

# MACROECONOMIC FORECASTS FOR 2021



**Back to Growth**



11'2020

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# INFORMATION DISCLOSURE

This Review includes a detailed description of the current domestic and external macroeconomic setting and a consistent set of forecasts that takes into account the interrelationships between the economies of the EDB operating region and the external sector.

The forecasts of the main macroeconomic indicators were prepared by the EDB using an integrated system of models based on a multi-country structural dynamic macroeconomic general equilibrium model. More detailed information about the structure of the integrated system of models, its main components, and its use for analysis of the macroeconomic situation and forecasting is contained in a joint EDB and EEC report entitled “Forecasting System for the Eurasian Economic Union”.

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# LIST OF ABBREVIATIONS

<b>AMD</b> — Armenian dram	<b>RF CB</b> — Central Bank of the Russian Federation
<b>BYN</b> — Belarusian ruble	<b>RK</b> — Republic of Kazakhstan
<b>CBRA</b> — Central Bank of the Republic of Armenia	<b>RT</b> — Republic of Tajikistan
<b>COVID-19</b> — Respiratory infection caused by the SARS-CoV-2 coronavirus	<b>RUB</b> — Russian ruble
<b>CPI</b> — Consumer Price Index	<b>TJS</b> — Tajik somoni
<b>EDB / the Bank</b> — Eurasian Development Bank	<b>TONIA</b> — Tenge Overnight Index Average
<b>EU</b> — European Union	<b>USD</b> — U.S. dollar
<b>GDP</b> — Gross Domestic Product	<b>U.S. or USA</b> — United States of America
<b>IBL</b> — Interbank Loans Market	% — per cent
<b>IFO</b> — International Financial Organization	<b>% YoY</b> — Year-on-Year growth rate
<b>IT</b> — Information Technology	<b>pp</b> — percentage point
<b>KGS</b> — Kyrgyz som	
<b>KR</b> — Kyrgyz Republic	
<b>KZT</b> — Kazakh tenge	
<b>MIACR</b> — Moscow Interbank Actual Credit Rate	
<b>NB KR</b> — National Bank of the Kyrgyz Republic	
<b>NB RK</b> — National Bank of the Republic of Kazakhstan	
<b>NBT</b> — National Bank of Tajikistan	
<b>OECD</b> — Organisation for Economic Co-operation and Development	
<b>OPEC</b> — Organization of Petroleum Exporting Countries	
<b>PMI</b> — Purchasing Managers' Index	
<b>RA</b> — Republic of Armenia	
<b>RB</b> — Republic of Belarus	
<b>RB NB</b> — National Bank of the Republic of Belarus	
<b>RF</b> — Russian Federation	

## SUMMARY

**This year has been marked by unrivaled challenges for the economy of the EDB operating region.** The COVID-19 pandemic has caused widescale social and economic meltdown. Countries are experiencing a decline in economic activity and mutual trade, a downturn in real income, and growth in underemployment and unemployment. We believe that the aggregated GDP of the EDB member countries will decline by 3.8% in 2020 after a 1.7% increase in the previous year. The economy of Armenia will experience a 6.4% decline; the Belarus economy 1.5%; the Kazakhstan economy 3.0%; the Kyrgyzstan economy 7.5%; and the Russian economy 4%. In Tajikistan, economic growth will slow to 4.5%, down from 7.5% in 2019.

**State economic support measures for both the population and business have been instrumental in helping contain the output decline in the region.** They are primarily focused on strengthening national health systems, supporting household income and providing aid to small and medium-sized businesses affected most by the pandemic. Kazakhstan and Russia, which have significant fiscal reserves compared with the region as a whole, have introduced the most ambitious anti-crisis packages (about 8.7% and 4.5% of GDP, respectively). We believe this will make up for about 2–3% of GDP losses in Kazakhstan and 1.3–2.3% in Russia this year. Armenia has deployed significant socio-economic support (about 3.7% of GDP): this will soften the decline in the country's output by about 1.8–2.2% in 2020. In Belarus, Kyrgyzstan and Tajikistan, the volume of state support is relatively small (about 1.1%, 2.4% and 2.5% of GDP, respectively), on account of limited fiscal reserves among other reasons.

### State economic and population support measures in the EDB member countries in 2020

	Armenia	Belarus	Kazakhstan	Kyrgyzstan	Russia	Tajikistan
<b>Scope of budgetary support measures, % of GDP</b>	3.7	1.1	8.7	2.4	4.5	2.5
<b>Compensation for GDP losses, %</b>	1.8–2.2	0.2–0.5	2.0–3.0	0.5–1.0	1.3–2.3	0.4–1.2

**Note:** budgetary support measures, among other items, include soft loans and loans guaranteed by government authorities.

**Source:** EDB calculations

**The EDB base case is based on the assumption that the COVID-19 pandemic will slow down, with restrictive measures being eased both globally and in the countries of the EDB operating region in the first half of 2021.** External demand will gradually expand for the EDB member countries in 2021. Social distancing, weakened investment demand and the continued high savings rate will limit the pace of recovery in business activity abroad. Our base case projects Eurozone GDP to increase by 4.5% in 2021 after a 7.5% decline in 2020; the U.S.'s to increase by 4.1% after a 3.7% decline; and China's to increase by 8.5% after 2.0% growth. The average price of Urals crude oil is expected to reach USD 49 per barrel after a price of USD 41 in 2020.

**Forecasts of key macroeconomic indicators of the EDB member countries (base case)**

Country	GDP		Inflation (at end of year)		Exchange rate to U.S. Dollar (the year's average)		IBL rate (the year's average)	
	2020	2021	2020	2021	2020	2021	2020	2021
Armenia	-6.4	4.9	1.2	1.1	487	492	5.0	4.2
Belarus	-1.5	-0.1	6.4	5.5	2.45	2.61	9.7	9.1
Kazakhstan	-3.0	4.4	7.3	5.3	413.9	423.8	9.1	8.3
Kyrgyzstan	-7.5	3.7	6.5	5.2	77.3	83.2	3.6	4.0
Russia	-4.0	3.2	4.2	3.5	72.3	74.5	4.9	4.2
Tajikistan	4.5	6.1	8.5	5.3	10.3	11.6	11.5	10.3

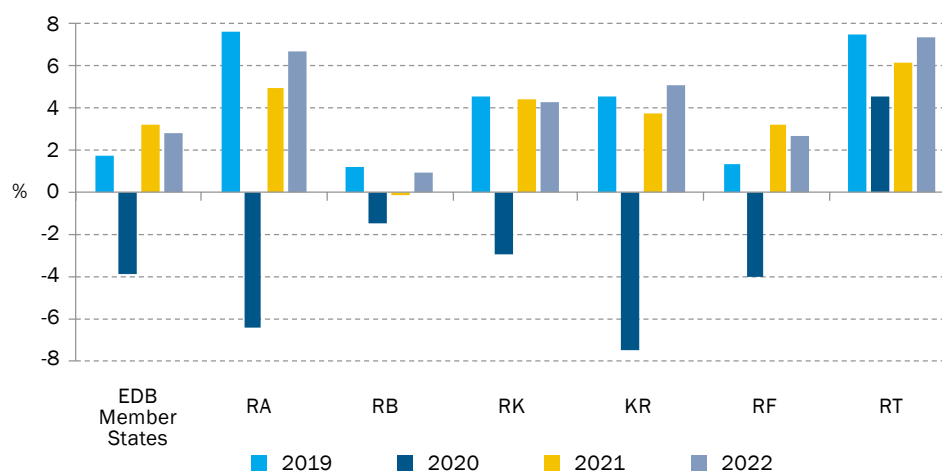
**Note:** GDP and inflation are in % change YoY; the exchange rate against the U.S. dollar is in units of the national currency for USD 1; IBL is in % (or the refinancing rate for Tajikistan).

**Source:** EDB calculations

**The easing of the lockdown will boost the recovery of consumer and investment activity in the countries of the EDB operating region in 2021.** The external demand boom and higher commodity prices will aid exports. Most of the Bank’s member countries are expected to maintain a soft monetary policy in the coming year. This will provide a favorable financial environment for expanding domestic demand. However, a number of factors will slow down the pace of economic recovery. The EDB base case assumes that governments will gradually ease health requirements, with social distancing remaining obligatory next year at the very least. Investment growth will be weak amid high uncertainty. Support for the population and business using fiscal policy measures will be reduced.

**Remittances will provide additional support to the economies of Armenia, Kyrgyzstan and Tajikistan in 2021.** Due to the decline in the inflow of transfers of labor migrants in 2020, these countries have experienced an additional negative impact on household income and domestic demand. As economic activity recovers in the donor states, primarily in Russia, their volume will increase in the coming year. According to EDB calculations, remittances will account for about 0.5 p.p. of GDP growth in Armenia in 2021 and about 0.8–1 p.p. in Kyrgyzstan.

**Figure 1.**  
**Real GDP growth rates**  
**of the EDB member**  
**countries**

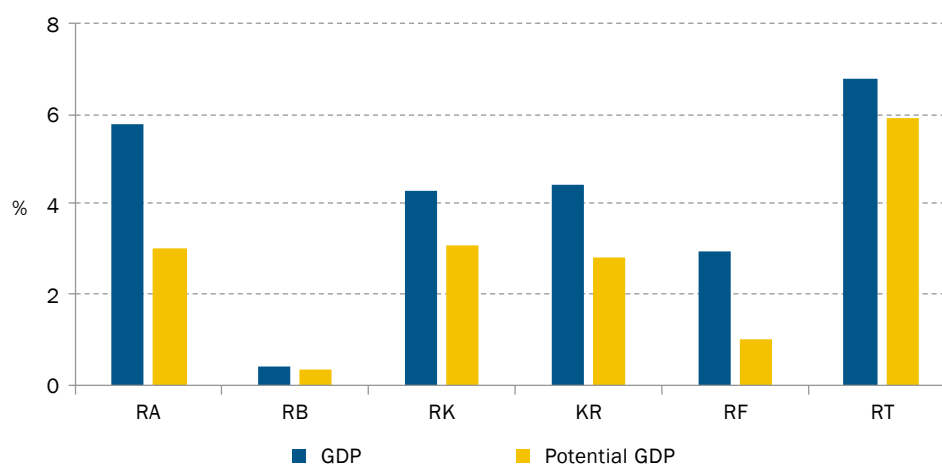


**Source:** EDB calculations

**Back to economic growth in 2021.** The EDB projects growth in the economy of Armenia at 4.9% in 2021; that of Kazakhstan at 4.4%; that of Kyrgyzstan at 3.7%; that of Russia at 3.2%; and that of Tajikistan at 6.1%. Only Kazakhstan will experience a full GDP recovery in 2021 to the pre-crisis level of 4Q2019, as we estimate its decline in 2020 to have been relatively small. Armenia, Kyrgyzstan and Russia will reach their pre-crisis production level in the first half of 2022. The slow recovery is largely due to the high losses this year. In Belarus, we expect GDP to decrease by 0.1% in 2021 and its volume to reach the level of 4Q2019 only in the first half of 2023. Limited fiscal reserves, low investment demand and the unstable finances of the real sector will slow down the speed of recovery of the Belarusian economy.

