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World Economic Situation and Prospects 2011

Press Release

Sluggish economic recovery in the Commonwealth of Independent States – UN report

Dynamics in the region remain highly dependent upon the economic performance of the Russian Federation

Moscow, 18 January 2011: The Russian economy remains the engine of growth among the countries of the Commonwealth of Independent States (CIS) and Georgia, according to a United Nations report released today. Its return to economic expansion in 2010 contributed to the renewed dynamism in the region, boosting exports, financial flows and remittances — all critical for the region's low-income countries. The regional economy grew by 4.1 per cent in 2010 and is expected to increase at a similar pace in 2011 and 2012, says the report, *World Economic Situation and Prospects 2011 (WESP)*.

Commonwealth of Independent States (CIS) and Georgia: Rates of growth of real GDP, 2007-2012[a]

Annual percentage change	2007	2008	2009	2010[b]	2011[c]	2012[c]
CIS and Georgia	**8.8**	**5.2**	**-7.0**	**4.1**	**4.1**	**4.3**
Armenia	13.7	6.9	-14.2	3.5	4.5	3.0
Azerbaijan	25.1	10.7	9.3	3.5	3.0	6.5
Belarus	8.6	10.2	0.2	5.0	7.0	5.0
Kazakhstan	8.9	3.3	1.2	5.5	5.3	5.5
Kyrgyzstan	8.5	8.4	2.3	-3.5	6.0	6.0
Republic of Moldova	3.0	7.8	-6.5	3.5	3.5	4.0
Russian Federation	8.5	5.2	-7.9	3.9	3.7	3.9
Tajikistan	7.6	7.9	3.4	5.0	5.5	5.0
Turkmenistan	11.6	10.5	6.1	6.0	10.0	10.0
Ukraine	7.9	2.3	-15.2	4.1	4.5	5.1
Uzbekistan	9.5	9.0	8.1	8.0	7.0	8.0
Georgia	12.3	2.3	-3.9	6.0	6.5	4.0

Source: United Nations, *World Economic Situation and Prospects 2011*.

Note: Georgia officially left the CIS on 18 August 2009. However, its performance is discussed in the context of this group of countries for reasons of geographic proximity and similarities in economic structure.

a Regional averages are calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

b Partly estimated.

c Forecasts, based in part on Project LINK.

Following a sharp contraction in 2009, output in the CIS bounced back in 2010, driven by recovering commodity prices and general improvement in the external environment, the report states. Domestic demand in the region is gathering momentum. Consumer demand in the Russian Federation benefited from expansionary fiscal policy, which included increases in pensions and public sector wages. Exports have increased as world trade recovered from its collapse of two years ago.

Output recovery was accompanied by an improvement in employment and wages across the region. In the Russian Federation, a sharp fall in wage arrears and job creation helped to propel growth. Employment growth in Kazakhstan has been the fastest in the region and, notably, job creation even continued during the 2009 economic slowdown.

Nonetheless, overall economic performance remains far below potential in most of the CIS economies, says *WESP*.

Inflationary pressures caused by droughts

Inflation in the CIS and Georgia continued to decline through mid-2010 despite the economic rebound, the delayed pass-through effects of the currency devaluations during 2009 and loose monetary policies, states the report. Inflation started to pick up again in the second half of 2010, however, as a consequence of a number of supply shocks, including, in particular, the droughts in the Russian Federation and Ukraine which caused food prices to increase sharply.

Authorities in most CIS countries have supported the economic recovery by cutting interest rates and implementing fiscal stimulus measures. The recovery in turn has boosted government revenues, particularly in the energy-producing countries of the CIS, where revenues were boosted further by the rebound in world commodity prices. Nonetheless, fiscal deficits persist throughout the region. In 2010, the Russian Federation ran a fiscal deficit for the second year in a row, after a long period of having generated fiscal surpluses. An expected shift towards fiscal tightening during 2011 could weaken growth and dampen prospects for employment generation, unless offset by a recovery in credit supplies to the private sector and further strengthening of private consumption and investment.

The report says that imports increased as domestic demand strengthened, particularly in the Russian Federation. Several non-energy exporting CIS countries, such as Armenia, Georgia and Tajikistan, benefited from rising export prices, but as import demand increased as well, their current-account deficits remain large. The CIS overall, however, has a surplus on its current account which increased in 2010.

Banking systems and financial risks in the CIS economies

The financial sector was one of the channels through which the global crisis was transmitted to the CIS economies. In several countries, the banking system came under severe pressure, prompting the need for strong policy responses. In contrast, a low degree of financial development and limited integration into international capital markets provided some protection elsewhere, particularly to the financial sectors of regional low-income economies.

Despite the improved external environment and ongoing economic recovery, the banking sector remains fragile in the CIS due to a combination of funding problems and an increasing number of non-performing loans. Countries that relied mainly on domestic deposits as a source of funding (such as Uzbekistan and Turkmenistan) were relatively sheltered from the financial crisis. Most countries, however – even those with current-account surpluses – relied on external sources of finance. As access to international capital markets dried up and many foreign banks withdrew their resources, the credit supply in the CIS economies came to an abrupt halt. Although liquidity conditions have since improved, the need to rebuild balance sheets and weak investment demand have contributed to continued sluggish growth of credit throughout the region. Only in the Russian Federation are there clear signs of improvement.

Financial fragility continues further because of currency mismatches and little mobilization of domestic savings. During the height of the crisis, many of the CIS countries were forced to devalue their currencies, making foreign debt more expensive while earnings in domestic currency fell. As credit risks are easing, currency risks remain.

Several countries in the region, including low-income economies in Central Asia, have reacted by introducing regulatory changes, such as higher reserve deposit requirements, in order to reduce the exchange rate risks to the health of the banks. In Ukraine, foreign currency lending to households has been prohibited outright.

Deepening of domestic financial markets will be needed, however, for a more lasting solution to the prevailing foreign-exchange risks. Providing more solid domestic financial instruments should also pull more domestic savings into the financial system. While doing so has been a stated policy target in some countries in the region for some time, the recent crisis has provided new impetus to pursue this goal, particularly in Kazakhstan and the Russian Federation.

Major challenges remain

The economic recovery in the CIS has relied heavily on improved external conditions, including the rebound in commodity prices. Economic dynamics in the CIS at large further remain highly dependent upon the health of the Russian economy. A renewed slowdown in the global economy, which is a continued risk given prevailing weaknesses in developed economies (*see global press release*), would directly affect growth prospects in the CIS. The key challenges for the CIS economies to achieve sustained growth will be to diversify their economies in order to reduce external vulnerability and to overcome the prevailing fragilities of the financial sector.

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http://www.un.org/esa/policy/wess/wesp.html

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