“Fiscal consolidation is a priority in the medium term to reduce vulnerabilities, rebuild policy buffers, and ensure sustainability. The authorities’ consolidation plans appropriately focus on restraining current spending while preserving social and capital outlays. Reforms in tax policy and administration and public financial management should continue.

“Maintaining a tight monetary policy stance is necessary to mitigate underlying inflationary pressures. Stronger de facto independence will help the central bank to maintain low inflation.

“Creating a well-functioning financial sector is key to supporting private sector-led growth. The new banking code, once approved, will help restore confidence in the banking system. The resolution of Zalkar Bank was an important step, and its operations will need to be closely supervised to ensure compliance with prudential standards.

“Diversification of the economy will help reduce volatility in growth stemming from disruptions in gold production. Good governance and sound institutions remain critical to create a level playing field, improve investor confidence, and lay the foundation for strong private sector-led growth.”
Statement by René Weber, Executive Director for the Kyrgyz Republic
And Jerome Duperrut, Advisor to Executive Director
June 10, 2013

On behalf of our Kyrgyz authorities, we thank staff for the constructive surveillance policy discussions in the context of the Article IV Consultation, the insightful staff reports, and the continued support under the Extended Credit Facility (ECF) arrangement. The authorities remain committed to strengthening the foundations for growth and development: maintaining macro-economic stability, improving institutions and governance, promoting national reconciliation, and strengthening regional cooperation. The essential contribution of the Fund in all three dimensions of its activities—surveillance, lending, and capacity development—is acknowledged and highly appreciated. The ECF will continue to provide a solid anchor for economic policies going forward. The positive traction of Fund’s advice is clearly shown in Box 1.

Macro-economic outlook and policies

After a difficult 2012, when economic growth was negative as a result of a temporary large contraction in gold production due to adverse geological factors, the outlook for 2013 is more reassuring. Gold production has recovered and non-gold growth continues to show strength. Capital investment activity, partly linked to the reconstruction efforts in the South of the country, retail trade, and exports are significant contributors. Over the first four months of the year, GDP grew by 8.2 percent, which puts the Kyrgyz Republic on track to meet staff’s forecast for 2013. The authorities are confident that the Kyrgyz Republic will be able to grow at a similar, swift pace over the medium-term. At the same time, we concur with staff that risks exist, with fluctuations in the gold production and price, and an economic slowdown in the main partner countries being the most pronounced ones. The Kyrgyz authorities are committed to negotiating in a responsible manner with its foreign investor on the financial, environmental, and social aspects of the Kumtor mine in order to find a lasting and mutually beneficial agreement. They are keenly aware that a stable and predictable business climate is key to attracting investment and generating sustainable and inclusive growth. The Kyrgyz Republic has also started preparations to join the customs union of Belarus, Kazakhstan, and Russia, which should further open export markets as well as improve the economy’s competitiveness and investment environment. Russia’s recent accession to the World Trade Organization (WTO) and Kazakhstan’s proceeding WTO accession process strengthen the case for joining the regional customs union.

Major progress in enhancing the stability of the domestic banking system has been made with the sale of 90 percent of shares of Zalkar Bank to Russia’s Investment and Trade Business Holding, which was a precondition for the completion of this review. The authorities expect that the recapitalization of this bank will be completed by the end of the year. Furthermore,
with the support of the Fund’s technical assistance, they are making good progress in revising the Banking Code. This Code is expected to be submitted to Parliament for approval in September. The authorities are looking forward to the upcoming FSAP mission in July, based on which they expect to deepen the domestic debt market and further strengthen the financial sector.

With an unanticipated decline in gold-related fiscal revenue and public spending approaching 40 percent of GDP, major corrective action was needed by the authorities in the second half of 2012 to meet the overall fiscal deficit target under the ECF arrangement. This adjustment effort included significant cuts in spending on goods, services, and infrastructure, while pro-poor spending was protected. The authorities note staff’s assessment that the Kyrgyz Republic compares favorably with others in terms of tax collection, including among countries in the region. The ministry of finance has recently regained the overall responsibility of all fiscal policy matters, as the tax policy unit was transferred back from the ministry of economy. Going forward, the authorities are committed to further consolidate the fiscal position, in line with program objectives. They expect tax revenues to level off in part following tax policy changes, such as the reduction of some fee-based services, but they are confident that the tax intake will benefit from further improvements in tax administration. On the expenditure side, the civil service reform should result in a lower overall wage bill, while leaving some room to allow for targeted wage increases. A new law on public procurement should allow for curbs on public goods and services spending. Combined with reductions in transfers and subsidies, these savings should create some fiscal space for increased education, health, and social assistance outlays. The authorities plan to reform the pension system with a view to make it more equitable, efficient, and sustainable. Based on this fiscal policy strategy, the ratio of public debt to GDP should continue its downward path over the coming years. The authorities will update their medium-term debt management strategy accordingly.

The National Bank of the Kyrgyz Republic (NBKR) is committed to keeping monetary policy tight in order to ensure that inflation remains in single digits. Further monetary policy tightening could be considered to prevent second-round effects from rising food and fuel prices. The NBKR appreciates the staff’s thorough discussion of the determinants of monetary policy transmission mechanism, as well as the helpful Fund technical assistance. The NBKR has indicated that it will review the effectiveness of its current monetary targeting framework and its signaling instruments and that it sees merit in further improving its communication to the markets. The authorities agree with the staff’s assessment that the exchange rate is broadly in line with fundamentals and that the current level of reserves is adequate. They continue to value the flexible exchange rate regime, with the NBKR refraining from intervening in the foreign exchange market, except in cases of excessive volatility.

The Kyrgyz authorities are committed to improve on past laxity in combating money laundering and the financing of terrorism (AML/CFT). In October 2011, they made a high-