

Regional Economic Outlook

Economic Developments, Prospects, and Policy Issues in Central Asia

Presentation at the Senior Officials' Meeting of CAREC, Dushanbe, November 2, 2007

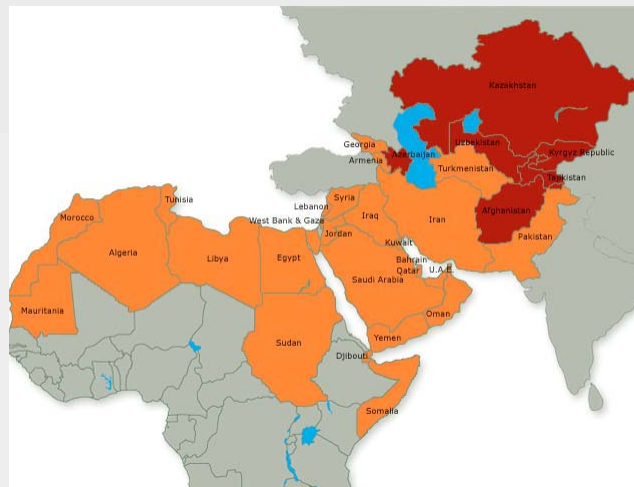
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CAREC Countries Covered by the Middle East and Central Asia Department (MCD)



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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

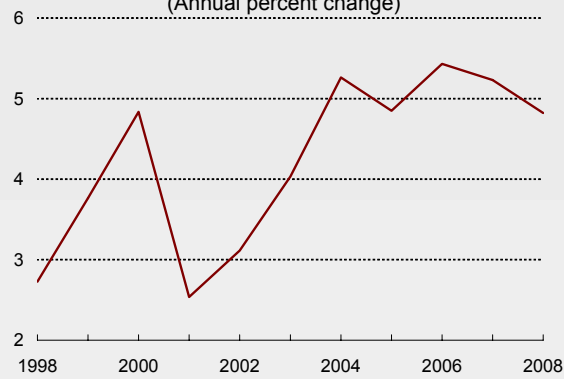
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Global Economic Background

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World Real GDP Growth

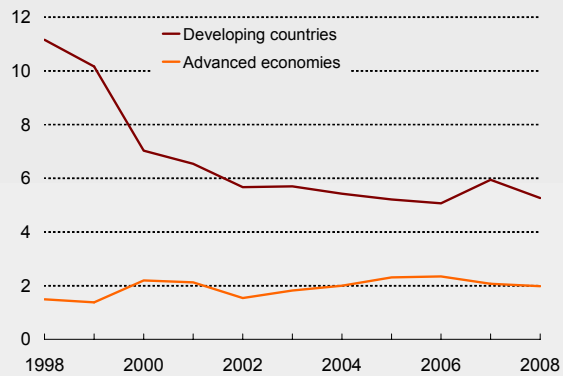
(Annual percent change)



Global growth remains strong, but the recent financial turmoil is expected to dampen its momentum.

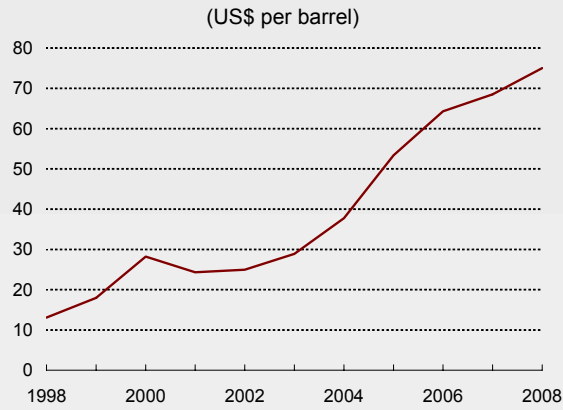
Consumer Price Inflation

(Annual percent change)



