Macroeconomics of the region

Macroeconomics of countries:
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Trends in Q3 2013:
- The world economy: recovery in industrial output and international trade
- The United States: continuing positive trends
- Europe: steady signs of recovery from prolonged recession
- Asia: Growth acceleration compared with Q2 2013
- The CIS:
  1) High growth rates in Central Asia; relatively low growth rates in the European part of the CIS
  2) Signs of a loss of external sustainability in Belarus and Ukraine
  3) Fiscal consolidation amid decreased export and tax revenues

Outlook and risks:
- The world economy: a gradual acceleration in economic growth
- Commodity markets: a moderate fall in the prices of energy resources and metals, with the dynamics of food prices remaining vulnerable to the influence of weather conditions
- The CIS: fiscal and external consolidation in a number of CIS countries amid low growth rates of export revenue

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Q3 2013 saw emerging signs of increased economic activity in the CIS region. This was associated with an improvement in the general economic situation in the world. Under the influence of stimulus monetary measures, positive trends continued in Japan and the United States. In Q2 2013 the economies of the Eurozone had begun to show signs of recovery from prolonged recession. The considerable openness of developing economies, and also their dependence on demand from leading economies, determined their growth dynamics. In particular, annual GDP growth in China and India, which had slowed slightly at the beginning of 2013 to 7.6% and 2.7% respectively, accelerated to 7.8% and 2.7% in Q3 2013. Global economic growth gradually gained momentum; and it was accompanied by a recovery in industrial output and international trade - see Figure 1.1. The economies of the CIS countries in Central Asia were under the positive influence of Asian developing countries; while the economies of the CIS countries located close to Europe continued to have relatively low economic growth rates. In general the aggregate GDP of the CIS countries grew by 1.6% in annual terms in Q3 2013, compared with 1.5% in Q2 2013.

Under the influence of the still weak global demand, the prices and traded volumes of primary goods remained weak. They are the main source of export and fiscal revenues for the CIS economies. The average price of Brent crude reached $109 per barrel compared with up to $112 per barrel in 2012; the annual price increase was 4.5% in Q3 2013. In Q3 2013 positive annual growth rates were also shown by the price of natural gas (3.3%), cotton (9.1%) and ferrous metals (18.9%); whereas there was a continued decline in the price of non-ferrous metals (-8%), gold (-20%) and many foodstuffs (-4.6%) - see Figure 1.2. The slowly recovering demand and the low price of export goods led to a weakening in the trade balances of CIS countries. Apart from the oil and gas exporters (Azerbaijan, Kazakhstan, Russia and Turkmenistan), there were weak export figures in: Armenia (net exporter of non-ferrous metals); Kyrgyzstan (gold exporter); and, to a lesser degree, Tajikistan, where a decrease in aluminum exports was largely compensated for by a decrease in imports.

Source: CPB World Trade Monitor, World Bank

Source: Word Bank
Apart from changes in the terms of trade, the labor exporting economies (Armenia, Kyrgyzstan, Moldova and Tajikistan) were characterized by changes in the inflows of cash remittances from abroad. In Q3 2013, the annual growth of remittances from Russia to other CIS countries was 12% compared to an average of 27% during the previous three years. Despite the moderation in inflows of remittances, the labor exporting economies showed high growth rates, especially in the retail trade and services sectors. The weighted average of annual GDP growth of this group of countries accelerated to 5.6% in Q3 2013 compared with 5.1% in Q2 2013. The non-production sector (retail trade, services and construction) in these and many other CIS economies remained a major driver of economic growth. In Q3 2013 the aggregate growth rate of retail trade turnover in the CIS countries was 5.3%, the same as in Q2 2013 - see Figure 1.4.

Amid an unfavorable external price situation, the aggregate annual growth rate of industrial output in the region was negative (-0.2% in Q3 2013 compared with 0% in Q2 2013). The downturn in industrial output and investment activity has apparently reached its bottom. The rise in the real volumes of major exports in Q3 2013 should lead to a recovery in investment and production activity at the end of 2013 or at the beginning of 2014.

Belarus and Ukraine are included into a group of economies with diversified structures of exports. They experienced a rise in their current account deficits, which reached 8.6% of GDP in Belarus and 10.8% of GDP in Ukraine by the end of Q3 2013 - see Figure 1.3. Their monetary authorities continue the policy of a rigid peg of the national currency to the US dollar. As a result the external imbalances are financed from the international reserves of their central banks, which almost reached critical levels in 2013. In both countries, the deterioration in external sustainability was due to government policy aimed at stimulating domestic demand amid weakening of GDP growth and unfavorable external conditions. In Belarus, it can be related to the incomplete consolidation of the external balance following the 2011-2012 crisis.
Efforts to consolidate public finances helped to stabilize the fiscal situation in most CIS countries. Amid low state budget revenue due to weak external demand, many CIS governments took measures at the beginning of 2013 to adjust their budget expenditure. Those measures resulted in an improvement in the fiscal balances - see Figure 1.5. The CIS countries had an aggregate state budget surplus equal to 1.9% of GDP in Q3 2013, up from 1.8% of GDP in Q2 2013. The successes in the fiscal sphere are largely attributed to regulations that were adopted in some CIS countries to impose restrictions on public spending and other consolidation measures. In the oil and gas exporting countries, budget restrictions regulate the process of receiving and spending oil and gas revenues. In other countries, which are less dependent on the price of export goods, measures to consolidate the budget largely relate to the improvement of tax administration and the imposition of limitations on operating expenses and borrowings. An exception to the general trend was Ukraine, which experienced an increase in the state budget deficit amid a rise in social spending with almost unchanged state budget revenue as a percent of GDP.

The average annual growth of consumer prices slowed to 6% in Q3 2013 from 6.8% in Q2 2013 and 6.5% in Q3 2012 - see Figure 1.6. In the oil and gas exporting economies, lower inflation rates resulted from lower growth rates of the money supply. The considerable deceleration of inflation in Ukraine and Belarus was due to a decline in economic activity. In some of the labor exporting countries, the annual rise in prices slightly accelerated due to the loosening of monetary policy in the previous quarters. Higher inflation rates were also seen in Uzbekistan and Turkmenistan, which indicated the emergence of signs of overheating. The annual rate of growth of money supply slightly accelerated to 16.5% in Q3 2013 from 15.9% in Q2 2013. It was accompanied by the increased economic activity of commercial banks. Nonetheless, the continued stable indicators of commercial banks suggest the controllability of this process.

Figure 1.5. **Government budget**: (in % of GDP)

Figure 1.6. **Monetary sphere**: (in %, year-on-year)

Source: national agencies
The continued trend towards recovery of the world economy should produce a positive effect on the macroeconomic situation in the CIS economies. According to an IMF forecast published in October 2013, the world’s GDP will grow by 2.9% in 2013 with subsequent growth acceleration to 3.6% in 2014. Although forecasts have been revised downward, signs of growth acceleration in global industrial output in the latter half of 2013, give grounds to expect a moderate improvement in the macroeconomic indicators of the economies of developing countries in the years to come. The prices of primary goods will change in directions that reflect the different nature of the factors determining them. In particular, there is expected to be a moderate decline in the price of energy resources and metals, whereas the dynamics of food prices remain vulnerable to the impact of weather conditions.

For the CIS economies, the consensus forecast of international organizations predicts a GDP growth rate of 2% for 2013 and subsequent acceleration to 3% and 3.7% for 2014 and 2015, respectively. To all appearances, the macroeconomic correction will continue in the CIS economies, accompanied by fiscal consolidation amid lower growth rates of export revenue. At the same time economic growth will accelerate in the oil and gas exporting economies (Russia, Kazakhstan, Azerbaijan and Turkmenistan), with the main drivers being the non-primary sectors. The labor exporting economies (Armenia, Kyrgyzstan, Moldova and Tajikistan) are expected to have a gradual decrease in their foreign trade deficit. This will mainly be due to the consolidation of public finances and a steady reduction in the external debt burden. The economies of Belarus and Ukraine have the most uncertain development prospects. In both countries, recovery in balance of payments sustainability requires measures aimed at limiting domestic demand, including the tightening of budgetary policy, and, maybe, external financial support.
Azerbaijan’s economic growth slightly accelerated in Q3 2013. The country’s GDP increased by 5.4% year-on-year in Q1-Q3 2013 in real terms against an increase of 5% in Q1-Q2 2013. A key contribution to the acceleration was made by the oil and gas sector. Its output had a zero annual rise in Q1-Q3 2013 following a decrease of 0.7% in Q1-Q2 2013, and a decrease of 4% in Q1 2013. While remaining high, the rise in output in the non-oil and gas sector slowed down. It was 10.4% in Q1-Q3 2013 compared with 10.9% in Q1-Q2 2013. There was a year-on-year rise of 30% in construction following an increase of 35.5% in Q1-Q2 2013. The rise in fixed capital investment slowed from 22.9% in Q1-Q2 to 19% in Q1-Q3 2013. Agricultural output rose from 4.4% to 4.9%; and retail sales rose to 9.6% in Q1-Q3 2013 after a rise of 9.1% in Q1-Q2 2013.

The rapid growth of private consumption, which is evidenced by the upward trend in retail trade, and the growth in fixed capital investment were supported by rising public spending. It amounted to 29.8% of GDP in Q1-Q3 2013 compared with 27.8% of GDP in Q1-Q3 2012. The surplus in the state budget, including the revenues of the State Oil Fund, amounted to 7.1% of GDP, down from 10.1% of GDP in Q1-Q3 2012. The volume of the State Oil Fund continued to grow, increasing to a total of $35.8 billion (49.5% of GDP in the previous four quarters) at the end of Q3 2013 compared with $34.7 billion (48.3% of GDP in the previous four quarters) at the end of Q2 2013.

Available data suggest that the country’s balance of payments slightly improved in Q3 2013. Azerbaijan had an export surplus of $10 billion (18.3% of GDP) in Q1-Q3 2013, up from 17.3% of GDP in Q1-Q2 2013. Nonetheless, a rise in domestic consumption and a decrease in export revenue led to a fall in the trade surplus compared with Q1-Q3 2012, when it amounted to $18.9 billion (37.2% of GDP).

Inflation stabilized at low levels due to the de-facto fixed exchange rate of the national currency and the decelerating growth of the money supply in the economy. The annual growth of M2 decreased to 19.4% in Q3 2013 compared with 21.7% in Q2 2013 and 25.5% in Q4 2012. The annual growth rate of consumer prices was 2.3% at the end of Q3 2013, up from 1% at the beginning of 2013.

The annual growth of bank lending continued accelerating, reaching 30% at the end of Q3 2013 compared with 28.3% at the end of Q2 2013, and 25.5% at the end of 2012. The ratio of capital to risk-weighted assets rose to 17.3% in Q3 2013 compared with 16.8% at the end of 2012 and the beginning of 2013. The ratio of liquid assets to total assets fell to 11%, the lowest level in at least four years.

