
Country Report

Kyrgyz Republic

May 2009

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The Economist Intelligence Unit

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Kyrgyz Republic

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Summary

- Outlook for 2009-10** The Kyrgyz Republic will be increasingly vulnerable to the risk of unrest, possibly violent, over the forecast period. The opposition will continue to mount public protests, but the authorities will deal robustly with dissent. The Economist Intelligence Unit expects the president, Kurmanbek Bakiyev, to benefit from the administrative resources at his disposal to ensure his re-election in the presidential poll to be held in July 2009. Fiscal policy will face challenges over the forecast period, owing to the poor macroeconomic environment. However, financial support from Russia will enable the government to run larger budget deficits than originally planned in 2009-10. We have again revised downwards our forecast for real GDP in 2009, and now expect a contraction of 3%, following growth of 7.6% in 2008. The economy will continue to contract in 2010. Despite further increases in gas import prices, inflationary pressures will abate, owing to lower global prices for food, fuel and other commodities. Despite a downturn in demand for Kyrgyz exports and a fall in remittance inflows, the current-account deficit will narrow as a share of GDP as domestic demand slows.
- The political scene** The presidential administration looks more assured after securing a package of financial support from Russia. An early presidential election has been called for July 23rd. The opposition has failed to agree on a unified candidate in the election, limiting its chances of ousting Mr Bakiyev. Popular support for opposition demonstrations against the government appears to be waning.
- Economic policy** A financial aid package from Russia, to support budgetary expenditure and to invest in the hydropower sector, will offset to some extent the impact that the global downturn has on the Kyrgyz Republic. The som has depreciated against the US dollar by 20% since September 2008. The authorities have continued to intervene to support the som, but are becoming reluctant to deplete the stock of foreign-currency reserves further.
- The domestic economy** Real GDP growth slowed to only 0.2% in the first quarter of 2009. Industrial output contracted by almost 20%. Consumer prices fell in March, for the first time since August 2008, but inflation remains high, at 13.6% year on year.
- Foreign trade and payments** Exports fell by 12.3% year on year in the first quarter, but imports fell more rapidly, by 18.9%. The trade deficit therefore narrowed, to US\$404m, compared with US\$518m in the year-earlier period.
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Basic data

Total area	198,500 sq km
Population	5.22m (end-2007 official estimate)
Main towns	Population in '000 (end-2004 estimates)
	Bishkek (capital) 804
	Osh 228
	Jalalabad 78
	Kara Kul 63
Climate	Continental high mountain
Languages	Kyrgyz and Russian are the official languages
Weights and measures	Metric system
Currency	The som was introduced on May 10th 1993. The average exchange rate in 2008 was Som36.57:US\$1
Time	5 hours ahead of GMT
Fiscal year	Calendar year
Public holidays	January 1st (New Year); January 7th (Orthodox Christmas); February 23rd (Defenders' Day); March 8th (International Women's Day); March 21st (Noruz); March 24th (National Revolution Day); May 1st (Labour Day); May 5th (Constitution Day); May 9th (Victory Day); August 31st (Independence Day); October 2nd (end of Ramadan); November 7th (Great October Socialist Revolution Day); December 9th (Feast of Sacrifice)

Political structure

Official name	Kyrgyz Republic	
Form of state	The Kyrgyz Soviet Socialist Republic declared its independence in August 1991 and changed its name to the Kyrgyz Republic. A constitution was approved on May 5th 1993. The president's powers were enhanced by referendums held in February 1996 and February 2003. A new constitution was approved at a referendum in October 2007	
National legislature	After the parliamentary election in February 2005, the Jogorku Kenesh became a unicameral chamber of 75 deputies, elected for a five-year term. Under changes approved at a referendum in October 2007, the number of seats in the legislature has been raised to 90	
National elections	December 16th 2007 (parliamentary) and July 10th 2005 (presidential); next elections due in July 2009 (presidential) and December 2012 (parliamentary)	
National government	If a party wins more than one-half of the vote, it has the right to nominate the prime minister, who must then be approved by the president (if no party wins a majority, the president will entrust one of parliament's parties with forming a coalition)	
Head of state	Kurmanbek Bakiyev, taking over from Askar Akayev, who was president from October 1991 until March 2005, when he fled the country after protesters in the capital, Bishkek, stormed government buildings	
Main political parties	Ak Jol (True Path); Social Democratic Party of Kyrgyzstan (SDPK); Communist Party of Kyrgyzstan (KPK); Socialist Party Ata-Meken (Fatherland); Alga (Forward), Kyrgyzstan!; Adilet (Justice); Ar-Namys (Dignity); Asaba (Banner); Democratic Party of Women of Kyrgyzstan; Erkindik (Freedom); Mekenim (Fatherland) Kyrgyzstan movement; Moya Strana (My Country); Progressive-Democratic Party Erkin Kyrgyzstan (ErK); Party of Communists of Kyrgyzstan (PKK); Protection Party; Republican People's Party; Ak Shumkar	
Key members of government	Prime minister First deputy prime minister Deputy prime minister Agriculture, water management & processing industry Culture & information Defence Economic development & trade Education & science Emergency situations Finance Foreign affairs Health Industry, energy & fuel resources Internal affairs Justice Labour & social protection Migration & employment committee State property committee Transport & communications	Igor Chudinov Omurbek Babanov Uktomkhan Abdullayeva Iskenderbek Aydaraliyev Sultan Rayev Bakytbek Kalyev Akylbek Japarov Abdulda Musayev Kamchybek Tashiyev Marat Sultanov Kadyrbek Sarbayev Marat Mambetov Ilyas Davydov Moldomusa Kongantiyev Nurlan Tursunkulov Nazgul Tashpayeva Aygul Ryskulova Tursun Turdumambetov Nurlan Sulaymanov
Head of National Security	Murat Sutalinov	
Prosecutor-general	Elmurza Satybaldiyev	
Central bank chairman	Marat Alapayev	

Economic structure

Annual indicators

	2004 ^a	2005 ^a	2006 ^a	2007 ^a	2008 ^a
GDP at market prices (Som bn)	94.4	100.9	113.8	141.9	185.0
GDP (US\$ bn)	2.2	2.5	2.8	3.8	5.1
Real GDP growth (%)	7.0	-0.2	3.1	8.5	7.6
Consumer price inflation (av; %)	4.1	4.3	5.6	10.2	24.5
Population (m)	5.1	5.1	5.2	5.2	5.3 ^b
Exports of goods fob (US\$ m)	733	687	906	1,337	1,847
Imports of goods fob (US\$ m)	-904	-1,106	-1,792	-2,636	-3,754
Current-account balance (US\$ m)	3	-60	-299	-268	-708 ^b
Foreign-exchange reserves excl gold (US\$ m)	528	570	764	1,107	1,153
Exchange rate (av) Som:US\$	42.65	41.01	40.15	37.32	36.57

^a Actual, ^b Economist Intelligence Unit estimates.

Main origins of gross domestic product 2008	% of total	Main components of gross domestic product 2007	% of total
Agriculture & forestry	29.8	Private consumption	87.5
Industry	19.7	Public consumption	17.1
Services	50.6	Gross fixed investment	25.0
		Change in stocks	1.6
		Net exports	-31.2

Principal exports 2008	% of total	Principal imports 2008	% of total
Precious metals & stones	29.5	Mineral products	30.3
Mineral products	29.0	Machinery & equipment	11.3
Textiles	8.1	Chemicals	7.1
Chemicals	8.0	Food, beverages & tobacco	6.2

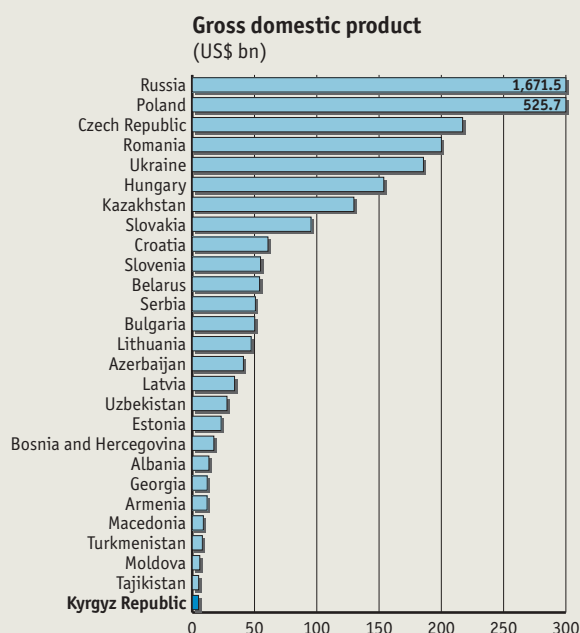
Main destinations of exports 2008	% of total	Main origins of imports 2008	% of total
Switzerland	26.8	Russia	36.7
Russia	19.3	China	18.0
Uzbekistan	14.2	Kazakhstan	9.3
Kazakhstan	11.2	Turkey	3.7

