Deutsche Bank
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Current Issues
Emerging markets

CIS frontier countries
Economic and political prospects

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Robust growth, especially in Central Asia. Frontier CIS economies have grown at a robust rate of 8% yoy on average since the turn of the century. Growth prospects for 2013-14 remain fairly positive at around 5% p.a., with stronger growth expected in the Central Asian CIS economies.

Mixed macroeconomic fundamentals. Fiscal accounts are solid in many CIS frontier countries, and the oil exporters also enjoy a comfortable external asset position. However, some energy importers still post large current account deficits despite some recent improvements. Dependency on remittances remains high.

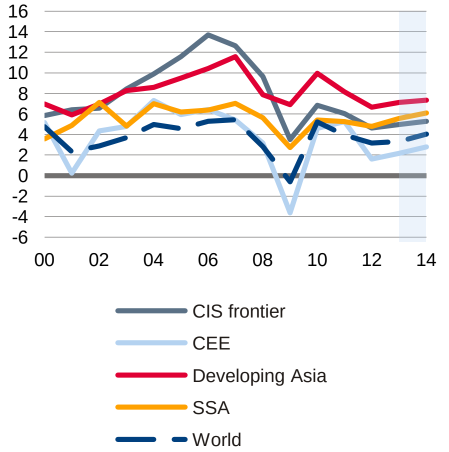
Less trade with Russia, more trade with China. Trade links with Russia have diminished significantly, although they remain substantial. China and emerging Asia are becoming increasingly important trade partners for the region.

Improving business and regulatory environment, but still a long way to go. Some of the countries have been implementing structural reforms, but much needs to be done to strengthen institutional and policy frameworks, develop financial markets, diversify away from commodities and improve the business climate and governance more generally.

Source: DB Research

CIS frontier countries

Real GDP growth 1



Sources: IMF, DB Research

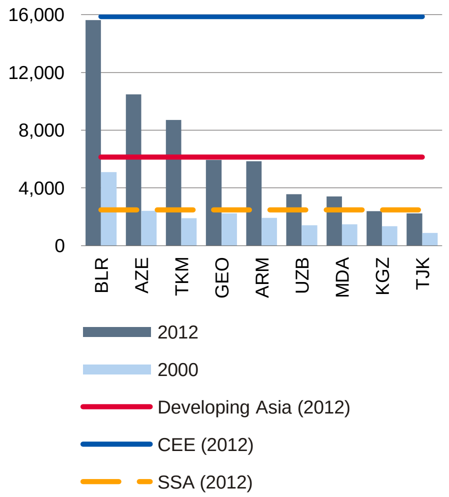
The breakup of the Soviet Union resulted in the creation in 1991 of the Commonwealth of Independent States (CIS) aimed at maintaining and developing relations among the former member states. Despite sharing a common political and economic past, these countries are quite heterogeneous and their success in implementing market reforms and embracing a global competitive environment has been mixed. This report sheds some light on the recent economic and political developments in a subset of the post-Soviet economies, including Armenia, Azerbaijan, Belarus, Georgia, Moldova, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, henceforth referred to as "frontier CIS[1]" countries.

The report is structured as follows: we first review key developments in the frontier CIS countries as a whole, with a focus on GDP growth, inflation, trade and external accounts, the business climate and social issues. The second part of the report is devoted to individual analyses for each of the 9 frontier CIS countries.

Robust growth track record

Frontier CIS economies have grown at a robust rate of 8% yoy on average since the turn of the century, even outpacing developing Asia in 2003-08 (see chart 1). Turkmenistan and Azerbaijan were among the five fastest-growing economies in the world between 2000 and 2012, averaging 13.6% and 11.9% p.a. respectively. Despite lower growth rates since the global financial crisis, we expect medium-term growth of around 5% p.a. for the CIS frontier countries.

Per capita GDP: Low but increasing 2



Sources: IMF, DB Research

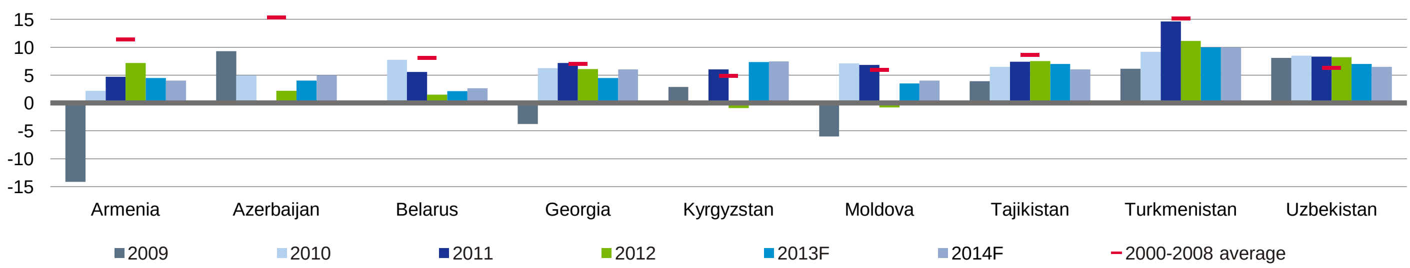
Increasing per capita income

Per capita GDP has increased significantly in all CIS frontier countries over the past years (see chart 2). Again, Azerbaijan and Turkmenistan stand out: income per head in these countries has more than quadrupled since 2000 (in PPP-adjusted terms). Income levels differ widely: while Belarus has an income level similar to Central and Eastern European countries (at PPP), that in Kyrgyzstan and Tajikistan is below Sub-Saharan Africa's.

Positive growth outlook for 2013-14 …

If, as DB expects, global growth accelerates in H2 2013 and in 2014, GDP growth in CIS frontier economies will be fairly robust for most countries (chart 3). However, as in most other regions in the world, growth will remain below pre-global crisis levels.

Growth below pre-crisis levels 3



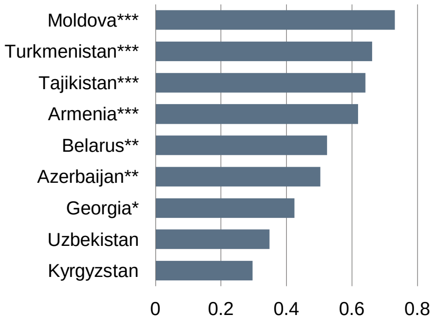
Sources: IMF, DB Research

[1] The proper name would be "frontier CIS plus Georgia", since Georgia left the CIS in August 2009 following the Five-Day War with Russia. For brevity considerations we will call the grouping just "frontier CIS".

CIS frontier countries

Growth highly correlated with Russia's 4

Real GDP growth correlation coefficient, 1995-2012



Note: Significance levels: ***- 1%, **- 5%, *-10%

Sources: IMF, DB Research

Turkmenistan and Kyrgyzstan are expected to outperform their peers by growing above 7% p.a. over the next two years. At the other end of the spectrum, Belarus will only grow by 2-3%.

... although slowdown in Russia poses risk

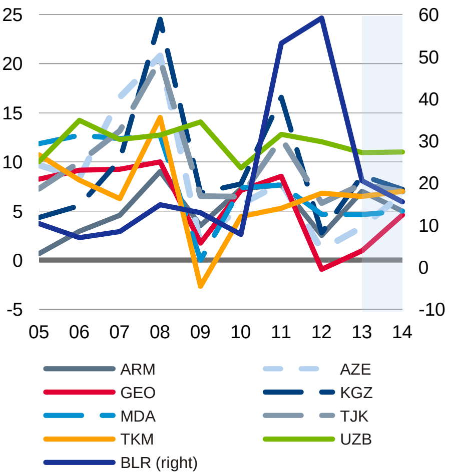
Growth in Russia has historically had a large impact on the rest of the CIS countries, primarily via remittances, FDI and exports (more on this below). Thus, the current slowdown in the Russian economy poses downside risks for growth in the frontier CIS markets. Chart 4 shows the historical correlation of growth between CIS economies and Russia. The strongest co-movement is in Moldova and the weakest in Kyrgyzstan.