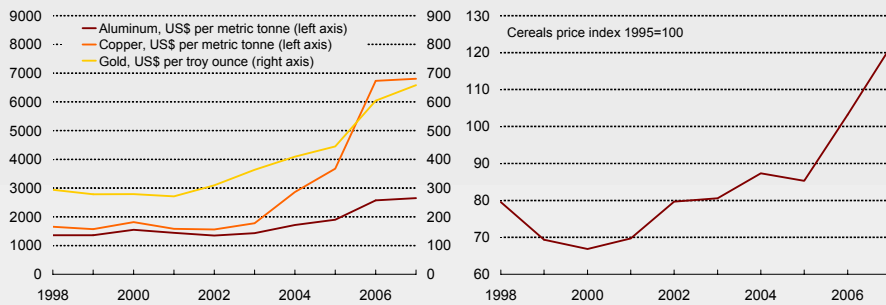
Inflation is projected to ease.

Developments in Oil Prices



Oil prices have continued to rise and are projected to remain high.

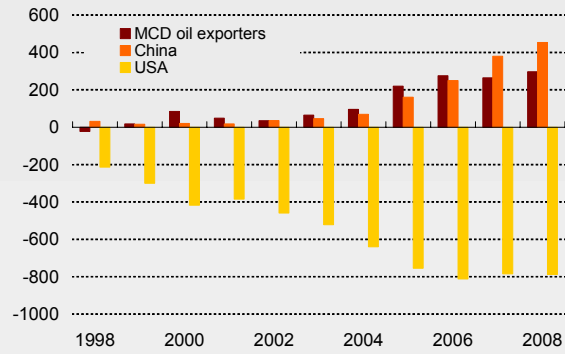
Non-Oil Commodity Prices



- Metal prices have remained high.
- Food prices have increased.
- Most non-oil commodity prices are projected to retreat in 2008 from their recent highs.

Current Account Balance

(In billions of U.S. dollars)

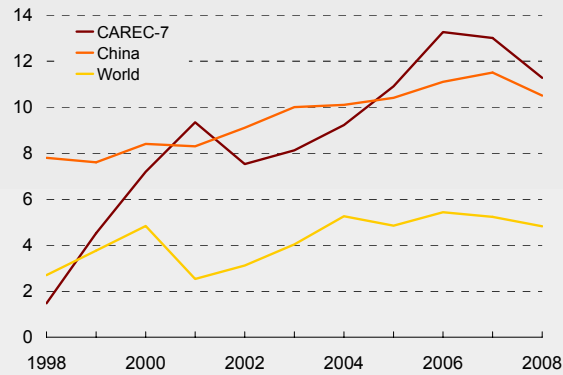


Global imbalances are showing signs of stabilizing, albeit at a high level.

Economic Developments and Prospects for the CAREC Group

Real GDP Growth

(Annual average change; in percent)

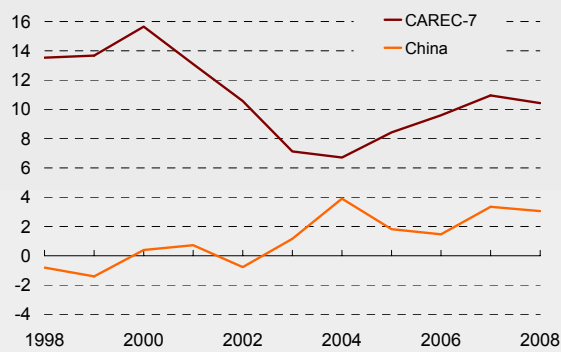


- CAREC countries are growing strongly—well above global average.
- Near-term growth prospects are good.

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Consumer Price Inflation

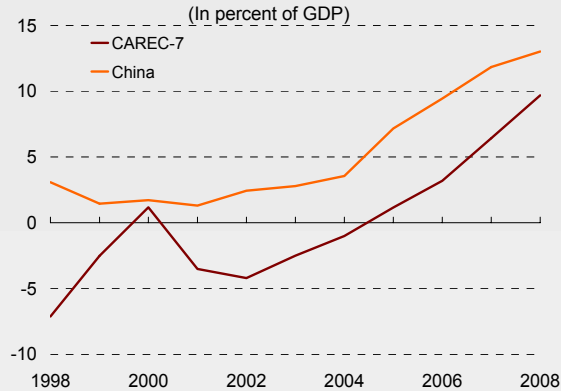
(Annual average change; in percent)



- But inflation also remains high in CAREC-7.
- Average inflation seems to be getting entrenched around 10 percent.
- Recent figures show increasing inflation for nearly all CAREC-7 countries.

