

Regional Economic Outlook

Economic Developments, Prospects, and Policy Issues in Central Asia

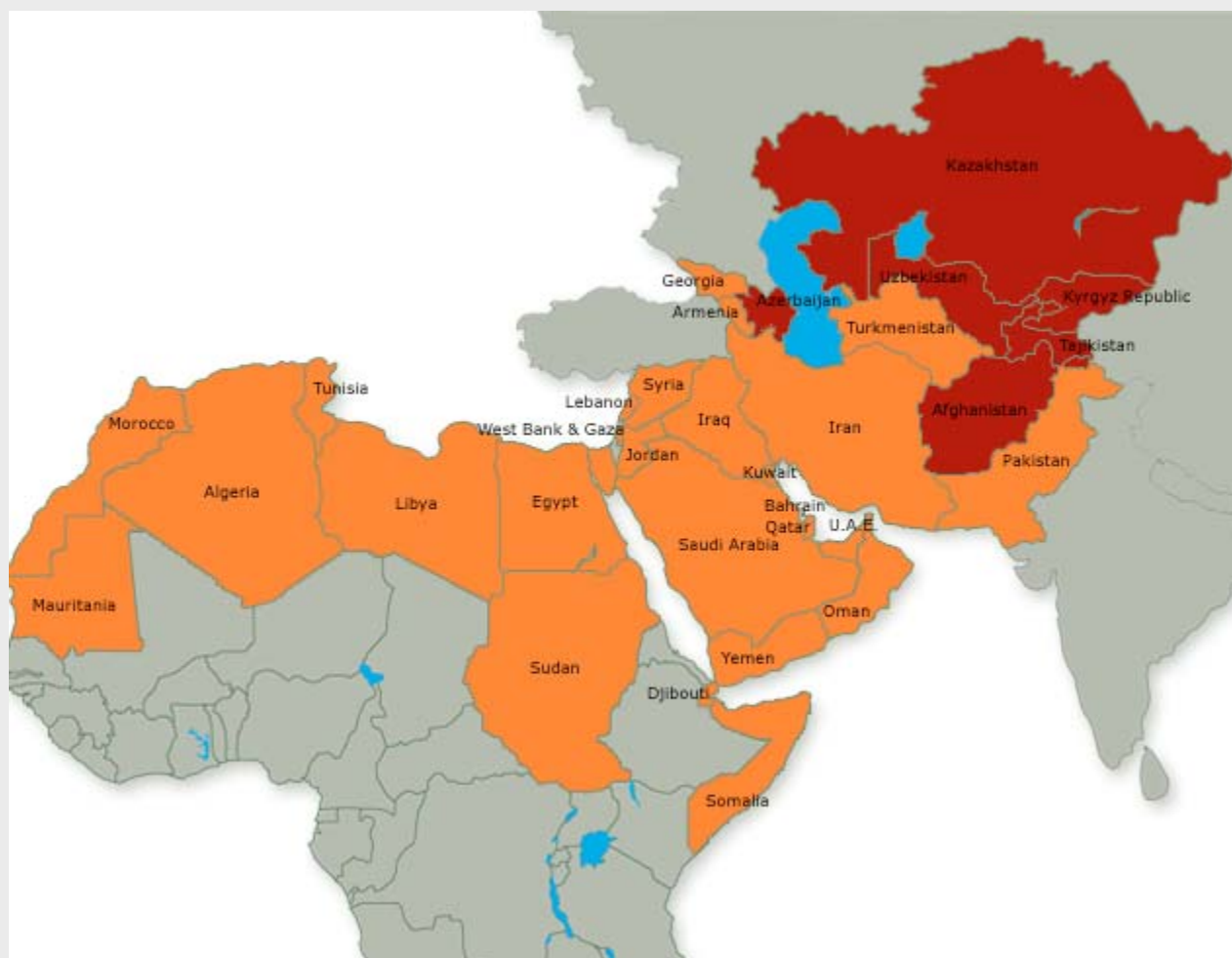
**Presentation at the Senior Officials' Meeting of CAREC,
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CAREC Countries Covered by the Middle East and Central Asia Department (MCD)



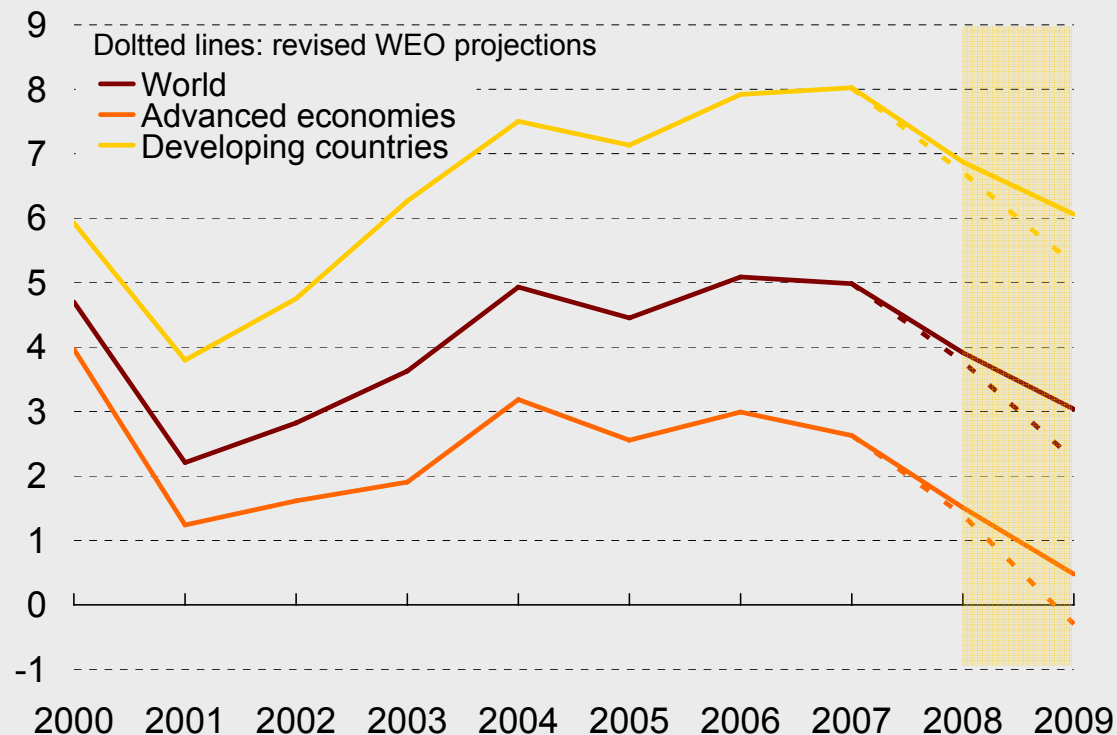
Outline of Presentation

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

Global Economic Background

World Real GDP Growth

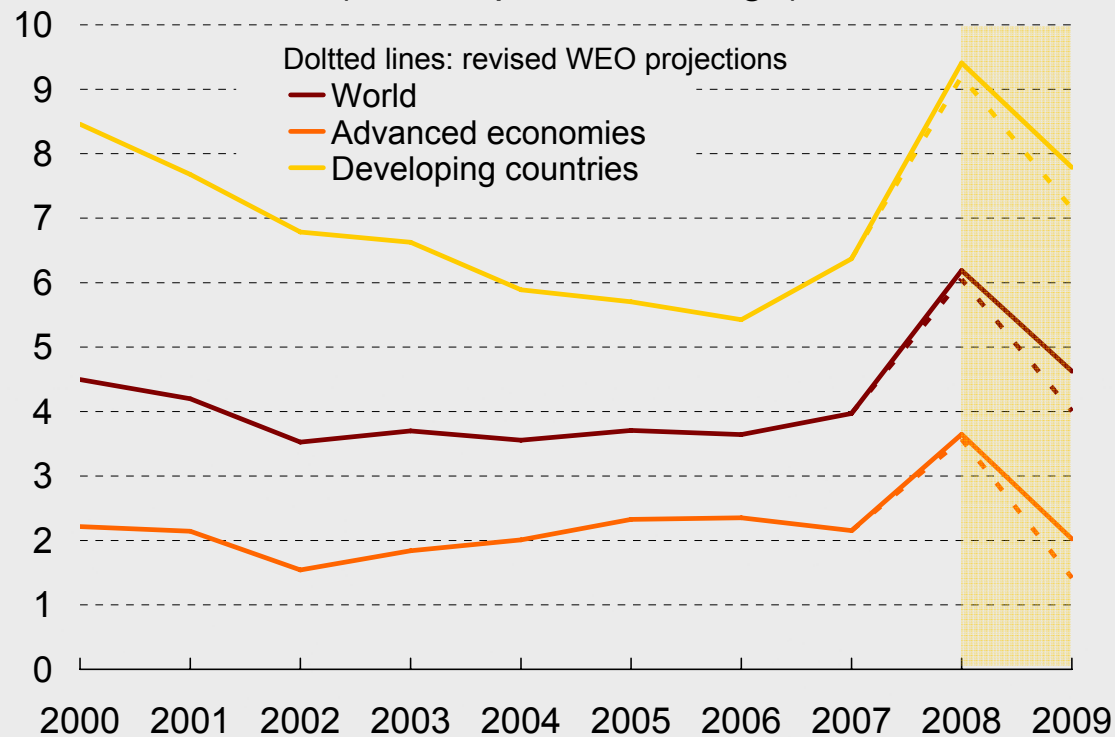
(Annual percent change)



- The slowdown in global growth, which started in mid 2007 with the financial turmoil, has deepened further in 2008.
- The global economy is projected to enter a major downturn in the second half of 2008 and through 2009.

