Macroeconomics of the region

Macroeconomics of countries:

- Azerbaijan: 7–8
- Armenia: 9–11
- Belarus: 12–14
- Kazakhstan: 15–17
- Kyrgyzstan: 18–20
- Moldova: 21–22
- Russia: 23–25
- Tajikistan: 26–28
- Turkmenistan: 29–30
- Uzbekistan: 31–32
- Ukraine: 33–35

Outlook and risks:

- **The world economy**: the risk of a slowdown in growth under the influence of economic dynamics in China
- **Commodity markets**: a negative impact of the resumption of oil exports by Iran
- **The CIS**: a return to positive GDP growth rates, a decline in inflation, an improvement in the state of balances of payments, more flexible exchange rate policies

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The present analytical report was prepared by the Research Department of the Eurasian Development Bank (EDB). The information and conclusions contained in this report are not a recommendation and are based on public data.
The fall in the aggregate GDP of the CIS countries deepens in Q2 2015

The negative factors that caused a slowdown in economic growth in 2014 and Q1 2015 are still in place in Q2 2015

Economic dynamics differ by country in the group of oil and gas exporting countries

The labor exporting countries improve their GDP growth rates

Macroeconomics of the region

The fall in the aggregate GDP of the CIS countries deepened in Q2 2015, reaching 4.4% compared with a fall of 2.6% in Q1 2015. The further plunge in GDP growth into negative territory primarily reflected an increase in the magnitude of the GDP fall in Russia and Belarus, as well as a slowdown in GDP growth in Kazakhstan. At the same time the magnitude of Ukraine’s GDP fall decreased—mainly due to the low base of Q2 2014—while the economic growth rate rose in Armenia, Azerbaijan, Kyrgyzstan and Tajikistan. So the economic dynamics of the CIS countries were characterized by the lack of a common trend.

The negative factors that had determined the slowdown and, later, the fall in economic activity in the CIS region since 2014 were still in place in Q2 2015. These included the low prices of primary commodities, and restrictions on access to international capital markets due to sanctions against Russian companies and banks; although oil prices partially recovered in the period. The rise in exports from the CIS region in real terms apparently accelerated further compared with Q1 2015. This is suggested by the dynamics of the physical volume of exports. For instance, the growth rate of exports of natural gas from Russia became positive in Q2 2015. This factor continued to have a positive effect on the economies of CIS countries, partially compensating for the impact of negative factors.

Economic dynamics differed by country in the group of oil and gas exporting countries (Azerbaijan, Kazakhstan, Russia and Turkmenistan) in Q1 2015, and were still different in Q2 2015. The GDP growth rate deteriorated in Russia and Kazakhstan, whereas Azerbaijan’s GDP growth accelerated again amid a rise in agricultural output and a loose fiscal policy, which supported the fast expansion of household consumption.

Most of the labor exporting countries (Armenia, Kyrgyzstan, Moldova and Tajikistan) improved their GDP growth rates due to increased activity in the extractive industry (Armenia and Kyrgyzstan), and a higher growth rate in the agricultural sector (Armenia and Tajikistan). In those countries, the impact of these factors outweighed the influence of negative factors common for the labor exporting countries, such as a decrease in the volume of cash remittances from migrant workers, and a decline in investment and lower demand for the countries’ export commodities. Moldova was the only country in the group to experience a slowdown in economic growth. As a result, the aggregate year-on-year GDP growth rate of the labor exporting countries rose from 4.6% in Q1 2015 to 5.6% in Q2 2015.

Figure 1.1. World industrial production and trade

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

Source: CPB World Trade Monitor, World Bank

Source: Word Bank
The magnitude of the GDP fall in the countries with a diversified structure of exports (Belarus, Ukraine and Uzbekistan) decreased in Q2 2015 but remained highly significant. The size and dynamics of the fall reflected trends in the economy of Ukraine, which experienced a double-digit GDP fall as a consequence of the internal armed conflict. Due to the low base effect – the economic downturn began in the country in the first months of 2014 – and the stabilization of economic activity this spring, Ukraine’s GDP fall slowed from 17.6% in Q1 to 14.7% in Q2 2015, which caused the GDP fall rate of this group of countries to decrease from 13.2% in Q1 to 11.8% in Q2 2015.

A fall in investment activity and weaker domestic demand in the region led to a decrease or a significant slowdown in the rise in imports in almost all CIS countries. In Q2 2015 amid the stabilization of the external environment, a boost to economic activity and improved foreign trade balances resulted from: more flexible exchange rate policies; and the depreciation of regional currencies in real terms compared with the start of 2015. In the labor exporting countries, corrections in the real exchange rates and a return to currency parity led to a slowdown in the fall in the volume of migrant remittances. The relative stabilization of the geopolitical situation resulted in a decline in capital outflows from the oil and gas exporting countries and the countries with a diversified structure of exports. As a result, amid a decreased extent of forex interventions, the reserve assets of the central banks of CIS countries grew by $4.6 billion, reaching a level sufficient for financing 12 months’ worth of imports of goods.

In Q2 2015, the state budgets of the CIS countries had a deficit slightly lower than that in Q1 2015. The expenditure of the budgets differed significantly from its level in Q2 2014 in connection with countercyclical budgetary policy amid the slowdown in economic growth in the oil and gas exporting countries.

In the labor exporting countries, there was a considerable decrease in the state budget deficit as a result of a reduction in non-priority expenses. An improvement in the state of the public finances also occurred in the countries with a diversified structure of exports, where revenue rose and expenditure was cut. In Q2 2015 the aggregate consolidated budget of the CIS region had a deficit amounting to 1.9% of GDP against a surplus equal to 2.1% of GDP in Q2 2014.

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**Figure 1.3. Balance of payments:** current account balances’ components and foreign exchange reserves

**Figure 1.4. CIS countries’ GDP growth (in %, year-on-year)**

Source: national agencies
The stabilization of the situation in the currency exchange markets of CIS countries in Q2 2015 led to a decrease in the extent of forex interventions. This enabled central banks to slightly loosen their monetary policy. There was a slowdown in the rise in consumer prices in all the CIS economies as the effect of regional currencies’ depreciation in late 2014 and early 2015 gradually lessened and inflation expectations faded. The average annual inflation rate in the CIS countries fell to 16.9% in June 2015 from 17.5% in March 2015. The average quarterly consumer price index for the CIS countries rose by 17.1% compared with Q2 2014. The considerable reduction of forex interventions led to a slight acceleration of the growth of money supply in the oil and gas exporting countries, and a slowdown in the contraction of money supply in the labor exporting countries. In Ukraine, amid the depreciation of the hryvnia, annual inflation accelerated from 33.6% to 58.9%, and massive forex interventions led to a fall in the growth rate of money supply. A rise in interest rates in early 2015 and the consequent increase in the cost of loans led to a slowdown in bank lending growth in almost all the CIS countries. The weak economic dynamics also affected the quality of the assets of commercial banks in the region: the share of nonperforming loans in banks’ loan portfolios grew in many economies.

The external environment deteriorated again for the economies of the CIS region in Q3 2015: the prices of most primary commodities declined throughout July and the first half of August. This was amid heightened apprehensions about a possible slowdown in economic growth in China, as well as the anticipated increase in oil exports from Iran following the reaching of an agreement on Iran’s nuclear program. A decrease in the prices of the goods that form the bulk of exports to non-CIS countries generated a new round of depreciation of regional currencies. In particular, the Russian ruble, the Belarusian ruble, and the Kazakh tenge fell in value against the dollar and the euro. The National Bank of Kazakhstan abandoned tight control over the exchange rate of the tenge, and announced a transition to a floating exchange rate system. The new round of currency depreciation had a limited effect on economic growth in Russia and Belarus because these economies had already experienced a significant fall in domestic demand and the value of the national currency and, consequently, improved noticeably their balances of payments earlier in 2015.

