

The Kyrgyz Republic Recent Economic Developments: January-September 2005

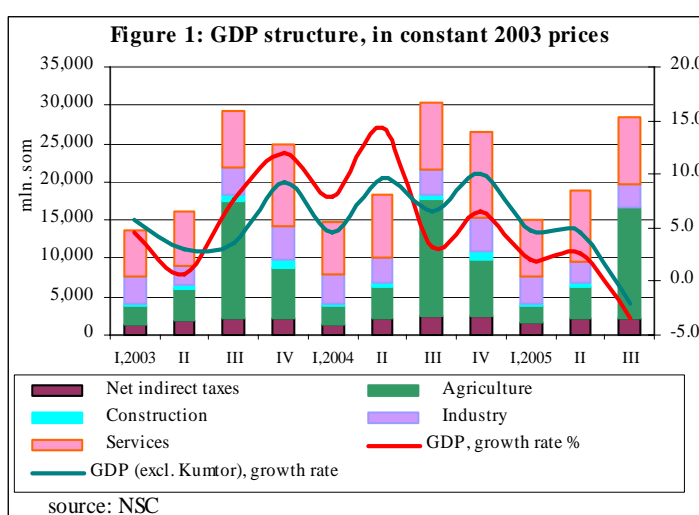
Summary

After the election of the President and appointment of the Prime Minister, the state authorities were focused on establishment of a new government's structure and appointment of new members of the Cabinet of Ministers, which have been finalized only at the end of September. The main differences of the new government's structure from the old one are the following: (i) responsibility for economic policy has been transferred back to the Ministry of Finance from the Ministry of Economic Development, Industry, and Trade; (ii) new bodies, the State Committee for Migration and Employment and the Ministry of Culture have been established; and (iii) some regulatory agencies have been moved from government's structure to the presidential subordination. Overall, despite establishment of the new government, political environment remains fragile. Demonstrations in support of different interests have been taking place from time to time. There is on-going disorder in prison system.

The fragile political environment, in addition to continued decline in gold production and increase in oil price continued negatively affect macroeconomic developments in the third quarter of 2005. Real GDP declined by 0.4 percent in January-September of 2005. Non-gold real GDP grew only by 1.2 percent, mainly due to continued growth of services, while agricultural sector declined and non-gold industry grew by less than one percent. Fixed investment continued also to decline in the third quarter of this year. Based on results of the second quarter economic performance, the government has revised its earlier projection of the real GDP growth for 2005 from 5 percent to 3 percent; however, even this growth rate is unlikely to be achieved. Inflation during January-September came to 2.1 percent compared with 0.2 percent in the similar period of last year. Meantime, the non-gold GDP deflator increased to 9 percent from 5.9 percent in January-September of last year, reflecting significant increases in agriculture producer prices. The nominal exchange rate of Som against US\$ and real effective exchange rate remained relatively stable. External imbalance increased to 4.8 percent of GDP compared with 3.0 percent of GDP in nine months of last year, reflecting continued decline in gold exports and increase in imports, and is expected to exceed 6 percent for the year as a whole. At the same time, the general government budget deficit declined to 2.6 percent of GDP from 2.9 percent of GDP in January-September of last year, mainly due to increase in revenues from increased imports. The payroll tax rate was reduced by two percentage points to 31 percent. The government raised salaries of teachers and medical staff by 15 percent on average from July 1, salaries of police by 50 percent from May 1, and pensions by 8 percent on average from April 1. Government expenditure policies envisage further increase in salaries and pensions in 2006. On tax policies, the government has declared its intention to implement the following measures from 2006: (i) reduction of the corporate income tax from 20 to 10 percent; (ii) increase of the excise tax rate on alcohol by 16 percent on average; (iii) increase of the agriculture land tax by 10 percent; and (iv) increase of the motor vehicle tax by three times.

