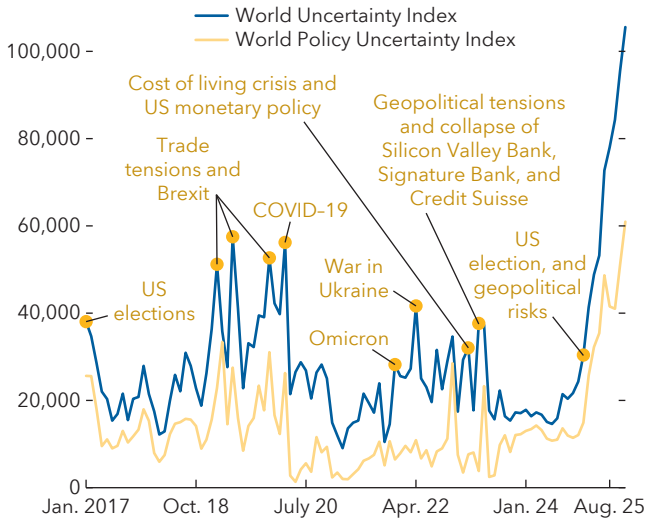
1. Regional Developments and Economic Outlook: Resilience amid Uncertainty: Will It Last?[1]

1.1. Global Context: Surprising Resilience

In recent months, the global economy has continued to show resilience to a series of shocks that have generated severe uncertainty about its stability and future trajectory (Figure 1.1). On the tariff front, although the end of the pause after the April 2 tariff announcement resulted in slightly lower statutory tariff rates and has not triggered retaliatory actions by US trading partners, overall US tariff rates remain well above pre-escalation levels. Meanwhile, new concerns have emerged regarding the potential economic impact (and spillovers to other economies) of tighter immigration restrictions and perceived independence of US economic institutions. These developments, alongside new concerns about longer-term fiscal sustainability in a few key advanced economies, have added to the uncertain outlook.

Figure 1.1. World Uncertainty Indices
(Index, GDP-weighted 71 countries)



Sources: Ahir, Bloom, and Furceri (2022); World Uncertainty Index (WUI); and IMF staff calculations.
Note: The WUI measures overall uncertainty across the globe. World Policy Uncertainty Index measures policy uncertainty across the globe. Both indices are GDP weighted averages for 71 countries.

Still, trade flows and economic activity have remained robust. Growth held up in the first half of 2025, with year-over-year quarterly annualized growth rates of about 3.5 percent. Although inflation has picked up somewhat or remained steady in some economies, there is limited evidence so far that higher tariffs have pushed up prices. This unexpected resilience and muted inflation response may partly reflect temporary factors, such as the frontloading of consumption and investment in anticipation of tariff hikes, trade diversion through third countries, and corporate strategies involving inventory management and the use of healthy profit margins as a buffer (October 2025 *World Economic Outlook*). As these factors fade, the impact of earlier shocks may become more evident, as hinted by weakening labor markets, softer consumer confidence, and rising core inflation and inflation expectations in the United States.

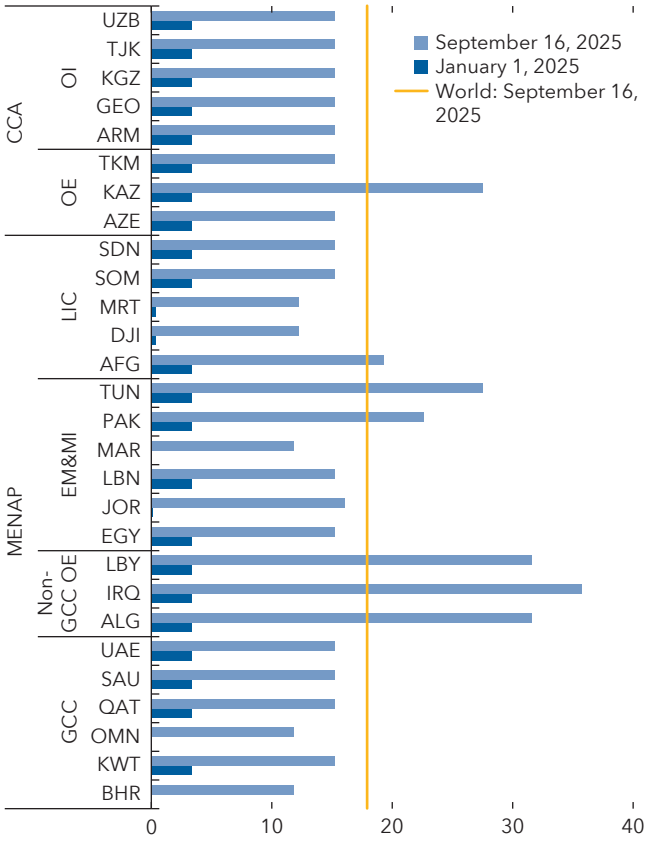
In this context, global growth is projected to slow slightly, from 3.3 percent in 2024 to 3.2 percent in 2025 and 3.1 percent 2026, although these forecasts represent a 0.4 and 0.1 percentage point upward revision from April, respectively. Advanced economies are projected to grow at 1.6 percent during 2025–26, with the United States at about 2 percent (slightly higher than the April forecast), and the euro area growing at 1.2 percent. Growth in emerging markets and developing economies is projected to moderate from 4.3 percent in 2024 to 4.2 percent in 2025, an upward revision of 0.5 percentage point compared to April. Global inflation is expected to decline to 4.2 percent in 2025 and 3.7 percent in 2026, remaining above target in the United States but staying subdued in most other regions.

[1] This chapter was prepared by Apostolos Apostolou, Vizhdan Boranova, Bronwen Brown, Eliakim Kakpo, Salem Nechi, Borislava Mircheva (lead), and Bilal Tabti.

1.2. Recent Developments: Economic Resilience amid High Uncertainty and Conflicts

Despite ongoing global uncertainty and renewed geopolitical tensions, including a short-lived conflict between the Islamic Republic of Iran and Israel in June, economies in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) and Caucasus and Central Asia (CCA) have shown resilience so far in 2025.[2] MENAP oil exporters benefited from the faster-than-expected unwinding of OPEC+ voluntary production cuts, whereas lower oil prices helped oil importers. External financial conditions have remained accommodative, with lower spreads, weaker exchange rates, strong capital inflows, and increased access to capital markets for several MENAP and CCA countries. In the CCA region, growth continued to outperform expectations, driven by robust domestic demand and strong hydrocarbon output among oil exporters, while inflation accelerated.

Figure 1.2. Effective Simple Average Tariff Rate with the United States
(Percent)



Source: World Trade Organization.
Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income economy; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

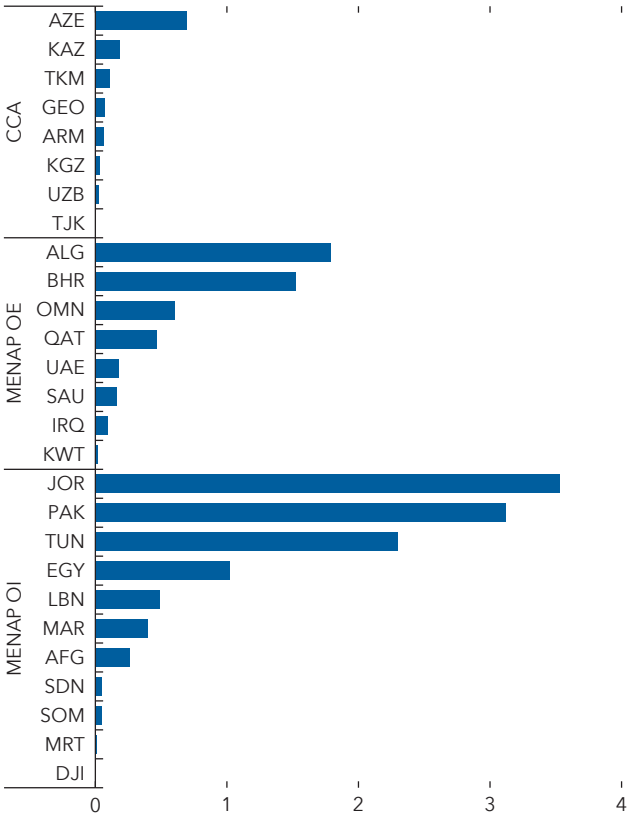
The expiration of the 90-day pause on US tariffs, announced on April 2, led to a relatively moderate increase in tariff rates for most MENAP and CCA economies. By the end of September, effective US tariff rates for most countries in these regions had converged to a range of 10–15 percent, with some notable exceptions (Algeria, Iraq, Kazakhstan, Pakistan, Tunisia) (Figure 1.2). Although these rates remain significantly higher than in 2024, the overall impact on merchandise exports is expected to be limited. This reflects the regions' low exposure to the US market—which accounts for only about 4.5 percent of their total merchandise trade—and the exemption of oil products from the new tariffs (Figure 1.3).[3]

Heightened tensions from trade disputes and regional conflicts have not had a major impact on MENAP and CCA merchandise trade so far in 2025. Between January and May, the value of merchandise exports from MENAP emerging market and middle-income economies increased by 8.0 percent compared to the same period last year, underpinned by sustained trade with China and the European Union, as well as continued expansion in intra-regional trade (Figure 1.4). Among CCA oil importers, export values increased sharply, largely because of continued rerouting of trade to Russia. Although overall the value of merchandise exports declined for oil exporters, reflecting lower oil prices compared to last year, non-oil exports have remained resilient, particularly in GCC economies. The

[2] In this chapter, the geographic grouping of the MENAP region includes Afghanistan only through 2024, as projections are not available from 2025 onward.

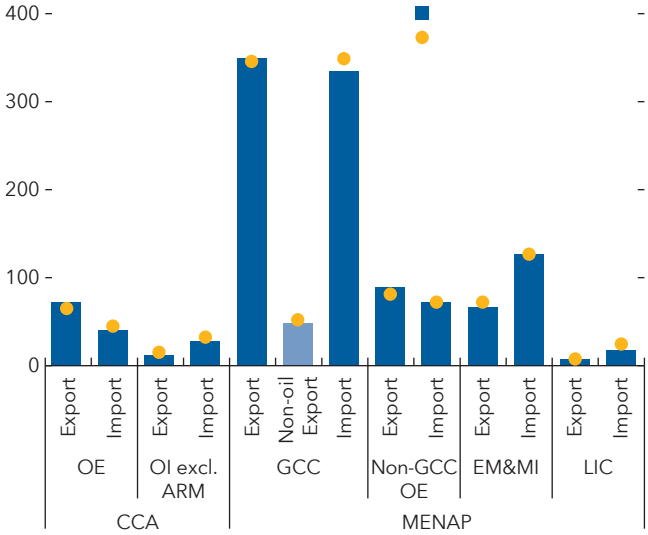
[3] These estimates should be seen as an upper bound, as they capture only the direct "partial equilibrium" impact of higher tariffs. For example, they do not account for the potential positive impact from trade diversion associated with tariffs being lower in MENAP and CCA economies compared to than those applied to competitor countries.

Figure 1.3. Estimated Export Value Losses Related to New United States Tariffs
(Percent of 2024 manufacturing exports)



Source: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Manufacturing exports refer to difference between the value of total goods exports and the value of oil exports. Predicted losses are short-term partial equilibrium estimates derived from US tariff actions as of August 18, 2025 and short-run elasticities from Boehm and others (2023). CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

Figure 1.4. CCA and MENAP Regions: Goods Trade Value, January–May 2025
(Billions of US dollars)



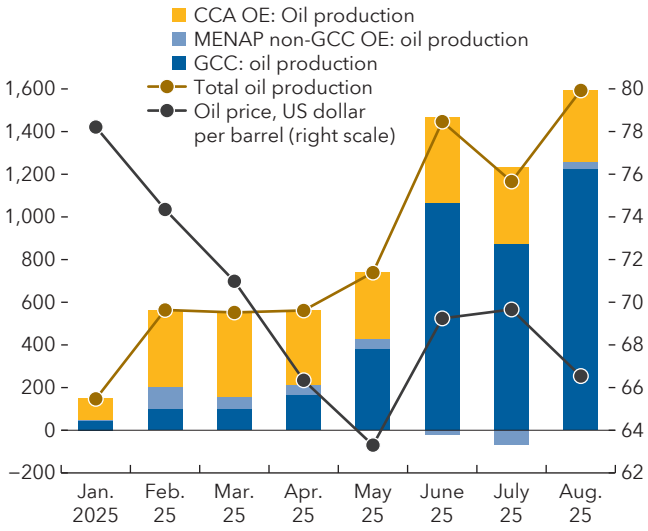
Sources: IMF, Direction of Trade database; and IMF staff calculations.
Note: GCC non-oil export includes Bahrain, Oman, Qatar, and Saudi Arabia. CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; EM&MI = emerging market and middle-income economies; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

Israel–Iran war in June had only a short-lived impact on trade transiting the Strait of Hormuz. However, trade volumes through the Suez Canal have yet to recover from the collapse experienced in 2024.

