

The Kyrgyz Republic

Recent Economic Developments: January-September 2006

Summary

The political environment remained volatile in the 3rd quarter of 2006. In mid-September 2006 political tension between the Parliament and President/Government was aggravated due to accusations that security services had attempted to plant drugs on the ex-speaker of the Parliament. The Eighth People's Kurultai, or congress, convened on September 17 by opposition, put a set of reform demands to the President and the government.

Real GDP grew by 3.2 percent in the first 9 months of 2006, compared with the same period in 2005, which was lower than official forecasts, mainly due to a significant decline in gold production. Non-gold growth was solid at 6.1 percent, driven mainly by services (8.6%) and construction (21.7%) while agriculture remained relatively stagnant (2.8%). Investment grew almost by 26 percent in the same period and was mainly driven by the private sector. Average inflation rose to 5.8 percent compared with 4.0 percent in the same period last year, while inflation measured by the GDP deflator increased to 11.6 percent from 7.6 percent in January-September of last year, reflecting significant increases in agricultural producer prices. The nominal exchange rate remained relatively stable, while the real effective exchange rate depreciated by 4 percent. The external current account deficit increased to 14.2 percent of GDP compared with 5.2 percent of GDP in first nine months of last year, reflecting export growth of 17.4 percent (partly limited by the continued decline in gold exports) and a 59.7 percent increase in imports. The current account deficit is expected to exceed 17 percent for the year as a whole. The general government budget deficit declined to 1.6 percent of GDP from 2.9 percent of GDP in January-September of last year, mainly due to increases in revenues from higher imports.

1. Growth

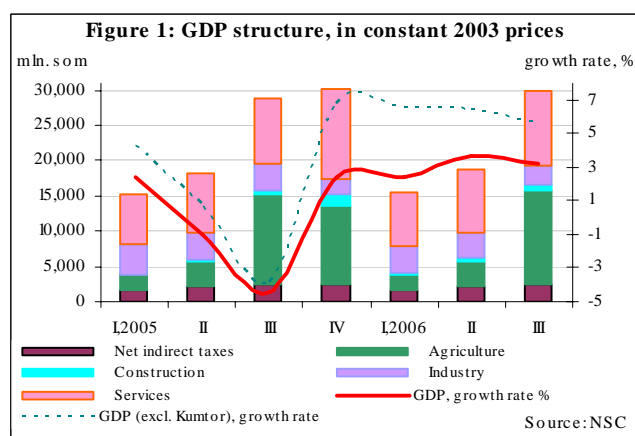
Real GDP increased by 3.2 percent, despite the decline of Kumtor's gold production by 37 percent. Non-gold GDP grew by 6.1 percent compared with 1.2 percent growth in January-September of 2005. Positive growth was possible due to high growth in trade (15.4 percent), construction (21.7 percent). The growth in construction offset represented a rebound from low levels in 2005, but agriculture failed to recover from the depression of output in 2005. The growth of services has reduced industry to 14.7 percent of GDP compared with 16.4 percent in the same period of 2005.

Non-gold industrial output grew by 5.6 percent in real terms. Among major industrial sectors that demonstrated positive growth were textiles (32 percent), which now make up 5.2 percent of industrial production, food (6.8 percent), and the production of construction materials (6.2 percent), all due to high external and domestic demand. The mining industry increased by 4.2 percent due to growth of non-oil minerals, while energy only grew by one percent.

Table 1: Growth rates of GDP and value added of sectors

	2003	2004	2005	9 m.05	9 m.06
GDP	7.0	7.0	-0.6	-1.8	3.2
GDP excl. Kumtor-gold	5.4	7.8	1.4	1.2	6.1
Agriculture	3.2	4.1	-4.2	-14.2	2.8
Construction	-2.2	5.4	2.1	-18.8	21.7
Industry (incl. Kumtor)	15.6	2.7	-12.6	10.9	-11.4
Services	7.3	11.9	8.1	5.5	8.6

Source: NSC



Agricultural output grew by 2.8 percent, and so has not recovered from the 14 decline in the first 9 months of 2005. Production of grain crops has declined by 8 percent, but overall crop growth was driven by increased harvest of fruits (due to favorable weather conditions) and by cotton production (48 percent). Livestock production has shown modest growth.

