



## THE KYRGYZ REPUBLIC: RECENT ECONOMIC DEVELOPMENTS

FIRST QUARTER 2007

### SUMMARY

The political life of the first three months of 2007 was marked by approval of a new government structure envisaging the establishment of a few new ministries and agencies, and the appointment of a new Prime Minister Azim Isabekov, who was later dismissed after two months of service. This happened after rejection by the Parliament of Felix Kulov as head of the Government. After breakdown of the 'tandem', Felix Kulov joined the opposition requesting deeper political reforms and thus catalyzing opposition activities.

The new Government decided not to join the HIPC Initiative – a decision which was driven mostly by the political motives and reflected strong discontent of the part of civil society. The state budget for 2007 was approved only in the first days of April 2007 due to political instability and long discussions in the Parliament regarding introduction of a two-tier budget system implied by the implementation of fiscal decentralization.

Despite the highly turbulent political atmosphere, macroeconomic results were encouraging. Real GDP grew by 7.3%, and non-gold GDP by 9.5%. Growth was driven by services sector (trade and communication) and construction. Fixed investments increased by 74% mainly driven by domestic private sector. Consumer price inflation reached 4% (annualized, Mar 07/Mar 06); GDP deflator was at 4.4% in Q1 2007 compare with 7.1% in Q1 2006, driven mostly by agricultural producer prices. Both nominal exchange rate and REER remained stable compared to end-2006. Current account deficit stayed at 3% of annual GDP (with the annual current account deficit Q2 2006-Q1 2007 reaching 15.8%), reflecting a 63% increase in imports of goods and services that outpaced exports growth of 32% in the first quarter of 2007.

### 1. GROWTH

**Real GDP** increased by 7.3%, mainly driven by services and construction. Kumtor's gold production was still on the decline<sup>1</sup> and without it real GDP growth was high at 9.5%. Such an impressive growth was possible due to high growth in construction (46%) albeit from low base, trade (13.4%), and communication and transport (22%). Agricultural growth was moderate, though slightly better than last year.

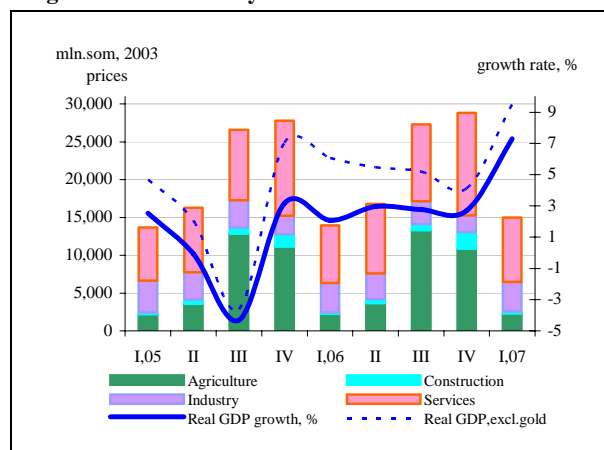
Table 1: Real GDP growth rate

	2005	2006	Q1'05	Q1'06	Q1'07
GDP	-0.2	2.7	2.5	2.1	7.3
GDP excl. gold	1.9	5.1	4.7	6.1	9.5
Agriculture	-4.2	1.5	-6.8	1.0	2.1
Construction	17.6	8.5	5.8	-13.4	45.7
Industry	-13.4	-9.8	9.1	-7.0	0.3
Services	8.4	8.4	3.0	8.2	11.2

Source: NSC

**Non-gold industrial value added** grew by 10.2%. Major industrial sectors that contributed to the growth were energy (7%), food (13%), and construction materials.

Figure 1: Real GDP by sectors



Source: NSC

**Agricultural output** grew by 2.1% recovering slowly from the sector's decline in 2005, and

<sup>1</sup> Gold production in 2007 is expected to exceed 2006 level for about 30%.

reflecting mostly developments in livestock sector, given the seasonality of crop production.

**Construction** demonstrated a dramatic 45.7% growth, which partly was explained by the low base in previous year. This solid growth was mostly driven by sizeable investments in mining and energy sectors as well as in housing construction. Total fixed investments grew by 74%, with 43% of total financing originated from companies' funds and 38% from households.