Oil production has accelerated in 2025 (Figure 1.5). Over the course of the year, OPEC+ countries fully unwound the 2.2 million barrels per day (mb/d) in voluntary cuts that were introduced in November 2023 and previously expected to remain in place until September 2026. As a result, oil production in GCC countries rose by 968,000 b/d between February and June, and by an additional 158,000 b/d between June and August. By contrast, production in MENAP non-GCC economies has remained flat because of capacity constraints, ongoing conflicts, and international sanctions. In September 2025, OPEC+ announced the start of another phased rollback of production cuts, this time from the tranche introduced in April 2023, which had been expected to last until the end of 2026.[4] Combined with tepid global demand and strong supply growth from non-OPEC+ producers, this decision helped keep oil prices relatively low. Aside from a temporary spike related to the Iran–Israel tensions in mid-June, oil prices have generally remained within the $60–$70 range since mid-2025.

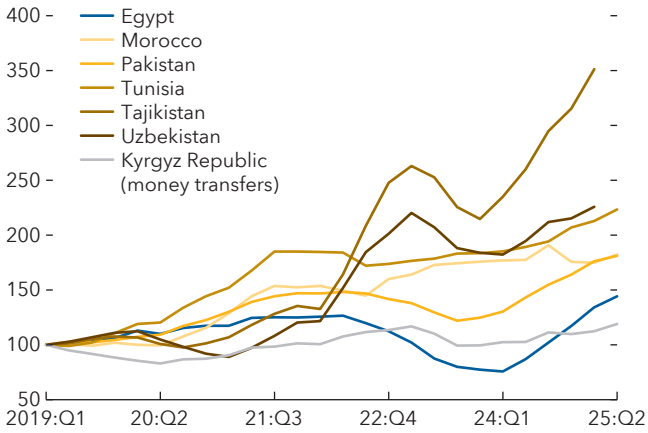
[4] The decision made in September is to restore 137,000 barrels per day starting in October 2025, out of the 1.66 mb/d overall cut introduced in April 2023. Alongside the supply restrictions of 2 mb/d introduced in November 2022 and expected to remain in effect through the end of 2026, these cuts total approximately 5.85 mb/d, or about 6 percent of global oil demand.

Figure 1.5. Change in Oil Production since December 2024 and Oil Price
(Thousand barrels per day)



Sources: Joint Organizations Data Initiative; Haver Analytics; Organization of the Petroleum Exporting Countries; Rystad; and IMF staff calculations.
Note: Saudi Arabia had temporary overproduction in June 2025 (actual of 9.752 mb/d vs. quota of 9.367 mb/d). CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

Figure 1.6. Inward Remittances
(Index, January 2019:Q1 = 100)



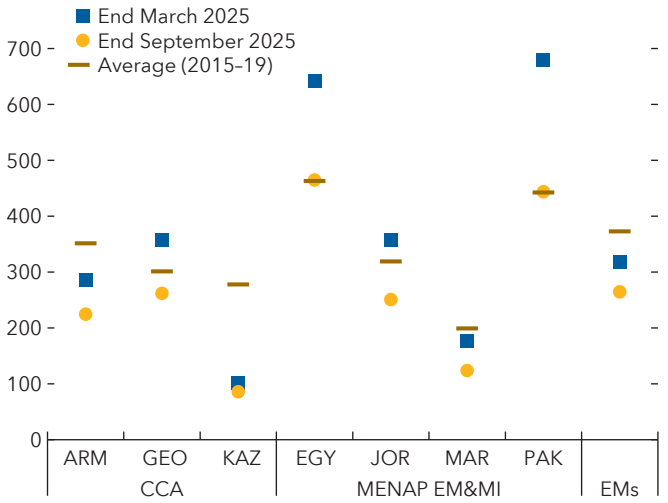
Sources: Haver Analytics: IMF, Balance of payments database; and IMF staff calculations.

Robust remittances and tourism inflows are sustaining external balances in several MENAP and CCA countries (Figure 1.6). In the MENAP region, remittances continued to accelerate in 2025, particularly in Egypt and Pakistan, contributing to improvements in current account balances. In the CCA, total inward remittances have generally increased since the onset of war in Ukraine and have continued to grow in several countries (Kyrgyz Republic, Tajikistan, Uzbekistan). In others (Armenia, Georgia), remittance inflows have plateaued but remain at elevated levels. Tourism inflows have also rebounded in some MENAP economies (Egypt, Morocco, Tunisia).

Overall financial conditions have remained supportive in 2025, despite neutral to tight monetary policy stances. Gross inflows into bonds and equities generally rebounded across the MENAP and CCA regions. Sovereign spreads continued to narrow, falling below pre-pandemic averages in some cases (Figure 1.7). Capitalizing on strong investor appetite for regional debt, several countries successfully tapped international markets in 2025. As of September 2025, cumulative bond issuance in the MENAP and CCA regions exceeded $36.8 billion, nearly matching the full-year total for 2024 and surpassing the average of the past three years. Nominal effective exchange rates generally weakened (Figure 1.8), in some cases reflecting currency pegs to the U.S. dollar (GCC economies, Jordan, de-facto in Azerbaijan). Private sector credit growth remained robust in many MENAP and CCA economies, also on account of large-scale investment projects tied to diversification efforts and infrastructure update.

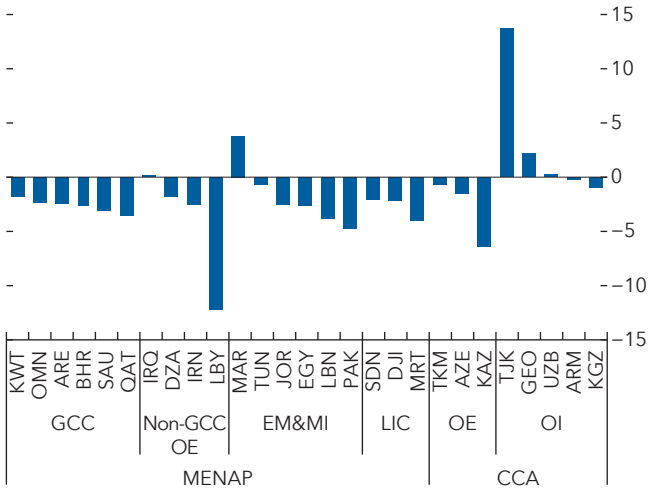
Strong domestic demand, increased oil production, and accommodative financial conditions helped sustain economic activity across most MENAP and CCA economies in the first half of 2025. In many countries, GDP growth in the first quarter—or first half—of 2025 outpaced both the 2024 average and the same period last year (Figure 1.9). In the GCC, growth remained solid, supported by robust domestic demand, driven in part by ongoing diversification efforts and the rebound in hydrocarbon production. Among MENAP oil importers, growth in 2025 benefited from strong tourism inflows (Egypt, Morocco, Tunisia), a rebound in agricultural production (Jordan, Morocco, Tunisia), rising infrastructure investment (Morocco), and resilient remittances (Egypt, Jordan,

Figure 1.7. Sovereign External Debt Spreads
(Basis points)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Government bond spreads are from J.P. Morgan Global Bond Index–Emerging Markets. Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; EMs = emerging markets; EM&MI = emerging market and middle-income economy; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

Figure 1.8. Nominal Effective Exchange Rate
(Percent change, August 2025 versus December 2024)

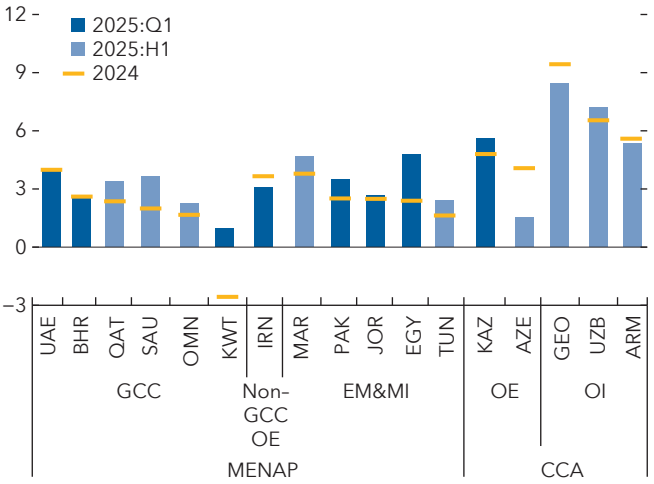


Sources: IMF, INS database; and IMF staff calculations.
Note: Negative values refer to currency depreciation. CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

Pakistan). In the CCA region, growth in 2025 accelerated in Kazakhstan and Uzbekistan, with domestic demand driven by strong credit expansion and remittances, respectively. However, growth moderated slightly (although remaining robust) in Armenia, Georgia and more noticeably in Azerbaijan, where the slow execution of public investment projects and technical issues constraining oil production weighed on activity, respectively.

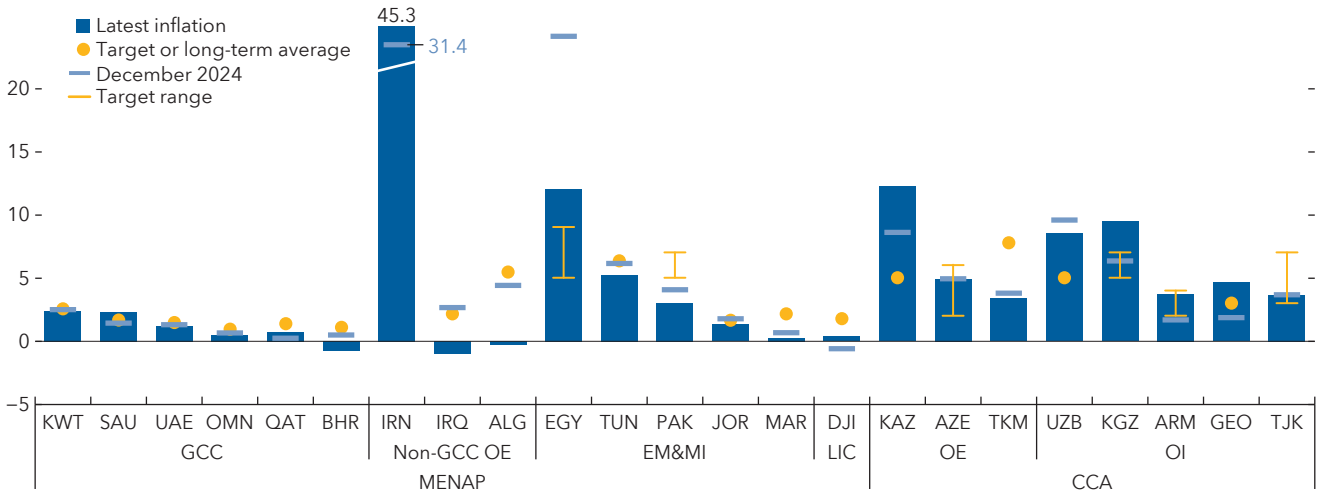
Inflation trends diverged across the MENAP and CCA regions. By July 2025, headline (year over year) inflation had fallen in most MENAP economies, remaining relatively low or close to targets or historical averages, reflecting lower food and energy prices and tight monetary policy stances (Figure 1.10). The Islamic Republic of Iran remained an outlier, with inflation rising because of exchange rate pressures, loose monetary and fiscal policies, and international sanctions. In Egypt, inflation eased from previous highs but remained elevated because of pass-through from ongoing supply shocks, currency depreciation, and energy price adjustments. By contrast, headline inflation was higher in nearly all CCA countries by July 2025 compared to the end of 2024, except for

Figure 1.9. CCA and MENAP Regions: Real GDP Growth
(Year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

