

INTERNATIONAL MONETARY FUND

# REGIONAL ECONOMIC OUTLOOK

MIDDLE EAST AND  
CENTRAL ASIA

Trade-Offs Today for Transformation  
Tomorrow

**2021**  
OCT



World Economic and Financial Surveys

Regional Economic Outlook

**Middle East  
and Central Asia**



**OCT 21**

©2021 International Monetary Fund

### Cataloging-in-Publication Data

Names: International Monetary Fund. Middle East and Central Asia Department, issuing body. | International Monetary Fund, publisher.

Title: Regional economic outlook. Middle East and Central Asia.

Other titles: Middle East and Central Asia. | MCD REO. | World economic and financial surveys.

Description: Washington, DC : International Monetary Fund, 2021. | World economic and financial surveys, 0258-7440. | Oct. 21. | Includes bibliographical references.

Identifiers: ISBN 9781513592770 (Paper)

9781513593036 (ePub)

9781513593111 (WebPDF)

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 R445 2021

The *Regional Economic Outlook: Middle East and Central Asia* is published twice a year, in the spring and fall, to review developments in the region. Estimates, projections, and policy considerations are those of the IMF staff and do not necessarily represent the views of the IMF, its Executive Board, their national authorities, or IMF Management.



Please send orders to:  
International Monetary Fund, Publication Services  
P.O. Box 92780, Washington, DC 20090, U.S.A.  
Tel.: (202) 623-7430 Fax: (202) 623-7201  
[publications@imf.org](mailto:publications@imf.org)  
[www.imfbookstore.org](http://www.imfbookstore.org)  
[www.elibrary.imf.org](http://www.elibrary.imf.org)

# Contents

<b>Acknowledgments</b>	<b>v</b>
<b>Country Groupings</b>	<b>vii</b>
<b>Assumptions and Conventions</b>	<b>ix</b>
<b>1. Regional Developments and Outlook: From Crisis Management to Transformational Recovery</b>	<b>1</b>
Global Backdrop: A Dichotomy between the Haves and Have Nots	1
Not Out of the Woods	1
Uneven Recovery and Rising Inflation	3
Outlook: Subdued and Fragile Recovery	4
Rising Risks and Vulnerabilities	8
Starker Policy Trade-offs on the Way to a Transformational Recovery	9
Investing in the Future to Emerge Stronger	12
References	13
<b>2. Labor Market Challenges during the Pandemic, the Role of Informality, and the Road Ahead</b>	<b>18</b>
Long-Standing Labor Market Challenges at the Dawn of the Pandemic	18
The Pandemic's Unprecedented Impact on Labor Markets	18
The Pandemic's Uneven Effects across the Region	20
What Are the Prospects for the Labor Market Recovery in the Near Term?	23
Looking Ahead: Policy Actions toward an Inclusive Recovery	29
References	32
<b>3. COVID-19 and the Corporate-Sector Outlook</b>	<b>33</b>
Uneven Recovery after an Unprecedented Crisis	33
Corporate Outlook amid Elevated Uncertainty	40
Policy Actions for the Recovery and Beyond	43
References	46
<b>Figures</b>	
1.1 Average Daily Infections and Deaths versus People Vaccinated	2
1.2 Higher Vaccination Rates in More Affluent Countries	2
1.3 ME&CA: Monetary Policy Rates	3
1.4 Rising Inflation	4
1.5 Headwinds and Tailwinds: Diverse Set of Factors Affecting 2022 Outlook	5
1.6 Outlook Losses Expected to Persist for Some Countries	7

## REGIONAL ECONOMIC OUTLOOK: MIDDLE EAST AND CENTRAL ASIA

1.7	ME&CA: Public Debt	7
1.8	ME&CA: Cumulative Capital Flows	8
1.9	Recent Trends in Social Unrest	9
1.10	ME&CA: Number of SOEs	12
2.1	Labor Market Outcomes: 2018-19	19
2.2	Labor Market Outcomes during the Pandemic across Regions	19
2.3	Quarterly Employment Dynamics for Selected Countries during Previous Downturns and the COVID-19 Shock	20
2.4	The Labor Market during Downturns and the COVID-19 Shock	21
2.5	Pandemic's Impact on Labor Market Outcomes of Various Demographic Groups	22
2.6	Employment by Worker Nationality	22
2.7	Impact of the Pandemic on Public/Private Employment	23
2.8	Labor Market Policy Responses During the Pandemic in ME&CA Region	23
2.9	Okun's Coefficients from Panel Regressions	24
2.10	Distribution of Okun's Coefficients by Country	25
2.11	Distribution of Unemployment Change Implied by the April 2021 WEO GDP growth Projections for 2021-22	26
2.12	GDP Growth Consistent with Stable Unemployment Rate and Gap with World Economic Outlook Projections	27
2.13	Okun's Coefficients and Structural Variables	28
2.14	Public Wage Premiums and Okun's Coefficient-	31
3.1	Revenue Growth and Profitability Compared to Previous Crises	34
3.2	Revenue Growth Performance across Groups of Firms	35
3.3	Firm Performance by Size and Sector at the Peak of the Crisis	36
3.4	Digitalization and Firm Resilience	37
3.5	SMEs Received Less Policy Support than Large Firms	37
3.6	Policy Support Contributed to Soften Liquidity Pressures during 2020	38
3.7	Reduction in Production Costs Helped Contain Liquidity Pressures during 2020	38
3.8	Pockets of Vulnerabilities across Groups of Firms	39
3.9	Recent Trends in Nonperforming Loans and Loan Loss Provisioning	40
3.10	Capital Buffers and Provisioning by Level of Corporate Exposure	40
3.11	Firm at Risk: Share of Firms Facing Liquidity Needs (with Cash Balances below Zero)	41
3.12	Debt at Risk: Share of Debt Held by Firms Facing Liquidity Problems	42
3.13	Firm at Risk: Share of Firms Facing Solvency Problems (with Equity below Zero)	43
3.14	Assessing Firm's Viability	44

### Tables

2.1	Labor Market Outcomes—COVID-19 Compared with Global Shocks	20
	Selected Economic Indicators, 2000–22	47

## Acknowledgments

The Middle East and Central Asia *Regional Economic Outlook* (REO) is prepared annually by the IMF's Middle East and Central Asia Department (MCD). The analysis and projections contained in the MCD REO are 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 their consultations with member countries.

The analysis in this report was coordinated under the general supervision of Jihad Azour (Director of MCD). The project was directed by Taline Koranchelian (Deputy Director in MCD), S. Pelin Berkmen (Chief of MCD's Regional Analytics and Strategy Division), Yasser Abdih (Deputy Chief of MCD's Regional Analytics and Strategy Division), and Cesar Serra (Deputy Chief of MCD's Regional Analytics and Strategy Division).

The primary contributors to this report were Nordine Abidi, Mohamed Belkhir, Olivier Bizimana, Rodrigo Garcia-Verdu, Troy Matheson, Jeta Menkulasi, and Sahra Sakha. Additional contributors were Ali Abbas, Gareth Anderson, Carol Baker, Mehdi El-Herradi, Mohamed Jaber, Tannous Kass-Hanna, Geoffrey Keim, Armine Khachatryan, Moheb Malak, Futoshi Narita, Lawrence Norton, Monica Petrescu, Sidra Rehman, Azim Sadikov, Jesus Sanchez, Suchanan Tambunlertchai, and Atticus Weller.

Gohar Abajyan, Azhin Ihsan Abdulkarim, Oluremi Akin-Olugbade, Shant Arzoumanian, Vizhdan Boranova, Bashar Hlayhel, Kate Nguyen, Roy Randen, and Ahmad Jawed Sakhi managed the database and provided research assistance. Jonathan Saalfield also contributed to the research.

Production support was provided by Haya Abu Sharar and Gintare Gedrimaite. Cheryl Toksoz of the Communications Department coordinated the editing and production of the REO, in collaboration with Lorraine Coffey. Ramdane Abdoun, Nordine Abidi, Ali Jassim H Al-Sadiq, Mohamed Belkhir, Shafiq Samir Ghawi, Vahram Janvelyan, Nia Sharashidze, and Robert Tchaidze reviewed the translations. They collaborated with Sherif Helmy and Baya Kourdali (Arabic), Jean-Yves Lestienne and Monica Nepote-Cit (French), and Alexandra Akchurin and Svetlana Andryunina (Russian), as well as Xiao Chen Wang with the Translation Coordination Center. Cooper Allen provided editorial support.



# Country Groupings

The October 2021 *Regional Economic Outlook (REO): Middle East and Central Asia* covers countries and territories in the Middle East and Central Asia Department (MCD) of the International Monetary Fund (IMF) referred to as ME&CA countries and territories. It provides a broad overview of recent economic developments and prospects and policy issues for the medium term. To facilitate the analysis, the 32 ME&CA countries and territories covered in this report are divided into three (nonoverlapping) groups, based on export earnings and level of development: (1) Oil Exporters (ME&CA OE), (2) Emerging Market and Middle-Income Countries (ME&CA EM&MI); and (3) Low-Income Developing Countries (ME&CA LIC). Additional analytical and regional groups provide more granular breakdown for analysis and continuity. The country and analytical group acronyms and abbreviations used in some tables and figures are included in parentheses.

ME&CA OE include Algeria (ALG), Azerbaijan (AZE), Bahrain (BHR), Iran (IRN), Iraq (IRQ), Kazakhstan (KAZ), Kuwait (KWT), Libya (LBY), Oman (PMN), Qatar (QAT), Saudi Arabia (SAU), Turkmenistan (TKM), and United Arab Emirates (UAE).

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

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

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

CCA oil exporters (CCA OE) include Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan.

CCA oil importers (CCA OI) include Armenia, Georgia, the Kyrgyz Republic, and Tajikistan.

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

MENA oil exporters (MENA OE) include Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Yemen.

MENAP oil importers include Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syrian Arab Republic, Tunisia, and West Bank and Gaza.

MENA oil importers include Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Somalia, Sudan, Syrian Arab Republic, Tunisia, and West Bank and Gaza.

Notes: The ME&CA OE, ME&CA EM&MI, and ME&CA LIC aggregates were first introduced in the April 2021 REO as MCD OE, MCD EM&MI, and MCD LIC.

For Afghanistan, all projections for 2021–22 are omitted and excluded from aggregates due to an unusually high degree of uncertainty.

For Lebanon, all projections for 2021–22 are omitted due to an unusually high degree of uncertainty.

Somalia is included in all regional aggregates starting with the October 2017 REO.

For Sudan, data for 2012 onward exclude South Sudan.

For Syrian Arab Republic, all data are omitted and excluded from aggregates from 2011 onwards due to the uncertain economic situation.



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

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

The Non-GCC oil-exporting countries are Algeria, Iran, Iraq, Libya, and Yemen.

Fragile states and conflict-affected countries (FCS) include Afghanistan, Djibouti, Iraq, Lebanon, Libya, Somalia, Sudan, Syrian Arab Republic, Tajikistan, and Yemen.

North Africa countries include Algeria, Djibouti, Egypt, Libya, Mauritania, Morocco, Sudan, and Tunisia.

Conflict countries include Libya, Syrian Arab Republic, and Yemen.

## Assumptions and Conventions

A number of assumptions have been adopted for the projections presented in the October 2021 *Regional Economic Outlook: Middle East and Central Asia*. It has been assumed that established policies of national authorities will be maintained that the price of oil<sup>1</sup> will average US\$65.68 a barrel in 2021 and US\$64.52 a barrel in 2022, and that the six-month London interbank offered rate (LIBOR) on US dollar deposits will average 0.2 percent in 2021 and 0.4 percent in 2022. These are, of course, working hypotheses rather than forecasts, and the uncertainties surrounding them add to the margin of error that would in any event be involved in the projections. The 2021 and 2022 data in the figures and tables are projections. These projections are based on statistical information available through late September 2021.

The following conventions are used in this publication:

- In tables, ellipsis points (. . .) indicate “not available,” and 0 or 0.0 indicates “zero” or “negligible.” Minor discrepancies between sums of constituent figures and totals are due to rounding.
- An en dash (–) between years or months (for example, 2011–12 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, 2011/12) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY 2012).
- “Billion” means a thousand million; “trillion” means a thousand billion.
- “Basis points (bps)” refer to hundredths of 1 percentage point (for example, 25 basis points are equivalent to ¼ of 1 percentage point).

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

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

<sup>1</sup>Simple average of prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate crude oil.



# 1. Regional Developments and Outlook: From Crisis Management to Transformational Recovery

*With uneven vaccination rollouts, the recovery in the Middle East and Central Asia (ME&CA) is expected to be multispeed and fragile and countries need to maintain focus on managing the pandemic. The ongoing subdued recovery is expected to solidify in 2022 as the vaccine rollouts progress. Meanwhile, new challenges are emerging with rising inflation due to pandemic-related supply shortages and higher commodity prices. Hence, headwinds to the outlook and uncertainty about how quickly the pandemic can be overcome have increased. Economic scarring could be extensive given weak employment, increased inequities and poverty, corporate sector vulnerabilities, and debt sustainability risks. Near-term policy trade-offs have become more acute, with fiscal space already eroded, declining monetary policy space, and increasing geopolitical and social unrest risks. As the region prepares for a new journey in the post-pandemic world, the crisis presents opportunities that could lead to a transformational recovery marked by more resilient, inclusive, and greener economies. Domestic policies would need to be comprehensive and exploit synergies to enable this transformation. Global and regional cooperation will also be crucial for vaccine deployment and leveraging digitalization, adaptation to climate change, and transition to lower carbon dependence to strengthen the region's medium-term growth prospects.*

## Global Backdrop: A Dichotomy between the Haves and Have Nots

A multispeed global economic recovery continues amid a resurgent pandemic, with differing vaccine rates and policy support emerging as the principal factors driving divergent recovery paths across countries and regions (October

Prepared by Troy Matheson under the guidance of S. Pelin Berkmen, with inputs from Rodrigo Garcia-Verdu and Jeta Menkulasi, and excellent research assistance from Azhin Ihsan Abdulkarim, Oluremi Akin-Olugbade, Vizhdan Boranova, and Roy Randen.

2021 *World Economic Outlook*). Activity in most advanced economies continues to normalize, while many other countries are contending with more fragile recoveries. Uncertainty about the path of the pandemic has increased. Global financial conditions have remained supportive, but global inflation is rising, partly due to pandemic related supply shortages, and employment is subdued. Commodity prices have surprised on the upside since April, with average petroleum spot prices expected to be \$65.7 in 2021, before declining to \$56.3 in the medium term—which is above the 2020 average of \$41.3 but below the 2019 average of \$61.4. The Organization of Petroleum Exporting Countries and other major oil producers (OPEC+) has agreed to gradually phase out 5.8 million barrels per day of production curbs by September 2022. Food prices have soared to their highest level since 2014 (an expected increase of 27.8 percent in 2021, compared to 13.9 percent in April) and are expected to increase further by 1.9 percent in 2022.

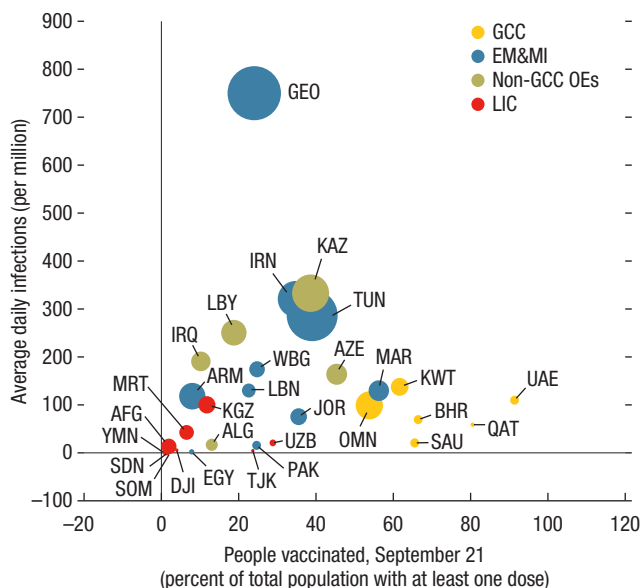
## Not Out of the Woods

The ME&CA region is facing a new wave, with about two thirds of the region's countries facing a new pandemic outbreak. However, infection and death rates are relatively contained in countries that had made early progress toward vaccinating their populations (Figure 1.1). Social and economic restrictions, albeit less stringent than in early 2020, have generally remained in place, but mobility rates have somewhat decoupled from containment measures.

Vaccine rollouts are progressing, but overall vaccination rates remain low from a global perspective, reflecting a combination of supply and procurement bottlenecks and logistical obstacles. As of September 21, countries in the region fall into three broad categories: 1) five countries where more than 60 percent of the total population

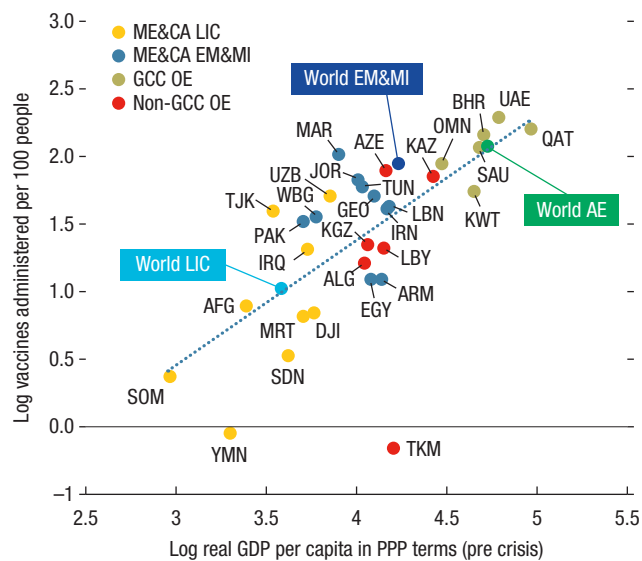
**Figure 1.1. Average Daily Infections and Deaths versus People Vaccinated**

(Infection and death rates<sup>1</sup> during Jun. 30–Sep. 21)



Sources: Airfinity, Our World in Data; UNICEF; and IMF staff calculations.  
 Note: Low infection rates for some countries could reflect underreporting given limited testing capacities. Country abbreviations are International Organization for Standardization country codes.  
<sup>1</sup>Death rates are reflected in size of bubbles.

**Figure 1.2. Higher Vaccination Rates in More Affluent Countries**



Source: IMF, World Economic Outlook database; and IMF staff calculations.  
 Note: Country abbreviations are International Organization for Standardization country codes. AE = advance economy; CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income country; GCC = Gulf Cooperation Council; LIC = low-income country; ME&CA = Middle East and Central Asia; OE = oil exporter; PPP = purchasing power parity.  
<sup>1</sup>Vaccines administered as of 09/21/2021.

has received at least one dose; 2) 17 countries follow with important progress, including 13 with coverage higher than 20 percent; and 3) the remaining 10 countries, which have vaccinated less than 10 percent of their population. Consistent with global trends, more affluent countries in the region—some oil exporters and emerging market and middle-income countries (EM&MI)—have procured vaccines from a more diverse number of sources and had more successful rollouts than low-income countries (LICs), which have faced delayed and uneven delivery so far (Figure 1.2). However, recent donations—covering sufficient doses to inoculate 7 percent of the region’s LICs’ population on average—have tripled the number of average daily doses administered in LICs since August.

*Policy support.* The wide range of policy responses played a key role in protecting livelihoods and vulnerable populations and in mitigating economic, banking, and corporate sector risks

(October 2020 *Regional Economic Outlook: Middle East and Central Asia*).

- *Fiscal.* Most countries that experienced a resurgence of the pandemic during 2021 extended emergency measures, in line with their fiscal space (for example, Algeria, Bahrain, Georgia, Kazakhstan, Morocco, and the UAE). Some countries introduced new measures in 2021 (for example, support for small and medium enterprises and vulnerable households in Oman, and new cash transfers in Sudan). In other countries, emergency spending measures were kept the same, reduced or allowed to expire while some below-the-line liquidity support measures without a direct budgetary cost have remained in place (for example, Egypt and Pakistan have kept some tax relief measures in place).
- *Monetary and macro-financial.* Although policy interest rates remain low for many countries, some countries in the Caucasus and Central

Asia (CCA) region and Pakistan have begun to tighten monetary policy (Figure 1.3). Some of the macro-financial measures introduced in 2020 have expired (for example, the loan guarantee program and waivers for electronic transaction fees in Saudi Arabia). Other measures have been extended (for example, delayed recognition of loan impairments and reduced capital buffer and risk weights in Kazakhstan, and credit subsidies, credit guarantees and loan repayment deferrals in Gulf Cooperation Council (GCC) countries), and some have introduced new policies (for example, the government guarantee program for bank loans and small and medium enterprises in Kuwait).

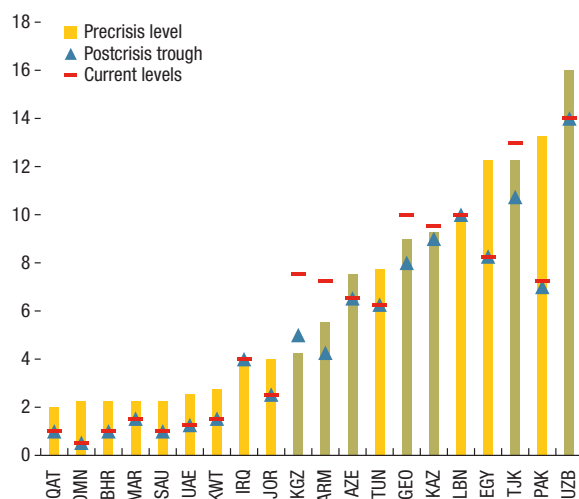
## Uneven Recovery and Rising Inflation

The recovery is ongoing, but it is uneven and incomplete, with new waves of the virus emerging. GDP growth in the first half of 2021 has increased and purchasing managers' indices point to a continued recovery in business activity but at a somewhat moderated pace since July.

**Pickup in trade.** Consistent with global trends, merchandise trade has recovered to its pre-pandemic level. Hotel demand has also been increasing, but it has remained below pre-pandemic levels in almost all countries. Remittances continue to provide crucial support for some countries (for example, Georgia, Kyrgyz Republic, and Tajikistan). Overall, the current account balances of oil exporters have started to recover with higher oil prices and global recovery, after most countries moved sharply into deficit in 2020.

**Supportive global financial conditions.** Emerging and developing economies experienced a brief episode of capital outflows in early 2021 due to inflation concerns in the United States, but these flows reversed in May as these fears subsided. The region has experienced cumulative net capital inflows of \$2.9 billion up to the end

**Figure 1.3. ME&CA: Monetary Policy Rates (Percent)**



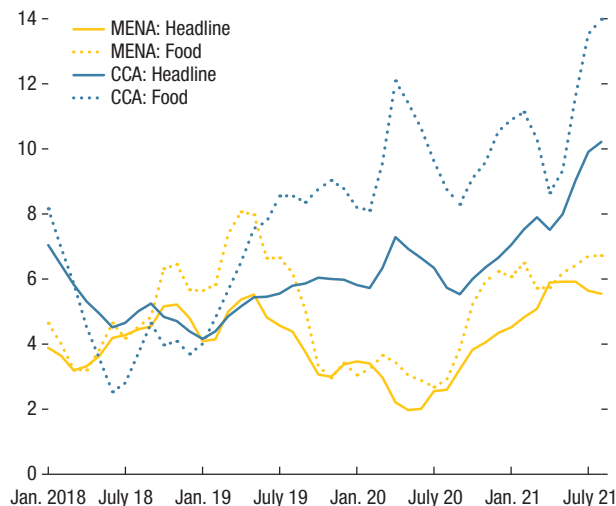
Source: Haver analytics.

Note: Yellow bars represent Middle East and North Africa countries, and green bars represent Caucasus and Central Asia countries. Country abbreviations are International Organization for Standardization country codes. ME&CA = Middle East and Central Asia.

of August. Sovereign bond spreads have declined since 2020, and countries in the region continued to tap international markets, benefiting from these favorable financing conditions, with 19 Eurobond issuances totaling \$19.8 billion since the beginning of this year. Relative to the same period in 2020, the total value of issuances has been reduced by half due to reduced issuances in Qatar, Saudi Arabia, and the UAE (reflecting lower financing needs with higher oil prices and ongoing recovery) more than offsetting increases in Armenia, Georgia, and Oman.

**Rising inflation** (Figure 1.4). Meanwhile, headline inflation has been increasing, reflecting both international and domestic factors, such as higher global food and energy prices and shipping costs, pass-through from earlier depreciations, the ongoing domestic recovery in some countries, and monetary financing in others. Food inflation is feeding into headline inflation, particularly in LICs (for example, Kyrgyz Republic and Tajikistan) and in countries with high shares of imported food in their consumption items (for example, Algeria and Armenia). Excluding food and energy prices, core

**Figure 1.4. Rising Inflation**  
(Year-over-year percent change; simple average)



Sources: Haver Analytics; National Authorities; IMF, *CPI database*; and IMF staff calculations.