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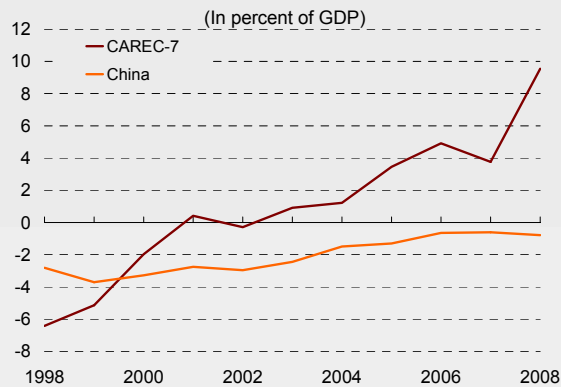
External Current Account Balance



- External surpluses are growing.
- Region continues to benefit from strong inflows:
 - High oil prices (AZE, KAZ)
 - Strong prices for non-oil commodities (KAZ, KGZ, UZB)
 - Rising non-commodity exports (PRC, UZB)
 - Growing remittances (AZE, KGZ, TJK, UZB).

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Central Government Fiscal Balance

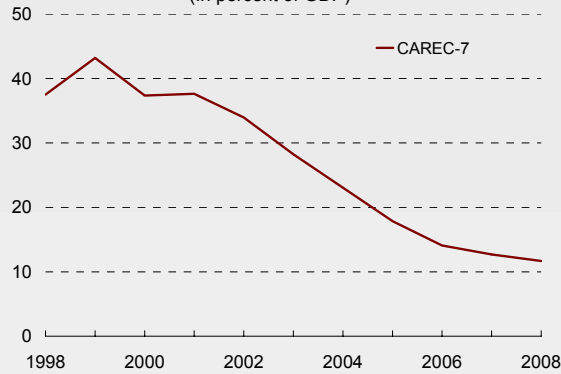


- Fiscal balances have improved in recent years in CAREC countries.
- Azerbaijan and Kazakhstan are running large surpluses owing to high oil revenue, despite significant easing in Kazakhstan in 2007.
- Widening of fiscal deficits are projected in Mongolia and Tajikistan.

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Total Government Debt

(In percent of GDP)

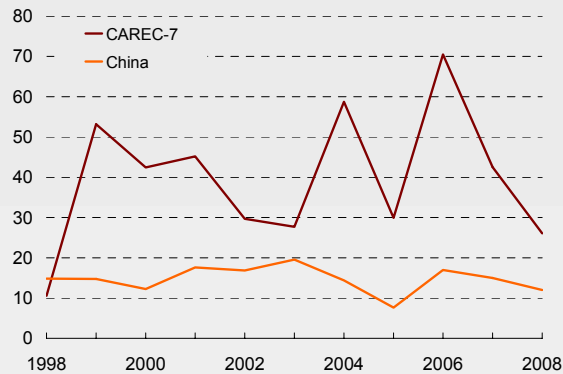


- Government debt remains on a downward trend.
- Most countries implemented prudent fiscal policies; some have also benefited from debt restructuring and debt relief.
- Tajikistan’s debt-to-GDP ratio is projected to increase because of large investments financed by concessional loans from China.

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Monetary Growth

(Percent change from previous period)

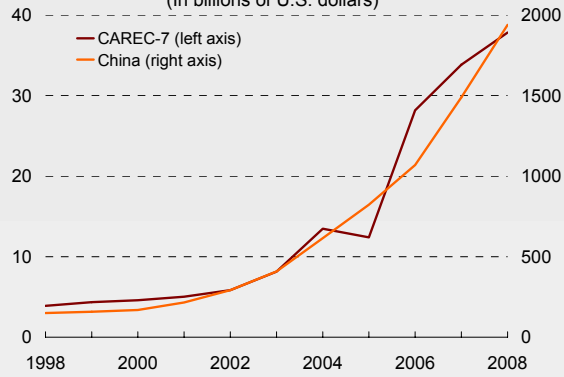


- Monetary growth slowed down in 2007, except in Tajikistan.
- Broad money still continues to grow faster than GDP in CAREC-7.
- Partly reflects healthy process of financial deepening.
- But has also added to inflationary pressure.

