Macrofinancial Developments and Systemic Change in CIS Central Asia from 2009 to 2014[1]

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CIS Central Asia's structural heterogeneity may have deepened since the global crisis of 2008–09. Kazakhstan and Turkmenistan are relatively rich oil and gas exporters, the Kyrgyz Republic and Tajikistan are poor energy importers, and Uzbekistan is a more diversified but still rather poor economy. The rich hydrocarbon exporters typically achieve "twin surpluses" (current account and budget), while the hydrocarbon importers are often saddled with "twin deficits," but benefit from remittance inflows. In contrast to the poorer countries, the energy exporters tend to attract large amounts of FDI and have carried out generous infrastructure modernization programs. Per capita income growth of the rich and the poor countries has diverged in recent years. No recession had occurred in Central Asia in 2009 and mostly robust GDP growth has ensued since. Growth drivers have been: recovering energy and other resource prices and/or export volumes, generous private and public investment expenditures, and substantial remittances. Fixed exchange rates (to the U.S. dollar) tend to be opted for by the oil and gas countries, floating currencies are preferred by the others. While price stability policies vary and inflation rates have on average come down to below double digits, price levels remain strongly exposed to volatile international food and staples markets. Banking sectors are fragile across the region; they are either recovering from a legacy of collapsed credit booms or suffering from high nonperforming loans as a result of connected lending or they require periodic subsidies for performing quasi-fiscal activities.

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This article builds on a previous contribution on the same topic published in this journal five years ago (Barisitz, 2009). It is meant to provide a concise analytical overview and update (2009–14) of the institutional and economic policy frameworks as well as of macroeconomic policies and challenges in the five Central Asian countries of the Commonwealth of Independent States (CIS), i.e. Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan. Special emphasis will be laid on monetary and exchange rate policies and on banking sector and financial stability developments. Some basic economic aspects of the region are not dealt with again. The study quickly enters into details.[3]

Section 1 starts with a horizontal flyover of the region, outlining political and economic regimes in the countries concerned, and comparing the evolution of structural, macroeconomic and selective banking indicators from the global crisis

[1] *This is a follow-up study to Barisitz, S. 2009. Macrofinancial Developments and Systemic Change in CIS Central Asia. In: Focus on European Economic Integration Q3/09. 38–61. Essential points of the present study were presented by the author on May 17, 2014, under the title "Central Asia: Extraordinary Structural and Institutional Heterogeneity at the Borderlands between Eastern Europe and East Asia" at the conference "Autocracy and Market Economy. The Transformation of Eastern Europe and East Asia in Comparison" organized by the Research Platform "Wiener Osteuropaforum" and the University of Vienna.*

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[3] *For those less acquainted with this region, which may appear relatively "exotic" to Western readers, it is suggested to consult Barisitz (2009) beforehand (section 2 "Macro-Structural Overview of Central Asia: Impressive Heterogeneity").*

of 2008–09 to 2013, in some cases to 2014. This is followed by country-by-country close-ups in sections 2 to 6, which give country-specific information on evolving policy conditions and some essential details with respect to monetary policy and banking supervision experiences and reforms. An overall comparative assessment (section 7) summarizes analyzed facts and draws conclusions on salient institutional and structural developments, and on performances and challenges of economic policies in CIS Central Asia.

1 Macro-Structural Overview: Regional Diversity Has Become Entrenched in Recent Years

The political frameworks of most Central Asian countries are characterized by a variety of authoritarian regimes. Less political freedom typically goes hand in hand with fewer economic liberties. In this sense, the "highly authoritarian" political regimes (according to the Economist Intelligence Unit Democracy Index) in Turkmenistan and Uzbekistan correspond to "repressed" economic regimes (according to the Heritage Foundation Economic Freedom Scores).[4] In Tajikistan, a plainly authoritarian government goes with a mostly unfree economic environment. In Kyrgyzstan, a hybrid (no longer authoritarian) regime accompanies a mostly unfree economic setting. Kazakhstan finally features the combination of a mildly authoritarian regime with a moderately free business environment. The cases of Kazakhstan and the Kyrgyz Republic[5] are therefore somewhat at variance with the above principle of matching of political and economic freedom or lack of freedom.[6]

In terms of average wealth or GDP per capita (measured in U.S. dollars at market exchange rates), Kazakhstan (with USD 13,150 in 2013) remains by far the richest country of Central Asia, and, given its robust recent growth rates, is even approaching Russia's GDP per capita level (see table 6). Kazakhstan's relatively liberal business environment has certainly been helpful in this respect. Highly centralized Turkmenistan is number two, followed by interventionist Uzbekistan on a much lower per capita level.[7] Both Turkmenistan and Uzbekistan, however, (according to official data) recorded the most dynamic income growth of the region since the crisis of 2008–09. Finally, remote, small and politically unstable Kyrgyzstan and Tajikistan are the poorest Central Asian and CIS countries and have exhibited below-regional average income growth rates. Thus, regional income diversity has been on the increase recently.

To a considerable extent these income and wealth differences appear to be linked to sharply differing export and import structures. More than 80% of Turkmen, about two-thirds of Kazakh and one-third of Uzbek exports consist of oil, gas and other mineral products. Kazakhstan also exports metals, Uzbekistan cotton and metals. In contrast, the Kyrgyz Republic and Tajikistan do not sell

[4] *For more information on the EIU Democracy Index, see www.eiu.com/public/topical_report.aspx?campaignid=DemocracyIndex12; for more information on the HF Economic Freedom Scores, see www.heritage.org/index.*

[5] *The official term "Kyrgyz Republic" and "Kyrgyzstan" are used here as synonyms. The same applies here for the official term "Turkmenistan" and "Turkmenia."*

[6] *This particular issue will be taken up in more detail below.*

[7] *Given the pronounced degree of state dominance in the Turkmen and Uzbek economies, official statistical data on income, GDP and other economic categories have to be treated with caution.*

hydrocarbons (see chart 2). Gold and food are Kyrgyzstan's main exports, aluminum and cotton Tajikistan's. Import structures are largely complementary and have probably served to deepen existing regional disparities: Turkmenia, Uzbekistan and Kazakhstan import substantial shares of machinery and equipment (ranging from about 15% to over half of total imports), which may be used for modernizing the production apparatus and infrastructure (see below). On the other hand, expectedly, energy and food feature among Kyrgyzstan's and Tajikistan's main staples purchased from abroad (see chart 3).

The balance of migrants' remittance flows seems to present a reverse mirror image of Central Asian countries' comparative wealth. Given low-income Tajikistan's and Kyrgyzstan's large number of guest workers earning money abroad – mostly in Russia and Kazakhstan –, workers' remittances make up no less than 45% of Tajik GDP[8] and 30% of Kyrgyz GDP (in 2012). Uzbek guest workers' remittances attain a size of about 7% of the country's GDP, while "rich" Kazakhstan's and Turkmenistan's remittances are (close to) zero (see table A2 in the annex).

Russia and China are the two largest trading partners of all five CIS Central Asian countries (as depicted in chart A1 of the annex). Central Asian trade with Russia on average still exceeds trade with China, but the latter is quickly catching up (Saint-Paul, 2013). Russia and China together account for about 30% to 40% of regional foreign trade turnover. Italy is Kazakhstan's third-largest trading partner and the EU as a whole accounts for about one-third of the country's trade turnover; in other words, the European Union is Kazakhstan's leading trading partner. This does not hold for the other four countries of the region.[9] The Eurasian Customs Union (CU) – established in 2010 and comprising Belarus, Kazakhstan and Russia – and the Eurasian Economic Union (EAU) – which will come into effect in January 2015 and may soon also include the Kyrgyz Republic and possibly Tajikistan as Central Asian members – may somewhat slow down the dynamics of trade reorientation toward China. While a lot remains to be implemented, the EAU formally envisages the free movement of goods, services, capital and labor between member countries.

In Central and Eastern Europe, the banking sectors' ownership structure is dominated by – mostly Western European – FDI. In Central Asia, in contrast, either state-owned banks (SOBs) are in control (Turkmenistan and Uzbekistan)[10] or domestically owned credit institutions hold sway (Kazakhstan and Tajikistan)[11]. Only in the Kyrgyz Republic is a large share (not quite half) of credit institutions' assets owned by foreigners – mostly Kazakh business groups (see chart 4). Regional banking sectors have remained rather weak financially; in Turkmenia, Uzbekistan, Tajikistan and the Kyrgyz Republic (to a smaller degree), banks have continued to fulfill quasi-fiscal functions. Therefore, such credit institutions have tended to

[8] *Almost half of the Tajik labor force reportedly works outside the country; in 2013, remittances even covered more than half of the country's GDP. Thus, Tajikistan is the most remittance-dependent country of the world (Emerging Europe Monitor: Russia & CIS, 2014a).*

[9] *Other salient trading partners of Central Asian countries are: Kazakhstan (the regional economic heavyweight), Turkey, Afghanistan, Iran, Switzerland and South Korea (see chart A1 in the annex).*

[10] *SOBs make up about 90% of Turkmen and approximately two-thirds of Uzbek banking assets.*

[11] *Domestic business groups, often well connected to current or past governments, account for more than half of Kazakh and more than three-quarters of Tajik banking assets.*

require recurrent ad-hoc liquidity injections, periodic bailouts or recapitalizations by the authorities.

Central Asia has not featured major economic reform advances as measured by EBRD transition indicators[12] in recent years. Privatization, governance, enterprise restructuring, and competition policy in the last five years largely stalled across the region; price liberalization, trade and foreign currency system reform showed slight improvements, particularly in Tajikistan and Turkmenistan. After having carried out steps of deregulation prior to the crisis of 2008–09, most countries reregulated their banking sectors in the last five years. More generally, looking at unweighted averages derived from EBRD transition indicators, one can conclude that all Central Asian countries had been moving on paths of modest reform progress (on different levels) prior to the crisis. However, after the crisis only two countries (Tajikistan and Turkmenistan) continued in this general direction, while the other three (Kazakhstan, the Kyrgyz Republic and Uzbekistan) did no longer exhibit any meaningful progress and actually slid back slightly.

Interestingly, while the EBRD as well as the Heritage Foundation view Turkmenistan and Uzbekistan as repressed or at least partially centrally planned economies, the reform performances of Kyrgyzstan, Kazakhstan and Tajikistan are considered to be quite comparable by the EBRD, with the Kyrgyz Republic in the lead, whereas (as mentioned above) the Heritage Foundation sees Kazakhstan – as a moderately free economy – in the lead.

