

Kyrgyz Republic

Economic Update
No.1 | Spring 2015

Adjusting to a Challenging Regional Economic Environment



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**Macroeconomics
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Kyrgyz Republic:

Adjusting To a Challenging Regional Economic Environment

Kyrgyz Republic Economic Update No. 1

Spring 2015

Government Fiscal Year: January 1 – December 31
Currency Equivalents: Exchange Rate Effective as of April 13, 2015
Currency Unit = Kyrgyz Som (KGS)
US\$1 = 63.8680 KGS
Weights and Measures: Metric System

Abbreviations and Acronyms

EEU	Eurasian Economic Union
FDI	Foreign direct investment
GDP	Gross domestic product
LFPR	Labor force participation rate
LFS	Labor Force Survey
NBKR	National Bank of the Kyrgyz Republic
NSC	National Statistics Committee of the Kyrgyz Republic
VAT	Value added tax
pps	Percentage point
y-o-y	Year-on-year

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Foreword

World Bank economic reports on the Kyrgyz Republic are published every six months. This report was prepared by Bakyt Dubashov (Economist) with contributions from Saida Ismailakhunova and Aibek Baibagysh Uulu (both Poverty Economist). The report benefited from the guidance of Aurelien Kruse (Senior Economist) and Naoko Kojo (Senior Economist). Sarah Babirye and Zakia Nekaien-Nowrouz (Program Assistants) formatted the report.

*Miria A. Pigato
Practice Manager
Macroeconomics and Fiscal Management
Global Practice*

Overview

Growth in the Kyrgyz Republic slowed significantly in 2014, reflecting the deteriorating external environment and supply-side constraints. Economic growth fell to 3.6 percent in 2014 from 10.9 percent in the previous year, partly because exports to Russia and other neighboring countries plunged. Re-export businesses were affected as the Eurasian Economic Union (EEU) began to exercise stricter border control on goods imported from third countries. On the supply side, lower production at the Kumtor gold mine and a poor harvest due to adverse weather also depressed growth. The fall of the Russian ruble and the Kazakh tenge led to a significant depreciation of the Kyrgyz som, which together with increases in energy tariffs drove inflation up from 4 percent in 2013 to 10.5 percent in December 2014. Although export growth was negative (–6.4 percent), imports declined even more (–7.2 percent), which—together with lower income outflows—helped to reduce the current account deficit from 15 percent in 2013 to 13.7 percent of GDP. The current account deficit was financed by borrowing and foreign direct investment (FDI). On the fiscal side, slower growth affected tax revenues, which were essentially flat at 25.3 percent of GDP but non-tax revenues went up by over a percentage point of GDP, to 6.7; together with grants, that brought total revenues to just under 35 percent of GDP. Meanwhile, a significant expansion of public investment spending brought the deficit to an estimated 4.1 percent of GDP in 2014, up from 3.9 percent in 2013, in spite of less spending on recurrent outlays. Higher spending and the depreciation of the som translated into a significant increase in public debt, from 46.1 percent of GDP in 2013 to 53 percent for 2014. Job creation was stagnant. Poverty remained high: the most recent (2013) national estimates are absolute poverty 37.0 percent and extreme poverty 2.8 percent.

Macroeconomic policy sought to mitigate the impact of the som’s depreciation. The som has lost 22.4 percent of its value against the U.S. dollar since July 2014 despite heavy central bank intervention to smooth volatility in the foreign exchange market. To curb inflation and credit growth, the National Bank of the Kyrgyz Republic (NBKR) tightened its monetary stance by increasing the interest rate from 6 percent in late June 2014 to 11 percent in December 2014. Prudent monetary policy has been supported by fiscal measures to curb growth in recurrent spending while prioritizing public investment, mainly in the energy and road sectors.

In 2015 economic growth is projected to be anemic but to recover slowly thereafter. With remittances expected to decline further and external demand to remain weak, growth is projected to decline to 1.7 percent in 2015. Assuming that external demand for Kyrgyz goods and labor recovers, growth is expected to pick up to 4 percent in 2017, supported by fiscal consolidation. While the deficit is likely to expand to 7.6 percent of GDP in 2015 because of higher public investment, a reduction in non-investment spending should help bring the deficit back to about 4 percent of GDP in 2017. In 2016, when public debt is expected to peak at 62 percent of GDP, it should begin to decline as a share of GDP. However, the risks to this outlook are significant. A protracted slowdown in Russia and in the region will reduce remittances and put further pressures on the exchange rate and prices. Domestically, political institutions that are still evolving may limit the ability of the government to implement reforms. The parliamentary elections in October 2015 might also delay some reforms. Taken together these factors may cloud the growth outlook and jeopardize poverty reduction gains.

A. Recent Political Developments

Although the political situation remains fluid, core public management functions have been protected. In the year since April 2014, when the current government was approved by parliament, a number of key ministers have resigned, among them the ministers of energy, education, health, and justice. The government has nevertheless managed to maintain a normal workflow and make progress on its policy agendas.

The Kyrgyz Republic is moving to integrate with the EEU, whose members are Russia, Kazakhstan, Belarus, and Armenia. The Kyrgyz government has signed an agreement to become a member in May 2015. The agreement is intended to deepen economic integration with the EEU member countries through free movement of goods, services, capital, and labor within the EEU. While greater regional integration should create growth opportunities for the Kyrgyz economy in the medium and long term, there are likely to be short-term difficulties.

