

Kyrgyz Republic

Social and Economic Development in 2022 and Medium-Term Prospective

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The materials presented may not coincide with the official opinion of the EDB and the EFSD governing bodies.

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LIST OF ABBREVIATIONS

CA – current account

CoM KR – Cabinet of Ministers of the Kyrgyz Republic

CPI – consumer price index

EAEU – Eurasian Economic Union

EFSD Project Unit – Project Unit of the Eurasian Fund for Stabilization and Development

GDP – gross domestic product

GIR – gross international reserves

ILO – International Labour Organisation

KR – Kyrgyz Republic

MF KR – Ministry of Finance of the Kyrgyz Republic

NB KR – National Bank of the Kyrgyz Republic

NSC KR – National Statistical Committee of the Kyrgyz Republic

PIP – Public Investment Programme

SCNS KR – State Committee for National Security of the Kyrgyz Republic

US – United States of America

VAT – value added tax

The economy of the Kyrgyz Republic has shown resistance to external shocks associated with the volatility of world energy and food prices, the disruption of transport and logistics chains, and the volatility of exchange rates of the national currencies of major trading partners against the background of an aggravated geopolitical crisis. The economic growth accelerated to 7.0% in 2022, due to increased gold production and the impact of new economic conditions on the economy. The migration of capital and people, mainly from the Russian Federation, had an impact on the growth of domestic demand, which put pressure on inflation. An additional factor contributing to higher domestic demand and inflation was a weaker fiscal position associated with higher government expenditures on labour and capital investment. Although the actions of the NB KR facilitated the stabilisation of the exchange rate and maintained the stability of the banking sector, inflation accelerated by the end of the year, among other things, as a result of monetary operations.

Real Sector and Labour Market

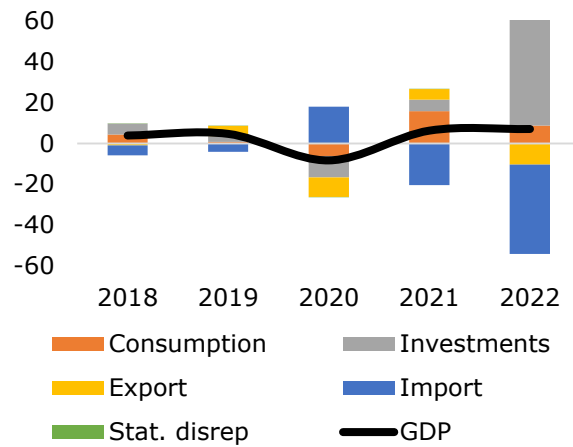
In 2022, the economy of the Kyrgyz Republic developed in the context of expanded gold production and adaptation to new economic conditions in the region. The GDP growth accelerated to 7.0% in 2022 from 6.1% in 2021 (5.9%, net of gold, versus 6.8% in 2021), which is significantly higher than the average annual growth rate in the pre-crisis period of 2015–2019 (4.3%). The increase in gold production is the main factor accelerating economic growth. However, net of gold production, the economic growth slowed amid the high base in 2021 in the services, which grew sharply due to the recovery of consumer activity after the COVID-19 pandemic.

Gross capital formation and consumption made a positive contribution to GDP growth rates (Figure 1). At the same time, a significant negative contribution to net exports was generated by a sharp decline in gold exports and an increased demand for imports. The substantial contribution of the gross capital formation is associated with the growth of inventories, which was mainly a result of the accumulation of stocks of gold produced in the country, part of which was purchased by the National Bank. In addition, the State domestic capital investments, which grew by a factor of 2.3, influenced the increase in the gross capital formation. A positive contribution of consumption was due to both inflows of capital and migrants from other countries and higher government expenditures on labour in the budget sector employees.

A recovery of investment activity (capital investment grew by 4.2%) was driven by an increase in government capital expenditures, as well as growth in net FDI (up by 28.6%) due to the relocation of companies from the Russian Federation. As in the previous year, capital investment was mostly financed from domestic sources (up by 1.9%), while external financing grew at a faster pace (6.4%), due to accelerated foreign lending (24%). Capital investment flowed mainly to mining (19.1%), transport (12.3%), electricity (5.9%), education (5.5%), and finance (4.1%).

