

Kyrgyz Republic Program Note

April 2016

Current- IMF supported program: A 3-year, SDR 66.6 (approximately US\$100 million) arrangement under the Extended Credit Facility (ECF) was approved by the IMF Executive Board in April 2015. The First Review took place in December 2015, and the Second Review is planned for June 2016.

Background

Despite significant reform efforts over the past two decades, persistent structural weaknesses limit potential growth. Dependence on gold, remittances, and foreign aid leaves the economy vulnerable to external shocks and makes it difficult to generate broad-based prosperity. As productivity lags, growth continues to rely on large-scale capital spending and an abundant supply of labor. The link between credit expansion and economic growth is weak as the financial sector is still underdeveloped. Despite progress in improving infrastructure and energy reliability, significant gaps remain. Poverty is high, with large differences in development across regions. Still nascent institutions, frequent changes in government, and a challenging business environment further hamper economic development.

The economic environment is more challenging than at the onset of the program. The regional economic slowdown that was transmitted primarily through a decline in remittances, a slowdown in trade, and exchange rate pressures has amplified domestic vulnerabilities. At the same time, large external borrowing has significantly increased debt levels, and the som depreciation has elevated financial and debt vulnerabilities. Given this environment, a more decisive implementation of reforms is needed.

Role of the IMF

The program draws from the government's 2013-17 National Strategy for Sustainable Development, and supports the authorities' efforts to generate inclusive growth and reduce poverty through reducing macroeconomic vulnerabilities, achieving fiscal sustainability, supporting banking sector reforms, strengthening debt management, and encouraging structural reforms to expand the economy's potential. The key policies under the program are:

- Fiscal consolidation to maintain public debt at sustainable levels;
- Strengthened public debt management through the preparation of a medium-term debt management strategy to be complemented by a review of the public investment framework;
- Tighter monetary policy by keeping the policy rate positive in real terms in order to keep inflation under control;

- Maintaining a flexible exchange rate, with limited interventions to smooth volatility without resisting trends;
- Strengthening banking sector resilience through the introduction of macro-prudential measures, resolution of banks under liquidation and the adoption of the Banking Law; and
- Speeding up structural reforms, with the aim of promoting inclusive growth and reducing poverty by reforming tax administration, strengthening public financial management, improving the business environment, and combating corruption.

The IMF is also supporting the Kyrgyz Republic by providing technical assistance in public financial management, public investment management, expenditure policy, tax policy and administration, monetary policy management, banking supervision, balance of payments statistics, and AML/CFT.

Challenges ahead

The economy continues to face significant challenges associated with a weak regional economic environment, high public debt, and the transition to the Eurasian Economic Union. These challenges, together with volatile growth and inflation, increase the economy's vulnerability to external shocks. If appropriate policies are implemented, the Kyrgyz Republic will weather these challenges and improve medium-term prospects.