CAUCASUS AND CENTRAL ASIA

Economic activity remained strong in the first half (H1) of 2023, driven by domestic demand, though growth slowed in every country except Kazakhstan and Tajikistan, compared to H1 2022. Inflation accelerated in Kazakhstan but slowed in the other seven countries as import prices stabilized, allowing some easing of monetary policy. The outlook remains dependent on external factors, including growth in key trade partners, oil prices, the pace of remittances and private transfers, and inflows of tourists and migrants from the Russian Federation.

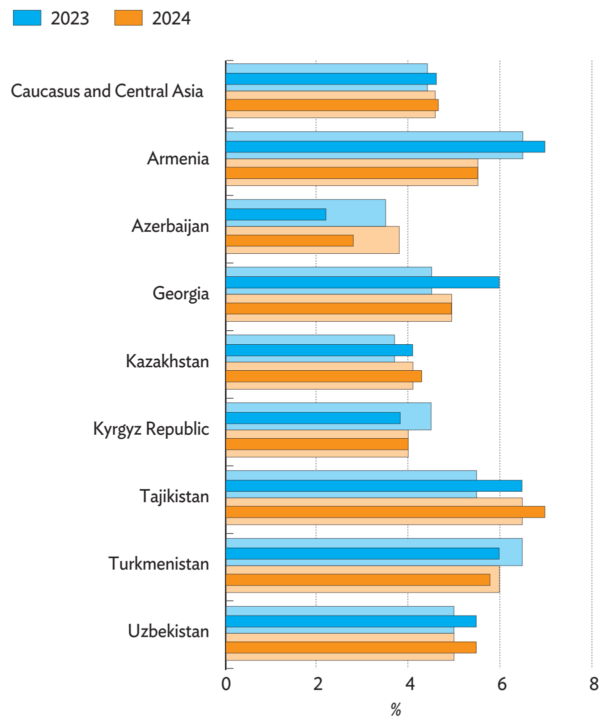
Subregional Assessment and Prospects

Subregional growth is projected to fall from 5.1% in 2022 to 4.6% in 2023 and then inch up to 4.7% in 2024. Compared with projections in *Asian Development Outlook April 2023* (*ADO April 2023*), the forecast for average annual growth has been upgraded by 0.2 percentage points for 2023 and by 0.1 percentage points for 2024, reflecting a better outlook in several economies than earlier expected (Figure 2.1.1). The upward revision accommodates domestic demand that beat expectations in Armenia, Georgia, Kazakhstan, Tajikistan, and Uzbekistan. It reflects robust tourism and migrant flows from the Russian Federation, which continue to fuel consumption in Armenia and Georgia; fiscal stimulus in Kazakhstan and Uzbekistan; monetary policy easing in Armenia, Georgia, and Tajikistan; and higher inward money transfers in Georgia and Tajikistan. Growth forecasts have been trimmed for Azerbaijan, where lower oil production weighs on the outlook, the Kyrgyz Republic amid a slowdown in gold production, and for Turkmenistan.

Kazakhstan, the largest economy in the subregion, remained resilient in H1 2023. Economic growth was driven by expansionary fiscal policy, higher oil production, and a robust economy outside of the large

Figure 2.1.1 GDP Growth in the Caucasus and Central Asia

Strong growth during the first half of 2023 in a majority of countries prompt an upward revision in growth forecasts.



GDP = gross domestic product.

Note: Lighter colored bars are *Asian Development Outlook April 2023* forecasts.

Source: *Asian Development Outlook* database.

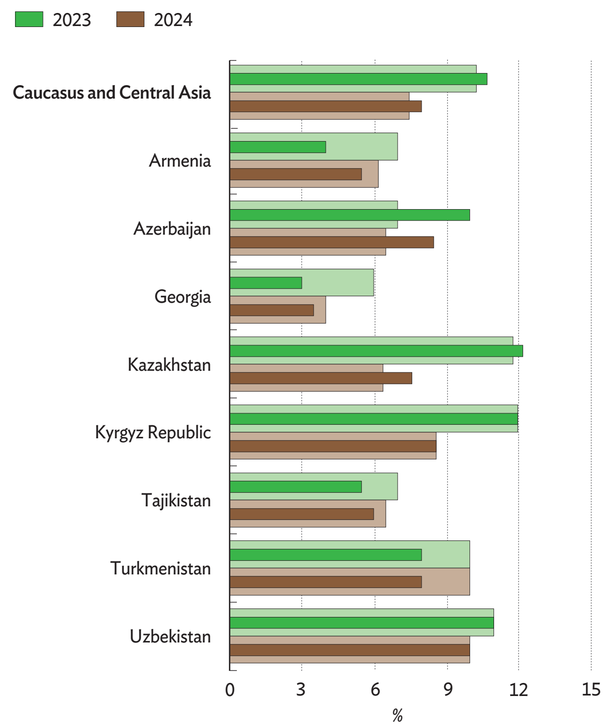
The subregional assessment and prospects were written by Lilia Aleksanyan. Kazakhstan was written by Genadiy Rau, and the other economies by Muhammadi Boboev, Begzod Djalilov, Grigor Gyurjyan, Jennet Hojanazarova, Gulnur Kerimkulova, George Luarsabishvili, and Nail Valiyev; and Shuhrat Mirzoev, consultant. All authors are in the Central and West Asia Department.

petroleum industry. Oil production expanded but still remained below Kazakhstan's voluntary quota agreed with the Organization of the Petroleum Exporting Countries (OPEC). Beyond oil, construction grew by double digits in H1 2023, driven by programs to modernize state infrastructure and support housing, while services accelerated in line with increased private and public consumption. Elsewhere, in Azerbaijan, a steady decline in oil production in H1 2023 trimmed the growth outlook despite robust gas exports. In Armenia, growth led in 2022 by expansion in construction and services continued at a slightly reduced pace in H1 2023. Tourism, consumption, and investment remained strong drivers of growth despite declining net inflow of money transfers from the Russian Federation. Georgia's economy also continued to perform well in H1 2023, helped by expansion in construction and services, steady tourism revenue, trade, and continuing financial inflows from Russian migrants, which have strengthened the Georgian lari. In the Kyrgyz Republic, a drop in gold production in H1 2023 trimmed growth, while in Tajikistan a surge in remittances from a rising number of migrant workers helped sustain unexpectedly strong growth. In Uzbekistan, growth in H1 2023 was higher than anticipated because of continued fiscal support, resilient trade, strong expansion in industry including mining, and robust investment. Consumption, meanwhile, was slowed by persistent double-digit inflation. In Turkmenistan, elevated inflation in H1 2023 continued to hold down real incomes and private consumption, prompting slightly lower growth forecasts.