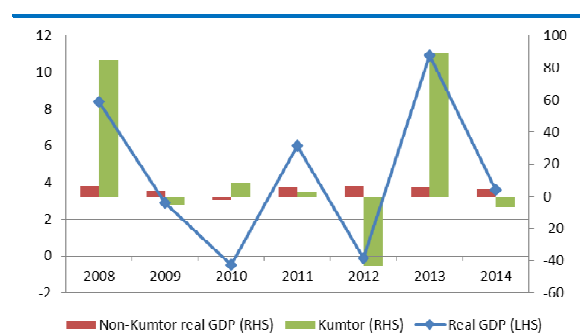
B. Recent Economic Developments

Economic Growth

Economic growth moderated in 2014 due to slack external demand, lower production at the Kumtor gold mine, and a poor harvest. Real GDP growth declined to 3.6 percent year-on-year (y-o-y) in 2014 from 10.9 percent (y-o-y) a year earlier mainly as a result of the economic slowdown in Russia. Kumtor gold production was lower by about 6 percent than a year ago although it was in line with the announced goal of 550,000–600,000 ounces of production. Adverse weather pushed down agricultural yields by 0.6 percent (y-o-y), further reducing economic output (Figure 1).

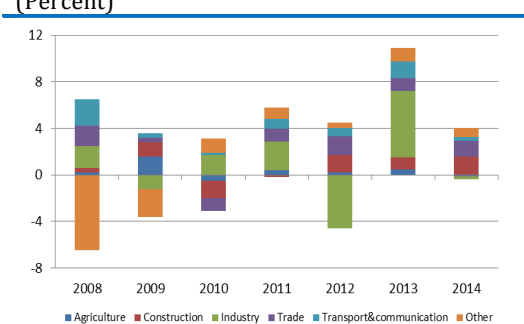
Non-gold economic growth was driven by construction and the services sector. Real GDP excluding gold grew at 4.6 percent (y-o-y) in 2014, slower than the 6.1 percent (y-o-y) of a year earlier. As in previous years, construction and trade continued to perform strongly, the former growing at 24.9 percent (y-o-y) and the latter at 8.3 percent (y-o-y). In addition, transport grew at 2.9 percent and communications at 5 percent (Figure 2).

Figure 1. Real GDP Growth, 2008–14
(Percent)



Source: National Statistics Committee.

Figure 2. Contribution to Growth by Sector, 2008–14
(Percent)



Source: National Statistics Committee.

On the demand side, growth was driven by investment, but consumption growth was feeble, and growth in net exports was negative. Higher public investment spending, mainly financed by foreign sources, and private investment in the construction sector led growth in 2014, but stagnant remittances and moderate wage growth depressed consumption. Although this also contributed to lower imports, a parallel decline in exports accounted for the negative net contribution of trade.

The slowdown in Russia and a weakened ruble depressed exports to and remittance flows from Russia in 2014. Kyrgyz exports to Russia in U.S. dollar terms are estimated to have fallen by 20 percent (y-o-y) mainly because of the economic slowdown in Russia. Remittances also declined in dollar terms, by 3 percent (y-o-y) in 2014, after having grown 8 percent in 2013, though the main reason was not so much lower volumes as exchange rate effects.

Tensions with neighboring countries also affected economic activity. Tighter customs control at the Kazakh-Kyrgyz border (in line with EEU requirements) and border closures with Tajikistan due to border disputes adversely affected trade and reduced the incomes of small and medium businesses.

However, the Kyrgyz economy grew significantly in the first two months of 2015, thanks to recovery in the gold sector. Preliminary data suggest that real GDP grew by 9.5 percent (y-o-y) in January and February as the production of the Kumtor gold mine went up by 68 percent, y-o-y. However, the non-gold economy grew at just 3.8 percent (y-o-y) because of slower growth in investment and, on the supply side, a contraction of non-gold industrial output (-2.6 percent, y-o-y) and slower growth in construction (12.2 percent, y-o-y, from 46.5 percent a year before).

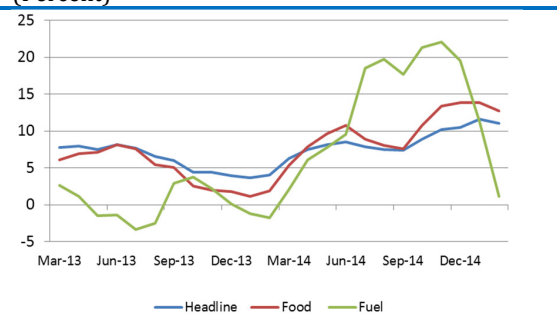
Inflation

Inflation surged as domestic prices adjusted to a weakening of the Kyrgyz som against the U.S. dollar. Annual inflation reached 10.5 percent in December 2014, up from 4 percent a year earlier. The som depreciation affected expectations, possibly triggering second-round effects. In addition, the decision to join the EEU increased demand for durable goods, sending their prices up.

