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FROM RECOVERY TO SUSTAINABLE GROWTH

MACROECONOMIC OUTLOOK 2022

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25 November **2021**



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EDB

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The document contains a detailed description of the current domestic and external macroeconomic conditions, and a consistent set of forecasts. The analysis covers existing mutual links among six economies (Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan) and their key trading partners. Macroeconomic projections are developed by the EDB using the integrated modelling system underpinned by a multi-country dynamic stochastic general equilibrium model. Additional information on that system is presented in a joint EDB and EEC report (EDB, 2016).

Keywords: economic growth, forecast, GDP, inflation, exchange rate, demand, monetary policy, budget, interest rate, investments.

JEL: E17, F15, F31, H62, O11.

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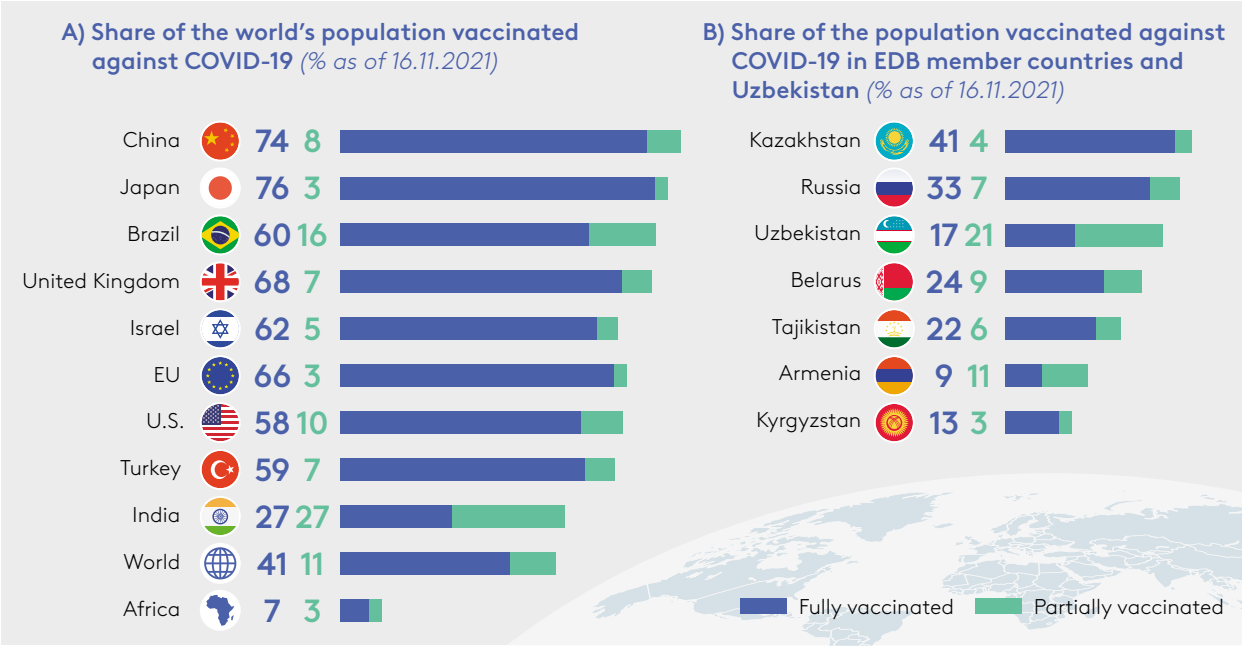
SUMMARY