Note: CCA = Caucasus and Central Asia; MENA = Middle East and North Africa. MENA includes ALG, BHR, EGY, IRN, IRQ, JOR, KWT, MAR, OMN, QAT, SAU, SOM, TUN, UAE, and WBG. CCA includes ARM, AZE, GEO, KAZ, KGZ, TJK, and UZB. Latest data are as of Aug. 2021 except for TUN (Mar. 2021) KWT (Apr. 2021), ALG (Jun. 2021), BHR, OMN, TJK, and UAE (Jul. 2021). Data were extrapolated based on latest available inflation growth rates as indicated.

inflation has been picking up in Jordan, Morocco, Qatar (from a low base), Iraq, and Pakistan.

**Weak employment.** Employment in most countries remains below pre-pandemic levels (for example, Armenia, Bahrain, Iran, Saudi Arabia, and Tunisia). The sensitivity of labor markets to broader economic conditions in many countries in the region appears to be weak, on average, particularly during upswings, reflecting the high prevalence of informality, other structural bottlenecks, and lower employment prospects after prolonged unemployment periods (Chapter 2). This suggests employment losses experienced during the pandemic may take some time to unwind.

**Increasing inequities.** The impact of the pandemic has been uneven across groups. The low-skilled, the young, women, and migrant workers were affected the most, with the employment of women and youth declining in 2020 by 6 and 10 percent, respectively, which is more than for men and total adults (about

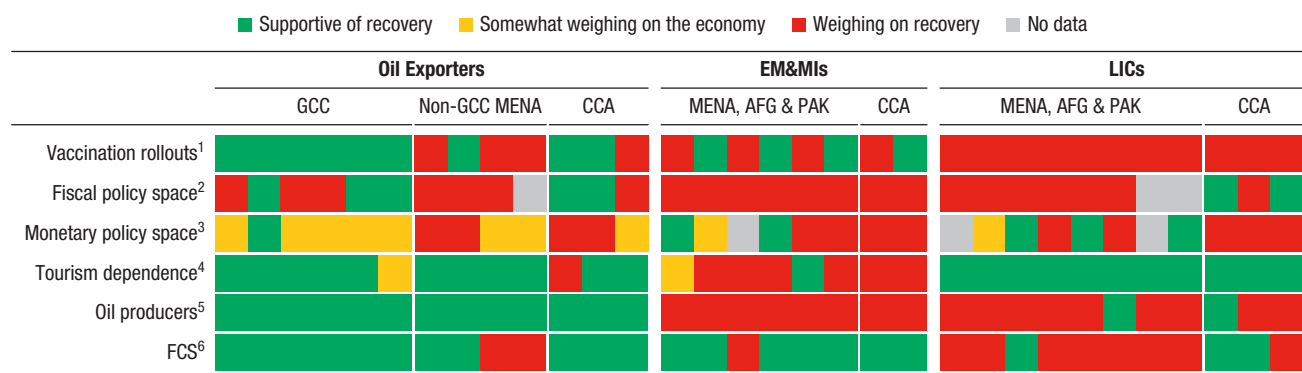
4 percent each). Unlike in previous crises, informal workers were not spared. Similarly, many workers in high contact-sensitive service sectors (such as travel and tourism) face the prospect of slower and more uneven recoveries until the pandemic is contained (Chapter 2). In addition, smaller firms, those in high contact-intensive sectors and with preexisting vulnerabilities have fared worse than others (Chapter 3). On the positive side, firms with greater digital connectivity have been able to partly mitigate the pandemic's impact.

**Banking systems** have been resilient so far, but risks are building unevenly. Although profitability has declined, nonperforming loans have remained broadly stable, and banks have increased buffers against credit and liquidity risks, partly reflecting supportive macro-financial policies. However, banks with higher exposure to the corporate sector have lower capital adequacy ratios, lower liquidity, and higher nonperforming loans; and those exposed to the hard-hit high contact-sensitive sectors have seen an increase in nonperforming loans. Higher loan-loss provisions, partly due to regulatory requirements, suggest that banks perceive risks in advance and are building buffers against a potential deterioration in asset quality when policy support is withdrawn (Chapter 3).

## Outlook: Subdued and Fragile Recovery

After contracting by 3.2 percent in 2020, real GDP in the **Middle East and North Africa (MENA)** region is projected to expand by 4.1 percent in both 2021 and 2022, upward revisions of 0.1 and 0.4 percentage points since April, respectively. Meanwhile, inflation in the region is projected to increase to 12.9 percent in 2021 with higher food and energy prices and monetary accommodation in some countries, before subsiding to 8.8 percent in 2022. The increase in government gross debt for MENA oil importers (projected at more than 100 percent of GDP in 2021) led to a close to 50-percent rise in gross financing needs during 2021–22 (to \$390 billion) compared to 2018–19.



**Figure 1.5. Headwinds and Tailwinds: Diverse Set of Factors Affecting 2022 Outlook**

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

<sup>1</sup>Vaccination rollouts: green represents 40 percent population coverage by end-2021; otherwise, red.

<sup>2</sup>Fiscal policy space: red represents no market access and/or debt-to GDP at or above the median; otherwise, green.

<sup>3</sup>Monetary policy space: red is whether IMF World Economic Outlook inflation projections for 2021 are at or above median or inflation target; green represents below median and target; orange represents peggers and currency boards.

<sup>4</sup>Tourism dependence: red is if both, the tourism share of GDP and the tourism share of total employment, are greater than 10 percent; orange if either one of these criteria is met; otherwise, green.

<sup>5</sup>Oil producers: green represents oil exporters; otherwise, red.

<sup>6</sup>FCS = Fragile states and conflict-affected countries: red represents FCS; otherwise, green.

Economic activity in the **CCA** region is also recovering, with real GDP projected to expand by 4.3 percent in 2021 (an upward revision of 0.7 percentage points) and 4.1 percent in 2022, following a contraction of 2.2 percent in 2020. Inflation is expected to accelerate to 8.5 percent in 2021 (an upward revision of 1.6 percentage points), reflecting the pass-through from higher global food and commodity prices and past depreciations, and ongoing recovery in demand, before gradually declining below the target bands from 2022 onwards, with dissipating temporary factors and higher policy interest rates.

## Forces Shaping the Outlook

2021 is still being shaped by the ongoing COVID-19 pandemic and OPEC+ production curbs for oil exporters. Going forward, the recovery in the region will be defined by the confluence of five factors (Figure 1.5). First, **vaccination rollouts**: countries that have made more progress toward vaccinating their populations (GCC countries and some EM&MIs) will be more resilient to the emergence of new virus variants. Second, **policy space**: only a handful countries in the region have macro policy

space with low debt and inflation to support the recovery (some oil exporting countries and a few countries in the CCA region with low debt levels). Third, **tourism dependence**: countries that rely more on tourism will continue to face headwinds. Fourth, **oil market developments**: higher oil prices and declining OPEC+ production curbs will support the economic activity of oil exporters, with spillover effects to the rest of the region; on the other hand, higher oil prices represent a drag on growth and will put pressure on inflation in oil-importing countries. Lastly, **political and humanitarian challenges**: growth in fragile and conflict-affected countries will hinge on the resolution of existing conflicts, political uncertainty, and other humanitarian challenges.

## Oil Exporters

Oil exporters, particularly GCC countries, will benefit from the recovery in global demand, higher oil prices, and wider vaccine coverage than most other countries (Figure 1.2). Vaccination rates for all GCC countries have already reached 40 percent of their populations and are expected to cover 70 percent by the end of 2021. Nevertheless, many countries still have economic and social



restrictions in place, which will continue to weigh on the outlook until the pandemic is contained. Real GDP is projected to expand by 4.5 percent in 2021 (2.8 percent excluding Libya) and 4.0 percent in 2022, reflecting a rebound in both oil and non-oil GDP. Oil activity is expected to expand by 5.3 percent and 4.4 percent in 2021 and 2022, respectively, reflecting a surge in oil production in Libya and a gradual expansion in supply among OPEC+ countries after August 2021. Vaccine rollouts and higher oil prices will also support confidence and activity in the non-oil sector, which is set to expand by 3.9 and 3.4 percent in 2021 and 2022, respectively. Over the medium term, real GDP losses are expected to be more contained for oil exporters than other groups (Figure 1.6).

Inflation is projected to rise to 10.5 percent in 2021 and moderate to 8.0 percent in 2022 (an upward revision of 0.3 percentage points in both years). High inflation is mainly driven by non-GCC oil exporters, with inflation in the GCC countries peaking at 2.8 percent in 2021.

Higher oil prices and exports are expected to strengthen oil exporters' external positions, with their current account balance projected to move from a deficit of 1.9 percent of GDP in 2020 to a surplus of 3.6 percent of GDP in 2021 (above the pre-pandemic level). This surplus is expected to decline gradually over the medium term in line with the projected stabilization in oil prices. Gross official reserves are expected to increase by \$95 billion to almost \$1 trillion in 2021, an upward revision of more than \$100 billion since April.

Fiscal deficits are projected to decline, starting from 2021, reflecting the ongoing recovery, higher oil prices, expiring measures, and consolidation efforts. Nonetheless, government debt as a share of GDP, while declining relative to peaks reached during the crisis, will likely remain higher than its precrisis level over the medium term. As a result, public gross financing needs are projected to remain elevated at \$473 billion overall during 2021–22, compared to \$310 billion during 2018–19.

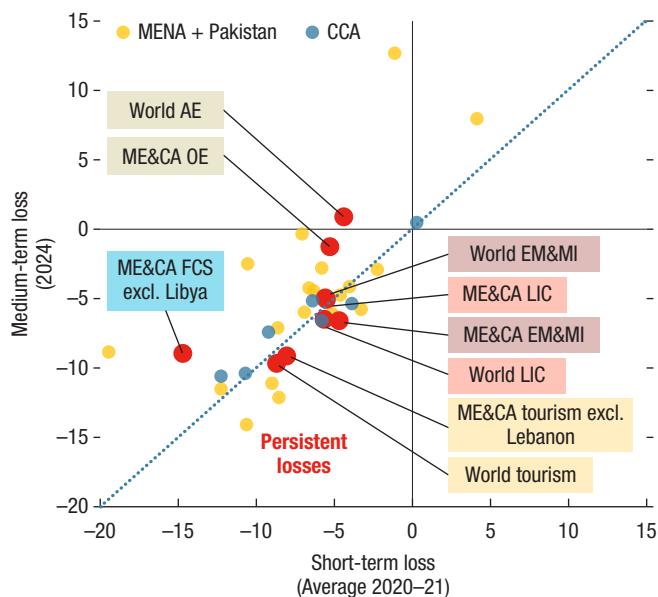
## Emerging Market and Middle-Income Countries

The recovery in EM&MIs will be uneven. Some countries have made notable progress toward increasing vaccination rates since April (for example, Jordan, Morocco, and Tunisia), while others have fallen behind (Figure 1.2). At the current pace of inoculations, vaccination coverage on average is expected to reach about 40 percent of populations by mid-2022 and 70 percent by the end of 2022. Countries that rely more on travel and tourism will benefit less from the ongoing global recovery. Real GDP is projected to expand by 3.6 percent in 2021 and rise further by 4.2 percent in 2022, remaining below growth rates projected for global EM&MIs in 2021 and 2022 (6.7 percent and 5.1 percent, respectively). Over the medium term, real GDP is expected to remain below precrisis projections by about 6.6 percent, broadly in line with global peers (Figure 1.6).

Inflation is projected to increase in all EM&MIs, except in Pakistan. Overall, inflation for this group is expected to remain above 7.5 percent in 2021–22, before gradually declining to 6.0 percent over the medium term. In addition to international food prices, the evolution of exchange rates and oil prices will be important factors behind inflation dynamics in countries with flexible exchange rates, since, on average, they explain about a quarter of inflation volatility historically.

As the recovery proceeds, fiscal balances are expected to gradually improve due to a cyclical recovery in revenues, the expiration of pandemic-related measures, and the prospect for medium-term fiscal adjustment in countries with elevated debt burdens (for example, Egypt and Pakistan). Aggregate debt is projected to rise from 86.8 percent of GDP in 2020 to 91.7 percent of GDP in 2021 and gradually decline between 2022 and 2026, returning to the precrisis level in 2023. However, this decline masks divergent dynamics across countries over the medium term, with debt ratios projected to be higher than pre-pandemic levels in Armenia, Georgia, and Tunisia and lower in Egypt, Jordan, and Pakistan (Figure 1.7).

**Figure 1.6. Output Losses Expected to Persist for Some Countries**  
(Percent difference from precrisis projections)

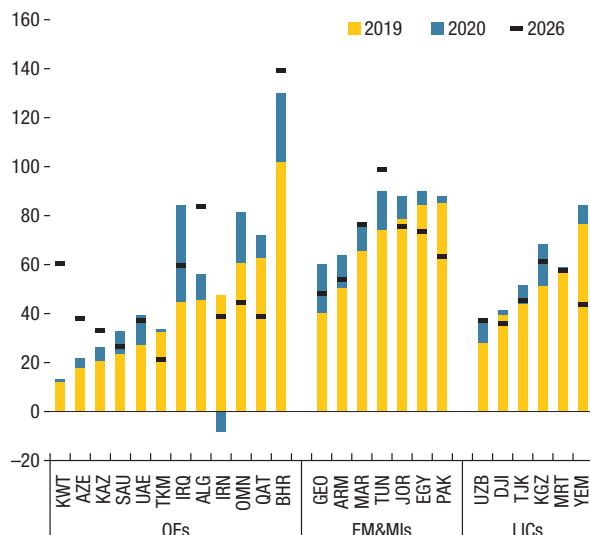


Sources: National authorities; and IMF staff calculations.  
Note: AE = advanced economy; CCA = Caucasus and Central Asia; EM&MI = emerging market and middle-income economy; FCS = fragile and conflict-affected state; LIC = low-income country; ME&CA = Middle East and Central Asia; and OE = oil exporter.

The debt buildup in 2020 led to a significant rise in public gross financing needs, projected to hit \$564 billion overall during 2021–22, about a 20-percent increase compared to 2018–19. In addition, the increase in debt and contingent liabilities (stemming from off-budget measures like the provision of loans or guarantees, as well as many other forms of quasi-fiscal operations, including through state-owned enterprises) has weakened government balance sheets, threatening debt stabilization prospects (Box 1.1).

After shrinking due to the collapse in domestic demand and oil prices in 2020, the aggregate current account deficit is projected to widen from its 2020 level of 3.4 percent of GDP to 3.9 percent of GDP in 2022. This reflects the balance between a positive impact from the global recovery on merchandise exports, the impact of higher oil prices and domestic demand recovery on imports, and a slower recovery of travel and

**Figure 1.7. ME&CA: Public Debt**  
(Percent of GDP)



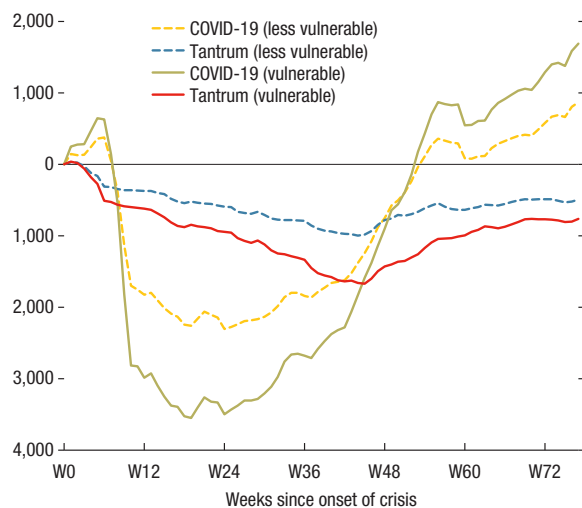
Sources: IMF World Economic Outlook database; and IMF staff calculations.  
Note: Sudan is excluded from the LIC group. Country abbreviations are International Organization for Standardization country codes. EMMI = emerging market and middle-income economies; LIC = low-income economies; ME&CA = Middle East and Central Asia; OE = oil exporter.

tourism (for example, Armenia, Azerbaijan, Georgia, Lebanon, and Morocco).

### Low-Income Countries and Fragile and Conflict-Affected States

LICs—many of which are also fragile and conflict-affected states (FCS)—have relatively low vaccination rates and a heavy reliance on the multilateral initiatives for vaccine procurement. These countries, particularly FCS, also have limited health care and testing capacity, making it very difficult to track key pandemic trends. Absent strengthened multilateral action to bolster vaccine supplies, vaccination rates are not expected to reach 70 percent until 2024, exacerbating existing economic and social challenges. Activity is projected to expand by 3.4 percent in 2021 and 4.4 percent in 2022, with growth gradually rising over the medium term in tandem with rising vaccination rates. Consistent with global trends, the pandemic is expected to have lasting effects, with real GDP expected to remain below already

**Figure 1.8. ME&CA: Cumulative Capital Flows**  
(Millions of dollars)



Sources: EPFR database; and IMF staff calculations.

Note: At time  $t$ , if the country is below the median value (of foreign exchange reserves), then it is characterized as "vulnerable". W1 for Tantrum is May 22, 2013, and W1 for COVID-19 is January 22, 2020. ME&CA = Middle East and Central Asia.

low precrisis projections by 4.8 percent over the medium term (Figure 1.6).

Beyond COVID-19 developments, a more sustained recovery in fragile and conflict-affected countries continues to be marred by conflict (Libya, Syria, West Bank and Gaza, Yemen), humanitarian emergencies (Afghanistan, Somalia, Syria, Yemen), and risks of continued economic and political instability (Afghanistan, Lebanon, Libya, Sudan). The outlook for Djibouti is also clouded by conflict in neighboring Ethiopia. Lebanon is in a very severe economic crisis, aggravated by the pandemic, and urgently needs to deal with a wide array of complex economic and social challenges. Similarly, the turmoil in Afghanistan has pushed its fragile economy, already reeling from the pandemic and drought, into an acute economic crisis with a falling output, paralyzed banks, and rising poverty (Box 1.2).

On the positive side, Sudan, with the help of the international community and the IMF, took bold actions to move to a market-determined exchange rate, raise revenue and reduce subsidies, and start to address deep-rooted governance

deficiencies, improving its longer-term prospects and social conditions. As a result, Sudan became the 38th country to reach the Heavily Indebted Poor Countries (HIPC) Decision Point with an immediate reduction in external public debt of \$28 billion that will eventually decrease to \$6 billion (14 percent of GDP) at the HIPC Completion Point.

## Rising Risks and Vulnerabilities

**The pandemic and vaccine rollout.** The rapid spread of the Delta variant and the threat of more virulent variants have increased uncertainty about how quickly the pandemic can be overcome. Faster progress toward vaccinations would save lives and expedite the recovery, but vaccine delays and further outbreaks represent important downside risks that could delay the recovery and threaten debt sustainability.

**Tighter global financial conditions and financing risks.** Given large financing needs, EM&MI countries remain vulnerable to a rise in global bond yields if global inflationary pressures persist longer than expected. A tightening in global financial conditions could lead to capital outflows and higher sovereign spreads, exposing particularly those with lower reserves and weaker external accounts (Figure 1.8). This would lead to a rise in interest rates across the region and reduce demand support; pose challenges for highly leveraged firms; increase financing, rollover, debt non-stabilization risks, and worsen bank-sovereign linkages, which, in turn, could further weigh on credit to the private sector and threaten the recovery and financial stability (Box 1.1 and April 2021 *Regional Economic Outlook: Middle East and Central Asia*).

**A persistent rise in inflation.** This could be due to continued global supply constraints, food price increases, and de-anchoring inflation expectations in countries with weak monetary frameworks. Rising inflation would both hurt the poorer segments of society more, aggravating existing inequalities, and trigger further increases

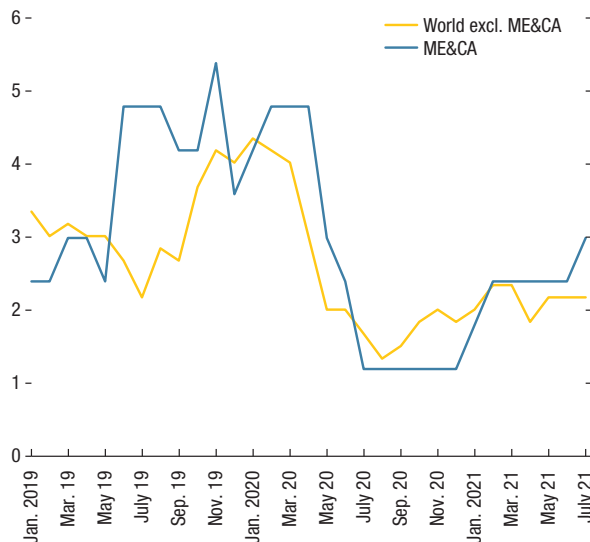
in policy rates, reducing policy support for the fragile recovery.

**Premature withdrawal of policy support.** More broadly, high debt levels and inflation raise the risk of premature withdrawal of policy support. This, together with low vaccination rates, would leave economies vulnerable to the emergence of new variants, impacting firms in the hardest-hit sectors and vulnerable households. This in turn could increase bankruptcies, defaults and nonperforming loans, leading to the materialization of corporate and banking sector risks (Chapter 3). In addition, such outcomes would increase unemployment and exacerbate inequities (Chapter 2).

**A rise in social unrest, geopolitical, and security risks.** While lower than in 2019, social unrest has increased in 2021 and could pick up further, due to repeated infection waves, dire economic conditions, high unemployment and food prices, particularly for LICs and FCS (Figure 1.9). This risk is exacerbated by heightened political uncertainty and geopolitical tensions in some countries (for example, in Iraq, Lebanon, Libya, Tunisia, and Yemen). The crisis in Afghanistan is impoverishing millions, especially women and vulnerable groups and has already displaced thousands of Afghans internally. This can set off a wave of refugees, the main channel of outward spillovers to the region (Box 1.2).

**Crisis legacies, increased inequality, poverty, and scarring.** A longer-term risk for the region is that an uneven recovery from the pandemic leads to a permanent widening of existing wealth, income, and social gaps and, ultimately, weaker growth and less inclusive societies. In addition, about 7 million more people are estimated to have entered extreme poverty during 2020–21 in the region compared to pre-crisis projections. Overall, crisis legacies and preexisting vulnerabilities—such as debt overhang, high structural unemployment, prevalence of inefficient state-owned enterprises that limit private sector innovation and pose fiscal risks, and commodity dependence—could weigh on the region’s growth prospects in the post-COVID-19 world if left unaddressed.

**Figure 1.9. Recent Trends in Social Unrest**  
(Fraction of countries, percent, six-month moving average)



Source: Barrett and others, 2020.

Note: Social unrest events are inferred from exceptionally large increases in country media coverage of key terms related to protests, riots, and other forms of civil disorder. ME&CA = Middle East and Central Asia.

**Climate shocks.** Climate change, a principal driver of more frequent and intense weather-related disasters, poses significant challenges to the ME&CA region, particularly given the region’s large adaptation needs and its dependence on hydrocarbons (Box 1.3).

## Starker Policy Trade-offs on the Way to a Transformational Recovery

As the COVID-19 pandemic continues, difficult policy trade-offs lay ahead. Many countries in the region are facing the prospect of a protracted recovery. Moreover, in addition to the limited fiscal policy space, countries now face the added burden of diminishing monetary space, given rising inflation. As such, countries face multiple challenges: striking the right balance between protecting lives and livelihoods, fostering a self-sustaining, inclusive, and greener recovery, preserving fiscal sustainability and financial stability, and investing in the future. To prepare

economies for the post-pandemic world, national policies need to be comprehensive to exploit synergies. Regional cooperation could support these efforts through vaccine deployment and by leveraging accelerating global trends.

**Accelerated vaccine deployment** is needed to save lives, support recovery, and reduce divergences. The strength and duration of the global and regional recovery rests on how well the virus is contained everywhere in the world. In the absence of coordinated action, unequal vaccine deployment will leave the region exposed to further threats to lives and livelihoods, particularly for LICs, FCS, and middle-income countries with limited policy space. Swift vaccination of populations is, therefore, the main short-term policy priority. This entails stepping up efforts to procure and deliver doses while ensuring that health systems are adequately resourced. Strong global and regional cooperation is needed to achieve the goal of vaccinating at least 40 percent of the population by the end of this year and 70 percent by the first half of 2022. So far, the region has secured 576 million vaccines (52 percent of which has been committed by the COVID-19 Vaccines Global Access initiative and African Union's African Vaccine Acquisition Trust), implying that it is short by about 66 million vaccines (24 million for the MENA region, 7 million for Afghanistan, 21 million for Pakistan, and 14 million for the CCA region).<sup>1</sup>

**Fiscal policy requires a careful balancing act** to preserve debt sustainability while supporting the recovery. Countries where vaccine deployment is slow and infection rates are rising should continue to support lives and livelihoods. Any additional fiscal support should be well targeted toward the most vulnerable and consider available fiscal space. In countries with fiscal space, the eventual withdrawal of policy support should

be clearly communicated and gradual to avoid any unnecessarily sharp adjustments that could threaten the recovery. Countries without fiscal space would need to adjust despite the fragile recovery, highlighting the importance of quality and composition of the adjustment. To make the adjustment growth friendly, measures could rely on reallocating spending and increasing its efficiency, eliminating subsidies that benefit the rich, containing high wage bills, and mobilizing revenue (October 2021 *Fiscal Monitor*). Risks to debt stabilization should be carefully managed, including by closely monitoring contingent liabilities accumulated during the pandemic (Box 1.1). Oil exporters should use the opportunity provided by higher oil revenues to rebuild policy space, aim to avoid procyclical spending if the recovery is on hold, and focus any additional spending toward addressing longer-term transformational challenges.

