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Q2 2013 was characterized by a more distinct trend in the world economy towards an increased disparity between developed and developing economies, whose growth sharply decelerated. The annual growth rate of China’s GDP fell from 7.6% in Q2 2012 to 7.5% in 2013, which was the lowest level since 1990; while India’s GDP growth rate decreased from 3.4 to 2.4%. The slowdown in growth of these economies was: partly due to the postponed influence of a decline in external demand for their industrial exports from the developed economies; and partly due to the consolidation of domestic demand amid measures taken to strengthen the public finances, or improve the sustainability of the financial sector. Meanwhile many developed economies began to show signs of recovery from recession in Q2 2013. For the first time during the recession the European economy experienced quarterly growth (+2.8%), and a considerable improvement in annual growth. Under the influence of stimulus measures of economic policy, primarily of a monetary nature, positive trends continued in Japan and the United States, which had annual GDP growth rates of 1.2% and 1.6% respectively. Despite the weakness of developing countries, stronger demand from developed markets supported global trade and industrial production.

The poorer economic performance of the CIS countries in Q2 2013 was primarily caused by global trends. The considerable openness of the region’s economies and their dependence on the demand from Europe and Asia determines their growth dynamics. The aggregate GDP of the CIS member countries grew by 1.4% in Q2 2013, which was significantly lower than in Q2 2012 when the growth rate was 4%, and even lower than Q1 2013’s level of 1.7%. Nonetheless, an improvement took place in the Moldova and Kyrgyzstan economies, where the 2012 low base determined a strong growth in 2013. The fall in industrial output apparently reached the bottom: the level of decline was the same as Q1 2013 (-0.2%). Favorable weather conditions and the low base of 2012 determined record high growth rates in the agricultural sector. The retail trade and services sector was for the first time affected by the slowdown in the growth rates of other economic sectors, which apparently reflected weaker consumer demand. Investment activity fell as well and the aggregate indicator turned out to be negative, which subsequently had an impact on construction and the financial sector.

The world economy in Q2 2013 is characterized by a rebalancing between developed and developing economies.

The poorer economic performance of the CIS countries in Q2 2013 is primarily caused by global trends.
World prices of primary commodity and food fall in both annual and quarterly terms

In certain countries, weaker domestic demand leads to a decrease in imports and an improvement in the external balance; while in other countries, the sustained strong domestic demand, coupled with the fixed exchange rate of the national currency, boosts imports and deteriorates the current account balance.

The global market prices of the main export commodities of the CIS countries – except natural gas and cotton – showed a negative rise in both annual and quarterly terms. The average price of Brent crude in Q2 2013 was $103 per barrel, whereas the annual average price for the period between July 2012 and June 2013 was $109 per barrel. World food prices continued to fall: the composite index of food prices decreased by 4.5% in annual terms and 3% in quarterly terms.

In certain countries, a weak domestic demand led to a decrease in imports and an improvement in the external balance. In some other countries, the sustained strong domestic demand, coupled with the lower flexibility in exchange rate, boosted imports and deteriorated the current account balance. In particular, amid a fall in the prices of major export commodities, the exchange rate of the Russian ruble fell in both nominal and real terms. Together with an increase in external demand, this led to a decrease in imports and an improvement in the foreign trade balance. Gas and oil exporting countries, such as Azerbaijan and Kazakhstan, experienced a rise in the real exchange rate of the national currency, and a decline in the export surplus in foreign trade. In labor exporting countries (Armenia, Kyrgyzstan, Moldova and Tajikistan), the volume of transfers (cash remittances from abroad) as a percentage of GDP was at the same level as Q1 2013 according to preliminary estimates. Amid the relatively stable real exchange rate of national currencies, there continued to be deficits in the trade balances. In the group of countries with a diversified structure of exports, there were different trends in the external balances: Ukraine experienced a decrease in foreign trade and current account deficits; whereas Belarus’ foreign trade deficit grew significantly.

A major reason for concern is the outflow of capital from developing economies amid the current imbalances in the global economy. In particular, in Q2 2013, CIS countries experienced a rise in the unregistered outflow of capital. This led to a decrease in the reserves of the central banks, which shrank by 3% in Q2 2013 in nominal terms. However, given the downward trend in imports, the reserves remained sufficient to cover 13 months’ imports.

Figure 1.3. Terms of trade: international commodities’ and food prices

Figure 1.4. Balance of payments: current account balances’ components and foreign exchange reserves

Source: World Bank

Source: national agencies
The deterioration of the economic situation affects the condition of public finances. The aggregate figure for the state budget surplus of the CIS countries amounted to 1.2% of GDP, being lower than Q1 2013 (1.9% of GDP) and Q2 2012 (3.5% of GDP). The lower export revenues of the oil and gas exporting economies put pressure on the state budgets. In response to existing external economic factors, those countries took measures to consolidate and adjust public spending, which eventually helped to retain positive fiscal balances. The state budgets of the labor exporting countries traditionally had a deficit in the second quarter of the year. The joint figure for the budget deficit of these countries amounted to 0.4% of GDP amid an increase in tax revenues and cash remittances from abroad. This is lower than 2012 (1.1% of GDP). Amid a rise in social spending and almost the same level of budget revenue, Ukraine’s budget deficit grew to 6.4% of GDP in Q2 2013.

The dynamics of consumer prices were determined by: a fall in food prices in the world; a seasonal decrease in the domestic prices of agricultural produce; and also the weak performance of the real sector of the economy. The annual growth rate of consumer prices was 6.7% in Q2 2013, remaining at almost the same level as Q1 2013, when it was 6.77%. Amid stable interest rates and money growth rates (13.6 to 14.7%), the inflation rate in the oil and gas exporting countries remained at the same level. The central banks of some labor exporting countries loosened their monetary policy. This led to a slight acceleration of inflation, from 5 to 5.8%. In the economies with a diversified export structure, a weakening in economic dynamics had an impact on the dynamics of prices: the annual growth of consumer prices fell from 5.6% in Q1 to 4.8% in Q2 2013.

Amid weak economic activity, there was a slowdown in bank lending. The oil and gas exporting countries and the countries with a diversified export structure experienced an especially sharp slowdown. On the contrary, commercial banks in the labor exporting countries increased lending amid more favorable conditions. A positive feature of the situation in the banking sector was an improvement in the quality of banks’ loan portfolios: the aggregate volume of non-performing loans decreased in almost all countries.

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

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

Source: national agencies
According to a July 2013 forecast from the International Monetary Fund, the world’s GDP will grow by 3.1% in 2013 with a subsequent acceleration to 3.8% in 2014. The IMF revised its forecast downward. This was due to fears that rebalancing might take more time as central banks were gradually completing monetary stimulus measures, and the financial conditions in the global financial market had somewhat deteriorated. Thus, despite the signs of revival in the second half of 2013, the growth of the world economy is expected to be lower than 2012. A growth upturn is predicted in the world’s leading economies, whereas rapidly growing developing economies are expected to decelerate their economic growth. The process of rebalancing is expected to continue until 2015. Despite a decrease in the degree of global imbalances, the process of macroeconomic correction will continue in individual economies (see Analytical Insert). Despite the revised forecasts, the positive signs that emerged in global industrial output in August and September 2013 give grounds to expect a substantial improvement in macroeconomic indicators of the economies of developing countries in 2013.

As for the CIS economies, the current consensus forecast predicts a growth rate of 2.4% for 2013 and a subsequent acceleration to 3.4% in 2014 and 4.1% in 2015.

The IMF’s July forecast predicts that the world’s GDP will grow by 3.1% in 2013 with a subsequent acceleration to 3.8% in 2014.

The current consensus forecast for the CIS economies predicts a growth rate of 2.4% for 2013 and a subsequent acceleration to 3.4% in 2014 and 4.1% in 2015.

As for the CIS economies, the current consensus forecast predicts a growth rate of 2.4% for 2013 and a subsequent acceleration to 3.4% in 2014 and 4.1% in 2015. The more pessimistic expectations for 2013 are due to a revision of the growth forecast for the Russian economy. A slowdown is expected in 2013 for the economic growth of Armenia, Tajikistan, Turkmenistan and Uzbekistan. The other economies in the region are predicted to have a rise in the GDP growth rate. The oil and gas exporting countries will apparently experience macroeconomic correction. This implies a decrease in current account surpluses and the emergence of a budget deficit as public revenues are to grow at a lower rate. Economic growth is expected to accelerate – from 2.2% in 2013 to 4.1% in 2015 – with the non-primary sector to be the main driving force. The labor exporting economies will gradually reduce the external balance deficit. This will be primarily through the consolidation of public finances, and the gradual reduction of the external public debt. The continued high GDP growth rates (5.2 to 5.4%) will help the governments get rid of external indebtedness. In the economies with a diversified export structure the external imbalance will stabilize at the current level; this is despite rather optimistic forecasts for economic growth of 2.9 to 4.2%.

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

<table>
<thead>
<tr>
<th>2006</th>
<th>2007</th>
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<td>CIS</td>
<td>Oil and gas exporters</td>
<td>Labour exporters</td>
<td>Exporters with diversified structure</td>
<td>EDB</td>
<td></td>
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</tbody>
</table>

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

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

Source: national agencies, estimates and forecasts by the IMF
Azerbaijan: Stabilization of oil production, continued high growth in non-oil sector

Azerbaijan’s economic growth accelerated in Q2 2013. In the first half of 2013, the country’s GDP grew by 5% year-on-year in real terms compared with 3.1% in Q1 2013. The main contribution to the acceleration was made by a lower rate of decline in oil and gas production, which decreased by only 0.3% against 4% in Q1. It is evident that there was a rise in production of these commodities in Q2 2013 compared with Q2 2012. In the non-oil and gas sector, growth slowed down to 10.9% in the first half of 2013 against 11.4% in Q1 2013. Nonetheless, the dynamics of the non-oil and gas sector remained strong: the annual growth rate at the end of the first half of 2013 was 22.9% in construction; 24.6% in the building materials industry; and 21% in the metallurgical industry. The agricultural sector and the food industry had relatively modest growth rates of 4.9 and 3.7%, respectively. Retail trade rose by 9.1% in real terms. This reflected a rapid rise in household consumption that was supported by an increase in pay, which rose by 6.8% on average. Fixed capital expenditure increased by 22.9% year-on-year, down from 36.1% in Q1 2013.

Public expenditure in the first half of 2013 amounted to 27% of GDP, turning out to be slightly smaller than in the first half of 2012, when it was 27.5% of GDP. Thus, a significant rise in public spending in Q1 2013 – to 34.9% of GDP from 23.1% of GDP in Q1 2012 – was offset by relatively low spending in Q2 2013. Nonetheless, the surplus of the state budget, including the budget of the State Oil Fund of the Republic of Azerbaijan (SOFAZ), amounted to 6.4% of GDP. This was twice as small as in Q2 2012, when it was 13.4% of GDP. The resources of SOFAZ totaled $34.7 billion at the end of the first half of 2013, up from $34.1 billion at the end of Q1 2013, amounting to about 50% of 2012’s GDP.

Throughout Q2 2013, there was a gradual acceleration of inflation in the country following a slowdown to negative figures at the end of 2012. At the end of June 2013, the annual growth rate of consumer prices index was 1% compared with 0.6% in March amid an almost fixed exchange rate of the national currency against the US dollar and a stable increase in money supply. The annual growth rate of M2 was slightly above 20% throughout Q2 2013.

The current account surplus was $2.4 billion in Q2 2013 and $6.5 billion, or 18.6% of GDP, in the first half of 2013, decreasing from $8.2 billion, or 24.9% of GDP, in the first half of 2012.

