

MACROECONOMIC FORECAST

Strong Recovery Growth
in 2021

March 2021



EDB MACROECONOMIC FORECAST: STRONG RECOVERY GROWTH IN 2021

MARCH 2021

 **EDB | 15 years**

Center for Country Analysis,
Research Department

Moscow
2021

Vinokurov, E., Kuznetsov, A., Berdigulova, A., Fedorov, K., Kharitonchik, A., Babajanyan, V. (2021) *EDB Macroeconomic Forecast: Strong Recovery Growth in 2021. March 2021*. Moscow: Eurasian Development Bank.

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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 (IMS) 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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ABBREVIATIONS

- ADB** – Asian Development Bank
- Armstat** – Statistical Committee of the Republic of Armenia
- Belstat** – National Statistical Committee of the Republic of Belarus
- BNS RK** – Bureau of National Statistics of the Republic of Kazakhstan
- CAB** – current account balance
- CB RA** – Central Bank of the Republic of Armenia
- CB RF** – Central Bank of the Russian Federation (Bank of Russia)
- COVID-19** – COronaVirus Disease 2019
- CPI** – consumer price index
- EAEU, Union** – Eurasian Economic Union
- ECB** – European Central Bank
- EDB, Bank** – Eurasian Development Bank
- EEC** – Eurasian Economic Commission
- EFSD** – Eurasian Fund for Stabilization and Development (p.k.a. EurAsEC Anti-Crisis Fund)
- EoP** – end of period
- EoY** – end of year
- EU** – European Union
- FDI** – foreign direct investment
- FCS RF** – Federal Customs Service of the Russian Federation
- FX** – foreign exchange
- FXR, IRA** – foreign exchange reserves, international reserve assets
- GDP** – gross domestic product
- GVA** – gross value added
- IBL** – interbank loans market
- IFI** – international financial institution
- IMF** – International Monetary Fund
- IT** – information technologies
- KR** – Kyrgyz Republic
- MED RF** – Ministry of Economic Development of the Russian Federation
- MF (MinFin)** – Ministry of Finance
- MIACR** – Moscow Interbank Actual Credit Rate
- MNE RK** – Ministry of National Economy of the Republic of Kazakhstan

NB KR – National Bank of the Kyrgyz Republic

NB RB – National Bank of the Republic of Belarus

NB RK – National Bank of the Republic of Kazakhstan

NBT – National Bank of Tajikistan

NSC KR – National Statistical Committee of the Kyrgyz Republic

OFZ – federal loan bond

OPEC – Organization of the Petroleum Exporting Countries

p.a. – per annum

PMI – purchasing managers' index

p.p. – percentage point(s)

RA – Republic of Armenia

RB – Republic of Belarus

RF – Russian Federation

RK – Republic of Kazakhstan

Rosstat – Federal State Statistics Service of the Russian Federation

RT – Republic of Tajikistan

SDR – Special Drawing Rights

SRC MF RK – State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan

SRE – standard risk estimate

TONIA – Tenge OverNight Index Average

USA – United States of America

VAT – value added tax

YTD – year-to-date

% y/y – year-on-year growth rate

AMD – Armenian dram

BYN – Belarusian rouble

KZT – Kazakh tenge

KGS – Kyrgyz som

RUB – Russian rouble

TJS – Tajik somoni

USD, U.S. dollar, \$ – United States dollar

SUMMARY

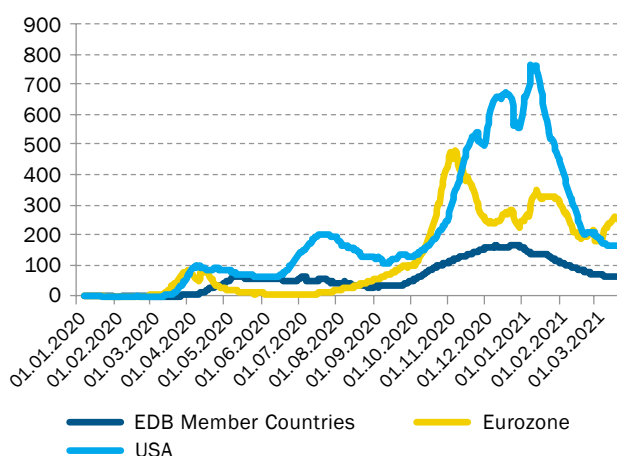
The world economy is on a path to recovery. The Global PMI Composite Output Index remains above the 50-point threshold: it stood at 53.2 points in February 2021. However, recovery is proceeding at an extremely uneven pace on both national and sectoral levels. Business activity is steadily growing in the U.S., China, and Russia, while in the Eurozone and UK this process is inhibited by difficult epidemiological situations. Manufacturing remains the key economic recovery driver, with services still struggling to deal with the remaining restrictions.

The global economy will be growing rapidly in 2021, as the pandemic recedes amid mass vaccinations, and major world economies preserve their current monetary and fiscal stances. As a result, foreign demand for goods and services exported by EDB member countries will increase. The 2021 GDP growth in the Eurozone, the U.S., and China is projected at 4.3%, 5.5%, and 8.5%, respectively. Recovery of global economic activity will support energy prices. Throughout 2021, the average Urals oil price is expected to stay around USD 55 per barrel, a level with which most countries in the EDB region of operations are comfortable.

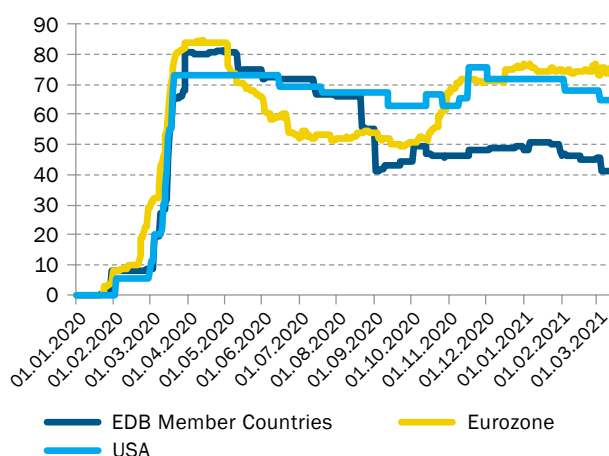
The epidemiological situation in EDB member countries is improving. The number of daily new COVID-19 cases registered in countries in the EDB region of operations, and in the world at large, has decreased relative to December 2020 – January 2021. In conjunction with the vaccination campaigns launched around the world, this enables a step-by-step lifting of restrictions which were the key driver of the 2020 economic slowdown. The gradual reduction of the number of new coronavirus cases and the easing of restrictions across the region are generally consistent with the assumptions made in the EDB November forecast (EDB, 2020).

Course of the Pandemic and Strength of Response

(A) Number of Officially Confirmed COVID-19 Cases
(per 1 million population, 7-day average)

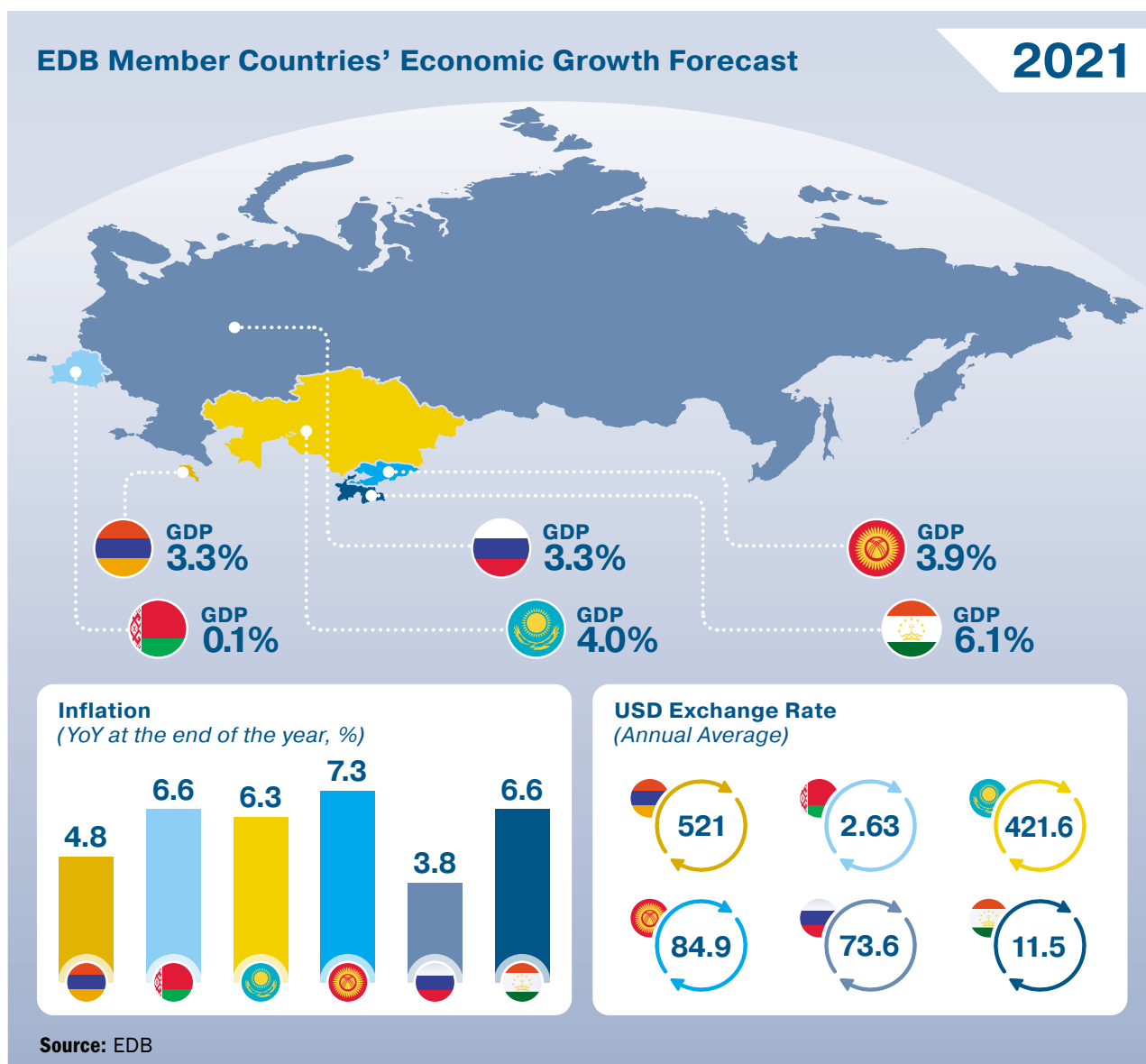


(B) COVID-19 Government Response Stringency Index
(points, maximum = 100)



Source: Oxford University, Johns Hopkins University, EDB calculations

The year 2021 will become a period of a strong recovery for the EDB member countries' economies. The rollback of social distancing measures and improvement of external economic conditions will become the key factors that will encourage expansion of consumer and investment demand. Growth of remittances by migrant workers will be an additional growth driver in Armenia, the Kyrgyz Republic, and Tajikistan. The EDB forecasts that in 2021 the aggregate GDP of the region will increase by 3.3%, following a drop by 3% in 2020. By the end of 2021, the economies of Kazakhstan and Russia will have grown by 4% and 3.3%, respectively, reaching their pre-crisis levels by late 2021 – early 2022. In Armenia and the Kyrgyz Republic, economic recovery will take more time, and is likely to be completed some time in 2022. This is largely attributable to the depth of recession in 2020, smaller fiscal capacity, and heightened political risks. The 2021 GDP growth in Armenia and the Kyrgyz Republic is projected at 3.3% and 3.9%, respectively. Economic activity in Belarus in 2021–2022 will remain below pre-crisis levels. In 2021, its GDP is projected to increase only by 0.1% due to elevated uncertainty and worsening economic sentiment.



Significant acceleration of inflation in EDB member countries will be temporary, and inflation will slow down in the second half of 2021. At the end of 2020, the rise of consumer prices in the Eurasian region exceeded targets set by most national/central banks. The main reason was a substantial global rise in food prices. Under the influence of that factor, inflation in countries in the EDB region of operations remained high at the beginning of this year. Additional price pressure is generated by pandemic-driven supply chain disruptions and COVID-19 response costs. Under the baseline scenario, we anticipate the combined impact of those factors on consumer prices to be gradually diminishing throughout 2021. Together with stabilization of national currency exchange rates, this will encourage disinflation across the region by the end of 2021. The Consumer Price Index increase by the end of 2021 is projected at 4.8% in Armenia, 6.6% in Belarus, 6.3% in Kazakhstan, 7.3% in the Kyrgyz Republic, 3.8% in Russia, and 6.6% in Tajikistan.

EDB member country exchange rates against the U.S. dollar will stabilize in 2021. At the beginning of this year, currencies of countries in the EDB region of operations remain relatively stable vs. the U.S. dollar. National currencies are supported by rising oil prices. Average 2021 exchange rates of the Russian rouble and Kazakh tenge against the U.S. dollar are projected at 73.6 and 421.6, respectively.

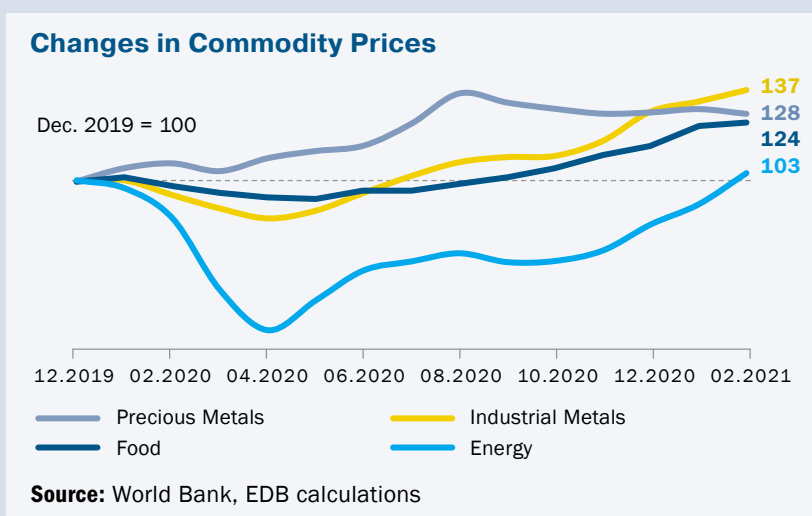
Expansionary monetary policies will continue in most countries of the region throughout 2021, while the scale of fiscal support will decline. Instability and high uncertainty associated with the economic recovery process warrant preservation of soft monetary conditions. However, acceleration of inflation in EDB member countries and growing inflationary expectations leave virtually no room for reduction of key rates by central/national banks. We expect monetary regulators to maintain a balance between the need to support business activity and to restrain rise in prices. Average 2021 interbank market interest rates are projected at about 6.2% in Armenia, 8.3% in Belarus, 8.4% in Kazakhstan, 4.0% in the Kyrgyz Republic, and 4.6% in Russia. Most countries in the region intend to take steps to reduce their fiscal deficits and curb public debt growth.

Strong recovery but certain risks may impact its realization. COVID-19 pandemic prospects and the post-crisis global economy recovery path remain the key uncertainty factors. The vaccination against the new coronavirus is proceeding around the world unevenly and, in most countries, sluggishly. Its impact on the spread of infection will have become meaningful by the middle of the year at the earliest. New waves of coronavirus cannot be ruled out both globally and within the EDB operating region. The impact that the pandemic may have on potential GDP growth rates in certain economies, including major economies, remains highly uncertain. With all those threats in mind, the EDB has developed a risk scenario envisaging slow recovery of the global economy. If it is realized, global GDP growth will fall short of the baseline scenario by 1.1 p.p. in 2021, by 1.6 p.p. in 2022, and by 1.0 p.p. in subsequent years. In that case, the average Urals oil price in 2021 will be USD 44 per barrel.

In 2021, economies of EDB member countries will be recovering even under the risk scenario, albeit at a slower rate. In 2021, Russia's GDP will increase by 1.9% under the risk scenario, 1.4 p.p. less compared to the baseline scenario. Kazakhstan's economic growth rate under the risk scenario will be 1.8 p.p. less than suggested by the baseline scenario, and amount to 2.2%. National currencies of countries in the EDB region of operations will come under pressure as global uncertainty builds up, and investors flee into safe-haven assets. Inflation risks will go up due to devaluation of national currencies, higher inflationary expectations, and persistent supply-chain issues. In such conditions, the

leeway for monetary stimulus will be limited, while mounting threats to debt sustainability will hamper the use of fiscal stimuli.

A global asset inflation trend emerged in the middle of last year. By the end of February 2021, prices in all key commodity groups exceeded their pre-crisis levels. Food prices have gone up by 24% since December 2019, reaching the highest level since 2013. Over the same period, industrial metals prices have risen by 37.5% – metals have not been so expensive since 2011. Having started with metals and food, asset inflation later spread on to energy products. Since the beginning of 2021, the oil price has increased by more than 20%, reaching pre-crisis values.



This strong growth of commodity prices is largely attributable to temporary factors, including supply disruptions, pandemic-provoked production chain gaps, and the rapid recovery of the Chinese economy. Over the next two quarters, the upward pressure that those factors are exerting on commodity prices will be weakening, and price rises will be decelerating. It is this course of events that the EDB has used as the foundation for its baseline scenario. However, this is primarily the effect of extremely soft monetary policies pursued by the world's largest central banks, and the impact of that factor will persist for a rather long period of time.

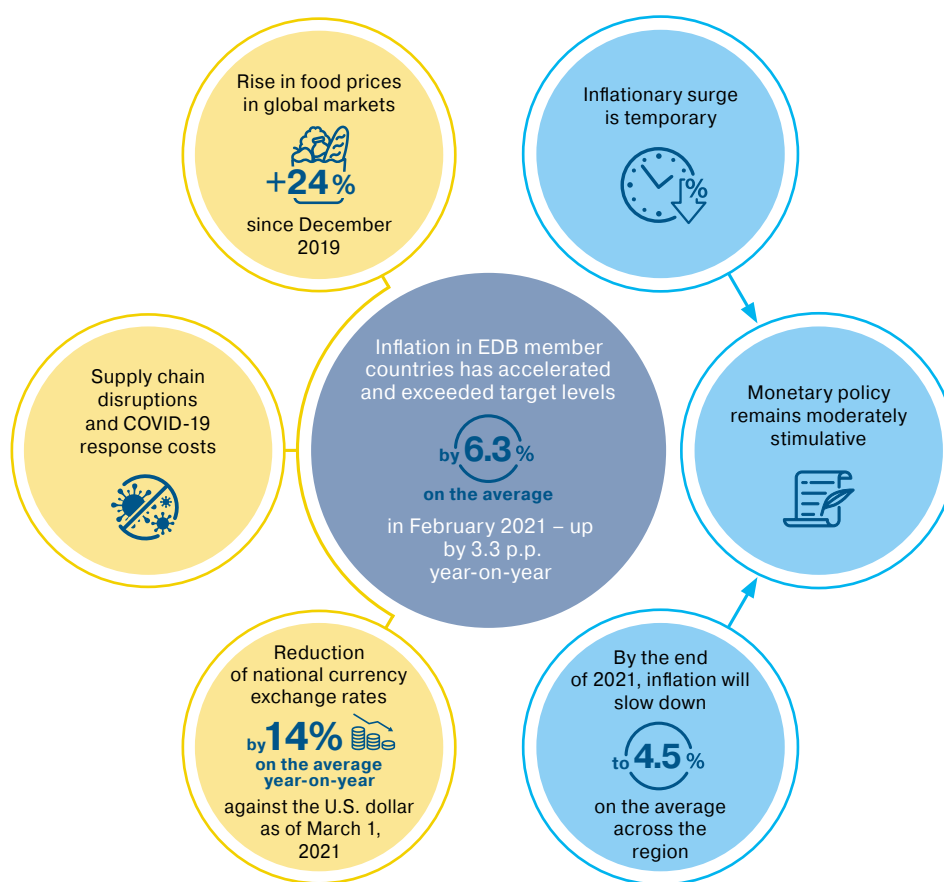
For the Eurasian region – a supplier of commodities to the world market – appreciation of metals and energy is generally a positive development. It produces growing export proceeds, higher budget revenues, and an upbeat economic sentiment. Naturally, that positive impact is largely felt in Russia and Kazakhstan, countries where commodities account for a large chunk of the national economy, but that impact is passed on to the other EDB member countries because of their close economic and financial integration. According to an EDB study, even a temporary increase of oil prices by 10% per year is capable of boosting the aggregated GDP of EDB member countries by an additional 0.14 p.p. (EDB, 2019).

The rapid rise of global food prices deserves special mention. We pay significant attention to that factor in our Macroeconomic Forecast, as it became the key inflation acceleration driver in countries in the EDB region of operations in late 2020 – early 2021. In February, its average rate reached 6.3%, by 3.3 p.p. higher than a year earlier. As we point out in the Macroeconomic Forecast, the

inflationary surge will be temporary, and price growth will decelerate in the second half of the current year. We expect that monetary regulators will be cautious in making tightening decisions, and this year their policies will remain moderately stimulative in most EDB member countries. At the same time, the risk of steady inflation growth in the region remains high, and needs to be considered with due care. If it does materialize, tighter monetary policies will need to be pursued to assure price stability, which may in turn decelerate post-crisis economic recovery.

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Inflation: Drivers and Forecasts



Source: EDB

EXTERNAL ECONOMIC CONDITIONS

Current Situation

At the beginning of 2021, global business activity is continuing to recover despite the spread of the coronavirus. Global Composite PMI was 52.3 points in January and 53.2 points in February. Business activity is expanding in a number of large economies, such as the USA, China, and Australia.¹ Reduced activity is observed in the Eurozone and the United Kingdom, where more stringent quarantine restrictions have had an adverse impact on the Services sector. Still, the output decline in European countries at the beginning of 2021 is much less pronounced than during the first wave.² This means that the population and businesses have adapted to the prevailing social distancing regime. By sector breakdown, the first months of 2021 were marked by an increase of industrial output and the restoration of financial services, while consumer services continued to decline.

Raw materials prices are rising. At the beginning of March, the Urals oil price exceeded USD 65 per barrel, a more than 20% increase since the beginning of the year. The oil price rise is supported by several factors, including upbeat market sentiment fuelled by commencement of vaccination campaigns, and compliance with crude oil production cuts negotiated by OPEC+ member countries. Food prices, primarily for grain, sugar, and vegetable oil, have been rapidly rising since the beginning of the year.³ Their dynamics are largely determined by lower supply, pandemic-related supply disruptions, and significant demand generated by China. Active recovery of the Chinese economy is also a key driver supporting the rise of industrial metal prices.⁴ In February, gold was priced at USD 1,808 per ounce, a USD 59 decrease relative to January, as investors showed more interest in risk assets.

At the beginning of 2021, inflation in the USA and the Eurozone increased, but remained below target levels. In February, consumer prices rose 0.9% y/y in the Eurozone (December 2020: -0.3% y/y) and 1.7% in the USA (December 2020: 1.36% y/y). The higher inflation is largely attributable to rising global energy prices, pandemic-related production chain disruptions, and transport costs. Despite the mounting inflationary pressures, the U.S. Federal Reserve System and the ECB continue to pursue extremely soft monetary policies, implementing large-scale quantitative easing programs and keeping key rates at historically low levels. This can be explained by the need to support economic recovery, and by the fact that COVID-related inflation drivers are likely to weaken as the pandemic abates.

¹ In the U.S., composite PMI values for February and January were 59.5 points and 58.7 points, respectively; in China – 51.7 points and 52.2 points, respectively; and in Australia – 53.7 points and 55.9 points, respectively.

² In the Eurozone, composite PMI values for February and January were 48.8 points and 47.8 points, respectively; and in the United Kingdom – 49.6 points and 41.2 points, respectively. In March, April, and May 2020, those values stood at 29.7, 13.6, and 31.9, respectively, in the Eurozone, and at 36.0, 13.8, and 30.0, respectively, in the United Kingdom.

³ The World Bank's Food Price Index increased by 26.2% y/y in February 2021, and by 20.6% y/y in January.

⁴ The World Bank's Metals & Minerals Price Index increased by 45.9% y/y in February, and by 32.4% y/y in January.

Forecast

Table 1. Projected Values of Key Foreign Economic Indicators (Baseline Scenario)

Increase Year-on-Year, % (unless otherwise stated)

	Urals Oil Price (USD per bbl, annual average)	Gold Price (USD per oz., annual average)	USA Real GDP	Eurozone Real GDP	China Real GDP
2021	55	1,858	5.5	4.3	8.5
2022	57	1,856	3.6	4.6	5.7
2023	59	1,748	2.0	2.1	5.4

Source: EDB calculations

In 2021–2022, the global economy will be recovering. The EDB baseline scenario assumes deceleration of the spread of coronavirus around the world starting in 2Q 2021, facilitated by the recently started vaccination campaigns. Quarantine restrictions in the world's largest economies will be eased. Alongside preservation of expansionary fiscal and monetary policies, this will help restore consumer and investment demand and boost international trade. The speed of the global economic recovery may be adversely affected by the probable retention of social distancing measures, elevated uncertainty persisting after restrictions are lifted, and long-lasting implications of changes to investment plans. Under the baseline scenario, 2021 GDP growth rates are projected at 5.5% for the USA, 4.3% for the Eurozone, and 8.5% for China.

In the medium term, oil prices will stabilise at approximately USD 60 per barrel. Oil prices will be spurred by the growing demand for energy resources fuelled by global economic recovery. In addition, higher demand for raw materials will enable OPEC+ member countries to boost the oil supply, which will operate as a balancing factor. On the whole, oil prices around USD 60 per barrel are comfortable for the countries in the EDB region of operations. According to the baseline scenario, the rise in prices for food and industrial metals will be decelerating throughout 2021, following a spike in the second half of 2020 and the beginning of 2021. This will be facilitated by easing of supply disruptions caused by the pandemic, and completion of the active phase of recovery of the Chinese economy. Gold prices will continue to be supported by expansionary monetary policies pursued by the leading central banks. Nevertheless, the EDB baseline scenario assumes a gradual devaluation of precious metals as risks to the global economy recede.

In 2021, inflation in the Eurozone and the USA will increase. Gradual recovery of business activity, rising energy prices, and food price hikes in the world markets in late 2020 and early 2021 will become the key inflation drivers. The EDB forecasts that in 2021 the average annual growth rate of the Consumer Price Index in the Eurozone will be 1.4%. In 2022, we expect Eurozone average annual inflation to decelerate to 1% due to exhaustion of inflationary effects generated by food price hikes. Subsequently, the inflation rate is projected to gradually approach the EDB target – close to (but not more than) 2%. In 2021, the average rate of growth of the household final consumption expenditure deflator in the USA is projected at 2.1%. We expect that in 2022–2023, the U.S. inflation rate will remain a little above 2% against the backdrop of significant fiscal stimulus and an extremely loose monetary policy.

In the medium term, key interest rates in the Eurozone and the USA will remain at their current levels. Under the baseline scenario, we anticipate that monetary authorities in developed countries will

maintain an extremely accommodative monetary environment to facilitate business activity recovery in 2021–2023. The U.S. Federal Reserve System and the ECB may start to phase out their quantitative easing programs during 2022, provided that the Eurozone and U.S. economies stay on a sustainable path to restore equilibrium.

Risks

Slow global economic recovery remains a possibility. Contributing factors may include mass vaccination challenges, emergence of new coronavirus strains, or strong secondary adverse effects of the pandemic. Besides, the impact that the pandemic may have on potential GDP growth rates in some economies, including major economies, remains highly uncertain. Accordingly, the EDB risk scenario assumes a more sluggish global economic recovery over the medium term, and a more significant reduction of economic growth potential compared to the baseline scenario. Global GDP growth will fall short of the baseline scenario forecast by 1.1 p.p. in 2021, by 1.6 p.p. in 2022, and by 1.0 p.p. in subsequent years.

A slower global economic recovery would bring down commodity prices. Under the risk scenario, the average Urals oil price is projected at USD 44 per barrel in 2021, and USD 40 per barrel in 2022–2023. Industrial metal prices will stabilise at lower levels as well, while the gold price will be supported by its safe-haven status. Under the risk scenario, inflation in the Eurozone and the USA is expected to remain considerably below medium-term targets due to weak economic activity and falling energy prices.

