



Regional Economic Outlook Caucasus and Central Asia

May 21, 2010



Outline

Global Outlook

CCA Outlook



Multi-speed recovery

Recovery so far

- Proceeding at varying speeds
- Steep falls in activity not followed by quick rebounds

Recovery ahead

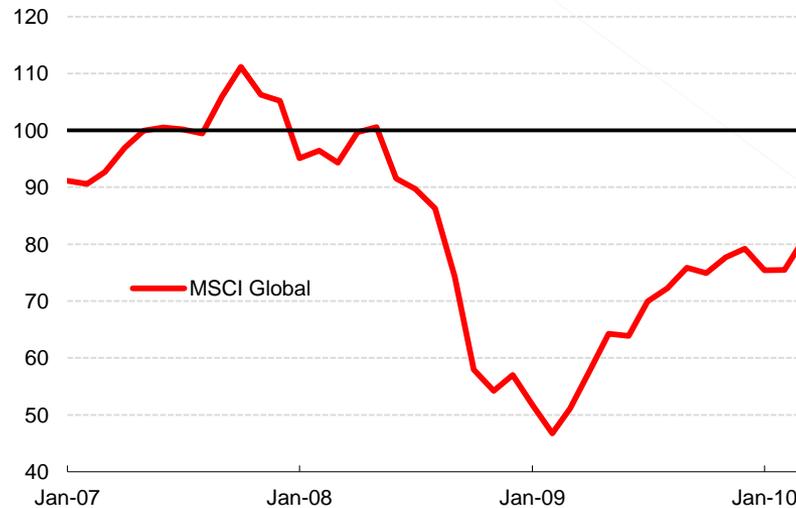
- Subdued growth prospects for many advanced economies
- Solid growth prospects for many emerging economies



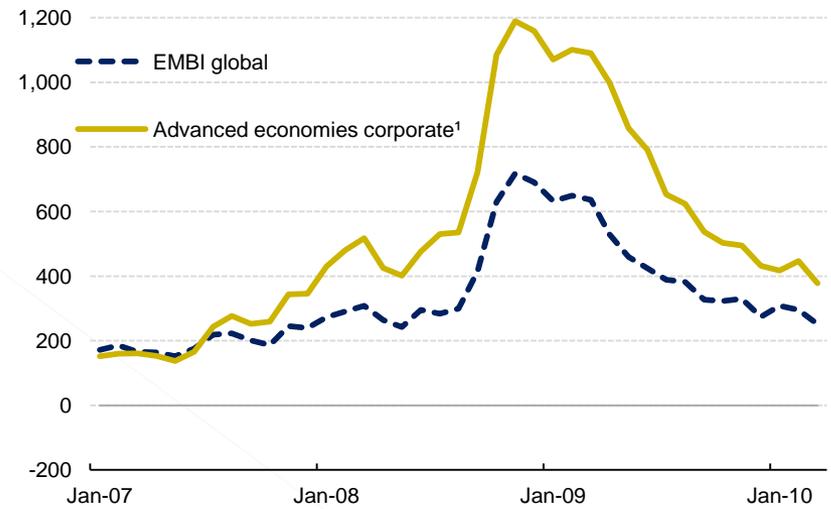
Global financial markets have recovered faster than expected

Global Stocks

(Morgan Stanley MSCI Stock Price Indices in U.S. Dollars, MER Weighted; 2007 = 100)



Sovereign and Corporate Bond Spreads (Basis points)

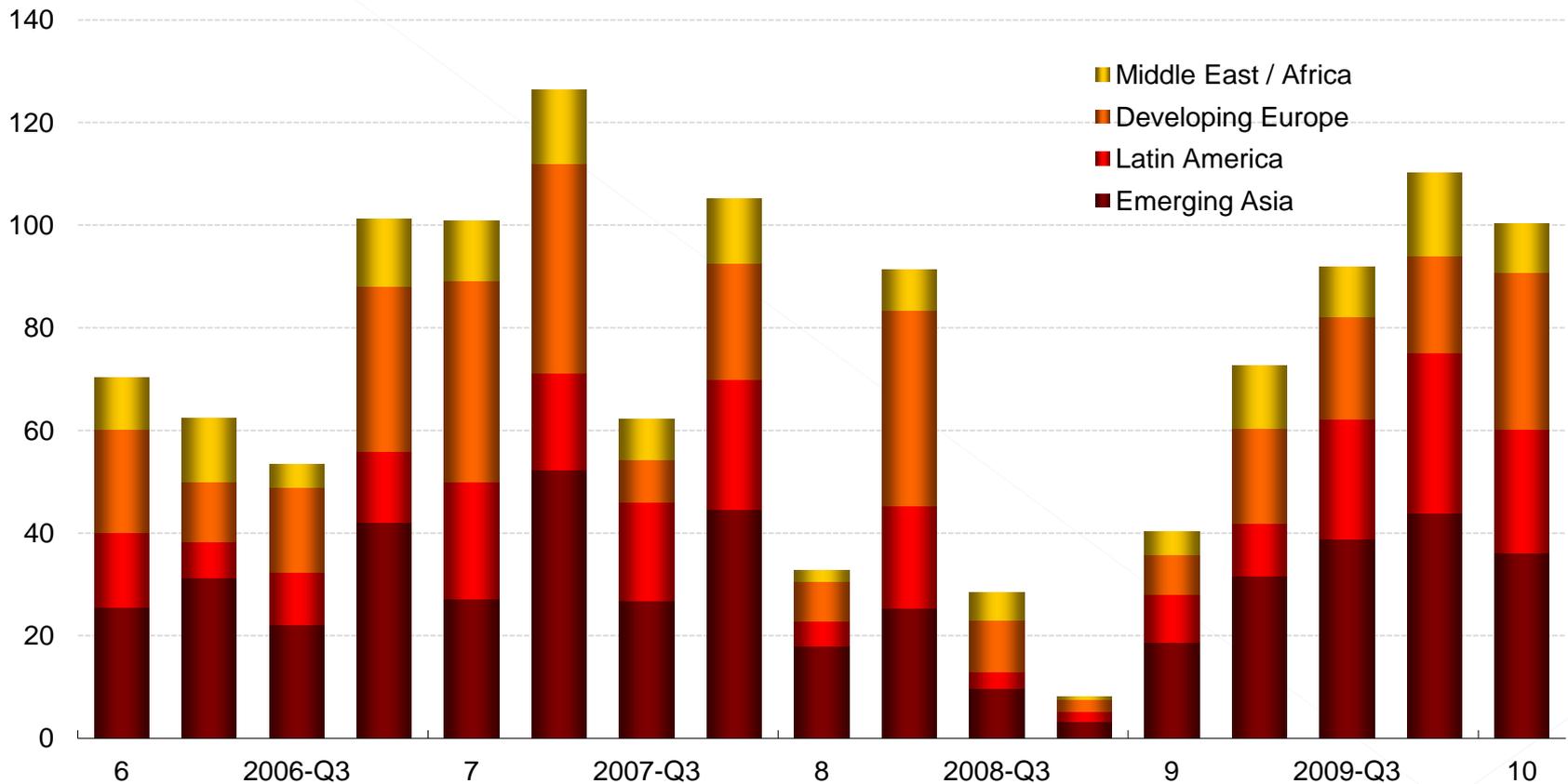


¹ Averages of BB-B US, BB-B Euro, and BBB Japan corporate bond spreads.



