Key Messages

October 2023 Regional Economic Outlook: Middle East & Central Asia
Building Resilience and Fostering Sustainable Growth

- With the World Bank–IMF Annual Meetings returning to the Arab World for the first time in two decades, it is time to rethink the region's development model.
- Growth in many economies in the Middle East and Central Asia is slowing, reflecting the combined effect of tighter policies, oil production cuts, and domestic challenges.
- Inflation is easing, but large differences persist between countries. Elevated debt levels in some countries continue to pose challenges.
- The balance of risks has improved since April as adverse global challenges have receded. Still, risks remain tilted to the downside, and climate-related threats are rising.
- Tight policies to reduce inflation and maintain debt sustainability and financial stability remain the priority. Macroprudential policy can ease tensions between price and financial stability objectives.
- Structural reforms can help support near-term growth and longer-term growth prospects. Sequencing and packaging reforms strategically can magnify growth dividends.
- Promoting inclusive growth will require substantial reforms to close the gap between the development models of the past and what is needed going forward.

Growth in ME&CA is slowing this year while longstanding challenges persist.

In the *Middle East and North Africa*, real GDP growth is set to slow to 2.0 percent this year (a downgrade of 1.1 percentage points from April) as tight policies to safeguard macroeconomic stability, OPEC+ oil production cuts, and country-specific headwinds weigh on economic activity. As some of these factors fade, economic activity is forecast to improve in 2024, with growth reaching 3.4 percent (unchanged from April)—but to remain below its prepandemic historical average over the medium term.

Despite some moderation, real GDP growth in the *Caucasus and Central Asia* is projected to remain relatively robust in 2023 at 4.6 percent (a 0.3 percentage-point upgrade), reflecting the continued impact of trade and financial flows from Russia and strong domestic demand. The gradual normalization of these flows will likely dampen activity in 2024, with growth easing to a still-strong 4.2 percent (a 0.3 percentage-point downgrade). Amid persistent structural challenges, medium-term growth is projected to remain lackluster.

Inflation is receding, but it remains elevated in some countries. Average inflation in MENA is forecast to peak at 17.5 percent in 2023 (partly reflecting high inflation in a few economies; 13.4 percent excluding Egypt and Sudan) before easing to 15.0 percent in 2024 (9.7 percent, excluding Egypt and Sudan). In the CCA, price pressures are expected to continue abating, falling from 11.0 percent in 2023 to 8.3 percent in 2024.

Financing conditions remain generally tight. MENA central banks have continued raising rates in 2023, albeit at a slower pace than last year. The monetary policy cycle appears to have peaked in the CCA. A higher-for-longer interest rate environment could strain ME&CA financial institutions, with implications for banking sector profitability, credit provision, economic growth, and financial stability.

Risks have receded since April but remain to the downside. On the upside, a faster-than-anticipated global decline in inflation would reduce pressure on central banks to raise interest rates further. On the downside, a larger-than-expected slowdown in China or major advanced economies could reduce external demand. An escalation of the war in Ukraine could reignite price pressures and worsen food insecurity. Climate shocks or natural disasters could impact infrastructure, agriculture output, food prices, and social stability.

Amid tight macro policies, structural reforms can help build resilience and raise growth.

Monetary policy: Maintain focus on price stability. In countries with persistent inflationary pressures, a continued tight monetary policy stance is essential until signals of sustained disinflation are well-established. For some economies, this may require further tightening. For example, policy rates remain below model-based estimates of natural rates in Egypt, Pakistan, and Tunisia. Where inflation is returning to target and underlying inflationary pressures are abating, policy easing should be done cautiously and with due attention to signs of renewed price pressures.

Fiscal policy: Build buffers to strengthen resilience. Fiscal consolidation efforts should continue to build buffers and safeguard debt sustainability, especially in emerging markets. Economic diversification and boosting fiscal buffers among oil exporters would help ensure resilience. All countries would benefit from domestic revenue mobilization and spending efficiency. Fiscal reforms (for example, increasing budget transparency and adopting credible medium-term fiscal frameworks) will reinforce efforts and facilitate access to external market financing.

Structural reforms: Transform the economy to prepare for tomorrow's challenges. Implementing structural reforms is critical to solving the deep-seated economic challenges constraining growth in ME&CA. A first-generation reform package that includes governance, external sector, and regulatory reform could increase output by almost 10 percent over five years. Governance reforms are especially important and can generate positive output effects even during periods of weak growth or limited policy space. Major governance reforms could increase output by about 6 percent over five years. The benefits of reforms are also evident beyond governance. Notably, regulatory quality reforms have a positive impact on output, contributing to a 4 percent increase after five years.

The IMF has expanded support to the region.

- The World Bank–IMF Annual Meetings in Marrakech provide a platform for wide-ranging policy discussions on challenges facing the region and the global economy. The overarching themes of the 2023 Annual Meetings are building resilience, securing a transformational recovery, and reinvigorating global cooperation.

- Since the onset of the pandemic, the IMF has provided $34 billion in new financing to 15 ME&CA countries (including $26.3 billion to 8 MENA countries) and allocated $49.3 billion special drawing rights to boost the region's reserve assets. Over the past year, IMF programs were approved for Armenia, Egypt, Mauritania, Morocco, and Pakistan. Additionally, since 2020, the IMF has provided about $6 billion in emergency financing and enhanced its emergency financing facilities. Morocco recently became the first ME&CA country to secure financing under the Fund's Resilience and Sustainability Facility, which provides long-term financing to strengthen economic resilience by supporting policy reforms that reduce climate change-related risks, among others.