The banking sector’s lending to the national economy increased significantly compared with Q1 2013. As of the end of June, the annual growth rate of lending was 28.3% against 22.5% at the end of March. The contributions of public and private banks to lending growth became more similar: lending by public banks increased by 25.2% year-on-year in Q1 2013 and by 28.5% in the first half of 2013, whereas lending by private banks rose by 20.8 and 28.3%, respectively.
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
**Trends**

**Armenia: Sharp slowdown in GDP growth amid deteriorating balance of payments**

Armenia’s GDP is estimated to have grown by 3.5% year-on-year in the first half of 2013. The GDP year-on-year growth rate fell dramatically from 7.5% in Q1 to 0.6% in Q2 2013. The drop was largely due to: weaker external demand in Q2 2013; persistent high uncertainty in the Eurozone; a slowdown in Russia’s economic growth; lower domestic demand; low investment activity; and the high-base effect. The weak external demand led to an almost zero increase in manufacturing industry output, which rose by 0.2% against 6.7% in Q1 2013. This negatively offset significant growth in the mining industry, which accelerated to 10.2% from 5.9% in Q1 2013. A slump in the power generation and supply industry, whose output fell by 12%, aggravated the situation in the industrial sector. Low investment activity led to a higher decline in construction: minus 21.4% compared with minus 14.8% in Q1 2012. Due to lower consumption, the growth rate of the services sector fell to 3.6% from 7.6% in Q1 2013. The agricultural sector’s output growth accelerated to 4.1% from 2.4% in Q1 2013.

Indicators for Armenia’s external economic activities continued to deteriorate in Q2 2013. This was reflected by a steady decrease in the gross international reserves and the depreciation of the dram. Between January and June 2013 the international reserves shrank by $194 million - 10.7% and 3.9% year-on-year. The national currency kept depreciating throughout the first five months of 2013. As in Q1 2013, the difficult situation in the foreign exchange market was a consequence of an additional decrease in the capital and financial account surpluses. The main items of the current account balance continued to improve: exports rose by 9.9%; imports decreased by 2.1%; and the rise in net cash remittances from emigrants accelerated to 10.5%.

The slowdown in economic activity in Q2 2013 did not affect the stability of public finances. State budget revenue rose by 20.4% year-on-year in the first half of 2013, while expenditure increased by only 8%. As a result, the state budget had a surplus of 26.5 billion dram, or 1.6% of GDP. The continued growth of public revenue amid the economic slowdown was attributable to progress made in tax administration, and an increase in extra payments by major taxpayers. The modest rise in public expenditure was due to the shortfall in the implementation of capital expenditure plans, including the North-South Road Corridor transport infrastructure project.

Inflation accelerated to 6.5% at the end of June 2013 from 3.4% at the end of Q1 2013. This was largely due to 2012’s low base, and exceeded the central bank’s target band of 2.5 to 5.5%. The effects of monetary factors became weaker – the annual growth rate of M2X fell to 15.6%. This was due to a decline in lending, which was caused by the slowdown in economic activity. As a result, the profitability indicators of the banking sector remained low despite some improvement in Q2 2013. The average ROA (return on assets) rate of banks was 1.62% and the ROE (return on equity) rate was 9.91 %, while the share of non-performing loans decreased to 5.16% as of the end of July 2013.

**GDP growth substantially slows in the first half of 2013 to an estimated 3.5%**

**An additional decrease in the capital and financial account surpluses leads to tensions in the foreign exchange market**

**The slowdown in economic activity in Q2 2013 does not affect the stability of public finances**

**The annual inflation rate rises to 6.5% in June 2013, exceeding the central bank’s target band**
Outlook

Armenia: Inflation acceleration amid slowdown in economic activity

The Indicator of Economic Activity (IEA) rose modestly by 2.1% in annual terms in July 2013. This was due to a large 10.9% increase in agricultural output, which offset a 1.5% decline in industrial output. However, the general trend towards a slowdown remains. The weaker external demand continued to manifest through the lack of growth in trade, and low growth in the services sector (0.7%). The construction sector is still in decline and its output decreased by 8.1% year-on-year. All in all, the IEA fell to 4% for the period January-July 2013. Given good indicators in the agricultural sector and a weakening high-base effect in the industrial sector, the IEA should slightly rise in Q3 2013. Armenia’s GDP growth is expected to slow down in 2013. It will be 5% according to a consensus forecast based on forecasts from the EDB, the IMF, the World Bank and the Asian Development Bank, against 6.2% projected by the government.

The state of the balance of payments apparently considerably improved in July 2013. The gross international reserves grew to $1,749.5 million – increasing by $144 million in one month alone – and the dram strengthened to 407 against the US dollar. This improvement was probably due to an improvement in the current account balance through, among other things, a rise in net cash remittances from abroad (about $144 million came in July alone), and a potential increase in the financial account surplus in connection with a rise in external borrowing. The increase in the gross international reserves through external borrowing, and the nominal rise in the exchange rate of the Armenian currency cannot be viewed as sustainable. This is due to the relatively high level of the external debt, the persistent structural problems (the foreign trade deficit amounts to 25% of GDP), and the expected slowdown in economic growth in the second half of 2013.

The fall in export prices in 2013 will affect: the export-oriented industries; GDP growth; and export and fiscal revenues. Simultaneously, due to the shortfalls in the implementation of capital expenditure in the first half of 2013, one should expect acceleration in the growth of public spending and a return to a budget deficit. The deficit should not exceed the level of 2.6% of GDP projected by the government for 2013, and may even turn out to be lower. In the mid-term period (2014-2015), the government aims – within the framework of cooperation with the IMF – to keep the budget deficit below 2% of GDP.

Inflation accelerated to 8.5% at the end of July in annual terms due to a 14.5% increase in the gas and electricity supply rates. This exceeded considerably the ceiling of the central bank’s target band of 2.5% to 5.5%. In the future, inflation pressure caused by monetary factors will probably be limited. This will be due to the slowdown in economic activity, money supply and lending growth rates, and also the tightening of monetary policy. Favorable weather conditions should offset the consequences of a hailstorm and further reduce the inflation pressure. Nonetheless, it will be unrealistic to offset the effect of an increase in the price of Russian natural gas on the final figures and reduce an inflation rate to the projected level of 5.5%. In its most recent forecast, the central bank predicts the annual inflation rate will be 5.5% to 7% at the end of 2013.

GDP growth will continue to slow down to 5% in 2013, according to a consensus forecast

The growth of the gross international reserves through external borrowing, and the nominal rise in the exchange rate of the Armenian currency cannot be viewed as sustainable

One should expect an acceleration in the growth of public spending and a return to a budget deficit

It will be unrealistic to reduce the inflation rate to the projected level of 5.5%
Armenia

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

![GDP and output chart](chart1)

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)

![Foreign trade chart](chart2)

Source: national agencies, IMF

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

![Government sector chart](chart3)

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)

![Monetary sector chart](chart4)

Source: national agencies

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

![Economic growth chart](chart5)

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)

![Savings and investments chart](chart6)

Source: estimates and forecasts by national agencies and the IMF
**Belarus: Unsteady growth amid external imbalance**

In Q2 2013 GDP decreased by 0.5% compared with Q2 2012. The economy therefore returned to negative growth, as in Q1 2013 GDP had increased by 3.8% year-on-year, which was more than initially expected. In the first half of 2013, the country had a year-on-year GDP growth rate of 1.4%. A significant rise took place in non-tradable sectors: retail trade (19.3% in Q2, and 19.2% in the first half of 2013); and construction sector (6.7% in Q2, and 8.8% in the first half of 2013). That ensured positive overall economic growth. The industrial sector experienced a year-on-year output fall of 7.2% in Q2 2013, and a 4.2% fall in the first half of 2013. This was primarily caused by a decline in manufacturing activity, especially the oil-refining and chemical industries, and a less significant decline in the extractive sector (1.3% in the first half of 2013). Agricultural output reportedly increased by 0.7% in Q1 2013 and 1.5% in the first half of 2013.

The annual inflation rate, standing at about 22% throughout Q1 2013, began to fall in Q2 2013, decreasing to 19.8% in June. The monthly rise in consumer prices was below 1% from April through June 2013. Under these circumstances, the National Bank made a series of reductions in its refinance rate, lowering it from 30% in early March to 23.5% in June 2013.

On the fiscal front, there was no change in Q2 2013: the federal budget had a surplus of 800 billion rubles, or 0.3% of GDP, in both Q1 2013 and the first half of 2013. The surplus of the consolidated budget (the federal budget, local budgets and the Social Security Fund) amounted to 5.4 trillion rubles, or 1.9% of GDP.

The balance of payments improved compared with Q1 2013, when the current account deficit reached $2.5 billion, or 17.1% of GDP. In Q2 2013 the current account deficit was $0.6 billion, or 3.3% of GDP. This resulted in a current account deficit amounting to 10.4% of GDP in the first half of 2013. However, this progress was largely due to an improvement in the primary income balance, which had a surplus of $43 million in Q2 2013 following a deficit of $1.9 billion in Q1 2013, when massive dividend payments to foreign investors had to be made in line with the seasonal pattern. The surplus in the balance of trade in goods and services decreased in Q2 2013, shrinking to $46.2 million from $340 million in Q1 2013. The deterioration in the trade balance was due to import growth outpacing export growth amid an increase in consumer and investment demand in the country.

The growth of the banking sector’s lending to the economy slightly slowed down to 38.9% year-on-year at the end of June 2013 compared with 42% at the end of March 2013. This slowdown is attributable to both a decrease in the demand for loans amid the decline in economic growth, and the reduction of lending by banks or authorities. The sustainability indicators of the banking sector deteriorated: the ratio of regulatory capital to risk-weighted assets decreased to 20% at the end of the first half of 2013 from 20.7% at the end of March; while the ratio of liquid assets to total assets fell to 26.9% from 28%.
Outlook

Belarus: Risks of slump in economy, external unsustainability

Available data for the first months of Q3 2013 suggest the lack of pronounced changes in economic dynamics compared with Q2 2013. Acceleration occurred in the decline in the manufacturing sector, whose output fell by 7.1% year-on-year compared with 4.9% in the first half of 2013. This was despite a slowdown in the decline in the mining sector, where output decreased by 0.9% year-on-year after a decrease of 1.3% in the first half of 2013. At the same time the growth of consumer and, especially, investment activity accelerated. Retail sales increased by 20.4% year-on-year in real terms in the first seven months of 2013 following a 19.4% rise in January-June; while the annual growth of fixed capital expenditure increased to 18.4% from 8.8% in the first half of 2013. Thus Belarus’ economic growth was of a very lopsided and, consequently, unsteady nature. The overall GDP growth may go far into the negative if the surge in consumption and investment, the sustainability of which is doubtful, peters out.

The situation with public finances (narrowly defined) is relatively unanxious: data for Q2 2013 confirm the expectations that we expressed in the previous issue of the Macromonitor. The national budget will be close to balance and have a deficit of no more than 2% of GDP if quasi-fiscal financing is taken into account. Meanwhile, the authorities’ economic policy includes raising pay in government-funded organizations, which leads to a general rise in pay in the country. In the first seven months of 2013, average monthly pay was 5,450,000 rubles ($615), 17.9% higher in real terms than in the same period of 2012. The rise in pay puts pressure on the balance of payments.

