Macroeconomics of the region

Macroeconomics of countries:
Azerbaijan 6–7
Armenia 8–10
Belarus 11–13
Kazakhstan 14–16
Kyrgyzstan 17–19
Moldova 20–21
Russia 22–24
Tajikistan 25–27
Turkmenistan 28–29
Uzbekistan 30–31
Ukraine 32–34

Trends:

- **The world economy**: more even growth, the stabilization of major currencies against the US dollar, a partial recovery in oil prices
- **The United States**: a slowdown in GDP growth, the likelihood of a gradual tightening of monetary policy in 2015-2016
- **Europe**: the recovery of economic growth, a tense situation over Greece
- **Asia**: a gradual slowdown in GDP growth, cautious measures to stimulate the economy in China
- **The CIS**:
  - A fall in GDP in Russia, Belarus and Ukraine; a slowdown in growth in the Asian part of the region
  - A partial recovery in the value of the Russian ruble
  - An unresolved armed conflict in Ukraine, continued Western sanctions against Russia

Outlook and risks:

- **The world economy**: continued growth, the risk of uncontrolled developments in Greece
- **Commodity markets**: The rebalancing of the oil market, risks associated with 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, the continuing risk of an escalation of the Ukraine conflict

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Macroeconomics of the region

CIS countries’ aggregate GDP falls compared with Q1 2014

In Q1 2015 the CIS countries’ aggregate GDP fell by 2.7% year-on-year. The plunge in the growth rate into negative territory was due to a contraction in GDP in Russia, Belarus and Ukraine, and a slowdown in economic growth in Kazakhstan, Armenia and Tajikistan. Exceptions to the general negative trend were Kyrgyzstan, Moldova and Azerbaijan, whose economic growth accelerated in Q1 2015 for different reasons.

The fall in economic activity in the region was caused by the same factors whose negative effects were seen in 2014. Q1 2015 saw a continued fall in the prices of primary commodities, which form the bulk of CIS countries’ exports, primarily energy resources. Energy prices at the end of March were 47% lower than March 2014, whereas energy prices at the end of December were 39.5% lower than December 2013, according to data from the World Bank. Prices of metals and agricultural goods also continued to fall, but in a more moderate way. Meanwhile, the fall in prices began to have a positive impact on the physical volume of demand for CIS countries’ exports. Despite the lack of homogeneity in this regard by goods and countries, exports from the region rose in real terms in Q1 2015 amid an increase in the physical volume of exports of oil, petroleum products and metals from Russia.

Russia and Kazakhstan experience a negative impact from external shocks

Among the oil and gas exporting CIS countries, Russia and Kazakhstan experienced the most significant negative impact from external shocks. Russia had a fall in GDP, while there was a significant slowdown in GDP growth in Kazakhstan. At the same time GDP growth accelerated in Azerbaijan and remained at the level of Q4 2014 in Turkmenistan. In both cases, a positive impact on economic growth came from the dynamics of oil and gas production and a stable situation in the non-oil and gas sectors, as well as fiscal stimulus financed with resources from various funds. The labor exporting countries (Armenia, Kyrgyzstan, Moldova and Tajikistan) experienced a negative impact from the deteriorating economic situation in the region. This led to a decline in the volume of cash remittances from migrant workers; a decrease in investment inflows; and a fall in demand for their exports. Due to this, the aggregate GDP growth of this group of countries slowed down to 3.4% from 4.5% in Q4 2014. So the slowdown in economic growth for this group of countries was appreciable but not dramatic. The slowdown happened not across all countries of the group. In particular, GDP growth accelerated in Kyrgyzstan, amid a rise in gold production at the Kumtor mine, and in Moldova, amid a significant fall in demand for imported goods and an improvement in the foreign trade balance. In Armenia and Kyrgyzstan, the contraction of domestic demand was offset by a rise in copper and gold production and good figures for the agricultural sector. In Tajikistan, consumption remained robust, apparently due to a more active use of savings for consumption purposes.

GDP growth in the labor exporting countries slows down in Q1 2015

Prices of primary commodities continue to fall in Q1 2015

Among the oil and gas exporting CIS countries, Russia and Kazakhstan experienced the most significant negative impact from external shocks. Russia had a fall in GDP, while there was a significant slowdown in GDP growth in Kazakhstan. At the same time GDP growth accelerated in Azerbaijan and remained at the level of Q4 2014 in Turkmenistan. In both cases, a positive impact on economic growth came from the dynamics of oil and gas production and a stable situation in the non-oil and gas sectors, as well as fiscal stimulus financed with resources from various funds. The labor exporting countries (Armenia, Kyrgyzstan, Moldova and Tajikistan) experienced a negative impact from the deteriorating economic situation in the region. This led to a decline in the volume of cash remittances from migrant workers; a decrease in investment inflows; and a fall in demand for their exports. Due to this, the aggregate GDP growth of this group of countries slowed down to 3.4% from 4.5% in Q4 2014. So the slowdown in economic growth for this group of countries was appreciable but not dramatic. The slowdown happened not across all countries of the group. In particular, GDP growth accelerated in Kyrgyzstan, amid a rise in gold production at the Kumtor mine, and in Moldova, amid a significant fall in demand for imported goods and an improvement in the foreign trade balance. In Armenia and Kyrgyzstan, the contraction of domestic demand was offset by a rise in copper and gold production and good figures for the agricultural sector. In Tajikistan, consumption remained robust, apparently due to a more active use of savings for consumption purposes.

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 countries with a diversified structure of exports experience a fall in GDP, which is very strong in Ukraine and moderate in Belarus.

Q1 sees an improvement in trade balances in the region.

The aggregate balance of payments of the CIS countries is negative as a result of massive forex interventions.

Q1 2015 sees a decline in state budget revenue in CIS countries due to a fall in economic activity.

The magnitude of the economic fall in the countries with a diversified structure of exports increased in Q1 2015 compared with late 2014. The CIS countries’ aggregate GDP decreased by 13.2% year-on-year against a 10.2% year-on-year fall in Q4 2014. The dramatic drop was attributable to a slump in economic activity in Ukraine amid the armed conflict in the country. The fall in GDP in Belarus was far less at 2%.

According to currently available data for the balance of payments, there was some improvement in trade balances. The depreciation of the national currencies in many CIS countries led to a considerable decrease in imports, or a slowdown in the growth of imports in almost all countries. In the labor exporting countries, an improvement in figures for foreign trade was, to a certain extent, offset by a decline in the inflow of migrant remittances. The oil and gas exporting countries experienced an increase in the volume of capital outflows due to the complicated geopolitical situation in the region. Amid the strengthening of the US dollar in international markets against the currencies of developing countries, and the depreciation of the national currencies, the aggregate balance of payments of the CIS countries was negative as a result of massive forex interventions. Due to this, the reserve assets of the central banks of CIS countries shrank by $31.4 billion in Q1 2015.

Q1 2015 saw a decrease in state budget revenue in CIS countries due to: a decline in economic activity; the decreased volume of cash remittances from abroad; negative changes in the external economic environment; and a fall in foreign trade. Amid the contraction of the money supply, many CIS countries piled up investment expenditure within the framework of countercyclical budgetary policy. The consolidated budgets of the CIS countries had an average deficit equal to 3.2% of GDP against a surplus equal to 3.2% of GDP in Q1 2014. The transfer of the greater part of expenditure to Q1 2015 due to anti-crisis measures in Russia had a considerable impact on these dynamics. The depreciation of the national currencies in economies with a high degree of dollarization led to increased expenditure. Nonetheless, a consolidation of lower-priority expenditure and a rise in the efficiency of tax administration partially compensated for a fall in fiscal revenue; which, to some extent, decelerated the deterioration of the public finances.
Inflation continues to accelerate in the region despite the tightening of monetary policy and a slowdown in money growth. Inflation rates in the region continued to rise despite a tightening of monetary policy and a slowdown in the growth of the money supply. The average growth rate of the consumer price index in the CIS region rose to 16.4% in Q1 2015 from 10.3% in Q4 2014. Intensive forex interventions led to a sharp contraction in the money supply; and a rise in the cost of loans led to a slowdown in the growth of bank lending in almost all CIS countries. The acceleration of inflation took place in all major groups of CIS countries. In particular, the inflation rate rose from 9.2% to 14.9% on average for the oil and gas exporters, primarily due to the acceleration of inflation in Russia following the sharp fall in the ruble’s value in late 2014. A significant acceleration in the rise in consumer prices – from 21% to 30.8% – occurred in the countries with a diversified structure of exports. Amid some slowdown in inflation in Belarus, there was a sharp rise in consumer prices in Ukraine due to the depreciation of the hryvnia. In the labor exporting countries, inflation accelerated from 5.7% to 6.8%. The depreciation of the national currencies in those highly dollarized economies had a very quick impact on domestic prices.

