

The Kyrgyz Republic Recent Economic Developments: January-March 2005

Summary

For the Kyrgyz Republic, the first quarter of 2005 was remarkable by crucial political changes. The President and the whole government of the country have been dismissed as a result of population discontent with unfair parliamentary elections, accomplished by a revolution on March 24. The events had an immediate impact on tourism, hotel and retail trade services, which declined in March remarkably. A large number of retail traders were looted in Bishkek. An impact on other sectors was not so direct and immediate, and, most likely, can be observed later on this year. In particular, this relates to agriculture, where partially due to political instability in regions, field works were delayed this spring, which can negatively affect annual agricultural growth. In industry no significant performance changes are expected. There are a number of new initiatives on taxes, such as to reduce profit tax from 20 percent to 10 percent and to increase VAT threshold, which, if introduced could change fiscal parameters of the budget. Political instability could negatively affect inflow of foreign direct investments this year and reduce tourism revenue this summer. Finally, the overall economic performance will depend on how soon the country will get political stability after Presidential elections scheduled on July 10, 2005.

For the time being, given that the events happened at last week of March, the main indicators for the first quarter were not noticeably affected.

Continued decline of Kumtor related gold production slowed down real GDP growth rate to 2.0 percent in the first quarter of 2005 (compared to 7.8 percent in the same period last year), while non-Kumtor GDP grew by 4.8 percent in real terms (compared to 4.6 percent in the same period last year). Growth continued to be underlined by strong development of services and recovery of some industrial sectors. However, retail trade and hotel services, reflecting mostly the recent events, declined in March. Nominal and real exchange rates were relatively stable; however, short-term outflow of deposits, including in foreign currency, with consequent increase in demand on foreign currency in the last week of March created some pressure on exchange rate, which was handled by increased foreign exchange interventions of the National Bank. Current account deficit increased to 2.3 percent of GDP from 1.0 percent of GDP in the first quarter of 2004, reflecting mainly strong increase in imports. Merchandise imports increased by 25.6 percent, while merchandise exports increased only by 5.7 percent. Fiscal performance was improved: general government fiscal deficit was slightly lower than in January-March, 2004 (0.8 percent of GDP against 0.9 percent), underlined by a better revenue performance, which financed the increase in expenditures.

1. Growth

- **Real GDP** grew by 2.0 percent, based on contribution of services (2.9 percentage points), non-gold industry (1.4 percentage points), and agriculture (0.2 percentage points); while decline in Kumtor related gold production reduced aggregate output growth by 2.8 percentage points. Non-gold GDP grew by 4.8 percent, which is 0.2 percentage points higher than its growth in the first quarter of last year.
- **Non-gold industrial output** increased by 6.6 percent in real terms, led by growth of external and domestic demand on some industrial products. For example, textile industry and rubber and plastic items