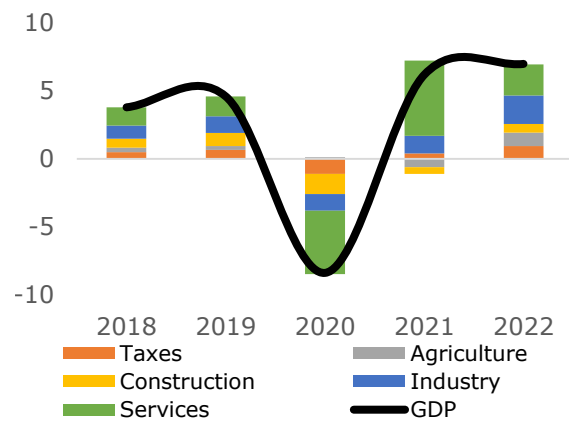
In terms of sectors, the largest contribution to the GDP dynamics was made by manufacturing (2.1 p.p.), retail and wholesale trade (1.3 p.p.), and agriculture (1.0 p.p.). The production of metals (mainly gold) grew by 22.3% in 2022, being the main contributor to the growth of the manufacturing industry. The growth in agriculture was driven by two factors: a high harvest of grain crops (against a low harvest last year due to low water) and bank loans, among other things, provided under the government project "Agriculture Finance 10" (totalling 478 million KGS). The slowdown growth in services sector is attributable to the high base of 2021, which saw a high rate of recovery from the crisis. However, the acceleration to 7.7% compared to the 2017–2019 average (6.2%) indicates further steady development of the sector. A number of services sectors saw accelerated growth rates. Specifically, the inflow of foreign citizens due to geopolitical tensions (according to the SCNS KR, in 9 months of 2022, the inflow increased by 1.8) as well as a fiscal stimulus (wage increases in the budget sector), and the automation of tax and customs procedures (the introduction of cash registers and electronic waybills), were key drivers of accelerating growth in the hotel and restaurant services sector to 23.8% (a contribution of 0.3 p.p.) against an increase of 18.6% a year earlier. There was also rapid growth in the wholesale trade in cars (38.5% against 21.2% in 2021), which was achieved owing to re-exports to Russia (an increase by a factor of 1.9) in the context of restrictions due to sanctions.

Figure 1. Contribution to GDP growth, by use components (p.p., y-o-y)



Source: NSC KR, EFSD estimates

Figure 2. Contribution to GDP growth, by production components (p.p., y-o-y)



Source: NSC KR

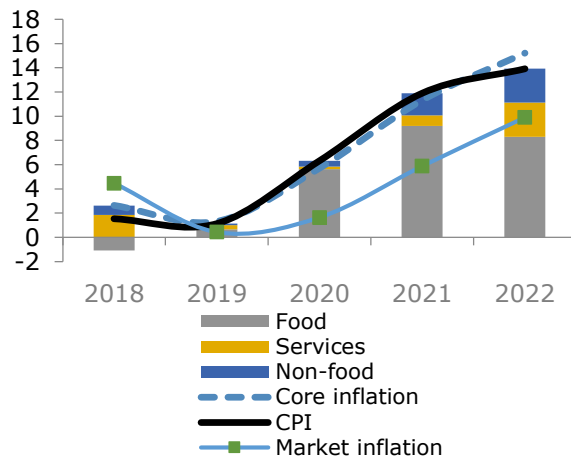
Stronger domestic demand had an effect on the labour market. The unemployment rate, calculated based on the ILO methodology, was 5.3% in 2021. In 2022, the number of officially registered unemployed decreased, on average by 3.9% over the year. The employment grew by 1.9% in 2022, supported by an increase in the number of workers in the manufacturing industry, transport, tourism services, financial sector, administration, and education.

The faster growth in salaries and wages was largely driven by increased government expenditures on labour in the budget sector in April and August 2022. Salaries and wages increased by 22.3% y-o-y in real terms in 2022 against a 1.5% decrease in 2021. The main contribution to the growth of real wages was made by the public administration sector (3.8 p.p.), healthcare (2.8 p.p.), and education (8.4 p.p.). In addition, the dynamics of the wage growth were influenced by the increase in wages and salaries in agriculture (1.4 p.p.), retail trade (1.2 p.p.), and the tourism services (2.2 p.p.) against the background of a higher inflow of relocated persons and tourists. In particular, the most significant increase in real wages was observed in agriculture (92.4% y-o-y), tourism (86.9% y-o-y), health and social services (20.8% y-o-y), and education (23.9% y-o-y).