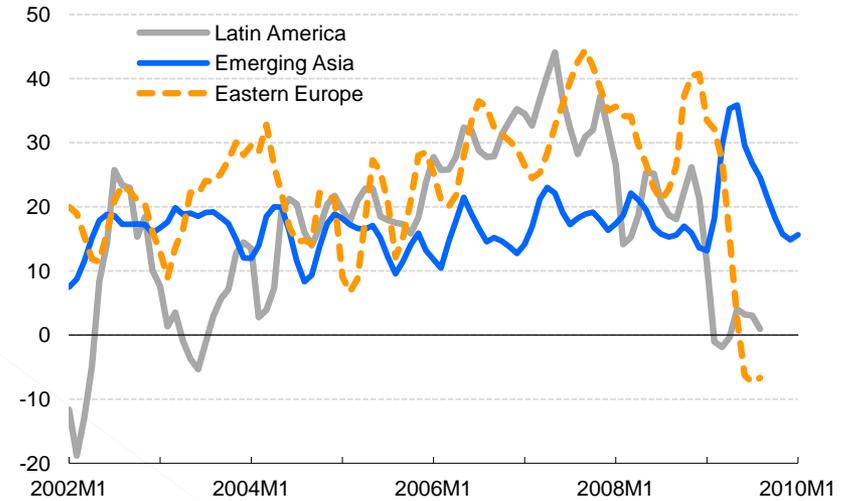
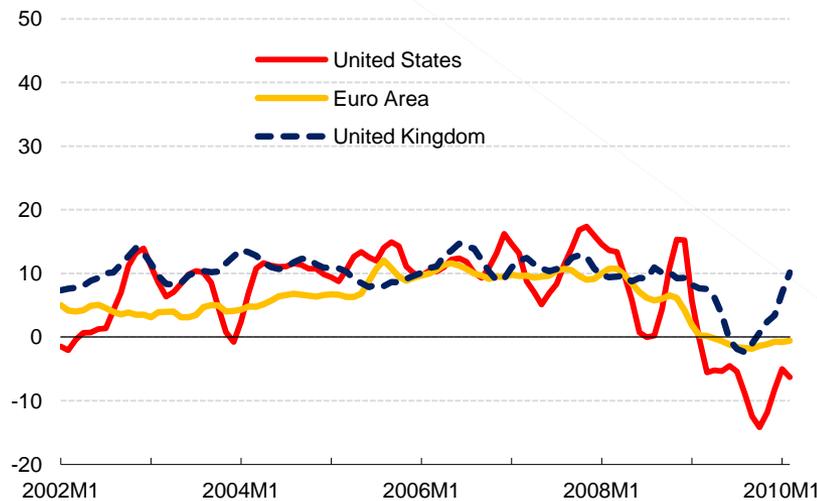
Capital flows have returned to emerging markets after sudden stop

Emerging Market External Bond and Equity Issuance
(Billions of U.S. dollars)



Bank credit remains hard to come by in many countries

Private Credit Growth
(Annualized percent change of 3mma over previous 3mma)



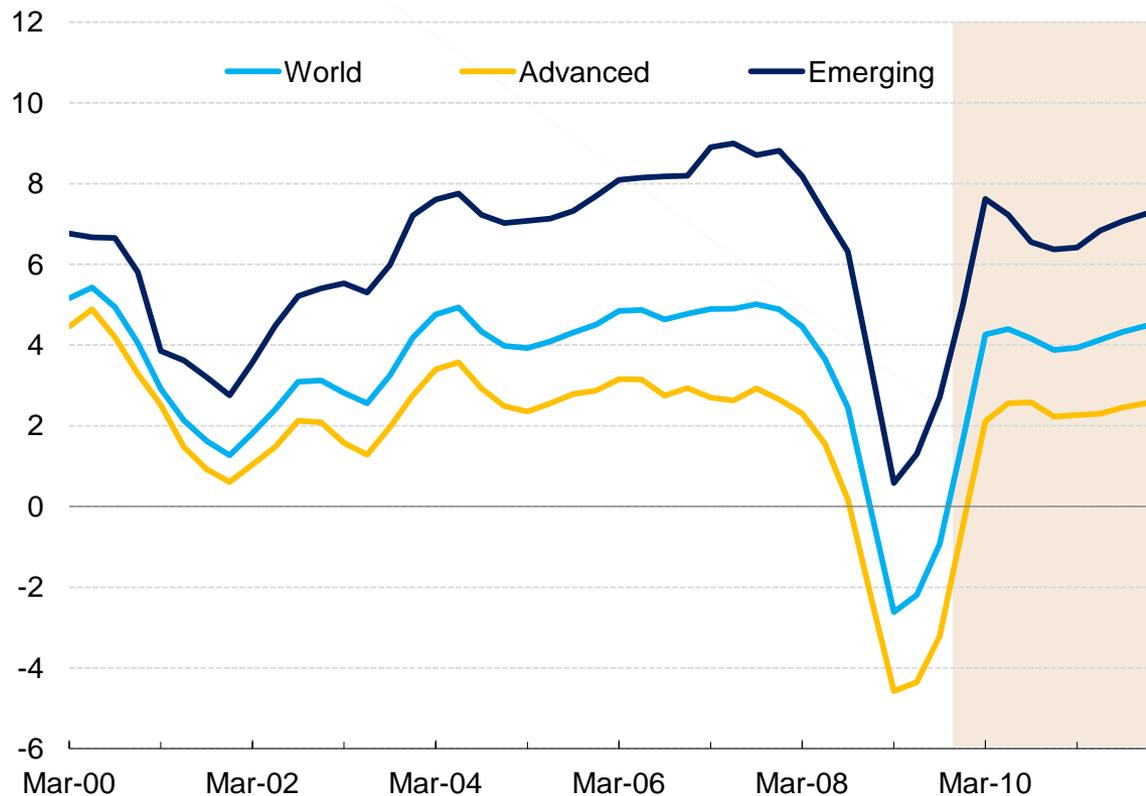
Banks need to rebuild capital

Source: Bank of England, European Central Bank, and the Federal Reserve Board.



World economy set for a further recovery at varying speeds

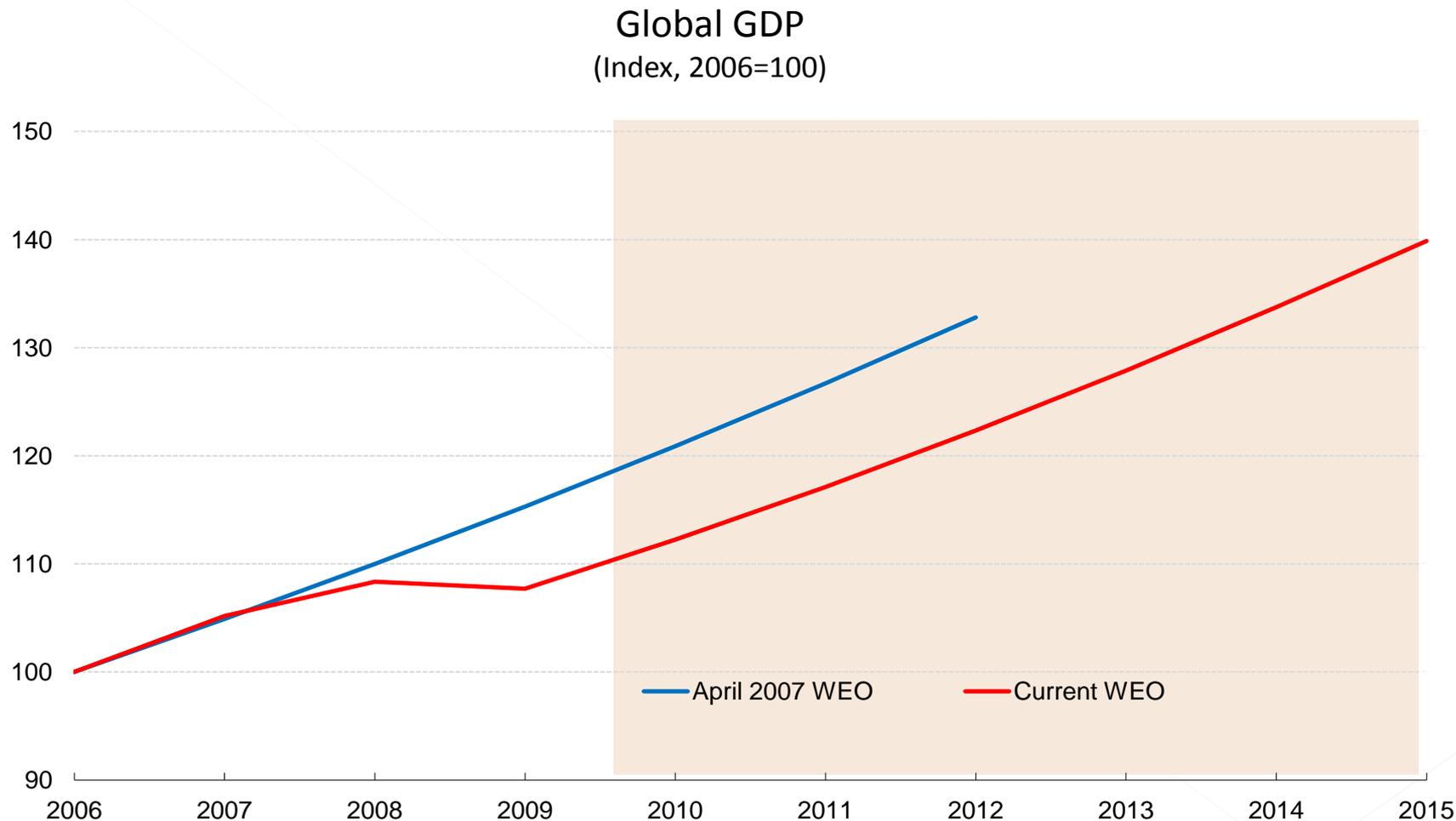
Real GDP Growth
(Percentage growth from previous year)



