MIDDLE EAST
AND CENTRAL ASIA
DEPARTMENT

Riding the Waves: Building Resilience in an Era of High Uncertainty

Chapter 2, May 2025 Regional Economic Outlook for the Middle East and Central Asia

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Outline

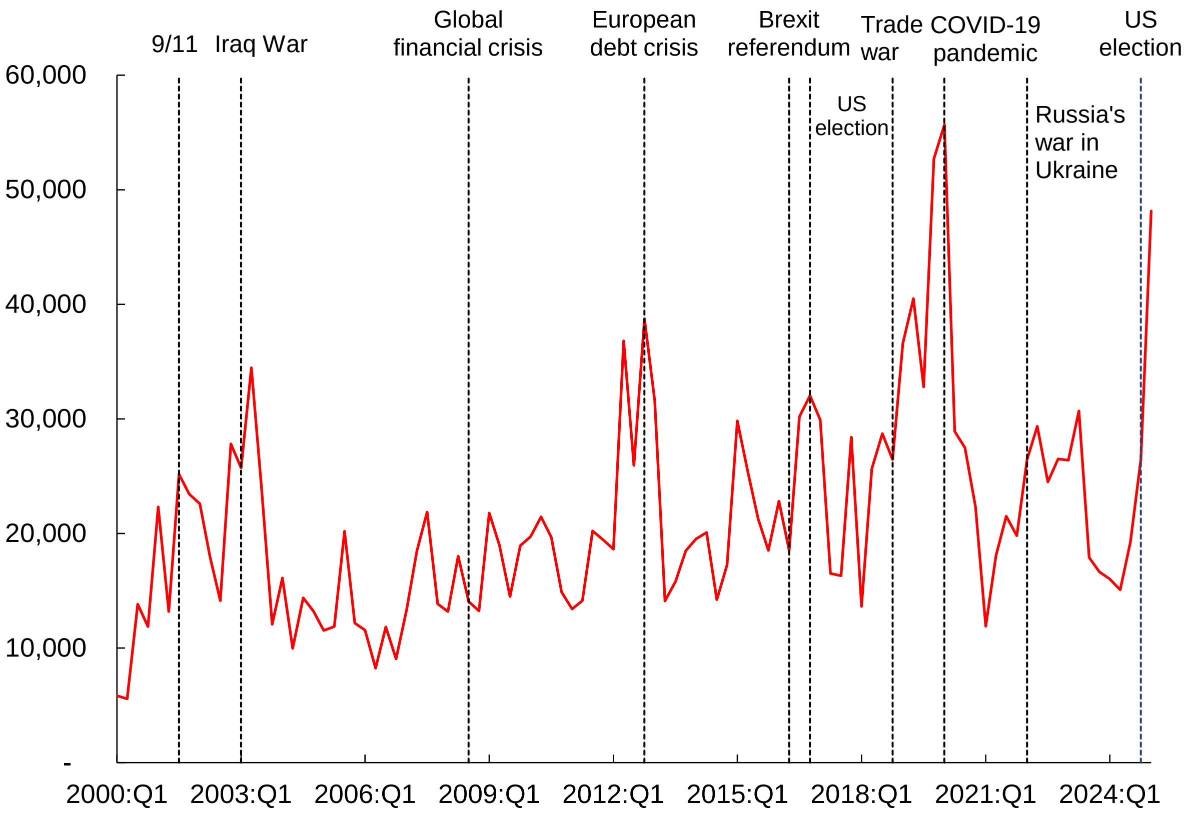
- Our analysis aims to answer the following key questions for MENA & CCA countries:
  - How has uncertainty evolved over time across MENA and the CCA?
  - Which factors are bigger contributors to uncertainty (global, regional, & domestic)?
  - What are the key drivers of domestic uncertainty?
  - What are the impacts of a rise in uncertainty on financial markets and the real economy?
  - What underlying characteristics/conditions amplify or mitigate the impacts?
  - What are the policy implications of these findings?

Rising Global Uncertainty

Global uncertainty has been trending up

Global uncertainty has been trending up over the past 25 years and has been rising recently…

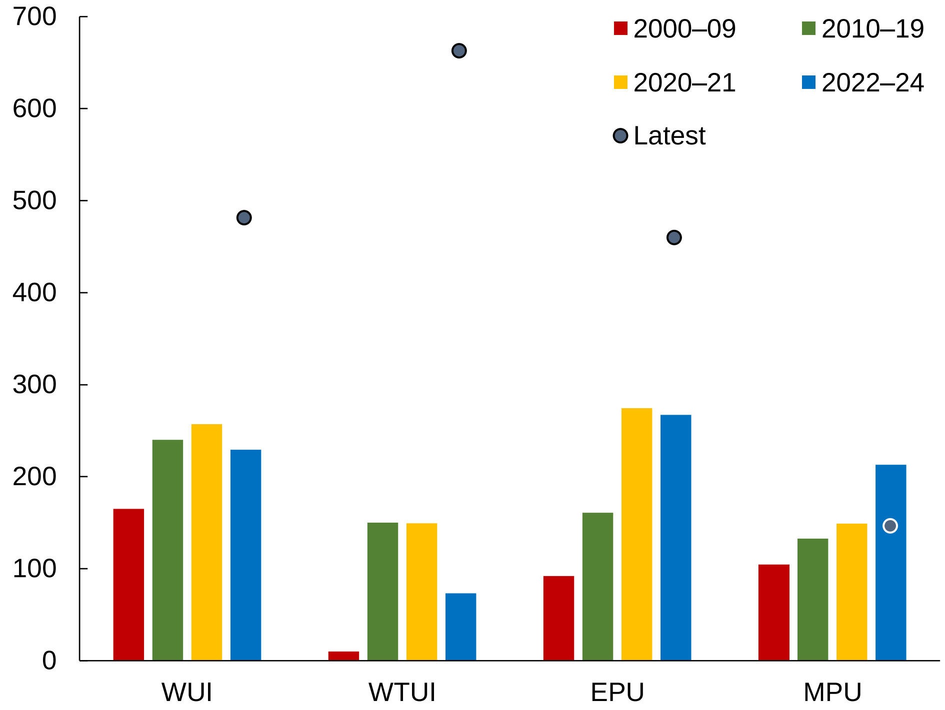
World Uncertainty Index (WUI), 2000-24
(Index value)



