

The Kyrgyz Republic Recent Economic Developments: January-March 2006

Summary

The political environment slowly improved during January-March. The open conflict between President and Speaker of the Parliament has been resolved by resignation of the Speaker and election of new one. The Parliament has started to pay more attention to legislative work and approved several economic related decisions such as reducing profit and income taxes, abolishing several inefficient local taxes, reducing employer contributions to the Social Fund. The government introduced a patent based simplified tax system for sewing small enterprises, many of which are currently in the shadow economy due to inefficiencies in tax administration. The government made a decision effective from May 1 to unify differentiated electricity tariffs for residential consumers aiming at commercial loss reduction.

GDP grew only by 2.4 percent in real terms mainly due to anticipated contraction of gold production. Non-gold GDP increased by 6.5 percent mainly due to continued strong growth of services and a one time increase in production of machinery. Inflation increased to 3 percent compared with 1.3 percent in the first quarter of 2005. This acceleration is mainly explained by significant food prices increase caused by decline in agricultural output in the last year. The nominal and real effective exchange rates have remained relatively stable. The current account deficit increased to 3.1 of GDP from 0.9 percent of GDP in the first quarter of 2005, reflecting a strong increase in imports. This deficit has been mainly financed by an increased inflow of FDI and borrowing. On fiscal side, the general government budget deficit was remarkably reduced to 0.2 percent of GDP from 1 percent of GDP in January-March 2005 due to improved revenue collection performance and expenditure reduction. The average monthly wage increased by 14 percent and the average monthly pension increased by 12 percent in real terms compared with their levels in the first quarter of last year.

1. Growth

- **Real GDP** grew by 2.4 percent based on contribution of services of 4.0 percent, non-gold industry of 1.3 percent, and others sectors of 0.6 percent, while decline in gold industry contributed negatively 3.5 percent. Non-gold real GDP grew by 6.5 percent.
- **Non-gold industrial output** increased by 9 percent in real terms. This significant increase is explained by a one off six fold growth in machinery production in January of 2006, and by 10.6 percent increase in food processing, mainly livestock based.
- **Agricultural output** increased by 0.9 percent in real terms and seasonally it has small share in the GDP structure in the first half of the year.
- **Construction sector output** increased by 7.7 percent in real terms. Private real

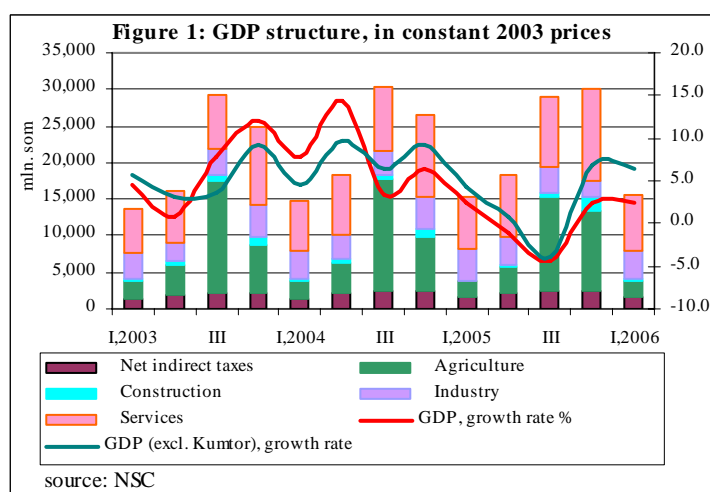


Table 1: Growth rates of GDP and value added of sectors

	2003	2004	2005	I 2004	I 2005	I 2006
GDP	7.0	7.0	-0.6	7.8	2.4	2.4
GDP excl. Kumtor-gold	5.4	7.8	1.4	4.6	4.8	6.5
Agriculture	3.2	4.1	-4.2	-1.3	-6.7	0.9
Construction	-2.2	5.4	2.1	-6.9	-16.0	7.7
Industry (incl. Kumtor)	15.6	2.7	-12.6	5.0	12.8	-9.1
Services	7.3	11.9	8.1	14.2	1.5	8.9

