Caucasus and Central Asia Update to the Regional Economic Outlook

APRIL 2019

Regional Studies Division
Outline

“Addressing Legacy Challenges Amid Global Headwinds”

• Growth Prospects for Caucasus and Central Asia (CCA) Steady But too Low

• Legacies and Unfinished Reforms

• Global Headwinds Make Reforms more Urgent and Difficult

• Actions are Needed In Monetary, Fiscal, and Structural Areas
Outlook for the CCA
Growth has stabilized

CCA Oil Exporters Real GDP Growth, 2013–20
(Percent change)

Sources: National authorities; and IMF staff calculations.
Note: CCA OE = Caucasus and Central Asia oil exporters

CCA Oil Importers Real GDP Growth, 2013–20
(Percent change)

Sources: National authorities; and IMF staff calculations.
Note: CCA OI = Caucasus and Central Asia oil importers
Inflation pressures are modest

Consumer Price Inflation
(Percent change, year average)

Sources: National authorities; and IMF staff calculations.

Note: CCA = Caucasus and Central Asia; EMDE = emerging markets and developing economies.
However, growth is too low to raise living standards...

GDP per capita and Years to Convergence
(US Dollars and years, 2018)

Sources: National authorities; and IMF staff calculations.
Note: EM = emerging market economies; EMEU = emerging and developing Europe; LIC = low-income countries. Chart shows time to converge to current LIC graduation threshold (Uzbekistan, Kyrgyz Republic, and Tajikistan) or emerging Europe (others) threshold assuming medium-term aggregate output and population growth rates hold indefinitely.
Legacies and Unfinished Reforms
Positive policy legacies of shocks

- Strengthened macroeconomic policy frameworks and greater exchange rate flexibility

- **Fiscal frameworks were strengthened by** introducing fiscal rules, reform of tax codes, and improving fiscal transparency.

- **Pragmatic implementation of monetary and exchange rate policies** has helped countries manage external pressures while containing inflation and reducing dollarization.

- As a result, **buffers erosion was limited and growth has stabilized.**
But, there are challenging legacies that restrain growth

- Weak banking systems
- Incomplete monetary policy framework transitions
- Limited fiscal space
Weak banking systems in some countries

Sources: National authorities; and IMF staff calculations.
Note: NPL= nonperforming loans. Problem loans include watch, nonperforming, and restructured loans. NPLs are classified into substandard, doubtful, and loss loans. Armenia excludes loss loans from NPLs and total loans.

Sources: IMF, International Financial Statistics (IFS); National authorities; and IMF staff calculations.
Note: All countries are adjusted for exchange rate effects, except Azerbaijan due to data availability.

Sources: National authorities and IMF staff estimates
Note: Data from Dec. 2018 or latest available

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## Incomplete monetary policy framework transitions

### Monetary and Exchange Rate Policies in CCA Countries

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Note: Based on IMF staff broadly defined classification categories. Hard Peg includes: exchange arrangement with no separate legal tender and currency board arrangement. Soft peg includes: conventional pegged arrangement, pegged exchange rate within horizontal bands, stabilized arrangement, crawling peg and craw-like arrangement. Float includes: floating and free floating. Other includes other managed arrangements.
Fiscal space has become limited

Public and Publicly Guaranteed Debt
(Percent of GDP)

Sources: National authorities; and IMF staff calculations.
Note: Azerbaijan includes approximately 30 percent of GDP in guarantees.
Global Headwinds Make Policy Efforts More Urgent and More Difficult

Commodity prices

Weak external demand

Increased global uncertainty
Oil and commodities prices and are lower and more volatile

**APSP Crude Oil**
(US dollar per barrel)

**Commodity Price Indices**
(2005 = 100)

Sources: National authorities; and IMF staff calculations.
Note: APSP = average petroleum spot price. APSP is the average of UK Brent, Dubai Fateh, and West Texas Intermediate crude oil prices.
Weaker external demand

Global Growth (Percent)

Top Trading Partners, Revisions (Arrows indicate direction of revisions from October 2018)

Cyclicality of Remittances, Inflows to CCA and GDP Growth in Russia (Annual growth rates, percent)

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

Note: CCA = Caucasus and Central Asia. CCA oil exporter real non-oil GDP growth does not include Uzbekistan due to data availability.
Limited export diversification heightens external risks

Total Exports and Destinations of CCA Countries
(Percents of total)