In the field of monetary policy, the authorities take contradictory measures. In late July, the National Bank raised the interest rates on some types of its loans without raising the refinance rate. Other steps by the authorities, in particular with regard to banks’ compliance with their reserve requirements, are de facto aimed at loosening monetary policy. The cumulative effect of the measures taken by the authorities on lending growth and inflation will become clear later in 2013. The officially declared target of reducing inflation to 12% in 2013 still seems very ambitious.

The lopsided nature of the country’s economic growth is reflected in the poor state of the balance of payments. The current account deficit, which amounted to more than 10% of GDP in the first half of 2013, should experience an extra negative pressure in the second half due to the seasonal increase in the import of energy resources. The international reserves of the National Bank, calculated in accordance with the IMF’s standards, totaled $7.9 billion, enough to cover about two months’ imports. Given the limited size of the reserves, making the Belarus economy externally sustainable again may require a slowdown in the growth of personal consumption and investment. At the same time, an improvement in the economic situation in the region may have a positive effect on the condition of the country’s balance of payments due to an increase in external demand for Belarusian products. The direction that the cumulative effect of positive and negative factors will take in the remaining part of 2013 will largely depend on the authorities’ policies.
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

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
**Trends**

**Kazakhstan: Acceleration in GDP growth amid deterioration in balance of payments and republican budget**

The GDP growth accelerated in Q2 2013 to 5.5% against 4.6% in Q1 2013, which resulted in a 5.1% year-on-year growth rate in the first half of 2013. Amid a continued high growth rate in the services sector (7.8%), a major factor behind the improvement was recovery of growth in the construction sector (3.7% in Q2), and an acceleration of growth in the agricultural sector (1.9%). The recession in the Eurozone and the slowdown in Russia’s economic growth caused a fall in the price of exported metals and oil, and weaker external demand. This led to a continued modest 2% growth in manufacturing industry output, and a slowdown in mining industry output to 1.7%. As a whole, the growth in industrial output decelerated to 1.7%. Regarding demand, there were signs of improvement only in investment, which grew by 12.4% in the first half of 2013 in nominal terms. The population’s real income rose by 2.0%, while public expenditure decreased by 2.9% and lending growth slowed to 13.9%.

According to the National Bank’s estimation for the first half of 2013, the state of the balance of payments deteriorated in Q2 2013 as a result of the recession in the Eurozone, and uncertainty in the international market situation. The balance of payments had a deficit of $284.5 million, or 0.3% of GDP. This was as a result of price reduction and weakening external demand for exported raw materials, exports decreased by 12% year-on-year in the first half of 2013; and it was also due to an increase in the outflow of capital. The significant deterioration in the balance of payments was attributable to: firstly a decrease in the current account surplus, which shrank to 2.3% of GDP from 8.4% of GDP in the first half of 2012; and secondly to the emergence in the first half of 2013 of a capital and financial account deficit (including errors and omissions), that occurred primarily as a result of a decrease in other incoming short-term foreign capital flows. The deterioration in the balance of payments led to a decrease in the gross international reserves of the National Bank. The reserves contracted by $6.2 billion compared with June 2012 for reasons including the fall in world gold prices, and the expansion of the range of the tenge’s volatility.

The state of public finances in the first half of 2013 remained stable despite an expected 2.4% decrease in state budget revenue. This was attributable to a slight acceleration of GDP growth in Q2 2013, and also a timely downward revision of the state budget and the optimization of expenditure. In particular, amid the fall in revenue, there was a more significant decrease in public spending, which was reduced by 2.9%. As a result, the budget had a slight deficit estimated at 0.4% of GDP.

Inflationary pressure gradually eased in Q2 2013. At the end of Q2 2013 the annual inflation rate had decreased to 5.9% from 6.8% at the end of Q1 2013. It fell below the National Bank’s target band of 6% to 8%. The contribution of monetary factors to inflation processes remained limited: the annual M2 growth rate was only 7.7% in June. Despite measures taken by the government, problems existing in the banking sector were unfavorable to the expansion of lending to the economy. In the sector the share of non-performing loans made up 35% as of June 1, 2013.
**Outlook**

**Kazakhstan: Favorable prospects for GDP growth**

In Q3 2013, the weak trend of economic growth acceleration continued. There was an improvement in all sectors of the economy in January-July 2013. It was the most appreciable in construction, which resumed growth, reaching a 1.8% year-on-year output increase following a 4.9% year-on-year fall in Q1 2013. Growth in agriculture accelerated to 1.8% due to seasonal factors. Growth in various branches of the services sector remained high: retail trade rose by 12.4%, communications services by 14.4%, and transport services by 8.3%. The industrial output growth remained at 1.9%. Persistent problems in the metallurgical industry (the decline increased to 3.9% in January-July) continued to have a negative impact on the general indicators of the industrial sector. This offset the acceleration of growth in the extractive industry (2.6% year-on-year in the period).

Regarding demand, certain signs of acceleration could be seen in the sphere of investment, which grew by 7.1% in the period, while the real wage increased by only 0.5%. In general, economic growth may slightly speed up in Q3 2013. A consensus forecast, based on forecasts from the EDB, the IMF, the World Bank, the Asian Development Bank and the EBRD, predicts a GDP growth of 5.2% for 2013, with the EDB forecasting 5.6%. In 2014, one should expect growth acceleration to 5.4%. Amid the continued relatively robust domestic demand, the moderate acceleration of growth will be secured by: a higher external demand; an improvement in the industrial sector’s indicators; and also growth in construction due to an increase in investment activity. The growth in agricultural output and the start of oil production in the offshore Kashagan field will produce an additional positive effect on GDP growth. Kashagan is the world’s largest oil discovery in more than four decades.

The 2014-2016 draft of the budget law adopted by the government of Kazakhstan provides for a 10.4% increase in public revenue in 2014 compared with 2013; whereas expenditure is projected to rise by 10.1% in 2014. The budget law generally suggests that the government intends to use its oil savings for stimulating the economy. An additional target transfer amounting to 150 billion tenge is projected to be made out of the National Fund of Kazakhstan for infrastructure projects and preparations for World EXPO 2017. The financing of all major development programs is preserved. The new budget law’s pronounced focus on development goals provides additional reserves for the development of the national economy and GDP growth in 2014.

In August 2013, the annual inflation rate in Kazakhstan fell to 5.8% and still remains below the National Bank’s target band of 6-8%. The contribution of monetary factors remains minimal. The M2 growth slowed to 4.8% at the end of July 2013, plunging below the GDP growth rate. This may have an unfavorable effect on economic activity in the short term. The National Bank forecasts the annual inflation rate to return to the target band of 6-8% by the end of 2013 after some slowdown in Q3 2013. Given the existing downward pressure on the tenge from external factors, and also minimal deviation of the factual inflation from the low threshold of the target band, the National Bank should not revise and ease its monetary policy.
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

**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
Trends

Kyrgyzstan: High economic growth rate in Q2 2013

The growth of GDP accelerated in Q2 2013, standing at 8.2% against Q2 2012 and at 1.6% against Q1 2013. The main contribution to the acceleration was made by the low base of 2012 for the output of the metallurgical industry. Despite recovery, gold production remains at a low level and a complete return to the pre-crisis levels is expected by the end of 2013. If the contribution of the companies engaged in the development of Kumtor gold deposit is not taken into account, Kyrgyzstan’s annual GDP growth exceeded its rate for Q1 2013 (4.9%) by more than 1%, reaching 6.1%. Growth accelerated in almost all industries. There were high growth rates in telecommunication services (24.9%), retail trade (10.1%), transportation (6.8%), and construction (15.5%). The country had a huge foreign trade deficit in Q2 2013, which amounted to 70% of GDP. This was primarily due to: continued problems in gold mining; the beginning of the harvest season in agriculture that led to a rise in the import of petroleum products; structural changes in the textile industry; and high domestic demand. Fixed investments primarily came from foreign loans, while private consumption rose due to cash remittances from abroad. The remittances continued to grow, although the growth rate slowed down due to the dynamics in the economies of donor countries.

The dynamics of inflation during Q2 2013 was largely determined by a fall in the price of food commodities. Nonetheless, the contribution of non-food commodities increased in June, which might have prompted the National Bank to raise its discount rate. Due to 2012's low base, the annual inflation rate was 7.8%, with food contributing 4.3%, non-food consumer goods about 1.5%, and services 2%.

In Q2 2013, the state budget had a deficit of 5% of GDP. The size of the deficit was mainly determined by capital expenditure under the government’s investment programs, some of them were postponed due to uncertainty with regard to the arrival of a number of loans and grants from international organizations. However, the state budget deficit in the first half of 2013 amounted to 0.3% of GDP. Amid growing imports, public revenue came from VAT, excise taxes and customs duties; while there was almost no revenue from income tax and profit tax. Another source of budget revenue is dividends and the profit of state-owned enterprises.

Amid a more moderate annual growth rate of the money supply (21.8%), bank lending grew at a high rate (33.2%). The main contribution to this growth was made by loans provided for agricultural development and the trade sector. This sector was influenced by the general revival of the economy, and by the implementation of a low-interest lending program for farmers. An increase occurred in the share of medium and longer term loans, and also in the share of loans in the national currency. In the first half of 2013, the financial indicators of the banking sector were satisfactory with regard to the profitability and quality of loans.
Outlook

Kyrgyzstan: Rise in imports threatens high external deficit and growth of external debt

At the end of August 2013, the economic growth rate remained strong at 8%; and at 5.9% if the contribution of the gold mining companies is not taken into account. Major features of the dynamics of the last two months were a high growth rate of agricultural output due to a good harvest in crop production, and a 5% year-on-year drop in the mining industry (excluding the Kumtor mine). Despite the impressive current dynamics and favorable forecasts, a consensus forecast for 2013 GDP growth is 7.4%. A consensus forecast for 2014 and 2015 predicts growth rates of 6.2 and 5.4%, respectively, which meet the forecasts for long-term economic growth rates.

In August 2013, the annual rise in prices slowed down to 6.6%. The National Bank’s discount rate rose to 4.2% at the end of August from 3.2% in June. Given declining global food prices, and tighter monetary policy, one can expect a further decrease in the annual inflation rate to between 6 and 6.5% by December 2013.

In the first seven months of 2013, the state budget had a deficit of 1.9% of GDP. As a percent of GDP, state budget revenue remained almost the same as in the same period of 2013, while expenditure decreased by 1.7%. A decline occurred in many expenditure items except for social security spending. The projected budget deficit is still high at 5.3% of GDP. This is despite the fact that the 2013 state budget is based on conservative forecasts for revenue, and implies measures for restricting non-priority capital expenditure and keeping current social spending at the same level.

Bank lending continued to grow at a fast pace, with the annual growth rate reaching 37.6% in July 2013. The National Bank says in a recently published report that there is demand for money in the economy. Lending in the national currency continues to grow, with most lending being loans for agricultural development within the framework of a low-interest lending program for farmers. Amid the general upturn in the economy and, in particular, the construction sector – the sector’s gross output rose by 17.6% year-on-year in January-July 2013 – mortgage and construction loans, which grew from 5.6 to 6.5%, are another factor behind the growth in bank lending. Nonetheless, given the fact that the National Bank’s discount rate rose by 1% in July and August, one should expect a cooling in the bank lending market.

