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Kyrgyz Republic: 2006 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Structural Performance Criterion—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Kyrgyz Republic

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2006 Article IV consultation with the Kyrgyz Republic, third review under the Poverty Reduction and Growth Facility, and request for a waiver of a structural performance criterion, the following documents have been released and are included in this package:

- the staff report for the combined 2006 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Structural Performance Criterion, prepared by a staff team of the IMF, following discussions that ended on August 30, 2006, with the officials of the Kyrgyz Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 19, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;
- a staff statement of November 3, 2006 updating information on recent economic developments;
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its November 3, 2006 discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively; and
- a statement by the authorities of the Kyrgyz Republic.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of the Kyrgyz Republic*
Memorandum of Economic and Financial Policies by the authorities of the
Kyrgyz Republic*
Statistical Appendix
Technical Memorandum of Understanding*
*Also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

Staff Report for the 2006 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Structural Performance Criterion

Prepared by Middle East and Central Asia Department
(in cooperation with other departments)

Approved by David Owen and Scott Brown

October 19, 2006

- Discussions for the 2006 Article IV consultation and third review under the PRGF arrangement approved in February 2005 were held in Bishkek during August 15–30, 2006. The team comprised Messrs. Neuhaus (head), Naseer, Kumah, Ms. Morsy (all MCD), Messrs. Sadikov (PDR), Skaarup (FAD), and Solé (MCM). Mr. McHugh, the incoming resident representative, joined some of the meetings. Together with an overlapping World Bank team, the mission also discussed potential Completion Point triggers under the enhanced HIPC Initiative.
- The mission met President Bakiev; the Prime Minister and First Deputy Prime Minister; the Ministers of Economy and Finance and of Labor and Social Protection; the Chairman of the NBKR; other senior government officials; as well as parliamentarians and representatives of civil society and the business and donor communities.
- In recent years, macroeconomic policy has been generally consistent with the Fund's advice, but the track record on structural reforms and governance issues has been mixed. In concluding the 2004 Article IV consultation in November 2004, Directors commended the government for the prudent economic policies of recent years, after the emergence of severe imbalances stemming from the 1998 Russian crisis. They underscored, nonetheless, the need for further fiscal consolidation to underpin external debt sustainability. At that time, Directors also discussed the staff's Ex Post Assessment of Long-Term Program Engagement. In May 2006, the Board completed the second review under the PRGF arrangement on a lapse-of-time basis and endorsed the authorities' Second Annual Progress Report on their PRS and the staffs' JSAN.
- The attached Letter of Intent and Memorandum of Economic Policies (Attachments I and II) set out the authorities' economic program through end-2007.The authorities have requested completion of the third review and a waiver for nonobservance of an end-June 2006 structural PC.
- The Kyrgyz Republic has accepted the obligations under Article VIII Sections 2 (a), 3, and 4 of the Fund's Articles of Agreement, and maintains an exchange system free of restrictions on payments and transfers for current international transactions. The NBKR continues to maintain a managed float exchange rate regime. In line with their recent practice, the authorities have agreed to publication of this report.

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EXECUTIVE SUMMARY

The government has maintained macroeconomic discipline, despite lingering political tensions. Year-to-date performance under the PRGF-supported program has been good. Inflation has been in line with program projections and will likely remain below the 5.7 percent end-year target. Moreover, there are encouraging signs of a rebound in economic activity. All end-June quantitative targets were met—in some cases by wide margins—owing partly to buoyant tax revenue. All structural benchmarks have also been met to date. Staff supports the authorities' request for a waiver for nonobservance of the end-June structural PC on the transfer of Centerra shares to the State Property Fund, based on the remedial actions they have taken to effectively fulfill the spirit of the missed PC.

The policy discussions focused on the government's economic plans and structural reform priorities going forward and the supporting role expected from the Fund and other donors. They also touched on the opportunities and risks posed by proposals to boost development spending. The new Country Development Strategy seeks to spur private sector-led growth and poverty eradication in a low-inflation environment. To achieve these goals, the authorities plan to deepen reforms to remove structural bottlenecks and address governance issues, as well as to enhance the business climate and the transparency and efficiency of public sector operations.

The authorities' program for 2007 targets a decline in inflation to 4½–5 percent and output growth of 5½ percent. To that end, they will pursue a prudent monetary policy, maintain the managed floating exchange rate regime, and cap the primary and the overall fiscal deficits at about 3 percent of GDP. The government expects HIPC and MDRI debt relief to underpin debt sustainability and create fiscal space for additional poverty reducing spending.

The program envisages further improvements in tax administration and public financial management to support fiscal consolidation and enhance the quality and targeting of public spending. Staff stressed the need to carefully phase in the fiscal decentralization mandated by parliament, and to ensure that any additional development spending financed by asset sales or new external loans is of high quality and fully integrated into the budgetary process. The program also features further steps to enhance the operations of the central bank and modernize the financial system. Staff urged the authorities to secure approval of pending legislation to increase the central bank's autonomy, complete the revenue-neutral tax reform launched earlier this year, and introduce a best-practice tax code.

Staff considers the risks to the outlook—stemming mainly from an escalation of political tensions or internal pressures to relax fiscal discipline and slow the reform drive—to be manageable on balance. On this basis, it recommends completion of the third review under the PRGF arrangement.

I. Developments Since the late 1990s

1. The shock from the Russian financial crisis of 1998 and the authorities' weak policy response to it seriously destabilized the Kyrgyz economy in the latter part of the 1990s. The accommodating policy stance avoided a downturn in economic activity, at the expense of stubbornly high inflation and a spike in the fiscal and external current account deficits, financed by a rapid and unsustainable buildup in external public debt. The economic turbulence and lax enforcement of prudential requirements led to a number of bank failures as loan delinquency increased rapidly.

Selected Economic Indicators, 1997–2006

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
										Proj.
GDP per capita (U.S. dollars)	374	340	255	278	308	321	380	434	473	528
Real GDP (pct. change)	9.9	2.1	3.7	5.4	5.3	0.0	7.0	7.0	-0.6	4.0
Inflation (average, in percent)	23.4	10.5	35.9	18.7	6.9	2.1	3.1	4.1	4.3	5.7
Exchange rate (soms per U.S. dollar, average)	17.4	21.0	39.2	47.8	48.4	46.9	43.7	42.6	41.0	...
Poverty rate (consumption approach)	...	...	...	63	56	55	50	46	44	...
External current account balance (pct. GDP)	-7.8	-22.3	-14.8	-4.3	-1.5	-5.0	-4.1	-3.4	-8.3	-11.0
General government deficit (pct. GDP)	-9.3	-10.2	-12.0	-9.7	-5.2	-5.6	-4.9	-4.5	-3.9	-3.1
Official reserves (mos. g.n.f.s. imports)	2.2	2.8	4.6	5.3	4.5	4.3	4.1	4.9	4.1	4.1
External public debt (pct. GDP) 1/	51.2	72.3	109.4	111.1	99.8	98.8	98.5	88.2	78.6	71.7

Sources: Kyrgyz authorities, and Fund staff estimates.

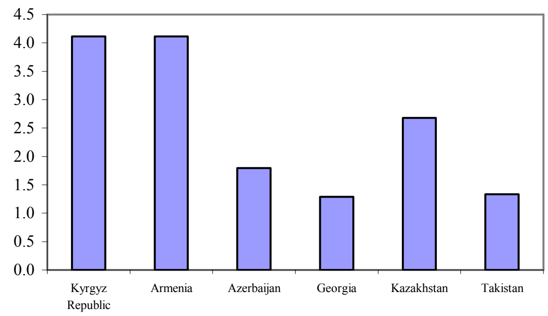
1/ Excluding debts owed by the Kumtor gold mine.

2. **From late 2001, however, the government reasserted macroeconomic discipline and established a good track record under successive PRGF-supported programs.** Identifying the external debt overhang as a fundamental constraint, the authorities launched a multi-year fiscal adjustment underpinned by improvements in tax administration, prudent spending and a streamlining of the Public Investment Program that had in part driven the debt accumulation, while seeking to create the conditions for a rise in private investment. A firm monetary policy helped reduce inflation and maintain a broadly stable nominal exchange rate.

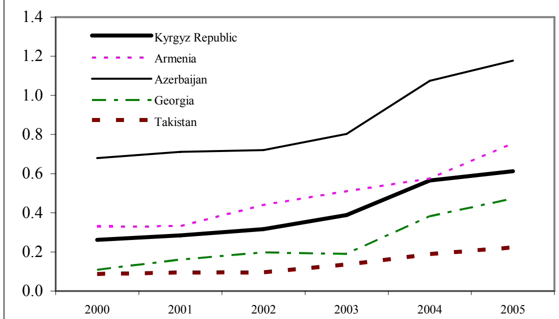
3. **The authorities also introduced market-oriented reforms to enhance prospects for economic and social development,** including price and trade liberalization, state enterprise privatization, and elimination of directed subsidized credits. As a consequence, overall economic performance improved, aided by a rapid rebound in activity in Russia and Kazakhstan and soaring international gold prices. Nevertheless, recurrent gaps in implementation of envisaged reforms and festering governance problems weakened the effectiveness and credibility of the Akayev administration, prompting its collapse during the March 2005 *Tulip Revolution*.

Economic Performance in the CIS Region in the early 2000s

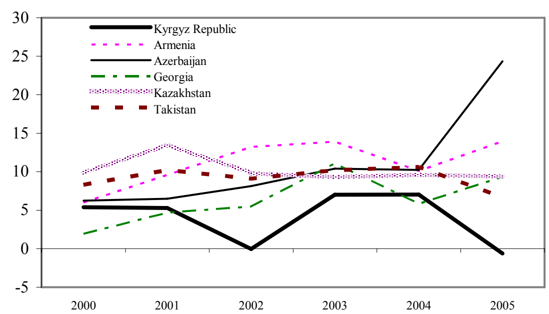
Gross International Reserves, end-2005
(In months of imports)



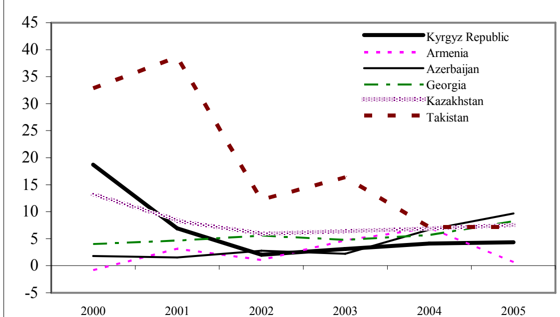
Gross International Reserves, 2000-05
(In billions of U.S. dollars)



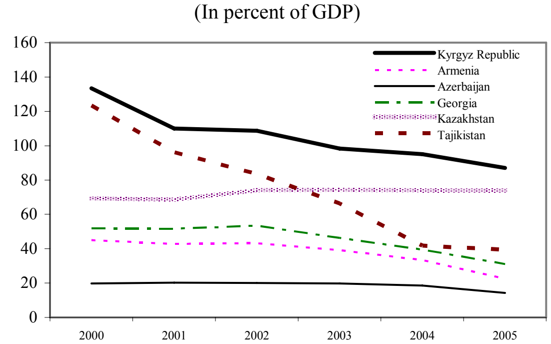
Real GDP Growth, 2000–05
(In percent)



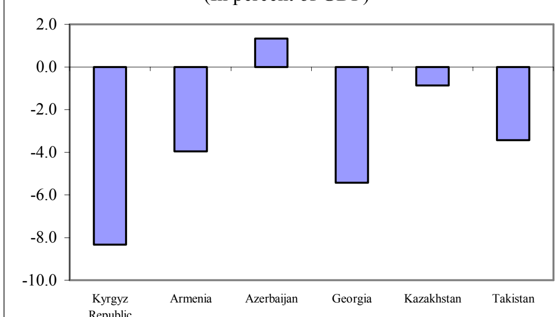
Inflation, 2000–05
(In percent)



Total External Debt, 2000–05
(In percent of GDP)



Current Account Balance, 2005
(In percent of GDP)



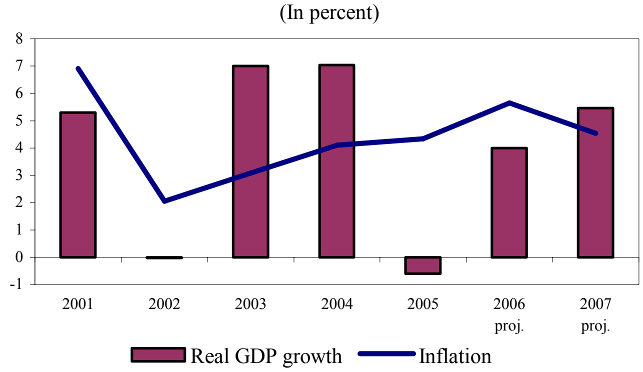
Source: Country authorities and Fund staff estimates.

II. RECENT PERFORMANCE UNDER THE PROGRAM

4. **Real GDP grew by 3.5 percent year-on-year during January–August 2006, after a small contraction last year;** excluding the Kumtor gold mine, which recently suffered a serious accident, output rose by 6.6 percent during the period. Inflation (5.1 percent in the 12 months ending August) has remained in line with the program. For the year as a whole, the authorities expect to keep inflation below the target of 5.7 percent, but they have scaled back their real GDP growth projection to 4 percent.

Real GDP Growth and CPI Inflation, 2001-07

(In percent)



Source: Kyrgyz authorities; and Fund staff projections.

Key Projections, 2004–07

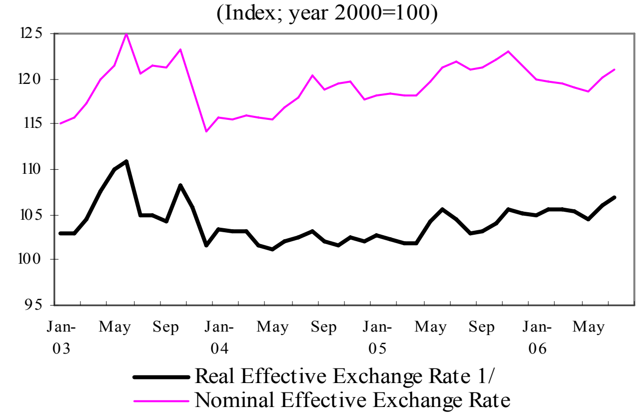
	2004	2005	2006		2007
	Actual	Actual	Prog.	Proj.	Proj.
Real GDP (percent change)	7.0	-0.6	5.0	4.0	5.5
Inflation (average, in percent)	4.1	4.3	5.7	5.7	4.5
External current account balance (percent of GDP)	-3.4	-8.3	-6.8	-11.0	-9.8
General government primary balance (excluding grants, percent of GDP)	-3.9	-2.8	-3.3	-2.9	-2.9

Source: Fund staff estimates and projections.

5. **Since early 2006, monetary policy has been conducted in an environment of stronger-than-expected foreign exchange receipts and continued remonetization.** Sizable unsterilized intervention has sparked a 40 percent increase in reserve money in the 12 months ending September, well above the program's indicative limits. Despite this intervention, mirrored in a rise in gross foreign exchange reserves to $690 million by end-September (4 months of projected 2007 imports of goods and services), the som has appreciated by 4.7 percent against the dollar since the beginning of the year; in real effective

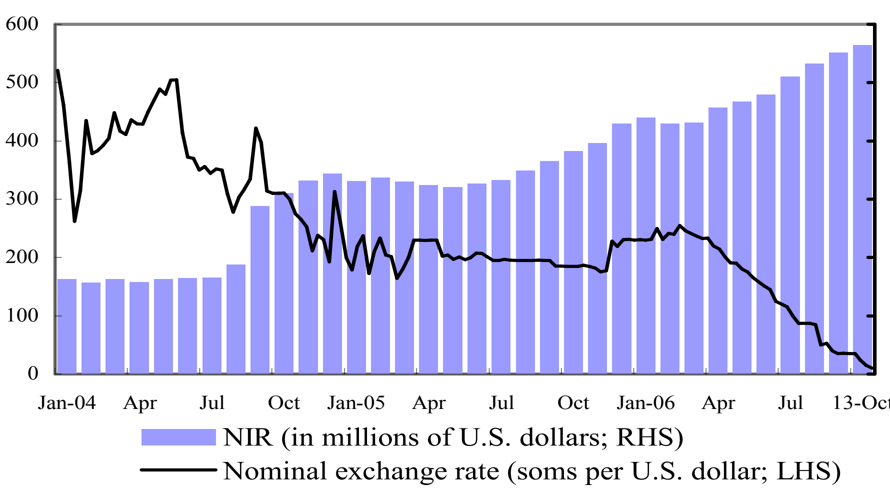
terms, it has appreciated by nearly 5 percent since end-2004. Private sector credit has grown rapidly in the year-to-date, albeit from a low base. Nonperforming loans have decreased from over 13 percent of total loans at end-2002 to 8½ percent in mid-2006, but their level has remained relatively high and edged up in recent months. The NBKR has gradually increased policy interest rates, which are now positive in real terms.

Effective Exchange Rate Developments, 2003-06
(Index; year 2000=100)



Source: INS database.
1/ Against 20 major trading partners. Increase indicates appreciation.

Net International Reserves and Nominal Exchange Rate, 2004-06



Source: Kyrgyz auhtorities.

6. **The external current account deficit has widened over the past two years, to an estimated 11 percent of GDP in 2006, despite a surge in workers' remittances.** The deficit is being financed by a rise in the net capital and financial account balance, resulting in a buildup in gross foreign reserves and a strengthening of the currency. Part of the current

account deterioration reflects a revision in the statistical series on shuttle trade, which was mirrored by a large increase in net financial capital inflows including errors and omissions.[1] Imports have increased rapidly, sparked by rising world fuel prices and strong demand for consumer goods and construction materials, buoyed by the recovery in nongold domestic activity. Despite persistently high world gold prices, gold exports have sagged due to a gradual weakening in the grade of the Kumtor mine pit under exploration and a recent accident in that mine. By contrast, nongold exports, which suffered from the political turbulence associated with the March 2005 revolution, have since recovered, driven by rapid growth in Russia and Kazakhstan.

Balance of Payments, 2004–07

(in millions of U.S. dollars)

	2004	2005	2006	2007
			Proj.	
Current account balance	-76	-203	-301	-302
Of which: Trade balance	-171	-419	-672	-723
Current transfers (net)	209	332	447	522
Capital and financial account (including errors and omissions)	166	252	421	406
Of which: Medium- and long-term loans, net	12	-40	62	78
FDI (net)	131	83	149	110
Overall balance	90	49	120	104
Of which: Increase in gross foreign reserves	161	81	112	92

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

7. **The PRGF-supported program remains on track.** All end-June quantitative performance criteria (PCs) were met, in some cases by wide margins (Table 1). In particular, the primary fiscal deficit before grants undershot the half-year target by 1 percent of GDP as a result of revenue gains from stricter tax enforcement at customs and robust import growth. Despite a faster-than-expected increase in current expenditure, total spending was in line with the program due to delayed execution of the investment budget. Based on preliminary third quarter data and the thrust of the supplementary budget that will shortly be sent to parliament, the authorities expect to comfortably meet the full-year primary deficit target (3.3 percent of GDP). Strong payroll tax collections allowed the Social Fund to clear old arrears and make nationwide pension payments current, despite a 2 percentage-point payroll tax reduction in January. The half-year indicative limit on the electricity sector's quasi fiscal

[1] There are indications that recorded workers' remittances may be underestimated (thereby overstating the current account deficit). An ongoing regional survey on immigration and remittances is expected to shed more light on this problem.

deficit (QFD) was met owing to rising cash collections, and the annual limit of 5.9 percent of GDP will also likely be met, aided by the unification of household tariffs in May 2006.

8. **All structural benchmarks through end-September 2006 were also met (**Table 3**).** The authorities are requesting a waiver for nonobservance of the end-June structural PC on transferring shares in the Centerra Canadian mining conglomerate (held by the Kyrgyzaltyn SOE) to the State Property Fund,[2] based on a legal finding that the transfer would not be feasible; they noted that an April 21 Kyrgyzaltyn board resolution—prohibiting Centerra share sales without government authorization and specifying that proceeds from any sales should be used in accordance with government guidelines—effectively fulfills the spirit of the missed PC.

III. Report on the Discussions

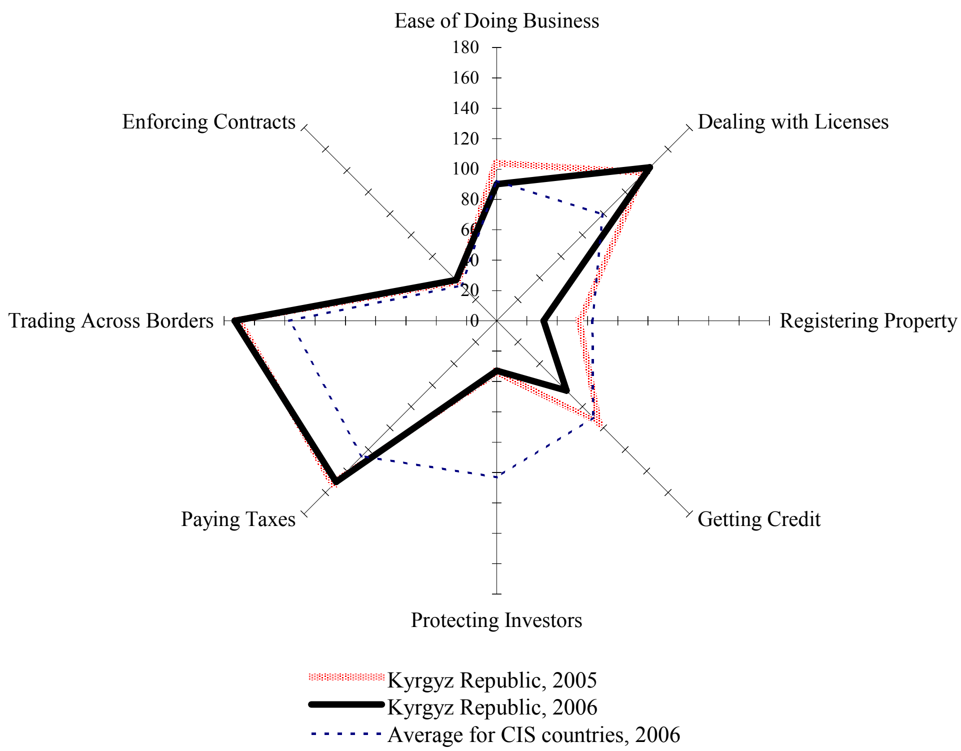
A. Overview

9. **The Article IV consultation discussions took stock of past economic performance and the upcoming challenges faced by the government in the remaining four years of its current term.** The discussions included a review of the government's macroeconomic plans and structural reform priorities featured in the updated poverty reduction strategy that is about to be finalized (now known as the Country Development Strategy (CDS)), as well as the supporting role expected from the Fund and other donors. They also touched on the opportunities and risks posed by evolving plans to boost development spending, sparked by the heightened expectations aroused by the *Tulip Revolution*.

10. **The authorities indicated that in the period ahead, they will seek to spur private sector-led growth in an environment of low inflation.** They plan, however, to maintain the macroeconomic stability that has become entrenched over the past several years, after the severe economic dislocations and a hyper-inflation episode experienced during the early years of independence. The government's economic strategy is anchored on initiatives to eradicate poverty and corruption, as well as to improve the business climate and the efficiency and transparency of public sector operations. Accordingly, fiscal space anticipated from debt relief under the enhanced HIPC Initiative and MDRI and from further strides in domestic resource mobilization will be accompanied by improvements in the quality of public spending. At the same time, the authorities expect to scale up and better target poverty reducing spending to facilitate achievement of the Millennium Development Goals (Table 16). An overarching challenge facing the administration is to defuse lingering political tensions and smooth relations with parliament, especially to secure passage of essential legislation.

