CENTRAL ASIA

Armenia
Azerbaijan
Georgia
Kazakhstan
Kyrgyz Republic
Tajikistan
Turkmenistan
Uzbekistan

Armenia

The economy came back from its sharp contraction of 2009, but only slowly owing to a sharp fall in agricultural output. As the recovery takes hold, the authorities will need to wind down their anticrisis measures and return to the stronger precrisis fiscal position while normalizing monetary policy. The outlook is for a gradual pickup in growth on the assumption that exports, foreign investment, and remittances continue to strengthen. Structurally, though, further acceleration of reforms is crucial for improving the business environment and boosting the economy's competitiveness.

Economic performance

The economy grew very rapidly in the early years of the decade, underpinned by the large inflows of foreign direct investment and remittances. Growth, however, plummeted in late 2008 and in 2009 under the weight of the global crisis. Countercyclical fiscal and monetary policies, as well as improved economic conditions around the world and in the Russian Federation particularly, have helped the country to stabilize and return to growth. GDP expanded by 2.6% in 2010, despite a slump in agriculture (Figure 3.1.1).

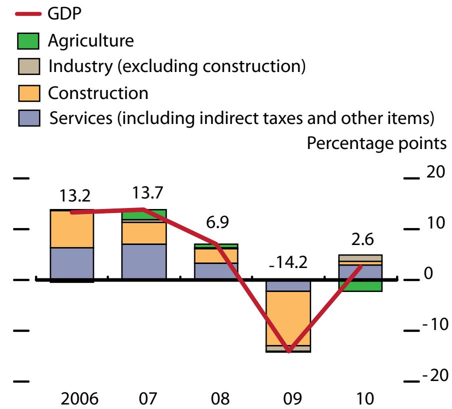
Agriculture contracted by 13.4%, reflecting poor weather that seriously damaged crops across the country. This left industry (excluding construction) to be the driving force of the recovery, expanding by 9.5%, much of which was generated by export-oriented mining and metallurgy. Increased volumes of foodstuffs, drinks, and pharmaceuticals helped buttress growth. Construction, which propelled high growth in earlier years before its collapse took down the economy by 14.2% in 2009 (Figure 3.1.2), expanded by 3.7% in 2010, mainly due to government anticrisis spending.

The trade and services sector grew by 4.4%, primarily on increased service volumes in such areas as financial, insurance and real estate activities and information and communications technology.

From the demand side, private expenditure and investment grew by an estimated 5%, reflecting the gradual recovery in global activity and its impact on the domestic economy. Remittance inflows from workers abroad picked up by 15.4% to $1.1 billion after a weak performance in 2009, though they remained below their 2008 peak level of $1.4 billion. Inflows of foreign direct investment amounted to around $750 million in 2010, up by 3.5% year on year, with communications, electricity, gas, and water the largest beneficiaries. Public consumption and investment moderated alongside a diminishing expansionary fiscal policy as anticrisis measures taken up a year earlier began to be wound down.

An inflation targeting framework underpins monetary policy. A

3.1.1 Contributions to growth (supply)



Sources: National Statistical Service of the Republic of Armenia. http://www.armstat.am; Central Bank of Armenia. http://www.cba.am (both accessed 1 March 2011).

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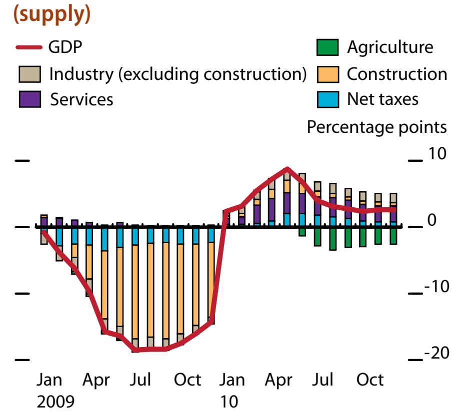
3.1.2 Monthly contributions to growth (supply)



Sources: National Statistical Service of the Republic of Armenia. http://www.armstat.am; Central Bank of Armenia. http://www.cba.am (both accessed 1 March 2011).

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This chapter was written by Grigor Gyurjyan of the Armenia Resident Mission, ADB, Yerevan.

sharp fall in domestic agricultural production and higher international wheat and other cereal costs led, however, to a spike in headline inflation to 9.4% in December 2010 from a year earlier (Figure 3.1.3), pushing inflation above the upper limit of the central bank's inflation target band (4% +/-1.5%). Average annual inflation was 8.2% for the year. Items keeping food inflation high were dairy, eggs, meat, and grain products, in that order, with price increases ranging from 18.7% to 13.1%. The higher food inflation was offset by moderating nonfood inflation, mainly due to weakening prices in private cars, medicines, garments and knitwear, footwear, detergents, and beauty items.

As inflation picked up, the central bank tightened monetary policy and gradually raised its refinancing rate by 225 basis points in January–May 2010 to 7.25% and kept it there through December. Despite this tightening and measures to de-dollarize the economy, the share of foreign currency loans in banks stayed high, increasing from 51.9% at end-2009 to 57.4% 12 months later, while the share of foreign currency deposits fell from 73.4% to 69.0%.

Broad money supply grew by 11.8% in 2010. Credit to the economy jumped by about 28%, reflecting positive macroeconomic trends and a slight decline in interest rates due to allocation of funds attracted by banks. The contribution of net foreign assets to monetary growth was negative, mainly due to the central bank's interventions, which aimed to smooth large exchange rate movements (Figure 3.1.4).

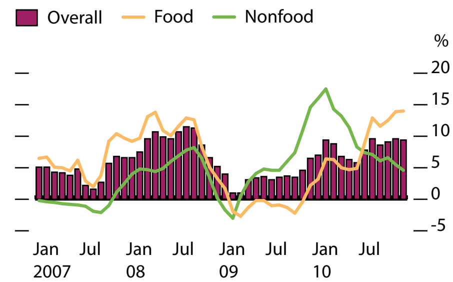
Fiscal policy aimed to continue supporting the recovery while addressing medium-term fiscal and debt vulnerabilities. A 14.5% increase in tax revenue and restrained spending have significantly eased the fiscal imbalance. Improvements in tax and customs administration, progress in introducing an electronic tax-filing system, and strengthened taxpayer services (such as "taxpayer service centers") along with greater economic activity boosted tax receipts. But despite climbing slightly from 16.7% in 2009 to 16.9%, the tax-to-GDP ratio is still low internationally. Total budget revenue rose by 10%, but as a share of GDP declined from 22.9% in 2009 to 22.2% in 2010.

Total expenditure increased by a mere 0.5% from 2009. A budget deficit of 4.9% of GDP recorded in 2010 was well below the 6% of GDP projected by the government in late 2009 and a sizable 7.6% recorded in 2009 (Figure 3.1.5). About 60% of the deficit in 2010 was financed through domestic resources.

Outstanding public external debt climbed quickly to nearly $3.0 billion in 2009 and rose by another $300 million in 2010, reaching about 35.1% of GDP (Figure 3.1.6), with about 22.5% coming from central bank borrowing. Domestic public debt edged up to $428 million in 2010, and is relatively small at 4.5% of GDP. Although the level of total public debt is high, given that most is on concessional terms, debt service is manageable. Debt projections from the International Monetary Fund indicate that the total debt ratio will move up to about 50% of GDP in 2012, reflecting an increase in external borrowing, before declining to 43.5% of GDP in 2013.

While the public finance situation is improving, weaknesses remain in the balance of payments. Exports surged by 46.9%, much of which was generated by export-oriented mining and metallurgy,

3.1.3 Inflation



Source: National Statistical Service of the Republic of Armenia. http://www.armstat.am (accessed 1 March 2011).

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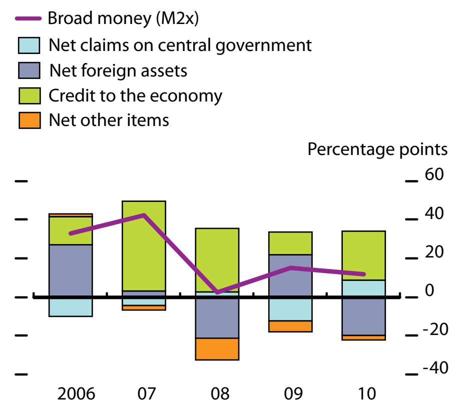
3.1.4 Contributions to money supply (M2x) growth



Source: Central Bank of Armenia. http://www.cba.am (accessed 1 March 2011).

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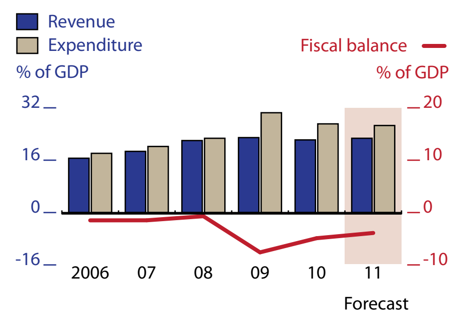
3.1.5 Fiscal balance indicators



Source: National Statistical Service of the Republic of Armenia. http://www.armstat.am (accessed 1 March 2011).

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3.1.6 External debt

Source: National Statistical Service of the Republic of Armenia. http://www.armstat.am (accessed 1 March 2011).

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primarily due to soaring international prices of copper, molybdenum, and other nonferrous metals (but also due to a better global economic environment). After tumbling by 25.0% in 2009, imports showed growth of 19.8% in 2010, boosted by domestic demand that was lifted by improving investment and rebounding remittances.

The trade deficit pushed out slightly to an estimated $2.3 billion, but larger remittances and factor income helped narrow the current account deficit to 14.6% of GDP in 2010 from 16.0% (Figure 3.1.7). The large current account gap was financed primarily by donor inflows and foreign direct investment.

The central bank maintains a floating exchange rate regime. Given the large import content of consumption, its interventions in the foreign exchange market aimed to prevent steep fluctuations in the value of the dram while safeguarding reserves. Over the year, the nominal effective exchange rate appreciated by 9.7%, and the real effective exchange rate by 11.4%, reflecting higher inflation in Armenia than in its main trading partners (Figure 3.1.8).

Gross international reserves contracted by about $150 million to $1.8 billion at end-December 2010, equivalent to about 5 months of import cover. Three-year arrangements equivalent to $395 million with the International Monetary Fund were approved in June 2010, following a $540 million stand-by arrangement approved in March 2009. These arrangements have helped to replenish reserves as the authorities seek to strengthen the external position. Their economic program aims to restore fiscal and external sustainability, preserve financial stability, and support growth and poverty reduction.

Economic prospects

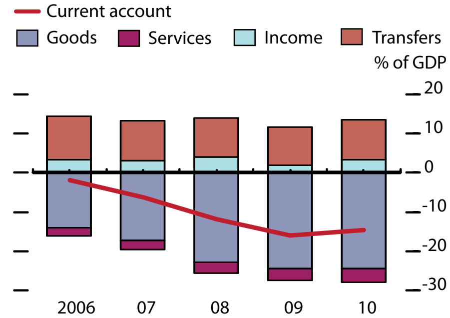
Continued growth in Armenia depends heavily on that in the Russian Federation. Strong performance there will boost foreign direct investment inflows, migrants' remittances, and demand for exports. As a result of improved external conditions—along with a rebound in agriculture, which is expected to grow by 10% this year—GDP is projected to expand by 4.0% in 2011 and 4.5% in 2012.

The government's efforts toward diversifying the economy and stimulating exports will provide additional impetus to growth and should make it less volatile. Investments in large-scale infrastructure, such as highways and rural roads, as well as the water-supply system, will continue to bolster public spending.

Fiscal policy is expected to be gradually tightened in 2011 and 2012 given concerns on the large buildup of external debt. This year's fiscal consolidation should be achieved through stronger revenue collection, stemming from the positive economic outlook and improving tax administration. The 3-year midterm spending program calls for suspension of public sector salary increases up to 2013 and freezing spending on purchases of equipment and property. The government envisages reducing the budget deficit to about 4% in 2011. The priority areas for expenditure include support for social programs and infrastructure.