1. Growth

- **Real GDP** declined by 0.4 percent, reflecting the decline in Kumtor related gold production by 21.4 percent and agriculture by 4.1 percent, while services increased by 6.8 percent, construction by 1.6 percent, and non-gold industry was almost stagnant. Non-gold real GDP grew by 1.2 percent compared with 6.9 percent



growth in January-September of 2004. As a result of strong growth of services, the share of services in GDP increased by 1 percentage point to 37.6 percent.

- **Non-gold industrial output** increased only by 0.8 percent in real terms after three years of tangible recovery. Mining industry declined by 17 percent, and production of construction materials, despite strong domestic and external demand, declined by 6.5 percent. On positive side, textile industry and tobacco product industry continued to recover.
- **Agricultural output** declined by 4.1 percent in real terms, most probably caused by political instability in regions during spring field works and the substantial increase in fuel prices. Given that harvesting was near to completion by the end of third quarter, the annual agricultural output is likely to decline too.
- **Construction sector output** increased by 1.6 percent in real terms. In the public sector, investments in construction of Bishkek-Osh road and in power sector declined, while investments for irrigation increased. Construction in private sector continued to grow dynamically.
- **Services** grew by 6.8 percent in real terms, mainly provided by continued strong growth of trade, food, hotel, and communication services. While trade services and imports have been strongly growing, the official statistics suggests that transportation services are declining, which is questionable given strong link between developments of transportation and trade.

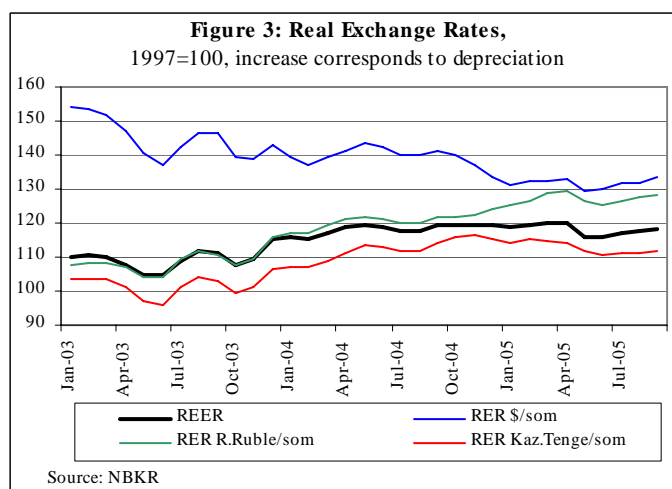
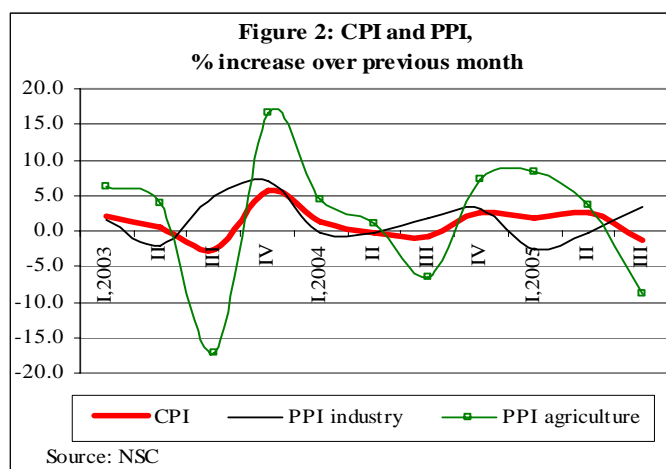
Table 1: Growth rates of GDP and value added of sectors

	2001	2002	2003	2004	2004 9 m.	2005 9 m.
GDP	5.3	0.0	7.0	7.1	7.3	-0.4
GDP excl. Kumtor-gold	4.1	3.1	5.4	7.8	6.9	1.2
Agriculture	7.3	3.0	3.2	4.1	1.0	-4.1
Construction	4.0	1.4	-2.2	3.5	-1.8	1.6
Industry (incl. Kumtor)	4.8	-13.4	15.6	3.5	5.6	-9.3
Services	3.9	4.4	7.3	11.7	15.7	6.8