[2] These shares are currently valued at $360 million or 13 percent of GDP.

Kyrgyz Republic: Indicators of the Business Climate, 2005–06 1/



Source: World Bank.
1/ The score on each item refers to the country's rank among all 175 countries surveyed in ease of doing business. Thus, a lower rank indicates a better business environment.

11. **The authorities indicated that the Kyrgyz Republic has a good potential for rapid economic growth in the coming years.** In this connection, they noted that it will be essential to maintain macroeconomic stability, deepen economic reforms, and diversify the economy to reduce its vulnerability to external shocks. Staff concurred with this assessment and stressed that fully exploiting this potential would also hinge importantly on stabilizing the political situation, asserting the rule of law, and continuing to tackle deep-seated governance issues. In this vein, staff projects average real GDP growth of 5.2 percent during 2006–11, on the back of a recovery in gold output from the problems experienced in 2005–06 and the coming on stream of new mines, as well as sustained increases in the nongold

manufacturing and services sectors underpinned by productivity gains and new investment.[3] Per capita income would then rise to $760 by the end of the decade, from about $280 in 2000.

12. **After launching a revenue-neutral tax reform early this year,[4] the authorities now plan to focus on further improvements in tax and customs administration that might eventually permit further rate reductions—especially of the onerous payroll tax.** In addition, the authorities are embarked on improvements in public financial management with donor assistance that should help improve the quality and targeting of outlays. In particular, they will take steps to improve budget preparation and execution and the tracking of poverty reducing and other outlays.

13. **Besides the ongoing financial system reforms described below, the government is also poised to add momentum to other growth and macrocritical reforms.** Several actions aligned with the CDS are envisaged to address deep-seated energy and mining sector problems; foster good governance and transparency; promote social development; and enhance the business climate,[5] while addressing sectoral bottlenecks in infrastructure and agriculture. Some of these reforms are expected to be fleshed out over the coming months as floating HIPC Completion Point triggers, with the expectation that they would be substantially completed by end-2008. The authorities are also considering further measures to improve labor market flexibility, in order to foster job creation and encourage legalization of the economy (MEP, ¶22).

B. Short- and Medium-Term Economic Policies

14. **The authorities' economic program for 2007 targets a decline in end-year inflation to 4½–5 percent and real GDP growth of 5½ percent, premised on a recovery in gold output and buoyant growth in agriculture, construction and services.** The monetary program assumes continued remonetization of the economy. It limits reserve money

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[3] For details, see the Preliminary HIPC Initiative Document (see IMF Country Report No. 06/147).

[4] The package included cuts in the corporate and personal income taxes and in the payroll tax, accompanied by hikes in the rates of motor vehicle, nonagricultural land (pending), and liquor excise taxes (see IMF Country Report No. 05/402).

[5] A February 2006 government order convened an inter-agency commission tasked with proposing measures to reduce barriers on business activities and streamlining the operations of law enforcement and regulatory bodies.

Box 1. Kyrgyz Republic: Sources of Growth, 1993–2011

The main findings of a standard growth accounting framework to analyze the country's growth experience and prospects are summarized below. The results need to be qualified, however, given the shortcomings in the database and the large (if declining) share of the underground economy. Growth is expected to rebound and average 5.2 percent a year in 2006–11, assuming continued fiscal consolidation to crowd-in the private sector and successful implementation of reforms, including to improve the business environment. This would improve employment opportunities and living conditions and reduce poverty in line with the CDS.

Sources of Real GDP Growth, 1993–2011

	1993–98	1999–2005	2006–11 Proj.
	(Period average, in percent)		
Real GDP Growth	-3.2	4.0	5.2
Factor accumulation	-1.6	1.1	2.0
Labor	-0.8	1.1	1.1
Capital stock	-0.8	-0.1	0.9
TFP growth	-1.6	2.9	3.3

Sources: Kyrgyz authorities; and Bank-Fund staff estimates.

- Output decline in the early 1990s was driven by capacity underutilization, factor diminution, and a decline in total factor productivity (TFP) stemming from the severe dislocations associated with the collapse of the USSR. Significant TFP gains spurred growth from the late 1990s.
- Growth during 2006–10 would be driven by continued factor accumulation and productivity increases. These dynamics are expected to be aided by fiscal consolidation and improvements in the business environment. Factor accumulation would contribute 2 percentage points and the TFP contribution to growth would increase to 3.3 percentage points, from a 2.9 percentage-point average in 1999–2005. The capital stock would grow at an annual average of 3 percent, providing a contribution to growth of 0.9 percentage points—a fourfold-increase from the average in 2001–05. Labor productivity would also increase somewhat, supported by improvements in skills acquisition (through enhanced on-the-job training), health conditions and greater labor market flexibility.

A staff sensitivity analysis (maintaining a 5 percent depreciation rate) shows that a 20 percent variation in the initial capital stock would impact little on the distribution of factor contributions to growth—yielding only a 0.2 percentage-point variation in medium-term real GDP growth. However, an annual one percentage-point shortfall in capital stock growth would yield a more than proportionate decline in output growth and limit medium-term factor accumulation and TFP growth.

growth to 22½ percent, consistent with broad money growth of 24 percent during the year and a gain in net international reserves that would keep end-year gross reserves at 4.3 months of projected imports of goods and services. The fiscal stance would be broadly unchanged from 2006, with a primary deficit before grants of just under 3 percent and a similar overall cash deficit, covered from external sources and privatization proceeds. As indicated in the attached Memorandum of Economic Policies (MEP), the program includes quantitative PCs and structural benchmarks through June 2007 and indicative end-year targets; the quantitative targets may need to be updated at the time of the 4th review under the arrangement early next year to reflect interim HIPC Initiative assistance after reaching the Decision Point.

15. **Influential political leaders and interest groups have been advocating a vigorous industrial policy,** including rehabilitation of obsolete Soviet-era plants and promotion of "strategic" sectors (e.g., fertilizer and cement plants). This would be accompanied by large investments in infrastructure, such as a rail link from China to Uzbekistan crossing the Kyrgyz Republic; expansion of power transmission lines; and installation of fiber-optics cables. These projects would possibly involve FDI or external loans that are at an advanced stage of negotiation. Furthermore, and echoing the public's expectations of rapid results—fueled by pent-up frustrations with the limited progress made by the previous government—there are political pressures for injecting an aggregate demand stimulus into the economy, especially through creation of a development fund to provide directed subsidized credits or top-up the public investment program, which could be financed with the proceeds from asset sales (especially the sizable public sector holdings of Centerra shares).

16. **Staff advised the authorities to limit direct intervention in the economy and focus on creating a business climate conducive to private-sector led growth.** It also urged them to carefully assess the viability of large infrastructure projects, with assistance from expert IFIs. Further, staff flagged the inherent risks of an active industrial policy (e.g., resource misallocation, forgone tax revenue, and rent-seeking), which would be exacerbated by the governance problems that remain to be tackled. More generally, staff underscored that any significant fiscal or credit stimulus financed by asset sales or external loans should be transparent and closely aligned with the annual economic programs to safeguard near-term macrostability and longer-term debt sustainability.

Fiscal and quasi-fiscal issues

17. **The 2007 budget bill sent to parliament in August, which is aligned with the CDS and the Medium-Term Budgetary Framework published last May, envisages further revenue gains stemming from stricter tax enforcement and passage of a pending bill increasing nonagricultural land taxes.** Staff urged the authorities to secure prompt passage of the best-practice tax code before parliament to underpin further improvements in tax administration (an end-March 2007 structural benchmark), and to resist political pressures to weaken the State Tax Inspectorate and the Large Taxpayers Unit (LTU) (broadening the

coverage of the LTU is an end-September structural benchmark). Despite the recent gain in tax receipts (which was, however, heavily tilted towards customs duties and VAT on imports—partly reflecting better customs administration and introduction of simplified procedures for shuttle traders), there is scope for further strengthening the Kyrgyz tax effort, as evidenced by a comparison with the experience of several other CIS countries.

Total General Government Tax Revenue
(Including social security contributions)

(In percent of GDP)

	2004	2005	Rank (2005)
Armenia	16.6	17.6	9
Azerbaijan	22.7	26.9	5
Georgia	18.2	19.8	8
Kazakhstan	22.3	26.8	6
Kyrgyz Republic	**18.3**	**20.2**	**7**
Moldova	29.8	32.3	3
Russia	36.1	40.8	1
Tajikistan	15.2	16.0	10
Ukraine	29.1	33.9	2
Uzbekistan	28.7	28.4	4

Sources: Country authorities; and Fund staff estimates.

18. **The budget's expenditure envelope features an average 10 percent increase in government wages and pensions**, which are still relatively low, and a rise in capital spending in relation to GDP (MEP, ¶12–14). Social spending is expected to increase to 15¾ percent of GDP, from a projected 15½ percent in 2006, and priority expenditures could be topped up if interim assistance under the HIPC Initiative becomes available in 2007. To cushion the effect on vulnerable groups of phased adjustments in power tariffs during the year (see below), the budget includes a social safety net equivalent to 0.4 percent of GDP. As part of the ongoing civil service reform, the authorities intend to reduce the civilian workforce (currently estimated at 25,000 persons) by about 10 percent over the next two years and to introduce performance-based competitive salaries for key personnel, while keeping the wage bill broadly constant relative to GDP over the medium term. Moreover, the government plans to implement a Public Financial Management (PFM) action plan over the next two years prepared in consultation with donors, focusing on strengthening budget transparency and enhancing the tracking, monitoring, and reporting of poverty related spending (an end-June 2007 structural benchmark).

19. **Parliament has mandated a gradual reduction in the retirement age with potentially serious longer-term fiscal consequences, and overturned the June 2006 presidential veto to that bill.** Faced with this stalemate, the government is refusing to enforce this legislation and seeking World Bank assistance to design a broader pension reform, possibly including a voluntary private pension pillar (Box 2). Besides helping ensure the longer term financial viability of a downsized pay-as-you go system, the authorities expect the reform to strengthen domestic savings and spark capital market development. Staff stressed the need for a broad political consensus on the way forward, following an ample debate on the trade-offs between lowering the retirement age, raising pension benefits and further lowering payroll taxes.[6] Should a fully funded private scheme emerge as a consensus centerpiece of the reform, it would need to be phased in gradually to limit the transitional fiscal costs.

20. **Parliament also passed a bill in 2003 mandating far-reaching fiscal decentralization, a dormant measure slated to gather pace from 2007** (MEP, ¶15). The plan is to move to a two-tier system comprising the center and local communities—effectively bypassing the provincial (*oblast*) and municipal governments—to increase the scope for decision-making at the grassroots level. The authorities see this as a political imperative, despite the teething problems that will likely emerge. To safeguard macroeconomic stability, staff advised them to phase in the process carefully and at a measured pace, *pari passu* with the buildup in local government capacity, including strengthening PFM at the local level and a clear demarcation of revenue sharing and expenditure responsibilities of each government tier. Introducing a harmonized framework for fiscal coordination and general government reporting would further facilitate the transition to the two-tier system.

21. **The energy sector action plan just submitted by the authorities (as an end-September structural benchmark) features measures to put the sector's financial position on a sound footing, deliver reliable power supplies, and create the basis for significant energy exports to neighboring counties** (MEP, ¶16). A principal goal is to reduce the electricity sector's QFD to 5½ percent of GDP in 2007 (an indicative program target).[7] This should be achieved through phased adjustments of tariffs from late 2006 to reach cost-recovery levels by 2010, and supporting steps to strengthen utility bill collections, reduce technical losses and theft, and increase private participation in the distribution

[6] In line with the priority it attaches to job creation, the government will reduce the payroll tax by 2 percentage points in two equal steps in April and October 2007, to 27 percent, bringing it closer to the 25 percent medium-term target.

[7] According to the updated methodology on cost recovery tariffs agreed between the authorities and the World Bank, the historical QFD series has been revised upwards and the 2006 deficit is now projected at 7.4 percent of GDP (vs. the original forecast of 5.9 percent).

Box 2. Kyrgyz Republic: Pension Reform Issues

The foundations of the current pension system were set with World Bank assistance in 1997, comprising the gradual introduction of a notional defined contribution system, a minimum guaranteed pension (12 percent of the economy-wide salary) for all retirees, and stronger links between contributions and benefits. These measures were supported by a phased increase in the retirement age from 60/55 years (men/women) to 62.7/57.7 years at present and 63/58 years by 2007.

Earlier this year, however, parliament overturned a presidential veto on a bill lowering the retirement age to its previous level by 2008. Realizing that this would jeopardize the pensions system's long-term viability, the government has so far not enforced the bill (estimated to entail an annual average cost of ¾ percent of GDP over the next four years, rising further over time). More generally, easing retirement would run counter to international pension reform trends, including in the CIS region as indicated in the comparator data below, and complicate the achievement of the government's twin goals of further reducing payroll taxes and enhancing pension benefits over time.

Retirement Age in CIS Countries

	Men/women	Year
Armenia	63/63	2005/2011
Azerbaijan	62/62	2000/2012
Belarus	60/55	1999
Georgia	65/60	1995
Kazakhstan	63/55	2002
Kyrgyz Republic	**63/58**	**2007**
Moldova	65/60	2009
Russia	60/55	N.A.
Tajikistan	63/58	2003
Turkmenistan	62/57	1998
Ukraine	60/55	1992
Uzbekistan	60/55	1994

Source: Country authorities.

The authorities are exploring the option of introducing a funded pillar to the pension system in 2008, which would entail annual fiscal costs roughly estimated as rising from 0.1 percent to 0.5 percent of GDP during 2009–13, and stabilizing at that level until the system fully matures. This scenario would include a gradual increase in the funded component of payroll tax contributions by 6 percentage points and a gradual reduction by 5 percentage points in the pay-as-you-go component. The World Bank has cautioned the authorities on the risks of introducing a funded pension pillar before the prerequisites are fully in place, including a robust financial market and capacity-building in portfolio management by participating institutions.

The fiscal costs of the funded pension pillar could be mitigated by increasing the minimum years of payroll tax contributions for those seeking retirement or introducing base-broadening measures. For example, a permanent increase in the coverage of payroll tax collections from a projected 24.5 percent of the economy's wage bill in 2006 to about 26 percent would raise revenues by about ¼ percent of GDP. As a separate element of a broader pension reform, the option of early retirement with reduced pensions could be considered as a step to lessen pressures for reducing the general retirement age.

utilities. Meanwhile, the authorities are also reviewing World Bank proposals to strengthen the financial position of the gas and coal sectors, possibly including the automatic pass-through of gas import costs and competitive tendering for multi-year procurement of imported fuel.

Monetary and Financial Sector Policies

22. **The monetary authorities expressed satisfaction with the decline in inflation over the past several months, and saw the rapid growth in money and credit aggregates as a healthy manifestation of financial deepening.** In anticipation of a further rapid increase in credit to the private sector, the authorities will step up bank supervision, especially monitoring financial soundness indicators closely and taking prompt remedial measures as warranted. Nonbank financial institutions are also growing rapidly from a low base, and an Agency for Financial Surveillance and Reporting was created in 2005 to regulate pension funds, insurance companies, foreign exchange bureaus, and the securities market. The authorities indicated that they plan to refine money demand forecasts, particularly to better reflect the importance of dollarization and the large shadow economy. The NBKR will also broaden the menu of monetary control instruments and price these instruments more flexibly to keep liquidity expansion in check (MEP, ¶17). Increasing the NBKR's autonomy is key to underpin investor confidence, longer-term economic stability, and the momentum of financial sector reforms, but prospects for passage of the enabling legislation before parliament are uncertain.

23. **Although financial intermediation remains shallow by international standards, the authorities are making good progress in modernizing the financial system** (MEP, ¶18). In particular, they have embarked on a medium-term banking sector development strategy with MCM and World Bank assistance, comprising actions to modernize the payment system, nurture microfinance, and introduce a deposit insurance scheme in late 2008 (Box 3). In this connection, they have introduced a phased increase in bank capital requirements and continued to strengthen bank supervision. They also plan to transition to international capital measures and standards under Basel II guidelines after further implementation of the recommendations of the 2005 Basel Core Principles assessment. Initiatives under way include (a) establishment of a sounder legal foundation for use and for seizure (in case of default) of collateral, to foster mortgage and other term lending; and (b) preparatory steps towards introduction of an insurance scheme for small depositors by late 2008. The authorities are also planning to pave the way for the development of Islamic banking—so far virtually nonexistent in the country—in light of the interest of certain donors in financing these operations. In the coming months, the NBKR will issue enabling regulations on Islamic banking and train supervisors for its implementation, possibly with MCM technical assistance. The gamut of financial sector reforms will be reviewed by the joint Fund/World Bank FSAP update mission scheduled for October 2006.

24. **The authorities indicated that the small real appreciation of the som since end-2004 had not materially affected external competitiveness.** Staff concurred with this assessment, based on the sustained increase in nongold exports and other indicators, such as market shares and relative wage costs (Box 4). The officials noted that the managed exchange rate float had served them well in dealing with strong net foreign exchange receipts over the past months. In this vein, they expected to limit foreign exchange market intervention mainly to smoothing fluctuations and securing the programmed international reserve buildup. Staff cautioned that any significant aggregate demand stimulus (e.g., with proceeds from asset sales or external borrowing) could further exacerbate pressures towards a real appreciation of the currency, thereby underscoring the importance of buttressing competitiveness over the medium term through productivity gains and economy-wide wage moderation.

Kyrgyz Republic: Financial Deepening and Credit Expansion, 2005

(In percent)

	Financial deepening (end-period M2/GDP)	Credit expansion (end-period private sector credit/GDP)
Armenia	12.6	8.2
Azerbaijan	15.4	9.7
Georgia	16.5	14.8
Kazakhstan	27.7	36.4
Kyrgyz Republic	**21.3**	**8.0**
Moldova	43.1	21.2
Russia	33.3	25.7
Tajikistan	7.8	17.2
Turkmenistan	12.4	...
Ukraine	45.7	33.5
Uzbekistan	7.6	22.8

Sources: Country authorities; and Fund staff estimates.

External Sector Issues

25. **To avoid a new cycle of debt buildup as the country seeks external debt relief, the public sector will continue to refrain from nonconcessional external borrowing or guarantees.** The government will also ensure that any concessional public borrowing meets the 45 percent floor on the grant element specified in the program (MEP, ¶23). Staff underscored that the quality of large private investment projects in the pipeline should be carefully vetted to forestall the potential emergence of contingent public sector liabilities. The authorities are also taking steps to further enhance external debt management institutions and procedures, including capacity building and formulation of a new external debt management strategy by end-March 2007, a structural benchmark under the program (MEP, ¶24). To align the coverage of public debt with the requirements under the HIPC Initiative, the authorities are conducting a survey of nonguaranteed external debt of public enterprises.

Box 3. Kyrgyz Republic: Financial Sector Reforms, 2000–06

In the aftermath of the Russian financial crisis, which led to bank failures in the Kyrgyz Republic, the monetary authorities set up a debt and bank restructuring agency in 2000 as the sole liquidator of failed banks, and they have since taken steps to enhance the resilience of the financial sector to shocks. The authorities also adopted a regulatory response policy aimed at (a) ensuring transparency and predictability of regulatory enforcement, while making it less prone to discretion and arbitrariness; and (b) reducing political maneuvering to circumvent banking regulations. The broad reform agenda going forward includes steps to (i) encourage consolidation of the banking system; (ii) enhance bank supervision and the NBKR's autonomy; (iii) bolster the payment system; and (iv) enhance confidence in the banking system and foster further financial deepening. Specific actions in these areas are summarized below:

(i) **Consolidating the banking system:** In early 2006, the authorities increased minimum capital requirements on banks to som 60 million ($1.5 million); they are scheduled to rise further to som 100 million ($2.5 million) from January 2008. They have also strengthened their assessment of banks' compliance with prudential requirements.

(ii) **Enhancing bank supervision and the NBKR's autonomy**: The NBKR has taken steps to enhance bank supervision, including hiring highly qualified staff and upgrading staff training. In addition, it has developed a supervisory framework for market, country, and transfer risk as recommended by the September 2004 advisory mission of MFD (now MCM); the NBKR has since instructed banks to maintain adequate capital to cover these risks with effect from January 2007 and it has maintained close contacts with foreign bank supervisors, particularly in Russia and Kazakhstan. The NBKR has also introduced regulations for consolidated supervision to monitor risks faced by financial institutions, in line with the recommendations of the 2005 Basel Core Principles for Effective Banking Supervision Assessment. A bill before parliament seeks to amend the central bank charter to enhance its autonomy and ensure legal protection of its employees in performing official duties.

(iii) **Bolstering the payment system:** In 2006, the authorities formulated an action plan to develop the payment system, including payment of utility bills and salaries of civil servants through banks—to be subsequently extended to all payments to and from hospitals and schools. To support the gradual transition to payments through banks, the NBKR will commission a bulk clearing and cash processing center by end-November 2006, which will help extend the system of payments through banks to all public sector employees and enterprises. In addition, the NBKR is moving ahead with plans to develop a real-time gross settlement system with World Bank assistance, and it is preparing tender documents for general ledger development contracts to help develop a nexus of payments and depository functions and enhance interbank operations.

(iv) **Enhancing financial intermediation:** To boost confidence in the banking system and protect depositors, the NBKR is poised to introduce a deposit insurance scheme for small depositors by late 2008. Enabling legislation on deposit insurance has already been submitted to parliament and the NBKR has drawn up the modalities for commercial banks' participation; it has also estimated the level of protection, the total cost and the cost-sharing between banks and the government. To enhance debtor information gathering by lenders, the NBKR created a Credit Information Bureau in 2000, which was transformed (with donor assistance) into an independent credit bureau in 2003. Further, the authorities will issue a privatization tender for the Kyrgyz Agricultural Finance Corporation by end-2006. More generally, the pace of financial deepening will depend on progress in legal and judicial reforms, and establishment of effective contract enforcement mechanisms. The authorities plan to amend the civil, housing and land codes and the laws governing collateral, to harmonize provisions on collateralized lending by financial institutions and facilitate collateral seizure in cases of default.

(v) AML/CFT developments: New AML and CFT legislation entered into force in August 2006. The newly established Financial Intelligence Unit is proposing enabling amendments to the relevant criminal codes.

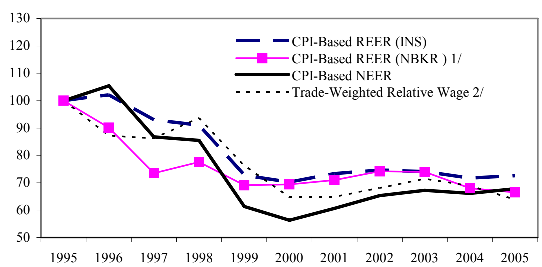
Box 4. Kyrgyz Republic: Competitiveness Indicators

- **Competitiveness in purchasing power parity terms seems to have changed little in the past half decade**, as the appreciation of the som against the dollar and the Chinese yuan was largely offset by the som's depreciation against the Russian ruble and the Kazakh tenge. In real effective terms, the som stayed broadly flat during the period. This came after a real appreciation in the mid-1990s (similar to the experience of other transition economies whose currencies had become increasingly undervalued), and a sharp depreciation during the 1998–99 Russian crisis. While the Fund's INS series is based on a simple average of 1999–2000 trade weights, the NBKR's nominal and real effective exchange rate index is built using a three-year moving average of trade weights excluding gold and energy exports.

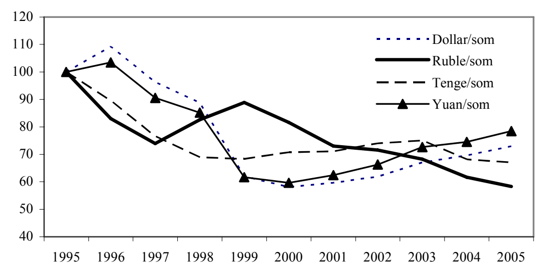
- Penetration of Kyrgyz exports in its three main trading partners (Russia, Kazakhstan and China), which together account for over two-thirds of total exports, increased in 2003–04 (after a slump in 2001). Part of this ground was lost in 2005, as Kyrgyz output and exports were buffeted by the March 2005 political developments, but preliminary half-year data for 2006 suggest that nongold exports have increased rapidly.