The global economy has passed its peak of recovery: global GDP growth will slow down to a balanced pace. The most active stage of the post-pandemic recovery in the major economies ended during 2–3Q2021, which will naturally result in a gradual slowdown of economic growth to a more moderate pace. In the baseline scenario, we project China's GDP to grow by 5.2% in 2022 vs 8% in 2021. In addition to the exhaustion of pent-up demand, factors that we expect to drive the slowdown of the Chinese economy include the dynamics of the construction sector, which shows clear signs of cooling, and tighter government regulation. In the U.S. and the Eurozone, we expect GDP growth to slow to 3.7% and 4.3% in 2022, respectively, from 5.5% and 5.1% in 2021. Growth in the U.S. and the Eurozone will remain above potential, supported by fiscal and monetary stimulus measures, the scale of which will gradually diminish. Uncertainty over the pandemic remains a risk to the global economy; however, the impact of coronavirus outbreaks on GDP has reduced significantly over time, in particular, through vaccination campaigns (Figure 1) (See: In focus: "The COVID-19 Pandemic and Economic Activity: Correlation Is Weakening").

Figure 1. Vaccination Worldwide and in EDB Member States



Note: Figures for Uzbekistan are as of 20 October; figures for Armenia are as of 31 October; figures for Tajikistan and Belarus are as of 7 November; figures for China are as of 12 November, and figures for the United Kingdom are as of 15 November.

Source: Our World in Data (Mathieu et al., 2021), calculations by EDB analysts.

Global inflationary pressures will persist in 2022, but will ease as the global demand trend normalises. We expect energy prices to remain high in early 2022. They could fall further as the demand growth stabilises and supply builds up, including that of OPEC+. The baseline scenario assumes an average Urals oil price of $72.5 per barrel in 2022. Supply delays and component shortages will continue to have a pro-inflationary impact, with the pressure of these factors subsiding gradually as the global economy slows.

> As a result, inflation in the U.S. and the Eurozone will slow during 2022 but will remain above pre-pandemic figures. The baseline scenario forecasts annual average inflation of about 4% in the U.S. and near 3% in the Eurozone in 2022. With higher inflation, we expect the monetary stimulus to ease in developed countries and assume two 0.25 p.p. rate hikes by the Fed in the 2nd half of 2022.

GDP growth in the EDB region is expected to be around 4% in 2021. Economic activity in the region as a whole returned to the pre-pandemic level by mid-2021. In 4Q2021, we expect the region's GDP to exceed the pre-crisis figure by around 1%. The recovery of EDB member states' economies this year was supported by the effects of fiscal and monetary policy easing in 2020, as well as by individuals and institutions adapting to the pandemic, expanding global demand and soaring prices for the region's key exports. The recovery process among countries in the Bank's operating region was uneven: the GDPs of Belarus, Kazakhstan, Russia and Tajikistan exceed the pre-pandemic levels, while Armenia and Kyrgyzstan have not yet managed to reach them (Figure 2). Due to the greater downturn in the economies of Armenia and Kyrgyzstan last year, they need more time to recover. **Overall GDP growth in 2021 is projected at 4.5% for Armenia, 2.1% for Belarus, 3.8% for Kazakhstan, 3.7% for Kyrgyzstan, 4.1% for Russia and 7.9% for Tajikistan.**

Figure 2. Economic Recovery in EDB Member States

Real GDP
(4Q2019 = 100%, seasonally adjusted)

	IV.19	I.20	II.20	III.20	IV.20	I.21	II.21	III.21	IV.21
Aggregated GDP	**100**	100	91	96	98	99	100	100	**101**
Armenia	**100**	100	85	92	91	96	97	95	**97**
Belarus	**100**	99	96	99	100	100	102	101	**100**
Kazakhstan	**100**	100	93	95	98	99	100	101	**104**
Kyrgyzstan	**100**	98	87	92	87	88	92	94	**97**
Russia	**100**	100	91	96	98	99	100	100	**101**
Tajikistan	**100**	101	101	103	105	108	110	112	**113**

Note: As new data becomes available, seasonally smoothed values of real GDP may be adjusted over the historical period. Initial GDP values for 3 and 4Q2021 are estimates by EDB analysts.

