Central Asia: Real GDP recoveries set to diverge as wider risks remain to the downside

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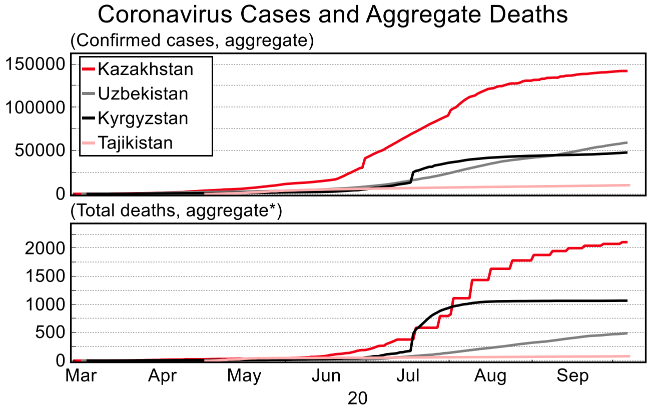
Central Asia, which comprises Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan and Tajikistan, has been hit by the impacts of coronavirus. In 2Q 2020, lockdown measures led to severe constraints on economic activity, while a much weaker external backdrop impacted commodity exports, oil prices, and remittance flows. The region has felt this through multiple channels so far from falls in real GDP to strong external pressures on currencies (Kazakh Tenge and the Uzbek Som are 8-10% weaker against the USD since January). However, given varying lengths of lockdowns and different economic structures, the extent of recessions will vary. Some countries have not been as heavily impacted and will recover faster, while in others, recessions will be deeper and recoveries more gradual. Irrespective, risks will remain to the downside across the wider region due to the ongoing threat of coronavirus infections.

Activity Hit the Hardest in Kyrgyzstan in 1H 2020

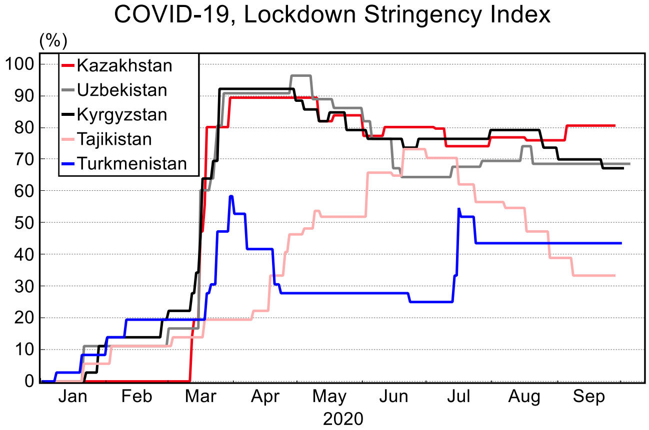
The region overall has been quick to introduce lockdown measures which have kept coronavirus cases low by international standards, and naturally as these have been eased, output is picking up again. In fact, Turkmenistan and Uzbekistan looked to have escaped some of the worst effects, and seem to be recovering quicker. Turkmenistan's exports have been supported by the stronger economic recovery in China, its main trade partner, while, Uzbekistan's exports have benefited from healthy demand for gold and food exports.

Coronavirus Cases and Aggregate Deaths



*Note: There has been a reclassification of deaths in Kyrgyzstan which has led to the dip of total deaths in early August
Source: WHO, Macrobond, MUFG Bank Economic Research Office

COVID-19, Lockdown Stringency Index



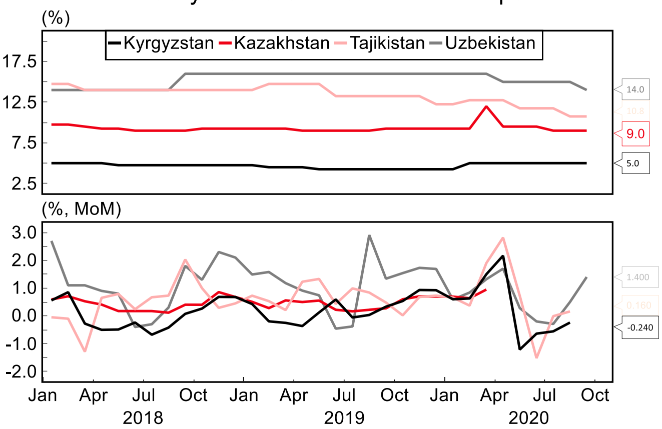
Source: University of Oxford COVID-19 Government Response Tracker, Macrobond, MUFG Bank Economic Research Office

Meanwhile in Kazakhstan, real GDP dipped by 2.9% YoY over the first seven months of 2020, due to a fairly large drop in services of around 6.2% YoY, although this was partially counteracted by an increase in the production of goods by 2.1% YoY and industrial output by 1.3% YoY. Industrial output figures reportedly saw broad based growth from automobile production, to the agriculture, construction, and manufacturing sectors, as the ability to maintain social distancing in some of these sectors is likely to have helped growth.