Construction increased by 21.7 percent in real terms. Such a solid growth has been driven by increased investments in communication and transportation sectors (reconstruction of strategic roads, such as Bishkek-Osh) as well as in mining (exploration works) and processing industries. Investments made by the private sector continued to grow rapidly.

Services grew by 8.6 percent in real terms, mainly provided by strong growth of trade, food, and hotel services. The summer tourism season was exceptional this year with a large number of tourists visiting the country.

2. Inflation, exchange rate, and interest rates.

Consumer prices increased by 2.5 percent from beginning of the year compared with 2.1 percent increase during the same period of last year. Inflation increased mainly due to higher vegetable prices as well as increased fees for education and notarial services. Given seasonal pattern of prices, it is projected that the inflation rate for 2006 will be about 5.7 percent.

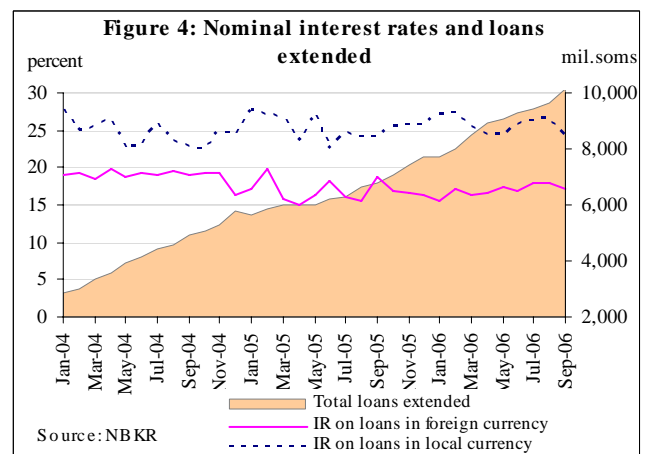
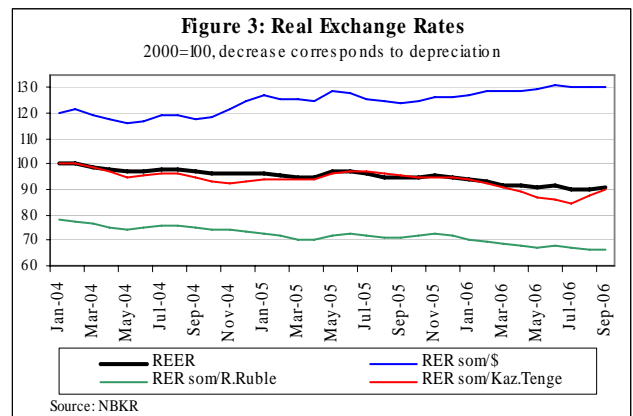
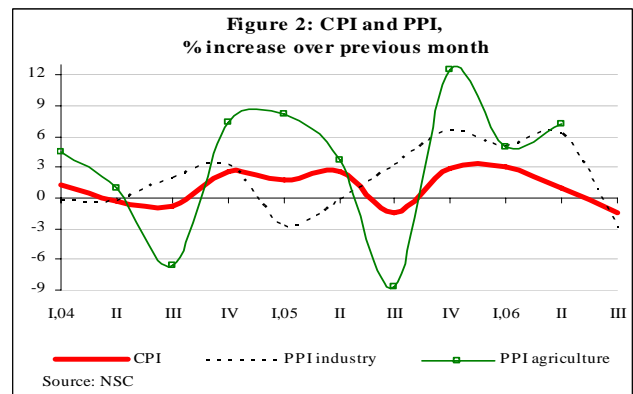
Producer prices increased in agriculture by 16.6 percent over the level in the same period of last year, reflecting stronger external demand and increase in cost of inputs; in industry – by 17.1 percent, mainly due to increase in gold prices (by 40 percent).

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 8.7 and 4.9 percent, respectively. Following international trends, real appreciation of the som to US dollar was equal to 3 percent.

Average weighted **interest rate** on commercial bank loans extended in local currency remained at 25 percent and in foreign currencies – at 17 percent. Though there was no change in interest rates in last two years, lending to private sector continued to grow on a rapid pace and reached 9.2 percent of GDP by September 2006, of which 46 percent were provided on a long-term basis (compared with 35 percent by end of 2005).