**Economies of the states in the region will grow in 2021–2022 at a faster rate than their potential GDP.** Due to economic growth recovery, this trend will not result in macroeconomic imbalances, other factors remaining equal.

**Figure 2.**  
Actual and potential GDP growth rates in EDB member countries (average for 2021–2022)



Source: EDB calculations

**Due to increased risks, including geopolitical ones, most of the currencies of the EDB member countries are undervalued against the U.S. dollar.** The Russian ruble and the Kazakh tenge still have the potential to strengthen against the U.S. currency. As the pandemic weakens, the growth in oil prices and the recovery of investor interest in risky assets will support national currencies in 2021. The average Russian ruble exchange rate against the U.S. dollar is projected at 74.5, while the tenge rate is projected at 423.8. It should be noted that high geopolitical risks will continue to pressurize the Russian currency. The average annual exchange rates of the Armenian dram, the Belarusian ruble and the Kyrgyz som against the U.S. dollar are projected to be close to their current levels in the coming year: 492, 2.61 and 83.2, respectively.

**The EDB projects inflation to slow down in the countries of the operating region in 2021.** The growth rate of the consumer price index in Armenia will decline to 1.1%, from 1.2% in 2020, in Belarus, to 5.5% from 6.4%; in Kazakhstan, to 5.3% from 7.3%; in Kyrgyzstan, to 5.2% from 6.5%; in Russia, to 3.5% from 4.2%; and in Tajikistan, to 5.3% from 8.5%. Moderate domestic demand will continue to limit the growth of consumer prices in the EDB member countries. The pressure on inflation caused by the national currency exchange rates and the increase in world food prices that has occurred this year is expected to gradually decrease.

**The EDB projects monetary policy in most countries in the region to remain stimulative in 2021.**

This will support the recovery of economic activity and ensure that inflation remains close to the target. The average interbank market rate in Armenia is projected at around 4.2% in 2021, 9.1% in Belarus, 8.3% in Kazakhstan, 4.0% in Kyrgyzstan and 4.2% in Russia.

**Risks to the EDB base case remain heightened and skewed towards the downside.** How the COVID-19 pandemic evolves is a key factor of uncertainty. The financial and commodity markets reacted positively to recent reports of progress in development of an effective vaccine. However, there are still trials left to be carried out, while the vaccine transportation conditions are challenging. This results in risks to the Bank's projections being shifted to the downside. If the rapid increase in infections is not curbed promptly and the mass distribution of vaccines is delayed, the loss of economic growth will be much more severe than assumed in the base case. Growing global uncertainty and investors opting for defensive assets may pressurize the currencies of the EDB's operating region. Inflation risks will increase due to the weakening of national currencies, higher inflationary expectations and anticipated challenges related to the supply of goods. The leeway for monetary stimulus under such circumstances will be limited, while the increasing threats to debt sustainability will present new challenges for fiscal policy.

We believe that the oil price will average around USD 41 next year in the event of the global economic recovery coming at half the pace compared to that expected under the base case, which is 16% lower than the USD 49 built into the base case. Under this scenario, Russia's GDP will lose about 0.8 p.p. of growth in 2021, and Kazakhstan will lose about 0.9 p.p.

*"The dozen or so global economic crises that we have faced since the war show that people always find ways to solve complex problems: that is why the recession will be followed by a period of recovery. We believe that most economies of the EDB operating region will return to growth in 2021. We project the aggregated GDP growth rate of the EDB member countries at 3.2% in 2021, after a 3.8% decline in 2020.*

*However, the uncertainty and risks are very high in the current environment. In the wake of high uncertainty, it is most important for the Bank's member countries to maintain government support measures for the economy, especially for small and medium-sized businesses and employment, thus curbing the negative social and economic consequences of the pandemic to the extent possible.*

*Achieving a stable growth trajectory while maintaining macroeconomic and debt stability is of particular relevance in the coming year. Even under a favorable scenario, an increase in the long-term economic growth rate of countries in the Bank's operating region will require government measures aimed at overcoming structural constraints."*

*Evgeny Vinokurov  
EDB Chief Economist*

# EXTERNAL ECONOMIC CONDITIONS

## Current situation

### **Expansion of global economic activity in 3Q2020 amid eased lockdown restrictions**

3Q2020 delivered a dynamic global economic recovery after a decline in the previous quarter, facilitated by the easing of restrictive measures and support provided through stimulative fiscal and monetary policies. As a result, the global aggregate PMI averaged 52 p.p. in July–September after 36.8 in April–June, and the U.S. and Eurozone economies regained most of the ground lost in the first half of the year (the GDP decline in 3Q2020 slowed down to 2.9% and 4.4% YoY, from 9% and 14.8% YoY in the previous quarter, respectively). China's GDP increased by 4.9% YoY in July–September (3.2% YoY in 2Q), supported by large-scale fiscal and financial incentives.

### **Slowdown in the recovery process in 4Q2020 due to an increase in the rate of COVID-19 infection...**

At the beginning of 4Q2020, global economic activity continued to expand: the global aggregate PMI amounted to 53.3 p.p. in October, after 52.5 a month earlier. However, the economic trend is mixed: growth in activity was recorded in the U.S., China, India and Australia, while there was a contraction in Japan, and the Eurozone saw stagnation amid a downturn in the service sector. With COVID-19 infections on the rise, stricter lockdown restrictions in European countries, social distancing and high uncertainty, the recovery process in the world's largest economies is likely to slow down and their functioning is likely to remain at a level far below their potential in the rest of 2020.

### **...puts pressure on commodity prices**

The increase in the spread of COVID-19 and the re-introduction of restrictions in EU countries at the end of October–November resulted in increased volatility in commodity prices. Oil prices have declined; they will remain under pressure till the end of the year. The prices of key industrial metals after a rapid recovery at the end of 2Q–3Q2020 remain above pre-crisis levels and they are supported by the growth of production in China. The upward trend remains in food prices, largely determined by the rise in the price of vegetable oils, sugar, dairy products and cereals amid a decrease in their supply and an increase in demand. The price of gold remains near its highest levels in recent years in the wake of uncertainty and soft monetary policy of the world's leading central banks.

### **Weak inflation background amid restrained economic activity**

Inflationary pressures remain weak in major economies due to continued reduced economic activity and low energy prices. U.S. CPI amounted to 1.2% YoY in October 2020 (0.6% YoY in June); while that of the Eurozone was minus 0.3% YoY (0.3% YoY in June) and that of China was 0.5% YoY (2.5% YoY). Food prices are putting some pressure on inflation. However, since the recovery in economic activity slowed down in 4Q2020, the EDB's forecasts assume that the weak inflationary background in the world's largest economies will continue in the short term.

**Increased risk premiums for emerging markets**

Volatility remains high in the global currency market. Increased concerns about the global economic outlook have put pressure on emerging market currencies. Risk premiums for developing countries remain above pre-crisis levels and are likely to remain heightened in the short term due to uncertainty about the development of the pandemic and the global economic recovery process.

**Forecasts****Gradual global economic recovery**

The base case involves a slowdown in the COVID-19 pandemic in the first half of 2021. Lockdown restrictions will be eased in the world's largest economies, which, along with stimulative fiscal and monetary policies, will be instrumental in a recovery in consumer and investment activity, as well as international trade. However, the return to the pre-crisis level of production will be slow. This is due to social distancing requirements and increased uncertainty being maintained after restrictions are lifted, as well as the prolonged impact of business plan revisions on investments.

**Moderate oil price growth**

Under the EDB base case, oil prices will grow at a moderate pace in 2021–2022, supported by a recovery in global economic activity. The food segment can also expect a slight medium-term increase, also due to the projected upturn in energy prices. Stimulative monetary policy of leading central banks will continue to provide support to gold prices in 2021–2022. However, the base case assumes a gradual decrease in the price of gold as the risks to the global economy weaken.

**Moderate inflation background...**

Under the EDB's forecasts, inflation will gradually increase in the U.S. and the Eurozone in 2021–2022 as business activity and energy prices recover. That said, inflation will remain below the target in the countries under review since the economies will not be operating at full potential.

**...will cause leading central banks to maintain low interest rates**

On account of moderate inflationary pressures and the need to support the economic recovery process, the EDB forecasts assume a stimulative monetary policy in the world's largest economies in the medium term. This will lead to the key interest rates of the U.S. and Eurozone monetary regulators remaining at their current levels in 2021–2022, among other impacts.

**Forecasts of key foreign economic indicators (base case)**

	Average annual Urals oil price (USD per barrel)	Average annual gold price (USD per troy ounce)	U.S.'s real GDP growth rate, %	Eurozone's real GDP growth rate, %	China's real GDP growth rate, %
<b>2020</b>	41	1,785	-3.7	-7.5	2.0
<b>2021</b>	49	1,919	4.1	4.5	8.5
<b>2022</b>	53	1,865	3.1	3.9	5.5

**Source:** EDB calculations

## Risks

### **The development of the pandemic and its impact on long-term economic growth remain highly uncertain**

There is high uncertainty about the prospects for global economic recovery, largely because of the unpredictable development of the COVID-19 pandemic. The risks to the Bank's base case are skewed to the downside. Possible delays in the development and distribution of sustainable vaccines, a longer period of restrictive measures and social distancing than those planned in the base case, severe secondary effects of the pandemic affecting investment and consumer activity, as well as an increase in the debt burden (especially in developing countries) may lead to a stronger reduction in the potential for global economic growth. Among other sources of risk are a no-deal Brexit, increased protectionism in world trade and the unstable geopolitical situation.

A faster recovery than that assumed in the EDB's base case cannot be ruled out, either. It might come true should stable vaccines be developed soon and all countries receive access to them; this might advance the lifting of restrictions and social distancing measures and reduce the secondary effects of the pandemic.