Public mobility data suggests activity is picking up although the recovery will be gradual. Footfall for retail and recreation in Tajikistan (supported by the lowest level of stringency measures), Kazakhstan, and Kyrgyzstan has remained on an upward trajectory since July even as some purchases may have shifted online. Fiscal support measures in Kazakhstan and Uzbekistan to the tune of 8.0% and 6.0% of GDP, respectively, together with monetary policy rate cuts in Kazakhstan, Tajikistan and Uzbekistan, may have also helped. After attempting to ease market volatility with a hike in March, the National Bank of Kazakhstan cut its main policy rate by 300bps to 9.0%. The National Bank of Tajikistan cut rates by 195bps to 10.8% in Tajikistan, and the Central Bank of Uzbekistan cut by 100bps to 15.0%.

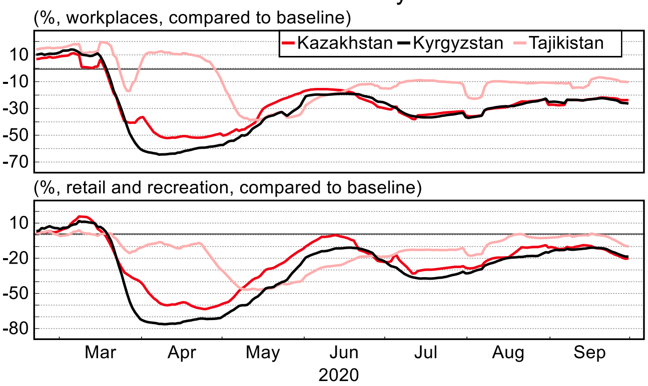
Overall, the sharpest drop of real GDP is likely to be in Kyrgyzstan over 1H 2020 due to the multiple impacts of COVID-19, the closure of its main gold processing plant in 1Q 2020 and the decline of remittances (which stood at ~30% of GDP in 2019). Remittance outflows from Russia, the main source for the region, fell by 20.1% YoY in 1Q 2020. Tajikistan too has been squeezed by weaker remittances flows, but activity looks to have remained more robust.

Policy Rates Cut As Inflation Drops



Source: Macrobond, MUFG Bank Economic Research Office

Public Mobility



Source: Google LLC "Google COVID-19 Community Mobility Reports". https://www.google.com/covid19/mobility/ Accessed: 21st August, Macrobond, MUFG Bank Economic Research Office

Real GDP Expected to Recover in 2H 2020

The outlook over the final half of 2020 should see real GDP pick-up again across the region following the easing of the lockdown restrictions and the normalization of the global economy, however the recovery will be fragmented. Turkmenistan and Uzbekistan are forecast to see a steady recovery and could still see slightly positive real GDP growth of sub-1.0% YoY this year (although clearly weak by historical averages), while Kazakhstan and Tajikistan will see a slower rebound. The IMF forecasts real GDP to drop by around 3.0% YoY in 2020 in Kazakhstan. Tajikistan could see a similar level of real GDP decline, meanwhile, Kyrgyzstan will have the weakest recovery and sharpest drop to real GDP this year of up to 10.0% YoY (according to its economic ministry).

There are a couple of main reasons for the divergence of recoveries. First, Turkmenistan and Uzbekistan have benefitted from more resilient exports, be it gold and food in the case of Uzbekistan or natural gas to China in the case of Turkmenistan, which broadly speaking is likely to continue. In contrast, exports have been hit more in Kazakhstan and Tajikistan by the decline of the oil price in 1H 2020, despite reasonable industrial production figures.

Next, policy responses have differed. Kazakhstan and Uzbekistan have been able to introduce fairly large fiscal packages, while as a result of fiscal constraints, Tajikistan has had to resort more to the easing of lockdown restrictions (which may also risk further coronavirus outbreaks). High fiscal debt and external vulnerabilities in Kyrgyzstan, have also limited a larger policy response. Lastly, the recovery in Kyrgyzstan will also be affected by the closure of its main gold processing plant in 1Q 2020 which is likely to drag on output over the rest of 2020, while remittances will remain much weaker over 2H 2020 (which stood at ~30% of GDP in 2019, similar to Tajikistan). Clearly these will be two significant factors over 2H 2020. Recent protests in Kyrgyzstan after the holding of elections will also provide further downside risks. It is unclear yet how events will unfold but tensions will remain high, and real GDP is likely to be affected.

