Turkmenistan

Growth reportedly moderated as expansion apart from hydrocarbons slowed with fiscal consolidation. Inflation accelerated, and the current account deficit narrowed. Continued fiscal consolidation will slow growth further in 2019 and 2020. Inflation will likely ease but remain near double digits, and higher hydrocarbon export volumes will further narrow the current account deficit. The government needs to evaluate and mitigate the social impact of subsidy reform.

Economic performance

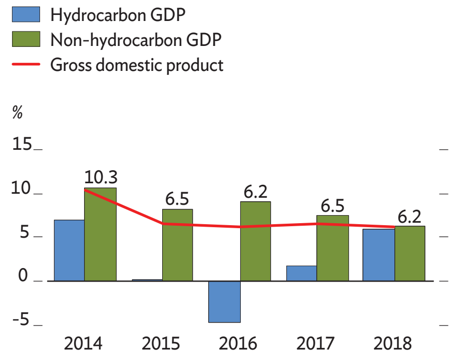
The government reported GDP growth at 6.2% in 2018, down from 6.5% a year earlier (Figure 3.7.1). On the supply side, the hydrocarbon industry expanded by 6.0%, well up from 1.7% in 2017. However, growth in the larger non-hydrocarbon economy slowed from 7.5% in 2017 to 6.2% last year.

From preliminary estimates, industry growth accelerated from 5.4% in 2017 to 6.0%. Gains in hydrocarbons were partly offset by slower expansion in construction. Growth in services slowed from 7.9% to 6.8% with less expansion in construction and despite strong performances in trade, transport, and communications. Agriculture growth is estimated to have slowed from 5.9% in 2017 to 4.8% as adverse weather affected harvests of strategic crops, notably cotton and wheat.

On the demand side, investment continued to drive growth despite a cut in government capital spending. The International Monetary Fund (IMF) estimated gross investment in 2018 down from the equivalent of 41.0% of GDP in 2017 to 37.0%, of which 3.4 percentage points was foreign direct investment (FDI), mainly for gas, oil, and chemical processing (Figure 3.7.2). Growth in consumption weakened, especially private consumption, as inflation and a widening gap between the official and parallel market exchange rates eroded real household incomes despite a nominal 10.0% rise in public sector salaries, pensions, and stipends in January 2018.

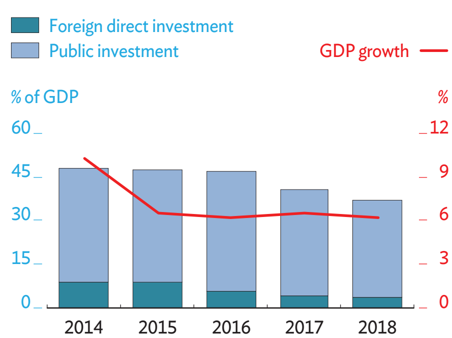
No official estimate is available for inflation in 2018, but in November 2018 the IMF estimated inflation at 9.4%, up from 8.0% in 2017 (Figure 3.7.3). Actual inflation may have been higher, as estimated by other foreign sources, with pressures on the foreign exchange market driving up prices for imported goods. Adding to inflation were subsidy cuts and consequent

3.7.1 GDP growth by sector



Sources: International Monetary Fund. 2018. *Regional Economic Outlook, Middle East and Central Asia*; ADB estimates.

3.7.2 Gross investment including foreign direct investment



Sources: International Monetary Fund. 2018. Press release following a staff visit; ADB estimates.

This chapter was written by Jennet Hojanazarova of the Turkmenistan Resident Mission, ADB, Ashgabat.

increases in prices for utilities, public transportation, food, and services. To stem even larger increases, the government instituted price controls for selected foods and services.

Monetary policy focused on containing inflation as the Central Bank of Turkmenistan kept strict control of cash in circulation, promoted noncash payments instead, and imposed restrictions on foreign exchange transactions. Although credit growth slowed from 17.0% in 2017 to 12.0%, lending remained sizable at the equivalent of 60% of GDP, mostly subsidized credit to state-owned enterprises in priority sectors to facilitate import substitution and promote exports (Figure 3.7.4).

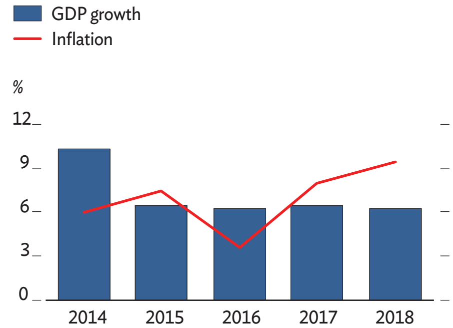
The state budget deficit is estimated to have narrowed from the equivalent of 2.8% of GDP in 2017 to 0.9%, reflecting fiscal consolidation that reduced capital spending and cut subsidies under major subsidy reform (Figure 3.7.5). Revenue was estimated at 14.4% of GDP, down from 14.9% last year, with expenditure falling from 17.7% of GDP in 2017 to 15.3%. Budget financing came mainly from central bank purchases of Treasury securities. The government reported that over 70% of outlays were for social spending and a 10.0% rise in salaries, pensions, and stipends. The non-hydrocarbon fiscal deficit narrowed from 7.7% of GDP in 2017 to 5.5%. Extra-budgetary operations remained large, however, and should be incorporated into the budget to improve transparency and accountability in public finance. Public debt incurred by both the government and state enterprises was estimated to equal 30.9% of GDP at the end of 2018, up from 28.8% a year earlier.