- Trade-weighted relative wage costs have remained broadly unchanged since 2000, and remain lower than during the preceding five years (within that period, Kyrgyz wage premia relative to the main trading partners during 1995-97 shifted into sizable relative discounts in the aftermath of the Russian crisis).

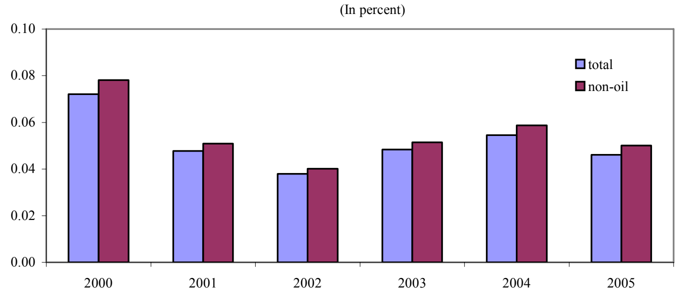
Kyrgyz Republic: Indicators of External Competitiveness, 1995-2005
(Indices, 1995=100)



Kyrgz Republic: Bilateral Real Exchange Rate of the Som, 1995-2005
(Indices 1995=100)



Share of Kyrgyz non-gold goods in imports of main trading partners 3/
(In percent)



1/ NBKR uses a three year moving average trade weights, while the INS index is based on average trade weights for 1999-2001.
2/ Relative wages index weighted by the INS trade weights.
3/ The three main trading partners (Russia, Kazakhstan, and China) account for about 70 percent of Kyrgyz external trade.

26. **The Kyrgyz Republic is an active member of regional integration initiatives under the Eurasian Economic Community (EURASEC).**[8] During their recent summit in Sochi, EURASEC members agreed to work towards a common energy market and develop a concept paper on hydropower regulations in Central Asia. In addition, Belarus, Kazakhstan and Russia are preparing the legal groundwork for introduction of a customs union. The Kyrgyz authorities noted that they might join that union after other EURASEC members join the WTO, so that their most-favored-nation import tariffs would be similar to the relatively low rates applied by the Kyrgyz Republic—the first CIS member of the WTO.

27. **Despite a notable improvement in regional transit systems in recent years, the authorities look forward to a further easing of costly external barriers to Kyrgyz exports.** They saw the agreement with Kazakhstan allowing permit-free cargo and passenger transit through its territory as an important first step, but noted the scope for further liberalization, especially regarding the payment of various fees and cumbersome truck inspections. They also hope to secure an easing of very costly customs escort procedures imposed by Uzbekistan on excisable goods (i.e., the vast majority) transported through its territory.

Technical Assistance and Data Issues

28. **The authorities expressed appreciation for the TA provided by the Fund in recent years, especially in the fiscal, financial sector and statistical areas** (Appendix I). Going forward, they count on assistance to follow up on the findings of the upcoming FSAP update mission, as well as on Islamic banking and development of a government securities market. The quality and timeliness of economic data have improved over the years, but there is scope for further enhancing the quality of real sector and balance of payments data. The Kyrgyz Republic subscribed to the Special Data Dissemination Standards in February 2004, and data provided to the Fund are generally adequate for program monitoring and surveillance.

C. Capacity to Repay and Medium-Term Risks

29. **Despite a significant improvement in the Kyrgyz Republic's debt indicators since 2000, reflecting prudent debt management, fiscal consolidation, and the concessional March 2005 Paris Club restructuring,[9] the external debt burden remains**

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[8] Other members include Belarus, Kazakhstan, Russia, Tajikistan and Uzbekistan. Armenia, Moldova and Ukraine are observers.

[9] Restructuring agreements have been signed with all Paris Club creditors. Regarding non-Paris Club creditors, Pakistan converted all Kyrgyz debt into a grant and negotiations with China, India and Korea are advanced. Progress in discussions with other creditors has been slow, despite best-faith efforts from the Kyrgyz Republic.

heavy. This is borne out by the joint debt sustainability analysis undertaken by Fund and World Bank staffs (Annex I).[10] The end-2005 ratios of the NPV of debt to GDP (46 percent) and to government revenue (277 percent) exceed the sustainability thresholds set for low-income countries in the same peer group of *medium performers* (based on the World Bank's Country Performance and Institutional Assessment index), namely 40 percent and 250 percent, respectively. By contrast, the ratios of the NPV of debt to exports (120 percent) and of debt service to exports (7½ percent) are well below the indicative thresholds of 150 percent and 20 percent, respectively.

30. All critical debt indicators are projected to fall under threshold levels in the next few years in the staffs' baseline scenario, and to continue improving throughout the projection period, although their evolution is highly sensitive to the assumptions underlying the projections or to shocks portrayed in stress tests. In addition, the Kyrgyz Republic has established a record of timely servicing its obligations to the Fund, and its capacity to repay the Fund going forward is expected to remain strong.

31. **Risks to the outlook (which appear manageable on balance) stem mainly from possible escalation of political tensions or internal pressures to relax fiscal reform discipline and slow the reform drive.** These risks would be mitigated by greater accountability and transparency from all branches of government. Continued engagement of the donor community through a close policy dialogue and technical and financial support to the reform effort could also play a part.

IV. Staff Appraisal

32. **After coping with the dislocations stemming from the collapse of the USSR and the 1998 Russian financial crisis, the previous administration left a legacy of entrenched macroeconomic stability.** The government liberalized the economy early on and launched other comprehensive structural changes, but the reform effort weakened over time and serious governance issues were allowed to fester. This led to growing disenchantment of the citizenry, culminating in the March 2005 *Tulip Revolution*.

33. **The new administration has shown commendable resolve in maintaining macroeconomic stability, despite lingering political tensions.** In particular, it has displayed fiscal prudence and pledged continued adherence to market-friendly policies aimed at fostering private sector-led growth and eradicating poverty. The authorities secured approval of a revenue-neutral tax package (featuring rate cuts to ease the burden on capital and labor) and unified household electricity tariffs, as part of a longer-term drive to put the power sector on a stronger footing. Meanwhile, they have continued to modernize the

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[10] Domestic public debt at 7 percent of GDP is relatively low and not expected to materially rise in the foreseeable future.

financial system and introduced a new legal framework to curtail money laundering and the financing of terrorism.

34. **Performance in the year-to-date year under the PRGF-supported economic program has been good.** Inflation has remained in line with the program and is expected to stay below the end-year target of 5.7 percent. The outlook for output growth during the year has been scaled back to 4 percent because of an accident in a major gold mine, but there are encouraging signs of a rebound in activity in other sectors. All end-June quantitative PCs were met, in some cases by wide margins, owing partly to buoyant revenue from import transactions, and all structural benchmarks have also been met to date. Staff supports the authorities' request for a waiver for nonobservance of the end-June structural PC on the transfer of Centerra shares to the State Property Fund, based on the remedial actions they have taken to effectively fulfill the spirit of the missed PC.

35. **Going forward, the Kyrgyz Republic's new *Country Development Strategy*, designed in consultation with domestic stakeholders and donors, provides a good platform for action.** The overarching purpose of the CDS is to realize the country's promising potential for growth in a low-inflation environment, while improving the lot of the poor and moving towards achievement of the Millennium Development Goals. Besides political stability and firm adherence to the rule of law, progress in that direction will require bold efforts to tackle governance issues, improve the business climate, and diversify the economy under the stewardship of the private sector. The authorities should also proceed to implement promptly the energy sector action plan designed with World Bank assistance. This will be crucial to reduce the sector's sizable quasi-fiscal deficit, provide adequate power supplies to the growing economy, and tap into the considerable potential for regional energy exports. Furthermore, staff would caution the authorities about the risks (in terms of resource misallocation, forgone tax revenue, and rent-seeking opportunities) of the expansive industrial policy that has been floated recently by influential business and political groups.

36. **Against this backdrop, the authorities' economic program for 2007 appropriately seeks to maintain macroeconomic stability—targeting a decline in end-period inflation to 4½–5 percent and a rebound in real GDP growth to 5½ percent.** To that end, the authorities plan to keep the primary fiscal balance before grants below 3 percent of GDP—broadly unchanged from 2006. In addition, their prudent monetary program seeks to moderate the growth of liquidity and secure a further buildup in international reserves that would slightly raise the import coverage of gross reserves.

37. **The authorities plan to gradually divest their shares in the Centerra mining conglomerate and use the proceeds to spur growth.** These resources would likely be channeled through a development fund that could be set up shortly, which would need to be fully integrated into the general government budget and subject to close parliamentary scrutiny. In this regard, topping up investment in high-yielding public projects seems

preferable to stoking the ongoing credit boom. Moreover, the government should refrain from reintroducing directed subsidized lending by the financial system. In any event, it will be important to closely align any additional poverty reducing spending made possible by interim assistance under the enhanced HIPC Initiative, as well as any additional aggregate demand stimulus financed by asset sales or external loans, with the annual economic programs. As such, some modifications to the 2007 economic program may be warranted at the time of the fourth review under the arrangement in early 2007.

38. **In the fiscal area, the top priorities are to strengthen tax administration so as to establish a solid foundation for fiscal consolidation, and to deepen the ongoing reforms in public financial management—including improvements in budgetary design and execution and in the tracking and targeting of poverty reducing spending.** Meanwhile, every effort should be made to secure approval of the increase in nonagricultural land taxes and the best-practice tax code that are both before parliament, as well as to resist vested-interest pressures for slowing the reforms of the State Tax Inspectorate and the Large Taxpayers Unit. Furthermore, the authorities need to carefully phase in the fiscal decentralization mandated by parliament to avert a loss in fiscal control, while seeking to build capacity and clearly demarcating the fiscal responsibilities of each tier of government.

39. **The authorities' continue to object to the reduction in the retirement age, despite strong political pressures.** To break the stalemate with parliament, the government would be advised to continue working towards broad understandings on a fiscally sustainable pension reform, while clearly communicating to the public the tradeoffs between lowering the retirement age, on the one hand, and further reducing the payroll tax and increasing pension benefits over time, on the other hand. Going forward, the pension reform proposals under consideration should be carefully assessed with expert international assistance. Creation of a voluntary, privately funded pension pillar could have positive spillovers on private savings and capital market development, provided the appropriate prerequisites are put in place beforehand and the new system is phased in gradually to mitigate transitional fiscal costs.

40. **The authorities have successfully kept inflationary pressures in check, thanks in part to continued remonetization of the economy.** However, high international fuel prices and the envisaged phased hikes in electricity and natural gas tariffs, as well as the prospects for scaling-up the 2007 spending envelope (with resources from interim HIPC assistance and additional asset sales or external loans) could rekindle price pressures and call for a tighter monetary stance. The authorities should also continue strengthening bank supervision and take remedial actions if the quality of loan portfolios deteriorates as a result of the ongoing credit boom. More generally, the authorities' plans to deepen financial reform are sound and the upcoming FSAP update mission should provide a good opportunity to fine-tune them. Meanwhile, staff urges the government to seek prompt passage of the amendments to the central bank charter and pertinent legal codes aimed at strengthening the NBKR's autonomy.

41. **Debt relief under the HIPC Initiative and MDRI could play an important role in underpinning macroeconomic stability and debt sustainability, while creating fiscal space for additional poverty reducing spending.** The authorities are taking welcome steps to further enhance external debt management, and the program continues to preclude the contracting or guaranteeing of nonconcessional external loans. To avoid a new cycle of debt buildup and forestall the emergence of contingent public sector liabilities, the government should also ensure that large private investments for which it may help secure external financing are of the highest caliber.

42. **The managed exchange rate float regime maintained by the Kyrgyz Republic has served the country well over the past several years.** Staff concurs with the authorities' assessment that external competitiveness as gauged by a number of indicators remains broadly adequate. The authorities would be advised, nonetheless, to refrain from significant unsterilized intervention in the near future, in order to help keep liquidity growth in check. Over the longer term, it will also be important to buttress competitiveness by fostering productivity gains and pursuing prudent wage policies.

43. I**n sum, the new government has established a record of prudent macroeconomic management during its first year-and-a-half in office.** The challenge going forward is to leverage these gains to enhance the opportunities for rapid, sustained economic and social development. The structural reforms envisaged in the CDS, including those embedded in the PRGF-supported program, provide a solid blueprint for action. Success in these endeavors will hinge, however, on smoothing relations with parliament to secure passage of essential legislation, and a skillful communication effort to forge a strong domestic consensus on the reform agenda. While there are a number of risks in the outlook—stemming mainly from a possible escalation of political tensions or internal pressures to relax fiscal discipline and slow the reform drive—these risks appear manageable. On this basis, staff recommends completion of the third review under the PRGF arrangement.

44. It is proposed that the next Article IV consultation with the Kyrgyz Republic take place within 24 months, subject to the provisions of the decision on consultation cycles in program countries.

Table 1. Kyrgyz Republic: Quantitative Program Targets for 2005–06 1/

(In millions of soms, unless otherwise indicated; eop)

	200	200						
	Decembe PC	Marc Indicative targets		June			Septembe Indicative Targets	Decembe PC
	Actual	IMF Country Report 06/235	Actual	IMF Country Report 06/235	Adj. Target 2/	Actual	IMF Country Report 06/235	
I. Performance criteria								
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	41	36	41	41	39	45	41	45
2. Ceiling on net domestic assets of the NBKR (eop stock)	-	-	-	-	-	-	-	-
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	2,75	1,09	6	1,37	…	14	2,54	3,70
4. Cumulative floor on state government tax collections in cash	16,36	3,59	4,06	793	…	8,74	12,51	17,65
5. Ceiling on the stock of central government budget arrears	0	0	0	0	…	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	…	0	0	0
7. Cumulative floor on payroll collections in cash of the social fund	4,91	1,10	1,25	2,29	…	2,55	3,43	4,82
8. Ceiling on the stock of social fund arrears to the Medical Insurance Fund	0	0	0	0	…	0	0	0
9. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new external debt with maturity of less than one year (continuous, in millions of U.S. dollars)	0	0	0	0	…	0	0	0
10. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of one year or more (millions of U.S. dollars)	0	0	0	0	…	0	0	0
							0	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	0	0	0	…	0	0	0
II. Indicative targets								
1. Ceiling on reserve money (eop stock)	15,46	13,75	15,34	15,54	…	16,96	15,90	17,70
2. Ceiling on the cumulative quasi-fiscal deficit of the electricity sector (in millions of soms)	7,60	...	...	374	…	3,70	...	6,50
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 3/		(as specified in paragraph 30 of the TMU attached to Country Report No. 06/235)						

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Definitions are provided in the Technical Memorandum of Understanding.

2/ Targets adjusted for the nondisbursement of the EU food security grant ($4.8 million in Q1), the ADB grant ($7.8 million in Q2), and the EU health sector SWAP grant ($4.0 million in Q2).

3/ New concessional loans during the year.

Table 2. Kyrgyz Republic: Quantitative Program Targets for 2006–07 1/

(In millions of soms, unless otherwise indicated; eop)

	2006	2007			
	December	March Indicative Target	June PC	September Indicative Target	December Indicative Target
	Proj.	Proj.	Proj.	Proj.	Proj.
I. Performance criteria					
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	518	572	594	638	661
2. Ceiling on net domestic assets of the NBKR (eop stock)	-2,034	-1,958	-1,465	-1,893	-2,097
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	3,221	589	1,130	2,285	3,461
4. Cumulative floor on state government tax collections in cash	18,431	4,236	9,238	14,634	20,671
5. Ceiling on the stock of central government budget arrears	0	0	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	0
7. Cumulative floor on payroll collections in cash of the Social Fund	4,945	1,373	2,706	4,053	5,421
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0	0	0	0	0
9. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new external debt with maturity of less than one year (continuous, in millions of U.S. dollars)	0	0	0	0	0
10. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of one year or more (millions of U.S. dollars)	0	0	0	0	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	0	0	0	0
II. Indicative targets					
1. Ceiling on reserve money (eop stock)	19,642	20,617	22,038	23,351	24,065
2. Ceiling on the cumulative quasi-fiscal deficit of the electricity sector (in millions of soms)	…	…	3,822	…	6,633
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 2/	…	(as specified in the revised TMU attached herewith)			

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Definitions are provided in the Technical Memorandum of Understanding.
2/ New concessional loans during the year.

Table 3. Kyrgyz Republic: Structural Conditionality

I. March–December 2006

Structural benchmarks for end-March 2006

- Prepare, in close cooperation with the Fund staff, an action plan for the State Tax Inspectorate to streamline its operations, retrench redundant personnel, and introduce a merit-based pay system. [Observed]

Structural benchmarks and performance criteria (*) for end-June 2006[1]

- Develop a supervisory framework for market, country, and transfer risk as recommended by the September 2004 technical assistance mission of the IMF's Monetary and Financial Systems Department. [Observed]

- Establish an independent audit committee to oversee the external and internal audit functions of the NBKR as recommended by the Safeguards Assessment Report conducted by Finance Department in 2005. [Observed]

- The government will take the appropriate legal steps (accompanied by enabling regulations) to transfer the Centerra shares currently owned by KyrgyzAltyn JSC to the State Property Fund.* [Not Observed]

Structural benchmarks for end-September 2006

- Prepare an action plan to reduce the energy sector's quasi-fiscal deficit in close cooperation with World Bank staff, addressing problems of transmission and distribution losses, payment indiscipline, and tariff adjustment. [Observed]

- Expand the operation of the Large Taxpayers Unit to cover at least 60 percent of tax revenues. [Observed]

Structural benchmarks for end-December 2006

- Conduct an independent review of the NBKR's internal audit function. The review could be performed by the internal audit department of another central bank, and should include a review of the capacity of the NBKR's internal audit division, as recommended by the Safeguards Assessment Report conducted by Finance Department in 2005.

[1] Actions labeled with an asterisk are structural performance criteria.

Table 3 (concluded). Kyrgyz Republic: Structural Conditionality

- Bring KAFC to the point of sale and issue a privatization tender for the company.
- Submit to IMF staff a report prepared by the ministry of labor and social protection recommending measures to improve labor market flexibility.
- Secure approval of legislation that has been already sent to parliament to enhance the NBKR's legal independence and ensure legal protection of its employees in performing official duties.

II. March–June 2007

Structural benchmarks for end-March 2007

- The government will submit to parliament amendments (drafted by the NBKR) to the civil, housing and land codes, as well as to all the laws governing collateral, in order to harmonize provisions on collateralized lending by financial institutions and facilitate collateral seizure in cases of default.
- Approval of the tax code bill that is before parliament.
- The government will adopt a new medium-term external debt management strategy aimed at ensuring external debt sustainability, as described in paragraph 24 of the RMEP.

Structural benchmarks for end-June 2007

- The NBKR will implement regulations for consolidated supervision to monitor risks faced by financial institutions, in line with the recommendations of the 2005 Basel Core Principles for Effective Banking Supervision Assessment.
- The government will introduce a new and detailed budget classification, based on the best practice reporting of government finances (GFS 2001), which will permit monitoring of poverty reducing expenditures in the monthly budget execution reports.

Table 4. Kyrgyz Republic: Selected Economic Indicators, 2003–11

	2003	2004	2005	2006		2007	2008	2009	2010	2011
		Actual		IMF Country Report No. 6/235	Proj.			Proj.		
Nominal GDP (in billions of soms)	83.9	94.4	100.1	111.1	110.1	121.3	135.5	150.9	166.7	179.9
Nominal GDP (in millions of U.S. dollars)	1,921	2,216	2,441	2,646	2,751	3,071	3,431	3,819	4,147	4,396
Real GDP (growth in percent)	7.0	7.0	-0.6	5.0	4.0	5.5	7.0	6.5	5.0	3.5
GDP per capita (in U.S. dollars)	381	435	473	508	528	583	645	710	763	800
Consumer prices (percent change, eop)	5.6	2.8	4.9	5.7	5.7	4.5	4.0	4.0	4.0	4.0
Consumer prices (percent change, average)	3.1	4.1	4.3	5.7	5.7	4.5	3.9	4.0	4.0	4.0
Unemployment rate	8.9	9.0	9.7	...	...	...	...	...	...	...
Poverty rate (consumption approach)	50	46	44	...	...	...	...	...	...	...
Investment and savings (in percent of GDP)										
Investment	20.5	20.9	21.8	22.6	22.8	23.2	23.0	22.8	23.0	23.9
Public	4.8	4.5	4.2	4.4	4.4	4.5	4.7	4.9	5.0	5.0
Private	15.8	16.4	17.6	18.2	18.4	18.7	18.3	17.9	18.0	18.9
Savings	16.4	17.4	13.4	15.8	11.8	13.3	14.8	16.5	16.9	17.4
Public	-0.9	-0.1	-0.2	0.9	0.9	0.9	1.8	1.8	1.7	1.7
Private	17.3	17.6	13.6	14.9	10.9	12.4	13.0	14.7	15.2	15.6
Savings/Investment balance	4.1	3.4	8.3	6.8	11.0	9.8	8.2	6.4	6.1	6.6
General government finances (in percent of GDP) 1/										
Total revenue and grants	22.2	23.1	24.3	24.0	24.9	24.9	25.4	25.4	25.1	25.3
Tax revenue	17.7	18.3	20.2	19.2	20.2	20.5	20.7	21.0	21.2	21.4
Total expenditure (including net lending)	27.0	27.5	28.2	27.1	28.1	28.0	27.8	28.0	27.9	28.0
Of which : Current expenditure	22.7	23.5	24.5	23.1	24.0	24.0	23.6	23.6	23.4	23.5
Capital expenditure	4.8	4.5	4.2	4.4	4.4	4.5	4.7	4.9	2.9	2.9
Overall fiscal balance (cash basis)	-4.9	-4.5	-3.9	-3.1	-3.2	-3.1	-2.5	-2.6	-2.8	-2.8
Primary balance excluding grants	-3.9	-3.9	-2.8	-3.3	-2.9	-2.9	-2.8	-2.5	-2.3	-2.2
Banking sector 2/										
Net foreign assets (percent change, eop)	50.0	108.7	20.1	12.5	23.3	23.0	...	...	...	...
Net domestic assets (percent change, eop)	5.8	-52.3	54.5	35.4	84.1	26.8	...	...	...	...
Credit to private sector (in percent of GDP)	4.7	7.0	8.0	8.6	10.5	11.5	...	...	...	...
Broad money (percent change, eop)	34.5	33.6	25.5	17.0	35.1	24.0	...	...	...	...
Velocity of broad money 3/	6.0	5.6	4.7	4.4	3.8	3.4	...	...	...	...
Interest rate 4/	23.0	24.3	25.7	...	...	...	...	...	...	...

Table 4 (concluded). Kyrgyz Republic: Selected Economic Indicators, 2003–11

	2003	2004	2005	2006		2007	2008	2009	2010	2011
		Actual		IMF Country Report No. 6/235	Proj.			Proj.		
External sector										
Current account balance (in percent of GDP)	-4.1	-3.4	-8.3	-6.8	-11.0	-9.8	-8.2	-6.4	-6.1	-6.6
Export of goods and services (million USD)	745	943	942	1,072	1,101	1,299	1,545	1,821	1,934	2,007
Export growth (percent change)	16.4	26.6	-0.1	13.8	16.9	18.0	18.9	17.9	6.2	3.8
Import of goods and services (million USD)	875	1,127	1,397	1,607	1,786	2,042	2,261	2,469	2,616	2,736
Import growth (percent change)	15.7	28.8	23.9	13.1	27.9	14.3	10.7	9.2	6.0	4.6
Gross official reserves (million USD) 5/	359	544	609	627	721	811	926	1061	1143	1261
Gross reserves (months of imports, eop)	3.8	4.7	4.1	4.4	4.2	4.3	4.5	4.9	5.0	5.4
External public debt outstanding										
(in percent of GDP) 6/	98	88	79	78	72	66	61	57	54	52
Debt service-to-export ratio (in percent) 6/	15.7	9.4	13.6	5.6	7.9	6.6	5.4	5.4	7.8	5.5
Memorandum items										
Exchange rate (soms per U.S. dollar, average)	43.7	42.6	41.0	...	...	...	...	...	...	...
Real effective exchange rate										
Index (1995=100)	73.7	71.4	72.1	...	...	...	...	...	...	...

