

The Kyrgyz Republic Recent Economic Developments in 2006

Summary

The political environment in the Kyrgyz Republic for the whole year was turbulent and was driven mainly by opposition demands for constitutional reform promised by the new country leaders after March 2005 revolution. As a result, in early November 2006 a new constitution was adopted, which limited the role of the President and shifted more power to the Parliament. However, in December 2006, after resignation of Felix Kulov's government and the threat of Parliamentary dissolution, the Constitution was revised again, resulting most of the President's powers being restored.

These political tensions throughout the year were compounded by high profile political scandals and events, such as an attempt to plant drugs on the ex-speaker of the Parliament; resignation of the several key political figures (Secretary of State, Chairman of National Security Service) in spring, discussions of the possibility of the country to join HIPC initiative, and finally, resignation of the government. The difficult and unproductive relationship between the former government and Parliament was another feature of the past year, and this affected consideration and approval of major laws and critical decisions, such as Country Development Strategy and 2007 state budget.

The turbulent political atmosphere contributed to a relatively poor economic performance in 2006. Real GDP grew by only 2.7 percent in 2006 that was much less than the authorities' target¹. However, non-gold growth was encouraging at 5.1 percent, driven mainly by services (8.4 percent) and construction (8.5 percent). Domestic demand remained a leading driver of the growth. Fixed investments grew by 18 percent mainly driven by domestic private sector. Average inflation rose to 5.6 percent compared with 4.4 percent in 2005, while inflation measured by the GDP deflator increased to 9.2 percent from 7.1 percent, reflecting substantial increases in agricultural producer prices. The nominal exchange rate of the som against US dollar appreciated by 7.7 percent, while the real effective exchange rate remained relatively stable. The current account deficit increased to a worrying level of 23.6 percent of GDP² compared with 8.3 percent of GDP in 2005, reflecting a 59 percent increase in imports of goods and services that outpaced export growth of 23 percent. Fiscal performance has improved due to increased revenues and the general government budget deficit declined to 3.1 percent of GDP from 3.8 percent in 2005.

1. Growth

Real GDP increased by 2.7 percent, which was mainly affected by a 34 percent decline of Kumtor's gold production. At the same time, non-gold GDP grew by 5.1 percent compared with 1.9 percent in 2005. Positive growth was possible due to high growth in trade (14.4 percent), construction (8.5 percent) and tourism industry (19.8 percent). Among the factors influencing high growth rates in the construction sector in last two years was growing demand for the real estate, which was bolstered by a growing inflow of the labor remittances. Agriculture failed to recover from the 2005 depression partly due to declined productivity of grains.

Table 1: Real growth rate of GDP and sectors

	2002	2003	2004	2005	2006
GDP	0.0	7.0	7.0	-0.2	2.7
GDP excl. gold	3.1	5.4	7.8	1.9	5.1
Agriculture	3.0	3.2	4.1	-4.2	1.5
Construction	1.4	-2.2	5.4	17.6	8.5
Industry	-10.5	15.6	2.7	-13.4	-9.8
Services	4.4	7.3	11.9	8.4	8.4

Source: NSC

¹ In the end of 2006, the National Statistical Committee made an upward revision of 2005 GDP data that resulted in its increase from Som 100.9 billion to Som 113.2 billion, mainly due to revision of the construction value added. So, 2005 real GDP decline became 0.2 percent instead of 0.6 percent previously.

² Based on preliminary NBKR data

Non-gold industrial output grew by 3.7 percent in real terms. Among major industrial sectors that demonstrated positive real growth of production were textiles (19 percent) and construction materials (21.7 percent), all due to high external and domestic demand. The energy sector declined slightly by 0.7 percent.

Agricultural output grew only by 1.5 percent, and so has not recovered from the decline in 2005. Production of grain crops has declined by 6 percent, but overall crop decline was offset by increased harvest of fruits and vegetables, partly due to favorable weather conditions. Livestock production has shown modest growth.

Construction continued to demonstrate a quite sustainable growth and increased by further 8.5 percent in real terms. This growth has been driven by increased investments in communication and transportation sectors (reconstruction of strategic roads, such as Bishkek-Osh), processing industries, mining (exploration works), housing, and energy (including recovering albeit still small investments in new hydro-stations). Overall fixed investment grew by 18 percent, with three quarters of financing originating from the domestic private sector.

