KAZAKHSTAN

Highlights

- **Real GDP growth remains above 4 per cent.** The economy grew by 4.3 per cent year-on-year in the first three quarters of 2019, enabled by expansion in construction, trade and transportation. Annual inflation remains within the central bank's target band.
- **The blue-chip phase of the government's privatisation programme commenced with Kazatomprom's initial public offering (IPO).** In November 2018, Kazatomprom, the world's largest uranium producer, sold 15 per cent of its shares. The IPO was conducted on the London Stock Exchange and on the new Astana International Exchange.
- **An asset quality review (AQR) of the banking sector has been initiated.** The AQR will assess loan quality and bank capital needs of the 14 largest banks. The results are expected in December 2019.

Key priorities for 2020

- **The authorities need to further accelerate the implementation of structural reforms.** Key short-term priorities include measures to facilitate public-private partnerships, implement tariff reform in regulated sectors and improve the fiscal framework, all of which are critical for increasing the competitiveness of the economy.
- **Commercialisation and privatisation of large SOEs should advance.** The state- and quasi-state-owned enterprises should make further progress in improving operational efficiency and corporate governance practices to maximise value for the government.
- **The banking sector needs to be strengthened.** Despite a significant clean-up of the banking sector, asset quality remains a key risk in the system caused by weaknesses in governance and lending to related parties.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	1.2	1.1	4.1	4.1	3.9
Inflation (average)	6.7	14.6	7.4	6.0	5.2
Government balance/GDP	-6.3	-4.5	-4.4	2.7	0.5
Current account balance/GDP	-3.3	-5.9	-3.1	0.0	-1.5
Net FDI/GDP [neg. sign = inflows]	-3.6	-12.6	-2.9	-0.1	-2.5
External debt/GDP	83.0	118.9	100.3	88.5	89.0
Gross reserves/GDP	15.1	21.6	19.3	18.1	n.a.
Credit to private sector/GDP	37.7	33.0	29.9	27.3	n.a.

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Macroeconomic performance

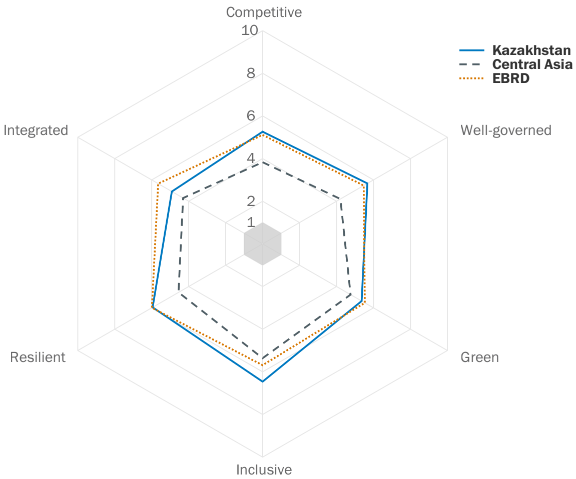
The economy is growing steadily. Real GDP growth continued at 4.3 per cent year-on-year in the first three quarters of 2019. It was supported by expansions in construction, trade and transportation. Oil production slowed down in the first nine months of 2019 due to planned repair works in the three main oilfields. As a result, exports declined by 4.5 per cent year-on-year in US dollar terms in the first eight months of 2019. At the same time, imports rose by 13.2 per cent. The growth in real wages, fuelled by increases in minimum wages and public sector salaries, continues to support private consumption. Fixed investment increased by 9.7 per cent in the first nine months of 2019, partly related to the construction of the Saryarka gas pipeline.

The exchange rate has been broadly stable. Capital outflows and rouble depreciation weakened the tenge against the US dollar by 14 per cent over the course of 2018, but depreciation of the exchange rate in the first half of 2019 has been limited despite market pressures. Annual inflation reached 5.5 per cent in October 2019. Rising inflationary pressures prompted the central bank to increase the base rate by 25 basis points to 9.25 per cent in September 2019. Credit growth has slightly accelerated (6 per cent year-on-year in September 2019), with loans growing only in the retail sector. The non-performing loan (NPL) ratio stood at 9.3 per cent in September 2019.

Fiscal and external accounts improved in 2018. The fiscal balance turned to a surplus of 2.6 per cent of GDP in 2018 from a deficit of 4.4 per cent in 2017, on account of higher tax revenues and a moderation of government spending. The non-oil fiscal deficit narrowed to 5.0 per cent of GDP in 2018 from 10.5 per cent in 2017. Growth on the revenue side was driven by increased corporate income tax and value added tax receipts as well as improved tax administration. Lower spending in 2018 was due mainly to a reduction in banking sector support outlays. However, in 2019 the guaranteed transfer from the National Oil Fund has been increased to KZT 2.70 trillion (US$ 7 billion) to finance various social support programmes. The current account came almost to balance in 2018, supported by rising net exports, after a deficit of 3.1 per cent of GDP in 2017, but the deficit widened again in the first half of 2019.

Moderate growth is expected to continue. The economy is expected to expand more slowly, by 3.9 per cent in 2019 and 3.6 per cent in 2020, as the contribution of mining is expected to moderate. With minimum wages increasing in January 2019, growth in real incomes, along with higher consumer lending, will continue to drive private consumption. Downside risks include a possible deterioration in the external environment and an escalation of internal banking sector weaknesses.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government is enhancing its efforts to attract investment. The Coordination Council for Attracting Foreign Investment, chaired by the prime minister, was created in April 2019. Combined with concrete benefits for investors, including special legal and tax regimes and simplified procedures for obtaining work permits for expatriates, the new approach represents a concerted effort to promote investment opportunities in Kazakhstan to foreign investors.

Renewable energy is gaining traction, while legislative reforms on the green economy are under way. The share of renewable energy in the energy mix increased to 1.2 per cent in total production volume in 2018, up from 1.0 per cent in 2017, with the government aiming to achieve a target of 3.0 per cent by 2020. The ecological code is currently being updated to bring the current legislation in line with Organisation for Economic Co-operation and Development standards and introduce best available technologies. Adoption of the code is expected in 2020. At the same time, in other areas progress on the green economy transition has been limited. Despite the re-launching of the emissions trading system in January 2018, trading of quotas has not commenced. Energy efficiency measures in buildings and industry are lagging behind the declared targets due to weak regulation and lack of economic incentives.

The government has frozen utilities tariff reform. The current system of tariff regulation does not motivate utility companies to improve their performance and minimise operating costs. Most of these firms are therefore loss-making. The first steps have been taken to change long-term tariff regulation to stimulate the economic involvement of utility firms in reducing their operating costs. A new performance-based tariff methodology was developed for water, wastewater, district heating and electricity distribution sectors, and approved by the tariff regulator. The new methodology was referenced in a new law "On Natural Monopolies" that came into force in December 2018. However, the work on methodology has experienced a temporary set-back, with its detailed promulgation delayed due to the government's decision to reduce or freeze tariffs for all utilities across the country in 2019 in order to reduce the social burden.