Source: NSC

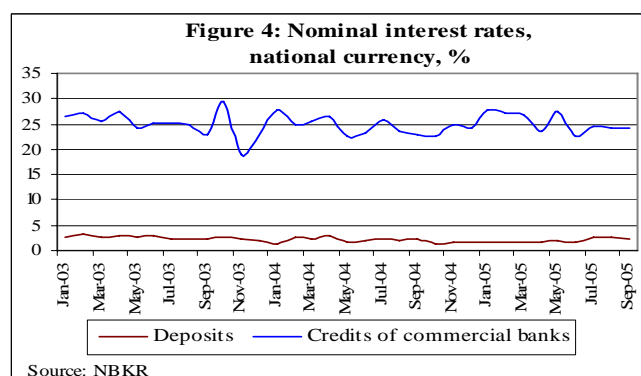
2. Inflation, exchange rate, and interest rates.

- **Consumer prices** increased by 2.1 percent from beginning of the year compared with 0.2 percent increase during the same period of last year. Inflation increased mainly due to raise in food prices, and it is expected that they will seasonally grow further in fourth quarter. Average consumer prices in January-September increased by 4 percent over the prices in the same period of last year. Meantime agriculture producer prices increased by 12.4 percent over the prices in the same period of last year, reflecting decline in agricultural output and increase in cost of inputs.
- **The real effective exchange rate** and real exchange rate of Som against US dollar remained relatively stable. The real exchange rate of Som against Russian Ruble depreciated by 3.4 percent during January-September due to higher inflation in Russia than one in Kyrgyzstan, while the nominal exchange rate appreciated by 2.4 percent. In contrast, the real exchange rate of Som against Kazakh Tenge appreciated by 3.0 percent, reflecting



nominal appreciation of Som against Kazakh Tenge by 4.3 percent.

- **Average weighted interest rate** on commercial bank loans remained at around 25 percent, and there was no tangible declining trend over last two years. On positive side lending to private sector continued to grow.



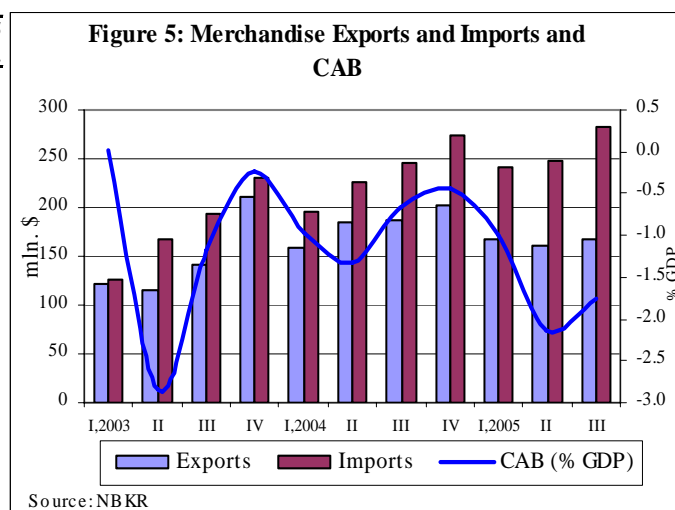
3. External Sector

- **Current account deficit** increased to 4.9 percent of GDP in January-September of 2005 from 3 percent of GDP in the same period of last year due to both decline in gold exports and increase in imports.
- **Merchandise exports** declined by 6.3 percent in nine months of this year over its value in the same period of last year. Gold exports declined by 17 percent in value terms and by 23 percent in real terms. Exports other than gold and fuel for military base declined by 1 percent.
- **Merchandise imports** (c.i.f.) increased by 15.6 percent, reflecting increase in imports of food products, energy products, and investment goods. The import of oil products increased by 33.7 percent in dollar terms due to dramatic increase in prices, while in real terms it decline by 4.4 percent.

