

INTERNATIONAL MONETARY FUND

REGIONAL ECONOMIC OUTLOOK

MIDDLE EAST AND CENTRAL ASIA

Steering Through Uncertainty:
Strengthening Resilience
in Challenging Times

2026
OCT



INTERNATIONAL MONETARY FUND

REGIONAL ECONOMIC OUTLOOK

MIDDLE EAST AND
CENTRAL ASIA

Steering Through Uncertainty:
Strengthening Resilience
in Challenging Times

2026
OCT



Cataloging-in-Publication Data
IMF Library

Names: International Monetary Fund, publisher.

Title: Regional economic outlook. Middle East and Central Asia : steering through uncertainty:
strengthening resilience in challenging times.

Other titles: Middle East and Central Asia : steering through uncertainty: strengthening resilience in
challenging times. | Middle East and Central Asia. | steering through uncertainty: strengthening resilience
in challenging times. | strengthening resilience in challenging times. | Regional economic outlook:
Middle East and Central Asia.

Description: Washington, DC : International Monetary Fund, 2026. | Oct. 2026. | Includes bibliographical
references.

Identifiers: ISBN:

9798229056908 (paper)

9798229057189 (ePub)

9798229057004 (Web PDF)

Subjects: LCSH: Economic forecasting–Middle East. | Economic forecasting –Asia, Central. | Economic
development–Middle East. | Economic development–Asia, Central. | Middle East–Economic conditions.
| Asia, Central–Economic conditions.

Classification: LCC HC415.15.A1 R44 2026



Publication orders may be placed online or through the mail:

International Monetary Fund, Publication Services

P.O. Box 92780, Washington, DC 20090, U.S.A.

T. +(1) 202.623.7430

F. +(1) 202.623.7201

publications@IMF.org

elibrary.IMF.org

Contents

Acknowledgments	vi
Country Groupings	vii
Assumptions and Conventions	ix
Middle East and Central Asia: Country Abbreviations	ix
Key Messages	x
1. Steering Through Uncertainty: Strengthening Resilience in Challenging Times	1
Global Context: A Differentiated Outlook of the Global Economy	1
Recent Regional Developments: Resilience and Divergence	1
Outlook: Slower Normalization with Uneven Recoveries	7
Risks: Narrowing Margins of Adjustment	11
Policy: From Cushioning the Shock to Building Resilience	14
The IMF Is Committed to Supporting the MENAP and CCA Regions	18
References	27
2. Inflation Dynamics in the Middle East and Central Asia: How Policy Frameworks and Structural Characteristics Shape the Transmission of Global Supply Shocks	29
Introduction	29
Global Supply Shocks and Inflation: An Historical Perspective	30
The Empirical Model and Baseline Results	31
What Explains Diverging Inflation Pass-Through?	33
Which Structural Features Matter Most for Inflation Pass-Through?	37
Conclusion	37
References	39
3. Trade Diversification in Turbulent Times: Implications for Economic Growth and Resilience in MENAP and the CCA	41
Introduction	41
Trade Diversification Patterns in MENAP and the CCA Region	42
Adverse External Shocks and the Mitigating Effects of Trade Diversification	45
Export Diversification Trade-Offs: Resilience versus Welfare	46
Structural Policies and Export Diversification in Practice	50
Conclusion	51
References	52
BOXES	
Box 1.1. Energy Markets: Disruptions and Offsetting Factors	19
Box 1.2. An Adverse Scenario	20
Box 1.3. Monetary and Fiscal Policy Responses for Oil Importers to the War in the Middle East	21

Box 1.4. Oil Consumption Subsidies and the War in the Middle East	23
Box 2.1. Supply Shocks, Firm Markups, and Inflation	38

FIGURES

Figure 1.1. Change in Commodity Prices	2
Figure 1.2. Primary Oil Production	3
Figure 1.3. Real GDP Growth	3
Figure 1.4. Hotel Occupancy Rates	4
Figure 1.5. Net Remittances	4
Figure 1.6. Nominal Effective Exchange Rate	4
Figure 1.7. Policy Measures	4
Figure 1.8. Headline Inflation	5
Figure 1.9. 1-Year Ahead Inflation Expectations	6
Figure 1.10. Real ex Ante Policy Interest Rates	6
Figure 1.11. Trade Balances	7
Figure 1.12. Official Foreign Reserves	7
Figure 1.13. Oil Price Projections	8
Figure 1.14. Real GDP Growth: MENAP Oil Exporters Directly Affected by the Conflict	8
Figure 1.15. 2026–30 Cumulative Growth Forecast Revisions	9
Figure 1.16. CCA: GDP Growth Forecasts	9
Figure 1.17. CCA and MENAP Regions: Headline Inflation Forecast	10
Figure 1.18. Fiscal Impulse	11
Figure 1.19. Gross Financing Needs and Bank Exposures to Sovereign Debt, 2025	12
Figure 1.20. Impact of Additional 20 Percent Increase in Food Prices on Net-Imports, 2027	13
Figure 1.21. ODA Dependence and Food insecurity	13
Figure 1.22. CCA: Real GDP Growth Projections	13
Figure 1.23. Inflation Gap with Target and Monetary Policy Stance	14
Figure 1.24. Gross General Government Debt	15
Figure 1.25. Diesel: Pass-through of Global Prices to Domestic Retail Prices, By Region and Country	16
Figure 1.26. External Demand Shock	18
Figure 1.27. Enhanced Preparedness and Restricted Access: Impact on Real GDP	18
Figure 2.1. Global Supply Chain Pressure Index	31
Figure 2.2. Impact of Global Supply Shocks on the Middle East and Central Asia	32
Figure 2.3. Impact of Global Commodity Price Shocks on Headline CPI in MENAP and CCA	33
Figure 2.4. Impact of Global Supply Shocks by Policy Frameworks in MENAP and CCA	34
Figure 2.5. Impact of Global Supply Shocks and Debt in the Middle East and Central Asia	35
Figure 2.6. Impact of Global Supply Shocks by Central Bank Independence	35
Figure 2.7. Impact of Global Supply Shocks by Structural Characteristics	36
Figure 2.8. Decomposition of Inflation Pass-Through	37
Figure 3.1. Trade Diversification, Resilience, and Growth	42
Figure 3.2. Trade Diversification in 2024	43
Figure 3.3. Exports of Services	44
Figure 3.4. Exposure to Maritime Trade Disruptions and Trade Cost Impacts	45
Figure 3.5. Dynamic Responses to Adverse External Shocks	46
Figure 3.6. Export Diversification and Welfare Trade-Offs	47
Figure 3.7. Quantitative Model—Export Diversification Dividends	49

Figure 3.8. Structural and Industrial Policies and Export Diversification.....	51
Box Figure 1.1.1. Cumulative Oil Supply Shortfalls.....	19
Box Figure 1.1.2. Cumulative Change in Brent Prices.....	19
Box Figure 1.2.1. Price of Oil.....	20
Box Figure 1.2.2. Real GDP.....	20
Box Figure 1.2.3. CPI Inflation.....	20
Box Figure 1.3.1. Non-Oil Output Gap.....	21
Box Figure 1.3.2. Government Debt in Percent of GDP.....	21
Box Figure 1.4.1. Effects of Oil Consumption Subsidies: CPI Inflation, 2026.....	23
Box Figure 1.4.2. Effects of Oil Consumption Subsidies: Budgetary Fiscal Balance in Percent of GDP, 2026...	23
Box Figure 2.1.1. Impact of Global Supply Shocks on Core Inflation by Firm Markups.....	38

TABLES

Table 1.1. Selected Economic Indicators.....	24
Table 1.2. Real GDP Growth.....	26

Acknowledgments

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

The analysis in this Regional Economic Outlook was coordinated under the general supervision of Jihad Azour (MCD Director). The project was directed by Roberto Cardarelli (Chief, MCD Regional Analytics and Strategy Division), John Bluedorn (Deputy Chief, MCD Regional Analytics and Strategy Division), and Giovanni Melina (Deputy Chief, MCD Regional Analytics and Strategy Division).

The primary contributors to this report were Ayumi Akiyama, Kassia Antoine, Apostolos Apostolou, Vizhdan Boranova, Serpil Bouza, Bronwen Brown, Mona ElShazly, Philipp Engler, Elmir Eyvaz-zada, Lucyna Gornicka, Vrinda Handa, Etibar Jafarov, Eliakim Kakpo, Elmer Li, Daria Minina, Florian Misch, Karmen Naidoo, Elisa Navarra, Salem Nechi, Naima Smaini, Bilal Tabti, Marina Mendes Tavares, Subi Suvetha Velkumar, Francis Vitek, Xianghong Yao, and Yipei Zhang.

Nokuthula Nkhoma led COM's editorial team and managed report production. Administrative Coordinators Helida Graca and Sukham Lertprasert provided production support. Mona ElShazly, Eliakim Kakpo, Alexei Miksjuk, and Tokir Mirzoev reviewed the translations and collaborated on the content with Heba Khalil and Noha ElShalkany (Arabic), Alexia Auzière, Sylvain Cazaux, Quentin Roulland, and Jeanne Valensi (French), and Svetlana Andryunina and Inna Davidova (Russian), with editorial input from Baya Kourdali and Mona Hassan (Arabic), Marion Delépine (French), and Svetlana Dorofeeva (Russian), with coordination support from Ranwa Nasfi (Translation Coordination Center)—all from Language Services, Corporate Services and Facilities Department.

Country Groupings

Middle East and Central Asia: Regional Groupings

Middle East and Central Asia			Other Regional Groups	
Caucasus and Central Asia (CCA)	Middle East and North Africa (MENA)	Other	Arab World	North Africa
Armenia	Algeria	Afghanistan	Algeria	Algeria
Azerbaijan	Bahrain	Pakistan	Bahrain	Djibouti
Georgia	Djibouti		Djibouti	Egypt
Kazakhstan	Egypt		Egypt	Libya
Kyrgyz Republic	Iran		Iraq	Mauritania
Tajikistan	Iraq		Jordan	Morocco
Turkmenistan	Jordan		Kuwait	Sudan
Uzbekistan	Kuwait		Lebanon	Tunisia
	Lebanon		Libya	
	Libya		Mauritania	
	Mauritania		Morocco	
	Morocco		Oman	
	Oman		Qatar	
	Qatar		Saudi Arabia	
	Saudi Arabia		Somalia	
	Somalia		Sudan	
	Sudan		Syrian Arab Republic	
	Syrian Arab Republic		Tunisia	
	Tunisia		United Arab Emirates	
	United Arab Emirates		West Bank and Gaza	
	West Bank and Gaza		Yemen	
	Yemen			

MENA, Afghanistan, Pakistan: Analytical Groupings¹

Oil Exporters		Oil Importers		Fragile and Conflict-Affected States (FCS)	
Gulf Cooperation Council (GCC)	Other	Emerging Market and Middle-Income Economies (EM&MIs)	Low-Income Countries (LICs)	All FCS	Conflict-Affected States
Bahrain	Algeria	Egypt	Afghanistan	Afghanistan	Afghanistan
Kuwait	Iran	Jordan	Djibouti	Iraq	Iraq
Oman	Iraq	Lebanon	Mauritania	Lebanon	Lebanon
Qatar	Libya	Morocco	Somalia	Libya	Somalia
Saudi Arabia		Pakistan	Sudan	Somalia	Sudan
United Arab Emirates		Tunisia	Syrian Arab Republic	Sudan	Syrian Arab Republic
		West Bank and Gaza	Yemen	Syrian Arab Republic	West Bank and Gaza
				West Bank and Gaza	Yemen
				Yemen	

Caucasus and Central Asia: Analytical Groupings

Oil Exporters		Oil Importers	
		Emerging Market and Middle-Income Economies (EM&MIs)	Low-Income Countries (LICs)
Azerbaijan		Armenia	Kyrgyz Republic
Kazakhstan		Georgia	Tajikistan
Turkmenistan			Uzbekistan

¹ The Middle East and Central Asia region is divided into two main nonoverlapping groups, based on export earnings, namely (1) oil exporters; and (2) oil importers. The oil importers group comprises (1) emerging market and middle-income countries (EM&MI) and (2) low-income countries (LICs) based on the income level. Additional analytical and regional groups might be used to provide a more granular breakdown for analysis and continuity.

Assumptions and Conventions

Several assumptions have been adopted for the projections presented in the *October 2026 Regional Economic Outlook: Middle East and Central Asia*. It is assumed that the established policies of national authorities will be maintained, the price of oil² will average US\$95.74 a barrel in 2026, US\$87.39 a barrel in 2027, and US\$70.46 a barrel in 2031; the three-month nominal yield on the US Treasury bills will average 3.8 percent in 2026, 4.3 percent in 2027, and 3.5 percent in 2031. These are working assumptions rather than forecasts, and the uncertainties surrounding them add to the margin of error that would, in any event, be involved in the projections. The 2026–31 data in the figures and tables are projections. Unless otherwise noted, these projections are based on statistical information available through end September 2026.

This publication uses the following conventions:

- Minor discrepancies between sums of constituent figures and totals are because of rounding.
- An en dash (–) between years or months (for example, 2025–26 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2025/26) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY 2026).
- “Billion” means a thousand million; “trillion” means a thousand billion.
- “Basis points (bps)” refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

The term “oil” includes gas, which is also an important resource in several countries.

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

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

Middle East and Central Asia: Country Abbreviations

AFG	Afghanistan	IRN	Iran	MRT	Mauritania	SYR	Syrian Arab Republic
ALG	Algeria	IRQ	Iraq	MAR	Morocco	TJK	Tajikistan
ARM	Armenia	JOR	Jordan	OMN	Oman	TUN	Tunisia
AZE	Azerbaijan	KAZ	Kazakhstan	PAK	Pakistan	TKM	Turkmenistan
BHR	Bahrain	KWT	Kuwait	QAT	Qatar	UAE	United Arab Emirates
DJI	Djibouti	KGZ	Kyrgyz Republic	SAU	Saudi Arabia	UZB	Uzbekistan
EGY	Egypt	LBN	Lebanon	SOM	Somalia	WBG	West Bank and Gaza
GEO	Georgia	LYB	Libya	SDN	Sudan	YEM	Yemen

² Simple average of prices of UK Brent, Dubai Fateh, and West Texas Intermediate crude oil.

Key Messages

Economic Developments and Outlook: *An uneven impact across the region*

- The escalation of the war in the Middle East has delivered a substantial shock through disruptions to energy production, shipping, tourism, trade, and confidence.
- The economic impact has been highly uneven. Oil exporters directly affected by disruptions have seen a sharp slowdown, while many oil importers have remained more resilient, supported by strong domestic demand, remittances, tourism, and timely policy responses.
- The Caucasus and Central Asia (CCA) has weathered the shock relatively well, with resilient remittance inflows, solid growth, and easing inflation.
- The outlook depends on a normalization of security and trade conditions. Under the baseline, MENAP growth is projected to rebound to 6.6 percent in 2027 after contracting by about 1.3 percent in 2026, driven by a recovery in Gulf oil exporters.
- Growth in MENAP oil importers is expected to strengthen further as inflation pressures ease, while CCA growth remains robust at 5.2 percent in 2026 and 5.0 percent in 2027.
- Inflation is projected to rise in MENAP in 2026, while continuing to decline in the CCA. Fiscal and external buffers are weakening across much of the region.

Risks: *High uncertainty amid downside risks*

- Uncertainty remains exceptionally high, and risks are firmly tilted to the downside.
- Further disruptions to energy production or trade routes could raise energy prices, weaken growth, and worsen inflation. Tighter global financial conditions could raise borrowing costs, weaken global demand, and, for oil exporters, lower oil prices.
- For the CCA, a further escalation of Russia's war in Ukraine and tighter sanctions could disrupt trade, affect cross-border payments, and reduce external demand and remittances. At the same time, a durable end to Russia's war in Ukraine could improve sentiment, reduce risk premiums, and lower external borrowing costs.
- Low-income and fragile states remain particularly vulnerable given high food-import dependence, large financing needs, and declining development assistance.

Policy Priorities: *Maintaining stability while strengthening resilience*

- If inflation risks materialize, monetary policy should remain the first line of defense. A tighter monetary stance should be supported by prudent fiscal policy, particularly in countries with limited fiscal space.
- Given persistent downside risks, rebuilding or preserving fiscal buffers remains essential across the region, through credible fiscal consolidation, stronger domestic revenue mobilization, more efficient spending, and robust fiscal frameworks.
- All countries should refrain from introducing broad-based subsidies and instead aim to support those most affected by higher commodity prices through targeted, temporary, and budget-neutral cash transfers.
- In the CCA, the priority is to maintain sufficiently tight monetary and fiscal policy stances and further strengthen central bank independence so that inflationary pressures will abate.
- Structural reforms are needed to raise productivity, create jobs, diversify economic activity and trade, deepen regional integration, and strengthen long-term resilience.
- Countries should use the current period of disruption to position themselves to benefit from technological change, including artificial intelligence.

1. Steering Through Uncertainty: Strengthening Resilience in Challenging Times¹

Global Context: A Differentiated Outlook of the Global Economy

The global economy is proving resilient but increasingly uneven. Economic activity in 2026 held up better than expected despite the war in the Middle East and persistent trade tensions, supported in part by strong AI-related investment. This has produced a more differentiated global picture: economies benefiting from favorable terms of trade or technology-linked exports are better cushioned, while others face higher import bills, weaker demand, and narrower policy space.

Recent developments point to considerable adaptability, but also to diminishing buffers. The oil and gas shock linked to the conflict has had a smaller impact than initially feared, as supply rerouting, inventory drawdowns, fiscal support, and lower energy intensity helped contain the drag on activity (Box 1.1). Firms and markets have continued to adjust, supported in part by optimism around technology. However, inventories have fallen, commodity markets remain vulnerable to disruptions, fragmentation could reduce efficiency, uncertainty may delay investment, and financing conditions could tighten abruptly—especially where fiscal risks are elevated.

Global growth is projected at 3.1 percent in 2026 and 3.4 percent in 2027, broadly unchanged on a cumulative basis from the April 2026 *World Economic Outlook*. Headline inflation is expected to rise temporarily to 4.7 percent in 2026, mainly reflecting higher energy and food prices, before easing to 4.1 percent in 2027.

The stable global aggregate masks a substantial differentiation of the growth outlook across economies. Countries with limited exposure to the conflict and strong links to the technology cycle are expected to hold up better, and energy exporters outside the conflict zone should benefit from improved terms of trade. By contrast, energy importers with limited technology-sector links are projected to face higher import costs, exchange rate pressures, weaker real incomes, and more constrained fiscal space. Many low-income and vulnerable economies fall into this group, increasing the risk that recent shocks widen income gaps.

World trade growth is projected to slow in 2026 before recovering in 2027, reflecting the drag from tariffs, production-chain adjustments, and continued strength in technology-related trade. Global imbalances are expected to decline modestly, as large fiscal deficits, limited domestic rebalancing, technology-driven capital flows, and differences in demand composition continue to sustain external gaps. The medium-term outlook remains weak by historical standards and uneven across economies, reflecting lingering structural challenges but also differences in AI preparedness and energy resilience.

Recent Regional Developments: Resilience and Divergence

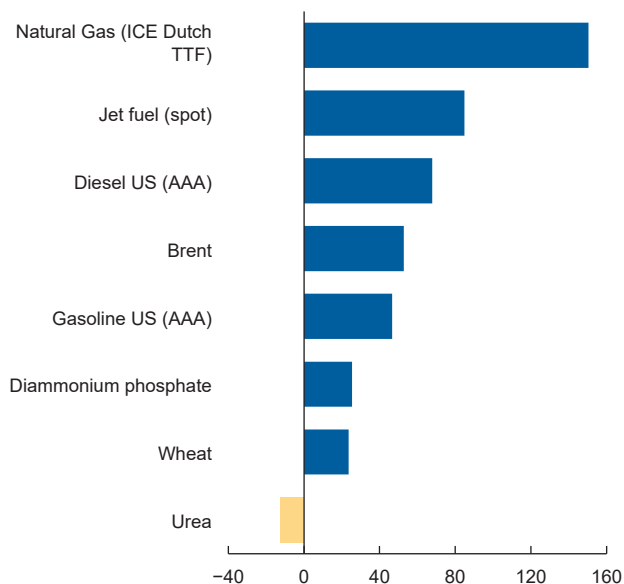
Developments since April point to a large but uneven shock from the Middle East conflict. Directly affected Gulf exporters have suffered substantial oil and gas production losses and weaker non-oil activity, especially in trade, transport, and tourism, partly cushioned by policy support. Several oil importers in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region have remained resilient, supported by remittances, tourism, accommodative financial conditions, and policy measures. In the Caucasus and Central Asia (CCA), some oil producers have faced disruptions and slower growth, while some importers have benefited from rerouted trade and strong domestic demand. Higher food and energy prices have raised inflation unevenly, reflecting differences in initial

¹ This chapter was prepared by Ayumi Akiyama, Kassia Antoine, Apostolos Apostolou, Vizhdan Boranova, Philipp Engler, Elmir Eyvaz-zada, Vrinda Handa, Marina Mendes Tavares, Daria Minina, Salem Nechi, Naima Smaini, Subi Suvetha Velkumar, Francis Vitek and Xianghong Yao.

conditions, subsidies, price controls, and exchange rate regimes. Responses have relied mainly on fiscal and administrative measures with limited monetary policy tightening. External positions have diverged, improving for some energy exporters but weakening for importers.

Energy prices have remained highly volatile in 2026. After surging from about \$65 per barrel in January to nearly \$118 at the end of March, oil prices have fluctuated around \$90 per barrel since then. Resumed hostilities moved Brent prices to above \$100 per barrel in September, about 50 percent above pre-war levels. While the Brent futures curve has shifted upward relative to April, it continues to imply a gradual decline in prices over the medium term. Refined product prices rose more sharply than crude prices since late February, with jet fuel up about 85 percent, diesel 68 percent and gasoline 45 percent, and global exports still well below pre-conflict levels. This reflects reduced Gulf supply, the loss of global refining capacity since the Russia-Ukraine and Middle East conflicts began, and low inventories. As of September, crack spreads—the premium of oil product prices over crude—were at a historic high. Natural gas prices were about 150 percent above pre-conflict levels in September, but remained well below their 2022 peak, as non-Gulf liquefied natural gas supplies continue to offset part of the Gulf shortfall. Price pressures have also extended beyond energy, with wheat and diammonium phosphate up about 25 percent since late February, while urea has declined by some 12 percent (Figure 1.1).

Figure 1.1. Change in Commodity Prices
(Percent change, since Feb. 27, 2026)

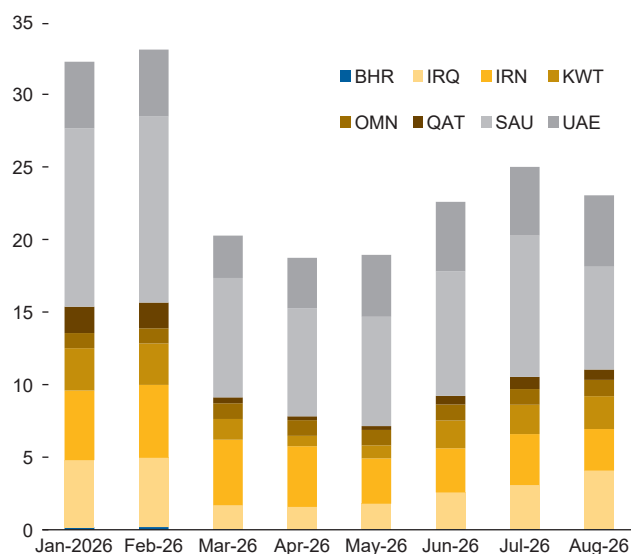


Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Data as of September 16, 2026. For gasoline, diesel and natural gas, data are as of September 15, 2026. For jet fuel, data are as of September 14, 2026. Gasoline, diesel, and jet-fuel prices are from the United States. AAA = American Automobile Association; ICE = Intercontinental Exchange; TTF = Title Transfer Facility (Dutch natural gas benchmark).

For MENAP oil exporters directly affected by the conflict, oil and gas production remains well below pre-war levels as of August. Output fell from 33 million barrels per day in February to a low of close to 19 million barrels per day in May (Figure 1.2). Countries with the greatest reliance on the Strait of Hormuz and limited alternative export routes (Bahrain, Iraq, Iran, Kuwait, Qatar) were the hardest hit, with oil and gas production falling by up to 86 percent in Qatar. Saudi Arabia and the United Arab Emirates were less severely affected, as damage was more limited and alternative pipelines helped cushion the shock, while production in Oman increased. Production had recovered somewhat after May, particularly in Iraq, Kuwait, and Qatar, though remaining about 30 percent below February levels, but fell again in August, as disruption to pipeline operations and maritime traffic through Bab el Mandeb pushed production in Saudi Arabia to its lowest level since the start of the conflict. The contraction in oil sector activity largely explains the decline of Saudi Arabia's GDP in the first half of 2026 (Figure 1.3), while energy trade and production disruptions significantly reduced GDP growth in Bahrain, Iran, Kuwait, and most severely Qatar. By contrast, growth accelerated in Oman in H1:2026.

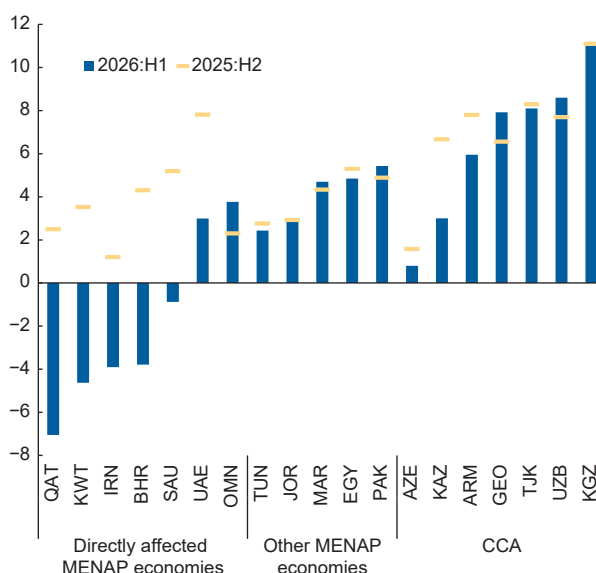
Non-oil activity was also affected in MENAP countries directly exposed to the conflict, though impacts varied considerably across countries. Gulf Cooperation Council (GCC) authorities took decisive measures to preserve critical trade and logistics networks, support firms and households, maintain the flow of credit, and safeguard financial stability. Although non-oil activity eased, it held up better than expected in most countries. As of early September, international flight arrivals had recovered in most cities but remained below year-earlier levels in Dubai and Kuwait. Tourism activity weakened, with hotel occupancy rates declining in the directly affected economies, with the largest declines recorded in Bahrain, the United Arab Emirates, and Iraq, and the smallest in Saudi Arabia (Figure 1.4).

Figure 1.2. Primary Oil Production
(Millions of barrels per day)



Sources: International Energy Agency; and IMF staff calculations.
Note: Data labels in the figure use International Organization for Standardization (ISO) country codes.

Figure 1.3. Real GDP Growth
(Year-over-year percent change)



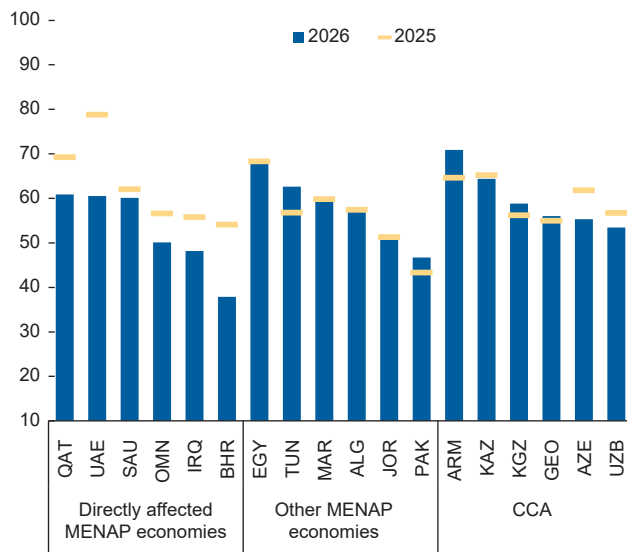
Sources: Haver Analytics; and IMF staff calculations.
Note: For BHR, IRN, JOR, KAZ, KWT, PAK, QAT, and UAE, data are as of 2026Q1. Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, Pakistan.