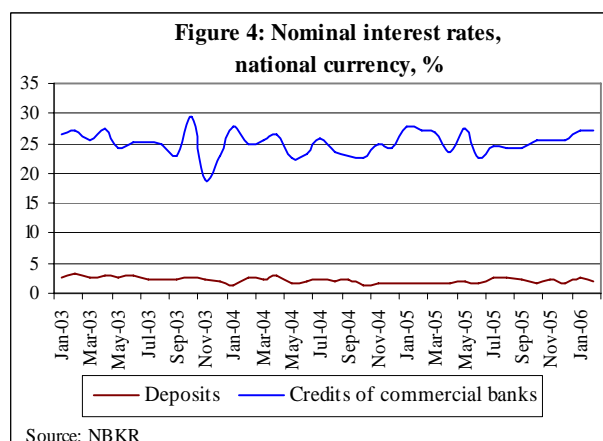
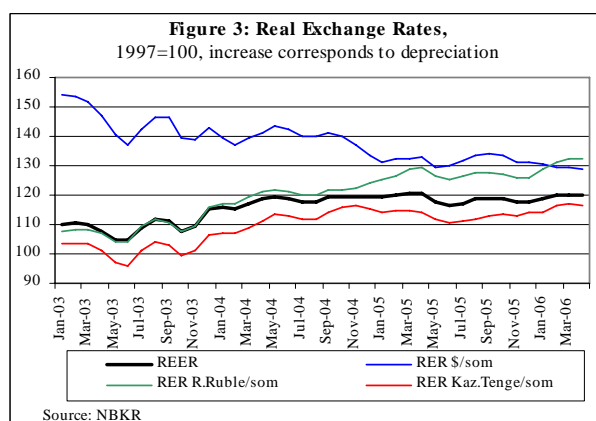
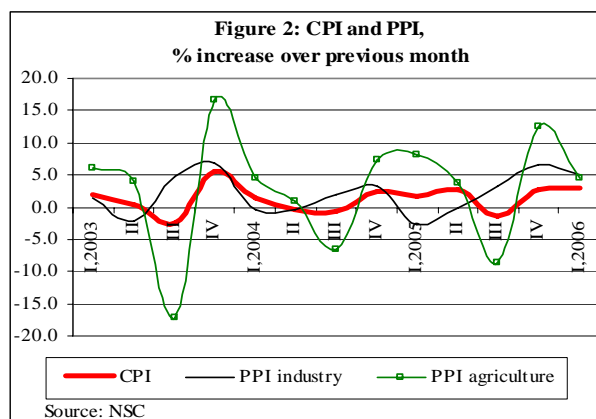
Source: NSC

estate construction, led by strong demand, continued to increase and there was also positive sign in increase in construction of industrial entities.

- **Services** grew by 8.9 percent in real terms. This growth continued to be driven by strong growth of trade, food, hotel, transport, and communication services.

2. Inflation, exchange rate, and interest rates.

- **Consumer prices** increased by 3.0 percent from the beginning of this year compared with 1.3 percent during the same period of 2005. Food prices increased by 6.8 percent, which was much higher than seasonal price increase, and it is mainly explained by decline in agricultural output last year.
- **The real effective exchange rate** and real exchange rate of Som against US dollar remained relatively stable. The real exchange rate of Som depreciated by 5.0 percent against Russian Ruble and by 2.5 percent against Kazakh Tenge, which was related mainly to nominal appreciation of Russian and Kazakh currencies against US dollar.
- **Average weighted interest rate** on commercial bank loans slightly increased and it could be explained by change in structure of loans as financial market remains shallow rather than be interpreted as a trend. Overall interest rate still remains high.



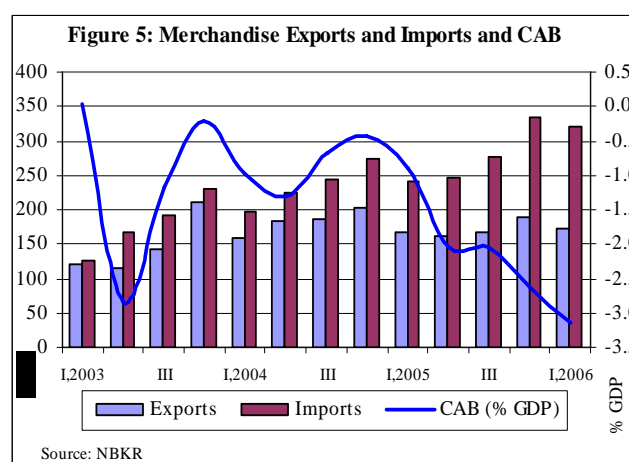
3. External Sector

- **The current account deficit** increased to 3,1 percent of GDP in the first quarter of 2006 compared with 0.9 percent in the same period of last year, reflecting strong increase in imports. There is a sign of non-gold and non-oil export recovery; however, it still remains weak and unsustainable. Workers' remittances continued to increase substantially, but this increase in transfers together with exports increase was not enough to compensate substantial increase in imports.