Services grew by 8.4 percent in real terms, mainly provided by strong growth of trade (14 percent) and hotel and restaurants services (20 percent). Despite the considerable growth of trade turnover, including imports, the growth of freight services was reported at only 2.8 percent. In total, real growth of commercial services grew almost by 12 percent, while public services have shown no growth.

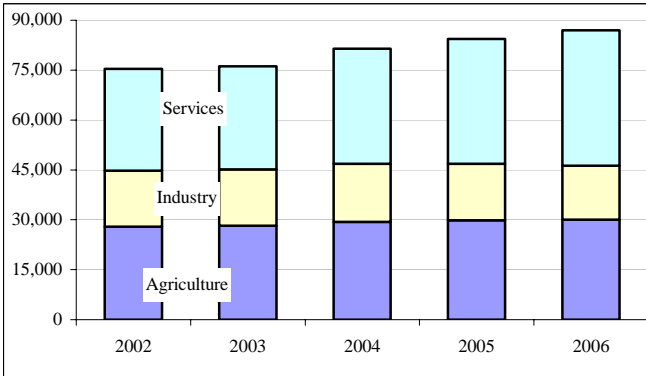
2. Inflation, exchange rate, and interest rates.

Consumer prices increased by 5.1 percent in 2006 compared with 4.9 percent in 2005. The inflation grew mainly due to higher food prices as well as increased fees for some utilities, educational and notary services.

Producer prices increased in agriculture by 12 percent over the level in 2005, reflecting stronger external demand and increase in cost of inputs; in industry – by 10 percent, mainly due to increase in gold prices (by 40 percent).

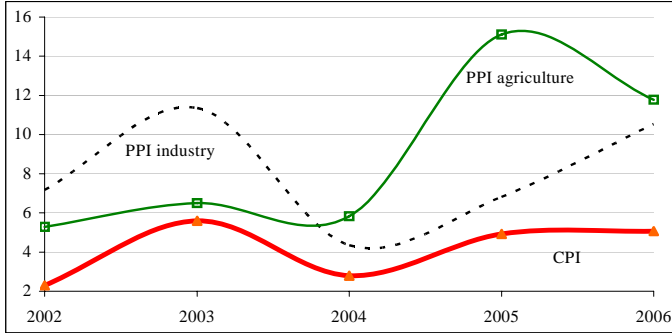
The real effective exchange rate remained relatively stable with some tendency to depreciation. This trend is mostly explained by higher inflation rate in Kazakhstan and Russia, two major trading partners. The real exchange rate against the Russian ruble and Kazakh tenge depreciated by 6.6 and 1.7 percent, respectively. Following international trends, real appreciation of the som to US dollar was equal to 10 percent.

Figure 1: GDP structure (mil.soms in constant 2003 prices)



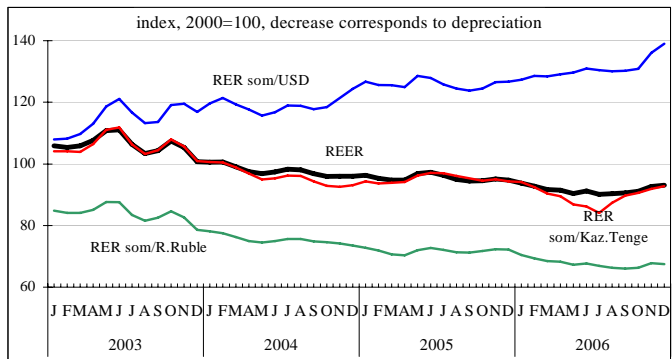
Source: NSC

Figure 2: CPI and PPI (% eop)



Source: NSC and WB staff calculations

Figure 3: Real Exchange Rates



Source: NBKR

The average weighted **interest rate** on commercial bank loans remained at the 2005 level: 25 percent for Som loans and 17 percent – for loans issued in foreign currencies. Despite this, lending to private sector continued to grow rapidly and reached 10 percent of GDP by end of 2006, of which 53 percent was provided on a long-term basis (compared with 35 percent by end of 2005). While the banking credit growth became possible because of an increased deposit base, 78 percent of the latter was represented by demand deposits. Traditional sectors that consumed most of the credits were trade (41 percent of total credit portfolio), mortgage (14%), industry (11%), and households (8%).