Consumer Price Inflation

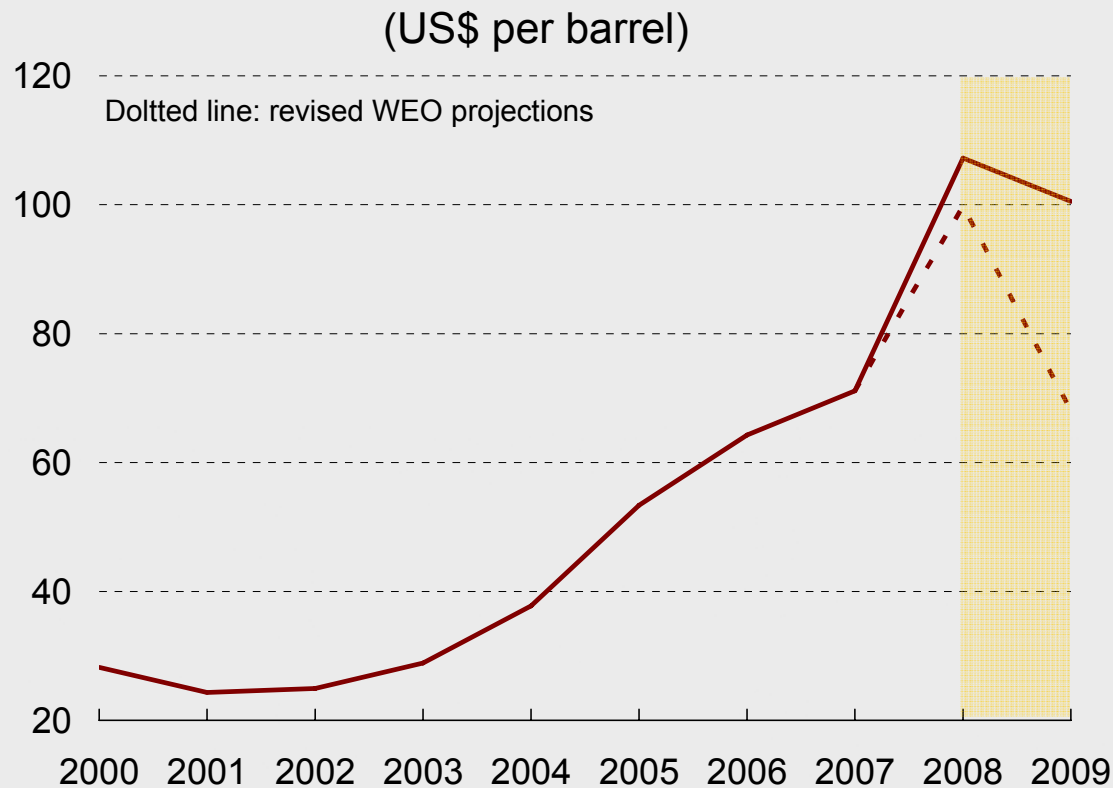
(Annual percent change)



—Inflation has picked up around the world in the wake of higher oil and food prices.

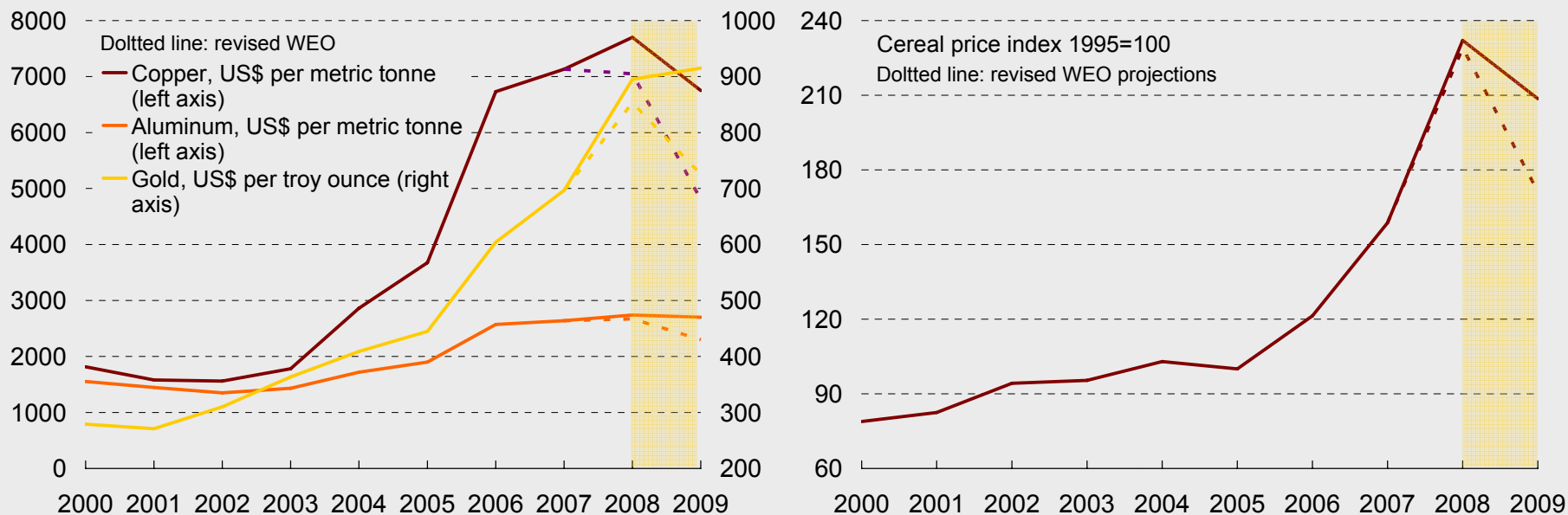
—As commodity prices stabilize and economic slack increases, inflation is expected to fall gradually.

Developments in Oil Prices



- The surge in oil prices reflected strong demand from emerging market economies combined with a sluggish supply response.
- Prices have fallen since July 2008 due to weakening global demand.

Non-Oil Commodity Prices



- Metal prices have decline sharply from their peaks in March 2008 and are unlikely to recover while global activity is slowing.
- Food prices have also fallen in recent months with improved harvests for major grains and oil seeds.

Risks to the Global Outlook

The global outlook is highly uncertain and risks are to the downside:

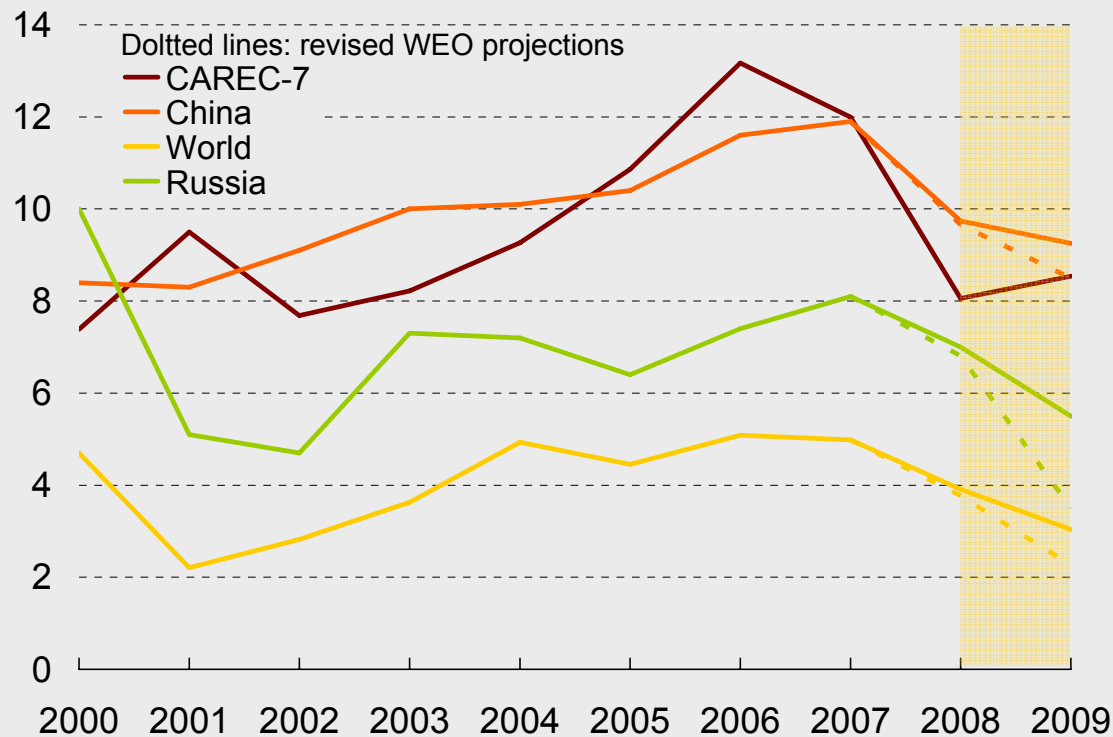
- A full-blown “credit crunch” due to:
 - the continuation of financial stress at very high levels
 - deeper and more protracted credit constraints from deleveraging.
- A sharper and more prolonged downturn in the US economy
- Potential disruptions to capital flows.