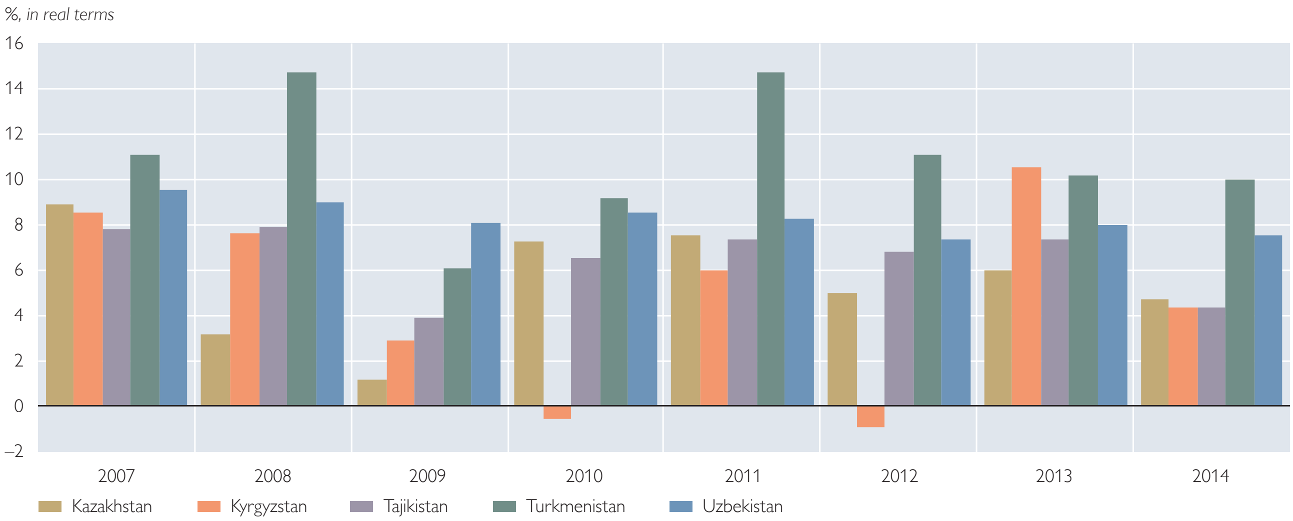
Average annual economic growth in the six years from 2008 to 2013 remained impressively high across the region, although post-2008–09-crisis growth was doubtlessly lower than precrisis rates of increase. Thus, (unweighted) average annual GDP growth in the five CIS Central Asian countries, which had stood at 8.5% in the four years preceding the crisis, i.e. from 2004 to 2007, fell to 7.4% in the four years following the crisis (2010–13). In contrast to Russia and almost all CESEE and Western countries, no Central Asian country suffered a recession in 2008–09, as can be seen in chart 1. Kyrgyzstan did experience modest slumps in 2010 and in 2012; these were, however, not connected to the global crisis, but to domestic structural and economic problems (see below). From 2008 to 2013, annual CPI inflation (end-year) in Central Asia came down from levels of 8% to 20% to converge to between 5% and 7%, with Uzbekistan as an outlier at 12% (2013, see also below).

Given Central Asia's immense economic potential, FDI would certainly be needed across the region. FDI flows to the major energy exporters Kazakhstan and Turkmenistan have been generous in recent years. These two countries together with the energy exporter Uzbekistan also boast frequent or regular trade as well as current account surpluses. In contrast, the energy importers Kyrgyzstan and Tajikistan are typically saddled with current account deficits. Fiscal results appear to replicate this picture. The energy exporters including Uzbekistan feature budget surpluses, which, together with their positive current account balances, make up "twin surpluses," whereas the energy importers chalk up budget shortfalls and "twin deficits." Given that the Kyrgyz Republic and Tajikistan are poor countries, they receive international financial assistance. Both benefit from IMF

[12] *EBRD transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy, and 4+ representing the standards of a developed market economy.*

Chart 1

GDP Growth



Source: IMF, national statistics.

Note: Data for 2014 are forecasts.

Extended Credit Facility Arrangements, from program loans and grants for budget support from external donors, and from foreign-financed Public Investment Programs (PIPs).

2 Kazakhstan: High Growth and Accumulating Wealth, but Tenacious Banking Problems

2.1 Some Salient Structural and Institutional Aspects

Together with Kyrgyzstan, Kazakhstan has in recent years remained the most market-oriented economy in the region (according to EBRD transition indicators as well as Heritage Foundation Economic Freedom Scores). In line with 2011 figures, more than half of the Kazakh banking sector's assets are privately owned by domestic business groups, about one-quarter is accounted for by state-owned or nationalized banks (see below) and about one-fifth is foreign owned. The country has a well-replenished oil stabilization fund, the National Fund of the Republic of Kazakhstan (NFRK, with assets corresponding to almost one-third of GDP). In recent years, Kazakhstan's public investment holding company and state development agency Samruk Kazyna (SK, established in 2008) has expanded its portfolio of state-owned enterprises across a number of sectors. SK managed over USD 78 billion in assets in 2010, which had risen to over USD 100 billion (or approximately 50% of GDP) by mid-2013 (Chazan, 2013). About three-quarters of SK's assets are accounted for by the oil, gas and financial sectors. Roughly one-third of corporate deposits in Kazakh banks belong to firms held by the development agency. SK plays a pivotal role as an instrument of industrial policy, which includes efforts to diversify the economy through the financing of non-oil projects. The Kazakh tenge is convertible for current, capital and financial account transactions (since 2007).

Table 1

Kazakhstan: Key Macroeconomic and Financial Sector Indicators

	2007	2008	2009	2010	2011	2012	2013[1]
GDP growth (in real terms, %)	8.9	3.2	1.2	7.3	7.5	5.0	6.0
Current account balance (% of GDP)	–8.1	4.7	–3.6	0,9	5.4	0.3	0.1
Net FDI flows (% of GDP)	7.7	9.7	8.7	2.5	4.9	6.0	3.6
Gross external debt (% of GDP)	93.9	79.8	97.9	79.9	66.6	69.5	68.5
Debt service ratio (% of exports of goods and services)	. .	41.7	63.2	32.1	24.2	33.7	26.0
Gross international reserves (% of GDP)[2]	17.1	14.7	20.0	19.1	15.6	14.0	15.5
NFRK[3] foreign assets (% of GDP)	20.4	20.3	21.2	20.9	23.2	28.5	31.4
General government budget balance (% of GDP)	4.7	1.1	–1.4	1.4	5.9	4.5	5.2
CPI inflation (year-end, %)	18.8	9.5	6.2	7.8	7.4	6.0	4.8
Exchange rate: KZT/USD (annual average)	122.6	120.3	147.5	147.4	146.7	149.2	150.3
Level of monetization (broad money/GDP, %)	36.6	38.5	43.4	39.2	35.4	34.8	35.3
Credit to the economy (% of GDP)	59.9	49.0	50.2	39.5	35.9	37.2	40.1
of which: foreign currency-denominated loans (%)	43	44	48	42	36	31	31
of which: nonperforming loans (%)	3	5	22	24	31	30	31
Asset share of foreign-owned banks (%)	38.5	12.9	17.2	17.5	22.0	. .	. .
Domestic credit (% of GDP)	41.0	54.2	54.6	45.4	40.3	42.5	41.8
Capital adequacy ratio (%)	14.2	14.9	–8.2	17.9	17.4	18.1	17.0
Memo items:							
GDP (nominal, KZT billion)	12,641	16,268	17,008	21,815	27,572	30,219	33,426
GDP (nominal, USD billion)	103.1	135.2	115.3	148.0	188.0	202.6	222.4

Source: National statistics, IMF, Asian Development Bank, World Bank, EBRD.

[1] *Partly estimates.*
[2] *NFRK financial assets are not included.*
[3] *NFRK = National Fund of the Republic of Kazakhstan (oil stabilization fund).*

2.2 Macroeconomic and Banking Sector Developments

While the Kazakh economy overall quickly recovered from the crisis of 2008–09 and economic growth rates have since remained robust, recent years have been marked by serious banking problems and the launching of strategies to solve them. Kazakhstan's relatively strong ties with the global economy and financial markets were reflected in the decline of the country's economic growth rate to 1.2% in 2009 and in its current account and budget deficits of 3.6% and 1.4% of GDP, respectively, that year. Moreover, as shown in table 1, Kazakh banks' nonperforming loans (NPLs) more than quadrupled (as a share of total loans) and the sector's capital adequacy ratio (CAR) turned negative that year.

The macroeconomic data also reflect the impact of the authorities' Anti-Crisis Plan (ACP), which comprised public support of a total amount of about USD 12 billion over 2009–10 (about 5% of annual GDP in both years) to four of the largest banks and the nationalization of three of them, financial assistance to SMEs, real estate, farming sectors, and other measures. The National Bank of Kazakhstan's (NBK's) devaluation of the tenge by 20% in February 2009 established a new stable exchange rate toward the U.S. dollar, or more precisely, a narrow trading band around a central parity of KZT 150/USD. The monetary authority also cut the refinancing rate (the main policy rate) by a total of 350 basis points to 7.0% and reduced banks' reserve requirements (Barisitz, 2010, pp. 56–58, 73–74). Despite the receipt of public assistance, three overleveraged banks (Bank Turan-Alem – BTA, Alliance Bank, Temir Bank) defaulted on their external obligations and entered into restructuring negotiations with their foreign creditors, which produced agreements on substantial haircuts in 2010 (Barisitz, 2013, pp. 184–185).

