

In Washington, D.C. (EST): 10:00 a.m., April 20, 2012

Caucasus and Central Asia Set for Solid Growth, But Global Risks Loom Large

The Caucasus and Central Asia (CCA) region recorded fairly strong economic performance in 2011, underpinned by robust commodity exports and remittance inflows. Although growth of such flows is expected to moderate in the near term—reflecting a weaker external environment—CCA economies are still expected to hold up well. This broadly positive outlook presents an opportunity for CCA policymakers to rebuild policy buffers, prepare for downside risks that might materialize, and foster an inclusive growth agenda.

Following a Fairly Strong Performance in 2011, the Outlook Remains Broadly Positive

Economic recovery continued at a robust pace in the CCA region in 2011, supported by high commodity exports and strong remittance inflows. The region's oil and gas exporters—Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan—saw 6.8 percent growth on average, and the importers—Armenia, Georgia, the Kyrgyz Republic, and Tajikistan—grew by 6.1 percent. Both groups saw improvements in their external current account positions.

After rising sharply during the first half of 2011, inflation has been on a downward trend in most countries through early 2012, benefiting from a moderation in international food prices, good harvests in the region, and monetary policy tightening in some countries. The ongoing euro area crisis has had a limited impact so far, but the region remains vulnerable to a downturn, with spillovers via Russian and global growth.

The near-term outlook remains broadly positive for CCA oil and gas exporters. Despite a weaker

external environment, oil and gas prices are still expected to remain high this year and next, which will help maintain high export levels and sustain activity in the nonhydrocarbon sector through continued public spending. As such, growth in the oil and gas exporters, while slowing from a fast pace, is expected to remain fairly strong, with Kazakhstan, Turkmenistan, and Uzbekistan projected to grow by 6 percent or more in 2012–13. Following last year's sharp drop in oil output, Azerbaijan's hydrocarbon production is expected to remain broadly unchanged in the near term, but continued strong nonhydrocarbon growth will help the economy expand by an average of 2.5 percent in 2012–13, up from 0.1 percent in 2011.

Despite some weakening in key growth drivers, CCA oil and gas importers are also expected to hold up fairly well. On account of lower global demand, these countries are likely to see a moderation in export growth, but nowhere near the sharp collapse witnessed in 2009. Despite an expected slight easing in Russia's growth this year, total remittance inflows to CCA oil and



gas importers are still forecast to expand—by 12.7 percent in 2012 compared with 20.2 percent in 2011. As a result, most of these countries—Georgia, the Kyrgyz Republic, and Tajikistan—would still grow by a fairly solid rate of 5–6 percent this year and next. Armenia’s post-crisis construction sector weaknesses remain a drag on growth, forecast at about 4 percent in 2012–13.

But Subject to Significant Downside Risks

Nonetheless, downside risks continue to loom large. The most immediate concern is that a severe escalation of the euro area crisis would trigger a much sharper decline in global growth than currently envisioned—including in Russia and China. If such a scenario materializes, external demand, commodity export prices, remittances, and capital flows would sharply decline, dragging down CCA growth.

While CCA oil and gas exporters can draw on their accumulated foreign assets to mitigate the effect of such a shock, the oil and gas importers have smaller buffers and limited policy space. An upside risk to the oil and gas exporters is a further rise in oil prices resulting from geopolitical tensions in the Middle East. Oil and gas importers would face a higher import bill, but would also benefit from increased remittances from Russia.

Time to Bolster Buffers and Advance Inclusive Growth

Given the increasingly uncertain and fragile global environment, CCA countries should take advantage of their strong recovery to rebuild policy buffers and prepare for any downside risks. In this regard, fiscal consolidation should continue, or commence, in most countries. For the oil and gas importers, this adjustment should aim to rebuild fiscal buffers and put debt on a

downward path, and—coupled with exchange rate flexibility—would help rein in their large external current account deficits, most notably in Armenia and Georgia. While oil and gas exporters have ample fiscal space, considerable scope exists to improve the quality and efficiency of public spending.