Inflation and Monetary Policy

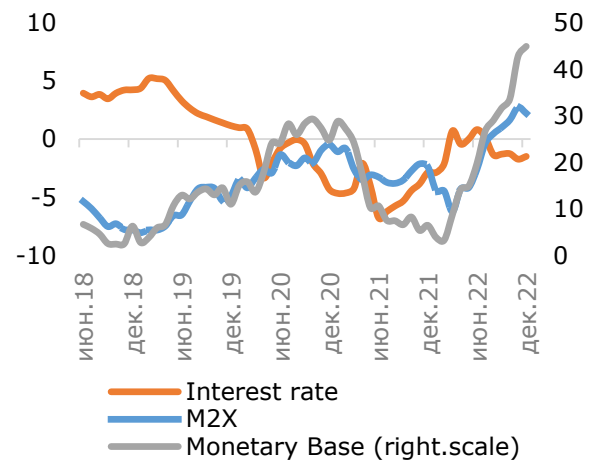
The main contribution to the acceleration of inflation was made by an increase in prices for non-food goods and services, while the contribution of food inflation decreased. Consumer goods inflation (CPI) was 14.7% in December 2022 (compared to 11.2% in December 2021). Against the background of favourable weather conditions and decelerated growth of world prices, the growth of food prices slowed down at end-2022 (15.8%) compared to August (18.9%), while remaining above that in December 2021 (13.3%). The growth of prices for non-food products (12.7% against 9.7% in December 2021) and services (9.1% against 7.1%) had accelerated by end-2022, which boosted the average contribution of these components to the overall inflation rate (Figure 3). In particular, there was a significant increase in prices for clothing, footwear, household items, as well as transportation services, hotel and restaurant services, and recreation services. It led to an acceleration of the core and market inflation to 17.5% and 13.2%, respectively, in 2022 (against 10.9% and 6.8% in December 2021).

Figure 3. Inflation (in %, y-o-y)



Source: NSC KR, EFSD calculations

Figure 4. Monetary indicators (in %, end of period, y-o-y)



Source: NB KR, NSC KR

Inflationary pressure intensified during the year under the influence of the fiscal impulse, flows of foreign capital, and the NB KR's operations related to gold purchases. Salaries and wages were raised for some categories of civil servants in April that contributed to accelerating consumer activity. As a result of the fiscal impulse and a strong inflow of foreign currency deposits in the context of the geopolitical conflict, which exceeded the volume of foreign currency outflows in the form of remittances, excess liquidity in the banking sector started to grow rapidly in May, which was partly facilitated by the NB KR's operations related to purchases of foreign currency in the summer of 2022. In addition, in Q2 and Q3, the NB KR carried out operations to purchase gold on the domestic market, which also contributed to the growth of money supply. To curb the growth of inflationary pressure and smooth out exchange rate fluctuations, the NB KR performed interventions selling foreign exchange and sterilisation operations with securities. Moreover, amid growing geopolitical conflict and emerging volatility in the interbank foreign exchange market, the NB KR raised interest rate to 14% in March and kept it at this level until November 2022 (dropping it down to 13% by the year end). However, amid significant increase in the volume of non-monetary gold in the NB KR assets, the monetary policy measures taken were insufficient to curb the growth of money supply. At end-2022, the base money growth was 44.9% (against 6.5% at end-2021), and the broad money supply M2X growth was 30.6% (against 19.1%).

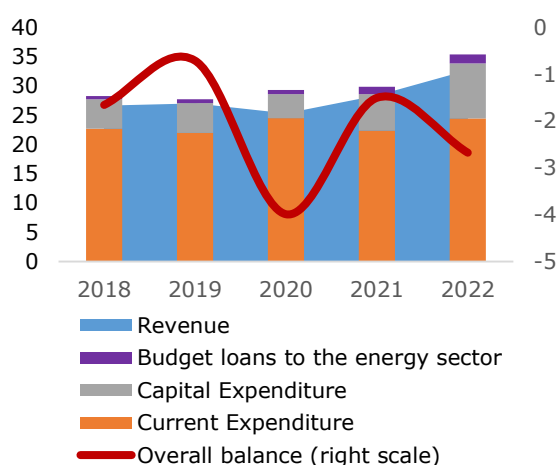
Budget Sector and Government Debt

The fiscal position weakened in the context of a greater increase in state budget expenditures compared to revenues and growth of budget lending to the energy sector. State budget expenditures increased by 5.2 p.p. in 2022, reaching 33.8% of GDP (against 28.6% in 2021). In addition, the volume of budget loans to energy companies and investment funds on-lent under the Public Investment Programme increased to 1.5% of GDP in 2022 (against 1.3% in 2021). The state budget deficit, including loans to the energy sector, amounted to 2.7% of GDP, having increased by 1.2 p.p. compared to 2021 (1.5% of GDP). Despite an increase in interest costs related to servicing the government debt, the primary deficit, which includes budget loans to the energy sector, also increased (1.5% of GDP against 0.4%).

