Kyrgyz Republic

While the peaceful transfer of power in 2011 and the swift formation of a new government in 2012 laid the foundation for growth, low gold production nevertheless caused GDP to contract by 0.9%. In 2013 growth is expected to rebound to 5.5%. Meanwhile, the government will begin implementing its new Sustainable Development Strategy, 2013–2017, a blueprint for building a stable society, strengthening the rule of law, and improving the investment climate.

Economic performance

GDP declined during 2012 as adverse geological factors affected gold production. Despite some recovery in gold output toward the end of the year and 5.0% growth in other sectors, real GDP contracted by 0.9% (Figure 3.5.1). All sectors except gold and agriculture showed robust gains, reflecting growing public confidence. Agricultural growth was hurt by a poor grain harvest.

Industrial output fell by 13.8%, reflecting a 27.2% drop in manufacturing, which reflected in turn the decline in gold output and lower production of machinery and equipment. Growth in other key manufacturing subsectors averaged a robust 6.1%, driven by higher domestic consumption. Output of textiles grew by 12.5%, and chemical production by 22.7%, to supply growing trade with the Russian Federation and Kazakhstan. Mining output grew by 22.5%, reflecting higher extraction of coal, basalt, and other minerals. Construction grew by 17.3%, following the sluggish 2.5% growth of 2011, because of large investments in new buildings and repairs to existing structures.

Agriculture grew by only 1.2%, less than the 1.9% rise in 2011. Lower productivity and adverse weather caused a 10.0% decline in the grain harvest, which was offset by 2.4% growth in livestock production.

Services, which provide half of GDP, grew strongly for the second consecutive year, by 6.2%. The strongest gains were in transportation at 8.9%, trade 10.5%, and hotels and restaurants 11.7%, reflecting higher consumer demand and improved cross-border trade.

On the demand side, private consumption is estimated to have grown by more than 6%, as higher employment, wage increases averaging 16.5%, and a rise in remittances exceeding 17.0% fueled an 11.0% increase in retail sales.

Investment expanded by 21.5%, including a 30.2% rise in gross fixed capital formation, following the 3.1% investment decline in 2011. The increases, all in the private sector, reflected gains in energy, mining, processing, and trade but were partly offset by declines in

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communications, transport infrastructure, and housing. Government investment shrank by 4.8%, as austerity measures aimed to reduce lower-priority spending. Net exports declined, as export volumes fell by 13.1% while import volumes grew by 26.2%.

Measured as a year average, inflation slowed significantly to 2.8% from 16.6% in 2011, with a 3.9% decline in food prices largely offsetting a 10.1% rise in other prices. Inflation rose slightly during the second half of the year led by higher prices for wheat, which caused the 12-month (December over December) inflation rate to reach 75%, above the comparable rate of 5.7% for 2011 (Figure 3.5.2).

Despite improved tax collection, rapid growth in social expenditures caused the budget deficit to widen to 6.6% of GDP from 4.8% in 2011 (Figure 3.5.3). Government revenue rose to 28.6% of GDP from 27.2% in 2011, reflecting growth aside from gold and improved tax administration. However, higher wages, pensions, and spending on energy infrastructure caused expenditures to rise to 35.2% of GDP from 31.9% in 2011.

Public debt, equivalent to 47.9% of GDP at the end of 2012, rose slightly from 45.6% of GDP in 2011 but was far below the 55.2% of 2010 (Figure 3.5.4), partly because of agreements reached with Turkey and the Russian Federation to write off debt. The agreement with the Russian Federation, ratified in November 2012, provided for the immediate write-off of $189 million in debt and the phased write-off of the remaining $300 million over 10 years starting in 2016.

Extensive dollarization in the Kyrgyz Republic and a shallow financial sector limit the impact of monetary policy. During 2012 the central bank relaxed monetary policy as inflation slowed, steadily lowering the policy rate over the year from 13.6% at the beginning to 2.6% at year-end, in line with declining core inflation and growing confidence in the banking sector. The average deposit rate rose slightly, to 5.4% from 4.9% in 2011, while the lending rate fell to 23.0% from 23.8% in 2011.

During 2012, the deposit base grew by 36.1% and credit to the economy grew by 26.2%. The share of nonperforming loans at year-end fell again to 7.2% in 2012 from 10.2% in 2011 and 15.8% in 2010. The value of the Kyrgyz som remained relatively stable against the US dollar but depreciated slightly during the second half of the year, sliding from Som46.69 to the dollar in January to Som47.40 by 31 December 2012 (Figure 3.5.5). The central bank intervened in the foreign exchange market only to smooth short-term fluctuations.

The external current account deficit is estimated to have widened to 20.9% of GDP from 6.1% in 2011, reflecting lower export volumes and a slight fall in gold prices.

The trade deficit is estimated to have increased significantly, to $3.0 billion, as higher purchases of gasoline and diesel fuel caused imports to rise by 26.2%, while exports fell by 13.1%, mainly reflecting lower gold exports. Members of the Commonwealth of Independent States remained the Kyrgyz Republic’s largest trading partners. Remittances rose to $1.8 billion from $1.5 billion in 2011 (Figure 3.5.6), reflecting positive developments in the Russian Federation and Kazakhstan. Investment inflows rose by 26.7%, largely reflecting new investments in the energy sector and elsewhere. Gross international reserves climbed by 12.7% to $2.1 billion.

3.5.2 Inflation


3.5.3 Fiscal indicators


3.5.4 External debt

Note: Government debt refers to both government and government-guaranteed debt.


