

Caucasus and Central Asia: Favorable Near-Term Outlook Provides Opportunities for Reform

Following a solid growth performance in 2012, the near-term outlook remains broadly favorable across the Caucasus and Central Asia, reflecting high oil prices for the oil and gas exporters and strong non-oil commodity prices and robust remittances in the oil and gas importers. Risks to this favorable outlook could stem from still-subdued world demand, domestic political uncertainties, and geopolitical risks in the region. Policymakers, particularly in the oil-importing countries, should take advantage of the favorable outlook to re-establish fiscal policy buffers that were eroded in the aftermath of the global crisis. Across the region, countries should reinvigorate their reform efforts to address longstanding structural issues, with a view to improving governance, building an investor-friendly environment, developing a more inclusive financial system, and fostering regional trade and finance integration.

Solid but Moderating Growth

The Caucasus and Central Asia (CCA) region continued to post solid economic growth in 2012, though, at 5.7 percent, moderately lower than in previous years. This moderation in growth reflected subdued external demand, a sharp decline in agricultural output in Kazakhstan, and disruptions to gold production in the Kyrgyz Republic. The near-term outlook remains broadly favorable for CCA oil and gas exporters (Azerbaijan, Kazakhstan, Turkmenistan, Uzbekistan), reflecting the region's limited direct exposure to Europe, and continued high oil prices. Growth is projected to be resilient, at an average of 5.8 percent in 2013 and 6.1 percent in 2014. Most oil and gas exporters are projected to grow between 5 percent and 8 percent in 2013–14, supported by high non-oil growth and, in Kazakhstan, higher oil production. Azerbaijan's growth—still largely sustained by strong non-oil growth—is expected to recover in 2013–14, as oil output is beginning to stabilize.

Growth in the CCA oil and gas importers (Armenia, Georgia, the Kyrgyz Republic, Tajikistan) is also expected to remain fairly strong at 6 percent and 5.8 percent on average respectively in 2013 and 2014. Growth is projected to moderate in Armenia, Tajikistan, and Georgia, but to recover strongly in the Kyrgyz Republic on account of the resumption in gold production.

Inflation Low but Concerns Rising

Inflation has declined across the CCA from elevated levels in 2011, benefiting from lower international food prices and monetary policy tightening in some countries. However, inflation remained in double digits in Uzbekistan, reflecting administrative price increases, faster currency depreciation, and demand pressures from wage increases. Average inflation is expected to rebound moderately in 2013 and 2014, in line with strong economic activity, and, particularly in the oil and gas importers, looser fiscal stances.



Contrasting External Sector Developments

Current account developments are following different paths among oil and gas exporters and importers. The current account balance in the CCA oil and gas exporters declined to 7.1 percent of GDP in 2012, from 10.6 percent in 2011, mainly because of stagnating oil and gas production coupled with strong import growth in light of solid non-oil economic growth. By contrast, the current account deficit in the oil and gas importers remained high at 9.9 percent in 2012, though Tajikistan posted a much lower and declining deficit, helped by benign global conditions for import prices and growing remittances that reflect the continuing recovery of Russia's economy.

The current account balances in the CCA oil and gas exporters are projected to continue declining in 2013 and 2014, reflecting an expansionary fiscal policy in Azerbaijan, and a modest decline in projected global energy prices. By contrast, CCA oil and gas importers are expected to post lower deficits in 2013 and 2014, helped by lower import growth and strong remittance inflows in the Kyrgyz Republic and Tajikistan.

Near-Term Challenges: Policies to Bolster Resilience

Downside risks, arising from slower global growth, domestic political uncertainties, and geopolitical risks in the region, continue to weigh on the outlook for CCA economies. Should any of these risks materialize, growth would sharply decline through lower exports, remittances, and foreign investment.

