Macroeconomics of the region

Macroeconomics of countries:

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Trends in 2014:

- **The world economy**: uneven growth, an increased degree of the conflict of major central banks’ policies
- **The United States**: a likelihood of tighter monetary policy in 2015
- **Europe**: slow and unsteady economic growth in the Eurozone, probable monetary policy loosening
- **Asia**: a further slowdown in GDP growth in China, strong fluctuations in the rate of economic growth in Japan amid an increase in the sales tax rate

**The CIS**:
1) Low GDP growth rates amid the Ukraine crisis and the fall in oil prices
2) The danger of a deterioration of the state of the balances of payments
3) A dramatic downturn in the economy of Ukraine

Outlook and risks:

- **The world economy**: transition to more even and steady growth
- **Commodity markets**: a gradual recovery of oil prices
- **The CIS**: A negative impact of external political instability and a fall in oil prices on GDP growth rates

The present analytical report was prepared by the Research Department of the Eurasian Development Bank (EDB). The information and conclusions contained in this report are not a recommendation and are based on public data.

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Macroeconomics of the region

The slowdown in the region’s GDP growth almost stops in Q3 2014

The CIS countries’ aggregate GDP grew by 0.73% year-on-year in Q3 2014, according to our estimate. The region’s GDP growth rate almost ceased to fall: it was 0.75% in Q1 and 1.05% in Q2 2014. In Q1/Q2 2014, a decline in the growth rate was experienced by all major groups of the CIS countries, including: the oil and gas exporters, the labor exporters, and the countries with a diversified structure of exports. However there were uneven economic dynamics in Q3 2014. Aggregate GDP growth almost did not slow down for the oil and gas exporting countries and accelerated for the labor exporting countries. At the same time the group of countries with a diversified structure of exports experienced a significant deterioration in its GDP growth amid a major downturn in economic activity in Ukraine.

The external economic environment for the CIS countries considerably deteriorated in Q3 2014. The strengthening of Western sanctions further restricted access to international capital markets for Russian companies and banks. There was also a dramatic fall in world prices of energy resources, which are the main export commodity of the CIS countries (see Figure 1.2). In addition, the expected fall in contract prices for natural gas, which tend to follow oil prices with a lag, affected the general physical volume of gas exports from Russia. Metal prices remained relatively stable amid a general fall in commodity markets, thus supporting the CIS economies where the metallurgical industry plays a significant role. The fall of the prices of agricultural produce, on the contrary, accelerated; they had slowed down in Q1/Q2 2014 (also see Figure 1.2).

The external shock had a limited impact in Q3 2014 on the rate of economic growth in the CIS country group of oil and gas exporters (Azerbaijan, Kazakhstan, Russia and Turkmenistan). Their aggregate GDP grew by 1.1% year-on-year, the same as in Q2 2014. There was a limited slowdown (from 0.8 % to 0.7%) in GDP growth in Russia. A slowdown in the growth of Russian household consumption was partially offset by a lower fall in fixed capital investment, and a decrease in the volume of imports. Kazakhstan’s GDP growth accelerated due to a rise in investment and an increased contribution of net exports, the effect of which outweighed the impact of the poor dynamics of household consumption. Azerbaijan’s GDP growth accelerated slightly due to a slowdown in the fall in oil production.

Figure 1.1. World industrial production and trade

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Source: CPB World Trade Monitor, World Bank

Figure 1.2. Terms of trade: international commodities’ and food prices

Source: World Bank
The annual GDP growth rates of the CIS labor exporting countries rises from 3.7% to 5% in Q3 2014

The aggregate GDP of the countries with a diversified structure of exports decreases by 3.1% compared with Q3 2013

The year-on-year improvement seen in Q1-Q2 2014 in the state of the CIS countries’ public finances continues in Q3 2014

The region’s current account balance improves in Q1-Q3 2014 due to an improvement in the current account balances of Russia, Belarus and Ukraine

The GDP growth of the labor exporting countries (Armenia, Kyrgyzstan, Moldova and Tajikistan) accelerated in Q3 2014 from 3.7% to 5%. This was despite the fact that the economies of these countries experienced a negative impact again in connection with a decrease in the volume of cash remittances sent from Russia to the CIS countries. This decrease was 5.5% in Q3 2014 and is primarily attributable to the weakening of the ruble, which resulted in a fall in the volume of remittances in terms of currencies that are more rigidly pegged to the dollar than the Russian currency. As with the oil and gas exporters, the vectors of the economic dynamics differed within the group. Tajikistan significantly improved its GDP growth figure amid acceleration in the growth in government-funded investment; and so did Armenia amid acceleration in the output rise in the industrial and agricultural sectors. GDP growth slowed in Kyrgyzstan primarily due to a fall in the growth rates in construction and gold production in the country, following high growth rates in Q1/Q2 2014.

The aggregate GDP of the countries with a diversified structure of exports decreased by 3.1% compared with Q3 2013 following a 2.8% year-on-year decrease in Q2 2014. The further fall in the GDP of this country group is fully attributable to a deep drop in Ukraine’s GDP amid the armed conflict in the country. In Belarus there was acceleration in GDP growth primarily due to a rise in net exports, which offset a slowdown in the rise in household consumption and a fall in investment.

The year-on-year improvement that was seen in Q1-Q2 2014 in the state of the CIS countries’ public finances continued in Q3 2014. The average surplus of the consolidated budgets of the CIS countries in Q1-Q3 2014 amounted to 2.6% of GDP compared with 2.2% in 2013. Nonetheless, this figure for Q3 2014 proved to be worse than that for Q3 2013 (2.2% against 2.3%). Russia and Azerbaijan continued to improve their consolidated budget surplus. However the impact of fiscal policy looseness in other CIS countries, including Kazakhstan and Belarus, turned out to be weightier in Q3 than earlier in 2014.

Balance of payments data for Q3 2014 have not yet been published in many CIS countries. However available data suggest that the region’s current account balance improved in both Q1-Q3 2014 and Q3 2014. This was due to: an improvement in the current account balance of Russia amid tighter budget policy compared with 2013; and the weakening of Belarusian and Ukrainian national currencies, as well as an improvement in their current account balances. The consolidation of domestic demand in Belarus and Ukraine – primarily investment demand – was part of a general recovery of balance of payments sustainability, which was disturbed in 2012 and 2013. Data for Kazakhstan’s foreign trade indicate that there was a gradual decline in the positive effect on the state of the balance of payments from a significant one-time currency devaluation carried out at the beginning of 2014.
Inflation continued to accelerate in the region. The average annual growth in the consumer price index for the CIS countries was 8.3% in Q3, up from 7.8% in Q2 2014. There was a rise in the inflation rate in two of the three major groups of CIS member countries. Inflation accelerated from 7.4% to 7.5% on average for the oil and gas exporters amid the ruble’s depreciation in Russia; and in Kazakhstan a combination of a loose budget policy and the postponed effect of the February currency devaluation. A more significant acceleration in inflation (from 12.4% to 16.3%) took place in the countries with a diversified structure of exports amid loose control over the rise in prices on the part of the central banks of Belarus and Ukraine. In the labor exporting countries, inflation slowed from 5.3% to 4.5%. This was due to: a slowdown in the growth of money supply, which was apparently attributable to the central banks’ efforts to smooth out fluctuations in the exchange rates of the national currencies amid the depreciation of the ruble; and also to a fall in the prices of energy resources and agricultural produce under the influence of external factors.

A dramatic change in the external economic environment became a key factor in 2014; and it will continue to have an impact on the economic situation in the CIS region in 2015. The change was caused by: a substantial strengthening of the US dollar against other currencies amid diverging monetary policies of major central banks; and a fall in the prices of primary commodities. An especially sharp fall occurred in energy prices after the Organization of the Petroleum Exporting Countries (OPEC) decided in November not to reduce oil production quotas. An immediate and major result of the external shock for the region’s economy was a dramatic weakening of the Russian ruble, including against local currencies. The ruble’s depreciation was considerably aggravated by the impact of the West’s sanctions, which restricted access to international capital markets for Russian companies and banks. The effects of the shock on real activity in the Russian economy and the stability of its financial sector remain limited at the moment. The floating exchange rate regime, which had mostly been maintained in the country for two or three years before the 2014 developments, ensures a quick adaptation of the Russian economy to external changes. Irrespective of whether or not these effects will continue to be limited, the weakening of the ruble has already caused other CIS countries to start experiencing serious negative pressure on their balances of payments.