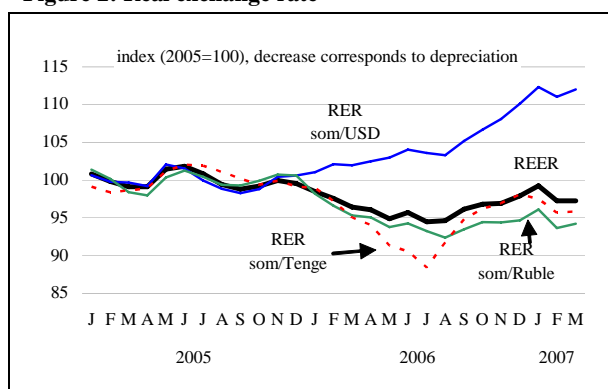
**Services** grew by 11.2% in real terms, mainly provided by strong growth of trade (13.4%) and transport/communication (22%). In total, real growth of commercial services grew almost by 14.7%, while public services grew by less than 1%.

## 2. Inflation, exchange rate, and interest rates.

**Consumer prices** increased by 2% (Mar07 to Dec06) compared with 3% in 1Q 2006, due to increased prices for vegetables/fruits and natural gas.

**Producer prices** in agriculture grew by 17%, reflecting higher prices for crops and vegetables. Industrial producers increased prices by 9.2%.

Figure 2: Real exchange rate



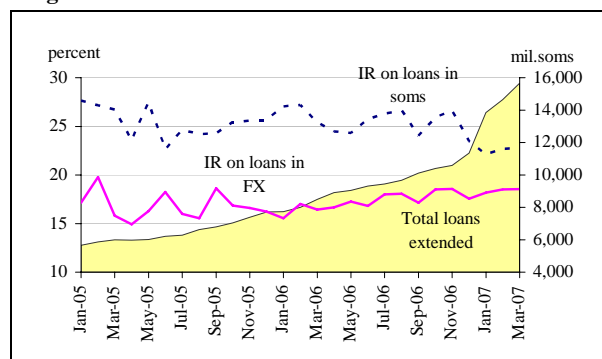
Source: Staff calculations based on NBKR data

The **real effective exchange rate** remained stable and followed a pattern of nominal exchange rates. The som continued to appreciate in real terms against US dollar, but developed favorably compared to currencies of Russia and Kazakhstan.

The average weighted **interest rate** on bank loans in national currency declined to 23% against 27% recorded in Q1 2006. Depreciation

of the US dollar resulted in a slight upward correction of the interest rate up to 18% for non-som loans, which was by 2 percentage points higher than in Q1 2006. Banking lending continued to grow with rapid pace (38% growth compared to end-2006<sup>2</sup>), of which 61% were provided on a long-term basis. Two-third of the loans portfolio was represented by trade (37% of total credit portfolio), mortgage (13%), and consumer loans (15%).

Figure 3: Bank credit and interest rates



Source: NBKR

The stock of deposits grew by 10% in Q1 2007, and included an increased share of longer-term deposits (30% of total against 22% by end-2006) and a decline in the share of deposits in foreign currencies (59% of total against 69% by end-2006).

## 3. External Sector<sup>3</sup>

The **current account deficit** was at 3% (1.6% in Q1 2006) of annual GDP due to rapid growth rate of imports of goods and services (by 63%). Exports performance was also solid with 32% increase driven by non-gold items.

**Merchandise exports** increased by 41% over Q1 2006, with non-gold and non-oil exports' growth at 28%. Gold exports declined by 18% driven by a 25% decline in volume.

<sup>2</sup> The high lending growth is mainly explained by inclusion of the loans extended by Ayil Bank (previously, Kyrgyz Agricultural Finance Corporation, KAFC). Without Ayil Bank loans increased for 20%. Ayil Bank was granted a banking license in end-2006; it specializes in crediting of agricultural producers.

<sup>3</sup> NBKR revised the 'Worker's remittances' data for 2000-2006 as a result of estimating the cash component of remittances not captured by formal remitting channels. Thus, inflow of remittances in 2006 is now estimated at historically high 749 mln.US\$ equivalent to 27% of GDP.

