

# Caucasus and Central Asia

## Regional Economic Outlook Spring 2011



**Кавказ и Центральная Азия**  
**Перспективы развития региональной экономики**  
Весна 2011 года

# Overview

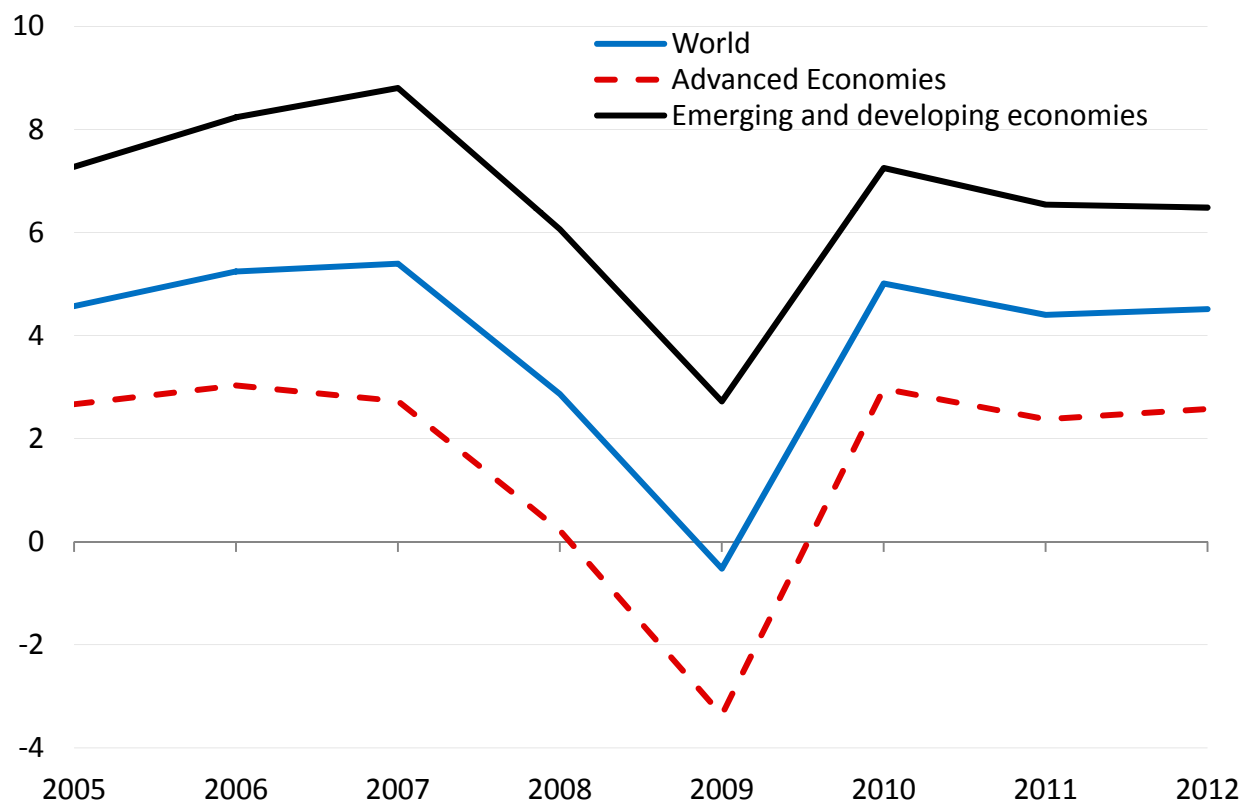
World Economic Outlook

Caucasus and Central Asia (CCA) Developments and Outlook



# Global growth: A multiple-speed world

**WEO Real GDP Growth Projections**  
(2005-12, percent change from a year earlier)

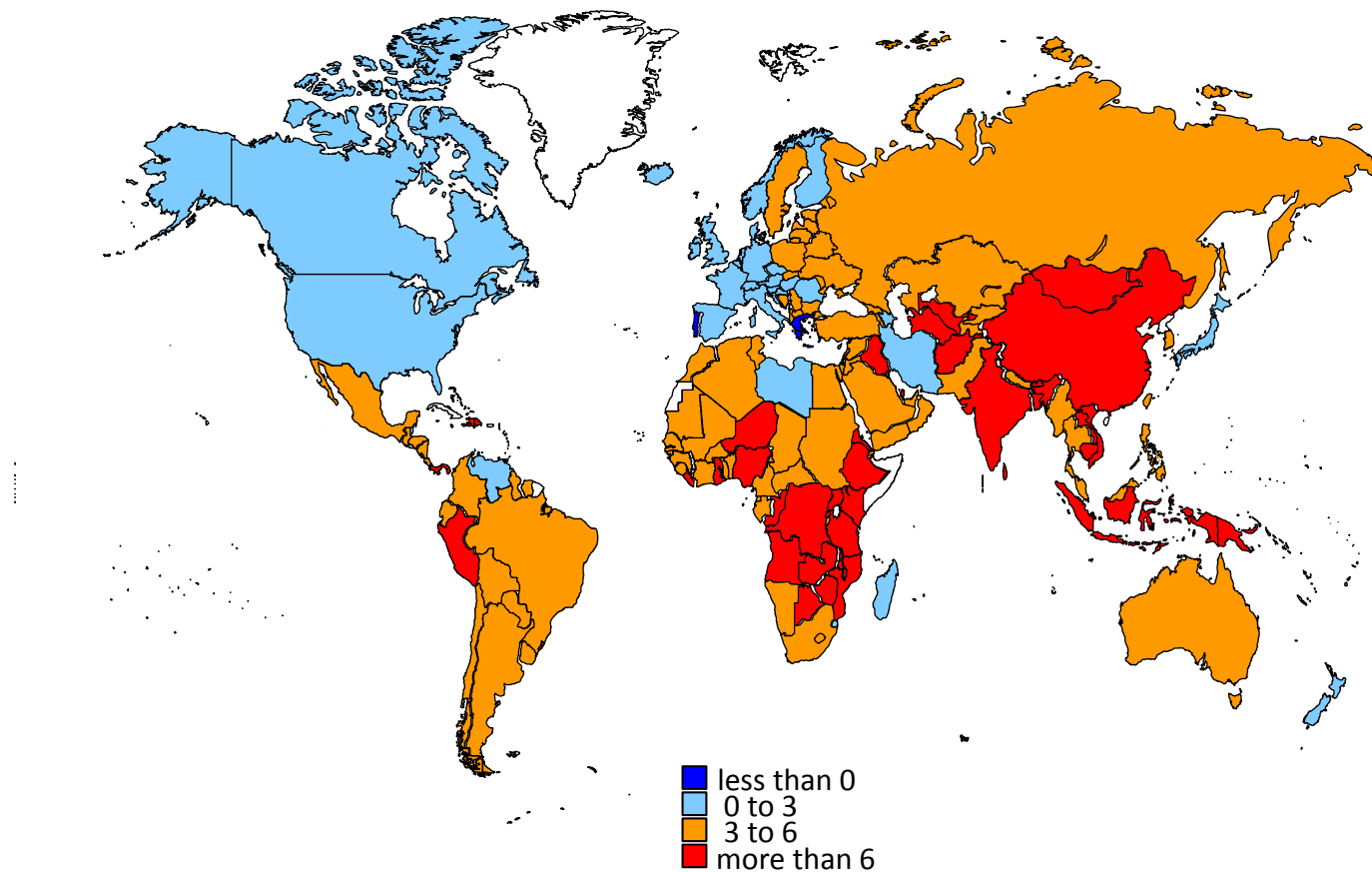


Source: IMF, *World Economic Outlook*.