Economic Developments and Prospects for the CAREC Group

(based on October 2008 WEO)

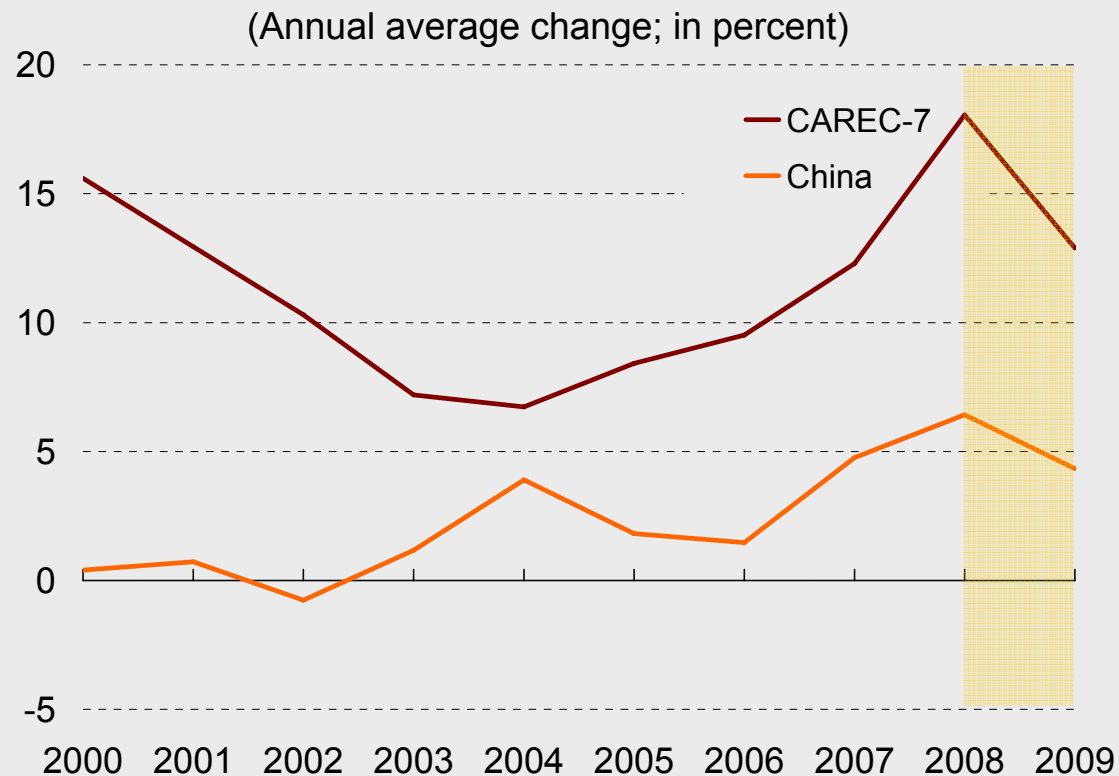
Real GDP Growth

(Annual average change; in percent)



- Despite some moderation, growth in CAREC countries remains strong and well above global average.
- Downside risks to growth in CAREC countries have increased.

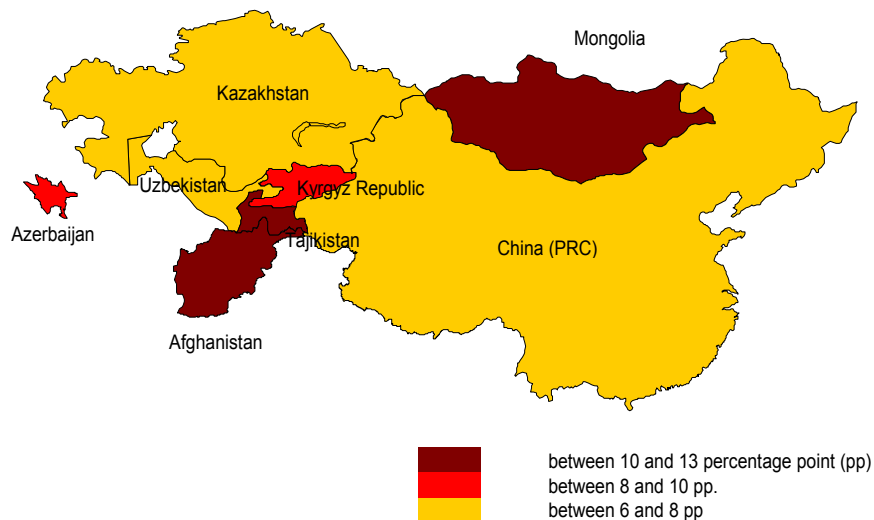
Consumer Price Inflation



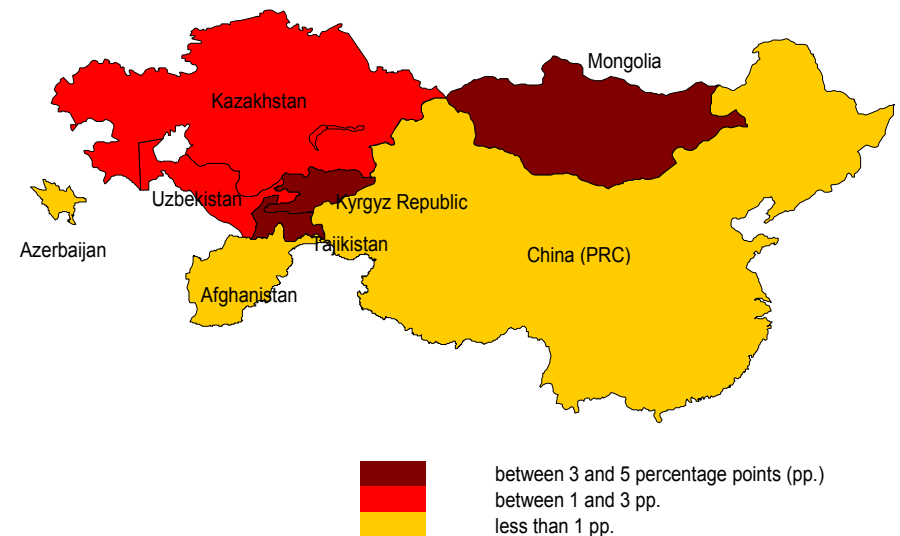
- Inflation picked up in all CAREC countries, with higher food prices significantly affecting headline inflation.
- CAREC-7 is expected to record the highest regional inflation in the world.

Contribution of Food and Energy Prices to the Change in Headline Inflation (end-2006 to latest observation in 2008, year on year)

FOOD



ENERGY

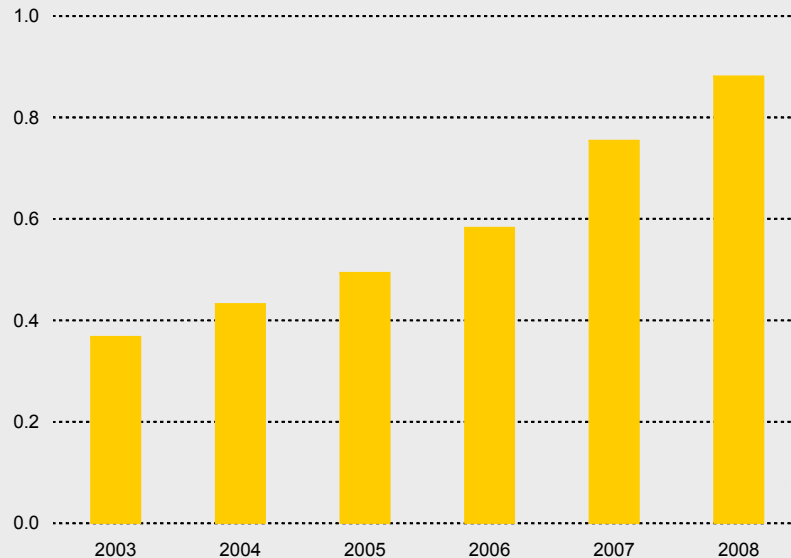


- Food and energy prices affected inflation in all CAREC countries.
- The contribution of food prices to inflation ranged from 7 percentage points in PRC to 13 percentage points in Afghanistan.
- The contribution of energy prices to inflation ranged from less than 1 percentage point in Azerbaijan to 4.5 percentage points in Mongolia.

Pass through of International Oil Prices in CAREC Countries

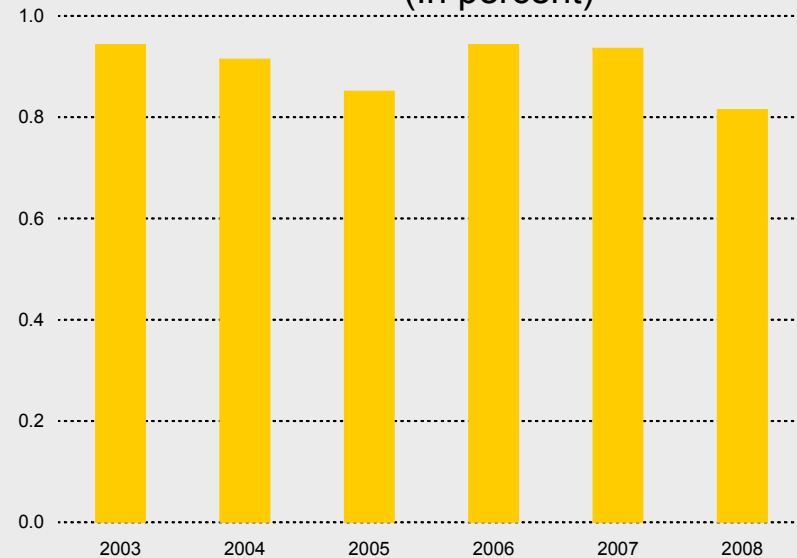
Gasoline Prices

(In U.S. dollars per liter, end of period)



Domestic Gasoline Prices Relative to U.S. Prices

(In percent)



- Retail prices for gasoline have increased in all CAREC countries in 2008.
- Retail prices in all CAREC countries except China and Mongolia remain below international levels.

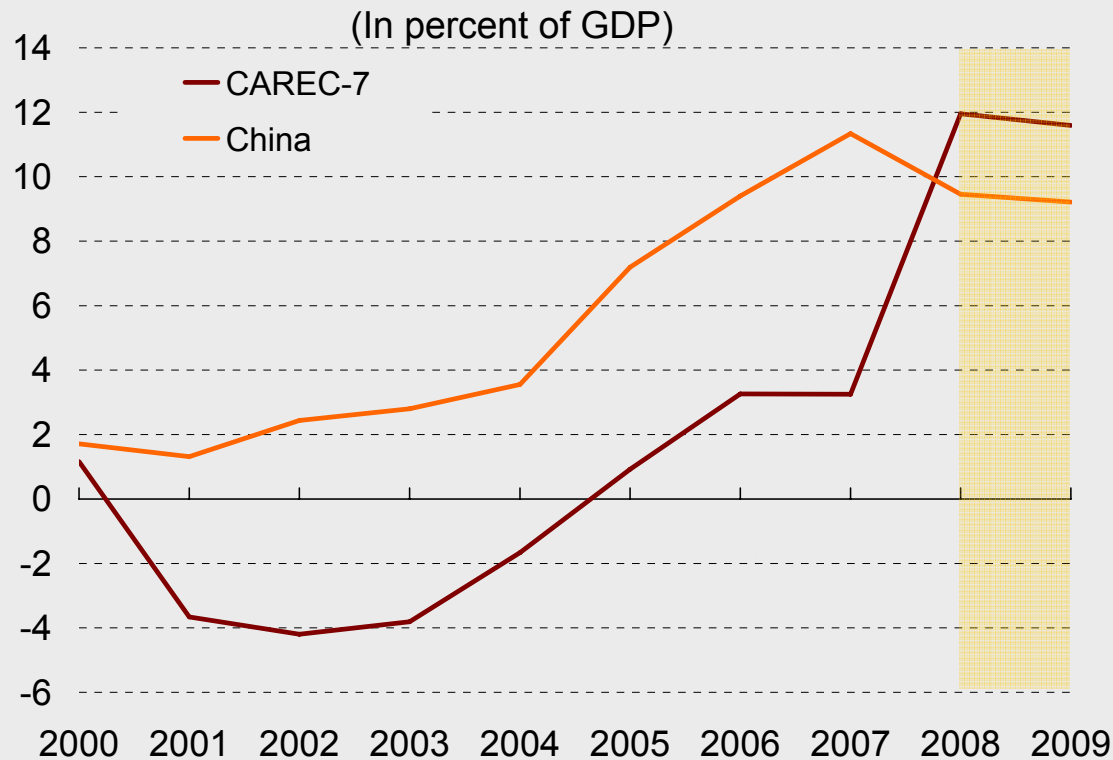
Wage Increase in CAREC Countries, 2007-08

