KYRGYZ REPUBLIC

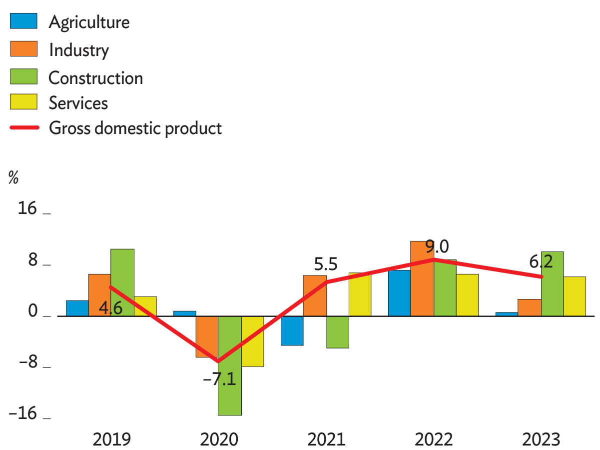
Growth remained strong in 2023 with robust gains in almost all sectors but a slowdown in gold production. Inflation subsided with smaller increases in food prices but remained elevated. The current account deteriorated with a surge in imports and large unrecorded reexports. Growth is projected to moderate in 2024 and 2025 with smaller gains in construction and services. Inflation should decline under continued tight monetary policy. Inflation can be tackled with more effective monetary policy.

Economic Performance

Growth slowed but remained robust in 2023. Growth moderated to 6.2% from 9.0% in 2022, a figure revised up from the previously released 6.3% mainly because the National Statistics Committee recalculated the share of net indirect taxes in GDP. On the supply side, growth in industry slowed from 11.9% in 2022 to 2.7% as metal production, especially gold, fell by 12.8% and expansion in manufacturing plunged from 16.4% in 2022 to 2.0% with lower output of fabricated metals, machinery, and equipment, and despite faster growth in textiles and garments. Growth in services remained robust because of gains in accommodation and food services but slowed somewhat, from 6.8% in 2022 to 6.2%, with slower expansion in transport, storage, information, and communications. Poor rainfall slashed growth in agriculture from 7.3% in 2022 to 0.6% as cereal production fell by 14.6%. Construction growth accelerated from 9.1% in 2022 to 10.3% on higher investment in mining, manufacturing, energy, transport, trade, and housing (Figure 2.5.1).

Figure 2.5.1 Supply-Side Growth

Growth moderated but remained robust in 2023 with a pickup in construction and continued gains in services.



Source: National Statistics Committee of the Kyrgyz Republic.

Slower expansion in consumption trimmed growth on the demand side. According to data available for only the first 9 months of 2023, growth in private consumption fell by half from 16.4% in the same period of 2022 to a still robust 7.9%, sustained by gains in consumer lending, real wages, and net remittances. Expansion in public consumption rose from 0.5% in 2022 to 1.1% in 2023 because of higher civil service wages. Fixed capital investment rose by 34.6%, mainly from higher domestic spending on energy, water, and education facilities, while foreign investment declined by 26.3%.

Inflation slowed but remained elevated, reflecting strong domestic demand. Average annual inflation slowed from 13.9% in 2022 to 10.8% in 2023. Year-on-year inflation fell by half from 14.3% in

This chapter was written by Nurbek Jenish and Zhamilia Bataeva, Kyrgyz Resident Mission consultants.

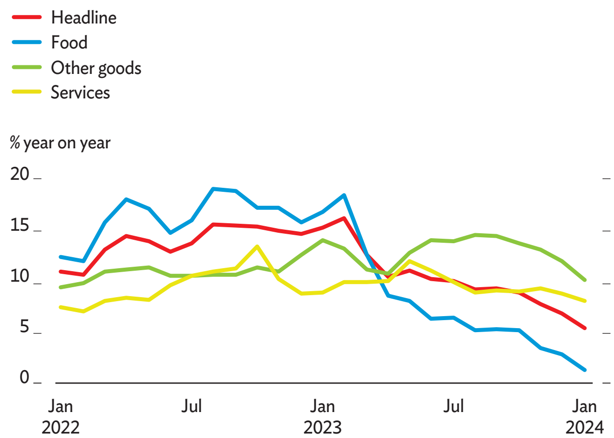
December 2022 to 7.3% in December 2023, slightly above the 5.0%–7.0% target range of the National Bank of the Kyrgyz Republic, the central bank (Figure 2.5.2). The decline in inflation came mainly from lower global food prices, seasonal factors that reduced food inflation, and tight monetary policy. The central bank kept its policy rate at 13.0% throughout the year despite slowing inflation. Food inflation similarly fell by half, from 16.2% to 8.4%, but prices rose from 11.1% to 13.3% for other goods and from 9.8% to 10.0% for services, the latter largely reflecting tariff hikes on electricity, other utilities, and transportation.