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ General government comprises state government and social fund finances. State government comprises central and local governments.
2/ Projections are based on program exchange rates specified in the Technical Memorandum of Understanding.
3/ 12-month GDP over end-period broad money.
4/ Weighted average interest rate on som-denominated loans.
5/ Gross reserves exclude international reserves of the NBKR that are pledged or blocked.
6/ Excluding obligations of the Kumtor gold mine.

Table 5. Kyrgyz Republic: Summary of General Government Fiscal Operations, 2004–07

	2004		2005		2006	
	Act.		Act.		IMF Country Report No. 06/235	
	Million of soms	Percent of GDP	Million of soms	Percent of GDP	Million of soms	Percent of GDP
Total revenue and grants	21,756	23.1	24,286	24.3	26,672	24.0
Total revenue	21,016	22.3	23,883	23.9	25,517	23.0
Current revenue	20,699	21.9	23,750	23.7	25,366	22.8
Tax revenue 1/	17,280	18.3	20,182	20.2	21,352	19.2
Income tax	2,636	2.8	3,516	3.5	3,065	2.8
VAT	6,830	7.2	7,089	7.1	7,721	6.9
Excises	1,245	1.3	1,150	1.1	1,379	1.2
Customs	449	0.5	1,664	1.7	1,978	1.8
Land tax	335	0.4	319	0.3	559	0.5
Road tax and Emergency Fund	1,270	1.3	1,410	1.4	1,550	1.4
Retail sales tax	548	0.6	605	0.6	675	0.6
Social fund revenue (excluding government contribution)	3,293	3.5	3,821	3.8	3,703	3.3
Other	673	0.7	610	0.6	724	0.7
Nontax revenue	3,419	3.6	3,568	3.6	4,014	3.6
Capital revenue	318	0.3	133	0.1	151	0.1
Grants	740	0.8	403	0.4	1,155	1.0
Total expenditure	26,419	28.0	28,683	28.6	30,500	27.4
Current expenditure	22,189	23.5	24,482	24.5	25,650	23.1
Wages	5,487	5.8	6,329	6.3	6,981	6.3
Transfers and subsidies 2/	2,879	3.1	3,401	3.4	4,173	3.8
Social Fund expenditures	5,413	5.7	5,664	5.7	6,062	5.5
Interest 3/	1,290	1.4	1,592	1.6	928	0.8
Purchases of other goods and services	7,121	7.5	7,497	7.5	7,506	6.8
Capital expenditure (including PIP)	4,229	4.5	4,201	4.2	4,850	4.4
Domestically financed capital expenditure	1,043	1.1	961	1.0	1,393	1.3
Foreign loan financed PIP	3,187	3.4	3,240	3.2	3,457	3.1
Financial balance	-4,663	-4.9	-4,397	-4.4	-3,828	-3.4
Net lending	-439	-0.5	-451	-0.5	-354	-0.3
Accrual surplus (+) / deficit (-)	-4,224	-4.5	-3,945	-3.9	-3,473	-3.1
Cash surplus (+) / deficit (-)	-4,238	-4.5	-3,945	-3.9	-3,473	-3.1
Primary balance excluding grants	-3,687	-3.9	-2,757	-2.8	-3,701	-3.3
Total financing	4,238	4.5	3,945	3.9	3,473	3.1
External financing	4,689	5.0	3,708	3.7	3,681	3.3
Public investment program (PIP)	3,187	3.4	3,240	3.2	3,457	3.1
Disbursements (BOP support)	1,250	1.3	0	0.0	748	0.7
Total amortization	-1,618	-1.7	-1,845	-1.8	-523	-0.5
Arrears and rescheduling	1,871	2.0	2,313	2.3	0	0.0
Domestic financing	-4,252	-4.5	76	0.1	-495	-0.4
Exceptional Financing 4/	3,801	4.0	161	0.2	287	0.3
Memorandum items:						
Social spending	13,216	14.0	14,646	14.6	16,689	15.0
Health and education	6,283	6.7	7,201	7.2	8,325	7.5
Social security benefits and pensions	6,933	7.3	7,445	7.4	8,364	7.5
Project grants (foreign financed PIP)	355	0.4	637	0.6	1,101	1.0
Capital expenditures incl. PIP project grants	4,584	4.9	4,838	4.8	5,952	5.4
Primary balance	-2,948	-3.1	-2,353	-2.4	-2,463	-2.2

Table 5 (concluded). Kyrgyz Republic: Summary of General Government Fiscal Operations, 2004–07

	2006		2007			
	Proj.		IMF Country Report No. 06/235		Proj.	
	Million of soms	Percent of GDP	Million of soms	Percent of GDP	Million of soms	Percent of GDP
Total revenue and grants	27,454	24.9	29,126	23.8	30,149	24.9
Total revenue	26,695	24.3	27,992	22.9	29,209	24.1
Current revenue	26,558	24.1	27,817	22.8	29,088	24.0
Tax revenue 1/	22,253	20.2	23,649	19.4	24,914	20.5
Income tax	3,488	3.2	3,343	2.7	3,517	2.9
VAT	8,373	7.6	8,686	7.1	9,545	7.9
Excises	1,220	1.1	1,485	1.2	1,402	1.2
Customs	2,260	2.1	2,242	1.8	2,544	2.1
Land tax	365	0.3	565	0.5	565	0.5
Road tax and Emergency Fund	1,467	1.3	1,680	1.4	1,630	1.3
Retail sales tax	672	0.6	728	0.6	744	0.6
Social Fund revenue (excluding government contribution)	3,822	3.5	4,060	3.3	4,243	3.5
Other	587	0.5	861	0.7	724	0.6
Nontax revenue	4,305	3.9	4,169	3.4	4,174	3.4
Capital revenue	137	0.1	174	0.1	120	0.1
Grants	759	0.7	1,134	0.9	940	0.8
Total expenditure	31,318	28.5	33,155	27.1	34,499	28.4
Current expenditure	26,467	24.0	27,958	22.9	29,054	24.0
Wages	6,977	6.3	7,679	6.3	7,593	6.3
Transfers and subsidies 2/	4,466	4.1	4,626	3.8	4,620	3.8
Social Fund expenditures	6,304	5.7	6,497	5.3	6,765	5.6
Interest 3/	1,011	0.9	1,024	0.8	1,239	1.0
Purchases of other goods and services	7,709	7.0	8,132	6.7	8,836	7.3
Capital expenditure (including PIP)	4,850	4.4	5,197	4.3	5,445	4.5
Domestically financed capital expenditure	1,394	1.3	1,532	1.3	1,528	1.3
Foreign loan financed PIP	3,457	3.1	3,665	3.0	3,917	3.2
Financial balance	-3,864	-3.5	-4,030	-3.3	-4,350	-3.6
Net lending	-390	-0.4	-574	-0.5	-590	-0.5
Accrual surplus (+) / deficit (-)	-3,474	-3.2	-3,455	-2.8	-3,760	-3.1
Cash surplus (+) / deficit (-)	-3,474	-3.2	-3,455	-2.8	-3,760	-3.1
Primary balance excluding grants	-3,221	-2.9	-3,566	-2.9	-3,461	-2.9
Total financing	3,474	3.2	3,455	2.8	3,760	3.1
External financing	3,459	3.1	3,384	2.8	3,510	2.9
Public investment program (PIP)	3,457	3.1	3,665	3.0	3,917	3.2
Disbursements (BOP support)	536	0.5	342	0.3	395	0.3
Total amortization	-666	-0.6	-624	-0.5	-741	-0.6
Arrears and rescheduling	132	0.1	0	0.0	-61	-0.1
Domestic financing	-272	-0.2	-239	-0.2	30	0.0
Exceptional Financing 4/	287	0.3	310	0.3	220	0.2
Memorandum items:						
Social spending	17,025	15.5	18,801	15.4	19,189	15.8
Health and education	8,246	7.5	9,520	7.8	9,574	7.9
Social security benefits and pensions	8,779	8.0	9,280	7.6	9,615	7.9
Project grants (foreign financed PIP)	1,101	1.0	1,746	1.4	1,746	1.4
Capital expenditures incl. PIP project grants	5,952	5.4	7,191	5.9	7,191	5.9
Primary balance	-2,463	-2.2	-2,521	-2.1	-2,521	-2.1

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Includes payroll tax revenue (contribution to the Social Fund), net of the government contribution to the Social Fund.

2/ Excludes transfer to Social Fund.

3/ Starting in 2006, interest and amortization reflect bilateral agreements signed following March 2005 Paris Club agreement.

4/ Mainly privatization proceeds.

Table 6. Kyrgyz Republic: General Government Finances, 2004–07

	2004	2005	2006						
	Year	Year	1Q		2Q		3Q	4Q	Year
	Act.	Act.	Prog.	Actual	Prog.	Actual	Prog.		Prog.
					(In millions of soms)				
Total revenue and grants	21,756	24,286	5,180	5,910	6,659	7,108	6,685	8,148	26,672
Of which: Tax revenue 1/	17,280	20,182	4,499	5,092	5,227	5,683	5,491	6,135	21,352
Grants	740	403	0	0	367	0	105	684	1,155
Total expenditure (excluding net lending)	26,419	28,683	6,262	5,970	7,172	7,847	8,087	8,978	30,500
Current expenditure	22,189	24,482	5,306	5,437	5,874	6,895	6,845	7,625	25,650
Capital expenditure (including PIP)	4,229	4,201	956	534	1,299	953	1,242	1,352	4,850
Financial balance	-4,663	-4,397	-1,082	-61	-513	-739	-1,402	-830	-3,828
Net lending	-439	-451	159	127	-205	-201	-196	-113	-354
Accrual surplus (+) / deficit (-)	-4,224	-3,945	-1,242	-187	-308	-538	-1,206	-717	-3,473
Cash surplus (+) / deficit (-)	-4,238	-3,945	-1,242	-188	-308	-538	-1,206	-717	-3,473
Primary balance excluding grant	-3,687	-2,757	-1,099	-61	-278	-79	-1,165	-1,159	-3,701
Total financing	4,238	3,945	1,242	188	308	538	1,206	717	3,473
External financing	4,689	3,708	950	386	711	544	846	1,173	3,681
Domestic financing	-4,252	76	273	-202	-423	-12	236	-581	-495
Exceptional Financing 2/	3,801	161	19	4	19	6	124	124	287.0
					(In percent of GDP)				
Total revenue and grants	23.1	24.3	4.7	5.4	6.0	6.5	6.0	7.3	24.0
Of which: Tax revenue 1/	18.3	20.2	4.0	4.6	4.7	5.2	4.9	5.5	19.2
Grants	0.8	0.4	0.0	0.0	0.3	0.0	0.1	0.6	1.0
Total expenditure (excluding net lending)	28.0	28.6	5.6	5.4	6.5	7.1	7.3	8.1	27.4
Current expenditure	23.5	24.5	4.8	4.9	5.3	6.3	6.2	6.9	23.1
Capital expenditure (including PIP)	4.5	4.2	0.9	0.5	1.2	0.9	1.1	1.2	4.4
Net lending	-0.5	-0.5	0.1	0.1	-0.2	-0.2	-0.2	-0.1	-0.3
Accrual surplus (+) / deficit (-)	-4.5	-3.9	-1.1	-0.2	-0.3	-0.5	-1.1	-0.6	-3.1
Cash surplus (+) / deficit (-)	-4.5	-3.9	-1.1	-0.2	-0.3	-0.5	-1.1	-0.6	-3.1
Primary balance excluding grants	-3.9	-2.8	-1.0	-0.1	-0.2	-0.1	-1.0	-1.0	-3.3
Total financing	4.5	3.9	1.1	0.2	0.3	0.5	1.1	0.6	3.1
External financing	5.0	3.7	0.9	0.4	0.6	0.5	0.8	1.1	3.3
Domestic financing	-4.5	0.1	0.2	-0.2	-0.4	0.0	0.2	-0.5	-0.4
Exceptional Financing 2/	4.0	0.2	0.0	0.0	0.0	0.0	0.1	0.1	0.3
Memorandum item:									
Social spending	14.0	14.6	3.1	3.2	3.4	4.0	4.0	4.5	15.0

Table 6 (concluded). Kyrgyz Republic: General Government Finances, 2004–07

	2006	2007				
	Year	Q1	Q2	Q3	Q4	Year
	Proj.	Proj.				
			(In millions of soms)			
Total revenue and grants	27,454	6,230	7,305	7,848	8,766	30,149
Of which: Tax revenue 1/	22,253	5,332	6,056	6,449	7,077	24,914
Grants	759	119	119	320	383	940
Total expenditure (excluding net lending)	31,318	7,017	8,465	8,938	10,079	34,499
Current expenditure	26,467	6,117	7,128	7,100	8,709	29,054
Capital expenditure (including PIP)	4,850	900	1,337	1,838	1,370	5,445
Financial balance	-3,864	-787	-1,160	-1,090	-1,313	-4,350
Net lending	-390	-117	-160	-102	-210	-590
Accrual surplus (+) / deficit (-)	-3,474	-669	-1,000	-988	-1,103	-3,760
Cash surplus (+) / deficit (-)	-3,474	-669	-1,000	-988	-1,103	-3,760
Primary balance excluding grant	-3,221	-589	-541	-1,155	-1,176	-3,461
Total financing	3,474	669	1,000	988	1,103	3,760
External financing	3,459	780	615	1,304	811	3,510
Domestic financing	-272	-116	379	-322	89	30
Exceptional Financing 2/	287	6	6	6	203	220
			(In percent of GDP)			
Total revenue and grants	24.9	5.7	6.6	7.1	8.0	24.9
Of which: Tax revenue 1/	20.2	4.8	5.5	5.9	6.4	20.5
Grants	0.7	0.1	0.1	0.3	0.3	0.8
Total expenditure (excluding net lending)	28.5	6.4	7.7	8.1	9.2	28.4
Current expenditure	24.0	5.6	6.5	6.5	7.9	24.0
Capital expenditure (including PIP)	4.4	0.8	1.2	1.7	1.2	4.5
Net lending	-0.4	-0.1	-0.1	-0.1	-0.2	-0.5
Accrual surplus (+) / deficit (-)	-3.2	-0.6	-0.9	-0.9	-1.0	-3.1
Cash surplus (+) / deficit (-)	-3.2	-0.6	-0.9	-0.9	-1.0	-3.1
Primary balance excluding grants	-2.9	-0.5	-0.5	-1.0	-1.1	-2.9
Total financing	3.2	0.6	0.9	0.9	1.0	3.1
External financing	3.1	0.7	0.6	1.2	0.7	2.9
Domestic financing	-0.2	-0.1	0.3	-0.3	0.1	0.0
Exceptional Financing 2/	0.3	0.0	0.0	0.0	0.2	0.2
Memorandum item:						
Social spending	15.5	3.6	4.2	4.1	5.1	15.8

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Includes payroll tax revenue (contribution to the Social Fund), net of the government contribution to the Social Fund.
2/ Mainly privatization proceeds. Includes som 3,589 million related to the Kumtor mine restructuring for 2004.

Table 7. Kyrgyz Republic: State Government Finances, 2005–07

(In millions of soms)

	2005	2006								2007				
	Year	1Q		2Q		3Q	4Q	Year		1Q	2Q	3Q	4Q	Year
	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Prog.	Proj			Proj.		
Total revenue and grants	20,379	4,259	4,862	5,745	6,084	5,752	7,129	22,886	23,548	5,114	6,231	6,775	7,706	25,826
Total revenue	19,975	4,259	4,862	5,379	6,084	5,647	6,446	21,731	22,789	4,996	6,112	6,454	7,323	24,886
Current revenue	19,929	4,256	4,859	5,366	6,059	5,616	6,425	21,663	22,736	4,989	6,106	6,445	7,306	24,845
Tax revenue	16,361	3,599	4,063	4,334	4,679	4,579	5,137	17,650	18,431	4,236	5,002	5,395	6,037	20,671
Income tax	3,516	735	918	677	806	733	919	3,065	3,488	926	799	846	946	3,517
VAT 1/	7,089	1,500	1,677	1,974	2,128	1,946	2,301	7,721	8,373	1,785	2,347	2,461	2,952	9,545
Excises	1,150	324	279	343	275	359	353	1,379	1,220	311	353	363	375	1,402
Customs	1,664	374	477	460	644	518	626	1,978	2,260	478	630	682	753	2,544
Land tax	319	86	70	91	59	167	214	559	365	93	91	160	222	565
Road tax and Emergency Fund	1,410	287	365	415	378	430	418	1,550	1,467	319	418	449	443	1,630
Retail sales tax	605	150	154	164	178	180	181	675	672	160	182	198	204	744
Other 2/	610	144	124	209	209	246	125	724	587	164	181	236	143	724
Nontax revenue	3,568	657	795	1,032	1,380	1,036	1,288	4,014	4,305	753	1,104	1,049	1,268	4,174
Capital revenue	46	3	3	13	25	31	21	68	53	7	6	10	18	40
Grants	403	0	0	367	0	105	684	1,155	759	119	119	320	383	940
Total expenditure (excluding net lending)	25,156	5,319	5,022	6,248	6,943	7,048	8,030	26,645	27,342	6,020	7,453	7,847	8,930	30,250
Current expenditure	20,956	4,363	4,488	4,949	5,990	5,806	6,678	21,795	22,491	5,120	6,116	6,009	7,560	24,805
Wages and social fund contributions	7,484	1,294	1,605	2,066	2,228	2,180	2,610	8,150	8,150	1,710	2,333	2,316	2,466	8,825
Transfers and subsidies 3/	3,401	699	828	922	990	1,182	1,369	4,173	4,466	971	1,257	1,212	1,183	4,620
Transfers to social fund	982	260	260	260	270	260	260	1,038	1,155	321	321	321	321	1,284
Interest	1,592	143	127	397	459	146	241	928	1,011	198	578	153	310	1,239
Purchases of other goods and services 4/	7,497	1,967	1,668	1,304	2,043	2,037	2,198	7,506	7,709	1,920	1,627	2,007	3,280	8,836
Capital expenditure (including PIP)	4,201	956	534	1,299	953	1,242	1,352	4,850	4,850	900	1,337	1,838	1,370	5,445
Domestically financed capital expenditure	961	276	89	424	270	303	391	1,393	1,394	350	400	450	328	1,528
Foreign-financed PIP	3,240	680	444	875	683	940	962	3,457	3,457	550	937	1,388	1,042	3,917
Financial balance	-4,778	-1,060	-160	-502	-859	-1,296	-901	-3,759	-3,794	-906	-1,222	-1,072	-1,224	-4,424
Net lending	-451	159	127	-205	-201	-196	-113	-354	-390	-117	-160	-102	-210	-590
Accrual surplus (+) / deficit (-)	-4,326	-1,219	-287	-297	-658	-1,100	-788	-3,404	-3,404	-788	-1,061	-970	-1,014	-3,834
Cash surplus (+) / deficit (-)	-4,326	-1,219	-287	-297	-658	-1,100	-788	-3,404	-3,404	-788	-1,061	-970	-1,014	-3,834
Primary balance excluding grants	-3,138	-1,076	-160	-267	-199	-1,059	-1,231	-3,632	-3,151	-708	-602	-1,138	-1,087	-3,535
Total financing	4,326	1,219	287	297	658	1,100	788	3,404	3,404	788	1,061	970	1,014	3,834
External financing	3,708	950	386	711	544	846	1,173	3,681	3,459	780	615	1,304	811	3,510
Public investment program (PIP)	3,240	680	444	875	683	940	962	3,457	3,457	550	937	1,388	1,042	3,917
Disbursements (BOP support)	0	328	0	0	0	0	420	748	536	395	0	0	0	395
Total amortization	-1,845	-58	-78	-163	-187	-93	-208	-523	-666	-94	-264	-104	-280	-741
Arrears and rescheduling	2,313	0	20	0	48	0	0	0	132	-71	-58	20	49	-61
Domestic financing	457	250	-103	-434	108	129	-509	-564	-342	3	441	-339	0	104
Exceptional Financing 5/	161	19	4	19	6	124	124	287	287	6	6	6	203	220

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ In 2005, the VAT and customs revenues were reclassified, leading to lower VAT and higher customs duty collections.
2/ Mainly mineral resource tax and motor vehicle tax.
3/ Excludes transfer to Social Fund (columns for original program include transfer to Social Fund).
4/ Includes carry-forward expenditure from previous fiscal year (som 994 million in 2004, som 945 million in 2005, and som 480 million in 2006).
5/ Mainly privatization proceeds. Includes som 3,589 million related to the Kumtor mine restructuring for 2004.