The weakening of the Russian ruble causes other CIS countries to start experiencing serious negative pressure on their balances of payments.
A deterioration in access to international capital markets and trade restrictions will remain another factor that negatively affects economic growth in the region.

Growing external imbalances within the region will constitute a source of risks in 2015 and 2016.

The deterioration in access to international capital markets for Russian companies and banks, and trade restrictions caused by the West’s sanctions against Russia will remain another factor that negatively affects economic growth in the region. Despite attempts to resolve the conflict in Ukraine, there is currently no certainty with regard to the prospects for an easing of the sanctions. The impact of this factor will continue to impede a recovery in investment spending in the Russian economy, and aggravate the negative effect of the fall in energy prices on its financial stability. These factors negatively affect the economies of other CIS member countries through trade and financial channels and the channel of cash remittances.

Our forecast regarding GDP growth in the CIS countries is based on the assumption that the Western sanctions against Russia will not be lifted until at least late 2015. This scenario assumes that there will be low GDP growth rates in the region in 2015 and a rise in the rates in 2016. Russia is the largest economy in the region, and it made the transition to a generally floating exchange rate regime before the drop in world oil prices in Q4 2014. This fact will probably make it possible for CIS countries to avoid downturns in economic activity similar in magnitude to those seen in 2008 and 2009. At the same time growing external imbalances within the region will constitute a source of risks in 2015 and 2016.

Figure 1.7. **Economic growth** (GDP growth): consensus forecasts by national and international institutions (in %)

Figure 1.8. **Savings and investment** (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)

Source: estimates and forecasts by national agencies, the EDB, the ADB, the World Bank, the EBRD, the IMF

Source: national agencies, estimates and forecasts by the IMF
Azerbaijan: slowdown in decline in oil sector, fall in growth rate in non-oil sector

Azerbaijan’s GDP growth accelerated to 2.5% year-on-year in Q1-Q3 2014 from 2.1% in Q1-Q2 2014. As occurred previously, there was an increase in output in the non-oil sector (6% rise), while the oil and gas sector showed a decline in output (2% fall).

The respective figures were +7% and -3.9% in Q1-Q2 2014, and +8.8% and -4.1% in Q1 2014. This means that the growth rate of the non-oil sector and that of the oil and gas sector drew closer throughout 2014.

In the non-oil sector, high growth rates were shown by retail trade and construction with year-on-year increases of 9.3% and 8.5%, respectively, in Q1-Q3 2014. Growth in the construction sector accelerated from 3.4% in Q1-Q2 2014 following a slowdown in Q2 2014. A negative growth rate was experienced by the agricultural sector whose output decreased by 3.7% compared with Q1-Q3 2013.

The state of public finances remained noticeably better than in Q1-Q3 2013. The aggregate surplus of the state budget and the State Oil Fund amounted to 10.1% of GDP compared with 7.1% of GDP in Q1-Q3 2013. The improvement was due to: a reduction in public spending in terms of percentage of GDP; and an increase in the State Oil Fund’s revenues, which were not yet affected by the fall in world oil prices that became appreciable in September. The State Oil Fund’s assets totaled $37.4 billion (53.8% of GDP), slightly decreasing in nominal terms and increasing in terms of percentage of GDP.

Data for the Azerbaijani economy’s balance of payments indicate a decrease in the country’s trade surplus in Q3 2014 compared with Q3 2013. This is despite high oil prices in June and August, and amid declining oil production and a rise in domestic consumer and investment demand.

Inflation accelerated slightly in the country in Q3 2014 under the influence of a stronger year-on-year rise in food prices resulting from a poor crop. As a result, annual growth in the consumer price index increased to the year’s highest level of 2.3% in September. The inflation rate then resumed falling under the influence of: a slowdown in the growth in monetary aggregates in Q3 2014 amid negative dynamics of oil prices; and the de facto fixed exchange rate of the national currency, the manat, against the US dollar. M2 grew by 2.1% in Q3 2014 compared with a growth of 3.6% in Q3 2013 and a growth of 5.4% in Q2 2014. There was a decrease in M2 in the three-month period between August and October 2014.

The slowdown in the growth in the money supply in the economy still had a limited impact on lending activity. The annual growth rate of bank lending was 19.2% in September, slightly down from 21.6% in June 2014.
Azerbaijan

Figure 2.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the State Statistics Committee of Azerbaijan

Figure 2.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

Source: national agencies

Figure 2.3. **Government sector**: sum of state budget and oil fund balances (in % of GDP)

Source: national agencies

Figure 2.4. **Monetary sector**: the central bank’s rate (in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

Source: national agencies

Figure 2.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF

Figure 2.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by national agencies and the IMF
Armenia: acceleration in GDP growth amid low inflation and deterioration in balance of payments

Armenia’s GDP growth slowed down to 2.7% year-on-year in Q1-Q2 2014, and then accelerated to 5.3% in Q3 2014. This led to a year-on-year GDP growth rate of 3.8% in Q1-Q3 2014 against a growth of 3.8% in Q1-Q3 2013. The acceleration of GDP growth was largely due to a sharp increase in agricultural output, which rose by 9.7% year-on-year in Q3 2014 as a result of the expansion of the network of hothouse farms. The agricultural sector accounted for 30% of GDP growth in Q3 2014. The good performance of the agricultural sector had a favorable effect on manufacturing industry (+12.9%) and the transport sector (+21.8%). The sectors dependent on domestic demand – cash remittance from abroad – continue to be in a difficult situation. The construction sector and the mining industry experienced output declines of 7.7% and 7.3%, respectively, in Q3 2014. Retail trade continued to have a very modest rise (2.0%). Nonetheless, some other branches of the services sector showed high growth rates, which pushed up aggregate economic growth.

The balance of payments deteriorated in Q3 2014. In August and September, the gross international reserves shrank by $250 million to $1,663 million as of the end of September. The deterioration in the balance of payments was caused by: a decline in the volume of cash remittances from abroad, which decreased by 6.9% year-on-year in Q3; and the expansion of the foreign trade deficit, which increased by 11% because imports rose by 8.6% whereas exports increased by only 3.6%. This was amid the unfavorable external market environment: a fragile recovery in the Eurozone; a slowdown in economic growth in Russia; a fall in copper, gold and food prices; and heightened geopolitical tensions in the region. Apart from the negative impact from the current account balance, the balance of payments was apparently affected by a decline in the inflow of foreign investment, which, like in Q1 and Q2 2014, led to a decrease in the financial account surplus amid limited external borrowings.

The condition of the state budget remained stable in Q3 2014 despite a slowdown in the growth in revenue and a sharp increase in expenditure. In particular, the annual growth rate of revenue fell to 5.1%, whereas the rise in public spending sharply accelerated to 18.6%. This followed restraint on expenditure, including capital expenditure, in Q1-Q2 2014. As a result, the state budget moved from a surplus to a deficit, which amounted to 0.3% of GDP against a surplus of 2.2% in Q3 2013.

Annual inflation slowed to 1.5% as of the end of Q3 2014 compared with 1.8% at the end of Q2 2014. This was despite a further loosening of monetary policy, a slight acceleration in bank lending, and an increase in the money supply.

The banking sector’s efficiency indicators deteriorated. The average ROA (return on assets) rate fell to 1.1% in Q3 2014 from 1.7% in Q1-Q2 2014, while the ROE (return on equity) rate decreased to 7.2% from 10.5%.

The share of loans overdue for more than 90 days grew to 6.6% from 6.1% in Q1-Q2 2014.
Outlook

Armenia: constrained GDP growth, conservative fiscal policy, moderate inflation

Armenia’s economic growth will remain limited until the end of 2014 due to: the negative impact of the weakening domestic demand, including the negative effects of the dram’s depreciation; and weaker external demand resulting from the slowdown in Russia’s economic growth and the low growth rate in Europe. This is despite the possible favorable effect of acceleration in the implementation of postponed expenditure. The Indicator of Economic Activity (IEA) deteriorated again in October 2014. The IEA rose by 4.2% in the first 10 months of 2014, and its annual growth rate was 3.7% in October. The economy of Armenia turned out to be highly sensitive to: the slowdown in economic growth in Russia; and the heightened geopolitical uncertainty through a decline in investment activity, a slowdown in the growth in migrant workers’ remittances, and decreasing exports. The consensus forecast of international organizations predicts a GDP growth of 3.3% for 2014, with EDB forecasting a growth rate of 4.0%.