# EDB MEMBER COUNTRIES

## Key macroeconomic indicators (base case)

Indicator	2017	2018	2019	2020F	2021F	2022F
<b>EDB Member Countries</b>						
Aggregate real GDP, %	2.1	2.7	1.7	-3.8	3.2	2.8
<b>Republic of Armenia</b>						
GDP in constant prices, %	7.5	5.2	7.6	-6.4	4.9	6.7
Inflation (at end of year), %	2.6	1.8	0.7	1.2	1.1	2.4
IBL rate (the year's average), %	5.9	6.1	5.8	5.0	4.2	5.1
National currency to U.S. dollar exchange rate (the year's average)	483	483	480	487	492	486
<b>Republic of Belarus</b>						
GDP in constant prices, %	2.5	3.1	1.2	-1.5	-0.1	0.9
Inflation (at end of year), %	4.6	5.6	4.7	6.4	5.5	4.7
IBL rate (the year's average), %	9.5	10.7	10.1	9.7	9.1	7.7
National currency to U.S. dollar exchange rate (the year's average)	1.93	2.04	2.09	2.45	2.61	2.64
<b>Republic of Kazakhstan</b>						
GDP in constant prices, %	4.1	4.1	4.5	-3.0	4.4	4.2
Inflation (at end of year), %	7.1	5.3	5.4	7.3	5.3	5.2
IBL rate (the year's average), %	9.9	8.4	8.4	9.1	8.3	8.0
National currency to U.S. dollar exchange rate (the year's average)	326.0	344.7	382.8	413.9	423.8	433.5
<b>Kyrgyz Republic</b>						
GDP in constant prices, %	4.7	3.8	4.5	-7.5	3.7	5.1
Inflation (at end of year), %	3.7	0.5	3.1	6.5	5.2	4.2
IBL rate (the year's average), %	1.7	2.2	2.9	3.6	4.0	5.6
National currency to U.S. dollar exchange rate (the year's average)	68.9	68.8	69.8	77.3	83.2	83.5
<b>Russian Federation</b>						
GDP in constant prices, %	1.8	2.5	1.3	-4.0	3.2	2.7
Inflation (at end of year), %	2.5	4.3	3.0	4.2	3.5	3.8
MIACR rate (the year's average), %	9.0	7.1	7.2	4.9	4.2	4.7
National currency to U.S. dollar exchange rate (the year's average)	58.3	62.5	64.7	72.3	74.5	72.9
<b>Republic of Tajikistan</b>						
GDP in constant prices, %	7.1	7.3	7.5	4.5	6.1	7.4
Inflation (at end of year), %	6.7	5.4	7.6	8.5	5.3	5.2
Refinancing rate (the year's average), %	15.1	14.2	13.8	11.5	10.3	9.2
National currency to U.S. dollar exchange rate (the year's average)	8.5	9.2	9.5	10.3	11.6	12.0

**Source:** national agencies of the EDB member countries, EDB calculations

# REPUBLIC OF ARMENIA

## Current situation

### **GDP to decrease by 6.4% in 2020**

Armenia's economy continues to experience a downturn. In January–September 2020, it amounted to 6.6% YoY (7.5% YoY in September). Consumer and investment demand declined due to the negative effects of the coronavirus pandemic and the escalation of the conflict in Nagorno-Karabakh. We believe that these factors will result in the GDP of the country declining by 6.4% in 2020.

### **Inflation below the CBRA target**

In October 2020, inflation was 1.3% YoY, down from 1.4% YoY in September. The EDB projects the reduced demand in the economy to retain a significant disinflationary impact on prices in the coming months. This might lead to the growth remaining under the CBRA target in the current year (4±1.5%).

### **Armenian dram weakens moderately against the U.S. dollar**

Despite the growth of economic and political risks in 2020, the national currency (dram) has declined in price against the U.S. dollar moderately, by 2.9% as of the end of October compared to December 31, 2019. This was facilitated by an improvement in foreign trade in goods, with its deficit declining to USD 1.8 billion in January–September 2020, down from USD 3.7 billion in the same period of 2019. Imports decreased by 13.7% YoY, while exports decreased by only 4.4% YoY: the decline in prices for exporters' products was partially offset by an increase in physical volumes of sales, primarily non-ferrous metal ore concentrates.

### **Monetary policy to be eased to support the economy**

The Central Bank of the Republic of Armenia strengthened its stimulative monetary policy amid a slowdown in economic activity and inflation sticking below the target range. The regulator lowered the refinancing rate from 5.5% at the beginning of the year to 4.25% as of the end of October 2020. The actions of the CBRA affected the indicators of both the financial market and the banking sector. In January–September 2020, IBL rates and government bond yields experienced a downturn. Growth in bank lending to the economy accelerated from 18% YoY at the end of 2019 to 18.9% YoY in September 2020, despite the decrease in real economic activity.

### **Increased budget deficit**

In January–September 2020, the budget posted a deficit of AMD 155 billion. In the same period of the previous year, the budget had a positive surplus of AMD 95 billion. The state of public finances deteriorated as spending increased: expenses experienced an upturn to AMD 1,230 billion, from AMD 1,053 billion in the previous year, partially according to plan and partially due to the financing measures aimed at combating the coronavirus outbreak and supporting the economy. Budget revenues decreased to AMD 1,075 billion, from AMD 1,148 billion in January–September 2019.

**Total volume of support for the economy will amount to 3.7% of GDP in 2020**

The amount of funding for measures implemented in 2020 by the Armenian authorities to support the economy amid the coronavirus pandemic can be estimated at AMD 230 billion (3.7% of GDP). AMD 150 billion (2.3% of GDP) of this funding accounts for measures structured into a series of phased programs (as of September 2020, there were 24 of them). Some were aimed at providing economic support to business (agriculture, tourism, small and medium-sized businesses, microbusinesses, information technology and other industries) through the provision of grants, co-financing, refinancing of loans, and subsidizing interest rates. Others involve social support for various groups of population. In addition, support in the amount of 1.4% of GDP has been provided as tax breaks.

**Rising public debt**

On the back of the budget deficit, the national debt of Armenia has begun to grow again and reached AMD 3.8 trillion, or USD 7.9 billion, as of end September 2020 (versus AMD 3.5 trillion, or USD 7.3 billion, at the end of 2019). In early October 2020, Fitch downgraded Armenia's credit rating from BB- to B+ with a stable outlook. The decision was due to a sharper than expected decline in the country's GDP and a deterioration in economic forecasts.

## Forecasts

### Key macroeconomic indicators of the Republic of Armenia (base case)

Indicator	2017	2018	2019	2020F	2021F	2022F
<b>GDP</b> in constant prices ( <i>% growth YoY</i> )	7.5	5.2	7.6	-6.4	4.9	6.7
<b>Consumer price index</b> ( <i>% growth in December to previous year's December</i> )	2.6	1.8	0.7	1.2	1.1	2.4
<b>IBL rate in national currency</b> ( <i>the year's average, %</i> )	5.9	6.1	5.8	5.0	4.2	5.1
<b>National currency to U.S. Dollar exchange rate</b> ( <i>the year's average</i> )	483	483	480	487	492	486

Source: National agencies, EDB calculations

**Recovery of demand in the economy amid a gradual decrease in the intensity of the pandemic**

The EDB's base case assumes that the country's authorities will be able to avoid the introduction of restrictive measures comparable in severity to those applied in the first half of 2020 on account of the gradually decreasing intensity of the COVID-19 pandemic, as well as maintain control over foreign policy and military risks. Growth in remittances sent to the country and in export prices (in particular, ores and metals) as the economic situation in the world normalizes will support the recovery in demand.

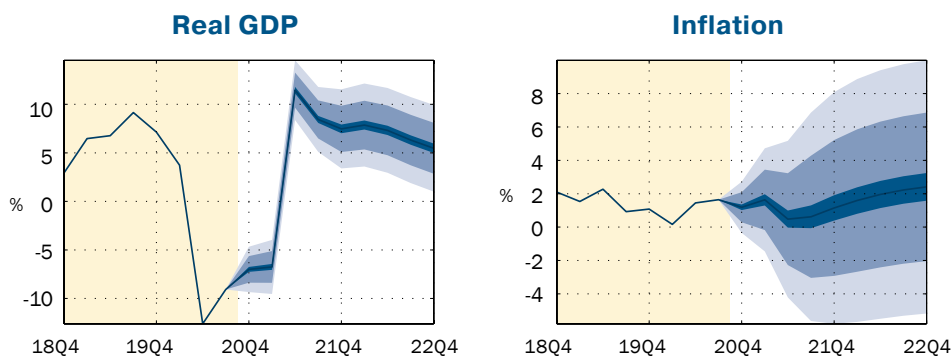
**The economy will return to the level of 2019 no sooner than 2022**

We believe that GDP will increase by 4.9% in 2021 and by 6.7% in 2022. Moderate global business activity and continuing foreign policy tensions in the region will impede quicker recovery of the economy. As a result, the Armenian economy will not be able to reach the level of 4Q2019 until 2022.

**Inflation returning to bottom of target in 2022**

The EDB projects the reduced demand in the economy to retain a significant disinflationary impact in 2020–2021. Short-term price trends will be affected primarily by changes in the price of food in the domestic market. In 2022, inflation is expected to return to the lower limit of the target range of the CBRA ( $4 \pm 1.5\%$ ), driven by the recovery in investment activity. The stimulative policy of the Central Bank will help drive this.

**Figure 3.<sup>1</sup>**  
**Economic activity and inflation in the Republic of Armenia**



**Note:** seasonally adjusted data.

**Source:** EDB calculations

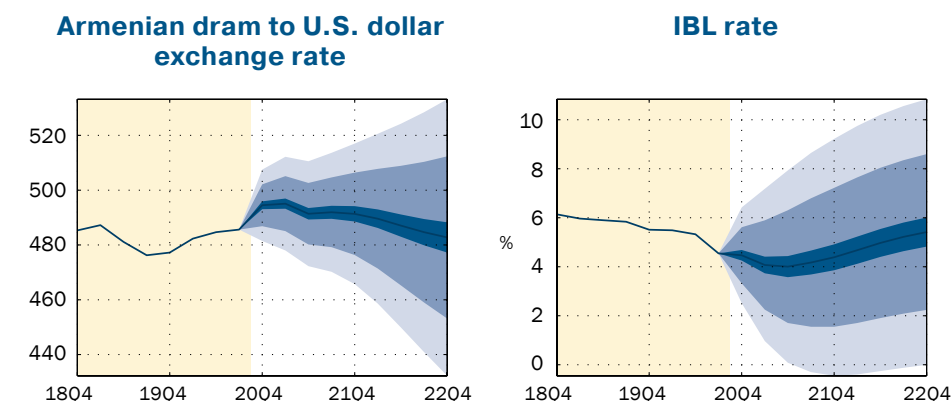
**Rates to increase as inflation speeds up**

The EDB’s forecasts assume monetary policy to remain stimulative in the medium term, factoring in the weak inflationary background. In our base case, the cycle of refinancing rate rises will begin at the end of 2021 as inflation gradually returns to the target range.

**Dram exchange rate to stabilize**

The dram is expected to maintain a stable exchange rate against the U.S. dollar in the medium term. An increase in export revenues, as well as an increase in foreign investment and remittances in 2021–2022, will be drivers behind the national currency’s stability as the situation in the world economy improves. The dram to U.S. dollar real exchange rate will favor a near-equilibrium level over the period.

**Figure 4.**  
**Armenian dram rate and IBL rate**



**Source:** EDB calculations

<sup>1</sup> Here and elsewhere the chart ranges correspond to the 10%, 50% and 75% confidence intervals.