Sources: Ahir, Bloom, and Furceri 2022; World Uncertainty Index (WUI); and IMF staff calculations. Note: The quarterly WUI at global level is a US dollar GDP-weighted average of 143 country-level indices and ends in the first quarter of 2025.

…consistent across various measures of uncertainty

Selected Measures of Global Economic Uncertainty, 2000-24
(Index value, scaled)



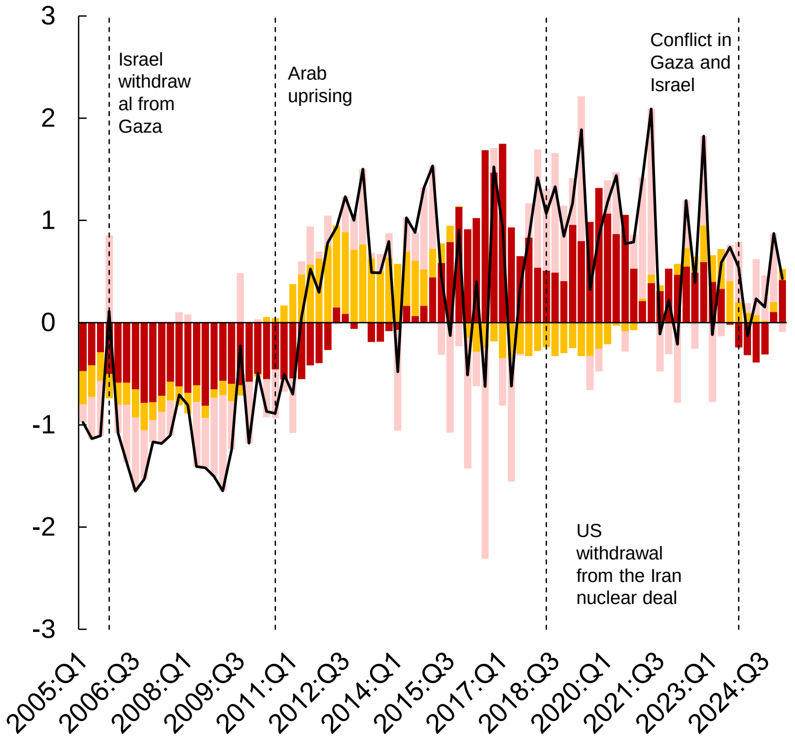
Sources: Ahir, Bloom, and Furceri 2022; World Uncertainty Index (WUI); Husted, Rogers, and Sun 2017; US Monetary Policy Uncertainty (MPU) Index; Davis 2016; Global Economic Policy Uncertainty (EPU) Index; and IMF staff calculations. Note: The quarterly WUI at global level is a US dollar GDP-weighted average of 143 country-level indices and ends in the first quarter of 2025. The latest available observations for the WUI, WTUI, EPU, and MPU are for first quarter of 2025, first quarter of 2025, January 2025, and second quarter of 2024, respectively. EPU and MPU are constructed using a method similar to WUI and are based on the search results of major US newspapers.

Significant Common Drivers of Uncertainty

A closer look at contributors to aggregate uncertainty in the Middle East and Central Asia

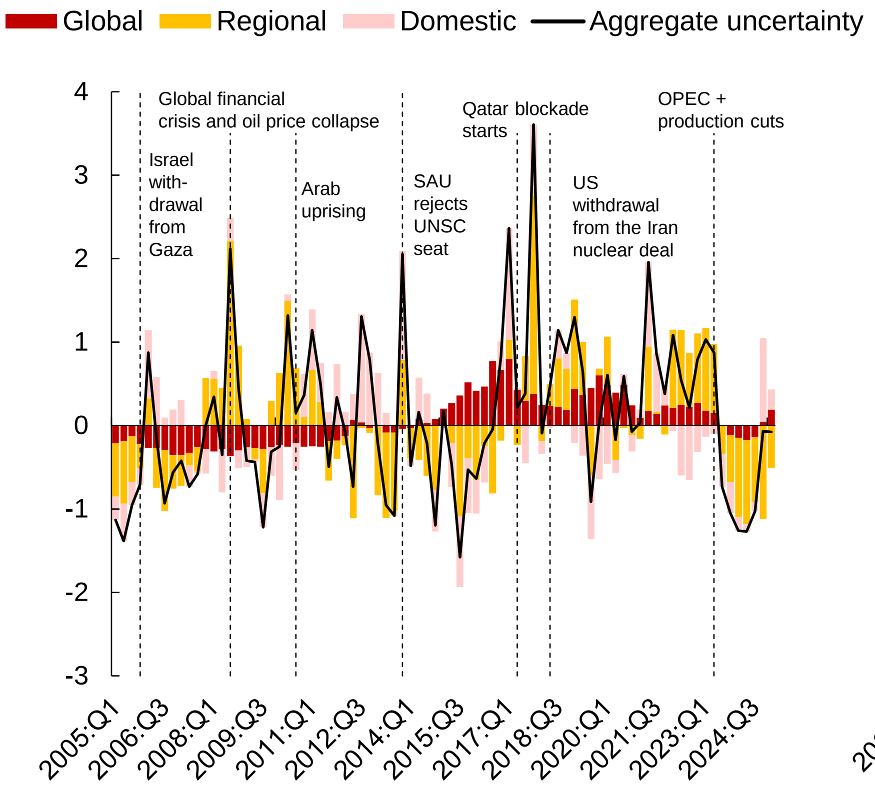
The Arab Spring caused a regional spike in MENA (excl. GCC)