In general, given the medium-term economic dynamics, one can predict that if the current growth rate of imports continues, there will be a very high deficit in the external balance. This would be due to both a high state budget deficit and a rise in the private sector’s borrowings. To date, Kyrgyzstan’s gross external debt has approached the size of its annual GDP. To control the pace of debt accumulation it is most important to preserve the flexibility of the exchange rate of the national currency. This helps to regulate the volume of demand for imported goods.
Kyrgyzstan

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

Source: the National Statistics Committee of Kyrgyzstan

Figure 6.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q1 2008 = 100)

Source: national agencies

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

Source: national agencies

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

Source: national agencies

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

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

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

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

**Moldova: Substantial acceleration in growth this year and normalization in mid-term**

The annual growth of Moldova’s economy accelerated in Q2 2013 to 6.3% from 3.5% in Q1 2013. This was amid a significant 11.6% increase in industrial output and favorable trends in the agricultural sector, whose output rose by 6.6%. The growth of household consumption also sped up amid a high rise in retail trade and services, as well as in the population’s income. Investment activity still remained low; but a rise in freight transportation and construction suggest it will recover to former levels before the end of 2013. The condition of the current account surplus, which amounted to 6.6% of GDP in Q1 2013, may somewhat deteriorate as a result of the first half of 2013. This is heralded by a zero rise in the export of goods and a slowdown in the growth of cash remittances from abroad. Nonetheless, given the improvement in the economic situation in Europe, one can expect an increase in the sustainability of the country’s external balance in the remaining part of 2013. If Europe’s economic growth continues to accelerate, forecasts for the Moldovan economy’s growth will be revised upwards. The current forecasts of the government and the International Monetary Fund predict a growth of 4%. A consensus forecast for Moldova’s GDP growth for 2013, 2014 and 2015 is 3.5, 4 and 5% respectively.

In the first half of 2013, the consolidated budget had a deficit amounting to 1% of GDP. Q2 2013 had a decrease in non-tax and other revenue, while a 4% rise in all revenue was secured by internal taxes on goods and services. State budget expenditure increased by 8% in Q2 2013, the state budget deficit amounted to 1.6% of GDP, up from 0.4% of GDP in Q1 2013. It should be noted that although the country’s external debt exceeded 80% of GDP at the end of 2012, the debt did not grow any further in the first half of 2013. As of the end of June 2013, the public debt amounted to 21.7 million lei, or around 23.8% of GDP.

Due to a seasonal fall in food prices, there was deflation throughout the summer months. Meanwhile, prices of non-food consumer goods and services rose after the National Bank lowered its key interest rate. The National Bank has revised upwards its forecast for annual inflation from 4.1 to 4.3% for 2013 and from 3.7 to 3.8% for 2014, which is quite in line with the medium-term target inflation band of 3.5 to 6.5%. By loosening its monetary policy, the central bank tries to stimulate domestic demand.

The banking sector of Moldova kept a steady growth rate for lending in the first half of 2013, with the annual rise in the sector’s loan portfolio varying between 13 and 16%. However, the share of non-performing loans in the total volume of loans grew slightly: from 13% in March to 15.2% in June. Meanwhile, the sustainability indicators of the banking sector remained at a favorable level: as of the end of June, the ratio of capital to risk-weighted assets was 25.2%, while the profitability rate of assets was 2%.
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: Upturn in extractive industries, decline in investment, low general growth**

The slowdown in economic growth that began in the spring of 2012 continued throughout Q2 2013. The year-on-year GDP growth rate in Q2 2013 was 1.2% compared with 1.6% in Q1 2013 and 3.4% in 2012. GDP growth in the first half of 2013 was 1.4%. The growth in industrial output slightly accelerated to 0.3% compared with the same period in 2012 against a zero % year-on-year rise in Q1 2013. There was a limited recovery in the extractive sector with a rise of 1%; this followed a drop of 4.9% in Q1 2013. This was offset by a 1.2% year-on-year fall in the manufacturing sector, after a 1.3% rise in Q1 2013. The agricultural sector’s growth rate decreased to 1.4% from 1.6% in Q1 2013. Retail sales’ growth slowed from 4% in Q1 2013 to 3.5% in Q2 2013. Fixed capital expenditure showed a negative growth, decreasing by 3% year-on-year in Q2 2013. In general, the positive effect of the recovery in the physical volume of exports, in particular of natural gas and petroleum products, which determined the upturn in the extractive sector, was offset by a fall in investment and a slowdown in the growth of private consumption. This is reflected in a slowdown in the rise in retail sales.

The current account surplus decreased in Q2 2013 to $6.9 billion from $25.1 billion in Q1 2013, or to 1.4% of GDP from 5.1%. Factors determining the decrease were: a fall in the price of major Russian exports amid the last twist of the debt crisis in Europe; and a seasonal deterioration in the income account due to Russian companies’ payments of dividends to foreign investors.

In the first half of 2013, the federal budget had a surplus of 306.9 billion rubles, or 1% of GDP; while the consolidated budget had a surplus of 535.3 billion rubles, 1.7% of GDP. The respective figures for the first half of 2012 were 0.9 and 3.3% of GDP. Thus the ongoing deterioration in the economic situation primarily affected regional budgets.

The annual inflation rate reached its peak of 7.4% in May. It started declining under the influence of a high-base effect caused by acceleration in the rise of prices in the middle of 2012, when the authorities significantly raised government-regulated tariffs. In June, annual inflation fell to 6.9%. The Bank of Russia kept its policy unchanged despite the slowdown in economic growth. It expected a decline in inflation to levels close to 2013’s target band of 5 to 6%.

The growth of bank lending to the economy slowed amid the central bank’s relatively tight monetary policy and the economic growth deceleration from 21.1% in March to 18.7% in June 2013. The sustainability indicators of the banking sector slightly improved in Q2 2013: the ratio of capital to risk-weighted assets rose to 13.5% in June from 13.4% in March. The ratio of risk-weighted assets to total assets rose to 52.5% in June from 51.7% in March.
Russia: Growth acceleration amid improvement in external environment

The weak economic results of Q2 2013 prompted Russian authorities and international organizations to revise downwards their forecasts regarding 2013’s GDP growth. At present the median forecast of the Ministry of Economic Development, the EBD, the IMF, the World Bank, the EBRD and the CIS Statistical Committee for Russia’s GDP growth for 2013 is 2%. Most forecasts predict acceleration in economic growth throughout the latter half of 2013. The reasons for this will include: the recovery of external demand for Russian exports amid an improvement in the external economic environment; the recovery of production in the agricultural sector, which was affected by a drought in 2012; and the expected loosening of monetary policy by the Bank of Russia. Forecasts differ with regard to how strong this acceleration will be.

Currently available data for Q3 2013 indicate acceleration in the rise: in retail sales (from 3.5% in June to 4.4% in July); and in agricultural output (from 2.1% in June to 5.8% in July). Fixed capital expenditure did not resume steady growth, although it is the fourth quarter that typically makes a determining contribution into annual outcomes in that regard. In general, economic statistics give grounds to expect a higher GDP growth rate in the second half of 2013.

Inflation continued to slow in July and August 2013. The effect of a new summer increase in the regulated tariffs was less significant than in 2012. A relatively favorable situation in the agricultural sector led to a seasonal fall in food prices. The annual growth rate of consumer prices was 6.5% in July. Nonetheless, the monthly rise in consumer prices was positive in August and did not differ significantly from a year before. The general rise in prices was fueled by: a rise in energy prices; and the weakening of the ruble against the US dollar in the middle of the summer within the framework of global trends. The relative steadiness of private consumption, which only slightly decelerated its growth in the spring and summer, was probably also a factor preventing inflation from slowing. Given these circumstances, there is a greater likelihood of inflation going beyond the central bank’s target band in 2013. This means that the loosening of the central bank’s monetary policy, broadly expected this fall, may be less substantial and occur later than many analysts expect.

The balance of payments should improve under the influence of higher prices for Russian exports. In particular, the current account surplus will increase again following a decline in Q2 2013. Simultaneously, a rise in price of primary commodities, an increase in the physical volume of exports, and the weakening of the ruble compared with the first half of 2013 will have a positive effect on the condition of public finances. To all appearances, the federal budget will have a slight deficit, which will amount to no more than 0.5% of GDP.

In general, the economic situation still gives grounds to expect the Russian economy to resume growing at a moderate rate in 2013 and 2014 in the absence of external negative shocks. An improvement in the external economic environment as a result of the resumption of growth in the Eurozone’s economies and the stabilization of Asia’s economic growth would contribute to this trend.

The poor economic results of Q2 2013 prompt Russian authorities and international organizations to revise downwards their forecasts for 2013’s GDP growth.

Data for Q3 2013 give grounds to expect a higher GDP growth rate in the second half of 2013.

Inflation continues to slow in July and August.

The monthly growth rate of prices remains positive in August.

There is a greater likelihood of inflation going beyond the central bank’s target band in 2013.

The balance of payments should improve under the influence of higher prices for Russian exports.

An improvement in the external economic environment and stimulus measures will contribute to a recovery of GDP growth.
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
**Trends**

**Tajikistan: A 7.7% GDP growth amid strong non-tradable sector and signs of improvement in metallurgical industry**

Annual GDP growth in Tajikistan accelerated in Q2 2013 to 7.7% from 7.3% in Q1 2013, and 7.6% in Q2 2012. The “non-exporting” sector of the economy (retail trade and services) continued to be the main driver of GDP growth. Industrial output rose by 7.7% year-on-year, primarily due to the power and heat industry. There were some signs of improvement in the metallurgical industry, which showed a 3.6% year-on-year rise in output in Q2 2013 after a 0.8% decrease in Q1 2013. However, the decline in the textile industry became stronger, increasing from 6% in Q1 2013 to 16% in Q2 2013, amid a fall in the prices of textile products in world markets. Similarly, deterioration occurred in the foreign trade deficit, which grew to 43% of GDP from 34% in Q1 2013. This was due to a fall in the export of aluminum and cotton and a rise in demand for imported goods. Fixed investments rose by 43%, which was mainly due to an impressive 50% growth in construction. To all appearances, cash remittances from abroad, which support consumption and economic development in the country, are also the main driver of growth in the construction sector.

At the end of Q2 2013, the state budget had a small deficit amounting to 0.4% of GDP. It remained therefore at about the same level as a percentage of GDP as last year. Year-on-year increases occurred in both public revenue, which increased from 21% to 22.4% of GDP, and public expenditure, which increased from 27% to 28.5% of GDP. The main contribution to the nominal growth of expenditure was made by consumer spending (the payment of wages and salaries, and purchases of goods and services) and social transfers to the population. Public spending under a government investment program substantially decreased due to a reduction in the funding of the Rogun hydroelectric power plant.

The current monetary policy of the authorities is aimed: at stimulating the economy; and at maintaining a high growth rate of bank lending to the economy through an additional reduction in the average interest rates on loans in the banking sector. The annual inflation rate was 5.8% in Q2 2013. A fall in world food prices affected the dynamics of consumer prices in Tajikistan; according to the World Bank, food prices fell by 4.6% in annual terms. According to data from Tajik authorities, food accounts for one-fifth of the country’s imports. Nonetheless, an appreciable increase occurred in the price of non-food consumer goods, which rose by 5.2%. To all appearances, this was a consequence of the loosening of the authorities’ monetary policy – the average growth of money supply rose from 10.7% in Q1 2013 to 21% in Q2 2013. Due to the high growth rate of money supply, there was a very high rise in bank lending. The growth of lending to the economy outpaced the rise in deposits: the ratio of loans to deposits was 1.2 in June 2013 compared with 1.0 in June 2012. The level of “covering” foreign-currency deposits with loans rose from 0.9 to 1.2. The degree of the dollarization of lending (the share of foreign-currency loans) increased from 60% in June 2012 to 62% in June 2013.