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

	2003	2004	2005	I 2004	I 2005	I 2006
CAB (% GDP)	-4.2	-3.4	-7.6	-1.0	-0.9	-3.1
CAB (million US\$)	-81	-75	-187	-21	-22	-84
Merchandise Exports	590	733	687	159	168	173
Gold exports	260	287	231	67	68	62
Non-gold exports	331	446	456	92	100	111
Merchandise Imports(fob)	724	904	1,115	190	225	302
Exports of services	155	209	255	43	53	60
Imports of services	151	231	300	44	63	73
Net income	-62	-90	-77	-28	-19	-21
interest payments (scheduled)	-27	-37	-38	-8	-4	-4
Current Transfers net	112	209	363	39	64	77

Source: NBKR and WB staff estimates; Imports includes estimates



- **Merchandise exports** increased by 3 percent. Gold exports, which accounted 36 percent of total exports, declined by 9 percent in value terms, while in real terms they declined by 30 percent. Non-gold and non-oil exports increased by 7.6 percent, reflecting increase in exports of investment goods.
- **Merchandise imports** increased by 34 percent. The most substantial increases were recorded in imports of food and oil products. Imports of oil products increased by 70 percent in value terms, of which half of the increase was attributed to import price increase and another half - to volume increase. The imports increased most significantly from Russia (oil products) and China (consumer goods).

4. General Government budget

- Due to a significant increase in budget revenue collection and sharp curtailment in government expenditures, **the fiscal deficit** of the general government budget declined to 0.2 percent of GDP in the first quarter of 2006 from 1.0 percent of GDP recorded in first quarter of 2005. The deficit was mainly financed by external (PIP) borrowing.
- **General government revenue** increased to 5.5 percent of GDP compared with 5.2 percent in the first quarter of 2005. The most significant contribution to this increase was made through an improvement in tax collections, which ensured about 70 percent of this increase (Table 4). The most significant and lasting improvements have been observed in collections of import duties. Customs authorities collected import duties of 0.5 percent of GDP, which is 2.3 times higher in nominal terms than its level in the first quarter last year, excises on imports of 0.2 percent of GDP (10 percent increase), and VAT on imports of 1.4 percent of GDP (13 percent growth) reflecting an increase in imports and better administration.

Table 3: General government budget (% of GDP)

	January - March				
	2004	2005	2004	2005	2006
Total revenue	23.4	24.9	4.9	5.2	5.5
Taxes	18.3	20.2	3.9	4.5	4.6
Income and profit tax	2.7	3.3	0.6	0.8	0.8
VAT	7.2	7.1	1.4	1.5	1.5
Excises	1.3	1.1	0.3	0.3	0.3
Customs	0.5	1.7	0.1	0.2	0.4
Payroll	3.5	3.8	0.9	1.0	0.9
Others	3.1	3.1	0.6	0.7	0.7
Non-tax and Capital Grants	4.0	3.7	0.7	0.7	0.7
Grants	1.1	1.0	0.2	0.0	0.1
Total expenditure	27.9	29.2	5.9	6.3	5.6
Current	23.0	24.4	5.2	5.4	4.9
Wages	5.8	6.3	0.9	1.0	1.2
Transfers&subsidies	8.4	8.8	1.7	2.0	2.0
Interest	1.9	1.5	0.2	0.2	0.1
Goods and services	6.9	7.8	2.4	2.3	1.6
Capital	4.9	4.8	0.8	0.9	0.6
Foreign financed PIP	3.8	3.9	0.6	0.7	0.5
Net lending	-0.5	-0.5	-0.1	-0.1	0.1
Balance	-4.0	-3.9	-1.0	-1.0	-0.2

