FOR AGENDA

SM/08/202

June 30, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Turkmenistan—Staff Report for the 2008 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2008 Article IV consultation with Turkmenistan, which is tentatively scheduled for discussion on **Wednesday, July 16, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Turkmenistan indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Winglee (ext. 35693) and Mr. Abdoun (ext. 38394) in MCD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Asian Development Bank, the European Bank for Reconstruction and Development, the European Commission, the Islamic Development Bank, and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

TURKMENISTAN

Staff Report for the 2008 Article IV Consultation

Prepared by the Staff Representatives for the 2008 Consultation with Turkmenistan

Approved by Adam Bennett and Mark Plant

June 30, 2008

- **Mission:** April 28–May 8, 2008 in Ashgabat.
- **Team:** Messrs. Winglee (head), Abdoun, Puig, Sumlinski, and Ms. Rios (assistant) (all MCD), and Ms. Kokenyne (MCM). Ms. Hojanazarova, IMF Ashgabat Office Manager, assisted the mission. Messrs. Bennett (MCD), and Moser and Muratnarzarov (both OED) participated in some of the policy discussions.
- **Key counterpart officials**: Mr. Geldymuradov, Deputy Prime Minister for economic issues; Mr. Gochiev, Minister of Finance; Mr. Gurbanmuradov, Minister of Economy and Development; Mr. Geoklenov, Chairman of the Central Bank of Turkmenistan (CBT); and other ministers and senior officials. A brief press statement on the mission was issued.
- **Exchange system**: Turkmenistan continues to avail itself of the transitional arrangements under Article XIV and maintains an exchange restriction and multiple currency practices subject to Fund approval under Article VIII, Sections 2 (a), and 3. The de-facto exchange rate regime is a conventional pegged arrangement.
- **Data quality:** Remains weak, particularly national accounts and price statistics, and continues to hinder surveillance, but there is close cooperation to address this.
- **Previous consultation:** Concluded on May 11, 2007; staff report SM/07/135.

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EXECUTIVE SUMMARY

The 2008 Article IV consultation discussions focused on policies to start the economic reform process, especially the unification of the exchange rates and supporting policies, to maintain macroeconomic stability and advance reforms in the financial and trade areas.

Economic developments and outlook

Turkmenistan has benefited from increased hydrocarbon export prices and export outlets. These generated strong economic growth and large fiscal and external surpluses in 2007, which are expected to continue in the medium-term. Inflation started to pick up in late 2007 and reached 16 percent in March 2008, reflecting higher international food prices, regional weather problems, and an 8-fold increase in domestic petroleum prices. The official and commercial exchange rates were unified at the mid-point between them on May 1, 2008.

Views of the authorities

The authorities have embarked upon a program of economic transformation. In addition to reforms in the social, hydrocarbon, and industrial sectors, they envisage financial reforms with the already completed exchange rate unification as the first step toward integrating Turkmenistan into the international economy. These reforms will be accompanied by policies to mitigate adverse price and social effects, including by reducing duty and excise rates. Fiscal and monetary policies will aim to support a stable exchange rate, which could serve as a nominal anchor for the economy. The authorities plan to redenominate the manat (removing zeros) at the start of 2009, and are considering reforms to the banking system (including allowing greater competition and the gradual entry of foreign banks).

Staff recommendations

- **Foreign exchange should be readily accessible for all current transactions.** Duties and excise taxes, as well as non-tariff barriers to trade, should be reduced in order to limit the inflationary effects of the exchange rate unification.
- **Moderate increases in public spending would be appropriate to protect real incomes,** while phasing-in administered price increases. Reduce low-priority public spending if excess demand pressures emerge. Progressively strengthen public financial management, especially by expanding the coverage of the budget.
- **Monetary policy should support the new exchange rate as a nominal anchor**. The CBT should phase out directed credits and raise interest rates, while commercial banks expand credit and attract deposits from the private sector on market terms.
- **Major reforms are needed to deepen the financial sector,** to create a commercial credit culture, develop competition, and strengthen accounting and auditing.
- **Staff encourages further efforts to improve the quality of economic and financial data** and their systematic publication.

I. Introduction

1. **Turkmenistan is a landlocked country with an economy dominated by a large hydrocarbon sector (mainly natural gas).** In 2007 this sector contributed about 25 percent of GDP and 90 percent of exports, and has benefited from recent successes in raising export prices and expanding outlets. Until recently, Turkmenistan maintained a state-dominated economy, lagging well behind other Commonwealth of Independent States (CIS) countries in economic reforms.

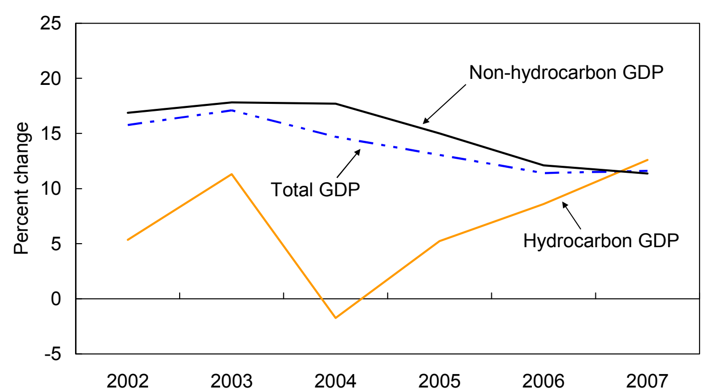
2. **In 2007, President Berdimuhamedov launched a program of social and economic reforms, and sought to improve relations with neighboring countries and international institutions.** Reforms to the exchange system and administered prices began in early 2008, and initiatives were launched to attract foreign direct investment (FDI). The 2008 Article IV consultation focused on the key near-term measures to accelerate these economic reforms, and especially to support exchange rate unification, which was a key recommendation in the 2007 Article IV consultation.

II. Background

A. Developments and Outlook in 2007 and 2008

3. **Economic conditions remain robust (Table 1) and the outlook for the hydrocarbon sector has greatly improved.** Growth reached 11½ percent in 2007, driven by increased hydrocarbon output and broad-based growth in the non-hydrocarbon economy, including in the construction, transport and communication, and retail sectors.[1] For 2008, real GDP growth is projected at 11 percent, based on buoyant hydrocarbon sector prospects (Box 1), and with growth in the nonhydrocarbon sector boosted by public spending on rural development and infrastructure.

Real GDP growth remained strong in 2007



Sources: Data provided by authorities, and Fund staff estimates.

[1] The decline in growth estimates since 2003 reflects the greater use of internationally standard methodologies, not less buoyant economic conditions. Further revisions to methodologies and growth estimates are possible.

Box 1: Overview of the Hydrocarbon Sector

Turkmenistan has a large endowment of natural gas. The authorities estimate that natural gas reserves amount to 24.6 trillion cubic meters (tcm) which, if confirmed, would make them the 4th largest in the world. This is substantially more than the British Petroleum (BP) estimate of 2.7 tcm. The first phase of an international audit of gas reserves, which would cover the Dauletabad-Donmez field (the main field supplying gas exports to Russia), is expected to be completed in the second half of 2008. Later phases of the audit will be prioritized by foreign interest in new gas contracts. Oil reserves are estimated to be more modest than gas reserves, at 1.8 billion barrels.

Reserves and Production of Natural Gas, 2007

	Proved reserves (in tcm)	Share of total (in percent)	Annual production (in bcm)
Russian Federation	44.7	25.2	607
Iran	27.8	15.7	112
Qatar	25.6	14.4	60
Turkmenistan			
Unofficial estimate 1/	24.6	N/A	72
Saudi Arabia	7.2	4.0	76
UAE	6.1	3.4	49
USA	6.0	3.4	546
Nigeria	5.3	3.0	35
Venezuela	5.2	2.9	29
Algeria	4.5	2.5	83
Iraq	3.2	1.8	…
Norway	3.0	1.7	90
Indonesia	3.0	1.7	67
Turkmenistan			
BP estimate	2.7	1.5	72
Kazakhstan	1.9	1.1	27

Source: BP, Statistical Review of World Energy, 2008

1/ As reported by the Turkmen authorities, but not yet independently audited.

Hydrocarbon production continues to be heavily dominated by state enterprises, but the new government has started to attract more FDI. Since the late 1990s, three international oil companies (IOCs) have operated off-shore oil and gas fields in the Caspian Sea under production sharing agreements (PSAs), and are now expanding these operations. Contacts with other IOCs to develop new off-shore gas fields are being intensified. In 2007, the first PSA with a foreign company—CNPC of China—to develop an on-shore gas field was approved.

Export prospects have improved significantly. As recently as 2004, lack of alternative export prospects kept export prices low, $44 per thousand cm, with half paid as barter. Subsequent negotiations have raised the prices. Recent agreements were reached with:

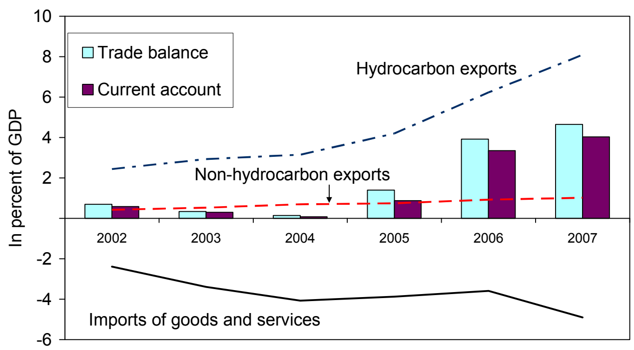
- Russia to increase the gas export price from $100 per thousand cm in 2007 to an average price of $140 in 2008, and to switch to market prices thereafter. The capacity of the Central Asia-Center pipeline network—the main outlet for Turkmenistan's gas exports—is being increased by 20 billion cm (bcm) from its current capacity of about 43 bcm. Construction of a new pipeline along the Caspian shore will start in 2009.[1] The additional capacity of up to 20 bcm should be available starting in 2010-11.
- China to build a 7,000 km gas pipeline with an eventual capacity of 30 bcm. Construction started in 2007 and is expected to be finished by 2010. The 30-year agreement provides also for a formula linking the Turkmen gas export price to the world oil price.
- Iran to raise the gas export price in 2008 from $75 per thousand cm to about the 2008 export price for Russia. There are also plans to move to international prices starting in 2009.

