



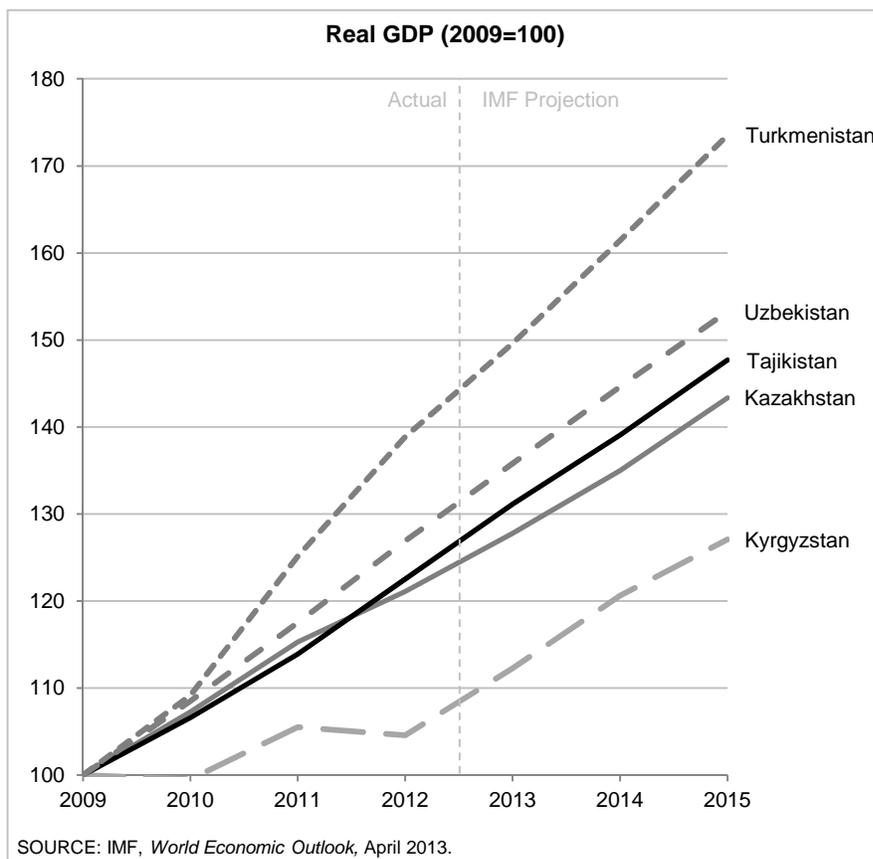
## Economic Overview

Economic growth for Central Asia is strong but has moderated since 2011 as a result of the euro area sovereign debt crisis. The average annual change in GDP for countries in the region fell from 8.7 percent in 2011 to 6.1 percent in 2012, and is expected to rise again to 6.9 percent in 2013. Weaker export demand from Europe is hurting several Central Asian countries; however, high oil and commodity prices and strong domestic demand continue to support growth, particularly among net energy exporters (Turkmenistan, Uzbekistan, and Kazakhstan).

Turkmenistan had the highest growth in the region in 2012, propelling it to upper-middle income status, and is expected to have the strongest growth again in 2013 thanks to expanding oil and gas exports.

Uzbekistan reported strong growth in 2012, with services, industry, and agriculture all expanding, and higher remittances contributing to increased consumption. Growth is expected to be slightly lower in 2013 due to reduced commodity prices and weaker growth in Russia and China, two of Uzbekistan's main export markets and sources of remittances. However, the Uzbek government has plans for high investment and infrastructure spending, which will help maintain growth of an estimated 7.0 percent in 2013. Kazakhstan should recover in 2013 from a severe drought in 2012 that lowered its agricultural sector output.

Kyrgyzstan's economy contracted in 2012 due to a decrease in gold production and a poor grain harvest. It is expected to grow again at 7.4 percent in 2013. Investments have been high, and gold production should recover. Political instability and poor business environment, however, pose a risk to Kyrgyzstan's recovery. Tajikistan saw higher growth in 2012 because of high remittance levels and an expansion of industry, especially in mining and textiles. Growth is expected to remain high in 2013; however, the country's dependence on remittances poses a risk.



