

The Kyrgyz Republic Recent Economic Developments: January-December 2005

Summary

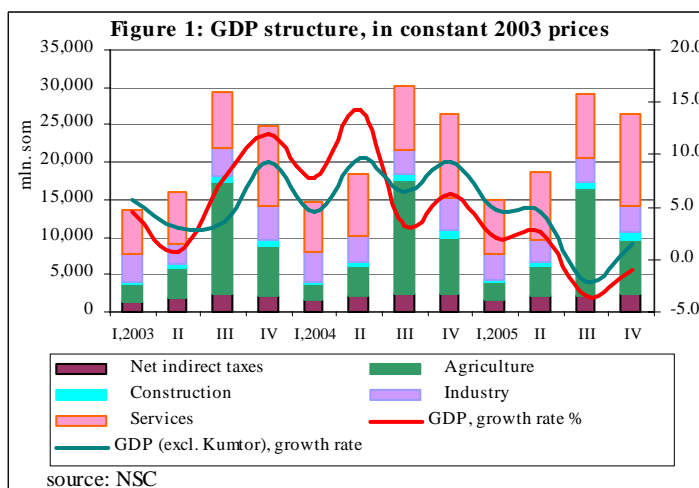
Since early 2005 the country has undergone serious political turmoil, which led to a change of President and the Government. Despite the peaceful election of the President in July, appointment of the Prime Minister and Cabinet of Ministers, the political environment has remained very fragile during the whole year. Currently there is open conflict among different branches of power: President, Prime-Minister, and Parliament. The political instability and uncertainties have negatively affected the economy.

One of the actions of new government aimed at improving the effectiveness of public administration, the authorities made a decision to eliminate some regional units of the ministries and agencies and retrench public employment, in November 2005. In December 2005, new heads of local self-governments were elected. Election results show that only around 25 percent of previous heads were re-elected.

The political instability, further aggravated by a decline in gold production and increase in oil price caused a fall in real GDP by 0.6 percent. On the supply side, in addition to decline in gold production, agricultural production contracted significantly, mainly due to political events in the rural areas during the spring field works. Economic performance in other production sectors was also sluggish. A positive sign in economic development was the continued strong growth of services. Political uncertainties also caused higher price increases than anticipated at the beginning of the year. The end-year inflation increased to 4.9 percent in 2005 compared with 2.8 percent in 2004; however, this price increase could be considered as moderate given the scale of events during the year. The monetary authorities managed to keep the nominal exchange rate relatively stable throughout the year and at the same time to increase international reserves. The real effective exchange rate also remained relatively stable. However, the external current account deficit significantly increased to 9 percent of GDP in 2005 from 3.4 percent of GDP in 2004, reflecting a dramatic increase in trade deficit, which was partially offset by a very strong increase in workers' remittances. The increase in trade deficit was due to the decline in gold exports, stagnation of non-gold exports, and continued increase in imports, of which the increase in oil prices had a significant affect. On fiscal side, due to good revenue collection and despite increased expenditures, the general government budget deficit was reduced to 3.9 percent of GDP in 2005 from 4.0 percent in 2004. The annual average wage increased by 12 percent in real terms in 2005 compared with its level in 2004 and the average annual pension increased by 7 percent in real terms.

1. Growth

- **Real GDP** declined by 0.6 percent reflecting decline in Kumtor related gold production by 23 percent, agriculture sector production by 4.2 percent, and non-gold industrial production by 5 percent. The decline in these sectors was partially compensated by an increase in services of 8.1 percent and construction of 2.1 percent. Non-gold real GDP grew by 1.4 percent.



- **Non-gold industrial output** declined by 5 percent in real terms. This decline, mainly related to political instability in the country, was recorded in almost all sectors of industry, except the textile industry.
- **Agricultural output** declined by 4.2 percent in real terms due to the involvement of rural people in the political events and a substantial increase in fuel price.
- **Construction sector output** increased by 2.1 percent in real terms. In the public sector, investments in re-habilitation of roads and power sector declined, while investments in irrigation systems, mainly financed by donors, increased. In the private sector, investments in real estate construction increased by 19 percent.
- **Services** grew by 8.1 percent in real terms. Services, like other sectors of the economy, were affected by political instability in the second quarter of 2005; however, they recovered quite quickly and grew strongly in the second half of the year. The growth of services was driven by strong growth of trade, food, hotel, and communication services.

