

The Kyrgyz Republic Recent Economic Developments: January-June 2006

Summary

In May, a relatively short period of political stability was disrupted by series of high profile resignations at the highest levels of the government (Secretary of State, Chairman of National Security Service), and was followed by time-consuming and politically difficult new appointments and reshuffles which consumed the time and energy of the authorities. This coincided with the time of murder of notorious criminal Ryspek in mid May, which provoked new unrest in different regions of the country.

Nonetheless, economic performance was better than expected. Real GDP grew by 3.1 percent, compared with the same period in the previous year, albeit from low basis (in January-June 2005 GDP declined by 0.6 percent). This figure was driven by growth in almost all non-gold sectors of economy with the result that non-gold GDP increased by 6.5 percent. Inflation increased to 4.1 percent compared with 3.6 percent in the first half of 2005, mainly due to rises in food prices. The nominal and real effective exchange rates depreciated slightly, but did not slow the strong growth of imports. As a result, the current account deficit increased to 7.1 of GDP from 3.4 percent of GDP in the first half of 2005, despite noticeable growth in exports. On fiscal side, the general government budget deficit was reduced to 1 percent of GDP from 2.1 percent of GDP in January-June 2005, mainly due to improved revenue collection.

1. Growth

- **Real GDP** grew by 3.1 percent, while non-gold GDP grew by 6.5%, driven by a growth in services (7.6%) non-gold industry (11%) percent, and construction (9.5%), while the gold industry continued its decline with a fall of 32% in output. While registering positive growth (2.4%) agriculture has not recovered from the steep decline of 2005.
- **Non-gold industrial output** increased by 11 percent in real terms. The growth was the result of continuing increases in food processing, machinery production, construction materials, and production and distribution of gas, electricity and water. After introduction of privileged tax regime in early 2006, textile and clothing industry demonstrated rapid increase of production outputs at 26 percent compare to last year, with clothing production increased by 40 percent, partly as result of some previously informal production now being recorded in official statistics.

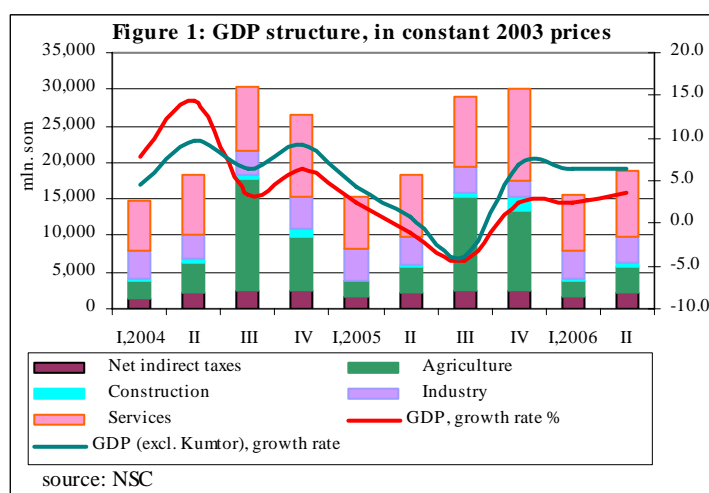


Table 1: Growth rates of GDP and value added of sectors

	2004	2005	6 m. 2004	6 m. 2005	6 m. 2006
GDP	7.0	-0.6	9.2	0.5	3.1
GDP excl. Kumtor-gold	7.8	1.4	7.4	4.7	6.5
Agriculture	4.1	-4.2	0.6	-10.7	2.4
Construction	5.4	2.1	1.3	-14.5	9.5
Industry (incl. Kumtor)	2.7	-12.6	15.8	9.7	-6.7
Services	11.9	8.1	15.7	2.5	7.6