The ACP stimulus, the fledgling recovery of the world economy and notably the recovery of oil, gas and other raw material prices contributed to Kazakhstan's economic upturn in 2010 and 2011 (Combe, 2012, p. 17). In early 2011, the NBK somewhat changed its policy emphasis from supporting the financial and real sectors to keeping inflation on a downward path: The refinancing rate was raised to 7.5% and thus the easing cycle implemented during the crisis was partly reversed. To sterilize inflows of capital, the monetary authority also sharply increased its issuance of short-term notes. Even administrative measures were applied to combat price rises: Price caps were introduced on staple food items and the periodic adjustment of utility tariffs was postponed. Inflation slightly declined to 7.4% at end-2011. However, credit institutions did not benefit much from the upswing, given that the most dynamic sectors (e.g. oil, other natural resources, metallurgy) relied little on bank funding and that banks remained bogged down by their legacy of past poor lending, particularly to the real estate and construction sectors. Many credit institutions, especially some of the larger ones, continued to be burdened with high and even increasing NPLs.[13]

With continuing global economic weakness in 2012 and 2013, Kazakh GDP growth moderated to between 5% and 6%, while NFRK foreign assets reached record levels (31% of GDP in 2013, see table 1)[14]. Persisting and teething problems with bad assets, both domestic and external (probably also connected to fraudulent practices) contributed to BTA's renewed default on its external obligations. This triggered some additional recapitalization measures by its government shareholders and the launch of negotiations on a second debt restructuring round in early 2012. The authorities then developed a new mechanism to deal with impaired bank loans, combining a centralized bank Problem Loans Fund (PLF), financed by the NBK and other investors, with special purpose vehicles (SPVs), set up in a decentralized manner with individual banks and benefiting from preferential provisioning requirements. The PLF has focused on NPLs other than bad real estate loans, while SPVs were assigned to real estate and construction loans. Implementation of the new mechanism has so far been slow, though. In 2013, the authorities attempted another, more administrative approach to improving credit quality: The NBK introduced regulatory NPL ceilings, which appear ambitious (15% of total loans by end-2014, 10% by end-2015) (IMF, 2012a, p. 12; IMF, 2014a, p. 11).

Given the renewed weight of banking problems[15] and the simultaneous weakening of inflationary pressures, the NBK moved back to a more accommodative monetary policy stance by cutting its policy rate by 200 basis points to 5½% in the

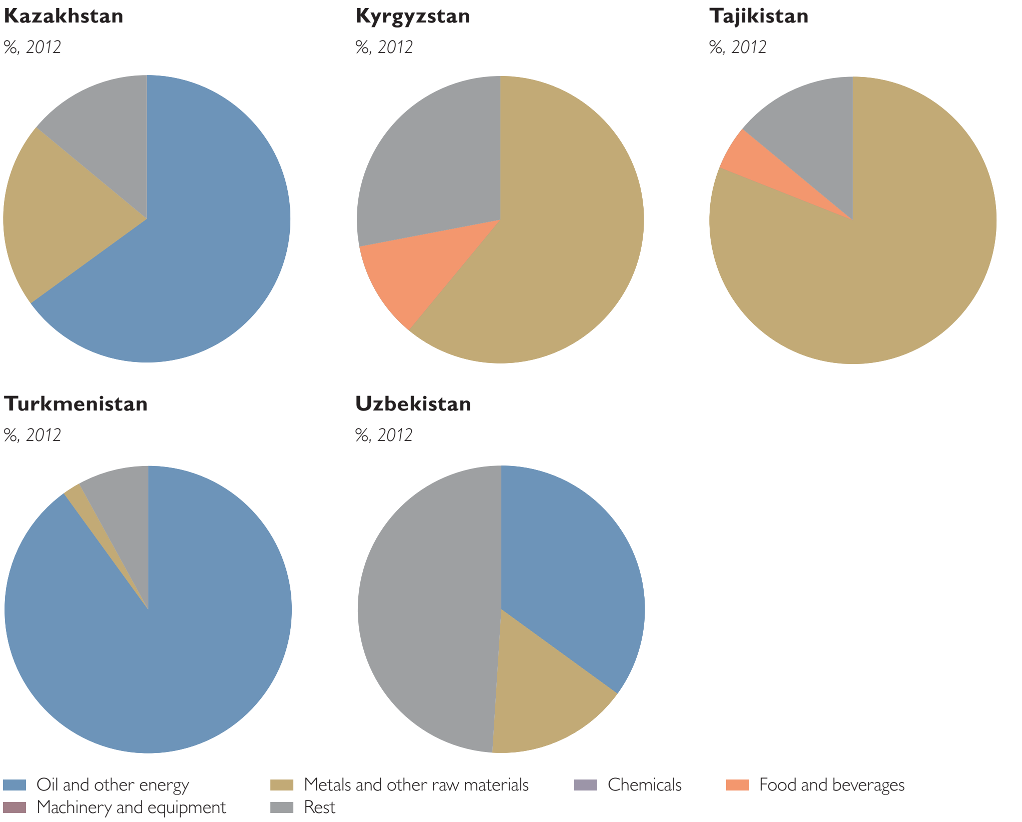
[13] *Overall, NPLs came to 31% of total loans in 2011 and have remained largely at this level since then (see table 1).*

[14] *While the oil and gas business is certainly at the core of the Kazakh economy's still robust expansion, hydrocarbon projects also bear high risks, as exemplified by the Kashagan project, which is related to one of the largest oil deposits on earth. Kashagan oil is located beneath the bottom of the northern Caspian Sea, but is difficult to access, because it lies very deep and is under great pressure. Compared to originally planned deadlines and project budgets, the Kashagan venture has (so far) accumulated a delay of eight years and cost overruns of about 400%: Instead of the planned USD 10 billion, the project – jointly undertaken by a number of Western corporations, a Chinese firm and the Kazakh national resource company Kazmunaigaz – has so far cost almost USD 50 billion and is still not successfully extracting the "black gold" (Feitz, 2014; Gente, 2014).*

[15] *There has lately been one exception to the overall sluggish banking activity (compared to the precrisis period), namely the reacceleration of consumer credit since 2012.*

Chart 2

Major Exported Goods



Source: National statistics.

summer of 2012. The tenge's real appreciation since 2009, but particularly the strong devaluation of the Russian ruble in the first two months of 2014 (on top of its modest slide in 2013), prompted the NBK to devalue the national currency by another 19% in February 2014, exactly five years after the previous large devaluation. At KZT 185/USD, the Kazakh currency is again managed within a narrow corridor (table 6). Despite some price controls, the devaluation has fueled inflation, which reached 6.9% at end-May 2014 (year on year), and it may have a negative impact on consumer credit quality.

3 Kyrgyzstan: Reform Oriented, but Jolted by Recurrent Political Instability

3.1 Some Salient Structural and Institutional Aspects

The Kyrgyz Republic and Kazakhstan are assessed to be very close with regard to the overall economic reform progress achieved (as mentioned above). One particular difference between the two is that Kyrgyzstan has been a member of the WTO (since 1998)[16], while the Kazakh tenge is the only fully convertible currency of the region. An important structural aspect of the Kyrgyz economy is its dependence

[16] *The WTO counts two member states in CIS Central Asia – the Kyrgyz Republic and Tajikistan (the latter joined in 2013, see below).*

Table 2

Kyrgyzstan: Key Macroeconomic and Financial Sector Indicators

	2007	2008	2009	2010	2011	2012	2013[1]
GDP growth (in real terms, %)	8.5	7.6	2.9	–0.5	6.0	–0.9	10.5
Current account balance (% of GDP)	–6.0	–8.1	0.7	–6.4	–6.5	–15.1	–14.1
Net FDI flows (% of GDP)	5.5	5.2	4.1	9.1	11.2	4.4	10.5
Gross external debt (% of GDP)	60.3	70.0	88.0	91.4	78.6	83.5	80.1
Debt service ratio (% of exports of goods and services)	14.0	26.8	41.4	25.9	11.1	11.3	11.3
Gross international reserves (% of GDP)	29.1	22.5	32.0	33.6	29.5	31.8	30.8
General government budget balance (% of GDP)[2]	–0.3	0.0	–3.5	–6.5	–4.6	–5.4	–4.0
CPI inflation (year-end, %)	20.1	20.1	0.0	18.9	5.7	7.5	4.0
Exchange rate: KGS/USD (annual average)	37.3	36.6	42.9	46.0	46.1	47.0	48.4
Level of monetization (broad money/GDP, %)	29.6	25.2	28.4	31.1	27.8	31.7	34.5
Credit to the private sector (% of GDP)	15.5	14.2	12.9	12.5	11.7	13.5	16.3
of which: foreign currency-denominated loans (%)	62.5	63.7	59.6	52.9	52.5	51.9	50.7
of which: nonperforming loans (%)	3.5	5.3	8.2	15.8	10.2	7.2	5.9
Capital adequacy ratio (%)	31.0	32.6	33.5	31.0	30.3	28.3	24.6
Memo items:							
GDP (nominal, KGS billion)	141.90	187.79	201.24	220.45	285.98	310.50	350.00
GDP (nominal, USD billion)	3.804	5.131	4.680	4.794	6.199	6.603	7.225

Source: National statistics, IMF, Asian Development Bank, World Bank, EBRD.

[1] *Partly estimates.*
[2] *Excluding externally financed programs.*

on gold extraction (15% of GDP) and gold exports (between 30% and 35% of total exports). Gold production, carried out by a foreign investor in one large open-pit mining site (Kumtor) in the central Tienshan range, has repeatedly been the subject of controversy, worker unrest and tensions between the investor and the authorities.

Almost half of the country's banking sector's assets (2010) are owned by foreign – mostly Kazakh – businessmen, while about one-third is owned by private domestic banks. Due to banking turbulences and some nationalizations, state-owned banks' share expanded recently. The Kyrgyz authorities manage some limited practices of directed lending: Under the Affordable Loans for Farmers (ALF) program and some other government-supported schemes, the authorities lend to state-owned banks, particularly the Settlement and Savings Company (SSC, the largest state-owned bank) for further onlending to agriculturalists and other beneficiaries at predetermined (subsidized) interest rates (IMF, 2012b, p. 6; see also table 6). Kyrgyzstan is Central Asia's most open country (in terms of exports and imports of goods and nonfactor services to GDP, see table A1 in the annex), and its openness further increased in recent years. Given the country's small size and its exposure to external and internal economic instability, Kyrgyz inflation tends to be very volatile.

3.2 Macroeconomic and Banking Sector Developments

While the Kyrgyz economy did not experience a recession as a consequence of the global economic crisis, it did witness repeated bouts of economic contraction (in 2010 and 2012), caused by domestic political turmoil or industrial unrest.[17]

[17] *The country had already gone through comparable domestically triggered slumps in 2002 and 2005 (Barisitz, 2009, p. 39).*

Kyrgyzstan therefore witnessed the weakest average GDP growth rate of the region in the six years from 2008 to 2013 (4.2% p.a.).

The authorities' macroeconomic stance was somewhat loosened in order to overcome the impact of the crisis of 2008–09. Inflation had practically disappeared at end-2009, largely due to the crisis-triggered reversal in international commodity prices and the slowdown of activity. The National Bank of the Kyrgyz Republic's (NBKR's) flexible managed floating policy facilitated the downward adjustment of the external value of the Kyrgyz som in 2009 and 2010. In 2009, the Russian Federation also provided some generous budgetary support and debt relief.