- Fading fiscal stimulus
 - Less inventory restocking
- will hold back growth later in 2010 and 2011



Global financial crisis is leaving lasting scars on output levels





Global Policy Challenges

- Devise credible exit strategies—medium-term fiscal consolidation plans urgently needed
- Repair and reform financial systems
- Combat unemployment
- Manage capital flows



Caucasus and Central Asia

Oil & Gas Exporters

Oil & Gas Importers





Key Messages

An incipient recovery

- I. Substantial shocks in 2009, but economic impact cushioned by policy response and donor support
- II. Recovery as the global economy picks up speed
- III. Events in Southern Europe little impact so far

Energy exporters:

- I. Exit from accommodative policies as growth gains traction
- II. Medium term: private sector and diversification

Energy importers:

- I. Fiscal constraints curtail governments' room to maneuver
- II. Medium term: rein in large external deficits

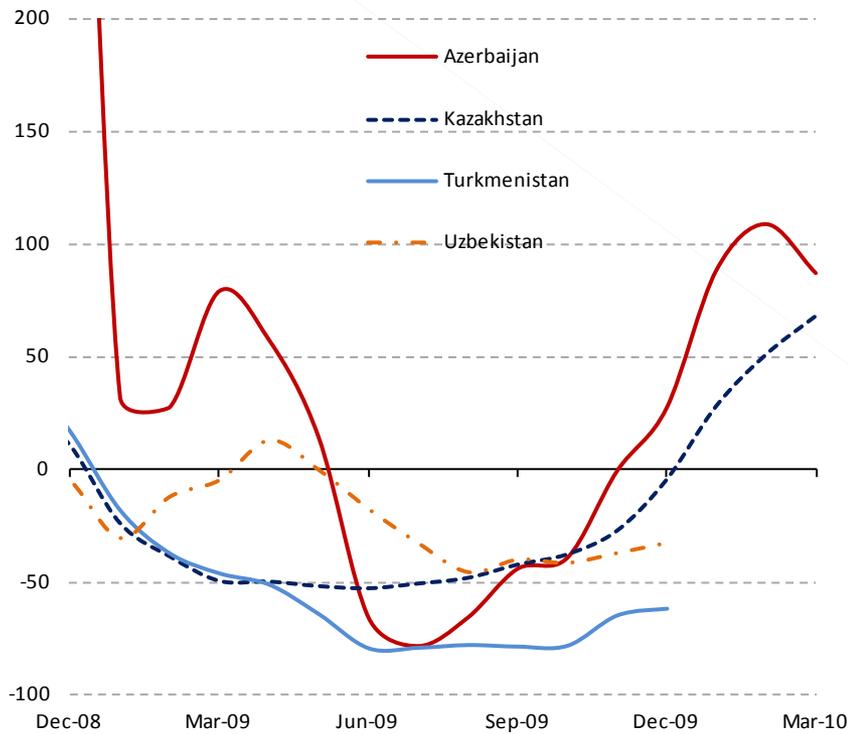
Mounting stress in banking systems

- I. Slow credit growth is weighing on outlook
- II. Policies should focus on repairing balance sheets

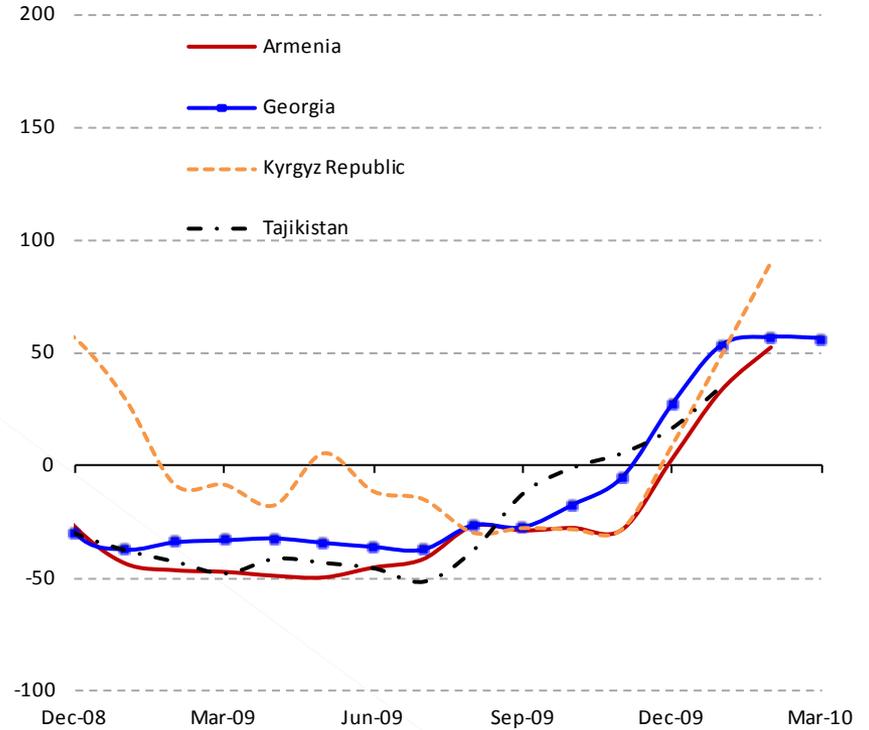


Exports are picking up

Exports of Goods in U.S. Dollars
(Annual growth, 3-month moving average; percent)



Sources: National authorities; International Financial Statistics, IMF; and staff calculations.

