

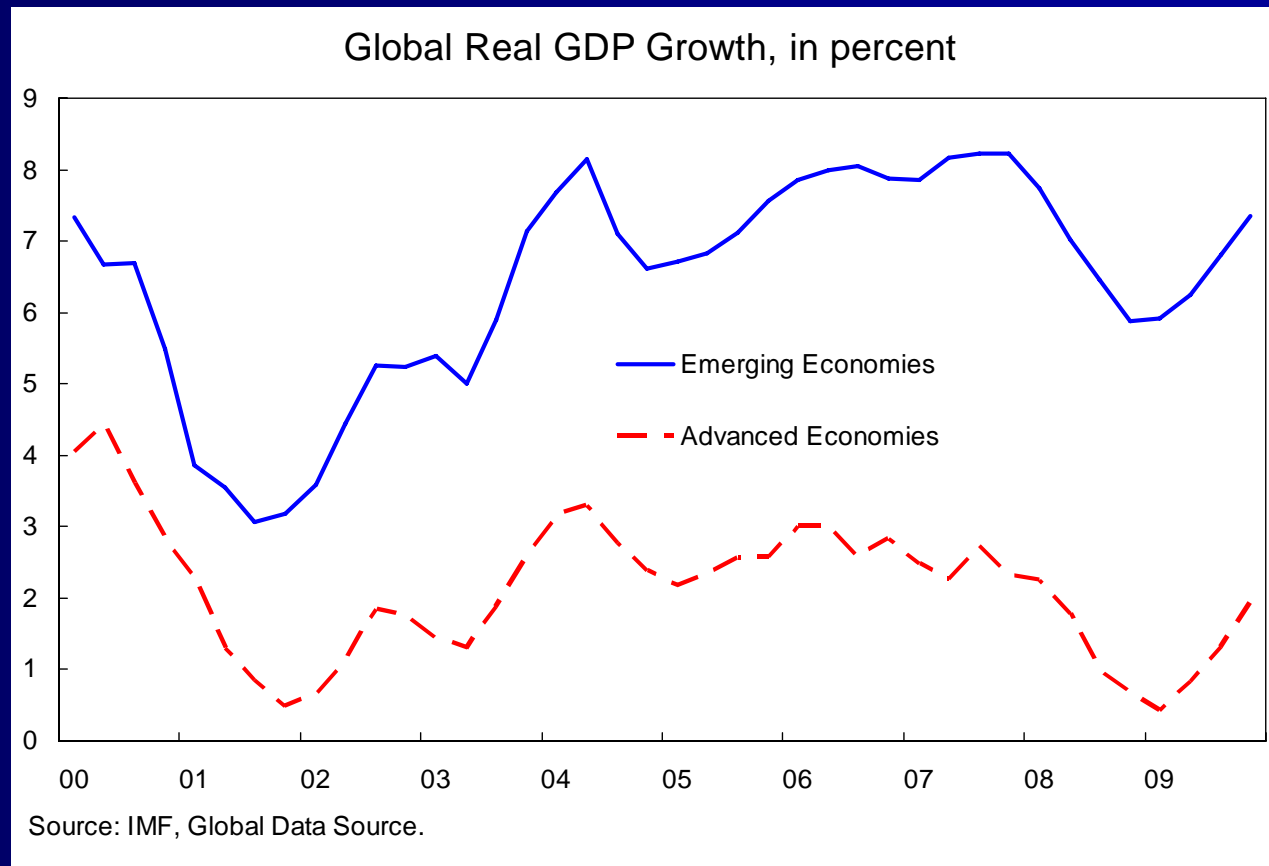
# KYRGYZ REPUBLIC

MACROECONOMIC POLICY  
RESPONSES TO CURRENT  
EXTERNAL SHOCKS

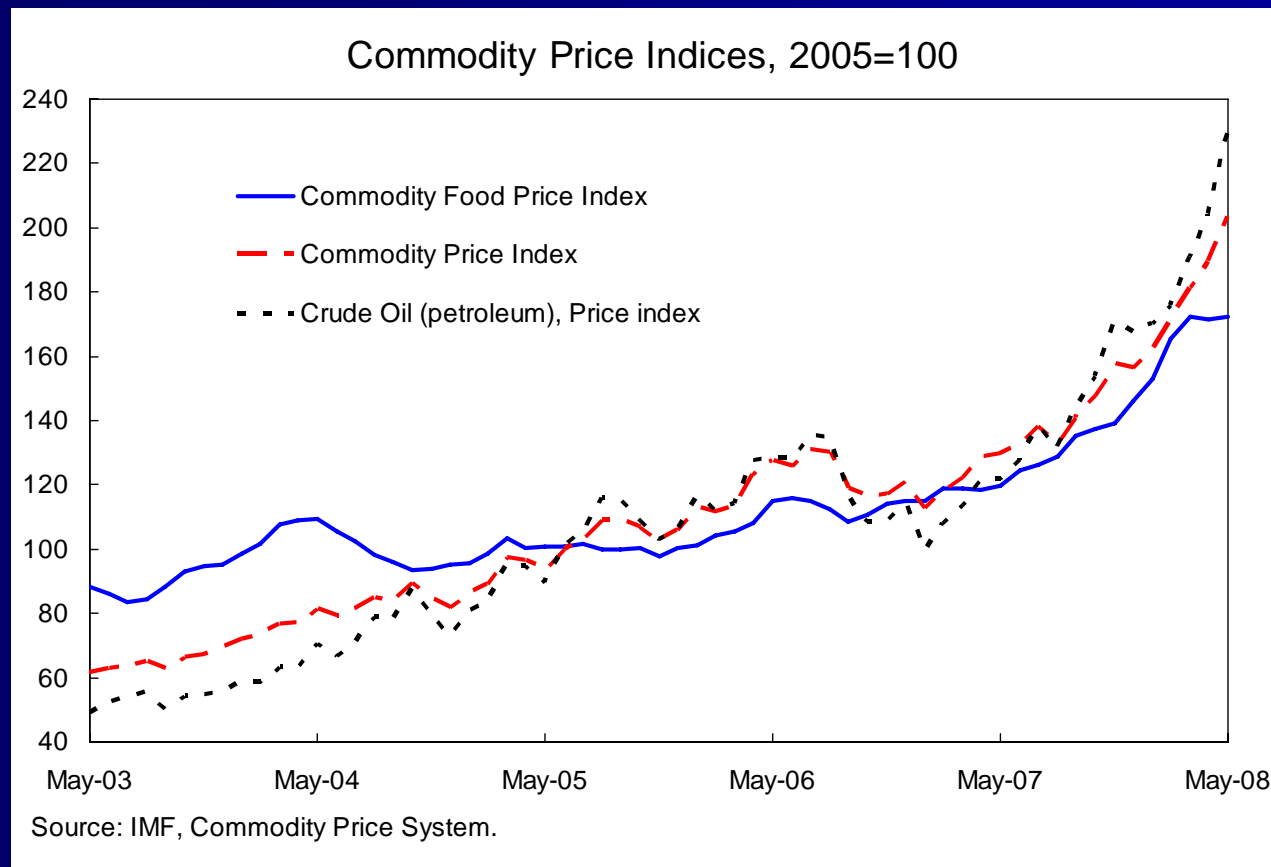