Due to strengthening domestic activity and fast-rising global

3.1.7 Balance-of-payment components



Source: National Statistical Service of the Republic of Armenia. http://www.armstat.am (accessed 1 March 2011).
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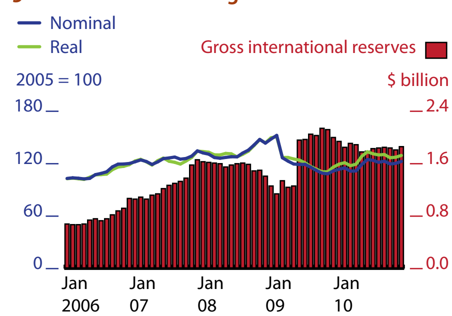
3.1.8 Effective exchange rates and reserves



Sources: International Monetary Fund. International Financial Statistics online database; Central Bank of Armenia. http://www.cba.am (both accessed 1 March 2011).
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3.1.1 Selected economic indicators (%)

	2011	2012
GDP growth	4.0	4.5
Inflation	7.5	5.5
Current account balance (share of GDP)	-13.0	-12.3

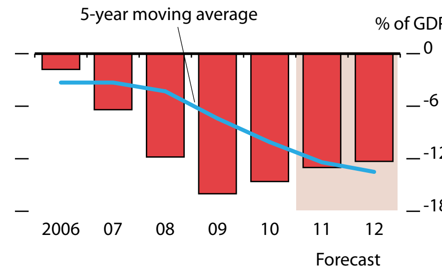
Source: ADB estimates.

commodity prices, inflation pressures will persist in 2011, though inflation is expected to come down from its 2010 high. Monetary policy is shifting to a tighter stance to combat these pressures: in February this year, the central bank increased the refinancing rate by 0.5 percentage points, to 7.75%. Inflation is forecast at 7.5% in 2011 and 5.5% in 2012.

Recovering remittance inflows and transfers as well as the large infrastructure projects are seen boosting domestic demand for imports, such that they rise by about 12.0% in 2011 and 10.0% in 2012.

Given the expected growth in major trade partners and expected outcomes of the government's export diversification and promotion actions, exports are expected to expand by 15.0% in 2011 and by about 10.0% in 2012. This increase will be backed by strengthening from new investments in chemicals and metallurgy. The trade deficit is seen narrowing moderately. Backed by the robust remittance inflows, the current account deficit is forecast to ease to 13.0% of GDP in 2011 and to 12.3% of GDP in 2012 (Figure 3.1.9).

3.1.9 Current account balance



Sources: National Statistical Service of the Republic of Armenia. http://www.armstat.am (accessed 1 March 2011); ADB estimates.

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Development challenges

The immediate to midterm macroeconomic challenges include tightening the monetary and fiscal stances, ensuring debt sustainability through concessional financing, and reducing external imbalances.

Fiscal consolidation will require action on both the revenue and expenditure sides. The authorities acknowledge the need for a faster pace of reforms in the areas of tax and customs administration.

Further efforts for better governance will likewise be important to improve social policy, improve the distribution of resources, and reduce poverty. The government is aware of oligopolies in key sectors of the economy that have strong links with entrenched elites. It therefore intends to continue its efforts to reduce corruption, enforce competition, modernize public expenditure management, and strengthen the civil service and judiciary.

For reducing reliance on minerals and metals, which account for the bulk of exports, the government needs urgently to take steps to diversify the industrial base. A one-stop shop for business registration is set to come into effect this year, which should reduce barriers to entry for new businesses.

Azerbaijan

Although growth in oil output slowed in 2010, higher oil prices led to a large balance-of-payments surplus, while a revival in the non-oil economy, driven by public expenditure, led to solid but slower overall growth. Growth and the balance of payments are both predicted to remain strong in 2011 and 2012. Inflation was moderate but local and external factors will stoke price pressures in 2011. Supporting growth in the non-oil sector and reducing dependence on oil revenue represent a significant long-term challenge.

Economic performance

GDP growth at 5.0% in 2010 was markedly lower than the very high rates of the previous few years when large investments rapidly expanded Azerbaijan's oil and gas resources. Growth in the oil economy (defined to include gas production) is estimated to have slowed to 1.8%. The non-oil economy performed well, growing by 7.9%, as it recovered from the headwinds of the global recession. With oil and gas production growth leveling off (oil production in 2010 was at 377.4 million barrels), the outlook is for moderate overall growth based largely on non-oil activity (Figure 3.2.1).

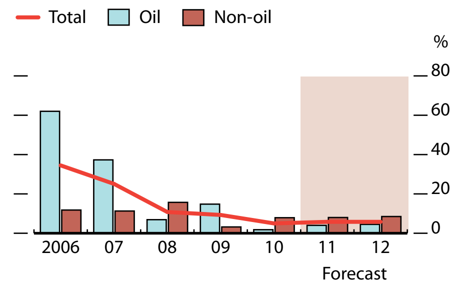
Robust growth in the non-oil economy in 2010 was driven largely by public investment, mainly in infrastructure projects that led to a 20.3% expansion in construction activity (Figure 3.2.2). This was a marked recovery from the 8.3% contraction in investment in 2009, when much lower oil prices and global crisis–related uncertainty reined in public and private investment. Non-oil manufacturing is estimated to have grown by about 6.8%, after 2009's 12.6% contraction. Several public and private industrial plants started operations and SOCAR, the state-owned oil company, expanded into non-oil manufacturing.

Services growth was robust at 7.2%, driven by the strong expansion in the non-oil economy as well as gains in gas transport services and new technologies in mobile communications and Internet access.

Agriculture performed poorly, contracting by 2.2% in 2010 after 3.5% growth in 2009. This reflected a 33% drop in grain production that was caused by flooding, a decline in the area cultivated, and falling yields. Production of other agricultural products such as cotton and tobacco picked up.

Public investment, mainly in the non-oil sector, rose to 13% of GDP, accounting for nearly three-quarters of overall domestic investment. Although private investment fell slightly as a share of total investment, it was well above its low of 2008. Foreign direct investment in oil has been declining since 2006 with the completion of large investment

3.2.1 Oil and non-oil GDP growth



Source: State Statistical Committee of the Republic of Azerbaijan. http://www.azstat.org

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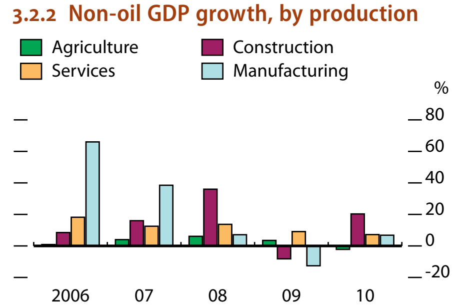
3.2.2 Non-oil GDP growth, by production



Source: State Statistical Committee of the Republic of Azerbaijan. http://www.azstat.org

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projects as well as SOCAR's self-financing of new projects. Inflows into manufacturing, transport, and communications went up.

Inflation crept up steadily during the year, to 5.7% in December 2010 year on year from 1.5% in December 2009 (Figure 3.2.3). The upturn was largely driven by rising prices of basic food items, including wheat, reflecting both higher import prices and the poor grain harvest. Nonfood prices increased moderately over the year. Demand factors, such as a pay hike for public servants and a robust expansion in credit to the private sector, appear to have put some additional pressure on these supply-side factors.

The State Oil Fund of Azerbaijan (SOFAZ), set up to save a part of the nation's hydrocarbon earnings, is channeling some of its revenue to the budget for financing public investment projects. Despite large transfers of this nature in 2010, SOFAZ assets surged by 52.8% to $22.8 billion at year-end, buoyed by higher oil prices.

Budget expenditure rose by 11.3% in 2010, though as a share of GDP it moderated by about 1 percentage point to 28.3% (Figure 3.2.4). Besides the salary hike, 2010 saw markedly higher social and defense outlays; public investment came in at 13% of GDP. Tax collection increased by only 4.4% in 2010, as customs revenue contracted because of lower imports of machinery and equipment. Total budget revenue declined by 2 percentage points to 27.4% of GDP. The large gap between budget expenditure and revenue was again bridged by substantial SOFAZ transfers, keeping the overall budget deficit small (0.9% of GDP).

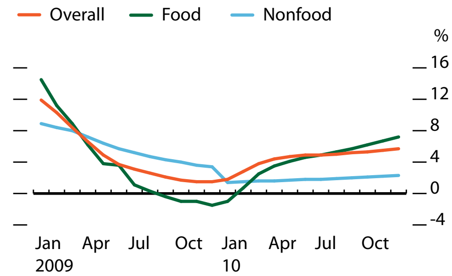
Without the SOFAZ transfers the deficit would have been 15.1% of GDP, and these transfers have been rising in absolute terms and relative to GDP in recent years. They now make up over one-half of the government resources that finance budget expenditure. To arrest this trend, the government would need to increase revenue from taxes and other charges, though a substantial move would stymie policies that seek strong expansion in non-oil economic activity.

The Central Bank of Azerbaijan adopted an expansionary monetary policy in 2009, aiming to counter the impact of the downdraft on growth from lower oil prices and an uncertain economic outlook. It set the refinancing rate at 2.0% and the reserve requirement at 0.5%. It raised the refinancing rate to 3.0% in November 2010 and to 5% in March 2011, responding to the strengthening in the non-oil economy and inflation pressures. It continues, however, to provide long-term loans and additional special financing support to private companies and banks at its discretion.

Evidence of recovery is seen in a 9.7% rise in credit to the private sector and a 24% expansion in the broad money supply (Figure 3.2.5), which in part reflected a rebound in net foreign assets as the overall balance returned to a large surplus. A sign of financial deepening and greater confidence in the banking system was that the ratio of broad money to GDP rose from 23.8% in 2009 to 25.3% in 2010.

In overseeing the commercial banks, the central bank is implementing Basel standards to improve banking regulation and stability, as well as to strengthen public trust in the banking system. Banks have therefore boosted their capital position. Similarly, to extend access to financial and banking services in rural areas particularly, the government has initiated

3.2.3 Monthly inflation



Sources: International Monetary Fund. International Financial Statistics online database (accessed 10 March 2011); State Statistical Committee of the Republic of Azerbaijan. http://www.azstat.org

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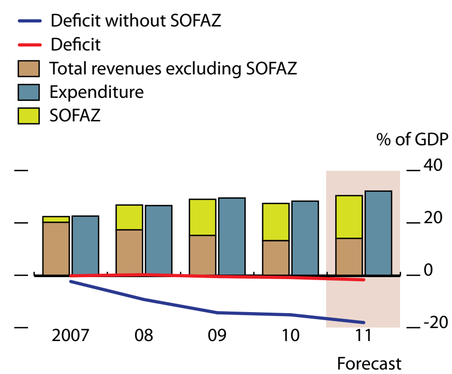
3.2.4 Fiscal indicators



SOFAZ = State Oil Fund of Azerbaijan.

Source: Ministry of Finance. http://www.finance.gov.az

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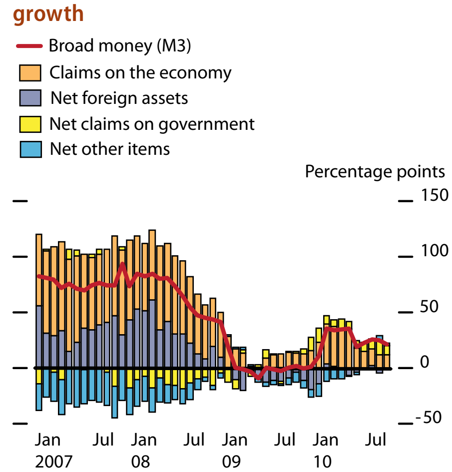
3.2.5 Contributions to money supply (M3) growth



Source: International Monetary Fund. International Financial Statistics online database (accessed 1 March 2011).

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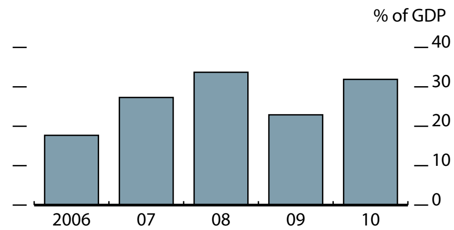
the Azerpost project, which offers services (including microcredit, money transfers, and distribution of pensions) through post offices.

On the external front, the marked global increase in oil prices led to an estimated 24% gain in exports (oil and gas account for about 95% of goods exports). Non-oil exports saw a small gain despite agriculture's contraction. Imports witnessed virtually no upturn despite the revival in non-oil growth.

Similarly, net services and income payments were little changed from a year earlier while workers' remittances, a marginal item in the balance of payments but an important source of support for rural households, tumbled. Resting mainly on strength in oil pricing, the current account surplus was boosted to $16.5 billion in 2010, about 31.9% of GDP, from $10.2 billion a year earlier (Figure 3.2.6).

Gross international reserves jumped by nearly 20% to $6.4 billion at end-2010. With the surge in SOFAZ assets, total foreign assets now amount to about 56% of GDP. Public external debt is relatively small at $3.7 billion, about 9% of GDP.

3.2.6 Current account balance



Source: Central Bank of the Republic of Azerbaijan. http://www.cbar.az (accessed 1 March 2011).

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Economic prospects

As oil prices are projected to go up in 2011 and remain high in 2012, the main challenge for the government will be to maintain macroeconomic stability. Growth in oil revenue will allow a continued rise in social expenditure and investment in infrastructure that should spur private activity and improve the investment climate.