It is not inconceivable that global economic activity will recover faster than envisaged by the EDB baseline scenario. That will become possible if the mass vaccination campaigns prove to be fast and efficient. That course of events will make it possible to promptly lift restrictions and discontinue social distancing measures, thereby diluting secondary effects of the pandemic. Oil and industrial metal prices will continue to rise, and remain higher than those envisaged in the EDB baseline scenario.

EDB MEMBER COUNTRIES

Table 2. Key Macroeconomic Indicators (Baseline Scenario)

Indicator	2018	2019	2020	2021F	2022F	2023F
EDB Member Countries						
Aggregated Real GDP, % y/y	3.0	2.3	-3.0	3.3	2.7	2.7
Republic of Armenia						
GDP in Constant Prices, % y/y	5.2	7.6	-7.6	3.3	4.3	5.3
Inflation (EoP), % y/y	1.8	0.7	3.7	4.8	3.0	3.2
IBL Rate (annual average), %	6.1	5.8	5.1	6.2	6.6	6.8
Exchange Rate, Local Currency Unit per USD (annual average)	483	480	489	521	511	508
Republic of Belarus						
GDP in Constant Prices, % y/y	3.1	1.4	-0.9	0.1	0.7	1.5
Inflation (EoP), % y/y	5.6	4.7	7.4	6.6	5.2	4.7
IBL Rate (annual average), %	10.7	10.1	7.8	8.3	8.4	8.2
Exchange Rate, Local Currency Unit per USD (annual average)	2.04	2.09	2.43	2.63	2.68	2.74
Republic of Kazakhstan						
GDP in Constant Prices, % y/y	4.1	4.5	-2.6	4.0	4.5	5.1
Inflation (EoP), % y/y	5.3	5.4	7.5	6.3	5.0	4.8
TONIA Rate (annual average), %	8.4	8.4	9.0	8.4	7.9	7.6
Exchange Rate, Local Currency Unit per USD (annual average)	344.7	382.8	413.0	421.6	424.8	430.0
Kyrgyz Republic						
GDP in Constant Prices, % y/y	3.8	4.6	-8.6	3.9	5.5	3.7
Inflation (EoP), % y/y	0.5	3.1	9.7	7.3	4.1	4.8
REPO-7 Rate (annual average), %	2.2	3.0	3.6	4.0	5.0	6.3
Exchange Rate, Local Currency Unit per USD (annual average)	68.8	69.8	77.3	84.9	85.2	85.7
Russian Federation						
GDP in Constant Prices, % y/y	2.8	2.0	-3.1	3.3	2.5	2.5
Inflation (EoP), % y/y	4.3	3.0	4.9	3.8	3.7	4.0
MIACR (annual average), %	7.1	7.2	4.9	4.6	5.0	5.2
Exchange Rate, Local Currency Unit per USD (annual average)	62.5	64.7	71.9	73.6	71.4	72.5
Republic of Tajikistan						
GDP in Constant Prices, % y/y	7.6	7.4	4.5	6.1	7.5	7.1
Inflation (EoP), % y/y	5.4	8.0	9.4	6.6	5.1	5.8
Refinancing Rate (annual average), %	14.2	13.8	11.5	11.0	10.6	10.0
Exchange Rate, Local Currency Unit per USD (annual average)	9.2	9.5	10.3	11.5	11.9	12.3

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

REPUBLIC OF ARMENIA

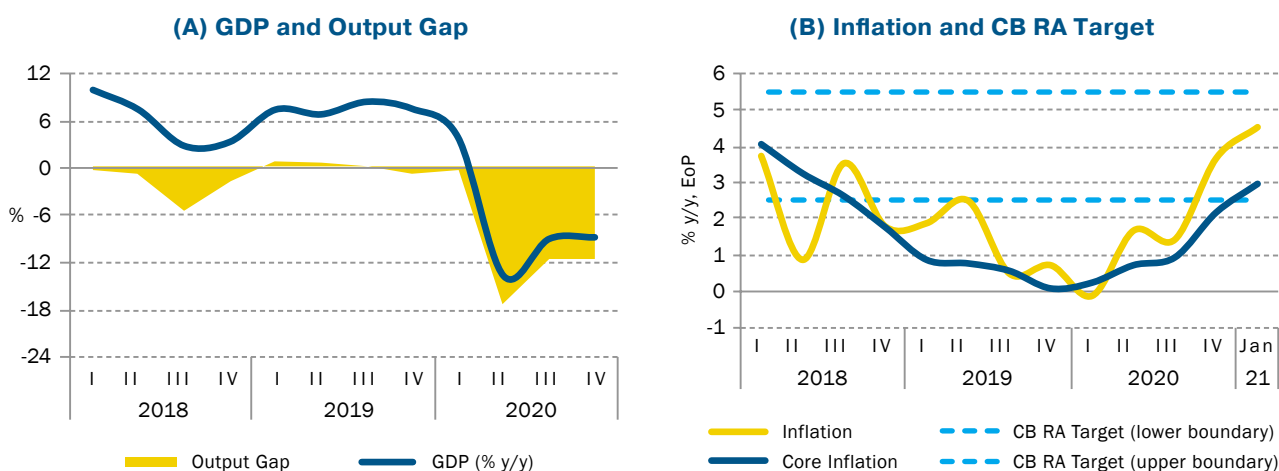
Current Situation

Economic Activity

In 2020, GDP contracted by 7.6%, driven by adverse consequences of COVID-19 and military situation in the country (Figure 1.A). Consumer demand decreased due to social distancing measures, decline of remittances from abroad, and the household lending slowdown. Investment activity weakened due to, among other things, the reduction of construction work. Military operations and uncertainty dampened consumer and investment activities. According to EDB calculations, consumer demand and capital investments had a negative contribution to GDP growth of 11.6 p.p. and 1.4 p.p. (they declined by 14% y/y and 8.6% y/y, respectively). Government measures of economic support and an accommodative monetary policy kept business activity up. Public consumption and net exports contributed positively to GDP growth in 2020 by 1.9 p.p. and 4.6 p.p., respectively. Growth of potential GDP declined from 4.0–4.5% to 3.0% per year in Armenia.

The Services sector experienced the most significant decline in 2020 because of the quarantine restrictions imposed on tourism and social interaction. Trade, Transport, Hotels and Restaurants, and Culture, Entertainment and Leisure were the most heavily affected areas. The Services sector contributed negatively to GDP growth by 5.3 p.p in 2020. Meanwhile, information technologies (software development) and financial services improved. Manufacturing output decreased, mostly due to a decline in the production of tobacco, beverages, and jewellery. Ore mining and metal production supported industrial production; this was facilitated by the recovery of the Chinese economy and rising copper prices. Construction contributed negatively (by 0.4 p.p.) to GDP growth, primarily due to the decline of construction financed by private individuals. In 2020, agricultural output declined because of a poor fruit harvest and a drop in milk production (a contribution of –0.5 p.p. to GDP growth).

The Economic Activity Index decreased by 7.5% y/y in the beginning of 2021. Consumer and investment demand remained weak amid high uncertainty and the tense political situation in the country. Declining private sector income, weak consumer lending, and the difficult epidemiological situation abroad continued to constrain economic activity.

Figure 1. Economic Activity and Inflation in the Republic of Armenia

Source: Armstat, EDB calculations

Inflation

At the start of 2021, inflation continued to accelerate, reaching 4.5% y/y in January (3.7% y/y in December 2020) (Figure 1.B). The rise in food prices was the key driver – it amounted to 6.8% y/y, in line with the increase of global prices. Weakening of the dram in late 2020 and the surge of inflationary expectations continue to impose upward pressure on consumer prices. The EDB projects an acceleration of inflation up to 5.3% in March. Higher energy prices, in turn, will affect the annual rate of price increases.

External Sector

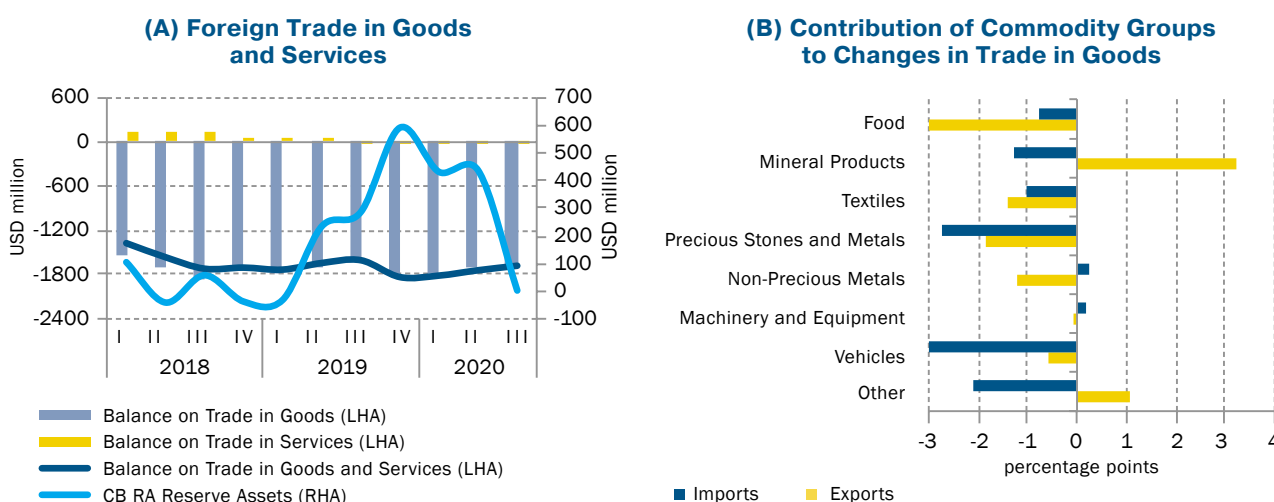
In 2020, international trade in goods decreased by 13.2%, under the negative impact of the COVID-19 pandemic. Imports and exports of goods declined by 17.7% and 3.9%, respectively. With imports shrinking faster than exports, the international trade balance in goods improved, with the trade deficit contracting from USD 4.2 billion in 2019 to USD 2 billion in 2020. According to nine-month data of 2020, exports and imports of services decreased by 53% y/y and 58% y/y, respectively, due to the reduction in travel and passenger traffic in conditions of closed borders and a tense public health situation (Figure 2.A).

Low demand for motor vehicles became one of the key drivers behind the significant decline of imports of goods. Vehicle imports dropped by 74.4% y/y, contributing negatively to total imports by 10.2 p.p. Decline in investment activities was also accompanied by a decrease in the volume of imports of precious stones and metals. The drop in exports was attributed to the economic slowdown in trading partner countries and the decline of industrial production resulting from restrictions related to the coronavirus pandemic and the military operations in Nagorno-Karabakh in 4Q 2020. Conversely, exports were supported by the increase in foreign sales of mineral products (by 11.5% y/y in 2020) as copper prices rose and demand recovered in China (Figure 2.B).

In 2020, EAEU member countries accounted for 31.7% of total Armenian foreign trade in goods. The share of Union states increased by 3.4 p.p. compared to 2019. In 2020, Armenian exports to the EAEU decreased by 8.3%, while imports from the EAEU increased by 0.1% due to doubled imports from Kazakhstan and an 18% y/y increase from Belarus. Russia is Armenia’s largest EAEU trading partner; it accounts for 96% of the volume of Armenia’s EAEU operations.

Net foreign direct investment in the Armenian economy over the first nine months of 2020 amounted to USD 144 million, decreasing by USD 6.2 million year-on-year. The share of incoming FDI in GDP was 1.6%, with almost no year-on-year change. The deterioration of the business environment due to the pandemic has affected FDI inflow. In 2021, uncertainty related to the external and internal political situation will have an adverse impact on investment activity.

Figure 2. Foreign Trade Indicators of the Republic of Armenia



Note: In Figure 2.A, the foreign trade balance represents a four-quarter moving sum.
Source: Armstat, CB RA, EDB calculations

In late 2020, the situation in the internal FX market deteriorated, despite the improved foreign trade balance. In December 2020, net demand for foreign currency was USD 53 million, against a USD 8.0 million net supply in December 2019.⁵ The reversal resulted from a surge of foreign currency demand in October 2020 due to elevated uncertainty. By the end of 2020, the real effective exchange rate appreciated by 1.6% y/y, as inflation in Armenia increased faster than in most of its partner countries.

In January 2021, the Armenian dram weakened against all main currencies (except the Russian rouble). The national currency depreciated against the U.S. dollar and the euro by 8.8% y/y and 19.1% y/y, respectively, and appreciated against the Russian rouble by 9.5% y/y. Depreciation of the dram was driven by persistent net demand for foreign currency in the domestic market. In February 2021, net demand stood at USD 35.8 million vs. a USD 12.2 million net supply in February 2020. This indicates that depreciation expectations may remain strong in the near future.

⁵ By the end of 4Q 2020, net demand for foreign currency increased to USD 165 million from USD 41 million in 4Q 2019.

Foreign exchange reserves of the Republic of Armenia as of February 1, 2021 amounted to USD 2.4 billion. They decreased by USD 0.3 billion year-on-year due to public debt service payments, cash withdrawals by local banks, and sale of foreign currency by the CB RA.

Fiscal Sector

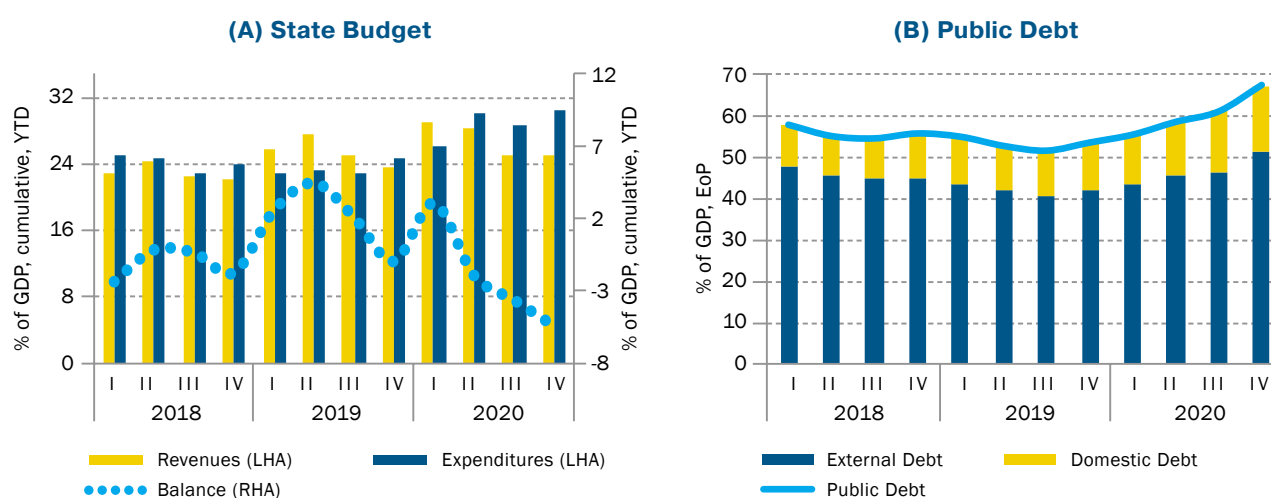
In 2020, the state budget deficit of the Republic of Armenia comprised 5.4% of GDP, against 1.0% of GDP in 2019 (Figure 3.A). The budget deficit widened as expenditures grew faster than revenues, which went up by 5.8 p.p. to 30.6% of GDP due to the need to finance supportive measures against the negative socio-economic effects of the pandemic and military operations. The share of state budget revenues in the GDP increased by 1.4 p.p. to 25.2%. Revenue growth was restrained by weak economic activity, poor financial performance of Armenian enterprises, reduction of imports in value terms, and tax exemptions granted by the government the year before, as part of its countercyclical fiscal policy.

Government support of the economy in 2020 is estimated at AMD 237.9 billion, or 3.8% of GDP. The bulk of that support (2.4% of GDP) was used to finance economic assistance to individual enterprises (subsidization of interest rates, refinancing of loans, job preservation), social assistance to the general population, and long-term economic recovery programs. The remaining funds were used to finance additional health-care expenditures and tax exemptions. Fiscal policy had an expansionary effect on economic activity in 2020.

In 2020, public debt rose by 13.8 p.p. to reach 67.3% of GDP by the beginning of 2021. The debt burden increased due to the increase of both external liabilities (by 8.0 p.p. of GDP) and liabilities under domestic government bonds (by 5.2 p.p. of GDP) (Figure 3.B). In 2020, the Republic of Armenia borrowed USD 0.34 billion, largely from the IMF (USD 0.3 billion). At the beginning of 2021, almost 75% of public debt was denominated in foreign currency. If public debt exceeds 60% of GDP, the ability of the government to increase current expenditures is restricted over the medium term by fiscal rules.⁶

At the start of 2021, the Ministry of Finance of Armenia issued new FX government bonds. Eurobonds with a total principal amount of USD 750 million and term to maturity of 10 years had a yield of 3.8% p.a., the lowest among all previous bond issuances in the international markets. Total investor demand exceeded USD 2.5 billion. Moody's Investors Service assigned the issue a Ba3 credit rating with a "Stable" outlook. At the beginning of 2021, the risk premium paid by Armenia in the international financial markets decreased, reflecting the termination of hostilities in 2020.

⁶ According to the RA Budget System Law, (1) if public debt exceeds 40% of GDP, capital expenditures should be equal to, or higher than, the total deficit; (2) if public debt ranges from 50% to 60% of GDP, the above rule applies, and the current expenditure growth rate should not exceed the historical nominal GDP growth rate; (3) if public debt exceeds 60% of GDP, the two above rules apply, and the amount of current expenditures should not exceed the amount of tax revenues. The government may, by special decree, define exceptional and force-majeure circumstances in which these rules may be breached.

Figure 3. Fiscal Sector Indicators of the Republic of Armenia

Note: (1) Figure 3.A presents changes in the state budget of the Republic of Armenia; (2) Figure 3.B presents changes in the public debt of the Republic of Armenia.

Source: MinFin RA, Armstat, EDB calculations

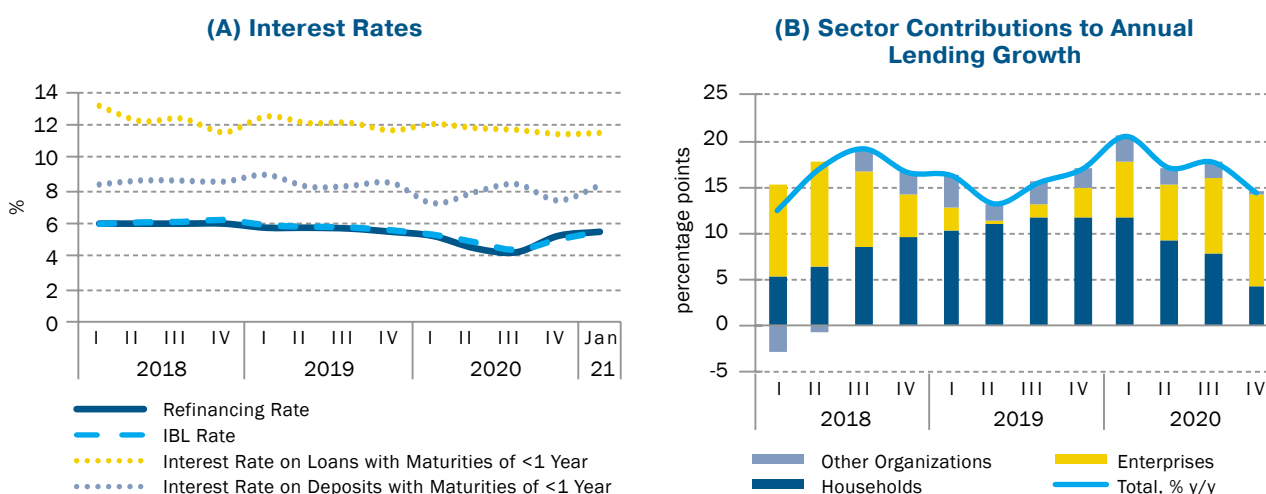
Monetary Sector

In February 2021, the Central Bank increased the refinancing rate to 5.5% p.a.. In 2020, the CB RA cut the refinancing rate four times, taking it down to 4.25% p.a. due to weak demand and low inflation. In December 2020, when price hikes in the international commodity and goods markets gave rise to inflationary pressures in the economy, the regulator raised the refinancing rate by 1.0 p.p. to 5.25% p.a. amid accelerating inflation and a higher country risk premium.

At the beginning of 2021, the value of short-term financial assets went up (Figure 4.A). Bank loan rates remained relatively stable throughout 2020, despite the cut of the refinancing rate. Volatility of deposit rates increased as economic activity diminished. In 2Q 2020 and 3Q 2020, there was an outflow of bank deposits (mostly foreign currency deposits of households). In late 2020 and early 2021, deposits began to increase in response to the refinancing rate hike.

The slowdown in economic activity had an adverse impact on bank lending in 2020. In December 2020, consumer lending grew by 1.4% y/y compared to 30.6% y/y in December 2019. By the end of 2020, the share of non-performing loans increased by 1.1 p.p. to 6.6% of total loans, with overdue consumer loans and mortgages mainly contributing to the increase. Government support programs encouraged expansion of lending to businesses, producing an increase of 23.1% y/y. Most borrowers came from industry, agriculture, transport, and construction. In 2020, overall domestic lending increased by 15.2% y/y (18.0% y/y in 2019) (Figure 4.B). The low volume of household loans is likely to constrain consumer demand growth over the short term.

In 2020, dollarization of bank deposits in Armenia decreased. As of January 1, 2021, 42.3% of deposits and 49.0% of loans were denominated in foreign currencies. Over the year, dollarization of deposits went down by 2.3 p.p., while loans remained virtually unchanged.

Figure 4. Monetary Sector Indicators of the Republic of Armenia

Note: Figure 4.B represents changes in the volume of lending to businesses, households, and other financial institutions and non-commercial organizations.

Source: CB RA, EDB calculations

Forecast

Table 3. Key Macroeconomic Indicators of the Republic of Armenia (Baseline Scenario)

Indicator	2018	2019	2020	2021F	2022F	2023F
GDP in constant prices (year-on-year increase, %)	5.2	7.6	-7.6	3.3	4.3	5.3
Consumer Price Index (EoY, year-on-year increase, %)	1.8	0.7	3.7	4.8	3.0	3.2
AMD IBL Rate (p.a., annual average, %)	6.1	5.8	4.8	6.2	6.6	6.8
AMD/USD Exchange Rate (annual average)	483	480	489	521	511	508

Source: national statistical agencies, EDB calculations

Key Assumptions

Reduction of COVID-19 incidence throughout 2021. Under the baseline scenario, we expect a gradual rollback of sanitary requirements both in the country and abroad. That will facilitate recovery of business activity in countries that are Armenia's key trading partners.

Slowdown of potential GDP growth rate due to the epidemic. Potential output has declined due to an extended lack of demand in the service sector related to tourism and the restaurant business, and it may take a while to recover to pre-crisis levels. Meanwhile, the subsequent full-scale operation of the Sotk Gold Mine will be hindered due to obstacles that have emerged after the military operations, which may influence the volume of industrial production and exports.

Transition to a neutral fiscal policy over the medium term. Under the *State Budget Law of the Republic of Armenia for 2021 and Medium-Term Expenditures Framework for 2021–2023*, a gradual

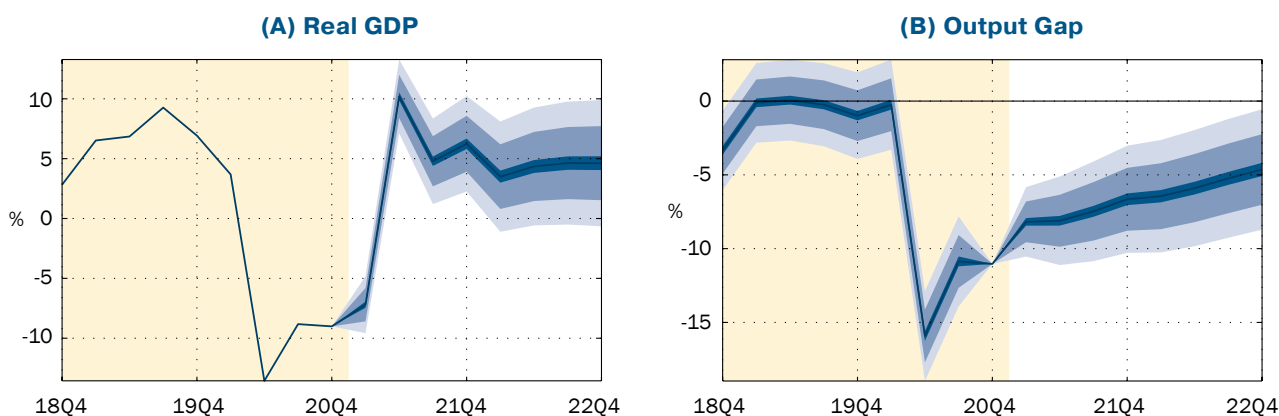
fiscal consolidation is planned in 2021, with subsequent transition to a neutral fiscal policy over the medium term. In 2021, public expenditures will decrease by 2.5 p.p. of GDP, while revenues will increase by 0.3 p.p. of GDP. Over the medium term, the government will work towards attaining debt sustainability and ensuring compliance with the fiscal rules. Accordingly, the authorities plan to gradually boost tax revenues, increase current expenditures in line with the long-term GDP growth trajectory, and improve the structure of gross expenditures by raising the share of capital expenditures.

Economic Activity

The EDB forecasts that in 2021, GDP will increase by 3.3% (Figure 5.A). In 2021, consumer demand will remain muted due to modest growth of personal incomes and consumer lending. Recovery will be further constrained by the completion of business support and job preservation programs approved by the government during the pandemic. Investment activity will remain weak throughout 2021 due to heightened economic and political uncertainty, the unstable financial position of businesses, and limited lending. Meanwhile, several factors will work to support demand: (1) acceleration of remittances from abroad due to economic recovery in Russia, Western Europe, and the USA, particularly as borders open and labour migration resumes, and (2) restoration of income generated by exports and tourism.

Average economic growth of 4.8% in 2022–2023. Deterioration of the investment climate and anticipated tightening of fiscal policy will become additional factors that slow down economic recovery in Armenia. As a result, a negative output gap will persist throughout the forecast period, and the national economy will continue to operate below its potential (Figure 5.B).

Figure 5.7 Economic Activity Forecast for the Republic of Armenia



Source: EDB calculations

Inflation

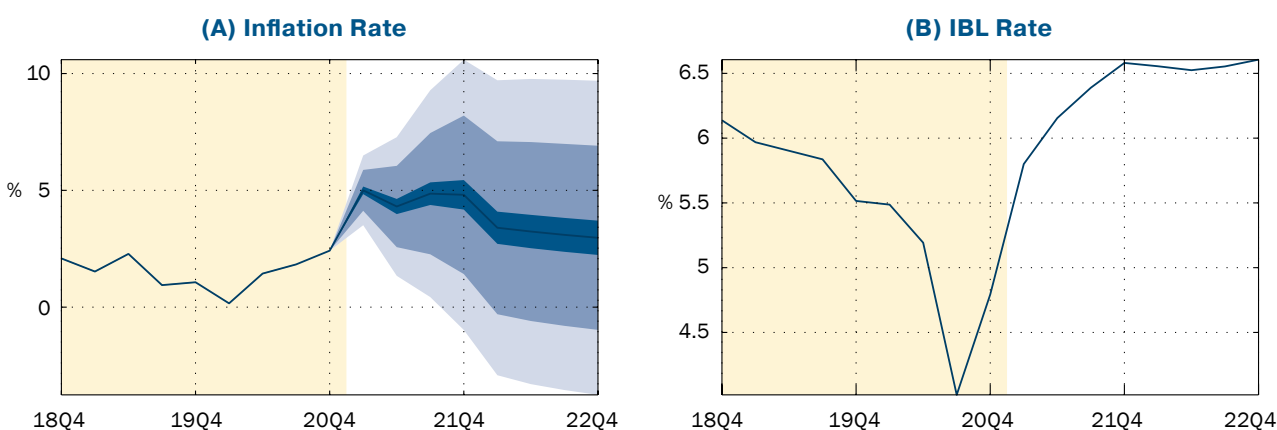
Deceleration of inflation to 4.8% by the end of 2021 (Figure 6.A). The weakening of the dram and rise in food prices that occurred in 2020 will continue to impact the annual inflation rate, keeping it rather high. By the end of 2021, the influence of those factors will be fading away, along with the anticipated stabilization of global food prices and of the exchange rate of the national currency. Rising energy costs

⁷ Here and below, chart ranges correspond to 10%, 50%, and 75% confidence intervals.

will also push prices up throughout the year. Weak consumer demand will have a disinflationary impact. Ultimately, it is projected that by the end of 2021 inflation will be near the target set by the Central Bank of Armenia ($4\pm 1.5\%$).

