USAID
Economic Analysis
and Data Services

EADS Economic Trends Report
South and Central Asia

November 2011

Economic Overview

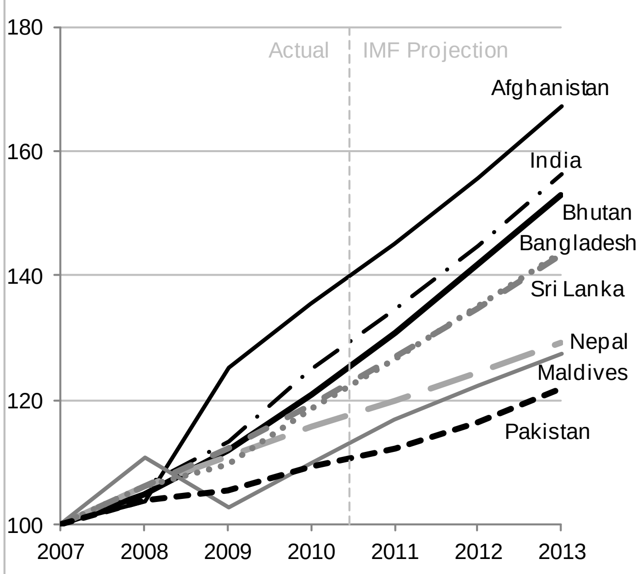
Economic growth projections remain strong in South and Central Asia thanks to strong commodity prices and increases in exports.

Growth in South Asia is expected to slow down but will remain at a buoyant 7.2 percent in 2011. In India, the region's largest economy, growth is forecast to average 7.7 percent during 2011–12 down from 10.1 percent in 2010. Afghanistan's GDP growth was 8.2 percent in 2010 and is predicted at 7.1 percent in 2011 down from 20.9 percent in 2009, which was driven by a record harvest and an upswing in donor grants. By contrast, Pakistan, the region's second largest economy, lags significantly behind the rest of South Asia with a growth rate of 2.6 percent in 2011, down from 3.8 in 2010. This is partly due to the devastating flooding across much of the country in July and August 2010. Real GDP Growth in Pakistan is not expected to reach the pre-crisis 5 percent during the forecasted period of 2011–2013.

With strong commodity prices thus far, growth in Central Asia has continued to recover, although modestly compared with pre-crisis rates. GDP in Kazakhstan (over half of regional GDP) is set to expand by around 5.9 percent yearly during the next three years driven by high commodity prices and deepening links with other developing Asian economies. In Kazakhstan the increase in oil production is expected to be lower than in previous years while non-oil GDP growth is expected to ease slightly from the strong rebound in 2010 in Kazakhstan and Turkmenistan.

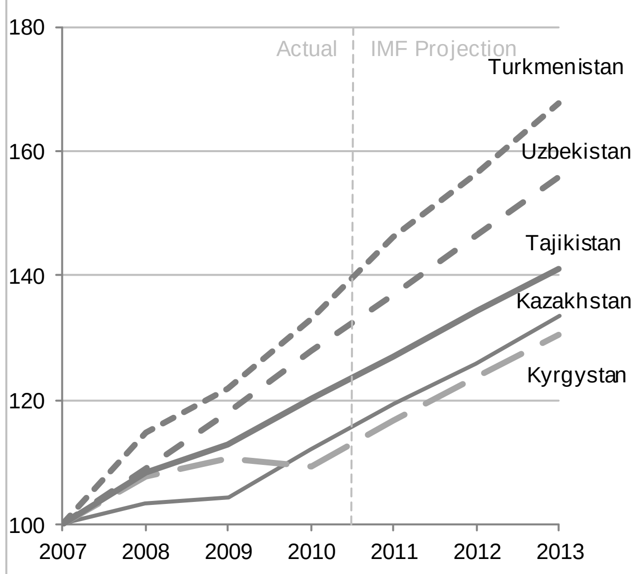
Central Asia's sociopolitical environment, with long-standing tensions and unresolved conflicts, remains a source of risk, further exacerbated by the possibility of spillovers from events in the MENA region.

Real GDP (2007=100) in South Asia



SOURCE: IMF, *World Economic Outlook*, September 2011.

