



KYRGYZ REPUBLIC

Highlights

- **Real GDP contracted sharply in the first three quarters of 2020.** A drop of 6.0 per cent in GDP year-on-year in this period was partly influenced by a 7 per cent year-on-year drop in remittances in the first eight months of 2020, and by strong social distancing measures which had a severe impact on services and construction.
- **Bilateral and multilateral creditors have provided support.** The Kyrgyz Republic was the first country to receive Covid-19-related emergency financial assistance from the International Monetary Fund (IMF), amounting to a Rapid Credit Facility of US\$ 241.8 million, while major bilateral creditor countries have agreed to postpone debt repayments.
- **The government responded to the pandemic with a package of economic stimulus measures.** An anti-crisis fund, amounting to 2 per cent of GDP in 2020 and 7 per cent of GDP in 2021, was created to provide concessional financing to enterprises in the hardest-hit sectors and encourage digitalisation.

Key priorities for 2021

- **The authorities should continue providing targeted support to vulnerable households and small and medium-sized enterprises (SMEs).** This will be particularly vital in the hardest-hit sectors, such as hospitality and construction, with a focus on preserving existing, and creating new, jobs for returning migrants and young workers, including through public work programmes.
- **Further efforts are needed to digitalise the economy.** Measures should be taken to upgrade internet connectivity, particularly in the regions, and develop digital skills to enable remote learning and working.
- **Maintaining macroeconomic stability while exercising fiscal discipline will be important.** The government has committed to stabilise public debt at a sustainable level, and the authorities should therefore refrain from non-priority spending in order to bring the fiscal deficit below 3 per cent of GDP in 2021.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.3	4.7	3.5	4.5	-9.5
Inflation (average)	0.4	3.2	1.5	1.1	6.0
Government balance/GDP	-5.8	-3.7	-0.6	-0.1	-7.0
Current account balance/GDP	-11.6	-6.2	-12.1	-5.6	-14.0
Net FDI/GDP [neg. sign = inflows]	-9.1	1.4	-1.7	-2.5	-0.5
External debt/GDP	100.2	91.0	83.8	82.7	n.a.
Gross reserves/GDP	28.9	28.3	26.6	28.7	n.a.
Credit to private sector/GDP	20.6	21.4	23.4	25.8	n.a.

Covid-19: macroeconomic implications

The economy is being severely affected by Covid-19 disruptions. This is due to the country's high external vulnerability, strict lockdown measures crippling domestic demand, and the government lacking the means for significant stimulus spending. With travel restrictions in place and bleaker economic prospects in Russia, the Kyrgyz Republic is seeing a significant reduction in remittances and a worsening of domestic demand conditions. Remittance inflows from Russia declined by 7 per cent year-on-year in US dollar terms in the first eight months of 2020, severely affecting domestic consumption and construction activities. The state of emergency from late March until mid-May 2020, and milder social distancing measures in place since June 2020, have depressed domestic demand; a dramatic drop in imports from China (65 per cent year-on-year in the first five months of 2020) hit associated domestic production, re-export activities, and budget revenues. A particular concern is that many households rely on the large informal economy (23 per cent of GDP in 2018 according to official estimates), comprising mostly micro enterprises that are difficult to target by the government's fiscal stimulus and other support measures.

Real GDP dropped 6.0 per cent year-on-year in the first three quarters of 2020, driven by contractions in construction, retail trade and the hospitality industry (down 7.7, 16.2 and 45.4 per cent year-on-year, respectively). Agriculture grew by 2.1 per cent year-on-year during the same period. Industrial production shrank by 1.9 per cent year-on-year as mining recorded a decline of 5.9 per cent. Excluding the Kumtor gold mine, GDP declined by 7.1 per cent year-on-year during this period.

The exchange rate depreciated after a lengthy period of stability since mid-2016. In March 2020, the weakening of oil prices and the fall in remittances led to a significant weakening of the som by 16 per cent over the month. The som has somewhat strengthened since then, supported partly by foreign exchange interventions. Inflation spiked at 8.6 per cent year-on-year in April 2020, but gradually decelerated to 5.4 per cent in September (within the central bank's target corridor of 5-7 per cent), as restrictive measures weigh on domestic demand and the earlier impact of panic hoarding subsided.

The economy is facing a deep recession in 2020 but some growth in 2021. With domestic demand remaining subdued and tourism activities not materialising in the third quarter of 2020, we expect a GDP contraction of 9.5 per cent in 2020. In 2021, the economy is forecast to grow by 3.0 per cent with domestic demand picking up and international trade, transport and tourism linkages being partially revitalised. This forecast is subject to very significant downside risks stemming from the political turmoil in the wake of the October 2020 elections.

Policy response to Covid-19

The government's anti-crisis measures are aimed at protecting public health, stabilising the socio-economic situation and re-launching economic activity. Reflecting the tight fiscal space, the policy response has focused mostly on supporting enterprise liquidity rather than on social protection for households. In May 2020, an anti-crisis fund was created to provide concessional financing to enterprises of around 2 per cent of GDP in 2020 and 7 per cent of GDP in 2021. The main targeted sectors are tourism, light industry, the pharmaceutical industry, manufacturing, agribusiness and freight transportation. In order to promote digitalisation, concessional loans are also available to SMEs transitioning to digital systems with transparent accounting and reporting of operations. Other measures include reduced social contributions by businesses, a moratorium on business inspections and a temporary ban on bankruptcy procedures of businesses until 2021.