Privatisation is proceeding but at a slow pace. As of the end of July 2019, 734 out of 922 state-owned enterprises earmarked for privatisation had been sold for Tenge 453 billion (US$ 1.2 billion). In November 2018, Kazatomprom, the world's largest uranium producer, sold only 15 per cent of its shares for US$ 451 million out of the 25 per cent planned to be privatised. The IPO was conducted on the London Stock Exchange and on the new Astana International Exchange. Partial privatisations of two other blue-chip assets – Air Astana, the national carrier, and Kazakhtelecom, the national telecommunications operator – have been postponed to late 2019. The government is falling behind its target of cutting the share of the state in the economy to 15 per cent by 2020, with the latest data showing that the share remains at 48 per cent. Preparation for privatisation of sizeable blue chip companies is taking longer than expected due to complexities in restructuring and commercialising large operations and a lack of momentum in regulatory reform in key sectors.

Banking sector restructuring has continued and the supervisory framework of the central bank has improved. In April 2019 Moody's credit ratings agency upgraded its forecast for the banking sector from "stable" to "positive", enabled by improved capitalisation and asset quality and an overall better liquidity situation. Following the merger of two large banks in July 2018 and revocation of the licences of three smaller banks, sector consolidation has continued in 2019. The fourth largest bank, Tsesnabank, had its distressed assets acquired by the state-owned Problem Loan Fund and was bought out by First Heartland Bank in February 2019. The National Bank of Kazakhstan has strengthened its supervisory functions by shifting to risk-oriented supervision in January 2019. The new approach is forward-looking and focuses on pre-empting risks by identifying problems early on. Another key development is the launch of the independent AQR of 14 (out of 28) banks in August 2019, which will be key to understanding the real situation with problem loans and identifying additional provisioning needs.

KYRGYZ REPUBLIC

Highlights

- **Economic growth has improved.** Real gross domestic product (GDP) growth accelerated to 6.1 per cent year-on-year in the first three quarters of 2019 from 3.5 per cent in 2018, reflecting strong gains in the mining and manufacturing sectors and the low base effect.
- **The fiscal deficit has narrowed.** The general government deficit declined to 1.3 per cent of GDP in 2018, from 4.6 per cent in 2017, due to fiscal consolidation measures. This has contributed to a reduction of public debt to 56.0 per cent of GDP.
- **A Business Ombudsman has been established.** This is a major step towards more transparency and predictability and an overall improvement of the business climate. The weak rule of law and inadequate protection of property rights are widely regarded as key obstacles to doing business.

Key priorities for 2020

- **Regulatory reform needs to be accelerated.** The sustainability of municipal infrastructure and the energy sector should be improved through tariff reform, and greater private-sector participation should be promoted in the energy sector by implementing measures to increase competition across the value chain.
- **Governance should be strengthened.** Corruption and public governance issues remain major hindrances to private-sector development. Strengthening private property protection and the enforcement of contracts would significantly ease the difficulty of doing business.
- **Fiscal consolidation should continue.** In order to maintain debt sustainability, the government should adhere to the fiscal rule, currently under parliamentary consideration, which requires the deficit to not exceed 3 per cent of GDP and caps the public debt at 70 per cent of GDP.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	3.9	4.3	4.7	3.5	4.3
Inflation (average)	6.5	0.4	3.2	1.5	1.2
Government balance/GDP	-2.7	-6.4	-4.6	-1.3	-3.0
Current account balance/GDP	-15.9	-11.6	-6.2	-8.7	-10.0
Net FDI/GDP [neg. sign = inflows]	-17.1	-9.0	1.4	-0.6	-2.0
External debt/GDP	99.9	100.2	91.0	84.0	n.a.
Gross reserves/GDP	26.6	28.9	28.3	26.6	n.a.
Credit to private sector/GDP	22.8	20.6	21.4	23.9	n.a.

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Macroeconomic performance

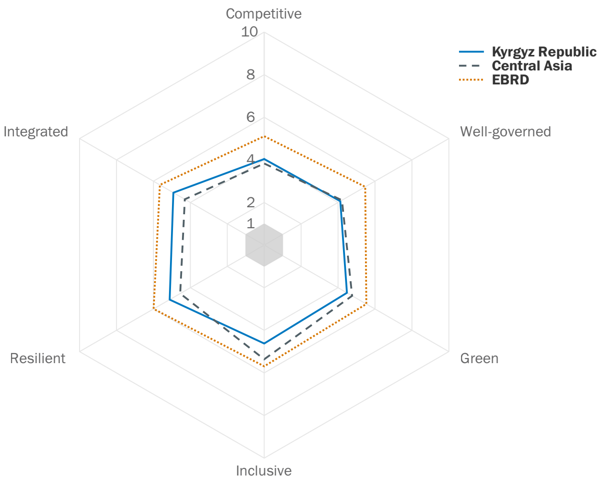
The economy is growing steadily. Following a moderation of real GDP growth to 3.5 per cent in 2018 from 4.7 per cent in 2017, economic growth picked up to 6.1 per cent year-on-year in the first three quarters of 2019, reflecting strong gains in the mining and manufacturing sectors and the low base effect. Gold production has rebounded thanks to an increased ore grade and a higher recovery rate. Excluding the Kumtor gold mine, GDP growth in the first three quarters of 2019 reached 3.2 per cent year-on-year. Net remittances, however, declined by 12.0 per cent year-on-year in US dollar terms in the first eight months of 2019.

Inflation remains subdued. Average annual inflation decelerated to 1.5 per cent in 2018 from 3.2 per cent in 2017 on the back of falling food prices. Inflation remained low in September 2019 at 2.3 per cent and is expected to stay well below the central bank target of 5.0 to 7.0 per cent. The low inflationary environment prompted the central bank to cut the policy rate twice in 2019 by 25 basis points each time – in February and May – to 4.50 per cent and 4.25 per cent, respectively. The strong loan growth observed in 2018 continued in the first half of 2019, with total credit expanding by 15.0 per cent year-on-year in September 2019.

The fiscal deficit has narrowed but external deficits have widened. The general government deficit declined to 1.3 per cent of GDP in 2018 from 4.6 per cent in 2017 as a result of lower current expenses. This has contributed to a reduction of public debt to 56.0 per cent of GDP in 2018 from 58.8 per cent in 2017. According to estimates from the International Monetary Fund, the current account deficit widened to around 8.7 per cent of GDP in 2018 from 6.2 per cent in 2017, reflecting reduced gold exports and a marked slowdown in growth of remittances from Russia due to the weaker rouble. In the first half of 2019, the deficit started narrowing, however, to US$ 370 million versus US$ 804 million a year earlier, as gold exports recovered. The exchange rate remained stable in nominal terms in 2018 and 2019 but continued to appreciate in real effective terms.

