

The Kyrgyz Republic Recent Economic Developments: January-June 2005

Summary

Despite appointment of acting President, Prime Minister, and interim government, political environment remained unstable in the second quarter of 2005. Supreme Court, surrounded by protestors, did not function for some period of time; protests continued to take place in regions; White House was captured by protestors once more again. New government made efforts to formulate own strategic vision; however, given interim nature and lack of unity within new government, it failed to present coordinated and credible program. Peaceful election of the President on July 10, 2005 and pre-determined candidate for the position of Prime Minister brought some political certainty; however, society and businesses are waiting establishment of new government and announcement of its socio-economic program.

Political instability, in addition to continued decline in gold production and unfavorable weather conditions, negatively affected economic developments in the second quarter of 2005. The real GDP growth rate was only 2.4 percent in January-June of 2005. Non-Kumtor real GDP growth rate slowed down to 4.7 percent, compared with 7.4 percent during the first half of 2004. Preliminary data for first seven months of 2005 shows that non-Kumtor GDP growth rate continued to decline, averaging to 2.7 percent. This indicates that the government's projected annual output growth rate of 5.0 percent for this year is unlikely to be achieved.

The GDP growth in January-June was provided by continued growth of services and construction, while industrial and agricultural output declined. Inflation increased to 4.4 percent compared with 1.0 percent in the first half of last year, indicating that annual inflation will also exceed government targeted 4.0 percent. On the positive side, nominal exchange rate of Som against US\$ and real effective exchange rate were relatively stable during the first half of 2005. Current account deficit remained at 3.3 percent of GDP; however, imports increased, exports declined due to decline in gold exports, and the gap was compensated by increase in inflow of private transfers. Fixed domestic investments and foreign direct investments slowed down in the second quarter of this year. The general government budget deficit declined to 1.5 percent of GDP from 2.3 percent of GDP in the first half of last year, mainly due to increase in tax collection in the first quarter of this year.

1. Growth

- Real GDP** grew by 2.4 percent, based on contribution of services (4.3 percentage points) and construction (0.2 percentage points); while decline in Kumtor related gold production reduced output growth by 2.3 percentage points and agriculture by 0.2 percentage points. Non-gold GDP grew by 4.7 percent compared with 7.4 percent growth in the six months of 2004.
- Non Kumtor-gold industrial output** declined by 1.3 percent in real terms. Mining industry declined by one third. Construction material production, strongly growing last two years, declined by 3.2 percent. Meantime textile industry, rubber and plastic items production, and power production and distribution continued to grow. Food

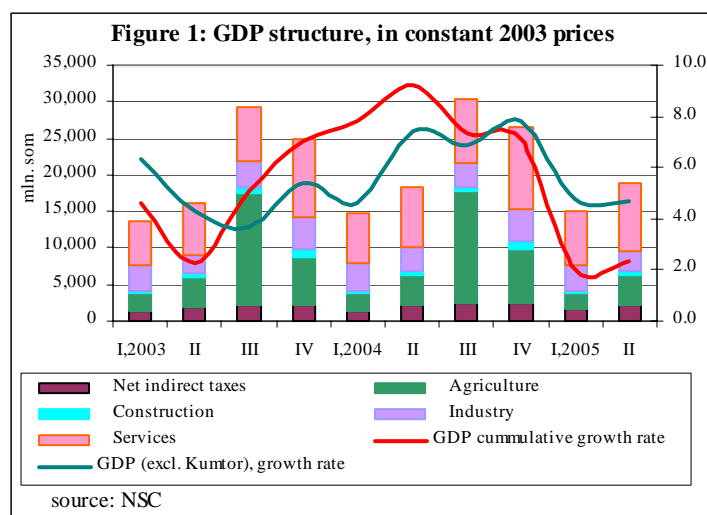


Table 1: Growth rates of GDP and value added of sectors

	2001	2002	2003	2004 6 m	2004 6 m	2005
GDP	5.3	0.0	7.0	7.1	9.2	2.4
GDP excl. Kumtor-gold	4.1	3.1	5.4	7.8	7.4	4.7
Agriculture	7.3	3.0	3.2	4.1	0.6	-1.1
Construction	4.0	1.4	-2.2	3.5	1.3	6.8
Industry (incl. Kumtor)	4.8	-13.4	15.6	3.5	15.8	-10.4
Services	3.9	4.4	7.3	11.7	15.7	9.5