Though retail gasoline prices declined slightly, higher tariffs for electricity and heating also fueled inflation. As part of the energy reforms, the government raised those tariffs for both households and businesses by an average of about 27 percent in September 2014. At the same time, a decline in global oil prices helped to bring down fuel inflation (Figure 3).

Inflation problems continued into 2015. A further fall of the som against the U.S. dollar pushed inflation to 11.5 percent in January. However, there was some moderation in February, most likely in response to tightened monetary conditions.

Figure 3. Inflation, March 2013–December 2014 (Percent)



Source: National Statistics Committee.

Balance of Payments

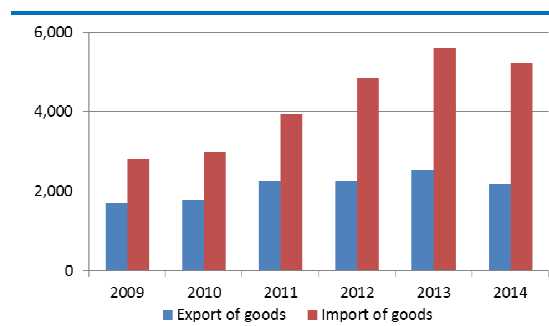
The external trade environment deteriorated. Trade in the second half of 2014 was disappointing. Weakening in the economies of the main trade partners dampened demand for Kyrgyz products, stricter border controls affected re-export businesses, and international gold prices fell. As a result, total exports in U.S. dollar terms dropped by 6.4 percent in 2014 and imports by 7.2 percent (Figure 4).

Trade with Russia contracted. Kyrgyz exports to Russia declined by 20 percent in 2014, mostly because of less demand for Kyrgyz textiles, agricultural products, glass, and spare parts for machines and equipment. Imports from Russia also declined: oil imports in particular fell as tariff harmonization across the Kyrgyz Republic and Tajikistan made re-export of oil unprofitable.

Stricter border control with EEU countries discouraged re-export businesses. Trade activities in Dordoi and Karasuu markets—once wholesale hubs for the region—are winding down, leading to fewer jobs in the services sector.

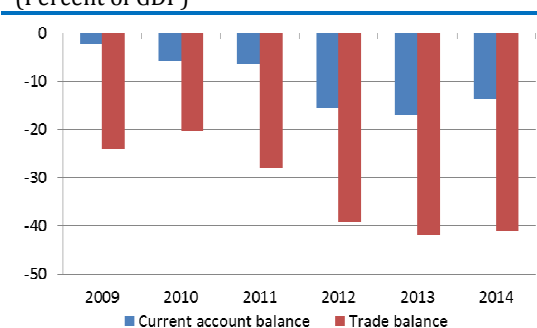
Adverse terms of trade developments affected revenues from gold exports. Although gold exports increased in volume by 6 percent y-o-y, their value fell by close to 3 percent in U.S. dollar terms as world prices fell.

Figure 4. Exports and Imports, 2009 – 14
(US\$ Millions)



Source: NBKR.

Figure 5. Trade and Current Account Balances, 2009–14
(Percent of GDP)



Source: NBKR.

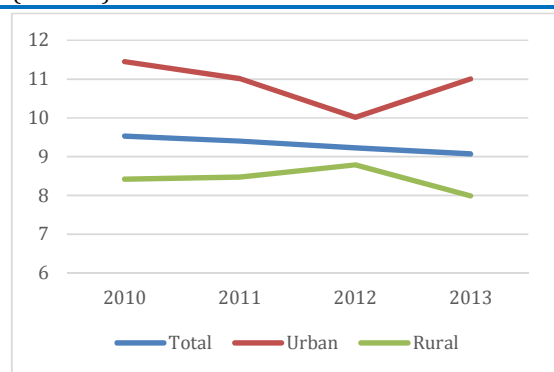
With imports declining faster than exports and lower income outflows, the current account deficit shrank. The trade deficit declined from 41.8 percent of GDP in 2013 to 40.9 percent in 2014. This, along with less income flowing in, led to a decline in the current account deficit from 15 percent of GDP in 2013 to 13.7 percent (Figure 5). At the same time, the services balance deteriorated, mainly because transport services provided to Kyrgyz residents by foreign companies increased. In addition, lower remittances more than offset higher public grant support, leading to a fall in transfers from 31 percent of GDP in 2013 to 29.1 percent of GDP.

The current account deficit was financed by external borrowing and FDI. Intensive work on public investment projects was accompanied by substantial state borrowing (5.5 percent of GDP, up from 2.5 percent in 2013). Moreover, higher borrowing by the private sector brought total borrowing to 8.3 percent of GDP in 2014, up from 2.7 percent in 2013. However, FDI inflows declined from 8.7 percent of GDP in 2013 to 2.8 percent in 2014 (US\$626 million in 2013 vs US\$211 in 2014).