Subregional inflation is expected to decelerate from 12.9% in 2022 to 10.6% in 2023 and further to 8.0% in 2024. This is a slight upward revision of 0.3 percentage points for the 2023 forecast and 0.5 points for 2024 (Figure 2.1.2). It reflects higher inflation forecasts in Azerbaijan and Kazakhstan for both 2023 and 2024. In Kazakhstan, inflation accelerated—despite some appreciation of the Kazakhstan tenge and the central bank's maintenance of a high policy interest rate—to reach an average of 17.2% year on year in the first 7 months of 2023. With an expected rise in domestic fuel and utility tariffs, more robust economic activity, and higher government spending under a revised budget, average annual inflation is expected to slow to 12.7% in 2023, not 11.8% as forecast in *ADO April 2023*, and to 7.6% in 2024, not 6.4% as forecast in *ADO April 2023*.

Figure 2.1.2 Inflation in the Caucasus and Central Asia

Higher inflation in Azerbaijan and Kazakhstan prompt higher average projected inflation for the subregion.



Note: Lighter colored bars are *Asian Development Outlook April 2023* forecasts.
Source: *Asian Development Outlook* database.

In Armenia, Georgia, and Tajikistan, inflationary pressures eased faster than expected in the first 7 months of 2023, prompting downward revisions to inflation forecasts for 2023 and 2024. In Armenia, average annual inflation slowed from 8.3% to 3.6% in line with lower global commodity prices and tight monetary policy. In Georgia, average annual inflation slowed from 12.9% to 4.0%, reflecting a high base, lower commodity prices, and a stronger lari. In Tajikistan, inflation decelerated considerably, from 7.0% in H1 2022 to 3.0% a year later. In response to weaker inflation, the central banks of all three countries recently cut policy rates, with Armenia and Georgia relaxing tight monetary policy for the first time since 2020. In Turkmenistan, a slowdown in price inflation for imports, continued restrictive monetary policy, and price controls are expected to ease inflation more quickly than foreseen in April. In the Kyrgyz Republic and Uzbekistan, inflation forecasts remained unchanged. In Uzbekistan, inflation accelerated from

10.6% in H1 2022 to 11.0% in H1 2023 on higher wages and pensions and will remain elevated throughout the year with expected hikes in energy tariffs. In the Kyrgyz Republic, inflation decelerated slightly from 13.0% in the first 7 months of 2022 to 12.4% a year later, but an electricity tariff hike and expansionary fiscal policy kept it above the central bank target.

External account developments in the region have been dominated by oil production and prices, exports, and money transfers. Despite moderately rising oil production, lower oil prices will further weaken the current account balance in Kazakhstan, which is likely to revert to deficit at the end of the year, but not in Azerbaijan, where oil prices, though declining, are still high enough to keep the current account in surplus. As Armenia and Georgia see money transfers and trade in services normalize, their current account deficits will likely widen, as in Uzbekistan with declining remittances. In Tajikistan, by contrast, continued strong remittances will help narrow the current account deficit. Despite the Kyrgyz Republic's resumption of gold exports, the current account will remain in substantial deficit as imports surge.

Risks to the outlook remain largely on the downside. Uncertainty and risks to the subregional outlook remain high, notably spillover from a slowdown in Russian economic growth and a further decline in oil prices. Any economic contraction in the Russian Federation in 2023 or 2024 would significantly affect the outlook across the Caucasus and Central Asia, but particularly for countries that depend heavily on migrant remittances. Oil market developments, including price changes and OPEC-mediated production curbs, will weigh on economic activity in oil exporters, with spillover effects on the rest of the region. Disruption to core Caspian Pipeline Consortium infrastructure could affect exports and growth in Kazakhstan.

Kazakhstan

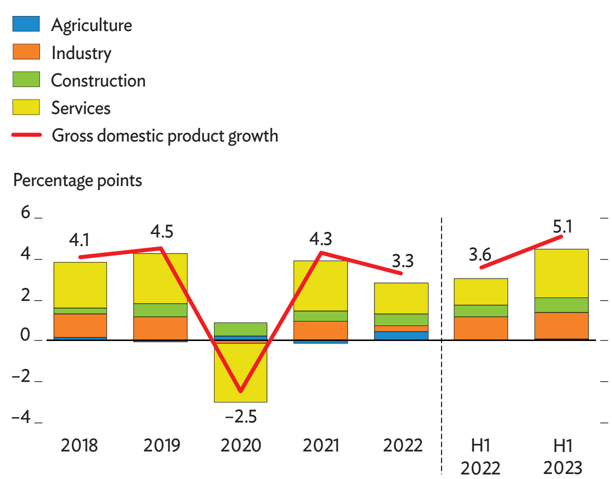
Economic growth accelerated in the first half (H1) of 2023, supported by expansionary fiscal policy and strong global demand for commodities. Because higher spending on infrastructure modernization and social programs lifted consumption and investment more than anticipated, this update revises growth forecasts in both 2023 and 2024. Meanwhile, government-approved petroleum and utility price increases indicate more persistent inflation than projected in *ADO April 2023*.

Updated Assessment

Procyclical fiscal policy supported economic expansion. GDP growth accelerated from 3.6% year on year in H1 2022 to 5.1% a year later (Figure 2.1.3), reflecting higher mineral extraction and increased outlays for infrastructure and social protection financed by export revenue and higher transfers from the National Fund for the Republic of Kazakhstan (NFRK), the sovereign wealth fund. Growth in services rose from 2.6% to 4.9%, driven primarily by increases of 10.4% in wholesale and retail trade, 8.8% in communication, and 7.4% in transport, these gains reflecting low bases as curfews and lockdowns kept activity low in H1 2022. Mining growth similarly rose from 1.9% to 3.7%, with output increasing by 5.6% for oil, 2.5% for gas, and 17.4% for other minerals.

Figure 2.1.3 Supply-Side Contributions to Growth

Growth in the first half of 2023 was higher than a year earlier.



Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics.