Meanwhile, there is the risk of a significant impact of currency depreciation in Q3 2015 on the economies in the Central Asian part of the CIS region, which were more sustainable in 2014 and Q1-Q2 2015.

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

<table>
<thead>
<tr>
<th>CIS</th>
<th>Oil and gas exporters</th>
<th>Labour exporters</th>
<th>Exporters with diversified structure</th>
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Source: national agencies

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

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<tr>
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Source: national agencies
There is the risk of a significant impact of the currency depreciation in Q3 2015 on the economies of the Central Asian CIS countries.

We expect the average price of Brent to be $50 per barrel in 2015 and $55 in 2016.

Amid some general stabilization in international financial markets, the volatility of the prices of oil and other primary commodities, and also the volatility of the Russian ruble against major world currencies, has decreased appreciably since Q2 2015. If this trend proves sustainable, it will be easier for the economies of the Central Asian CIS countries to successfully complete their adaptation to the deteriorated external economic environment. This includes a readjustment of the central bank’s policy regarding the exchange rate of the national currency. The economic situation in China and, to a much lesser extent, the possible imminent tightening of monetary policy in the United States – with the federal funds rate increasing – potentially represent the most significant risks to macroeconomic stability in the region as a whole and the recovery of GDP growth in the remaining part of 2015 and in 2016.

We believe that the most probable scenario for the economic situation in the world is that: economic growth in China, which is stimulated by government policies if necessary, will continue to gradually slow down; and the economies of the United States, Europe and Japan will keep growing at rates similar to the current ones. The increased oil exports from Iran will slow the recovery of oil prices in 2016, although a decline in oil production in countries that are not members of OPEC will prevent a fall in oil prices. We expect the average price of Brent to be $50 per barrel in 2015 and $55 in 2016.

Given the above-stated scenario, one can expect that the aggregate GDP of the CIS countries will fall by 3 to 4% in 2015 and then resume rising, increasing by 0.5 to 1.5% in 2016. Most of the region’s economies will increase their sustainability in this period as a result of measures taken by authorities under the current circumstances to consolidate the state budget and increase the flexibility of exchange rate policy.

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Figure 1.7. **Economic growth** (GDP growth): consensus 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

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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: strong GDP growth amid deterioration in balance of payments and fiscal revenue**

Azerbaijan’s GDP growth accelerated in Q2 2015, which led to a year-on-year GDP growth rate of 5.7% in Q1-Q2 2015 compared with a growth of 5.3% in Q1 2015. The non-oil sector of the country’s economy remained a key driver of growth with a year-on-year rise of 9.2% in Q1-Q2 2015. Good growth figures were also shown by the non-oil industry (14.1%), retail trade (13.4%), the communications sector (10.7%), the services sector (6%), and the construction sector (11.5%). Agricultural output rose by 7.3%. The rise in output in the oil and gas sector slowed to 1.3%, which, given the great importance of this sector for the national economy, limited overall growth. Consumption was apparently the main driver of growth, which was stimulated by a 21.1% increase in bank lending and a 6.2% rise in income. Investment (+3.7%) and exports (+2.1% and +16% for the non-oil sector) also made their contribution to the acceleration of GDP growth.

Despite the continued positive growth rate of exports in real terms, exports in nominal terms decreased by 44.4% due to the fall in world oil prices. Simultaneously, the slowdown in the rise in imports (+10.1%) strengthened due to, among other reasons, the appreciation of the manat. Nonetheless, this combination of factors continued to negatively affect the surplus in foreign trade, which shrank by 66.2% in Q1-Q2 2015. As a result, the current account surplus decreased to $66.3 million from $6,381 million in Q1-Q2 2014. Amid a financial account deficit, this decrease in the current account surplus caused a negative balance of payments and a decrease in the international reserves, which shrank by $0.9 billion compared with March 2014 to $8.5 billion. The manat kept relatively stable throughout the entire period due to the international reserves.

The continued unfavorable external environment led to deterioration of the public finances. State budget revenue decreased by 19.9% year-on-year. Amid a slight consolidation of expenditure (-0.5%) in the period, this led to a state budget deficit in Q2 2015. The consolidated budget, which includes the State Oil Fund, moved from a surplus to a deficit as a result of a 40.2% year-on-year decrease in the State Oil Fund’s revenue. The Fund’s assets diminished by $1.4 billion since January 2015 to $35.8 billion.

Under the influence of external factors and strong growth in the agricultural sector, consumer prices fell by 1.1% month-on-month, with food prices decreasing by 2.7%, and prices of non-food consumer goods remaining flat. The year-on-year inflation rate in June 2015 was 3.4%, with food prices rising by 5.5%, non-food goods increasing in price by 2.8%, and services rising by 1.3%.
Azerbaijan

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

Source: the State Statistics Committee of Azerbaijan

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

Source: national agencies

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

Source: national agencies

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

Source: national agencies

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

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

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

Source: estimates and forecasts by the IMF
Economic activity accelerated in Q2 2015 despite the continued unfavorable external environment: Russia’s recession, the low growth rate in Europe, low metal and food prices, etc. These had a negative impact on the state of foreign trade and domestic demand with the net inflow of cash remittances falling by 36.1% year-on-year in Q1-Q2 2015. Major drivers of economic growth included the agricultural sector (primarily, crop production) and the industrial sector (in particular, the copper mining industry). The growth rate of retail trade continued to deteriorate, while that of the construction sector remained low. As a result, Armenia’s GDP grew by 5.1% year-on-year in Q2 2015 compared with a growth of 2.2% in Q1. The country’s year-on-year GDP growth rate in Q1-Q2 2015 was estimated at 3.8% against a growth of 2.7% in Q1-Q2 2014, although many international organizations had predicted significantly lower growth rates.

The balance of payments improved in Q2 2015. The gross international reserves grew by $54.4 million in Q2 to $1,545 million, or 4.8 months’ worth of imports. The current account balance continued to improve throughout Q2 2015 as a result of a decrease in the foreign trade deficit. The trade deficit amounted to 11.7% of GDP in Q2 and 16.4% of GDP in Q1 2015. It had shrunk from 29.2% of GDP due to the fall in imports exceeding the decrease in exports, amid a contraction in domestic demand and the depreciation of the national currency. It is also probable that financial account transactions led to sufficient capital inflow. The combination of these factors caused the dram to stabilize and strengthen throughout the period.

The state budget had a deficit equal to 1.6% of GDP in Q2 2015. This was because the dynamics of revenue moved to negative territory, falling by 1.7% year-on-year, while the growth rate of expenditure, including operating expenses, accelerated to 15.5%. As a result, the state budget deficit in Q1-Q2 2015 amounted to 1.6% of GDP, whereas there was a budget surplus in Q1-Q2 2014. A decrease in major tax components of revenue, including value-added tax, was due to the contraction of domestic demand and the fall in foreign trade (in particular, a decrease in revenue from excise taxes due to the fall in imports). Under these circumstances, the expansion of expenditure was largely financed from external sources and was caused by the need to maintain the countercyclical nature of fiscal policy.

Annual inflation was 5.5% in June 2015, down from 5.8% in May, whereas the central bank’s target band was 2.5 to 5.5%. Consumer prices declined throughout Q2 2015. June became the fifth consecutive month of month-on-month deflation for almost all categories of consumer goods. The deflation was caused by a contraction of the money supply, low energy prices, weakening domestic demand, and the high growth rate in the agricultural sector.

