Kyrgyz Republic

Growth slowed in 2018 in tandem with smaller gains in mining and manufacturing. Inflation decelerated by half, and the current account deficit widened sharply. Growth is projected to recover in 2019 and continue accelerating in 2020 on recovery in gold production and slower but continued growth in the region. Inflation will be higher and the current account deficit wider. Reducing risks from flooding and associated disasters has become urgent with climate change.

Economic performance

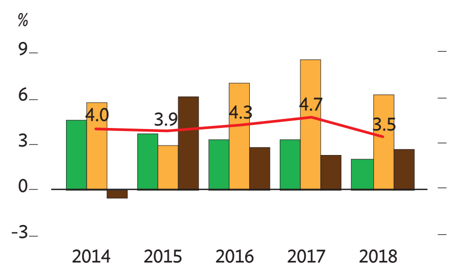
Growth declined from 4.7% in 2017 to 3.5% in 2018 as slower growth in the large gold mining industry outweighed gains in textiles and apparel.

On the supply side, growth in industry slowed from 8.6% in 2017 to 6.2% as expansion in mining plunged from 58.4% to 8.1% and that of manufacturing fell less dramatically from 6.7% to 5.0% (Figure 3.5.1). Gold production in the first half of 2018 was 40% lower than in the same period a year earlier because of the poor quality of ore, but it recovered substantially in the second half of the year as ore quality improved. Construction expanded by 7.8%, decelerating marginally from 7.9% in 2017 as slower growth in investment into mining, energy generation, and transport offset acceleration elsewhere. Growth in agriculture rose from 2.2% in 2017 to 2.7% on gains in horticulture and animal husbandry. Growth in services slowed from 3.3% in 2017 to 2.1% as expansion in retail and wholesale trade diminished from 7.1% to 5.1%.

On the demand side, growth found support from higher public investment into energy and transport infrastructure projects, and from higher public and private consumption, the latter reflecting a 5.5% rise in remittances, with all remittances equal to a quarter of GDP (Figure 3.5.2).

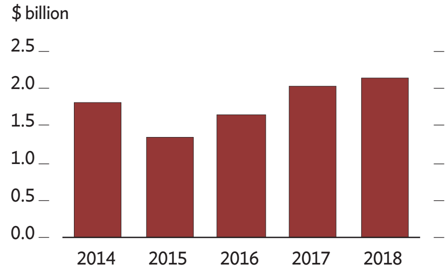
Average annual inflation slowed from 3.2% in 2017 to 1.5% last year as a good harvest and substantial imports of food from Uzbekistan cut food prices by 2.6%. Prices rose by 1.1% for goods other than food and by 4.1% for services. Inflation in December 2018 year on year was only 0.5%, down sharply from 3.7% a year earlier (Figure 3.5.3). In the course of 2018, the Kyrgyz som depreciated only slightly, by 1.5%, against the US dollar (Figure 3.5.4).

3.5.1 GDP growth by sector



Source: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 8 March 2019).

3.5.2 Remittances



Source: National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 13 March 2019).

This chapter was written by Gulkayr Tentieva of the Kyrgyz Resident Mission, ADB, Bishkek.

The fiscal deficit narrowed from the equivalent of 3.3% of GDP in 2017 to 1.2% despite higher spending on infrastructure projects. Revenue slipped from 25.4% of GDP in 2017 to 24.3%, while expenditure fell more steeply from 28.7% of GDP to 25.5%. The smaller deficit and higher GDP trimmed external government debt from 53.1% at the end of 2017 to 48.0% at the end of 2018. Domestic government debt equaled less than 8.0% of GDP.

Monetary policy remained cautious as the National Bank of the Kyrgyz Republic, the central bank, limited its currency interventions to simply smoothing excess exchange rate volatility. It reduced the policy interest rate from 5.00% at the end of 2017 to 4.75% in May 2018 and further to 4.50% in February 2019. The average deposit interest rate declined by 0.2 percentage points to 4.1%, while the average lending rate fell by 1.0 percentage point to 15.0%. Deposits rose by 10.4% and credit by 13.1%, while growth in broad money slowed from 17.9% in 2017 to 5.5%. At the end 2018, nonperforming loans were stable at 7.5% of the total. Dollarization remained extensive, with the share of loans in foreign currency at the end of 2018 unchanged at 38.0% and the share of deposits at 44.5%, down from 48.7% at the end of 2017.