## Two-speed Recovery: Marked Differences in Growth Rates

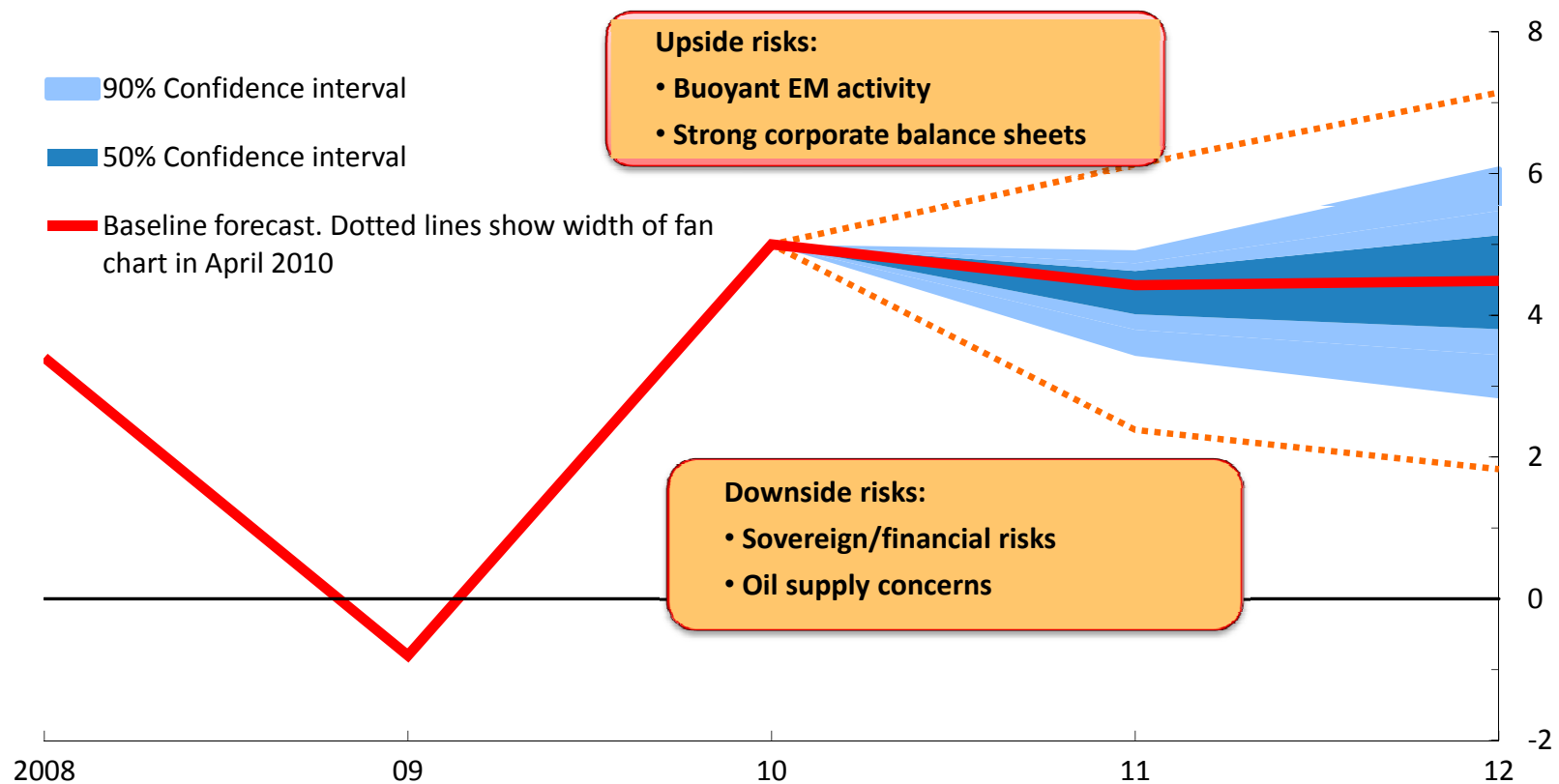
**Average Projected Real GDP Growth during 2011-2012**  
(percent)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

# Downside risks, while diminished, dominate

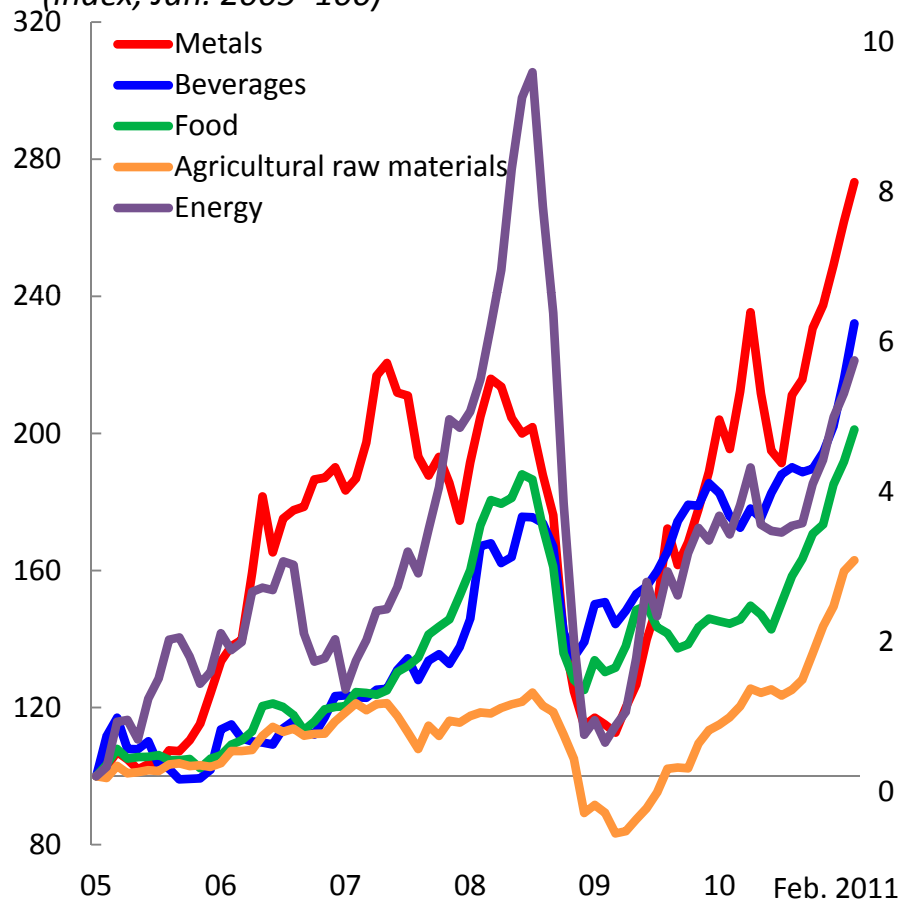
Prospects for World GDP Growth  
(percent change)