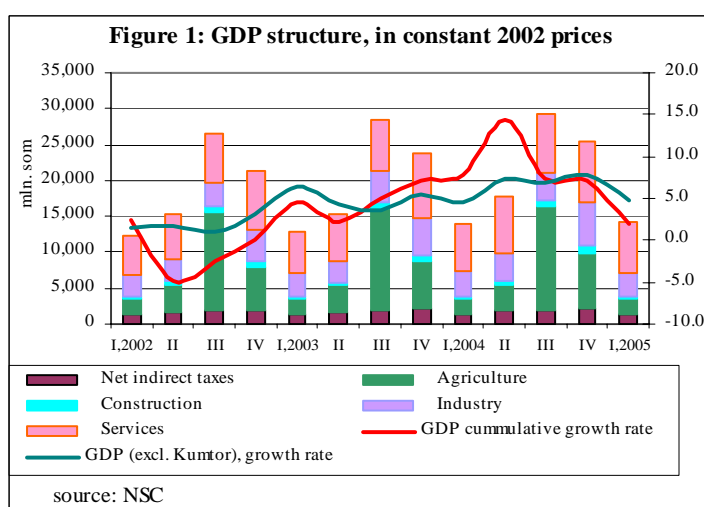


Table 1: Growth rates of GDP and value added of sectors

	2002	2003	2004	I 2004	I 2005
GDP	0.0	7.0	7.1	7.8	2.0
GDP excl. Kumtor-gold	3.1	5.4	7.8	4.6	4.8
Agriculture	3.0	3.2	4.1	-1.3	1.1
Construction	1.4	-2.2	3.5	-6.9	5.0
Industry (incl. Kumtor)	-13.4	15.6	9.5	5.0	-5.9
Services	4.4	7.3	8.9	14.2	6.4

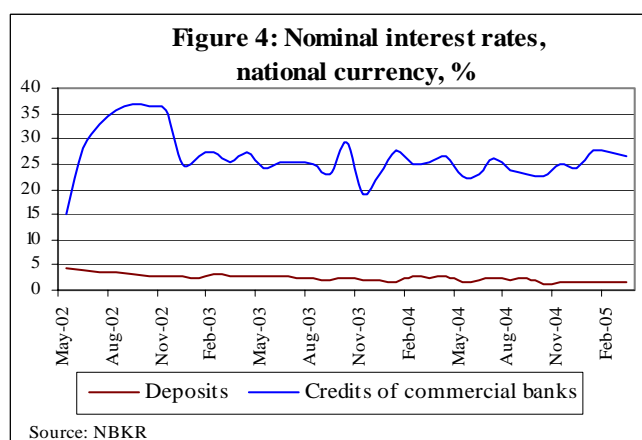
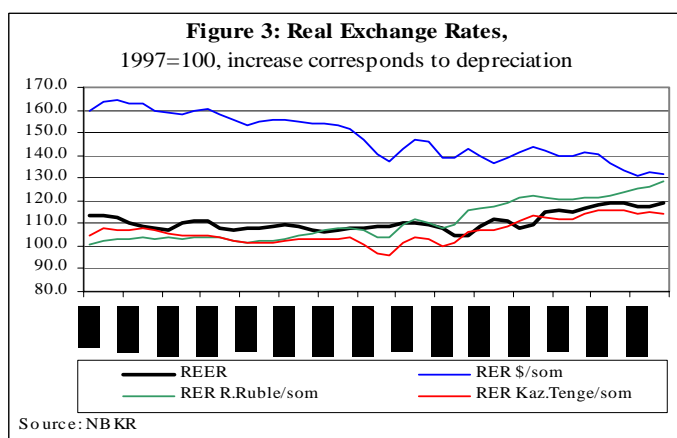
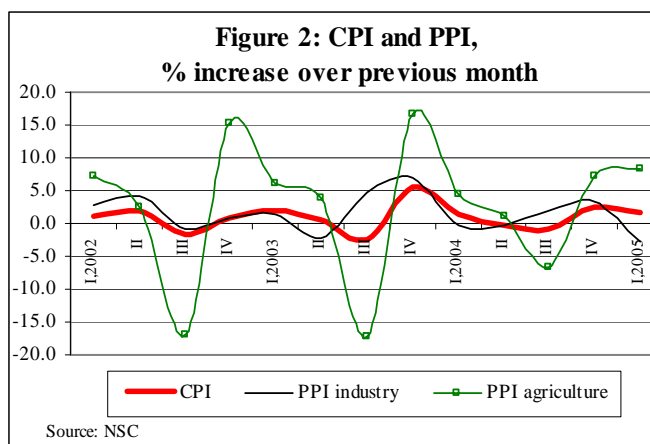
Source: NSC

production doubled; construction material production increased by 19 percent; and power production and distribution increased by 6.4 percent. On the other hand, food production, which has been growing strongly over the last three years, declined by 14 percent.