Inflation rate close to 3.0% in 2022–2023. Under the baseline scenario, inflationary expectations will decline over the medium term as the exchange rate of the national currency stabilises, and the refinancing rate continues to increase. Inflation is expected to stay within the target range set by the regulator.

Figure 6. Projected Inflation Rate and IBL Rate in the Republic of Armenia



Source: EDB calculations

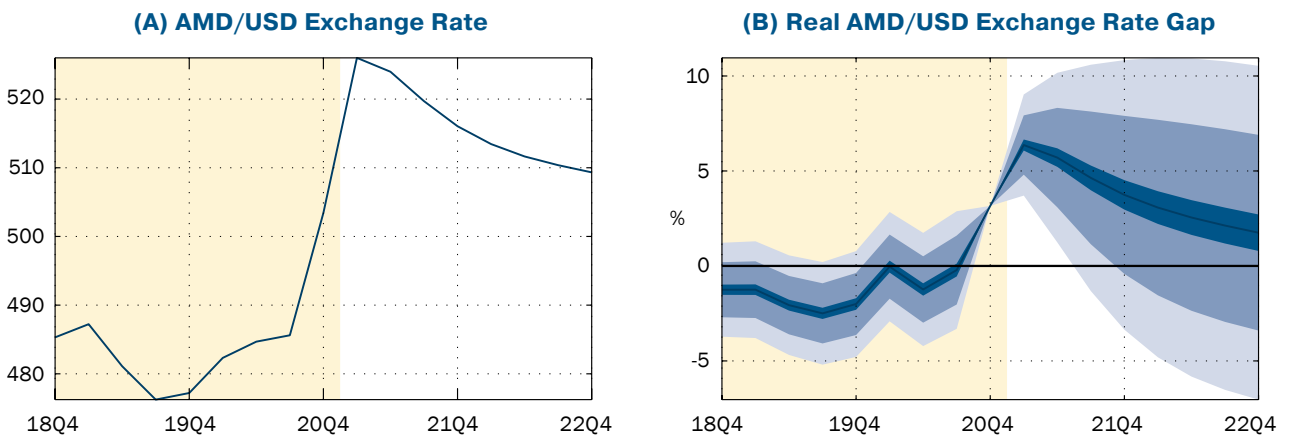
Monetary Policy and Armenian Dram Exchange Rate

Accommodative monetary environment in the first half of 2021. Monetary policy will retain its accommodative nature to support recovery of economic activity. At the same time, the increase in the inflation rate and inflationary expectations will reduce the scale of the monetary stimulus. According to the baseline scenario, in 2021, the IBL rate will rise to 6.2%, getting close to the key rate. Over the medium term, we expect the key rate to remain relatively stable as economic growth accelerates (Figure 6.B).

The average 2021 exchange rate of the Armenian dram to the U.S. dollar is projected at AMD 521 per USD 1.00. Under the baseline scenario, in 2021 the deficit of foreign trade in goods and services will improve in the context of weak domestic demand for imports and restoration of foreign demand supporting exports. Depreciation expectations will continue to influence the Armenian currency. As a result, in 2021, the AMD/USD exchange rate will stay close to its current levels (Figure 7.A). Together with the accelerating inflation, this will reduce the undervaluation of the national currency by the end of 2021 (Figure 7.B).

Armenian dram stability vs. U.S. dollar in 2022–2023. Next year, the AMD/USD exchange rate will strengthen against the backdrop of growing external demand and recovering remittances. The stability of the national currency will continue to improve as the country's balance of payments approaches its equilibrium state, with a significant inflow of foreign investment and transfers.

Figure 7. Projected AMD/USD Exchange Rate



Source: EDB calculations

Risks

If the pandemic lingers, it may take longer for the Armenian economy to recover. If mass vaccination hits a snag, or new coronavirus strains emerge, global economic recovery may slow down. If the risk scenario is realised, GDP growth in Armenia in 2021 will be 1.9% y/y, while in 2022–2023 the Armenian economy will grow 1.1 p.p. per year slower than in the baseline scenario. The average annual AMD/USD exchange rate will be 526.3 to 1.00, which is 0.9% less than projected in the baseline scenario. By the end of 2021, inflation may slow down to 3.7% y/y, as weak consumer demand is exacerbated by lower economic activity and reduced remittances.

REPUBLIC OF BELARUS

Current Situation

Economic Activity

In 2020, the Belarusian GDP decreased by 0.9%, amid the COVID-19 pandemic and aggravation of the social and political situation in the country (Figure 8.A). Social distancing, social isolation, deceleration of individual income growth and of consumer lending have resulted in depressed consumer demand.⁸ In 2020, investment activity declined under the influence of several factors, including deterioration of economic sentiment and the financial results of Belarusian companies, complication of private sector access to bank funding, growth of uncertainty, and emergence of transport and logistical challenges.⁹ In 2020, business activity was supported by intensification of lending to state-owned companies and strong external demand for food products and fertilisers.

In 2020, the Services sector sustained the heaviest losses due to stringent sanitary requirements and border closures. Transport, Hotels and Restaurants, and Entertainment and Leisure are some of the most heavily affected sectors. According to EDB calculations, the negative contribution of the Services sector to GDP growth in 2020 was 1.2 p.p.¹⁰ Deceleration of the IT sector, one of the key drivers of Belarusian economic growth over the last several years, became an alarming signal. In 2020, the contribution of the IT sector to GDP growth decreased to 0.4 p.p. from 0.7 p.p. in 2019. By the end of 2020, Manufacturing sector output reached the level of the previous year, facilitated by the strong performance by potassium fertiliser producers and expansion of lending to state-owned companies. In 2020, the Agriculture sector added 0.4 p.p. to GDP growth, largely due to a 19.6% increase of the grain and pulse harvest.

By the end of 2020, the potential GDP growth rate in Belarus decreased to 0.5–1% under the influence of the pandemic aftermath and sluggish investment activity. At the end of 2019, the EDB estimated potential GDP growth rate at about 1–1.5% per year. Low labour productivity at state-owned enterprises and disproportionate allocation of financial resources¹¹ restrict potential economic growth.

In 2020, financial results of Belarusian companies took a deep plunge. Net profit decreased by 42.6%, while the number of loss-making companies went up by 11.2%, and their share increased by 1.5 p.p. to 15.1%. In 2020, outstanding credits and loans increased by 23.8%, and by January 1, 2021, reached 37.8% of sales revenues (2019: 32.7%). Debts due to Belarusian entities increased by 21.2%, with debts due from foreign partners up by 33.5%. In an environment with bleak economic growth

⁸ In 2020, consumption of paid services by the population decreased by 9.2%, catering sales dropped by 20%, and non-food product purchases by 0.2%. The rate of growth of real disposable income decreased from 6.1% in 2019 to 4.6% in 2020.

⁹ In 2020, capital investments dropped by 6.8%, with costs of acquisition of machines, equipment, and vehicles down by 16.4%.

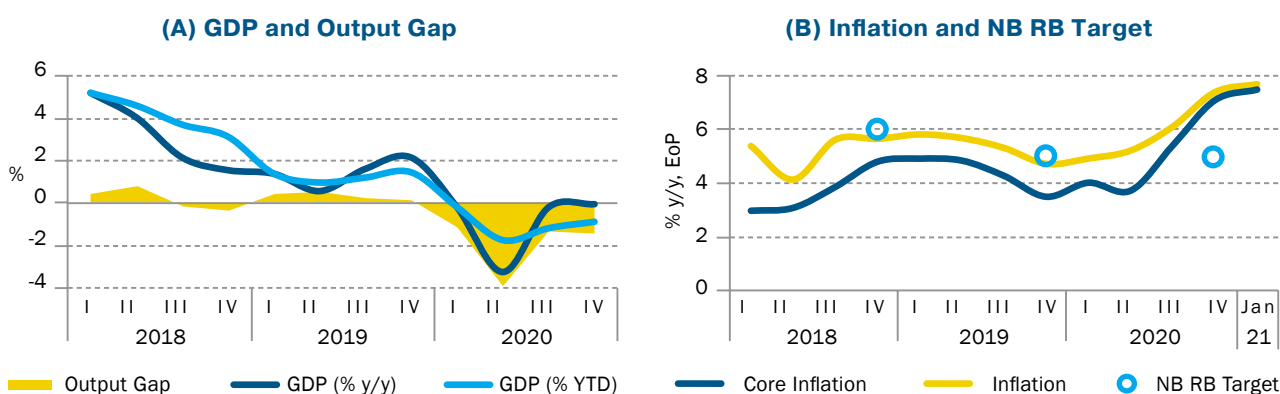
¹⁰ Excluding Information Technologies and Communications.

¹¹ D.L. Kalechits (2021), Deputy Chairman of the Board, National Bank of the Republic of Belarus, notes that “financial stability is threatened by substandard efficiency of allocation of financial resources in the economy. Credit resources are often channelled to uncompetitive enterprises at the expense of efficient business agents, which diminishes the overall economic potential of the state.”

prospects, there is a risk that further deterioration of the financial position of Belarusian companies may undermine macroeconomic stability.

At the beginning of 2021, economic activity remained at a low ebb. In January–February 2021, GDP increased by 0.8% y/y. Economic growth was supported by the low base effect in oil refining and potassium fertilisers production, and higher heat and electricity generation due to cold winter weather.¹² GVA generated by Information Technologies and Communications increased by 2.9% y/y, but remained well below historical levels. In January–February 2021, consumer demand and investment demand were depressed. During the same period, investments in active fixed assets dropped by 11.2% y/y, retail turnover by 3.6% y/y, and catering sales by 19.3% y/y. Economic activity continued to be constrained by high uncertainty, diminishing lending to the private sector, and the difficult epidemiological situation both in Belarus and abroad. According to EDB estimates, because of the weak domestic demand, in 1Q 2021 the output gap will remain negative at –1.8%.

Figure 8. Economic Activity and Inflation in the Republic of Belarus



Source: Belstat, EDB calculations, EEC

Inflation

At the beginning of 2021, inflation continued to accelerate, reaching 7.7% y/y in January and 8.7% y/y in February (Figure 8.B). Food prices are continuing to rise at a high rate due to the ongoing growth of prices around the world, and a poor vegetable harvest in Belarus. Inflation in the Food segment is likely to remain high until the new harvest is brought in. Acceleration of consumer price growth was strongly affected by the rise of medicinal drug prices in January 2021 and February 2021 by 14.4% y/y and 20.0 y/y, respectively. The increase can be attributed both to elevated demand due to the COVID-19 pandemic, and price adjustments in the wake of a VAT rate hike on January 1, 2021. The direct contribution of that hike to inflation in 2021 will amount to 0.5–0.6 p.p. The weakening of the Belarusian rouble in 2020 and heightened inflationary expectations continue to affect the annual growth of consumer prices. In addition, costs are rising due to supply chain disruptions caused by border closures and strict sanitary controls. The EDB projects that in March 2021 inflation will remain above 8% y/y.

¹² In January–February 2020, output of the oil refining industry and chemical industry decreased by 39.2% and 18.5%, respectively, due to reduction of supplies from Russia and failure to execute contracts for the supply of potassium fertilisers to China. In January–February 2021, oil refining industry and chemical industry output increased by 44.1% y/y and 30% y/y, respectively.

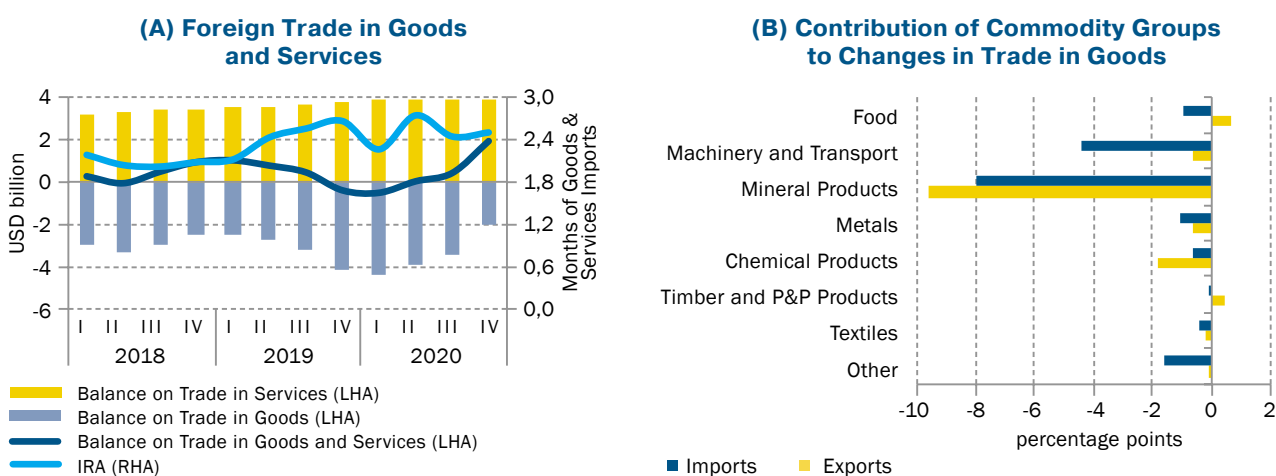
External Sector

In 2020, the volume of international trade in goods decreased by 15.1% because of the negative impact of the COVID-19 pandemic. Imports and exports of goods declined by 17.2% and 12.6%, respectively.¹³ With imports shrinking faster than exports, the balance of international trade in goods improved, and its deficit decreased from USD 4.2 billion in 2019 to USD 2 billion in 2020 (Figure 9.A). In 2020, the surplus of foreign trade in services amounted to USD 3.9 billion, having increased by USD 0.1 billion year-on-year.

Goods imports declined more than exports, which can be explained by a number of factors. In 2020, consumer goods exports from Belarus increased by 1.9%, while imports decreased by 10.2% (Figure 9.B). That happened due to three key factors: high foreign demand for food, border closures, and weakening of the Belarusian rouble, which made Belarusian producers more competitive vis-à-vis their foreign peers.¹⁴ Strong reduction of capital investments in the Belarusian economy resulted in imports of investment goods declining more than their exports (-12.2% and -6.4%, respectively). Because of the warm winter, natural gas imports in 2020 decreased by USD 184 million. Belarusian exports were supported by record-breaking deliveries of potassium fertilisers abroad – about 11.8 million tons, 14.7% up from 2019.

In 2020, EAEU member countries accounted for 49.5% of total Belarusian foreign trade in goods. The share of Union states decreased by 1.3 p.p. vs. 2019. In 2020, Belarusian exports to the EAEU went down by 3.9%, while imports from the EAEU declined by 25.6%. Russia is the largest EAEU trading partner of Belarus, with 97% of total EAEU operations.

Figure 9. Foreign Trade Indicators of the Republic of Belarus



Note: (1) In Figure 9.A, the foreign trade balance is represented as the moving four-quarters total; (2) P&P – Pulp and Paper.
Source: Belstat, NB RB, EDB calculations

In 2020, net foreign direct investment in the Belarusian economy amounted to USD 1.4 billion, up by USD 0.1 billion year-on-year. It should be noted that FDI took a noticeable dive in the second half of 2020.

¹³ According to NB RB data.

¹⁴ In 2020, Belarusian food exports increased by 7.5% in volume terms.

In 2020 to early 2021, the situation in the internal FX market deteriorated, despite an improvement of the foreign trade balance. In 2020, net demand for foreign currencies amounted to USD 1.6 billion, replacing a USD 2.4 billion net supply in 2019. The reversal was caused by an increase of devaluation expectations fuelled by uncertainty caused by the COVID-19 pandemic and political developments in the country. In January–February 2021, net demand for foreign currencies persisted at USD 356.4 million. Individuals purchased USD 201.4 million on a net basis, almost USD 30 million more than in January–February 2020.

Since the beginning of 2021, the Belarusian rouble has weakened against the foreign currency basket by 0.6%.¹⁵ The Belarusian rouble has declined against the U.S. dollar and the Russian rouble by 0.5% and 1.9%, respectively, and strengthened against the euro by 2.5%. Depreciation of the Belarusian rouble was driven by the persistent net demand for foreign currencies in the domestic market. According to EDB estimates, in 1Q 2021, the Belarusian rouble remained undervalued by 6–7% against the U.S. dollar, and by 3–4% against the currencies of its key trading partners.¹⁶ At the beginning of 2021, undervaluation of the Belarusian rouble against the U.S. dollar declined due to high inflation in Belarus.

As of March 1, 2021, reserve assets of the Republic of Belarus amounted to USD 7.1 billion. They had decreased by USD 1.7 billion year-on-year, primarily due to the massive sale of foreign currencies by the National Bank to counter deterioration of the situation in the domestic foreign currency market.¹⁷ As of March 1, 2021, the reserves were sufficient to cover 2.4 months of imports of goods and services. That falls below the generally accepted sufficiency threshold (3 months), but still exceeds the averages reported by Belarus prior to the 2020 crisis (2.3 months in 2017–2019). As of March 1, 2021, reserves excluding monetary gold and SDRs amounted to USD 3.8 billion. Taking into consideration the large forthcoming public debt service payments, uncertain IT sector prospects, and previous surges of demand for foreign currencies on the part of the general population, such reserves are estimated as minimally acceptable in the event of new crises.¹⁸

Fiscal Sector

By the end of 2020, the deficit of the consolidated budget of the Republic of Belarus stood at 1.8% of GDP. In 2019, the budget had been executed with a surplus of 2.3% of GDP (Figure 10.A). The fact that the 2020 budget was executed with a deficit resulted in rouble deposits held by the government with the NB RB decreasing by a factor of two to BYN 1.7 billion as of January 1, 2021. Fiscal reserves declined accordingly.

The emergence of a fiscal deficit in 2020 can be explained by the drop in revenues by 2.3% of GDP caused by deceleration of economic activity both in the country and abroad, decline of oil prices, and deterioration of the financial results of Belarusian companies. Reduction of Belarusian budget revenues in 2020 was generally of a cyclic nature.

¹⁵ As of March 17, 2021.

¹⁶ Undervaluation of the Belarusian rouble emerged in the first half of 2020 and rose in 3Q 2020 due to the two surges of devaluation expectations in March 2020 and August 2020.

¹⁷ In March 2020 – February 2021, the National Bank sold at the exchange USD 1.8 billion (MinFin RB operations are not included). In February 2021, total sales amounted to about USD 300 million.

¹⁸ The average public debt repayment and service payments in 2021–2023 are estimated at more than 5% of GDP. In August 2020, individuals purchased USD 622 million on a net basis.

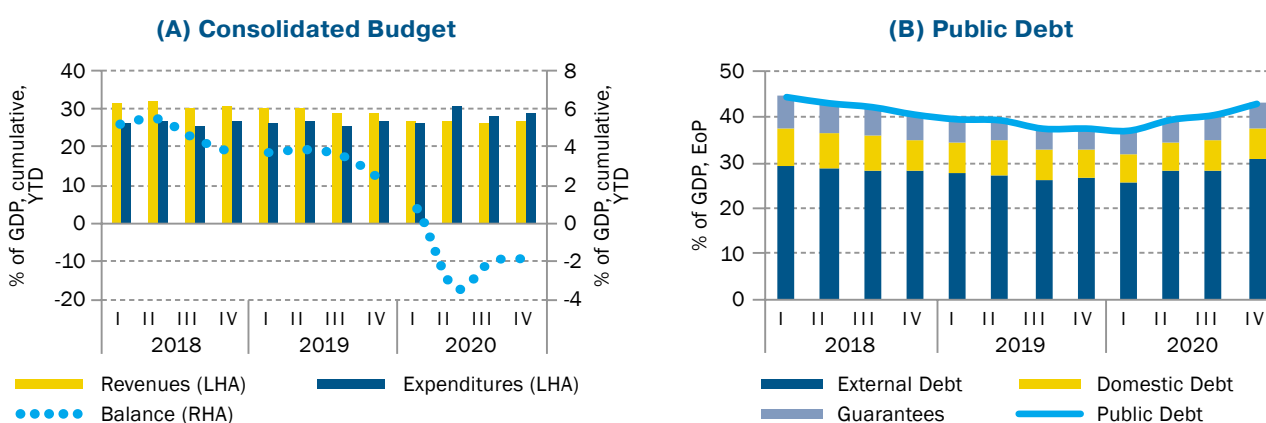
In 2020, expenditures of the consolidated budget increased by 1.8% of GDP. A significant increase of appropriations noted in 2Q 2020 was largely related to restructuring of debts owed by grain-processing companies. In 2H 2020, the share of expenditures in total GDP remained virtually unchanged year-on-year. This budget execution may have been attributable to strong threats to debt sustainability in the second half of 2020.

Government support of the economy in 2020 is estimated at BYN 2 billion, or 1.4% of GDP. The bulk of that support was represented by bank credits against guarantees provided by the central government and local authorities. On the whole, in 2020 central government guarantees increased by 1.3% of GDP to 5.6% of GDP. According to our estimates, government support measures compensated 0.2–0.7% of 2020 GDP losses.

In 2020, public debt increased by 5.5% of GDP to reach 42.9% of GDP by the beginning of 2021.¹⁹ The growth of the debt burden is explained by assumption of additional external liabilities (4.3% of GDP) and guarantees (1.3% of GDP) (Figure 10.B). In 2020, the Republic of Belarus raised USD 3.15 billion in foreign markets, primarily in the form of government bonds (USD 1.4 billion), loans provided by the government and Russia's banks (USD 1.05 billion), and an EFSD loan (USD 0.5 billion). More than 90% of public debt is denominated in foreign currencies, which subjects the state to high currency and liquidity risks. In January 2021, public debt continued to grow and, according to EDB estimates, reached 43.7% of GDP by February 1, 2021. The increase is attributable to the issue of FX-denominated domestic government bonds.

Accumulation of public debt proceeded against the backdrop of declining reserve assets and growing threats to debt sustainability. Procurement of long-term financing has made it possible to create a reserve that can be used to discharge government obligations over the short term and maintain reserve assets at a minimally acceptable level. Over the medium and long term, solvency risks remain elevated due to bleak economic growth prospects and the tight public debt repayment schedule.

Figure 10. Fiscal Sector Indicators of the Republic of Belarus



Notes: (1) Figure 10.A presents changes in the consolidated budget of the Republic of Belarus; (2) Figure 10.B presents changes in central government debt and debt guaranteed by the central government.

Source: MinFin RB, Belstat, EDB calculations

¹⁹ Central government debt and debt guaranteed by the central government, according to EDB calculations based on MinFin RB and Belstat data.

Monetary Sector

In 1Q 2021, monetary conditions remained tight due to prudential measures and money supply restrictions imposed by the National Bank. In 1H 2020, the National Bank reduced the refinancing rate three times, taking it down to a historical minimum of 7.75% p.a. In 2H 2020, there was a significant increase in risks to macroeconomic and financial stability, primarily due to a surge of demand for foreign currencies on the part of the general population and Belarusian companies, strong outflow of bank deposits, and a significant increase of deposit interest rates. To mitigate those risks, the National Bank tightened its monetary policy by restricting the access of banks to standing facilities, and subsequently prolonging that restriction pending approval of an appropriate resolution by the National Bank Board. The refinancing rate remains unchanged, while IBL interest rate volatility has increased (Figure 11.A).

An unusual situation has emerged in the financial market, where bank deposit interest rates have exceeded bank loan interest rates since September 2020. In January 2021, the average interest rate on new BYN term deposits stood at 13.1%, while in July 2020 it was 7.7%. The rate hike can be explained by the outflow of household deposits provoked by devaluation expectations.²⁰ In turn, during the same period of time, the average interest rate on new BYN market loans changed very little, from 10.9% in July 2020 to 11.1% in January 2021 (Figure 11.A). Banks may increase loan interest rates, but that ability is limited by application of the estimated values of standard risk.²¹ Because of the abnormal difference between loan and deposit interest rates and the mounting risks, banks reduced the amount of loans extended to economic agents in September–December 2020 and in January 2021 by 12% y/y and 14.8% y/y, respectively. It should be noted that in March 2021, the National Bank increased the estimated value of standard risk for corporate and retail loans by more than 1 p.p., to 12.9% and 14.69%, respectively. It is highly likely that the increase will make bank loans more expensive.

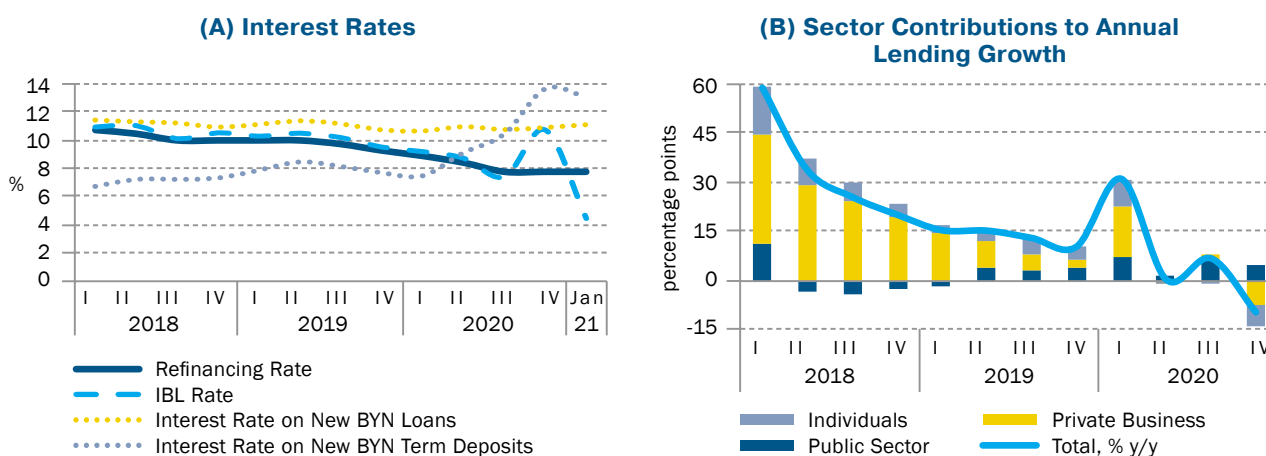
In September–December 2020, the amount of BYN loans extended to state-owned enterprises increased by 17.1% y/y. Conversely, the amount of loans received by private companies and individuals was down by 17.9% and 25.4%, respectively (Figure 11.B). In January 2021, new BYN loans to the public sector increased by 5% y/y, while new BYN loans to private companies and individuals decreased by 14.8% y/y and 33.6% y/y, respectively. This shows that companies of different forms of ownership are treated differently for the purposes of allocation of financial resources. Redistribution of resources in favour of the less productive state-owned enterprises limits the economic growth potential of Belarus, and may have negative consequences for financial and macroeconomic stability should the economy experience any powerful shocks.²²

FX penetration of bank deposits and loans in Belarus remains one of the highest in the EDB region of operations. As of February 1, 2021, 65.8% of all deposits and 62.8% of corporate loans were denominated in foreign currencies. High FX penetration makes the real sector of the economy more vulnerable to currency and liquidity risks, and reduces the efficiency of monetary regulation.

²⁰ In 2020, individual and corporate term BYN deposits decreased by 11.7% and 2.1%, respectively. In January 2021, individual term BYN deposits increased by 1.5% after interest rates on such deposits had been raised.

²¹ The estimated value of standard risk (EVSR) is calculated on the basis of average interest rates set by systemically important banks assigned to Importance Group 1 during the month preceding the calculation month. If interest rates applied by the banks to market loans exceed the EVSR, such banks are subject to more stringent regulatory control. Due to its calculation methodology, the EVSR is characterised by strong inertia – it changed little, if at all, during the period from August 2020 to February 2021.

