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Regional Economic Outlook

Economic Developments, Prospects, and Policy Issues in Central Asia

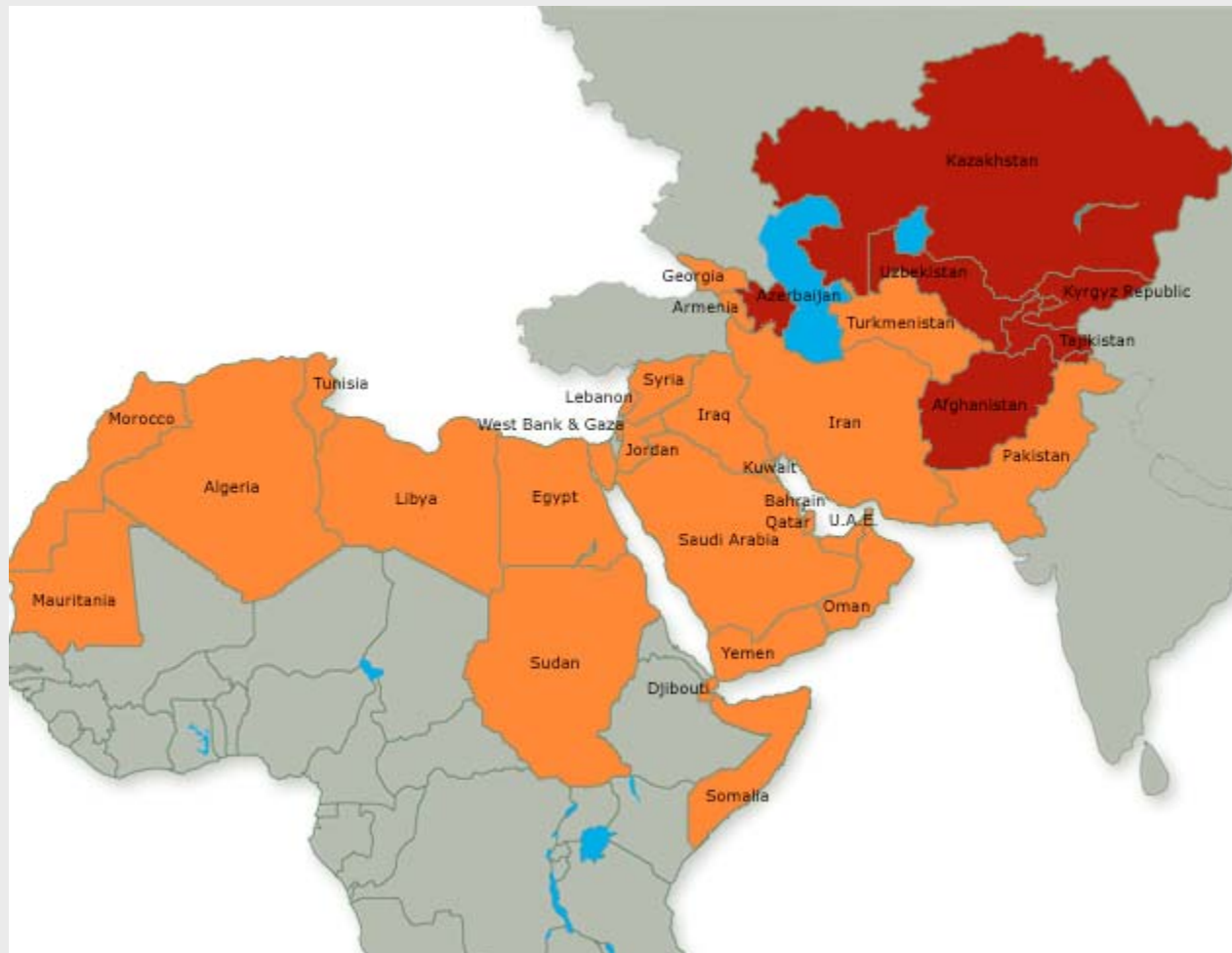
**For Presentation at the Senior Officials' Meeting of
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International Monetary Fund

CAREC Countries Covered by the Middle East and Central Asia Department (MCD)



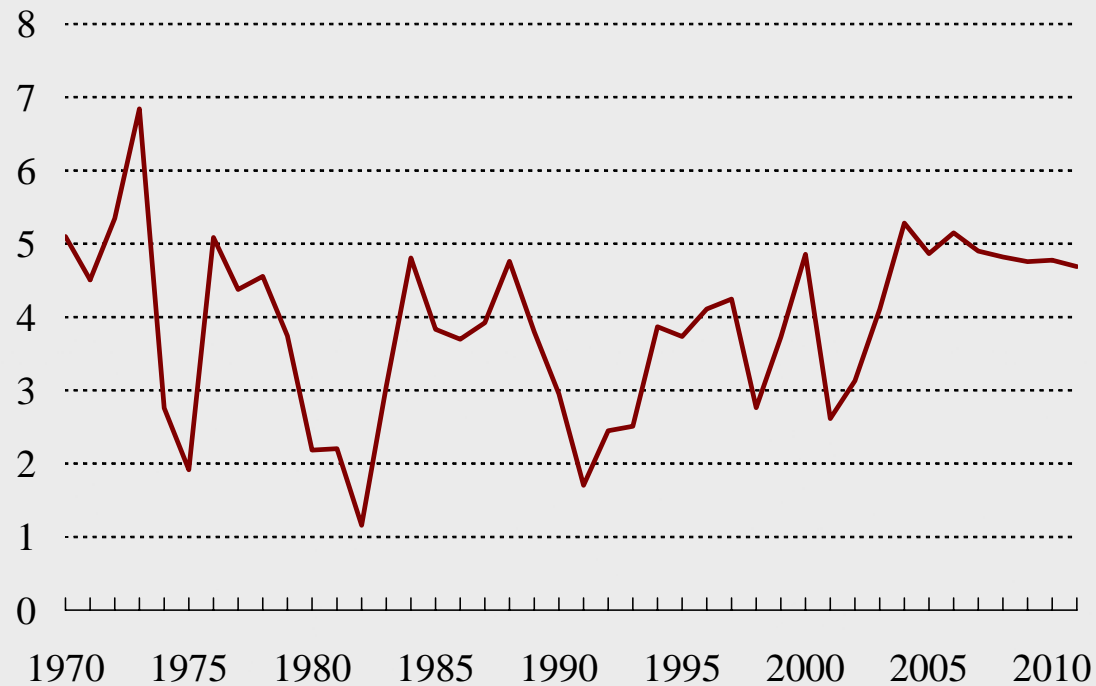
Outline of Presentation

- Global Economic Background
- CAREC-6 Countries:
 - ✓ Economic developments and prospects for the CAREC-6 group
 - ✓ Individual country prospects and key policy issues
 - ✓ Common policy issues