## Fiscal and Monetary Policy

Turkmenistan, Kazakhstan, and Uzbekistan (the energy-exporting countries) all achieved current account surpluses in 2012, though the surpluses were lower than in 2011. This allows them some space to pursue more expansionary fiscal policies. The government of Turkmenistan is providing fiscal stimulus through investments in industrial and social infrastructure. Kazakhstan is pursuing industrial and social spending and a conservative monetary policy to contain inflation, though it did have low interest rates in 2012. Uzbekistan has also increased spending on public investment, wages, and social services. It has tightened its monetary policy somewhat in response to inflationary pressures; it has also continued to depreciate its currency in order to encourage exports.

Kyrgyzstan's fiscal deficit rose in 2012 despite tax revenue increases because of higher social spending. High dollarization in the economy limits the effectiveness of monetary policy; however, the central bank lowered the policy rate in 2012 as inflation slowed. Kyrgyzstan also experienced a current account deficit of 20.9 percent of GDP in 2012, up from 6.1 percent in 2011, due to low gold production and high fuel costs. Tajikistan's current account went from surplus to deficit in 2012 as imports increased. It ran a fiscal surplus, however, as tax and nontax revenues increased faster than spending. Tajikistan also pursued a looser monetary policy because of low inflation.

### World Bank Income Groups

Out of the five Central Asian countries, Kazakhstan and Turkmenistan are classified as upper-middle income, Uzbekistan is lower-middle income, and Kyrgyzstan and Tajikistan are low income.

**Net Energy Exporters:** Kazakhstan, Turkmenistan, and Uzbekistan.

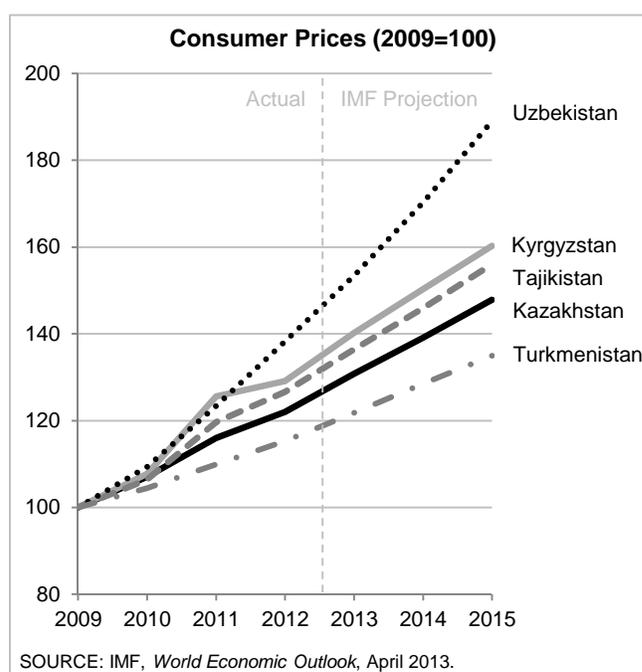
**Net Energy Importers:** Kyrgyzstan and Tajikistan.

Real GDP Growth, 2013 (IMF Projections)	East Asia 7.8%	Central Asia 6.9%	South Asia 4.7%

## Inflation

Despite concerns about inflation in Central Asia in 2011, inflation moderated in 2012, with four of the five countries in the region hitting their targets. It is expected to be slightly higher in 2013, with an average inflation rate of 8.0 percent. In Kazakhstan, Kyrgyzstan, and Tajikistan, food prices either declined or increased only slightly in 2012, lowering inflation and allowing for looser monetary policy. Kyrgyzstan had the lowest inflation in the region at 2.8 percent due to a decline in food prices. Non-food inflation was much higher. Inflation in Kyrgyzstan is expected to rise to 8.6 percent in 2013.

Turkmenistan has the lowest projected inflation in the region through 2015, with subsidies and price controls on food, fuel, and transport keeping price increases low. However, recent price liberalization in Turkmenistan has increased inflationary pressure;



inflation should increase slightly from 4.9 percent in 2012 to 5.6 percent in 2013. Uzbekistan has the highest inflation in the region. Its central bank has been intervening in the foreign exchange market to depreciate the local currency, which increases inflationary pressures; the IMF has argued it should loosen its foreign exchange policy. Wages and pension increases have also contributed to inflation in Uzbekistan, as have higher bread, fuel, and utility prices, which the government subsidizes and raised the prices of in order to recover costs. Despite these pressures and the high rate, the government reported that inflation was within its target of 7 percent; the IMF, however, reports a rate of 12 percent, as depicted in the graph. Inflation in Uzbekistan is expected to hover around 11 percent per year through 2015.