Although the negative factors that determined a slowdown in economic growth and then a GDP fall in CIS countries continue to exist, their impact has weakened compared with late 2014 and Q1 2015. Firstly, the world prices of energy resources, which constitute the bulk of the region’s exports, have partially recovered compared with the start of 2015. This was amid a rise in demand for these primary commodities, and a fall in investment in their production in the world. Secondly, some reduction in tensions over the Ukraine crisis has led to a decrease in political risks for Russian companies and banks. These factors have had a positive effect on export proceeds, and led to a decrease in the volume of capital outflows from the CIS countries. Amid these circumstances, the Russian ruble has appreciably strengthened compared with its value in Q4 2014 and Q1 2015; which, apart from the above-mentioned factors, was helped by: the general stabilization in the world’s foreign exchange markets amid a slowdown in GDP growth in the United States; and growth recovery in other leading economies. The strengthening of the ruble has, in its turn, led to a decrease in pressure on the balances of payments of the CIS countries other than Russia; and made it easier for them to achieve the goal of supporting GDP growth and preserving macroeconomic stability.
The strengthening of the ruble leads to a decrease in pressure on balances of payments in the CIS region. The consolidation of expenditure and measures taken in the field of monetary and currency exchange policies lead to an improvement in balances of payments.

The CIS countries have achieved some progress in their adaptation to the changes in the external economic environment. This is amid: the strengthening of the ruble; the restoration of relative stability in the financial market of Russia; and the measures that were taken in the field of budgetary policy. One of the signs of this is an improvement in the current account balance of the CIS region, which had a surplus equal to 6.5% of GDP in Q1 2015 compared with 5.5% in Q1 2014. The improvement in balances of payments in the CIS region was attributable to the consolidation of public spending and measures taken by CIS countries in the field of monetary and currency exchange policies. These included a revision of existing pegs of the national currencies, most of which were pegged to the US dollar to some degree or another.

Our expectations with regard to economic growth in the CIS region in the remaining part of 2015 and 2016 are based on the assumption that the average price of Brent crude will be $60 per barrel in 2015 and increase to $70 in 2016, and that the Western sanctions against Russia will not be radically toughened. This scenario predicts that the aggregate GDP of the CIS countries will decrease by 2 to 3% in 2015, and resume growth in 2016 increasing by 1.5% to 2.5%. A condition for the continued sustainability of the budgets and balances of payments of the CIS countries’ economies will be the completion and preservation of the changes that have been made in budgetary and monetary policies to reduce spending, and make the exchange rates of the national currencies more flexible.
**Trends and outlook**

**Azerbaijan: acceleration of GDP growth amid deterioration in balance of payments and public finances**

Azerbaijan’s annual GDP growth accelerated in Q1 2015, reaching 5.3% compared with 3.7% in Q4 2014 and 2.5% in Q1 2014. The growth acceleration was attributable to a significant rise of 7% in the non-oil sector of the economy. Good growth figures were shown by the non-oil industry (9%), retail trade (9.6%), the communications sector (9.3%), the services sector (5.3%) and the construction sector (14.5%). Agricultural output increased by 3.4%. The oil and gas sector had a growth of 3.4%, which, given the great importance of this sector for the economy, limited the overall growth. Major drivers of growth included consumption, which was stimulated by bank lending and a 5.7% rise in income, and exports, which rose by 20.8% in real terms, while non-oil exports increased by 38.9%. With a rise of 3%, investment made a smaller contribution to the growth acceleration.

The high growth rate of exports in real terms was due to a rise in oil production, and currency devaluation. Despite this, exports in nominal terms decreased by 43.4% due to a fall in world prices of oil, which accounts for 89% of the total volume of exports. A 68% decrease in the trade surplus resulted from a significant 27.1% rise in imports in the period that was due to strengthening domestic demand. As a result, the current account surplus narrowed to only $57.8 million (0.5% of GDP) compared with a surplus of $3,332 million (19.9% of GDP) in Q1 2014. Coupled with the financial account deficit, this deterioration in the current account balance, amid the national currency’s fixed exchange rate, triggered a sharp contraction in the international reserves, and subsequently the depreciation of the manat. The reserves have shrunk by $4.2 billion since December 2014.

The state of the public finances deteriorated as world oil prices fell. In Q1 2015 state budget revenue decreased by 12.1% year-on-year. Amid a partial consolidation of expenditure (-4.2%), this led to a state budget deficit equal to 2.2% of GDP. The consolidated budget, which includes the State Oil Fund, moved from a surplus to a deficit equal to 2.2% of GDP as a result of a 35.7% year-on-year decrease in the State Oil Fund’s revenue. The Fund’s assets decreased by $2.1 billion in Q1 2015 to $34.9 billion.

Under the influence of the depreciation of the national currency, annual inflation accelerated to 4.5% in March 2015. The acceleration reached its peak in February and mainly affected food prices, which rose by 6.6% month-on-month. The inflation rate remained moderate due to a fall in food and energy prices in international markets, and the lack of influence on inflation from monetary factors. M2 supply decreased by 23% year-on-year in March 2015. The fall in money supply in the economy had an effect on lending activity, which started to decrease month-on-month in March. However, the annual growth rate of bank lending continued to be high at 29.8%, which was solely due to a revaluation of loans in US dollars following the currency devaluation.
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
Trends

Armenia: agricultural, industrial and construction sectors support economic growth

Amid weaker domestic demand in Q1 2015, Armenia’s annual GDP growth proved to be stronger than expected at 2.2% against 2.6% in Q4 2014 and 3.1% in Q1 2014. Retail trade fell by 5.3% as a result of: a 37.7% decrease in the volume of cash remittances from abroad; a slowdown in lending growth; limited fiscal stimulation; and the depreciation of the dram, which negatively affected consumption and, probably, investment. There was a fall in many domestic services including public services (except information, communications and financial services). The weakening domestic demand also affected a number of branches of manufacturing industry, which fell by 4.5%, fueled by negative effects from a decrease in external competitiveness, and from the real strengthening of the dram. Amid weak growth in the Eurozone and falling metal prices, economic growth was supported by unexpectedly good growth figures for: the mining industry (+31.8% due to a recovery in copper production following a fall in Q1-Q2 2014); the agricultural sector (+4.9%); and the construction sector (+1.2%).

After a difficult January and February 2015, the balance of payments improved in March. On the one hand, the foreign trade balance improved throughout Q1 2015. In particular, as a result of the contraction of domestic demand, the fall in imports (-30.5%) exceeded the fall in exports (-20.1%). This partially offset the negative impact of the drop in migrant workers’ remittances on the current account balance. On the other hand, the financial account surplus should have increased because of an issue of Eurobonds in the amount of $500 million in March 2015. As a result, the gross international reserves recovered in March to $1,491 million, or 4.2 months’ worth of imports, leading to the nominal strengthening of the dram at the end of Q1 2015.