Global Economic Background

World Real GDP Growth

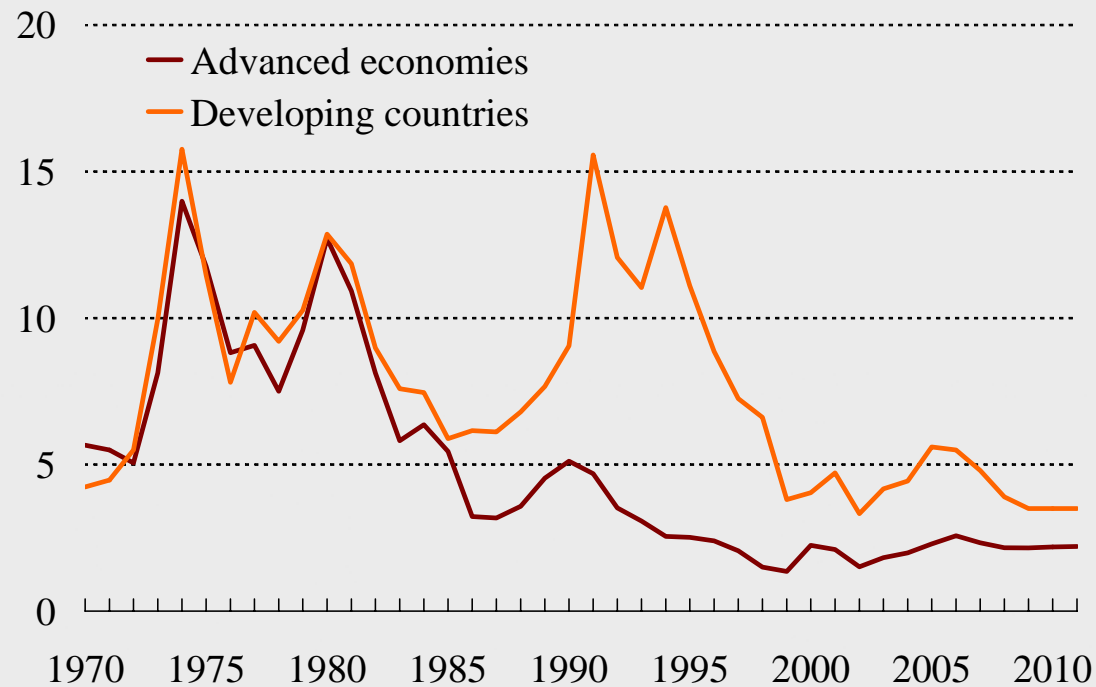
(Annual percent change)



Global growth is the highest for 30 years...

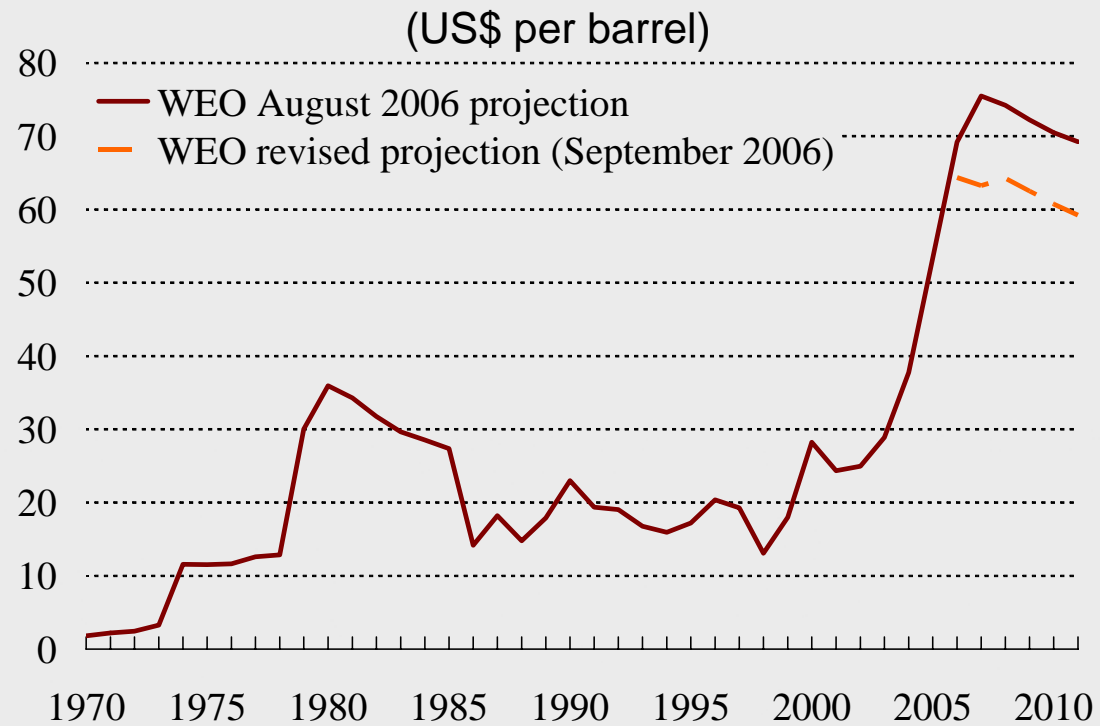
Consumer Price Inflation

(Annual percent change)



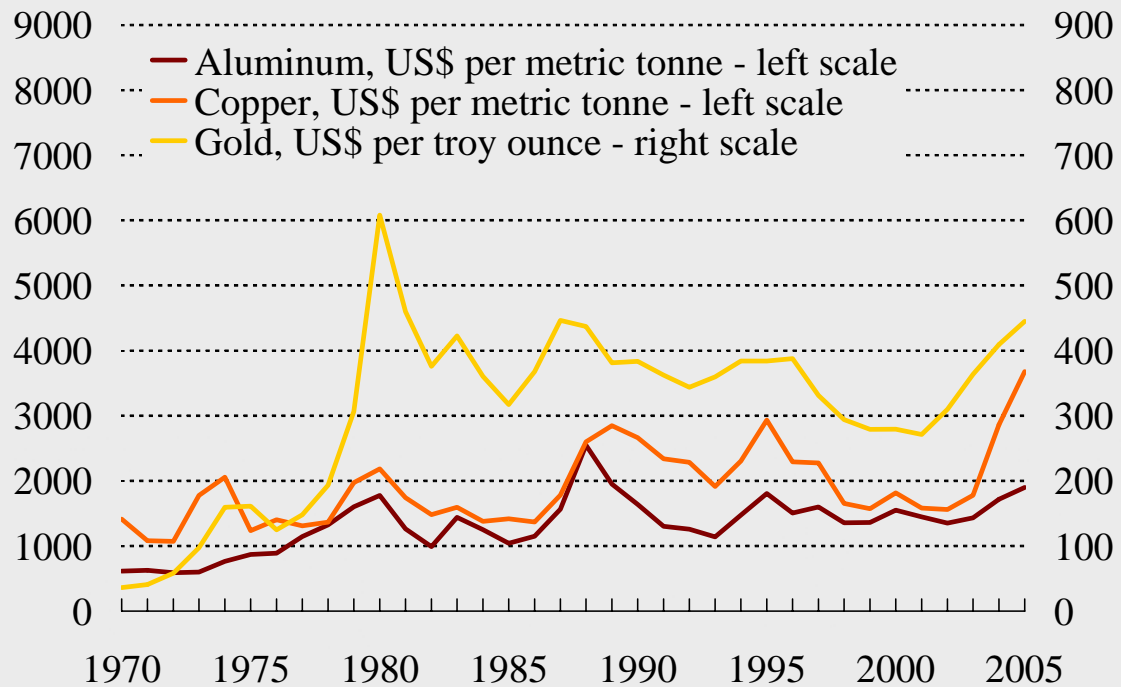
...while inflation remains low.

Developments in Oil Prices



Oil prices have risen sharply, but are easing.