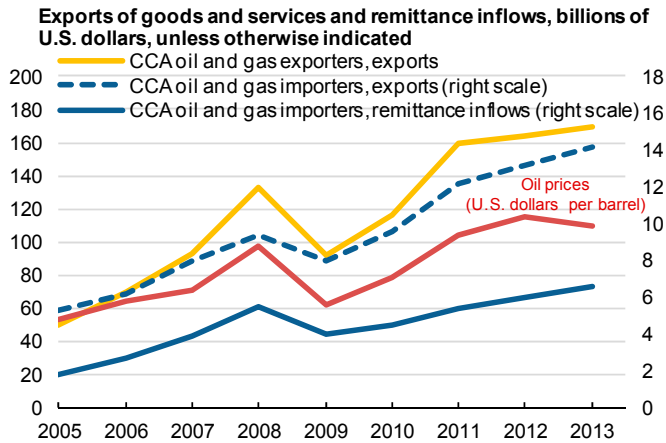
The easing of inflationary pressures in most countries should give monetary policy some room to maneuver. Nonetheless, such pressures could arise again in some countries (Azerbaijan, Uzbekistan) if current plans for macroeconomic policy easing are followed through, in which case monetary tightening would be appropriate, including through greater exchange rate flexibility. Monetary (and fiscal) policy, however, should stand ready to adjust quickly if external downside risks materialize.

Banking sector balance sheets remain impaired in a number of CCA countries (Kazakhstan, Kyrgyz Republic, Tajikistan), requiring continued policy attention. In particular, nonperforming loans are still high—most notably in Kazakhstan—weighing on bank lending and limiting growth of private domestic demand. Developing a clear plan to address problem loans that includes replenishment of bank capital, where needed, remains a priority.

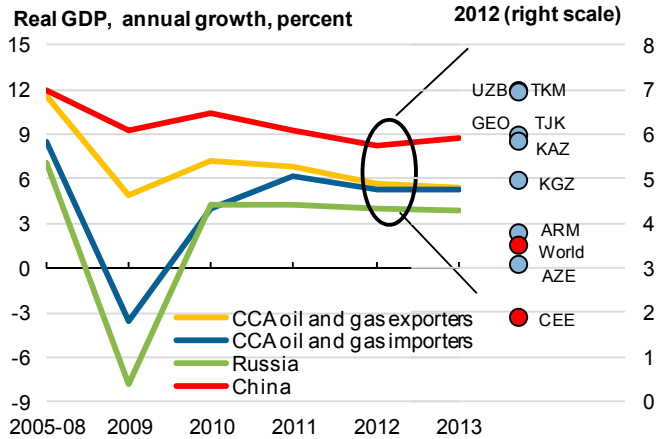
Over the medium term, the key challenges facing the region are creating jobs and fostering high, sustained, and inclusive growth. Meeting those challenges will depend on progress toward diversifying economies away from natural resources; improving the business environment, transparency, and governance; boosting regional trade integration; resolving skill mismatches; enhancing banking sector competition; and removing impediments to access to credit for small and medium-sized enterprises.

CCA: Recent Economic Developments and Outlook

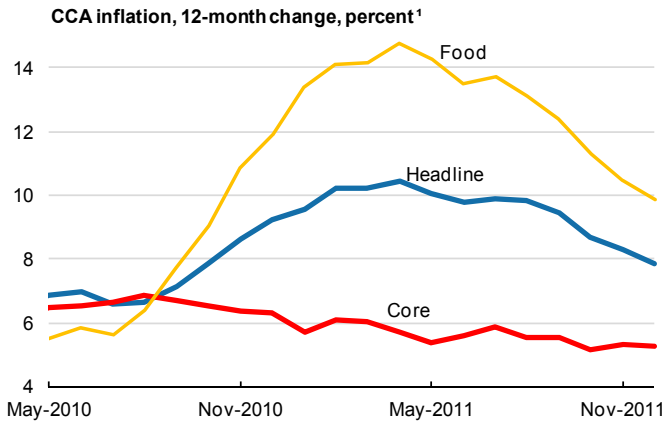
On account of a weaker external environment, growth in exports and remittances is slowing.



