

Kyrgyz Republic

Growth improved to 4.6% from 4.3% in 2016, reflecting gains in industry, along with higher government spending and remittance earnings. Inflation accelerated to 3.2%, and the current account deficit narrowed to 4.8% of GDP from 11.6% in 2016. Growth is projected to moderate to 3.5% in 2018 before recovering to 4.0% in 2019. The government is promoting economic diversification through digitalization.

Economic performance

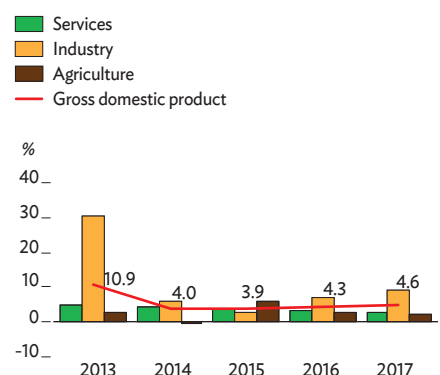
Growth accelerated to 4.6% from 4.3% in 2016 as strong gains in industry offset slower growth in services and agriculture (Figure 3.5.1). On the supply side, industry expanded by 9.3%, up from 7.1% in 2016, with large increases of 78.4% in mining, 7.6% in manufacturing, and 10.1% in electricity generation. Growth in construction slowed to 7.1% from 9.3% in 2016, despite slightly faster growth in fixed capital investment, mostly in construction for mining, energy generation, and transport. Agriculture expanded by 2.2%, less than the 2.9% rise in 2016, with crops up by 2.5% and animal husbandry by 2.0%. Services rose by 2.6%, down from 3.4% in 2016, as growth in wholesale and retail trade slowed to 3.5% from 8.0% a year earlier.

On the demand side, growth found support from higher public consumption and investment linked to election spending and a modest rise in private consumption that reflected a 24% improvement in remittance earnings (Figure 3.5.2).

Average inflation accelerated to 3.2% from 0.4% in 2016, while the year-on-year inflation rate to December reached 3.7% (Figure 3.5.3). Higher inflation reflected price increases of 2.7% for food, 4.0% for alcoholic beverages, 3.2% for other goods, and 6.9% for services. Inflation would likely have been higher if the average value of the Kyrgyz som against the US dollar had not appreciated by 1.5% during the year (Figure 3.5.4).

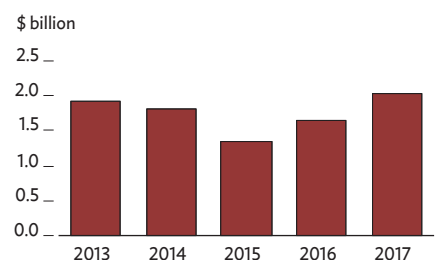
The government managed to narrow the fiscal deficit to 3.2% of GDP from 4.4% in 2016 despite election-related spending. Revenue rose to the equivalent of 28.7% of GDP from 27.4% in 2016, while expenditure rose slightly but remained equal to 31.8% of GDP. With the smaller deficit and currency appreciation, external government debt fell to 56.0% of GDP from 56.6% in 2016. Domestic debt equaled less than 6% of GDP.

3.5.1 GDP growth by sector



Source: National Statistics Committee of the Kyrgyz Republic. <http://www.stat.kg> (accessed 14 March 2018).

3.5.2 Remittances



Source: National Bank of the Kyrgyz Republic. <http://www.nbkr.kg> (accessed 14 March 2018).

Monetary policy remained cautious in 2017, with the National Bank of the Kyrgyz Republic, the central bank, intervening on currency markets only to smooth excess volatility. It kept the policy interest rate at 5.0%. The average deposit interest rate declined by 0.2 percentage points to 4.4%, while the average lending rate fell by 2.1 percentage points to 16.2%. Deposits rose by 10.4% and credit by 13.1%, while broad money grew by 17.9%, slightly more than the 14.6% growth in 2016. At the end of 2017, the incidence of nonperforming loans was 7.6%, down from 8.8% in 2016. However, dollarization remained extensive at the end of 2017, with 39.5% of loans and 49.8% of deposits in foreign currency.

The current account deficit is estimated to have narrowed to 4.8% from 11.6% in 2016, reflecting some improvement in the trade balance. Trade rose by 12.5% as exports expanded by 14.4% on gains in gold and agricultural products, and as higher demand for oil products, construction materials, textiles, and consumer goods lifted imports by 11.4%. By the end of 2017, international reserves had risen by \$0.2 billion to reach \$2.2 billion, or cover for 4.4 months of imports. With a decline in private debt and currency appreciation, external debt including government-guaranteed and private debt is estimated to have fallen to equal 94.9% of GDP at the end of 2017, down significantly from 103.2% a year earlier (Figure 3.5.5).