	Coverage	Size of Increase (in percent)
Afghanistan	Minimum wage in the civil service	12
Azerbaijan	Minimum wage	150
Kazakhstan	Minimum wage	23
Kyrgyz Republic	Civil service wages	30–80
Tajikistan	Civil service wages	40
Uzbekistan	Civil service wages	80
China	Average annual wage	19
Mongolia	Civil service wages	88

Sources: Country authorities and IMF staff estimates.

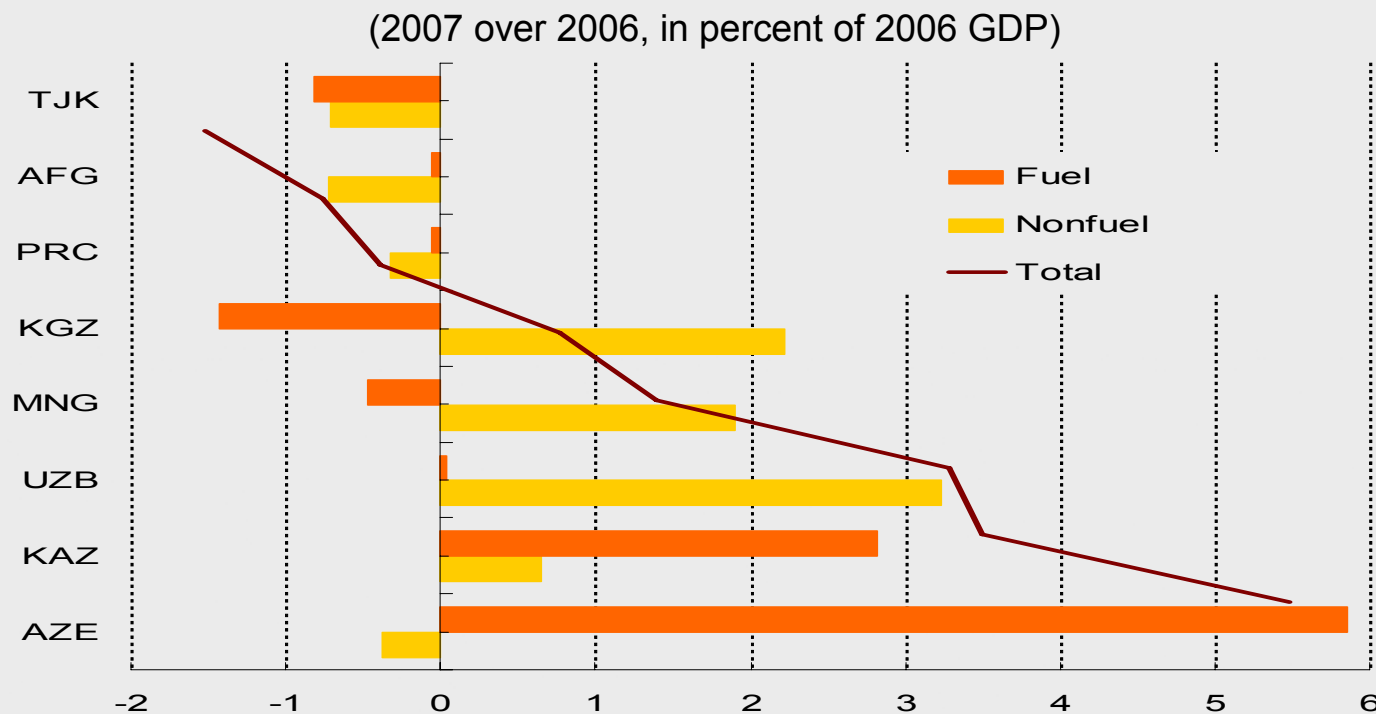
- Wages have been increased in all CAREC countries partly to soften social tensions from the decline in real wages and purchasing power.
- This semblance of a wage-price spiral may affect inflationary expectations.

External Current Account Balance



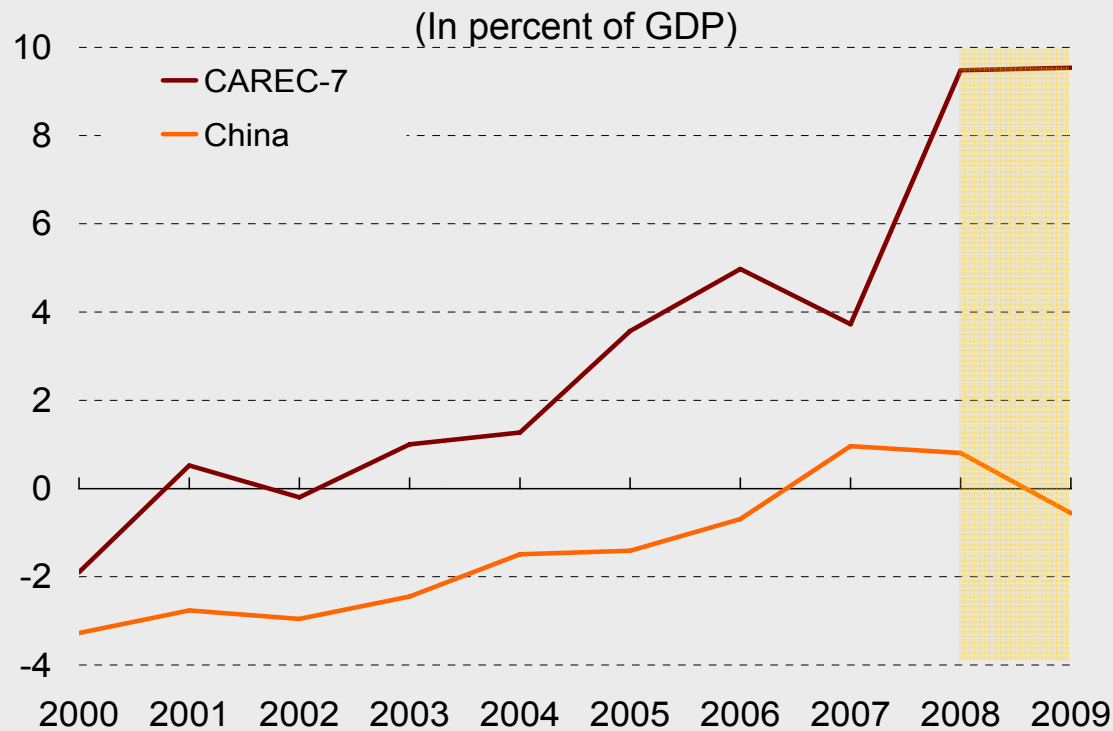
- The external surplus of CAREC-7 is expected to rise in 2008 due to significant strengthening in external positions in AZE and KAZ.
- External positions in 2009 are expected to weaken in all CAREC countries.

First-Round Impact of Commodity Price Changes on the External Current Account



- Higher commodity prices have had a diverse impact on balance of payments across the CAREC region.
- The impact ranged from negative 1.5 percent of GDP in TJK to positive 5.5 percent of GDP in AZE.

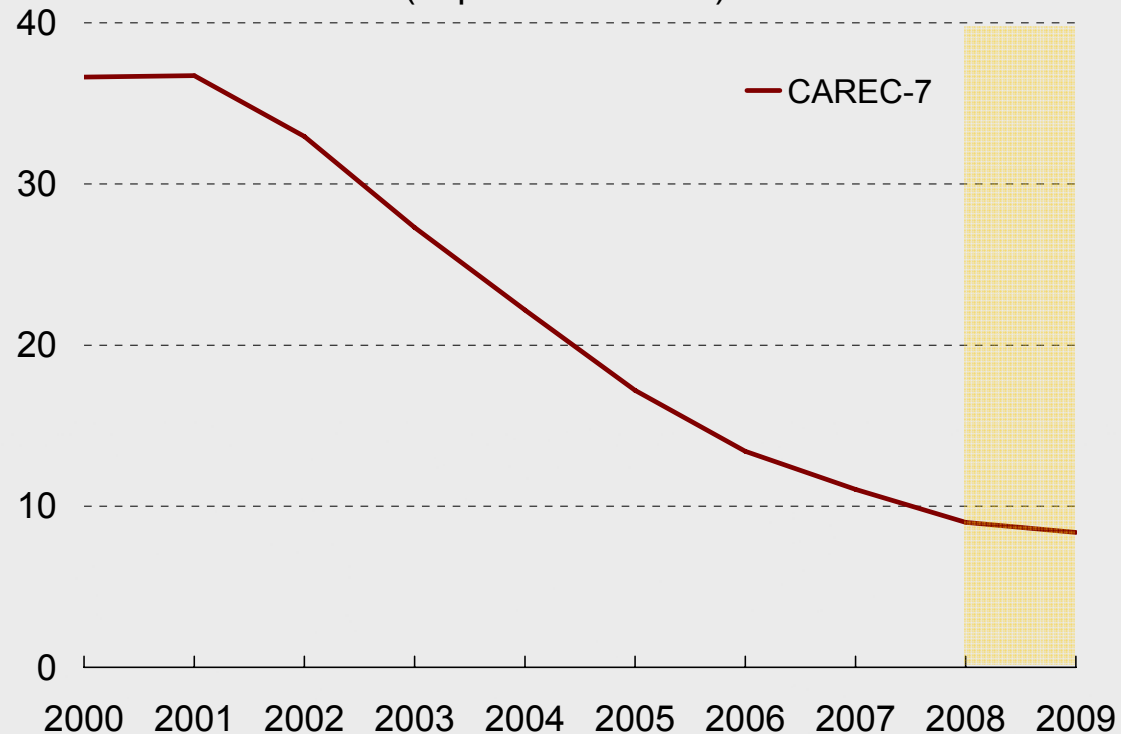
Central Government Fiscal Balance



- Government savings in CAREC-7 are expected to increase substantially.
- AZE, KAZ, and UZB have been running large surpluses owing to high commodity prices and constrained spending to contain demand pressures.
- PRC is cautiously using expansionary fiscal policy to sustain growth.