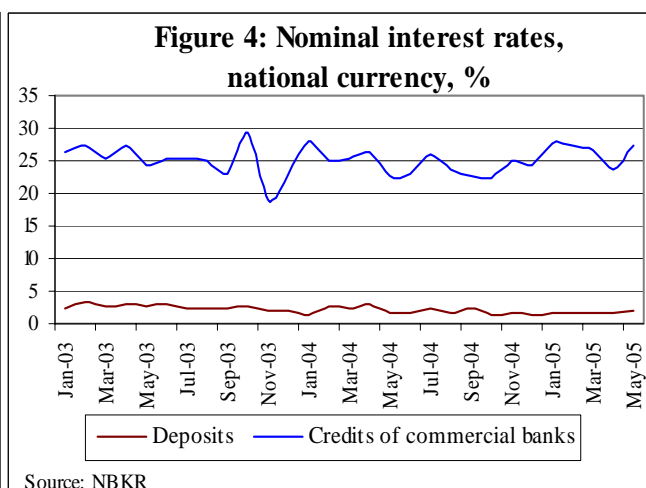
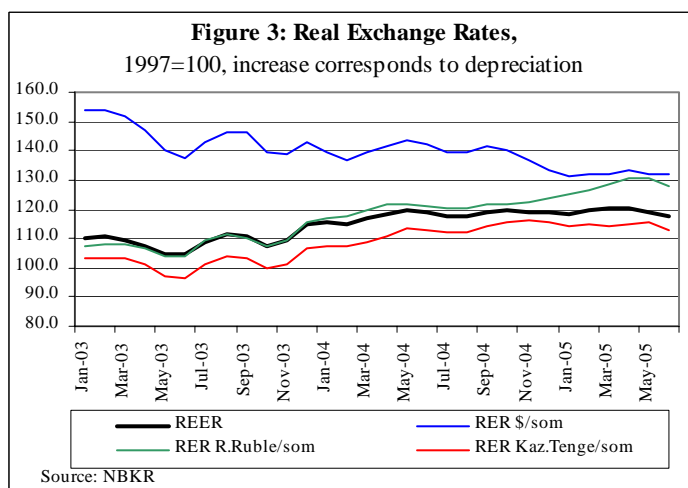
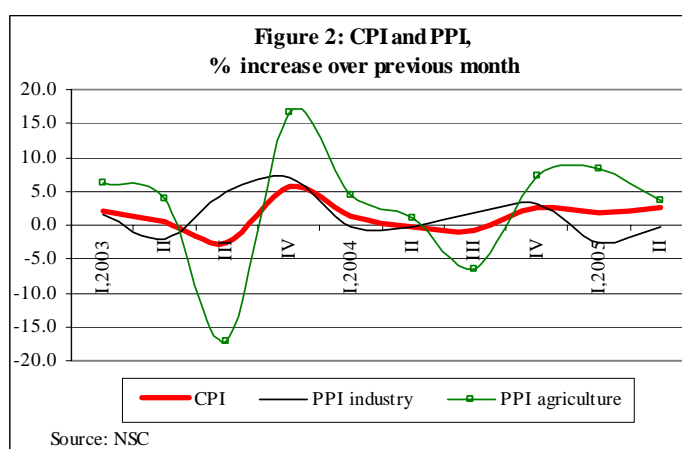
Source: NSC

production, declined in the first quarter, recovered its growth in the second quarter.

- **Agricultural output** declined by 1 percent in real terms. Harvesting was delayed this year due to unfavorable weather conditions. Third quarter results will better indicate annual outturn in agricultural sector, but at this stage one could project that political instability in regions during spring field works and substantial increase in diesel price most probably will reduce annual growth rate of agricultural sector.
- **Construction sector output** increased by 6.8 percent in real terms. Construction in private sector was growing most dynamically.
- **Services** grew by 9.5 percent in real terms. However, development of services, affected by political instability, was not stable. Thus, retail services and services of hotels declined in March-May – period of political uncertainty. The six month growth was ensured by strong development in January-February and recovery of growth in June.