Table 7 (concluded). Kyrgyz Republic: State Government Finances, 2005–07

(In percent of GDP)

	2005	2006								2007				
	Year	1Q		2Q		3Q	4Q	Year		1Q	2Q	3Q	4Q	Year
	Act.	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Prog.	Proj.	Proj.				
Total revenue and grants	20.4	3.8	4.4	5.2	5.5	5.2	6.4	20.6	21.4	4.6	5.7	6.2	7.0	21.3
Total revenue	20.0	3.8	4.4	4.8	5.5	5.1	5.8	19.6	20.7	4.5	5.6	5.9	6.7	20.5
Current revenue	19.9	3.8	4.4	4.8	5.5	5.1	5.8	19.5	20.7	4.5	5.5	5.9	6.6	20.5
Tax revenue	16.3	3.2	3.7	3.9	4.3	4.1	4.6	15.9	16.7	3.8	4.5	4.9	5.5	17.0
Income tax	3.5	0.7	0.8	0.6	0.7	0.7	0.8	2.8	3.2	0.8	0.7	0.8	0.9	2.9
VAT 1/	7.1	1.3	1.5	1.8	1.9	1.8	2.1	6.9	7.6	1.6	2.1	2.2	2.7	7.9
Excises	1.1	0.3	0.3	0.3	0.2	0.3	0.3	1.2	1.1	0.3	0.3	0.3	0.3	1.2
Customs	1.7	0.3	0.4	0.4	0.6	0.5	0.6	1.8	2.1	0.4	0.6	0.6	0.7	2.1
Land tax	0.3	0.1	0.1	0.1	0.1	0.2	0.2	0.5	0.3	0.1	0.1	0.1	0.2	0.5
Road tax and Emergency Fund	1.4	0.3	0.3	0.4	0.3	0.4	0.4	1.4	1.3	0.3	0.4	0.4	0.4	1.3
Retail sales tax	0.6	0.1	0.1	0.1	0.2	0.2	0.2	0.6	0.6	0.1	0.2	0.2	0.2	0.6
Other 2/	0.6	0.1	0.1	0.2	0.2	0.2	0.1	0.7	0.5	0.1	0.2	0.2	0.1	0.6
Nontax revenue	3.6	0.6	0.7	0.9	1.3	0.9	1.2	3.6	3.9	0.7	1.0	1.0	1.2	3.4
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.4	0.0	0.0	0.3	0.0	0.1	0.6	1.0	0.7	0.1	0.1	0.3	0.3	0.8
Total expenditure (excluding net lending)	25.1	4.8	4.6	5.6	6.3	6.3	7.2	24.0	24.8	5.5	6.8	7.1	8.1	24.9
Current expenditure	20.9	3.9	4.1	4.5	5.4	5.2	6.0	19.6	20.4	4.7	5.6	5.5	6.9	20.4
Wages and Social Fund contributions	7.5	1.2	1.5	1.9	2.0	2.0	2.3	7.3	7.4	1.6	2.1	2.1	2.2	7.3
Transfers and subsidies 3/	3.4	0.6	0.8	0.8	0.9	1.1	1.2	3.8	4.1	0.9	1.1	1.1	1.1	3.8
Transfers to Social Fund	1.0	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.0	0.3	0.3	0.3	0.3	1.1
Interest	1.6	0.1	0.1	0.4	0.4	0.1	0.2	0.8	0.9	0.2	0.5	0.1	0.3	1.0
Purchases of other goods and services 4/	7.5	1.8	1.5	1.2	1.9	1.8	2.0	6.8	7.0	1.7	1.5	1.8	3.0	7.3
Capital expenditure (including PIP)	4.2	0.9	0.5	1.2	0.9	1.1	1.2	4.4	4.4	0.8	1.2	1.7	1.2	4.5
Domestically financed capital expenditure	1.0	0.2	0.1	0.4	0.2	0.3	0.4	1.3	1.3	0.3	0.4	0.4	0.3	1.3
Foreign-financed PIP	3.2	0.6	0.4	0.8	0.6	0.8	0.9	3.1	3.1	0.5	0.9	1.3	0.9	3.2
Financial balance	-4.8	-1.0	-0.1	-0.5	-0.8	-1.2	-0.8	-3.4	-3.4	-0.8	-1.1	-1.0	-1.1	-3.6
Net lending	-0.5	0.1	0.1	-0.2	-0.2	-0.2	-0.1	-0.3	-0.4	-0.1	-0.1	-0.1	-0.2	-0.5
Accrual surplus (+) / deficit (-)	-4.3	-1.1	-0.3	-0.3	-0.6	-1.0	-0.7	-3.1	-3.1	-0.7	-1.0	-0.9	-0.9	-3.2
Cash surplus (+) / deficit (-)	-4.3	-1.1	-0.3	-0.3	-0.6	-1.0	-0.7	-3.1	-3.1	-0.7	-1.0	-0.9	-0.9	-3.2
Primary balance excluding grants	-3.1	-1.0	-0.1	-0.2	-0.2	-1.0	-1.1	-3.3	-2.9	-0.6	-0.5	-1.0	-1.0	-2.9
Total financing	4.3	1.1	0.3	0.3	0.6	1.0	0.7	3.1	3.1	0.7	1.0	0.9	0.9	3.2
External financing	3.7	0.9	0.4	0.6	0.5	0.8	1.1	3.3	3.1	0.7	0.6	1.2	0.7	2.9
Public investment program (PIP)	3.2	0.6	0.4	0.8	0.6	0.8	0.9	3.1	3.1	0.5	0.9	1.3	0.9	3.2
Disbursements (BOP support)	0.0	0.3	0.0	0.0	0.0	0.0	0.4	0.7	0.5	0.4	0.0	0.0	0.0	0.3
Total amortization	-1.8	-0.1	-0.1	-0.1	-0.2	-0.1	-0.2	-0.5	-0.6	-0.1	-0.2	-0.1	-0.3	-0.6
Arrears and rescheduling	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	-0.1	-0.1	0.0	0.0	-0.1
Domestic financing	0.5	0.2	-0.1	-0.4	0.1	0.1	-0.5	-0.5	-0.3	0.0	0.4	-0.3	0.0	0.1
Exceptional financing 5/	0.2	0.0	0.0	0.0	0.0	0.1	0.1	0.3	0.3	0.0	0.0	0.0	0.2	0.2
Memorandum items:														
Primary balance	-3.1	-1.0	-0.2	-0.2	-0.2	-1.0	-1.1	-3.3	-2.9	-0.6	-0.5	-1.1	-1.0	-2.9
Domestic balance 6/	0.1	-0.4	0.2	0.7	0.2	0.0	0.3	0.5	0.6	-0.1	0.1	0.5	0.2	0.6

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ In 2005, the VAT and customs revenues were reclassified, leading to lower VAT and higher customs duty collections.

2/ Mainly mineral resource tax.

3/ Excludes transfer to Social Fund.

4/ Includes carry-forward expenditure from previous fiscal year (1.1 percent of GDP in 2004, 0.9 percent of GDP in 2005 and 0.4 percent of GDP in 2006).

5/ Mainly privatization proceeds. Includes som 3,589 million related to the Kumtor mine restructuring for 2004.

6/ Overall balance (in cash) excluding foreign financed PIP and foreign interest payments.

Table 8. Kyrgyz Republic: Social Fund Operations, 2005–07

	2005	2006								2007				
	Year	1Q		2Q		3Q	4Q	Year		1Q	2Q	3Q	4Q	Year
	Act.	Prog.	Actual	Prog.	Actual	Prog.	Prog.	Prog.	Proj.			Proj.		
Total revenue	5,063	1,132	1,289	1,225	1,336	1,170	1,428	4,955	5,079	1,406	1,366	1,382	1,401	5,555
Total contribution	4,976	1,111	1,270	1,204	1,316	1,150	1,407	4,872	4,995	1,386	1,346	1,362	1,381	5,475
Contribution from government	1,156	211	241	311	312	237	409	1,169	1,173	290	293	308	341	1,232
Contribution from nongovernment	3,821	900	1,028	893	1,004	912	998	3,703	3,822	1,096	1,054	1,053	1,040	4,243
Other revenue	87	21	19	21	20	21	21	83	84	20	20	20	20	80
Total expenditure	5,664	1,414	1,449	1,495	1,486	1,536	1,616	6,062	6,304	1,608	1,626	1,720	1,811	6,765
Pension fund (cash)	5,330	1,347	1,389	1,428	1,436	1,469	1,549	5,794	6,014	1,568	1,586	1,630	1,662	6,446
Social insurance fund (cash)	79	0	0	0	0	0	0	0	0	0	0	0	0	0
Employment fund (cash)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Medical insurance fund (cash)	254	67	60	67	50	67	67	268	290	40	40	90	149	319
Net accumulation of arrears	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Financial balance	-601	-282	-161	-271	-150	-366	-188	-1,107	-1,225	-202	-260	-338	-410	-1,210
Budgetary transfer	982	260	260	260	270	260	260	1,038	1,155	321	321	321	321	1,284
Overall balance	381	-23	99	-11	120	-106	71	-69	-70	119	61	-17	-89	74
Total revenue	5.1	1.0	1.2	1.1	1.2	1.1	1.3	4.5	4.6	1.3	1.2	1.3	1.3	4.6
Total contribution	5.0	1.0	1.2	1.1	1.2	1.0	1.3	4.4	4.5	1.3	1.2	1.2	1.3	4.5
Contribution from government	1.2	0.2	0.2	0.3	0.3	0.2	0.4	1.1	1.1	0.3	0.3	0.3	0.3	1.0
Contribution from nongovernment	3.8	0.8	0.9	0.8	0.9	0.8	0.9	3.3	3.5	1.0	1.0	1.0	0.9	3.5
Other revenue	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1
Total expenditure	5.7	1.3	1.3	1.3	1.4	1.4	1.5	5.5	5.7	1.5	1.5	1.6	1.6	5.6
Pension fund (cash)	5.3	1.2	1.3	1.3	1.3	1.3	1.4	5.2	5.5	1.4	1.4	1.5	1.5	5.3
Social insurance fund (cash)	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employment fund (cash)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Medical insurance fund (cash)	0.3	0.1	0.1	0.1	0.0	0.1	0.1	0.2	0.3	0.0	0.0	0.1	0.1	0.3
Net accumulation of arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.6	-0.3	-0.1	-0.2	-0.1	-0.3	-0.2	-1.0	-1.1	-0.2	-0.2	-0.3	-0.4	-1.0
Budgetary transfer	1.0	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.0	0.3	0.3	0.3	0.3	1.1
Cash balance	0.4	0.0	0.1	0.0	0.1	-0.1	0.1	-0.1	-0.1	0.1	0.1	0.0	-0.1	0.1
Memorandum items:														
Average monthly pension (in som; end of period) 1/	796	811	831	854	881	876	876	876	906	969	969	969	969	969
Payroll tax rate	31	29	29	29	29	29	29	29	29	29	28	28	27	27
Revenue collection in cash	4,912	1,100	1,250	1,192	1,303	1,138	1,393	4,823	4,945	1,373	1,333	1,348	1,367	5,421
Cash collection ratio (in percent)	98.7	99.0	98.5	99.0	99.0	99.0	99.0	99.0	99.0	99.0	99.0	99.0	99.0	99.0

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Includes payments to compensate vulnerable households for electricity tariff increases introduced in June 2002.

Table 9. Kyrgyz Republic: Medium-Term Expenditure Framework for General Government by Functional Classification, 2004–10

(In percent of GDP)

		2004	2005	2006	2007	2008	2009	2010
		Act.	Act.	Prog.		Proj.		
	Total expenditure 1/	27.5	28.2	28.1	28.0	27.8	28.0	27.9
I.	General public services	3.3	3.0	2.8	2.7	2.6	2.6	2.5
II.	Defense	1.5	1.4	1.3	1.3	1.2	1.2	1.2
III.	Public order and safety affairs	1.3	1.7	1.6	1.5	1.5	1.4	1.4
	Social spending	14.0	14.6	15.5	15.8	16.0	16.3	16.6
IV.	Education	4.6	4.9	5.0	5.1	5.2	5.3	5.4
V.	Health	2.0	2.3	2.5	2.8	3.0	3.2	3.4
VI.	Social security and welfare affairs 2/	2.1	2.1	2.5	2.6	2.7	2.8	2.9
VII.	Pension fund 3/	5.2	5.3	5.5	5.3	5.1	5.0	4.9
VIII.	Housing and community services	1.1	1.0	1.0	0.9	0.9	0.9	0.9
IX.	Recreational, cultural and religious activities	0.6	0.6	0.6	0.5	0.5	0.5	0.5
X	Energy complex (electricity production)	0.2	0.2	0.2	0.2	0.2	0.2	0.2
XI.	Agriculture, water resources, forestry	2.2	2.1	2.0	1.9	1.8	1.8	1.8
XII.	Mining and mineral resources	0.3	0.3	0.3	0.3	0.3	0.3	0.2
XIII.	Transportation and communication	2.0	1.8	1.7	1.6	1.6	1.6	1.5
XIV.	Other economic affairs and services	0.7	0.7	0.7	0.6	0.6	0.6	0.6
XV.	Other (including net lending)	0.2	0.6	0.6	0.6	0.6	0.6	0.5

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Including PIP and net lending.
2/ Excluding net transfer to the Social Fund, but including the contingency item for social compensation in case of electricity tariff increases.
3/ Social Fund operations net of transfers to other funds.

Table 10. Kyrgyz Republic: NBKR Accounts, 2005–07 1/

	2005	2006						2007			
	Dec.	Mar.	Jun.		Sep.	Dec.		Mar.	Jun.	Sep.	Dec.
	Act.	Act.	Prog.	Act.	Prog.	Prog.	Proj.		Proj.		
	(Annual percent change)										
Net foreign assets	24.2	25.0	24.6	36.7	13.1	11.4	27.5	36.1	29.1	25.0	23.1
Net domestic assets	108.9	-47.0	-30.3	-37.6	51.0	217.6	-5.1	-54.4	62.6	-31.5	-69.8
Net claims on general government	182.6	7.5	-26.3	18.8	-4.5	-25.1	-13.6	-15.6	-4.0	-24.1	-13.1
Claims on rest of the economy	-27.3	-21.1	13.3	-59.1	53.1	80.1	-51.8	-30.0	58.5	125.1	-39.0
Reserve money	24.9	21.8	21.8	32.9	14.6	14.5	27.0	34.3	29.9	23.9	22.5
Currency in circulation	20.5	13.6	16.1	28.9	12.6	15.0	27.6	34.1	27.7	23.9	21.6
Commercial banks' reserves and other balances	114.9	132.4	79.4	73.4	29.2	11.0	23.1	35.6	46.7	24.3	28.7
	(Contribution to broad money growth, in percent) 2/										
Net foreign assets	24.0	19.5	19.3	28.8	11.3	11.3	27.1	27.7	24.5	23.5	23.0
Net domestic assets	1.0	-1.7	-1.3	-1.6	1.7	3.2	-0.1	-0.8	1.3	-0.6	-0.4
Of which: Net claims on general government	6.2	0.5	-1.9	1.3	-0.3	-1.9	-1.0	-0.8	-0.3	-1.5	-0.6
Reserve money	24.9	17.8	18.0	27.2	13.1	14.5	27.0	26.8	25.8	23.0	22.5
Of which: Currency in circulation	16.1	10.3	12.1	21.7	10.0	13.0	23.9	23.2	21.1	19.9	18.9
	(In millions of soms)										
Net foreign assets	15,236	15,049	15,090	16,554	15,108	16,977	19,424	20,481	21,371	23,113	24,030
Net international reserves	17,477	17,290	17,310	18,984	17,328	19,176	21,736	22,598	23,467	25,205	26,102
Long-term foreign liabilities	-2,353	-2,353	-2,332	-2,332	-2,332	-2,311	-2,311	-2,226	-2,205	-2,201	-2,180
Other foreign assets	164	164	163	-46	163	163	50	153	153	153	153
Balances with CIS countries	-51	-51	-51	-51	-51	-51	-51	-45	-45	-45	-45
Net domestic assets	230	299	458	410	797	731	219	136	667	239	35
Net claims on general government	1,188	1,048	816	1,316	951	890	1,026	884	1,263	924	766
Loans to government in forex (Turkish loan)	1,943	1,943	1,981	1,943	1,981	1,981	2,033	1,888	1,926	1,926	1,926
Total government deposits (-)	-5,202	-5,329	-5,366	-4,801	-5,232	-4,792	-4,680	-4,677	-4,236	-4,575	-4,533
Treasury bonds 3/	3,897	3,884	3,651	3,523	3,651	3,151	3,023	3,023	3,023	3,023	2,823
Treasury bills	550	550	550	650	550	550	650	650	550	550	550
Repos	-50	-85	62	-198	200	200	-197	-150	-100	-200	-215
Claims on commercial banks	351	346	346	344	342	342	342	333	333	328	329
Other items net 4/	-1,259	-1,011	-765	-1,052	-695	-701	-953	-931	-829	-813	-845
Reserve money	15,466	15,348	15,549	16,965	15,905	17,708	19,642	20,617	22,038	23,351	24,065
Currency in circulation	13,414	13,331	13,486	14,971	13,795	15,430	17,115	17,881	19,114	20,243	20,812
Commercial banks' reserves and other balances	2,052	2,018	2,063	1,994	2,110	2,278	2,527	2,736	2,924	3,108	3,253
Of which: Required reserves	1,160	768	1,302	1,372	1,499	1,411	1,725	1,773	2,043	2,027	2,174
Memorandum items:											
Reserve money growth (in percent, relative to end of previous year)	24.9	17.8	18.0	27.2	13.1	14.5	27.0	26.8	25.8	23.0	22.5
Net international reserves (in millions of dollars), nonadjusted	416	412	412	452	413	457	518	572	594	638	661
Net domestic assets (in millions of soms), nonadjusted 5/	-1,943	-1,869	-1,752	-1,756	-1,413	-1,469	-2,034	-1,958	-1,465	-1,893	-2,097

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Figures for 2004–05 are based on program exchange rates (including 42 soms per dollar) specified in the TMU (see IMF Country Report No. 05/119); projections for 2007 use new program exchange rates spec revised TMU.

2/ Contribution is defined as annual change of asset stock relative to previous year's reserve money stock (in percent).

3/ Includes government securities issued in December 2002 to replace restructured bonds, as well as those issued for revaluation losses, lost capital in the Central Asia Development Bank, and capitalized past interest arrears on bonds.

4/ Includes since December 2002, revaluation losses, lost capital in the Central Asia Development Bank, and capitalized past interest arrears on bonds.

5/ Excludes medium- and long-term central bank liabilities (i.e., the loan by the Eximbank of Turkey and the EBRD/IDA enterprise loan channeled through the NBKR).

Table 11. Kyrgyz Republic: Monetary Survey, 2005–07 1/

	2005		2006				
	Dec.		Mar.	Jun.		Sep.	Dec.
	Act.	Act. 2/	Act.	Prog.	Act.	Prog.	Prog.
	(Annual percent change)						
Net foreign assets	31.1	20.1	27.7	38.9	27.0	19.1	12.5
Net domestic assets	47.3	54.5	36.1	-38.8	64.6	23.5	35.4
Net claims on general government	24.2	24.2	-2.0	-20.9	0.4	-6.5	-47.8
Credit to the rest of the economy	30.3	32.0	38.8	-8.8	49.0	17.0	19.9
Broad money (M2X)	33.8	25.5	29.4	22.7	34.9	20.0	17.0
Currency held by the public	17.5	17.5	13.6	13.5	29.1	9.8	14.5
Total deposit liabilities	56.0	40.6	63.6	38.3	44.6	35.4	20.9
	(Contribution to broad money growth, in percent) 3/						
Net foreign assets	26.0	16.9	17.4	32.5	18.0	17.7	10.1
Net domestic assets	7.9	8.6	5.7	-8.5	11.3	5.5	6.9
Domestic credit	11.7	13.0	11.4	-5.0	15.1	6.7	4.3
Net claims on general government	1.4	1.6	-0.1	-1.7	0.0	-0.5	-3.1
Credit to the rest of the economy	10.3	11.4	11.6	-3.4	15.0	7.2	7.4
Other items net	-3.9	-4.4	-5.7	-3.5	-3.7	-1.2	2.6
Broad money (M2X)	33.8	25.5	23.1	24.0	29.3	23.3	17.0
Currency held by the public	10.0	11.4	7.3	8.9	15.3	6.8	8.9
Total deposit liabilities	23.8	14.1	15.8	15.1	14.0	16.4	8.1
	(In millions of soms)						
Net foreign assets	21,153	17,232	17,033	19,791	18,096	18,851	19,393
Of which: Long-term foreign liabilities (-)	-2,353	-2,353	-2,353	-2,332	-2,332	-2,332	-2,311
Net domestic assets	4,743	4,170	4,550	2,294	6,167	4,940	5,647
Domestic credit	9,989	9,416	10,066	7,046	11,124	9,622	10,335
Net claims on general government	1,406	1,406	1,295	1,063	1,350	1,218	734
Credit to the rest of the economy	8,583	8,010	8,771	5,983	9,774	8,404	9,601
Of which: In forex	6,255	5,813	6,274	4,207	6,799	5,910	6,721
Other items net	-5,246	-5,246	-5,516	-4,752	-4,957	-4,682	-4,688
Broad money (M2X)	25,895	21,402	21,583	22,085	24,264	23,791	25,040
Of which: Broad money, excluding forex deposits (M2)	16,281	15,959	16,052	16,558	18,286	17,608	19,156
Currency held by the public	13,065	13,065	12,959	12,787	14,545	13,080	14,961
Total domestic currency deposit liabilities	3,216	2,894	3,094	3,772	3,742	4,528	4,196
Memorandum items:							
Broad money (M2X) growth (in percent, relative to end of previous year)	33.8	25.5	23.1	24.0	29.3	23.3	17.0
Credit to the rest of the economy (in percent of GDP)	8.6	8.0	...	...	...	... .	8.6
M2X velocity 4/	3.9	4.7	...	...	...	... .	4.4
M2X multiplier	1.7	1.4	...	...	...	... .	1.4
Dollarization indicators (in percent) 5/							
Asset dollarization	72.9	72.6	71.5	70.3	69.6	70.3	70.0
Liability dollarization	37.1	25.4	25.6	25.0	24.6	26.0	23.5

Table 11 (concluded). Kyrgyz Republic: Monetary Survey, 2005–07 1/

	2006	2007			
	Dec.	Mar.	Jun.	Sep.	Dec.
	Proj.		Proj.		
Net foreign assets	23.3	30.9	26.9	22.8	23.0
Net domestic assets	84.1	60.9	58.3	37.8	26.8
Net claims on general government	-22.2	-26.5	-1.5	-20.6	8.9
Credit to the rest of the economy	43.9	28.7	35.5	20.0	19.7
Broad money (M2X)	35.1	37.2	34.8	26.4	24.0
Currency held by the public	27.0	30.8	24.6	24.0	22.5
Total deposit liabilities	47.8	46.8	50.2	29.8	26.0
Net foreign assets	18.7	18.2	16.8	16.0	17.0
Net domestic assets	16.4	9.6	12.4	8.4	7.0
Domestic credit	15.0	7.5	11.9	6.4	8.2
Net claims on general government	-1.5	-1.2	-0.1	-0.9	0.3
Credit to the rest of the economy	16.4	8.7	12.0	7.3	7.9
Other items net	1.4	2.1	0.5	2.0	-1.1
Broad money (M2X)	35.1	27.8	29.2	24.3	24.0
Currency held by the public	16.5	13.8	12.4	12.9	12.9
Total deposit liabilities	18.6	14.0	16.9	11.5	11.1
Net foreign assets	21,240	22,298	22,957	24,855	26,216
Of which: Long-term foreign liabilities (-)	-2,311	-2,226	-2,205	-2,201	-2,180
Net domestic assets	7,678	7,320	9,760	8,835	9,642
Domestic credit	12,618	12,238	14,576	13,634	14,912
Net claims on general government	1,094	952	1,330	991	1,033
Credit to the rest of the economy	11,524	11,286	13,246	12,643	13,879
Of which: In forex	7,762	7,652	8,941	8,534	9,299
Other items net	-4,940	-4,918	-4,816	-4,800	-5,270
Broad money (M2X)	28,918	29,618	32,718	33,690	35,858
Of which: Broad money, excluding forex deposits (M2)	21,724	22,224	24,274	25,117	26,752
Currency held by the public	16,595	16,955	18,123	19,213	20,331
Total domestic currency deposit liabilities	5,130	5,270	6,151	5,903	6,421
Memorandum items:					
Broad money (M2X) growth (in percent, relative to end of previous year)	35.1	27.8	29.2	24.3	24.0
Credit to the rest of the economy (in percent of GDP)	10.5	10.1	11.7	10.9	11.5
M2X velocity 4/	3.8	3.8	3.5	3.5	3.4
M2X multiplier	1.5	1.4	1.5	1.4	1.5
Dollarization indicators (in percent) 5/					
Asset dollarization	67.4	67.8	67.5	67.5	67.0
Liability dollarization	24.9	25.0	25.8	25.4	25.4

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Figures for 2004–05 are based on program exchange rates (including 42 soms per dollar) specified in the TMU (see IMF Country Report No. 05/119); projections for 2007 use new program exchange rates specified in the revised TMU.

2/ From December 2005 onward, commercial banks' deposit liabilities and loans to nonresidents are reclassified as foreign liabilities and assets respectively.

3/ Contribution is defined as annual change of asset stock relative to previous year's broad money stock (in percent).

4/ 12-month GDP over end-period broad money.

5/ Asset dollarization is measured as the ratio of credit extended in foreign exchange to total banking system credit to the private sector, and liability dollarization as the share of foreign exchange deposits in broad money.