Robust GDP growth is expected to continue in the short term. GDP growth is expected to reach 4.3 per cent in 2019, driven by increased gold production. Exports from the Kumtor gold mine, more evenly distributed over the year than in 2018, and private consumption, supported by further increases in real wages and remittances, are expected to be major contributors to economic growth in the short term. The scope for fiscal expansion is, by contrast, very limited. Downside risks include the weakening of growth in Russia, with negative implications for remittances and increasing fiscal pressures related to the parliamentary elections in 2020.

Assessment of transition qualities (1-10)



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Major structural reform developments

The business environment is improving. The Kyrgyz Republic was among the top 20 most improved countries in the World Bank's *Doing Business 2020* report. The country has made significant progress in three areas: getting electricity, getting credit and paying taxes. The reliability of the country's electricity supply has been enhanced by modernising the infrastructure and better monitoring outages. The country has also improved access to credit information by providing credit scores to banks, financial institutions and borrowers. Lastly, paying taxes has been made easier by consolidating the tax on interest income into the corporate income tax and by introducing an online platform for filing and paying taxes. The country ranks 80th out of 190 countries in this year's report.

Progress has been made towards a strategic agreement between the government and Centerra Gold on the Kumtor gold mine. The two parties – Centerra Gold and the Kyrgyz government – had entered into a strategic agreement in September 2017, which settled an environmental dispute and allowed the subsidiary company of Centerra Gold to transfer cash to its parent company in Canada. However, the deadline for implementing the agreement has been postponed by the Kyrgyz authorities several times since then. In August 2019, Centerra Gold announced that all conditions to complete the agreement were satisfied or waived, and the parties are now moving to terminate the remaining legal proceedings. Establishing a stable and permanent framework for operations in and ownership of the Kumtor gold mine demonstrates the government's commitment to legal stability and will help attract more foreign direct investment.

A decree establishing a Business Ombudsman has been signed. The signing took place in December 2018. The Business Ombudsman institution aims to protect the rights of businesses by investigating their complaints about instances of abuse of power by the state, municipalities and entities controlled by them. The Business Ombudsman and its deputies are selected unanimously by three votes – the government, international partners and business associations – which preserves balance and ensures commitment from these three key stakeholders. The Ombudsman's activity is financed by international development partners. This is a major step towards more transparency and predictability and an overall improvement of the business climate. However, the key to success of the institution will be in its implementation.

The central bank has strengthened its supervisory framework but compromised its credibility by acquiring a troubled bank. The National Bank of the Kyrgyz Republic (NBKR) continued transitioning to risk-oriented supervision by introducing amendments in June 2018 to the requirements of risk management policies and procedures of banks. It also approved new provisions related to inspections of banks, in line with the new approach. However, other issues pertaining to governance and oversight arrangements in the NBKR, such as independence of its board, remain unaddressed. In addition, in October 2018 the NBKR acquired a troubled bank – Rosinbank – after taking possession of the shares that it had accepted as collateral for emergency liquidity assistance. This measure is unwelcome as it carries the risk of a conflict of interest between ownership and the NBKR's supervisory role.

The Kyrgyz Republic has endorsed the open skies policy. Amendments to the Air Code of Kyrgyzstan, signed in January 2019, unilaterally declare an open skies policy and the fifth freedom for countries that want to operate international flights through the airspace of the Kyrgyz Republic. The fifth freedom allows foreign airlines to carry passengers, baggage, freight and mail on flights from the Kyrgyz Republic to third countries (outside their origin) and back. This is expected to bring more international traffic to Manas International Airport and stimulate the country's air travel market.

The legal framework for anti-money laundering and combating the financing of terrorism has been improved. The updated law "On Combating Terrorist Financing and Money Laundering" came into force in September 2018. It adopts international standards on combating money laundering, the financing of terrorism and financing the proliferation of weapons of mass destruction, as provided in the Financial Action Task Force recommendations. The law provides requirements to ensure transparency of beneficial owners of legal entities and a database of beneficial owners of legal entities established and registered in the Kyrgyz Republic. The NBKR now needs to update the relevant regulations in line with the new law.

MONGOLIA

Highlights

- **Strong growth rates are being sustained.** The economy expanded by 7.3 per cent year-on-year in the first half of 2019, accelerating from 6.9 per cent in 2018, mainly due to increases in gross capital formation related to the underground expansion of the Oyu Tolgoi copper mine.
- **The authorities are taking steps to strengthen the banking sector albeit with some delays in resolving bank undercapitalisation.** Following an Asset Quality Review, some banks were supposed to take action to boost capital by the end of 2018 but, as of September 2019, not all of them have met capital requirements in full.
- **Key tax laws have been revised by the parliament.** Amendments to the General Law on Taxation, the Corporate Income Tax Law, the Value Added Tax Law and the Personal Income Tax Law were passed in March 2019. One of the key changes includes a reduction in the licence transfer tax for land rights.

Key priorities for 2020

- **Financial-sector reforms should advance.** The central bank should strengthen the supervision of the sector and implement the non-performing loan (NPL) resolution strategy.
- **It is critical to maintain fiscal discipline to achieve a commitment to reducing debt.** The authorities need to avoid fiscal loosening in the run-up to parliamentary elections in 2020 and should adhere to the budget targets agreed under the International Monetary Fund (IMF) programme.
- **Governance issues need to be addressed.** Maintaining judicial independence and improving judiciary capabilities to effectively deal with commercial cases are essential for attracting investment, including in non-extractive sectors. The authorities should also take concrete measures to reduce corruption.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	2.4	1.2	5.3	6.9	6.8
Inflation (average)	5.9	0.5	4.6	7.6	8.1
Government balance/GDP	-8.5	-17	-1.9	-3.4	0.5
Current account balance/GDP	-4.0	-6.3	-10.1	-17.0	-15.0
Net FDI/GDP [neg. sign = inflows]	-0.8	37.2	-13.1	-15.0	-18.0
External debt/GDP	171.3	183.9	245.4	235.3	n.a.
Gross reserves/GDP	25.6	11.6	26.3	26.5	n.a
Credit to private sector/GDP	53.9	56.9	53.0	56.2	n.a

