

KYRGYZ REPUBLIC

Highlights

- **Economic growth decelerated in 2018.** In the first three quarters of 2018 the economy grew by 1.2 per cent year-on-year after reaching 4.6 per cent in 2017. A sharp drop in gold production was the main reason for the slow-down.
- **Regional cross-border linkages are deepening.** The Kyrgyz Republic and Uzbekistan are on track to resolve long-standing border issues, and ties with Kazakhstan are strengthening again.
- **A new long-term development strategy has been unveiled.** The new strategy focuses on measures to digitalise the economy, improve the effectiveness of the public administration, create better opportunities for education and training, and improve the business environment.

Key priorities for 2019

- **Fiscal policy should be tightened.** In 2017, pre-election spending delayed the authorities' efforts to reduce the budget deficit. The authorities need to pursue fiscal consolidation in line with the target deficit of 2.5 per cent of GDP agreed with the IMF.
- **Business climate challenges need to be tackled and access to electricity improved.** Business disputes over environmental protection and property rights issues need to be resolved. The authorities need to agree a stable and permanent framework for operations and ownership of the Kumtor gold mine and other mining investments to demonstrate their commitment to legal stability and ensure the attractiveness of the country for foreign direct investment.
- **The banking sector should be strengthened.** Non-performing loans (NPLs) and dollarisation continue to pose challenges for the economy. The central bank should further strengthen its supervisory and regulatory capacity.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	4.0	3.9	4.3	4.6	2.7
Inflation (average)	7.5	6.5	0.4	3.2	2.5
Government balance/GDP	-0.5	-1.4	-4.4	-3.2	-3
Current account balance/GDP	-16	-16	-11.6	-4	-6
Net FDI/GDP [neg. sign = inflows]	-4.6	-17.1	-9.1	-1.2	-0.7
External debt/GDP	99.0	115.3	116.3	107.3	n.a.
Gross reserves/GDP	26.2	26.6	28.9	28.7	n.a.
Credit to private sector/GDP	20.1	22.6	20.0	21.8	n.a.

Macroeconomic performance

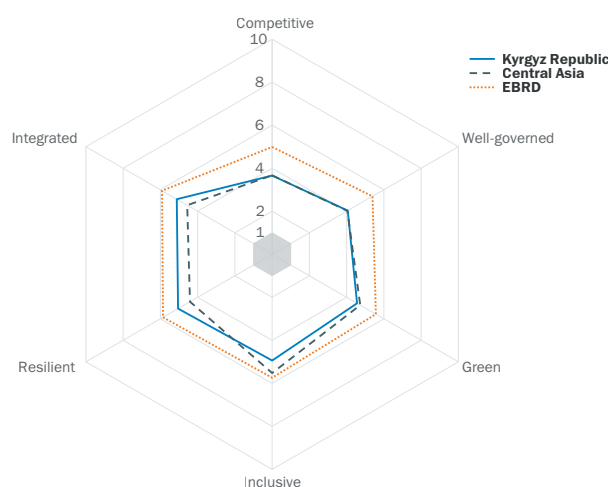
The economy grew strongly in 2017, but growth has slowed in 2018. After 4.6 per cent growth in 2017, real GDP increased by only 1.2 per cent year-on-year in the first three quarters of 2018, reflecting a sharp decline in Kumtor gold production. In the first half of 2018, output of gold from Kumtor shrank by 30 per cent year-on-year. While exports declined by 4.9 per cent in the first eight months of 2018, imports increased by 15 per cent. Excluding Kumtor, real GDP increased by 2.4 per cent year-on-year in the first three quarters of 2018, aided by the acceleration in growth in services and agriculture. Remittances have continued to grow also in 2018 after a strong recovery in 2017.