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

	2001	2002	2003	2004	2004 9 m.	2005 9 m.
CAB (% GDP)	-1.2	-3.1	-4.2	-3.4	-3.0	-4.9
CAB (million US\$)	-26	-49	-81	-75	-65	-116
Merchandise Exports	480	498	590	733	530	497
Gold exports	227	163	260	287	225	186
Non-gold exports	254	335	331	446	306	311
Merchandise Imports (fob, includes estimates)	450	572	724	904	643	735
Exports of services	80	142	155	209	150	166
Imports of services	125	149	151	231	164	195
Net income	-64	-57	-62	-90	-72	-63
interest payments (schedt)	-39	-32	-27	-37	-24	-23
Current Transfers net	51	88	112	209	134	215

Source: NBKR



4. General Government budget

- Due to good performance in budget revenue collection, **fiscal deficit**¹ of the general government budget declined to 2.6 percent of GDP from 2.9 percent of GDP in January-September 2004, despite the concurrent increase of the government expenditures. The deficit was mainly financed by external (PIP) borrowing.

¹ Includes changes in reported expenditure arrears to represent accrual basis

Table 3: General government budget (% of GDP)

	2003	2004	January-September		
			2003	2004	2005
Total revenue	23.0	23.5	16.2	16.2	17.5
Taxes	17.7	18.3	12.5	13.2	14.4
Income and profit tax	2.7	2.7	1.8	1.9	2.5
VAT	6.6	7.3	4.5	5.1	4.9
Excises	1.4	1.3	1.0	1.0	0.9
Customs	0.5	0.5	0.3	0.3	1.1
Payroll	3.5	3.5	2.6	2.6	2.8
Others	3.1	3.1	2.4	2.3	2.2
Non-tax and Capital	4.7	4.0	3.2	2.8	2.6
Grants	0.6	1.1	0.5	0.3	0.5
Total expenditure	28.1	27.8	20.0	19.4	20.4
Current	23.2	22.9	16.5	16.1	17.0
Wages	5.8	5.8	3.6	3.7	4.2
Transfers&subsidies	8.7	8.4	5.8	5.8	6.3
Interest	1.6	1.9	0.9	1.2	1.0
Goods and services	7.1	6.8	6.2	5.3	5.4
Capital	4.9	4.9	3.6	3.3	3.4
Foreign financed PIP	3.7	3.8	2.9	2.6	2.8
Net lending	-0.5	-0.5	-0.3	-0.3	-0.3
Balance	-4.6	-3.9	-3.5	-2.9	-2.6

Source: the MEF and WB staff calculations

- General government revenue** increased to 17.5 percent of GDP, compared to 16.2 percent of GDP in January-September 2004, which provided additional Som 2.2 billion for the general government budget. Taxes other than payroll tax increased by 1.0 percentage point of GDP (or Som 1.6 billion), mainly due to significant rise in tax collections recorded in the first quarter of 2005, contributing about 40 percent to the total nine month tax revenue increase, and ongoing, albeit more modest increase observed in the second and third quarters. Continued increase in imports and improved customs administration remained to be the main factors of budget revenue growth. During 9 months of this year against the same period of 2004 collections of taxes and duties on imports (VAT, excises and customs duties) increased by 21 percent in nominal terms, and their share in total state taxes made up to 49 percent, while in 2004 these indicators were at 38 and 47 percent correspondingly. At the same time, collections of taxes on domestically produced goods and services (other than income taxes) have been declining over the year, and in the third quarter of this year collection of these taxes was Som 170 million lower than one in the same period of last year.