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**Annual GDP growth accelerates in Q2 2013 to 7.7% from 7.3% in Q1 2013**

**There are some signs of improvement in the metallurgical industry, but the decline in the textile industry becomes stronger**

**Q2 2013 sees an impressive, 50% growth in construction**

**The state budget has a small deficit amounting to 0.4% of GDP at the end of Q2 2013**

**The annual inflation rate stands at 5.8% in Q2 2013**

**The growth of lending to the economy outpaces the rise in deposits**
Outlook

Tajikistan: Slight deceleration of the economy under the impact of the weak performance of industrial production

According to officially published data for the real sector of the economy, a slowdown in industrial output continued. 20% of the rise of industrial output belongs to the metallurgical and textile industries. Significant features of the current dynamics in the economy are: a 15.3% increase in agricultural crop production; a 4.7% year-on-year output decrease in the metallurgical industry; and a 10.2% decrease in the textile industry. Since the impact of agriculture in Q4 2013 will decrease, one can expect lower economic growth rates by the end of 2013. The current consensus forecast for GDP growth is 7% for 2013 with a subsequent slowdown to a long-term level of 6% in 2014 and 2015.

The annual growth rate of the consumer price index was 4.6% in August 2013. Out of the three major groups of commodities in the consumer basket, non-food goods were the greatest contributor to this rise – almost 60%. Since the downward trend in world food prices is expected to continue in 2013, such monetary policy of the authorities seems to be justified, especially considering the fact that the government’s goal for 2013 is to prevent inflation from rising above 9%. The IMF forecasts inflation to increase to 7.7% by the end of 2013 compared with 6.4% in 2012.

The condition of the state budget was satisfactory in the first half of 2013 due to lower capital investment. However, the rise in spending was somewhat higher than the rise in (estimated) nominal GDP. Public spending continues to determine the rise in fixed investment. In general, according to the 2013 Budget Law, the budget is designed to “take the country out of communication isolation, achieve energy independence, and ensure food security and the social protection of the population of the country.” The authorities expect: state budget revenue to total 12.1 billion somoni in 2013; GDP to grow by 7.4%; and inflation to be 9%. Power generation remains the main priority of economic activity, accounting for 16.9% of the total volume of investment. According to the finance minister, 13 grant agreements totaling 923 million somoni were signed in the first half of 2013. It is most likely that these grants will be used for achieving these strategic goals. The situation regarding the external debt and the balance of payments also seems to be generally satisfactory.

An issue of concern is signs of overheating in the banking sector. The foreign trade deficit amounts to 47% of GDP, and is almost fully covered by cash remittances from abroad; while the foreign exchange reserves are relatively small. Therefore the current high growth rate of foreign-currency lending poses the risk of deterioration in the economic situation. This scenario may come true if the flow of cash remittances slows its growth or, what is worse, begins to decrease.
Figure 9.1. **GDP and output**: GDP growth and output change by sectors, (in %, year-on-year)

Source: the Agency on Statistics under President of Tajikistan

Figure 9.2. **Foreign trade**: exports, imports, current account (left scale, in billions of US dollars), real effective exchange rate – REER (right scale, index – Q1 2008 = 100)

Source: national agencies

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

Source: national agencies

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

Source: national agencies, IMF (IFS)

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

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

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

Source: estimates and forecasts by national agencies, the IMF and the EBD
Turkmenistan: Acceleration in GDP growth amid high hydrocarbon prices and expansion of gas production

Turkmenistan’s GDP grew by 9.7% year-on-year in the first half of 2013. It grew from 9.2% in Q1 2013 to an estimated 10.2% in Q2 2013. This was due to acceleration in investment growth amid sustained robust consumer demand.

The government retains the role of being the main driver of economic growth. It stimulates the national economy within the framework of investment policy; and its social policy is aimed at increasing the population’s income at the expense of accumulated buffer reserves. The expansion of investment-policy’s scale contributed to investment acceleration to 7.9% in the first half of 2013 from 5.1% in Q1 2013; 64% of the investment went into the production sphere. This allowed investment to reach 43% of GDP, and produced a direct effect on the construction sector’s performance. The sector increased its output by 17.7% year-on-year, carrying out more than 1,865 projects throughout the country, and produced cement, rolled metal products, bitumen and other products. In its turn, the implementation of the government’s program aimed at raising the population’s living standards led a 10.7% increase in average wage and preserved robust consumer demand. This had a positive effect on retail trade and the entire services sector, which increased by 19.6% and 11.3% respectively.

Due to the government’s investment policy and diversification measures, there was an increase in output in the following branches of manufacturing industry: the production of polypropylene; pharmaceutics; fabrics; knitwear goods; and other products. Despite the government’s strategic plans, the growth rates in the power generation industry (0.1%) and the oil production industry (1.9%) remained modest. The same modest dynamics are observed in the oil-refining, chemical, machine-building, food and light industries, which had industrial output growth of 6.6%. Growth in the agriculture sector was 7% as a result of government support.

Despite the unfavorable combination of exports decreasing by 13.4%, and imports rising by 15.1% in annual terms, Turkmenistan preserved an external trade surplus. The reasons for this included the price of natural gas increasing by 7.4% on the average in Q2 2013. Given the sustained level of foreign investment, the current account balance should remain positive. The high gas prices also contributed to an 18.1% higher-than-planned level of tax revenue in the first half of 2013; while expenditure amounted to 95.7% of the plan. Therefore, one should conclude that Turkmenistan will have a state budget surplus in 2013. As for inflation, it is difficult to gauge its rate for an administratively regulated economy because of the lack of reliable data.

The start of gas production in the Galkynysh field, whose reserves are estimated at 26 trillion cubic meters, and also the continued high prices of hydrocarbons, coupled with expanding opportunities for natural gas export to China, lead to favorable prospects for economic growth in Turkmenistan. This is within the framework of the existing economic development model. As a result the external trade surplus and public revenue will increase. A revised consensus forecast predicts a GDP growth of 10% for both 2013 and 2014.
Turkmenistan

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

Source: national agencies

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

Source: IMF

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

Source: national agencies

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

Source: national agencies and the ADB

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

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

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

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

**Uzbekistan: Sustained high GDP growth rate**

The annual GDP growth rate accelerated to an estimated 8.5% in Q2 2013. This was: after a minor slowdown in economic growth in Q1 2013 to 7.5%; in spite of a slowdown in Russia; more modest growth rates in China; and persistent uncertainty in the international market situation. Uzbekistan’s economic growth recovered to 8% in the first half of 2013, and it spread to all sectors of the economy. This was as a result of acceleration in investment growth, which increased by 10.5% year-on-year in the first half of 2013, and the population’s real income rise of 16.3%, stimulated by the government’s expansive fiscal policy.

1,233 new production facilities were put into operation in the first half of 2013. This was within the framework of a program implemented by government in order to improve the industrial sector’s competitiveness and diversify its production. The number of new investment projects increased to 141, worth $6.8 billion. In the second half of 2013, growth in the industrial sector accelerated to 8.2%, and in construction to 16.1%. Agricultural output increased by 7.3% due to the government’s policy aimed at the capitalization and modernization of the agricultural sector. More than 3.4 trillion sums (about 7% of GDP) were injected into the economy. This was within the framework of a government program titled “The Year of Well-Being and Prosperity” aimed at improving the population’s living standards and the quality of life. Coupled with increasing cash remittances from Uzbek migrant workers in Russia, this stimulated domestic demand and contributed to growth in retail trade (14.6%) and services (11%).

An 11.4% increase in exports was ensured by the expansion of Uzbekistan’s export potential, and rising prices for almost all major export items except gold. This led to a large external trade surplus of $442.4 million. In Q2 2013 the price of natural gas increased by 7.4% and cotton by 2.7%. Taking into account the government’s official statements about foreign investment expansion, the probability of preserving the balance of payments’ surplus in Uzbekistan could be considered as high. The increase in export revenue and GDP growth also led to a state budget surplus. A significant rise in government expenditure, increasing by 26% year-on-year, led to a reduction in the state budget surplus. In the first half of 2013, the surplus was 68.7 billion sums or 0.1% of GDP. Official inflation did not exceed the government’s projected level of 7 to 9%, but given the excessive stimulus measures, the objective inflation should have been higher. The IMF estimates that the country will have an inflation of 10.9% in 2013.

Due to government stimulation, GDP growth in 2013 should apparently surpass the 7.5% level predicted by a consensus forecast that is based on forecasts from the IMF, the World Bank, the EBRD and the ADB. It should be closer to the government’s forecast of 8%. Deterioration should be expected in public finances and the balance of payments, which should remain positive. The government expects a budget deficit of 1% of GDP. Major risks for the economy of Uzbekistan are related to the administrative nature of the existing economic development model. It is characterized by high public sector participation, and severe restrictions on foreign-currency transactions on foreign and domestic trade. This model is not sustainable in the long run and structural reforms continue to be a major challenge for Uzbekistan.
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: GDP decline amid improvement in external balance

In Q2 2013, Ukraine’s GDP decreased by 1.1% compared with Q2 2012. The same 1.1% year-on-year decrease occurred in the first half of 2013. There was therefore negative GDP growth during the fourth consecutive quarter. The decline in industrial output became steeper. It decreased by 5.3% year-on-year in the first half of 2013, compared with a decrease of 5% in Q1 2013. This was because of a more significant fall in the extractive industry: from 0.2% in Q1 2013 to 1.3% in the first half of 2013. Even greater decreases occurred in coal production (0.3% in Q1 2013 and 4.6% in the first half of 2013), and the manufacturing industry (6.9% in Q1 2013 and 7.4% in the first half of 2013). This was primarily because of deterioration in the performance of the food processing industry, whose output decreased by 1.8% year-on-year in the first half of 2013 after a rise of 2.8% in Q1 2013. At the same time, growth in the agricultural sector accelerated from 5.8% in Q1 2013 to 15.4% in the first half of 2013. This was mainly due to the low base of 2012, which saw a poor grain crop. The rise in retail trade slowed from 13.4% in Q1 2013 to 11.2% in the first half of 2013. Regarding demand, a significant decrease occurred: in the volume of fixed capital expenditure, which dropped by 14.6% year-on-year in the first half of 2013 after a 3% increase in Q1 2013; and in the physical volume of exports, which decreased by 12.5% in Q2 2013 after a decline of 4.5% in Q1 2013.

On the positive side, the fall in fixed capital investment and the slowdown in the growth of private consumption made possible a noticeable improvement in the balance of payments: in Q2 2013, the current account deficit amounted to $2.3 billion, 60% less than in Q2 2012. The respective figure for the first half of 2013 was $5.1 billion, down from $5.8 billion in the first half of 2012. Nonetheless, the international reserves of the National Bank continued to shrink in Q2 2013, totaling $23.2 billion (3.1 months’ average monthly imports in the quarter) compared with $24.7 billion (3.3 months’ imports) in Q1 2013. This decrease was largely related to the repayment during Q2 2013 of the official external debt, including the debt owed to the IMF.

The state budget deficit in the first half of 2013 was 3.5% of GDP, a considerable increase compared with the first half of 2012, when it was 1% of GDP. A key role in the rise in state budget expenditure belonged to social security spending, which grew by 55% compared with 2012; while budget revenue almost did not change.

The month-on-month growth rate of consumer prices fluctuated around zero throughout Q2 2013, while the annual inflation rate remained negative at between minus 1 and 0%. The National Bank kept the national currency pegged to the US dollar at around 8.1 hryvnia for one dollar. Amid the de facto fixed exchange rate of the national currency, the improvement of the balance of payments led to more loose monetary conditions. In particular, the annual growth rate of M2 increased to 17.9% in June from 16% in March.