Prospects for pipelines to export gas to Europe and Pakistan and India are advancing more slowly as a result of ongoing uncertainties about the legal status of the Caspian Sea and the security situation in Afghanistan.

1/ Turkmenistan's policy is to transport gas to its border and sell to buyers willing to bear pipeline investment costs beyond the border. Investments on the domestic sections of gas pipelines could be about $1 billion in 2008-10.

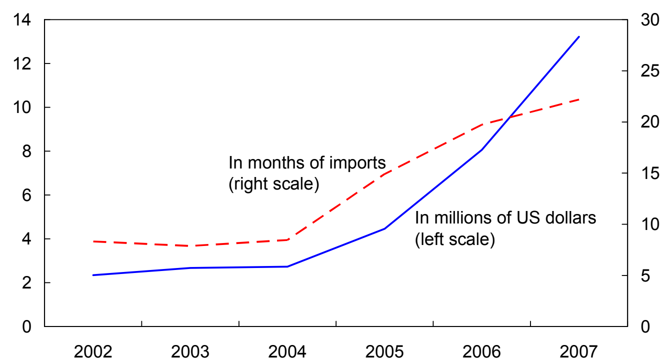
4. **Reflecting the favorable market conditions for hydrocarbon exports, the current account surplus and international reserves are growing strongly.** In 2007, with hydrocarbon export revenues up 30 percent, the current account surplus reached 15½ percent of GDP and gross international reserves rose to $13 billion (equivalent to about 22 months of import cover) as the authorities chose to save a large part of their hydrocarbon income. The recent growth in FDI inflows, mainly reflecting the investment in offshore oil operations in the Caspian Sea, is expected to continue. Staff projects a further increase in the current account surplus to 23½ percent of GDP in 2008, with reserves reaching $20 billion.

Export prices increases resulted in large surpluses...



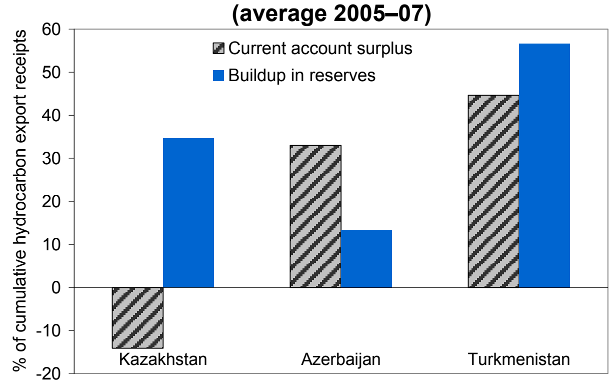
Source: Data provided by authorities.

… and large increases in international reserves



Sources: Data provided by authorities, and Fund staff estimates.

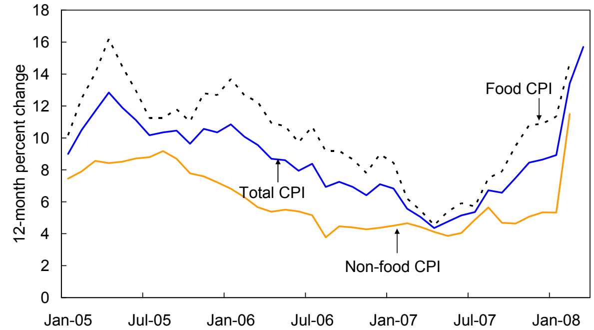
Savings of hydrocarbon exports were high (average 2005–07)



Sources: International Financial Statistics, and national sources.

5. **Inflation was low for much of 2007, but it started to accelerate at the end of the year,** due to higher international food prices[2] and supply shortages caused by the extremely cold winter. Headline inflation in 2008 is being boosted further by the progressive adjustment of administered prices to market levels, with an 8-fold increase in domestic petroleum prices in February 2008[3] and very large increases in bus and rail fares and airline ticket prices in May and early June 2008. Inflation reached almost 16 percent in March 2008 (year on year).

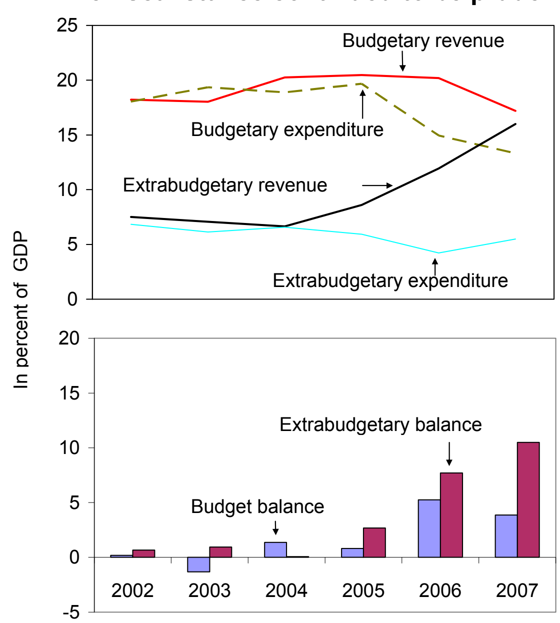
Exogenous factors pushed inflation up since late 2007



Sources: Data provided by authorities, and Fund staff estimates.

6. **The fiscal stance has generally been restrained.** The 2007 budget surplus amounted to 4 percent of GDP. Revenue growth fell to only 4 percent, despite the large increase in hydrocarbon export values, due to a change in the allocation of hydrocarbon revenues in favor of off-budget revenue. Budget expenditure was lower than allocated due to the slow execution of the capital investment program (Table 2). Although the initial 2008 budget seemed expansionary with a projected deficit of 3 percent of GDP, this reflected a contingency allowance to finance projects in rural development and tourism, which would have been previously implemented off-budget, as well as conservative gas export price assumptions. Other aspects of expenditure, such as the 10 percent increase in wages, were restrained. Staff estimate that off-budget operations in 2007 showed an additional surplus of 11 percent of GDP, with extrabudgetary government spending estimated at about 6 percent of GDP.[4]

The fiscal stance continued to be prudent



Sources: Data provided by authorities, and Fund staff estimates.

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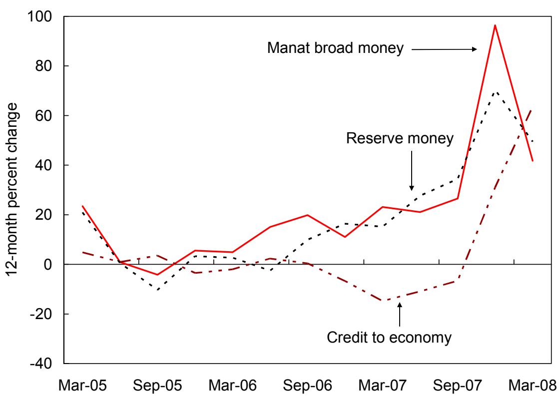
[2] Although Turkmenistan is a small net food importer, domestic food prices tend to follow regional prices.

[3] The direct impact on consumers was substantially offset by a free quota for a basic consumption level.

[4] Extrabudgetary government revenue and expenditure have been estimated by the staff using BOP, monetary, and investment data.

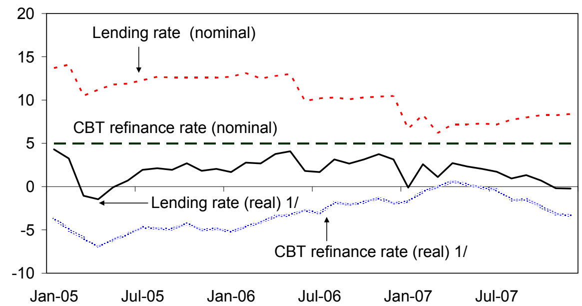
7. **The monetary stance was loosened in the last part of 2007 and then tightened again in early 2008.** (Tables 3 and 4) In 2007, credit to the economy grew by 30 percent, reflecting a large increase in directed credits to the cotton sector, partly funded by the CBT. As a result, reserve money growth reached 70 percent at end-2007, and manat broad money almost doubled. However, the partial repayment of the agricultural loans and increased sales of foreign exchange ahead of expected unification sharply reduced both reserve money and manat broad money in the first quarter of 2008. Meanwhile, nominal interest rates remained unchanged as inflation picked up.

In late 2007, monetary policy loosened driven by credit...



Source: Data provided by authorities.