²² According to EDB calculations, in 2017–2019, labour productivity at private companies was, on the average, 22% higher than at companies fully or partially owned by the state. In addition, NB RB reports that, although state-owned companies have a limited independent debt service capacity, they account for a large chunk of total outstanding loans, estimated at 14% of GDP (Kalechits, 2021). The EDB estimates total loans to all Belarusian economic agents at 40% of GDP as of January 1, 2021.

Figure 11. Monetary Sector Indicators of the Republic of Belarus

Note: Figure 11.B presents changes in total disbursement of BYN loans.

Source: NB RB, EDB calculations

Forecast

Table 4. Key Macroeconomic Indicators of the Republic of Belarus (Baseline Scenario)

Indicator	2019	2020	2021F	2022F	2023F
GDP in constant prices (year-on-year increase, %)	1.4	-0.9	0.1	0.7	1.5
Consumer Price Index (EoY year-on-year increase, %)	4.7	7.4	6.6	5.2	4.7
One-Day BYN IBL Rate (p.a., annual average, %)	10.1	7.8	8.3	8.4	8.2
BYN/USD Exchange Rate (annual average)	2.09	2.43	2.63	2.68	2.74

Note: The 1Q 2021 IBL rate was adjusted by the EDB based on the assumption that it would have been higher than the refinancing rate by 0.4–0.5 p.p. if the National Bank had not imposed restrictions on standing facilities.

Source: national statistical agencies, EDB calculations

Key Assumptions

The spread of the COVID-19 pandemic will be slowing down throughout 2021. Under the baseline scenario, we expect a gradual rollback of sanitary requirements both in the country and abroad. That will facilitate recovery of supply chains and business activity in countries that are the key trading partners of Belarus.

Debt sustainability will be retained over the medium term. The baseline scenario envisages uninterrupted discharge by the Republic of Belarus of its debt obligations in 2021–2023. Because of its weak economic growth potential, this may require full refinancing or even a further increase of public debt over the medium term to maintain reserve assets at a level sufficient to cover about two months of imports.

Fiscal policy will be contractionary over the medium term. The information provided in *Main Directions of Fiscal and Tax Policy of the Republic of Belarus for 2021–2023* points to a gradual tightening of fiscal policy over the medium term. That will deter recovery of economic activity. Limited

fiscal reserves, hefty public debt payments, and weak income build-up potential limit the possibilities for fiscal stimulation of the Belarusian economy.

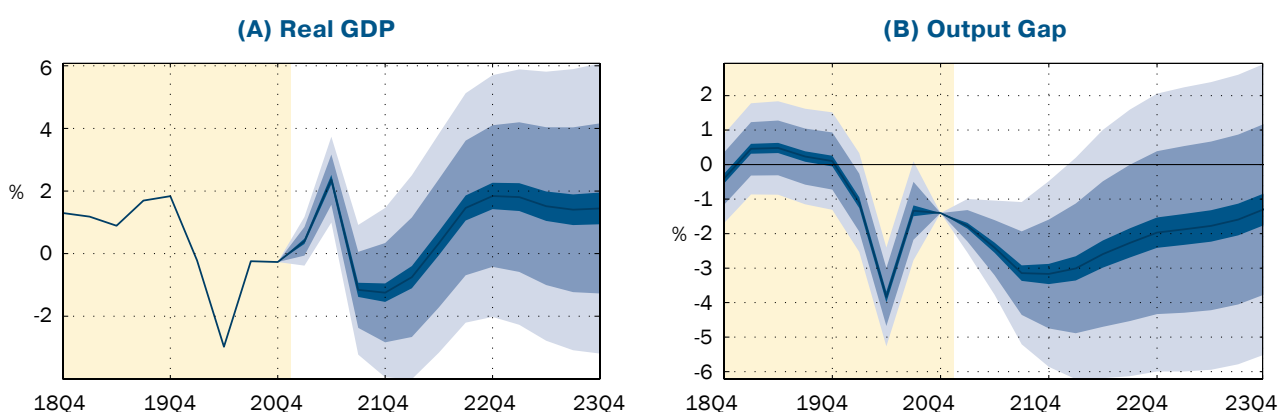
The National Bank will retain control over the money supply. This assumption is indirectly confirmed by the fact that in 2021 the National Bank has resumed the use of the BYN monetary base as an operational monetary policy target.

Economic Activity

In 2021, the Belarusian economy will continue to stagnate. The EDB forecasts that in 2021 the Belarusian GDP will increase by 0.1% (Figure 12.A). Compared to the previous forecast (EDB, 2020), this estimate has been increased by 0.2 p.p. because the adverse impact of the second wave of the pandemic on the Services sector in late 2020 and early 2021 has proven to be less devastating than expected. On the whole, in 2021, economic activity in Belarus will remain at a lower level than before the crisis, primarily due to a lull in investment activity caused by elevated uncertainty, deteriorating economic sentiment, the unstable financial position of Belarusian businesses, and limited lending to the private sector. In 2021, consumer demand will remain weak due to the anticipated deceleration of personal income growth and tightening of lending conditions. In 2021, the Belarusian economy will be supported by recovery of business activity in the countries that are the key trading partners of Belarus, and gradual rollback of sanitary restrictions as the epidemiological situation returns to normal.

The EDB forecasts that in 2022–2023 the Belarusian GDP will be growing at an average rate of 1.1% per year. Over the medium term, economic growth will be stifled by low productivity of labour at state-owned enterprises and existing disproportions in allocation of financial resources.²³ Deterioration of the investment climate and anticipated tightening of fiscal policy will become additional factors that will slow down economic recovery in Belarus. Sluggish recovery will contribute to long-term preservation of a negative output gap, meaning that the economy is operating below its full potential (Figure 12.B).

Figure 12. Economic Activity Forecast for the Republic of Belarus



Note: data seasonally adjusted.

Source: EDB calculations

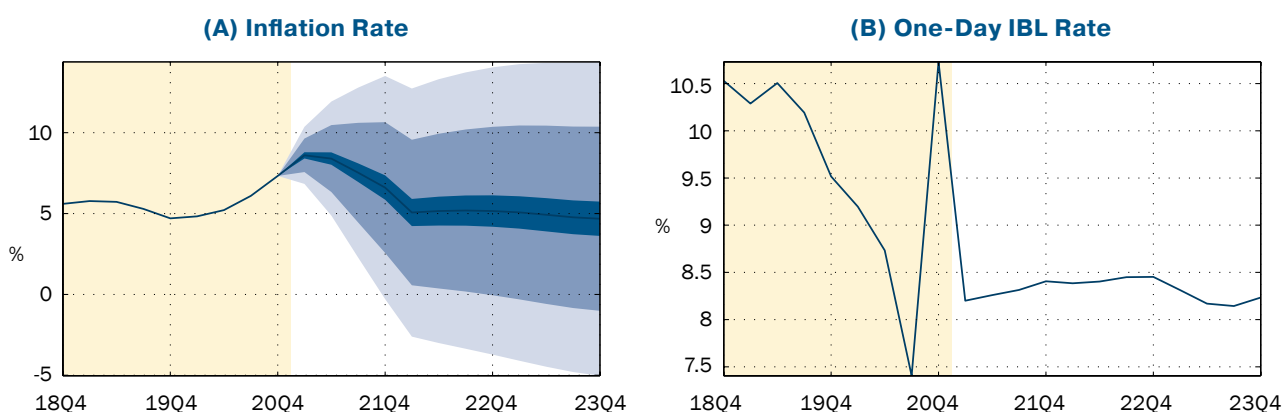
²³ In his report, D.L. Kalechits (2021), Deputy Chairman of the Board, National Bank of the Republic of Belarus, notes that “financial stability is threatened by substandard efficiency of allocation of financial resources in the economy. Credit resources are often channelled to uncompetitive enterprises at the expense of efficient business agents, which diminishes the overall economic potential of the state.”

Inflation

By the end of 2021, inflation will slow down to 6.6%, after having accelerated in the first half of the year. Consumer prices will continue to rise at a rate of more than 7% throughout most of the year (Figure 13.A). The weakening of the Belarusian rouble and the rise in food prices that occurred in 2020 will continue to impact the annual inflation rate, keeping it rather high. The increase of the VAT rate for certain groups of goods in January 2021 will add 0.5–0.6 p.p. to the growth rate of consumer prices. By the end of 2021, the inflationary influence of exchange rates and food prices will be fading away amid the anticipated stabilization of both global food prices and the exchange rate of the national currency. Weak consumer demand will have an additional disinflationary impact. Ultimately, it is projected that by the end of 2021 inflation will reach 6.6%, exceeding the target set by the National Bank (maximum 5%).

Inflation in 2022–2023 is projected at about 5%. Under the baseline scenario, we assume a moderate abatement of inflationary expectations over the medium term, provided that the government pursues a consistent monetary policy. This will make it possible to keep inflation close to the National Bank’s target in an environment characterised by gradual recovery of economic activity and reduction of the disinflationary impact of domestic demand.

Figure 13. Projected Inflation Rate and IBL Rate in the Republic of Belarus



Note: The 1Q 2021 IBL rate was adjusted by the EDB on the assumption that it would have been higher than the refinancing rate by 0.4–0.5 p.p. if the National Bank had not imposed restrictions on permanently available liquidity maintenance operations. Inflation data are seasonally adjusted.

Source: EDB calculations

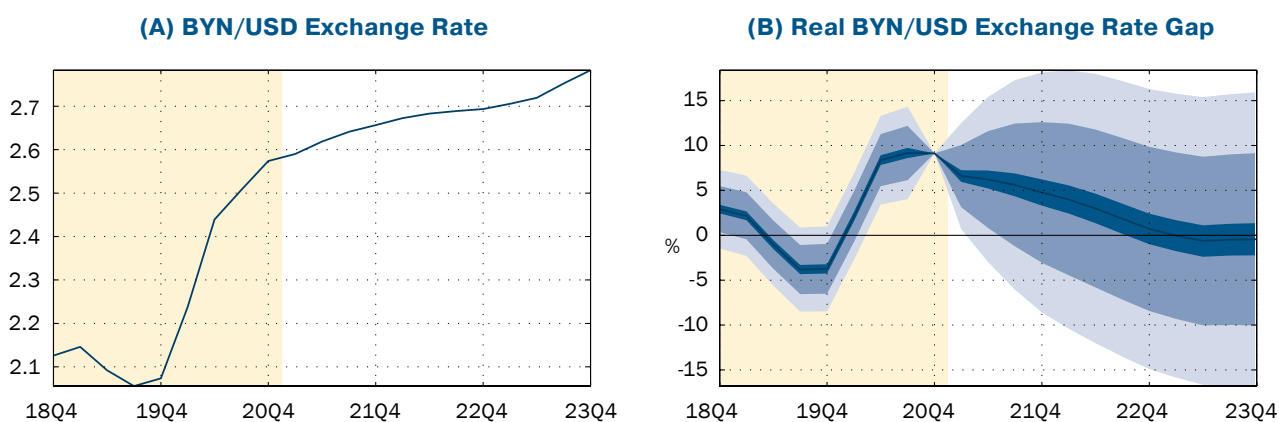
Monetary Policy and Belarusian Rouble Exchange Rate

Monetary policy will remain tight throughout the first half of 2021. We expect that the National Bank will keep the monetary policy tight by controlling money supply and applying prudential measures designed to restrain the banks from increasing BYN lending on market terms. Acceleration of inflation and elevated devaluation expectations are the key determinants of the restraining monetary policy. Gradual normalization of monetary conditions is possible during the second half of the year, provided that the situation in the domestic FX market remains stable. Normalization will involve reduction of interest rates on BYN term deposits to bring them closer to 10%, and expansion of private sector access to market loans.

In 1H 2021, the interbank market lending rate will remain volatile. During the second half of the year, it will return to the upper part of the interest rate range set by the NB RB (about 8–8.75%), provided that restrictions on permanently available liquidity maintenance operations are lifted (Figure 13.B.). According to the EDB forecast, retention of the IBL rate at around 8–8.5% over the medium term will make it possible to keep the inflation rate close to the National Bank’s target in the absence of additional shocks.

In 2021, the average BYN/USD exchange rate is projected at about BYN 2.63 per USD 1.00. Under the baseline scenario, we expect that in 2021 the surplus of foreign trade in goods and services will remain at about 1–1.5% of GDP. Weak domestic demand will hamper restoration of imports, while exports will be supported by the expanding external demand and the projected rise of key commodity prices. In turn, devaluation expectations will continue to affect the Belarusian national currency. We project that the BYN/USD exchange rate will remain close to its current level throughout 2021 under the operation of those factors (Figure 14.A). Together with accelerating inflation, this will reduce the undervaluation of the national currency by the end of 2021. It is projected that BYN adjustment to an equilibrium level will be completed in 2022 (Figure 14.B). The BYN devaluation trend will persist over the medium term due to the relatively slow rate of economic growth. This will necessitate ongoing support of Belarusian producers from the standpoint of the price factor. The fact that the inflation rate in Belarus is higher than in the countries which are its key trading partners will be an additional driver of the nominal devaluation of the Belarusian rouble.

Figure 14. Projected BYN/USD Exchange Rate



Note: In Figure 14.B, positive values correspond to undervaluation of the Belarusian rouble.

Source: EDB calculations

Risks

It remains highly uncertain how social and political events that took place in 2020 will affect economic growth potential. If the situation moves in an adverse direction, it will further worsen the investment climate in Belarus. Outflow of labour resources and IT companies may accelerate as borders open and relocation costs decline. Negative developments will reduce the growth potential of the Belarusian economy over the long term due to the loss of its technological sophistication and erosion of human capital. Over the medium term, such a turn of events is likely to precipitate a deep production decline and realization of potential threats to debt and financial stability.

A significant increase of non-market lending to stimulate GDP growth will result in acceleration of inflation and devaluation of the Belarusian rouble. According to our estimates, over the medium term potential Belarusian GDP may grow at a rate of 0.5–1% per year. Sustainable acceleration of economic growth will require large-scale structural transformations designed to boost the productivity of labour and improve the competitiveness of the Belarusian economy. Over the short term, business activity may be galvanised by building up money-issuance lending. This tool, however, is not capable of increasing the growth potential over the long term, and its application might result in devaluation of the national currency and acceleration of inflation.

Debt sustainability may be jeopardized if the government runs into problems in its attempts to refinance the public debt. New loans received by the Government of the Republic of Belarus in 2020 helped to spread the debt burden over a longer period of time. However, in 2022–2023 debt payments are expected to rise to USD 3.5–4.0 billion per year. They will have to be refinanced due to insufficiency of reserve assets and bleak economic growth prospects.

The EDB has analysed a risk scenario which is based on a number of key assumptions. One of those assumptions is that in 2020 the pandemic had a stronger negative effect on potential Belarusian GDP than envisaged by the baseline scenario. It is also expected that recovery of business activity in the countries that are the key trading partners of Belarus will be slow, commodity prices will go down, and pressure on the national currencies of emerging economies will become stronger.²⁴ In such conditions, investment activity in Belarus will be less pronounced than under the baseline scenario. Under the risk scenario, consumer demand will decline, while demand for foreign currencies on the part of the general population will increase in line with devaluation expectations.

Realization of the risk scenario will result in the Belarusian economy going into a slump in 2021–2022. In 2021 and 2022, GDP will decrease by 1.4% and 2.6%, respectively, while in 2023 it will grow by 0.4%. In 2021, the average BYN/USD exchange rate will stand at about BYN 2.80 per USD 1.00, or 6% down relative to the baseline scenario. Because of the devaluation of the national currency, inflation will be 8% in 2021 and 7% in 2022. In 2023, it will decelerate to 5% due to weak domestic demand. As inflationary pressure grows stronger and the national currency becomes weaker, interest rates may rise: the average IBL rate is projected at 10.5% in 2021, and 11.6% in 2022. The fiscal policy will have a more restrictive impact on economic growth due to consolidation of expenses accompanied by dilution of budget revenues. It should be noted that adverse developments in the external sector may trigger realization of other threats to the Belarusian economy. However, the risk scenario developed by the EDB does not envisage realization of threats related to financial and debt destabilization.

²⁴ A detailed description of the risk scenario for the global economy is presented in the section entitled *External Economic Conditions*.

REPUBLIC OF KAZAKHSTAN

Current Situation

Economic Activity

Government-initiated crisis response measures have somewhat mitigated the adverse consequences of the pandemic. According to a preliminary BNS RK estimate, in 2020 Kazakhstan's GDP decreased by 2.6%. Restrictions imposed during emergency periods inflicted the most damage on the Services sector, which declined by 5.6%. In the Mining sector, the dynamics were constrained by the OPEC+ agreement, while manufacturing industries maintained positive growth. Industrial output decreased by 0.4%. In 2020, strong Agriculture performance (+5.6% y/y) was partially attributable to recovery of grain production after the poor harvest in 2019. The Construction sector reported 11.2% growth, supported by government programs to expand residential housing construction and soft mortgage lending.

In 2020, domestic demand was supported by General Government sector operations. Decrease of investment activity (–3.4% vs. 2019) is predominantly attributable to reduction of capital investments in the mining industry. Its negative contribution accounted for 11.8 p.p., while the year before the sector was one of the key investment drivers. The aggregate contribution of industries that reported growth of capital investment made up 10.6 p.p., which can be explained, at least in part, by higher budget allocations (health care, water and electricity supply) and low exposure of certain industries to the adverse impact of the COVID-19 pandemic (agriculture, telecommunications). Consumer activity declined due to epidemiological restrictions and decrease of real income and consumer lending. Domestic supply was bolstered by government support programs, including the payment of minimal wages during the quarantine.

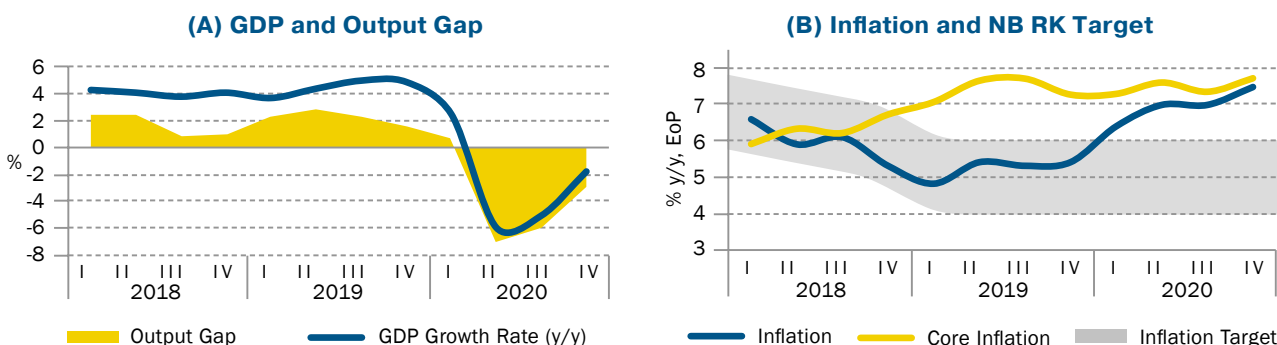
At the beginning of 2021, economic activity was shaped by one-off factors. According to preliminary MNE RK estimates, in January 2021 GDP decreased by 4.5% y/y. Decline of oil production is partially explained by an emergency shutdown at the Tenghiz Field. Reduction of consumer activity at the beginning of the year occurred amid a growing number of new COVID-19 cases and imposition of partial restrictions. Composite RK PMI, as measured by IHS Markit in January 2021, stood at 44.9 points (December 2020: 44.7 points). The decline accelerated in the Production sector, but slowed down in the Services sector. Despite the deterioration of certain indicators, optimism²⁵ for the next 12 months remained at its highest since February 2020.

Inflation

At the beginning of 2021, inflation remained high. The CPI went up by 7.4% y/y (December 2020: 7.5% y/y). Food products remained the key contributor to total inflation (11.4% y/y). Rising global prices and supply chain restrictions pushing up freight costs are affecting the prices of imported food products. Decline in production of certain types of animal products and shrinking vegetable supply also exerted upward pressure on food price inflation. The CPI remained stable in the non-food segment.

²⁵ According to an IHS Markit survey, companies are hoping for rollback of quarantine restrictions and subsequent growth of consumer demand.

Figure 15. Economic Activity and Inflation in the Republic of Kazakhstan



Source: BNS RK, NB RK, EDB calculations, EEC

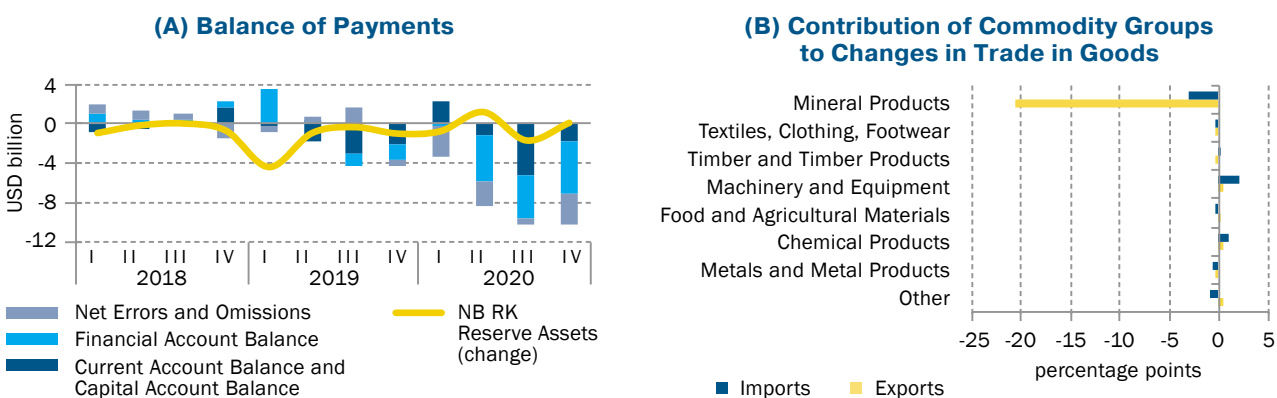
External Sector

In 2020, foreign trade turnover in goods and services decreased by 17.8% y/y due to restrictions imposed in the country and abroad, and decline of global oil prices. The narrowing of the current account deficit was expedited by reduction of outflow under the *Primary Income Balance* item and an increase of transfers (receipt of a setoff payment within the framework of the Karachaganak Consortium). Inflow of capital from financial operations was secured by attraction of foreign direct investment and long-term loans, and by redemption of securities previously placed abroad by the General Government sector (Figure 16.A).

Retention of Balance of Trade Surplus. Declining oil prices and the OPEC+ agreement led to a reduction of 2020 RK export revenues by 19.1%. Suspension of operations for the duration of the quarantine was another key driver, with foreign deliveries decreasing for most other consolidated export items, with the exception of chemical products, machines, and equipment. Imports dropped by 4.1%, mainly due to reduction of the volume of imported mineral products, metals, and metal products.

In 2020, the volume of mutual trade between the RK and other EAEU member countries decreased by 9.1%, with exports and imports going down by 13.5% and 7.3%, respectively. Russia remained the largest trading partner with the highest share of mutual trade between the RK and EAEU member countries (92.3%).

Figure 16. Foreign Trade Indicators of the Republic of Kazakhstan



Source: SRC MF RK, NB RK, EDB calculations

Since the beginning of 2021, the Kazakh tenge has strengthened against the U.S. dollar by 0.8%.²⁶ At the end of January, pressure in the domestic FX market built up due to the escalation of the geopolitical situation in the region and the general strengthening of the U.S. dollar in the global market. At the beginning of February, following a reversal in the domestic FX market, the tenge began to strengthen, in line with the accelerated growth of global oil prices.

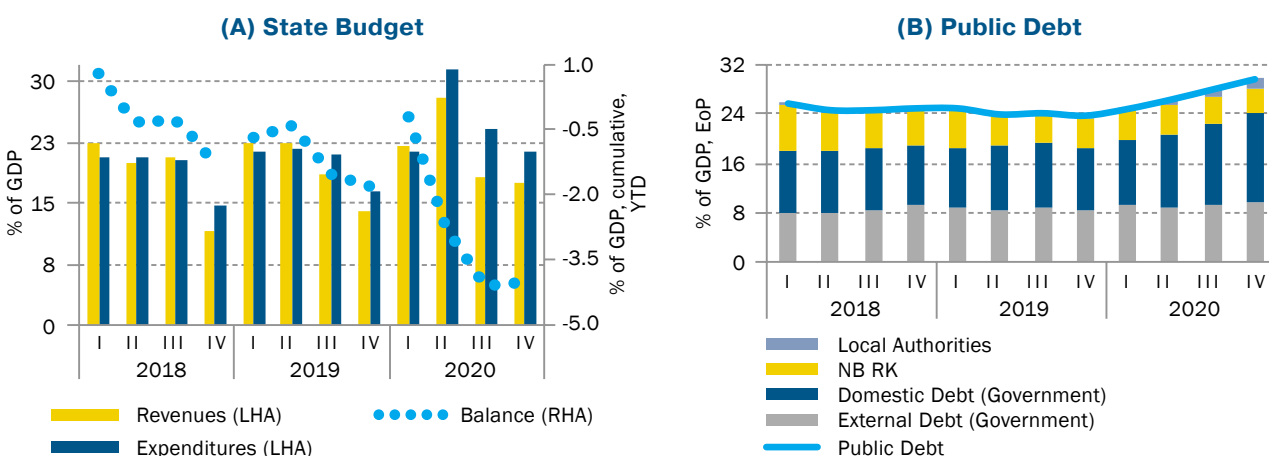
Consolidated international reserves²⁷ as of February 1, 2021, amounted to USD 93.3 billion. They had gone down by 1.1% since the beginning of 2021 due to a decrease in the nominal value of the gold and assets owned by the RK National Fund.

Fiscal Sector

The RK state budget deficit at the end of 2020 stood at 4.0% of GDP (2019: 1.8% of GDP). Revenues rose by 13.8% y/y because of an increase in the amount of transfers from the RK National Fund (1.6x) and non-tax revenues (3.0x). Tax revenues were down by 7.1% y/y due to a decline in economic activity and reduction of prices for key RK export commodities. Expenditures rose by 23.6% y/y, as a result, among other things, of government efforts to support the economy and mitigate the adverse consequences of the pandemic, and growth of salaries in the Education sector.

As of January 1, 2021, Kazakhstan’s public debt stood at 29.4% of GDP, a 5.7 p.p. increase year-on-year. The increase is attributable to domestic borrowings against the backdrop of an expanding fiscal deficit, primarily in the form of long-term state treasury bills. Since the beginning of 2020, amounts due under those state treasury bills have increased by 48.7%. In May 2020, the MF RK began to issue short-term securities. By the end of the year, amounts due under such securities increased to KZT 350.8 billion. During the period under review, foreign public debt has increased by 18.8% as the government has issued Eurobonds and received a series of loans from foreign commercial banks and international development institutions.

Figure 17. Fiscal Sector Indicators of the Republic of Kazakhstan



Source: MF RK, BNS RK, EDB calculations

²⁶ As of March 1, 2021.

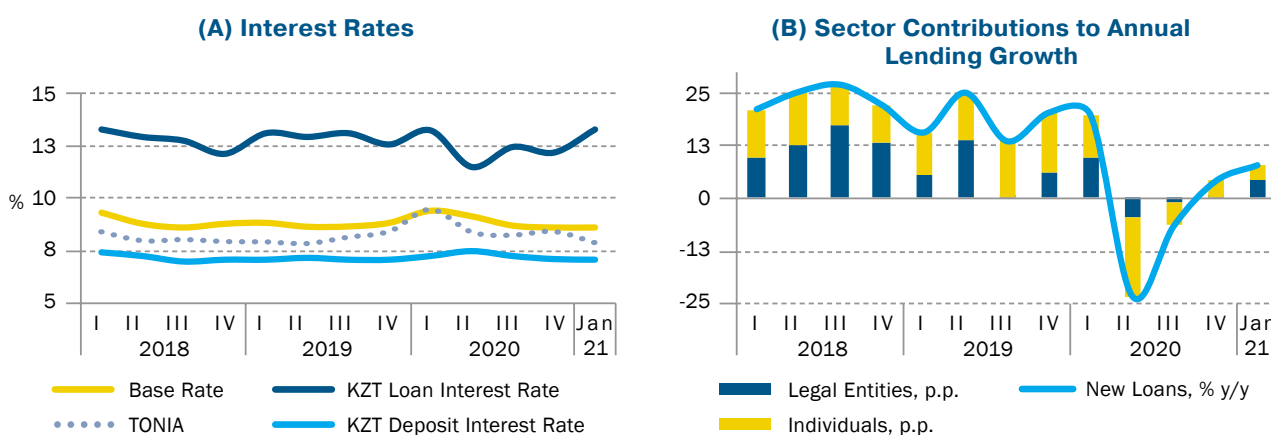
²⁷ Including NB RK international reserves and National Fund assets.