Table 12. Kyrgyz Republic: Medium-Term Balance of Payments, 2004–11

(In millions of U.S. dollars)

	2004	2005	2006		2007	2008	2009	2010	2011
	Actual	Actual	IMF Country Report No. 06/235	Proj.	Proj.				
Current account balance	-76	-203	-179	-301	-302	-282	-243	-255	-288
excluding transfers	-284	-536	-601	-748	-824	-836	-823	-855	-925
Trade balance	-171	-419	-474	-672	-723	-678	-596	-648	-731
Exports, fob	733	687	786	753	901	1115	1356	1430	1453
CIS countries	278	305	347	375	405	434	465	505	560
Of which: Energy	31	33	38	39	44	49	55	62	70
Non-CIS countries	456	382	439	378	496	682	892	925	893
Of which: Gold	287	231	268	187	289	469	674	699	653
Imports, fob	904	1106	1260	1425	1624	1793	1952	2078	2184
CIS countries	554	641	747	882	1004	1097	1182	1249	1306
Of which : Energy	240	289	353	445	512	539	558	572	604
Non-CIS countries	349	465	513	543	621	696	770	829	878
Of which: Trade under the simplified customs regime	5	85	102	152	186	223	243	258	272
Services	-14	-36	-61	-13	-20	-39	-52	-35	2
Noninterest service	-14	-36	-61	-13	-20	-39	-52	-35	2
Receipts	210	256	285	348	398	429	465	503	554
Payments	-224	-291	-347	-361	-418	-468	-517	-538	-552
Income	-100	-81	-65	-63	-81	-119	-175	-173	-196
Interest payments 1/	-37	-37	-19	-22	-24	-26	-36	-38	-40
Other net income	-63	-44	-46	-41	-58	-93	-139	-135	-157
Current Transfers (net)	209	332	422	447	522	554	580	601	637
Official	24	23	37	32	43	53	48	37	39
Private	185	309	385	415	479	502	532	564	598
Capital Account	-16	-11	-6	-24	-9	-2	3	7	9
Official	28	52	41	40	49	50	50	49	50
Of which: Debt forgiveness	0	19	0	0	0	0	0	0	0
Private	-44	-63	-46	-64	-58	-52	-47	-42	-41
Financial account	182	263	208	445	413	411	397	352	420
Commercial banks	-30	28	-12	40	40	32	32	32	24
Medium- and long-term loans, net	12	-40	73	62	78	89	100	55	107
Disbursement	78	83	112	102	115	124	141	145	154
Of which: Loan financed PIP	71	79	82	87	98	106	114	122	129
Amortization 1/	-66	-104	-39	-41	-37	-35	-41	-90	-47
Foreign direct investment (net)	131	83	89	149	110	104	116	124	141
Portfolio investment (net)	-2	-4	6	8	12	13	13	14	15
Derivatives and net short-term flows (including errors and omissions)	71	196	52	186	173	172	136	127	133

Table 12 (concluded). Kyrgyz Republic: Medium-Term Balance of Payments, 2004–11

(In millions of U.S. dollars)

	2004	2005	2006		2007	2008	2009	2010	2011
	Actual	Actual	IMF Country Report No. 06/235	Proj.	Proj.				
Overall balance	90	49	23	120	102	127	157	105	141
Financing	-90	-49	-23	-120	-102	-127	-157	-105	-141
Net international reserves	-164	-93	-41	-136	-110	-135	-157	-105	-141
Gross official reserves (- increase)	-161	-81	-18	-112	-90	-115	-135	-82	-118
IMF (net)	-4	-12	-23	-24	-20	-20	-22	-24	-23
Exceptional Financing (including arrears)	46	44	0	3	-2	0	0	0	0
BOP support loans (ADB)	28	0	8	8	0	8		0	0
BOP support loans (WB)	0	0	10	5	10	0	0	0	0
Financing gap (-)	0	0	0	0	0	0	0	0	0
Memorandum items:									
GDP (in millions of U.S. dollars)	2,216	2,441	2,646	2,751	3,071	3,431	3,819	4,149	4,398
Current account balance (in percent of GDP)	-3.4	-8.3	-6.8	-11.0	-9.8	-8.2	-6.4	-6.1	-6.6
Growth of exports of goods and services (volume, percent)	22.3	-8.2	2.2	1.0	12.9	16.7	15.3	3.5	1.9
Growth of imports of goods and services (volume, percent)	25.1	13.3	6.7	13.2	8.8	9.5	8.3	4.9	2.4
External Public Debt (US$ million) 2/	1,954	1,918	2,068	1,973	2,037	2,101	2,159	2,225	2,296
as percent of GDP	88	79	78	72	66	61	57	54	52
External Public Debt (NPV US$ million) 2/	1,322	1,133	1,153	1,175	1,221	1,269	1,314	1,364	1,417
as percent of GDP	60	46	44	43	40	37	34	33	32
as percent of exports	140	120	108	107	94	82	72	71	71
Public debt service-to-exports ratio 2/ 3/	6.4	7.4	5.6	5.9	5.3	5	5	4	4
Gross reserves 4/	544	609	627	721	811	926	1061	1143	1261
in months of subsequent year's imports	4.7	4.1	4.4	4.2	4.3	4.5	4.9	5.0	5.4

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Starting 2006, interest and amortization reflect bilateral agreements signed following March 2005 Paris Club agreement to grant debt relief on London terms.
2/ Public and publicly guaranteed debt.
3/ Net of resheduling.
4/ Valued at end-period exchange rates.

Table 13. Kyrgyz Republic: Indicators of Fund Credit, 2005–10

(In percent, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010
		Projections				
Outstanding Fund credit (end-of-period)						
In millions of SDRs	124.5	108.4	94.8	81.3	66.5	50.3
In millions of U.S. dollars	183.8	159.1	140.8	121.1	99.3	75.3
In percent of quota 1/	140.2	122.1	106.8	91.5	74.9	56.6
In percent of GDP	7.5	5.8	4.6	3.5	2.6	1.8
In percent of total exports	19.5	14.4	10.8	7.8	5.5	3.9
In percent of external public debt	9.6	8.1	6.9	5.8	4.6	3.4
In percent of gross reserves (beginning of period)	33.8	26.2	19.5	14.9	10.7	7.1
Debt service due to the Fund						
In millions of SDRs	21.5	19.2	16.6	15.2	15.1	16.5
In millions of U.S. dollars	31.8	28.2	24.7	22.7	22.5	24.7
Of which:						
Charges/interests	1.0	0.9	0.7	0.6	0.5	0.4
Repurchases and repayments	30.8	27.3	24.0	22.1	22.0	24.3
In percent of quota 1/	24.3	21.6	18.7	17.1	17.0	18.6
In percent of GDP	1.3	1.0	0.8	0.7	0.6	0.6
In percent of total exports	3.4	2.6	1.9	1.5	1.2	1.3
In percent of total debt service	24.9	32.2	28.6	27.2	22.8	16.4
In percent of total public debt service	45.4	43.3	36.0	32.1	27.2	29.4
In percent of gross reserves (beginning of period)	5.9	4.6	3.4	2.8	2.4	2.3

Sources: IMF, Finance Department, and Fund staff calculations.

1/ Kyrgyz Republic quota: SDR 88.8 million.

Table 14. Kyrgyz Republic: Prospective Use of Fund Resources, 2005–10

(in millions of SDR, unless otherwise stated)

	Outstanding	Proj.				
	End-Dec. 2005	2006	2007	2008	2009	2010
PRGF transactions	124.5					
Disbursements		2.5	2.5	1.3	0.0	0.0
Repayments		18.6	16.1	14.8	14.7	16.2
Total Fund credit outstanding	124.5	108.4	94.8	81.3	66.5	50.3
Total Fund credit outstanding 1/	140.2	122.1	106.8	91.5	74.9	56.6
Disbursements under PRGF 1/	0.0	2.9	2.9	1.4	0.0	0.0

Sources: IMF, Finance Department; and Fund staff calculations.

1/ Relative to the quota of SDR 88.8 million.

Table 15. Kyrgyz Republic: Reviews and Disbursements Under the Three-Year PRGF Arrangement

Date	Action	Associated Disbursement
February 23, 2005	Approved three-year arrangement.	SDR 1.26 million
October 24, 2005	Completed first review based on end-June 2005 performance criteria.	SDR 1.27 million
May 5, 2006	Completed second review based on end-December 2005 performance criteria.	SDR 1.27 million
November 1, 2006	Complete third review based on end-June 2006 performance criteria.	SDR 1.27 million
On or after February 15, 2007	Complete fourth review based on end-December 2006 performance criteria, and adopt conditions and disbursements for the third year of the arrangement.	SDR 1.27 million
On or after August 15, 2007	Complete fifth review based on end-June 2007 performance criteria.	SDR 1.27 million
On or after February 15, 2008	Complete sixth review based on end-December 2007 performance criteria.	SDR 1.27 million

Table 16. Kyrgyz Republic: Millennium Development Goals

	1990	2004	2015 Target	ON track/ OFF track
Goal 1. Eradicate extreme poverty and hunger				
Target: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.				
Poverty headcount ratio at $1 a day (PPP) (percent of population)1/	20	2	10	on track
Goal 2. Achieve universal primary education				
Target : Ensure that, by 2015, children will be able to complete a full course of primary schooling				
Net primary enrollment ratio (percent of relevant age group)	92	90	100	on track
Goal 3. Promote gender equality and empower women				
Target : Eliminate gender disparity in primary and secondary education preferably by 2005 and at all levels of education by 2015				
Ratio of girls to boys in primary and secondary education (percent)	100.2	100.6	100	on track
Goal 4. Reduce child mortality				
Target : reduce by two-thirds between 1990 and 2015, the under-five mortality rate				
Under-five mortality rate (per 1,000)	80	68	26.7	on track
Goal 5. Improve maternal health				
Target : Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.				
Maternal mortality ratio (WHO modeled estimate, per 100,000 live births)	…	110	…	n/a
Goal 6. Combat HIV/AIDS, malaria and other diseases				
Target : Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases				
Tuberculosis cases detected under DOTS (percent)	3	61.7	1.5	off track
Goal 7. Ensure environmental sustainability				
Target: Halve by 2015 proportion of people without access to safe drinking water				
Access to improved water source (percent of population)	78	77	89	on track
Goal 8. Develop a global partnership for development				
Target: In cooperation with private sector, make available the benefits of new technologies, especially information and communications				
Fixed line and mobile phone subscribers (per 1,000 people)	71	106.1	…	on track
Other				
Life expectancy at birth (years)	68.3	68.2		

Source: World Bank Development Indicators.

1/ Poverty indicator for 1995 was used as a proxy for 1990.

ANNEX I. KYRGYZ REPUBLIC: JOINT IMF-WORLD BANK DEBT SUSTAINABILITY ANALYSIS

The staff's debt sustainability analysis (DSA) suggests that the Kyrgyz Republic's external debt continues to pose a heavy burden, placing the country at a high risk of debt distress. The debt outlook remains highly vulnerable to exogenous shocks or reversals of the prudent macroeconomic policies that have become entrenched in recent years. Accordingly, careful debt management and donor support on highly concessional terms will be crucial to ensure that debt indicators remain on a downward path.

1. **The DSA presented below was prepared jointly by Fund and World Bank staffs in consultation with the authorities, using the joint Bank-Fund Low-Income Country Debt Sustainability Framework (LIC DSF).**[1, 2] Macroeconomic assumptions underlying the baseline scenario in this DSA (Box 1) are consistent with the framework presented in the staff report for the 2006 Article IV Consultations and in the preliminary HIPC document (IMF Country Report No. 06/417 dt. November 2006). The external debt data used for this exercise were updated by staffs using information provided by the authorities for the stock of debt as of end-2004 and information on disbursements and debt restructuring agreements signed in 2005.[3]

I. Background: structure of external debt and developments in 2005

2. **The Kyrgyz Republic's nominal stock of public and publicly guaranteed external debt as of end-2005 is estimated at $1,918 million** (79 percent of GDP). In present value terms, this is equivalent to $1,133 million (46 percent of GDP), of which 72 percent is owed to IFIs and the remaining 28 percent to bilateral creditors.

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[1] There are important conceptual and methodological differences between a DSA conducted under the HIPC Initiative and the LIC DSF. The latter is a forward-looking exercise aimed at helping frame sustainable, country-specific borrowing and fiscal policies in low-income countries, while the former focuses on assessing eligibility for HIPC Initiative debt relief and calculating its amounts using fixed uniform thresholds to ensure uniformity of treatment across countries. NPV of debt under the LIC DSA is calculated using (a) a fixed 5 percent discount rate, compared to currency-specific discount rates for HIPC DSA; (b) WEO exchange rate projections (compared to fixed exchange rates as of the end of the base year; and (c) annual exports (compared to three-year average of exports, net of re-exports) as the denominator in the debt burden-to-exports ratios. Findings of the LIC DSA have no bearing on a country's status under the enhanced HIPC Initiative (see www.imf.org) "Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations.")

[2] The last LIC DSA (external debt only) prepared by Fund staff was included in the request for the current PRGF arrangement (IMF Country Report No. 05/119).

[3] These data refer to public and publicly guaranteed external debt. The 2004 stock of debt was reconciled and used in the DSA for the preliminary HIPC document.

3. **The March 2005 Paris Club agreement was a key factor influencing public external debt in 2005.** Paris Club creditors agreed to restructure the country's bilateral obligations on concessional terms and provided considerable immediate cash relief. On ODA loans, they granted a 40-year repayment period with 13 years' grace, at interest rates at least as favorable as the original concessional rates. On non-ODA credits, they agreed to halve the NPV, following either the debt reduction or debt service-reduction options. Further, to grant temporary cash flow relief, creditors capitalized 80 percent, 75 percent, 70 percent, and 65 percent of interest accrued in 2005, 2006, 2007, and 2008, respectively, and extended the repayment period to 23 years with a 7-year grace period. The authorities have completed bilateral agreements with all Paris Club creditors and are currently conducting negotiations with the remaining bilateral creditors. Staffs estimate that full participation of all bilateral creditors at comparable terms would result in a reduction of about 40 percent in the NPV of public bilateral debt.

II. External Debt Sustainability

4. **While the assumptions outlined in Box 1 underpin the baseline projections of debt sustainability indicators, staff conducted a series of stress tests to assess their sensitivity to less favorable scenarios.** In addition to standard alternative scenarios and stress tests embedded in the LIC DSA template, an additional Kyrgyz-specific test gauges the impact of a sharp fall in gold price on debt indicators (recognizing that gold accounts for one-fourth of total Kyrgyz exports), simulating the effect of a cumulative 40 percent decline in gold prices in 2007–09, followed by a return to their baseline path thereafter. In addition to accounting for the first-round impact of the shock on exports, the scenario factors in second-round effects by assuming a slowdown in growth and FDI and allowing currency depreciation. The analysis also presents a scenario accounting for the impact of debt relief under the HIPC Initiative and the MDRI on the Kyrgyz Republic's debt sustainability, given the authorities intention to seek relief under the HIPC Initiative.

5. **As noted below, the current debt burden places the Kyrgyz Republic at a high risk of debt distress.** Nevertheless, the baseline scenario shows a cautiously favorable improvement in the external debt outlook over time. At 277 percent in 2005, the NPV of debt-to-revenue ratio is above the policy based indicative threshold of 250 percent.[4, 5] This indicator and the NPV of debt-to-GDP ratio would fall below their indicative thresholds by

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[4] The Kyrgyz Republic is rated as a *medium performer* based on the World Bank's Country Performance and Institutional Assessment Index. The relevant policy-dependent thresholds are 40 percent for the NPV of the debt-to-GDP ratio, 150 percent for the NPV of debt-to-exports ratio, 250 percent for the NPV of debt-to-revenue ratio, 20 percent of the debt service-to-exports ratio, and 30 percent of the debt service-to-revenue ratio.

[5] Central government revenues excluding grants.

Macroeconomic Assumptions 2006–26

Annual real GDP growth would average 4½ percent, on the back of strong private investment, including FDI, spurred by improvements in business climate. In the near term, growth would be supported by a rebound in mining and the initial impact of reforms in the energy sector, while services, primarily tourism-related, and a reformed energy sector would underpin long-run growth. Consistent with the assumption of conservative fiscal and monetary policies, long-term inflation would average 4 percent, and the Kyrgyz som would remain stable against the U.S. dollar in real terms.

Following an accident in the Kumtor gold mine in 2006, **exports are slated to recover, growing by an average of 5.3 percent a year.** In addition to normalization of Kumtor operations, this recovery would be underpinned by the start of mining in other major gold deposits and robust import demand from Russia and Kazakhstan, particularly for industrial and processed food products. As this growth pattern would keep exports vulnerable to a depletion of mining deposits, a sharp drop in world commodity prices, and natural disasters, export diversification efforts need to be directed to creating an enabling business environment to exploit the considerable export potential, particularly in tourism and hydroenergy. Long run projections assume that a sharp drop in gold output from the expected closure of the Kumtor mine in 2012–13 will be moderated by sustained gains in the tourism and energy sectors. In all, by the end of the period, exports growth would stabilize around 4¾ percent a year.

Consistent with growth projections and expected FDI inflows, imports would grow at 5 percent a year. They would continue to be sourced mainly from CIS trading partners and China, with oil products and consumer goods dominating the commodity structure.

The current account deficit is projected to narrow from 8¼ percent of GDP in 2005 to 5¼ percent in 2025. Buoyed by strong income growth in Russia and Kazakhstan, private transfers—mainly worker's remittances amounting to almost 15 percent of GDP in 2006—will remain large, financing a significant share of the trade deficit. In the long run, a projected narrowing in the current account deficit would be supported by fiscal consolidation and increased private savings.

Net FDI would increase gradually to 3.5 percent of GDP by the end of the projection period. While in the near term FDI would be concentrated in traditional sectors, like mining and industry, business climate improvements should yield a more diversified structure of FDI in the outer years. The foreign loan-financed part of the Public Investment Program would decline from 3¼ percent of GDP at present to 2½ percent in 2026. International reserves would stay at 4–5 months of imports.

Medium-term public borrowing—to finance Public Investment Program and fill financing gaps—will be contracted on highly concessional terms, primarily from IFIs. Over the DSA horizon, concessionality of new external public borrowing would gradually decline from around 45 percent in 2006–10 about 17 percent in 2020–26, as more borrowing will be contracted at less concessional terms from bilateral and commercial creditors.

Central government revenues (excluding grants) are projected at around 17½ percent of GDP in 2006–10, and would increase gradually by a total of ¾ percentage points by 2026.

end-2006 and end-2008, respectively, and steadily decline further, continuing on a downward path underpinned by the assumed fiscal consolidation and prudent debt management. Given that the Kyrgyz Republic is an open economy with a high exports-to-GDP ratio, the NPV of debt-to-export ratio would stay well below the corresponding threshold throughout the projection period. With the anticipated closure of the largest gold mine, Kumtor, in 2012 or 2013, the ratio would increase somewhat at that time before falling to about 65 percent by the end of projection period.

6. **Debt service indicators are expected to remain manageable throughout the DSA horizon.** This reflects the high concessionality of both existing multilateral debt and new borrowing, as well as debt relief delivered by Paris Club creditors in 2005. In sum, the debt service would amount to 5½ percent of exports (12 percent of revenues) in the medium term, but reach 7 percent of exports (15 percent of revenues) during the later stage of the projection period, driven by new borrowing and the repayment of previously restructured bilateral debt.

7. **Stress tests and alternative scenarios show the Kyrgyz Republic's debt sustainability as highly vulnerable to large shocks or less favorable assumptions.** The NPV of debt-to-GDP ratio stays above the threshold under almost all tests, while the NPV of debt-to-revenue is especially sensitive to assumptions on export growth, projections of nondebt creating inflows, and a combination of four standard tests (B4), breaching the relevant threshold over the DSA horizon. Debt service burden ratios, however, prove relatively more resilient under several scenarios, staying below indicative levels, although they too deteriorate considerably by 2026. An alternative scenario (A2) suggests that a 2 percent higher interest rate on new borrowing would make debt unsustainable, with the debt service burden becoming heavy in the medium term. The additional country specific scenario (A3) designed by staff shows that the debt situation could also worsen in the event of a sharp fall in gold price. All sustainability indicators would deteriorate over the medium term, but the NPV of debt-to-exports and the debt service ratio would still remain below their thresholds.

8. **Additional risks to the debt sustainability outlook would arise if the government violated the program's prohibition on the contracting of *nonconcessional* loans in order to finance large investment projects under discussion with bilateral creditors.**[6] Even if these loans were concessional, it would be important to ensure that the underlying projects are viable, so as to safeguard debt sustainability.

9. **Under the enhanced HIPC initiative and subsequently the MDRI, the Kyrgyz Republic could avail itself of a significant fiscal space that could be directed to poverty**

[6] The DSA does not include these loans as neither their terms and conditions as well as government involvement nor potential returns from the projects being discussed were known to staff at the time of preparation of this DSA.

reducing spending.[7] Assuming that it reaches the HIPC decision point at the turn of this year and the completion point by end-2008, debt service in 2007-2015 would decline from 4½ percent of exports (10½ percent of revenues), before any debt relief, to 2 percent of exports (4 percent of revenues), after application of debt relief from both initiatives. The relief would also improve sustainability indicators in the near to medium term, although, in the outer years, the NPV of debt ratios would rise, reflecting new borrowing—primarily to finance PIP projects.

III. Public Debt Sustainability

10. **Since external debt accounts for more than 90 percent of total public debt, the public DSA results are similar to the external DSA findings.** The public DSA assumes further fiscal consolidation (measured by the primary balance) of about 1 percent of GDP from 2006 to 2026, stemming from an increase in revenues of about 2 percentage points of GDP due to stricter tax enforcement and better compliance. Almost half of the revenue increase would finance higher pension outlays driven by the projected population aging, whereas capital spending would increase by ½ percentage point of GDP and noninterest current spending would remain broadly unchanged in relation to GDP. In this baseline scenario, the NPV of public debt-to-GDP is about 50 percent in 2006 and stabilizes slightly below 40 percent in the long term. The ratio of NPV of debt to general government revenue declines from just under 200 percent in 2006 to about 140 percent in 2026, while the ratio of the NPV of debt to central government revenue before grants would drop from 279 percent in 2006 to 214 percent by 2026. Standard stress tests show that current debt levels are highly vulnerable to shocks to the economy and, under an alternative scenario with real GDP growth for 2007 and 2008 of one half standard deviation lower than the baseline, the ratios of the NPV of debt to GDP and the NPV of debt to central government revenue before grants would increase to 85 percent and 463 percent, respectively, by 2026.

