CENTRAL ASIAN REPUBLICS, AZERBAIJAN, AND MONGOLIA

Rising oil and gas production in the first three quarters of 2001 have contributed to stronger than expected growth. However, with uncertain agricultural prospects, emerging external and fiscal imbalances in some economies, softening oil and gas prices, and increasing concern about regional instability following the 11 September attacks on the US, growth in the Central Asian republics, Azerbaijan, and Mongolia is expected to slow in 2002.

Economic Indicator (percent)	1998	1999	2000	2001		2002	
				Current	*ADO 2001*	Current	*ADO 2001*
GDP growth	2.1	4.9	7.8	7.7	3.3	5.5	4.8
Inflation rate	7.9	20.7	26.6	9.5	10.6	9.9	10.0
Export growth	-16.2	1.4	31.0	4.1	-0.3	10.8	10.7
Import growth	-11.1	-12.8	-6.4	31.2	24.4	11.7	11.8
Current account/GDP	-5.5	-1.3	2.5	2.6	2.6	3.6	3.6

Economic Assessment. The economies of the Central Asian republics and Azerbaijan have maintained strong growth so far in 2001. Preliminary figures indicate that real GDP grew by about 7.0 percent in the first quarter of the year, compared to 6.5 percent in the corresponding period of 2000. The subregion's growth in the first quarter was due in large part to buoyant world oil prices. Recoveries in gold and aluminum production is also a contributing factor, which helped the Kyrgyz Republic and Tajikistan register GDP growth of 6.6 percent and 7.6 percent, respectively. Kazakhstan achieved 13.0 percent growth in the first three quarters of 2001, primarily on account of new pipeline capacity coming onstream, enabling a sharp increase in oil exports. In Tajikistan, where aluminum production has picked up strongly and economic rehabilitation has begun to bear fruit, GDP growth was officially reported to be 12.1 percent from January to September 2001. These two factors have contributed significantly to the high aggregate GDP growth for the subregion in 2001. However, widespread drought has adversely affected agricultural performance. Policy slippage and a decline in investment in Uzbekistan reduced its GDP growth to 2.8 percent in the first quarter of 2001 from 3.0 percent in the same period in 2000. Losses in the livestock sector, resulting from two consecutive severe winters and from a recent outbreak of foot and mouth disease, took a heavy toll on Mongolia's output in 2000 and early 2001. With GDP growth of 1.1 percent in 2000, Mongolia's real growth is expected to recover moderately in 2001.

The impact on the subregion of the 11 September attacks on the US has yet to be fully felt. However, additional public expenditures on domestic

The Central Asian republics comprise Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.

and border security as well as an adverse impact on export earnings due to a softening of commodity and hydrocarbon prices and lower tourist arrivals have been reported. These will put the already fragile fiscal and external balances in the subregion under pressure, necessitating enhanced concessional financial inflows.

As the economies of the Central Asian republics have continued to grow, the unemployment situation appears to have improved in some countries. In Kazakhstan, for instance, the officially recorded unemployment rate declined to 3.8 percent of the total workforce during the first quarter of 2001 compared with 4.5 percent a year earlier. Similarly in Tajikistan, the official unemployment rate dropped to 2.5 percent by March 2001 from 3.0 percent a year earlier. In the Kyrgyz Republic, however, the official unemployment figure went up to 6.0 percent by the end of April, possibly as a result of the slowdown in agricultural growth. The actual unemployment situation, however, is less clear than implied by these official statistics as they at best reflect broad trends. In Mongolia, results of the 2000 Population Census showed an unemployment rate of 17 percent, against the official statistic of 4.6 percent for the same period. Data from the National Statistical Office for September 2001 shows an unemployment rate of approximately 4.7 percent.

A tight monetary policy stance has continued. Broad money supply grew more slowly in the first quarter of 2001 than a year earlier in Azerbaijan, Kazakhstan, and the Kyrgyz Republic. Year-on-year consumer price inflation fell significantly in Kazakhstan to 8.9 percent in March 2001 from 20.2 percent a year earlier. However, increases in public sector wages and higher energy and food prices have contributed to rising inflation in Tajikistan and Uzbekistan.

The year-on-year inflation rate in Mongolia fell to 8.0 percent by end-2000, but accelerated again in the first half of 2001 partly due to higher electricity tariffs and a decline in domestic meat supplies due to severe winter weather. The seasonal increase in meat supplies has since, however, helped reverse some of the earlier rise in food prices, easing inflationary pressures from mid-2001. Current monetary policy in Mongolia is geared to reducing inflation to about 8 percent by the end of 2001.

Fiscal balances have continued to improve in the subregion, benefiting from increasing oil and gas revenues and improved tax collection. According to government statistics, four countries registered a fiscal surplus in the first quarter of 2001: Azerbaijan (1.1 percent of GDP), Kazakhstan (7.6 percent), Kyrgyz Republic (2.4 percent), and Turkmenistan (0.7 percent). In Tajikistan and Uzbekistan, however, fiscal accounts remained marginally in deficit at 0.5 percent and 0.4 percent of GDP, respectively. Mongolia's revised budget for 2001 plans to keep the fiscal deficit at about 7 percent of GDP to reverse the buildup of the debt-to-GDP ratio.