Economic activity in other MENAP economies has remained resilient so far in 2026. In the first half of 2026, GDP growth in Egypt, Jordan, Morocco, Pakistan, and Tunisia remained broadly in line with the second half of 2025 (Figure 1.3). High-frequency indicators, including industrial production and purchasing managers' indices, have generally remained resilient or point to only modest contractions so far in 2026, while unemployment rates declined in the second quarter of 2026. Several factors help explain this resilience:

- *Remittances and tourism inflows have remained robust* (Figures 1.4 and 1.5). So far in 2026, net remittances as a share of GDP have exceeded levels recorded during the same period last year in Egypt, while remaining broadly stable in Morocco, Pakistan and Tunisia. In contrast to the GCC, tourism has proved resilient in most MENAP oil importers. Jordan experienced only a modest deterioration during the early stages of the conflict, followed by a rebound in more recent data, supported by strong intra-regional travel. Countries that were insulated from the conflict, such as Egypt, Morocco, Tunisia, and Pakistan have recorded stable, or even higher, hotel occupancy rates in 2026 compared with last year.
- *Financial conditions have remained broadly supportive*. Capital outflows that emerged after the onset of the conflict have largely dissipated, and exchange rate depreciation pressures remained contained as of August, with most countries exhibiting exchange rate appreciations in nominal effective terms since February (Figure 1.6). Depreciations were confined to a handful of countries—Egypt, which stands out with a decline of about 6 percent, followed by Algeria, and Tunisia. Sovereign spreads have narrowed across most economies, while stronger sovereign issuers retained access to international capital markets.
- *Governments moved quickly to cushion the impact of the conflict*. IMF staff have identified about 50 discretionary support measures across MENAP and CCA economies since the start of the war (Figure 1.7). Most measures sought to shield households and firms from higher energy and food prices, including through fuel subsidies, price controls, tax reductions, and direct transfers. Roughly three-quarters of these measures were untargeted. Although these measures are costly and could weigh on public finances, available data so far point to only a limited deterioration in fiscal balances across the region, with the main exception of Iraq, which entered the conflict with already acute financing constraints.

Figure 1.4. Hotel Occupancy Rates

(Average first 37 weeks of 2026 versus same period 2025)

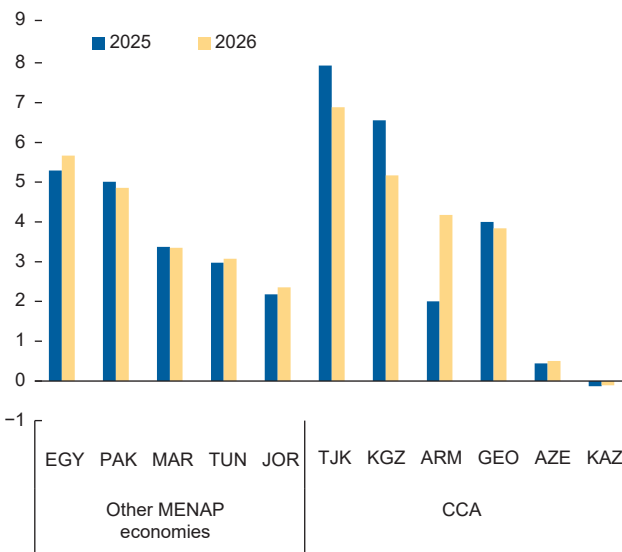


Sources: Costar; and IMF staff calculations.

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, Pakistan.

Figure 1.5. Net Remittances

(YTD, share of 2026 GDP versus share of 2025 GDP)

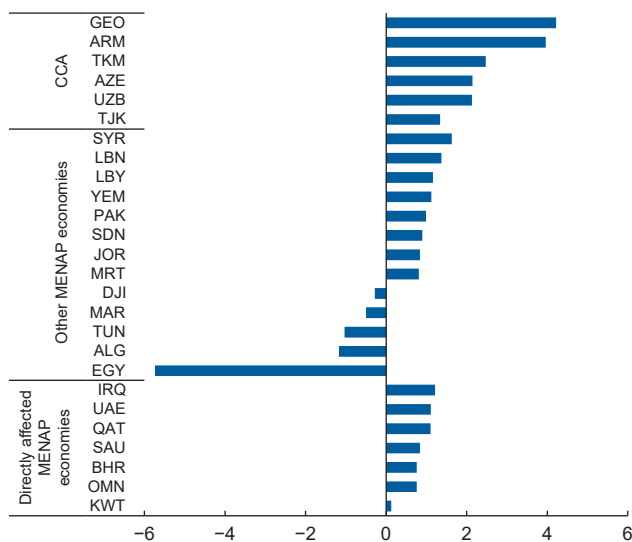


Sources: Haver Analytics; IMF, Regional Economic Outlook database; and IMF staff calculations.

Note: For TJK, data are as of 2026Q1, the remaining countries correspond to 2026Q2. 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, Pakistan.

Figure 1.6. Nominal Effective Exchange Rate

(Percent change, February-August 2026)

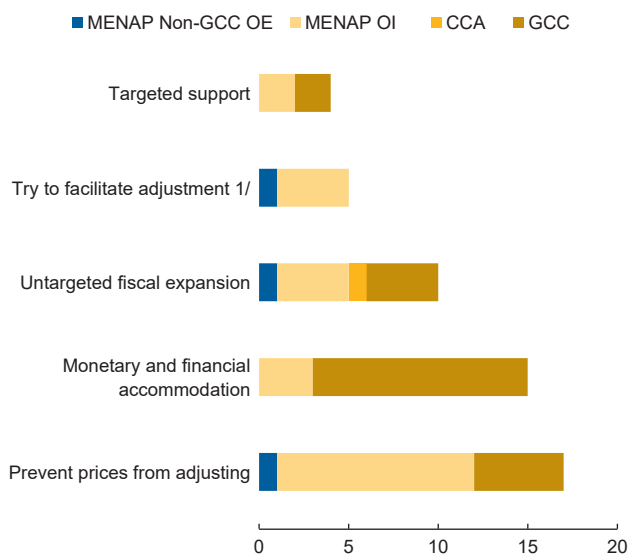


Sources: IMF, EER database; and IMF staff calculations.

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, Pakistan.

Figure 1.7. Policy Measures

(Number of tracked measures)



Sources: IMF, Global Policy Tracker; and IMF staff calculations.

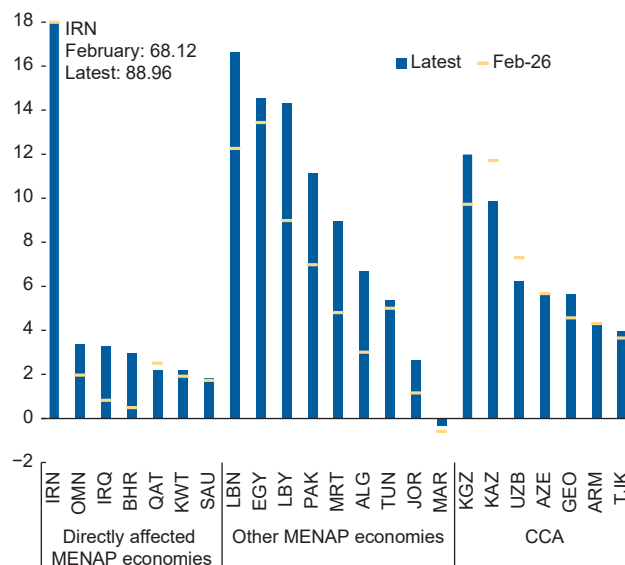
Note: 1/ Measures to support adjustment through energy-savings, higher domestic energy prices, and energy-sector financing initiatives. Data are as of June 2026. CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; MENAP = Middle East and North Africa, Afghanistan, Pakistan; OE = oil exporter; OI = oil importer.

- Economic activity has remained robust across much of the CCA in 2026. Limited direct exposure to the Middle East conflict, together with strong domestic demand, remittances, and trade and transit flows, has supported activity. Disruptions to trade through Iran and Russia have nevertheless required costly rerouting and adjustments to logistics networks. GDP growth slowed in Azerbaijan and Kazakhstan (Figure 1.3)—the latter reflecting disruptions to oil production—and moderated modestly in Armenia amid softer (though still robust) domestic demand. By contrast, several CCA economies have continued to benefit from shifts in regional trade and transit patterns. The Kyrgyz Republic continued to record the region’s strongest growth, while activity remained strong in Georgia, supported by buoyant exports of goods and services. Growth accelerated in Uzbekistan and remained robust in Tajikistan, underpinned by domestic demand. Labor market conditions have remained solid, with unemployment generally declining across the region during the first half of 2026.

- Inflationary pressures have generally risen in 2026. Higher food prices and shipping costs have added to inflationary pressures (Figure 1.8). However, existing subsidies, price controls, and fixed exchange rates have limited pass-through to general prices in GCC economies. Year-over-year headline inflation rose to 3 percent and 3.4 percent in Bahrain and Oman as of July and August 2026 respectively, while remaining contained in other GCC countries. Among other oil exporters, headline inflation accelerated strongly in Algeria, Iraq, and especially Iran, from already elevated levels. In MENAP oil importers, inflationary pressures have risen most sharply in Egypt and Pakistan (to 14.5 and 11.1 percent year over year, respectively, in August), reflecting higher food and energy-related prices and, in Egypt, also on account of the exchange rate depreciation; Lebanon remains the highest in the group at about 17 percent, while Morocco stands out with prices still falling. In the CCA, headline inflation rose noticeably in Georgia, as higher energy and electricity prices pushed it further above the central bank’s target, while core inflation remained closer to target. By contrast, inflation has remained relatively stable in Azerbaijan, reflecting softer domestic demand pressures, and in Armenia, where increased domestic supply—linked to Russian import restrictions—helped contain price pressures. In Uzbekistan and Kazakhstan, inflation continued to decline from still-high, above-target levels supported by base effects as well as tight monetary conditions and the exchange rate appreciation against the US dollar (reflecting strong capital inflows and high oil prices in Kazakhstan), with the Kyrgyz Republic now posting the region’s highest rate at about 12 percent.

Monetary policy responses have varied greatly across the region. In MENAP, policy-rate responses since the start of the conflict have differed across exchange-rate regimes. Among countries with flexible exchange rates, Pakistan was the only one to raise interest rates after the conflict began. Among U.S. dollar-pegged regimes, Iraq moved first, followed in September by Jordan and most GCC economies, in line with the Federal Reserve. Policy responses have also varied across the CCA. Armenia and Georgia raised their policy rates in September and May, respectively—their first increases in four years—while Kazakhstan cut rates three times since June despite still-elevated inflation, citing a sustained disinflation trend while acknowledging significant remaining risks. With inflation expectations edging up in parts of the region, particularly among some oil importers (Figure 1.9), the limited policy response has led to a modest easing of the monetary policy stance, with real ex-ante policy rates declining in most countries, most markedly in the CCA (Figure 1.10).

Figure 1.8. Headline Inflation
(Year-over-year, percent)

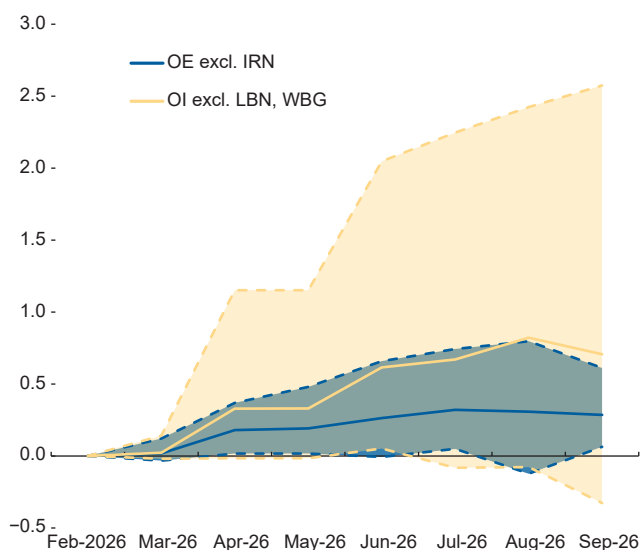


Sources: Haver Analytics; IMF, Regional Economic Outlook database; and IMF staff calculations.

Note: Latest available data as of publication. 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, Pakistan.

Figure 1.9. 1-Year-Ahead Inflation Expectations

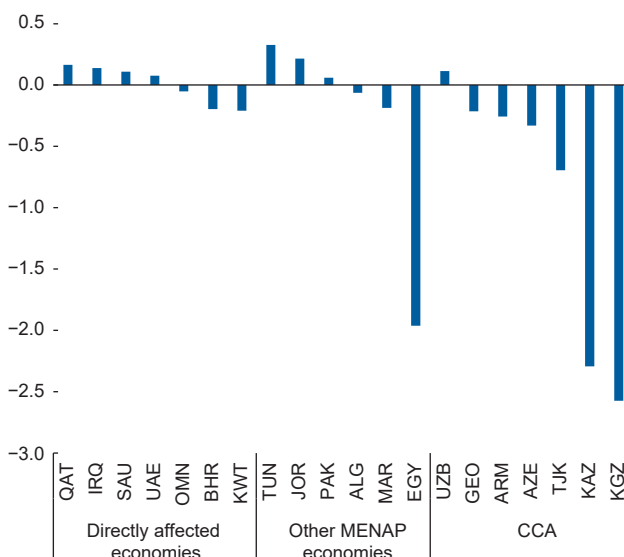
(Percentage points, difference versus February 2026, simple averages)



Sources: Focus Economics; and IMF staff calculations.
 Note: Dashed lines indicate respective minimum and maximum values at each date CI. Data labels in the figure use International Organization for Standardization (ISO) country codes.
 OE = oil exporter; OI = oil importer.

Figure 1.10. Real ex Ante Policy Interest Rates

(Percentage points change, September versus February 2026)



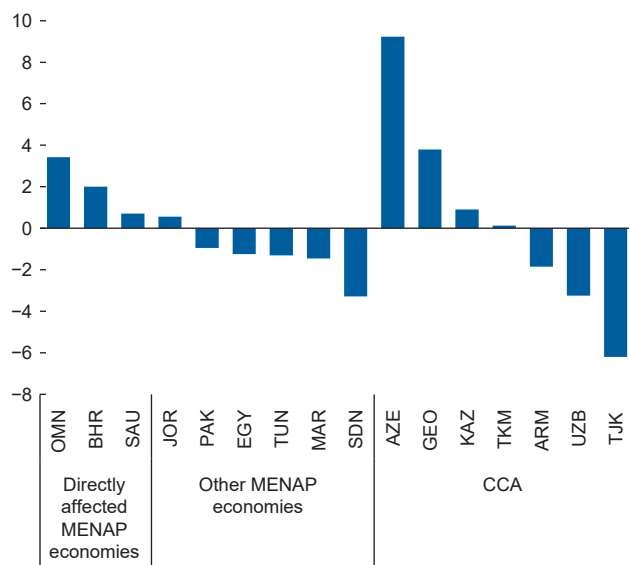
Sources: Haver Analytics; Focus Economics; and IMF staff calculations.
 Note: Difference between nominal policy rates and one-year ahead inflation expectations from Focus Economics. Data labels in the figure use International Organization for Standardization (ISO) country codes.

The impact of the conflict on external positions has differed sharply across MENAP and the CCA. For MENAP oil exporters directly affected by the conflict, higher energy prices and import compression have offset the impact of lower export volumes on the trade balance (Figure 1.11). By contrast, goods trade balances have generally deteriorated in MENAP oil importers so far in 2026, with Jordan a notable exception (mainly on account of stronger exports). In the CCA, trade balances weakened in most oil-importing economies. In Tajikistan, the deterioration reflected a higher import bill, while in Armenia and Uzbekistan it was driven mainly by lower export revenues, owing to Russia's import restrictions and reduced gold export volumes, respectively. By contrast, Georgia's trade balance improved so far this year, supported by strong export growth and subdued import growth. Among oil exporters, both Azerbaijan and Kazakhstan recorded stronger trade balances. Changes in international reserves have been mixed, but countries with the largest reserve declines since the start of the conflict generally entered the shock with comfortable reserve positions, with Bahrain as a notable exception (Figure 1.12).

Low-income countries have generally experienced lower growth and higher inflation amid weaker official development assistance. Fertilizer prices have evolved unevenly since the start of the conflict, with urea prices falling back to below their pre-war levels, while phosphate prices have remained elevated, because of export restrictions and disruptions in the supply of key inputs such as sulfur. Food prices have also risen sharply since June, with wheat and maize affected by continued disruptions to exports from Russia and Ukraine, as well as weather-related production concerns (Figure 1.1). These pressures have fed into consumer prices in MENAP low-income countries such as Djibouti, Mauritania, and Somalia, given the large weight of food in consumption baskets and high import dependence. Higher import bills have widened trade deficits, while lower official development assistance has further weakened current account balances, notably in Afghanistan and Somalia. At the same time, remittances—up 8 percent year over year in Somalia in the first half of 2026—and targeted social protection measures in Mauritania have helped cushion household incomes.

Figure 1.11. Trade Balances

(Percent of GDP, 2025 YTD versus 2026 YTD)



Sources: Haver Analytics; IMF, Regional Economic Outlook database, and IMF staff calculations.

Note: Latest data available as of publication. Data labels in the figure use International Organization for Standardization (ISO) country codes. CCA = Caucasus and Central Asia;

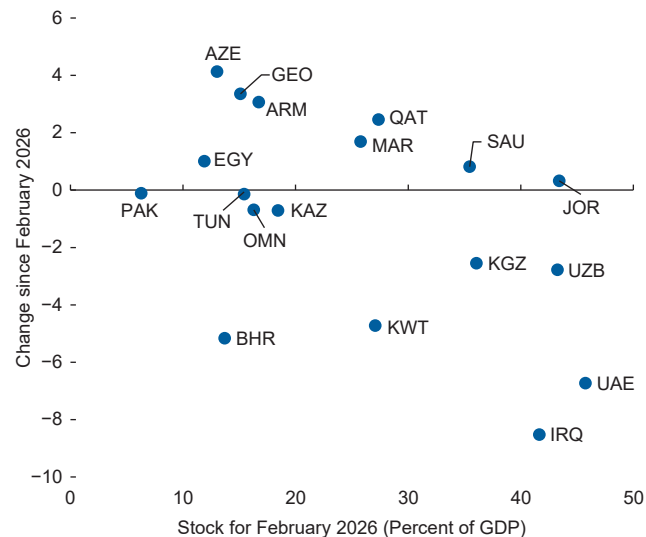
EM&MI = emerging market and middle-income economy;

GCC = Gulf Cooperation Council; LIC = low-income country;

MENAP = Middle East and North Africa, Afghanistan, Pakistan.

Figure 1.12. Official Foreign Reserves

(Percent of 2026 GDP)



Sources: Haver Analytics; and IMF staff calculations.

Note: Data for BHR, OMN, and UAE refer to July 2026 while the remaining countries correspond to August 2026. Data labels in the figure use International Organization for Standardization (ISO) country codes.

Outlook: Slower Normalization with Uneven Recoveries

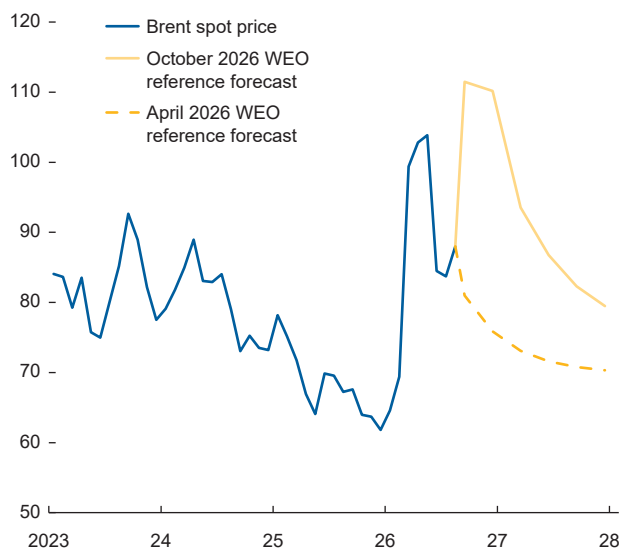
The outlook remains highly uneven across the Middle East and Central Asia. Following weaker MENAP growth in 2026, growth is projected to rebound in 2027 as energy production and trade are expected to gradually recover. CCA growth is expected to remain robust, however, moderating to more sustainable rates. MENAP inflation is expected to rise in 2026, before gradually easing in 2027, while CCA inflation is expected to continue to decline, both benefitting from a normalization of commodity prices and monetary policy tightening. Fiscal policy is generally set to become more accommodative in 2026, followed by renewed consolidation from 2027.

The baseline scenario assumes that energy production and trade conditions will normalize by the end of 2027. Consistent with the October 2026 *World Economic Outlook*, the disruptions to energy trade and production are assumed to continue through the first quarter of 2027, with a resolution of hostilities thereafter allowing flows through the Strait of Hormuz to recover gradually. Until the first quarter of 2027, energy flows through the Strait of Hormuz are expected to remain at roughly current levels, with more severe shortages avoided through a combination of further inventory drawdowns, greater use of alternative routes, and some additional supply from producers outside the Middle East. Crude oil price projections for 2026 and 2027 have been revised up relative to the April *World Economic Outlook* (Figure 1.13). Prices are now projected to average close to \$96 per barrel in 2026 and \$87 per barrel in 2027, compared with \$82.2 and \$76, respectively, in April, with the forecast peaking at about \$110 per barrel in late 2026 before declining steadily as normalization proceeds. Prolonged disruptions to Middle East supply and low inventories also imply higher projected natural gas prices than in April. Higher energy and fertilizer costs, together with more expensive transport and insurance, are projected to raise food prices by 5 percent in 2026 and 2.4 percent in 2027 (compared to 6 and 0.7 percent, respectively, in April).

For 2026, growth projections for MENAP have been revised down sharply since April, reflecting the longer-than-expected duration of the conflict. Growth is now projected at about -1.3 percent in 2026, 2.7 percentage points below the April projection.

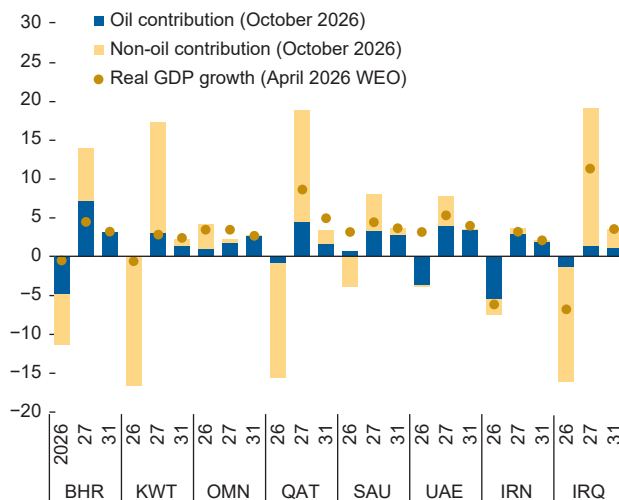
- The downgrade is concentrated among Gulf oil exporters directly affected by the conflict. GCC countries are now expected to face negative overall growth in 2026, with the only exception of Oman. Bahrain, Iraq, Kuwait, and Qatar are all expected to experience double-digit GDP contractions, reflecting severe hydrocarbon disruptions as well as spillovers to trade, logistics, and confidence (Figure 1.14). Although relatively less affected by the disruptions in energy trade, Saudi Arabia and the United Arab Emirates are now also projected to experience a recession in 2026. By contrast, Oman is projected to expand somewhat faster than envisaged in April, reflecting its limited Hormuz-related exposure.
- Emerging markets and middle-income MENAP oil importers are expected to grow somewhat faster in 2026, compared to April. The same factors that have supported economic resilience so far in 2026 are expected to continue sustaining activity going forward. For this group, aggregate growth is expected to accelerate to 4.2 percent in 2026 from 3.9 percent in 2025, 0.3 percentage point above the April projection. The acceleration and revision are driven by Egypt (where growth is about 1 percentage point higher than in the April forecast) and Tunisia (0.3 percentage point). By contrast, growth projections for 2026 are broadly unchanged for Jordan and Pakistan compared to April. Lebanon is expected to experience a marked contraction in 2026, reflecting extensive conflict-related damage and the adverse impact of regional tensions on key drivers of the economy (such as tourism and remittances).
- Economic activity in MENAP low-income countries is expected to remain highly uneven. Growth for the group is projected to strengthen to 4.8 percent in 2026. The acceleration largely reflects a rebound in Sudan from a deeply depressed base, as reconstruction begins in Khartoum after the change in territorial control in early 2025, while extractive sector activity continues to support growth in Mauritania. By contrast, declining aid flows are expected to weigh on activity in fragile economies dependent on official development assistance, including Somalia, while the outlook for Yemen is further constrained by its proximity to the conflict and the re-escalation of the civil war.

Figure 1.13. Oil Price Projections
(US dollars per barrel, Brent)



Sources: IMF, Global Assumptions Database; IMF, Primary Commodity Price System; and IMF staff calculations.
Note: WEO = World Economic Outlook.

Figure 1.14. Real GDP Growth: MENAP Oil Exporters Directly Affected by the Conflict
(Year-over-year percent change)

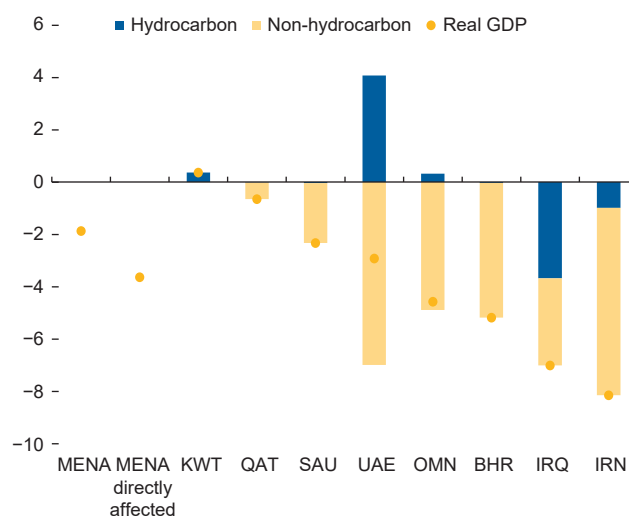


Sources: IMF, World Economic Outlook; and IMF staff calculations;
Notes: Data labels in the figure use International Organization for Standardization (ISO) country codes. MENAP = Middle East and North Africa, Afghanistan, Pakistan; OE = oil exporter; WEO = World Economic Outlook.

- Growth is projected to rebound strongly in MENAP in 2027. Aggregate GDP growth in MENAP is expected to accelerate to 6.6 percent in 2027, an upward revision of 2 percentage points relative to April. The rebound is driven mainly by MENAP oil exporters directly affected by the conflict, where the restoration of damaged facilities and export capacity is expected to lift hydrocarbon output. For these countries, GDP growth is generally expected to return to its pre-conflict trend rate over the medium term. However, cumulative output over 2026–30 is projected to remain below pre-conflict projections, suggesting that the economic impact of the conflict may last longer (Figure 1.15). The degree of the impact varies significantly across countries and largely reflects lost activity in the non-oil sector. Oil-sector output remains affected in Iraq and Iran, while it is expected to accelerate in the United Arab Emirates, reflecting greater expected production after the exit from OPEC+. Among MENAP oil importers, medium-term growth is expected to be supported by the fading terms-of-trade shock, together with continued support from remittances and tourism. Growth will also benefit from higher infrastructure spending in Morocco and Jordan, as well as from continued reforms and macroeconomic stabilization efforts, including under IMF-supported programs, in Egypt, Jordan, and Pakistan. The outlook for Lebanon and West Bank and Gaza remain dominated by assumptions about conflict, reconstruction, and recovery.

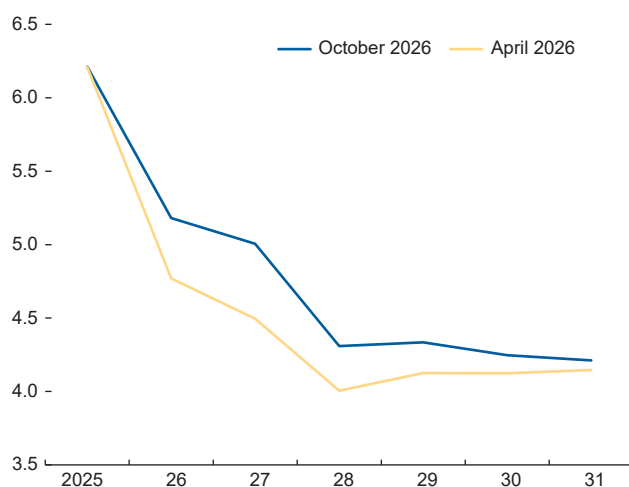
Growth in CCA is still projected to moderate toward a more sustainable pace (Figure 1.16). Average growth in the region is now projected to slow to 5.2 percent in 2026 and 5 percent in 2027 from 6.2 percent in 2025 (about ½ percentage point above what was expected in April for both years) before gradually stabilizing above 4 percent over the medium term. These aggregates mask some divergence between oil importers and oil exporters. Growth in CCA oil importers has been revised up by 1.5 percentage points in 2026, driven by Georgia, the Kyrgyz Republic, Tajikistan, and Uzbekistan, where strong investment, remittances, and financial and capital inflows are expected to offset the negative shocks from the conflicts, while growth projections for Armenia are broadly unchanged since April. By contrast, growth projections for Azerbaijan, Kazakhstan, and Turkmenistan have been revised down slightly in 2026, reflecting supply constraints that are expected to limit oil sector activity, as well as a less accommodative fiscal policy stance in Azerbaijan. Still, growth has been revised upward for Kazakhstan in 2027, reflecting a recovery in oil production, and for Turkmenistan from 2027 onward, reflecting stronger capital accumulation besides a recovery in hydrocarbon production.