**Difficult trade-offs for monetary policy.** Central banks have the difficult task of curbing rising inflation without chocking the fragile recovery. If inflation expectations remain anchored, central banks could afford to look through transitory inflation pressures and avoid tightening policy until the recovery takes hold. However, anchoring of inflation expectations might be difficult and hard to judge in real time. Therefore, if inflation proves more persistent, central banks may need to raise interest rates (as was done in some countries) to prevent de-anchoring of inflation expectations. In countries with pegged exchange rates, monetary accommodation is expected to decline as advance country monetary policies normalize.

**Improving policy frameworks to ease trade-offs.** The amount of policy space available depends on overall policy frameworks, and credible steps toward improving them can ease some of the trade-offs. First, fiscal adjustments should be anchored in a medium-term fiscal plan that clearly illustrates debt sustainability over the medium term, which in turn could increase trust and reduce adjustment needs (October 2021 *Fiscal Monitor*, Chapter 2). Second, countries with weaker monetary frameworks are more

<sup>1</sup>Vaccines secured come from bilateral deals, donations received, and committed vaccines through global and regional initiatives. They do not represent doses delivered. The estimated shortfalls represent the number of additional doses (beyond those secured) needed to ensure the original target of 60 percent population coverage and were estimated before the recent revision of the target to 70 percent in response to the risk of surging new variants.



limited in the monetary accommodation they can provide without risking destabilizing inflation. Improvements in monetary frameworks (including by avoiding monetary financing of budgets) and clear communication strategies would help relax this trade-off. Third, because debt and financing risks have risen, countries should bolster their debt management strategies, including by taking advantage of current favorable conditions to reprofile debt, expanding the investor base, and developing domestic capital markets (April 2021 *Regional Economic Outlook: Middle East and Central Asia*).

#### **Careful calibration of financial policies.**

Depending on the strength of the economic recovery and the scope of policy support, 15 to 25 percent of firms in the region may need to be either restructured or liquidated (Chapter 3). Therefore, a gradual withdrawal of financial sector support remains key to preventing defaults that would harm private sector recovery, employment, and financial stability. Given limited fiscal space, emergency measures should increasingly target distressed but viable firms and sectors. Appropriate financial safety nets—including bank resolution and deposit insurance frameworks—will help guard against financial stability risks. Support for private sector credit should be maintained, and banks' exposures to sovereigns should be monitored (April 2021 *Regional Economic Outlook: Middle East and Central Asia*). Over the longer term, enhancing insolvency frameworks and developing domestic capital and debt markets would support corporate sector adjustment.

#### **Labor market policies focused on the future.**

Improved education and training opportunities and hiring incentives would help facilitate the mobility of workers toward sectors where job opportunities are expanding and support the transition to a post-COVID-19 economy (Chapter 2). Countries that implemented labor retention schemes (for example, Azerbaijan, Egypt, and Jordan) helped prevent sharper rises in unemployment while the crisis was unfolding; as the recovery gains momentum, these countries should unwind these schemes, promote a return to

active job searches, and re-engage those who have become displaced. In countries with fiscal space, measures to support job creation, such as carefully designed, temporary, and targeted hiring subsidies, could be used. Countries also need to implement structural reforms to incentivize formal, youth, and women employment and to enhance mobility for migrant workers.

#### **IMF support and Special Drawing Rights (SDR) allocation.**

The IMF, which has already supported its members in the region with \$20 billion in financing since the pandemic began, continues to coordinate with other regional and international institutions to help countries successfully plot a course toward a stronger and more durable recovery. Moreover, in parallel with the World Bank, the IMF has helped in facilitating the Debt Service Suspension Initiative by G20 and Paris Club creditors, and has supported the Common Framework for debt treatment, which helps to address acute sovereign debt challenges. The IMF is currently revamping its broader strategy for FCS, which will articulate how the IMF's core competencies, mandate, and instruments can be leveraged to help across the fragility and conflict spectrum. It will also clarify how modalities of engagement can be better customized to the special characteristics of FCS and spell out how the IMF can contribute and cooperate with other partners.

The IMF's 2021 general allocation of SDR—the largest in the history of the IMF—became effective in August, increasing the region's reserve assets by \$49.3 billion. At a time when many countries face difficult choices between meeting essential health and social spending needs, supporting their economies more broadly, and fulfilling obligations on external borrowing, the SDR allocation is set to ease some of the constraints and help them better manage the trade-offs. For SDRs to have maximum benefit, decisions on how to best use them should be prudent, well-informed, and consistent with macroeconomic sustainability and transparency.

## Investing in the Future to Emerge Stronger

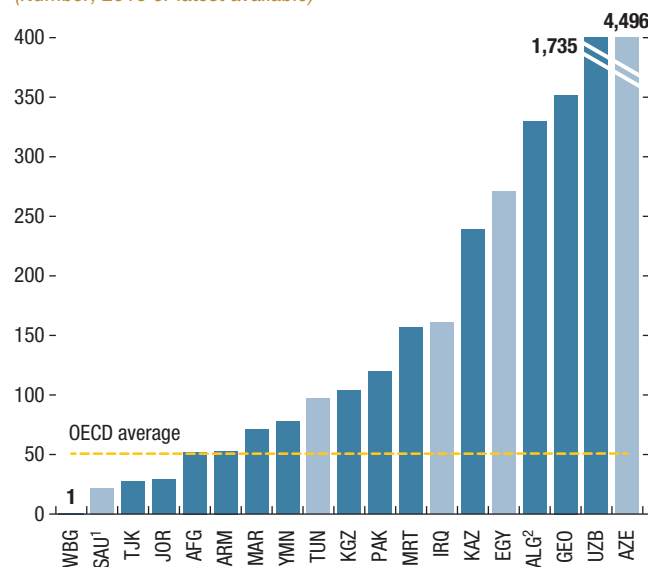
The region faces long-standing structural issues, and these came into sharp focus at the onset of the pandemic. If left unaddressed, these challenges will remain vulnerabilities in the post-pandemic world. However, the crisis also provided silver linings for a transformational recovery that would lead to a new development model, one that contributes to enhanced growth and puts the region on a more sustainable and inclusive economic path.

### Rethink the role of the state, foster a dynamic private sector, and enhance social protection.

State interventions during the pandemic have helped mitigate the health and social impact of the crisis. This would be an opportune moment to build on this and revisit social contracts to reorient them toward health and education, expand the quality and coverage of safety nets, and reexamine the role and efficiency of existing subsidies. In parallel, a thorough reevaluation of the ultimate objectives of state-owned enterprises—which have a large footprint in the region (Figure 1.10)—and their governance, together with competition-enhancing regulatory reform, is critical to identify and reduce fiscal risks while promoting private sector innovation and growth (see Rigo and others 2021). Labor market reforms could support this process by reducing excessive protection of public sector jobs and supporting the creation of good-quality jobs in the private sector (see Chapter 2). Improving anti-corruption frameworks would also help lay the foundation for stronger growth (see Jarvis and others 2021).

**Leverage emerging global trends.** It is important to ensure the region does not fall behind important global trends and leverages emerging growth opportunities. Many countries in the region used the crisis as an opportunity to accelerate these trends. For example, Morocco set up a centralized digital registration system for vaccinated people and introduced a unified internet portal to better tailor the delivery of public services to citizens' needs, improve transparency, and facilitate efficiency gains. Digital

**Figure 1.10. ME&CA: State-Owned Enterprises**  
(Number, 2019 or latest available)



Source: OECD; National authorities; and IMF staff calculations.

Note: Country abbreviations are International Organization for Standardization country codes. OECD = Organisation for Economic Co-operation and Development. Light shaded bars show data from alternative data sources.

<sup>1</sup>Saudi Arabia reporting is limited to the portfolio of entities under the remit of the reporting institution and therefore cannot be considered wholly representative of the national SOE portfolio.

<sup>2</sup>Number of SOEs in Algeria is representative of SOEs with 90 to 100 percent government ownership.

solutions have also been used to reach informal workers in Egypt. The Central Bank of Tunisia conducted an experiment with the Banque de France in July for a cross-border transfer of wholesale central bank digital currency, while the central banks of UAE and Saudi Arabia have undertaken a similar joint initiative through Project Aber. Such alternative cross-border transfer channels have the potential to enhance transparency, increase speed, and lower costs for cross-border transactions, with knock-on effects on economic activity, further expanding the participation of diasporas in domestic economies. Building on the crisis response, countries should invest in digital technologies and infrastructure to better identify vulnerable groups, deliver support, promote financial inclusion, and catalyze new growth and employment opportunities.

**Adapt to climate change, mitigate emissions, and diversify economies.** While several countries

have national climate strategies (for example, Egypt, Saudi Arabia, and the UAE), many countries in the region are in the early stages of drawing up national adaptation plans, and these efforts need to be accelerated. Regional cooperation could support national efforts to adapt to climate change, mitigate emissions, and manage transition risks, creating opportunities for green investments and job creation (Box 1.3).

## References

- Camarota, S. 2015. “The High Cost of Resettling Middle Eastern Refugees.” Center for Immigration Studies (CIS), Washington, DC.
- Jarvis, C., G. Pierre, and others. 2021. “Economic Governance Reforms to Support Inclusive Growth in the Middle East, North Africa, and Central Asia.” IMF Departmental Paper No. 2021/001, International Monetary Fund, Washington, DC.
- Mirzoev, T.N., Zhu, L., Yang, Y., Zhang, M.T., Roos, M.E., Pescatori, M.A. and Matsumoto, M.A. 2020. “The future of oil and fiscal sustainability in the GCC Region.” IMF Departmental Paper No. 2020/001, International Monetary Fund. Washington, DC.
- Richwine, J., S. Camarota, and K. Zeigler. 2020. “The fiscal costs of refugee resettlement, no free lunch for taxpayers.” CIS, Washington, DC, March.
- Rigo, E, C. Richmond and others. 2021. “State-Owned Enterprises in Middle East, North Africa, and Central Asia; Size, Costs, and Challenges.” IMF Departmental Paper No. 2021/019, International Monetary Fund, Washington, DC.



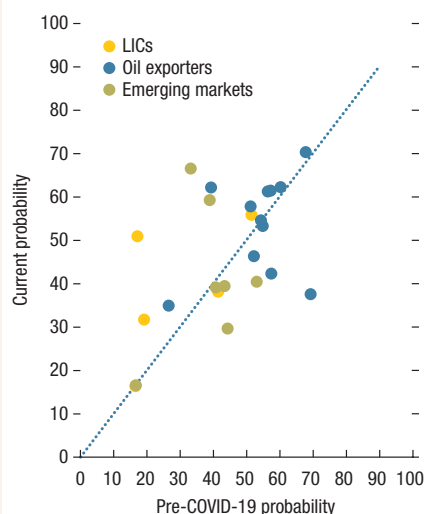
### Box 1.1. ME&CA: Medium-term Debt Stabilization Risks

The COVID-19 shock has raised fiscal deficits and public debt-to-GDP ratios across the ME&CA region, worsening debt stabilization prospects in several countries.<sup>1</sup> Importantly, most ME&CA countries face a higher probability (than they did pre-COVID-19) that debt would not stabilize over a three-year horizon, based on an analysis using the IMF’s new Sovereign Risk and Debt Sustainability Framework debt fan-chart toolkit (Box Figure 1.1.1). Notably, for some emerging market countries (EMs), particularly those under IMF-supported programs, the probability of debt non-stabilization is expected to decrease, benefiting from the medium-term frameworks provided under these programs.

These projections underscore the need for fiscal prudence and urgency. Even before COVID-19, the probability of debt non-stabilization was high (44 percent on average across ME&CA countries in our sample), and this probability increased further post-COVID-19, leaving countries without the fiscal space needed to absorb additional shocks. A decomposition of projected medium-term debt flows shows that reducing debt to pre-COVID-19 levels would require much stronger fiscal adjustment (than envisaged pre-COVID-19) for over a decade (see October 2021 *Fiscal Monitor*, Chapter 2). However, even these projections may be optimistic, as they rest on several favorable baseline assumptions (Box Figure 1.1.2). In particular,

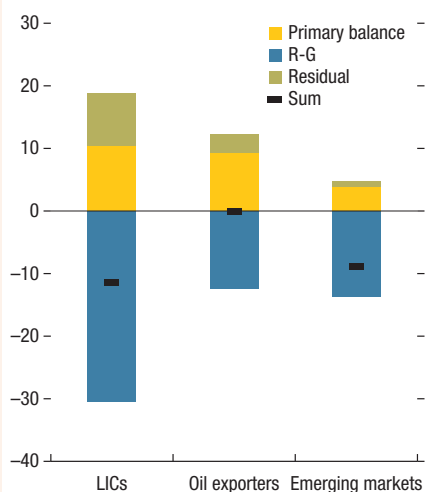
1. Under the baseline, ME&CA countries are projected to benefit from significantly negative interest rate-growth differentials, similar to, and in some cases exceeding, their pre-COVID-19 average (Box Figure 1.1.3). Clearly, though, risks of lower growth are now more elevated due to new COVID-19 waves and medium-term scarring, as well as of a sudden rise in global interest rates and the ensuing large financing needs.
2. The material debt reductions targeted for EMs hinge on relatively strong fiscal adjustment efforts over the medium term. However, the socio-political feasibility of these efforts may be tested in the context of fragile and high unemployment-ridden recoveries (Box Figure 1.1.2).
3. Many countries have provided extraordinary financial support during the pandemic through off-budget measures and quasi-fiscal operations, including through state-owned enterprises (see Rigo and others 2021). A materialization of these contingent liabilities may add to the above factors.

**Box Figure 1.1.1. Probability of Debt Nonstabilization [Debt(2024) > Debt(2023)]**



Sources: National authorities; and IMF staff calculations. Note: LIC = low-income country.

**Box Figure 1.1.2. Decomposition of Cumulative Debt Changes between End-2020 and End-2026**



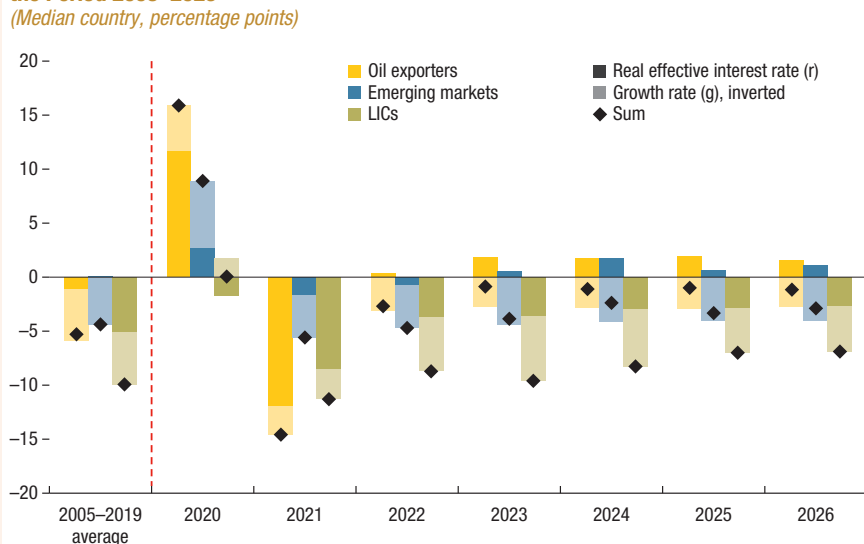
Sources: National authorities; and IMF staff calculations. Note: LIC = low-income country; R-G = Real interest rate on debt minus real growth rate of the economy.

Prepared by Tannous Kass-Hanna, Lawrence Norton, Sidra Rehman, and Suchanan Tambunlertchai, with research assistance from Kate Nguyen, Jonathan Saalfeld, Ahmad Jawed Sakhi. The project was led by Ali Abbas.

<sup>1</sup>This box excludes Afghanistan, Lebanon, Libya, Somalia, Sudan, Syria, Uzbekistan, and the West Bank and Gaza.

## Box 1.1 (continued)

**Box Figure 1.1.3. ME&CA: Real Effective Interest Rates and Real Growth Differential over the Period 2005–2026**  
(Median country, percentage points)

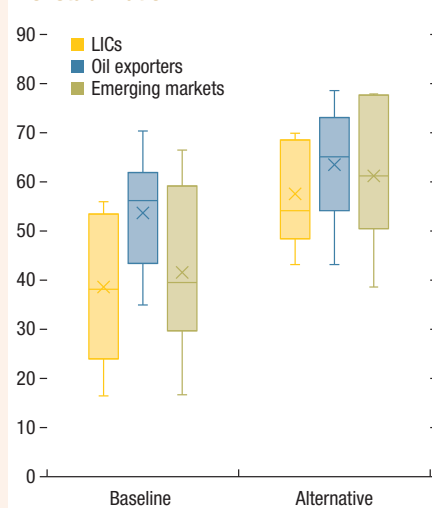


Sources: National authorities; and IMF staff calculations.  
Note: LIC = low-income country; ME&CA = Middle East and Central Asia.

An adverse scenario, where these baseline assumptions are “tested,” increases further the probability of debt non-stabilization. The alternative scenario assumes (during 2022–26): (i) higher real effective interest rates by 150 basis points; (ii) a cap on yearly projected growth for each country at the average real growth during the period 2001–19; (iii) lower primary balances by 1 percent of GDP for EMs and oil exporters, and 0.5 percent of GDP for low-income countries (LICs), to account for possible optimism in medium-term fiscal frameworks; and (iv) an additional 1 percent of GDP in contingent liability materializations every year, to account for implicit and explicit government guarantees of private sector or state-owned enterprises’ (SOE) debt. The probability of debt non-stabilization increases markedly under the alternative scenarios, particularly for EMs and LICs (Figure 1.1.4).

This calls for continued vigilance and consideration of fiscal adjustment measures once the recovery is underway, anchored in a credible medium-term fiscal plan. Steps toward stronger institutions would enhance the credibility of medium-term adjustment, which would help anchor expectations and signal a commitment to fiscal prudence, including careful budgeting of likely risks to the public balance sheet from SOEs and other contingent liabilities. Given high debt levels, maintaining policy space for critical spending will also require expedited structural reforms to boost growth, debt management strategies to reduce confidence risks arising from near-term financing pressures, and additional grant and concessional financing from development partners.

**Box Figure 1.1.4. Baseline versus Alternative Scenario Probabilities of Debt Nonstabilization**



Sources: National authorities; and IMF staff calculations.  
Note: LIC = low-income country.

## Box. 1.2. Turmoil in Afghanistan—Outward Spillovers

*The turmoil in Afghanistan is expected to generate important economic and security spillovers to the region and beyond. It has fueled internal displacement and could trigger a surge in refugees to neighboring countries, Turkey, and Europe. While financial spillovers have been limited, “cash” trade across borders is likely to grow. The disruption of exports to Afghanistan could have a macroeconomic and social impact on some neighbors. Beyond economic spillovers, concerns about adverse security implications for the region could weigh on risk sentiment and growth prospects.*

Afghanistan has sustained multiple shocks in the aftermath of the Taliban’s return to power. With nonhumanitarian aid halted and foreign assets largely frozen, Afghanistan’s aid-dependent economy faces severe fiscal and balance-of-payments crises. Cash shortages and the loss of correspondent banking relationships have crippled Afghan banks. These shocks could cause up to a 30 percent output contraction, with falling imports, a depreciating Afghani, and accelerating inflation. The resulting drop in living standards threatens to push millions into poverty and could lead to a humanitarian crisis.

The turmoil is fueling a surge in Afghan refugees. By the end of 2020, there were 3.5 million people displaced inside Afghanistan and nearly 3 million Afghan refugees around the world, half of them in Pakistan. Assuming that 1 million Afghans flee their country and settle in other countries in proportion to the existing stock of Afghan refugees, the annual cost of hosting new refugees would vary from \$100 million in Tajikistan (1.3 percent of GDP) to about \$300 million in Iran (0.03 percent of GDP) and more than half a billion dollars in Pakistan (0.2 percent of GDP).<sup>1</sup> A large influx of refugees could put a burden on public resources in refugee-hosting countries, fuel labor market pressures, and lead to social tensions, underscoring the need for assistance from the international community.

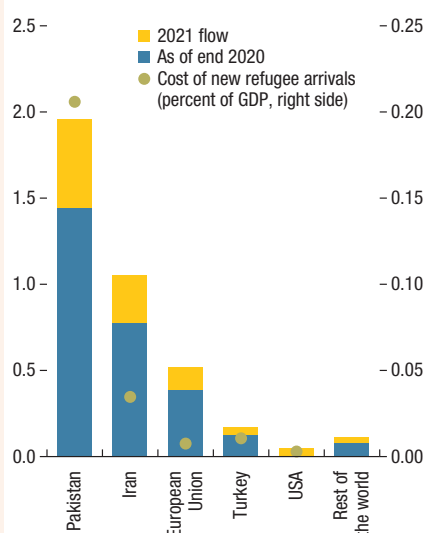
Exports to Afghanistan are macroeconomically and socially relevant for Iran, Pakistan, Turkmenistan, and Uzbekistan. They make up 4–8 percent of these countries’ exports, although their share in domestic economies is rather small. While the macroeconomic impact of a drop in exports to Afghanistan appears manageable, there will likely be important sectoral and social implications. Exports are concentrated in agricultural and basic consumer goods, fuel, and raw materials, production and distribution of which employ vulnerable populations, such as farmers and small traders.

Although financial spillovers have been limited given the negligible exposure of foreign financial institutions to Afghanistan’s small banking sector, cross-border “cash” flows could increase. With Afghanistan receiving large donor funds, there has been a substantial “cash” flow across the borders in recent years, with US dollar banknotes exported from Afghanistan as part of legitimate trade and possibly illicit flows. This cross-border flow of cash will likely grow, raising new anti–money laundering/combating the financing of terrorism concerns, but its net balance could reverse now that Afghanistan itself is experiencing shortages of foreign currency. Furthermore, trade in border regions could shift to the Pakistani rupee and Iranian rial.

Prepared by Armine Khachatryan (EUR-lead), Mohamed Jaber, Jesus Sanchez (both MCD) with guidance from Azim Sadikov.

<sup>1</sup>See Camarota (2015) and Richwine and others (2020).

**Box Figure 1.2.1. Afghan Refugees and Asylum-Seekers**  
(Millions of people)



Sources: UNHCR; country news; and IMF staff calculations.  
Note: IMF staff projections based on UNHCR data and country news. For illustrative purposes, the projections assume one million new refugees from Afghanistan and allocate them in host countries in proportion to the existing stock of Afghan refugees.



## 2. Labor Market Challenges during the Pandemic, the Role of Informality, and the Road Ahead

*The COVID-19 shock has exacerbated the already huge labor market challenges in the Middle East and Central Asia (ME&CA) region. Job losses in most countries in 2020 were unprecedented in magnitude, scope, and speed. With the low-skilled, the young, women, migrant workers, and informal workers among the hardest hit, the most vulnerable have shouldered the pandemic's burden disproportionately. The empirical analysis shows that the sensitivity of labor markets to output in the region has been typically very small, but even then, the sheer magnitude of the pandemic's hit to the region's GDP growth has caused significant damage to labor markets. Such weak sensitivity reflects the high prevalence of informality and other institutional features suggesting that, in the absence of reforms, many countries would need very strong growth to reduce unemployment. These findings highlight the need for structural reforms that make labor markets more responsive to growth, such as reducing informality, rationalizing large public sector employment, and addressing regulatory impediments in product and labor markets. As the recovery firms up, countries should shift from employment retention to facilitating reallocation, which can limit scarring or hysteresis effects, skill losses, and a lasting increase in inequality.*

### Long-Standing Labor Market Challenges at the Dawn of the Pandemic

The region entered the pandemic with dismal labor market outcomes (Figure 2.1). The ME&CA region's average unemployment rate in 2018–19 (9.4 percent) was the highest regional rate worldwide, and its labor force participation rate (55 percent) was the lowest. This standing

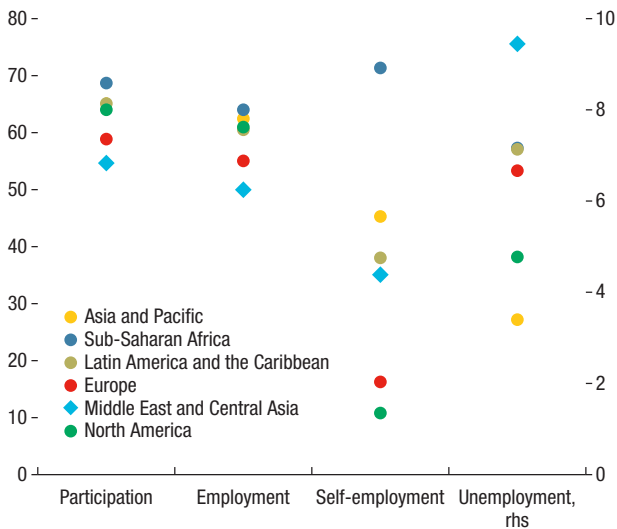
Prepared by Olivier Bizimana, Rodrigo Garcia-Verdu, Jeta Menkulasi, and Sahra Sakha, with excellent research assistance from Azhin Ihsan Abdulkarim, Shant Arzoumanian, Bashar Hlayhel, and Ahmad Jawed Sakhi.

has prevailed for much of the past two decades and implies that the region has some of the lowest employment-to-working-age-population ratios globally. Although education levels have been trending upward (Assaad and others 2018; Purfield and others 2018), female labor force participation has stagnated at about 33 percent in 2018–19, compared with 53 percent in Latin America and the Caribbean and 54 percent in the Asia and Pacific region. Meanwhile, female and youth average unemployment rates—already in double digits—have worsened over the past decade, an alarming trend for the region. Informal employment, proxied by self-employment, stood at 35 percent of total employment in 2018–19 and at almost 50 percent for the ME&CA region's low-income countries (with Somalia, Sudan, and Yemen among the highest). Such high levels of informality imply that many workers have little or no social protection or unemployment benefits, undermining inclusiveness in the labor market. However, these outcomes mask differences within the ME&CA region. For example, through the dawn of the pandemic, the Caucasus and Central Asia (CCA) subregion had lower unemployment, on average, than the Middle East, North Africa, Afghanistan, and Pakistan (MENAP)—the unemployment rate in 2018–19 stood at 7.9 percent in the former and 9.9 percent in the latter (10.2 percent in the Middle East and North Africa (MENA)). The share of informal workers (in total employment), though, has been higher, on average, in CCA than in MENAP.