- **Agricultural output**, which is seasonally based on only livestock production in the first quarter, increased by 1 percent in real terms. Spring agricultural field works were negatively affected this year by both unfavorable weather conditions and political instability in regions, which could lead to decline in agricultural growth.
- **Construction sector output** increased by 5.0 percent in real terms. In public sector, investments in construction of roads increased; and in private sector, real estate construction keeps strong growth rates.
- **Services** grew by 6.4 percent in real terms, reflecting strong development pattern of trade, food, hotel, and communication services. However, in March, hotel and retail trade services, affected by political events, declined by 15 percent and 7 percent, respectively. There is also potential risk that political uncertainty could cause decline of tourism in the third quarter.

2. Inflation, exchange rate, and interest rates.

- **Consumer prices** (March to December) increased by 1.7 percent, compared to 1.3 percent increase in the first quarter of 2004. Average inflation was at 3.0 percent over its level in the first quarter of last year.
- **The real effective exchange rate**, as well as bilateral real exchange rates of Som against US dollar and Kazakh Tenge, remained relatively stable. The real exchange rate of Som against Russian Ruble depreciated by 4.0 percent, reflecting relatively higher inflation in Russia.
- **Average weighed interest rate** on commercial bank loans increased to 27 percent compared with 25 percent last year; however, this reflects changes in structure of loans portfolio rather than increase in interest rates.



3. External Sector

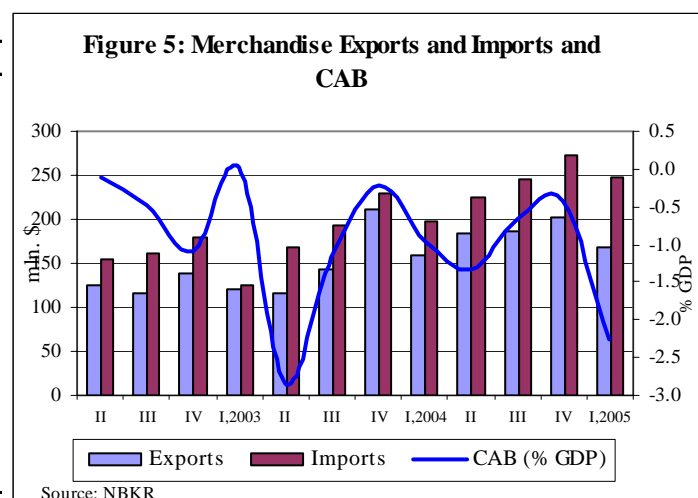
- **Current account deficit** increased to 2.3 percent of GDP from 1.0 percent of GDP in the first quarter of 2004, reflecting strong growth of imports.

- **Merchandise exports** increased by 5.7 percent, reflecting mainly increase in exports of consumer goods and energy products. Despite significant decline in gold production, gold exports value, partially due to gold price increase, remained at around the first quarter of last year level.
- **Merchandise imports (c.i.f.)** increased by 25.6 percent, reflecting the increase in imports of food products, energy products, and investment goods.

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

	2002	2003	2004	I 2004	I 2005
CAB (% GDP)	-3.1	-4.2	-3.4	-1.0	-2.3
CAB (million US\$)	-49.4	-80.6	-75.1	-21.4	-52.9
Merchandise Exports	498.1	590.3	733.2	158.9	167.9
Gold exports	162.8	259.6	287.4	67.3	67.8
Merchandise Imports (fob, includes estimates)	572.0	723.7	904.4	190.1	261.6
Exports of services	142.0	154.7	208.9	42.5	47.7
Imports of services	148.5	151.3	231.1	44.2	40.4
Net income	-57.4	-62.4	-90.2	-27.9	-25.9
interest payments (scheduled)	-31.9	-27.1	-36.8	-8.1	-4.0
Current Transfers net	88.4	111.7	208.5	39.4	59.4