Ron van Rooden

International Monetary Fund

# GLOBAL GROWTH IS SLOWING



# INTERNATIONAL FOOD AND FUEL PRICES HAVE SURGED

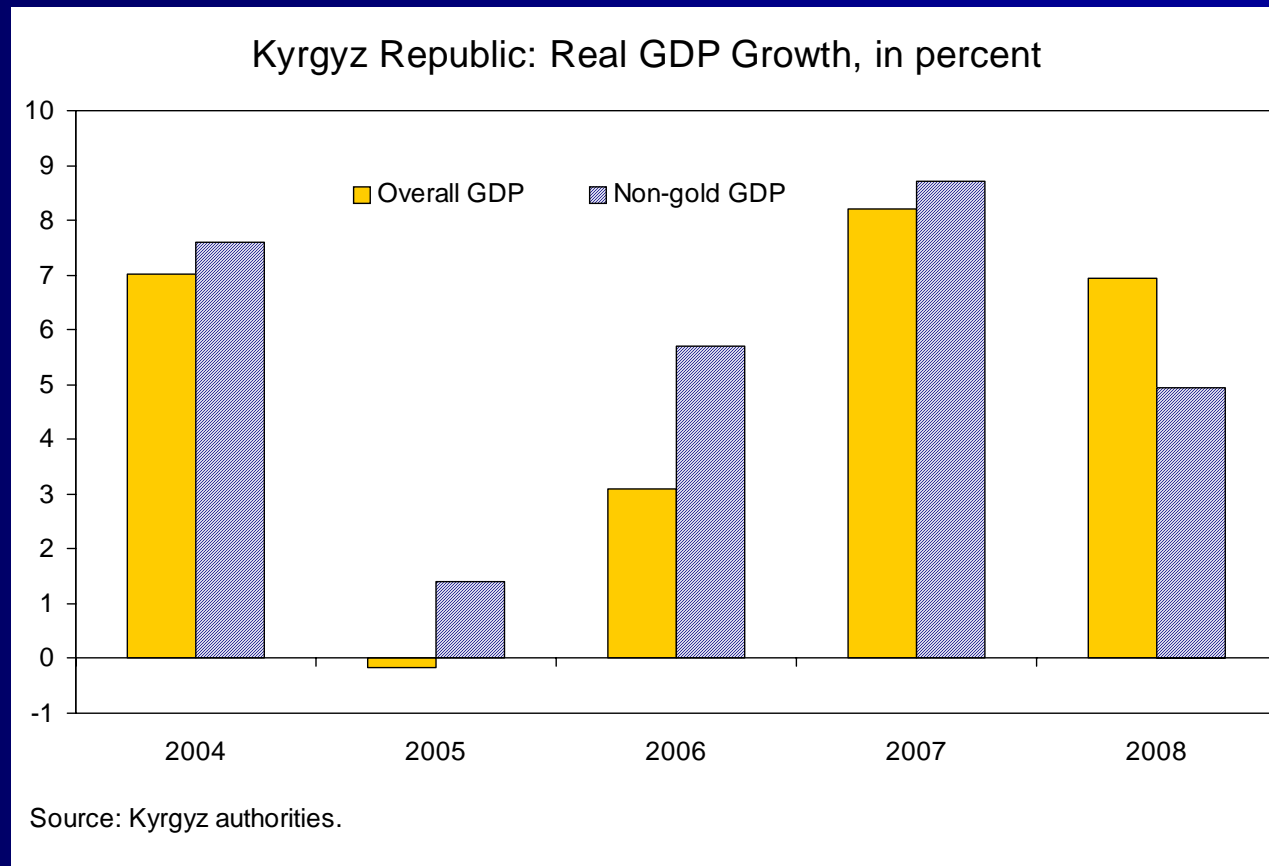


# Kyrgyz Republic

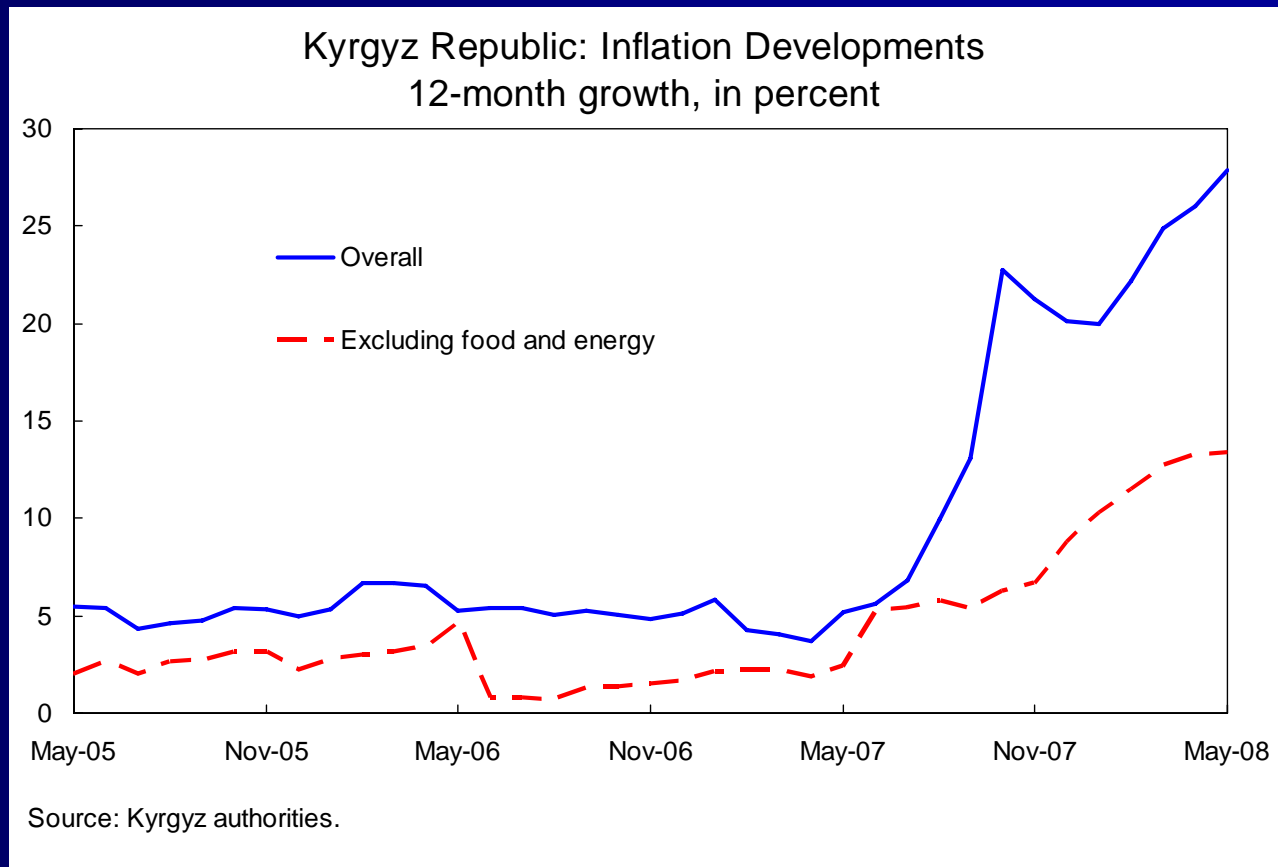
The macroeconomic consequences of these external shocks are severe:

- Risks to macroeconomic stability
- Decline in incomes and increase in poverty

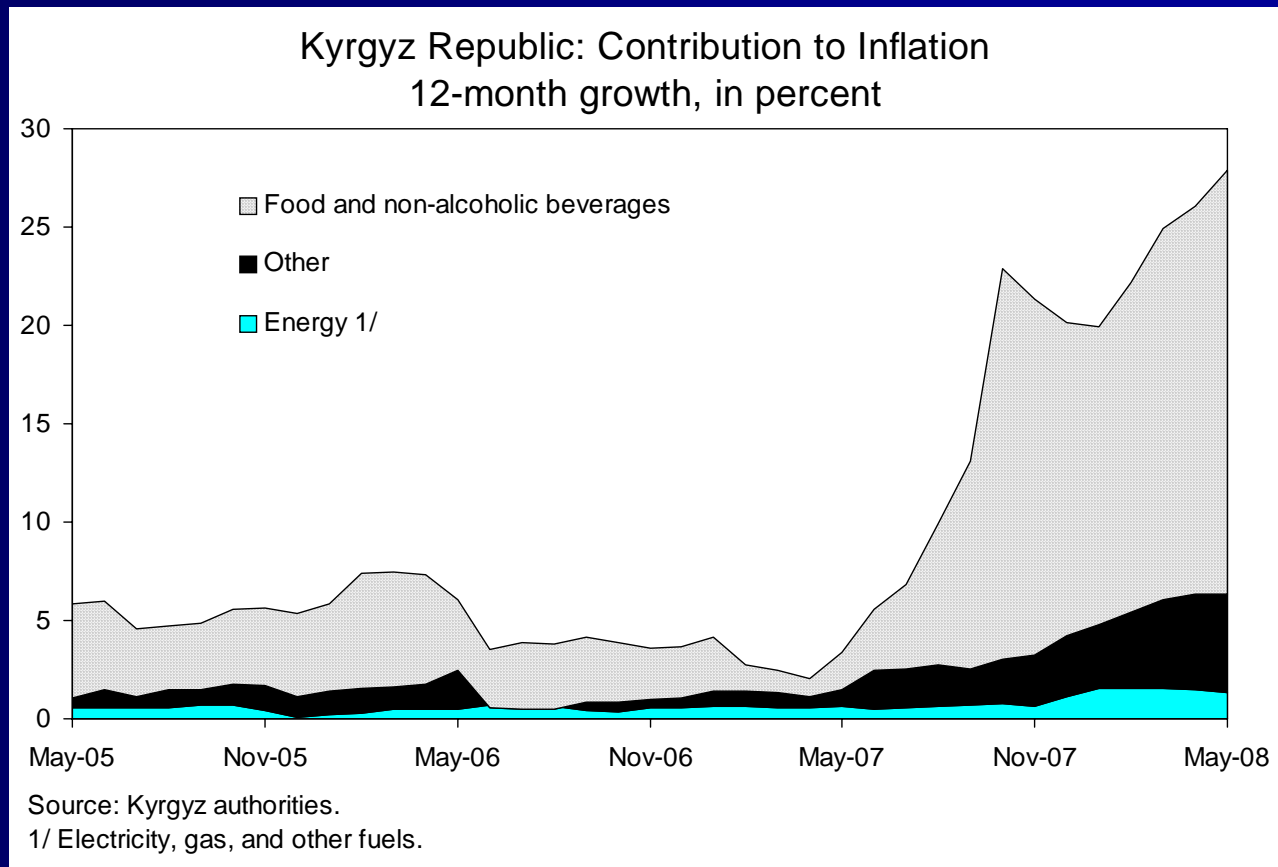
# A slowdown in economic growth



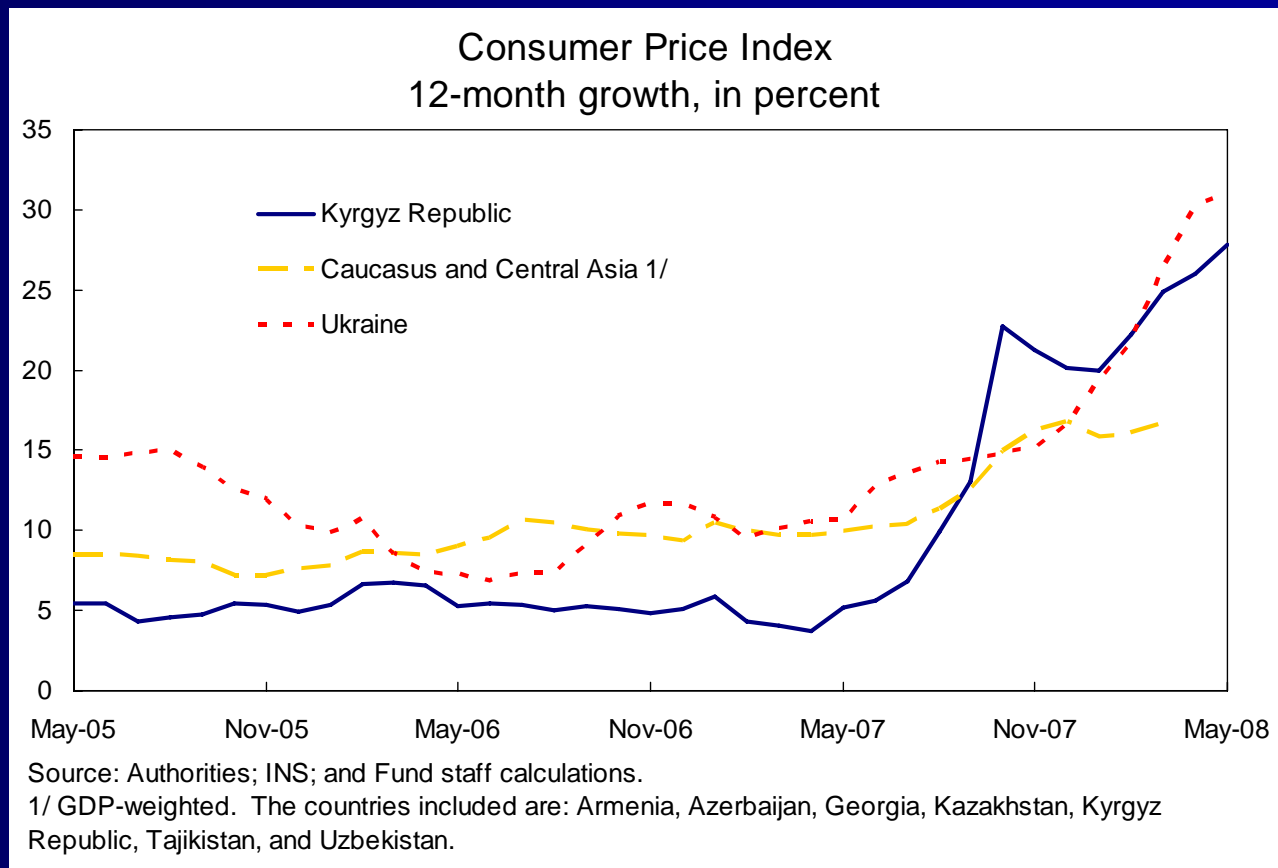
# A sharp increase in inflation



# Largely driven by food prices



# Kyrgyz Republic is not alone



# Balance of payments is expected to worsen

- Import bill for food and energy products is projected to be almost \$300 million higher
- Inflows from exports, remittances, and other private capital flows are expected to slow
- Only partially offset by higher gold export earnings