Monetary Sector

In February 2021, the base rate of the NB RK was preserved at 9.0%. According to our estimates, under current monetary conditions, it will be possible to attain the inflation target by the end of 2021 without significantly limiting the rate of economic growth. The strengthening of inflation risks in combination with depressed business activity leaves the National Bank little room for manoeuvre. The TONIA rate has remained below base rate, which testifies to the existence of a liquidity surplus in the banking system. In 2020, average KZT loan and deposit rates decreased vs. 2019 by 0.7 p.p. and 0.2 p.p., respectively (Figure 18.A).

New loans extended by commercial banks in 2020 decreased by 3.7%, primarily due to the contraction of lending to Trade, Communication, Construction, and other other (unclassified) industries industries. Positive Industry and Agriculture growth rates were achieved, in part, as a result of government soft lending programs. By the end of 2020, the share of non-performing loans in the total loan portfolio went down to 6.8% (2019: 8.1%). In 2020, new deposits taken by the banks increased by 14.0% year-on-year.

Figure 18. Monetary Sector Indicators of the Republic of Kazakhstan



Note: Figure 18.B presents changes in total disbursement of KZT loans.

Source: NB RK, EDB calculations

Forecast

Table 5. Key Macroeconomic Indicators of the Republic of Kazakhstan (Baseline Scenario)

Indicator	2019	2020	2021F	2022F	2023F
GDP in constant prices (year-on-year increase, %)	4.5	-2.6	4.0	4.5	5.1
Consumer Price Index (EoP year-on-year increase, %)	5.4	7.5	6.3	5.0	4.8
TONIA Rate (p.a., annual average, %)	8.4	9.0	8.4	7.9	7.6
KZT/USD Exchange Rate (annual average)	382.8	413.0	421.6	424.8	430.0

Note: F stands for "Forecast."

Source: national statistical agencies, EDB calculations, EEC

Key Assumptions

Economic activity is still affected by the course of the pandemic. A budget-sponsored mass COVID-19 vaccination campaign started on February 1, 2021. It is anticipated that it will last until the end of the year and cover about one third of the total RK population. The baseline scenario assumes a gradual rollback of sanitary requirements both in the country and abroad, which will facilitate recovery of global supply chains, foreign and domestic demand.

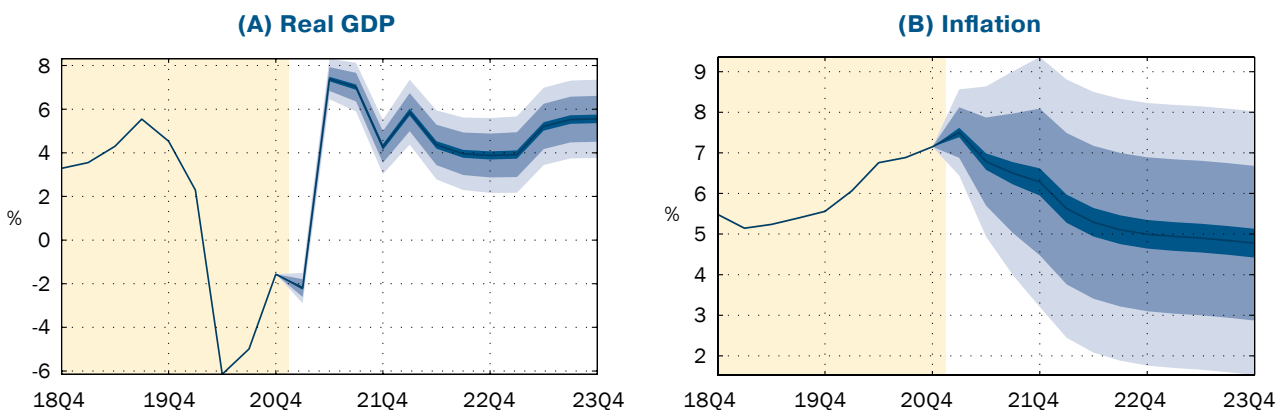
Budget consolidation is expected over the medium term. According to the Law of the Republic of Kazakhstan *On the Republican Budget for 2021–2023*, the state budget deficit is to be reduced from 3.4% of GDP in 2021 to 2.1% of GDP in 2023. Accordingly, we believe that fiscal incentives will be gradually withdrawn as the national economy recovers.

A reduction of the current inflation target is expected. Based on NB RK statements and mid-term MNE RK forecasts, we believe that the inflation target for 2021–2022 may be set in the form of a corridor, 4.0–6.0%. Over the next two years, that corridor may be narrowed to 4.0–5.0%, which will require the monetary authorities to make additional efforts to keep annual CPI changes within the range.

Economic Activity

The EDB projects active recovery growth. In 2021, Kazakhstan’s GDP will increase by 4.0% (Figure 19.A). Further abatement of the adverse impact of the pandemic on business activity will become the key factor. 2Q 2021 will be marked by the highest growth rate during the year, primarily due to the low base effect, as in 2Q 2020 operations at most enterprises were suspended after the imposition of a quarantine. Rollback of sanitary requirements will create conditions conducive to recovery in the Services sector, especially with respect to retail and wholesale trade, restaurants, and entertainment centres. We estimate that cross-border travel restrictions will be lifted at an uneven rate, and recovery of activity in Transport and Logistics and International Tourism will be stretched out over time. Fiscal stimulus will continue to support the economy, even though their contribution will be somewhat diluted by the more vigorous economic activity throughout 2021 and the high 2020 base. It is anticipated that the economy will return to its pre-crisis level (4Q 2019) by the end of 2021.

In 2022–2023, economic growth is expected to accelerate as new production facilities are put into operation. Revitalization of business activity in 2022 will largely be the consequence of the full lifting of sanitary restrictions in Kazakhstan and its trading partners. Restoration of international passenger traffic and full-scale operation of supply chains will intensify international trade in goods and services, and provide an additional impetus to foreign investment. It is expected that in 2023, oil production at the Tenghiz Field will increase following the completion of an expansion project. Therefore, according to EDB estimates, in 2022 and 2023 GDP growth in the RK will accelerate to 4.5% and 5.1%, respectively (Figure 19.A).

Figure 19. Economic Activity and Inflation Forecast for the Republic of Kazakhstan

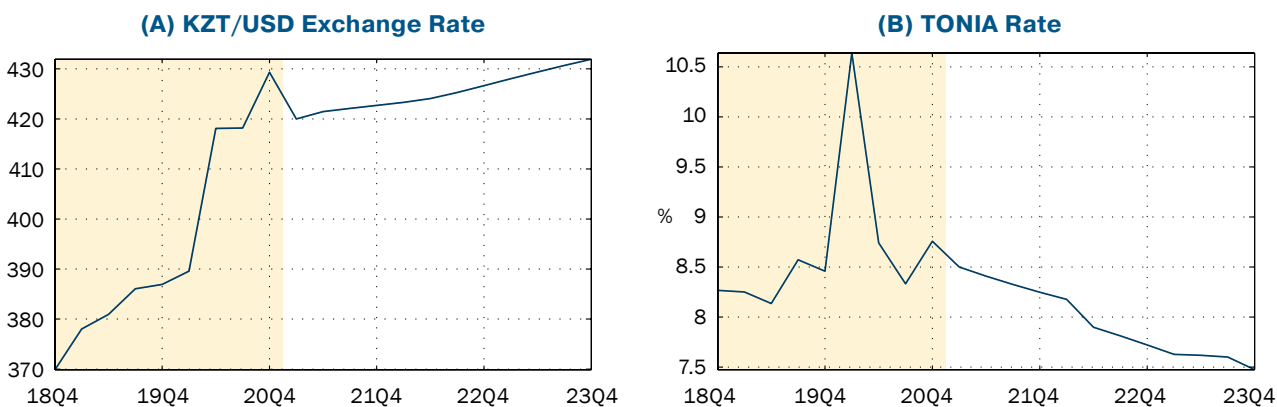
Note: data seasonally adjusted.

Source: EDB calculations, EEC

Inflation

In 2021, inflation will remain above its target value. The rise in consumer prices will tend to decelerate throughout the year (Figure 19.B), although inflation will remain above the 4.0–6.0% target. The weakening of the tenge in 2020 and the rise of food prices will remain the key inflation drivers. The exchange rate pass-through effect will have been exhausted by the end of 1Q 2021. The effect of global food price hikes will be dwindling throughout the year, to fully disappear at the beginning of 2022. Additional disinflationary impact will be generated by weak consumer demand. As a result, 2021 EoY inflation is projected at 6.3%.

Inflation will stabilise within the 2022–2023 target range. Exhaustion of the effect of inflationary drivers over the medium term will anchor inflationary expectations at a stable level. This will make it possible to keep inflation within the National Bank target range in an environment characterised by gradual recovery of economic activity and reduction of the disinflationary impact of domestic demand.

Figure 20. Projected KZT/USD Exchange Rate and IBL Rate in the Republic of Kazakhstan

Source: EDB calculations, EEC

Monetary Policy and Kazakh Tenge Exchange Rate

In 2021, monetary policy will continue to seek a balance between inflationary risks and risks related to the slackening of economic activity. Epidemiological uncertainty increases risks to sustainable economic recovery, and may necessitate additional measures to support domestic demand. On the other hand, inflationary risks may hinder adherence to a stimulative monetary policy. We believe that the current base rate will make it possible to slow down inflation without generating excessive pressure on business activity in the country. The base rate may be reduced by 0.25 p.p. in 4Q 2021, as inflationary expectations stabilise.

Over the medium term, the potential for reduction of the base rate remains strong. Stabilization of inflation within the target range (as the economy approaches the equilibrium level in 2023) creates conditions conducive to restoration of neutral monetary conditions. According to EDB estimates, by the end of the period under review, the base rate may be reduced to 7.5–8.5% (Figure 20.B).

In 2021, the average KZT/USD exchange rate is projected at about KZT 421.6 per USD 1.00. The rapid rise of global oil and metal prices in late 2020 and early 2021 will contribute, in part, to the strengthening of the tenge in 1Q 2021. Its current movements are to some extent dictated by recovery of the positions the tenge had lost in early autumn of 2020 (Figure 20.A).

In 2022–2023, the Kazakh tenge is projected to weaken against the U.S. dollar by an average of 1.0% per year. That will be consistent with an equilibrium path of the KZT exchange rate, and will not have any additional inflationary effect. The fact that the inflation rate in Kazakhstan is higher than in the countries that are its key trading partners will be an additional driver of nominal devaluation of the Kazakh tenge.

Risks

Epidemiological uncertainty in Kazakhstan and around the world may slow down economic recovery. Emergence of new virus strains and inefficient use of vaccines may result in an extension of the current restrictions. That, in turn, will postpone global economic recovery, keeping demand for energy resources in a depressed state. According to EDB calculations, if oil prices remain at USD 40 per barrel in 2022–2023, and global economic recovery proceeds slower than expected, Kazakhstan's GDP will grow at an average rate of 2.2% per year, which is 1.8 p.p. below the level envisaged by the baseline scenario.

The RK remains exposed to elevated inflationary risks. If restrictions in Kazakhstan and its trading partners remain in force longer than expected, it is highly likely that additional imbalances will emerge in certain commodity markets. That, combined with the aspiration of each country to ensure its food safety, will intensify external inflationary pressures. Realization of deferred consumer demand as business activity recovers is fraught with additional risks of accelerating inflation.

KYRGYZ REPUBLIC

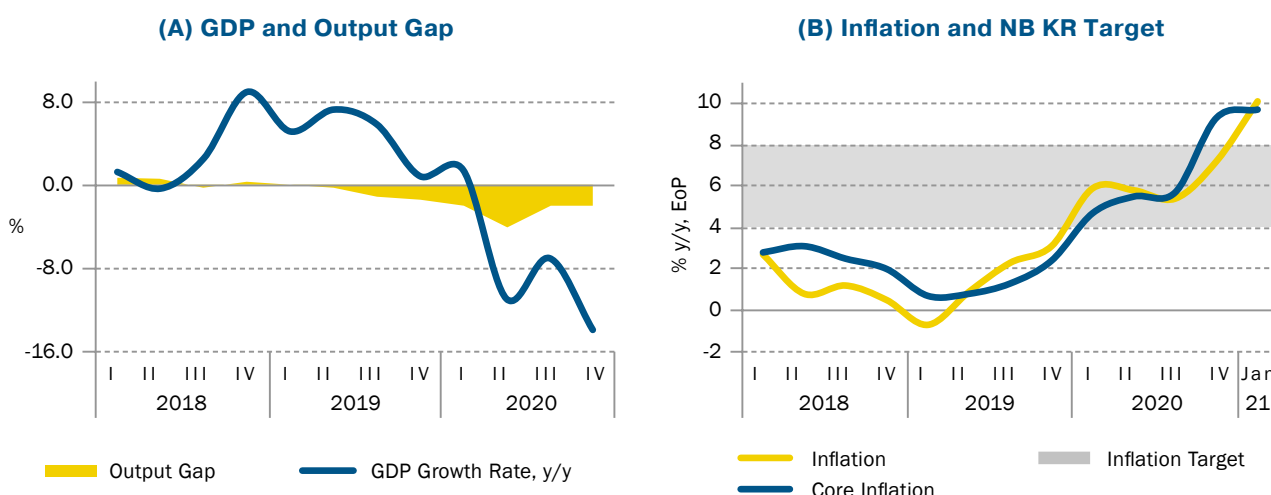
Current Situation

Economic Activity

Widespread reduction of economic activity in 2020. According to a preliminary NSC KR estimate, in 2020 the Kyrgyz Republic's GDP decreased by 8.6%. That decrease is the largest of the last 26 years; unlike previous slumps during that period, it was characterised by pervasive deceleration of economic activity (see [Box](#)). Imposition of a quarantine in April–May 2020, rapid deterioration of the epidemiological situation in July, escalation of social and political tensions in October, and scheduled reduction of gold production at the Kumtor Mine were the key drivers of reduction of consumer and investment activity. The external sector had an additional adverse impact on Kyrgyzstan's economy, e.g., reduction of external demand for Kyrgyzstan's goods (with the exception of gold), limited operation of border checkpoints, and transport/logistical challenges.

At the beginning of 2021, economic activity remained at a low ebb. In January 2021, GDP decreased by 7.6% y/y. Output decline was reported in Industry (–9.5% y/y), Construction (–22.5% y/y), Retail and Wholesale Trade (–12.0% y/y), Transport (–12.1% y/y), and Restaurants and Hotels (–34.0% y/y). High uncertainty and the difficult epidemiological situation in the country and abroad continued to constrain economic activity.

Figure 21. Economic Activity and Inflation in the Kyrgyz Republic



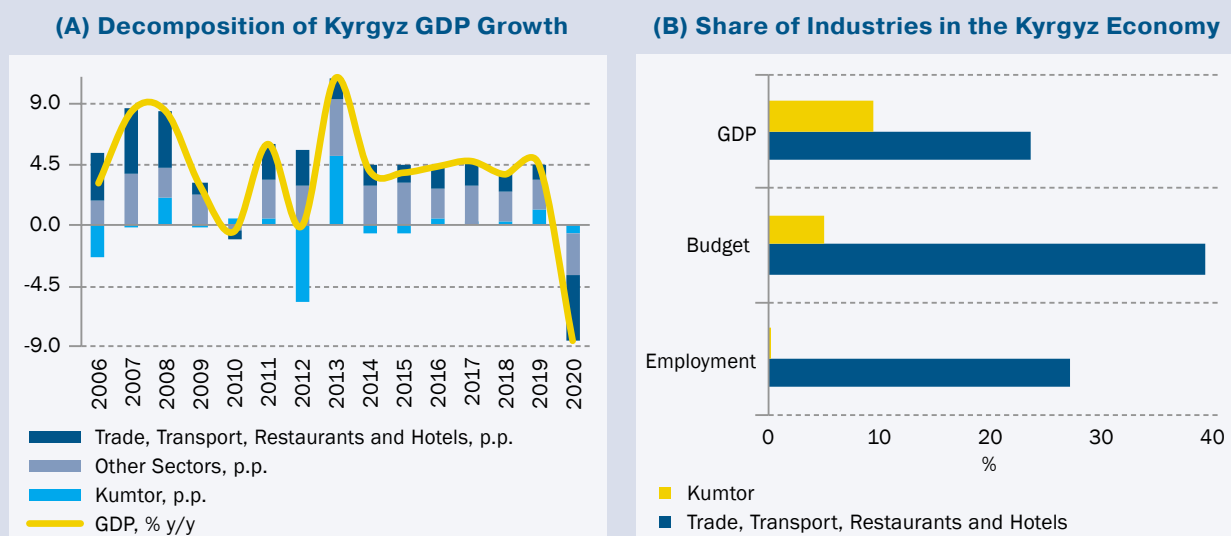
Source: NSC KR, NB KR, EDB calculations, EEC

Box. Comparison of the Impact of the COVID-19 Pandemic and Kumtor Operations on Economic Growth in the Kyrgyz Republic

The volatility of Kyrgyzstan's GDP over the last several decades has been largely determined by the operation of Centerra Gold, a Canadian mining company responsible for the development of the Kumtor Gold Mine. Recovery of economic growth in 2006 was hampered by a decrease of gold extraction at the Kumtor mine. The GDP slump in 2010 was offset, by about one third, by the output growth reported by the mining company. The most impressive GDP swings were registered in 2011–2014, when annual economic growth rates fluctuated from –0.1% to 10.9% (Figure 22.A). Even though Centerra Gold production accounted for an average of 8–9% of GDP, the company's impact on the Kyrgyz economy was narrowly spread and focused on several areas. Foreign trade is a major channel of influence: in 2009–2019, foreign gold supplies accounted, on the average, for 42.2% of total exports. The second key channel of influence is the General Government sector. An average of 5% of budget revenues in 2009–2020 was represented by the gross income tax paid by the Kumtor mine. According to Centerra Gold, aggregate payments to the General Government sector, including mandatory payments to various funds, other taxes and duties in 2018 and 2019 were equivalent to 6.4% and 8.9% of total state budget revenues, respectively. Centerra Gold's payments to Corporate sector players in connection with the supply of goods and services in 2019 were equivalent to 1.1% of Kyrgyzstan's GDP. The company does not play any significant role in the labour market. Therefore, export revenues and KR General Government revenues are the main areas of Centerra Gold's influence.

The COVID-19 pandemic had a limited impact on mine operations. According to Centerra Gold's management, 2020 gold output was in line with the annual plan. However, the adverse effects of the pandemic touched upon a broad range of other sectors of the economy, and reduced the income of a significant part of the economically active population. In 2020, output by Trade, Transport, and Restaurants and Hotels (the sectors most heavily affected by the pandemic) decreased by 15.7%, 30.9%, and 45.1%, respectively, while their consolidated negative contribution to the GDP amounted to 4.8 p.p. Those figures are comparable to the 45.9% drop in gold production at the Kumtor mine in 2012, which at that time amounted to a 5.6 p.p. contribution to the GDP's decrease. However, the negative impact on the economy produced by such a massive drop in production at a key gold mining company was limited to a 19.2% decline in the volume of exports, while household consumption and gross capital accumulation in 2012 increased by 11.3% and 42.4%, respectively. A comparable negative contribution of adverse COVID-19 effects to 2020 GDP is associated with the pervasive deterioration of the economic situation. Three sectors of the economy (Trade, Transport, and Restaurants and Hotels) employ more than a quarter of the economically active population, while taxes paid on their goods and services accounted for about 40% of total budget revenues during the period under review. The average contribution of those sectors to the GDP over the last 11 years is 23.3% (Figure 22.B). According to an NSC KR survey, 44% of households included in the sample reduced their spending in 2020 due to the negative impact of the pandemic (Kuznetsov et al., 2021). A preliminary report by the KR statistical agency says that in 2020, investments and tax revenues decreased by 24.7% and 12.0%, respectively. Output decline was registered in industries whose aggregate share in 2020 GDP amounted to 63.7%. Positive growth rates registered in the aggregated GDP sectoral structure did not exceed 1.6%, while the average annual rate of economic growth in 2014–2019 was 4.2%.



Figure 22. Significance of the Kumtor Mine and the Services Sector for the Kyrgyz Economy

Note: Average shares of Kumtor and of Trade, Transport, and Restaurants and Hotels in GDP in 2009–2020, and in total employment in 2009–2019. Average shares of gross income tax paid by Kumtor and taxes on goods and services in state budget revenues in 2009–2020.

Source: EDB calculations, NSC KR, MF KR, Centerra Gold

Inflation

At the beginning of 2021, inflation continued to accelerate and reached 10.1% y/y in January (December 2020: 7.2% y/y) (Figure 21.B). Rising food prices remain the main inflation driver, primarily due to the ongoing rise in global prices for oil crops, sugar, and grain, and the reduction of animal product output in trading partner countries. We estimate that the impact of these factors will begin to weaken by the middle of 2021. The depreciation of the Kyrgyz som in 2020 continued to drive the annual growth of consumer prices. In addition, costs are rising due to supply chain disruptions caused by border closures and strict sanitary controls to counter the pandemic. The scheduled increase of alcohol and tobacco excise duties in 1Q 2021 will create additional upward pressure on the annual CPI.

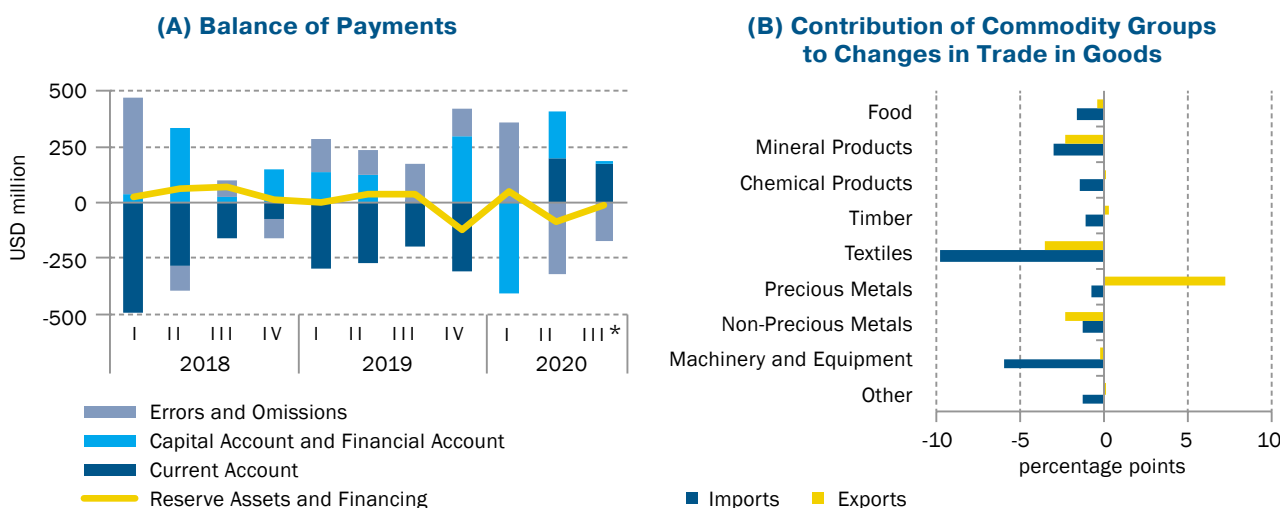
External Sector

In 2020, there was a significant contraction of foreign trade. Border closures and temporary suspension of business activity in the country resulted in a decline of foreign trade in goods and services, with the exception of deliveries of gold abroad, where annual sales revenues increased by 18.5% in the context of rising global precious metal prices. Current transfers decreased due to a reduction of the volume of official assistance from foreign countries. On the other hand, the U.S. dollar equivalent of cash remittances sent by labour migrants to the KR was higher than in 2019. In 2020, there was a net outflow of capital related to the operations of foreign direct investors and commercial banks. The Government sector raised external financing in the form of soft borrowings from international development organizations (Figure 23.A).

The trade deficit declined. Exports increased, primarily because of the growing income from deliveries of gold abroad amid rising global precious metal prices. Textile production, a key sector of international operations in the KR, sustained material damage during the pandemic. Disruption of transport and logistical chains led to a drop in the volume of imported raw materials used by Kyrgyz enterprises to manufacture clothing products which, among other things, curtailed their export capacity. Imports of machines and equipment also declined due to reduction of investments, including government investments.

In 2020, the volume of mutual trade between the KR and other EAEU member countries decreased by 12.5%, with exports and imports going down by 14.9% and 11.7%, respectively. In 2020, Russia and Kazakhstan traditionally accounted for the bulk of mutual trade between the KR and EAEU member countries (64.9% and 33.1%, respectively).

Figure 23. Foreign Trade Indicators of the Kyrgyz Republic



Note: * Preliminary data. The balance of payments was prepared in accordance with the requirements of the 5th edition of the *IMF Balance of Payments Manual*.

Source: NSC KR, NB KR, EDB calculations

Since the beginning of 2021, the Kyrgyz som has weakened against the U.S. dollar by 1.5%.²⁸ At the end of January, pressure in the domestic FX market built up due to the surge of volatility in the regional financial markets and the general strengthening of the U.S. dollar in the global market. To diffuse that pressure, the NB KR conducted currency interventions for a total amount of USD 87 million.

Gross international reserves of the Kyrgyz Republic as of February 1, 2021 amounted to USD 2.7 billion, having increased by 13.0% year-on-year due to the growing volume of physical gold and the rising global precious metal prices. The expansion of the portfolio of securities placed in foreign markets also had a positive effect on the country’s reserve assets.

²⁸ As of March 1, 2021.

Fiscal Sector

According to preliminary NSC estimates, in 2020, the state budget deficit of the Kyrgyz Republic amounted to 3.3% of GDP (2019: 0.1% of GDP) (Figure 24.A). The negative balance increase is attributable to a drop in revenues amid a broad contraction of economic activity and modest growth of General Government expenditures (2.6%), primarily social expenditures.

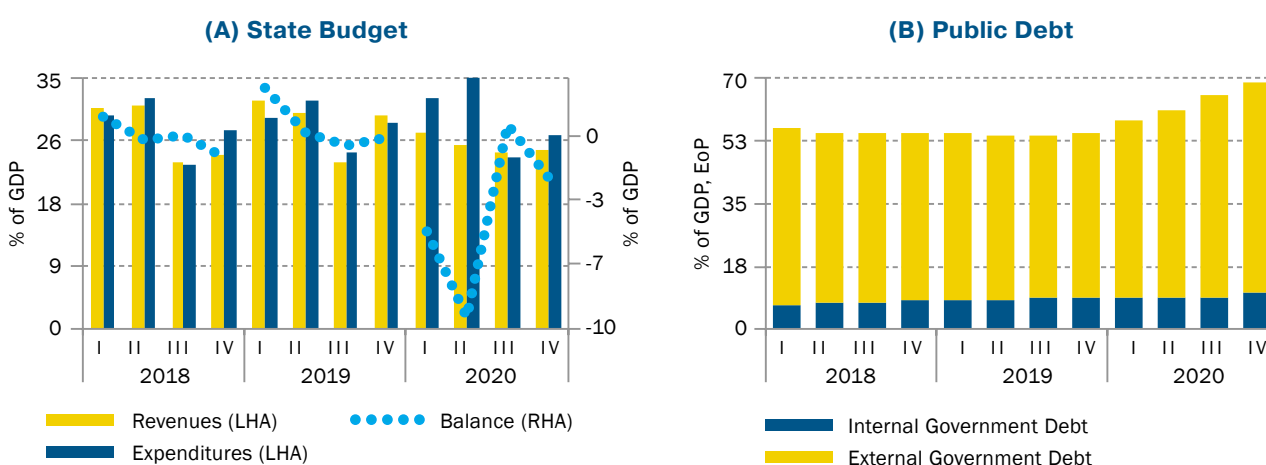
In 2020, state budget revenues went down by 9.1% due to a decrease in tax revenues (negative contribution: 8.7 p.p.) and official transfers from foreign governments (–0.9 p.p.). Non-tax revenues and receipts from the sale of non-financial assets rose as a result of a series of one-off operations, such as payment of profits and dividends by certain entities.

