

CCA Region Highlights

Economic activity in the Caucasus and Central Asia (CCA) region is weakening, mainly because of the near-term slowdown and rising regional tensions affecting Russia, a key trading partner and source of remittance and investment inflows, as well as weaker domestic demand in a number of CCA countries. Near-term risks are to the downside and tied to the fortunes of large trading partners. Policies need to focus on bolstering economic stability and, where needed, short-term support to ailing economic growth. In addition, a new model for high, sustained, diversified, and inclusive growth is needed to set the direction for economic policies for the next decade.

Headwinds from Russia

Weakening domestic demand and spillovers from the slowdown in Russia are dampening economic growth in the CCA to about 5½ percent in 2014–15, ¾ of a percentage point lower than projected in the May 2014 *Regional Economic Outlook* Update. Despite weaker growth and declining food prices, inflation is set to rise to about 6½ percent in 2014–15, reflecting the pass-through from recent exchange rate depreciation, particularly in Kazakhstan.

Risks are to the downside. A further deepening of geopolitical tensions between Russia and Ukraine could have a significant impact on the CCA region, over both the near and medium term. A protracted period of slower growth in other trading partners, particularly Europe or China, would also affect external demand. Domestic risks stem from delays or reversals in growth-enhancing structural reforms, especially in the areas of governance and competition.

Reforms Need to Support Stability and Growth

Fiscal balances across the region are deteriorating. Shrinking budget surpluses and rising breakeven oil prices expose the CCA oil exporters to greater fiscal risks and call for gradually strengthening fiscal positions by containing expenditure growth and improving tax collection. A pause in fiscal consolidation is justifiable in countries with less favorable near-term growth prospects, particularly among the region's oil importers, though fiscal consolidation needs to resume, once cyclical conditions allow to rebuild buffers against future shocks.

Renewed inflation pressures call for cautionary monetary policy. Monetary tightening may be needed if inflation pressures persist, particularly in Kazakhstan. Many countries need to strengthen monetary policy frameworks by moving away from targeting the exchange rate and creating new and credible anchors. To enhance the effectiveness of monetary policy, countries need to strengthen the transmission mechanism by improving banks' loan quality and discouraging dollarization and directed lending.

CCA countries need to improve their growth model. While growth has been strong over the past two decades, it has remained volatile and dependent on commodities, and poverty and unemployment continue to be major concerns. Moreover, medium-term growth prospects have been weakening faster than in other regions of the world. Comprehensive reforms of governance, regulatory quality, and the rule of law are needed to create an environment conducive to sustained and equitable increases in productivity, jobs, and growth. Important priorities include further diversification of commodity-based economies, improving access to finance, strengthening the business climate, and pursuing balanced regional and multilateral trade integration.

CCA Region: Selected Economic Indicators, 2000–17*(Percent of GDP, unless otherwise indicated)*

	Average 2000–10	2011	2012	2013	Projections			
					2014	2015	2016	2017
CCA								
Real GDP (annual growth)	9.1	6.7	5.6	6.6	5.5	5.6	5.3	5.5
Current Account Balance	0.8	7.3	3.2	1.9	1.6	0.7	0.7	1.0
Overall Fiscal Balance	2.2	6.7	4.7	2.8	1.6	1.0	1.2	1.0
Inflation, p.a. (annual growth)	9.8	9.0	5.3	6.0	6.4	6.4	6.4	6.4
CCA Oil Exporters								
Real GDP (annual growth)	9.5	6.7	5.6	6.8	5.6	5.7	5.4	5.5
Current Account Balance	2.1	9.3	4.7	2.8	2.7	1.6	1.4	1.7
Overall Fiscal Balance	2.9	7.9	5.5	3.4	2.1	1.4	1.6	1.3
Inflation, p.a. (annual growth)	10.0	8.8	5.7	6.3	6.5	6.5	6.5	6.5
CCA Oil Importers								
Real GDP (annual growth)	6.6	6.4	5.4	5.6	4.6	4.9	4.9	5.0
Current Account Balance	-8.2	-10.4	-10.3	-7.0	-8.4	-8.1	-7.3	-6.4
Overall Fiscal Balance	-3.5	-3.3	-2.3	-2.3	-2.7	-2.4	-2.3	-2.3
Inflation, p.a. (annual growth)	8.0	10.7	2.1	3.6	5.0	6.2	5.7	5.2

Sources: National authorities; and IMF staff calculations and projections.
 CCA oil exporters: Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan.
 CCA oil importers: Armenia, Georgia, the Kyrgyz Republic, and Tajikistan.