The dynamics of bank lending remained moderate, with annual growth being 9.6% at the end of Q2 2015, up from 8.3% at the end of Q1 2015. The share of nonperforming loans was relatively large at 9.2% in June. The average ROA (return on assets) ratio was -0.6%, while the ROE (return on equity) ratio was -4.6%.
Outlook

Armenia: agriculture and mining remain key sectors for economy

The year-on-year rise in the Indicator of Economic Activity (IEA) slowed to 3.7% in July and August, which resulted in a 3.9% rise for the first eight months of 2015. The industrial and agricultural sectors remained key drivers of economic growth and continued to compensate for a fall in retail sales and low growth rates in the construction and services sectors. It is probable that Armenia’s economic growth will start slowing down in Q3-Q4 2015 as a result of: the continued favorable prospects for the external environment; a certain deterioration of the extractive industry’s performance; and the continuing decline in domestic demand. However the country will still have an annual growth rate of 2.0 to 2.5%, although an updated consensus forecast predicted a growth of 0.8% for 2015. The recovery of copper production will continue to have a positive effect on GDP growth until the end of 2015. Sectors of the manufacturing industry will be supported by the high growth rate of the agricultural sector resulting from better conditions for export within the framework of the Eurasian Economic Union.

Positive trends in investment in the extractive industry and the agricultural sector will support foreign trade and the fiscal sector. However the external environment is unfavorable due to: the fall in cash remittances from Russia; the low growth rate in Europe; and low prices for exported metals. This increased external indebtedness, and together with the dram being overvalued in real terms, it will have a negative impact on the current account balance and the exchange rate of the national currency. The current account deficit will be financed with external loans and resources from the international reserves due to the diminishing inflow of foreign investment. The reserves were equal to 5.5 months’ worth of import in July 2015. They remain an important factor for ensuring external sustainability amid the continuing pressure on the dram resulting from an upsurge of market volatility.

Weak domestic demand and the decrease in imports will continue to affect state budget revenue until the end of 2015. This negative impact will be only partially offset by the favorable effect of the high growth rates of the industrial and agricultural sectors and the rise in exports. The government still faces the need to increase fiscal revenue, which remains at a historically low level. However, an increase in taxes and duties, as well as any reduction in expenditure in the context of the recent increase in electricity rates would be a difficult decision from the social and political standpoints. In any case, one can expect a controlled expansion of the state budget deficit. The combination of the growing state budget and current account deficits will determine the extent of the need for external borrowings, and may become a source of an increase in public debt.

Annual inflation slowed down again, falling to 3.6% in August 2015. Coupled with the external factors that put deflationary pressure on prices, such an inflation rate gives the central bank a relatively free hand with regard to the use of instruments to stimulate the economy. The central bank needs to keep inflation within its target band of 2.5 to 5.5%, but the probable weakening of the dram carries a risk of inflation rising above the target.
Armenia

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

Source: the National Statistical Service of the Republic of Armenia

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

Source: national agencies, IMF

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

Source: national agencies

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

Source: national agencies

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

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

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

Source: estimates and forecasts by national agencies and the IMF
Belarus: fall in GDP amid drop in exports and investment, stable consumer demand

Belarus’ GDP fell by 3.3% year-on-year in Q1-Q2 2015 amid: the economic recession and currency depreciation in Russia; tighter fiscal and monetary policies in the country; and a decline in the inflow of foreign capital. Under these circumstances, industrial output dropped by 7.4% and the construction sector’s output fell by 7%. There was a positive but insignificant growth rate in the retail trade sector with retail sales rising by 1.1% year-on-year. This indicated relatively stable consumer demand despite a 3% decrease in real pay in Q1-Q2 2015. Investment, on the contrary, fell significantly, decreasing by 13.5% compared with a 1.1% year-on-year fall in Q1 2015. This determined the acceleration of the country’s GDP fall from 2.1% in Q1 2015.

At the start of 2015, the National Bank significantly loosened control over the value of the Belarusian ruble. The regulator reduced the extent of its forex interventions and stopped the contraction of the money supply, which took place in late 2014 and the first months of 2015 amid interventions in support of the national currency. The annual growth rate of M2 supply rose in Q2 2015, increasing to 13.2% in June from 10.8% in March and 17.1% in January.

The transition to a more flexible exchange rate regime gradually reduced to zero the strengthening of the national currency, which took place in late 2014 amid interventions in support of the national currency. The real effective exchange rate (REER) of the Belarusian ruble rose by 1.6% year-on-year in Q1 2015, after an 11.9% rise in Q4 2014, and fell by 0.9% in Q2 2015. This led to weaker pressure on the balance of payments. The deficit in foreign trade in goods significantly decreased in Q2 2015; while the international reserves of the National Bank grew slightly to $4,621 million (1.4 months’ worth of imports) at the end of June, recovering from the year’s lowest level of $4,560 million in March.

The consolidated budget surplus grew to 3.9% of GDP in Q1-Q2 2015 and only 0.1% of GDP in 2014 as revenue rose faster than expenditure. The increase in state budget revenue was because: Belarus had been allowed to keep all revenue from export duty on petroleum products instead of transferring it to the Russian treasury; and the government had resumed the collection of customs duty on potash exports. Simultaneously, the government significantly reduced the extent of quasi-fiscal financing by curtailing loan programs.

The growth rate of bank lending to the economy remained relatively stable throughout Q2 2015 after recovering in Q1 from low levels in Q4 2014.
Outlook

Belarus: transition to GDP growth, strengthening of balance of payments amid flexible exchange rate policy

Data available for Q3 2015 indicate that the magnitude of Belarus’ annual GDP fall may significantly increase by the end of Q3. This will primarily be due to a greater fall in agricultural output amid the high base of Q3 2014. At the same time, the extent of the fall in output in the industrial and construction sectors began to decrease amid similar dynamics of investment demand and continued high demand from households. Given the growth figures of the agricultural sector for Q4 2014, the magnitude of the downturn in agricultural output will decline throughout Q4 2015 and its negative impact on GDP will decrease. Amid partial recovery of investment activity, the rate of the fall in the country’s GDP will cease to rise in Q4 2015.

The factors that may help the economy resume growth after the predicted stabilization period include a monetary policy adequate to the current economic situation, which will enable the National Bank to pursue a more flexible exchange rate policy than implemented in the past. The extent of the National Bank’s control over the exchange rate of the rubel changed throughout 2015. The National Bank tightened control over the rate amid the depreciation of the Russian ruble in July and early August. This was accompanied by a slowdown in the growth of money supply, and had a negative effect on the growth of bank lending. The loosening of control over the exchange rate in August was followed by a fall in the Belarusian rubel’s value against the currency basket of the US dollar, the euro and the Russian ruble. Consequently, the weakening of the rubel in REER terms will contribute to: the recovery of competitiveness by Belarusian exports, primarily in the Russian market; stable dynamics of money aggregates; and will also reduce the risk of a fall in the National Bank’s international reserves. The low level of the reserves is one of the main problems of the economy in the short and medium term.

