Macrofinancial Developments and Systemic Change in CIS Central Asia

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In CIS Central Asia, the institutional economic framework is found to be remarkably heterogeneous across the region: Kazakhstan and the Kyrgyz Republic are market-oriented reforming economies, Tajikistan and Uzbekistan can be characterized as hybrid economies, while Turkmenistan remains largely centrally-planned. All CIS Central Asian countries – except for Turkmenistan – have introduced current account convertibility, if obstructed by trade restrictions in the Uzbek case. Kazakhstan liberalized its capital account in early 2007. Energy and other export proceeds, remittance inflows, FDI and other capital inflows and credit booms have contributed to the region's strong economic expansion, at least up to 2007. In this period, Central Asia has pragmatically coped with the potentially conflicting dual goals of combating inflation while preventing too strong currency appreciation (to support competitiveness). The global inflationary spike and the world financial crisis substituted a new policy dilemma for the old one: whether to give priority to fighting inflation or to bailing out credit institutions. With its relatively large banking sector, Kazakhstan was the only country really struck by this dilemma. The Kazakh authorities heavily intervened and partially nationalized the sector, which has, however, not prevented nationalized banks from defaulting. At the other extreme, the Turkmen and Uzbek financial sectors have remained insulated from international financial contagion, albeit at high costs in terms of economic development and income.

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1 Introduction

The purpose of this paper is to provide a concise analytical overview of the institutional and economic policy frameworks as well as the macroeconomic policies and challenges in the five countries of CIS Central Asia (Kazakhstan, Kyrgyzstan,[2] Tajikistan, Turkmenistan and Uzbekistan) in a comparative manner. Special emphasis will be laid on monetary and exchange rate policies and on banking sector and financial stability developments. References will also be made to the positions of Austrian banks, where they are present. The study is not aimed at testing a particular hypothesis, but at presenting, analyzing and interpreting information on a specific region, from which stylized facts and policy assessments can be drawn as conclusions (empirical induction). To the best of the author's knowledge, there is no other study that focuses on surveying and evaluating Central Asian countries' monetary, exchange rate and banking policies as well as policy frameworks in a comparative and up-to-date way.[3]

The study starts with a horizontal flyover of the region (section 2), comparing the evolution of macroeconomic, institutional, structural as well as banking and financial indicators across the five countries since the early years of the new millennium. This is followed by country-by-country policy close-ups (section 3),

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[2] *The terms "Kyrgyzstan" and "Kyrgyz Republic" will here be used as synonyms.*

[3] *The author plans to publish a follow-up study with a focus on the financial sector of Kazakhstan, the largest economy of the region.*

giving country-specific information on policy conditions and essential details with respect to monetary policy and banking supervision experiences and reforms. Section 4 briefly describes the activities of Austrian banks in the region. An overall comparative assessment (section 5) summarizes analyzed facts and draws conclusions on the success and challenges of Central Asian monetary and banking sector policies, while taking into account the diverse repercussions and implications of the current global financial and economic crisis.

2 Macro-Structural Overview of Central Asia: Impressive Heterogeneity

Occupying a territory approximately the size of the current EU, the five countries of CIS Central Asia (i.e. the former Soviet Central Asian republics) together boast about 60 million inhabitants. While oil and mineral-rich Kazakhstan comprises over two-thirds of Central Asian territory and GDP, Uzbekistan accounts for almost half of the regional population. Extraordinary natural resource wealth and reform-oriented economic policies have lifted Kazakhstan's GDP per capita to EUR 5,800 (exchange rate-based) in 2008, which is way above the respective levels of the other countries of the region. Gas-rich but isolationist Turkmenistan is number two (EUR 1,850 in 2007). Interventionist Uzbekistan (an exporter of cotton, energy and metals)[4] as well as mountainous and remote Kyrgyzstan (exporter of metals, minerals and food) and Tajikistan (aluminum exports) feature GDP per capita levels of around EUR 600, which are the lowest of the region and the CIS.

While coming from modest points of departure, average annual economic growth in the nine years from 2000 to 2008 is impressively high in all countries, except perhaps in Kyrgyzstan, which experienced bouts of stagnation in 2002 and 2005 (chart 1). Why has growth been strong? For one, Central Asia has benefited from economic recovery after the partly deep transition depression of the 1990s, which had lasted particularly long in the region, and also after the Russian crisis of 1998. Secondly, since all of these countries are resource exporters, resource – particularly energy – price rises in recent years have boosted growth. Thirdly, in most countries, remittances and/or inflows of capital have also played a role recently.

Given that Russia has been a main trading partner, a major source of remittances, an important focus of financial linkages and key competitor of the region, Russia's buoyant economic development until the fall of 2008 and its slump afterwards left their marks in Central Asia (Jardaneh, 2009; see also chart 1 and table 6 as well as tables 4 and 5 in the annex). In late 2008, under the impact of the global crisis, growth declined substantially in Kazakhstan, the Kyrgyz Republic and Tajikistan. It appears that in 2009, Turkmenistan and Uzbekistan, which both constitute highly centralized, state-controlled and relatively secluded economies, are also being affected, if to a more limited degree.

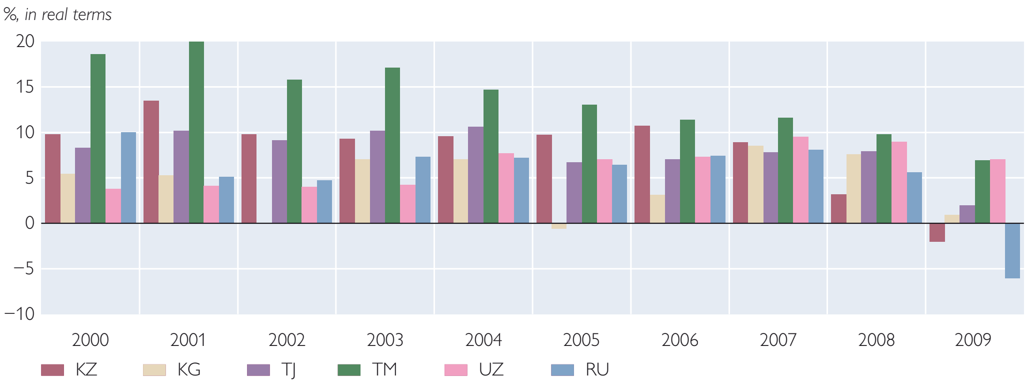
Major regional energy exporters – Kazakhstan, Turkmenistan and Uzbekistan – have chalked up large trade surpluses in recent years, while energy importers – the Kyrgyz Republic and Tajikistan – are saddled with large trade deficits. However,

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

the latter countries have received sizable inflows of workers' remittances. Net inflows of foreign direct investment are substantial in Kazakhstan, smaller in Turkmenistan (though, apparently, catching up), Kyrgyzstan and Tajikistan, and minor in Uzbekistan. Net FDI inflows have dominated capital and financial accounts, except in 2006 and 2007, when portfolio inflows and cross-border loans temporarily expanded strongly in some countries. In 2000–2008, Central Asian annual inflation rates were on an average level of 8% to 15%: Inflation came down from previous instability in the early years of the decade, reached something like a trough in 2003 and 2004, then climbed again and witnessed a spike in 2007, before easing in 2008. This spike was largely due to the global energy and food price explosion. With most of their own currencies hardly older than 15 years, Central Asian economies continue to witness high levels of dollarization.

Chart 1

GDP Growth



Source: National statistics, IMF, EBRD.

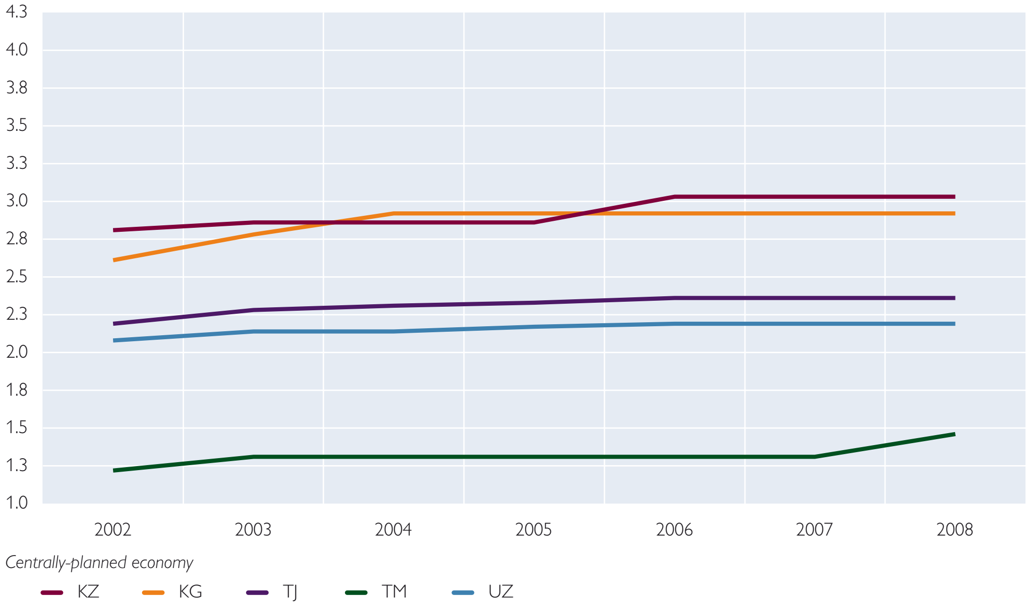
Note: Data for 2009 are forecasts of the IMF World Economic Outlook April 2009.