Economic growth accelerates in Q3 2013: the country’s GDP increases by 5.4% year-on-year in Q1-Q3 2013 in real terms

The oil and gas sector shows zero annual growth following a decrease in Q1-Q2 2013

The rise in output in the non-oil and gas sector slows down

High growth in private consumption is supported by a higher rise in public spending

The balance of payments slightly improves in Q3 2013 but is worse than in Q1-Q3 2012

Inflation stabilizes at low levels

Growth of bank lending continues to accelerate
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 – Q1 2008 = 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: Slowdown in GDP growth amid weak domestic demand

Armenia’s economy showed relatively poor results in Q3 2013 - GDP grew by only 1.4% in annual terms and by 2.6% in Q1-Q3 2013. The low economic growth rates in Europe and Russia, coupled with limited domestic consumption and declining investment, had a deterrent effect on the economy. There was a negative rise in real wages and a slowdown in bank lending, which rose by 12.6% at the end of Q3 2013. Domestic demand was stimulated only by migrant workers’ remittances, which rose by 10.6%. Investment activity could not recover due to: the long drawn out correction of Armenia’s economic development model after the 2008-2009 crisis; lower than projected public fixed capital investment; and declining foreign direct investment. As a result: the rise in output in the mining industry became a decrease of 1.4%; the rise in the trade sector slowed to 2.7%; and construction fell by 17.4%. A rise of 7.3% in agricultural output had a positive effect on manufacturing industry, which rose by 14.7%, and ensured general positive GDP dynamics.

The balance of payments improved in Q3 2013 due to: expanding export potential; weak domestic demand; and an increase in the financial account surplus. The deficit of the current account balance continued to improve, and amounted to 13.8% of GDP in Q1-Q2 2013. The foreign trade deficit decreased, with exports increasing by 11.5% and imports by 9.4%, despite an average 8.3% fall in copper prices in Q3 2013. The net inflow of remittances grew by 10.6%. The financial account surplus sharply increased due to a successful debut issue by the Armenian government of $700 million worth of Eurobonds in September 2013. As a result, by the end of September, the gross international reserves grew to $2,430.6 million, equal to 7.1 months’ imports, and the dram strengthened a little.

During Q1-Q3 2013, despite a slowdown in economic activity, the state budget had a surplus of 1% of GDP. This was due to: improved tax administration; changes made to tax regulations; and an increase in extra payments from large taxpayers. The growth rate of state budget revenue continued to be high at 17.9% in annual terms, with revenue from all major taxes increasing. A more moderate 8.6% rise in expenditure was due to shortfalls in the implementation of expenditure plans, including plans for fixed capital investment. Total expenditure was 8.4% lower than projected.

The annual inflation peaked at 9.3% in August 2013 due to an increase in the price of imported Russian natural gas, and then fell to 8.2% at the end of September. Owing to the non-monetary nature of inflation in the country, the limited impact of monetary factors (M2 growth had slowed to 10.3%); and slowing economic growth, the central bank did not shift its monetary policy towards toughening. The banking sector’s indicators improved in Q3 2013 despite the low growth rate of lending to key industries. Aggregate assets and liabilities continued to grow. The share of non-performing loans decreased to 5.6%, while the profitability indicators remained modest, with the average ROA (return on assets) rate of banks being 1.3 and the ROE (return on equity) rate standing at 8.0.
**Outlook**

**Armenia: Limited GDP growth, need for reforms**

The Indicator of Economic Activity (IEA) improved to 4.8% in annual terms in October 2013 and to 3.4% in January-October 2013. The industrial and the agricultural sectors, with increases of 14.2% and 8.2% respectively, remained the main drivers of economic growth. Nevertheless, growth was still limited. International organizations have revised downward their GDP growth forecasts and the government expects a growth rate of 4.1%. The revised consensus forecast puts GDP growth in 2013 at 4.5% – the EDB expects a rate of 3.1% – and predicts growth recovery to 4.8% in 2014 after the slowdown in 2013. The government forecasts a growth rate of 5.2% and the EDB expects Armenia’s GDP to grow by 4.8% in 2014, which roughly meets the country’s growth potential.

Armenia’s external public debt is estimated to be 29.7% of GDP, and the gross external debt to be 77.3% at the end of Q1-Q2 2013. It also has continued structural problems with the foreign trade deficit in Q1-Q3 2013 amounting to 28.2% of GDP. These two factors mean that the growth of the gross international reserves through borrowing from external sources and slowing imports cannot be viewed as sustainable. Funds earned by selling Eurobonds had to be used to repay external debts, which led to a decrease in the international reserves in October 2013. The dram should continue to be under pressure and the structural problems regarding Armenia’s balance of payments require more substantial reforms.

The Central Bank of Armenia expects that the state budget will have a deficit of about 1.8% of GDP in 2013 – the forecast was 2.6%. The 2014 state budget includes an increase in operating expenditure without an increase in the tax burden and, consequently, an increase in the budget deficit to 2.6% of GDP. This is above the 2% sustainability level recommended by the IMF. The annual inflation rate fell to 6.6% despite a seasonal acceleration in the rise in prices in November 2013. This allowed the central bank to revise its inflation forecast for 2013 to between 6.5 and 7%. An inflation rate of 2.5 to 5.5% is projected for 2014. A gas supply agreement with Russia, and the abolition of Russia’s duty on petroleum products, will have a positive effect resulting in inflation returning to the projected levels.

The government has carried out structural and institutional reforms; and the ‘2014 Doing Business survey’ ranks Armenia 37th among 189 nations. However the fact that the country has not abandoned the old development model is indicated by: the economic slowdown; a fall in fixed capital investment, which amounted to only 15% of GDP in Q1-Q2 2013 compared with 39.8% in 2008; the downturn in the construction sector; the high inflation rate; the large current account deficit; and the growth of external debt in 2013. Armenia’s leaders face complicated tasks in both the short and the long term. The possibility of using fiscal and monetary instruments is limited; and the country is under the conditions of transport isolation. The government should: try to ensure acceleration in GDP growth; increase the export potential; develop infrastructure; and at the same time solve the acute social problems and reduce the high poverty rate. The decision to join the Customs Union of Belarus, Kazakhstan and Russia should help the government to fulfill the complicated economic tasks that confront it.

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The revised consensus forecast puts GDP growth in 2013 at 4.5%

Downward pressure on the dram should continue and the structural problems regarding the balance of payments require more substantial reforms.

The central bank expects that the state budget will have a deficit of about 1.8% of GDP in 2013 – the forecast was 2.6%.

The central bank revises its inflation expectations for 2013 to between 6.5 and 7%.

The decision for Armenia to join the Customs Union should help the government to fulfill the complicated economic tasks that confront it.
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 – Q1 2008 = 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’ positive economic growth returned in Q3 2013. The country’s GDP grew by 0.7% in Q3 2013 compared with Q3 2012, and by 1.1% year-on-year in Q1-Q3 2013. The growth continued to be primarily due to retail trade and the construction sector, which showed year-on-year increases of 18.9% and 5.9%, respectively, in Q1-Q3 2013. In the same period, the extractive industry output fell by 0.7%, the agricultural sector output fell by 2.3% and manufacturing industries output fell by 4.8%. The largest decreases occurred in the oil refining and chemical industries, whose outputs fell by 21.3% and 26.4%, respectively. Fixed capital investment retained high growth rates, increasing by 10.6% year-on-year in Q3 2013, by 9.3% in Q1-Q3 2013, and by 9.8% in Q1-Q2 2013.

Q3 2013 saw an end to a downward trend in the inflation rate, which was observed throughout Q1-Q2 2013. The annual growth rate of consumer prices fell from 19.8% at the end of June to 15% at the end of August. In August consumer prices rose by only 0.1% amid a seasonal slowdown in food inflation. In September, the rise in prices in Belarus accelerated again: the prices rose by 1.7% in September and by 1.9% in October. The acceleration of inflation followed a series of reductions in the National Bank’s refinance rate. It was last lowered in June to 23.5% compared with 30% at the beginning of 2013. However, it may be premature to conclude that the National Bank’s interest rate policy was the main factor behind the acceleration of inflation. A factor of no less importance was the depreciation of the Belarusian ruble, which accelerated in Q3-Q4 2013.

Belarus’s balance of payments deteriorated in Q3 2013 compared with Q1-Q2 2013. This was amid a marked decrease in exports of petroleum products and a rise in imports, primarily imports of energy resources, which were apparently of a seasonal nature. Also in Q3 2013 there was a considerable increase in the income account deficit due to payments on the external public debt. The current account deficit rose to $1.6 billion (8.6% of GDP) in Q3 2013 following a deficit of $0.7 billion (3.9% of GDP) in Q2 2013. It was 9.3% of GDP in Q1-Q3 2013. The international reserves of the National Bank shrank from a peak of $8.3 billion in May to $7.4 billion at the end of September, and to $6.8 billion at the end of October. The gradual devaluation of the national currency, within the framework of the controlled peg to the US dollar, apparently did not reduce pressure on the international reserves of the National Bank. The rate fell from 8,700 rubles for $1 in the middle of 2013 to 9,300 in November 2013.

The growth of bank lending slowed from 38.9% at the end of Q2 2013 to 37% at the end of Q3 2013. Acceleration in the growth of lending to individuals from 35 to 37.2% was offset by a slowdown in the growth of lending to public non-financial organizations from 51.1 to 42.3%. Nevertheless, the ratio of regulatory capital to assets fell by one point compared with June to 19% at the end of Q3 2013. The share of problem loans slightly grew to 4.6% at the end of Q3 2013 from 4.5% in the middle of 2013.
Outlook

Belarus: Measures to restore external sustainability

The unsteady state of the external balance has been the main problem of the Belarusian economy since at least Q3-Q4 2012. The current account deficit amounted to 8.6% of GDP in Q3 2013, and 9.3% of GDP in Q1-Q3 2013 compared with a surplus equal to 0.1% of GDP in Q1-Q3 2012. The deficit is expected to grow further due to a seasonal rise in imports of energy resources in Q4 2013. The size of the international reserves of the National Bank need to be stabilized. Therefore the government has to choose a set of measures to restore the stability of the balance of payments through the consolidation of domestic demand. These measures may include both steps in the field of monetary policy to limit bank lending to the economy and changes to fiscal policy in the broad sense – these are measures that will increase public revenue and reduce public spending and limit the rise in pay. Additional efforts to attract capital into the country, including through privatization or donor financing, can ease the implementation of these measures but cannot replace them. This is because a capital inflow in itself cannot eliminate the external imbalance of the Belarusian economy.

The need to restrict domestic demand contributes to the prospect of Belarus having a negative GDP growth rate throughout 2014. A decline in activity in the fields of consumption and investment, which had a high growth rate in 2013, will probably not be fully offset by exports. This is due to the slow recovery of growth in the economies of Belarus’ major trading partners. Nevertheless, exports will rise, and some sectors of the Belarusian economy already showed signs of this in 2013. In particular, mineral output resumed growth in Q3 2013, while the chemical industry displayed signs of revival at the beginning of Q4 2013.

