iran, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, and United Arab Emirates. MENA excluding fragile and conflict-affected states: Algeria, Bahrain, Djibouti, Egypt, Islamic Republic of Iran, Jordan, Kuwait, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, and United Arab Emirates. Gulf Cooperation Council: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates. Arab World: MENA excluding Islamic Republic of Iran. Arab World oil exporters: Algeria, Bahrain, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

CCA: Selected Economic Indicators, 2000–25

(Percent of GDP, unless otherwise indicated)

	Average 2000–20	2021	2022	2023	Projections 2024	2025
CCA						
Real GDP (percent change, year over year)	6.3	5.3	5.2	4.9	3.9	4.8
Current Account Balance	–0.1	0.5	5.8	–1.5	–1.9	–1.3
Overall Fiscal Balance	1.6	–3.0	0.5	–1.3	–2.1	–1.9
Inflation (percent change, year over year)	8.8	9.6	13.0	9.7	7.7	7.1
CCA Oil and Gas Exporters						
Real GDP (percent change, year over year)	6.5	3.8	3.8	3.9	2.9	4.6
of which nonhydrocarbon growth	6.4	4.9	6.0	4.1	3.6	3.3
Current Account Balance	0.3	3.1	9.4	0.4	–0.7	0.1
Overall Fiscal Balance	2.2	–2.3	1.8	–0.4	–1.5	–1.4
Inflation (percent change, year over year)	7.7	9.1	14.2	11.1	7.2	6.7
CCA Oil and Gas Importers						
Real GDP (percent change, year over year)	6.0	7.7	7.3	6.5	5.4	5.2
Current Account Balance	–1.9	–6.1	–3.4	–6.1	–5.0	–4.7
Overall Fiscal Balance	–0.9	–4.8	–2.9	–3.6	–3.6	–3.1
Inflation (percent change, year over year)	10.9	10.3	11.0	7.6	8.5	7.8
CCA Emerging Market and Middle-Income Countries						
Real GDP (percent change, year over year)	5.5	8.7	11.6	8.0	5.9	5.2
Current Account Balance	–9.0	–7.4	–2.2	–3.4	–4.6	–4.8
Overall Fiscal Balance	–1.9	–4.6	–1.9	–1.7	–3.3	–3.2
Inflation (percent change, year over year)	4.3	8.6	10.6	2.3	2.8	4.0
CCA Low-Income Developing Countries						
Real GDP (percent change, year over year)	6.2	7.4	6.0	6.1	5.3	5.2
Current Account Balance	0.8	–5.6	–3.9	–7.3	–5.1	–4.7
Overall Fiscal Balance	–0.3	–4.9	–3.4	–4.5	–3.8	–3.1
Inflation (percent change, year over year)	12.9	10.7	11.1	9.3	10.3	9.0

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

Note: Caucasus and Central Asia (CCA) oil and gas exporters: Azerbaijan, Kazakhstan, and Turkmenistan. CCA oil and gas importers: Armenia, Georgia, Kyrgyz Republic, Tajikistan, and Uzbekistan. CCA emerging market and middle-income countries: Armenia and Georgia. CCA low-income developing countries: Kyrgyz Republic, Tajikistan, and Uzbekistan.

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