MENA ex. GCC: Decomposition of WUI, 2005-24
(Index value)



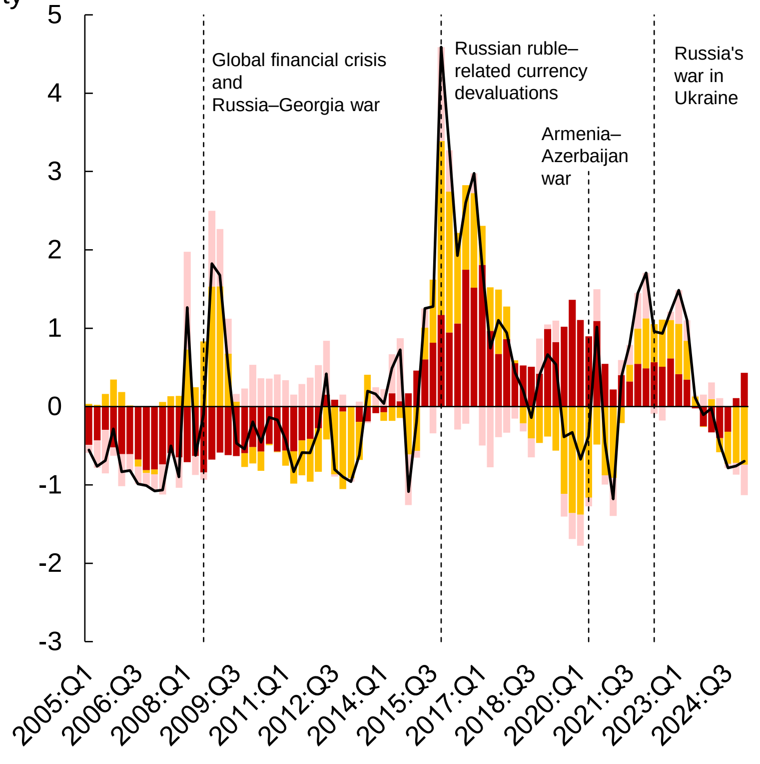
While oil prices and geopolitical events played a role in the GCC

GCC: Decomposition of WUI, 2005-24
(Index value)



The CCA was affected by the global and regional factors (e.g., Russia)

CCA: Decomposition of WUI, 2005-24
(Index value)