The annual growth of bank lending accelerated from 5.1% in March to 6.7% in June. The indicators of stability of the banking sector generally deteriorated during Q2 2013. In particular, the ratio of capital to risk-weighted assets fell in the quarter to 18% from 18.2% in Q1 2013. The share of liquid assets in the total volume of assets shrank to 22.7% from 24.7% in Q1 2013.
Outlook

Ukraine: Strengthening of public finances, modest GDP growth rate

The improvement of the balance of payments in Q2 2013 is a positive fact of significant importance. The sustainability of the Ukrainian economy noticeably increased compared with the end of 2012 and early 2013. Nonetheless, risks in the field of external balance remain. Payments on the external debt in 2013 and 2014 will keep putting pressure on the country’s international reserves. They may continue to shrink, declining to levels within two to three months' imports. In the short term, a negative impact on the balance of payments will come from the rise in energy prices. This rise is still higher than the simultaneous rise in the prices of Ukraine’s exports, primarily metals. However, the recovery of the physical volume of metal exports, especially in 2014, will produce a positive effect on the balance of payments.

Ukraine’s GDP growth rates will apparently return to positive figures, although they will not be high. The positive effects on GDP will be due to increases in: investment activity; agricultural output; and the export of metals, which has not yet begun but is probable in 2014. They will be offset by the decline in the growth of private consumption, which is currently at levels that are not sustainable. The forthcoming consolidation of public finances is one of the factors that will negatively affect the growth of household consumption in the next one or two years.

The 2013 rise in the state budget deficit has apparently become the main risk factor for the Ukrainian economy in the near future. One may expect that throughout the second half of 2013, and to a greater extent in 2014, public revenue will be supported by the recovery of export revenue, especially metal exports, and the general stabilization of economic activity in the country. Nonetheless, the seasonal peak of government expenditure at the end of 2013 will lead to an increase in the budget deficit compared with the first half of 2013. It is probable that the state budget deficit will exceed 5% of GDP by the end of 2013.

In the field of monetary policy and lending, the positive trends that took place throughout the first half of 2013, such as the recovery of the growth in money supply and the growth in bank lending, will probably continue. Under these circumstances, inflation should return to positive annual rates.

The general economic situation in Ukraine started to move in a positive direction in the first half of 2013. It will be possible to determine how sustainable the positive changes are only towards the end of 2014, when the 2013-2014 peak of payments on the external debt is over. The passing of this peak will create favorable conditions for reviewing the authority’s approach to their macroeconomic policy, including its exchange rate and monetary components. There are grounds to believe that the policy of maintaining a de-facto fixed exchange rate of the hryvnia considerably increased the costs of the 2008-2009 and 2012-2013 recessions for the Ukrainian economy.
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
Analytical insert

Global imbalances: five years after

Konstantin Fedorov

In the years preceding the 2007-2009 world crisis, experts’ attention was drawn to an increase of so-called global imbalances: current account deficits in some countries, and current account surpluses in others. Factors determining the emergence of these imbalances, and associated risks, were the subject of much discussion in economic circles (see, for instance, Blanchard and Milesi-Ferretti, “Global Imbalances: In the Mid-Stream?” the IMF, 2009). In this note, we attempt to look at the dynamics of the values that characterize the mentioned imbalances in the period that followed the crisis, and determine what conclusions can be drawn on this basis with regard to the nature of global imbalances. We also want to assess the likelihood of a crisis comparable with the 2007-2009 crisis, to the extent that is possible within the framework of a brief analytical paper.

Economists who studied the global imbalances pointed to the following factors as ones that can potentially be behind this phenomenon (see Blanchard and Milesi-Ferretti, 2009):

1. Differences between countries in terms of savings. In particular, countries facing the prospect of a rapid increase in the population’s average age may have a higher standard of savings. Sometimes the cultural peculiarities of countries are pointed to as factors explaining differences in the standards of savings.

2. The lack of a strong social insurance system may have the same effect or strengthen the effect (1).

3. Differences in the productivity of investment: countries that have more opportunities for capital investment can intensively attract foreign capital. Advantages for attracting investment may be both of a steady nature, due to fundamental features of the economy, and connected with speculative hikes in one market or another. Real estate markets frequently play a role in such cases.

4. Countries with developed financial markets can attract large volumes of investment from abroad because they can offer external investors an attractive choice of financial assets in terms of volume and liquidity.

5. Countries experiencing difficulties in protecting ownership rights may show an unnaturally high level of capital outflow and, consecutively, a high current account surplus.

6. Countries with relatively poorly developed and uncompetitive financial systems, which do not offer investors a sufficient choice of reliable and acceptably profitable instruments for capital investment, can turn out to be capital exporters, having a high current account surplus.

7. The governments and private sectors of countries that have experienced a crisis of one nature or another in the relatively recent past can invest significant resources in the creation of reserves. Such motives may have influenced the behavior of countries in the Asia-Pacific region and, possibly, Russia, throughout the 2000s, or at least in the first half of the decade.

8. Policies aimed at ensuring the competitiveness of exports, which include interventions in the foreign exchange market for the purpose of weakening the national currency, and measures to limit domestic demand with a view to prevent prices from rising.

9. Imbalances can be connected with the existence of structural problems in the field of public finances.
If such problems exist in large economies, they may have a global impact.

Blanchard and Milesi-Ferretti (2009) divide factors 1-8, and associated processes, into: “good,” connected with natural differences in the condition and needs of economies (primarily 1 and 3); and “bad,” connected with the existence of structural problems and distortions in various countries (almost all others). From the standpoint of the objectives of our analysis, it is more important to answer the question as to which of them can become the source of a crisis in the event of a sharp correction of imbalances. Of the greatest risk in this respect are the imbalances that: either cannot be steady in principle (those connected with speculative phenomena); or are connected with a policy that cannot be maintained indefinitely long due to the existence of economic and political risks (policy aimed at stimulating exports to the detriment of domestic consumption).

Figure 1 shows for a few countries, or groups of countries, the diagrams of: the current account balance; the consolidated budget balance; and the external balance of the private sector1 (as a percentage of GDP). The first section of the figure shows the dynamics of the above-mentioned indicators for the largest economies (the Eurozone, the United States, Japan and China, and also the Asian developing economies as a whole). The second section contains data for the Eurozone countries. The third section provides data for the countries of Central and Eastern Europe plus Russia and Turkey. The fourth section contains data for large exporters of crude oil and natural gas, including Russia and Kazakhstan. The diagrams were created on the basis of annual data for the period between 1990 and 2012, which are available in the IMF’s World Economic Outlook (WEO) database as of April 2013. In addition, we cite the IMF’s forecasts for variables in the diagrams for the period between 2013 and 2018, also using the April 2013 WEO database as the source. Apart from this, the diagrams contain historical data, and the IMF’s forecasts for the growth of the world’s GDP, and the Eurozone’s GDP, in the second and the third section.

In the diagrams, one can see three periods that correspond to the phases of the global business cycle since the mid-2000s: the overheating in the years preceding the 2007-2009 crisis, which was accompanied by the growth of imbalances; the cooling of economic activity between 2007 and 2013, amid which global imbalances sharply decreased; and the forecast period following 2013, during which, according to the IMF, there will be a recovery of the economic growth rate in the world. We mark these periods with different colors: red for the overheating, blue for the cooling and light red for normalization and growth recovery.

In the first instance, it should be noted that the imbalances started to grow in the latter half of the 1990s, and growth accelerated in the 2000s, reaching its peak in 2007, and then sharply decreased to the present moment. In 2012-2013, the size of the current account deficit of leading economies amounted to approximately 50% of the maximum levels. The IMF expects that the size of the external imbalances of the largest economies will remain largely unchanged throughout the next few years, as the imbalances have reached a level close to that forecast for the period between 2014 and 2018.

Based on our diagrams, we can make a number of observations, which are not necessarily original.

The roles of transient and permanent factors in the formation of global imbalances were approximately equal. If the IMF is right in its forecasts, the global imbalances that took place in the middle of the past decade were half due to the influence of the following temporary factors in the above-listed factors: (3) a surge in investment activity in the United States and peripheral countries in Europe on the one hand; and (8) the policy aimed at supporting exports, primarily in China; and also (7) the accumulation of foreign exchange reserves after the crisis of the late 1990s in Asia and Russia. More permanent reasons account for the remaining half of the imbalances. The above-listed factors from 2 to 6 and 9 could play their role in this

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1 The external balance of the private sector is the difference between the current account balance and the consolidated budget balance. Thus, the private sector means everything that does not pertain to the government budget. In particular, the private sector includes companies partly or fully owned by the state. So, the term “private” here is used for the lack of a better one.
In the opinion of the IMF, the continued budget deficit in the United States, which amounts to some 4% of GDP, will play a key role for global imbalances’ extension into the 2014-2018 period.

This deficit will remain the only significant imbalance of global importance during the forecast period. Its existence will be maintained by continued current account surpluses in Asia, in some countries in the Eurozone, and in some countries among oil and gas exporters.

The probability of a global-scale crisis has significantly decreased compared with the middle of the past decade. If the IMF’s forecasts are correct, the size of current account deficits and surpluses currently existing in the world are basically close to sustainable levels. If this is true, the probability of large-scale macroeconomic corrections involving a large number of countries is currently significantly lower than in the mid-2000s. For the largest economies, the consolidation of external balances in the period between 2008 and 2013 was, according to the IMF’s forecasts, a little excessive. In 2014-2018, the United States may slightly increase the current account deficit again because of a recovery in consumption and investment following the post-crisis consolidation. China and the Asian developing countries as a whole may increase their current account surpluses again amid a rise in exports to the United States and Europe.

The period of the rise and fall in global imbalances between 1990 and 2010 involved two groups of participants, whose composition varied in a rather limited manner. The first group (capital recipients within the framework of imbalances) primarily included the United States, and also most of the countries of Central and Eastern Europe (former transition economies). The second group (capital investors within the framework of imbalances) included Japan, China and the Asian developing countries in general, rich European countries, and oil and gas exporters. During the last few years, the first group has lost European countries that were especially strongly affected by debt and budgetary crisis in the region (in particular, Ireland, Spain, Hungary, which will apparently be soon joined by Greece). Kazakhstan has moved into the second group.

The IMF expects that in the period between 2014 and 2018, the composition of both groups will remain largely the same as at present. However, there are some exceptions. For instance, the IMF forecasts that Russia will have a zero current account balance by 2018; it was even predicted to go to a negative current account balance.

Despite the smaller scale of global imbalances, they have not vanished altogether. The IMF does not expect their disappearance in the future. The existence of imbalances may in itself not be a source of instability if the permanent factors behind them retain their force.