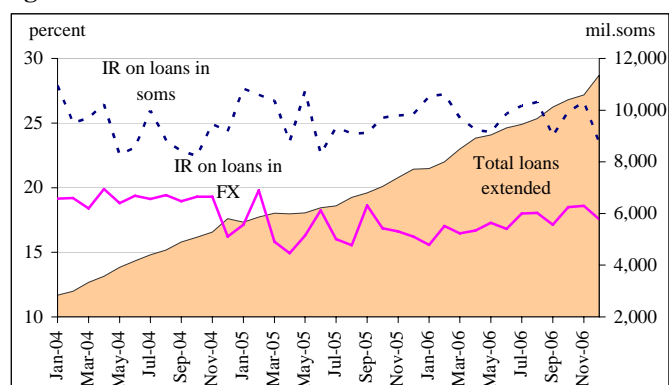
3. External Sector

The **current account deficit** increased to 23.6 percent of GDP in 2006 due to increased imports of goods by 63 percent and in spite of solid commodity export performance (18 percent) driven by non-gold items. Nevertheless, international reserves rose due to increased inflows of remittances, FDI and short-term capital, reaching a historically high 817 million US dollars (4.4 months of imports). It should be mentioned that considerable size of errors and omissions (up to 14 percent to GDP) suggests under-recording of remittances inflow and export transactions, so the current account deficit may be overestimated.

Merchandise exports increased by 18.1 percent over 2005 level. Volume of the gold exports declined by 37 percent, but due to rise in international gold prices, its value decreased only by 10.7 percent. Exports other than gold grew by 33 percent driven mainly by increase of food, textile and re-exported oil products.

Merchandise imports (fob) exceeded 2005 level by 63 percent, reflecting increase in imports of energy, capital goods, and consumer goods. The import of major oil products went up by 68 percent in dollar terms both due increase in prices 15 percent and quantity 46 percent. Machinery and equipment import went up considerably driven by construction and services development (transportation, communication).

Figure 4: Nominal interest rates and loans extended



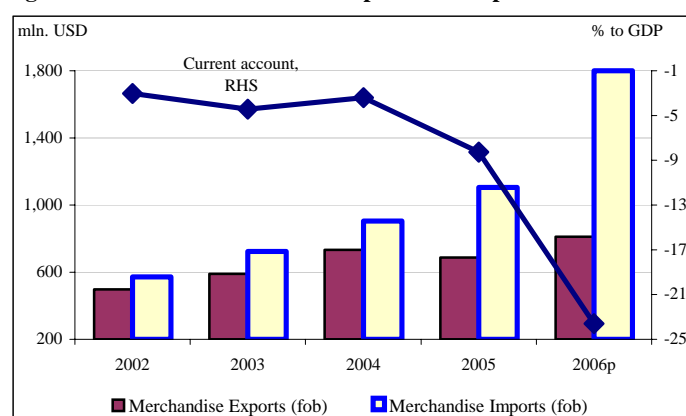
Source: NBKR

Table 2: Current Account Balance (million US\$)

	2002	2003	2004	2005	2006p
Current account	-49	-85	-76	-203	-665
<i>as % to GDP</i>	-3.0	-4.4	-3.4	-8.3	-23.6
Merchandise Exports (fob)	498	590	733	687	811
Gold exports	163	260	287	231	206
Merchandise Imports (fob)	571	723	904	1,106	1,799
Exports of services	142	158	210	256	347
Imports of services	148	160	224	291	424
Net income	-58	-62	-100	-81	-53
Interest payments (sched.)	-32	-27	-37	-37	-32
Current transfers (net)	88	112	209	332	454
Workers' remittances (inflow)	30	70	179	313	486

Source: NBKR

Figure 5: CAB and merchandise exports and imports



Source: NBKR

4. General Government budget

The fiscal deficit of the general government decreased to 3.1 percent of GDP (as compared with 3.8 percent in 2005), mainly due to considerable growth of import-related revenues.