In 2015, the economic situation will be determined by two contradictory factors. On the one hand, the anticipated economic recession in Russia will have a negative impact. On the other hand, Armenia’s membership in the Eurasian Economic Union (EAEU) should contribute to the expansion of exports of agricultural products and processed agricultural products to other EAEU countries, especially in the context of the continued Western sanctions against Russia. Armenia can also rely on a fall in energy prices as a result of their fall in international markets, as well as on the potential expansion of foreign investment. According to the consensus forecast, the GDP growth rate in 2015 will be similar to 2013 and 2014 and may be 3.8%, with EDB forecasting 4.2%.

The balance of payments deteriorated in October and November 2014 amid a high volume of short-term payments on external liabilities. This led to: a decrease in the gross international reserves, which amounted to $1,530 million as of the end of November, $133.3 million less than October; and the emergence of pressure on the dram. The pressure was increased by the strengthening of the dollar against the euro and many currencies in developing markets, and the depreciation of the Russian ruble. As a result, in November 2014 the Central Bank of Armenia lowered the exchange rate of the dram, which had begun to rapidly depreciate under the influence of speculative activity and fearful anticipation. The stabilization of the dram continues to depend on the external market environment, including the stabilization of the ruble, and also on whether the monetary policy of the central bank is decisive and tight enough.

Growing public spending may cause the state budget to have a deficit in 2014, but the deficit may be lower than the 2.3% of GDP projected for 2014. The budget situation remains under control, including due to the IMF’s country program. The 2015 state budget estimates approved by the IMF, look rather conservative and envisage a moderate expansion of the deficit to 2.34% of GDP with an extremely moderate growth rate of both revenue and expenditure.

The annual inflation rate was 2.6% at the end of November 2014, remaining close to the lower boundary of the target band. Inflation might accelerate, but in view of the current depreciation of the dram, it should remain moderate due to the impact of external factors, including the fall in energy prices, and the tightening of monetary policy. In 2015, given the effect of the devaluation of the dram and price correction following the country’s accession to the EAEU, inflation may exceed the target band of 2.5% to 5.5%.
Armenia

Figure 3.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the National Statistical Service of the Republic of Armenia

Figure 3.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

Source: national agencies, IMF

Figure 3.3. **Government sector**: state budget (in % of GDP)

Source: national agencies

Figure 3.4. **Monetary sector**: the central bank’s rate(in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

Source: national agencies

Figure 3.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF

Figure 3.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by national agencies and the IMF
Belarus: slowdown in growth in consumption, fall in investment, moderate decrease in current account deficit

Belarus’ annual GDP growth rate rose again in Q3 2014. This led to a year-on-year GDP growth of 1.5% in Q1-Q3 2014 compared with 1.2% in Q1-Q2 2014. A considerable contribution to the general economic growth was made by the extractive branches of the industrial sector, which increased their output by 43%. Manufacturing industry resumed growth, increasing output by 0.3% year-on-year in Q1-Q3 2014 after a decline of 1.7% in Q1-Q2 2014. The agricultural sector showed an output increase of 2.9%, also after a decline in Q1-Q2 2014. At the same time, the growth rate of retail trade fell to 9.5% in Q1-Q3 2014 from 11.5% in Q1-Q2 2014, while construction fell back into negative territory, decreasing by 4.9% year-on-year after zero growth in Q1-Q2 2014. These facts suggest a continuing contraction of domestic demand, which even accelerated in Q3 2014. A significant contribution was made by consumer demand, which decreased due to a decline in real pay. The annual growth rate of average real pay in the country was only 0.8% in Q1-Q3 2014 compared with 20.5% in Q1-Q2 2014. Average real pay has fallen year-on-year in each month since June.

Annual inflation, which accelerated in Q1-Q2 2014, remained at levels close to 20% throughout Q3 2014. The money supply continued to grow, pushing up inflation. The annual growth rate of M2 reached 25.6% in September, up from only 12.1% in July. This was after the National Bank lowered its refinance rate to 20.5% in July and to 20% in August. It also reduced the scale of its forex interventions in support of the national currency amid relative stability in the financial market throughout the greater part of Q3 2014.

The negative trend in the state of public finances continued in Q3 2014. In Q1-Q3 2014, the state budget had a surplus equal to 0.8% of GDP compared with a surplus of 1.4% in Q1-Q3 2013.

Available data suggest that the state of the current account balance slightly improved compared with 2013 amid the consolidation of domestic demand. The country had a surplus of $165.8 million (0.8% of GDP) in foreign trade in goods and services in Q3 2014, whereas there was a trade deficit of $970 million (4.9% of GDP) in Q3 2013. That roughly corresponded to the negative impact of the decline in capital inflows to the country on the balance of payments. The international reserves of the National Bank remained between $6.2 billion and $6.4 billion throughout Q3 2014. A decrease in imports led to a rise in the reserves from 1.4 to 1.8 months’ worth of imports.

Despite the accelerating growth in money supply, the rise in bank lending continued to slow down amid high risks in the economy, which primarily related to external sustainability. In particular, the annual growth rate of banks’ net claims on the other sectors of the economy fell from 26.1% in June to 18.5% in September 2014.
Outlook
Belarus: moderate GDP growth, risk of deterioration in balance of payments amid real strengthening of national currency

Available data for Q3-Q4 2014 suggest that the situation in the economy of Belarus generally met our expectations. Amid a moderate fall in average pay, the rise in household consumption began to slow down to rates more compatible with general macroeconomic stability than those seen in 2013 and Q1-Q2 2014. The process of consolidation of private consumption will probably take a significant part of 2015, and continue to have a deterring influence on the country’s GDP growth during this period. This effect may, to a certain extent, be offset by a recovery of investment activity, which experienced a considerable downturn in 2014. At the same time the positive contribution of net exports to GDP growth may diminish due to the exhaustion of a one-time positive effect from the launch of a Belarusian-Russian oil production company in 2014. This effect manifested itself in a sharp rise in the extractive industry. The aggregate effect of the above-mentioned factors on the economy will ensure a GDP growth rate of zero to 1.5% in 2015. Additional substantial risks for GDP growth relate to: the impact of the real strengthening of the national currency on exports; and financial stability under the conditions of the rubles’ sliding peg to the US dollar and the currency depreciation in Russia. At the moment it is difficult to numerically assess the influence of these factors.

Given the monthly growth rates of consumer prices in Q4 2014, and also the dynamics of the money supply, it is possible to expect a slowdown in the annual growth rate of the consumer price index to 18-19% at the end of 2014, and a gradual recovery of the rate to between 20 and 25% later in 2015. Nonetheless, there is significant uncertainty with regard to monetary and price policies in the remaining part of 2014. Theoretically, the National Bank’s support of the existing foreign currency policy may lead to a quick reversal of trends in these spheres with a contraction of the money supply and a sharp slowdown in inflation. A contrary scenario – a revision of foreign currency policy – is also fraught with risks for the economy. In particular, it will lead to considerable acceleration of inflation.

The dynamics of the balance of payments in Q1-Q3 2014 indicate a decrease in the current account deficit to about 5% of GDP in 2014. This would represent an improvement compared with 2013, when the current account deficit amounted to more than 10% of GDP. The existing positive trend in the state of the current account balance may become stable, and contribute to a general improvement in the external sustainability of the Belarusian economy. This is providing there are no steps in 2015 toward stimulating GDP growth or certain of its components, such as investment and household consumption. An excessive real strengthening of the national currency, which we discussed above, is currently a major risk that may obstruct this scenario.
Belarus

Figure 4.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the National Statistics Committee of Belarus

Figure 4.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

Source: national agencies, IMF

Figure 4.3. **Government sector**: consolidated budget (in % of GDP)

Source: national agencies

Figure 4.4. **Monetary sector**: the central bank’s rate (in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

Source: national agencies, IMF (IFS)

Figure 4.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: national agencies, estimates by the EBD, the World Bank, the EBRD, the IMF

Figure 4.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by national agencies, the IMF and the EBD
Kazakhstan: improvement in GDP growth figure, stability of tenge, deterioration in state of public finances, controlled inflation

Kazakhstan’s GDP grew by 4.4% year-on-year in Q3 2014 compared with a 4.0% increase in Q2 and a 3.8% increase in Q1. This led to a growth of 4.1% in Q1-Q3 2014. The improvement in the country’s economic growth, especially in July and August, was primarily attributable to more intensive investment activity with annual growth in investment accelerating to 5.5% in Q1-Q3 2014. This was amid relatively robust consumer demand and a greater contribution of net exports. Major drivers of the GDP growth included the construction sector with a 4.8% year-on-year increase in Q3 2014, and the services sector with an 8.1% increase. A small but symbolic increase of 0.1% took place in the industrial sector. It was caused by an improvement in the mining industry, whose output rose by 0.8% due to a modest upturn following a setback in the production of coal, crude oil, natural gas and non-ferrous metal ore. There was a continued decline in manufacturing industry, whose output fell by 0.9% despite an upturn in the output of the iron and steel industry.