However, in 2010, the Kyrgyz economy was struck by a deep political crisis: In April, a popular uprising[18] toppled the previous regime, and in June, ethnic conflict in the south of the country exacerbated the already difficult political situation. The subsequent constitutional referendum and parliamentary elections in October 2010 helped stabilize the situation and put the economy back on a path of recovery, though the political environment has remained tenuous. The economy was seriously disrupted in 2010, with GDP declining by 0.5% and twin deficits (fiscal and current account shortfalls) reappearing. However, following a global spike of food and fuel prices, annual inflation shot back up to 18.9% in 2010. In response, the NBKR tightened monetary policy by significantly increasing its sales of short-term notes and raising reserve requirements. Receding global food prices in 2011 helped bring down price dynamics.

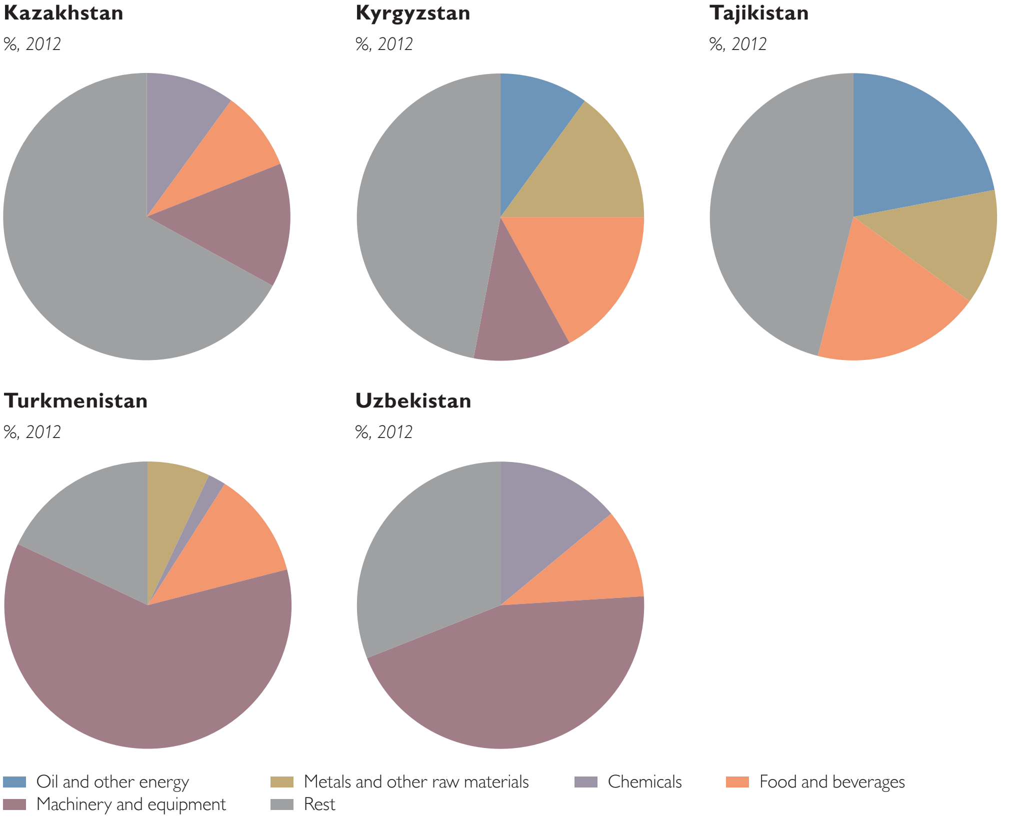
Given the crisis-related credit crunch, the share of NPLs in total loans tripled (to 16%) from end-2008 to end-2010. In late 2010, the NBKR introduced temporary administration in Asia Universal Bank (AUB), the largest bank, and in four other credit institutions after AUB had experienced a significant outflow of nonresident deposits, allegedly linked to the previous rulers, and after it had become known that a sizeable portion of its liquid assets placed abroad was nonrecoverable. AUB was subsequently nationalized and the four other banks placed in conservatorship. Deposits in the above five delinquent banks were shifted to entities believed to be safer, particularly foreign banks and the largest state-owned bank, the SSC (see above). AUB was split into a "good bank" – Zalkar bank – and a "bad bank" absorbing AUB's impaired assets. With substantial delay, Zalkar was finally sold to a Russian investor (ITB Bank) in 2013 (IMF, 2013a, p. 14).

2011 witnessed economic stabilization, which however turned out to be much shorter than expected, since the outbreak of industrial unrest and disruptions in gold production triggered a renewed home-grown recession the following year (GDP: –0.9%). The current account gap widened sharply (to above 15% of GDP in 2012). Fiscal as well as monetary policy were again slightly eased in response to the economic weakening and the moderation of inflation. Thus, the monetary authority reduced its policy rate to 3%. Although distributional disputes between the gold mining company and the government went on, prolonging uncertainty, economic growth bounced back strongly (+11%) in 2013 (table 2). Once the crisis had been overcome, monetary reins were tightened again: The central bank stepped up its sterilization efforts via NBKR notes. In early 2014, after a two-year dispute, the authorities finally reached a new agreement on the Kumtor gold mining

[18] *Protests were fueled by allegations of authoritarianism and corruption.*

Chart 3

Major Imported Goods



Source: National statistics.

site with the foreign investor, which should have positive effects on the business environment.

In the first quarter of 2014, the Kyrgyz som came under pressure due to the decline of the Russian ruble and the devaluation of the Kazakh tenge. To smooth sharp fluctuations, the NBKR intervened, selling about USD 200 million or around 9% of its foreign reserves. The monetary authority also raised its policy rate to 6% and tightened a limit on banks' net open foreign exchange positions. The Kyrgyz currency's depreciation against the U.S. dollar spiked at 22% in March, but more recently around half of the loss was recouped, and reserves have been reaccumulating (IMF, 2014b, p. 6).

4 Tajikistan: On the Catching-Up Route, but Remaining under the Sway of International Price Movements and Directed Lending Practices

4.1 Some Salient Structural and Institutional Aspects

In terms of the depth of economic reforms carried out, Tajikistan occupies a middle position among the countries of Central Asia (according to the assessment of the EBRD as well as of the Heritage Foundation). Tajikistan joined the WTO in March 2013. The small mountainous country's main exports are aluminum (more than half of total exports), cotton (about one-fifth), and electricity. More than three-quarters of Tajik commercial banks are owned by domestic business groups.

Table 3

Tajikistan: Key Macroeconomic and Financial Sector Indicators

	2007	2008	2009	2010	2011	2012	2013[1]
GDP growth (in real terms, %)	7.8	7.9	3.9	6.5	7.4	7.5	7.4
Current account balance (% of GDP)	–8.6	–7.6	–5.9	–1.2	–4.7	–2.0	–1.9
Net FDI flows (% of GDP)	4.3	5.8	0.7	0.3	1.0	1.9	1.8
Gross external debt (% of GDP)[2]	33.7	29.2	33.2	33.9	32.1	29.8	25.2
Debt service ratio (% of exports of goods and services)	13.0	10.5	20.3	7.5	5.1	. .	. .
Gross international reserves (% of GDP)	2.3	2.9	5.6	8.4	8.8	8.7	8.1
General government budget balance (% of GDP)[3]	1.6	1.4	–0.5	–0.4	0.9	1.9	–0.1
CPI inflation (year-end, %)	19.8	11.9	5.0	9.8	9.3	6.4	6.1
Exchange rate: TJS/USD (annual average)	3.44	3.43	4.14	4.38	4.61	4.76	4.76
Level of monetization (broad money/GDP, %)	21.4	16.5	19.6	20.6	24.6	23.6	24.1
Credit to the private sector (% of GDP)	29.7	25.7	21.5	13.3	13.6	12.3	12.5
of which: foreign currency-denominated loans (%)	68.2	63.8	63.4	54.2	59.3	. .	. .
of which: nonperforming loans (%)[4]	2.8	5.4	10.4	7.5	7.2	9.5	. .
Capital adequacy ratio (%)	19.4	24.2	25.4	24.5	21.3	23.3	. .
Memo items:							
GDP (nominal, TJS billion)	12.780	17.609	20.623	24.705	30.069	36.161	41.690
GDP (nominal, USD billion)	3.712	5.135	4.982	5.642	6.523	7.592	8.537

Source: National statistics, IMF, Asian Development Bank, World Bank, EBRD.

[1] Partly estimates.
[2] Public and publicly guaranteed external liabilities.
[3] Excluding externally financed programs.
[4] Including loans more than 30 days overdue.

Monetary policy and banking supervision are saddled with considerable structural weaknesses: The interbank market is virtually nonexistent and functioning money markets are absent. Directed lending to agriculture, particularly to the cotton sector, has constituted an important function of the country's banking system. The Tajik somoni (TJS) became convertible for current account transactions in 2004. Similar to the case of Kyrgyzstan, the small size of the Tajik economy and its dependence on food and fuel supplies from external markets contribute to explaining its highly volatile rate of inflation.

4.2 Macroeconomic and Banking Sector Developments

Tajik economic expansion moderated from about 8% in 2008 to 4% in 2009. In the framework of countercyclical fiscal policy, small budget deficits (about ½% of GDP) were incurred in 2009 and 2010.[19] Using its managed floating exchange rate regime in a flexible manner (not unlike the NBKR), the National Bank of Tajikistan (NBT) let the Tajik somoni depreciate by about 28% in the course of 2009 and 2010, as a result of which the current account deficit narrowed substantially. In light of a benign turn of international commodity prices, inflation declined from double digits at the beginning of the year to 5% in December 2009, before regaining momentum (table 3). Credit to the private sector contracted in 2009 and 2010, probably due to efforts to rein in directed lending policies.