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Economic prospects

Growth is expected to rebound to 5.5% in 2013 and 4.5% in 2014 (Figure 3.5.7) on the back of higher gold production and investments, mainly from the Russian Federation and the People’s Republic of China, in energy and transport infrastructure projects. However, gold output could fall below expectations if the political environment deteriorates, weakening investment incentives. The restoration of public confidence and greater political stability should raise domestic demand, spurring growth in the private sector apart from gold. Good economic conditions in the Russian Federation and Kazakhstan will likely promote growth by generating higher remittances and external demand. Reform in state governance also holds promise.

The service sector will remain the major source of economic expansion, with growth expected at 5.0% each year. Transportation and communications should perform well, as major road networks and energy infrastructure are rehabilitated and communication networks are expanded. Industry is expected to grow by 10.0% each year, with metals and metallurgy the main drivers, gold remaining the principal output, and gold and energy showing the highest growth rates.

Inflation is expected to rise to 7.5% in 2013 with the rebound in gold output and infrastructure investments in the energy sector, and then ease to 5.5% in 2014. Substantial price hikes are not expected for food, which occupies 45% of the consumer price index, given current forecasts for declining global food prices.

The fiscal deficit should narrow to 5.5% of GDP in 2013 and 4.0% in 2014 as gold-related tax revenues rise. The government is committed to fiscal consolidation in the medium term and will be guided by conservative revenue forecasts, restrained expenditure on low priority items, and social considerations. Total revenue is expected to increase to 33.0% of GDP, as improving tax administration remains high on the government’s agenda. Total expenditure is expected to rise to 38.3% of GDP, reflecting lower current expenditure but higher capital spending. Future pension increases will continue to be tied to changes in the income officially deemed necessary for subsistence.

Monetary policy is expected to remain cautious as the central bank works to absorb any excess liquidity caused by government spending. The central bank will likely raise the policy interest rate if inflation rises, as expected. Nominal interest rates are expected to stay in the 13.0%–15.0% range, helping the som to appreciate during 2013.

The current account balance is forecast to improve, with rapid export growth narrowing the deficit to 7.0% of GDP in 2013 and further to 5.0% in 2014 (Figure 3.5.8). Exports are forecast to grow by 20.0% in 2013 and 15.0% in 2014, mainly due to a rebound in gold exports during 2013 and higher exports of textiles and agricultural produce in 2013 and 2014. These exports should benefit from anticipated accession into the customs union with Belarus, Kazakhstan, and the Russian Federation in 2014, though trade may fall initially with countries outside the union. Imports are expected to grow steadily at 15.0% both in 2013 and 2014 because imported equipment, machinery, and fuel are needed for new infrastructure projects in energy, transport, and other sectors. External reserves are forecast to climb to $2.2 billion in 2013.
and $2.4 billion in 2014. Foreign direct investment inflows will depend largely on the government implementing its proposed structural reform and improvements to the investment climate. External government and government-guaranteed debt is forecast to subside to about 44% of GDP.

Policy challenges—energy security and reform

Increasingly unreliable electricity supply is among the binding constraints on growth that pose major risks to economic development.

The Kyrgyz Republic has the potential to expand hydropower capacity, which supplies more than 80% of all locally generated electricity. However, the sector is plagued by high commercial and technical losses, poor corporate governance, corruption, aging assets in serious need of rehabilitation and upgrading, and artificially low tariffs.

Energy security remains a primary concern. The country is a net energy importer, with 70% of its energy needs supplied by imported coal, oil, and gas. While Central Asia is rich in fossil fuels, the delivery of fuel imports, particularly of gas, is not always reliable. Because electricity generation exceeds domestic needs, the Kyrgyz Republic is a net electricity exporter. However, the seasonal nature of hydropower generation means that the country suffers from winter electricity shortages. Whether the Central Asian electricity grid, a legacy of the Soviet era, will continue to link countries in the region adds to uncertainty about energy security.

To resolve these challenges, in 2012 the government adopted a new energy sector strategy and developed its energy sector reform action plan. The plan aims to improve state regulation, strengthen the management of energy companies, make corporate activities more transparent, gradually raise tariffs, and expand production to increase exports of electricity and stabilize domestic electricity supply. To improve energy security in the short term, the government plans to complete a 500 kilowatt power substation and the 410 kilometer Datka–Kemin electricity grid. Over the longer term, the government has begun feasibility studies for two electricity grids connecting the country’s system with that of Kazakhstan (Kemin–Almaty) and the People’s Republic of China (Datka–Hudjent). Important but aging assets, especially the Toktogul hydropower plant, urgently need rehabilitation.

The government is negotiating several energy projects, including Kambar–Ata II and a cascade of smaller hydropower stations on the Naryn River. However, sustaining the energy system will require billions of dollars of investment in new projects and the rehabilitation of existing assets. Thus, improving the investment climate, protecting investor rights, and developing a new tariff policy remain as challenges to achieving a more secure energy supply that contributes to economic development.

### 3.5.1 Selected economic indicators (%)

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<thead>
<tr>
<th>Indicator</th>
<th>2013</th>
<th>2014</th>
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</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>5.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Inflation</td>
<td>7.5</td>
<td>5.5</td>
</tr>
<tr>
<td>Current account balance (share of GDP)</td>
<td>–7.0</td>
<td>–5.0</td>
</tr>
</tbody>
</table>

*Source: ADB estimates.*

### 3.5.8 Current account balance

<table>
<thead>
<tr>
<th>Year</th>
<th>% of GDP</th>
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</thead>
<tbody>
<tr>
<td>2008</td>
<td>–21</td>
</tr>
<tr>
<td>2009</td>
<td>–14</td>
</tr>
<tr>
<td>2010</td>
<td>–7</td>
</tr>
<tr>
<td>2011</td>
<td>0</td>
</tr>
<tr>
<td>2012</td>
<td>3</td>
</tr>
<tr>
<td>2013</td>
<td>7</td>
</tr>
<tr>
<td>2014</td>
<td>14</td>
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*Click here for figure data*