# **In dealing with these shocks, policies will need to walk a fine line between tackling inflation and protecting growth and the poor**

- Higher international prices need to be passed on to domestic prices to ensure allocative efficiency and avoid excessive fiscal costs
- But this will cause a large drop in real incomes, especially of poor households
- Avoid price controls and export bans or taxes, as they reduce farmer incentives

# Cushion the impact on the poor

- Best option: targeted direct cash or in-kind transfers
- Non-distortive and lower fiscal costs
- Conditional on meeting requirements
- For example, UMB, school feeding programs, food stamps; subsidized flour for the poor
- Capacity constraints may affect targeting and speed and efficiency of execution

# Cushion impact on the poor

- Second best measures: temporarily reduce taxes and tariffs, or introduce subsidies, on one or two products that are most vital for the poor
- Likely to result in higher fiscal costs and creating distortions
- Should be reassessed as direct transfer programs are strengthened

# Longer term measures to reduce vulnerability to food and fuel price shocks

Increase agricultural production by:

- Upgrading infrastructure, distribution and storage systems
- Enhance competition
- Provide stable regulatory environment and access to financing
- Remove remaining trade barriers

## Longer term measures to reduce vulnerability to food and fuel price shocks

Reduce the need for energy imports by:

- Moving ahead with energy sector reforms to reduce losses, reduce demand, and attract new investment to increase energy production

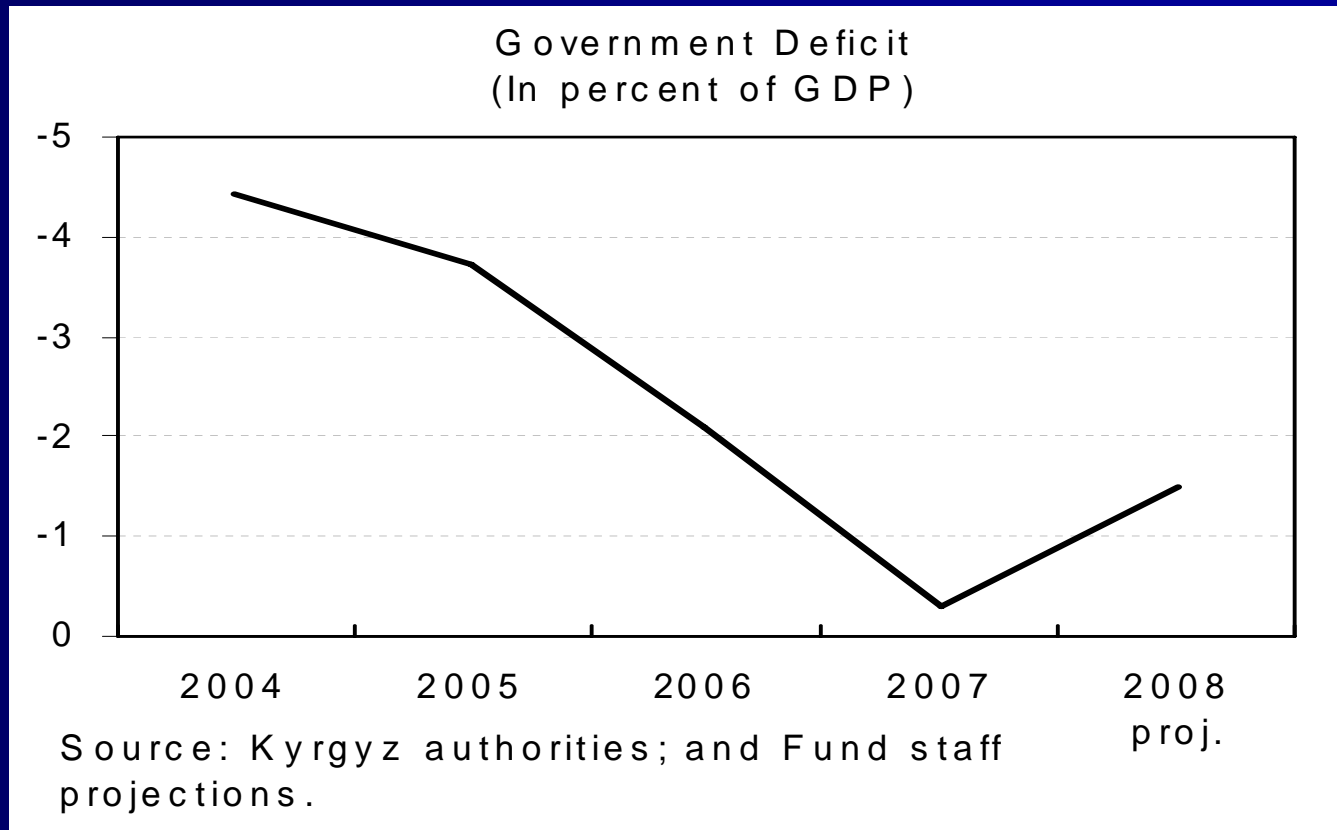
# Fiscal policy

- Need to pay for measures to support the poor
- But need to be supportive of monetary policy in reducing inflation
- While maintaining fiscal sustainability
- And while supporting growth