Figure 1.10. CCA and MENAP Regions: Headline Inflation
(Year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Long-term average inflation is for the 2015–24 period. Data labels in the figure use International Organization for Standardization (ISO) country codes. EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income economy; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

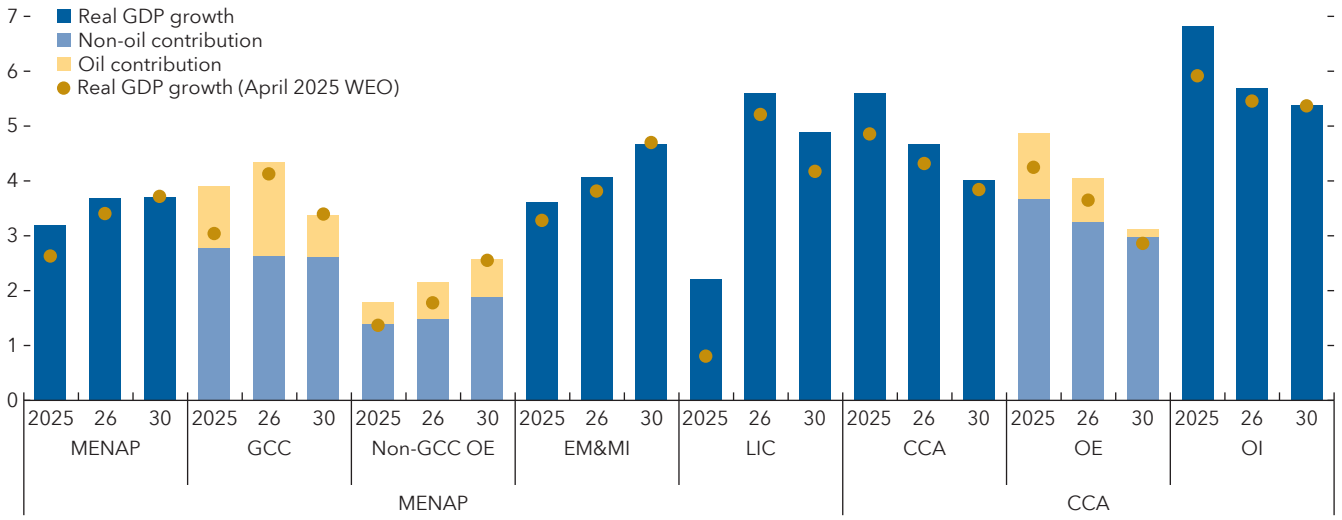
Turkmenistan. Inflationary pressures in the CCA region reflect several factors, including one-off electricity tariff reforms (Kyrgyz Republic), imported inflation mainly from Russia (the main trading partner) (Kazakhstan, Kyrgyz Republic), and demand pressures (Kazakhstan, Kyrgyz Republic).

A few countries have made progress toward peace, laying the groundwork for economic recovery. In Lebanon, the ceasefire with Israel in place since November 2024 offers hope for a period of peace and reconstruction, despite recent airstrikes and the deep economic scars left by the conflict. In Syria, a political transition has opened new economic prospects after the long-running conflict took a heavy toll on economic activity. More than half a million refugees and over 1.2 million internally displaced people have returned, placing additional strain on already significant humanitarian needs (UNHCR 2025). In Yemen, progress on the 2023 UN peace road map has stalled, but a ceasefire agreement with the United States has held since May 2025. Meanwhile, humanitarian conditions remain dire, particularly in Sudan, where the number of people in need of assistance rose sharply in 2025 compared to the previous year (OCHA 2025a), and in Gaza where more than 64,000 fatalities had been recorded by the end of July 2025 and over three-quarters of structures were either damaged or destroyed (OCHA 2025b).

1.3. Outlook: From Economic Resilience to Stronger Growth

GDP growth in the MENAP region is projected to strengthen in 2025 at a faster pace than anticipated in May. Upward revisions reflect stronger oil production among oil exporters, continued progress on structural reforms in key emerging market and middle-income economies, and improved agricultural production. GDP growth in the CCA region has also been revised upward, supported by buoyant domestic demand and strong hydrocarbon production growth. Medium-term growth projections remain broadly unchanged, pointing to a gradual acceleration in MENAP because of payoffs from structural reforms and macroeconomic stabilization efforts. By contrast, growth in the CCA is expected to moderate over the medium term as it returns to potential after recent years of rapid expansion. Inflation in the MENAP region is expected to remain subdued or decline gradually in 2025–26,

Figure 1.11. CCA and MENAP Regions: Real GDP Growth Forecast
(Year-over-year percent change)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer; WEO = *World Economic Outlook*.

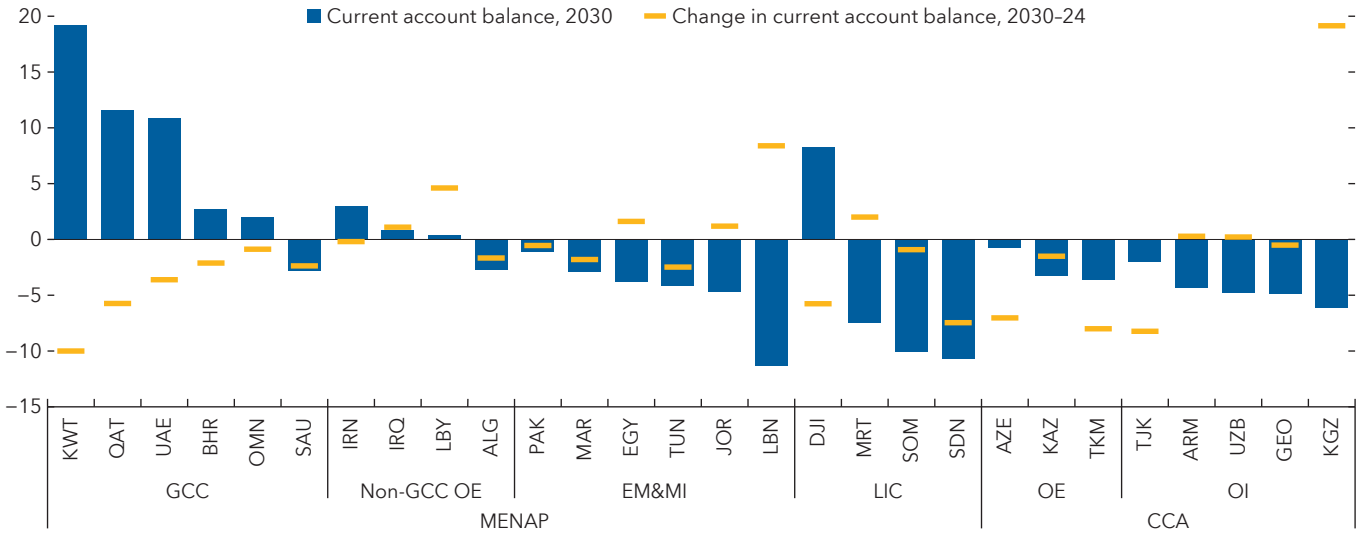
reflecting lower food and energy prices and conservative fiscal and monetary policy stances. In CCA economies, however, inflation is projected to rise in 2025 because of continued strong demand pressures, before beginning to decelerate in 2026.

The economic resilience observed so far in 2025 has led to an upward revision of growth projections compared to May. GDP growth in the MENAP region is now projected to reach 3.2 percent in 2025, up from 2.1 percent last year, an upgrade of 0.6 percentage point compared to May (Figure 1.11). This revision reflects the factors that have sustained economic activity amid high global uncertainty: increased oil production and robust domestic demand among oil exporters;[5] continued positive impacts from reform efforts (Jordan); further macroeconomic stabilization efforts (Egypt); stronger investment (Morocco); and a rebound in agricultural production because of favorable climatic conditions (Morocco, Pakistan, Tunisia) and expanded arable land (Sudan). However, growth projections for some MENAP low-income countries (LICs) have been revised down because of lower gold production (Mauritania) and cuts in foreign aid (Somalia). Growth projections for the CCA region have been raised to 5.6 percent for 2025, slightly above last year's 5.5 percent, and 0.7 percentage point higher than the May projection. This upgrade reflects stronger hydrocarbon production (Kazakhstan) and strong domestic demand fueled by credit growth (Armenia, Georgia, Kazakhstan) and fiscal expansion (Armenia, Kazakhstan, Kyrgyz Republic).

Medium-term growth projections have remained largely unchanged since May, with expectations of stronger growth in MENAP and a gradual slowdown in the CCA region. In MENAP, the favorable outlook is mainly because of higher growth in a few emerging markets and LICs, driven by expected payoffs from structural reforms (Egypt, Jordan, Morocco) and post-conflict macroeconomic stabilization efforts (Somalia, Sudan), respectively. Pakistan's growth is projected to increase to 3.6 percent in 2026, supported by steady reform implementation and improving financial conditions and confidence. In the GCC economies, growth is projected to accelerate to about 4.1 percent in 2026–27 as continued strong domestic demand drives non-oil growth alongside higher oil production, before moderating to about 3.4 percent, reflecting lower oil production while non-oil growth

[5] Oil production in the MENAP region is projected to reach 25.7 mb/d in 2025, 200,000 b/d higher than projected in May 2025 and 400,000 b/d above 2024 levels.

Figure 1.12. CCA and MENAP Regions: Current Account Balance
(Percent of GDP)

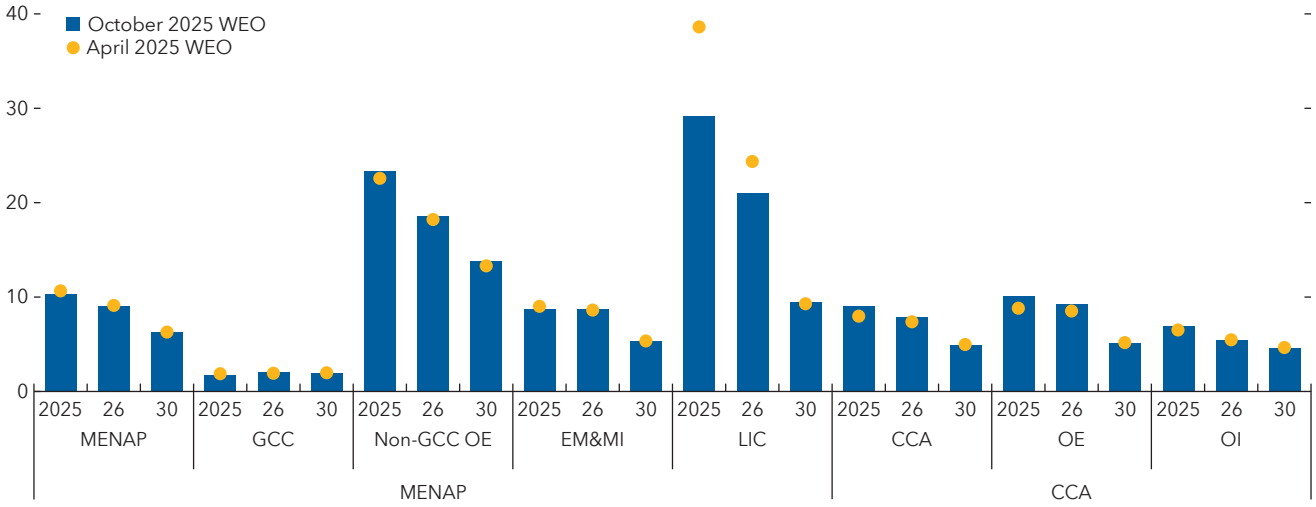


Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

stabilizes at robust rates. By contrast, in non-GCC oil exporters, continued heavy dependence on oil production and slower progress on structural reforms and economic diversification are expected to result in medium-term growth that hovers around 2.6 percent. In the CCA, growth is projected to slow gradually to around 4 percent over the medium term, as the effects from the war in Ukraine fade and hydrocarbon production levels off.