### The Pandemic's Unprecedented Impact on Labor Markets

The pandemic has taken a heavy toll on labor markets globally and in the ME&CA region. The average unemployment rate in the region increased from 9.4 percent before the crisis (the average of 2018–19) to 10.7 percent in 2020, the

**Figure 2.1. Labor Market Outcomes: 2018–19**  
(Percent, left scale and right scale)



Sources: ILOSTAT database, International Labour Organization modeled estimates; and IMF staff calculations.

Note: Unemployment is unemployment rate; participation is labor force participation rate; employment is employment-to-working-age-population ratio; and self-employment is self-employment in percent of total employment. rhs = right-hand scale.

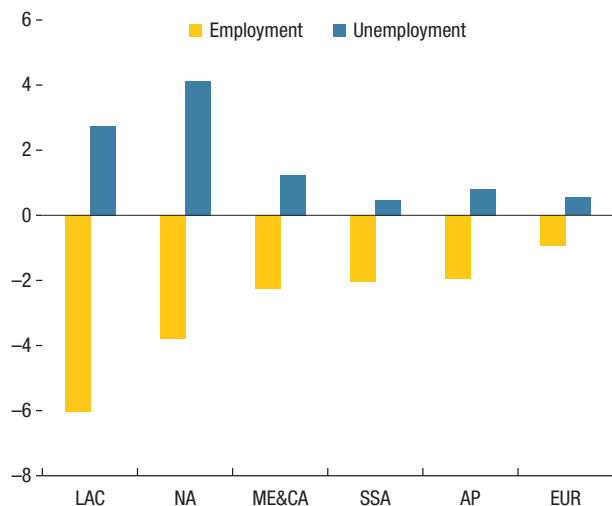
second largest regional increase after the Americas (Figure 2.2). With workers becoming unemployed or dropping out of the labor force, employment in the region fell by an estimated 8 million persons or, in proportion to the working-age population, by 2.2 percentage points—a decline that is again second only to the Americas.

The pandemic's impact on labor markets in the ME&CA region has been unprecedented in magnitude (Table 2.1).<sup>1</sup> For the median country, the unemployment rate increase in 2020 dwarfed those seen during the global financial crisis and the 2014–15 oil price shock. Additionally, labor force participation saw an unparalleled fall, likely because of the futility of job searches while lockdowns were imposed and social distancing exercised. The decline in hours worked and employment were also much larger this time.<sup>2</sup>

<sup>1</sup>This is also true for MENA when comparing the pandemic's impact on labor markets with those of the Arab Spring.

<sup>2</sup>All the findings in the text are robust to using the region's average instead of the median.

**Figure 2.2. Labor Market Outcomes during the Pandemic across Regions**  
(Percentage points, change from 2018–19)



Sources: ILOSTAT database, International Labour Organization modeled estimates; and IMF staff calculations.

Note: Employment is employment-to-working-age-population ratio. Employment and unemployment are the average change in the indicated variable across countries in the region, calculated relative to its average value over 2018–19. AP = Asia and Pacific; EUR = Europe; LAC = Latin America and the Caribbean; ME&CA = Middle East and Central Asia; NA = North America; SSA = sub-Saharan Africa.

High-frequency data analysis reinforces the exceptional nature of the pandemic's impact and highlights its unique speed (Figure 2.3). In almost all MENAP and CCA countries for which quarterly labor market statistics are available, employment losses have been unprecedented at the onset of the pandemic compared with declines registered during previous recessions or slowdowns.<sup>3</sup> Although a few countries appear to have seen a strong rebound in the second half of 2020 and the first quarter of 2021 (such as Egypt, Kyrgyz Republic, and Uzbekistan; Figure 2.3, panel 1), employment in most countries remains below its pre-pandemic levels (Figure 2.3, panels 2–4).

Another novel feature of the pandemic crisis is that it nullified the conventional pattern that informality acts as a buffer (see Loayza

<sup>3</sup>Three alternative criteria are used to define a recession or slowdown for robustness. The slowdowns or recessions shown in the comparison with 2020 are those episodes for which the three criteria coincide. See [Online Annex 2.1](#) for details.



**Table 2.1. Labor Market Outcomes—COVID-19 Compared with Global Shocks**

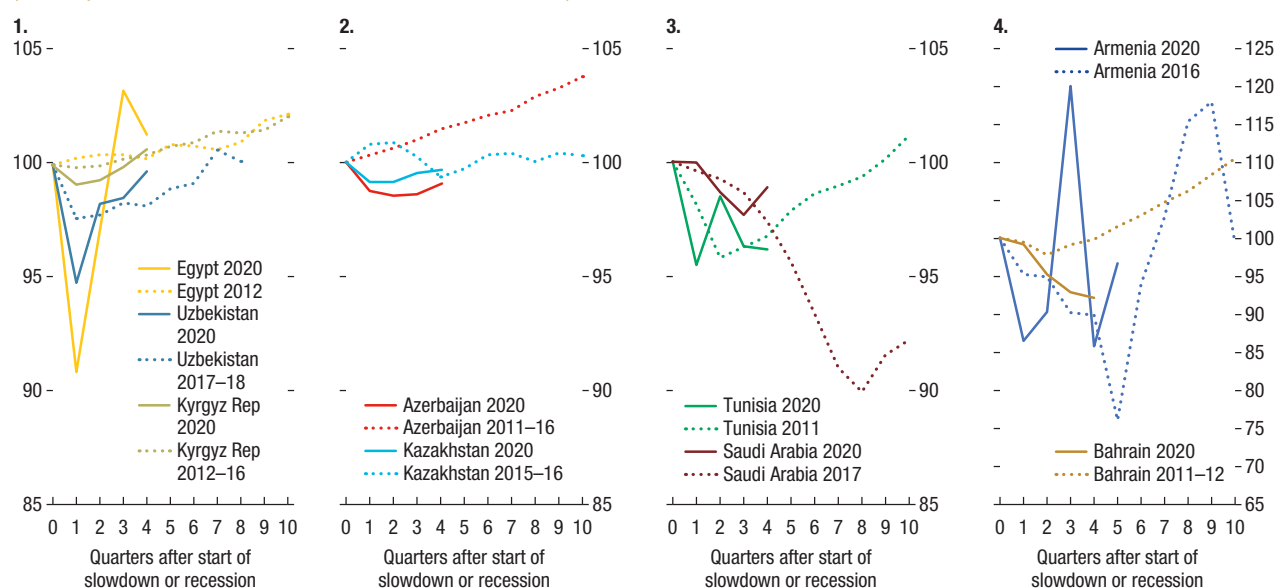
	Pre-GFC	GFC	Pre-Oil Shock	Oil Shock	Pre-COVID	COVID
Unemployment rate	9.3	9.0	9.1	9.6	9.0	10.2
Labor force participation rate	50.3	49.9	49.5	49.6	49.7	48.1
Employment-to-working age population ratio	45.3	44.6	44.5	43.8	43.5	41.5
Ratio of total weekly hours worked <sup>1</sup>	42.1	42.2	42.1	42.1	41.6	40.3

Sources: ILOSTAT database, International Labour Organization modeled estimates; and IMF staff calculations

Note: All values are median and in percent, unless otherwise noted. Pre-crisis is defined as two years before each crisis episode. COVID covers 2020; oil shock, 2014–15; and GFC, 2008–09. GFC = global financial crisis.

<sup>1</sup>Ratio of total weekly hours worked to population aged 15–64.

**Figure 2.3. Quarterly Employment Dynamics for Selected Countries during Previous Downturns and the COVID-19 Shock**  
(Index: quarter before start of slowdown or recession = 100)



Source: IMF staff calculations based on data from national authorities.

and Rigolini 2011 for the countercyclicality of informality). In contrast to previous economic downturns, during which the informal sector provided alternative employment to workers who lost their jobs in the formal sector, self-employment slumped in MENAP and CCA in 2020 (Figure 2.4).<sup>4</sup> This unusual response reflects the shock's exceptional nature and the drastic measures taken to contain the virus. Indeed, lockdowns and social distancing measures have led many businesses to shut down, affecting informal workers, many of whom work in highly contact-intensive service sectors. In MENAP and CCA, employment in market

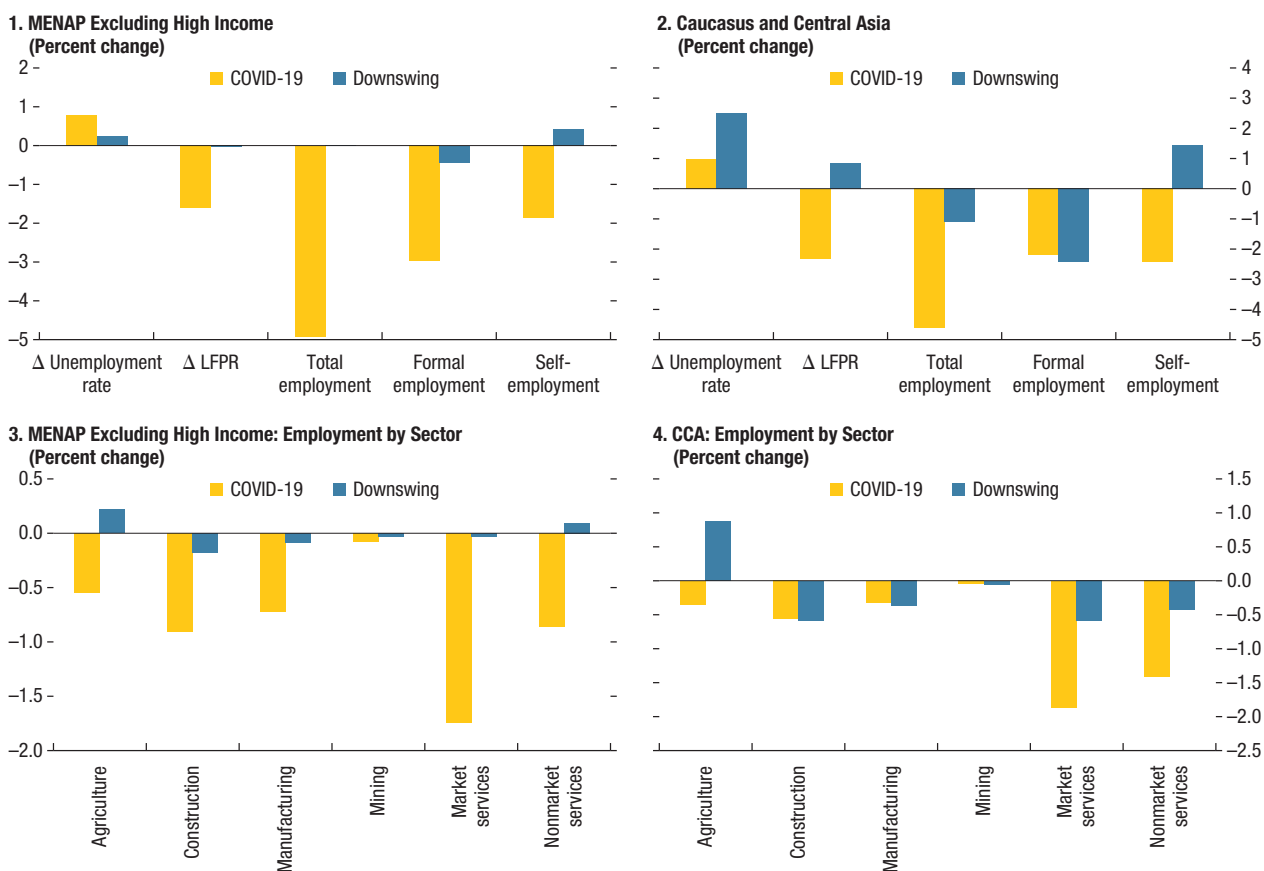
<sup>4</sup>See [Online Annex 2.2](#) for details on the event study underlying Figure 2.4.

services (which includes trade, transportation, and accommodation and food), where informality is common, plunged in 2020, whereas it was resilient during past downturns. Employment in the agriculture sector, where informality is prevalent, declined in 2020 in both the MENAP and CCA subregions, whereas it was countercyclical during past downswings.

## The Pandemic's Uneven Effects across the Region

The shock's impact was heterogeneous across country groupings within the ME&CA region. For example, relative to rates in 2018–19, average

Figure 2.4. The Labor Market during Downswings and the COVID-19 Shock



Sources: ILOSTAT database, International Labour Organization modeled estimates; and IMF staff calculations.

Note: Data of the event studies are for 1990–2019. The downswings and upswings are computed using all years and countries for which GDP data are available. Informal employment is proxied by self-employment. Formal employment is measured as total employment excluding self-employment. The statistics for employment correspond to the demeaned growth and the contributions to growth by status (formal and informal employment) and by sector, respectively. The data for 2020 are from ILO (2021). CCA = Caucasus and Central Asia; LFPR = labor force participation rate; MENAP = Middle East, North Africa, Afghanistan, and Pakistan;  $\Delta$  = change.

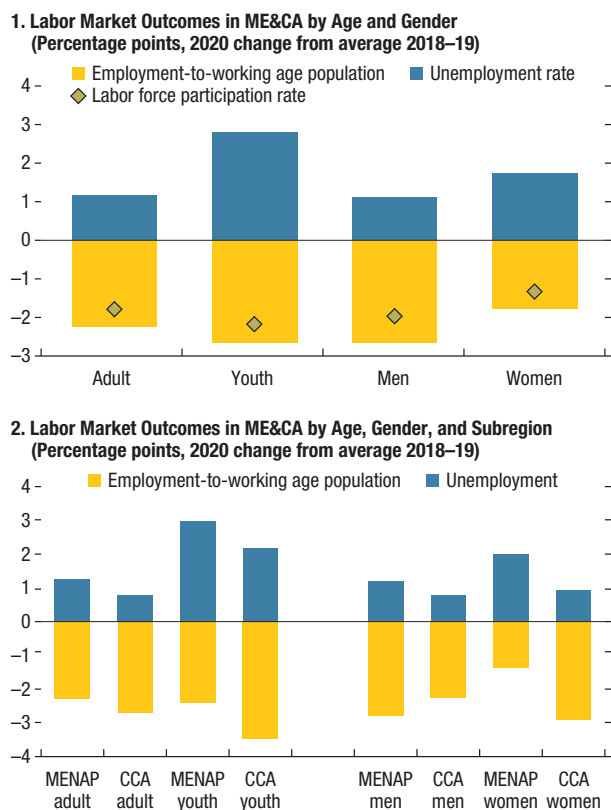
unemployment increased more in MENAP than in CCA—by 1.3 percentage points in the former (1.4 in MENA) and 0.8 percentage points in CCA. Within MENAP, unemployment in Gulf Cooperation Council (GCC) economies increased an unprecedented 3 percentage points to 5.4 percent in 2020—the highest overall unemployment rate in the GCC’s history, according to International Labour Organization estimates (ILO 2021).

The pandemic has had profoundly different impacts across socioeconomic groups and sectors, leaving some to shoulder most of the burden, while others suffered less and are likely to recover faster.

- The crisis generally affected *women* more than men because of their sectoral distribution of employment and their overrepresentation in unpaid care work. Relative to the average of 2018–19, women’s unemployment rate in 2020 increased by more than men’s (Figure 2.5, panel 1), and their employment levels fell by 6.1 percent compared with 3.9 percent for men. The corresponding declines in the employment-to-working-age-population ratio, however, were larger among *men*, most likely because of women’s underrepresentation in the region’s labor force, particularly for MENAP (Figure 2.5, panel 2). Overall, the pandemic compounded the gender gap in labor market outcomes.



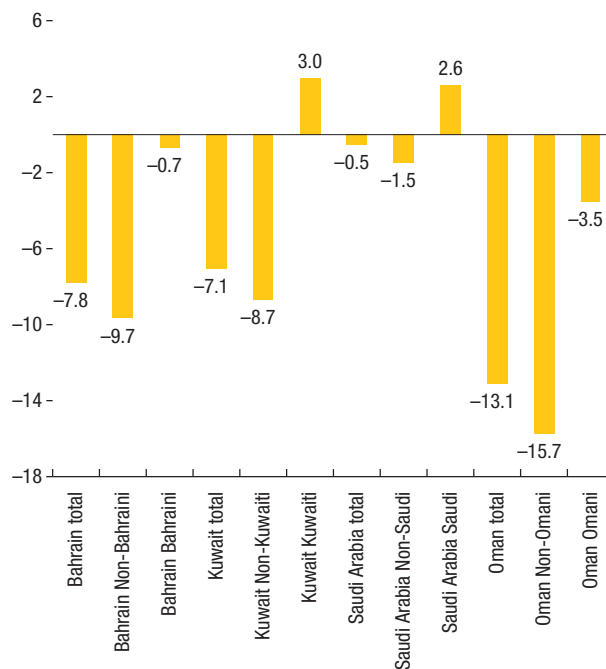
**Figure 2.5. Pandemic's Impact on Labor Market Outcomes of Various Demographic Groups**



Sources: ILOSTAT database, International Labour Organization modeled estimates; and IMF staff calculations.  
 Note: “Change” is the change in the average of the indicated variable across countries in the region relative to the average value over 2018–19. CCA = Caucasus and Central Asia; ME&CA = Middle East and Central Asia; MENAP = Middle East, North Africa, Afghanistan, and Pakistan.

- The pandemic hit *young* people more severely, with larger adverse effects on their labor market outcomes than on those of adults (Figure 2.5, panel 1). Broadly, the increase in youth unemployment was around two and half times that of adults or more (Figure 2.5, panel 2).
- *Low-skilled workers* were not spared, either. Their employment decline was nearly twice that of high-skilled workers, potentially reflecting the latter’s greater ability to work from home and their higher prevalence in areas with wider internet access. Among the low-skilled, women were affected disproportionately more than men.

**Figure 2.6. Employment by Worker Nationality (Percent, 2020:Q4/2019:Q4)**

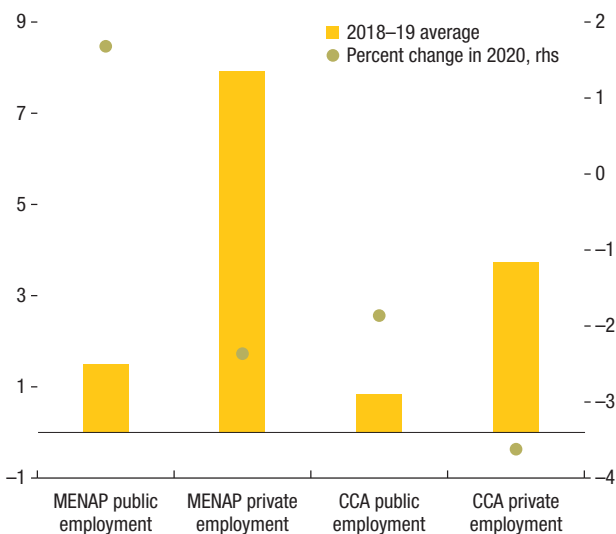


Source: IMF staff calculations based on data from national authorities.

- *Migrant workers* took a deep hit (Figure 2.6). The GCC countries, which have some of the highest shares in the world of migrant workers in their working populations, experienced a sharp decline in migrant employment, with adverse implications for their domestic consumption and outward remittances.
- *The contact-intensive sectors’* decline in employment in 2020 was around three times that of noncontact-intensive sectors. Women are concentrated more in the former and particularly in the service sector, so their employment took a larger hit than men.
- The pandemic had a profound impact on the region’s *private employment* (-2.5 percent) and, to a lesser extent, on public employment (-1.1 percent; Figure 2.7). These averages, however, mask a high degree of heterogeneity across countries and subregions, with a particularly stark decline in private employment in CCA (-3.6 percent) compared with MENAP (-2.4 percent). Public

**Figure 2.7. Impact of the Pandemic on Public and Private Employment**

(Millions of employed workers and percent change)



Sources: ILOSTAT database, International Labour Organization modeled estimates; and IMF staff calculations.

Note: Public employment refers to the following sectors: public administration and defense, health and social services, and education. Private employment includes the following: manufacturing, services, mining, wholesale and retail, transport, financial activities, agriculture, utilities, and real estate. CCA = Caucasus and Central Asia; MENAP = Middle East, North Africa, Afghanistan, and Pakistan; rhs = right-hand scale.

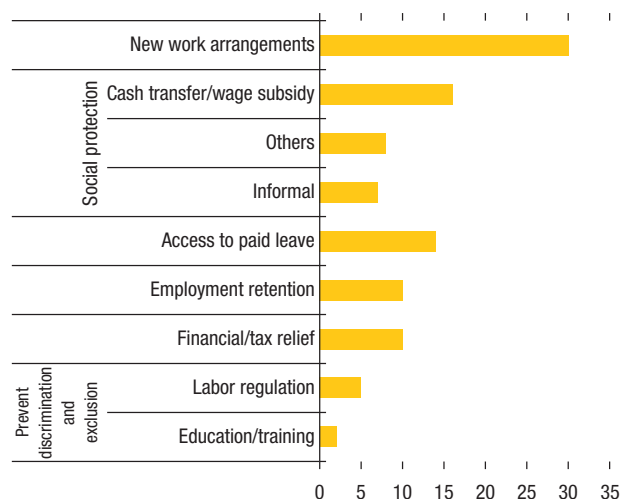
employment in 2020 actually increased in MENAP countries.

- The pandemic has weighed on *wages*. With a few exceptions, countries saw a moderation in real wage growth in 2020 from the average in 2018–19.

Many countries implemented wide-ranging measures to support firms and workers (Figure 2.8). The pandemic would have taken a heavier toll without these measures. Most countries supported the establishment of remote work, and many provided wage subsidies to enterprises or to workers directly (for example, Iran, Kazakhstan, and Morocco) and access to paid leave, or instituted employment retention programs (for example, Armenia, Azerbaijan, Georgia, Jordan, and Saudi Arabia). Some countries implemented support policies, mainly through cash transfers, to cushion the impact on

**Figure 2.8. Labor Market Policy Responses during the Pandemic in the ME&CA Region**

(Number of countries)



Sources: ILO Policy Response Tracker; and IMF staff calculations.

Note: Country policy responses are presented within these categories, which were defined by the ILO. ILO = International Labour Organization; ME&CA = Middle East and Central Asia.

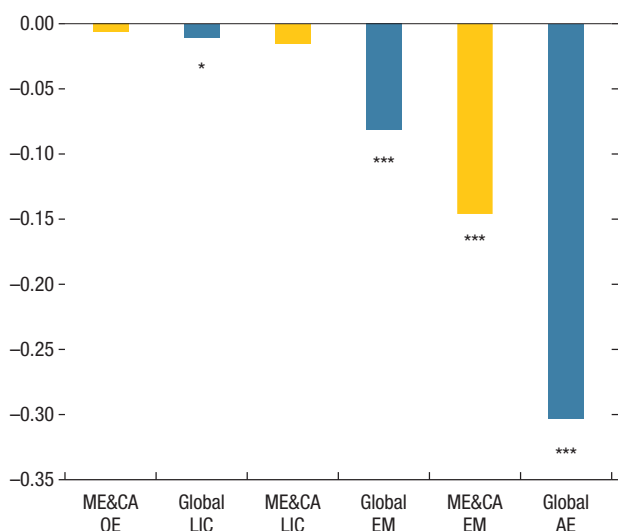
informal workers (Azerbaijan, Egypt, Iran, Jordan, Morocco) (World Bank 2021).