Employment and Labor Markets

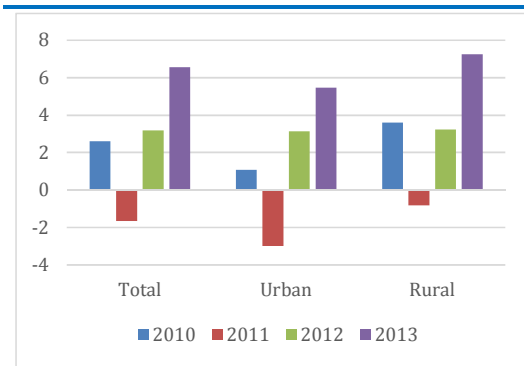
Labor market trends are negative. In the last four years growth of the labor supply¹ (employed and unemployed) has been declining. From 2012 to 2013 the labor supply contracted by 0.5 percent, mainly because the urban labor force went down by about 1 percent. The reduction in the labor supply was associated with increasing inactivity: in 2013, the number of those in the labor market who were inactive went up by 6.6 percent, mostly in rural areas (Figure 6). According to recent estimates the inactivity ratio (number of inactive workers to the adult population) went from 35 percent in 2012 to 37 percent in 2013 (Figure 7).

Figure 6. Domestic Unemployment Rate, 2010–13
(Percent)



Source: National Statistics Committee, LFS.

Figure 7. Growth of Unemployment, 2010–13
(Percent)



Source: National Statistics Committee, LFS.

A growing share of those working are self-employed. In 2013 about 40 percent of workers were self-employed and only 30 percent were wage-earners. While the share of self-employed slightly declined from 2012 (42 percent) the long-term trend is for more individual employment and growing informality—work outside of enterprises or without a formal job contract. In 2013, 70 percent of employment was informal.

There are gender differences in labor supply. The labor force participation rate (LFPR) for men is higher than for women by more than 20 percentage points (pps). The LFPR has been declining slightly for the last four years, particularly for women. In 2013, the female LFPR declined by 2 pps, indicating that women face constraints in the labor market on both the supply and demand sides.

Average monthly wages have gone up in recent years, but not enough to discourage emigration for employment. According to official statistics, the average monthly wage in 2014 was US\$231.8. The average in the private sector was 1.7 times higher than in the public sector. In sectors where Kyrgyz emigrants typically work, wages tend to be twice as high abroad as domestically.

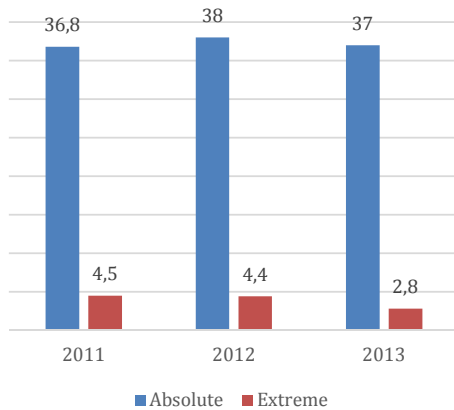
Poverty

With economic growth low, poverty is high and stable. The 2013 national poverty estimates were absolute poverty of 37 percent and extreme poverty of 2.8 percent. That was a decline of about 1 pp

¹ The estimates are based on LFS collected by NSC and carried out using NSC's individual weights, excluding workers reporting work abroad.

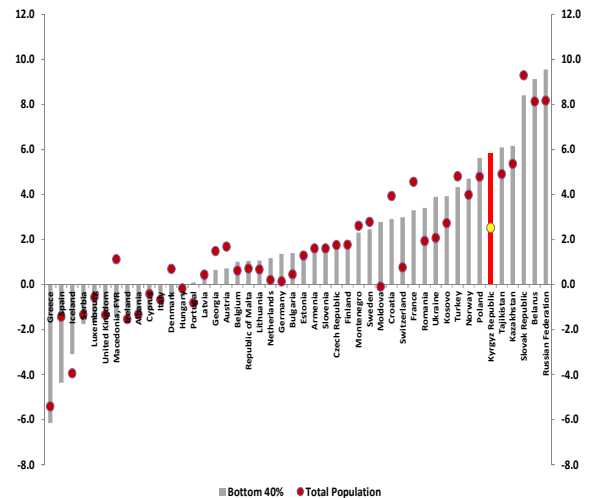
from 2012 but an increase relative to 2011 (Figure 8). In 2013, about 2.14 million people (of 5.7 million total) were still below the poverty line of 27,768.5 soms.² However extreme poverty seems to have decreased by 1.6 pps from 2012. In absolute terms, about 159,000 people cannot afford a minimum basket of food, which is estimated to cost about 16,249.10 soms.

Figure 8. Absolute and Extreme Poverty Rates, 2011–13
(Percent of Population)



Source: National Statistics Committee, 2014,

Figure 9. Consumption of the Bottom 40 Percent, Europe and Central Asia
(Percent)



Source: ECAPOV and EUSILC data.

Poverty is responsive to GDP trends in that episodes of economic growth are correlated with poverty reduction and with faster growth in the consumption of the bottom 40 percent. Despite volatility in economic growth, private consumption has grown fairly steadily, which may explain the lack of large swings in poverty in 2011–13. During that time, average consumption growth for all households was 2.5 percent but the growth rate for the bottom 40 percent had been about 6 percent in 2006–11 (Figure 9).

For 2010–13 the labor market was the most important factor in reducing poverty in the Kyrgyz Republic. Labor market earnings and pensions were responsible for about 7 pps of the reduction in poverty, making them the largest factors, with remittances contributing another 1 pp. Though most remittances went to just 15 percent of the population, their growth fueled expansion of the nontradables sector and employment growth in low-skilled occupations like construction and services.