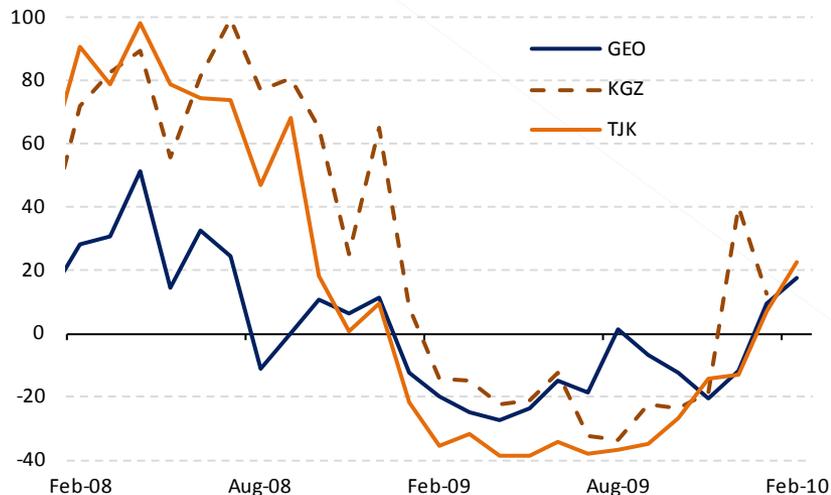


Sources: National authorities; International Financial Statistics, IMF; and staff calculations.



Remittances are rebounding and capital inflows resuming

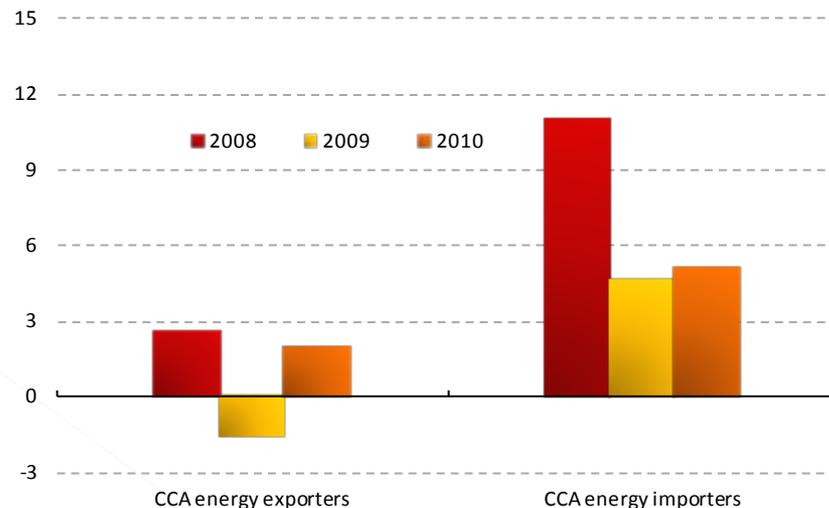
Remittance Inflows
(Annual growth; percent)



Sources: National authorities.

With Russia returning to growth, remittances inflows are increasing again

Net Private Capital Flows
(Percent of GDP)



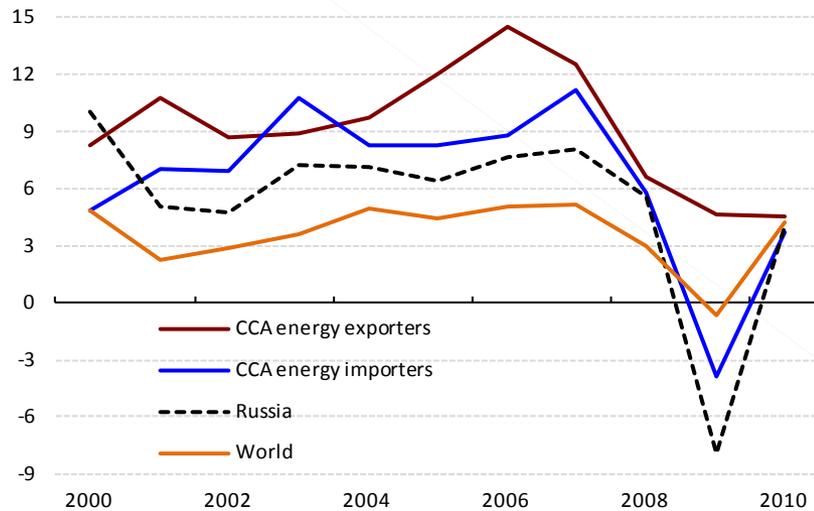
Sources: National authorities; and staff calculations.

Energy exporters: net outflow in 2009. Energy importers: large drop



Growth is recovering in 2010...

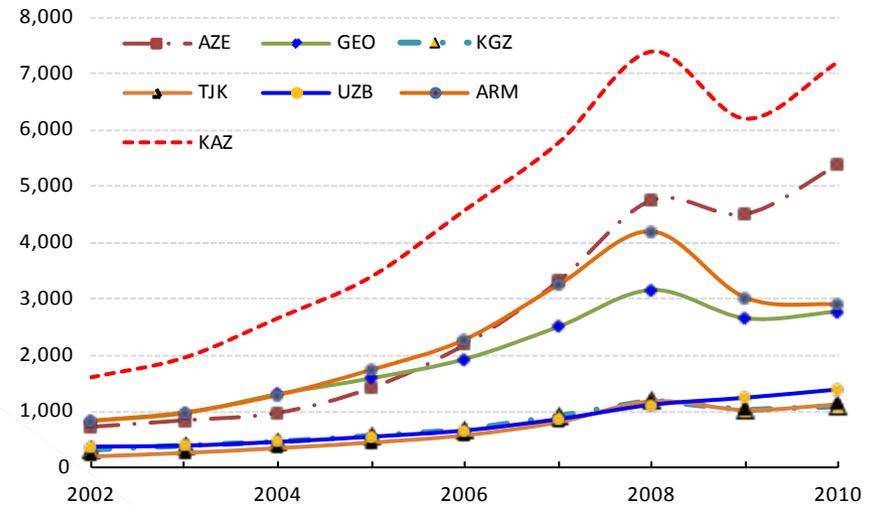
Real GDP Growth (Annual change; percent)



Sources: National authorities; and staff calculations.

... but remains below pre-crisis levels

Gross National Disposable Income Per Capita (U.S. Dollars)



Sources: National authorities; and staff calculations.

The fall in per-capita income is reversing





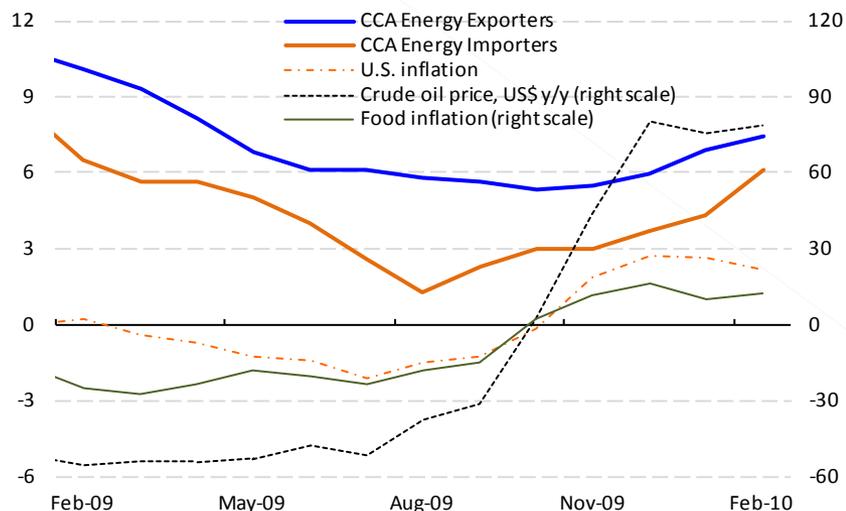
Downside risks to the outlook

- Uncertainty regarding the speed of the global recovery
- Protracted political tensions in Central Asia could hold back energy trade, transport, and the region's growth potential
- Stress in the banking sector is holding back credit growth and weighing on economic activity