Oil Exporters
- Mineral products
- Metals
- Chemicals & allied industries
- Other

Sources: UN COMTRADE database; and IMF staff calculations.
Note: RoW = rest of the world; CCA = Caucasus and Central Asia.
Turkmenistan and Uzbekistan are excluded from oil exporters due to data availability. Tajikistan is excluded from oil importers due to data availability.
Increased global uncertainty

Global Economic Policy Uncertainty (GEPU) Index and Geopolitical Risk (GPR) Index

Using data for 18 countries that account for 2/3 of global GDP


Federal Reserve Funds Rate

Central tendency lower and upper bounds (March 2019)
Central tendency (March 2019)
Central tendency (December 2018)

Note: The central tendency excludes the three highest and three lowest projections for each variable in each year. Sources: FOMC, Summary of Economic Projections; and Fund staff estimates.
Combined effect of weaker demand and global uncertainty is intensifying

CCA Exports and imports volume
(Weighted average annual growth, percent)

Sources: IMF, Research department; and National authorities
Note: CCA = Caucasus and Central Asia. Uzbekistan is excluded due to data availability.
Actions are Needed In Monetary, Fiscal, and Structural Areas
Enhance resilience and address legacy challenges

Monetary
- Complete transition to credible, rules-based frameworks
- Scope for further exchange rate flexibility

Fiscal
- Consolidation needed where debt is high
- Contain contingent liabilities

Structural
- Tackle financial sector weaknesses
- Improve governance
- Make room for private sector growth
Growth-friendly fiscal consolidation is needed

Oil exporters
(Percent of GDP and Non-oil GDP)

Oil importers
(Percent of GDP)

Sources: National authorities; and IMF staff calculations and estimates.
Addressing governance weaknesses

Governance Indicators, 2017 1
(Average of score estimate -2.5 – 2.5, weak to strong)


Note: AE = advanced economies; CCA = Caucasus and Central Asia; EMASIA = emerging Asia; EMEU = Emerging Europe; LAC = Latin America and the Caribbean; MENAP = Middle East, North Africa, Afghanistan and Pakistan; and SSA = sub-Saharan Africa.

1/ Use of indicators should be considered carefully as they are derived from perceptions-based data. Ranges are for the average confidence interval for CCA. Confidence intervals for peer groups are negligible.
Make room for private sector growth

Challenges to Doing Business in CCA
(Number of countries identifying the constraint among the top five)

- Access to finance
- Tax rates and regulation
- Inflation
- Corruption
- Foreign currency regulations
- Inadequately educated workforce
- Inefficient govt bureaucracy
- Poor work ethic in national labor
- Policy instability
- Insufficient capacity to innovate
- Government instability

Note: Turkmenistan and Uzbekistan are excluded due to data availability.

Business Entry Density Rate
(Number of newly registered firms with limited liability per 1,000 working-age people)

Note: Data correspond to most recent value within the period 2014–16. All CCA countries are 2016 values. AE = advanced economies; CCA OE= Caucasus and Central Asia oil exporters; CCA OI = Caucasus and Central Asia oil importer; EMASIA = emerging Asia; EMEU = Emerging Europe, GEO = Georgia; LAC = Latin America and the Caribbean; and SSA = sub-Saharan Africa.
IMF engagement in the CCA region

Analytical Projects

• “Opening Up in the CCA: Policy Frameworks to Support Regional and Global Integration” (February 2019).

• “Fintech, Inclusive Growth and Cyber Risks in MENAP and CCA” (September 2018).

• “Building Resilient Banking Sectors in the CCA” (August 2018).

• “A Growth-Friendly Path for Building Fiscal Buffers in the CCA” (June 2018).

Programs

A program is in place with Georgia (EFF). Armenia reached staff-level agreement on a 3-year precautionary SBA and in Tajikistan discussions are underway for a new ECF.

Capacity Development

Fund technical assistance has increased in the past 2-3 years. Areas covered include bank supervision & resolution, monetary framework, fiscal risks, tax policy, revenue administration, public financial management, financial stability and statistics.

Annual Joint Vienna Institute seminars and trainings. Preparations for a new regional TA center are underway, with the center expected to open in the second half of CY2020.
Takeaways

▪ Steady growth, but too low to raise living standards

▪ Ensure higher growth by addressing legacy challenges and completing reforms

▪ Global headwinds increase urgency for action