



KYRGYZ REPUBLIC

Highlights

- **Economic growth has improved.** Real gross domestic product (GDP) growth accelerated to 6.1 per cent year-on-year in the first three quarters of 2019 from 3.5 per cent in 2018, reflecting strong gains in the mining and manufacturing sectors and the low base effect.
- **The fiscal deficit has narrowed.** The general government deficit declined to 1.3 per cent of GDP in 2018, from 4.6 per cent in 2017, due to fiscal consolidation measures. This has contributed to a reduction of public debt to 56.0 per cent of GDP.
- **A Business Ombudsman has been established.** This is a major step towards more transparency and predictability and an overall improvement of the business climate. The weak rule of law and inadequate protection of property rights are widely regarded as key obstacles to doing business.

Key priorities for 2020

- **Regulatory reform needs to be accelerated.** The sustainability of municipal infrastructure and the energy sector should be improved through tariff reform, and greater private-sector participation should be promoted in the energy sector by implementing measures to increase competition across the value chain.
- **Governance should be strengthened.** Corruption and public governance issues remain major hindrances to private-sector development. Strengthening private property protection and the enforcement of contracts would significantly ease the difficulty of doing business.
- **Fiscal consolidation should continue.** In order to maintain debt sustainability, the government should adhere to the fiscal rule, currently under parliamentary consideration, which requires the deficit to not exceed 3 per cent of GDP and caps the public debt at 70 per cent of GDP.

Main macroeconomic indicators %

| | 2015 | 2016 | 2017 | 2018 | 2019 proj. |
|-----------------------------------|-------|-------|------|------|---------------|
| GDP growth | 3.9 | 4.3 | 4.7 | 3.5 | 4.3 |
| Inflation (average) | 6.5 | 0.4 | 3.2 | 1.5 | 1.2 |
| Government balance/GDP | -2.7 | -6.4 | -4.6 | -1.3 | -3.0 |
| Current account balance/GDP | -15.9 | -11.6 | -6.2 | -8.7 | -10.0 |
| Net FDI/GDP [neg. sign = inflows] | -17.1 | -9.0 | 1.4 | -0.6 | -2.0 |
| External debt/GDP | 99.9 | 100.2 | 91.0 | 84.0 | n.a. |
| Gross reserves/GDP | 26.6 | 28.9 | 28.3 | 26.6 | n.a. |
| Credit to private sector/GDP | 22.8 | 20.6 | 21.4 | 23.9 | n.a. |

Macroeconomic performance

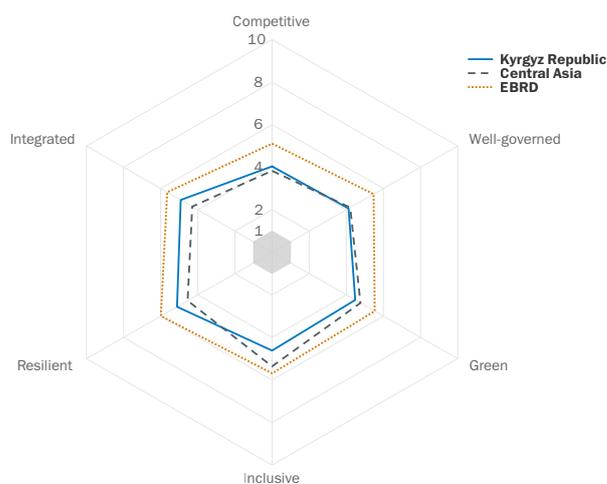
The economy is growing steadily. Following a moderation of real GDP growth to 3.5 per cent in 2018 from 4.7 per cent in 2017, economic growth picked up to 6.1 per cent year-on-year in the first three quarters of 2019, reflecting strong gains in the mining and manufacturing sectors and the low base effect. Gold production has rebounded thanks to an increased ore grade and a higher recovery rate. Excluding the Kumtor gold mine, GDP growth in the first three quarters of 2019 reached 3.2 per cent year-on-year. Net remittances, however, declined by 12.0 per cent year-on-year in US dollar terms in the first eight months of 2019.

Inflation remains subdued. Average annual inflation decelerated to 1.5 per cent in 2018 from 3.2 per cent in 2017 on the back of falling food prices. Inflation remained low in September 2019 at 2.3 per cent and is expected to stay well below the central bank target of 5.0 to 7.0 per cent. The low inflationary environment prompted the central bank to cut the policy rate twice in 2019 by 25 basis points each time – in February and May – to 4.50 per cent and 4.25 per cent, respectively. The strong loan growth observed in 2018 continued in the first half of 2019, with total credit expanding by 15.0 per cent year-on-year in September 2019.