3. External Sector

The current account deficit increased to 14.9 percent of GDP in January-September of 2006 from 5.2 percent of GDP in the same period of last year. Although export was impressive (17.4%), driven by non-gold



items, imports of goods increased by almost 60 percent. Nevertheless, international reserves rose due to increased inflows of FDI and short-term capital, reaching a historically high 718.9 million US dollars (4 months of imports). It should be mentioned that considerable size of errors and omissions suggests under-recording of remittances or export transactions.

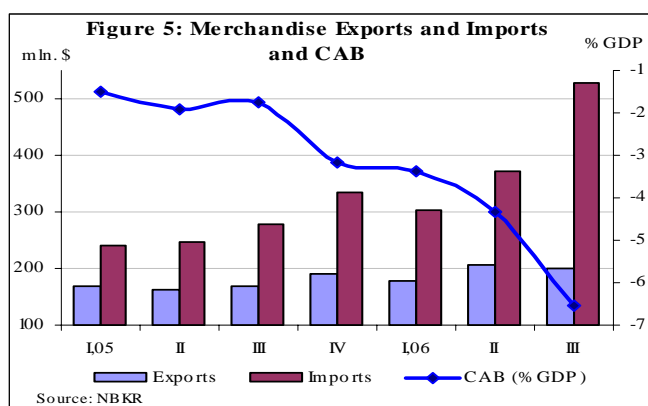


Table 2: Current Account Balance (million US\$)

	2003	2004	2005	9 m.2005	9 m.2006
CAB (% GDP)	-4.2	-3.4	-8.3	-5.2	-14.2
CAB (million US\$)	-81	-75	-204	-127	-392
Merchandise Exports	590	733	687	497	583
Gold exports	260	287	231	186	169
Non-gold exports	331	446	456	311	414
Merchandise Imports (fob, includes estimates)	724	904	1,101	772	1,193
Exports of services	155	209	255	185	251
Imports of services	151	231	292	208	284
Net income	-62	-90	-81	-59	-55
interest payments (scheduled)	-27	-37	-43	-23	-21
Current transfers, net	112	209	332	231	308

Source: NBKR

Merchandise exports increased by 17.4 percent over its value in the same period of last year. Gold exports declined by only 9 percent in value terms despite a fall in volume of 35 percent, due to the rise in international gold prices. Export other than gold grew by 33 percent driven mainly by increase of vegetables, textile and re-exported oil products.

Merchandise imports (c.i.f.) increased by 59.6 percent, reflecting increase in imports of capital goods, energy, and food products. The import of oil products increased by 60 percent in dollar terms both due increase in prices (22 percent) and quantity (31 percent). Machinery and equipment import went up considerably driven by construction and services development (transportation, communication).

General Government budget

The fiscal deficit of the general government

decreased to 1.6 percent of GDP (as compared with 2.9 percent in January-September 2005), mainly due to considerable growth of import-related revenues.

General government revenue increased to 19.0 percent of GDP compare with 17.4 percent in the January-September 2005. The most significant contribution to this increase was made through a continuing growth of custom duties and VAT on imports accounting for almost 80 percent of increase in budget revenue's.

General government expenditure, as percentage of GDP, remained almost at the level of January-September, 2005, though in nominal terms it increased by Som 2 billion. 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. The majority of additional revenues were used for financing salaries and pensions, and capital repair.

Table 3: General government budget (% of GDP)

	January - September				
	2004	2005	2004	2005	2006
Total revenue	23.4	24.9	16.2	17.4	19.0
Taxes	18.3	20.2	13.2	14.4	15.6
Income and profit tax	2.7	3.3	1.9	2.5	2.1
VAT	7.2	7.1	5.1	4.9	5.7
Excises	1.3	1.1	1.0	0.9	0.8
Customs	0.5	1.7	0.3	1.1	1.7
Payroll	3.5	3.8	2.6	2.8	2.9
Others	3.1	3.1	2.3	2.2	2.3
Non-tax and Capital Grants	4.0	3.7	2.8	2.6	3.1
Grants	1.1	1.0	0.3	0.5	0.3
Total expenditure	27.9	29.2	19.5	20.6	20.7
Current	23.0	24.4	16.2	17.2	17.7
Wages	5.8	6.3	3.7	4.2	4.2
Transfers&subsidies	8.4	8.8	5.8	6.3	5.7
Interest	1.9	1.5	1.2	1.0	0.9
Goods and services	6.9	7.8	5.4	5.7	6.8
Capital	4.9	4.8	3.3	3.4	3.1
Foreign financed PIP	3.8	3.9	2.6	2.8	2.4
Net lending	-0.5	-0.5	-0.3	-0.3	-0.1
Balance	-4.0	-3.9	-3.0	-2.9	-1.6