The hydrocarbon economy is expected to grow steadily at about 3%–4% in the forecast period as oil and gas development sets the stage for faster expansion in later years. Robust growth of the non-oil economy is expected to stay driven by public sector investment. The government is planning investment spending of $4.2 billion in 2011, which will drive a rapid expansion in construction with positive knock-on effects on the rest of the economy.

Agriculture is seen growing steadily on the assumption of good weather and continued government support, including reductions in value-added tax on agricultural inputs and in the lending rate of the main agro-leasing company, and completion of irrigation and infrastructure initiatives. Growth of 8% is foreseen in the non-oil sector in 2011 and 2012. Overall GDP growth is projected at 5.8% in both years.

The central bank will aim to meet the credit demands of the non-oil economy while keeping consumer price inflation in check, though price rises will probably be driven mainly by external factors. The exchange rate may come under some upward pressure because of larger surpluses in the balance of payments, but the bank will resist a marked appreciation as it would retard non-oil export development. Inflation is seen reaching 7.5% in 2011 as global price pressures increase, gliding down to 7.0% in 2012 as they moderate.

Higher oil export revenue will outweigh the import growth arising from strengthening investment and the rising income–related consumer spending. The current account surplus is expected to be 27.8% of GDP in 2011 and 25.0% in 2012, as import demand rises in response to growth of incomes and appreciation of the manat, and as growth in oil revenue slows.

3.2.1 Selected economic indicators (%)

	2011	2012
GDP growth	5.8	5.8
Inflation	7.5	7.0
Current account balance (share of GDP)	27.8	25.0

Source: ADB estimates.

Development challenges

Developing the non-oil sector and diversifying the economy is the government's longer-term priority. Agriculture, manufacturing, telecommunications, and tourism all have potential for growth. Agriculture is particularly crucial, as 40% of the population still lives in rural areas. Although government programs have attempted to support the sector, the rural population depends largely on remittances. Further steps include rehabilitating and maintaining irrigation and other infrastructure, improving land-management practices, enhancing inputs as well as credit and agricultural services, and boosting incentives for private participation.

Improved physical infrastructure, particularly roads, railways, and energy, is also essential for the non-oil sector. Additionally, medium- and long-term private sector growth will depend on a stable macroeconomic environment and a better legal and regulatory framework, among other measures. Azerbaijan is now ranked 54 out of 183 in the World Bank's *Doing Business 2011* report, ahead of most countries in the region. This ranking reflects progress over the past year in providing access to credit and simplifying tax payment procedures.

The report shows that trade facilitation, too, requires work, as Azerbaijan is one of the 10 hardest countries from which to trade across borders. If it is to become a successful exporter, it needs to reduce both formal and informal barriers to trade. In addition, the procedures and permits required for certain sectors or operations need to be streamlined, while governance and transparency should be improved to ensure that the large public investment program provides its maximum potential benefit.

3.2.2 Global rankings on the ease of trading across borders, 2011

Niger	174
Burkina Faso	175
Burundi	176
Azerbaijan	177
Tajikistan	178
Iraq	179
Congo, Republic of	180
Kazakhstan	181
Central African Republic	182
Afghanistan	183

Note: Out of 183 countries worldwide.
Source: World Bank. *Doing Business 2011*.

Georgia

On the back of stronger trade demand and remittances, as well as a fiscal stimulus, the economy bounced back to solid growth in 2010, though inflation also accelerated, largely on global price pressures. The outlook is for measured growth with increased reliance on the private sector (including remittances from abroad) and for continued inflation pressures. Major risks relate to a weak recovery in foreign investment and other capital flows.

Economic performance

The economy recovered from the sharp contraction in the second half of 2008 and in 2009 to grow at 6.4% in 2010 (Figure 3.3.1). The broad-based recovery was underpinned by a marked pickup in export demand and robust remittances, strong government investment, and a rebound in credit to the private sector. A striking revival in gross fixed capital formation of 22.5%, after a 32.8% drop in 2009, was the main impetus.

On the production side, industry and services grew steadily at about the same pace. Industry advanced by 9.7%, led by high growth in manufacturing due to the rebound in export demand and to strengthening consumer demand. Services picked up by 7.1% on account of high growth in trade, transport, and tourism as Georgia's west coast tourist venues bounced back to a highly successful season. By contrast, agriculture contracted marginally. Once a strong exporter, it has become a low-profit sector as it cannot compete with grain and livestock imports.

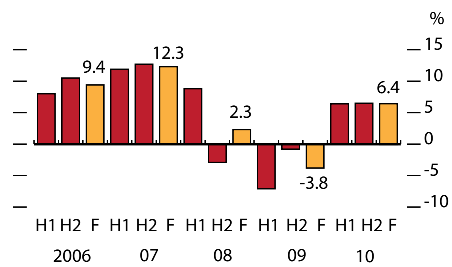
Headline inflation accelerated from around mid-2010 to 13.7% by February 2011 (Figure 3.3.2). The uptick was largely attributable to food items (with a weight of 40.5% in the index), which rose by 28.4% owing to mounting global food prices. Price increases in other sectors were moderate, pointing to limited pressures from the demand side.

In light of the renewed inflation pressures and economic recovery, the National Bank of Georgia switched to monetary tightening in the second half of 2010, raising the policy rate in steps to 8% by February 2011. It also doubled the reserve requirements to 10% on lari-denominated deposits in April 2010 and on deposits in other currencies to 15% in February 2011.

Despite these policies, credit to the economy grew by 20.4% in 2010 owing to rising business and bank confidence. The M3 broad money aggregate rose by 34.8% as both local and foreign currency deposits climbed (Figure 3.3.3). Dollarization of deposits declined by 1.3 percentage points to 72.1%.

Interest rates on both deposits and lending decreased during 2010, by 150 and 300 basis points, respectively (Figure 3.3.4). As with the reduction in dollarization, the change appears due to a lower risk perception, as the high uncertainty associated with the global downturn fades.

3.3.1 GDP growth



F = full year.

Source: National Statistics Office of Georgia. http://www.statistics.ge (accessed 15 March 2011).

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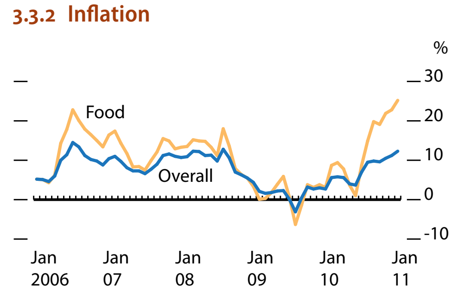
3.3.2 Inflation



Source: National Statistics Office of Georgia. http://www.statistics.ge (accessed 15 March 2011).

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This chapter was written by George Luarsabishvili of the Georgia Resident Mission, ADB, Tbilisi.

The change in the monetary policy stance is expected to have a greater impact on the economy in 2011. The upward revision in the policy rate has narrowed its gap with deposit rates, making it less attractive to use the refinancing facility. Increases in reserve requirements have reduced excess bank reserves, as apparently reflected in slowing loan volumes in early 2011, to a level that will make monetary control more effective.

The main prudential ratio in the financial system is well above the minimum requirement: the average risk-weighted capital adequacy ratio was 17.4% at end-2010. Moreover, the ratio of nonperforming loans to total loans declined to 11.6% at year-end and banks made an aggregate profit (after 2009's loss).

Recovery in economic activity along with improved tax administration brought about a revival in tax receipts and general government income (excluding grants). Total revenue increased by 11.4% year on year. On the expenditure side, the government raised social spending and salaries, adjusting largely by containing other current expenditure items such as spending on goods and services for public administration. Capital spending and net lending rose somewhat more than planned in the original program. Still, the deficit narrowed to 6.5% of GDP in 2010 from 9.2% a year earlier (Figure 3.3.5).

Foreign financing was much higher than a year earlier and provided more than 80% of the deficit financing, although Treasury bills remained important.

External public and publicly guaranteed debt increased from 31.4% of GDP in 2009 to 37.4% in 2010. The debt repayment burden will become very heavy in 2013, when a large Eurobond issue matures and significant repayment obligations to the International Monetary Fund fall due. Rapid fiscal consolidation is essential in preparing to make these payments.

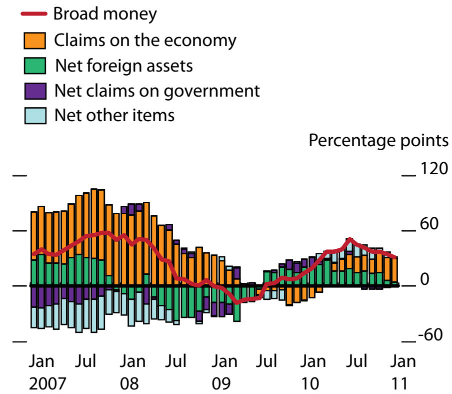
A recovery in global demand and higher prices of ferroalloys and nonferrous metals—the country's leading export commodities—helped to boost exports by 23.5%; imports grew by 15.8%. The trade deficit widened to $2.6 billion, though this was largely offset by stronger net remittances and services exports.

The current account deficit amounted to an estimated 11.4% of GDP in 2010, up from 11.2% in 2009 (Figure 3.3.6). Inflows of foreign direct investment (FDI), however, were disappointing. They had been expected to come back as the main source of growth, but missed the $600 million target.

The lari depreciated against the US dollar by about 5% in 2010. Weaker inflows in the first half of the year and banks' buildup of foreign exchange balances led to a larger depreciation in this period, but the currency subsequently strengthened (Figure 3.3.7) on improved earnings and capital inflows. Because of the steeper increase in domestic prices than in major trade partners, the real effective exchange rate appreciated by 2.8%.

Gross international reserves gained about $155 million, rising to $2.3 billion at end-2010, equivalent to about 4 months of 2011 estimated imports. Reserves were bolstered by drawing on funds from the International Monetary Fund made available under stand-by arrangements originally approved in 2008 and augmented in 2009 to a cumulative amount of about $1 billion.

3.3.3 Contributions to money supply (M3) growth



Source: International Monetary Fund. International Financial Statistics online database (accessed 17 March 2011).

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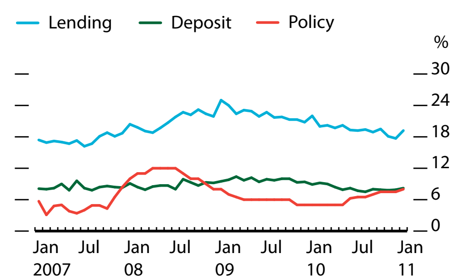
3.3.4 Interest rates



Source: National Bank of Georgia. http://www.nbg.gov.ge (accessed 17 March 2011).

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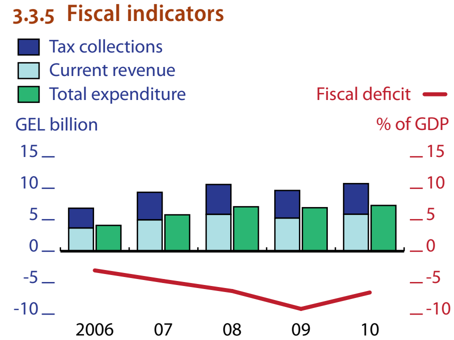
3.3.5 Fiscal indicators



Sources: International Monetary Fund. 2008. *Country Report* No. 08/328. October; 2009. *Country Report* No. 09/267. August; 2009. *Country Report* No. 09/331. December; 2011. *Country Report* No. 11/31. January. http://www.imf.org; Ministry of Finance of Georgia. http://www.mof.ge/en (accessed 17 March 2011).

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Economic prospects

Growth in 2011 will be measured because of the cyclical revival of 2010 and a phased withdrawal of fiscal stimulus in view of the need for consolidation. Hence more modest growth of 5.5% is projected. With greater reliance on the private sector as a driver, growth is forecast to be sustained at 5.0% in 2012.

Even though the growth of broad money is seen slowing to 20%–25% in 2011, the central bank's monetary program calls for a 15%–20% increase in credit to the private sector, which it perceives as appropriate for the growth target. The central bank is committed to a flexible exchange rate regime, and is moving to adopt inflation targeting.

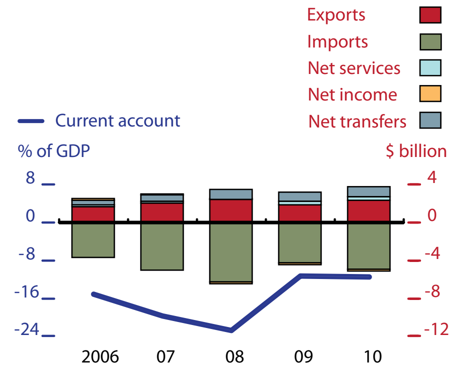
Inflation is expected to be high in 2011 at 9.5% given the ongoing surge in global food and oil prices. It should edge down in 2012 on the view that food price rises will be largely over and that oil and other import prices increase only moderately.