Higher volumes of imports and revenues from the Kumtor mine field, along with improved tax administration, contributed to the growth of tax revenues in the state budget. The main contribution to state budget revenues was

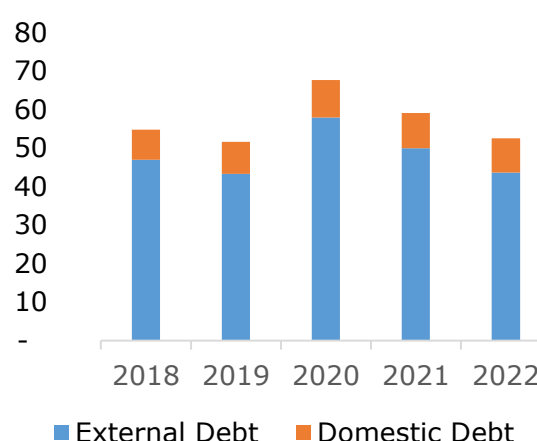
made by tax payments, which increased to 24.9% of GDP from 20.4% a year earlier. Against the background of higher imports, there was an increase in revenues from the VAT on imports, in particular from countries outside the EAEU (6.1% of GDP against 3.2% a year earlier). The measures implemented to improve tax administration contributed to better collection of taxes on domestic production and incomes (VAT and excise tax on domestic production, personal income and profit taxes, etc.), up to 9.3% of GDP (against 8.3% in 2021). In addition, the funds received from the development of the Kumtor mine field (2.1% of GDP) contributed to higher tax revenues. Grants amounted to 2.2% of GDP (against 1.9%), while non-tax revenues were 5.7% of GDP (against 6.1%). Overall, state budget revenues increased by 4.2 p.p. of GDP and amounted to 32.6% of GDP (against 28.4% in 2021).

Figure 5. State budget (in % of GDP)



Source: MF KR

Figure 6. Government debt (in % of GDP)



Source: MF KR

A raise in salaries and wages in the budget sector and an increase in domestic capital investment contributed to higher budget expenditures. The increase in domestic capital investment (9.4% of GDP against 6.2% a year earlier) was associated with the purchase of buildings, machinery and equipment, and the replenishment of state material reserves. Current state budget expenditures also increased, amounting to 24.4% of GDP (against 22.4% a year earlier). Increases in salaries and wages, as well as social benefits resulted in higher labour costs (10.5% of GDP against 9.9%), social benefits (1.9% of GDP against 1.7%), and transfers to the Social Fund and the Mandatory Health Insurance Fund (MHIF) (5.4% of GDP against 5.3%).

The government debt declined against the growth of economic growth and exchange rate appreciation. In the context of economic growth and exchange rate appreciation, the government debt decreased to 52.0% of GDP from 59.0% in 2021 (or by 9.5% in nominal terms). The external government debt went down from 49.2% of GDP at the beginning of the year to 41.8% of GDP at the year end, while the domestic government debt increased from 9.8% to 10.2% of GDP during the period.

External Sector

In 2022, there was a substantial expansion of the current account deficit due to a significant increase in imports (80.8%) and a decrease in net inflows of remittances (-21.2%). The increase in nominal volumes of imports was a result of high prices for hydrocarbons, as well as growing non-oil imports from countries outside the EAEU (an increase of US \$2.7 billion), most of which could be attributable to re-exports to the Russia, which are not fully reflected in the trade balance. It explains the

large positive “errors and omissions” in the balance of payments¹ (US \$2.5 billion, or 31.4% of GDP). The decrease in net remittances occurred in the context of a strong outflow (up by 113.4%) and a slight inflow (up by 6.4%) of funds via money remittance systems. The outflow was mainly directed to Russia (an increase of US \$385.2 million) and Turkey (an increase of US \$222.3 million). It could be attributable to the transit of Russian capital, as well as potential payments for goods under parallel imports.

