Kyrgyz Republic

Economic growth jumped to 10.5% in 2013, and the current account deficit narrowed to 10.4% of GDP, reflecting a rebound in gold production. Meanwhile, inflation accelerated to 6.6%. Growth is expected to return to 6.5% in 2014 and 5.5% in 2015, while inflation should average 6.0%–7.0%. The major challenge remains enacting governance reforms to improve the investment climate and boost investor confidence.

Economic performance

GDP rebounded by 10.5% during 2013, driven mostly by a recovery in gold production that outpaced expectations (Figure 3.5.1). All sectors except agriculture showed robust growth as the private sector expanded.

On the supply side, industrial output grew by 28.0%, reflecting 45.4% growth in manufacturing driven by a near doubling of gold output from the low base in 2012. Growth in other manufacturing subsectors slowed to 3.5% from 6.1% in 2012, dragged down by declines in textiles, utilities, and the production of minerals other than gold, as well as by somewhat slower growth in construction.

Services, which provide about half of GDP, grew strongly for the third consecutive year, at 5.1%. The strongest gains were in transportation (5.8%), trade (7.0%), and hotels and restaurants (11.1%), in view of higher consumer demand and improved cross-border trade. Agriculture outperformed the meager 1.2% rise in 2012, expanding by 2.9% as gains in grain and vegetable output outweighed a small decline in livestock production.

On the demand side, private consumption is estimated to have grown by 9.9%, as higher employment, wage increases, and a rise in remittances boosted retail sales by 7.5%. Investment growth plummeted to 2.3% from the 42.1% recorded in 2012, as higher private investment was offset by a 14% decline in government investment due to cuts in lower-priority spending.

Annual average inflation rose to 6.6% from 2.8% in 2012, mainly because nonfood prices climbed by 6.3%, and utility charges by 6.8%, while food prices rose by only 1.8%. Inflation decelerated during the second half of the year, led by lower prices for wheat, which reduced the 12-month (December over December) inflation rate to 4.0% from 7.5% during 2012 (Figure 3.5.2).

The fiscal deficit narrowed to 4.0% of GDP in 2013 from 5.4% in 2012, reflecting expenditure cuts. Total revenue fell to 29.0% of GDP from 34.5% in 2012, despite better tax administration. Expenditure declined to 32.8% of GDP from 39.8% in 2012, as current and capital spending both shrank (Figure 3.5.3).

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Despite the large government deficit, public debt (almost all external) declined to 43.7% of GDP from 46.9% at the end of 2012, reflecting a debt write-off agreement reached with the Russian Federation and higher economic growth (Figure 3.5.4).

Extensive dollarization limits the impact of monetary policy in the Kyrgyz Republic. The central bank raised the policy interest rate from 2.64% at the beginning of the year to 4.17% at year-end, in line with inflationary pressures during the year. The average deposit rate rose slightly, to 4.26% from 4.11% in 2012, while the lending rate fell to 18.40%, from 19.90% in 2012.

Confidence in banks has strengthened. During January–December 2013, the deposit base grew by 32.9% and credit to the economy by 34.5%. The nonperforming loan ratio improved further, falling to 5.5% in December 2013 from 7.2% a year earlier. The local currency depreciated by 4% against the US dollar, with $1 equaling Som47.4 in January and Som49.3 in December. The central bank intervened in the foreign exchange market only to smooth excess volatility (Figure 3.5.5).

The current account deficit is estimated to have narrowed considerably, to 10.4% of GDP from 15.3% in 2012, helped by the recovery in gold output and lower prices for imported food and fuel. Remittances rose by 7.4% to $1.9 billion, reflecting positive developments in the Russian Federation and Kazakhstan (Figure 3.5.6). Gross international reserves remained stable at $2.2 billion.

**Economic prospects**

GDP is expected to grow by 6.5% in 2014 and 5.5% in 2015 (Figure 3.5.7). This estimate assumes that gold production remains stable and that investments in energy and transport infrastructure projects, mainly from the Russian Federation and the People’s Republic of China, materialize as expected. The projected growth slowdown in 2015 anticipates some slackening in the pace of investment projects during 2015. Government expenditures will remain a driver of economic activity amid gradual recovery in the private sector. Higher domestic demand, encouraged by greater political stability and an improved investment climate, should spur growth in the private sector unconnected to gold. Growth is expected to stabilize at about 5% in the medium term, supported by infrastructure investments and continued increases in credit.

On the supply side, services will remain the major source of growth, expanding by more than 5% annually. 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 about 10% annually, with metals and metallurgy being the main drivers and gold remaining the principal output.

The ongoing dispute with the Centerra Gold company over the government’s share of the Kumtor gold mine may cause risks to the outlook. In September 2013, the government signed a memorandum of understanding whereby it would exchange 33% of its shares in Centerra Gold for a 50% stake in the Kumtor goldmine. Parliament initially...
opposed the deal but, in February 2014, approved the memorandum with the proviso that the details of the new agreement be negotiated within 3 months.