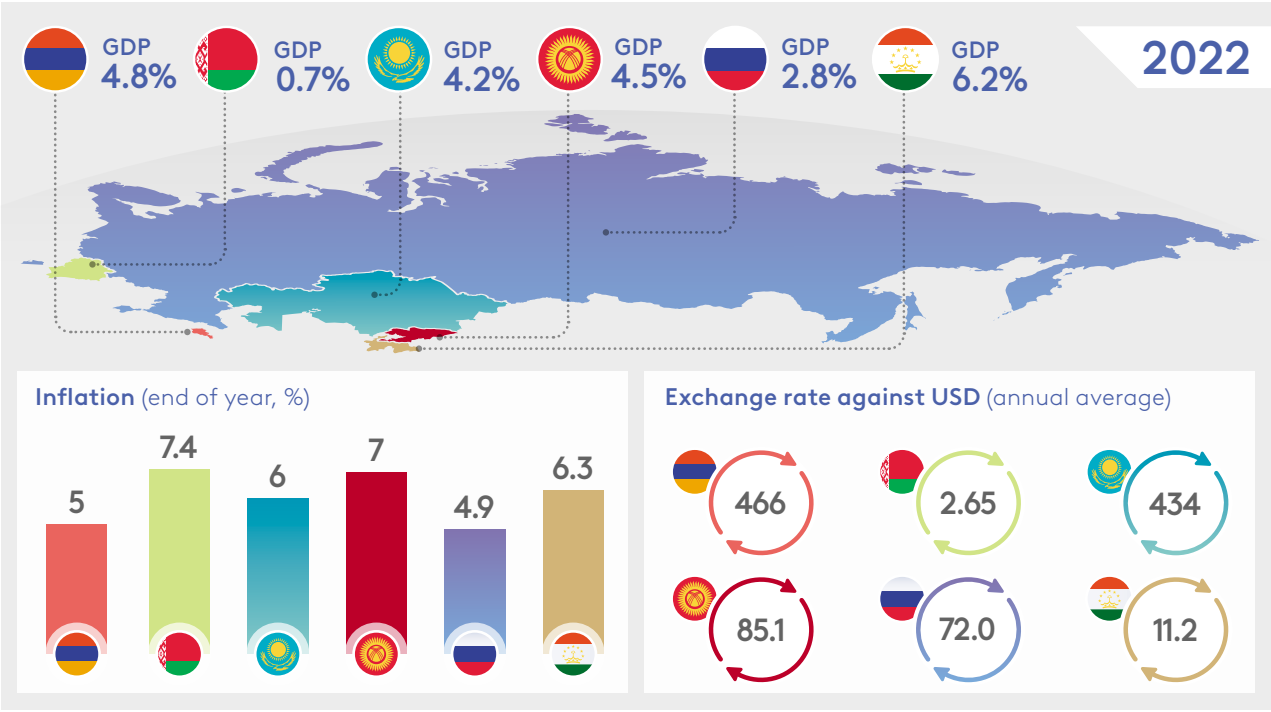
Source: calculations by EDB analysts.

Economic growth in the EDB operating region is forecasted to exceed the pre-pandemic rate in 2022. After the end of the active recovery stage, economic development in the Bank's operating region is going to proceed at a balanced pace. Given these conditions, the fiscal stimulus is being reduced and monetary conditions are being tightened to prevent economies from overheating. As a result, in the baseline scenario, GDP growth for the region is projected at 2.9% in 2022 vs 4% in 2021. Despite the slowdown, economic growth will remain above the pre-pandemic rate (2.3% in 2019). This will be facilitated by government measures to support investment, the realisation of the potential for increased activity in services and oil production. In 2022, we forecast 2.8% GDP growth in Russia and 4.2% in Kazakhstan. High global energy prices, coupled with government development programmes, will support economic activity in the region's major economies. Strong GDP growth is projected in Armenia and Kyrgyzstan,

at 4.8% and 4.5%, respectively. The economies of these countries will complete their recovery to pre-pandemic figures. Tajikistan's economic growth is expected to reach a steady rate of around 6–7% per annum. In Belarus, the baseline scenario expects GDP growth of 0.7% in 2022. The effects of restrictive measures from a number of Western countries may curb business activity in Belarus. Russia's support could help the Belarusian economy adapt to them.