Looking at comparative structural reform indicators as measured by the EBRD (EBRD, 2008, pp. 4–5) shown in charts 2 to 4, it appears obvious that most of Central Asia still has a considerable reform path to go. Judging from average transition scores, even the most advanced countries – Kazakhstan and the Kyrgyz Republic – are still in the midst of institutional adjustment. At the other end, Turkmenistan essentially remains a centrally-planned economy. Uzbekistan and Tajikistan can be regarded as hybrid economies in that they continue to incorporate important nonmarket components in their economic systems. The ownership structure of Central Asian banking sectors is quite varied. Only in the Kyrgyz Republic does this structure resemble that of a typical Central or Southeastern European country dominated by foreign strategic investors. In Kyrgyzstan, Kazakh credit institutions overwhelmingly prevail among foreign investors, who in 2007 accounted for 59% of all domestic banking assets. In Kazakhstan and Tajikistan, domestic private banking groups dominate the sector, while in the Turkmen and Uzbek sectors, state-owned banks hold sway.

Chart 2

Average Transition Scores (according to EBRD Assessment)

Industrialized market economy



Centrally-planned economy

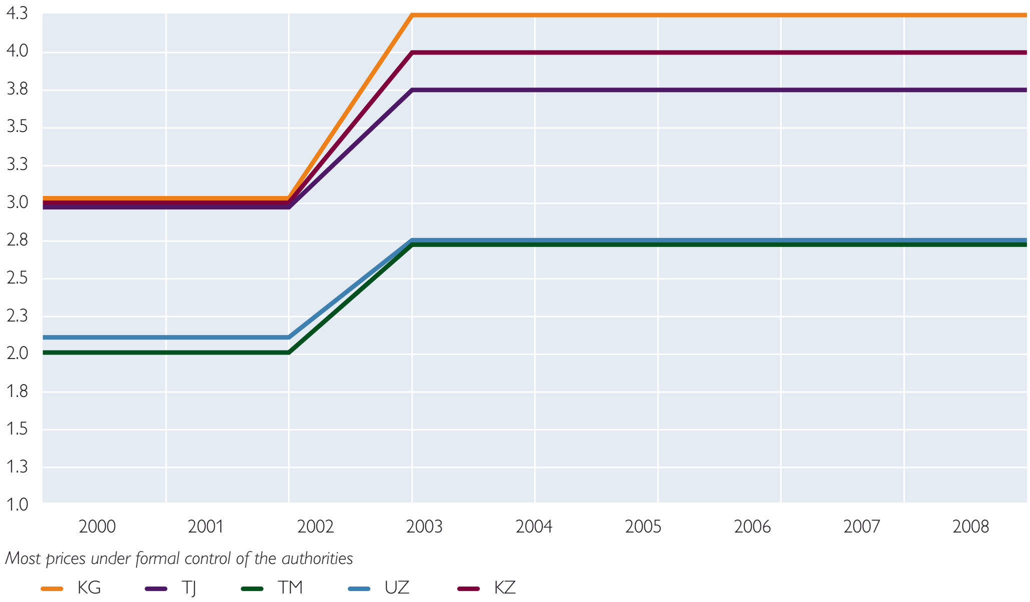
Source: EBRD.

Note: Data for 2008 are preliminary data or estimates.

Chart 3

Price Liberalization

Complete price liberalization with no price control outside housing, transportation and natural monopolies



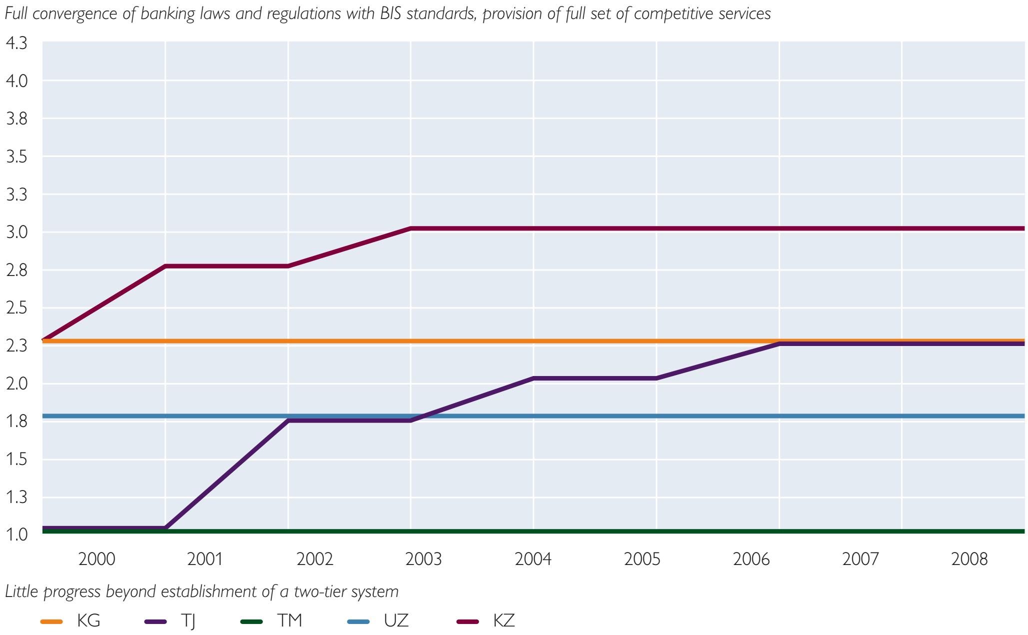
Most prices under formal control of the authorities

Source: EBRD.

Note: Data for 2008 are preliminary data or estimates.

Chart 4

Banking Reform and Interest Rate Liberalization



Source: EBRD.

Note: Data for 2008 are preliminary data or estimates.

3 Monetary and Banking Policy Country Close-Ups

3.1 Kazakhstan

3.1.1 Policy Environment

Being by far the largest Central Asian economy and the major FDI recipient of the region, Kazakhstan will be dealt with in somewhat more detail. Kazakhstan achieved current account convertibility in 1996 (with its acceptance of Article VIII of the IMF Articles of Agreement) and completely eliminated capital and financial account restrictions in January 2007. As shown in table 1, the country saw impressive growth, which even surpassed 10% in 2006, but sharply decelerated to 3.2% in 2008 under the impact of the global crisis. The driving forces of past growth were strong inflows of export proceeds (oil, gas, metals; see table 3 in the annex) and of capital (FDI, portfolio investments, loans) and the swift expansion of domestic demand.[5] One of the most spectacular credit booms of all transition countries accompanied strong real growth.[6]

In the process of aggressive expansion, Kazakh banks became very reliant on capital inflows, which, in turn, fueled the domestic credit boom. External liabilities rose to about half of the banking sector's aggregate balance sheet in mid-2007,

[5] *Data on demand components of GDP in the region are only available for Kazakhstan and Kyrgyzstan (see table 1 in the annex).*

[6] *Total bank loans (in EUR) are reported to have increased more than fivefold over just three years (end-2003 to end-2006) in Kazakhstan. In this period, retail loans expanded more than ten times, with triple-digit growth rates each year (Raiffeisen Research, 2008, p. 54).*

thus even exceeding the amount of deposits.[7] Important acquisitions by foreign strategic investors (UniCredit Bank Austria in June 2007 purchased a 92% stake in ATF Bank, the fifth-largest domestic credit institution, for EUR 1.6 billion; Kookmin Bank, a South Korean outfit, in March 2008 acquired a 30% share in TsentrKredit, the sixth-largest domestic bank, for EUR 400 million; Alnair Capital, an Abu Dhabi-based private equity firm, adjusted its stake in Kazkommertsbank, the number one Kazakh bank)[8] raised the share of foreign-owned credit institutions in total assets to about 15% at end-September 2008. The lion's share of the banking sector has remained in domestic private ownership. Most debt-creating capital inflows consisted of credits taken up in international markets and of Eurobond issues, and not of loans and funds granted by parent banks (IMF, 2009a, p. 26).

