Kyrgyz Republic

The economy is still recovering from the political crisis of April 2010. A new government has been set up, public confidence is slowly returning, and all sectors have seen growth. Improved tax administration and high gold prices increased government revenue, but higher civil service wages and social spending, alongside continuing reconstruction in the south, strained overall finances. Integration into the customs union with the Russian Federation, Belarus, and Kazakhstan may be a challenge, with risks of inflation pressures, unemployment, and trade disruptions.

Economic performance

Following a sluggish first quarter, real growth picked up as the year progressed, reaching 5.7% for 2011 (Figure 3.5.1). All sectors showed robust gains, reflecting improved security and sustained public confidence after the events of April 2010, which saw the ouster of the president and ethnic violence in the south.

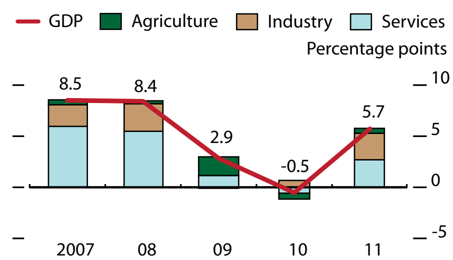
Agriculture showed a modest bounceback to 2.3% growth, following its 2.6% contraction in 2010. Land under cultivation increased by 9%, because shortages of fuel and financing were less severe than in 2010, although a drought in the south kept grain production stagnant.

Industry expanded by 8.8%, with growth in nearly all major subsectors (Figure 3.5.2). Manufacturing grew by 9.8%, or 18.8% excluding gold production, which declined slightly year on year due to low gold concentration in ore extracted during the year. Textile and chemical industries grew especially fast, reflecting the resumption of trade with the Russian Federation and Kazakhstan (disrupted by the crisis). However, food processing declined, reflecting the previous year's fall in agricultural production and the weak recovery in 2011. Also within industry, construction declined by 3.9%—adding to the 18.5% fall in 2010—reflecting a slow recovery of private sector confidence and the continuing postponement of several large projects that were put on hold in 2010.

The services sector, which fell sharply in 2010 following the political events, rebounded by 5.2%, reflecting improved consumer sentiment and the reopening of borders with Kazakhstan and Uzbekistan. (The borders were closed periodically after April 2010. By October that year the border with Kazakhstan was largely reopened, and in October 2011 Uzbekistan reopened an important border crossing.) Most of its subsectors saw growth, including trade, hotels and restaurants, and transport and communications, although real estate contracted by 1.7% on continuing fears of socioeconomic turbulence.

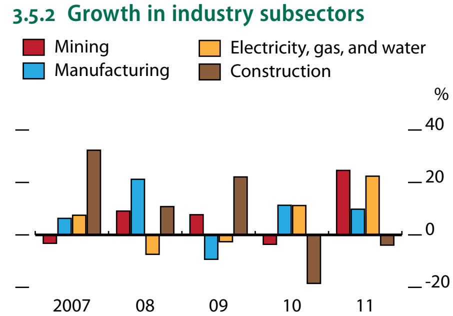
On the demand side, private consumption is estimated to have grown by 4.5%, reflecting a notable rise in retail sales, despite a small increase

3.5.1 Contributions to growth (supply)



Source: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 15 March 2012).

3.5.2 Growth in industry subsectors



Source: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 15 March 2012).

This chapter was written by Gulkayr Tentieva of the Kyrgyz Resident Mission, ADB, Bishkek.

in unemployment. The growth in consumption was driven largely by returning consumer confidence and an increase in remittances to $1.4 billion, equivalent to 25% of GDP, reflecting more Kyrgyz migrants working in the Russian Federation in 2011.

Private investment is estimated to have fallen by a further 16%, after a 23% decline in 2010. By contrast, the growth rate of government investment roughly doubled to an estimated 16%, reflecting continued spending to rehabilitate damaged infrastructure in the south.

Consumer prices rose by 16.6% on a year-average basis, mainly because of rapid price increases during the first half of the year. Inflation slowed during the second half, and the 12-month (December over December) rise in the consumer price index was only 5.6% (Figure 3.5.3).

Food prices, which rose by 25.9%, were the main driver of inflation; nonfood prices rose by 10.3%. The slowdown in inflation during the second half of the year largely reflected good harvests in the Russian Federation and Kazakhstan, which lowered the cost of imported food, along with the impact of tighter monetary policy.

The overall budget deficit rose slightly, to 7.6% of GDP, as increases in tax revenue offset higher social—but not capital—spending (Figure 3.5.4).

Government revenue rose by around 30%, reflecting strong economic growth, high gold prices, and reforms in tax policy and administration, including improved customs valuation, higher excise tax yields, a stronger large taxpayer unit, and more effective audit procedures. Total revenue and grants reached 32.2% of GDP.

Government spending rose by 34%, reflecting higher government grants, wages, and social outlays to raise pensions toward the national subsistence level. Total expenditure reached 39.7% of GDP, and total public and publicly guaranteed debt—external and domestic—declined to 52% of GDP at end-2011.