Large impact of food prices on inflation

Inflationary pressures subsided considerably in 2012 (chart 5), with prices actually falling in Georgia and Azerbaijan towards the end of the year. Moderating inflation was mostly driven by the decline in global food prices. Food constitutes a large share of consumer baskets in the region (from 31% in Georgia to 60% in Tajikistan). In 2013-14 inflation is expected to remain in the single digits (except in Uzbekistan). Belarus is a special case, since the country went through a depreciation-inflation spiral, with inflation peaking at 109.7% in January 2012, although it has been on a declining path since then (see page 9 for more details).

CPI inflation 5

% yoy (aop)



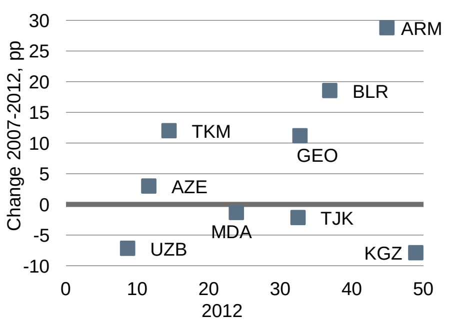
Sources: IMF, DB Research

No major concerns on the fiscal front

Due to their significant oil and gas revenues, Azerbaijan, Turkmenistan and Uzbekistan exhibit fiscal surpluses – although these are likely to decline over the medium term, according to the IMF. The rest of the frontier CIS countries have fiscal deficits, but, with the exception of Kyrgyzstan, they are below 5% of GDP (chart 7). With regard to public debt, it ranges from only 9% of GDP in Uzbekistan to 49% in Kyrgyzstan (chart 6). The global financial crisis forced some countries to step up public borrowing in order to support the economy. The largest increase in public debt was in Armenia, at 30 pp in 2007-2012. Public debt in Kyrgyzstan and Uzbekistan actually dropped by 7-8 percentage points over the same period, driven by debt write-offs and net external debt repayments, respectively.

Public debt build-up following the crisis 6

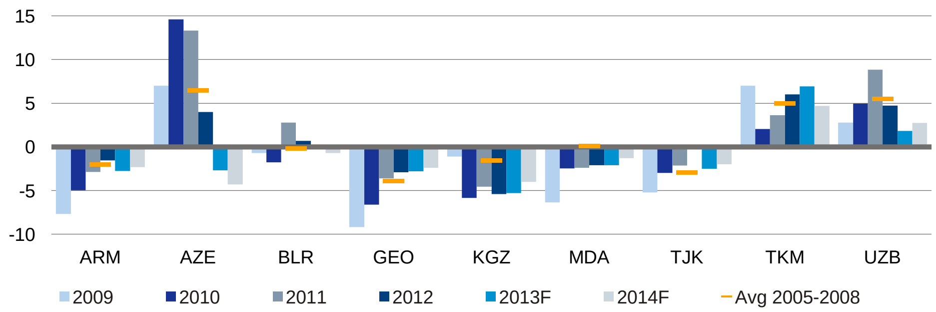
% of GDP



Sources: IMF, DB Research

Fiscal balance 7

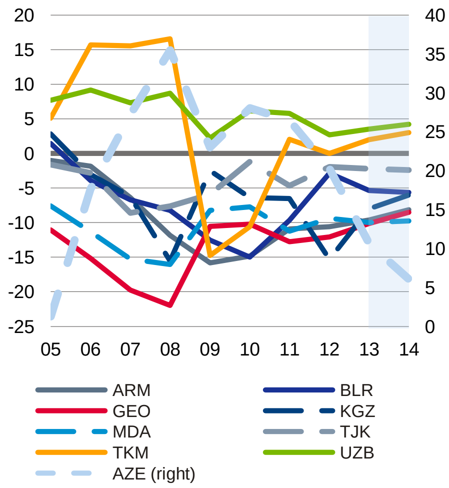
% of GDP



Sources: IMF, DB Research

Current account balance 8

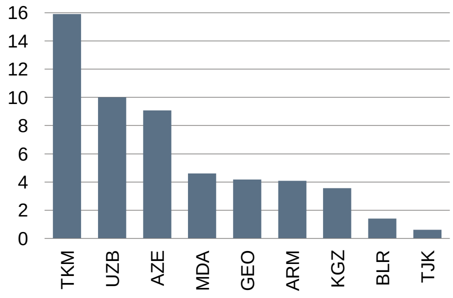
% of GDP



Sources: IMF, DB Research

Foreign exchange liquidity 9

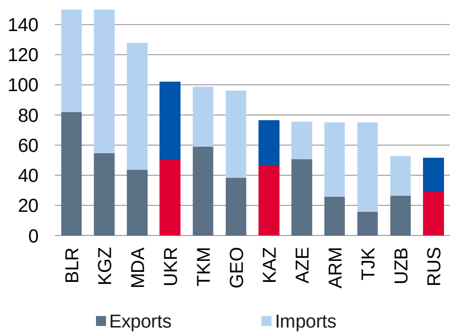
Import coverage of FX reserves, months (2013e)



Sources: IMF, EIU, DB Research

Trade openness 10

Goods and services, % of GDP (2012)



Sources: IMF, EIU, DB Research

External balances depend on oil trade position

Similarly to their fiscal position, hydrocarbon exporters Azerbaijan, Turkmenistan and Uzbekistan record current account (CA) surpluses, while oil importers exhibit deficits. CA deficits in Georgia, Moldova and Armenia have narrowed from their peaks of 22%, 15.8% and 14.8%, respectively, but they are expected to remain close to 10% for the foreseeable future (chart 8). FX liquidity positions – as measured by import coverage of official FX reserves – are weakest in Belarus and Tajikistan, at below the “safe” level of 3 months of imports (chart 9).

Strong trade links with Russia and the euro area

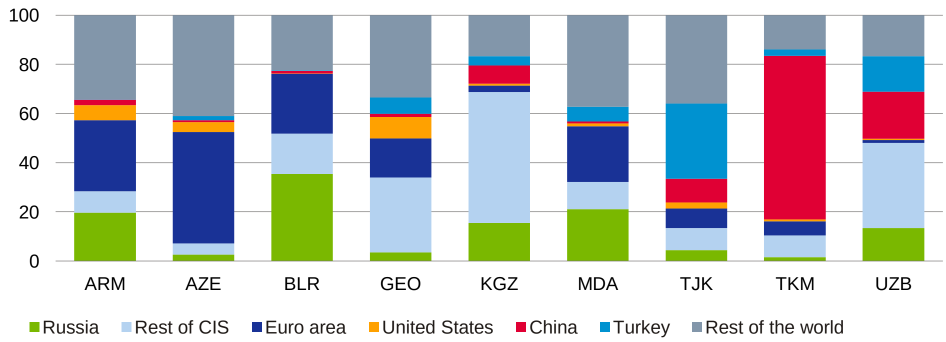
Frontier CIS countries differ largely in terms of trade openness; while trade in Belarus and Kyrgyzstan accounts for over 150% of GDP, it stands at just around 53% in Uzbekistan (see chart 10). The main export destinations are the CIS countries (including Russia, Ukraine and Kazakhstan) and the euro area. Russia remains among the largest export market for most of the CIS frontier economies (see chart 11), although its share has diminished over the last decade (except for Armenia and Kyrgyzstan). Georgia’s exports to Russia have declined sharply since 2007 as a result of a ban by Russia on imports of Georgian wine and mineral water. The ban has recently been lifted, which should give a boost to Georgian exports over time. The euro area is the main export destination for Azerbaijan, driven by hydrocarbon exports.