2. Inflation, exchange rate, and interest rates.

- **Consumer prices** (December-June) increased by 4.4 percent, compared to 1.0 percent increase during the same period of last year. Inflation increased mainly due to increase in food prices. Even assuming a slow down in price increases and seasonal price declines during the second half of this year, annual inflation could be expected to be at about 4.7 percent, compared to 2.8 percent last year, and government’s 2005 projection of 4.0 percent.
- **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 2.8 percent as inflation in Russia remains higher than one in Kyrgyzstan. In contrast, the real exchange rate of Som against Kazakh Tenge appreciated by 2.1 percent, reflecting nominal appreciation of Som against Kazakh Tenge.
- **Average weighed interest rate** on commercial bank loans and deposits remained stable at around 26 percent and 2 percent respectively. However, political instability caused some fluctuations in financial sectors. Thus, at the end of March and beginning of April there was short term outflow of deposits of individuals, which was recovered later.



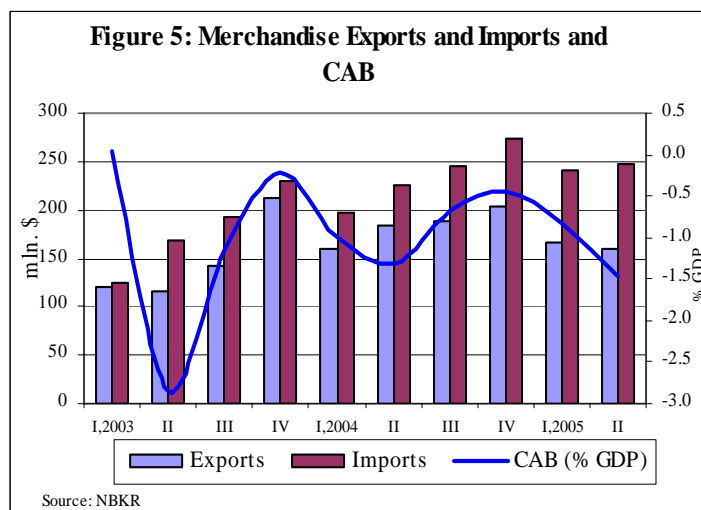
3. External Sector

- **Current account deficit** remained at 2.3 percent of GDP as in January-June of 2004; however, imports increased, exports declined due to gold export decline, and the gap was compensated by increase in inflow of private transfers.
- **Merchandise exports** declined by 4.3 percent in the first half of this year over its value in the same period of last year. Decline in gold production caused reduction in gold exports by 16.4 percent. Exports other than gold and fuel for military base slightly increased.
- **Merchandise imports** (c.i.f.) increased by 15.6 percent, reflecting increase in imports of food products, energy products, and investment goods.

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

	2001	2002	2003	2004	6 m. 2004	6 m. 2005
CAB (% GDP)	-1.2	-3.1	-4.2	-3.4	-2.3	-2.3
CAB (million US\$)	-26.5	-49.4	-80.6	-75.1	-50.6	-55.8
Merchandise Exports	480.3	498.1	590.3	733.2	342.9	328.0
Gold exports	226.7	162.8	259.6	287.4	150.0	125.4
Merchandise Imports (fob, includes estimates)	449.9	572.0	723.7	904.4	407.4	457.6
Exports of services	80.3	142.0	154.7	208.9	94.4	114.5
Imports of services	124.7	148.5	151.3	231.1	97.5	115.4
Net income	-63.6	-57.4	-62.4	-90.2	-56.6	-57.4
interest payments (sched)	-39.3	-31.9	-27.1	-36.8	-20.7	-21.6
Current Transfers net	51.1	88.4	111.7	208.5	73.7	132.1