The next few years could be a period of strong investment growth. Ensuring the sustainability of economic growth and enhancing its potential becomes crucial once the recovery from the pandemic-induced shocks is over. There is reason to believe that the world, including EDB member states, is seeing the beginning of a new investment cycle. Indeed, investment is key to providing an impetus to increase the long-term growth rate of economies. Public authorities in the Bank's member states are taking steps to support investment. These include, for example, major state programmes in Kazakhstan (Economy of Simple Things, Business Road Map and 10 National Projects), as well as national projects and NWF investments in infrastructure projects in Russia. Further improvements in the business climate and incentives for private initiatives are important to ensure sustainable economic growth.

Figure 3. Outlook for EDB Member States' Key Macroeconomic Indicators



Source: calculations by EDB analysts.

In the baseline scenario, we project inflation in the region to slow down to 5.3% in 2022, from 8.2% in 2021. The influence of demand factors on prices will gradually weaken as the recovery period in economies comes to an end. Pressure from supply disruptions will continue in 2022, but will gradually subside. In the baseline scenario, we expect commodity prices to decrease during 2022. Nevertheless, increased producer costs will continue to exert the upward pressure on consumer prices, and inflation in most EDB member states will remain above the target in 2022. In Armenia, we project inflation of 5% at the end of 2022 after 8% in 2021; 7.4% after 10% in Belarus; 6% after 8.4% in Kazakhstan; 7% after 9.8% in Kyrgyzstan; 4.9% after

7.9% in Russia; and 6.3% after 8.3% in Tajikistan. We expect inflation in EDB member states to return to the target levels in 2023 as pro-inflationary factors are neutralised.

Monetary conditions in EDB member states will have a disinflationary impact in 2022. Key rates in EDB member states could be increased by the end of 2021 amid high inflation. We expect the key rate to be 8–8.5% in Russia, 9.75–10% in Kazakhstan and around 10% in Belarus at the end of this year. A prolonged period of higher inflation is likely to require key interest rates to remain above their neutral levels for an extended period. We see a possible start of a rate-cutting cycle in Russia, Kazakhstan and Belarus in the 2nd half of 2022 as inflation slows down. By the end of 2022, the key rate in Russia may be lowered to about 7%; the base rate in Kazakhstan may be decreased to 9.5–9.75%; and the refinancing rate in Belarus may be reduced to 9–9.5%. The trend towards neutral levels is likely to complete its journey in 2023. In Armenia and Tajikistan, interest rates are also likely to start falling in the second half of 2022, with a gradual trend towards neutral figures in 2023. In the Kyrgyz Republic, the policy rate in 2022–2023 is projected to be 7.5–8%.

Comfortable oil prices and high interest rates on assets in national currencies will continue to support the currencies of EDB member states in 2022. In 4Q2021, the currencies of most EDB member countries have become slightly overvalued against the dollar. Real currency appreciation is supported by high global energy and metal prices, as well as rising key interest rates in the Bank's operating region. These factors will continue well into 2022. However, as the monetary stimulus is phased out in developed countries, yields on their government bonds will increase, which could lead to lower demand for assets denominated in the currencies of the Bank's member countries. This factor will limit their scope for strengthening in 2022. The average annual exchange rate of the Russian rouble against the dollar in 2022 is projected to be around 72, with the Kazakh tenge at about 434 to the dollar.