External positions are projected to worsen over time in many MENAP and CCA economies, though at a slower pace than projected in May. Despite an upward revision of about 2.5 percentage points of GDP for 2025–26—largely reflecting higher oil production—the weighted current account surplus of GCC economies is still expected to narrow from 7.1 percent of GDP in 2024 to about 3.7 percent in 2030, because of lower oil export revenues and increased imports related to ongoing diversification efforts (Figure 1.12). In non-GCC oil exporters, Algeria's current account deficit is expected to widen in the near term, reflecting lower oil prices and limited production gains. By contrast, Iraq's external position is projected to improve over the medium term because of fiscal consolidation and a gradual increase in oil exports. Among MENAP oil importers, the current account deficit in 2025 is expected to widen slightly in Morocco and Tunisia, while remaining broadly stable in Jordan as robust demand boosts imports. Over the medium term, external positions are projected to strengthen gradually in Jordan and Egypt (as exports benefit from the normalization of regional trade and sustained growth in tourism inflows). Conversely, they are expected to deteriorate moderately in Morocco (because of rising investment-related imports ahead of the FIFA 2030 World Cup) and Tunisia (because of projected weaker export dynamism). Among MENAP LICs, external positions are expected to weaken over the medium term in Djibouti, Somalia, and Sudan because of robust import momentum associated with port expansion and renewable energy projects (Djibouti), a normalization of imports to pre-conflict levels to support reconstruction efforts (Sudan), and lower official grants (Somalia). In the CCA region, current account deficits are projected to widen in both the near and medium term among oil exporters, reflecting lower hydrocarbon prices and declining oil and gas production. In Tajikistan, external balances are expected to weaken as remittances normalize with easing labor demand

Figure 1.13. CCA and MENAP Regions: Headline Inflation Forecast and Revisions
(Year-over-year percent change, end of period)



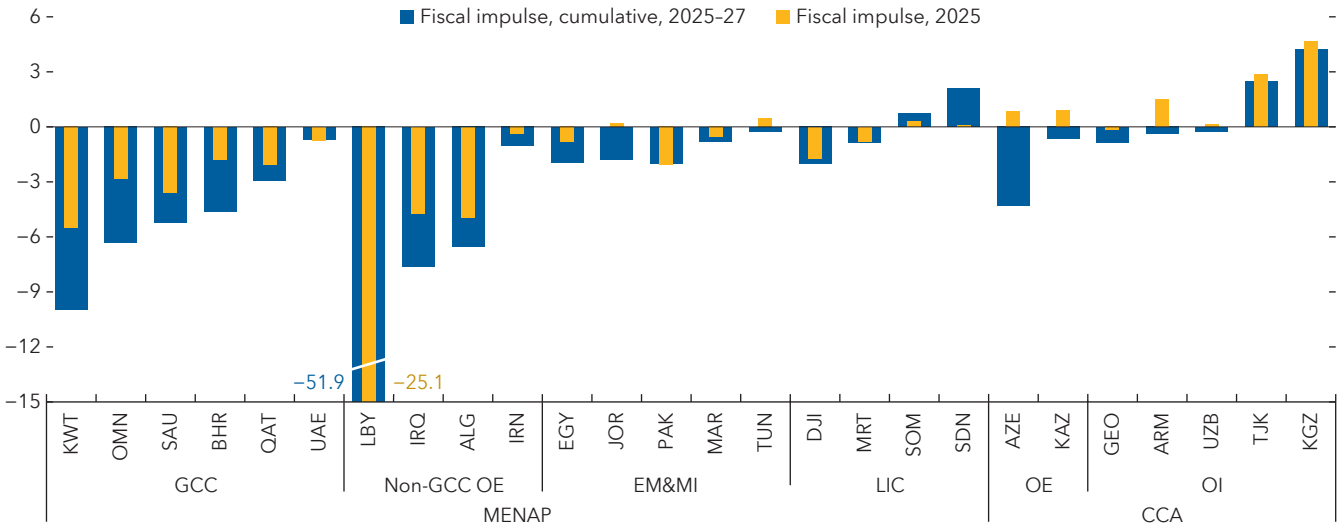
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income country; MENA = Middle East and North Africa; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer; WEO = *World Economic Outlook*.

in destination countries.[6] Across most MENAP and CCA countries, reserve import coverage is expected to decline. Nonetheless, GCC and CCA oil exporters are projected to maintain substantial external reserves that can provide significant buffers.

Inflation is projected to ease over the medium term across both regions. In the MENAP region, inflation in GCC economies is expected to remain stable and moderate, averaging about 2 percent over the forecast horizon. Among non-GCC oil exporters, inflation is expected to decline but remain relatively high, especially in the Islamic Republic of Iran, where annual inflation is projected to reach 45 percent by the end of 2025 (Figure 1.13). For MENAP oil importers, inflation is projected to remain low in Jordan and fall from elevated levels in Egypt, supported by the waning effects of past currency depreciation and energy price hikes, while it is expected to decelerate only slightly in Tunisia, owing to continued monetary financing of fiscal deficits. In Pakistan, while inflation has decelerated significantly this year thanks to lower food and energy prices, it is expected to increase in 2026 on account of the normalization of these prices and the phasing out of short-term electricity subsidies. In some conflict-affected economies, including Lebanon and Sudan, significant inflationary pressures are expected to moderate, supported by progress in macroeconomic stabilization. In the CCA region, after increasing in 2025 in all countries except for Uzbekistan, inflation is projected to fall slowly, as domestic demand also slows on account of tighter fiscal policy stances. The only exceptions are Turkmenistan, where inflation is expected to gradually pick up and stabilize at an elevated level (8 percent) due to looser monetary policy and higher public sector wages and pensions, as well as Tajikistan, where inflation is projected to rise gradually although remaining within the 5 ±2 percent target range over the forecast horizon.

[6] Among CCA oil importers, the Kyrgyz Republic is projected to see a marked improvement in its current account balance. However, this largely reflects a methodological change: beginning in 2025, revenues from re-exports will be classified as proper export revenues, rather than being recorded as errors and omissions.

Figure 1.14. CCA and MENAP Regions: Fiscal Impulse
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: The fiscal impulse is calculated as the difference between the primary fiscal balance, with a negative sign (so a negative fiscal impulse implies a tighter fiscal policy stance). The definition of the primary fiscal balance varies by country: for oil exporters, it refers to the annual non-oil primary fiscal balance expressed as a percentage of non-oil GDP; for oil importers, it refers to the cyclically adjusted primary fiscal balance as a percentage of GDP. Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

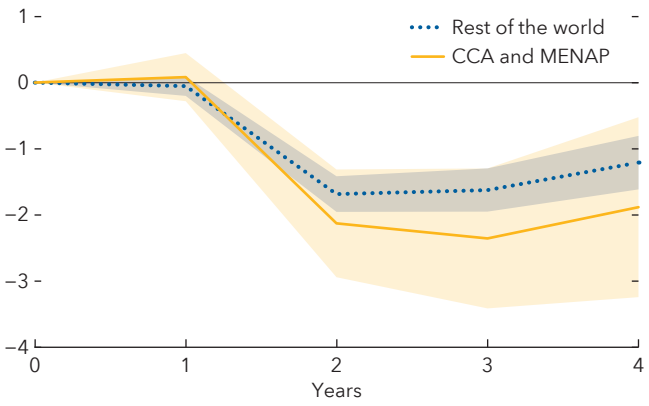
In most MENAP economies, the fiscal policy stance is projected to be contractionary, while in the CCA region, some fiscal consolidation is expected to begin in most countries from 2026 onward.[7] Among MENAP oil exporters, non-oil primary fiscal balances are set to strengthen, supported by spending rationalization efforts (Algeria, Kuwait, Oman, Saudi Arabia) and by efforts to mobilize non-hydrocarbon revenues (Iraq), resulting in a negative fiscal impulse (Figure 1.14). In MENAP oil importers, cyclically adjusted primary fiscal balances are projected to improve, as tax policy and tax administration reforms help mobilize tax revenues (Egypt, Jordan, Morocco, Pakistan) and energy subsidy reforms help contain spending (Egypt, Morocco, Pakistan). Among MENAP LICs, the fiscal stance is expected to improve in Djibouti and Mauritania, while primary fiscal balances are expected to deteriorate in Sudan (mainly on account of reconstruction spending) and Somalia (because of lower external grants). In CCA economies, fiscal stances are generally projected to be expansionary in 2025 but to turn contractionary from 2026 onward, driven by declining capital expenditures (Azerbaijan) and fiscal reforms boosting non-oil revenue (Kazakhstan). The main exceptions are the Kyrgyz Republic and Tajikistan, where fiscal policy is projected to remain expansionary in the medium term, mainly on account of higher capital spending.

1.4. Risks: Will Resilience Last?

Risks to the outlook remain tilted to the downside. Although high global uncertainty has not yet adversely affected MENAP and CCA economies, a lagged negative impact cannot be ruled out. Fiscal concerns and greater-than-projected inflationary pressures in key advanced economies may lead to higher-for-longer interest rates, which would particularly affect countries in the region with high government financing needs, banking sectors more exposed

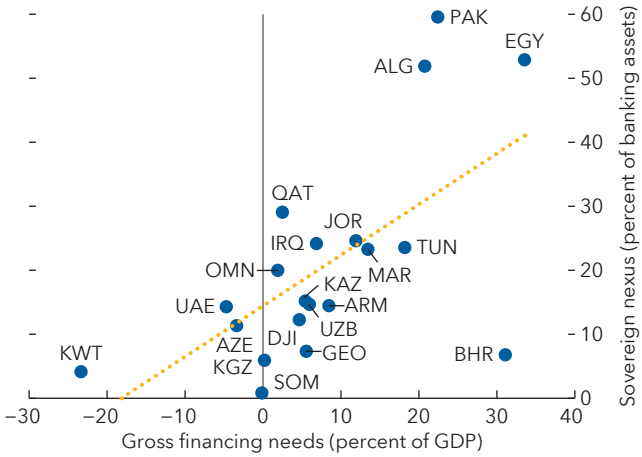
[7] One caveat of this assessment is that changes in general or central government budgets may only partially capture the degree to which fiscal policy affects growth in those MENAP and CCA economies where a sizable portion of stimulus occurs through off-budget spending by state-owned enterprises or Sovereign Wealth Funds. Limited data on the full public sector's impulse to economic activity prevents such an assessment.

Figure 1.15. CCA and MENAP Regions: Impacts of Global Uncertainty Shocks on Real GDP Growth
(Percent, impact of a one standard deviation shock on uncertainty)



Source: IMF, May 2025 *Regional Economic Outlook: Middle East and Central Asia*.
Note: CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

Figure 1.16. Sovereign Nexus and Gross Financing Needs, 2024



Sources: Haver Analytics; IMF, International Finance Statistics database; Regional Economic Outlook database; World Economic Outlook database; and IMF staff calculations.
Note: The sovereign nexus is calculated as banks' net claims on central, state, local governments, and state-owned enterprises, as a share of total bank assets. For Bahrain, it includes only bank claims on the general government. Data labels in the figure use International Organization for Standardization (ISO) country codes.

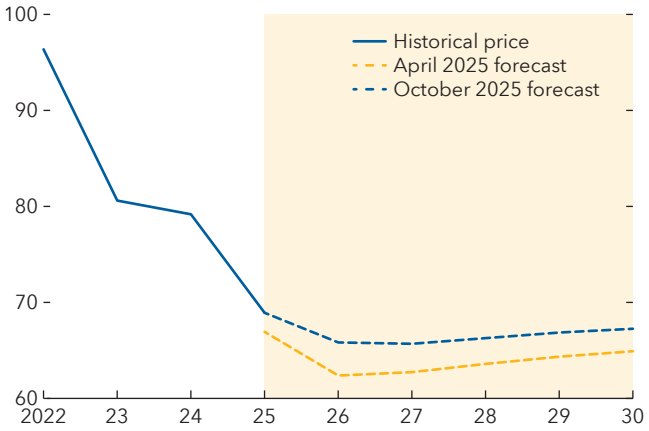
to sovereign risk, and greater reliance on foreign financing. Renewed geopolitical tensions continue to pose a persistent risk; however, there is potential upside from a faster-than-expected resolution of conflicts and a more aggressive implementation of long-standing structural reforms.

Persistent high global uncertainty represents a key downside risk. IMF analysis shows that a 1 standard deviation shock to the World Uncertainty Index is associated with average output losses in the MENAP and CCA regions peaking at about 2.5 percent two years after the shock (Figure 1.15) (see Chapter 2, May 2025 *Regional Economic Outlook: Middle East and Central Asia*). Output losses associated with higher uncertainty appear primarily through reduced domestic demand dampening consumption and investment (and associated imports) as well as lower exports.