Source: NBKR



4. General Government budget

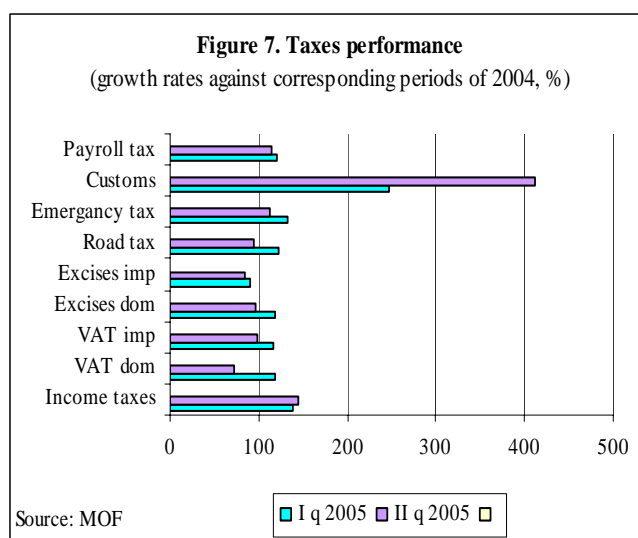
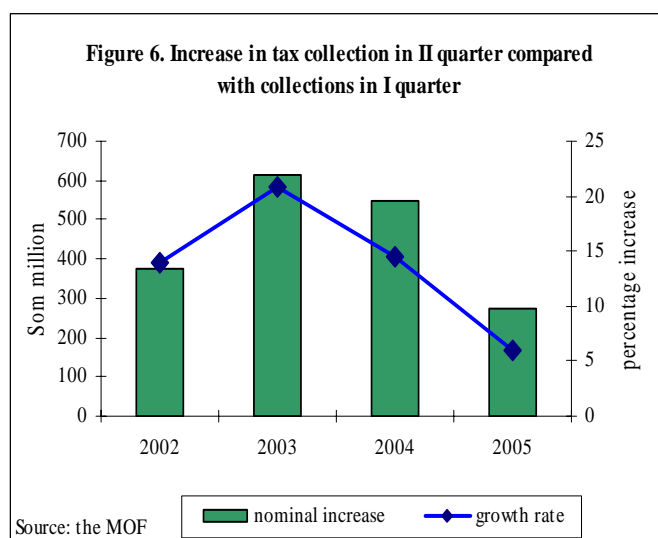
- Due to increase in budget revenue, **fiscal accrual deficit** of the general government budget declined to 1.0 percent of GDP from 2.3 percent of GDP, recorded in January-June 2004. The deficit was mainly financed by external (PIP) borrowing.
- The significant improvement in revenue collection throughout the first half of the year brought the **general government revenue** collection to 11.1 percent of GDP, which is considerably higher than in previous year in both nominal (by 1.3 Som billion) and relative (by 0.5 percentage points) terms. It is important to note that this good performance is mainly explained by revenue upsurge in first quarter. At the same time, the results of second quarter show that expectations of significant increase in the government revenues after Mach revolution were not justified. Whereas tax collections in April – June were still higher than in the first quarter 2005, their increase was notably slower than it

Table 3: General government budget (% of GDP)

	2003	2004	January-June		
			2003	2004	2005
Total revenue	23.0	23.5	10.1	10.6	11.1
Taxes	17.7	18.4	7.8	8.6	9.1
Income and profit tax	2.7	2.7	1.2	1.2	1.6
VAT	6.6	7.3	2.6	3.3	3.1
Excises	1.4	1.3	0.6	0.6	0.6
Customs	0.5	0.5	0.2	0.4	0.6
Payroll	3.5	3.5	1.7	1.7	1.8
Others	3.1	3.1	1.4	1.4	1.4
Non-tax and Capital	4.7	4.0	2.3	1.7	1.6
Grants	0.6	1.1	0.1	0.2	0.3
Total expenditure	28.1	27.9	13.0	13.1	12.8
Current	23.2	23.0	11.0	11.2	10.9
Wages	5.8	5.8	2.2	2.4	2.5
Transfers&subsidies	8.7	8.5	3.9	3.7	4.1
Interest	1.6	1.9	0.8	1.0	0.9
Goods and services	7.1	6.8	4.1	4.1	3.4
Capital	4.9	4.9	2.0	1.9	1.9
Foreign financed PIP	3.7	3.8	1.6	1.5	1.6
Net lending	-0.5	-0.5	-0.2	-0.2	-0.2
Balance	-4.6	-4.0	-2.6	-2.3	-1.5

Source: the MOF and WB staff calculations

was recorded during the previous years. In addition, collections of main taxes (VAT, excises, road tax, and land tax) in the second quarter of this year were lower than in April-June 2004.



- **The general government expenditure** was at 12.8 percent of GDP, which is slightly lower than in January-June 2004. In the second quarter, interim government made expenditure decisions which influenced resources allocations. Accordingly, financing of the Ministry of Interior has increased by a fourth compared with its financing in the first half of 2004, and payments of social assistance allowances (including UMB and privileges) increased by 40-70 percent. Similarly pension payments increased by 14 percent over the last year, with the Pension fund accumulating about 81 million som of arrears. Expenditures on wages and salaries of health and education sectors were 25 percent higher than in the first half of 2004, which is mainly explained by salary increases for these sectors in the second half of 2004. More allocations were also made for procuring equipment and inventories (by 20 percent), medicines (by 35 percent), and food (by 54 percent).

