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Main Economic Indicators of Kyrgyzstan

Macro indicators	2012	2013	2014
Gross pub. debt, bill KGS	152	164	211
Nominal GDP, bill KGS	310	355	397
Real GDP growth, %	-0,9	10,5	3,6
Gross gov. debt/GDP,%	49,0	46,1	53,0
Deficit (surplus)/GDP,%	-5,7	-0,7	-0,5
Inflation rate,%	7,5	4,0	10,5
Curr. Account balance/GDP,%	-15,6	-15,0	-13,7

Development indicators 2014

Inequality adj. HDI	0,52
GDP per capita (Thou. of USD)	3,36

Default indicator As of 21.08.2015

5Y Gov Bond Yield, %	17,8
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Sources: RAEX (Europe) calculations based on data from IMF, World Bank, NBKR, Ministry of Finance of the Kyrgyz Republic, National Statistical Committee of the Kyrgyz Republic

Introduction

Constant economic struggles in the CIS region alongside an ongoing weakening of the KGS and a decline in gold production (in 2014) were the main drivers of a slow growth of the Kyrgyz economy and a consequent increase in public debt and spending to overcome such slowdown. Fiscal policy remains expansionary and the transmission mechanism of the monetary policy is still ineffective. External exposure remains a big concern for Kyrgyzstan. Most of its debt is external, imports are a big part of the economy and its trade partners have imbalances that have translated directly to the internal market. Regarding the financial system, the banking sector has shown resilience despite a recent halt in domestic credit.

Economic growth was weak in 2014, however, it bounced back in the beginning of 2015, mainly due to an increase in gold production. The Kyrgyz economy grew at a rate of 3,6% of GDP in real terms in 2014 affected by diminished gold production, a slowdown in the Russian and Kazak economy – which caused a decrease in exports as well as remittances (more than 20%) – and lower than expected agricultural output due to weather conditions. However, in the 1H 2015, the economy has grown 7,1% in real terms as compared to the same period of 2014, driven by the manufacturing industry, especially gold production. If the output of the “Kumtor” mine is excluded, the growth rate amounts to 4,5% in real terms. However, total real growth at the end of the year is expected to remain low due to the continued slowdown in the Russian and Kazak economies.

Government debt continues to increase, however, short-term debt remains low. Government debt was 53% of GDP in 2014 and has been steadily increasing. As of 30th of June 2015 the reported figure was equal to 223,3 Bill KGS, which is an increase of 4% since the end of last year. As mentioned in our previous report¹, most of this debt is external (94% of the total public debt) which, combined with the recent depreciation and volatility of the KGS, presents a risk and potential imbalances for the Kyrgyz government. However, short-term debt remains at very acceptable levels (0,8% of GDP as of June 2015).

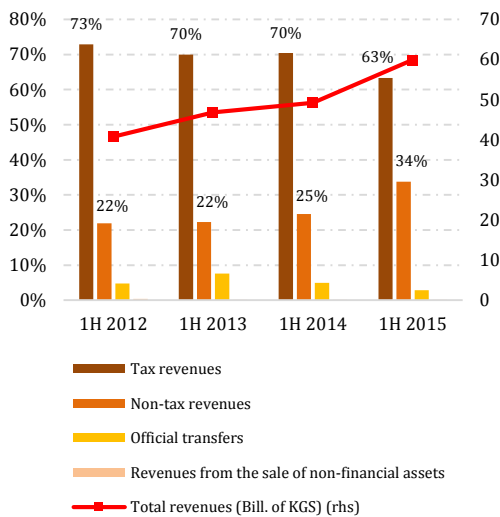
¹ Research Report on Kyrgyzstan from 27th of February 2015
http://raexpert.eu/reports/Research_report_Kyrgyzstan_27.02.2015.pdf

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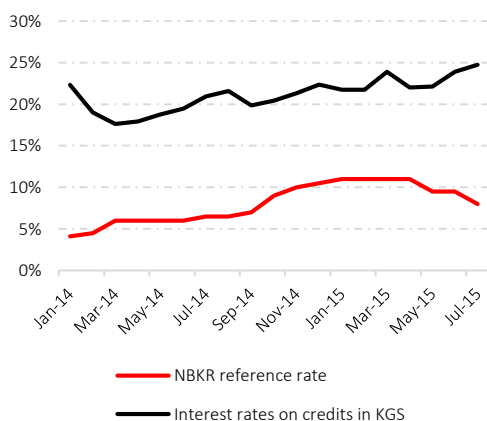
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Graph 1: Share of different sources of income in total revenues



Source: RAEX (Europe) calculations based on data from the National Statistical Committee of the Kyrgyz Republic

Graph 2: NBKR reference rate vs lending rate



Source: RAEX (Europe) calculations based on data from the NBKR

Fiscal policy remains expansionary and revenues have slightly picked up in the 1H 2015. According to official figures reported by the Ministry of Finance of the Kyrgyz Republic, the fiscal deficit of the state budget was 0,5% of GDP in 2014, however, it is expected to widen at the end of the current year. Capital spending continued its growing trend at the beginning of 2015, especially on repair and maintenance of roads and construction of social facilities among other investments, in order to propel the economy amid regional economic turbulence. On the contrary, current expenditures remained flat. Nevertheless, there are signs of an increase in current spending leading to the parliamentary elections later this year. On the other hand, even with the decrease of the share of tax income in total revenues, the Ministry of Finance reported a general increase in the amount of income in 1H 2015 compared to the same period of previous years (see graph 1). This increase was mainly due to the growth of non-tax revenues, especially dividends, property income and interests.