Real GDP (2007=100) in Central Asia



SOURCE: IMF, *World Economic Outlook*, September 2011.

Countries covered in this report include. Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan under Central Asia and Afghanistan, Bangladesh, Bhutan, India, Maldives, Sri Lanka, Nepal, and Pakistan under South Asia. Due to data limitations, not all countries are represented in every graph or analytical section.

Fiscal and Monetary Policy

Government debt is high across South Asia and exceeds the average for developing countries, reflecting the impact of long-term structural fiscal deficits. In Pakistan, after rising to 6.3 percent of GDP in 2009–10, the deficit continued to expand in the first half of 2010–11 tied to flood-related outlays, high power-sector subsidies, and increased defense spending. In Bhutan, the fiscal deficit rose to an estimated 4.4 percent of GDP in 2010–11 as the government continues to deploy money into development and infrastructure projects (including roads, financial services and information technology).

The increase in commodity prices in 2009 and 2010 helped reduce government deficits among regional exporters (Kazakhstan, Turkmenistan and Uzbekistan) in Central Asia. Kyrgyzstan and Tajikistan are expected to reduce their large external and fiscal deficits due to significant remittance receipts and official aid, linked in Kyrgyzstan to post- conflict reconstruction efforts.

World Bank Income Groups

Three out of five Central Asian countries (Kazakhstan, Turkmenistan, and Uzbekistan) are classified as middle income countries. Similarly, most South Asian economies in this study have reached middle income status (the Maldives, Bhutan, India, Sri Lanka, and Pakistan). Three countries: Afghanistan, Bangladesh, and Nepal are still classified as low income.

The IMF recommends that economies in Central Asia discontinue pro-cyclical policies and instead build on structural reforms to increase resilience to future shocks. Countries such as Kyrgyzstan have begun raising interest rates to ease price pressure and strengthening reserve and liquidity requirements. Energy exporters are cautioned to resist pressure to increase spending and to improve the efficiency of public spending. Energy importers such as Kyrgyzstan and Tajikistan are advised to start rebuilding fiscal buffers depleted during the crisis to ensure medium-term fiscal sustainability.

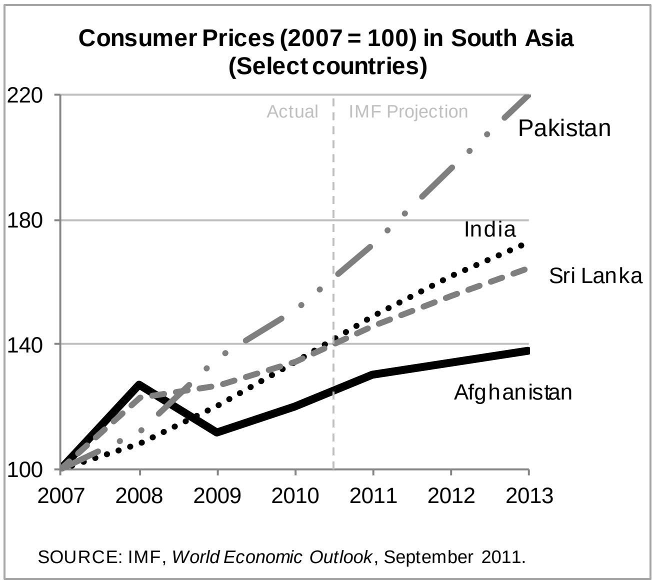
Real GDP Growth Rates, 2010–2011	South Asia 7.2%	Central Asia 6.8%