# Fiscal policy

- Some widening of the overall budget deficit relative to the near-balance in 2007 is appropriate, but less than envisaged in the 2008 budget
- Create additional room for social spending by reducing non-priority spending and further improving revenue collection
- More grants

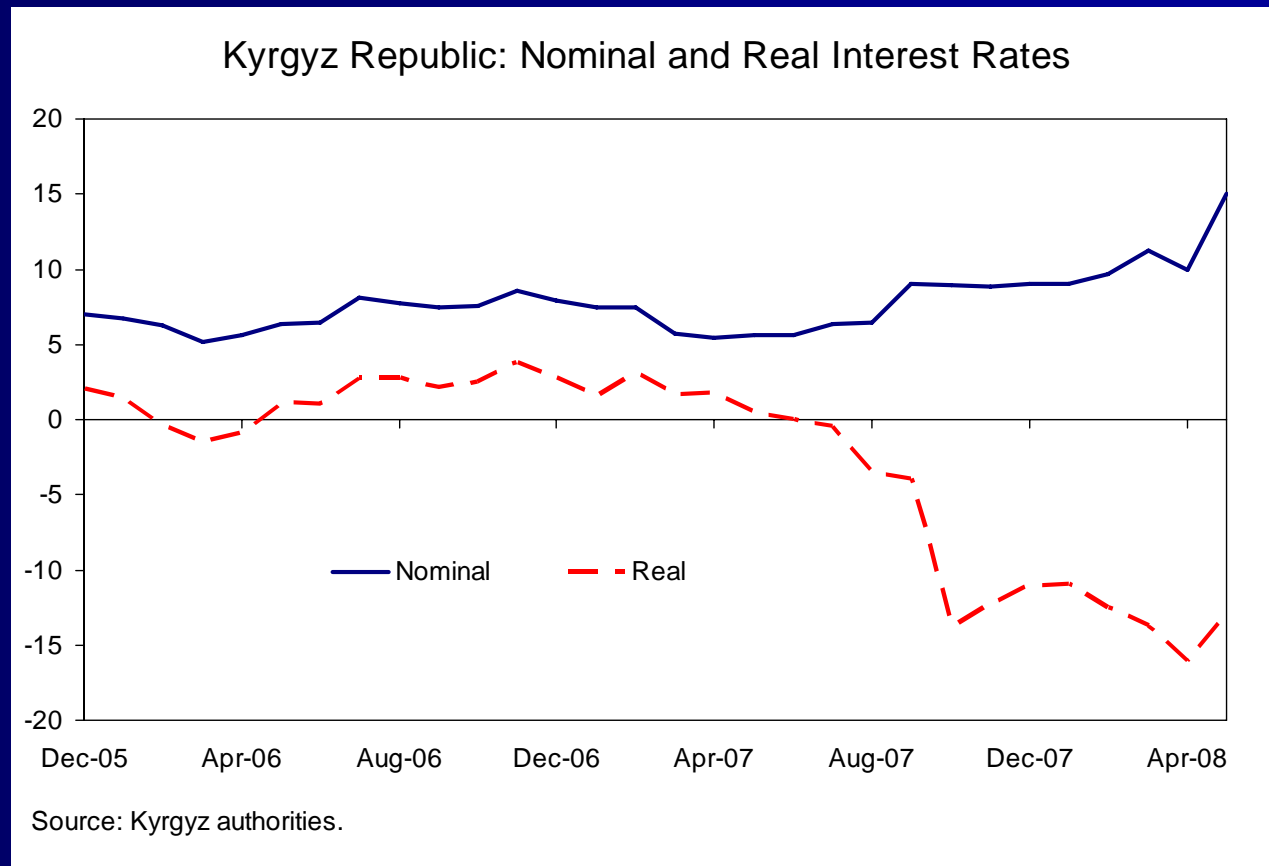
# Fiscal policy



# Monetary policy

- Focus on bringing inflation under control
- Accommodate first-round effects, but fight second-round effects
- A further tightening of monetary policy, including a more substantial rise in interest rates, is needed to avoid inflation becoming entrenched