Economic prospects

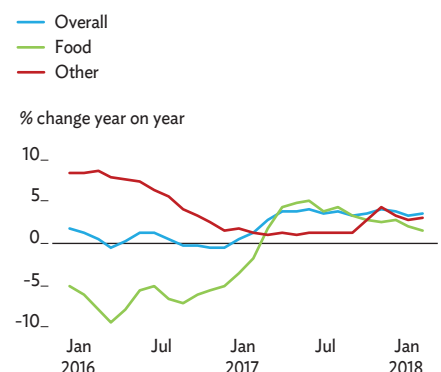
Growth is projected to slow to 3.5% in 2018, reflecting an expected decline in output from the Kumtor, the main mine in the important gold-mining industry (Figure 3.5.6). Recovery to 4.0% is expected in 2019 with some improvement in the domestic economy and continued growth in the region.

On the supply side, growth should come from agro-processing, light industry, and, to some extent, construction. On the demand side, higher remittances will raise household incomes, bolstering private consumption. Over the longer term, the country should benefit from increased foreign trade and the free movement of labor, capital, and services provided by membership in the Eurasian Economic Union (EEU).

Inflation is forecast to accelerate to 4.0% in 2018 and 4.5% in 2019 with continued growth and higher tariffs required by EEU membership. However, inflation could worsen with depreciation of the som in response to weakness in the currencies of Kazakhstan and the Russian Federation.

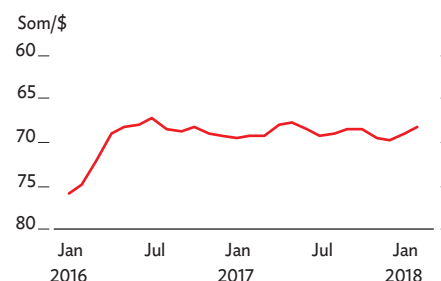
The central bank is expected to maintain a flexible exchange rate and continue to limit interventions to smooth excessive exchange rate volatility. Monetary policy will likely stay focused on maintaining price stability in view of the expected rise in inflation.

3.5.3 Monthly inflation



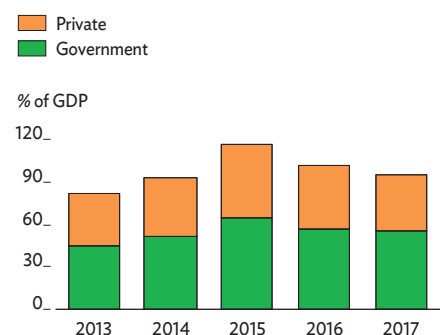
Source: National Bank of the Kyrgyz Republic.
<http://www.nbkr.kg> (accessed 14 March 2018).

3.5.4 Exchange rate



Source: National Bank of the Kyrgyz Republic.
<http://www.nbkr.kg> (accessed 5 March 2018).

3.5.5 External debt



Note: Government debt is both government and government-guaranteed debt.

Sources: Ministry of Finance; National Statistics Committee. <http://www.stat.kg>; National Bank of the Kyrgyz Republic. <http://www.nbkr.kg> (both accessed 20 February 2018).

The fiscal deficit is projected to narrow to equal 2.5% of GDP in 2018 and 2019 as the government restrains expenditure while improving tax policy and administration. Tax revenue could rise if EEU accession yields more customs revenue than now forecast. Fiscal consolidation remains a priority to rebuild government finances and ensure debt sustainability. Consolidation will likely involve rationalizing expenditure by reforming public wages, cutting subsidies, and improving the targeting of the social benefits. The government aims to raise revenue as well by broadening the tax base and strengthening tax and customs administration. External public debt is projected to equal 55.0% of GDP at the end of 2018 and 56.0% a year later.

The current account deficit is expected to widen to 12.0% in 2018 and then narrow to 10.0% in 2019 (Figure 3.5.7). Export growth is projected to slow to 8.0% in 2018 with lower gold exports and then recover to 14.0% in 2019 with higher exports of agricultural products and textiles. Infrastructure projects are expected to boost imports by 12.0% in 2018 and 11.0% in 2019. Remittances will likely rise by a further 25%–30% in 2018 and 2019, reflecting advantages to Kyrgyz migrant workers from the EEU treaty. International reserves are forecast to remain at \$2.2 billion in 2018 and reach \$2.3 billion at the end of 2019. The outlook for exports and the current account balance could worsen with weak demand from EEU trade partners and because of Kyrgyz products' poor compliance with EEU veterinary and agricultural standards.