The state of the balance of payments improved throughout Q3 2014 despite deterioration in the external market environment, and a continuing contraction of exports, which decreased by 5.5% year-on-year in Q3 2014. This had a favorable effect on the stability of the tenge. The foreign trade surplus increased by 6.8% year-on-year in Q3 2014 due to a fall in imports (-12.6%). The improvement in the balance of payments was attributable to a combination of a better current account balance and a higher financial account surplus (including errors and omissions). As a result, the gross international reserves grew by $1,490 million to $27,961 million as of the end of September.

According to the most recent data, the state of public finances deteriorated in Q3 2014. The state budget deficit in Q3 2014 was 3.5% of GDP compared with a deficit of 1.9% of GDP in Q3 2013. The main reason was that state budget revenue decreased by 2.4%, while expenditure rose by 7.2%. The decline in revenue took place amid lower economic growth rates and a fall in oil prices. During Q1-Q3 2014 state budget revenue rose by only 11.9%, whereas spending increased by 16.4%. The state budget deficit in Q1-Q3 2014 thus amounted to 1.9% of GDP, while the consolidated budget has a surplus equal to only 2.0% of GDP.

In September 2014, inflation accelerated again in both monthly and annual terms (0.5% and 7.4% respectively), whereas the annual target band was 6 to 8%. The annual growth rate of food prices was 7.4%, while prices of non-food consumer goods rose by 8.4% and services increased in price by 6.5%. The acceleration of inflation was due to the delayed effect of the January currency devaluation, an increase in fuel prices and, partially, looser monetary policy. It is remarkable that the rise in producer prices slowed down further to 9.7% in annual terms, which was attributable by external factors.
A new economic policy, Nurly Zhol, has been announced. It envisages economic activity being stimulated by additional fiscal stimulus and an active role of the quasi-public sector, international financial organizations, and the private sector. This policy should support the positive mood of economic agents, and it will have a favorable effect on the economy in Q4 2014 and throughout 2015. According to the consensus forecast of international organizations, the country’s GDP will grow by 4.3% in 2014, with EDB predicting a growth rate of 4.2%. The country’s GDP growth may accelerate to 4.7% in 2015 as a result of: structural measures taken within the framework of the new economic policy; the launch of a second program of industrial and innovation development; the privatization of large enterprises; an improvement in the investment climate; a possible improvement in the state of the banking sector; and transition to the Eurasian Economic Union. EDB forecast a GDP growth of 4.6%, despite the impossibility to increase oil production. Major risks include the ambiguous dynamics of oil prices, the Ukraine crisis, and the degree of the slowdown in economic growth in Russia and China.

The tenge remains under pressure in the context of: the critical deterioration in the external environment including the fall in oil price and the ruble’s depreciation; a loss of price competitiveness; a reduction in the production of major export commodities; and the high volume of short-term external liabilities. The difficult situation is compensated for by the contraction of imports and an increase in external borrowings, which included an issue of $3.5 billion worth of Eurobonds in October and November 2014. As it is impossible to increase oil production, the state of the balance of payments may deteriorate in 2015 by virtue of a possible long-lasting fall in oil prices and limited external demand. Balance of payments equilibrium depends on, in addition to numerous external factors: the degree of the expansion of the export potential of non-primary commodities (under the conditions of the new EAEU); the intensity of use of the accumulated resources of the National Fund of Kazakhstan; the use of external loans; the tightness of monetary policy; and the degree of readiness of the National Bank for transition to inflation targeting.

Guarantors of fiscal sustainability are: the high volume of resources of the National Fund; the continued consolidated budget surplus (2% of GDP in Q1-Q3 2014); and the relatively moderate fiscal policy. This is in the context of possible deterioration in public finances and the expansion of fiscal stimulus measures in 2015. Nonetheless, one should expect the tightening of financial discipline and the expansion of the tax base.

Annual inflation rates are currently low as a result of: the tightening of monetary policy; the contraction of exports; weaker domestic demand; administrative control over prices; and falling prices of imports and oil. The inflation rate was 7.6% in November 2014, including a small rise in producer prices of 3.4% year-on-year in November. Inflation will be limited to a level close to 8% in 2014. In 2015, the National Bank plans to additionally reduce it to 5% - 7%. However, there are certain risks relating to a possible rise in electricity prices, heightened uncertainty with regard to the dynamics of the tenge’s exchange rate, and a possible rise in prices of imports.
Kazakhstan

Figure 5.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the Agency of Statistics of Kazakhstan

Figure 5.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

Source: national agencies, IMF

Figure 5.3. **Government sector**: consolidated and state budgets (in % of GDP)

Source: national agencies

Figure 5.4. **Monetary sector**: the central bank’s rate (in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

Source: national agencies, IMF (IFS)

Figure 5.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: estimates and forecasts by national agencies the EDB, ADB, the World Bank, the EBRD, the IMF

Figure 5.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by national agencies, the IMF and the EBD
Kyrgyzstan: slowdown in construction, some recovery in consumer activity

The slowdown in Kyrgyzstan’s economic growth that began in early 2014 continued in Q3. The notable features of Q3 2014 included a growth slowdown in the construction sector and a slight rise in consumer demand. The construction boom, which was the main driver of economic activity, was gradually falling away as support from other sectors of the economy was decreasing. The year-on-year growth in the construction sector’s output decreased to 14.3% in Q1-Q3 2014, compared to 18.5% in Q1-Q2 and 24.7% in Q1 2014. A recovery in consumer activity is shown by data for the retail trade, which increased by 5.3% compared with a rise of 4.3% in Q1-Q2 2014, and annual growth in real pay (+1.9%) amid a slowdown in inflation.

Amid a decline in fluctuations in the exchange market, the rise in inflation slowed down to 7.9% in annual terms in July 2014, compared with 8.5% in June 2014. The annual inflation rate was 7.6% at the end of Q3, slightly down from 8% at the end of Q2 2014. The National Bank of Kyrgyzstan raised its base lending rate by one point to 7% upon the expected increase in heating and electricity prices. However, exchange rate fluctuations recommenced in August-September 2014 amid increased economic activity and the depreciation of the Russian ruble. This made the National Bank resume limited forex interventions. The National Bank’s floating exchange rate policy in general allowed it to keep the international reserves at a safe level sufficient to finance 4.8 months of imports, and also to reduce the foreign trade deficit. The som equivalent of cash remittances from abroad grew by 11%, thereby supporting the national economy.

The rise in budget revenue in 2014 was attributable to additional non-tax revenues and grants, whereas tax revenues slightly decreased as a percentage of GDP to 21.3% from 21.4% in Q1-Q3 2013. The decrease in imports in 2014 was the main reason for more modest expectations for tax revenues. At the same time the increase in the budget deficit was due to a rise in capital expenditure and, in particular, a rise in lending within the framework of a program of public investment, which amounted to 9.7% of GDP compared with 6.8% of GDP in Q1-Q3 2013.

There was a rather difficult situation in the sphere of lending. Growth in the external liabilities of the banking sector and a fall in economic activity were accompanied by a rise in lending in foreign currency. Annual growth in lending was 44.7% in September 2014, primarily due to an increase in the volume of foreign currency loans in the trade and construction sectors. Simultaneously, there was a decline in the growth rate of the deposit base, which indicated increased risks for the sustainability of the banking system. Nonetheless, at the end of September, the indicators of assets’ quality and liquidity in the banking sector remained beyond critical values.

Although the liquidity ratio had been on the decline since the beginning of 2014, it was 55.1% at the end of September. The share of nonperforming (classified) loans was 4.2% of the total volume. However, there was a small rise in the volume of “loans under supervision,” which made up 5.6% of the total volume.
Outlook

Kyrgyzstan: moderate economic growth rate amid risks and structural changes

Annual economic growth accelerated to 3.7% in October 2014, which was attributable to continued support from the construction sector and recovery in retail trade and the services sector. Industrial output, in which the gold mining industry accounts for a large share, showed a decline because of the high base of 2013. Kumtor Gold Company expected that more than half of the year’s gold production would be in Q4 2014. If this expectation comes true and if other sectors of the economy continue their contribution, it is likely that Kyrgyzstan will have a GDP growth rate of around 3% in 2014.