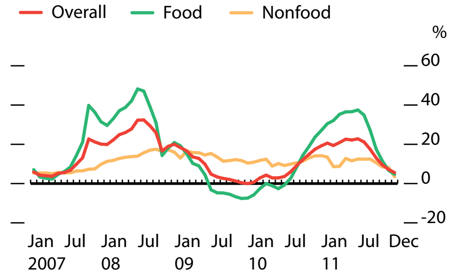
Extensive dollarization of the economy and a shallow financial sector limit the impact of monetary policy in the country. Still, in 2011 the National Bank of the Kyrgyz Republic raised its policy rate steadily over the year, from 5.5% to 13.5%. Credit growth in the broad financial system accelerated to 19.2% from 18.2% in 2010, reflecting in part the lagged impact of earlier expansionary policy and the low reserve requirement set by the central bank in 2010. Commercial banks were responsible for most of the increased lending. The ratio of nonperforming loans to total credit portfolio declined, from 13.8% to 9.8%. Higher nominal interest rates contributed to the local currency's appreciation from March to August.

The current account deficit narrowed slightly to 6.8% of GDP from 8.0% in 2010, despite higher imports, reflecting a less negative income balance and stronger remittances, which reached 25% of GDP (Figure 3.5.5).

Trade rebounded strongly, after the fall in 2010 due to the border closures. Exports are estimated to have grown by 31.1%, with gold remaining the largest item. Imports grew by an estimated 34.4%, mainly reflecting higher imports of gasoline and diesel fuel. The Commonwealth of Independent States countries remained the largest trading partners, with 64% of trade volume.

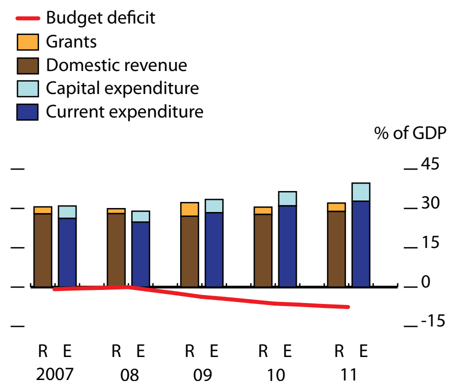
Foreign direct investment fell by 14% reflecting continued weak investor confidence. Nevertheless, net international reserves rose by 7% to $1.8 billion.

3.5.3 Monthly inflation



Source: National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 15 March 2012).

3.5.4 Budget indicators

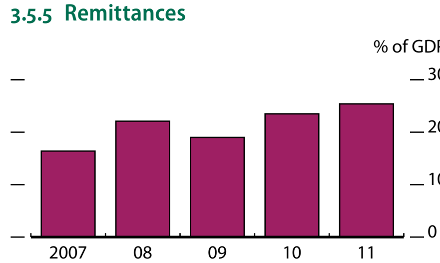


R = Revenue; E = Expenditure.

Note: Domestic revenue includes capital receipts.

Sources: International Monetary Fund. 2009. *Country Report No. 09/209*. July; 2010. *Country Report No. 10/336*. October; 2011. *Country Report No. 11-354*. December. http://www.imf.org; Ministry of Finance.

3.5.5 Remittances



Source: ADB estimates based on data from National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 15 March 2012).

Economic prospects

GDP growth is expected to slow to 5.0% in 2012 and then rise to 5.5% in 2013 (Figure 3.5.6). With the restoration of public confidence and political stability, higher domestic demand and stronger investor confidence are expected to spur private sector activity in the non-gold sectors. Against this, the adverse impact of the eurozone recession on Kazakhstan and the Russian Federation—key trading partners and sources of worker remittances—will inhibit growth. Private transfers are expected to stay around 20–25% of GDP, however.

Growth is expected to be driven by the industry and services sectors. Government plans to provide subsidized loans to farmers in 2012 are expected to promote growth in agriculture.

Large investment projects in infrastructure will drive construction, such as rehabilitating major road networks and building new power grids. Many other projects, including additional power grids and hydropower plants, remain under negotiation.

Private consumption growth is forecast at 5.9% and 5.1%, respectively, in 2012 and 2013, although continuing tensions in the south could jeopardize these increases. Net exports are likely to show little growth, as slower growth in the country's main trading partners—the People's Republic of China, Kazakhstan, the Russian Federation, and the eurozone, point to only modest prospects for exports.

Year-average inflation is expected to continue decelerating, to 5.0% in 2012, reflecting tighter fiscal and monetary policies and likely moderation in the prices for imported food (Figure 3.5.7). Inflation is forecast to rise to 5.5% in 2013, on expected price increases for imported food.

The government aims to reduce the fiscal deficit to 7.3% of GDP or less in the next 2 years, in order to improve debt sustainability and contain inflation pressures. These lower deficits would likely maintain the ratio of total public debt to GDP at 52–53% in the forecast period.