The Silk Road, revisited

China and developing Asia are becoming increasingly important trade partners, particularly for frontier CIS economies in Central Asia (charts 11 and 12). The trade dynamics of Turkmenistan with China have changed radically since late 2009 when the new gas pipeline connecting the two countries became operational. In 2010 alone exports to China increased by a factor of 27 and stood at 67% of total Turkmen exports in 2012, from below 1% in 2005. Meanwhile, Turkmenistan’s imports from China increased from 5% of the total in 2005 to 20% in 2012. Projects in the transportation and energy sectors supported by the Central Asia Regional Economic Cooperation (CAREC) Program will give additional impetus to the development of trade relations with China.

CIS export partners' structure 11

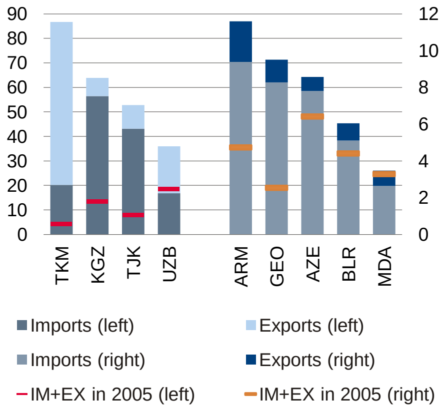
% of total



Sources: IMF DOTS, DB Research

Increasing role of China in trade flows 12

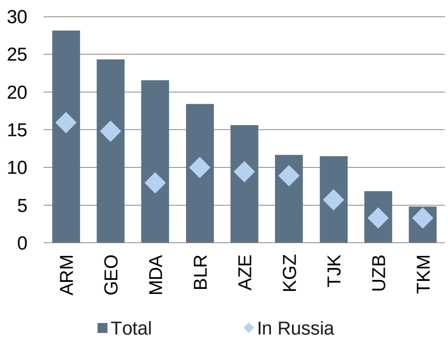
% of total imports & exports (2012)



Sources: IMF DOTS, DB Research

Diaspora 13

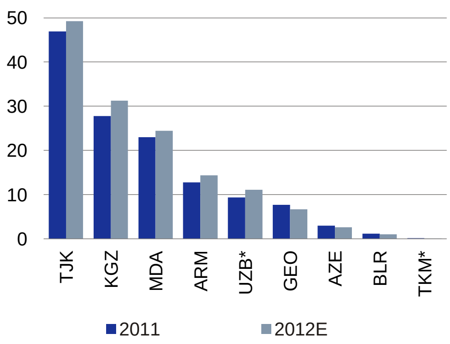
% of total population, 2010



Sources: WB, IMF, DB Research

Remittance inflows play a major role 14

% of GDP



* Remittance inflows from Russia via MTOs

Sources: WB, CBR, DB Research

High dependence on remittance inflows

Most of the frontier CIS economies receive sizeable remittances from abroad, a consequence of a large diaspora who are primarily resident in Russia (chart 13). As much as 28% of Armenia's population are emigrants, according to WB statistics, and Russia is host to over half of them.

According to the World Bank, 3 CIS frontier markets were among the top-5 remittance receivers in the world in 2011: Tajikistan at 46.9% of GDP, Kyrgyzstan, 29.1% and Moldova, 23% (chart 14). Notably, remittance inflows remained relatively resilient throughout the crisis and quickly recovered to pre-crisis levels (as percentage of GDP). Remittances are not only an important source of foreign exchange, but they also help to alleviate poverty (more on poverty trends below).

Underdeveloped financial markets

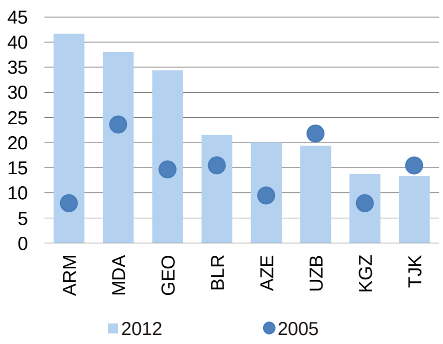
Over the past two decades the CIS frontier economies made uneven progress in developing their financial systems and advancing financial integration with the rest of the world. Financial depth in Armenia, Moldova and Georgia is relatively high at 35-40% of GDP (chart 15) and has increased significantly over the past few years. In the rest of the frontier CIS countries, credit as percent of GDP is very low at 20% of GDP and below.

Development of capital markets is even lower (chart 16). While all countries except Tajikistan and Turkmenistan have established stock exchanges, these have low capitalisation and liquidity. The "least shallow" stock market is in Uzbekistan with a capitalisation of 5.4% of GDP (by comparison, Kazakhstan: 7% and Russia: 39%).

The corporate bond market is relatively active in Belarus, with outstanding bonds at 11.2% of GDP at end-2012, compared with only 0.5% at end-2007[2] . Overall, further strengthening of the institutional and regulatory framework is a precondition for the development of deeper financial markets in the region[3].

Credit to the private sector 15

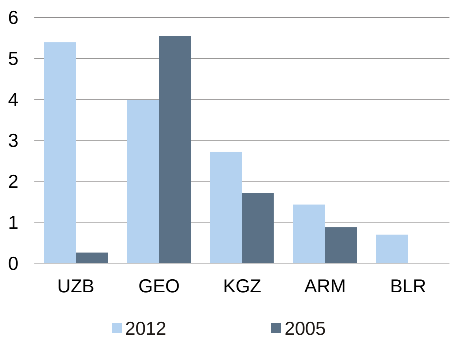
% of GDP



Sources: IMF IFS, DB Research

Stock market capitalisation 16

% of GDP



Sources: FEAS, WB, UZSE, KSE

[2] Calculated based on data from Cbonds.
[3] OECD "Capital markets in Eurasia: Two decades of reform" (2012, expanded 2nd draft) provides a detailed overview of capital markets development in CIS.

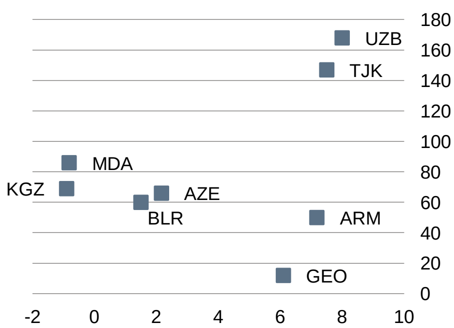
Ease of Doing Business (DB) ranking 17

Economy	DB 2013	DB 2012
Georgia	9	12
Armenia	32	50
Kazakhstan	49	56
Belarus	58	60
Azerbaijan	67	66
Kyrgyz Republic	70	69
Moldova	83	86
Russian Federation	112	118
Ukraine	137	152
Tajikistan	141	147
Uzbekistan	154	168

Sources: WB, DB Research

Doing Business ranking vs GDP growth 18

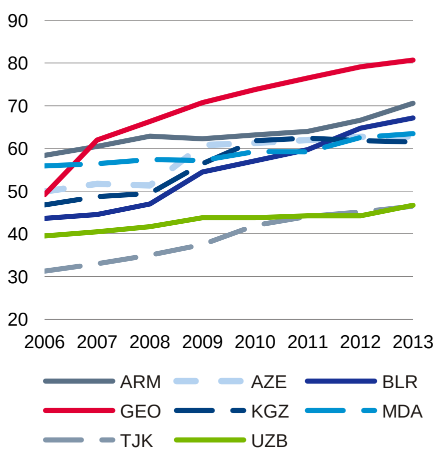
X axis: Real GDP growth, % yoy, 2012
Y axis: DB 2012 ranking



Sources: WB, DB Research

Narrowing the gap 19

Distance to frontier, percentage points



The scale: 0 lowest performance to 100 the frontier, derived as highest score achieved on each of the indicators

Sources: WB, DB Research

Business environment has improved

Several of the CIS frontier countries have implemented regulatory reforms to improve the domestic business environment, as indicated by the World Bank Doing Business (DB) ranking[4] (chart 17). Apart from Azerbaijan and Kyrgyzstan, every country improved its score compared with last year.

