



KYRGYZ REPUBLIC

Highlights

- **The economy is recovering but gold production has dropped.** Real gross domestic product (GDP) expanded by 0.1 per cent year-on-year in the first three-quarters of 2021. However, gold production and exports declined significantly. Remittances are surging, supporting domestic demand. Services are recovering, while labour-intensive agriculture contracted in January-September 2021 due to drought.
- **A new tariff policy for heat and electricity has been proposed.** Once implemented, the policy would see a gradual increase in tariffs to achieve cost recovery by 2025. Substantial tariff reforms have been adopted in the past few years but have not been implemented consistently because of concerns about affordability and potential political repercussions.
- **Construction of the CASA-1000 electricity transmission line in the Batken region has started.** The project, with a total cost of US\$ 1 billion, will help unlock the hydropower potential of Central Asia and significantly reduce carbon emissions in the region.

Key priorities for 2022

- **The immediate priority is to continue supporting sectors affected by the Covid-19 pandemic and sustain private-sector employment.** Beyond this immediate need, the country should improve the conditions for investment in the labour-intensive sectors of the economy, such as hospitality, modern agriculture, and the garment and food processing industries. At present, the economy is dependent on aid and remittances (about 30 per cent of GDP), with Russia's economy serving as a safety valve for pressures building up in the Kyrgyz labour market.
- **Fiscal consolidation is urgently needed.** Public debt rose from 51.6 per cent to 68.0 per cent of GDP in 2020, of which external public debt (58.3 per cent of GDP) is on concessional terms. To reduce the debt burden to manageable levels, the government should downsize non-priority spending. The authorities should streamline the tax and customs administration, optimise the public sector wage bill (at 13 per cent of GDP, it is one of the highest in the region, about 30 per cent of government expenditure) and reduce energy subsidies (as part of the recently announced tariff reform).
- **Issues surrounding the Kumtor gold mine should be resolved.** It is critical that the government restores the country's access to global gold markets and addresses foreign investors' concerns resulting from the appointment of external management in the Kumtor Gold Company in May 2021.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.7	3.5	4.5	-8.6	2.5
Inflation (average)	3.2	1.5	1.1	6.3	12.0
Government balance/GDP	-3.7	-0.6	-0.1	-3.3	-4.0
Current account balance/GDP	-6.2	-12.1	-5.6	4.5	-6.0
Net FDI/GDP [neg. sign = inflows]	1.4	-1.7	-2.5	4.0	2.0
External debt/GDP	91.0	83.8	82.7	89.9	n.a.
Gross reserves/GDP	28.3	26.6	28.7	29.9	n.a.
Credit to private sector/GDP	21.4	23.4	24.6	28.5	n.a.

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Covid-19: macroeconomic implications

Economic growth is being held back by a major drop in gold production and exports.

The economy is recovering from the lows of the 2020 recession and real GDP posted a small growth of 0.1 per cent year-on-year in the first three-quarters of 2021. Recovery is constrained by a major contraction of gold exports (down 2.9 times year-on-year in January-August 2021, and that is despite Jerooy, the country's second-largest gold mining project, moving to production in March 2021). On top of that, on 17 September 2021, the London Bullion Market Association (LBMA) temporarily suspended Kyrgyzaltyn, the country's state-owned gold producer, from its list of acceptable refiners. LBMA's decision may also restrict Kyrgyzaltyn's access to other gold hubs, including Switzerland and New York. On the positive side, GDP excluding Kumtor grew by 3.6 per cent year-on-year in the first three-quarters of 2021, driven by growth in retail trade, transport and communication. Agriculture was down by 5 per cent year-on-year in the same period, due to drought. Services expanded by 5.7 per cent year-on-year, enabled by the increased inflow of remittances (up 21 per cent year-on-year in US dollar terms in the first eight months of 2021) and the easing of lockdown measures.

Inflation is rising. Inflation has been consistently above the central bank's target corridor of 5-7 per cent so far in 2021, reaching 13.5 per cent in September 2021. This trend reflects rising global food prices along with the remittance-financed surge in consumer demand. To quell inflationary pressures, the central bank raised the policy rate stepwise from 5.5 to 6.5 per cent in April and to 7.5 per cent in July 2021.

International trade has strongly rebounded. Imports in the first eight months of 2021 increased by 41 per cent year-on-year, driven by major increases in clothing and accessories (up by a factor of 4.3 (x4.3)), knitted fabrics (x2.7), and threads and fibres (x1.8), reflecting positive dynamics in the country's textile production and re-exporting activity. Including gold, total exports in January-August 2021 were down 19.5 per cent year-on-year.

The economy is expected to grow moderately in 2021. A projected 2.5 per cent growth rate is fuelled by a strong recovery in remittances from Russia and growth in private consumption, which will positively affect the services industry. However, fixed investment is expected to remain subdued in 2021 due to political risks and investment climate concerns resulting from the government's decision to take temporary control of Kumtor in May 2021 and the ratcheting up of inspections and regulatory pressure on medium-sized businesses. Real GDP growth is projected to accelerate to 5.0 per cent in 2022. Significant downside risks are associated with the Covid-19 pandemic continuing to weigh on the hospitality sector in 2022 and the Kyrgyz Republic's future ability to access global gold markets.