The state budget had a deficit equal to 1.7% of GDP in Q1 2015. This was due to: an acceleration in expenditure growth to 13% (because of an increase in spending on wages, social payments, and current consumption); and a slowdown in the annual growth of revenue to 1.6% amid the slowdown in economic growth and a fall in foreign trade. The expansion of the state budget deficit was apparently financed from external sources, including the Eurobonds issued in March 2015.

Annual inflation accelerated to 5.8% in March 2015. This was caused by the currency devaluation at the end of 2014, and the low base effect. Inflation was held back by: a fall in energy prices; tight monetary policy; a contraction of the dram money supply; and weak domestic demand. The tight monetary policy affected the financial sector through a rise in interest rates, and reserve requirements for deposits in foreign currency, which determined a slowdown in the annual growth of bank lending to 14.2%. As a result, the profitability indicators of the banking sector deteriorated amid growing nonperforming loans, which made up 8.3% of the total volume of banks’ loan portfolio at the end of Q1 2015. In particular, the average ROA (return on assets) ratio was -0.2%, while the ROE (return on equity) ratio was 1.7%.
Outlook

Armenia: probability of slowdown in GDP growth amid continued high financial needs

The Indicator of Economic Activity (IEA) rose to 3.2% in annual terms in April 2015 as a result of an acceleration of growth in the mining industry. Amid falling domestic demand, the agricultural sector continued to support economic growth. A continued contraction of domestic demand led to a further fall in retail trade, and a slowdown in growth in the services sector. The construction sector in fact had zero growth. Economic activity will be determined by several contradictory factors in the remaining part of 2015. In particular, the positive effect of the recovery in copper production on GDP growth should decrease in Q3-Q4 2015. At the same time, amid a deepening recession in Russia and limited opportunities for fiscal stimulation, domestic demand will not recover. This is despite signs of a slowdown in the fall in migrant remittances in dollar terms, and a limited recovery in investment, which remains probable in connection with the country’s accession to the Eurasian Economic Union.

The Indicator of Economic Activity (IEA) rose to 3.2% in annual terms in April 2015 as a result of an acceleration of growth in the mining industry. Amid falling domestic demand, the agricultural sector continued to support economic growth. A continued contraction of domestic demand led to a further fall in retail trade, and a slowdown in growth in the services sector. The construction sector in fact had zero growth. Economic activity will be determined by several contradictory factors in the remaining part of 2015. In particular, the positive effect of the recovery in copper production on GDP growth should decrease in Q3-Q4 2015. At the same time, amid a deepening recession in Russia and limited opportunities for fiscal stimulation, domestic demand will not recover. This is despite signs of a slowdown in the fall in migrant remittances in dollar terms, and a limited recovery in investment, which remains probable in connection with the country’s accession to the Eurasian Economic Union.

The recovery of exports will be impeded by: the loss of external price competitiveness; the recession in Russia; the weak recovery in the Eurozone; and low metal prices. According to the updated consensus forecast of international organizations, Armenia’s GDP growth may slow to 0.8% in 2015.

The external environment and the real strengthening of the dram will continue to have a negative effect on the state of the balance of payments, and the dynamics of the national currency’s exchange rate. The negative effect of the decline in export proceeds and cash remittances from abroad will continue to be partially offset by a fall in imports, which is caused by the contraction of domestic demand. Given the limited inflow of foreign investment, emerging gaps in the current account balance will probably be financed with external borrowings; and in high-volatility periods in currency exchange markets using resources from the international reserves. The reserves amounted to 4.8 months’ worth of imports as of the end of May 2015. The possible deterioration of the current account balance, the real strengthening of the dram, and the relatively high volume of payments on external liabilities suggests a continued downward pressure on the dram throughout Q1 2015. Its intensity will also be determined by external factors.

The slowdown in Armenia’s economic growth and the fall in foreign trade will continue to have a negative impact on state budget revenue. Amid the continued moderately loose fiscal policy, this will contribute to the expansion of the state budget deficit. Given the need to take countercyclical measures, the problem of the growing state budget deficit will most likely be solved with the help of external sources without a revision of the medium-term budget parameters. 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 the public debt.

Some decline in inflation expectations in the economy (5.1% in annual terms in May 2015) suggests a probable extinction of the inflationary effect of the currency devaluation. Given the limited influence of monetary factors and the fall in the prices of energy resources and other imported goods, annual inflation will fluctuate around the upper boundary of the central bank’s target band of 2.5 to 5.5%.
Armenia

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

Source: the National Statistical Service of the Republic of Armenia

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

Source: national agencies, IMF

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

Source: national agencies

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

Source: national agencies

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

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

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

Source: estimates and forecasts by national agencies and the IMF
Belarus: fall in GDP amid decrease in exports, investment

Belarus’ GDP decreased by 2% year-on-year in Q1 2015. The main factor behind the fall in economic activity in Belarus was the deteriorated economic situation in Russia, which accounts for a significant part of Belarusian exports. The government started to reduce public spending in late 2014, and took measures in Q3-Q4 2014 with a view to preserving the Belarusian rubel’s de facto flexible peg to the US dollar. This also had a negative impact on economic growth. Under these circumstances, industrial output decreased by 7.3% year-on-year in Q1 2015, while the agricultural and construction sectors showed positive growth rates of 5.1% and 6.5%, respectively. The high growth rate in the construction sector was partially due to the peculiarities of statistical reporting in the country. Retail trade also showed a positive growth rate, but the rate was significantly lower than that in 2014 at 1.9%. Fixed capital investment decreased by 1.1%.

At the very end of 2014, the National Bank abandoned the rubel’s flexible peg to the US dollar. After currency devaluation, it switched to pegging the rubel to a basket of three currencies – the dollar, the euro and the ruble. The share in the basket was: ruble 40%, and euro and US dollar 30% each.

Despite the National Bank’s continued relatively tight control over the value of the rubel against the currency basket, the new system helped reduce the scale of forex interventions in the currency exchange market, and stop the contraction of the money supply. The annual growth rate of the M2 supply was 10.8% in March, down from 14.5% in December, and up from 6.8% in January. Annual inflation reached its peak at 17.1% in January, accelerating under the influence of the rubel’s depreciation against the dollar and the euro, and slowed down in the following months to 16.2% in March 2015.

The transition to the new exchange rate regime just slowed the strengthening of the national currency. It did not reduce it to zero in terms of the real effective exchange rate (REER). The rubel’s REER rose by 18.1% year-on-year in Q1 2015. It is difficult to assess the impact of this factor on the balance of payments. On one hand, the current account deficit in Q1 2015 amounted to $1.1 billion (8.6% of GDP), against $1.9 billion (11.3% of GDP) in Q1 2014. On the other hand, this improvement was, at least partially, due to a large fall in imports in January, whereas the respective figures for February and March 2015 were appreciably worse than those for February and March 2014. The National Bank’s reserves continued to shrink in Q1 2015, but not as quickly as in December 2014. They amounted to $4.6 billion (1.4 months’ worth of imports) compared with $5.1 billion at the beginning of 2015.

The consolidated budget surplus grew to 3.2% of GDP in Q1 2015 from 0.4% of GDP in Q1 2014 as the government considerably tightened budgetary policy, and limited the growth of expenditure.

Lending activity remained weak in Q1 2015 against the backdrop of tight monetary policy. Banks’ net claims on the other sectors of the economy sharply increased in January 2015, apparently reflecting the rise in the rubel cost of loans in foreign currency following the devaluation, and decreased slowly in February and March.
Judging from available data for Q2 2015, it can be concluded that the annual GDP growth rate will continue to plunge into negative territory, and reach an estimated -3% to -4%. A positive aspect is that this fall is primarily due the deterioration of the growth figures for construction and investment, which in the first instance reflect their statistically inflated levels in Q1 2015 (some large projects were taken into account in statistical data only after their completion in the first months of the year). If this effect is borne in mind, economic activity in the country may be close to stable, and may probably recover in Q3-Q4 2015. The pace of this recovery will largely depend on the general economic situation in the region. A serious deterrent factor for Belarus’ economic growth may be the value of the national currency. It has risen in REER terms and thereby reduced the competitiveness of Belarusian products in Russia, Belarus’ main export destination. Another deterrent factor for economic growth is weak domestic demand amid tight budgetary policy, which will affect the rise in wages and salaries (the country has had a negative annual growth rate in average real pay since the middle of 2014).