There is a cluster of academic studies assessing the impact of better Doing Business indicators on promoting growth and FDI inflows in a country, but the results are not robust to changes in specification and country samples[5]. Chart 18 shows GDP growth vs. the Doing Business ranking for 2012.

Uzbekistan was among the top-10 countries in terms of improvement in the 2013 DB ranking, due to reforms in three or more areas. The country jumped 14 positions to (a still low) 154th among 185 countries, due to simplified procedures to start a new business, improved access to credit, faster and less bureaucratic export procedures and better regulations in resolving insolvency. The top performer in the DB 2013 index was Georgia, in 9th place, having implemented changes in 6 out of 10 areas covered by the index during last year.

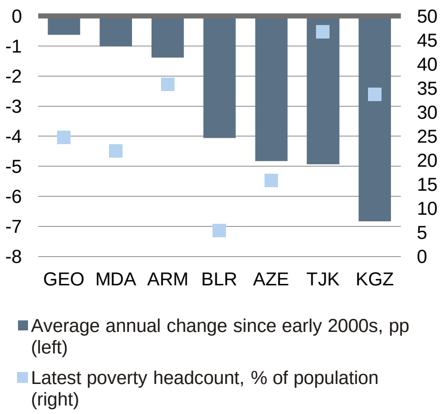
Given that the DB index is a relative ranking, we look at a measure of distance to the “frontier” or best practice, i.e. the highest score achieved on each of the Doing Business categories[6]. Chart 19 shows that all countries have narrowed the gap vis-à-vis the global best practice in recent years. Georgia is far ahead in creating a favourable business environment, while Tajikistan and Uzbekistan still have a long way to go.

Considerable progress in overcoming poverty albeit from a very high base

Continued growth in the region helped to reduce poverty during the last decade (see chart 20). The comparison is rather arbitrary as the reference years as well as the nationally-defined poverty lines are different. According to the World Bank, poverty[7] has decreased fastest in Kyrgyzstan, Tajikistan and Azerbaijan. However, despite the improved picture, almost half of the population in Tajikistan continues living below the poverty line, as does one-third of the population in Armenia and Kyrgyzstan and one-quarter of the population in Georgia and Moldova. These are high rates both in absolute terms and compared with the rest of the world. As regards income distribution, most countries are more equal than Russia, and inequality has declined (except in Kyrgyzstan) (see chart 21).

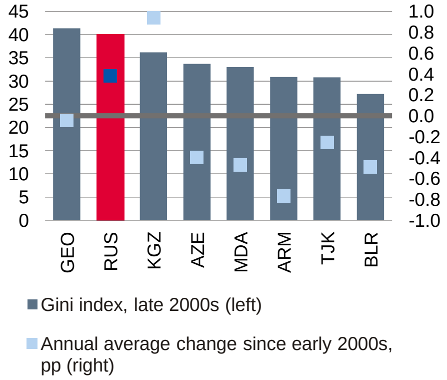
4 The World Bank Doing Business ranking gives a quantitative assessment of regulations on starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency.
5 See e.g. Djankov, McLiesh, Ramalho (2006), Jayasuriya (2011), Corcoran, Gillanders (2012), Haidar (2012).
6 Includes 9 out of the 10 Doing Business categories. The final score is the simple average of the country’s percentile ranking across categories .
7 Defined as poverty headcount at national poverty line as a percentage of total population.

Poverty headcount 20



Sources: WB, DB Research

Income inequality 21



Note: 0 = perfect equality, 100 = perfect inequality

Sources: WB, DB Research

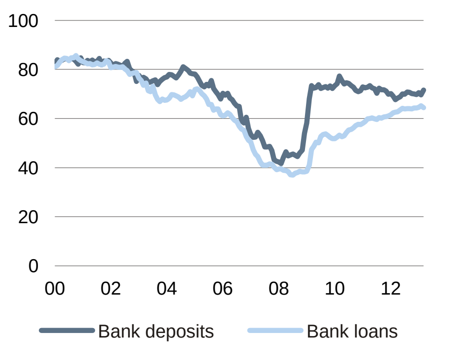
Armenia

S&P: Not rated (NR), Moody's: Ba2 (neg), Fitch: BB- (stab)[8]

Moderate growth prospects

ARM: High level of dollarisation 22

Foreign-currency denominated as a % of total



Sources: CBA, DB Research

The economy surprised on the upside in 2012, growing by 7.2% yoy in real terms. This strong performance was underpinned by 9.3% growth in agriculture supported by favourable weather conditions as well as solid growth in services and industry. The construction sector stabilised, after going through a boom-and-bust cycle (it was a leading cause of the 14% decline in real GDP in 2009). Medium-term growth potential is around 4-5%, below the double-digit growth prior to the crisis. On the demand side, growth is supported by private consumption on the back of remittance inflows. Remittances accounted for as much as 13% of GDP in 2012, originating primarily in Russia and the US.

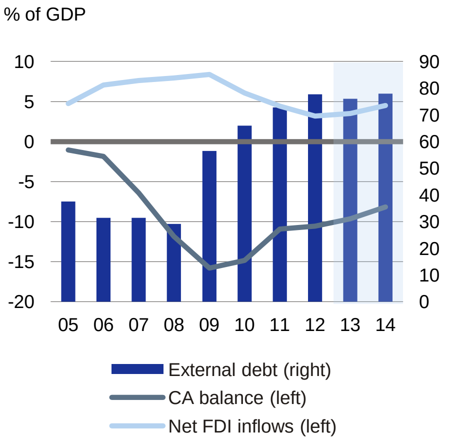
Inflation moderated to 2.6% in 2012, but is expected to increase on the back of a rise in imported Russian gas prices as well as higher food prices due to bad weather. The key refinancing rate has been unchanged at 8% since the last 50bp cut in September 2011. The effectiveness of monetary policy, however, is constrained by the high dollarisation of the economy: 72% of deposits and 64% of loans are denominated in foreign currency (data as of March 2013). Dollarisation had declined significantly in the years before the global crisis, but it has recently picked up again (see chart 22).

Fiscal consolidation set to continue

The fiscal deficit declined to 1.5% of GDP in 2012 from a peak of 7.7% in 2009 and is expected to increase to 2.6% in 2013. The crisis led to a tripling of the public debt-to-GDP ratio (to 45% in 2012 compared with 16% in 2007). Fortunately, most of the debt is on concessional terms, easing the refinancing burden; debt redemptions are expected to peak this year.

[8] Indicates long-term foreign currency sovereign credit ratings by the leading rating agencies and the respective outlook (negative, positive, stable). NR indicates that the country is not rated.