The above factors indicate that Belarus’ GDP will fall by 3.5 to 4.5% in 2015, and grow by zero to 0.5% in 2016. Inflation will continue to slow down, although the impact of the August drop in the value of the rubel will reduce the pace of this slowdown. As a result, the annual growth rate of the consumer price index will be 11 to 12% in December 2015. If the National Bank pursues a monetary targeting policy, one can expect inflation to slow to a level of around 10% in 2016. A more significant slowdown may be prevented by steps that the government has to take to deregulate prices under its commitments made by the country as a member of the Eurasian Economic Union. The current account deficit will decrease in 2015 to 3 to 4% of GDP – i.e. to a greater extent than we predicted in the previous issue of the CIS Macromonitor – as a result of a more significant contraction of investment demand. Unexpected changes in the economic situation in the region and the government’s policies, both monetary and fiscal ones, may cause actual economic dynamics to differ from forecasts.
Belarus

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

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

*Source: the National Statistics Committee of Belarus*

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

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

*Source: national agencies, IMF (IFS)*

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

**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: national agencies, estimates by the EBD, the World Bank, the EBRD, the IMF*
Kazakhstan: slowdown in GDP growth amid noticeable deterioration in public finances and external trade balance

Kazakhstan’s GDP growth slowed down to 1.3% year-on-year in Q2 2015, which resulted in a 1.7% growth rate for Q1-Q2 2015. Oil prices rose in Q2 2015 and the extractive industry showed a 1.1% rise in output. However, export and fiscal revenue decreased significantly, negatively affecting the balance of payments and public finances. Domestic demand was also affected through a fall in fiscal expenditure and the real income of the population. Negative factors for domestic demand and the economy in general included a loss in external competitiveness, the emergence of high devaluation expectations, and a decrease in bank lending. As a result, the growth rate of retail trade fell to 1.1% in Q2 from 3.1% in Q1 2015. Throughout the entire period, negative trends strengthened: in the transport sector (+6.5% after +7.1% in Q1); the communications industry (-0.1% after +7.3%); and manufacturing industry (+0.1% after +0.5%). A positive contribution to the growth rate of the construction sector (+6.7% after +1.9%) and some kinds of services were made by an increase in the volume of financing for the government’s anti-crisis measures, including capital expenditure. The agricultural sector (+3%) also supported economic growth.

An analysis of statistical data indirectly suggests that the state of the balance of payments deteriorated in Q2 2015. The National Bank’s gold and foreign exchange reserves shrank by $229 million (0.8%) compared with Q1 2015 to $28.9 billion, or 9.2 months’ worth of imports. Payments to service the gross external debt continued to be high. The decrease in the gold and foreign exchange reserves was probably connected with a drop in the trade surplus, which diminished by 26% compared with Q1 2015 and by 60% in annual terms. This drop was provoked by the loss in external competitiveness and an acceleration of the growth of imports, which rose by 19.2% compared with Q1 2015 amid a weak recovery in exports (+1.4%). It should be noted that the use of resources from the National Fund of Kazakhstan helped maintain the balance of payments in the context of pressure on the tenge.

The state budget had a surplus equal to 0.3% of GDP in Q2 2015, and a surplus equal to 0.1% of GDP in Q1-Q2 2015. Under the conditions of a deteriorating external environment, it was possible to keep the state budget balanced only due to transfers from the National Fund of Kazakhstan and a timely consolidation of expenditure. The state of the consolidated budget showed the critical condition of the public finances. Consolidated budget revenue fell by 37.4% year-on-year in Q2 2015 while expenditure was reduced by only 1.6%. As a result, the consolidated budget had a deficit equal to 9% of GDP and a deficit equal to 5.1% of GDP in Q1-Q2 2015.

Annual inflation slowed to 3.9% in June from 5.2% in March to stand below the National Bank’s target of 6 to 8%. This slowdown resulted from a combination of both external factors (the dynamics of world prices of primary commodities, and the depreciation of the national currencies of major trading partners) and domestic factors (seasonal factors, weaker demand, tighter monetary policy). The share of nonperforming loans decreased from 23.4% in March 2015 to 9.98% at the end of June as a result of taking over the loan portfolio from BTA Bank. The financial soundness indicators of the banking sector were affected by deterioration of the current economic situation, despite support from the government.
**Outlook**

**Kazakhstan: slowdown in GDP growth amid acceleration of inflation**

In July and August 2015, the unfavorable external environment and a loss in external competitiveness continued to put negative pressure on: the state of foreign trade, the real sector of the economy, public finances and monetary accounts. The Indicator of Economic Activity (IEA) became negative in annual terms, falling to 3.4% in August due to a fall in consumer and investment activity amid a continued significant decrease in exports. The result was a downturn in the industrial sector in August, in particular the extractive industry. The slowdown in the construction and agricultural sectors became more pronounced amid negative trends in the services sector.

In response to deterioration of the economic situation, the government, on the one hand, increased the use of resources from the National Fund of Kazakhstan to finance anti-crisis measures, simultaneously reducing non-priority expenses in a situation where fiscal revenue kept falling. On the other hand, the government continued to pursue tight monetary policy amid the de facto fixed exchange rate of the national currency. External imbalances were offset by: resources of the National Fund of Kazakhstan; external loans; and the widening of the band for fluctuations in the exchange rate of the tenge. Nonetheless, the accumulated structural imbalances in the economy and continued low oil prices in the medium term led to radical changes in macroeconomic policy in August 2015: the government switched to inflation targeting and a free-floating exchange rate. Under the conditions of high devaluation expectations, the transition to the new regime was accompanied by a sharp correction in the tenge’s value and high volatility in financial markets.

Following the drop in the value of the tenge in August, an improvement in the external balance will be achieved through: the recovery of the economy’s competitiveness; a quicker decrease in imports; and a rise in exports in certain branches of the industrial sector. The favorable effect of the tenge’s dramatic depreciation on exports will be limited by the deteriorating external environment, which will continue to put pressure on the extractive and metallurgical industries. The degree of positive impetus will also be limited by the small share of the non-primary manufacturing sector in the structure of the economy and exports. The services sector, including retail trade, may experience the negative impact of contracting domestic demand. The negative effect of the currency depreciation on consumption will hardly be offset by its favorable effect on the industrial sector. However, the implementation of the government’s anti-crisis measures is facilitated by a partial recovery of fiscal revenue following the currency depreciation. Kazakhstan’s economy will experience a more significant slowdown in 2015 and the country’s GDP will grow by 0.5 to 1%.

Given the large share of imports in consumption and the transition to more flexible price formation for petroleum products, an acceleration of inflation can be expected as a consequence of the currency depreciation. It is also likely that the government will continue tight monetary policy and actively use administrative measures in order to keep inflation within the target band of 6 to 8%. The continued deflationary pressure from external factors will help the government achieve this difficult objective.
Kazakhstan

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

Source: the Agency of Statistics of Kazakhstan

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

Source: national agencies, IMF

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

Source: national agencies

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

Source: national agencies, IMF (IFS)

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

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

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

Source: estimates and forecasts by national agencies, the IMF and the EBD
There was a slowdown in the growth of consumer demand and a fall in investment activity in early 2015 amid the volatility and increased uncertainty of the exchange rate. However, Kyrgyzstan’s year-on-year GDP growth rate rose to 7.3% in Q1-Q2 2015 from 4.1% in Q1-Q2 2014. Increased gold production and gold exports, and also a fall in imports played a key role in the acceleration of GDP growth. Significant support for the growth of GDP (excluding gold mining) came from a rise in agricultural output as a result of favorable weather conditions, and an acceleration of growth in wholesale and retail trade amid a decline in devaluation expectations.

The balance of payments of the Kyrgyz economy was under the influence of opposing factors, which determined a decrease in the foreign trade deficit. Falls in prices in international primary commodity markets led to a contraction of the volume of foreign trade in terms of value. There was a decline in demand for imported cars and light industry products amid decreased domestic demand and the country’s accession to the Eurasian Economic Union. The rise in industrial output led to an increase in gold exports. Amid the restoration of exchange rate parity, the year-on-year fall in the volume of migrant remittances in dollar terms slowed down to 25.4% in Q1-Q2 2015. The foreign trade deficit was financed by the inflow of foreign direct investment and borrowed capital.

The state budget had a surplus equal to 2.1% of GDP in Q1-Q2 2015. The fiscal balance became positive due mainly to additional non-tax revenue from gold production and relatively moderate capital expenditure. However, Q2 2015 saw a significant increase in operating expenditure, which led to a rise in the current deficit of the state budget.