**Merchandise imports** (cif) increased by 83%, reflecting increase in imports of energy, capital, and consumer goods. Import prices for oil products stabilized at the level of Q1 2006, but the quantity increased by 81%, partly driven by re-export needs. Machinery and equipment import increased 2.5 times, reflecting bulk investments in mining, energy and communication sectors.

**Table 2: Current account**

	2005	2006	Q1'05	Q1'06	Q1'07
Current account	-29	-411	-11	-44	-108
<i>as % to GDP</i>	<i>-1.2</i>	<i>-14.2</i>	<i>-0.5</i>	<i>-1.6</i>	<i>-3.0</i>
Goods Exports (fob)	687	811	168	178	251
Gold exports	231	206	68	62	51
Goods Imports (fob)	1,106	1,797	225	311	529
Exports of services	256	368	53	55	58
Imports of services	291	461	62	70	93
Net income	-75	-48	-19	-20	-21
Interest payments	-36	-32	-4	-4	-5
Current transfers	500	716	49	75	84
Remittances inflow	514	749	54	81	90

Source: NBKR

Source: NBKR

International reserves rose to US\$ 825 million (3.8 months of imports). External debt is estimated at US\$ 2,170 mil (for end of March 2007), which is equivalent to 68% of estimated 2007 GDP.

#### 4. Main legislative changes with an economic impact in Jan-Mar 2007

1. **The decree of the government of the Kyrgyz Republic on implementation of the Law of the Kyrgyz Republic “On public procurements”, # 2, January 9, 2007.**  
To improve the public procurement system and rational usage of public resources the Government ordered to create a separate tender commission for each tender. Funds to cover training needs of specialists on public procurement to be provided. The State Agency on Public Procurement is obliged to support procurement organizations with regulating documents.
2. **The decree of the Government of the Kyrgyz Republic “On limiting the share of foreign citizens and stateless individuals conducting wholesale and retail activities in the Kyrgyz Republic”, #10, January 12, 2007 (The Decree was later postponed till end of 2007).**  
In order to protect domestic labor market and to create conditions for local business, the Government limits the share of foreign entrepreneurs. As of 1<sup>st</sup> of April 2007 the following quota is to be applied in regards to foreign citizens registered as private entrepreneurs, including those licensed for business activities and carrying out wholesale and retail trade:
  - through shopping complexes, markets and mini-markets, as well as through nonstationary outlets – 0%;
  - through stationary sales outlets – no more than 10% of the total number of businessmen using the above-listed facilities.
3. **The decree of the government of the Kyrgyz Republic “On program of development of export and import substitutions for 2007-2010”, # 43, February 9, 2007.**  
The decree approves (i) the program of actions to strengthen export capacity and import substitutions; (ii) an action plan to develop and encourage export in 2007-2010, including improvements in tax and customs procedures, technical regulation area, financial markets, industry and tourism; and (iii) a list of investment projects to help development of import substitution production up to USD 200 mln.
4. **Law of the Kyrgyz Republic on amendment of the Law “On Free Economic Zones in the Kyrgyz Republic”, # 36, March 22, 2007.**  
The amendment clarifies some free economic zones (FEZ) regulations in terms of their taxation, and states that FEZ entities, irrespective of registration dates, are prohibited to import, keep, produce and market excisable goods within the territory of the FEZs of the Kyrgyz Republic without taxpaying and customs fees. Previously, the FEZ entities were not allowed to market exisable goods to non-FEZ entities within the FEZ territory, and taxation rules were not specified.
5. **The decree of the Government of the Kyrgyz Republic “On Country Development Strategy for 2007-2010”, # 84, March 23, 2007.**  
The government approved the revised version of the “Country Development Strategy for 2007-2010” and submitted the draft to the President for consideration.
6. **The Law “On State Statistics”, #40, March 26, 2007.**  
The law creates legal basis for conducting the state policy on official statistics to achieve comprehensive, reliable, justified and timely statistical information on social, economic, demographic and ecological situation in the Kyrgyz Republic.
7. **The Law on Introducing ammendments to the Law ‘On State Social Pension Provision’, #43, April 09, 2007 ( approved by the Parliament at March 26, 2007).**  
Retirement age was reduced to 60 years for men, and 56 years for women (previously, the retirement ages were 63 years for men and 58 years for women).