Gross reserves increased, with a higher share of assets in gold (Figure 2.5.3). The central bank sold $655.7 million in 2023, mainly to smooth excess volatility in the Kyrgyz som as the Russian ruble weakened by about 25% against the dollar. This held som depreciation against the dollar to about 4.0% in 2023. Despite currency interventions, ongoing purchases of domestically mined gold and the conversion of nonmonetary gold on the central bank's balance sheet to foreign exchange enabled gross reserves to rise by about $0.5 billion in 2023 to $3.2 billion at the start of 2024, cover for about 3 months of projected imports.

Strong revenue performance pushed the budget into surplus. The general government fiscal balance moved from a deficit equal to 1.0% of GDP in 2022 to a 1.0% surplus in 2023 as revenue grew faster than expenditure (Figure 2.5.4). Improved tax administration and an expanded tax base boosted revenue from 29.5% of GDP in 2022 to 31.9% in 2023, with gains in both tax and nontax revenue. Gains in tax revenue reflected a 34.2% rise in value-added tax collections on unusually strong imports. Nontax revenue benefited from a more than doubling of revenue from state-owned assets, including dividends from the Kumtor mine and a profit distribution from the central bank. Government spending increased slightly from 30.5% of GDP in 2022 to 30.9% on a higher wage bill and social benefits. With strong nominal GDP growth, public debt declined from 46.9% of GDP at the end of 2022 to 45.5% a year later, with domestic debt rising from 9.2% of GDP to 11.8% and external debt falling from 37.6% of GDP to 33.7% (Figure 2.5.5).

Figure 2.5.2 Monthly Inflation

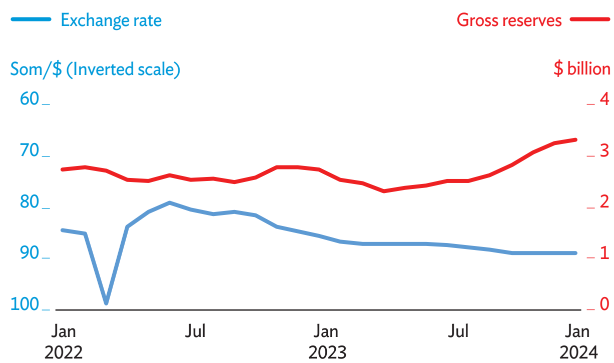
Headline inflation subsided in 2023 as food price inflation plunged.



Source: National Statistics Committee of the Kyrgyz Republic.

Figure 2.5.3 Exchange Rate and Gross Reserves

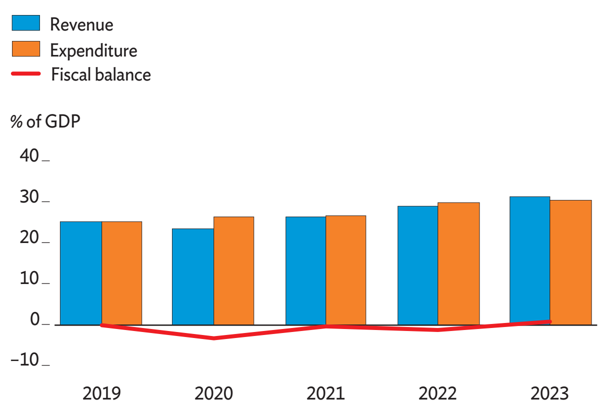
The Kyrgyz som depreciated marginally against the dollar in 2023, while gross reserves increased.



Source: National Bank of the Kyrgyz Republic.