# Surging Commodity Prices and Inflation

## Commodity Prices

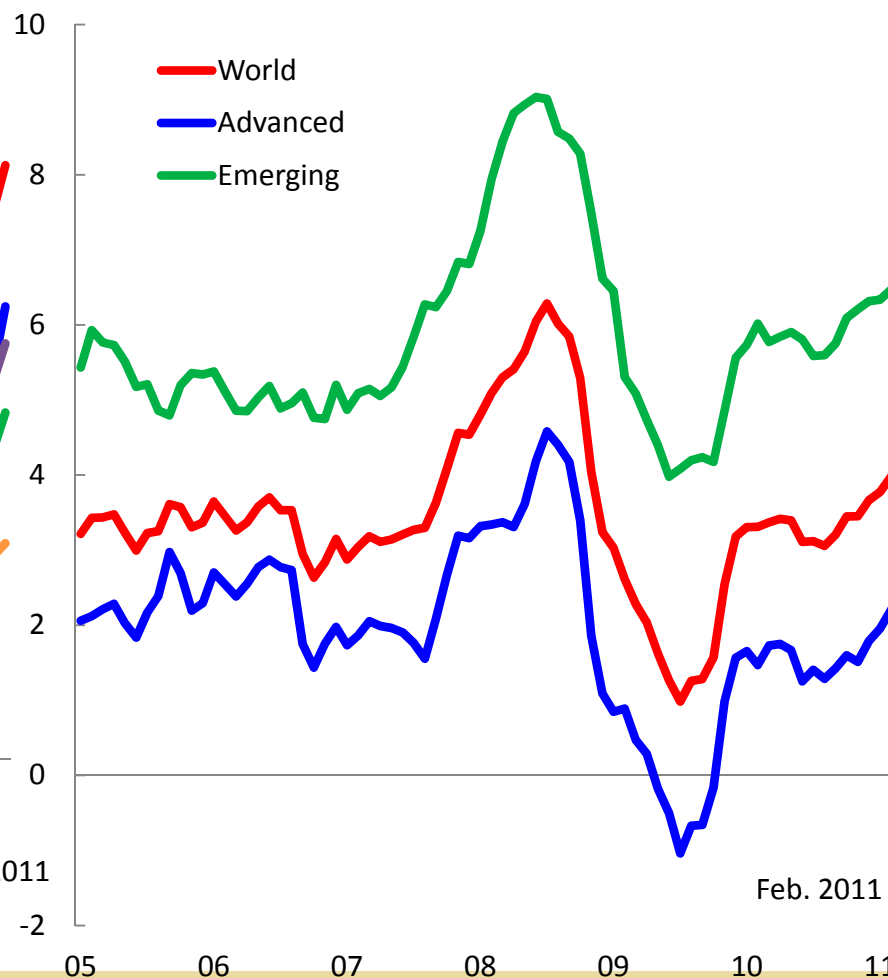
(index; Jan. 2005=100)



Source: IMF, Global Data Source.

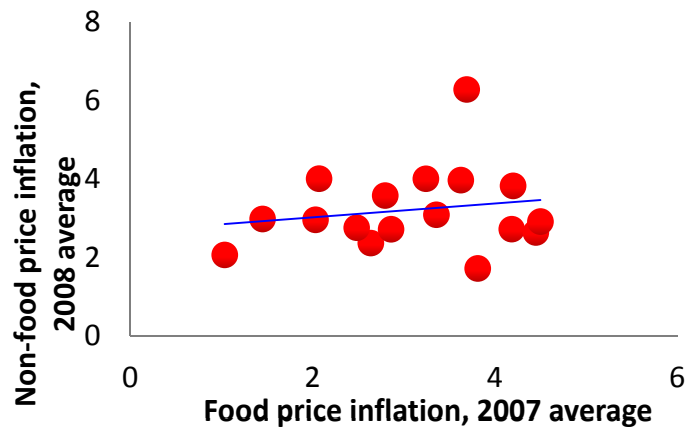
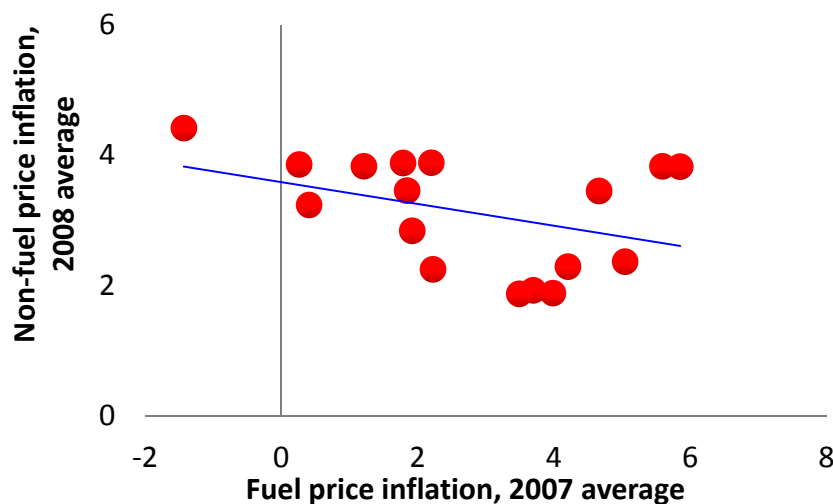
## Headline CPI Inflation

(percent; year over year)

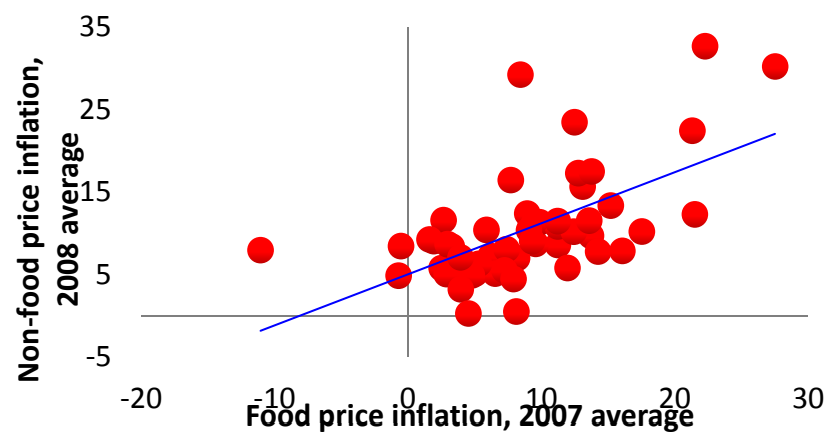
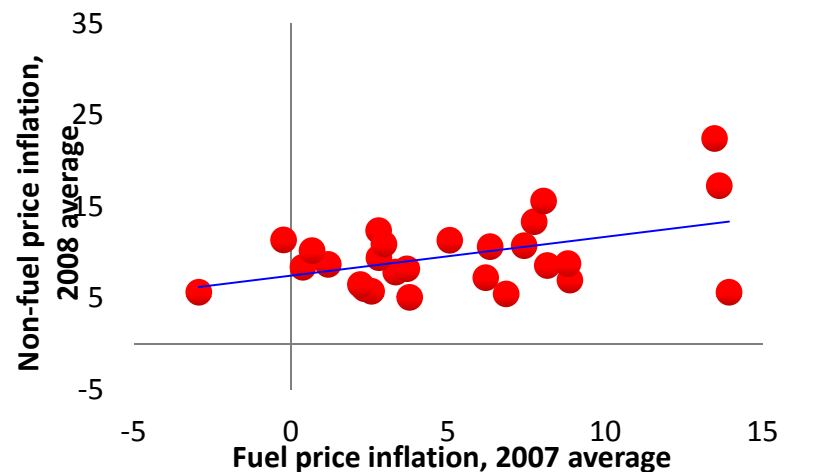