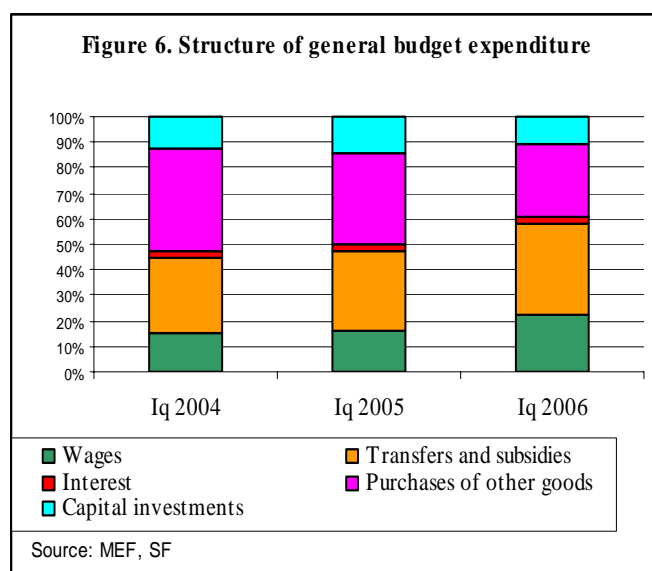
Source: the MEF and WB staff calculations

Table 4. General budget revenue collection increase (I q 2006 against I q 2005)

	(Som million)
Total revenue and grants	816.3
Tax revenue	558.8
Income and profit taxes	32.7
VAT, of which	149.5
domestic	-12.1
import	161.6
Payroll tax	24.4
Excises	-7.5
domestic	-23.5
import	16.0
Customs	267.0
Land tax	17.7
Road and Emergency Fund	65.7
Other	9.4
Nontax revenue	147.6
Capital revenue	-12.7
Grants	122.5

Source: The MEF, SF

Figure 6. Structure of general budget expenditure



Source: MEF, SF

- **The general government expenditure** reduced to 5.6 percent of GDP from 6.3 percent of GDP in the first quarter of 2005, and it has been the lowest level for the last three years. In the structure of expenditures the reduction has been made in expenditures on non-protected items, while expenditures on protected items have been increased due to the last year salary increases. Thus, the share of wages increased from 16 percent of total general budget expenditure in the first quarter 2005 to 22 percent in the first quarter of 2006, the share of transfers and subsidies – from 31 percent to 36 percent; while the shares of expenditures on other goods declined from 36 percent to 28 percent and capital investments (including both domestic and foreign financed investments) – from 14 percent to 11 percent

5. The main legislative changes with an economic impact in the first quarter 2006

1. The law of the KR “On Amendments and Addenda to the Tax Code of the Kyrgyz Republic”, # 32, February 1, 2006

According to amendments:

- Criteria for defining fixed assets changed;
- A uniform income tax rate set at 10 %;
- Profit tax rate reduced from 20% to 10 % (effective from January 1, 2006 for entities other than natural monopolies; for natural monopolies it is effective from January 1, 2007)
- Supplies of agricultural products by agricultural producers to be VAT exempted;
- VAT payment procedure for imported fixed assets through offsets is established;
- Some local taxes abolished.

2. The law of the KR on Introducing Amendments to the Law of the KR “On Tariffs for State Social Insurance”, #63, February 24, 2006.

According to the law, the tariffs are reduced for employers from 23 percent to 21 percent effective from January 1, 2006, according to the following scheme:
to the Pension Fund – 19 percent; to the Medical Insurance Fund – 2 percent.

3. Decrees of the President of the KR on salary increase for selected categories of staff of the Ministry of Labor and Social protection, state scientific institutions, state universities, and state cultural institutions, # 130, 131, 132, 133, March 20, 2006.

Effective from April 1, 2006 to increase salaries of the staff of the following institutions:

- Centers for social payments and social workers – by 50 percent;
- State homes for aged – by 15 percent;
- State scientific institutions (except National Academy of Science) – by 50 percent;
- National Academy of Science – by 15 percent;
- State universities – by 50 percent;
- State cultural institutions – by 35 percent.

4. The law of the KR “On excise tax rates for 2006”, #189, January 6, 2006.

Excises for oil products increased effective from January 1, 2006.