Apart from forex interventions, the National Bank tightened its monetary policy, raising its discount rate to 10% and increasing the reserve requirement for commercial banks. This led to a further decline in the growth rate of the money supply. However, annual inflation accelerated to 10.2% by November amid a seasonal rise in food prices and a weakening of the national currency. The increase in heating and electricity prices may push up the rise in prices in further. December’s annual inflation rate may slightly exceed the target level. In general, despite the National Bank’s effort to achieve its objectives regarding inflation, the high degree of dollarization of the economy and the substantial external debt are the main obstacles to efficient monetary policy.

The state budget deficit in the first 10 months of 2014 amounted to 3.4% of GDP. On the one hand, an increase in capital investment in infrastructure projects supported the slowing economic growth. On the other hand, the persistent state budget deficit led to a constant rise in the external debt, which amounted to 48.3% of GDP in September 2014. Difficulties are created in keeping macroeconomic policy stable by: the continued high degree of dependence on external assistance; the unsteady state budget revenues amid market fluctuations in the real sector of the economy; and the anticipated failures of important state budget revenue. An additional factor of risk is fiscal sustainability, considering the current slowdown in economic growth and the pace and conditions of Kyrgyzstan’s accession to the EAEU. The country’s dependence on external assistance may further increase amid: the poor efficiency of tax and customs administration; the susceptibility of the real sector of the economy to swings in external factors; and the continuing external imbalance.

Potential problems relating to external liabilities are gradually shifting to the private sector, whose external borrowings have grown to 40% of GDP. The greater part of this debt is formed by long-term loans owed by the corporate non-banking sector, and by intragroup liabilities owed by subsidiary companies to their parent companies. Despite this, in the long term there may emerge difficulties in servicing it in periods of market fluctuations in GDP and exports. This is due to the moderate volume of gold and foreign exchange reserves acting as a factor of “safety pillow”. However, the short-term external private debt makes up only about 5% of the total amount, which makes the problem somewhat easier to bear.
Figure 6.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the National Statistics Committee of Kyrgyzstan

Figure 6.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

Source: national agencies

Figure 6.3. **Government sector**: state budget (in % of GDP)

Source: national agencies

Figure 6.4. **Monetary sector**: the central bank’s rate (in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

Source: national agencies

Figure 6.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: estimates and forecasts by national agencies the EDB, the ADB, the World Bank, the EBRD, the IMF

Figure 6.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by national agencies, the IMF and the EBD
Trends and outlook

Moldova: consumption, construction and exports viewed as major driving factors behind growth

Despite increased risks in the region, Moldova continued its economic growth in Q1-Q3 2014, with private consumption and exports of agricultural, food and textile products being the main driving factors. Gross agricultural output rose by 8.6% year-on-year in Q1-Q3 2014, while industrial output increased by 4.7%. Simultaneously, a 4.4% rise in retail trade, the continuing inflow of cash remittances from abroad and a slowdown in inflation supported consumer activity in the country. Growth in the construction sector extended in Q3-Q4 2014, amounting to 14% in Q3. In Q1-Q3 2014, fixed capital investment grew by 9.4% year-on-year.

Moldova’s economy grew by 4.7% in Q1-Q3 2014, but the consensus forecast of international organizations predicted a moderate GDP growth rate for 2014: the growth may slow to 2%. A recovery of economic growth to between 3.8% and 4% can be expected in 2015 and 2016 provided the situation in the region stabilizes.

The National Bank of Moldova kept its base interest rate unchanged throughout Q1-Q3 2014. However, a slowdown in economic activity in the real and banking sectors, coupled with forex interventions, led to a decline in the growth rate of money supply. The annual inflation rate, which rose to 5.8% in March 2014, fell to 4.8% by October. A decrease in imports allowed the National Bank to keep its international reserves at a level sufficient to cover six months of imports as of the end of September 2014.

A positive impact on the balance of payments resulted from: the fall in prices; the leu’s depreciation; the continued rise in agricultural output; and a steady increase in migrant workers’ remittances, which rose by 8.1% year-on-year to amount to 22% of GDP. The foreign trade deficit in Q1-Q3 2014 decreased by 4.5% compared with Q1-Q3 2013 to total $2.1 billion. However, the influence of the economic crisis in neighboring states and administrative barriers led to a change in the structure of foreign trade: the share of CIS countries in Moldova’s exports and imports diminished from 39.6% to 32.8% and from 30.4% to 26.9%, respectively.

The deficit in the national public (consolidated) budget in Q1-Q3 2014 amounted to 79.6 million leu, considerably down from 642.5 million leu, or 1% of GDP, in Q1-Q3 2013. Expenditure rose insignificantly year-on-year, which was due to lower-than-projected funding for capital expenditure, whereas social expenditure programs were financed in full.

The annual growth rate of bank lending was 21% at the end of Q3 2014. The banking sector’s sustainability indicators slightly deteriorated in Q3 2014. In particular, the capital adequacy ratio continued to fall, decreasing to 19.8% from 19.9% in June 2014 and 23% at the end of 2013. The share of nonperforming unfavorable loans grew to 12.3% from 11.9% in June 2014. The deterioration in the banking sector indicates potential risks connected with the large share of foreign capital in the sector and deterioration in the state of systemically important banks, where the share of nonperforming loans made up 20 to 25% of the total lending portfolio.
Moldova

Figure 7.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the National Bureau of Statistics of Moldova

Figure 7.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

Source: national agencies

Figure 7.3. **Government sector**: state budget (in % of GDP)

Source: national agencies

Figure 7.4. **Monetary sector**: the central bank’s rate (in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

Source: national agencies

Figure 7.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: estimates and forecasts by national agencies, the World Bank, the EBRD, the IMF

Figure 7.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by national agencies and the IMF
Russia: slow fall in annual GDP growth rate, national currency depreciation, acceleration in inflation

Russia’s economic growth continued to slow down in Q3 2014. The country’s GDP grew by 0.7% year-on-year in Q3 2014 compared with an annual growth of 0.9% in Q1 and a growth of 0.8% in Q2. Annual economic growth in Q1-Q3 2014 amounted to 0.8%, the same as in Q1-Q2 2014. The relatively smooth slowdown in economic growth was attributable to the influence of differently directed processes. On the one hand, a fall in the annual growth rate of retail sales from 2.7% in Q1-Q2 2014 to 2.3% in Q1-Q3 2014 suggests that the growth in household consumption slowed significantly in Q3 2014. On the other hand, the fall in investment slowed down to 2.5% in Q1-Q3 2014 from 2.8% in Q1-Q2 2014. A positive contribution to economic growth was made by net exports. They increased due to a decline in imports amid the weakening of the ruble and foreign trade restrictions that were imposed in the context of the Ukraine crisis.

The ruble resumed weakening against major world currencies at the beginning of Q4 2014. This was due to general trends in financial markets as well as to the toughening of the Western sanctions and the fall in oil prices. A further acceleration of inflation was one of the consequences of the depreciation of the ruble. The annual growth rate of the consumer price index reached 8% in September, rising from 7.8% in June and 6.5% in December 2013. The Bank of Russia raised its key interest rate to 8% in July and did not change it in the third quarter. The capital adequacy ratio decreased to 15% in September. The capital adequacy ratio decreased to 14.4% in August and recovered to 15% in September. The capital adequacy ratio decreased to 12.6% at the end of Q3 2014 from 12.8% at the end of Q2 and 13.5% at the end of 2013. The share of problem loans amounted to 6.6% at the end of Q3 2014 compared with 6.5% at the end of Q2 and 6% at the end of 2013.

The weakening of the ruble throughout 2014 led to a year-on-year improvement in the state of the balance of payments and the budget balance. According to preliminary estimates, the balance of payments had a current account surplus of $11.4 billion (2.2% of GDP) in Q3 2014 compared with a current account deficit of $0.7 billion (0.2% of GDP) in Q3 2013. The financial account deficit amounted to $1.6 billion in Q3 2014, down from $4.5 billion in Q3 2013. The financial account balance significantly improved compared with Q1-Q2 2014, when it had a deficit of $29.8 billion in Q2 and a deficit of $49.1 billion in Q1 2014.