... with real interest rates turning negative

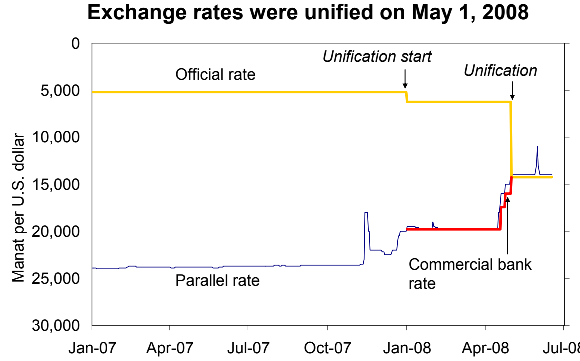


1/ Based on past 12-months end of period inflation.

Sources: Data provided by authorities, and Fund staff estimates.

8. **The process of exchange rate unification was launched at the start of 2008 and was completed on May 1, 2008.** The former dual exchange rate system comprised: (i) an official rate pegged at manat 5,200 per U.S. dollar; and (ii) a parallel market rate, 4-5 times more depreciated. Effective January 1, 2008, the authorities devalued the official rate to manat 6,250 per US dollar, and introduced a commercial rate of manat 20,000 per US dollar (some 20 percent above the earlier parallel rate) at which banks could trade freely with the public. After expeditious preparations, the two markets were unified on May 1, at the rate of manat 14,250 per US dollar. New foreign exchange regulations were issued at the start of June that continued the commitment to provide unrestricted access to foreign exchange for making payments and transfers for current international transactions. These actions have eliminated certain exchange restrictions and a multiple currency practice subject to approval under Article VIII Sections 2 (a) or 3, while others remain. Fund staff is keeping the issue under review. Meanwhile parallel market activity has diminished substantially and the rate generally remains very close to the new official rate.

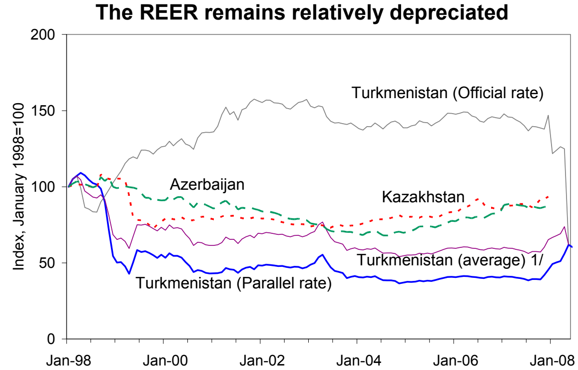
Exchange rates were unified on May 1, 2008



Sources: Data provided by authorities, and Fund staff collections.

9. **The authorities' chosen level for the unified exchange rate is consistent with Turkmenistan's strong external position.**[5] The appreciation of the parallel/commercial rate should help contain CPI inflation as most consumption goods were imported at this rate. The REER of Turkmenistan's unified exchange rate remains more depreciated than those for Azerbaijan and Kazakhstan[6] and the table below shows that Turkmen wages (in US dollar terms) are still below the levels in these countries as well. The unified rate is close to the implicit average exchange rate for which the model-based assessments do not conclusively show misalignment (Box 2). Nevertheless, the appreciation of the parallel/commercial rate, and increases in domestic petroleum and transport prices have put pressure on the competitiveness of the private sector. Aware of this challenge, the authorities plan to enhance productivity and boost competitiveness by reducing import tariffs, and accelerating structural reforms in the areas of telecommunications, business licensing, and financial services.

The REER remains relatively depreciated



1/ Equally weighted average of official and parallel exchange rates.

Sources: Information Notice System. Data provided by authorities, and Fund staff estimates.

CIS: Nominal Average Wages, 2000–08

(In US dollars per month)

	2000	2001	2002	2003	2004	2005	2006	2007	2008 Proj.
Azerbaijan	50	56	65	79	101	125	167	198	237
Armenia	42	44	48	60	81	114	150	230	286
Belarus	74	87	105	121	161	218	271	321	...
Georgia	37	46	52	59	82	113	156	210	...
Kazakhstan	101	118	133	155	208	254	324	428	514
Kyrgystan	26	30	36	44	53	63	81	...	...
Moldova	33	42	51	64	89	105	129	160	...
Russia	79	111	139	179	234	302	391	455	...
Tajikistan	9	10	12	15	21	29	35	48	...
Turkmenistan (official)	115	169	183	337	356	481	485	485	...
Turkmenistan (parallel)	33	40	44	83	78	102	105	108	195
Uzbekistan	...	39	39	41	52	74	93	141	...
Ukraine	42	58	71	87	111	157	206	...	...

Sources: Commonwealth of Independent States (CIS) Statistics and IMF staff estimates.

[5] Fund staff conducted seminars and discussions during 2007 on options for unification, and the final path reflects many of the recommendations made.

[6] However, Turkmenistan's CPI may have underestimated inflation during 1999-2002 due to delays in updating the basket.

Box 2. External Sustainability and the Assessment of the Exchange Rate

The assessment of Turkmenistan's exchange rate gives a wide variation in the size and sign of the estimates. It is severely constrained by the quality of macroeconomic data, uncertainty about the resource endowment, and the previous dual exchange rate system. Taking into account the latter, an average exchange rate with a 50-50 weighting has been assumed as the economy's implicit exchange rate. The macroeconomic balance (MB) and equilibrium real exchange rate (ERER) approaches, adapted to a panel of 13 MCD oil countries, yield conflicting results: overvaluation for the former, and a substantial undervaluation for the latter. The results of the external sustainability approach vary widely depending on the assumed level of Turkmenistan's hydrocarbon reserves: a significant overvaluation in the low case (LC) scenario, which assumes BP's hydrocarbon reserves estimates; and a significant undervaluation in the baseline scenario, which uses a mid-point between LC and the authorities' estimates.

Turkmenistan: Summary of Estimates of Real Exchange Rate Misalignment

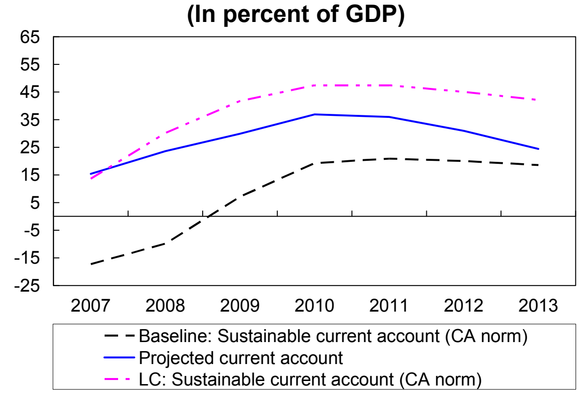
	Current account (In percent of GDP) Norm	Proj.	Estimated over (+)/under (-) valuation	Comments
1. Macroeconomic Balance Approach (2013) 1/				
Average of three methods 2/	34	31	13	Overvalued
2. Equilibrium Real Exchange Rate Approach (Weighted average rate) 1/ 3/				
2006			-26	Significantly undervalued
Average 2000-06			0	No deviation
3. External Sustainability (2013)				
Baseline	17	31	-61	Significantly undervalued
Low case (LC)	43	31	52	Significantly overvalued

1/ Based on ongoing research work in MCD.
2/ The model has been estimated over the period 1971-2006, using a panel of 13 MCD oil countries and three methods: the generalized method of moments, OLS, and fixed effects methods. The explanatory variables included the fiscal balance, the age dependancy ratio, population growth, initial NFA, oil balance, outgrowth and relative income.
3/ The model has been estimated over the period 1980-2006, using the fixed effects estimator. The explanatory variables included the relative productivity, fiscal balance, CA balance, terms of trade, and openess ratio.

The MB approach indicates that Turkmenistan's projected current account (CA) for 2013 is about 3 percent of GDP lower than the CA norm consistent with medium-term equilibrium. This CA deviation would reflect an exchange rate overvaluation of about 13 percent.[1]

In contrast, the ERER approach yields a significant undervaluation of about 26 percent in 2006.

Turkmenistan: External Sustainability (In percent of GDP)

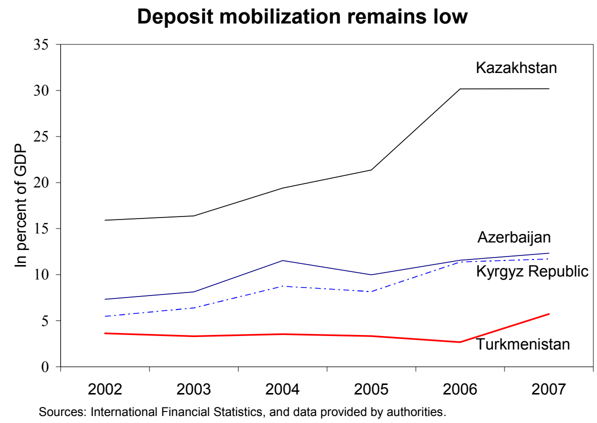


Sources: Data provided by authorities, and Fund staff estimates and projections.

The external sustainability approach is based on the permanent income approach, but depends critically on the level of gas reserves, the rate of extraction, the rate of interest, and the future path of oil prices. Under this approach, the net present value of the exhaustible hydrocarbon export stream over the extraction period is converted into a constant permanent real annuity. This annuity is then used as the sustainable nonhydrocarbon CA balance to derive a CA norm. The CA norm depends on hydrocarbon reserves: the lower the reserves (LC), the higher the need to save and the higher CA norm, here implying a significant overvaluation (52 percent); the baseline scenario by contrast shows a significant undervaluation (61 percent).

[1] Based on a trade balance elasticity (-0.23) derived from a study of trade elasticities in MCD's oil exporting countries.