## Risks

- External and domestic political risks** In the short term, there are still risks of a repeated slowdown in economic growth due to the risk of new outbreaks of coronavirus both in the world and within the country. Political risks, both domestic and external, i.e. those involving the confrontation in Nagorno-Karabakh or the Western sanctions policy against Armenia's economic partners (Russia), can also affect the Armenian economy.
- Longer pandemic will increase damage to the economy** It is still uncertain when the pandemic will end. Should it last longer than the period built into the base case, then the damage to the economy will be higher than expected. According to the EDB calculations, under the scenario in which the global economic recovery in 2021 will be slow and the oil price will be lower than in the base case (when global GDP growth is 1.6 p.p. less and oil is 16% cheaper), the rate of GDP growth in Armenia will be 2.5 p.p. below the base forecast and will amount to about 2.4% in 2021.
- Risk of rapid public spending reduction** The public debt level is a source of risk for the country. As of mid-2020, it reached 58.4% of GDP (53.5% at the end of 2019). The need to limit the debt burden may lead to a rapid reduction of public spending, which will hold back the GDP growth rate in the medium term, thus slowing down the economic recovery.
- Risk of national currency weakening** The uncertain economic situation in the world and geopolitical tensions may cause instability in the currency market in the country, resulting in the weakening of the dram (a more significant weakening than that observed from January to October 2020). Such a scenario might have mixed consequences for the economy. It will make Armenian producers more competitive in the domestic and external market, and open the way for inflation to be brought to within the CBRA target range. However, it will also decrease consumer activity, at least in the short term, as well as increase public debt as a share of GDP, as it has a significant part denominated in foreign currency.

# REPUBLIC OF BELARUS

## Current situation

### **1.5% GDP reduction in 2020 due to weakening consumer and investment demand**

Economic activity remains moderate in Belarus in 4Q2020. The decline in the country's GDP amounted to 1.1% YoY in the first 10 months. Consumer and investment demand is limited by increased uncertainty amid socio-political tensions, a decline in market lending and a weak financial performance of companies, as well as social distancing and a slowdown in income growth. These factors will continue to hold back business activity in the coming months. We forecast that GDP of the RB will decrease by 1.5% in 2020.

### **Acceleration of inflation to 6.4% by the end of 2020**

Inflationary expectations affecting prices and ruble weakening in August–September caused inflation to increase to 6.2% YoY in October. However, these factors are decreasing their influence and the acceleration of the inflation rate is declining. Moderate demand is having a disinflationary effect. We forecast the CPI growth rate to amount to 6.4% YoY in 2020.

### **Belarusian ruble weakens against a background of net demand for foreign currency in the domestic market**

The surplus of trade in goods and services of the Republic of Belarus increased in January–September 2020 (USD 1.5 billion after USD 0.6 billion a year earlier) on account of a faster decline in imports (down 18.8% YoY) compared to exports (down 15.5% YoY). The weakening ruble, the growth of food supplies abroad and tourism restrictions were the drivers behind it. Despite the improvement in the trade balance, there was significant net demand for foreign currency, largely driven by devaluation expectation spikes in March and August. This translated into the Belarusian ruble weakening by 21.5% against the US dollar as of November 17 since the beginning of the year, and weakening against the currency basket by 10.3%. We project the RB NB to have sold some USD 1.6 billion on the currency exchange in January–October<sup>2</sup> in order to support the national currency: this became the main driver behind the decline in reserve assets from USD 9.4 billion at the beginning of the year to USD 7.5 billion as of November 1.

### **Monetary policy tightening in the second half of 2020 due to accelerated inflation**

Due to the increasing short-term pro-inflationary factors, the RB NB restricted banks' access to permanently available liquidity support operations in August, subsequently extending the restrictions until January 19, 2021. As a result, despite the refinancing rate being maintained at 7.75%, the volume of market lending has decreased since the end of August and the cost of

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<sup>2</sup> This calculation does not take into account the likely purchase of foreign currency in the domestic market by the RB Ministry of Finance.

resources in the interbank market has increased. Bank deposit rates have increased significantly in recent months on account of an outflow of the population's deposits amid increased devaluation expectations. However, the cost of lending has changed little on average due to the estimated values of standard risk used, while banks have limited the amount of funds available for borrowing.

**Budget posts deficit** The consolidated budget of the public administration sector of the Republic of Belarus posted a deficit, which amounted to 1.8% of GDP in the first nine months of this year (a surplus of 3.6% of GDP a year earlier). Revenues declined by 5.6% YoY in the wake of the economic recession and lower oil prices. Spending increased by 9.1% YoY, in particular, as a result of government measures to support the economy to mitigate the effects of the pandemic. Since the budget posted a deficit, it has led to a reduction in the government's ruble funds in the RB NB by almost BYN 2 billion since the beginning of the year, to BYN 1.5 billion as of October 1. The fiscal reserves were thus reduced.

**State support made it possible to make up for about 0.2–0.5% of GDP losses in 2020** The volume of anti-crisis support for the Belarusian economy is about 1.1% of GDP this year (2% of GDP including a loan from the Eurasian Fund for Stabilization and Development), according to our calculations based on reports from government officials. The main volume falls on loans from state banks under guarantees of the government and local authorities: about BYN 800 million<sup>3</sup> (overall, the limit of state guarantees has been expanded by BYN 1.2 billion). The amount of tax benefits and preferences is estimated at more than BYN 34 million, and the amount of support for rental vacations exceeded BYN 30 million. Another BYN 325 million served as incentive payments to health and social services workers for working during the coronavirus pandemic. We believe that state support reduced the scale of the decline in Belarus' GDP by about 0.2–0.5% in the current year.

**Increased public debt** As of October 1, 2020, the public debt increased to 35.3% of GDP (33.7% as at the beginning of the year), mainly due to external borrowing and revaluation of the currency component of the public debt on account of the weakening of the Belarusian ruble. The consolidated budget posting a deficit, limited fiscal and reserve assets, a tight schedule of payments on public debt in the medium term and the unstable situation in the domestic currency market increase the risks to the debt sustainability of the Republic of Belarus.

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<sup>3</sup> For more information, please see: <http://government.by/ru/content/9603>

## Forecasts

### Key macroeconomic indicators of the Republic of Belarus (base case)

Indicator	2017	2018	2019	2020F	2021F	2022F
<b>GDP</b> in constant prices ( <i>% growth YoY</i> )	2.5	3.1	1.2	-1.5	-0.1	0.9
<b>Consumer price index</b> ( <i>% growth in December to previous year's December</i> )	4.6	5.6	4.7	6.4	5.5	4.7
<b>IBL rate in national currency</b> ( <i>the year's average, %</i> )	9.5	10.7	10.1	9.7	9.1	7.7
<b>National currency to U.S. Dollar exchange rate</b> ( <i>the year's average</i> )	1.93	2.04	2.09	2.45	2.61	2.64

Source: National agencies, EDB calculations

#### Stagnating Belarus economy

Under the base case, Belarusian GDP will decrease by 0.1% in 2021. The 1.2 p.p.<sup>4</sup> decline compared to the previous projection can be explained by a number of factors, such as the continued socio-political tensions in the country and a longer-than-expected period of restrained monetary policy. Next year will experience the largest effect on economic activity from monetary measures as a result of the slow process of providing a monetary impulse to the real economy.

We expect weak investment activity in 2021: it will be limited by increased uncertainty and the unstable finances of businesses. Consumer demand will remain moderate amid the projected slowdown in household income growth. Fiscal policy tightening is expected; it will become an additional driver limiting the rate of domestic demand recovery. The recovery of business activity abroad, including in Russia, as well as a gradual easing of health restrictions as the epidemiological situation normalizes, will support the economy of the Republic of Belarus in 2021–2022. Monetary policy measures are projected to support domestic demand at the end of 2021–2022.

#### Recovery of pre-crisis output volume in 2023

We project economic growth to remain weak at 0.9% in 2022. As a result, the pre-crisis level of GDP (4Q2019) will be reached only in the first half of 2023. Slow recovery will result in a negative output gap remaining throughout the forecast period, indicating that the economy will operate at a level below its potential.

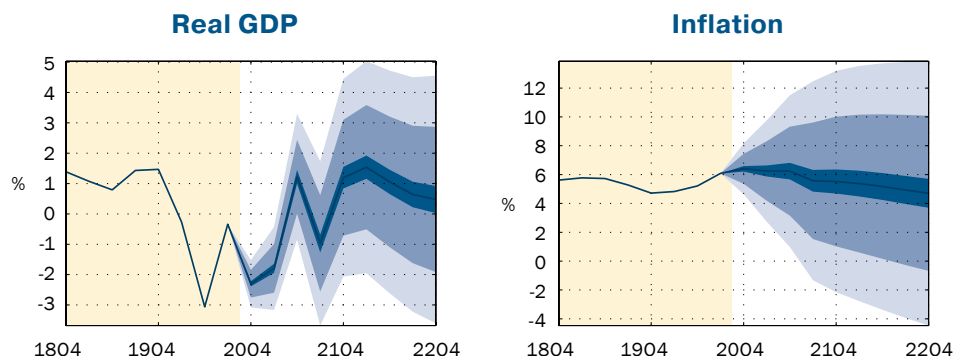
Under the base case, part of the IT sector will be relocated and debt repayments by the RB are assumed to be smoothed. The latter may require full refinancing and even an increase in public debt to maintain the level of reserve assets at near two months' worth of imported goods and services.

<sup>4</sup> For more information, please see EDB Macroreview. September 2020. Republic of Belarus.

**Inflation to slow down in 2021–2022 amid moderate demand**

The growth rate of the consumer price index is expected to amount to 5.5% YoY in 2021. Weak domestic demand and the normalization of the Belarusian ruble exchange rate dynamics will help reduce inflation. In 2022, inflation is projected to slow down to 4.7% YoY, due to the implementation of a balanced monetary policy and lowering inflation expectations.

**Figure 5. Economic activity and inflation in the Republic of Belarus**



**Note:** seasonally adjusted data.  
**Source:** EDB calculations

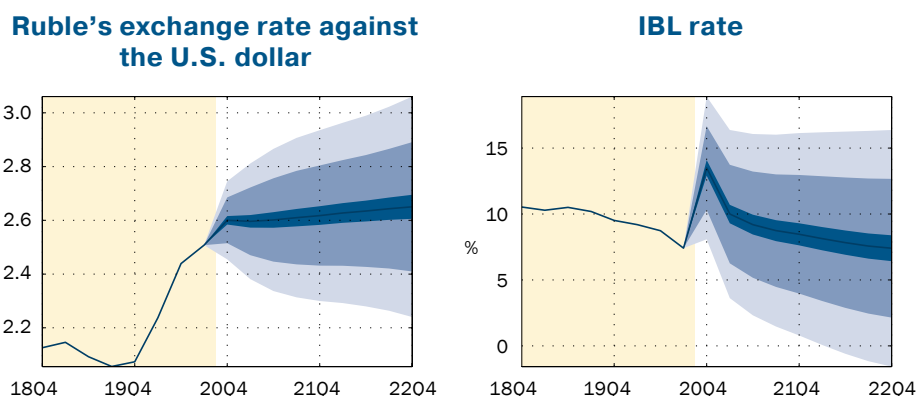
**Potential for refinancing rate reduction in the medium term**

The EDB’s base case assumes the end of restrictions on permanently available liquidity management operations from January 20, 2021. The gradually decreasing devaluation and inflationary expectations will facilitate the return of the cost of borrowing in the interbank market to the upper band of the RB NB’s interest rate corridor (about 8–8.75%) during 2021. In the medium term, we still see potential for the refinancing rate to decline to about 7–7.5% against expected low economic growth; however, its implementation will largely be determined by the state of the domestic financial market.