General government revenue increased to 26.8 percent of GDP, demonstrating 2.1 percentage points increase over 2005 level. In nominal terms revenue amount reached Som 30.3 billion, which is by Som 5.4 billion higher of the previous year level. About 2/3 of this increase was made due to continuing growth of custom duties and VAT on imports, and payroll taxes collected by the Social Fund.

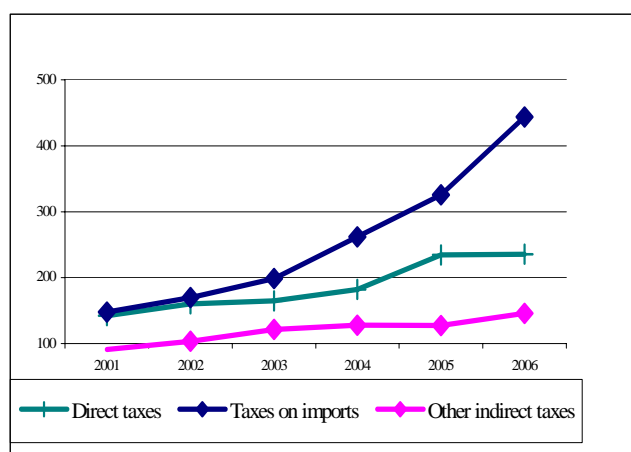
General government expenditure, as percentage of GDP, has reached 30 percent, which is just slightly higher 2005 level. Current expenditures grew more remarkably by 1.3 percentage points or by around Som 3.5 billion in nominal terms. Additional resources allowed the government to improve financing of other-than-salary items, though quarterly releases of the funds were extremely uneven (with 40 to 60 percent of funds released in the fourth quarter). Increases in expenditure were recorded for almost all sectors, but social sectors (education, health and social insurance), as well as transport, were among those benefiting the most.

Table 3: General government budget (% of GDP)

	2004	2005	2006
Total revenue	23.4	24.7	26.8
Taxes	18.3	20.0	21.6
Income and profit tax	2.7	3.3	2.9
VAT	7.2	7.0	8.1
Excises	1.3	1.1	1.1
Customs	0.5	1.6	2.5
Payroll	3.5	3.8	4.0
Others	3.1	3.1	3.2
Non-tax and Capital Grants	4.0	3.7	4.3
	1.1	1.0	0.8
Total expenditure	27.9	29.0	30.0
Current	23.0	24.2	25.5
Wages	5.8	6.3	5.9
Transfers&subsidies	8.4	8.7	8.8
Interest	1.9	1.5	1.3
Goods and services	6.9	7.7	9.5
Capital	4.9	4.8	4.5
Foreign financed PIP	3.8	3.8	3.4
Net lending	-0.5	-0.4	-0.2
Balance	-4.0	-3.8	-3.1

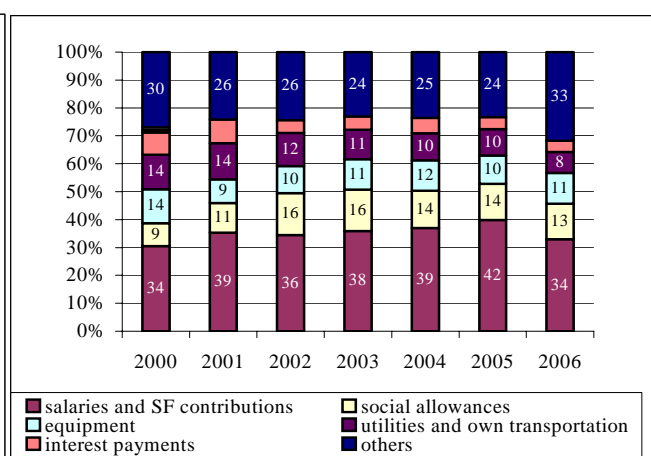
Source: the MEF and WB staff calculations

Figure 6. Tax collections (indices 2000=100)



Source: MF

Figure 7. Structure of the State budget expenditures



Source: MF

5. The main legislative changes with an economic impact in October-December 2006

1. Decrees of the President of the KR on salary increase for employees in health care, education, scientific institutions, culture, and social protection. Decree # 637-641, December 28, 2006.