Source: NSC

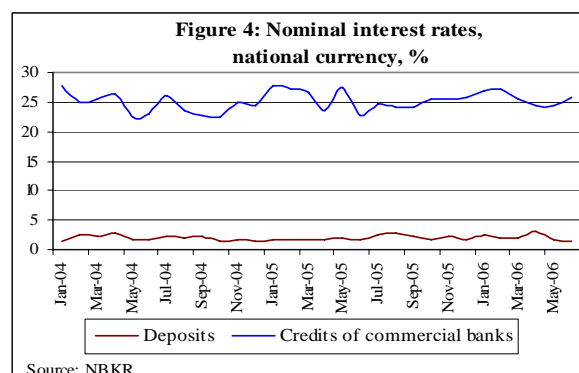
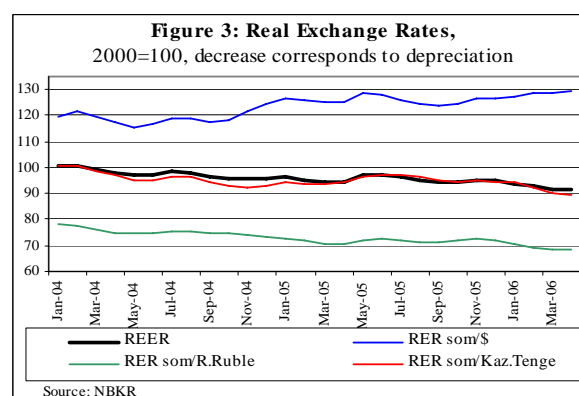
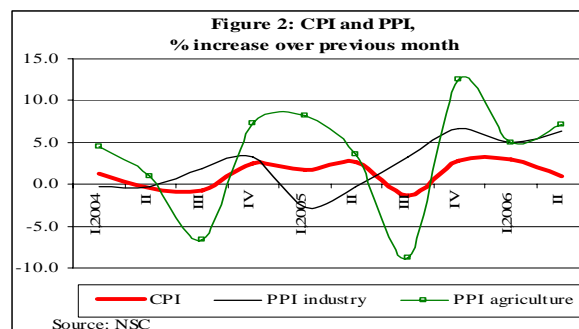
- **Agricultural output** increased by 2.4 percent in real terms, which could be explained by favorable weather conditions allowing earlier start of harvesting season. At the same time, reported drop in crop productivity could have a negative impact on the sector's performance indicators later in the year.
- **Construction sector** continued to be on a strong track. The sector's output increased by 9.5 percent in real terms. The most rapid growth rates of construction were observed in transport and

communications sector (which more than double) and private real estate construction (by 43 percent).

- **Services** grew by 12 percent in real terms. This growth continued to be driven by strong growth of trade, food and hotel services.

2. Inflation, exchange rate, and interest rates.

- **Consumer prices** grow from the beginning of year by 4.1 percent, compare to 3.6 percent in January-June last year. Food prices increased by 7.6 percent, due to rapid growth prices on fruits and vegetables (despite quite significant growth of their production), meat, and sugar (caused by sharp decrease of domestic production and import of more expensive sugar).
- **The real effective exchange rate¹** depreciated by 3.7 percent; the same but more strong tendency was observed for real exchange rate of Som against Russian Ruble (by 6.3 percent), and against Kazakh Tenge (by 8.7 percent), which was related mainly to nominal appreciation of Russian and Kazakh currencies against US dollar. At the same time, real exchange rate of Som against US dollar continued to appreciate (by 3.4 percent), due to both increased supply of dollars on domestic market, including from transfers from abroad, and worldwide dollar's depreciation against other major currencies.
- **Average weighted interest rate** on commercial bank loans remained at almost the same high level as in the previous year, and deposit rates remained at quite a low level (with a further drop during May and June).



3. External Sector

- **The current account deficit** reached 7.1 percent of GDP in first half of 2006, which is more than double the same period of last year, mainly due to strong increase in imports and despite quite remarkable increase of non-gold export volumes.
- **Merchandise exports** increased by 16 percent. While gold exports, accounting for one third of total exports, remained almost at the level of previous period in value terms, with an increase in prices offsetting the fall in output, non-gold exports increased by 27 percent. The most significant growth was recorded for some items of food, construction materials, electricity, and clothes.
- **Merchandise imports** increased by 45 percent. Mineral products (including coal, gas, and oil products) continued to be the major part of imports (33 percent), and the next largest group was