Oil production cuts voluntarily agreed with the Organization of the Petroleum Exporting Countries (OPEC) in April did not affect Kazakhstan, which has been increasing oil production since March 2022 while remaining below its quota. Expansion in manufacturing still benefited from firms relocating from the Russian Federation but slowed from 5.8% year on year in H1 2022 to 3.5%. Growth in construction accelerated from 9.2% to 12.3%, strongly supported by state programs to modernize infrastructure and support housing. In March 2023, the government allocated a further $320 million to modernize the country's aging heating supply infrastructure before next winter. Agriculture expanded moderately, as expected, with growth up from 1.4% year on year in H1 2022 to 3.2%.

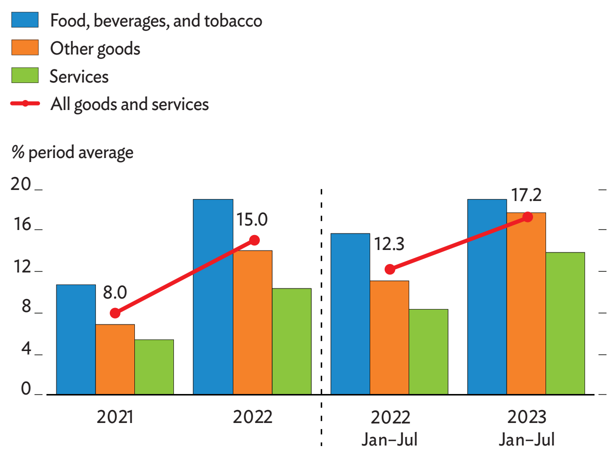
Higher consumption and investment offset a decline in net exports. Demand-side data, available only for the first quarter of 2023, show consumption reversing 1.9% contraction year on year in the first quarter to grow by 9.5% as private consumption grew by 9.8% and public consumption by 8.4%. Strong infrastructure and housing support boosted overall investment by 29.8%. However, net exports declined as growth in imports of goods and services rose by 31.9% and exports by only 4.0%.

High inflation prompted the National Bank of Kazakhstan, the central bank, to revise its inflation target. Average inflation accelerated from 12.3% in the first 7 months of 2022 to 17.2% a year later, reflecting price increases of 19.0% for food, 17.8% for other goods, and 13.9% for services (Figure 2.1.4). The government approved increases in state-regulated prices of 7.0% for regular gasoline and 15.6% for utilities. A July 2023 survey commissioned by the central bank found respondents expecting, on average, annual inflation to reach 16.9%. The central bank reset its inflation target to 5% in the medium term, phasing out its earlier inflation corridor of 4%–5% for 2023–2024. At the same time, it forecast inflation at 11%–14% in 2023 and 9%–11% in 2024, eventually falling to the targeted 5% after 2025.

Monetary policy remained tight and the exchange rate stable. After raising the key policy rate several times in 2022, the central bank kept it unchanged at 16.75% in H1 2023. The Kazakhstan tenge fluctuated mildly and gradually appreciated by 1.8% against the US dollar in the period (Figure 2.1.5), with no central bank interventions reported since May 2022.

Figure 2.1.4 Average Inflation

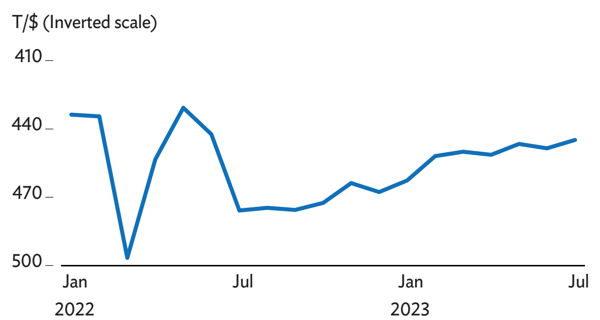
Inflation accelerated sharply in the first half of 2023.



Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics.

Figure 2.1.5 Exchange Rate

The Kazakhstan tenge has been far more stable against the US dollar this year, gradually appreciating to July 2023.



US = United States.

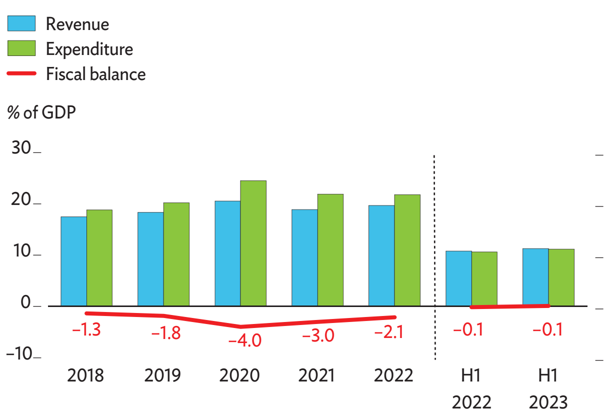
Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics.

During H1 2023, the central bank converted $3.5 billion of NFRK foreign exchange receipts to tenge before transferring them to the state budget. In July 2023, the government reduced the mandatory sale of foreign exchange earnings from 50% of state enterprise earnings to 30%. Following a 13.9% surge in broad money supply over the full year 2022, it expanded by only 1.2% in H1 2023. In the period, deposits grew by 2.8%, and credit by 5.9%, with lending increases of 2.2% to firms, 5.7% for mortgages, and 10.1% for other consumer credit. Foreign currency deposits declined by 13.1% to account for 25.6% of all deposits, while deposits in tenge rose by 9.7%. The share of nonperforming loans increased slightly, from 3.4% at the end of 2022 to 3.6% in June 2023.

State budget dependence on transfers and borrowing persisted. In H1 2023, state budget expenditure was 26.7% higher than in the same period of 2022 (Figure 2.1.6). Government spending rose by 25.8% for education, 28.1% for social services, and 15.2% for health care, such that social expenditure constituted more than half of the budget outlays, even as expenditure on construction and energy infrastructure almost doubled from a low base. In the first 6 months of 2023, tax revenue grew by 25.5% on increases of 41.8% from value-added tax, 27.2% from personal income tax, and 21.0% from corporate tax. Yet the budget remained vulnerable to volatile extractive industry revenue and took a hit as oil export duty receipts declined in H1 2023 by 14.4% because of lower average oil prices on the global market. The higher expenditures are financed by an additional $1.7 billion in NFRK transfers approved in March 2023 and a 68.6% rise in borrowing for the year.

Figure 2.1.6 Fiscal Indicators

Both revenue and expenditure increased in the first half of 2023.