The subregion's external sector performance so far in 2001 has been encouraging. Exchange rates have tended to stabilize, although some currencies have experienced marginal depreciation. Tajikistan introduced a new national currency, the *somoni*, in October 2000 to replace the Tajik rouble. The transition was smooth but the new currency had depreciated by 4.7 percent against the dollar by March 2001. The trade balance in the Central Asian republics has also strengthened during 2001. Trade surpluses were recorded in Azerbaijan, Kazakhstan, and Turkmenistan due to strong oil and gas exports. The Kyrgyz Republic also posted a trade surplus in March 2001, as a result of stronger gold exports and weaker imports due to import compression. The trade performance of Tajikistan and Uzbekistan has, however, lagged behind because of slow export growth that, combined with rising import costs, generated a trade deficit for both these countries. The continued high levels of external debt have remained serious concerns in the Kyrgyz Republic and Tajikistan.

Economic Management Issues. Azerbaijan and Tajikistan have achieved some progress in structural reforms, along with implementation of IMF-sponsored programs. Nevertheless, it will be some time before the impact of these reform efforts will be felt. In the Kyrgyz Republic, the IMF reform programs, under the Poverty Reduction and Growth Facility that had fallen behind by the end of the second quarter, were revived in September. The lack of private sector development in the non-oil sector remains a particular concern in Azerbaijan and Kazakhstan, where levels of poverty remain high despite significant GDP growth. Both these countries have established state oil funds to better manage their increasing oil revenues. The persistence of multiple exchange rates in Turkmenistan and Uzbekistan has caused concern in some quarters, as they generate wide-ranging distortions and rent-seeking practices. Although the Government of Uzbekistan announced some significant measures in July 2001 toward currency unification and further trade liberalization, significant steps still remain to be taken to create a favorable policy regime for the expansion of competitive manufacturing and export capacities. Much of the desired improvements in the economic outlook depends on the Government's commitment to effectively implement its planned stabilization and reform measures. At the subregional level, progress remains limited in developing a more integrated market through economic cooperation. In fact, barriers to flows of trade and services within the subregion appear to have increased.

Forecast. Average growth for the Central Asian republics and Azerbaijan is expected to be 7.7 percent in 2001, which is marginally below the growth rate of 7.8 percent achieved in 2000. This estimate for 2001 growth is significantly higher than the 3.3 percent projected in *ADO 2001* in April this year. The better economic prospects for 2001 are primarily the result of the much stronger growth performance in Kazakhstan due to the buoyant oil and gas sector that has benefited from new pipeline capacity. Turkmenistan is also expecting larger exports of gas with more pipeline capacity being made available by the Russian Federation, while rising aluminum production has stimulated growth in Tajikistan. At the same time, however, the adverse impact of the drought, occurring for the second year running, will likely pull down growth rates in Uzbekistan in 2001.

The 11 September attacks are likely to adversely impact fourth quarter economic performance in the subregion; their effects are likely to be more pronounced in the short to medium term. This is on account of a probable slowdown in export earnings as oil, cotton, and other commodity prices remain depressed as a consequence of slower global economic activity. The business sentiment has worsened and investment activity, both foreign and domestic, is expected to decline over the rest of 2001. Fiscal balances are also likely to come under pressure with higher outlays on security and on coping with the anticipated influx of refugees.

Therefore, 2002 GDP growth in the Central Asian republics and Azerbaijan is likely to be marginally slower than in 2001 in view of the international prices for oil and gas remaining depressed until the global economic recovery takes hold in the latter half of 2002. The estimated growth rate of 5.5 percent in 2002 is lower than the 7.7 percent in 2001 in view of the longer and deeper slowdown in the global economy and the adverse impact of the 11 September attacks. GDP growth in Mongolia for 2001 is expected to be modest, followed by a marginal improvement in 2002. The possibility of a third severe winter could also be a negative factor.

Subregional inflation in 2001 is likely to remain under control, although higher inflationary pressures may emerge in Uzbekistan due to a possible currency devaluation and rising food prices. The average consumer price inflation rate in the subregion is expected to be 9.5 percent in 2001, lower than the 26.6 percent in 2000. Average inflation in 2002 will likely increase marginally to 9.9 percent. The fiscal stance could become further strained, as a result of reduced revenues and the greater need for public spending on securing borders, maintaining domestic security, and meeting refugee costs. The subregion's external balances will remain highly dependent on global demand and international prices for its major exports of primary commodities and energy products. With limited improvement in the trade and current account positions expected in 2001 and 2002, debt servicing is likely to become more difficult in already highly indebted countries, such as the Kyrgyz Republic and Tajikistan.