Convergence in rural and urban poverty rates was reversed in 2013, mainly because of a plunge in urban poverty. Since 2004 the gap between rural and urban poverty rates had been narrowing, but in 2013 it widened as rural poverty went up 1.8 pps, to 41.4 percent of the rural population, and urban poverty dropped by 7 pps, to 28.5 percent of the urban population. This

² The poverty line was calculated using the “cost of basic needs” approach in 2011 and inflated to account for price changes in 2012 and 2013. Thus, the poverty lines are in nominal Kyrgyz soms.

dynamic underlines the annual volatility of regional poverty rates, and the possible direct link between rural poverty rates and growth in the agriculture sector. The poverty rate based on the extreme poverty line in urban areas went down from 4.2 percent in 2012 to 1.6 percent in 2013, perhaps in part because food prices were largely unchanged. Rural extreme poverty continues to decline.

The poverty gap ratio went down in 2012–13, which suggests that the poor have become better off. The ratio shows how far the consumption per capita of the poor lies below the poverty threshold. In 2012–13 the poverty gap narrowed by 0.7 pp and the poverty severity index (the squared poverty gap) eased by 0.4 pps in 2012–13, indicating that inequality among the poor and the depth of poverty are both decreasing. The gap for food poverty was close to zero.

C. Economic and Structural Policies

Fiscal Developments

The deficit widened in 2014 mainly because of higher capital spending. Though tax revenues grew marginally as a share of GDP, higher non-tax revenues and greater grant support pushed up total revenues by 1.3 pps of GDP in 2014. Current expenditures fell slightly, by 0.6 pps, as a share of GDP as the government maintained controls over purchases of goods and services and froze most public wages. Meanwhile, capital spending, mainly on foreign-financed public investment projects, increased significantly, by 1.4 pps of GDP. As a result, the deficit, including grants, widened to an estimated 4.1 percent of GDP in 2014, up from 3.9 percent in 2013. Public debt went up from 46.1 percent of GDP in 2013 to 53 percent at the end of 2014.

Tax revenues were almost flat at 25.3 percent of GDP in 2014, due to both less domestic activity and lower imports. Slower growth affected income tax and VAT receipts, though excise revenue went up due to higher rates on tobacco and gasoline and diesel. Corporate and personal income taxes remained flat, but slightly higher tax payments from Kumtor (1.2 percent of GDP in 2014 vs 1 percent in 2013) increased total 2014 income taxes to 4.9 percent of GDP from 4.8 percent a year earlier. VAT revenues declined by 0.2 pps, to 8.2 percent of GDP, but revenues from the excise tax went up from 1.2 percent of GDP in 2013 to 1.6 percent.

Minimal growth in tax revenues was counterbalanced by higher non-tax revenues and grants. Non-tax revenues went up from 5.6 percent of GDP in 2013 to 6.7 percent in 2014, as the Megacom company, one of the largest providers of mobile connections, paid dividends accumulated over last three years, following a court decision that recognized government ownership. The government also received more grant support from both Russia and China based on economic cooperation agreements.

Total expenditures went up from 37 percent of GDP in 2013 to 38.8 percent in 2014 based on more capital spending. Capital spending went up from 7 percent of GDP in 2013 to 8.4 percent because more intensive work related to construction of the North-South alternative road, building the new Datka-Kemin power transmission line, and rehabilitation of the Bishkek thermal plant led to faster disbursement of donor support and loans from China. The government's own capital spending also increased, in part due to co-financing of donor projects and increased construction and rehabilitation work on water irrigation systems and road repair.

Meanwhile, current spending fell slightly as wages and social expenditures remained flat and purchases of goods and services declined as a share of GDP. Current spending went down from 30.1 percent of GDP in 2013 to 29.5 percent in 2014 thanks to slower growth in the wage bill, social expenditures, and purchases of goods and services. Despite a wage increase for some public employees (law enforcement and judiciary), the wage bill remained constant as a share of GDP (7.8 percent); transfers and social spending (including Social Fund expenditures) declined by 0.2 pps to 12.6 percent of GDP; and purchases of goods and services declined by 0.5 pps to 8.2 percent of GDP.

Table 1. General Government Budget
(Percent of GDP)