IV. Debt Distress Classification

11. **The Kyrgyz Republic is assessed to be at high risk of debt distress, as evidenced by the NPV of debt-to-revenue and the NPV of debt-to-GDP ratios, which were above their indicative thresholds at end-2005.**[8] Although these indicators are projected to improve and move below the thresholds, they would approach or breach the thresholds if the Kyrgyz Republic were to experience an exogenous shock or relax its prudent debt management policy, as suggested by alternative scenarios and stress tests. Under the baseline

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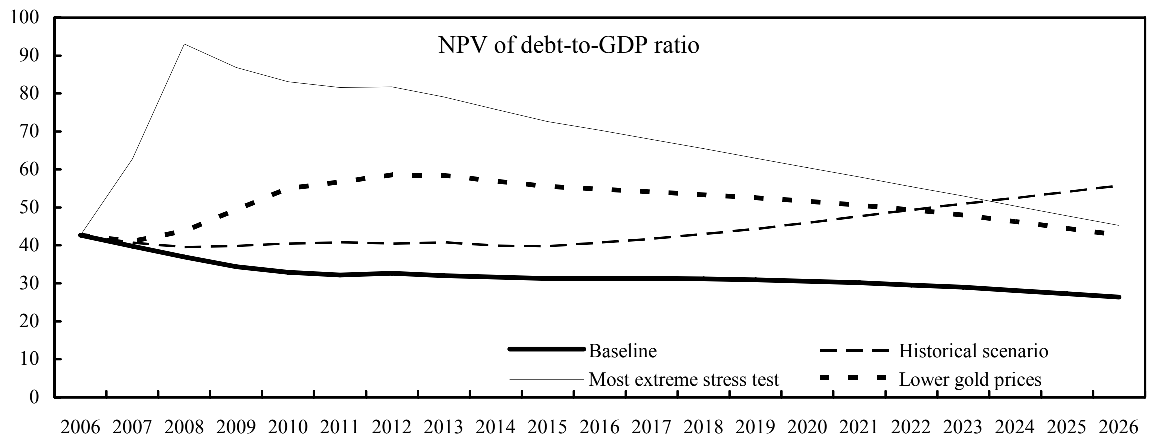
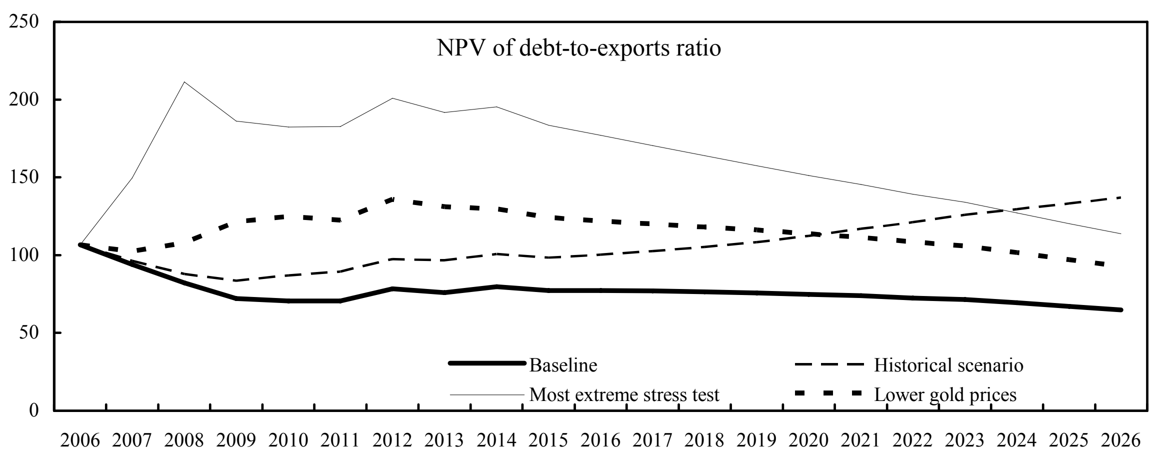
[7] Estimates of the debt relief under the HIPC Initiative are from the HIPC Preliminary document, which used end-2004 debt and government revenue data. Debt relief will be recalculated at the Decision point using end-2005 data and will accordingly differ from the preliminary numbers used in this DSA.

[8] This classification is based on the guidelines set out in "Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations" (see www.imf.org).

scenario, the debt service burden would remain well below threshold, reflecting the high concessionality of the Kyrgyz external debt and the 2005 Paris Club debt relief.

Figure 1. Kyrgyz Republic: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006–26
(In percent)





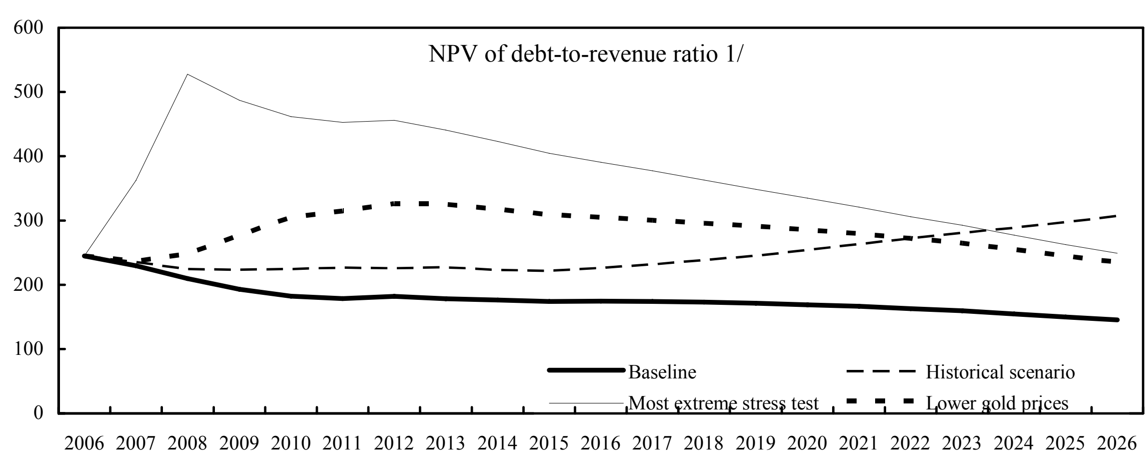
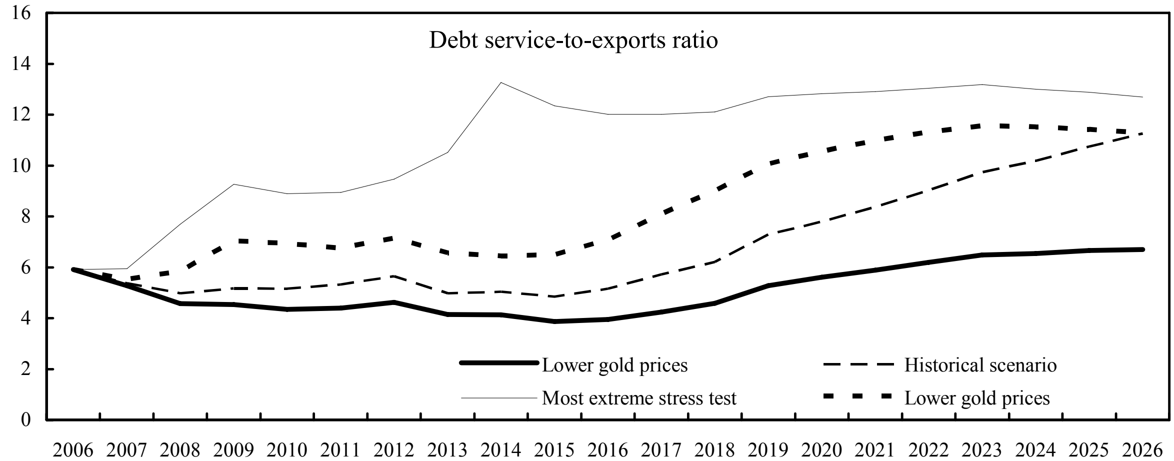
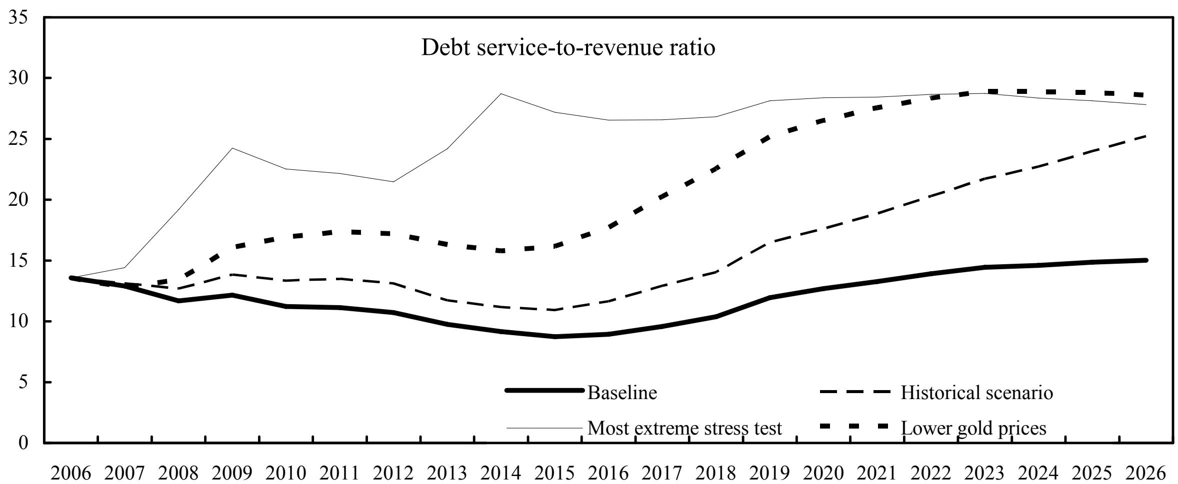


Figure 1 (concluded). Kyrgyz Republic: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006–26
(In percent)





Source: Staff projections and simulations.
1/ Central government revenues excluding grants.

Figure 2. Kyrgyz Republic: Indicators of Public and Publicly Guaranteed External Debt Assuming Delivery of Debt Relief under the HIPC Initiative and the MDRI, 2006–26
(In percent)

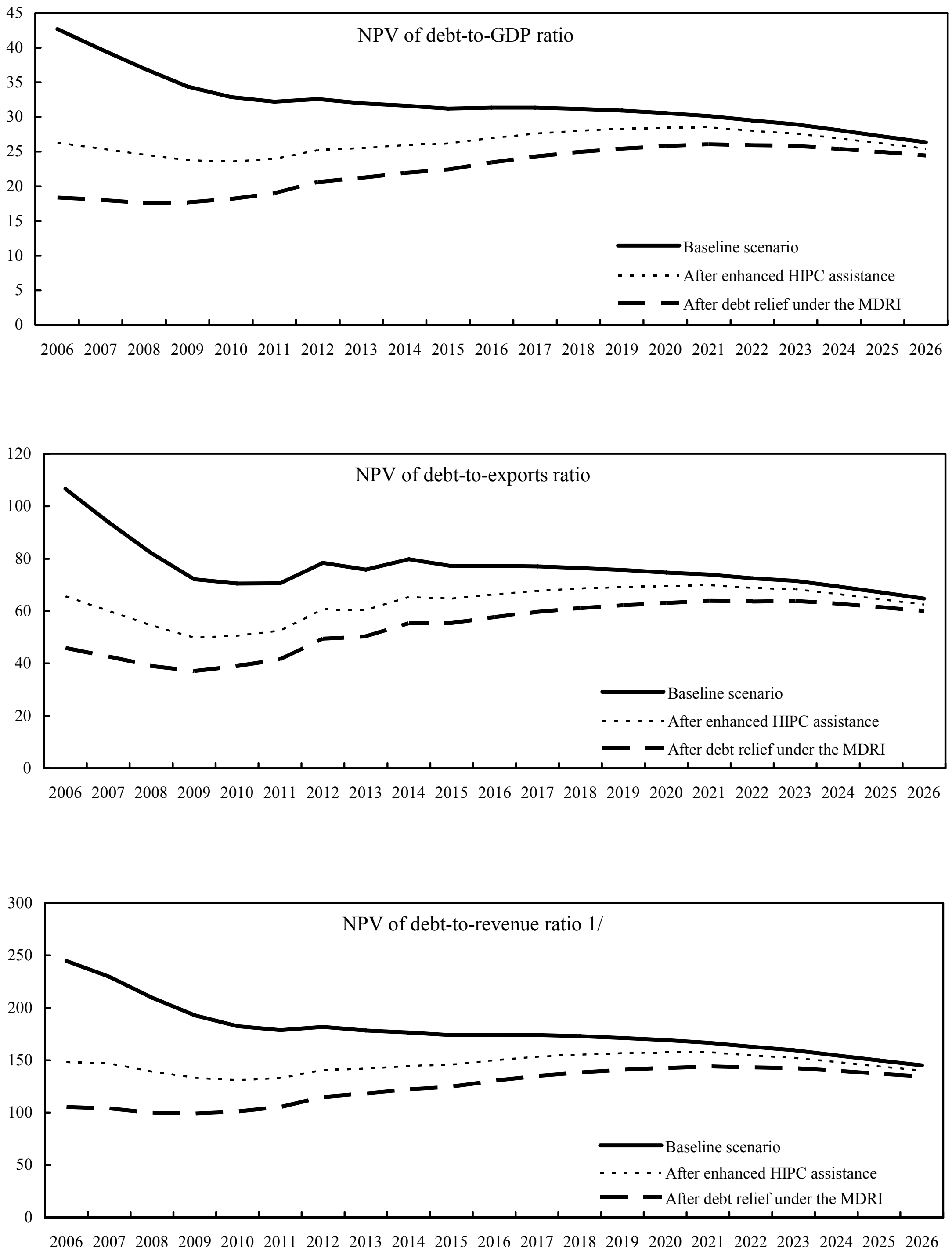
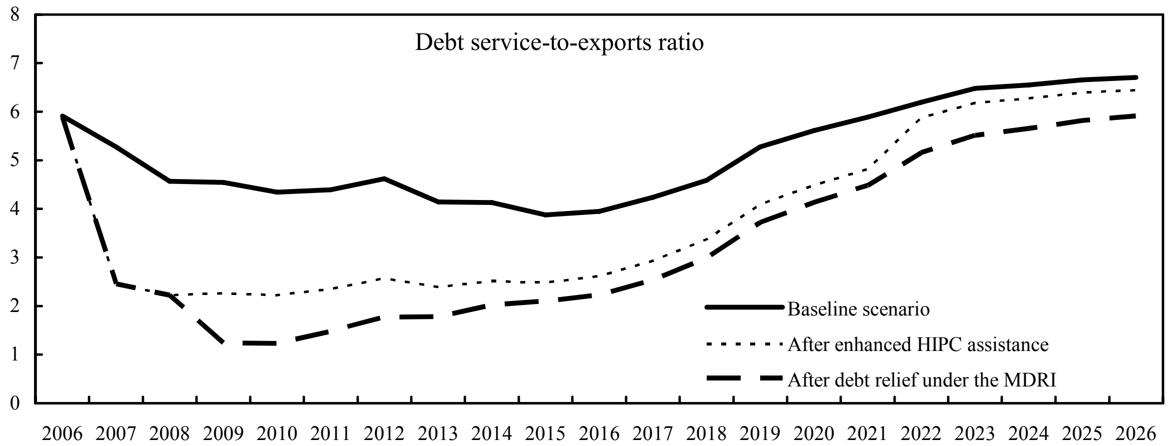
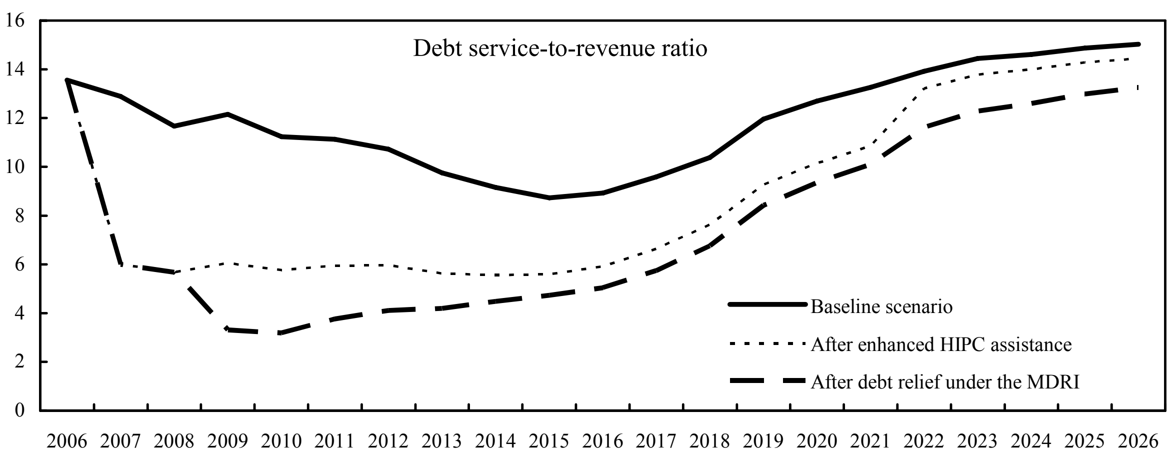


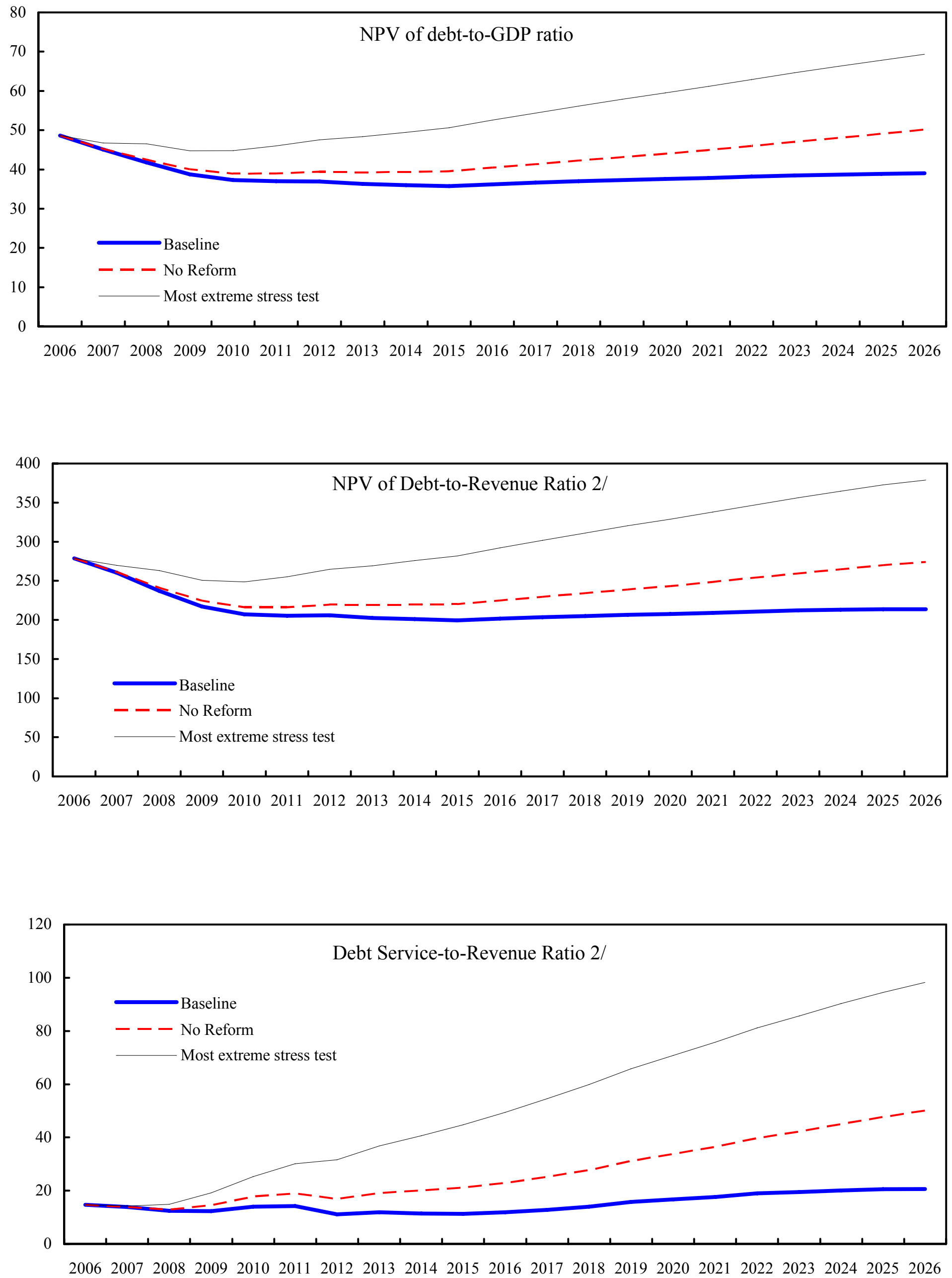
Figure 2. (concluded) Kyrgyz Republic: Indicators of Public and Publicly Guaranteed External Debt Assuming Delivery of Debt Relief under the HIPC Initiative and the MDRI, 2006–26
(In percent)





Source: Staff projections and simulations.
1/ Central government revenues, excluding grants.

Figure 3. Kyrgyz Republic: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006–26
(In percent)



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2016.
2/ Central government revenues excluding grants.

Table 1. Kyrgyz Republic: External Debt Sustainability Framework, Baseline Scenario, 2004–26 1/

(In percent of GDP, unless otherwise indicated)

	Actual		Historical	Standard	Est.	Projections								
											2006–11			2012–26
	2004	2005	Average 6/	Deviation 6/	2006	2007	2008	2009	2010	2011	Average	2016	2026	Average
External debt (nominal) 1/	**95.2**	**83.1**			**75.6**	**70.0**	**64.9**	**60.4**	**56.3**	**55.1**		**50.5**	**38.7**	
Of which: Public and publicly guaranteed (PPG)	88.2	78.6			71.7	66.3	61.2	56.5	53.6	52.2		46.7	33.2	
Change in external debt	-8.1	-12.1			-7.5	-5.6	-5.1	-4.5	-4.0	-1.3		-1.0	-1.2	
Identified net debt-creating flows	-16.3	-3.8			2.6	2.6	0.8	-0.5	0.4	1.5		2.2	0.0	
Noninterest current account deficit	**1.7**	**6.8**	**5.1**	**5.9**	**10.1**	**9.1**	**7.4**	**5.4**	**5.2**	**5.7**		**6.6**	**3.6**	5.6
Deficit in balance of goods and services	8.3	18.6			24.9	24.2	20.9	17.0	16.4	16.6		17.4	13.3	
Exports	42.5	38.6			40.0	42.3	45.0	47.7	46.6	45.6		40.6	40.7	
Imports	50.9	57.2			64.9	66.5	65.9	64.6	63.0	62.2		58.0	54.0	
Net current transfers (negative = inflow)	-9.4	-13.6	-6.4	3.1	-16.2	-17.0	-16.2	-15.2	-14.5	-14.5		-13.4	-11.2	-12.8
Other current account flows (negative = net inflow)	2.8	1.8			1.5	1.9	2.7	3.6	3.3	3.6		2.6	1.5	
Net FDI (negative = inflow)	**-5.9**	**-3.4**	**-2.7**	**2.3**	**-5.4**	**-3.6**	**-3.0**	**-3.0**	**-3.0**	**-3.2**		**-3.3**	**-3.5**	-3.4
Endogenous debt dynamics 2/	**-12.1**	**-7.2**			**-2.1**	**-2.9**	**-3.6**	**-2.9**	**-1.9**	**-1.0**		**-1.1**	**-0.1**	
Contribution from nominal interest rate	1.7	1.5			0.8	0.8	0.8	0.9	0.9	0.9		1.1	1.5	
Contribution from real GDP growth	-6.3	0.5			-2.9	-3.7	-4.4	-3.8	-2.8	-1.9		-2.2	-1.6	
Contribution from price and exchange rate changes	-7.5	-9.3			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**8.1**	**-8.2**			**-10.1**	**-8.2**	**-5.9**	**-4.1**	**-4.4**	**-2.8**		**-3.2**	**-1.2**	
Of which: Exceptional financing	-2.1	-1.8			-0.1	0.1	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	...	51.0			46.6	43.5	40.7	38.2	35.6	35.1		35.2	31.9	
In percent of exports	...	132.0			116.5	102.7	90.3	80.2	76.4	76.9		86.6	78.4	
NPV of PPG external debt	**...**	**46.4**			**42.7**	**39.8**	**37.0**	**34.4**	**32.9**	**32.2**		**31.4**	**26.4**	
In percent of exports	...	120.3			106.7	94.0	82.1	72.1	70.5	70.6		77.2	64.8	
Debt service-to-exports ratio (in percent)	9.4	13.6			7.9	6.6	5.4	5.4	7.8	5.5		5.8	9.6	
PPG debt service-to-exports ratio (in percent)	6.4	7.4			5.9	5.3	4.6	4.5	4.3	4.4		4.0	6.7	
Total gross financing need (billions of U.S. dollars)	0.2	0.1			0.1	0.1	0.1	0.1	0.1	0.2		0.2	0.5	
Noninterest current account deficit that stabilizes debt ratio	9.9	18.9			17.6	14.7	12.5	10.0	9.3	6.9		7.7	4.8	
Key macroeconomic assumptions														
Real GDP growth (in percent)	7.0	-0.6	4.7	4.9	4.0	5.5	7.0	6.5	5.0	3.5	5.2	4.5	4.3	4.3
GDP deflator in U.S. dollar terms (percent change)	7.8	10.8	1.4	13.5	8.4	5.8	4.4	4.5	3.5	2.4	4.8	2.6	2.7	2.6
Effective interest rate (percent) 5/	1.9	1.7	3.1	1.5	1.1	1.1	1.2	1.6	1.6	1.7	1.4	2.3	3.9	2.8
Growth of exports of G&S (US dollar terms, in percent)	26.6	-0.1	8.6	14.3	16.9	18.0	18.9	17.9	6.2	3.8	13.6	7.7	7.4	6.3
Growth of imports of G&S (US dollar terms, in percent)	28.8	23.9	9.1	23.0	27.9	14.3	10.7	9.2	6.0	4.6	12.1	6.4	6.5	6.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	51.7	52.7	51.8	45.3	45.3	45.3	48.7	22.8	17.5	24.9
Memorandum items:														
Nominal GDP (billions of U.S. dollars)	2.2	2.4			2.75	3.07	3.43	3.82	4.15	4.40		6.1	12.2	
Central government revenues excluding grants (in percent of GDP)	15.6	16.7			17.5	17.3	17.6	17.8	18.0	18.0		18.0	18.2	

