

# Kyrgyz Republic

Sociopolitical protests in Bishkek in April 2010 that ousted the former president, followed by ethnic violence in the south in June, battered the economy. Disruption was then exacerbated by border closures with Kazakhstan and Uzbekistan, the main transport conduits for trade. The crisis has put public finances under severe stress, alleviated by a July 2010 \$1.1 billion pledge of assistance from donors. The time taken to return to normality will depend heavily on the new government's ability to bring about and maintain political and social stability.

## Economic performance

After modest growth of 2.9% in 2009, the country was recovering well from the global economic crisis as GDP growth bounded to 16.4% in the first quarter of 2010. But the closures of international borders following the April and June events stopped imports and exports at times, intensifying the impact of the internal disruptions on the economy. For all 2010, GDP dropped by 1.4% (Figure 3.5.1).

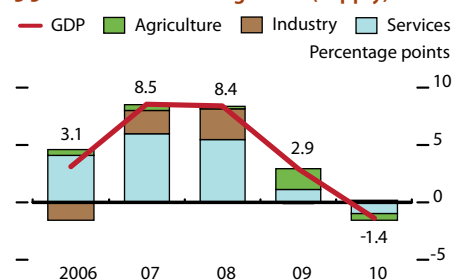
All sectors contracted in 2010, except for gold and other industrial production, which grew by 8% and 11.3%, respectively. Gold output climbed mainly because of a higher ore yield. Expansion in industrial production was largely attributable to a low 2009 base, reflecting the impact of global and regional recession. Some subsectors, however, showed strong outturns: garments were up by an estimated 50% and electricity, gas, and water services were together 11% higher.

Agricultural output fell by 2.8% largely due to delays in sowing crops (a knock-on effect of the disturbances) and an ensuing lower harvest in part caused by shortages of imported fuel. Construction output fell by 22.8%, as unrest and supply disruptions curtailed work, including that on large investment projects in the hydropower and mining subsectors.

The contraction in GDP would have been more severe without expanded gold production. Also of help was an estimated 25% increase in workers' remittances (from the Russian Federation and Kazakhstan, the country's main economic partners) that boosted a major source of income for the population, helping to ease the downward pressure on aggregate demand (Figure 3.5.2).

The imposition of duty by the Russian Federation on oil exports to the Kyrgyz Republic raised domestic oil-product prices by about 35%. This and increasing imported food prices, combined with lower domestic wheat production, have significantly added to inflation pressures. In the second half of 2010, inflation accelerated steadily and reached 19.2% at year-end, with food prices up by 27% (Figure 3.5.3). The April 2010 reversal of electricity and heating tariff increases to their 2009 levels (tariffs were

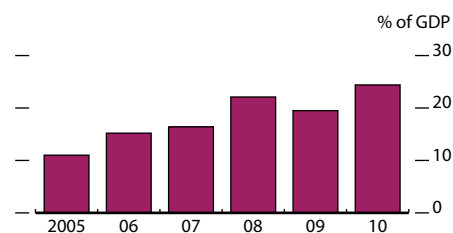
3.5.1 Contributions to growth (supply)



Source: National Statistics Committee of the Kyrgyz Republic. <http://www.stat.kg> (accessed 28 February 2011).

[Click here for figure data](#)

3.5.2 Remittances



Source: National Statistics Committee of the Kyrgyz Republic. <http://www.stat.kg> (accessed 11 March 2011).

[Click here for figure data](#)

doubled on 1 January 2010) helped to mitigate price escalation. Low inflation early in the year kept annual average inflation to 8.0%.

The April and June 2010 events have significantly increased budgetary expenditure on compensation to the families of victims; unplanned spending for the constitutional referendum and elections; outlays associated with rehabilitating damaged infrastructure and buildings; security expenditure; and subsidies for utility companies due to the tariff-hike reversal. On the revenue side, improved tax administration in the second half of the year helped to offset the negative impact of the crisis and border closure on value-added tax and customs collections.

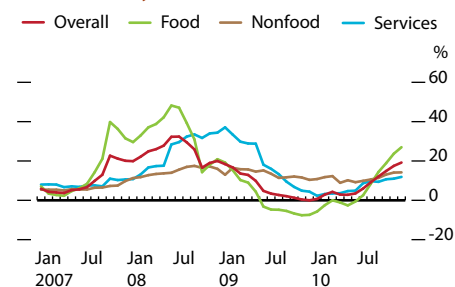
In 2010, the budget deficit widened to an estimated 6.5% of GDP (Figure 3.5.4). Assistance from both bilateral and multilateral donors as well as use of the \$300 million Russian loan proceeds (received in 2009) covered financing needed for the enlarged deficit. Since some of the recent spending increases were one time (for rehabilitation and social protection, resettlement, and reconstruction), they can be unwound as the situation improves in 2011, though much rebuilding will still be needed in 2012. Reconstruction, alongside the government's plans to greatly increase salaries of teachers and other social sector workers from May 2011, will further widen the budget deficit. Government estimates of the budget deficit for 2011 are around 9%.