Policymakers across the CCA economies should take advantage of the still-favorable outlook to re-establish fiscal policy buffers. This should be done through enhancing the quality and efficiency of public spending, avoiding further increases in hard-to-reverse items, revising the numerous existing tax

exemptions, improving tax collection, and reining in general subsidies.

Continued solid growth and the recent increases in global food prices may rekindle inflation across the region, as food weighs heavily in CCA consumption baskets. Monetary policy should stand ready to exit from its accommodative stance.

In addition, to improve the effectiveness of monetary policy, the monetary framework should be further strengthened by mopping up excessive liquidity, reducing directed lending, and enhancing communications. Allowing more exchange rate flexibility would help in dealing with external shocks, and would contain sterilization costs. Developing domestic financial markets could also help reduce dollarization and increase the effectiveness of monetary policy.

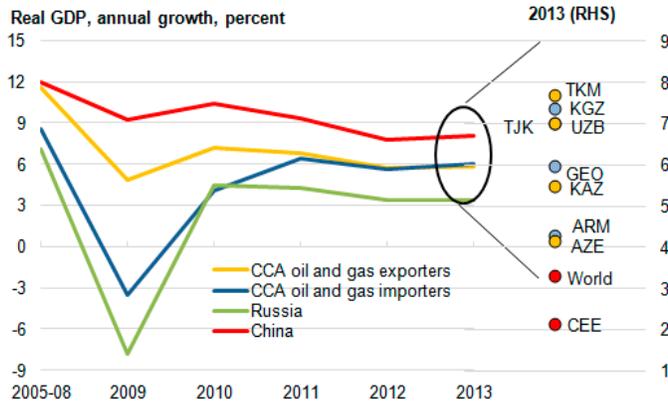
Medium-Term Challenges: Enhancing Inclusive Growth

Key medium-term challenges for the region include creating jobs and fostering high, sustained, and inclusive growth. While some CCA countries have made progress toward achieving a business-friendly environment, further efforts toward this end will be needed by all. Countries also need to reinvigorate their efforts to diversify their economies away from natural resources, further improve their infrastructure, reduce the role of the state in the economy, and promote transparency and good governance. Lowering regional trade barriers would also promote greater economic diversification and growth.

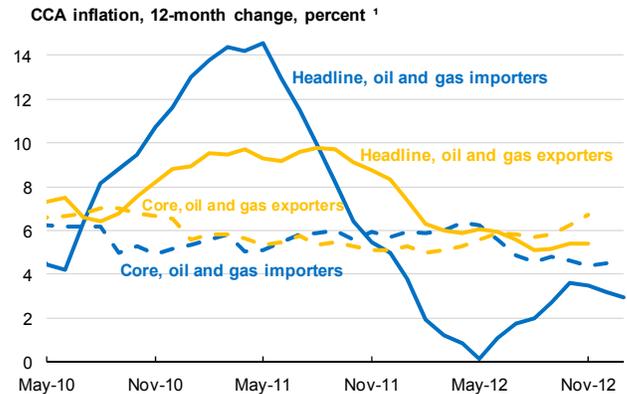
Financial sector reform should aim at enhancing competition and improving access to finance. Reform should include improving regulatory and supervisory frameworks, addressing directed or connected lending, deepening domestic capital markets, improving credit information, and strengthening creditor rights.

Caucasus and Central Asia: Recent Economic Developments and Outlook

The economic outlook remains favorable across the CCA.

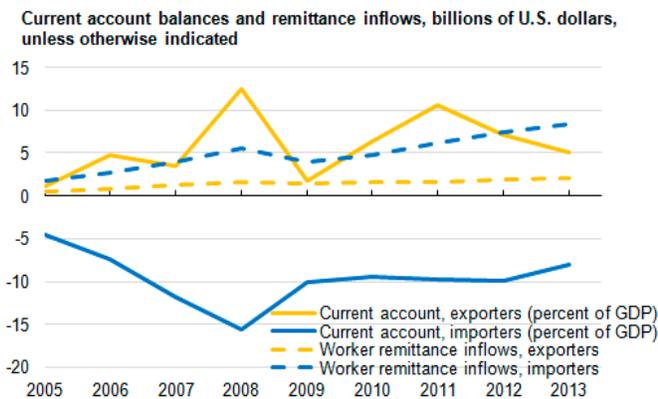


Inflationary pressures are currently low in most countries, but headline inflation has been rising in oil importers.