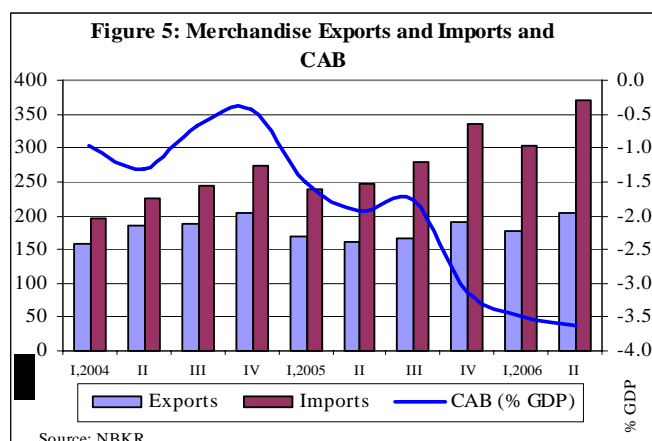
¹ Methodology for real effective exchange rate calculation was changed in May, 2006. Now, the unit of the national currency is expressed in units of foreign currency, and the base period for construction of indexes is 2000.

machineries and equipment (15 percent). Import of oil products grew by 66 percent in value terms, of which contribution of price increase was 17 percent, and volume increase – 41 percent. Within non-energy imports, the most significant growth was recorded for motor vehicles, and such food items like wheat, sugar and chocolate stuff.

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

	2004	2005	6 m. 2004	6 m. 2005	6 m. 2006
CAB (% GDP)	-3.4	-8.3	-2.3	-3.4	-7.1
CAB (million US\$)	-75	-204	-51	-83	-189
Merchandise Exports	733	687	343	329	383
Gold exports	287	231	150	125	123
Non-gold exports	446	456	193	204	260
Merchandise Imports	904	1,101	407	458	652
(fob, includes estimates)					
Exports of services	209	255	94	112	121
Imports of services	231	292	98	128	156
Net income	-90	-81	-57	-47	-46
interest payments (scheduled)	-37	-43	-21	-19	-16
Current Transfers net	209	332	74	130	162

Source: NBKR



3. General Government budget

- **The fiscal deficit** of the general government decreased to 1 percent of GDP (as compared with 2.1 percent in January-June 2005) due to continued growth of budget revenues and some reductions in spending (mainly interest payments).

Table 3: General government budget (% of GDP)

	January - June				
	2004	2005	2004	2005	2006
Total revenue	23.4	24.9	10.4	11.3	12.2
Taxes	18.3	20.2	8.4	9.3	9.8
Income and profit tax	2.7	3.3	1.2	1.6	1.5
VAT	7.2	7.1	3.3	3.2	3.5
Excises	1.3	1.1	0.6	0.6	0.5
Customs	0.5	1.7	0.2	0.6	1.0
Payroll	3.5	3.8	1.7	1.9	1.9
Others	3.1	3.1	1.4	1.5	1.5
Non-tax and Capital	4.0	3.7	1.8	1.7	2.0
Grants	1.1	1.0	0.2	0.3	0.3
Total expenditure	27.9	29.2	13.0	13.6	13.2
Current	23.0	24.4	11.1	11.7	11.6
Wages	5.8	6.3	2.3	2.5	2.7
Transfers&subsidies	8.4	8.8	3.7	4.2	4.1
Interest	1.9	1.5	1.0	0.9	0.5
Goods and services	6.9	7.8	4.0	4.1	4.2
Capital	4.9	4.8	1.9	1.9	1.7
Foreign financed PIP	3.8	3.9	1.5	1.6	1.3
Net lending	-0.5	-0.5	-0.2	-0.2	-0.1
Balance	-4.0	-3.9	-2.4	-2.1	-1.0

Source: the MEF and WB staff calculations

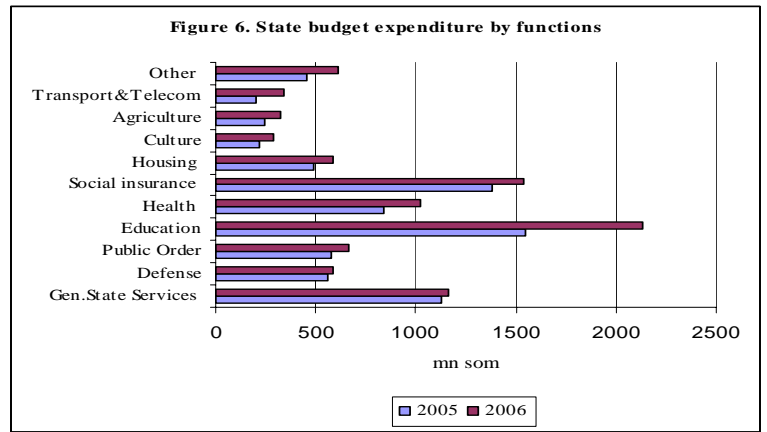
Table 4. State budget tax collections (Som million)