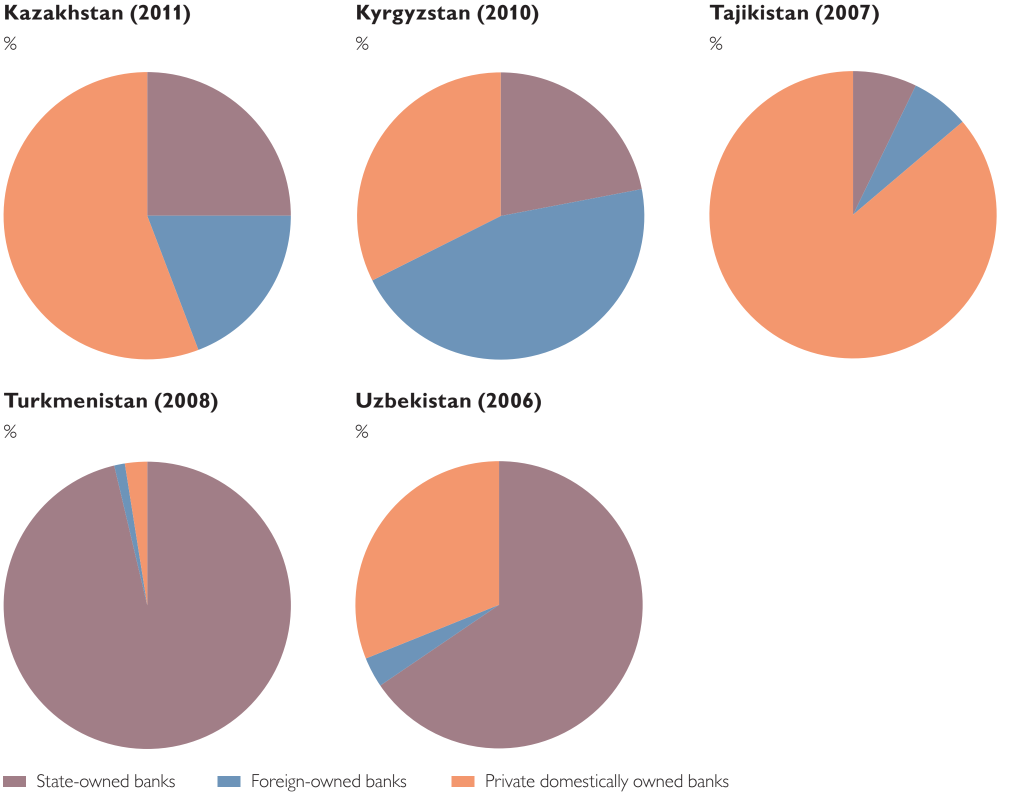
[19] *This figure excludes the externally financed Public Investment Program (PIP) and related grants, which made up about 3% to 5% of GDP.*

In order to break with the long-standing practice of allocating directed NBT credits via commercial banks to state-owned enterprises (SOEs) and private firms of the cotton sector, the government launched a cotton debt resolution strategy in 2009–10. The strategy envisaged the write-off of all farm debt – principally directed cotton loans – of about TJS 2.3 billion (i.e. a tenth of GDP or half of the entire credit volume). It further envisaged the issuance of around TJS 450 million of T-bills to commercial banks, and other assistance measures. The monetary authority's cotton debt department was closed in mid-2009 and a recapitalization strategy was adopted for the NBT. Moreover, prudential norms were tightened and supervision was stepped up; the supervisor demanded in 2010 that those banks with the highest NPLs present time-bound action plans to deal with potential capital losses (IMF, 2010, pp. 7, 11).

Pushed by roller-coaster global commodity prices, particularly of grain, flour and fuel, and by somoni depreciation, inflation rose back to almost 10% at end-2010. This gave rise to some post-crisis tightening efforts in early 2011: Policy rates were sharply increased, and the government even imported food products and sold food products from strategic reserves in an attempt to ensure adequate market supplies and curb any speculative distortions. Still, headline inflation remained largely under the sway of international food prices; after peaking at 14.8% in May 2011, inflation was down at 9.3% at the end of the year and stood at 6.4% at end-2012, as shown in table 3.

Chart 4

Ownership Structure of the Central Asian Banking Sectors



Source: National statistics.

Soon the financial sector required renewed attention. Against the background of insufficient capital levels at some banks, NBT liquidity injections were stepped up in late 2010 and 2011, which in turn fueled credit expansion. Then the monetary authority's liquidity support fell sharply, following the government bailout of Agroinvestbank (AIB) in mid-2012, the largest Tajik credit institution by assets and mostly associated with agricultural and SOE financing (table 6). The government purchased bad loans at virtually no discount and provided capital. The operation came at a total fiscal cost of 2% of GDP, and gave the authorities a majority stake in AIB, while leaving existing private shareholders with the remaining equity and effective control over the bank's management.

Meanwhile, the recapitalization of the NBT continued, but at a slower pace than anticipated. Overall, notwithstanding the above effort to write off all farm debt and achieve a clean slate, NBT-managed directed credits and lending to related parties seem to persist as familiar traits of the Tajik banking sector and continue to contribute to its modest profitability (IMF, 2013b, pp. 8–9).

5 Turkmenistan: Impressive Economic Opening Up while Remaining the Most Centrally Planned Economy in the Region

5.1 Some Salient Structural and Institutional Aspects

While having made some progress in the reform of foreign exchange regulations and in price liberalization, Turkmenia has remained the most centrally directed and state-planned economy of Central Asia (according to EBRD transition indicators). Central planning is the main tool for allocating resources. The overwhelmingly government-owned banking sector (about 95%; see chart 4) continues to play a key role as an agent of quasi-fiscal policy by carrying out directed lending instructions. Such instructions have also been a constituent part of a large-scale program of infrastructural investment and modernization, which has contributed to promoting economic growth and, more notably, to successful export diversification.

Some extrabudgetary institutions have helped channel funds to realize the authorities' goals. As a case in point, the Foreign Exchange Reserve Fund (FERF) has been used to save shares of hydrocarbon export revenues. The Stabilization Fund of Turkmenistan (SFT, established in 2008) has accumulated state budget surpluses. And the State Development Bank (SDB) was created in 2011 to foster economic development by taking over some directed lending activities from state-owned banks (table 6). The SDB has also acquired funding for these activities from the SFT. In 2010, the FERF was estimated to account for about two-thirds of all fiscal resources. It has remained outside the state budget and is managed by the Central Bank of Turkmenistan (CBT). In mid-2013, the SDB held about one-third of the total assets and one-fourth of the total credit of the banking sector. In pursuing their objectives, these three entities, to some extent, appear to lack a comprehensive coordination strategy.

The country unified its previously dual exchange rate system in mid-2008 and partly liberalized access to foreign exchange for current international transactions in 2009. Nevertheless, prepayments continue to be required for exports and imports, and banks are not permitted to conduct foreign exchange transactions with nonpublic customers without seeking prior approval of the monetary authority. With the exchange rate unification and currency redenomination, the CBT pegged the Turkmen manat to the U.S. dollar (exchange rate: 2.85 TMT/USD). While the

Table 4

Turkmenistan: Key Macroeconomic and Financial Sector Indicators

	2007	2008	2009	2010	2011	2012	2013[1]
GDP growth (in real terms, %)	11.1	14.7	6.1	9.2	14.7	11.1	10.2
Current account balance (% of GDP)	15.5	16.5	–14.7	–10.6	2.0	0.0	0.5
Net FDI flows (% of GDP)	3.3	5.9	22.5	16.4	11.6	8.9	7.5
Gross external debt (% of GDP)	2.4	2.8	2.4	4.1	10.0	18.1	19.6
Debt service ratio (% of exports of goods and services)	1.2	1.4	5.1	23.3	16.8	29.0	34.1
Gross international reserves (% of GDP)	50.9	77.4	93.8	84.8	76.5	75.1	72.2
General government budget balance (% of GDP)	16.6	31.5	15.5	–0.7	12.5	16,1	8.6
CPI inflation (year-end, %)	8.6	8.9	0.1	4.8	5.6	7.8	7.0
Exchange rate: TMT/USD (official, annual average)	1.04	2.30	2.85	2.85	2.85	2.85	2.85
Level of monetization (M2/GDP, %)	48.9	48.5	57.2	74.9	77.3	87.2	97.9
Credit to the economy (% of GDP)	24.2	20.1	22.6	27.3	25.4	26.0	25.3
of which: foreign currency-denominated loans (%)	59.3	54.3	49.4	43.1	33.1	26.6	27.0
of which: nonperforming loans (%)	0.4	0.1	0.1	0.1	0.0	0.0	. .
Capital adequacy ratio (%)	15.9	30.9	16.5	17.2	19.4	45.3	. .
Memo items:							
GDP (nominal, TMT billion)	27.00	49.47	57.61	63.12	83.32	100.22	115.56
GDP (nominal, USD billion)[2]	25.96	21.52	20.21	22.15	29.23	35.16	40.56

Source: National statistics, IMF, Asian Development Bank, World Bank, EBRD.

[1] *Partly estimates.*
[2] *Valued at the official exchange rate.*

manat is formally nonconvertible for balance of payments transactions,[20] the currency may, with some regulatory exceptions, actually have approximated current account convertibility according to the IMF (2013c, p. 2). Contrary to most of its regional peers and despite its overall rigid state-controlled system, Turkmenistan from 2007 to 2012 moved from being the most secluded economy to one of the most open economies of the region (see table 4 and table A1 in the annex).

5.2 Macroeconomic and Banking Sector Developments

Turkmen economic growth (according to official data) was not more than dented during the crisis (dropping to 6.1% in 2009), and remained very strong in recent years. Economic expansion was supported during the crisis by large public investments in the construction of gas export pipelines and other infrastructure within the framework of the National Program of Social and Economic Development. A major public expenditure effort was carried out in 2009 and 2010: The budget balance (including the FERF) declined from a positive 32% of GDP in 2008 to –1% in 2010, while the current account swung from a surplus of 17% of GDP in 2008 to deficits of almost the same size in the following two years. However, as one might expect in the context of such a huge capital formation program, the resulting current account shortfall was largely caused and more than covered by FDI inflows.

Credit to the economy was also on the rise in these years, reflecting stepped-up program financing by directed loans. The temporary sharp decline of inflation (to 0.1%) in 2009 was primarily due to falling import prices coupled with the

[20] *The Turkmen authorities continue to avail themselves of Article XIV of the IMF Articles of Agreement.*

stabilization of the exchange rate and a selective liberalization of the trade and foreign exchange regime. In the following years, food price increases and accommodative policies contributed to the rekindling of inflation. This happened notwithstanding widespread administrative controls and frequent supply-side government interventions, including the saturation of domestic markets with targeted imports (IMF, 2011, p. 13).