Export revenue rose in 2018 on recovery in global hydrocarbon prices and increased demand for gas from the People's Republic of China. This and import restrictions narrowed the current account deficit from 11.5% of GDP in 2017 to an estimated 8.2%. Estimated growth in exports soared from 6.3% in 2017 to 26.0%, while imports expanded by 9.3% following an 18.0% drop in 2017. FDI inflows in 2018 were estimated at $1.5 billion, most of them for oil, gas, and chemical production. Besides FDI, external borrowing remained significant, risking debt accumulation and the eventual need to draw down the central bank's international reserves, a concern in a period of rising loan repayments and low global energy prices. External debt rose from the equivalent of 25.1% of GDP in 2017 to 26.7% last year.

Economic prospects

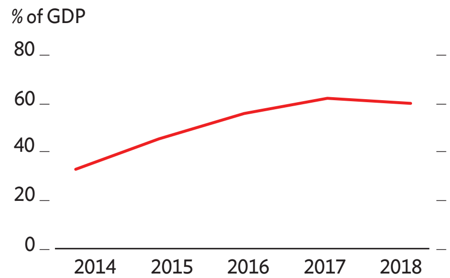
Continued fiscal consolidation is projected to slow growth to 6.0% in 2019 and 5.8% in 2020. On the supply side, further recovery in hydrocarbons is expected to help industry expand by 6%–7%, supported by gains in agricultural processing, light industry and food products, construction materials, and chemicals, which are all targets for import substitution.

3.7.3 GDP growth and inflation



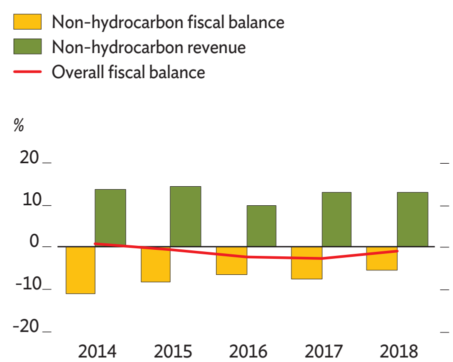
Sources: International Monetary Fund. 2018. *Regional Economic Outlook, Middle East and Central Asia*; ADB estimates.

3.7.4 Credit



Sources: International Monetary Fund. 2018. Press release following a staff visit; ADB estimates.

3.7.5 Government fiscal balance



Note: Fiscal data refer to the general government. Nonhydrocardon fiscal balance and revenue are percentages of non-oil gross domestic product, and the overall fiscal balance is a percentage of total gross domestic product.

Sources: International Monetary Fund. 2018. *Regional Economic Outlook, Middle East and Central Asia*; ADB estimates.

With announced government support for farmers, agriculture is forecast to expand by 4% in both years, while services are projected to grow by 5%–6% annually.

With slower growth, inflation is likely to decelerate slightly but remain near double digits, given the likelihood of further price adjustments and foreign exchange shortages. The government is expected to continue its efforts to curtail inflation by maintaining a fixed exchange rate and administrative price controls, supporting import substitution, and limiting foreign exchange conversion. Banks will continue to direct their lending to state-owned enterprises in priority sectors.

The state budget envisages further cuts to capital spending, continued subsidy reform, and improved tax administration to better mobilize revenues. The government plans to develop a medium-term fiscal framework with technical assistance from the IMF, which should include a path for annual reductions in public investment. The state budget is projected to incur deficits equal to 1.3% of GDP in 2019 and 0.9% in 2020 (Figure 3.7.6). The government aims to continue support for social services, with over 70% of budget expenditure going for such outlays plus wages, pensions, and stipends. Treasury bonds in local currency are expected to provide budget financing equal to 4.2% of GDP and allow some existing domestic debt to be refinanced.

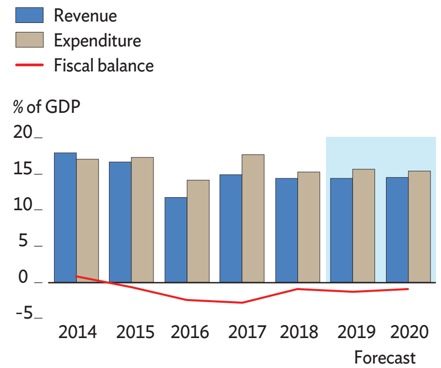
Contracts for larger gas shipments are forecast to lift merchandise exports by 14.0% in 2019 and 10.0% in 2020, outpacing projected merchandise import growth of 6.2% in 2019 and 0.5% in 2020. With the completion of large projects that require imports of advanced equipment and services, the current account deficit is expected to narrow to 5.7% of GDP in 2019 and 3.4% in 2020 (Figure 3.7.7). As financing other large investments would require further accumulation of external debt, which is already projected to equal 29.4% of GDP in 2019 and 31.0% at the end of 2020, a sound debt-management strategy is required, especially given low hydrocarbon prices and a sizable external deficit (Figure 3.7.8).