During the period until 2018, macroeconomic correction will be in the form of the rebalancing of government budgets and the private sector’s balance in individual countries. At present significant macroeconomic imbalances are of a symmetric nature: state budget deficits are compensated by surpluses in the private sector’s balance. Such a situation can be seen in the United States, Japan and many countries in the Eurozone. Thus, the process of macro rebalancing will not have to be accompanied by a significant correction in the external balances of the involved countries. The rebalancing process will be controlled by the national authorities to a greater degree than during the 2007-2009 global crisis, and even than during the 2011-2013 debt crisis in the Eurozone. This is because in each case debtors and creditors are mostly residents of one country.
Figure 1. Global imbalances: current account, consolidated budget, and private current account balances, in % of GDP

The largest economies:

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<tr>
<th>CA balance</th>
<th>Consolidated budget balance</th>
<th>Private sector CA balance</th>
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<tr>
<td>heating up</td>
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<td>cooling down</td>
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<td>back to growth</td>
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Eurozone:

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<tr>
<th>CA balance</th>
<th>Consolidated budget balance</th>
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<td>heating up</td>
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<tr>
<td>back to growth</td>
<td>back to growth</td>
<td>back to growth</td>
</tr>
</tbody>
</table>
Central and Eastern Europe, Russia, Turkey:

- **CA balance**: heating up, cooling down, back to growth
- **Consolidated budget balance**: heating up, cooling down, back to growth
- **Private sector CA balance**: heating up, cooling down, back to growth

Oil and gas exporters:

- **CA balance**: World GDP growth, Russia, Kazakhstan, Saudi Arabia, United Arab Emirates
- **Consolidated budget balance**: World GDP growth, Russia, Kazakhstan, Saudi Arabia, United Arab Emirates
- **Private sector CA balance**: World GDP growth, Russia, Kazakhstan, Saudi Arabia, United Arab Emirates

Revival of the Great Silk Road

Elvira Kurmanalieva

In the Middle Ages, the Great Silk Road connected Eastern Asia and the Mediterranean region. It provided the basis in the Eurasian supercontinent for the development of international trade, transport logistics, customs business, and commodity and monetary relations. When sea transport routes emerged, the role and global importance of continental Eurasia diminished. However, a recent trend shows a revival of the Great Silk Road.

The New York Times published recently an article about the launch of a new rail transport route from China to Europe. The article advertised a project of Hewlett Packard (HP), which found it cheaper to carry goods to Europe by rail from the western Chinese city of Chongqing. HP had moved there because of high costs in the eastern coast. Bloomberg News published an interview with a HP representative. He said that the transport from China to Western Europe of one container: by air costs $30,000; by sea takes 45 days and costs $10,000; by rail takes 21 days and costs $20,000. Similar arguments are presented by multinational corporations such as DHL, BASF and Ford Motor Company. They have also moved to the western part of China; and investigate more economical and quicker methods of delivering their products to customers in Europe. Thus, the balance between different means of transportation undergoes gradual change. Since high oil prices have made transportation by air unaffordable, and the low cost of transportation by sea is overshadowed by an additional three to five days of waiting in seaports, transportation by rail seems more advantageous.

China’s economic statistics confirm the above statements. Under the influence of the slowdown in economic growth in the post-crisis years of 2010 and 2011, the number of foreign companies registered in Shanghai has decreased by 29%, whereas the number of Chongqing-registered foreign companies decreased by only 2%. The considerable gap between the levels of per-capita income continues. In 2012 it was $3,800 in Chongqing against $6,400 in Shanghai. Despite this the growth rate of disposable income (see Picture 1) in western China (Zhengzhou, Chengdu and Chongqing) is higher than in the eastern coast of the country (Shanghai, Guangzhou and Shenzhen). Meanwhile, the International Monetary Fund predicts a further gradual slowdown in China’s economic growth from 7.8 % last year to 7.5% by 2018. This is due to factors including a rise in pay and companies’ costs. In response to the emerging signs of the slowdown, Chinese authorities have announced a new program aimed at stimulating the economy through a $112 million increase in public spending for the accelerated construction of railroads, primarily in the central and western regions of the country.

There has been a rise in the global economy’s demand for infrastructure investment. According to estimates from the World Bank, prepared for the G20 governments, developing countries are to invest between $200
million and $300 million a year in: the maintenance of economic growth; the deepening of integration; and the improvement of transport linkages and networks. According to other estimates, following the global crisis, the main positive changes have primarily happened in railroad infrastructure. Major players in this market expect these positive trends to strengthen in both the structure of the market and technologies, and the geographic focus. The reservation is that railroad infrastructure primarily relies on public investment, although there are a number of projects financed by various investors.

Meanwhile, freight transportation grows at a fast pace in the three member countries of the Common Economic Space (see Picture 2). This trend is especially pronounced in Kazakhstan, where the volume of freight transportation in 2012 was 70% larger than in 2001. According to a report from Kazakhstan Temir Zholy, the country’s national rail operator, proceeds from the transportation of goods in transit accounted for the greater part of the 13% rise in the company’s revenues in 2012.

Russia and Kazakhstan are the richest countries in the CIS, and occupy more than 90% of the area of the Commonwealth, and one-third of the total area of Eurasia. They experienced the problem of a slowdown in their economic growth in 2012. Looking for an impetus to growth, their authorities are considering various schemes for developing infrastructure, including transport infrastructure. In 2012 Kazakhstan launched a 293-kilometer rail line between Zhetygen and Korgas as part of the Western China-Western Europe project. It plans to complete before 2015 the construction of rail lines between Zhezkazgan and Beyneu, and between Arkalyk and Shubarkol. The design cost is estimated at some 700 billion tenge. Russian authorities also plan to spend 562 billion rubles before 2018 on the modernization of the Baikal-Amur Mainline, and the Trans-Siberian Railway. These investments annually amount to 0.3 to 0.4% of GDP. According to estimates from Sberbank’s Center for Macroeconomic Research, the infrastructure spending multiplier is 0.55. This means that an additional 0.15 to 0.2% GDP growth will be generated every year. The Center also cites the example of the United States, where this multiplier generates an extra 0.8% GDP growth. It refers to the argument that government spending in developing countries is, in general, less efficient than in developed economies.

Apart from a direct effect, one should note benefits from the expansion of foreign trade and international trade. Picture 3 depicts a railroad index, calculated as a ratio between the length of railroad track and the total territory, and the level of per-capita income in 40 countries of the world. The direct line (linear trend) indicates a positive correlation between the level of income and the development degree of infrastructure. Above the trend line, there are economies with a high level of per-capita income, where the length of railroad track is insignificant compared with the territory of the country. Below the trend line, there are economies with an insufficient lev-
el of per-capita income, including Russia and Kazakhstan. EC Harris, an international built asset consultancy firm headquartered in the United Kingdom, puts the BRICS countries (Brazil, Russia, India, China and South Africa) in the lower half of its rankings while calculating its global infrastructure investment index, referring to the existence of high risks in those countries. However, EC Harris stresses that the BRICS countries are attractive when business and financial risks are well managed.

Despite the existing problems and risks, there is a significant demand for investment in transport infrastructure in the region’s countries. Such investment is especially important for countries that have areas without a direct transport link to seaports. The changes taking place in China only contribute to the development of transport routes across Eurasia.

For its part, the Eurasian Development Bank is actively involved in the revival of the Silk Road by participating in: the construction of a railroad car plant in Tikhvin, Russia; the organization of the manufacture of freight cars and tank containers in Belarus; and projects in the railroad industry in Kazakhstan. The Bank’s analysts estimate that the implementation of these plans potentially has a strong effect for sustainable development through a positive impact on: the development of the vehicle-building industry; the efficient use of existing transport infrastructure; the creation of new jobs; governments’ tax revenues; and international trade.
Analytical insert
In search of the middle class in EDB countries

Arman Ahunbaev

I. There is a need to correctly define and assess the middle class in the EDB member countries.

Numerous reports from authoritative international organizations, research surveys, newspaper articles, and public and political discussions on issues relating to economic development frequently focus on the key role of the middle class. The heightened interest is because it is the middle class that is believed to be the main driver of GDP growth, and a stabilizer for democratic processes in society. GDP is viewed from both the standpoint of consumption as a determining source of demand, and the standpoint of supply as a class with a heightened propensity to accumulate human capital. It is believed that the fast expansion of the middle class in the world, coupled with a high pace of economic development, leads to a change in the structure of consumption and considerably strengthens pressure on the distribution and value of resources from a global standpoint (Goldman Sachs, 2009). Also, it is believed that the formation of the middle class creates a foundation for political stability in society, and a basis for healthy conservatism. This protects the country from sharp political imbalances, but leads to the emergence of new forms of political pressure. It is of strategic interest for the EDB to find out whether a middle class exists in the EDB countries and, if it exists, what role it plays in the process of economic development in these countries. This is also of interest from the standpoint of the development of the region in general.

II. The concept of middle class is always relative and the choice of a definition for middle class depends on the objectives the researcher sets.

In literature, there is not a single definition of the term “middle class.” Definitions significantly differ depending on the objectives of the research. An assessment of the middle class directly depends on a specific historical period and place, and is determined by various factors such as the history, culture and development level of a specific nation. The concept of the middle class – like the concepts of poverty and inequality – is a subject of interest for many social sciences including economics, sociology, and political science. It actually becomes a relative concept and assumes political significance. Although the middle class does not have clear features, there is a need to choose a definition for it. A brief review of the basic literature on the subject will help us determine the methodology we need to assess the middle class in the EDB countries and analyze it correctly.

The concept of a social class, including the middle one, is based on the size of income, the structure of consumption, the nature of the main occupation, and even the concept of self-identification. From a sociological standpoint, the analysis of the middle class is based on relative concepts that make it possible to analyze class differences in society. This is frequently with regard to the nature of the main occupation. In economic literature, the analysis of the middle class primarily focuses on the distribution of income in society. Economists use both relative and absolute definitions. Relative definitions enable them to compare the middle class in different countries through an analysis of various configurations of income distribution. Absolute definitions define the middle class as households with a quantitatively determined level of income or consumption. See Banerjee, Abhijit V. and Esther Duflo (2007), ADB (2010), Easterly (2001) and Birdsall (2012).

Since we have set ourselves the task of measuring the size of the middle class in the EDB countries, we will use a combination of relative and absolute definitions. The middle class should include the population strata that cannot be included with either the rich or the poor. Using international definitions for poverty, it is possible to use the absolute poverty threshold for defining the middle class for any country. According to the
methodology of the World Bank: the extreme poverty threshold is a per-capita income of $1.25 a day at purchasing power parity (PPP), or $456.25 per capita a year; and the moderate poverty threshold is $2 a day at PPP, or $600 per capita a year. We will use a threshold of $20 per capita at PPP as the upper line, and then we will discuss a threshold of $10 a day as the lower line. This will make it possible to exclude from our analysis the population strata that can find themselves beyond the relative poverty threshold. We can try to assess the usefulness of this level for the EDB countries. From the standpoint of political economy, we will try to define the middle class using the 90th percentile. This is rather a relative indicator that makes it possible to exclude the rich population from the analysis.

III. Economic development leads to a decrease in poverty and a rise in the population’s income, the distribution of which is characterized by heightened social inequality.

The World Bank has developed methodology for the classification of countries by the level of gross national income (GNI) per capita. This makes it possible to preliminarily determine the status of the EDB countries and compare them. To classify countries in 2012, the World Bank divides countries into four categories depending on the level of GNI per capita. Using the World Bank Atlas method, the categories are: countries with low income (per-capita GNI of up to $1,035); the lower segment of countries with middle income (per-capita GNI of between $1,036 and $4,085); the upper segment of countries with middle income (per-capita GNI of between $4,086 and $12,615); and countries with high income (per-capita GNI of at least $12,616).