In July 2010, the donor community pledged \$1.1 billion assistance over 30 months. External support will be critical in helping the authorities to deal with the consequences of the crisis. External—mainly concessional—borrowing increased publicly guaranteed external debt from around 53% in 2009 of GDP to an estimated 62% in 2010. The external debt ratio is forecast to reach 67% by end-2011. Although the International Monetary Fund rates the country's risk of debt distress as moderate, the government will need to follow prudent policies to ensure external debt sustainability.

In response to the crisis, the National Bank of the Kyrgyz Republic (NBKR, the central bank) eased its monetary stance by lowering the reserve requirement by 1.5 percentage points to 8.0% in May 2010, and adjusted the sale of its notes to changing monetary circumstances. Nevertheless, credit to the economy increased by only 2.7% due to weak demand and troubled banking conditions. The public's preference to increase its cash holdings at the expense of deposits surged after the April events, pressuring banking system liquidity and complicating the central bank's monetary operations. Despite the downturn in economic activity and banking sector problems, external finance of the fiscal expansion increased monetary aggregates. In 2010, money supply rose by 18.6%, primarily due to increased foreign assets (Figure 3.5.5).

The crisis shook financial stability. Loan quality has worsened dramatically—the ratio of nonperforming loans rose from 7.9% before April to an estimated 16% at year-end. The deterioration in quality has been mainly concentrated in loans for trade and commerce. The NBKR introduced temporary administration at seven banks (later reduced to four), including Asia Universal Bank—the largest bank with over 20% of bank deposits—after it experienced a large nonresident deposit outflow, allegedly linked to the previous regime. To mitigate deposit-run risks, the authorities nationalized the bank and created a new bank based on

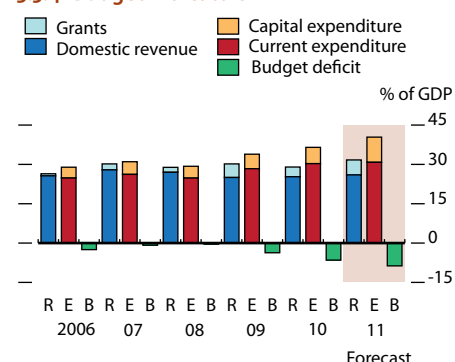
### 3.5.3 Monthly inflation



Source: National Statistics Committee of the Kyrgyz Republic. <http://www.stat.kg> (accessed 28 February 2011).

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### 3.5.4 Budget indicators



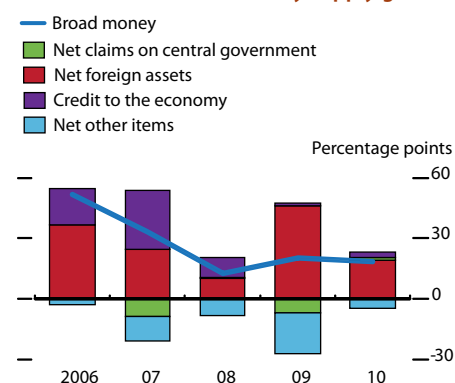
B = Balance; E = Expenditure; R = Revenue.

Note: Domestic revenue includes capital receipts.

Sources: International Monetary Fund. 2008. *Country Report No. 08/381*. December; 2009. *Country Report No. 09/209*. July; 2010. *Country Report No. 10/336*. October. <http://www.imf.org>; Ministry of Finance.

[Click here for figure data](#)

### 3.5.5 Contributions to money supply growth



Source: National Bank of the Kyrgyz Republic. <http://www.nbkr.kg> (accessed 11 March 2011).

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the old one. Despite difficulties, the banking system remains adequately liquid and capitalized.

In April and May, the NBKR undertook large US dollar sales in the foreign exchange market to meet public demand and prevent an excessive depreciation of the local currency. For much of the rest of the year, it intervened to offset pressures for appreciation stemming from large donor-funded external budgetary support. Over the year, the som depreciated by around 7% against the dollar (Figure 3.5.6). In view of continued large expected inflows of external assistance in 2011, the NBKR plans to intervene to forestall an unwarranted appreciation of the exchange rate and reduce excess bank liquidity created by these operations.