Policy challenge—assessing and mitigating the social impact of subsidy reform

In response to the adverse impact of lower global hydrocarbon prices on budget revenue, the government has taken significant measures to rationalize public spending. Besides trimming capital spending, it has initiated comprehensive subsidy reform.

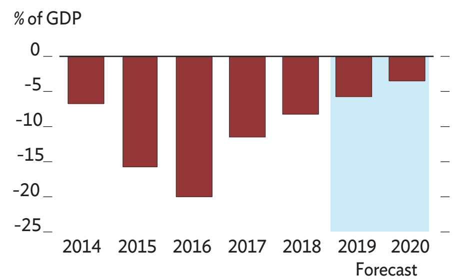
Since 1991, generous subsidies have been a key element of Turkmenistan's effort to distribute to citizens benefits from the country's resource wealth and ensure the well-being of low-income households. Along with petroleum products,

3.7.6 Fiscal indicators



Sources: International Monetary Fund. 2018. *Regional Economic Outlook, Middle East and Central Asia*; ADB estimates.

3.7.7 Current account balance



Sources: International Monetary Fund. 2018. *Regional Economic Outlook, Middle East and Central Asia*; ADB estimates.

3.7.1 Selected economic indicators (%)

	2019	2020
GDP growth	6.0	5.8
Inflation	9.0	8.2
Current account balance (share of GDP)	–5.7	–3.4

Source: ADB estimates.

some health-care services and basic public utilities such as electricity, gas, water, and heating have historically been provided at very low prices. In addition, large subsidies were given for 17 other types of products: certain foods, medicines, public transportation, housing, telephone, kindergarten, and other services. The IMF reports that Turkmenistan has maintained some of the largest energy subsidies in the Commonwealth of Independent States.

The government began to reform subsidies in 2014, liberalizing prices to various degrees on regulated goods and services. In January 2019, it ended free electricity, gas, and water allotments for households. As the government aims to achieve cost recovery in its provision of services, further cuts in subsidies are envisaged, with consequent price increases for many products and services. These and future price increases will have important social consequences that need to be properly assessed and addressed.

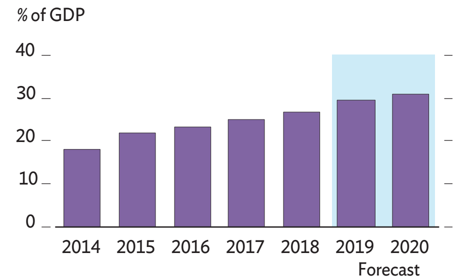
The World Bank's *Macro Poverty Outlook 2018* suggests that rising inflation and further cutbacks in social subsidies have eroded living standards and households' real purchasing power. As income disparities are large, low-income households may have been affected substantially (Figure 3.7.9).

A comprehensive review of existing social protection programs is needed to inform efforts for their improvement, taking into account households' real income, purchasing power, and rates of unemployment and poverty. Improving data bases and strengthening the capacity of state institutions to conduct periodic assessments using best international practices can help maintain adequate social safety nets, to cushion the negative effects of subsidy cuts and rising inflation on income and living standards. In tandem with such programs, macroeconomic policies should aim to sustain growth, control inflation, and create more productive jobs. A gradual and phased-in approach to subsidy cuts and price liberalization would provide time to strengthen social safety nets.

Apart from enhancing social protection, Turkmenistan could do more to improve other aspects of social development. Despite high subsidies and social spending, many health and education indicators lag those of economies with high human development, according to the latest United Nations' human development report. Thus, savings from subsidy reform should be used to improve the quality of health care and education services, and targeted support for low-income households.

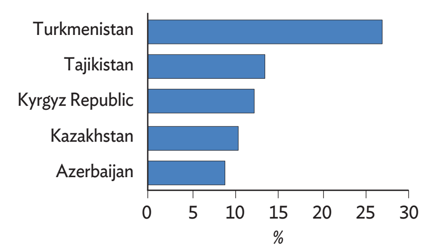
Subsidy reform can be more successful when it is part of a larger agenda encompassing institutional reform to improve public finances and economic efficiency while maintaining adequate living standards. The government thus needs to ensure that measures to preserve living standards are an integral part of its subsidy reform program.

3.7.8 External debt



Sources: International Monetary Fund. 2018. *Regional Economic Outlook, Middle East and Central Asia*; ADB estimates.

3.7.9 Inequality in income, 2017



Note: The Atkinson inequality index, used here, indicates heightened inequality as a higher percentage.

Source: United Nations Development Program. 2018. *Human Development Indices and Indicators: 2018 Statistical Update.*