The annual rise in consumer prices accelerated to 15.5% in October. This exceeds significantly the government’s inflation forecast of 12% for 2013, which apparently will not be met. As a result the projected inflation figure contained in the government’s Social and Economic Development Forecast for 2014 was increased to 14.5% from 11% in initial versions of the document. Thus the government does not plan to make a considerable additional effort to decrease the inflation rate in 2014. It is going to focus on ensuring that GDP growth recovers to the 3.3% level set out in the Forecast.

In Q1-Q3 2013 the consolidated budget had a surplus equal to 1.4% of GDP, and the federal budget had a surplus equal to 0.3% of GDP (according to data from the finance ministry). This suggests that Belarus will have a moderate budget deficit in 2013. The government expects to have a balanced budget in 2014. It may be more important that the government has set itself a less ambitious target for 2014 than it did for 2013 for the growth of the population’s real income. However, even the relatively moderate projected growth of 3% seems to be hardly realistic considering the current economic situation in the country.
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 – Q1 2008 = 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: High GDP growth amid deterioration in external indicators, problems in banking sector

Kazakhstan’s GDP growth accelerated to 5.7% in Q1-Q3 2013 due to its acceleration to 6.6% in annual terms in Q3 2013. Major factors behind the acceleration included: the continued robust domestic demand stimulated primarily by consumer lending, which increased by 48.6% year-on-year in Q1-Q3 2013; increased investment activity, which grew by 7.9% in real terms; a rise in oil production; and favorable weather conditions. The trade and services sector retained a high growth rate (an increase of 12.6% in trade). There were rises of: 3% in the mining industry; 5.5% in agriculture; and 2.5% in construction. A matter of concern is a slowdown to 1.2% in manufacturing industry, which was caused by a 14% downturn in the iron and steel industry.

The low external demand, a fall in oil and metal prices, decrease in output in the iron and steel industry, a decline in foreign investment, an increase in the outflow of short-term capital during Q3 2013 and a decline in confidence in the national currency had a negative effect on Kazakhstan’s balance of payments. According to preliminary estimates, the state of the current account balance has significantly deteriorated with the deficit increasing to $1.5 billion in Q3 2013. The final balance of payments indicators for Q1-Q3 2013 were affected by the current account deficit, connected with a decrease in the foreign trade surplus and an increase in the secondary income deficit. The current account surplus decreased to $153.1 million (0.1% of GDP) from $3.5 billion in Q1-Q3 2012. As a result, the balance of payments had a deficit of $3.1 billion (2.1% of GDP). The gross international reserves shrank from an amount equal to eight months’ imports in 2012 to an amount equal to six months’ imports at the end of Q3 2013. Confidence in the tenge weakened and the dollarization of the economy accelerated, which led to the expansion of the volatility range of the tenge.

Amid the higher GDP growth rate and a recovery in oil prices in Q3 2013, the rise in public revenue accelerated in September. It increased by 5.7% year-on-year in Q1-Q3 2013 compared with 5.4% in Q1-Q2 2013. The state of public finances generally improved in Q1-Q3 2013. Due to changes made to the budget and high level of unused funds, the growth of public expenditure remained limited at 2.8% while public revenue rose at a higher rate. This led to a relatively small budget deficit of less than 1% of GDP.

The annual inflation rate in Kazakhstan fell to 5.4% by the end of Q3 2013. This was due to a seasonal fall in food prices, which decreased by 3.7% compared with Q3 2012, and an increased high-base effect for services. The inflation rate remained below the National Bank’s target band of 6% to 8%. The contribution of monetary factors to the inflation process continued to be minimal. In particular, the annual growth rate of M2 was only 3.4% at the end of Q3 2013 despite a limited acceleration in the growth of bank lending to 14.7% from 14% in Q1-Q2 2013. Lending was restrained by the prolonged recovery of the banking sector. As of the end of September 2013, outstanding loans made up 29.8% of all loans.
Outlook

Kazakhstan: Favorable growth outlook amid expansion of fiscal stimulus measures

The trend towards growth acceleration will continue in Q4 2013 amid a modest recovery in metal prices in international markets and a seasonal rise in consumption. According to the most recent official statements, GDP growth retained an upward trend. In January-November 2013, Kazakhstan’s GDP rose by 6% year-on-year. This met the government’s expectations, and was considerably higher than the updated consensus forecast of 5.3% for 2013, with the EDB predicting a growth rate of 5.6%.

Kazakhstan’s GDP growth may accelerate in 2014. Oil production should resume in the offshore Kashagan field after technical problems have been solved. Oil prices should remain at a high level. The 2014 budget provides for the expansion of fiscal stimulus packages. The state of the banking sector should improve, which would have a positive effect on investment activity. The negative impact of the downturn in the iron and steel industry on the industrial sector should weaken. The outlook for the non-oil industrial sector remains favorable due to continued government support and improved competitiveness of the economy. The consensus forecast for 2014 predicts a GDP growth rate of 5.6%, with the EDB also putting it at 5.6%, while the government expects a rate of 6%.

In October 2013, due to a continued decrease in the trade surplus, the balance of payments indicators deteriorated further. The tenge’s rate against the multi-currency basket fell but then rose considerably in November 2013. This was because the National Bank set itself the task of keeping the tenge from depreciating, as well as because of global factors and a tax period leading to higher demand for tenge. However, the tenge may slightly weaken by the end of 2013. In 2014, the state of the balance of payments may improve due to a rise in oil production and a relatively favorable global outlook.

In Q4 2013, one should expect acceleration in the growth of fiscal spending, which would lead to an increase in the budget deficit. Updated government projections put the deficit at no more than 2.3% of GDP, while unofficial sources expect a deficit equal to 1.8% of GDP. The state of the public finances of Kazakhstan does not give cause for concern given: the rise in revenue of the National Fund of Kazakhstan; and the surplus in the consolidated budget, which amounted to 4.5% of GDP in Q1-Q3 2013. The government expects that the state budget deficit will amount to 2.4% of GDP in 2014, 2.2% in 2015, and 1.9% in 2016.

The annual inflation rate fell to 4.9% by the end of October 2013, with the National Bank’s target band being 6 to 8%. Inflation will be within the target band by the end of 2013. The top management reshuffle at the National Bank should not lead to substantial changes in monetary policy. For 2014, the National Bank has kept a target inflation band of 6 to 8%, which seems to be realistic. According to the World Bank’s forecast, food prices will continue to decline. The rise in the foreign trade surplus will be limited, which will be a restraining factor for the growth of the money supply. The prolonged process of the banking system’s recovery will continue to restrain the growth of bank lending to the economy, which will weaken the impact of monetary factors.
**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 – Q1 2008 = 100)

Source: national agencies, IMF

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

Source: national agencies, EDB

**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: Rise in foreign trade deficit amid double-digit growth rate and improvement in fiscal sphere

Kyrgyzstan’s annual GDP growth accelerated in Q3 2013 to 10.5%. Output recovery at the Kumtor gold mine after 2012’s slump had a positive impact on the dynamics of industrial output, which increased by 36.7% (year-on-year) in Q3 2013. Without taking into account the companies involved in the development of the Kumtor deposit, the GDP rose by 7.3% (year-on-year) despite a decrease in output in the textile and the food industries under the influence of weak external demand. The main contribution to GDP growth was traditionally made by the retail trade and services sector, which had an annual growth rate of 8.5%. A major contribution to the current positive economic dynamics was made by the 8.8% rise in the agricultural sector, and the 31.2% rise in the construction sector.

Despite the double-digit growth rate, the economy of the country continued to be affected by external trends. Low world prices for Kyrgyzstan’s major export commodities (gold, foodstuffs and textiles) led to a decrease in the volume of exports. Also a rise in domestic consumption and an inflow of foreign investment led to an increase in imports. The foreign trade deficit in Q3 2013 amounted to 57% of GDP. The net inflow of cash remittances amounted to 26.6% in Q3 2013, down from 30.4% in Q2 2013 and 27% in Q3 2012. The annual growth rate of remittances from abroad also decreased, falling to 6.8% from 8.2% in Q2 2013, and 14.5% in Q3 2012.

A positive feature of 2013 was the decrease in both the fiscal deficit and the external debt of the public sector. The state budget had a deficit equal to 3.7% of GDP in Q3 2013 compared with 8% of GDP in Q3 2012. The improvement was due to both an increase in budget revenue and reduced capital investment. Amid a rise in imports, the main contribution to state budget revenue was made by value-added tax on imports, excise taxes and customs duty. The revenue from income tax and profit tax decreased. The dynamics of operating expenditure (19% of GDP) was supported by the government’s social obligations, whereas investment spending decreased due to a revision of the program of external borrowing.

The annual inflation rate fell to 6.7% in Q3 2013 from 7.6% in Q2, and 7.7% in Q1. The monthly dynamics of inflation show that food prices traditionally showed an increase after the end of summer. Base inflation (7.2%) stood at a level higher than the general inflation, which made the National Bank conduct a cautious monetary policy. The National Bank’s rate was somewhat higher than its level in Q1-Q2 2013, while the growth of the money supply slightly slowed to 20.2%.

Amid economic activity there was a rise in demand for loans. Bank lending grew by 38% in annual terms. Meanwhile indicators for the quality of the banking sector’s assets remained satisfactory - as of September, the share of classified loans were 5.8% of the aggregate loan portfolio.
Outlook

Kyrgyzstan: GDP growth of 7.2% for 2013, subsequent slowdown to 5-6%

Kyrgyzstan’s GDP grew by 10.8% year-on-year in the first 11 months of 2013. The country’s current high economic growth rate was primarily driven by: gold production with 50% of the output target for 2013 is expected to be produced at the Kumtor mine in Q4 alone; the low base of 2012; the fact that manufacturing industry experienced a decrease of 27.2% in 2012; and agriculture and non-tradable sectors (construction, retail trade and services). If the government reaches an agreement in its negotiations with Canadian-based gold mining and exploration company Centerra Gold, there will be a greater chance of a high GDP growth rate (more than 8%) being retained until the end of 2013. The current consensus forecast predicts Kyrgyzstan’s GDP growth rate to be 7.2% in 2013 and then moderating to 6.3% in 2014, and to 5.3% in the medium term.

Inflation slowed sharply by November 2013, with the annual inflation rate being 4.4%. Despite the expected traditional rise in prices in December, the annual inflation rate will apparently remain at the level predicted by the National Bank (5% or below). The National Bank forecasts an inflation rate of 6.5% for 2014. In recent years, the country’s central bank has taken measures to adjust its monetary and lending policies. In particular, the National Bank has reduced to the minimum its participation in the inter-bank foreign exchange market and strengthened its instruments for liquidity management.