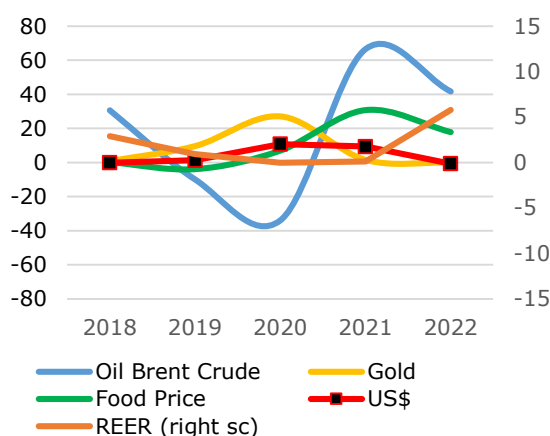
According to the NB KR, the current account deficit increased to 49.7% of GDP in 2022 (compared to 8.5% in 2021) and was mainly balanced by “net errors and omissions”. The financial account surplus, which emerged against the background of an inflow of foreign direct investment (up by 33.5%), also partially financed the current account deficit. Starting from the beginning of the year, the NB KR conducted foreign exchange interventions, buying and selling foreign exchange to stabilise the exchange rate of the local currency, with net sales at US \$229.1 million (against net sales of US \$698.95 million in 2021). As a result, the international reserves declined by 6% during the year to US \$2.78 billion (against US \$2.98 billion at end-2021), or 3.2 months of current imports of goods and services.

The exchange rate dynamics were influenced by inflows and outflows of foreign exchange in the context of a geopolitical crisis and operations of the NB KR in the foreign exchange market. The average exchange rate of the local currency appreciated by 0.6% in 2022 compared to 2021. However, the dynamics within the year were heterogeneous and highly volatile. For example, in Q1, when the KGS nominal exchange rate depreciated against the US dollar – by 14% in January–March, with most of the depreciation (15.5% y-o-y) occurring in late February and mid-March, or 5.8% y-o-y – the NB KR conducted interventions selling foreign exchange to stabilise the exchange rate for a total of US \$217.6 million. As the exchange rate stabilised, the NB KR started purchasing foreign exchange in Q2 2022. Those operations totalled 190.7 million US dollars. By the end of H1 2022, the exchange rate had appreciated by 6.2% compared to the beginning of the year and depreciated by 1.4% in annual terms. The local currency appreciated due to the effects of measures taken by the NB KR² and an inflow of foreign exchange deposits in Q2 2022. In H2 2022, the exchange rate gradually depreciated as the volume of imports of goods increased and the demand for foreign exchange became stronger – in November–December, the NB KR sold foreign exchange in the amount of US \$202.2 million.

¹ A more detailed analysis of this balance of payments item is presented in the Annex.

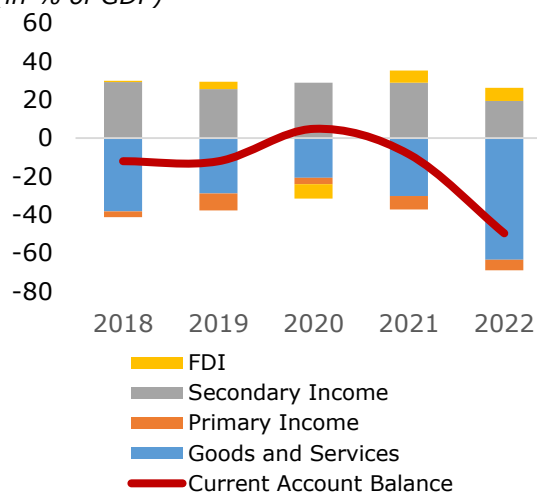
² In order to support the exchange rate, the NB KR introduced a temporary ban on exports of US dollars by financial and credit institutions and households, established a market-based regime for the formation of the official exchange rate of the Russian ruble to the Kyrgyz som, and temporarily reduced the volume of transactions and the purchase exchange rate of the Kazakhstani tenge for banks.