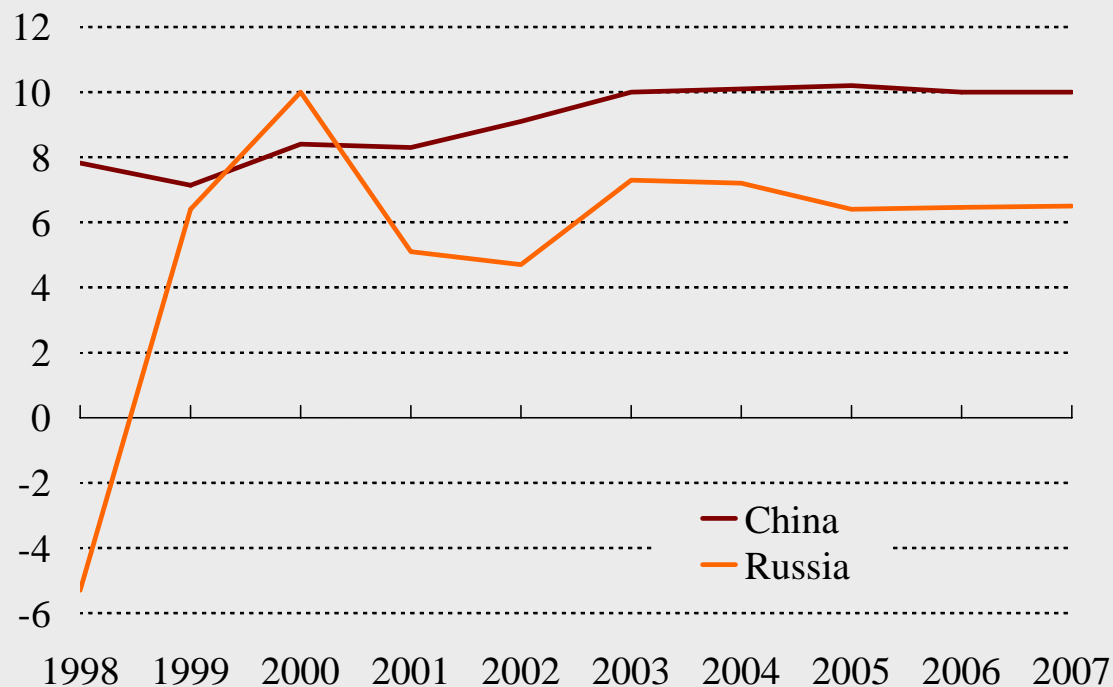
Non-Oil Commodity Prices



Metal prices have also risen due to strong demand growth.

Real GDP Growth

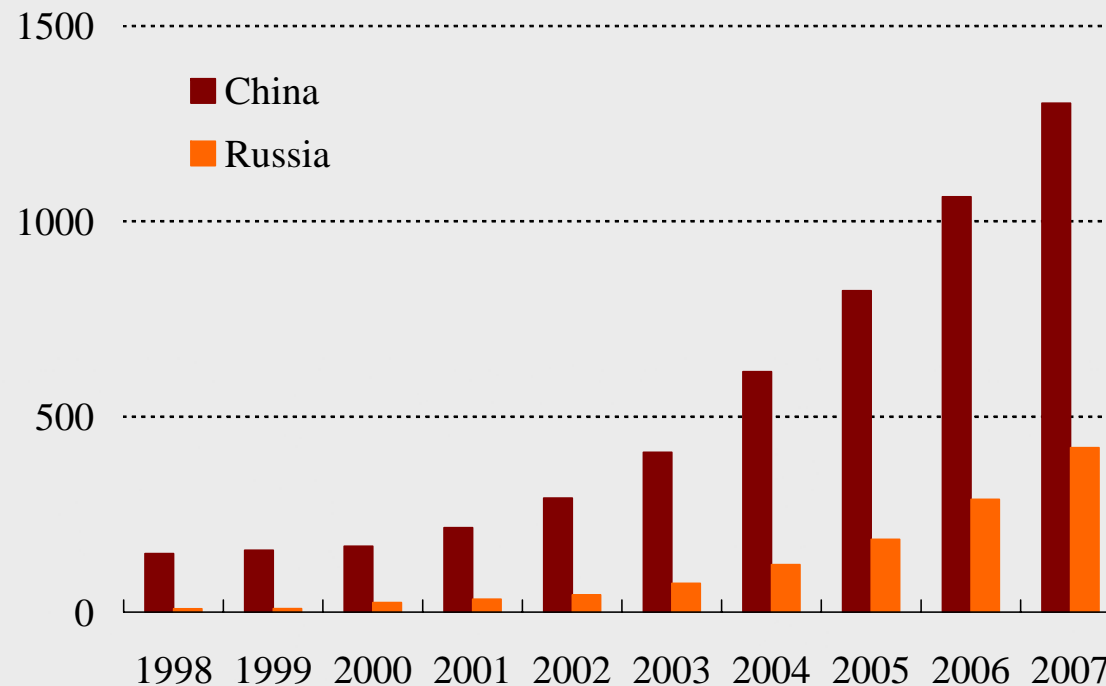
(Annual percent change)



Russia and China are growing rapidly.

International Reserves

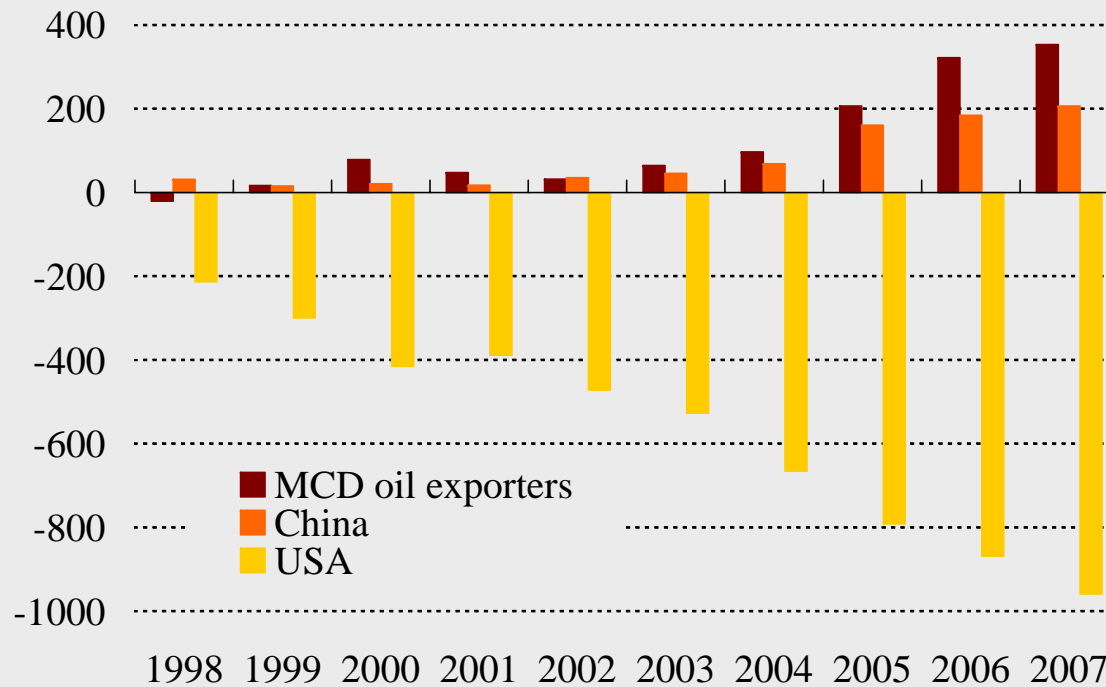
(In billions of U.S. dollars)



Reserves of Russia and China are also increasing rapidly.

Current Account Balance

(In billions of U.S. dollars)

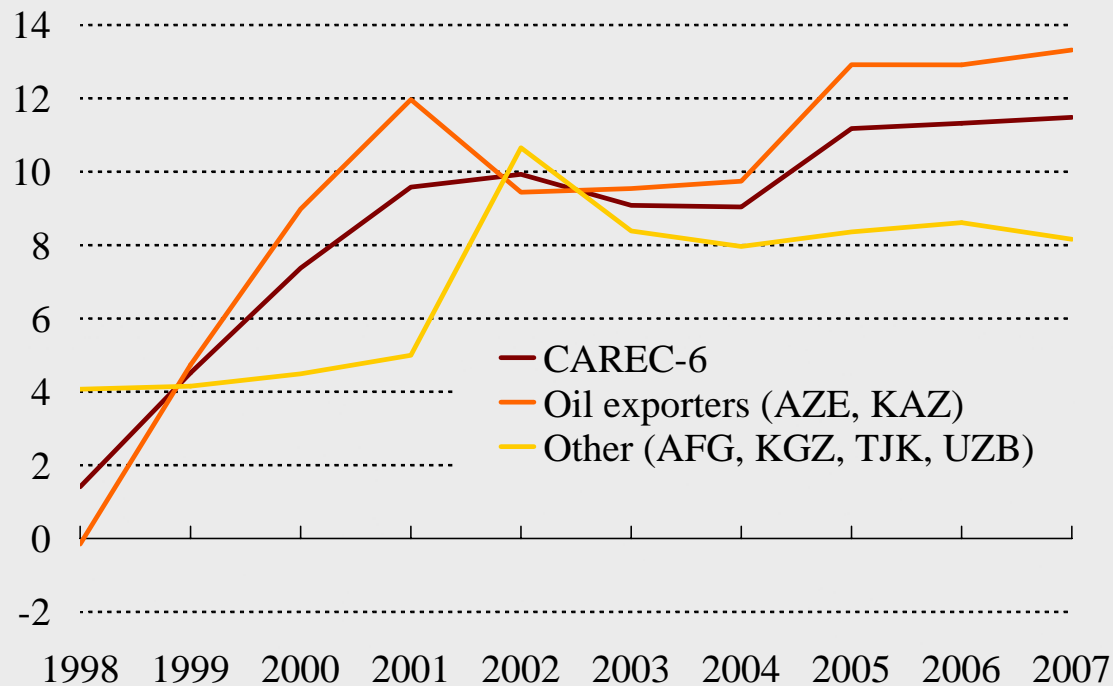


Global imbalances continue to widen.