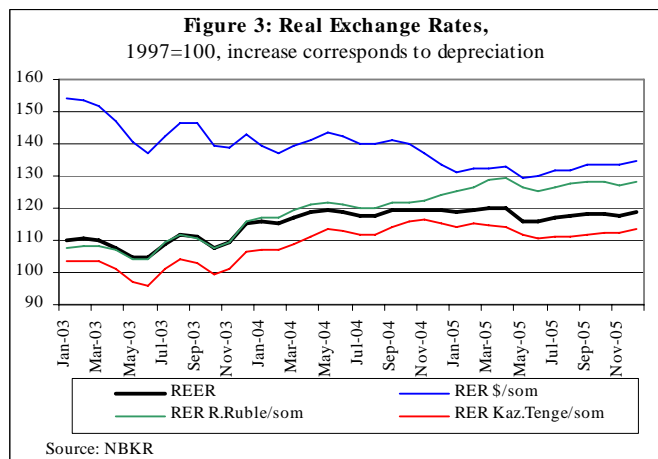
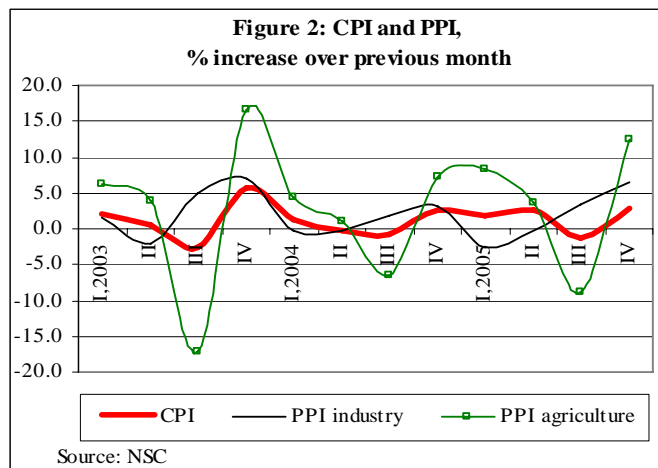
Table 1: Growth rates of GDP and value added of sectors

	2001	2002	2003	2004	2005
GDP	5.3	0.0	7.0	7.0	-0.6
GDP excl. Kumtor-golk	4.1	3.1	5.4	7.8	1.4
Agriculture	4.5	-9.0	3.2	4.1	-4.2
Construction	4.0	1.4	-2.2	5.4	2.1
Industry (incl. Kumtor)	2.6	2.9	15.6	2.7	-12.6
Services	3.9	4.4	7.3	11.9	8.1

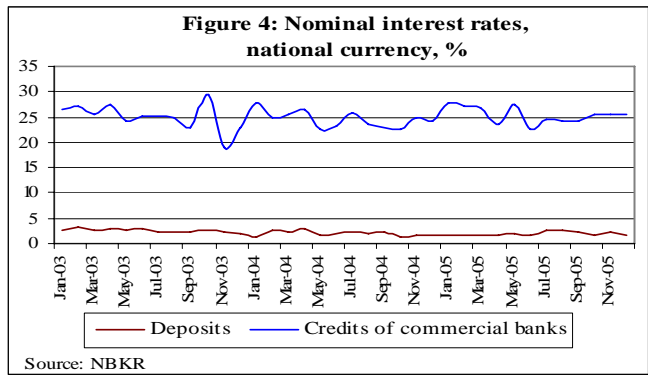
Source: NSC

2. Inflation, exchange rate, and interest rates.

- **End-year consumer prices** increased by 4.9 percent compared with 2.8 percent in 2004. Inflation increased mainly due to the decline in agricultural output, which caused a 10 percent increase in food prices, and the increase in world oil prices. The GDP deflator increased by 6.8 percent in 2005 compared with 4.8 percent in 2004, again mainly reflecting increase in agricultural producer prices.
- **The real effective exchange rate** and real exchange rate of Som against US dollar remained relatively stable. The recovery of the US dollar on international markets and its stability in 2005 relative to the previous two years also contributed to the stability of Som against US dollar. The National Bank, to prevent a sharp depreciation of the exchange rate, intervened strongly in foreign exchange markets at the end of March and beginning of April- the period of the main political turmoil. However, later it managed to recover its international reserves and even increase them. The real exchange rate of Som against Russian Ruble depreciated by 3.5 percent reflecting still higher inflation in Russia, while the real exchange rate of Som against Kazakh Tenge slightly appreciated by 1.6 percent.