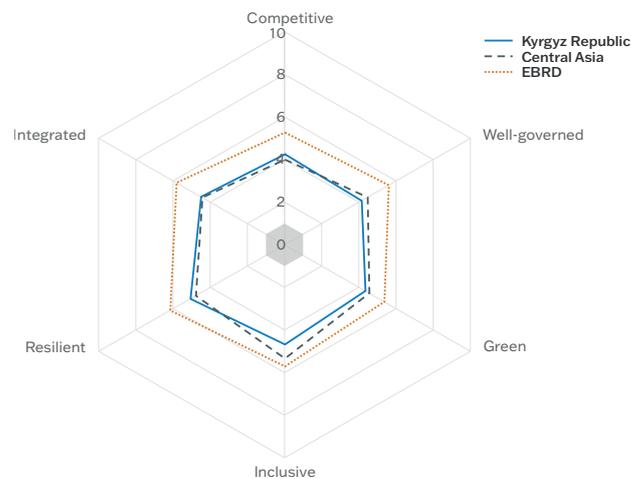
Policy response to Covid-19

Additional measures to support economic recovery were adopted in February 2021.

They are outlined in the Plan of Priority Measures to ensure social stability and economic sustainability. First, the plan seeks to improve the quality and increase the number of electronic government services available to the public. Second, to aid businesses, the government will simplify administrative procedures and invest in the automation of customs and tax processes. Third, to ensure the healthcare system is resilient to future waves of the Covid-19 pandemic, the government will intensify the vaccination campaign and introduce preventive measures in schools to curb the spread of coronavirus.

An export ban on some food, medical and pharmaceutical products was introduced in November 2020. The ban on food exports was extended in June 2021 for another six months. The list of restricted items include wheat, wheat flour, sugar, rice, vegetable oil and chicken eggs. In addition, imports of granulated sugar and refined vegetable oil were exempt from value added tax (VAT) until the end of August 2021 for private-sector companies, and until the end of December 2021 for the State Material Reserves Fund. Enterprises processing certain domestic agricultural inputs (such as flour from cereals, vegetables and nuts) only need to pay 20 per cent VAT. Medicines and pharmaceutical products are also subject to a temporary export ban to ensure adequate domestic supply.

Assessment of transition qualities (1-10)



Structural reform developments

A new tariff policy for heat and electricity for 2021-25 was announced. Stalled for at least a decade due to concerns about affordability and potential political repercussions, this reform, announced in June 2021, envisages a gradual increase in tariffs to achieve cost recovery by 2025. A new constitution and the shift to a presidential system could make it easier to implement necessary energy reforms. At the moment, the Kyrgyz Republic has one of the lowest electricity tariffs in the world, leading to inefficient use of energy, severe under-spending on maintenance and new investment, as well as poor supply reliability and quality. In 2021 the electricity deficit is forecast at around 3 billion kilowatt-hours (to be covered by electricity imports from Kazakhstan, Turkmenistan and Uzbekistan).

Overzealous anti-corruption efforts are being reined in. Implementation of the new Anti-Corruption Strategy for 2021-24 had led to a wave of tax audits targeting the country's medium-sized businesses, which many in the business community viewed as harassment. In June 2021 President Sadyr Japarov issued a decree shutting down the notorious Anti-Corruption Committee under the State Security Council, and announced the government's intention to streamline the tax, judicial and law enforcement systems with an eye to stopping business harassment and improving the country's investment climate. Corruption is seen as a major obstacle to private-sector development, as the Kyrgyz Republic ranks 124th out of 180 countries on Transparency International's Corruption Perceptions Index in 2020.

A new tax code is being developed to simplify tax administration and reduce informality. The new tax code envisages simplifying VAT refunds and reimbursements and developing an alternative approach to resolving tax disputes. Tax administration procedures will be streamlined to reduce the scope for interpretation and eliminate inconsistencies in applying legal norms and requirements. This is an important reform for the country as the current tax administration is complicated and tax compliance costs are very high.

Construction of the CASA-1000 project has begun. This project, which started in the southern part of the country in February 2021, will facilitate the export of hydropower from the Kyrgyz Republic and Tajikistan to and through Afghanistan and to Pakistan. CASA-1000 could provide substantial revenues to the Kyrgyz Republic and Tajikistan with minimal impact on regional carbon emissions. However, recent instability in Afghanistan has placed a significant degree of uncertainty over its prospects.

The banking sector remains resilient despite deteriorating asset quality. Weakening asset quality is manifested in rising non-performing loan ratios (11.4 per cent in June 2021 versus 8.1 per cent in January 2020). Nevertheless, the banking sector remains resilient with the capital adequacy ratio at 22.9 per cent as of the end of March 2021 and the liquidity ratio at 65.5 per cent. Both indicators are well above the ratios set by the central bank.