Thus, Kazakhstan was hit particularly hard by the U.S. and global liquidity squeeze since the late summer of 2007. The drying up of capital inflows terminated the credit boom. With lending stagnating (in real terms) from September 2007 and then contracting throughout 2008 and early 2009, the credit crunch had incisive repercussions for the rest of the economy. Moreover, capital outflows put an end to the persistent appreciation pressure on the tenge. About EUR 2.8 billion worth of nonresidents' assets were withdrawn from August to December 2007.

However, oil and commodity prices did not flag for some time; on the contrary, regardless of the weakening global economy in the wake of the subprime crisis, speculative pressures reportedly contributed to skyrocketing international (and hence also Kazakh) energy, food and other commodity prices in the first half of 2008. Bad local harvests also played a role. Largely supply side-driven, Kazakh inflation more than doubled from August to December 2007 and spiked at above 20% in August 2008 (year on year). The mix of declining domestic and external demand and further strongly improving terms of trade produced a measured slowdown of GDP growth in 2007 (to 8.9%) and the first months of 2008. This slowdown accelerated once the aggravation of the financial crisis in September 2008 sent energy and metal prices tumbling.

Given the curtailment of foreign refinancing, reinforced by the severe deterioration of the global economy in the fall of 2008, Kazakh banks could no longer roll over most of their external debt and had to find funds to service sizable maturing liabilities in order to stave off insolvency. Kazakh banks' had strongly engaged themselves in lending to the construction, real estate and retailing sectors, with 40% of bank credit secured by real estate. These sectors were among the hardest hit by the crisis, which reflected rapidly worsening loan quality, once the Kazakh housing bubble had burst.[9] Given the high level of dollarization (above 40% of credits in 2007), banks incurred considerable exchange rate risks (indirect credit risks) from foreign currency lending to often unhedged and soon distressed borrowers, notably households.

[7] *Total Kazakh external liabilities have expanded to very high levels (over 85% of GDP in 2006–2008). They have consisted overwhelmingly of private debt, about half of which was bank debt in 2007.*

[8] *The largest foreign commitment is that of UniCredit Bank Austria: At mid-2008, ATF Bank (purchased by UniCredit Bank Austria in mid-2007) held a market share of 8% of total assets. Austria's Raiffeisenbank planned to establish a greenfield subsidiary in Kazakhstan, but this plan was suspended because of the deterioration of the global economic situation (see also section 4).*

[9] *The oil sector has not been primarily reliant on domestic banks for its financing.*

Table 1

Kazakhstan: Key Macroeconomic and Financial Sector Indicators

	2000	2002	2004	2005	2006	2007	2008
GDP growth (in real terms, %)	9.8	9.8	9.6	9.7	10.7	8.9	3.3
Current account balance (% of GDP)	2.0	–4.2	0.8	–1.9	–2.4	–7.8	5.1
Net FDI flows (% of GDP)	7.0	8.9	12.6	3.1	7.3	6.6	4.1
Gross external debt (% of GDP)	69.3	74.1	75.8	79.9	87.8	86.0	85.5
Gross reserves excl. gold (% of GDP)[1]	8.7	10.5	19.6	12.7	22.9	16.7	14.9
General government budget balance (% of GDP)	–1.0	1.0	2.5	5.8	7.5	–1.7	–2.1
CPI inflation (year-end, %)	9.8	6.6	6.7	7.5	8.4	18.8	9.5
Exchange rate: KZT/ USD (annual average)	142.1	153.3	136.0	132.9	126.1	122.6	120.3
Level of monetization (M2/GDP, %)	15.3	19.2	27.8	27.2	36.0	36.4	38.8[2]
Credit to the private sector (% of GDP)	10.6	18.6	26.5	35.7	47.8	58.9	48.9
of which: foreign currency-denominated (%)	. .	68.3	49.4	49.3	46.9	40.9	52.1
of which: nonperforming (%)	2.1	4.1	4.2	3.3	2.4	2.7	. .
Asset share of foreign-owned banks (%)	19.8	34.3	32.4	7.3	5.9	15.8	14.8[2]
Capital adequacy ratio (%)	25.7	17.2	15.3	14.9	14.8	14.2	14.9
Stock market capitalization (% of GDP)	7.5	5.5	8.7	18.6	54.3	39.2	. .

Source: National statistics, IMF, EBRD, wiiw.

[1] Do not include financial assets of NFRK (oil stabilization fund).
[2] End-September.

Note: Figures for 2008 are preliminary data.

3.1.2 Policy Practice

Back in the years of seemingly relentless economic expansion, the authorities may have found themselves locked into a policy aimed at potentially conflicting dual goals. On the one hand, price stability was pursued through reserve money growth targeting and important fiscal sterilization activities.[10] On the other hand, against the background of large inflows of resource export proceeds, too strong an appreciation of the domestic currency was to be prevented in order to secure the competitiveness of the non-resource tradable sector through foreign exchange interventions (purchases) (possible Dutch disease problem, similarities to situation in Russia; see also Égert and Leonard, 2008).

Once confronted with the global liquidity squeeze and runaway inflation of late 2007 and early 2008 – a new policy dilemma – the government and the National Bank of Kazakhstan (NBK) opted for protecting the banking sector first, while intermittently intervening in favor of price stability. In the fall of 2007, the NBK injected about EUR 4 billion (around a quarter of its foreign currency reserves) to support the heavily leveraged banking sector as well as the tenge. This included the relaxation of reserve requirement rules, stepped-up refinancing operations for banks and large-scale repurchases of NBK notes (open market policy). In order to reassure the population and market participants, the Kazakh currency was de facto pegged to the U.S. dollar in October 2007 (IMF, 2008a, p. 6).

Once the acute threat to the stability of the banking sector appeared to have been staved off, the NBK sharply adjusted the refinancing rate (by 2 percentage points in December 2007) to check inflation. Thanks to very high oil prices up to the summer of 2008, the authorities managed to replenish foreign exchange re-

[10] These latter measures were carried out by delivering budget surpluses and building up assets in the National Fund of the Republic of Kazakhstan (NFRK), the country's oil stabilization fund, established in 2001.

serves above the level they had prior to the crisis. As of September 2008, the country's total foreign currency assets (official reserves plus the oil stabilization fund) exceeded EUR 33 billion (about 40% of GDP). Banking regulation and supervision have been tightened and are certainly among the most advanced in the CIS, but there is still a need to move further on the path from compliance-oriented to risk-based accounting and supervision.

The "second wave" of the U.S. and global financial crisis and the ensuing global recession destabilized the situation of the Kazakh financial sector anew, and this time more profoundly. To face the repercussions of the substantial weakening of the terms of trade, the sharp deceleration of growth, the worsening of credit quality (in particular after the Kazakh housing bubble had burst), the mortgage crisis and banks' sizable debt repayment obligations in 2009, the authorities in November 2008 announced the creation of a distressed assets fund (a new fund comprising a planned amount of about EUR 4.5 billion) and amended Kazakhstan's legislation to enable the state to buy stakes in the country's largest credit institutions.

In particular, the National Fund of the Republic of Kazakhstan (NFRK) agreed to place EUR 2.7 billion into the capital of the country's four largest banks. The latter together account for about two-thirds of banking sector assets, none of the four are foreign owned. In February 2009, the state thus acquired an equity stake of about 75% in Bank Turan Alem (BTA), the largest bank, and agreed to acquire a comparable stake in Alliance Bank, the fourth-largest credit institution. The state took minority stakes in the other two credit institutions. The Kazakh public development agency Samruk Kazyna (set up in October 2008) is holding the state's shares. The authorities have pointed out that the nationalizations are intended to be only temporary measures to help redress the situation. The authorities further plan to spend about EUR 9 billion (around 10% of GDP) in 2009–2010 as part of their economic stabilization program. Meanwhile, lower commodity prices and slower economic and credit growth contributed to a remarkable dip in inflation, to 8.8% year on year in April 2009 (see also table 1).