Quarterly indicators

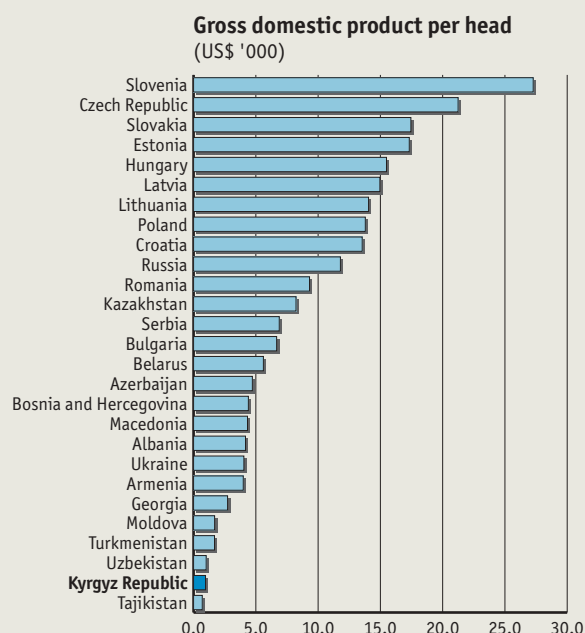
	2007			2008				2009
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Government finance (Som bn)								
Revenue & grants	8.3	9.5	11.9	9.2	11.8	12.2	13.4	9.8
Expenditure & net lending	8.2	8.1	14.3	7.1	12.4	11.8	13.7	10.2
Balance	0.1	1.4	-2.4	2.1	-0.6	0.4	-0.4	-0.4
Wages & prices								
Monthly earnings (Som)	3,904.2	3,957.9	4,637.2	4,658.5	5,287.7	5,458.0	6,281.7	5,573.0
% change, year on year	34.1	29.2	29.5	36.8	35.4	37.9	35.5	19.6
Consumer prices (2000=100)	136.0	140.7	157.6	164.0	175.1	181.8	186.8	190.5
% change, year on year	4.8	9.8	21.3	22.3	28.7	29.2	18.5	16.2
Producer prices (2000=100)	169.6	178.1	192.8	209.2	222.6	229.7	230.3	239.1
% change, year on year	4.9	12.3	20.9	26.8	31.3	29.0	19.5	14.3
Financial indicators								
Exchange rate Som:US\$ (av)	38.0	37.7	35.1	36.2	36.3	35.2	38.6	40.9
Exchange rate Som:US\$ (end-period)	38.0	36.9	35.5	36.4	35.9	36.7	39.4	42.6
Lending rate (av; %)	25.3	25.3	25.3	21.8	26.4	19.8	19.9	-
Deposit rate (av; %)	4.1	5.6	5.4	6.1	5.6	5.7	4.0	-
M1 (end-period; Som bn)	26.2	28.5	32.3	-	-	-	-	-
% change, year on year	51.0	41.9	40.2	-	-	-	-	-
M2 (end-period; Som bn)	35.1	38.6	43.1	-	-	-	-	-
% change, year on year	45.6	41.0	33.2	-	-	-	-	-
Sectoral trends, production								
Coal & lignite ('000 tonnes)	47.2	95.4	169.9	66.9	47.5	145.5	232.4	-
Natural gas (m cu metres)	3.8	2.2	4.9	5.9	3.8	3.6	4.0	-
Crude oil (b/d)	1,381.7	1,437.9	1,357.6	1,213.0	1,389.7	1,638.7	1,462.0	-
Electricity (bn kwh)	2.6	3.2	4.0	4.9	1.9	2.2	2.7	-
Foreign trade (US\$ m)								
Exports fob	257.7	304.2	323.5	267.9	377.0	497.6	499.0	235.1
Imports cif	646.8	720.1	892.0	785.8	1,020.8	1,091.9	1,159.1	639.5
Trade balance	-389.1	-415.9	-568.5	-517.9	-643.8	-594.3	-660.1	-440.4
Balance of payments (US\$ m)								
Merchandise trade balance fob-fob	-302	-325	-468	-	-	-	-	-
Services balance	0	82	61	-	-	-	-	-
Income balance	-8	-11	-3	-	-	-	-	-
Net transfer payments	237	319	282	-	-	-	-	-
Current-account balance	-73	65	-127	-	-	-	-	-
Reserves excl gold	885	1,012	1,107	1,063	1,154	1,208	1,153	970

Sources: IMF, *International Financial Statistics*; National Statistical Committee; National Bank of the Kyrgyz Republic.

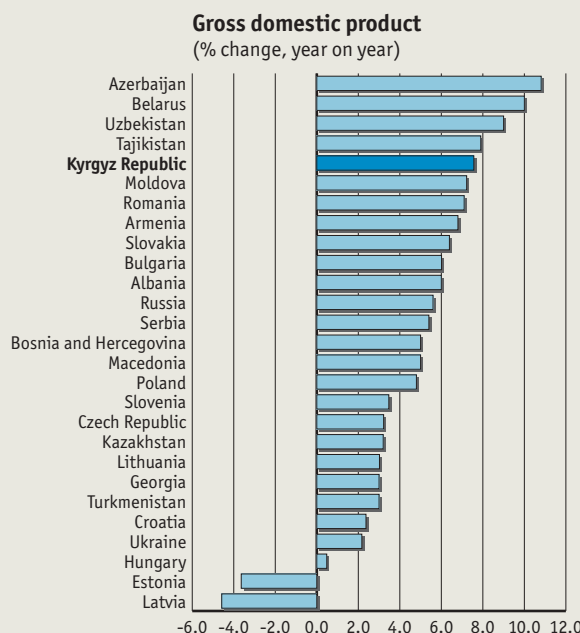
Comparative economic indicators, 2008



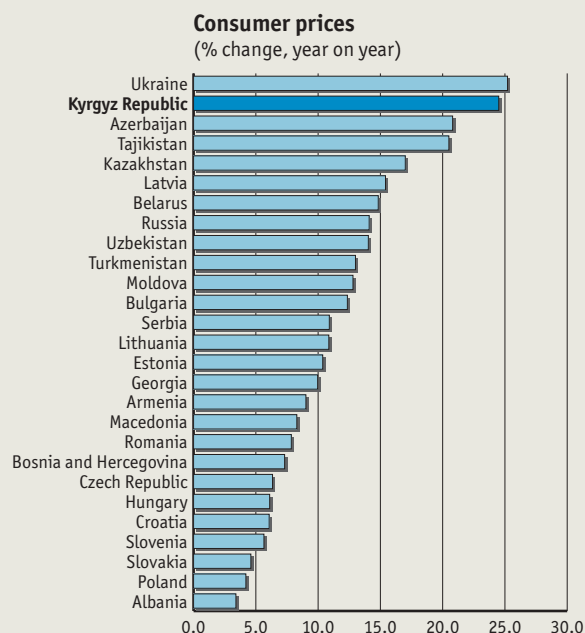
Sources: Economist Intelligence Unit estimates; national sources.



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Sources: Economist Intelligence Unit estimates; national sources.

Outlook for 2009-10

Political outlook

Domestic politics Despite the comparative stability since the parliamentary election held in December 2007, the Kyrgyz Republic will remain vulnerable to the risk of unrest over the forecast period. The sidelining of the opposition by the presidential administration in the election in 2007—a poll that was criticised by international observers—will continue to cast doubt on the legitimacy of parliament. Furthermore, it is likely that the president, Kurmanbek Bakiyev, will follow the lead of rulers in neighbouring states in exploiting the administrative resources at his disposal to ensure his re-election at the presidential election to be held in July 2009. Opposition forces have become slightly more cohesive than in the past, but have been unable to agree on a unified presidential candidate, making Mr Bakiyev's re-election more likely. There is limited opposition representation in parliament, with the pro-presidential Ak Jol (True Path) party holding almost 80% of the seats. The extra-parliamentary opposition movement will continue to mount occasional public protests, as it has little recourse other than to take its grievances to the streets.

The grievances of the opposition continue to be centred partly on what it perceives as the illegitimacy of the current parliament and the disproportionate power in the hands of the presidency. However, these constitutional wrangles will probably continue to find little sympathy among the population. The opposition will therefore attempt to rally the public behind it by concentrating instead on the more resonant issues of harsh economic conditions and controversial privatisations. Public protests on such issues are likely in the context of high inflation and a forecast rapid slowdown in economic growth, and will have an increasing potential to turn violent as economic hardship deepens. However, the government is likely to be able to contain them. One approach adopted by the government will be financial, by means of increasing welfare payments to support vulnerable groups, for example. The government will also be increasingly prepared to use force to quell any violent unrest.

Despite previous fissures within the pro-presidential administration, the ruling elite is now more self-assured, having secured from Russia significant funding for budgetary support and investment. Furthermore, the authorities have shown that they are able to co-opt dissenting voices, and are more willing than in the past to apply police, media and administrative methods to secure their position and to curb dissent, and to do so more robustly and systematically than before.

International relations The authorities have tended to try to pursue a multi-vectoral foreign policy—that is, one that seeks to maintain good relations with all the main powers in the region. However, following the announcement of the closure of the US airbase at Manas, Russia has become a much more prominent partner. The US military presence at Manas has been a contentious issue, and although it has provided the authorities with much-needed revenue, this was dwarfed by a loan package agreed with Russia in February. Nevertheless, ties with the US will

not suffer a complete rupture, given that the uncertain security situation in Afghanistan is expected to lead to a certain degree of tolerance on the part of Russia to a US presence in the region, at least in the immediate term.

Economic policy outlook

Policy trends Policy trends in 2009-10 will be predominantly based on limiting the impact of external economic shocks. The Kyrgyz Republic has developed a policy programme with the IMF, having agreed an 18-month arrangement under the Fund's exogenous shocks facility (ESF). Nevertheless, the goal of meeting the Fund's criteria will have to be balanced against preventing a rise in social instability, particularly in a context in which inflation is still high and a rapid downturn in growth is forecast. The government's medium-term policy emphasis is on cutting inflation, sustaining growth and reducing poverty.