Figure 2.5.4 Fiscal Indicators

The general government fiscal balance improved as revenue rose more than expenditure.

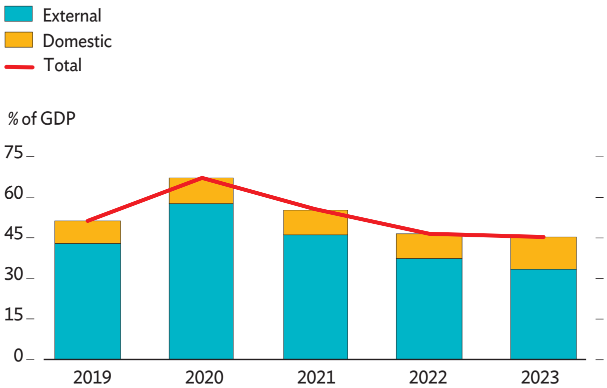


GDP = gross domestic product.

Source: National Bank of the Kyrgyz Republic.

Figure 2.5.5 Public Debt

Total debt declined slightly as a percentage of GDP, with more domestic debt and less external.

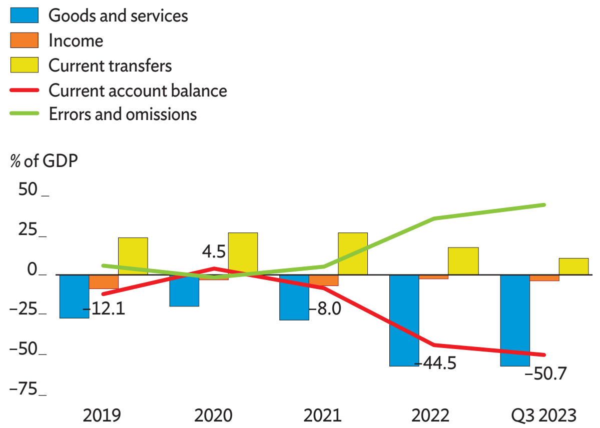


GDP = gross domestic product.

Source: Ministry of Finance.

Figure 2.5.6 Current Account Components

The current account deficit widened in 2022 and the first 9 months of 2023.



GDP = gross domestic product, Q = quarter.

Note: Preliminary data for 2023 are for the first 9 months and presented as a percentage of annualized GDP.

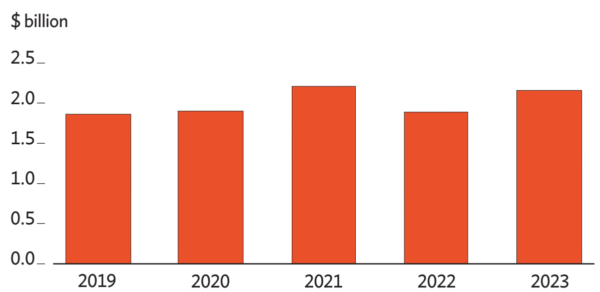
Source: National Bank of the Kyrgyz Republic.

The banking sector remains sound. Banks remained liquid and well-capitalized, with a capital adequacy ratio of 24.8% and a liquidity ratio of 77.4% at the start of 2024. Nonperforming loans dropped from 12.8% in 2022 to 9.2% at the end of 2023. Credit grew by 26.3% in 2023, with consumer lending up by 68.8% and mortgage lending by 23.2%. Deposits expanded by 27.3%.

The current account deficit widened, while errors and omissions remained large. The recorded deficit, which does not fully count reexports to the Russian Federation because of limited monitoring of trade within the Eurasian Economic Union, surged from 44.5% of GDP in 2022 to 50.7% in the first 3 quarters of 2023, reflecting a larger trade deficit, a smaller surplus in services, and persistently large errors and omissions (Figure 2.5.6). Following an 18.1% drop in exports in 2022, when gold exports dropped hundredfold to $13.1 million, exports surged by 46.8% in 2023 as gold exports rebounded sharply to $1.28 billion. Imports, which rose by 75.7% in 2022, increased a further 26.0% in 2023 because of strong domestic demand and imports of consumer goods and vehicles, mainly from the People's Republic of China, for reexport. After data revision to account for money transferred via mobile phone, the central bank reported a 14.5% increase of net money transfers in 2023, reversing a 14.6% decline in 2022, as outflows declined (Figure 2.5.7).