Risks to Remain to Downside in 2H 2020

All said, despite diverging recoveries, wider risks throughout the region will remain to the downside over the rest of 2020. The main risk will continue to be the threat of further lockdowns, followed by external headwinds such as weaker remittances and exports, amid a much weaker global economic backdrop. Indeed, Kazakhstan has had to increase the level of lockdown measures recently as coronavirus cases have grown. External demand from key trading partners[1] will also be weak throughout 2020. Remittances to Kyrgyzstan and Tajikistan could drop substantially[2], while Kazakhstan and Uzbekistan remain exposed to further low oil prices[3], granted cushioned by greater exchange rate flexibility. The region's dynamics will help the recovery in the longer term, but we will see a bumpy trajectory in the short term.

On top of the hit to real GDP in both Kyrgyzstan and Tajikistan, fiscal and external vulnerabilities have also increased. Kyrgyzstan and Tajikistan have had to ask to restructure some of their government debts as a result of the impacts of coronavirus this year. Government debt has been fairly high over recent years, and despite some reduction still stood at 56.3% of GDP in Kyrgyzstan and 45.4% in Tajikistan in 2019, well above the average for emerging and developing Europe of 31.3% of GDP. The foreign currency share of these figures is high (86.7% in Kyrgyzstan and around 81.4% in Tajikistan) meaning government debt service costs have mechanically increased due to recent currency pressures. Overall fiscal risks have clearly increased this year and will remain a real concern despite the largely concessional nature of government debt and relatively long debt maturity in both countries. The sharper drop of real GDP in Kyrgyzstan will also hurt, and the trajectory for public finances will remain challenging for the rest of 2020 and further ahead given events.

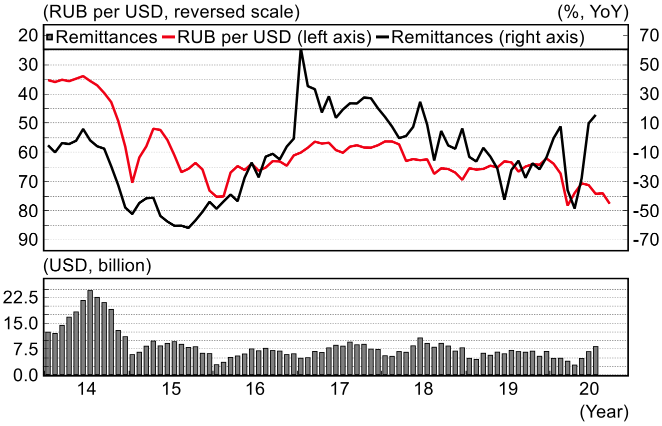
[1] We forecast a drop of real GDP in the EU by -8.0% and -6.0% in Russia in 2020 in our latest report on Russia "Risk of weaker and more uneven recovery rises as nation continues to grapple with COVID-19" (Published 24th August 2020). Link here: https://www.bk.mufg.jp/report/econew/MUFG-Economic-Brief-20200824.pdf.

[2] The Asian development bank forecasts remittances to central Asia to fall by 24% YoY this year.

[3] In 2019, non-manufactured exports, as a percent of current account receipts (CXR), stood at 73.6% in Kazakhstan and 39.0% in Uzbekistan, the bulk of which are hydrocarbon.

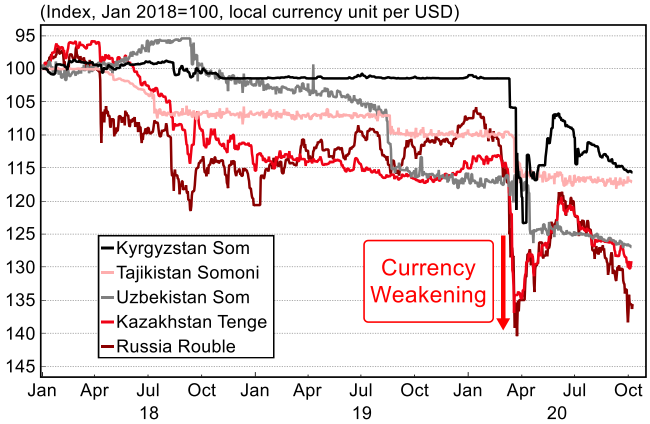
Pressures in Turkmenistan, Uzbekistan and Kazakhstan will be lower but there could still be complications as current account deficits (CADs) may reverse some of their recent improvements in 1H 2020, due to stronger private consumption drawing in imports, and exchange rates may remain under some pressure. Key policy rates may also need to be raised given the reduction of key policy rates and potential higher inflation as demand improves. Central Asia will undoubtedly face a tough time this year, yet longer term, given its young and growing population, relatively reform minded governments and increasing levels of regional cooperation and foreign investment inflows, its recovery should prove relatively quick. In the case of Kazakhstan and Tajikistan, it may take till mid-2021 for real GDP to recover back to pre-coronavirus levels, although for Kyrgyzstan it will be longer.

Russian Rouble & Remittance Outflows



Source: CBRF, Macrobond, MUFG Bank Economic Research Office

Exchange Rate Pressures Likely to Remain



Source: Macrobond, MUFG Bank Economic Research Office