- **Average weighted interest rate** on commercial bank loans remains high (at around 25 percent). Lending to the private sector, after declining in the second quarter related to political instabilities, continued to grow.



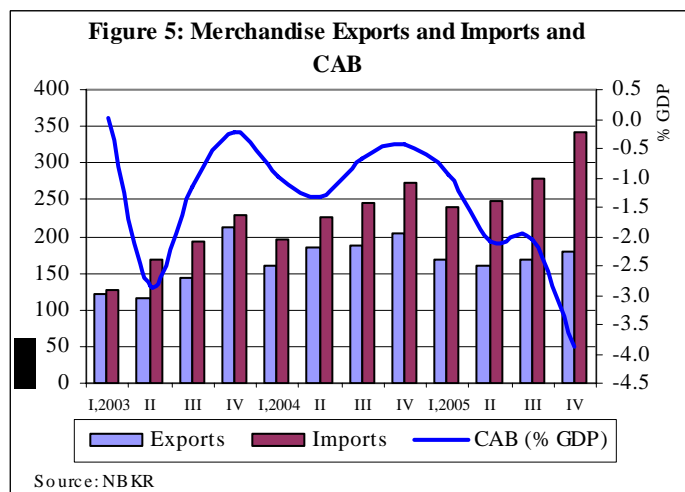
3. External Sector

- **The current account deficit** increased to 9 percent of GDP in 2005 from 3.4 percent in 2004, reflecting decline gold exports and increase in imports. Workers' remittances continued to increase substantially, but this increase in transfers was not enough to compensate the dramatic increase in trade deficit.

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

	2001	2002	2003	2004	2005
CAB (% GDP)	-1.2	-3.1	-4.2	-3.4	-9.0
CAB (million US\$)	-26	-49	-81	-75	-219
Merchandise Exports	480	498	590	733	676
Gold exports	227	163	260	287	231
Non-gold exports	254	335	331	446	445
Merchandise Imports (fob, includes estimates)	450	572	724	904	1,121
Exports of services	80	142	155	209	255
Imports of services	125	149	151	231	308
Net income	-64	-57	-62	-90	-79
interest payments (schec)	-39	-32	-27	-37	-36
Current Transfers net	51	88	112	209	358

Source: NBKR



- **Merchandise exports** declined by 8 percent in 2005, mainly due to a 20 percent decline in gold exports. Non-gold exports were stagnant, reflecting a decline in agricultural and industrial outputs. In the geographical structure of non-gold exports, the decline was recorded mainly in non-CIS countries. Exports to CIS countries increased by about 10 percent, mainly due to increase in exports to Kazakhstan by 29 percent, while exports to Russia even slightly declined.
- **Merchandise imports** increased by 24 percent. Although a part of this increase could be related to adjustments made to import trade statistics (around 5 percent increase), a significant increase was recorded in all functional categories of imports. The most substantial increases were recorded in imports of food and oil products. The increase in imports of oil products purely related to increase in oil prices, while volume of oil imports slightly declined. The imports mainly increased from Russia, China, and the USA.

4. General Government budget

- Due to good performance in the budget revenue collection and despite the increase in the government expenditures, **the fiscal deficit** of the general government budget declined to 3.9 percent of GDP from 4.0 percent of GDP in 2004. The deficit was mainly financed by external (PIP) borrowing.
- **General government revenue** increased to 24.8 percent of GDP compared with 23.4 percent in 2004, which provided additional US\$ 66 million of resources for the government expenditures. The main sources of revenue increase were custom collections, which accounted for more than half of the total increase reflecting both an increase in imports and improved custom

administration, and income taxes, which contributed one third of total increment mainly reflecting the increase in wages and salaries. Other taxes either increased modestly or did not increase at all (table 4). The most notable decrease of VAT on domestic goods collections was explained mainly by two factors: (i) general stagnation of domestic economic activities, and (ii) increased amounts of VAT refunding due to better payment discipline.