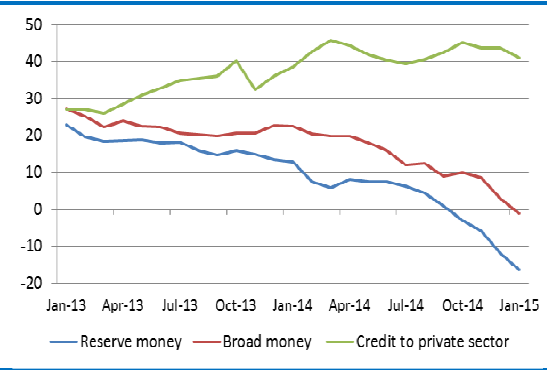
	2013	2014
Total revenues and grants	33.4	34.7
Total revenues	31.0	32.2
Current revenues	30.8	32.1
Tax revenues	25.2	25.3
Income taxes	4.8	4.9
VAT	8.5	8.2
Excises	1.2	1.6
Customs	3.3	3.5
Land tax	0.2	0.2
Sales tax	1.8	1.8
Social Fund (excl. government contribution)	4.7	4.5
Other	0.6	0.5
Non-tax revenues	5.6	6.7
Capital revenues	0.2	0.1
Grants	2.4	2.5
Program grants	1.6	2.0
PIP grants	0.8	0.6
Total expenditure (incl. net lending)	37.0	38.8
Current expenditure	30.1	29.5
Wage	7.8	7.8
Transfer and subsidies	3.5	3.4
Social Fund expenditures	9.3	9.2
Interest	0.8	0.9
Purchase of other goods and services	8.7	8.2
Capital expenditure	7.0	8.4
Domestically financed	2.0	2.3
PIP loans	4.1	5.6
PIP grants	0.8	0.6
Net lending	-0.1	0.8
Overall balance	-3.9	-4.1
Financing	3.9	4.1
External	5.1	5.6
Domestic	-1.2	-1.4

Source: Treasury report.

Monetary and Exchange Rate Policies

Rapid credit expansion and high inflation led to a tightening of monetary policy. Early in 2014, the NBKR moved from targeting monetary aggregates to directly setting the interest rate. The central bank has since raised the interest rate five times, from 6 percent in March 2014 to 11 percent in February 2015. Along with the sale of U.S. dollars in the exchange market, these decisions led to declines in the money supply of 1.2 percent (y-o-y) and in reserve money of 16.4 percent (y-o-y) in January 2015 (Figure 10). However, the effectiveness of the interest rate channel seems to have been limited, given high dollarization and a large percentage of cash transactions in the economy. Thus, credit growth is still high, although it did decline from 41 percent in 2013 to 37.4 percent in February 2015.

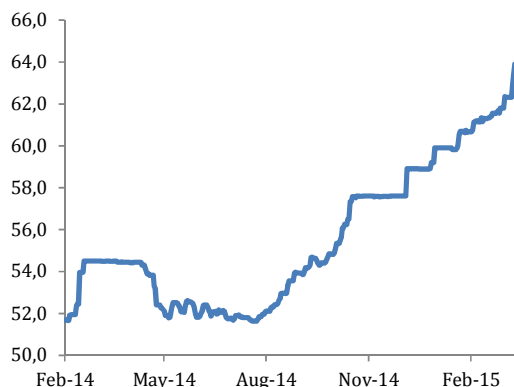
Figure 10. Money Supply and Credit Growth, January 2013-January 2015 (Percent)



Source: NBKR.

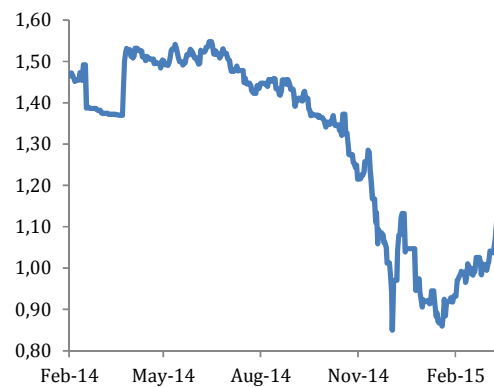
The NBKR has been struggling to relieve the pressure on the som. A further fall of the Russian ruble against the U.S. dollar in the second half of 2014 kept the som under pressure: since July 2014, it has lost 22.4 percent of its value against the U.S. dollar with the central bank selling US\$480 million in the foreign exchange market to ensure a smooth depreciation (Figure 11). However, this also made the som stronger against the ruble, worsening the already weak export performance (Figure 12). Overall, since July 2014 the som in real terms has appreciated by 12.5 percent as the effective nominal exchange rate have appreciated by about 10 percent and domestic inflation was higher than in trading partner countries (Figure 13).

Figure 11. Som-US dollar Exchange Rates, 2014-15 (Soms per US dollar)



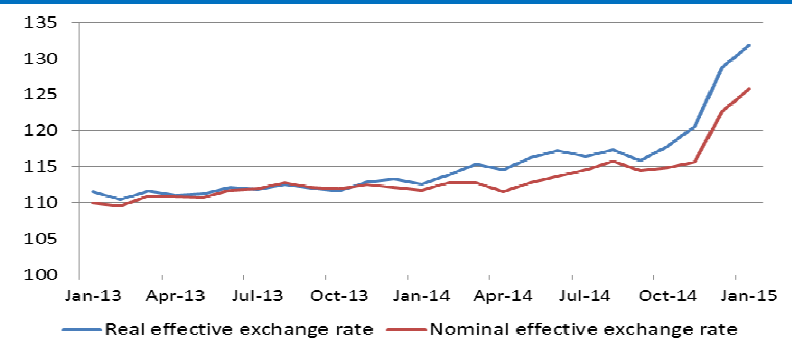
Source: NBKR.

Figure 12. Som-Russian Ruble Exchange Rates, 2014 - 15 (Soms per Russian Ruble)



Source: NBKR.

Figure 13. Nominal and Real Effective Exchange Rates, 2013 - 15
(index, 2000=100)



Source: NBKR.