A key channel of contagion could be a tightening of global financial conditions. A sharp repricing of stocks amid elevated valuations, particularly in technology and AI-related sectors, could hurt wealth and consumption. Several advanced economies are projected to run sizable fiscal deficits amid historically elevated levels of public debt (see the October 2025 *Global Financial Stability Report)*. Heightened concerns over fiscal sustainability could contribute to a rise in term premiums, especially if compounded by uncertainties related to geoeconomic fragmentation and global trade disputes. Additionally, stronger-than-expected inflationary pressures from persistently elevated tariffs may prompt central banks to adopt a more restrictive monetary policy stance than assumed in the baseline. With sovereign spreads already compressed relative to historical standards, this could translate into a higher cost of funding for MENAP and CCA economies. Higher borrowing costs may exacerbate fiscal and financial vulnerabilities across the two regions, particularly in economies with elevated projected government gross financing needs and banking sectors that hold relatively large shares of sovereign bonds on their balance sheets (Algeria, Egypt, Pakistan) (Figure 1.16).

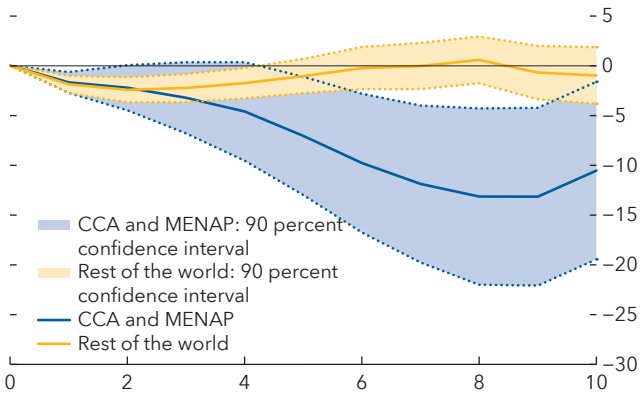
Signs of rapidly rising real estate prices in some GCC economies—amid rapid credit growth and high valuations—pose some concern. These challenges are compounded by data limitations, including the absence of real estate and property price indices (Bahrain, Kuwait), and the need for greater consistency in daily property transaction

Figure 1.17. Oil Prices
(US dollars per barrel)



Source: IMF, World Economic Outlook database.

Figure 1.18. 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. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

data (Qatar). In some CCA countries, rising levels of distressed assets—especially in the construction, consumer, and mortgage segments—could heighten vulnerability to a reversal in consumer sentiment or a correction in house prices.

A sharper-than-projected depreciation of the US dollar could have varied implications for the MENAP and CCA regions. For oil importers with more exchange rate flexibility, an appreciation of local currencies could help ease inflationary pressures, reduce the import bill, lower the local currency cost of US dollar-denominated debt, and ease external financing conditions by increasing demand for domestic assets. For oil exporters with exchange rates pegged to the US dollar, further weakness in local currencies could improve the competitiveness of non-oil exports (including tourism) but also raise the cost of imports, particularly from Asia and Europe, contributing to imported inflation. This effect may be tempered by the fact that a substantial share of imports is invoiced in US dollars (for instance, approximately 80 percent of Saudi Arabia's imports). Conversely, a sudden and steep reversal of the recent decline in the US dollar could deter capital and financial inflows into the region, compounding the impact of reduced official grants due to cuts in international aid.

Risks associated with oil prices are relatively balanced. Under the baseline, oil prices are projected to average around $69 per barrel in 2025, falling to $66 in 2026 and remaining at that level through 2030, based on early September 2025 futures prices. This is well below the 2024 average of $79 per barrel (Figure 1.17). A faster rebound in production among OPEC+ members, combined with weaker-than-expected global demand, could lead to an oversupply and push oil prices below the baseline, negatively affecting the fiscal and external positions of oil exporters. On the other hand, an escalation of geopolitical tensions in the region—including the possibility of additional sanctions on Russian and Iranian exports—could drive prices higher. Although this would improve prospects for regional oil exporters, it could pose challenges for oil-importers, particularly those with high fuel subsidies, heavy reliance on imported fuel, and relatively high energy intensity of GDP.

Although geopolitical tensions have so far been contained, they remain a main risk for MENAP and CCA economies. The recent Iran–Israel war was short-lived, but the risk of renewed—and potentially broader—escalation remains acute, with possible spillovers to neighboring countries. These could include increased refugee flows as well as logistical and energy supply disruptions. At the same time, the unresolved Gaza crisis could undermine regional economic and trade stability to a greater extent than currently assumed in the baseline.

Beyond the immediate impact, conflicts impose long-lasting economic costs. Chapter 2 of the April 2024 *Regional Economic Outlook: Middle East and Central Asia* found that in the MENAP and CCA regions, output per capita remains, on average, about 10 percent below its pre-conflict trend a decade after the start of a severe conflict (Figure 1.18). Bordering economies are also affected, with per capita output dropping immediately by about 1.5 percent and a further 6 percent over 10 years.

The CCA region remains vulnerable to the ongoing war in Ukraine, with risks closely tied to the timing and nature of any eventual peace agreement, its broader geopolitical implications, and complex spillover effects. An escalation of the conflict and related sanctions on Russia could negatively affect tourism, trade, remittances, and investment flows, while exacerbating currency depreciation pressures that could fuel inflation. Bilateral sanctions may give rise to regulatory risks for financial institutions, including pressure on correspondent banking relationships, which would require continued investment to strengthen anti-money laundering and counter-terrorism financing (AML/CFT) frameworks, as well as enhanced due diligence by banks. However, a protracted conflict scenario—accompanied by more severe bilateral sanctions—could also lead to sustained capital and migrant inflows from Russia, along with increased trade re-routing through CCA economies. Although such dynamics could temporarily boost demand and support external balances, they are likely to heighten financial integrity and legal risks, particularly if the origin of funds is illicit. Moreover, these inflows are unlikely to be sustainable over the long term.

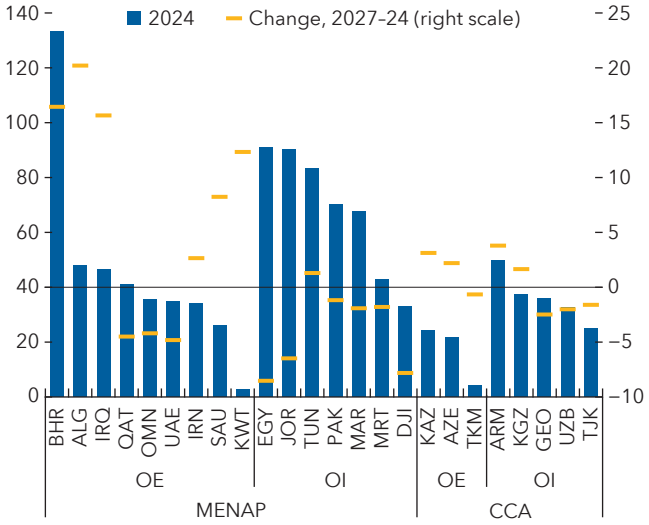
The MENAP and CCA regions are also exposed to the recurrence of severe climate events. Renewed episodes of drought could harm economic activity and employment in countries highly dependent on agricultural production (Egypt, Morocco, Tunisia). The severe flooding in Pakistan during the third quarter of 2025 may have more adverse effects on growth, inflation, and the current account than currently estimated, although these impacts remain highly uncertain.

There are also a few upside risks to the current projections. In many MENAP economies, faster implementation of structural reforms could yield stronger economic gains than currently reflected in the baseline. In conflict-affected countries, a swift and lasting resolution of such conflicts could accelerate reconstruction efforts under enhanced regional and international cooperation, paving the way for broader reforms and improved governance. In the CCA region, medium-term growth could exceed current projections if the positive effects of recent developments—largely related to spillovers from the war in Ukraine and multiyear infrastructure investment projects—prove more enduring than anticipated, potentially lifting potential output above baseline estimates (see Box 1.1). Additionally, a peace agreement between Armenia and Azerbaijan could open the door to greater regional cooperation and integration.

1.5. Policies: Build Buffers, Strengthen Resilience, and Seize Opportunities

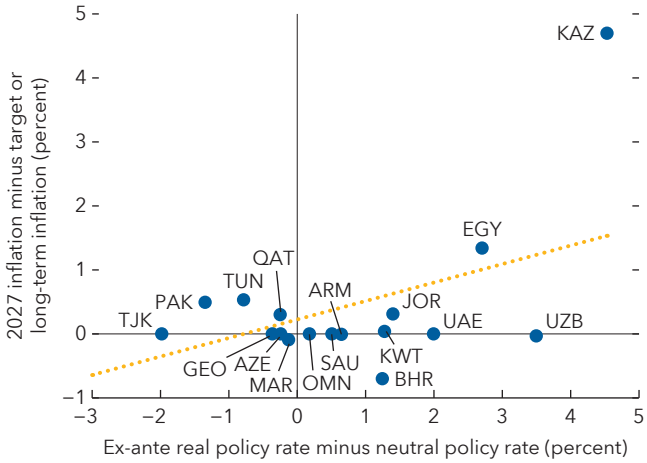
The persistence of downside risks underscores the need for cautious macroeconomic policies that prioritize buffer building, alongside bold structural reforms to enhance resilience against adverse shocks. The relatively conservative fiscal policy stance embedded in current projections appears appropriate, given the expected acceleration of growth in many MENAP economies and the return to potential growth levels in the CCA region. In countries experiencing persistent inflationary pressures, a tight monetary policy stance should be maintained until inflation expectations are clearly aligned with target levels. To better withstand global shocks, some countries may need to enhance their institutional fiscal and monetary policy frameworks to more effectively anchor long-term fiscal and inflationary expectations. Given existing vulnerabilities, robust financial sector frameworks and targeted macroprudential measures are crucial to containing emerging risks and safeguarding financial stability. Structural reforms aimed at economic diversification and private sector development remain essential for capitalizing on opportunities presented by a changing global economic landscape. Accelerating the adoption of artificial intelligence (AI) will be important for supporting income convergence; however, accompanying policies must be

Figure 1.19. CCA and MENAP Regions: General Government Gross Debt
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

Figure 1.20. Monetary Policy Stance



Sources: Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.
Note: The ex-ante real policy rate is equal to the difference between the nominal policy rate and the projected (end of period) inflation rate in 2027. The natural rate is estimated in Chapter 2 of the May 2023 *Regional Economic Outlook: Middle East and Central Asia*. For Gulf Cooperation Council economies, an inflation target of 2 percent is considered. The dashed line corresponds to a linear fit. Data labels in the figure use International Organization for Standardization (ISO) country codes.

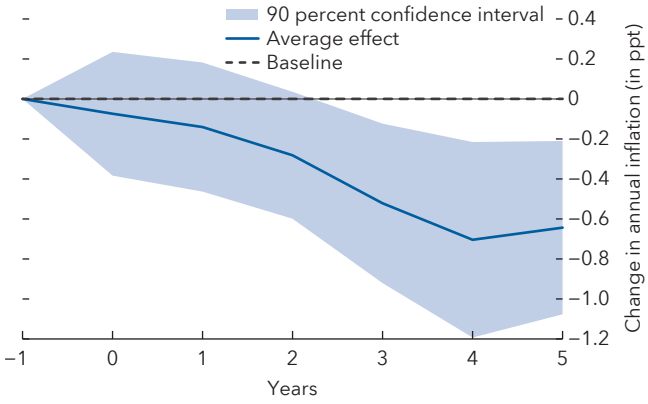
carefully designed to minimize the risk of job displacement, particularly among youth. For countries emerging from conflict, a successful economic recovery will require swift progress in securing macroeconomic stabilization, strengthening institutions, and improving access to financing.

Countries with limited fiscal space should prioritize rebuilding margins of maneuver to prepare for potential downside risks. Fiscal positions in MENAP and CCA economies have generally improved since the deterioration associated with the pandemic crisis, in line with the rebound in growth. However, in some cases, fiscal deficits remain above pre-pandemic levels (Armenia, Libya, Tunisia), and public debt is projected to rise over the medium term (Algeria, Bahrain, Iraq) or stabilize at, or modestly decline from, relatively high levels (Egypt, Jordan, Morocco, Tunisia) (Figure 1.19). Rebuilding fiscal buffers in these economies would require a credible process of fiscal consolidation, carefully calibrated to the current stage of the business cycle and the need to sustain investment critical for long-term growth– while minimizing the burden on the most vulnerable populations. This process should combine efforts to mobilize fiscal revenues—such as narrowing tax gaps and reducing informality—with measures to rationalize current spending. Priorities include better control of public wage bills, which remain elevated in many countries, and more targeted and efficient income support and social protection programs, as recently implemented in Egypt and Morocco.