Worsening external balances, the strong depreciation of the Russian ruble in late 2008 and early 2009 and mounting losses of currency reserves[11] in defending the tenge exchange rate against the U.S. dollar eventually prompted the NBK to devalue the national currency by 20% in one stroke in early February 2009 (Pindyuk, 2009, p. 104). The monetary authority intends to keep the new rate stable. While reducing pressures on the tenge, the sharp devaluation has made it more expensive for banks to service their relatively large foreign currency liabilities and it has increased credit risk related to unhedged debtors. Therefore, although the refinancing rate was simultaneously cut back to 9.5% to stimulate lending, pressures for further state intervention grew. Meanwhile, it turned out that BTA's financial needs were higher than originally assessed. In April 2009, President Nazarbayev instructed the government to devise a plan to help restructure major banks' foreign debt. In late April, BTA defaulted on a EUR 420 million loan, which is understood to be triggering payments on credit default swap (CDS) contracts written on the bank – the first such event in the CIS region since the

[11] *Gross international reserves of the NBK shrank by almost a fifth in the five months to end-January 2009.*

start of the world financial crisis (Neue Zürcher Zeitung, 2009).[12] Depending on the further unfolding of the world economic crisis, Kazakhstan will likely experience recession in 2009 (see forecast in chart 1).[13]

3.2 Kyrgyz Republic

The Kyrgyz Republic has been WTO member since 1998 and achieved current account convertibility already in 1995. While the country is the second-poorest of Central Asia and the CIS (in terms of per capita GDP), it has witnessed strong, but volatile economic growth in recent years. Driving forces have included demand for and prices of the country's export staples (gold, electricity). At the same time, Kyrgyzstan is an importer of oil and gas. Inflows of workers' remittances (20% to 25% of GDP, some 90% of which coming from Russia and Kazakhstan) have also contributed substantially to growth. Finally, a modest credit boom supported by a fledgling banking sector, nearly half of which is Kazakh-owned, accompanied growth recently. In 2006, the current account balance turned negative again and strongly deteriorated in 2008. This change was largely triggered by expanding domestic demand, weakening external demand and worsening terms of trade (see below). Increasing capital inflows (FDI, portfolio capital and loans) bridged the gap. Given the robust inflows of remittances and capital, up to 2007 strong remonetization and nominal appreciation pressures on the Kyrgyz som prevailed.

Starting in the second half of 2007, the country was struck by painful external shocks. It suffered from a mostly supply side-driven sharp increase of CPI inflation (skyrocketing fuel and food import prices), which jumped from 5% at end-2006 to 20% at end-2007 and peaked at 32% in July 2008, before declining again to 20% at the end of that year (table 2). In late 2007, the global liquidity squeeze prompted foreign-owned – mostly Kazakh – banks to recall credit lines to their subsidiaries in Kyrgyzstan to shore up liquidity at home, which put an end to the credit boom; in late 2008, loan growth ground to a halt. However, the Kyrgyz banking system has so far weathered the spillover effects from the crisis in Kazakhstan relatively well, due to its high capitalization and liquidity. Still, deteriorating credit quality is bound to exert new pressures. The population's trust in banks may drop in 2009. The substantial weakening of economic expansion in Russia and Kazakhstan in 2008 affected exports[14] and is going to undermine remittance flows: Many guest workers in Russia and Kazakhstan are no longer needed in 2009 and are being sent home (Libération, 2008). In September 2008, nominal appreciation pressures on the som evaporated and the Kyrgyz currency depreciated about 15% until end-March 2009. The country's GDP growth descended from above 8% in 2007 to about 7.6% in 2008 and is expected to drop sharply in 2009.

Looking at policy conduct, in the benign economic situation up to 2007 the National Bank of the Kyrgyz Republic (NBKR) had successfully checked inflation through monetary targeting and had resisted som appreciation pressures by –

[12] *Bank Turan-Alem's total foreign liabilities are reported to stand at almost EUR 10 billion (near 15% of the country's entire external debt). The authorities have declared that they do not intend to guarantee the loans of (nationalized) BTA or of any other bank. BTA has entered negotiations to sell a majority stake to Sberbank (Russia), as pointed out by NBK Governor Marchenko at the EBRD Annual Conference in mid-May 2009.*

[13] *According to preliminary figures, GDP shrank by 2.2% in the first quarter of 2009 (year on year).*

[14] *These two neighbors accounted for 40% of the Kyrgyz Republic's exports in 2007.*

partly sterilized – foreign currency market interventions. However, high dollarization (share of foreign currency-denominated deposits: about two-thirds) rendered monetary policy challenging. Budgetary policies were gradually tightened. The authorities' reaction to the sharp increase of inflation in the fall of 2007 and its persistence in 2008 included monetary tightening (substantial increase of interest rates, expansion of open market transactions with T-bills and NBKR bills, curtailment of foreign exchange interventions) and further tightening of fiscal policies (build-up of government deposits at the NBKR).

The deepening of the global financial and economic crisis since September 2008, the decline of staples prices, the slowdown in domestic demand and the authorities' policy actions have further reined in inflation, which fell to 16.7% in February 2009 (year on year). Contingency plans for supplying liquidity and capital to "strategic banks" have been drawn up: The authorities have established a fund of EUR 75 million to refinance credit institutions, if necessary. First refinancing measures may be taken in mid-2009. The impact of the crisis may also be cushioned by a sizable financial support package, including concessional budgetary assistance offered in early 2009 by the Russian Federation (IMF, 2009b).

Table 2

Kyrgyz Republic: Key Macroeconomic and Financial Sector Indicators

	2000	2002	2004	2005	2006	2007	2008
GDP growth (in real terms, %)	5.4	0.0	7.0	−0.6	3.1	8.5	7.6
Current account balance (% of GDP)	−5.7	−4.0	5.0	2.8	−3.1	−0.2	−6.5
Net FDI flows (% of GDP)	−0.5	0.3	6.0	1.8	6.5	7.2	4.7
Gross external debt (% of GDP)	124.4	111.1	95.1	85.5	77.9	61.2	45.8
Gross reserves excl. gold (% of GDP)	15.0	18.1	25.1	24.7	28.7	31.8	24.2
General government budget balance (% of GDP)	−11.4	−5.3	−4.4	−3.4	−2.5	−0.7	−1.3
CPI inflation (year-end, %)	9.5	2.3	2.8	4.9	5.1	20.1	19.8
Exchange rate: KGS/USD (annual average)	47.7	46.9	42.7	41.0	40.2	37.3	36.6
Level of monetization (M2/GDP, %)	11.3	14.6	20.6	21.2	28.4	31.2	..
Credit to the private sector (% of GDP)	4.2	4.2	7.1	8.0	10.5	15.9	18.7
of which: foreign currency-denominated (%)	69.0	57.1	70.4	71.3	69.5	62.2	64.7
of which: nonperforming (%)	13.4	13.3	6.4	8.2	6.2	3.5	5.3
Asset share of foreign-owned banks (%)	24.6	50.4	70.1	73.6	71.5	58.7	..
Capital adequacy ratio (%)	..	36.4	23.0	26.5	28.5	31.0	32.5
Stock market capitalization (% of GDP)	0.3	0.5	1.5	1.7	3.1	3.1	..

Source: National statistics, IMF, EBRD.

Note: Figures for 2008 are preliminary data.

3.3 Tajikistan

Tajikistan achieved current account convertibility in 2004. The landlocked mountainous country bordering Afghanistan emerged from a civil war in the late 1990s and remains the poorest of Central Asia and the CIS (it featured per capita GDP of about EUR 520 in 2008). However, thanks to impressive and sustained economic expansion, Tajikistan has been catching up with some of its neighbors. As table 3 indicates, growth remained robust also in 2007 (7.8%) and 2008 (7.9%). The driving forces have been sharply expanding private transfers from Russia and Kazakhstan: Guest workers' remittances increased to almost a third of Tajik GDP in 2006 and to about 45% in 2008. Rising, if volatile, prices for the country's export staples aluminum, cotton and electricity (table 3 in the annex) contributed to growth, while Tajikistan remains a net energy importer.

In 2006–2008, bad harvests in the region as well as global energy and food price hikes (external shocks) contributed to pushing Tajik CPI inflation from single to double digits (19.7% in December 2007). Saddled with institutional and structural weaknesses, including serious shortcomings in corporate governance, banking legislation, regulation, supervision and enforcement, the country's financial sector remains at a modest level of development and possesses only limited linkages to international financial markets.[15] The interbank market is virtually nonexistent. That said, loan growth accelerated in 2007 and the credit-to-GDP ratio almost doubled from end-2006 to end-2008 (table 3), buoyed by the surge of remittance inflows as well as by rising nonresident deposits. The sudden credit expansion could have led to the accumulation of unrecognized credit risk. At least up to mid-2008, the Tajik somoni had been under appreciation pressure (due to rising inflows of remittances). However, the deepening of the global economic crisis in late 2008 appears to have finally affected Tajikistan in that commodity prices have receded, exports have declined while import demand has still been strong, the inflow of remittances has been leveling off and credit growth has come down again.