Economic Developments and Prospects for the CAREC-6 Group

Real GDP Growth

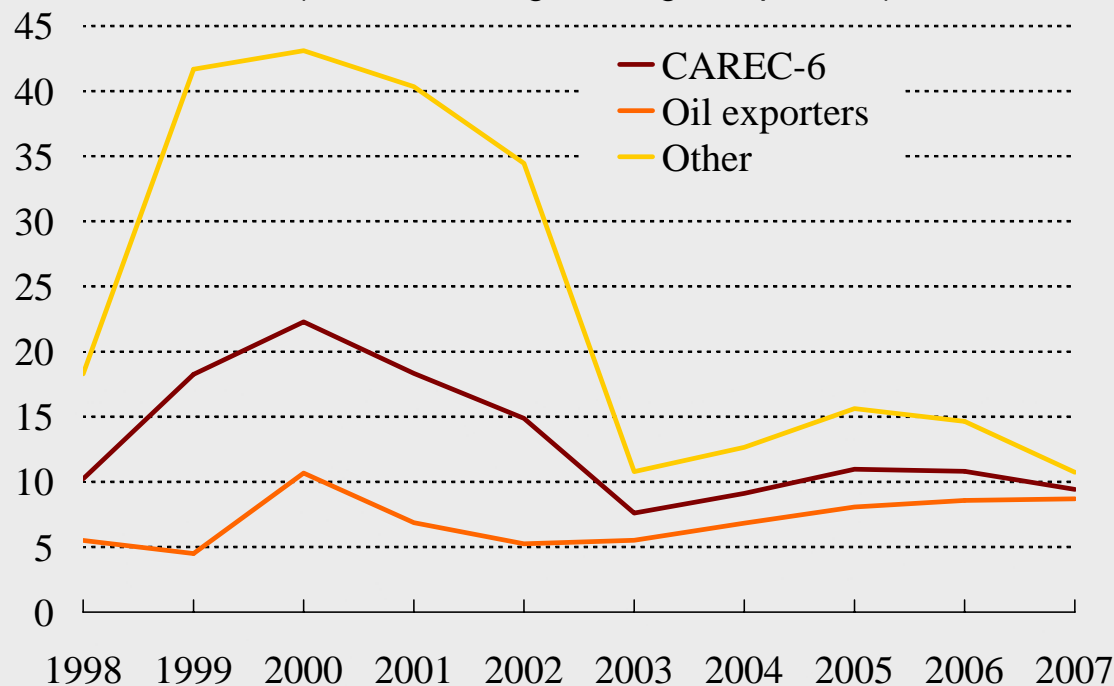
(Annual average change; in percent)



- CAREC-6 countries are growing strongly—well above global average.
- Near-term growth prospects are good.

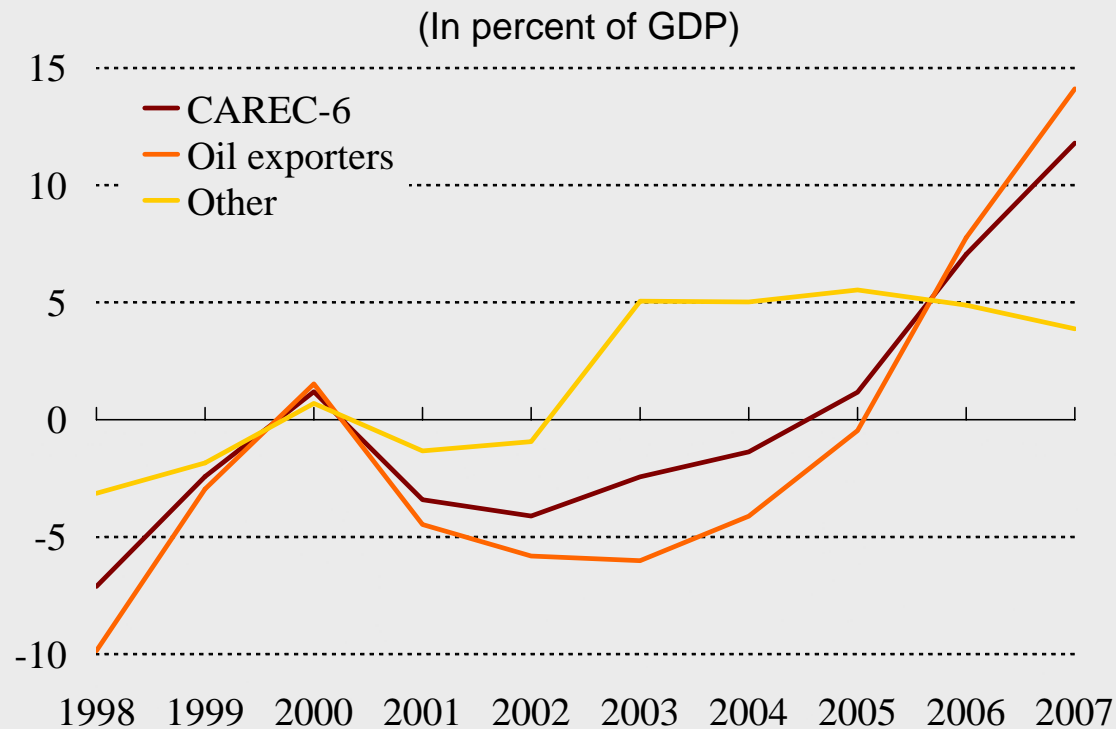
Consumer Price Inflation

(Annual average change; in percent)



- But inflation also remains high.
- Average inflation seems to be getting entrenched around 10 percent.
- Recent figures show increasing inflation for all CAREC-6 countries except Afghanistan and Uzbekistan, where inflation is already in double digits.