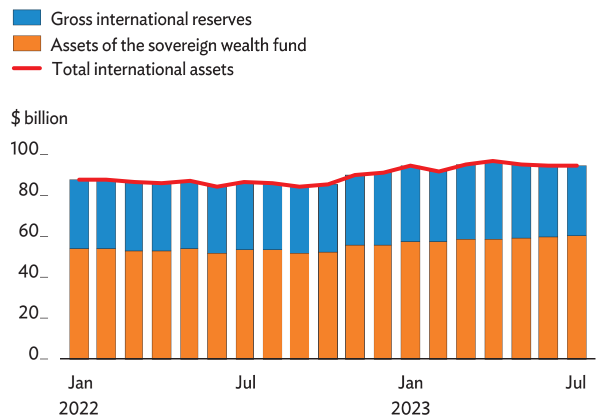
GDP = gross domestic product, H1 = first half.

Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics.

External debt as a share of GDP fell to a decade low. Gross foreign exchange reserves declined by 1.8% to $34.4 billion in June 2023 (Figure 2.1.7), of which 55.7% were in monetary gold. Reserves provided cover for 6.2 months of imports of goods and services. In H1 2023, receipts to the NFRK declined by 28.1% from the same period in 2022 as tax payments from oil companies slid in line with lower oil prices. However, NFRK assets increased to an estimated $59.8 billion as budget transfers were 11.0% lower than in the same period last year. By the end of March 2023, nominal external debt had risen to $161.4 billion, equal to 69.4% of GDP. Intercompany debt, primarily for oil and gas projects, had declined to $92.8 billion, or 39.9% of GDP (Figure 2.1.8), with $16.6 billion coming due in 2023. Public sector external debt declined to $30.7 billion, or 13.2% of GDP, with $3.6 billion due this year.

Figure 2.1.7 Foreign Currency Reserves and Sovereign Wealth Fund Assets

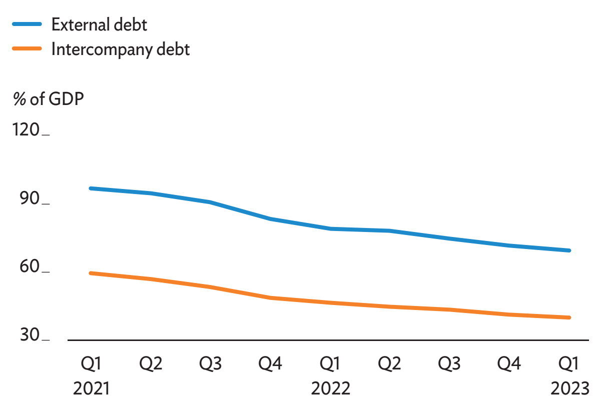
Gross reserves declined from January to July 2023, while sovereign wealth fund assets increased.



Source: National Bank of the Republic of Kazakhstan.

Figure 2.1.8 External Debt and Intercompany Debt

External and intercompany debt declined in tandem.



GDP = gross domestic product, Q = quarter.

Source: National Bank of the Republic of Kazakhstan.

The current account reverted to a deficit. Preliminary estimates for H1 2023 indicate a current account deficit of $3.6 billion, equal to 1.4% of GDP, as the trade surplus in goods fell by half. Despite moderately rising oil production, merchandise exports declined by 10.6% to $38.5 billion, reflecting a 25% decline in Brent oil prices. Merchandise imports grew by 32.1% to $28.7 billion on higher imports of footwear, textiles, and leather goods. Lower export earnings reduced foreign investors' profits by 6.8% to $12.0 billion.

Prospects

Rising incomes will boost consumption. On the demand side, consumption is now projected to expand by 3.9% in 2023, revised up from 1.6% in *ADO April 2023*, and by 3.6% in 2024. This trend reflects nominal household income rising by 17.1% year on year in the second quarter of 2023 and higher government expenditure. Increased government investment in infrastructure modernization will boost gross capital formation by 9.1% in 2023. Lower prices for major export commodities and rising imports will drive down net exports.

Services and industry will lead broad-based growth on the supply side. The forecast for growth in services this year is revised up from 3.3% in *ADO April 2023* to 4.2% on anticipated expansion in trade, transport, and communications. Government efforts to attract foreign direct investment in mining and manufacturing are expected to increase local production, while the government's continuing programs to support housing and modernize infrastructure will boost construction. However, escalating trade and investment sanctions on the Russian Federation, a main trade partner, pose downside risks to the outlook (Table 2.1.1 and Figure 2.1.9).

Table 2.1.1 Selected Economic Indicators in Kazakhstan, %

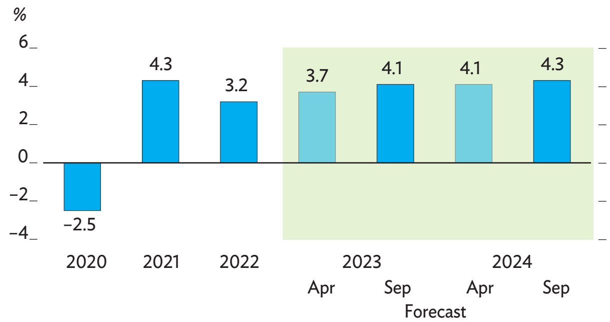
Procyclical fiscal policy supports higher forecasts for growth, and higher utility and petroleum prices indicate more persistent inflation.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	3.2	3.7	4.1	4.1	4.3
Inflation	15.0	11.8	12.7	6.4	7.6

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Figure 2.1.9 GDP Growth

Procyclical fiscal policy supports higher forecasts for growth.

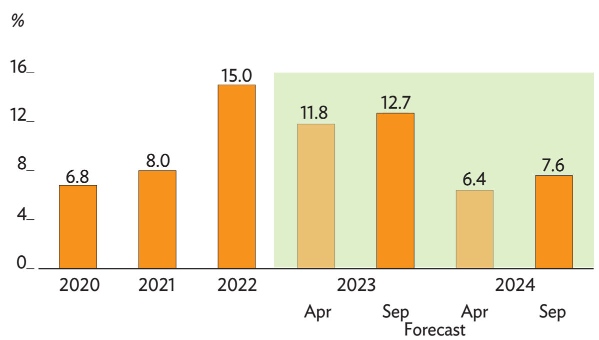


GDP = gross domestic product.
Source: *Asian Development Outlook* database.

Inflation will diminish gradually but remain above the central bank target. Government-approved hikes in petroleum prices and utility tariffs have raised the cost of producing and transporting goods. In addition, procyclical fiscal policy has adding to inflationary pressure despite continued tight monetary policy. This update therefore raises inflation projections for both 2023 and 2024, but still on an easing trend (Figure 2.1.10).