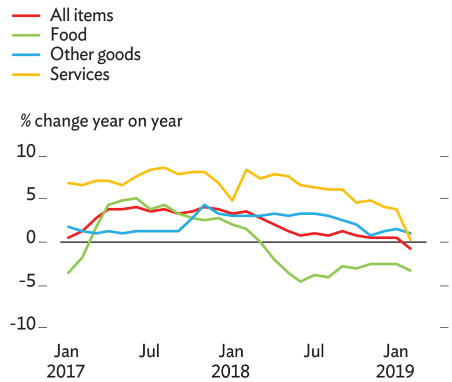
The current account deficit is estimated to have widened by half from the equivalent of 6.5% of GDP in 2017 to 10.0%. Trade increased by 6.6%, with exports stagnant, as gains in cement, metals, cotton, and textiles could not offset lower gold shipments, and with imports rising by 9.2% on increases for oil products, construction materials, textiles, and consumer goods. Growth in remittances was estimated at 5.5%, down sharply from 24.3% in 2017. International reserves remained at $2.2 billion at the end of 2018, providing cover for 3.8 months of imports. External debt, including government-guaranteed and private debt, is estimated to have fallen from the equivalent of 92.4% of GDP at the end of 2017 to 83.9% at the end of the third quarter of 2018 (Figure 3.5.5). External government and government-guaranteed debt stood at 48.0% of GDP.

Economic prospects

Growth is expected to recover to 4.0% in 2019 and 4.4% in 2020 with some improvement in the domestic economy, especially gold production, and despite adverse effects from a slowdown in the region, especially in Kazakhstan and, in 2019, the Russian Federation, the country's two main regional partners (Figure 3.5.6).

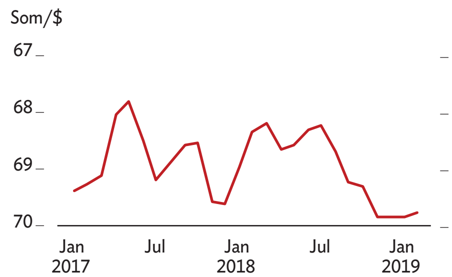
On the supply side, gains in industry from recovery in gold production—and, less importantly, in agro-processing, light industry development, and, to some extent, construction—should support growth over the next 2 years. On the demand side, continued increase in remittances will raise household

3.5.3 Monthly inflation



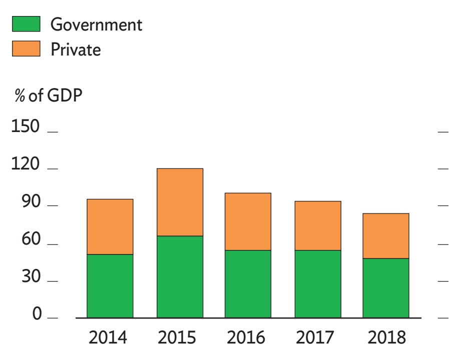
Source: Bulletin of the National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 13 March 2019).

3.5.4 Exchange rate



Source: National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 14 March 2019).

3.5.5 External debt



Note: Government debt is both government and government-guaranteed debt. Data for 2018 are as of the end of the third quarter.

Sources: The Ministry of Finance; National Statistics Committee. http://www.stat.kg; National Bank of the Kyrgyz Republic. http://www.nbkr.kg (both accessed 20 February 2019).

incomes, bolstering private consumption. Over the longer term, membership in the Eurasian Economic Union (EEU) should catalyze growth through increased foreign trade and freer movement of labor, capital, and services within the EEU.

Inflation is expected to accelerate to 3.0% in 2019 and 3.5% in 2020 on higher growth (Figure 3.5.7). The forecast factors in the risk of greater depreciation of the Kyrgyz som against the US dollar if the currencies of the country's main regional partners weaken.

The central bank is expected to continue to permit a flexible exchange rate and limit its interventions to smoothing excessive volatility. In view of the expected rise in inflation, monetary policy will likely remain focused on maintaining price stability. The central bank aims to establish a policy of inflation targeting over the medium term, using an inflation target of 5%–7%.

