

Kyrgyz Republic

Economic Update
Spring 2024

Special Topic: Business Support Programs in the Kyrgyz Republic: A Snapshot for the 2020-2022 Period



Macroeconomics, Trade & Investment

Global Practice

Kyrgyz Republic Economic Update

Special Topic: Business Support Programs in the Kyrgyz Republic: A Snapshot for the 2020-2022 Period

Spring 2024

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Government Fiscal Year: January 1 – December 31
Currency Equivalent: Exchange Rate Effective as of May 31, 2024
Currency Unit = Kyrgyz Som
KGS 87.7000
Weight and Measures: Metric System

Abbreviations and Acronyms

BPS	Business Pulse Survey
CPI	Consumer Price Index
EAEU	Eurasian Economic Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
KGS	Kyrgyz Som
NBKR	National Bank of the Kyrgyz Republic
NPL	Non-performing Loans
NSC	National Statistics Committee
OECD	Organization for Economic Cooperation and Development
OPEC	Organization for Petroleum Exporting Countries
PIP	Private Investment Program
PMI	Purchasing Managers' Index
PPI	Producer price inflation
PV	Present Value
REER	Real Effective Exchange Rate
SNA	System of National Accounts
SOE	State-owned enterprises
TFP	Total Factor Productivity
US	United States
VAT	Value-added tax
WB	World Bank

Kyrgyz Republic Economic Update: Business Support Programs in the Kyrgyz Republic: A Snapshot for the 2020-2022 Period

EXECUTIVE SUMMARY

Recent Economic Developments

- 1. The real economy grew at a quick pace in 2023, with GDP growth of 6.2 percent.** The economy continued its rebound from the severe recession of 2020 with a third consecutive year of buoyant growth. Growth was driven primarily by exports boosted by the resumption of gold exports in 2023 after a suspension in 2022. Consumption and investment also contributed to growth. On the production side, growth was driven primarily by service sectors – trade, hotel and restaurants, transport – and construction. In contrast, growth in agriculture and manufacturing slowed in 2023.
- 2. Year-on-year consumer price inflation halved in 2023, from 14.7 percent in December 2022 to 7.3 percent in December 2023.** The fall in overall inflation was mainly a result of much lower food price inflation, reflecting a decline in global food prices. However, inflation of non-food items and services prices remained high.
- 3. The current account deficit is estimated at 38 percent of GDP in 2023 (about US\$5 billions), and this exceptionally high deficit is due to a large amount of unrecorded exports.** While still exceptionally high, the current account deficit declined from 42 percent of GDP in 2022, thanks to exports growth. Exports of goods and services increased from US\$3.6 billion in 2022 to US\$5.4 billion in 2023. Imports of goods and services are estimated to have amounted to more than US\$14 billion, representing an 34 percent increase from the previous year. A sizeable share of these imports were destined for re-export to Russia and other Eurasian Economic Union countries. However, recorded re-exports were only US\$150 million in 2023, and errors and omissions amounted to US\$6 billion (compared to an average of US\$305 million in 2018-21), most likely attributable to unrecorded re-exports.
- 4. The National Bank of the Kyrgyz Republic (NBKR) kept its policy rate unchanged over 2023, at 13 percent, but intervened to support the exchange rate.** While monetary policy passthrough is weak in the Kyrgyz Republic, high dependence on imports means that exchange rate plays an important role in price formation in the short term. The NBKR's interventions in the foreign exchange market in 2023 suggest that it has actively managed the exchange rate, likely to aim to limit inflation passed through from exchange rate depreciation.
- 5. The budget recorded a surplus of 1.2 percent of GDP in 2023, compared to a deficit of 1.3 percent of GDP in 2022.** The stronger fiscal balance in 2023 was attributable to the buoyant tax revenues, particularly VAT, excise taxes and customs duties. The main reason for the buoyancy of indirect taxes was the growth of imports, especially imports for re-export. Total revenues were also boosted by non-tax revenues. As a share of GDP, total revenues increased by more than three percentage points to 35.9 percent in 2023. With higher outlays on wages and pensions total expenditures increased to 36.1 percent of GDP in 2023 from 35.8 percent a year earlier. Public debt as a ratio to GDP fell from 46.9 percent at end-2022 to 45.5 percent at end-2023.
- 6. Poverty in the Kyrgyz Republic remains high despite strong growth.** The COVID-19 pandemic and price shocks, particularly due to Russia's invasion of Ukraine, led to double-digit inflation

in 2021-2022, which contributed to a sharp increase in the population falling below the national poverty rate from 25.3 percent in 2020 to 33.3 percent in 2021, and remaining high at 33.2 percent in 2022.

Outlook and Risks

7. **Real GDP growth is projected to decelerate to 4.5 percent in 2024, as output returns to its potential level.** The re-export trade is expected to grow in 2024, although at a slower pace, supporting growth in related services. Remittances inflows are projected to recover somewhat as Russia's economy continues to exhibit strong demand for migrant labor. However, growth is expected to decelerate from high levels in the past two years because of constraints on the supply side of the economy.

8. **The current account balance is projected to improve in 2024.** The current account deficit is expected to shrink to 22 percent of GDP from an estimated 38 percent in 2023. Exports are projected to grow strongly, driven by gold exports reflecting an increase in production volume and higher global gold prices.¹ Gold will continue to be the country's primary export commodity. Imports are projected to increase due to higher imports of food and other consumer goods, chemical products, machinery and equipment. An expected increase in remittance inflows in US dollar terms by 8 percent would also contribute to strengthening the current account balance.

9. **Inflation should continue to edge down in 2024.** Consumer price inflation is projected to decline to 6.5 percent at the end of 2024. The announced increase in electricity tariffs by 10.8 percent for all categories of consumers, which are expected to come into force in May 2024, will raise the overall price level. However, the prospects for global food prices in 2024 are favorable, which should help to alleviate domestic inflation, given the large weight of food in the consumer basket and the importance of imports for domestic food supplies.

10. **The fiscal balance is expected to turn into a deficit in 2024.** Tax revenues are expected to fall moderately in 2024 as re-export trade slows. At the same time, current expenditures are expected to decline, reflecting restraint on wage bill and goods and services spending. In contrast, capital expenditures are projected to increase slightly due to higher spending on building infrastructure, including preparatory work on the Kambarata 1 power plant. These projections imply an overall fiscal deficit of 1.6 percent of GDP and, with nominal GDP projected to grow, a fall in public debt to 44.8 percent of GDP.

11. **Real GDP growth over the medium term is unlikely to be higher, on average, than 4 percent a year.** This is because there is limited scope to raise the contribution of capital accumulation to growth with the investment-to-GDP ratio already relatively high. In addition, labor outmigration and limited business dynamism reduce the potential contribution of employment. Consequently, raising the real GDP growth rate above 4 percent in a sustainable way would require faster TFP growth and accelerated structural reforms.

12. **The fiscal position is at risk in the medium term.** There are risks on both sides of the budget, which could lead to a marked deterioration in the fiscal balance. It is difficult to envisage that the Kyrgyz Republic will be able to indefinitely levy indirect taxes on imports destined for re-export. Moreover, a large share of current expenditures now comprises non-discretionary items (wages, pensions, interest

¹ In addition to a projected increase in production at Kumtor, gold production growth from other mining companies are expected in 2024.

payments). With more current expenditures rigid downwards, should tax revenues fall, the fiscal balance could worsen significantly and lead to rising debt levels.

13. **There are several critical reforms areas the government could focus on to achieve higher productivity and growth.** To improve business dynamism, the government should strengthen the competition framework, and support this with reforms to the SOE legal framework. The high tax and administrative burden that disproportionately falls on smaller, formal firms should also be addressed. The government could also improve the implementation of investment laws and regulations, for example, to provide better-defined guarantees and protections to investors. Given the importance of international trade to the Kyrgyz Republic, reforms to reduce non-tariff barriers and ease trade facilitation, including new digital and risk-based systems, will be important.

Special Topic: Business Support Programs in the Kyrgyz Republic: A Snapshot for the 2020-2022 Period

14. **This section evaluates the business support programs deployed in the Kyrgyz Republic amid the emergency situation triggered by the COVID-19 crisis from 2020 to 2022.** This analysis brings to light the fiscal consequences of these interventions. The analysis leverages firm-level data to identify which businesses received state support and provides insights into the overall scale and breadth of these measures on the economy. Through a detailed review of the extent, range, and precision of targeting these actions, this study aims to inform public financial management practices and aid in crafting future support schemes, enhancing their efficiency and efficacy.

15. **The analysis draws from the Business Pulse Survey (BPS) survey conducted in the Kyrgyz Republic.** It offers a representative snapshot of formal private enterprises, including information of business characteristics, performance, and business support programs. Drawing from this dataset, the analysis aims to answer three questions:

- i) What is the proportion of firms that received support?
- ii) Was there any mismatch between demand and support received by businesses?
- iii) Was there any mistargeting (i.e., firms that received support were the ones that suffered the most economic shocks from COVID-19)?

16. **The analysis examined the extent of government aid, its alignment with business needs, and the precision of targeting firms impacted by the crisis.** The findings reveal a constrained scope of aid, with small and medium-sized enterprises more frequently benefiting from measures such as payment deferrals and fiscal exemptions. A significant obstacle to accessing support was a general lack of awareness among businesses of all sizes. Additionally, the analysis identified a noticeable mismatch between the support firms desired and what they received, suggesting opportunities for policy refinement. Although aid targeting demonstrated effective sector-level alignment, firm-level nuances indicated instances of mistargeting, with some unaffected firms also receiving aid. However, in regional and global comparison, the Kyrgyz Republic's targeting of business support during the pandemic was effective, displaying better alignment than in other regional peers.

I. RECENT ECONOMIC DEVELOPMENTS

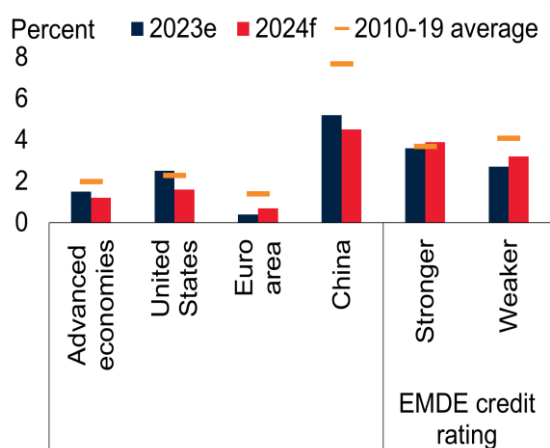
In 2023, the Kyrgyz Republic sustained a rapid economic growth of 6.2 percent, largely driven by exports, including the re-export of merchandise goods to Russia and other the Eurasian Economic Union countries and growth in international tourism. The service sectors were the primary beneficiaries of this growth. Consumer price inflation, which had been elevated for several years, halved over 2023 to 7.3 percent by December, nearing the central bank's target range. Although monetary policy remains relatively tight, banking sector loan growth picked up to 26 percent in 2023, supported by good liquidity positions and rising domestic deposits. Poverty is estimated to have decreased to 11.2 percent of the population (measured at the international poverty line for lower-middle-income countries). Buoyed by strong border tax receipts, the government budget moved from a deficit to a surplus of 1.2 percent of GDP. However, it's worth noting that the reliability of economic statistics is a growing concern in the Kyrgyz Republic, with the Balance of Payment subject to significant errors and omissions, and national account data recently sharply revised.