There is also room to improve fiscal frameworks to better anchor long-term fiscal expectations. Although several countries have recently strengthened their fiscal frameworks, MENAP and CCA countries continue to lag other emerging markets, as measured by the IMF's Fiscal Rule Strength Index. Chapter 2 of the October 2025 *World Economic Outlook* shows that strong fiscal frameworks can help anchor private sector expectations of future fiscal policy by lending credibility to official (budget) projections and reinforcing commitment to medium-term debt sustainability. Consistent with this finding, staff empirical analysis shows that countries with *strong fiscal rules*—those that are legally grounded, transparent, well-monitored and enforced, and resilient to shocks—tend to experience lower sovereign risk premiums This, in turn, can help expand available fiscal space and allow stronger countercyclical fiscal responses to negative shocks (Box 1.2).

Monetary policy should continue to ensure price stability. As noted above, medium-term inflation is projected to remain elevated—and above target levels—in a few MENAP and CCA economies (Egypt, Kazakhstan, Tunisia), warranting a restrictive monetary policy stance (Figure 1.20). In countries where inflation is projected to converge toward central bank targets, a return to a more neutral or accommodative stance should be carefully calibrated. For countries with fixed exchange rate regimes, monetary policy must remain consistent with maintaining the peg. In countries with more flexible exchange rates, any monetary easing should remain contingent on clear evidence that inflation expectations are firmly anchored. Across all regimes, monetary policy decisions should be communicated clearly and transparently, with a strong emphasis on safeguarding the actual and perceived independence of central banks. Extensive literature shows that compromising central bank independence leads to higher inflation and risk premiums, eventually requiring a more prolonged period of tight monetary policy to re-anchor expectations. These risks are amplified when monetary policy decisions are perceived as motivated by efforts to lower public financing needs. Forthcoming IMF research (Gershenson and others forthcoming) finds that a 1 standard deviation improvement in central bank independence in the MENAP region could lead to a cumulative decline in inflation of between 0.5 and 0.75 percentage point (compared to the baseline) after four years (Figure 1.21). Finally, maintaining financial stability would require close monitoring of the impact of potential tighter financial conditions on bank asset quality. Authorities should stand ready to recalibrate macroprudential policies as needed and continue strengthening supervisory and regulatory frameworks.

Figure 1.21. MENAP Region: Estimated Cumulative Impact of Increase in Central Bank Independence Index on Inflation



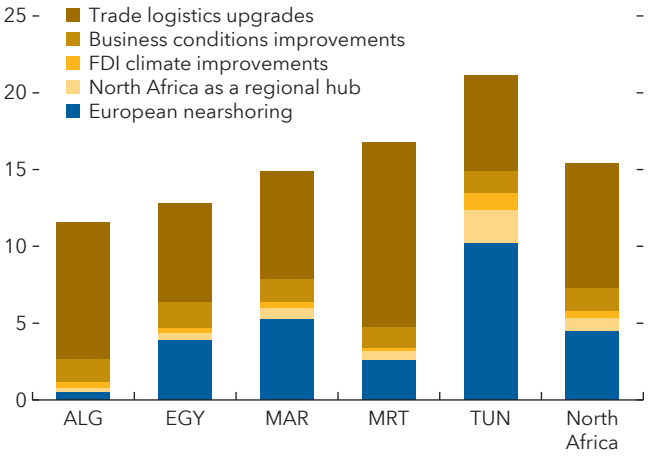
Sources: Gershenson and others (forthcoming); and IMF staff calculations.
Note: MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

Given the risk of more frequent global shocks going forward, there may be a greater role for exchange rate flexibility to help cushion the impact of such shocks to economic activity. Staff empirical analysis in Box 1.3 shows that the effectiveness of exchange rate flexibility as a shock absorber is greater as countries deepen financial markets and diversify away from commodities. Using a standard IMF macro-economic model, the box also shows that the adoption of a credible inflation targeting monetary policy regime with more flexible exchange rates could reduce the output losses associated with an adverse global scenario in both MENAP and CCA economies.

Building resilience against future shocks and seizing opportunities in the evolving global trade landscape would also require an acceleration of structural reforms. Recent reforms have played a significant role in sustaining growth across the MENAP and the CCA regions. Reforms have included tax and energy sector measures in Pakistan, energy price reform in Uzbekistan, and diversification agendas in Jordan, Morocco, and Saudi Arabia. These initiatives have strengthened resilience and supported durable, private-sector-led growth. Nonetheless, further progress is needed in several longstanding and emerging areas, including:

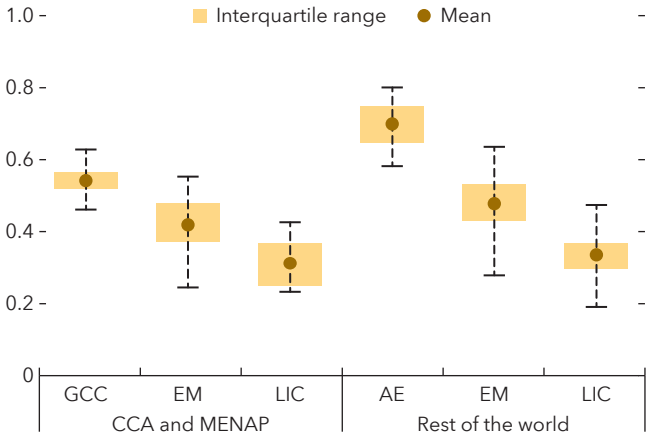
- *Private Sector Development.* A dynamic and resilient private sector is essential for job creation and economic diversification in the region. In many MENAP and CAA economies, private sector development remains hindered by persistent market barriers that limit market entry for new firms and constrain the growth of small businesses and startups. Addressing these challenges will require continued reforms to reduce the dominant role of state-owned enterprises, streamline burdensome government regulations, enhance financial inclusion (especially of small and medium-sized enterprises), and improve general governance.

Figure 1.22. North Africa: Real Export Gains from Higher Integration with the European Union and Sub-Saharan Africa
(Percent deviation from baseline)



Sources: Rayner and others (forthcoming).
Note: Data for North Africa are calculated as simple averages of the data for individual countries. Data labels in the figure use International Organization for Standardization (ISO) country codes.

Figure 1.23. Artificial Intelligence Preparedness, 2023
(Index, 0 to 1)



Sources: Cazzaniga and others (2024); and IMF staff calculations.
Note: EM includes both oil-importing and oil-exporting emerging markets. AE = advanced economy; CCA = Caucasus and Central Asia; EM = emerging market; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

- *Trade Diversification*. Tackling structural barriers to deeper integration can allow the MENAP and CCA regions to diversify export markets, improve regional connectivity, and capitalize on opportunities arising from the ongoing restructuring of global supply chains. Forthcoming IMF research (Rayner and others forthcoming) shows that a package of reforms that increase North Africa's economic linkages with Europe and Sub-Saharan Africa by improving trade logistics, fostering nearshoring, promoting trade liberalization, and strengthening the business environment would boost North Africa's real exports by 10 percent after 5 years, thereby accelerating income growth and job creation (Figure 1.22).[8]
- *AI Preparedness*. The advent of generative AI presents an opportunity for countries in the MENAP and CCA regions to boost productivity and accelerate economic transformation. IMF research shows that emerging markets and LICs in these regions lag somewhat behind GCC economies and their peers in other regions in terms of AI preparedness (Figure 1.23). This gap mainly reflects shortcomings in digital infrastructure, regulation, and innovation (Cazzaniga and others 2024).[9] Rapid progress in these areas would be needed to prevent a further widening of the income gap with more advanced economies.
- *Labor Market Reforms*. Although the adoption of AI could boost productivity, recent IMF research suggests it could also reduce job opportunities for young people.[10] This poses a particular challenge for MENAP and CCA economies, which already face much higher youth unemployment rates compared to peer regions (Figure 1.24). To minimize the risk that AI adoption exacerbates this issue, governments should invest in human

[8] Rayner and others (forthcoming) assess the potential gains to North African economies from trade logistics upgrades (improvements in logistics performance), business conditions improvements (increase in labor productivity), FDI climate improvements (increase in sectoral productivity through tariff and non-tariff barrier reductions), European nearshoring (greater demand from Europe for tradeable goods from North Africa), and efforts to promote North Africa as a regional hub (reduction in tariffs and non-tariff barriers within North Africa and with rest of the world).

[9] Cazzaniga and others (2024) builds an index of AI preparedness across countries based on four key areas relevant for AI adoption: (1) digital infrastructure (capturing accessible and affordable internet and mature e-commerce infrastructure); (2) human capital and labor market (quality of education, digital skills, labor market flexibility); (3) innovation and integration (capturing innovation capacity and trade and financial openness); and (4) regulation and ethics (strong legal frameworks).

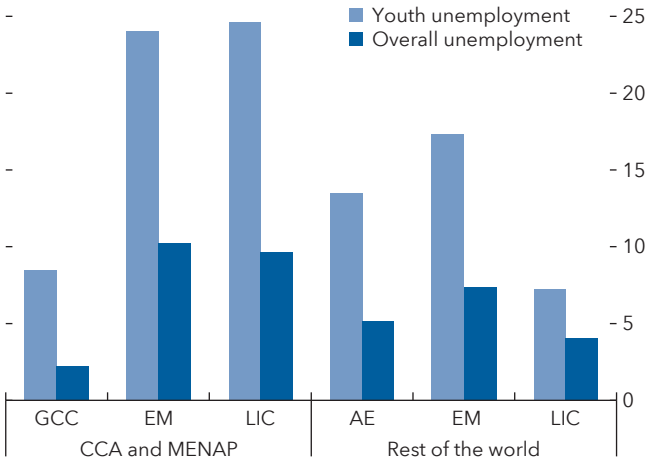
[10] Brynjolfsson and others (2025) and Lichtinger and Hosseini Maasoum (2025) find that AI adoption in the United States was associated with a decline in the employment of early-career workers, consistent with the automation of routine cognitive tasks often performed by more junior workers.

capital, implement more effective active labor market policies, update labor codes that encourage flexible job formats, and provide targeted support for young job seekers.

In economies emerging from conflict, Chapter 2 shows that a successful economic recovery will require swift progress in the following areas:

- *Macroeconomic stabilization.* Efforts to stabilize the macroeconomy are needed to lay the foundation for recovery and lasting peace. In the short term, reducing volatility in real output growth and inflation can increase the odds of a successful economic recovery. On the monetary side, inflation could be contained through currency reform, the elimination of monetary financing, and the rebuilding of foreign exchange reserves. On the fiscal side, controlling expenditure and boosting domestic revenue mobilization can create space for essential reconstruction and social spending, including the protection of basic services, and humanitarian aid.
- *Adequate Financing.* Securing sufficient financing can play a key role in supporting post-conflict recovery. Debt relief can be especially effective by freeing resources for rebuilding instead of debt servicing, while also helping to restore investors and donors' confidence. Additionally, support from international financial institutions, including the IMF, can be catalytic by unlocking further resources and strengthening policy frameworks.
- *Institutional and Governance Improvements.* Strong institutions and governance increase the chances of a durable recovery and lasting peace. Over the long term, strengthening government effectiveness and accountability not only improves public service delivery but also supports structural reform implementation and the efficient use of resources. Strong institutions promote the efficient use of resources. Therefore, financing in key areas such as healthcare, infrastructure, and social protection can help jumpstart economic activity and improve living conditions.

Figure 1.24. Unemployment Rates, Latest
(Percent)



Sources: International Labour Organization, Labor Force Statistics; and IMF staff calculations.
Note: EM includes both oil-importing and oil-exporting emerging markets. AE = advanced economy; CCA = Caucasus and Central Asia; EM = emerging market; GCC = Gulf Cooperation Council; LIC = low-income country; MENA = Middle East and North Africa, Afghanistan, and Pakistan.