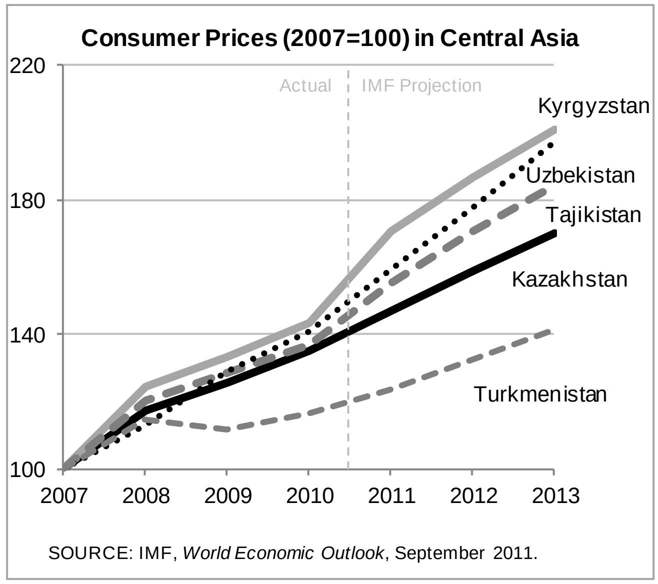
Inflation

Headline inflation has begun to pick up and is forecast to reach double digits in several Central Asian economies. According to the IMF, this reflects the sharp increase in commodity prices in the first half of the year and the high share of food in the consumption baskets, but in countries such as Kyrgyzstan and Uzbekistan it is also due to current or recent demand pressure. Energy exporters stand to gain from increases in oil prices, while energy importers will be cushioned to some degree by higher remittances from Russia.

Inflation is high across South Asia, reflecting higher international food and fuel prices and past macroeconomic loosening. Additionally, a series of local one-off factors have contributed to price pressures including the economic disruptions from flooding in Pakistan and Sri Lanka as well as the partial liberalization of oil prices in India.

In Bangladesh, rapidly rising inflation and the growing imbalance in external trade remained major challenges to macroeconomic stability in 2011 with the combination of higher international food prices and easy monetary and credit conditions fuelling inflation. The widening gap between import payments and export receipts and the sharp slowdown in remittance growth created pressure on foreign reserves and led to the depreciation of the taka.



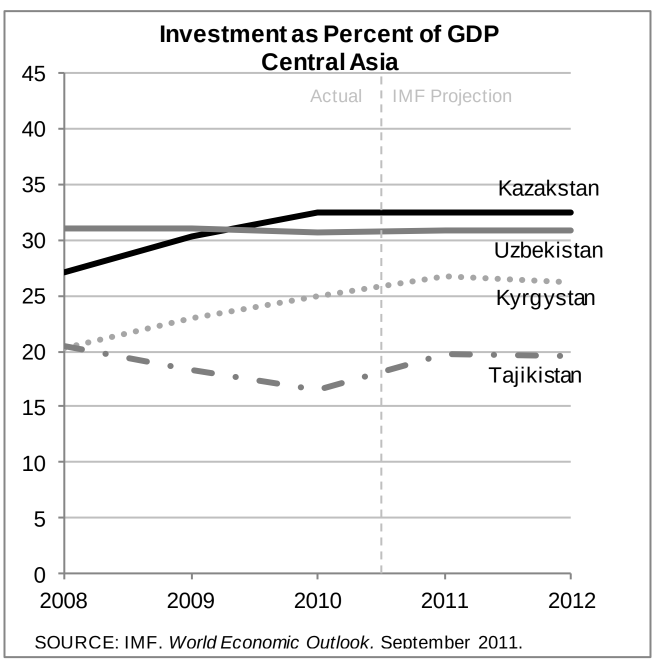


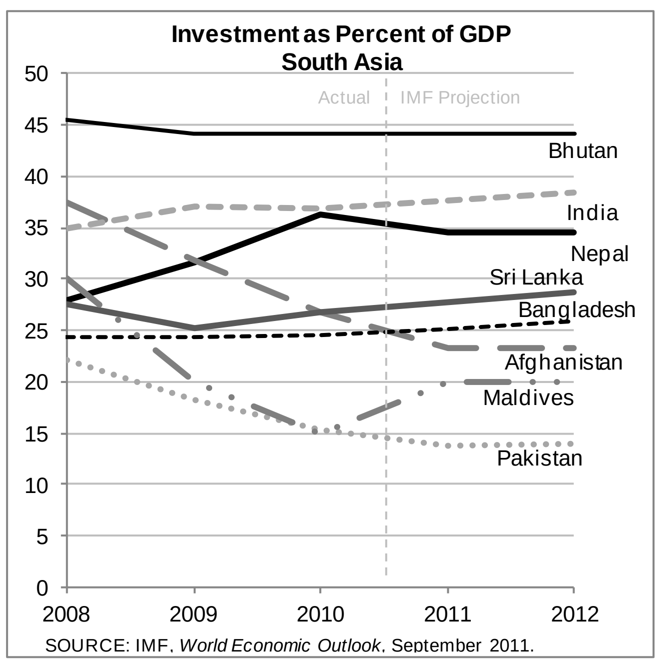
Inflation in South Asia could become a substantial impediment to growth as policymakers face numerous challenges in reducing price pressures. Continued high inflation, unless offset by exchange rate depreciation, is likely to weaken into the region's international competitiveness and discourage foreign investment.