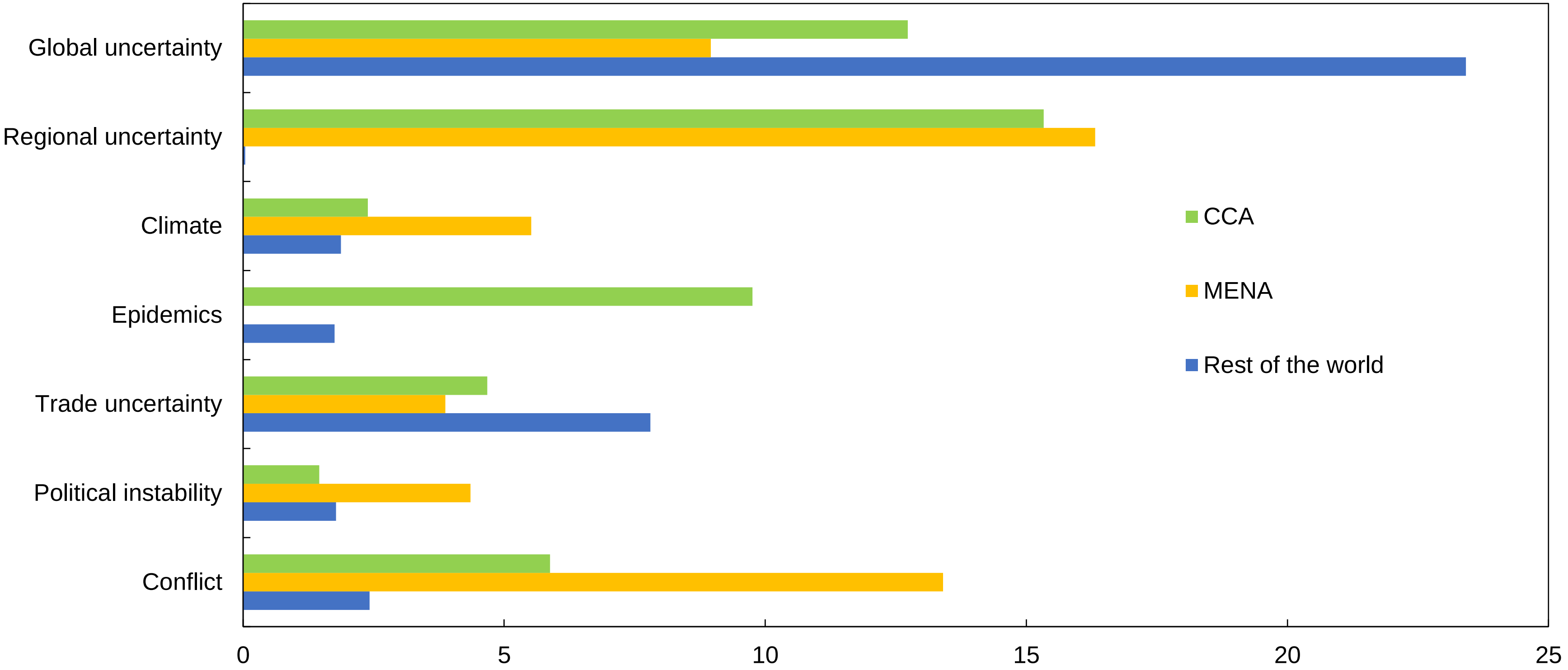


Sources: Ahir, Bloom, and Furceri 2022; World Uncertainty Index (WUI) database; and IMF staff calculations.
Note: The charts display decompositions of aggregate (US dollar GDP-weighted) uncertainty indexes by region, derived from a dynamic factor model. The aggregate indexes are scaled to have a mean of zero and a standard deviation of one over the indicated period. The model assumes that uncertainty in each country is driven by three types of shocks: global (common to all countries), regional (common to all countries in each region after taking account of global shocks), and domestic (country-specific). The model is estimated using quarterly uncertainty indexes from the WUI database covering 143 countries across seven regions. The sample spans from the first quarter of 2000 to the first quarter of 2025. CCA = Caucasus and Central Asia; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa (and Pakistan); SAU = Saudi Arabia; UNSC = United Nations Security Council; WUI = World Uncertainty Index.

Different Domestic Drivers of Uncertainty Across MENA and CCA

Drivers of uncertainty differ between the MENA and CCA regions, and within the regions, compared to the rest of the world

MENA and CCA : Relative Contributions to Domestic Uncertainty
(Percent)



Sources: Ahir, Bloom, and Furceri 2022; World Uncertainty Index (WUI); Our World in Data; Center for Systemic Peace, Integrated Network for Societal Conflict Research; Torres Munguía and others 2022; Uppsala Conflict Data Program, Georeferenced Event dataset; and IMF staff calculations.
Note: Standard errors are clustered at the country-level. Relative contributions add up to less than 100 because the error term (unexplained component) contributes from 48 percent to 61 percent of the total variation (Sterck 2019 methodology). Climate-driven uncertainty is captured by absolute deviations from the 1950–90 country average temperature. Epidemic-induced uncertainty is based on the count of infectious diseases outbreaks. Adverse political events include successful and attempted coups, auto-coups, assassinations or coerced resignations of the executive power, and eviction of leadership by rebel or foreign forces but does not include alleged coup plots or coup plots. Conflict is an indicator variable equal to 1 when the number of conflict-related deaths exceeds the 75th percentile worldwide. Trade uncertainty is measured by the country value of the World Trade Uncertainty Index. CCA = Caucasus and Central Asia; MENA = Middle East and North Africa (and Pakistan).

The Persistent Economic Effects of Uncertainty

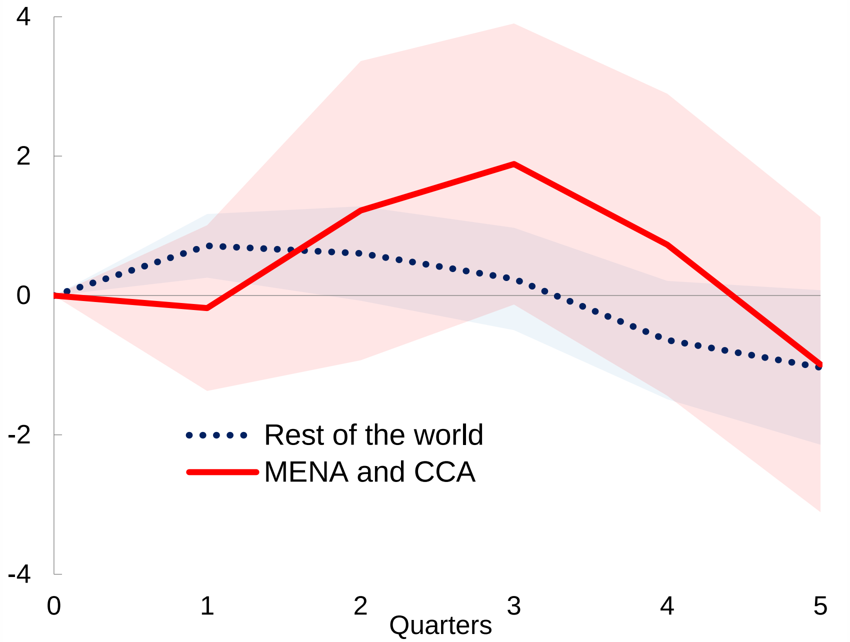
Domestic uncertainty shocks first materialize in financial markets and also have persistent negative GDP impacts