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Macroeconomic performance

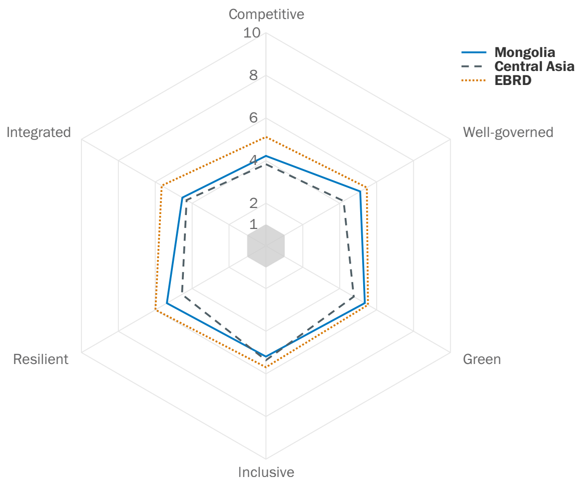
Real GDP growth remains strong. Economic growth accelerated to 6.9 per cent in 2018 and to 7.3 per cent year-on-year in the first half of 2019. Growth was primarily driven by fixed investment in the mining sector, related to the underground expansion of the Oyu Tolgoi copper mine. Gross capital formation increased by around 25.0 per cent year-on-year in the first half of 2019. Inflation accelerated from an average of 4.3 per cent in 2017 to 6.8 per cent in 2018. Credit growth expanded to 27.0 per cent in 2018 from 10.0 per cent in 2017. In response to these developments, the central bank tightened monetary policy by raising the policy rate from 10.0 per cent to 11.0 per cent in November 2018 and by restricting the growth of consumer lending through a ceiling on the household debt-to-income ratio. Inflation reached 9.0 per cent year-on-year in June 2019, exceeding the central bank's 8.0 per cent target.

External pressures intensified in 2018. Exports rose by 13.0 per cent year-on-year in US dollar terms in 2018 and imports surged by 35.0 per cent in the same period. High import growth was driven by major inflows of foreign direct investment, which financed purchases of machinery and equipment. This led to a further widening of the current account deficit to 15.0 per cent of GDP in 2018 from 10.0 per cent in 2017. In the second half of 2018, the tugrik came under pressure, depreciating overall by 8.0 per cent in 2018. However, in the first six months of 2019 the current account deficit narrowed slightly, as the growth of exports outpaced that of imports. Exchange rate pressures eased in the first half of 2019. This, coupled with central bank interventions, has stabilised the exchange rate. Gross international reserves continued rising and reached US$ 3.2 billion in June 2019, covering six and a half months of imports.

The fiscal position continued improving. The overall fiscal balance was in surplus in 2018 (versus a 3.8 per cent of GDP deficit in 2017). This is the first time this has happened since 2010. This was achieved by improved economic performance and fiscal adjustment policies. Revenues increased due to rising tax receipts from value added tax and social insurance. A moderation in capital expenditures also contributed to better fiscal performance. Public debt decreased to 73.3 per cent of GDP in 2018 from 84.6 per cent in 2017, according to the IMF.

High growth will continue, although at a slightly slower pace. The economy is projected to grow by 6.8 per cent in 2019, slowing down somewhat to 5.4 per cent in 2020, aided by further investment in the underground expansion of Oyu Tolgoi. Private consumption is also projected to support GDP growth as real incomes rise, thanks in part to an increase in public workers' salaries. Downside risks include a possible slowdown in growth in China and the stalling of reforms due to political uncertainty in the run-up to parliamentary elections, which are scheduled for 2020.

Assessment of transition qualities (1-10)



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Major structural reform developments

The authorities are taking steps to strengthen the banking sector, but delays are occurring. An Asset Quality Review in 2017 identified a capital shortfall in the sector of around 2.0 per cent of GDP. Banks were supposed to take action by the end of 2018 but, as of September 2019, not all of them have met capital requirements in full. The regulator – Bank of Mongolia (BoM) – is committed to ensuring all banks raise capital as required. In April 2019, the BoM dissolved Capital Bank, as the bank failed to fulfil requirements for reserve and capital adequacy and could no longer carry out normal operations. Weak asset quality remains a concern for the sector, with NPLs rising at the end of 2018 and reaching 10.5 per cent of total loans as of June 2019.

The sixth review of the IMF's three-year Extended Fund Facility has been suspended. Disbursements have been impeded since December 2018, partly due to the delays in financial-sector reform regarding banks' capitalisation. In addition, as requested by the IMF, the BoM launched a forensic review in July 2019 to ensure that the additional capital, contributed by shareholders of five banks in 2018, is from legitimate sources. For 2019, the programme goals are to continue reducing public debt, resume international reserve accumulation, ensure the banking system is well-capitalised and strengthen the investment climate to attract foreign capital.

Key tax laws, including the licence transfer tax, have been amended. Amendments to the General Law on Taxation, the Corporate Income Tax Law, the Value Added Tax Law and the Personal Income Tax Law were passed by the parliament in March 2019. The changes will be effective from January 2020. One of the key amendments includes a reduction in the licence transfer tax for land rights. In 2017 the authorities introduced a payment of a 30.0 per cent tax rate on gross assessed value of transfer of licence for land use, including exploration and extraction licences for mining, which further increases the costs of doing business for investors. The revised law lowers the rate to 10.0 per cent of the assessed net value of the transfer rights. Furthermore, there are reductions in the withholding tax on income provided to non-residents and tax on dividends for foreign investors. Other changes concern the simplification of reporting procedures and the provision of tax relief for companies that are struggling financially.

Judicial reform has experienced a major setback. In March 2019 the parliament adopted a new regulation regarding the dismissal of judges, prosecutors and the head of the Anti-Corruption Agency. Legal amendments were quickly passed by the parliament and were not subject to hearings and public consultations. They allow the National Security Council (consisting of the president, the chairman of the parliament and the prime minister) to remove judges and prosecutors, thus undermining judicial independence and investor confidence in the country. The president then dismissed 17 judges, as well as the head and deputy head of the Mongolian anti-corruption agency, supposedly on the grounds of corruption. Transparency International has issued several statements condemning these developments, while UN Special Rapporteurs from the United Nations have urged the government not to politically interfere in the judicial system.

Data transparency is improving, with Mongolia subscribing to the IMF's Special Data Dissemination Standard. Previously, Mongolia implemented the enhanced General Data Dissemination System, which includes maintaining a National Summary Data Page, where key macroeconomic and financial indicators are published online. In April 2019, Mongolia made the next step in enhancing data dissemination in line with the best international practices by committing to ensure timely availability of statistics in accordance with an advance release calendar. This measure is key to enhancing decision-making by the authorities and enabling access to important data for external stakeholders.

TAJIKISTAN

Highlights

- **Officially reported economic growth remains strong.** Real GDP grew by 7.5 per cent year-on-year in the first half of 2019 as growth in services and industry picked up.
- **The first two turbines of the Rogun hydropower plant (HPP) were put into operation.** The first turbine, launched in November 2018, produced 211.3 million kWh of electricity in the first half of 2019, while the second turbine came online in September 2019.
- **Barqi Tojik, the state-owned energy company, has been unbundled into power generation, transmission and distribution.** Two entities were created which will be responsible for electricity transmission and distribution and will be subordinated to Barqi Tojik, which retains electricity generation.