Positive changes in fiscal policy are less obvious. Figures forecast for 2014 and 2015 show that the government has certain control over operating expenditure, which remains at a constant level or decreases as a percent of GDP. However, the projected expenditure has been increased, which makes it dependent on the dynamics of state budget revenue and the receipt of foreign loans. In addition, the parliament of Kyrgyzstan has adopted a regulation imposing a limitation on the size of the external debt, setting it at 60% of GDP for the medium term. The external public debt amounted to $2.8 billion, or 42% of GDP, in June.

There is a need for sustainable growth given: the significant vulnerability of the economy to external and domestic shocks; the high level of the external public debt; and the high dependence of the economy on the inflow of cash remittances. Continued positive GDP growth would allow the government to meet its current liabilities to creditors, carry out reforms, and counter domestic and external shocks. According to the IMF, if the country’s economic growth is steady then its external debt will remain at a stable level in the medium term. The current imbalance between savings and investment will gradually decrease. A further consolidation of fiscal policy and measures to increase its efficiency would help to reduce the state budget deficit, and provide sufficient incentives for the development of the private sector.
Kyrgyzstan

Figure 6.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

![GDP and output chart]

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 – Q1 2008 = 100)

![Foreign trade chart]

Source: national agencies

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

![Government sector chart]

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)

![Monetary sector chart]

Source: national agencies

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

![Economic growth chart]

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)

![Savings and investments chart]

Source: estimates and forecasts by national agencies, the IMF and the EBD
Trends and outlook
Moldova: Steady growth rate due to manufacturing and external trade

In Q3 2013, stable growth trends emerged in the economy of Moldova especially in: the agricultural sector; the manufacturing sector (the food, chemical, electrical machine-building and metallurgical industries); and foreign trade (exports of farm produce, foodstuffs and textile goods). Agricultural output increased by 85% year-on-year. This was largely due to the low base of 2012 - there was a slump of 60.3% in Q3 2012. The volume of remittances from abroad grew by 8.8% year-on-year, and real salaries rose by 5.5%, which gave an impetus to domestic demand. Fixed capital investment increased by 22.6%, with FDI making up a considerable part. In Q1-Q2 2013 FDI increased by 50%. The government expects an economic growth rate of 5.5% for 2013 compared with a decline of 0.8% in 2012. International organizations have revised upward their GDP growth forecasts for 2013 but lowered their forecasts for 2014. The final consensus forecast for GDP growth is 4.5% for 2013, and 4 to 5% for 2014. The short-term prospects of economic growth for Moldova are characterized by uncertainty. They depend on the dynamics of the economies of European and CIS countries, with structural problems impeding long-term growth.

The annual inflation rate was 3.9% in September 2013 and rose to 4.9% in November. The National Bank of Moldova raised its forecast for the average annual inflation rate due to a rise in transportation tariffs in November, and increases in the utility rates in August and September. For the following eight quarters, the inflation rate is forecast to be within plus or minus 1.5 points around the target of 5%.

The revenue of the national (consolidated) public budget in Q3 2013 was 5.5% higher than in Q3 2013, whereas expenditure grew by 9.4%. The state budget had a deficit of 192.2 million lei, or less than 1% of GDP. The budget deficit in Q1-Q3 2013 amounted to 0.9% of GDP, which met the government’s expectations. The public debt grew by 7.7% since the beginning of 2013, primarily due to internal borrowings, which increased by 6.1%. The external public debt increased by $12.1 million, or 1%. The gross external debt grew significantly and the rise was due to an increase in the private sector’s liabilities.

The annual growth rate of bank lending was 14% in September 2013. The main contribution to the growth of lending was made by: commercial loans; loans provided to the food industry; and consumer loans. By September 2013, the average interest rate of loans in national currency reached an all-time low of 11.79% per annum. At the same time the quality of the aggregate loan portfolio remained as it was at the end of 2012. The share of NPLs in the total volume of loans was 14.5% in September, and indicators for profitability and capital adequacy improved. The average ROA (return on assets) rate of banks was 2 and the ROE (return on equity) rate was 10.5, while the capital adequacy ratio was 24.6%.
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 – Q1 2008 = 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
Trends

Russia: Recovery in exports of primary commodities, decline in investment, steady consumption growth

The economic situation in Russia did not generally change during Q3 2013 compared with the spring and early summer of 2013. The recovery in exports continued following the decrease in Q1 2013. Exports of most of the main Russian primary commodities increased in physical terms compared with Q3 2012. The growth of household consumption may have slightly accelerated compared with Q2 2013, as the dynamics of retail sales suggests. The annual growth rate of retail sales was 3.8% at the end of Q3 2013 against 3.5% at the end of Q2 2013. At the same time fixed capital investment showed a negative growth rate, decreasing by 1.2% year-on-year in Q3 2013, and by 1.4% year-on-year in Q1-Q3 2013.

At the end of Q3 2013 there continued to be a moderate positive annual growth rate in the extractive industries of 1.4%; the manufacturing industries had an output decrease of 0.8%; the agricultural sector had an annual growth rate of 1.6% following an increase of 1.8% at the end of Q2 2013; and the construction sector had a zero annual growth rate after a 3.6% year-on-year decrease in Q2 2013.

As a result, the decrease in fixed capital investment and inventories offset the positive contribution made to the general growth by exports. The annual GDP growth rate was 1.2% at the end of Q3 2013, which was the same as at the end of Q2 2013. GDP grew by 1.3% in Q1-Q3 2013.

The current account surplus in Q3 2013 amounted to $1.1 billion compared with $5.8 billion in Q3 2012. The decrease occurred as the investment income deficit expanded from $11.6 billion to $15.9 billion, while the trade surplus slightly decreased from $23.1 billion to $22.8 billion.

The federal budget had a surplus of 653 billion rubles (1.3% of GDP) in Q1-Q3 2013 compared with a surplus amounting to 1.5% of GDP in Q1-Q3 2012. Budget revenue and expenditure decreased simultaneously year-on-year as a percent of GDP.

Inflation slowed down in Russia during Q3 2013. The annual growth rate of consumer prices fell from 6.9% in June to 6.1% in September, coming closer to the upper boundary of the target band of 5 to 6%, which had been set by the Bank of Russia for 2013.

The annual growth of bank lending slightly accelerated in Q3 2013, reaching 33.8% at the end of September compared with 30.1% at the end of June. While the growth of corporate lending accelerated from 13.2 to 13.8%, the growth of lending to private individuals slowed from 33.5 to 30.5%. The sustainability indicators of the banking sector did not change much compared with Q2 2013. The ratio of capital to assets was 13.4% at the end of September, slightly down from 13.5% at the end of June. The share of problem loans did not change in Q3 2013, standing at 6.3%.

The general economic situation does not undergo change compared with the spring and early summer of 2013

Fixed capital investment shows a negative growth rate again

The extractive industries retain positive growth rates, while the manufacturing sector experiences a decline in output

The current account surplus diminishes due to a rise in the investment income deficit

The federal budget has a surplus equal to 1.3% of GDP in Q1-Q3 2013

Inflation slows down throughout Q3 2013

The annual growth of bank lending accelerates in Q3 2013
Outlook

Russia: GDP growth acceleration amid recovery in investment activity, inventory restocking

The unimpressive economic outcomes of Q1-Q3 2013 suggest that Russia will have a modest GDP growth rate for 2013, although Q4 2013 will probably see acceleration in economic growth. The most evident factor leading to the acceleration is a rise in agricultural output. Contrary to forecasts the rise did not take place in Q3 2013 because the harvesting season in the European part of the country began about a month later than usual due to unfavorable weather conditions in the early autumn. The recovery in the growth rate of investment in both fixed capital and inventories is a less evident factor but a longer-term one. The key role of a decline in investment activity for the current slowdown in GDP growth makes us think that the slowdown is primarily cyclical.

Q3 2013 confirmed the apprehension that the inflation rate might exceed the central bank’s target band. After a slowdown in the rise in consumer prices to 6.1% in September, the annual growth of consumer prices accelerated again to 6.3% in October. Despite the role of food prices in this acceleration, which indicates that it may not last long, the rise in the inflation rate makes it impossible that the central bank’s inflation target for 2013 will be met. This means that the central bank may loosen its policy relatively late into 2014 at the earliest, and will not take measures to ensure that inflation decelerate to levels close to the 5% target set for 2014. The boundaries of the target band were set at 3.5 to 6.5%. The achievement by the central bank of its inflation objectives will be eased by the government’s decision to freeze or limit the rise in government-regulated rates, which was made with a view to supporting economic growth.

In Q3-Q4 2013, the government made important decisions in the field of fiscal policy as a result of a downward revision of official forecasts for GDP growth, and the need to abide by the “budget rule.” The Law on the Federal Budget for 2014 and the 2015-2016 Period provides for a lower level of spending than was provided for by the Law on the Federal Budget for 2013 and the 2014-2016 Period: 13.96 trillion rubles (19.0% of GDP), against 14.21 trillion rubles (19.2% of GDP). The respective figures for 2012 were 13.39 trillion (20.1% of GDP). Up to 150 billion rubles (0.1 to 0.2% of GDP) in resources of the National Welfare Fund is expected to be invested in a number of infrastructure projects. As the spending of resources of off-budget funds is also planned to be cut, public spending is expected to be reduced by an amount equal to some 2% of GDP against 2013, which will be to a limited extent compensated for by the investment of resources from the National Welfare Fund.

Thus the current economic situation gives grounds to expect a recovery in economic growth following the slowdown in 2013, which will be constrained by relatively tight fiscal and monetary policies. Under such circumstances, GDP may grow by 2.5 to 3% in 2014 amid the continued stability of the balance of payments and public finances.
Russia

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

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 – Q1 2008 = 100)

Source: national agencies

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

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)

Source: national agencies, IMF (IFS)

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

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)

Source: estimates and forecasts by national agencies, the IMF and the EBD
Tajikistan: Economic growth supported by retail trade and services amid decline in industrial output

Tajikistan’s annual economic growth rate remained unchanged at 7.2% in Q3 2013 despite a 0.9% decrease in industrial output. World prices and demand for aluminum and food had been low since 2012. This led to a 6.4% decrease in the metallurgical industry’s output, and a 13.5% fall in output in the food industry. A recovery in cotton prices in world markets made it possible – after a prolonged decline – to increase the textile industry’s output. It rose by 10.6% compared with a decrease of 6% in Q1 2013, and a 16% decrease in Q2 2013. Economic growth was ensured by retail trade (a rise of 25.2%) and services (a rise of 16.8%), which were supported by the inflow of cash remittances. In Q1-Q2 2013, remittances from Russia to Tajikistan amounted to 44% of GDP. Fixed capital investment grew by 30.9% in Q3 2013, primarily due to a rise in public investment in energy and transport infrastructure, and also in housing construction.

Low external demand for Tajikistan’s major export commodities led to a decrease in exports. Continued high domestic demand, supported by remittances from abroad, led to a rise in imports, primarily imports of goods for personal consumption. There was a rise of 22.6% in average real pay. As a result, the foreign trade deficit increased to 30% of GDP in Q3 2013 compared with a deficit equal to 27% of GDP in Q3 2012.