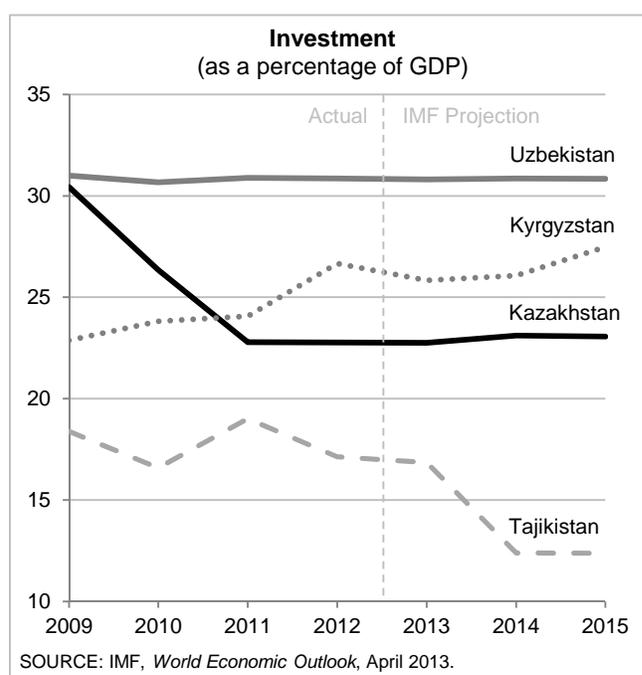
CPI Inflation, 2013 (IMF Projections)	East Asia 6.1%	Central Asia 8.0%	South Asia 8.1%
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## Investment

The net energy exporting countries continue to post strong investment rates. Uzbekistan has the highest investment as a percent of GDP at 30.9 percent. It is expected to hold steady at that rate through 2018. Uzbekistan has been working hard to improve its investment and business climate. Kazakhstan's investment rate dropped sharply in 2010 and 2011 and is projected to remain close to 23 percent through 2018.

Turkmenistan is not pictured in the graph because its investment data are not available in the *World Economic Outlook*. However, according to the Asian Development Bank (ADB) and Business Monitor International (BMI), its investment surged in 2012 with hydrocarbon and public sector investment. Because of Turkmenistan's poor business environment, BMI does not see foreign investment being made in any sector besides hydrocarbons despite a government-led investment drive.

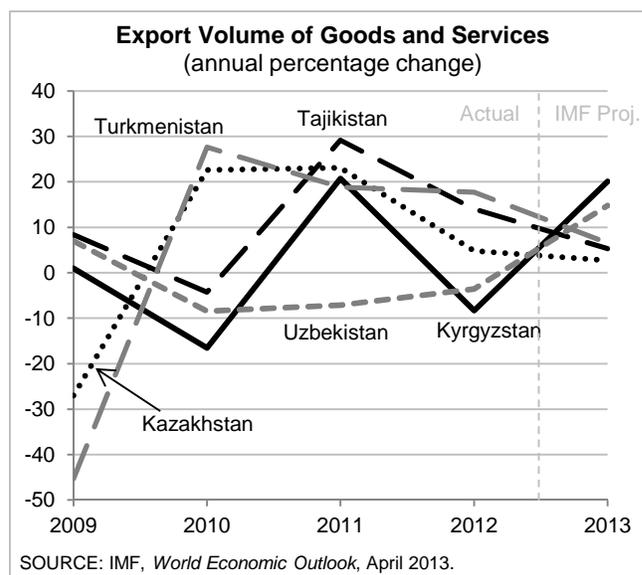
Kyrgyzstan saw investment grow in 2012 because of increases in private sector investment; government investment actually decreased. Kyrgyzstan's investment rate is projected to go down in 2013 and then grow moderately through 2018 as it follows a new investment and growth plan. BMI is very pessimistic on the investment plan because of Kyrgyzstan's poor business climate and political instability. It believes that most future foreign investment will be aid investment, especially from Russia or China as they seek to stabilize the region following the pullout of NATO forces from Afghanistan. Tajikistan has the lowest investment at 17.1 percent of GDP and it is expected to continue to decline until 2016. Tajikistan's public investment decreased in 2012 as it tried to cut expenditures, and its private investment remains low at below 5 percent of GDP due to an unfriendly business environment.