Total Government Debt

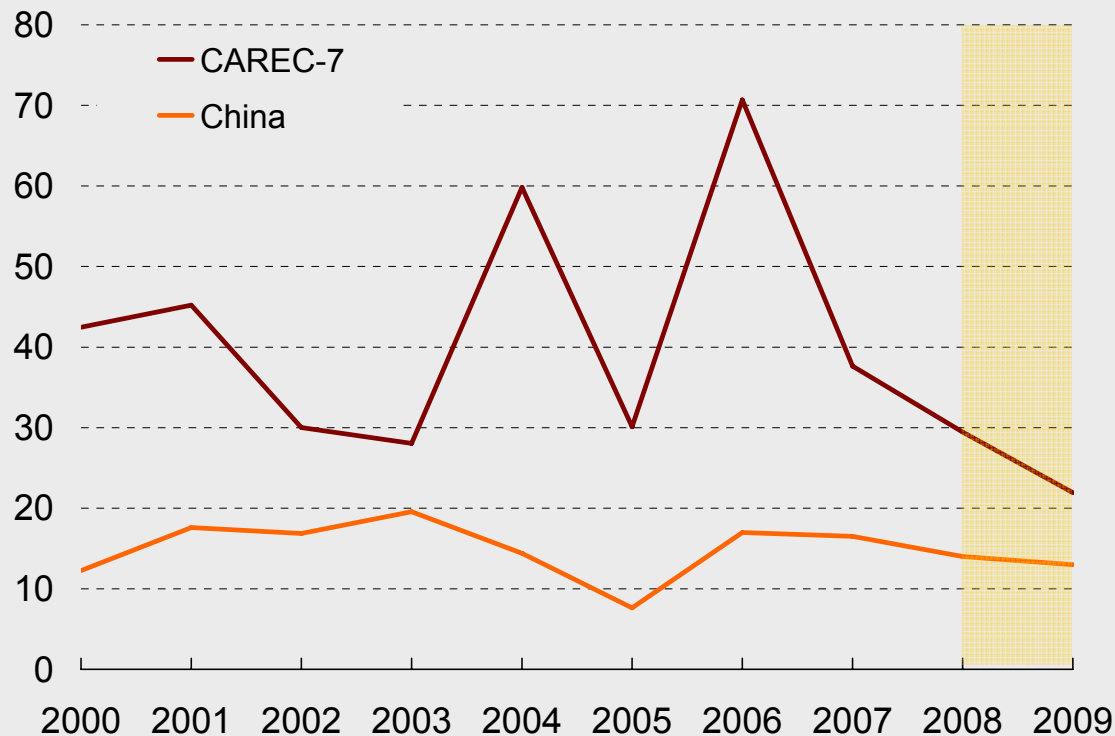
(In percent of GDP)



- Government debt remains on a downward trend.
- Tajikistan's debt-to-GDP ratio is projected to increase in 2009 because of large investments financed by concessional loans.

Monetary Growth

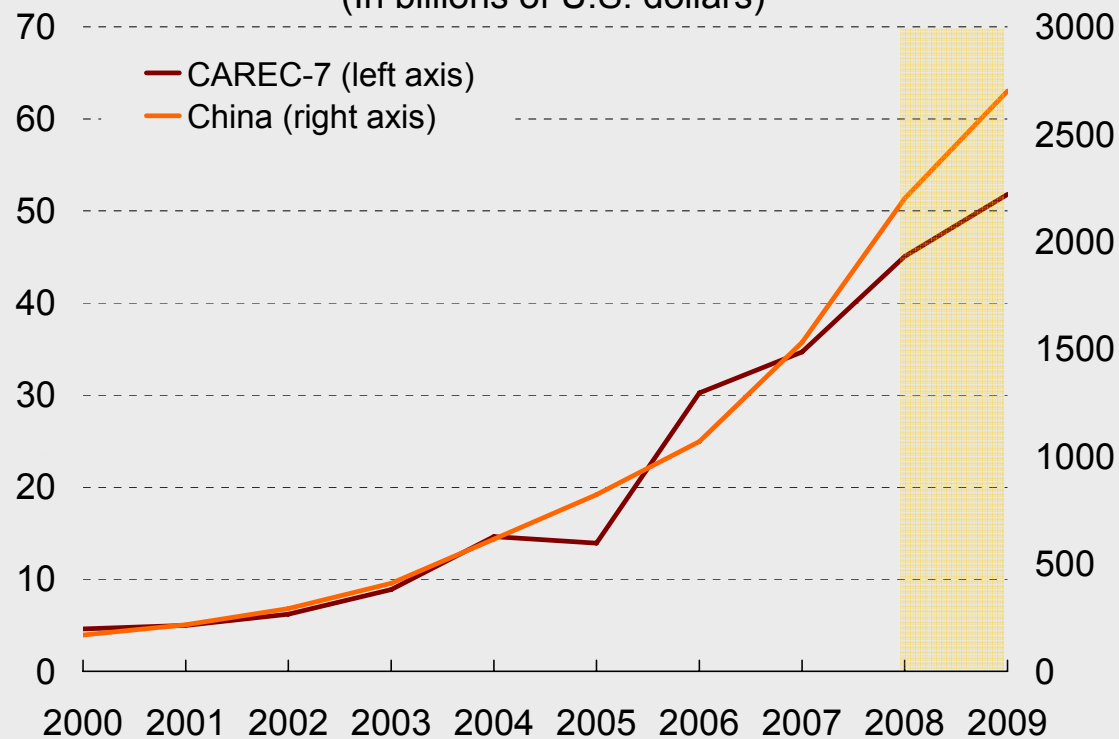
(Percent change from previous period)



- Monetary growth has slowed down in 2008 (except in AFG and AZE) with policy tightening in response to inflationary pressures.
- Broad money still continues to grow faster than GDP in CAREC-7, partly reflecting the process of monetization and financial deepening.

Gross Official Reserves

(In billions of U.S. dollars)



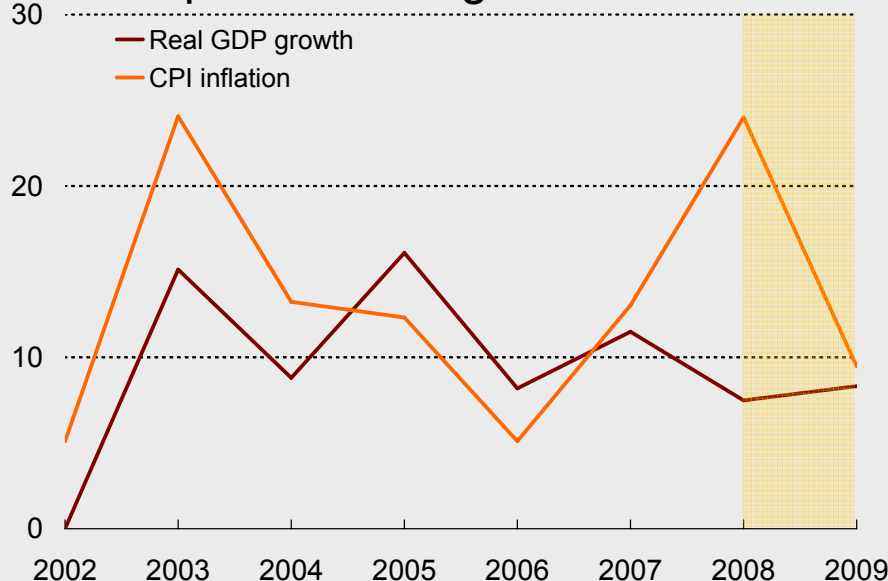
- Gross official reserves are increasing steadily in all CAREC countries.
- Official reserves of CAREC-7 and China each increased fivefold in the last five years.
- Progress in building reserves and reducing debt has put the region in a better position to absorb shocks and address development needs.²¹

Individual Country Prospects and Key Policy Challenges

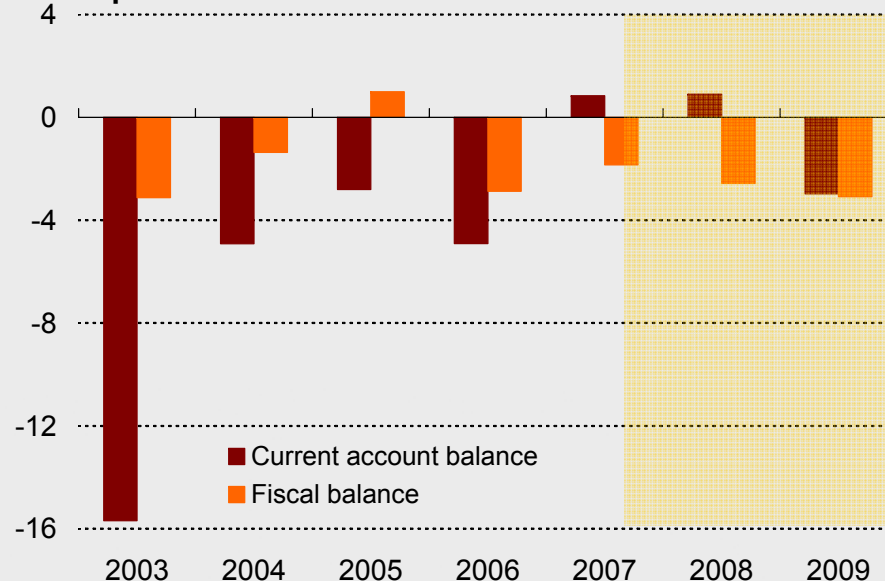
(based on October 2008 WEO)