While debt sustainability has improved, vulnerability to external and domestic risks persists. The Kyrgyz Republic is considered at moderate risk of debt distress because of continuing vulnerabilities regarding currency stability and possible deterioration in the fiscal balance. With public external debt now equal to 56% of GDP, total external debt could, barring shocks, be less than 96% of GDP by the end of 2019.

Policy challenge—promoting diversification through digitalization

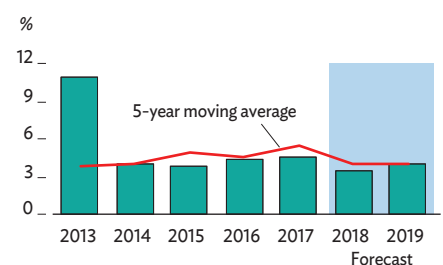
The Kyrgyz Republic is a small, landlocked country with limited natural resources and a narrow economic base. Worker remittances and gold exports have been its main income sources. Remittances from Kazakhstan and the Russian Federation have averaged about 25% of GDP during the past 5 years, while gold production has been estimated to provide on average 8.7% of GDP and 30% of export earnings. With limited opportunities for growth in these areas, the Kyrgyz Republic needs to diversify its economy and find new income sources.

3.5.1 Selected economic indicators (%)

	2018	2019
GDP growth	3.5	4.0
Inflation	4.0	4.5
Current account balance (share of GDP)	-12.0	-10.0

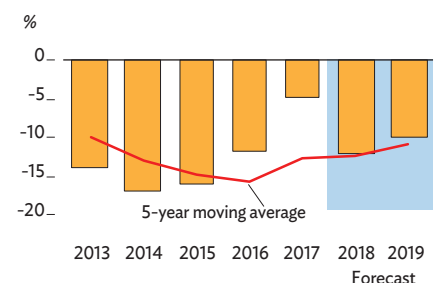
Source: ADB estimates.

3.5.6 GDP growth



Sources: National Statistics Committee of the Kyrgyz Republic. <http://www.stat.kg> (accessed 14 March 2018); ADB estimates.

3.5.7 Current account balance



Sources: National Bank of the Kyrgyz Republic. <http://www.nbkr.kg> (accessed 14 March 2018); ADB estimates.

A key obstacle to further development has been the country's lack of advanced business facilities, including poor connectivity. According to the *Global Competitiveness Report 2017–2018*, in which the Kyrgyz Republic ranks 102 out of 137 countries, it ranks particularly low in innovation at 127 and business sophistication at 126. It also lags in technological readiness at 102 and infrastructure at 109. With technological innovation dramatically reshaping the global environment and information flows becoming increasingly important, improving the country's poor digital environment is essential for developing new sources of income and employment.

To respond to these challenges, the government introduced the Taza Koom program of support for sustainable development through digitalization and innovation. It involves creating a countrywide fiber-optic network to improve internet access in even the most remote areas, increase digital transactions, and strengthen public service delivery to communities and firms. The goal is to encourage a shift toward higher-tech and innovative activities that can support better-paying jobs. The program aims to improve public administration and the delivery of services such as education and health care, heighten transparency in the public sphere to fight corruption (as the name suggests), and reduce the transaction costs that firms incur to meet registration and other regulatory requirements and to pay taxes.

Taza Koom's current action plan covers the year beginning in August 2017. It includes projects on information infrastructure, cyber security to enable a cashless economy, and the streamlined delivery of services by regional and municipal governments. Its digital infrastructure project is laying fiber-optic lines, expanding access to mobile high-speed internet and the applications available, and providing means to achieve a more fault-tolerant network with improved data transmission. Another project aims to ensure the availability of information in multiple languages, including Kyrgyz.

While the Taza Koom program has the potential to advance diversification through digitalization, additional measures would help achieve this goal.

One would be to accelerate reform to improve the business climate by addressing problems with contract enforcement, reliable electricity supply, resolving insolvency, and paying taxes—all areas where the country ranks especially low, at 100 or worse among 190 countries covered in the most recent World Bank *Doing Business* survey.

Others would be to improve the management of public investment, encourage private investors to fill supply gaps in infrastructure for energy and other areas, and increase job training so that workers can satisfy the skills requirements of new jobs. Also helpful would be reform to trade policies that would maximize benefits from preferential arrangements accorded by the Kyrgyz Republic's trading partners.