10. **The banking sector is very small and dominated by state banks.** Direct monetary controls, the predominance of cash as a means of payment, and the distorted foreign exchange market (prior to unification) have limited its role in the economy. As a result, deposits are only about 5 percent of GDP, while 90 percent of commercial bank credit goes to state enterprises, often at relatively low interest rates. The financial soundness indicators reported by the authorities indicate a general compliance by the banks with existing norms. However, the CBT recognizes that this may not represent a true picture and a project to introduce International Financial Reporting Standards (IFRS) in the banking system is underway. So far, two banks (out of twelve) are participating in the pilot project.



B. Medium-Term Outlook and Risks (2009-13)

11. **Turkmenistan's medium term economic and financial outlook is favorable under the current scenario for energy prices.** Real GDP growth is expected to be in the 8–10 percent per year range, the budget would continue to be in surplus, and the external current account surplus would remain at over 30 percent of GDP (Table 6). However, comprehensive economic reforms are needed to diversify the economy, increase employment, and develop the private sector.

12. **The downside risks to the external outlook are fairly limited,** since Turkmenistan's gas export price is still catching up to the European market price. Thus, even if world oil prices fall $30 below the WEO trajectory and the Turkmen gas export price stays at US$140 per tcm (less than half the EU import price), the external current account balance would continue to record surpluses of about 11 percent of GDP. A further $10 per barrel decline in oil price would reduce the surplus by 2 percent of GDP.

III. Authorities' Views

13. **The discussions took place as the authorities are starting their reform process.** They plan to achieve strong and sustainable economic growth, improve job creation and living standards, and smoothly integrate Turkmenistan into the international economy (Box 3). The authorities are making progress in the hydrocarbon, infrastructure, and social areas. Exchange system reform is seen as a first step in developing the financial sector, while also contributing to more market-based prices and the development of the private sector. The policy discussions focused on policies to support exchange rate unification and address its social effects, as well as complementary reforms to the banking sector and to develop the private sector.

Box 3: Turkmenistan's Program of Renewal and Transformation

The Presidential Program of major developmental priorities for 2008-09 envisages:

a. Diversifying energy exports (developing power generation and transmission in addition to gas) and developing international transport routes (especially the north-south rail link);

b. Developing the oil and gas sector and expanding capacity, in accordance with the plan to 2030;

c. Developing an industrial base by renovating oil refineries, and establishing petrochemical facilities, resource-based industries, and textile processing and production;

d. Continuing reforms in the social sphere, including in education and health care (with voluntary medical insurance), with special emphasis on improving living standards in rural areas, under the Rural Development Program;

e. Developing recreational resources, especially the Avaza tourist zone, and related free economic zone;

f. Expanding international economic relations, especially mutually beneficial trade; and

g. Developing the private sector, especially in agriculture and services, including by revising the legal framework for farming, the Foreign Investment Law, and the Tax Code, and reviewing licensing requirements.

A. Exchange Rate Unification

14. **The authorities intend to keep the exchange rate stable in the current situation.** They agreed that a stable exchange rate vis-à-vis the dollar would serve as a nominal anchor to stabilize inflation expectations related to the pass-through effects of exchange rate unification, and adjustments in administered prices and wages. They would also use this period to develop the foreign exchange market, which could be a precursor to greater exchange rate flexibility.

15. **The authorities are committed to ensure the ready availability of foreign exchange for current transactions in the unified market.** The recent changes in the foreign exchange system utilize considerable Fund input, and the new regulations aim to ensure the sustainability of the unified rate.[7] Since unification, there have been some queuing as well as periodic spikes in the parallel rate, but these should gradually disappear as teething problems with the supply of currency are ironed out and as confidence in the new system is built up. Going forward, the CBT requested further Fund technical assistance (TA) for currency redenomination (removal of zeros) at the start of 2009.

[7] The mission presented a seminar on approaches to such regulations and market development, and provided a note with specific recommendations.

16. **Complementary trade liberalization measures in support of the new exchange rate are planned**. Duty and excise rates will soon be cut substantially, as the unification of the exchange system greatly raised the values of import duties at existing rates. A review of non-tariff trade barriers, previously used to limit access to foreign exchange at the official rate, may also be considered to improve competition and help ensure that the appreciation of the market rate is reflected in import prices.

B. Impact on Inflation and Macroeconomic Policies

Inflation outlook

17. **The authorities expressed their desire to avoid excessive inflation that might result from exchange rate unification and price adjustments.** Notwithstanding the exogenous factors driving the recent increase in prices, the authorities are seeking to contain inflation to 12–14 percent in 2008, including by limiting the pass-through of the devaluation of the official exchange rate on controlled prices in 2008.[8] Fiscal and monetary policies will remain restrained to achieve this objective. Structural measures such as trade liberalization should also foster the inflation-dampening effects of the appreciation of the market exchange rate. There would be scope for further administered price adjustments in 2009.

Fiscal policy

18. **The authorities recognized that fiscal policy in Turkmenistan remains key in maintaining macroeconomic stability.** Notwithstanding the improvement in the country's financial situation, they intend to maintain a prudent fiscal stance, consistent with past spending behavior. They are preparing a supplementary budget for 2008 which would reflect higher gas export prices and the effects of exchange rate unification. In particular, a surplus of about 4 percent of GDP could be expected, after explicitly incorporating the expenditures assumed in the contingency allowance in the original budget, as well the valuation impact on expenditure from the exchange system unification, and additional social spending/subsidies[9] to limit the impact of unification on consumers. The authorities indicated that they would be monitoring the impact of unification on consumer prices, before deciding on an additional wage and pension increase in 2008. They were interested in working with international organizations to develop a more targeted approach to addressing the social impact of price and exchange rate reforms.

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[8] Domestic and international airfares and public transport fares were increased substantially after the Article IV mission. These and other administrative price increases could result in a higher inflation outcome in 2008, but staff does not have sufficient information to revise its projections.

[9] Staff estimate this at about 1½ percent of GDP.

Summary of Government Operations, 2006–08

	2006	2007	2008	
			Budget	Proj.
	(In percent of GDP)			
Budgetary operations				
Revenue	20.2	17.2	15.3	19.4
Nonhydrocarbon	9.3	8.6	...	5.6
Hydrocarbon	10.9	8.6	...	13.8
Expenditure	14.9	13.3	18.4	15.1
Current	14.1	12.1	13.0	10.7
Capital	0.9	1.2	5.4	4.4
Budget balance	5.3	3.9	-3.1	4.3
Nonhydrocarbon budget balance	-5.7	-4.8	...	-9.5
Extra-budgetary operations				
Revenue	11.9	16.0	...	29.9
Expenditure	4.2	5.5	...	8.6
Balance	7.7	10.5	...	21.3

Sources: Fund staff estimates and projections.

19. **The authorities indicated that they intend to use part of the increased hydrocarbon revenue** for public sector investment, especially to improve social and economic infrastructure.[10] In view of the high import content of such projects, this increase in spending is considered consistent with the economy's absorptive capacity. Staff estimate that there would be a large increase in the surplus on extrabudgetary operations, to about 21 percent of GDP.

20. **The authorities intend to reform the country's budget system.** The medium-term project (with European Union support) aims to implement comprehensive reforms in various budget areas, including macro-fiscal analysis, budget coverage and preparation, treasury operations, and accounting and reporting. As a step towards budget unification, the authorities abolished some sectoral extrabudgetary funds in early 2008.

Monetary policy

21. **The CBT is committed to restraining inflation, and recognized that a successful nominal anchor would require adjustments in the monetary framework.** They noted that in the near term, money demand is likely to be unpredictable, thus diminishing the signaling value of monetary aggregates. The exchange rate will therefore serve as the nominal anchor

[10] Historically, budget investment represented only a small share of public investment, compared with off-budget or state enterprise investments. The increase in the budget coverage started in 2007.

for the time being. In view of the uncertainties regarding the outlook and the impact of structural reforms, the authorities are open to considering further changes to the foreign exchange system, including greater flexibility, in due course.

22. **Reflecting its commitment to strengthen monetary policy, the CBT agreed on the need to limit the increase in directed credit.** They explained that the sharp increase in CBT credit to banks and state enterprises in late 2007 and early 2008 was exceptional. They stressed that repayments of these loans had already begun, and such credit would be limited in the future. More generally, they were open to suggestions that progressively establishing central bank independence from directed credit pressures would be needed to strengthen monetary policy operations. Similarly, removal of the obligation for directed credits from commercial banks would be needed to enable them to afford market interest rates on deposits. This was a precondition for developing indirect monetary management instruments,[11] in which the CBT and MOF are interested.

C. Banking Reform

23. **The authorities identified banking sector operations as the next area of reform** after exchange rate unification and currency redenomination. Key objectives would be to strengthen financial intermediation, especially in foreign exchange operations, attract savings, and provide improved banking services. The authorities are upgrading the payments system and considering options for increasing competition in the sector, including gradually allowing the entry of foreign banks.[12] A pilot program is underway to introduce international financial reporting and auditing standards. This could be expedited as exchange rate unification has removed a significant impediment to achieving international standards. Also, the authorities are making progress towards establishing an AML/CFT framework, with Fund technical assistance.

D. Other Issues

24. **Recognizing the importance of data quality for policy design and implementation**, the authorities stressed their intentions to make progress in this area. The State Statistics Committee is working with the Fund sponsored advisor to improve national accounts and prices, and with the World Bank to survey living standards and assess the extent of the informal economy.

[11] In support of this, the staff presented a seminar about the issuance of government securities and the development of such a market, including for a country with a budget surplus.