Progress on implementing the structural reform agenda is likely to continue to be impeded by a combination of political divisions within the country, social concerns and vested interests. The authorities have pledged to make foreign direct investment (FDI) a priority. However, uncertainty remains regarding the government's ability to implement such policies, as domestic opposition to the sale of state assets is strong, and investors will remain wary because of the poor business environment and high levels of corruption. A more difficult international economic environment will also limit new FDI into the Kyrgyz Republic. Since 2007 additional uncertainty has been created in the important gold sector by the protracted process of revision of the government's joint-venture agreement with the leading foreign investor in the sector, Cameco Corporation (Canada). These factors mean that, for the most part, only foreign investors familiar with the business environment in Central Asia—essentially Russian and Kazakh companies—will seek opportunities in the Kyrgyz Republic. The sale of assets to such firms is unlikely to attract controversy, owing to the long-standing historical links with these two countries. Nevertheless, FDI will be limited by the weak growth outlook for both Russia and Kazakhstan.

Fiscal policy The latest available data indicate a small budget deficit in the first quarter of 2009, following a surplus of 0.8% of GDP in 2008. However, the authorities estimate that the general government budget (a broader measure than the budget tracked in our tables, which excludes budgetary financing of the Social Fund) recorded a deficit of 1.3% of GDP in 2008. The government's attempt to maintain a relatively tight fiscal policy stance will come under pressure during the forecast period. The government is targeting a deficit of 1.7% of GDP on the general government budget in 2009. However, budgetary support from Russia amounting to US\$300m will enable the authorities to adopt a looser fiscal stance. The authorities will be reluctant to cut expenditure because of the need to use wage and pension increases to offset the impact on the population of the deteriorating economic outlook. A new tax code, introduced on January 1st 2009, reduced the rate of value-added tax (VAT) from 20% to 12%, and the unified tax code for small businesses fell from 10% to 6%. This last measure will improve compliance, thus lessening the detrimental impact that the cut has on revenue. However, the combined tax cuts are expected to lead to a loss of

Som3.4bn (US\$90m) in tax revenue in 2009. Revenue will also suffer from a contraction in real GDP, as the government's fiscal plan is based on a scenario that envisages real GDP growth of around 5%, which is much too optimistic. The worsening economic environment, and the possibility of public discontent, will tempt the authorities to apply expansionary expenditure measures. Combined, these factors are forecast to produce wider than targeted budget deficits in the forecast period. The Economist Intelligence Unit forecasts a state budget deficit of 2.6% of GDP in 2009, and one of 3.4% of GDP in 2010.

Monetary policy

The effectiveness of monetary policy will remain constrained by the underdeveloped nature of the domestic financial sector. A recent trend of rapid depreciation of the som has led the National Bank of the Kyrgyz Republic (NBKR, the central bank) to make extensive foreign-currency sales, and this trend is likely to continue over the next few months. This will help the central bank to control the som money supply, but the NBKR will be reluctant to deplete its foreign reserves excessively. However, in 2009 a reduction in imported inflation linked to lower food and fuel prices will alleviate pressure on the NBKR to defend the som as an anti-inflationary measure. A reduction in remittance inflows relative to 2007-08 will also help to prevent rapid money supply growth.

Economic forecast

International assumptions

International assumptions summary

(% unless otherwise indicated)

	2007	2008	2009	2010
Real GDP growth				
World	5.0	3.0	-1.8	1.9
OECD	2.7	0.9	-4.0	0.2
EU27	2.8	0.8	-4.1	-0.5
Exchange rates				
Rb:US\$	25.6	24.9	35.0	36.2
US\$:€	1.369	1.470	1.323	1.385
SDR:US\$	0.651	0.629	0.666	0.648
Financial indicators				
¥ 3-month repo rate	0.61	0.78	0.41	0.48
€ 3-month interbank rate	4.27	4.65	1.48	1.43
Commodity prices				
Oil (Brent; US\$/b)	72.7	97.7	40.0	50.0
Gold (US\$/troy oz)	696.7	870.2	900.0	887.5
Food, feedstuffs & beverages (% change in US\$ terms)	30.9	28.8	-25.8	3.8
Industrial raw materials (% change in US\$ terms)	11.2	-5.1	-42.2	14.9

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

We expect the economies of two of the Kyrgyz Republic's most important economic partners, Kazakhstan and Russia, to contract in 2009, given the impact of global financial turbulence and a slowdown in growth worldwide. The two countries are important destinations for Kyrgyz non-gold exports, as well as the main host countries for Kyrgyz migrant labour. In addition, Kazakh banks control a significant proportion of the Kyrgyz banking sector. Prices for oil

will fall sharply in 2009, before increasing in 2010. This will help to offset the impact on the Kyrgyz Republic's import bill of a doubling in gas import prices. Prices for other commodities and food are also expected to decline markedly in 2009, before recovering slightly in 2010. The price of gold, the country's main export commodity, is forecast to stabilise in 2009-10. However, they will remain at historically high levels over the forecast period.

Economic growth Real GDP growth slowed from 8.5% in 2007 to 7.6% in 2008. The slowdown was partly in response to the sharp rise in inflation since late 2007, and to continuing supply problems in the power sector. A downturn in the Russian and Kazakh economies will have a knock-on effect on growth in 2009, in terms of reduced demand for Kyrgyz exports and a fall in inflows of remittances to fund private consumption. Real GDP growth slowed to just 0.2% year on year in the first quarter of 2009, as industrial output slumped. A deepening of financial sector problems in Kazakhstan will have a further detrimental effect on the Kyrgyz construction sector and on the availability of credit for investment, as many Kyrgyz banks are owned by Kazakh parent institutions. Growth in private consumption and fixed investment will also suffer from the sharp rise in inflation seen in 2008. Continuing problems in the electricity-generating sector are likely to hamper industrial output. Economic activity was constrained by the frequent institution of power cuts in 2008, and until large-scale new power projects come on stream, this problem is likely to persist. We therefore forecast a contraction in real GDP of 3% in 2009. The economy will not begin to recover until the end of the forecast period, so that we expect a further small contraction, of 1%, in 2010.

Inflation Continuing power shortages and a doubling in the cost of gas imports in 2009 will exert significant upward pressure on prices. However, we forecast a sharp fall in international oil prices in 2009, which will ease imported inflationary pressures. Forecast falls of over 25% in average food prices and over 40% in the prices of industrial raw materials will also contribute to a slowdown in Kyrgyz inflation compared with 2008. A slowdown in consumer demand will also curtail price growth for domestically produced goods and for services, although utilities prices are likely to continue to rise. We now forecast average annual inflation at 7.5% in 2009, compared with 24.5% in 2008, and expect further disinflation, to an average of 5.5%, in 2010. The authorities' attempts to ease inflationary pressure through administrative and monetary measures will also contribute to the slowdown in price growth.

Exchange rates The som saw a sharp reversal in a trend of slow nominal appreciation in September 2008, and has fallen by around 20% since then, as investors withdraw from perceived higher risk in emerging-market currencies. The NBKR has been selling foreign-currency reserves to support the som, so that foreign-exchange reserves, which had stood at US\$1.2bn at the end of 2008, had fallen to US\$1.05bn by end-March 2009. The NBKR is unlikely to continue such heavy intervention in the currency markets for long, in order not to deplete its reserves too rapidly. Reserves fell from 4.4 months of import cover at the end of 2007 to an estimated 3.3 months one year later. Given that the US dollar is likely to remain strong against emerging-market currencies, we have revised our

forecast for trends in the som exchange rate over the forecast period. We now forecast that the Kyrgyz will depreciate much more rapidly, to Som49.1:US\$1 by end-2009, from Som39.4:US\$1 at end-2008. The annual average exchange rate is forecast at Som45.2:US\$1, down from Som36.6:US\$1 in 2008. As greater stability returns to international financial markets, we expect the som to revert gradually to its earlier trend of a slow appreciation from mid-2010 onwards, although it will still depreciate slightly over the year as a whole, to Som49.7:US\$1 by year-end. A faster depreciation will be prevented by IMF disbursements and by lower debt repayments as the external debt burden falls, owing to the renegotiation of Paris Club debt and the government's policy of tapping only concessional sources of credit.

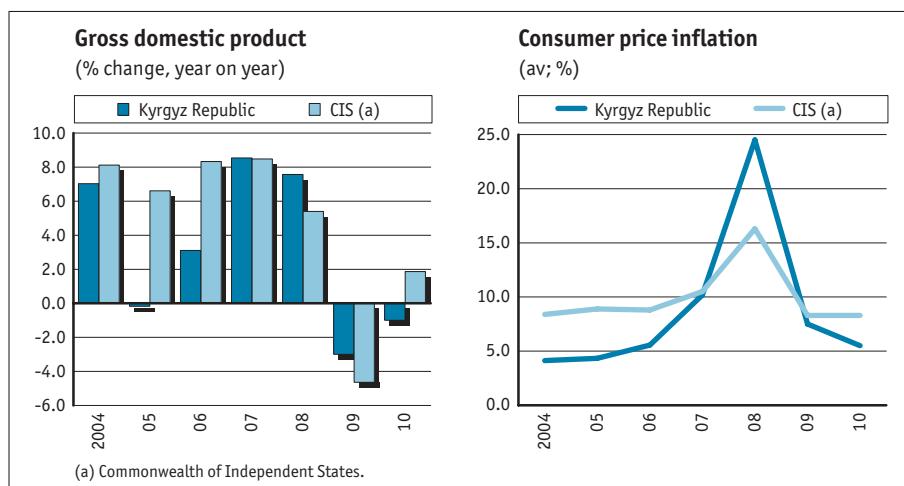
External sector The Kyrgyz Republic has been recalculating its current-account data to take account of unrecorded remittance inflows and shuttle trade re-exports. Until this process is complete, year-on-year comparisons will remain problematic. Nevertheless, the deficit has still widened markedly since 2005, driven by rising energy import prices and, in 2008 in particular, high food prices. We now estimate the deficit at 14% of GDP in 2008. A downturn in the economies of the Kyrgyz Republic's main trading partners will curtail export revenue in 2009. However, import costs will decline more rapidly, despite a doubling in the price of gas imports from Uzbekistan in 2009. This will result in a marked narrowing of the trade deficit in US dollar terms compared with 2008. A rapid downturn in construction in Russia and Kazakhstan, which act as hosts to large numbers of Kyrgyz migrant labourers, will result in a fall in remittance inflows in 2009, eroding the transfers surplus. The balance on services and income will remain fairly stable, but these are not significant contributors to the overall current-account balance, which we forecast at 9.5% of GDP in 2009. Although we expect a slight pick-up in demand for Kyrgyz exports in 2010, together with a less steep gas price increase and some recovery in remittance inflows, higher global commodity prices will prevent a more rapid narrowing of the current-account deficit in that year. We therefore forecast a deficit of 9% of GDP in 2010.