Figure 2.5.7 Net Money Transfers

Net money transfers increased in 2023 as outflows declined.



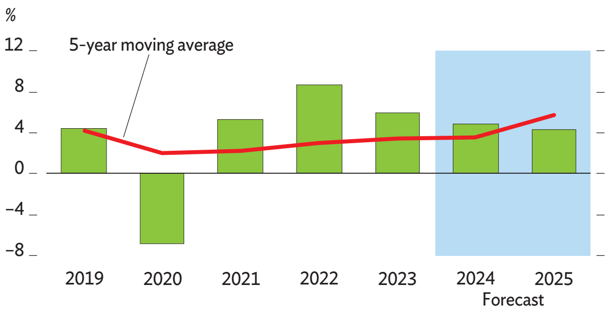
Source: National Bank of the Kyrgyz Republic.

Economic Prospects

Growth is projected to moderate further toward its long-term potential rate. Despite strong growth in January–February 2024 at 8.6%, GDP expansion is expected to decline to 5.0% in 2024 and further to 4.5% in 2025, reflecting slower growth in construction and services (Figure 2.5.8 and Table 2.5.1). Public programs for housing notwithstanding, construction on urban infrastructure, irrigation, and social and industrial facilities will slow to 9.0% in 2024 and stabilize in 2025. Growth in tourism will further support growth in services, though to a lesser extent of 5.0% annually. Gold production is expected to decelerate gradually as the Kumtor mine depletes, though recently announced new technologies for gold extraction may buoy

Figure 2.5.8 Gross Domestic Product Growth

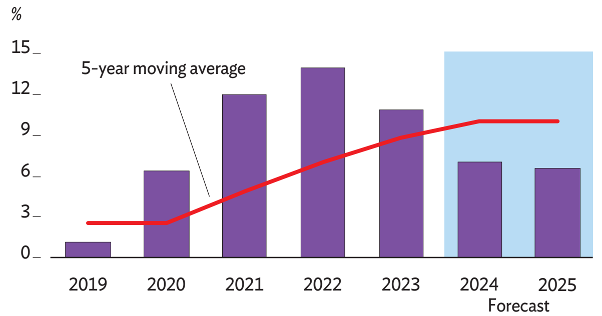
Growth is forecast to moderate in 2024 and 2025 with slower expansion in construction and services.



Sources: National Statistics Committee of the Kyrgyz Republic; Asian Development Bank estimates.

Figure 2.5.9 Annual Inflation

Inflation is projected to slow in 2024 and 2025.



Sources: National Statistics Committee of the Kyrgyz Republic; Asian Development Bank estimates.

Table 2.5.1 Selected Economic Indicators, %

Growth will slow and inflation decelerate in 2024 and 2025.

	2022	2023	2024	2025
GDP growth	9.0	6.2	5.0	4.5
Inflation	13.9	10.8	7.0	6.5

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

production. In any case, expansion in manufacturing is projected to accelerate growth in industry to 4.0% in 2024 and 2025. Growth in agriculture is forecast to recover to 2.5% each year, with livestock providing most of the increase, as crop production will continue to face a scarcity of water for irrigation. On the demand side, investment and private consumption will remain the main sources of growth, with higher household incomes supporting private consumption as inflation slows and remittances are projected to remain robust.

Inflation is projected to decelerate further toward the central bank target. It will slow to 7.0% in 2024 and 6.5% in 2025 as an improved global food market and slowing domestic demand reduce inflationary pressures (Figure 2.5.9). The government adopted an action plan to regulate price increases for essential food items during 2024, which is also expected to help curb inflation. In January–February 2024, moderating food prices lowered year-on-year inflation to 5.5%, within the central bank's 5.0%–7.0% target range for the first time since September 2020. The central bank is expected to maintain a relatively tight monetary policy and continue intervening in the foreign exchange market to smooth exchange rate fluctuations.

