



THE KYRGYZ REPUBLIC: RECENT ECONOMIC DEVELOPMENTS

FIRST QUARTER OF 2008

SUMMARY

The first quarter of 2008 was politically quiet. The consolidation of power by the President with majority of seats in the Parliament held by pro-presidential party allowed the initiation of long awaited and high profile decisions and reforms, such as privatization of state owned enterprises in strategic sectors (energy, banking, telecommunication) and improvement of business environment (including introduction of the new Tax Code). Though the country managed to get through the very cold winter of 2008 without energy disruptions, electricity rationing started in March 2008. The fight against inflation (mainly by providing tax incentives for flour and bakery producers and importers) was one of the key issues that new Government had to deal with, since the inflation rate remained high.

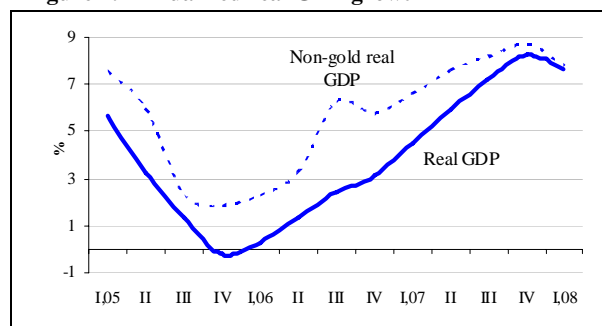
Economic growth in the first quarter of 2008 was not as strong as a year ago, but at still encouraging rate (6.1% growth of real GDP). Inflation in the first three months was high at 6.1% since December 2007 (or 25% in annual terms), led by food and services prices. The exchange rate remained relatively stable, and real appreciation that occurred in the second half of 2007 has reversed back somewhat. Bank credit growth was not high due to slower pace of bank lending. Current account deficit widened further (up to 9% of GDP compared to 4.4% in Q1 2007), and the international reserves declined slightly. The fiscal balance for Q1 2008 was estimated at a deficit of 0.5% of GDP¹ as a result of more than usual expenditures made in the period.

1. GROWTH

Real GDP grew by 6.1% based on services (8.2%) and the recovery of gold production by 14%. Agriculture, construction and non-gold industry contributed modestly to growth, with overall non-gold real GDP increased by 5.8%.

¹ According to IMF estimates.

Figure 1: Annualized real GDP growth



Source: Calculations based on NSC data.

Non-gold industry increased by 2.1% in real terms, which was considerably lower than in previous periods. This modest growth was mainly explained by decline in production of oil-products, non-gold mining and machinery sectors, while key driving sectors such as textile, food processing, and energy continued growing.

Agricultural output increased by 1.7%, and this was the continuation of sluggish developments that lasts since 2005.

Table 1: Real GDP growth rate

| | 2006 | 2007 | I'06 | I'07 | I'08 |
|---------------------|-------|------|------|------|------|
| GDP | 3.1 | 8.2 | 2.4 | 8.5 | 6.1 |
| GDP excl. gold | 5.7 | 8.7 | 6.7 | 10.9 | 5.8 |
| Agriculture | 1.7 | 1.5 | 0.9 | 2.0 | 1.7 |
| Construction | 19.1 | 20.2 | 26.1 | -0.6 | 2.2 |
| Industry | -10.9 | 7.3 | -8.2 | 2.2 | 4.2 |
| Industry excl. gold | 3.6 | 10.7 | 9.4 | 12.5 | 2.1 |
| Services | 9.0 | 12.4 | 8.3 | 14.2 | 8.2 |

Source: NSC

Construction slowed down in Q1 2008, due to slower dynamics of housing construction. Negative growth of **fixed investment** by 1.9% in real terms was mainly associated with the contraction of individual housing construction. Other sectors, such as manufacturing, trade and tourism, have seen solid growth in fixed investments. Nevertheless, housing construction constituted 26% of total fixed investment followed by manufacturing (15%), trade (12%), and energy (11%). Dominance of domestic

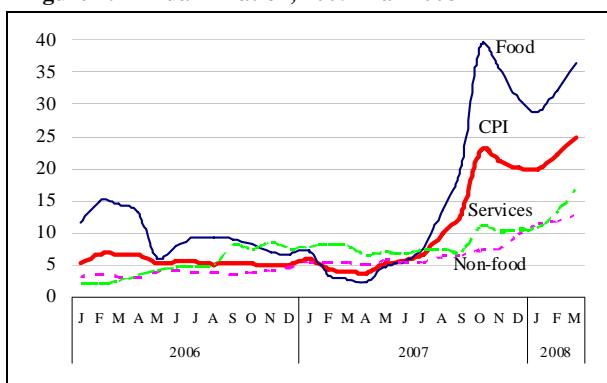
sources of investments remained (83% of total), where companies' own funds (38%) and households' savings (39%) are the main sources of finance.