## What Are the Prospects for the Labor Market Recovery in the Near Term?

Higher growth is necessary for creating jobs and reducing unemployment, but it is not sufficient. How labor markets respond to economic fluctuations is equally important. To better understand how unemployment would decline as the recovery takes hold, this section estimates Okun's coefficients, which measure sensitivity or responsiveness of unemployment to a unit (for example, a dollar) change in real output.<sup>5</sup> The section then computes the growth rates needed to reduce the unemployment rate over the near term in its baseline scenario. It also discusses how the pandemic might have affected the historical relationship between unemployment and output and the possibility of hysteresis effects, where

<sup>5</sup>See [Online Annex 2.3](#) for further details.

**Figure 2.9. Okun's Coefficients from Panel Regressions by ME&CA Economic Groupings and Global Income Groupings**



Source: IMF staff calculations.

Note: The bars show the estimated Okun's coefficients from the change specification. AE = advanced economies; EM = emerging markets; LIC = low-income countries; ME&CA = Middle East and Central Asia; OE = oil exporters.

\* $p < .10$ ; \*\* $p < .05$ ; \*\*\* $p < .01$ .

not all job losses can be recouped—both of which impact the speed of the recovery. Finally, the section empirically identifies the factors that explain the cross-country variation in the estimated Okun's coefficients to understand why some countries respond strongly to growth but others don't.

### The Sensitivity of Labor Markets to Output Fluctuations Has Been Historically Small in ME&CA . . .

As in other developing countries, labor markets in the ME&CA region have not been very responsive to GDP growth.<sup>6</sup> Indeed, the sensitivity of unemployment to output fluctuations (Okun's coefficient) is very low for the region (an average value of  $-0.035$ ) and its subgroupings, broadly comparable to emerging market and developing economies and low-income countries

<sup>6</sup>Ball and others (2019) found that Okun's coefficient averaged  $-0.4$  for advanced economies and  $-0.2$  for developing ones.

(Figure 2.9).<sup>7</sup> Additionally, there is significant variation across country groupings and subregions. For example, labor markets in MENAP respond less to output fluctuations than in CCA, with an average Okun's coefficient of  $-0.013$  and  $-0.075$ , respectively. Okun's coefficient for MENAP when high-income countries are excluded from the sample ( $-0.031$ ) is higher in absolute value than for the overall MENAP group, but still lower than in CCA. This low responsiveness in the MENAP group is mainly due to GCC countries, where unemployment has generally not been sensitive to growth,<sup>8</sup> and regressions by income groupings confirm this. By contrast, labor markets in the region's emerging market and middle-income countries are more sensitive to output (higher Okun's coefficient in absolute value) than in both the ME&CA region's oil exporters and low-income countries.<sup>9</sup>

There is considerable cross-country heterogeneity in the responsiveness of labor markets to output fluctuations (Figure 2.10). Based on country-by-country regressions, Okun's relationship appears to hold in many countries in the region, so that higher growth is associated with declining unemployment. The response of unemployment to growth is relatively small for the majority of MENAP countries, but unemployment appears more responsive to output fluctuations in the North African economies: in some, a 1 percentage point increase in GDP growth is associated with about a 0.4 percentage point decline in the unemployment rates (comparable with advanced economies). Labor markets in much of the rest of the subregion appear to show little responsiveness to output fluctuations, with Okun's coefficients close to zero in some countries and even displaying positive

<sup>7</sup>Using 25 ME&CA countries, a panel regression is run separately for each geographic and income subgroup. For GCC, the estimations use non-oil GDP.

<sup>8</sup>The low sensitivity of unemployment in GCC countries reflects their dual labor market, where expatriate workers for much of the past decades had to leave the host country when they lost their jobs and hence did not show up as unemployed, while nationals' employment has been protected in the public sector, thereby not moving much in downturns.

<sup>9</sup>The estimation of a version of Okun's law using employment yields qualitatively the same results.

(although statistically insignificant) values in others (for example, the GCC economies). In the CCA, there is relatively less variation across countries in the responsiveness of unemployment to output growth.

### ... Which Could Weigh on the Speed of the Region's Labor Market Recovery over the Near Term ...

Simulations based on the estimated relationship between unemployment and GDP growth suggest that labor market recovery will likely be slow and uneven across the region in the near term (Figure 2.11).<sup>10</sup> For MENAP, conditional on the IMF's real GDP growth projections, unemployment rates would decline on average in 2021–22 only in some countries—those where unemployment is more sensitive to growth, where the growth outlook is relatively positive, or both, for example, North Africa—while in the CCA, unemployment would decline in most countries.

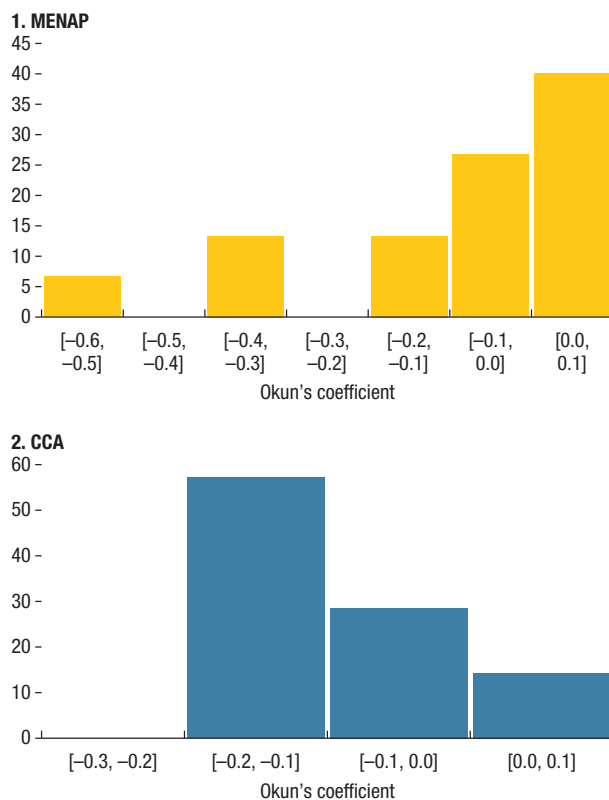
### ... and Likely Require Very High Growth Rates to Make a Dent in Unemployment.

Without reforms, the growth rate required to stabilize unemployment is high in many countries.<sup>11</sup> To stabilize the unemployment rate in some MENAP economies (especially those where unemployment is barely responsive to GDP growth like some GCC economies), growth would need to reach close to 10 percent (Figure 2.12, panel 1)—to reduce unemployment, growth would need to exceed this threshold. Similarly, in some CCA countries, unemployment-stabilizing growth would need to rise above 8 percent. Such growth rates are much higher than what

<sup>10</sup>The projections of unemployment during the recovery (2021–22) are assessed using the country-by-country Okun's relationships and the average GDP growth forecasts for 2021 and 2022 from the IMF's April 2021 *World Economic Outlook*. The number of countries in Figure 2.11 is smaller than in Figure 2.10 because the analysis underlying Figure 2.11 uses countries where the Okun's relationship is empirically valid over the sample period.

<sup>11</sup>See [Online Annex 2.3](#) for the computation of such growth rates.

**Figure 2.10. Distribution of Okun's Coefficients by Country (Percent)**



Source: IMF staff estimates.

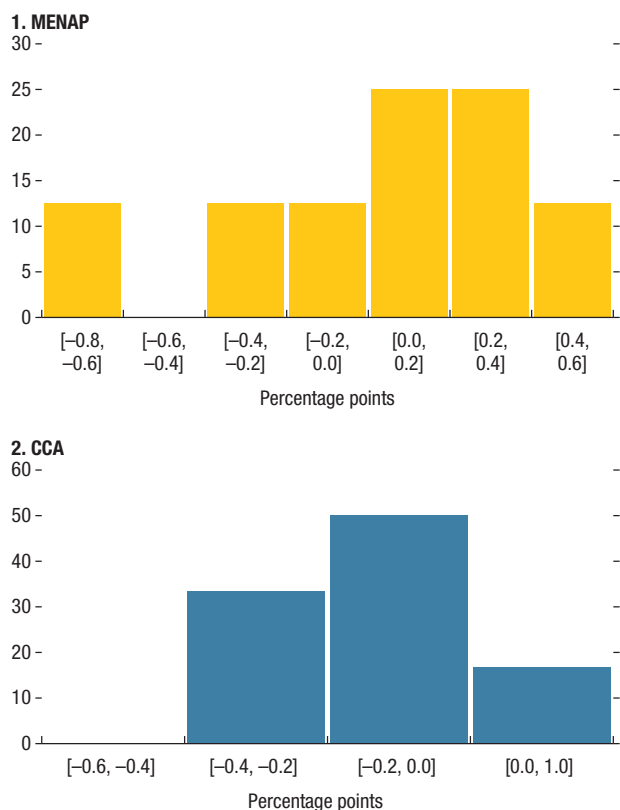
Note: CCA = Caucasus and Central Asia; MENAP = Middle East, North Africa, Afghanistan, and Pakistan.

was realized on average over the pre-pandemic period and, for many countries, exceed IMF growth projections, which implies that if these projections materialize, they will be insufficient to create enough jobs for unemployment to decline (Figure 2.12, panel 2).

All these results are derived from using the average response of unemployment to output fluctuations, based on the historical relationship and over both downturns and upturns.

*What if the historical relationship has changed as a result of the crisis and associated restrictions and policy responses?* The pandemic-related restrictions have affected some of the most employment-intensive sectors disproportionately, which may have led to a larger-than-usual increase in unemployment during the crisis.

**Figure 2.11. Distribution of Unemployment Change Implied by the April 2021 WEO GDP Growth Projections for 2021–22 (Percent)**



Source: IMF staff estimates.  
Note: CCA = Caucasus and Central Asia; MENAP = Middle East, North Africa, Afghanistan, and Pakistan; WEO = *World Economic Outlook*.

This means that a faster-than-normal decline in unemployment is also possible once restrictions are lifted fully. At the same time, however, some of the responses to the crisis might have dampened the increase in unemployment, suggesting a shallow fall in unemployment during the recovery. First, the rapid development of teleworking in many sectors has prevented some job losses, thus limiting the rise in unemployment. Second, policies to preserve existing jobs, such as job retention programs, have dampened the increase in unemployment. Third, the post-pandemic structural transformation affecting the sectoral composition of employment (for example, new capital-intensive sectors emerging and other more labor-intensive sectors disappearing) could also lower the responsiveness of unemployment to

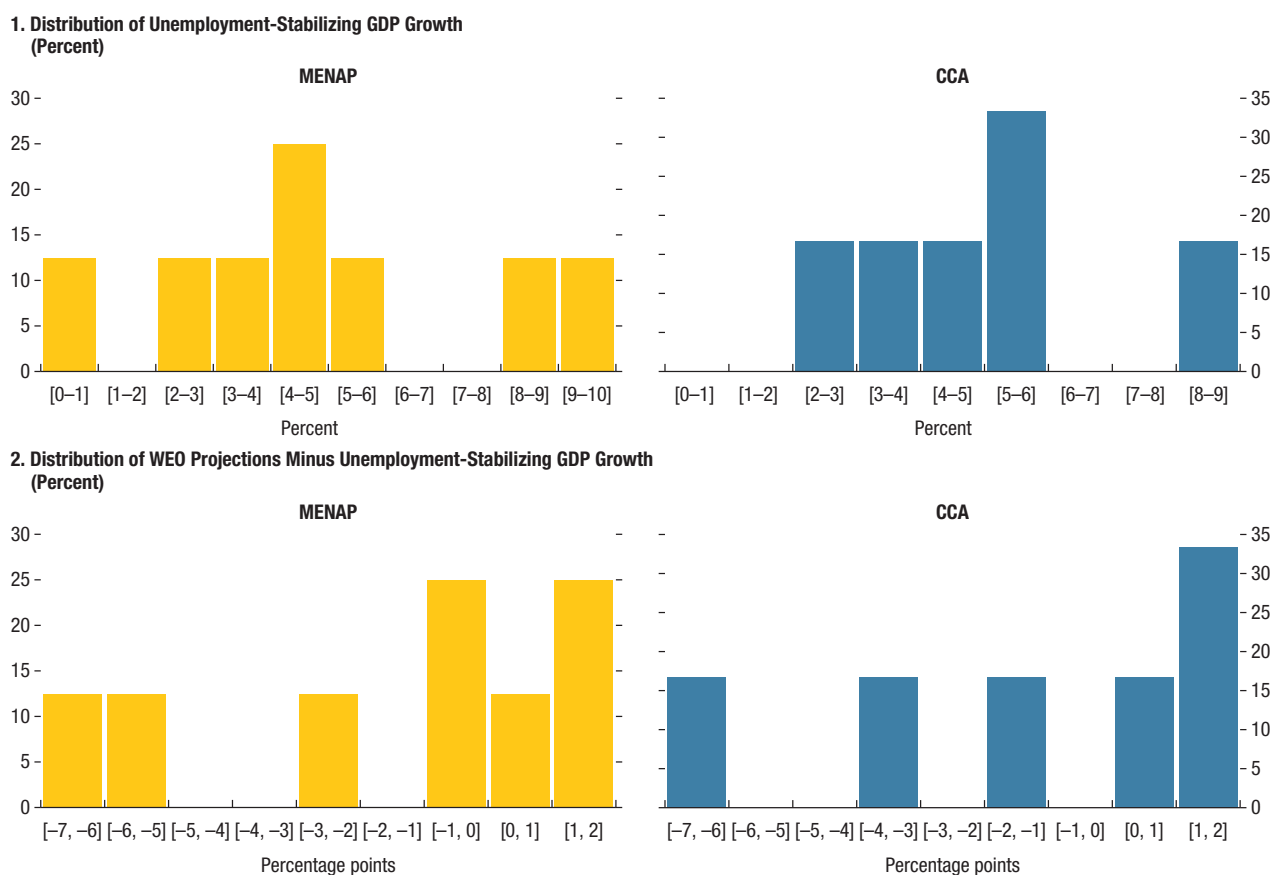
output. Overall, there is no evidence that either set of factors have dominated; in fact, simulations of the unemployment rates for 2020, based on the Okun's law relationship estimated with historical data through 2019, do not show any systematic bias. In other words, the exceptional decline in economic activity in 2020 (the largest over the past quarter century) created exceptional job losses.

*What if downturns have long-lasting effects on labor market recovery?* The unemployment response in downturns may be larger than in upturns, which implies that on average, job losses incurred during downturns are not recouped fully during upturns, pointing to hysteresis effects caused by prolonged unemployment (or inactivity). To test this possibility, an unbalanced panel regression for ME&CA emerging markets is estimated, demonstrating a stronger response of unemployment in downturns for an average emerging market (see Figure A.2.4 in [Online Annex 2.4](#)).<sup>12</sup> This implies that, on average, Okun's coefficients for the recovery may be even smaller (in absolute value) than those used in the reported simulations. These results are consistent with empirical evidence on the region that recessions can have long-lasting effects on unemployment (October 2020 *Regional Economic Outlook: Middle East and Central Asia*) and employment (based on evidence for a selected number of countries with sufficiently long high-frequency data).

### The Weak Labor Market Response to Output Fluctuations is Due to Structural Factors, Including Informality . . .

Differences across countries in labor market policies, economic structures, and institutions are likely to affect how quickly labor markets adjust to output fluctuations. In addition to

<sup>12</sup>This hypothesis cannot be tested by running regressions at the country level because of the absence of time series long enough for many countries to capture sufficient episodes of upswings and downswings.

**Figure 2.12. GDP Growth Consistent with Stable Unemployment Rate and Gap with World Economic Outlook Projections**

Source: IMF staff estimates.

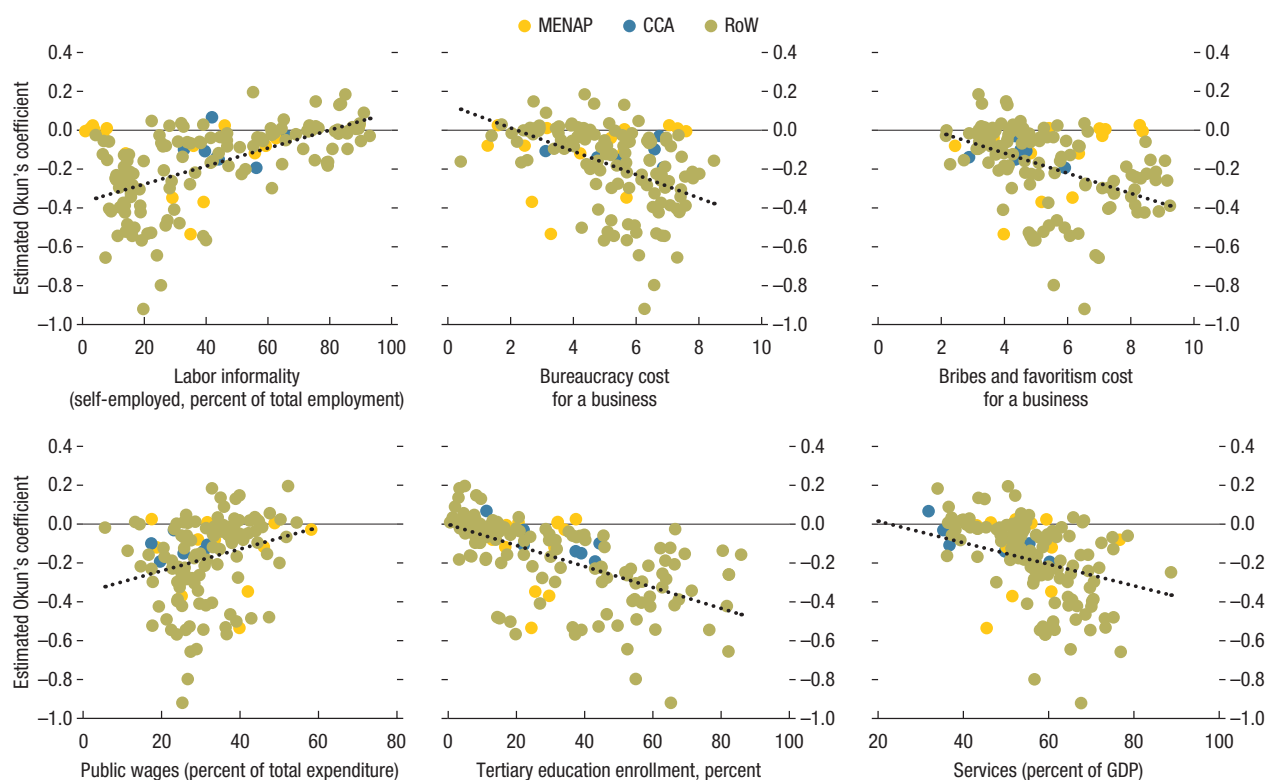
Note: The figures present the distribution of the GDP growth required to stabilize unemployment that results from the change specification of Okun's law and the difference with the April 2021 *World Economic Outlook* projections for GDP growth. CCA = Caucasus and Central Asia; MENAP = Middle East, North Africa, Afghanistan, and Pakistan; WEO = *World Economic Outlook*.

evidence from prior research that overly stringent labor market regulations weigh on labor market outcomes (Abdih 2011, Ahn and others 2019), the chapter's empirical results from a global sample (using bivariate regressions) demonstrate that a weaker (less negative) Okun's coefficient is associated with the following factors, including for the ME&CA region (Figure 2.13; and Figure A.2.5 in [Online Annex 2.5](#)):

- *A higher level of informality*, because it acts as a safety net, allowing workers who lost their jobs during downturns to make the transition to informal employment rather than face unemployment or drop out of the labor force.
- *Rigid product market regulatory framework*, such as high costs related to bureaucracy, and favoritism, which raise labor market frictions significantly.
- *Greater flexibility in wage setting*, which allows some of the burden of labor market adjustment to fall on wages and not all on employment.
- *Lower skills levels*, because low-skilled workers tend to have less dynamism in the formal labor market.
- *Large public sector employment and high wage premiums*, because the former is a more stable source of employment and thus less responsive



Figure 2.13. Okun's Coefficients and Structural Variables



Sources: IHS Markit; World Economic Forum, Global Competitiveness Report, Executive Opinion Survey; ILOSTAT, ILO modeled estimates; UNESCO Institute for Statistics; World Bank, World Development Indicators; and IMF staff estimates.  
 Note: Larger values for bureaucracy and bribery indicate better outcomes/ratings (that is, lower costs). All results are statistically significant at the 10 percent level or less (that is, 5 or 1 percent).

to growth, while the latter can divert labor from the private sector.

- *High share of agriculture and low share of services* in value added, which could signal low levels of skill and high levels of informality.

Informality is one of the most robust determinants of Okun's coefficient (see Ahn and others 2019). When all variables are included in the regression, only labor informality, the share of services' value added in GDP, and level of education or skill remain statistically significant.<sup>13</sup>

<sup>13</sup>This result does not necessarily mean that the other variables are not important. Rather, it reflects the high degree of collinearity among the various concepts; lack of a direct impact after controlling for informality, education, and share of services (in other words, other variables affect Okun's coefficient only through these three variables); or both.

### ... with the Latter Having Implications for the Post-Pandemic Labor Market Recovery

Will informality hinder or facilitate the recovery? The trajectory of labor market recovery in the near term is still uncertain because the pandemic's effects are still unfolding amid the surge of new variants and the slow pace of vaccination in many countries. Two scenarios seem plausible, but the lack of high-frequency data makes it hard to assess which one is more likely to materialize:

- Economies with a prevalent informal sector could see a faster-than-usual rebound in employment in the short term once health risks are controlled. Lockdown measures and other restrictions affected employment severely in sectors with a high degree of

informality (high-contact services). This suggests that employment in those sectors could bounce back quickly once the restrictions are lifted completely and the economies return to normalcy. Recent studies of emerging market and developing economies suggest that informal jobs were hit harder at the beginning of the pandemic crisis but should experience a quicker rebound in a recovery phase relative to other jobs because they are subject to minimal hiring and setup costs (Alfaro, Becerra, and Eslava 2020). For the region, this suggests that a faster recovery in informal employment is possible because informal jobs are flexible in terms of hiring costs. Although such a rebound in informal employment bolsters total employment in the near term, the reentry of workers into the formal sector when the economy returns to the expansionary phase of the business cycle would facilitate a more lasting and stronger economic recovery.

- Persistently high informality would hinder a robust and sustained economic recovery. Because many countries in the region continue to face challenges in accessing vaccines, the pandemic looks unlikely to abate anytime soon and could remain a hurdle to the recovery. For these countries, workers who have a strong presence in the sectors hit by the crisis (such as tourism) likely face the grim prospects of losing their skills and being employable only in informal jobs when they eventually return to the labor market. This could lead to long-lasting damage—hysteresis effects—and dampen the recovery, including by lowering overall productivity in the economy.

### Looking Ahead: Policy Actions toward an Inclusive Recovery

Policy needs to protect the vulnerable and create conditions for strong labor markets. Closing social safety gaps and supporting vulnerable groups that the pandemic hit unevenly are paramount.

Otherwise, countries would face increased risks of hysteresis and ultimately lower potential and inclusive growth. At the same time, policies should address the underlying causes of weak labor market responses, which will accelerate a cyclical recovery and contribute to higher and sustained growth in the long term.

### Crisis-Related Labor Market Measures Should Be Recalibrated

As recoveries gain momentum, policies need to shift from a focus on employment retention to facilitating reallocation. Unwinding *labor retention programs* (for example, in Azerbaijan, Egypt, and Jordan) as the recovery gains traction will help avoid supporting jobs that might become permanently unviable. Countries experiencing a strong recovery in labor markets and activity (for example, Egypt and Uzbekistan) can move away from retention toward reallocation policies (April 2021 *World Economic Outlook*) and begin to promote a return to active job search, ensuring reengagement of those who became increasingly detached from the labor market during the crisis. Countries with fiscal space could support job creation through *carefully designed, temporary, and targeted hiring subsidies* (OECD 2021). Incentives could also help promote workers' mobility to other expanding job opportunities.

Policy should minimize the risk of deep scars on those who the pandemic hit hard. Active *labor market policies* could be expanded to promote reallocation, such as modernizing and strengthening the role of public employment services to improve worker employability and facilitate their placement, especially for youth. Vocational training, which few countries in the region have prioritized during the pandemic, should be encouraged further to improve employment opportunities and address skills mismatches. Resources will need to be devoted to reverse learning losses among children who lost instructional time during the pandemic and more broadly to invest in high-quality education. This will help address youth unemployment



by reducing skills mismatches, and boost productivity.