Global and Regional Economic Developments and Outlook

17. **Advanced economies saw resilient growth last year, with the United States driving much of the momentum due to solid consumer spending and expansionary fiscal policies.** Despite rising borrowing rates, growth in the United States reached 2.5 percent in 2023 (Figure 1). In contrast to the United States, the growth of the Euro area slowed sharply in 2023, to an estimated 0.4 percent. High energy prices—primarily related to Russia's invasion of Ukraine—weighed on household spending and firms' activity, particularly in manufacturing. The downturn in late 2023 reflected the ongoing decline in exports amid deteriorating export price competitiveness and tepid external demand. Russia grew by a robust rate of 3.6 percent as a surge in government spending supported larger social outlays, wages, and investment, especially in industries related to defense, boosting activity in manufacturing and construction. Russia's crude oil exports remained stable, with energy shipments shifting from the European Union to China and India. China grew by 5.2 percent in 2023. After a strong post-COVID rebound in early 2023, growth momentum in China has slowed. Deflationary pressure, falling capacity utilization, and a sluggish labor market suggest that aggregate demand is falling short of aggregate supply.

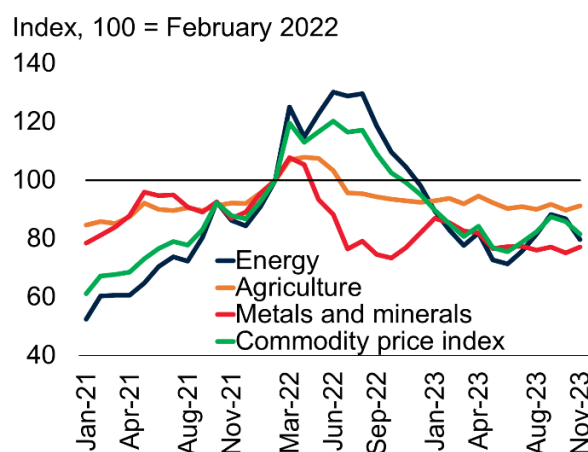
18. **According to January 2024 forecasts, global growth is anticipated to slow to 2.4 percent in 2024, marking the third consecutive year of deceleration.** This is primarily attributed to the persistent effects of tight monetary policies aimed at curbing decades-high inflation, coupled with restrictive credit conditions, and sluggish global trade and investment. However, it's important to note that near-term prospects are diverging. While output growth is projected to slow in 2024 in advanced economies as a whole and in China, falling well below its 2010-19 average pace, aggregate growth is set to improve in emerging market and developing economies with strong solid credit ratings, remaining close to pre-pandemic average rates. This suggests a potential for these economies to maintain their growth momentum, which should instill a sense of hope in the global economic outlook. Global trade growth in 2023 was the slowest outside global recessions in the past 50 years, growing by an estimated 0.2 percent, with goods trade contracting amid anemic global industrial production. However, global trade growth is projected to pick up to 2.3 percent in 2024, partly reflecting a recovery of demand for goods and, more broadly, in advanced economy trade.

Figure 1: Growth by country



Source: WB Global Economic Prospects

Figure 2: Commodity prices



Source: WB Global Economic Prospects

19. **Most commodity prices weakened in U.S. dollar terms in 2023 and early 2024 amid robust supplies and weak demand, though they remain above pre-pandemic levels.** Despite the volatility triggered by the conflict in the Middle East, crude oil prices fell in 2023 as robust output by non-OPEC members, especially the United States, offset the OPEC+ production cuts and the heightened geopolitical uncertainty (Figure 2). Grains prices decreased by 11 percent in 2023 and dropped further in early 2024, reflecting better-than-expected and dropped further in early 2024, reflecting better-than-expected crop conditions. Wheat prices followed the same downward trend amid softening demand and significant export flows from the Russian Federation. The precious metals index, for which gold is a major component, rose by almost 10 percent in 2023 and is expected to increase further in 2024, supported by heightened geopolitical uncertainty and strong central bank purchases.

20. **Growth in Europe and Central Asia is estimated to have more than doubled to 3.3 percent in 2023, driven by more robust domestic demand, the resumption of growth in the Russian Federation and Ukraine, and the robustness of the Turkish economy.** Growth is expected to moderate in 2024 to 2.8 percent. Nevertheless, despite sluggish activity in the euro area, incoming indicators, such as the manufacturing purchasing managers' index (PMI) and retail sales growth, point to robustness in the region's largest economies. Activity has also benefited from rising tourism, with tourist arrivals surpassing their 2019 levels. Protracted geopolitical tensions and heightened policy uncertainty could pose a risk to the region's economic outlook.

Economic Growth

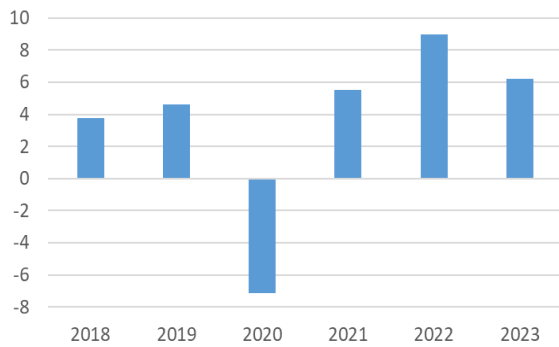
21. **The real economy grew strongly in 2023, recording a GDP growth of 6.2 percent.** The economy continued its rebound from the severe recession of 2020 with a third consecutive year of buoyant growth (Figure 3).² Growth was driven primarily by exports boosted by the resumption of gold exports in 2023 after a suspension in 2022. Exports are estimated to have increased by 49 percent in real terms in 2023, contributing 14.9 percentage points to overall growth. Consumption growth is estimated to have been much more subdued, at only 4.8 percent (down from 17 percent a year earlier) and contributed 4.2 percentage points. Investment growth is estimated to have remained unchanged at 7

² Analysis of growth performance is complicated by the unavailability of expenditure components of GDP growth for 2023 as a whole at the time of the preparation of this report. The estimates of these expenditure components presented in the report are based on data for the first 3 quarters of 2023 and preliminary annual sectoral growth data.

percent with a 1.5 percentage points contribution to growth. These positive contributions to growth were partially offset by strong import growth of 22.8 percent in real terms with a negative 20 percentage points contribution (Figure 4).

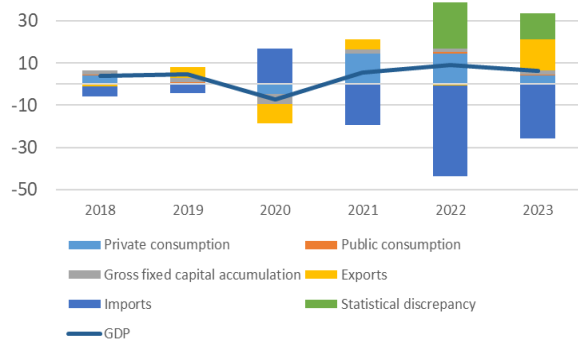
22. On the production side, there was a marked shift in the composition of growth in 2023 compared to the previous year. Growth was driven primarily by service sectors – trade, hotel and restaurants, transport – and construction in 2023 (Figures 5 and 6). Hotels and restaurants recorded 23 percent real growth following 25 percent growth in 2022, while trade grew 15 percent after 11 percent growth in 2022. Buoyant regional demand for merchandise trade and tourism underlies the strength of the services sectors that expanded by 6.8 percent and 6.2 percent in 2022 and 2023, respectively. In contrast, growth in agriculture and manufacturing slowed sharply in 2023 from solid rates recorded in 2022. The slowdown of growth in agriculture to 0.6 percent from 7.3 in 2022 was mainly caused by a worsening of climatic conditions that affected the harvest, while a decline in production of gold (by 21.8 percent), as well as machinery and equipment, resulted in the slowdown in manufacturing to 2 percent from 16.1 percent a year earlier.

Figure 3: Real GDP growth (percent)³



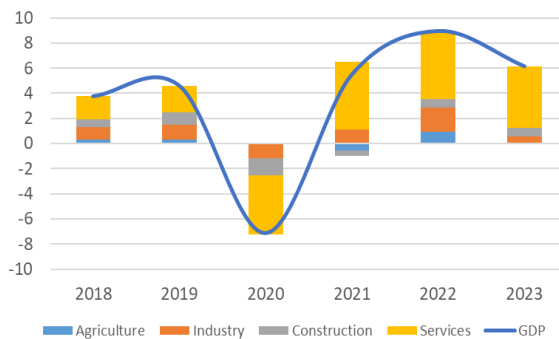
Source: NSC

Figure 4: Contribution to growth by expenditure (percentage points)



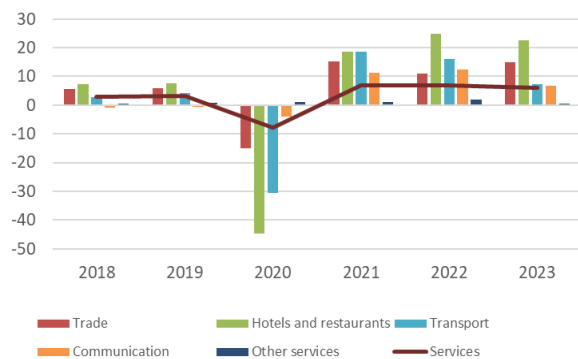
Source: NSC

Figure 5: Contribution to growth by sector (percentage points)



Source: NSC

Figure 6: Services growth (percent)



Source: NSC

³ Non-gold GDP growth has not been published since February 2022.

Box 1: Revision of Gross Domestic Product data

In accordance with international practice, reporting of annual gross domestic product (GDP) in the Kyrgyz Republic includes the calculation and publication of both preliminary GDP and revised GDP. The latter is computed based on updated sectoral input data and the final state budget execution report. In September 2023, following the recommendations of international experts, the National Statistics Committee (NSC) switched to the standards of the 2008 System of National Accounts (SNA) from the standards of the 1993 SNA. In order to ensure consistency in GDP data, the 2008 SNA was used to recalculate historical annual nominal and real GDP data for 2019-2022 by production. In addition, at the end of 2023, the Statistics Committee adopted a new methodology for calculating net taxes on goods component of annual GDP as part of its work to improve national statistics. This new methodology was developed with the IMF's technical assistance and was also used to recalculate historical nominal and real GDP data for 2019-2022 by production. As a result of these changes, nominal and real GDP data for 2019-2022 were revised upward. This, however, created significant discrepancies in GDP data calculated by production and expenditure, which were treated as statistical discrepancies. An amount of statistical discrepancy in GDP by expenditure for 2022, for example, was 16.4 percent of GDP.

Nominal GDP (bln. Soms)

	2019	2020	2021	2022
SNA 1993	619.1	601.8	739.8	919.4
SNA 2008 + new methodology for net taxes on goods	654.0	639.7	782.9	1,020.7
Net taxes on goods	83.2	65.5	100.2	140.8

Real GDP growth (percent)

	2019	2020	2021	2022
SNA 1993	4.6	-8.4	6.2	7.0
SNA 2008 + new methodology for net taxes on goods		-7.1	5.5	9.0

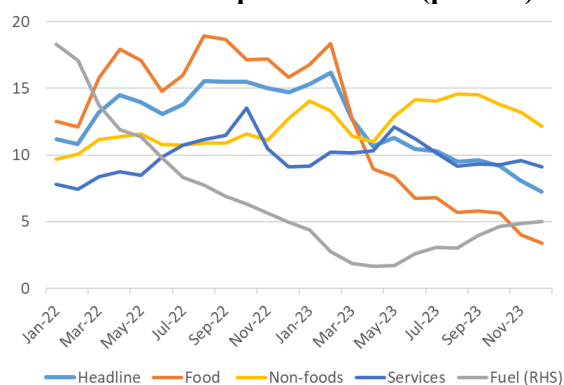
Price Inflation

23. **Year-on-year consumer price inflation halved in 2023, from 14.7 percent in December 2022 to 7.3 percent in December 2023 (Figure 7).** It thus ended 2023 only just above the NBKR's target band of 5-7 percent. The fall in overall inflation was mainly a result of much lower food price inflation, reflecting exogenous external developments in global food prices, especially the 15 percent fall in global cereals prices in 2023. Food price inflation fell from 15.9 percent in December 2022 to just 3.4 percent in December 2023. Food comprises 63 percent of the household consumption basket, and hence, movements in food price inflation have a significant influence on overall consumer price inflation.