Services grew by 8.2% in real terms which was mainly due to strong growth of transport / communication sector (44%). Growth of trade, the key sub-sector, slowed to 5.5% compared with average 10% annually since 2005.

2. PRICES

Inflation continued to be high in the first quarter of 2008 with CPI growing to 6.1% compared to end-2007 (2% in Q1 2007). In annual terms **consumer prices** increased by 24.9% (Mar 08 to Mar 07) compared with 4% a year ago. Prices for food (7.1% up since end-2007) were the main driver of overall price increase, though price for services also rose considerably (6.4%).

Figure 2: Annual inflation, 2005-Mar 2008



Source: Staff calculations based on NSC data

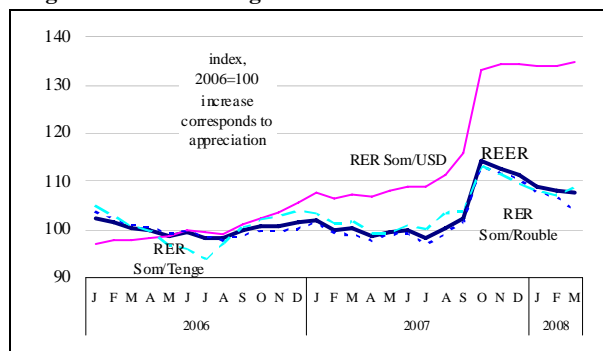
Producer prices in agriculture grew by 6.4% over the first quarter of 2008 reflecting sustained increased prices for grains and vegetables. Producer prices in industry grew by 14.4% since end-2007, mainly due to price increase in mining, food, and energy sub-industries.

Wages in Q1 2008 averaged 129 US dollars meaning no growth since Q4 2007. This was mainly related to seasonality of activities in key sectors such as agriculture and trade, where private sector dominates. The public sector enjoyed an increase in wages as a result of Government's decision to increase wages across all state institutions.

Real exchange rates stabilized after sharp appreciation happened in Sep-Nov 2007. Compared to December 2007 **real effective exchange rate** index depreciated by 3.6%

driven by real depreciation to Russian rouble (6%). Real appreciation of the som against US dollar remains the strongest, exceeding by more than 30% its level in 2006.

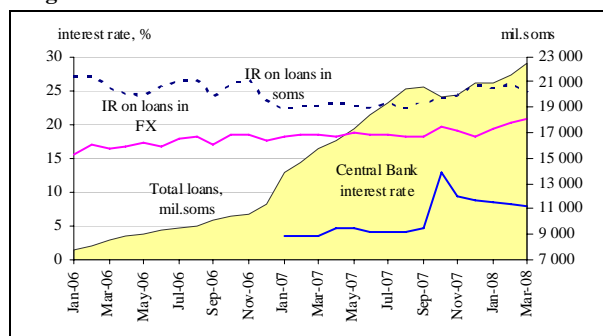
Figure 3: Real exchange rate



Source: Staff calculations based on NBKR data

Interest rate for bank loans both in national and foreign currencies were adjusted upward to reflect higher inflation. In the first quarter of 2008 interest rates for loans in som were high at 25% (compared with 23% in average in 2007), while interest rates for loans in foreign currencies averaged 20% in Q1 2008 (18%).

Figure 4: Bank credit and interest rates



Source: NBKR

Growth rates of banking lending slowed somewhat (8% growth since Dec 2007) as a result of the impact of the sub-prime crisis in international markets. Term composition and key borrowing sectors remained broadly unchanged with 62% of credits provided on a long term basis, and 2/3 of credits being provided to trade (36%), mortgage (14%) and agriculture (12%).