1.6. The IMF Remains Committed to Supporting the MENAP and CCA Regions

The IMF remains deeply engaged in the MENAP and CCA regions, providing policy advice, financing, and capacity development. Since 2020, the Fund has approved $55.7 billion in financing for countries across MENAP and the CCA. Notably, $21.4 billion has been approved since early 2024 for programs in Egypt (augmentation under the Extended Fund Facility, EFF, and a Resilience and Sustainability Facility, RSF), Jordan (EFF and RSF), Morocco (Flexible Credit Line), and Pakistan (EFF and RSF). Beyond financing, the IMF has delivered more than 385 technical assistance and capacity development projects across 31 countries in these regions, amounting to $36.8 million during the fiscal year 2024/25. The IMF's strong regional presence—through resident representative offices, technical assistance centers, and its office in Riyadh—ensures close engagement on the ground. Finally, the IMF works in close coordination with the World Bank and regional partners to support recovery in conflict-affected states in the Middle East, combining policy advice, financial assistance, and capacity development to strengthen stability and resilience.

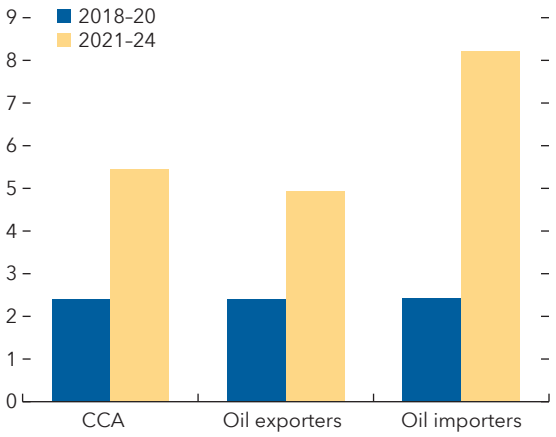
Box 1.1. Caucasus and Central Asia: Growth Beyond Recovery

GDP growth in the Caucasus and Central Asia (CCA) region has accelerated significantly over the past four years exceeding projections. Beyond the rebound from the COVID-19 crisis, the war in Ukraine and broader geopolitical realignments have substantially reshaped the regional economic landscape.[1] The region experienced a sustained inflow of skilled migrants (mainly from Russia) as well as a surge in the inflows of financial capital that sustained credit growth. In addition, many countries boosted investment in infrastructure and pursued greater regional integration. These shocks appear to have triggered structural shifts in the allocation of capital, labor, and entrepreneurship, with some CCA economies emerging as "adjustment hubs" that attract investment and talent.[2]

A key question is whether these shifts have durably reshaped and boosted long-term potential growth. To test this hypothesis, potential output was estimated for all CCA economies (except Turkmenistan because of data constraints) using a production function approach and a series of complementary methodologies, implying the adoption of filters to time series of production factors as well as econometric models. Capital input was estimated using investment data and a perpetual inventory method, whereas labor input was estimated using labor force participation rates, non-accelerating inflation rate of unemployment (NAIRU), and average hours worked. Total factor productivity was found as the residual.

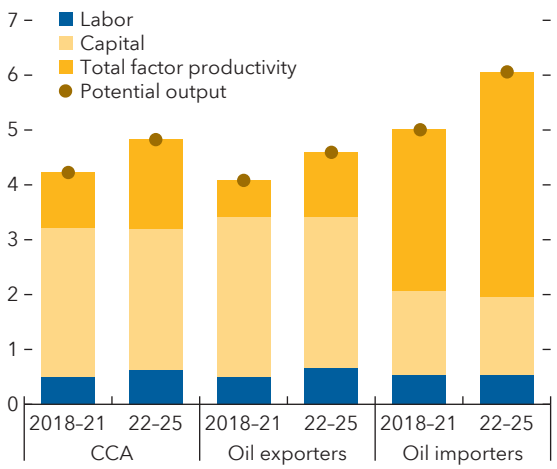
The results indicate a meaningful rise in potential growth in the region. The regional weighted average potential growth rose from 4.2 percent in 2018–21 to 4.8 percent in 2022–25. However, these averages mask notable differences across countries:

Box Figure 1.1.1. Caucasus and Central Asia: Real GDP Growth
(Percentage)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: CCA = Caucasus and Central Asia.

Box Figure 1.1.2. Caucasus and Central Asia: Contributions to Potential Output
(Percent)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: CCA = Caucasus and Central Asia.

This box was prepared by Nasir Rao and Fatima Zaidi.

[1] May 2025 *Regional Economic Outlook: Middle East and Central Asia*; Oxford Analytica 2024.

[2] Heckenthaler 2024; May 2023 *Regional Economic Outlook: Middle East and Central Asia*.

Box 1.1. ***(continued)***

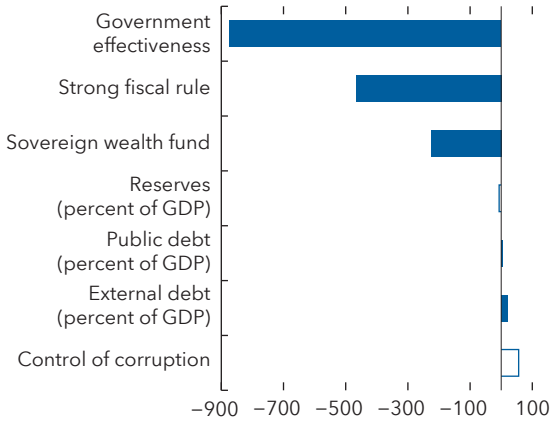
- Oil-importing economies experienced a more notable rise in potential growth, increasing from 5.0 to 6.1 percent. This improvement was primarily driven by gains in total factor productivity. Inflows of high-quality capital and labor—including from Russia and concentrated in information technology and capital-intensive industries—have reinforced this trend, generating efficiency gains that are likely to be lasting. These results suggest that a new growth model is taking shape in CCA economies, powered by an improvement in skills, technology, and entrepreneurial capacity, rather than just faster production factor accumulation.
- Oil-exporting economies, on the other hand, saw only modest improvements. Their heavy reliance on resource sectors and limited structural flexibility have constrained their ability to convert capital and labor inflows into sustained productivity growth.

Box 1.2. Fiscal Rules, Spreads, and the Impact of Global Shocks

Strong fiscal frameworks can help anchor private sector expectations of future fiscal policy by lending credibility to official (budget) projections and commitments. Adopting credible medium-term fiscal frameworks and fiscal rules can help achieve this objective and indirectly contribute to lower sovereign spreads and higher credit ratings (Acalin and others 2025; Badinger and Reuter 2017; Sawadogo 2020; Islamaj, Penaloza, and Sommers 2024).

Some economies in the MENAP and CCA regions (for example, Mauritania, Oman, Tajikistan, and Saudi Arabia) operate under informal fiscal rules, but few have formally adopted rules that are codified in legislation. According to the IMF's updated Fiscal Rules Dataset (Alonso and others forthcoming), only one-quarter of economies in the MENAP and CCA regions have formal operational fiscal rules, compared to two-thirds in emerging market and developing economies, and over 80 percent in advanced economies. Although the adoption of a fiscal rule is not necessarily conducive to stronger fiscal frameworks (as unwarranted deviations from it may undermine its credibility), "strong" fiscal rules can bolster the credibility of official projections and anchor private sector expectations of future fiscal policy. Based on the IMF's Fiscal Rule Strength Index, the MENAP and CCA regions are generally behind other regions, with their fiscal strength below the average for advanced and other emerging markets (the only exception being Georgia).

Box Figure 1.2.1. Determinants of Sovereign Spreads
(Coefficient estimates, basis points)



Sources: IMF, World Economic Outlook database; IMF, Fiscal Rules Database (Alonso and others, forthcoming); Bloomberg L.P.; World Bank, Worldwide Governance Indicators; and IMF staff calculations.
Note: Using a sample of 57 countries over the period of 1996–2021, the regression specification includes fixed effects and a control for global financial market volatility, with clustered standard errors. A strong (weak) fiscal rule is defined as a score in the top (bottom) third of the Fiscal Rule Strength Index distribution. Hollow bars indicate that the association is not statistically significant at the 10 percent level.

Empirical analysis shows that countries with "strong" fiscal rules typically enjoy lower sovereign spreads (by about 400 basis points) compared to those with weak or no fiscal rules (Box Figure 1.2.1). Over and above the presence of strong fiscal rules, differences in spreads across countries are determined by the strength of government institutions (proxied by government effectiveness scores), the size of economic buffers, and debt levels. For example, large buffers help explain why GCC countries benefit from better creditworthiness while lacking formal fiscal rules.

The additional fiscal space allowed by lower sovereign spreads may be useful to reduce the macro-economic impact of adverse global shocks. Empirical analysis using a local projections approach (Jordà 2005) applied to a global panel over the past three and a half decades estimates how real output has responded to adverse global shocks under different fiscal policy frameworks. Adverse shocks are captured by a 1 standard deviation rise in the GDP-weighted World Uncertainty Index, equivalent to a jump from the 10th to 50th percentile of the historical distribution of the indicator (building on Chapter 2, April 2025, IMF *Regional Economic Outlook: Middle East and Central Asia*).

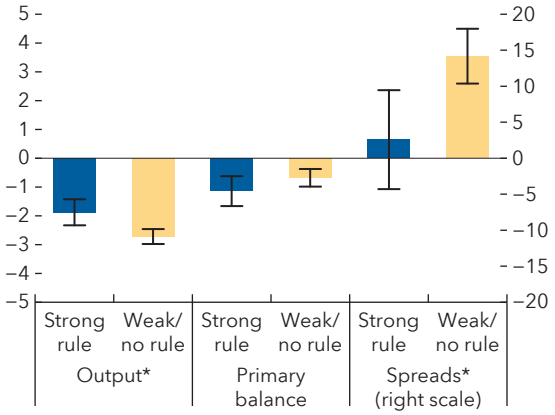
This box was prepared by Karmen Naidoo and Salem Nechi.

Box 1.2. *(continued)*

The analysis shows that economies with stronger fiscal frameworks—defined as those in the top one-third of the IMF's Fiscal Rules Strength Index distribution—experience smaller output losses one year after an adverse global shock compared to those with weaker fiscal frameworks (those with weak or no fiscal rules) (Box Figure 1.2.2). The behavior of primary fiscal balances and spreads after a global shock suggests that economies with weaker fiscal frameworks tend to be more fiscally constrained and thus mount a more limited countercyclical policy response (smaller decrease in the primary balance) while experiencing a significant increase in borrowing costs (higher spreads).

Box Figure 1.2.2. Impact of Global Shocks: Different Fiscal Frameworks

(Percent impact one year after shock, 1 standard deviation uncertainty shock)



Sources: IMF, World Economic Outlook database; Ahir, Bloom, and Furceri (2022); World Uncertainty Index (WUI) database; Federal Reserve Bank of St. Louis, Federal Reserve Economic Data database; IMF, Sovereign Spread Monitor; Uppsala Georeferenced Event Database; Center for Research on the Epidemiology of Disasters, Emergency Events Database EM-DAT; World Bank, Worldwide Governance Indicators; Alonso and others (forthcoming); IMF, Fiscal Rules Dataset; and IMF staff calculations.
Note: A local projections approach is used to assess the impacts of global uncertainty shocks. The shock happens in year 1 and corresponds to a 1 standard deviation increase in the GDP-weighted World Uncertainty Index as measured by Ahir, Bloom, and Furceri (2022). Regressions include country fixed effects, two lags of shock, and two lags of the dependent variable, and control for conflict shocks, natural disasters, epidemics, Federal Reserve fund rates, global oil prices, and political stability and government effectiveness indices. A strong (weak) fiscal rule is defined as a strength score in the top (bottom) third of the Fiscal Rule Strength Index distribution (see Alonso and others forthcoming, for details). Black lines represent the 90 percent confidence interval.
* Denotes a statistically significant difference between the two groups of economies.

Box 1.3. Monetary Policy Frameworks and the Economic Impact of Shocks

Monetary policy frameworks in the MENAP region point to a strong preference for exchange rate stability. Among MENAP oil exporters, this manifests primarily via pegged exchange rate regimes, with the Gulf Cooperation Council (GCC) countries favoring more open capital accounts.[1] MENAP oil importers also prioritize exchange rate stability, typically using managed exchange rate regimes that preserve some degree of monetary policy autonomy thanks to less open capital accounts. By contrast, CCA countries lean toward greater monetary autonomy, coupled with more open capital accounts. According to the IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions* (IMF 2023), about half of MENAP and CCA countries operate under some form of de facto peg.[2] Although recent years have seen a gradual shift toward greater exchange rate flexibility, most countries in the region continue to favor managed regimes that balance exchange rate stability with some room for adjustment, partly reflecting limited financial market development and shallow currency markets.