	2005		2006		Total increase
	Iq	IIq	Iq	IIq	
Total tax revenue	3,529	3,911	4,063	4,679	1,302
of which					
Income and profit taxes	834	793	866	749	-12
personal income tax	382	437	426	438	44
profit tax	327	286	397	266	51
other income taxes	124	71	43	45	-107
VAT	1,527	1,645	1,677	2,128	632
domestic goods	319	278	306	405	116
imported goods	1,209	1,368	1,370	1,723	517
Excises	286	278	279	275	-11
domestic goods	126	128	102	110	-42
imported goods	161	150	177	165	31
Customs	210	412	477	644	499
Land tax	52	53	70	59	24
Road and Emergency Fund	302	359	365	378	83
Other	318	371	330	445	86

Source: the MEF and WB staff calculations

- **General government revenue** increased to 13.2 percent of GDP compare with 11.3 percent in the first half of 2005. The most significant contribution to this increase was made through a continuing improvement in tax collections, especially custom duties and VAT, due to increased import volumes and better customs administration.

- General government expenditure** was reduced to 13.2 percent of GDP from 13.6 percent of GDP in June-July 2005, though in nominal terms an increase at Som 900 million was recorded. Additional funds were used mainly for increase of salaries and pensions, as well as for financing other transfers and subsidies. Education, health and social insurance sectors were among those received the highest increases in funding.



4. The main legislative changes with an economic impact in second quarter 2006

1. The law of the KR “On additions to the Law on state social insurance tariffs” # 86, May 12, 2006

The law envisages measures to stimulate and legalize light industry development by introduction simplified tax regime based on patents, as well as setting up social insurance payments at 25 percent of patent fee.

2. The law of the KR on Introducing Amendments to the Tax Code, #89, June 3, 2006.

The law clarifies positions of the Tax Code regarding exemption of imported fixed assets from VAT payment.

3. The law of the KR “On reorganization “Bishkek” Free Economic Zone”, #91, June 28, 2006.

According to the law, the territory of JSC “International airport Manas” is moved out of “Bishkek” FEZ territory. Besides that, all business entities, working on the territory of Manas airport, are excluded from the list of “Bishkek” FEZ entities. All business entities registered in “Bishkek” FEZ and dealing with Manas airport, are supposed to pay all taxes according to legislation.

