TURKMENISTAN

Highlights

- **Growth in 2016 is expected to reach 6.5 per cent**, the same level as in 2015, supported by foreign direct investment (FDI) both in the extractive and non-extractive sectors and gradual improvement in the external environment. However this has been offset by the negative effects on growth of currency restrictions in the country.
- **Pressure on the local currency has been increasing.** This reflects the deteriorating external economic environment and the significant depreciation of other regional currencies. Stringent foreign exchange regulations have been introduced, which is negatively affecting the ability of businesses in the country to carry out operations.
- **The government is increasing tariffs in the utility sector.** Measures include reducing the free rations of electricity consumption, and installation of gas and water meters across the country has started. This can be considered a positive development in the context of creating a more sustainable and less distorted economy overall and the utility sector in particular.

Key priorities for 2017

- **Efforts to improve the business environment need to accelerate.** It is important to accelerate structural reforms, with particular focus on commercialisation of state-owned companies and their gradual privatisation; trade liberalisation should also be increased.
- **The financial supervision framework needs to be strengthened**, with a gradual reduction in state-directed lending and state lending programmes implemented by the commercial banks, moving to a more market-based credit intermediation.
- **Reform in the utility sector needs to continue.** The government needs to accelerate its efforts to reform the utility sector by installing water and electricity meters across the country and gradually bringing tariffs towards cost recovery levels; building on the recent positive reform steps in the sector.

Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	11.1	10.2	10.3	6.5	6.5
Inflation (average)	5.3	6.8	6.0	6.4	6.9
Government balance/GDP	6.3	1.2	0.8	-0.7	-0.8
Current account balance/GDP	0.0	-7.2	-7.5	-10.3	-18.5
Net FDI/GDP [neg. sign = inflows]	-8.9	-9.0	-8.8	-12.2	-12.5
External debt/GDP	18.1	20.8	17.4	23.2	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic performance

GDP growth has declined to 6.5 per cent in 2015 and 6.2 per cent in the first half of 2016 from 10.3 per cent in 2014, reflecting lower oil and gas prices, as well as the economic slow-down in the neighbouring region. Gazprom's decision, announced at the beginning of 2015, to cut gas imports from Turkmenistan, adversely affected gas exports; however, the effect was mitigated by increased gas exports to China. Flour subsidies were reduced and petrol prices increased by 60 per cent in 2015, which contributed to increased inflation (6.4 per cent in 2015 versus 6.0 per cent in 2014).

Pressure on the local currency has been building, reflecting the deteriorating external economic environment and the significant depreciation of other regional currencies. In January 2015, the central bank devalued the manat by 19 per cent. Pressure on the currency has continued, but further devaluation has not yet happened. Instead, the authorities have responded by introducing stringent foreign exchange regulations, which have mitigated pressure on the currency, while at the same time negatively affecting the ability of businesses in the country to carry out import-export operations.

Low oil and gas prices continue to put pressure on Turkmenistan's external balances. While the fiscal position remained in balance in 2015, the current account deficit widened significantly, reaching 10.3 per cent of GDP. Trade performance deteriorated, with exports down by 38.5 per cent as a result of low revenues from gas exports and imports down by 15.5 per cent in 2015 year-on-year. The drop in imports reflects the reduction in purchasing power of consumers following the devaluation, as well as increased restrictions on car imports introduced by the authorities in August 2015.

Growth in 2016 is expected to remain at the same level as 2015, reaching 6.5 per cent, supported by FDI both in the extractive and non-extractive sectors and a gradual improvement in the external environment, but offset by the negative effects of the foreign exchange restrictions on the real economy. Plans related to the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline have been finalised, with work on the Turkmen part of the pipeline already under way, resulting in increased investment. In 2017, growth can be expected to recover slightly to 7.1 per cent, reflecting expected gradual improvements in commodity prices and inward FDI.

Major structural reform developments

Progress on structural reforms in the past year has been modest, although some improvements have materialised. The country remains in the early stage of transition, with a significant state presence in all sectors of the economy. Competitiveness of the private sector is low due to the challenging business environment and interference by the state; although the authorities have shown openness towards privatisations. In June 2016 the President of Turkmenistan urged the government to accelerate privatisation efforts to sell around 30 state companies in 2016 in the third stage of the state programme of privatisation for 2013-16. To date, 39 (out of a total of 89 companies under the first and second stages of the programme) have been privatised. The government has also intensified its efforts to achieve economic diversification through providing improved incentives to local firms for import substitution and increased exports.

In light of the challenging economic situation, the government is increasing (effective average) tariffs in the utility sector, through reducing the free rations of electricity consumption. Installation of gas and water meters across the country's entire territory has started and there is a plan to gradually eliminate the free rations and increase tariffs. While prices still remain significantly below cost-reflective levels, these recent moves can be considered as positive early steps in reforming the utility sectors. In 2015, the government also increased natural gas and gasoline prices and reduced food subsidies, which can be interpreted as a positive move in the context of creating a more sustainable and less distorted economy.

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The financial sector is underdeveloped, with significant state-directed lending channelled through the banking sector. The authorities have adopted a programme for 2010-2030 to develop the banking sector, envisaging (among other things) privatisation of state banks in 2016-2020. The EBRD and other international financial institutions (IFIs) are supporting the government and the central bank in these financial sector reform efforts, but progress so far has been limited.

Turkmenistan continues its efforts to diversify export market routes as well as export markets. The construction of the Turkmen part of the TAPI pipeline started in December 2015. The first tranche of US$ 45 million was approved in June 2016, to finance the initial stage of construction of TAPI at the Afghan-Pakistan segment. At the same time, negotiations on the project for the construction of the 300-kilometre-long Trans-Caspian Gas Pipeline to the Azerbaijani coast to re-export Turkmen gas to Europe through Turkey have been accelerated, in an effort to cooperate with the international community and contribute to energy security in Europe. As for relations with Russia, which was the main customer of Turkmen gas until 2008, Gazprom has filed a case in the international arbitration court seeking US$ 5 billion from Turkmengaz as a result of a pricing dispute from 2010-15. The court is expected to rule on the case in mid-2017.

The opening up of Iran provides new opportunities. The two countries signed a gas barter deal in June 2016 worth US$ 30 billion up until 2026. Turkmenistan will receive technical, manufacturing and engineering supplies from Iran in exchange for gas supply to the country. Iran is the second largest Turkmen gas purchaser after China, while Turkmenistan is the largest gas supplier for Iran. The two countries also agreed to boost trade to US$ 60 billion over the next decade (trade turnover reached US$ 600 million in 2015).