The positive trend that was seen in the state of the public finances in Q1-Q2 2014 continued into Q3 2014. The federal budget had a surplus of 1.2 trillion rubles (2.1% of GDP) in Q1-Q3 2014, while the consolidated budget had a surplus of 1.5 trillion rubles (2.8% of GDP) compared with 0.7 trillion and 0.9 trillion rubles (1.4% and 1.9% of GDP) in Q1-Q3 2013, respectively.

The dynamics of bank lending in Q1-Q3 2014 in general corresponded to the dynamics of monetary aggregates. The annual growth rate of banks’ claims on the other sectors of the economy reached a minimum of 14.4% in August and recovered to 15% in September. The capital adequacy ratio decreased to 12.6% at the end of Q3 2014 from 12.8% at the end of Q2 and 13.5% at the end of 2013. The share of problem loans amounted to 6.6% at the end of Q3 2014 compared with 6.5% at the end of Q2 and 6% at the end of 2013.
Outlook

Russia: recovery of investment growth, rise in net exports, slowdown in growth of private consumption

Russia’s economic growth figures in the remaining part of 2014 and 2015 will be determined by the differently directed effects that we mentioned at the beginning of the previous section – 'Russia trends'. On the one hand, the fact that in Q3 2014 the volume of investment as a percentage of GDP reached the minimum level in seven years suggests that a recovery may begin in 2015. This will be due to the implementation of large-scale projects in the field of gas production and transportation, as well as in the field of road construction. Simultaneously, net exports will continue to make a positive contribution to general economic growth under the influence of the effects of the ruble’s depreciation, which will remain strong at least throughout 2015. However, there will be a negative impact on investment and household consumption resulting from: the fall in world oil prices; the extremely wide range of fluctuations in the exchange rate of the ruble in Q4 2014; and the drastic measures taken by the central bank in December to tighten its monetary policy. The growth in household consumption may become negative amid: a decline in the real income of the population under the conditions of accelerating inflation; the relatively low level of indexation for public employees’ salaries that is projected in the 2015 budget estimates; as well as a slowdown in the growth in bank lending to individuals. Given the dynamics of the Russian economy in the most recent months for which statistics exist - the balance of the influence of the above-mentioned processes on the country may be such that its GDP growth will be 0.5% to 0.8% in 2014, and between minus 1% and plus 0.2% in 2015. This will depend on the evolution of the Western sanctions and the behavior of oil prices. Nonetheless, the probability of a fall in GDP to an extent comparable to that seen in 2008 and 2009 remains small considering: the relatively high degree of consolidation of investment activity; and the flexible exchange rate regime, which ensures the economy’s rapid adaptation to external shocks.

If energy prices stabilize and the ruble’s value ceases to decrease, it is probable that inflation will slow down from the current high rates amid a moderate growth in monetary aggregates. The central bank’s 2015-2017 guidelines project a decline in the annual growth rate of the consumer price index to 4%+/− 1.5% in 2017. Unlike similar guidelines adopted in 2014, the new document does not set any inflation targets for 2015 and 2016. The central bank thus leaves room for maneuver under the conditions of the current uncertainty.

A significant deterioration in the balance of public finances in the final part of 2014 was prevented by the weakening of the ruble amid a fall in prices for Russian exports in Q3-Q4 2014, as well as the surge of inflation. It is most probable that unlike 2013, the federal budget will have a surplus in 2014. As for 2015, the budget may have a limited negative or positive balance. The impact of the fall in world oil prices on the balance of payments will be more considerable, although the current account balance will probably remain positive under the conditions of the flexible exchange rate of the national currency.

The country’s economic growth figures in the remaining part of 2014 and 2015 will be determined by differently directed effects

Net exports will continue to make a positive contribution to economic growth

The balance of differently directed effects may shift in a negative direction by the impact of sanctions and falling oil prices on consumption and investment

If energy prices stabilize and the ruble’s value ceases to decrease, inflation will probably slow down in 2015

The weakening of the ruble amid a fall in export prices in Q3-Q4 2014, as well as a surge of inflation prevent a significant deterioration in the balance of public finances
Russia

Figure 8.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

![GDP and output chart]

Source: the Federal State Statistics Service

Figure 8.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

![Foreign trade chart]

Source: national agencies

Figure 8.3. **Government sector**: consolidated and federal budget (in % of GDP)

![Government sector chart]

Source: national agencies

Figure 8.4. **Monetary sector**: the central bank’s rate (in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

![Monetary sector chart]

Source: national agencies, IMF (IFS)

Figure 8.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

![Economic growth chart]

Source: estimates and forecasts by national agencies, the EBD, the World Bank, the EBRD, the IMF

Figure 8.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

![Savings and investments chart]

Source: estimates and forecasts by national agencies, the IMF and the EBD
Tajikistan: acceleration in GDP growth due to strong investment activity

Due to an acceleration in the rise in fixed capital investment, the annual GDP growth rate rose to 7.0% in Q3 2014. This led to a growth of 6.9% in Q1-Q3 2014 compared with a growth of 7.4% in Q1-Q3 2013. The strong investment activity increased by 27.4% year-on-year in Q1-Q3 2014. It compensated for weakening consumer demand, which was on the decline due to: a fall in migrant workers’ remittances, which decreased by 1.1% year-on-year in Q3 2014 and by 0.8% in Q1-Q3 2014; and a fall in exports, which decreased by 11.8% in Q1-Q3 2014. Industrial output retained a high growth rate (5.6%) due to high growth figures in the extractive industry. In the construction sector, the volume of newly commissioned fixed assets was four times higher than Q3 2013. Retail trade grew by 6.7% compared with an increase of 17.2% in Q1-Q3 2013, while the growth rates in the services, transportation and agricultural sectors remained modest at 2.5%, 3.0% and 3.0%, respectively.

The state of the current account balance should have deteriorated in Q3 2014 amid: an unfavorable external market environment; a fall in the output of major export commodities; deterioration in the state of price competitiveness; and the decline in the volume of cash remittances from abroad. The foreign trade balance deteriorates tangibly. In particular, due to a decrease in the output and export of cotton, aluminum and various agricultural produce, Tajikistan’s exports fell by 11.8% in Q1-Q3 2014. Imports rose by 20.2% as a result of increased investment activity financed with foreign funds. In Q1-Q3 2014, there was a foreign trade deficit of more than $2.7 billion, or 42.5% of GDP, compared with a deficit equal to 35.7% of GDP in Q1-Q3 2013. The low volatility of the somoni, amid a limited volume of interventions in the exchange market during the period, indicates relative equilibrium in the balance of payments due to the financial account balance.

The state of public finances remained steadily positive in Q1-Q3 2014. The state budget surplus amounted to 1.9% of GDP without taking into account the government’s public investment program financed from external sources. On the one hand, due to restrictions on public spending, including capital expenditure to finance large-scale infrastructure projects, the annual growth rate of expenditure slowed down to 16.1%. On the other hand, an improvement in tax administration – tax revenue rose by 23.9% year-on-year in the period – and the high GDP growth rate led to acceleration in the growth in public revenue to 14.4%.

Annual inflation slowed to 6.6% at the end of Q3 2014, largely due to a slowdown in the rise in prices of services following a sharp hike in the price of utilities in July. Additional deterring factors were the tightening of monetary policy and the contraction of net remittances from abroad, which in combination led to a slowdown in the growth of the money supply.

The annual growth rate of bank lending fell to 29.9%, while the share of outstanding loans increased to 11% at the end Q3 2014 from 9.2% at the end of 2013. At the same time banks’ profitability indicators improved but remained low: the average ROA (return on assets) rate was 1.7% at the end of Q3 2014, while the ROE (return on equity) rate was 10.8%.
Outlook

Tajikistan: moderate slowdown in economic growth amid difficulties with balance of payments

Economic activity in Tajikistan slowed down in October 2014, which was primarily caused by the national economy’s growing reaction to the slowdown in economic growth in Russia and the ruble’s depreciation. Domestic consumer demand apparently weakened significantly because of acceleration in the decline in migrant workers’ remittances from Russia, which amounted to 47.1% of GDP in Q1-Q3 2014. Additional negative effects on economic activity are: the continued unfavorable external environment; the low export potential; the deteriorating state of the weak banking system; and the high level of poverty. These effects are offset by state investment. According to the median consensus forecast of international organizations, the country’s GDP growth will slow to 6.2% in 2014, whereas the government expects a growth rate of 7.5%.