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

- **Decree of the Acting President of the KR “On reorganization of financial bodies of the Kyrgyz Republic”, # 103, April 14, 2005**
The Decree approves reorganization of Revenue Committee under the Ministry of Finance of the KR into State Tax Inspectorate under the Government of the Kyrgyz Republic and State Customs Inspectorate under the Government of the Kyrgyz Republic. The Department of Financial Police under the Ministry of Finance to be transformed into the Department of Financial Police under the Government of the KR.
- **Decree of the Acting President of the KR “On ratification of the Credit Agreement between Kyrgyz Republic and Asian Development Bank on “Southern Transport Corridor Road Rehabilitation Project”, # 110, April 18, 2005**
The amount of credit is US\$32.8 mln. The Project will rehabilitate part of the Osh-Sary Tash-Irkeshtam road to extend Bishkek-Osh road. The Project will foster regional cooperation by rehabilitating a key transport corridor linking the Kyrgyz Republic, China, and Uzbekistan.
- **Decree of the Acting President of the KR “On institutional and structural transformations in the sphere of technical regulation in the Kyrgyz Republic”, #149, April 30, 2005**
The decree assigns the Ministry of Economic Development, Industry and Trade of KR as authorized body for technical regulation issues.
- **The Resolution of the Government of the KR “On measures for effective work of the alcohol industry of the Kyrgyz Republic”, # 205, June 6, 2005**

Since June 1, 2005, transit of spirit and alcohol products through the Kyrgyz territory is subject to obtaining permission from the State Tax Inspection (STI) upon depositing the amount equivalent to value of goods including tax and customs fees on the account of the Central Customs Inspectorate.

- **The Resolution of the Government of the KR “On amendment of the Resolution of the Government #375, August 12, 1996 “About registration threshold of VAT””, #208, June 8, 2005**

The resolution increases VAT registration threshold for agricultural producers from Som 500 thousand to Som 2,500 thousand, starting from July 1, 2005.