The fiscal deficit has narrowed but external deficits have widened. The general government deficit declined to 1.3 per cent of GDP in 2018 from 4.6 per cent in 2017 as a result of lower current expenses. This has contributed to a reduction of public debt to 56.0 per cent of GDP in 2018 from 58.8 per cent in 2017. According to estimates from the International Monetary Fund, the current account deficit widened to around 8.7 per cent of GDP in 2018 from 6.2 per cent in 2017, reflecting reduced gold exports and a marked slowdown in growth of remittances from Russia due to the weaker rouble. In the first half of 2019, the deficit started narrowing, however, to US\$ 370 million versus US\$ 804 million a year earlier, as gold exports recovered. The exchange rate remained stable in nominal terms in 2018 and 2019 but continued to appreciate in real effective terms.

Robust GDP growth is expected to continue in the short term. GDP growth is expected to reach 4.3 per cent in 2019, driven by increased gold production. Exports from the Kumtor gold mine, more evenly distributed over the year than in 2018, and private consumption, supported by further increases in real wages and remittances, are expected to be major contributors to economic growth in the short term. The scope for fiscal expansion is, by contrast, very limited. Downside risks include the weakening of growth in Russia, with negative implications for remittances and increasing fiscal pressures related to the parliamentary elections in 2020.

Assessment of transition qualities (1-10)



Major structural reform developments

The business environment is improving. The Kyrgyz Republic was among the top 20 most improved countries in the World Bank's *Doing Business 2020* report. The country has made significant progress in three areas: getting electricity, getting credit and paying taxes. The reliability of the country's electricity supply has been enhanced by modernising the infrastructure and better monitoring outages. The country has also improved access to credit information by providing credit scores to banks, financial institutions and borrowers. Lastly, paying taxes has been made easier by consolidating the tax on interest income into the corporate income tax and by introducing an online platform for filing and paying taxes. The country ranks 80th out of 190 countries in this year's report.

Progress has been made towards a strategic agreement between the government and Centerra Gold on the Kumtor gold mine. The two parties – Centerra Gold and the Kyrgyz government – had entered into a strategic agreement in September 2017, which settled an environmental dispute and allowed the subsidiary company of Centerra Gold to transfer cash to its parent company in Canada. However, the deadline for implementing the agreement has been postponed by the Kyrgyz authorities several times since then. In August 2019, Centerra Gold announced that all conditions to complete the agreement were satisfied or waived, and the parties are now moving to terminate the remaining legal proceedings. Establishing a stable and permanent framework for operations in and ownership of the Kumtor gold mine demonstrates the government's commitment to legal stability and will help attract more foreign direct investment.

A decree establishing a Business Ombudsman has been signed. The signing took place in December 2018. The Business Ombudsman institution aims to protect the rights of businesses by investigating their complaints about instances of abuse of power by the state, municipalities and entities controlled by them. The Business Ombudsman and its deputies are selected unanimously by three votes – the government, international partners and business associations – which preserves balance and ensures commitment from these three key stakeholders. The Ombudsman's activity is financed by international development partners. This is a major step towards more transparency and predictability and an overall improvement of the business climate. However, the key to success of the institution will be in its implementation.

The central bank has strengthened its supervisory framework but compromised its credibility by acquiring a troubled bank. The National Bank of the Kyrgyz Republic (NBKR) continued transitioning to risk-oriented supervision by introducing amendments in June 2018 to the requirements of risk management policies and procedures of banks. It also approved new provisions related to inspections of banks, in line with the new approach. However, other issues pertaining to governance and oversight arrangements in the NBKR, such as independence of its board, remain unaddressed. In addition, in October 2018 the NBKR acquired a troubled bank – Rosinbank – after taking possession of the shares that it had accepted as collateral for emergency liquidity assistance. This measure is unwelcome as it carries the risk of a conflict of interest between ownership and the NBKR's supervisory role.

The Kyrgyz Republic has endorsed the open skies policy. Amendments to the Air Code of Kyrgyzstan, signed in January 2019, unilaterally declare an open skies policy and the fifth freedom for countries that want to operate international flights through the airspace of the Kyrgyz Republic. The fifth freedom allows foreign airlines to carry passengers, baggage, freight and mail on flights from the Kyrgyz Republic to third countries (outside their origin) and back. This is expected to bring more international traffic to Manas International Airport and stimulate the country's air travel market.

The legal framework for anti-money laundering and combating the financing of terrorism has been improved. The updated law "On Combating Terrorist Financing and Money Laundering" came into force in September 2018. It adopts international standards on combating money laundering, the financing of terrorism and financing the proliferation of weapons of mass destruction, as provided in the Financial Action Task Force recommendations. The law provides requirements to ensure transparency of beneficial owners of legal entities and a database of beneficial owners of legal entities established and registered in the Kyrgyz Republic. The NBKR now needs to update the relevant regulations in line with the new law.