A factor that has a positive effect on the pace of the recovery of economic activity in Q3-Q4 2015 may be monetary policy, which is looser than in late 2014 and early 2015. The National Bank’s move to loosen its monetary policy is prompted by the need to support economic growth. The slowdown in inflation in Q1 2015 creates certain opportunities for the regulator in this regard. However, it may be necessary to gradually loosen control over the currency exchange market to prevent the loosened monetary policy from having a negative impact on the balance of payments. The National Bank has announced an intention to change its policy to avoid this. It has started taking appropriate measures, which include not only increasing the flexibility of the exchange rate but also improving the system of trading in the exchange market. The pace of this process is limited by the fact that excessive fluctuations in the rubel’s exchange rate may hamper the servicing of the external public debt considering the fact that, according to the National Bank, the country has to pay $19.3 billion (26% of GDP) in 2015 alone. Given these circumstances, the government’s policy and the degree of its influence on economic growth will be partially determined by the stability of external financing in the form of investment, lending and support from international organizations or other states.

It currently seems probable that Belarus’s GDP will stop falling in the middle of 2015, and Belarus will have a GDP fall of 2% to 3% in 2015. The slowdown in inflation will stop, and the annual growth rate of the consumer price index will be 12% to 13% at the end of 2015. The current account deficit will decrease to 5% to 6% of GDP amid a decline in domestic demand, including demand for both consumer and investment goods.
Belarus

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

![GDP and output chart]

Source: the National Statistics Committee of Belarus

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

![Foreign trade chart]

Source: national agencies, IMF

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

![Government sector chart]

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)

![Monetary sector chart]

Source: national agencies, IMF (IFS)

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

![Economic growth chart]

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)

![Savings and investments chart]

Source: estimates and forecasts by national agencies, the IMF and the EBD
Kazakhstan: slowdown in GDP growth amid low inflation and stabilized balance of payments

Kazakhstan’s GDP growth slowed to 2.2% year-on-year in Q1 2015 compared with 4.8% in Q4 2014, and 4.7% in Q1 2014. The slowdown in economic growth was caused by: a fall in the price of major exported primary commodities (oil, metals and wheat); the recession in Russia, which accounted for 15.8% of Kazakhstan’s foreign trade in 2014; and indirect effects of the geopolitical crisis over Ukraine. Domestic manifestations of the external shock had a negative impact on economic growth. These included: the strengthening of the tenge; high devaluation expectations; tight monetary policy, which led to problems with liquidity in the inter-bank market and the contraction of lending (-1% in annual terms); and a limited growth rate of fiscal expenditure. Nonetheless, domestic demand continued to be a growth driver, offsetting the negative contribution of exports, which almost halved. It included: government-stimulated investment demand, which rose by 2.9%; and consumer demand, which is partially supported by the increased purchasing power of the tenge. Growth in retail trade and construction slowed down but remained in positive territory at 3.1% and 1.9%, respectively. There was no slowdown in growth in other branches of the services sector. The industrial sector showed a small, but positive growth rate of 0.6%, while agricultural output rose by 3%.

Despite the critical deterioration in the conditions for foreign trade, the state of the balance of payments remained stable throughout Q1 2015. Its sustainability was indicated by an increase in the National Bank’s gold and foreign exchange reserves, which grew by $200 million since December 2014 to total $29.1 billion (8.7 months’ worth of imports) at the end of March 2015. There was a sharp, 47.3% drop in exports against a 15.2% drop in imports and, probably, a current account deficit. The increased international reserves was attributable to the positive dynamics of the financial account balance and, in particular, an increase in transfers from the National Bank of Kazakhstan to the state budget, which rose by $3.7 billion (25%). These transfers compensated for the deterioration of the current account balance and helped hold back pressure on the tenge.

The state of the public finances deteriorated in Q1 2015. The deficit was 0.2% of GDP in the state budget and 0.6% of GDP in the consolidated budget. This was due to shortfalls of revenue from major taxes due to the contraction of exports of primary commodities, and the slowdown in economic growth. In addition, increased expenditure within the framework of countercyclical fiscal policy contributed to the emergence of fiscal gaps.

Annual inflation slowed from 7.4% in December 2014 to 5.2% in March 2015 to stand below the National Bank’s target of 6 to 8%. Monetary and non-monetary factors were behind the slowdown in inflation. M2 supply fell by 12.7% due to: the tightening of monetary policy; an increase in interest rates; the contraction of lending amid better figures for the banking sector; reduced transactions with the external world; and limited fiscal stimulation. International prices of energy resources, food and Kazakhstan’s imports fell as a result of the fall in the value of the national currencies of the country’s major trading partners. This also contributed to the slowdown in inflation and to producer price deflation (-13.9% in annual terms).
Outlook
Kazakhstan: low GDP growth rate amid balance of payments difficulties

A balance between the positive effect of fiscal stimulation, the negative effects of the contraction of oil revenue, and the degree of monetary policy tightening is of decisive importance for: the dynamics of GDP growth; the balance of payments; the stability of the tenge; the state of the public finances; and the dynamics of inflation in Q2-Q4 2015.

In 2015 one can expect continued weak domestic demand, including its consumer component, and a negative contribution from declining exports. The drivers of GDP growth will continue to be the capital and current expenditure of the government and the quasi-public sector under the conditions of extremely limited lending to the economy. Amid the impossibility of actively using monetary policy, the efficiency of public spending and the government’s ability to maintain it at a proper level become decisively important in the remaining part of 2015. This includes through an expansion of the budget deficit to 3% of GDP. Difficulties may be experienced by: sectors connected with domestic demand, in particular retail trade and many services sectors including the banking sector; and industries connected with external demand, such as the extractive industry and branches of the metallurgical industry. GDP growth will remain positive due to: the construction and agricultural sectors; some branches of the services sector; and manufacturing industry. The Indicator of Economic Activity did not change, standing at 2% in May 2015. According to the consensus forecast of international organizations, GDP will grow by 1.6% in 2015, with EDB predicting a GDP growth of 1.4%.

The decline in domestic demand in 2015, and a corresponding fall in imports, should partially compensate for the negative impact on the balance of payments of the significant decrease in exports and foreign direct investment. Nonetheless, the current account balance may be negative, which will increase pressure on the tenge given the existing overvalue of the tenge in real terms against the national currencies of major trading partners, and a general upward trend in the value of the US dollar. If the tenge’s exchange rate remains stable, one can expect a further decrease in the international reserves and a buildup of external debt. The National Bank’s gold and foreign exchange reserves shrank by $386 million in April and May despite some recovery of oil prices, which rose by 16.4% in this period. With the resources of the National Fund of Kazakhstan taken into account, the international reserves decreased by $1.1 billion in April and May to become 9% smaller than at the end of May 2014.

Annual inflation slowed to 4.3% in May 2015 with the National Bank’s target being 6 to 8%. The recovery in energy prices was followed by an administrative increase in fuel prices, and the strengthening of the Russian ruble. Although monetary policy may remain tight, one should expect that this may lead to a limited acceleration of inflation, and its return to the lower boundary of the target band. If additional external shocks emerge and the transition to inflation targeting takes less time, the acceleration of inflation may be more appreciable, but still under control.
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
**Trends**

**Kyrgyzstan: acceleration of growth in gold production, slowdown in other economic sectors**

The mixed dynamics of the terms-of-trade conditions led to a favorable improvement in the external trade balance. A decrease in the trade deficit resulted from: changing prices in international commodity markets; a favorable rise in gold production; and a decline in demand for imports. The depreciation of the Russian ruble led to a 37.3% decrease in migrant remittances. The improvement of the foreign trade situation compensated for the fall in remittances. In Q1 2015 the current account deficit was 18.5% of GDP compared with 28.3% of GDP in Q1 2014. The deficit was largely financed by the inflow of foreign direct investment and the National Bank’s forex interventions.