Investment, 2013 (as a percentage of GDP) (IMF Projections)	East Asia 31.0%	South Asia 28.8%	Central Asia 27.1%
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## Trade

Many Central Asian countries depend heavily on one or a few commodities for their export earnings, some of which did very well in 2012. Many countries also had high imports to support consumption and investment. Turkmenistan reported the largest increase in exports in 2012, due to high oil and gas prices and increasing production. However, rising exports were offset by rising imports, especially of equipment and services for the industrial and fuel sectors. Turkmenistan is expected to keep expanding its fuel sector. It is trying to diversify its economy, since its dependence on oil makes it vulnerable to changes in price, but its business environment may need to improve for this to be successful. BMI thinks Turkmenistan may be focusing its attention on Asia, including China, as an export market. It has shifted attention from the European-bound Trans-Caspian pipeline to the Asian-bound Trans-Afghanistan pipeline, which may indicate a reorientation toward Asian markets.



Tajikistan saw the second-highest export growth, especially in cotton, textiles, and mining, though consumption from high remittances led to an even larger rise in imports. Tajikistan was affected by a dispute with Uzbekistan, which cut off natural gas supplies, affecting Tajik aluminum and cement companies. Tajikistan's export growth in 2013 is projected to be lower than that of 2012. Its aluminum exports may decrease because of aging facilities and the continued natural gas dispute with Uzbekistan; cotton, another major export, may also grow slowly. The ADB identified four factors that will affect Tajikistan's growth in exports: the Russian economy, the trade and transportation situation in the region, the amount of rain affecting agriculture and hydropower generation, and political stability.

Kazakhstan's export growth declined in 2012 and should continue to decline until 2015 despite rising oil prices. It is projected to increase oil production in the coming years, including from the Kashagan oil field that should be operational in 2014. However, imports are also projected to grow quickly, and its dependence on oil and gas exports makes Kazakhstan vulnerable to commodity prices. Uzbekistan's exports are projected to increase in 2013 after contracting from 2010–2012, though ADB says it needs to diversify its export base and sell higher-value-added products. Uzbekistan is highly dependent on natural gas, which accounts for over 90 percent of its export earnings, and its trade surplus is projected to dwindle as imports rise. Kyrgyzstan also saw declining exports in 2012. It experienced a ten-day shutdown and labor issues at the Kumtor gold mine, which it strongly depends on for its exports. Fuel costs were high, which hurt Kyrgyzstan's balance of trade. Trade should grow in 2013 as gold exports recover and textile and agricultural exports increase.

The region is in a state of transition regarding trade agreements. Tajikistan joined the World Trade Organization (WTO) in March 2013 and agreed to improve its trade regime as a condition of accession. Turkmenistan has requested its deputy Prime Minister to begin looking into accession. However, BMI does not foresee Turkmenistan joining in the next decade

### WTO Status of Central Asian Countries

*Neither member nor observer:* Turkmenistan.

*Observer:* Kazakhstan and Uzbekistan.

*Member:* Kyrgyzstan and Tajikistan.

due to the possibility that President Berdymukhammedov may change his mind about entry; the extensive economic policy reforms that would be necessary before accession; and possible objections from existing members on human rights grounds. In the region, only Kyrgyzstan and Tajikistan are WTO members; Kazakhstan and Uzbekistan are observers and have begun negotiations. Kyrgyzstan is also likely to join the customs union with Russia, Belarus, and Kazakhstan by 2014. This would open the union up to Tajikistan as well, which plans to join but does not share a border with the current members; once Kyrgyzstan is in, this barrier would be removed. ADB predicts that accession would raise Kyrgyzstan's trade with other union members, although it may initially fall with non-union members. The World Bank's *Doing Business* report finds that it is difficult and costly to trade across borders for all countries in the region, as further discussed in the next section.