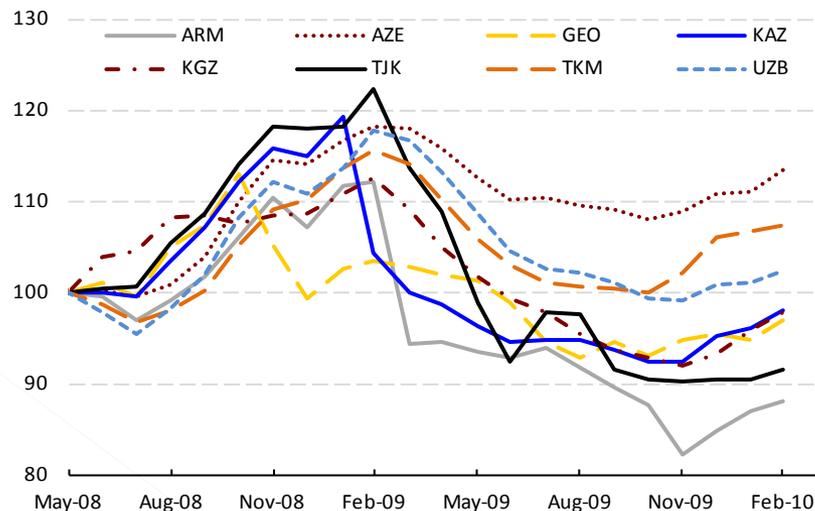
Policies in the region to focus on preserving competitiveness

Consumer Price Index (Period average; annual growth, percent)



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

Real Effective Exchange Rate (Index; May 2008=100; upward movement indicates appreciation)



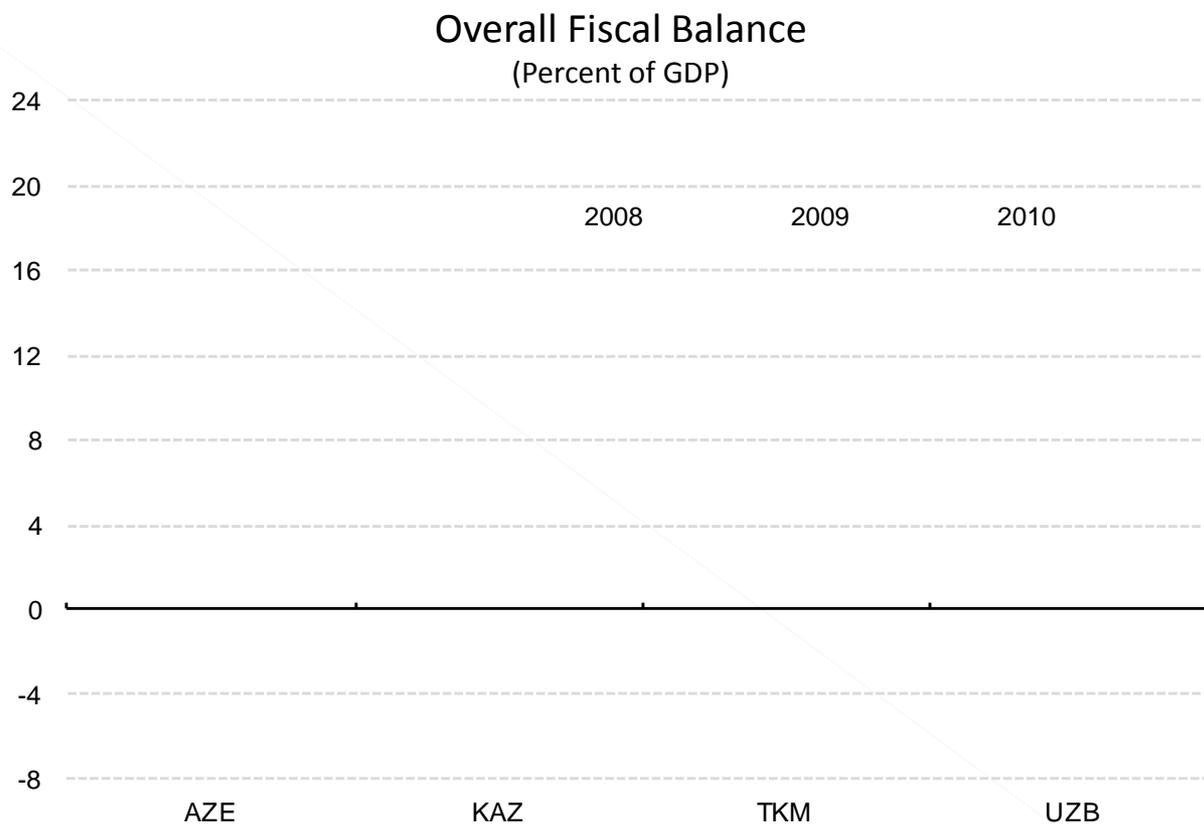
Sources: Information Notice System, IMF.

Monetary and exchange rate policy should preserve the average decline in inflation in 2009 ...

... and safeguard recent competitiveness gains



For most oil exporters: Time to exit expansionary fiscal policies



Sources: National authorities; and staff calculations.

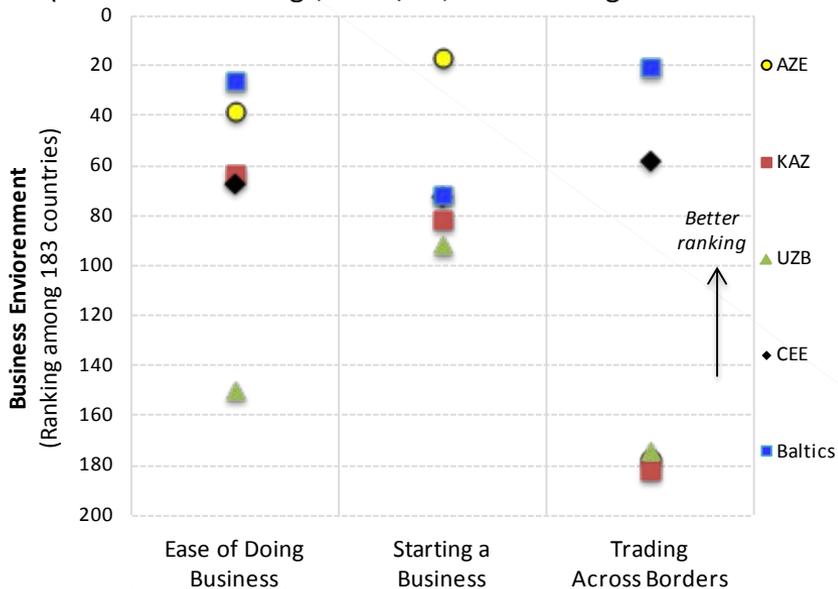
*Fiscal balances projected to increase only in Azerbaijan;
Kazakhstan needs continued fiscal stimulus.*



Oil exporters: Turn to medium-term challenges

Ease of Doing Business

(Worldwide rankings, 2009/10, with 1 being the best outcome)



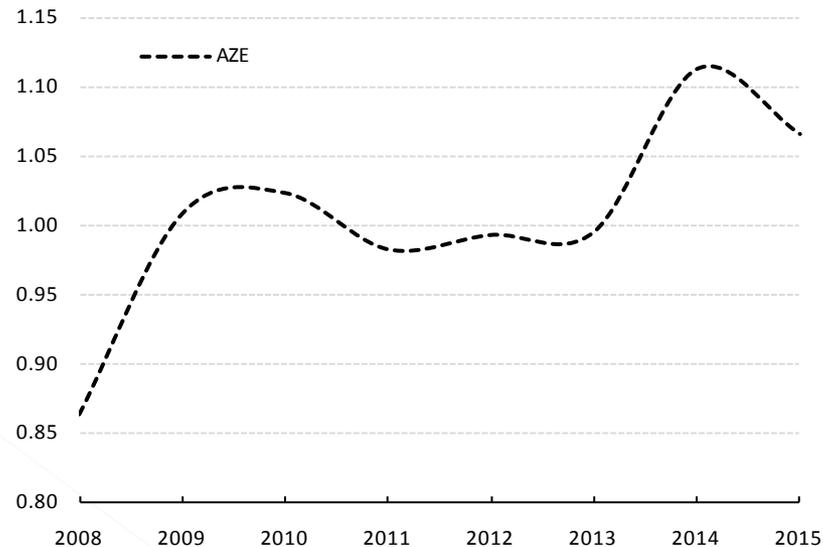
Sources: World Bank; and staff calculations

Notes: CEE denote Central and Eastern Europe economies. Regional averages weighted by GDP at purchasing power parity.