Table 3: General government budget (% of GDP)

	2003	2004	2005
Total revenue	23.0	23.4	24.8
Taxes	17.7	18.3	20.2
Income and profit tax	2.7	2.7	3.3
VAT	6.6	7.2	7.1
Excises	1.4	1.3	1.1
Customs	0.5	0.5	1.7
Payroll	3.5	3.5	3.8
Others	3.1	3.1	3.1
Non-tax and Capital	4.7	4.0	3.6
Grants	0.6	1.1	1.0
Total expenditure	28.3	27.9	29.1
Current	23.4	23.0	24.3
Wages	5.8	5.8	6.3
Transfers&subsidies	8.7	8.4	8.8
Interest	1.6	1.9	1.5
Goods and services	7.3	6.9	7.7
Capital	4.9	4.9	4.8
Foreign financed PIP	3.7	3.8	3.9
Net lending	-0.5	-0.5	-0.5
Balance	-4.8	-4.0	-3.9

Source: the MEF and WB staff calculations

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

	Increase against previous period				2005 total
	Iq	IIq	IIIq	IVq	
Tax revenue increase	653	446	478	798	2,375
of which					
Income and profit taxes	230	247	230	139	846
personal income tax	52	91	80	78	301
profit tax	72	117	111	64	365
other income taxes	107	38	38	-3	180
VAT	229	-137	29	137	259
domestic goods	52	-102	-25	-32	-108
imported goods	177	-34	55	169	367
Excises	-8	-32	-32	-23	-96
domestic goods	10	-6	-32	-36	-65
imported goods	-17	-26	0	13	-31
Customs ^{1/}	125	312	363	419	1,219
Land tax	-8	0	-27	19	-16
Road and Emergency Fund	66	15	0	56	137
Other	19	41	-85	51	26

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.

- **The general government expenditure** increased to 29 percent of GDP from 28 percent in 2004 year. The 2005 government budget was definitely socially oriented. The social sectors (education, health, and social protection and insurance) have got the remarkable increases in funds allocation (by 11-19 percent in nominal terms), accounting for about 70 percent of the total expenditure increase (table 5). In addition to social sectors, because of the riots in 2005, expenditures on law enforcement bodies increased by 34 percent in nominal terms. In the economic structure of recurrent expenditures, expenditures on salaries and pensions accounted more than 50 percent (reflecting their increase by 13 percent), non-pension transfers- about 18 percent, and interest and utilities - about 14 percent. Despite some improvements, the quarterly allocations of funds remained to be very uneven and biased towards the end of the year, especially for non-protected items. Thus, in 2005, the budget institutions received about 38 percent of total funds for procurement of equipment, medicine, and food in forth quarter only, while in 2004 this share was at 50 percent.