The fiscal deficit is projected to widen again to 1.7% of GDP in 2019 on higher current and capital spending. As the government aims to restrain expenditure on low-priority items while improving tax policy and administration, the fiscal deficit is seen easing to 1.2% in 2020 (Figure 3.5.8). Fiscal consolidation remains a major concern, the goal being to rebuild fiscal space for later accommodation as needed and to ensure debt sustainability. Consolidation efforts will focus on rationalizing expenditure by reforming public wages, cutting subsidies, and improving the targeting of social benefits. The government intends to raise revenue as well by broadening the tax base and strengthening tax and customs administration. The aim is to keep external public debt below 50% at least to the end of 2020.

The current account deficit is expected to widen to 12.0% in both 2019 and 2020 (Figure 3.5.9). Higher gold exports are projected to raise export growth above 10.0% in both years, while infrastructure spending is projected to boost imports by 14.0% in 2019, subsiding a bit to 12.0% in 2020. However, growth in exports other than gold may continue to be constrained—and the current account deficit large—as Kyrgyz products struggle to comply with EEU veterinary and agricultural standards and if demand from EEU trade partners is weaker than expected. Remittances will likely rise by a further 5%–10% over the course of 2019 and 2020, reflecting the continuing advantages to Kyrgyz migrant workers of membership in the EEU since 2015 and continued, if modest, growth in the Russian Federation. International reserves are forecast to remain at $2.2 billion in 2019 and 2020 (Figure 3.5.10).

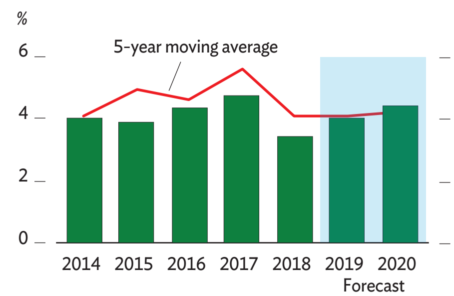
While debt sustainability has improved in the Kyrgyz Republic, the International Monetary Fund assesses the country as facing moderate risk of debt distress because of continuing vulnerability involving currency stability and

3.5.1 Selected economic indicators (%)

	2019	2020
GDP growth	4.0	4.4
Inflation	3.0	3.5
Current account balance (share of GDP)	–12.0	–12.0

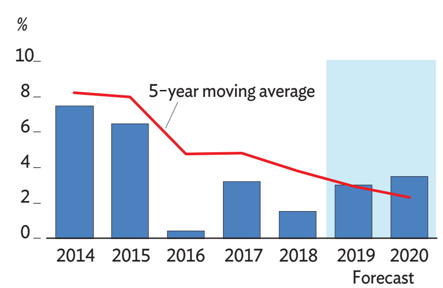
Source: ADB estimates.

3.5.6 GDP growth



Sources: National Statistics Committee of the Kyrgyz Republic. http://www.stat.kg (accessed 8 March 2019); ADB estimates.

3.5.7 Inflation



Sources: National Bank of the Kyrgyz Republic; ADB estimates.

possible deterioration in the fiscal balance. Barring shocks, and assuming that public external debt stays below 50% of GDP as intended, total external debt could remain below 90% of GDP for at least the next few years.

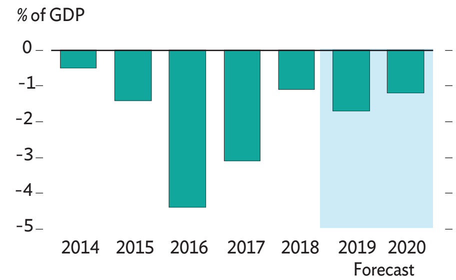
Policy challenge—reducing risks from flooding and associated disasters

The Kyrgyz Republic is at high risk from extreme weather events, a situation that is likely to worsen under climate change. The country's vulnerability to harm from climate change is ranked at 68 of 181 countries in the Notre Dame Global Adaptation Index in 2017. Moreover, the Kyrgyz Republic is located in a seismically active mountainous region prone to earthquakes, floods, mudslides, avalanches, snowstorms, and mountain lake spills. Disasters from natural hazards such as floods and earthquakes occur frequently and are estimated to cost the equivalent of 1.0%–1.5% of GDP annually. Water resources are particularly vulnerable, particularly in the southwestern districts, where droughts, landslides, flooding, and other water-related disasters are frequent. Landslides comprise a quarter of all disasters and cause half of disaster-related fatalities. Risk is heightened by a lack of investment in preventive works, inadequate risk management, and the limited amount of state and local government resources available to address risks.