**Belarusian ruble tending to weaken**

The Belarusian ruble is currently undervalued against the currencies of the main trading partners, including the U.S. dollar. The exchange rate is expected to adjust to an equilibrium level during 2021–2022 provided that the situation in the domestic financial market stabilizes and the pandemic is contained; the process is slow due to heightened devaluation expectations. In nominal terms, the Belarusian ruble will weaken at a moderate rate as inflation in Belarus stays higher than in its main trading partner countries.

**Figure 6. Belarusian ruble exchange rate and IBL rate**



**Source:** EDB calculations

## Risks

**It is unclear how socio-political events will influence economic growth potential**

The uncertain impact of socio-political events on business activity in the country in recent months is the key risk to our forecasts. The likely deterioration of the investment climate, as well as the outflow of a substantial part of the IT sector and labor resources, will reduce the adaptability of the economy and bring losses of human capital, resulting in a reduction of growth potential. Should an unfavorable scenario develop, there is a high probability of a deeper economic downturn in 2021 than that forecasted in the base case, and near-zero growth in 2022. The rate of ruble depreciation and debt sustainability risks will increase, with inflation likely to reach double-digits due to a steady increase in inflationary and devaluation expectations.

**Likely increase in non-market lending**

The precarious financial position of non-financial sector businesses, the high debt burden and lack of own working capital are significant sources of risk to the Belarusian economy. In these circumstances, the volume of non-market lending to support the activities of state-owned enterprises may increase. This will provide short-term support for output and employment, while leading to imbalances in the wake of low potential economic growth.

**Slow recovery in external demand will deepen the downturn in the Belarusian economy**

It is still highly uncertain how the COVID-19 pandemic will develop. Belarus' GDP decrease will amount to 0.7% in 2021 in the event of a global economic recovery at half the pace of that assumed in the base case; this is 0.6 p.p. lower than the forecast built into the base case. The average Belarusian ruble exchange rate against the U.S. dollar is projected at 2.76, 6% weaker than under the main scenario.

**Geopolitical tensions in the region remain a significant source of risks for the economy of the Republic of Belarus**

The likely tightening of anti-Russian sanctions may significantly affect the economy of Belarus due to close trade and economic relations between Belarus and Russia. We believe that the growth of potential GDP of the Russian Federation under this scenario may decrease by about 0.4–0.6 p.p., which will reduce the growth of potential GDP of the Republic of Belarus by about 0.1–0.3 p.p.

# REPUBLIC OF KAZAKHSTAN

## Current situation

### **3.0% GDP reduction in 2020 due to weakening consumer and investment demand**

Economic activity remains moderate in Kazakhstan in 4Q2020. The decline in the country's GDP amounted to 2.9% YoY in the first 10 months. Maintained lockdown measures, the suspension of investment projects, the decline in market lending and real incomes, weak foreign economic activity and fulfilling the OPEC+ agreement are limiting consumer and investment demand. Measures of state support from fiscal and monetary policy are instrumental in mitigating the negative consequences. These factors will continue to have a key impact on business activity in the coming months, and the EDB believes that Kazakhstan's GDP will decline by 3.0% in 2020.

### **Acceleration of inflation to 7.3% by the end of 2020**

Inflation increased to 7.1% YoY in October, from 5.4% in December 2019, due to the weakening tenge affecting prices (mainly food prices), lower production in the livestock sector and higher food prices in the world market. Weak domestic demand is driving price stability in the non-food segment. Monetary conditions are also curbing inflation acceleration in the consumer sector. We believe that pro-inflationary and disinflationary factors will cancel each other out for the rest of the year, thus ensuring annual CPI remains close to the current level.

### **Weakening of the tenge as export revenue decreases**

The positive balance of trade in goods of the Republic of Kazakhstan decreased in January–August as exports declined faster than imports. This was affected by weak external demand for Kazakh goods, the OPEC+ agreement, falling world commodity prices and weak domestic consumer activity. The decline in foreign exchange earnings from foreign economic activity has been accompanied by increased turbulence in global financial markets and increased geopolitical risks in the region in recent months, which has increased net demand for U.S. dollars from residents of Kazakhstan. This translated into the tenge weakening by 12.5% to mid-November since the beginning of the year. In order to stabilize the national currency, the NB RK has sold USD 1.8 billion of the foreign exchange.

### **Base rate unchanged in the second half of 2020 due to accelerated inflation risks**

In the second half of the year, the base rate has remained unchanged at 9.0%. Strengthening pro-inflationary factors hindered the indicator's decline. However, maintaining a stimulative monetary policy will be required to support the economic recovery process. We expect the base rate to remain at the current level until the end of 2020, but we assume that it is likely to increase should inflationary pressures be on the upswing. The cost of loans and interest rates on deposits in 3Q2020 did not change significantly compared to 2Q2020.

**Increasing budget deficit**

The state budget deficit of the Republic of Kazakhstan amounted to KZT 1.8 trillion in the first nine months of this year (KZT 0.6 trillion a year earlier). Revenues increased by 10.9% YoY on account of an increase in the volume of transfers from the National Fund of the Republic of Kazakhstan (by 1.6 times) and non-tax revenues (by 1.9 times). Tax collections decreased by 10.3% YoY amid reduced economic activity and lower prices for key export commodities of the Republic of Kazakhstan. Spending increased by 23% YoY, in particular, as a result of government measures to support the economy to mitigate the adverse effects of the pandemic and to increase wages in the education sector.

**State anti-crisis support will soften the decline in business activity**

The Kazakh authorities have introduced a wide range of state support measures for businesses and the population to mitigate the negative impact of the pandemic. The total volume of anti-crisis financing, excluding tax preferences and local aid, has amounted to KZT 5.9 trillion (8.7% of GDP). The government has focused on providing soft loans under its programs “Roadmap for Employment” and “Economy of Simple Things”, the development of housing construction, as well as the expansion of social support for citizens of the Republic, including the payment of a minimum wage to those temporarily unemployed. We believe this will make up for 2–3% of GDP losses.

**Rising public debt**

As of October 1, 2020, public debt in tenge had risen by 19.3% YoY, mainly due to the issuance of long-term government treasury debt and the placement of eurobonds, as well as being partially due to the exchange rate revaluation.

**Forecasts****Key macroeconomic indicators of the Republic of Kazakhstan (base case)**

Indicator	2017	2018	2019	2020F	2021F	2022F
<b>GDP</b> in constant prices ( <i>% growth YoY</i> )	4.1	4.1	4.5	-3.0	4.4	4.2
<b>Consumer price index</b> ( <i>% growth in December to previous year's December</i> )	7.1	5.3	5.4	7.3	5.3	5.2
<b>TONIA rate</b> ( <i>the year's average, %</i> )	9.9	8.4	8.4	9.1	8.3	8.0
<b>National currency to U.S. Dollar exchange rate</b> ( <i>the year's average</i> )	326.0	344.7	382.8	413.9	423.8	433.5

**Source:** National agencies, EDB calculations

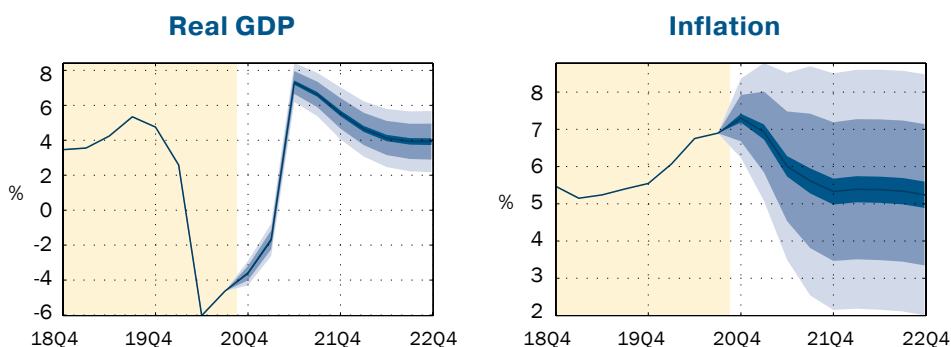
**Economic growth to recover in 2021–2022 on account of implementation of public programs**

Under the EDB's base case, Kazakh GDP will increase by 4.4% in 2021 and by 4.2% in 2022. In 2021, fiscal stimulus is expected to remain roughly at the level of 2020 and the budget deficit is expected to fall to 2.5% of GDP in 2022. State development programs, such as expansion of infrastructure and housing, support and development of businesses, productive employment and mass entrepreneurship, will help the economy recover. The Kazakh economy will also be stimulated in 2021–2022 by the easing of monetary policy projected in 2021, as well as increased business activity abroad, in particular, in Russia.

**Recovery of pre-crisis output volume in 2021** As a result, we expect that the pre-crisis (4Q2019) level of GDP can be reached in mid-2021. The negative gap will gradually contract in 2021–2022.

**Inflation to slow down in 2021–2022 amid moderate demand** The growth rate of the consumer price index is expected to amount to 5.3% YoY in 2021. The exhaustion of pro-inflationary factors prevalent in 2020 (the weakening tenge, feverish demand, lower production in certain sectors of animal farming and higher global food prices) will help reduce inflation. In 2022, inflation is projected at 5.2% YoY, while the disinflationary impact of weak domestic demand will gradually weaken.

**Figure 7. Economic activity and inflation in the Republic of Kazakhstan**

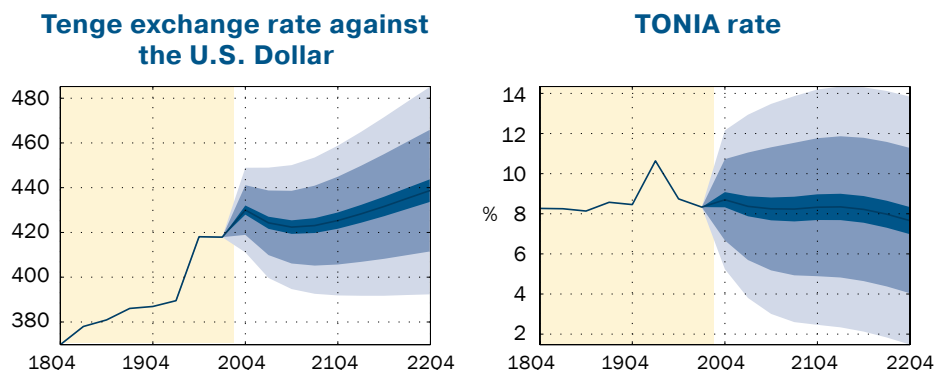


**Note:** seasonally adjusted data.  
**Source:** EDB calculations

**Potential for base rate reduction in the medium term** The EDB’s base case assumes that the epidemiological situation normalizes in the country and the world, which will be accompanied by a decrease in devaluation and inflationary expectations. Since the economy will operate below its potential, this will require mitigating the monetary policy further. As the economy approaches equilibrium levels, interest rates will adjust to a neutral level in the interbank credit market.