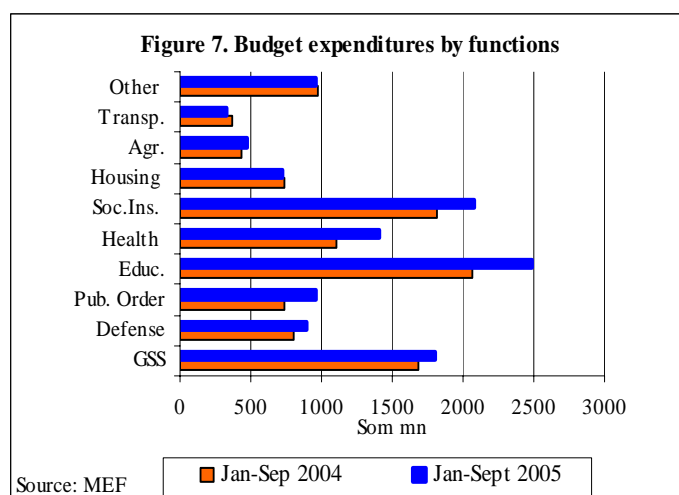
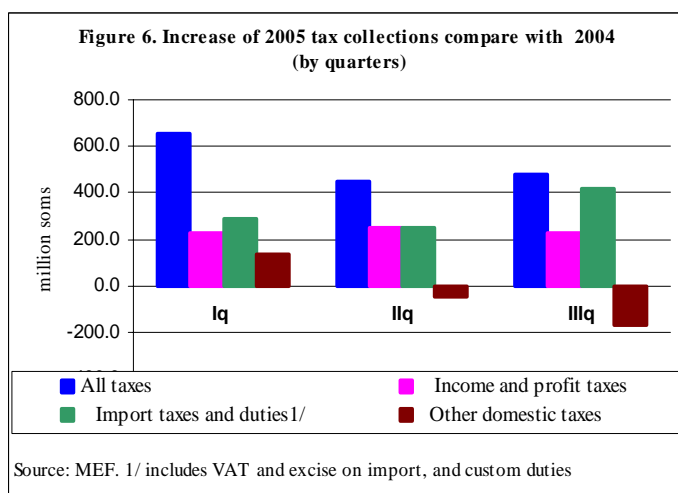
Table 4. Tax collection increase in 2005 against 2004 (Som million)

	Iq	IIq	IIIq	January-September
Tax revenue increase	653	446	478	1,577
of which				
Income and profit taxes	230	247	230	707
personal income tax	52	91	80	223
profit tax	72	117	111	300
other income taxes	107	38	38	183
VAT	229	-137	29	122
domestic goods	52	-102	-25	-76
imported goods	177	-34	55	198
Excises	-8	-32	-32	-72
domestic goods	10	-6	-32	-28
imported goods	-17	-26	0	-44
Customs ^{1/}	125	312	363	795
Land tax	-8	0	-27	-35
Road and Emergency Fund	66	15	0	81
Other	19	41	-85	-21

Source: the MEF and WB staff calculations

1/ According to new customs procedures effective from 2005, all payments to the customs by individuals are recorded as customs duties, while earlier they were divided on VAT and custom duties. This explains significant increase in reported customs duties in 2005.

- General government expenditure** reached 20.4 percent of GDP (Som 20.3 billion) that is one percentage point more (or by Som 2 billion) the expenditure in January-September of last year. Financing of almost all sectors increased, but the most significant growth was observed in public order (by 30 percent), education (by 20 percent), health care (by 28 percent), and social protection (by 32 percent). At the same time, according to the Central Treasury report, the overall state budget for nine months was actually financed only by 90 percent. Because of recent increases in salaries and pensions, expenditures for these items increased by 15 percent, and the share of these expenditures in total expenditure reached 38 percent. Financing of such items as food and medicines increased by 50 percent.