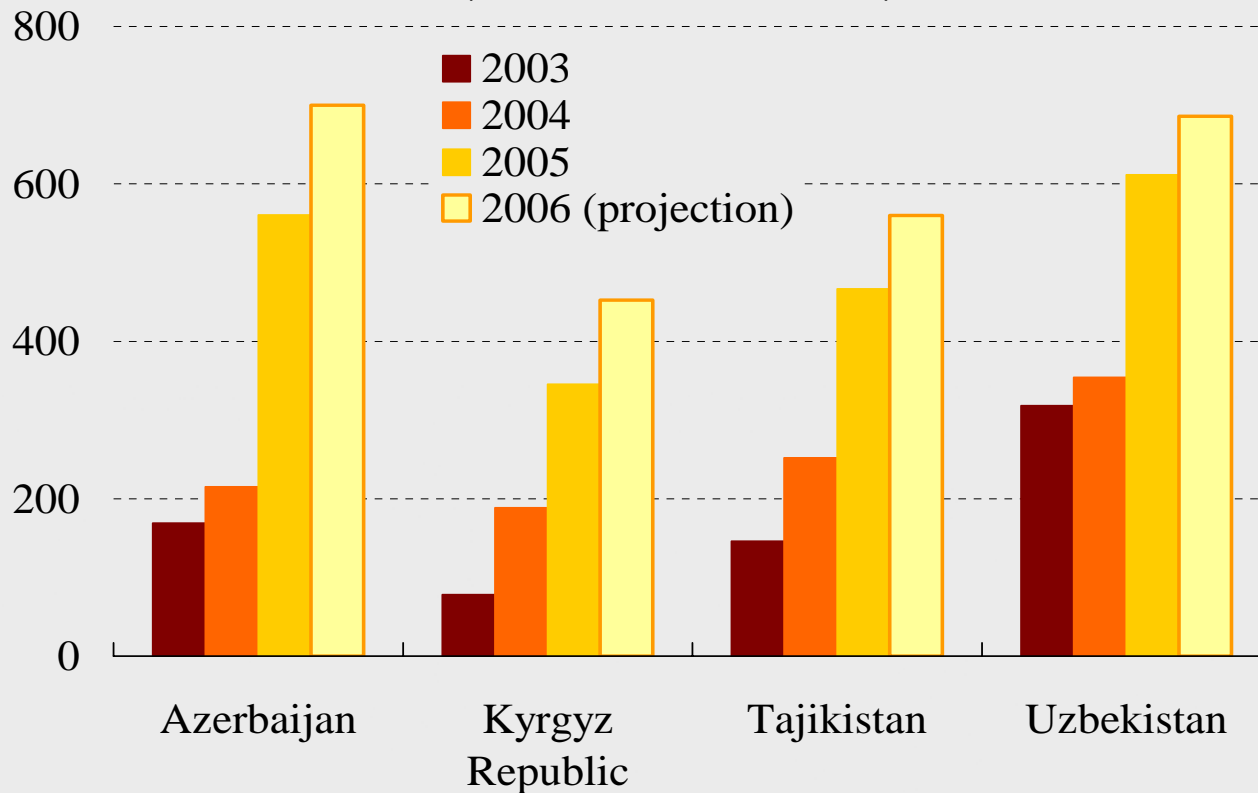
External Current Account Balance



- External surpluses are growing.
- Region continues to benefit from strong inflows:
 - High oil prices (AZE, KAZ)
 - Strong prices for non-oil commodities (KAZ, KYZ, UZB)
 - Growing remittances (AZE, KYZ, TJK, UZB).

Total Remittance Inflows

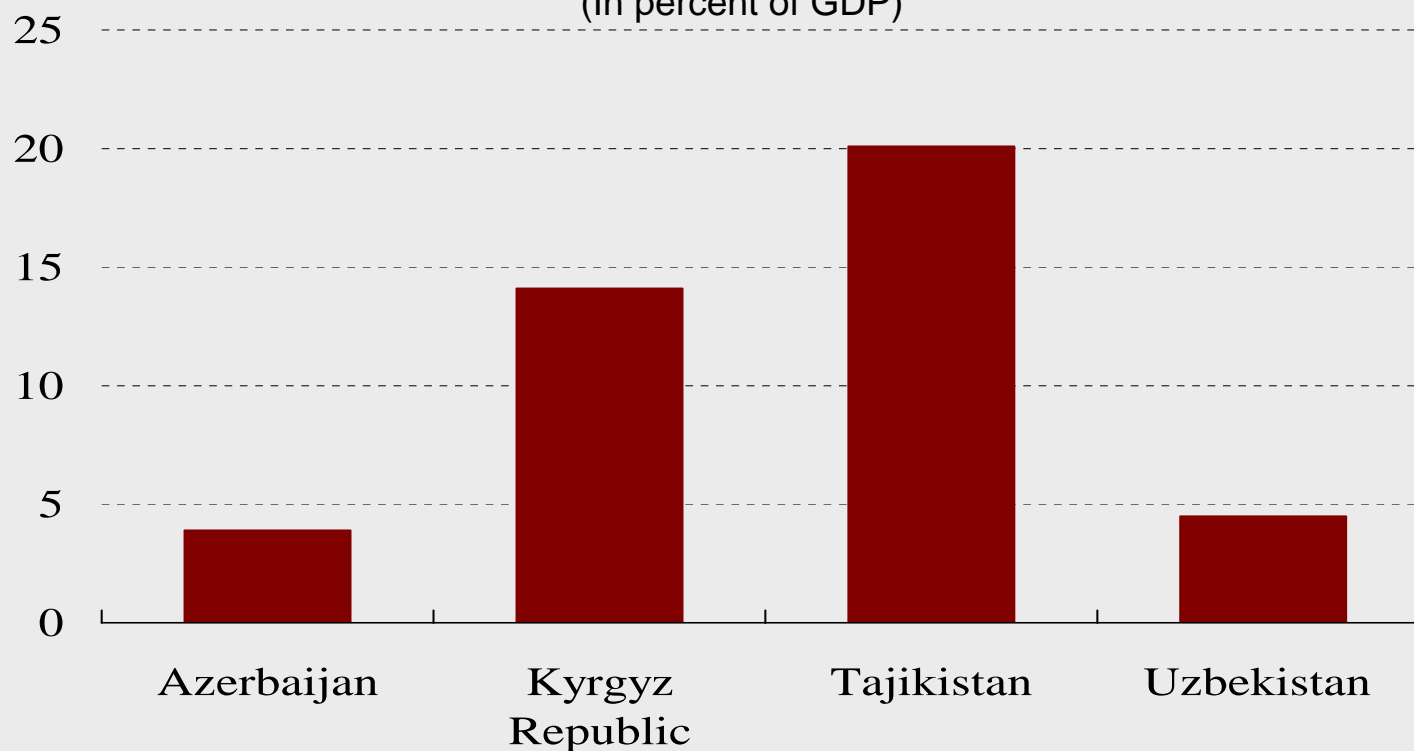
(In millions of U.S. dollars)



- Remittances have grown dramatically in the past few years.
- They are outstripping official development assistance and are on a par with foreign direct investment, except in Azerbaijan.

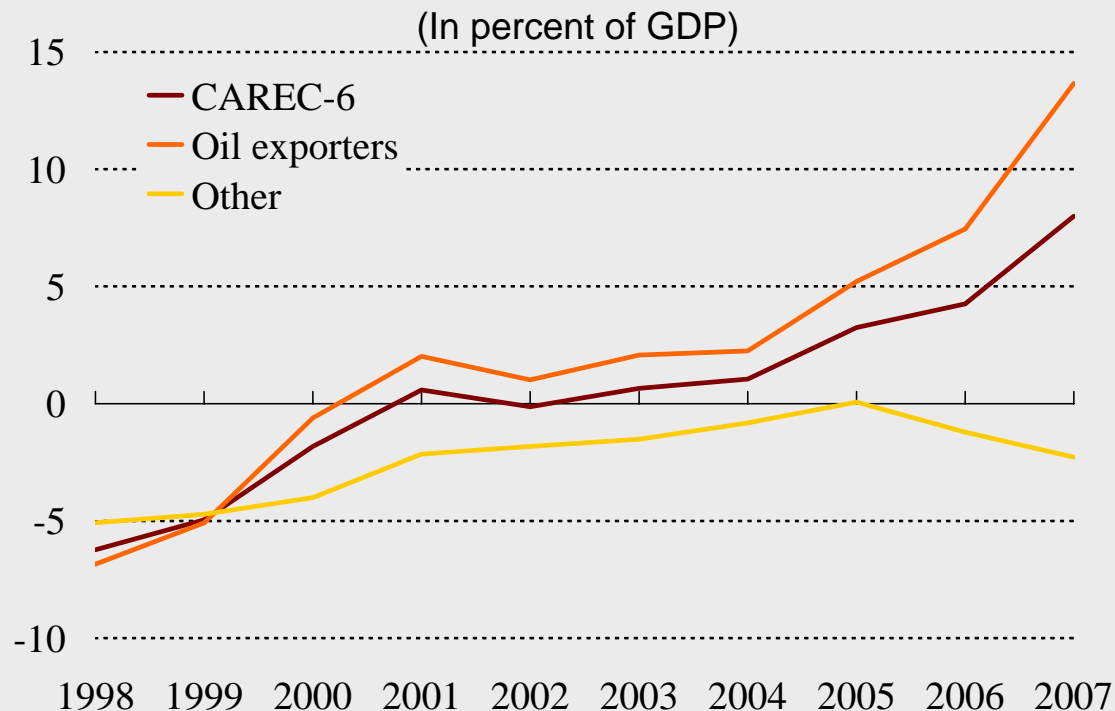
Total Remittance Inflows

(In percent of GDP)