Looking at policy conduct, in recent years the National Bank of Tajikistan (NBT) aimed at combating inflation through reserve money growth targeting, including changing banks' reserve requirements. In order to support the export sector, somoni appreciation was checked through foreign currency interventions, largely unsterilized for lack of instruments. The NBT therefore faced a policy dilemma of potentially conflicting goals of price stability versus industrial competitiveness, not unlike the challenges encountered by the NBK up to 2007. In such an environment, prudent fiscal policy is central to the overall macropolicy effort: The budget balance, excluding externally financed public investment programs, has been kept near zero or slightly positive in recent years. Government deposits have been built up at the NBT. As a result of the monetary authority's repeated interventions, the somoni has slightly but almost continuously depreciated (in nominal terms) against the U.S. dollar, the euro and the Russian ruble. Another element of the rudimentary policy framework still attached to administrative centralism is the traditional practice of allocating directed NBT credits to the cotton sector, which persisted at least until 2008 and contributed to the intermittent loosening of the monetary stance.[16]

Inflation receded from its August 2008 peak of over 25% (year on year) to 9.4% in April 2009, helped by the recent retrenchment in international fuel and food prices. In 2009, spillover effects from the world economic crisis are expected to sharply dampen annual growth and worsen Tajikistan's external position by cutting into remittance flows (already down by one-fifth in January 2009 year on year). Credit quality may swiftly deteriorate. In anticipation of likely difficulties

[15] *After the monetary authority had opened up the banking sector to foreign presence in 2007, one foreign-owned bank – Kazkommertsbank Tadzhikistana (from Kazakhstan) – took up operations in early 2008, and its capital constitutes around one-fifth of total sector capital.*

[16] *An episode of misreporting of foreign exchange reserves to the IMF was followed by a special audit of the NBT in accordance with a Staff-Monitored Program in the second half of 2008. According to the IMF, the Tajik monetary authority's autonomy and governance require ambitious strengthening (IMF, 2008b, p. 11).*

and hardships coming, the Tajik Finance Ministry approved an important package of socially-oriented anti-crisis measures, which aimed at, inter alia, increased social protection, job creation and the development of education and health infrastructures (Nuttall, 2009, p. 50).

Table 3

Tajikistan: Key Macroeconomic and Financial Sector Indicators

	2000	2002	2004	2005	2006	2007	2008
GDP growth (in real terms, %)	8.3	9.1	10.6	6.7	7.0	7.8	7.9
Current account balance (% of GDP)	−6.0	−3.6	−4.0	−2.7	−2.8	−11.2	−8.8
Net FDI flows (% of GDP)	2.4	3.0	13.1	2.4	2.4	4.3	3.8
Gross external debt (% of GDP)	120.7[1]	105.8	55.3	50.9	42.2	40.6	42.5
Gross reserves excl. gold (% of GDP)	8.7	8.1	9.0	4.0	4.0	2.9	3.9
General government budget balance (% of GDP)[2]	−5.6	−2.4	−2.4	−2.9	1.7	−6.2	−6.2
CPI inflation (year-end, %)	60.8	14.5	5.7	7.1	12.5	19.7	11.8
Exchange rate: TJS/USD (annual average)	2.20	2.76	2.97	3.12	3.30	3.44	3.43
Level of monetization (M2/GDP, %)	8.5	10.0	11.7	13.0	16.5	21.4	21.2
Credit to the private sector (% of GDP)	13.6	16.2	17.4	17.2	16.0	28.9	31.4
of which: foreign currency-denominated (%)	..	..	56.9	57.6	66.9	68.2	53.2
of which: nonperforming (%)	10.8	84.2	18.7	13.8	11.3	4.9	..
Asset share of foreign-owned banks (%)[3]	71.9	1.8	6.2	8.9	6.5	6.6	..
Capital adequacy ratio (%)	..	..	38.7	34.2	27.8	19.4	..

Source: National statistics, IMF, EBRD, ADB.

Note: Figures for 2008 are preliminary data.

[1] 2001.
[2] Including externally financed public investment programs.
[3] Including credit unions.

3.4 Turkmenistan

For more than 15 years since the collapse of the USSR (late 1991), Turkmenistan has upheld economic policies guided by central planning (production targets, state-driven capital formation, key price controls), dominant public ownership, rigorous state control over foreign trade and payments. Answering to central instructions, the small and almost entirely state-owned banking sector has performed the function of on-lending directed credits at low interest rates to state-owned firms. But following former President Niazov's death in December 2006, the new president of the republic, Berdymukhamedov, has pursued a cautious course of economic reform and opening up the country since 2007. Turkmenistan is very rich in hydrocarbon resources, particularly natural gas deposits beneath the Caspian Sea (hydrocarbons make up 85% to 90%, gas about half of total exports – see table 3 in the annex).[17]

Despite infrastructural bottlenecks, Turkmenistan has benefited from rising prices and quantities of exported resources in recent years. While official statistics probably overstate it, GDP growth seems to have been strong recently (over 11% p.a. on average in 2005–2008, according to IMF estimates, see table 4). Economic expansion has been driven by sizable inflows of export proceeds and by public investment campaigns. Continuing increases of hydrocarbon prices coupled with import controls have contributed to driving up trade, current account and budget

[17] *Although relatively large, Turkmenistan is Central Asia's least open economy: Turkmen exports and imports of goods and nonfactor services together equaled but 55% of GDP in 2007 (table 2 in the annex).*

surpluses, enabling the country to successively reduce its external debt and boost its international reserve position. In contrast, until recently, the nonmarket environment has not attracted much foreign private investment outside the oil sector.

Prior to 2008, in an environment of strong foreign currency inflows (export proceeds) and strict exchange controls, the authorities conducted generally tight macroeconomic policies through monetary, fiscal and administrative means. The Central Bank of Turkmenistan (CBT) ran a dual exchange rate system (with the official rate of the Turkmen manat pegged to the U.S. dollar and a parallel rate, separated by a spread of about 450%). Access to foreign exchange as well as to domestic currency was rigorously rationed. All foreign trade transactions required the approval of the State Commodity Exchange (Comex). Given this type of pre-transition framework, the level of monetization has been stagnating and the credit-to-GDP ratio even contracting until most recently. Reserve money growth has been controlled through variations of the volume of directed credits as well as through export-driven foreign currency purchases by the central bank, which have been partly sterilized through fiscal measures. Budgets have been balanced or – more recently – in surplus; however, surpluses have partly been achieved by cutting back services, sequestering expenditures or accumulating arrears, i.e. by defaulting on public obligations. Shares of hydrocarbon export revenues have been saved in the Foreign Exchange Reserve Fund (FERF) and other extra-budgetary funds.

The major reform step of 2008 was exchange rate unification (supported by the IMF). After expeditious preparations, on May 1, 2008, the official and parallel market rates were unified at the mid-point, a level assessed to be broadly consistent with the country's robust external position. In June 2008 new foreign exchange regulations were issued that committed the authorities to provide unrestricted access to foreign currencies for making payments for current international transactions. Over 100 exchange offices across the country were opened. The CBT supports a stable unified rate, which may serve as a nominal anchor for the economy (IMF, 2008c, p. 3).[18] The authorities approved a new constitution that highlights the protection of private property rights and passed new laws and legal reforms on foreign investment. Despite the authorities' tight macroeconomic stance, the exchange rate unification, selective price adjustments and hikes in prices of imported foodstuffs contributed to pushing up CPI inflation from 8.7% in December 2007 to 12.0% a year later (table 4). Competition in the banking sector is to be raised, including by gradually allowing the entry of foreign credit institutions.

Notwithstanding its relative isolation, Turkmenistan is not aloof from the global economy and the current crisis. The Turkmen economy is being affected – to a limited degree – by sharply declining commodity export demand, prices and terms of trade.[19] The authorities intend to further boost budgetary capital expenditure in 2009.

[18] *The manat continues to be nonconvertible for balance of payments transactions (Article XIV of IMF Articles of Agreement), i.e. for transactions on the current as well as the capital and financial accounts.*

[19] *The shutdown of Turkmenistan's main gas export pipeline to Russia (due to an explosion in early April 2009) halted most gas exports for at least three months.*

Table 4

Turkmenistan: Key Macroeconomic and Financial Sector Indicators

	2000	2002	2004	2005	2006	2007	2008
GDP growth (in real terms, %)[1]	18.6	15.8	14.7	13.0	11.4	11.6	9.8
Current account balance (% of GDP)	13.6	13.0	1.2	10.5	16.3	16.1	19.6
Net FDI flows (% of GDP)	4.3	6.2	5.2	5.0	7.0	6.2	6.3
Gross external debt (% of GDP)	72.2	37.1	17.9	11.4	7.0	4.9	..
Gross reserves excl. gold (% of GDP)[2]	59.9	52.4	39.6	55.0	78.8	103.7	..
General government budget balance (% of GDP)[3]	−0.3	0.2	1.4	0.8	5.3	3.9	4.3
CPI inflation (year-end, %)	7.4	7.8	9.0	10.4	7.1	8.6	12.0
Exchange rate: TMM/USD (annual average)[4]	8,477	10,098	10,375	11,015	10,882	10,721	23,000
Level of monetization (M3/GDP, %)	19.4	13.0	12.3	10.2	9.2	14.9	..
Credit to the economy (% of GDP)	..	37.1	23.7	18.1	14.0	15.1	..
of which: foreign currency-denominated (%)	..	64.7	55.7	47.0	44.3	34.4	..
of which: nonperforming (%)	..	0.3	0.4	0.3	0.2	0.2	..
Asset share of foreign-owned banks (%)	1.3	1.7	1.0	1.0	1.0	1.1	..