State budget expenditure increased in Q3 2013 due to public investment (8.9% of GDP), and increases in pensions and pay for public employees in September 2013. The state budget had a deficit of 0.7% of GDP in Q3 2013 despite the fact that the rise in the population’s real income and imports stimulated tax revenue - the most considerable contribution was made by income tax, profit tax and VAT. However, there was a surplus equal to 0.9% of GDP in Q1-Q3 2013.

The dynamics of inflation was determined by a decline in food prices. The annual growth rate of consumer prices was 4.4% at the end of Q3 2013; and the average inflation rate for Q1-Q3 2013 was 5.6%. This allowed the National Bank to slightly loosen its monetary policy, lowering the refinancing rate to 5.5% by the end of September from 6.5% at the beginning of 2013. Non-food goods had a greater role in the September inflation, while the base inflation rate (excluding the contribution of potatoes, flour and fuel) exceeded the indicative price rise.

The annual growth of bank lending accelerated to 40.4% in Q3 2013. The rise in lending was accompanied by an increase in external debts owed by private companies. The private sector’s external debt grew by $82 million, or 6%, in Q1-Q2 2013. In Q3 2013, the share of classified loans in the aggregate loan portfolio increased from 18% in June to 21% in September. The coverage of loans with deposits steadily fell to 0.7 at the end of September, while the degree of dollarization of lending (the share of foreign-currency loans) remained at 61%.
Outlook

Tajikistan: Consensus forecast predicts growth slowdown to 6% in medium term

Data for the first 11 months of 2013 show that industrial output kept declining because of the continued stagnation in the light and metallurgical industries. The retail trade and services sector will apparently remain the main driver of economic growth in 2013. However, according to data from the central bank of Russia, amid a slowdown in economic activity in Russia, the growth rate of remittances from the Russian Federation to other CIS countries was only 8% in Q3 2013 compared with 17% on average in 2012 and Q1-Q2 2013. The government expects Tajikistan’s GDP to grow by 7.4% in 2013 and by 7.5% in 2014. However international donors have revised downward their forecasts for economic growth for both 2013 and the medium term. The current consensus forecast for GDP growth is 7.1% for 2013 with subsequent slowdown to 6% in 2014 and 2015.

The annual inflation rate was 3.5% in November 2013. The contribution of non-food goods was 1.9%. The base inflation rate rose to 4.3% excluding the impact of some foodstuffs and fuel, which account for about 25% of the consumer basket. The National Bank has set an inflation target of 7.5% for 2014, which meets the consensus forecast of international organizations. The dynamics of prices in Tajikistan remains vulnerable to the influence of world prices of petroleum products and food, which the World Bank forecasts will continue to be rather stable.

The situation in the banking sector is the main short-term risk factor. The annual growth rate of bank lending was 42.5% in October 2013. Apart from the growing burden of non-performing loans, a matter of concern is the rapid growth of the share of outstanding loans in the aggregate loan portfolio of banks. They made up 6.5% at the beginning of 2013, and reached the 10% mark by October. An increasingly large contribution to the growth of lending is made by loans in foreign currency. A slow rise in the volume of deposits leads to the widening of the gap between the deposit base and the volume of loans issued by banks. To all appearances, the rise in lending in recent months is attributable to the increased external liabilities of the banking sector.

The government expects the total volume of tax revenue in 2014 to amount to about 21% of GDP, whereas tax revenue in 2013 is expected to be at 20.1% of GDP. Social spending and fixed capital investment in infrastructure continue to be major expenditure items. There is a relatively low level of investment in the Tajik economy – the World Bank estimates it at about 18% of GDP – with government sources accounting for the greater part, and private investment amounting to only around 6% of GDP. The small size of the private sector, which could become the main driver of long-term economic growth, is the main structural problem for Tajikistan’s economy.
Tajikistan

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

Source: the Agency on Statistics 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 – Q1 2008 = 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
**Trends and outlook**

**Turkmenistan: Gas and government determine development model**

Turkmenistan’s economic growth accelerated to 10.6% in annual terms in Q3 2013. The country’s GDP increased by 10% in Q1-Q3 2013. Amid a substantial weakening in external demand, the main drivers of economic growth were: the government’s investment policy; the expansion of gas export routes; infrastructure construction; and the government’s policy aimed at increasing the population’s income, which was financed with hydrocarbon export revenues accumulated in buffer reserves, and supported by targeted bank lending. The annual growth rate of budget expenditure was 27.3% at the end of Q3 2013.

The growth of fixed capital investment slowed down in Q3 2013 (from 7.9% in Q1-Q2 2013 to 7.2% in Q1-Q3 2013) but this did not prevent GDP growth from accelerating. Fixed capital investment amounted to 46.5% of GDP, with 63.9% of the total amount going into the production sphere. Investment priorities include: many parts of the manufacturing sector; infrastructure construction (the construction sector rose by 20.4%); and the gas industry (data for gas production are not available). In Q3 2013 there was a large increase in the output of fabrics, textile and knitted goods, and building materials, with cement output increasing by 89.9%, and bitumen output by 51.1%. The growth rate was 3.3% in the power generation industry, and oil production increased by 1.4%. The growth of crop production should have accelerated as wheat output increased by 37.5%. The growth of livestock production remained very limited. The growth rate of retail trade kept high at 19.6%, with a 10.9% rise in average pay being one of the reasons.

Paradoxically, amid increased gas production and the expansion of new export routes to China and Iran, Q1 2013 saw a decrease in exports. Natural gas, oil and petroleum products account for 90.1% of exports, which were 12% in Q1-Q3 2013, and 13.4% in Q1-Q2 2013. Amid robust domestic investment demand, the growth of imports accelerated to 15.6% against 15.1% in Q1-Q2 2013. The decrease in exports led to a fall of 5.1% in fiscal revenue in annual terms. Nevertheless, the export surplus should have remained significant. The volume of fiscal revenue in Q1-Q3 2013 was 20.7% higher than projected. Since budget expenditure totaled 96% of the projected amount, the state budget will presumably have a surplus. As for inflation, it is difficult to gauge its rate for an administratively regulated economy due to the lack of reliable data.

There is a possibility that the price of hydrocarbons may fall. However gas production is beginning in the Galkanysh field, the world’s second largest with reserves estimated at 26 trillion cubic meters. There are also steadily expanding opportunities for gas exports to new destinations - China, Iran, Europe and Afghanistan, Pakistan and India - under the TAPI pipeline project. These two factors will continue to provide the leadership of the country with the necessary financial resources. The government plans to triple the volume of gas production within the next two decades. This remains the basis for the government investment and social policies currently in place. Accordingly, the Turkmen economy’s prospects from the standpoint of GDP growth, fiscal revenue and external sustainability remain favorable. In the short term, according to a revised consensus forecast, the country’s GDP will grow by 10% in both 2013 and 2014. Judging by the budget estimates for 2014, the government expects a GDP growth of 11%.
Turkmenistan

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

![GDP growth chart]

Source: national agencies

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

![Foreign trade chart]

Source: IMF

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

![Government sector chart]

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)

![Monetary sector chart]

Source: national agencies and the ADB

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

![Economic growth chart]

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)

![Savings and investments chart]

Source: estimates and forecasts by the IMF
**Trends and outlook**

**Uzbekistan: Government actively stimulates development**

Uzbekistan’s GDP growth rate continued to be high at 8.3% in Q3 2013 compared with Q3 2012. GDP growth was 8.1% in Q1-Q3 2013. The continued high growth rate was attributable to robust domestic demand stimulated by the government’s economic policy, bank lending and private cash remittances. The expansion of export routes for natural gas gave an additional impetus to economic dynamics. In Q1-Q3 2013, the annual growth of government investment accelerated to 12.5% and the growth of average pay and average pension increased to 17.3% and 27.8%, respectively. The aggregate real income of the population rose by 15.9%.

Growth rates remained high in almost all sectors due to government efforts aimed at: increasing economic competitiveness; diversifying and modernizing the economy; raising the population’s living standards; and increasing construction of infrastructure. 2,200 production facilities were put into operation, and $201.1 million worth of worn-out equipment was replaced in Q1-Q3 2013. There was a growth rate of 9.4% in the industrial sector, due to high output figures in the machine-building, building materials and light industries. The growth in other sectors was: agriculture 6.8%; retail trade 14.7%; services 13%; construction 19.2%.

The trade surplus significantly increased in Q3 2013 due to measures taken by the government to expand export potential. Since the beginning of 2013, Uzbekistan began to export more than 260 new products, and 469 more companies became involved in exports and import substitution. Output in 1,089 production localization projects increased by 40% in annual terms. There was also a good cotton harvest (3.35 million metric tons), and a rise in world prices for Uzbekistan’s major export commodities. Cotton prices rose by 9.1% and natural gas prices increased by 3.3% in annual terms in Q3 2013, which compensated for a decrease in gold prices. As a result, the rise in exports accelerated to 13% in Q1-Q3 2013. Since imports, limited by administrative measures, rose by only 4.9%, the country had an export surplus of more than $1 billion. Given the growth of foreign investment, which increased by $1.4 billion (12.4%) in Q1-Q3 2013, the probability of Uzbekistan retaining a balance of payments surplus is considered to be high.

The increased export revenue and the high GDP growth rate led to a state budget surplus equal to 0.2% of GDP in Q1-Q3 2013. The official inflation rate remained within the projected band of between 7 and 9%. However, given the excessive stimulation, the real inflation rate should have been at a higher level. International organizations estimate it to be 11% for 2013.

The short-term outlook for Uzbekistan’s economic dynamics remains favorable. The consensus forecast, based on forecasts from the IMF, the World Bank, the EBRD and the Asian Development Bank, predicts a GDP growth rate of 7.5% for 2013. This is close to the government-expected 8% growth. In 2014, GDP growth will remain high due to the expansion of fiscal policy. According to an updated consensus forecast, the country’s GDP will grow by 7.1% in 2014, whereas the government expects a growth rate of 8.1%.
Uzbekistan

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

Source: national agencies

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

Source: national agencies

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

Source: national agencies

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)

Source: national agencies and the IMF

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

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

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

#### Ukraine: Balance of payments deterioration amid looser monetary policy, decrease in international reserves

Ukraine’s economy continued to decline in Q3 2013. The country’s GDP decreased by 1.3% compared with Q3 2012 following a 1.3% year-on-year decrease in Q2 2013. This was amid a slowdown in retail trade and agricultural output, which had rises of 9.8% and 3% in Q1-Q3 2013 after rises of 11.2% and 15.4% in Q1-Q2 2013. There was simultaneously a recovery or an improvement in the industrial and the construction sectors, which had output decreases of 5.2% and 5.3% in Q1-Q3 2013 compared with decreases of 15.1% and 17.8% in Q1-Q2 2013, respectively.