Recent government announcements signal plans to continue improving tax administration and customs collection. Revenue is targeted to reach 32–33% of GDP over the forecast period.

On the spending side, cuts for operations, along with a planned 20% reduction in the civil service headcount this year, are forecast to offset the impact of higher pensions and other socially oriented expenditures. Total expenditure is forecast at 39.6% of GDP in 2012 and 38.7% in 2013.

Monetary policy should remain conservative, reflecting central bank support of fiscal policy to mitigate inflation pressures. Nominal interest rates are likely to stay within the 13–15% band, contributing to further appreciation of the local currency this year.

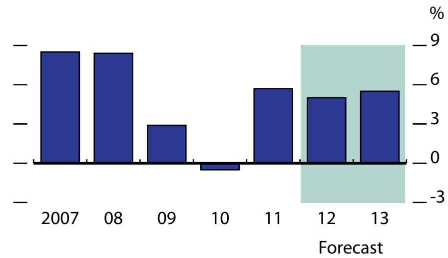
The current account balance is projected to improve somewhat to a deficit of 6.6% of GDP in 2012 before returning to and 6.8% in 2013 (Figure 3.5.8). Following the sharp recovery in 2011, export growth is forecast to moderate to 11.8% and then to 7.7% in 2013, as predicted slower growth in Kazakhstan and the Russian Federation weaken demand for the country's exports. Import growth is forecast to ease to 10.4% and 9.2%, respectively, reflecting increasing domestic production of foodstuffs, continuing but slower remittance growth, and moderating imported food prices in 2012.

3.5.1 Selected economic indicators (%)

	2012	2013
GDP growth	5.0	5.5
Inflation	5.0	5.5
Current account balance (share of GDP)	-6.6	-6.8

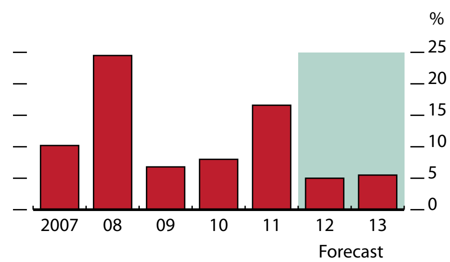
Source: ADB estimates.

3.5.6 GDP growth



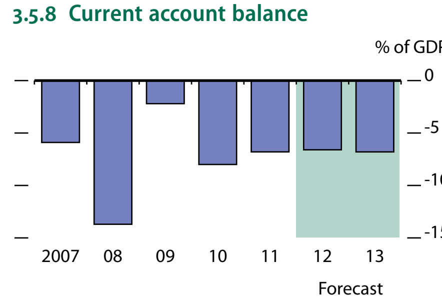
Sources: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 1 March 2012); ADB estimates.

3.5.7 Inflation



Sources: National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 15 March 2012); ADB estimates.

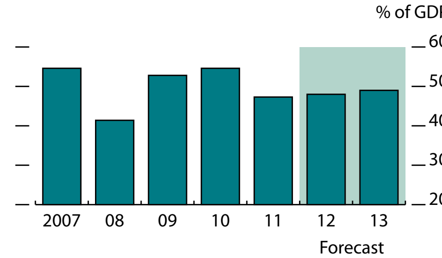
3.5.8 Current account balance



Sources: National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 15 March 2012); ADB estimates.

Foreign direct investment inflows will largely depend on the government pushing through with its proposed structural reforms, which include a reduction in business licenses as part of a broader effort to reduce regulatory burdens on activity. The ratio of total external debt to GDP is expected to remain relatively stable at around 48–49% in the forecast period (Figure 3.5.9).

3.5.9 External debt



Sources: The Ministry of Finance; National Statistics Committee. http://www.stat.kg; National Bank of the Kyrgyz Republic. http://www.nbkr.kg (both accessed 15 March 2012); ADB estimates.

Policy challenge—joining the customs union

Although economic activity is recovering after the crisis of 2010, political stability and investor confidence still need strengthening. As investments have been falling, the government is considering providing new tax incentives to investors. Unless substantial new investment is generated, this move could raise the fiscal deficit and increase the debt-to-GDP ratio.

Over the longer term, the planned accession of the Kyrgyz Republic into the customs union that Belarus, Kazakhstan, and the Russian Federation inaugurated in January 2012 poses major challenges to the economy. Entry into the customs union would make the country subject to new common external tariffs, which are generally higher than those now in force in the Kyrgyz Republic. These new tariffs would raise the price, and reduce the volume, of "shuttle trade" products, which consist largely of textiles reexported from the People's Republic of China to the Russian Federation and Kazakhstan. The shuttle trade was estimated to contribute 3–4% of GDP in 2005–2009.

The terms of accession, including the common external tariffs, are being discussed. The government is concerned that premature accession may entail job losses and is seeking measures to mitigate the possible negative economic effects. Conflicts between customs union arrangements and the country's obligations as a World Trade Organization member also need to be resolved.