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Gross Official Reserves

(In billions of U.S. dollars)



- Gross official reserves are increasing steadily in all CAREC countries.
- Increases reflect sharp improvements in current account positions in some countries, and higher capital inflows in others.
- Progress in building reserves and reducing debt has put the region in a better position to absorb shocks and address development needs. 17

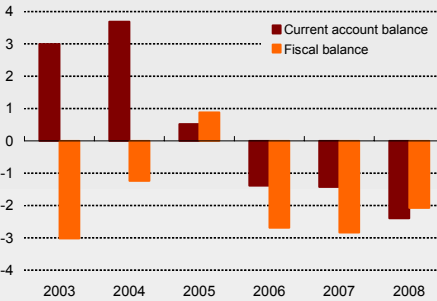
Individual Country Prospects and Key Policy Challenges

Afghanistan

Annual percent change



In percent of GDP

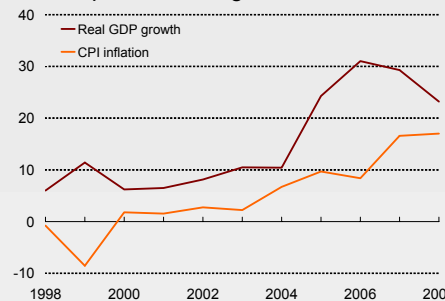


Key policy challenges:

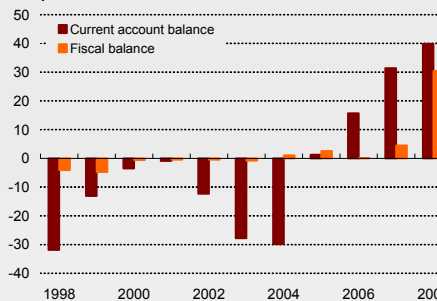
- Fiscal independence: develop a modern tax and customs administration, and introduce a broad-based sales tax.
- Development and stability of the financial system: strengthen reforms, in particular the banking supervision.
- Reducing political interference in economic policies: avoid measures that undermine the transparency of the trade regime and increase the government's role in the economy.

Azerbaijan

Annual percent change



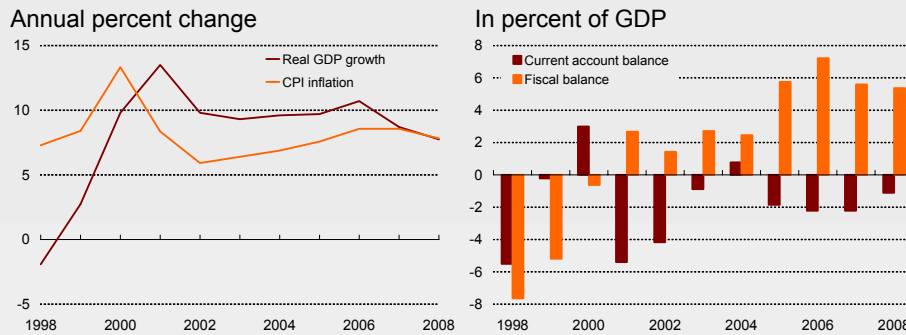
In percent of GDP



Key policy challenges:

- Ensuring an efficient and transparent use of oil revenues: adopt medium-term budgeting, improve coordination between monetary and fiscal policies, and strengthen expenditure management.
- Reducing inflation: tighten monetary policy and restrain fiscal stimulus.
- Improving competitiveness: step up financial sector reforms, improve the business climate, and tackle governance problems.