Source: National statistics, IMF, EBRD, ADB.

[1] *Official statistics until 2004, IMF estimates thereafter.*

[2] *Includes foreign currency reserves of the CBT plus the Foreign Exchange Reserve Fund (FERF).*

[3] *Significant off-budget expenditures occur through extra-budgetary funds and lending.*

[4] *The series refers to a weighted average between the official rate (which until exchange rate unification in May 2008 remained stable vis-à-vis the U.S. dollar at 5,200) and the curb rate (parallel forex market), as calculated by the EBRD.*

Note: Figures for 2008 are preliminary data.

3.5 Uzbekistan

Since independence (late 1991), Uzbekistan has followed a national strategy of self-sufficiency and import substitution ("localization program") and has conserved some components of the former central planning system, including compulsory state orders, directed credits, a large public sector encompassing most banks, multiple exchange rates, rigorous control of foreign trade and of cash circulation inside and outside banks. While some of these reins have since been eased (e.g. elimination of multiple exchange rates and formal adoption of current account convertibility of the Uzbek sum in October 2003), business activity continues to be saddled with layers of bureaucracy (tightening of trade restrictions and cash rationing in 2002–2003, which partly cancelled out the liberalizing effect of convertibility). The authorities have used banks as agents for supplying state-guaranteed credits to state-owned enterprises and for the financial monitoring of and collecting taxes from clients. This has undermined public confidence in the banking sector and financial intermediation has been kept at one of the lowest levels in the CIS and the transition world (Barisitz, 2007, pp. 146–147).

Nevertheless, the country has benefited from favorable market conditions and high prices for its major export commodities, which are somewhat diversified (gold, cotton, hydrocarbons, metallurgy and machinery), affording some protection from boom and bust cycles. In recent years, rising inflows of remittances from Russia and Kazakhstan have reached at least 15% of GDP and stimulated internal demand. Expanding current account surpluses (also due to strong import protection) have enabled a steady and substantial reduction of foreign debt and the build-up of sizable gross reserves (see table 5). Buoyant Uzbek economic growth (average annual rate of about 8% in 2004–2008) has thus been led by exports, remittances, and, to a smaller extent, state-driven investment programs.

The authorities have dealt with the persistent and strong foreign exchange inflows in recent years by adhering to generally tight monetary, fiscal and administrative policies. The Central Bank of Uzbekistan (CBU) has controlled reserve money growth through raising banks' mandatory deposits and hiking the refinancing rate, but also through the limited use of indirect monetary instruments (partial sterilization), namely CBU certificates of deposit and Treasury bills. At the same time, in order to support export competitiveness, the monetary authority has conducted a policy of de facto gradual nominal depreciation of the sum vis-à-vis the U.S. dollar, which, however, was varied according to the circumstances: Increasing inflationary pressures in 2005 and 2006 triggered a temporary tightening of the policy stance, which in May 2006 gave rise to the reclassification of the exchange rate regime from a managed float to a conventional U.S. dollar peg. The temporary stabilization of inflation in 2007 (at a high level of about 12%) was followed by the authorities' stepped-up interventions on the foreign currency market and a changed behavior of the nominal exchange rate, which in early 2008 gave rise to a renewed reclassification of the regime as a crawling peg – largely tying up again with the above-mentioned gradual nominal depreciation strategy (IMF, 2008d, p. 16).

Given buoyant (export-related) budgetary revenues, budget surpluses have been achieved since the early years of the new millennium. Fiscal policy has been instrumental in sterilization efforts by accumulating government deposits at the CBU and by building up the Uzbekistan Fund for Reconstruction and Development (UFRD), an entity established for fiscal stabilization and investment. As at end-September 2008, the UFRD comprised about EUR 600 million (4% of GDP).

Notwithstanding the rigid banking environment, some recent developments have been promising. Government-guaranteed loans are on the decline and the traditional practice of on-lending foreign credit lines under state supervision has waned over time, lowering the foreign currency exposure of domestic banks. However, as long as banks are not freed from their non-core functions, including financial oversight and tax collection, there appears to be little prospect of any market-oriented take-off of the sector (IMF, 2008d, p. 14).

Rising inflation constituted the country's major macroeconomic challenge in 2008, while the deepening global economic crisis has led to some refocusing of policies in 2009. Inflationary pressures in 2008 emanated from the global rise in food and energy prices in the first half of the year, persisting strong foreign currency inflows, adjustments of government-administered wages and prices of utilities as well as the slight nominal depreciation of the sum. These pressures were somewhat mitigated by increased CBU sterilization efforts, a sizable budget surplus (5% of GDP), the further accumulation of foreign currency proceeds in the UFRD and export restrictions for several food items. Still, CPI inflation grew in 2008 to 14.4% (year on year, the highest level since 2002, as shown in table 5).

Given its insulated financial system, Uzbekistan has not been directly affected by the international financial crisis. Instead, the global economic downturn is impacting the economy via exports and remittances.[20] At end-2008, the Uzbek president outlined a large-scale anti-crisis package in four decrees. It targets

[20] *The authorities have reported GDP growth of 7.9% in the first quarter of 2009 (year on year), which is only a slight slowdown compared to the year-earlier period.*

export promotion, further emphasizes import substitution, promotes higher energy efficiency, instructs banks to step up financial support of the real sector and provides for the intensified development of small and medium-sized enterprises. The total cost of the package is estimated at 4% of GDP.

Table 5

Uzbekistan: Key Macroeconomic and Financial Sector Indicators

	2000	2002	2004	2005	2006	2007	2008
GDP growth (in real terms, %)	3.8	4.0	7.7	7.0	7.3	9.5	9.0
Current account balance (% of GDP)	2.4	1.4	9.9	13.1	17.2	19.1	16.9
Net FDI flows (% of GDP)	0.8	0.8	1.6	0.6	1.1	3.3	3.8
Gross external debt (% of GDP)	48.9	44.1	37.3	31.3	22.8	17.4	15.4
Gross reserves excl. gold (% of GDP)	7.5	15.5	18.2	19.4	26.1	33.2	38.3
General government budget balance (% of GDP)[1]	–2.5	–1.9	0.6	1.2	5.2	5.1	5.0
CPI inflation (year-end, %)	28.2	21.6	9.1	12.3	11.4	11.9	14.4
Exchange rate: UZS/ USD (annual average)[2]	361	885	999	1,072	1,220	1,264	1,320
Level of monetization (M3/GDP, %)	12.2	10.6	12.2	14.4	15.2	16.3	..
Credit to the economy (% of GDP)	27.9	34.0	24.6	21.8	17.4	15.0	15.9
of which: foreign currency-denominated (%)	..	80.0	73.2	68.8	56.9	43.3	..
of which: nonperforming (%)	..	..	2.1	8.9	3.0	2.8	2.8
Asset share of foreign-owned banks (%)	2.2	3.2	4.4	..	..	..	..
Stock market capitalization (% of GDP)	0.6	0.4	0.1	0.3	4.3	..	..

Source: National statistics, IMF, EBRD, ADB.

[1] Includes extra-budgetary funds, but excludes local government.

[2] Dual exchange rates were in operation until October 2003. Data show a weighted average between official, bank and parallel market rates (as referred to by the EBRD).

Note: Figures for 2008 are preliminary data.

4 Aside: Austrian Banks' Presence in Central Asia

Austrian banks are present in Kazakhstan and Kyrgyzstan. In 2001, Raiffeisen International became a minority shareholder of Bank Turan-Alem (BTA), the second-largest (in terms of assets) Kazakh bank at the time. Since the planned increase of its 7.7% capital participation to majority shareholding was not feasible, the group sold its stake in August 2006. After looking for takeover targets for over a year, Raiffeisen reportedly concluded that the prices of possible targets were too high. Therefore, the bank changed its strategy and opted for setting up a greenfield subsidiary. However, in reaction to the global economic crisis and in order to cut costs, Raiffeisen in March 2009 suspended these plans (Silk Road Intelligencer, 2009).

In June 2007, UniCredit Bank Austria paid EUR 1.63 billion for a 92% stake of ATF Bank, the sixth-largest Kazakh credit institution of the time. After achieving a net (after-tax) profit of EUR 43 million in 2007, ATF recorded a net loss of almost the same size (EUR 41 million) in 2008. At end-2008, ATF had a market share of 8% of total assets of the Kazakh banking sector. In order to cope with the worsened global and national economic situation and to comply with requests by the Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Markets and Organizations (FMSA), ATF bank (which meanwhile had become the fifth-largest of the country) in March 2009 approved a rights issue to raise its own capital by 30%. Other restructuring measures decided the same month included staff cuts and a ban on expansion of the branch network in a quest to bring costs down. At end-April 2009, overdue loans were reported to make up over a quarter of total ATF credits. In early May, ATF bank fully redeemed a EUR 380 million loan; part of the payment was refinanced by the parent bank, UniCredit (Economist Intelligence Unit, 2009; Kazakhstan Newsline, 2009).