[12] Three banks with foreign shareholdings currently operate in Turkmenistan and a European bank is currently in discussions about opening a branch. The Avaza enterprise zone has been slated as the initial area for more liberal conditions for foreign banks.

IV. Staff Appraisal

25. **Turkmenistan's authorities should be commended for making a decisive start in reforming the economy.** The early unification of the exchange system has sent the world a strong signal of their desire to move ahead with reforms. While further reforms will require persistence to face the inevitable challenges, the greatly strengthened external outlook should make the economic adjustments easier to manage. The staff encourages the authorities to reach out for international expertise in support of their reform agenda.

26. **Positioning the unified exchange rate broadly mid-way between the old official and commercial rates reflects a balance of factors in the context of uncertainties.** This path to convergence reflected discussions with the staff and involved a substantial appreciation of the parallel/commercial exchange rate, permitted by the favorable external outlook. The strategy aimed to limit the inflationary impact of the unification, while at the same time having due regard for its adverse effect on competitiveness. The various methodologies for assessing the appropriateness of the level of the unified exchange rate give conflicting results, which preclude a confident assessment that the unified rate is either significantly undervalued or overvalued at the present time.

27. **The unification of the exchange system should provide a solid base for further reforms.** The stability of the new exchange rate for the next year will provide a useful nominal anchor during the envisaged price reforms and currency redenomination. The authorities should implement the new regulatory framework for the foreign exchange market based on the policy of unrestricted access to foreign exchange for all current international transactions. Reductions in customs duty and excise rates and nontariff barriers to imports, in addition to other reforms to the business environment, will be needed to ameliorate the unification's impact on inflation and competitiveness. As the reforms proceed, the operation of the foreign exchange market could be reviewed.

28. **Staff supports a moderate increase in public spending, in the context of a generally restrained fiscal stance.** It will be important to protect real household incomes while the effects of exchange rate unification and other administered price adjustments are being phased in. Staff urges the authorities to work with international organizations to develop a targeted approach to addressing the social impact of structural reform. While planned spending on productive sectors and rural development will have important economic and social benefits, the authorities should be prepared to review low-priority spending if excess demand pressures emerge.

29. **Staff welcomes the authorities' plan and early steps in comprehensive budget reform.** Following the substantial gains in fiscal management from exchange rate unification and administered price increases, upgrading budgetary management and control measures, and incorporating into the budget the government's extra-budgetary operations, as well as

reforming hydrocarbon revenue management, will be important to strengthen fiscal discipline, accountability, transparency, and project evaluation.

30. **CBT's monetary operations should be strengthened to support the exchange rate as a nominal anchor.** Notwithstanding the stability of the exchange rate, headline inflation may increase further for some time, as recent and prospective price adjustments work their way through the system following the exchange system unification. The CBT should tightly control its credit expansion, while moving to market-based instruments of monetary control and developing money and foreign exchange markets. Phasing out the requirement that the CBT and commercial banks provide credits to favored sectors and enterprises at low interest rates would provide the resources for banks to pay more attractive interest rates on deposits and promote a commercial banking culture. The financial burden of directed credits should be transferred to the budget.

31. **Efforts need to be made to address the very low level of financial intermediation in the economy.** Developing more efficient account-based foreign exchange and domestic payment systems will be a start, but this needs to be complemented by more attractive interest rates and improved public confidence in banks, including perceptions about security and the privacy of client information. Although available indicators do not suggest problems in banks' loan portfolios, the staff encourages the authorities to bring accounting and auditing up to international standards more rapidly. Staff also recommends developing more competition among the existing banks, as well as allowing the entry of reputable foreign banks to help stimulate international class services, and implementing core AML/CFT measures.

32. **Weaknesses in data quality continue to hamper surveillance and policy making.** Staff welcomes the cooperative approach to addressing data issues in national accounts and prices, and encourages the authorities to consider the systematic publication of economic and financial data in statistical bulletins and other outlets.

33. **Turkmenistan maintains an exchange restriction and multiple currency practices subject to approval by the Fund** under Article VIII, Sections 2(a) or 3, as described in the Informational Annex. While welcoming the recent progress, the staff does not recommend their approval and urges their elimination as soon as feasible.

34. It is proposed that the next Article IV consultation takes place on the standard 12-month cycle.

Table 1. Turkmenistan: Selected Economic Indicators, 2004–09

	2004	2005	2006	2007	2008	2009
		Actuals		Est.	Proj.	
Output and prices	(Annual percentage change)					
Real GDP	14.7	13.0	11.4	11.6	10.8	10.4
Real non-hydrocarbon GDP	17.7	15.0	12.1	11.4	13.0	12.5
Consumer prices (end of period)	9.0	10.4	7.1	8.6	12.0	12.0
Consumer prices (period average)	5.9	10.7	8.2	6.3	13.0	12.0
Investment and saving	(In percent of GDP)					
Gross investment	23.4	21.5	18.3	19.6	33.9	35.0
Public sector	20.0	17.7	13.5	14.6	27.0	26.1
Of which: State budget	1.0	1.0	0.9	1.2	4.4	4.3
Private sector	3.4	3.8	4.8	5.0	6.9	8.9
Gross savings	24.1	26.7	34.0	35.1	57.5	65.3
State budget operations	(In percent of GDP)					
Revenue	20.3	20.5	20.2	17.2	19.4	20.9
Of which: Nonhydrocarbon revenues	11.8	9.9	9.3	8.6	5.6	4.8
Expenditure	18.9	19.7	14.9	13.3	15.1	15.6
Overall balance	1.4	0.8	5.3	3.9	4.3	5.3
Nonhydrocarbon state budget balance	-8.0	-9.8	-5.7	-4.8	-9.5	-10.8
Monetary sector 1/	(12-month percent change, unless otherwise indicated)					
Net credit to the government (in percent of beginning broad money) 2/	-4.2	-14.8	-50.3	-26.5	-33.5	-25.1
Credit to the economy	3.6	-3.5	-6.7	31.0	16.5	16.4
Broad money, including foreign currency deposits at CBT (M2)	12.7	27.9	55.9	72.2	19.6	41.8
Manat broad money	13.6	5.6	11.0	96.4	15.3	24.1
Velocity of manat broad money (relative to non-HC GDP)	10.2	11.4	12.2	10.2	9.5	9.0
Reserve money	11.0	3.3	16.4	70.3	12.5	14.0
External sector	(In percent of GDP, unless otherwise indicated)					
Exports of goods (in US$, annual change in percentage)	11.2	28.3	44.7	27.4	33.5	36.7
Exports of gas	12.9	12.6	15.9	18.5	33.5	45.2
Exports of oil and oil products	9.4	11.8	13.2	12.4	18.8	16.2
Imports of goods (in US$, annual percentage change)	22.1	-6.4	-13.2	47.8	51.6	33.0
Merchandise trade balance	5.0	11.6	21.5	20.4	30.1	35.5
Current account balance	0.6	5.1	15.7	15.4	23.5	30.1
Foreign direct investment	2.5	2.4	3.4	3.3	5.6	6.9
Total public sector external debt 3/	9.0	5.4	3.3	2.4	2.9	2.5
Gross international reserves (in millions of U.S. dollars)	2,729	4,458	8,059	13,222	19,596	29,166
In months of imports of goods and services	8.5	14.9	19.7	22.2	25.4	32.3
Memorandum items:						
Nominal GDP (in billions of manat)	73,820	89,308	111,254	136,244	247,152	361,670
Nominal GDP (in $US millions) 4/	14,196	17,175	21,395	26,201	21,337	25,380
Manats per U.S. dollar (official, period average)	5,200	5,200	5,200	5,200	…	…
Manats per US$ (parallel, period average)	23,856	24,607	23,942	23,416	…	…
REER (average, percent change)	-3.5	2.5	4.5	-1.2	…	…

Sources: Turkmen authorities; and Fund staff estimates and projections.

1/ Monetary projections for 2008 exclude the reevaluation effect of the unification of the exchange rates.

2/ Comprises budgetary support and excludes the counterpart for the funds deposited at the FERF.

3/ Separate data on short-term debt are not available.

4/ GDP valued at the official exchange rate.