# From Fuel/Food to Core: Evidence from the Last Spike

Advanced Economies



Emerging Economies



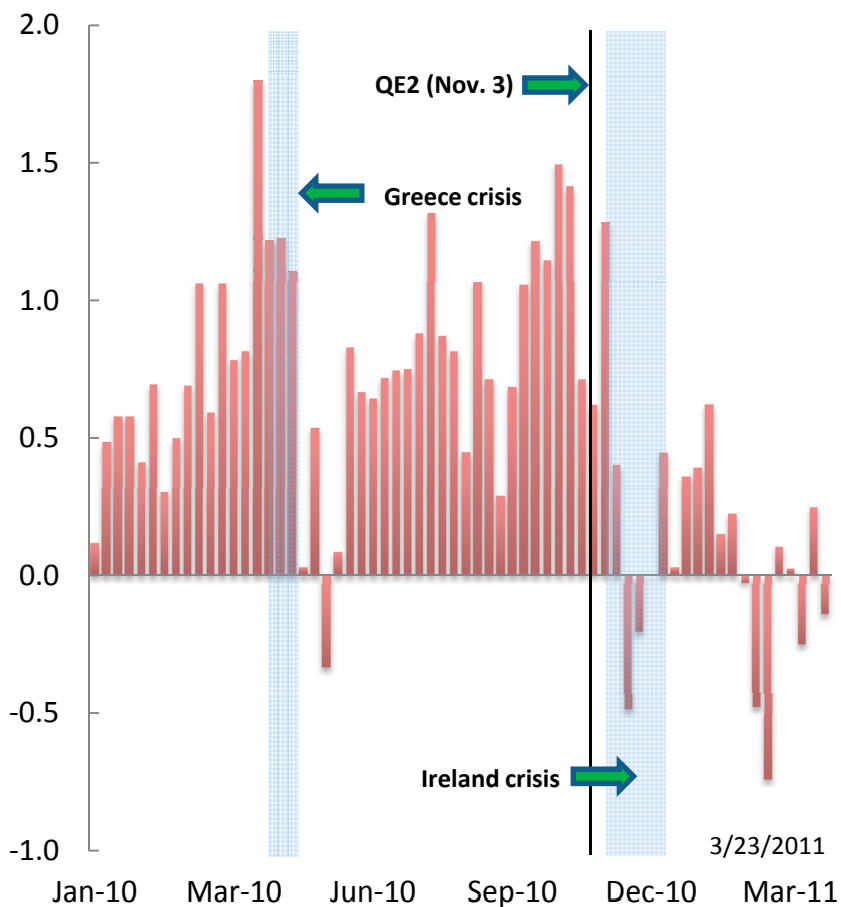
Sources: IMF, *World Economic Outlook*; and IMF staff estimates.



# Capital Flows to EMs have slowed since Fall 2010

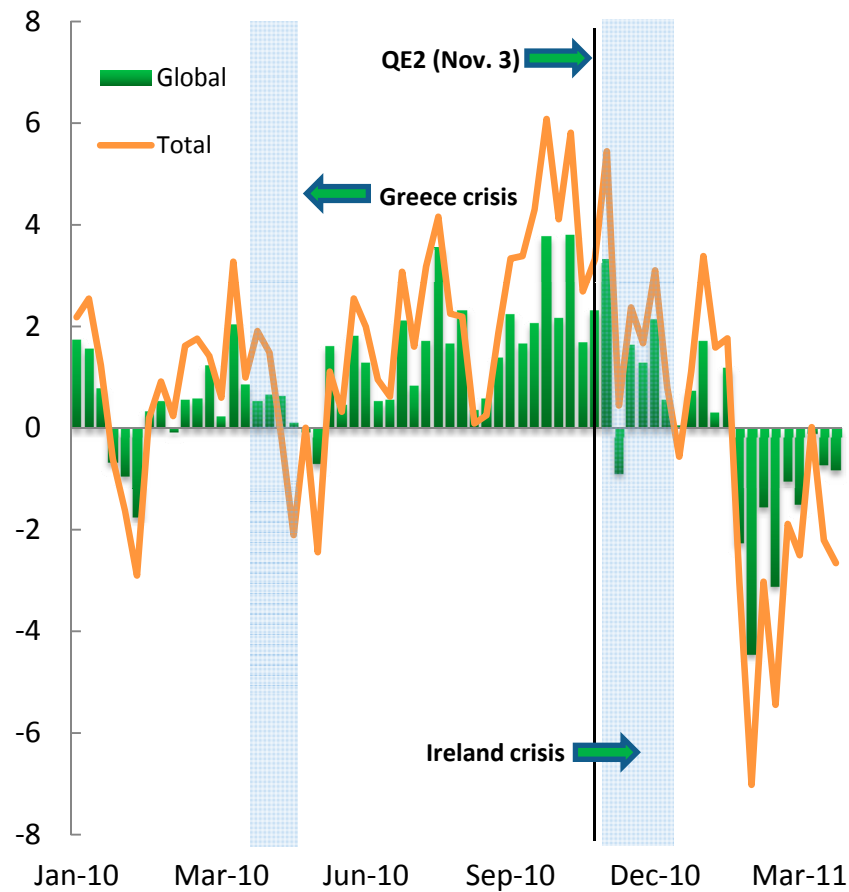
(billions of U.S. dollars, weekly flows)

## Bond Funds



Source: EPFR Global.