Afghanistan

Annual percent change



In percent of GDP

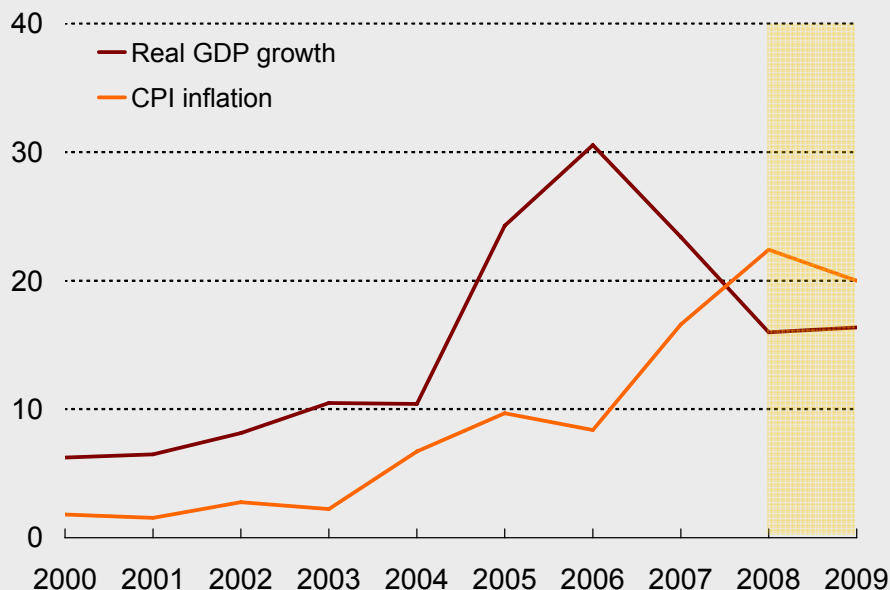


Key policy challenges:

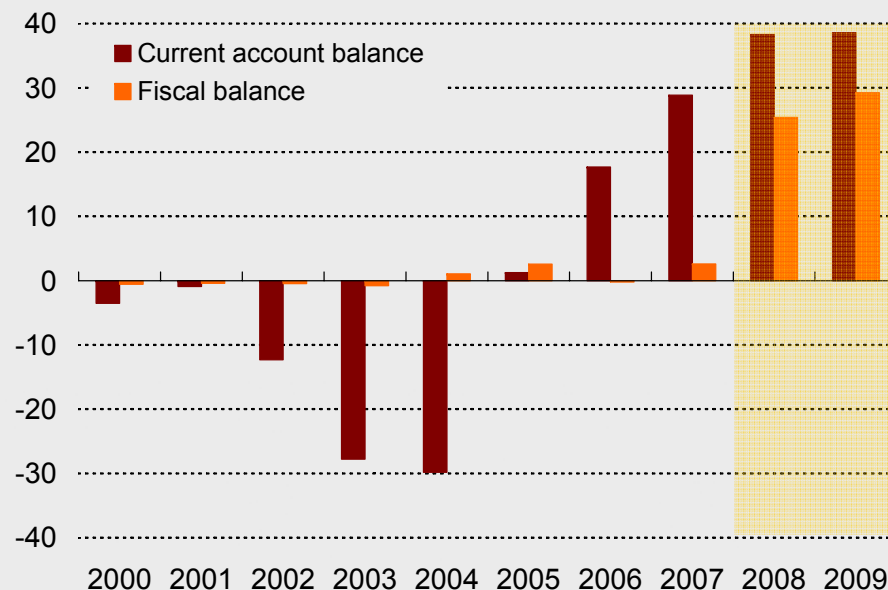
- Gaining fiscal independence: develop a modern tax and customs administration, while prioritizing expenditure.
- Preventing inflation from becoming entrenched: develop monetary policy framework and ensure financial sector stability.
- Reducing political interference in economic policies and sustaining the momentum of reforms

Azerbaijan

Annual percent change



In percent of GDP

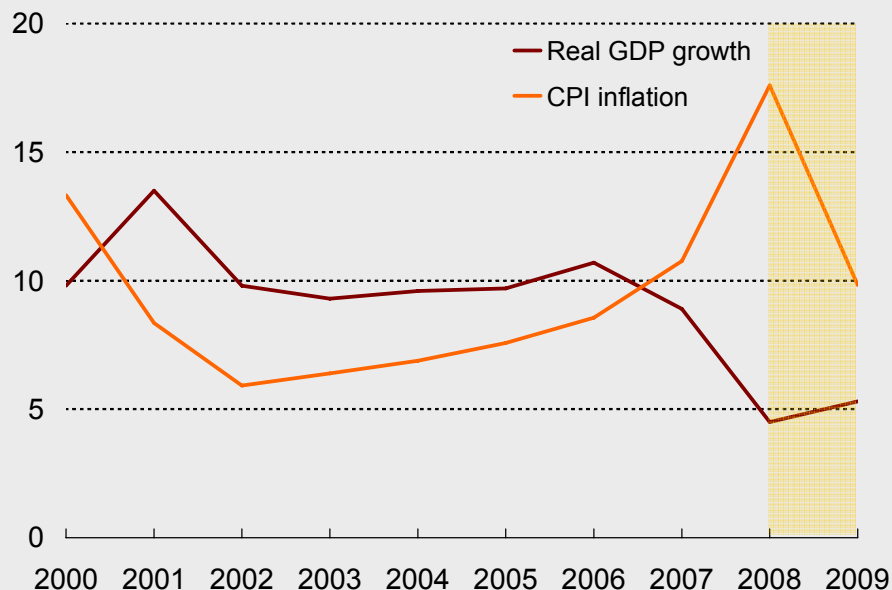


Key policy challenges:

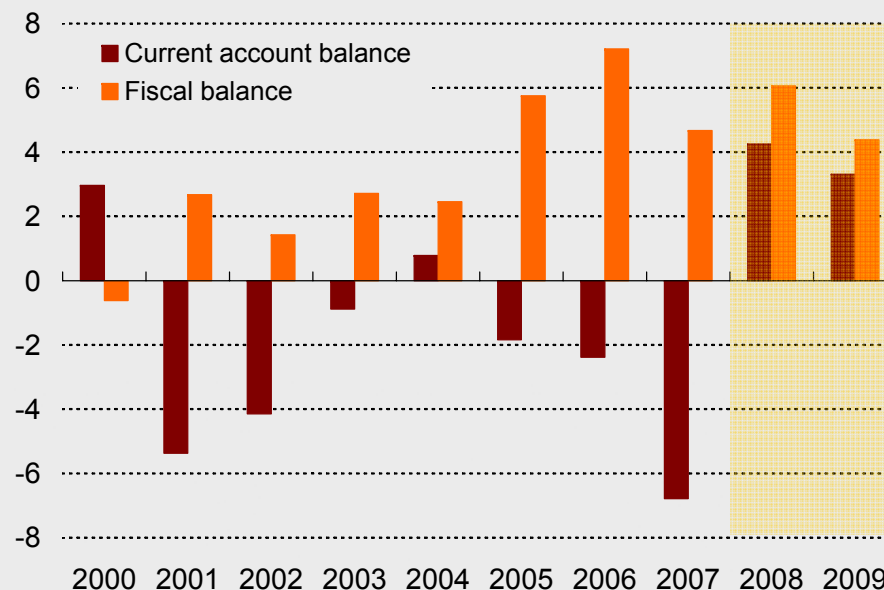
- Reducing inflation: moderate the fiscal impulse and use monetary policy more actively to manage liquidity in the banking system.
- Strengthening public expenditure management: introduce a medium-term expenditure framework and a system to select investment projects.
- Continue strengthening banking regulation and supervision, while taking steps to develop other pillars of the financial system.

Kazakhstan

Annual percent change



In percent of GDP



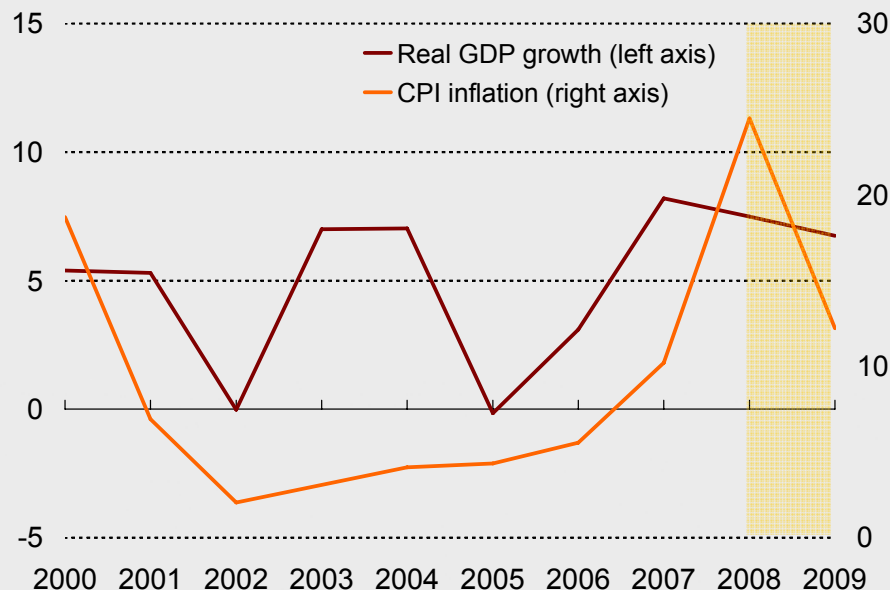
Key policy challenges:

Managing the short-term risks in the financial sector and broader economy given the continuing very difficult external environment.

