



KYRGYZ REPUBLIC

Highlights

- **Economic growth is expected to reach 5.0 per cent in 2015**, compared with 3.6 per cent in 2014, driven by the robust performance in gold production and also by investment and financial support provided by Russia as part of the accession to the Eurasian Economic Union (EEU).
- **The Kyrgyz Republic has joined the EEU.** The country became a full member of the EEU in August 2015. EEU membership can be expected to create opportunities for increased trade with other EEU countries and should lead to deeper regional integration, but it could also create disruptions in trade with non-member countries.
- **Significant uncertainty has arisen surrounding the Kumtor gold mine.** The agreement reached in December 2013 on establishing a joint venture and increasing the Kyrgyz stake in Kumtor was abandoned by the Kyrgyz authorities in April 2015. Negotiations on a new structure of mine ownership are ongoing.

Key priorities for 2016

- **Effective implementation of the commitments under the EEU accession is key.** A first priority should be on preparing domestic industries for taking advantage of the enlarged EEU market, as well as mitigating the adverse impact on industries that will be negatively affected (for example, some of the re-export industries).
- **A resolution to the Kumtor gold mine ownership structure is needed.** The mine is critical for the country's economic performance, having accounted for over 7 per cent of GDP and 40 per cent of exports in 2014. The establishment of a stable framework for mining operations, including steady progress in the Extractive Industries Transparency Initiative (EITI) implementation, would help rebuild investor confidence.
- **Sound structural reforms, improvements in governance and strong financial sector regulation are essential to boost economic growth and reduce vulnerabilities.** It is important to reduce the obstacles for doing business in the country, with corruption and political instability representing two of the most problematic factors. The country needs to enhance private sector-led growth to reduce its high dependence on gold output, and remittances from Russia and Kazakhstan. A more stringent implementation of financial sector regulation is required, in the light of rising vulnerabilities.

Main macroeconomic indicators %

	2011	2012	2013	2014	2015 proj.
GDP growth	6.0	-0.9	10.5	3.6	5.0
Inflation (average)	16.6	2.8	6.6	7.5	8.5
Government balance/GDP	-4.6	-5.7	-3.7	0.1	-2.5
Current account balance/GDP	-9.6	-15.6	-15.0	-16.8	-17.7
Net FDI/GDP [neg. sign = inflows]	-11.2	-4.4	-8.5	-2.3	-7.3
External debt/GDP	76.3	79.3	71.9	76.3	n.a.
Gross reserves/GDP	36.4	30.7	31.8	29.7	n.a.
Credit to private sector/GDP	10.9	12.9	15.4	18.0	n.a.

Macroeconomic performance

Economic growth jumped in the first half of 2015 to 7.3 per cent, around double the 3.6 per cent rate recorded in 2014, mainly on the back of robust performance in gold production and the base effect from the back-loaded production in the previous year. The non-Kumtor growth, at 4.4 per cent year-on-year in the first half of 2015, also remains robust, notwithstanding negative external shocks since 2014. Domestic demand weakened as a result of declining remittances from Russia, which were down by 24 per cent in January to August 2015. Non-gold exports were down by 30 per cent, while imports fell 17 per cent in the first half of 2015.

The depreciation of the rouble and other external factors increased pressure on the Kyrgyz currency. The som weakened by around 16 per cent from the start of 2014 until mid-2015, with most of the depreciation coming in 2014. The National Bank of the Kyrgyz Republic (NBKR) heavily intervened in the currency market and gradually tightened monetary policy, bringing the policy rate to 11 per cent in January 2015, subsequently easing it to 8 per cent in July. Gross international reserves decreased by 10 per cent year-on-year, and they stood at US\$ 1.9 billion as of the end of June 2015, covering around three months of imports. Inflation had picked up by the end of 2014, averaging 7.5 per cent in 2014, driven by exchange rate weakening. However, it had dropped to 5.0 per cent by July 2015 year-on-year.

The external and fiscal balances are under pressure. The current account deficit reached 16.8 per cent of GDP in 2014, with both exports and imports narrowing due to the regional slow-down and lower gold prices, with exports of services and foreign direct investment (FDI) also negatively affected. External public debt increased to 53 per cent of GDP in 2014 from 46 per cent the year before, as a result of materialisation of the public investment programme, with half of it funded by concessional borrowing from China EximBank. The fiscal deficit is expected to widen to accommodate large infrastructure spending. This will primarily be financed by Russian, Chinese, World Bank and International Monetary Fund (IMF) loans.