Figure 1.15. 2026–30 Cumulative Growth Forecast Revisions
(Percentage points)



Sources: IMF, World Economic Outlook; and IMF staff calculations. Notes: The chart shows the difference between currently projected cumulative output between 2026 and 2030, and the same projections done in January 2026. Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. MENA = Middle East and North Africa. WEO = World Economic Outlook.

Figure 1.16. CCA: GDP Growth Forecasts
(Percent)

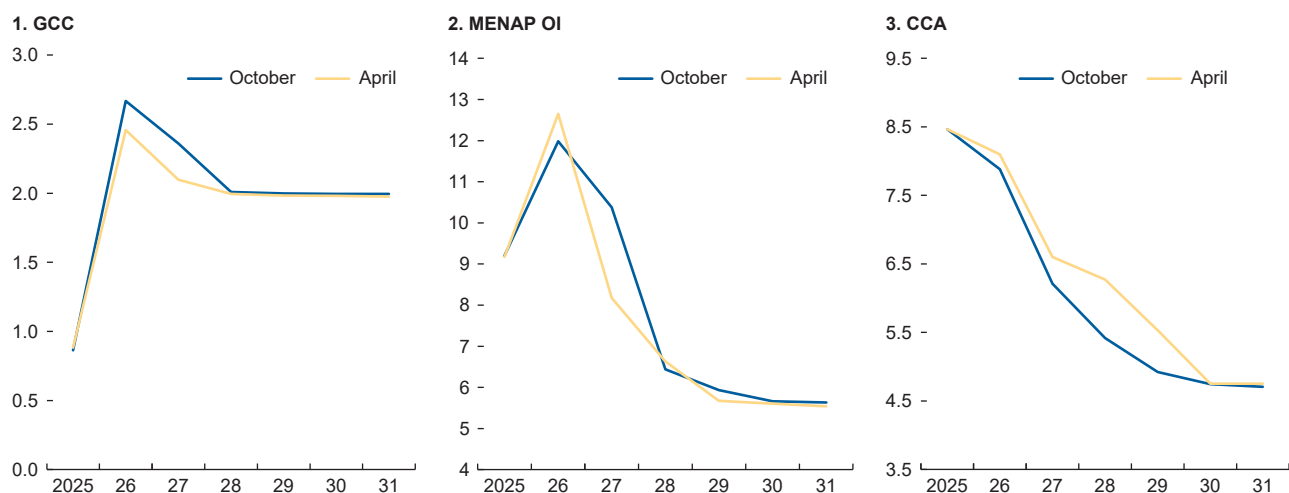


Sources: IMF, World Economic Outlook database; and IMF staff calculations. Note: CCA = Caucasus and Central Asia.

External balances are expected to deteriorate in 2026 for most MENAP and CCA economies, but generally improve gradually over the medium term, though with marked differences across countries and regions. For the GCC, the current account surplus is projected to fall from 5 percent of GDP in 2025 to 1.3 percent in 2026. The largest declines are expected in Qatar, owing to substantial energy export losses, and the United Arab Emirates, mainly because of weaker non-oil exports. After rebounding strongly in 2027–28, GCC current account balances are projected to narrow gradually as energy prices decline and diversification-related investment remains high. Among other MENAP countries, higher oil prices are expected to improve Algeria’s external position while current account balances are projected to weaken in 2026 in Jordan, Morocco, and Tunisia, as stronger imports are only partly offset by robust remittances and tourism receipts. Over the medium term, external positions should strengthen in Egypt, Jordan, and Morocco, supported by lower commodity prices and export diversification, but weaken in Pakistan as imports rise and remittances moderate. Among MENAP low-income countries, the 2026 external outlook has been revised downward for Mauritania and Sudan, reflecting continued dependence on food and energy imports, and for Somalia, where these issues compound with declining aid flows. Among CCA oil exporters, external positions in Azerbaijan and Kazakhstan are expected to improve more rapidly in 2026 than projected in April, supported by higher oil revenues, before weakening from 2027 as energy prices ease. Projections for oil importers have been revised downward for Armenia, the Kyrgyz Republic, and Uzbekistan, reflecting the adverse terms-of-trade shock, Russia’s import restrictions affecting Armenia, and strong import growth in Uzbekistan. By contrast, current account balances in Georgia and Tajikistan are projected to weaken from 2026, but by less than anticipated in April.

Figure 1.17. CCA and MENAP Regions: Headline Inflation Forecast

(Year-over-year percent change, end of period)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OI = oil importer.

Inflation is generally projected to rise in 2026 and then decline more slowly than anticipated in April. In GCC economies, higher food, energy, and transportation costs are expected to lift average inflation from 0.9 percent in 2025 to 2.7 percent in 2026 and 2.4 percent in 2027, slightly above the April forecast (Figure 1.17). Inflation is expected to return to 2 percent from 2028, supported by lower commodity prices, exchange rate pegs, and continued fiscal discipline. Elsewhere in MENAP, inflation is projected to fall from very high levels in Iran, largely because of base effects, but remain persistent in Iraq. In most MENAP oil importers, inflation is expected to accelerate in 2026, though less than projected in April, while Egypt is expected to record a modest deceleration. Inflation should decline from 2027, but more slowly than anticipated in April, reflecting sizable upward revisions for Egypt and Pakistan—3.6 and 1.5 percentage points, respectively. Prospects for low-income countries remain highly divergent: 2026 inflation has been revised upward in Mauritania and Djibouti, while Sudan is expected to record an even faster decline than projected in April. In the CCA, inflation is projected to decline from 2026

onward, slightly faster than anticipated in April. This aggregate trend largely reflects stronger disinflation in Kazakhstan and, in 2027, Turkmenistan. By contrast, inflation in CCA oil importers is expected to accelerate in 2026—with Uzbekistan the sole exception—before generally resuming a downward path from 2027.

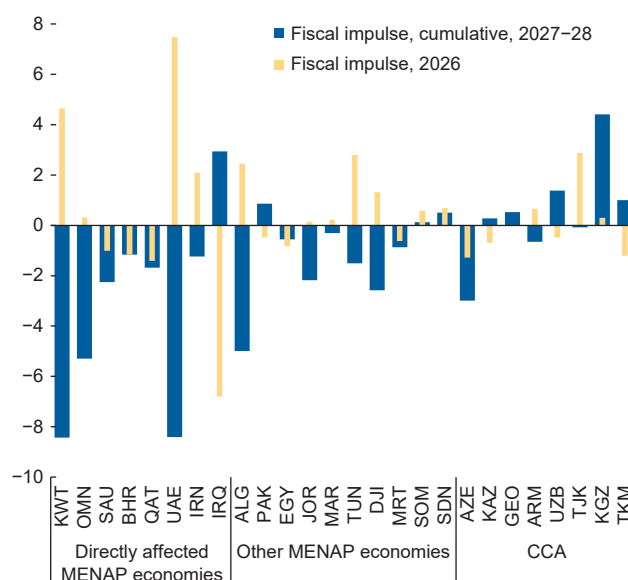
Fiscal policy stances are expected to turn accommodative in 2026 in many MENAP economies, with fiscal consolidation resuming from 2027. In MENAP, the fiscal policy stance in 2026 is projected to be restrictive in countries with limited fiscal space such as Bahrain, Iraq, and Pakistan, but also in Qatar and Saudi Arabia. In other countries, fiscal positions are projected to weaken in 2026, reflecting support to households and firms to cushion the terms-of-trade shock (Morocco, Algeria, and Tunisia), as well as higher investment to begin repairing conflict-related infrastructure damage (United Arab Emirates and Kuwait) (Figure 1.18). From 2027 onward, fiscal policy stances are expected to turn restrictive in almost all MENAP economies. Fiscal stances vary across the CCA. Azerbaijan and Kazakhstan are expected to continue consolidating in 2026, with consolidation extending beyond 2026 in Azerbaijan. By contrast, fiscal policy is projected to ease in most oil-importing CCA countries, except Armenia, in 2026 and turn restrictive in 2027–28.

Risks: Narrowing Margins of Adjustment

Risks to the regional outlook remain tilted to the downside. Renewed hostilities and further disruptions through the Strait of Hormuz could prolong output losses and drive energy prices above the baseline as existing buffers fade. A reassessment of AI-related returns in key advanced economies could trigger equity corrections, weaken investment and global demand, and lower oil prices. Higher interest rates could raise borrowing costs, with risks particularly in economies with large financing needs and banks heavily exposed to sovereign debt. On the upside, a faster and durable de-escalation of the regional conflicts, stronger return from AI investment, deeper trade integration and diversification, and faster renewable-energy investment would all improve the outlook.

A renewed escalation of the war in the Middle East remains a key downside risk for the region. A longer or more severe conflict would deepen disruptions to shipping routes and energy infrastructure, force further oil production shutdowns, weaken hydrocarbon production and exports, and slow non-hydrocarbon activity in MENAP oil exporters. This scenario could trigger a much larger rise in energy prices than assumed in the baseline, especially if the factors that have helped contain the impact of the shock on commodity prices were to weaken over time (Box 1.1). Renewed disruptions to energy infrastructure could also exacerbate shortages of refined oil products, pushing retail energy prices higher. Rising energy and food prices could heighten social pressures in vulnerable economies with limited fiscal space to cushion the pass-through to domestic prices. Such a scenario would weaken growth in conflict-affected MENAP oil exporters and, to a lesser extent, in oil importers in the Middle East and Central Asia, while benefiting regional energy exporters less directly exposed to the conflict (Box 1.2).

Figure 1.18. Fiscal Impulse
(Changes in fiscal balances, inverted sign, percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

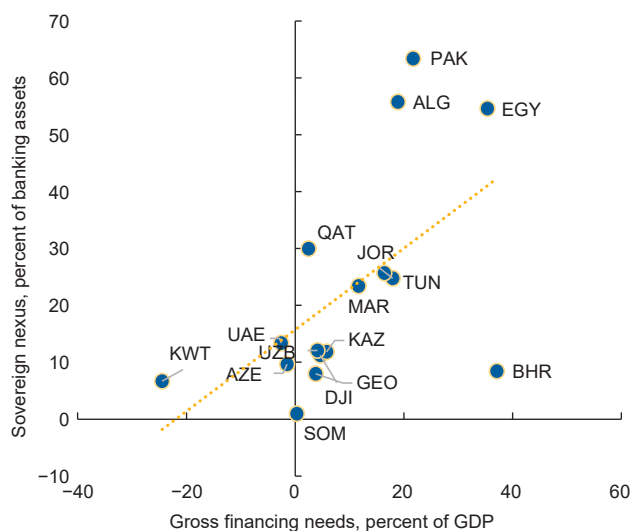
Note: The fiscal impulse is calculated as the annual change of the primary fiscal balance, with an inverted sign (a negative fiscal impulse implying a tighter fiscal policy stance). For oil exporters, it refers to the annual non-oil primary fiscal balance expressed as a percentage of non-oil GDP; for oil importers, it refers to the cyclically adjusted primary fiscal balance as a percentage of GDP (or the primary fiscal balance in cases where the cyclically adjusted balance is unavailable). For some GCC countries, the 2026 fiscal impulse reflects large declines in the denominator rather than new discretionary fiscal measures. For Egypt, the fiscal impulse is based on cyclically adjusted central government balance. 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, Pakistan.

A reassessment of AI-related expectations would also affect the region through global demand, financial markets, and oil prices. As highlighted in the October 2026 *World Economic Outlook*, if expectations of AI-driven profitability and productivity gains were to prove overly optimistic, investment in AI-related infrastructure could slow sharply and equity markets could face a broad repricing, with spillovers to global financial conditions and demand. Under this scenario, lower oil prices resulting from weaker global demand would be a key channel of contagion for oil exporters in the Middle East and Central Asia, while the adverse effects of lower global demand on oil importers would be partly offset by the positive terms of trade shock associated with lower commodity prices. GCC economies are also directly exposed through their sovereign wealth funds' substantial investments in US markets.² AlHassan and others (2026) illustrate this vulnerability in a downside scenario where a reassessment of AI-related productivity gains leads to lower technology investment, weaker global equity prices, and tighter financial conditions, reducing GCC output by about 1 percent cumulatively over two years.

Tighter global financial conditions could expose fiscal and financial vulnerabilities. A reversal of market sentiment would tighten global financial conditions, eroding a key supporting factor for many economies in the Middle East and Central Asia so far in 2026. Higher oil prices than in the baseline would reignite inflation concerns and force major central banks to raise interest rates higher and for longer than currently assumed. Concerns about rising government debt could also lead to higher government borrowing costs than in the baseline, heightening fiscal sustainability concerns in countries with large gross financing needs, like Algeria, Egypt and Pakistan (Figure 1.19). In countries where banks rely more heavily on external funding or hold large amounts of government securities, an abrupt repricing of financial assets could further reduce lending to the private sector, weaken investment and growth, and reinforce adverse feedback loops between fiscal vulnerabilities, banking systems, and the real economy. Economies reliant on external financing and weaker external positions could face capital outflows, exchange rate depreciation pressures, wider sovereign spreads, and tighter domestic financial conditions.

Higher-than-projected food prices or further declines in official development assistance would materially increase risks for low-income countries in the Middle East and Central Asia. Agricultural price pressures could intensify as higher costs of fertilizer, a strengthening El Niño, and continued disruptions to cereal trade because of the Russia-Ukraine conflict threaten to raise production costs and constrain global food supplies in 2027 and beyond. The large share of food in consumption baskets and the relatively greater import dependence make Middle East and Central Asia's low-income countries particularly vulnerable to further increases in food prices. IMF staff estimates suggest that a further 20 percent increase in cereal prices could raise net imports for low-income countries by between 0.06 and 0.4 percent of GDP, above the average impact on other countries in the region (Figure 1.20). Continued declines in official development assistance would add to these pressures,

Figure 1.19. Gross Financing Needs and Bank Exposures to Sovereign Debt, 2025
(Percent)

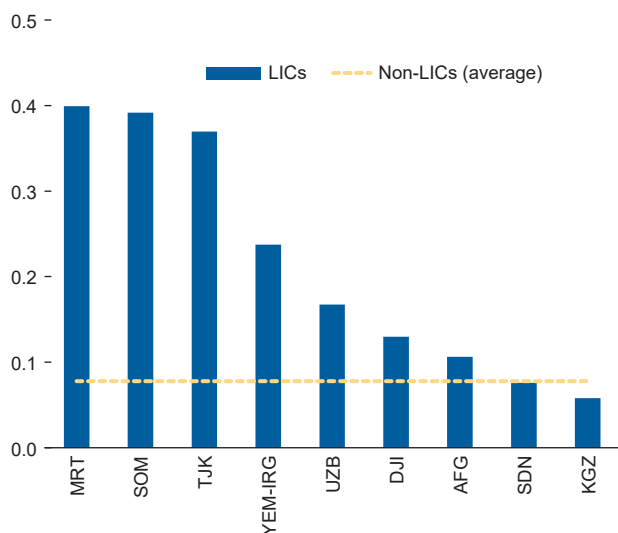


Sources: Haver Analytics; IMF, Regional Economic Outlook database; IMF Monetary and Financial Statistics (MFS); and IMF staff calculations.

Note: Data labels in the figure use International Organization for Standardization (ISO) country codes.

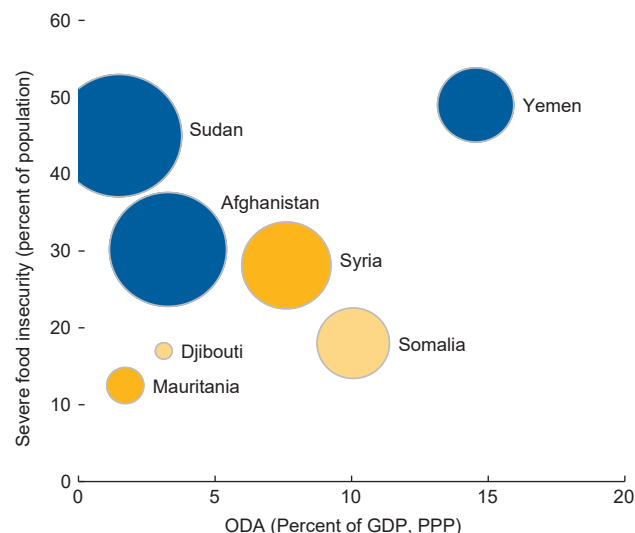
² Estimates compiled in Valladares (2026), using 2024 assets under management and information from sovereign fund documents, suggest that 11 GCC sovereign wealth funds held about \$1.7-1.9 trillion in US assets, equivalent to roughly one-third of their combined assets under management.

Figure 1.20. Impact of Additional 20 Percent Increase in Food Prices on Net-Imports, 2027
(Percent of GDP)



Sources: FAO; IMF, Regional Economic Outlook database; IMF, World Economic Outlook database; IPC; OECD ODA dataset; UN Comtrade; World Food Programme; and IMF staff calculations. Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. LICs = low-income countries.

Figure 1.21. ODA Dependence and Food Insecurity

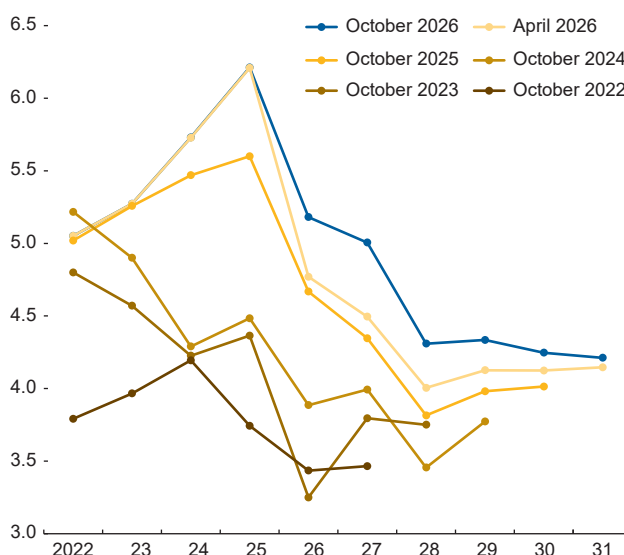


Sources: FAO; IMF, Regional Economic Outlook database; IMF, World Economic Outlook database; IPC; OECD ODA dataset; World Food Programme; and IMF staff calculations. Note: The size of the bubble is the latest population size (2024 or 2023). Bubble colors represent estimated decline in official development assistance in real terms since 2021: Blue >50 percent; orange 27-50 percent; and yellow <27 percent.

especially where aid dependence and food insecurity are high (Afghanistan, Sudan, Yemen) (Figure 1.21). A larger or more persistent shock would raise the fiscal cost for Djibouti and Mauritania in their attempt to gradually adjust basic food products and fuel prices.

CCA economies remain highly exposed to developments in the Russia-Ukraine war. Baseline projections assume a gradual return to potential growth for CCA economies, as the positive spillovers that have supported the region since the onset of the war—including trade rerouting, migration, remittances, and capital inflows—fade over time. The repeated upward revisions to growth projections since the war in Ukraine began, however, suggest that growth could again exceed expectations if some of these spillovers prove more durable than currently assumed, continuing to support investment, productivity, and potential output (Figure 1.22). A further escalation and tighter sanctions could disrupt trade, transport corridors, and cross-border payments, while weaker growth in Russia and a depreciation of the ruble could reduce external demand and remittance inflows, adding pressure to growth and on current account balances in the CCA. At the same time, an end to Russia's war in Ukraine and a lifting of sanctions on Russia could improve sentiment toward the CCA region, reduce risk premiums, and lower external borrowing costs.

Figure 1.22. CCA: Real GDP Growth Projections
(Year-over-year percent change)



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

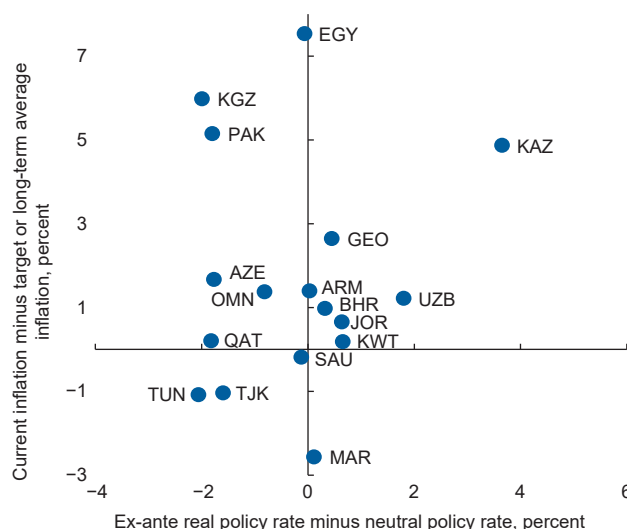
Upside risks stem primarily from stronger-than-expected productivity growth and economic diversification. Momentum in AI-related investment could prove stronger and more persistent than assumed in the baseline, while faster diffusion of AI technologies, together with complementary investment in digital infrastructure, energy systems, and human capital, could generate larger productivity gains than currently embedded in forecasts. Several GCC economies are already investing heavily to position themselves as global AI hubs and could benefit disproportionately from stronger AI-related demand and investment. In this upside scenario, stronger global demand would push energy prices above current assumptions. This would benefit oil exporters in the Middle East and Central Asia, while weighing on economies that rely heavily on imported energy. At the same time, efforts to diversify supply chains and trade routes could accelerate investment in new pipelines, transport infrastructure, and alternative export corridors, supporting activity in both MENAP and CCA while strengthening resilience to future disruptions. The development of the Middle Corridor and other regional transport links could further enhance trade, logistics and investment opportunities in the CCA. Higher and more volatile fossil fuel prices could also encourage faster investment in renewable energy, energy storage, and efficiency, creating new growth opportunities for economies with stronger renewable-energy potential and critical minerals endowments.

Policy: From Cushioning the Shock to Building Resilience

In the near term, policies should remain focused on maintaining economic stability and mitigating the impact of the conflict within countries' policy space. Any support needed should be temporary, well targeted, and tailored to capacity. This applies particularly if downside risks materialize, where policies should remain agile and proactive. In flexible exchange rate regimes, monetary policy should remain the first line of defense to contain inflation, especially where expectations are weakly anchored. Stronger central bank independence and fiscal rules can reduce inflation pass-through and adjustment costs. Over the medium term, rebuilding fiscal buffers through credible consolidation, broader tax bases, stronger administration, and more efficient spending would be essential. Costly and regressive energy subsidies should be phased out as shocks recede, with savings redirected to targeted social protection. Decisive efforts on structural reforms, including trade and production diversification, energy efficiency, and AI preparedness will help raise countries' potential growth and strengthen resilience.

If inflationary risks materialize, monetary policy should be the main line of defense. Although baseline forecasts generally point to moderating inflation in the Middle East and Central Asia from 2027 onward, authorities should remain prepared for renewed price pressures if the Middle East conflict persists longer than assumed and the adverse scenario discussed in Box 1.2 materializes. Countries should stand ready to tighten monetary policy, particularly where inflation is already above target and the policy stance appears accommodative, with ex-ante policy rates below estimated neutral levels (Figure 1.23), a combination most evident in the Kyrgyz Republic and Pakistan. Where fiscal space is limited, authorities should avoid using fiscal stimulus to offset the impact of tighter monetary policy. As shown in

Figure 1.23. Inflation Gap with Target and Monetary Policy Stance
(Percent)



Sources: Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.

Note: The ex-ante real policy rate is the difference between the nominal policy rate and 2027 IMF staff projected inflation rate. For countries with a currency peg to the US dollar, a 2 percent inflation target is assumed. For countries with a target band, the midpoint of the band is used. Neutral policy rates are estimated by IMF staff as in Chapter 2 of the April 2023 *Regional Economic Outlook: Middle East and Central Asia*. Monetary policy data labels in the figure use International Organization for Standardization (ISO) country codes.

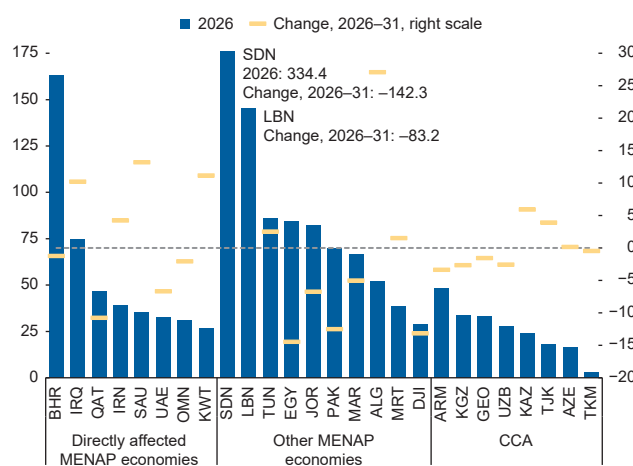
Box 1.3, countercyclical fiscal support in such circumstances could prove counterproductive: higher sovereign spreads and rising debt sustainability concerns would offset its stabilization benefits and worsen both inflation and debt dynamics. A more appropriate policy mix would combine a tighter monetary stance to keep inflation expectations anchored with cautious fiscal policy to safeguard sustainability and reduce the overall cost of adjustment. Such cautious response could well include budget-neutral, well-targeted and temporary forms of support for those segments of the population that are most affected by the commodity price shock. Where fiscal policy is contributing to excess demand, as in a few CCA economies, fiscal restraint should instead complement monetary tightening, irrespective of available fiscal space, particularly where monetary transmission is weak.

An active fiscal response may be warranted for countries directly impacted by the conflict, but its scale and composition of support should be carefully calibrated to available fiscal space. A more prolonged conflict could further weaken non-oil activity in MENAP oil-exporting countries and increase the risk of medium-term scarring. Countries with sizable buffers, such as Saudi Arabia and the United Arab Emirates, could consider easing the fiscal stance within a credible medium-term framework. By contrast, countries with more limited buffers, such as Bahrain and Iraq, should meet new spending needs mainly through reprioritization and rephasing of planned expenditure. Fiscal support should focus on preserving viable firms, easing supply bottlenecks, repairing damaged infrastructure, and financing investments that strengthen resilience to future shocks. These measures should be guided by rigorous cost-benefit analysis and financed through an appropriate mix of budgetary resources, borrowing, and private participation, with all fiscal costs and contingent liabilities transparently assessed and managed.

Over the medium term, strengthening policy frameworks and economic fundamentals would help reduce the inflationary impact of external supply shocks. Chapter 2 of this *Regional Economic Outlook* shows that stronger fiscal buffers, more credible and independent central banks, deeper financial markets, and more flexible labor markets can dampen the pass-through from external cost shocks to domestic prices and inflation expectations. In particular, after a global supply shock, headline CPI after two years is estimated to rise by a cumulative 6 percent in economies with weaker central bank independence, compared with about 1.5 percent in those with stronger independence; the former also experience a larger increase in inflation expectations, more pronounced monetary tightening, and greater output losses. Economies in the Middle East and Central Asia with these characteristics typically require smaller policy rate increases to contain second-round effects from supply shocks and have historically experienced less persistent inflation. Strengthening the economic fundamentals would therefore lower the output costs of disinflation and make inflation less vulnerable to external price shocks over the long term.

Rebuilding fiscal buffers remains essential for countries with limited fiscal space, given the shock-prone environment. Although baseline projections generally point to improving fiscal positions over the medium term, public debt is projected either to rise further (Algeria, Iraq) or to remain high (Bahrain, Egypt, Jordan, and Tunisia) (Figure 1.24). Rebuilding fiscal buffers in these economies requires a credible process of fiscal consolidation, based on a durable expansion of the tax base through new revenue measures, stronger tax administration, and better compliance, an area where the Middle East and Central Asia show a relatively higher tax gap than other regions. Spending efficiency would also need to improve, with prioritization that safeguards growth- and

Figure 1.24. Gross General Government Debt
(Percent of GDP)



Sources: IMF, World Economic Outlook; and IMF staff calculations. Note: Data are as of September 10, 2026. 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, Pakistan.