Key priorities for 2020

- **Banking sector stabilisation is an immediate priority.** While the sector has been recapitalised, the protracted resolution and restructuring of the two troubled banks continues to hinder sector development. Legacy problems of weak governance and directed and related party lending should be tackled vigorously.
- **Efforts to address investment, regulatory and institutional gaps in the energy sector should be stepped up.** The required measures include restructuring Barqi Tojik's debt, implementing the recently adopted tariff methodology and establishing an independent sector regulator. There is a need for greater transparency, higher efficiency, independent oversight, and careful management of public investments.
- **Business environment constraints should be addressed**. Simplifying tax policies and improving tax administration are of paramount importance to incentivise firms operating in the real economy to become more transparent.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	6.0	6.9	7.1	7.3	7.0
Inflation (average)	5.8	5.9	7.3	3.8	7.9
Government balance/GDP	-2.0	-9.0	-6.0	-2.8	-4.5
Current account balance/GDP	-6.1	-4.2	2.2	-5.0	-6.0
Net FDI/GDP [neg. sign = inflows]	-5.8	-3.5	-2.6	-2.9	-2.5
External debt/GDP	51.3	61.2	71.2	69.8	n.a.
Gross reserves/GDP	6.3	9.4	14.4	14.6	n.a
Credit to private sector/GDP	22.7	19.2	13.7	12.3	n.a

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Macroeconomic performance

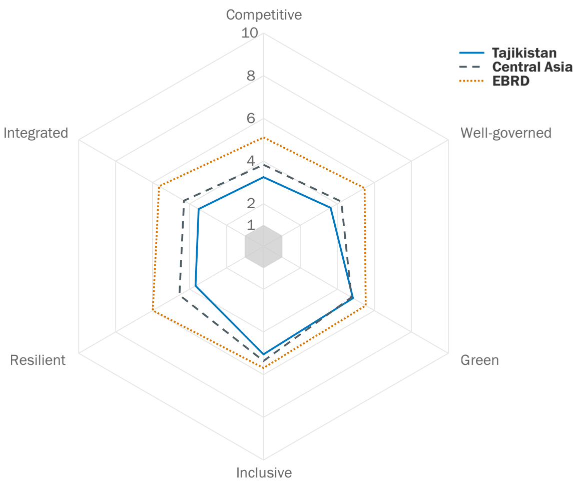
The economy continues to grow by more than 7.0 per cent. In the first half of 2019 officially reported real GDP growth was 7.5 per cent year-on-year, following 7.3 per cent growth in 2018. Growth was driven by gains in services and industry. Exports increased by 8.1 per cent year-on-year in US dollar terms in the first six months of 2019, while imports grew by 2.3 per cent. However, fixed investment contracted by 8.6 per cent in the same period, mainly due to lower public investment in the energy sector, which also contributed to a slowdown in import growth. The economy continues to face structural challenges stemming from the solvency and liquidity issues in the banking sector, as well as a significant debt overhang.

Inflation has accelerated. After decelerating to an average of 3.8 per cent in 2018 from an average of 7.3 per cent in 2017, inflation started rising again in early 2019, mainly due to higher food prices. Inflation reached 8.1 per cent year-on-year in September 2019, nearing the upper bound of the central bank's targeted inflation corridor of 5.0 to 9.0 per cent. Nevertheless, the central bank reduced its refinancing rate to 13.25 per cent in May 2019 from 14.75 per cent set in February 2019, with the expectation that inflationary pressures would subside in the second half of 2019. The somoni has been broadly stable since August 2018, supported by the administrative measures introduced by the authorities in 2015. In August 2019, the central bank devalued the currency by 2.7 per cent to bring the official exchange rate closer to the unofficial rate.

Fiscal accounts have improved but external deficits are rising. The fiscal deficit narrowed in 2017 and 2018, with the authorities undertaking fiscal consolidation aimed at reducing the large amount of public debt. Capital expenditures were reduced, except for infrastructure outlays for the construction of the Rogun dam. Public debt fell to 47.9 per cent of GDP in 2018 from 50.4 per cent in 2017. The current account turned into a deficit of 5.3 per cent of GDP in 2018 from a surplus of 2.1 per cent in 2017 as imports surged rapidly. The significant growth in imports largely reflects the purchase of equipment for the construction of the Rogun HPP. In the first half of 2019, the growth of exports exceeded that of imports and the current account deficit slightly narrowed to 3.1 per cent of GDP.

A moderation in the growth rate is likely in the short term. Real GDP growth is projected at 7.0 per cent in 2019 and 6.3 per cent in 2020. Fiscal challenges, combined with a difficult business environment, are likely to continue to weigh on economic activity. Remittances, electricity exports from the Rogun HPP, and improving bilateral ties with Uzbekistan are expected to be the main growth drivers. An agreement on an International Monetary Fund (IMF) programme, which is currently under negotiation, would support economic stability by enabling banking sector resolution, building fiscal and external buffers and improving the investment climate.

Assessment of transition qualities (1-10)



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Major structural reform developments

The business environment is improving. Tajikistan was among the top 10 improvers in the World Bank's *Doing Business 2020* report, rising from 126th to 106th place (out of 190 countries). Areas of improvement included starting a business, getting credit and trading across borders. Access to credit is helped by the introduction of a collateral registry and establishment of a secured-transactions system. The new registry will allow business owners to use movable assets such as motor vehicles and livestock to secure business loans. This is an important step towards enabling secured lending and expanding access to credit by accepting collateral beyond land and real estate – Tajikistan now ranks 11th on this indicator. Trading across borders was made easier by prioritising customs clearance of perishable goods exports. However, the country continues to experience major bottlenecks in getting electricity, paying taxes and resolving insolvency.

The Rogun dam – the largest HPP in Central Asia – has begun operating. The first unit of the Rogun HPP started operating in November 2018 and produced 211.3 million kWh of electricity in the first half of 2019. The second unit was launched in September 2019. Once all six turbines are operational, the Rogun HPP is expected to generate 13.1 billion kWh of electricity per year. This will be sufficient to close the domestic energy deficit, which is particularly acute in the winter, and export electricity to Afghanistan and Pakistan. In the past, Tajikistan has resorted to regular power rationing during the winter and, while formal limits on power delivery have been lifted as of now, the country still experiences occasional power outages. The Rogun HPP is not only expected to strengthen the energy security of the country but also to become the main driver of economic growth and living standards. However, there are challenges with the full implementation of the project, primarily related to financing. While Tajikistan used proceeds from the sale of Eurobonds to finance the initial stages of the project, further funding options remain unclear given the constrained fiscal space and weak investment climate.

