Growth accelerated in 2022, reflecting a rebound in gold production, strong domestic demand, and milder-than-expected impact on the economy from the Russian invasion of Ukraine. Inflation also accelerated, and both fiscal and current account deficits widened. Growth and inflation are expected to moderate over the forecast period, with diminishing external inflow of funds and less favorable conditions in trade partners. Pension reform is needed for more sustainable and inclusive growth.

**Economic Performance**

The economy performed better than expected, with growth accelerating. Despite global and regional shocks, growth rose from 6.2% in 2021 to an estimated 7.0% in 2022 (Figure 2.5.1). On the supply side, industry excluding construction expanded by 12.2%, almost double the rate in 2021, driven by a rebound in gold production. Growth in services slowed from a strong 8.4% in 2021 to 4.8% with smaller but still notable gains in trade, at 7.7%, and transport at 10.1%. Expansion remained high at 23.8% in hotels and restaurants, which benefited from capital inflow and foreign arrivals, mostly from Russia. After contracting by 4.9% in 2021, construction expanded by 8.0% in line with increased investment, both foreign and domestic. Agriculture reversed drought-induced decline by 4.6% in 2021 with growth by 7.3%, which reflected a strong 40.5% increase in grain production.

**Private consumption and investment were the main demand-side drivers of growth.** Growth in domestic demand surged from 3.8% in the first 3 quarters of 2021 to 33.2% in the same period of 2022. On the demand side, higher household savings slowed growth in private consumption from 11.1% in 2021 to a still-strong 9.0% in 2022, supported mainly by increases in real wages and inward money transfers. Public consumption grew by 0.8% in the first 3 quarters of the year, up slightly from 0.3% in the same period of 2021, with the data not yet fully reflecting significant increases to public wages and pensions and border-related spending introduced in the last quarter of 2022. Growth in gross capital formation jumped by more than threefold, supported by strong expansion in both gross fixed capital formation and changes in inventories. The deficit in net exports widened by 3.4 times as imports spiked and exports declined.

This chapter was written by Gulnur Kerimkulova of the Kyrgyz Resident Mission (KYRM), ADB, Bishkek and Zhamilia Bataeva, KYRM consultant.
Inflation remained elevated, reflecting high commodity prices and strong domestic demand. Average annual inflation rose from 11.9% in 2021 to a decade high of 13.9% in 2022, mainly on higher global prices for food and energy, wage growth, and a surge in demand from an influx of relocating Russians (Figure 2.5.2). By category, inflation slowed from 18.0% in 2021 to 16.2% for food but accelerated from 9.0% to 17.3% for alcoholic beverages and tobacco, from 7.3% to 11.1% for other goods, and from 4.4% to 9.8% for services. Inflation reached 14.7% year on year in December 2022, well above the 5%–7% target range set by the National Bank of the Kyrgyz Republic, the central bank. In the first quarter of 2022, the central bank tightened monetary policy in response to increasingly broad inflation and inflationary expectations and a nearly 24% plunge by the Kyrgyz som, in tandem with the Russian ruble, against the US dollar. During this period it raised the policy rate three times by a cumulative 600 basis points to 14.0%. The policy rate then remained unchanged until 29 November, when it was lowered by 100 basis points to 13.0%, despite demand pressures, to support growth and in the light of slowing inflation and a full recovery in the exchange rate (Figure 2.5.3).

Fiscal policy became more expansionary as the general government deficit widened from 0.2% of GDP in 2021 to 1.1% in 2022 (Figure 2.5.4). Intensified tax administration efforts and cyclical revenue recovery substantially improved revenue collection in 2022 from the equivalent of 29.0% of GDP in 2021 to 32.7%. However, expenditure expanded even more, reflecting increases in public wages, pensions, public investment, and spending in the Batken region after tensions there at the border. Outlays rose from 29.3% of GDP in 2021 to 33.8%, with large sums directed to countercyclical measures. With public debt equaling 52% of GDP at the end of 2022, public debt service payments reached 10.8% of all expenditure (Figure 2.5.5).

The current account deficit ballooned from 8.7% of GDP in 2021 to 48.6% in the first 3 quarters of 2022 (Figure 2.5.6). Net money transfers from abroad including remittances remained positive in 2022 but declined by 21.2% (Figure 2.5.7). The decline likely reflected larger outflow from capital flight as Russian rubles were converted into US dollars and sent abroad.
Imports increased by 72.6%, reflecting higher oil prices and domestic demand. Exports declined by 20.5% as gold exports were suspended and reexports to other countries in the Eurasian Economic Union were likely not fully documented. During this period the central bank purchased domestically produced gold. Gross foreign exchange reserves declined, reducing cover for imports of goods and services from 5.3 months in 2021 to 3.6 months. Central bank foreign exchange interventions in 2022 entailed net sales of $229.1 million. However, external debt, including government-guaranteed and private debt, is estimated to have fallen from the equivalent of 89.9% of GDP at the end of 2021 to 74.3% at the end of September 2022.

Banks stayed financially healthy despite some weakening in asset quality, and the interest rate spread remained relatively high. In 2022, bank lending continued to grow as credit in local currency rose by 19.0%, including consumer lending by 50.4% and mortgage lending by 24.6%. The share of loans in foreign currency fell by 4.4 percentage points to 23.6%, but the share of foreign currency deposits increased to 48.3%. The spread between lending and deposit rates widened in a tightening monetary environment as hikes to lending rates in local currency outpaced higher deposit rates. Deposits grew by 39.5%, though little went into time deposits. Bank profitability improved as return on assets rose from 1.2% in 2021 to 5.9% in 2022, reflecting higher non-interest income. Banks remained liquid and well-capitalized with a capital adequacy ratio of 25.6% and a liquidity ratio of 82.8% at the end of 2022. However, nonperforming loans increased from 11.1% of all loans in 2021 to 12.8% in 2022.