Figure 2.1.10 Inflation

Higher utility and petroleum prices indicate more persistent inflation.



Source: *Asian Development Outlook* database.

Higher expenditure will outpace growth in tax revenue. March 2023 amendments to the state budget increased state budget expenditure from 21.3% of GDP this year, as projected in *ADO April 2023*, to 23.0%. The revenue forecast is also raised, from 18.7% of GDP to 20.0%, reflecting higher projected tax revenue and a decision to boost transfers from the NFRK by a quarter. The 2023 budget deficit will remain equal to 3.0% of

GDP as the non-oil deficit rises from 7.2% of GDP to 7.8%. Government and government-guaranteed debt will remain at about 25% of GDP in the forecast period.

The current account will return to deficit. The merchandise trade surplus will fall by a third in 2023 in tandem with lower commodity prices before rebounding in 2024. The service deficit will gradually deepen despite higher earnings from cargo transit, while the primary income deficit will fluctuate along with petroleum earnings.

Strong export earnings will facilitate debt repayment and increase reserves. Despite higher transfers to the budget, NFRK assets at the end of 2023 will exceed the $58.0 billion forecast in *ADO April 2023* to reach $59.0 billion, equal to 26.3% of GDP. Similarly, higher oil prices and production are projected to push assets by the end of 2024 past the earlier forecast of $60.0 billion to $62.0 billion. Projections for gross international reserves are revised down to $34.5 billion at the end of 2023, providing cover for 6.2 months of imports of goods and services, and $36.4 billion at the end of 2024. Assuming continued exchange rate stability, and that oil and mining companies use windfall profits to repay intercompany debt, external debt including intercompany debt is now forecast lower, falling from the equivalent of 69% of GDP at the end of 2023 to 67% a year later, both projections 5 percentage points lower than forecast in April.

Other Economies

Armenia

Growth moderated slightly but remained in double digits. It slowed from 11.1% in the first half (H1) of 2022 to 10.5% in H1 2023, buoyed by still-robust domestic demand. On the supply side, growth in services moderated from 14.9% to 14.2% as rapid gains in a few components—notably information technology at 63.1%, trade at 22.8%, and real estate at 10.4%—were offset by slower growth or declines in other services. Industry excluding construction grew by a mere 0.3% as gains in manufacturing and utilities marginally outweighed a 3.0% decline in mining and quarrying. Construction grew by 19.2% on higher private construction and public investment for roads and social infrastructure. Agriculture contracted by 0.2% as lower livestock output offset gains in crop production. On the demand side, growth in private consumption slowed from 10.3% to 6.7% as net money transfer inflow decreased, and despite lower inflation. Public consumption reversed a 2.6% decline in H1 2022 to grow by 16.1% on public salary increases in January 2023 and higher social spending. Gross fixed capital formation improved on 17.7% growth in H1 2022 with 20.1% a year later, reflecting higher public and private investment. With still-robust expansion in H1 2023 and continued higher spending and investment, both public and private, this update raises the growth forecast for 2023 (Table 2.1.2). It maintains the forecast for 2024, assuming some moderation in domestic and external demand.

Table 2.1.2 Selected Economic Indicators in Armenia, %

Robust growth in the first half of 2023 and heavy investment spending prompt a higher growth projection for 2023, while sharply slower inflation supports lower inflation forecasts for 2023 and 2024.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	12.6	6.5	7.0	5.5	5.5
Inflation	8.6	7.0	4.0	6.2	5.5

GDP = gross domestic product.
Sources: Asian Development Bank estimates.

Inflation fell sharply despite strong aggregate demand. Average annual inflation slowed from 8.3% in the first 7 months of 2022 to 3.6% a year later, in line with waning impact from exogenous shocks last year. Prices rose by 2.6% for food and 2.8% for other goods, offsetting a 5.4% increase for services. Despite buoyant aggregate demand, falling prices for goods—in particular lower import prices with a relatively stable exchange rate—brought deflation at 0.1% month on month in July 2023. With annualized inflation below the 2.5%–5.5% target based on month-to-month data, the Central Bank of Armenia lowered its refinancing rate by a cumulative 50 basis points in two steps in June and August 2023 to 10.25%, the first decreases since the third quarter of 2020. As inflation slowed more than expected in H1 2023, this update reduces inflation forecasts for 2023 and 2024.

Fiscal policy continued to support domestic demand. Budget revenue grew by 18.1%, reflecting solid growth and higher tax collection. Current expenditure rose by 12.1%, primarily on higher social spending and salaries. Capital outlay grew by 18.0% but fell below the semiannual budget target by 46.7%. With the budget surplus in H1 2023 at about $350 million, equal to 2.9% of GDP, the fiscal deficit this year is now projected to be less than the planned equivalent of 3.1% of GDP.

The current account deficit widened from 6.0% of GDP in the first quarter of 2022 to 7.7% a year later. The causes were a larger trade deficit and a deeper deficit in the balance of private transfers, which more than offset a surplus in services. As a percentage of GDP, the trade deficit widened from 12.9% to 14.9% because imports grew more than exports in absolute amounts, although exports, which have been smaller than imports, grew at a slightly faster rate (98.2% versus 89.7%). Imports and exports are expected to moderate somewhat in the rest of this year, narrowing the trade deficit and the current account deficit, as higher transfers and gains from tourism, transportation, and information and communication technology offset part of the larger deficit in goods.

Azerbaijan

A continued decline in oil production cut growth. Weaker performance in hydrocarbons slashed growth from 6.2% in the first 7 months of 2022 to 0.7% a year later. Mining reversed 0.8% growth to contract by 3.4% as oil output fell by 7.7%, and despite a 3.3% rise in gas production. Manufacturing grew by 11.2%, reflecting gains in petrochemicals and food processing. Higher investment boosted growth in construction from 8.7% in the first 7 months of 2022 to 13.2%. Expansion in agriculture, driven mainly by livestock production, was unchanged at 3.3%. Growth in services slowed substantially, from 10.6% to 1.6%, as a 10.5% decline in transportation offset much of a 28.4% gain in hospitality from higher tourist inflows.

Domestic demand remained robust, supported by private and public consumption. Higher household income boosted private consumption by 5.1% in the first half of 2023, though continued double-digit inflation may curb real incomes and consumption later in the year. Public consumption accelerated on higher spending for social services and will remain robust to the end of 2023. Investment rose by 10.4%, led by projects outside of the large hydrocarbon industry. Net exports contracted as imports outgrew exports in the first 5 months of 2023. In light of slower growth in hydrocarbons and tight monetary policy, this update forecasts a deeper slowdown in 2023 and 2024 (Table 2.1.3).