Institutional and regulatory reforms in the energy sector have proceeded. In June 2019, the government established two new joint stock companies (transmission and distribution) subordinated to Barqi Tojik, a state-owned energy company, which retains electricity generation. These companies are later expected to be separated from Barqi Tojik. A draft action plan on improving the financial viability of Barqi Tojik for 2019-25 has been prepared, the implementation of which would require US$ 1.2 billion. Part of the funds will be used to repay debt owed to two HPPs, Sangtuda-1 and Sangtuda-2. In addition, a new electricity tariff methodology was approved in June 2019, which envisages gradual increases in electricity tariffs. A new tariff-setting unit is expected to be established by the end of 2019 with the primary function of setting tariffs for the regulated sectors.

Banking sector restructuring after the crisis in 2016 is still under way, with the resolution of problematic systemic state-owned banks pending. Resolution of the two troubled banks, Agroinvestbank and Tojiksodirotbank, is high on the agenda of financial sector reforms to be targeted by a potential IMF programme, which has been under discussion for the last three years. Further consolidation in the sector is expected, including through a potential increase in capital requirements for banks. Banking sector indicators are moving in the right direction. For example, overdue and non-performing loans, mostly concentrated in the two banks, declined from around 35.8 per cent of total loans at the end of 2017 to 24.8 per cent in June 2019. However, data quality remains an issue. Loan and deposit dollarisation fell to 52 per cent and 48 per cent, respectively, as of the end of June 2018. Apart from contraction in the demand for foreign currency loans, this was in part due to measures to reduce the foreign exchange exposure of banks by prohibiting foreign currency-denominated mortgage loans to unhedged borrowers and increasing the risk weight for foreign currency loans from 100 per cent to 150 per cent.

Businesses continue to face restrictions on currency convertibility. This is flagged as a top concern in the World Economic Forum's Executive Opinion Survey. Banks are unable to meet the foreign currency demands of clients, which necessitates prioritising specific sectors and transactions, as recommended by the central bank (for example, export-oriented transactions, or imports of food and fuel). The shortage of foreign currency liquidity in part reflects the contraction in remittances from Russia, limited inflows of foreign exchange from exports, and low foreign direct investment. Compliance requirements related to remittance operations have been tightened by the regulator, which had the effect of shifting remittances to informal channels to some extent.

TURKMENISTAN

Highlights

- **Officially reported GDP shows strong growth figures.** Growth of GDP remains above 6 per cent, driven by an acceleration of growth in industry. The official exchange rate remains overvalued at 3.5 manats per US dollar but pressures on the parallel market exchange rate have been easing since the beginning of 2019.
- **Turkmenistan has signed a long-awaited five-year contract with Russia for gas delivery.** Regular gas supplies to Russia had been stopped since 2016. The new contract reduces Turkmenistan's dependence on China as its sole gas export market.
- **Free access to electricity, gas and water ended in 2019.** This is indicative of the government's stated intention to move to a market-based economy and improve public finances.

Key priorities for 2020

- **Currency convertibility issues need to be addressed and the exchange rate should be adjusted to reflect macroeconomic fundamentals.** Removing exchange rate distortions would improve the competitiveness of the country's exports and correct external imbalances while stimulating growth of the private sector.
- **The authorities need to reduce the role of the state in the distribution of resources.** Key necessary steps include the commercialisation of state-owned enterprises, transparent privatisation, and a reduction in state-directed lending.
- **It is critical to deal with governance gaps.** Greater transparency and data availability, stronger protection of property rights, and an improved regulatory environment are essential for enabling foreign direct investment (FDI) inflows and strengthening the role of the private sector.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	6.5	6.2	6.5	6.2	6.3
Inflation (average)	7.4	3.6	8.0	13.2	13.5
Government balance/GDP	-0.7	-2.4	-2.8	-0.2	-0.1
Current account balance/GDP	-15.6	-20.2	-10.3	5.7	-1.0
Net FDI/GDP [neg. sign = inflows]	-8.5	-6.2	-5.5	-4.9	-5.0
External debt/GDP	21.8	23.1	25.1	25.4	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic performance

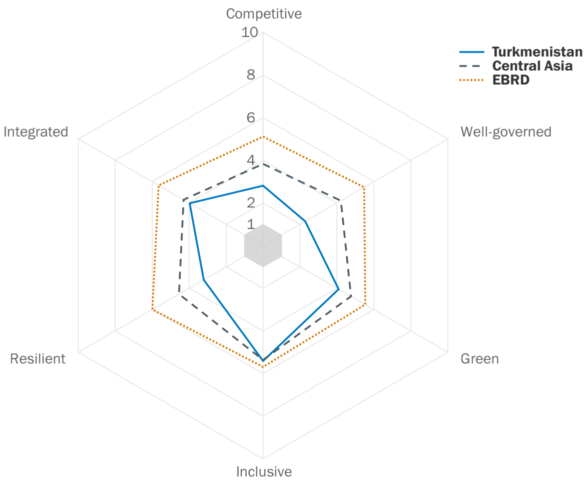
The economy continues to grow strongly according to official figures. Reliable economic data are hard to find in Turkmenistan but, according to official figures, economic growth remains above 6 per cent. The growth rate accelerated marginally to 6.3 per cent year-on-year in the first three quarters of 2019 from 6.2 per cent in 2018. This was enabled by acceleration of growth in industry (6.9 per cent versus 4.6 per cent a year earlier). Exports were reported to have risen by 7.5 per cent year-on-year in the first three quarters of 2019, helped by a resumption of gas exports to Russia. Imports contracted by 5 per cent in the same period. Retail trade turnover increased by 19 per cent in the period January to July 2019. Credit growth reached around 10 per cent in the first half of 2019. However, fixed investment continued to contract as public spending decreased.

The exchange rate remains overvalued and exchange rate controls continue to be imposed. The central bank is still implementing foreign exchange rationing, which severely disrupts foreign trade and profit repatriation. While exports recovered to US$ 11.2 billion (26 per cent of GDP) in 2018 after a deep slump in the previous two years, it remains uncertain how much of the exports actually translate to export proceeds. The gap between the official and unofficial exchange rates has widened significantly, suggesting that the manat is overvalued. The parallel market exchange rate stayed around 17 to 19 manats per US dollar in the first three quarters of 2019 (well above the official rate of 3.5 manats), but pressures have been easing since the beginning of the year. Average inflation accelerated to 13.6 per cent in 2018 from 8.0 per cent in 2017, also due to increases in public sector wages and pensions and higher gasoline prices.

Fiscal adjustment is proceeding and the external position has improved. The general government fiscal balance turned to a surplus of 0.6 per cent of GDP in 2018 from a deficit of 2.8 per cent in the previous year. This was enabled by reductions in state subsidies and cuts in capital expenditure. The current account registered a surplus of 3.1 per cent of GDP in 2018 (versus a deficit of 10.3 per cent in 2017). Higher gas demand from China enabled strong export growth in 2018 (by 49.6 per cent year-on-year in US dollar terms). In contrast, registered imports declined by 47.8 per cent in 2018.