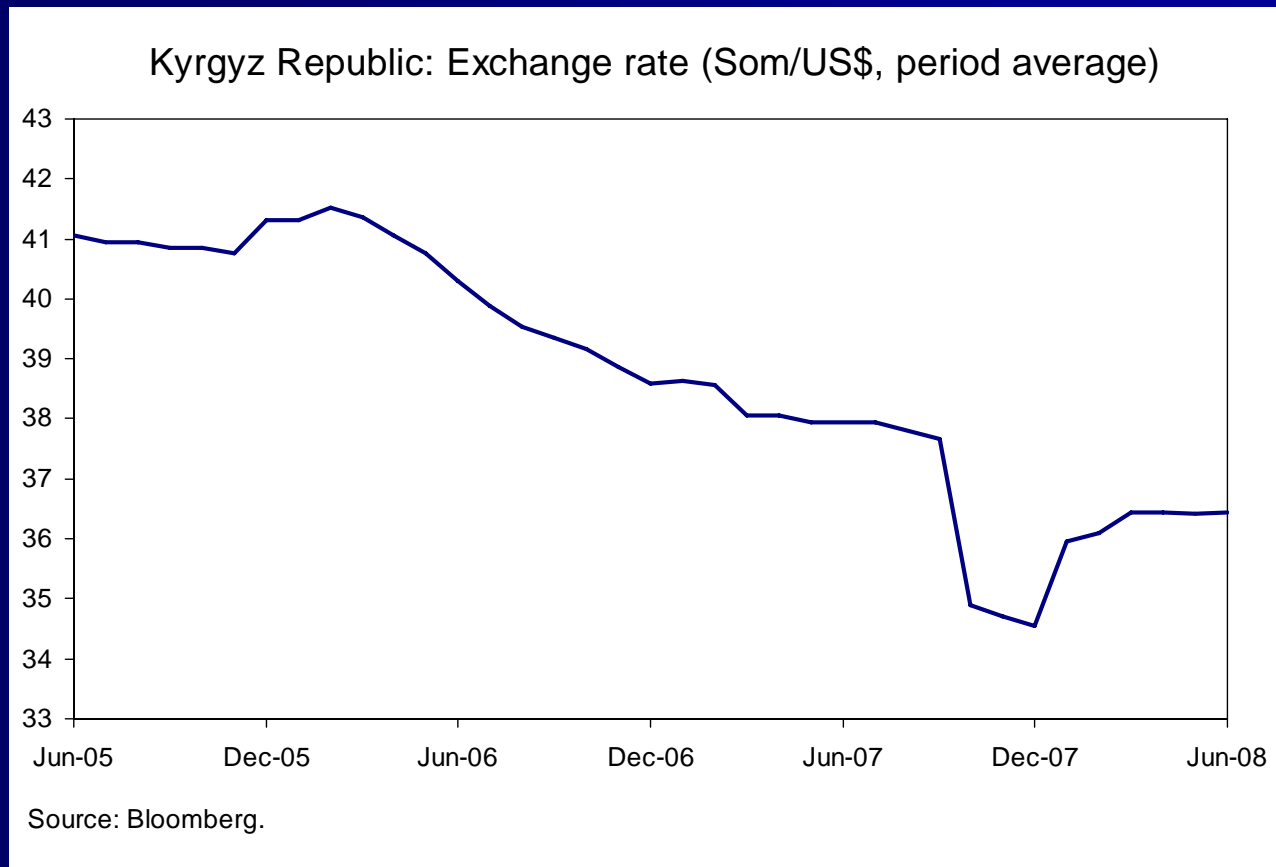
# Monetary policy



# Exchange rate policy

- Low level of financial intermediation: power of interest rates relatively weak, making the exchange rate a more powerful instrument
- High import content in CPI: pass-through from exchange rate to prices strong
- Little room for cutting back on food and fuel imports

# Exchange rate policy



# Exchange rate policy

- Resist downward pressure on the exchange rate
- Mobilization of concessional financing to finance a balance of payments need
- If inflows resume, allow the rate to appreciate

# Conclusion

- Reducing inflation while protecting growth and the poor will be a very tough challenge
- It requires decisive action
- Sooner, rather than later, as inflation can become entrenched and the costs to reduce it will increase
- Look for support