**Tenge tending to weaken** The tenge is currently undervalued against the currencies of the main trading partners, including the U.S. dollar. The exchange rate is expected to adjust to an equilibrium level during 2021 assuming a slowdown in the coronavirus spread and normalization of the geopolitical situation. In nominal terms, the tenge will weaken at a moderate rate (about 1–2%) as inflation in Kazakhstan stays higher than in its main trade partner countries.

**Figure 8. Kazakh tenge exchange rate and TONIA rate**



**Source:** EDB calculations

## Risks

### **Uncertain development of the global epidemiological situation**

At the beginning of November 2020, coronavirus statistics reached new heights daily. This compelled several governments to implement lockdown measures. Although they are moderate compared to those introduced in the spring, the activities of organizations in the service sector are either significantly limited or completely suspended. Thus, there are still heightened risks to the prospects for global economic recovery and, as a result, stability in the global oil market. An increase in demand and a reduction in the export volumes of a number of food products may drive up their prices in the world market. Should an unfavorable scenario happen, slower recovery of the economy of Kazakhstan is likely to occur in the medium term and pro-inflationary risks are likely to increase.

According to the EDB's calculations, if oil prices remain at the current year's level in 2021 and the global economic recovery is delayed, the rate of GDP growth in Kazakhstan will be 0.9 p.p. below the base forecast, reaching about 3.5% in 2021.

### **Geopolitical tensions in the region**

The likely tightening of anti-Russian sanctions may significantly affect the economy of Kazakhstan due to close trade and economic relations between Kazakhstan and Russia. Increased volatility in the domestic currency market will be the first reaction. Should secondary effects materialize, the Republic's external trade and business activity will decrease.

# KYRGYZ REPUBLIC

## Current situation

### **7.5% GDP reduction in 2020 on account of adverse effect of pandemic and escalation of political situation**

Economic activity remains weak in the Kyrgyz Republic in 4Q2020. The decline in the country's GDP reached 7.4% YoY in the first 10 months. Weak foreign economic activity, partial closure of the borders with China, consequences of lockdown measures imposed previously and the suspension of investment projects are limiting consumer and investment demand. Increased socio-political uncertainty has had a further negative impact on the economy. The gold mining sector is also expected to make a negative contribution to this year's GDP. We forecast GDP of the KR to decrease by 7.5% in 2020.

### **Acceleration of inflation to 6.5% YoY by the end of 2020**

Inflation rose to 7.2% YoY in October due to an increase in the cost of food in the world market and demand for meat products from Kyrgyz producers. The acceleration of the som's depreciation rate was instrumental in increasing the cost of consumer goods in the Republic (mainly food products). Weak domestic demand is maintaining price stability in the non-food segment. We believe that the impact of pro-inflationary factors associated with higher global prices for grain, vegetable oil and sugar will increase during the rest of the year, causing further acceleration of inflation.

### **Weakening som in the wake of increased volatility in global markets**

The negative balance of trade in goods of the Kyrgyz Republic decreased in January–August as exports experienced an upswing and imports decreased. The increase in foreign currency earnings from sales abroad was largely driven by the increase in world gold prices, while exports decreased by 19.0% YoY excluding that factor. The closure of borders with China and weak domestic consumer activity drove the import trends. The decline in the trade deficit was accompanied by increased turbulence in global financial markets and increased geopolitical risks in the region. This translated into the som weakening by 22.0% to mid-November since the beginning of the year. The NB KR acted as a net seller of foreign currency in the domestic market in order to smooth out sharp fluctuations in the exchange rate of the national currency. From January to November 1, the net sales volume amounted to USD 345.7 million.

### **Stimulative interest rates on money market**

In the second half of the year, the policy rate remained unchanged at 5.0%. On the one hand, declining business and investment activity requires maintaining a stimulative monetary policy. On the other hand, increased pro-inflationary risks prevent a rate reduction. We expect the rate to remain at the current level until the end of 2020, but it could increase should inflationary pressures be on the upswing. The cost of loans increased to 17.2% by the end of 3Q from 16.7% in June 2020. New deposit rates were volatile, however, their quarterly average remained approximately at the level of 2Q.

**Increased budget deficit**

The public budget deficit increased to 3.4% of GDP in the first nine months of this year (0.5% of GDP a year earlier). The decrease in revenue is caused by a reduction in tax collections on account of the economic downturn. Their loss was partially offset by an increase in non-tax revenues and transfers from international organizations. The growth in expenditures was due to increased allocations intended to contain the pandemic, as well as higher salaries for teachers and law enforcement officials.

**Soft loans will compensate for about 0.5–1% of GDP losses in 2020**

The government of the Kyrgyz Republic has attracted external borrowings under subsidized financing from international financial institutions in order to smooth out the negative impact of the coronavirus on the economy. Amid falling tax revenues, part of the funds received was used to support the budget and to finance measures to contain COVID-19. State support for business in 2020 provided in the form of soft loans totalling KGS 14 billion (2.4% of GDP) has been approved. We believe that the GDP of the Kyrgyz Republic would have decreased by 8.0–8.5% in 2020 instead of our projected 7.5% without the soft loan program provided by the government.

**Rising public debt**

As of September 1, 2020, public debt increased to 65.0% of GDP (56.5% of GDP a year earlier), mainly due to new preferential external financing received from international development institutions and, to a lesser extent, due to the issuance of domestic public debt.

**Forecasts****Key macroeconomic indicators of the Kyrgyz Republic (base case)**

Indicator	2017	2018	2019	2020F	2021F	2022F
<b>GDP</b> in constant prices ( <i>% growth YoY</i> )	4.7	3.8	4.5	-7.5	3.7	5.1
<b>Consumer price index</b> ( <i>% growth in December to previous year's December</i> )	3.7	0.5	3.1	6.5	5.2	4.2
<b>REPO rate – 7d</b> ( <i>the year's average, %</i> )	1.7	2.2	2.9	3.6	4.0	5.6
<b>National currency to U.S. Dollar exchange rate</b> ( <i>the year's average</i> )	68.9	68.8	69.8	77.3	83.2	83.5

**Source:** National agencies, EDB calculations

**Economic growth recovery in 2021–2022**

Under the EDB's base case, Kyrgyz GDP will increase by 3.7% in 2021 and by 5.1% in 2022. As the situation in the global economy stabilizes and business activity in key trading partner countries (Russia, Kazakhstan, China) increases, the Kyrgyz Republic's economy will develop along the

path of recovery growth. The resumption of the inflow of remittances will contribute to the strengthening of domestic consumer demand. At the same time, the decline in gold production at the Kumtor mine will curb growth.

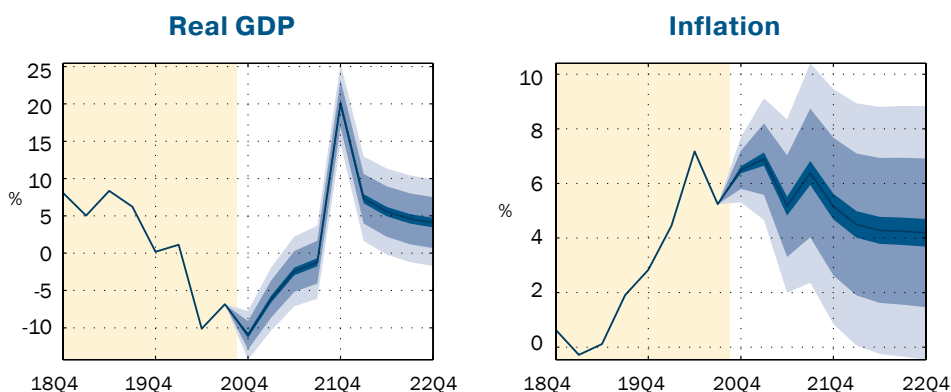
### Recovery to pre-crisis output volume in early 2022

As a result, we believe that the pre-crisis level of GDP (4Q2019) will be reached only in early 2022. The negative output gap will slowly decrease throughout the forecast period, indicating that the economy will operate at a level below its potential.

### Inflation to slow down in 2021–2022 amid moderate demand

The growth rate of the consumer price index is expected to amount to 5.2% YoY in 2021. The exhaustion of pro-inflationary factors prevalent in 2020 (the weakening som, feverish demand for prime necessities, higher global and regional food prices) will help reduce inflation. A gradual recovery in economic activity will help reduce the disinflationary impact of domestic demand during 2022, thus making the return of the CPI indicator to the lower threshold of the target more sustainable.

**Figure 9.**  
Economic activity and inflation in the Kyrgyz Republic



**Note:** seasonally adjusted data.

**Source:** EDB calculations

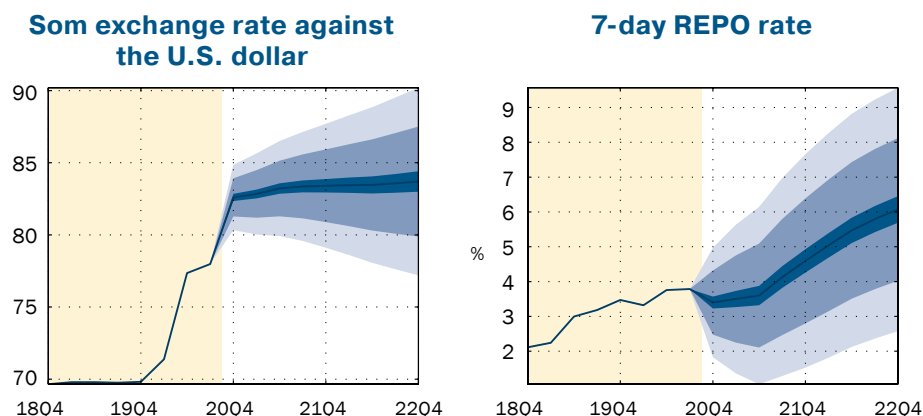
### Policy rate increased in 2022

We believe that the potential for reducing the policy rate in the medium term is exhausted, which is why we expect it to remain at 5.0% until the end of 2021. At the same time, rates in the interbank credit market will continue to remain below the key rate. A gradual increase in inflation will require that stimulative interest rate policy be weakened, which will be expressed in a gradual increase in the policy rate.

### Som tending to weaken

The som is currently undervalued against the currencies of the main trading partners, including the U.S. dollar. We expect the exchange rate to adjust to an equilibrium level before mid-2022 as the epidemiological and geopolitical situation in the world normalizes. In nominal terms, the som will continue to weaken at a moderate pace.