Source: the MEF and WB staff calculations

5. The main legislative changes with an economic impact in the third quarter 2006

- 1. Law of the Kyrgyz Republic “On Introducing Changes into the Law of the Kyrgyz Republic “On Investments in the Kyrgyz Republic”, # 144, July 31, 2006, entered into force on August 8, 2006.**

Adoption of the given Law was aimed at increasing the investment attractiveness of the country and guarantee of protection of investment rights. In particular, the law expands right of investors to choose the most favorable conditions not only in investment legislation but also in tax and customs legislation in the event the existing legislation is changed.

- 2. Law of the Kyrgyz Republic “On Counteraction of financing of terrorism and legalization of incomes obtained in a criminal way (money laundering)”, #58, August 8, 2006.**

This Law of the Kyrgyz Republic is aimed at protection of rights and legitimate interests of citizens, society and state, preservation of integrity of the financial system of the Kyrgyz Republic against criminal encroachment via establishment of a mechanism to fight financing of terrorism and legalizing of incomes obtained in a criminal way (money laundering).

- 3. Decree of the President of the KR on salary increase for staff of social protection sector, # 340, July 1, 2006.**

The salary for above mentioned category was increased by 20 percent effective July 1, 2006.

- 4. Law of the Kyrgyz Republic “On minimal social standards”, #149, August 7, 2006.**

The law defines principles of legal regulations, establishing and implementing of state minimal social standards necessary for providing important life/vital needs of population.

The law contains and provides definitions of system of social standards and its types, minimal consumption budget, describes authority of state bodies and local self-governance in area of state social standards as well as procedure of implementing and use of state social standards.