5. The main legislative changes with economic impact in April – June 2005

- **Law of the Kyrgyz Republic “On Structure of the Government of the Kyrgyz Republic”, September 30, 2005**
The law approves new structure of the Government, consisting of 13 ministries and 2 committees.
- **Decree of the Government of the Kyrgyz Republic “On Draft Law of the KR “On Introducing Changes into the Law of the KR “On Tariffs of Insurance Fees for State Social Insurance”, #442, September 20, 2005**
The draft law suggests reduction of the insurance tariffs from 23 down to 21 per cent for employers (legal entities); including for Pension Fund - from 21 to 19 per cent from 2006.
- **Decree of the Acting President of the KR “On salary increase of education and health related employees of the KR”, # 260 of July 1, 2005**
The salary of culture and health related employees to be increased by 15 percent from July 1, 2005.
- **The Decree of the Government of the KR “On establishment of e-data-base of the (newly) developed normative and legal acts of the Kyrgyz Republic”, # 318 of July 26, 2005**
According to the decree, the Ministry of Justice of the Kyrgyz Republic shall create an e-data base of newly developed draft normative acts, and post them on the official website of the Ministry for public discussion.
- **The Decree of the Government of the KR “On minimal standards of health budget financing of the KR”, # 280 of July 1, 2005**
The decree approves minimal standards of health budget financing of the KR by health care programs.
- **The Decree of the Acting President of the KR “On measures for reduction of interference of controlling, law enforcement, and other state bodies into activities of entrepreneurial entities”, # 284 of July 23, 2005**
The Government of the KR has to establish a special commission on preparation of legislative and other proposals, aimed at elimination of all unjustified barriers for entrepreneurial activities and excessive governmental functions.