Fiscal stimulus will remain limited, while high collections of value-added tax may subside. Improvements to tax and customs administration are expected to continue, but the rate of mandatory social contributions employers pay on wages is likely to fall by half in 2024 in most sectors, from 27.25% to 12.25%. Revenue is projected to moderate to 30.0% of GDP in 2024 and 2025, with a possible slowdown in value-added tax collections on imports if growth in reexports decelerates or reverses. Expenditure is projected as moderating to 29.0% of GDP in both 2024 and 2025, despite higher spending on health, education, the construction and rehabilitation of transport and irrigation infrastructure, and affordable housing. With external debt payments projected at about $400 million annually in 2024–2026, external debt is expected to decline further as a percentage of GDP during this period.

The current account deficit is projected to narrow. This will reflect a further rise in gold exports, slower import growth, and reexports better reflected in external accounts. The trade deficit should shrink as export growth rises with higher gold exports, including sales of gold accumulated by the central bank and expansion in other exports. Imports of vehicles intended for reexport are expected to decline because the reexport of cars from the Kyrgyz Republic to the Russian Federation is likely to become unprofitable from 1 April 2024, when Russian customs clearance for reexported vehicles will increase. Import growth should decline as well because of slower growth in domestic demand.

Downside risks weigh on the outlook. Continuing geopolitical tensions could slow growth in the Russian Federation, reducing trade, investment, and remittances for the Kyrgyz Republic. Slower growth and declines in vehicle imports would also cut revenue, limiting funds to rehabilitate existing infrastructure and finance new infrastructure projects. Power shortages from aging electricity infrastructure and limited water supply, unfavorable weather, and a sustained drop in gold prices would exacerbate these risks.

Policy Challenge—Strengthening Monetary Policy Transmission

Despite a recent decline in inflation, inflation expectations have remained high in the Kyrgyz Republic. Recent external shocks, including a surge in food prices, supply-chain disruptions, and currency depreciation in 2022, have been the main sources of inflationary pressures. Inflation remained high, at 7.3% at the end of 2023. Despite the decline of inflation to 5.5% in February 2024, inflation expectations remain elevated, according to the central bank.

Structural factors hamper the effectiveness of monetary policy. Despite tight monetary policy, with the central bank raising its policy rate six times since 2021 and selling foreign exchange to curb inflation, expectations of high inflation persist. The financial system is shallow and underdeveloped, with a small and uncompetitive banking sector and a nascent stock market. The banking system has continuing excess liquidity, concentrated in a few banks, that is not lent to the private sector or other banks. These features, together with restricted access to international capital markets, limit the central bank's ability to affect lending rates or the exchange rate. Financial literacy also remains low despite central bank efforts to improve it. This hinders the formation of expectations, thwarts communication, and limits the central bank's credibility.

High dollarization weakens monetary policy transmission amid risks of financial stability and currency mismatches. Despite a gradual decline in dollarization over the past 8 years, both the private and the public sector rely heavily on foreign currency borrowing, increasing vulnerabilities in case of exchange rate movements. Historically high reliance on remittances also limits monetary policy. Despite the issuance of long-term government securities in som, local currency debt accounts for only 25.9% of total public debt. Administrative and macroprudential measures in place—such as differentiated minimum reserve requirements with higher reservations for liabilities denominated in foreign currency, higher loss provisions for foreign currency loans, and regulatory limits on commercial banks' net open foreign exchange positions—should be implemented further and complemented with stronger macroprudential policies to reverse dollarization.

Frequent foreign exchange interventions limit how much the exchange rate can be a shock absorber, possibly undercutting monetary policy transmission. According to a study by the International Monetary Fund, currency depreciation in the Kyrgyz Republic by 10 percentage points boosts inflation in the first year by 3 points. The central bank frequently intervenes in the foreign exchange market to smooth exchange rate fluctuations, mainly by selling foreign currency in periods of som depreciation.

Bolstering the credibility and independence of the central bank is crucial. The central bank uses standard channels of announcements and press releases on its website. Better communication achieved by sharing more detailed and transparent information could improve policy predictability and lower inflation expectations. The central bank can benefit from further aligning its communications to best practices, improving public financial literacy, and adopting a forward-looking strategy. Streamlining central bank gold purchases and adhering to rules for profit distribution from the central bank to the budget are essential to strengthen central bank governance and independence.