



THE KYRGYZ REPUBLIC: RECENT ECONOMIC DEVELOPMENTS

2007

SUMMARY

The last quarter of 2007 was very intense with political activity. A new Parliament was elected based on a new Constitution approved by national referendum in October 2007. The elections were held on purely party based system, and the pro-president party won over two thirds of seats with only two other parties sharing minority of seats. The most popular opposition party was excluded from parliament for not reaching the vote threshold in one southern region. By end of 2007 a new Government was formed, including many ministers from the previous one.

Macroeconomic performance for 2007 was remarkable with the highest growth since 1997 and the best fiscal performance since independence. However, 2007 was also marked by a sharp and significant increase in consumer prices (20%) – reflecting particularly the increase in food prices. Due to continued appreciation of the som against US dollar and rising prices, REER appreciated towards end of year. Banking credit grew rapidly reaching 15% of GDP. Though current account deficit widened further (19% of GDP¹) the balance of payments remained strong with international reserves growing to record high. Fiscal position for 2007 was balanced thanks to solid growth of revenues and a tight expenditure policy.

1. GROWTH

Real GDP increased by 8.2% in 2007 with construction (20%), commercial services (17.6%) and non-gold industry (10.7%) as the key driving sectors. This high growth occurred despite a decline in gold production and slow recovery of agriculture.

¹ National Bank is revising current account data to include estimations of re-exported goods, which probably will reduce current account deficit to the level less than 10% of GDP.

Industry (including gold) grew by 7.3%. Most of the industrial sub-sectors demonstrated strong growth this year, where major contributing sectors were energy (7.8%), textile (27%), food (4.3%), and production of construction materials.

Agricultural output grew modestly by 1.5%, which was even lower than in previous year. Livestock demonstrated stable growth, while crop production growth was slow and unstable due to declining productivity of grains and reduced allocation of land to key export crops.

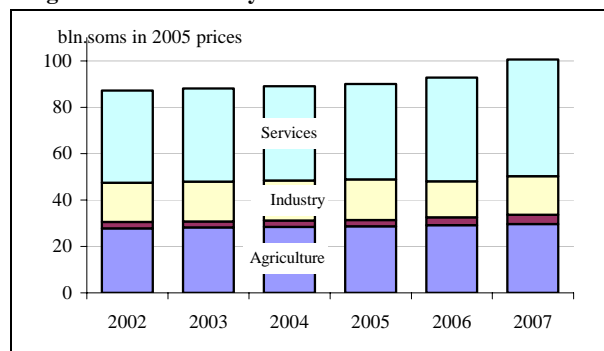
Table 1: Real GDP growth rate

	2003	2004	2005	2006	2007
GDP	7.0	7.0	-0.2	3.1	8.2
GDP excl. gold	5.4	7.6	1.9	5.7	8.7
Agriculture	3.2	4.1	-4.2	1.7	1.5
Construction	-2.2	5.4	17.6	19.1	20.2
Industry	15.6	2.7	-13.4	-10.9	7.3
Industry excl. gold	7.0	4.7	-6.0	3.6	10.7
Services	7.3	11.9	8.4	9.0	12.4

Source: NSC

Construction demonstrated a strong 20.2% growth. Housing construction took 28% of total fixed investment followed by mining (16%), communication (13%), manufacturing (11%), and energy (8.5%).

Figure 1: Real GDP by sectors



Source: Calculations based on NSC data.

Growth of **fixed investment** was modest - only 3%. Companies own funds (48%) and households' savings (23%) were the main sources of finance. Geographically, allocation of

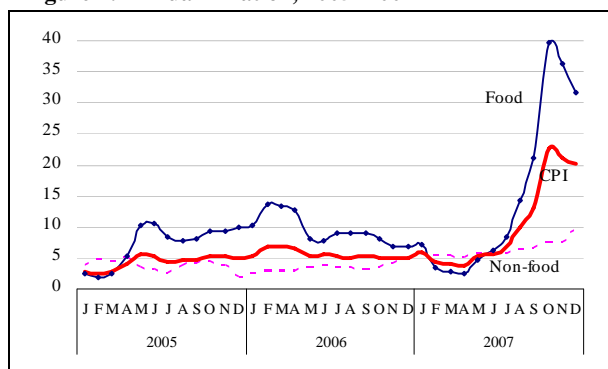
fixed investment was mostly concentrated in the north part of the country (84%).