The exchange rate has been broadly stable. The som slightly appreciated in 2017, supported by the stabilisation of the Russian rouble and the recovery of remittances. However, exchange rate pressures in April and August 2018 related to the weakening of the rouble amid US sanctions against Russia prompted depreciation pressures on the som and a modest intervention by the central bank to control these pressures. The weakening of the som was thus limited, which has resulted in an effective appreciation against the rouble and the tenge. Inflation moderated from 3.7 per cent year-on-year in December 2017 to 1.2 per cent in September 2018. The NBKR reduced its policy rate from 5.0 per cent in 2017 to 4.75 per cent in May 2018.

Fiscal and external deficits have remained sizeable. Despite significant expenditure growth, the fiscal deficit narrowed to an estimated 3.3 per cent of GDP in 2017 from 4.6 per cent in 2016, mainly due to higher budget revenues on the back of the growing economy. Under the IMF's three-year Extended Credit Facility programme signed in April 2015, the Kyrgyz Republic had agreed to reduce the fiscal deficit further to 2.5 per cent of GDP in 2018. Public debt rose from 57 per cent at the end of 2017 to 58 per cent of 2017 GDP at the end of August 2018, indicating increasing fiscal vulnerability. The current account deficit narrowed to 4.0 per cent of GDP in 2017 from 11.6 per cent in 2016 thanks to strong export growth and higher external transfers. However, it almost doubled to US\$ 515 million in the first half of 2018 from US\$ 270 million a year earlier.

Short-term growth is projected to be moderate. Real GDP is expected to grow by 2.7 per cent in 2018 and 3.2 per cent in 2019. Growth will likely be rather moderate due to weak mining output. However, remittance inflows and relatively low inflation will stimulate growth in real wages and improve household demand. Non-mineral exports should grow thanks to further Eurasian Economic Union integration. Downside risks include a slower than assumed recovery in mining output and weaker than assumed growth of the Russian economy.

Assessment of transition qualities (1-10)



Major structural reform developments

The business environment remains challenging despite the government's efforts to stimulate private sector development. Recent policies for private sector development focused on tax administration reforms, improvement of customs regulation, and reforming antitrust laws as outlined in the Programme for Private Sector Development for 2015-17. The Kyrgyz Republic ranked 70 out of 190 countries in terms of ease of doing business, according to the World Bank's *Doing Business 2019* report. This is a slight improvement from 2018 but the country still scores below the regional average (Europe and Central Asia), with large gaps remaining in paying taxes, getting electricity, and enforcing contracts.

A new ambitious development strategy is being designed. The draft of a "Sustainable Development Strategy of the Kyrgyz Republic for 2018-2040" was adopted by the National Council for Sustainable Development under the President of the Kyrgyz Republic in November 2017 and was reviewed by the council in August 2018 after public consultations. The strategy rests on programmes for the transition to the digital economy, the enhancing of the effectiveness of the public administration, creating better opportunities for education and training, and improving the business environment.

Uncertainties related to major projects have re-emerged. In September 2017 Centerra Gold, the operator of Central Asia's largest gold mine Kumtor, signed an agreement with the government, which settled an environmental dispute and allowed the subsidiary company to transfer cash to the parent company in Canada. However, as of August 2018 the agreement had not come into force as several conditions still need to be satisfied. The deadline for enforcing the agreement is being postponed by the Kyrgyz authorities, who have indicated they may want to review it. Another project – the construction of the Upper-Naryn cascade of hydropower plants – is also delayed by legal complications regarding compensation claims by RusHydro, a Russian power generation company. In 2016, the agreement with RusHydro to build the hydropower stations was terminated by the government because of concerns about the ability of the Russian government to follow through on proposed investment in the project.

Relations with other Central Asian countries are being strengthened. In October 2017, Uzbekistan and the Kyrgyz Republic ratified a long-awaited agreement to demarcate 85 per cent of the shared border, which represents a major step in improving bilateral ties. Uzbekistan also expressed its support for the building of a large-scale hydroelectric dam on the Naryn river in the Kyrgyz Republic, discarding its previous concerns over disruption of the water flow required for Uzbekistan's agricultural sector. Relations with Kazakhstan are improving too after the two sides settled disputes in December 2017 concerning Kazakhstan's imposition of tightened border controls.