Kyrgyz Republic: Key macroeconomic indicators

	2001	2002	2003	2004	2005	2005	2005	2005	2005	2006
						I	II	III	IV	I
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
GDP, som million	73,883	75,367	83,872	94,351	100,116	16,992	20,615	33,842	28,668	18,608
GDP, USD million	1,525	1,606	1,919	2,212	2,441	414	501	827	699	450
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
Inflation (% average, CPI)	6.9	2.1	3.1	4.1	4.3	3.0	...	...	...	6.2
Deflator GDP (%)	7.3	2.3	3.8	5.1	6.8	5.4	7.1	9.1	4.7	6.9
Wage, average for KR (som per month)	1455	1684	1916	2203	2570	2269	2466	2589	2932	2661
Wage, average for KR (US\$ per month)	30	36	44	52	63	55	60	63	72	64
Pension, average for KR (som per month)	558	561	647	709	791	781	762	801	849	873
Pension, average for KR (US\$ per month)	12	12	15	17	19	19	19	20	21	21
Exchange rate (som/\$, end of period)	48	46	44	42	41	41	41	41	41	41
Exchange rate (som/\$, avg of period)	48	47	44	43	41	41	41	41	41	41
REER (end of period, 1997=100, up=depreciation)	107	109	115	119	118	121	116	119	118	120
RER of som/US\$ (end of period, 1997=100, up=dep)	160	154	143	134	131	132	130	134	131	129
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	19.0
External Sector										
Current account balance (% GDP) ³	-1.2	-3.1	-4.2	-3.4	-7.6	-0.9	-2.0	-2.1	-2.6	-3.1
Exports (mln US\$, f.o.b.)	480	498	588	733	687	168	161	168	190	173
- Power	47	22	19	22	21	1	3	11	6	1
- Gold	227	163	260	287	231	68	58	60	45	62
- Other	207	313	312	424	435	100	100	97	139	110
Imports (mln US\$, c.i.f.)	472	640	716	941	1,101	240	248	278	336	320
- Food	44	64.0	78	110	140	30	31	36	43	44
- Other consumer goods	128	130	178	194	211	45	51	51	65	50
- Energy	121	152	180	256	314	68	66	80	101	112
- Other intermediate goods	121	125	152	217	245	44	61	66	73	53
- Capital goods	58	116	128	163	191	53	38	45	55	60
External Debt (mln US\$)	1678	1785	1,943	2,106	2,023	2,086	2,016	2,018	2,023	2,009
Public External Debt (mln US\$)	1436	1576	1,652	1,957	1,882	1,932	1,871	1,880	1,882	1,870
External Debt (% GDP)	110.0	111.1	101.2	95.2	82.9	85.5	82.6	82.7	82.9	75.0
Total debt service to exports of GS (%)	30.8	20.7	22.1	13.7	11.9	7	15	7	17	9
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
Public external borrowing (excl. IMF, mln \$)	110	88	75	95	92	19	7	17	49	21
FDI (mln \$) ¹	5	5	46	175	60	11	8	28	13	15
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
Grants	0.8	1.1	0.6	1.4	1.0	0.0	0.3	0.2	0.5	0.1
Tax	12.4	13.9	14.2	14.8	16.3	3.5	3.9	4.1	4.8	3.7
Social fund contributions	4.0	4.2	3.5	3.5	3.8	1.0	0.9	0.9	1.0	0.9
Nontax and capital	3.2	3.5	4.6	4.0	3.6	0.7	1.0	0.9	1.0	0.7
Expenditures	26.2	27.9	27.6	27.4	28.7	6.2	7.1	6.8	8.7	5.7
Current (other than interest)	20.5	20.7	21.7	21.1	22.8	5.3	5.4	5.3	6.8	4.8
o.w. transfers & subsidies	8.2	9.4	8.7	8.4	8.8	2.0	2.2	2.2	2.4	2.0
wages & salaries	4.9	5.4	5.7	5.8	6.3	1.0	1.6	1.7	2.1	1.2
Interest payments	1.7	1.9	1.6	1.9	1.5	0.2	0.7	0.1	0.5	0.1
Capital	5.3	6.0	4.9	4.9	4.8	0.9	1.1	1.5	1.4	0.6
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
Net lending	-1.1	-0.6	-0.5	-0.5	-0.5	-0.1	-0.1	-0.1	-0.2	0.1
Fiscal Balance (accrual)	-5.8	-5.2	-4.7	-4.0	-3.9	-1.0	-1.0	-0.7	-1.3	-0.2
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
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

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