**Figure 10.**  
Kyrgyz som exchange rate and REPO rate



Source: EDB calculations

## Risks

### The risks of a second wave of the epidemic began manifesting themselves in mid-autumn 2020

The risks of a second wave of the epidemic in the key trading partners of the Kyrgyz Republic began manifesting themselves in mid-autumn 2020, which may delay the recovery of exports, excluding gold. The deterioration of the epidemiological situation in the Kyrgyz Republic may lead to the voluntary suspension or unused capacity of companies at their own initiative. It might also increase the risk of a longer return to the full operation of border crossings with China. An increase in demand and a reduction in exports of a number of food products may drive up their value in the world market. Should an unfavorable scenario happen, slower recovery of the economy of the Kyrgyz Republic is likely to occur in the medium term and pro-inflationary risks are likely to increase.

According to EDB calculations, weak recovery growth of the world economy in 2021 (at 1.6 p.p. less than in the base case) will result in a slowdown in the GDP growth rate of the Kyrgyz Republic by 1.0 p.p., to 2.7%.

### Geopolitical tensions in the region

Tougher anti-Russian sanctions may have a significant negative impact on the economy of the Republic, above all an increase in volatility of the som against the U.S. dollar. Should second-round effects materialize, exports of the Kyrgyz Republic to the Russian Federation and the inflow of remittances to the Republic will be limited. Risks of socio-political tension may remain within the country in 2021.

### Limited prospects for increasing public debt

By the end of 2020, public debt is likely to exceed the threshold of 60% of GDP, thus only providing an avenue for attracting loans on preferential terms. Under no growth in the tax base and an increasing volume of external debt servicing, public spending is more likely to be reduced, curbing the GDP growth rate in the medium term, thus slowing down the economy recovery.

# RUSSIAN FEDERATION

## Current situation

### **4% GDP reduction in 2020 due to weakening consumer and investment demand**

The recovery of economic activity seen at the beginning of 4Q2020 has slowed down. The decline in GDP amounted to 4.7% YoY in October, up from 3.0% YoY in September, according to the Ministry of Economic Development of the Russian Federation. This resulted in an economic decline of 3.6% YoY over the ten months. Tougher domestic health restrictions are curbing consumer demand, while investment may take a hit from renewed concerns about the prospects for economic growth in the face of the pandemic. Along with the likely weakening of external demand, these factors will continue to limit business activity in the Russian Federation in the short term, which, we believe, will lead to a 4% reduction in GDP by the end of 2020.

### **Inflation at the end of this year will be close to the Bank of Russia's target**

Inflation increased to 4% YoY in October (3.7% a month earlier). The weakening of the ruble has had both a direct and indirect impact on prices, due to higher inflationary expectations of both the population and businesses. The growth in prices of some food products (oils and sugar) has significantly accelerated, in particular, amid their rise in price in the world market. Domestic demand continues to have a disinflationary impact. The impact of the latter factor on prices may increase in the short term due to a slowdown in the recovery of consumer activity. As a result, the EDB projects inflation to amount to 4.2% YoY at the end of 2020.

### **Undervaluation of the Russian ruble due to geopolitical risks and investors turning to defensive assets**

Pressure on the Russian ruble increased in October and early November, mainly on account of a decrease in investor interest in risky assets amid the elevating number of COVID-19 cases in the world. The remaining threat of tougher sanctions from the United States has added a geopolitical premium to the national currency exchange rate. We believe that the Russian ruble is oversold, but its potential to strengthen before the end of the year is limited due to geopolitical risks and uncertainty about the evolution of the pandemic.

### **Moderately stimulative monetary policy**

The key rate was kept at 4.25% at the Bank of Russia meetings in September and October 2020, which, we believe, is a moderately stimulative monetary policy. Soft monetary conditions are required to mitigate the negative effects of the pandemic and create conditions for a post-crisis recovery in economic activity. Strengthening of short-term pro-inflationary factors, primarily the weakening of the ruble and the growth of inflationary expectations, hinders further reductions of the key rate. We believe the key rate will be in the 4–4.25% range at the end of this year.

**Increased budget deficit**

In January–October 2020, the federal budget posted a deficit of RUB 1.8 trillion (a surplus of RUB 3.16 trillion a year earlier). Revenues decreased by 9.2% YoY, largely on account of a 35.2% YoY drop in oil and gas revenues. Revenue from income tax decreased significantly, due to the deterioration in corporate profits. Budget expenditure grew by 25.4% YoY in the first 10 months. A key contribution was made by increasing amounts allocated for social policy, health, the national economy and inter-budget transfers.

**Budget support has helped limit the negative economic and social consequences of the pandemic**

The increase in federal budget spending is largely due to the government introducing measures to support the population and business, with its volume estimated at about 4.5% of GDP this year. The government is primarily focused on strengthening the health system, supporting household income and providing aid to small and medium-sized businesses through loan programs, deferred rent payments, tax and administrative relief, among other items. State measures help mitigate the negative economic and social consequences of the pandemic: according to our calculations, their implementation made up for about 1.3–2.3% of GDP losses in 2020.

**Forecasts****Key macroeconomic indicators of the Russian Federation (base case)**

Indicator	2017	2018	2019	2020F	2021F	2022F
<b>GDP</b> in constant prices ( <i>% growth YoY</i> )	1.8	2.5	1.3	-4.0	3.2	2.7
<b>Consumer price index</b> ( <i>% growth in December to previous year's December</i> )	2.5	4.3	3.0	4.2	3.5	3.8
<b>MIACR Rate</b> ( <i>the year's average, %</i> )	9.0	7.1	7.2	4.9	4.2	4.7
<b>National currency to U.S. Dollar exchange rate</b> ( <i>the year's average</i> )	58.3	62.5	64.7	72.3	74.5	72.9

**Source:** National agencies, EDB calculations

**Easing of restrictive measures during 2021**

The base case projection's key assumption is that restrictive measures will be gradually eased at home and abroad over the course of 2021. However, we expect social distancing to be observed in the coming year, with its scale weakening as the pandemic dies down.

Potential economic growth will begin to recover in 2021–2022, which will be supported by the implementation of state development programs aimed, among other things, at increasing investment activity. The structural reforms' maximum effect is expected to be felt in the long term.

**Budget stimulus to weaken in medium term**

Fiscal policy will remain stimulative in the medium term, but the volume of anti-crisis support will significantly decrease in 2021–2022, resulting in a negative fiscal impulse. The country risk premium for Russia will remain

heightened in the short term due to uncertainty about the development of the pandemic and the geopolitical factor.

### Economic activity to recover to pre-crisis level during 2022

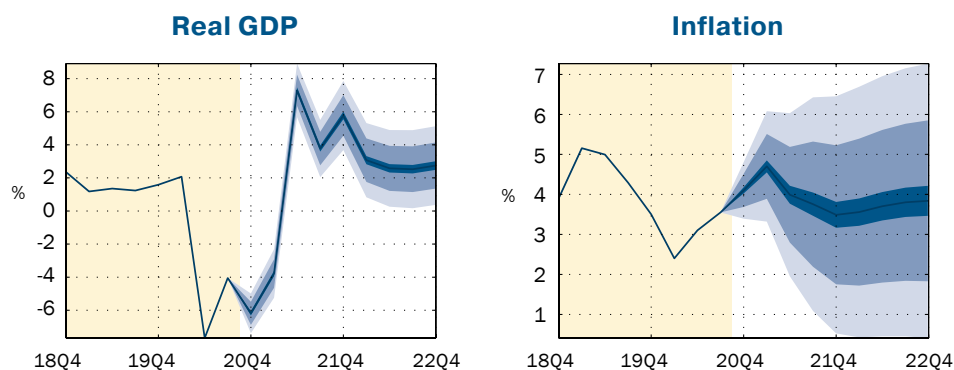
The easing of health restrictions at home and abroad will help a resumption of recovery in economic activity in Russia in the first half of 2021. In the EDB's base case, consumer and investment demand is expected to be revived, fostered by a soft monetary policy. Rising oil prices, increased business activity in trading partner countries and the undervalued ruble will support Russian exports. Inertia of investment due to the revision of business plans, increased uncertainty, partial continuation of social distancing and a gradual weakening of fiscal stimulus will limit the speed of economic recovery. As a result, we project the aggregated GDP growth rate at 3.2% in 2021 after a 4% decline in 2020.

The recovery of GDP to the pre-crisis level (4Q2019) will be completed during 2022; at the end, we expect growth of 2.7%. Nevertheless, the negative output gap will remain throughout the forecast period, although it will gradually decrease.

### Inflation below target in medium term

The economy functioning at a level below its potential will have a disinflationary impact in 2021. In addition, the EDB's base case expects the exchange rate dynamics to normalize, leading to a gradual weakening of the pass-through effect. We project inflation to slow down to 3.5% YoY by the end of 2021. A gradual recovery in economic activity will help reduce the disinflationary impact of domestic demand during 2022, which will increase the growth rate of the consumer price index to 3.8% YoY that year.

**Figure 11.**  
Economic activity and inflation in the Russian Federation



**Note:** seasonally adjusted data.

**Source:** EDB calculations

### Stimulative monetary policy in 2020–2022

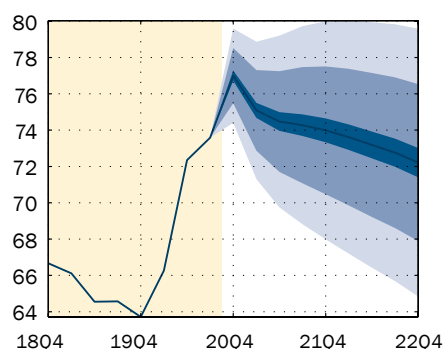
We expect a stimulative monetary policy in 2021–2022 to be maintained to help the economic recovery process and prevent a significant downward deviation of inflation from the target. However, the degree of monetary support required for the economy will gradually decrease: the base case assumes that a cycle of key rate raises will begin in the second half of 2021, and that it will approach 5% by the end of 2022, i.e. it will be near the neutral level.

### Correction of exchange rate to equilibrium level in 2021

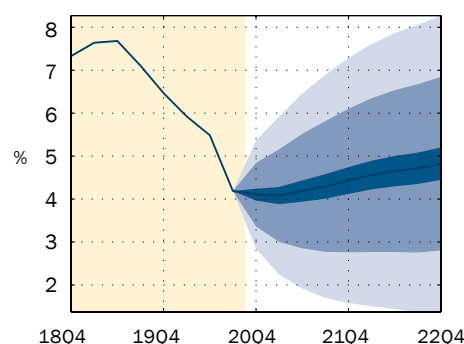
The Russian ruble exchange rate against the U.S. dollar is expected to adjust gradually to the equilibrium level in 2021 as the pandemic slows down and investors' demand for risky assets increases. This implies national currency strengthening against the average exchange rate of 4Q2020. High geopolitical risks will limit the adjustment speed. We believe that the Russian ruble's exchange rate versus the U.S. dollar will thus average some RUB 74.5 in 2021.

