

Regional Economic Outlook: Middle East and Central Asia Executive Summary for the Caucasus and Central Asia Region

Growth in the Caucasus and Central Asia (CCA) region exceeded expectations in 2017, but momentum is set to fade, according to the IMF's latest *Regional Economic Outlook* (REO). The report highlights the importance of raising medium-term growth in the CCA region, outlining how growth-friendly fiscal policies, increased private activity, and improved resilience to global shocks are essential to delivering this goal.

Strong external conditions were among the factors that led to 4.1 percent growth in the CCA region in 2017—a marked improvement over 2.5 percent growth in 2016. Higher oil prices, coupled with strong public investment in Azerbaijan and increased demand for metals and agricultural products for Kazakhstan, boosted oil-exporting countries in the region. Oil importers, which grew at an even stronger rate of 5.9 percent last year, were helped by rising remittances, strong external demand, and some country-specific factors.

However, growth is expected to drop back to 4 percent in 2018 and 2019. Over the medium term, that rate is expected to stabilize at around 4.2 percent, less than half of the average growth rate experienced in the early 2000s. At this pace, it will take the region nearly two decades to reach the per capita income levels of emerging Europe. Additionally, there is growing concern about rising risks, particularly as the global environment becomes less favorable. The indirect impact of escalating global trade tensions could be significant through their negative effect on commodity prices and the growth prospects of key CCA trading partners. An unexpected tightening of global financial conditions is also a concern as it could lead to capital flow reversals, sharp movements of exchange rates, and higher domestic interest rates. Finally, reform complacency threatens the outlook, as the temporary boost from commodity prices may lead some countries to defer still-needed structural reforms.

Given this environment, the REO makes the case for CCA countries to accelerate reform efforts to strengthen the role of the private sector in their economies. Countries should enhance their institutional frameworks and look for more opportunities for regional integration.

Further fiscal consolidation is also needed in order to rebuild buffers, and the banking system should be strengthened by improving governance and enforcing regulatory compliance. Both of these policy priorities are essential to enhancing resilience to external shocks and addressing risks from weak financial sectors, high public debt, and external vulnerabilities.

In its analytical chapters, the REO considers measures needed to achieve growth-friendly fiscal consolidation with limited space and foster a dynamic job-creating private sector. The report finds that by rebalancing the composition of fiscal adjustment and moving to a more progressive tax structure, countries can better ensure their policies are equitable and growth friendly. At the same time the report contends that increasing access to finance, investing in education and

infrastructure, and improving government effectiveness can help boost the region's potential to foster and attract private investment—and thereby increase private-sector-led growth.