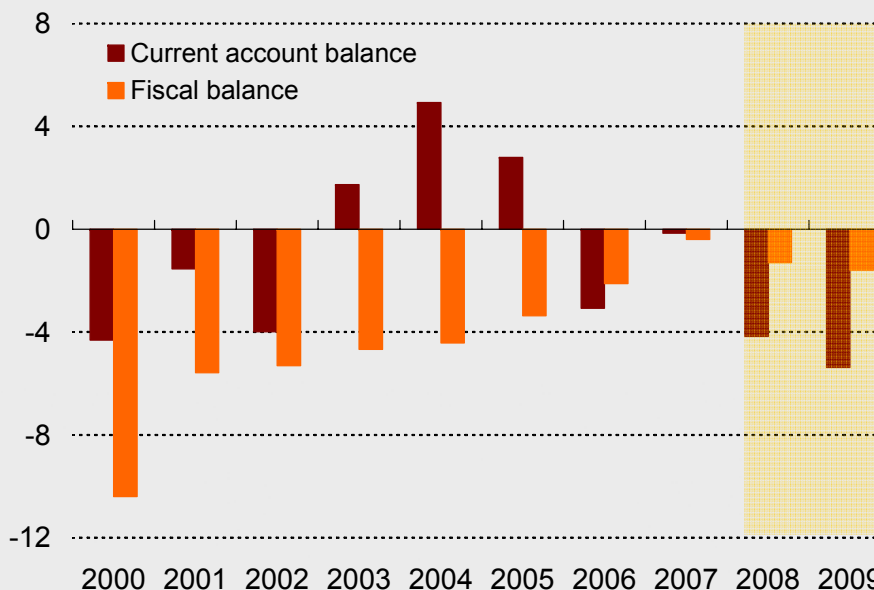
- continue strengthening banking supervision in order to identify emerging liquidity and solvency issues in good time.
- defend the exchange rate if significant downward pressure emerges, subject to a clear operational rule to limit reserve losses.
- allow automatic stabilizers to work if economic growth slows.

Kyrgyz Republic

Annual percent change



In percent of GDP

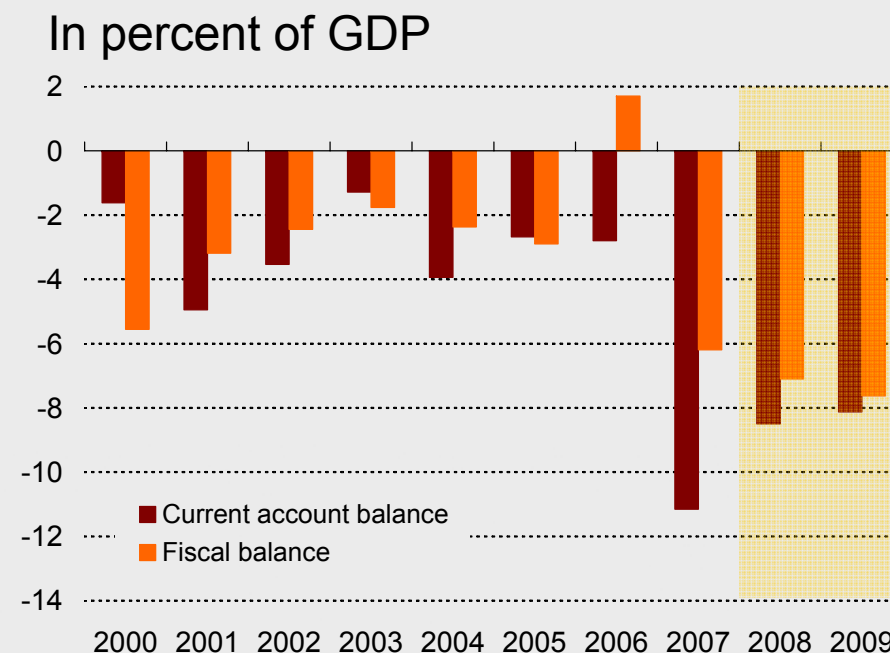
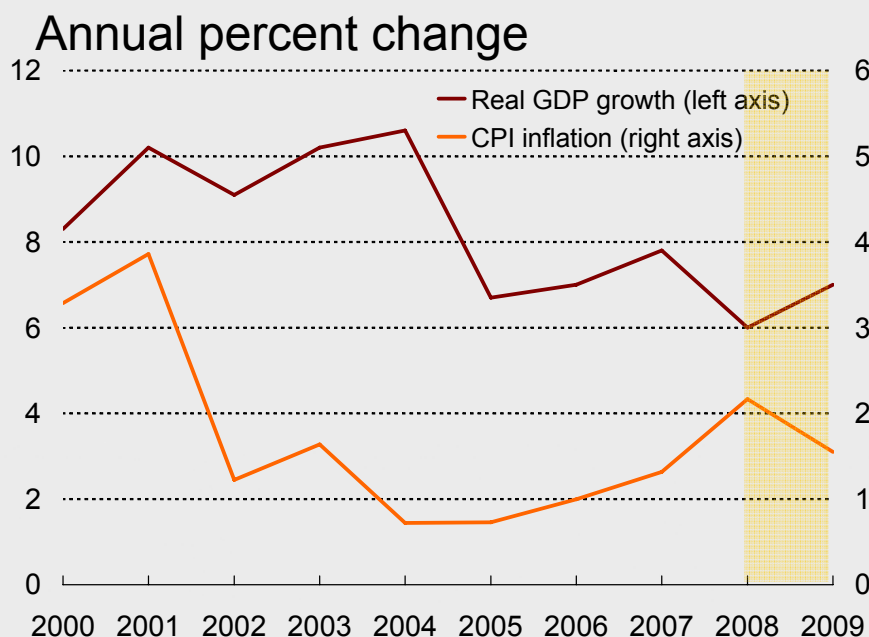


Key policy challenges:

Managing the effects of regional economic slowdown and potential spillovers from the global financial crisis.

- Maintain a tight monetary policy and use the exchange rate policy to help the disinflation process.
- Balance the need to help reduce inflation with the need to support growth and the poor in the conduct of fiscal policy
- Closely monitor banks and further strengthen bank supervision.

Tajikistan

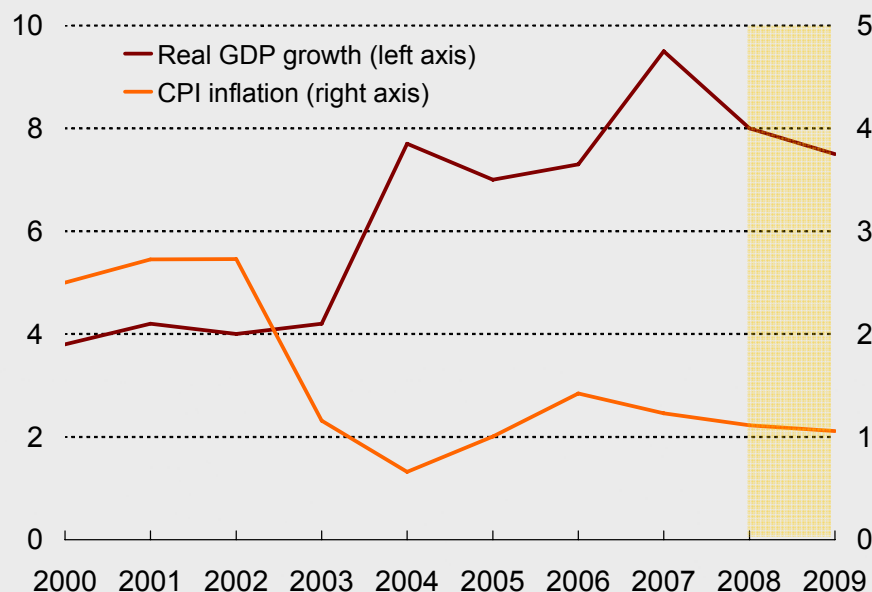


Key policy challenges:

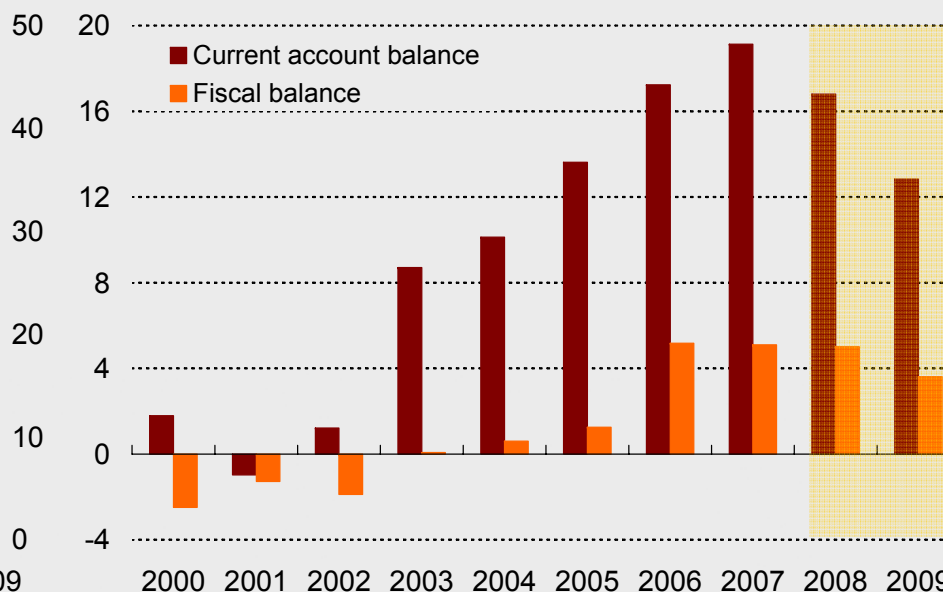
- Reducing inflation: maintain cautious fiscal policy stance and modestly scale back unsterilized foreign exchange market transactions.
- Securing continued donor support: implement staff monitored program to reestablish credibility vis-à-vis donors.
- Managing potential spillovers from the global financial crisis: step up banking supervision and allow greater exchange rate flexibility if remittance inflows slow significantly.