Services grew by 12.4% in real terms which was mainly provided by strong growth of trade (11%) and transport/communication (44%). In total, real growth of commercial services reached 17%, while public services stayed stagnant.

2. PRICES

The sharp increase in consumer prices was a notable feature of 2007. **Consumer prices** increased by 20.1% (Dec 07 to Dec 06) compared with 5.1% in 2006, due to increased prices of food products (bread, flour, cooking oil, meat, vegetables) and some services.

Figure 2: Annual inflation, 2005- 2007



Source: Staff calculations based on NSC data

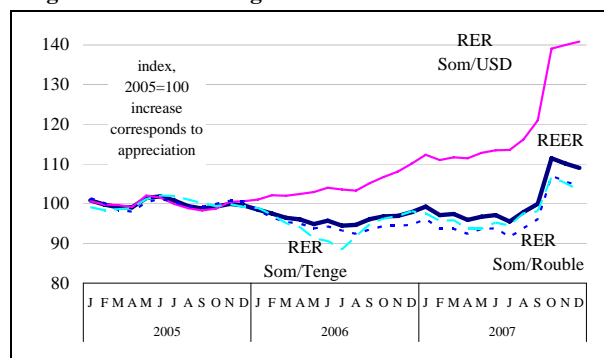
Producer prices in agriculture grew by 24.5% over 2006, reflecting sustained internal and foreign demand for bakeries, vegetables, milk and meat. Producer prices in industry grew by 20.5% since December 2006, mainly due to price increase in food, energy, chemical and construction materials sub-industries.

Average **wages** in 2007 increased by 31% over 2006, which has exceeded equivalent of 100 US dollars per month. This was due to increase of wages for public servants in the beginning of the year, and increase of wages in the strongly growing sectors such as trade, communication and transport.

The real effective exchange rate as well as nominal rate appreciated sharply in September and October 2007 as soon as the NBKR weakened the almost fixed nominal rate policy maintained since March 2007. Real appreciation of the som against US dollar was the strongest,

while real appreciation of the som to currencies of Russia and Kazakhstan was comparable with REER appreciation.

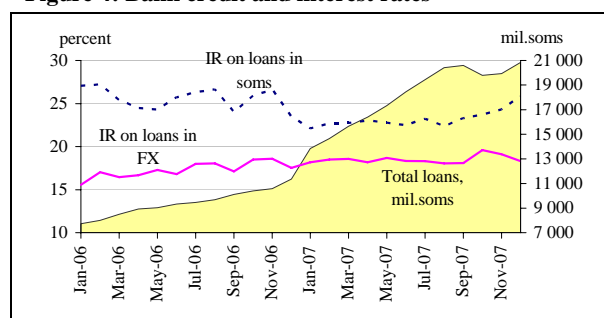
Figure 3: Real exchange rate



Source: Staff calculations based on NBKR data

Although still high, the average weighted **interest rate for bank loans** in national currency declined to 23% in 2007 against 26% recorded in 2006. Interest rates for loans in foreign currencies averaged 18% in 2007, which was slightly higher than a year ago. However, banking lending continued to grow rapidly (84% growth compared to end-2006²) to reach 14.9% of GDP, of which 2/3 were provided on a long-term basis mainly due to increased housing lending. Nevertheless, lending appeared to be slowing in September-October as a result of the impact of the sub-prime crisis in international markets.

Figure 4: Bank credit and interest rates



Source: NBKR

Distribution of the banking credit among sectors didn't change much with trade taking 38% of total credit stock, and followed by mortgage (16%), agriculture (12%), and construction and industry (each 7%).

The stock of deposits grew by 39% in 2007 and reached 16.8% of GDP. Only 12% of deposits

² The numbers are exaggerated since Ayil Bank (which specializes in agricultural credit) was granted a banking license at the end of 2006. Without Aiy Bank loans increased by 55%.

were put in banks on a long term basis, which limits basis for longer lending. Banks have done some progress in attracting household savings, which was demonstrated by growth of private deposits by 51% over 2007. About 52% of bank deposit stock was in foreign currency by end-2007, compare to 66% in end-2006 due to depreciation of the US dollar.