Kyrgyz Republic: Key macroeconomic indicators

	2001	2002	2003	2004	2004	2004	2004	2004	2005	2005	2005
					I	II	III	IV	I	II	III
GDP and prices											
GDP real growth (%)	5.3	0	7.0	7.1	7.8	14.3	3.3	6.5	2.0	2.6	-3.4
GDP, som million	73,883	75,367	83,872	94,078	15,742	19,432	32,446	26,458	17,105	20,856	35,511
GDP, USD million	1,525	1,606	1,919	2,205	365	447	764	635	417	507	867
GDP per capita dollar (at avg x-rates)	308	322	381	431	...	...	...	...	...	...	...
Poverty headcount (% of population) ⁴	56	55	50	46	...	...	...	...	...	...	...
Extreme Poverty headcount (% of population) ⁴	25	23	17	13	...	...	...	...	...	...	...
Inflation (% beginning-to-end of period, CPI)	3.7	2.3	5.6	2.8	1.3	-0.4	-0.7	2.6	1.7	2.6	-1.4
Inflation (% average, CPI)	6.9	2.1	3.1	4.1	5.3	...	...	...	3.0	...	...
Deflator GDP (%)	7.3	2.3	3.8	8.9	6.5	5.8	7.4	0.0	6.5	4.6	13.3
Wage, average for KR (US\$ per month)	30	36	44	52	45	47	49	60	55	60	59
Pension, average for KR (US\$ per month)	12	12	15	17	16	16	17	17	19	18	19
Exchange rate (som/\$, end of period)	48	46	44	42	43	43	42	42	41	41	41
Exchange rate (som/\$, avg of period)	48	47	44	43	43	43	42	42	41	41	41
REER (end of period, 1997=100, up=depreciation)	107	109	115	119	117	119	119	119	120	116	118
M2 (e.o.p as percent of GDP)	11.1	14.6	17.5	20.6	16.0	16.9	17.7	20.6	19.8	21.1	22.7
External Sector											
Current account balance (% GDP) ³	-1.2	-3.1	-4.2	-3.4	-1.0	-1.3	-0.7	-0.4	-1.0	-2.1	-1.8
Exports (mln US\$, f.o.b.)	480	498	588	733	159	184	187	203	167	161	168
- Power	47	22	19	22	1	5	10	6	1	3	11
- Gold	227	163	260	287	67	83	75	63	68	58	60
- Other	207	313	312	417	90	96	103	127	99	100	97
Imports (mln US\$, c.i.f.)	472	640	716	941	197	226	245	274	240	248	283
- Food	44	64.0	78	110	20	29	30	31	30	31	36
- Other consumer goods	128	130	178	194	48	46	47	54	45	51	52
- Energy	121	152	180	256	60	54	56	86	69	66	81
- Other intermediate goods	121	125	152	217	42	58	62	56	44	61	67
- Capital goods	58	116	128	163	26	40	50	47	53	38	47
External Debt (mln US\$)	1678	1785	1,943	2,106	1,982	1,999	2,034	2,106	2,086	2,016	2,018
Public External Debt (mln US\$)	1436	1576	1,652	1,957	1,798	1,814	1,851	1,957	1,932	1,871	1,880
External Debt (% GDP)	110.0	111.1	101.2	95	89.9	90.7	92.2	95.5	87.9	84.9	85.0
Total debt service to exports of GS (%)	30.8	20.7	22.1	13.7	17.6	16.3	6.1	15.3	10	23	8
Public debt service to state revenues&grants (%)	27.7	23.3	14.6	12.9	9.0	19.0	10.2	13.0	9.9	14.0	8
Public external borrowing (excl. IMF, mln \$)	110	88	75	95	8	17	47	23	19	7	26
FDI (mln \$) ¹	5	5	46	175	16	146	16	-3	10.7	8.4	12.7
General Government Budget (percent of GDP)²											
Revenues and grants	20.4	22.7	22.9	23.5	4.9	5.5	5.8	7.2	5.3	6.1	6.2
Grants	0.8	1.1	0.6	1.1	0.2	0.0	0.0	0.9	0.0	0.3	0.2
Tax	12.4	13.9	14.2	14.9	3.1	3.7	3.9	4.3	3.5	3.9	4.1
Social fund contributions	4.0	4.2	3.5	3.5	0.9	0.8	0.9	0.9	1.0	0.9	0.9
Nontax and capital	3.2	3.5	4.6	4.0	0.7	1.0	1.0	1.2	0.7	1.0	0.9
Expenditures	26.2	27.9	27.6	27.3	5.8	7.0	6.3	8.2	6.1	7.0	6.7
Current (other than interest)	20.5	20.7	21.7	21.0	4.9	5.0	4.9	6.1	5.2	5.3	5.2
o.w. transfers & subsidies	8.2	9.4	8.7	8.4	1.7	2.0	2.1	2.6	2.0	2.2	2.0
wages & salaries	4.9	5.4	5.7	5.8	0.9	1.4	1.4	2.1	1.0	1.6	1.7
Interest payments	1.7	1.9	1.6	1.9	0.2	0.9	0.2	0.7	0.2	0.7	0.1
Capital	5.3	6.0	4.9	4.9	0.8	1.2	1.4	1.6	0.9	1.1	1.5
of/which foreign financed PIP	4.4	4.7	3.7	3.8	0.6	0.9	1.1	1.1	0.7	1.0	1.2
Net lending	-1.1	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1
Fiscal Balance (accrual)	-5.8	-5.2	-4.7	-3.9	-0.9	-1.4	-0.6	-1.0	-0.9	-0.9	-0.6
Memo:											
Primary Deficit (w/o interest and PIP)	0.2	1.4	0.5	1.8	-0.1	0.3	0.7	0.8	0.0	0.8	0.7
Primary Deficit (w/o interest)	-4.2	-3.3	-3.2	-2.0	-0.7	-0.6	-0.4	-0.3	-0.7	-0.2	-0.4

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 The NBKR has revised current account in order to include estimates of under recorded imports from China

⁴ Poverty data is consumption based. The NSC revised poverty sample since 2003; therefore poverty data for 2003 is not comparable