Following an uncertainty shock, spreads increase …

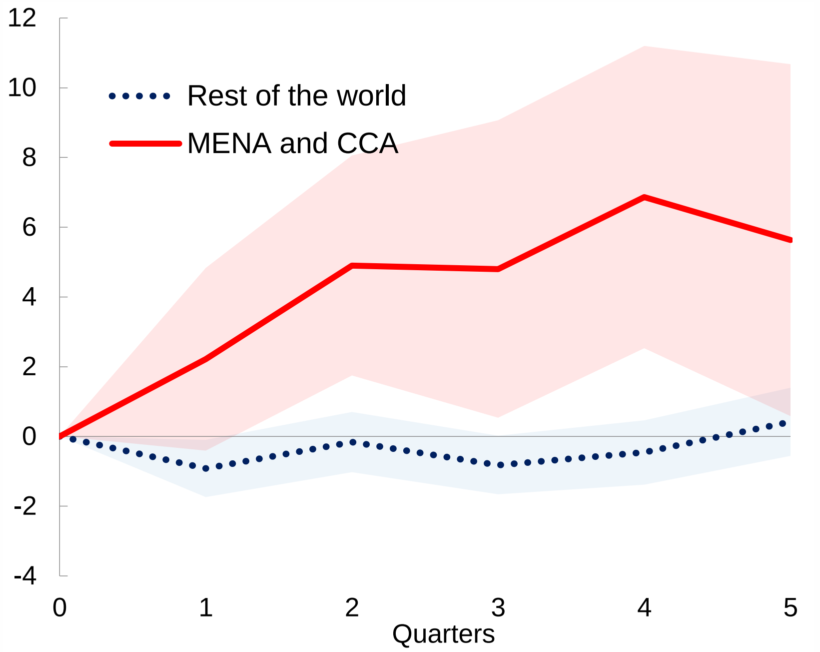
… as does stock market volatility …

… and real GDP declines persistently.

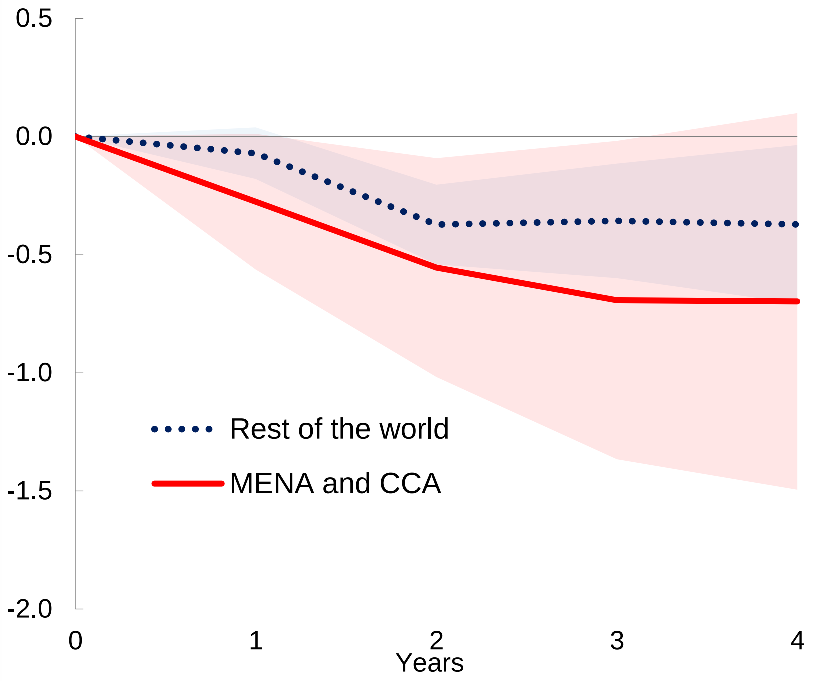
Impact of Domestic Uncertainty on Spreads
(Percent, impact of a one standard deviation shock on uncertainty)



Impact of Domestic Uncertainty on Stock Market Volatility
(Percent, impact of a one standard deviation shock on uncertainty)



Impact of Domestic Uncertainty on Real GDP
(Percent, impact of a one standard deviation shock on uncertainty)



Sources: IMF, World Economic Outlook database; Ahir, Bloom and Furceri (2022); World Uncertainty Index (WUI) database; Torres Munguía and others 2022; Uppsala Georeferenced Event Database; Center for Research on the Epidemiology of Disasters, Emergency Events Database EM-DAT; World Bank, Worldwide Governance Indicators; and IMF staff calculations.
Note: The impacts of uncertainty are assessed using a local projections approach. The shock happens in quarter 1 (panels 1 and 2) or year 1 (panel 3) and corresponds to a one standard deviation increase in the country-level uncertainty indicator. Panel 1 and 2 regressions include time and country (panel 1) or stock market (panel 2) fixed effects, three lags of the shock, and three lags of the dependent variable. Panel 1 shows the impact on spreads, defined as the quarterly average of daily sovereign spreads weighted across maturities. Panel 2 shows the impact on stock market volatility, defined as the standard deviation of weekly stock market prices over the quarter. Panel 3 regressions includes time and country fixed effects, two lags of the shock, two lags of the dependent variable, and control for openness to trade, investment share, terms of trade shocks, trade partners' growth, control of corruption, conflict shocks, natural disasters, and epidemics. Shaded areas represent the 90 percent confidence interval. "Rest of the world" excludes countries in the CCA and MENA regions (and Pakistan). CCA = Caucasus and Central Asia; EMs = emerging markets; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa (and Pakistan); REER = real effective exchange rate; WUI = World Uncertainty Index. *$p < .10$; **$p < .05$; ***$p < .01$.