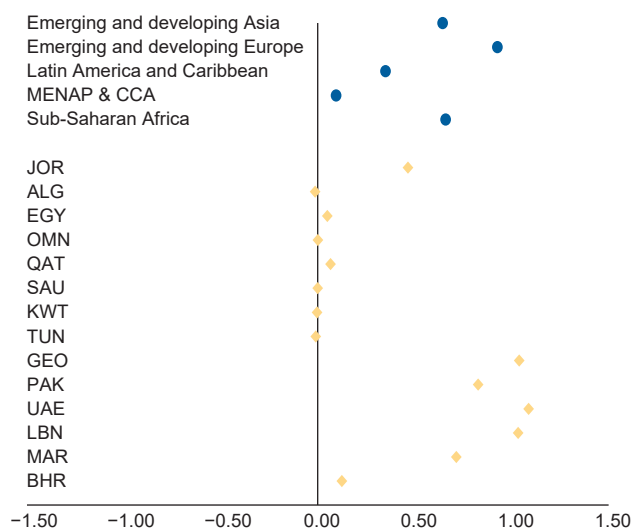
equity-enhancing outlays, such as infrastructure, human capital, and targeted social protection. Stronger fiscal frameworks, anchored in fiscal rules that are legally grounded, transparent, well-monitored and enforced, and resilient to shocks, would ease the adjustment and lower its output costs by reinforcing commitment to medium-term debt sustainability and anchoring private sector expectations (Hasan and others 2026).

Energy subsidies are costly and regressive and should be phased out as the impact of the commodity price shock recedes. In many economies in the Middle East and Central Asia, the relatively lower pass-through from global fuel prices to domestic retail prices, compared with other regions, points to the continued role of administered pricing in absorbing part of the shock (Figure 1.25). Energy subsidies and administered prices can help cushion the near-term effects of higher global prices on inflation and activity. However, they also tend to be regressive (Chapter 2 of the October 2026 *World Economic Outlook*) and shift part of the adjustment burden to public finances. Model simulations suggest that oil consumption subsidies reduced the inflationary impact of the regional oil price surge by about 0.4 percentage point in 2026, at an estimated fiscal cost of about 0.5 percent of GDP, with sizable variation across subregions depending on subsidy use (Box 1.4). Energy subsidy reforms implemented in recent years in several countries (Bahrain, Egypt, United Arab Emirates) have reduced vulnerabilities and created greater policy flexibility. Economies in the Middle East and Central Asia should build on this progress by strengthening energy pricing frameworks to leverage price signals, contain fiscal costs and preserve incentives for efficient energy use, while expanding well-targeted social protection for vulnerable households.

In MENAP low-income economies, support to vulnerable households should be calibrated to administrative capacity, as well as available fiscal space. Countries should avoid broad food price subsidies and reallocate spending toward well-targeted and temporary assistance programs that protect the most vulnerable. The design of assistance should be guided by the drivers of food insecurity (affordability vs. availability), targeting capacity, and administrative feasibility. Countries where food is available and markets function reasonably well (Djibouti and Mauritania) should consider cash transfers or vouchers, while countries where markets are thin and disrupted, or food access is constrained by conflict or acute shortages (Afghanistan, Somalia, Sudan and Yemen), could instead rely on in-kind food assistance programs (Amaglobeli and others 2026). In-kind assistance should be temporary and require adequate targeting capacity, as prolonged in-kind support can be costly and distort local markets. Stronger domestic revenue mobilization and better aid coordination will also be essential to preserve essential services, limit arrears, and reduce the risk that declining aid exacerbates food insecurity, displacement-related spending pressures, and inflation.

Authorities should stand ready to safeguard financial stability amid downside risks. Financial supervisors should continue to monitor bank liquidity and funding conditions, asset quality in the sectors most exposed to the conflict–tourism, transport, and trade-related activities—and sovereign-bank linkages where public debt is elevated (Bahrain) and banks hold large stocks of government securities (Egypt, Pakistan, Tunisia). Where

Figure 1.25. Diesel: Pass-through of Global Prices to Domestic Retail Prices, By Region and Country
(Elasticity; February 23–September 14)



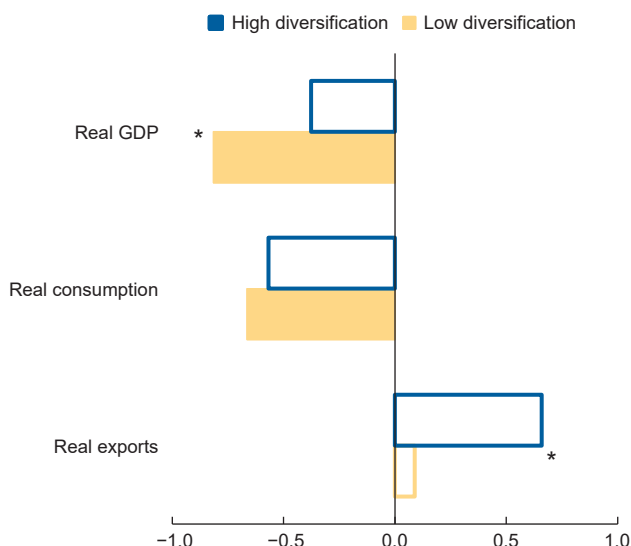
Sources: Global Petrol Prices; US Energy Information Administration; and IMF staff calculations.
Note: Pass-through is calculated for diesel prices as the ratio between the difference in domestic retail prices and the difference in international prices (spot prices). Regional estimates reflect the median. 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, Pakistan.

liquidity pressures emerge, support should be temporary, well targeted, and provided against adequate collateral, with a clear exit strategy. In economies with flexible exchange rates, foreign exchange intervention should be reserved for disorderly market conditions. Exchange rate flexibility can help preserve reserves and facilitate external adjustment (Egypt, Pakistan) but may also increase inflationary pressures through higher import prices. The appropriate balance between exchange-rate adjustment and monetary policy tightening will depend on country circumstances. Where external buffers are thin and financing needs are large, credible macroeconomic frameworks and transparent communication can help contain risk premia and preserve market access.

Policymakers should also try to convert ongoing disruptions and volatility into long-term opportunities for their countries. Policy efforts so far have focused on mitigating the immediate effects of trade disruptions and heightened uncertainty, but greater frequency and persistence of global shocks in the recent past underscore the need to accelerate reforms that lift productivity and reduce reliance on a narrow set of sectors and markets. Beyond efforts on improving the business environment, enhancing competition, and strengthening governance, which have been emphasized in previous Regional Outlook reports, current IMF staff analysis underscores two areas where further advances are needed:

- *Trade diversification.* Chapter 3 of this *Regional Economic Outlook* shows that greater trade diversification enhances resilience to shocks, including disruptions in trade and transport networks. Despite notable progress over the past two decades, MENAP and CCA economies remain less diversified in trade than the rest of the world. They export a narrower basket of goods than economies elsewhere, and MENAP economies remain particularly exposed to disruptions in maritime trade. Chapter 3 shows that deeper export diversification in MENAP and the CCA could significantly strengthen economic resilience by reducing the decline in activity after adverse external shocks (Figure 1.26). The benefits are greatest when diversification is supported by structural reforms that improve allocative efficiency and boost productivity, including more flexible labor markets and higher human capital. Deeper trade integration can play a further role in dampening the impact of external shocks, by enabling lower cost trade routing. Industrial policy can also increase export diversification, but unless it addresses clearly identified market failures, it may reduce overall welfare because of its accompanying fiscal and efficiency costs. Moreover, empirical evidence points to the greater effectiveness of structural reforms than industrial policies in promoting export diversification over the past two decades.
- *Artificial intelligence.* Recent IMF analysis shows that the adoption of AI offers Middle East and Central Asia economies a unique opportunity to raise productivity, support diversification, and strengthen medium-term growth (AlHassan and others 2026). Several GCC economies are making substantial investments to position themselves as global AI hubs. In 2025, Qatar, Saudi Arabia, and the United Arab Emirates announced AI-related investments exceeding 5 percent of GDP, amounting to roughly \$120 billion, with most investments concentrated in data centers and AI infrastructure. The analysis suggests that AI adoption could raise annual growth across MENAP and CCA economies by about 0.1–0.6 percentage point per year, over the medium term, though gains will vary with countries' exposure to AI technologies and their preparedness to adopt them (Figure 1.27). Realizing these benefits will require not only investments in digital infrastructure, human capital, workforce upskilling, and innovation ecosystems, but also the development of exportable AI services and access to external markets to fully capture the macroeconomic gains from AI-related investments. AI readiness should be viewed as part of a broader structural reform agenda—not a substitute for it. Improvements in education, governance, trade openness, and private sector dynamism remain essential if AI is to contribute to productivity growth and more diversified economies.

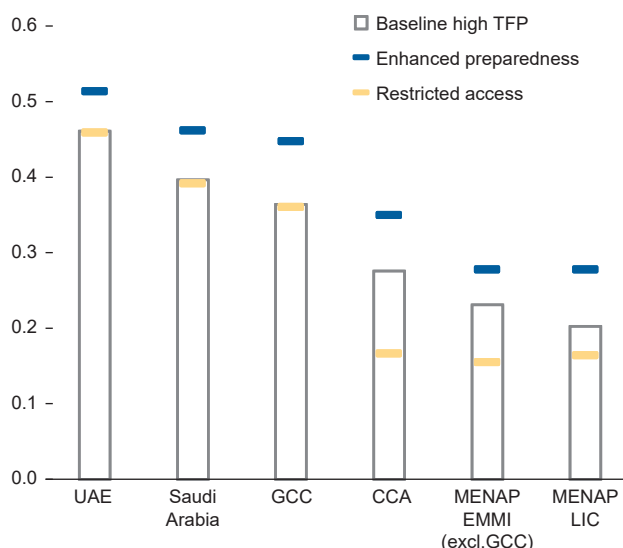
Figure 1.26. External Demand Shock
(Percentage points at two-year horizon)



Sources: CEPII, BACI database; IMF, Global Economic Environment database; IMF, World Economic Outlook database; and IMF staff calculations.

Note: High diversification refers to economies in the top quartile of the Export Product Diversification Index, while low diversification refers to all other economies. An asterisk (*) indicates that the high- and low-diversification group estimates differ significantly at the 10 percent level or lower. Hollow bars indicate lack of significance of the group coefficient at the 10 percent level.

Figure 1.27. Enhanced Preparedness and Restricted Access: Impact on Real GDP
(Percentage point deviation from no shock scenario, 10-year average annual impact)



Sources: IMF Global Integrated Monetary and Fiscal Model (GIMF); and IMF staff calculations.

Note: CCA = Caucasus and Central Asia; EMMI = emerging market and middle-income economy; GCC = Gulf Cooperation Council, GCC excludes the United Arab Emirates and Saudi Arabia; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, Pakistan; UAE = United Arab Emirates.

The IMF Is Committed to Supporting the MENAP and CCA Regions

The IMF remains deeply engaged across the MENAP and CCA regions, providing policy advice, financing, and capacity development. Since 2020, the IMF has approved about \$48 billion in financing for countries across MENAP and the CCA. Support has included new and augmented arrangements as well as emergency financing for economies facing balance of payments pressures from higher energy and food import costs, alongside continued program engagement in Armenia, Egypt, Jordan, Mauritania, Pakistan, and Somalia, and a precautionary Flexible Credit Line arrangement with Morocco. Beyond financing, the IMF has delivered 437 technical assistance and capacity development projects across 31 countries in these regions during FY2026. The IMF's strong regional presence, through resident representative offices, technical assistance centers, and its office in Riyadh, supports close engagement with country authorities. The IMF also works closely with the World Bank and regional partners to support conflict-affected states and address food insecurity in vulnerable economies, combining policy advice, financing, and capacity development.

Box 1.1. Energy Markets: Disruptions and Offsetting Factors

The war in the Middle East has significantly disrupted global oil supplies. By July, cumulative supply losses attributable to the conflict had reached 1.8 billion barrels. Although these disruptions have far exceeded those recorded during previous conflicts, including the 1973 oil shock and the 1990 Gulf War (Figure 1.1.1), the increase in crude oil prices has been more muted than in those episodes and smaller than the scale of the supply losses would have led many to fear (Figure 1.1.2).

Figure 1.1.1. Cumulative Oil Supply Shortfalls
(Billions of barrels)

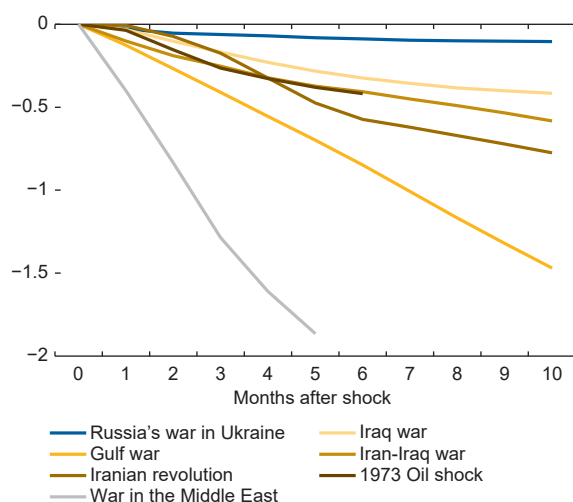
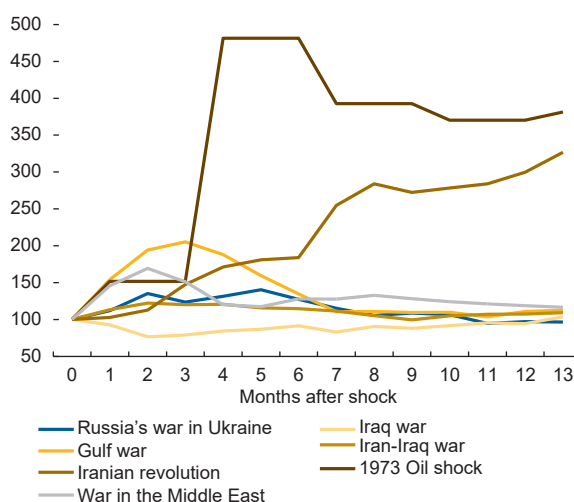


Figure 1.1.2. Cumulative Change in Brent Prices
(Index, month before shock = 100)



Sources: IEA; Kpler; and IMF staff calculations

Market adjustments and inventory drawdowns have helped offset the supply shock and kept prices from rising much higher. Four factors have been at play, mitigating the impact on prices:

- **A solid starting position.** In the days before the war, the oil market was running a surplus of about 2.1 million barrels per day (mb/d) on average, which acted as an initial buffer.
- **New oil supply from non-Gulf producers,** adding about 1.8 mb/d relative to the period immediately before the war, cumulatively about 280 million barrels from March through July. These additions have plateaued near 2 mb/d even as the conflict has dragged on, as capacity limits began to bite.
- **Demand compression.** Final product demand fell by 750 million barrels in March through July relative to pre-war levels, an average of 4.9 mb/d over the period. The pace of adjustment has eased over the summer as crude exports partially recovered after the June U.S.-Iran Memorandum of Understanding. Asia accounted for the bulk of the contraction, with China contributing about one-quarter of the decline.
- **Inventory drawdowns.** Observed crude and product inventories fell by about 440 million barrels in March through July relative to pre-war, at an average pace of 2.9 mb/d. Organisation for Economic Co-operation and Development (OECD) government stocks accounted for half of the drawdown, mainly reflecting strategic reserve releases, while non-OECD stocks and oil-on-water also fell.

This box was prepared by Hela Mrabet.

Box 1.2. Adverse Scenario

This box presents a model-based simulation of an adverse scenario that illustrates the risks to the outlook for economies in the Middle East and Central Asia.¹

In this scenario, consistent with the adverse scenario in Box 1.2 of the October 2026 *World Economic Outlook*, the conflict is assumed to continue through the second quarter of 2027, with trade conditions gradually normalizing over the course of the year. Until hostilities end, disruptions to oil production among affected MENAP oil exporters are assumed to remain proportional to those observed, on average, so far in 2026. As supply disruptions persist, the factors that have thus far cushioned the impact on oil prices fade, pushing oil prices to an average of about \$130 per barrel in 2027, roughly 45 percent above the baseline. The energy shock and concerns with the fiscal outlook lead to a reassessment of risks on long-term public borrowing, raising term premiums and medium-term inflation expectations to varying degrees worldwide. These effects are all assumed to decay gradually as trade recovers. Finally, heightened uncertainty impedes business investment in exposed economies, persistently reducing potential non-oil growth by 0.2 percentage points.

In this scenario, directly affected MENAP and CCA oil exporters would bear the brunt of the impact: real GDP falls by an average of about 3.8 percent while inflation rises about 1¼ percentage points above baseline in 2027. Fiscal and external balances improve slightly, as the revenue impact from the higher oil prices more than offsets that from the lower volume of oil exports. Other MENAP oil exporters benefit from improved terms of trade, lifting growth 1.4 percentage points above baseline in 2027 as inflation rises 0.7 percentage points. For MENAP and CCA oil importers, the terms-of-trade deteriorations generate stagflation, reducing average real GDP by about 0.5 percent while raising their consumer price index (CPI) inflation by about 1 percentage point relative to baseline in 2027, while moderately worsening their fiscal and current account balances.

Figure 1.2.1. Price of Oil
(US dollars per barrel)

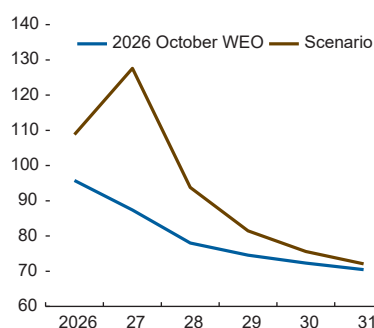


Figure 1.2.2. Real GDP
(Percent, deviation from baseline)

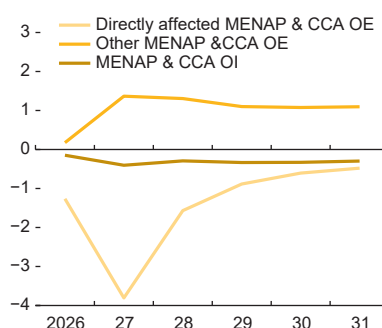
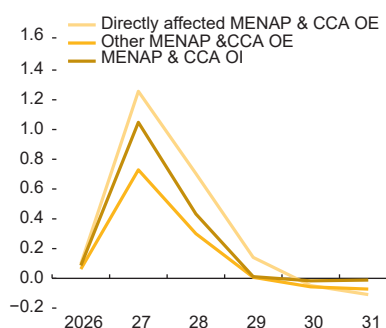


Figure 1.2.3. CPI Inflation
(Percentage points, deviation from baseline)



Sources: MCD-DSGE Model simulation results; IMF World Economic Outlook database; and IMF staff calculations.

Note: CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, Pakistan; OE = oil exporter; OI = oil importer; WEO = World Economic Outlook.

The author of this box is Francis Vitek.

¹ The box uses MCD-DSGE Model, a global DSGE model linking 20 economies in the Middle East and Central Asia to the systemic economies. For more details, see Troug and Vitek (forthcoming).

Box 1.3. Monetary and Fiscal Policy Responses for Oil Importers to the War in the Middle East

This box presents scenario analysis highlighting how economies in the Middle East and Central Asia with monetary policy autonomy should calibrate their monetary and fiscal policy mix in response to a global supply shock like the one posed by the Middle East conflict. To do so, it uses the MCD-DSGE Model of Box 1.2 to simulate the impact on oil-importing economies in the Middle East and Central Asia with monetary policy autonomy from the energy production disruptions associated with the Middle East conflict, together with higher global food prices and tighter global financial conditions.

As the worsening of the terms of trade increases CPI inflation and reduces non-oil output gaps, central banks react in the model by tightening the monetary policy stance (under a flexible inflation targeting or managed exchange rate regime) to limit second-round effects of the shock. Fiscal policymakers can react in two ways: i) with a passive fiscal policy, characterized by an acyclical fiscal response that only allows the full working of automatic stabilizers, and ii) with an active fiscal policy response that complements the working of automatic stabilizers with a countercyclical expenditure-based fiscal stimulus.

Figure 1.3.1. Non-Oil Output Gap
(Percentage points, deviation from pre-conflict baseline)

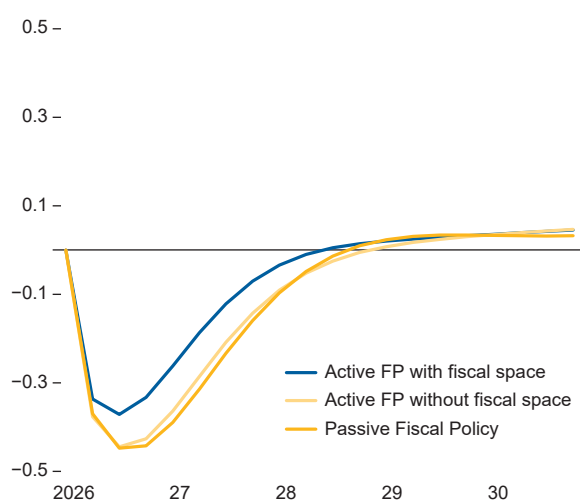
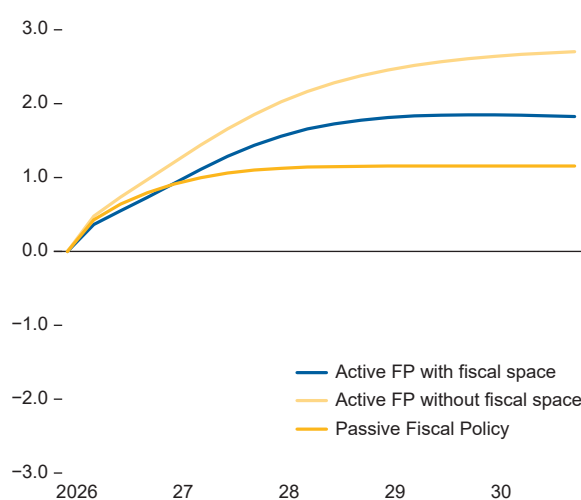


Figure 1.3.2. Government Debt in Percent of GDP
(Percentage points, deviation from pre-conflict baseline)



Sources: MCD-DSGE Model simulation results.

Note: The figures depict scenario simulation results under i) active fiscal policy with fiscal space (red); ii) active fiscal policy without fiscal space (green); and iii) passive fiscal policy (blue). FP = fiscal policy.

The simulations are run to differentiate the results based on the presence of fiscal space and the degree to which inflation expectations are anchored. The lack of fiscal space is modeled by assuming that an active fiscal policy response triggers an additional widening of government bond spreads by 400 basis points, as is typical during sovereign stress episodes (Caterina and Saenz 2021). Well-anchored and less-well-anchored inflation expectations are modeled by assuming high and low nominal price and wage rigidities, respectively.

The results show that the inflationary impact of the shock is predicted to be substantial if expectations are not well anchored, triggering a significantly larger interest rate hike under the model's monetary policy rule and further lowering non-oil output.

Box 1.3. (continued)

If fiscal space exists, then fiscal policy easing can ameliorate this monetary policy tradeoff, with timely and targeted fiscal stimulus significantly mitigating the fall in the non-oil output gap, particularly where inflation expectations are well anchored. In the absence of fiscal space, however, providing fiscal stimulus would be counterproductive, as the greater increase in interest rates triggered by the widening of the government bond spread amid mounting public debt sustainability concerns would negate the stabilization of non-oil output, while raising government debt.

This box was prepared by Francis Vitek.

Box 1.4. Oil Consumption Subsidies and the War in the Middle East

Oil consumption subsidies are widespread in the Middle East and Central Asia and dampen the transmission of global fuel price changes to domestic retail prices. Estimated gasoline and diesel pass-through coefficients are well below one in many countries.

This box examines how oil consumption subsidies shaped the economic impact of the war in the Middle East. Using counterfactual simulations in the MCD-DSGE model, it compares the effects of conflict-related oil production shutdowns with and without subsidies.

The shutdowns are estimated to have increased oil prices by 18.5 percent in the first quarter of 2026 and 57.5 percent in the second quarter, broadly in line with observed price movements. Oil consumption subsidies are estimated to have reduced the impact of this oil price surge on CPI inflation in the Middle East and Central Asia regions by 0.4 percentage point in 2026, although the effects varied markedly across subregions depending on the prevalence of the subsidies (Figures 1.4.1 and 1.4.2).

These findings are consistent with the empirical results reported in Chapter 2, which identify fuel subsidies as the largest contributing factor to inflation pass-through from global supply shocks in the region. The higher subsidies are estimated to have increased fiscal costs by 0.5 percent of GDP across the region in 2026, with substantial variation across subregions.

Figure 1.4.1. Effects of Oil Consumption Subsidies: CPI Inflation, 2026
(Percentage points, deviation from counterfactual)

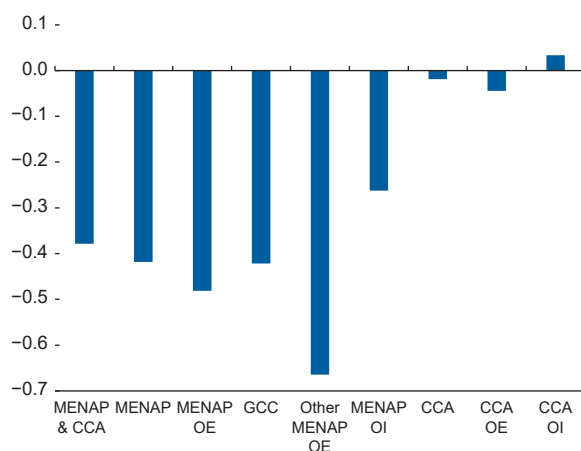
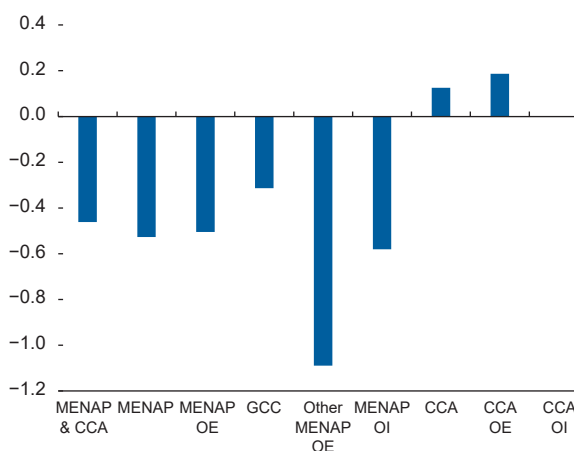


Figure 1.4.2. Effects of Oil Consumption Subsidies: Budgetary Fiscal Balance in Percent of GDP, 2026
(Percentage points, deviation from counterfactual)



Sources: MCD-DSGE Model simulation results.

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, Pakistan; OE = oil exporter; OI = oil importer.

The author of this Box is Francis Vitek.

Table 1.1. Selected Economic Indicators*(Year-over-year percent change, unless otherwise indicated)*

		Projections		
	2025	2026	2027	2031
Middle East and North Africa Region, Afghanistan, Pakistan (MENAP) ^{1,2}				
Real GDP Growth	3.3	-1.3	6.6	3.7
Current Account Balance (percent of GDP)	1.1	-1.2	1.2	0.7
Overall Fiscal Balance (percent of GDP)	-3.4	-5.0	-2.8	-2.1
Inflation (period average)	11.7	13.8	10.8	6.2
MENAP Oil Exporters				
Real GDP Growth	3.0	-5.1	8.0	3.1
Non-oil GDP Growth	2.8	-1.4	4.0	3.3
Current Account Balance (percent of GDP)	2.9	0.1	3.4	2.4
Overall Fiscal Balance (percent of GDP)	-2.9	-4.6	-1.6	-1.4
Inflation (period average)	10.9	16.7	10.2	6.7
Gulf Cooperation Council (GCC)				
Real GDP Growth	4.5	-4.8	9.1	3.4
Non-oil GDP Growth	4.5	-0.8	4.5	3.8
Current Account Balance (percent of GDP)	5.0	1.3	4.6	3.5
Overall Fiscal Balance (percent of GDP)	-0.8	-2.3	0.6	0.7
Inflation (period average)	1.7	2.7	2.4	2.0
MENA Region Non-GCC Oil Exporters				
Real GDP Growth	1.0	-5.5	6.5	2.6
Non-oil GDP Growth	0.6	-2.2	3.2	2.5
Current Account Balance (percent of GDP)	-2.3	-3.4	0.4	-0.6
Overall Fiscal Balance (percent of GDP)	-8.3	-10.8	-7.7	-7.4
Inflation (period average)	24.3	38.3	21.8	13.8
MENAP Oil Importers ^{1,2}				
Real GDP Growth	3.7	4.2	4.4	4.5
Current Account Balance (percent of GDP)	-4.0	-4.3	-4.5	-3.1
Overall Fiscal Balance (percent of GDP)	-4.9	-6.0	-5.8	-3.6
Inflation (period average)	12.9	9.9	11.9	5.7
MENAP Emerging Market and Middle-Income Economies				
Real GDP Growth	3.9	4.2	4.2	4.5
Current Account Balance (percent of GDP)	-3.0	-3.9	-4.2	-2.7
Overall Fiscal Balance (percent of GDP)	-5.2	-6.2	-6.0	-3.7
Inflation (period average)	11.7	9.2	11.0	5.5
MENAP Low-Income Countries ^{1,2}				
Real GDP Growth	1.3	4.8	9.6	6.2
Current Account Balance (percent of GDP)	-15.3	-12.1	-11.6	-11.4
Overall Fiscal Balance (percent of GDP)	-1.8	-1.9	-2.1	-1.0
Inflation (period average)	32.7	23.5	30.4	9.2
Middle East and North Africa (MENA) Region ¹				
Real GDP Growth	3.3	-2.0	7.0	3.6
Current Account Balance (percent of GDP)	1.3	-1.3	1.4	0.9
Overall Fiscal Balance (percent of GDP)	-3.3	-5.2	-2.7	-1.8
Inflation (period average)	12.8	14.9	11.0	6.2
Caucasus and Central Asia (CCA)				
Real GDP Growth	6.2	5.2	5.0	4.2
Current Account Balance (percent of GDP)	-2.7	-0.1	-0.8	-3.0
Overall Fiscal Balance (percent of GDP)	-1.6	-0.6	-1.7	-1.8
Inflation (period average)	8.4	8.0	6.7	4.7
CCA Oil Exporters				
Real GDP Growth	5.1	3.7	4.1	3.3
Non-oil GDP Growth	4.5	5.3	4.2	3.9
Current Account Balance (percent of GDP)	-1.7	2.4	1.3	-2.1
Overall Fiscal Balance (percent of GDP)	-1.6	-0.1	-1.1	-1.2
Inflation (period average)	9.2	8.9	7.2	4.8

	2025	Projections		
		2026	2027	2031
CCA Oil Importers				
Real GDP Growth	7.9	7.6	6.4	5.5
Current Account Balance (percent of GDP)	-4.7	-4.6	-4.6	-4.5
Overall Fiscal Balance (percent of GDP)	-1.6	-1.7	-2.6	-2.6
Inflation (period average)	7.1	6.7	5.8	4.7

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

¹ Excluding Syria.