Forecast summary

(% unless otherwise indicated)

	2007 ^a	2008 ^a	2009 ^b	2010 ^b
Real GDP growth	8.5	7.6	-3.0	-1.0
Exports of gold ('000 kilograms)	10.6	18.1	19.2	19.9
Consumer price inflation (av)	10.2	24.5	7.5	5.5
Lending rate	24.6	23.3	25.8	23.3
Government balance (% of GDP) ^c	0.1	0.8 ^d	-2.6	-3.4
Exports of goods fob (US\$ m)	1,337	1,847	1,393	1,669
Imports of goods fob (US\$ m)	-2,636	-3,754	-2,308	-2,542
Current-account balance (US\$ m)	-268	-708 ^d	-406	-361
Current-account balance (% of GDP)	-7.0	-14.0 ^d	-9.5	-9.0
Exchange rate Som:US\$ (av)	37.32	36.57	45.23	49.95
Exchange rate Som:US\$ (end-period)	35.50	39.42	49.09	49.73
Exchange rate Som:€ (av)	51.07	53.76	59.81	69.18
Exchange rate Som:Rb (av)	1.46	1.47	1.29	1.38

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Including central and local budgets, but not the Social Funds. ^d Economist Intelligence Unit estimates.



The political scene

Aid package makes the authorities more secure

Emerging from a winter of power shortages and blackouts, with the impact of the regional economic slowdown looming and faced with a unifying opposition, at the beginning of 2009 the government seemed to be firmly on the defensive. However, the announcement by the president, Kurmanbek Bakiyev, of a large aid package from Russia during a visit to Moscow at the start of February has changed the political and economic outlook of the Kyrgyz Republic considerably. The aid package is worth a total of US\$2.3bn, which is close to half of the Kyrgyz Republic's entire GDP in 2008. Economically, it gives the government much greater room for manoeuvre to counter the impact on output and jobs of the fall in demand linked to the regional economic downturn (see Economic policy). Internationally, it draws the country more firmly into the "sphere of influence" claimed by the Russian president, Dmitry Medvedev, as one of the five principles of Russian foreign policy formulated by him in the wake of the conflict with Georgia in August 2008. Regarding domestic politics, it will have altered the self-confidence of the main political forces, lifting the mood of the authorities and demoralising its opponents. This was shown most clearly by the speed with which an early presidential election was called.

A presidential election is called early

In retrospect, probably the latest date at which Mr Bakiyev's campaign for re-election can be said to have started was the end of January, with his articulation of a new "ideology of reasonable balance" in a televised broadcast to the nation. In the broadcast, he prioritised improving the performance of the public administration, and stressed the vital role of the intelligentsia in the ongoing task of nation-building. To meet the challenges of the future, he argued, a reasonable balance had to be struck between innovation and the preservation of cultural traditions; in the economy, between free markets and state regulation; and in politics, between democracy and state control. This was followed on February 11th by a televised question-and-answer session with selected journalists, in which Mr Bakiyev stated directly that, making use of his constitutional right, he intended to stand again for the presidency, based on his record of economic progress and political stability.

Clarification had been called for by an opposition MP, Asylbek Jeenbekov of the Social Democratic Party of Kyrgyzstan (SDPK), on whether the president's term in office—and thus the date of the presidential election—was to be governed by the constitution in place at the time of Mr Bakiyev's election in July 2005, or by the one that he introduced in a snap referendum in October 2007. The Constitutional Court decided on the former, ruling that the inauguration of a new head of state should take place no later than October 25th this year. At the end of March the legislature, the Jogorku Kenesh, used its prerogative to set the election date for July 23rd. In his pronouncements on this issue, Mr Bakiyev was keen to stress that, as with any other citizen, the president is subject to the law and that he would abide by the court's ruling. In fact, co-ordination of state institutions has been tightened under his presidency, including by means of an active personnel policy. It is therefore more likely that the calling of an early presidential election was the concerted action of the ruling state group, calculated to capitalise on the successful negotiation of the aid deal with Russia and the popularity of the decision to close the US air base at Manas Airport. It was probably also designed to attempt to secure Mr Bakiyev's re-election before the full impact of the regional economic crisis stirs up underlying political divisions and economic grievances.

The opposition appears to be losing momentum

Most reports suggest that the national anti-government rallies—planned for March 27th by the United People's Movement (UPM), a recently forged umbrella organisation of opposition groups and parties—turned out to be relatively sparsely attended. Even by simply splitting the difference between official and opposition estimates, a figure is reached of around 10,000-12,000 protesters participating at all locations nationwide. The actual number of attendees was probably considerably lower. At the rally in the capital, Bishkek, which took place at a location agreed with the authorities beforehand, the protest organisers were keen to reassure state officials that no one had been brought in from locations outside the city. The opposition's demands included the right to nominate half of the candidates to electoral commissions and high-profile state offices, in an attempt to ensure that the presidential election, called only days earlier, would be free and fair. Mr Bakiyev was given until the end of April to comply, although there was no indication of how the UPM intended to compel him do so, other than by organising yet one more campaign of "indefinite protests".

The announcement of the election just days before the rally suggests that it was timed to disrupt the plans of the government's opponents—not least, because one of their main demands has been for the president to step down and for a fresh election for the head of state to take place. The relatively low turnout at the protest suggests that the UPM has lost a good deal of momentum, compared with the beginning of the year, when the movement's creation from all of the main strands of the political opposition appeared to hold out the hope of a new and politically more effective stage in the opposition's development. The rally's lack of resonance with the general population is also perhaps explained by rising uncertainty now that the effects of the economic crisis are beginning to be felt: the government, in the wake of securing significant new donor financing, has been able to announce a series

of ambitious plans for economic stabilisation and fiscal stimulation (see Economic policy).

The opposition fails to agree on a single candidate

The leaders of the UPM had at least promised to select a single candidate for the presidential race by April, and at a national gathering at the end of the month Almazbek Atambayev was chosen as the opposition candidate. Mr Atambayev, who was prime minister for eight months during 2007, is the head of the SDPK, one of the two small opposition parties that made it into parliament in the controversial election of December 2007; the other is the Communist Party of Kyrgyzstan (KPK), which is backing Mr Bakiyev in the presidential race. Were he to win the presidential election, he has promised to reduce the powers of the presidency—one of the main political demands of the opposition, which favours a more parliamentary form of government. Following the withdrawal of one of the constituent parties, Asaba (Banner), from the UPM in early April, at the beginning of May another, Ak Shumkar, broke ranks to field its own leader, Temir Sariyev, as a presidential candidate. This probably marks the end of the opposition's hopes of mounting a unified and successful presidential campaign.

Prospects for political instability

More Tulips in the spring?

Outbreaks of political unrest in a number of east European countries since the end of 2008 seem likely to be only the first rumblings of far greater eruptions of social protest in the year to come, as the full impact of the global economic crisis is felt. The economic downturn might therefore have negative implications for political stability in the region—that is, not just for the continued rule of incumbent governments, but also for the continued existence of established political systems.

For the Kyrgyz Republic, the main issue is whether the political system that has developed since the second half of 2007 is sufficiently robust to face down any possible surge in political and social conflict, or whether it would be more prudent to expect a re-run of the "Tulip Revolution" of 2005, in which perceptions of corruption and electoral falsification led to mass demonstrations and the removal of the previous president, Askar Akayev.

The Economist Intelligence Unit has developed a political instability index to facilitate comparison of countries' vulnerability to unrest, conceived as an exacerbation of underlying social and political tendencies to unrest by economic distress. For this reason, the overall index is made up of two component indices, one to capture underlying vulnerability and a second to measure economic distress.

Although the Kyrgyz Republic does not rate as the east European country most vulnerable to political instability in 2009—that accolade goes to Ukraine—within Central Asia, it vies with Tajikistan for this position, with the two ranked in joint 33rd place globally, along with countries that include Myanmar and Argentina, on an overall score of 7.1, out of a maximum possible instability score of 10.

In our index, the Kyrgyz Republic, along with Tajikistan and Uzbekistan, starts off at greater risk from the impending economic stress, on the assumption that poorer countries are less well equipped to cope with it. However, the overall political instability scores for all countries in the region, and Russia, worsen significantly in 2009 relative to 2007, reflecting a large increase in their scores for economic distress. This is because, in view of the intensification and spread of the world economic crisis to the region, all of them face a significant risk of a fall in real GDP per head this year—of more than 4% in the case of Russia—and all except Kazakhstan are at significant risk of the rate of unemployment rising above 10%.

For all of the countries in question, corruption is rated as high, and all of them, except Russia, have only become independent states in recent times—that is, since the demise of the Soviet Union in 1991. Tajikistan is scored as slightly more vulnerable to the underlying causes of unrest than the Kyrgyz Republic, partly because it has a greater number of large-scale episodes of political instability in the recent past (at least 50,000 people were killed in its five-year civil war of the 1990s), and partly because its infant mortality rate is higher than expected for its level of income, a measure that stands in as an indicator of the level of social provision. The Kyrgyz Republic, however, is more vulnerable as a political regime that is

neither fully democratic nor wholly authoritarian, whereas all the other Central Asian countries (but not Russia) have the advantage, from the point of view of state stability, of being authoritarian regimes. Additionally, Uzbekistan, Turkmenistan and Russia are more ethnically homogeneous.