The National Bank reduced noticeably its forex interventions amid a decline in the volatility of exchange rates. Intensive forex interventions and a rise in the base lending rate in early 2015 led to a fast slowdown in inflation and a sharp decrease in som liquidity: the som money supply diminished by 12.3% compared with Q2 2014. The annual growth rate of consumer prices fell to 4.6% from 8.5% in March 2015 and 11.6% in December 2014. This prompted the National Bank to lower its base lending rate to 8% by the end of July compared with 11.6% in January 2015.

The contraction of som liquidity, the low growth rate of bank deposits, and measures taken to restrict lending in foreign currency led to a fall in the growth of lending. Banking statistical data for Q1-Q2 2015 indicated a slowdown in the growth of lending in both som and adjusted to exchange rate changes foreign currency loans. The depreciation of the som gave a fresh impetus to the dollarization of the economy: the share of deposits in foreign currency was 60.8% at the end of June 2015. The shares of nonperforming (classified) loans and “loans under supervision” in the total volume of the banking sector’s loan portfolio slightly increased to 5.5% and 10.2%, respectively.
Gold exports were the main reason for the strong GDP growth in early 2015, with the year-on-year growth rate of exports in real terms being 14.8% in Q1 2015. Kumtor Gold Company has announced that gold production in 2015 is expected to be between 470,000 and 520,000 ounces, or 14.6 and 16.2 tons, compared with 567,000 ounces in 2014. In this regard, one can expect a sharp year-on-year decrease in gold production in Q3-Q4 2015 and, consequently, a drop in Kyrgyzstan’s exports. As gold production slowed, signs of the economy’s weakness became more pronounced. The country’s GDP with and without taking into account the Kumtor mine’s contribution grew by the same rate of 5% year-on-year in August compared with 6% and 5% in July and 9% and 7% in June 2015, respectively. The construction sector experienced a year-on-year fall of 5.8%.

A slowdown can be expected in the rise in exports in the remaining part of 2015 amid the continuing contraction of domestic demand. GDP growth in annual terms may slow to 2% in Q3 2015, and move into negative territory in Q4.

The current median consensus forecast of international organizations predicts Kyrgyzstan’s GDP to grow by about 1.8% in 2015. However, one can expect an acceleration of economic growth in the longer term considering the new opportunities opened up by the country’s membership of the Eurasian Economic Union if investment resumes growth.

Changes in the exchange rate systems and the values of the currencies of Kyrgyzstan’s major trading partners in early 2015 affected the dynamics of the country’s balance of payments, and led to increased volatility in the exchange rate of the som. Downward fluctuations in the exchange rate of the som caused annual inflation to accelerate to 5.9% by mid-September. Given these circumstances, it is important for the National Bank to keep pursuing a flexible exchange rate policy in order to support the economy from the standpoint of both the external balance and monetary policy.

According to updated fiscal estimates, the 2015 state budget may have a deficit equal to up to 5.7% of GDP. The government plans to raise the pay of certain categories of public employees, spend more for social support, increase expenses on the upcoming parliamentary elections, and increase the volume of capital expenditure in 2015. The bulk of these expenses are expected in Q3-Q4, i.e. before and after the October parliamentary elections. Given the modest growth in income, a continuation of the policy aimed at holding back the growth of spending to make it correspond to the rise in revenue would allow the government to create a buffer reserve for the event of a sharp deterioration in the economic situation. However, the parliamentary elections may have an impact on efforts to curb expenditure growth.

So one can expect some rise in prices amid a slowdown in economic activity and an increase in public spending in the remainder of 2015. Recurrent forex interventions and a possible increase in the National Bank’s base lending rate would compensate for the rise in prices to a certain extent. The inflation rate for 2015 is expected to be 6 to 7%.
**Figure 6.1. GDP and output:** GDP growth and output change by sectors, (in %, year-on-year)

Source: the National Statistics Committee of Kyrgyzstan

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

Source: national agencies

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

Source: national agencies

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

Source: national agencies

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

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

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

Source: estimates and forecasts by national agencies, the IMF and the EDB
Moldova: contraction of domestic demand and crisis in banking sector

Moldova’s GDP growth slowed down to 2.5% year-on-year in Q2 2015 from 4.8% in Q1 2015 and 4.3% in Q2 2014. Amid a fall in the expected profit margin, and a rise in prices, there was a downturn in investment activity and a slowdown in the rise in consumer demand in the economy. This became a major reason for a contraction of domestic demand and a decrease in imports. Amid the complicated geopolitical situation in the region and the weakness of neighboring economies, the country experienced a 28.4% year-on-year fall in the volume of migrant remittances and a decline in demand from CIS countries for Moldova’s major export items. This led to a shift of exports from the CIS to the European Union: the share of exports to the EU grew from 53% to 63.1%. Exports increased in real terms, which supported production in many sectors of the economy. Amid deterioration in the banking sector and continued geopolitical risks, many international organizations revised downwards their economic growth forecasts for 2015 to a fall of 1.5% (from a 2.8% rise in December 2014).

The decrease in imports and the slowdown in economic activity led to lower-than-expected state budget revenue. Although fixed capital investment decreased, the state budget had a deficit equal to 3.6% of GDP in Q2 2015, compared with a deficit of 1.5% of GDP in Q2 2014, with the social sector traditionally accounting for most of the expenditure with 70%. The state budget deficit in Q1-Q2 2015 was 1.2% of GDP.

The stabilization of fluctuations in the exchange rate of the national currency and the decrease in imports in Q2 2015 helped the government keep the international reserves at a level sufficient for financing 3.7 months’ worth of imports of goods and services. The National Bank resumed forex interventions in August in response to increased fluctuations in the exchange rate. Under these circumstances the National Bank continued to tighten monetary policy, raising its base refinance rate to 19.5% in September from 13.5% in March 2015. Nonetheless, the annual inflation rate rose from 7.1% in March 2015 to 12.2% in August. The National Bank once again revised upwards its projection for average inflation for 2015, this time to 9.3%.

There was a progressive loss in trust in the banking sector amid the weakening of the national currency and the continuing problem of three struggling major banks (Banca Sociala, Banca de Economii and Unibank). The total volume of bank deposits (adjusted to exchange rate changes) decreased by 10%. The fall in bank deposits and the tightening of monetary policy led to a de facto cessation of lending in the banking sector. In July 2015, the total amount of banks’ loan portfolio was 0.5% smaller than in December 2014. Despite measures taken to strengthen banking supervision, the share of “bad” loans in the banking sector grew to 16.4% by the end of July compared with 12.9% at the end of 2014. The capital adequacy ratio was 14.9% in July, whereas the minimum required level was 16%. The situation in the banking sector reached a critical level in the summer, when the National Bank introduced a special administration regime for the three problem banks.
Moldova

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

Source: the National Bureau of Statistics of Moldova

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

Source: national agencies

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

Source: national agencies

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

Source: national agencies

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

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

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

Source: estimates and forecasts by national agencies and the IMF
Russia: stabilization of real activity and inflation at mid-year

Russia’s GDP fell by 4.6% year-on-year in Q2 2015 and by 3.4% in Q1-Q2 2015. The magnitude of the GDP fall increased from 2.2% in Q1 2015 amid low oil prices, a massive outflow of capital, Western sanctions, and the central bank’s tight monetary policy. These factors led to a contraction of domestic demand: retail sales and fixed capital investment decreased by 9.4% and 7.1%, respectively, in June in annual terms. Acceleration of the contraction in the economy was primarily due to a more significant fall in investment. Judging from the dynamics of retail sales, consumer demand remained stable after a sharp fall at the start of 2015. Exports kept rising in real terms, which partially offset the impact of the contraction of domestic demand on GDP. Under the influence of these processes, the month-on-month fall in economic activity remained almost unchanged in June and July.