² Excluding Afghanistan in 2026–31.

Note: Data refer to the fiscal year for Afghanistan and Iran (March 21/March 20), and Egypt and Pakistan (July/June).

CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa; MENAP = MENA, Afghanistan, and Pakistan.

Table 1.2. Real GDP Growth

(Year-over-year percent change)

	October 2026				April 2026				Revision since April 2026			
	2025	2026	2027	2031	2025	2026	2027	2031	2025	2026	2027	2031
Middle East and North Africa Region, Afghanistan, Pakistan (MENAP)^{1,2}	3.3	-1.3	6.6	3.7	3.2	1.4	4.6	3.7	0.1	-2.7	2.0	0.0
MENAP Oil Exporters	3.0	-5.1	8.0	3.1	2.8	-0.1	4.8	3.2	0.2	-5.0	3.2	-0.1
Gulf Cooperation Council (GCC)	4.5	-4.8	9.1	3.4	4.4	2.0	4.8	3.7	0.1	-6.8	4.3	-0.3
Bahrain	3.5	-11.3	13.9	3.1	3.1	-0.5	4.5	3.3	0.4	-10.8	9.4	-0.2
Kuwait	2.7	-16.7	17.1	2.2	3.5	-0.6	2.8	2.4	-0.8	-16.1	14.3	-0.2
Oman	2.4	4.1	2.2	2.6	2.4	3.5	3.4	2.7	0.0	0.6	-1.2	-0.1
Qatar	1.8	-15.6	18.8	3.3	2.8	-8.6	8.6	5.0	-1.0	-7.0	10.2	-1.7
Saudi Arabia	4.6	-3.3	7.9	3.6	4.5	3.1	4.5	3.6	0.1	-6.4	3.4	0.0
United Arab Emirates	6.2	-3.9	7.7	3.5	5.8	3.1	5.3	4.0	0.4	-7.0	2.4	-0.5
MENA Region Non-GCC Oil Exporters	1.0	-5.5	6.5	2.6	0.6	-3.1	4.8	2.6	0.4	-2.4	1.7	0.0
Algeria	3.9	3.8	3.2	3.0	3.8	3.8	2.9	2.6	0.1	0.0	0.3	0.4
Iran	-0.9	-7.6	3.6	2.0	-1.5	-6.1	3.2	2.1	0.6	-1.5	0.4	-0.1
Iraq	-0.4	-16.0	19.0	3.5	-0.4	-6.8	11.3	3.5	0.0	-9.2	7.7	0.0
Libya	15.9	3.3	2.9	2.1	15.9	6.7	4.5	3.8	0.0	-3.4	-1.6	-1.7
MENAP Oil Importers^{1,2}	3.7	4.2	4.4	4.5	3.8	3.8	4.3	4.4	-0.1	0.4	0.1	0.1
MENAP Emerging Market and Middle-Income Economies	3.9	4.2	4.2	4.5	3.9	3.9	4.2	4.4	0.0	0.3	0.0	0.1
Egypt	4.4	5.1	4.7	4.8	4.4	4.2	4.8	4.8	0.0	0.9	-0.1	0.0
Jordan	2.8	2.7	3.1	3.0	2.7	2.7	3.1	3.0	0.1	0.0	0.0	0.0
Lebanon	4.0	...	...	...	4.0	...	...	...	0.0	...	...	...
Morocco	4.9	4.5	4.2	4.0	4.9	4.9	4.5	4.0	0.0	-0.4	-0.3	0.0
Pakistan	3.2	3.6	3.5	4.5	3.1	3.6	3.5	4.5	0.1	0.0	0.0	0.0
Tunisia	2.7	2.4	2.0	1.5	2.5	2.1	1.6	1.5	0.2	0.3	0.4	0.0
West Bank and Gaza	4.3	...	...	...	...	...	...	...	...	...	...	...
MENAP Low-Income Countries^{1,2}	1.3	4.8	9.6	6.2	3.0	1.8	5.9	4.1	-1.7	3.0	3.7	2.1
Afghanistan	1.5	...	...	...	3.0	...	...	...	-1.5	...	...	...
Djibouti	4.9	5.6	5.0	5.5	6.0	6.0	6.0	5.5	-1.1	-0.4	-1.0	0.0
Mauritania	3.6	4.4	4.4	3.0	4.2	4.4	4.5	3.0	-0.6	0.0	-0.1	0.0
Somalia	3.1	2.3	2.7	4.0	3.0	2.6	3.1	4.2	0.1	-0.3	-0.4	-0.2
Sudan	0.0	7.0	15.0	8.0	3.2	0.7	8.1	4.5	-3.2	6.3	6.9	3.5
Syria	...	...	...	...	...	...	...	...	...	...	...	...
Yemen	-0.5	-1.5	0.0	2.5	-0.5	0.5	1.5	2.5	0.0	-2.0	-1.5	0.0
Middle East and North Africa (MENA) Region¹	3.3	-2.0	7.0	3.6	3.2	1.1	4.8	3.6	0.1	-3.1	2.2	0.0
Caucasus and Central Asia (CCA)	6.2	5.2	5.0	4.2	6.2	4.8	4.5	4.1	0.0	0.4	0.5	0.1
CCA Oil Exporters	5.1	3.7	4.1	3.3	5.1	3.9	3.8	3.3	0.0	-0.2	0.3	0.0
Azerbaijan	1.4	1.7	2.3	2.5	1.4	2.2	2.5	2.5	0.0	-0.5	-0.2	0.0
Kazakhstan	6.5	4.4	4.9	3.6	6.5	4.6	4.4	3.6	0.0	-0.2	0.5	0.0
Turkmenistan	3.6	2.4	2.5	2.6	3.6	2.6	2.0	2.3	0.0	-0.2	0.5	0.3
CCA Oil Importers	7.9	7.6	6.4	5.5	7.9	6.1	5.6	5.4	0.0	1.5	0.8	0.1
Armenia	7.1	5.5	5.5	5.0	7.2	5.3	5.5	5.0	-0.1	0.2	0.0	0.0
Georgia	7.5	7.2	5.7	5.0	7.5	5.3	5.0	5.0	0.0	1.9	0.7	0.0
Kyrgyz Republic	11.1	9.0	7.0	5.3	11.1	6.1	6.1	5.2	0.0	2.9	0.9	0.1
Tajikistan	8.4	7.3	6.8	5.5	8.4	6.0	4.8	4.5	0.0	1.3	2.0	1.0
Uzbekistan	7.7	7.8	6.5	5.7	7.7	6.5	5.9	5.7	0.0	1.3	0.6	0.0

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

Note: Data refer to the fiscal year for Afghanistan and Iran (March 21/March 20), and Egypt and Pakistan (July/June).

CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa; MENAP = MENA, Afghanistan, and Pakistan.

¹ Excluding Syria.² Excluding Afghanistan in 2026–31.

References

- AlHassan, Abdullah, Serpil Bouza, Vrinda Handa, Giovanni Melina, Nareg Mesrobian, Karmen Naidoo, John Ralyea, and others. 2026. "Harnessing Artificial Intelligence's Potential in the Middle East and Central Asia." IMF Departmental Paper, International Monetary Fund, Washington, DC.
- Amaglobeli, David, Todd Benson, Tewodaj Mogues, and Kaleb Tamiru Gulilat. 2026. "How to Classify and Choose among Food Assistance Spending Modalities: Practical Guidance on Targeting and Design." IMF How To Notes 2026/001, doi: 10.5089/9798229035101.061
- Caterina, Rho, and Manrique Saenz. 2021. "Financial Stress and the Probability of Sovereign Default." *Journal of International Money and Finance* 110: 102305.
- Dudu, Hasan, Troy Matheson, Dirk Muir, Karmen Naidoo, Salem Nechi, and Pedro Rodriguez. 2026. "Resilience by Design: What Role Can Policy Frameworks Play in the Middle East and Central Asia?" IMF Working Paper WP/26/138, International Monetary Fund, Washington, DC.
- Troug, Haytem, and Francis Vitek. Forthcoming. "A Global DSGE Model for Oil-Dependent Economies." IMF Working Paper, International Monetary Fund, Washington, DC.
- Valladares, Mayra Rodriguez. 2026. "Should We Worry about Gulf Countries Reducing Investments in the U.S.?" *Forbes*, March 7.

2. Inflation Dynamics in the Middle East and Central Asia: How Policy Frameworks and Structural Characteristics Shape the Transmission of Global Supply Shocks¹

This chapter examines how global supply shocks have shaped inflation dynamics in the Middle East and North Africa, Afghanistan, and Pakistan (MENAP) and Caucasus and Central Asia (CCA) regions. It shows that the size and persistence of inflation pass-through vary widely across countries, depending on their policy frameworks and structural characteristics. Gulf Cooperation Council (GCC) economies tend to experience relatively smaller inflation pass-through, as energy subsidies and fixed exchange rates provide some insulation. Similarly, CCA economies also experience lower pass-through, underpinned by energy subsidies, stronger central bank independence, and lower debt. By contrast, other MENAP economies face larger and more persistent inflationary effects, driven by food and energy price increases, lower energy subsidies, and rising inflation expectations amid structural vulnerabilities such as high debt and shallow credit markets. Low-income countries and fragile and conflict-affected states are particularly exposed to food inflation, reflecting their heavy reliance on imported food and fertilizer, weaker supply chains, limited market integration, and weak policy fundamentals such as low central bank independence and high public debt. Fuel subsidies and less flexible exchange rates are not only associated with a softer immediate inflationary impact of supply shocks but are also linked to wider fiscal deficits and larger output losses, respectively. Where financial markets are shallow and labor market flexibility is low, inflation surges and second-round effects are larger and accompanied by sharper monetary policy tightening. High public debt is linked to more inflationary pressures: headline inflation rises four times more than in low-debt economies, reflecting sharper exchange rate depreciation and rising inflation expectations. Weaker central bank independence coincides with a stronger inflation response and more costly tightening. By contrast, stronger independence is associated with more contained inflation, less policy tightening, and smaller output losses.

Introduction

The war that started in February 2026 in the Middle East and the closure of the Strait of Hormuz—a critical trade artery—have disrupted global supply chains, pushed up commodity prices and inflation expectations, and prompted major regional central banks to adopt a more cautious stance (see Chapter 1). In Egypt, Jordan, Kazakhstan, Morocco, and Pakistan, monetary authorities flagged upside inflation risks from energy, food, and exchange rate pressures, underscoring vigilance against second-round effects (Bank Al-Maghrib 2026; Central Bank of Egypt 2026; Central Bank of Jordan 2026; National Bank of Kazakhstan 2026; State Bank of Pakistan 2026). The Central Bank of the United Arab Emirates similarly cited geopolitical tensions as a key source of uncertainty, warning that shipping disruptions and higher global commodity prices could lift imported inflation (Central Bank of the United Arab Emirates 2026).

In this context, this chapter examines how global supply shocks have historically transmitted to inflation across the Middle East and Central Asia, and whether the current episode differs from earlier shocks. The analysis differentiates between the GCC, MENAP (excluding the GCC), and CCA regions, while accounting for policy

¹ This chapter was prepared by Vizhdan Boranova, Serpil Bouza (lead), Mona ElShazly, Elmer Li, and Karmen Naidoo, under the supervision of Giovanni Melina and with contributions from Etibar Jafarov on Box 2.1.

frameworks and key structural characteristics that shape inflation pass-through and persistence. These include exchange rate regimes, fuel subsidies, public debt, central bank independence, financial depth, and labor market flexibility.² Together these factors also influence both the effectiveness of monetary policy and the scale of tightening needed to contain supply-driven inflationary pressures.

Recent IMF work has examined the inflationary impact of global supply-chain shocks (April 2022 *Regional Economic Outlook: Middle East and Central Asia*)³ and the role of central bank independence in anchoring inflation expectations (October 2021 *World Economic Outlook*).⁴ A more recent study examines how sectoral and external price shocks, including energy and import-price shocks, pass through to broader domestic inflation and core inflation (October 2024 *World Economic Outlook*).⁵ However, relatively limited attention has been paid in the literature to how policy frameworks and structural characteristics interact with supply-driven shocks. One of the exceptions is work by Auer, Burstein, and Lein (2024), which shows that global supply disruptions raise inflation through higher imported input costs, with the effects varying according to countries' exposure to global production networks. Similarly, Di Giovanni and others (2022) find stronger inflationary pressures in economies more integrated into global trade, with pass-through shaped by trade structures, import composition, and domestic market conditions. Shapiro (2022) shows that supply factors accounted for a sizable share of the 2021–22 post-COVID-19 inflation surge, reflecting shortages, bottlenecks, and other supply constraints alongside strong demand. However, these studies primarily focus on advanced economies or global aggregates. Gershenson and others (2026) show that stronger central bank independence enhances credibility, anchors expectations, and improves inflation management in the MENAP and CCA regions. This chapter takes a broader approach by examining how supply shocks transmit across the GCC, MENAP (excluding the GCC), and CCA regions and how their effects vary with policy frameworks and a wide range of structural characteristics.

Global Supply Shocks and Inflation: An Historical Perspective

This chapter uses the Global Supply Chain Pressure Index (GSCPI) to capture global supply-chain pressures—a narrower concept than global supply shocks more broadly. The GSCPI is a widely used indicator of external supply shocks that combines shipping costs, delivery delays, and manufacturing bottlenecks across major economies.⁶ It also closely co-moves with changes in global commodity prices (Figure 2.1, panel 1). The index peaked during the COVID-19 pandemic, the post-pandemic supply-chain crunch, and Russia's invasion of Ukraine, episodes that each reflected acute strains in global supply chains and commodity markets. The latest war in the Middle East has again pushed up the GSCPI, reflecting renewed pressures on shipping routes, energy, and food prices. Although the peak is less than half of the COVID-19 surge, its immediate inflationary impact in the Middle East and Central Asia regions from March to July has been about four times larger. This underscores both the severity of the current shock and its proximity to many economies in the region (Figure 2.1, panel 2). For context, a one-standard-deviation increase in the GSCPI is broadly comparable in magnitude to the increase in global supply-chain pressures associated with the 2008 commodity price spike. During this episode, average inflation in the region reached 10.5 percent.

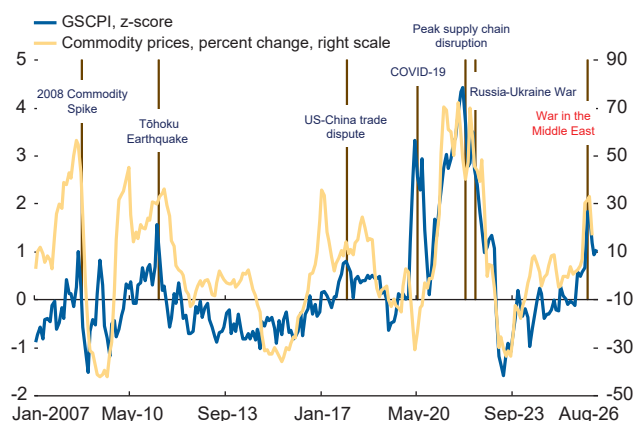
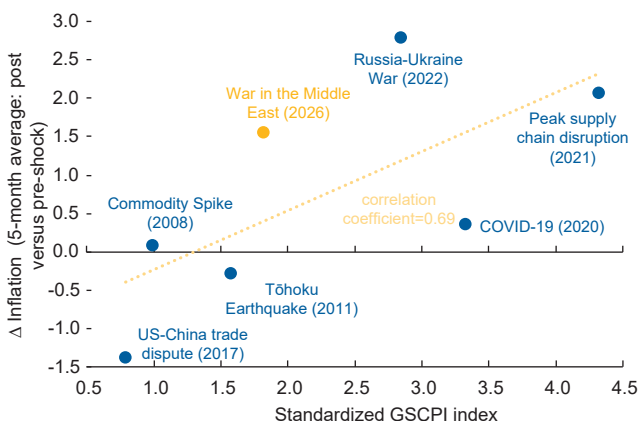
² Export diversification is another structural characteristic that may shape the transmission of global supply shocks; though beyond this chapter's scope, it is addressed in Chapter 3 of this *Regional Economic Outlook* issue.

³ Chapter 2, prepared after Russia's war in Ukraine drove up global food and energy prices—with inflationary pressures comparable to those from the war in the Middle East—disentangles domestic and external drivers of inflation in the Middle East and Central Asia. It demonstrates that global food prices pass through most strongly, oil price effects are muted given widespread energy subsidies, and inflation expectations play a prominent role. However, it does not assess how structural characteristics shape the transmission of global supply shocks.

⁴ Chapter 2, prepared after the COVID-19 pandemic—when unprecedented fiscal and monetary support, combined with supply-chain disruptions, fueled inflation surges—shows that the anchoring of inflation expectations is positively correlated with central bank independence using a global dataset. However, its scope was confined to a narrower set of institutional features, whereas the present chapter examines a broader range of structural characteristics in the Middle East and Central Asia.

⁵ Chapter 2 finds that sector-specific price shocks can generate significant spillovers to headline and core inflation, with the extent and persistence of pass-through varying across sectors and depending on factors such as input-output linkages, the flexibility of prices, and the nature of the initial shock.

⁶ The GSCPI is developed by the Federal Reserve Bank of New York. Alternative measures of supply-chain disruptions, including the Global Supply Chain Stress Index (GSCSI), yield qualitatively similar results (see the Online Annex).

Figure 2.1. Global Supply Chain Pressure Index**1. GSCPI and Commodity Prices****2. Inflation and GSCPI in MENAP and CCA**

Sources: Federal Reserve Bank of New York; Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations. Note: CCA = Caucasus and Central Asia; GSCPI = Global Supply Chain Pressure Index; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

The Empirical Model and Baseline Results

The degree of inflation pass-through and the effectiveness of the policy response depend not only on the size of the imported inflation shock but also on country-specific policy frameworks and structural characteristics. Inflation expectations are also a key determinant of whether global supply shocks result in temporary price increases or broader and more persistent inflationary pressures. Because such shocks originate outside the domestic economy, policymakers may be reluctant to tighten monetary policy in response. However, when rising import prices become embedded in inflation expectations and are reflected in wage and price setting, a timely policy action may be required to prevent inflationary pressures from becoming more persistent. Structural and institutional features, including exchange rate regimes, energy subsidies, public debt levels, central bank credibility, labor market flexibility, and financial market depth, can shape both the transmission of global supply shocks to domestic inflation and the effectiveness of policy responses. Examining the role of these factors is the focus of this chapter.

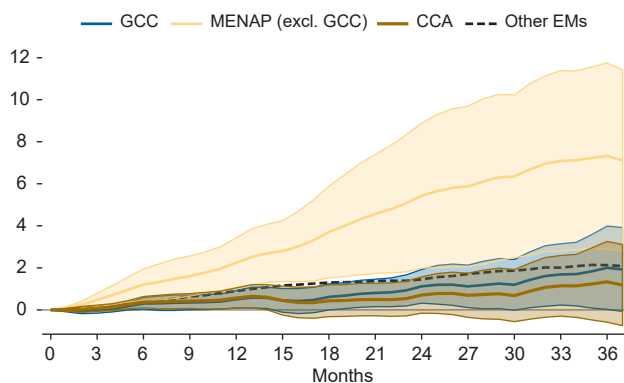
This section estimates the size and persistence of the pass-through of global supply-chain pressures to inflation in MENAP and CCA economies using local projections (Jordà 2005) over a sample between September 1997 and July 2026. The analysis estimates the impact of a one-standard deviation increase in the GSCPI on monthly inflation over horizons up to three years (see the Online Annex for details). Because the GSCPI is a standardized composite of price and non-price indicators, the estimated coefficients represent the inflation responses to global supply-chain pressures, rather than the conventional pass-through of an upstream price change (such as an imported input or commodity) to domestic prices. In addition, these estimates should be interpreted as primarily directional and associative rather than structural or causal, capturing the historical co-movement of inflation with global supply-chain shocks conditional on country characteristics. As estimates represent averages across different types of historical supply-chain pressures, the relevance of particular country characteristics may vary with the source of the pressure.

The results show that the impact on inflation is largest and most persistent in MENAP (excluding the GCC), where the headline consumer price index (CPI) level rises by 7 percent over three years, relative to a no-shock baseline. This is equivalent to an average impact on annual inflation of 2.4 percentage points over the same horizon. By contrast, the effects in GCC and CCA economies are much more contained—about 1 percent within two years—and broadly in line with those observed in emerging markets outside the region (Figure 2.2, panel 1).

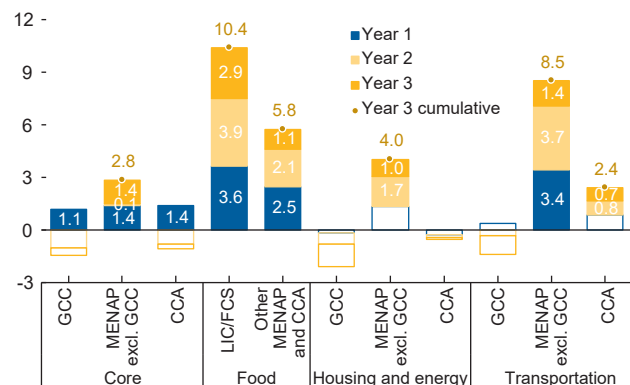
Core CPI and inflation expectations also rise significantly, with MENAP (excluding the GCC) showing persistent increases into the third year, pointing to second-round effects beyond imported food and energy. Food inflation rises across all country groups, but nearly twice as much in low-income countries and fragile and conflict-affected states, reflecting stronger pass-through from global food and agricultural-input prices, high import dependence, and exchange rate depreciation (IMF 2021; Rother and others 2023; Abel and Bluedorn 2026).⁷ These effects are compounded by domestic supply and weather shocks, as well as transport and logistical constraints (Kohlscheen 2022), which amplify and prolong food price shocks. In addition, these economies have high debt, which limits available fiscal space to cushion the shock. Energy and transportation pressures are also especially prominent in MENAP (excluding the GCC) (Figure 2.2, panel 2).

Figure 2.2. Impact of Global Supply Shocks on the Middle East and Central Asia
(Percent)

1. Impact on Headline Inflation



2. Impact on Core, Food, and Energy Inflation



Sources: Consensus Economics; Federal Reserve Bank of New York; Focus Economics; Haver Analytics; IMF, CPI database; IMF, Exchange Rate database; IMF, International Finance Statistics database; IMF, Regional Economic Outlook database; IMF, World Economic Outlook database; World Bank; and IMF staff calculations.

Note: The results are based on a local projections approach, with a one-standard-deviation GSCPI shock (see the Online Annex). Hollow bars indicate that the results are not significant at the 90 percent level. CCA = Caucasus and Central Asia; FCS = fragile and conflict-affected state; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; other EMs = emerging markets excluding MENAP and CCA.

The analysis also shows that the pass-through has intensified substantially over time. Relative to the previous decade, the two-year impact on headline CPI is 2 percentage points higher in MENAP (excluding the GCC) and increased considerably in both the GCC and the CCA, where it strengthened from near-negligible levels to a material response (see the Online Annex).⁸

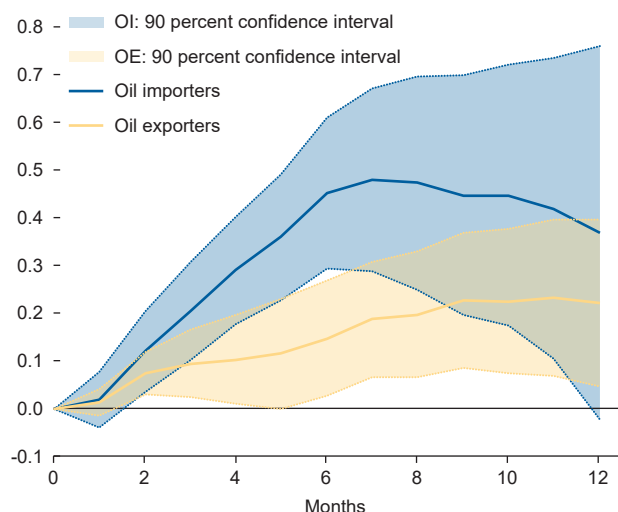
Replacing the GSCPI with global oil and food price shocks reveals that food price shocks have a stronger and longer-lasting impact on inflation than oil price shocks. A 10 percent increase in oil prices raises inflation by about 0.4 percentage point over the first year in MENAP oil importers—twice the effect in oil exporters (Figure 2.3, panel 1). By contrast, a 10 percent increase in food prices raises inflation by more than 2 percentage points in MENAP (excluding the GCC) and in the CCA, and by half as much in the GCC over the first year (Figure 2.3, panel 2). Although the effect of oil price shocks fades after one year, the impact of food price shocks persists beyond two years.

⁷ Chapter 1 of the April 2021 *World Economic Outlook*, prepared after the COVID-19 pandemic, finds that global food price shocks pass through to domestic food prices with considerable heterogeneity across countries, with emerging markets and low-income countries experiencing larger and faster increases owing to greater food-import dependence and weaker currencies.

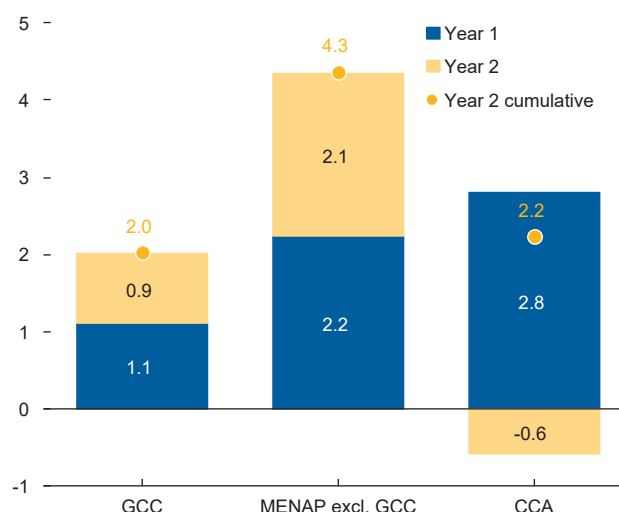
⁸ This result holds when excluding the post-2020 period, when the GSCPI peaked and stayed elevated relative to previous decades.

Figure 2.3. Impact of Global Commodity Price Shocks on Headline CPI in MENAP and CCA
(Percent)

1. Ten Percent Increase in Oil Prices



2. Ten Percent Increase in Food Prices



Sources: Consensus Economics; Federal Reserve Bank of New York; Focus Economics; Haver Analytics; IMF, CPI database; IMF, Exchange Rate database; IMF, International Finance Statistics database; IMF, World Economic Outlook database; IMF, Regional Economic Outlook database; World Bank; and IMF staff calculations.

Note: The results are based on a local projections approach where the shock is defined as a 10 percent increase in the global oil and food prices above their respective trends (see the Online Annex). The oil price is the average of Brent crude, West Texas Intermediate crude, and Dubai oil prices. CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

What Explains Diverging Inflation Pass-Through?