Figure 7. Terms of trade (in %, y-o-y)



Source: World Bank, national authorities, EFSD estimates

Figure 8. Balance of payments (in % of GDP)



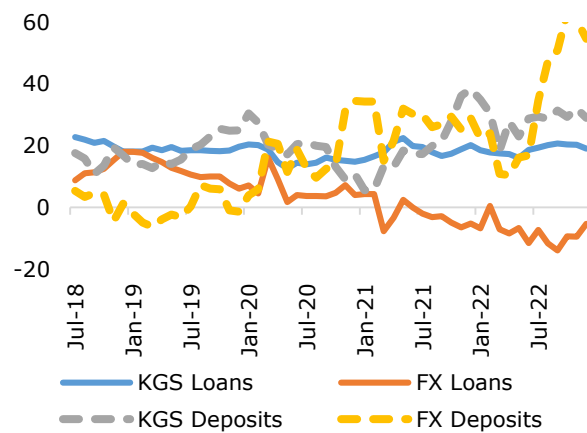
Source: NB KR, NSC KR, EFSD estimates

Financial Sector

The deposit base of banks grew mainly due to an inflow of non-residents' foreign exchange savings, which was attributable to the "card tourism" in the context of the departure of international payment systems and foreign exchange restrictions in Russia. Foreign currency deposits grew strongly (up by 55.6%, y-o-y in the US dollar terms, against 17.8% y-o-y a year earlier) owing to foreign currency current accounts of legal entities and demand deposits of non-resident private individuals. Despite a slight slowdown, the demand for local currency deposits remained at a high level (29.0% y-o-y against 38.3% y-o-y), while the share of current accounts and demand deposits increased (to 63% against 59%). The demand for local currency term deposits fell (16.1% against 22.9%), despite higher weighted average interest rates (up to 12.25% against 10.89% a year earlier).

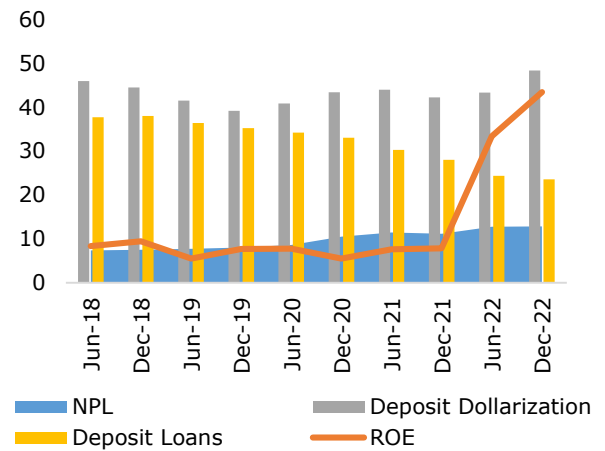
An increase in interest rates and continuing decline in bank lending in foreign currencies held back the growth of the loan portfolio of commercial banks. Bank lending grew by 12.2% y-o-y in 2022 (against 11.8% y-o-y a year earlier). Bank lending was constrained by the continuing decline in foreign currency loans (-6.4% y-o-y in US dollar terms against -7.6% y-o-y a year earlier). Against the background of rising interest rates (the weighted average lending interest rate for local currency loans increased to 17.1% in December 2022 against 16.25% a year earlier), that was accompanied by deceleration of the growth rate of local currency loans from 20.2% in the previous year to 19.0% in 2022. The main drivers of lending in KGS were consumer loans (8.4 p.p.), mortgage loans (3.4 p.p.), and loans to agriculture (3.4 p.p.).

Figure 9. Bank loans and deposits
(in %, y-o-y)



Source: NB KR

Figure 10. Banking sector indicators
(in %)



Source: NB KR

In 2022, the banking system remained stable, and there was a significant increase in profitability and disproportionate growth of foreign currency deposit liabilities compared to loan assets. An increase in foreign currency deposits, accompanied by a decrease in lending in foreign currency, resulted in a significant drop of the foreign currency loan to deposit ratio (31.7% in December 2022 against 53.2% a year earlier). The inflow of foreign currency deposits into the banking system also contributed to higher profitability of banks due to the growth of non-interest operating incomes. In December 2022 compared to 2021, the return on capital was up to 43.4% (against 7.8% a year earlier), and the return on assets was 5.9% (against 1.2% a year earlier). Net profits of the banking sector grew by a factor of almost 6.5 in 2022, mainly due to an increase in non-interest operating incomes (up by 358%), predominantly explained by the "card tourism". The capital adequacy ratio was 19.2% in December 2022 (unchanged compared to a year earlier), and the share of bad loans in total loans increased to 12.8% (against 11.1% a year earlier). The rate of dollarization of deposits, against the background of a significant inflow of foreign currency deposits of non-residents, was 48.3% at end-2022 (against 42.2% a year earlier). The rate of dollarization of loans fell to 23.6% (against 28.0%).