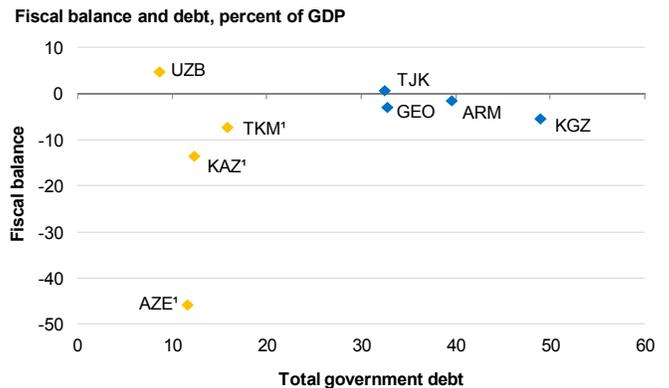


¹ Based on PPPGDP weights. Turkmenistan is excluded from CCA aggregates.

Current account: declining surpluses in the oil and gas exporters, but consolidation in the oil and gas importers.

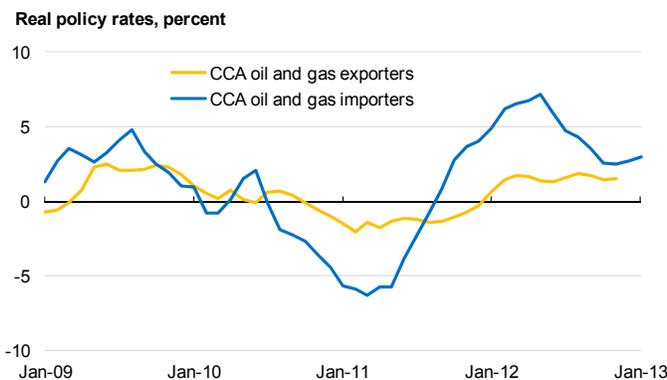


Fiscal consolidation is needed to rebuild buffers, particularly in countries with higher debt.

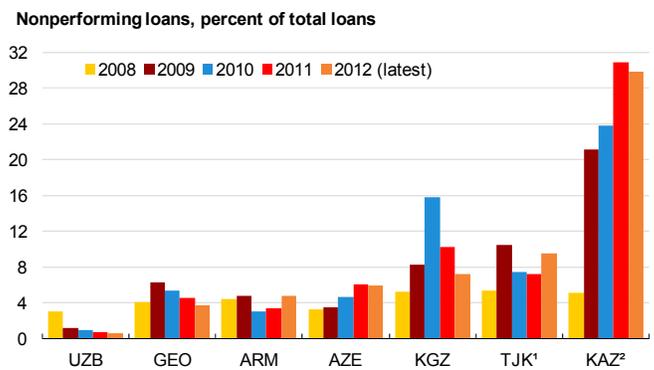


¹ Non-oil and gas fiscal balance in percent of non-oil and gas GDP.

Real interest rates have been declining in the CCA oil importers.



Asset quality remains a source of concern in some countries.



¹ Overdue by 30 days or more.

² 90-day basis.

Sources: National authorities; and IMF staff calculations.