GDP growth is forecast to moderate slightly in the short term. We expect GDP to grow by 6.3 per cent in 2018 and 6.0 per cent in 2019, provided the external demand for gas remains favourable, although we note the difficulty of providing forecasts in the absence of reliable data. The resumption of gas exports to Russia following a three-year interruption is expected to improve growth prospects. Growth will continue to be weighed down by fiscal restraint, restricted access to foreign exchange except for priority projects, a difficult business environment and limited FDI inflows.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government has ended social transfers for electricity, gas and water. The relevant decree was signed in September 2018 and took effect from January 2019. Turkmen citizens had enjoyed such benefits since late 1992. This termination of transfers is an indication of the government's stated intention to move to a market-based economy but is also suggestive of the difficult economic conditions faced by the country, notwithstanding the reported high growth rates. In addition, the government intends to increase domestic gasoline prices, which are currently among the lowest in the region, to achieve cost-recovery levels. The most recent price hike (by about 50 per cent) was implemented in February 2018.

Turkmenistan has signed a long-awaited five-year contract with Gazprom. Under the terms of the contract, signed in July 2019, 5.5 billion cubic metres (bcm) of gas will be exported to Russia annually. This follows the short contract signed in mid-April 2019 for delivery of 1.2 bcm of Turkmen gas from April to June 2019 (Russia had stopped buying Turkmen gas at the beginning of 2016). There are no details on pricing. The new contract is likely to somewhat ease the pressure on the external accounts and reduce the country's dependence on China as its sole gas export market.

Turkmenistan has ratified the convention on the legal status of the Caspian Sea. Ratification took place in December 2018 and follows signing of the convention by Azerbaijan, Iran, Kazakhstan, Russia and Turkmenistan in August 2018. This is an important milestone for the region after more than 20 years of discussions, and it ends the dispute over ownership of water resources. The Caspian Sea has been granted a special legal status, whereby each of the five countries has 15 miles from the coast of territorial waters and a further 10 miles of sovereign fishing waters. The convention makes it possible to build pipelines along the seabed, provided they adhere to environmental requirements. It therefore lays the foundation for construction of the Trans-Caspian pipeline between Turkmenistan and Azerbaijan, which would deliver gas from Turkmenistan to Turkey and then to Europe. Further uncertainties remain regarding the delimitation of the seabed and subsoil resources, but nevertheless the agreement represents an important step for major energy projects.

A land fund established in October 2018 will allocate land to private farmers under a lease of up to 99 years. The land transferred to tenants for long-term use should be used only for agricultural purposes. Farmers are required to use 70 per cent of the land to grow crops (cotton and wheat) to fulfil government demand. In addition, state purchasing prices for those crops have been increased since January 2019. The government also subsidises farming costs by providing concessional loans, at 1 per cent interest for 10 years, to finance acquisition of agricultural equipment. These measures are designed to promote the growth of agriculture and to increase productivity of the sector.

Foreign investors have filed several cases against the government of Turkmenistan. In April 2019 MTS, a Russian telecommunications company, filed a case against Turkmenistan with the International Centre for Settlement of Investment Disputes (ICSID), an international arbitration institution. MTS states that it had to terminate its operations in Turkmenistan because of the government's actions, with losses amounting to US$ 1.5 billion. In October 2018 SECE Group, a Turkish construction company, and Unionmatex, a German engineering company, also filed cases with ICSID, citing the non-payments of contractually owed monies by the Turkmen government. These add to a few other arbitration cases pending since 2009. Weak property rights and a complex regulatory environment characterised by arbitrary enforcement continue to constrain the inflow of FDI and are major obstacles to doing business in the country.

UZBEKISTAN

Highlights

- **The economy is growing strongly.** Real gross domestic product (GDP) growth reached 5.1 per cent in 2018 and 5.7 per cent year-on-year in the first three quarters of 2019, and the country has moved towards greater exchange rate flexibility.
- **The government has initiated a large-scale restructuring and privatisation programme.** A total of 29 state-owned enterprises (SOEs) in the energy, chemical, financial and consumer sectors have been selected for privatisation, and major SOEs in the energy and transportation sectors are undergoing reorganisation.
- **Uzbekistan has issued its first Eurobond.** Issued in February 2019, it consists of two tranches of US$ 500 million five-year and US$ 500 million 10-year sovereign bonds. Standard & Poor's (S&P) and Fitch assigned first-time sovereign ratings for Uzbekistan at "BB- Stable" in December 2018, and Moody's assigned it "B1 Stable" in February 2019.

Key priorities for 2020

- **Efforts to restructure and privatise SOEs need to step up.** The newly established State Assets Management Agency should facilitate the improvement of corporate governance practices, transparency and accountability of SOEs and take forward privatisation of identified SOEs in a transparent manner.
- **Price liberalisation should continue.** Following the liberalisation of bread prices and increases in utility tariffs combined with social safety net increases in 2018, it is important to continue price adjustments and to bring energy and water prices closer to cost recovery levels.
- **Banking-sector reform is critical.** State-directed lending still remains prevalent with negative implications for credit intermediation in the economy and effective banking supervision. The state's presence in the sector should be reduced and privatisation of the state-owned banks should be taken forward.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	7.4	6.1	4.5	5.1	5.5
Inflation (average)	8.5	8.8	13.9	17.5	14.6
Government balance/GDP	1.1	1.6	1.8	2.2	0.5
Current account balance/GDP	0.6	0.4	2.5	-7.1	-6.0
Net FDI/GDP [neg. sign = inflows]	-0.1	-2.0	-3.0	-1.2	-3.5
External debt/GDP	16.1	18.6	34.1	34.5	n.a.
Gross reserves/GDP	36.6	39.4	57.5	65.7	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic performance

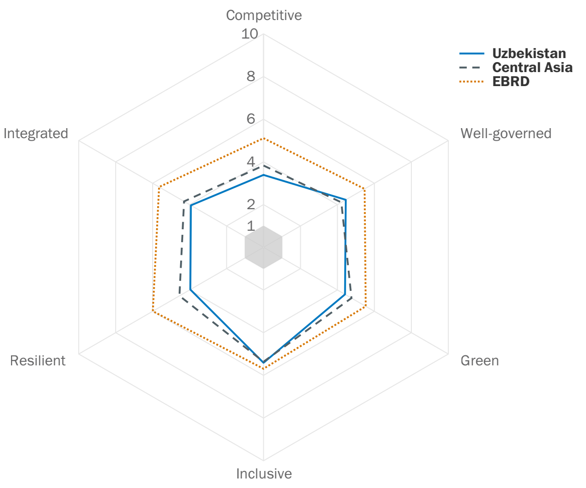
Economic growth remains robust. The economy continued growing steadily in the first three quarters of 2019 at 5.7 per cent year-on-year on the back of strong performance in the industry, construction and services sectors. Exports increased by 45.0 per cent year-on-year in US dollar terms in the first eight months of 2019, and imports by 33.0 per cent, reflecting trade liberalisation policies. Credit expansion remains high at 60.4 per cent year-on-year in August 2019, which has supported the growth of infrastructure investment and surging imports. Average inflation decelerated to 14.1 per cent in the first three quarters of 2019 from 18.9 per cent during the same period in 2018. This mostly stems from the slower growth of food prices, which has compensated for an increase in services inflation. The central bank has kept the policy rate unchanged at 16.0 per cent since September 2018.