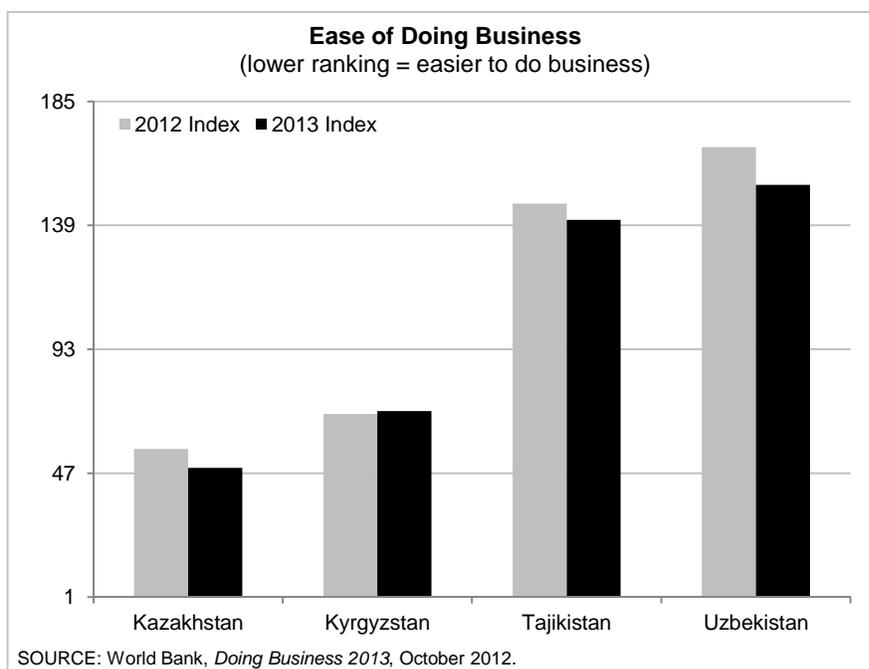
## Business Environment

Improving the business environment is a critical challenge for Central Asian countries. According to the World Bank's *Doing Business* rankings of 185 countries and territories, Kazakhstan has the best business environment in the region with a strong rank of 49th in the world, while the two lowest ranked countries in the region (Tajikistan and Uzbekistan) both improved their scores for the 2013 index.

The World Bank does not include Turkmenistan in its *Ease of Doing Business* rankings. BMI considers Turkmenistan's business environment unfriendly, with high levels of state ownership and control. As a

result, most of its investment comes from the government rather than from the private sector. Despite challenges in their business environments, Uzbekistan and probably Turkmenistan are able to post high levels of investment and strong forecast GDP growth due to money coming in from fuel exports. However, to diversify their economies and encourage private sector growth in other industries, both countries will need to address their business climates. Kyrgyzstan has a decent business climate for the region, but it is still sufficiently difficult for businesses that BMI doubts its ability to attract its desired level of foreign investment. As other countries continue to make reforms, those that maintain their policies are likely to slide in the ranks, and Kyrgyzstan fell from 69th to 70th.

The region has been improving on several measures of its business environment. Uzbekistan greatly improved its rank from the 2012 to the 2013 index, going from 168th to 154th with reforms in opening a business, getting credit, trading across borders, and resolving insolvency. Kazakhstan and Tajikistan have also made progress, with Tajikistan showing improvement in protecting its investors and Kazakhstan improving the ease of getting credit and starting a new business. Both Uzbekistan and Kazakhstan were among the top ten most improved countries in the 2013 index.



Despite generally low scores, the region does have a strong environment in some measures. In enforcing contracts, for instance, all four countries included in the rankings are well above the median rank of 93rd. The region performs worst in the sub-category of trade, where all four countries that are measured are near the bottom, and Uzbekistan is the lowest-ranked country in the world at 185th. The other three countries in the ranking all worsened their ranks for trading across borders from the 2012 to the 2013 index. All of the countries in Central Asia are landlocked, which contributes to the cost of trade.

#### Additional Information

For questions or more information, please contact the author, Katherine Shanahan, at [kshanahan@devtechsys.com](mailto:kshanahan@devtechsys.com).

For country-specific data and additional information about the countries covered in this report, please visit the ESDB Country Portal at [http://esdb.eads.usaidallnet.gov/query/do?\\_program=/eads/esdb/countryPortal](http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal).

Sources used in compiling this report include the semi-annual *World Economic Outlook* from the International Monetary Fund (<http://www.imf.org/>), the *Global Economic Prospects* and *Doing Business* from the World Bank (<http://www.worldbank.org/>), the annual *Asian Development Outlook* from the Asian Development Bank (<http://www.adb.org/>), and Business Monitor International Business Forecast Reports (<http://www.businessmonitor.com/>).