Political instability index for Russia and Central Asia in 2009

	Index (out of 10)			Country ranking	
	Overall index	Underlying vulnerability	Economic distress	Region	World
Kyrgyz Republic	7.1	6.3	8.0	1	33
Tajikistan	7.1	6.3	8.0	1	33
Russia	6.5	5.0	8.0	n/a	65
Uzbekistan	6.3	4.6	8.0	3	70
Turkmenistan	6.2	5.4	7.0	4	74
Kazakhstan	4.8	4.6	5.0	5	124

Source: Economist Intelligence Unit.

Mr Bakiyev looks likely to win re-election

In effect, Russia's aid package has returned Kyrgyz politics to the track that it was on before late 2008, when, for a time, power shortages and the aftershocks of factional rivalry started to make Mr Bakiyev's government look vulnerable. In this light, the unexpected calling of an early presidential election follows the pattern of the constitutional referendum and the parliamentary election before it, in which a confident presidential administration was able to wrong-foot an irresolute and fractious opposition by pressing ahead with well-prepared political initiatives at short notice. The Economist Intelligence Unit considers the Kyrgyz Republic to be one of those countries at high risk of political unrest as a result of the global economic crisis. This could yet produce a decisive shift in attitudes against existing political institutions, especially if the government's economic measures are insufficiently, or insufficiently quickly, effective. In addition, the death of a prominent political figure, Medet Sadyrkulov, in a car crash in March has the potential to re-open rifts in the ruling elite, if the balance of the system of clan patronage that underlies formal politics is perceived to be threatened. However, with considerable additional resources with which to patronise elite factions and to address any rise in popular grievances, and with the opposition appearing to disintegrate early on in the campaign, the most likely outcome is that Mr Bakiyev will win the presidential election in July. (He would probably win, even if the vote was substantially free and fair—although, on the evidence of the most recent electoral outings, he is unlikely to take that chance.) Furthermore, the ruling group has shown itself capable of systematically and methodically augmenting its powers, and of using them, if necessary, to further its interests—most recently by means of the legal harassment of those opponents considered to pose the greatest threat (February 2009, The political scene). The broad pattern of behaviour of the ruling elite thus suggests that it has the resources and the will to face down any outburst of social unrest, should the need arise.

Democracy index: the Kyrgyz Republic

The Economist Intelligence Unit's 2008 democracy index ranks the Kyrgyz Republic 114th out of 167 countries, putting it third-lowest among the 34 countries considered to be hybrid regimes. This designation includes three other former Soviet states—Russia, Armenia and Georgia. The Kyrgyz Republic has the highest score among the five former Soviet Central Asian states, and is alone among them in being classed as a hybrid regime: all the others are categorised as authoritarian, along with the Kyrgyz Republic's southern neighbour, China.

Corruption brings down overall score

The Kyrgyz Republic scores particularly poorly in the category assessing *government functioning*, where it is outranked by most other former communist states in central and eastern Europe. Pervasive corruption, as well as public mistrust of the government and state officials, contributes to the poor score for this category. The Kyrgyz Republic also scores fairly poorly for *political participation*, reflecting low levels of political party membership and voter cynicism regarding the political class.

Administration has grown more autocratic

Historically, the Kyrgyz Republic had been viewed as a beacon of democratic freedoms in Central Asia, compared with its more autocratic former Soviet neighbours. However, since the "Tulip Revolution" in 2005, when the then president, Askar Akayev, was ousted by a wave of popular protest over perceived electoral manipulation, the country has undergone something of a reversal. *Civil liberties* are increasingly under threat in the light of new, more restrictive laws governing the media and the right to hold public demonstrations. Although the Kyrgyz Republic scores highly in this category in comparison with its Central Asian neighbours, the presidential administration of Kurmanbek Bakiyev has shown itself increasingly willing to deal harshly with popular protest. Opposition demonstrations that turned violent were forcibly dispersed by riot police in mid-2007.

Democracy index

	Overall score	Overall rank	Electoral process	Government functioning	Political participation	Political culture	Civil liberties	Regime type
Kyrgyz Republic	4.05	114	4.83	1.86	3.89	4.38	5.29	Hybrid regime

Note. Overall and component scores are on a scale of 0 to 10; overall rank is out of 167 countries.

Note on methodology

There is no consensus on how to measure democracy and definitions of democracy are contested. Having free and fair competitive elections, and satisfying related aspects of political freedom, is the *sine qua non* of all definitions. However, our index is based on the view that measures of democracy that reflect the state of *political freedom* and *civil liberties* are not "thick" enough: they do not encompass sufficiently some crucial features that determine the quality and substance of democracy. Thus, our index also includes measures of *political participation*, *political culture* and *functioning of government*, which are, at best, marginalised by other measures.

Our index of democracy covers 167 countries and territories. The index, on a 0 to 10 scale, is based on the ratings for 60 indicators grouped in five categories: *electoral process and pluralism*; *civil liberties*; the *functioning of government*; *political participation*; and *political culture*. The five categories are inter-related and form a coherent conceptual whole. Each category has a rating on a 0 to 10 scale, and the overall index of democracy is the simple average of the five category indexes.

The category indexes are based on the sum of the indicator scores in the category, converted to a 0 to 10 scale. Adjustments to the category scores are made if countries fall short in the following critical areas for democracy:

- whether national elections are free and fair;
- the security of voters;
- the influence of foreign powers on government; and
- the capability of the civil service to implement policies.

The index values are used to place countries within one of four types of regimes:

- full democracies—scores of 8 to 10;
- flawed democracies—score of 6 to 7.9;
- hybrid regimes—scores of 4 to 5.9;
- authoritarian regimes—scores below 4.

The full methodology for the index and related discussion can be found at www.eiu.com/DemocracyIndex2008.

Economic policy

Russian aid will counter the impact of economic downturn

At the beginning of March Akylbek Japarov, the minister of economic development and trade, said that state budget expenditure was to be reduced in an upcoming review, although he stressed that the cuts would affect the capital budget rather than social spending, with benefits set to increase and pensions to rise from April 1st. This indicates that the economic crisis, in combination with some ill-timed changes to the tax code, has started to constrain the government's room for manoeuvre on fiscal policy.

However, against the background of a deterioration in the underlying fiscal position, at the beginning of February the president, Kurmanbek Bakiyev, announced that a substantial package of aid from Russia had been secured. Amounting to more than US\$2.3bn—or close to one-half of the Kyrgyz Republic's GDP in 2008—the package is made up of a US\$150m grant, a US\$300m budgetary support loan, a further loan of US\$1.7bn for completion of a high-profile hydro-electric project, and a US\$194m debt-for-equity swap and debt cancellation.

According to the finance minister, Marat Sultanov, the grant element of the package, which had already been transferred by the beginning of April, is to be used as a contingent reserve in the event that the economy deteriorates because of the global economic crisis. At the end of March Mr Japarov referred to the sum as a "stabilisation fund", suggesting that it will be used in the first instance to support official foreign-exchange reserves. Along with the second US\$25m tranche of the IMF's exogenous shocks facility (ESF; February 2009, Economic policy), approved in May, this will bolster the economy's defences against external destabilisation.

At a press conference in February Mr Sultanov and the prime minister, Igor Chudinov, said that the budgetary support loan of US\$300m was to be used to back viable projects in the real economy. Mr Bakiyev followed this up in a televised address in mid-March, in which he made clear his preference for investing the loan in infrastructure and jobs. However, he also announced plans to increase oversight of how development funds are spent. To ensure transparency and control, the work of a new monitoring council is to be supervised by "prominent people", including members of the political opposition. In a novel twist, he announced that the holders of senior posts on the council would be decided by means of a competition, open to all qualified people aged 27-45—a step apparently designed to lend an inclusive and youthful appeal to his re-election campaign (see The political scene).

Loan will support the electricity sector

The largest part of the Russian aid package is a loan (priced at 3 percentage points above Libor and repayable over 20 years from 2017) of US\$1.7bn for the construction of the Kambarata-1 hydroelectric facility on the Naryn River. This is to be undertaken by a specially created 50:50 joint venture of the state-owned companies Kyrgyz Electric Stations and Russia's Unified Energy System (UES), which will operate the plant in common. In the immediate term the project will provide demand for construction suppliers, such as cement plants, hit by the fall in activity in the domestic construction sector, which contracted by

around 11% in 2008, according to the National Statistical Committee (NSC). It will also provide work for an estimated 15,000-18,000 construction workers, helping to absorb some of those returning home after the fall-off in building work in Russia and Kazakhstan. Over the longer term the additional generating capacity will make the country less prone to power outages and will reduce reliance on foreign energy, such as Uzbek gas. It will boost the potential to raise electricity exports, which were scaled back dramatically in 2008 because of low water levels in the Toktogul Reservoir.

The fourth element of the aid package is a swap of 48% of shares in TNK Dastan, which makes submarine torpedoes, and ownership of a building in Bishkek in return for a portion of the US\$193.5m in debt that the country owed to Russia at the start of 2009, with the remainder reportedly written off under Paris Club rules. Although this does not provide any new money, it will free up state resources for use elsewhere at a critical time.