Source: NBKR



4. General Government budget

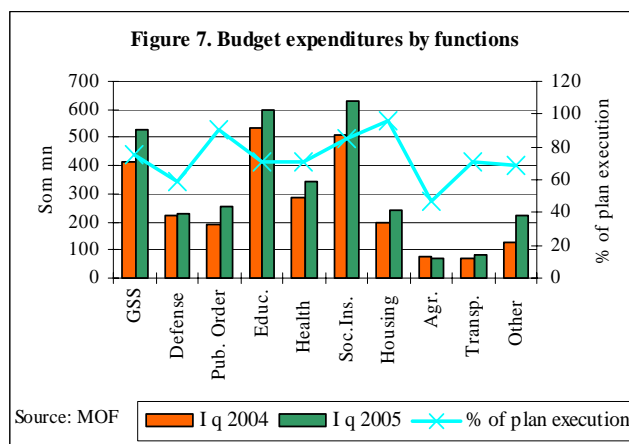
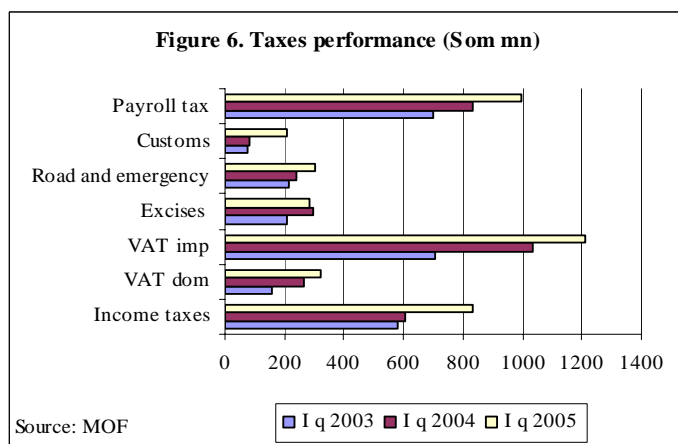
- **Fiscal deficit (accrual)** of the general government budget was at 0.8 percent of GDP, which was 0.1 percentage points lower than it was in the first quarter of 2004. The deficit has largely been financed by external borrowing for PIP projects (0.6 percent of GDP). The last round of Paris Club debt restructuring further improved country's ability to service external debt, with debt repayments being significantly reduced over the last two years.
- **General government revenue collection** improved significantly to 5.3 percent of GDP compared to 4.9 percent in the first quarter of 2004. The government received additional Som 615 million of revenues, solely due to increase of tax collections. Collections of almost all major taxes (and especially of custom duties) increased significantly, mainly due to improved administration. At the same time, the March events had a negative impact on collections of local taxes, including land tax.
- **The general government expenditure** increased to 6.2 percent of GDP, which was the highest level for the first quarter of last three years. Financing of almost all economic items increased, including salaries (by 19 percent), purchases of equipment (by 45 percent), food (by 43 percent), pensions (by 9 percent), and social allowances (doubled). The latter increase has been caused mainly by changes in the scheme of financing of unified monthly benefit (UMB): instead of providing the monthly amounts to UMB recipients, the Ministry of Labor and Social Protection

Table 3: General government budget (% of GDP)

	2003	2004	January-March		
			2003	2004	2005
Total revenue	22.9	23.4	4.3	4.9	5.3
Taxes	17.7	18.4	3.5	3.9	4.6
Income and profit tax	2.7	2.7	0.7	0.6	0.8
VAT	6.6	7.3	1.0	1.4	1.6
Excises	1.4	1.3	0.3	0.3	0.3
Customs	0.5	0.5	0.1	0.1	0.2
Payroll	3.5	3.5	0.8	0.9	1.0
Others	3.1	3.1	0.6	0.6	0.7
Non-tax and Capital Grants	4.6	3.9	0.7	0.7	0.7
Grants	0.6	1.1	0.0	0.3	0.0
Total expenditure	28.1	27.8	5.6	5.9	6.2
Current	23.2	22.9	4.9	5.1	5.3
Wages	5.7	5.8	1.0	0.9	1.0
Transfers&subsidies	8.7	8.5	1.7	1.7	2.0
Interest	1.6	1.9	0.2	0.2	0.2
Goods and services	7.3	6.7	2.0	2.3	2.1
Capital	4.9	4.9	0.7	0.8	0.9
Foreign financed PIP	3.7	3.8	0.6	0.7	0.7
Net lending	-0.5	-0.5	-0.1	-0.1	-0.1
Balance	-4.7	-4.0	-1.2	-0.9	-0.8