## Equity Funds



3/23/2011





## Conclusions

### Advanced economies

- Heal fiscal and financial
- Increase growth above potential
- Increase potential growth

### Emerging and developing economies

- Watch for overheating
- Tighten monetary policy
- Be aware of capital inflows

### Rebalancing still essential

- Needed to increase growth in advanced economies, especially U.S.
- And allow for fiscal consolidation in AEs

## Caucasus and Central Asia—Outline

CCA developments and outlook

Immediate challenges:

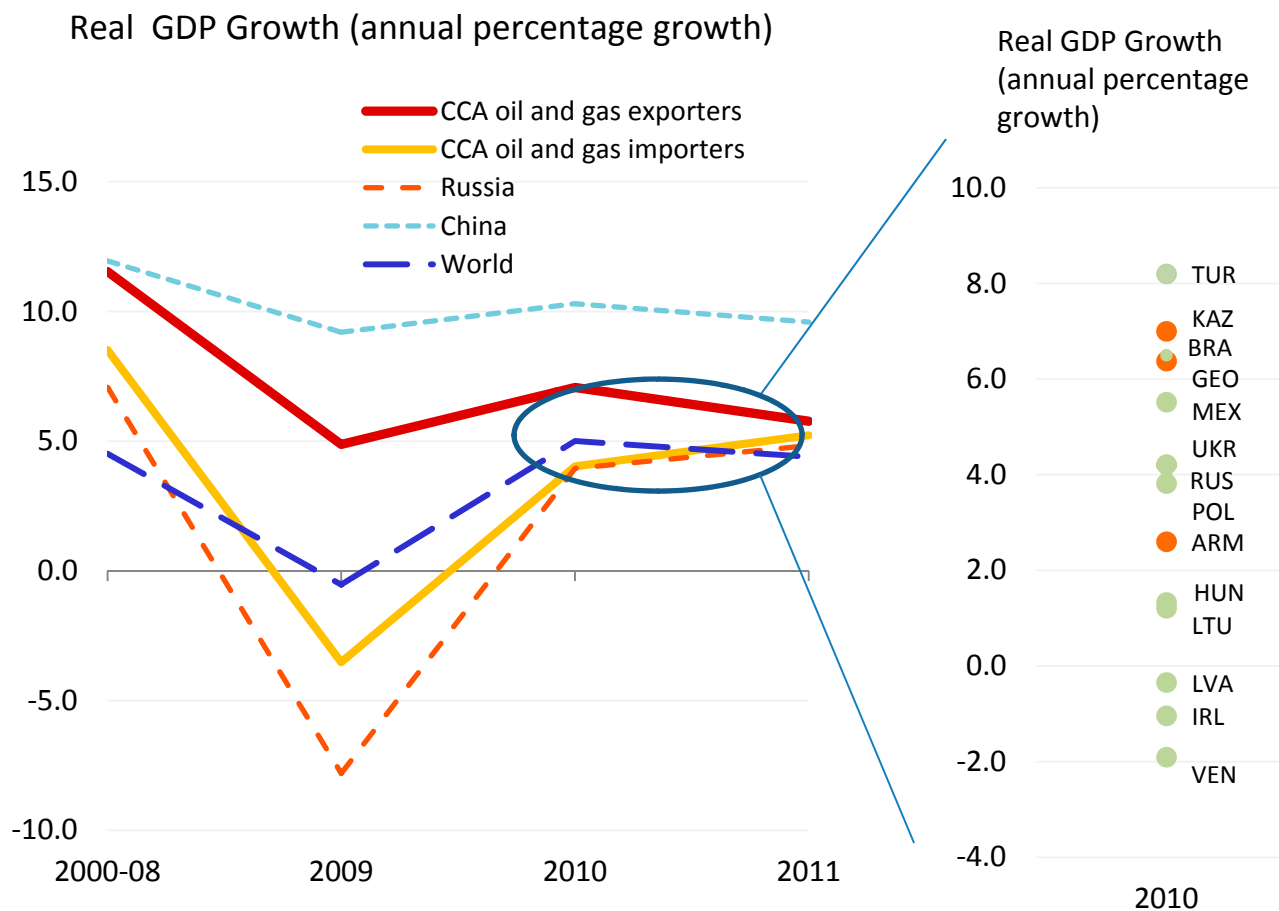
- Inflationary pressures
- Fiscal pressures
- Impaired banking sectors

Medium-term challenge: sustaining strong, inclusive, and diversified growth



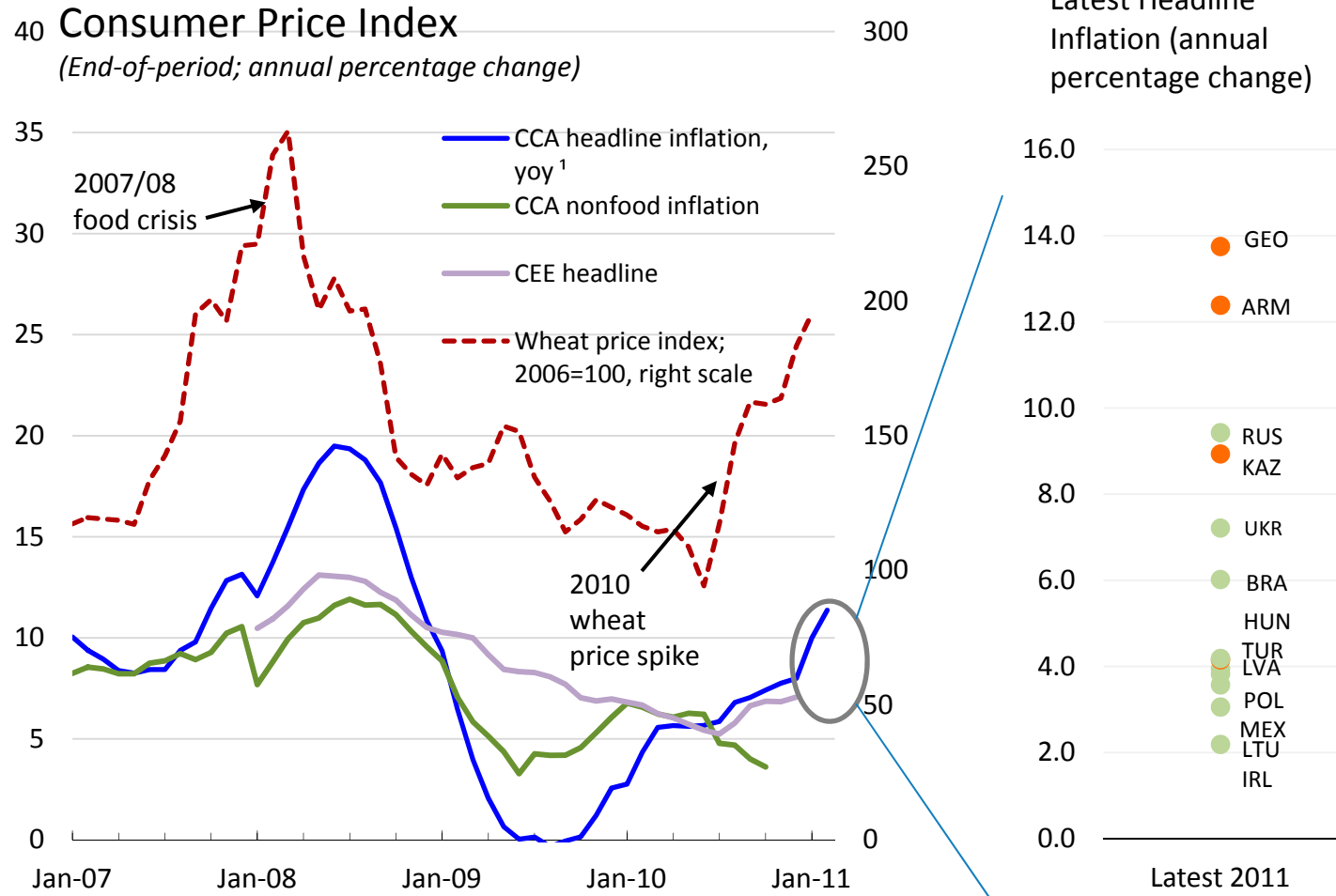
## Strong recovery underway

- Post-crisis recovery took hold in 2010
- Led by strength of natural resource sectors in oil and gas exporters
- Recovery set to broaden to all CCA countries in 2011



# Inflation has surged: Risks of becoming entrenched?

- Headline inflation has picked up
- Food and fuel are the driving factors
- Public spending may also be adding demand pressure



Sources: IMF, *World Economic Outlook*; and national authorities.