Rethinking social protection and policies to support the formalization of labor is important for the recovery to limit scarring, especially for workers who could remain trapped in the informal sector. The pandemic has offered some lessons on how to extend social safety nets to informal workers: several countries, such as Egypt and Morocco, introduced targeted cash transfer programs, leveraging financial innovation and digitalization. Governments should also facilitate formalization because countries with higher informality levels tend to be associated with lower welfare, per capita income, and productivity and higher poverty. Doing so will involve implementing a battery of policies, including carefully designed minimum wages, and labor taxation, since high labor tax wedges can reduce formal employment. The burden of taxation could shift away from labor toward consumption taxes, which are less likely to distort the formal-versus-informal jobs margin, but low-income households would need to be compensated for any regressive impact through cash transfers.<sup>14</sup> As labor market formalization progresses, there is a need to protect workers through well-designed unemployment insurance (see Duval and Loungani 2019). Formalization can also help bolster labor market adjustment to the business cycle when combined with the following policies.

### Structural Policies Can Improve Recovery and Boost Potential Growth

Governments need to accelerate policies to improve the business environment. This would require a holistic reform approach, including promoting e-government, strengthening independent scrutiny to allow audit agencies and the public at large to provide effective

<sup>14</sup>Another way to reduce arbitrage opportunities between informal and formal employment would be to better align the effective tax rates on self-employment (simplified or turnover tax rate) and wage employment (the personal income tax rate).

oversight and to promote accountability and fiscal transparency, and fostering a strong and independent judiciary to ensure contract enforcement and improve integrity, including in the civil service. Additionally, removing barriers to competition can help improve the employment response to output changes and raise employment rates above their very low precrisis levels.

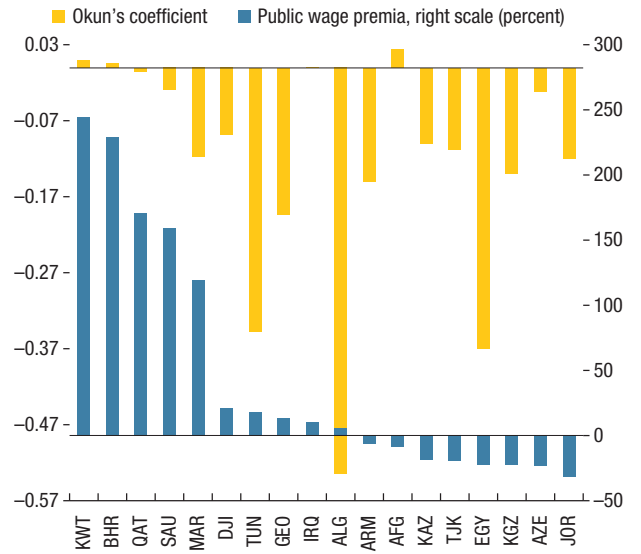
Reform to the labor market regulatory framework is also needed. The region fares well on labor market flexibility indicators compared with other emerging markets, especially in the CCA subregion, though with significant heterogeneity across countries. However, important impediments remain to be addressed, such as rigidity in hiring and firing formal sector workers in Algeria, Morocco, and Tunisia; and low flexibility in wage determination in Pakistan and Tunisia.

There is room to reduce the public sector's role as the employer of first and last resort. The use of public sector employment as a countercyclical tool (as the average MENAP country did during the pandemic) is risky because it is difficult to reduce such employment after the countercyclical need disappears. Excessive protection and higher wage premiums in public sectors (Figure 2.14) have distorted incentives and led to labor market segmentation and labor mispricing (IMF 2016, 2018). There is a need to curb public sector employment and tackle the high procedural requirement for dismissals and reform severance pay. In the GCC, where segmentation is between nationals and expatriate employment, allowing migrant workers greater flexibility to move between jobs (as Qatar, Saudi Arabia, and the UAE have done) will benefit them through higher wages.

Finally, there is a need to address long-standing gaps in gender inequality. In many countries, women are largely responsible for household tasks and caring for children and the elderly. Affordable access to early childhood facilities can help increase female labor market participation. Moreover, strengthening laws to combat discrimination against women, promoting wage transparency, and enforcing equal pay laws more effectively

will be needed. Additionally, fostering digital transformation can strengthen women’s position in the labor market by providing more flexible ways of working that facilitate the combination of paid work with caregiving responsibilities.

**Figure 2.14. Public Wage Premiums and Okun’s Coefficient**



Source: IMF staff estimates.

Note: Wage premium refers to public-private sector wage gap in percent and is taken from IMF (2018). Country abbreviations are International Organization for Standardization (ISO) country codes.

## References

- Abdih, Yasser. 2011. "Closing the Jobs Gap." *Finance and Development* 48: 2.
- Ahn, JaeBin, Zidong An, John C. Bluedorn, Gabriele Ciminelli, Zsóka Kóczán, Davide Malacrino, Daniela Muhaj, and Patricia Neidlinger. 2019. "Work in Progress: Improving Youth Labor Market Outcomes in Emerging Market and Developing Economies." IMF Staff Discussion Note 19/02, International Monetary Fund, Washington, DC.
- Alfaro, Laura, Oscar Becerra, and Marcela Eslava. 2020. "EMEs and COVID-19: Shutting Down in a World of Informal and Tiny Firms." NBER Working Paper 27360, National Bureau of Economic Research, Cambridge, MA.
- Assaad, Ragui, Rana Hendy, Mounir Lassassi, and Shaimaa Yassin. 2018. "Explaining the MENA Paradox: Rising Educational Attainment, Yet Stagnant Female Labor Force Participation." IZA Discussion Paper 11385, IZA Institute of Labor Economics, Bonn, Germany.
- Ball, Laurence, Davide Furceri, Daniel Leigh, and Prakash Loungani. 2019. "Does One Law Fit All? Cross-Country Evidence on Okun's Law." *Open Economies Review* 30 (5): 841–74.
- Duval, Romain, and Prakash Loungani. 2019. "Designing Labor Market Institutions in Emerging Market and Developing Economies: Evidence and Policy Options." IMF Staff Discussion Note 19/04, International Monetary Fund, Washington, DC.
- International Labour Organization (ILO). 2021. *World Employment and Social Outlook: Trends 2021*. Geneva: International Labour Organization.
- International Monetary Fund (IMF). 2016. "Managing Government Compensation and Employment— Institutions, Policies, and Reform Challenges." IMF Policy Paper, International Monetary Fund, Washington, DC.
- International Monetary Fund (IMF). 2018. "Public Wage Bills in the Middle East and Central Asia." IMF Departmental Paper 18/01, International Monetary Fund, Washington, DC.
- Loayza, Norman, and Jamele Rigolini. 2011. "Informal Employment: Safety Net or Growth Engine?" *World Development* 39 (9): 1503–15.
- Organisation for Economic Co-operation and Development (OECD). 2021. *OECD Employment Outlook 2021: Navigating the COVID-19 Crisis and Recovery*. Paris: Organisation for Economic Co-operation and Development.
- Purfield, Catriona, Harald Finger, Karen Ongley, Benedicte Baduel, Carolina Castellanos, Gaelle Pierre, Vahram Stepanyan, and Erik Roos. 2018. "Opportunity for All: Promoting Growth and Inclusiveness in the Middle East and North Africa." IMF Departmental Paper 18/11, International Monetary Fund, Washington, DC.
- World Bank. 2021. "Taking Stock of COVID-19 Labor Policy Responses in Developing Countries." JobsWatch COVID-19 Brief (March 3), World Bank, Washington, DC.
- World Economic Forum. 2019. *The Global Competitiveness Report 2019*.

### 3. COVID-19 and the Corporate-Sector Outlook

*An uneven recovery is emerging across firms in the Middle East and Central Asia (ME&CA) region, after being hit hard by the COVID-19 crisis. Despite policy support and firms making large cost adjustments, high-contact-intensive sectors, firms with preexisting vulnerabilities, small firms, and those lacking digital connectivity faced the brunt of the pandemic. Although liquidity and solvency risks have been contained so far for the overall corporate sector, liquidity stress is projected to remain elevated for these vulnerable firms, but solvency concerns could be exacerbated only in the event of a subdued economic recovery or premature withdrawal of policy support. Banking systems have been resilient so far, thanks to macro-financial policies and liquidity support, but risks are building up in those highly exposed to vulnerable firms. Over the medium term, a stress-testing exercise suggests that 15 to 25 percent of firms in the region may need to be either restructured or liquidated. Thus, until the recovery takes hold, targeted policy support to vulnerable but viable firms and sectors remains vital to prevent firm defaults. Moreover, swift restructuring of viable but insolvent firms and liquidation of unviable ones would help ensure a stronger and more resilient recovery. To preserve financial stability, authorities should closely monitor macroprudential risks, maintain appropriate financial safety nets, and encourage vulnerable banks to use the period of respite that policy support affords to strengthen buffers against upcoming risks.*

#### Uneven Recovery after an Unprecedented Crisis

The nonfinancial corporate sector in the Middle East, North Africa, and Pakistan (MENAP) entered the pandemic with weaker fundamentals than before previous crises and relative to firms

Prepared by Nordine Abidi, Mohamed Belkhir and Sahra Sakha, with inputs from Mehdi El-Herradi, Moheb Malak and Monica Petrescu and excellent research assistance from Oluremi Akin-Olugbade and Kate Nguyen.

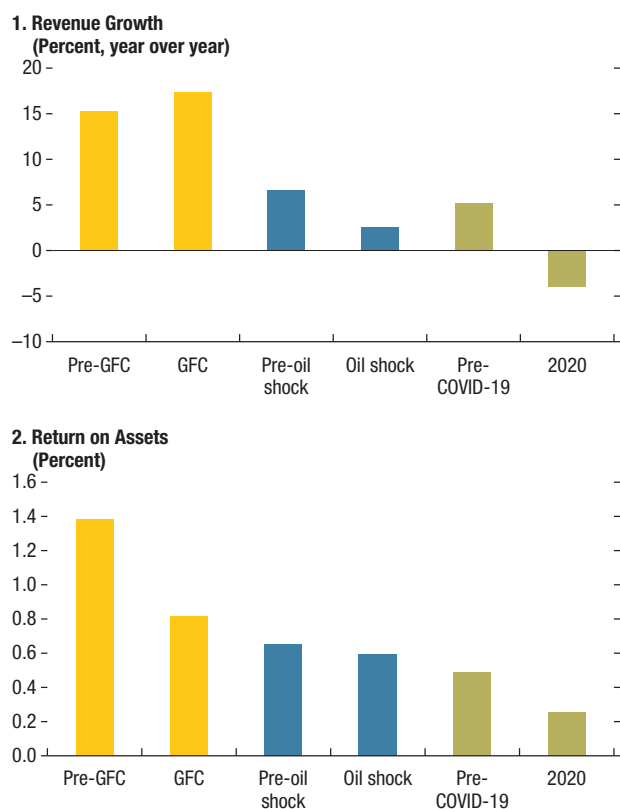
in emerging market economies (October 2020 *Regional Economic Outlook: Middle East and Central Asia*).<sup>1</sup> In particular, pre-pandemic revenue growth, profitability and liquidity were lower, and leverage was higher. The pandemic has added to the region's woes through an unprecedented decline in corporate revenue and profitability (Figure 3.1).

#### After a Sharp Hit, a Steady but Uneven Recovery Is Emerging

After a historic revenue drop in the first half of 2020, the gradual lift of containment measures allowed some firms in MENAP to start recovering.<sup>2</sup> The pandemic's second wave by the end of 2020 did not interrupt the emerging recovery because countries followed a different approach to lockdowns with less restrictions to work and travel. By the first quarter of 2021, revenue growth and profitability for the corporate sector had returned to pre-pandemic levels. However, not all firms have benefited equally from the recovery, and a widening divergence is emerging across different groups of firms.

<sup>1</sup>The analysis is based primarily on publicly listed firms from the Compustat database, which has limited data for countries in the Caucasus and Central Asia (CCA). This is complemented by the latest European Bank for Reconstruction and Development–European Investment Bank–World Bank Business Environment and Enterprise Performance Surveys (BEEPS) and the World Bank's COVID-19 Follow-Up Enterprise Surveys (ES COVID-19), which collected information around the peak of the pandemic for both listed and unlisted firms from Armenia, Azerbaijan, Egypt, Georgia, Jordan, Kazakhstan, Kyrgyz Republic, Lebanon, Morocco, Tajikistan, Tunisia, Uzbekistan, and West Bank and Gaza. This data is used to assess whether the pandemic's impact on firms in the CCA region was comparable to that in MENAP and to document small and medium enterprises' (SMEs) performance, the mitigating role of digitalization, and the reach of policy support across the two regions.

<sup>2</sup>During the first half of 2020, the median corporate revenue contraction in MENAP (based on publicly listed firms from Compustat) and the one reported by large firms in CCA countries (based on BEEPS-ES COVID-19 surveys) were broadly similar at 18 percent (year over year).

**Figure 3.1. Revenue Growth and Profitability Compared to Previous Crises**

Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations. Note: Results are based on nonfinancial firms that released annual reports in 2020. Pre-crisis is defined as two years before each crisis episode, and pre-COVID-19 presents medians of 2018–19. Revenue growth is the year-over-year growth rate of quarterly sales. Return on assets is 100 times the ratio of net income before extraordinary items over assets. Sample includes firms from Bahrain, Egypt, Jordan, Kuwait, Morocco, Oman, Pakistan, Qatar, Saudi Arabia, Tunisia, and United Arab Emirates. GFC = global financial crisis.

Firms' recovery in oil-exporting countries is lagging that of oil-importing countries. Although revenues in oil exporters contracted by about half of the decline in oil importers during the first half of 2020, revenues and profitability in oil importers had recovered faster by the end of 2020 and continued to outperform during the first quarter of 2021, mirroring trends seen in other emerging markets (Figure 3.2, panel 1). This performance gap reflects: (i) the prevalence of firms in hard-hit, high-contact-intensive (HCI) sectors in oil exporters (20 percent higher than in oil importers); and (ii) the deep loss of expatriate employment—particularly in HCI sectors—in Gulf Cooperation Council (GCC)

countries, which accounted for 70 percent of their labor force pre-pandemic and has yet to recover (Chapter 2).

Firms in HCI sectors faced the brunt of the pandemic and are yet to recover. During the first half of 2020, revenues in these sectors contracted more than in low-contact-intensive (LCI) sectors (–11 and –7 percent, respectively, year over year; Figure 3.2, panel 2). By the first quarter of 2021, revenues in LCI sectors had recovered significantly (18 percent year over year), and profitability had exceeded pre-pandemic levels. Meanwhile, revenue growth in HCI sectors continued to decline.

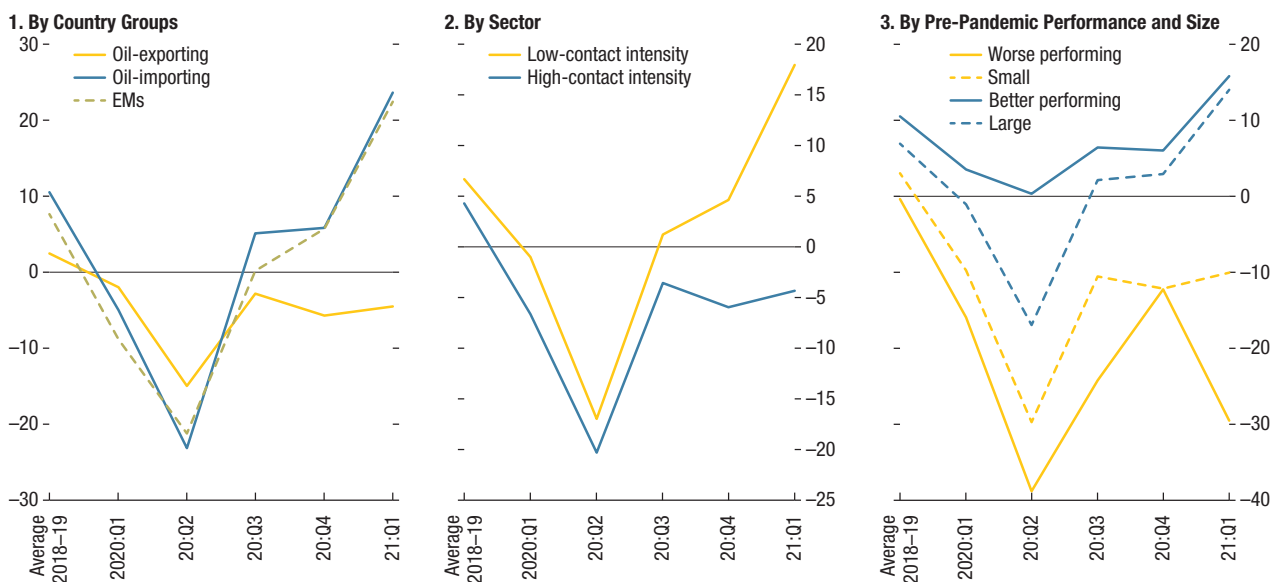
Firms with weaker pre-pandemic fundamentals and small firms were hit harder.

- The performance gap between the pre-pandemic better- and worse-performing firms—ranked by their 2018–19 profitability (top and bottom quartile, respectively)—widened by the end of 2020 (Figure 3.2, panel 3).<sup>3</sup> This is because the worse-performing firms faced plummeting revenues during the first half of 2020, and the median better-performing firm did not see contraction. By the first quarter of 2021, the worse-performing firms continued experiencing a sharp decline (–30 percent year over year), but better-performing firms had recovered strongly (16 percent).
- Revenues of small publicly listed firms contracted almost twice than those of large peers during the first half of 2020.<sup>4</sup> By the first quarter of 2021, they were still contracting (–11 percent year over year), and large firms were recovering strongly (14 percent; Figure 3.2, panel 3).
- Moreover, SMEs in ME&CA (smaller unlisted firms with less than 250 workers) were affected heavily in key job-rich sectors. Their revenue and job losses at the peak of the

<sup>3</sup>Pre-pandemic better-performing firms also entered the crisis with significant liquidity buffers and equity positions.

<sup>4</sup>Small (large) firms, based on the sample of publicly listed firms from Compustat, are defined as those with total assets below (above) the median (country-specific) total assets in 2019.

**Figure 3.2. Revenue Growth Performance across Groups of Firms**  
(Percent, year over year)



Sources: S&P Global Market Intelligence; Compustat; and IMF staff calculations.

Note: High-contact-intensive sectors include services, retail, health, and transportation, while low-contact-intensive ones comprise consumer durables and nondurables, manufacturing, chemicals, business equipment, telecommunication, and utilities. Firms are ranked by their pre-pandemic performance based on their average profitability in 2018–19 (bottom and top quartile of the 2018–19 profitability distribution). EMs = emerging market economies.

pandemic were slightly deeper compared with large firms (Figure 3.3, panels 1 and 2). But their revenue plummeted by 40–45 percent in the service, hospitality, and tourism sectors compared with a contraction of about 10 percent for large firms (Figure 3.3, panel 3). Similarly, the gap in job losses was more pronounced in these sectors, where SMEs' jobs declined by 32 percent compared with 20 percent in large firms. The crisis affected these firms more because they tend to be less diversified, downsizing is more difficult (so they are more vulnerable to a fall in demand), and banks tend to cut lending to them more aggressively in bad times (see Joseph, Kneer, and van Horen 2021).

State-owned enterprises' (SOEs) recovery is falling behind. SOEs entered the crisis in a weaker position (revenue growth of 2.5 percent, about half of the median privately owned firm in MENAP), but their revenues declined by less (–6 percent year over year) than the median

private firm (–19 percent) during the first half of 2020—likely reflecting government support and presence in the utilities sector, which faced a more persistent demand. By the first quarter of 2021, however, SOE revenues were still contracting (–3.5 percent), and those of privately owned firms had recovered strongly (10 percent).

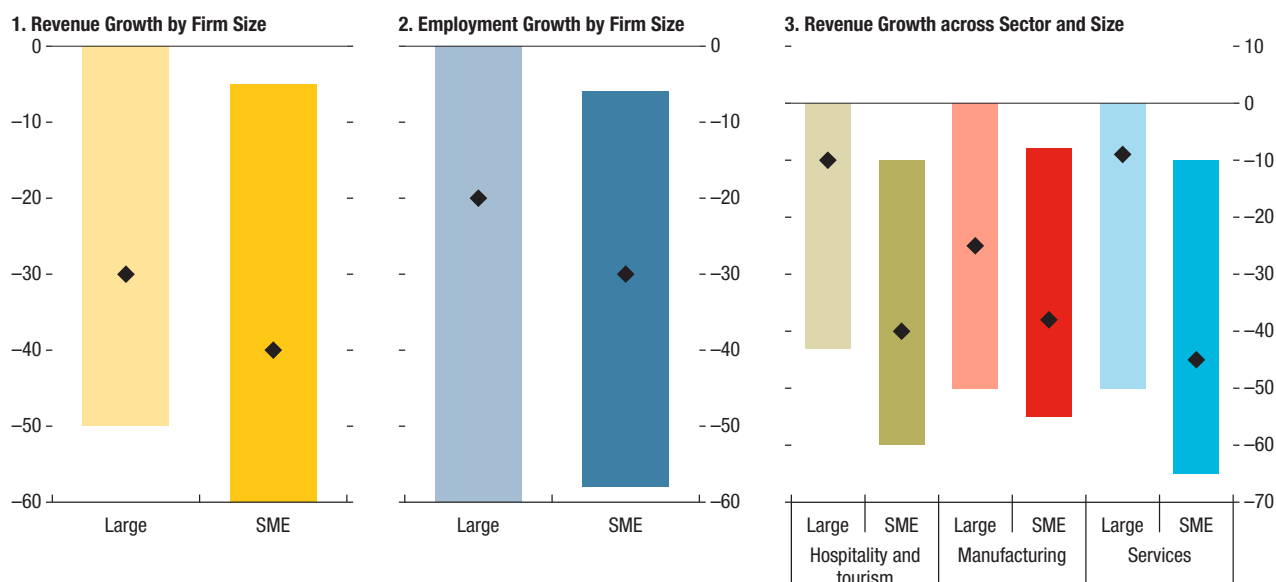
By contrast, firms with digital connectivity were able to partly mitigate the pandemic's impact. A regression analysis suggests that firms in ME&CA that invested in digital technologies before the pandemic experienced a lower decline in sales at the pandemic's peak of about 4 percentage points compared with those that had not (Figure 3.4; see Abidi, El-Herradi, and Sakha (2021) and [Online Annex 3.1](#) for details).

### Policy Support and Cost Adjustments Helped Firms Weather the Shock

Policy support and firms' agility in adjusting their business models and operations in response to



**Figure 3.3. Firm Performance by Size and Sector at the Peak of the Crisis**  
(Percent, year over year)



Sources: Business Environment and Enterprise Performance Survey and the COVID-19 follow-up enterprise surveys; and IMF staff calculations.  
Note: Boxes represent interquartile ranges and markers represent the median. Small and medium enterprises employ fewer than 250 people, while large enterprises employ 250 or more people. Employment growth is computed by taking the percentage difference between the number of full-time employees in 2019 and 2020. Revenue growth is estimated by the reported percentage drop in sales in 2020 compared with 2019. 2020 estimates were based on prevailing conditions at the peak of the pandemic, when most surveys were conducted.

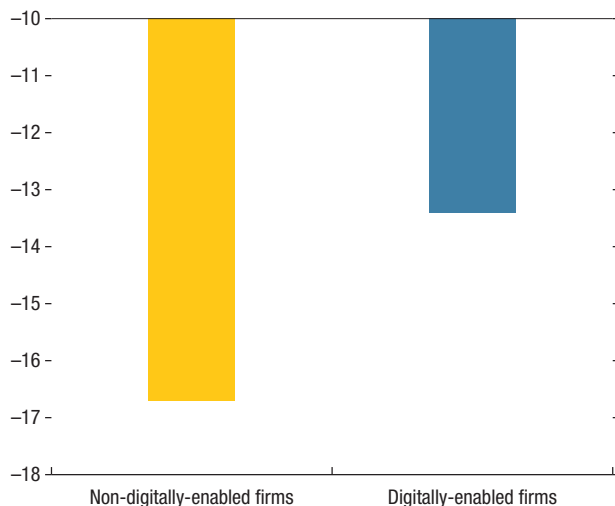
the pandemic were crucial in relieving immediate liquidity pressures, preventing bankruptcies, and facilitating the emerging recovery. Countries across the region deployed an array of fiscal, monetary, and macro-financial measures to support firms. Tax deferrals, furlough programs, and wage subsidies are reported as the most common forms of policy support in the region during the pandemic. Policy rate cuts, liquidity support, and loan guarantee programs helped reduced borrowing costs. Overall, 34 percent of firms in a sample of ME&CA countries indicate that they received at least one type of policy support.<sup>5</sup> However, SMEs had relatively limited access, with 33 percent of them receiving at least one type of policy support compared with 48 percent of large firms (Figure 3.5).

For the median firm in MENAP, financial statements reveal the important contribution of policy support during 2020.

<sup>5</sup>Based on a limited sample of 3,511 reporting firms from BEEPS and ES-COVID-19 Surveys, covering six countries in ME&CA.