International reserves are adequate. Despite the large NBKR sale of U.S. dollars in the second half of 2014, the Republic still has international reserves of US\$1.9 billion, equivalent to 3 months of imports. The reserves were replenished with official foreign inflows.

Financial sector indicators are still appropriate despite the economic slowdown. The capital adequacy ratio had declined to 22.2 percent as of January 31, 2015, from 24.7 percent a year earlier, but is still much higher than the 12 percent required. Profitability indicators—return on assets at 2.1 and return on equity at 14.9—are still sound. Moreover, nonperforming loans declined slightly to 4.8 percent from 5.6 percent a year earlier.

Structural Reforms

Some progress was made on public sector reforms though more effort is needed. After adoption of the public sector reform road map in May 2014, the government turned its attention to moving on the policy actions it identified to (1) increase coordination in anticorruption activities between government agencies and between the government and the court system; (2) revise the system of public services; (3) establish more professional management in the energy sector; and (4) adopt the new energy tariff strategy. While these are promising steps toward a more effective public sector, there is a long list of reforms remaining that covers the court system, public finance management, civil service, and the mining sector.

A new public procurement law that meets international standards has been enacted. The new law will remove loopholes in public procurement, decrease opportunities for corruption, and increase the value for money obtained from public funds.

Steps were taken to improve business regulation. Since the new law on licensing and permits was passed, regulations have been drafted to spell out the requirements for specific businesses, establish procedures for overseeing license holders, and introduce a licensing roster.

The Private Sector Development Strategy approved in February 2015 should give a new impetus to reforms. The strategy targets removal of impediments to business activities and improvements in the investment climate. It should also reinforce current reforms in the financial sector, such as introduction of credit registry systems, private-public partnerships, and inspections as part of regulatory reform.

The Kyrgyz Republic is moving to integrate into the EEU. With the Republic scheduled to join the EEU in May 2015, the government has accelerated adoption of legislative amendments and upgrading of customs and laboratory infrastructure. It has become necessary to amend customs tariffs and non-tariff regulations, the customs administration, technical regulations, and veterinary, sanitation, and phytosanitary standards. The amended laws and the new technical standards are expected to open up the EEU market for Kyrgyz producers. However, trade with non-EEU countries may be affected.

Despite progress in reforming the business environment, there are still areas of concern. According to a business survey by the Kyrgyz Trade Chamber in early 2015, the private sector cited corruption, interference of government bodies, and lack of protection for private property as the main obstacles to running a business.

D. Outlook

In 2015 growth is projected to moderate to 1.7 percent before rebounding in the following two years to 4 percent in 2017. Developments in Russia will continue to affect economic activities in the Kyrgyz Republic. With the Russian economy projected to contract by 3 percent in 2015, exports to Russia may stagnate and remittances decline by more than 15 percent from 2014. In the short term, accession of the Republic to the EEU is expected to create only limited opportunities, but growth is expected to pick up to 4 percent in 2017, assuming recovery of exports to Russia and other neighboring countries and growth of remittances to support domestic consumption.

Accession to the EEU could trigger gradual formalization of the economy. Kyrgyz companies wanting to export to the EEU market will be required to meet EEU standards and comply with stricter technical regulations. This should force some companies currently operating informally to regularize their activities, which would increase tax collections and improve labor market outcomes.

A relatively full pipeline of public investments and a healthy banking sector should support growth. Public investments in energy and communications are likely to remain strong over the next few years, especially with the start of construction of line D of the Central Asia–China gas pipeline, hydro power plant rehabilitation, and upgrade of road links, with financing secured from China, or multilateral agencies (World Bank, European Bank for Reconstruction and Development) and regional development banks (Asian Development Bank, Eurasian Development Bank). With a capital adequacy ratio above 20 percent, the banking sector is relatively well-placed to support businesses as opportunities emerge.

Inflationary pressures are expected to rise based on the som's depreciation against the U.S. dollar and the Republic's adoption of EEU trade tariffs. Assuming no significant increases in international food prices, average annual inflation is projected to rise to 10.8 percent in 2015 and then slowly decline to 7–8 percent by 2017. Relieving inflationary pressures will require that the authorities keep monetary policy tight and be steadfast in fiscal consolidation.

The current account deficit is expected to widen slightly over the medium term. Gold exports are expected to stay robust because prices are projected to be fairly stable at about US\$1,300 per troy ounce. Non-gold exports are likely to be limited by slower growth in main trading partners and gradual introduction of the EEU standards. However, easier access to EEU markets with a preferential transition period could help offset some of the negative impact. While lower re-exports will reduce imports, import-intensive infrastructure projects should be a countervailing influence. With Russian

growth likely to be about 0.3 percent over the medium term, private transfers are expected to remain stable.

The fiscal challenge over the medium term is to support growth while holding to a justifiable fiscal stance. While the deficit is expected to grow to 7.6 percent of GDP in 2015 due to higher public investment spending, in the medium term fiscal consolidation will involve reducing non-investment spending. The deficit is projected to decline to near 4 percent of GDP by 2017. After peaking at 62 percent of GDP in 2016, public debt should begin declining thereafter. However, that will be difficult because low growth lessens the prospects for increasing revenues.