Reallocation of state expenditures. In 2020, government spending to attain economic objectives in Agriculture, Fuel and Energy, Mining, Transport, and Communications was completely terminated to offset the tax revenue shortfall, and due to the need to finance measures designed to prevent the spread of the coronavirus. Budget appropriations for environmental protection, culture, leisure, and religion were cut, while appropriations for health care went up by 23.3%. Additional expenditures were incurred to finance salary raises for teachers and law enforcement officers.

In 2020, public debt increased by 16.5% of GDP to reach 68.1% of GDP by the beginning of 2021. The growth of the debt burden can be attributed to the increase of both external liabilities (by 15.0% of GDP) and liabilities under domestic government treasury bonds with maturities ranging from 2 years to 10 years (by 1.5% of GDP) (Figure 24.B). Most new foreign borrowings by the Government of the KR were soft loans received from international development institutions. The debt burden further increased as a result of nominal reduction of the GDP and devaluation of the national currency.

Moody’s Investor Service affirmed local and foreign currency issuer ratings of the KR at B2, and changed the outlook from “Stable” to “Negative.” Support provided by development partners reinforces the government’s credit portfolio. On the other hand, elevated political uncertainty limits the ability of the Government sector to finance economic needs to counter the negative impact of the pandemic, and may have a restraining effect on investment activity.

Figure 24. Fiscal Sector Indicators of the Kyrgyz Republic



Source: MF KR, NSC KR, EDB calculations

Monetary Sector

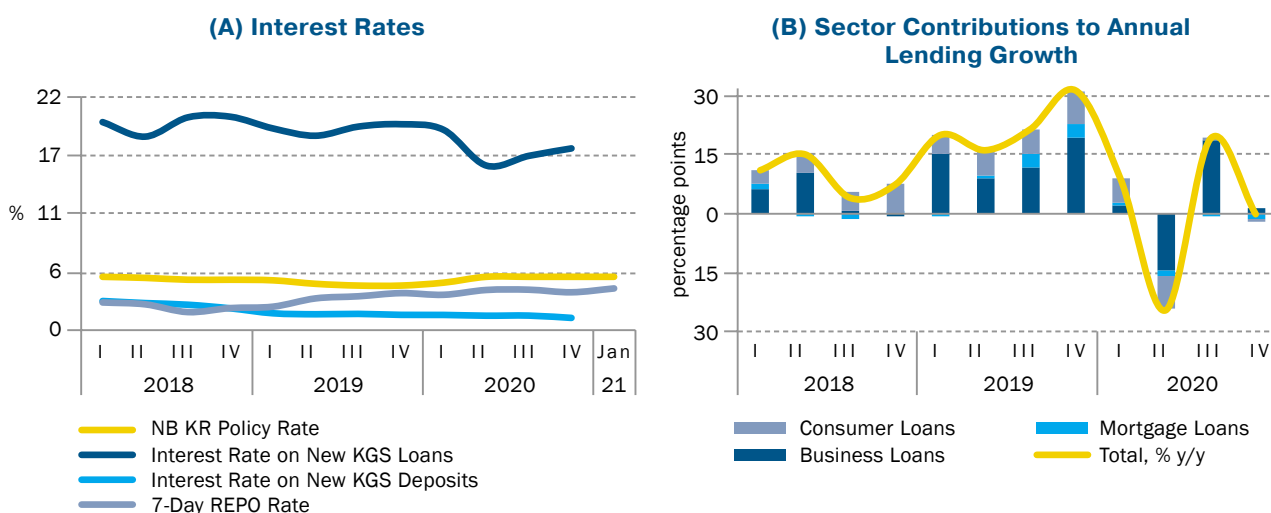
In February 2021, the National Bank of the KR increased the policy rate by 0.5 p.p. to 5.5%.

On the one hand, economic activity is still on the ebb, with the key economic sectors suffering from production slump. On the other, inflation risks are getting higher. In particular, domestic demand is tending to recover under conditions of a growing inflow of cash remittances by labour migrants, while the ongoing rise of global and regional food prices fuels inflationary expectations. By the middle of the year, the influence of inflationary factors will probably begin to weaken. The interbank lending market rate has remained below the policy rate, although the two rates continue to converge. In 2020, average KGS loan and deposit rates decreased vs. 2019 by 2.0 p.p. and 0.2 p.p., respectively (Figure 25.A).

Lending activity was supported by government-sponsored soft lending programs. New loans extended by commercial banks in 2020 decreased by 0.5%, mostly because of contraction of mortgage loans (by 10.2%) and consumer loans (by 3.2%) due to weak consumer demand. Corporate lending rapidly recovered in 3Q 2020, as the government launched a soft lending program to mitigate the impact of the pandemic on local businesses. However, in 4Q 2020 new business loans took a plunge (Figure 25.B). By the end of 2020, the share of non-performing loans in the total loan portfolio rose to 10.5% (2019: 8.0%), as the financial position of borrowers worsened.

In 2020, new deposits decreased by 3.0% due to a reduction of corporate FX deposits. As a result, by the end of 2020, the share of new bank deposits denominated in foreign currencies went down to 30.3% (2019: 41.8%). New deposits denominated in the national currency increased by 16.2%.

Figure 25. Monetary Sector Indicators of the Kyrgyz Republic



Note: Figure 25.B presents changes in total disbursement of KGS loans.

Source: NB KR, EDB calculations

Forecast

Table 6. Key Macroeconomic Indicators of the Kyrgyz Republic (Baseline Scenario)

Indicator	2019	2020	2021F	2022F	2023F
GDP in constant prices (year-on-year increase, %)	4.6	-8.6	3.9	5.5	3.7
Consumer Price Index (EoP year-on-year increase, %)	3.1	9.7	7.3	4.1	4.8
7-Day REPO Rate (p.a., annual average, %)	3.0	3.6	4.0	5.0	6.3
KGS/USD Exchange Rate (annual average)	69.8	77.3	84.9	85.2	85.7

Source: national statistical agencies, EDB calculations, EEC

Key Assumptions

In 2021, the spread of the COVID-19 pandemic will slow down. Under the baseline scenario, we expect that sanitary requirements will be gradually rolled back abroad, and the pandemic will remain under control in the country. That will facilitate recovery of global supply chains, and of foreign and domestic demand.

It is expected that the budget deficit will decline. According to the budget law, the deficit of the consolidated KR budget will be reduced over the next three years. It is planned that the deficit will be 1.4% of GDP in 2021, 0.9% of GDP in 2022, and 0.7% of GDP in 2023.

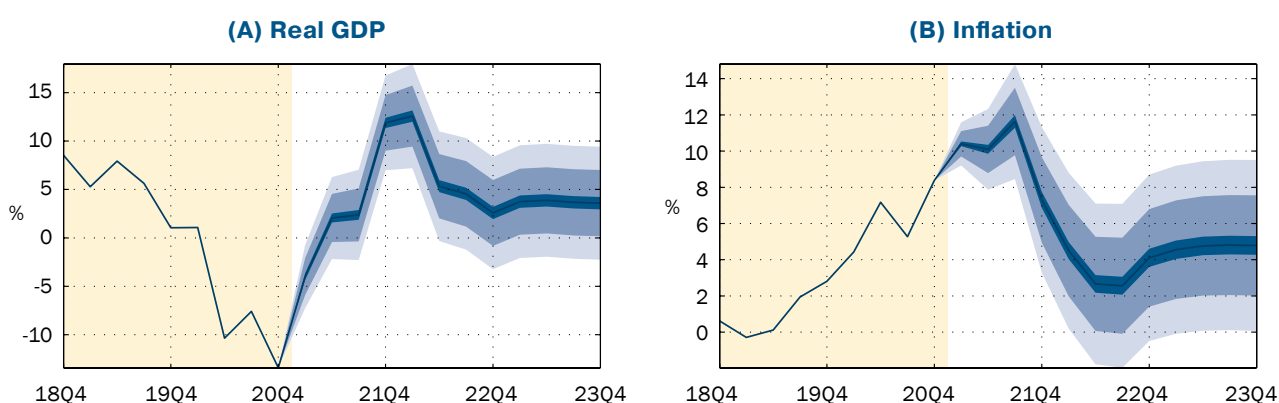
The period of operation of the Kumtor Gold Mine is to be extended. According to the technical report published by [Centerra Gold Inc. \(2021\)](#) in February 2021, the revised operating life of the mine is 11 years, and ore beneficiation operations have been extended to 2031. On that basis, we believe that potential growth rates will not decline in 2023–2026 as previously assumed.

Economic Activity

The EDB forecasts recovery of economic growth in 2021. According to our estimates, in 2021 Kyrgyzstan's GDP growth rate will amount to 3.9% ([Figure 26.A](#)), largely due to a significant rollback of sanitary restrictions compared to the previous year. In 2Q 2021, positive changes are expected in Trade and Services, including the operation of trade and entertainment centres, restaurants, and professional service providers. Recovery of activity in Transport and Tourism will probably be protracted and relatively slow-paced due to the preservation of certain restrictions on cross-border movement. Projected growth of incoming cash remittances will support domestic demand. Rollback of the quarantine in trading partner countries may have a positive effect on Kyrgyz deliveries abroad. Depressed investment demand will constrain economic recovery against the backdrop of high uncertainty and scheduled fiscal consolidation. According to Centerra Gold's plans, in 2021 gold production at the Kumtor mine will decrease by about 12.0% which, in our opinion, may reduce GDP growth by 1.0–1.3 p.p. Preservation of high gold prices in the global market may partially offset the production slump in the Gold Mining sector.

Over the medium term, the economic growth rate will be largely determined by Kumtor Mine output, which in 2022 and 2023 is expected to increase by 15.3% and 1.8%, respectively. As a result, Kyrgyzstan's mid-term GDP growth is likely to be volatile, accelerating by 5.5% in 2022 and increasing by 3.7% in 2023. Domestic consumer demand will be supported by a higher inflow of cash remittances. Export supplies will be constrained by the mid-term reduction of global gold prices and appreciation of the real effective exchange rate. These factors will partially offset the strengthening of external demand against the backdrop of normalization of global epidemiological situation and full-scale restoration of global transport chains. According to our estimates, during the period under review the economy will continue to operate below its full potential, although the negative gap will reduce by 1.9 p.p.

Figure 26. Economic Activity and Inflation Forecast for the Kyrgyz Republic



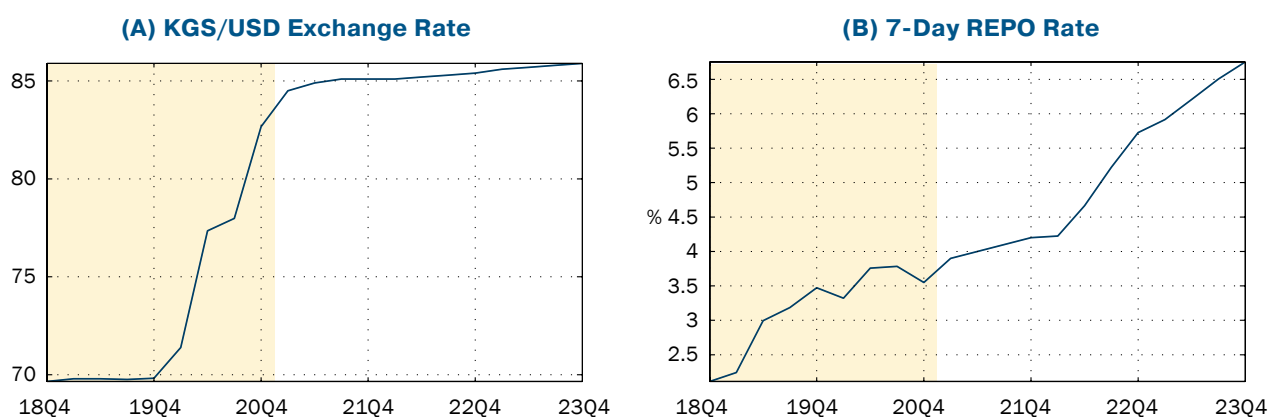
Note: data seasonally adjusted.

Source: EDB calculations, EEC

Inflation

It is expected that inflation will slow down to 7.3% by the end of 2021. Consumer prices will continue to rise at a rate of more than 10% until September 2021 (Figure 26.B). The weakening of the som and the rise of global and regional food prices that occurred in 2020 will continue to impact the annual inflation rate, keeping it at a rather high level. By the end of 2021, the influence of these factors will be fading away, along with the anticipated stabilization of both global food prices and the exchange rate of the national currency. The high cost of energy in the world markets relative to 2020 will continue to fuel inflation throughout 2021. As a result, by the end of 2021 the inflation rate is projected at 7.3%.

The EDB forecasts that in 2022–2023 inflation will be muted. With the nominal KGS/USD exchange rate projected to remain stable over the medium term, CPI growth is expected to decelerate. That factor will play the decisive role, but its influence will be partially offset by the gradual recovery of domestic demand and disposable income. The situation in the global food markets may have a neutral impact on domestic prices, and the pressure exerted by the oil market will also abate over the medium term. As a result, in 2022 and 2023, inflation will fail to reach the target, and will amount to 4.1% and 4.8%, respectively.

Figure 27. Projected KGS/USD Exchange Rate and IBL Rate in the Kyrgyz Republic

Source: EDB calculations, EEC

Monetary Policy and Kyrgyz Som Exchange Rate

According to the EDB baseline scenario, in 2021 the policy rate will remain at 5.5%. We believe that the accelerated inflation reported in late 2020 and early 2021 was largely the result of temporary factors. The pressure exerted by global food prices will begin to wear off in the second half of 2021, but the economy will continue to operate below its full potential and, therefore, will need to be stimulated. Taking into consideration the fact that the interbank lending rate is still lower than the refinancing rate, we believe they may converge by the end of 2022 (Figure 27.B).

We assume that the Kyrgyzstani som will remain stable over the medium term. Under the baseline scenario, we expect the existing FX policy to be continued over the medium term. In line with the floating exchange rate regime, monetary authorities will continue their currency interventions to prevent sharp fluctuations of the exchange rate. Therefore, we believe that during the period under review the exchange rate of the national currency will move within the range of KGS 84–86 per US\$ 1.00.

Risks

Uncertainty with respect to the epidemiological situation is the key risk assumed in the EDB baseline scenario. Emergence of new strains of the virus may slow down the opening of borders in KR's key trading partners, which will have a powerful impact on its export-oriented industries, and slow down the economic recovery process. If supply chain disruptions persist, that will increase manufacturers' costs and boost the probability of a further rise in global food prices as a result of the limited supply of agricultural products and elevated demand for them, fuelled, among other things, by a variety of food safety measures. These factors may exert upward pressure on domestic prices in the KR.

Capacity to increase public debt is limited. By the end of 2020, public debt exceeded the threshold value of 60% of GDP, making soft borrowings the only viable option. As taxable income is not growing, while the external debt service burden is getting heavier, cuts in public expenditures are becoming increasingly likely. That will constrain GDP growth over the medium term, slowing down economic recovery.

The EDB has analysed a risk scenario which is based on a number of key assumptions. One of these is that in 2020, the pandemic will have a more negative effect on Kyrgyzstan's potential GDP than envisaged by the baseline scenario. It is also expected that recovery of business activity in the countries that are the key trading partners of the KR will be slow, energy prices will go down, gold prices will go up, and pressure on the national currencies of emerging economies will become stronger.²⁹ In such conditions, business activity in the KR will be much less robust than under the baseline scenario. Consumer demand will decline, while demand for foreign currencies on the part of the general population will increase, in line with higher devaluation expectations.

Realization of the risk scenario will result in slower economic growth in the KR in 2021–2022 relative to the baseline scenario. Kyrgyzstan's GDP will increase by 2.8% in 2021, 2.9% in 2022, and 4.2% in 2023. Under the risk scenario, in 2021 the average annual KGS/USD exchange rate will be KGS 88.3 per USD 1.00, or 4% lower than envisaged by the baseline scenario. Because of the devaluation of the national currency, inflation will reach 10.0% by the end of 2021 and slow down to 4–4.7% in 2023 due to weak domestic demand. As inflationary pressure grows stronger and the national currency becomes weaker, it may become necessary to raise interest rates: the 7-day REPO rate is projected at an average of 6.5% in 2021 and 7.5% in 2022.

²⁹ A detailed description of the risk scenario for the global economy is presented in the section entitled *External Economic Conditions*.

RUSSIAN FEDERATION

Current Situation

Economic Activity

In 2020, the Russian GDP dropped by 3.1% due to the contraction of domestic and foreign demand (Figure 28.A). Social distancing measures and reduction of personal incomes by 3.5% resulted in a decrease of household consumer spending by 8.6%. Capital expenditures went down by 6.2% due to elevated uncertainty, declining corporate profits, and transport and logistical challenges. In volume terms, 2020 exports fell by 5.1%, largely due to a reduction of oil output under the OPEC+ agreement and contraction of external demand.³⁰ Economic activity support factors included loosening of the monetary policy and crisis response measures implemented by the government. Those measures, estimated at 4.5% of GDP, are deemed to have compensated more than 2% of total GDP losses.

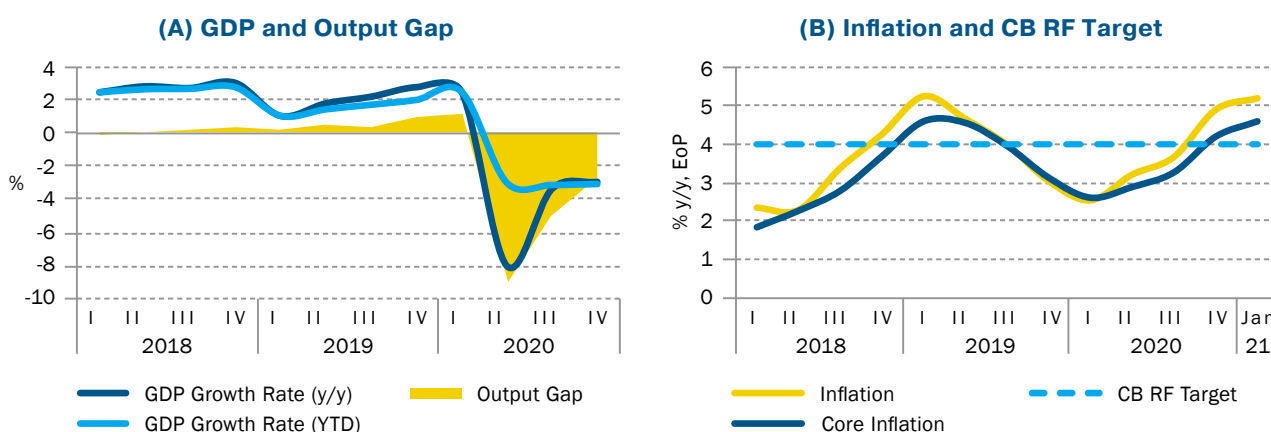
In terms of sectoral breakdown, the largest negative contributions to the 2020 GDP were made by Mineral Extraction and Transport: –0.9 p.p. and –0.7 p.p., respectively.³¹ Reduction of activity in those sectors is largely attributable to the decline of demand for energy, decrease of oil production under the OPEC+ agreement, and restrictions on domestic and international travel. The Services sector sustained heavy losses due to contracting consumer demand and stringent sanitary restrictions. In 2020, Trade, Hotels and Restaurants, and Leisure and Entertainment were responsible for 0.7 p.p. of the total GDP decrease. Processing was affected by the pandemic much less than Services, due, among other things, to the fact that restrictions imposed on the operation of industrial enterprises were relatively lenient. Processing GVA remained virtually the same as in 2019, with additional support from the increased output of medicines and chemical products. Financing and Insurance added 0.4 p.p. to that indicator due to a surge of demand for financial services.

In January–February 2021, the Russian GDP decreased by 2.5% y/y.³² At the beginning of the year, consumer demand continued to recover: in February, decline of personal consumption of paid services decelerated to 6% y/y (–8.7% in January 2021, and –11.1% in December 2020), while retail trade turnover approached pre-crisis levels (–0.7% y/y in January–February 2021 after –3.6% y/y in December 2020). In January–February 2021, industrial production decreased by 2.8% y/y after a rapid recovery at the end of 2020 (+2.1% y/y in December 2020). Industrial sector performance was influenced by the calendar factor: in January 2021, there were fewer workdays than the year before, while in February 2021 there were fewer calendar days. Figures adjusted for that factor show that industry remains on the recovery path, and Manufacturing output is close to pre-crisis levels. The evolution of PMI values in Manufacturing confirms that recovery is continuing: in January and February, PMI stood at 50.9 points and 51.5 points, respectively, remaining above the 50-point threshold. According to EDB estimates, recovery of economic activity resulted in a reduction of the negative output gap from 2.6% in 4Q 2020 to 1.5–2% in 1Q 2021.

³⁰ According to Rosstat data, in 2020 oil output in Russia amounted to 512 million tonnes (including gas condensate), which is 8.7% less than in 2019.

³¹ EDB estimates based on Rosstat data.

³² Estimate by the Ministry of Economic Development of the Russian Federation.

Figure 28. Economic Activity and Inflation in the Russian Federation

Source: Rosstat, CB RF, EDB calculations, EEC

Inflation

At the beginning of 2021, inflation increased to 5.2% y/y in January and 5.7% y/y in February (Figure 28.B). It continued to accelerate in the first half of March to reach 5.8% y/y as of March 15, 2021. The EDB estimates that by the end of March, the CPI will have increased by 5.7–6% y/y. Domestic consumer prices are strongly affected by the rise in global food prices. Thus, in February 2021, the World Bank's Food Price Index went up by 26.2% y/y to reach its highest value since 2013. Supply chain disruptions and COVID-19 response costs are raising producer costs. In February 2021, producer prices in the manufacturing industry increased by 12.1% y/y (food producer prices – by 14.2% y/y). The depreciation of the rouble in 2020 became an additional inflation driver at the beginning of 2021. According to our calculations, during the period from 2Q 2020 to 1Q 2021, the exchange rate factor has added about 1.6–1.7 p.p. to annual CPI growth.³³ The full realization of the exchange rate pass-through effect is expected in 2Q 2021.

External Sector

In 2020, the current account surplus of Russia's balance of payments decreased by USD 32.3 billion and amounted to USD 32.5 billion (2.2% of GDP).³⁴ Deterioration of that indicator can be attributed to the decline of the positive balance of trade in goods by USD 75.9 billion (Figure 29.A). The adverse effect that the deterioration of the balance of payments had on the current account was partially offset by the decrease of the deficit of foreign trade in services and the balance of revenues (by USD 18.4 billion and USD 25.2 billion, respectively) due to travel restrictions and declining profits of Russian enterprises.

The drop of oil and gas exports by USD 90 billion became the key driver of contraction of Russia's balance of trade surplus in 2020. The drop had been caused by the decrease of prices and foreign demand for hydrocarbons due to the pandemic, and oil production cuts under the OPEC+ agreement. In 2020, oil and gas exports remained at the same level as in 2019. There was a significant increase in food supplies amid persistently strong demand and rising global prices. Exports of precious metals and stones doubled, probably because the Bank of Russia had stopped buying gold in the domestic market,

³³ The exchange rate factor incorporates changes of consumer prices in key trading partners.

³⁴ Estimate of the Balance of Payments of the Russian Federation by the Bank of Russia.

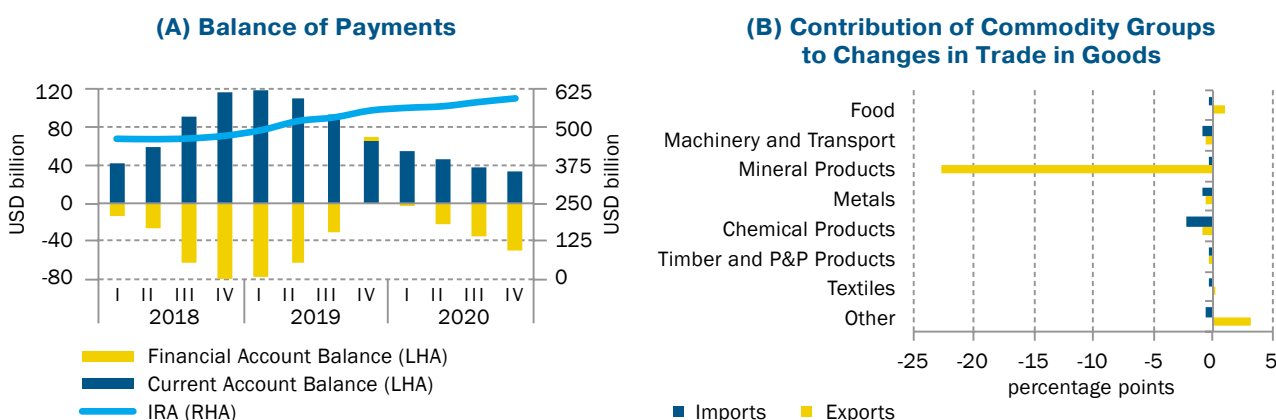
while global prices had gone up. Non-oil and gas exports were impaired by a drop in prices of fertilisers and most metals, and by the shrinking exports of investment goods due to heightened global uncertainty and border closures. According to the FCS RF, in 2020, imports of goods into Russia decreased by USD 14.2 billion (5.7%) due to the declining domestic demand and the weakening rouble. Reduction of imports into Russia was reported for all major commodity groups (Figure 29.B).

In 2020, EAEU member countries accounted for 9% of total Russian foreign trade in goods.³⁵

The share of Union states increased by 0.4 p.p. vs. 2019. In 2020, Russian exports to the EAEU dropped by 13.7%, while imports from the EAEU decreased by 7.5%. Reduction of exports of Russian goods to the EAEU market was reported for most major commodity groups. Russian exports to the EAEU were supported by the increase in the sales of food products, textiles, and pharmaceuticals, probably because of the COVID-19 pandemic.

In 2020, private sector capital outflow from Russia increased by USD 25.7 billion and amounted to USD 47.8 billion. That change is primarily attributable to the reduction of liabilities of the non-bank sector by USD 45.5 billion. Inward FDI and portfolio investments dropped by USD 27.5 billion and USD 9.9 billion, respectively, due to the pandemic-driven loss of “risk appetite” by investors, the looming threat of increasingly harsh anti-Russian sanctions, and shrinking profits of Russian companies.

Figure 29. Foreign Trade Indicators of the Russian Federation



Notes: (1) In Figure 29.A, the current account balance and the financial account balance are represented as moving four-quarter totals; (2) in Figure 29.A, the financial account balance excludes IRA changes; positive changes are net borrowings.

Source: FCS RF, EEC, CB RF, EDB calculations

During the first months of 2021, the RUB/USD exchange rate remained within the 72–76 range. The Russian currency was supported by the rise in oil prices and the optimism of global market players due to the commencement of vaccination campaigns and the apparent sustainability of global economic recovery. The looming threat of more stringent anti-Russian sanctions, conversely, hampers the strengthening of the rouble. According to EDB estimates, in 1Q 2021 the Russian currency remains undervalued against the U.S. dollar by approximately 7%.

As of March 1, 2021, reserve assets of the Russian Federation amounted to USD 586.3 billion.

The reserves had declined by USD 9.5 billion since the beginning of the year, mostly because of the drop

³⁵ EDB calculation based on FCS RF data.

in global gold prices. Resumption of foreign exchange purchases in the middle of January triggered, in line with the budget rule, by the rise in oil prices, had a positive impact on the reserves. They currently cover more than 20 months of imports of goods and services, significantly in excess of traditional adequacy criteria (such as the “three-month rule”).