Once new gas pipelines aimed at diversifying export markets to China and Iran had become operational in 2010, the growth of exports, GDP and imports accelerated in 2011 and remained in double digits in 2012 and 2013. In this way, the Turkmen economy's openness increased substantially. Public capital formation continued to expand through imported machinery and equipment; accordingly, the current account remained near balance and FDI inflows were substantial.[21] The budget balance reverted to a surplus position. Gross external debt grew quickly in recent years, but remains at a low level (20% of GDP in 2013, see table 4).

6 Uzbekistan: Continuing State-Directed Growth as Isolation Increases

6.1 Some Salient Structural and Institutional Aspects

Since the global economic crisis of 2008 and 2009, Uzbekistan has remained a strongly centralized and state-led economy. Uzbek economic growth is supported and partly directed by the government's Industrial Modernization and Infrastructure Development Program (IMP). State-owned banks continue to account for about 80% of total banking assets and go on carrying out non-core functions of credit institutions, including cash monitoring and controls of their clients as well as tax administration (table 6). State-owned banks remain prominent in carrying out directed lending (typically below market rates) in the framework of the above-mentioned IMP program and other official schemes (IMF, 2013d, pp. 14–15).

The Fund for Reconstruction and Development (FRD) contributes to this activity. Established in 2006, the FRD accumulates revenue in excess of established cut-off prices on mineral resources and thus aims to shield the state budget from the effects of volatile commodity prices as well as to stimulate investment and economic development by extending long-term loans to banks for cofinancing government-selected projects. The FRD's resources quickly multiplied from about USD 1 billion at end-September 2008 to USD 11 billion four years later. The country continues to feature formal – but not de facto – current account convertibility, as foreign currency rationing for imports and other exchange restrictions (e.g. surrender requirements at 100% for cotton and gold and at 50% for other exports) remain commonplace. Like that of most Central Asian economies, Uzbekistan's trade openness (exports and imports of goods and nonfactor services to GDP) declined from 2007 to 2012. Moreover, Uzbekistan – although a relatively large economy – became the least open country of the region (see table A1 in the annex).[22]

[21] *In 2013, production at the world's second-largest gas field, Galkynysh (formerly called Yolotan, in the Mary oasis in southeastern Turkmenia) was inaugurated. Further investment, export expansion and diversification is planned through the construction of the Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline, which, however, faces considerable bureaucratic and security challenges (Emerging Europe Monitor: Russia & CIS, 2014b).*

[22] *This is in utter contrast to the development of neighboring, even more centrally managed, Turkmenia.*

Table 5

Uzbekistan: Key Macroeconomic and Financial Sector Indicators

	2007	2008	2009	2010	2011	2012	2013[1]
GDP growth (in real terms, %)	9.5	9.0	8.1	8.5	8.3	8.2	8.0
Current account balance (% of GDP)	7.3	8.7	2.2	6.2	5.8	2.7	3.7
Net FDI and portfolio investment flows (% of GDP)	3.1	2.5	2.5	4.2	3.6	1.7	1.7
Gross external debt (% of GDP)	17.5	13.1	15.0	14.8	13.4	13.1	18.9
Debt service ratio (% of exports of goods and services)	8.6	6.2	5.8	4.1	3.6	6.4	3.3
Gross international reserves (% of GDP)	33.6	33.3	36.5	37.4	39.8	35.9	34.3
General government budget balance (% of GDP)[2]	5.2	10.2	2.8	4.9	8.8	4.7	1.8
CPI inflation (year-end, %)[3]	11.9	14.4	10.6	12.1	13.3	10.4	11.8
Exchange rate: UZS/USD (annual average)	1,264	1,320	1,466	1,577	1,711	1,885	2,079
Level of monetization (broad money/GDP, %)	16.6	17.2	18.7	22.6	23.8	24.4	25.4
Credit to the economy (% of GDP)	15.0	15.2	16.4	18.5	19.4	19.6	19.6
of which: foreign currency-denominated loans (%)	43.6	34.6	36.4	39.4	41.9	39.5[4]	. .
of which: nonperforming loans (%)	2.8	3.0	1.2	1.0	0.7	0.5	. .
Capital adequacy ratio (%)	23.8	23.2	23.4	23.4	24.2	24.3	. .
Memo items:							
GDP (nominal, UZS billion)	28,196	37,747	49,043	61,794	77,751	96,664	117,386
GDP (nominal, USD billion)	22.31	28.61	33.46	38.96	45.35	51.17	56.47

Source: National statistics, IMF, Asian Development Bank, World Bank, EBRD.

[1] *Partly estimates.*
[2] *Including the Fund for Reconstruction and Development.*
[3] *Based on authorities' source data and IMF staff calculations using international methodology.*
[4] *As at end-September 2012.*

6.2 Macroeconomic and Banking Sector Developments

Uzbek economic growth (according to official data) continued during and after the crisis at about the same speed as before the crisis (between 7% and 9%, in real terms). The current account surplus declined post-2008, but remained positive. Gross external debt remained at low double digits (as a percentage of GDP). As table 5 shows, CPI inflation persisted in double digits (for various reasons, as explained below); the rising price level became a major preoccupation of the authorities.

Economic growth in the crisis year 2009 eased only slightly from 2008 (from 9.0% to 8.1%) as a result of the country's low exposure to global financial markets and thanks to important countercyclical measures, including higher industrial and infrastructure investment through FRD lending, largely in the IMP framework. Accordingly, the fiscal surplus shrank sharply in 2009. Apparently due to this increased liquidity and to continuing de facto foreign currency restrictions, a margin between the official exchange rate and the parallel rate in the unofficial cash foreign currency market emerged.

In 2010 and 2011, prices for Uzbekistan's main exports – cotton, hydrocarbons, steel and gold – recovered. Stimulus policy switched from a largely fiscal to a monetary nature: Driven by stepped-up foreign currency purchases by the Central Bank of Uzbekistan (CBU) and by strong credit growth, broad money growth accelerated. Yet, this contributed to the increase of inflation from 10.6% at end-2009 to 13.3% two years later. The expansion of foreign currency purchases took place as part of the authorities' attempt to lift the competitiveness of the export sector by somewhat accelerating the depreciation of the Uzbek sum within the framework of the crawling peg-like exchange rate arrangement adopted in 2008. Other factors responsible for the swelling of the price level were: continued demand-boosting policies (linked to government programs and the FRD), and administrative price rises of fuel, utilities and bread aimed at achieving cost recovery.

Fiscal as well as monetary policies were tightened in 2011. The CBU enlarged its sterilization of excess liquidity resulting from the accumulation of foreign assets,[23] while the government increased its deposits with the monetary authority as well as the FRD. As a result, reserve and broad money growth decelerated in 2011 and 2012, and inflation came down again to 11%. The margin that had emerged in 2009 between the official exchange rate and the parallel rate narrowed somewhat in 2012, reflecting the more limited availability of the Uzbek sum. Given that the sustained state-led modernization expenditures, the continued official policy of gradual depreciation of the Uzbek sum and the (basically necessary) administrative price adjustments have constituted core elements of the authorities' economic strategy, the resulting "inflation trap" may not be that easy to escape.

The setbacks in the global recovery in 2013 and the stagnation of commodity prices had a dampening impact on Uzbek economic growth, which the authorities countered by serving a new fiscal stimulus. The budget surplus declined from 4.8% in 2012 to 1.8% in 2013 – and thus reached the lowest level in almost a decade (table 5). Given the banking sector's quasi-fiscal functions, its capital adequacy has continued to be under pressure since the crisis but has been upheld with sustained capital injections by the authorities. Of course, as long as these activities continue and as credit institutions are obliged to fulfill non-core functions (as mentioned above), public trust in banks will not grow and market-oriented financial deepening will not be possible in Uzbekistan (Coleman, 2012, pp. 107–109; EBRD, 2012, pp. 158–159).

7 Comparative Assessment and Conclusions: With Reforms Largely Ground to a Halt, the Role of Oil and Gas as a Determinant of Relative Prosperity Is Unbroken

7.1 Predominance of Political Authoritarianism and Economic Interventionism, Banking Sectors Often Instruments of Quasi-Fiscal Policies

As one might expect, less political freedom typically goes hand in hand with fewer economic liberties, also in Central Asia. This can be seen from a juxtaposition of the Economist Intelligence Unit Democracy Index with Heritage Foundation Economic Freedom Scores for the countries of the region: Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan. However, there appears to be one exception, namely that the Kyrgyz Republic is assessed as a hybrid (non-authoritarian) regime by the Economist Intelligence Unit, yet at the same time as an economically mostly unfree country by the Heritage Foundation, while Kazakhstan is graded as mildly authoritarian, but moderately free for business. This seeming paradox might be explained by the fact that Kyrgyzstan, although it had experienced a pro-democracy uprising in 2010, which ushered in a parliamentary

[23] *Liquidity mopping-up operations included the sale of CBU certificates of deposit at more attractive interest rates in 2012 than before.*

regime, remains politically highly unstable and poor. Governance leaves a lot to be desired and implementation of laws remains weak. One can certainly argue that persistent political instability cannot but affect the business climate and economic freedom. At the same time, it would seem evident that in the Kazakh case, major hydrocarbon resource extraction and wealth generation have necessitated a minimum degree of transparency of rules for international corporations that possess needed technologies.

On the structural economic front, not much has changed since the crisis of 2008–09. Kazakhstan and Turkmenistan continue to be relatively rich (in terms of GDP per capita) hydrocarbon exporters, which have modernized their economies by importing considerable amounts of machinery and equipment. In contrast, the Kyrgyz Republic and Tajikistan remain relatively poor hydrocarbon importers and prominent recipients of remittance transfers (mostly from Kyrgyz or Tajik guest workers in Russia or Kazakhstan) (see chart 3 and table A2 in the annex). Well-financed modernization efforts by the hydrocarbon exporters and less leeway for comparable efforts on the part of the hydrocarbon importers may mark deepening regional disparities within Central Asia. Uzbekistan occupies a structural "middle position:" While it is a hydrocarbon exporter, it sells a more diversified product range than do Kazakhstan or Turkmenia. Uzbekistan is a rather low-income country (though richer than Kyrgyzstan and Tajikistan) and receives some limited remittances from its guest workers abroad. As to current account and budget developments, the hydrocarbon exporters (including Uzbekistan) typically achieve "twin surpluses" (of both balances)[24], while the hydrocarbon importers are usually saddled with "twin deficits" or at best only modest budget surpluses (Tajikistan).