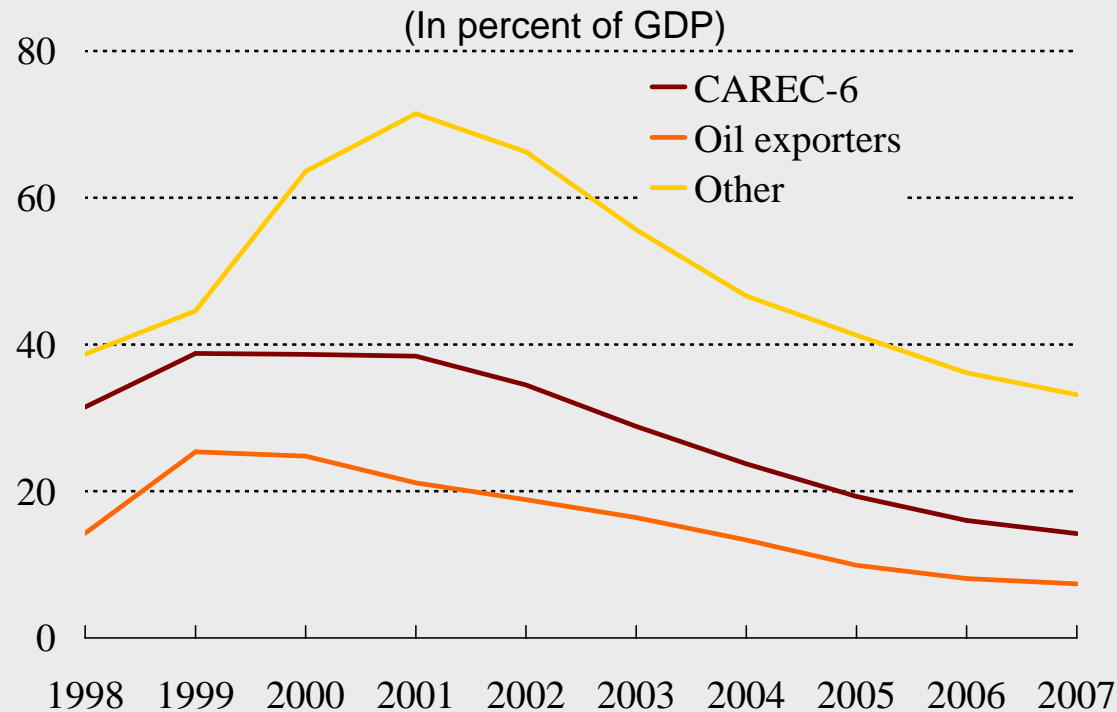
- The importance of remittances in the economy is particularly high in the Kyrgyz Republic and Tajikistan.

Central Government Fiscal Balance



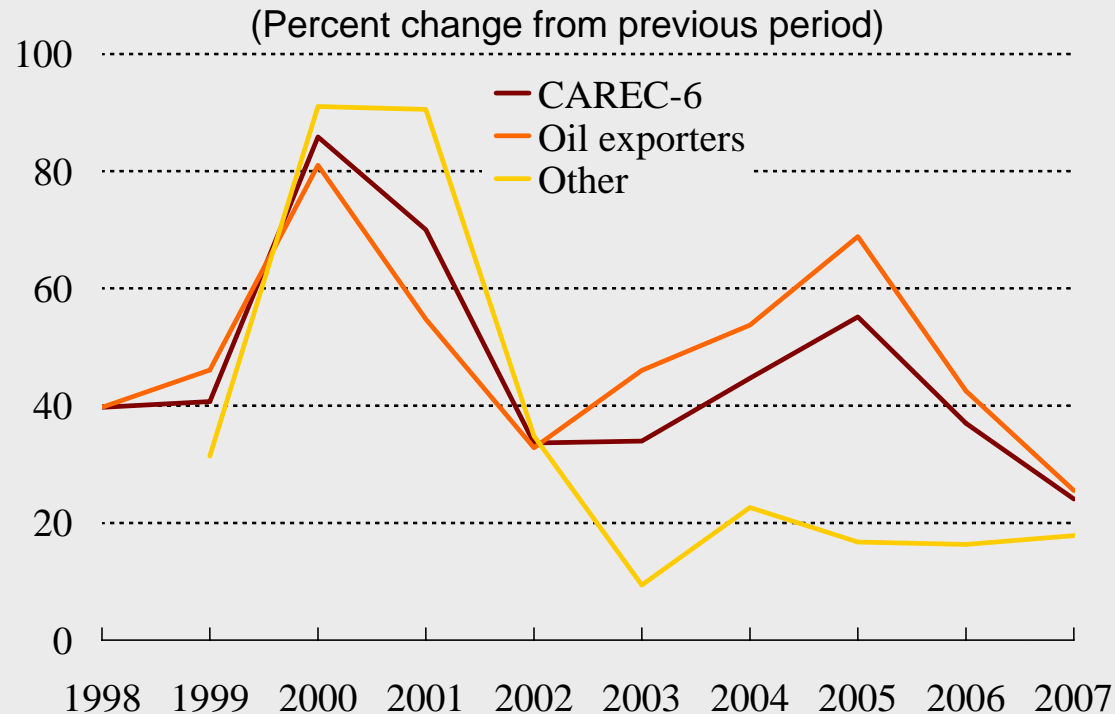
- Fiscal position continues to strengthen; region has moved from a deficit of 6 percent of GDP in 1998 to an estimated surplus of 4 percent in 2006.
- Azerbaijan and Kazakhstan are running larger surpluses owing to high oil revenue, but significant easing planned for 2007 in Kazakhstan.
- In other countries, weakening in fiscal positions are projected in 2006¹⁸ and 2007.

Total Government Debt



- Government debt remains on a downward trend.
- Most countries implemented prudent fiscal policies; some have also benefited from debt restructuring and debt relief.
- But new debt-financed projects are under way or being planned in Kyrgyz Republic and Tajikistan—they have not yet been built into these favorable debt projections.