Russia's aid package thus alters the position of the Kyrgyz authorities considerably. In theory, a decline in output as a consequence of a drop in demand for goods and services could be expected to trigger a fall in interest rates, which should in turn induce a rise in investment demand—in this way offsetting the impact of the original demand shock. In the Kyrgyz Republic, however, with an underdeveloped financial sector, this effect would be muted, so that, unchecked, more of the impact of the original fall in demand would feed through as loss of output and jobs. The timely provision of funds from Russia is doubly valuable, therefore, at so critical a juncture, giving the government the means to counter the negative impact of a fall in trade, remittances and inward investment by increasing social spending and business support, while staving off the prospect of a fiscal crisis. In combination with funds from other sources—such as from the improved revenue deal with the Centerra gold mining company, which at the end of April was reported to have guaranteed more than US\$3bn to the budget over the long term—it could also make it easier for the government to realise its medium-term development goals.

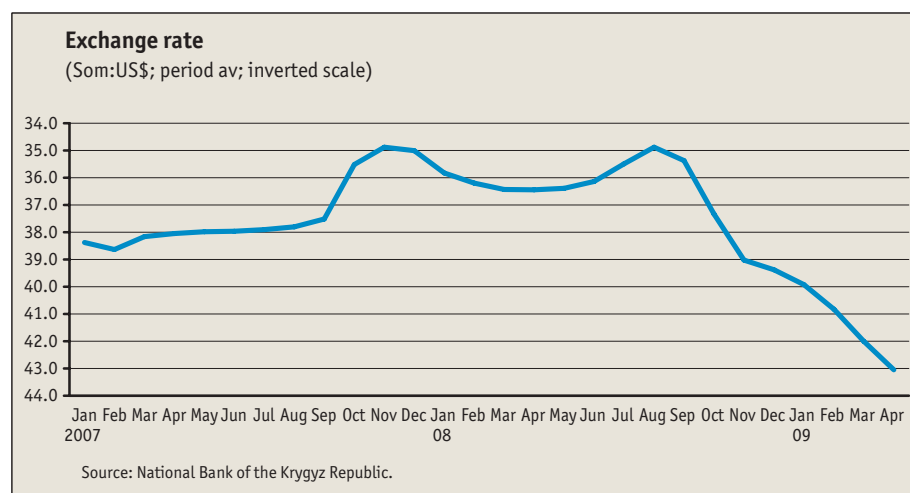
The som continues to fall

At the beginning of February 2009 a 20% devaluation of the Kazakh tenge caused a rush for hard currency in the Kyrgyz Republic, in anticipation that a steep som depreciation might follow. The Kyrgyz Republic operates a managed float. However, the fall of the tenge—itself partly in response to a substantial fall in the Russian rouble in January—must have increased the pressure to allow a depreciation of the som to match, in order to maintain competitiveness against the currencies of two of the Kyrgyz Republic's leading trade partners, and so avoid further damage to export competitiveness in a rapidly deteriorating external environment. In 2008 the real effective exchange rate (REER) of the som had already appreciated by around 8%, according to a report by the Asian Development Bank (ADB), reflecting higher inflation in the Kyrgyz Republic than in the economies of its leading trade partners.

The question of the optimal exchange-rate policy for the authorities to adopt has been high on the agenda at least since the slide of the Kyrgyz som at the beginning of September 2008, as part of a broader weakening trend among

emerging-market currencies against the US dollar. As exports, remittances and inward investment decline compared with their previous levels, the corresponding fall in foreign-currency inflows will only add to depreciation pressure. In early April Mr Japarov admitted that the som would probably continue to decline in value, given the excessive costs incurred in supporting the currency in the early months of the year (gross international reserves fell by 15% between June 2008 and March 2009, according to the IMF). Nevertheless, the authorities still hope that this can be achieved relatively gradually, as it has been up until now. In this respect, the transfer of funds from Russia as instalments of its aid package could mitigate to a considerable extent the immediate downward pressure on the som.

Thus, in April the som appeared to steady around Som43:US\$1, having fallen from around Som39.5:US\$1 at the beginning of 2009 and a peak of Som34.5:US\$1 at the beginning of September 2008—a nominal depreciation of about 20% over eight months. By contrast, in this period the Kyrgyz currency strengthened rapidly against the Russian rouble, from about Som1.8:Rb1 in early September 2008 to Som1.2:Rb1 in February 2009, although it has since come back down to around Som1.35:Rb1, which is still a nominal appreciation of more 30% since September.



Gross international reserves, although down from US\$1.3bn in July 2008, picked up slightly in March, to US\$1.05bn, from a low of US\$1.03bn in February, probably reflecting in part replenishment through donor financing (February 2009, Economic policy), but also perhaps a decision to maintain reserves and let the currency find its own level, at a time when the focus has started to switch to cautious monetary easing as part of a range of measures to stimulate economic growth. At the end of April the NBKR's discount rate dipped below 12%, having come close to 16% at the end of October 2008.

Development plan is overoptimistic

In parallel with the onset of the presidential campaign (see The political scene), and perhaps conceived as an integral part of it, at the end of January Mr Japarov announced a reformulation of the Kyrgyz Republic's medium-term economic development plan. It was approved by the government at the end of February. The plan aims to make improvements in three strategic areas: creating

a lighter and more flexible regime for the regulation and taxation of business, and implementing measures to attract and protect investment; improving the service offered by state administrative and legal institutions, notably by targeting measurable improvements in corruption indicators; and enhancing the living standards of the population, mainly by means of investment in health, education and social protection. The *Country Development Strategy for 2009-11* requires an estimated total of US\$8.2bn in investment over three years, with the majority of funds to be found from the public purse, but with more than one-third, or US\$2.8bn, to be drawn from private investors, and US\$600m from multilateral agencies. However, even the most downbeat of the growth scenarios underlying the plan—the so-called anti-crisis scenario, for annual GDP expansion of 2.8%—now looks unachievable, at least for 2009, which could undermine the resources available to the authorities to pursue their plans.

Central Asian water

A meeting of regional leaders exposes underlying resource conflicts

A meeting of the five Central Asian presidents in the former Kazakh capital of Almaty at the end of April, called to discuss joint measures to reverse the ecological damage to the Aral Sea, again featured the contentious issues of regional energy and water use, stirring up underlying interstate hostilities. The summit ended with a statement of common interest in developing a mechanism for the use of the region's water and for the protection of its environment. However, the lack of any detail to accompany this pledge suggests that an agreement is not at hand.

The crux of the problem is that the waters of the two main Central Asia rivers, which originate in the energy-poor states of the Kyrgyz Republic and Tajikistan, are vital for agricultural irrigation and other purposes for the energy-rich countries of Uzbekistan, Kazakhstan and Turkmenistan, which lie downstream. In the Soviet era, the necessary exchange of resources was accomplished by central mechanisms within a single country. With independence and the erection of national borders, however, these mechanisms soon broke down and have never been durably replaced, causing periodic flare-ups in relations between the Central Asian countries ever since.

Co-operation on this issue within Central Asia is not without precedent. In October 2008 the basis for a short-lived deal was agreed by the heads of state in Bishkek, the Kyrgyz capital. The parties agreed to an arrangement whereby, up to the first quarter of 2009, the downstream states would supply energy to the upstream countries to induce the latter to release water in accordance with the preferred timing of the former.

Amid ecological discussions at the recent summit, the Kyrgyz president, Kurmanbek Bakiyev, attempted to raise for discussion the possibility of reviving the October 2008 agreement. He suggested that his country should manage the storage and timely supply of water as a service for which the downstream countries should pay. His intervention was given short-shrift by his Uzbek counterpart, Islam Karimov, who was eager to restrict discussion to the agreed ecological agenda, putting in doubt the possibility that a permanent solution for the equitable use of the region's water resources along the lines of the October deal is likely to be found soon.

In the run-up to the summit, Uzbekistan scored some successes in its effort to bring the other downstream countries, Turkmenistan and Kazakhstan, around to its way of thinking—that if the Kyrgyz and Tajik hydro schemes have to go ahead, they should do so with the consultation, and perhaps participation, of all those likely to be affected by their operation. In late February the Turkmen president, Gurbanguly Berdymukhamedov, expressed the view that regional energy projects should take into account the interests of all states concerned—echoing Uzbekistan's consistent line. Following a meeting of the Kazakh prime minister, Karim Masimov, with Mr Karimov in Tashkent, the Uzbek capital, in April, a joint statement vowed that the two countries would present a united front on the topic of regional water use. In response, the Tajik president, Imomali Rahmon, described as "groundless" the claims that his country's hydropower schemes would affect water flows and cause soil damage. At the Almaty gathering, Mr Bakiyev stressed that hydrological calculations showed that water flows would be unaffected by the upstream hydropower projects.

Significant new developments since October's temporary agreement are likely to have stoked the anxieties of the downstream nations regarding their upstream neighbours' intentions. In particular, the announcement in early February of

Russia's extension of a considerable loan, of US\$1.7bn, to the Kyrgyz Republic for the construction of the Kambarata-1 hydropower facility on the Naryn River, as well as Russia's direct involvement in the joint venture responsible for the construction and operation of the plant, will have sent alarm bells ringing in Tashkent.

In part, Mr Karimov is reluctant to discuss in an open format the most pressing and persistent resource issue affecting interstate relations regionally, because the construction of hydropower plants could threaten water flows to important cotton-growing regions in Uzbekistan and Turkmenistan.

In addition, Russian involvement in the upstream hydropower schemes alters relations in two ways. First, it could reduce the dependence of the Kyrgyz Republic and Tajikistan on Uzbek gas, inhibiting the effectiveness of a cut-off in gas supplies as a means of enforcing Uzbek policy. Second, it strengthens the position of the upstream countries, in that their interests are now more closely aligned with those of Russia, neutralising to some extent any latent threat from Uzbekistan's relative military strength.