The central bank has moved towards greater exchange rate flexibility. As of August 2019, the monetary authorities have removed the 5.0 per cent limit on daily exchange rate fluctuations. In addition, the sale of foreign currency by commercial banks is now allowed for purposes other than business or tourism travel, including in cash form, which was not possible earlier. This is part of a wider set of measures to further liberalise the foreign exchange market. The exchange rate was broadly stable in 2018 and in the first half of 2019, but market pressures intensified in August 2019.

The external position has weakened, but the fiscal deficit is contained. Uzbekistan's current account posted a deficit in 2018 – for the first time since 1999 – of 7.1 per cent GDP in 2018. This was caused by surging capital imports reflecting higher investment in housing and infrastructure to modernise the economy. The overall fiscal deficit, according to the International Monetary Fund's definition which includes policy lending, increased to 2.1 per cent of GDP in 2018 from 1.9 per cent in 2017. Public debt is low at around 20.0 per cent of GDP in 2018.

Real GDP growth is projected to remain stable in the short term. The economy is predicted to grow by 5.5 per cent in 2019 and 5.8 per cent in 2020, driven by further expansion of fixed investment, helped by rapid credit expansion and foreign direct investment (FDI) facilitated by the government's policies. Downside risks include a slowdown in the economies of trading partners and a continued credit surge, which may ignite inflationary pressures.

Assessment of transition qualities (1-10)



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Major structural reform developments

A Reform Roadmap for 2019-21 was adopted in early 2019. The roadmap outlines economic reform goals in five “strategic directions”. These include maintaining macroeconomic stability, strengthening social protection and accelerating market transition, including through the creation of an Economic Council, a consulting platform bringing together the government and local and international experts. FDI and greater private-sector participation via privatisations and public-private partnerships (PPPs) are seen as the main priorities of economic development. In this regard, the new PPP Law, adopted in May 2019 and based on the recommendations of international financial institutions, will be an important step towards increasing the overall attractiveness of investment.

A large-scale privatisation programme has been launched and SOE restructuring is moving forward. Since January 2019 the newly established State Assets Management Agency has been responsible for SOE restructuring, corporatisation and optimisation of state ownership of assets. A presidential decree signed in April 2019 sets out steps for the privatisation of 29 state-owned enterprises (SOEs) in the energy, chemical, financial and consumer sectors. In most cases, the SOEs billed for sale were mid-size, and only partial privatisations were proposed. Controlling (51 per cent or above) stakes were offered in the remaining companies, except for minority shares in three banks, an insurance company and a cement plant. In addition, a presidential decree adopted in January 2019 sets out the framework for preparing the Uzbek Metallurgy Plant, Almalyk and Navoi mining and metallurgy plants, which are potentially very valuable assets, for initial and secondary public offerings in 2022-23. SOEs in energy and transportation are undergoing restructuring, along with the separation of managerial, supervisory and regulatory responsibilities.

Institutional and legal reforms in the energy sector are advancing. In February 2019, a new Ministry of Energy was established as a policy-setting and regulatory body in the oil and gas and power sectors. The overall sector reform will be guided by a new strategy, signed in March 2019, for further development and reform of the energy sector. Among other measures, the strategy envisages the splitting of Uzbekenergo, the vertically integrated state-owned electricity utility, into three separate entities (generation, transmission and distribution). In addition, in July 2019 the government announced measures to unbundle Uzbekneftegas, a state-owned oil and gas company, into gas and oil, pipelines and gas distribution companies. A key advance in the sector includes the adoption of a new electricity tariff methodology in April 2019, which outlines measures to bring tariffs to full cost recovery levels and aims to achieve financial sustainability of electricity companies. The government introduced higher utility tariffs in August 2019.

The pace of banking-sector reform has been slow. Distortions in the banking sector, due to state-directed lending at preferential terms, remain unaddressed. A new concept for financial-sector development, currently under progress, envisages lowering state ownership in banks, reforming the government’s approach to directed lending and developing capital markets. Three banks have been earmarked for privatisation with a proposed sale of a 25 per cent equity stake in each. Amendments to the banking law and central bank law were approved by the parliament in September 2019. The amendments provide greater independence to the central bank operations and improve its supervisory powers, ensure its transparency and accountability and include provisions to ensure better corporate governance in banks.

Tax reforms have advanced. Measures adopted so far in 2019 include the simplification of tax reporting, reductions in several types of taxation, including corporate income tax, and wider applicability of value added tax. A key change was the introduction of a turnover-based taxation for small businesses to operate under the simplified tax regime, replacing headcount-based taxation. This removes the incentive for small firms to limit firm growth beyond a certain size. At the same time, some elements of the original plan have undergone significant changes since June 2018, when the plan was first published, and uncertainty remains as to how exactly the tax reform will be implemented. A revised tax code will come into force in January 2020, instead of December 2018 as originally planned.

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Steps have been taken to further improve fiscal transparency. A presidential resolution signed in August 2018 envisages measures for bringing budget accounting in line with international standards and inclusion of the budget in the Open Budget Index rankings after 2020. The authorities have published medium-term fiscal projections and an assessment of key fiscal risks in the 2019 budget. Another major advance is the publication of a citizen's guide to the budget, which encourages greater public engagement. By the end of 2019, the government plans to bring off-budget expenditure (primarily, the Uzbekistan Fund for Reconstruction and Development) on budget.

Uzbekistan tapped the international bond market with a debut Eurobond placement. Two tranches of a US$ 500 million five-year sovereign bond, yielding 4.75 per cent and a US$ 500 million 10-year sovereign bond yielding 5.375 per cent were successfully placed in February 2019. Uzbekistan received its first sovereign credit ratings "BB- Stable" from S&P and Fitch in December 2018 and a "B1 Stable" from Moody's in February 2019. According to a presidential decree, US$ 889.2 million will be deposited in banks, US$ 20 million will be loaned to Agrobank and US$ 89.9 million will be loaned to the state-owned enterprise Navoi mining and metallurgical complex, a large gold and uranium producer.