24. **However, inflation of non-food items and services prices remained high.** The decline in these components, which combined account for half of the overall consumer basket, was much more moderate. Inflation of non-food items declined to 12.2 percent at the end of December 2023 from 12.7 percent at the end of December 2022, and services price inflation remained unchanged at 9.1 percent over this period. The persistence of inflation of many of these items, especially of services (reflected in the increase in the services GDP deflator), is likely to be attributable to the strength of aggregate demand in the economy. As such, the inflation improvement in 2023 has been driven by a positive external surprise this year, but domestic price pressures remain.

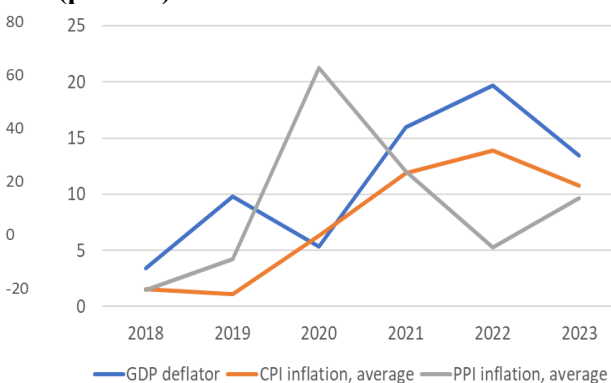
25. Other measures of price inflation confirm that there remains considerable underlying price pressure in the domestic economy. Producer price inflation (PPI) and GDP deflator remained elevated in 2023. The average PPI inflation increased to 9.7 percent in 2023 from 5.3 percent in 2022 while the GDP deflator, which has remained persistently high since 2020, declined to 13.4 percent in 2023 (Figure 8). Taken together, these measures and elevated CPI in non-tradeable sectors suggest that despite the drop in headline CPI, underlying price inflation pressures remain, which is likely to be a concern for the monetary authorities in the future.

Figure 7: Headline inflation and food, fuel, non-foods and services price inflation (percent)



Source: NSC

Figure 8: CPI, PPI inflation and GDP deflator (percent)



Source: NSC

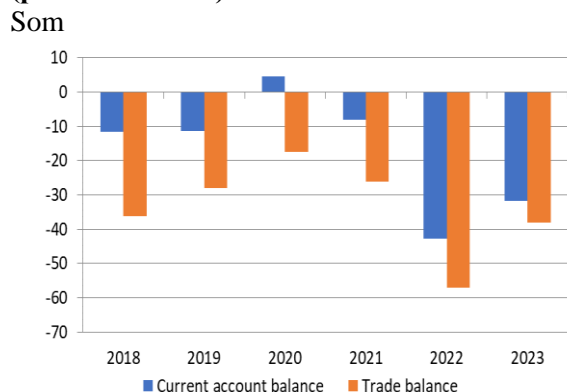
The Balance of Payments

26. The current account of the balance of payments (BoP) was dominated by very large trade flows, some of which were not fully recorded. Based on preliminary statistics, the current account deficit is estimated at 38 percent of GDP in 2023 (about US\$5 billion), down from 42 percent in 2022, but still exceptionally high (Figure 9). Imports of goods and services are estimated to have amounted to more than US\$14 billion, representing a 34 percent increase in US dollar terms from the previous year (Figure 10). The surge in imports began after Russia’s invasion of Ukraine and the ensuing sanctions on Russia. For example, imports of goods from Korea, Japan, Germany and the US increased by 3.5, 2.8, 2.6 and 1.8 times, respectively, in 2023. A sizeable share of these imports were destined for re-export to Russia and other Eurasian Economic Union (EAEU) countries. However, recorded re-exports were only US\$150 million in 2023, and errors and omissions amounted to more than US\$6 billion (compared to an average of US\$305 million in 2018-21), most likely attributable to unrecorded re-exports. Excluding these errors and omissions, the current account deficit was mainly financed by FDI and borrowings (Figure 11). The current account deficit after adjustment to take account of unrecorded re-exports to Russia was estimated at around 11 percent of GDP in 2022, according to the IMF’s External Sector Assessment.⁴

27. Exports performance improved while remittance inflows declined. Exports of goods and services increased from US\$3.6 billion in 2022 to US\$5.4 billion in 2023 (Figure 10). More than one-third of the growth of exports was accounted for as officially recorded re-exports. Additionally, a resumption of gold exports contributed almost US\$1.3 billion to exports in 2023 (Figure 12). Meanwhile, remittance inflows declined by 12 percent to US\$2.7 billion in 2023, reversing an increase of similar magnitude in 2022 (Figure 13). The fall was entirely attributed to lower receipts of remittances from Russia.

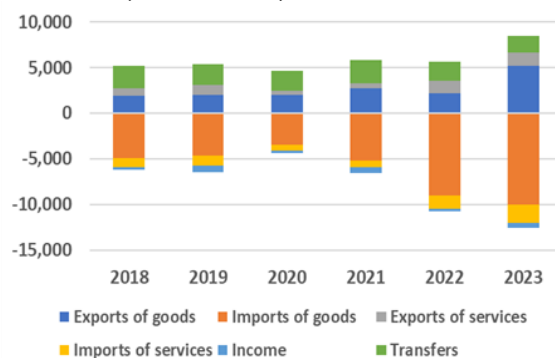
⁴ IMF Staff Report for the 2024 Article IV Consultation.

Figure 9: Trade and current account balances (percent of GDP)



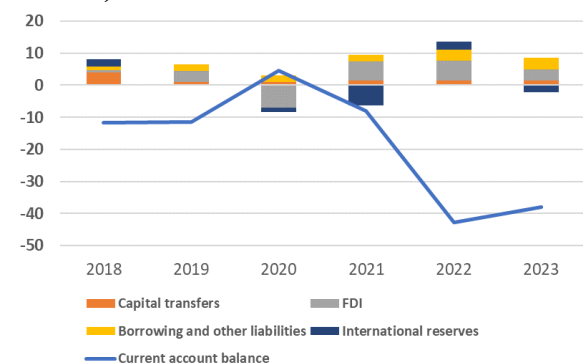
Source: NBKR

Figure 10: Exports, imports, income and transfers (US\$ million)



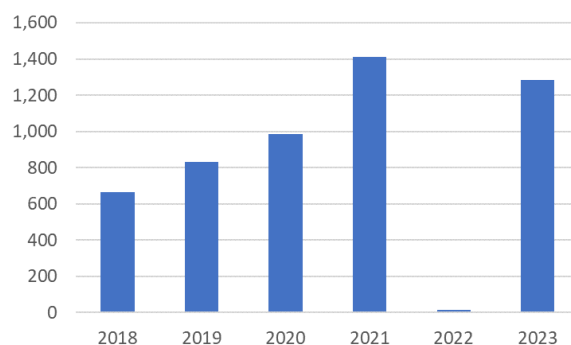
Source: NBKR

Figure 11: Current account financing (percent of GDP)⁵



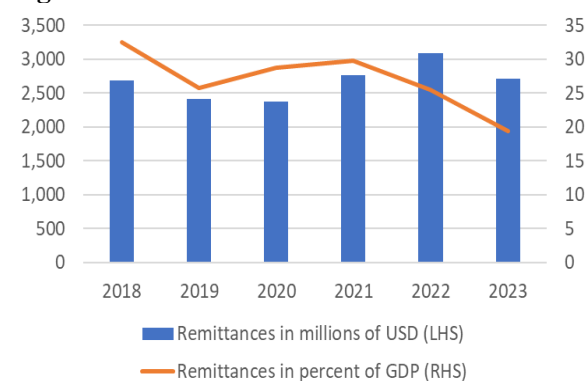
Source: NBKR

Figure 12: Exports of gold (US\$ million)



Source: NBKR

Figure 13: Remittance inflows



Source: NBKR

⁵ This figure does not include errors and omissions.

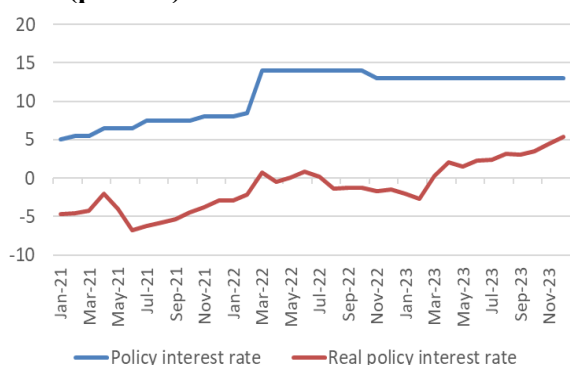
Monetary and Exchange Rate Policy

28. **The stance of monetary policy, in terms of the nominal policy interest rate of the NBKR, remained unchanged during 2023.** Monetary policy is aimed at price stability and reduced excess volatility in the exchange rate. The NBKR policy rate has remained at 13 percent since November 2022. As inflation fell over 2023, the real policy rate (the nominal rate adjusted for backward-looking inflation), which had been negative at the end of 2022, gradually became positive for the first time since 2020 (Figure 14). As of end-December 2023, the real policy interest rate was 5.3 percent. However, the policy rate has not been effective in influencing interest rates in banks and credit conditions, mainly due to the shallowness of the financial sector and the persistently high liquidity (Figure 15). On the other hand, for an economy like the Kyrgyz Republic with a high dependence on imports, exchange rate developments play an important role in price formation in the short term. The NBKR’s interventions in the foreign exchange market in 2023 suggest that it has actively managed the exchange rate, likely to aim to limit inflation passed through from exchange rate depreciation. To support the domestic currency, the NBKR sold US\$656 million in 2023, almost double that of foreign exchange sales in 2022 (Figure 16).

29. **Despite significant foreign exchange sales, the NBKR built up official international reserves thanks to an accumulation of monetary gold.** Gross official international reserves at the end of 2023 were equal to 3.1 months of imports (US\$3.2 billion), up from 2.8 months of imports (US\$2.8 billion) at the end of 2022 (Figure 17). The main reason for the increase was the conversion by the NBKR of US\$666 million of its holdings of non-monetary gold into monetary gold. Despite the slight increase, the level of international reserves remains very low, especially considering that the country is highly vulnerable to external shocks.

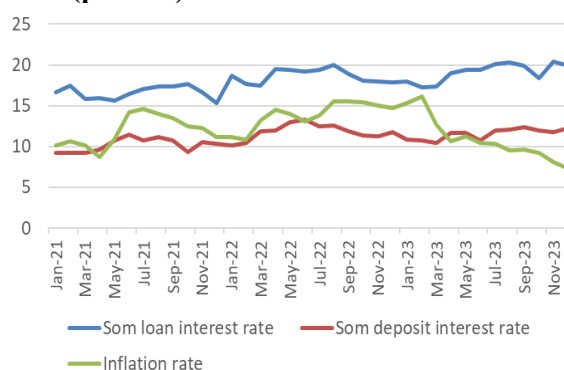
30. **The real effective exchange rate appreciated in 2023 despite evidence it was already overvalued in 2022.** The nominal bilateral KGS/US\$ exchange rate depreciated by 4 percent in 2023, and the nominal effective exchange rate depreciated by 1.4 percent (Figure 18). However, the real effective exchange rate (REER) index appreciated by 6 percent in 2023 as domestic inflation in the Kyrgyz Republic exceeded that of its trading partners. The IMF estimates that the REER was overvalued by 16 percent in 2022.⁶ This undermines the external competitiveness of the Kyrgyz economy.