Kyrgyz Republic: Key macroeconomic indicators

	2002	2003	2004	2005	2005	2005	2005	2006	2006	2006	
					I	II	III	IV	I	II	III
GDP and prices											
GDP real growth (%)	0.0	7.0	7.0	-0.6	2.4	-1.0	-4.4	2.5	2.4	3.6	3.2
GDP, som million	75,367	83,872	94,351	100,116	16,992	20,615	33,842	28,668	18,608	23,428	40,230
GDP, USD million	1,606	1,919	2,212	2,441	414	501	827	699	450	580	1,015
GDP per capita dollar (at avg x-rates)	322	381	434	473	...	...	...	...	...	...	...
Poverty headcount (% of population) ⁴	55	50	46	43	...	...	...	...	...	...	...
Extreme Poverty headcount (% of population) ⁴	23	17	13	11	...	...	...	...	...	...	...
GDP per capita, 1990=100	62	65	69	68	...	...	...	...	...	...	...
GNI per capita dollar GDP (Atlas)	290	340	400	440	...	...	...	...	...	...	...
Inflation (% beginning-to-end of period, CPI)	2.3	5.6	2.8	4.9	1.7	2.6	-1.4	2.8	3.0	1.0	-1.5
Inflation (% average, CPI)	2.1	3.1	4.1	4.3	3.0	...	...	...	...	...	...
Deflator GDP (%)	2.3	3.8	5.1	6.8	5.4	7.1	9.1	4.7	6.9	9.7	15.1
CPI index, average 1998=100	176.1	181.5	189.0	197.2	...	...	...	...	...	...	...
Wage, average for KR (som per month)	1684	1916	2203	2570	2269	2466	2589	2932	2661	2911	2881
Wage, average for KR (US\$ per month)	36	44	52	63	55	60	63	72	64	72	73
Pension, average for KR (som per month)	561	647	709	791	781	762	801	849	873	848	...
Pension, average for KR (US\$ per month)	12	15	17	19	19	19	20	21	21	21	...
Exchange rate (som/\$, end of period)	46	44	42	41	41	41	41	41	41	40	39
Exchange rate (som/\$, avg of period)	47	44	43	41	41	41	41	41	41	40	40
REER (end of period, 2000=100, up=appreciation)	107	101	96	95	95	97	94	95	92	91	91
M2 (e.o.p as percent of GDP)	14.6	17.5	20.5	21.3	19.8	21.0	23.0	21.3	19.5	21.8	24.8
External Sector											
Current account balance (% GDP) ³	4	3	3	3							
Current account balance (mln US\$)	-3.1	-4.2	-3.4	-8.3	-1.5	-1.9	-1.8	-3.2	-3.4	-4.3	-6.5
Exports (mln US\$, f.o.b.)	498	588	733	687	168	161	168	190	178	205	200
- Power	22	19	22	21	1	3	11	6	2	4	17
- Gold	163	260	287	231	68	58	60	45	62	61	45
- Other	313	312	424	435	100	100	97	139	114	140	137
Imports (mln US\$, c.i.f.)	640	716	941	1,101	240	248	278	336	304	371	527
- Food	64.0	78	110	140	30	31	36	43	39	54	62
- Other consumer goods	130	178	194	211	45	51	51	65	53	62	74
- Energy	152	180	256	314	68	66	80	101	101	112	119
- Other intermediate goods	125	152	217	245	44	61	66	73	54	75	99
- Capital goods	116	128	163	191	53	38	45	55	57	67	173
External Debt (mln US\$)	1785	1,943	2,106	2,023	2,086	2,016	2,018	2,023	2,008	2,150	2,152
Public External Debt (mln US\$)	1576	1,652	1,957	1,882	1,932	1,871	1,880	1,882	1,870	1,920	1,924
External Debt (% GDP)	111.1	101.2	95.2	82.9	85.5	82.6	82.7	82.9	73.0	78.1	78.2
Total debt service to exports of GS (%)	20.7	22.1	13.7	11.9	7	15	7	17	7	9	6
Public debt service to state revenues&grants (%)	23.3	14.6	12.9	11.8	9.7	16.5	8.6	11.9	10.2	10.8	...
Public external borrowing (excl. IMF, mln \$)	88	75	95	92	19	7	17	49	9	13	24
FDI (mln \$) ¹	5	46	175	43	11	8	28	-4	11	113	35
General Government Budget (percent of GDP)²											
Revenues and grants	22.7	22.9	23.4	24.8	5.2	6.1	6.1	7.4	5.5	6.7	7.1
Grants	1.1	0.6	1.4	1.0	0.0	0.3	0.2	0.5	0.1	0.2	0.3
Tax	13.9	14.2	14.8	16.3	3.5	3.9	4.1	4.8	3.7	4.3	4.7
Social fund contributions	4.2	3.5	3.5	3.8	1.0	0.9	0.9	1.0	0.9	1.0	1.0
Nontax and capital	3.5	4.6	4.0	3.6	0.7	1.0	0.9	1.0	0.7	1.3	1.1
Expenditures	27.9	27.6	27.4	28.7	6.2	7.1	6.8	8.7	5.7	7.5	7.7
Current (other than interest)	20.7	21.7	21.1	22.8	5.3	5.4	5.3	6.8	4.8	5.9	6.3
o.w. transfers & subsidies	9.4	8.7	8.4	8.8	2.0	2.2	2.2	2.4	2.1	2.1	1.6
wages & salaries	5.4	5.7	5.8	6.3	1.0	1.6	1.7	2.1	1.2	1.5	1.5
Interest payments	1.9	1.6	1.9	1.5	0.2	0.7	0.1	0.5	0.1	0.7	0.1
Capital	6.0	4.9	4.9	4.8	0.9	1.1	1.5	1.4	0.6	1.0	1.4
of/which foreign financed PIP	4.7	3.7	3.8	3.9	0.7	0.9	1.2	1.1	0.5	0.8	1.0
Net lending	-0.6	-0.5	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	0.1	-0.2	-0.1
Fiscal Balance (accrual)	-5.2	-4.7	-4.0	-3.9	-1.0	-1.0	-0.7	-1.3	-0.2	-0.8	-0.6
Memo:											...
Primary Deficit (w/o interest and PIP)	1.4	0.5	1.6	1.5	-0.1	0.7	0.6	0.3	0.5	0.7	0.5
Primary Deficit (w/o interest)	-3.3	-3.2	-2.1	-2.4	-0.8	-0.3	-0.5	-0.8	-0.1	-0.1	-0.5

Source: 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 2002 is based on fewer sample based household survey; therefore poverty data for 2002 is not comparable with later year data.