Kyrgyz Republic: Key macroeconomic indicators

	2000	2001	2002	2003	2004	2004	2004	2004	2004	2005	2005
						I	II	III	IV	I	II
GDP and prices											
GDP real growth (%)	5.4	5.3	0	7.0	7.1	7.8	14.3	3.3	6.5	2.0	2.6
GDP, som million	65,358	73,883	75,367	83,872	94,078	15,742	19,432	32,446	26,458	17,105	20,856
GDP, USD million	1,370	1,525	1,606	1,919	2,205	365	447	764	635	417	507
GDP per capita dollar (at avg x-rates)	279	308	322	381	431	...	...	...	...	...	...
Poverty headcount (% of population) ⁴	63	56	55	50	46	...	...	...	...	...	...
Extreme Poverty headcount (% of population) ⁴	33	25	23	17	13	...	...	...	...	...	...
Inflation (% beginning-to-end of period, CPI)	9.6	3.7	2.3	5.6	2.8	1.3	-0.4	-0.7	2.6	1.7	2.6
Inflation (% average, CPI)	18.7	6.9	2.1	3.1	4.1	5.3	...	...	...	3.0	...
Deflator GDP (%)	27.2	7.3	2.3	3.8	8.9	6.5	5.8	7.4	0.0	6.5	4.6
Wage, average for KR (som per month)	1227	1455	1684	1902	2203	1956	2050	2101	2503	2269	2315
Wage, average for KR (US\$ per month)	26	30	36	44	52	45	47	49	60	55	56
Pension, average for KR (som per month)	462	558	561	647	709	685	711	721	720	780	839
Pension, average for KR (US\$ per month)	10	12	12	15	17	16	16	17	17	19	20
Exchange rate (som/\$, end of period)	48	48	46	44	42	43	43	42	42	41	41
Exchange rate (som/\$, avg of period)	48	48	47	44	43	43	43	42	42	41	41
REER (end of period, 1997=100, up=depreciation)	114	107	109	115	119	117	119	119	119	120	116
M2 (e.o.p as percent of GDP)	11.3	11.1	14.6	17.5	20.6	16.0	16.9	17.7	20.6	19.4	20.6
External Sector											
Current account balance (% GDP) ³	-5.6	-1.2	-3.1	-4.2	-3.4	-1.0	-1.3	-0.7	-0.4	-0.8	-1.5
Exports (mln US\$, f.o.b.)	511	480	498	588	733	159	184	187	203	167	161
- Power	80	47	22	19	31	2	6	13	10	3	6
- Gold	197	227	163	260	287	67	83	75	63	68	58
- Other	234	207	313	312	411	89	95	100	127	97	97
Imports (mln US\$, c.i.f.)	559	472	640	716	941	197	226	245	274	240	248
- Food	61	44	64.0	78	110	20	29	30	31	30	31
- Other consumer goods	149	128	130	178	194	48	46	47	54	45	51
- Energy	129	121	152	180	256	60	54	56	86	69	66
- Other intermediate goods	113	121	125	152	217	42	58	62	56	44	61
- Capital goods	107	58	116	128	163	26	40	50	47	53	38
External Debt (mln US\$)	1712	1678	1785	1,943	2,106	1,982	1,999	2,034	2,106	2,086	2,017
Public External Debt (mln US\$)	1403	1436	1576	1,652	1,957	1,798	1,814	1,851	1,957	1,932	1,871
External Debt (% GDP)	125.0	110.0	111.1	101.2	95	89.9	90.7	92.2	95.5	85.8	83.0
Total debt service to exports of GS (%)	28.1	30.8	20.7	22.1	13.7	17.6	16.3	6.1	15.3	10	23
Public debt service to state revenues&grants (%)	37.4	27.7	23.3	14.6	12.9	8.8	18.5	10.7	13.0	9.9	14.1
Public external borrowing (excl. IMF, mln \$)	127	110	88	75	95	8	17	47	23	11	13
FDI (mln \$) ¹	-2	5	5	46	175	16	146	16	-3	10.8	8.3
General Government Budget (percent of GDP)²											
Revenues and grants	18.5	20.4	22.7	22.9	23.5	5.0	5.6	5.6	7.2	5.1	5.9
Grants	0.9	0.8	1.1	0.6	0.3	0.2	0.0	0.0	0.1	0.0	0.2
Tax	12.3	12.4	13.9	14.2	14.9	3.1	3.8	3.7	4.3	3.5	3.8
Social fund contributions	3.7	4.0	4.2	3.5	3.5	0.9	0.8	0.9	0.9	1.0	0.9
Nontax and capital	1.5	3.2	3.5	4.6	4.0	0.7	1.0	1.0	1.2	0.7	1.0
Expenditures	28.1	26.2	27.9	27.6	27.4	5.9	7.1	6.1	8.3	5.9	6.7
Current (other than interest)	18.6	20.5	20.7	21.7	21.1	5.0	5.1	4.7	6.3	4.9	5.0
o.w. transfers & subsidies	7.5	8.2	9.4	8.7	8.5	1.7	2.0	2.1	2.7	1.8	2.2
wages & salaries	4.4	4.9	5.4	5.7	5.8	0.9	1.4	1.4	2.1	1.0	1.5
Interest payments	2.2	1.7	1.9	1.6	1.9	0.2	0.9	0.2	0.7	0.2	0.7
Capital	7.8	5.3	6.0	4.9	4.9	0.8	1.2	1.4	1.6	0.9	1.0
of/which foreign financed PIP	6.5	4.4	4.7	3.7	3.8	0.6	0.9	1.1	1.1	0.7	0.9
Net lending	-0.5	-1.1	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1
Fiscal Balance (accrual)	-9.6	-5.8	-5.2	-4.7	-4.0	-0.9	-1.4	-0.6	-1.1	-0.8	-0.8
Memo:											
Primary Deficit (w/o interest and PIP)	-0.9	0.2	1.4	0.5	1.7	-0.1	0.3	0.7	0.7	0.1	0.9
Primary Deficit (w/o interest)	-7.4	-4.2	-3.3	-3.2	-2.1	-0.7	-0.6	-0.4	-0.4	-0.6	0.0

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 state fund, which became an extrabudgetary Fund in 1991. The quarterly data are on cash basis and based on the Treasury reports

³ Th 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 with previous year data