3. EXTERNAL SECTOR

Preliminary BOP data indicate that the **current account** deficit for 2007 grew to 19.5% of GDP due to continued rapid growth of imports in goods and services (by 47%). Export performance was also solid with a 40% increase driven by non-gold items. The growing trade deficit was counterbalanced by increased inflow of migrants' remittances (by 30%).

Table 2: Current account, mln.USD

	2003	2004	2005	2006	2007
Current account	-43	29	-29	-380	-734
<i>as % to GDP</i>	-2.2	1.3	-1.2	-13.3	-19.5
Exports (fob)	590	733	687	811	1 151
Gold	260	287	231	206	225
Imports (fob)	723	904	1 106	1 792	2 724
Exports of services	158	210	256	374	514
Imports of services	160	224	291	461	591
Net income	-62	-102	-75	-28	-68
Interest payments	-27	-37	-36	-18	-34
Current transfers	154	315	500	716	985
Remittances inflow	143	307	514	749	1 020

Source: NBKR preliminary data

Merchandise exports increased by 42% in 2007, driven by non-gold export items. Gold exports recovered in 2007, but solely due to gold price increase, since export volumes were still lower than in 2006. Among non-gold items food and oil exports have shown strongest performance (69 and 88% growth, respectively).

Merchandise imports (fob) increased by 52% and reached record high 2.7 bln.US dollars, reflecting strong growth of food (57% growth), intermediate goods (49%), and energy (44%). Import of oil products increased by 47% driven exclusively by volume growth. About 35% of imported oil products were re-exported, mainly to Afghanistan. Growth of investment goods import by 23% was significantly induced by VAT exemption on the import of fixed assets in form of technological equipment and machines.

In financial account FDI and long term loans played main role in financing the current account deficit. Net foreign borrowing of the private sector was notably higher in 2007 than that of the public sector. However, reflecting problems in statistical coverage, 'Errors and omissions' were on the rise and were of magnitude of the current account deficit.

Table 3: Financial account, mln.USD

	2003	2004	2005	2006	2007
Financial account	-14	134	21	323	336
FDI, net	46	132	43	182	225
LT loans, net	-14	49	18	62	108
Public sector	34	56	17	54	44
Private sector	-48	-7	1	8	63
ST flows, net	-46	-46	-40	79	4
Errors & Omissions	67	-25	58	283	664
Internation.reserves	389	565	612	817	1 177
<i>in months of imports</i>	4.1	4.9	3.3	3.0	3.0

Source: NBKR preliminary data

International reserves rose to a historical high US\$ 1177 million at end 2007, which covered 3 months of imports. A conservative borrowing policy kept external debt at US\$ 2.3 bln (end-2007), which was equivalent to 62% of GDP. External debt service was modest, absorbing about 6% of exports.

4. GENERAL GOVERNMENT BUDGET

The fiscal outturn for 2007 demonstrated significant improvements in government's positions. Due to considerable increase of revenue the government managed to reach, for the first time during the independence, almost balanced budget execution, accompanied by sizeable increase in expenditures.

General government revenue increased to 30.8 percent of GDP, which was by 4 percentage points higher than in 2006. The most significant contribution to this increase was made through an improvement in tax collections, which ensured about 60 percent of this increase, mainly due to VAT and custom duties. Another important source of revenue growth was rise of PIP grants that more than doubled compared to 2006.

Table 4: General government budget, % of GDP

	2004	2005	2006	2007
Total revenue	23.5	24.7	26.8	30.8
Taxes	18.3	20.0	21.6	22.9
Income & profit tax	2.7	3.3	2.9	2.9
VAT	7.2	7.0	8.1	9.1
Excises	1.3	1.1	1.1	1.0
Customs	0.5	1.6	2.5	2.7
Payroll	3.5	3.8	4.0	3.9
Others	3.1	3.1	3.2	3.3
Non-tax and Capital Grants	4.0	3.7	4.3	5.6
Grants	1.2	1.0	0.8	2.3
Total expenditure	27.9	29.0	30.0	30.8
Current	23.0	24.2	25.5	23.5
Wages	5.8	6.3	5.9	7.1
Transfers&subsidies	8.4	8.7	8.9	8.5
Interest	1.9	1.5	1.3	0.6
Goods and services	6.9	7.7	9.3	7.3
Capital	4.9	4.8	4.5	7.3
Foreign financed PIP	3.8	3.8	3.4	2.7
Net lending	-0.5	-0.4	-0.2	0.1
Balance	-3.9	-3.8	-3.1	-0.03