Source: the MOF and WB staff calculations

started providing lump sum payments of annual UMB for piloted families from the beginning of this year to stimulate more effective utilization of this assistance by recipients and reduce poverty more effectively. At the same time, the budget expenditures for utilities declined by 20 percent, which led to increase in arrears of local budgets before utility providers. Financing of almost all sectors has increased remarkably (see Figure 7), albeit expenditure plan for state budget was under executed by 25 percent.



5. The main legislative changes with economic impact in January-March 2005

1. Water code of the Kyrgyz Republic (# 8, January 12, 2005).

The Water code regulates the legal framework of usage, protection, and development of water resources of the Kyrgyz Republic. The code established the main principles of water management, environment protection, and public policy on water management.

2. The Law on amendments to the Law of the Kyrgyz Republic on stimulating employment (# 31, February 13, 2005).

The law envisages changes of sources of Employment Fund financing from social insurance contributions to the state budget. Accordingly, the level of social security contributions reduced from 33 percent to 32 percent from January 1, 2005.

3. The Law on Pledge (# 49, March 12, 2005.)

The new edition of the law introduces, *inter alia*, simplified (extrajudicial) foreclosure. In addition, it includes some provisions from the law on mortgage, which became ineffective since introduction of the law on pledge.

4. The Law on Customs schedule for 2005 (# 48, March 10, 2005.)

The law established an order of formation and application of the customs tariff, and specifies customs schedule for 2005.

5. The Law on basic excise tax rates for the imported and domestically produced excisable goods (# 56, March 23, 2005.)

The law approves basic excise tax rates for excisable goods for 2005.

6. The Law on basic land tax rates for agricultural lands, land lots, summer cottage plots, settled areas and non agricultural lands for 2005 (# 57, March 23, 2005.)

The law approves the basic land tax rates for all types of lands.

7. Presidential decree on salary increase of culture related employees (# 21, January 19, 2005.)

The salary of culture related employees to be increased by 30 percent from April 1, 2005 in two phases.