The country’s balance of payments deteriorated considerably again after an improvement in Q1-Q2 2013. In Q3 2013 there was a current account deficit of $5.2 billion, which was equal to 10.8% of GDP. The current account deficit thus amounted to $10.2 billion in Q1-Q3 2013, up from $9.6 billion in Q1-Q3 2012. Under the conditions of the de facto fixed exchange rate of the Ukrainian currency, the hryvnia, the current account deficit was financed through dipping into the international reserves of the National Bank. The reserves shrank to $21.6 billion, or 2.4 average months of imports of goods and services in Q3 2013, as of the end of September. This is compared to $23.2 billion, 3.1 average months of imports in Q2 2013, at the end of June.

Meanwhile, the National Bank reduced the refinance rate in August, continuing the move it began in June. Money growth in the economy accelerated. The volume of M2 at the end of September was 19.2% higher than in September 2012. The annual growth rate of M2 was 17.9% at the end of June 2013, and 14.2% at the end of December 2012. The loosening of monetary policy took place amid the continued rigid pegging of the hryvnia to the US dollar. The national currency’s rate fluctuated within a narrow range around the mark of 8.1 hryvnia for one US dollar throughout Q3 2013. Inflation did not react to the change in the National Bank’s policy, continuing to have negative annual growth rates through Q3 2013 (-0.5% in September).

The situation in the fiscal area remained difficult. The state budget deficit during Q1-Q3 2013 amounted to 35.2 billion hryvnia (3.4% of GDP), compared with 2.4% in 2012 and 0.9% of GDP in 2011. The growth of the deficit throughout the past two years was primarily due to a rise in public expenditure, which increased from 25.6% of GDP in 2011 to 27.3% in Q1-Q3 2013. State budget revenue amounted to some 24.0% of GDP in Q1-Q3 2013 after standing at a level of 24% of GDP in Q1-Q3 2012 and 2011. Against the backdrop of the ongoing recession, the size of public revenue turned out to be more stable than the nominal size of GDP.

The annual growth of bank lending to the economy accelerated to 6.6% at the end of September compared with 4.4% at the end of June. Meanwhile, the share of problem loans in the total volume continued to decrease, shrinking from 15.2% at the end of Q2 2013 to 14% at the end of Q3 2013. Other sustainability indicators of the banking sector generally somewhat deteriorated. In particular, the capital adequacy ratio fell from 18% in Q2 to 17.9% in Q3 2013.

GDP diminishes by 1.3% in real terms amid a slowdown in growth in trade and the agricultural sector, and stabilization in the industrial sector and construction

The balance of payments deteriorates significantly again after an improvement in Q1-Q2 2013

The National Bank lowers the refinance rate again in August

Inflation continues to have negative growth rates

The state budget deficit in Q1-Q3 2013 amounts to 35.2 billion hryvnia, or 3.4% of GDP

The annual growth of bank lending to the economy accelerates to 6.6%
Outlook

Ukraine: High degree of economic uncertainty

The balance of payments deterioration in Q3 2013 means that the progress in its strengthening that occurred during Q1-Q2 2013 proved to be unsustainable. One of the factors that determined the deterioration in the balance of payments was a rise in imports of natural gas from Russia, which almost ceased in Q1 and Q2 2013. The government-declared policy aimed at increasing the country’s energy independence thus had a limited effect. It is difficult to determine the real degree of its influence on the balance of payments because imports of gas were uneven throughout 2013. It is very likely that Ukraine will soon pass the peak in gas purchases, and then have a period in which the pressure of imports of energy resources on the balance of payments will be relatively weak. Ukraine could have at least a six-month relatively calm period for taking measures to improve its external sustainability. This is providing there are no any additional negative shocks that would affect Ukraine’s export revenue, budget situation, banking sector, and the access to international financing in 2014.

Such measures would be naturally expected to include steps aimed at decreasing the budget deficit. The state of public finances is less dramatic than could be expected considering the general economic situation with budget revenue being at a rather high level as a percent of GDP. As is mentioned above, the budget deficit is caused by the higher growth rate of expenditure. The volume of expenditure as a percent of GDP is close to the highest level since at least the mid-2000s, if not earlier. One can assume that the government has opportunities to reduce its spending from the current high levels.

The results of the measures taken in late Q2 and in Q3 2013 in the field of monetary and lending policies require analysis. There are no grounds to say that the reduced refinance rate caused the balance of payments to deteriorate and the international reserves to resume shrinking in the past few months. Nevertheless, loosening the National Bank’s policy without making the hryvnia exchange rate more flexible was a risky move. If the fall in the international reserves accelerates, the monetary authorities may encounter a need to raise the refinance rate to the previous level or a higher one. Abandoning the hryvnia peg to the US dollar could be an alternative solution, but the current period of high uncertainty in the Ukrainian economy is probably not a very good time for such a step.

Contrary factors are expected to influence the dynamics of the country’s GDP throughout 2014. The general normalization of the economic situation in the region will help a recovery in growth, especially in sectors with a high export-output ratio, such as the iron and steel industry, machine-building and agriculture. At the same time, the inevitable consolidation of domestic demand will have a negative impact on economic activity. The recent sharp increase in political tensions in the country may lead to the influence of negative factors on the economy becoming predominant.
Ukraine

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

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 – Q1 2008 = 100)

Source: national agencies

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

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)

Source: national agencies

Figure 12.5. **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 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)

Source: estimates and forecasts by national agencies and the IMF
Medium-term outlook for primary commodity markets

Arman Ahunbaev

I. A fall in the price of commodities in 2013 led to a deterioration in the economic situation in many post-Soviet countries

External and budgetary stability and also the general economic dynamics in most of the CIS member countries have a strong dependence on export revenues received from trade in various primary commodities. These can be divided into three large groups: (1) energy resources (crude oil, natural gas and coal); (2) metals and derivatives (copper, aluminum, alumina, gold, ferrous ore, steel, etc); (3) agricultural and food materials (cotton, wheat, etc).

In order to understand the prospects of the economies of post-Soviet countries, it is necessary to have an idea of the current situation and prospects in international primary commodity markets. These markets determine the price of commodities strategically important for the region’s economies.

A gradual fall in the price of all major categories of primary commodities can be viewed as the main trend for primary goods in the first 11 months of 2013. This is attributable to a general slowdown in demand from developing economies amid the gradual recovery of the economies of developed countries. This slowdown: had a negative impact on the dynamics of the CIS economies; led to a decrease in export and fiscal revenues; caused a slowdown in activity in the industrial sector; and, in certain cases, created some tension with regard to the balances of payments in the region. The World Bank’s global price index for energy commodities (crude oil, natural gas and hard coal) declined in Q3-Q4 2013 after a short-term leap in Q3 2013. The leap was caused by the expansion of the Syria conflict, and by a decrease in production in Iraq and Libya. The index eventually stabilized at the level of the last three years. The decline spread to all categories of non-energy commodities and precious metals. The global price index for non-energy commodities retained a downward trend, which began in Q3-Q4 2012 and continued throughout 2013.

II. A limited fall in oil and gas prices amid a rise in coal prices

The baseline scenario outlook for the dynamics of commodity prices rules out major shocks from both the supply and demand. The consensus forecast for the period between 2013 and 2017 predicts a limited fall in the price of crude oil and natural gas. Coal prices should rise from the current low levels because of acceleration in the process of replacing oil with alternative sources of energy. There is a growing demand for oil...
from developing countries that are not members of the Organization for Economic Cooperation and Development (OECD). Major factors influencing the energy market and leading to a decline in oil prices will include: a rise in the production of conventional oil – including in non-OPEC countries – and especially in the production of unconventional oil; and the growing energy efficiency, which also includes the process of replacing oil with alternative sources of energy. It is also expected that: on the one hand, prices will not drop below the maximum costs of the extraction of extra-heavy oil from bituminous sands in Canada ($80/bbl in constant 2013 dollar terms); and on the other hand, the OPEC countries will retain the policy of limiting oil production, maintaining its volume at a rather high level while not fostering the process of replacing oil with new sources of energy. According to the median consensus forecast, the price of Brent crude will be $105 per barrel in 2014, $103.5 in 2015, $102 in 2016 and $93.5 in 2017.

III. A gradual fall in the price of precious metals (gold and silver) amid a rise in the price of industrial metals

Market prices of precious and industrial metals will have different trends and dynamics, reflecting the different nature of factors determining them. In particular, the possible medium-term decline in the price of precious metals used as reserve assets is attributable to positive assessments of the world economy’s prospects, and less pessimistic perceptions of relevant global risks. The consensus forecast predicts that gold prices will fall to $1,275 per ounce (by 10% in annual terms) in 2014 and further decline to $1,178 by 2017. The dynamics of silver prices will be generally comparable to the dynamics of gold prices.

The situation regarding industrial metals is not simple. The dynamics will be largely determined by the economic performance of developing countries, especially China, which accounts for 45% of the world’s metal consumption. The world reserves of many metals are currently at the maximum level as a result of considerable investment in the last few years. This will result in market demand being quickly satisfied, and cause constant downward pressure on the price of industrial metals. In the medium term, despite the positive outlook for the Chinese economy, the downward pressure on prices will have a greater effect on the iron and steel industry - prices may additionally drop by 26% by 2016 compared with the 2013 level. The price dynamics will be different for non-ferrous metals, such as aluminum, copper, nickel and zinc, which are used in more complicated industrial production processes such as machine-building and electronics industries. According to the consensus forecast, there will be an 8% decrease in copper prices by 2017. For almost all other non-ferrous metals, one should expect a steady rise in prices, which is predicted to last until 2017. In particular, prices are expected to rise by 20% for aluminum, 16% for zinc, and 19% for nickel.
IV. Prices of agricultural products and food to fall in the short term and resume rising in the medium term (until 2017)

Weather conditions are the main factor that determines the price dynamics of agricultural products and food. Other factors are: the price of hydrocarbons, including biofuels; macroeconomic conditions; and trade policies. Various forecasts suggest that in the short term – 2014 - the production of major agricultural commodities will have positive growth rates. These forecasts take the weather factor into account, and include forecasts from the World Bank and the US Department of Agriculture. Agricultural markets will not experience shortages, and prices will fall compared with 2013. An additional downward factor will be the predicted fall in the price of fertilizers, which is attributable to a reduction in production costs and, in particular, a decline in the price of natural gas. This trend will continue in the medium term and the price of fertilizers will restrain the possible rise in prices of agricultural products throughout the period until 2017. For the medium term, the consensus forecast suggests that under the influence of major factors, the price of agricultural products may gradually resume rising. Following a fall of 7% by 2015 compared with 2013, wheat prices may rise by 20% by 2017. Similarly, cotton prices may increase by 3.4 % by 2017 following a fall of 5% in 2014 compared with 2013.