Table 2. Turkmenistan: State Budget Operations, 2004-09

	2004	2005	2006	2007		2008		2009
		Actuals		Budget	Actual	Budget	Proj.	Proj.
				(In trillions of manat)				
Total revenue	15.0	18.3	22.5	21.8	23.4	25.6	47.9	75.6
O/w: Nonhydrocarbon	8.7	8.8	10.3	9.1	11.7	...	13.9	17.4
Hydrocarbon	6.2	9.5	12.2	12.7	11.8	...	34.0	58.2
Tax revenue	14.1	17.6	21.1	21.8	22.5	25.6	46.9	74.3
Income tax	1.7	1.6	1.6	1.6	1.9	2.0	2.1	...
Profit tax	1.5	2.4	4.3	4.3	5.2	5.6	12.9	...
Property tax	1.0	0.5	0.5	0.6	0.6	0.6	0.6	...
Value added tax	4.1	5.1	6.1	6.3	6.5	6.6	14.6	...
Natural resource tax	1.7	2.7	2.8	2.9	2.8	3.1	9.1	...
Excises	0.5	1.5	1.7	1.7	1.2	1.5	3.0	...
Payroll tax (pension and security)	2.9	3.1	3.0	3.0	3.5	3.9	4.0	...
Other taxes and duties 1/	0.7	0.8	0.9	1.3	0.9	2.3	0.7	...
Nontax revenue	0.8	0.7	1.4	…	0.9	…	1.1	1.3
Total expenditure	13.9	17.6	16.6	21.5	18.1	30.8	37.4	56.5
Current expenditure	13.2	16.7	15.7	16.9	16.5	21.7	26.5	41.1
Of which: Wage bill	6.3	7.7	7.4	…	7.7	...	9.7	11.8
Social services	9.8	12.0	11.1	11.7	12.1	15.8	19.3	29.6
General services	2.3	3.7	4.0	4.0	3.8	5.1	6.1	9.6
National economy	0.7	0.4	0.6	0.6	0.6	0.6	0.8	1.3
Other expenditure	0.4	0.6	0.0	0.5	0.0	0.2	0.3	0.5
Centralized capital investment	0.8	0.9	1.0	4.6	1.6	9.1	10.9	15.4
Overall state budget balance	1.0	0.7	5.8	0.4	5.3	-5.2	10.6	19.0
Nonhydrocarbon state budget balance	-5.9	-8.8	-6.3	-12.3	-6.5	...	-23.4	-39.1
Financing (deficit +)	-0.3	-0.7	-5.8	-0.3	-5.3	5.2	-10.6	-19.0
Domestic	-0.4	-0.7	-5.7	-0.3	-5.3	5.2	-10.6	-19.0
CBT	-0.3	-1.2	-5.0	-0.3	-6.0	5.2	-10.6	-19.0
Commercial banks	0.0	-0.2	-1.1	0.0	-0.6	0.0	0.0	0.0
Other	-0.1	0.8	0.4	0.0	1.3	0.0	0.0	0.0
External	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
				(In percent of GDP)				
Total revenue	20.3	20.5	20.2	16.0	17.2	15.3	19.4	20.9
O/w: Hydrocarbon	8.5	10.6	10.9	...	8.6	...	13.8	16.1
Nonhydrocarbon	11.8	9.9	9.3	...	8.6	...	5.6	4.8
Tax revenue	19.2	19.7	19.0	16.0	16.5	15.3	19.0	20.5
Nontax revenue	1.1	0.7	1.2	…	0.7	…	0.4	0.4
Total expenditure	18.9	19.7	14.9	15.8	13.3	18.4	15.1	15.6
Current expenditure	17.9	18.7	14.1	12.4	12.1	13.0	10.7	11.4
O/w: Wage bill	8.5	8.6	6.6	...	5.7	…	3.9	3.3
Social services	13.2	13.4	9.9	8.6	8.9	9.4	7.8	8.2
General services	3.2	4.1	3.6	3.0	2.8	3.0	2.5	2.7
Capital expenditure	1.0	1.0	0.9	3.4	1.2	5.4	4.4	4.3
Overall balance of state budget	1.4	0.8	5.3	0.3	3.9	-3.1	4.3	5.3
Nonhydrocarbon state budget balance	-8.0	-9.8	-5.7	...	-4.8	...	-9.5	-10.8
Memorandum items								
Extrabudgetary revenue (FERF)	6.7	8.6	11.9	...	16.0	...	29.9	36.6
Extrabudgetary expenditure	6.6	5.9	4.2	...	5.5	...	8.6	8.0
Extrabudgetary balance	0.1	2.7	7.7	...	10.5	...	21.3	28.6
Overall fiscal balance	1.4	3.5	13.0	...	14.4	...	25.6	33.8

Sources: Turkmen authorities; and Fund staff estimates and projections.

1/ For budgets, includes nontax revenue.

Table 3. Turkmenistan: Monetary Survey, 2005–09

	2005	2006	2007					2008					2009
			Mar	Jun	Sep	Dec		Mar		Jun	Sep	Dec	
			Actuals			Actual	Revalued	Prelimin.	Revalued	Projections			
	(In trillions of manat end-of-period stocks, unless otherwise indicated)												
Net foreign assets	18.8	38.9	45.8	54.1	61.7	66.5	182.2	81.8	186.5	207.9	240.8	276.7	407.6
Net foreign assets of the monetary authorities	22.8	41.9	48.5	56.7	64.1	68.8	188.4	84.2	192.0	213.2	245.8	282.9	419.2
Net foreign assets of commercial banks	-4.0	-3.0	-2.7	-2.6	-2.4	-2.3	-6.2	-2.4	-5.5	-5.3	-5.0	-6.2	-11.6
Net domestic assets	-6.9	-20.3	-24.4	-30.4	-35.2	-34.5	-118.8	-51.2	-131.4	-149.0	-174.1	-200.8	-300.0
Domestic credit	-4.8	-22.5	-30.1	-36.2	-40.7	-40.2	-112.8	-55.2	-121.6	-139.2	-164.3	-191.0	-290.2
Net claims on Government	-21.4	-38.0	-44.2	-50.8	-56.4	-60.6	-145.4	-78.2	-159.2	-177.3	-202.7	-229.0	-334.5
Of which: Budgetary support	-0.9	-6.9	-9.5	-11.4	-12.6	-12.4	-11.9	-15.4	-15.4	-18.0	-20.5	-23.1	-42.2
Central Bank	-0.8	-5.8	-8.8	-10.7	-11.9	-11.8	-11.3	-14.6	-14.6	-17.2	-19.8	-22.4	-41.4
Commercial banks	-0.1	-1.1	-0.7	-0.7	-0.7	-0.6	-0.6	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Credit to the economy	16.7	15.5	14.1	14.7	15.8	20.4	32.7	23.0	37.6	38.1	38.4	38.0	44.3
Of which: In foreign currency	7.7	6.9	7.0	7.1	7.3	7.1	19.4	11.4	26.0	27.2	26.2	25.1	29.6
State enterprises	15.4	14.0	12.6	13.1	14.0	18.5	…	21.3	…	36.1	36.1	35.5	41.0
Private sector	1.3	1.5	1.5	1.6	1.7	1.8	…	1.7	…	2.0	2.2	2.5	3.3
Other items (net)	-2.1	2.1	5.7	5.8	5.4	5.8	-6.0	4.0	-9.8	-9.8	-9.8	-9.8	-9.8
Broad money (M2)	11.9	18.6	21.3	23.8	26.5	32.0	63.5	30.6	55.1	59.0	66.7	75.9	107.6
Manat broad money	6.4	7.1	8.1	8.5	9.4	14.0	14.0	11.5	11.5	11.9	15.3	16.1	20.0
Currency outside banks	3.4	4.1	4.3	4.3	4.8	6.2	6.2	6.1	6.1	6.4	7.6	8.3	9.7
Manat deposits	3.0	3.0	3.8	4.2	4.6	7.8	7.8	5.3	5.3	5.5	7.7	7.9	10.4
Demand deposits	1.4	1.5	2.5	2.9	3.4	6.7	6.7	…	…	…	…	…	…
Time and savings deposits	1.5	1.5	1.3	1.3	1.1	1.1	1.1	…	…	…	…	…	…
Foreign currency deposits 1/	5.5	11.5	13.2	15.3	17.1	18.1	49.5	19.1	43.6	47.0	51.4	59.8	87.6
	(Percent change of beginning period broad money, 12-month basis)												
Credit to the economy	-6.5	-9.4	-18.9	-11.9	-6.4	25.9	…	41.9	…	98.7	85.4	55.2	8.2
Manat broad money	3.6	5.9	11.8	9.8	11.2	36.9	…	15.9	…	14.5	22.4	6.7	5.1
	(Percent change, 12-month basis)												
Broad money (M2) 1/	27.9	55.9	65.1	57.6	49.6	72.2	…	43.5	…	148.2	151.8	136.8	41.8
Excluding revaluation effect 2/	…	…	…	…	…	…	…	22.6	…	6.9	15.2	19.6	…
Reserve money	3.3	16.4	15.2	27.7	34.4	70.3	…	49.5	…	47.9	48.5	12.5	14.0
Manat broad money	5.6	11.0	23.2	21.1	26.8	96.4	…	41.8	…	40.6	63.3	15.3	24.1
Credit to the economy	-3.5	-6.7	-14.8	-10.9	-6.7	31.0	…	63.6	…	159.8	143.5	86.9	16.4
Excluding revaluation effect 2/	…	…	…	…	…	…	…	48.5	…	41.3	36.7	16.5	…
	(In billions of US dollars, unless otherwise indicated)												
Memorandum items:													
Net foreign assets	3.6	7.5	8.8	10.4	11.9	12.8	12.8	13.1	13.1	14.6	16.9	19.4	28.6
Credit in foreign currency	1.5	1.3	1.4	1.4	1.4	1.4	1.4	1.8	1.8	1.9	1.8	1.8	2.1
Foreign currency deposits	1.1	2.2	2.5	2.9	3.3	3.5	3.5	3.1	3.1	3.3	3.6	4.2	6.1
Velocity of average manat broad money to non-HC GDP	11.4	12.2	...	...	...	10.2	...	...	...	...	...	9.5	9.0
Official exchange rate (end of period)	5,200	5,200	5,200	5,200	5,200	5,200	14,250	6,250	14,250	14,250	14,250	14,250	14,250

Source: Central Bank of Turkmenistan; and Fund staff estimates and projections.
1/ Most of the foreign currency deposits belong to state enterprises and are held with the central bank.
2/ For 2008, excludes effects from devaluation on foreign exchange component of money aggregates.