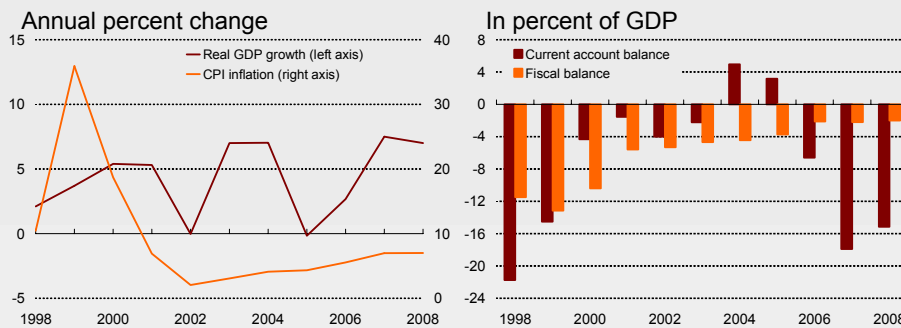
Kazakhstan



Key policy challenges

- Dealing with sudden stop in external funding of the banking system: raise interest rates and possibly increase exchange rate flexibility if pressure on tenge re-emerges.
- Reducing banking sector risks: strengthen prudential regulations and intensify banking supervision.
- Sustaining impressive economic performance: continue prudent management of oil revenue and intensify structural reforms.

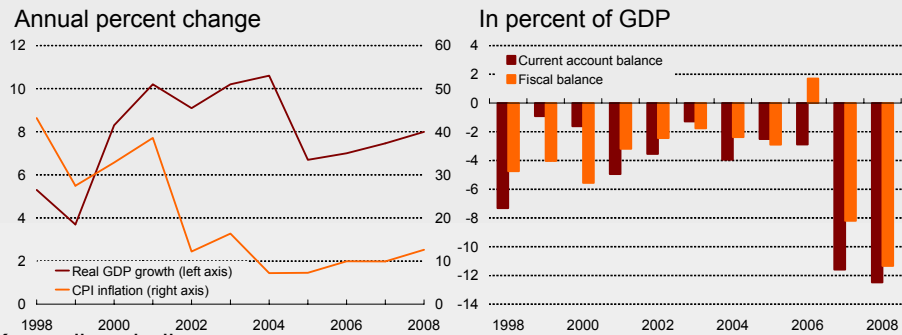
Kyrgyz Republic



Key policy challenges:

- Reducing inflation: tighten monetary policy, reduce unsterilized intervention in the foreign exchange market, and allow appreciation of the exchange rate.
- Fiscal consolidation: broaden the tax base and improve tax administration.
- Strengthening the underpinnings of growth: improve the regulatory environment and accelerate structural reforms.

Tajikistan

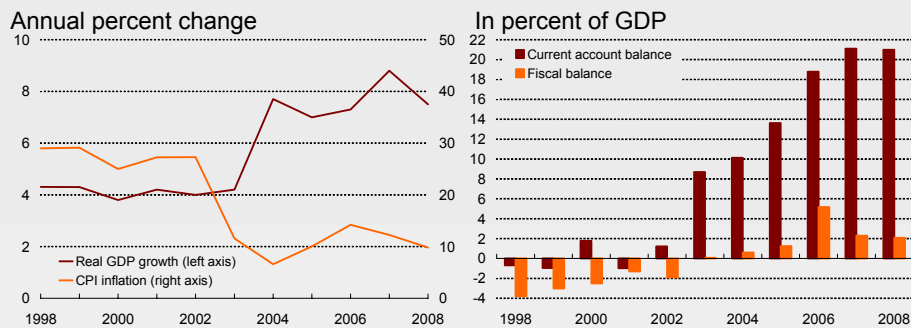


Key policy challenges:

- Reducing inflation: implement a more cautious fiscal policy and a tighter monetary policy.
- Making good use of increased donor support, while avoiding new cycle of excessive borrowing: put in place a well-defined debt management framework and contract debt only on concessional terms.
- Reforming the banking sector: discontinue subsidized and directed lending operations, and strengthen regulatory and supervisory framework.