Table 2.1.3 Selected Economic Indicators in Azerbaijan, %

Continued decline in oil production prompts a projection for a deeper growth slowdown in 2023 and 2024, while unexpectedly high inflation in the first part of 2023 supports a forecast for more persistent inflation.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	4.6	3.5	2.2	3.8	2.6
Inflation	13.9	7.0	10.0	6.5	8.5

GDP = gross domestic product.
Sources: Asian Development Bank estimates.

Inflationary pressures persist despite monetary tightening. Inflation declined from 13.0% year on year in the first 7 months of 2022 to 12.2% a year later with some moderation in food price inflation, from 18.7% to 14.3%, in line with diminishing global food prices. Inflation for other goods rose, however, from 7.0% to 11.0% and for services from 10.1% to 10.4%. With these developments, this update raises inflation projections for 2023 and 2024. To address inflation, the central bank raised the policy interest rate from 8.25% to 9.0% in three steps from January to May, and the government established a working group to monitor prices and recommend ways to curb inflation and achieve price stability.

The fiscal outlook has improved but remains dependent on oil prices. Elevated oil prices and tax collections early in 2023 boosted revenue more than expected. This prompted the government in June 2023 to raise planned 2023 expenditure by 9.2% through increased public investment and social spending. This should help sustain demand. Credit to the economy grew by 8.8% in the first 7 months of 2023, but broad money declined by 2.2% as a 28.5% drop in foreign currency deposits more than offset higher domestic currency deposits. The share of deposits in local currency rose to 64.4%.

High oil prices drove the current account to a surplus equal to 10.0% of GDP in the first quarter of 2023. However, the merchandise trade surplus declined from $5.4 billion in the first quarter of 2022 to $4.7 billion a year later as imports picked up by 40.5% and oil exports declined by 10.4%, with export volumes remaining below Azerbaijan's quota agreed with the Organization of the Petroleum Exporting Countries and other exporters (OPEC+). The current account is forecast to remain in surplus, reflecting a decision by OPEC+ to raise oil prices by tightening supply. Assets of the State Oil Fund of the Republic of Azerbaijan, the sovereign wealth fund, rose by 12.0% from the end of 2022 to $54.9 billion, while the central bank's reserves reached $9.2 billion, bringing total strategic reserves to $64.1 billion, or about twice GDP.

Georgia

Growth has moderated but remains robust, supported by tourism and financial inflows. Growth moderated from 10.6% in the first half of 2022 to 7.6% a year later as industry contracted by 0.7% and agriculture by 2.3%, and despite strong growth in construction at 15.1% and services at 10.2%. Expansion in services reflected increases of 14.0% in wholesale and retail trade, 15.7% in accommodation and food services, 44.2% in information and communication, and 17.2% in arts, entertainment, and recreation, much of this reflecting a recovery in tourism. On the demand side, growth came from strong domestic demand, reflecting high consumer spending on goods and services, particularly by Russian migrants, and continued revival in investment and tourism. Foreign direct investment remained high at nearly $500 million in the first quarter of 2023, and the unemployment rate declined by more than 3 percentage points to 17.3%. Such encouraging figures prompt this update to raise the growth forecast for 2023 but not for 2024, in light of an expected return to growth potential and possible fallout from slowing global expansion (Table 2.1.4).

Table 2.1.4 Selected Economic Indicators in Georgia, %

Strong growth and lower inflation in the first half of 2023 prompt a higher growth projection for 2023 and lower forecasts for inflation in 2023 and 2024.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	10.1	4.5	6.0	5.0	5.0
Inflation	11.9	6.0	3.0	4.0	3.5

GDP = gross domestic product.

Source: Asian Development Bank estimates.

Inflation has fallen below target, helped by a relatively stable Georgian lari and prudent macroeconomic policies. With inflation year on year continuing to decline to 0.3% in July 2023, average annual inflation slowed from double digits throughout 2022 to 4.0% in 2023 to July despite increases of 7.3% for food, 24.9% for rental housing, and 12.1% for hospitality. Apart from a high base in 2022, slower inflation reflected lower import prices and transport costs with increased transit volume, strong foreign currency inflow that supported the lari, continued fiscal consolidation, and tight monetary policy that kept the policy rate high at 10.25% despite a 0.25% cut in August. Core inflation—which excludes food, nonalcoholic beverages, energy, regulated tariffs, and certain transport charges—slowed from 6.9% in December 2022 to 3.2% in July 2023. The National Bank of Georgia, the central bank, increased reserves to more than $5.0 billion, which the International Monetary Fund declared adequate. With inflation decelerating, this update cuts inflation forecasts for 2023 and 2024.

A small budget surplus in the first half of 2023 reflected strong revenue and ongoing fiscal consolidation. Revenue increased by 18.4% over the first half of 2022, outpacing 15.2% growth in public expenditure that saw substantial social spending and capital outlays for priority public infrastructure. Public sector debt remained low, equal to 39.8% of GDP, as strong economic growth and a relatively stable lari boosted GDP. While three-quarters of this debt is in foreign currency, much of external debt is on concessional terms or at fixed interest rates.

The current account deficit narrowed sharply from the equivalent of 13.3% of GDP in the first quarter of 2022 to 3.2% a year later. This reflected soaring money transfers and higher service surpluses from travel and from information and communication technology. Money transfer inflows, following a record high in 2022, increased in the first 7 months of 2023 at an annual rate of 27.5% to $2.7 billion, nearly half of it coming from the Russian Federation. In the same period, merchandise exports increased by 15.7% on strong vehicle reexports, and imports rose by 19.0% on high domestic demand and a relatively stable lari against the US dollar. In the first half of 2023, revenue from tourism increased by 57.9% year on year to reach $1.8 billion. Downside risks to the current account include, aside from domestic political polarization and geopolitical risks, a possible weakening of external demand, rising global interest rates that could constrain capital inflow, and a widening investment–savings gap.