A fall in imports and a slowdown in economic growth affected tax revenue, which rose by 1.7% in Q1 2015 compared with a 4.5% rise in Q1 2014. The government moderated its current expenditure, which amounted to 26.8% of GDP in Q1 2015 compared with 29.3% of GDP in Q1 2014; whereas the share of capital expenditure remained at the 2014 level of 2.6% of GDP. However, the consolidation of the state budget proved insufficient, because the budget had a smaller surplus than those in the respective quarters of the previous two years.

The National Bank combined forex interventions with other measures of monetary regulation, due to the high degree of dollarization of the economy, and the weakness of the interest-rate channel of monetary transmission. Amid intensive forex interventions and an increase in the base lending rate in January 2015, the short-term lending contraction in the banking sector was the result of a sharp decrease in the som money supply, which diminished by 12.3% year-on-year. Simultaneously, the annual rise in consumer prices slowed sharply – from 11.6% in December 2014 to 8.5% in March 2015. This became the main reason for the National Bank’s decision not to change the base lending rate until the end of March 2015.

A contraction of som liquidity led to a decline in the growth rate of bank lending. Banking statistical data for Q1 2015 indicated a slowdown in the lending growth rate in both som and foreign currency, with the value of foreign currency loans adjusted to exchange rate changes. The depreciation of the som gave a fresh impetus to the dollarization of the economy. The share of deposits in foreign currency was 64.1% at the end of March 2015. Meanwhile, the shares of nonperforming (classified) loans and ‘loans under supervision’ in the total volume of the banks’ loan portfolio slightly increased to 5.4% and 9.7%, respectively.

The 7% economic growth at the beginning of 2015 was mainly due to a rise in the gold mining industry’s output. Gold production at the Kumtor mine increased by 59.6% due to high gold content in ore, and the processing of reserves stockpiled from Q4 2014. Amid a gradual decline in devaluation expectations, there was a slight rise in retail and wholesale trade. The continued growth in construction reflected public investment in energy infrastructure, whereas growth in housing construction slowed down significantly.
Outlook

**Kyrgyzstan: slowdown in GDP growth in 2015, likelihood of acceleration in medium term**

The annual GDP growth rate stood at 6.9% in May 2015. Economic growth continued to be driven by gold production, while there was a slowdown in growth in other industrial branches, and the construction and services sectors. There was deflation in the consumer market in May 2015 amid a seasonal decrease in prices, while the annual inflation rate fell to 6%. The current median forecast for 2015 is 1.7%, whereas the average annual rise in prices is expected at 7% to 8%. In 2015, the volume of migrant remittances will be modest, and a reduction is forecasted in gold production from the Kumtor mine. A decline can be expected in the physical volume of exports, and a slowdown in growth in consumer and investment activity. Weak domestic demand will lead to a decline in demand for imported goods, thereby to some extent decelerating the pace of the slowdown in GDP growth.

The dynamics of the subsequent economic situation depend to a large extent on the degree of success in overcoming current challenges. The impact of the depreciation of the Russian ruble will affect the inflow of migrant remittances. We estimate that the pace of the fall in the volume of remittances from abroad will be decelerating in the remaining part of 2015, but we expect a drop of 17% in dollar terms for the whole of 2015. Moreover, the predicted decrease in gold production will affect the dynamics of the trade balance, and lead to a rise in the current account deficit. Under such circumstances, the preservation of a flexible exchange rate regime is an important condition for the success of both monetary policy, and the maintenance of the external balance.

Parliamentary elections, expected in Q4 2015, may have an impact on the subsequent economic and political situation in Kyrgyzstan. Despite the rather high GDP growth rate in the first five months of 2015, the slowdown in the services sector and lower demand for housing construction indicate a slowdown in economic activity.

The unemployment and poverty rates may rise in 2015. The fall in economic activity in Russia will prompt migrant workers to return to their home country. In addition, there will be a loss of jobs in the re-export sector. In the run-up to the parliamentary elections, this may put upward pressure on public expenditure. According to the adopted budget estimates, the 2015 state budget should have a deficit equal to 3.3% of GDP, but new estimates put the deficit at 5.7% of GDP. State budget revenue in January-April 2015 amounted to 33.5% of GDP against 35% of GDP in January-April 2014. Amid this modest rise in revenue, continued efforts to hold 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, since the country has joined the Eurasian Economic Union, there has been an investment inflow within the framework of the Russian-Kyrgyz Development Fund. The country’s EAEU membership has also created the opportunity to enhance its production potential, and the competitiveness of the economy in the medium term through: broader access to the EAEU market; the harmonization of technical requirements; and the removal of non-trade barriers within the union.

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**Kyrgyzstan may end up with a GDP growth of only 1.7% for 2015**

**Migrant remittances may decrease 17% in dollar terms**

**Parliamentary elections may have an impact on the economic and political situation in the country**

**Membership in the Eurasian Economic Union makes growth acceleration possible**
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
Trends and outlook

Moldova: depreciation of national currency and rise in prices, amid geopolitical risks and weak banking sector

The dynamics of the external sector in Q1 2015 were characterized by considerable decreases in the volume of foreign trade (-18.3%) and the volume of migrant remittances (-22.8%), as well as a shift of exports from the CIS to the European Union. The share of exports to the EU grew from 55.6% to 65.5% – amid the depreciation of the leu and an unstable political and economic situation in neighboring countries. The decrease in the foreign exchange inflows put pressure on the exchange rate of the leu, which weakened by 19.8% in Q1 2015. This led to an 18.8% decrease in the National Bank's international reserves in Q1 2015. Pressure on the exchange rate of the leu eased in April, when the size of the international reserves was sufficient to cover 3.2 months’ of imports.

Along with making massive forex interventions, the National Bank raised its base lending rate five times within six months, increasing it from 6.5% to 14.5%. The depreciation of the leu created inflationary pressure. The annual inflation rate rose from 4.7% in December 2014 to 8.1% in May 2015, thereby exceeding the upper boundary of the National Bank’s medium-term target band of 3.5 to 6.5%. The National Bank revised upwards its average inflation rate forecast for 2015 to 8.7%. The intensive forex interventions led to lending contraction in the banking sector. In April 2015, the volume of banks’ loan portfolio was 0.9 lower than in December 2014. Despite measures taken to increase banking supervision, legal entities and individuals reduced their bank deposits in leu by 6.4% between December 2014 and April 30, 2015, while the share of nonperforming assets in the banking sector grew to 14%. Three major banks accounted for the bulk of these assets: the share of nonperforming assets rose to 37% at Banca Sociala, to 79% at Banca de Economii, and to 72% at Unibank. The capital adequacy ratio slightly increased in April 2015 to 14.6% but was still below the minimum required level of 16%.

The state budget had a surplus equal to 1.4% of GDP in Q1 2015. While tax revenue remained at the same level as in 2014, amounting to 34.7% of GDP, the main contribution to the rise in revenue was made by non-tax revenue. The social spending accounted for 75.4% of the state budget expenditure in Q1 2015.