The salary level to be increased by 30 percent for the above mentioned sectors' staffs, effective January 1, 2007.

2. Decree of the President of the KR "On the size of basic pensions" #642, December 28, 2006.

The basic pension was increased by 24% to 363 soms (from 293 soms), effective from January 1, 2007.

3. The Law "On Access to the Information Handled by State Bodies and Local Self-Governments"

On November 14, 2006, the draft Law was adopted by the Jogorku Kenesh of the Kyrgyz Republic, on December 28 was signed by the President, decree # 213.

According to the Law, information on activities of state bodies and local self-governments is publicly available. The Law is meant to realize and protect the right of citizens for access to the information handled by state bodies and local self-governments, to ensuring maximum possible openness, publicity, and transparency of state bodies' and local self-governments' activities.

4. The Law "On Amendments and Supplements to the Law of the Kyrgyz Republic 'On 2005 Base Rates of Tax on the Use of Agricultural Land, Homestead and Dacha Plots, Land in Inhabited Localities, and Non-agricultural Land'", adopted by the Jogorku Kenesh in November 16, 2006.

As a result of changes made in Article 5 of the above draft Law, the base rates of land tax on the use of land in inhabited localities and non-agricultural land have been tripled.

Kyrgyz Republic: Key macroeconomic indicators

	2000	2001	2002	2003	2004	2005	2006 prelim.	2006 I	2006 II	2006 III	2006 IV
GDP and prices											
GDP real growth (%)	5.4	5.3	0.0	7.0	7.0	-0.2	2.7	2.1	3.0	2.8	2.7
GDP, mln soms	65,358	73,883	75,367	83,872	94,351	100,899	113,176	18,857	23,350	39,021	31,948
GDP, mln US\$	1,370	1,525	1,606	1,919	2,212	2,460	2,818	456	578	984	821
GDP per capita dollar (at avg exchange rate)	279	308	322	381	434	478	542	..	..	..	..
Poverty headcount (% of population) ⁴	63	56	55	50	46	43	..	..	..	..	..
Extreme Poverty headcount (% of population) ⁴	33	25	23	17	13	11	..	..	..	..	..
GDP per capita, 1990=100	59	62	62	65	69	68	69	..	..	..	..
Inflation (% beginning-to-end of period, CPI)	9.6	3.7	2.3	5.6	2.8	4.9	5.1	3.0	1.0	-1.5	2.5
Inflation (% average, CPI)	18.7	6.9	2.1	3.1	4.1	4.4	5.6	...	...	...	...
Deflator GDP (% to prev.period)	27.2	7.3	2.3	3.8	5.1	7.1	9.2	4.7	8.7	12.5	8.5
Wage, average (soms per month)	1,227	1,455	1,684	1,916	2,203	2,570	3,059	2,661	2,911	2,881	3,059
Wage, average (US\$ per month)	26	30	36	44	52	63	76	64	72	73	79
Pension, average (soms per month)	462	558	561	647	709	791	906	843	871	915	906
Pension, average (US\$ per month)	10	12	12	15	17	19	23	20	22	23	23
Exchange rate (som/US\$, end of period)	48	48	46	44	42	41	38	41	40	39	38
Exchange rate (som/US\$, avg of period)	48	48	47	44	43	41	40	41	40	40	39
REER (end of period, 2000=100, up=appreciation)	98	106	107	101	96	95	93	92	91	91	93
Unemployment rate (% of labor force)	7.5	7.8	12.5	9.9	8.5	8.1	..	..	..	..	..
M2 (e.o.p as % of GDP)	11	11	15	17	21	21	27	19	21	24	27
External Sector											
Current account balance (% to GDP) ³	-5.6	-1.2	-3.0	-4.4	-3.4	-8.3	-23.6	-3.3	-4.2	-4.0	-12.1