Table 4. Turkmenistan: Summary Accounts of the Central Bank, 2005–09
(In trillions of manat end-of-period stocks, unless otherwise indicated)

	2005	2006	2007					2008					2009
			Mar	Jun	Sep	Dec		Mar		Jun	Sep	Dec	
			Actuals			Actual	Revalued	Prelimin.	Revalued	Projections			
Net foreign assets	22.8	41.9	48.5	56.7	64.1	68.8	188.4	84.2	192.0	213.2	245.8	282.9	419.2
Foreign assets 1/	23.2	41.9	48.5	56.7	64.1	68.8	188.4	84.2	192.0	213.2	245.8	282.9	419.2
Foreign liabilities	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic assets	-12.4	-24.9	-29.5	-35.1	-39.9	-41.1	-130.6	-56.5	-140.9	-158.5	-185.8	-213.9	-320.9
Domestic credit (net)	-10.8	-27.5	-35.7	-41.6	-45.9	-47.5	-126.0	-61.2	-132.8	-150.5	-177.7	-205.8	-312.8
Net claims on government	-21.3	-36.9	-43.5	-50.1	-55.8	-60.0	-144.8	-77.4	-158.4	-176.5	-201.9	-228.3	-333.7
Of which: Budgetary support	-0.8	-5.8	-8.8	-10.7	-11.9	-11.8	-11.8	-14.6	-14.6	-17.2	-19.8	-22.4	-41.4
Credit to state enterprises	2.9	2.9	3.2	3.5	3.8	3.7	10.1	7.3	16.7	17.4	15.9	14.4	13.6
Of which: In foreign currency	2.9	2.9	3.2	3.5	3.8	3.7	10.1	7.3	16.7	17.4	15.9	14.4	13.6
Claims on banks	7.5	6.5	4.5	5.0	6.1	8.8	8.8	8.9	8.9	8.6	8.3	8.0	7.4
Other items net	-1.6	2.6	6.3	6.4	6.0	6.5	-4.6	4.7	-8.1	-8.1	-8.1	-8.1	-8.1
Reserve money	5.1	5.9	6.2	6.5	7.2	10.1	10.1	9.3	9.3	9.6	10.7	11.4	13.0
Currency issued	3.5	4.2	4.3	4.4	4.8	6.2	6.2	6.2	6.2	6.5	7.6	8.3	9.7
Outside banks	3.4	4.1	4.3	4.3	4.8	6.2	6.2	6.1	6.1	6.4	7.6	8.3	9.7
Cash with banks	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank deposits	1.6	1.8	1.9	2.1	2.4	3.9	3.9	3.1	3.1	3.1	3.1	3.1	3.3
Required reserves	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.5	0.5	0.6	0.7	0.9	1.4
Other deposits	1.4	1.5	1.6	1.7	2.0	3.5	3.5	2.6	2.6	2.5	2.4	2.2	1.9
State enterprise deposits	5.3	11.1	12.8	15.1	17.0	17.6	47.7	18.5	41.9	45.1	49.4	57.6	85.4
In manat	0.2	0.1	0.2	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
In foreign currency	5.1	10.9	12.7	14.7	16.5	17.3	47.4	18.2	41.6	44.9	49.1	57.3	85.1
	(In billions of US dollars, unless otherwise indicated)												
Memorandum items:													
Net international reserves	4.4	8.1	9.3	10.9	12.3	13.2	13.2	13.5	13.5	15.0	17.3	19.8	29.4
Gross international reserves	4.5	8.1	9.3	10.9	12.3	13.2	13.2	13.5	13.5	15.0	17.3	19.8	29.4
Credit to state enterprises in foreign exchange	0.6	0.6	0.6	0.7	0.7	0.7	0.7	1.2	1.2	1.2	1.1	1.0	1.0
State enterprise deposits in foreign exchange	1.0	2.1	2.4	2.8	3.2	3.3	3.3	2.9	2.9	3.1	3.4	4.0	6.0
Reserve money (percent change, 12-month basis)	3.3	16.4	15.2	27.7	34.4	70.3	…	49.5	…	47.9	48.5	12.5	14.0
Official exchange rate (end of period)	5,200	5,200	5,200	5,200	5,200	5,200	14,250	6,250	14,250	14,250	14,250	14,250	14,250

Source: Central Bank of Turkmenistan; and Fund staff estimates and projections.
1/ Comprises assets of the Central Bank, Foreign Exchange Reserve Fund, and Gas and Oil Fund.

Table 5. Turkmenistan: Balance of Payments, 2004–09
(In millions of U.S. dollars; unless otherwise indicated)

	2004	2005	2006	2007	2008	2009
		Actuals			Projections	
Current account	82	875	3,351	4,037	5,013	7,648
Goods	705	1,997	4,598	5,334	6,431	9,007
Exports, of which	3,854	4,944	7,155	9,114	12,163	16,629
Gas	1,825	2,169	3,402	4,853	7,154	11,481
Oil and oil products	1,330	2,029	2,826	3,240	4,006	4,115
Cotton	154	95	143	209	150	138
Imports	-3,148	-2,947	-2,558	-3,780	-5,732	-7,622
Consumer goods and foods	-566	-555	-647	-826	-1,316	-1,837
Capital and intermediary goods	-2,582	-2,392	-1,911	-2,954	-4,416	-5,785
Services	-562	-599	-674	-687	-904	-1,043
Exports	362	326	357	434	507	600
Imports	-923	-925	-1,031	-1,121	-1,411	-1,643
Factor income	-108	-563	-626	-747	-658	-467
Credit	205	78	345	398	620	944
Of which , interest	41	76	343	397	511	844
Debit	-312	-641	-971	-1,145	-1,278	-1,411
Of which , interest	-48	-48	-49	-45	-19	-22
Current transfers (net)	46	40	54	137	144	151
Public	4	5	6	13	14	15
Private	42	35	48	124	130	137
Capital and financial account	-334	723	179	714	1,362	1,922
Capital account	26	14	34	133	60	60
Financial account	-360	709	144	581	1,302	1,861
Net foreign direct investment	354	418	731	856	1,200	1,740
Portfolio investment	0	0	0	-30	-30	-30
Medium and long-term borrowing	90	30	66	37	180	150
Scheduled amortization	-565	-346	-261	-261	-181	-131
Trade credits (net)	-194	698	-353	104	300	300
Currency and deposits	12	-19	-42	-113	-113	-138
Other assets (net)	-135	-143	-66	-79	-120	-95
Repayment of rescheduled debt	78	70	70	65	65	65
Errors and omissions	193	93	112	397	0	0
Overall balance (deficit -)	-58	1,690	3,642	5,147	6,375	9,569
Financing	58	-1,690	-3,642	-5,147	-6,375	-9,569
Reserve assets (increase -)	-56	-1,726	-3,604	-5,158	-6,375	-9,569
Exceptional financing	115	35	-38	11	0	0
Change in arrears (net)	-95	-27	-38	11	0	0
Rescheduling of debt	209	63	0	0	0	0
Memorandum items:						
Turkmenistan's gas export price ($US per tcm)	43.4	48.7	73.5	96.2	140.0	200.0
Turkmenistan's international crude oil price ($US per barrel)	27.7	44.0	54.4	57.4	77.0	76.2
Current account as percent of GDP	0.6	5.1	15.7	15.4	23.5	30.1
Gross official international reserves (US$ million)	2,729	4,458	8,059	13,222	19,596	29,166
In months of next year's imports of goods and services	8.5	14.9	19.7	22.2	25.4	32.3
External public debt ($US million)	1,273	924	713	627	627	646
In percent of GDP at official exchange rate	9.0	5.4	3.3	2.4	2.9	2.5
Debt service ($US million) 1/	404	331	311	306	200	152
In percent of exports of goods and services	9.6	6.3	4.1	3.2	1.6	0.9

Sources: Turkmen authorities; and Fund staff estimates and projections.
1/ Historical data reflect actual payments made.