The IMF approved the US\$ 92.4 million Extended Credit Facility in April 2015. The new three-year programme will support the authorities' efforts to reduce macroeconomic vulnerabilities, encourage structural reforms and support financial sector stability.

GDP growth is expected to increase to 5.0 per cent in 2015, despite the significant downward pressure from sharply lower remittances from Russia and Kazakhstan and a more difficult external environment; depreciation of the Russian rouble; and sharply slower growth in Kazakhstan, the country's main trading partner and a key source of remittances. The increase is mainly driven by robust performance in gold production and the base effect from the back-loaded production in the previous year. The growth is also supported by increased infrastructure spending, financing provided by Russia and Kazakhstan as part of the EEU accession, and lower oil prices. The lack of a permanent solution to the issues surrounding the Kumtor gold mine remains an important downside risk to growth. In 2016, growth is expected to decline to 3.9 per cent, reflecting a continued, challenging external environment.

Major structural reform developments

The Kyrgyz Republic's accession to the EEU was finalised in August 2015. The treaty on joining the EEU with Russia, Kazakhstan, Belarus and Armenia was signed on 23 December 2014. All member countries ratified the accession agreement and on 12 August the country became a fully fledged member of the EEU. Membership represents both opportunities and risks for the Kyrgyz Republic. The introduction of higher tariffs for non-member states is expected to hurt trade with other countries during the transition period, particularly re-export trade with China. On the other hand, some industries will benefit from better access to the enlarged EEU market, in particular agriculture and food processing. This, however, requires effective implementation of veterinary and various quality standards of the EEU. Russia and Kazakhstan are providing financial support to smooth the short-term negative effects in the accession process. A US\$ 1 billion Russia-Kyrgyz development fund alongside a US\$ 200 million grant from Russia and a US\$ 100 million grant from Kazakhstan, could help mitigate short-term disruptions via increased investment in customs infrastructure, sanitary testing and certification facilities.

The Kyrgyz Republic has also taken steps to improve governance and transparency in the energy sector. Amendments to legislation in the energy sector and also the Mid-Term Tariff Policy from 2014-17 for heat and electrical energy have been approved, which envisage a gradual increase in heating and power tariffs. The electricity tariffs were increased in November 2014 and further in August 2015; however the rates are still far from cost-reflective levels. The government also established an independent regulator for the energy sector in November 2014, serving as a single entity for economic regulation of the sector.

Uncertainties surrounding the Kumtor gold mine remain. In December 2013, the two sides – Centerra Gold and the Kyrgyz Republic – had come close to a resolution of the mine ownership structure, when a deal was agreed for the government to exchange 33 per cent shares in Centerra Gold for 50 per cent in a Kumtor joint venture. However, in early April 2015, the government announced that it had abandoned its plans to increase its stake, as the change in the mine's reserves from 8.5 million oz to 6.1 million oz made the deal less appealing. In July 2015 the State Agency of Environmental Protection and Forestry extended Centerra Gold's permits for emissions into the atmosphere and waste disposal into the tailings pond from its Kumtor gold mine until the end of 2015. The company is still awaiting approval for the 2015 annual mining plan, and negotiations on a stable long-term solution are ongoing.

The Kyrgyz Republic terminated the cooperation agreement with the United States in July 2015. This was due to the US State Department granting a human rights award to Azimjon Askarov, jailed for life for inciting ethnic hatred. The 1993 agreement is the legal framework through which the United States has been providing humanitarian and technical economic assistance to the Kyrgyz Republic, making the country the biggest Central Asian recipient of US aid at around US\$ 2 billion since its independence. The termination of the agreement could put the US assistance programmes in jeopardy.

Public finance management and banking sector reforms are lagging. The introduction of a single treasury account, a unified structure of government bank accounts that gives a consolidated view of government cash resources, has been delayed due to ongoing attempts to identify a service provider. The banking code is still awaiting approval, despite having been submitted to parliament in September 2013. The code is expected to enhance the independence of the national bank and improve the bank resolution framework. The first parliamentary hearing of the draft banking code was held in June 2015.