Amid a rise in oil prices in the spring of 2015 and a consequent strengthening of the ruble, the Bank of Russia had the opportunity to continue to reduce its lending rate, which fell from 14% at the end of March to 11.5% in June. The central bank stopped repo transactions used for providing banks with dollar liquidity, which had been made since January with a view to stabilizing the ruble’s exchange rate. The bank started simultaneously to purchase foreign currency within the framework of sterilized interventions in the market in order to restore its reserves. Under these circumstances, the growth of money supply continued to recover: the annual growth rate of M2 supply rose to 6.8% in June from 6.2% in March. Inflation slowed down as the effects of currency depreciation faded away. The monthly growth rate of the consumer price index was 0.2% in June, the lowest level in 11 months.

In both Q1 and Q2 2015 the current account balance of the balance of payments was positive. The current account surplus was significantly higher than that in Q2 2014 in nominal terms and, especially as a percentage of GDP. The surplus was $19.2 billion (5.7% of GDP) in Q2 2015 and $48.1 billion (7.9% of GDP) in Q1-Q2 2015. This compares with a surplus of 2.5% of GDP in Q2 2014 and a surplus of 4.1% of GDP in Q1-Q2 2014. Unlike in Q1 2015, the financial account surplus in Q2 2015 was lower than that in Q2 2014, which reflected a decline in the outflow of capital. The central bank’s reserves slightly decreased compared with Q1 2015 but began to slowly rise in May.

The balance of the federal and the consolidated budget remained negative in Q1-Q2 2015, with the deficit amounting to 2.3% and 2.6% of GDP, respectively. The deficits, especially the federal budget deficit, proved smaller than those in Q1 2015 (4.2% and 2.7% of GDP). However, from 2011 through to 2014 the federal and consolidated budgets had a surplus in Q1-Q2. The deterioration in the consolidated budget position was due to a rise in expenditure (4.2% of GDP) rather than a decrease in revenue (1.7% of GDP).

The annual growth rate of bank lending continued to decrease in Q2 2015. In particular, the volume of banks’ net claims on the other sectors of the economy fell to 13.2% in June from 21.3% in March. The monthly growth rate of the claims kept declining until May and resumed rising in June. The capital adequacy ratio did not change compared with the end of Q1 (12.9%), but the share of problem assets grew from 7.5% in March to 8.2% in June.

GDP falls by 4.6% year-on-year in Q2 2015 and by 3.4% in Q1-Q2 2015

Acceleration of the fall is primarily due to a more significant decrease in investment

Amid a relative recovery in oil prices in the spring of 2015 and a consequent strengthening of the ruble, the Bank of Russia continues to reduce its lending rate

The current account balance of the balance of payments is positive in Q2 2015

The central bank’s reserves slightly decrease compared with Q1 2015

The balance of the federal and the consolidated budget remains negative in Q1-Q2 2015

The annual growth rate of bank lending continues to decrease in Q2 2015
**Outlook**

**Russia: slowdown in inflation, reduction in interest rates, end of recession**

The relative stabilization of economic activity in real terms, which began to be felt in the Russian economy in the middle of 2015, may give way to movement in various directions. There continues to be the risk of an additional fall in GDP under the influence of a further decrease in oil prices and volatility in financial markets. This may force the central bank to tighten its policy again. There is also the risk of new escalation in the Ukraine crisis. However, it is highly probable that Russia’s seasonally adjusted GDP will resume growth in quarterly terms in Q1-Q2 2015 providing: energy prices recover or their volatility decreases; the world economy does not experience a significant contraction; and Western sanctions against Russia are not toughened. If this scenario comes to pass, a positive change in the economic situation could be helped by a resumed reduction in the central bank’s key lending rate. This would lead to an improvement in the conditions of lending to the economy and, consequently, a recovery in investment activity. Investment would be fueled by an improvement in the financial position of companies. As a result of the ruble’s depreciation in Q1-Q2 2015, their profit increased by 43% on average compared with Q1-Q2 2014. Due to lesser uncertainty in the external environment, companies would be able to use their resources for implementing investment plans postponed in 2014 and early 2015. In addition, the dynamics of GDP would be supported by the continuing rise in exports. Consumer demand, on the contrary, will remain low amid a weak rise in wages, including in the public sector of the economy. Nonetheless, the year-on-year GDP growth rate will remain in negative territory in the remainder of 2015. We expect Russia’s GDP to fall by 3 to 4% in 2015 and to rise by zero to 1% in 2016 due to the low base of comparison.

Inflation kept low until the middle of August, apart from acceleration in July as a result of an increase in government-regulated rates. The fall in the ruble’s value in July and August caused the rise in prices to accelerate again, but its impact will remain limited unless the ruble depreciates again at a similar pace. Under such circumstances, the annual growth rate of the consumer price index will decrease to 12 to 13% by the end of 2015 and then to levels below 10% in Q1 2016.

Given the results of Q1-Q2 2015, both the federal and the consolidated budget will have a deficit equal to around 2.5% of GDP in 2015. This is unless the situation in the economy requires financing for additional anti-crisis measures before the end of 2015.

The current account surplus in the balance of payments had increased significantly by Q1-Q2 2015 amid a strong outflow of capital. It will decrease in 2015 as a whole amid recovering domestic demand, although the depreciation of the ruble in the latter half of the summer will hamper this process. The overall balance of the balance of payments may become positive in 2016 if the central bank resumes foreign currency purchases for replenishing its international reserves, which were suspended this past summer amid instability in the currency exchange market.
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 – Q2 2009 = 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: strong GDP growth, slowdown in lending growth, decline in inflation rate

Although Tajikistan’s GDP growth accelerated from 5.3% in Q1 2015 to 7.5% in Q2, the growth figure for Q1-Q2 2015 still indicated signs of the country’s economy weakening. The year-on-year GDP growth rate fell to 6.4% from 6.7% in Q1-Q2 2014. A 3.5% decrease in household real disposable money income was accompanied by a 59.2% drop in the inflow of cash remittances from Russia (according to data from the Russian central bank), while the overall inflow of private transfers decreased by 32.0% in Q1-Q2 2015 (according to the National Bank of Tajikistan). Nonetheless, year-on-year growth in retail trade accelerated from 8.9% in Q1-Q2 2014 to 10.9% in Q1-Q2 2015. This was partially attributable to an upturn in the construction sector, which showed a record high growth rate of 41.4%. The industrial and agricultural sectors also continued to support overall economic growth, but their growth rates were on the decline. Deterioration of the general economic situation was also evidenced by decreases in the volume of services and output in other economic sectors, which experienced a negative growth rate of -4.0%.

There was a foreign trade deficit of $1,140.3 million in Q1-Q2 2015, down from a deficit of $1,950.6 million in Q1-Q2 2014. This was because imports (-25.0%) fell faster than exports (-7.9%). Despite the strengthening of the somoni in real terms, and also a fall in the prices of Tajikistan’s major export items, exports were supported by off-exchange commodities. The exports included: precious stones and metals 13.5%; cotton fiber 0.9%; aluminum 1.2%; and electricity 0.3%. There was a decrease of almost all imported items. Data for the balance of payments has not yet been released. The current account deficit may have decreased in Q1-Q2 2015 because the decrease in the inflow of cash remittances from abroad may have been offset by a contraction in the deficit of the balance of goods and services.

The state budget had a surplus equal to 3.7% of GDP in Q1-Q2 2015. The GDP growth rate in Q2 was higher than that in Q1 2015. This led to an increase in revenue from profit tax, and a slowdown in the fall in revenue from excise and other external taxes, which decreased as a consequence of the decline in external economic activity. State budget expenditure grew slower than revenue. It was mainly on the fuel and energy sector, and the development of transport and communications infrastructure.