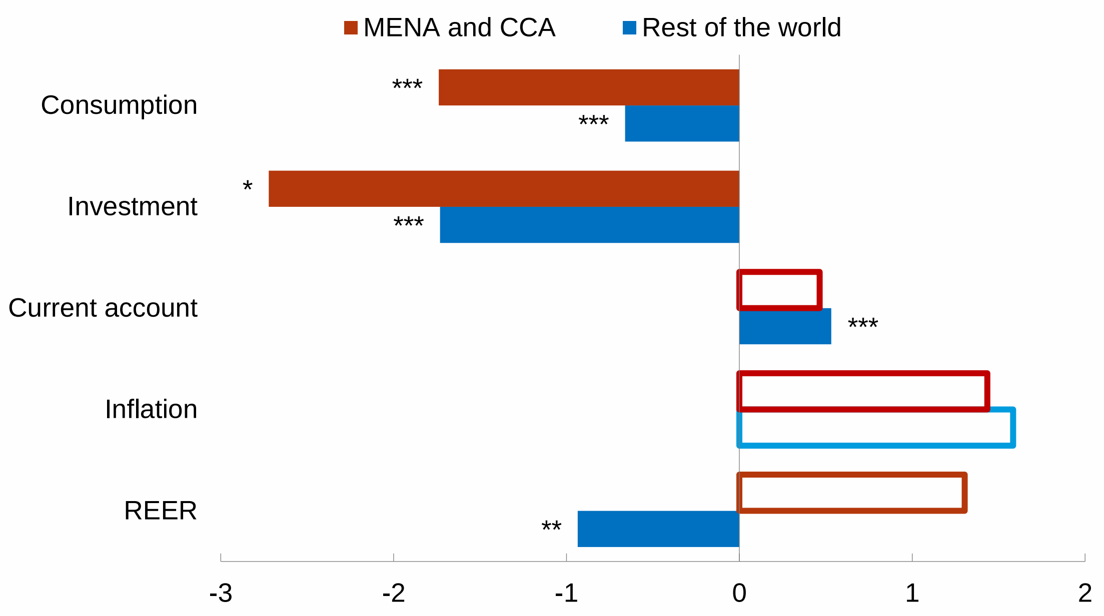
The economic consequences go beyond output while pre-existing conditions play a mediating role

Consumption and investment are main channels of disruptions while the current account balance increase.

Worse pre-existing economic and institutional conditions tend to lead to pronounced negative consequences.

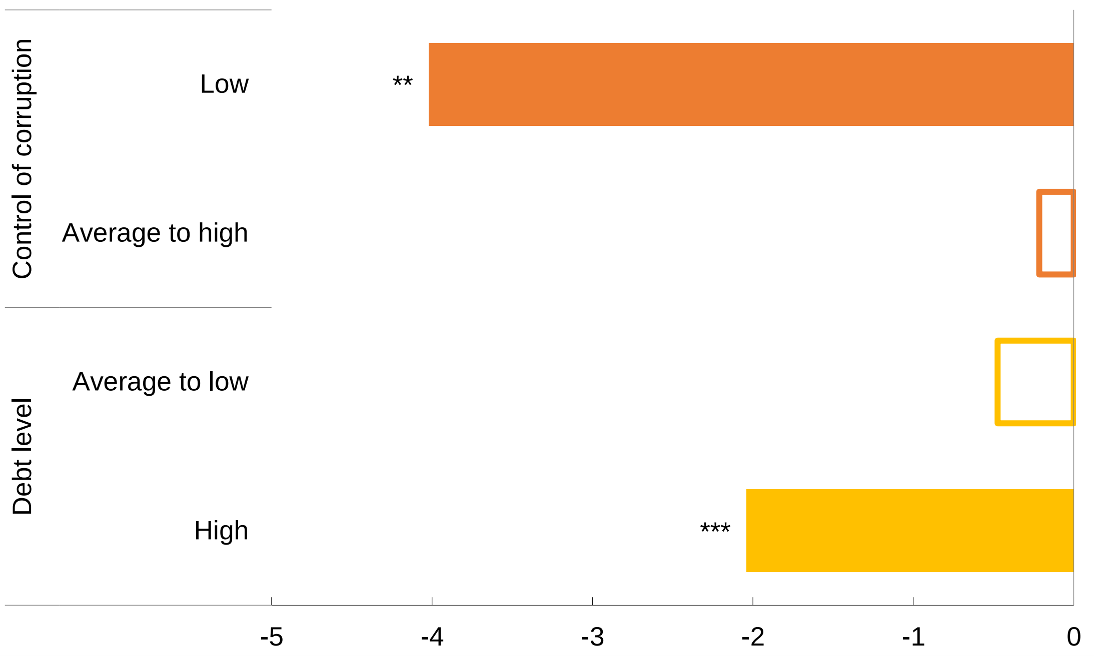
Additional Economic Impacts

(Percent, impact of a one standard deviation shock on uncertainty two years after the shock)