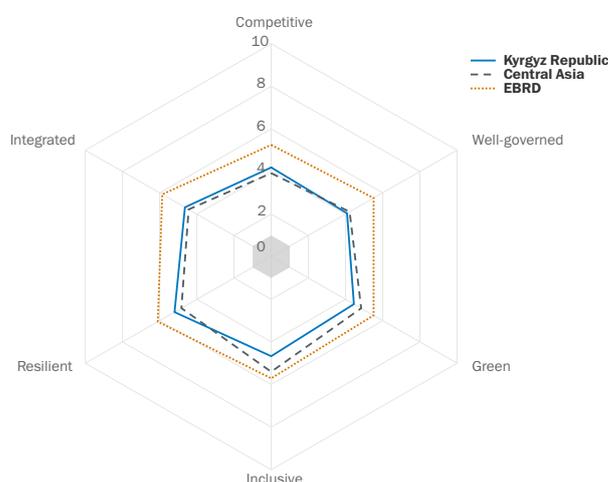
The central bank loosened prudential requirements and postponed enactment of several financial regulations. As of March 2020, the National Bank of the Kyrgyz Republic recommends banks and non-bank financial institutions (NBFIs) to provide a grace period for loan repayments of at least three months, it prohibits the imposition of fines and penalties for non-fulfilment of loan obligations, and it allows banks and NBFIs not to downgrade the loan classification category when changing the terms of contracts of the affected borrowers. In addition, the liquidity ratio has been lowered from 45 per cent to 30 per cent, short-term liquidity ratio requirements are removed and

risk-weights of corporate and retail loans in foreign currency are reduced from 150 per cent to 100 per cent. According to government estimates, half of the banks' loan portfolios have undergone loan restructuring since the start of the Covid-19 crisis.

The Kyrgyz Republic was the first country to receive Covid-19-related emergency financial assistance from the IMF. The IMF provided US\$ 120.9 million in March 2020 and another US\$ 121.1 million in May 2020 after doubling the country's quota under the Rapid Credit Facility. The loan is helping the country close a balance-of-payments gap estimated at about US\$ 500 million. Given strong pressures on the fiscal account, the IMF support helps to preserve fiscal space for essential Covid-19-related health expenditures. In addition, the government received US\$ 50 million in loan and grant financing from the Asian Development Bank and a US\$ 100 million loan from the Eurasian Development Bank. The state budget recorded a deficit of 7.1 per cent of GDP in May 2020 (compared with a surplus of 1 per cent a year ago) reflecting significant healthcare spending and loss of taxes on ailing enterprises and international trade.

Major bilateral lenders have agreed to a postponement of external debt repayments. In June 2020 a memorandum was signed by the government with Paris Club countries – Germany, France, Denmark, Japan and South Korea – to delay repayments until 2022-24. Debt restructuring is also being considered with these countries. Similar agreement was reached with China, Saudi Arabia and Kuwait and the G20 economies. The IMF assesses the Kyrgyz Republic's risk of debt distress as moderate, and the authorities have committed to keep the general government deficit at or below 3 per cent of GDP in the short and medium term. Public debt is estimated at 62.2 per cent of the forecasted GDP in June 2020, up from 54 per cent in 2019.

Assessment of transition qualities (1-10)



Structural reform developments

Banking sector indicators remain stable, partly helped by the relaxation of prudential regulations. The capital adequacy ratio was 25.6 per cent at 30 June 2020 (compared with 24 per cent in 2019). The liquidity ratio stood at 63 per cent at 30 June 2020 (compared with 64 per cent in 2019). The non-performing loan ratio increased slightly to 8.8 per cent in July 2020 from 7.9 per cent a year ago. Nevertheless, the sector's capitalisation and asset quality are expected to worsen somewhat, reflecting the economic contraction in 2020.

The Kyrgyz Republic has to import electricity in 2020 and early 2021 because of a shortage of water in the Toktogul reservoir. The country is planning to purchase 1 billion kWh of electricity from Kazakhstan, Tajikistan and Turkmenistan. The cost of imported electricity exceeds revenues

from residential tariffs, necessitating cross-subsidisation by other sectors. Residential tariffs are to remain unchanged in 2020, thus failing to encourage households to save energy. Consequently, electricity consumption in the Kyrgyz Republic exceeds that of peer countries with similar weather conditions, according to an IMF study. Low tariffs also lead to suboptimal investment in the sector, inefficient use of energy, and financial losses. Energy sector companies' cumulative debts reached KGS 110 billion as of May 2020 (US\$ 1.5 billion, 19 per cent of GDP).

E-government reforms have progressed thanks to steps taken under the digital transformation concept “Sanarip Kyrgyzstan 2019-2023”. In the UN Global E-Government Development Index for 2020, the Kyrgyz Republic ranked 83rd out of 193 countries, second after Kazakhstan in Central Asia. The country advanced eight notches from last year. In particular, the Kyrgyz Republic posted a 73 per cent improvement in telecommunications infrastructure.

The new Business Ombudsman Institute is operational. The institute, established to defend the rights, interests and freedoms of entrepreneurs, accepted its first complaints in April 2020 in the midst of the crisis. As of the end of September 2020, 17 investigations had been completed, with five cases resolved with an overall monetary value of around KGS 7 million (US\$ 86,000).