The depreciation of the leu led to a rise in external demand for Moldovan products. Moldova’s GDP grew by 4.8%, year-on-year, in Q1 2015, with the contribution of exports to the growth amounting to 3%. Continued growth in the agricultural sector (+4.4%) stimulated the rise in industrial output (+9.1%), including the output of the agricultural processing industry. Despite the general economic growth, the construction sector (+6.2%) and retail trade (+3.9%) experienced a slowdown compared with previous quarters. Amid the deterioration in the banking sector and continued geopolitical risks, many international organizations have revised downwards their GDP growth forecasts for 2015 to a fall of 1.5% (from a 2.8% rise in December 2014).
Moldova

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

![GDP and output chart]

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)

![Foreign trade chart]

Source: national agencies

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

![Government sector chart]

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)

![Monetary sector chart]

Source: national agencies

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

![Economic growth chart]

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)

![Savings and investments chart]

Source: estimates and forecasts by national agencies and the IMF
Trends
Russia: fall in GDP, stabilization of ruble, surge in inflation

In Q1 2015 Russia’s year-on-year GDP growth moved into negative territory at -1.9%. The economy experienced the negative impact of the fall in world oil prices, which lasted until the end of February, and a capital outflow, which remained strong after a surge in Q4 2014. The capital outflow was a response to deteriorating foreign trade conditions for the Russian economy and the simultaneous weakening of the ruble. The sanctions imposed by the West against Russia in 2014 had a significant aggravating effect on the ruble’s depreciation. Under these circumstances, retail sales experienced a 6.7% fall, while fixed capital investment decreased by 6%, industrial output declined by 0.4% and the construction sector’s output dropped by 4.7%.

The Russian currency continued to weaken until the end of January. Later, it recovered, and finished Q1 2015 at levels of late 2014 against the US dollars. Major factors behind the strengthening of the ruble in February-March 2015 included the recovery of oil prices and a decrease in the capital outflow after a peak in Q4 2014. Given these circumstances, the Bank of Russia was able to start reducing its policy rate. The rate was 14% at the end of March 2015, down from 17% at the end of 2014. The reduction of the policy rate, as well as growing bank deposits in rubles amid the restoration of trust in the ruble and the banking sector, led to a rise in the annual growth rate of the M2 supply from 2.2% at the end of December 2014 to 6.2% at the end of March 2015. Inflation continued to accelerate under the influence of the postponed effect of the ruble’s depreciation in 2014. The monthly growth rate of the consumer price index reached its peak of 3.9% in January, while the index’s annual growth rate reached its peak of 16.9% in March 2015.

The current account balance in Q1 2015 had a surplus of $23.5 billion. Despite a fall in exports, a stronger decrease in imports prevented the surplus from falling greatly from its level in Q1 2014, when it was $25.9 billion. In terms of percentage of GDP, the surplus grew significantly, from 5.9% to 8.8%. The financial account surplus amounted to $27.9 billion, or 10.4% of GDP against $47.2 billion (10.7% of GDP) in Q1 2014. The reserve assets diminished by $10.1 billion in Q1 2015 amid the central bank’s continued interventions in the currency exchange market with a view to supporting the ruble.

In Q1 2015 the federal and the consolidated budget had deficits equal to 4.2% and 2.7% of GDP, respectively, compared with surpluses equal to 1.1% and 3.4% of GDP in Q1 2014. The deterioration in the budget figures was primarily due to a shift of expenditure to Q1 2015 (due to the need to finance anti-crisis measures) and, to a lesser extent, due to a fall in revenue.

Tight monetary policy, decreased demand for loans, and a fall in the ruble cost of loans in foreign currency led to a decline in the volume of banks’ net claims on the other sectors of the economy from 22.1% in late December 2014 to 17.8% at the end of March 2015. The capital adequacy ratio rose to 12.9% at the end of March from 12.5% at the end of 2014. The share of problem assets grew to 7.5% from 6.7% at the end of 2014.
Outlook

Russia: return to growth amid slowdown in inflation, looser monetary policy

The impact of the negative factors that determined the fall in economic activity in late 2014 and the first months of 2015 somewhat weakened in the following months. Primarily, the partial recovery of oil prices in Q1 2015 led to a rise in Russia’s export proceeds, and a decrease in apprehension with regard to the state of the balance of payments. At the same time, a decline in tension over Ukraine eased the risk of more drastic Western sanctions. As a result of these circumstances, and also the fact that the peak of payments on the external public debt was over, Q2 2015 saw a continued decline in the capital outflow and the strengthening of the ruble. Inflation slowed down under these circumstances, which allowed the central bank to loosen its monetary policy. In May the regulator lowered its base lending rate to 12.5%, and started to buy foreign currency for the purpose of replenishing its international reserves. Bank lending began to recover in April. Although these changes could not have an effect on real economic activity in April-May 2015, the situation should have changed later. One can expect that Russia’s GDP will fall by 2 to 3% in 2015, and that the economy will resume growth in 2016. We expect that Russia will have a GDP growth of around 1% in 2016 considering the postponed effect of the current fall in investment in construction and, possibly, a continued effect of the sanctions. Russia’s economy may show a higher growth rate in 2017.

Inflation considerably slowed down in April-May 2015 amid the stabilization of the ruble’s exchange rate, weak demand and a low growth rate of the money supply. The growth rate of the consumer price index is currently about 0.4% a month, which was its level before the period of economic instability began in 2014. One can expect that the annual growth rate of the consumer price index will be about 12% at the end of 2016. Afterwards this rate will fall, moving into the central bank’s target band of 2.5 to 5.5% in 2017 if the central bank continues to pursue its inflation targeting policy.

The budget deficit will apparently decrease in the remaining part of 2015 compared with its amount in terms of percentage of GDP in Q1 2015. This will result from a decrease in expenditure as the bulk of anti-crisis measures were financed at the beginning of 2015, as well as from the authorities’ declared intention to abandon some of the measures if the economic situation proves less unfavorable than expected.

Russia’s balance of payments adapted relatively quickly to the fall in export proceeds, which was due to the central bank’s flexible exchange rate policy, although the central bank used forex interventions in times of extreme volatilities in the currency exchange market. If there are no new negative shocks, the balance of payments will have a current account surplus in 2015, but it will amount to 3 to 5% of GDP, down from 8.8% in Q1 2015 amid a partial recovery in imports and a decline in the capital outflow. The balance of payments will remain negative, reflecting the impact of the central bank’s forex interventions in support of the ruble at the beginning of 2015. This impact will be partially offset by the central bank’s current purchases of foreign currency.

The impact of negative demand weakens due to the partial recovery of oil prices, a decline in tensions over Ukraine, a slowdown in inflation, and a reduction in the base lending rate

One can expect that GDP will fall by 2 to 3% in 2015, and that the economy will resume growth in 2016

Inflation considerably slows down in April-May 2015 amid the stabilization of the ruble, weak demand and a low growth rate of the money supply

The budget deficit will apparently decrease in the remainder of 2015

The current account surplus in 2015 will probably be lower than that in Q1

The overall balance of the balance of payments will remain negative
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
**Tajikistan: emergence of external imbalances leads to slowdown in economic growth**

A downward trend in growth continued in Tajikistan’s economy amid a deepening recession in Russia, the country’s main trading partner. In Q1 2015 GDP grew by 5.3% year-on-year compared with 7.0% in Q1 2014. A 43.8% year-on-year decrease in the inflow of migrant remittances led to a contraction in domestic demand. The volume of services decreased by 5.7%, while the growth rate of retail trade fell to 10.7% from 13.1% in Q1 2014. There was a slowdown in the agricultural sector, whose growth rate fell from 13.6% in Q1 2014 to 5.3% in Q1 2015. There was a more dramatic drop in the construction sector’s growth rate. With a year-on-year growth of 38.1%, this sector was a major driver of economic growth in Q1 2014, but its output in Q1 2015 was at almost the same level with a rise of 0.9%. The industrial sector was a growth driver in Q1 2015. Its growth rate rose from 3.6% to 16.7%. The rise was due to the production of non-energy materials, the metallurgical industry, and electric power generation.