<sup>1</sup> Jan and Feb 2011 CCA headline CPI does not include TKM.



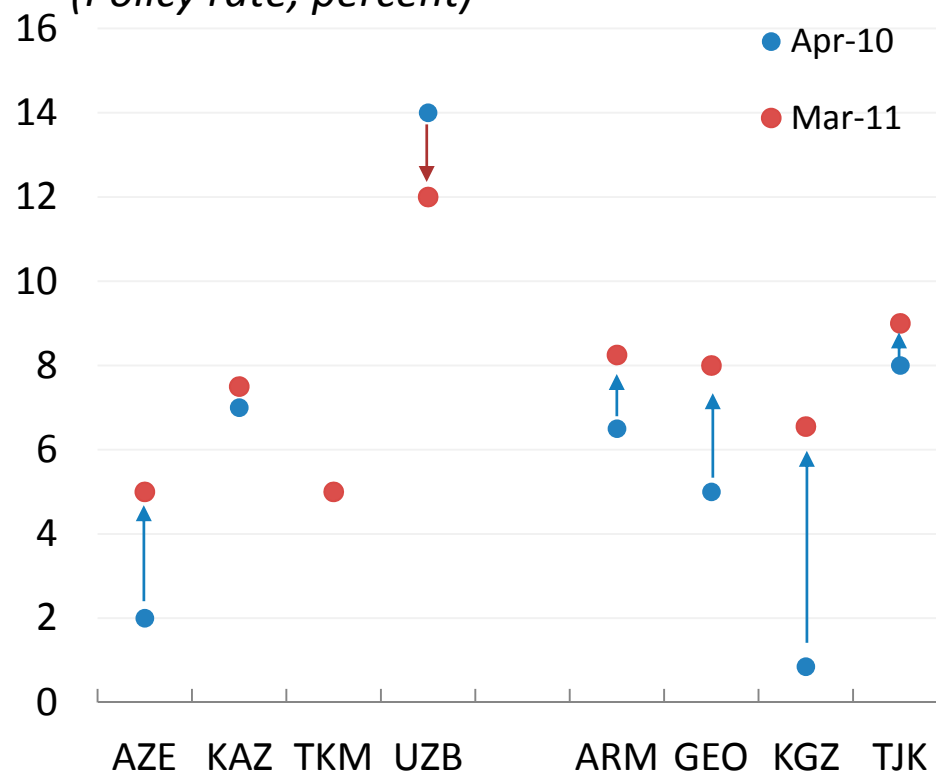
## Policy response: Central banks are tightening

CCA central banks have raised interest rates

Some countries have used reserves requirements or other sterilization measures

CCA governments have taken administrative actions to limit price increases or cut taxes

Adjustment in Policy Rates, 2010-11  
(Policy rate; percent)



Sources: National authorities.



## Policies to reduce inflation

Watch closely for signs of second-round effects: core inflation, wages, and credit growth

Continue to respond proactively to higher headline inflation; further tightening likely to be needed

Ensure that supporting policies in place, including to protect the poor

# Spending pressures threatening fiscal consolidation plans

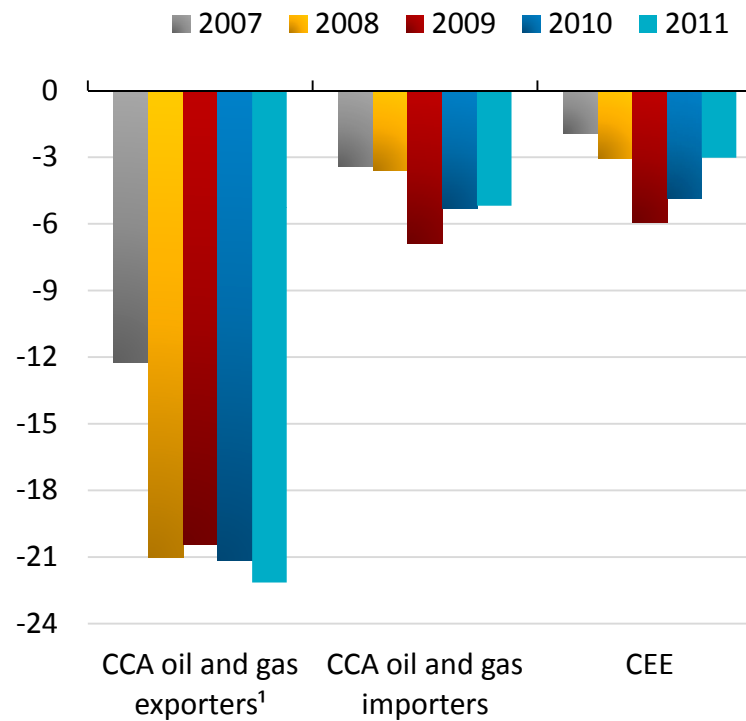
Higher prices leading to increased pressures for higher wages, pensions, and subsidies

Oil importers, with limited fiscal space, need to reduce deficits

Oil and gas exporters, with ample fiscal space, plan more gradual consolidation...

...and non-oil deficits remain far above pre-crisis levels

Fiscal Deficits  
(Fiscal balance; percent of GDP)



Sources: National Authorities; and IMF staff calculations.

<sup>1</sup> Non-oil and gas fiscal balance over non-oil and gas GDP is used.



## Fiscal policy recommendations

Target spending measures to alleviate inflation effects on the poor

Avoid across-the-board spending pressures that feed into inflation

For CCA oil & gas importers: limited fiscal space calls for prioritizing of spending  
For the exporters: ensure efficient spending of windfalls, strengthen non-oil revenues





## Impaired banking sectors in some countries

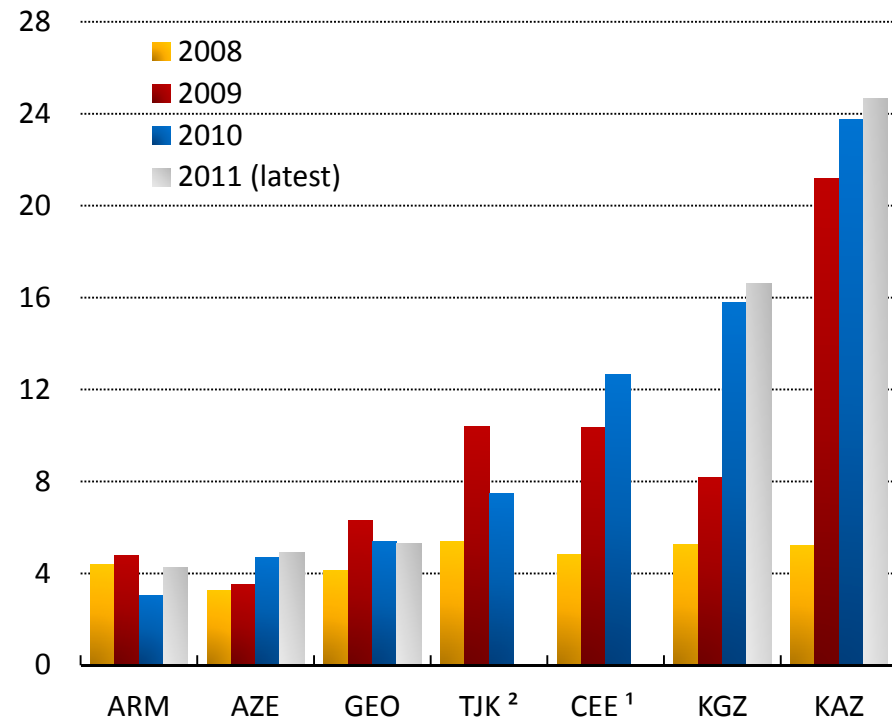
High and rising NPLs in some countries continue to impair balance sheets