External and domestic risks to this outlook are significant. A protracted slowdown in Russia and in the region would depress inflows of remittances and demand for Kyrgyz exports, which would add to pressures on the exchange rate and prices. Domestically, the challenging political environment may limit the ability of the government to implement reforms in an election year.

Annex 1. Economic and Social Indicators – Kyrgyz Republic 2010-2017

Selected Indicators	2010	2011	2012	2013	2014 Prel.	2015		2016		2017
						Projections				
Income and Economic Growth										
GDP (current LCU, billions)	220.4	286.0	310.5	355.3	397.3	438.4	486.3	541.2		
GDP (current US\$, billions)	4,793.5	6,199.0	6,605.1	7,333.0	7,398.0	7,368.0	7,429.4	7,949.5		
GDP Growth (% change, y-o-y)	-0.5	6.0	-0.1	10.9	3.6	1.7	3.2	4.0		
GDP Per Capita (US\$)	880	1,125	1,186	1,282	1,281	1,217	1,261	1,336		
Gross Investment (% of GDP)	28.1	24.0	26.1	26.2	26.9	28.4	29.2	29.6		
Public (% of GDP)	7.0	5.5	7.7	7.0	8.4	10.7	9.8	8.4		
Private (% of GDP)	21.1	18.5	18.5	19.0	18.5	17.6	19.4	21.2		
Money and Prices										
Inflation, Consumer Prices (% change, y-o-y, end of year)	19.2	5.7	7.5	4.0	10.5	11.2	7.0	7.0		
Inflation, Consumer Prices (% change, y-o-y, period average)	7.8	16.6	2.8	6.6	7.5	10.8	8.0	6.8		
Nominal Exchange Rate (LCU/US\$, end of period)	47.10	46.48	47.40	48.44	53.7					
Real Effective Exchange Rate Index (2000=100)	111.3	112.5	112.6	113.3	128.8					
M2 (% GDP)	31.4	27.8	31.7	34.0	31.3	30.7	31.3	31.4		
Fiscal (% of GDP, unless otherwise indicated)										
Revenues	30.5	31.8	33.8	33.4	34.7	33.4	32.8	32.9		
Expenditures	36.8	36.4	39.5	37.3	38.8	41.0	39.2	37.1		
Current	31.4	30.9	31.4	30.7	29.5	30.2	29.4	28.7		
Capital	5.4	5.5	7.7	7.2	10.0	10.7	9.8	8.4		
Overall Fiscal Balance After Grants	-6.3	-4.6	-5.7	-3.9	-4.1	-7.6	-6.5	-4.2		
Primary Fiscal Balance	-5.4	-3.6	-4.7	-3.0	-3.3	-6.7	-5.5	-3.2		
Total Public Debt	59.7	49.4	49.0	46.1	53.0	58.8	62.0	61.4		
External Public Debt	56.8	46.2	46.9	43.7	51.0	57.0	59.5	59.5		
External Accounts (% of GDP, unless otherwise indicated)										
Export growth, f.o.b (nominal US\$, % yoy)	8.2	23.7	-0.9	19.9	-19.0	1.3	8.9	7.6		
Import growth, c.i.f (nominal US\$, % yoy)	5.9	32.0	31.2	8.7	-5.8	3.9	5.5	7.5		
Merchandise exports	38.2	36.6	34.0	34.9	30.6	30.7	32.1	32.3		
Merchandise imports	62.4	63.5	73.2	77.8	67.6	69.6	70.2	70.6		
Services, net	-4.8	-1.7	-5.4	-0.7	-2.1	-1.4	-0.2	0.1		
Workers' Remittances, Net (US\$, millions)	1,244	1,662	1,952	2,101	2,100.0	1,785.0	1,964.0	2,258.0		
Current Account Balance	-6.4	-6.5	-15.6	-15.0	-13.7	-17.0	-15.6	-13.5		
Foreign Direct Investment, net inflows	9.1	11.2	4.4	8.7	2.8	3.9	5.8	5.8		
External debt, total	88.4	76.7	78.6	72.9	81.2	88.3	89.1	87.0		
Population, Employment and Poverty										
Population, Total (millions)	5.4	5.5	5.6	5.7	5.8	5.8	5.9	5.9		
Population Growth (% change, y-o-y)	1.2	1.2	1.7	2.0	1.1	1.0	1.0	1.0		
Unemployment Rate (% of labor force)	8.6	8.5	8.4	8.3						
Poverty Headcount Ratio at National Poverty Line (% of population)	33.7	36.8	38.0	37.0						
Poverty Headcount Ratio at US\$1.25 a day (PPP) (% of population)	6.7	5.03						
Poverty Headcount Ratio at US\$2 a day (PPP) (% of population)	22.9	21.64						
Inequality - Income Gini	36.51	33.38						
Life Expectancy	69.3	69.6	70.0	70.2						
Other										
CPIA (overall rating)	3.7	3.6	3.6	3.6						
Economic Management	4.2	4.2	4.0	3.8						
Structural Policies	3.8	3.7	3.7	3.7						
Social Inclusion and Equity Policies	3.6	3.6	3.6	3.6						
Public Sector Management and Institutions	3.0	3.0	3.1	3.1						

Source: Kyrgyz authorities and Bank staff estimates and projections

".." indicates not available.



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