The stock of deposits in banks stayed stagnant in the first quarter of 2008 (16.1% of GDP). Analysis of the deposits structure shows continuation of de-dollarization process (49% of deposits were on foreign currency against 59% in Mar 2007) and contraction of stocks on checking accounts (55% of all deposits against 70% a year ago).

3. EXTERNAL SECTOR²

The **current account** deficit increased to 8.7% of GDP in the first quarter of 2008 compared with 4.4% in the same period of last year reflecting strong increase in imports. Despite recovery of gold exports, strong growth of import resulted in widening trade deficit that was partially offset by inflow of workers' remittances.

Table 2: Current account, mln.USD

| | 2006 | 2007 | I' 06 | I' 07 | I' 08 |
|---------------------|-------|-------|-------|-------|-------|
| Current account | -282 | -232 | -19 | -131 | -363 |
| <i>as % to GDP</i> | -9.9 | -6.2 | -0.8 | -4.4 | -9.2 |
| Exports (fob) | 906 | 1 337 | 202 | 300 | 272 |
| Gold | 206 | 225 | 62 | 51 | 76 |
| Imports (fob) | 1 792 | 2 635 | 310 | 504 | 738 |
| Exports of services | 379 | 684 | 62 | 95 | 181 |
| Imports of services | 461 | 582 | 70 | 136 | 177 |
| Net income | -43 | -56 | -18 | -35 | -50 |
| Interest payments | -20 | -26 | -3 | -4 | -5 |
| Current transfers | 730 | 1 020 | 116 | 150 | 150 |
| Remittances inflow | 762 | 1 065 | 122 | 162 | 164 |

Source: NBKR preliminary data

Merchandise exports declined by 9% in Q1 2008³. Gold exports recovered and reached 149% of its value in Q1 2007, mainly due to increase of world prices. Among non-gold items agriculture and textile export demonstrated positive performance, while energy export declined.

Merchandise imports (fob) increased by 47%, continuing rapid growth of textile, energy and food products, as well as investment goods. While increased import bill for food products and energy is explained by growing world prices, increased textile import was driven by re-export activities majority of which was not captured by official statistics.

As it was the case in previous periods, 'Errors and omissions' were the main financing item of current account deficit, given that financial account played modest role. Estimated net FDI inflow increased by 21%, thus becoming the second major foreign capital item after remittances.

² National Bank revised 2006 and 2007 commodity export data to reflect unrecorded portion of agriculture exports.

³ Q1 2008 export data does not include estimates of agriculture goods exports. Without the estimate export development was positive with 7% growth.

Table 3: Financial account, mln.USD

| | 2006 | 2007 | I' 06 | I' 07 | I' 08 |
|-----------------------------|------|-------|-------|-------|-------|
| Financial account | 328 | 305 | 80 | 86 | 53 |
| FDI, net | 182 | 179 | 11 | 46 | 67 |
| LT loans, net | 66 | 44 | 10 | 17 | 21 |
| Public sector | 54 | 28 | 8 | 4 | 12 |
| Private sector | 12 | 16 | 1 | 13 | 9 |
| ST flows, net | 79 | 82 | 60 | 23 | -34 |
| Errors & Omissions | 187 | 282 | -61 | 70 | 220 |
| Internation.reserves | 817 | 1 177 | 605 | 825 | 1 140 |
| <i>in months of imports</i> | 3.0 | 3.5 | 2.9 | 2.8 | 3.4 |

Source: NBKR preliminary data

Stock of international reserves slightly declined compared to end-2007, though covering 3.4 months of imports. Total external debt increased to US\$ 2.4 bln, which was equivalent to 55% of GDP. External debt service was modest, absorbing about 7% of exports.