Consumer Price Inflation (IMF Projections for 2011)	South Asia 12.2%	Central Asia 9.9%

Investment

Afghanistan, Bangladesh, Bhutan, India, and Sri Lanka all have large planned investment and reconstruction projects, which should bolster GDP growth in future years by improving productivity and potential output.





In India investment is expected to remain sluggish, reflecting in part, recent corporate sector governance issues and a less favorable financing environment. Despite India's strong growth, FDI fell by nearly one-third in 2010. Most other South Asian economies also saw their FDI inflows reduced with the notable exceptions of the Maldives, Bangladesh and Sri Lanka where FDI rose 45.8, 30.4, and 18.2 percent in 2010.

Private capital inflows into Central Asia, which were strong in the second and third quarters of 2010 eased in the fourth quarter of that year and into 2011. Significant improvements will likely be delayed until further along in the regional recovery or until there are substantial improvements in the region's investment climate.

The European debt crisis remains a risk to Central Asian economies, which have strong ties to high-income Europe. An unexpected or disorderly resolution of European debt could lead to a sharp reversal in capital flows to developing countries, with a disproportionate impact on Central Asia economies.

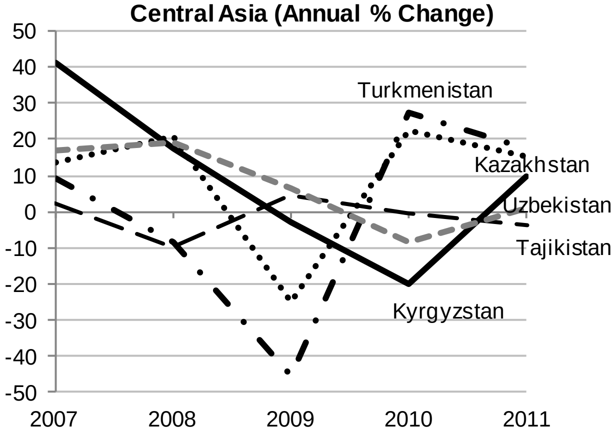
FDI Inflows, 2009–2010 (percent change)	South Asia -29.2%	Central Asia -28.2%

Trade

South Asia recorded strong export volume growth in early 2011, led by India, Pakistan and Sri Lanka, supported by strong external demand from China. However, the recent rise in oil prices is projected to translate into significant terms of trade deterioration for South Asia, compared with importers in most other developing regions. The subsequent decrease in real incomes will be tempered by increases in other commodities. For example, South Asia's cotton producers (such as India) are likely to see significant gains in terms of trade as cotton prices are projected to rise by one-third, whereas textile exporters (such as Bangladesh) are likely to see greater deterioration in their terms of trade.

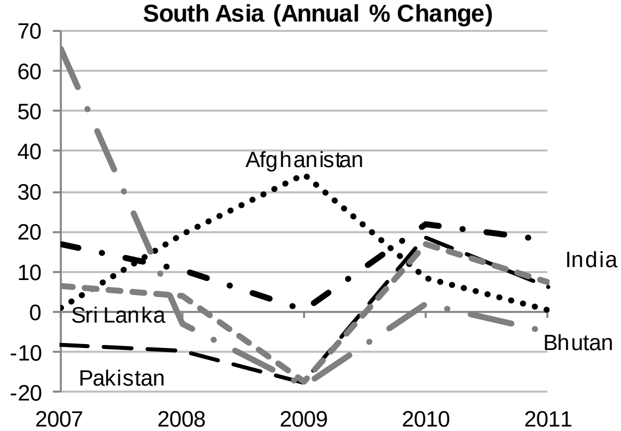
A drop in overseas jobs for Bangladeshi workers, especially in the Middle East countries, a major source of remittances inflows into Bangladesh- contributed to a slowdown in the growth of remittance earnings. Although remittance inflow was weak in the first half of the year, it started to pick up in February 2011 with a rise in overseas employment. Inflows of foreign direct investment and foreign aid slowed down putting further pressures on the country's foreign exchange reserves. Despite this and the slowdown in remittance growth and higher import growth, gross foreign exchange reserves remained high.