Medium-Term Prospective

Under the baseline scenario, the economic growth is expected to slow down to 4.7% in 2023 amid lower public capital investment, as well as weaker private sector consumer and investment activity. Neutralizing the overheating will allow the economy to return to a long-term rate of economic growth. By 2025, the GDP growth is expected to gradually accelerate to 5.1%. The medium-term growth rates would be supported by accelerated growth of exports, as well as private consumption and investment.

Closing the positive gap that formed in 2022 would ease the inflationary pressure. By end-2023, inflation would slow down to 9.7% and by 2025 it would decline to the level of the medium-term target range set by the NB KR. Such dynamics would be facilitated by persistently tight monetary conditions in 2023, which would be slightly relaxed by the year end, while banks' ability to expand lending to the economy would be constrained by high interest rates and the presence of non-performing loans in the overall portfolio. At the same time, amid unstable external environment, it may be accompanied by an upward trend in foreign currency liabilities in the banking

system. In the medium term, monetary policy is expected to gradually normalise, with inflation going back to the medium-term range targeted by the NB KR.

To maintain fiscal stability, it would be necessary to consolidate expenditures over the medium term. The state budget deficit at 2.6% of GDP in 2023 is projected to continue to have a boosting effect on the economy. Despite the expected reduction in capital expenditures, state budget expenditures would be slightly higher than in 2022 owing to an increase in current state budget expenditures. The implementation of measures to automate fiscal procedures and the continuing high volumes of imports would help maintain a moderate upward trend in tax collection. A shortfall in tax revenues in 2024–2025 compared to official forecasts may require fiscal consolidation. Efforts to curb a significant increase in expenditure obligations and consolidate low-priority expenditures may result in a small surplus of the state budget by 2025, close to a balanced value (0.4% of GDP).

It is assumed that as the economy gradually adapts, new logistics channels and production links will emerge which will have a positive impact on increasing export volumes by 2025 by 32.7% compared to 2022, mainly due to the growth of other (non-gold) export volumes (54.1%). A recovery in remittances and exports would facilitate a gradual reduction of the current account deficit. However, the stability of the balance of payments would weaken against the background of a projected decrease of gross international reserves to 2.1 months of imports by 2025 compared to 3.3 months in 2022.

Risks to Medium-Term Outlook

In the medium term, the economy of the Kyrgyz Republic would operate in the environment of uncertainty associated with the geopolitical conflict in the Eurasian region. Deterioration of the geopolitical situation in the region would have more adverse consequences, among other things, owing to intensified logistical constraints in foreign trade and restrictions on capital transactions. Depreciation of the Russian ruble may lead to a further decrease in inward remittances to Kyrgyzstan, which would put pressure on the balance of payments and the exchange rate of the local currency. An additional risk is associated with a sudden outflow of foreign capital from Kyrgyzstan, leading to sharp deceleration of consumption growth, as well as an additional round of depreciation of the local currency and an upsurge in prices. Low gross reserves would constrain the ability of the NB KR to support the exchange rate.

An important factor of uncertainty is the ability of domestic enterprises and banks to adapt to the changed environment. The progress in absorbing foreign investment, creating new enterprises and niches for exports, and gaining access to new markets would largely depend on the pace of developing trade logistics and reducing non-tariff restrictions. In addition, changes in the domestic business environment may have an effect on the ability of the Kyrgyz economy to adapt to the emerging new economic conditions.

There is a risk of mounting domestic macroeconomic imbalances associated with an expansion of government efforts to stimulate the economy. The implementation of the authorities' expenditure plans is fraught with risks associated with the formation of budget revenues. A shortfall in tax revenues may lead to an expansion of the state budget deficit through additional debt financing and erosion of fiscal and debt sustainability. In addition, in the absence of balanced monetary policies, fiscal stimulus may lead to higher inflation and mounting macroeconomic imbalances.