Table 6. Turkmenistan : Medium-Term Scenario, 2006–2013

	2006	2007	2008	2009	2010	2011	2012	2013
	Actuals		Projections					
				(In percent of GDP)				
Hydrocarbon sector 1/								
Crude oil production (in millions of barrels/day)	0.18	0.20	0.21	0.22	0.22	0.22	0.23	0.23
Natural gas production (in billions of cm)	64.7	72.8	78.1	85.6	92.4	101.8	111.8	122.0
Hydrocarbon exports (in billions of US$)	6.2	8.1	11.2	15.6	20.6	22.5	24.5	26.2
Turkmenistan's crude oil export price (US$ per barrel)	54.4	57.4	77.0	76.2	75.2	74.8	74.6	74.6
Turkmenistan's gas export price (US$ per thousand cm)	73.5	96.2	140.0	200.0	261.0	256.8	252.7	246.2
National income and prices (in percent change)								
Real GDP	11.4	11.6	10.8	10.4	9.4	10.1	10.3	10.2
Real nonhydrocarbon GDP	12.1	11.4	13.0	12.5	13.0	13.0	13.0	13.0
CPI	8.2	6.3	13.0	12.0	9.0	6.5	6.0	6.0
GDP deflator (in percent change)	11.8	9.7	63.7	32.6	16.5	2.9	2.8	2.4
Investment and saving								
Gross investment	18.3	19.6	33.9	35.0	31.4	30.6	31.4	32.6
Of which : Public sector	13.5	14.6	27.0	26.1	24.2	23.5	24.4	25.6
O/w: State budget	0.9	1.2	4.4	4.3	4.7	6.0	7.5	9.5
FDI	3.4	3.3	5.6	6.9	5.9	5.7	5.6	5.4
Gross savings	34.0	35.1	57.5	65.3	68.7	66.0	63.2	59.6
State budget								
Total revenue	20.2	17.2	19.4	20.9	28.3	27.6	27.0	26.2
Of which : Hydrocarbon revenue	10.9	8.6	13.8	16.1	4.6	4.9	5.2	5.6
Total expenditure	14.9	13.3	15.1	15.6	14.8	16.6	18.8	21.6
Current	14.1	12.1	10.7	11.4	10.0	10.7	11.3	12.1
Capital	0.9	1.2	4.4	4.3	4.7	6.0	7.5	9.5
Overall budget balance	5.3	3.9	4.3	5.3	13.5	11.0	8.2	4.6
Non-hydrocarbon balance (deficit -)	-5.7	-4.8	-9.5	-10.8	-10.2	-11.7	-13.6	-16.0
External sector			(In billions of U.S. dollars; unless otherwise indicated)					
Exports of goods, f.o.b., of which:	7.2	9.1	12.2	16.6	21.7	23.6	25.6	27.5
Non-oil exports	0.9	1.0	1.0	1.0	1.1	1.1	1.2	1.2
Imports of goods, fob	2.6	3.8	5.7	7.6	9.0	10.6	12.8	15.7
Current account balance	3.4	4.0	5.0	7.6	12.1	13.0	13.2	12.7
(in percent of GDP)	15.7	15.4	23.5	30.1	37.3	35.3	31.8	27.1
Official reserves	8.1	13.2	19.6	29.2	43.4	58.8	74.8	90.6
(in months of next year's imports)	19.7	22.2	25.4	32.3	41.6	47.3	49.6	49.6
Official exchange rate (manats per US dollar, aver.)	5,200	5,200	…	…	…	…	…	…

Sources: Turkmen authorities; and Fund staff estimates and projections.

1/ Assumes hydrocarbon reserves of 1.8 billion barrels of oil and 14 trillion cubic meters of natural gas.

Table 7. Turkmenistan: Financial Soundness Indicators for Commercial Banks, 2004-2007
(In percent unless otherwise indicated)

	2004	2005	2006	2007
Capital Adequacy				
Total regulatory capital/risk-weighted assets	19.8	19.2	25.3	15.9
Regulatory Tier I capital/risk weighted assets	19.4	18.9	25.5	16.0
Total regulatory capital/total assets	5.5	6.0	6.6	5.2
Asset quality				
Long term credits/total assets 1/	47.3	40.4	36.0	29.7
Long term credits/total capital 1/	854.9	669.7	546.9	571.0
Foreign exchange loans/total loans 1/	43.7	35.5	34.8	26.0
NPLs/total loans	2.0	1.5	0.6	0.4
NPLs/total capital	31.2	20.9	7.0	6.2
Distribution of assets by risk weight category	100.0	100.0	100.0	100.0
0 percent	95.8	96.3	96.5	96.2
20 percent	3.8	3.4	3.3	3.6
50 percent	0.2	0.1	0.1	0.1
100 percent	0.2	0.2	0.1	0.1
Profitability				
Return on (average) assets	4.6	4.8	5.4	4.1
Return on (average) equity	83.7	79.0	82.7	78.6
Interest margin/gross income	24.2	32.1	32.3	33.8
Expenses/revenues	76.2	74.2	76.1	74.3
Non-interest expenses/gross income	36.3	37.6	42.1	48.1
Personnel expenses to noninterest expenses	60.3	74.5	60.9	52.3
Liquidity				
Loans to deposits ratio	97.9	96.5	92.1	86.7
Liquid assets/total assets	23.6	24.1	37.6	70.8
Liquid assets/short-term liabilities	66.0	63.8	105.7	90.9
Demand deposits/total liabilities	9.2	9.7	17.0	29.2
Total (non-interbank) deposits to total (non-interbank) loans	21.6	24.8	36.1	52.1

Source: Central Bank of Turkmenistan
1/ Includes interbank loans.

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International Monetary Fund

700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2008 Article IV Consultation with Turkmenistan

On July 16, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Turkmenistan.[13]

Background

Turkmenistan is a landlocked country with an economy dominated by a large hydrocarbon sector (mainly natural gas) contributing about 25 percent of GDP and 90 percent of exports. Until recently, Turkmenistan maintained a state-dominated economy, lagging well behind other Commonwealth of Independent States (CIS) countries in economic reforms. However, in 2007 it launched a program of social and economic reforms, and improved relations with neighboring countries and international institutions. Reforms to the exchange system and administered prices began in early 2008, and steps were taken to attract foreign direct investment (FDI).

Economic conditions remain robust and the outlook for the hydrocarbon sector has greatly improved. In 2007, growth reached 11½ percent, driven by increased hydrocarbon output and broad-based activity in the non-hydrocarbon economy, including the construction, transport and communication, and retail sectors. Inflation was low for much of the year, but started to accelerate in the last quarter, due to higher international food prices and supply

[13] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

shortages caused by the extremely cold winter. Headline inflation in the first half of 2008 was boosted further by the progressive adjustment of administered prices to market levels, with an 8-fold increase in domestic petroleum prices in February 2008, and very large increases in bus and rail fares and airline ticket prices in May and early June 2008. Inflation reached almost 16 percent in March 2008 (year on year).

The fiscal stance has generally been restrained. The 2007 budget surplus amounted to 4 percent of GDP. Revenue growth was only 4 percent, despite the large increase in hydrocarbon exports receipts, due to a change in the allocation of hydrocarbon revenues in favor of off-budget revenue. Expenditure was lower than budgeted, reflecting the slow execution of the investment program. Staff estimates that off-budget operations registered an additional surplus of 11 percent of GDP, with extrabudgetary government spending estimated at about 6 percent of GDP.

Monetary conditions loosened in the last quarter of 2007, but were tightened in early 2008. Credit to the economy grew 30 percent in 2007, reflecting a large increase in directed credits to the cotton sector, partly funded by the Central Bank of Turkmenistan (CBT). As a result, reserve money growth reached 70 percent, and manat broad money almost doubled. However, in the first quarter of 2008, the partial repayment of the agricultural loans and increased sales of dollars contributed to a sharp reduction in both reserve money and manat broad money.

Reflecting the favorable market conditions for hydrocarbon exports, the current account surplus and international reserves grew strongly in 2007. With hydrocarbon export revenues up 30 percent, the current account surplus reached 15½ percent of GDP and gross international reserves rose to $13 billion (equivalent to about 22 months of import cover), notwithstanding a 50 percent increase in imports. The recent growth in FDI inflows, mainly reflecting investments in offshore oil operations in the Caspian Sea, is expected to continue.

The process of exchange rate unification was launched at the start of 2008 and was completed on May 1, 2008. The former dual exchange rate system comprised (i) an official rate pegged at manat 5,200 per U.S. dollar; and (ii) a parallel market rate, 4-5 times more depreciated. Effective January 1, 2008, the authorities devalued the official rate to manat 6,250 per US dollar, and introduced a commercial rate of manat 20,000 per US dollar at which banks could trade freely with the public. Although the transition was originally planned to last for most of 2008, the two markets were unified on May 1, at the rate of manat 14,250 per US dollar, a level consistent with the country's strong external position. At the start of June, the authorities issued new foreign exchange regulations, which allow the CBT to provide ready access to foreign exchange.

The banking sector remains very small and dominated by state banks. Direct monetary controls, the predominance of cash as a means of payment, and the distorted foreign exchange market (prior to unification) have limited its role in the economy. As a result, deposits are only about 5 percent of GDP, while 90 percent of commercial bank credit goes to state enterprises, often at relatively low interest rates. The financial soundness indicators indicate banks' general compliance with existing norms. To improve the accuracy of the assessment of the financial sector, a project to introduce International Financial Reporting Standards (IFRS) in the banking system is underway.

Executive Board Assessment

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Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Turkmenistan: Selected Economic Indicators

	2003	2004	2005	2006	2007
	(Annual percentage change)				
Production and Prices					
Real GDP	17.1	14.7	13.0	11.4	11.6
Consumer price index (e.o.p.)	3.1	9.0	10.4	7.1	8.6
	(In percent of GDP)				
Investment and Saving					
Gross investment	25.3	23.4	21.5	18.3	19.6
Gross savings	28.1	24.1	26.7	34.0	35.1
General Government (State budget)					
Total revenue	18.0	20.3	20.5	20.2	17.2
Total expenditure and net lending	19.4	18.9	19.7	14.9	13.3
Overall balance (+ =surplus)	-1.3	1.4	0.8	5.3	3.9
	(Annual changes)				
Monetary indicators					
Reserve money	74.9	11.0	3.3	16.4	70.3
Manat broad money	33.4	13.6	5.6	11.0	96.4
	(In millions of U.S. dollars, unless otherwise specified)				
External sector					
Exports of goods	3,465	3,854	4,944	7,155	9,114
Of which : Hydrocarbons	2,934	3,154	4,198	6,228	8,093
Imports of goods	2,579	3,148	2,947	2,558	3,780
Current account	304	82	875	3,351	4,037
In percent of GDP	2.7	0.6	5.1	15.7	15.4
Gross international reserves	2,673	2,729	4,458	8,059	13,222
In months of imports	7.9	8.5	14.9	19.7	22.2
Exchange rate (in manats per US dollar)					
Official (period average)	5,200	5,200	5,200	5,200	5,200
Parrallel (period average)	20,994	23,856	24,607	23,942	23,416

Sources: Turkmenistan authorities; and Fund staff estimates.