Kyrgyz Republic

A slowdown in gold production cut growth during the first 7 months of 2023. GDP growth decelerated to an estimated 2.9% during the first 7 months of 2023 from 6.4% during the same period last year as industry contracted by 2.0%. Industry contraction reflected a decline in manufacturing as the production of metals, mainly gold, reversed a 46.7% increase to fall by 11.7%, as well as smaller gains in mining and quarrying. Growth in services accelerated to 4.6%, led by strong performance in wholesale and retail trade and in food and accommodation. Expansion in construction remained robust at 11.2%, reflecting higher domestic investment. Due to unfavorable weather, agriculture contracted by 1.7%, reversing 6.4% growth during the same period last year. On the demand side, with data available from only the first quarter, growth came from higher public consumption and gross fixed capital formation. Net money transfers from abroad including remittances fell by 28.5% year on year in the first half of 2023, likely moderating private consumption. With lower-than-expected growth in the first 7 months of 2023, this update reduces projected growth for 2023 but maintains the *ADO April 2023* forecast for 2024 amid the lagged effect of expansionary fiscal policy (Table 2.1.5). Risks remain on the downside. Growth could slow with any net reversal of capital inflows, lower than projected economic growth in the Russian Federation, lower remittances, or secondary sanctions. Alternatively, the outlook could improve on continued growth in trade and demand from an influx of expatriate Russians.

Table 2.1.5 Selected Economic Indicators in the Kyrgyz Republic, %

Growth was lower than expected in the first 7 months of 2023, prompting a downward revision for 2023 projections, while forecasts of inflation remain unchanged from ADO April 2023.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	6.3	4.5	3.8	4.0	4.0
Inflation	13.9	12.0	12.0	8.6	8.6

GDP = gross domestic product.

Note: GDP statistics were revised by the National Statistics Committee in June 2023 in line with the international standard of the System of National Accounts 2008.

Sources: National Statistics Committee of the Kyrgyz Republic; Asian Development Bank estimates.

Inflation subsided in the first 7 months of 2023 as global food and energy prices began to decline. Average annual inflation slowed from 13.0% in January–July 2022 to 12.4% a year later, decreasing from 15.2% to 11.1% for food but rising from 10.8% to 13.0% for other goods and from 8.8% to 10.5% for services. Average annual core inflation was 13.1% in January–July 2023. Factors contributing to continued inflation included expansionary fiscal policy and higher electricity tariffs and other administered prices. Inflation year on year declined from 15.3% in January 2023 to 10.3% in July 2023 but remained well above the 5%–7% target range of the National Bank of the Kyrgyz Republic, the central bank. Considering persistent uncertainty and elevated inflationary expectations, the central bank has kept its policy rate unchanged at 13.0% since the end of November 2022. To smooth volatility and avoid excessive swings in the exchange rate, the central bank sold $500.2 million in foreign exchange in January–July 2023, more than double sales in the same period of 2022. With slower growth in domestic demand expected, further depreciation of the Kyrgyz som likely, a poor harvest, and elevated core inflation, this update retains earlier forecasts for slowing but still high inflation in 2023 and 2024.

Continued strong tax collection offset the impact of slower growth and higher wage expenditure on the budget. The preliminary general government fiscal balance showed an estimated surplus equal to 1.2% of GDP in the first half of 2023, unchanged from the same period in 2022 and buoyed by energetic tax enforcement and higher value-added tax receipts from increased imports. Fiscal policy is expected to be more expansionary in the rest of this year, reflecting persistent demand for higher public expenditure alongside rising debt servicing cost, in line with expectations in *ADO April 2023*.

Data from the first quarter of 2023 show a massive current account deficit. Already large in 2022, the deficit widened to equal 45.0% of GDP as imports rose by 26.5% under supply chain restructuring in the subregion. At the same time, resumed shipments of gold concentrates boosted exports by 14.2%.

Tajikistan

Growth remains robust, only minimally disrupted by the Russian invasion of Ukraine. Economic expansion accelerated from 7.4% year on year in the first half (H1) of 2022 to 8.3% in H1 2023 as industry and services rebounded, and on sizable remittances from migrant workers in high demand in the Russian Federation. Industry surged by 24.4% on gains in electrical supply and manufacturing, in particular food processing, textiles, and clothing. Expansion in agriculture increased from 6.0% to 7.9% after good weather allowed spring crops to be sown early. Growth in services slowed from 12.8% year on year in H1 2022 to 5.5% a year later with lower growth in transportation, communication, and financial services, and despite large gains in wholesale and retail trade and hospitality services.

Growth has been supported by higher public and private investment. The average inflation-adjusted salary increase accelerated from 2.8% year on year in H1 2022 to 11.8% in H1 2023. Moreover, in March 2023 the government boosted salaries by 20%–25% for military and law enforcement personnel, followed by a 20% rise in July of base pensions and other social benefits—all of which lifted private consumption. Gross investment grew by 27.1% year on year during the first 6 months of 2023. With strong growth reported in H1 2023, this update raises growth projections for 2023 and 2024 (Table 2.1.6).

Table 2.1.6 Selected Economic Indicators in Tajikistan, %

Rapid growth in the first half of 2023 prompts upward revisions to projected growth in 2023 and 2024, while falling inflation supports lower inflation projections for both years, with both indicators still deteriorating somewhat from 2022.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	8.0	5.5	6.5	6.5	7.0
Inflation	4.2	7.0	5.5	6.5	6.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Inflation has decreased considerably. Inflation dropped sharply from 8.3% year on year in June 2022 to 2.4% in June 2023 as average inflation year on year fell from 7.0% in H1 2022 to 3.0%. Food price inflation rose slightly from 2.3% to 2.9% as prices for other goods rose by 2.3%. For services, 1.1% inflation reversed to 0.4% deflation, with planned utility tariff increases postponed to H2 2023. Inflation subdued, the National Bank of Tajikistan, the central bank, lowered its policy rate from 13.0% to 11.0% in February 2023 and to 10.0% in May, partly to boost investment and domestic spending. The Tajik somoni depreciated by 7.0% against the US dollar in H1 2023 but appreciated by 11.4% against the Russian ruble. In view of these developments, and despite upcoming utility tariff increases, this update reduces inflation projections for 2023 and 2024.

Higher revenue and a tight fiscal stance have improved the fiscal outlook. Following a small deficit last year, the government kept the deficit below the equivalent of 0.5% of GDP in H1 2023. Though a new tax code initially reduced revenue in 2022, tax revenue in H1 2023 exceeded original projections by 7.3% to reach 22.5% of GDP. Collection of many major taxes outpaced original projections, with corporate income up by 12.3% from H1 2022, value added by 6.5%, property by 9%, and excise by 32.6%. Expenditure was $1.7 billion in H1 2023, 10.1% shy of the original budget allocation and reflecting a tight fiscal stance. Public debt was $3.6 billion at the end of June 2023, having fallen from the equivalent of 34.8% of GDP at the end of 2022 to 31.1%.