A new tax code that was passed in September 2010 (effective 1 January 2011) should boost government revenue. Its impact, along with the government's continued commitment to containing current spending, is seen narrowing the fiscal deficit to 4.0% of GDP in 2011 and to 3.4% in 2012. Special measures to protect low-income families from high inflation, such as electricity vouchers introduced in February 2011 and food vouchers the following month, will require cuts in budgeted expenditure to maintain the 2011 deficit target. Fiscal adjustment, unlike in 2010, will involve holding back capital spending.

The current account deficit is expected to widen slightly to 12.6% of GDP in 2011 as rising food and oil prices add to the import bill. A steady stream of remittances and services surpluses as well as growing export revenue from a sustained global recovery will help to rein in the deficit. It is projected to narrow to 11.4% of GDP in 2012, largely reflecting a further narrowing of the trade gap. External financing requirements of the current account deficit will increasingly rely on private inflows, such as FDI, as official development assistance slows.

External risks associated with this outlook include a setback in the global recovery, higher than expected global commodity prices, and weaker FDI inflows. On the domestic front, the most significant risk is slow fiscal consolidation.

3.3.6 Current account components



Source: National Bank of Georgia. http://www.nbg.gov.ge (accessed 17 March 2011).

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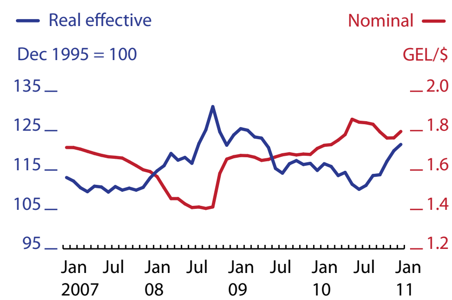
3.3.7 Exchange rates



Source: National Bank of Georgia. http://www.nbg.gov.ge (accessed 17 March 2011).

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Development challenges

A key challenge is to make growth sustainable over the medium term. The country therefore needs to diversify its production structure and exports from traditional products. The current limited physical, financial, and human capital are key bottlenecks.

Further efforts are needed to improve the fiscal deficit and to continue implementing reforms so as to prevent systemic risks from developing in the private sector.

3.3.1 Selected economic indicators (%)

	2011	2012
GDP growth	5.5	5.0
Inflation	9.5	6.0
Current account balance (share of GDP)	-12.6	-11.4

Source: ADB estimates.

Kazakhstan

In 2010 the economy showed a V-shaped recovery, driven by a revival in external demand, higher oil prices, and anticrisis measures. The outlook is for steady moderate growth and a comfortable current account surplus. Nevertheless, limited credit availability from restructured but still weak banks and rising inflation are headwinds. To diversify the economy and raise productivity, the government is implementing an industrial-innovation program.

Economic performance

The recovery that started in the last quarter of 2009 continued into 2010, giving full-year growth of 7.0% (Figure 3.4.1). Improved global economic conditions, a revival in external demand for oil and minerals, and mounting oil prices all played a role, as did anticrisis measures put in place in 2009. Bank restructuring was also a positive factor, though private credit to the economy stayed weak.

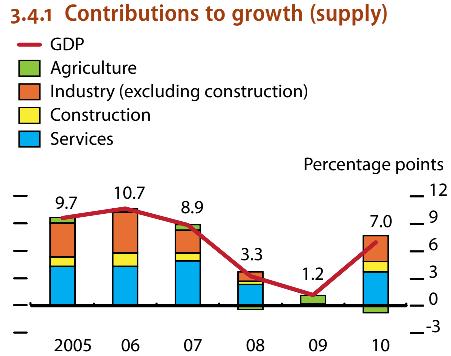
This solid growth performance was driven by 9.6% growth of industry. Manufacturing expanded by 18.4% and mining by 5.3%. Construction, which slowed sharply during 2007–2009, gained some momentum and grew at 1.0% in 2010. Agriculture contracted by 11.7% in 2010 as a result of damage that severe summer droughts caused to about 10% of arable land. With overall economic activity picking up, services expanded by 6.0%.

On the demand side, after a stagnant 2009 and with the recovery beginning to take hold, private consumption and gross fixed investment grew by 7.5% and 7.0%, respectively, in 2010 (Figure 3.4.2). Credit conditions stayed tight, which may have held back further increases in private consumption and investment. After the slump of 2009, export volume grew by 9.5% in 2010, as demand for oil and other key exports picked up. With rising consumption and investment, imports grew by 6.5% in 2010.

Overall average annual inflation reached 7.1% in 2010, remaining within the target band of 6%–8% of the National Bank of Kazakhstan (NBK). In January 2011, year-on-year headline inflation was, however, at 8.1%, 0.8 percentage points higher than a year earlier. This rise was largely due to the continued increase in prices of food items (Figure 3.4.3). The sharp drop in agricultural output as a result of the severe droughts that afflicted Kazakhstan and the Russian Federation in 2010 contributed to the food price surge. Inflation for nonfood items and services continued to moderate, indicating some slack in the economy.

With the economy beginning to gain traction but also showing signs of weak private sector activity, the NBK kept the refinancing rate at 7.0% during 2010, unchanged since September 2009. It also maintained the

3.4.1 Contributions to growth (supply)



Source: Agency of Statistics of the Republic of Kazakhstan.

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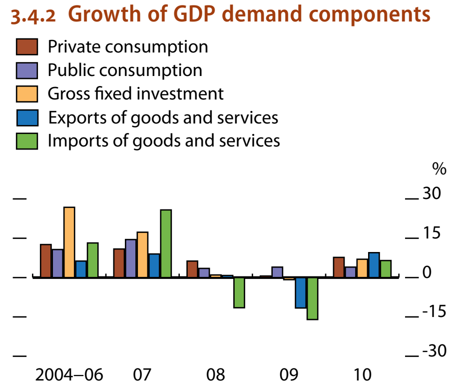
3.4.2 Growth of GDP demand components



Sources: Agency of Statistics of the Republic of Kazakhstan; Economics Intelligence Unit. 2011. *Kazakhstan Country Report*. March.

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This chapter was written by Utsav Kumar, consultant of the Central and West Asia Department, ADB, Manila; and Christopher T. Hnanguie and Manshuk Nurseitova of the Kazakhstan Resident Mission, ADB, Astana.

reserve requirements, which it had lowered to a historical low in March 2009, to boost liquidity. Broad money supply increased by 14.1% in 2010, largely on account of higher net foreign assets (Figure 3.4.4). Credit to the economy grew by 6%, though that to the private sector rose by only 0.8% in 2010, reflecting both weak private sector activity and risk aversion among banks.

After the onset of the financial crisis and with falling oil prices, foreign exchange reserves came under stress. The NBK devalued the tenge in February 2009 by about 20%, following a similar adjustment in the Russian Federation, from T120/$ in 2008 to T150/$, with a 3% band. As the economic recovery gathered pace and oil prices came back from their lows, the NBK introduced in February a wide, asymmetric trading band of +10%/-15% around T150/$. Over the course of the year, the nominal exchange rate appreciated marginally.

Budget revenue increased due to the improvement in economic activity, higher oil prices, and the reintroduction in mid-August 2010 of an oil export duty of $20 per ton. Transfers from the oil fund, the National Fund of the Republic of Kazakhstan (NFRK), were also used to support the budget. As a result, current revenue climbed by 28%.

Total expenditure increased by 21%: 19% on current items, due to higher social spending and wages; 55% on capital items, due to investments in priority projects. The fiscal deficit narrowed to 2.5% of GDP in 2010 from 2.9% a year earlier. Most of the deficit was financed through domestic sources, although foreign financing increased.

After a contraction in 2009, exports jumped by 38.5% in 2010 due to the improved global economic environment and higher oil prices. Imports recovered to grow by 10.3% in 2010. The modest pickup in imports points to weak private domestic demand as well as lack of credit. The $28.9 billion trade surplus was partly offset by a persistent services deficit, as well as by a negative balance in the income and current transfers accounts combined (Figure 3.4.5).

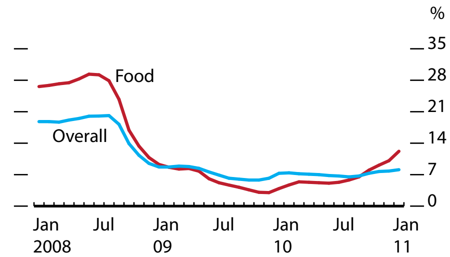
The current account balance moved back into positive territory from a deficit of $4.4 billion (3.8% of GDP) to a surplus of $4.3 billion in 2010 (3.0%). Gross international reserves at end-2010 climbed by 22.5% to $28.3 billion. Assets of the NFRK rose by 25.5% to $30.6 billion (Figure 3.4.6). An important development on the trade front was the formation of a three-country customs union (Box 3.4.1).

Total external debt grew rapidly from the early 2000s, reaching about 92% of GDP just as the global capital markets began to wobble in August 2007. The rapid increase in debt was due to external borrowing by banks to finance consumption and construction (Figure 3.4.7). The debt composition has changed significantly, with public and publicly guaranteed debt, always low, now accounting for only 4.3% of the total. Almost half the total private debt outstanding is intracompany debt, mainly reflecting liabilities for direct investment by oil companies.

The vulnerabilities of the banking system were exposed as the global crisis bit, putting pressure on foreign reserves as well as on the exchange rate. Banks' external debt came down after the crisis through September 2010.

The two largest banks had to be nationalized after the crisis, which had hit the banking system hard. The external debt obligations of these

3.4.3 Inflation



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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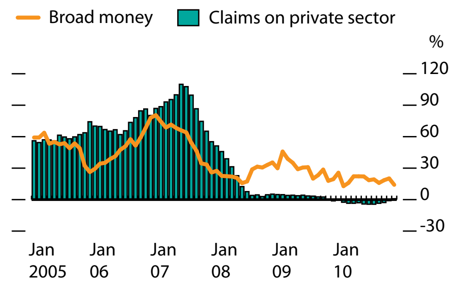
3.4.4 Growth of monetary aggregates



Note: Increase in private sector credit for February 2009–January 2010 were adjusted to exclude valuation changes on foreign currency–denominated loans stemming from the February 2009 devaluation.

Source: International Monetary Fund. International Financial Statistics online database (accessed 15 March 2011).

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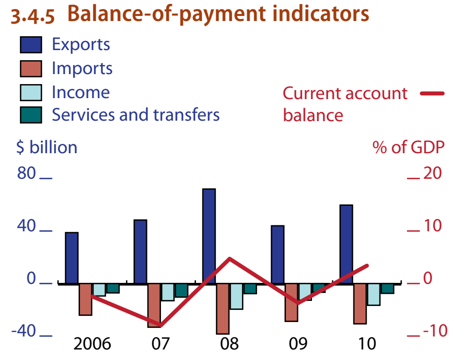
3.4.5 Balance-of-payment indicators



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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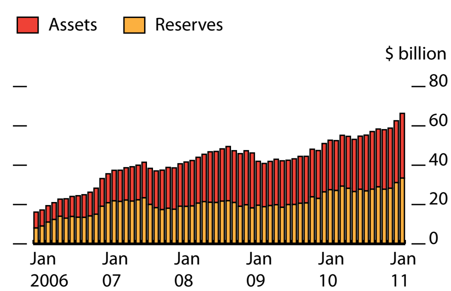
3.4.6 Official reserves and foreign exchange assets of the National Oil Fund



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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3.4.1 Customs union among Belarus, Kazakhstan, and the Russian Federation

The three countries formed a customs union in 2010. It removes duties on goods originating in member states and enforces a common external tariff for trade with third countries. It also establishes a common customs territory in which terminology, a customs code, and customs duties will be unified.

The union took effect on 1 January 2010 with a unified customs rate. At this first stage, the three countries removed most duties on trade among themselves.

On 1 July 2010, a customs code was launched between Kazakhstan and the Russian Federation, coming into force a few days later in Belarus. This second stage led to the adoption of common external tariffs.

In the third stage, customs clearance and control procedures at the Kazakh–Russian Federation border are scheduled to be abolished by 1 July 2011. (Such measures were implemented at the Belarus–Russian Federation border in July 2010.) By January 2012, a single economic space will be achieved among the three countries.

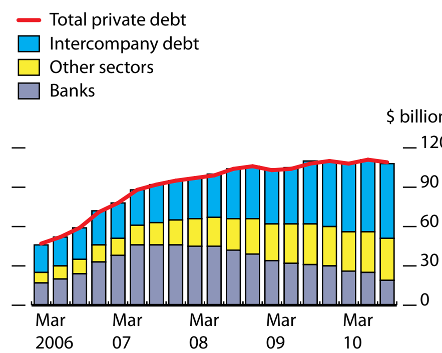
The tariff regime is based heavily on that in the Russian Federation, and Kazakhstan had to raise tariffs on around 45% of all imported items. The average common customs tariff rate is 10.6%, whereas previously Kazakhstan's simple most-favored-nation applied tariff was only 6.16%.

