

**EXECUTIVE
BOARD
MEETING**

SM/21/160
Correction 1

September 21, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Turkmenistan—Staff Report for the 2021 Article IV Consultation**

Board Action: The attached corrections to SM/21/160 (8/31/21) have been provided by the staff:

Evident Ambiguity **Page 12 (subsequent paragraphs renumbered)**

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views **Page 43 (para. 2, line 6)**

Typographical Errors **Page 43 (para. 2, lines 14-15)**

Questions: Mr. Steinberg, MCD (ext. 34808)
Mr. Bayar, MCD (ext. 34594)

25. While recognizing the large gap between the official and parallel market rate, the authorities did not see the need for changing exchange arrangements for the time being. They viewed exchange restrictions on the making of payments and transfers for current international transactions as crucial for addressing priority import needs of the country without causing a widening of the current account deficit. The authorities also considered the current pegged regime as appropriate for Turkmenistan for the foreseeable future, given the importance of natural gas exports for its economy and the fact that the respective contracts are denominated in dollars. The authorities agreed with staff, however, that an eventual move to a more flexible exchange rate regime and inflation targeting framework would need to be gradual and underpinned by the development of the appropriate institutional infrastructure and technical capacity. Building capacity in liquidity and economic forecasting is also important, as the foundation for increasing the CBT's operational independence. Clear public communication would build institutional credibility and bolster confidence. Over the longer term, transitioning to greater exchange rate flexibility with the interest rate as the main policy tool would facilitate adjustment to shocks, alongside financial market development. They were open to continuing TA dialogue on issues related to future reforms of exchange arrangements.

26. Staff stressed that phasing out directed credit would support external adjustment while promoting market-oriented financial intermediation. Banks need to be able to assess borrowers' loan repayment capacity and reflect the underlying risks in loan pricing and other conditions. The CBT can further enhance its liquidity management by using bills to mop up excess liquidity. Staff also recommended that the Central Bank Law and related legislation are amended to prohibit the CBT from purchasing government securities in primary auctions. The authorities considered directed concessional lending as a cornerstone of their IS/EP strategy and highlighted it as an important factor that helped Turkmenistan's corporate sector weather the pandemic.

~~**27. The authorities and staff concurred that the exceptional loan moratorium needs to be withdrawn carefully.** While extending a temporary respite to nonfinancial corporations, the moratorium shifted risks to the banking sector. Even before the pandemic, the authorities acknowledged problems in the banking sector, necessitating recapitalization. Considering these legacy issues and the impact of (i) the moratorium, (ii) slowdown in credit growth, (iii) continued directed lending practices, and (iv) worsening profitability, the official financial soundness indicators are likely understating risks. Staff encouraged the authorities to closely monitor the risks stemming from the loan moratorium and phase it out as soon as conditions permit.~~

28.—27. The authorities and staff concurred that the exceptional loan moratorium needs to be withdrawn carefully. While extending a temporary respite to nonfinancial corporations, the moratorium shifted risks to the banking sector. Even before the pandemic, the authorities acknowledged problems in the banking sector, necessitating recapitalization. Considering these legacy issues and the impact of (i) the moratorium, (ii) slowdown in credit growth, (iii) continued directed lending practices, and (iv) worsening profitability, the official financial soundness indicators are likely understating risks. Staff encouraged the authorities to closely monitor the risks stemming from the loan moratorium and phase it out as soon as conditions permit. The authorities viewed the

Annex IV. Estimating Real GDP Growth¹

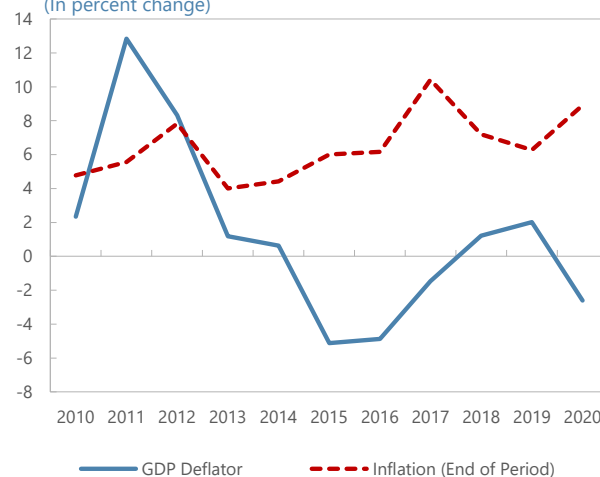
The Pandemic Year

1. Continued strong economic expansion in Turkmenistan in 2020, according to the official data, contrasts with global and regional experience, especially given larger shocks and the smaller policy response in Turkmenistan. As an undiversified gas exporter, Turkmenistan faced a sharp deterioration in its terms-of-trade owing to lower hydrocarbon prices, on top of a sharp drop in import demand for natural gas from China, its main trading partner. Although Turkmenistan did not officially register any COVID-19 infections, the stringency of its containment measures and mobility restrictions was comparable to that in other countries. At the same time, the authorities' macro-financial policy response was much smaller, centered on a loan moratorium. The fiscal stance was contractionary, and policy rates remained unchanged in 2020. Nonetheless, according to the official data, Turkmenistan economy expanded by 5.9 percent in 2020, while most of its global and regional peers plunged into a recession.

2. The narrative underlying the official GDP growth estimates is hard to reconcile with other available data.

Official GDP in current prices expanded by less than 1 percent in 2020, which, together with 5.9 percent real GDP growth, implies a negative GDP deflator. A very large difference (11.514 pps) between the official GDP deflator (-2.6 percent) and official CPI (8.9 percent) is uncommon. In addition, a sharp double-digit expansion in retail trade (28.9 percent) is at odds with much weaker growth in agriculture and imports. Strong growth in transportation is not consistent with prolonged border closures, restrictions on domestic travel, suspension of passenger and cargo flights, and a decline in fuel consumption¹. Cross-border data imply a broad-based decline in exports (including gas petrochemicals and fertilizers) and stagnant imports. Likewise, broad-based weakness in tax revenues, especially in consumption-based VAT and excises, and a drop in electricity generation (-6.8 percent) point to a weakening of economic activity.

Turkmenistan: Official GDP Deflator and Inflation
(In percent change)



Sources: National authorities, and IMF staff calculations.

Historical Data

3. Statistical anomalies are also evident in historical official GDP series. GDP and trade statistics are inconsistent, at times implying unrealistically strong domestic consumption growth. Also, GDP growth rates are uncorrelated with export growth. GDP deflators are highly volatile and for some sectors are unrealistically high or low (30–90 percent). Prolonged economic expansions are

¹ Prepared by Ömer E. Bayar, Levan Gogoberishvili (STA), and Amine Yaaqoubi, with inputs from Faten Saliba and Jean-Francois Wen (FAD).