Under Mr Karimov, Uzbekistan has pursued independence actively, playing off Russian and Western interest in its resources and strategic position to do so. In the wake of the August 2008 war between Russia and Georgia, the Russian president, Dmitry Medvedev, proclaimed a "sphere of influence" in the former Soviet space. Russia has often made this claim since the Soviet break-up, but the August war indicated that Russia was willing to back up its words with action. Uzbekistan must therefore be worried that Russia could use control of water flows for political leverage, to prevent Mr Karimov from straying too far from the fold.

As part of its long-term goal of keeping other powers out of its "near abroad", Russia—which was pointedly not invited to the April summit—appears to have been performing a rather transparent double role, playing off the upstream and downstream sides, urging co-operation to the one, while helping the other to push ahead with construction, perhaps in an attempt to reposition itself as the necessary outside arbiter. Appearing to recognise this threat, at the summit Mr Karimov said that "third parties which would very much like to take part in this discussion are also pursuing their aims".

With Central Asia now beset by the global economic crisis, it seems unlikely that the region's existing leaders—who for years have failed to produce a durable and mutually acceptable arrangement on water use—will be able to deliver on the declaration of the summit in late April. However, changes in the political environment as a result of weakening Uzbek leverage, greater Russian support for the upstream states and, more generally, a more assertive Russian profile in the region indicate that the situation that has prevailed in recent years might not be tenable. If the regional leaders alone cannot forge a more stable arrangement, perhaps this task will be performed by Russia.

Main economic policy indicators

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
State budget revenue (Som m)												
2007	1,894	2,043	2,355	2,564	2,580	3,111	2,880	2,900	3,732	3,846	3,510	4,574
2008	2,626	3,262	3,317	4,389	3,543	3,881	3,760	4,510	3,919	4,315	4,217	4,858
2009	3,064	3,351	3,428	-	-	-	-	-	-	-	-	-
State budget expenditure (Som m)												
2007	706	2,230	2,339	2,510	2,660	3,028	2,882	2,586	2,625	3,828	3,430	7,034
2008	803	2,676	3,665	4,501	3,618	4,260	4,160	3,724	3,883	4,523	3,306	5,914
2009	2,633	3,930	3,632	-	-	-	-	-	-	-	-	-
State budget balance (Som m)												
2007	1,188	-188	16	54	-80	83	-3	314	1,107	18	79	-2,460
2008	1,823	585	-348	-112	-74	-379	-400	786	36	-208	911	-1,056
2009	431	-579	-204	-	-	-	-	-	-	-	-	-
Exchange rate (Som:US\$; av)												
2007	38.38	38.63	38.16	38.05	37.98	37.96	37.90	37.80	37.52	35.51	34.88	35.01
2008	35.83	36.20	36.43	36.44	36.39	36.14	35.49	34.88	35.37	37.33	39.03	39.38
2009	39.92	40.83	42.00	43.05	-	-	-	-	-	-	-	-
Commercial bank lending rate (av; %)												
2007	22.3	23.0	27.9	31.9	16.9	25.3	25.4	19.9	25.3	24.7	27.3	25.3
2008	29.7	26.0	21.8	23.6	22.4	26.4	19.9	23.0	19.8	24.3	22.6	19.9
2009	32.1	27.3	-	-	-	-	-	-	-	-	-	-

Main economic policy indicators

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Commercial bank deposit rate (av; %)												
2007	6.0	5.5	5.4	5.8	6.2	4.1	6.7	5.7	5.6	3.9	5.5	5.4
2008	3.3	7.2	6.1	5.8	5.8	5.6	5.9	6.1	5.7	5.2	5.1	4.0
2009	5.7	7.1	-	-	-	-	-	-	-	-	-	-

Sources: IMF, *International Financial Statistics*; National Statistical Committee; Economist Intelligence Unit.

The domestic economy

GDP expands by 0.2% in first quarter

According to data from the National Statistical Committee (NSC), in the first quarter of 2009 real GDP increased by 0.2% year on year, compared with 5.2% growth in the first quarter of 2008. However, the data show a slight improvement compared with earlier in the year. In January-February GDP had contracted by 1.1%, and preliminary data show a further slight pick-up to growth of 0.5% in January-April. Growth is being sustained by the extraction industry, construction and parts of the services sector. In January-March output expanded by 12.5% year on year in the extraction sector, by 29% in construction and by 38% in communications. The services sector as a whole posted growth of 5.2%.

The main drag on economic growth in this period was the industrial sector, with overall industrial output contracting by 19.5% year on year in the first quarter, and by 21.1% if output from the Kumtor gold mine is excluded. Manufacturing output declined by 18.6%, and would have fallen further were it not for a fivefold increase in output of oil products, and a 45% increase in production of machinery and equipment. The sharp rise for machinery and equipment mainly reflects base-period effects, as output in the industry fell by almost 40% in the corresponding period of 2008.

Industrial production, Jan-Mar

(% change, year on year)

	2008	2009
Industrial production	4.7	-19.5
excl Kumtor production	3.0	-21.1
Mining ^a	-11.6	12.5
Manufacturing ^b	5.4	-18.6
Utilities	4.9	-23.8

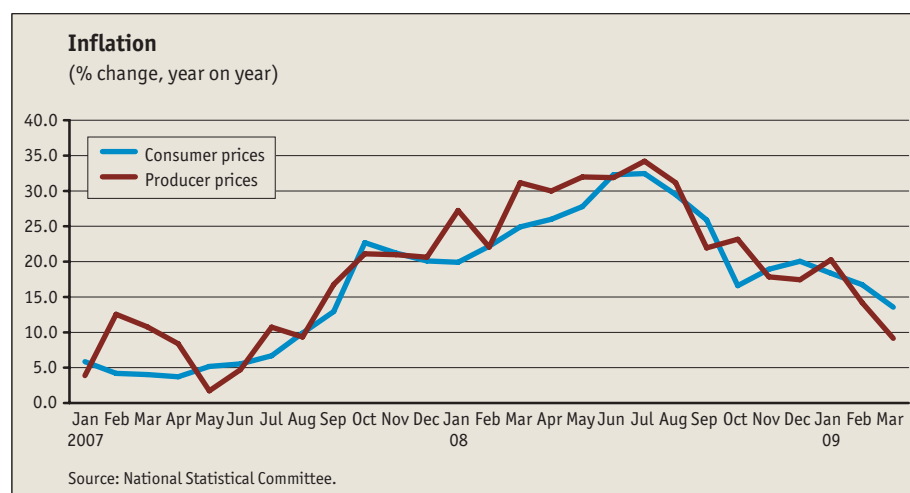
^a Comprises hydrocarbons and other minerals. ^b Includes gold output.

Source: National Statistical Committee.

Consumer prices fall in March

Consumer prices fell by 0.4% month on month in March 2009, the first month of deflation since August 2008. Annual inflation has fallen markedly from its peak of 32.4% in July 2008. However, it remains stubbornly high, at 13.6% in March. The consumer price index (CPI) was brought down by lower food prices, which fell by 2.3% compared with the end of 2008, with only the prices of meat (which went up by 4.2%), and of fruit and vegetables (which rose by 3%), bucking the trend, owing to seasonal factors. The prices for non-food goods rose by 4.4% in the first three months of 2009, and services prices went up by 2.8%. Imported inflation is also a factor, given the depreciation of the som in

recent months. However, producer price inflation has fallen to single figures for the first time since August 2007, reaching 9.2% year on year in March.



Parliament finally approves agreement with Centerra

On April 24th the Kyrgyz parliament, the Jogorku Kenesh, finally ratified an agreement between the government and Canadian-owned Centerra Gold, which operates the Kumtor gold mine. Under the agreement, which has been in dispute for two years (February 2009, The domestic economy), the Kyrgyz state's share in the project will increase from 15.6% to 33%. The Kyrgyz Republic is expected to earn at least US\$3.43bn from Kumtor by 2026, compared with US\$384m earned in the previous 15 years, according to the prime minister, Igor Chudinov.

The new agreement also replaces the tax regime at Kumtor with a simplified tax rate (effective from January 1st 2008), under which gross revenue will be taxed at a rate of 14%, including a 1% monthly contribution to the Issyk-Kul Regional Development Fund. The agreement involves the payment to the Kyrgyz government by Centerra of US\$22.4m, of which US\$11m comprises a shortfall in tax payments for 2008 in light of the changed tax regime. The agreement also expands Centerra's concession to include the area covered by its exploration and development licence, work on which had been suspended until the dispute has been resolved.

Following the agreement, Centerra announced that it plans to resume exploration work in and around the Kumtor gold mine. It also plans significant investment in underground development. Centerra reported that gold production at Kumtor was 63,000 troy oz in the first quarter of 2009, a fall of 16% year on year, owing to poorer grades of ore and lower recovery rates. Nevertheless, the company maintains its forecast for full-year production of 560,000-600,000 troy oz in 2009, compared with 556,000 troy oz in 2008.