V. Different impacts of price dynamics in primary commodity markets on CIS economies

Median consensus forecasts for major components of international primary commodity markets are pre-
sent above with regard to the CIS countries. One can conclude from the forecasts that in the medium term, other things being equal, exporters of hydrocarbons, such as Russia, Kazakhstan, Turkmenistan, Azerbaijan and Uzbekistan, should be prepared for a decrease in export and fiscal revenues. The situation regarding the balances of payments will not be as favorable as in the period of the steady rise in oil prices. This will require a more flexible macroeconomic policy from the governments of those countries.

In countries with a more diversified structure of exports, such as Ukraine and Belarus, the outlook for commodity markets indicates a decline in their production costs. This is due to the expected fall in the price of metals and hydrocarbons in the short term, which may have a favorable impact on their competitiveness. But in the medium term, this positive price effect will most likely fade. A matter of some concern is the continued decline in the price of ferrous ore and steel, which will certainly affect the state of the iron and steel industries of certain countries (Russia, Kazakhstan and Ukraine). It may take a long time to solve the problems of this branch of the industrial sector.

For countries exporting non-ferrous and precious metals, the outlook seems to be positive. Nevertheless, Armenia, a copper exporter, should be prepared for the possible decrease in export flows. This will have a negative impact on its external sustainability unless the rise in exports of agricultural products compensates for the possible losses. Since Kyrgyzstan is in a similar situation, it should be prepared for a further decrease in the price of gold, which is the country’s principal export commodity. The outlook is more favorable for Tajikistan. Its revenues from exports of aluminum and cotton will retain positive growth rates in the medium term.

In 2014, food and agricultural producers should be prepared for a rise in their revenues because of the expansion of production and, consequently, relatively high growth rates in the agricultural industry. In the medium term, these growth rates should fall and the possible rise in food prices between 2015 and 2017 will have upward pressure on the inflation rate in the region.
Analytical insert

Outlook for fiscal rules in policies of some EDB countries: what international experience shows

Konstantin Fedorov

I. Introduction

Fiscal rules, i.e. formal, usually legislatively introduced restrictions imposed by governments on their policy regarding the state budget, are becoming an increasingly widespread component of macroeconomic policy. In particular, such rules have become part of a standard package of recommendations given by international financial institutions to countries exporting primary commodities. The intention is to ensure the sustainable development of economies that are vulnerable to fluctuations in the price of their exports, or fluctuations in the volume of production. The use of fiscal rules is of interest to economists involved in the integration processes as two of the member countries of the Eurasian Development Bank (Russia and Kazakhstan) have economies in which extractive industries play a key role.

As a comprehensive source of facts and concepts on designing and applying fiscal rules reference can be made to Baunsgaard et al (2012) and Schaechter et al (2012). These papers have been written by economists of the International Monetary Fund.

At present there is a precedent for using these rules in Russia, where the first attempt to introduce a fiscal rule was made in 2008. That rule provided for targeting a non-oil deficit of the federal budget. Since 2013, the country has had a new fiscal rule imposing a restriction on federal budget expenditure on the basis of a base oil price, which is defined as the average export price of Urals crude in the previous 10 years (during a transitional period, shorter time intervals will be used, which will gradually increase to 10 years). This analytical insert has two objectives. The first one is to try to assess the vitality of fiscal rules in the economies of different countries on the basis of international experience. This matter is discussed in Part II. The second objective is to provide a brief description, in Part III, of a range of dilemmas that may face countries considering the possibility of using fiscal rules.

II. Primary commodity exporting counties: Who uses fiscal rules

We would like to determine which of the primary commodity exporting countries seek to use fiscal rules, and in what cases these rules can stay in force for a long time. In this case, we draw attention to two indicators for primary commodity economies. The first indicator is the size of revenues from exports of primary commodities as a percent of GDP (this value shows how large is the commodity wealth possessed by the country). The second indicator is the country’s GDP per capita in current dollar prices at purchasing power parity (this parameter shows how rich is the country). Both indicators are taken from the period between 2006 and 2010 (this is due to the use of data from Baunsgaard, 2012). There are simple reasons for our interest in these two indicators. A primary commodity exporting nation may decide to introduce a formal fiscal rule if: either it possesses primary commodity wealth of a relatively substantial size; or else the use of special mechanisms for managing it would make no sense. Very large commodity wealth can ensure the sustainability of public finances by virtue of its size. However it may potentially rob the nation of motivation to formalize budgetary policy. The size of per-capita GDP also can have an influence on the government’s interest in fiscal rules. For instance, low-income countries may have many urgent needs that prevent the government from concentrating on the creation of long-term rules; or there might be insufficient political stability to create

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1 This article focuses on rules specially intended for managing the budget of a nation that has significant public revenue from primary commodity exports.
the rules.

Figure 1 shows a diagram in which primary commodity exporting countries are represented by points in a plane having two axes: one axis shows the size of revenues from exports of primary commodities as a percent of GDP; and the other axis indicates per-capita GDP. By analyzing the diagram we can draw the following conclusions.

- With the exception of the two well-known and successful examples of using fiscal rules, Norway and Botswana, as well as the member countries of the Central African Economic and Monetary Community\(^2\), beyond the rectangle limited by some 11% of GDP for the size of revenues from primary commodity exports and $15,000 for GDP per capita at PPP, there are no countries that would use fiscal rules. In some cases, such countries made attempts to use fiscal rules, but those attempts were eventually abandoned. Perhaps, countries possessing large commodity wealth and/or high per-capita GDP do not have enough motivation to use fiscal rules.
- Countries having a size of public revenue from primary commodity exports below 11% of GDP, and per-capita GDP below $15,000, are more inclined to use fiscal rules than countries that are richer in primary commodities, or have higher per-capita GDP. Interestingly, countries using fiscal rules tend to stand on the boundaries of the rectangle, not inside it.
- It seems that membership in regional integration alliances is a significant stimulus for the introduction of fiscal rules. In particular, the member countries of the Central African Economic and Monetary Community represent a group of countries most of which would not use fiscal rules on a strictly individual basis, judging by the size of their revenue from primary commodity exports and GDP per capita.
- The EDB countries other than Russia are among the group of countries in which the emergence of fiscal rules is possible hypothetically. Naturally, we do not say that there is a hundred percent probability of this occurring.
- The boundaries of the rectangle where most of the countries using budgetary rules stand are rather approximate. The cases forming its right side and the right upper corner correspond to the countries that have introduced fiscal rules recently. In this regard, it is interesting to examine, among other things, whether Russia’s fiscal rule is a success or a failure.

\(^2\) It should be noted that this group of countries uses a rather loose budget rule, see Schaechter et al (2012).
Figure 1. Commodity exporting countries: principal commodity revenue (in % of GDP) vs. GDP per capita (current $, PPP), 2006-2010 averages.

Notations:
- no rule,
- fiscal rule enacted and observed,
- fiscal rule not observed,
- fiscal rule in the framework of the Central African Economic and Monetary Community,
- fiscal rule in the framework of the West African Economic and Monetary Union

III. Fiscal Rule Design: A Number of Choices

If the issue of the use of fiscal rules in the EDB countries where they are not currently at place ever reaches a practical stage, authorities will have to make a choice with regard to what the rule focuses on, the degree of its strictness or flexibility, and the degree of uniformity of approaches to different expenditure items within the framework of the rule (see Table 1).

Table 1. Fiscal Rule Dilemmas

<table>
<thead>
<tr>
<th>Rule’s focus:</th>
<th>Vs.</th>
<th>Management of the overall budget or debt</th>
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<tbody>
<tr>
<td>Resource revenue management</td>
<td>Hard targets/bounds</td>
<td>Flexible targeting</td>
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<tr>
<td>(incl. price-based rules)</td>
<td>vs.</td>
<td>Different treatment of current and investment expenditures</td>
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Budgetary rules – as far as their existence makes sense at all – impose limitations on the general parameters of the budget, such as the size of public expenditure or the size of the public debt. Despite this, in many cases they focus on the task of managing one revenue category or another. Usually they focus on revenue from exports of a primary commodity. Budgetary rules govern the distribution of revenues from such exports between consumption and investment on the one hand and, often but not always, saving in specially established funds on the other hand. In some cases, these rules use the term “base price” for the exported commodity, which is determined by various methods. The rule recently established in Russia falls into this category.

The choice of the optimal degree of strictness or looseness for a rule is rather complicated, and it is difficult to avoid mistakes and corrections. In principle, a flexible approach, that is, targeting for a certain level, not the rigid fixation or limitation of budget parameters, is preferable because this gives the government more opportunities to respond to circumstances. After establishing an excessively strict rule, authorities may encounter a situation where compliance with it and its existence are politically impossible. However, more flexible rules require more discipline and consistency in the sense that authorities should not abuse the opportunity to deviate from the target parameters of the budget and the public debt. In addition, more flexible rules require a relatively advanced budgetary process. This would imply the planning of public finances for a certain period of time (the adoption of a budget for several years), and the availability of a more or less developed analytical body for the government to determine structural components of the budget, such as the structural deficit.

Rules may place an emphasis on keeping investment spending at a certain level. This could be done: by restricting spending on operating expenses; and by providing for the possibility of a compromise with regard to other parameters of the budget, if this is required by the need to preserve investment spending. A special interpretation of investment spending within the framework of budgetary rules has its pros and cons. On the one hand, it can help to resist the temptation to replace them with spending on operating expenses. On the
other hand, it creates opportunities to bypass rules. It may lead to the emergence of parallel budgets, and a reduction in the financing of core institutions, such as public education, health systems, and law enforcement agencies, in favor of projects that are not necessarily of primary importance.

III. Conclusions

Our own thoughts on the type of rules that may be relevant for the EDB countries, if they take to the idea of using fiscal rules, can be summarized as follows. Firstly, apart from the Russian economy, it is only in the economy of Kazakhstan that exports of primary commodities play such a great role that it makes sense to consider establishing rules similar to those used in Russia, i.e. establishing rules focusing on the management of revenue from primary commodity exports. Secondly, the applicability of flexible fiscal rules depends on the development degree of the budgetary processes in the countries considering the possibility of introducing such rules. In practice, a government may consider imposing strict limitations on planned (not current) expenditure and the public debt, which, however, would not be too difficult to comply with. Authorities should not necessarily start by applying rules that create very strict conditions for the budget. An established rule can be made stricter later, when the authorities have more confidence with regard to the possibility of meeting the rule’s requirements. For countries with less developed budgetary processes, it makes sense to introduce and expand the practice of making a budget for several years. This would, among other things, make it possible to consider using more complicated and flexible rules in due course. In any case, apart from the rules themselves, it is extremely important to try to improve tax administration and the administration and planning of budget expenditure, including investment spending. An important task is to simply increase public revenue. This would make it easier to introduce fiscal rules, and make the need for them to be more understandable for the public.