As such, activity is moderating from a fast pace, but remains fairly strong across the region.

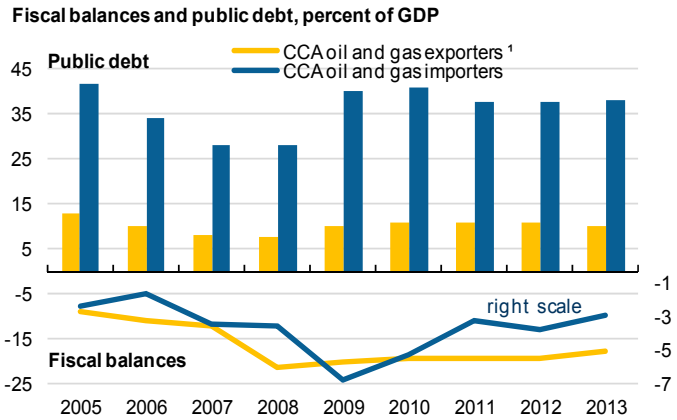


With inflationary pressures abating, monetary policy can ease if external conditions deteriorate significantly.



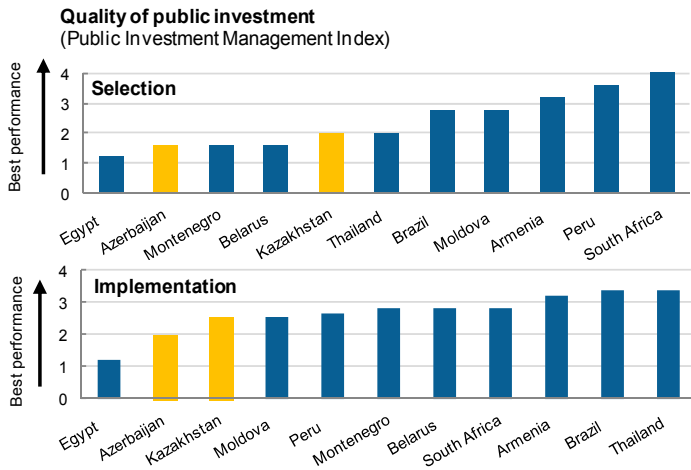
¹ Based on PPP GDP weights. Turkmenistan is excluded from CCA aggregates.

Fiscal consolidation is needed to rebuild buffers for countries with large debt.

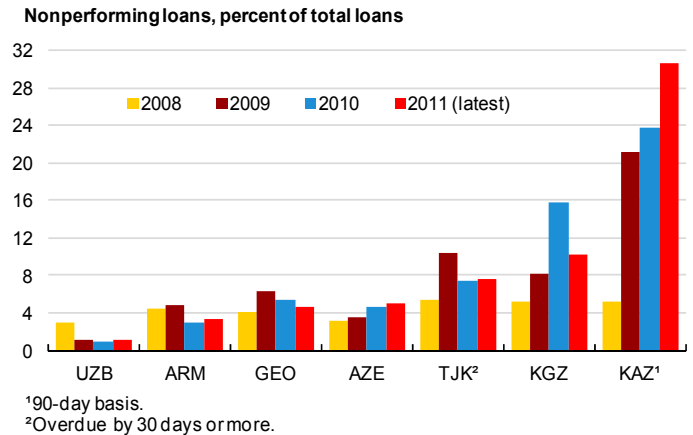


¹ Non-oil and gas fiscal balance in percent of non-oil and gas GDP.

Elsewhere, the focus should be on improving the efficiency and quality of public spending.



Bank balance sheets need to be repaired in some countries.



¹ 90-day basis. ² Overdue by 30 days or more.

Sources: National authorities; IMF staff calculations; and IMF Working Paper No.11/137.

Note: Armenia (ARM), Azerbaijan (AZE), Central and Eastern Europe (CEE), Georgia (GEO), Kazakhstan (KAZ), Kyrgyz Republic (KGZ), Tajikistan (TJK), Turkmenistan (TKM), and Uzbekistan (UZB).