Exports (mln US\$, fob)	511	480	498	588	733	687	811	178	205	195	233
Power	80	47	22	19	22	21	25	2	4	17	2
Gold	197	227	163	260	287	231	206	62	61	45	37
Other	234	207	313	312	424	435	580	114	140	132	193
Imports (mln US\$, c.i.f.)	559	472	640	716	941	1,101	1,723	304	371	449	599
- Food	61	44	64.0	78	110	140	211	39	54	50	68
- Other consumer goods	149	128	130	178	194	211	287	53	62	81	90
- Energy	129	121	152	180	256	314	507	101	112	123	171
- Other intermediate goods	113	121	125	152	217	245	332	54	75	97	106
- Capital goods	107	58	116	128	163	191	386	57	67	98	164
External Debt (mln US\$)	1,712	1,678	1,785	1,839	2,098	2,024	2,221	2,008	2,150	2,152	2,221
Public External Debt (mln US\$)	1,403	1,436	1,579	1,809	1,949	1,883	1,983	1,870	1,920	1,924	1,983
External Debt (% to GDP)	125.0	110.0	111.1	95.8	94.9	82.3	78.8	71.3	76.3	76.4	78.8
Total debt service to exports of G&S (%)	28.1	30.8	20.7	22.1	13.7	11.9	8.0	5	12	5	11
Public debt service to state revenues&grants (%)	37.4	27.7	23.3	14.6	12.9	11.7	4.0	3.0	4.6	2.8	5.1
Public external borrowing (excl. IMF, mln \$)	127	110	88	75	95	92	76	9	13	24	30
FDI (mln US\$) ¹	-2	5	5	46	175	43	103	11	113	-15	-6
Gross international reserves (mln US\$, end period)	261	285	317	389	565	612	817	605	651	719	817
General Government Budget (percent of GDP)²											
Revenues and grants	18.5	20.4	22.7	22.9	23.4	24.7	26.8	5.4	6.5	6.9	8.0
Grants	0.9	0.8	1.1	0.6	1.4	1.0	0.8	0.1	0.2	0.3	0.2
Tax	12.3	12.4	13.9	14.2	14.8	16.2	17.7	3.6	4.1	4.6	5.3
Social fund contributions	3.7	4.0	4.2	3.5	3.5	3.8	4.0	0.9	0.9	1.0	1.1
Nontax and capital	1.5	3.2	3.5	4.6	4.0	3.7	4.3	0.7	1.3	1.0	1.3
Expenditures	28.1	26.2	27.9	27.6	27.4	28.5	29.8	5.5	7.2	7.6	9.5
Current (other than interest)	18.6	20.5	20.7	21.7	21.1	22.6	24.6	4.7	5.8	6.1	8.0
o.w. transfers & subsidies	7.5	8.2	9.4	8.7	8.4	8.7	8.8	1.9	2.1	2.3	2.4
wages & salaries	4.4	4.9	5.4	5.7	5.8	6.3	5.9	1.2	1.4	1.4	1.9
Interest payments	2.2	1.7	1.9	1.6	1.9	1.5	1.3	0.1	0.7	0.1	0.5
Capital	7.8	5.3	6.0	4.9	4.9	4.8	4.5	0.6	1.0	1.4	1.5
of/which foreign financed PIP	6.5	4.4	4.7	3.7	3.8	3.8	3.4	0.5	0.8	1.0	1.1
Net lending	-0.5	-1.1	-0.6	-0.5	-0.5	-0.4	-0.2	0.1	-0.2	-0.1	-0.1
Fiscal Balance (accrual)	-9.6	-5.8	-5.2	-4.7	-4.0	-3.8	-3.1	-0.2	-0.8	-0.6	-1.5
Memo:											
Primary Deficit (w/o interest and PIP)	-0.9	0.2	1.4	0.5	1.6	1.5	1.6	0.5	0.7	0.5	0.0
Primary Deficit (w/o interest)	-7.4	-4.2	-3.3	-3.2	-2.1	-2.3	-1.8	-0.1	-0.1	-0.6	-1.1

Sources: Ministry of Finance, National Statistical Committee, Social Fund, National Bank and World Bank staff calculations.

¹ Includes repayment of FDI related debt

² The state budget consolidates central and local budgets and includes the foreign-financed public investment program and the deficit of the social fund, which became an extrabudgetary Fund in 1991. The quarterly data are on cash basis and based on the Treasury reports.

³ NBKR preliminary data

⁴ Poverty data is consumption based. Poverty data for 2003-05 are based on the Kyrgyz Integrated Household Survey and are not comparable with earlier year data.