ARM: Current account gap to remain large 23



Sources: IMF, DB Research

Vulnerable external position

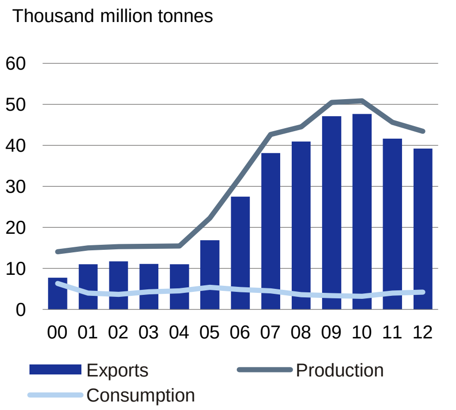
Armenia has a large current account (CA) deficit of around 10% of GDP, due to a structurally large trade deficit. Only around half of the CA deficit is financed by FDI inflows (see chart 23), rendering the economy vulnerable to external shocks. External debt has increased sharply in recent years, to 78% in 2012 from 32% in 2007. Armenia's export base is not well diversified, with precious and semi-precious stones and metals as well as base metals and minerals being the main export items. Russia, Germany, Belgium, Bulgaria and Iran were the top 5 export destinations in 2012, accounting for 55% of total exports.

Geopolitical risks are here to stay

Armenia's borders with two of its four neighbours, Azerbaijan and Turkey, remain closed. Negotiations with the former regarding the status of the breakaway Republic of Nagorno-Karabakh, mediated by France, US and Russia (who co-chair the OSCE Minsk Group), have not delivered any tangible results so far. Negotiations with Turkey towards opening the borders, which would boost trade and decrease transportation costs, also came to a halt in 2010.

Despite protests following the re-election of President Serge Sargsyan in February 2013, the incumbent and his Republican Party are expected to remain in power over the medium term given the fragmented opposition and lack of a viable agenda.

AZE: Oil production below its peak 24



Sources: BP, DB Research

Azerbaijan

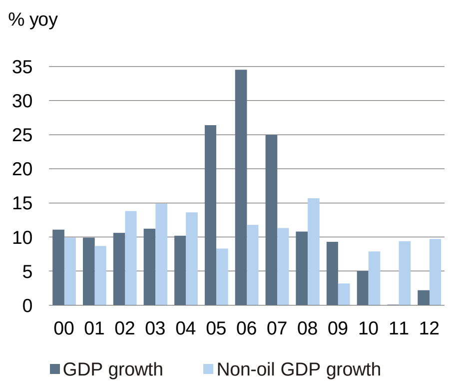
S&P: BBB- (stab), Moody's: Baa3 (stab), Fitch: BBB- (stab)

Oil-fuelled boom over past few years

Real GDP grew by almost 14% a year in the first decade of this century, fuelled by an oil boom. The country has an oil endowment of 7 bn barrels, which is the third largest among the CIS countries (after Russia and Kazakhstan). However, due to maintenance works on its main fields, oil output contracted by over 10% in 2011 and 5% in 2012 (see chart 24), dragging down overall GDP growth to only 2.2% in 2012. On the other hand, non-oil growth, driven by government spending, has recovered strongly from the 2009 slump (see chart 25). Still, the economy remains highly dependent on the hydrocarbons sector, which accounts for over 50% of GDP and over 90% of exports. For 2013-14, GDP growth is expected at around 4-5% p.a.

Inflation has been very volatile; it was only 1% on average last year but is expected to exceed the 5-6% Central Bank target for this year.

AZE: Non-oil sector supports growth 25

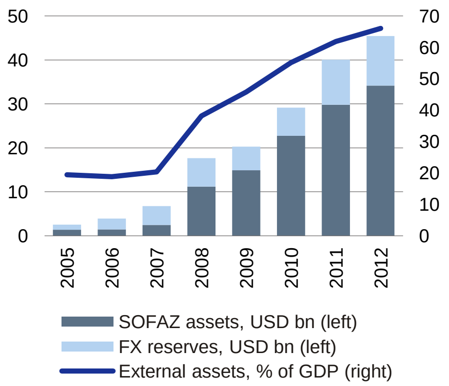


Sources: CEIC, DB Research

Need for more prudent fiscal policy

The state oil fund (SOFAZ) is an increasingly important source of financing for the government budget. The transfers from the fund amounted to 60% of total government expenditure in 2012 and are expected to rise further. The large non-oil primary deficit (45% of non-oil GDP in 2012) gives cause for concern. The overall budget is expected to be in deficit this year and next. Nevertheless, public debt levels should remain low at below 15%.

AZE: Large external assets 26



Sources: SOFAZ, IMF IFS, DB Research

Strong external position

Thanks to large trade surpluses, the current account surplus was a massive 22.4% of GDP on average in 2005 -2012, the largest by far among frontier CIS countries. The CA is expected to remain in surplus, albeit at lower levels. Large revenues from oil and gas exports have helped to build up a very comfortable external liquidity position. Adding together official FX reserves and SOFAZ assets, Azerbaijan's external assets amount to 65% of GDP (see chart 26). By comparison, public and publicly guaranteed external debt levels are only around 10% (no data are available on total external debt).

Presidential elections ahead

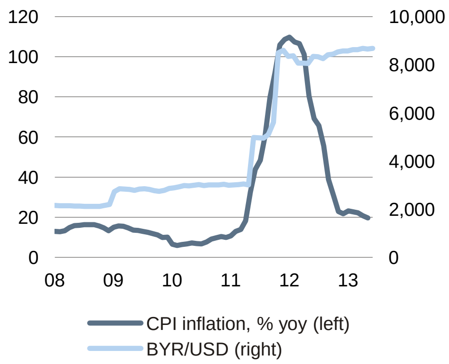
President Ilham Aliyev has been in power since 2003, when he succeeded his father, and is expected to be re-elected for a third term in October 2013. Presidential term limits were abolished in a referendum in 2009. Over the past months there have been protests against, for example, social inequality and poor conditions for soldiers in the army, but the government is expected to retain a firm grip on power. According to the World Bank governance indicators, Azerbaijan needs to address deficiencies in voice and accountability as well as corruption.

Belarus

S&P: B- (pos), Moody's: B3 (neg), Fitch: NR

Growth to remain fragile

BLR: Inflation-devaluation spiral 27



Sources: Global Insight, IMF IFS, DB Research

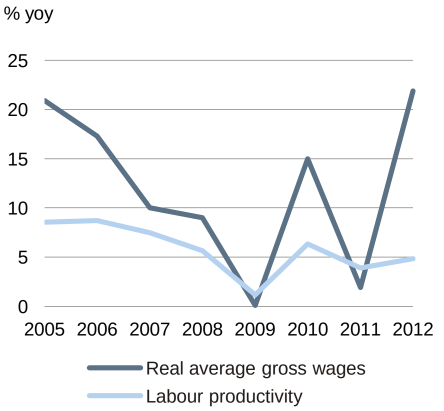
After years of strong growth (8% on average in 2000-08) on the back of cheap energy from Russia, foreign borrowing and expansionary domestic policies, Belarus suffered a macroeconomic crisis in 2011. In the run-up to presidential elections in December 2010 loose fiscal and monetary policies increased external imbalances, rendered the pegged exchange rate unsustainable and led to a depletion of FX reserves. The authorities were eventually forced to devalue the Belarusian ruble, first by 50% in May 2011 and then by another 50% in October 2011 (see chart 27). CPI inflation subsequently shot up, reaching a peak of almost 110% yoy in January 2012 (see chart 28). All this led to a sharp slowdown in economic growth. GDP growth is expected to be at 2-3% p.a. in 2013-14.

Financial support from Russia has been crucial

Financial assistance to Belarus from the EU and the US was curtailed due to concerns about a crackdown on the opposition. Moreover, negotiations with the IMF towards a programme stalled due to disagreement on the conditions. Russia remained thus the chief source of financial support for Belarus. Crucial deals involved the selling of the remaining 50% of Belarusian gas pipeline Beltransgaz to Gazprom for USD 2.5 bn as well as a USD 3 bn stabilisation loan from the Eurasian Economic Community.