Kyrgyz Republic: Key Macroeconomic Indicators

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2007 | 2007 | 2007 | 2007 | 2008 |
|---|--------|--------|---------|---------|---------|--------|--------|--------|--------|--------|
| | | | | | | I | II | III | IV | I |
| GDP and prices | | | | | | | | | | |
| GDP real growth (%) | 7.0 | 7.0 | -0.2 | 3.1 | 8.2 | 8.5 | 9.0 | 8.0 | 7.7 | 6.1 |
| Non-gold GDP growth (%) | 5.4 | 7.6 | 1.9 | 5.7 | 8.7 | 10.9 | 11.0 | 7.2 | 7.5 | 5.8 |
| GDP, mln soms | 83 872 | 94 351 | 100 899 | 113 800 | 139 749 | 22 242 | 27 626 | 48 687 | 41 195 | 28 144 |
| GDP, mln US\$ | 1 933 | 2 218 | 2 461 | 2 855 | 3 764 | 580 | 727 | 1 278 | 1 180 | 779 |
| GDP per capita dollar (at avg exchange rate) | 384 | 436 | 478 | 550 | 718 | | | | | |
| Poverty headcount (% of population) ¹ | 50 | 46 | 43 | 40 | .. | | | | | |
| Extreme poverty headcount (% of population) | 17 | 13 | 11 | 9 | .. | | | | | |
| GDP per capita, 1990=100 | 65 | 69 | 68 | 70 | 75 | | | | | |
| GNI per capita dollar (Atlas) | 340 | 400 | 450 | 500 | 600 | | | | | |
| Inflation (% beginning-to-end of period, CPI) | 5.6 | 2.8 | 4.9 | 5.1 | 20.1 | 2.0 | 2.5 | 5.5 | 8.9 | 6.1 |
| Inflation (% average, CPI) | 3.1 | 4.1 | 4.4 | 5.6 | 10.3 | | | | | |
| Deflator GDP (% to prev.period) | 4.0 | 5.1 | 7.1 | 9.4 | 13.5 | 5.3 | 6.9 | 18.7 | 17.2 | 19.3 |
| Wage, average (soms per month) | 1 916 | 2 203 | 2 570 | 3 270 | 4 637 | 3 404 | 3 904 | 3 958 | 4 637 | 4 658 |
| Wage, average (US\$ per month) | 44 | 52 | 63 | 81 | 133 | 89 | 103 | 104 | 133 | 129 |
| Pension, average (soms per month) | 647 | 709 | 791 | 906 | 1 120 | .. | .. | 1 120 | .. | .. |
| Exchange rate (som/US\$, end of period) | 44.2 | 41.6 | 41.3 | 38.1 | 35.5 | 38.1 | 38.0 | 36.9 | 35.5 | 36.4 |
| Exchange rate (som/US\$, avg of period) | 43.7 | 42.7 | 41.0 | 40.2 | 37.3 | 38.4 | 38.0 | 38.1 | 34.9 | 36.1 |
| REER (2000=100, end-period, up=appreciation) | 101 | 96 | 95 | 94 | 103 | 92 | 92 | 94 | 103 | 99 |
| Unemployment rate (% of labor force) | 9.9 | 8.5 | 8.1 | 9.3 | 11.5 | | | | | |
| M2 (e.o.p as % of GDP) | 17.5 | 20.5 | 21.1 | 28.4 | 30.8 | 26 | 29 | 29 | 31 | 21 |
| External Sector | | | | | | | | | | |
| Current account balance (% to GDP) ² | -2.2 | 1.3 | -1.2 | -9.9 | -6.2 | -4.4 | -2.0 | 2.3 | -3.1 | -9.2 |
| (mln US\$) | -42 | 29 | -29 | -282 | -234 | -131 | -62 | 77 | -118 | -363 |
| Exports (mln US\$, fob) | 588 | 733 | 687 | 906.0 | 1 337 | 300 | 308 | 354 | 376 | 272 |
| Power | 19 | 22 | 21 | 25 | 32 | 5 | 8 | 19 | 1 | 1 |
| Gold | 260 | 287 | 231 | 206 | 225 | 51 | 56 | 62 | 55 | 76 |
| Other | 312 | 424 | 435 | 675 | 1 080 | 244 | 244 | 272 | 319 | 195 |
| Imports (mln US\$, cif) | 716 | 941 | 1 101 | 1 723 | 2 429 | 488 | 555 | 628 | 758 | 786 |
| Food | 78 | 110 | 140 | 211 | 330 | 60 | 65 | 71 | 135 | 122 |