The value-added tax rate applied to third countries is 17%. Import customs duties from goods originating outside the union will be distributed among the three countries according to an agreed formula of 87.97% for the Russian Federation, 7.33% for Kazakhstan, and 4.70% for Belarus.

two banks and of two other smaller banks had to be restructured, resulting in debt relief of $11 billion. Overall, the share of nonperforming loans in the total loan portfolio is about 30%, and is a key factor hampering lending activity.

In addition, the restructuring of external debt has affected the private sector's access to international markets. The country's leading private bank, Kazkommertsbank, postponed its issuance of international bonds, citing unfavorable market conditions (although state-owned KazMunayGas and Kazakhstan Temir Zholy were readily able to raise money in international markets in 2010). Continued risk aversion has affected credit availability, in turn holding back private consumption and investment.

3.4.7 Private external debt



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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Economic prospects

The recovery of agriculture after the sharp contraction of 2010, capital expenditure by the government on priority projects in its program for 2010–2014, a sustained global recovery, and an increase in oil demand and prices will help run the growth momentum in 2011 and 2012. At the same time, banks' continued fragility and steep oil and food price rises may undermine the global economy and work against Kazakhstan's growth. The forecast is for GDP to grow by 6.5% in 2011 and 6.8% in 2012.

Construction will continue to face weaknesses as a result of lack of credit and the inability of the private sector to raise funds in international markets on attractive terms. Private consumption and total investment are expected to see continued growth in 2011 and 2012. Credit availability will be an important factor if higher growth rates are to be achieved. However, higher oil prices and external demand will help to boost consumption as well as investment in the oil sector.

The government is considering several programs that will help to support private consumption and investment over the projection horizon and beyond. One of them, Employment 2020, targets the self-employed, especially those in rural areas. It will provide support in the form of

3.4.1 Selected economic indicators (%)

	2011	2012
GDP growth	6.5	6.8
Inflation	8.5	6.0
Current account balance (share of GDP)	3.5	3.5

Source: ADB estimates.

relocation from economically depressed regions, subsidized leases of property, and day care for children.

Another, the Business Roadmap 2020, for entrepreneurs and exporters in priority sectors, will provide assistance in the guise of subsidized interest rates, guarantees for bank credits, grants, cofinancing of investment projects, and rescheduling of certain tax payments.

An increase in oil exports coupled with a doubling of the oil export duty to $40/ton from 1 January this year is adding to state coffers. A concurrent shift from a personal income tax flat rate to a progressive income tax (with rates at 10%–20%) will also lift revenue, as will a decision to hold off reducing the corporate income tax rate (currently at 20%) until 2013. Both social and capital expenditure on priority projects will climb. Overall, the government is likely to achieve its target of narrowing the fiscal deficit to 2.2% in 2011 and 1.7% in 2012.

With the surge in global food prices and the region still reeling from the effects of the severe droughts, the prices of many food items are likely to rise further. In February 2011, the government introduced price ceilings for essential food items. A utility fee increase in January 2011 and a boost to consumption from wage increases in the second half of 2011 will add to inflation pressures.

Some slack still appears to be in the economy, however—as observed from moderate prices of nonfood items and services—and this will help to contain inflation this year, to 8.5%, as inflation pressures subside later in the year. Inflation in 2012 is expected to be 6.0%.

Though the trading band for the exchange rate was widened in February 2010, the NBK has intervened to prevent the tenge from appreciating sharply. On 28 February 2011, it abolished the corridor for the tenge/$ exchange rate and introduced a managed float regime. It is unlikely that the tenge will be allowed to breach T141/$, as further appreciation, combined with the inflation differential with the advanced countries, could result in a loss of competitiveness.

The current account balance is projected to remain positive in 2011 and 2012, at 3.5% of GDP. Imports will increase on the back of higher private consumption and investment as banks become more willing to lend, and of government investment in a variety of priority projects. Exports will markedly increase further due to higher oil prices and stronger demand for oil. The trade surplus will be offset by the deficit on other components of the current account.

Development challenges

Diversifying the economy's industrial base, lowering reliance on natural resources, and generating more balanced and equitable development constitute the premier development challenges. Another is to increase competitiveness (Box 3.4.2).

3.4.2 Accelerated Industrial and Innovative Development Program

The primary thrust of the government's industrialization program (released in March 2010) is diversifying the economy and reducing reliance on oil. The second is increasing national competitiveness.

The program lists the following (among others) as critical to success: developing the priority sectors of the economy (heavy machinery, information and communications, education, and health care); strengthening the "social effectiveness" of the priority sectors and investment projects; and creating a favorable industrialization environment.

The strategy identifies four sectors where the efforts of the state will be concentrated:

- Traditional industries: natural gas sector, mining and metallurgy, atomic energy, and chemical industry.
- High domestic demand: machine building, pharmaceuticals, construction, and building materials.
- Predominantly export oriented: agribusiness, light industry, and tourism.
- Sectors of the future: information and communications technology, biotechnology, alternative power engineering, nuclear energy, and space.

State support to the priority sectors includes provision of physical infrastructure (such as information and communications, energy, and transport) and social infrastructure (such as skilled human resources).

Such support also includes measures to reduce administrative barriers, guidelines on technical regulations, and providing a conducive environment for foreign direct investment.

Kyrgyz Republic

Sociopolitical protests in Bishkek in April 2010 that ousted the former president, followed by ethnic violence in the south in June, battered the economy. Disruption was then exacerbated by border closures with Kazakhstan and Uzbekistan, the main transport conduits for trade. The crisis has put public finances under severe stress, alleviated by a July 2010 $1.1 billion pledge of assistance from donors. The time taken to return to normality will depend heavily on the new government's ability to bring about and maintain political and social stability.

Economic performance

After modest growth of 2.9% in 2009, the country was recovering well from the global economic crisis as GDP growth bounded to 16.4% in the first quarter of 2010. But the closures of international borders following the April and June events stopped imports and exports at times, intensifying the impact of the internal disruptions on the economy. For all 2010, GDP dropped by 1.4% (Figure 3.5.1).

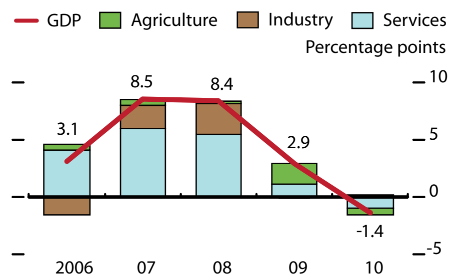
All sectors contracted in 2010, except for gold and other industrial production, which grew by 8% and 11.3%, respectively. Gold output climbed mainly because of a higher ore yield. Expansion in industrial production was largely attributable to a low 2009 base, reflecting the impact of global and regional recession. Some subsectors, however, showed strong outturns: garments were up by an estimated 50% and electricity, gas, and water services were together 11% higher.

Agricultural output fell by 2.8% largely due to delays in sowing crops (a knock-on effect of the disturbances) and an ensuing lower harvest in part caused by shortages of imported fuel. Construction output fell by 22.8%, as unrest and supply disruptions curtailed work, including that on large investment projects in the hydropower and mining subsectors.

The contraction in GDP would have been more severe without expanded gold production. Also of help was an estimated 25% increase in workers' remittances (from the Russian Federation and Kazakhstan, the country's main economic partners) that boosted a major source of income for the population, helping to ease the downward pressure on aggregate demand (Figure 3.5.2).

The imposition of duty by the Russian Federation on oil exports to the Kyrgyz Republic raised domestic oil-product prices by about 35%. This and increasing imported food prices, combined with lower domestic wheat production, have significantly added to inflation pressures. In the second half of 2010, inflation accelerated steadily and reached 19.2% at year-end, with food prices up by 27% (Figure 3.5.3). The April 2010 reversal of electricity and heating tariff increases to their 2009 levels (tariffs were

3.5.1 Contributions to growth (supply)



Source: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 28 February 2011).

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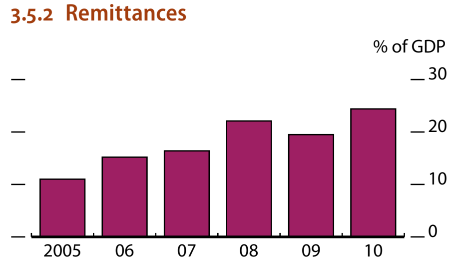
3.5.2 Remittances



Source: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 11 March 2011).

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This chapter was written by Nurbek Jenish, consultant of the Kyrgyz Resident Mission, ADB, Bishkek.

doubled on 1 January 2010) helped to mitigate price escalation. Low inflation early in the year kept annual average inflation to 8.0%.

The April and June 2010 events have significantly increased budgetary expenditure on compensation to the families of victims; unplanned spending for the constitutional referendum and elections; outlays associated with rehabilitating damaged infrastructure and buildings; security expenditure; and subsidies for utility companies due to the tariff-hike reversal. On the revenue side, improved tax administration in the second half of the year helped to offset the negative impact of the crisis and border closure on value-added tax and customs collections.

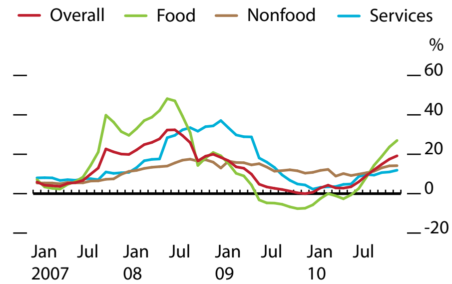
In 2010, the budget deficit widened to an estimated 6.5% of GDP (Figure 3.5.4). Assistance from both bilateral and multilateral donors as well as use of the $300 million Russian loan proceeds (received in 2009) covered financing needed for the enlarged deficit. Since some of the recent spending increases were one time (for rehabilitation and social protection, resettlement, and reconstruction), they can be unwound as the situation improves in 2011, though much rebuilding will still be needed in 2012. Reconstruction, alongside the government's plans to greatly increase salaries of teachers and other social sector workers from May 2011, will further widen the budget deficit. Government estimates of the budget deficit for 2011 are around 9%.

In July 2010, the donor community pledged $1.1 billion assistance over 30 months. External support will be critical in helping the authorities to deal with the consequences of the crisis. External—mainly concessional—borrowing increased publicly guaranteed external debt from around 53% in 2009 of GDP to an estimated 62% in 2010. The external debt ratio is forecast to reach 67% by end-2011. Although the International Monetary Fund rates the country's risk of debt distress as moderate, the government will need to follow prudent policies to ensure external debt sustainability.

In response to the crisis, the National Bank of the Kyrgyz Republic (NBKR, the central bank) eased its monetary stance by lowering the reserve requirement by 1.5 percentage points to 8.0% in May 2010, and adjusted the sale of its notes to changing monetary circumstances. Nevertheless, credit to the economy increased by only 2.7% due to weak demand and troubled banking conditions. The public's preference to increase its cash holdings at the expense of deposits surged after the April events, pressuring banking system liquidity and complicating the central bank's monetary operations. Despite the downturn in economic activity and banking sector problems, external finance of the fiscal expansion increased monetary aggregates. In 2010, money supply rose by 18.6%, primarily due to increased foreign assets (Figure 3.5.5).

The crisis shook financial stability. Loan quality has worsened dramatically—the ratio of nonperforming loans rose from 7.9% before April to an estimated 16% at year-end. The deterioration in quality has been mainly concentrated in loans for trade and commerce. The NBKR introduced temporary administration at seven banks (later reduced to four), including Asia Universal Bank—the largest bank with over 20% of bank deposits—after it experienced a large nonresident deposit outflow, allegedly linked to the previous regime. To mitigate deposit-run risks, the authorities nationalized the bank and created a new bank based on

3.5.3 Monthly inflation



Source: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 28 February 2011).

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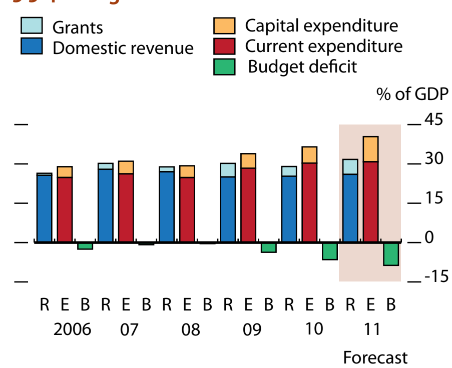
3.5.4 Budget indicators



B = Balance; E = Expenditure; R = Revenue.