The foreign trade deficit decreased to $537.2 million in Q1 2015 (compared with a deficit of $714.7 million in Q1 2014) as a result of a 12.7% rise in exports and a 16.9% fall in imports. The rise in exports was determined by increased exports of precious stones and metals, which contributed 26.8 percentage points to the overall growth; as well as by the recovery of cotton fiber exports, despite the fact that world cotton prices fell by 28.5% since Q1 2014. Although world aluminum prices rose, Tajikistan’s aluminum exports fell by 29.7% year-on-year in Q1 2015. The main contribution to the fall in imports was made by imports of mineral products, transport means and alumina. The decline in the volume of migrant remittances was compensated for by the decrease in the foreign trade deficit, which suggests that the current account deficit may have diminished in Q1 2015.

The slowdown in economic activity affected the public finances. The state budget had a surplus equal to 4.5% of GDP against a surplus amounting to 6.2% of GDP in Q1 2014. Public revenue grew through a six-fold increase in administrative duties and fees, while tax revenue fell by 0.5% year-on-year amid the fall in imports. Expenditure grew faster than revenue and was largely aimed at stimulating the economy. In particular, the government increased the financing of the transport and communications sector, and the fuel and energy sector. This may have given impetus to the rise in industrial output.

In Q1 2015 the consumer price index rose by 6.6% year-on-year as a result of the influence of non-monetary factors. The accumulated pressure in the domestic currency exchange market on the one hand supported the dynamics of inflation and, on the other hand, prompted the monetary authorities to make intensive forex interventions. As a result, the annual growth rate of the monetary supply fell to 4.5% from 22.3% at the end of Q1 2014. The annual growth of bank lending slowed to 31.7%, with the share of classified loans amounting to 28.6%. Banks’ average ROA (return on assets) ratio recovered to 3.0% as of the end of Q1 2015.
Outlook

Tajikistan: external shocks reveal vulnerability of existing model of economic growth

The downward trend in economic growth will continue until at least the end of 2015. The magnitude of the annual fall in the inflow of migrant remittances that was seen in Q1 2015 will probably be the same in Q2-Q4 2015, and lead to a decline in activities in the services and trade sectors. The contraction of domestic demand will be compensated for by foreign investment to a sufficient degree. In particular, Chinese investors will finance infrastructure, agricultural and mining projects within the framework of a three-year program. The rise in agricultural output may be held back by unfavorable weather conditions in the spring period. According to the median consensus forecast of international organizations, GDP will grow by 3.8%, with the government expecting a growth of 7.2%.

A decrease in exports proceeds in 2015 will result from: the slowdown in economic activity in the countries that are Tajikistan’s main trading partners; and the expected fall in world prices of cotton and aluminum, which constitute the bulk of Tajikistan’s exports. It is assumed that the re-imports of precious metals in late 2014 and in Q1 2015 were of a temporary nature, and their effects will run out by the end of 2015. The decrease in migrant remittances will limit the import of consumer goods, which in its turn reduce the volume of foreign trade. At the same time the overall volume of imports will be supported by the import of investment goods financed by foreign direct investment. In general, it is expected that the current account deficit will be more moderate in 2015 than 2014, when the current account deficit expanded from 0.7% to 8.0% of GDP.

The government’s state budget estimates for 2015 were based on the assumption that the year would see strong economic growth and a moderate depreciation of the somoni. However, the revenue figure for the first four months of 2015 was 4.4% lower than the target, which suggests difficulty in meeting the projected levels considering the changed economic situation. At the same time the expenditure estimates reflected plans to raise public employees’ pay by 25% in early September 2015. Additional pressure on the state budget may create a need to increase targeted social assistance amid a decline in real disposable personal income, and an increase in the number of the unemployed through the return of migrant workers. It will be difficult for the government to ensure a balanced state budget in 2015 without carrying out budget consolidation measures.

This year may end with a double-digit inflation rate because of the depreciation of the somoni. In response to these challenges, the National Bank uses both market and administrative mechanisms. This makes it possible to hold back the pace of the depreciation of the national currency, but reduces the buffer of safety against external factors, and leads to an expansion of multiple exchange rate practices.

According to the consensus forecast, GDP will grow by 3.8% in 2015 and by 4.4% in 2016, whereas the government expects a growth of 7.2% in 2015 and a growth of 7.4% in 2016.

Foreign trade will decrease in 2015

Public spending will grow faster than revenue

The annual inflation rate 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, IMF (IFS)

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

Source: national agencies

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

Source: national agencies, IMFs (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
The sufficient level of the fiscal and external reserves enabled the government of Turkmenistan to partially offset the unfavorable impact of external factors on the national economy, and keep GDP growth at double-digit rates. Turkmenistan’s economy grew by 10.0% in Q1 2015, which was ensured by positive contributions from almost all sectors. A growth slowdown in the production of natural gas to 5.0% was compensated for by a 10% increase in oil production. Retail trade rose by 16.9% year-on-year amid a 9.5% increase in average monthly pay. The transport and communications sector showed a rise of 15.8%, while investment increased by 7.1%, with its share in GDP reaching 36.5%. As unfavorable external economic conditions persist, the safety margin of the Turkmen economy is gradually eroded, and the government’s stimulus measures become insufficient to keep economic growth at a high pace. In particular, the GDP growth rate fell to 9.5% in January-May 2015. This trend is expected to continue until the end of 2015. According to the consensus forecast of international organizations, Turkmenistan’s economic growth will slow to 9.3% in 2015 from 10.3% in 2014, and 10.2% in 2013.

In Q1 2015 the volume of foreign trade decreased by 11.2%, with exports falling faster than imports. Although the government carried out a one-time currency devaluation in January 2015, reducing the value of the manat by 19.0%, exports fell by 15.5% in Q1 2015. This was most likely a consequence of the fall in world energy prices, which reduced the nominal volume of exports of natural gas to China, as the contract price of gas was pegged to fluctuations in oil prices. A decrease in gas exports to Russia in real terms also made a contribution to the overall decrease in exports. Imports fell by 5.9% in Q1 2015, which was attributable to the high base effect. In Q1 2014, imports rose by 16.2%. Given the deteriorated foreign trade balance, it is highly probable that the current account deficit expanded in Q1 2015.

The fall in export proceeds affected the state of public finances. State budget revenue decreased by 16.0% year-on-year in Q1 2015, while expenditure was 8.8% lower than projected, with 77.3% of all state budget expenditure being used to finance the social sphere. Given the fact that state budget expenditure decreased by 18.1% in Q1 2015, i.e. to a greater extent than revenue, one can expect that the state budget will be balanced in 2015.

As for inflation, according to government statistical data, the all-item consumer price index rose by 5.7% compared with December 2014. The acceleration of inflation was attributable to the devaluation of the manat, a rise in retail gasoline prices and a sharp increase in utility prices. The inflation rate is expected to be the same until the end of 2015. Inflation will be fueled by a rise in prices of imported goods, and the liberalization of the prices of utilities and transport services.
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
The economy of Uzbekistan was under the influence of negative factors such as: the contraction of domestic demand in Russia, which is the country’s main trading partner and major donor of migrant remittances; and the fall in world energy prices. The impact of these factors was more than compensated for by measures taken by the government within the framework of its policy aimed at stimulating domestic investment and consumer demand. As a result, Uzbekistan’s economic growth in Q1 2015 remained at its 2014 level of 7.5%. Investment activity (+8.7%) helped ensure high growth rates in the industrial sector (+7.9%) and the agricultural sector (+6.3%). The creation of additional jobs supported the level of the population’s income and consumer demand. The implementation of government programs aimed at boosting the manufacture of substitutes for imports, and reducing the share of imported components in domestic products, will make it possible to keep Uzbekistan’s economic growth at a high level in 2015. 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.

A strategic reorientation of gas exports from Russia to China helped lift the growth rate of exports from negative territory. In particular, exports increased by 13.9% in Q1 2015 compared with a rise of 8.4% in Q1 2014 and totaled $3.5 billion. Since imports fell by 2.0% to amount to $3.3 billion, the export surplus increased to $168 million. The decreased inflow of migrant remittances led to a fall in the current account surplus. Despite the deteriorated external economic conditions, Uzbekistan is expected to be one of the few countries in the region to have a current account surplus in 2015.