Main macroeconomic indicators

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Industrial output (% change, year on year)												
2007	-6.0	1.4	11.0	5.9	1.2	4.2	9.0	12.5	12.8	-3.9	-0.9	14.9
2008	6.6	4.4	-6.4	0.7	11.1	9.7	6.2	6.9	28.3	41.6	36.2	10.3
2009	-14.6	-29.7	-8.7	-9.4	-	-	-	-	-	-	-	-

Main macroeconomic indicators

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Registered unemployment ('000)												
2007	73.7	74.4	74.6	74.3	73.2	72.4	71.2	70.8	71.5	71.1	70.7	71.3
2008	71.3	72.0	72.4	72.2	72.2	71.3	69.8	69.1	68.4	68.1	68.1	67.2
2009	-	-	-	-	-	-	-	-	-	-	-	-
Consumer prices (% change, month on month)												
2007	2.1	-0.2	0.1	0.1	1.6	0.8	-0.2	1.9	3.6	9.0	-0.5	0.4
2008	2.0	1.7	2.4	1.0	3.0	4.3	0.0	-0.3	0.7	0.9	1.5	1.4
2009	0.5	0.3	-0.4	-	-	-	-	-	-	-	-	-
Consumer prices (% change, year on year)												
2007	5.8	4.2	4.0	3.7	5.2	5.5	6.7	9.9	12.9	22.7	21.2	20.1
2008	19.9	22.2	24.9	26.0	27.8	32.3	32.4	29.5	25.9	16.6	18.9	20.1
2009	18.3	16.7	13.6	-	-	-	-	-	-	-	-	-
Producer prices (% change, month on month)												
2007	-3.5	9.1	-0.1	0.3	-1.0	1.2	1.3	2.8	3.9	3.3	1.6	0.5
2008	1.8	4.7	7.3	-0.6	0.5	1.1	3.1	0.5	-3.4	4.3	-2.8	0.1
2009	4.3	-0.6	2.6	-	-	-	-	-	-	-	-	-
Producer prices (% change, year on year)												
2007	3.9	12.5	10.8	8.4	1.7	4.7	10.7	9.3	16.8	21.1	21.0	20.6
2008	27.2	22.1	31.2	30.0	32.0	31.9	34.2	31.2	21.9	23.2	17.8	17.4
2009	20.3	14.2	9.2	-	-	-	-	-	-	-	-	-
Average gross monthly wage^a (Som)												
2007	3,145	3,272	3,796	3,684	3,769	4,260	4,026	3,878	3,970	4,145	4,110	5,657
2008	4,335	4,471	5,169	5,086	5,146	5,632	5,621	5,268	5,485	5,660	5,507	7,678
2009	5,351	5,493	5,875	-	-	-	-	-	-	-	-	-
Average gross monthly wage^a (real % change, year on year)												
2007	16.2	23.1	27.2	26.0	27.6	29.9	23.3	18.2	11.8	5.3	8.3	7.0
2008	15.0	11.8	9.0	9.6	6.8	-0.1	5.4	4.9	9.7	17.1	12.7	13.1
2009	4.3	5.2	0.1	-	-	-	-	-	-	-	-	-
Average gross monthly wage^a (US\$)												
2007	81.96	84.69	99.47	96.81	99.22	112.22	106.21	102.58	105.82	116.71	117.82	161.59
2008	121.01	123.52	141.88	139.56	141.40	155.84	158.39	151.03	155.06	151.63	141.11	195.00
2009	134.04	134.54	139.87	-	-	-	-	-	-	-	-	-

^a Monthly wage data exclude small businesses.

Sources: National Statistical Committee; Interstate Statistical Committee of the Commonwealth of Independent States; Economist Intelligence Unit.

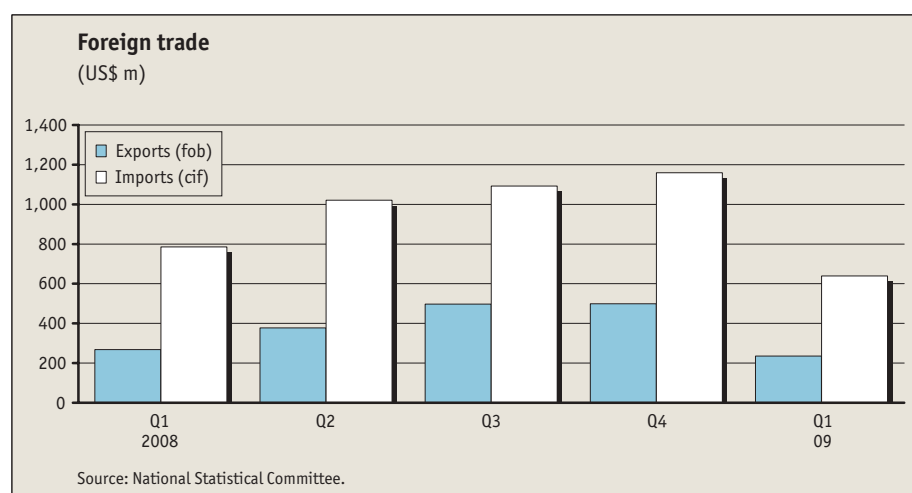
Foreign trade and payments

The trade deficit narrows as imports decline

According to the National Statistical Committee (NSC), in the first quarter of 2009 exports fell by 12.3% year on year, amounting to US\$235.1m. Imports fell by 18.9%, to US\$639.5m, resulting in a trade deficit of US\$404.4m, compared with one of US\$518m in the first quarter of 2008. Export performance in January-March 2009 was an improvement compared with the first two months of the year, when foreign sales dropped by 29.4%, outpacing the contraction in imports, which fell by 19.5%.

In the first two months of 2009—for which a more detailed breakdown is available—Russia, Kazakhstan, Uzbekistan and China were the Kyrgyz Republic's main trading partners. Russia accounted for 27.3% of total trade turnover, China for 15.2%, and Kazakhstan and Uzbekistan for 9.3% each. Switzerland, which

accounted for 5.2% of trade turnover in this period, maintained its position as a significant export market, mainly because it is the main market for gold sales.



External debt reaches 41% of GDP

The Kyrgyz Republic's external state debt had reached US\$2.56bn by end-March 2009, according to the National Bank of the Kyrgyz Republic (NBKR). This brings the government's total external debt to 40.6% of GDP. Private Kyrgyz enterprises are indebted to foreign creditors by a further US\$230m, according to the NBKR. The country's main creditors are the World Bank, the Asian Development Bank (ADB) and Japan. According to the finance minister, Marat Sultanov, in 2009 the country will spend US\$40m on servicing external debt.

In mid-April the prime minister, Igor Chudinov, said that the Kyrgyz Republic was holding discussions with Turkey on a US\$40m debt write-off. However, in November 2008 Mr Chudinov had already said that discussions were under way with Turkey concerning the write-off of US\$51m in debt, which implies that negotiations are making only slow progress.

In exchange for investment in the healthcare sector, the country could also write off significant debts to Germany, under a programme of the Global Fund to fight AIDS/HIV, tuberculosis and malaria. The country owes Germany €8.5m (US\$11.3m) under loans extended to the health sector; Germany is reportedly willing to write off 45% of the debt if the Kyrgyz government invests €4.6m into Kyrgyz Global Fund projects.

Additionally, under an agreement reached with Russia, US\$193.5m of Russian debt will be written off by mid-2009 (see Economic policy). In return, the Russian Federation will receive a 48% stake in Dastan, a manufacturer of naval torpedoes, as well as ownership of the Russian trade representative office in the capital, Bishkek.

Investment increases in 2008

According to the minister for economic development and trade, Akylbek Japarov, foreign investment into the Kyrgyz economy increased by 50% year on year in 2008, and amounted to US\$653m. The largest share of investment, of 52.5% of the total, went to the financial sector, the NSC reported. Mr Japarov attributed the increase in investment to the Kyrgyz Republic's improved rating in the World Bank's *Doing Business* report, in which it rose from 94th place to

68th. Although the government expects investment—excluding the funds from Russia to construct the Kambarata-1 hydroelectric power facility (see Economic policy)—to fall in 2009, it still expects the country to receive US\$500m-600m. However, this appears a highly ambitious target in the current global climate. Despite the improvement in the ease of doing business index, corruption remains a deterrent for foreign investors. Transparency International, in its 2008 Corruption Perception Index, rated the Kyrgyz Republic as one of the most corrupt countries worldwide, in 166th place out of 180 countries, a worse ranking than in 2007, when it was placed 150th out of 179 countries.

Main external indicators

(US\$ m unless otherwise indicated)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exports fob												
2007	74.6	77.3	97.8	76.3	83.6	97.8	108.5	101.4	94.2	101.2	103.8	118.2
2008	72.9	107.7	87.3	113.6	116.0	147.4	161.4	184.6	151.6	186.5	169.4	143.1
2009	75.0	52.5	107.6	–	–	–	–	–	–	–	–	–
Imports fob												
2007	160.1	171.6	203.1	214.6	226.4	205.4	221.0	252.4	203.7	247.4	40.1	329.2
2008	194.9	227.6	363.3	314.1	375.8	330.9	353.0	339.8	399.1	401.4	380.4	377.3
2009	206.4	195.4	237.7	–	–	–	–	–	–	–	–	–
Trade balance												
2007	-85.5	-94.3	-105.3	-138.3	-142.8	-107.6	-112.5	-151.0	-109.5	-146.2	63.7	-211.0
2008	-122.0	-120.0	-276.0	-200.5	-259.8	-183.5	-191.6	-155.2	-247.5	-214.9	-211.0	-234.2
2009	-131.4	-142.9	-130.1	–	–	–	–	–	–	–	–	–
Foreign reserves												
2007	738	751	770	807	842	885	933	972	1,012	1,018	1,112	1,107
2008	1,086	1,061	1,063	1,049	1,099	1,154	1,234	1,210	1,208	1,068	1,039	1,153
2009	1,011	950	970	–	–	–	–	–	–	–	–	–
Gold												
2007	54	56	55	56	55	54	55	55	61	65	66	70
2008	77	81	78	72	73	78	76	70	75	61	68	72
2009	76	78	76	–	–	–	–	–	–	–	–	–
International reserves												
2007	792	808	825	863	897	939	989	1,027	1,073	1,083	1,178	1,177
2008	1,162	1,141	1,141	1,121	1,172	1,232	1,309	1,280	1,283	1,128	1,107	1,225
2009	1,087	1,029	1,046	–	–	–	–	–	–	–	–	–

Sources: Interstate Statistical Committee of the Commonwealth of Independent States; IMF, *International Financial Statistics*; National Statistical Committee; Economist Intelligence Unit calculations.