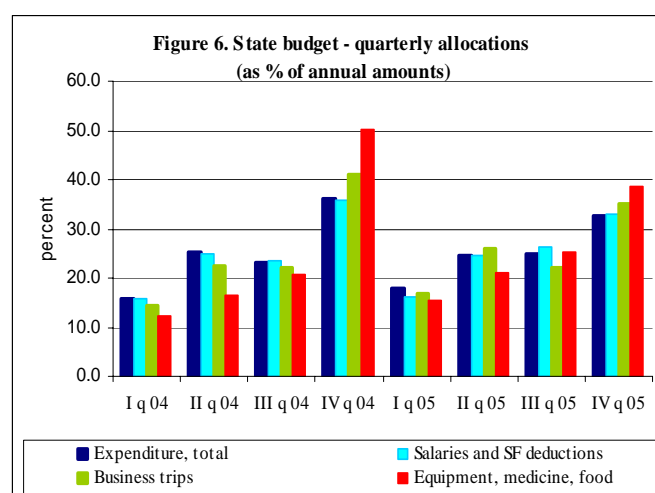


Table 5: Consolidated sectoral budgets (Som mn) 1/

	2004			2005			2005/2004, %
	budget means	special means	external PIP	budget means	special means	external PIP	
Gen.State Services	2637	461	335	2679	361	319	-2
Defense	1330	101		1349	70		-1
Public Order	1191	66		1537	144		34
Education	3320	1038	65	3788	1130	30	12
Health	2027	117	378	2402	136	468	19
Social insurance	6475	6		7159	47		11
Housing	1039	21		1015	26		-2
Culture	542	36		564	43		5
Fuel and energy	28	3	405	57	0	228	-34
Agriculture	765	131	1116	757	130	1360	12
Mining&construction	270	3		264	7		-1
Transport&Telecom	564	89	871	519	75	733	-13
Other	556	0	372	965	0	740	84
Total	20743	2073	3542	23056	2168	3877	10

1/ Cash basis, includes state budget, Social Fund budget and PIP

Source: the MOF, SF and WB staff calculations

5. The main legislative changes with an economic impact in forth quarter 2005

1. President's decree on streamlining state bodies structure, #462, October 15, 2005.

The decree includes list of state bodies (ministries, state committees and agencies) comprising the government of the Kyrgyz Republic.

2. Constitutional Law of the Kyrgyz Republic on the Government of the Kyrgyz Republic, #155, October 19, 2005

The Law determines organization and order of activity of the Government of the Kyrgyz Republic, in accordance with the Constitution of the Kyrgyz Republic. It includes provisions regarding (i) structure and composition of the government; (ii) rights and duties of the government, Prime-minister and ministers; (iii) management and operating procedures of the government; and (iv) basic principles of interactions between the government and the President.

3. Government's decree on basic issues appertaining to the ministries and committees, #493, October 21, 2005.

The decree states the line of competence of ministries and committees (by each body).

4. The government's decree on main results of the Chamber of Accounts audit of 2004 Republican budget execution, #496, October 22, 2005.

The decree summarizes results of the audit and requires the Ministry of Economy and Finance and other agencies to undertake certain activities to improve performance and follow recommendations done by the Chamber of Accounts. The major deficiencies of the budget execution, according to the CA, were as follows: (i) increase of expenditure part without having sources for deficit financing, leading to under financing of planned expenditures at Som 258.6 million; (ii) illegal use of limits on cash by the Central Treasury; (iii) underreporting of some revenues in the budget (e.g. Chinese grant in kind at Som 541 million); (iv) conducting transactions outside of the Treasury; (v) and others.

5. Decree of the President of the KR on approving "Provision of the National agency of the Kyrgyz Republic on issues of local governance", # 503, October 28, 2005

The National agency on issues of local self-governments is a state coordination body under the President of the Kyrgyz Republic with the main responsibilities to implement state policy in sphere of democratization of state management by creating necessary conditions for developing local self-governments, creating optimal system of interaction for self-governments, improving legislation, strengthening its financial and resource bases as well as social economic development of local municipalities of the Kyrgyz Republic

6. President's decree on streamlining of the public administration structure, #607, November 30, 2005.

The decree eliminates some jurisdictional and regional structures of the ministries and agencies and reduces total number of staff in public administration.

7. Government's decree on scale of payments for workers of social sphere, #561, December 7, 2005.

The decree envisages increase of salaries for social sphere workers, effective from April 1, 2006.

8. President's decree on base part of the pension, #640, December 22, 2005.

The decree increases the basic pension up to Som 293 (about 8.5 percent increase), effective from January 1, 2006.

9. Government's decree on broadening list of activities conducted on the patent base, #615, December 23, 2005.

To facilitate development and legalization of the garment industry, the decree includes production and marketing of garment in the list of activities conducted on the patent basis. This provision exempts garment producers from payment of taxes.