Policy Frameworks and Vulnerabilities

The inflation response to global supply shocks depends critically on policy frameworks—especially the exchange rate regime and the use of fuel subsidies to cushion the impact of higher prices—and preexisting vulnerabilities, notably high public debt.

- *Exchange rate regimes are a key transmission channel.* More flexible regimes, allowing greater currency adjustments, are associated with stronger inflation pass-through but a more contained output impact (Figure 2.4, panel 1).⁹ Under more flexible regimes, headline CPI rises by 1.7 percent in the first year and 2.9 percent cumulatively over two years, with the largest effects on food prices (over 4 percent) and transportation costs (above 7 percent). Under less flexible regimes, this channel is muted, keeping the pass-through smaller and mostly insignificant outside food and transportation, albeit linked to a significant output contraction in the second year after the shock.¹⁰ In addition, the capacity to absorb a supply shock in less flexible exchange rate regimes also depends on reserve adequacy, fiscal credibility, and the regime's sustainability (Obstfeld and Rogoff 1995).

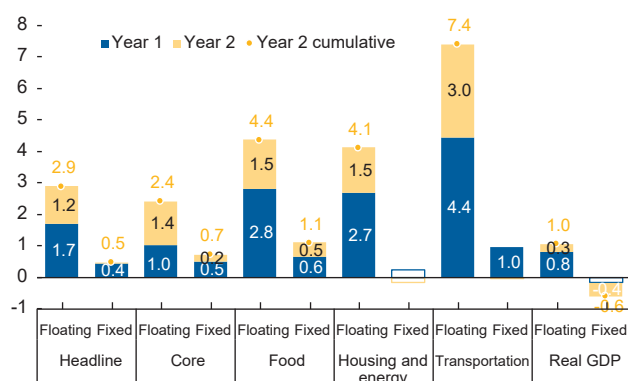
⁹ For the purposes of this analysis, economies are classified into fixed and flexible exchange rate regimes. Fixed regimes include conventional pegs and currency boards, whereas flexible regimes include floating and free-floating arrangements (see IMF 2009; IMF 2023).

¹⁰ Fixed exchange rate regimes are also associated with larger current account deteriorations following GSCPI shocks, highlighting potential external sector costs of inflation mitigation policies.

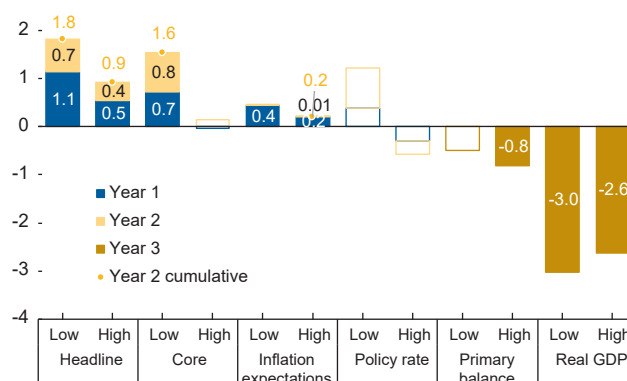
- *Fuel subsidies are associated with a smaller inflation pass-through, but with a fiscal cost.* Economies with high fuel subsidies exhibit roughly half the impact on headline inflation, more limited core price pressures, somewhat smaller cumulative output losses, and about half the rise in inflation expectations compared with low-subsidy economies (Figure 2.4, panel 2).¹¹ However, they also exhibit significantly weaker primary balances three years after the shock.

Figure 2.4. Impact of Global Supply Shocks by Policy Frameworks in MENAP and CCA
(Percent)

1. By Exchange Rate Regime



2. By Fuel Subsidy



Sources: Consensus Economics; Federal Reserve Bank of New York; Focus Economics; Haver Analytics; IMF, AREAER database; IMF, CPI database; IMF, International Finance Statistics database; IMF, World Economic Outlook database; IMF, Regional Economic Outlook database; World Bank; and IMF staff calculations.

Note: The results are based on a local projections approach, with a one-standard-deviation GSCPI shock (see the Online Annex). The impacts on inflation expectations and policy rate are both measured in percentage points. The impact on the primary balance is measured in percentage points of non-oil GDP. In panel 1, in addition to the baseline controls, the estimation controls for central bank independence, credit market depth, and public debt. Panel 2 maintains the baseline specification, as fuel subsidies have correlations of less than 0.1 with the other structural variables. Output gap is not controlled in the real GDP specification. Hollow bars indicate that the results are not significant at the 90 percent level. GSCPI = Global Supply Chain Pressure Index.

- *High public debt is linked to a larger inflationary and macroeconomic cost of global supply shocks.*¹² In high-debt economies, headline CPI rises by almost 8 percent over two years—about four times the response in low-debt peers—whereas core CPI increases by more than 2 percent (Figure 2.5, panel 1). Inflation expectations also rise by nearly 2 percentage points, alongside a policy-rate increase of about 1 percentage point over the second year, compared with no tightening in low-debt economies. Statistical analysis shows that about half of the more elevated inflation impact in high-debt economies can be attributed to the depreciation of the exchange rate and the rise in inflation expectations (Figure 2.5, panel 2). Furthermore, these findings are consistent with evidence that weak fiscal positions or high public debt can raise sovereign risk premiums, which then require sharper monetary policy tightening after inflationary shocks (Favero and Giavazzi 2004; Corsetti and others 2013).¹³ Higher rates, in turn, can weaken borrower repayment capacity, asset quality, funding conditions, and credit supply, while rising sovereign yields may transmit stress to financial institutions with significant government-security exposures with financial stability implications (October 2023 and April 2025 *Global Financial Stability Report*). The output cost is also slightly larger. These results point to a consistent pattern: in high-debt economies, supply shocks tend to coincide with higher sovereign risk, a weaker currency, and expectations of higher future inflation, alongside a stronger pass-through.

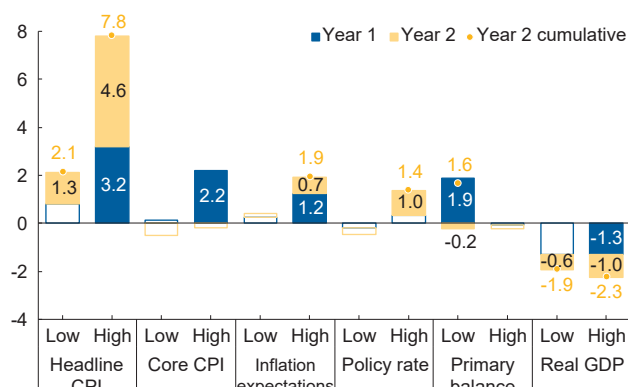
¹¹ Fuel subsidy intensity is measured as fuel subsidies to non-oil GDP, averaged over 2015–19 (before the COVID-19 and Ukraine shocks). The top tercile is labeled high-subsidy, whereas the bottom tercile is labeled low-subsidy.

¹² Countries are classified by public debt burden, measured as gross government debt relative to GDP and averaged over the sample. Countries in the top tercile are labeled high-debt, whereas those in the bottom tercile are labeled low-debt. The country-average public debt-to-GDP ratio is interpreted as a proxy for broader fiscal vulnerability.

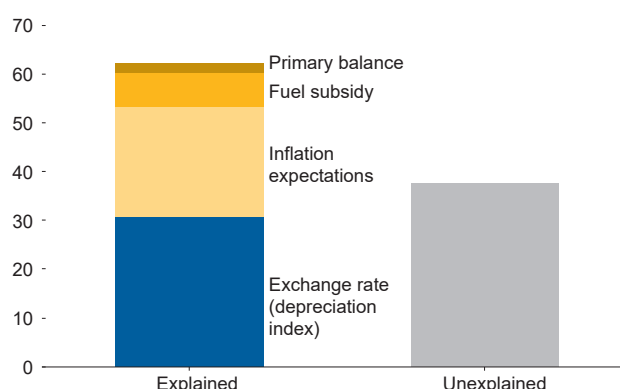
¹³ We provide a cursory analysis of this and find that a one-standard-deviation shock to the GSCPI is associated with a larger deterioration in sovereign credit ratings in high-debt economies compared to low-debt economies (see the Online Annex).

Figure 2.5. Impact of Global Supply Shocks and Debt in the Middle East and Central Asia
(Percent)

1. By Gross Public Debt Level



2. Decomposition of the Public Debt Inflation Gap



Sources: Consensus Economics; Federal Reserve Bank of New York; Focus Economics; Haver Analytics; IMF, CPI database; IMF, International Finance Statistics database; IMF, Exchange Rate database; IMF, World Economic Outlook database; IMF, Regional Economic Outlook database; World Bank; and IMF staff calculations.

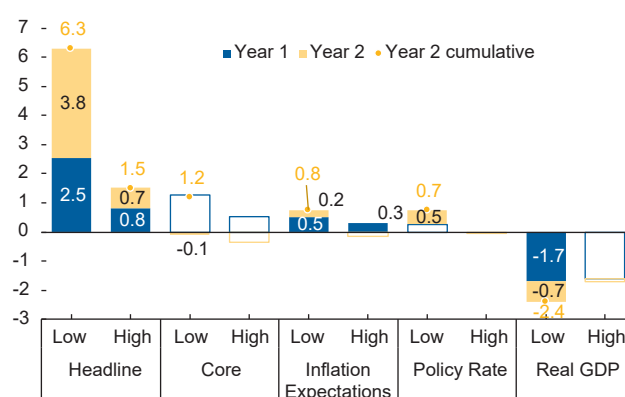
Note: Panel 1 uses a local projections approach, with a one-standard-deviation GSCPI shock (see the Online Annex). The differential inflation, inflation expectations, policy-rate responses, and first-year output losses are robust to controlling for central bank independence and labor market flexibility—the two structural variables that are most correlated with public debt. Impacts on inflation expectations and policy rate are in percentage points, and impacts on the primary balance are in percentage points of non-oil GDP. The output gap is not controlled in the real GDP specification. Hollow bars indicate that the results are not significant at the 90 percent level. Panel 2 uses a Gelbach (2016) statistical decomposition. CPI = consumer price index; GSCPI = Global Supply Chain Pressure Index.

Structural Characteristics

Several structural and institutional characteristics are correlated with both the pass-through of supply shocks to inflation and the effectiveness of the monetary policy response. These characteristics were selected because they are known to be especially relevant for the Middle East and Central Asia region, particularly MENAP, with the choice further guided by data availability.

- Central bank independence is associated with better-anchored expectations and lower inflation persistence after supply shocks (IMF 2022).¹⁴ In the Middle East and Central Asia region, a one-standard-deviation shock to the GSCPI is associated with headline CPI about 2 percent higher after one year and 3 percent higher after two years in economies with weaker central bank independence, compared with those with stronger independence (Figure 2.6).¹⁵ Inflation expectations

Figure 2.6. Impact of Global Supply Shocks by Central Bank Independence
(Percent)



Sources: Consensus Economics; Federal Reserve Bank of New York; Focus Economics; Haver Analytics; IMF, CPI database; IMF, International Finance Statistics database; IMF, Exchange Rate database; IMF, World Economic Outlook database; IMF, Regional Economic Outlook database; Romelli (2024); and IMF staff calculations.

Note: The results are based on a local projections approach, with a one-standard-deviation GSCPI shock (see the Online Annex). The impacts on inflation expectations and policy rate are measured in percentage points. Beyond the baseline controls, all specifications control for exchange rate regime and credit market depth. Output gap is not controlled for in the real GDP specification. Hollow bars indicate that the results are not significant at the 90 percent level.

¹⁴ The chapter uses the Romelli (2024) *de jure* measure of central bank independence, which builds on two previous commonly used measures of *de jure* legal independence. This indicator measures how insulated the central bank is from political interference in setting objectives, executing its preferred monetary policy, and assessing financial independence of the central bank, as well as reporting and disclosure practices. Countries in the top tercile of the central bank independence index distribution are classified as having stronger independence (labeled high), whereas those in the bottom tercile are classified as having weaker central bank independence (labeled low).

¹⁵ These results hold after controlling for other highly correlated variables, an approach which applies to all the regression analysis in this chapter (see the Online Annex).

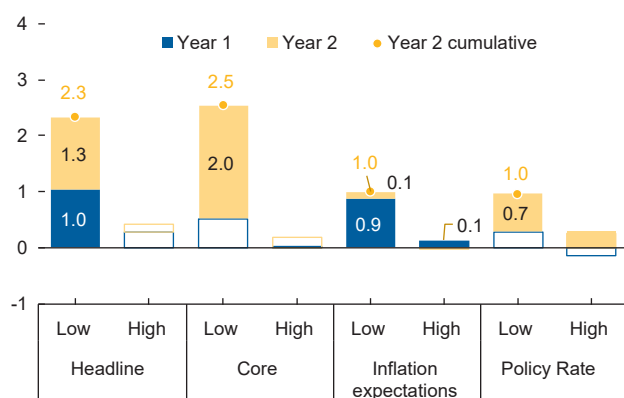
also rise more sharply, alongside 75 basis points of additional monetary tightening—at a steeper output cost. By contrast, more independent central banks tend to see contained inflation surges with no significant output losses, echoing Gershenson and others (2026), who find that stronger central bank independence is linked to sharper monetary policy effectiveness and lower inflation, particularly in MENAP.

- *Deeper credit markets are correlated with a smaller inflation pass-through and stronger monetary policy transmission.*¹⁶ Supply shocks coincide with sharper price increases with shallow financial markets, where inflation expectations tend to be less firmly anchored and financial frictions are linked to weaker monetary policy transmission. As a result, these economies require about 100 basis points of additional monetary tightening over two years, compared to economies with deeper credit markets (Figure 2.7, panel 1).
- *Rigid labor markets are associated with stronger inflation pass-through.*¹⁷ Economies with less flexible labor regulations tend to exhibit stronger inflation pass-through from supply shocks, with core inflation rising by an additional 1 percentage point per year for at least two years (Figure 2.7, panel 2). Where labor contracts, working hours, and wage bargaining are rigid, firms facing higher imported input, energy, or logistics costs may have less scope to reallocate labor or lower wages to absorb the shock, encouraging firms to pass higher costs on to consumers. This mechanism is especially relevant when wage setting is sticky or indexed, as the initial supply shock can trigger second-round wage-price dynamics and make inflation more persistent (Blanchard and Galí 2010; Lorenzoni and Werning 2023). Broader price pressures, together with less-anchored inflation expectations, are associated with a larger monetary policy response in economies with more rigid labor markets.

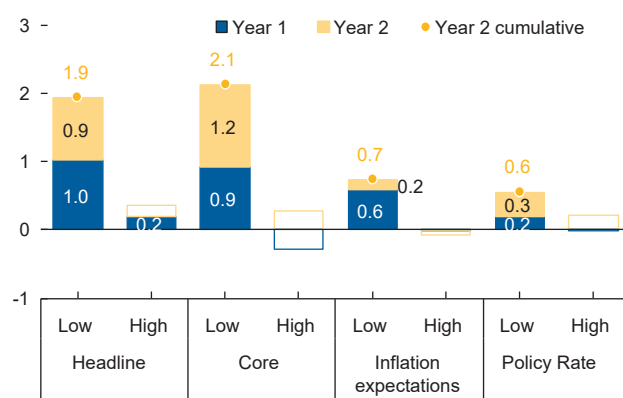
Figure 2.7. Impact of Global Supply Shocks by Structural Characteristics

(Percent)

1. By Credit Market Depth



2. By Labor Regulation Flexibility



Sources: Consensus Economics; Federal Reserve Bank of New York; Focus Economics; Haver Analytics; IMF, CPI database; IMF, International Finance Statistics database; IMF, Exchange Rate database; IMF, World Economic Outlook database; IMF, Regional Economic Outlook database; Fraser, Economic Freedom of the World database; and IMF staff calculations.

Note: The results are based on a local projections approach, with a one-standard-deviation GSCPI shock (see the Online Annex). Beyond the baseline controls, panel 1 adds the exchange rate regime, central bank independence score, public debt, and labor regulation flexibility; panel 2 adds the exchange rate regime, central bank independence score, and credit market depth. Impacts on inflation expectations and policy rates are measured in percentage points. Hollow bars indicate that results are not significant at the 90 percent level.

¹⁶ Countries whose private sector credit as a percentage of GDP falls into the top tercile of the distribution are classified as having deeper credit markets (labeled high), whereas those in the bottom tercile are classified as having shallow credit markets (labeled low).

¹⁷ This measure is based on regulations on labor contracts and wage setting: countries receive lower ratings where fixed-term contracts, or their duration, are restricted; minimum wages are higher; or wage setting is more centralized and subject to government intervention. Countries in the top tercile of the distribution are classified as having more flexible labor market regulation (labeled high), and those in the bottom tercile as having more rigid labor markets (labeled low).

Which Structural Features Matter Most for Inflation Pass-Through?

This section assesses the structural features most associated with the pass-through of global supply shocks to inflation in MENAP and CCA economies.

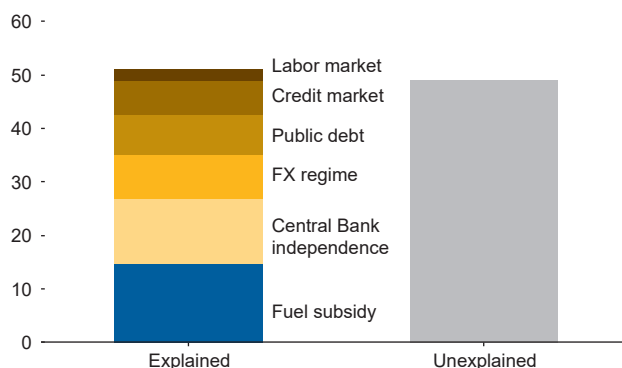
Figure 2.8 shows the estimated statistical contribution of six structural characteristics to the difference in the average pass-through of a global supply shock to inflation across MENAP and CCA economies over the past three decades. Fuel subsidies and central bank independence are the largest contributors to the cross-country difference in inflation pass-throughs, explaining 14½ percent and 12 percent of the response, respectively. They are followed by exchange rate regimes (8 percent), public debt (7.5 percent), and credit market depth (6.5 percent), while labor market rigidity plays a marginal role (2 percent).

These same structural features also help explain *why* the pass-through has intensified over time, as documented earlier in the “Global Supply Shocks and Inflation: An Historical Perspective” section (also see the Online Annex). Three developments raised the sensitivity of inflation to external supply shocks: (1) greater exchange rate flexibility, (2) higher public debt, and (3) a modest decline in labor market and wage flexibility.¹⁸ However, offsetting factors are also at play: all subregions have strengthened central bank independence and deepened credit markets, most notably the GCC. These gains have bolstered monetary policy effectiveness and partly offset the factors pushing pass-through higher. However, relative to other economies, the stronger pass-through in MENAP (excluding the GCC) is likely associated with higher public debt, shallower credit markets, less flexible labor markets, and lower fuel subsidies. In the CCA, the distinguishing features are comparatively shallow credit markets and rigid labor markets. For low-income countries and fragile and conflict-affected states, each of these structural features is an area of weakness, and together they are associated with their notably higher pass-through to inflation.

Conclusion

Policy responses should be calibrated to the risk of second-round effects. Monetary policy can look through temporary supply shocks where inflation expectations are well anchored (see also Bandera and others 2023; Forbes, Ha, and Kose 2026) but must respond forcefully where credibility is weak or financial markets are shallow, as delay allows price pressures to broaden and become costlier to reverse. Over the medium term, resilience hinges on stronger institutions and structural reforms. Central bank independence is the cornerstone priority: it is associated with anchored expectations, smaller second-round effects, and less policy tightening needed to restore price stability (see also IMF 2022; Gershenson and others 2026). Deeper credit markets reinforce monetary transmission—linked to smaller rate increases to contain inflation—while labor market reforms may limit wage-price pressures and speed reallocation, lowering the cost of stabilization.

Figure 2.8. Decomposition of Inflation Pass-Through
(Percent)



Sources: Federal Reserve Bank of New York; Haver Analytics; IMF, CPI database; IMF, Exchange Rate database; IMF, International Finance Statistics database; IMF, Regional Economic Outlook database; Romelli (2024); IMF, World Economic Outlook database; and IMF staff calculations.

Note: The results are based on a local projections approach, with a one-standard-deviation GSCPI shock. The stacked bars are based on a Gelbach (2016) statistical decomposition. For more information, see the Online Annex. GSCPI = Global Supply Chain Pressure Index.

¹⁸ Fuel subsidies have declined after the COVID-19 pandemic across subregions but remained elevated in the GCC and CCA (see the Online Annex).

Priorities differ across country groups. Low-income countries and fragile and conflict-affected states confronting acute food inflation should pair targeted social transfers with reforms that strengthen food security, including longer-term investments in resilient agricultural production, infrastructure, and regional trade to reduce supply constraints (Baptista and others 2022; Martin, Adam, and Gollin 2025). Consistent with the guidance set out in the April 2026 *World Economic Outlook* and *Fiscal Monitor*, the IMF generally favors temporary and targeted support measures over generalized fuel subsidies across all economies as they are often fiscally costly, poorly targeted, and difficult to unwind. High-debt economies, in particular, should preserve fiscal space and avoid generalized fuel subsidies that may amplify inflation through currency and expectations channels; credible medium-term frameworks anchored in debt sustainability reduce sovereign risk and reinforce monetary policy credibility, particularly where expectations are weakly anchored and transmission impaired. In summary, containing global supply shocks requires a forward-looking policy mix that anchors expectations, preserves fiscal space, strengthens institutions, and deepens credit and labor markets—leaving economies with stronger frameworks better placed to contain inflation at lower macroeconomic cost.

Box 2.1. Supply Shocks, Firm Markups, and Inflation

Relatively weaker competitive pressures compared with other regions can further amplify the pass-through of global supply shocks to domestic inflation in economies in the Middle East and Central Asia.¹

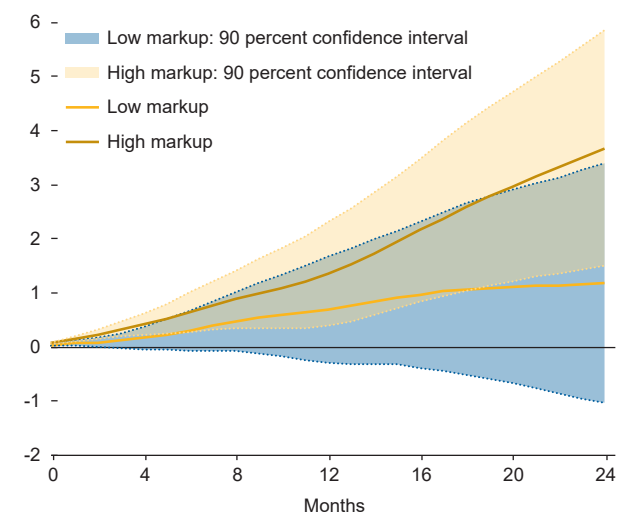
To assess how market structure and competition are linked to inflation pass-through, firm-level markup data for a subset of MENAP and CCA economies are used to estimate the inflationary impact of a one-standard-deviation increase in the GSCPI across economies with different sales-weighted markups. The results suggest that the inflationary impact of the shock is strongest and most persistent when firms have greater pricing power (Figure 2.1.1), as they may be better positioned to pass cost shocks through a broad range of goods and services.

This markup effect is considerably weaker for shocks in food and energy prices, possibly because administered prices and subsidy programs play a more prominent role in these cases, leaving less scope for domestic market structure to affect pass-through. It also varies across regions, with the amplification from higher markups most pronounced in MENAP (excluding the GCC) economies, pointing to a meaningful role for domestic competition in shaping inflation dynamics, and suggesting that policies to strengthen competitive pressures can help mitigate the inflationary impact of external supply shocks.

The author of this box is Etibar Jafarov, IMF Middle East and Central Asia Department.

¹ Acharya and others 2023; Alexander and others 2024; Kharroubi and others 2023.

Box Figure 2.1.1 Impact of Global Supply Shocks on Core Inflation by Firm Markups
(Percent)



Sources: Faris, Jafarov, and Rawat 2026; Federal Reserve Bank of New York; Haver Analytics; IMF, AREAER database; IMF, CPI database; IMF, International Finance Statistics database; IMF, Regional Economic Outlook database; IMF, World Economic Outlook database; Orbis firm database; and IMF staff calculations. Note: The results are based on a local projections approach, with a one-standard-deviation GSCPI shock. Impulse responses capture both the direct effect of the shock and its interaction with markups (see the Online Annex). Countries in the top quartile of the average markup distribution are labeled high-markup, and those in the bottom quartile low-markup.

References

- Abel, Will, and John Bluedorn. 2026. "Background Note on the Impact of the War in the Middle East on MCD FCS-LICs." FLPB Background Note, International Monetary Fund, Washington, DC.
- Acharya, Viral V., Matteo Crosignani, Tim Eisert, and Christian Eufinger. 2023. "How Do Supply Shocks to Inflation Generalize? Evidence from the Pandemic Era in Europe." NBER Working Paper 31790, National Bureau of Economic Research, Cambridge, MA.
- Alexander, Patrick, Lu Han, Oleksiy Kryvtsov, and Ben Tomlin. 2024. "Markups and Inflation in Oligopolistic Markets: Evidence from Wholesale Price Data." Bank of Canada Staff Working Paper 2024-20, Bank of Canada, Ottawa.
- Auer, Raphael A., Ariel Burstein, and Simon M. Lein. 2024. "Inflation and Global Supply Chains." *Journal of International Economics* 149: 103940.
- Bandera, Nicolò, Lauren Barnes, Matthieu Chavaz, Silvana Tenreyro, and Lukas von dem Berge. 2023. "Monetary Policy in the Face of Supply Shocks: The Role of Inflation Expectations." European Central Bank Forum on Central Banking Working Paper, June 26–28.
- Bank Al-Maghrib. 2026. *Board Meeting Press Release*. March 17 and June 24. Rabat: Bank Al-Maghrib.
- Baptista, Diogo Miguel Salgado, Mai Farid, Dominique Fayad, Laurent Kemoe, Loic S. Lanci, Tara S. Muehlschlegel, Prita Mitra, and others. 2022. "Climate Change and Chronic Food Insecurity in Sub-Saharan Africa." Departmental Paper No. 2022/016. Washington, DC: International Monetary Fund.
- Benigno, Gianluca, Julian di Giovanni, Jan Groen, and Adam I. Noble. 2022. "The GSCPI: A New Barometer of Global Supply Chain Pressures." Staff Report 1017, Federal Reserve Bank of New York, New York.
- Blanchard, Olivier, and Jordi Galí. 2010. "Labor Markets and Monetary Policy: A New Keynesian Model with Unemployment." *American Economic Journal: Macroeconomics* 2 (2): 1–30.
- Central Bank of Egypt. 2026. *Monetary Policy Committee Press Releases*. April 2, May 21, and July 9. Cairo: Central Bank of Egypt.
- Central Bank of Jordan. 2026. *Monetary Policy Committee Statement*. June 18. Amman: Central Bank of Jordan.
- Central Bank of the United Arab Emirates. 2026. *Quarterly Economic Review*. June 2026. Abu Dhabi: Central Bank of the United Arab Emirates.
- Corsetti, Giancarlo, Keith Kuester, André Meier, and Gernot J. Müller. 2013. "Sovereign Risk, Fiscal Policy, and Macroeconomic Stability." *Economic Journal* 123 (566): F99–F132.
- Di Giovanni, Julian, Şebnem Kalemli-Özcan, Alvaro Silva, and Muhammed A. Yıldırım. 2022. *Global Supply Chain Pressures, International Trade, and Inflation*. Federal Reserve Bank of New York Staff Reports 1017, Federal Reserve Bank of New York, New York.
- Faris, Walid, Etibar Jafarov, and Umang Rawat. 2026. "Competition and Productivity in Middle East and Central Asia: What Role Do Tariffs Play?" IMF Working Paper WP/26/143, International Monetary Fund, Washington, DC.
- Favero, Carlo A., and Francesco Giavazzi. 2004. "Inflation Targeting and Debt: Lessons from the Volatility of Public Debt in Emerging Markets." In *NBER Macroeconomics Annual 2004*, Volume 19, 83–118. Cambridge, MA: National Bureau of Economic Research.