Efforts to strengthen resilience under climate change and extreme weather events are guided by the government's national development, climate change, and sector strategies. The national development program for 2018–2022 includes proactive management of disaster and climate change risks and prioritizes building and rehabilitating irrigation infrastructure to achieve greater water-use efficiency. A comprehensive strategy introduced in 2018 for protecting the land and its people in emergencies to 2030 seeks to reduce disaster losses through, among other measures, improved monitoring and forecasting and the construction of protective structures. The strategy will require funding from 2018 to 2022 equal to 1.8% of annual GDP. A state program to develop irrigation from 2017 to 2026 seeks to use water resources more productively by constructing and modernizing infrastructure and by introducing improved technology. It requires funding equal to 10% of annual GDP.

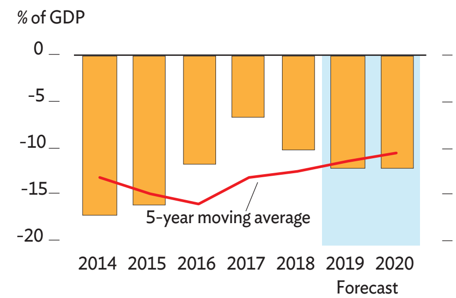
Development partners support government efforts through projects that emphasize modernizing irrigation systems and that target optimized and resilient agricultural production, as well as improved water productivity. One project is pilot testing a new system of hydrological monitoring and forecasting that uses satellite data.

3.5.8 Fiscal balance



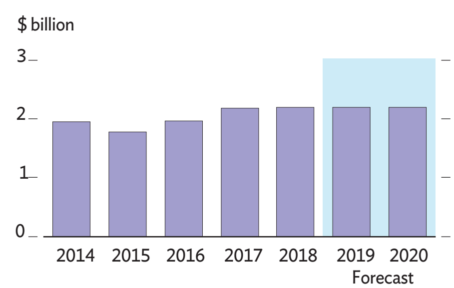
Sources: Ministry of Finance of the Kyrgyz Republic; ADB estimates.

3.5.9 Current account balance



Sources: National Bank of the Kyrgyz Republic. http://www.nbkr.kg (accessed 13 March 2019); ADB estimates.

3.5.10 Gross international reserves



Sources: National Bank of the Kyrgyz Republic; ADB estimates.

Other projects focus more on system rehabilitation rather than modernization, using a holistic approach to irrigation infrastructure, management, operation, and maintenance. Existing water-user associations deliver agricultural advisory services to their members, and smaller projects employ community-oriented approaches to improve water productivity and water management on farms.

The government is developing a pilot program to enhance climate resilience by coordinating various projects, avoiding overlap in investments and target areas, and incorporating lessons from earlier projects into later efforts. A system of forecasting mudflows for better protection of vulnerable settlements is being developed. In addition, the current Central Asia Hydromet Modernization Program supports capacity building in Kyrgyz Hydromet and equipment modernization to improve data collection and weather forecasting. Finally, several projects aim to strengthen climate resilience and cross-border management of water resources in the lower Syr Daria and Chu river basin.

To better coordinate and cost-effectively augment these efforts, the government needs to prioritize its goals and improve project implementation, as the Kyrgyz Republic has large infrastructure investment needs, to ensure the sustainable and effective management of efforts to reduce disaster risk. In the coming years, extreme weather events will likely become more frequent and severe with climate change, rising temperatures, and intensifying precipitation and snowmelt. Water availability is likely to decline even as demand increases—a situation that would only be aggravated by inefficient water resource infrastructure and insufficient resources to improve hydro-meteorological capacity.
The government needs to continue its efforts to improve institutional capacity to manage climate and disaster risk and thereby strengthen resilience.