## Kyrgyz Republic: Key macroeconomic indicators

	2000	2001	2002	2003	2004	2005	2006	2006	2006	2006	2006	2007
								I	II	III	IV	I
<b>GDP and prices</b>												
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	7.3
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	21,119
GDP, mln US\$	1,370	1,525	1,606	1,919	2,212	2,460	2,818	456	578	984	821	550
GDP per capita dollar (at avg exchange rate)	279	308	322	381	434	478	543	..	..	..	..	..
Poverty headcount (% of population) <sup>4</sup>	63	56	55	50	46	43	..	..	..	..	..	..
Extreme Poverty headcount (% of population) <sup>4</sup>	33	25	23	17	13	11	..	..	..	..	..	..
GDP per capita, 1990=100	59	62	62	65	69	68	70	..	..	..	..	..
GNI per capita dollar (Atlas)	280	280	290	340	400	450	500	..	..	..	..	..
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	2.0
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	2.0	4.0	5.1	7.1	9.2	4.7	8.7	12.5	8.5	4.4
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	3,448
Pension, average (soms per month)	462	558	561	647	709	791	906	843	871	915	906	..
Exchange rate (som/US\$, end of period)	48.3	47.7	46.1	44.2	41.6	41.3	38.1	41	40	39	38	38
Exchange rate (som/US\$, avg of period)	47.7	48.4	46.9	43.7	42.7	41.0	40.2	41	40	40	39	38
REER (2000=100, end-period, up=appreciation)	98	106	107	101	96	95	94	92	91	92	94	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	29	19	21	24	29	22
<b>External Sector</b>												
Current account balance (% to GDP) <sup>3</sup>	-5.5	-1.2	-1.9	-2.2	1.3	-1.2	-14.2	-1.6	-2.0	-1.1	-9.5	-3.0
Exports (mln US\$, fob)	511	480	498	588	733	687	811	178	205	195	233	251
Power	80	47	22	19	22	21	25	2	4	17	2	3
Gold	197	227	163	260	287	231	206	62	61	45	37	51
Other	234	207	313	312	424	435	580	114	140	132	193	196
Imports (mln US\$, cif)	559	472	640	716	941	1,101	1,723	304	371	449	599	555
Food	61	44	64	78	110	140	211	39	54	50	68	60
Other consumer goods	149	128	130	178	194	211	287	53	62	81	90	73
Energy	129	121	152	180	256	314	507	101	112	123	171	190
Other intermediate goods	113	121	125	152	217	245	332	54	75	97	106	89
Capital goods	107	58	116	128	163	191	386	57	67	98	164	144
External Debt (mln US\$)	1,712	1,722	1,785	2,018	2,100	2,024	2,197	1,988	2,130	2,132	2,197	2,170
Public External Debt (mln US\$)	413	1,436	1,579	1,809	1,949	1,883	1,980	1,870	1,920	1,924	1,980	1,977
External Debt (% to GDP)	125	113	111	105	95	82	78	70.6	75.6	75.7	78.0	60.9
Total debt service to exports (%)	28.1	30.8	20.7	22.1	13.7	11.9	7.9	5	12	5	10	8
Public debt service to state revenues (%)	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 US\$)	127	110	88	75	95	92	76	9	13	24	30	28
Worker's remittances (inflow, mln US\$)	44	24	79	143	307	514	749	122	179	223	224	136
Foreign direct investments (net, mln US\$) <sup>1</sup>	-2	5	5	46	175	43	182	11	113	-15	74	-7
International reserves (mln US\$, end period)	261	285	317	389	565	612	817	605	651	719	817	825
<b>General Government Budget (% of GDP)<sup>2</sup></b>												
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.

<sup>1</sup> Includes repayment of FDI related debt

<sup>2</sup> 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.

<sup>3</sup> NBKR preliminary data

<sup>4</sup> 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.