Note: Domestic revenue includes capital receipts.

Sources: International Monetary Fund. 2008. *Country Report* No. 08/381. December; 2009. *Country Report* No. 09/209. July; 2010. *Country Report* No. 10/336. October. http://www.imf.org; Ministry of Finance.

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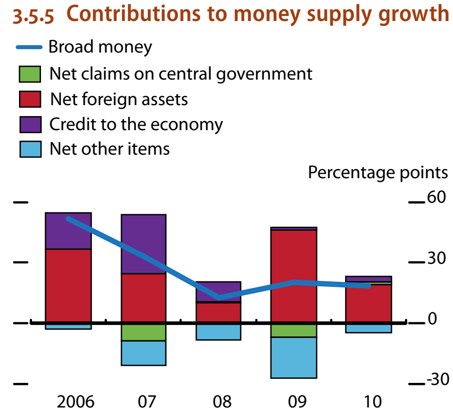
3.5.5 Contributions to money supply growth



Source: National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 11 March 2011).

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the old one. Despite difficulties, the banking system remains adequately liquid and capitalized.

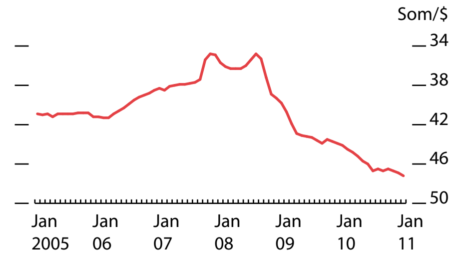
In April and May, the NBKR undertook large US dollar sales in the foreign exchange market to meet public demand and prevent an excessive depreciation of the local currency. For much of the rest of the year, it intervened to offset pressures for appreciation stemming from large donor-funded external budgetary support. Over the year, the som depreciated by around 7% against the dollar (Figure 3.5.6). In view of continued large expected inflows of external assistance in 2011, the NBKR plans to intervene to forestall an unwarranted appreciation of the exchange rate and reduce excess bank liquidity created by these operations.

Exporters did not fully benefit from the economic recovery in the Russian Federation and Kazakhstan in the wake of internal unrest and periods of closed borders. Further, the introduction of a customs union among the Russian Federation, Kazakhstan, and Belarus in July 2010 decreased the volume of Chinese goods that are reexported, as they now face higher duties into the union. Still, increased production of gold, the country's main export commodity, and rising gold prices helped to bolster export revenue that is estimated to have increased by 7.0% for the year.

Despite the border disruptions, imports are estimated to have increased by 15.0%. This expansion reflected higher import prices of food and fuel, though imports financed by donors and workers' remittances were also factors. The current account deficit is estimated at 5.0% of GDP in 2010, up from 2.4% a year earlier (Figure 3.5.7).

On the political scene, following the resignation of the former president in April, an interim government assumed power. It drafted a new constitution, which was adopted in a nationwide referendum in June, changing the country's political system into a parliamentary republic. (The country also elected an interim president, whose tenure will last until 31 December 2011. A presidential election under the new constitutional arrangement is scheduled for October 2011.) Parliamentary elections were held on 10 October 2010, with five parties winning seats. Following the creation of a majority coalition consisting of three parties in December 2010, Parliament elected a speaker and formed a government.

3.5.6 Exchange rate



Source: International Monetary Fund. International Financial Statistics online database (accessed 14 March 2011).

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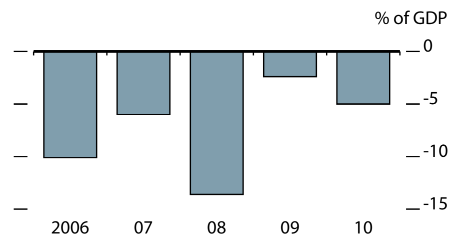
3.5.7 Current account balance



Source: National Bank of the Kyrgyz Republic. *Balance of Payments of the Kyrgyz Republic*. Various issues. http://www.nbkr.kg

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Economic prospects

The economy is expected to pick up with GDP growing at around 5% in 2011 and 2012. The forecasts rest on expectations of a normal security environment, continued reconstruction works, full resumption of trade and services flows, and improved investor confidence. They also rely heavily on construction growing by about 40%, mainly due to large-scale reconstruction works in the south. Services and industry are seen growing by 6% and 4%, respectively.

Economic expansion of the Russian Federation and Kazakhstan will also contribute to growth through increased demand for the Kyrgyz Republic's exports and higher remittances from workers in those two countries.

Considerable fiscal challenges loom over the next 2 years. Much reconstruction is still needed, and the government plans to increase

3.5.1 Selected economic indicators (%)

	2011	2012
GDP growth	5.0	5.0
Inflation	13.0	8.0
Current account balance (share of GDP)	-9.0	-9.0

Source: ADB estimates.

salaries of teachers, as well as medical and other social sector workers in 2011, yet is reluctant to cut down on pension and social protection spending as this might affect social stability. It therefore plans to improve tax and customs administration and cut nonpriority spending. Around 73% of the budget deficit will be financed by donors.

The pickup in economic activity with higher import prices for food and higher remittance spending will exert an upward pressure on consumer prices. The NBKR's monetary and exchange rate policies will aim to keep inflation in check by neutralizing the effects of large fiscal expansion yet support the postcrisis recovery. Cancellation of export duties on petroleum products by the Russian Federation from 1 January 2011 will help to mitigate upward pressures on prices. For 2011, average inflation is expected to move higher to 13.0% and then moderate to 8.0% in 2012 as global price pressures subside.

Extensive reconstruction works and a recovery in domestic demand will raise the import bill in the forecast period. Increases in global food and oil prices will also push imports higher. Gold prices are expected to rise by 5%–10% in 2011 and remain at historically high levels. Remittances are forecast to increase moderately, after their strong growth in 2010.

The current account deficit is projected at 9.0% of GDP in 2011 and 2012. Foreign direct investment is likely to remain low in the next 2 years due to the uncertain political and security situation, though large inflows of official external assistance are expected to finance the large current account deficit.

Development challenges

The country faces huge challenges in economic recovery, reconstruction, and social reconciliation. Success will not be easy given the considerable pressure on public financial resources in a weakened economy. Achieving sustainable robust economic growth remains the major challenge facing the country.

Tajikistan

Rising remittance inflows and strong industry and construction outturns revived growth in 2010, aided by a favorable climate that supported year-round hydropower output. The economy is projected to sustain growth in 2011–2012 despite risks from rising food and fuel prices, transport bottlenecks, and a poor investment climate.

Economic performance

GDP climbed to 6.5% in 2010 from 3.4% in 2009 (Figure 3.6.1). Industry grew by about 10%, as favorable weather allowed higher hydropower production (which accounts for most of the electricity generated), in turn allowing small and medium-sized enterprises to maintain continuous operations in winter. Thus industrial growth mainly came from these enterprises, particularly in light manufacturing and food processing, unlike previous years.

Aluminum production suffered due to limited imports of alumina, caused by intermittent disruptions to rail transit through Uzbekistan. These were largely resolved in the second half of the year. Indeed, the two countries have faced several bilateral issues over the years. At present, the main one relates to differences over managing riparian resources.

Public spending on key infrastructure projects, such as roads, tunnels, and transmission lines, grew, underpinning growth in construction.

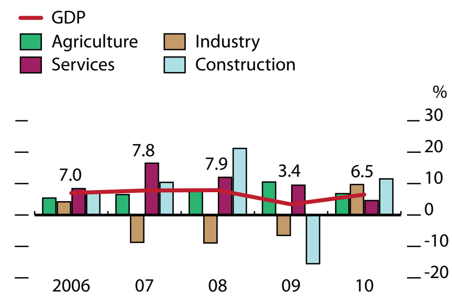
Growth in agriculture slowed to a still strong 6.8% after an unusually high 10.5% gain in 2009 (due to a reallocation of land to noncotton agriculture). Slowing activity in retail trade, as disruption in rail transit restricted imports, held services growth to about 5%.

Economic recovery in the Russian Federation lifted remittances by 29% to $2.4 billion in 2010 (Figure 3.6.2), the equivalent of 40% of GDP. They remained a key factor in economic and social stability in Tajikistan, supporting domestic demand and private consumption.

The government launched a massive public campaign to collect funds for building the Roghun hydropower plant in January 2010. It believes that, if carried out, this project could end perennial winter power deficits and allow Tajikistan to become a substantial regional electricity exporter. The campaign targeted raising $1.4 billion to construct the initial phase of Roghun by selling shares to the public. But, after the campaign had raised more than $186 million by May, the government suspended it after seeing the adverse impact on household consumption and economic activity. It remains, however, committed to the project.

End-of-period inflation nearly doubled to 9.8% in 2010 from 5.0% in 2009 (Figure 3.6.3), mainly because of rising food prices—particularly of wheat, following the drought in and subsequent suspension of exports by

3.6.1 GDP growth by sector



Sources: Tajikistan State Statistics Agency. http://www.stat.tj; International Monetary Fund.

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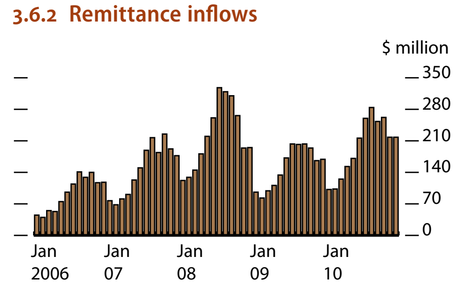
3.6.2 Remittance inflows



Sources: National Bank of Tajikistan; International Monetary Fund.

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This chapter was written by Kakhorjon Aminov of the Tajikistan Resident Mission, ADB, Dushanbe.

the Russian Federation. Higher global fuel prices and the imposition by that country (the main supplier of petroleum) of export duty on hydrocarbons added a further supply-side push. Demand-side pressures from increased remittance spending also stoked inflation, which averaged 6.4% in 2010.

Banks continued to face tight liquidity conditions and high rates of nonperforming loans. They are constrained by a low deposit base and a limited ability to attract capital inflows, while they have significant exposure to risky credits in agriculture and a shortage of sound investment opportunities.

The government wrote off about $500 million of doubtful cotton sector loans. This move cut banks' ratio of nonperforming loans from 28% at end-2009 to about 18% a year later, but as their compensation was in the form of very low yielding T-bills it contributed little to their liquidity, income, and ability to take up new lending opportunities. Trade disruption and delayed cargo deliveries hit trade finance, a sizable part of banks' normal business given that imports are over one-half of GDP.

All these factors restrained credit expansion to the private sector. To mitigate banks' difficulties, the government deposited $50 million collected during the Roghun campaign at commercial banks to strengthen their reserves and add to lending capacity.

In response to rising inflation, the central bank lifted its refinancing rate from 8.0% to 8.25% in November 2010 and to 9.0% in March 2011. In 2010, bank lending rates varied around 25% while deposit rates varied around 6.5%, the large spread reflecting both high doubtful loans and structural difficulties.

Tajikistan continued to pursue fiscal policy aimed at macroeconomic stabilization while sustaining pro-poor programs. The government's postcrisis plan, adopted in early 2010, aimed to lift social expenditure to 11.5% of GDP in 2010, but could not meet the target. This was mainly because revenue collection was under stress in the first half of last year owing to reduced collection of value-added tax on imports and of customs duties, but revenue picked up after the easing of the transit bottleneck.

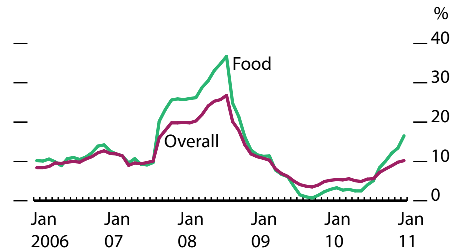
Although government revenue and expenditure did not fully reach budgeted levels, the overall deficit (excluding the public investment program and related grants) kept to the target of 1% of GDP in 2010 (Figure 3.6.4).

Recent fiscal deficits have been financed by external support, but borrowing capacity is low. The government's emphasis on completing infrastructure projects financed by external borrowing raised the debt-to-GDP ratio slightly to 34.4% of GDP in 2010 (Figure 3.6.5). The latest debt sustainability analysis from the International Monetary Fund (IMF), carried out in July 2010, puts Tajikistan at high risk of debt distress. The government is committed to controlling the debt level: its debt management strategy limits the ratio to 40% of GDP.

Higher global prices for aluminum and cotton underpinned a 40.9% surge in exports in 2010, a marked turnaround from the prior-year's 10.7% contraction. In volume terms, exports of aluminum rose moderately but cotton fell, as less land had been allocated to production. Imports grew by only 8.2%, mainly because of the rail disruptions.