Annual inflation slowed from 6.6% in June 2014 to 5.5% in June 2015. The fall in the world prices of food and petroleum products and tight monetary conditions determined by forex interventions led to a fall in the growth rates of money supply (+5.5% for M2 supply) and bank lending (+26.4% at the end of June 2015), with the share of classified loans increasing to 29.2%. Banks’ average ROA (return on assets) ratio was 2.0% as of the end of Q2 2015.
Outlook

Tajikistan: slowdown in economic growth

The high growth rate of the construction sector in Q2 2015 appears to be a consequence of the postponed statistical recording of completed projects. The construction was largely financed with foreign investment received in previous years, and is unlikely to become a steady trend. Measures have been taken to modernize existing facilities and build new ones in the agricultural sector, the fuel and energy sector, and the extractive and textile industries. They will make a modest positive contribution to the dynamics of economic growth, and help enhance the export potential of the country. At the same time the positive effect of the increased investment component will be partially offset by the unfavorable external economic environment. Uncertainty in world financial markets, which rose again in August 2015, increases the probability of: a continuation of the fall in migrant remittances; a contraction in domestic demand; and a rise in pressure on the domestic exchange market. The government has revised downward its forecast for the country’s economic growth from 7.2% to 6.4%. The consensus forecast of international organizations predicts Tajikistan’s GDP to grow by 3.7% in 2015.

Investment in the energy sector, the textile industry, and the gold mining industry has had a positive effect on exports. Although world gold and cotton prices tend to fall, it is these commodities that are expected to help export proceeds recover before the end of 2015. At the same time imports will keep decreasing due to the contraction of domestic consumer demand. A decrease in the foreign trade deficit will be accompanied by a decline in the inflow of migrant remittances. However, the current account deficit is expected to be more moderate in 2015.

Despite the high rate of economic growth, the government faces low growth rates for state budget revenue in 2015. This may be partially because taxes were collected when added value was being created in the construction sector, as well as because the practice of tax exemption has become widespread lately. In this regard, in August 2015, the government decided to reduce public spending in the remainder of 2015. In particular, the planned increase in salaries, pensions, student and other benefits, which was scheduled for September 1, was postponed indefinitely. If the government cuts non-investment expenditure as well, it is quite probable that the state budget will be balanced in 2015.

Inflation may accelerate in the remaining part of 2015 as a result of: an increase in rates in the services sector; the fall in the value of the somoni; and looser monetary policy. The pace of currency depreciation may be held back by the National Bank because the regulator has received an additional source of finance as a result of the signing a $500-million swap agreement with China. On the other hand, measures taken by the National Bank to reduce its interest rate for liquidity provided to banks and lower the reserve requirement may give monetary impetus to the rise in prices.

The consensus forecast of international organizations predicts GDP to grow by 3.7% in 2015 and by 4.6% in 2016, whereas the government expects growth rates of 6.4% and 7.0%.

The foreign trade deficit decreases

State budget revenue and expenditure are expected to decrease

Annual inflation may reach a double-digit level by the end of 2015
Tajikistan

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

Source: the Agency on Statistics under President of Tajikistan

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

Source: national agencies

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
As the downward trend in world oil prices persists, the safety margin of the economy of Turkmenistan is gradually eroded and the government’s stimulus measures are now insufficient to keep economic growth at a high pace. The country’s GDP growth slowed to 8.7% year-on-year in Q1-Q2 2015 against a growth rate of 10.3% in Q1-Q2 2014. Given the fact that the process of diversification of export destinations for natural gas was still in preparatory stages, a decrease in gas exports to Russia negatively affected the economic situation of the country. Economic growth was fueled by the industrial sector (+6.2%), the construction sector (+12.1%), the transport and communications sector (+11.3%), retail trade (+11.4%), the agricultural sector (+11.0%) and the services sector (+11.6%). Fixed capital investment rose by 7.9% and its share in GDP grew to 41.7%. Average monthly pay rose by 9.7% compared with an increase of 10.7% in Q1-Q2 2014.

It is expected that the pace of the slowdown in economic growth will somewhat decrease in Q3-Q4 2015 due to: the government’s measures to speed up projects aimed at creating infrastructure for entering the natural gas markets of Europe and China; and large grain and cotton crops. According to international organizations’ consensus forecast, Turkmenistan’s GDP will grow by 9.0% in 2015.

The downward trend in foreign trade became more pronounced in Q2 2015. As a result, the year-on-year fall in Turkmenistan’s foreign trade reached 23.2% in Q1-Q2 2015 against an 11.2% fall in Q1 2015 and an 8.3% rise in Q1-Q2 2014, while exports dropped by 31.1%. It is most likely that the sharp decrease in exports was due to the fall in world energy prices, which led to a decrease in the nominal volume of gas exports to China, as the contract price was pegged to fluctuations in oil prices. A decrease in gas exports to Russia in real terms also contributed to the fall in the total volume of exports. There was also a downward trend in imports, but imports fell at a more moderate pace, decreasing by 3.6% in Q1-Q2 2015 compared with a decrease of 5.9% in Q1 2015 and a rise of 9.3% in Q1-Q2 2014.

Given the deterioration of the foreign trade balance, it is quite probable that the current account deficit expanded in Q1-Q2 2015. Turkmenistan is expected to continue to have a current account deficit in Q3-Q4 2015 despite positive expectations with regard to a rise in grain and cotton exports.

In Q1 2015 state budget revenue fell 16.0% year-on-year, however it began to recover in Q2 2015, which enabled the government to proportionately increase public expenditure. Nonetheless, public finances remained balanced. State budget expenditure amounted to 90.4% of the projected figure, with the share of public funds spent for financing the social sector increasing from 77.3% in Q1 2015 to 79.3% in Q1-Q2 2015. Expenses on a number of scheduled cultural and entertainment events may put additional pressure on the state budget in Q3-Q4 2015.

According to official statistical data, the all-item consumer price index rose by 4.7% in Q1-Q2 2015 – against a rise of 3.2% in Q1-Q2 2014. This was a consequence of a one-time currency devaluation carried out by the government in January 2015.
Turkmenistan

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

Source: national agencies

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

Source: ADB

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

Source: national agencies

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

Source: national agencies and the ADB

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

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

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

Source: estimates and forecasts by the IMF
Trends and outlook

Uzbekistan: deterioration in external economic situation compensated for by active investment policy of government

Measures taken by the government to stimulate domestic investment and consumer demand compensated for the impact of negative external factors on the economy of Uzbekistan. These included: the fall in world energy prices; and deterioration of the economic situation in Russia, which is Uzbekistan’s major trading partner and the main donor of migrant remittances.

Uzbekistan’s economic growth accelerated to 8.7% in Q2 2015 from 7.5% in Q1 2015, which resulted in a year-on-year growth of 8.1% in Q1-Q2 2015, the same rate as in Q1-Q2 2014. Investment activity, which rose by 9.8%, helped ensure high growth rates in the industrial sector (+8.1%) and the agricultural sector (+6.5%). The creation of additional jobs supported the level of the population’s income and consumer demand. It will be possible to keep Uzbekistan’s economic growth at a high level in 2015 as a result of: the implementation of government programs aimed at boosting the manufacture of substitutes for imports, and reducing the share of imported components in domestic products; and the government’s move to slightly loosen monetary policy.

However, unfavorable external factors will have negative effects on the economy, which is expected to result in a slowdown in economic growth to 7.0% according to the consensus forecast.