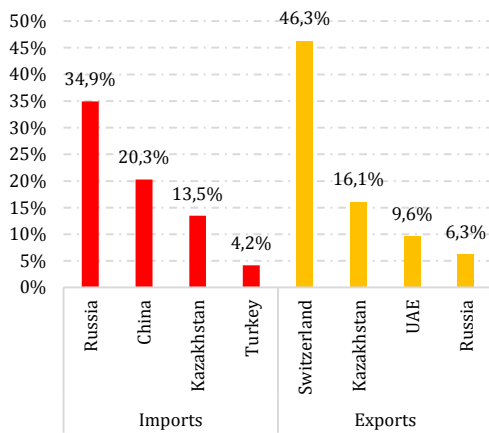
Monetary policy is still not fully effective. As mentioned in the Agency's previous assessment, monetary policy in Kyrgyzstan is complicated to implement even with the move from the Central Bank to set a reference interest rate instead of targeting monetary aggregates at the beginning of 2014. Among other factors, high and increasing dollarization levels (64,5% of total deposits and 52,6% of total loans in the 2Q 2015), large amounts of money outside banks, low levels of private credit and high levels of imports are obstacles for a successful transmission of the monetary policy to the economy. As shown in graph 2, this continues to be the case; the average weighted interest rates of commercial banks on credits extended in National currency are not completely correlated with the reference rates defined by the NBKR. In addition, a recent attempt from the Central Bank to halt the depreciation of the KGS by intervening the foreign exchange market, did not help to ease inflationary pressures.

Inflation continued to increase in the 1Q 2015 due to exchange rate depreciation and higher energy prices, though it has recently decreased sharply. Inflation levels continue to be dictated by the exchange rate pass-through where the growth rate of the CPI index is determined by the fluctuations in the exchange rate due to the substantial dependence on imports and dollarization in the economy. In addition to this, higher energy prices also contributed to the rise in the 12 month inflation from 4% in 2013 to 11,5% in the 1Q 2015. Nevertheless, as previously mentioned, adjustment from the Central Bank to the key reference rate has proved to have a better impact on inflation in the last months (12 month inflation in July was around 5%).

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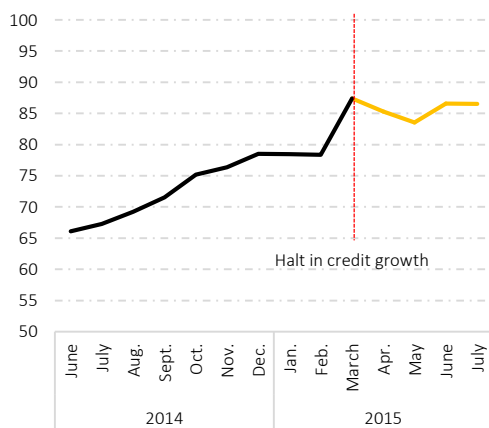
Graph 3: Major trade partners



Source: RAEX (Europe) calculations based on data from the National Statistical Committee of the Kyrgyz Republic

Kyrgyzstan's external exposure is still the biggest risk for the economy. The Kyrgyz economy is substantially exposed to external events. First of all, 94% of its debt comes from external sources, mainly international organizations. Secondly, the Kyrgyz economy can be characterized as an import based market. Last year the amount of imports was as high as 88% of GDP, the trade balance presented a deficit of 53% of GDP and the current account balance was -13,7% of GDP. The country also depends heavily on remittances from abroad, mainly from Russia. In addition, the main trading partners of Kyrgyzstan are countries which have had weak economic growth recently (see graph 3) such as Russia, Kazakhstan and China. Such a considerable external exposure of the economy has had internal consequences through the trade (reduction of export of 2,6% in the 1H 2015 from a year ago) and exchange rate channels in domestic demand and inflationary pressures. Furthermore, the accession to the Eurasian Economic Union (EEU) has not shown a positive effect so far in regard to trade, as was expected by this Agency. One of the conditions of the EEU membership is to impose certain tariffs on imports outside the Union, something that will adversely affect the commercial ties with China, its second major import source. The introduction of the country to the EEU has also not been well received by many Kyrgyz merchants who have recently claimed that inspections in the Kazak border are still in place and there is no free flow of goods.

Graph 4: Banks' credit to the economy (Bill. of KGS)



Source: RAEX (Europe) calculations based on data from the NBKR

The banking system continues to show resilience, but credit in the economy is still depressed. The latest banking system figures (June 2015) are positive: ROA was 1,6% and capital adequacy was high (20,9%). Nevertheless, private credit remains subdued. Despite a hike in 2014, it has flattened again in the 1H 2015 (see graph 4).

Conclusion

The dependence of the Kyrgyz economy on the external sector and neighbor economies, which have been performing poorly, is the main risk for the country. Kyrgyzstan is an import-dependent country and its public debt is mainly external. Recent trade deficit figures, slow GDP growth, inflation and fiscal deficit, are all connected to external imbalances. Monetary policy, although improving the pass-through to the economy, is still not effective enough to reach the NBKR's inflation target. On the positive side, the banking system can be considered as solid and healthy presenting positive and encouraging indicators in 2014 and along 2015. Further devaluation of the RUB and continued slowdown of the Russian and Kazak economies could bring additional downside risks to the Kyrgyz economy.

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