In 2015 the growth rate will remain at the level of 2014. However, the dynamics of economic activity will be determined by: the amount of the decrease in the volume of cash remittances from Russia; and the ability of the public and corporate sectors to compensate for this decrease by means of alternative sources of stimulating economic activity. In the long term the economic development of the country will continue to be impeded by: the high level of poverty and unemployment; the undeveloped financial sector; the limited production and export potential including as a result of a shortage of electricity, dependence on external energy sources, and the country’s transport isolation; and a great deal of institutional problems. The dynamics of the economy will depend on the efficiency of the government’s structural reform aimed at tackling major challenges, as well as on Tajikistan’s possible accession to the EAEU.

The state of the balance of payments deteriorated throughout October and November 2014. As a result, in the context of the depreciation of the ruble and the strengthening of the US dollar, pressure on the somoni has increased considerably. It is currently held back by the National Bank. This is indirectly evidenced by the existing gap between the official and inter-bank exchange rates of the somoni (which amounted to 4.0% as of early December 2014), and the large spread between the official and cash market rates (6.7%). This situation appears to be unsteady even in the short term given: the lack of new sources of foreign currency proceeds; and the National Bank’s small international reserves, which are enough to cover less than one month’s worth of imports. The deterioration trend will continue in 2015 due to: the present unfavorable outlook for the prices of the country’s main export commodities (aluminum and cotton); stagnating external demand; the continued faster growth in imports than in exports; and the decline in the volume of cash remittances from abroad, which will lead to a rise in external borrowings.

The state budget deficit in 2014 will remain at a controlled level. The government’s state budget estimates for 2015 are conservative and envisage a limited increase in expenditure and a deficit equal to 0.5% of GDP. Annual inflation should remain at the projected level of 7.5% at the end of 2014. The dynamics of prices will continue to be determined by non-monetary factors in 2015 because of structural barriers such as the high degree of dependence on imports, the country’s transport isolation and insufficient competition.

The consensus forecast of international organizations predicts the country’s GDP to grow by 6.2% in 2014 and by 6.1% in 2015, whereas the government expects growth rates of 7.5% and 7.2%.

The long-term dynamics of the economy will depend on the efficiency of structural reform

In the context of the depreciation of the ruble and the strengthening of the US dollar, pressure on the somoni has increased considerably and is currently held back by the National Bank

The government’s state budget estimates for 2015 are conservative and envisage a deficit equal to 0.5% of GDP.
Tajikistan

Figure 9.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the Agency on Statistics under President of Tajikistan

Figure 9.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

Source: national agencies, IMF (IFS)

Figure 9.3. **Government sector**: state budget (in % of GDP)

Source: national agencies

Figure 9.4. **Monetary sector**: the central bank’s rate (in %), the CPI growth (in %, year-on-year), M2 growth (in %, year-on-year)

Source: national agencies, IMF (IFS)

Figure 9.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: estimates and forecasts by national agencies, the EBD, the ABD, World Bank, the EBRD

Figure 9.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by national agencies, the IMF and the EBD
Turkmenistan: robust domestic demand compensates for slowdown in rise in exports

Turkmenistan’s GDP continued to grow at a high rate in Q3 2014, which resulted in an annual growth rate of 10.3% at the end of Q1-Q3 2014. The annual growth in investment accelerated to 8.3% in Q3 2014 and reached 45.1% of GDP. This included foreign investment stimulated by the government and aimed at creating social, transport, communications and engineering infrastructure, and raising the overall technological intensity of the economy. Due to the government’s active social policy, the growth rate of average pay rose to 10.4%, which, coupled with the high level of public consumption, had a favorable effect on consumer demand. Continued robust domestic demand in Q3 2014 compensated for the negative impact of the deteriorating trade conditions on exports, which increased by 5.6% in Q1-Q3 2014 compared with a rise of 8.3% in Q1-Q2 2014.

Despite some slowdown in production growth in Q3 2014, many major industries retained high growth rates due to the above-mentioned factors. In particular, electricity output increased by 11.1% year-on-year in Q1-Q3 2014, while natural gas production rose by 10.7%. The construction sector’s output increased by 17.3%, which had a favorable effect on the building materials industry. Cement output rose by 12.7% year-on-year in Q1-Q3 2014, while bitumen output increased by 26.4% and that of non-metallic building materials rose by 26.2%. Retail trade rose by 17.3%, while the transport sector showed a growth of 6.3%. Lower growth rates were seen in oil refining (2.5%), gasoline production (2.4%) and the output of liquefied hydrocarbon gas (4.1%). Indirect data suggest that there were continued high growth rates in the chemical and textile industries, whereas the growth figures of the agricultural sector remained modest.

Given the deteriorating trade conditions for Turkmenistan in Q3 2014, the annual growth rate of the country’s exports fell significantly from 8.3% in Q1-Q2 2014 to 5.6% in Q1-Q3 2014. The exports are characterized by a low degree of diversity, with natural gas, crude oil and petroleum products accounting for 90% of the total volume. It is possible to conclude that there was a slowdown in the growth of other exports, given the fact that exports of natural gas rose by 11.9% year-on-year in Q3 2014. The country’s foreign trade surplus should not decrease because of a more significant slowdown in the growth in imports, despite the lower growth rate of exports. Imports rose by 4.4% in Q1-Q3 2014 compared with an increase of 9.3% in Q1-Q2 2014.

The lower growth figure for exports led to a fall in the annual growth rate of fiscal revenue, which increased by 8% year-on-year in Q1-Q3 2014. Nonetheless, due to high figures in previous periods, revenue exceeded the projected level by 19.2%. Moreover, Q3 2014 also saw a slowdown in the annual growth in expenditure to 16.1% in Q1-Q3 2014, which caused total expenditure to fall 3.3% short of the projected figure. This means that the state budget should have a surplus in 2014. As for inflation, according to government statistical data, the all-item consumer price index fell by 1.67% compared with December 2013.

GDP continues to grow at a high rate in Q3 2014, which results in an annual growth rate of 10.3% at the end of Q1-Q3 2014

Electricity output increases by 11.1% year-on-year in Q1-Q3 2014, while natural gas production rises by 10.7%

Annual growth in exports slows to 5.6% in Q1-Q3 2014 from 8.3% in Q1-Q2 2014

The all-item consumer price index falls by 1.67% compared with December 2013
Turkmenistan

Figure 10.1. **GDP**: GDP growth (in %, year-on-year)

Source: national agencies

Figure 10.2. **Foreign trade**: exports, imports (in billions of US dollars)

Source: ADB

Figure 10.3. **Government sector**: state budget (in % of GDP)

Source: national agencies

Figure 10.4. **Monetary sector**: the left scale - CPI growth (in %, year-on-year); the right scale - M2 growth (in %, year-on-year)

Source: national agencies and the ADB

Figure 10.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Source: estimates and forecasts by the ABD, the EBRD, the IMF

Figure 10.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: estimates and forecasts by the IMF
Trends and outlook

Uzbekistan: high GDP growth rate despite deteriorating foreign trade balance and decrease in remittances from Russia

Uzbekistan’s annual GDP growth slowed down insignificantly to 8.1% in Q3 2014 from 8.7% in Q2 2014. This was despite: continued negative trends in external markets; the slowdown in economic growth in Russia and China, which led to a sharp slowdown in the rise in exports (+0.2% in Q1-Q3 2014 compared with +8% in Q1-Q2 2014); and a decrease in the volume of cash remittances from abroad (with remittances from Russia falling by 6.0% year-on-year in Q1-Q3 2014). In Q1-Q3 2014: the annual GDP growth rate remained at 8.1% due to the continued high growth rate of investment (+10.7%); while foreign investment, which made up 20.7% of the total volume of investment in the period, grew by 19%. An 18.7% increase in the population’s aggregate income became an additional factor behind economic growth.

The rise in industrial output accelerated to 8.4%, the industrial sector’s labor productivity increased by 6.6%, and product costs were reduced by 9.2% on average. This was the result of measures taken by the government to diversify the industrial sector, and supply the domestic market with competitive domestically manufactured goods. Due to high growth rates in the machine-building, metalworking, garment and food industries, the share of industries with higher added value in the total industrial output grew from 54.5% in Q1-Q3 2013 to 59% in Q1-Q3 2014. Impressive growth rates were reached in the construction sector (+18.9%), the agricultural sector (+6.8%), retail trade (+14.2%) and the services sector (+14.7%).