**Figure 12.**  
Russian ruble exchange rate and MIACR

**Ruble exchange rate against the U.S. dollar**



**MIACR**



Source: EDB calculations

## Risks

### A protracted pandemic may result in great losses for the Russian economy

The risks to the medium-term forecasts have shifted to the downside. The development of the pandemic is still uncertain. Should it be protracted, we might expect greater losses of economic growth than those built into the base case due to a continuous decline in investment and innovation activity. According to EDB calculations, weak recovery growth of the world economy in 2021 (1.6 p.p. less than in the base case) will result in an oil price drop of 16%, to USD 41 per barrel in 2021, compared to USD 49 in the base case. In such a situation, the growth rate of Russia's GDP will amount to 0.8 p.p. below the base forecast, reaching about 2.4% in 2021. Under such a scenario, the ruble will be about 84 to the U.S. dollar next year, over 12% weaker compared to the base case.

### Likely tougher sanctions pose a significant risk to Russia's economic growth

There is still a high chance of geopolitical tensions increasing and stricter anti-Russian sanctions being imposed; this might have a significant negative effect on the business climate. We believe that new tough sanctions may lead to a steady increase in the risk premium for Russia of 1–1.5 p.p., a decrease in investment growth by 2–3 p.p., and growth in potential GDP by about 0.4–0.6 p.p. compared to the base case.

# REPUBLIC OF TAJIKISTAN

## Current situation

<b>GDP growth to slow to 4.5% in 2020</b>	The growth of the Tajik economy slowed down to 4.2% YoY in January–September 2020 (after 7.5% in 2019) amid the coronavirus pandemic. The negative impact of factors caused by the infection outbreak was mainly felt in the non-production sector: retail sales decreased by 2.7% YoY (up 9.6% in 2019). The production sector was less affected, with industry increasing output by 10.7% YoY amid a capacity expansion, primarily in metallurgy and the food industry, and agriculture increasing by 8.1% YoY (vs. 13.6% and 7.1%, respectively, in 2019). We expect GDP growth to decelerate to 4.5% in 2020.
<b>Inflation to rise above the National Bank's target range</b>	In September 2020, inflation was 6.6% YoY (versus 8.0% YoY at the end of 2019). Price growth in the country is back within the National Bank's target range (6±2%) after accelerating in the first half of the year, when it exceeded 10% YoY for some period in the wake of higher food prices. However, we project an increase in their prices to lead to inflation temporarily exceeding the NBT's targets again and reaching 8.5% YoY by the end of 2020.
<b>National currency weakening</b>	The national currency of Tajikistan decreased against the U.S. dollar by 16.6% as of mid-November 2020 compared to December 31, 2019. The somoni weakened during two stages: in March (when the spread of coronavirus turned into a pandemic) and in early November (during the second outbreak of infection in the world). We believe that the exchange rate adjustment has brought it closer to a reasonable level on account of a reduction in remittances and foreign direct investment, as well as a high degree of economic uncertainty.
<b>NBT refinancing rate reduced</b>	The National Bank lowered the refinancing rate from 12.25% as of December 31, 2019 to 10.75% by the end of October 2020. The cost of lending in the economy of Tajikistan has decreased, affected by the NBT policy: the average interest rate on loans in somoni fell from 23.6% at the end of 2019 to 21.9% in September 2020. Furthermore, the growth of bank lending slowed down under weakening economic activity. In September 2020, it amounted to 9.8% YoY, down 12% from the end of 2019.
<b>Improvement of the state budget balance in the second half of 2020</b>	Support from international financial organizations, including that provided under agreements concluded this year <sup>5</sup> , helped improve the state budget balance in the second half of 2020. While in January–June 2020 it posted a

<sup>5</sup> The authorities estimate the potential amount of support from IFO, including beyond 2020, at USD 300.8 million (see 'Tajikistan Planning to Attract \$68.5 million from the ADB and WB to Support the National Economy', Avesta, July 17, 2020).

deficit of TJS 0.4 billion, or 1.2% of GDP (versus a surplus of TJS 0.2 billion, or 0.2% of GDP, a year earlier) amid reduced tax revenues, the budget posted a surplus of TJS 0.6 billion in January – August (versus TJS 0.1 billion a year earlier). The more restrained spending compared to last year also had a positive impact on the budget, in addition to the donor funds. The saving was largely achieved through a planned reduction of investment in the energy sector.

**The volume of expenditures on the fight against the consequences of the pandemic in 2020 will amount to at least 2.5% of GDP**

The amount of funding for measures taken by the government to address the coronavirus pandemic can be estimated at TJS 2.0 billion (2.5% of GDP)<sup>6</sup> at the very least. These measures comprise the cost of supporting economically vulnerable segments of the population, free medical care for patients with COVID-19 and citizens under medical supervision, sick pay and additional compensation for health workers. The authorities have also financed the cost of purchasing grain and seeds for agricultural enterprises in order to improve the country's food security during the pandemic; they have further provided time-limited tax holidays and financial support to some industries (primarily in the service sector) and small and medium-sized businesses.

**Growth in public debt**

The growth of the external financing contribution to the budget revenue was accompanied by an increase in public debt. The national authorities' external liabilities increased to USD 3.096 billion, or 38.4% of GDP, by the end of June 2020, from USD 2.925 billion (35.2% of GDP) in 2019.

## Forecasts

### Key macroeconomic indicators of the Republic of Tajikistan (base case)

Indicator	2017	2018	2019	2020F	2021F	2022F
<b>GDP</b> in constant prices ( <i>% growth YoY</i> )	7.1	7.3	7.5	4.5	6.1	7.4
<b>Consumer price index</b> ( <i>% growth in December to previous year's December</i> )	6.7	5.4	7.6	8.5	5.3	5.2
<b>Refinancing rate</b> ( <i>the year's average, %</i> )	15.1	14.2	13.8	11.5	10.3	9.2
<b>National currency to U.S. Dollar exchange rate</b> ( <i>the year's average</i> )	8.5	9.2	9.5	10.3	11.6	12.0

Source: National agencies, EDB calculations

**Economic growth to gradually recover in 2021–2022**

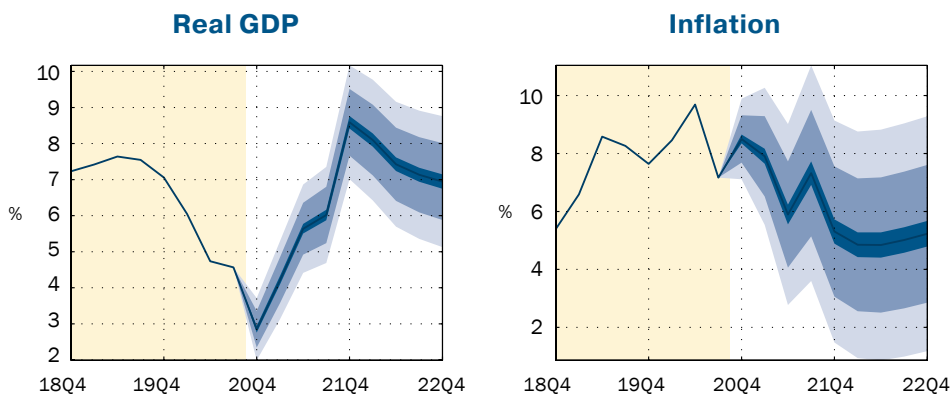
The 2021–2022 trends in the Tajik economy will be driven by the adverse impact of the COVID-19 pandemic and by the recovery processes to follow. In 2021 and 2022, the improvement of the global economic situation will foster a recovery of national GDP growth to 6.1% and 7.4%, respectively.

<sup>6</sup> See IMF, Staff Report (April 29, 2020), and <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#T>

**Inflation to be within target range of the NBT**

We project the moderate domestic demand to partially offset the impact of the weakening of the somoni in November 2020 on inflation. Consumer prices will grow by 5.3% by the end of 2021 in Tajikistan. In 2022, inflation will remain within the range set by the National Bank, amounting to 5.2%.

**Figure 13.**  
Economic activity and inflation in the Republic of Tajikistan



**Note:** seasonally adjusted data.  
**Source:** EDB calculations

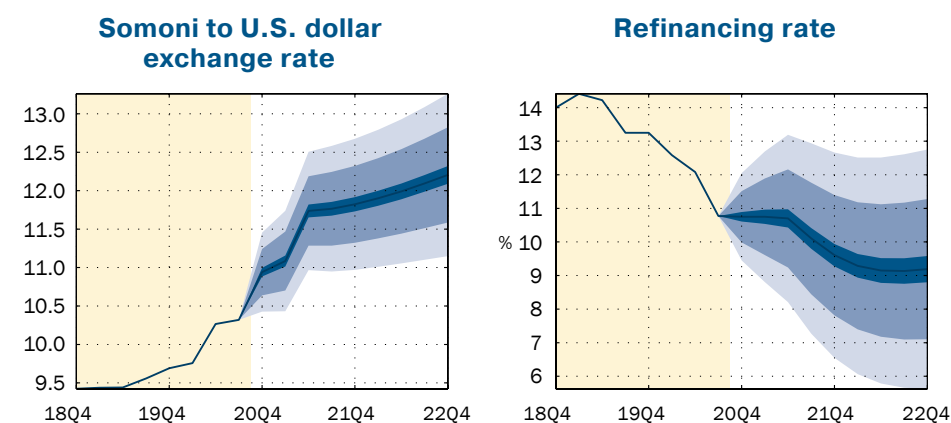
**Refinancing rate to remain unchanged in the first half of 2021**

We project the NBT to keep the refinancing rate at the current level or higher in the medium term (10.75%). In the first half of 2021, the need to limit the impact of the November weakening of the somoni on inflation will hinder policy changes in this area. Starting from the second half of 2021, the recovery of economic activity and weakening disinflationary pressure will induce a round of rate rises.

**Somoni to weaken smoothly**

Weakening of the Tajik currency against the U.S. currency will continue in 2021–2022. Its speed will depend on the difference in inflation levels between Tajikistan and its trade partners, among other factors.

**Figure 14.**  
Tajik somoni exchange rate and refinancing rate



**Source:** EDB calculations

## Risks

### **Protracted pandemic will increase damage to the economy**

The risks of a deterioration in the economy of Tajikistan relative to the base case remain high. Should the pandemic last longer than the duration built into the base case, then the damage from the coronavirus outbreak will be higher than expected. According to EDB calculations, under the scenario in which the global economic recovery in 2021 will be slow and the oil price is lower than in the base case (when global GDP growth is 1.6 p.p. less and oil is 16% cheaper), the rate of GDP growth in Tajikistan will be 1.3 p.p. below the base forecast and will amount to about 4.8% in 2021.

Geopolitical risks, including Western sanctions against Tajikistan's economic partners (Russia), may affect the country as well. Domestic political risks remain limited in the medium term.



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# **Eurasian Development Bank**

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DIRECTORATE OF RESEARCH,  
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