Differential Impact on Real GDP According to Pre-Existing Conditions

(Percent, impact of a one standard deviation shock on uncertainty two years after the shock)



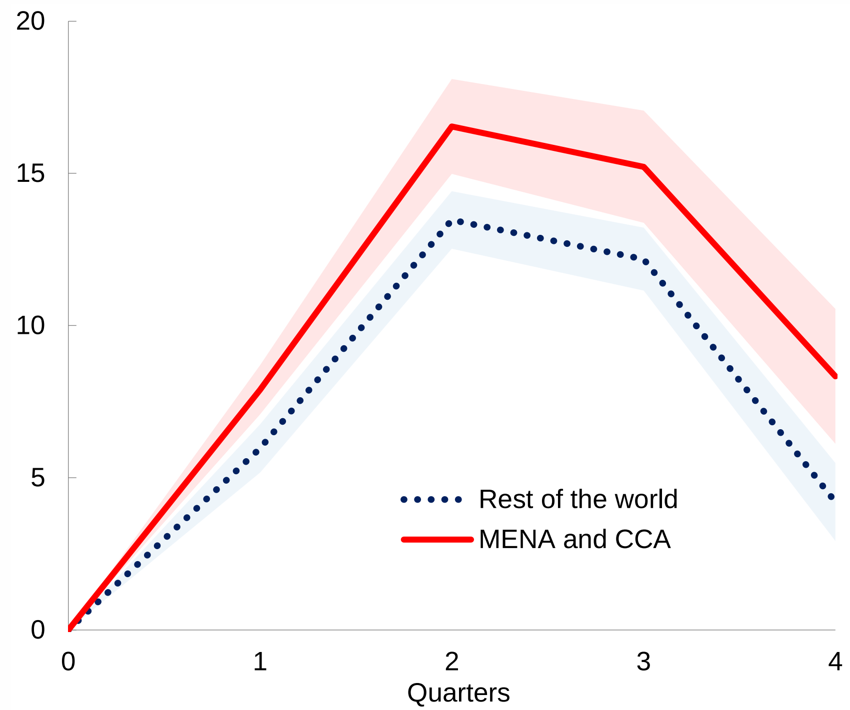
Sources: IMF, World Economic Outlook database; Ahir, Bloom, and Furceri (2022); World Uncertainty Index (WUI) database; Torres Munguía and others 2022; Uppsala Georeferenced Event Database; Centre for Research on the Epidemiology of Disasters, Emergency Events Database EM-DAT; World Bank, Worldwide Governance Indicators; and IMF staff calculations. Note: The impacts of uncertainty are assessed using a local projections approach. The shock happens in year 1 and corresponds to a one standard deviation increase in the country-level uncertainty indicator. Regressions include time and country fixed effects, two lags of the shock, two lags of the dependent variable, and control for openness to trade, investment share, terms of trade shocks, trade partners' growth, control of corruption, conflict shocks, natural disasters, and epidemics. Shaded areas represent the 90 percent confidence interval. Panel 1 shows the impact two years after the shock on several macroeconomic variables. All results are percent differences except for the current account balance as a percentage of GDP, for which it is the percentage point difference. Panel 2 shows the differential impact two years after the shock according to the control of corruption or the debt level during the year preceding the shock. Control of corruption is considered low if it is in the bottom 15 percent of the world distribution. Debt is considered high if it is in the top 25 percent of the distribution of the country's corresponding economic grouping (low-income country, emerging market and developing economy, or advanced economy). "Rest of the world" excludes countries in the CCA and MENA regions (and Pakistan); Hollow bars indicate a lack of significance. CCA = Caucasus and Central Asia; MENA = Middle East and North Africa (and Pakistan); REER = real effective exchange rate. *p < .10; **p < .05; ***p < .01.

Global uncertainty shocks also matter …

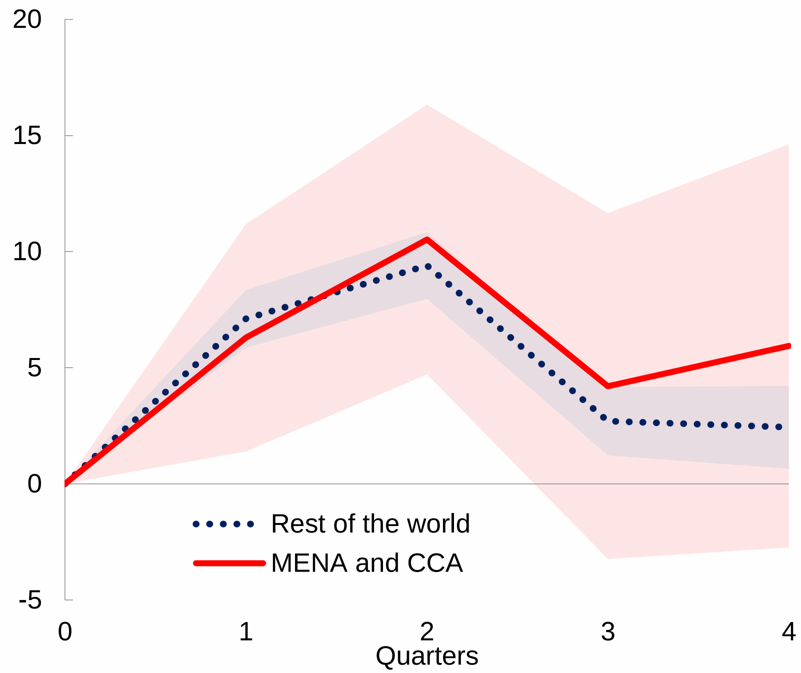
… with more pronounced impacts on financial markets, both spreads and stock market volatility