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Uzbekistan

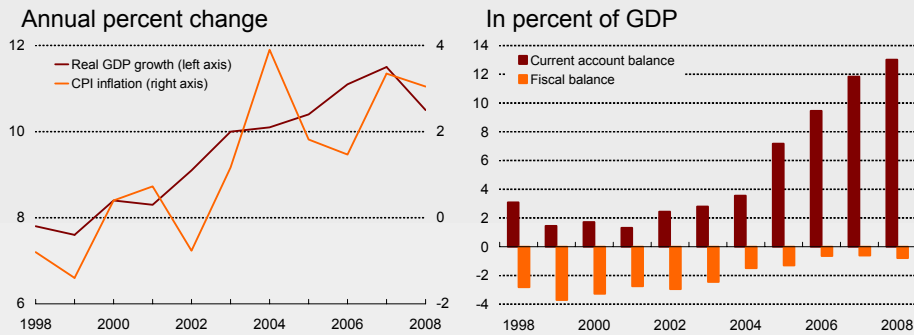


Key policy challenges:

- Reducing inflation: further tighten monetary policy, maintain a cautious fiscal stance, and adopt a flexible exchange rate policy.
- 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.

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China

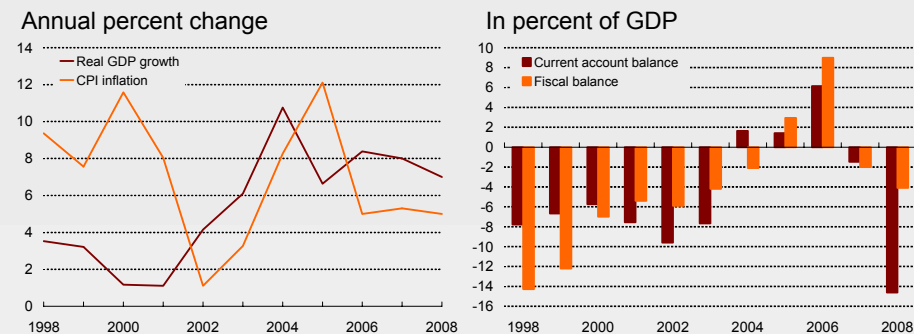


Key policy challenges:

- In the near term, preventing a surge in credit and investment growth: tighten monetary policy and appreciate the renminbi at a faster pace.
- In the medium term, rebalancing the economy away from heavy reliance on investment and exports towards consumption: develop the financial sector further to better intermediate China's large savings, and shift public expenditure towards higher health and education spending and accelerate pension reforms.

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Mongolia



Key policy challenges:

- Reducing inflation: tighten both monetary and fiscal policies.
- Preparing for the possibility of lower copper prices over the medium term: contain government expenditure, including through a better targeting of social transfers.
- Continuing to improve financial sector soundness: strengthen financial supervision, particularly of nonbank institutions.

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Common Policy Issues

- Macroeconomic performance has been strong and near-term prospects are favorable.
- Risks to the outlook:
 - The region is heavily dependent on volatile oil and non-oil commodity prices.
 - If the credit crunch continues, growth in developed countries could slow sharply with spillovers to Central Asia through trade and financial linkages.
 - Further spikes in oil and food prices could add to inflationary pressures.

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Common Policy Issues (continued)

- The most important challenge for the region is to manage the high levels of foreign exchange inflows to sustain its improved performance while limiting inflation that has accompanied it.
- To prevent inflation from becoming entrenched, monetary policy should be tightened and nominal exchange rates be allowed to appreciate in response to the permanently higher inflows.
- In a few countries where medium-term fiscal and external sustainability remains elusive, fiscal reforms are a priority. Governments need to carefully balance opportunities for external financing to raise investments with the need to prevent a deterioration in debt ratios.

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Common Policy Issues (continued)

- Financial sector reforms are a priority in the region. The agenda is different in each country, but includes steps to strengthen banking sector soundness, enhance competition, and deepen financial markets.
- More broadly, structural and institutional reforms should continue to promote private sector development, increase productivity in the non-commodity sector, boost countries' resilience to shocks, and foster further integration of CAREC countries into the global economy.
- Finally, regional cooperation, including through the CAREC program, should be increased to promote trade and investment, and improve the prospects for long-term growth.