Figure 14: Nominal and real policy interest rates (percent)



Source: NBKR

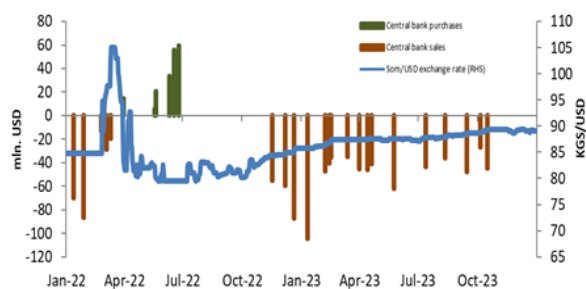
Figure 15: Inflation, loan, and deposit interest rates (percent)



Source: NBKR

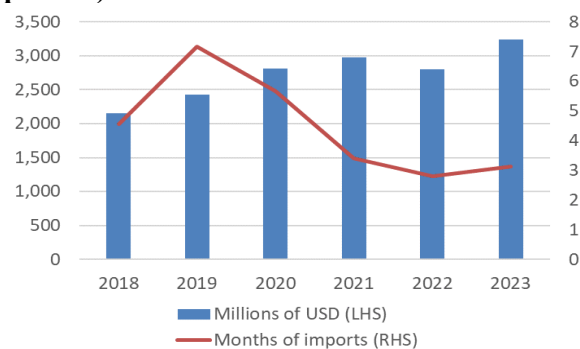
⁶ IMF Staff Report for the 2024 Article IV Consultation. This estimate is based on the IMF’s current account model for external balance assessment. After adjusting for estimated unrecorded re-exports, the IMF estimates that the actual current account deficit in 2022 was 10.9 percent of GDP, compared to what is estimated to be a current account norm of 5.3 percent of GDP. A depreciation of the REER is needed to close the gap between the actual current account deficit and the norm.

Figure 16: Exchange rate and NBKR interventions



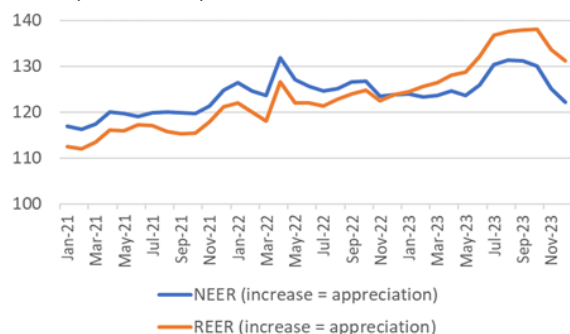
Source: NBKR

Figure 17: Gross international reserves (end of periods)



Source: NBKR

Figure 18: Nominal and real effective exchange rates (2010=100)



Source: NBKR

The Banking System

31. **Loan growth in 2023 was led by lending to the trade and transport sectors and consumer loans.** The commercial banks more than doubled lending growth from 12 percent in 2022 to 26 percent in 2023, taking advantage of the fact that they had held large volumes of liquidity, at 82.8 percent, at the end of 2022.⁷ The acceleration of bank lending in 2023 was also underpinned by bank deposit growth that remained robust at 27 percent. Loans to households – consumer loans and mortgages – recorded growth of 69 percent and 23 percent, respectively, in 2023. At the same time, growth in corporate loans by sector was mixed; there was rapid growth in loans issued to the transport sector (48 percent), agriculture (13 percent), and retail, wholesale, and commercial activities (32 percent), while in contrast, lending for industry and construction contracted by 2 percent and 8 percent, respectively.

32. **Bank loan quality began to improve in 2023.** Although the share of non-performing loans (NPL) in total loans remained high, there was a modest improvement in loan quality in 2023, with the NPL to total loan ratio declining to 9.2 percent at the end of the year compared to 12.8 percent at the end of 2022 (Table 1). The reduction in this ratio was not simply because the buoyant loan growth raised the denominator; the absolute value of loans classified as impaired fell by 9 percent in 2023, partially reversing the rises of 19 and 29 percent in 2021 and 2022, respectively. Capital adequacy remained high; the banking system’s total regulatory capital to risk-weighted assets stood at 24.8 percent at end-2023, slightly lower than at end-2022 because of the strong loan growth during the year. Despite its mediocre

⁷ The liquidity ratio is defined as the percentage of the amount of highly liquid assets to the expected net cash outflow in the next 30 days.

loan quality and modest interest rate margins (7-8 percent), the banking system remained very profitable in 2023, recording a return on assets of 4.4 percent and a return on equity of 32 percent thanks to foreign exchange operations amid high volatility of the Kyrgyz Som and other regional currencies against the US dollar, and commission fees for banking transactions.

Table 1: Banking sector indicators

	2018	2019	2020	2021	2022	2023
Capital adequacy (%)	23.7	24.0	24.9	22.2	25.6	24.8
NPLs/total loans (%)	7.5	8.0	10.5	11.1	12.8	9.2
Liquidity ratio (%)	66.9	64.0	64.9	71.3	82.8	77.4
Loan to deposits ratio (%)	101.0	103.0	95.9	80.3	65.0	66.0
Return on equity (%)	9.5	7.7	5.5	7.8	43.4	32.4
Return on assets (%)	1.4	1.2	0.9	1.4	5.9	4.4
Deposits in foreign currency (%)	44.5	39.1	43.4	42.2	48.3	49.3
Loans in foreign currency (%)	38.0	35.2	33.0	28.0	23.6	22.1

Source: NBKR

Fiscal Performance

33. **Buoyant indirect tax revenues enabled the general government budget to achieve a modest overall surplus in 2023.** Despite an increase in current expenditures by 1.3 percentage points to 28.9 percent of GDP, the budget recorded an overall surplus of 1.2 percent of GDP in 2023, compared to a small deficit of 1.3 percent of GDP in 2022 (Table 2). The higher overall fiscal balance in 2023 was attributable to the buoyant tax revenues, particularly VAT, which rose by 1.3 percentage points to 11.8 percent of GDP. Excise taxes and customs duties also rose (by 0.3 percentage points of GDP and 0.6 percentage points of GDP, respectively).

34. **The main reason for the buoyancy of indirect taxes was the growth of imports, especially imports for re-export.** Imports increased by approximately 35 percent in domestic currency terms in 2023, driven by re-export demand, as discussed above. In effect, the Kyrgyz Republic collected VAT, excise duties, and customs on goods destined for final use in other EAEU countries. Total revenues were also boosted by a substantial expansion of non-tax revenues, mainly on account of dividends paid state-owned companies (including dividends from Kumtor), which increased by 0.9 percentage points to 1.5 percent of GDP, and a profit distribution from the NBKR, which increased by 0.2 percentage points to 0.8 percent of GDP. However, income taxes contracted by 1.7 percentage points to 6.2 percent of GDP in 2023, as collection rates normalized after a boost from the collection of accumulated tax arrears in 2022. As a share of GDP, the buoyancy of indirect taxes raised total revenue to 35.9 percent, an increase of more than three percentage points in 2023 and over five percentage points cumulatively since 2021.

35. **Total expenditures rose to 36.1 percent of GDP in 2023 from 35.8 percent a year earlier.** The most significant contributors to this increase were higher outlays on wages and pensions, which increased by 0.5 percentage points to 9.7 percent of GDP and by 0.3 percentage points to 6 percent of GDP, respectively, as the full effects on the annual budget of substantial pay and pension increases implemented in 2022 were realized. There was an even more substantial increase in spending on purchases of goods and services, to 4.8 percent of GDP from 4.3 percent in 2022. However, this mainly reflected a rebound of the expenditure on medical supplies, which had seen a significant cut in 2022. At the same time, capital expenditures declined by 0.3 percentage points to 7.5 percent of GDP, reflecting

lower domestic financing of infrastructure projects as a share of GDP while funding provided by international donors remained at the same level.

Table 2: Fiscal Outturns, 2021-23 (percent of GDP)

	2021	2022	2023
Revenue and grants	31.8	34.6	37.2
Revenue	30.0	32.7	35.9
Tax revenue	24.2	27.5	29.2
Direct taxes	14.0	15.2	14.4
Indirect taxes	10.2	12.3	14.8
Non tax revenue	5.7	5.1	6.6
Grants	1.8	1.9	1.3
Total Expenditure	32.0	35.8	36.1
Current Expenditure	28.1	27.6	28.9
Wages	8.2	9.2	9.7
Transfer and subsidies	2.9	2.9	2.8
Pension	6.4	5.7	6.0
Interest	1.1	1.1	1.1
Purchase of goods and services	5.1	4.3	4.8
Capital expenditure	4.7	7.8	7.5
Domestically financed	1.3	4.6	4.3
Externally financed (PIP)	3.4	3.2	3.2
Net lending	-0.7	0.5	-0.3
Overall balance	-0.3	-1.3	1.2
Financing			
Domestic (net)	-1.3	-1.4	-2.3
External (net)	1.6	2.6	1.2

Source: Ministry of Finance of the Kyrgyz Republic

36. **Public debt has been declining.** Because the overall budget financing requirement was negative in 2023, combined with the strong growth of nominal GDP, the ratio of public debt to GDP fell from 46.9 percent at end-2022 to 45.5 percent at end-2023. This decline results from a fall in the external debt to GDP ratio to 33.7 percent from 37.6 percent whereas domestic debt to GDP increased to 11.8 percent from 9.2 percent. The interest costs of public debt are low, amounting to 1.2 percent of GDP in 2023, because most public debt is on concessional terms. The largest external creditor is China's Exim Bank with 39 percent of total external debt. The domestic debt portfolio consists almost exclusively of treasury bonds, with maturities of more than 1 year.

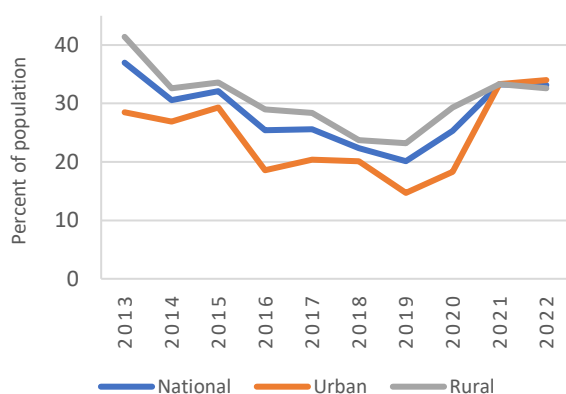
Poverty Developments

37. **The poverty rate in the Kyrgyz Republic remains high despite the strong growth performance since the COVID-19 pandemic shock.** The COVID-19 pandemic and price shocks, particularly due to Russia's invasion of Ukraine, led to double-digit inflation in 2021-2022, which significantly eroded the purchasing power of citizens and increased economic hardship for families nationwide. Associated with this, the share of the population below the national poverty rate increased

sharply from 25.3 percent in 2020 to 33.3 percent in 2021, and remained high at 33.2 percent in 2022 (Figure 19). Additionally, extreme poverty (as measured by the food component of the national poverty line) increased markedly from 0.5 percent in 2020 to 6.0 percent in 2022. This notable increase highlights the vulnerability of households during periods of economic contraction and shocks.

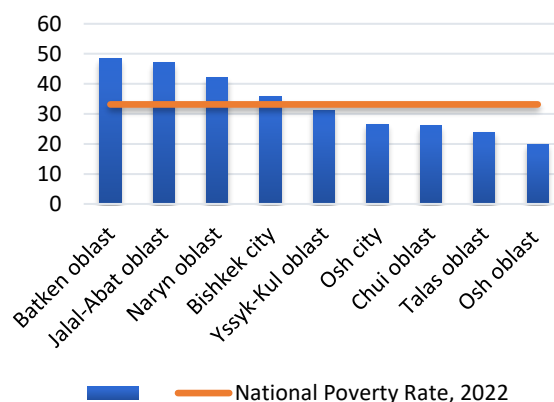
38. **Before 2021, poverty in the Kyrgyz Republic was primarily a rural phenomenon but significant shifts are altering this picture.** In 2021, the poverty rate in urban areas equaled that of rural areas for the first time, standing at 33.3 percent. In 2021, both rural and urban areas experienced increases in poverty, with rural poverty rising by 4.0 percentage points and urban poverty spiking by 15.0 percentage points. Cities like Bishkek and Osh saw the most substantial jumps, with poverty rates soaring by 19.0 and 13.9 percentage points, respectively. This surge in urban poverty can be attributed to the urbanization trend, driven by internal migration to major urban centers, leading to the expansion of urban areas and the concentration of poverty within them. By 2022, the urban poverty rate surpassed that of rural areas, standing at 34 percent compared to 32.6 percent in rural areas.