| Other consumer goods | 178 | 194 | 211 | 287 | 399 | 71 | 90 | 106 | 132 | 167 |
| Energy | 180 | 256 | 314 | 507 | 729 | 180 | 147 | 189 | 213 | 255 |
| Other intermediate goods | 152 | 217 | 245 | 332 | 494 | 87 | 125 | 133 | 150 | 97 |
| Capital goods | 128 | 163 | 191 | 386 | 476 | 91 | 128 | 128 | 129 | 145 |
| External Debt (mln US\$) | 2 018 | 2 100 | 2 024 | 2 184 | 2 282 | 2 172 | 2 216 | 2 269 | 2 282 | 2 408 |
| Public External Debt (mln US\$) | 1 809 | 1 949 | 1 883 | 1 980 | 2 077 | 1 977 | 1 989 | 2 052 | 2 077 | 2 188 |
| External Debt (% to GDP) | 104.4 | 94.7 | 82.2 | 76.5 | 60.6 | 73 | 71 | 66 | 61 | 55 |
| Actual debt service to exports (%) | 12 | 9 | 12 | 6 | 5 | 7 | 10 | 4 | 5 | 7 |
| Public external borrowing (excl. IMF, mln US\$) | 75 | 95 | 92 | 76 | 59 | 7 | 20 | 23 | 8 | 11 |
| Workers remittances (inflow, mln US\$) | 113 | 285 | 482 | 731 | 1 065 | 162 | 256 | 341 | 307 | 170 |
| % to GDP | 5.8 | 12.9 | 19.6 | 25.6 | 28.3 | | | | | |
| Foreign direct investments (net, mln US\$) | 46 | 175 | 43 | 182 | 178 | 46 | 34 | 79 | 20 | 42 |
| International reserves (mln US\$, end period) | 389 | 565 | 612 | 817 | 1 177 | 825 | 939 | 1 073 | 1 177 | 1 140 |
| General Government Budget (% of GDP)³ | | | | | | | | | | |
| Revenues and grants | 22.9 | 23.4 | 24.7 | 26.6 | 30.8 | 5.7 | 8.3 | | | |
| Grants | 0.6 | 1.4 | 1.0 | 0.8 | 2.3 | 0.1 | 0.6 | | | |
| Tax | 14.2 | 14.8 | 16.2 | 17.6 | 19.0 | 3.9 | 7.3 | | | |
| Social fund contributions | 3.5 | 3.5 | 3.8 | 3.9 | 3.9 | 0.9 | .. | | | |
| Nontax and capital | 4.6 | 4.0 | 3.7 | 4.3 | 5.6 | 0.8 | .. | | | |
| Expenditures | 27.6 | 27.4 | 28.5 | 29.7 | 30.9 | 5.2 | 8.1 | | | |
| Current (other than interest) | 21.7 | 21.1 | 22.6 | 24.4 | 30.2 | 4.7 | 7.1 | | | |
| Transfers & subsidies | 8.7 | 8.4 | 8.7 | 8.7 | 8.5 | 1.8 | .. | | | |
| Wages & salaries | 5.7 | 5.8 | 6.3 | 5.9 | 7.1 | 1.4 | .. | | | |
| Interest payments | 1.6 | 1.9 | 1.5 | 1.3 | 0.6 | 0.3 | .. | | | |
| Capital | 4.9 | 4.9 | 4.8 | 4.5 | 7.3 | 0.7 | 1.1 | | | |
| o.w. foreign financed PIP | 3.7 | 3.8 | 3.8 | 3.4 | 2.7 | 0.4 | 0.4 | | | |
| Net lending | -0.5 | -0.5 | -0.4 | -0.2 | 0.1 | -0.1 | -0.1 | | | |
| Fiscal Balance (accrual) | -4.7 | -4.0 | -3.8 | -3.1 | 0.0 | 0.5 | 0.2 | 1.0 | -1.8 | |
| Memo: | | | | | | | | | | |
| Primary Balance (w/o interest and PIP) | 0.5 | 1.6 | 1.5 | 1.6 | 3.3 | 1.1 | .. | .. | .. | |
| Primary Balance (w/o interest) | -3.2 | -2.1 | -2.3 | -1.7 | 0.6 | 0.7 | .. | .. | .. | |

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

¹ Poverty data is consumption based. Poverty data for 2003-06 are based on the Kyrgyz Integrated Household Survey.

² Preliminary data from the National Bank

³ The state budget consolidates central and local budgets and includes the foreign-financed public investment program and the deficit of the social fund.