Fiscal Sector

The federal budget deficit at the end of 2020 stood at 3.9% of GDP (2019: surplus of 1.8% of GDP). The negative balance emerged as revenues declined and expenditures rose (Figure 30.A). In 2020, the fiscal policy was stimulative and supportive of economic activity. According to our estimates, in 2020 the fiscal impulse amounted to about 3% of potential GDP.³⁶

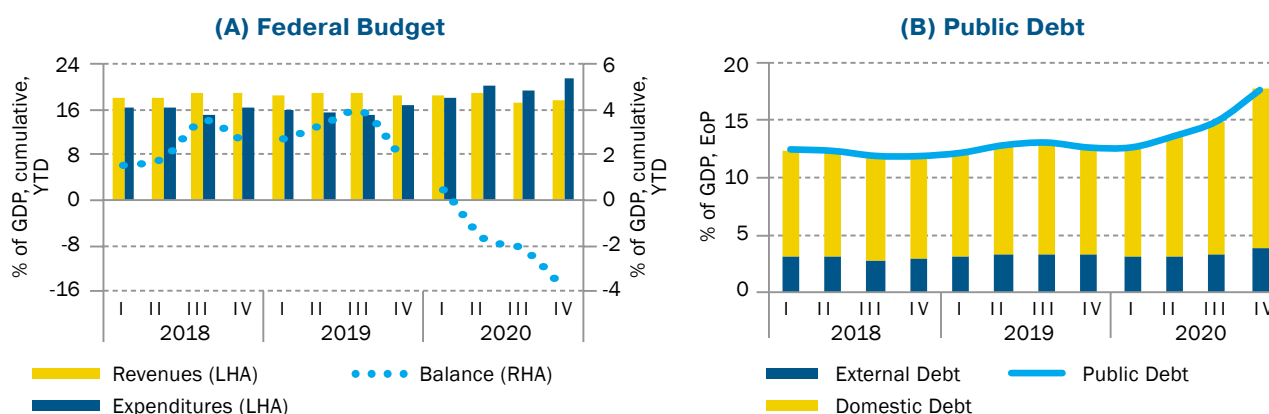
In 2020, federal budget revenues decreased by 0.95% of GDP due to a drop in oil and gas revenues by 2.3% of GDP caused by the collapse of mineral fuel prices and decline of mineral fuel production and exportation. In 2020, non-oil and gas revenues rose by 1.4% of GDP, mostly due to the transfer by the CB RF to the federal budget of proceeds from the sale of Sberbank (about 1% of GDP).

Federal budget expenditures increased by 4.7% of GDP, with a significant rise in spending on social policy (2.1% of GDP), health care (0.6% of GDP), and the national economy (0.7% of GDP). In most cases, spending was stepped up to support people and businesses during the pandemic.

By the end of 2020, public debt reached almost RUB 19 trillion (17.7% of GDP according to EDB calculations). The growth of the debt burden is explained primarily by an increase of domestic liabilities by 4.5% of GDP, leading to the emergence of a budget deficit (Figure 30.B). For example, the total amount of OFZs issued in 2020 was RUB 5.3 trillion, which is RUB 3.2 trillion more than in 2019. Most OFZs were purchased by Russian banks, with credit institution claims against the federal government under debt securities up by RUB 4.1 trillion in 2020. The share of non-residents in the OFZ market declined to 23.4% as of February 1, 2021, from the peak of 34.9% reported on March 1, 2020, amid growing risks and uncertainties around the world. In terms of the OFZ maturity profile, in 2020 the share of borrowings with maturities ranging from five to nine years increased to 65% of total OFZ liabilities, from 50% in 2019 (EDB calculations), while the share of long-term securities (with maturities of 10 years or more) went down from 35% to 24%. According to our calculations, average weighted yields of OFZs with fixed coupon rates decreased from 7.8% in 2019 to 5.7% in 2020, largely as a result of the key rate cut in 2020. The overall debt burden remains moderate, leaving room for additional fiscal support of the economy in the event of negative shocks.

In January–February 2021, the federal budget deficit was RUB 645 billion, a RUB 482 billion increase year-on-year, attributable primarily to the fact that expenditures, mostly related to social policy spending, remained consistently high (up by 14% y/y). Budget revenues decreased by 2.3% y/y, partially due to a decline in oil and gas revenues by 15.4% y/y, as the January 2021 Urals oil price had gone down by 11.8% year-on-year, while oil production had dropped by 9.4% year-on-year. If oil production gradually increases throughout the year, and oil prices remain higher than they were in 2020, oil and gas revenues may well rise in 2021. The notable increase of VAT revenues (up by 30.5% year-on-year in January–February 2021) may testify to a strong recovery of domestic demand.

³⁶ The fiscal impulse is measured as the change in the cyclically adjusted federal budget deficit (excluding Sberbank sale revenue and public debt service).

Figure 30. Fiscal Sector Indicators of the Russian Federation

Source: MinFin RF, Rosstat, EDB calculations

Monetary Sector

Monetary conditions in 1Q 2021 remained expansionary. In March 2021, the Bank of Russia increased the key rate by 0.25 p.p. to 4.50%, having completed the monetary policy easing cycle. This happened against the backdrop of accelerating inflation and swelling short-term inflationary risks. The key rate remains below the neutral range (5–6%), and supports the process of economic recovery. At the beginning of the year, short-term interbank rates had a small negative spread from the key rate, while bank liquidity remained excessive. Government bond yields have been rising since the beginning of the year: by March 19, 2021, yields on six-month bonds had increased by almost 0.6 p.p., while yields on five-year bonds had gone up by more than 1 p.p. The contributing factors included high expectations related to transition to the next key rate increase cycle, and rising yields reported by issuers of foreign bonds, including U.S. bonds.

Bank lending conditions were relaxed in the second half of 2020 after a significant tightening in the first half.³⁷ The move was encouraged by the persistently loose monetary policy and the initial recovery of business activity. According to EDB calculations, the average weighted interest rate on RUB loans to non-financial institutions went down to 6.46% in December 2020, and then to 6.3% in January 2021, from the local peak of 8.1% in April 2020 (Figure 31.A). Interest rates on RUB loans to individuals were at 10.1% in December 2020 and 10.7% in January 2021 (about 12% on the average in the first half of the year). The soft mortgage lending program also contributed to a reduction of loan interest rates in that segment.

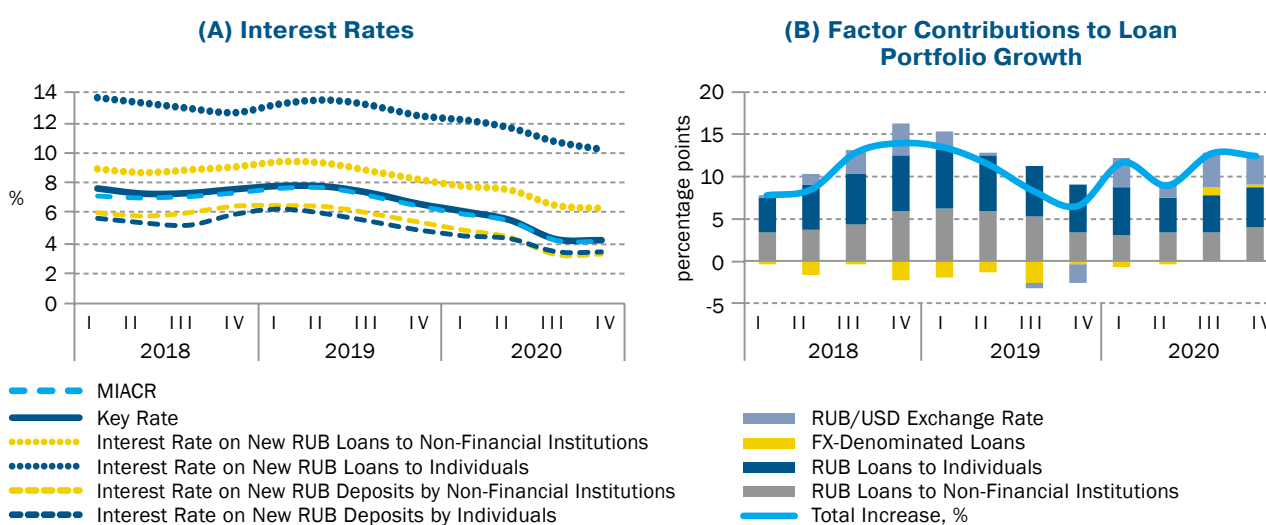
Demand for new loans recovered in the second half of 2020 after a decline in the first half. According to a survey of credit institutions, demand increased on the part of individuals and small and medium-sized enterprises, and stopped declining at large enterprises. The contributing factors included relaxation of lending conditions and recovery of business activity. In 2020, total lending to non-financial institutions and individuals increased by 9.2% (2019: 8.7%).³⁸ Loans to non-financial institutions went up by 6.9% (excluding FX revaluation), with rouble and foreign currency loans rising by 8.3% and 2.7%, respectively (Figure 31.B). The retail sector reported divergent trends. In 2020, the residential mortgage portfolio increased by almost 21% due, among other things, to the implementation of a soft

³⁷ According to quarterly credit institution surveys (*Changes in the Credit Policy of the Bank*) conducted by the Bank of Russia.

mortgage lending program.³⁹ The growth of consumer loans, conversely, decelerated from 20.9% in 2019 to 8.8% in 2020, as personal incomes declined, and banks faced increasingly higher lending risks.

FX penetration of bank deposits and loans in Russia remains moderate. As of February 1, 2021, 27.5% of all deposits and 27.9% of loans to non-financial institutions were denominated in foreign currencies. Their shares had increased by 3.3 p.p. and 3.1 p.p. year-on-year, respectively, due to devaluation of the Russian rouble. In 2020, fixed-term household deposits denominated in roubles and foreign currencies went down by 9.3% and 4.6%, respectively. The possible reasons include lower deposit interest rates and growing uncertainty.⁴⁰

Figure 31. Monetary Sector Indicators of the Russian Federation



Note: In Figure 31.B, loans to non-financial institutions include loans to individual entrepreneurs.

Source: CB RF, EDB calculations

Forecast

Table 7. Key Macroeconomic Indicators of the Russian Federation (Baseline Scenario)

Indicator	2019	2020	2021F	2022F	2023F
GDP in constant prices (year-on-year increase, %)	2.0	-3.1	3.3	2.5	2.5
Consumer Price Index (EoY year-on-year increase, %)	3.0	4.9	3.8	3.7	4.0
RUB MIACR (p.a., annual average, %)	7.2	4.9	4.6	5.0	5.2
RUB/USD Exchange Rate (annual average)	64.7	71.9	73.6	71.4	72.5

Source: national statistical agencies, EDB calculations

³⁸ January 1, 2021, vs. January 1, 2020, excluding revaluation of foreign exchange reserves. Non-financial institutions include individual entrepreneurs. EDB calculations.

³⁹ According to DOM.RF, total loans disbursed in 2020 under the soft mortgage lending program amounted to RUB 1 trillion.

⁴⁰ In December 2020, interest rates on personal RUB deposits with maturities of less than one year (excluding demand deposits) and more than one year were 3.42% and 4.17%, respectively. In December 2019, those interest rates were 4.74% and 5.56%, respectively.

Key Assumptions

Restrictions both in the country and abroad will be relaxed through the course of 2021. This will become possible as the pandemic spread slows down due to the recently initiated vaccination campaigns. External demand for Russian exports, supply chains, and consumer activity within the country will begin to recover. We expect social distancing measures to remain in place in 2021, but their scale will be decreasing as the pandemic abates.

Gradual recovery of potential economic growth in Russia. Implementation of government development programs designed, among other things, to spur investment activity will become the key determinant factor of that process. At the same time, recovery is likely to proceed gradually because of the significant decline of investment activity and probable deferred impact of that decline on potential economic growth.

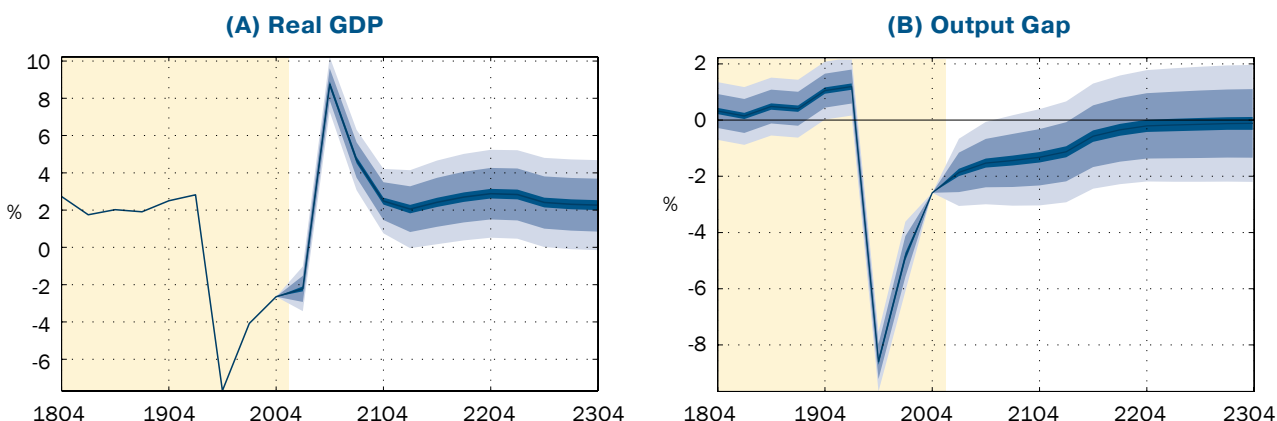
Phasing out of fiscal stimulus over the medium term. Fiscal policy will retain its stimulative nature, but the amount of anti-crisis support in 2021–2022 will be narrowing, which will constrain the speed of recovery of the Russian economy.

Economic Activity

Recovery growth of the Russian economy by 3.3% in 2021 (Figure 32.A). Compared to the previous forecast (EDB, 2020), the GDP growth estimate for 2021 has been upped by 0.1 p.p., because the negative impact of the second wave of the coronavirus pandemic on the economy in late 2020 and early 2021 has proven to be less significant than expected. In 1Q 2021, economic activity continued to recover. According to our estimates, the Russian GDP (seasonally adjusted) will increase by approximately 1% relative to 4Q 2020, reducing the negative output gap (Figure 32.B). Economic recovery continues in the context of rising oil prices (which have increased by more than 20% since the beginning of the year), and increasingly robust consumer demand remains a key contributing factor. We expect that expansion of consumer activity, as sanitary restrictions are being lifted, will be a driver of economic growth throughout 2021. Stimulative monetary policy and optimistic economic sentiment will also facilitate the gradual recovery of investment activity. Expanding foreign demand, rising oil prices, and the undervalued rouble will support Russian exports. Conversely, economic recovery will be hampered by investment inertia driven by revision of pre-pandemic business plans, heightened uncertainty, partial retention of social distancing restrictions, and reduction of fiscal stimulus. The Russian GDP will return to its pre-crisis level in late 2021 or early 2022.

It is projected that in 2022–2023, the Russian economy will be growing at an average of 2.5% per year. Under the baseline scenario, we expect that the active phase of economic recovery will be completed in 2021 or the first half of 2022. By the middle of 2022, the negative output gap will significantly contract and approach the zero mark (Figure 32.B). As a result, GDP growth will slow down over the medium term, following the 2021 peak. We expect that, as the recovery period draws to a close, the economic growth rate will stabilise at about 2.5% per year thanks to successful implementation of government development programs.

Figure 32. Economic Activity Forecast for the Russian Federation



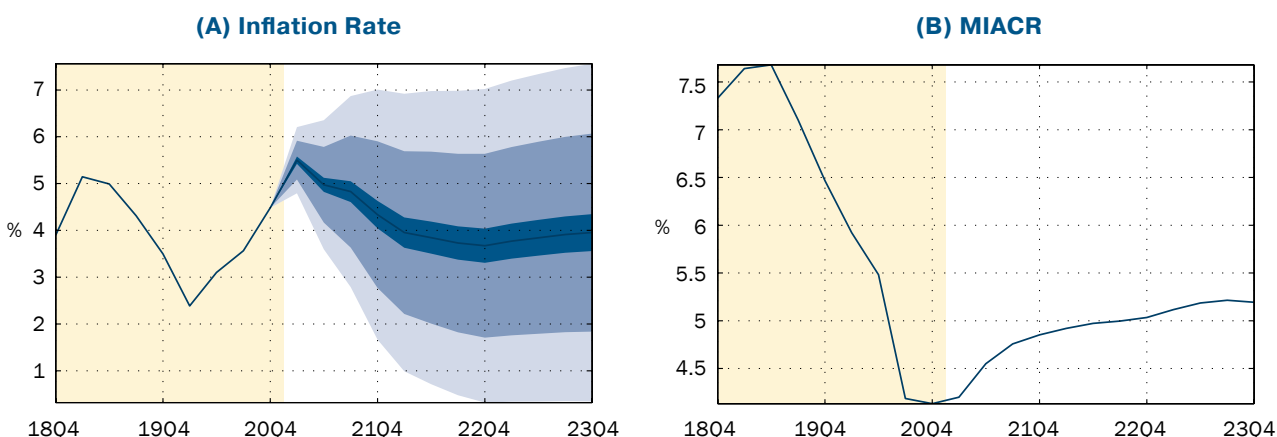
Note: data seasonally adjusted.
Source: EDB calculations

Inflation

In the second half of 2021, inflation will slow down to 3.8%. At the beginning of 2021, inflation remained high. In February 2021, it amounted to 5.7% y/y, reaching 5.8% y/y by the middle of March 2021, mostly due to rising food prices and pandemic-related delivery problems. Under the baseline EDB scenario, the annual growth rate of consumer prices will begin to steadily decline from 2Q 2021. That process will be facilitated by the strengthening of the Russian rouble, gradual restoration of supply chains, and deceleration of the rise in food prices. As a result, we expect inflation to go down to 3.8% by the end of the year (Figure 33.A).

Inflation in 2022–2023 is projected at about 4%. As economic activity recovers, its disinflationary impact will be waning. At the same time, we expect that changes in Russian rouble exchange rates will continue to exert downward pressure on inflation throughout 2022. As a result, the Consumer Price Index growth rate will remain somewhat lower than the Bank of Russia target, at 3.7%. Inflation is projected to return to the 4% mark in 2023, as the Russian economy reaches an equilibrium state.

Figure 33. Projected Inflation Rate and MIACR in the Russian Federation



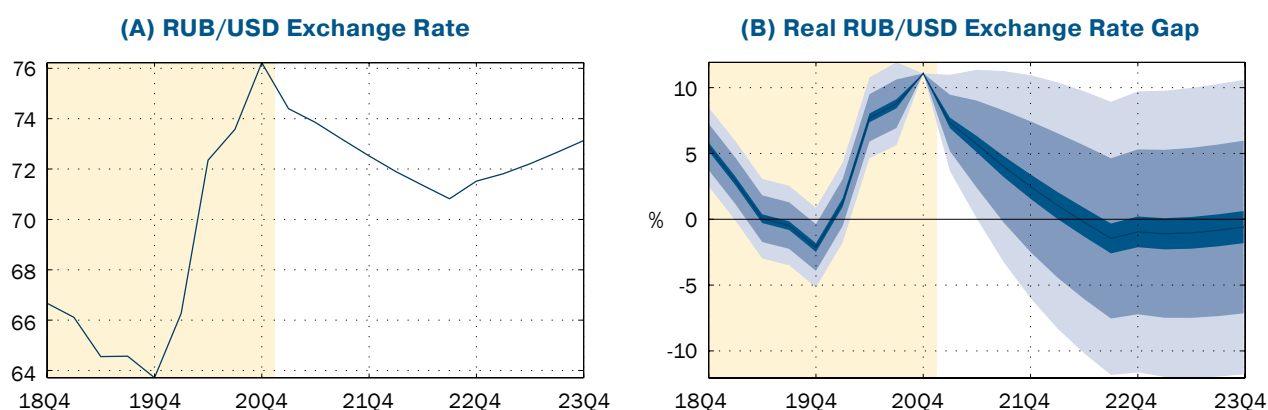
Note: Inflation data are seasonally adjusted.
Source: EDB calculations

Monetary Policy and Russian Rouble Exchange Rate

A gradual increase of the key rate in 2021–2022 with general preservation of a stimulative monetary environment. With inflationary risks getting stronger and Russian and foreign bond yields on the rise, we believe it is highly likely that the key rate will be raised by 0.25% to 4.75% in 2Q 2021. As the economy recovers and its disinflationary impact weakens, the extent of required monetary support will decrease. Accordingly, we anticipate that the key rate will be raised to 5.0–5.25% by the end of 2021. Transition to a neutral monetary policy is projected to be completed by late 2022 or early 2023. In 2021–2023, MIACR is projected to closely follow the key rate (Figure 33.B).

The average RUB/USD exchange rate in 2021 is projected at RUB 73.6 per USD 1.00. We expect that by the end of the year, the national currency will appreciate to RUB 72–73 per USD 1.00 (Figure 34.A). As a result, its undervaluation will significantly decline, and rouble correction to an equilibrium level is projected to be completed in the middle of 2022 (Figure 34.B). The strengthening of the rouble will be supported by the growing “risk appetite” among investors as the spread of the pandemic slows down, and by the rise in mineral fuel prices. Conversely, appreciation of the rouble may be hindered by persistent geopolitical risks. In 2023, the EDB projects a weakening of the rouble against the U.S. dollar by 1.5%. That will be consistent with an equilibrium path for the Russian rouble exchange rate. The weakening of the Russian rouble is linked to the fact that inflation in Russia is higher than in its key trading partners.

Figure 34. Projected RUB/USD Exchange Rate



Note: In Figure 34.B, positive values correspond to undervaluation of the Russian rouble.

Source: EDB calculations

Risks

If the pandemic continues for an extended period of time, this will impair economic growth in Russia. The EDB risk scenario is based on a number of key assumptions. One is that in 2020 the pandemic had a more negative effect on potential Russian GDP than envisaged by the baseline scenario. The scenario assumes that the coronavirus pandemic will drag out, and global GDP growth over the medium term will be slower than envisaged by the baseline scenario, with lower commodity prices

and stronger pressure on exchange rates of emerging economies' currencies.⁴¹ If the risk scenario is realised, the Russian GDP in 2021 will increase by 1.9%, which is 1.4 p.p. less than envisaged by the baseline scenario. The average RUB/USD exchange rate will stand at about RUB 78.8 per USD 1.00, or 7% down relative to the baseline scenario. Because of the devaluation of the national currency, inflation will reach 5% by the end of 2021, and MIACR average annual value will stand at 5.1%. Under the risk scenario, in 2022–2023 the Russian economy will be growing by approximately 1% per year due to the long-term negative effect of the pandemic on potential economic growth.

There is a risk that in 2021–2022, inflation will remain higher than the target level. Acceleration of inflation in 2020 was accompanied by higher inflationary expectations. Food products (staples that significantly shape consumer expectations) became considerably more expensive, leading to a risk of continued steady increase of inflationary expectations. In addition, recovery of domestic demand in 2021 may turn out to be inflationary, even if demand remains below pre-crisis levels. That is linked to production limitations: producers may not be able to promptly respond to rapid demand fluctuations. If monthly consumer price growth rates remain elevated, transition to a neutral monetary policy will occur faster than envisaged by the baseline scenario, and may be completed before the end of 2021.

If oil prices persist at levels close to their March 2021 peak, the Russian GDP may increase by 3.7% by the end of 2021. The EDB has considered a scenario where Urals oil prices in Q2–Q4 2021 remain close to USD 70 per barrel. The resultant average annual oil price will be almost 22% higher than envisaged by the baseline scenario. If that happens, the Russian economy may grow by 3.7% in 2021, which is 0.4 p.p. higher than envisaged by the baseline scenario. In that event, the Russian rouble will appreciate against the U.S. dollar to RUB 70–71 per USD 1.00 by the end of 2021.

⁴¹ A detailed description of the risk scenario for the global economy is presented in the section entitled *External Economic Conditions*.

REPUBLIC OF TAJIKISTAN

Current Situation

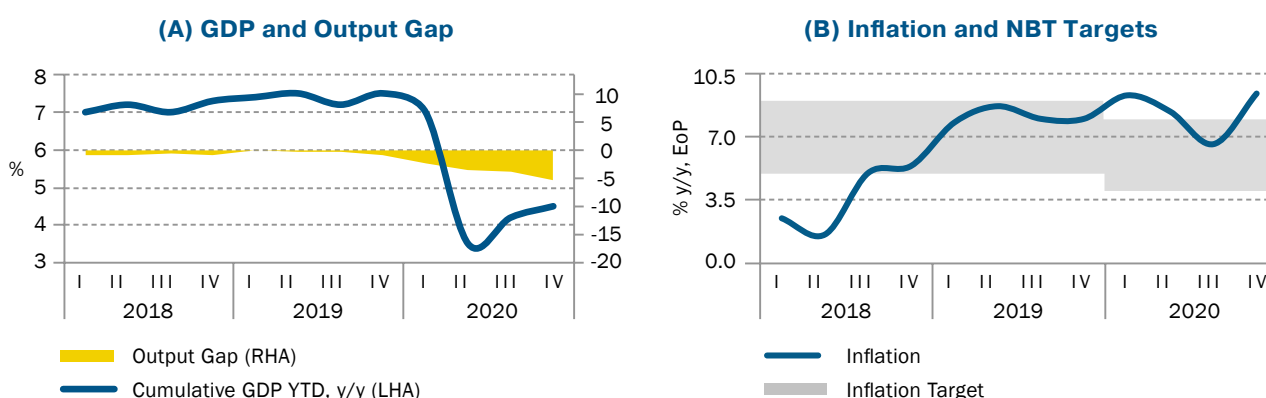
Economic Activity

Economic growth in Tajikistan slowed from 7.5% in 2019 to 4.5%⁴² in 2020 (Figure 35.A). With the spread of the coronavirus (both around the world and in Tajikistan), domestic demand contracted, as evidenced by the decline of trade turnover (retail and wholesale) by 6.8% (2019: up by 9.0%), of the volume of services provided to the general population by 9.9% (2019: up by 2.4%), and of fixed capital investments by 4.6% (2019: down by 6.4%).

In 2020, economic growth indicators remained positive owing to the industrial and agricultural sectors, with their combined contribution amounting to 4.4 p.p. (Statistical Agency under the President of the Republic of Tajikistan, 2021). In 2020, industrial and agricultural output increased by 9.7% and 8.8%, respectively. Positive changes in those two sectors were attributable to supply-side factors, specifically expansion of production capacity (in particular, in metallurgy) and a good harvest. The impact of those factors on economic growth was temporary.

Data for January 2021 indicate that domestic demand is recovering. In particular, trade turnover and capital investments increased by 10.0% y/y and 6.9% y/y, respectively. The recovery of consumer and investment activity is leading to high output growth rates (19.1% y/y) in various industries, including food processing and manufacturing of rubber, plastic, and other non-metal mineral products (construction materials constitute a dominant share of the latter's output).

Figure 35. Economic Activity and Inflation in the Republic of Tajikistan



Source: national statistical agency, EDB calculations

⁴² Increase of the "short-term indicator of development of key branches of the economy" published by the national statistical agency.

Inflation

In 2020, inflation accelerated, and by the end of December it reached 9.4% y/y (2019 EoY: 8.0% y/y). The CPI growth breached the upper boundary of the target interval set by the National Bank at the beginning of 2020 (Figure 35.B). One of the reasons for that was the rise in food prices (by an average of 13.1% relative to December 2019), to a large extent due to the global food price hike. The weakening of the national currency from TJS 9.7 per USD 1.00 to TJS 11.3 per USD 1.00 in 2020 also spurred accelerated growth of prices in the country. Inflation decreased in late 2020 and early 2021 as the impact of those two factors became less pronounced. By the end of January 2021, inflation went down to 9.5% from the peak of 9.8% reported in November 2020.