Overall, across the region, EBRD transition indicators have not measured any major reform progress in Central Asia since the global crisis of 2008–09, while prior to the crisis, all countries of the region are assessed to have made some structural or institutional advances. Banking sector reforms are a case in point: Precrisis deregulation was followed by post-crisis reregulation, almost across the board. The recent tightening of state control of banking sectors happened against the background of credit institutions' financial weakness; in contrast to the precrisis era, bank lending no longer played an important role as a driver of economic growth if one disregards the recent reacceleration of retail credit expansion in Kazakhstan. The fragility of the Kazakh and Kyrgyz banking sectors (which, as a rule, do not fulfill quasi-fiscal functions) is due to the busts or downturns that followed their precrisis credit booms and whose legacies (e.g. partly dismal asset quality) continue to plague these sectors. The other Central Asian countries' banking sectors, which are more involved in directed and subsidized lending practices, also feature weaknesses because the exercise of these functions generally does not constitute a profit-oriented activity. Credit institutions carrying out quasi-fiscal activity are often state owned and receive either periodic capital injections or other repeated public financial assistance.[25]

[24] *The Turkmen current account deficits in 2009 and 2010 were a temporary exception here. They can be explained by major public investment and infrastructural modernization efforts (including large-scale export pipeline construction), which also reflected exceptionally high FDI inflows.*

[25] *For a more detailed discussion of the strengths and weaknesses of the Central Asian banking sectors, see Dzhagitian (2013).*

Table 6

Comparative Overview of Some Macroeconomic, Structural and Policy-Related Indicators in Central Asia (updated)

	Nominal GDP per capita (market exchange rate, USD)		Average annual GDP growth rate, % precrisis (2004–07)/ post-crisis (2010–13)	Domestic currency and convertibility	Exchange rate regime	Main monetary policy instruments (used 2008–13):		Budgetary stabilization and investment funds:	Quasi-fiscal functions of credit institutions:
	2008	2013				to control inflation	to deal with/ control the exchange rate	yes or no/if yes: which name, size (USD billion)	yes or no/if yes, which functions
Kazakhstan	8,683	13,152	9.7/6.4	Kazakh tenge (KZT); current, capital and financial account convertibility (since 2007)	Oct. 2007: de facto U.S. dollar peg; Feb. 2009: devaluation by 18% against USD, establishment of narrow trading band to USD; Feb. 2010: widening of trading band; Feb. 2011: abolishment of trading band and return to (pre-2007) managed floating; Feb. 2014: new devaluation of 19% against USD, re-establishment of a narrow corridor	Sales/purchases of NBK notes and government T-bills, NBK reserve requirements, refinancing rate, administrative measures (price controls on food items, postponement of adjustment of utility tariffs)	NBK interventions in the foreign currency market to ensure stable exchange rate to the U.S. dollar	Yes: National Fund of the Republic of Kazakhstan (NFRK, national oil fund, end-2013: USD 70.5 billion), Samruk-Kazyna (SK, state investment holding company, end-2012: over USD 100 billion)	No
Kyrgyz Republic	972	1,282	4.4/3.7	Kyrgyz som (KGS); current account convertibility (since 1995)	Managed floating with no pre-announced path for exchange rate	Sales/purchases of NBKR notes and government T-bills, NBKR policy rate, reserve requirements, fiscal tightening	NBKR interventions (often unsterilized) in the foreign currency market; since March 2014: policy rate	No	Yes: Settlement and Savings Company (SSC): subsidized lending to agriculturalists and other beneficiaries in the framework of the Affordable Loans for Farmers (ALF) program
Tajikistan	696	1,049	8.0/7.2	Tajik somoni (TJS); current account convertibility (since 2004)	Managed floating with no pre-announced path for exchange rate	NBT refinance rate and other policy rates, reserve requirements, variation of liquidity loans, administrative measures (food imports and sales from strategic reserves of food products)	NBT interventions (largely unsterilized) in the foreign currency market	No	Yes: Agroinvestbank (AIB), others: financing of cotton sector and state-owned enterprises

Source: National statistics, IMF Staff Reports, IMF Annual Report on Exchange Arrangements and Exchange Restrictions 2013, Asian Development Bank, EBRD.

Table 6 continued

Comparative Overview of Some Macroeconomic, Structural and Policy-Related Indicators in Central Asia (updated)

	Nominal GDP per capita (market exchange rate, USD)		Average annual GDP growth rate, % precrisis (2004–07)/ post-crisis (2010–13)	Domestic currency and convertibility	Exchange rate regime	Main monetary policy instruments (used 2008–13):		Budgetary stabilization and investment funds:	Quasi-fiscal functions of credit institutions:
	2008	2013				to control inflation	to deal with/ control the exchange rate	yes or no/if yes: which name, size (USD billion)	yes or no/if yes, which functions
Turkmeni-stan	4,060	7,110	12.7/11.3	Turkmen manat (TMT); official nonconvert-ibility	Dual exchange rate system, official rate pegged to the U.S. dollar; May 2008: exchange rate unification, USD peg	Administrative measures (price controls for food items, food imports and sales from strategic reserves of food products), variation of volume of directed credits, managment of reserve money growth	CBT interventions at Interbank Currency Exchange (ICE) to support rate pegged to the U.S. dollar, restrictions in access to foreign currency for foreign trade and other external transactions, buildup of official foreign currency reserves	Yes: Stabilization Fund of Turkmenistan (SFT, budgetary fund), Foreign Exchange Reserve Fund (FERF, entity for saving and investing hydrocarbon export proceeds), other funds (2012: total revenue of extrabudgetary funds: USD 12.4 billion, total expenditure: USD 8.9 billion)	Yes: Daykhanbank (Agricultural Bank), State Development Bank, Khalkbank (former Sberbank), Turkmen-bashibank, Turkmenistan-bank, Prezident-bank, others: lending to agricultural and industrial entities, SOEs, small businesses, mortgage borrowers; banks used as agents for financial oversight
Uzbekistan	1,039	1,895	7.9/8.2	Uzbek sum (UZS); formal – but not de facto – current account convertibility (since 2003; maintenance of foreign currency rationing and other exchange restrictions)	May 2006: U.S. dollar peg; Jan. 2008: crawl-like arrangement toward the USD	Sterilization of excess liquidity resulting from accumulation of foreign currency assets through CBU certificates of deposit, sterilization also through fiscal tightening and government deposits at CBU, variation of directed lending, CBU refinance rate, reserve requirements	CBU interventions in the foreign currency market (to ensure gradual depreciation of Uzbek sum), buildup of official foreign currency reserves	Yes: Fund for Reconstruction and Develop-ment (FRD, budget energy stabilization and investment fund, 2012: total resources USD 11 billion)	Yes: National Bank of Uzbekistan, Asakabank, Uzpromstroy-bank, Agrobank, Pakhtabank: financing of farming and industrial firms, SOEs, small businesses; credit institutions used as agents for financial monitoring and tax collection
Russia (for compari-son)	11,665	14,634	7.2/3.4	Russian ruble (RUB); current, capital and financial account convertibility	Broad and adjustable trading band to USD/EUR basket; CBR has taken preliminary steps toward a free float/inflation targeting	CBR policy rate: refinancing rate, since Oct. 2013: rate on one-week open market operations, sales/ purchases of CBR notes and government T-bills, CBR reserve require-ments, administra-tive measures	CBR interventions in the foreign currency market	Yes: Reserve Fund (oil stabilization fund, end-2013: USD 87.4 billion), National Wealth Fund in support of pension system (end-2013: USD 88.6 billion)	No

Source: National statistics, IMF Staff Reports, IMF Annual Report on Exchange Arrangements and Exchange Restrictions 2013, Asian Development Bank, EBRD.

7.2 Overall Impressive Commodity-Driven Growth, Great Variety of Price Stability Toolkits, Trade Orientation Gravitating between China and Russia

While average growth in the region has been somewhat lower in recent years than before 2008–09, strong economic expansion has continued in Central Asia even after the crisis; moreover in 2009, none of the five countries experienced a recession.[26] Growth in recent years has generally been driven by the recovery of oil, gas and non-hydrocarbon (including gold, aluminum, cotton) resource prices and demand. Moreover, where applicable, generous programs of infrastructural investment and modernization stimulated economic activity. The poorer countries benefited from recovering inflows of guest workers' remittances (Combe, 2013, pp. 21–22). However, in 2010 and 2012, Kyrgyzstan suffered some small slumps triggered by bouts of domestic political instability (see chart 1 and table 2). As table 6 indicates, per capita income growth rates of the relatively rich (hydrocarbon) countries and of the rather poor (non-hydrocarbon) countries of the region have tended to diverge in recent years. For systemic reasons, the very high official growth rates of the state-controlled Turkmen and Uzbek economies have to be treated with caution, since they partly reflect centrally driven "forced growth."

From 2008 to 2013, Central Asian countries' inflationary trends converged around rates of between 5% and 7% (end-year), with the outlier Uzbekistan, however, witnessing price increases remaining in double digits (2013: 12%). This peculiarity can be explained by the Uzbek crawl-like exchange rate arrangement and by continued demand-boosting policies. The other countries of the region have either pegged their currencies (Turkmenia), with a narrow corridor (Kazakhstan), or carry on managed floating without a preannounced path for the exchange rate (Kyrgyzstan, Tajikistan) (table 6). Here again we have a familiar dichotomy: Hydrocarbon countries tend to opt for fixed or tightly managed exchange rates, while non-hydrocarbon countries are more inclined to floating. Uzbekistan, the intermediary player, accordingly features a kind of hybrid currency regime.

Apart from increasing policy rates, raising reserve requirements and reducing circulating liquidity through open market operations (sale of central bank and T-bills), tightening fiscal policies (including the transfer of revenues to extrabudgetary funds) have served as anti-inflationary instruments. Not surprisingly, administrative interventions, like price caps on food and consumer staples, or even outright state supply-side intervention through the import and sale of food items in order to saturate retail markets, have prominently featured in Central Asian countries' price stability toolkits. Despite all policy efforts, global (mostly supply-side) economic forces appear to maintain a momentous impact on regional inflationary ups and downs. In 2014, price rises are expected to gain momentum in Kazakhstan and Kyrgyzstan due to the most recent ruble, tenge and som depreciations.