- Forbes, Kristin, Jieun Ha, and M. Ayhan Kose. 2026. "Heaven or Earth? The Evolving Role of Global Shocks for Domestic Monetary Policy." NBER Working Paper 34806, National Bureau of Economic Research, Cambridge, MA.
- Gelbach, Jonah B. 2016. "When Do Covariates Matter? And Which Ones, and How Much?" *Journal of Labor Economics* 34 (2): 509–43.
- Gershenson, Dmitry, Omer Farouk Akbal, Mohamed Belkhir, Rhea Gupta, Koba Gvenetadze, Ashraf Khan, Subir Lall, and others. 2026. "Central Bank Independence and Monetary Policy Effectiveness in the Middle East, Central Asia, and Caucasus." IMF Departmental Paper 2026/009. International Monetary Fund, Washington, DC.
- International Monetary Fund (IMF). 2009. *Revised System for the Classification of Exchange Rate Arrangements*. Washington, DC: International Monetary Fund.
- International Monetary Fund (IMF). 2023. *Annual Report on Exchange Arrangements and Exchange Restrictions: Compilation Guide*. Washington, DC: International Monetary Fund.
- Jordà, Òscar. 2005. "Estimation and Inference of Impulse Responses by Local Projections." *American Economic Review* 95 (1): 161–82.
- Kharroubi, Enisse, Renée Spigt, Deniz Igan, Koji Takahashi, and Egon Zakrajšek. 2023. "Markups and the Asymmetric Pass-Through of Cost Push Shocks." BIS Working Paper 1150, Bank for International Settlements, Basel.
- Kohlscheen, Emanuel. 2022. "Understanding the Food Component of Inflation." BIS Working Paper 1056, Bank for International Settlements, Basel.
- Lorenzoni, Guido, and Ivan Werning. 2023. "Wage-Price Spirals." *Brookings Papers on Economic Activity* 2023 (Fall): 317–67.
- Martin, Lisa, Christopher S. Adam, and Douglas Gollin. 2025. "Transport Frictions and the Pass-Through of Global Price Shocks in a Spatial Model of Low-Income Countries." IMF Working Paper 2025/039, International Monetary Fund, Washington, DC.
- National Bank of Kazakhstan. 2026. *Monetary Policy Decision*. April 24. Almaty: National Bank of Kazakhstan.
- Obstfeld, Maurice, and Kenneth Rogoff. 1995. "The Mirage of Fixed Exchange Rates." *Journal of Economic Perspectives* 9 (4): 73–96.
- Romelli, Davide. 2024. "Trends in Central Bank Independence: A De Jure Perspective." BAFFI CAREFIN Centre Research Paper 217, Università Bocconi, Milan.
- Rother, Bjoern, Sebastian Sosa, Majdi Debbich, Chiara Castrovillari, and Ervin Prifti. 2023. "Global Food Crisis Update—Recent Developments, Outlook, and IMF Engagement." *IMF Note* 2023/002, International Monetary Fund, Washington, DC.
- Shapiro, Adam H. 2022. "Decomposing Supply- and Demand-Driven Inflation." Federal Reserve Bank of San Francisco Working Paper 2022-18, Federal Reserve Bank of San Francisco, San Francisco, CA.
- State Bank of Pakistan. 2026. *Monetary Policy Statement*, June 15. Karachi: State Bank of Pakistan.

3. Trade Diversification in Turbulent Times: Implications for Economic Growth and Resilience in MENAP and the CCA¹

Over the past few years, larger and more frequent shocks have put a premium on policies that strengthen economic resilience. This chapter examines how increasing trade diversification could help the economies of the Middle East and North Africa, Afghanistan, and Pakistan (MENAP) and Caucasus and Central Asia (CCA) regions better withstand shocks while supporting long-term economic performance. Using a mix of empirical and model-based analyses, the chapter finds that greater trade diversification helps economies dampen the economic effects of adverse shocks in general and recover more quickly from them, and it also shows that how diversification is increased matters. If diversification is brought about through industrial policies that do not address market failures, it can entail efficiency losses that weaken welfare and long-term growth prospects. By contrast, if fostered through structural reforms that improve allocative efficiency, trade diversification can bolster economic resilience without hurting long-term growth and welfare. In case the adverse shocks directly affect trade access, then policies that enhance regional integration can further boost trade diversification and resilience.

Introduction

Increasing geopolitical tensions, high uncertainty, and the large shocks of recent years have reemphasized the importance of economic resilience. The disruptions to production and trade caused by the war that began in the Middle East in February 2026—particularly to trade routed through the Strait of Hormuz—are generating large, negative effects on activity in some MENAP economies and raising questions about how policymakers can help shield their economies against similar shocks in the future (April 2026 *Regional Economic Outlook Update: Middle East and Central Asia*).

Using a mix of novel empirical and model-based analyses, this chapter provides an in-depth analysis of how trade diversification across export and import products, markets, transport modalities, and trading routes can enhance the ability of MENAP and CCA economies to adjust to external negative shocks.^{2,3} At the same time, not all trade diversification strategies are the same: policies that achieve greater trade diversification without regard to underlying comparative advantages could lower growth and economic welfare over the long term by reducing the productivity gains from specialization.⁴ This suggests that there could be a trade-off between near-term resilience and longer-term performance that should be carefully considered in the design of policies to promote trade diversification.

¹ This chapter was prepared by Ayumi Akiyama, Lucyna Gornicka, Eliakim Kakpo, Daria Minina, Florian Misch (co-lead), Elisa Navarra, Bilal Tabti (co-lead), Subi Suvetha Velkumar, and Yipei Zhang, under the supervision of John Bluedorn.

² Apart from the trade diversification channel which is this chapter's focus, there are other economic channels and structural features that can enhance economic resilience, defined as the ability to withstand adverse external shocks. Stronger macroeconomic policymaking and operational frameworks can help economies better buffer and adjust to shocks (see Chapter 2 of the October 2025 *World Economic Outlook*). Another possibility could be international risk-sharing through alternative allocations of financial and real assets abroad, which could also help diversify national income streams and boost resilience to shocks (see Benigno and Küçük 2012, among others). Strategic public investments can likewise play roles in enhancing resilience (Chapter 2 of the October 2020 *Fiscal Monitor*), but public spending efficiency is key (Chapter 1 of the October 2025 *Fiscal Monitor*).

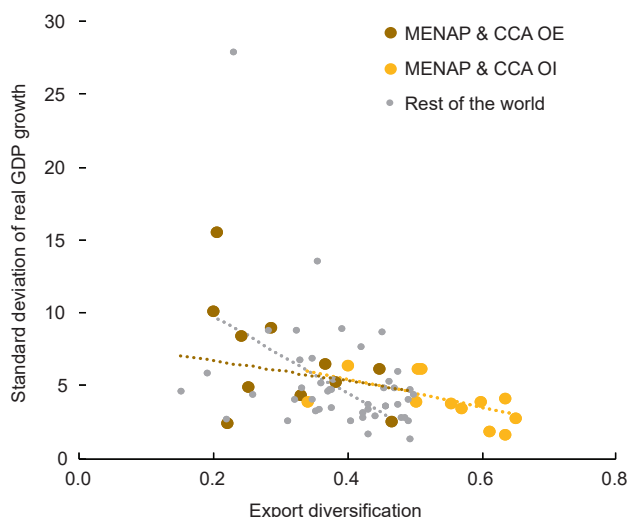
³ Newbery and Stiglitz (1984) theoretically demonstrate how greater openness to trade and specialization can amplify the exposure to sector-specific shocks and increase output volatility. Koren and Tenreyro (2007), Caselli and others (2020), Esposito (2022), and Allen and Atkin (2022) show how trade diversification can reduce exposure to shocks and lower output volatility, using quantitative trade models.

⁴ See, for example, Krugman (1979, 1980) and Eaton and Kortum (2002) for a discussion of the gains from specialization in the context of comparative advantage and economies of scale.

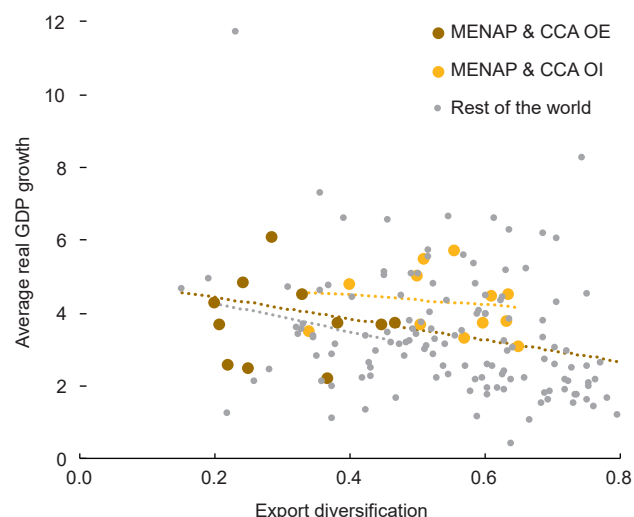
The empirical evidence suggests such a trade-off (Figure 3.1) where trade diversification is based on an index that ranges from 0 to 1, with higher values indicating greater trade diversification.⁵ In a sample of 154 economies over the period of 2002–24, a 1 standard deviation rise in the index of export product diversification is associated with a 0.4 standard deviation decline in output volatility, and also a 0.5 percentage point decline in average output growth over the period. Among MENAP and CCA economies, the trade-off appears to be larger for oil exporters.⁶

Figure 3.1. Trade Diversification, Resilience, and Growth

1. Output Volatility and Trade Diversification
(Percent)



2. Longer-Term Growth and Trade Diversification
(Percent)



Sources: CEPII BACI database; IMF, World Economic Outlook database; and IMF staff calculations.

Note: Export diversification = 1 – normalized Theil index, such that it ranges from 0 to 1, with higher values indicating greater export good diversification. See the Online Annex for details. Real GDP growth volatility is measured as the standard deviation of annual real GDP growth over 2002–24. The fitted lines in panel 1 correspond to the regression of real GDP growth volatility and, in panel 2, average real GDP growth on the export diversification index and the share of exports in GDP. “Rest of the world” includes all economies outside the MENAP and CCA regions. Fragile and conflict-affected states are excluded from the analysis. CCA = Caucasus and Central Asia; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter; OI = oil importer.

Trade Diversification Patterns in MENAP and the CCA Region

Export Product Diversification in MENAP and the CCA Lags the Rest of the World

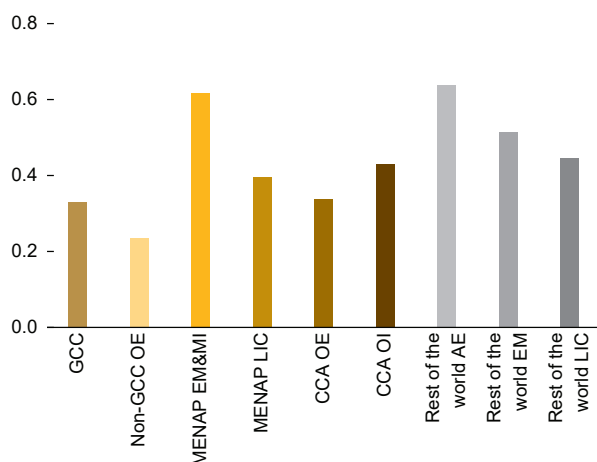
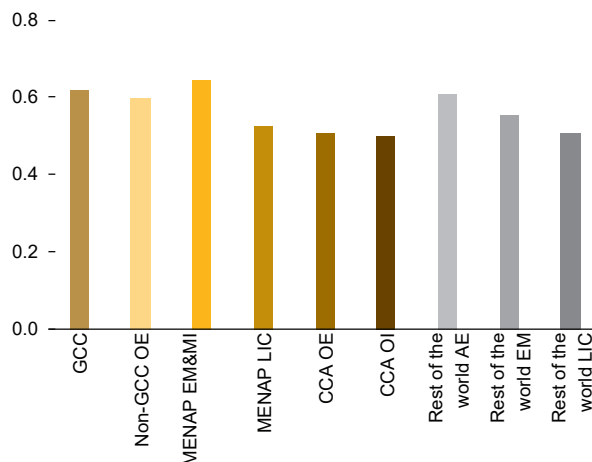
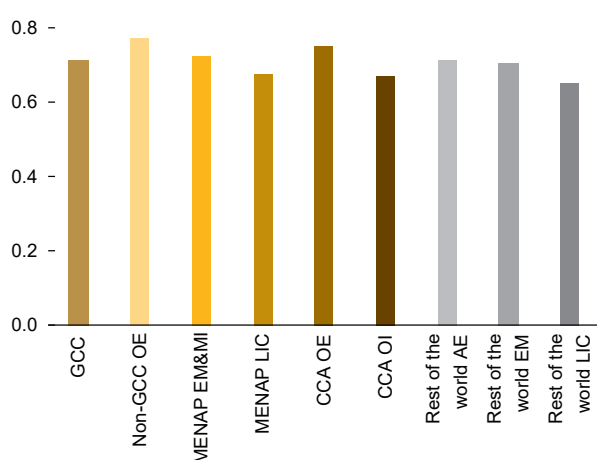
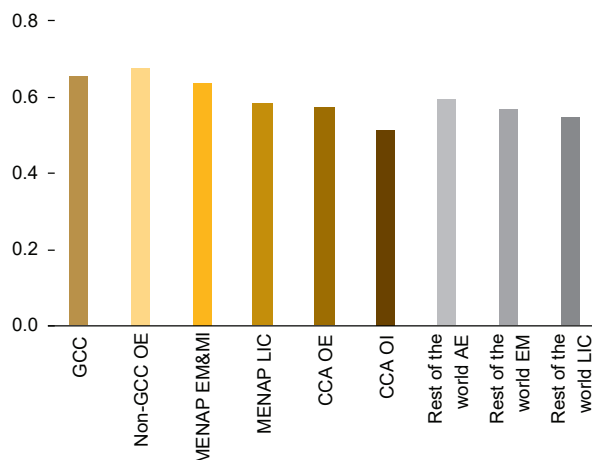
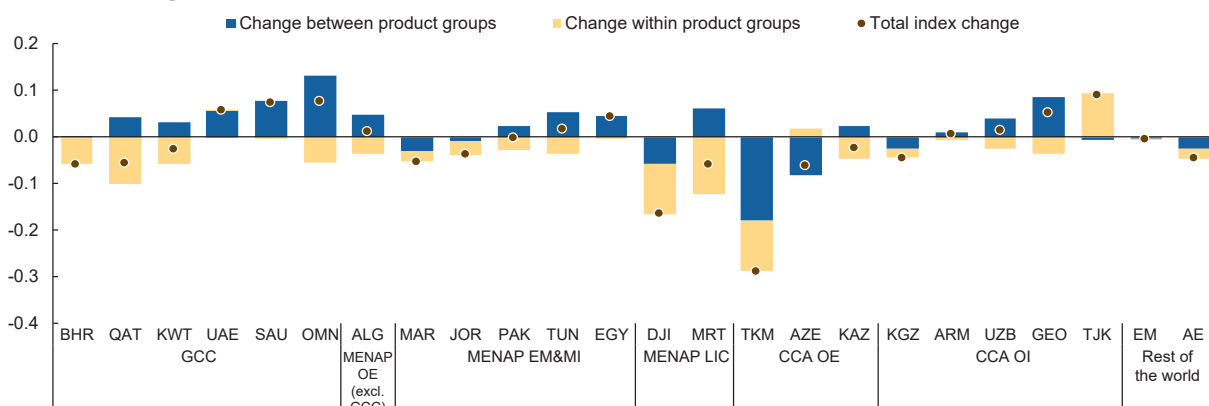
The trade diversification index shows that on average, MENAP and CCA economies have more concentrated exports than the rest of the world, except for MENAP emerging market and middle-income economies, which compare favorably to other emerging markets (Figure 3.2, panel 1).⁷

By contrast, MENAP and CCA economies are broadly in line with other emerging markets in export market diversification (Figure 3.2, panel 2) and import diversification across both products and markets (Figure 3.2, panels 3 and 4). Given these patterns, this chapter’s analysis focuses on export product diversification.

⁵ The stylized facts and empirical analysis are based on a Theil index of goods trade diversification, while the model-based analysis uses a Theil index measuring diversification across both goods and services exports. See the Online Annex for further details on the measure and its properties.

⁶ Greater trade diversification may also go together with moving up the value chain by exporting more complex goods and digitally deliverable services.

⁷ Export product (good) diversification is correlated with economic complexity, where MENAP and the CCA also lag the rest of the world. The Economic Complexity Index (ECI), computed by the Observatory of Economic Complexity, jointly reflects both the diversity and sophistication of the products a country exports. The literature finds that economic complexity is associated with higher long-term growth (Hidalgo and Hausmann 2009; Albeaik and others 2017; Mealy, Farmer, and Teytelboym 2019). See the Online Annex for further details on the ECI and its correlation with export diversification for MENAP and CCA economies.

Figure 3.2. Trade Diversification in 2024**1. Export Product Diversification***(Index)***2. Export Market Diversification***(Index)***3. Import Product Diversification***(Index)***4. Import Market Diversification***(Index)***5. Decomposition of Changes in Export Product Diversification by Economy, 2002-04 versus 2022-24***(Index change)*

Sources: CEPII BACI database; and IMF staff calculations.

Note: Diversification = 1 - normalized Theil index, such that it ranges from 0 to 1, with higher values signifying greater diversification along the indicated dimensions. See Online Annex for further details. The "rest of the world" category includes all countries except those in the MENAP and CCA regions and fragile and conflict-affected states, which are excluded from the analysis. Data labels in the figure use International Organization for Standardization (ISO) country codes. AE = advanced economy; CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; EM = emerging market; GCC = Gulf Cooperation Council; LIC = low-income country; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter.

Mixed Progress toward Greater Export Product Diversification

Less than 40 percent of the economies considered in the MENAP and CCA regions have seen gains in terms of export product diversification over the past two decades (Figure 3.2, panel 5). On average, GCC economies saw the largest gains both in absolute terms and compared to their low initial levels, helping to close 20 percent of the gap relative to other emerging markets. By contrast, the average MENAP emerging market and middle-income economy saw no significant change but was already above the average emerging market elsewhere. Changes in export diversification can be decomposed along two margins: the extensive margin, which captures expansion into new export product categories, and the intensive margin, which captures a more even distribution of exports within existing categories. In economies that saw improvements, greater export product diversification came from the extensive margin. By contrast, in economies that experienced a fall in export product diversification, greater concentration along the intensive margin was more important than concentration along the extensive margin.

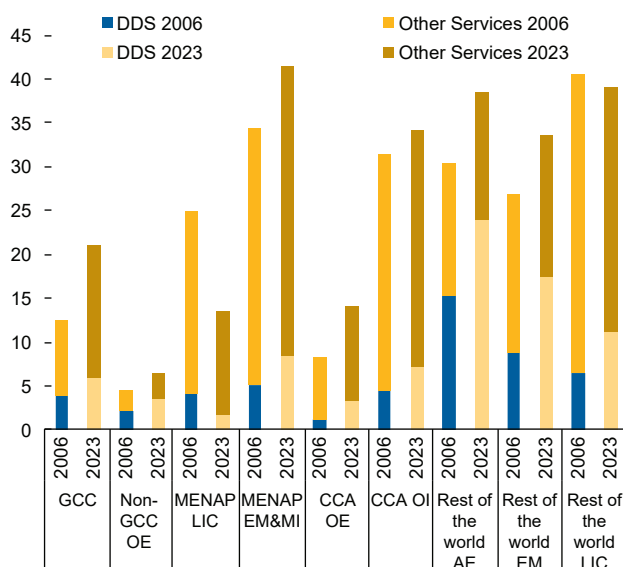
Services Trade Expands, but Exposure to Shocks Remains Uneven

MENAP and CCA economies have increased the share of services in total exports over the past two decades (Figure 3.3), which is another important source of diversification. However, unlike in other regions, this shift has been driven largely by sectors, such as travel and transport, which are not digitally deliverable and therefore potentially more exposed to disruptions in the physical movements of people and goods, including those linked to conflicts. At the same time, service exports have been less directly exposed to new US tariff actions in 2025–26, providing some buffer to MENAP and CCA economies.

MENAP Trade Highly Exposed to Maritime Chokepoint Disruptions

MENAP economies rely more heavily than other regions on maritime trade, much of which passes through key chokepoints exposed to recent geopolitical tensions and the war in the Middle East. This is particularly the case for Gulf Cooperation Council (GCC) economies and non-GCC MENAP oil exporters: maritime transport accounts for 81 percent and 76 percent of their goods exports, respectively, compared with less than half in other regions of the world (Figure 3.4, panel 1).⁸ Because a larger share of MENAP exports also transits through maritime chokepoints, the region is particularly vulnerable to disruptions in sea lanes and shipping routes.

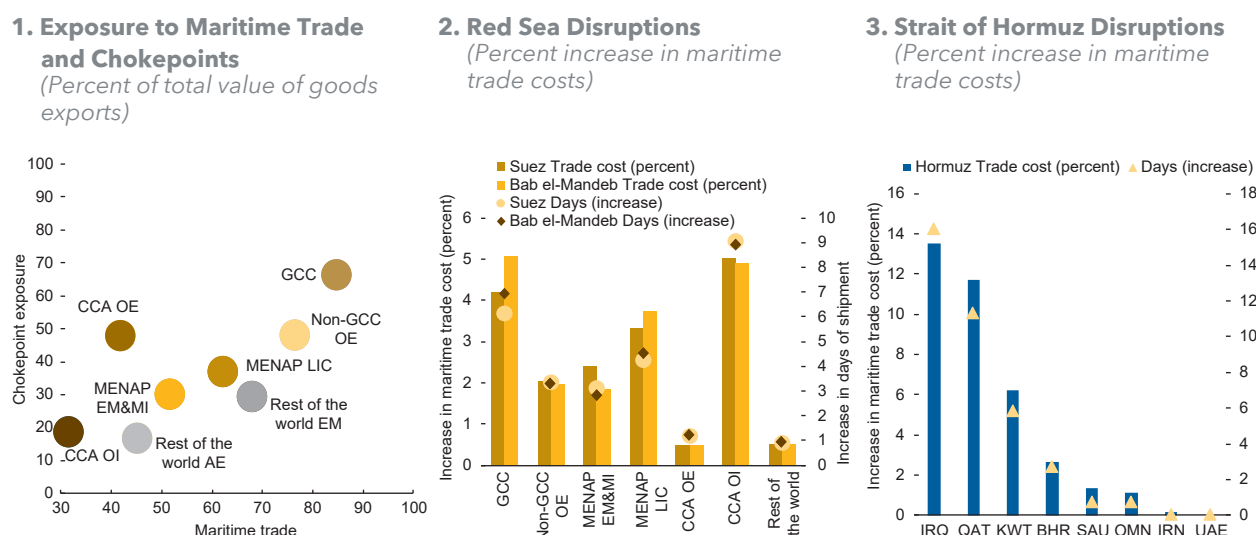
Figure 3.3. Exports of Services
(Percent of total exports)



Sources: Bilateral Trade in Services (BiTS) database; IMF, World Economic Outlook database; Li and others (2025); and IMF staff calculations.

Note: DDS = digitally deliverable services (services that can be delivered remotely). See the Online Annex for details. Non-GCC oil exporters comprise Algeria, Iran, Iraq, and Libya. The “rest of the world” category includes all economies except those in the MENAP and CCA regions. AE = advanced economies; CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economies; EM = emerging market; GCC = Gulf Cooperation Council; LIC = low-income countries; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter.

⁸ The mix of transport modes can reflect several factors: geography, the availability of infrastructure for land-based transport, the type of products exported, the location of export markets, and regional trade integration.

Figure 3.4. Exposure to Maritime Trade Disruptions and Trade Cost Impacts

Sources: CEPII BACI database; CEPII Gravity Database; CERDI, OECD, Economic Outlook database, InfraEconomy; IMF, PortWatch; Schott (2008); SeaDistance database; SeaRoute (Oak Ridge National Labs); Verschuur, Lumma, and Hall (2025); and IMF staff calculations. Note: The estimates reflect both direct shipping and indirect shipping through entrepôts in other economies. In the Strait of Hormuz scenario, trade cost increases capture both indirect maritime shipping costs and the maritime-equivalent cost of overland rerouting to neighboring economies' ports. See the Online Annex for further details on chokepoint exposure and trade cost estimations. Non-GCC OE = oil exporters in the MENAP region that are not part of the GCC, comprising Algeria, Iran, Iraq, and Libya. "Rest of the world" includes all economies outside the MENAP and CCA regions. Data labels use International Organization for Standardization (ISO) country codes. AE = advanced economy; 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.

To get a better sense of the magnitude of chokepoint exposure, trade rerouting costs are estimated by simulating the closures of the Red Sea and Strait of Hormuz using a spatial model of containerized maritime trade allowing for alternative routes.⁹ A persistent closure of the Bab el-Mandeb Strait or the Suez Canal would raise trade costs by 3 percent on average for MENAP and CCA economies, and by about 5 percent for GCC and CCA oil importers—roughly equivalent to an increase in shipping times by about eight days (Figure 3.4, panel 2). The closure of the Strait of Hormuz is estimated to have particularly large effects, raising trade costs by more than 13 percent in Iraq and 11 percent in Qatar, considering the cost of rerouting by land to ship from unaffected ports (Figure 3.4, panel 3). These estimates likely understate the full cost impact, as they do not account for non-containerized trade, higher energy prices, additional road or rail infrastructure investment costs, and the loss of economies of scale associated with shifting away from maritime transport.

Adverse External Shocks and the Mitigating Effects of Trade Diversification

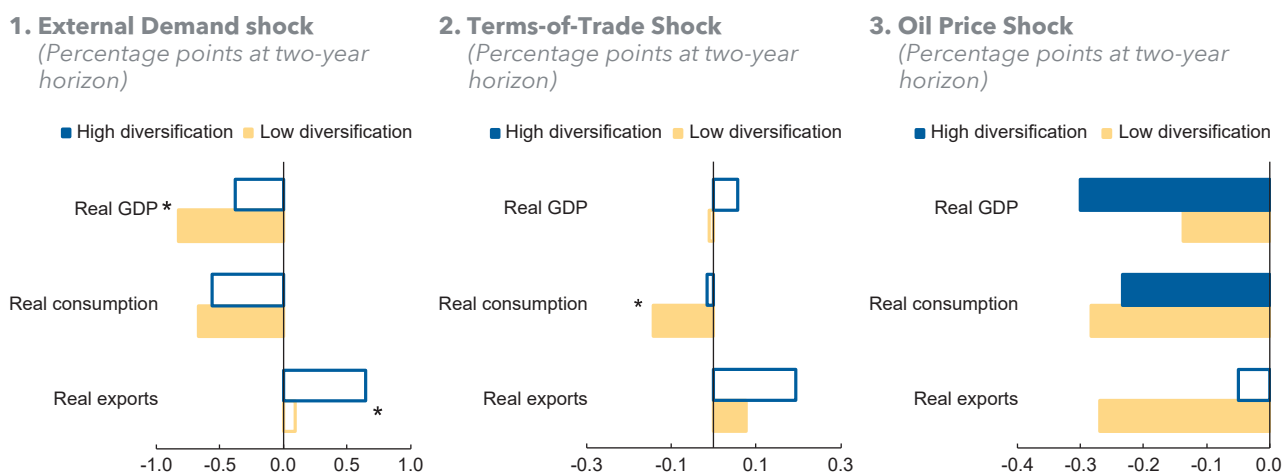
Trade diversification can strengthen resilience in two ways: by reducing an economy's exposure to any single adverse external shock and by improving its capacity to recover once a shock occurs. To assess these effects, this chapter estimates the annual dynamic responses of more- and less-diversified economies to three types of shocks: an external demand shock, a terms-of-trade shock, and an oil price shock. The estimates are based on local projection regressions following Jordà (2005).

⁹ Specifically, rerouting costs are estimated using a reduced-form equation derived from the quantitative general equilibrium spatial trade model developed by Ganapati, Foong, and Ziv (2024). In the case of the Strait of Hormuz closure scenario, the estimation assumes that regional integration allows for maritime containerized trade to be redirected through neighboring economies' ports (at some additional cost). The estimated trade costs do not apply to oil, gas, and other bulk cargo. See the Online Annex for further details.

More Diversified Exports Dampen Impacts of Adverse Shocks and Hasten Recovery

Greater export product diversification is associated with stronger resilience to adverse demand and terms-of-trade shocks (Figure 3.5, panels 1 and 2).¹⁰ After a 1 standard deviation adverse external demand shock, an economy in the top quartile of the Export Product Diversification Index (EPDI) experiences a decline in real GDP two years after the shock that is 0.5 percentage point smaller than in the rest of the sample. Diversification similarly helps buffer against terms-of-trade shocks: two years after a 1 standard deviation adverse shock, real GDP and real consumption in the most diversified economies fall 0.1 percentage points less than in less-diversified economies (Figure 3.5, panel 2). The effects of diversification are more limited after oil price shocks: while more diversified economies experience smaller consumption and export responses, diversification does not cushion the decline in GDP (Figure 3.5, panel 3). This is in part because real imports decline by relatively less.¹¹

Figure 3.5. Dynamic Responses to Adverse External Shocks



Sources: CEPII, BACI database; IMF, Global Economic Environment (GEE) database; IMF, World Economic Outlook database; and IMF staff calculations.