- Income tax payments (of taxes accrued from 2019 operations) contracted by 12 percent and effective tax rates declined by 2 percentage points in 2020. The largest drop in tax payments was observed in pre-pandemic worse-performing firms (-24 percent). The decline in effective tax rates was more pronounced in oil importers (-3 percentage points) compared with oil exporters (-0.2 percentage points). However, tax payments and effective tax rates contracted by less than that reported by the median firm in emerging markets (Figure 3.6, panel 1).
- Firms' interest expenses decreased by 10 percent, falling deeper among oil exporters compared with oil importers (-13 percent versus -8 percent, respectively). By comparison, the decline in interest expenses in the typical emerging-market firm was only about 2 percent (Figure 3.6, panel 2).
- Net borrowing during 2020, as a percentage of 2019 assets, increased by

**Figure 3.4. Digitalization and Firm Resilience**  
(Percentage drop in 2020 sales, peak of the pandemic)



Sources: Abidi, El-Herradi, and Sakha (2021, forthcoming); and IMF staff calculations.

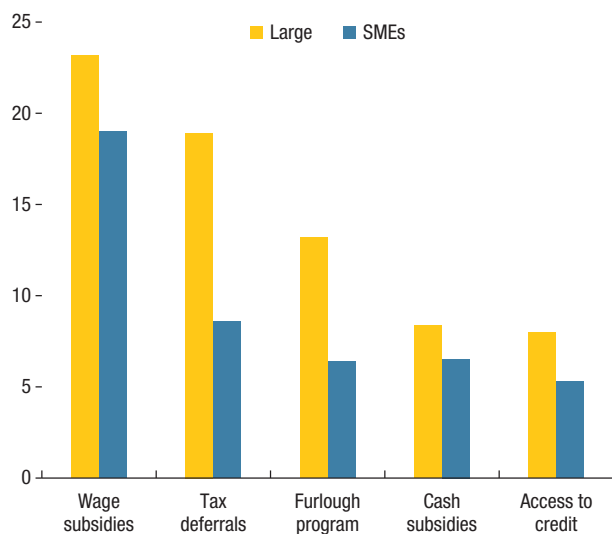
Note: The sample includes Armenia, Azerbaijan, Egypt, Georgia, Jordan, Kazakhstan, Kyrgyz Republic, Lebanon, Morocco, Tajikistan, Tunisia, Uzbekistan, and West Bank and Gaza. The empirical analysis is based on 2019–20 data.

A firm is classified as digitally enabled if it had a website and adopted a foreign technology before the pandemic. A foreign technology is included as a proxy of the quality of digitalization (for example, the existence of a payments system) and firms' commitment to technology adoption (digital diffusion). The digital index used in the regression analysis is built based on principal component analysis. The regression analysis controls for firm-specific variables, including firm age and size.

3 percentage points, slightly lower than the 4-percentage-point increase for the median firm across emerging markets.

Liquidity pressures were also contained through firms' large reduction of production costs and increased use of digital technologies (Figure 3.7). About 35 percent of reporting firms in the Business Environment and Enterprise Performance Surveys and the COVID-19 Follow-Up Enterprise Survey increased or started digital activities, and 30 percent changed their production process in response to the pandemic. By the end of 2020, firms' nonwage outlays were curtailed by 10 percent, and wage bills remained broadly unchanged. The latter, however, concealed marked differences between oil exporters and oil importers—wage bills in the former contracted by 5 percent, but those of the latter increased

**Figure 3.5. SMEs Received Less Policy Support than Large Firms**  
(Percent of SMEs and large firms)



Sources: Business Environment and Enterprise Performance Survey and the COVID-19 follow-up enterprise surveys; and IMF staff calculations.

Note: SMEs are defined as firms with less than 250 employees and large firms with more than 250 employees. Firms are surveyed on whether they have received any of the following mechanisms of support from local or national authorities: deferral of tax payments, access to finance, cash subsidies, wage subsidies, furlough program, fiscal exemptions, and others. We chose the five largest policies. SME = small and medium enterprise.

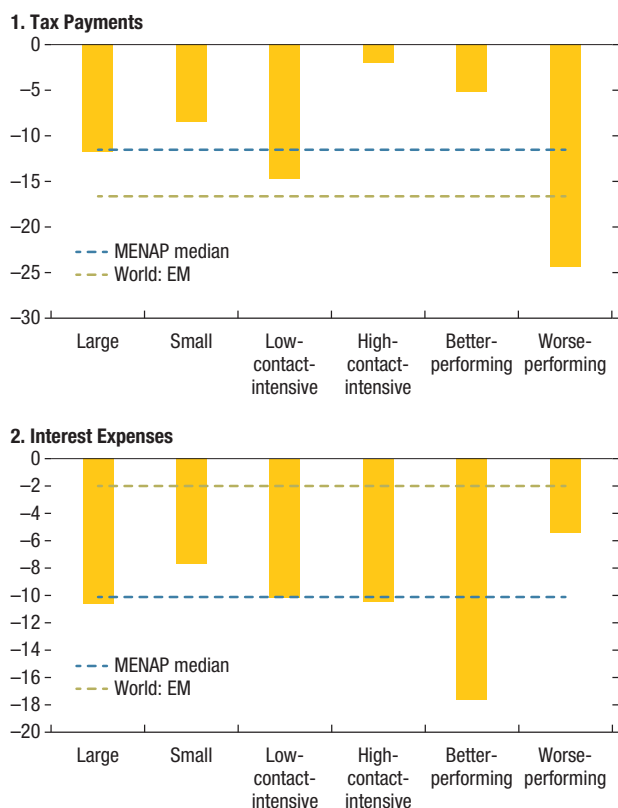
by 3 percent, reflecting the fall of expatriate employment in GCC countries.

### Liquidity and Solvency Concerns Have Risen for a Subset of Firms

COVID-19 has left some firms more vulnerable than others. The pre-pandemic worse-performing firms entered the crisis with impaired debt-service capacity (negative interest-coverage ratio [ICR]) and high debt burden (Figure 3.8, panel 1). Despite reducing their production costs sharply and receiving policy support, “zombification,”<sup>6</sup> liquidity, and solvency risks have risen for these firms. By contrast, pre-pandemic better-performing firms—largely resilient

<sup>6</sup>“Zombification” refers to a state in which a firm's profits become insufficient to cover its cost of capital. Banerjee and Hoffman (2020) define “zombie” firms as those that are unprofitable but remain in the market rather than exiting through takeover or bankruptcy. These firms tend to be smaller, less productive, and more leveraged, and they invest less in physical and intangible capital.

**Figure 3.6. Policy Support Contributed to Soften Liquidity Pressures during 2020**  
(Percentage change, year over year)

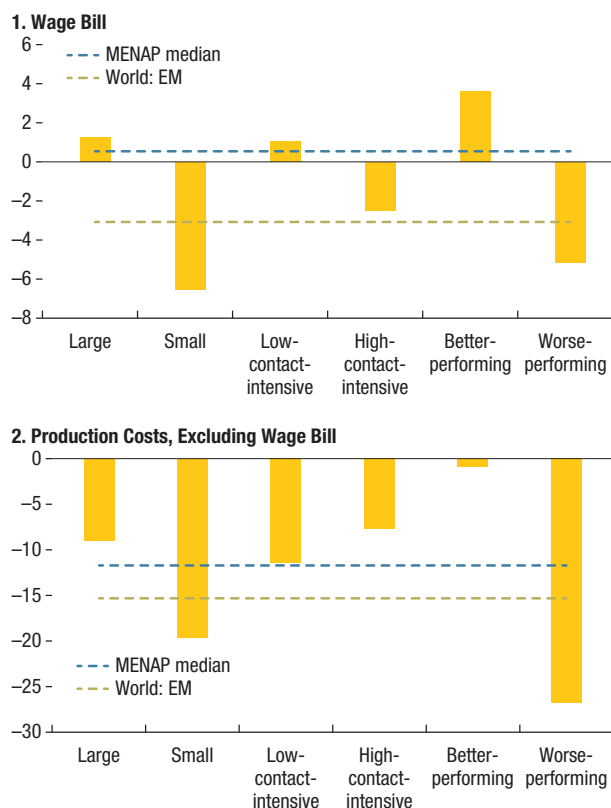


Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations. Note: High-contact-intensive sectors include services, retail, health, and transportation, while low-contact-intensive ones comprise consumer durables and nondurables, manufacturing, chemicals, business equipment, telecommunication, and utilities. Firms are ranked by their pre-pandemic performance based on their average profitability in 2018–19 (bottom and top quartile of the 2018–19 profitability distribution). Small (large) firms are defined as those with total assets below (above) the median country total assets in 2019. Tax payment data comes from the cash-flow statement, and thus reflects tax payment in 2020 from liabilities accrued based on 2019 operations. EM = emerging market economies.

during the pandemic—face low liquidity and solvency pressures.

Firms in HCI sectors were able to adjust their production costs during 2020 but not as much as firms in LCI sectors. These measures were effective in the acute phase of the crisis but addressed only short-term liquidity shortfalls, given the persistent headwinds facing HCI sectors. As a result, leverage—already elevated before the pandemic—has risen markedly (from 51 to 57 percent by the first quarter of 2021; Figure 3.8, panel 2).

**Figure 3.7. Reduction in Production Costs Helped Contain Liquidity Pressures during 2020**  
(Percentage change, year over year)

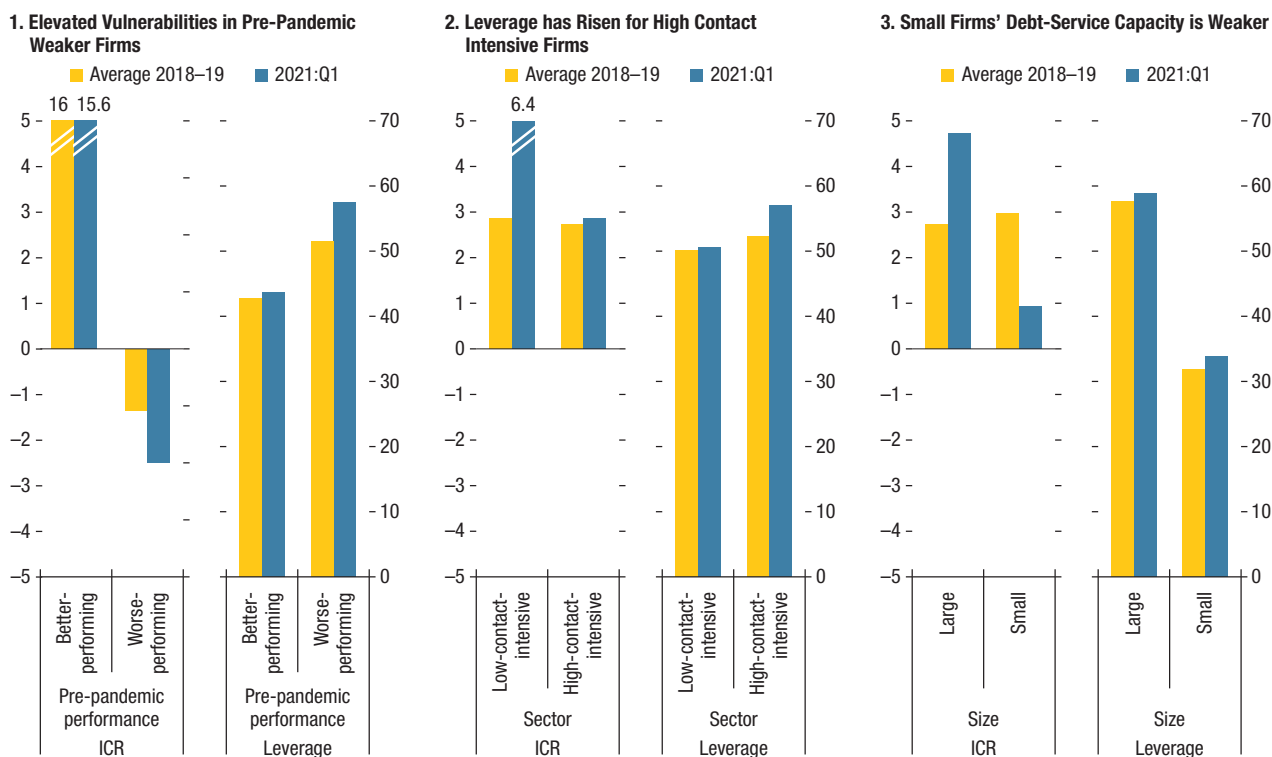


Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations. Note: High-contact-intensive sectors include services, retail, health, and transportation, while low-contact-intensive ones comprise consumer durables and nondurables, manufacturing, chemicals, business equipment, telecommunication, and utilities. Firms are ranked by their pre-pandemic performance based on their average profitability in 2018–19 (bottom and top quartile of the 2018–19 profitability distribution). Small (large) firms are defined as those with total assets below (above) the median country total assets in 2019. EM = emerging market economies.

High-debt accumulation in a period of subdued earnings heightens solvency risks.

Small firms faced the brunt of the pandemic, had lower access to policy support, and are facing a protracted recovery. Their subdued earnings, diminished debt-service capacity, and constrained access to credit could exacerbate liquidity and solvency risks further (Figure 3.8, panel 3).

**Figure 3.8. Pockets of Vulnerabilities across Groups of Firms**  
(Percent)



Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations.

Note: Pre-pandemic performance (worst- and best-performing firms) are computed based on the bottom and top quartile of the 2018–19 profitability distribution. High-contact-intensive sectors include services, retail, health, and transportation, while low-contact-intensive ones comprise consumer durables and nondurables, manufacturing, chemicals, business equipment, telecommunication, and utilities. Small (large) firms are defined as those with total assets below (above) the median country total assets in 2019. ICR = interest-coverage ratio, earnings before interest and tax over interest expense; leverage = total debt as a share of assets.

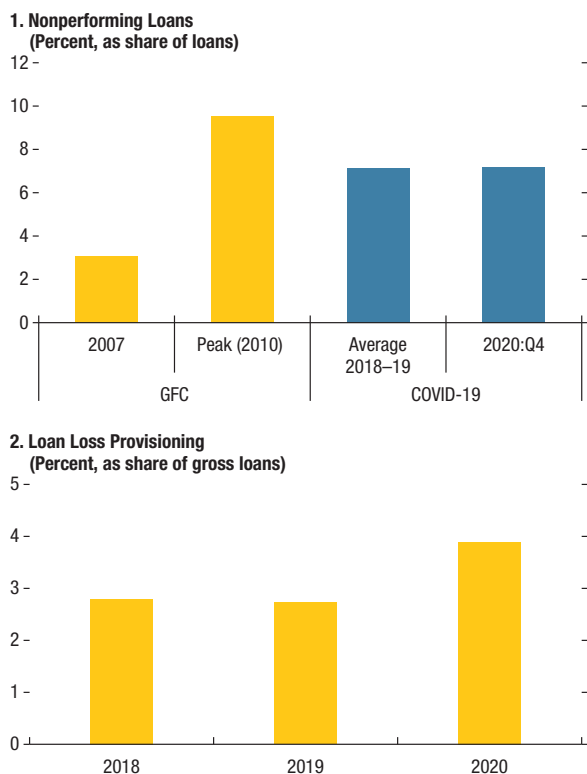
## The Region's Banking Systems Have Been Resilient but Risks Are Building Up Unevenly

Macro-financial policy and liquidity support have enabled banking systems in ME&CA to withstand the pandemic shock so far. Swift support—including measures to ease the burden of debt service and those allowing banks to sustain pressures through the release of macroprudential buffers and the modification of loan classification criteria (to pause or delay recognition of nonperforming loans [NPLs])—has protected financial stability so far. NPLs have remained broadly stable, averaging about 7½ percent of total loans. This contrasts with the dynamics observed in previous crises, including the global financial crisis, when NPLs rose rapidly (Figure 3.9, panel

1). However, loan-loss provisioning in 2020 was higher than in 2019, partly because of regulatory requirements, suggesting that banks perceive risks ahead and are building buffers against a potential deterioration in asset quality when policy support is withdrawn (Figure 3.9, panel 2).

Notwithstanding this resilience so far, risks to financial stability are building up unevenly, arising from pre-pandemic vulnerabilities, exposure to the corporate sector (particularly to the hard-hit HCI sectors), and easing of policies that have delayed NPL recognition. Banks with higher exposure to the corporate sector entered the crisis with higher NPLs, and lower capital adequacy and liquidity ratios, with these buffers deteriorating slightly in 2020; thus, they could be more susceptible to risk though mitigated by higher provisioning relative

**Figure 3.9. Recent Trends in Nonperforming Loans and Loan Loss Provisioning**



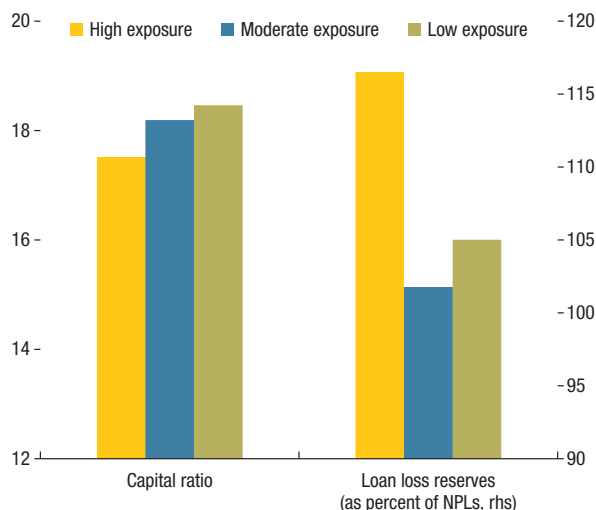
Sources: National authorities; and IMF staff calculations.  
Note: GFC = global financial crisis.

to NPLs (Figure 3.10). In addition, banking systems more exposed to HCI sectors have seen an increase in NPLs during the pandemic, reflecting the weaker performance of firms in these sectors. This exposure is highest in the GCC, but risk is tilted disproportionately toward low-income countries, which entered the pandemic with high NPLs and limited fiscal and external buffers amid a significant exposure to HCI sectors.

## Corporate Outlook amid Elevated Uncertainty

The region’s firms may have averted the worst, but a protracted health crisis and limited policy space may exacerbate liquidity and solvency risks, with spillover effects to the financial sector. Despite current favorable financing conditions, the pandemic has left a legacy of impaired

**Figure 3.10. Capital Buffers and Provisioning by Level of Corporate Exposure**  
(Percent)



Source: S&P Global Market Intelligence; Compustat; and IMF staff calculations.  
Note: NPL = nonperforming loan; rhs = right-hand scale.

debt-service capacity and exacerbated debt overhang in an important subset of firms, which—if unaddressed—could prompt financial stability risks and a prolonged period of weak economic performance. Subdued earnings and a premature and generalized withdrawal of policy support can increase vulnerable firms’ liquidity and solvency stress, potentially triggering a wave of bankruptcies in the region. In this context, it is critical to assess the near- and medium-term liquidity and solvency stress and the extent of viability and “zombification” in the region’s corporate sector.

Using stress-testing tools adapted to the region’s context, this section presents projections of firms’ liquidity, solvency, and viability indicators over 2021–23 based on real GDP growth and policy support scenarios.<sup>7</sup> The analysis estimates panel

<sup>7</sup>The stress-testing tools were developed in the context of the IMF’s *Global Financial Stability Report* and by Tressel and Ding (2021). This section uses two scenarios: (i) a baseline scenario, in which real GDP grows as forecast in the IMF’s *World Economic Outlook* with no change in policy support to firms relative to 2020; and (ii) an adverse scenario, in which real GDP growth would be one standard deviation (of the growth distribution) below *World Economic Outlook* projections, and policy support is withdrawn symmetrically across firms (for simplification) starting from 2022 through an assumed rise in firms’ effective interest rates by 200

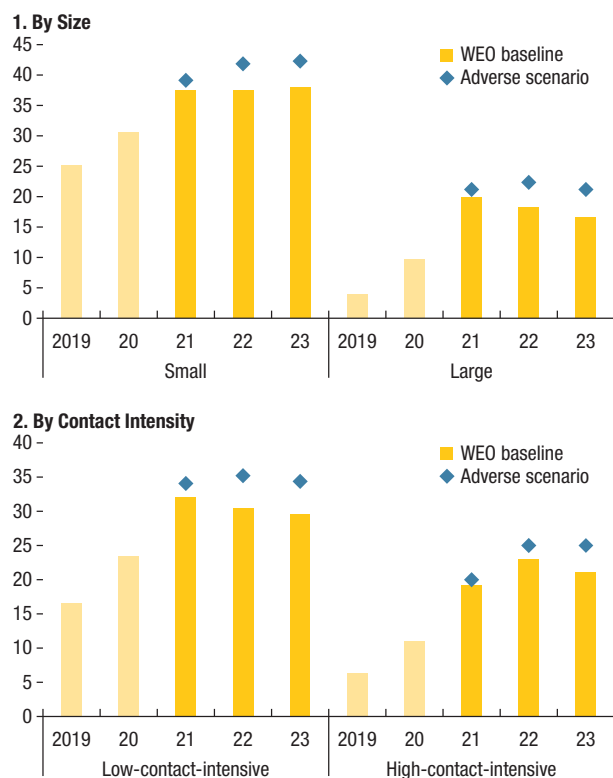
data regressions based on a sample of publicly listed firms from MENAP and relies on indicators used in the assessment of corporate vulnerabilities (cash balances, ICR, and equity) to gauge the extent of liquidity and solvency risks (see [Online Annex 3.2](#) for details).<sup>8</sup> These indicators are used to construct two metrics: “firm at risk” and “debt at risk.” High firm at risk suggests pervasive liquidity and solvency vulnerabilities. High debt at risk indicates that a large share of corporate debt is at risk of default if liquidity and solvency risks materialize.

### Liquidity Stress Is Projected to Remain Elevated for Small Firms

Small firms’ liquidity stress—measured as projected negative cash balances—would remain substantially high over the medium term and could be exacerbated further in an adverse scenario in which economic growth is subdued and policy support withdrawn. About 38 and 42 percent of small firms would face cash shortages and would have to borrow under the baseline and adverse scenarios, respectively, compared with 25 percent pre-pandemic (Figure 3.11, panel 1). This would put nearly 31 (baseline) and 37 (adverse scenario) percent of small firms’ debt at risk of default by 2023 if liquidity risks materialize (Figure 3.12, panel 1). By contrast, large firms’ liquidity prospects are more comfortable relative to small firms, reflecting stronger pre-pandemic cash positions.

Although liquidity needs are projected to remain above pre-pandemic levels across LCI and HCI sectors (Figure 3.11, panel 2), reflecting the pandemic’s heavy toll on contact-sensitive activities, the share of HCI firms facing liquidity needs would rise more than threefold (fourfold) to 21 percent (25 percent) by 2023 from a low

**Figure 3.11. Firm at Risk: Share of Firms Facing Liquidity Needs (with Cash Balances below Zero) (Percent)**



Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations. Note: Small (large) firms are defined as those with total assets below (above) the median country total assets in 2019. High-contact-intensive sectors include services, retail, health, and transportation, while low-contact-intensive ones comprise consumer durables and nondurables, manufacturing, chemicals, business equipment, telecommunication, and utilities. WEO = World Economic Outlook.

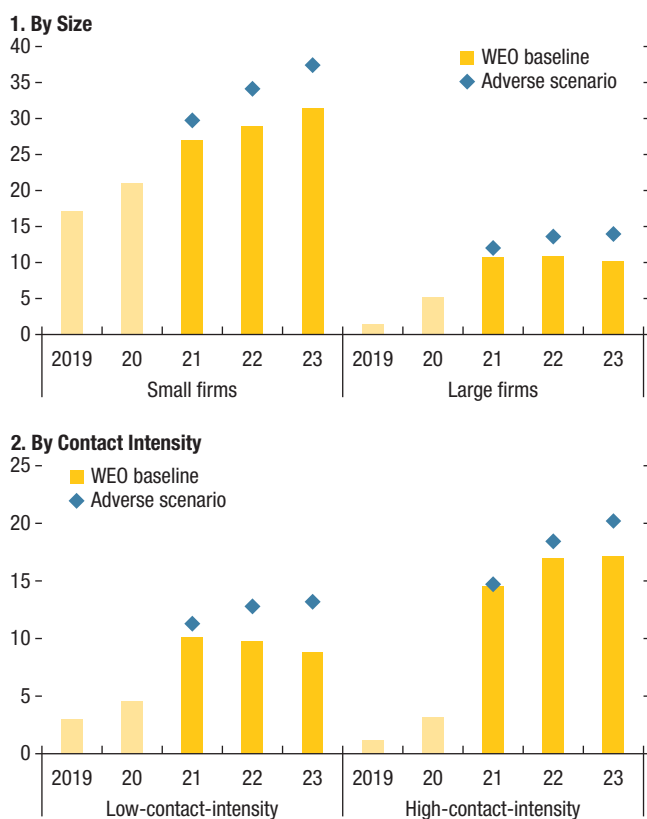
pre-pandemic level of 6 percent under the baseline (adverse) scenario. This would lead to a sharp rise in HCI sectors’ debt at risk of up to 20 percent of their overall debt (Figure 3.12, panel 2). In LCI sectors, the share of firms at risk of illiquidity would increase twofold over the medium term, from 17 to between 30 and 34 percent under the baseline and adverse scenarios, respectively. Although firm at risk would be higher in LCI sectors, debt at risk would be larger in HCI sectors (17–20 percent versus 9–13 percent in LCI sectors), reflecting the rapid rise in liquidity needs and borrowing of some HCI firms hit hard by the pandemic shock.

basis points (relative to 2020 rates) and in effective tax rates to their 2019 levels.