Caucasus and Central Asia: Selected Economic Indicators

	Average	2008	2009	2010	2011	2012	Projections	
	2000–07						2013	2014
Real GDP Growth	10.3	6.8	3.7	6.7	6.8	5.7	5.8	6.1
<i>(Annual change; percent)</i>								
Armenia	12.0	6.9	-14.1	2.2	4.7	7.2	4.3	4.1
Azerbaijan	15.9	10.8	9.3	5.0	0.1	2.2	4.1	5.8
Georgia	7.6	2.3	-3.8	6.3	7.2	6.5	6.0	6.0
Kazakhstan	10.2	3.2	1.2	7.3	7.5	5.0	5.5	5.6
Kyrgyz Republic	4.5	7.6	2.9	-0.5	6.0	-0.9	7.4	7.5
Tajikistan	8.7	7.9	3.9	6.5	7.4	7.5	7.0	6.0
Turkmenistan	15.2	14.7	6.1	9.2	14.7	11.0	7.7	7.9
Uzbekistan	6.0	9.0	8.1	8.5	8.3	8.0	7.0	6.5
Consumer Price Inflation	9.8	16.5	6.2	7.0	9.1	5.3	6.8	7.1
<i>(Year average; percent)</i>								
Armenia	2.9	9.0	3.5	7.3	7.7	2.5	4.2	4.0
Azerbaijan	6.2	20.8	1.6	5.7	7.9	1.1	3.4	6.7
Georgia	6.4	10.0	1.7	7.1	8.5	-0.9	1.0	4.6
Kazakhstan	8.5	17.1	7.3	7.1	8.3	5.1	7.2	6.4
Kyrgyz Republic	6.9	24.5	6.8	7.8	16.6	2.8	8.6	7.2
Tajikistan	17.2	20.4	6.5	6.5	12.4	5.8	7.7	7.0
Turkmenistan	8.1	14.5	-2.7	4.4	5.3	4.9	5.6	5.5
Uzbekistan	16.8	12.7	14.1	9.4	12.8	12.1	10.9	11.0
General Gov. Overall Fiscal Balance	1.4	6.1	0.8	3.7	6.3	4.6	2.1	1.7
<i>(Percent of GDP)</i>								
Armenia ¹	-2.5	-1.8	-7.7	-5.0	-2.9	-1.5	-2.8	-2.3
Azerbaijan ¹	0.5	20.3	7.0	14.6	13.3	4.0	-2.7	-4.3
Georgia	-1.8	-6.3	-9.2	-6.6	-3.6	-3.0	-2.8	-2.2
Kazakhstan	3.3	1.1	-1.4	1.4	5.9	4.6	4.8	4.5
Kyrgyz Republic	-4.5	0.0	-3.4	-6.3	-4.6	-5.4	-5.5	-4.0
Tajikistan	-2.8	-5.1	-5.2	-3.0	-2.1	0.6	-2.3	-1.2
Turkmenistan ²	1.9	10.0	7.0	2.0	3.6	15.5	6.9	4.7
Uzbekistan	0.9	10.2	2.8	4.9	8.8	4.7	1.8	2.7
Current Account Balance	-0.6	8.8	0.4	4.7	8.4	5.4	3.8	2.4
<i>(Percent of GDP)</i>								
Armenia	-5.9	-11.8	-15.8	-14.8	-10.9	-10.6	-9.6	-8.2
Azerbaijan	-3.5	35.5	23.0	28.0	26.5	20.3	10.6	6.0
Georgia	-10.4	-22.0	-10.5	-10.2	-12.8	-12.0	-10.0	-8.4
Kazakhstan	-2.4	4.7	-3.6	1.2	7.4	4.6	4.0	2.2
Kyrgyz Republic	-1.2	-15.5	-2.5	-6.4	-6.0	-12.7	-7.6	-6.1
Tajikistan	-3.4	-7.6	-5.9	-1.2	-4.7	-1.9	-2.2	-2.4
Turkmenistan	7.0	16.5	-14.7	-10.6	2.0	1.7	2.5	2.8
Uzbekistan	4.9	8.7	2.2	6.2	5.8	2.7	3.5	4.2

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

¹ Central government.

² State government.