Figure 19: National Poverty Rates



Source: National Statistics Committee

Figure 20: National Poverty Rates by Region, 2022



Source: National Statistics Committee

39. **The dynamics of the poverty gap within the Kyrgyz Republic mirrored the concerning increase in the national poverty rate.** There was a noticeable rise in the poverty gap,⁸ from 4.4 percent in 2020 to 6.8 percent in 2022. This upward trend in the poverty gap is indicative of not just an increase in the number of people living below the poverty line but also a worsening in the depth of poverty among the affected populations. The widening gap points to an increasing distance between the living standards of the poor and the poverty line, suggesting that those in poverty are falling further behind.

40. **Labor income and remittances were key drivers of poverty reduction in the previous years and continue to play important role in the households' income.** In 2022, household monetary incomes primarily came from labor earnings (68.9 percent), social transfers (14.5 percent), and sales of agricultural products from personal subsidiary farms (12.4 percent). Additionally, wages and salaries constituted 43.1 percent of average per capita disposable income. Notably, 12.6 percent of income stemmed from remittances. Remittances are an essential income source, especially for rural households, representing 17.6 percent of total income, and almost one-fourth of rural households receive remittances

⁸ The "poverty gap" is a measure of the extent to which individuals fall below the poverty line, capturing the intensity of poverty in a given area. It is calculated as the mean shortfall of the total population from the poverty line (where the poverty line is the minimum level of income deemed necessary to achieve an adequate standard of living), expressed as a percentage of the poverty line. This measure helps to understand not just the incidence of poverty, but also its depth and severity, by showing how far, on average, the poor are from reaching the poverty threshold.

from abroad⁹. Without remittances sent by labor migrants in 2022, the poverty rate would have surged by a substantial ten percentage points, reaching 43.3 percent.¹⁰

II. OUTLOOK AND RISKS

With much of recent growth driven by temporary factors stemming from COVID-19 recovery and then Russia's invasion of Ukraine, growth is projected to slow to 4.5 percent in 2024 and towards 4 percent in future years. While sharp rises in trade, financial flows and tourism have brought growth, further increases in growth rates are unlikely and indeed, risks are now tilted to the downside should there be a reversal of these trends. Especially with low external buffers and the country at a moderate risk of debt distress, policy should be geared towards guarding against risks as well as building the foundations for higher, productivity-led growth in future. A large, official current account deficit is expected to remain, which is a high risk particularly given the lack of capacity to adequately record international trade within the EAEU. The fiscal deficit is expect to return to a deficit, as significant public sector wage rises in the recent past now reflect a higher, rigid level of public expenditures. The announced Kambarata-1 hydropower plant presents a potential growth opportunity if prudently managed and accompanied by a broader economic reform program or otherwise it would turn into a liability. Key reforms to focus on will encourage a more flexible, dynamic private sector that can take advantage of opportunities in the economy and create jobs. This includes strengthening of the competition policy framework, and addressing undue burdens and distortions arising from the tax and licensing systems. Trade and FDI facilitating reforms are also importance to expand potential markets for Kyrgyz firms, bring in new, productive capital and strengthen efficiency and competition in markets.

41. **Regional and international developments have proved generally favorable for the Kyrgyz economy over the last two years.** The international sanctions imposed on Russia have created incentives for channeling goods exports to Russia through Central Asia, offering opportunities for Kyrgyz businesses to provide trade related services, such as transport and other logistics. In addition, there has been an influx of Russian visitors to the Kyrgyz Republic, boosting demand for tourism-related services. Finally, the strength of the Russian economy, combined with labor shortages, has ensured that opportunities remain in that country for migrant labor, including for Kyrgyz migrants; hence, remittance inflows have generally proved resilient. These factors have boosted domestic output through higher aggregate demand and supported BoP current account receipts, especially budget revenues. The Kyrgyz economy has also benefitted from the fall in food prices on international commodity markets, which has fed through to a rapid decline in domestic food price inflation, which eases pressure on household budgets and frees up space for spending on other items in the consumption basket. In the short term, for the rest of 2024, these favorable factors are likely to remain in place, but the medium term is more uncertain and poses significant risks for the Kyrgyz economy. In particular, if the shift in regional trade patterns that has occurred since 2022 were to be reversed, there would be adverse macroeconomic impacts through multiple channels.

42. **Growth is expected to cool from unusually high levels in the past two years, and towards the economy's supply capacity.** The re-export trade is expected to grow in 2024, although at a slower pace, supporting growth in related services. After a substantial drop in 2023, remittances inflows are projected to recover somewhat as Russia's economy continues to exhibit strong demand for migrant labor. However, it is unlikely that the very high rates of real GDP growth recorded in 2022 and 2023, which averaged 7.6 percent, can be sustained because of constraints on the supply side of the economy.

⁹ World Bank. 2022. Poverty Assessment: Poverty and Vulnerability in the Kyrgyz Republic.

¹⁰ NSC. 2023. On the level of poverty in the Kyrgyz Republic in 2022 (<https://stat.kg/media/publicationarchive/2a652573-efb0-4424-8e4c-534401ff6ff9.pdf>)

As discussed above, there was evidence that the economy was already reaching the limits of its supply capacity in 2023, with producer prices, wages and the GDP deflator for services all rising very rapidly. Real GDP growth is projected to decelerate to 4.5 percent in 2024, as output returns to its potential level. On the demand side, household consumption, supported by a recovery in remittance inflows and higher public investment, will be the most important sources of growth.

43. **The current account balance is projected to improve in 2024.** The current account deficit is expected to shrink to 22 percent of GDP from an estimated 36 percent in 2023. Exports are projected to grow strongly, by 28 percent in US dollar terms, driven by gold exports reflecting an increase in production volume by 4 percent and higher global gold prices.¹¹ Gold will continue to be the country's primary export commodity, while non-gold exports growth is expected to be driven by fruits and vegetables, textiles, and construction materials, mainly destined for Russia and other Central Asia countries. Services exports are also expected to increase primarily driven by tourism supported by rising domestic capacity and transportation related to regional trade. Imports are projected to increase by 4 percent in US dollar terms due to higher imports of food and other consumer goods, chemical products, machinery and equipment. After a fall in the previous year, as mentioned above, an expected increase in remittance inflows in US dollar terms by 8 percent would also contribute to strengthening the current account balance.

44. **Inflation should continue to edge downwards in 2024.** The announced increase in electricity tariffs by 10.8 percent for all categories of consumers, which are expected to come into force in May 2024, will raise the overall price level. However, the prospects for global food prices in 2024 are favorable, which should help to alleviate domestic inflation, given the large weight of food in the consumer basket and the importance of imports for domestic food supplies. Further, slower growth projected for 2024 is expected to reduce inflationary pressure. These should enable the overall CPI inflation rate to fall within the NBKR's target range of 5-7 percent. Consumer price inflation is projected to decline to 6.5 percent at the end of 2024.

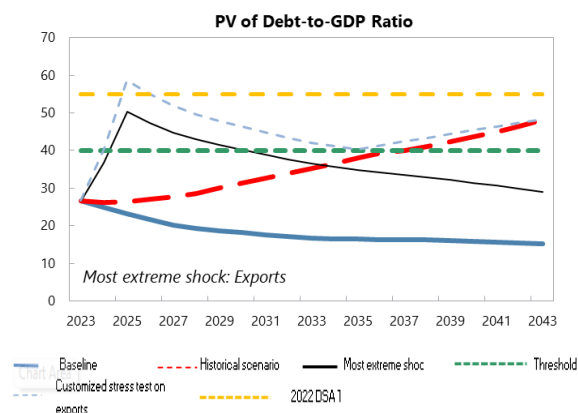
45. **The fiscal balance is expected to turn into a deficit in 2024.** Although re-export trade is assumed to continue in 2024, it is expected to grow at a slower pace. Similarly, wage growth is expected to be slower in 2024. As a result, tax revenues are projected to decline by 0.9 percentage points of GDP compared to the 2023 outturn. Non-tax revenues are also projected to be lower as dividends of Kumtor and the NBKR's profit, which boosted non-tax revenues in 2023, are expected to subside in 2024. In addition, grant support is expected to decline. At the same time, current expenditures are envisaged to decline by 1.4 percentage points, partly reflecting declines in wage bill, as the full impact of a large wage increase in 2022 fades, and in purchases of goods and services as a share of GDP. In contrast, capital expenditures are projected to increase slightly as the government budgeted higher spending on building infrastructure, including preparatory work on the Kambarata 1 power plant. These projections imply an overall fiscal deficit of 1.6 percent of GDP and, with nominal GDP projected to grow by over 13 percent in 2024, a fall in nominal government debt as a percent of GDP by around 0.7 percent points to 44.8 percent of GDP.

46. **The latest debt sustainability analysis conducted by the World Bank and the IMF in November 2023 assesses the Kyrgyz Republic's public debt as sustainable with moderate debt distress risk.** All public debt and external debt ratios remain below their respective sustainability thresholds in the baseline scenario. However, a standard shock to exports causes a breach for the PV of debt-to-GDP ratio between 2025 and 2029 (Figure 21). The assessment also indicates that the PV of total

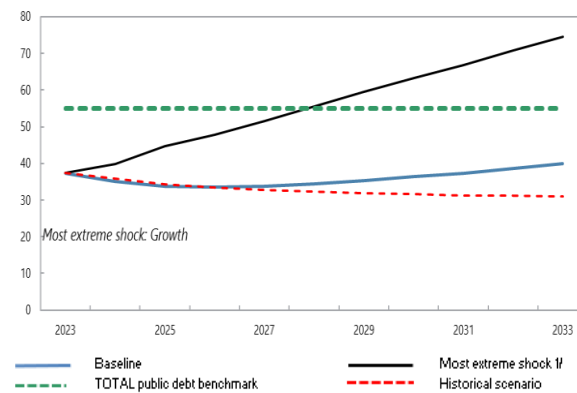
¹¹ In addition to a projected increase in production at Kumtor, gold production growth from other mining companies are expected in 2024.

public debt-to-GDP breaches its benchmark under the baseline scenario in 2028 under a standard shock to growth (Figure 22).