Economic Prospects

Growth is projected to slow to 4.5% in 2023 and further to 4.0% in 2024 as uncertainty increases (Figure 2.5.8 and Table 2.5.1). Geopolitical developments may spill over to weigh on growth and inflation through remittances, exchange rate fluctuation, and trade and financial links. Significant downside risks such as contraction in the Russian economy could reduce growth further or add to inflation. Gold production from the Kumtor mine is also highly uncertain. On the other hand, capital and migrant inflows from Russia could improve the growth outlook, as in 2022.
Inflation is expected to moderate somewhat but remain high (Figure 2.5.9). While elevated core inflation suggests continuing strong underlying price pressures, along with announced increases to electricity tariffs and other administered prices and likely further currency depreciation, average inflation is expected to decelerate to 12.0% in 2023, reflecting likely moderation in prices for imported food and energy. Inflation is forecast to decline further to 8.6% in 2024, as demand diminishes. The central bank is expected to intervene to smooth excess exchange rate volatility.

**Table 2.5.1 Selected Economic Indicators, %**

Growth and inflation are both expected to decelerate in 2023 and 2024.

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>6.2</td>
<td>7.0</td>
<td>4.5</td>
<td>4.0</td>
</tr>
<tr>
<td>Inflation</td>
<td>11.9</td>
<td>13.9</td>
<td>12.0</td>
<td>8.6</td>
</tr>
</tbody>
</table>

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Growth will decelerate as expansion in gold production and domestic demand slows. On the supply side, growth in industry is expected to slow, reflecting a gradual decline in gold production as the Kumtor gold mine approaches its capacity limit. Expansion in electricity generation is projected to slow because of low water levels. Following strong growth last year, agriculture will decelerate to 3.0% increase in 2023 and 2.5% in 2024, with expansion coming mainly in livestock as crop production slows. However, growth in services is forecast to remain largely unchanged, supported by growth in trade averaging 7.6% annually and continuing demand from the influx of Russians last year. On the demand side, private consumption and investment will grow more slowly as remittances and other money transfers decelerate. However, net exports will rise as gold exports are expected to resume, while growth in imports will slow with fewer reexports.

Expansionary fiscal policy is unlikely to reverse over the next 2 years. The fiscal deficit is projected to widen to an average of 2.5% of GDP in both years. Continuing improvement to tax and customs administration is expected to boost revenue. However, expenditure is expected to climb even more to cover wage and pension increases enacted in 2022 and as public debt service payments rise. Increased expenditure will likely keep the deficit elevated despite a planned reduction in domestically financed investment spending. With little foreign financing available, this could require further costly domestic borrowing.

The current account deficit is projected to narrow in 2023 and 2024 as gold exports resume and global energy and food prices moderate. Exports of other goods should continue to increase, supported by transit trade. Imports are expected to grow more slowly, with slower growth in domestic demand offsetting a rise in imports from continued regional and transit trade.
Converting nonmonetary gold on the central bank’s balance sheet into foreign exchange and monetary gold would support and diversify international reserves, though gross reserves are projected to decline further. Likely depreciation of the Kyrgyz som, mirroring an expected weakening of the Russian ruble against the US dollar during the forecast period, could affect the ratio of external debt to GDP in 2023 and 2024.

Encouragingly, the government has developed several initiatives to address these problems. In line with the Kyrgyz pension strategy, the government drafted in 2022 amendments to the law on state pensions. They aim for better balance by, for example, adjusting the number of years required for contributions and the retirement age for certain categories of people. The authorities have proposed amendments regarding contribution rates for some sectors and other changes. The strategy strives to strengthen the system’s defined contributions component as well, recognizing that the country’s financial system consists largely of banks and that the capital market remains shallow and underdeveloped. These measures may mitigate some weaknesses of the system. However, further reform is necessary to address continuing challenges under the current system, particularly because delaying reform will mean higher adjustment costs in the future.

Policy Challenge—Strengthening Pension Reform to Support Sustainable and Inclusive Growth

The current pension system is costly and complex. Despite improvements after decades of reform, some challenges remain: (i) dependence on the state budget to ensure financial sustainability, as government transfers cover more than 40% of pension fund expenditure; (ii) a high contribution rate of 27.25%, combined with relatively low benefits; and (iii) unregistered employment and evasion, which may reflect high contribution rates and poor coverage. System performance indicators could be further improved by, for example, increasing the wage replacement rate (30% in 2021) and by decreasing the system dependency ratio. The pension system has become structurally complex, with multiple components and special arrangements for workers in particular industries. In addition, the Kyrgyz Republic spends about 9% of GDP on its pension system despite having a relatively young population. These challenges may create further disincentives to comply with participation requirements and have a negative impact on economic growth at large. The problem is especially acute for about a million migrant workers abroad, as well as for farmers and other self-employed individuals. Failing to address these issues could worsen the country’s poverty rate.

The Kyrgyz Republic may need more systemic and thorough pension reform to support growth. Measures would promote sustainability by building a more simple and transparent pension system that would be easier to administer. Reform to encourage greater participation and compliance would reduce costs to the private sector and the financial burden on the state budget, freeing up government funds to invest in people and infrastructure for more sustainable growth. The authorities’ exceptional efforts provide almost full coverage to the elderly, contributing greatly to poverty alleviation in the country. However, the government should do more to address the issue of pension adequacy. This could reduce or even eliminate poverty among the elderly while making the system more efficient and mobilizing public support for reform. At the same time, the government should recognize that improving pensions can increase investment, generate national wealth, and promote more inclusive growth.