Literature:

Remittances and economic growth: FAVAR results for Armenia, Kyrgyzstan and Tajikistan

Elvira Kurmanalieva

Individuals’ cash remittances from abroad are an important item in the balance of payments of three EDB economies: Armenia, Kyrgyzstan and Tajikistan. These countries annually receive about $8 billion, an amount equal to 34% of their aggregate gross domestic product, which goes in the balance-of-payments category of “current transfers.” The objective of this insert is to describe the effects of remittances on the economic development of these three countries.

Cash remittances from migrant workers and ethnic communities are one of the most important international tools for the distribution of resources in the world economy. Due to the development of bank payment systems, remittances have become the second largest international flow of financial resources after foreign direct investment. They exceed official development assistance and portfolio investment. According to the World Bank’s estimates (World Bank, 2013), remittance flows totaled $400 billion in 2013, and may reach $700 billion by 2016. The largest nominal volumes of remittances flow to India ($71 billion), China ($60 billion) and the Philippines ($26 billion), and the largest volumes as a percent of GDP flow to Tajikistan (44% of GDP) and Kyrgyzstan (27% of GDP). The leading donor countries are the United States ($48 billion), Saudi Arabia ($26 billion), and Switzerland and Russia ($19 billion each). Amounting to less than 1% of the world’s GDP, these money flows, nonetheless, help to reduce the poverty level and develop the public education and health care systems, and small businesses in developing countries. For the donor economies, remittances are the most efficient form of helping economic development and the promotion of their image and culture. Also the use of immigrants’ labor is one of the ways of solving domestic structural problems connected with the ageing population or the distribution of labor resources. Remittances and migration also pose problems for both the donor countries and the recipient countries. Growing cultural imbalances, competition in the donor countries’ labor markets, and brain drain in the recipient countries are examples of negative effects from remittances.

Chami et al (2005) divide remittances into two groups: (i) altruistic remittances sent by migrant workers to family members and (ii) investment transfers. Altruistic remittances are an important source of financing the expenses of low- and medium-income households. This is a determining factor for the reduction of poverty. These remittances lead to a rise in imports of consumer goods, and sometimes may finance imports of goods that are otherwise unavailable in the country. In this case, remittances intended for consumption may be of a countercyclical nature in a crisis period, and be immune to the effects of business cycles in the donor countries. They will constitute a “safety cushion” for the recipient countries during a crisis. Investment remittances belong to various forms of private and social investments that do not get into households’ budgets. Investment remittances make it possible to stabilize the balance between investment and saving in an economy through a stable multiplicative effect on productivity and employment. However, investment remittances are largely a conceptual phenomenon derived from macroeconomic theory. According to many papers, the greater part of remittances (60% to 80%) is used for purchases of goods and everyday consumption. Only a small part may be used for implementing entrepreneurial initiatives.
The academic literature on remittances is dominated by the opinion that they have a positive effect on the reduction of poverty. However, researchers differ on their effect on long-term economic growth. Moreover, some researchers see a negative effect from remittances on GDP growth - Chami et al (2005), Barajas et al (2009), and Bettin & Zazzaro (2008). Shera & Meyer (2013) note in their paper that there are three major reasons that can prevent remittances from contributing to economic growth. Firstly, a considerable inflow of foreign exchange may create a phenomenon similar to Dutch Disease - where an increase in remittances from abroad is accompanied with a contraction of the workforce, and a rise in consumer demand for non-tradable goods. This will eventually lead to the expansion of the non-tradable sectors of the economy (retail trade, services and construction). Secondly, the dependence of economies on remittances may create a moral hazard, and diminish incentives for increasing labor productivity. This will undermine conditions for long-term economic growth. Thirdly, remittances have such a nature that they are not intended for investment. They are primarily a system of social insurance that helps poor people to pay their everyday expenses.

A number of recently published papers find a positive short-term effect on macroeconomic indicators for certain countries. They include additional variables in the analysis. Ang (2006) finds a positive effect on GDP growth in the Philippines. Giuliano & Ruiz-Arranz (2005) note a positive effect for economies with underdeveloped financial markets. Kaufmann et al (2003), on the basis of a survey of 114 countries, find a positive correlation with institutional variables; this shows the considerable influence of institutions. Glytsos (2005), on the basis of a survey of Egypt, Jordan and Morocco, conclude that the positive effect from the growth of remittances is lower than the negative effect from their sudden reduction. Kireyev (2006) believes that remittances: can have a long-term positive effect in an economy with a high marginal propensity to invest and import; whereas remittances have only a short-term effect in countries with a high marginal propensity to consume. So to gain a better idea of the significance of remittances for subsequent economic growth and macroeconomic stability, it is necessary to analyze them in combination with both the structure of the economy, and the current macroeconomic policy of the government.

When reviewing remittance flows to the three CIS labor-exporting economies, it should be noted that the volume of incoming remittances reached $5.8 billion by 2012, with more than 90% of all remittances coming from Russia. Since most migrant workers from those countries are employed in construction and retail trade in Russia, there is a strong correlation between outgoing remittances and these sectors of the Russian economy. Moreover, the World Bank finds a considerable correlation between the price of crude oil, an important export commodity for Russia, and outgoing remittances. Under such conditions, remittances and the economies of the three recipient countries are highly vulnerable to changes in the Russian economy, and
also to fluctuations in oil prices. (A positive correlation between oil prices and GDP growth in Armenia, Kyrgyzstan and Tajikistan was noted in the Analytical Insert in the December 2011 edition of the CIS Macromonitor).

The figures given below show that during the 2009 crisis, a sharp fall in oil prices led to a downturn in the Russian economy and a sharp decrease in the volume of remittances. The channel of remittances was one of the factors – but not the main one – behind the considerable setback in the economy of Armenia in 2009. In Kyrgyzstan and Tajikistan in 2009 remittances already amounted to 22% and 45% of GDP, respectively; and the depreciation of the national currencies played the role of a stabilizer to a certain extent. Brownbridge and Canagarajah (2010) believe that the negative impact of the decrease in remittances was partially absorbed by a decrease in imports of consumer goods, while households continued to maintain consumption, and investment in housing construction, at a high level.

### Results of econometric analysis

For evaluating the effects of remittances on the economies of Armenia, Kyrgyzstan and Tajikistan, we employ the method of factor-augmented vector autoregression (FAVAR), which can use many variables within a relatively short time span. FAVAR is estimated in two steps. Step 1 evaluates the relationship between global variables (in our case Y stands for remittances) and the main latent factor (F), derived from a series of country macroeconomic indicators. Step 2, on the basis of the results of Step 1, evaluates the effects of the global variable and the factor on each variable in the country series (X):

\[
\begin{bmatrix}
  F_t \\
  Y_t
\end{bmatrix}
= \Phi(L) \begin{bmatrix}
  F_{t-1} \\
  Y_{t-1}
\end{bmatrix} + \nu_t 

(\text{Step 1})
\]

\[
X_t = \Lambda' F_t + \Lambda' Y_t + \epsilon_t 

(\text{Step 2})
\]

The main advantage of this approach, which was for the first time proposed by Bernanke, Boivin and Eliasz (2005), is the possibility of estimating the effects of global variables on local ones, using a large number of...
series of various indicators. This approach ensures the possibility of resolving fluctuations into components characteristic of the series under examination and makes it possible to measure the statistical response of different local indicators to global shocks. The FAVAR model assumes that there exists a set of factors that are non-observable or latent. These factors merge with global variables into a vector that depends, according to the model, on previous values, falling under the standard VAR model. This approach makes it possible to more fully use information available in the panel data of time series of macroeconomic indicators. We estimated FAVAR in this way for evaluating the effects of remittances on the economies of Armenia, Kyrgyzstan and Tajikistan.

**Armenia**

Remittances amount to about $2.1 million, or 21% of GDP. Despite their small volume, Karapetyan & Harutyunyan (2013) note their considerable contribution to the growth of the construction and services sectors before the 2008 crisis. An estimated 72% of remittances are used for consumption and the remaining part is used for paying for education services, purchases of real estate and other expenses. While being a more stable source of foreign capital than foreign direct investment, remittances have a significant short-term effect on GDP growth in Armenia.

Our estimation confirms that remittances make a positive contribution to consumption and investment. It is somewhat surprising that the real GDP has a negative response, which, however, is not statistically significant. It is interesting that remittances make a positive contribution to the growth of exports, while the negative response of foreign direct investment (FDI) implies the existence of interchangeability between direct investment and remittances in Armenia.

**Kyrgyzstan**

In 2012, remittances reached a level of $2 billion, amounting to 31% of the country’s GDP. An estimated 70% of the total amount goes for everyday consumption (Aitymbetov, 2006). Akmoldoev & Budaichieva (2012) also note a correlation between remittances and imports (especially in recent years), and also the low volume of bank deposits held by recipients of cash remittances, who prefer to turn remittances
into cash.

Our analysis finds that GDP growth has a positive and statistically significant response to a rise in cash remittances. We also find, in confirmation of other research, that there is a statistically significant response from the volume of imports, this reaffirming the fact that in Kyrgyzstan, remittances are used for consuming imported goods, and also lead to a rise in prices (GDP Deflator).

**Tajikistan**

In Tajikistan, where the volume of remittances from abroad is almost equal to 52% of the country’s GDP, the marginal propensity to save is at a low level and the marginal propensity to import is 0.65 (Kireyev, 2005). Brownbridge & Canagarajah (2010) note that the propensity to spend remittances on imported consumer goods became one of the reasons for the lack of a setback during the 2009 crisis, when a 30% decrease in remittances was partly compensated for by a decrease in imports.

The results of our analysis also suggest that there is a statistically significant effect from remittances on imports. To all appearances, remittance flows influence the growth of the money supply (M1) and prices (GDP Deflator), and also stimulate the growth of real wages in the construction sector (Wage in construction), although these results are not statistically significant.

Thus, on the basis of our estimation, it is possible to draw a number of preliminary conclusions:

1. A statistically significant positive effect from remittances on GDP growth has been found for Kyrgyzstan, whereas the effect on the real volume of GDP in the other economies is negative and insignificant. Nevertheless, remittances have an effect on consumption, investment and exports in Armenia and there is a statistically significant effect on industrial output in Kyrgyzstan.
2. In each of the economies under examination, there is a positive effect from remittances on the rise in prices. In the case of Tajikistan, they additionally have an effect on the money supply and real wages in the construction sector, although this effect is statistically insignificant.
3. Remittances stimulate imports in Kyrgyzstan and Tajikistan.

Our analysis and conclusions can be of interest for both evaluating macroeconomic policy and forecasting economic dynamics. Nevertheless, there is a need for more analysis and research to increase the accuracy of the conclusions. Firstly, in order to exclude the inverse relationship between remittances and macroeconomic variables, it is necessary to test for the direction of causality. Secondly, it is necessary to exclude the endogeneity between GDP and remittances, which can be the cause of GDP’s negative response in our estimation. Thirdly, for getting a fuller picture, the analysis could cover the influence of the economies of the donor countries (Russia and Kazakhstan) on outflows of remittances.
Literature