Kyrgyzstan: Key macroeconomic indicators

	2020	2021	2022	2023	2024	2025
National accounts and prices (in %)						
Real GDP growth	-8.4	6.2	7.0	4.7	5.0	5.1
CPI (December, y-o-y)	9.7	11.2	14.7	9.7	8.0	6.6
Money and credit (in %)						
Broad money supply growth (y-o-y)	23.9	19.1	30.6	23.0	17.3	10.7
Policy interest rate	5.0	8.0	13.0	10.0	8.0	8.0
Public finance (in % of GDP)						
Budget revenues and grants	25.3	28.4	32.7	32.2	31.6	31.5
Budget expenditures	28.6	28.6	33.8	34.2	31.5	30.8
Loans to the energy sector	0.7	1.3	1.5	0.6	0.7	0.3
Budget balance (including loans to the energy sector)	-4.0	-1.7	-2.7	-2.6	-0.6	0.4
External Sector						
Net remittances (in % of GDP)	24.3	25.1	15.8	14.9	13.5	11.9
Current account* (in % of GDP)	4.8	-8.5	-49.6	-37.3	-33.7	-32.4
Net foreign direct investment (in % of GDP)	-7.5	6.4	6.9	6.8	9.2	9.5
Gross reserves, in months of imports of goods and services	5.7	3.4	3.3	3.1	2.8	2.1

Source: NSC KR, NB KR, MF KR

*To normalise time series with current statistics, unaccounted export flows were recorded under "net errors and omissions".

Annex: Forecasting Balance of Payments Given Current Distortions in Balance of Payments Statistics in the Kyrgyz Republic due to Unrecorded Transactions.

The balance of payments reflects economic transactions between the Kyrgyz Republic and other countries over a certain period of time. The balance of payments reflects operations with goods and services, incomes, financial assets and liabilities between residents and non-residents of the country. According to the rules of compiling the balance of payments, every recorded transaction is represented by two entries – one of the entries is designated a credit, while the other is designated a debit. The double-entry principle suggests that the sum of all credit entries must be equal to the sum of all debit entries and the closing balance must be zero. However, since the balance of payments is compiled using various sources, distortions occur. In statistics, the distortions are recorded under a balancing item called **“net errors and omissions”** (hereinafter referred to as NEO). This item is usually reflected in terms of export or import volumes, total trade, CA, GDP, etc. According to an IMF survey,³ there is no generally accepted level of NEO or generally recognised indicators to assess NEO. At the same time, some studies⁴ find that the level of NEO below 5–7% of total trade is acceptable. The most effective methods for eliminating distortions in the balance of payments are the development of data sources, enhancement of the verification of mirror data using international databases, and bilateral exchange of mirror data.

In 2001–2021, the level of NEO to total trade averaged about 1% (2% in 2011–2021), and that of NEO to GDP was about 2% (2% in 2011–2021). In 2022, there was an abnormal increase in NEO, which reached 20% of total trade, or 27% of GDP. This may be attributable to the imposition of sanctions on the Russian Federation and restrictions on imports of goods into the RF territory. Under these conditions, imports grew by 72.3%, and non-gold exports – by 62.3% (total exports fell by 20.6%). Most non-oil imports are probably re-exports to Russia, which are not fully reflected in trade statistics within the EAEU, as monitoring of trade within the Union is limited. Since Russia has closed foreign trade statistics, it is impossible to use mirror data to adjust balance of payments indicators.

It is assumed that one of the arrangements for parallel import is that merchandise imports from Europe destined for Kyrgyzstan transit through Russia, with customs clearance of the goods performed when they cross the EAEU border (i.e. in Russia). Then the goods stay in Russia and do not enter Kyrgyzstan. Therefore, the European Union is imposing a ban on the transit of certain types of goods through Russia. Another potential arrangement focuses on the opposite direction when merchandise imports come from China. Customs clearance of the goods takes place in Kyrgyzstan (recorded as imports for Kyrgyzstan), then the goods are shipped to Russia. Various potential arrangements for circumventing sanctions lead to cash flows remaining unrecorded in the balance of payments, creating serious distortions in statistics.

In its forecast, the EFSD Project Unit reflected part of unrecorded re-exports to Russia in the balance of payments under the NEO item. This was done in order to normalise time series of reporting data and form adequate forecast values for macroeconomic indicators, taking into account the distortions in statistics. The forecast included a gradual reduction in NEO throughout the entire forecast period. In the medium term, statistics are expected to be normalised, and such operations are expected to decline, against the background of tightening restrictions on the

³ [Analysis of Net Errors and Omissions, IMF 2019](#)

⁴ Mekhanizm zolotodenezhnykh potokov // Ekonomicheskaya mysl' v retrospektive. *Blaug, M.* 1994.

transit of sanctioned goods. Revaluation of exports, taking into account data limitations, for the reporting or forecast period may significantly distort the main macroeconomic indicators (GDP, CA, etc.), which can result in significant changes in approaches and recommendations to the authorities.