Figure 21: PV of Public External Debt-to-GDP Ratio **Figure 22: PV of Public Debt-to-GDP Ratio**



Source: IMF and World Bank



Source: IMF and World Bank

47. **Real GDP growth over the medium term is unlikely to be higher, on average, than 4 percent a year.** This is because, since around 2010, real growth has been driven primarily by factor accumulation, especially capital accumulation. In contrast, average annual total factor productivity (TFP) growth has been very low. There is limited scope to raise the contribution of capital accumulation to growth because, with the investment-to-GDP ratio already relatively high, at around 29 percent on average over 2015 to 2022, the savings (domestic or external) are not available to fund a significant and sustained increase in the investment rate which would be needed to accelerate the growth of capital accumulation. In addition, labor outmigration and limited business dynamism reduce the potential contribution of employment. Consequently, raising the real GDP growth rate above 4 percent in a sustainable way would require faster TFP growth, which should be a policy priority for the Kyrgyz Republic.¹²

48. **There are several critical reforms areas the government could focus on to achieve higher productivity and growth.** The new, World Bank Group Enterprise Survey highlights the severe challenges firms face in the Kyrgyz Republic. Firms report that a quarter of all interactions with public officials involve requests for bribes, five times more than the average in Europe and Central Asia. There are few new firms starting (272 per million people, well below comparators), firm informality is prevalent and there is a stark missing middle of medium sized companies. As a result, firms productivity is low. Structural reforms to strengthen competition in key product markets and facilitate new entry by private investors are imperative if productivity growth is to be raised sustainably.¹³ To improve business dynamism, the government should strengthen the de jure competition framework and its implementation, to ensure a fair, level playing field for all market participants, and support this with reforms to the SOE legal framework that support competition. The high tax and administrative burden that disproportionately falls on smaller, formal firms should also be addressed. The government could improve the implementation of investment laws and regulations, for example, to provide better defined guarantees and protections to investors. Given the high importance of international trade to the Kyrgyz Republic, reforms to reduce non-tariff barriers and ease trade facilitation, including new digital and risk-based systems, will be important. At the same time, to protect the vulnerable and improve efficiency of the social spending, it is important to strengthen the targeted social assistance programs.

¹² The World Bank’s Long Term Growth Model (LTGM) simulates GDP growth in the Kyrgyz Republic using assumptions about capital investment, labor force growth, TFP and human capital. With TFP growth of 0.5 percent per annum, the same as the average achieved during 2010-19, the LTGM generates a simulation of real GDP growth during 2024-28 of 4.0 percent.

¹³ These issues are analyzed in the forthcoming Country Economic Memorandum (World Bank, 2024).

49. **The current account deficit is projected to narrow to around 8 percent in the medium term.** The BoP has been supported in the last two years by increased regional demand for transit trade for goods and tourism, although some of this transit trade was not recorded in exports. These favorable factors do not appear sustainable beyond the short term, resulting in a decline in both exports and imports growth and a narrowing of the current account deficit in the medium term. Moreover, the IMF's External Sector Assessment concluded that the current account deficit, even after adjustment to take account of estimated unrecorded re-exports to Russia, was around 11 percent of GDP in 2022, which was around six percentage points of GDP higher than the estimated current account deficit norm. That implies that the current account deficit will have to narrow over the medium term if the external balance is to be sustainable. Excluding the re-export trade, non-gold merchandise and services exports together amount to just under 20 percent of GDP, so if the current account adjustment is to be brought about through higher earnings, these categories of export earnings would have to expand by around one-third. The alternative adjustment channel would be a compression of imports, but that would probably only happen if output growth were to fall.

50. **Sustained efforts by the NBKR to support the exchange rate would exacerbate the risks to the BoP.** Over the last two years, the NBKR has sold large amounts of foreign currency to the domestic market to support the nominal exchange rate, with the consequence that the REER appreciated by 8.4 percent cumulatively over the two years. Although the NBKR's gross official reserves increased in 2023, that was only because it converted its holdings of non-monetary gold into reserves.

51. **The fiscal position is also a source of risk in the medium term.** The vast expansion of imports for re-export brought substantial benefits for the budget through the additional receipts of indirect taxes on imports. Indirect taxes (VAT, customs duties, and excises) increased by three percentage points of GDP from 2021 to 2023. This allowed the Government to increase expenditures without worsening the fiscal balance. However, there are risks on both sides of the budget, which could lead to a marked deterioration in the fiscal balance. It is difficult to envisage that the Kyrgyz Republic will be able to indefinitely levy indirect taxes on imports destined for re-export. Either the re-export trade will eventually diminish as the geopolitical situation changes, or merchandise goods destined for re-export will be treated as genuine transit goods, which are not liable for indirect taxes in the transit countries. If, or when, this occurs, tax collections will inevitably decline.

52. **Structural changes to current expenditures will be difficult to reverse.** Budget policy decisions implemented in 2022 to raise public sector wages and pensions have brought about a structural shift in government expenditures, with current expenditures rising by 3.3 percentage points of GDP from 2021 to the budgeted level in 2024. A large share of current expenditures now comprises non-discretionary items (wages, pensions, interest payments) which are structural in nature; they cannot be cut in the short term. This means that current expenditures will likely remain in excess of 30 percent of GDP for the foreseeable future. With most current expenditures effectively being relatively rigid downwards, but tax revenues vulnerable to changes in the regional re-export trade, the overall fiscal balance could worsen significantly over the medium term with fiscal policy makers having limited policy tools to prevent this without significant cuts to domestically funded capital expenditures, which would be detrimental to long term growth. A deterioration in the overall fiscal balance would start to reverse the decline in the public debt to GDP ratio that has been achieved since 2020, and this would be exacerbated if the REER depreciates to facilitate BoP adjustment as discussed above, because this would induce revaluation effects on the stock of external public debt, relative to GDP.

III. SPECIAL TOPIC: BUSINESS SUPPORT PROGRAMS IN THE KYRGYZ REPUBLIC: A SNAPSHOT FOR THE 2020-2022 PERIOD

53. **This section examines the array of business support measures extended to private enterprises in the Kyrgyz Republic during the tumultuous years of 2020 to 2022.** This period was punctuated by a series of economic disturbances, including the COVID-19 pandemic and the Russian invasion of Ukraine. In the absence of a detailed mapping of business support programs deployed in the country, this analysis relies on representative firm-level data from the World Bank Business Pulse Survey to discern which businesses benefitted from government aid. This demand-side analysis¹⁴ offers a window into the magnitude and scope of these interventions and their economic impact, highlighting the fiscal implications of such support policies. The timeframe under scrutiny was fraught with multiple economic upheavals, from the pandemic to geopolitical conflicts, which must be considered when evaluating the operational landscape for businesses. By empirically examining how extensively, broadly, and accurately these support measures were targeted this study seeks to contribute to refining public financial management and developing more effective future support programs.

Business Support Policies: Objectives and Risks

54. **Business support policies are often justified to address market failures and achieve development goals—and they can take many different forms.** Business support policies—defined as measures targeting specific domestic firms—be they private or state-owned, industries, or narrowly defined economic activities—are often justified to address market failure as well-identified externalities, coordination failures, or public input under-provision. These measures can take different forms, such as concessional loans, equity injections, grants, guarantees, tax and customs deferral, tax concessions, export subsidies, import restrictions, local content requirements, discriminatory public procurement, etc.

55. **This type of instrument has been gaining attention recently, marking the renaissance of industrial policy.** Business support policies are often part of a broader package of industrial policy measures.¹⁵ Tracking these industrial policy measures is complex, but recent global initiatives have provided some clarity. Focusing on trade-related measures, the Global Trade Alert indicates that from November 2008 to December 2021, over 32,500 protectionist interventions were enacted worldwide, with a significant spike in 2021-2022. A study by Evenett et al. (2024)¹⁶ examines the latest wave of industrial policy measures in 2023, documenting over 2,500 such actions across advanced and emerging economies, with approximately 71 percent being trade-distorting.¹⁷

56. **The implementation of business support policies is not a decision to be taken lightly.** It carries fiscal and opportunity costs, making it a significant consideration for public financial management. Allocating funds to business support programs requires meticulous consideration, as it can detract from other public expenditures—for instance, education and health—that may yield higher returns, thus impacting the management of public finances. Additionally, these measures come with high costs and can increase fiscal strain, especially when tax revenues decrease and expenditures rise.

¹⁴ A demand-side analysis focuses on the recipient (and nonrecipients) of business support programs.

¹⁵ In this context, industrial policy measures have a wider scope, encompassing not only targeted interventions supporting firms or groups of firms in sectors and narrowly defined activities but also horizontal measures—i.e., focusing on the enabling environment of firms, encompassing regulations that influence the functioning of product markets, rules and spending on infrastructure, investments in human capital, etc.

¹⁶ Evenett, S., Jakubik, A., Martín, F., and Michele Ruta (2024) “*The Return of Industrial Policy in Data*”, IMF Working Paper No. 2024/001.

¹⁷ Evenett et al. (2024) analysis also details the variety of instruments used, noting that while advanced economies tend to favor direct financial grants and state loans, emerging markets often resort to import tariffs, state loans, tax relief, and broader trade restrictions—a reflection of policy preferences that do not require direct government budget outlays.

57. **Besides bearing fiscal costs, business support programs can lead to unintended negative effects by distorting efficient market functioning and allocative efficiency.** Business support measures alter recipient firms' cost and revenue structures, influencing their strategic decisions on matters such as production, market entry or exit, and expansion. They confer an advantage to the beneficiaries, which can distort their comparative advantage relative to competitors or potential market entrants. The deployment of such measures can unfairly tilt the competitive landscape, enabling certain firms to achieve market dominance without necessarily improving productivity or performance. Moreover, state support may encourage predatory pricing and other exclusionary tactics aimed at eliminating competition from unsupported firms. The implementation of business support measures can also influence the dynamics of cross-border trade and investment. When a government provides support to domestic firms, it can create an uneven playing field for foreign competitors who may not have access to similar advantages in their own countries. This can result in barriers to entry and reduced competition within the country's market that enacts these measures. These risks are compounded by the integration and complexity of industrial supply chains, which ultimately implies that business support programs in one country are likely to affect other countries.

58. **Whether business support programs have a positive impact or not critically depends on how they are designed.** Assessing the empirical evidence of the effects of business support programs must consider both the impact at the beneficiary level as well as possible spillover effects. OECD (2021)¹⁸ highlights several key principles that should guide the design of government support to ensure it is effective and minimizes market distortions: i) proportionality (support should be commensurate with the scale of the problem it aims to address; ii) time limitation (support should be temporary, possibly with a defined end date); iii) targeting (support should be directed towards those who need it most to reduce unnecessary windfall gains); iv) non-discrimination (support should not favor firms based on local content requirements or the nationality of the parent company); v) viability distinction (support should differentiate between viable and non-viable firms); vi) transparency (governments should publish relevant information about the support provided). The World Bank (2023)¹⁹ emphasizes that the level of distortion caused by state support to businesses varies depending on the instrument used. Therefore, governments should carefully select support measures and instruments based on the intended objectives and the potential for distortion. For instance, deferrals (e.g., of taxes, contributions, interest, or payments) are generally less distortionary than other forms of support. One-off and time-limited subsidies are less likely to have negative effects. Loans are typically less distortionary than grants, as they need to be repaid. The risk associated with state-guaranteed loans can be limited by capping the guarantee percentage and requiring a minimum premium. Recapitalizations can create market inefficiencies and are considered a more permanent form of support; when such measures are necessary, governments can encourage private sector involvement to limit competitive distortions, such as combining equity injections with bankruptcy proceedings.

Methodological Approach

59. **The analysis draws on data from the World Bank Business Pulse Survey (BPS) conducted in the Kyrgyz Republic in the 2020-2022 period.** The BPS, which has been implemented in over 40 countries, including the Kyrgyz Republic, was initially designed to assess the impact of the COVID-19 crisis on the private sector. It provides a representative overview of formal private enterprises, capturing details on business characteristics, performance, and participation in business support programs. The survey was carried out in three waves: the first in August-September 2020, the second in May-July 2021, and the third in March-May 2022. Consequently, the data offers a comprehensive snapshot that not only

¹⁸ OECD (2021) *Fostering Economic Resilience in a World of Open and Integrated Markets: Risks, Vulnerabilities and Areas for Policy Action*. Report prepared by the OECD for the 2021 UK Presidency of the G7, Paris.

¹⁹ World Bank (2023) *The Business of the State*. Washington, DC: World Bank.

encompasses the pandemic period but also includes the immediate aftermath of the Russian invasion of Ukraine, which began in February 2022.