External Sector

By the end of 2020, the merchandise trade deficit went down to USD 1.7 billion from USD 2.2 billion in 2019, or from 26.2% to 21.9% of GDP. Exports increased to USD 1.4 billion (17.7% of GDP) from USD 1.2 billion (14.2% of GDP) the year before, due to the doubling of revenues from sales of precious metals and stones (particularly gold) to abroad (Figure 36.A). Imports decreased from USD 3.3 billion in 2019 to USD 3.2 billion in 2020 (from 40.4% to 39.6% of GDP) in the context of declining domestic demand and falling energy prices.⁴³ There was a decrease in foreign purchases of certain goods, such as mineral products (by 12.3%), vehicles (by 30.4%), and stone, gypsum, and cement (by 13.9%).

The share of EAEU member countries in foreign trade in goods with Tajikistan decreased from 46.1% in 2019 to 43.3% in 2020. That can be explained both by expansion of trade with non-EAEU countries (the destination of the expanding exports of gold is mostly Western Europe) and by contraction of trade with EAEU member countries (from USD 2.1 billion in 2019 to USD 2.0 billion in 2020). The key drivers of the latter were the reduction of prices for oil, gas, and refined products, and the decline of ore concentrate sales, especially to Kazakhstan, due to the shrinking demand on the part of the metallurgical industry. Intensification of foreign economic relations with Belarus had a positive impact on the trade between Tajikistan and the EAEU in 2020. Imports from Belarus almost doubled from USD 26.4 million to USD 55.4 million due to active promotion of products manufactured by Belarusian enterprises in the Tajikistan market, backed by the governments of both countries.⁴⁴

Data for the first three quarters of 2020 point to a significant improvement of the Tajikistan balance of payments (Figure 36.B). In January–September of 2020, the current account had a surplus of USD 415.8 million (7.1% of GDP) vs. a deficit of USD 169.5 million (2.9% of GDP) over the same period of 2019. The shift of the current account balance into the positive domain was the net result of the increase of exports and decrease of imports, as discussed above. The effect of that factor on the current account balance outweighed the negative impact of reduced inflow of wages and salaries, which went down from USD 1,220.9 million in January–September 2019 to USD 1,065.3 million in January–September 2020 (down by 12.7% year-on-year). A considerable decrease of wages and salaries coming

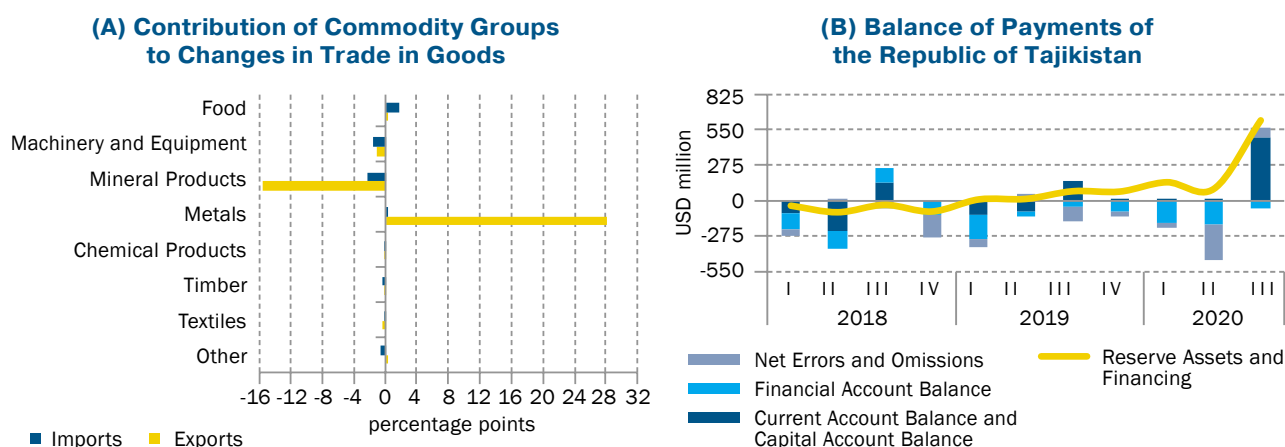
⁴³ Imports of the key item (mineral products) dropped by 12.3%.

⁴⁴ See: <https://www.belta.by/economics/view/eksport-belorussoj-selhozproduksii-v-tadzhikistan-v-janvare-aprele-vyros-na-628-396351-2020/>.

into the country in 2Q 2020 (by 55% y/y) was partially offset by the increase reported in 3Q 2020, when the economies of the countries from which Tajikistan's migrant workers make cash remittances began to recover after the slump caused by the COVID-19 pandemic.

In January–September 2020, the net inflow of foreign investment to Tajikistan increased, and the deficit of the financial account of the balance of payments expanded to USD 397.3 million from USD 273.7 million the year before. That occurred due to an increase in inward *Other Investments* (primarily in the form of trade finance), which exceeded the decrease in foreign direct investment (where net assumed liabilities in Q1–Q3 2019 stood at USD 187.4 million vs. USD 30.1 million in Q1–Q3 2020). The current account surplus and the increase of the net inflow of foreign investment in January–September 2020 resulted in a positive balance of operations with reserves of USD 874.0 million (January–September 2019: USD 103.6 million). That and rising gold prices boosted NBT reserve assets from USD 1.5 billion at the end of 2019 to USD 1.9 billion at the end of August 2020 (data for later months have not yet been published).

Figure 36. Foreign Trade Indicators and Balance of Payments of the Republic of Tajikistan



Source: national statistical agency, NBT, EDB calculations

Fiscal Sector

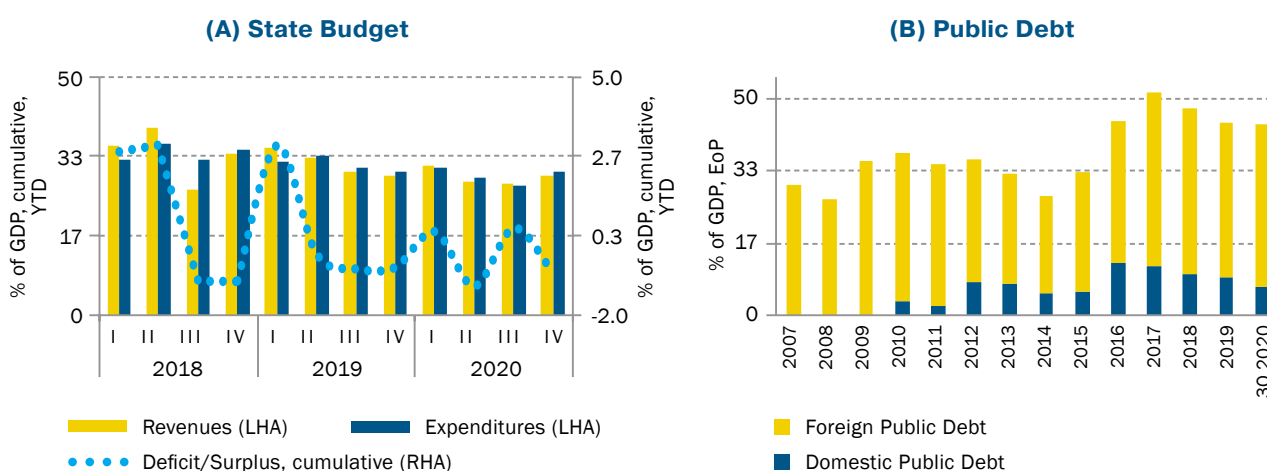
In 2020, the state budget of the Republic of Tajikistan was executed with a deficit of TJS 600.4 million (0.7% of GDP⁴⁵). That indicator had increased relative to 2019, when it stood at TJS 469.8 million, or 0.6% of GDP (Figure 37.A). Due to the need to fund coronavirus response programs, government spending increased to TJS 24.9 billion from TJS 23.7 billion in 2019. The increase of revenues in 2020 was more modest – they went up to TJS 24.3 billion from TJS 23.2 billion in 2019. Tax payments dropped from TJS 15.8 billion to TJS 15.4 billion, but that decrease was offset by an increase in other receipts, including grants provided by international donors.

The debt burden remains the same as at the end of 2019. At the end of 3Q 2020, liabilities of the General Government sector amounted to TJS 38.0 billion, or 44.2% of GDP (2019: TJS 34.9 billion, or

⁴⁵ EDB estimate.

44.4% of GDP). In January–September 2020, the share of domestic debt in total liabilities decreased from 8.8% of GDP to 6.5% of GDP. External liabilities of the government, conversely, increased from 35.6% of GDP to 37.7% of GDP from USD 2.9 billion to USD 3.1 billion (Figure 37.B). The chief source of funding raised by the government was international donor organizations, which expanded their financing programs⁴⁶ to support emerging economies in their fight against the COVID-19 pandemic. The soft terms of the loans extended by international financial institutions, as well as the decrease of liabilities to Tajikistan's debt holders, limit the growth of the debt service burden over the medium term.

Figure 37. Fiscal Sector Indicators of the Republic of Tajikistan



Note: Figure 37.B presents the gross debt of the Central Government of the Republic of Tajikistan.

Source: national statistical agency, World Bank, EDB calculations

Monetary Sector

The National Bank of Tajikistan cut the refinancing rate from 12.25% as of December 31, 2019, to 11% as of the beginning of March 2021 (Figure 38.A). In 2020, the monetary policy was eased, as demand in the economy remained depressed and inflation remained within the target interval ($6\pm 2\%$)⁴⁷ from July 2020 to September 2020 (Figure 35.B). With consumer prices rising faster in 4Q 2020 and at the beginning of 2021, the NBT refrained from cutting the rate further, and on February 8, 2021, increased it by 0.25 p.p. to bring inflation back to the target range.

The NBT policy encouraged overall reduction of interest rates in the economy. The average interest rate on TJS bank loans went down from 24.5% in 4Q 2019 to 21.2% in 4Q 2020, while the average interest rate on TJS deposits went down from 0.53% to 0.50%.

⁴⁶ Financing agreements were executed with the IMF (May 2020) and the EFSD (August 2020). Funding was also provided by the World Bank Group, the ADB, and other development institutions. The government estimates that support provided by the IFO amounts to as much as USD 300.8 million (see: <http://news.taj.su/?p=41210>).

⁴⁷ The target interval has been set at $6\pm 2\%$ since the beginning of 2020. It was shifted 1 p.p. down relative to the 2019 target interval ($7\pm 2\%$).

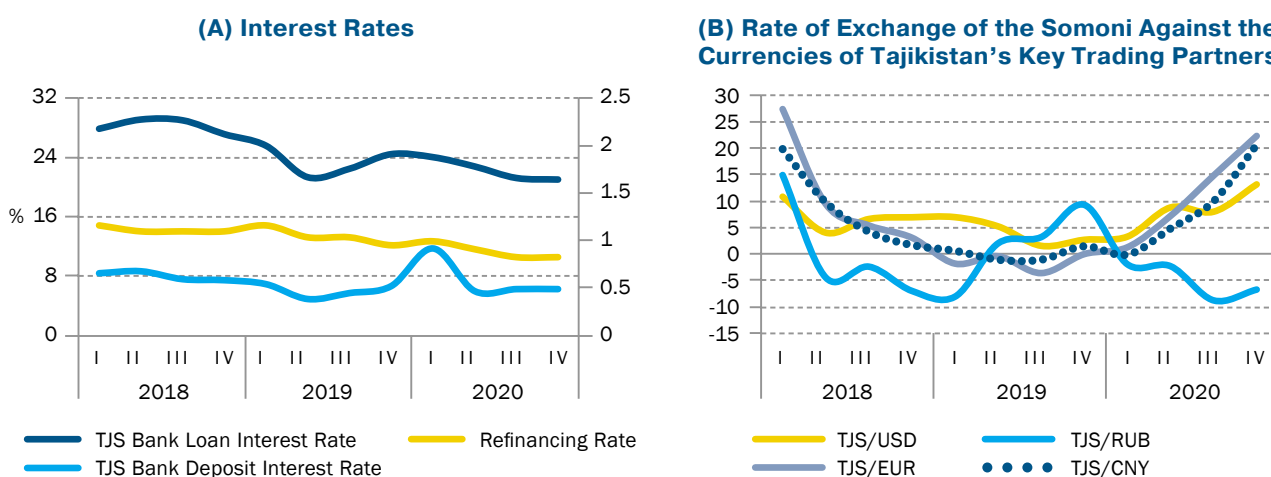
By the end of November 2020, loan portfolios of banks and micro-financing organizations increased by 12.0% y/y (the same as in 2019) due to the reduction of lending costs in response to the policy pursued by the NBT in order to offset the adverse impact of the pandemic on demand for lending, and to support economic growth, particularly in the second half of 2020.

Reduction of FX penetration of bank loan portfolios continued. The share of TJS loans in total bank loans increased from 51.3% at the end of 2019 to 58.1% at the end of 2020, facilitated by expansion of bank lending to the economy in the second half of 2020 following the NBT refinancing rate cut. The increase of the share of TJS deposits in total bank deposits was less impressive – from 51.4% in December 2019 to 52.0% in November 2020. Reduction of FX penetration of deposits was facilitated by the decline of inflow of foreign currencies in the form of cash remittances from abroad, while the weakening of the somoni, conversely, slowed that process.

In 2020, the somoni weakened against the U.S. dollar by 16.7% (Figure 38.B). Its devaluation against the euro and the yuan was even more significant (27.9% and 25.8%, respectively). Those changes in the FX market were the result of the negative impact of the pandemic on the inflow of financial resources in the form of cash remittances and foreign direct investment. The weakening of the Russian rouble and the Kazakh tenge (the currencies of Tajikistan’s leading trading partners) against the U.S. dollar was an additional driver.

In 2020, the real effective exchange rate of the somoni strengthened by an average of 3.3% vs. 2019. That was facilitated by the strengthening of Tajikistan’s currency against the Russian rouble, and by the fact that prices in Tajikistan rose at a faster pace than in most countries with which it maintains foreign economic relations.

Figure 38. Loan Interest Rates and Exchange Rates



Source: NBT, EDB calculations

Forecast

Table 8. Key Macroeconomic Metrics of the Republic of Tajikistan (Baseline Scenario)

Indicator	2019	2020	2021F	2022F	2023F
GDP in constant prices (year-on-year increase, %)	7.4	4.5	6.1	7.5	7.1
Consumer Price Index (EoY year-on-year increase, %)	8.0	9.4	6.6	5.1	5.8
Refinancing Rate (p.a., annual average, %)	13.8	11.5	11.0	10.6	10
TJS/USD Exchange Rate (annual average)	9.5	10.3	11.5	11.9	12.3

Source: national statistical agencies, EDB calculations

Key Assumptions

The spread of COVID-19 will slow down in 2021. Under the baseline scenario, we expect a gradual easing of sanitary requirements both in the country and abroad. That will facilitate recovery of economic activity in the countries from which Tajikistan receives retail cash remittances and investments. In addition, the absence of stringent epidemiological restrictions will have a direct positive impact on economic activity, particularly in the Services sector.

In 2021, price movements in the international commodity markets will be generally favourable for Tajikistan. The economic impact of the rise in (annual average) prices of non-ferrous metals and related ore concentrates will outweigh the effect of a decline in gold prices (revenues from gold sales in foreign markets influence domestic demand primarily through the budget channel, which mitigates the impact of short-term fluctuations of gold prices on GDP growth).

The fiscal policy will continue to have a stimulative effect on economic growth, as indicated by the parameters of the 2021 budget, which envisages support of government expenditures at 30.3% of GDP (2020: 30.2% of GDP), parallel to a limited deficit reduction from 0.7% of GDP to 0.5% of GDP.⁴⁸

The monetary policy will be supportive of economic growth. That will become possible due to the weakening of inflation processes against the backdrop of stabilization of prices in international food markets and higher somoni stability (to be supported by the strengthening of the Russian rouble and the Kazakh tenge against the U.S. dollar). Against this backdrop, the National Bank will be able to return to refinancing rate cuts without the risk of losing control over inflation.

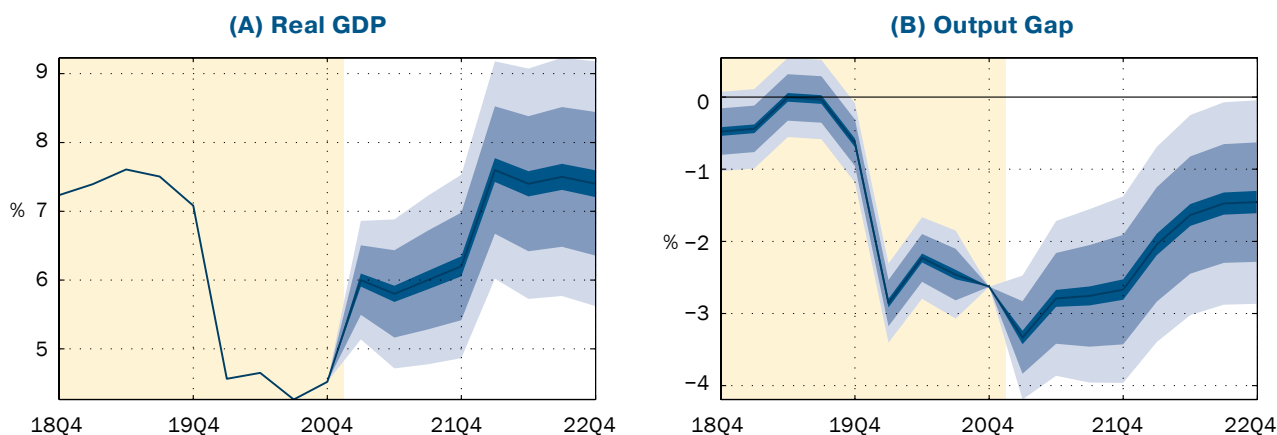
Economic Activity

According to EDB projections, in 2021 economic growth in Tajikistan will accelerate to 6.1% from 4.5% in 2020 (Figure 39.A). Economic activity will pick up against the background of rising inflow of retail cash remittances and foreign direct investment as the COVID-19 pandemic abates. Domestic demand will additionally be supported by stimulative fiscal and monetary policies. The rise of prices of non-ferrous metals and their ores will boost Tajikistan's exports.

⁴⁸ EDB estimate.

In 2022 and 2023, the GDP will increase by 7.5% and 7.1%, respectively. High economic growth rates are determined by structural factors such as strong demographics, low capital stock, and the positive impact of regional economic integration, primarily with Uzbekistan and the EAEU member countries.

Figure 39. Economic Activity Forecast for the Republic of Tajikistan



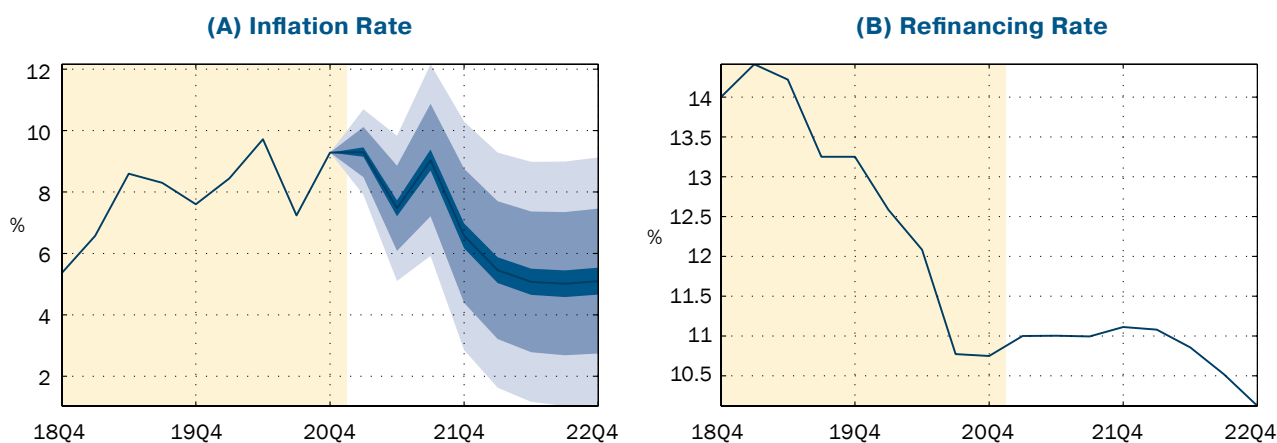
Source: EDB calculations

Inflation

By the end of 2021, inflation will stand at 6.6%. The growth of consumer prices will slow down relative to the 9.4% rate reported in 2020, in the context of persistently low domestic demand and the negative output gap (Figure 39.B). Stabilization of global food prices (see Table 8) and a rise of somoni stability will additionally weaken inflationary pressure on the national economy.

In 2022 and 2023, consumer prices will grow at the rate of 5.1% and 5.8%, respectively. Therefore, inflation will stay within the current target interval set by the NBT ($6\pm 2\%$). We do not expect those parameters to change in 2022–2023.

Figure 40. Projected Inflation Rate and Refinancing Rate



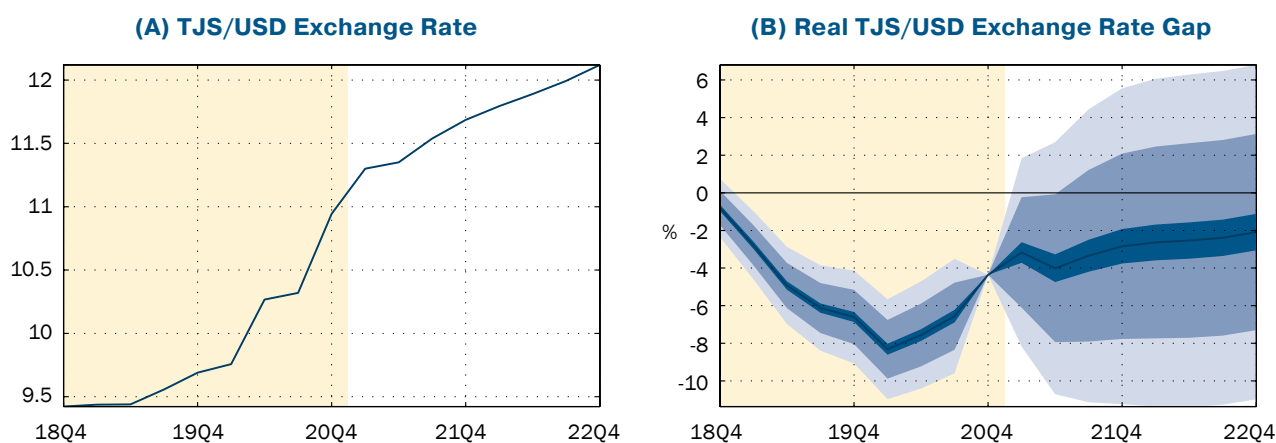
Source: EDB calculations

Monetary Policy and Tajik Somoni Exchange Rate

According to EDB baseline scenario, the refinancing rate is to be reduced in 2022 amid decelerating inflation and growing confidence in the stability of the national currency market (Figure 40.A). We expect that after a series of cuts, the refinancing rate will drop to about 10% p.a. (Figure 40.B).

The weakening of the national currency in November 2020 brought the TJS/USD exchange rate closer to the equilibrium rate. We expect that process to continue in 2021–2023, albeit at a slower pace than in 2020 (Figures 41.A, B). Its speed will depend on the difference between the rates of inflation in Tajikistan and its trading partners.

Figure 41. Projected TJS/USD Exchange Rate



Source: EDB calculations

Risks

The COVID-10 pandemic may last longer than envisaged by the EDB baseline scenario. If that risk is realised, global economic recovery will be slow. That may boost the probability of a drop in commodity prices and long-term preservation of restrictions on labour migration. As a result, under the risk scenario, the 2021 Tajikistan GDP will increase by 4.1%, which is 2 p.p. less than envisaged by the baseline scenario.

Inflation may persist above the upper boundary of the target interval set by the National Bank. That could be the result of high volatility of food prices in the country or strong fluctuation of the exchange rate of the national currency. It would impede economic support with monetary policy tools and, as a consequence, have a negative impact on GDP growth.

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GLOSSARY

Budget (fiscal) reserves

Available state budget funds that can be used to finance expenditures.

Budget (fiscal) impulse

Characterises the impact of fiscal policy on economic activity. If the budget impulse is positive, then the contribution of the fiscal policy to the GDP is positive.

FX penetration of bank deposits (loans)

Share of deposits (loans) denominated in foreign currencies in total deposit (loan) portfolios of commercial banks.

Neutral rate

The interest rate that corresponds to stable positioning of inflation and inflationary expectations at target levels, and of GDP and the real exchange rate at equilibrium levels.

Potential (equilibrium) GDP

The real GDP that would be produced by the economy during a certain period of time if production factors were used in the most efficient fashion. Potential GDP can also be defined as real GDP that can be sustainably produced by the economy without creating any economic imbalances.

Equilibrium currency rate

The real currency exchange rate that does not have either an inflationary or a disinflationary effect.

Output gap

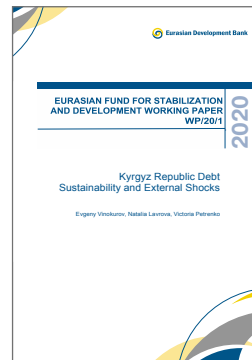
Deviation of the real GDP from its potential level. As a rule, a positive output gap points to the existence of surplus demand in the economy, and is an indicator of inflationary pressure. The reverse is true for the negative output gap.

Purchasing Managers' Index (PMI)

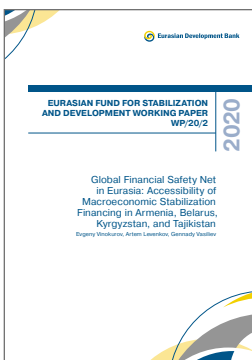
An indicator that characterises a change in business activity and operating conditions of private enterprises in the processing industry and the services sector. It is calculated on the basis of data collected during monthly surveys with the participation of purchasing managers. If the PMI is above 50 points, business activity is going up; if it is below 50 points, business activity is going down.



Macroeconomic Review (RU)
Macroeconomic Forecast (RU/EN)
Macroeconomic Review is a regular EDB publication, which provides a timely overview of the current macroeconomic conditions in the EDB member states and estimates their development in the short-term perspective.
Macroeconomic Forecast contains a detailed description of the economic development trends of the EDB member states. It also provides mid-term forecasts of the main macroeconomic indicators.



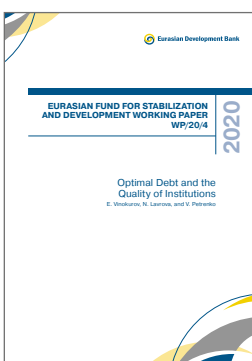
Working Paper WP/20/1 (RU/EN)
Kyrgyz Republic Debt Sustainability and External Shocks
 The document examines the resilience of the Kyrgyz debt under three stress-scenarios: (1) a global recession, (2) a financial crisis, and (3) the combination of a global recession and a financial crisis.



Working Paper WP/20/2 (RU/EN)
Global Financial Safety Net in Eurasia: Accessibility of Macroeconomic Stabilization Financing in Armenia, Belarus, Kyrgyzstan, and Tajikistan
 The document estimates the availability of stabilization financing for Armenia, Belarus, the Kyrgyz Republic, and Tajikistan based on three approaches.



Working Paper WP/20/3 (RU/EN)
Tajikistan and the Kyrgyz Republic Post-COVID-19: Debt Sustainability, Financing Needs, and Resilience to Shocks
 The COVID-19 outbreak has revealed the sensitivity of economies and their debt positions to a wide range of disruptions.



Working Paper WP/20/4 (RU/EN)
Optimal Debt and the Quality of Institutions
 Amid the COVID-19 pandemic policymakers now face the dilemma of whether to stimulate infrastructure development by raising debt, which may reduce future flexibility, or to strengthen their fiscal positions.



Report (RU)
Economic Effects of Tajikistan's Accession to the Eurasian Economic Union
 The report examines the main advantages of Tajikistan's possible accession to the EAEU.



Macroeconomic Forecasts for 2021 (RU/EN)
 The countries in the Bank's region of operations have been hit by widescale social and economic shocks this year due to the COVID-19 pandemic. The Bank forecasts its member states' aggregated GDP to contract by 3.8% in 2020 after a 1.7% increase in the previous year.



Report 21/1 (RU)
Promoting the Role of the EAEU Currencies in Global Transactions
 EAEU currencies service around 2% of global trade. As for the EAEU countries, payments in their currencies have notably increased over the past seven years – their share in trade flows jumped from 63% in 2013 to 74% in 2019.

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