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Research Report on Kyrgyzstan

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Introduction

The Kyrgyz republic stands nowadays as the one of less developed countries in the Central Asian region with a real per capita GDP of 3 212 USD and a Poverty Headcount ratio of 38%[1]. While gross government debt and current levels of deficit pose no risk for the Kyrgyz Republic, management of monetary policy is far from satisfactory. High inflation rates combined with poor development of financial intermediation and mistrust of people in the Kyrgyz banking sector are the main drivers of current levels of dollarization of deposit and loans and the significant degree of monetization in the economy.

Main Economic Indicators of Kyrgyzstan

Macro indicators	2011	2012	2013
Gross pub. debt, bill Som	141,2	152,1	167,1
Nominal GDP, bill Som	286,0	310,5	350,0
Nominal GDP growth, %	29,8	8,6	12,7
Gross gov. debt/GDP,%	49,4	49,0	47,7
Deficit (surplus)/GDP,%	-4,6	-5,7	-3,8
Inflation rate,%	5,7	7,5	4,0
Curr. Account balance/GDP,%	-6,5	-15,0	-12,6

Development indicators	2013
Inequality adj. HDI	0,62
GDP per capita (Thou. of USD)	2,61

Sources: RAEX (Europe) calculations based on data from World Bank, IMF, Bloomberg

Government debt load does not pose any risk for the Kyrgyz economy. Gross government debt/GDP ratio stands at reasonable levels (47,7% in 2013) and has remained almost flat in the last 3 years. Due to the fact that the Kyrgyz Republic is not rated by any CRA, except for RAEX Moscow, the chances of obtaining funds by open market operations are reduced and, if obtained, these funds are expensive. For that reason government debt denominated in foreign currency, which represents almost 94% of total debt, is entirely owed to international organizations. Furthermore, the Kyrgyz government faces no risk in terms of short-term debt, which accounted for 3,1% of GDP in 2013.

Reduction of government budget deficit figures over the last year was driven by higher real GDP growth rate. Since a number of changes to the tax burden and procedures was introduced by the new tax code approved in 2009 (see table 1), levels of deficit increased considerably averaging -4% of GDP during the period 2009-13. However, decline of deficit reported in 2013 (which reached a value of -3,8% that year), was mainly driven by strong real GDP growth (8,4% during 2012-13). High growth rate of real GDP observed in 2013 was fueled by restore of Kumtor gold mining production, which fell in 2012 due to a glacier movement.

High levels of bank deposit and loan dollarization as well as monetization of the economy, introduce moderate risk for Kyrgyzstan. Despite the share of dollar-denominated deposits and loans

[1] The Poverty headcount ratio measures the percentage of the population living below the national poverty line.

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Table 1: Changes to the tax burden and procedures

Tax types	Change introduced
All	Reduction of number of taxes from 16 to 8
Value added tax (VAT)	Reduction of VAT rate from 20 to 12
Sales tax	Establishing the sales tax which replaced the retail sales tax, road tax, and emergency funds.
Property tax	Introduction of a new property tax

Source: RAEX (Europe) calculations based on data from IMF

showed a constant decline during the period 2005-2012 in Kyrgyzstan, these figures are still well above those from CCA[2] countries (see table 2). Dollarization in Kyrgyzstan has been triggered by high and volatile inflation rates that have prevailed in the country during the last six years. Additionally, high levels of monetization of the economy (measured by currency outside banks/M2) evidence poor development of financial intermediation and mistrust of people in the Kyrgyz banking sector.

Table 2: Comparison of selected banking indicators (in %)

	Kyrgyzstan			CCA Average		
	2005	**2010**	**2012**	**2005**	**2010**	**2012**
Currency outside banks/M2	61,4	60,0	55,9	62,4	48,7	43,9
Deposits in USD in total deposits	72,2	52,9	51,9	63,1	51,1	41,4
Loans in USD in total loans	64,8	55,7	47,8	66,8	55,00	55,9

Source: RAEX (Europe) calculations based on data from IMF

Table 3: Inflation and broad money targets vs. actuals

		2008	2009	2010	2011	2012
Inflation rate (%)	Target	12-15	7,5(*)	7,5-9,5	8-10	7-9
	Actual	20	0	18,9	5,7	7,5
Broad money – M3[3] (% increase)	Target	17,3	23,3	19,3	15,7	18,3
	Actual	12,6	17,9	21,1	14,9	23,8

Source: RAEX (Europe) calculations based on data from IMF. (*) Revised mid-year

Monetary policy carried out by the central bank of Kyrgyzstan performed poorly over recent years. Although inflation rate has declined and became less volatile in the last 6 years, current levels are proof of the bad performance of the monetary policy carried out by the central bank of Kyrgyzstan. High Inflation rates have been driven by higher import prices (mainly oil and gas prices), as well as the increase of money in circulation reported in recent years. Moreover, the gap between target and actual values of inflation rate as well as broad money growth rate (see table 3) is evidencing the low quality of monetary policy management.

Discretionary government interventions in the financial markets represent the strongest hindrance for credit climate development in Kyrgyzstan. While the National Bank of Kyrgyzstan (NBKR) is endowed with a high degree of *de jure* independence (see table 4), *de facto* independence is hampered by frequent government judicial actions. Government initiatives to subsidize lending and to interfere with the interest rate policy harms the self-governance of the NBKR.

[2] CCA stands for Caucasus and Central Asia.
[3] M3 is a measure of money supply that includes M2 as well as large time deposits, institutional money market funds, short-term repurchase agreements and other larger liquid assets.

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Table 4: Comparison of de jure central bank independence

	Overall	Political	Economic
Kyrgyzstan	0,88	1,00	0,75
CCA average	0,74	0,78	0,71
Emerging	0,60	-	-
Advanced	0,96	-	-

Source: RAEX (Europe) calculations based on data from Arnone et al. (2007); Mishra et al. (2010). Higher score means higher independence

What is more, under the Kyrgyz legal system, legal "codes" supersedes "laws" in case of conflict between codes and laws. For example, the Civil Procedure code supersedes the laws governing banking regulation. A practical example of this situation (where the Civil Procedure code superseded the laws governing the banking system) is depicted by the recent ruling of the Inter District Court to extend the forbearance period for Zalkar bank.

Strongly developed nonbank financial-credit institutions (NFCIs) in Kyrgyzstan are the main providers of loans to individuals. NFCI showed a stronger development than Banks during the period 2009-2013. NFCI total assets more than doubled during the last five years, reaching a value of 23,5 billion KGS by 2013. Total credit portfolio of NFCIs showed a similar trend than that of total assets with an increase of more than 160% from 7,1 billion of KGS in 2009 to 19,1 billion of KGS in 2013. While total number of NFCI declined between 2012-13, as a result of license revocation of a number of microfinance organizations and credit unions, the number of exchange bureaus increased more than 9% during the same period fueled by larger inflows of remittances from border countries.

Conclusion

Based on a number of factors, the Republic of Kyrgyzstan shows a sound level of creditworthiness. Current debt load (especially short-term debt) do not pose any risk on the country. Furthermore, the latest tax code approved in 2009, allowed the government to increase budget revenues while at the same time provided less distortions to the taxation regime. In contrast, high levels of dollarization of bank loans and deposit as well as the significant degree of monetization of the economy stand as the main stress factors for Kyrgyzstan and must be kept on watch for future developments.

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