Strong remittances narrowed the current account deficit. The merchandise trade deficit in H1 2023 nearly doubled year on year as exports declined by 44.2% to $0.7 billion while imports rose by 19.1% to $2.7 billion. However, remittances were strong enough to narrow the current account deficit by 28.7%, from 12.4% of GDP in H1 2022 to 7.8% in H1 2023. Gross international reserves rose from $2.5 billion to $3.8 billion, providing cover for 9 months of imports of goods and services.

Table 2.1.7 Selected Economic Indicators in Turkmenistan, %

The growth forecast for 2023 is revised down to align with government projections, and inflation is now forecast to be slower than in 2022.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	6.2	6.5	6.2	6.0	6.0
Inflation	10.0	10.0	8.0	10.0	8.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Turkmenistan

The government reported growth at 6.2% in the first half of 2023, slightly above 6.0% reported a year earlier. On the supply side, growth came from all sectors. Expansion in the large hydrocarbon economy came mainly from reportedly higher production and exports of natural gas, while the economy excluding gas and oil benefited from growth in construction, wholesale and retail trade, transport, and catering. As reported by the government, industry performance aside from hydrocarbons and construction reflected stable output in electricity, chemicals, textiles, food processing, and other agro-industrial products. Private firms engaged in import-substitution programs continued to receive substantial government support. According to half-year reports, strategic crops of cotton and wheat, as well as a large variety of horticultural produce, have been sown with the aim of meeting annual production targets. On the demand side, the government reported higher net exports and public investment in industrial and social infrastructure. At the same time, elevated inflation and constraints on employment continued to hold down real incomes and private consumption. With limited availability of official statistics and continued uncertainty about growth data, the update revises the growth projection for 2023 to align with the official forecast and maintains the projection for 2024 (Table 2.1.7).

Import price inflation appears to have stabilized. Observed prices for imported goods and for locally produced goods with imported components appear to have stabilized as of mid-2023. They remain high, however, and could rise further. Monetary policy remains focused on controlling inflation by sustaining the official exchange rate and price controls for certain goods and services. Access to foreign currency remains limited to priority firms in import substitution and export promotion, and a substantial difference persists between official and parallel market exchange rates. In view of these developments, this update slightly reduces inflation forecasts for 2023 and 2024.

The fiscal outlook remains dependent on revenue from hydrocarbon exports. The government aims to keep the state budget balanced in 2023 and 2024, benefiting from the positive outlook for energy exports. However, any assessment of the overall fiscal position is complicated by a lack of data and rising capital expenditure on government construction projects using extra-budgetary funds.

Growth in gas exports to the People's Republic of China in the first half of 2023 is estimated to have been stable. More generally, higher demand for gas exports to the People's Republic of China and other countries in the region may raise total exports in both 2023 and 2024, though no export data are yet available. Imports are projected to rise only slowly, held down by government import-substitution programs and capital controls. With exports currently increasing faster than imports, this update projects a higher current account surplus in 2023 but a lower surplus in 2024.

Uzbekistan

Strong expansion in manufacturing and mining boosted growth beyond expectations in the first half (H1) of 2023. The government reported growth edging up from 5.4% year on year in H1 2022 to 5.6% in the same period of 2023. Growth was higher than anticipated because of strong expansion in industry and robust investment. Expansion in industry accelerated from 4.6% to 5.6%, with modest gains in manufacturing and in mining and quarrying. Growth in agriculture accelerated from 2.6% to 3.8% with healthy gains in crop and livestock production but edged down in services from 7.9% to 6.4% with slower expansion in trade, transport, and storage. Growth in construction slowed from 5.1% to 4.8% with smaller gains in housing, infrastructure, and repairs.

Higher investment was the main driver of growth, while consumption slowed because of high inflation. On the demand side, growth in gross capital formation accelerated from 6.6% year on year in H1 2022 to 7.9% on higher infrastructure spending and upgrades to machinery and equipment. Consumption growth slowed from 9.4% to an estimated 5.6% as persistently high inflation trimmed real household income and demand despite rising wages and pensions. The deficit in net exports widened by 4.4%, with the trade deficit expanding by 18.4% for goods, primarily from higher imports of petrochemicals and of machinery and transport equipment, while expanding tourism boosted the small surplus in services by nearly half.

In H2 2023, persistently high prices for food and energy and sluggish remittances will likely continue to trim real household income and consumption. However, industry, agriculture, and capital investment will likely maintain steadily higher growth in the rest of 2023 and in 2024. With these projections, this update raises growth forecasts for 2023 and 2024 (Table 2.1.8).

Table 2.1.8 Selected Economic Indicators in Uzbekistan, %

Growth forecasts for 2023 and 2024 are raised after growth in the first half of 2023 outpaced expectations.

	2022	2023		2024	
		Apr	Sep	Apr	Sep
GDP growth	5.7	5.0	5.5	5.0	5.5
Inflation	11.4	11.0	11.0	10.0	10.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Producer prices and wages rose with persisting inflation. Higher costs for imported food and capital goods, along with increased wages and pensions, edged up inflation from 10.6% in H1 2022 to 11.0% a year later. Exemptions from tax and customs duties for essential foodstuffs, set to continue until the end of 2023, helped slow food inflation from 14.2% to 13.8%. However, inflation for other goods accelerated from 9.0% to 9.5%, and for services from 6.6% to 8.3%. Despite persistent inflationary pressure, the monetary authorities retained the policy rate at 14.0% in July 2023. This update thus retains earlier inflation projections for 2023 and 2024.

The current account deficit widened sharply from the equivalent of 2.3% of GDP in H1 2022 to 6.3% a year later. Notable causes were cooling inward money transfers and a larger trade deficit. As the number of Uzbek seasonal migrant workers in the Russian Federation declined, smaller inward money transfers contracted the income surplus, as expected, by 12.3% from H1 2022. Imports rose by 26.0% on larger shipments of machinery and equipment, ferrous metals, and petrochemicals, far outstripping 16.0% higher exports of goods, with notable growth in gold, textiles, foodstuffs, copper, and petrochemicals. Service exports, by contrast, grew by 16.0% as demand for transport and tourism services surged, while service imports rose by only 4.0% on higher demand for shipping, business services, and information and communication services.