A number of factors may explain the above-described impressive economic and structural heterogeneity in the region. First, there is the evident geographic factor: Central Asian countries are sandwiched between more or less market-oriented

[26] *Average annual GDP growth (unweighted) in Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenia and Uzbekistan in the four years preceding the crisis of 2008–09, namely in 2004–07, had been 8.5%; this indicator declined to 7.4% in the four years following the crisis (2010–13).*

democracies and mildly authoritarian countries of Central and Eastern Europe on the one hand, and authoritarian but highly competitive China and the less authoritarian raw material producer Mongolia on the other. Second, as referred to above, the considerable variety of political regimes in the region contributes to explaining differing economic frameworks. Third, emerging market energy exporters (in Central Asia: Kazakhstan, Turkmenia, Uzbekistan) are typically richer and have more funds for development at their disposal than emerging market energy importers (here: the Kyrgyz Republic, Tajikistan). Accordingly, relatively poor energy importers are more likely to be a source of out-migration and to receive substantial guest workers' remittances as well as to benefit from international financial assistance.

However, more authoritarianism in Central Asia does not necessarily go together with lower economic growth or more modest per capita income, it can just as well be the contrary. In countries of the former Soviet Union – except for the Baltics – a decisive factor for economic prosperity appears to relate not so much to the issue whether a country is more or less authoritarian, but whether it possesses large hydrocarbon resources and is an oil/gas exporter or not.

Finally, one can also enumerate some elements of homogeneity in Central Asia: All countries of the region have featured relatively high economic growth in recent years and none experienced a contraction of GDP during the global recession of 2008–09. In the last decade, Central Asian countries witnessed little progress in economic reforms; moreover, since the crisis of 2008–09, reforms have largely stalled. All Central Asian countries' top trading partners are Russia and increasingly China (which together account for 30% to 40% of these countries' foreign trade turnover; see chart A1 in the annex). Only for Kazakhstan is the EU still the number one commercial partner. Russia may hope to recoup some ground in the coming years, with trade integration effects expected from the Eurasian Customs Union/Eurasian Economic Union (EAU; current members: Russia, Belarus and Kazakhstan).

Given the imposition of the new integration area's common customs tariff (which is higher than the previous Kazakh external tariff on many manufactured items, including machinery and equipment, vehicles, pharmaceuticals), and given the reduction of some nontariff barriers (e.g. the removal of border customs controls) on internal trade between members of the integration area, Kazakh trade within the EAU has clearly become easier (EBRD, 2012, p. 71). At the same time, imports from outside partners, like the European Union and China, have often become more expensive. Further to-be-expected EAU integration measures, like regulatory harmonization, will work in the same direction, unless harmonization converges toward EU standards. Thus, since the establishment of the Eurasian Customs Union and the EAU, Kazakhstan's trade with the EU has found itself at a relative disadvantage to its trade with Russia or with Belarus, in some cases also producing trade diversion effects, particularly with regard to industrial goods. However, Kazakhstan has apparently already seen rising shares of FDI inflows from outside the EAU as other countries – e.g. EU countries, which are the number one FDI source for Kazakhstan – seek to secure access to this integration area.

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Annex

Table A1

Trade Openness

	2007	2012
	Exports of goods and nonfactor services to GDP in %	
Kazakhstan	49.5	47.9
Kyrgyzstan	52.9	54.6
Tajikistan	20.7	18.2
Turkmenistan	36.8	58.5
Uzbekistan	39.7	27.9
	Exports and imports of goods and nonfactor services to GDP in %	
	2007	2012
Kazakhstan	92.4	77.5
Kyrgyzstan	137.1	154.3
Tajikistan	89.9	82.7
Turkmenistan	55.7	107.8
Uzbekistan	76.2	57.6

Source: National statistics.

Table A2

Migrants' Remittances or Current Transfers, 2010–13

	2010	2011	2012	2013[1]
	% of GDP, net			
Kazakhstan	–0.3	–0.2	–0.5	–0.7
Kyrgyzstan	27.4	28.3	30.3	29.8
Tajikistan	36.2	40.3	45.2	. .
Turkmenistan	0.5	0.3	0.2	0.2
Uzbekistan	4.5	6.0	6.8	6.6

Source: National statistics, IMF.

[1] Partly estimates.

Table A3

Russia: Key Macroeconomic and Financial Sector Indicators

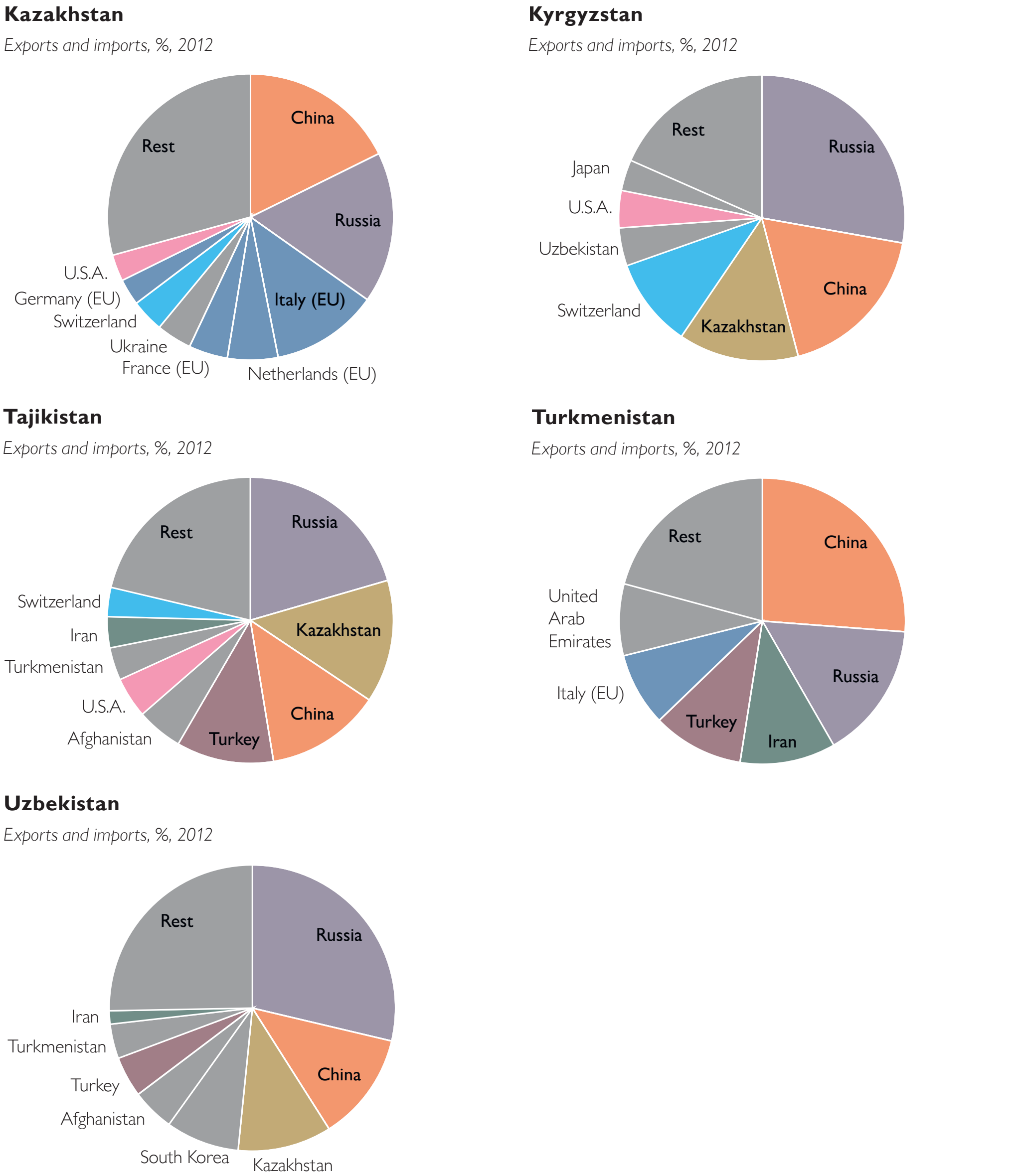
	2007	2008	2009	2010	2011	2012	2013[1]
GDP growth (in real terms, %)	8.1	5.2	–7.8	4.5	4.3	3.4	1.3
Current account balance (% of GDP)	5.9	6.2	4.1	4.4	5.1	3.5	1.6
Net FDI flows (% of GDP)	0.7	1.2	–0.7	–0.6	–0.8	–0.4	–0.3
Gross external debt (% of GDP)	36.4	28.9	38.2	32.1	28.7	31.6	34.8
Debt service ratio (% of exports of goods and services)	28.3	28.9	30.5	23.7	15.8	17.9	. .
Gross international reserves (% of GDP)	35.4	30.3	34.2	31.5	28.8	26.7	24.2
Combined assets of Reserve Fund and of National Welfare Fund (% of GDP)[2]	12.0[3]	13.5	12.4	7.5	5.9	7.3	8.6
General government budget balance (% of GDP)	6.0	4.9	–6.3	–3.4	1.5	0.4	–0.6
CPI inflation (year-end, %)	11.9	13.3	8.8	8.8	6.1	6.6	6.5
Exchange rate: RUB/USD (annual average)	25.58	24.81	31.68	30.36	29.38	31.07	31.82
Level of monetization (broad money/GDP, %)	44.0	39.4	49.2	51.4	51.5	51.9	54.1
Credit to the economy (% of GDP)	36.9	40.0	41.5	39.1	41.7	45.1	50.0
of which: foreign currency-denominated loans (%)	22.8	24.8	23.7	22.1	20.5	16.3	17.0
of which: nonperforming loans (%)[4]	11.0	13.5	19.5	19.7	17.2	15.4	14.1
Asset share of foreign-owned banks (%)	17.2	18.7	18.3	18.0	16.9	17.8	15.3
Capital adequacy ratio (%)	15.5	16.8	20.9	18.1	14.7	13.7	13.5
Memo items:							
GDP (nominal, RUB billion)	33,248	41,277	38,809	46,322	55,967	62,218	66,577
GDP (nominal, USD billion)	1,300	1,664	1,225	1,526	1,905	2,017	2,092

Source: National statistics, IMF, World Bank, EBRD.

[1] Partly estimates.
[2] Gross international reserves and assets of the Reserve Fund and the National Welfare Fund partly overlap.
[3] As at end-January 2008.
[4] Broader definition (share of doubtful, problem and bad loans in total loans).

Chart A1

Major Trading Partners' Share in Total Merchandise Trade Volume



Source: National statistics.