In the Kyrgyz Republic, ATF Bank acquired Energobank (a mid-sized credit institution) and renamed it ATF Bank Kyrgyzstan. At end-2008, ATF Bank Kyrgyzstan – now controlled by UniCredit Bank Austria – was the second-largest credit institution (in terms of assets) and possessed the largest loan portfolio of the country (18% of total bank credits).

5 Comparative Assessment and Conclusions

5.1 Policy Environment: Resource-, Capital- and Remittance-Driven Economies

Looking at policy conditions in Central Asia, a number of salient features can be summarized. The institutional economic framework varies remarkably across the region: Kazakhstan and the Kyrgyz Republic are market-oriented reforming economies; Tajikistan and Uzbekistan can be characterized as hybrid economies, combining important elements of centralized as well as decentralized planning; finally, as a rigidly centralized economy, Turkmenistan has conserved many ingredients of the Soviet system, but is currently undertaking cautious reform steps. All Central Asian countries run managed floating exchange rate regimes, some of which, however, have temporarily been reclassified as de facto pegs or crawling pegs. Kazakhstan and Kyrgyzstan achieved current account convertibility already in the 1990s, the former even liberalized its capital account in early 2007. Tajikistan and Uzbekistan introduced current account convertibility only recently; yet in the case of Uzbekistan, convertibility is largely canceled out by heavy trade restrictions and cash rationing. In institutional conformity, the Turkmen manat is nonconvertible (see table 6).

At least up to 2007, strong economic expansion was recorded throughout the region. This expansion benefited from the post-Soviet economic recovery process (following a partly deep and extended transition depression topped by the repercussions of the Russian crisis of 1998). Inflows of various kinds drove this growth: hydrocarbon export proceeds (Kazakhstan, Turkmenistan and, to a lesser extent, Uzbekistan), other commodities' export proceeds (Kyrgyzstan, Tajikistan, Uzbekistan), workers' remittances (Kyrgyzstan, Tajikistan and, to a lesser extent, Uzbekistan) as well as FDI and other capital inflows (Kazakhstan, Kyrgyzstan). Furthermore, credit booms played a role (in Kazakhstan and, to a smaller degree, in the Kyrgyz Republic and Tajikistan). Finally, state-driven investment programs (forced growth) made their contribution (in Turkmenistan and, to a lesser extent, Uzbekistan). The above-mentioned inflows did not only exert influence on the varying levels of inflation experienced, but also on appreciation pressures that emerged over these years. Then, from the second half of 2007 at least until mid-2008, inflation rose sharply everywhere. This was largely supply-side driven and reflected skyrocketing global and domestic energy and food prices, partly exacerbated by bad regional harvests. In most countries, inflation spiked in the late summer of 2008, before declining again under the impact of the global economic crisis.

The Central Asian impact of the U.S. subprime crisis of 2007 and of the deterioration of the U.S. and global financial crisis of 2008 has been heterogeneous. The Kazakh financial sector, one of the most developed in the CIS and highly indebted abroad, was severely struck by the sudden stop of capital inflows. This contributed to a persisting credit crunch, a mortgage crisis (bursting of housing bubble) and to the illiquidity or insolvency of some large banks. The global liquidity squeeze only indirectly, if still markedly, affected the fledgling Kyrgyz financial sector, dominated by Kazakh FDI: Parent banks recalled credit lines, which effectively ended the modest Kyrgyz credit boom. The Tajik financial sector is still at an early stage of development and possesses only weak linkages to international markets, but here too the deepening of the global financial market crisis contributed to bringing credit growth down again after a sudden surge. The Turkmen and Uzbek sectors have remained systemically insulated from the global crisis.

Table 6

Comparative Overview of Central Asia

	GDP per capita (EUR)[1]		GDP growth (%)		Exchange rate regime	Domestic currency and convertibility	General government budget balance (% of GDP)		Current account balance (% of GDP)		CPI inflation (year-end, %)		Credit to private sector/ to economy (% of GDP)		Asset share of foreign-owned banks (%)	
	2003	2008	2003	2008			2003	2008	2003	2008	2003	2008	2003	2008	2003	2008
Kazakhstan	1,832	5,812	9.3	3.2	managed floating with no preannounced path for exchange rate; Oct. 2007: de facto peg to U.S. dollar	Kazakh tenge (KZT); June 1996: current account convertibility; Jan. 2007: capital and financial account convertibility	2.7	−2.1	−0.9	5.3	6.8	9.5	21.9	45.9	56.9	14.8[2]
Kyrgyz Republic	337	645	7.0	7.6	managed floating with no pre-announced path for exchange rate	Kyrgyz som (KGS); Mar. 1995: current account convertibility	−4.7	−1.3	1.7	−6.5	5.6	19.8	4.8	18.7	61.2	58.7[2]
Tajikistan	217	522	10.2	7.9	managed floating with no pre-announced path for exchange rate	Tajik somoni (TJS); Dec. 2004: current account convertibility	−1.8	−6.2	−1.3	−8.8	13.7	11.8	14.0	31.4	3.6	6.6[2]
Turkmenistan	1,076	1,845[2]	17.1	9.8	dual exchange rate system, official rate pegged to U.S. dollar; May 2008: exchange rate unification, aim at stable rate	Turkmen manat (TMM); non-convertibilty	−1.3	4.3	5.2	19.6	3.1	12.0	28.0	15.1[2]	1.6	1.1[2]
Uzbekistan	342	671	4.2	9.0	multiple exchange rate system; Oct. 2003: unification of exchange rate, managed float; May 2006: U.S. dollar peg; Jan. 2008: crawling peg	Uzbek sum (UZS); Oct. 2003: formal current account convertibility	0.1	5.0	8.9	16.9	7.8	14.4	28.9	15.9	4.3	4.4[3]
Russia (for comparison)	2,640	8,036	7.3	5.6	since late 1998: managed floating with no pre-announced path for exchange rate	Russian ruble (RUB); June 1996: current account convertibility; July 2006: capital and financial account convertibility	1.3	5.2	8.2	5.9	12.0	13.3	23.0	48.0	7.4	18.7

Source: National statistics, IMF, EBRD, ADB, wiiw.

[1] *Converted at market exchange rate.*
[2] *September 2008.*
[3] *2004.*

Note: Figures for 2008 are preliminary data or estimates.

The collapse of hydrocarbon prices contributed to sharply cutting Kazakhstan's economic growth in 2008 and may contribute to pushing it into recession in 2009. Banks' balance sheets will likely worsen further. After still boasting strong expansion in 2008, the Kyrgyz Republic and Tajikistan risk a substantial deceleration in 2009, owing to both plummeting remittance inflows and falling export prices. In contrast, plummeting raw material prices are the only major external shock feeding through to Turkmenistan and Uzbekistan, which may help explain why their growth rates are not expected to budge that much.

5.2 Monetary Policy and Banking Reform

5.2.1 The Pre-Crisis Period (up to 2007): Managing Strong Inflows by Various Means

Given strong foreign exchange inflows (export proceeds, remittances and/or capital) into Central Asia through 2008, all countries have been confronted, at least to some degree, with the potentially conflicting dual goals of combating inflation while preventing too strong currency appreciation (to support competitiveness). They have all reacted, to varying degrees, by monetary targeting, (partially sterilized) foreign currency market interventions, adjusting key interest rates and tightening fiscal policies. Monetary targeting has been the most often used instrument. Foreign currency market interventions (mostly purchases) have run counter to the price stability goal, as they prevented nominal appreciation from exerting a disinflationary impact. Moreover, in as far as they remained unsterilized, they rendered the pursuit of monetary targeting more difficult. Interest rate policy has not tended to be very effective, because key rates have been negative in real terms (except in Uzbekistan), and monetization has been relatively low in most cases, implying a weak monetary transmission mechanism. However, tightening fiscal policies has often served as effective sterilization instrument: budget surpluses and transfers to extra-budgetary funds (in Kazakhstan, Turkmenistan and Uzbekistan), repayment of public external debt, and accumulation of government deposits in the central bank.

Hybrid or highly centralized economies (Tajikistan, Turkmenistan and Uzbekistan) have also preferably resorted to direct administrative interventions such as price controls, trade restrictions, surrender requirements, foreign currency and domestic cash rationing or the allocation of directed credits. To sum up, the problem of conflicting goals has most often been pragmatically solved: While generally emphasizing the importance of the price stability goal, Central Asian monetary policies have repeatedly compromised with the competitiveness goal.