<sup>8</sup>The sample of publicly listed firms from MENAP includes oil exporters (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates) and oil importers (Egypt, Jordan, Morocco, Pakistan, Tunisia). CCA countries are excluded, given their limited data in Compustat.



**Figure 3.12. Debt at Risk: Share of Debt Held by Firms Facing Liquidity Problems**  
(Percent of total debt)



Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations.  
Note: Small (large) firms are defined as those with total assets below (above) the median country total assets in 2019. High-contact-intensive sectors include services, retail, health, and transportation, while low-contact-intensive ones comprise consumer durables and nondurables, manufacturing, chemicals, business equipment, telecommunication, and utilities. WEO = World Economic Outlook.

## But Solvency Concerns Remain Restrained

Small firms' insolvency risk would be only exacerbated under adverse conditions. The share of insolvent small firms (those with negative equity) would rise from 7 percent pre-pandemic to 8 and 11 percent in 2023 under the baseline and adverse scenarios, respectively (Figure 3.13, panel 1). The share of large firms with negative equity, which was already smaller before the pandemic, is projected to remain low and stable over the medium term, reflecting stronger pre-pandemic

equity positions and capacity to generate profits compared with small firms.

Firms' equity positions across contact-intensive sectors would be resilient over the medium term (Figure 3.13, panel 2). After a sharp increase in 2020, the share of insolvent firms in HCI sectors would decline to pre-pandemic levels in the baseline scenario. Under adverse conditions, such a share would remain slightly above pre-pandemic levels across sectors, reflecting the additional hit on profitability. Some firms would continue to accumulate losses to the point of eroding their equity and falling into insolvency.

## Restructuring, Liquidation Concerns Emerge

Policymakers face the dilemma of identifying firms that should rely on market funding, receive government support, or be restructured or liquidated. To inform such an assessment, this section performs a triage of firms based on their viability.<sup>9</sup> A viable firm is one with the capacity to generate earnings before interest and taxes that more than cover its interest expenses (ICR above 1) under "normal economic conditions."<sup>10</sup> Firms are classified into three groups: (1) "sound" firms are those with pre- and post-pandemic ICR above 1, (2) "viable" firms are those that had an ICR above 1, but have become distressed post-pandemic (ICR below 1), and (3) "zombie firms" are those with impaired pre- and post-pandemic debt-service capacity (ICR below 1).<sup>11</sup>

<sup>9</sup>This chapter adopts a definition of viability consistent with the IMF's April 2021 *Global Financial Stability Report*, Tressel and Ding (2021), and Banerjee and Hoffman (2020).

<sup>10</sup>The viability assessment relies on the assumption that once the pandemic recedes, economic activity and structures will return to their pre-pandemic state—in other words, there will be no structural changes that would make otherwise profitable firms unprofitable permanently.

<sup>11</sup>Recent studies (Hong, Igan, and Lee 2021) define zombies as firms with an ICR below 1 and above a certain age to ensure that start-ups, which are yet to generate profits, are not classified as zombies. The present analysis uses the ICR only to identify zombies because it is based on a sample of publicly listed firms, which have typically been operating for several years.

Many firms are sound, accounting for 85 percent of firms both in oil-importing and oil-exporting countries in the baseline scenario (about 10 percentage points less under adverse conditions; Figure 3.14, panel 1). This implies that, at worst, 75 and 86 percent of corporate debt would be safe (low credit risk) in both country groups, respectively (Figure 3.14, panel 2).

Nevertheless, 15 percent of firms (up to 25 percent under adverse conditions) would require to be either restructured or liquidated in both country groups.

- Viable firms that may need debt restructuring represent 9 and 6 percent of firms in oil-importing and oil-exporting countries, respectively, in the baseline scenario (14 and 13 percent, respectively, under the adverse scenario). At worst, this would imply that 17 and 10 percent of corporate debt in oil importers and exporters, respectively, would need restructuring.
- A notable share of firms assessed as zombies might need liquidation if other corporate strategic and social objectives are not considered. This represents 6 and 9 percent of firms in oil-importing and oil-exporting countries, respectively, in the baseline scenario (9 and 12 percent, respectively, under the adverse scenario).<sup>12</sup>

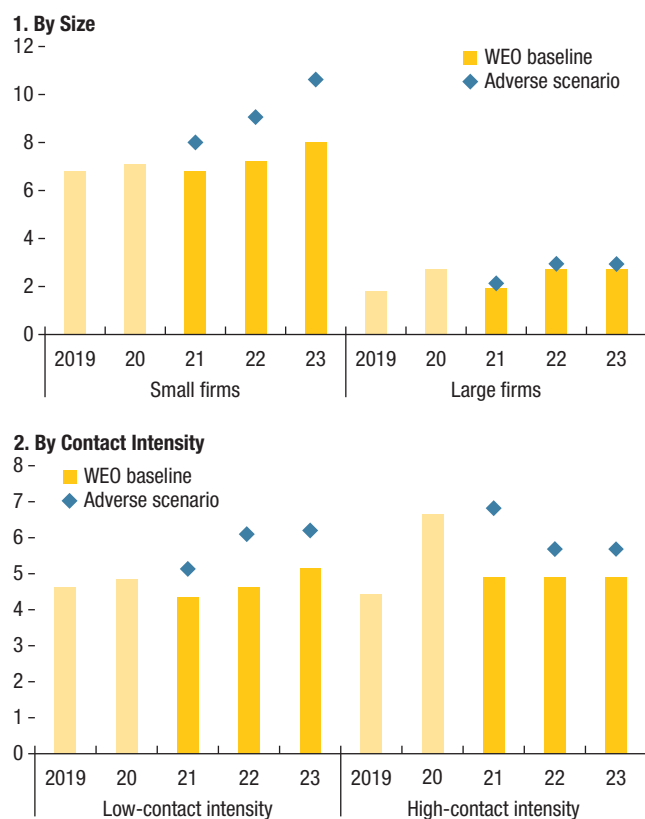
## Policy Actions for the Recovery and Beyond

Corporate vulnerabilities have receded on the aggregate, but heightened risks in some groups of firms call for a well-designed and targeted policy package to avert the materialization of these risks, which would deepen scarring from the crisis.

Policymakers should remain nimble and cautious about withdrawing policy support for vulnerable

<sup>12</sup>These are comparable to the shares of zombie firms in advanced economies and emerging markets reported by Tressel and Ding (2021): 12–13 percent and 9–11 percent, respectively. They also report comparable shares of debt to be liquidated at about 5–8 percent in advanced economies and 5–6 percent in emerging markets.

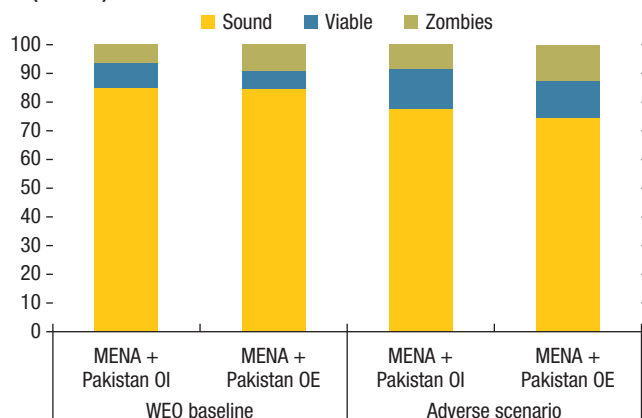
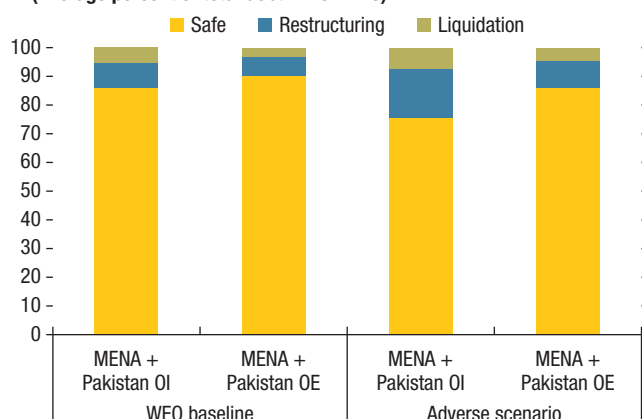
**Figure 3.13. Firm at Risk: Share of Firms Facing Solvency Problems (with Equity below Zero) (Percent)**



Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations. Note: Small (large) firms are defined as those with total assets below (above) the median country total assets in 2019. High-contact-intensive sectors include services, retail, health, and transportation, while low-contact-intensive ones comprise consumer durables and nondurables, manufacturing, chemicals, business equipment, telecommunication, and utilities. WEO = World Economic Outlook.

but viable firms prematurely, given the uncertainty about the pandemic's path and heightened liquidity risks (Chapter 1). Measures should be targeted progressively to those in need—distressed but viable firms—such as small firms and those in HCI sectors.

In the medium term, policies should shift toward fostering resource reallocation to viable firms and enabling a resilient recovery. Large firms in countries with well-functioning capital markets should be encouraged to raise equity to strengthen their balance sheets. Insolvent but viable small and medium firms, as first resort, should rely on

**Figure 3.14. Assessing Firm's Viability**
**1. Triage of Firms: Average Share in 2022–23 (Percent)**

**2. Composition of Debt (Average percent of total debt in 2022–23)**


Sources: S&P Global Market Intelligence, Compustat; and IMF staff calculations.  
 Note: MENA + Pakistan OE = Middle East, North Africa, and Pakistan oil exporters;  
 MENA + Pakistan OI = Middle East, North Africa, and Pakistan oil importers; WEO = World Economic Outlook.

their owners and shareholders for recapitalization. If they are unable to raise capital, government support might be required. Equity injections could be used for restructuring because they can flatten the insolvency curve, provide much-needed liquidity, and at the same time mitigate the debt overhang problem. Where available, sovereign wealth funds could be the vehicle through which authorities inject equity into firms if such support is extended with appropriate safeguards that ensure transparency, accountability, and good governance to prevent the misuse of public resources (April 2020 *Fiscal Monitor*). In countries with limited

or no fiscal space, governments could consider measures with lower fiscal costs (for example, the conversion of guaranteed debt into equity).

Some countries in the region have improved their insolvency frameworks (for example, United Arab Emirates), but policymakers need to make further efforts to strengthen such frameworks to facilitate the restructuring of viable but distressed firms and liquidation of non-viable firms. Reforms are needed to simplify procedures, increase the expertise and capacity of courts and insolvency administrators, and improve reorganization proceedings, by providing incentives for investors to supply capital to distressed firms, enabling out-of-court agreements between insolvent debtors and creditors (Demmou and others 2021), and introducing restructuring mechanisms with limited court intervention (for example, hybrid restructurings as implemented successfully in Georgia; Liu, Garrido, and DeLong 2020). Restructuring mechanisms designed for SMEs can help improve their survival rate and returns to creditors (Diez and others 2021). Reforms are needed to simplify procedural complexities and court proceedings for micro and small enterprises (World Bank Group 2018; UNCITRAL 2021).

SOEs' continued underperformance reinforces the need for reforms in governance and fiscal risk management, focused on improving SOE performance and reporting, and government oversight and assessment of fiscal risks (for example, as deployed successfully in Morocco; IMF 2021). Leveling the playing field between SOEs and private firms—including through restructuring, reorganization, and liquidation of SOEs—can help boost competition and bolster productivity.

Accelerating firms' digital connectivity not only increases resilience against future shocks but can also raise productivity and competitiveness (Sorbe and others 2019). High-speed broadband networks, reduced barriers to market entry and digital trade, financing for innovative start-ups, and strengthened electronic payment systems are all important factors that would help enhance productivity. Improving digital financial services

and investment in fintech can also help efforts in the region to enhance financial inclusion, especially for those with larger barriers to access to credit, such as SMEs (IMF 2019).

Once eased macroprudential buffers and loan classification rules are withdrawn, a delayed rise in NPLs will likely occur. If left unaddressed, it could endanger financial stability and, in some cases, require fiscal resources for recapitalization, thus strengthening the sovereign-bank nexus

further. Authorities should closely monitor these risks, follow a properly calibrated withdrawal of policy support, and encourage vulnerable banks to use the period of respite afforded by policy support to strengthen buffers against upcoming risks. In the medium term, efforts should also be directed toward the development of capital markets and distressed debt markets to help viable firms strengthen their balance sheets further and facilitate corporate sector restructuring through market mechanisms.

## References

- Abidi, Nordine, Mehdi El-Herradi, and Sahra Sakha. 2021. “Digitalization and Resilience: Firm-level Evidence During the COVID-19.” IMF Working Paper, forthcoming.
- Banerjee, Ryan, and Boris Hofmann. 2020. “Corporate Zombies: Anatomy and Life Cycle.” BIS Working Paper 882, Bank for International Settlements, Basel, Switzerland.
- Demmou, Lilas, Sara Calligaris, Guido Franco, Dennis Dlugosch, Müge Adalet McGowan, and Sahra Sakha. 2021. “Insolvency and Debt Overhang Following the COVID-19 Outbreak: Assessment of Risks and Policy Responses.” OECD Economics Department Working Paper 1651, Organisation for Economic Co-operation and Development, Paris.
- Díez, Federico J., Romain Duval, Jiayue Fan, José Garrido, Sebnem Kalemli-Özcan, Chiara Maggi, Soledad Martinez-Peria, and Nicola Pierri. 2021. “Insolvency Prospects among Small and Medium Enterprises in Advanced Economies: Assessment and Policy Options.” IMF Staff Discussion Note 2021/002, International Monetary Fund, Washington, DC.
- Hong, Gee Hee, Deniz Igan, and Do Lee. 2021. “Zombies on the Brink: Evidence from Japan on the Reversal of Monetary Policy Effectiveness.” IMF Working Paper 21/44, International Monetary Fund, Washington, DC.
- IMF (International Monetary Fund). 2019. “Financial Inclusion of Small and Medium-Sized Enterprises in the Middle East and Central Asia.” IMF Departmental Paper 19/02, International Monetary Fund, Washington, DC.
- IMF (International Monetary Fund). 2021. “State Owned Enterprises in Middle East, North Africa, and Central Asia: Size, Costs, and Challenges.” IMF Departmental Paper 21/019, International Monetary Fund, Washington, DC.
- Joseph, Andreas, Christiane Kneer, and Neeltje van Horen. 2021. “All You Need Is Cash: Corporate Cash Holdings and Investment after the Global Financial Crisis.” CESifo Working Paper 9053, Center for Economic Studies and the ifo Institute, Munich.
- Liu, Yan, José Garrido, and Chanda DeLong. 2020. “Private Debt Resolution Measures in the Wake of the Pandemic.” Special Series on COVID-19 (May 27), International Monetary Fund, Washington, DC.
- Sorbe, Stephane, Peter Gal, Guiseppa Nicoletti, and Christina Timiliotis. 2019. Digital Dividend: Policies to Harness the Productivity Potential of Digital Technologies. OECD Economic Policy Paper 26, OECD Publishing, Paris.
- Tressel, Thierry, and Xiaodan Ding. 2021. “Global Corporate Stress Tests—Impact of the COVID-19 Pandemic and Policy Responses.” IMF Working Paper 2021/212, International Monetary Fund, Washington, DC.
- UNCITRAL (United Nations Commission on International Trade Law). 2021. “Draft Text for a Simplified Insolvency Regime: Note by the Secretariat.” Working Group V, 58th Session (May 3–7), United Nations Commission on International Trade Law, New York. <https://undocs.org/en/A/CN.9/WG.V/WRP.172>.
- World Bank Group. 2018. *Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency*. Washington, DC: World Bank Group.

**MENA, Afghanistan, and Pakistan: Selected Economic Indicators, 2000–22***(Percent of GDP, unless otherwise indicated)*

	Average 2000–17	2018	2019	2020	Projections	
					2021	2022
<b>MENA<sup>1</sup></b>						
Real GDP (annual growth)	4.5	1.4	1.0	-3.2	4.1	4.1
<i>of which non-oil growth</i>	5.5	2.6	2.9	-2.9	3.6	3.6
Current account balance	7.4	3.8	1.2	-2.4	2.1	2.2
Overall fiscal balance	1.8	-2.1	-3.2	-8.3	-4.5	-3.9
Inflation (year average; percent)	7.1	9.7	6.8	10.4	12.9	8.8
<b>MENA oil exporters</b>						
Real GDP (annual growth)	4.6	0.6	0.1	-4.3	4.6	4.0
<i>of which non-oil growth</i>	5.8	2.1	2.7	-3.9	3.8	3.3
Current account balance	10.1	6.3	3.1	-1.8	3.7	3.7
Overall fiscal balance	3.6	-0.9	-2.3	-8.6	-3.9	-3.3
Inflation (year average; percent)	6.6	8.0	5.6	8.4	11.2	8.4
<b>MENA oil exporters excl. conflict countries and Iran</b>						
Real GDP (annual growth)	4.9	2.2	1.5	-5.9	2.7	4.6
<i>of which non-oil growth</i>	6.4	3.4	3.3	-5.6	4.2	3.7
Current account balance	11.9	6.6	3.9	-2.5	4.9	5.1
Overall fiscal balance	5.3	-1.0	-1.9	-9.5	-2.7	-1.4
Inflation (year average; percent)	3.2	2.2	-0.9	1.3	3.7	3.3
<b>Of which: Gulf Cooperation Council (GCC)</b>						
Real GDP (annual growth)	4.4	2.0	1.0	-4.8	2.5	4.2
<i>of which non-oil growth</i>	6.2	1.7	2.7	-3.9	3.8	3.4
Current account balance	13.6	8.6	5.8	-0.4	6.0	6.3
Overall fiscal balance	6.8	-1.5	-1.5	-8.8	-1.8	-0.4
Inflation (year average; percent)	2.6	2.2	-1.5	1.2	2.8	2.4
<b>MENA oil importers<sup>1</sup></b>						
Real GDP (annual growth)	4.1	3.5	3.3	-0.6	3.0	4.3
Current account balance	-3.9	-7.5	-6.7	-4.7	-5.1	-4.5
Overall fiscal balance	-6.6	-7.3	-6.9	-7.1	-7.0	-6.4
Inflation (year average; percent)	8.2	14.3	9.8	15.2	17.1	9.8
<b>MENAP<sup>1,2</sup></b>						
Real GDP (annual growth)	4.5	1.9	1.2	-2.9	4.1	4.1
<i>of which non-oil growth</i>	5.4	2.9	2.8	-2.6	3.6	3.6
Current account balance	6.8	2.9	0.8	-2.3	1.9	1.8
Overall fiscal balance	1.3	-2.4	-3.6	-8.2	-4.7	-4.1
Inflation (year average; percent)	7.1	8.9	6.7	10.4	12.4	8.8
<b>MENAP oil importers<sup>1,2</sup></b>						
Real GDP (annual growth)	4.2	4.1	2.9	-0.6	3.3	4.2
Current account balance	-2.8	-6.6	-5.8	-3.5	-3.8	-4.1
Overall fiscal balance	-5.9	-6.8	-7.4	-7.3	-7.0	-6.4
Inflation (year average; percent)	8.1	10.4	8.6	13.5	14.3	9.4
<b>Arab World<sup>1</sup></b>						
Real GDP (annual growth)	4.6	2.8	2.3	-4.5	4.4	4.5
<i>of which non-oil growth</i>	5.7	3.5	3.2	-3.9	3.8	3.9
Current account balance	8.1	3.5	1.3	-3.2	2.5	2.7
Overall fiscal balance	2.6	-2.1	-2.8	-9.2	-3.7	-2.6
Inflation (year average; percent)	...	...	...	...	...	...

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

<sup>1</sup>2011–22 data exclude Syrian Arab Republic.<sup>2</sup>2021–22 data exclude Afghanistan.

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

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

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

MENA oil exporters, excl. conflict countries and Iran: Algeria, Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

GCC countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

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

MENAP: MENA, Afghanistan, and Pakistan.

MENAP oil importers: MENA oil importers, Afghanistan, and Pakistan.

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



**CCA Region: Selected Economic Indicators, 2000–22***(Percent of GDP, unless otherwise indicated)*

	Average 2000–17	2018	2019	2020	Projections	
					2021	2022
<b>CCA</b>						
Real GDP (annual growth)	7.0	3.9	3.8	–2.2	4.3	4.1
Current account balance	0.0	0.2	–2.3	–3.4	–0.9	–1.4
Overall fiscal balance	1.4	2.0	0.6	–5.4	–2.8	–1.5
Inflation (year average; percent)	9.1	8.0	6.7	7.5	8.5	7.5
<b>CCA oil and gas exporters</b>						
Real GDP (annual growth)	7.1	3.8	3.4	–1.8	4.1	3.9
<i>of which non-oil growth<sup>1</sup></i>	7.4	3.1	3.6	–2.1	4.0	4.1
Current account balance	1.1	1.3	–1.7	–3.4	–0.3	–0.9
Overall fiscal balance	2.0	2.5	0.9	–5.3	–2.5	–1.3
Inflation (year average; percent)	9.5	8.9	7.1	7.8	8.4	7.8
<b>CCA oil and gas importers</b>						
Real GDP (annual growth)	6.0	5.1	6.1	–4.7	5.7	5.2
Current account balance	–8.6	–7.5	–6.7	–4.0	–5.5	–5.6
Overall fiscal balance	–2.4	–1.4	–1.3	–6.2	–4.7	–3.2
Inflation (year average; percent)	6.5	2.6	3.8	5.2	9.1	6.2

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

<sup>1</sup>Azerbaijan, Kazakhstan, and Turkmenistan. Uzbekistan data for non-oil GDP is not available.

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

CCA oil and gas importers: Armenia, Georgia, the Kyrgyz Republic, and Tajikistan.

**ME&CA: Selected Economic Indicators, 2000–22**  
(Percent of GDP, unless otherwise indicated)

	Average 2000–17	2018	2019	2020	Projections	
					2021	2022
<b>ME&amp;CA<sup>1,2</sup></b>						
Real GDP (annual growth)	4.7	2.2	1.5	-2.8	4.1	4.1
<i>of which non-oil growth</i>	5.5	3.0	2.9	-2.6	3.7	3.7
Current Account Balance	6.3	2.7	0.5	-2.4	1.7	1.5
Overall Fiscal Balance	1.4	-2.0	-3.2	-8.0	-4.5	-3.8
Inflation (year average; percent)	7.2	8.8	6.7	10.0	11.9	8.6
<b>ME&amp;CA oil exporters</b>						
Real GDP (annual growth)	4.9	0.9	0.4	-4.1	4.5	4.0
<i>of which non-oil growth</i>	6.0	2.3	2.8	-3.6	3.9	3.4
Current Account Balance	9.5	6.0	2.8	-1.9	3.6	3.5
Overall Fiscal Balance	3.7	-0.5	-2.0	-8.3	-3.8	-3.1
Inflation (year average; percent)	6.7	7.6	5.4	8.0	10.5	8.0
<b>ME&amp;CA Emerging Market and Middle-Income Countries<sup>1</sup></b>						
Real GDP (annual growth)	4.3	4.6	3.3	-0.6	3.6	4.2
<i>of which non-oil growth</i>	4.5	4.7	3.4	-0.5	3.6	4.3
Current Account Balance	-3.2	-6.8	-5.8	-3.4	-3.5	-3.9
Overall Fiscal Balance	-6.0	-6.9	-7.3	-7.6	-7.2	-6.5
Inflation (year average; percent)	7.4	7.8	6.6	8.0	8.2	7.7
<b>ME&amp;CA Low-Income Developing Countries<sup>2</sup></b>						
Real GDP (annual growth)	4.5	2.1	3.0	-1.5	3.4	4.4
<i>of which non-oil growth</i>	2.6	-0.6	0.2	-5.0	0.6	3.3
Current Account Balance	1.7	-5.4	-5.6	-5.0	-7.4	-7.4
Overall Fiscal Balance	-2.2	-2.1	-3.1	-3.5	-3.3	-2.9
Inflation (year average; percent)	12.9	24.9	19.5	39.1	49.2	19.7

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

<sup>1</sup>2011–22 data exclude Syrian Arab Republic.

<sup>2</sup>2021–22 data exclude Afghanistan.

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

The 32 ME&CA countries and territories are divided into three (nonoverlapping) groups, based on export earnings and level of development: (1) Oil Exporters (ME&CA OE), (2) Emerging Market and Middle-Income Countries (ME&CA EM&MI); and (3) Low-Income Developing Countries (ME&CA LIC).

ME&CA OE include Algeria, Azerbaijan, Bahrain, Iran, Iraq, Kazakhstan, Kuwait, Libya, Oman, Qatar, Saudi Arabia, Turkmenistan, and United Arab Emirates.

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

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