Note: Diversification = 1 – normalized Theil index, ranging from 0 to 1, with higher values indicating greater export product diversification. See the Online Annex for further details. High diversification refers to economies in the top quartile of the Export Product Diversification Index, while low diversification refers to all other economies. The external demand shock refers to the weighted growth of an economy's trading partners, with weights based on exports and scaled by the share of exports to GDP. The terms-of-trade shock is the ratio of the change in the import price index to the export price index. The oil price shock refers to the standardized annual oil price change scaled by the net trade oil balance. An asterisk (*) indicates that the high- and low-diversification group estimates differ significantly at the 10 percent level or lower. Hollow bars indicate lack of significance of the group coefficient at the 10 percent level. Cumulative responses to 1 standard deviation shocks are shown for a median economy. Fragile and conflict-affected states are excluded from the analysis. Sample size and composition vary across shocks and outcome variables because of data constraints. See the Online Annex for additional details.

Export Diversification Trade-Offs: Resilience versus Welfare

Policies that promote export diversification can boost economic resilience, but they may also involve efficiency costs if they push an economy away from its underlying comparative advantages. This section quantifies this potential trade-off using scenarios of alternative shocks and diversification policy designs from a multicountry, multisector general-equilibrium trade model with input-output linkages (Bonadio and others 2021; Bonadio and others 2025; Huo, Levchenko, and Pandalai-Nayar 2025). The analysis focuses on three representative MENAP and CCA economies: a GCC oil exporter, a non-GCC oil exporter in MENAP and the CCA, and a diversified MENAP emerging market and middle-income, oil-importing economy.

¹⁰ Our results relate to Ahn and Tan (2025), who find that greater diversification across suppliers helps mitigate the impact of adverse supply shocks, because it facilitates reallocation of supply chains in response to shocks, and to da Costa Neto and Romeu (2011), who find that greater export diversification across sectors and products helps mitigate the impact of financial crises on exports of Latin American economies.

¹¹ See the Online Annex for further details. The estimation sample across outcome variables varies because of data availability constraints.

Policy Design and Initial Economic Characteristics Affect Benefits and Costs of Export Diversification

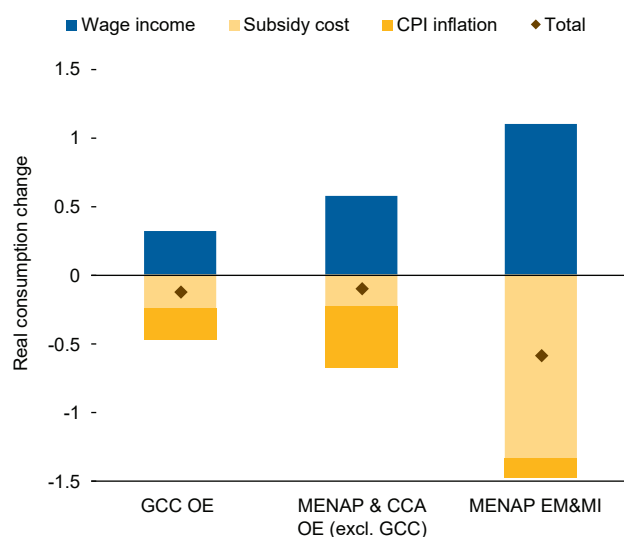
The model-based analysis highlights two key factors that determine the welfare outcomes of trade diversification across goods and services. The first is policy design: outcomes differ depending on whether diversification is pursued through targeted industrial policies,¹² such as export subsidies, or through broader structural reforms. The second is the economy's initial conditions: especially, whether it starts from a relatively diversified or concentrated export base.

- **Targeted export subsidies can increase diversification but reduce welfare.** Sectoral export subsidies may broaden the export base by shifting workers and resources away from sectors that reflect the economy's initial comparative advantage. However, these policies generate welfare losses by raising inflation through higher producer prices and by creating fiscal costs that more than offset the income gains from higher worker earnings (Figure 3.6, panel 1).¹³ This type of industrial policy could still deliver positive net benefits only if it were to address market failures—such as financial frictions or information asymmetries—that are large enough to outweigh near-term distortions (Baquie and others 2025; Chapter 3 of the October 2025 *World Economic Outlook*).

Figure 3.6. Export Diversification and Welfare Trade-Offs

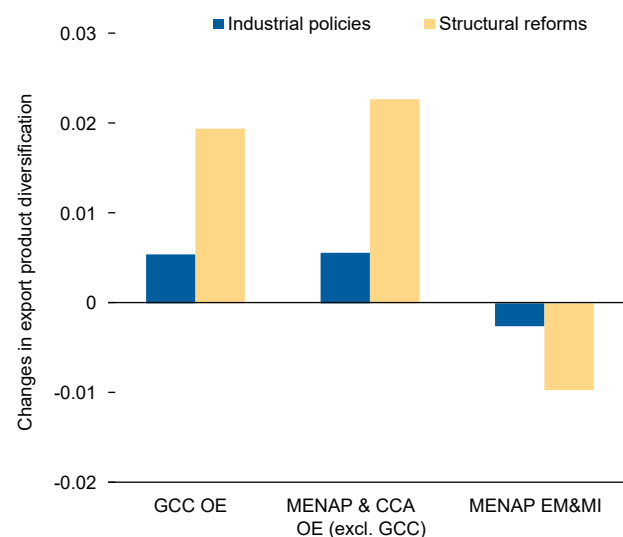
1. Costs and Benefits of Industrial Policy (Export Subsidies)

(Percent)



2. Policy Interventions and Export Diversification

(Index change)



Sources: Eora multi-region input-output (MRIO) database; Lenzen and others 2012, 2013; UNCTAD TRAINS database; and IMF staff calculations.

Note: Model-based scenarios use 2024 data as baseline. Export diversification = 1 - normalized Theil index, such that it ranges from 0 to 1, with higher values indicating greater export diversification. The structural reform package is assumed to deliver a labor productivity boost that closes half of the representative economy's productivity gap with the average advanced economy for all sectors and an increase in the sectoral labor supply elasticity from 1.5 to 4, raising labor market flexibility. The industrial policies package is assumed to take the form of sectoral export subsidies of 10 percent that target one high complexity good plus one service sector that are closest to the existing most competitive sector. See the Online Annex for details. CCA = Caucasus and Central Asia; CPI = consumer price index; EM&MI = emerging market and middle-income economy; GCC = Gulf Cooperation Council; MENAP = Middle East and North Africa, Afghanistan, and Pakistan; OE = oil exporter.

¹² Industrial policy is defined as targeted government interventions aimed at changing the relative prices across sectors or direct resources toward certain selectively targeted activities with the purpose of shifting the long-term composition of economic activity (Baquie and others 2025; Juhász and others 2025). Labor market flexibility is measured using an index sourced from the Fraser Institute's Economic Freedom of the World database, which captures the degree of flexibility in labor market regulations, including hiring and dismissal rules. See the Online Annex for further details.

¹³ The fiscal cost is modeled as a lump-sum tax on households that finances the subsidy. See the Online Annex for further details.

- **Structural reforms can improve both diversification and welfare.** Reforms that raise productivity and strengthen labor market flexibility support diversification by improving competitiveness and allocative efficiency without distorting comparative advantages. As a result, they raise both income and welfare.¹⁴
- **The initial export structure matters.** The size and direction of the impact of policy interventions depend on the economy's starting level of export diversification (Figure 3.6, panel 2). For oil exporters, with exports concentrated in capital-intensive commodity extraction, structural reforms generate larger gains in export product diversification than in an already-diversified emerging market economy, where diversification may decline. As labor becomes more mobile and productivity rises, workers shift toward more labor-intensive sectors where productivity gains translate more strongly into wages, broadening the export mix. However, in an emerging market economy that is already well diversified into less capital-intensive activities, the outcome reverses. The reason is that a uniform labor productivity boost, or export subsidies that target sectors that are close to the economy's most competitive sector, reinforce the existing comparative advantage and hence increase concentration.

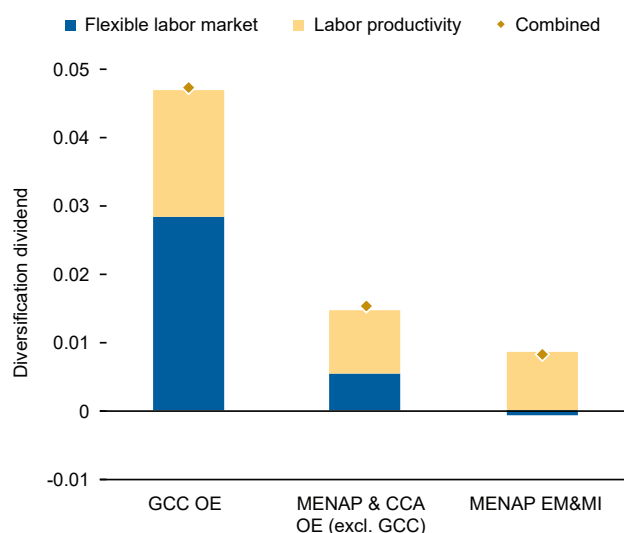
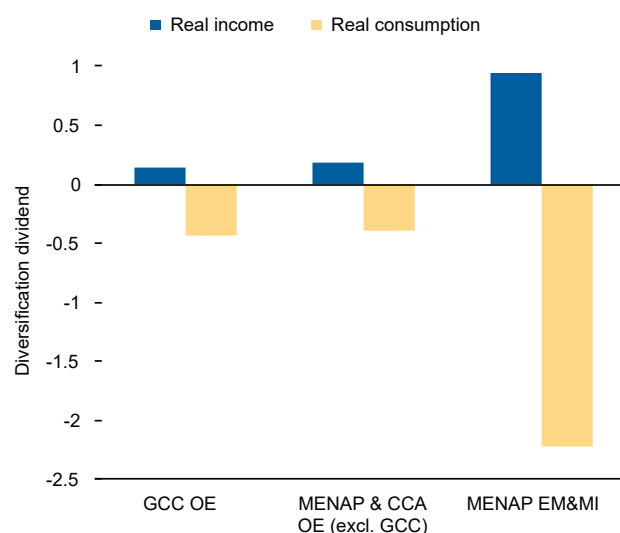
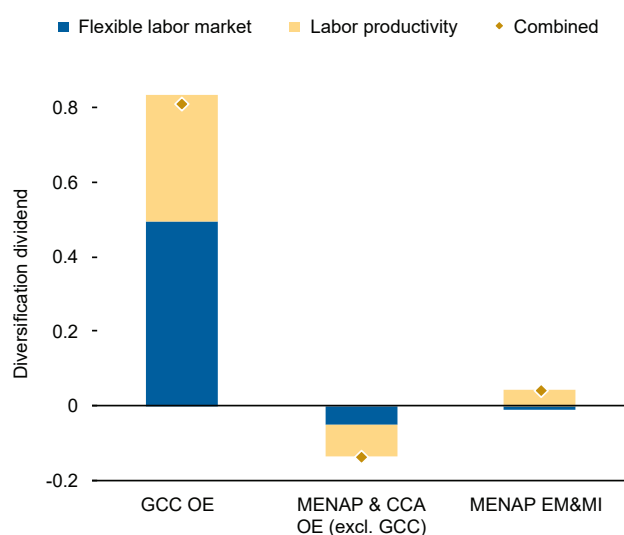
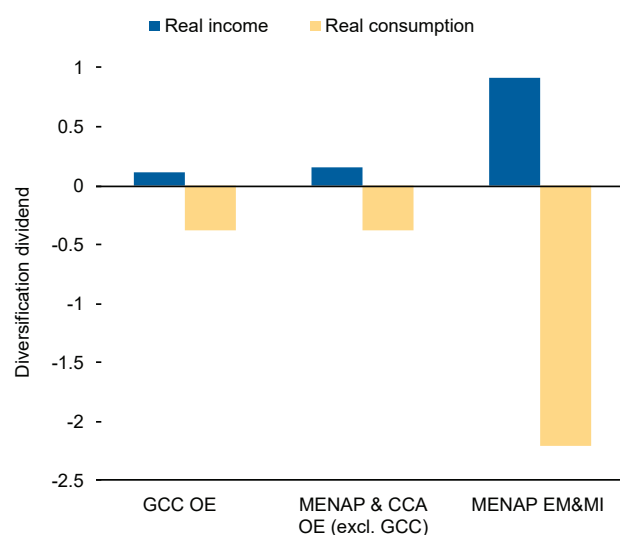
Structural Reforms Deliver a Larger Diversification Dividend than Export Subsidies

This subsection explores how the implementation of an export diversification policy affects the welfare outcomes of two adverse shocks: (i) a 10 percentage point increase in US tariffs and (ii) an increase in the economy-specific trade costs resulting from a persistent closure of the Strait of Hormuz (building on the scenario described in Section 3.2).

- **US tariff shock:** Structural reforms generally mitigate the adverse effects of higher US tariffs. In all three MENAP and CCA economy cases, post-reform income losses are smaller than under the (no diversification policy) baseline. The representative GCC oil exporter records the largest gains: its income loss falls by about one-third, from 0.15 to 0.10 percent. Decomposing the diversification dividend (the difference in welfare outcomes between the reform scenario and the baseline) reveals that both greater labor market flexibility and higher productivity contribute to stronger resilience (Figure 3.7, panel 1). Industrial policy also reduces the income impact of the tariff shock, but the real income gains from export subsidies relative to a no-reform scenario are more than offset by the fiscal costs. As a result, industrial policy increases—rather than reduces—the aggregate welfare cost of the tariff shock, by up to 2.2 percentage points for the diversified emerging market economy (Figure 3.7, panel 2).
- **Closure of the Strait of Hormuz:** For directly affected economies, welfare losses from the closure of the Strait of Hormuz—directly affecting trade access—are materially larger than those from higher US tariffs. The modeling results show that structural reforms help reduce these losses as they promote trade diversification across goods, services, and trading partners such that exports become less reliant on maritime transport through the Strait of Hormuz. For the representative GCC oil exporter, where the impact of the shock is largest, structural reforms only offset about one-third of the income losses. Additional measures that address the rise in trade costs more directly, including reducing trade barriers and enhancing transport links that deepen regional integration, could further reduce the losses from this shock. The decomposition again points to sizable resilience gains from both productivity improvements and greater labor market flexibility (Figure 3.7, panel 3). Under the Strait of Hormuz shock, industrial policy shows the same income-versus-consumption trade-off observed under the US tariff shock (Figure 3.7, panel 4).

Overall, these findings highlight the merit of pursuing trade diversification through broad structural reforms. Unlike industrial policies, structural reforms boost economic resilience without creating a trade-off with welfare: they expand the production frontier, rather than reallocating resources inefficiently. Industrial policies can raise welfare only when they correct market failures large enough to outweigh the distortions and fiscal costs they introduce.

¹⁴ Unlike industrial policies, structural reforms are assumed to be costless in the model. See the Online Annex for further details.

Figure 3.7. Quantitative Model—Export Diversification Dividends**1. US Tariffs and Structural Reforms***(Percentage points change)***2. US Tariffs and Industrial Policy***(Percentage points change)***3. Strait of Hormuz Closure and Structural Reforms***(Percentage points change)***4. Strait of Hormuz Closure and Industrial Policy***(Percentage points change)*

Sources: Eora multi-region input-output (MRIO) database; Lenzen and others (2012, 2013); UNCTAD TRAINS database; and IMF staff calculations.

Note: Model-based scenarios use 2024 data as baseline. See Online Annex for details on the model and scenario calibration. Diversification dividend = difference in the change in real consumption or income with reform and without reform. GCC = Gulf Cooperation Council; EM&MI = emerging market and middle-income economy; OE = oil exporter.

Structural Policies and Export Diversification in Practice

This section uses cross-country panel regressions to assess how structural reforms (that improve labor market flexibility and enhance human capital) and industrial policies are associated with export product diversification over the past two decades.

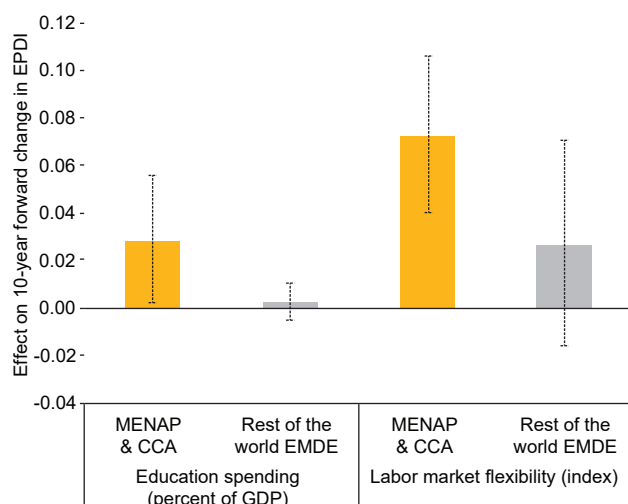
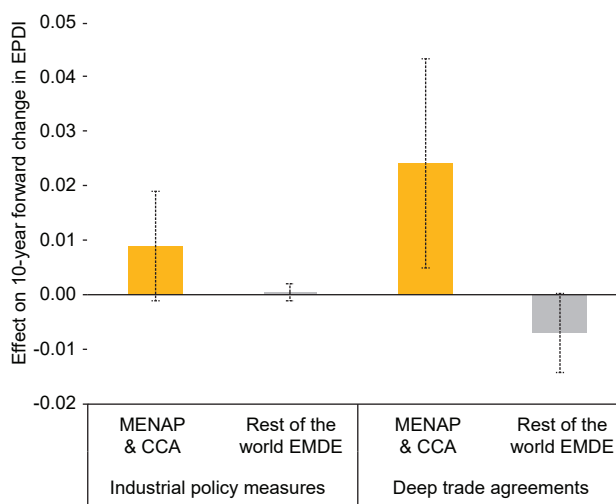
- **Labor market flexibility.** Consistent with the quantitative model results, the regression analysis demonstrates that greater labor market flexibility is positively associated with export product diversification, especially in MENAP and CCA economies. In these regions, a 1 standard deviation increase in labor flexibility, roughly equivalent to moving from the economy at the median to the economy at the 80th percentile in the region, is associated with a 0.07 increase in the EPDI over the following 10 years, which corresponds to closing about 85 percent of the gap in the EPDI between the MENAP and CCA regions and the rest of the world. In other emerging markets and developing economies (EMDEs), the corresponding increase in the EPDI is less than half of that for the MENAP and CCA regions (Figure 3.8, panel 1). The stronger association likely reflects greater scope for reform in MENAP and the CCA, where labor market rigidities remain more pronounced and may slow the reallocation of workers toward emerging tradable sectors.
- **Human capital investment.** Higher human capital investment can support export diversification by expanding the skills and capabilities needed to adopt more sophisticated production technologies and enter new export activities (Acemoglu and Zilibotti 2001; Hausmann and Rodrik 2003). Consistent with this mechanism, education spending, used as a proxy for human capital investment, is positively associated with trade diversification. In MENAP and CCA economies, increasing public education spending by 2 percentage points, which corresponds to moving an economy in the region from the median to the 80th percentile, is associated with an increase in the EPDI of about 0.06, or closing about 75 percent of the EPDI gap relative to the rest of the world. In other regions of the world, this effect is much smaller (Figure 3.8, panel 1). This pattern is consistent with the lower education spending in MENAP and CCA economies compared to other EMDEs over the past two decades and points to higher marginal returns to additional investment in human capital.
- **Industrial policy.** By contrast, estimates based on the industrial policy database of Juhász and others (2025) point to more limited and uncertain diversification gains from industrial policy. On average, 10 additional industrial policy measures per year are associated with an increase in the EPDI of about 0.1 in MENAP and the CCA, compared to a negligible effect elsewhere, but the estimates are statistically not significant (Figure 3.8, panel 2). The wide uncertainty around these estimates suggests that the effectiveness of industrial policy may depend on country-specific conditions and implementation capacity.

Greater Trade Integration May Also Increase Export Diversification

Greater trade integration, measured by participation in deep trade agreements,¹⁵ is also associated with statistically significant increases in the EPDI in MENAP and CCA economies, although the estimated impact is modest. A 15 percent annual increase in deep trade agreement exposure, defined as participation in deep trade agreements weighted by partner economies' size, with higher values reflecting stronger integration with larger markets through deeper agreements, is associated with an increase of about 0.02 in the EPDI for MENAP and CCA economies, but the effect is negligible in other EMDEs (Figure 3.8, panel 2). This positive association is consistent with findings by Kirabaeva, Rotunno, and Ruta (forthcoming) on the role of trade integration in supporting diversification.¹⁶

¹⁵ Deep trade agreements are agreements that cover both trade and additional policy areas, including international investment, and the protection of intellectual property rights as well as the environment.

¹⁶ The authors find that greater intra- and interregional integration could foster trade diversification across economies and sectors.

Figure 3.8. Structural and Industrial Policies and Export Diversification**1. Education Spending and Labor Market Flexibility**
(Index)**2. Industrial Policy Measures and Deep Trade Agreements**

Sources: Antoine, forthcoming; Fraser Institute, Economic Freedom of the World; IMF, World Economic Outlook database; Industrial Policy Database; Infrastructure quality database; Juhász and others 2025; World Bank, Deep Trade Agreements Database; World Bank, World Development Indicators; World Bank, Worldwide Governance Indicators; and IMF staff calculations.

Note: Export diversification = 1 - normalized Theil index, such that it ranges from 0 to 1, with higher values indicating greater export product diversification. See the Online Annex for further details. "Rest of the world EMDE" includes all emerging market and developing economies except those in the MENAP and CCA regions. CCA = Caucasus and Central Asia; EMDE = emerging market and developing economies; EPDI = export product diversification index; MENAP = Middle East and North Africa, Afghanistan, and Pakistan.

Conclusion

Despite notable progress over the past two decades, MENAP and CCA economies remain less diversified than the rest of the world in both export products and trade routes. On average, they export a less-diversified basket of goods than economies elsewhere, while MENAP economies also remain more vulnerable to disruptions of maritime trade. These findings point to significant scope to deepen export diversification in MENAP and the CCA. Doing so could help boost economic resilience. The empirical analysis shows that greater export product diversification has been associated with smaller declines in economic activity after adverse shocks in general over the past two decades.

However, the quantitative model results highlight an important policy trade-off. Industrial policy interventions can increase export diversification and wages, but they reduce overall welfare unless they address clearly identified market failures large enough to offset their fiscal and efficiency costs. By contrast, structural reforms that boost productivity and enhance allocative efficiency avoid this trade-off, increasing diversification and welfare at the same time. This chapter's empirical analysis also shows that over the past two decades, structural reforms have been more effective than industrial policies in promoting export diversification.

The results reinforce the importance of well-designed policies that boost trade diversification to ensure that they both strengthen broad economic resilience and enhance efficiency and welfare. However, if the adverse shocks directly affect trade access, then policies that enhance regional integration—lowering trade costs—can also help further boost trade diversification and resilience.

References

- Acemoglu, Daron, and Fabrizio Zilibotti. 2001. "Productivity Differences." *Quarterly Journal of Economics* 116 (2): 563–606.
- Ahn, JaeBin, and Brandon Joel Tan. 2025. "Supply Chain Diversification and Resilience." IMF Working Paper 2025/102, International Monetary Fund, Washington, DC.
- Albeaik, Saleh, Mary Kaltenberg, Mansour Alsaleh, and Cesar A. Hidalgo. 2017. "Improving the Economic Complexity Index." arXiv preprint arXiv:1707.05826.
- Allen, Treb, and David Atkin. 2022. "Volatility and the Gains from Trade." *Econometrica* 90 (5): 2053–92.
- Antoine, Kassia. Forthcoming. "Infrastructure for Productivity in the MENAP Region: Evidence on the Role of Infrastructure Quantity and Quality." International Monetary Fund, Washington, DC.
- Baquie, Sandra, Yueling Huang, Florence Jaumotte, Jaden Kim, Rafael M. Parente, and Samuel Pienknagura. 2025. "Industrial Policies: Handle with Care." IMF Staff Discussion Note 2025/002, International Monetary Fund, Washington, DC.
- Benigno, Gianluca and Hande Küçük. 2012. "Portfolio Allocation and International Risk Sharing." *Canadian Journal of Economics* 45 (2): 535–65.
- Bonadio, Barthélémy, Zhen Huo, Andrei A. Levchenko, and Nitya Pandalai-Nayar. 2021. "Global Supply Chains in the Pandemic." *Journal of International Economics* 133: 103534.
- Bonadio, Barthélémy, Zhen Huo, Andrei A. Levchenko, and Nitya Pandalai-Nayar. 2025. "Globalization, Structural Change and International Comovement." *Journal of Monetary Economics* 151: 103745.
- Caselli, Francesco, Miklós Koren, Milan Lisický, and Silvana Tenreyro. 2020. "Diversification through Trade." *The Quarterly Journal of Economics* 135 (1): 449–502.
- da Costa Neto, Maximiliano N. C., and Rafael Romeu. 2011. "Did Export Diversification Soften the Impact of the Global Financial Crisis?" International Monetary Fund, Washington, DC.
- Eaton, Jonathan, and Samuel Kortum. 2002. "Technology, Geography, and Trade." *Econometrica* 70 (5): 1741–79.
- Esposito, Federico. 2022. "Demand Risk and Diversification through International Trade." *Journal of International Economics* 135: 103562.
- Ganapati, Sharat, Woan Foong Wong, and Oren Ziv. 2024. "Entrepot: Hubs, Scale, and Trade Costs." *American Economic Journal: Macroeconomics* 16 (4): 239–78.
- Hausmann, Ricardo, and Dani Rodrik. 2003. "Economic Development as Self-Discovery." *Journal of Development Economics* 72 (2): 603–33.
- Hidalgo, César A., and Ricardo Hausmann. 2009. "The Building Blocks of Economic Complexity." *Proceedings of the National Academy of Sciences* 106 (26): 10570–75.
- Huo, Zhen, Andrei A. Levchenko, and Nitya Pandalai-Nayar. 2025. "International Comovement in the Global Production Network." *Review of Economic Studies* 92 (1): 365–403.
- Jordà, Òscar. 2005. "Estimation and Inference of Impulse Responses by Local Projections." *American Economic Review* 95 (1): 161–82.

- Juhász, Réka, Nathan J. Lane, Emily Oehlsen, and Verónica C. Pérez. 2025. "Measuring Industrial Policy: A Text-Based Approach." NBER Working Paper 33895, National Bureau of Economic Research, Cambridge, MA.
- Kirabaeva, Koralai, Luca Rotunno, and Michele Ruta. Forthcoming. "Trade Integration and Resilience in the Middle East and Central Asia." IMF Working Paper, International Monetary Fund, Washington, DC.
- Koren, Miklós, and Silvana Tenreyro. 2007. "Volatility and Development." *Quarterly Journal of Economics* 122 (1): 243–87.
- Krugman, Paul R. 1979. "Increasing Returns, Monopolistic Competition, and International Trade." *Journal of International Economics* 9 (4): 469–79.
- Krugman, Paul R. 1980. "Scale Economies, Product Differentiation, and the Pattern of Trade." *American Economic Review* 70 (5): 950–59.
- Lenzen, Manfred, Keiichiro Kanemoto, Daniel Moran, and Arne Geschke. 2012. "Mapping the Structure of the World Economy." *Environmental Science & Technology* 46 (15): 8374–81.
- Lenzen, Manfred, Daniel Moran, Keiichiro Kanemoto, and Arne Geschke. 2013. "Building Eora: A Global Multi-Region Input-Output Database at High Country and Sector Resolution." *Economic Systems Research* 25 (1): 20–49.
- Li, Nan, Sergii Meleshchuk, Qiuyan Yin, Dennis Zhao, and Robert Zymek. 2025. "Bilateral Trade in Services: Insights from a New Research Dataset." IMF Working Paper 2025/163, International Monetary Fund, Washington, DC.
- Mealy, Penny, J. Doynne Farmer, and Alexander Teytelboym. 2019. "Interpreting Economic Complexity." *Science Advances* 5 (1): eaau1705.
- Newbery, David M. G., and Joseph E. Stiglitz. 1984. "Pareto Inferior Trade." *Review of Economic Studies* 51 (1): 1–12.
- Schott, Peter K. 2008. "The Relative Sophistication of Chinese Exports." *Economic Policy* 23 (53): 6–49.
- Verschuur, Jasper, Jelte Lumma, and Jim W. Hall. 2025. "Systemic Impacts of Disruptions at Maritime Chokepoints." *Nature Communications* 16 (1): 10421.

IN THIS ISSUE

CHAPTER 1

Steering Through Uncertainty: Strengthening Resilience in Challenging Times

CHAPTER 2

Inflation Dynamics in the Middle East and Central Asia: How Policy Frameworks and Structural Characteristics Shape the Transmission of Global Supply Shocks

CHAPTER 3

Trade Diversification in Turbulent Times: Implications for Economic Growth and Resilience in MENAP and the CCA



PUBLICATIONS

REGIONAL ECONOMIC OUTLOOK
MIDDLE EAST AND CENTRAL ASIA - OCT 2026