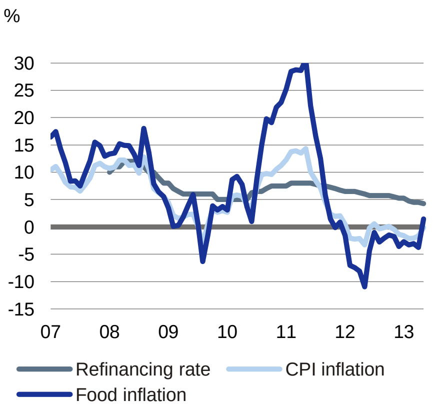
Improvement in policies but some slippage recently

Tighter monetary and fiscal policies as well as the economic slump led to a decline in inflation (to 19.7% yoy in May 2013) and a narrowing of the current account deficit to 2.9% of GDP in 2012 from 15% in 2010. At the same time, BLR: Wage growth exceeds productivity 28



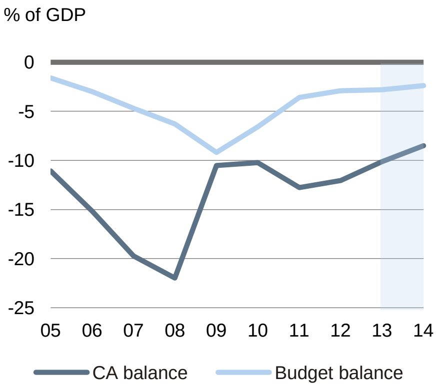
Sources: The Conference Board, CEIC, DB Research

GEO: Deflationary pressures continue 29



Sources: IMF IFS, Global Insight, Db Research

GEO: Twin deficits 30



Sources: IMF, DB Research

external debt increased to 55% of GDP in 2012 from 27% in 2007, and gross public debt rose to 37% from 18% over the same period. Parliamentary elections in September 2012 led again to a loosening of policy in the preceding months. Moreover, real wages grew sharply (see chart 28), outstripping productivity growth and thus denting competitiveness. FX-denominated lending has been continuously outpacing lending in local currency, which increases banking sector vulnerability to currency depreciation. A large external debt redemption schedule in 2013-15 adds to potential risks. Overall, much needs to be done to bring inflation further down and to start addressing structural short-comings, especially regarding the extensive presence of the state in the economy. On the political front, President Aleksander Lukashenko has been in power since 1994. The country's latest elections in 2012 resulted in a lower house of parliament with no opposition members.

Georgia

S&P: BB- (stab), Moody's: Ba3 (stab), Fitch: BB- (stab)

Growth set to slightly moderate

The economy rebounded fairly quickly from the contraction in 2009 caused by the global turmoil and the short war fought with Russia in August 2008. Real GDP grew strongly in 2010-12, at 6.5% on average, which is not far behind the pre-crisis pace of 7.6%. For 2013 we expect growth to be around 4.5%, picking up to 6% in 2014.

Subdued inflation

Inflation has been very volatile in recent years (see chart 29), driven by extreme variations in food prices. Since 2012 the country is in deflation. The National Bank of Georgia cut policy interest rates several times over the past months, trying to bring inflation closer to the 6% target for 2012-2014. However, a low level of financial intermediation and high dollarisation of both loans and deposits (68% and 65 % of total, respectively) constrain the effectiveness of monetary policy. The IMF projects inflation at 1% in 2013 and 4.6% in 2014.

Improving public finances and weak external accounts

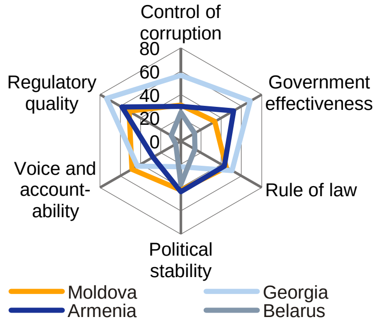
The previous government managed to bring down the budget deficit to 2.9% in 2012 from 9.2% of GDP in 2009, despite it being an election year (see chart 30). The new government is committed to continue on a fiscal consolidation path, albeit putting more emphasis on social spending (gradual pension hikes, introduction of basic health insurance, etc.). Public debt has been declining on the back of strong growth and lower budget deficits to a sustainable 33% of GDP (end-2012 level). The current account deficit remains wide at around 10% of GDP. It is largely financed by FDI inflows; however, the FDI coverage ratio has been decreasing (to below 50% in 2012 from over 80% in 2007). Gross external debt is high at 84% of GDP. Several Georgian companies issued Eurobonds last year, such as Bank of Georgia (USD 250 m), Georgian Railway (USD 500 m) and Georgian Oil and Gas Corporation (USD 250 m).

Tensions in the political scene

The Georgian Dream coalition led by Bidzina Ivanishvili unexpectedly won the parliamentary elections in October 2012, securing 83 of the total 150 seats and

WB Governance indicators in comparison 31

Percentile, 2011



Sources: WB, DB Research

KGZ: Political timeline – history of unstable government 32

Date	Selected events
2005	Tulip Revolution: Parliamentary elections fuel a wave of protests, which make president Askar Akayev (in office since 1991) flee to Russia and resign.
2005	Former prime minister (PM) Kurmanbek Bakiyev elected as President, nominating Felix Kulov as PM.
2006	Parliament speaker Omurbek Tekebayev resigns after a dispute with president and becomes the opposition leader.
2006	In response to mass protests president Bakiyev signs a new constitution to limit his powers (to be partially reinstated later in the year), PM Kulov and the government resign.
2007 Jan	Following the President's 2 failed bids to reinstate Kulov, Azim Isabekov becomes prime minister.
2007 Mar	Government resigns and opposition leader Almaz Atabayev becomes the new prime minister.
2007 Apr	Police cracks down on a week-long demonstration demanding the President's resignation.
2007 Oct	Constitutional changes approved in a referendum, considered highly controversial.
2007 Oct-Dec	Bakiyev dissolves the parliament and new elections result in a Parliament with no opposition members.
2009	President Bakiyev wins re-election.
2009	PM and government resign as the President announces sweeping reforms.
2010 Apr	Following protests President Bakiyev resigns
2010 May	Roza Otunbayeva becomes the head of the interim government formed by opposition leaders.
2010 Jun	Ethnic clashes between Uzbek and Kyrgyz communities lead to over 200 deaths and force hundreds of thousands to flee.
2010 Jun	Referendum transforms Kyrgyzstan into a parliamentary republic.
2010 Oct-Dec	Parliamentary elections and formation of a three-party coalition government.
2011 Oct	PM Almazbek Atambayev is elected as president.
2012 Aug-Sep	Collapse of the ruling coalition and a new three-party coalition government formed.
2013 Jan	Ethnic clashes between Uzbeks and Kyrgyz in the Sokh enclave.

Sources: BBC, Global Insight, DB Research

dealing a blow to president Mikheil Saakashvili (who is ending his second and last term this year) and his United National Movement. The new administration moved swiftly to launch investigations against former public officials and passed a constitutional amendment to constrain presidential powers. The parties are now gearing up for presidential elections due in October. In light of the tense cohabitation of the president and prime minister political risks have increased.

On the upside, the country has been quite efficient in implementing structural reforms and ranks best among its CIS frontier peers with regard to WB governance indicators, particularly government effectiveness and regulatory quality (see chart 31).