Business environment lagging those in comparators, holding back private sector growth

Oil Production

(Millions of barrels per day)

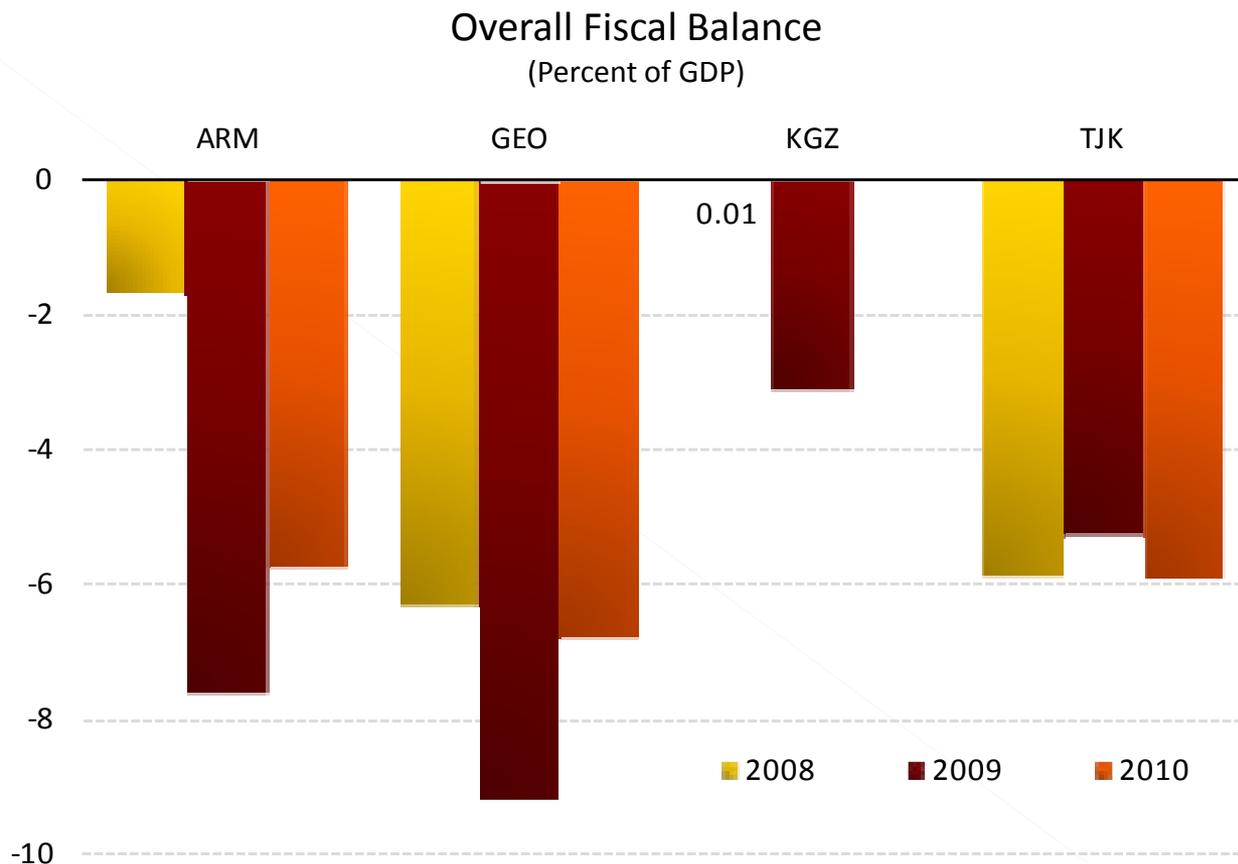


Sources: National authorities; and staff projections.

Non-oil economy to become driver of growth in Azerbaijan as oil production declines



Oil importers: Some fiscal tightening or neutral stance



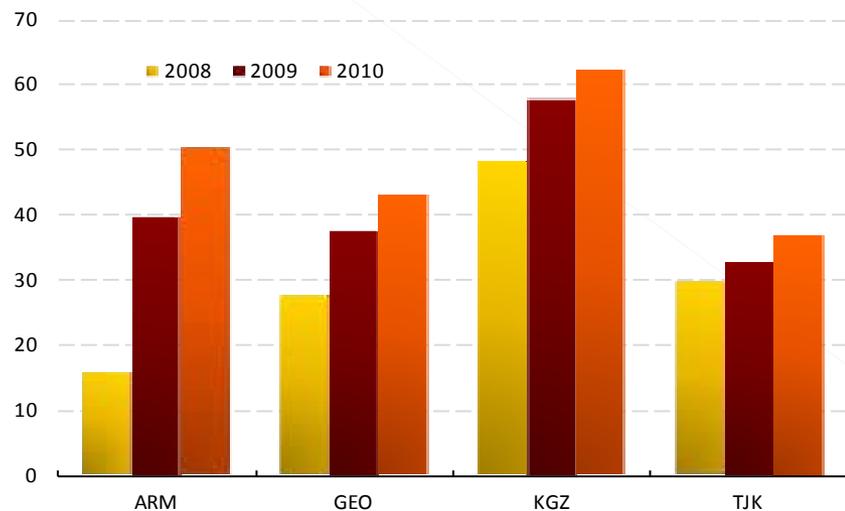
Sources: National authorities; and staff calculations.

Stance appropriate if projected growth materializes



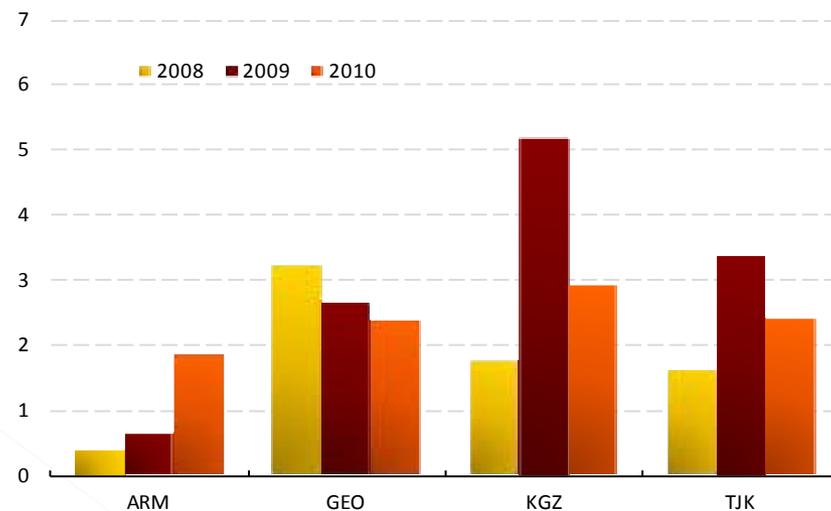
Oil importers: Have limited fiscal space

Government debt (Percent of GDP)



Sources: National authorities; and staff calculations.

Donor Grants (Percent of GDP)



Sources: National authorities; and staff calculations.