60. Drawing from this dataset, the analysis aims to answer three questions.

- i) What is the proportion of firms that received support?
- ii) Was there any mismatch between demand and support received by businesses?
- iii) Was there any mistargeting (i.e., firms that received support were the ones that suffered the most economic shocks from COVID-19 and the immediate effects of the Russian invasion of Ukraine)?

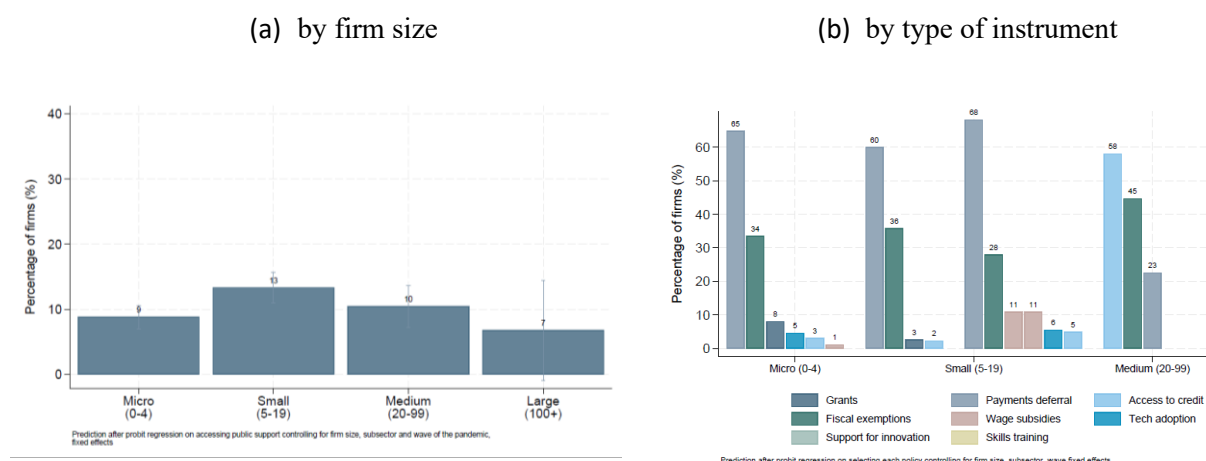
More details on the methodology applied can be found in the Annex.

Results

Reach of Government Support Measures

61. The reach of business support measures deployed in the Kyrgyz Republic in the 2020-2022 period was somewhat limited, but small and medium-sized enterprises (SMEs) were more likely to receive support, with the most frequent forms of support being deferrals and fiscal exemptions. Econometric analysis drawing from BPS data indicates that the average probability of receiving support, regardless of firm size, was just less than 11 percent, so the vast majority of firms did not receive support. Small and medium-sized enterprises had a slightly higher chance of receiving assistance (Figure 23, panel a), primarily through fiscal exemptions and payment deferrals (Figure 23, panel b). These two methods were the most prevalent for micro and small firms, whereas larger firms more frequently accessed credit facilities. Accommodation and food processing were more sectors most likely to receive support.

Figure 23: Average predicted probability of receiving any business support measures in the Kyrgyz Republic: 2020-2022 period

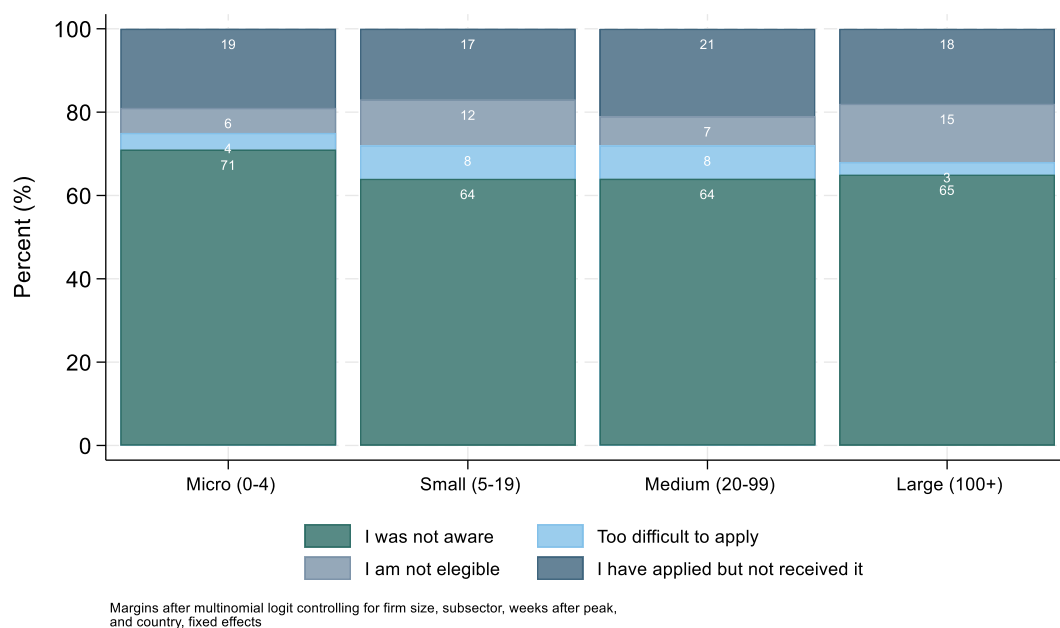


Source: World Bank. staff calculation using BPS data

Note: Average predicted probability from Probit estimations that control for size, sector, and round of the survey. Computations use sampling weights.

62. **Among the reasons cited by firms for not accessing support, lack of awareness was the biggest barrier cited among firms of all sizes.** Unawareness of available support programs was the predominant obstacle for businesses of all sizes, particularly among micro firms, in accessing state-sponsored assistance (Figure 24). A striking 71 percent of micro firms cited unawareness as the main hurdle, compared to 64 percent of small and medium firms and 65 percent of larger firms. The second most frequently reported challenge was applying for but not receiving policy support.

Figure 24: Reasons for not accessing business support programs in the Kyrgyz Republic (across firm size groups): 2020-2022 period



Source: World Bank. staff calculation using BPS data

Note: Average predicted probability from Probit estimations that control for size, sector, and round of the survey. Computations use sampling weights.

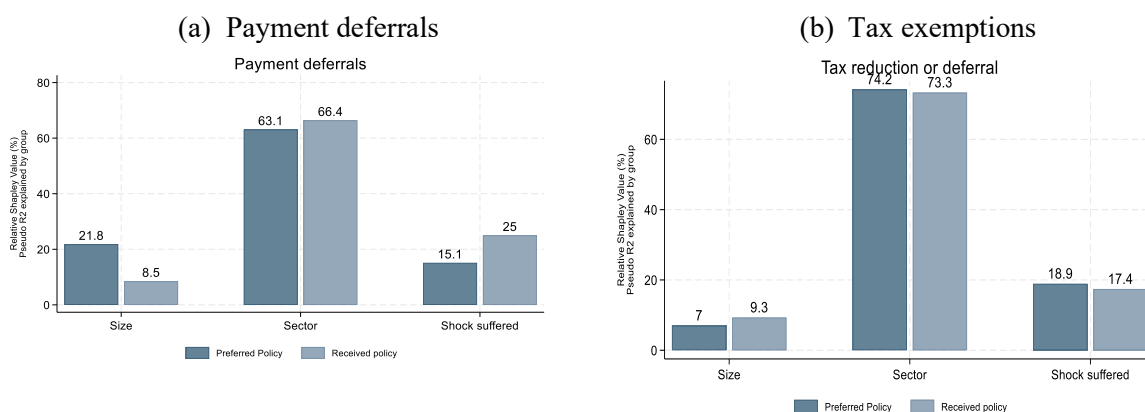
Match between Support Provided and Support Most Sought by Firms

63. **The survey can also shed light on whether the business support policies on offer matched what firms preferred.** In crisis and normal times, there might be a discrepancy between the support preferred by firms and the support received. This discrepancy can arise from several factors: available policies may be limited by a country's fiscal space or government preferences; complex or non-transparent application processes might deter firms from seeking public aid; and, unlike stating preferences, receiving support requires budgetary trade-offs. To shed light on these issues, a first take on the data suggests that among firms that received support, deferral of credit payments was the most common, followed by tax deferrals in 2020. In comparison, in 2020, most preferred type of support were fiscal exemptions and payment deferrals (see Tables A1 and A2 in the Annex). To complement these findings, an econometric analysis examined any potential mismatch between firms' preferred policies and the support they accessed. This exercise is instrumental because pinpointing the causes of the discrepancies between the demand for policy support provides insights that can be used to tailor support mechanisms more closely to firms' actual needs and preferences. The analysis utilized a Shapley decomposition method to identify which variables most significantly influenced whether firms sought or

received support. The results of this decomposition exercise are normalized to 1.²⁰ More details on the methodology applied can be found in the Annex.

64. Overall, results reveal a discernible, albeit potentially minor, mismatch in the support received by firms in the Kyrgyz Republic in the period under analysis. Notably, payment deferrals and fiscal exemptions, which include measures like tax reductions or deferrals and are the most accessed programs (Figure 25), were not the preferred support options for the recipient firms.²¹ The mismatch is predominantly attributed to differences in firm size and, to a lesser extent, the nature of the economic shock it has experienced. This highlights the need to comprehend the varying requirements of firms based on their size more thoroughly, particularly emphasizing the unique needs of SMEs to tailor policies more effectively to their needs.

Figure 25: (Mis)match between demand for and support received by businesses in the Kyrgyz Republic: 2020-2022 period (Shapley decomposition results)



Source: World Bank. staff calculation using BPS data (wave one only)

Note: Results from Shapley-Owen decompositions show the proportion of the R-squared (Pseudo R-squared) explained by different groups of variables in the Probit regression to identify the variables that contribute the most to explaining differences in preferences and access to policy.²²

Targeting of Business Support Programs

65. Determining whether the firms most affected by an economic shock received any form of government support is essential for evaluating the efficiency of public spending. In a moment of economic crisis, many support policies are supposed to be universal, allowing any firm to apply regardless of their level of impact. However, assessing whether the support effectively reached the most

²⁰ Since the question of policies demanded were only asked in wave 1 the Shapley decomposition results only use data from wave 1, i.e., August-September 2020. Absolute values of pseudo-R-squared vary by regression. Shapley values do not indicate the direction of the effect, but rather identify which groupings of variables contribute the most to explaining differences in both preferences and access to policy.

²¹ It is important to note that Shapley's values do not indicate the direction of the effect but rather highlight the factors that contribute the most. The larger the difference between the 'preferred policy' and 'received policy' bars, the more significant the mismatch between the supply and demand for policy support. The categories of 'size/sector/shock suffered' reveal the primary sources of mismatch, as indicated by the extent of the gap.

²² We first ran a Probit model with the dummy for each type of policy instrument (tax support, payment deferral, and access to credit) as the dependent variable (as preferred or received), controlling for size, sector, shock reported by the firm (e.g. supply, demand, or both). We then ran the Shapley decomposition to estimate the relative contribution of each regressor. We normalized the results to 1, after excluding the contribution of country fixed effects. Absolute values of Pseudo R-squared vary by regression. Computations use weights equal to the inverse of the number of observations in each country.