At the end of 2012, according to the World Bank’s methodology from the standpoint of GNI per capita, the greatest progress had been made by Russia and Kazakhstan, which are oil exporters. At the beginning of the 2000s, simultaneously with a sharp rise in prices of exported crude oil, these countries started to quickly increase their lead over the other EDB countries. They were already distinguished from other post-Soviet countries for higher income at the start of the transitional period. In 2004 Russia had been the first to enter the upper segment of countries with middle income. In 2012, it had a per-capita income of $12,700, and it also entered the group of countries with high income. Kazakhstan ascended into the upper segment of countries with middle income in 2006, and reached a per-capital GNI of $9,730 in 2012, ranking second among the EDB countries. We should also mention Belarus, which ranks firmly in the upper segment of countries with middle income. The rankings of the other EDB countries are more modest. For instance, Armenia is still in the lower segment of countries with middle income. Kyrgyzstan and Tajikistan have an extremely low growth rate of income. They have not made substantial progress in terms of economic development, and are in the group of countries with low per-capita income.

Figure 1. EDB countries in income classification

Figure 2. Kuznets curve

A higher level of per-capita income in a country does not necessarily mean that the country has a larger middle class. On the other hand, a low level of per-capita income does not mean that there is no middle class. The nature of income distribution within a country is important. Accordingly, although there can be an equal level of development in terms of GNI per capita, the size of the middle class can differ depending on...
the level of inequality in income distribution. It is also assumed that simultaneously with the level of economic development, after reaching a certain level, inequality in income distribution should gradually decrease (Kuznets S., 1955). From the standpoint of inequality in income distribution, measured using the Gini coefficient, the EDB countries meet the assertion that Belarus, Kazakhstan, Armenia and Kyrgyzstan show a clear decline in inequality in income distribution simultaneously with income growth, with Belarus having seen the greatest improvement. It should be particularly noted that Russia is distinguished from the other EDB countries for not only a high level of per-capita GDP but also a high level of inequality.

A simple look at the dynamics of income and the indicators of inequality in income distribution enables us to state that the middle class in the EDB countries grows in parallel with economic development: per-capita income increases and inequality in income distribution tends to decline. The same holds true for poverty. In absolute terms poverty has considerably decreased simultaneously with progress in economic development. It remains relatively high in Kyrgyzstan, Armenia, Tajikistan, and, to a lesser degree, Belarus. In Russia and Kazakhstan, which made significant progress in the 2000s, absolute poverty has fallen below 1%. Nonetheless, inequality in income distribution continues to be a characteristic feature of the EDB countries, and has a certain impact on the formation of the middle class. All the countries are characterized by rather serious inequality and have an “incorrect” Lorenz curve. In this regard, we should again mention Russia, which has the worst Lorenz curve among the EDB countries. Belarus has a more “just” form of the curve and the other countries are at intermediate levels.

IV. The share of the middle class in the total population of the EDB countries is very sensitive to the definition used in the research.

Having a notion of the major factors determining the development of the middle class, we will now try to assess it in the EDB countries. We will use the above-stated methodology for identifying the middle class in three stages: two absolute definitions; and one combined definition.

It is not recommended to use of an absolute definition with a lower threshold of $2 per capita a day at PPP and an upper threshold of $20 (see Table 1). For Kazakhstan, Armenia and Kyrgyzstan we get too high results. For countries with a higher level of GNI per capita and more favorable initial conditions, such as Russia and Belarus, one can see a decline in the middle class. This is due to people’s massive transition into the group with income exceeding $20 per capita a day at PPP. For Tajikistan, this definition would suggest that at 16.7% of the total population there was almost no middle class in the country at the end of the hard 1990s; and that the middle class grew phenomenally in the following decade to 72.7% of the total population in 2009. This is actually a result of a decline in poverty rather than the expansion of a real robust middle class in the country. The results of the estimation suggest a need for using a different definition. On the other hand, one can draw a useful conclusion: the middle class in its international absolute definition is large both at the beginning of the transitional period and at present.
The former definition leads to an excessive estimate because a large proportion of the population does not earn enough to be viewed as middle-class people under the narrower international absolute definition. At the same time this population group cannot be described as poor. The latter definition clearly shows this: the proportion of poor people becomes small, but the population still does not earn enough in most of the countries. From a purely economic standpoint considering the level of income and its distribution, the middle class is present, but remains limited, only in Belarus and Russia. In the other countries, the greater part of the population does not earn enough. Does this mean that the middle class did not exist and does not exist in other countries? Not at all from the standpoint of political economy. The definition of middle class for a given country should reflect its peculiarities. This can be ensured by adding elements of a relative definition.

By setting as the upper threshold the 90th percentile, it makes it possible to exclude from the estimation the people who are rich relative to the population of the country. The exclusion of the rich makes it possible to determine the essence of the middle class. It is in the middle between the poor and the rich, and exists in

Table 1. : Middle class assessment (low threshold – $2 per capita per day, PPP, 2005; high threshold – $20 per capita per day, PPP, 2005)

<table>
<thead>
<tr>
<th>Country</th>
<th>Middle class</th>
<th>% of total population</th>
<th>Middle class</th>
<th>% of total population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>1996</td>
<td>1919287</td>
<td>2010</td>
<td>2373167</td>
</tr>
<tr>
<td>Belarus</td>
<td>1993</td>
<td>10181661</td>
<td>2011</td>
<td>6961707</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>1993</td>
<td>13506889</td>
<td>2009</td>
<td>15683097</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>1993</td>
<td>2996830</td>
<td>2011</td>
<td>4321240</td>
</tr>
<tr>
<td>Russia</td>
<td>1993</td>
<td>124326092</td>
<td>2009</td>
<td>115117392</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>1999</td>
<td>1017808</td>
<td>2009</td>
<td>5417236</td>
</tr>
</tbody>
</table>

Sources: author’s calculations, PovcalNet Database, World Bank

In order to avoid an excessive estimate of the middle class, it is possible to use a per-capita income of $10 a day at PPP as the lower threshold (see Table 2). This allows excluding from the estimation the “fragile” population group that has just crossed the poverty threshold. The use of the new threshold is not recommended either, as most of the CIS member countries including Armenia, Kazakhstan, Kyrgyzstan and Tajikistan would simply have no middle class. The only exceptions are Belarus and Russia; however the results of the estimation under this narrow absolute definition for these countries also do not reflect the real state of affairs. This estimation, in combination with the previous one, suggests that in most of the countries with the “absent” middle class (Armenia, Kazakhstan, Kyrgyzstan and Tajikistan), a large proportion of the population is in the group with a per-capita income of between $2 and $10 a day at PPP. Even Kazakhstan, which is distinguished by its high level of GNI per capita, estimates made on the basis of this threshold show that only 11.1% of the total population fell into this group in 2011. In 1993 it was 4.4%. These groups are larger in Russia and Belarus, making up 35.8% in 2009 and 53.95% in 2011, respectively. This testifies to a higher level of income in these countries and, to all appearances, a broader middle class under the narrow absolute definition.

Table 2. : Middle class assessment (low threshold – $10 per capita per day, PPP, 2005; high threshold – $20 per capita per day, PPP, 2005)

<table>
<thead>
<tr>
<th>Country</th>
<th>Middle class</th>
<th>% of total population</th>
<th>Middle class</th>
<th>% of total population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>1996</td>
<td>105358</td>
<td>2010</td>
<td>60159</td>
</tr>
<tr>
<td>Belarus</td>
<td>1993</td>
<td>994207</td>
<td>2011</td>
<td>5104052</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>1993</td>
<td>725071</td>
<td>2009</td>
<td>1792814</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>1993</td>
<td>439023</td>
<td>2011</td>
<td>170953</td>
</tr>
<tr>
<td>Russia</td>
<td>1993</td>
<td>31501092</td>
<td>2009</td>
<td>50775398</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>1999</td>
<td>0</td>
<td>2009</td>
<td>125861</td>
</tr>
</tbody>
</table>

Sources: author’s calculations, PovcalNet Database, World Bank
each country irrespective of its overall income. The absolute lower threshold of $2 per capita a day at PPP should be kept, as the physical minimums remain the same for the population of any country.

Table 3.: Middle class assessment (low threshold – $2 per capita per day, PPP, 2005; high threshold – 90th percentile in the income distribution)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Low threshold</th>
<th>% of total population</th>
<th>High threshold</th>
<th>% of total population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>1996</td>
<td>822234</td>
<td>25.9%</td>
<td>1591990</td>
<td>53.7%</td>
</tr>
<tr>
<td>Belarus</td>
<td>1993</td>
<td>8242761</td>
<td>80.5%</td>
<td>6751407</td>
<td>71.3%</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>1993</td>
<td>11667347</td>
<td>71.4%</td>
<td>12242311</td>
<td>76.1%</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>1993</td>
<td>1339202</td>
<td>29.7%</td>
<td>2867592</td>
<td>52.0%</td>
</tr>
<tr>
<td>Russia</td>
<td>1993</td>
<td>79577016</td>
<td>53.6%</td>
<td>96881957</td>
<td>68.3%</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>1999</td>
<td>2509172</td>
<td>41.2%</td>
<td>5117851</td>
<td>68.7%</td>
</tr>
</tbody>
</table>

Sources: author's calculations, PovcalNet Database, World Bank

Estimates made on the basis of the new definition are more adequate from the standpoint of political economy, and make the middle class more specific for each country (see Table 3). The rich and the poor are excluded. In Armenia and Kyrgyzstan, the share of the middle class is 53.7% and 54% of the total population, respectively. The increase in the middle class occurs through both a decline in poverty, and relative to those countries a decrease in the quite large group of rich people. However, a great part of the population does not earn much. In Tajikistan, the share of the middle class is larger and reaches 68.7%. Given the very small proportion of the population with a per-capita income of between $10 and $20 a day at PPP, this indicates a small share of the rich population and a more even distribution of the low income. The growth of the middle class in the country occurred solely through combating poverty. In Kazakhstan, the situation regarding the middle class is more optimistic: the middle class has slightly grown to 76.1% of the total population. In Russia and Belarus, the middle class is also large, making up 68.3% and 71.3% of the population, respectively. Given the higher level of income in these countries, the expansion of the middle class in Russia occurred to a greater degree through a decrease in the number of the rich. In Belarus there is a contrary trend: the size of the middle class diminished through the expansion of the rich class.

V. The middle class in the EDB countries is non-homogenous.

Since there is no ideal definition for middle class, measuring its size in the EDB countries is a difficult task in both conceptual and technical terms. Nonetheless, every definition makes it possible to draw new conclusions and get a more accurate idea of economic development, income growth, changes in the structure of income and, of course, the middle class.

There is no doubt that the middle class exists in the EDB countries, but it is different and specific in and for each country. In Armenia and Kyrgyzstan, the middle class has grown to make up more than half of the population, but it is still actually a class with low income under the international absolute definition of middle class. The share of the poor population remains large. The role of the poor middle class in society is extremely limited and its interests are diluted by the interests of the rich and the poor.

The situation is somewhat different in Tajikistan. The poor population has considerably decreased, and the share of the middle class has grown to 76%, but as in Armenia and Kyrgyzstan, this stratum of the population has low income. Its role in society is rather high, but its interests are determined by its low income. It cannot play the role of a driving force for development in the capacity of a class with a heightened propensity to accumulate human capital.

In Kazakhstan, the middle class has made up and continues to make up a large share of the population (76% in 2009). Its income in general has a high growth rate, but the high rise in GNI per capita appears to
have a greater effect on the stable rich class. This income is not sufficient from the standpoint of the international absolute definition of the middle class ($10 to $20 per capita a day at PPP), which diminishes its role in development.

Belarus and Russia differ from the other EDB countries as their middle class fits more the international definitions, and embraces a large share of the population. It should be assumed that in these countries, the middle class is in a more mature state, and plays a considerable role in economic development, and in society in general. Russia is notable for the fact that a further expansion of the middle class is impeded by serious problems connected with the continued high level of social inequality.