Uzbekistan

Annual percent change



In percent of GDP

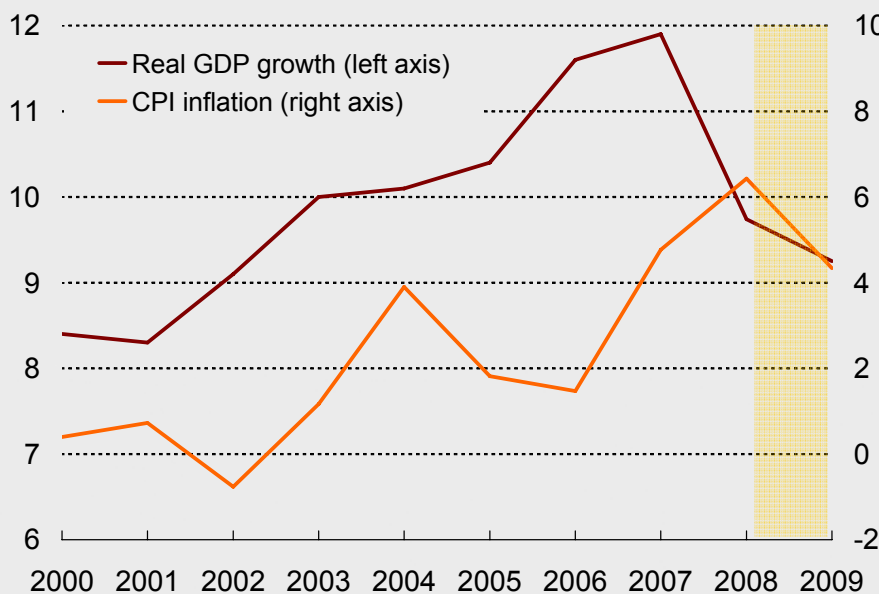


Key policy challenges:

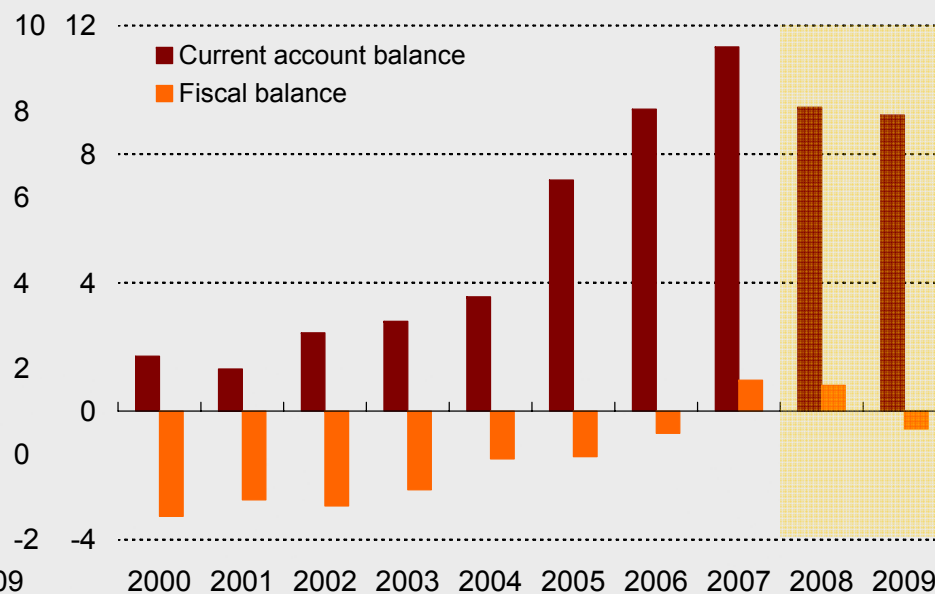
- Reducing inflation: further tighten monetary policy, adopt a flexible exchange rate policy, and maintain a cautious fiscal stance.
- Enhancing financial deepening: discontinue the role of banks in non-core activities and remove restrictions on cash withdrawals.
- Stimulating private sector development: eliminate barriers to trade, liberalize the foreign exchange system, and remove extensive regulations in the economy.

China

Annual percent change



In percent of GDP

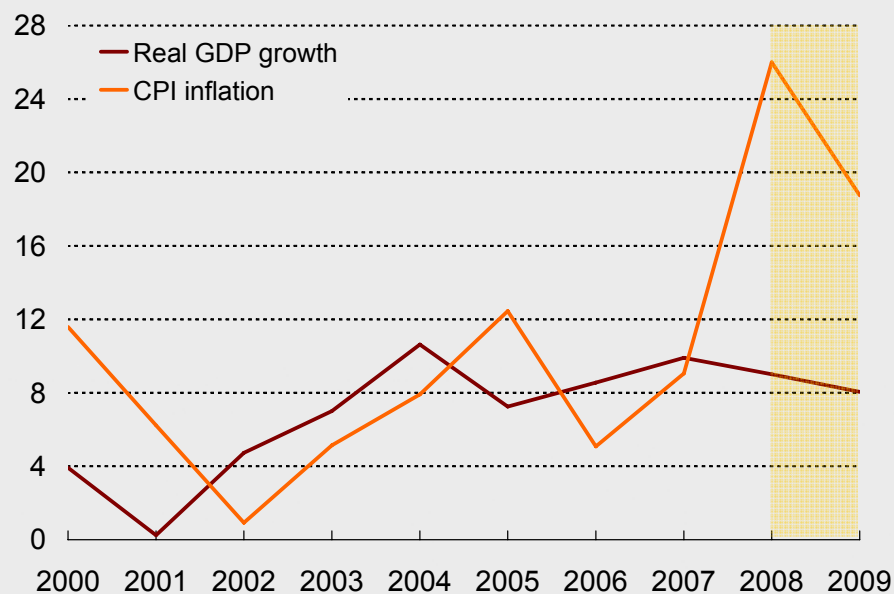


Key policy challenges:

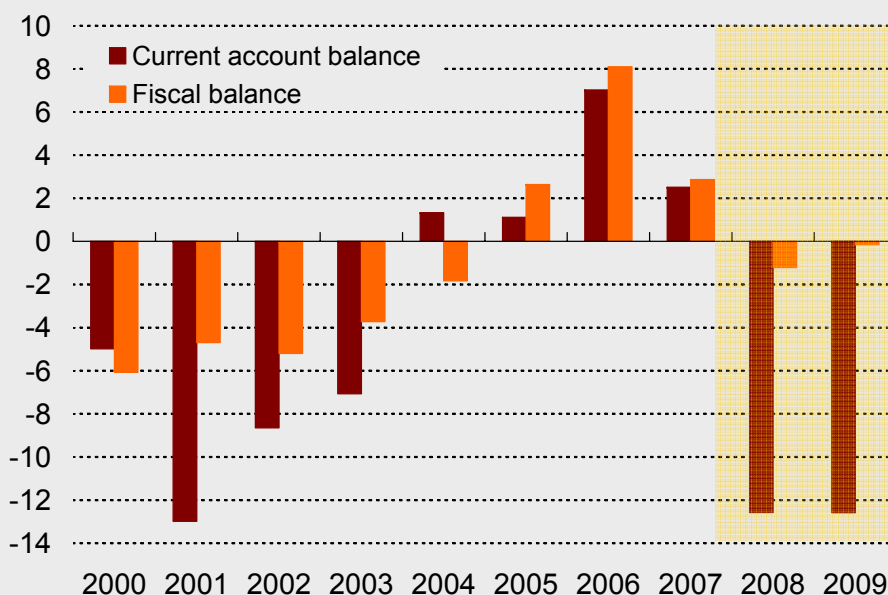
- The main priority is rebalancing the economy towards domestic consumption and reduce reliance on investment and exports. The exchange rate needs to appreciate faster and the cost of capital needs to be increased.
- If there were a sharper-than-expected economic slowdown, expansionary fiscal measures (including infrastructure spending, improving education, healthcare, and pensions, and moving the VAT to a consumption base) should be used to sustain growth.

Mongolia

Annual percent change



In percent of GDP



Key policy challenges:

- Reducing inflation by maintaining tight fiscal and monetary policies in the near term.
- Preparing for lower-than-expected copper prices by containing fiscal spending and maintaining a flexible exchange rate.
- Establishing transparent, stable and internationally competitive fiscal and mining regimes to take full advantage of vast mineral wealth while maintaining macroeconomic stability.

Common Policy Issues

- Macroeconomic performance of CAREC countries has been relatively strong.
- Risks to the CAREC region economic outlook are on the downside.
 - In the event of a sharper and more protracted slowdown in advanced economies and the Russian Federation than currently envisaged, economic growth could be lower.
 - Inflation could turn out higher than forecast if international food and fuel prices surge again, or if macroeconomic policy is not sufficiently tight.
 - Financial institutions in CAREC countries could also suffer should global financial conditions deteriorate further and the crisis become deeper.

Common Policy Issues (continued)

1. The most important challenge for the region in the short term is protecting the financial system and growth from the global crisis. To this end, countries need to:
 - respond quickly to ensure adequate liquidity and deal with burgeoning problems in weak institutions.
 - allow the exchange rate to absorb some of the pressure and in countries with large stocks of international reserves intervene to avoid disorderly market conditions.
 - halt monetary tightening in countries where inflationary pressures have been contained and growth deteriorated.
 - use countercyclical fiscal policy while maintaining confidence in medium-term fiscal sustainability.

Common Policy Issues (continued)

2. Financial sector reforms are a priority in the region and should strengthen resilience to the global turmoil. The agenda is different in each country, but includes steps to :
 - strengthen banking systems to prevent liquidity difficulties and ensure solvency;
 - tighten prudential regulations to promote appropriate lending, reduce loan concentration, ensure appropriate loan classification and adequate provisioning;
 - restructure and privatize inefficient state banks; and
 - deepen financial markets.

Common Policy Issues (continued)

3. Inflation is still a concern for the region. Policies to contain inflation need to be appropriate to individual country circumstances, but would generally include:
 - tightening monetary policy;
 - allowing nominal exchange rates to appreciate;
 - exercising fiscal restraint; and
 - preventing inflation expectations from becoming entrenched through higher wages.