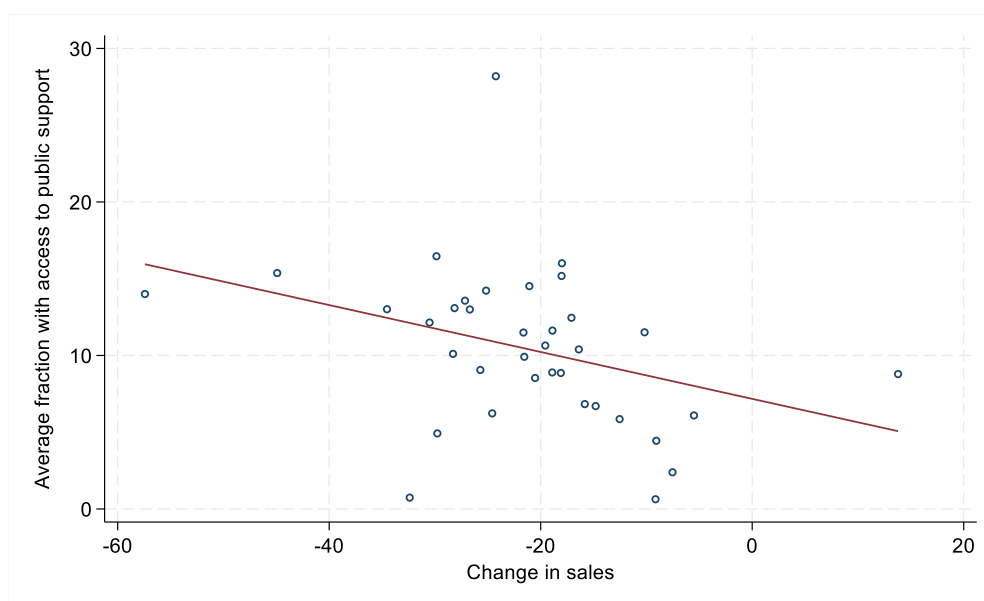
severely impacted firms is crucial. This assessment is particularly important for optimizing the allocation of public funds, especially in the context of limited fiscal space.

66. **The review of government support measures in the Kyrgyz Republic in the 2020-2022 period highlights a complex picture of effectiveness in targeting.** There's a clear trend at the sector level: sectors experiencing more severe sales declines were more likely to receive aid (Figure 26, panel a). This suggests a targeted approach to supporting the most affected sectors. However, a closer look at individual firms reveals inconsistencies that might indicate misalignment in support allocation.²³ Notably, the likelihood of getting public support didn't vary significantly among firms impacted by different economic disruptions—12 percent for those with demand shocks, 15 percent for supply shocks, and 12 percent for experiencing both. Interestingly, a small portion of firms that didn't report any pandemic-related impacts (10 percent) or decline in sales (13 percent) also received government aid (Figure 26, panel b).

67. **Yet, in comparison to other regions, the Kyrgyz Republic's targeting seems relatively effective, especially when compared to the higher rates of misalignment observed in regional peers, such as Uzbekistan, and globally.** For instance, Cirera et al. (2021)²⁴ reported that globally, about 20 percent of firms unaffected by the pandemic still received support, whereas in Uzbekistan, this figure was notably higher at 41 percent. This comparative analysis highlights the Kyrgyz Republic's relatively better precision in distributing aid amidst the pandemic.

Figure 26: Targeting of business support programs deployed in the Kyrgyz Republic: 2020-2022 period

(a) Scatterplot of (sector average) sales change and (sector average) access to support measures

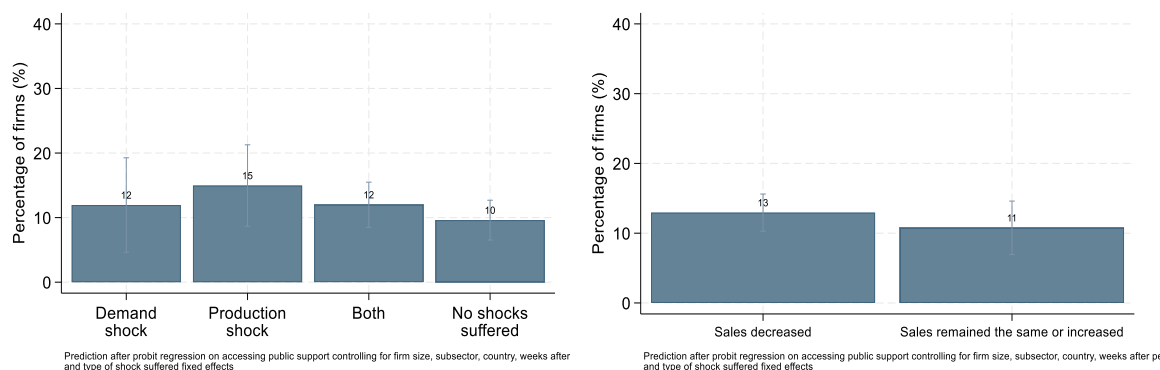


Source: World Bank staff calculation using BPS data. Note: these are binned scatterplots, and each represents a particular sectoral average.

²³ The BPS dataset includes a variable that differentiates firms based on whether they have encountered a demand shock (such as a decrease in demand) or a supply shock (including closed premises, labor shortages, or lack of inputs) from those that have experienced at least one of these issues.

²⁴ Cirera, X., M. Cruz, E. Davies, A. Grover, L. Iacovone, J. E. L. Cordova, D. Medvedev, F. O. Maduko, G. Nayyar, S. Reyes Ortega, and J. Torres. 2021. "Policies to Support Businesses through the COVID-19 Shock: A Firm Level Perspective." World Bank Research Observer 36 (1): 41–66.

(b) Probability of receiving business support measures in the Kyrgyz Republic in 2020-2022 period: by the magnitude of the shock suffered.



Source: World Bank staff calculation using BPS data

Note: Average predicted percentage of firms that received public support from separate probits that control for size, sector, country, and wave, in addition to fixed effects for the type of shock reported (including no shock). Sampling weights were used. Only wave one data (for 1000 firms) was used for this graph since the shock variables were only available for this sample subset.

Conclusions

68. **The evaluation of the Kyrgyz Republic's business support initiatives during 2020 to 2022 yields valuable insights into the government's approach to business assistance.** The analysis, while anchored in the specific context of 2020 to 2022—a period beset by various economic shocks—retains its relevance for two reasons. First, the potentially distortive effects of the support programs initiated during this era may have enduring impacts on the economy. Second, the patterns observed in this period in terms of scope, reach, and targeting of these initiatives likely reflect the Government of the Kyrgyz Republic's (GoK) ongoing strategy for business support, indicative of deep-seated systemic practices. This accentuates the importance of this analysis in pinpointing and addressing these persistent challenges. Likewise, the analysis seeks to contribute to refining public financial management and developing more effective future support programs.

69. **Drawing on Business Pulse Survey data, the study examined the extent of government aid, its alignment with business needs, and the precision of targeting firms impacted by the crisis.** The findings reveal a constrained scope of aid, with SMEs more frequently benefiting from measures such as payment deferrals and fiscal exemptions. A significant obstacle to accessing support was a general lack of awareness among businesses of all sizes. Additionally, the analysis identified a noticeable mismatch between the support firms desired and what they received, suggesting opportunities for policy refinement. Although aid targeting demonstrated effective sector-level alignment, firm-level nuances indicated instances of mistargeting, with some unaffected firms also receiving aid. However, in regional and global comparison, the Kyrgyz Republic's targeting of business support during the pandemic was effective, displaying better alignment than in other regional peers.

70. **The analysis identifies several areas for improvement in the design and administration of business support programs.** First, targeting accuracy needs to be enhanced. The insights into the programs' scope and breadth emphasized the importance of developing sophisticated mechanisms to identify and support the neediest firms, ensuring that public spending efficiently achieves its economic stabilization and recovery objectives.

71. **Second, addressing mismatches between the support sought by firms and the support provided is crucial.** This stresses the importance of adjusting program criteria, application processes,

and outreach strategies to enhance the accessibility and relevance of support measures, focusing on understanding and tailoring policies to the unique needs of SMEs.

72. **Third, the analysis underscores the need to strengthen accountability and transparency in public spending.** The findings from the assessment emphasize the importance of greater scrutiny and public discourse on government support allocation to improve the governance of public resources.

73. **More fundamentally, establishing a centralized oversight mechanism is important to ensure the effective administration of business support programs in the Kyrgyz Republic.** Currently, the Ministry of Economy is responsible for granting subsidies to state-owned enterprises (SOEs) and private-sector entities. However, the absence of a comprehensive inventory of business support programs, a formal definition of state aid, and formalized rules for the notification, approval, and provision of subsidies or incentives pose significant challenges. Moreover, the lack of clear criteria for awarding such subsidies or incentives, including the specification of exceptions under which state aid is permissible, further complicates the process. Addressing these issues is crucial for ensuring transparency, preventing market distortions, and fostering fair competition. Establishing a robust framework for oversight will also facilitate the evaluation of the effectiveness of these programs and their alignment with broader economic objectives.

Annex: Further Methodological Details

74. **The analysis draws from the Business Pulse Survey (BPS) survey conducted in the Kyrgyz Republic.** The BPS, conducted in more than 40 nations, including the Kyrgyz Republic, was originally designed to gauge the effects of the COVID-19 crisis on the private sector. It offers a representative snapshot of formal private enterprises of all sizes—micro, small, medium, and large—across diverse industries such as agriculture, manufacturing, retail, services, and construction. The BPS data encompasses vital facets of business performance, including sales revenue, cash flow, employment changes, and technology adoption. Notably, the survey gathers details on business support programs, capturing preferences for assistance, the extent of aid received from local or national governments, and the reasons for any lack of support. This rich dataset facilitates an evaluation of both the demand for policy intervention and the extent of governmental assistance provided to private entities amid the economic disturbances caused by the pandemic. In the Kyrgyz Republic, the BPS was administered in three waves: August-September 2020 with 1,886 participants, May-July 2021 with 1,008 participants, and March-May 2022 with 1,017 participants. Consequently, the data offers a comprehensive snapshot that not only encompasses the pandemic period but also includes the immediate aftermath of the Russian invasion of Ukraine, which began in February 2022.

Drawing from this dataset, the analysis aims to answer three questions.

i) What is the proportion of firms that received support? To answer this, the analysis estimated the average predicted probabilities of firms receiving support conditional on several attributes. These come from probit estimations that control for size, sector, and round of the survey. Computations use sampling weights. The regression equation used is as follows:

$$Y_i = \alpha + \beta W_i + \delta n + \delta g + \delta t + e_i$$

where Y_i is a dummy variable that denotes if firm i received government support or not, δn and δg denote size and sector fixed effects and δt denotes the survey round.

ii) Was there any mismatch between demand and support received by businesses? Following the approach adopted by Cirera et al. (2021), the analysis unfolds in two stages. Initially, a probit model is estimated for each policy instrument type (payment deferrals, tax exemptions, wage subsidies, and access to credit), incorporating controls for size group, sector of activity, and the shock reported by the firm (e.g., supply, demand, or both), along with country fixed effects. Notably, the BPS questionnaire enables the capture of two types of economic shocks: a demand shock (reduction of sales) and a supply shock (an increase in the price of production factors). Following the estimation of the probit model, the second stage involves conducting a Shapley decomposition to gauge the relative contribution of each regressor variable (size, sector, and type of shock).

iii) Was there any mistargeting (i.e., firms that received support were the ones that suffered the most of economic shocks from COVID-19 and the Russian invasion of Ukraine)? To shed light on the relationship between the type and magnitude of shock experienced by firms during the 2020-2022 period and their access to public support, the analysis estimated the average predicted percentage of firms that received public support from separate probits that control for size, sector, country, and round of the survey, in addition to fixed effects for the type of shock reported (including no shock). Computations use sampling weights.

Table A1. Specific business support policies received by firms in the Kyrgyz Republic (2020)

Grants	Payment Deferrals	Deferral of credit payments	Access to new credit	Loans with subsidized interest rates	Fiscal exemptions	Tax deferrals	Wage subsidies	Other forms of support
0.00%	12.57%	50.45%	3.49%	0.32%	1.03%	37.36%	0.00%	11.50%

Table A2. Most preferred business support programs by firms in the Kyrgyz Republic (2020)

Grants	Payment Deferrals	Access to new credit	Fiscal exemptions	Wage subsidies	Other forms of support
12.32%	27.39%	21.01%	41.16%	1.99%	17.65%