CCA: Selected Economic Indicators

	Average						Projections	
	2000–06	2007	2008	2009	2010	2011	2012	2013
Real GDP Growth	10.0	12.3	6.8	3.7	6.7	6.7	5.6	5.4
<i>(Annual change; percent)</i>								
Armenia	11.7	13.7	6.9	-14.1	2.1	4.4	3.8	4.0
Azerbaijan	14.6	25.0	10.8	9.3	5.0	0.1	3.1	1.9
Georgia	6.9	12.3	2.3	-3.8	6.3	7.0	6.0	5.5
Kazakhstan	10.3	8.9	3.2	1.2	7.3	7.5	5.9	6.0
Kyrgyz Republic	3.9	8.5	7.6	2.9	-0.5	5.7	5.0	5.5
Tajikistan	8.9	7.8	7.9	3.9	6.5	7.4	6.0	6.0
Turkmenistan	15.8	11.1	14.7	6.1	9.2	14.7	7.0	6.7
Uzbekistan	5.4	9.5	9.0	8.1	8.5	8.3	7.0	6.5
Consumer Price Inflation	9.6	11.4	16.5	6.2	7.0	9.2	6.7	7.5
<i>(Year average; percent)</i>								
Armenia	2.7	4.6	9.0	3.5	7.3	7.7	4.0	4.2
Azerbaijan	4.7	16.6	20.8	1.6	5.7	7.9	5.6	6.1
Georgia	6.1	9.2	10.0	1.7	7.1	8.5	1.7	5.5
Kazakhstan	8.1	10.8	17.1	7.3	7.1	8.3	5.5	7.0
Kyrgyz Republic	6.4	10.2	24.5	6.8	7.8	16.6	4.1	8.1
Tajikistan	17.8	13.2	20.4	6.5	6.5	12.4	7.9	8.4
Turkmenistan	8.4	6.3	14.5	-2.7	4.4	5.8	6.2	7.0
Uzbekistan	17.4	12.3	12.7	14.1	9.4	12.8	12.7	10.9
General Gov. Overall Fiscal Balance	1.1	3.1	6.1	0.9	3.8	6.3	4.3	3.5
<i>(Percent of GDP)</i>								
Armenia ¹	-2.5	-2.3	-1.8	-7.7	-4.9	-2.7	-3.1	-2.3
Azerbaijan ¹	0.2	2.6	20.3	7.2	15.0	13.3	10.9	7.1
Georgia	-1.4	-4.7	-6.3	-9.2	-6.6	-3.6	-3.5	-3.0
Kazakhstan	3.1	4.7	1.1	-1.4	1.4	5.7	4.4	4.4
Kyrgyz Republic	-5.1	-0.3	0.0	-3.5	-6.3	-4.8	-6.0	-5.8
Tajikistan	-2.4	-5.5	-5.1	-5.2	-3.0	-2.1	-3.3	-1.3
Turkmenistan ²	1.6	3.9	10.0	7.6	2.3	3.5	4.1	3.9
Uzbekistan	0.2	5.2	10.2	2.8	4.9	9.0	3.8	3.1
Current Account Balance	-0.9	1.6	8.9	0.4	5.2	8.5	7.0	5.6
<i>(Percent of GDP)</i>								
Armenia	-5.8	-6.4	-11.8	-15.8	-14.7	-12.3	-11.0	-9.5
Azerbaijan	-7.9	27.3	35.5	23.6	29.1	26.3	21.8	16.4
Georgia	-9.0	-19.7	-22.6	-11.3	-11.5	-12.7	-10.3	-9.3
Kazakhstan	-1.6	-8.1	4.7	-3.5	2.0	7.6	6.6	5.6
Kyrgyz Republic	-0.5	-0.2	-8.1	0.7	-6.9	-3.1	-4.8	-4.2
Tajikistan	-2.8	-8.6	-7.6	-5.9	2.1	-2.3	-3.6	-5.0
Turkmenistan	5.8	15.5	16.5	-16.0	-11.7	1.8	2.1	1.3
Uzbekistan	4.5	7.3	8.7	2.2	6.2	5.8	2.8	3.0

Sources: National authorities; and IMF staff estimates and projections.

¹Central government.

²State government.