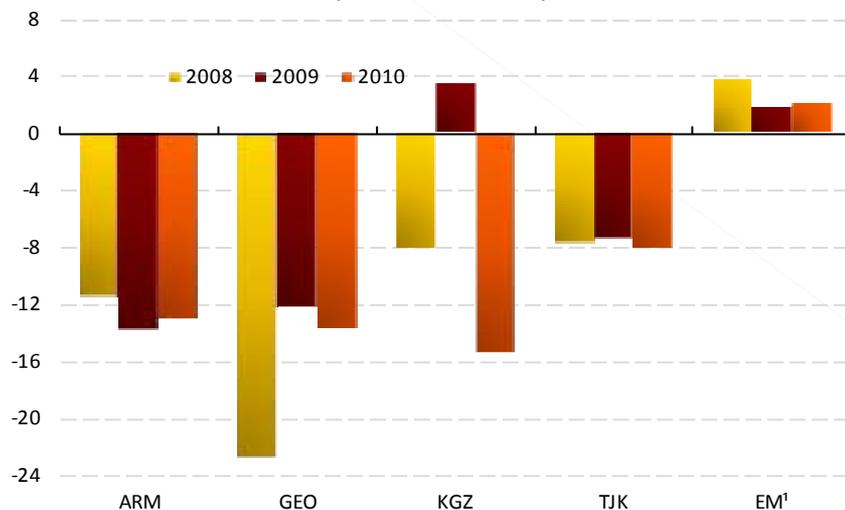
Fiscal policy constrained by growing public debt burden

Additional donor support would provide fiscal space, including for infrastructure investments



Oil Importers: Need to reduce external deficits

Current Account Balance (Percent of GDP)

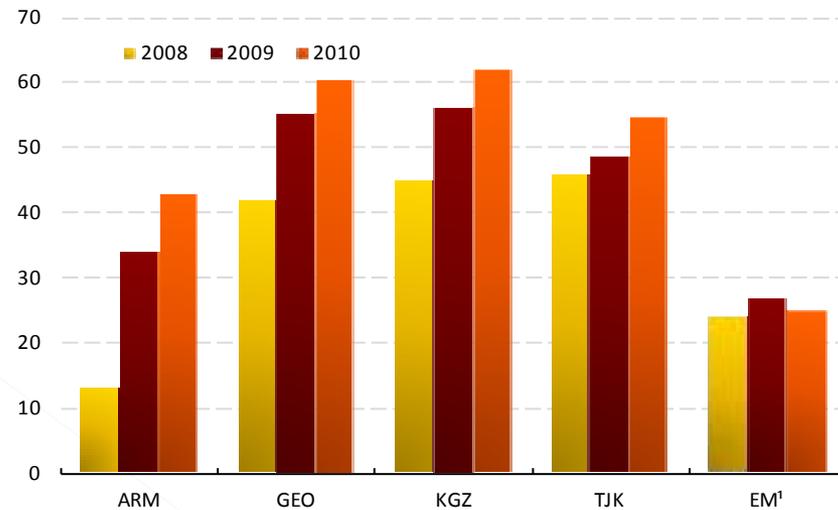


Sources: National authorities; and staff calculations.

¹ EM refers to emerging and developing economies.

Current account deficits remain high...

External Debt (Percent of GDP)



Sources: National authorities; and staff calculations.

¹ EM refers to emerging and developing economies.

... and external debt is increasing



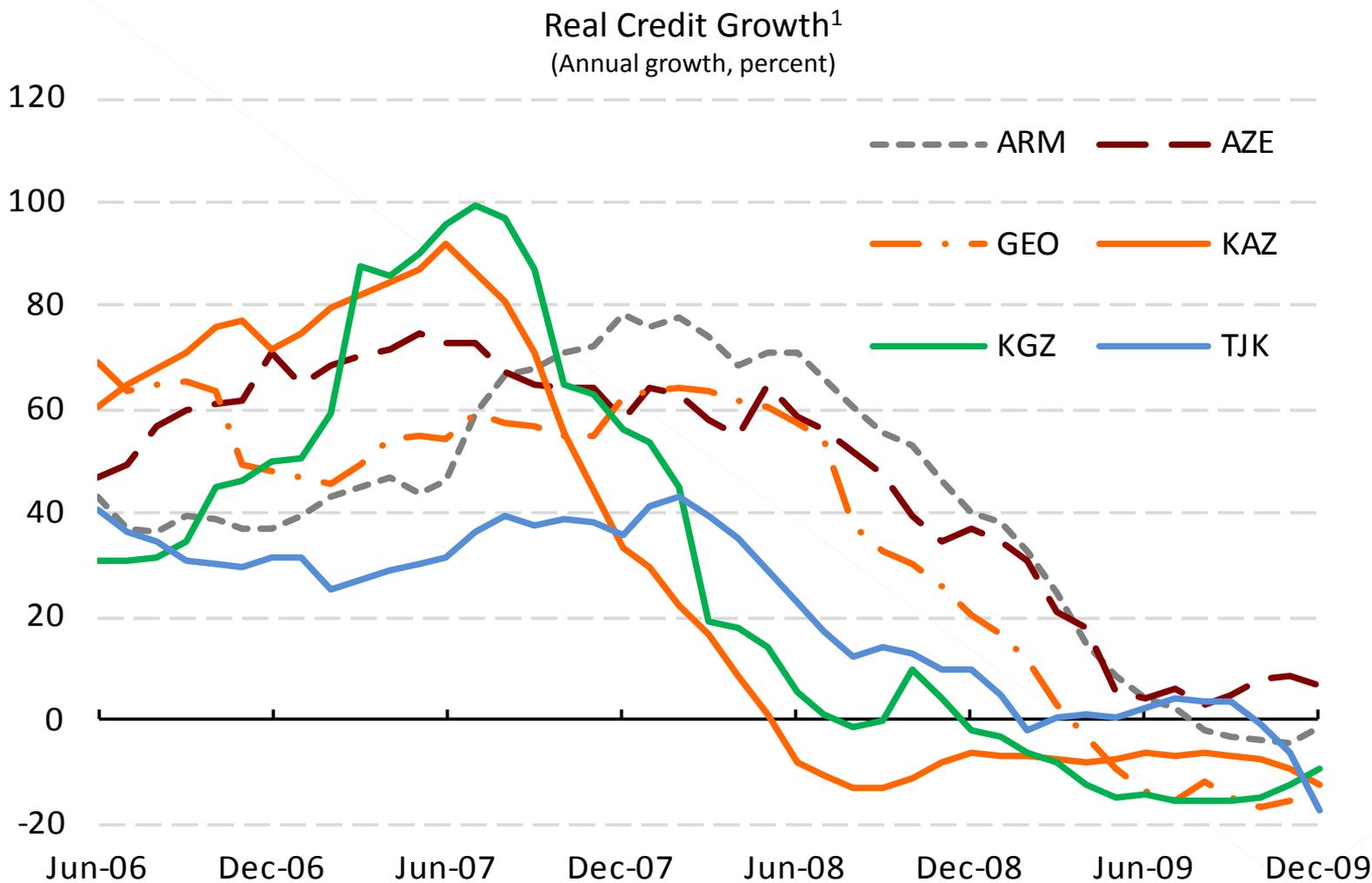
The global crisis had led to mounting stress in CCA banking systems...

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"You don't qualify for a loan or a credit card. We can however, offer you a free bank calendar."