Following positive dynamics in Q1 2015, the growth rate of exports moved again into negative territory in Q2 2015. As a result, exports decreased by 11.4% year-on-year in Q1-Q2 2015. Imports fell by 6.5% in the period, after a 2.0% decrease in Q1 2015 and a 4.6% rise in Q1-Q2 2014. Uzbekistan still had an export surplus in foreign trade, but it shrank to $83.4 million. As in Q1 2015, the inflow of cash remittances from migrant workers decreased by 60.0%, which caused the current account surplus to diminish. Despite the deteriorated external economic conditions, Uzbekistan is expected to be one of the few countries in the region not to have a current account deficit in 2015.

The state budget surplus increased to 0.2% of GDP in Q1-Q2 2015 from 0.1% of GDP in Q1-Q2 2014. Revenue from direct taxes rose by 16.7% and from indirect taxes increased by 16.8%. Most of public expenditure (59.2%) went for socially important programs. It is most likely that their share will grow in the remainder of 2015 because the pay of employees of public institutions and organizations, pensions, student and other benefits were raised by 10% on average on September 1.

According to government reports, the year-on-year inflation figure for Q1-Q2 2015 did not exceed the projected level of 6 to 7%. The looser monetary policy caused lending growth to accelerate to 30.5%. An additional boost to inflation may be given by the planned increase in utility rates, which are scheduled to rise by 7.5% on average in Q4 2015, and an increase in the minimum wage rate that employers are required to use in calculating pay raises.
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, ADB

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 ADB

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: stabilization of GDP, strengthening of balance of payments**

Ukraine’s GDP fell by 17.2% year-on-year in Q1 2015, 14.6% in Q2 2015, and 16.3% in Q1-Q2 2015. The magnitude of the GDP fall thus decreased in Q2 compared with Q1 2015. The improvement is attributable to the low base effect of Q2 2014, when the economy of the country started to be affected by the armed conflict in the Donbas region. Following a sharp fall in Q1 2015, Ukraine’s seasonally adjusted GDP did not change much in Q2 2015 compared with Q3-Q4 2014. However, most of the economy’s sectors still had double-digit year-on-year falls in output in Q1-Q2 2015: a 20.5% fall in the industrial sector; a 28.3% fall in the construction sector; and a 24.6% fall in the retail trade sector. The agricultural sector showed a lesser fall at 9.3%.

The state of the current account balance continued to improve. For the first time in five years, the balance was positive in Q2 2015 with a surplus of $526 million compared with a deficit of $941 million in Q2 2014. The improvement was because imports fell faster than exports. This was caused by, among other reasons, a devaluation of the national currency in Q1 2015. The financial account balance also became positive, which reflected a net capital inflow. The financial account surplus was $68 million. However, this surplus, the smallest in five years, was largely attributable to external loans received by the government. Nonetheless, the above-mentioned improvements helped increase the National Bank’s international reserves to $10.3 billion (2.1 months’ worth of imports) in June from $9.7 billion (1.8 months’ worth of imports) in March. This enabled the National Bank to keep the hryvnia pegged to the US dollar at a rate of 21 to 23 hryvnias for one dollar throughout the period.

Inflation quickly slowed down following acceleration in Q1 2015 amid the hryvnia’s depreciation and massive money expansion. The month-on-month growth rate of the consumer price index reached a 20-year record high of 14% in April, but fell to 0.4% in June amid tighter monetary policy with the annual growth of M2 money supply decreasing to 3.1% in June from 9% in March and 22.1% in February; the highly limited volatility of the exchange rate; and the GDP fall.

Positive trends seen in the state of the public finances in Q1 2015 extended into Q2 2015. The consolidated budget had a surplus of 12.3 billion hryvnias (1.5% of GDP) in Q1-Q2 2015 compared with a deficit of 20.8 billion hryvnias (3% of GDP) in Q1-Q2 2014. The improvement of the budget balance was mainly because revenue grew faster than expenditure due to, among other reasons, the price hike in Q1 2015.

The growth of bank lending slowed down in Q2 2015 amid the GDP fall and the tightening of monetary policy. The annual growth rate of lending was 5.8% in June, down from 17.9% in March. The consolidation of lending activity led to some improvement in the sustainability indicators of the banking sector. The regulatory capital adequacy ratio (the buffer that banks have to hold to protect depositors from potential shocks) rose to 9.0% in Q2 from 8.4% in Q1 2015, while the share of problem loans decreased to 24.3% from 24.7%.

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**GDP falls by 14.6% year-on-year in Q2 and by 16.3% in Q1-Q2 2015**

**Most sectors still have double-digit year-on-year falls in output in Q1-Q2 2015**

**The state of the current account balance continues to improve**

**The financial account balance also moves into positive territory**

**The international reserves grow by $0.6 billion in Q2 2015 to $10.3 billion**

**Inflation quickly slows down following acceleration in Q1 2015**

**Positive trends seen in the state of the public finances in Q1 2015 extend into Q2 2015**

**The growth of bank lending slows down in Q2 2015**
Outlook
Ukraine: improvement in economic growth rate, completion of re-structuring of external debt

Judging from the current dynamics of the key sectors of the Ukrainian economy, primarily the industrial sector, the country’s GDP ceased to fall in the middle of 2015; although it did not show significant growth either. One can expect a decline in the magnitude of the GDP fall in the remainder of 2015 compared with the respective periods in 2014 amid the low base of comparison. Available data suggest that the GDP fall will be at a level below 10% in Q4 2015. Nonetheless, Ukraine’s annual GDP growth rate will be significantly below zero in Q4 2015. GDP will likely fall by 10% or even more in 2015 compared with 2014; and may start showing positive annual growth rates in Q2 2016. The magnitude of the GDP fall in 2015 and the pace of the subsequent economic growth will depend on progress in the settlement of armed conflict in the southeastern part Ukraine and the restoration of economic activity in the conflict-torn areas. The peculiarities of the collection of statistical data in the areas uncontrolled by the central government may have an impact on the whole picture.

For the time being, the National bank maintains a flexible peg exchange rate regime. The extent of flexibility of the hryvnia’s exchange rate against the US dollar has increased compared with the period that preceded the currency’s devaluation in February 2015, although this extent remains highly limited. The tight monetary policy that the central bank uses to keep control over the exchange rate under the conditions of low international reserves is fraught with a deflation problem similar to the one that took place in the economy in 2012 and 2013. If this happens, the annual inflation rate may potentially fall from 55.3% in July to less than 40% at the end of 2015 and to levels close to zero in 2016. Such a happening, which we view as rather a hypothetical case, will impede the recovery of real economic activity after the disastrous 2014-2015 slump. Judging from what officials have said, the National Bank’s policy implies movement towards a more flexible exchange rate policy. The government is apparently deterred from going in this direction by fear that a further depreciation of the national currency may increase the burden of servicing the external public debt.

As a result of the contraction of domestic demand following the tightening of budgetary and monetary policies, the state of the balance of payments started to improve in Q2 2015. The government was able to service and repay external debts and gradually increase the international reserves, at least with the help of financial support from international organizations. The approval by the International Monetary Fund of another loan tranche for Ukraine at the end of July became a factor that helped maintain short-term stability in the economy. Major risks threatening the external sustainability of the Ukrainian economy in the near future are related to the need to make large payments on external debts in Q4 2015, as well as to the need to finance purchases of natural gas ahead of the 2015-2016 winter. Given these circumstances, an agreement with holders of the external public debt may play a key role in the long-term recovery of the sustainability of the country’s balance of payments.
Ukraine

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

![GDP and output chart](chart)

Source: the State Statistics Service of Ukraine

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

![Foreign trade chart](chart)

Source: national agencies

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

![Government sector chart](chart)

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)

![Monetary sector chart](chart)

Source: national agencies

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

![Economic growth chart](chart)

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)

![Savings and investments chart](chart)

Source: estimates and forecasts by national agencies and the IMF