The annual growth rate fell dramatically to 0.2% in Q1-Q3 2014 from 8% in Q1-Q2 2014. This resulted from a fall in the price of the country’s major export commodities (natural gas, gold and cotton) in Q3 2014; and it was despite the government’s measures to increase the competitive capacity of the industrial sector’s branches, and expand the volume and range of export products. It should be noted that the annual growth in imports slowed to 0.9% in Q3 2014. In the context of the high GDP growth rate, this was attributable to the existing administrative restrictions, and the expansion of a government program aimed at increasing the share of domestically made components in finished products. According to government data, the effect of import substitution in Q1-Q3 2014 was estimated at $870 million. As a result, the trade surplus increased to $900 million.

The high GDP growth rate led to continued strong annual growth in state budget revenue, which increased by 21.4% year-on-year. Although expenditure grew by 21.7% due to a sharp increase in social spending, the high revenue led to a state budget surplus equal to 0.1% of GDP in Q1-Q3 2014. This is without taking into account the revenue and expenditure of target funds. The government had expected the state budget to have a deficit equal to 1% of GDP in 2014.

According to official statements, in Q1-Q3 2014, the annual inflation rate did not exceed 6.8%, but international organizations’ estimates put the real inflation rate at above 10%.
Uzbekistan

Figure 9.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Figure 11.2. **Foreign trade**: exports, imports (in billions of US dollars)

Figure 11.3. **Government sector**: state budget (in % of GDP)

Figure 11.4. **Monetary sector**: the left scale - the central bank’s rate (in %) and CPI growth (in %, year-on-year); the right scale - M2 growth (in %, year-on-year)

Figure 11.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

Figure 11.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

Source: national agencies

Source: national agencies, ADB

Source: national agencies and the ADB

Source: estimates and forecasts by national agencies, the ADB, World Bank, the EBRD, the IMF

Source: estimates and forecasts by national agencies and the IMF
Trends

Ukraine: GDP drop, efforts to stabilize hryvnia amid decrease in international reserves

Ukraine’s economic downturn continued to deepen in Q3-Q4 2014 amid the armed conflict in the country. GDP fell by 5.1% year-on-year in Q3 2014 after a 1.2% decrease in Q1 and a 4.6% decrease in Q2. A major contribution to the economic drop was made by the industrial and construction sectors, which experienced year-on-year output decreases of 8.6% and 17.2% in Q1-Q3 2014, respectively, following decreases of 4.7% and 8.9% in Q1-Q2 2014. Retail trade also made its contribution to the GDP fall, with the volume of sales decreasing by 5.3% in Q1-Q3 2014 after a rise of 0.8% in Q1-Q2 2014. At the same time the agricultural sector managed to return to growth in Q3 2014, increasing its output by 16% year-on-year in Q1-Q3 2014 after a decrease of 3.9% in Q1-Q2 2014.

A contraction of domestic demand, including both investment demand and consumer demand, which began to fall in the middle of 2014, led to an improvement in the current account balance, which had a deficit equal to $992 million in Q3 2014, considerably down from $6 billion in Q3 2013. At the same time declining capital inflows into the country led to a decrease in the financial account surplus to $313 million from $5.4 billion in 2013. As a result, the country had a balance of payments deficit amounting to $663 million, slightly up from $635 million in Q3 2013. A greater increase in the balance of payments deficit was prevented by the second $1.4 billion tranche of an IMF loan that was received in September.

In Q3 2014, the National Bank of Ukraine repeatedly loosened and then tightened again control over the exchange rate of the hryvnia against the US dollar. The national currency weakened from 11.7-11.8 to around 13 hryvnia for one dollar. Due to the above-mentioned IMF loan tranche, the National Bank’s international reserves experienced only a limited decrease. The reserves shrank from $17.1 billion at the end of June to $16.4 billion at the end of September. Since imports continued to decline, the level of the international reserves recovered from 2.2 months’ to 2.4 months’ worth of imports. Simultaneously, the National Bank continued to maintain a high growth rate of the money supply. The annual growth rate of M2 was 14.2% in September, slightly up from 13.4% in June. Inflation kept accelerating under these circumstances. The annual growth rate of the consumer price index reached 17.5% in September compared with 12% in June.

The state of public finances improved in Q3 2014. The consolidated budget deficit in Q1-Q3 2014 amounted to 2.2% of GDP against a deficit equal to 3.2% of GDP in Q1-Q3 2013. One of the factors behind the improvement was the postponement of certain expenditure relating to the import of energy resources. At the same time there had been no transfers to the government from the National Bank since August.

The annual growth rate of bank lending fell from 17.2% in June to 14.7% in September amid a decline in economic activity. The share of problem loans in the banking sector’s assets grew to 16.7% in Q3 2014 from 14.6% in Q2, and 12.9% at the end of 2013. At the same time the regulatory capital adequacy ratio improved, rising to 16% from 15.9% at the end of Q2 2014.

Ukraine’s economic downturn continues to deepen in Q3-Q4 2014 amid the armed conflict in the country

A contraction of domestic demand, including both investment demand and consumer demand, leads to an improvement in the current account balance

The National Bank repeatedly loosens and then tightens again control over the exchange rate of the hryvnia against the US dollar in Q3 2014

The annual growth rate of the consumer price index reaches 17.5% in September

The state of the public finances improves in Q3 2014

The annual growth rate of bank lending falls amid a decline in economic activity
Outlook

Ukraine: slowdown in GDP drop, strengthening of public finances

The most recent available data lead to the conclusion that the annual rate of decline in industrial output reached its highest point at the end of Q3 2014 and slightly decreased in Q4 2014. Nonetheless, the rate remained significant: 20 to 30% for the extractive sector and 10 to 20% for the manufacturing sector. The rate of decline in the construction sector also reached its peak in August and started to fall later. The decline in retail sales and household consumption continued to deepen. The agricultural sector returned to positive rates of growth in Q3-Q4 2014, but there are signs that agricultural output will resume declining in Q4 2014. Given the high base of Q4 2013, it is likely that Ukraine’s GDP will fall by 6 to 8% in 2014. The extent of the GDP fall may significantly decrease in 2015 amid stabilization at low levels in the industrial and construction sectors. GDP growth will remain negative at least throughout most of 2015 as a result of: the fall in household consumption, which continues amid the consolidation of the state budget; and, perhaps, an additional weakening of the national currency. One can expect the country’s GDP to experience a moderate decrease of 0.5% to 2% in 2015.

Despite the declared intention to switch to a floating exchange rate regime, the National Bank’s policy still appears to be a series of attempts to fix the hryvnia against the dollar. Control over the exchange rate amid the continued external imbalance led to: a decrease in the international reserves to a dangerously low level of slightly less than $10 billion as of late November; and a contraction in the money supply, which began in September. The fall in money growth should lead to a slowdown in inflation, which is most likely to happen in early 2015 after acceleration in Q1-Q3 2014 under the influence of money expansion. However, the inflation deceleration may impede the return of the economy to growth, as was the case in 2013, when the Ukrainian economy fell into a recession.

The state of the balance of payments still remains unsustainable. The improvement of the current account balance in Q1-Q3 2014 was partly attributable to the postponement of large expenditures relating to energy imports. The country had imported almost no natural gas since June. The financial account balance fluctuates depending on the receipt of funds under international programs of assistance and large payments on debts. These fluctuations pose a significant risk amid the low level of the international reserves left at the disposal of the National Bank. Within the framework of a program supported by the IMF, the government plans to significantly reduce the deficit of the national oil and gas company, Naftogaz, and achieve a moderate decrease in the consolidated budget by around 0.5% of GDP. If these plans come to fruition, they will have a positive impact on the balance of payments in 2015. An improvement in the field of external sustainability would facilitate the fulfillment of tasks confronting the National Bank, which currently faces conflicting challenges in maintaining financial stability, curbing inflation and supporting economic growth.
Ukraine

Figure 12.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

![Graph of GDP and output change by sectors]

Source: the State Statistics Service of Ukraine

Figure 12.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q2 2009 = 100)

![Graph of foreign trade and REER]

Source: national agencies

Figure 12.3. **Government sector**: state budget (in % of GDP)

![Graph of state budget]

Source: national agencies

Figure 12.4. **Monetary sector**: the left scale - the central bank’s rate (in %) and CPI growth (in %, year-on-year); the right scale - M2 growth (in %, year-on-year)

![Graph of monetary sector]

Source: national agencies

Figure 12.5. **Economic growth**: GDP growth and forecasts by national and international institutions (in %)

![Graph of economic growth]

Source: estimates and forecasts by national agencies, the World Bank, the EBRD, the IMF

Figure 12.6. **Savings and investments**: (in % of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account balance (X-M)

![Graph of savings and investments]

Source: estimates and forecasts by national agencies and the IMF