5.2.2 The Crisis Period (since 2007): Coping with External Shocks – Skyrocketing Prices, Liquidity Squeeze and Global Recession

The unstable period following the summer of 2007, including the inflationary spike and the liquidity squeeze on the back of the global financial turmoil, immediately substituted a new policy dilemma for the old one: whether to give priority to fighting inflation or to help banks cope with their solvency problems. In the event, this only presented a dilemma for Kazakhstan, due to its relatively large banking sector. The Kazakh authorities on repeated occasions (in late 2007 and again late 2008) lent priority to helping credit institutions, given the systemic importance of the sector in this country and the severity of the crisis. Unavoidably, the liquidity injections partly contributed to the inflationary pressures. However, in times of relative calm, like in the first half of 2008, the NBK temporarily refocused activities on anti-inflationary measures.

The Kyrgyz banking sector is much smaller and in comparatively good shape. Therefore, the NBRK gave priority to fighting inflation; only most recently have contingency plans for supporting the banking sector emerged. Tajik conditions and experience have been comparable. Given the nonmarket orientation and "independence" of their banking systems from external economic shocks, the Turkmen and Uzbek authorities have not faced a policy dilemma in pursuing price stability recently. Nevertheless, with inflation in both countries attaining double digits in 2008, results have not been more impressive than elsewhere. Turkmen and Uzbek inflation dynamics have also been influenced by strong idiosyncratic factors: Rising price pressures in 2008 in these two economies probably have more to do with internal institutional adjustments and the selective release of built-up inflationary pressures.

The most frequently used measures to combat the inflationary spike of 2007–2008 in Central Asia have been fiscal tightening (except in Kazakhstan), interest rate increases (except in Turkmenistan and Uzbekistan, and despite this instrument's limited efficacy), monetary sterilization efforts and stepped-up price controls. However, while global economic forces appear to have been decisive in pushing up inflation in most of the region, they also seem to have had the pivotal impact in bringing it down again, authorities' efforts notwithstanding.

The current world financial and economic crisis since autumn 2008 has hit the Kazakh banking system in particular. Kazakh banks are continuing to struggle intensively, assisted by major liquidity injections and even by nationalization measures. These nationalizations have – at least temporarily – reversed historic privatization results achieved over a decade ago, however, they have apparently not prevented defaults. Notwithstanding the important assistance efforts so far undertaken by the authorities, in the case of Kazakhstan some observers may be inclined to add a further and highly topical economic policy dilemma, namely of choosing between reputational damage by default on the foreign debt of nationalized banks (including possible financial repercussions) versus financial damage through depletion of international and oil stabilization fund reserves. In this context, the authorities have so far apparently opted for pursuing the former route.

Another striking feature of manifold Central Asia is that the pervasive lack of reforms and different institutional nature may have saved the Turkmen and Uzbek banking sectors from the contagion effects of the international financial crisis, but for many years it has also prevented them from fulfilling the growth-enhancing functions of establishing and running viable payment systems and providing market-driven intermediation and investment finance. This once again underlines the degree of institutional heterogeneity and the selectiveness of exposure to globalization attained by a region that had featured a largely common point of departure less than two decades ago.

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Annex of Tables

Table 1

Demand Components of GDP in Selected Countries

Kazakhstan

	2002	2003	2004	2005	2006	2007
	% of GDP					
Household consumption	58.4	56.3	53.5	49.4	45.5	45.8
Government consumption	12.4	11.6	11.6	11.2	10.1	11.2
Gross fixed capital formation	25.7	23.8	25.1	27.8	30.0	30.5
Inventory adjustments	3.5	2.8	1.2	3.0	3.7	5.6
Net exports of goods and services	0.0	5.6	8.6	8.8	10.8	6.9

Kyrgyz Republic

	2002	2003	2004	2005	2006	2007
	% of GDP					
Household consumption	67.5	77.9	76.0	84.5	95.1	87.5
Government consumption	18.6	16.8	18.2	17.5	18.0	17.1
Gross fixed capital formation	16.5	13.8	14.8	16.2	23.4	25.0
Inventory adjustments	1.1	−2.0	−0.3	0.2	0.8	1.6
Net exports of goods and services	−3.8	−6.5	−8.7	−18.5	−37.3	−31.2

Source: IMF.

Table 2

Trade Openness

Exports of goods and nonfactor services to GDP (in %, 2007)

Kazakhstan	50.1
Kyrgyz Republic	52.9
Tajikistan	20.7
Turkmenistan	36.4
Uzbekistan	40.5

Exports and imports of goods and nonfactor services to GDP (in %, 2007)

Kazakhstan	93.3
Kyrgyz Republic	137.1
Tajikistan	89.9
Turkmenistan	55.1
Uzbekistan	70.8

Source: IMF.

Table 3

Major Traded Goods

Principal exported products or product groups (share in total exports, 2006)

	First	Second	Third
Kazakhstan	72% mineral products (oil, gas, coal a.o.)	16% nonprecious metals (copper a.o.)	4% chemicals
Kyrgyz Republic	27% precious stones and metals (gold a.o.)	22% minerals	12% food and beverages
Tajikistan	75% aluminum	9% cotton	4% electricity
Turkmenistan	50% natural gas	32% oil and oil products	2% cotton
Uzbekistan	17% cotton fibers	13% energy	13% ferrous and nonferrous metals

Principal imported products or product groups (share in total imports, 2006)

	First	Second	Third
Kazakhstan	27% machinery and equipment	16% transport equipment	14% mineral products
Kyrgyz Republic	31% mineral products and energy	16% machinery and equipment	14% food and beverages
Tajikistan	23% aluminum oxide	13% oil products and natural gas	5% grain
Turkmenistan	65% finished products	34% consumption goods	1% other
Uzbekistan	41% machinery and equipment	15% chemicals, synthetic materials	10% ferrous and nonferrous metals

Source: National statistics, Der Fischer Weltalmanach 2009.

Table 4

Major Trading Partners

Principal export destinations (ranking, share in total exports, 2007)

	First	Second	Third
Kazakhstan	15.5% China, P.R.	11.5% Germany	11.2% Russia
Kyrgyz Republic	20.7% Russia	19.9% Switzerland	18.1% Kazakhstan
Tajikistan	38.9% Netherlands	32.6% Turkey	6.6% Russia
Turkmenistan	51.2% Ukraine	18.4% Iran	5.0% Turkey
Uzbekistan	22.4% Russia	10.4 % Poland	9.4% Turkey

Principal import suppliers (ranking, share in total imports, 2007)

	First	Second	Third
Kazakhstan	35.4% Russia	22.1% China, P.R.	8.0% Germany
Kyrgyz Republic	40.5% Russia	14.7% China, P.R.	12.9% Kazakhstan
Tajikistan	32.1% Russia	13.1% Kazakhstan	10.8% China, P.R.
Turkmenistan	14.3% U.A.E.	11.6% Russia	10.3% Turkey
Uzbekistan	30.1% Russia	13.3% China, P.R.	13.0% South Korea

Source: IMF.

Table 5

Russia: Key Macroeconomic and Financial Sector Indicators (for Comparison)

	2000	2002	2004	2005	2006	2007	2008
GDP growth (in real terms, %)	10.0	4.7	7.1	6.4	7.4	8.1	5.6
Current account balance (% of GDP)	18.0	8.4	10.1	11.1	9.8	6.1	5.9
Net FDI flows (% of GDP)	−0.2	−0.1	0.3	0.1	0.7	1.0	0.4
Gross external debt (% of GDP)	61.5	44.1	36.1	33.7	31.6	35.7	29.3
Gross reserves excl. gold (% of GDP)	9.3	13.8	21.0	23.8	30.9	36.9	25.5
General government budget balance (% of GDP)	3.2	0.9	4.5	8.1	8.4	6.0	5.2
CPI inflation (year-end, %)	20.1	15.1	11.7	10.9	9.0	11.9	13.3
Exchange rate: RUB/USD (annual average)	28.13	31.35	28.81	28.30	27.34	25.58	24.81
Level of monetization (M2/GDP, %)	15.8	19.7	26.0	27.9	33.5	40.2	..
Credit to the private sector (% of GDP)	13.3	17.7	23.7	26.4	31.3	39.0	42.0
of which: foreign currency-denominated (%)	..	..	27.1	28.0	24.5	22.6	24.6
of which: nonperforming (%)	9.6	6.4	3.3	2.6	2.4	2.5	3.8
Asset share of foreign-owned banks (%)	9.5	8.1	7.6	8.3	12.1	17.2	18.7
Capital adequacy ratio (%)	..	19.1	17.0	16.0	14.9	15.5	16.8
Stock market capitalization (% of GDP)	15.3	36.7	44.6	72.9	103.4	111.8	..

Source: National statistics, IMF, EBRD.

Note: Figures for 2008 are preliminary data.