Kyrgyzstan

Not rated

Growth expected to recover

The economy contracted by 0.9% in 2012 mainly driven by a decline in gold output at the country's largest mine Kumtor due to geological factors. The mine has also been a target of demonstrations because of allegations of environmental damage, and calls have been made for its nationalisation. Strong remittance inflows from Russia have mitigated the economic slump. Kyrgyzstan is the second-largest remittance receiver among the CIS economies: remittances accounted for almost 1/3 of GDP in 2012. This year and next, GDP growth is expected to recover to over 7%.

Sharp deterioration of external accounts

Falling gold exports (which accounted for almost 40% of Kyrgyz exports over the past decade) and increasing imports due to higher fuel prices and robust domestic demand led the current account deficit to soar to over 15% of GDP in 2012. The CA deficit is expected to decline again to 8% this year as gold production resumes. Trade links of Kyrgyzstan with the other CIS economies are the strongest among frontier CIS countries. Particularly, the role of neighbouring Uzbekistan and Kazakhstan (27.8% and 21.2% of total exports in 2012) has been increasing over the last years, while the role of Russia is declining (still being the third largest export market in 2012). The country also signed a memorandum of understanding to join the planned Eurasian Customs Union (expected to come to life in 2015) as observer.

Gross external debt is very high at 80% of GDP; over half of which is public debt. External financing is supported by a 3-year IMF extended credit facility programme (in place since June 2011). In a recent review of the programme the IMF stated that “good progress” had been made and recommended further commitment to fiscal consolidation (fiscal deficit stood at 5.4% of GDP in 2012, while public debt was at 49% of GDP).

Competitiveness and governance need improving

Among the CIS countries included in the 2012-13 World Economic Forum's Global Competitiveness Index Kyrgyzstan scores the worst, coming 127th out of 144 countries[9]. Moreover, the World Bank ranks Kyrgyzstan in the lowest 10th

[9] The WEF defines competitiveness as “the set of institutions, policies, and factors that determine the level of productivity of a country”.

percent of its global country sample regarding rule of law and control of corruption.

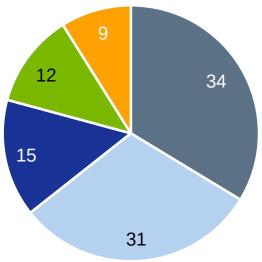
History of political instability

The political scene has been turbulent in Kyrgyzstan during the past few years, causing disruptions in policy implementation and often affecting economic outcomes (see chart 32). Clashes between Kyrgyz and Uzbek ethnic groups (72% and 14% of total population in 2011, respectively) add to political and social vulnerability.

Moldova

Moldovan parliament elected in 2010 — 33

Seats



* Pro-European Rule Coalition member

Source: Parliament of Moldova

S&P: NR, Moody's: B3 (stab), Fitch: NR

Growth to rebound but vulnerability to external shocks to remain

Moldova's economy was the second hardest hit among frontier CIS countries in the global financial crisis (after Armenia). GDP growth recovered strongly in 2010-11 but again turned slightly negative in 2012 due to adverse weather conditions for agriculture and sluggish external demand. In 2013-14 growth is expected to pick up to 3-4%. The export base of the country is narrow and consists mostly of agricultural products. The diversification of export markets is also low, with more than half of sales going to the EU. This renders the economy vulnerable to external shocks. Dependency on remittances from abroad is large: in 2012 they amounted to 24.4% of GDP.

Improving fiscal stance

The fiscal deficit has been declining after a peak of 6.4% of GDP in 2009. The IMF forecasts it at 2.1% in 2013 and 1.3% in 2014. While the size of the deficit is not a problem, the fact that it is to a large extent financed by grants points to vulnerabilities. Public debt is low at 23.8% of GDP (2012) and most of it is on concessional terms, mitigating refinancing risks. However, contingent liabilities from the debt of the separatist Transnistria region vis-à-vis the national gas company Moldovagaz are thought to be substantial.

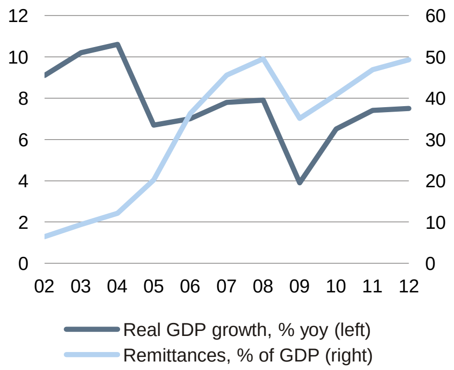
Weak external position

The current account deficit stood at a high 9.4% of GDP in 2012 and is expected to remain around 10% of GDP in the foreseeable future. Gross external debt is high at 74.4% of GDP (2012), most of which is private debt. The country has a stand-by arrangement with the IMF of which one tranche (out of six) remains to be disbursed.

Fragile political situation

The three-party Alliance for European Integration coalition collapsed this March and a no-confidence vote was placed on acting PM Vlad Filat. The new Coalition of a Pro-European Rule is essentially the same as before with the exception of part of the Liberal Party (see chart 33). Given that the coalition has only a small majority in parliament and is strongly opposed by the communist party, the political situation remains fragile, clouding the outlook for structural reforms. In addition, the issue of the separatist Transnistria region remains unresolved and progress has been limited.

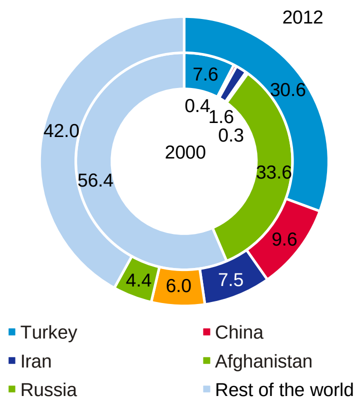
TJK: Remittances are important growth driver 34



Sources: WB, IMF, DB Research

TJK: Main export partners 35

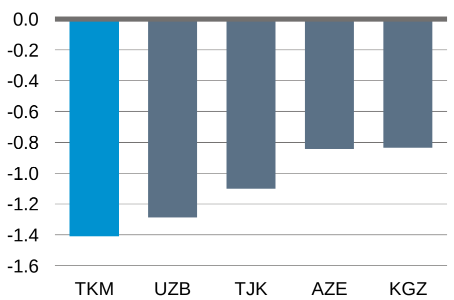
% of total



Sources: IMF DOTS, DB Research

WB Governance Indicators 36

From -2.5 (worst) to +2.5 (best) (2011)*



*Simple average of estimates for rule of law, political stability, government effectiveness, regulatory quality, voice and accountability and control of corruption.

Source: World Bank, DB Research

Tajikistan

Not rated

Growth to moderate

Tajikistan has a good growth track record, with real GDP expanding by 7.9% p.a. on average between 2000 and 2012, fuelled by migrant remittance inflows. Tajikistan is the largest remittance recipient in the world, with remittances amounting to close to 50% of GDP (see chart 34). Growth is expected to slow down to 6-7% in 2013-2014 on the back of weaker remittance inflows given the economic slowdown in Russia as well as softer commodity prices for its major export items (aluminium-66% and cotton-13% in 2012). Tajikistan is the poorest of the CIS countries, with per capita GDP of USD 2,230 (at PPP) in 2012. Besides a high reliance on remittances and commodity exports, very low external liquidity (FX reserves at less than 1 month of imports, vs 3 months considered a minimum) points to major vulnerability to external shocks.

Changing exports partners

As in many other frontier CIS economies, the importance of Russia as an export market has declined since the turn of the century: from 33.6% of total in 2000 to 4.4% in 2012 (see chart 35). On the other hand, Turkey has emerged as the main exports market for Tajikistan, consuming a share of 30.6% of exports in 2012 compared with 7.6% in 2000. Exports to China constituted 9.6% of total exports last year vs. 0.4% in 2000. In March Tajikistan joined the World Trade Organization, in principle a positive step towards greater integration in world markets and better trade rules.