… and on real output

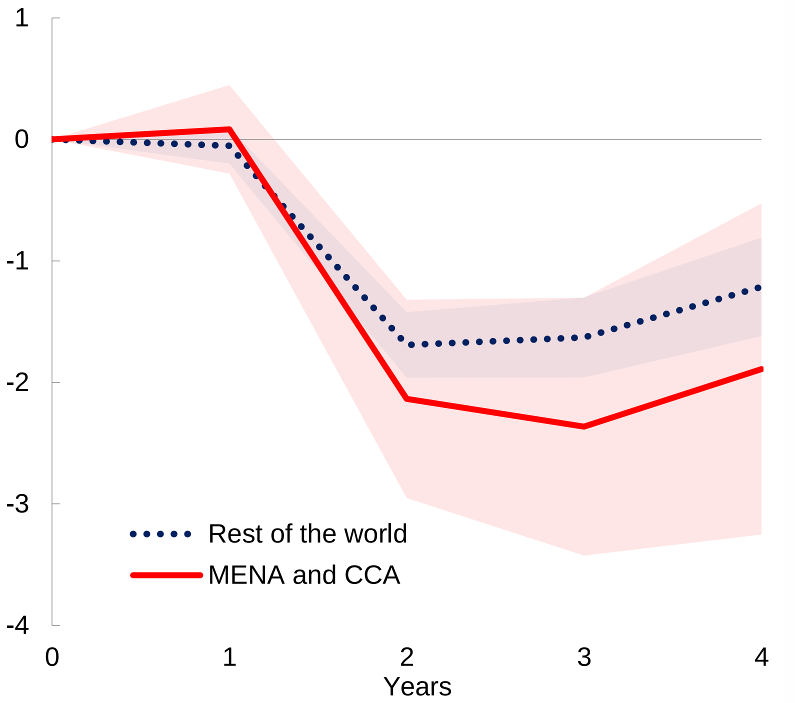
Impact of Global Uncertainty on Spreads
(Percent, impact of a one standard deviation shock on uncertainty)



Impact of Global Uncertainty on Stock Market Volatility
(Percent, impact of a one standard deviation shock on uncertainty)



Impact of Global Uncertainty on Real GDP
(Percent, impact of a one standard deviation shock on uncertainty)



Sources: IMF, World Economic Outlook database; Ahir, Bloom, and Furceri (2022); World Uncertainty Index (WUI) database; Torres Munguía and others (2022); Uppsala Georeferenced Event Database; Centre for Research on the Epidemiology of Disasters, Emergency Events Database EM-DAT; World Bank, Worldwide Governance Indicators; Federal Reserve Bank of St. Louis, Federal Reserve Economic Data database; Finaeon, Inc., GFDatabase; IMF, Sovereign Spread Monitor; Stock Market Prices, Global Financial Database; and IMF staff calculations.

Note: A local projections approach is used to assess the impacts of uncertainty. The shock happens in quarter 1 or year 1 and corresponds to a one standard deviation increase in the GDP weighted World Uncertainty Index as measured by Ahir, Bloom, and Furceri (2022). Regressions in panels 1 and 2 include year, quarter, and country (panel 1) or stock market (panel 2) fixed effects, three lags of the shock, three lags of the dependent variable, and control for domestic uncertainty. Regressions in panel 3 include country fixed effects, two lags of the shock, two lags of the dependent variable, and control for domestic uncertainty, openness to trade, investment share, terms of trade shocks, trade partners' growth, control of corruption, conflict shocks, natural disasters, epidemics, Federal Reserve fund rates, and global oil prices. Shaded areas represent the 90 percent confidence interval. "Rest of the world" excludes countries in the CCA and MENA regions (and Pakistan); CCA = Caucasus and Central Asia; EMs = emerging markets; GCC = Gulf Cooperation Council; MENA = Middle East and North Africa (and Pakistan).

Summary and Policy Takeaways

Summary

- Uncertainty shocks are highly synchronized across countries and regions.
  - Common global and regional shocks account for more than half of the variation of domestic uncertainty across MENA & CCA countries, with differences in share across sub-regions.
- Climate, epidemics and conflicts are important drivers of uncertainty for MENA & CCA vs. RoW.
- Domestic and global uncertainty shocks are associated with larger adverse financial and real impacts in the MENA and CCA regions than elsewhere.
- The effects of uncertainty on output are amplified by higher public debt and lower institutional quality.

Policy Takeaways

- Where buffers are low, the immediate priority should be to rebuild them.
  - Strengthen fiscal positions.
  - Accumulate international reserves.

- Diversify trade and financial relations through broader regional and cross-regional economic integration measures. (April 2024 *Regional Economic Outlook: Middle East and Central Asia*)

- Enhance macroeconomic frameworks and strengthening governance and institutions to bolster policy credibility and predictability. (October 2021 *Fiscal Monitor*, October 2024 *Global Financial Stability Report*)

- Mitigate the effects of conflict, climate and health shocks on domestic uncertainty.

Thank You