Export Volume of Goods and Services Central Asia (Annual % Change)



SOURCE: IMF, *World Economic Outlook*, September 2011.
NOTE: 2011 values are projections.

Export Volume of Goods and Services South Asia (Annual % Change)

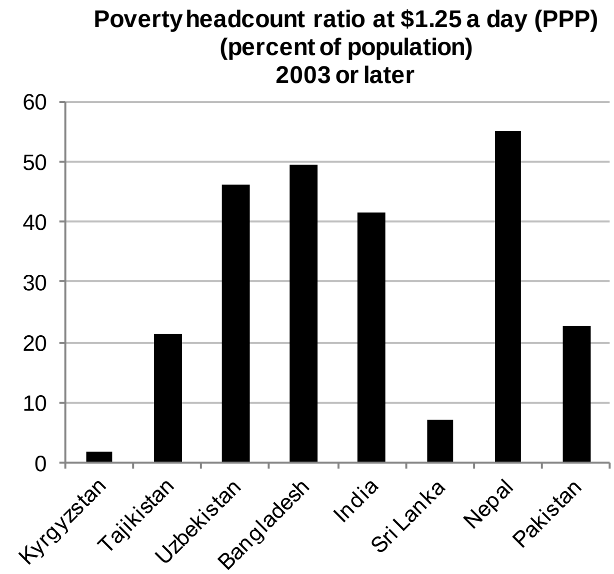


SOURCE: IMF, *World Economic Outlook*, September 2011.
NOTE: 2011 values are projections.

Exports from Central Asia have grown rapidly, most notably to Russia. For many economies in Central Asia, the combination of growing export volumes and rising commodity prices, especially oil, has contributed to a reduction in the region's trade deficit. Turkmenistan and Kazakhstan's export growth continues to improve while Uzbekistan reported slow export growth rates with a predicted annual change of 1.1 percent in 2011. Higher commodity prices will increase current account balances for commodity-rich countries in the region while having the opposite effect among importers.

Poverty Reduction and Millennium Development Goals

South Asia, particularly India and Bangladesh have made substantial progress in reducing income poverty during the last 10 years. However, achieving the non-income Millennium Development Goals (MDGs) remains a challenge in this region with more than 20 percent of the population living on less than $1.25 (PPP) a day in Bangladesh, India and Pakistan. In India, 40 percent or more children are still underweight. The same is true in Bangladesh, despite a drop in 23 percentage points between 1992 and 2007. Nepal has seen little change over the past decade with child malnutrition remaining at around 38.8 percent in 2006, down from 43 percent in 2001, but similar to 38.2 percent in 1998.



SOURCE: World Bank, *World Development Indicators*, 2011.
NOTE: Data is for the most recent year with data available in date range.

Maternal mortality ratios have declined substantially but are still extremely high in many economies. Afghanistan had a ratio of 1,800 in 2005. Several countries including Nepal, Bangladesh, India, and Pakistan have ratios between 100 and 830 in 2005 in contrast to the often less than 10 in developed economies.

With a relatively high standard of human development achieved (close to 90 percent of births are attended by skilled health staff), the Central Asian state of poverty is characterized by a lack of pro-poor growth. Enrollment ratios in are 80 percent or higher with 90 percent or higher completion ratios. Kazakhstan, Kyrgyzstan, and Uzbekistan have already achieved gender equality in secondary education. However, the Asian Development Bank expects that Tajikistan will miss the 2015 target.

Additional Information
For country-specific data and additional information about the countries covered in this report, please visit the EADS Country Portal at http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal. Sources used in compiling this report include the semi-annual World Economic Outlook from the International Monetary Fund (http://www.imf.org/), the Global Economic Prospects from the World Bank (http://www.worldbank.org/) and the annual Asian Development Outlook from the Asian Development Bank (http://www.adb.org).