Challenging business environment and governance issues

FDI has increased but remains very low at 0.7% of GDP (2012). Tajikistan scores second worst (after Uzbekistan) among its CIS peers in the World Bank Doing Business indicator (141 out of 185 countries). The country also fares poorly in the WB governance indicators, ranking in the bottom 10% in terms of control of corruption and voice and accountability and in the bottom 20% in terms of the remaining indicators (see chart 36).

Turkmenistan

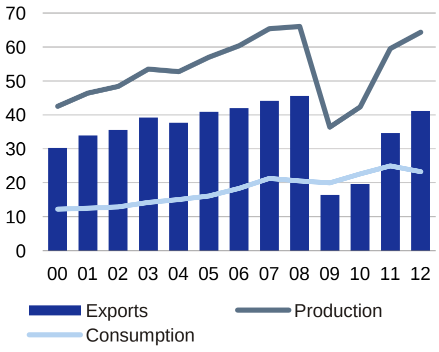
Not rated

Robust growth set to continue

Turkmenistan has been among the fastest growing economies in the world, expanding by 13.6% on average from 2000 to 2012 on the back of hydrocarbon exports and public investment. Due to its few ties with the global economy, growth was resilient through the global crisis and is expected to remain robust. Production and exports of natural gas have been increasing (see chart 37); the government expects gas production to reach 75-80bcm in 2013, given the start of operation of the new Galkynysh field in July. Turkmenistan's proven gas reserves were revised to 17.5tcm or 9.3% of the world total, the fourth largest in the world (BP estimates for 2012). At the same time Turkmenistan is the second largest gas producer in the CIS after Russia and 12th largest in the world (in 2012).

TKM: Rich in natural gas 37

Billion cubic metres



Sources: BP, DB Research

Low economic diversification

The energy sector accounted for three-quarters of industrial production in 2011, compared with 56% in 2000. Moreover, mineral fuels constitute 93% of total exports (2012). The pipeline structure has, however, been diversified, reducing vulnerability to events such as the 2009 explosion of a pipeline transporting gas to Russia, which caused exports to drop by 70%. New pipelines to China and Iran have become operational and further capacity building is underway (e.g. Turkmenistan-Afghanistan-Pakistan-India pipeline). Attracting more FDI is essential for the country to develop the infrastructure necessary to produce and export hydrocarbons. Efficient management of hydrocarbon revenues is also essential to mitigate concentration risk and sustain growth in the long run.

Comfortable external position

The current account is supported by strong and rising hydrocarbon exports. The rise has been largely driven by China, which has become Turkmenistan's main export partner with a share of 67% in 2012. External debt is very low and FX reserves are close to 60% of GDP[10], which helps to support the peg of the Turkmen manat to the USD.

Structural weaknesses persist, some hope for gradual changes

Under the rule of "President for life" Saparmurat Niyazov the country remained isolated from the world, both politically and economically. There has been some progress under the new President Gurbanguly Berdymukhammedov, in power since end-2006, to develop the political system, create a more favourable business environment and improve external diplomatic relations. Turkmenistan scores poorly in the WB governance ranking (see chart 36), particularly in relation to control of corruption, government efficiency and access to information (e.g. only 5% of the total population has access to the internet). The economy remains dominated by state monopolies. However, the President has called for a privatisation programme to take place from 2013 to 2016. In general, the macroeconomic situation and risks are difficult to assess due to the very limited availability of reliable data.

Uzbekistan

Not rated

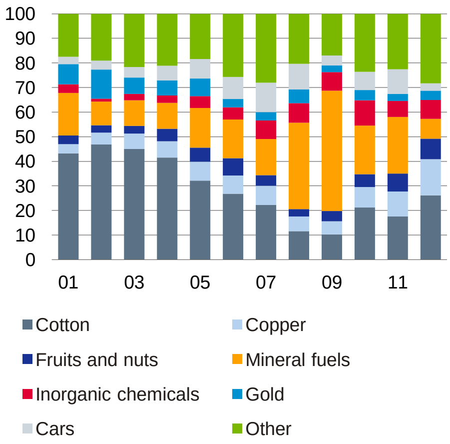
Robust growth profile

Uzbekistan experienced robust economic expansion over the last decade, with real GDP growing on average by 8% between 2004 and 2012. The country was largely resilient to the global financial turmoil due to being rather isolated from financial markets and the favourable prices of its main export items (natural gas, cotton and gold). The government plays an important role in stimulating growth via increases in public wages and pensions as well as public investment. Remittances (mainly from Russia) boost private consumption as well. Uzbekistan is the third largest gas producer in the CIS (behind Russia and Turkmenistan) and the 16th biggest in the world (2012). However, close to 80% of the produced gas is consumed in the internal market.

[10] Source: EIU.

UZB: Exports structure 38

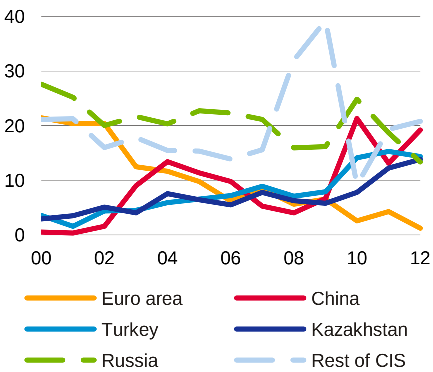
% of total



Sources: Intracen, DB Research

UZB: Main export partners 39

% of total exports



Sources: IMF DOTS, DB Research

Inflation has been persistently high in the country (12.2% on average between 2005 and 2012, according to the IMF). The Uzbek currency, the sum, has been depreciating by 7-10% annually over the last years, adding to inflationary pressures. The Central Bank is expected to continue tightly managing the sum, allowing gradual depreciation to support export competitiveness. Currency pressures led to introduction of new FX market restrictions early this year.

Strong external position

The current account has been in surplus since 2001 and is expected to remain in positive territory (albeit below the pre-crisis levels), supported by exports and remittance inflows. Public and external debt stocks are low at 10% and 20% of GDP, respectively.

Uzbekistan is the largest recipient of remittances from Russia among the CIS countries, accounting for close to one-third of these outflows (via money transfer operators). They amounted to 5.7 bn in 2012 (11% of GDP). Uzbekistan's export structure is more diversified compared to its peers, but the country still remains dependent on low value-added exports (cotton, copper, agricultural products, mineral fuels, gold) as well as chemicals and cars (see chart 38). China (19.2%), Turkey (14.3%), Kazakhstan (13.8%) and Russia (13.4%) were the largest export markets in 2012 (see chart 39). At the same time, the share of the euro area as export market has been steadily decreasing; from 21.4% in 2000 to 1.2% in 2012.

Structural weaknesses

The country scores poorly on governance indicators such as voice and accountability, control of corruption, rule of law and regulatory quality (see chart 36). Despite Uzbekistan's advancement by 14 positions in the WB Doing Business 2013 ranking, it remains in 154th place out of 185 countries. State ownership in the real economy and the financial sector is large, distorting competition and lowering efficiency. Availability of reliable data is low.

Uncertain political outlook

President Islam Karimov, who has ruled the country since 1989, is expected to continue firmly in power at least until the end of his third presidential term in 2015. Karimov's succession is uncertain. Tensions with neighbouring Tajikistan and Kyrgyzstan add to political risk. In addition, the country is at risk of terrorist attacks, particularly given its shared border with Afghanistan.

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