The increase in export earnings outpaced the unusually small rise in imports and kept the trade deficit largely unchanged from the previous

3.6.3 Inflation



Source: Tajikistan State Statistics Agency. http://www.stat.tj

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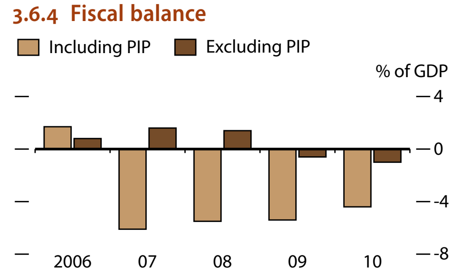
3.6.4 Fiscal balance



PIP = public investment program.

Source: International Monetary Fund. 2010. *Country Report* No. 10/374. December. http://www.imf.org

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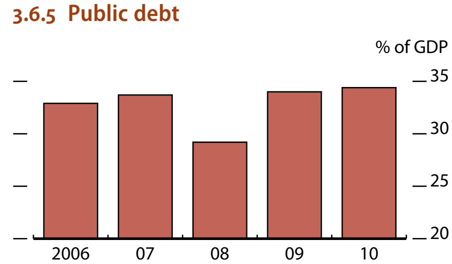
3.6.5 Public debt



Sources: International Monetary Fund; ADB estimates.

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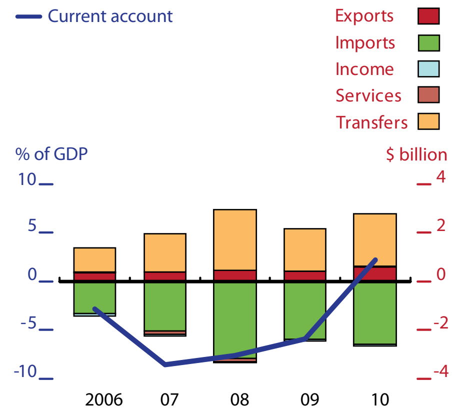
year. With the strong recovery in remittances, the current account is estimated to have moved to a surplus of 2.2% of GDP from a deficit of 5.9% of GDP in 2009 (Figure 3.6.6).

Following the large depreciation in 2009 that mirrored those of major trade partners, the somoni was stable against the US dollar in 2010, depreciating by only 0.7% (Figure 3.6.7). This reflected market conditions—good export performance and rising remittances in the face of restrained conditions on importing.

Foreign reserves picked up from $278 million in 2009 to $640 million. This increase was due to the improvement in the current account, while capital flows and credit disbursements, including those from the IMF, came in broadly as planned. But the level of foreign reserves remained low at year-end, equal to only 2.3 months of projected 2011 imports.

3.6.6 Current account balance



Sources: National Bank of Tajikistan; International Monetary Fund.

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Economic prospects

Growth is projected to edge up to 6.8% in 2011 and 7.0% in 2012, fueled by continued remittance inflows and by increases in aluminum and cotton prices in 2011, both of which fall off but stay high in 2012.

Remittances are forecast to grow by about 7% each year, reaching their precrisis high in 2012. They will underpin rising private consumption expenditure, boosting imports and so buoying budget revenue.

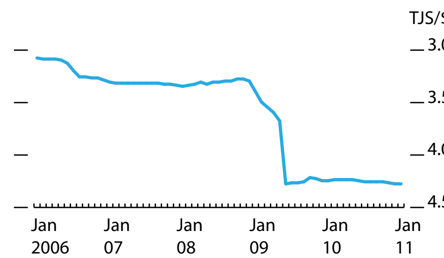
Production of aluminum and cotton is projected to rise moderately, responding to higher global prices (as well as reallocation of land back to cotton), but limited aluminum production capacity and inefficient cotton financing will hold back a stronger response. Agricultural processing, light industry, construction, and services will likely continue their strong growth.

Inflation in 2011 and 2012 is projected to increase to 10.5% and 9.5%, reflecting rising global food and fuel prices. The authorities are committed to maintaining a cautious fiscal and monetary stance under their economic program with the IMF and have averred that they would tighten policies if nonfood price pressures emerge. The central bank has already raised its refinancing rate.

Rising remittance-fueled consumption spending and expanding public investment are projected to generate much stronger import growth in 2011 and 2012 of about 28% and 10%, assuming normal regional trade and cargo transit arrangements. Exports are set to rise, by around 25% and 1%, largely reflecting global price movements. The trade deficit will deteriorate, and even with expected higher remittances the current account balance will move to a deficit of 4.3% and 6.4% of GDP.

These projections are subject to several external and internal risks, including growth in the Russian Federation's economy; the level of precipitation, essential for agriculture and water accumulation for electricity generation; and political and social stability.

3.6.7 Nominal exchange rate



Source: Tajikistan State Statistics Agency. http://www.stat.tj

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3.6.1 Selected economic indicators (%)

	2011	2012
GDP growth	6.8	7.0
Inflation	10.5	9.5
Current account balance (share of GDP)	-4.3	-6.4

Source: ADB estimates.

Development challenges

Tajikistan faces interrelated challenges that hinder reduction of widespread poverty and a move to higher and more sustainable growth. The first is its heavy reliance on remittances, which was keenly felt in 2009's global downturn. The second is its dependence on a

few exportable commodities and very narrow production base. The government therefore needs to strengthen infrastructure and services, improve the business and investment climate, and diversify agricultural output.

Many aspects of doing business, such as business registration procedures, investment protection, and tax systems, need to be improved, as seen clearly in the World Bank's latest *Doing Business* report. The share of private activity in GDP is below half, which is very low internationally. Private investment has been stagnant at less than 5% of GDP over the last 5 years, reflecting an unfavorable business environment and lack of investor confidence.

To boost economic activity, the government needs to focus on reducing risks to private investors, through, for example, providing and enforcing property rights, reducing corruption, and enhancing necessary supporting infrastructure. Improving the security situation and maintaining stability are also important.

Stagnating tax revenue and a weak fiscal position call for reform in the public resource management system, particularly tax policy and administration. Policy makers need to focus on implementing the comprehensive 5-year Tax Administration Reform Strategy, approved in 2010, which has financial and technical support from various development partners. Complemented by more efficient and better governed state-owned enterprises, such an approach could sharply raise revenue performance and reduce the call on the state budget.

3.6.2 Central Asian rankings on the ease of doing business, 2011

Georgia	12
Kyrgyz Republic	44
Armenia	48
Azerbaijan	54
Kazakhstan	59
Tajikistan	139
Uzbekistan	150

Note: Out of 183 countries worldwide. No ranking for Turkmenistan.

Source: World Bank. *Doing Business 2011*.

Turkmenistan

Growth recovered to near double-digit levels in 2010 with resumption of gas exports and new gas pipelines, alongside large-scale public investments. The outlook is for continued strong growth and moderate inflation. But moving the economy from its heavy dependence on hydrocarbons requires a diversified base of industries and services, as well as a dynamic private sector.

Economic performance

The economy rebounded in 2010 with government sources estimating GDP growth at over 9%, close to the levels seen prior to the global recession (Figure 3.7.1). Much of the growth derived from the resumption of natural gas exports to the Russian Federation, which were suspended for much of 2009, and the opening of new gas pipelines to the People's Republic of China and the Islamic Republic of Iran. The strong growth also came from large-scale public investments, a surge in foreign direct investment, and rapid gains in construction, transport and communications, textiles, and agriculture.

Natural gas remains the mainstay of the economy—hydrocarbon exports accounted for over 90% of exports in 2010. Moreover, hydrocarbon production is the main source of government revenue. Gas exports reportedly grew by 34% in 2010 from the previous year.

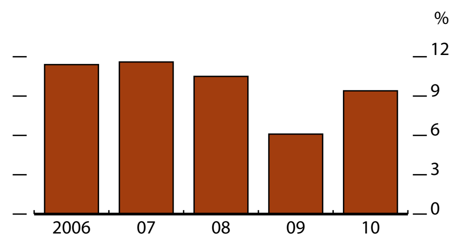
Consumer price inflation for the end of period was estimated to have risen from 0.1% in 2009 to 4.6% in 2010, giving a 2010 average of 3.9%, a switch from deflation of 2.7% in 2009 (Figure 3.7.2). The inflation partly reflects rising international food and grain prices, which went up by about 12% in 2010. Government controls over certain prices, wages, and pensions and a stable exchange rate helped to keep consumer prices in check.

The government's expansionary fiscal policy reduced the budget surplus from an estimated 7.8% of GDP in 2009 to 2.8% in 2010 (Figure 3.7.3). Much of the spending is guided by the National Program of Social and Economic Development, which was updated in mid-2010 to cover 2011–2030. The program entails large public investment in economic and social infrastructure.

The recovery in gas exports and increased earnings from higher oil export prices helped to narrow the current account deficit from an estimated 16.1% of GDP in 2009 to 4.7% in 2010 (Figure 3.7.4). The balance of trade in 2010 moved to a small surplus of $100 million, from a deficit of $1.8 billion in 2009. Estimated exports were $10.1 billion for the year, a slight increase from $9.5 billion in 2009. Imports were estimated to be $10.0 billion, down from $11.3 billion the previous year.

This chapter was written by Jennet Hojanazarova of the Turkmenistan Resident Mission, ADB, Ashgabat; and David Oldfield of the Central and West Asia Department, ADB, Manila.

3.7.1 GDP growth



Sources: International Monetary Fund. 2010. *Regional Economic Outlook, Middle East and Central Asia*. October. http://www.imf.org; ADB estimates.

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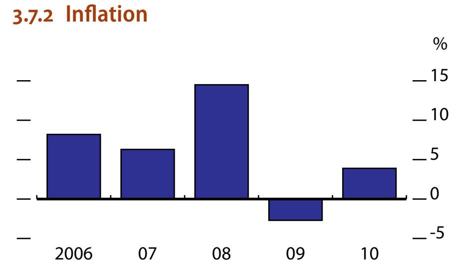
3.7.2 Inflation



Source: International Monetary Fund. 2010. *Regional Economic Outlook, Middle East and Central Asia*. October. http://www.imf.org

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Economic prospects

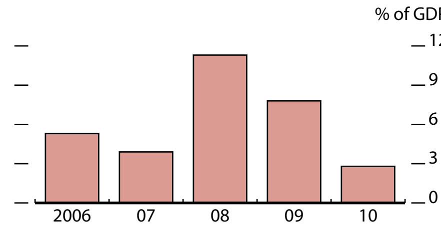
The outlook for 2011 and 2012 appears to be highly favorable, and growth is likely to be robust over the forecast period. The predicted growth rates will result from higher volumes of natural gas exports due to new pipelines with the People's Republic of China and the Islamic Republic of Iran, and continued implementation of the government's development policies. The global gas supply glut will likely peak in 2011 and gas prices will remain low, but demand by Turkmenistan's established buyers should stay strong.

Growing gas exports are necessary to finance the government's heavy spending on infrastructure and the social sector. It is expected to continue its fiscal stimulus, in line with the recently updated National Program. These measures, along with an expected rise in global food and other commodity prices, are likely to add to inflation in 2011, nudging it up to 5.0% in 2011 and 6.0% in 2012.

Trade with neighbors should receive a boost in 2012 if the construction of the new North–South railway linking Turkmenistan with Kazakhstan and the Islamic Republic of Iran is completed on schedule. Total exports are seen rising by nearly 24% in 2011, and imports by 4%. A potential trade surplus of over $2 billion in 2011 could lead to a current account surplus of 3.4% of GDP.

Long-term growth prospects are enhanced by the long-awaited agreement signed in December 2010 for the ambitious Turkmenistan–Afghanistan–Pakistan–India gas pipeline. While security challenges in two of the countries pose risks to construction and operation, the four countries have targeted a gas delivery date by 2015. On completion, the pipeline will deliver 33 billion cubic meters annually and increase Turkmenistan's total gas exports to Asia to over 90 billion cubic meters a year.

3.7.3 General government fiscal balance



Source: International Monetary Fund. 2010. *Regional Economic Outlook, Middle East and Central Asia*. October. http://www.imf.org

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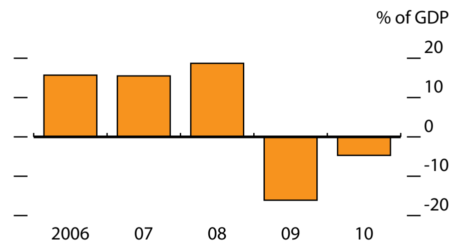
3.7.4 Current account balance



Source: International Monetary Fund. 2010. *Regional Economic Outlook, Middle East and Central Asia*. October. http://www.imf.org

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Development challenges

Highly dependent on exports of energy, Turkmenistan faces several challenges in diversifying the economy to high-value-added and technology-based goods and services. This requires numerous structural reforms—administrative, financial, and institutional, for example.