Kyrgyz Republic: Key macroeconomic indicators

	2001	2002	2003	2004	2005	2005	2005	2005	2005	2006	2006
						I	II	III	IV	I	II
GDP and prices											
GDP real growth (%)	5.3	0.0	7.0	7.0	-0.6	2.4	-1.0	-4.4	2.5	2.4	3.6
GDP, som million	73,883	75,367	83,872	94,351	100,116	16,992	20,615	33,842	28,668	18,608	23,428
GDP, USD million	1,525	1,606	1,919	2,212	2,441	414	501	827	699	450	580
GDP per capita dollar (at avg x-rates)	308	322	381	434	473	...	...	...	...	...	...
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	4.9	1.7	2.6	-1.4	2.8	3.0	1.0
Inflation (% average, CPI)	6.9	2.1	3.1	4.1	4.3	3.0	...	...	...	...	...
Deflator GDP (%)	7.3	2.3	3.8	5.1	6.8	5.4	7.1	9.1	4.7	6.9	9.7
Wage, average for KR (som per month)	1455	1684	1916	2203	2570	2269	2466	2589	2932	2661	2788
Wage, average for KR (US\$ per month)	30	36	44	52	63	55	60	63	72	64	69
Pension, average for KR (som per month)	558	561	647	709	791	781	762	801	849	873	848
Pension, average for KR (US\$ per month)	12	12	15	17	19	19	19	20	21	21	21
Exchange rate (som/\$, end of period)	48	46	44	42	41	41	41	41	41	41	40
Exchange rate (som/\$, avg of period)	48	47	44	43	41	41	41	41	41	41	40
REER (end of period, 2000=100, up=appreciation)	106	107	101	96	95	95	97	94	95	92	91
RER of som/US\$ (end of period, 2000=100, up=appreciation)	104	108	117	124	127	126	128	124	127	128	131
M2 (e.o.p as percent of GDP)	11.1	14.6	17.5	20.5	21.4	19.8	21.0	22.6	21.4	19.4	19.1
External Sector											
Current account balance (% GDP) ³	-1.2	-3.1	-4.2	-3.4	-8.3	-1.5	-1.9	-1.8	-3.2	-3.5	-3.6
Exports (mln US\$, f.o.b.)	480	498	588	733	687	168	161	168	190	178	205
- Power	47	22	19	22	21	1	3	11	6	2	4
- Gold	227	163	260	287	231	68	58	60	45	62	61
- Other	207	313	312	424	435	100	100	97	139	114	139
Imports (mln US\$, c.i.f.)	472	640	716	941	1,101	240	248	278	336	304	371
- Food	44	64.0	78	110	140	30	31	36	43	39	54
- Other consumer goods	128	130	178	194	211	45	51	51	65	53	62
- Energy	121	152	180	256	314	68	66	80	101	101	112
- Other intermediate goods	121	125	152	217	245	44	61	66	73	54	75
- Capital goods	58	116	128	163	191	53	38	45	55	57	67
External Debt (mln US\$)	1678	1785	1,943	2,106	2,023	2,086	2,016	2,018	2,023	2,009	2,013
Public External Debt (mln US\$)	1436	1576	1,652	1,957	1,882	1,932	1,871	1,880	1,882	1,870	1,892
External Debt (% GDP)	110.0	111.1	101.2	95.2	82.9	85.5	82.6	82.7	82.9	75.8	75.9
Total debt service to exports of GS (%)	30.8	20.7	22.1	13.7	11.9	7	15	7	17	9	8
Public debt service to state revenues&grants (%)	27.7	23.3	14.6	12.9	11.8	9.7	16.5	8.6	11.9	13.7	11.0
Public external borrowing (excl. IMF, mln \$)	110	88	75	95	92	19	7	17	49	21	23
FDI (mln \$) ¹	5	5	46	175	43	11	8	28	-4	11	13
General Government Budget (percent of GDP)²											
Revenues and grants	20.4	22.7	22.9	23.4	24.8	5.2	6.1	6.1	7.4	5.5	6.7
Grants	0.8	1.1	0.6	1.4	1.0	0.0	0.3	0.2	0.5	0.1	0.2
Tax	12.4	13.9	14.2	14.8	16.3	3.5	3.9	4.1	4.8	3.7	4.3
Social fund contributions	4.0	4.2	3.5	3.5	3.8	1.0	0.9	0.9	1.0	0.9	1.0
Nontax and capital	3.2	3.5	4.6	4.0	3.6	0.7	1.0	0.9	1.0	0.7	1.3
Expenditures	26.2	27.9	27.6	27.4	28.7	6.2	7.1	6.8	8.7	5.7	7.4
Current (other than interest)	20.5	20.7	21.7	21.1	22.8	5.3	5.4	5.3	6.8	4.9	6.2
o.w. transfers & subsidies	8.2	9.4	8.7	8.4	8.8	2.0	2.2	2.2	2.4	2.0	2.1
wages & salaries	4.9	5.4	5.7	5.8	6.3	1.0	1.6	1.7	2.1	1.2	1.5
Interest payments	1.7	1.9	1.6	1.9	1.5	0.2	0.7	0.1	0.5	0.1	0.4
Capital	5.3	6.0	4.9	4.9	4.8	0.9	1.1	1.5	1.4	0.6	1.0
of/which foreign financed PIP	4.4	4.7	3.7	3.8	3.9	0.7	0.9	1.2	1.1	0.5	0.8
Net lending	-1.1	-0.6	-0.5	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	0.1	-0.2
Fiscal Balance (accrual)	-5.8	-5.2	-4.7	-4.0	-3.9	-1.0	-1.0	-0.7	-1.3	-0.2	-0.7
Memo:											
Primary Deficit (w/o interest and PIP)	0.2	1.4	0.5	1.6	1.5	-0.1	0.7	0.6	0.3	0.4	0.4
Primary Deficit (w/o interest)	-4.2	-3.3	-3.2	-2.1	-2.4	-0.8	-0.3	-0.5	-0.8	-0.1	-0.3

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 with previous year data