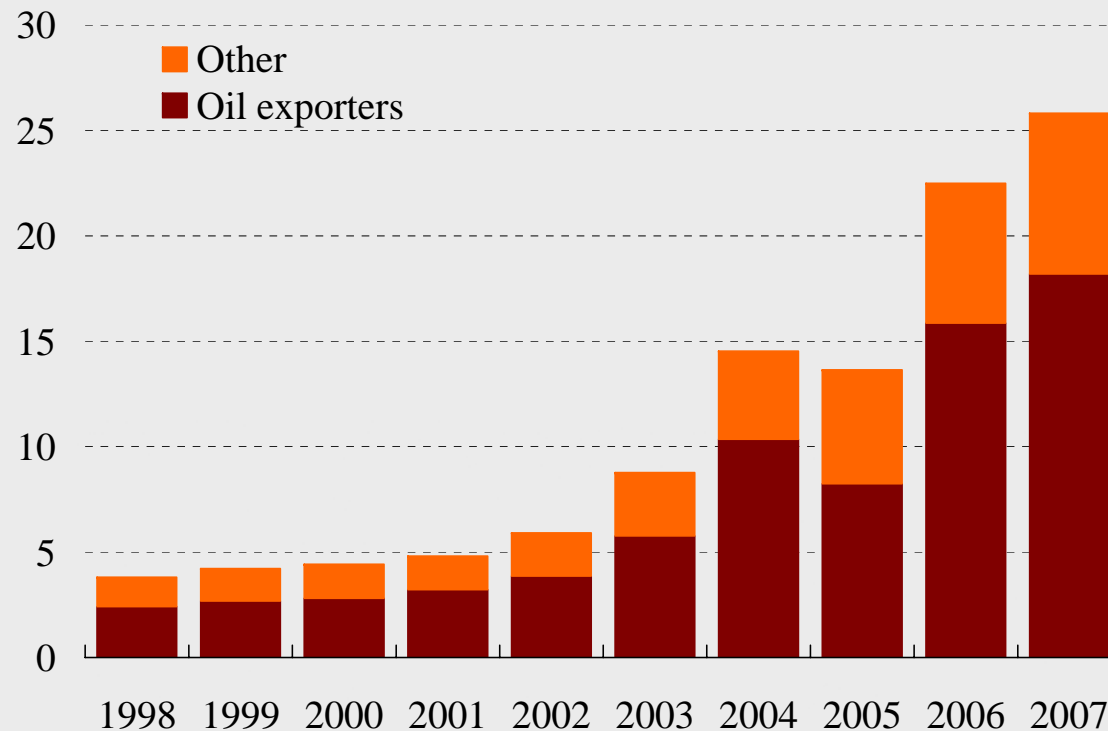
Credit to the Private Sector



- Credit growth remains high, especially in oil exporters.
- Strong inflows and low interest rates have fueled money and credit growth.
- Partly reflects healthy process of financial deepening.
- But has also added to inflationary pressure.

Gross Official Reserves

(In billions of U.S. dollars)



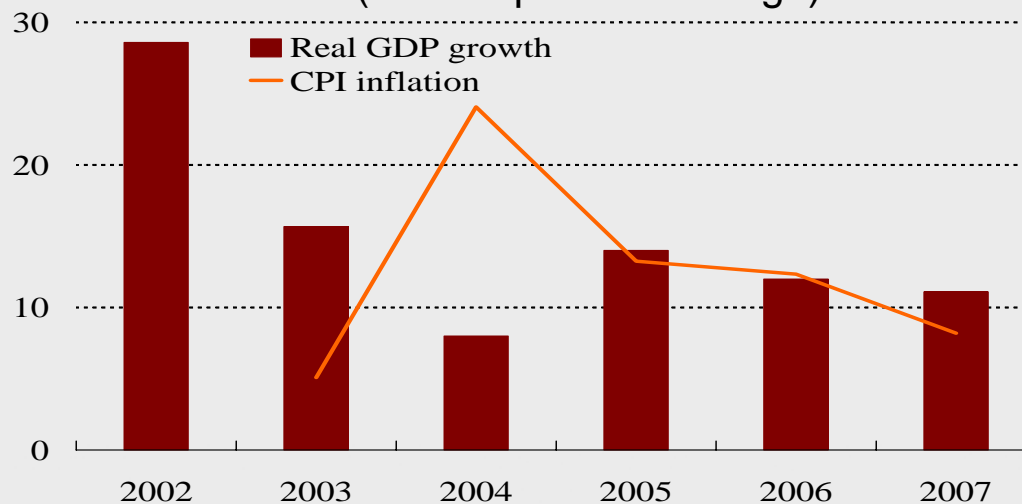
- Gross official reserves are increasing steadily.
- Increases reflect sharp improvements in current account positions in some countries, and higher capital inflows in others.
- Progress in building reserves and reducing debt has put the region in a better position to absorb shocks and address development needs.²¹

CAREC-6

Individual Country Prospects and Key Policy Challenges

Afghanistan

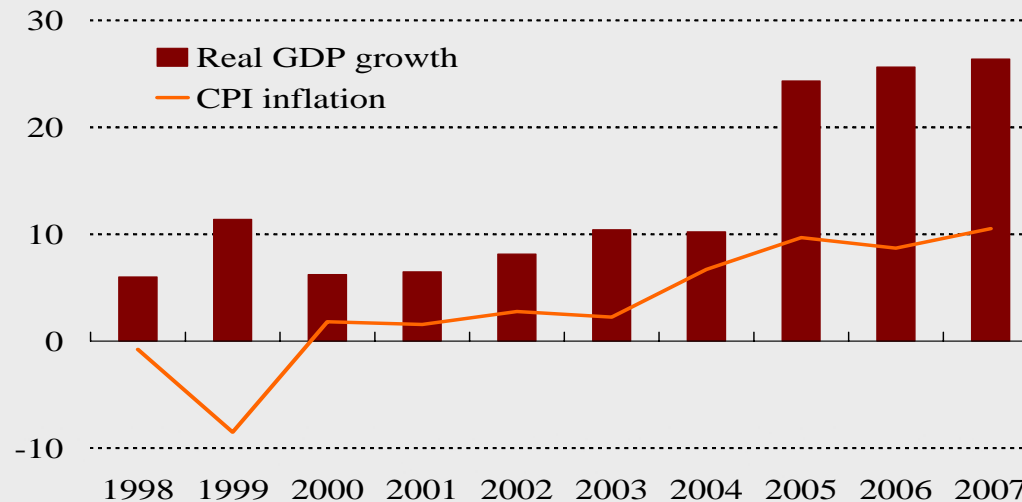
(Annual percent change)



- After averaging 13 percent over the past 3 years, GDP growth is projected at 12 percent in 2006 and 2007.
- The steady decline in inflation is expected to continue .
- Despite a significant increase, domestic revenue covers less than 70 percent of operating expenditures.
- Key policy challenges:
 - Ensuring fiscal sustainability through increasing revenue; managing operating expenditures prudently; implementing public administration reform; and following a sound debt policy.
 - Addressing the risks related to the security situation and the medium-term uncertainty about donor assistance.

Azerbaijan

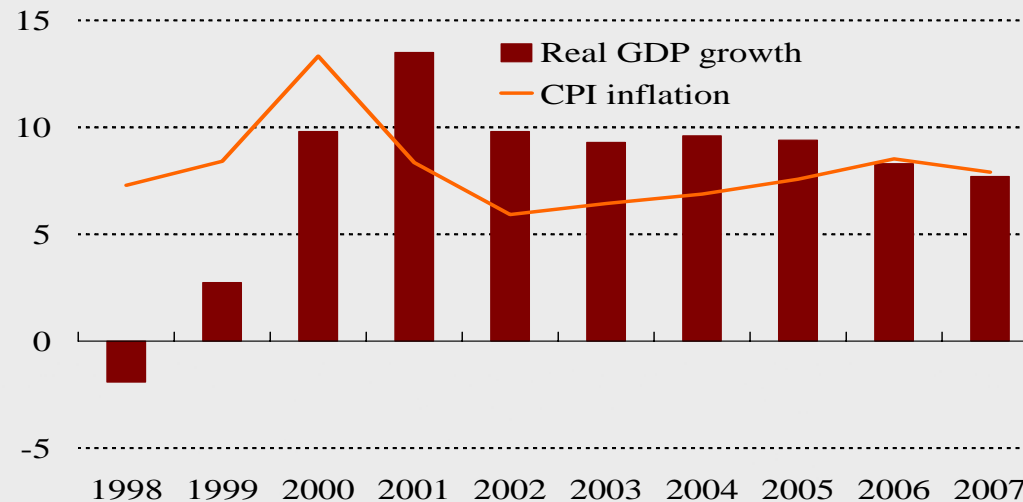
(Annual percent change)



- Growth prospects are exceptionally favorable. Real GDP is projected to grow by about 25 percent in both 2006 and 2007.
- Fiscal and external surpluses are increasing.
- The policy stance is expansionary, boosting domestic demand and money growth. As a result, inflation is likely to remain in double digits in 2006-07.
- Key policy challenges:
 - Managing the very high oil revenues to reduce poverty and improving infrastructure in a stable macroeconomic environment.
 - Transitioning to a more flexible exchange rate regime for maintaining macroeconomic stability.