Successful diversification also requires efficient reallocation of resource revenue to productive sectors. The government will therefore have to make a thorough cost-benefit analysis and prioritize value-added investments, and, going beyond gas-related industries, create processing and manufacturing industries capable of generating new sources of income. Ongoing large government investment in mining, textiles, food processing, and tourism are a step in the right direction, but much more investment is required.

Turkmenistan also needs to develop a dynamic private sector. An adequate legal and regulatory framework for private business must be in place, along with an expanded banking sector that can provide financial capital. Additionally, the country needs to develop entrepreneurship and expertise in market principles in the public and private sectors.

3.7.1 Selected economic indicators (%)

	2011	2012
GDP growth	9.0	10.0
Inflation	5.0	6.0
Current account balance (share of GDP)	3.4	7.0

Source: ADB estimates.

Uzbekistan

Strong economic growth in 2010 was driven by expanded public investment, increased net exports, and a pickup in workers' remittances. The outlook is for sustained public sector–oriented growth, and continued strong fiscal and external positions. The authorities need to keep a close eye on inflation, though it is expected to remain moderate. Diversification from the commodity and energy sectors, alongside private sector development, would help to generate broad-based and sustained growth.

Economic performance

The economy continued to perform well in 2010, supported by the effects of a fiscal stimulus, the government's medium-term investment program, and the global economic recovery. Growth was driven mainly by industry (including construction) and services (Figure 3.8.1), with estimated annual growth rates of 8.3% and 11.6%, respectively.

In industry, growth was led by the chemical, machinery, light, and food industries, which together expanded by 12.0% and accounted for almost half of total industrial output. These industries benefited from the significant public investment and commercial bank lending provided under the government's 2009–2010 anticrisis and industrial modernization programs. The chemical and machinery industries are also attracting investment from Asia and the Middle East. Construction grew at 8.1%, largely due to government support to rural infrastructure and housing development, as well as greater foreign investment in hydrocarbons.

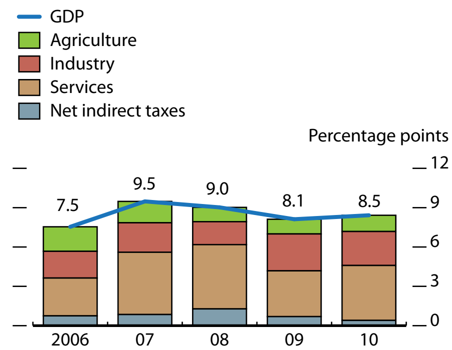
The expansion in services mainly reflected increases in government social spending for health care, especially in rural areas. Favorable weather and higher vegetable crop cultivation led to agricultural growth of 6.8%.

In 2010, the government continued implementing infrastructure programs aimed at developing rural areas and modernizing industry. The Fund for Reconstruction and Development (FRD) and state-owned banks allocated about $6.0 billion. Lending from commercial banks to the economy increased by one-third in 2010. Gross fixed capital investment rose by 9.2%, to the equivalent of around 30% of GDP (Figure 3.8.2). According to the government, about $3.9 billion, or 25.1%, was foreign.

The majority of foreign investment goes into fuel, energy, telecommunications, and automobile manufacturing. The government reported that it plans to attract up to $50 billion in foreign investment during 2011–2015. Notable projects include a joint venture with Daimler on bus assembly and expansion of production lines at GM Uzbekistan (a joint venture between General Motors and the state-owned Uzavtosanoat company). Under government initiatives to encourage use of natural gas in vehicles, a new joint venture between Uzbekistan and the Republic of Korea will construct gas compressor stations for cars.

In February and October 2010, the authorities raised utility prices

3.8.1 Contributions to growth (supply)



Sources: State Statistics Committee of Uzbekistan; ADB estimates.

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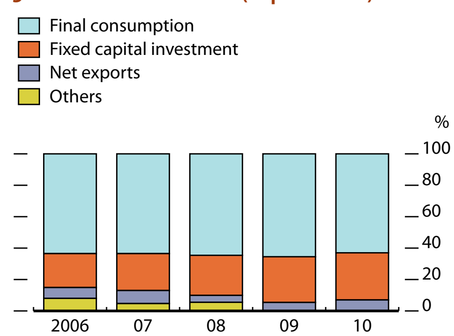
3.8.2 Structure of GDP (expenditure)



Note: Others refer to statistical discrepancy and changes in stocks.

Sources: Center for Economic Research. *Uzbekistan Almanac 2010*; ADB estimates.

Click here for figure data

This chapter was written by Iskandar Gulamov of the Uzbekistan Resident Mission, ADB, Tashkent.

for heating, hot water, and electricity by a cumulative 18%–30% in an attempt to bring them closer to cost-recovery levels. The increases, with depreciation of the local currency and a 30% annual hike in public wages and pensions, put upward pressure on inflation. The central bank sought to mitigate this pressure by slowing broad money growth to 34.6% from its peak of 43.8% in 2009. The government reported year-end inflation of 7.3%. The latest estimate from the International Monetary Fund for average inflation is 10.6% (Figure 3.8.3).

The local currency depreciated by 8.3% against the dollar in 2010. On 1 January 2011, the central bank reduced its benchmark refinancing rate from 14% to 12% to reduce the rates of loans provided under its programs for industrial modernization, rural housing construction, and small and medium-sized enterprises.

The general government budget is estimated to be in balance in 2010. Taking into account the FRD, the consolidated budget is estimated to have a surplus of 2.5% of GDP (Figure 3.8.4). The steep wage and pension hike, greater support for health care, as well as the rural development program have lifted budget spending to an estimated 34.6% of GDP. The government also provided tax exemptions for enterprises operating under investment and localization programs, but revenue gains from commodity exports and the utility price adjustments were enough to offset the increased expenditure.

In line with the policy of reducing direct taxation to encourage economic activity, in 2010 the government reduced the rates of both corporate and personal income taxes by 1 percentage point to 9% and 11%, respectively. The fiscal authorities also reduced the rate of the unified tax paid by micro and small firms from 8% to 7%. The share of direct taxes in GDP decreased from 7.1% in 2008 to an estimated 5.9% in 2010.

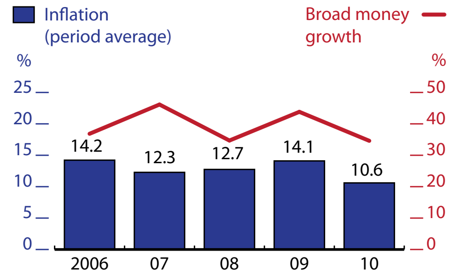
Reflecting the increased infrastructure development and subsequent rise in foreign financing, including government-guaranteed foreign debt, total external debt is estimated to have risen to 14.9% of GDP, slightly above the 2009 figure of 14.6%.

The international prices of gas, cotton, and gold, Uzbekistan's main export commodities, were historically high throughout 2010, leading to goods and services export growth of 10.8%. That growth was also aided by recovery in the Russian Federation, with the share of machinery, including passenger vehicles, in total exports more than doubling in 2010. Stronger growth in the Commonwealth of Independent States sharply boosted foodstuff exports.

The government reported that imports of goods and services fell by 6.8% in 2010. Imports of machinery and equipment, 44% of the total, dropped by 27.3%. Official import restrictions reduced imports, especially from countries in the Commonwealth of Independent States. Reflecting a pickup in global food prices as well as stronger consumption demand, the share of foodstuffs in imports climbed from 10.3% in 2009 to 10.9% in 2010.

Remittances sent to Uzbekistan from the Russian Federation rose by an estimated 22% in 2010 to $1.4 billion (to around 3.7% of GDP), given the economic pickup in that country. Due to improved exports and remittances, the current account surplus is estimated to have increased to 15.6% of GDP in 2010, from 11.0% of GDP in 2009 (Figure 3.8.5).

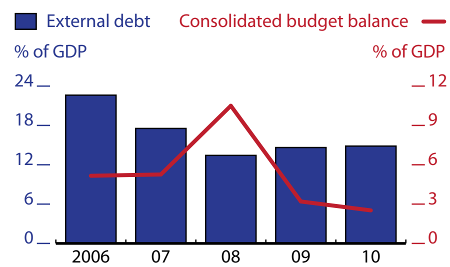
3.8.3 Inflation and money supply



Sources: International Monetary Fund. 2010. *Regional Economic Outlook: Middle East and Central Asia*. October. http://www.imf.org; ADB estimates.

Click here for figure data

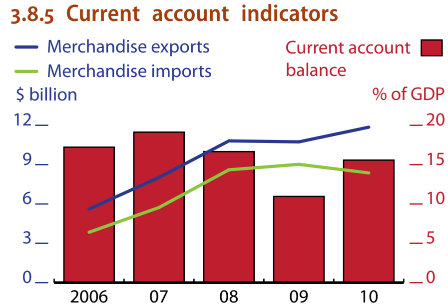
3.8.4 Fiscal and debt indicators



Sources: International Monetary Fund. 2010. *Regional Economic Outlook: Middle East and Central Asia*. October. http://www.imf.org; ADB estimates.

Click here for figure data

3.8.5 Current account indicators



Sources: International Monetary Fund. 2008. *Article IV Consultation*. July. http://www.imf.org; ADB estimates.

Click here for figure data

Economic prospects

Greater investment and infrastructure development will sustain GDP growth at 8.5% in 2011 and 8.4% in 2012. Industry (particularly construction) and services are expected to be the major contributors. Industrial output will be driven by domestic lending and foreign investment, while services will expand in line with higher domestic demand. Increasing lending coupled with favorable international prices will stimulate output of energy, machinery, and metals. Agriculture is expected to be driven by higher vegetable and fruit output, while grain production will improve moderately.

The share of investment in GDP is expected to climb rapidly in the forecast period, partly because the government is seen pursuing the infrastructure development programs faster. On 15 December 2010, it adopted a presidential decree that envisages spending $30 billion on 259 industrial projects and $23.1 billion on new construction in 2011–2015. Most financing for both sets of programs is planned to come from enterprises' own resources, loans from domestic banks, and FRD resources.

The government plans to direct up to 60% of budget spending ($6.2 billion) toward social programs—outlays on which are expected to rise by 14%—at the same time as raising allocations for investment (by 37%). It is also seen further reducing the tax burden and strengthening revenue collection. The consolidated budget, including the FRD, is forecast to post a surplus of 2.4% in 2011 and 2.0% in 2012.

Higher public sector wages and social payments alongside a gradual recovery in remittance inflows will sustain domestic consumption, as will government plans to create many jobs through infrastructure. Higher import costs, a more accommodative fiscal policy, and further depreciation of the local currency will stoke price pressures in 2011–2012. To counter them, the authorities are likely to adopt a monetary policy that slows money supply growth. Inflation is forecast at 8.8% in 2011 and 8.5% in 2012.

International prices for gold and cotton are seen peaking in 2011, but staying high. Uzbekistan's export prices for natural gas, which have approached international levels, are likely to stay at these high levels. Exports are forecast to grow at 14.0% in 2011 and 3.1% in 2012, supplemented by a gradual improvement in remittance inflows. The steep rise in public investment will likely offset the slower export growth in 2012 in terms of contribution to GDP.

Growth in imports will be driven by expansion of infrastructure development and by increases in global energy and food prices. Since machinery and equipment are the main import items, the post-2011 investment surge will drive imports even higher. Import growth is therefore put at 11.9% in 2011 and 16.3% in 2012. The current account surplus is projected at 16.3% and 12.6% of GDP.

The downside external risks to the forecasts are related to the pace of economic recovery in Uzbekistan's main trading partners as well as uncertainty in global financial markets. The immediate challenge is to manage rising pressures from fiscal expansion and global food price increases. To prevent unwanted fiscal-led pressure on monetary policy, the authorities are ready to adapt the structure of budget expenditure and the pace of nominal depreciation of the currency.

3.8.1 Development challenges

With one eye on the long-term goal of diversifying the economy, the government has designated 2011 as the year of small businesses and private entrepreneurs.

According to official statements, these two groups contributed more than half of total GDP and employed more than 70% of the total labor force in 2010. The central bank reported that total lending to both groups jumped by 40% that year to $1.7 billion. As well as lowering taxes, the government's program for 2011 targets better access to capital for them and simpler reporting requirements.

Sources of export income, too, need to be broadened and natural resources prudently managed, as the current resource-based approach is susceptible to volatility in global commodity prices.

Effective banking supervision and improved prudential banking requirements will help to guard against potential risks associated with rapid credit growth and greater commercial bank lending to state-owned enterprises.

Improving access to credit for small and medium-sized enterprises will widen the range of banking assets while benefiting the broader population through job opportunities.

3.8.1 Selected economic indicators (%)

	2011	2012
GDP growth	8.5	8.4
Inflation	8.8	8.5
Current account balance (share of GDP)	16.3	12.6

Source: ADB estimates.