Source: MEF and WB staff calculations

The **general government expenditure** reached 30.8 percent of GDP, which was again the biggest achievement since independence. Among recurrent expenditures, wages and salaries grew the most rapidly, reflecting the government's strong commitment to stop the long-term erosion of public servants real

earnings and offset the effects of inflation. Besides this, the government enormously increased capital spending – almost 5 times higher than 2006 level. Partly it was explained by big construction works done for Shanghai Cooperation Organization summit that took place in mid 2007, but also because of activating other investment activities.

5. MAIN LEGISLATIVE CHANGES

with an economic impact in October-December 2007

- **The resolution of the Government “On order of entrepreneurs inspections procedure”** (*November 6, 2007 #533*)

By this Resolution the Government approves a Regulation on order of the procedure for conducting inspection of entrepreneurs, approves the list of the authorized bodies (23 bodies in the list) having the right to conduct inspections, determines the Ministry of Economic Development and Trade as an authorized public body for entrepreneurship support and development. The Regulation is developed on the base of the Law of the KR “On entrepreneurs’ inspections procedure” (May 25, 2007). It regulates legal relationship concerned with the single order regulation and entrepreneurs’ inspections by the authorized bodies as well as determines the rights and obligation of such bodies.

- **The resolution of the Government “On VAT registration threshold”** (*December 12, 2007 #628*)

Starting from January 1, 2008 the Government determines the VAT registration threshold in amount of 4 mln. som for all business objects. For flour, bread and bakery producers and sellers the VAT registration threshold is 5 mln. som.

- **The resolution of the Government “On determining an immigration quote by Bishkek City, Osh City and the regions of the Kyrgyz Republic for 2008”** (*December 21, 2007 #615*)

This Resolution determines an immigration quote that establishes the limit number of foreign citizens and those without citizenship for immigration to the Kyrgyz Republic. The quote for the whole Republic is 2000 people, including for Bishkek City – 612 people, for Osh City – 50 people.

- **President Decrees “On increasing wages”** (*December 6, 2007 #540, #541, #542*)

The President of the Kyrgyz Republic decides to raise wages of workers of culture and health sectors, and workers of social protection institutions, whose payments are determined by the Single Tariff Scale, by 30 percent starting from January 1, 2008.