Kazakhstan

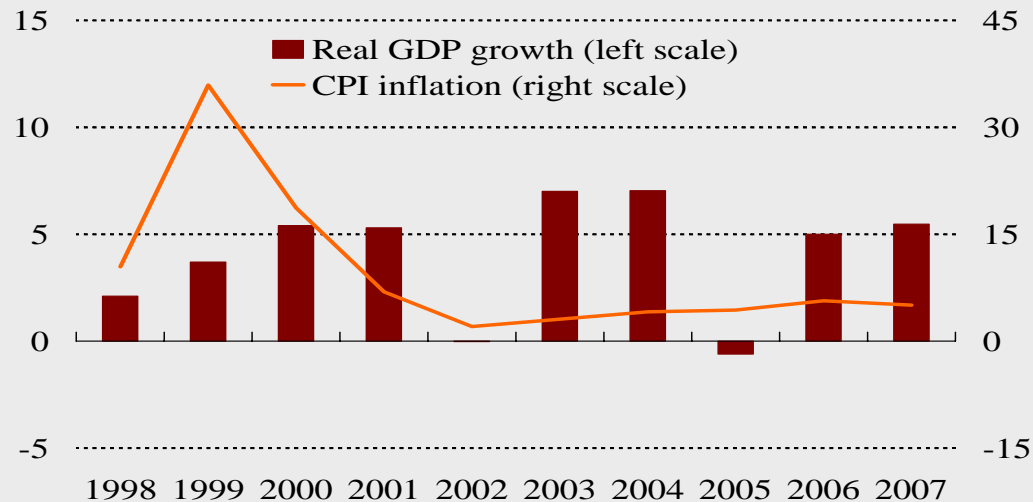
(Annual percent change)



- Growth averaged 10 percent over the past few years; projected at 8-9 percent in 2006-07.
- Fiscal and external positions remain strong.
- But credit growth continues, running at close to 70 percent, and inflation is up to almost 9 percent.
- Key policy challenge: further monetary tightening and strengthening of prudential regulations to limit banking sector risks and curb inflation.

Kyrgyz Republic

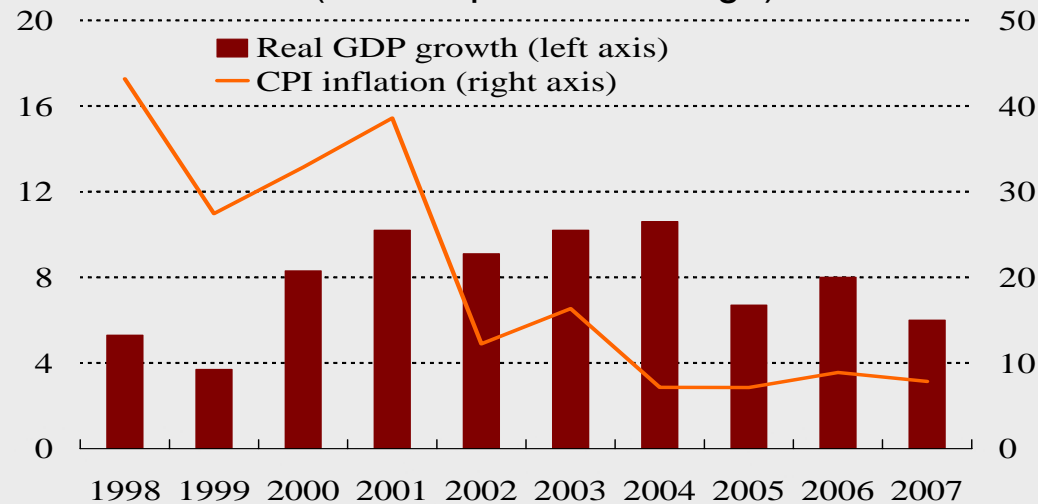
(Annual percent change)



- GDP is recovering; growth is projected at about 5 percent for 2006-07.
- Inflation is low but rising.
- Fiscal and external account deficits are large and debt ratios high.
- Key policy challenges:
 - Balancing opportunities for external financing of large investment projects with the need to avoid a new cycle of excessive borrowing.
 - Tightening monetary policy to keep inflationary pressures in check, and continuing to reform the financial sector.
 - Creating a regulatory environment to foster private sector-led growth. 26

Tajikistan

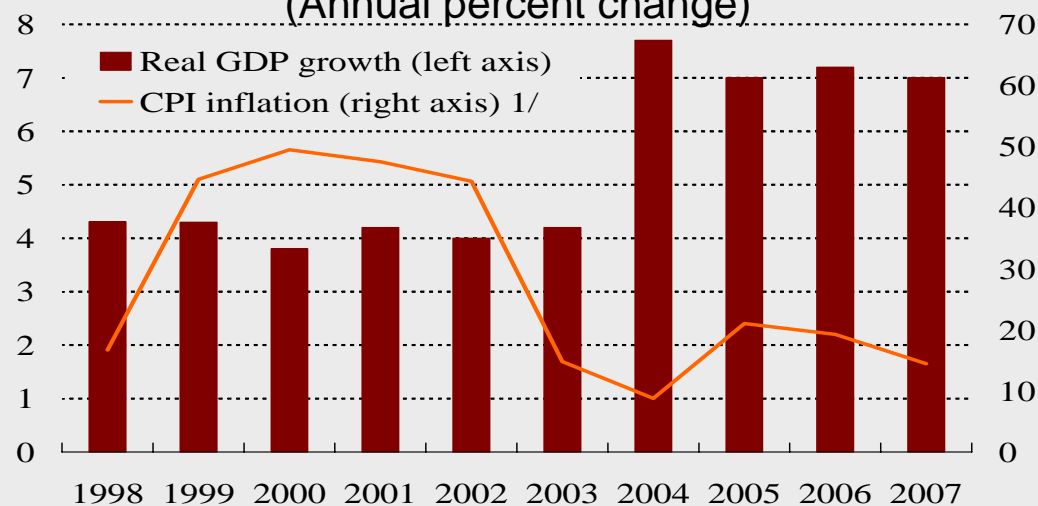
(Annual percent change)



- Growth averaged 9 percent over past three years; projected to remain high in 2006 and 2007.
- Inflation has accelerated in 2006.
- Fiscal and current account deficits are projected to widen in 2006 and 2007.
- Key policy challenges:
 - Making good use of increased donor support to achieve development goals, while avoiding new cycle of excessive borrowing.
 - Completing reforms in the areas of tax administration, public expenditure management, and monetary policy instruments.

Uzbekistan

(Annual percent change)



1/ IMF staff estimates.

- Growth averaged over 6 percent during the past three years; projected at 7 percent in 2006-07.
- Fiscal balance is projected to turn into deficit in 2007, but external surplus is expected to remain very large.
- Monetary policy has remained accommodative and inflation continues high in double digits.
- Key policy challenges:
 - Bringing inflation down through tightening monetary policy and adopting a more flexible exchange rate policy.
 - Stimulating private sector development through liberalizing trade and exchange systems, and undertaking financial sector reforms.

Common Policy Issues

- Macroeconomic performance has been strong and near-term prospects are favorable.
- Risks to the outlook:
 - The region is heavily dependent on volatile oil and non-oil commodity prices.
 - Global growth could slow.
 - Rising global interest rates could reduce capital inflows.

Common Policy Issues (continued)

- To prevent inflation from becoming entrenched, monetary policy should be tightened and nominal exchange rates be allowed to appreciate in response to the permanently higher inflows.
- Adjustment to higher oil prices remains a challenge.
- The pass-through of oil price increases to domestic prices should continue, especially in countries with weak fiscal and external positions, but with a strengthening of social safety nets.

Common Policy Issues (continued)

- Governments need to carefully balance opportunities for external financing and donor support to raise investments with the need to prevent a deterioration in debt ratios and avoid a new cycle of excessive borrowing.
- Structural and institutional reforms should continue to foster private sector development, increase productivity, and boost countries' resilience to shocks.
- Regional cooperation should be increased to promote trade and investment, and improve the prospects for long-term growth.