Exporters did not fully benefit from the economic recovery in the Russian Federation and Kazakhstan in the wake of internal unrest and periods of closed borders. Further, the introduction of a customs union among the Russian Federation, Kazakhstan, and Belarus in July 2010 decreased the volume of Chinese goods that are reexported, as they now face higher duties into the union. Still, increased production of gold, the country's main export commodity, and rising gold prices helped to bolster export revenue that is estimated to have increased by 7.0% for the year.

Despite the border disruptions, imports are estimated to have increased by 15.0%. This expansion reflected higher import prices of food and fuel, though imports financed by donors and workers' remittances were also factors. The current account deficit is estimated at 5.0% of GDP in 2010, up from 2.4% a year earlier (Figure 3.5.7).

On the political scene, following the resignation of the former president in April, an interim government assumed power. It drafted a new constitution, which was adopted in a nationwide referendum in June, changing the country's political system into a parliamentary republic. (The country also elected an interim president, whose tenure will last until 31 December 2011. A presidential election under the new constitutional arrangement is scheduled for October 2011.) Parliamentary elections were held on 10 October 2010, with five parties winning seats. Following the creation of a majority coalition consisting of three parties in December 2010, Parliament elected a speaker and formed a government.

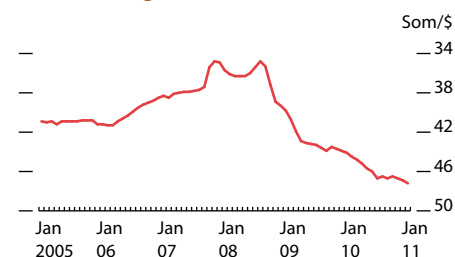
## Economic prospects

The economy is expected to pick up with GDP growing at around 5% in 2011 and 2012. The forecasts rest on expectations of a normal security environment, continued reconstruction works, full resumption of trade and services flows, and improved investor confidence. They also rely heavily on construction growing by about 40%, mainly due to large-scale reconstruction works in the south. Services and industry are seen growing by 6% and 4%, respectively.

Economic expansion of the Russian Federation and Kazakhstan will also contribute to growth through increased demand for the Kyrgyz Republic's exports and higher remittances from workers in those two countries.

Considerable fiscal challenges loom over the next 2 years. Much reconstruction is still needed, and the government plans to increase

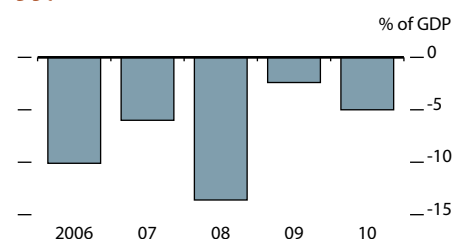
3.5.6 Exchange rate



Source: International Monetary Fund, International Financial Statistics online database (accessed 14 March 2011).

[Click here for figure data](#)

3.5.7 Current account balance



Source: National Bank of the Kyrgyz Republic, *Balance of Payments of the Kyrgyz Republic*. Various issues. <http://www.nbkr.kg>

[Click here for figure data](#)

3.5.1 Selected economic indicators (%)

	2011	2012
GDP growth	5.0	5.0
Inflation	13.0	8.0
Current account balance (share of GDP)	-9.0	-9.0

Source: ADB estimates.

salaries of teachers, as well as medical and other social sector workers in 2011, yet is reluctant to cut down on pension and social protection spending as this might affect social stability. It therefore plans to improve tax and customs administration and cut nonpriority spending. Around 73% of the budget deficit will be financed by donors.

The pickup in economic activity with higher import prices for food and higher remittance spending will exert an upward pressure on consumer prices. The NBKR's monetary and exchange rate policies will aim to keep inflation in check by neutralizing the effects of large fiscal expansion yet support the postcrisis recovery. Cancellation of export duties on petroleum products by the Russian Federation from 1 January 2011 will help to mitigate upward pressures on prices. For 2011, average inflation is expected to move higher to 13.0% and then moderate to 8.0% in 2012 as global price pressures subside.

Extensive reconstruction works and a recovery in domestic demand will raise the import bill in the forecast period. Increases in global food and oil prices will also push imports higher. Gold prices are expected to rise by 5%–10% in 2011 and remain at historically high levels. Remittances are forecast to increase moderately, after their strong growth in 2010.

The current account deficit is projected at 9.0% of GDP in 2011 and 2012. Foreign direct investment is likely to remain low in the next 2 years due to the uncertain political and security situation, though large inflows of official external assistance are expected to finance the large current account deficit.

## **Development challenges**

The country faces huge challenges in economic recovery, reconstruction, and social reconciliation. Success will not be easy given the considerable pressure on public financial resources in a weakened economy. Achieving sustainable robust economic growth remains the major challenge facing the country.