...which has caused a sharp slowdown in credit growth

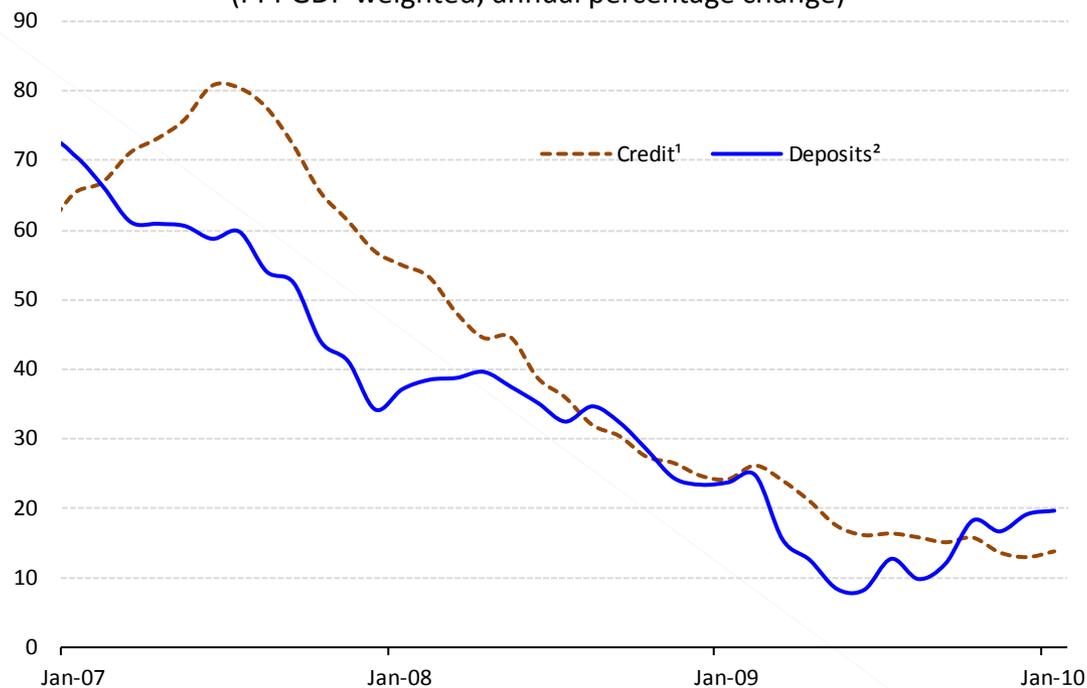


Sources: National authorities; and staff calculations.
¹ Real credit is exchange rate adjusted.



Funding dried up during the crisis and has not yet returned

Credit To Private Sector and Deposits
(PPPGDP weighted; annual percentage change)



Sources: National authorities; and staff calculations.

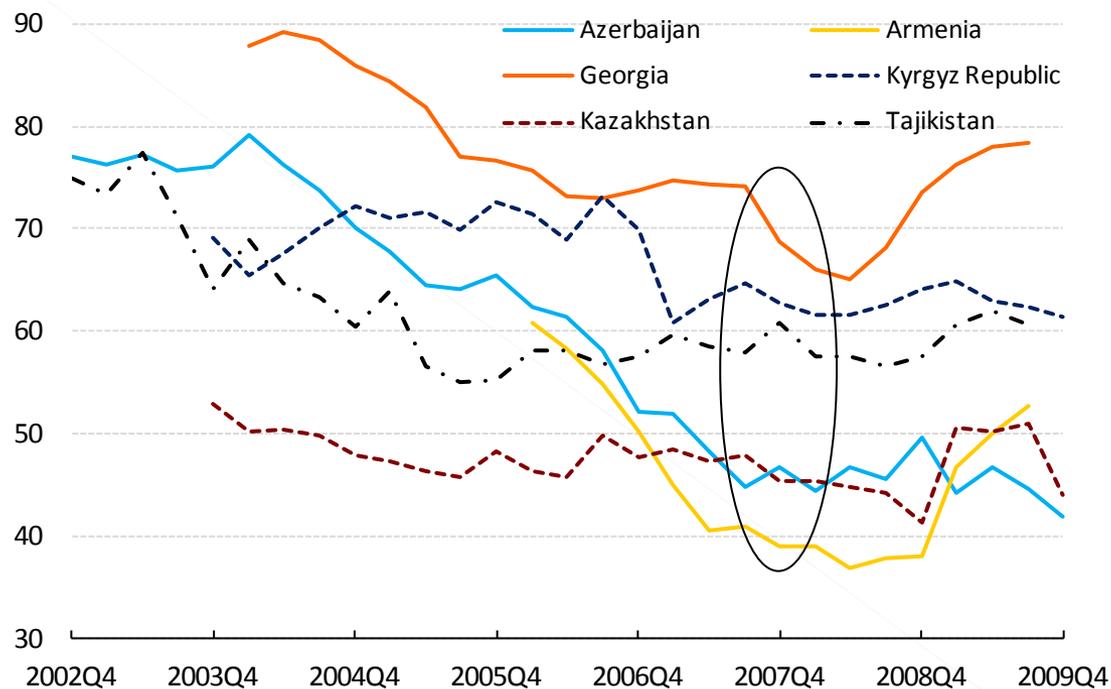
¹ Excludes Turkmenistan

² Excludes Turkmenistan and Uzbekistan.

A sharp reduction in funding, which had been fueling rapid and above-trend credit growth in previous years

High dollarization made banks vulnerable...

Share of Foreign Currency Loans in Total Loans
(Percent)



Sources: National authorities; and International Financial Statistics, IMF.

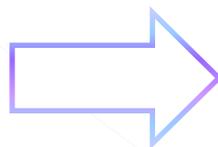
... to indirect currency risk, resulting from lending in foreign currency to imperfectly hedged domestic borrowers



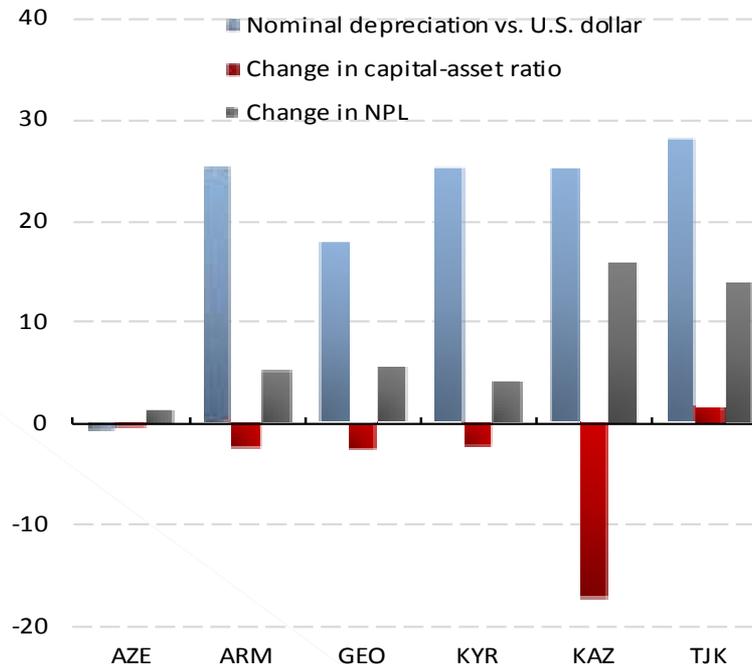
Exchange rates depreciated and balance sheets weakened

Bank balance sheets weakened as a result of :

- *Exchange rate depreciations—channeled primarily via exposure to indirect currency risk*
- *Deterioration in overall economic activity*
- *Loss of funds*



Depreciations and Balance Sheet Deteriorations
(Percentage points; except for depreciation: *percent*)



Sources: National authorities; and International Financial Statistics, IMF.
Note: depreciation is measured from pre-crisis to most recent 2009 data.

Policies should aid banks to repair balance sheets and, in some cases, provide liquidity and capital





Dedollarize over the medium term

- Policies should promote dedollarization to reduce vulnerabilities to sudden exchange-rate movements, and thus currency risk
- Macroeconomic stability, greater exchange rate flexibility, and prudential measures should encourage dedollarization
- Developing local debt markets can contribute to dedollarization by giving domestic agents access to a wider range of domestic-currency financial instruments
- Local debt markets would also provide a more diversified funding base for banks



Policies to start turning to medium term issues

- Exit from accommodative policies as recovery gains traction. This may take longer for the energy importers—additional donor support may be needed
- Energy exporters need to strengthen the business environment in the non-oil economy and diversify away from the hydrocarbon sector
- Energy importers need to arrest build up of external debt
- Restoring credit growth requires banks to repair balance sheets. In some cases, public support may be needed
- Dedollarization would remove a key vulnerability in future crises