Kyrgyz Republic: Key macroeconomic indicators

	1999	2000	2001	2002	2003	2004	2005	2006	2007
									<i>prel.</i>
GDP and prices									
GDP real growth (%)	3.7	5.4	5.3	0.0	7.0	7.0	-0.2	3.1	8.2
Non-gold GDP growth (%)	4.0	4.8	4.1	3.1	5.4	7.6	1.9	5.7	8.7
GDP, mln soms	48 744	65 358	73 883	75 367	83 872	94 351	100 899	113 800	139 749
GDP, mln US\$	1 249	1 370	1 525	1 614	1 933	2 218	2 461	2 855	3 764
GDP per capita dollar (at avg exchange rate)	255	279	308	324	384	436	478	550	718
Poverty headcount (% of population) ¹	64	63	56	55	50	46	43	40	..
Extreme poverty headcount (% of population)	23	33	25	23	17	13	11	9	..
GDP per capita, 1990=100	57	59	62	62	65	69	68	70	75
GNI per capita dollar (Atlas)	300	280	280	290	340	400	450	500	..
Inflation (% beginning-to-end of period, CPI)	39.9	9.6	3.7	2.3	5.6	2.8	4.9	5.1	20.1
Inflation (% average, CPI)	35.9	18.7	6.9	2.1	3.1	4.1	4.4	5.6	10.3
Deflator GDP (% to prev.period)	37.6	27.2	7.3	2.0	4.0	5.1	7.1	9.4	13.5
Wage, average (US\$ per month)	27	26	30	36	44	52	63	81	114
Pension, average (soms per month)	385	462	558	561	647	709	791	906	1 120
Exchange rate (som/US\$, end of period)	45.4	48.3	47.7	46.1	44.2	41.6	41.3	38.1	35.5
Exchange rate (som/US\$, avg of period)	39.0	47.7	48.4	46.9	43.7	42.7	41.0	40.2	37.3
REER (2000=100, end-period, up=appreciation)	116	98	106	107	101	96	95	94	104
Unemployment rate (% of labor force)	7.4	7.5	7.8	12.5	9.9	8.5	8.1	9.3	11.5
M2 (e.o.p as % of GDP)	13	11	11	15	17	21	21	28	31
External Sector									
Current account balance (% to GDP) ³	-14.7	-5.5	-1.2	-1.9	-2.2	1.3	-1.2	-13.3	-19.5
(mln US\$)	-183	-75	-18	-30	-42	29	-29	-380	-734
Exports (mln US\$, fob)	463	511	480	498	588	733	687	811	1 151
Power	52	80	47	22	19	22	21	25	33
Gold	184	197	227	163	260	287	231	206	225
Imports (mln US\$, cif)	614	559	472	640	716	941	1 101	1 723	2 429
Food	53	61	44	64	78	110	140	211	330
Other consumer goods	142	149	128	130	178	194	211	287	399
Energy	123	129	121	152	180	256	314	507	729
Other intermediate goods	137	113	121	125	152	217	245	332	494
Capital goods	160	107	58	116	128	163	191	386	476
External Debt (mln US\$)	1 673	1 712	1 722	1 785	2 018	2 100	2 024	2 184	2 336
Public External Debt (mln US\$)	367	413	1 436	1 579	1 809	1 949	1 883	1 980	2 077
External Debt (% to GDP)	134	125	113	111	104	95	82	76	62
Actual debt service to exports (%)	21	27	30	18	12	9	12	7	6
Worker's remittances (inflow, mln US\$)	1	44	24	49	113	285	482	731	1 020
Foreign direct investments (net, mln US\$)	44	-2	5	5	46	175	43	182	225
International reserves (mln US\$, end period)	249	261	285	317	389	565	612	817	1 177
General Government Budget (% of GDP)²									
Revenues and grants	20.4	18.5	20.4	22.7	22.9	23.4	24.7	26.6	30.8
Grants	0.6	0.9	0.8	1.1	0.6	1.4	1.0	0.8	2.3
Tax	12.3	12.3	12.4	13.9	14.2	14.8	16.2	17.6	19.0
Social fund contributions	4.0	3.7	4.0	4.2	3.5	3.5	3.8	3.9	3.9
Nontax and capital	3.5	1.5	3.2	3.5	4.6	4.0	3.7	4.3	5.6
Expenditures	32.0	28.1	26.2	27.9	27.6	27.4	28.5	29.7	30.9
Current (other than interest)	20.0	18.6	20.5	20.7	21.7	21.1	22.6	24.4	30.2
Transfers & subsidies	7.8	7.5	8.2	9.4	8.7	8.4	8.7	8.7	8.5
Wages & salaries	4.6	4.4	4.9	5.4	5.7	5.8	6.3	5.9	7.1
Interest payments	2.9	2.2	1.7	1.9	1.6	1.9	1.5	1.3	0.6
Capital	9.5	7.8	5.3	6.0	4.9	4.9	4.8	4.5	7.3
o.w. foreign financed PIP	8.4	6.5	4.4	4.7	3.7	3.8	3.8	3.4	2.7
Net lending	-0.4	-0.5	-1.1	-0.6	-0.5	-0.5	-0.4	-0.2	0.1
Fiscal Balance (accrual)	-11.6	-9.6	-5.8	-5.2	-4.7	-4.0	-3.8	-3.1	0.0
Memo:									
Primary Balance (w/o interest and PIP)	-0.3	-0.9	0.2	1.4	0.5	1.6	1.5	1.6	3.3
Primary Balance (w/o interest)	-8.7	-7.4	-4.2	-3.3	-3.2	-2.1	-2.3	-1.7	0.6

Sources: Ministry of Finance, National Statistical Committee, Social Fund, National Bank and World Bank staff calculations.

³ Poverty data is consumption based. Poverty data for 2003-06 are based on the Kyrgyz Integrated Household Survey.

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.