The threat of continued global inflation at elevated levels poses significant risks to the macroeconomic outlook of the Bank's member states. Ultra-soft fiscal and monetary policies in developed countries, deployed in response to the challenges of the pandemic, caused inflation and inflationary expectations to rise substantially. Along with that, developments in container shipping and supply chain disruptions are difficult to predict. The combination of prolonged supply shocks, increased inflationary expectations and tolerance of accelerating price growth by central banks in developed countries runs the risk of keeping global inflation at elevated levels for a prolonged period of time. We cannot rule out consumer price growth in the U.S. remaining close to 5% next year and about 2–4% over the next few years. The persistent higher inflation could result in interest rates being raised more aggressively than projected in our baseline scenario, above all in the U.S. Such a scenario would have a negative impact on global growth in 2022, increasing the risk premium for emerging countries and putting pressure on their currencies.

The economies of the EDB operating region will maintain robust economic growth in 2022, even in an adverse scenario. The risk scenario assumes higher world inflation as well as higher prices for fuel resources, combined with lower economic growth in 2022 compared with the baseline scenario. High energy prices and opportunities for greater fiscal stimulus will have a positive impact on economic activity in Russia and Kazakhstan. The continued growth of the region's largest economies will support business activity in other EDB member states through close trade, economic and financial linkages. As a result, despite the dampening effect of slower global growth, capital outflows and uncertainty, GDP in the EDB operating region could grow by 2.5% in 2022 even in the risk scenario.

EDB MEMBER STATES

Table 1. EDB Forecasts. Key Macroeconomic Indicators of EDB Member States (Baseline Scenario)

Indicator	2019	2020	2021F	2022F	2023F
EDB Member States					
Aggregate real GDP, % YoY	2.3	-2.9	4.0	2.9	2.4
Republic of Armenia					
GDP in constant prices, % YoY	7.6	–7.4	4.5	4.8	3.4
Inflation (end of period), % YoY	0.7	3.7	8.0	5.0	4.6
Interbank rate (year's average), %	5.8	4.8	6.3	6.7	6.1
Exchange rate of national currency to U.S. dollar (year's average)	480	489	505	466	480
Republic of Belarus					
GDP in constant prices, % YoY	1.4	–0.9	2.1	0.7	0.9
Inflation (end of period), % YoY	4.7	7.4	10.0	7.4	5.5
Refinancing rate (year's average), %	9.8	8.2	8.7	9.8	8.9
Exchange rate of national currency to U.S. dollar (year's average)	2.09	2.43	2.53	2.65	2.82
Republic of Kazakhstan					
GDP in constant prices, % YoY	4.5	–2.5	3.8	4.2	5.0
Inflation (end of period), % YoY	5.4	7.5	8.4	6.0	4.4
TONIA rate (year's average), %	8.4	9.0	8.7	9.3	8.5
Exchange rate of national currency to U.S. dollar (year's average)	382.8	413.0	424.9	434.0	443.0
Kyrgyz Republic					
GDP in constant prices, % YoY	4.6	–8.6	3.7	4.5	2.5
Inflation (end of period), % YoY	3.1	9.7	9.8	7.0	5.2
7-day Repo rate (year's average), %	3.0	3.6	5.7	8.4	8.3
Exchange rate of national currency to U.S. dollar (year's average)	69.8	77.3	84.6	85.1	85.5
Russian Federation					
GDP in constant prices, % YoY	2.0	–3.0	4.1	2.8	2.1
Inflation (end of period), % YoY	3.0	4.9	7.9	4.9	4.0
MIACR rate (year's average), %	7.2	4.9	5.7	7.7	5.7
Exchange rate of national currency to U.S. dollar (year's average)	64.7	71.9	73.4	72.0	73.5
Republic of Tajikistan					
GDP in constant prices, % YoY	7.4	4.5	7.9	6.2	6.9
Inflation (end of period), % YoY	8.0	9.4	8.3	6.3	6.4
Refinancing rate (year's average), %	13.8	11.5	12.2	12.6	10.9
Exchange rate of national currency to U.S. dollar (year's average)	9.5	10.3	11.3	11.2	11.8

Sources: national agencies of the EDB member countries, calculations by EDB analysts.