Kyrgyz Republic: Key macroeconomic indicators

	2000	2001	2002	2003	2004 Prel.	2004 I	2004 II	2004 III	2004 IV	2005 I
<u>GDP and prices</u>										
GDP real growth (%)	5.4	5.3	0	7.0	7.1	7.8	14.3	3.3	6.5	2.0
GDP, som million	65,358	73,883	75,367	83,872	94,078	15,742	19,432	32,446	26,458	17,105
GDP, USD million	1,370	1,525	1,606	1,919	2,205	365	447	764	635	417
GDP per capita dollar (at avg x-rates)	279	308	322	381	431	...	...	...	...	...
Poverty headcount (% of population)	52	48	44	39	35	...	...	...	...	...
Extreme Poverty headcount (% of population)	18	14	14	9	...	...	...	...	...	...
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
Inflation (% average, CPI)	18.7	6.9	2.1	3.1	4.1	5.3	...	...	...	3.0
Wage, average for KR (som per month)	1227	1455	1684	1902	2203	1956	2050	2101	2503	2269
Wage, average for KR (US\$ per month)	26	30	36	44	52	45	47	49	60	55
Pension, average for KR (som per month)	462	558	561	647	709	685	711	721	720	780
Pension, average for KR (US\$ per month)	10	12	12	15	17	16	16	17	17	19
Exchange rate (som/\$, end of period)	48	48	46	44	42	43	43	42	42	41
Exchange rate (som/\$, avg of period)	48	48	47	44	43	43	43	42	42	41
REER (end of period, 1997=100, up=depreciation)	114	107	109	115	119	117	119	119	119	120
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	20.1
<u>External Sector</u>										
Current account balance (% GDP) ³	-5.6	-1.2	-3.1	-4.2	-3.4	-1.0	-1.3	-0.7	-0.4	-2.3
Exports (mln US\$, f.o.b.)	511	480	498	588	733	159	184	187	203	168
- Power	80	47	22	19	31	2	6	13	10	3
- Gold	197	227	163	260	287	67	83	75	63	68
- Other	234	207	313	312	411	89	95	100	127	97
Imports (mln US\$, c.i.f.)	559	472	640	716	941	197	226	245	274	247
- Food	61	44	64.0	78	110	20	29	30	31	28
- Other consumer goods	149	128	130	178	194	48	46	47	54	48
- Energy	129	121	152	180	256	60	54	56	86	71
- Other intermediate goods	113	121	125	152	217	42	58	62	56	45
- Capital goods	107	58	116	128	163	26	40	50	47	55
External Debt (mln US\$)	1712	1678	1785	1,943	2,106	1,982	1,999	2,034	2,106	2,078
Public External Debt (mln US\$)	1403	1436	1576	1,652	1,957	1,798	1,814	1,851	1,957	1,932
External Debt (% GDP)	125.0	110.0	111.1	101.2	95	89.9	90.7	92.2	95.5	88.6
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	9.5
Public debt service to state revenues&grants (%)	37.4	27.7	23.3	14.6	13.0	9.0	18.9	10.3	13.3	14.6
Public external borrowing (excl. IMF, mln \$)	127	110	88	75	95	8	17	47	23	19
FDI (mln \$) ¹	-2	5	5	46	131	16	102	16	-3	19
<u>General Government Budget (percent of GDP)²</u>										
<u>Revenues and grants</u>	18.5	20.4	22.7	22.9	23.4	4.9	5.6	5.8	7.1	5.3
Grants	0.9	0.8	1.1	0.6	1.1	0.3	0.0	0.0	0.8	0.0
Tax	12.3	12.4	13.9	14.2	14.9	3.1	3.7	3.9	4.3	3.6
Social fund contributions	3.7	4.0	4.2	3.5	3.5	0.9	0.8	0.9	0.9	1.0
Nontax and capital	1.5	3.2	3.5	4.6	3.9	0.7	1.0	1.0	1.1	0.7
<u>Expenditures</u>	28.1	26.2	27.9	27.6	27.3	5.8	7.0	6.3	8.2	6.1
Current (other than interest)	18.6	20.5	20.7	21.7	21.0	4.9	5.0	4.9	6.2	5.1
o.w. transfers & subsidies	7.5	8.2	9.4	8.7	8.5	1.7	2.0	2.1	2.7	2.0
wages & salaries	4.4	4.9	5.4	5.7	5.8	0.9	1.4	1.4	2.1	1.0
Interest payments	2.2	1.7	1.9	1.6	1.9	0.2	0.9	0.2	0.7	0.2
Capital	7.8	5.3	6.0	4.9	4.9	0.8	1.2	1.4	1.5	0.9
of/which foreign financed PIP	6.5	4.4	4.7	3.7	3.8	0.7	0.9	1.1	1.1	0.7
Net lending	-0.5	-1.1	-0.6	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	-0.1
<u>Fiscal Balance (accrual)</u>	-9.6	-5.8	-5.2	-4.7	-4.0	-0.9	-1.4	-0.6	-1.1	-0.8
Memo:										
Primary Deficit (w/o interest and PIP)	-0.9	0.2	1.4	0.5	1.7	0.0	0.4	0.7	0.7	0.1
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

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