Empirical analysis indicates that exchange rate regimes have played a significant role in how economies adjust to global uncertainty shocks, but their effects depend critically on the economies' levels of financial development and economic diversification (Duttagupta, Fernandez, and Karacadag 2005; Frankel 2012; Chowdhury and others 2014). Well-developed and liquid financial markets facilitate market pricing of currencies, provide instruments for risk management, and enhance monetary policy transmission, among other benefits.

Countries that are heavily reliant on a single export or tied closely to a major trading partner may better support macroeconomic stability by pegging to that partner's currency (or a basket of partner currencies). By contrast, more diversified and globally integrated economies would benefit from exchange rate adjustment, as exposure to external shocks may be higher. Empirical results confirm that the reduction in output losses after an adverse global shock from a floating exchange rate regime is significant only in economies with higher levels of financial market development and diversified exports. For economies with low levels of financial development and concentrated exports, there is no discernible difference in impacts between fixed and floating regimes (Box Figure 1.3.1).[3]

Model-based analysis using MCDMOD from the IMF's Flexible System of Global Models (Andrle and others 2015) suggests that the adoption of credible inflation targeting regimes with flexible exchange rates could mitigate the adverse output effects of global shocks for MENAP and CCA economies compared to current monetary policy arrangements (Box Figure 1.3.2). It is important to note that this model-based analysis necessarily abstracts away from the critical questions of how economies may best transition to more flexible exchange rate arrangements while ensuring that policy credibility is maintained (or even enhanced).

This box was prepared by Hasan Dudu, Karmen Naidoo, and Salem Nechi.

[1] Commodity-exporting countries often gravitate toward fixed exchange rate regimes as a way to strengthen economic stability in the face of volatile global commodity prices (Levy-Yeyati and Sturzenegger 2016). By pegging their currencies to a stable anchor like the U.S. dollar these countries can limit exchange rate volatility, better anchor inflation expectations, and import monetary credibility. Such benefits are particularly valuable for economies with weak institutions or a history of high inflation (Levy-Yeyati and Sturzenegger 2003).

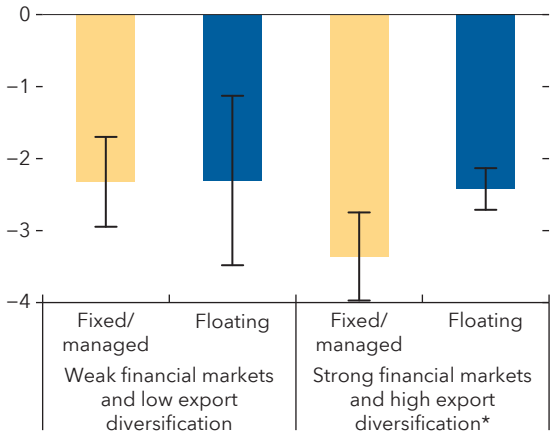
[2] Exchange rate regimes are mapped based on Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) classifications. Pegged: (1) Exchange arrangement with no separate legal tender; (2) Currency board arrangement; (3) Conventional pegged arrangement. Managed: (1) Stabilized arrangement; (2) Crawling peg; (3) Crawl-like arrangement; (4) Pegged exchange rate within horizontal bands; (5) Other managed arrangement. Floating: (1) Floating; (2) Free floating.

[3] The different outcomes of each exchange rate regime should be compared within each specification, not across specifications, due to differences in sample coverage.

Box 1.3. *(continued)*

Box Figure 1.3.1. Estimated Impacts of Global Shocks by Exchange Rate Regime and Country Characteristics

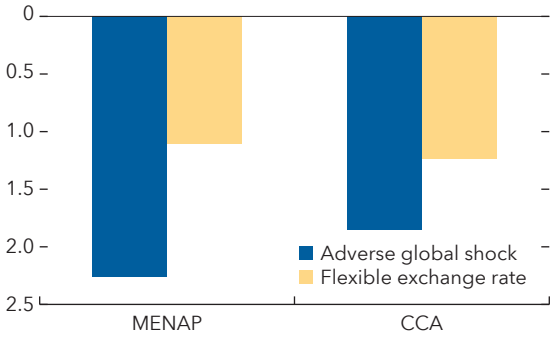
(Percent real GDP change one year after shock, 1 standard deviation uncertainty shock)



Sources: IMF, World Economic Outlook database; IMF, The Annual Report on Exchange Arrangements and Exchange Restrictions database; Ahir, Bloom, and Furceri (2022); World Uncertainty Index (WUI) database; Federal Reserve Bank of St. Louis, Federal Reserve Economic Data database; Uppsala Georeferenced Event Database; Center for Research on the Epidemiology of Disasters, Emergency Events Database EM-DAT; IMF, Financial Development Index Database; UNCTAD, UNCTAD Stat Merchandise Trade Matrix; and IMF staff calculations.
Note: A local projections approach is used to assess the impacts of global uncertainty shocks. The shock happens in year 1 and corresponds to a 1 standard deviation increase in the GDP-weighted World Uncertainty Index as measured by Ahir, Bloom, and Furceri (2022). Regressions include country fixed effects, two lags of shock, two lags of the dependent variable, and control for conflict shocks, natural disasters, epidemics, Federal Reserve fund rates, and global oil prices. Strong (weak) financial market development and high (low) export diversification are based on having a score above (below) the global median for each indicator, respectively.
*Denotes a statistically significant difference between the two groups of economies.

Box Figure 1.3.2. Model-based Impacts of Global Shock

(Real GDP, percentage change from baseline, average over first two years)



Sources: MCDMOD results; and IMF staff calculations.
Note: The adverse global shock scenario is drawn from the April 2025 World Economic Outlook and assumes higher trade barriers, global divergence (i.e., lower productivity in Europe, weaker demand in China, and a higher fiscal deficit in the United States), higher global uncertainty and tighter financial conditions. Flexible Exchange Rate (ER) scenario assumes all MCD countries switch from current ER regimes to flexible ER regimes. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

References

Acalin, Julien, Virginia Alonso, Clara Arroyo, Raphael Lam, Leonardo Martinez, Anh D.M. Nguyen, Francisco Roch, Galen Sher, and Alexandra Solovyeva (2025). "Fiscal Guardrails Against High Debt and Looming Spending Pressures." Staff Discussion Note 25/004, International Monetary Fund, Washington, DC.

Ahir, Hites, Nicholas Bloom, and Davide Furceri. 2022. "The World Uncertainty Index." NBER Working Papers 29763, National Bureau of Economic Research, Cambridge, MA. doi: 10.3386/w29763

Alonso, Virginia, Clara Arroyo, Ozlem Aydin, Vybhavi Balasundharam, Hamid R. Davoodi, Gabriel Hegab, Anh M. Nguyen, Natalia. Salazar, Galen Sher, Alexandra Solovyeva, and Nino Tchelishvili. Forthcoming. "Fiscal Rules and Fiscal Councils: Recent Trends and Revisions since the Pandemic." IMF Working Paper, International Monetary Fund, Washington, DC.

Andrle, Micale, Patrick Blagrave, Pedro Espaillat, Keiko Honjo, Benjamin L Hunt, Mika Kortelainen, René Lalonde, Douglas Laxton, Eleonara Mavrodeidi, Dirk V Muir, Susanna Mursula, and Stephen Snudden. 2015. "The Flexible System of Global Models – FSGM." IMF Working Paper 15/64, International Monetary Fund, Washington, DC.

Badinger, Harald, and Wolf Heinrich Reuter. 2017. "The Case for Fiscal Rules." *Economic Modelling* 60: 334–43.

Boehm, Christoph E., Andrei A. Levchenko, and Nitya Pandalai-Nayar. 2023. "The Long and Short (Run) of Trade Elasticities." *American Economic Review* 113 (4): 861–905.

Brynjolfsson, Erik, Bharat Chandar, and Ruyu Chen. 2025. "Canaries in the Coal Mine? Six Facts about the Recent Employment Effects of Artificial Intelligence. Working Paper, Stanford University Digital Lab.

Cazzaniga, Mauro, Florence Jaumotte, Longji Li, Giovanni Melina, Augustus J Panton, Carlo Pizzinelli, Emma J Rockall, and Marina Mendes Tavares. 2024. "Gen-AI: Artificial Intelligence and the Future of Work." IMF Staff Discussion Notes 24/001, Washington, DC.

Chowdhury, Mohammad Tarequl H., Prasad Sankar Bhattacharya, Debdulal Mallick, and Mehmet Ali Ulubaşoğlu. 2014. "An Empirical Inquiry into the Role of Sectoral Diversification in Exchange Rate Regime Choice." *European Economic Review* 67: 210–27.

Duttagupta, Rupa, Gilda Fernandez, and Cem Karacadag. 2005. "Moving to a Flexible Exchange Rate: How, When, and How Fast?" IMF Economic Issues 38, International Monetary Fund, Washington, DC.

Frankel, Jeffrey. A. 2012. "Choosing an Exchange Rate Regime." In *Handbook of Exchange Rates* (First Edition), edited by Jessica James, Ian W. Marsh, and Lucio Sarno. John Wiley and Sons, Inc.

Gershenson, Dimitry, Omer Faruk Akbal, Mohamed Belkhir, Rhea Gupta, Koba Gvenetadze, Ashraf Khan, Fei Liu, Antonio Manzanera Escribano, Nasir Rao, Umang Rawat, and Xiaoqiao Shen. Forthcoming. "Central Bank Independence and Monetary Policy Effectiveness in the Middle East, Central Asia and Caucasus." IMF Departmental Paper, Washington, DC.

Heckenthaler, Judith. 2024. "Central Asia's Shifting Regional Dynamics: Navigating the Impact of Russia's War Against Ukraine." DGAP Policy Brief, German Council on Foreign Relations (DGAP).

International Monetary Fund (IMF). forthcoming. "Gulf Cooperation Council: Enhancing Resilience to Global Shocks: Economic Prospects and Policy Challenges for the GCC Countries." IMF Policy Papers, Washington, DC.

International Monetary Fund (IMF). 2023. Annual Report on Exchange Arrangements and Exchange Restrictions 2023. Washington, DC.

Islamaj, Ergys, Agustin Samano Penaloza, and Scott Sommers. 2024. "The Sovereign Spread Compressing Effect of Fiscal Rules during Global Crises." World Bank Policy Research Paper 10741, Washington, DC.

Jordà, Òscar. 2005. "Estimation and Inference of Impulse Responses by Local Projections." *American Economic Review* 95 (1): 161–82.

Levy-Yeyati, Eduardo, and Federico Sturzenegger. 2003. "To Float or to Fix: Evidence on the Impact of Exchange Rate Regimes on Growth." *American Economic Review* 93 (4): 1173–93.

Levy-Yeyati, Eduardo, and Federico Sturzenegger. 2016. "Classifying Exchange Rate Regimes: 15 Years Later." HKS Working Paper No. 16-028, August.

Lichtinger, Guy, and Seyed Mahdi Hosseini Maasoum. 2025. "Generative AI as Seniority-Biased Technological Change: Evidence from US Resume and Job Posting Data." Working Paper

Oxford Analytica. 2024. "Ukraine War Fueling Economic Growth in Central Asia." Emerald Expert Briefings oxan-db

Rayner, Brett. Charalambos Tsangarides, Tsendsuren Batsuuri, Hannah Brown, Rana Fayez, Nadia Munir, Dirk Muir, Gian Plebani, Sahra Sakha, and Veronique Salins [2025]. "Connecting Continents - North Africa's Opportunity to Increase Economic Linkages with Europe and Sub-Sahara." Departmental Paper, forthcoming, Washington, DC.

Sawadogo, Pegdéwendé Nestor. 2020. "Can Fiscal Rules Improve Financial Market Access for Developing Countries?" *Journal of Macroeconomics* 65: 103214.

UN Office for the Coordination of Humanitarian Affairs (OCHA). 2025a. "Sudan Humanitarian Needs and Response Plan. December 24. https://www.unocha.org/sudan

UN Office for the Coordination of Humanitarian Affairs (OCHA). 2025b. "Reported Impact Snapshot: Gaza Strip."

September 25. https://www.ochaopt.org/content/reported-impact-snapshot-gaza-strip-10-september-2025.