An increase in expenditure with a view to supporting economic growth caused the state budget surplus to shrink to 0.1% of GDP from 0.3% of GDP in Q1 2014. A great part of expenditure went as before for investment. Along with that, there was some increase in social spending. In particular, an additional 593 billion sum was provided for financing a government program titled, “The Year of Attention and Care for the Senior Generation.” Nonetheless, total public expenditure in Q1 2015 was lower than projected, which enabled the government to follow cautious tax and budgetary policies.

According to government reports, the year-on-year inflation figure for Q1 2015 did not exceed the projected level of 6 to 7%. However, the International Monetary Fund estimated that the consumer price index in the country rose by 9.0% year-on-year in Q1 2015 after a rise of 11-12% in 2014. In order to stimulate lending, the central bank reduced its refinancing rate from 10% to 9% in January 2015. According to the IMF estimates, the growth rate of bank lending remains high. The official exchange rate of the Uzbek sum against the US dollar fell by 2.7% in Q1 2015. The large international reserves, coupled with administrative measures, enable the central bank to hold back the pace of the sum’s depreciation.
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: deepening fall in GDP, decline in current account deficit

The magnitude of the fall in Ukraine’s GDP continued to increase in Q1 2015 amid the armed conflict in the Donbass region. Ukraine’s GDP reportedly fell by 17.6% year-on-year in Q1 2015 compared with a year-on-year decrease of 14.8% in Q4 2014. Most of the economy’s sectors experienced a fall in output. In particular, industrial output decreased year-on-year by 21.4% in Q1 2015. The output fall was 22.6% for the extractive industry; 20.0% for the manufacturing industry; 15.5% for electric power, gas and water production and distribution; 25.9% for retail trade; 4.7% for the agricultural sector; and 31.3% for the construction sector. Average real pay decreased by 20.1%.

The fall in domestic demand, including both consumer and investment demand, led to a decrease in the current account deficit. According to preliminary data, the deficit amounted to $452 million (2.6% of GDP) in Q1 2015 compared with $1.5 billion in Q1 2014. The financial account deficit diminished as well, totaling $1.7 billion against $2.8 billion in Q1 2014. Due to this, the overall balance of payments deficit shrank to $1.9 billion from $4.3 billion in Q1 2014. A new loan tranche was received in early March under the IMF’s financial assistance program. It enabled the government to finance this deficit, and increase the National Bank’s international reserves to $9.7 billion (1.7 months’ worth of imports) from $7.5 billion (1.2 months’ worth of imports) at the end of 2014. After a new round of currency devaluation in February, the National Bank resumed pegging the hryvnia to the US dollar, setting the hryvnia’s exchange rate at around 24 hryvnias and then at 21 hryvnias for one dollar.

Inflation continued to accelerate throughout Q1 2015 under the influence of the depreciation of the hryvnia, which had lost half of its value against the US dollar since the middle of 2014. The annual growth rate of the consumer price index rose to 45.8% in March 2015 from 24.9% in December 2014. The growth of the money supply accelerated despite the double-digit fall in real GDP. In particular, the M2 money supply grew by 9.5% year-on-year compared with an increase of 5.4% at the end of 2014. This acceleration apparently contributed to the increased inflation rate in Q1 2015.

Meanwhile the state of the public finances improved significantly in 2015. The consolidated budget had a surplus of 14 billion hryvnias (3.8% of GDP) in Q1 2015 compared with a surplus of 497 million hryvnias (0.16% of GDP) in Q1 2014. The improvement of the budget balance was because tax revenue grew faster than expenditure due to, among other reasons, the high inflation rate.

Amid the rise in the money supply, the annual growth of bank lending accelerated to 17.9% in March 2015 from 12.1% in December 2014. At the same time the sustainability indicators of the banking sector considerably deteriorated in Q1 2015. For instance, the average regulatory capital adequacy ratio (the buffer that banks have to hold to protect depositors from potential shocks) fell to 8.4% from 15.6% in Q4 2014, while the share of problem loans grew to 24.7% from 19%. 

The fall in Ukraine’s GDP continues to deepen in Q1 2015

Most sectors experience a fall in output

The fall in domestic demand leads to a decrease in the current account deficit

A new loan tranche received from the IMF in early March 2015 enables the government to finance the balance of payments deficit and increase the international reserves

Inflation continues to accelerate throughout Q1 2015 under the influence of the depreciation of the hryvnia

The state of the public finances improves significantly in 2015

The annual growth of bank lending accelerates amid a rise in the money supply
Outlook

Ukraine: slowdown in GDP fall, consolidation of balance of payments, talks with creditors

Judging from available month-on-month data for the first part of 2015, the contraction of activity did not end in Q1 2015 in many sectors of the economy. Output in the construction sector continued to fall until April. Industrial output also fell but at a slower pace. For the time being, one can expect a moderation in the extent of the fall in Q3-Q4 2015 because of a lower base of comparison. Nonetheless, the fact that 2015’s fall in GDP is to a great extent caused by the armed conflict in the eastern part of the country, rather than any economic factors, means that the magnitude of the fall will remain significant until the end of 2015 unless the conflict is resolved. Given these circumstances, Ukraine’s GDP may fall by more than 10% in 2015.

The National Bank pursued a loose monetary policy in Q1 2015, which was mainly characterized by a strong expansion of the money supply in February, when the annual growth of the M2 supply jumped to 22%. Its policy was tightened appreciably in April (with M2 growth slowing down to 3.5%), as there was less need to monetize the budget deficit after an IMF loan tranche was received. The change in the National Bank’s policy had an effect on inflation in May, when consumer prices rose by only 2.2% following a 14% increase in April. If monetary policy remains tight, there will be a moderate slowdown in the annual growth in inflation to between 50% and 55% by the end of 2015 from 58.4% in May.

The tightening of budgetary and monetary policies, which in fact took place in March and April, led to an improvement in Ukraine’s balance of payments. The current account balance was positive in March and remained so in April. The National Bank’s international reserves grew in March to $9,970 million after reaching a minimum of $5,625 million in February. Half of March’s IMF tranche was used for replenishing the international reserves. The reserves remained relatively stable in the following months, amounting to $9.9 billion as of the end of May 2015. The gross external debt reached the equivalent of 95% of GDP in 2014, although it decreased in nominal terms. According to the IMF’s estimate (see IMF Country Report No. 15/69), the payments needed to be made in 2015 to service the external debt will amount to 39% of GDP.

One can conclude that the changes that happened to the Ukrainian authorities’ macroeconomic policy this past spring helped restore the sustainability of the budget and the country’s balance of payments. However, the risks of a setback to the progress that has been made in this regard will continue to be serious throughout the remainder of the year. These risks are associated with the fact that the improvement of the balance of payments in Q1 2015 was partially due to a pause in purchases of natural gas. A more serious problem is that there is the threat of a significant increase in the debt burden in the event of a new round of currency devaluation. At the same time the preservation of the hryvnia’s current peg to the dollar may have a negative impact on economic growth in the country. How and at what cost the government will achieve the goal of ensuring the sustainability of the economy and restoring economic growth depend on the outcome of Ukraine’s ongoing debt restructuring talks with holders of its sovereign debt.

The contraction of activity does not end in Q1 2015 in many sectors of the economy.

The magnitude of the fall will remain significant until the end of 2015 unless the armed conflict is resolved.

After pursuing a loose monetary policy in Q1 2015, the National Bank appreciably tightens its policy in April.

Consumer prices rise by 2.2% in May after a 14% increase in April.

The tightening of budgetary and monetary policies leads to an improvement in the balance of payments.

Changes to macroeconomic policy help restore the sustainability of the budget and the balance of payments.

The restoration of economic growth and sustainability depends on, among other things, the outcome of debt restructuring talks with creditors.
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 – Q2 2009 = 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