Resolution strategies need to proceed more forcefully in these countries

Policy challenges:

- Increasing competition
- Strengthening risk management
- Better supervision.

High, and Mostly Rising Levels of Nonperforming Loans  
(Nonperforming loans on 90-day basis; percent of total loans)

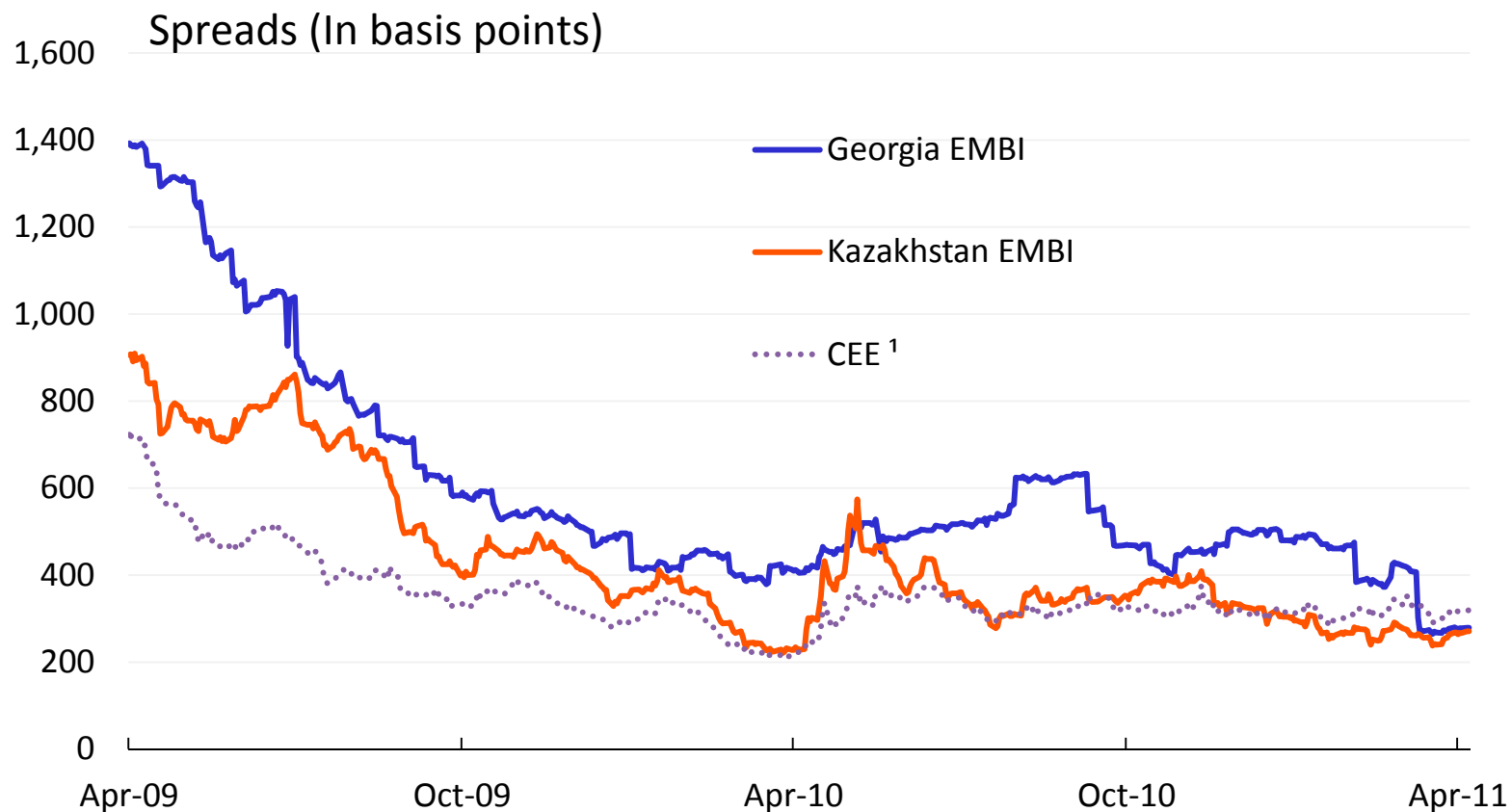


Source: National authorities.

<sup>1</sup> Simple average of NPLs for Albania, Bosnia, Bulgaria, Croatia, Hungary, Lithuania, Latvia, Macedonia, Montenegro, Poland, Romania, Russia, Serbia, Turkey, and Ukraine.

<sup>2</sup> 30-day basis.

# CCA EM spreads in line with other regions



Sources: National authorities; Bloomberg; and IMF staff estimates

<sup>1</sup> Average of EMBI spreads for Belarus, Bulgaria, Croatia, Hungary, Lithuania, Poland, Russia, Serbia, Turkey and Ukraine.



## Medium-term challenge: Sustaining strong, inclusive, diversified growth

Recovery led by commodities and public spending

Pre-crisis growth drivers yet to recover:

- Remittances
- Other foreign exchange inflows

...And some proved unreliable

CCA economies remain undiversified



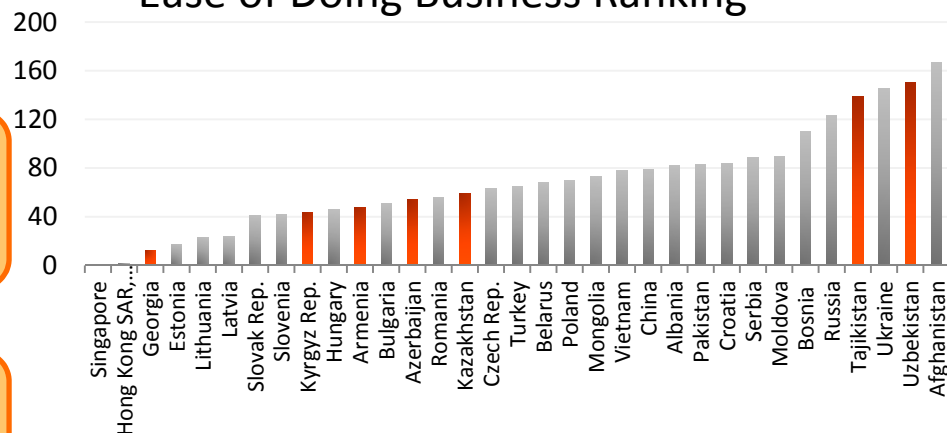
# Reduce the cost of doing business

Countries have made progress...  
but still hard to do business

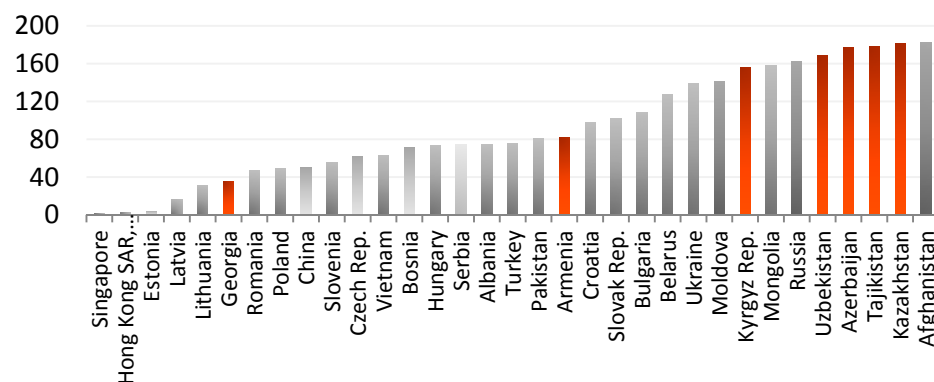
Key challenges: lack of competition and  
excessive role of the state

Intra-regional links costly, underdeveloped

Ease of Doing Business Ranking



Trading Cross Border Rank



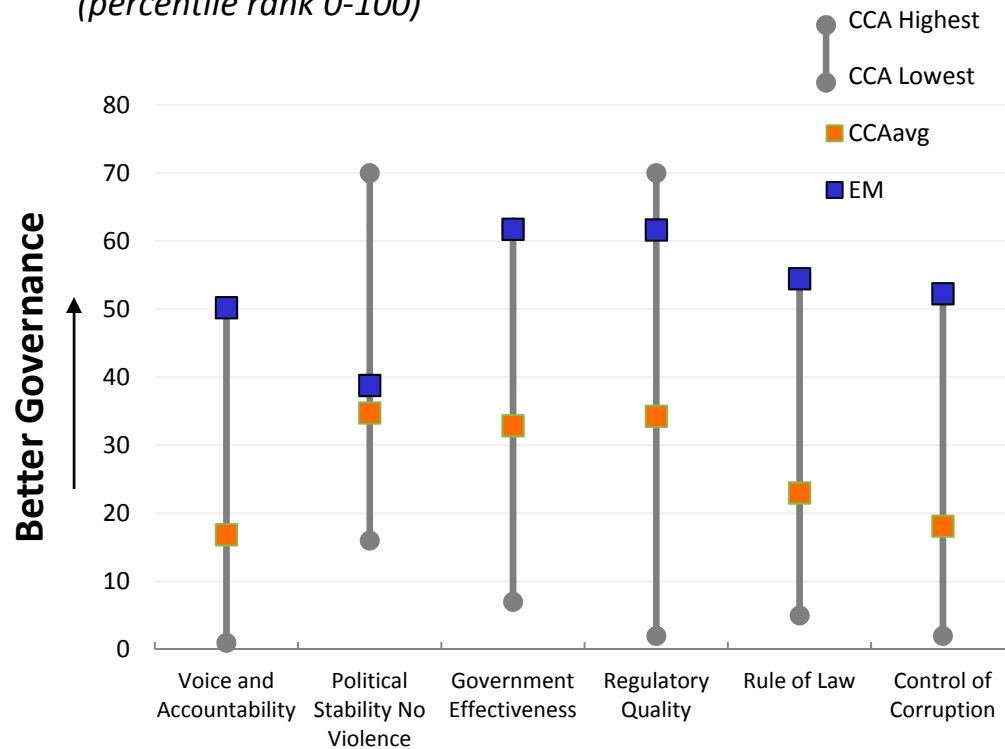
Sources: Ease of Doing Business 2011.



# Strengthen the quality of institutions and increase transparency

CCA institutional quality lags other regions

Governance Indicators <sup>1</sup>  
(percentile rank 0-100)



Sources: The 2009 Worldwide Governance Indicators; and IMF staff calculations.  
<sup>1</sup> EM is the average rank over 19 emerging markets.



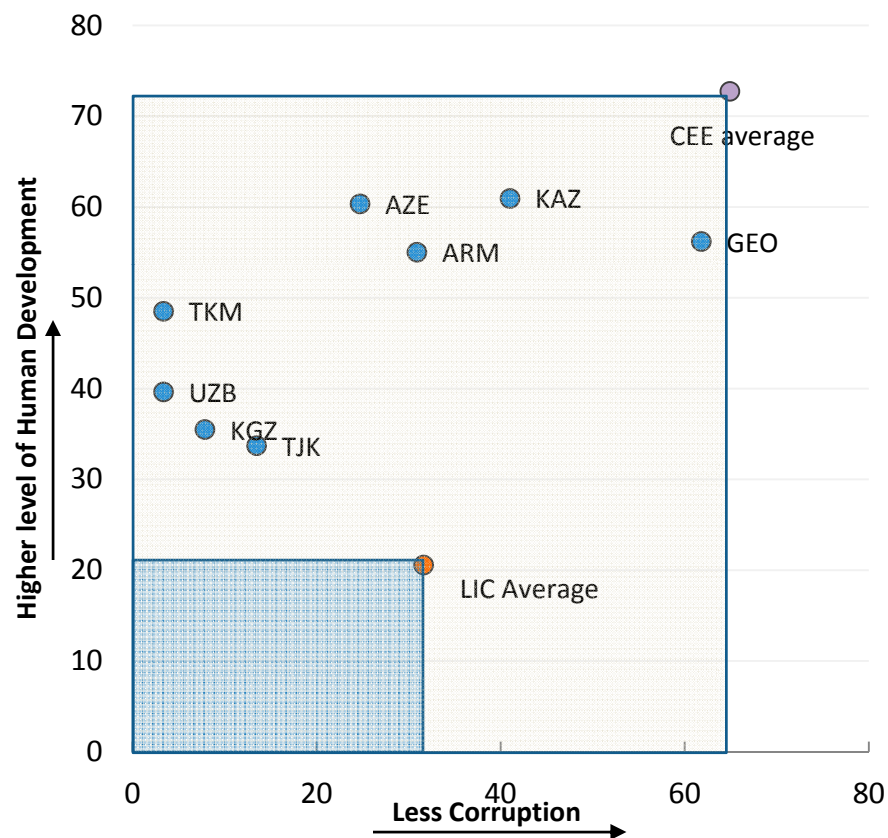
# Invest in human development and protect the poor

Poverty and inequality are high in some CCA countries

Unemployment and underemployment are concerns

Investment in human development and fighting corruption are keys to achieving inclusive growth

### Human Development and Corruption



Sources: 2010 UN Human Development Indicator and TI Corruption Perception.



Please visit the IMF's website

Full report:

<http://www.imf.org/external/country/tjk/rr/index.htm>

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