Average annual inflation is expected to stay within 6%–7% during 2014–2015. Substantial price hikes are not expected for food, which accounts for around half of the consumer price index, given current forecasts for declining global food and fuel prices. The recent depreciation of the Kyrgyz som by about 10% and its fluctuations, following the decline in the rouble and Kazakh tenge, may cause higher inflation in 2014, as well as higher dollarization.

The fiscal deficit is forecast at 4.0% of GDP in 2014 and 3.0% in 2015. This is despite the closure of the military transit center at Manas Airport in July 2014, as operations wind down in Afghanistan, and the consequent loss of rental revenue worth $60 million in 2014 and an annual $120 million thereafter. The government is committed to fiscal consolidation in the medium term and will be guided by conservative revenue forecasts as it restrains expenditure on low-priority items and weighs social needs. The loss of nontax revenues in 2014 is expected to be offset partly by grants and expenditure restraint. Revenue is expected to reach 30% of GDP in 2014 and 31% in 2015, as improving tax administration remains high on the government’s agenda. Expenditure is projected at 35% of GDP in 2014 and 34% in 2015, reflecting higher capital spending and somewhat lower current outlays.

Monetary policy is expected to remain restrictive, as the central bank aims to restrain inflation by absorbing excess liquidity arising from government spending. The central bank will likely increase the policy interest rate if inflation rises, as expected in 2014. Nominal interest rates are expected to stay in the 13.0%–15.0% range if the Kyrgyz som does not depreciate further.

The current account deficit is forecast to widen to 15.7% in 2014 because of substantial import-intensive foreign direct investment and new infrastructure projects, and then decline gradually in subsequent years (Figure 3.5.8). Exports are forecast to grow by about 8% in 2014 and 2015, mainly from higher gold exports by volume. However, falling gold prices and expected weaker demand, mainly for textiles, food, and machinery in the Russian Federation and other markets in the Commonwealth of Independent States, may worsen the trade outlook. Imports are expected to grow steadily, by about 10% in both 2014 and 2015, because of new infrastructure projects. Inflows of foreign direct investment will depend largely on the government implementing its proposed structural reforms and improvements to the investment climate. External reserves are forecast to climb to $2.3 billion in 2014 and $2.4 billion in 2015. Currency depreciation in the Russian Federation and Kazakhstan, where most Kyrgyz migrants work, may reduce remittances. Accession into the customs union with Belarus, Kazakhstan, and the Russian Federation—expected within the next few years—adds uncertainty, as trade may initially falter with countries outside the union, including the People’s Republic of China.
Policy challenge—promoting inclusive growth

The rising poverty rate in the Kyrgyz Republic, which climbed from 31.7% in 2009 to 38.0% in 2012, has shown how easily the poverty reduction achieved from 2005 to 2008 can be reversed. Moreover, poverty rates vary significantly across the regions. They are relatively low in Bishkek city (at 21.4%), the surrounding oblast of Chui (16.6%), and Issyk-Kul oblast (28.1%), but the other five oblasts have always been poorer, with poverty rates in some exceeding 50%. Poverty rates are also volatile, and studies are examining why. The National Statistics Committee’s report on poverty for 2012 found that inflation strongly affects the poverty rate because it drives the incomes of many near-poor people below the national poverty line. Inclusive growth, benefitting all regions and people, is thus an urgent priority and necessary for political and social stability and security.

In January 2013, the Kyrgyz President approved the National Sustainable Development Strategy (NSDS) for 2013–2017, which aims to achieve political stability and stable growth in GDP and household incomes. The NSDS recognizes persistent poverty and regional disparity as key challenges.

A 2012 diagnostic study identified political instability, weak rule of law, and corruption as binding constraints on inclusive economic growth. Other constraints include the failure of low-quality education and training programs to meet the demand for skilled labor, the high cost of finance, and unreliable electricity supply. The first two constraints are especially acute in remote oblasts.

Addressing these constraints and supporting private sector development will likely accelerate growth, but making growth inclusive requires giving people more equitable access to economic opportunities. Young people in remote oblasts and the poor and vulnerable in particular need greater access to the high-quality training and education that can make them employable. Improving access to affordable finance will help distribute economic opportunity more evenly across geographic areas.

The main economic priority of the NSDS is to create an enabling environment for the private sector, thereby attracting investment and promoting growth. The strategy aims to reduce poverty mainly by creating new jobs, upgrading education and training to promote employability, and improving social assistance to pensioners and low-income groups. The government intends to address regional disparity by attracting investment to areas outside of the traditional growth centers of Bishkek, Issyk-Kul, and Chui oblasts, largely by improving the business climate. The government program for 2013–2017 intends to facilitate inclusive regional development by decentralizing administration, strengthening local self-governance, and developing road maps for economic and social development in each region.

### 3.5.1 Selected economic indicators (%)

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<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
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<tbody>
<tr>
<td>GDP growth</td>
<td>6.5</td>
<td>5.5</td>
</tr>
<tr>
<td>Inflation</td>
<td>7.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Current account</td>
<td>–15.7</td>
<td>–15.1</td>
</tr>
<tr>
<td>balance (share of GDP)</td>
<td></td>
<td></td>
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Source: ADB estimates.