Kyrgyz Republic: Key macroeconomic indicators

	2001	2002	2003	2004	2005 Prel.	2005 I	2005 II	2005 III	2005 IV
GDP and prices									
GDP real growth (%)	5.3	0.0	7.0	7.0	-0.6	2.0	2.6	-3.4	-1.1
GDP, som million	73,883	75,367	83,872	94,351	100,116	17,105	20,856	35,511	26,644
GDP, USD million	1,525	1,606	1,919	2,212	2,441	417	507	867	650
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	...	...	...	...	...
GDP per capita, 1990=100	62	62	65	69	68	...	...	...	...
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
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	6.5	4.6	13.3	0.7
Wage, average for KR (som per month)	1455	1684	1916	2203	2570	2269	2466	2589	2932
Wage, average for KR (US\$ per month)	30	36	44	52	63	55	60	63	72
Pension, average for KR (som per month)	558	561	647	709	791	775	755	794	841
Pension, average for KR (US\$ per month)	12	12	15	17	19	19	18	19	21
Exchange rate (som/\$, end of period)	48	46	44	42	41	41	41	41	41
Exchange rate (som/\$, avg of period)	48	47	44	43	41	41	41	41	41
REER (end of period, 1997=100, up=depreciation)	107	109	115	119	119	120	116	118	119
RER of som/US\$ (end of period, 1997=100, up=dep)	160	154	143	134	135	132	130	133	135
Estimated unemployment rate	7.8	12.5	9.9	...	...	...	...	...	...
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
External Sector									
Current account balance (% GDP) ³	-1.2	-3.1	-4.2	-3.4	-9.0	-1.0	-2.1	-2.1	-3.9
Exports (mln US\$, f.o.b.)	480	498	588	733	676	167	161	168	179
- Power	47	22	19	22	21	1	3	11	6
- Gold	227	163	260	287	231	68	58	60	45
- Other	207	313	312	424	424	99	100	97	128
Exports GNFS (mln US\$)	561	640	745	942	931	221	220	236	254
Imports (mln US\$, c.i.f.)	472	640	716	941	1,108	240	248	278	342
- Food	44	64.0	78	110	140	30	31	36	43
- Other consumer goods	128	130	178	194	211	45	51	51	65
- Energy	121	152	180	256	320	69	66	80	106
- Other intermediate goods	121	125	152	217	245	44	61	66	73
- Capital goods	58	116	128	163	191	53	38	45	55
External Debt (mln US\$)	1678	1785	1,943	2,106	2,021	2,086	2,016	2,018	2,021
Public External Debt (mln US\$)	1436	1576	1,652	1,957	1,882	1,932	1,871	1,880	1,882
External Debt (% GDP)	110.0	111.1	101.2	95.2	82.8	85.5	82.6	82.7	82.8
Total debt service to exports of GS (%)	30.8	20.7	22.1	13.7	12.0	7	15	7	18
Public debt service to state revenues&grants (%)	27.7	23.3	14.6	12.9	...	9.7	16.5	8.6	11.9
Public external borrowing (excl. IMF, mln \$)	110	88	75	95	92	19	7	17	49
FDI (mln \$) ¹	5	5	46	175	59	11	8	28	12
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
Grants	0.8	1.1	0.6	1.4	1.0	0.0	0.3	0.2	0.5
Tax	12.4	13.9	14.2	14.8	16.3	3.5	3.9	4.1	4.8
Social fund contributions	4.0	4.2	3.5	3.5	3.8	1.0	0.9	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
Expenditures	26.2	27.9	27.6	27.4	28.7	6.2	7.1	6.8	8.7
Current (other than interest)	20.5	20.7	21.7	21.1	22.8	5.3	5.4	5.3	6.8
o.w. transfers & subsidies	8.2	9.4	8.7	8.4	8.8	2.0	2.2	2.2	2.4
wages & salaries	4.9	5.4	5.7	5.8	6.3	1.0	1.6	1.7	2.1
Interest payments	1.7	1.9	1.6	1.9	1.5	0.2	0.7	0.1	0.5
Capital	5.3	6.0	4.9	4.9	4.8	0.9	1.1	1.5	1.4
of/which foreign financed PIP	4.4	4.7	3.7	3.8	3.9	0.7	0.9	1.2	1.1
Net lending	-1.1	-0.6	-0.5	-0.5	-0.5	-0.1	-0.1	-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
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
Primary Deficit (w/o interest)	-4.2	-3.3	-3.2	-2.1	-2.4	-0.8	-0.3	-0.5	-0.8

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 report

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