Sources: Fund/Bank staff estimates and projections; and country authorities.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ Current-year interest payments devided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2. Kyrgyz Republic: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006–26

(In percent)

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of debt-to-GDP ratio								
Baseline	43	40	37	34	33	32	31	26
After HIPC	26	25	25	24	24	24	27	25
After MDRI	18	18	18	18	18	19	23	24
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007–26 1/	43	41	40	40	40	41	41	56
A2. New public sector loans on less favorable terms in 2007–26 2/	43	44	44	43	44	45	57	63
A3. Terms-of-trade shock (sharp decline in gold prices) 3/	43	41	44	49	55	57	55	43
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007–08	43	42	42	39	37	37	36	30
B2. Export value growth at historical average minus one standard deviation in 2007–08 4/	43	46	56	52	50	49	44	31
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2007–08	43	48	53	49	47	46	45	38
B4. Net nondebt creating flows at historical average minus one standard deviation in 2007–08 5/	43	53	61	57	55	54	47	32
B5. Combination of B1–B4 using one–half standard deviation shocks	43	63	93	87	83	82	70	45
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 6/	43	56	52	48	46	45	44	37
NPV of debt-to-exports ratio								
Baseline	107	94	82	72	71	71	77	65
After HIPC	66	60	55	50	51	53	66	63
After MDRI	46	43	39	37	39	42	58	60
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007–26 1/	107	96	88	84	87	89	100	137
A2. New public sector loans on less favorable terms in 2007–26 2/	107	104	98	90	94	98	140	155
A3. Terms-of-trade shock (sharp decline in gold prices) 3/	107	102	108	121	125	122	122	93
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007–08	107	94	82	72	71	71	77	65
B2. Export value growth at historical average minus one standard deviation in 2007–08 4/	107	137	197	173	169	170	170	119
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2007–08	107	94	82	72	71	71	77	65
B4. Net nondebt creating flows at historical average minus one standard deviation in 2007–08 5/	107	125	136	120	117	118	116	78
B5. Combination of B1–B4 using one-half standard deviation shocks	107	150	211	186	182	183	177	114
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 6/	107	94	82	72	71	71	77	65
NPV of debt-to-revenue ratio 7/								
Baseline	245	230	210	193	182	179	174	145
After HIPC	148	147	139	133	131	133	150	140
After MDRI	105	104	100	99	101	105	130	135
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007–26 1/	245	235	224	223	225	227	227	307
A2. New public sector loans on less favorable terms in 2007–26 2/	245	253	249	240	242	249	317	347
A3. Terms-of-trade shock (sharp decline in gold prices) 3/	245	237	248	277	305	315	305	235
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007–08	245	243	238	219	207	203	198	165
B2. Export value growth at historical average minus one standard deviation in 2007–08 4/	245	268	318	293	278	272	244	170
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2007–08	245	277	300	276	261	256	250	208
B4. Net nondebt creating flows at historical average minus one standard deviation in 2007–08 5/	245	306	348	321	304	298	262	176
B5. Combination of B1–B4 using one-half standard deviation shocks	245	363	528	487	461	453	391	249
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 6/	245	321	293	269	255	250	243	203

Table 2 (concluded). Kyrgyz Republic: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006–26

(In percent)

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
Debt service-to-exports ratio								
Baseline	6	5	5	5	4	4	4	7
After HIPC	6	2	2	2	2	2	3	6
After MDRI	6	2	2	1	1	1	2	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007–26 1/	6	5	5	5	5	5	5	11
A2. New public sector loans on less favorable terms in 2007–26 2/	6	5	5	5	5	5	7	14
A3. Terms-of-trade shock (sharp decline in gold prices) 3/	6	6	6	7	7	7	7	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007–08	6	5	5	5	4	4	4	7
B2. Export value growth at historical average minus one standard deviation in 2007–08 4/	6	6	8	9	9	9	11	13
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2007–08	6	5	5	5	4	4	4	7
B4. Net nondebt creating flows at historical average minus one standard deviation in 2007–08 5/	6	5	6	6	6	6	8	9
B5. Combination of B1–B4 using one-half standard deviation shocks	6	6	8	9	9	9	12	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 6/	6	5	5	5	4	4	4	7
Debt service-to-revenue ratio 7/								
Baseline	14	13	12	12	11	11	9	15
After HIPC	14	6	6	6	6	6	6	14
After MDRI	14	6	6	3	3	4	5	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007–26 1/	14	13	13	14	13	13	12	25
A2. New public sector loans on less favorable terms in 2007–26 2/	14	12	12	13	13	14	15	31
A3. Terms-of-trade shock (sharp decline in gold prices) 3/	14	13	13	16	17	17	18	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007–08	14	13	13	14	13	13	10	17
B2. Export value growth at historical average minus one standard deviation in 2007–08 4/	14	12	13	16	15	14	15	18
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2007–08	14	15	17	17	16	16	13	22
B4. Net nondebt creating flows at historical average minus one standard deviation in 2007–08 5/	14	12	14	17	15	15	17	19
B5. Combination of B1–B4 using one-half standard deviation shocks	14	14	19	24	23	22	27	28
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 6/	14	17	16	17	16	16	12	21
Memorandum items:								
Grant element assumed on residual financing (i.e., financing required above baseline) 8/	22	22	22	22	22	22	22	22
Central government revenues excluding grants (in percent of GDP)	17.5	17.3	17.6	17.8	18.0	18.0	18.0	18.2

Sources: Fund/Bank staff estimates and projections; and country authorities.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), noninterest current account in percent of GDP, and nondebt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Assumes a temporary 40 percent cumulative decline in gold prices in 2007–09 (which would revert thereafter to the baseline price path), accompanied by a slowdown in growth, exports and FDI in mining as well as currency depreciation.

4/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

5/ Includes official and private transfers and FDI.

6/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

7/ Central government revenues excluding grants.

8/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3.The Kyrgyz Republic: Public Sector Debt Sustainability Framework, Baseline Scenario, 2004–26

(In percent of GDP, unless otherwise indicated)

	2004	2005	Historical Average 5/	Standard Deviation 5/	Estimate 2006	Projections 2007	2008	2009	2010	2011	2006–11 Averag	2016	2026	2012–26 Averag
Public sector debt 1/	92.7	88.6			79.9	73.6	67.9	62.5	59.6	58.4		52.6	46.4	
Of which: Foreign-currency denominated	86.8	83.1			75.8	70.0	64.5	59.5	56.3	54.7		48.5	34.0	
Change in public sector debt	-14.2	-4.0			-8.7	-6.3	-5.8	-5.4	-2.9	-1.2		-1.0	-0.4	
Identified debt-creating flows	-17.0	-1.3			-7.0	-5.4	-5.5	-4.4	-2.3	-0.7		-1.0	-0.4	
Primary deficit	3.1	2.4	6.0	3.0	2.2	2.1	1.6	1.7	1.9	1.9	1.9	1.7	1.2	1.6
Revenue and grants	23.1	24.3			24.9	24.9	25.4	25.4	25.1	25.3		25.8	27.2	
Of which : Grants	0.8	0.4			0.7	0.8	1.2	0.8	0.3	0.3		0.3	0.3	
Primary (noninterest) expenditure	26.2	26.6			27.2	26.9	27.0	27.0	27.0	27.1		27.5	28.5	
Automatic debt dynamics	-16.1	-3.5			-9.0	-7.3	-6.9	-5.9	-4.1	-2.5		-2.7	-1.6	
Contribution from interest rate/growth differential	-7.9	0.9			-3.9	-4.1	-5.2	-4.5	-3.4	-2.3		-2.4	-1.4	
Of which : Contribution from average real interest rate	-1.1	0.3			-0.5	0.0	-0.4	-0.4	-0.4	-0.3		-0.1	0.5	
Contribution from real GDP growth	-6.8	0.6			-3.4	-4.1	-4.8	-4.1	-3.0	-2.0		-2.3	-1.9	
Contribution from real exchange rate depreciation	-8.2	-4.4			-5.1	-3.1	-1.7	-1.4	-0.7	-0.2		...	...	
Other identified debt-creating flows	-4.0	-0.2			-0.3	-0.2	-0.2	-0.1	-0.1	-0.1		-0.1	-0.1	
Privatization receipts (negative)	-4.0	-0.2			-0.3	-0.2	-0.2	-0.1	-0.1	-0.1		-0.1	-0.1	
Residual, including asset changes	2.8	-2.7			-1.7	-0.9	-0.3	-0.9	-0.6	-0.4		0.0	0.0	
NPV of public sector debt	...	53.9			48.7	45.1	41.8	38.7	37.3	37.0		36.2	39.1	
Of which: Foreign-currency denominated	...	48.4			44.5	41.4	38.4	35.7	34.1	33.3		32.1	26.7	
Of which: E xternal	...	46.4			42.7	39.8	37.0	34.4	32.9	32.2		31.4	26.4	
Gross financing need 2/	8.5	8.4			6.3	5.7	4.8	4.8	5.4	5.6		5.5	12.0	
NPV of public sector debt-to-revenue ratio (in percent) 3/	...	322.1			278.7	260.2	236.9	217.3	207.3	205.4		201.4	213.6	
Of which: External	...	277.3			244.7	229.7	209.7	193.0	182.5	178.9		174.5	144.5	
Debt service-to-revenue ratio (in percent) 3/ 4/	...	27.8			14.7	13.9	12.4	12.4	14.0	14.3		11.9	20.6	
Primary deficit that stabilizes the debt-to-GDP ratio	17.3	6.4			11.0	8.4	7.4	7.0	4.8	3.1		2.7	1.7	
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	7.0	-0.6	4.7	3.4	4.0	5.5	7.0	6.5	5.0	3.5	5.2	4.5	4.2	4.3
Average nominal interest rate on forex debt (in percent)	1.7	1.7	2.9	1.5	1.0	1.0	1.0	1.3	1.4	1.4	1.2	1.7	2.9	2.2
Average real interest rate on domestic currency debt (in percent)	-7.6	-3.4	-13.0	10.7	-2.3	4.6	1.3	1.4	0.8	1.9	1.3	1.7	1.6	1.6
Real exchange rate depreciation (in percent, + indicates depreciation)	-8.8	-5.0	2.9	21.7	-6.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.3	6.8	15.4	13.4	5.7	4.5	4.4	4.5	5.3	4.2	4.8	4.4	4.4	4.5
Growth of real primary spending (deflated by GDP deflator, in percent)	10.0	1.1	1.4	12.4	6.2	4.5	7.3	6.6	5.0	3.9	5.6	4.9	4.6	4.6
Grant element of new external borrowing (in percent)	...	...	...	...	51.7	51.8	52.4	45.3	45.3	43.2	48.3	22.3	23.7	...

Sources: Fund/Bank staff estimates and projections; and country authorities.

1/ Public and publicly guaranteed debt
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Central government revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium- and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4.The Kyrgyz Republic: Sensitivity Analysis for Key Indicators of Public Debt 2006–26

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of Debt-to-GDP Ratio								
Baseline	49	45	42	39	37	37	36	39
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	49	49	51	53	55	58	75	113
A2. Primary balance is unchanged from 2006	49	45	43	40	39	39	40	50
A3. Permanently lower GDP growth 1/	49	46	43	41	40	41	49	85
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007–08	49	47	47	45	45	46	53	69
B2. Primary balance is at historical average minus one standard deviations in 2007–08	49	52	56	52	51	50	49	50
B3. Combination of B1–B2 using one half standard deviation shocks	49	52	56	52	50	49	47	48
B4. One-time 30 percent real depreciation in 2007	49	62	57	53	50	50	47	50
B5. 10 percent of GDP increase in other debt-creating flows in 2007	49	55	51	48	46	46	45	46
NPV of Debt-to-Revenue Ratio 2/								
Baseline	279	260	237	217	207	205	201	214
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	279	285	290	296	306	323	417	616
A2. Primary balance is unchanged from 2006	279	261	241	225	216	216	225	274
A3. Permanently lower GDP growth 1/	279	263	243	228	223	227	272	463
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007–08	279	270	263	251	248	255	292	379
B2. Primary balance is at historical average minus one standard deviations in 2007–08	279	300	316	293	281	279	271	272
B3. Combination of B1–B2 using one half standard deviation shocks	279	297	314	290	277	274	263	263
B4. One-time 30 percent real depreciation in 2007	279	359	324	296	280	275	261	275
B5. 10 percent of GDP increase in other debt-creating flows in 2007	279	318	291	269	258	256	249	254
Debt Service-to-Revenue Ratio 2/								
Baseline	15	14	12	12	14	14	12	21
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	15	14	24	37	51	61	114	224
A2. Primary balance is unchanged from 2006	15	14	13	15	18	19	23	50
A3. Permanently lower GDP growth 1/	15	14	13	14	17	20	37	128
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007–08	15	14	15	19	25	30	49	98
B2. Primary balance is at historical average minus one standard deviations in 2007–08	15	14	33	53	54	53	49	52
B3. Combination of B1–B2 using one half standard deviation shocks	15	14	29	45	46	45	39	41
B4. One-time 30 percent real depreciation in 2007	15	15	14	15	18	19	21	40
B5. 10 percent of GDP increase in other debt-creating flows in 2007	15	14	42	40	41	41	37	42

Sources: Fund/Bank staff estimates and projections; and country authorities.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Central government revenues excluding grants.

ATTACHMENT I

Bishkek, Kyrgyz Republic

October 17, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Rato:

1. In February 2005, the IMF Executive Board endorsed the Kyrgyz Republic's three-year economic program, and approved a new Poverty Reduction and Growth Facility (PRGF) arrangement in support of that program. The second review under the program was concluded in May 2006 on a lapse-of-time basis.

2. On behalf of the government of the Kyrgyz Republic, we hereby transmit the attached Memorandum of Economic Policies (MEP), which includes program understandings reached with the IMF, describes in detail the implementation of the program to date, and sets out the objectives and policies that the government intends to pursue through end-2007. The MEP is consistent with the revised Country Development Strategy (CDS) that is expected to be finalized shortly. The government intends to make the contents of this letter and those of the attached MEP and its Technical Memorandum of Understanding (TMU), as well as the staff report on the third review under the PRGF arrangement and Article IV consultations, available to the public, and authorizes the staff to arrange for them to be posted on the IMF website after completion of the review by the Board.

3. The fourth review under the arrangement is expected to be completed on or after February 15, 2007 and the fifth review on or after August 15, 2007. As noted in Table 1, we have observed all the quantitative performance criteria for end-June 2006. However, a structural performance criterion on the transfer of the Centerra shares held on behalf of the nation by Kyrgyzaltyn JSC (a state enterprise) to the State Property Fund was not completed on time. We have since taken steps to prohibit the sale of Centerra shares without authorization from the government, as well as to ensure that the proceeds from any sale of these shares will be utilized strictly in accordance with government instructions. We are therefore requesting a waiver for nonobservance of this criterion. Quantitative performance

criteria, indicative targets and structural benchmarks through end-June 2007 are set out in Tables 2 and 3 of the MEP. We request disbursement of the SDR 1.27 million tranche available upon Board completion of the third review.

4. The government of the Kyrgyz Republic will provide the Fund with such information as the Fund may request in connection with progress in implementing the economic policies and achieving the objectives of the program. The government believes that the policies and measures set forth in the MEP are adequate to achieve the objectives of the program, but will take further measures to that end if deemed necessary. During the implementation of the current arrangement, the Kyrgyz Republic will consult with the Managing Director on the adoption of any measures that may be appropriate, at the initiative of the government or whenever the Managing Director requests such a consultation.

Very truly yours,

/s/	/s/
Feliks Kulov Prime Minister Kyrgyz Republic	Marat Alapaev Chairman National Bank of the Kyrgyz Republic

ATTACHMENT II

Memorandum of Economic Policies for the Kyrgyz Republic

I. RECENT ECONOMIC PERFORMANCE

1. The government's economic program for 2005–08, supported by the Poverty Reduction and Growth Facility (PRGF) arrangement approved by the IMF Executive Board in February 2005, aims to achieve sustained and rapid economic and social development in a low-inflation environment. This Memorandum reviews program implementation to date and describes our policies for 2007, as well as the thrust of our economic strategy for the remainder of this administration.

2. The government has successfully maintained macroeconomic discipline and adhered to the PRGF-supported program thus far in 2006. All end-June quantitative performance criteria (PCs) were observed, in some cases with ample margins, and all structural benchmarks through end-September were met (Tables 1 and 3). The government has taken corrective measures to achieve the original purpose of the end-June structural PC on the transfer of Centerra shares from Kyrgyzaltyn JSC to the State Property Fund.

3. Economic developments in the year-to-date have been encouraging. Inflation (5.1 percent in the 12 months ending in August) has remained broadly in line with the program, economic activity has begun to rebound, and the buildup in foreign reserves has been faster than expected. In particular, real GDP grew by 3.5 percent year-on year during January–August led by the agricultural and nongold industrial sectors, while output growth excluding the Kumtor mine was even higher at 6.6 percent, broadly in line with the trend in recent years. Despite rising nongold exports, the external trade deficit widened in the first half of 2006, driven by a rapid increase in imports sparked by the budding economic recovery and rising world fuel prices (an improvement in the statistical coverage of shuttle trade also played a part). Buoyed by workers' remittances and private capital inflows, gross reserves rose steadily, to \$690 million by late September (or 4 months of projected 2007 imports of goods and services). For 2006 as a whole, we expect to meet the program's inflation target (5.7 percent), but due to a serious accident at Kumtor last July, we have scaled back our real GDP growth forecast to around 4 percent.

4. Year-to-date fiscal performance has been better than envisaged. This has resulted partly from buoyant import and income tax receipts underpinned by steadfast implementation of the new customs code, along with renewed efforts to curb evasion. Despite a faster-than-expected increase in current spending, mainly on wages and on goods and services, total spending has remained in line with the program owing to delayed execution of the investment budget. Robust payroll tax collections have allowed the Social Fund to clear all of its arrears, making nation-wide pension payments current despite a 2 percentage-point

payroll tax reduction last January. In all, the half-year target for the primary balance before grants was met by a margin of about 1 percent of GDP. Based on preliminary results through the third quarter and the supplementary 2006 budget to be sent to parliament in early October, we expect to comfortably meet the program's full-year fiscal target (a primary deficit of 3¼ percent of GDP). Recognizing the importance of fiscal sustainability, the government will seek prompt passage of the pending bill to increase nonagricultural land taxes to ensure broad revenue neutrality of the 2006 tax reform package as programmed. To pave the way for medium-term fiscal consolidation, the government will make every effort to secure parliamentary approval of the new tax code bill by end-March 2007 (a structural benchmark under the program). Moreover, despite political pressures, it will adopt appropriate measures in order to continue to broaden the coverage of the Large Taxpayer Unit (LTU).

5. Since early 2006, monetary policy has been conducted in an environment of stronger-than-expected foreign exchange receipts and continued remonetization of the economy. In these circumstances, the NBKR conducted sizable unsterilized intervention in the foreign exchange market, though allowing the som to appreciate by 4.7 percent against the U.S. dollar since the beginning of the year (in real effective terms, the som appreciated by about 5 percent over the past 18 months). In addition, the NBKR has gradually increased policy interest rates, which are now positive in real terms, while the yield curve has returned to a more normal, upward-sloping pattern. Although reserve money increased by 40 percent in the 12 months ending September 2006—well above expectations—and the expansion in banking system credit to the private sector (albeit from a low base) has accelerated since the beginning of the year, inflation has remained in line with the program.

6. Financial sector reforms remain on track. To further enhance bank supervision, the NBKR has established the supervisory framework to assess market, operational, country and foreign exchange risks, and is improving its ability to stress-test banks. The activities of the new Agency for Financial Surveillance and Reporting will be clearly demarcated to avoid an overlap with those of the NBKR. Every effort will be made to secure approval of legislation before parliament to enhance the NBKR's legal independence and legal protection for its employees in performing official duties (an end-December structural benchmark). Parliament has already passed legislation to combat money laundering and financing of terrorism, and the Financial Intelligence Unit is drafting the corresponding amendments to the criminal code and other relevant legislation. As envisaged in the program, we will bring the Kyrgyz Agricultural Finance Corporation (KAFC) to the point of sale and issue a privatization tender for the company by end-2006.

7. The program's half-year target for the energy sector's quasi-fiscal deficit (QFD) was met with some margin, owing to a rise in cash collections of the distribution utilities. For the year as a whole, the government expects the QFD to decline to 5.9 percent of GDP, from 7.6 percent in 2005 (both estimates based on the original marginal cost benchmark of

2.3.U.S. cents per kilowatt/hour), on the back of the unification of household power tariffs last May and further efforts to bolster cash collections and curtail technical losses and theft; using the updated benchmark of 2.66 U.S. cents per kilowatt/hour agreed upon with the World Bank, the QFD would decline from 8.8 percent in 2005 to 7.4 percent in 2006.

II. Program Objectives and Economic Policies for 2007

8. Our economic adjustment and reform program for the remainder of this administration is consistent with the Country Development Strategy (CDS), which extends the national poverty reduction strategy to 2010, and the Country Assistance Strategy being developed jointly by the World Bank, the Asian Development Bank, and other donors. To alleviate poverty and foster private sector-led growth, the government will maintain macroeconomic stability and remove structural bottlenecks (particularly by improving the business climate through better governance and transparency, civil service reforms, and the establishment of an appropriate legal and regulatory framework), while minimizing its direct intervention in the economy.

9. For 2007, our economic program aims at securing real GDP growth of 5.5 percent, limiting end-period inflation to a range of 4.5–5.0 percent, and slightly increasing the import coverage of gross foreign reserves. Despite a rising fuel import bill, the external current account deficit would narrow to 9¾ percent of GDP from an estimated 11 percent in 2006, on the back of a rebound in export volumes and sustained workers' remittances, and it would be fully financed by FDI, other private inflows, and concessional assistance from the Fund and other donors. To achieve these objectives, we will continue to pursue prudent fiscal and monetary policies and seek to further reduce the quasi-fiscal deficit of the electricity sector. The general government primary balance before grants will be limited to just under 3 percent of GDP, with an overall deficit of a similar magnitude covered entirely from external sources and privatization proceeds. Moreover, the NBKR will set limits on the expansion of its net domestic assets, consistent with a slowdown in reserve money growth to 22½ percent by year's-end and a further foreign reserve buildup to keep gross reserve coverage at 4¼ months of projected 2008 imports of goods and services (Table 4). We will also intensify structural reforms to enhance the prospects for sustained growth and poverty reduction, and have accordingly established structural benchmarks on certain financial sector and public financial management reforms through end-June 2007 (Table 3).

10. In order to lighten the burden of the Kyrgyz Republic's external debt and free resources for priority spending, the government is seeking to introduce a comprehensive debt reduction effort. This includes a request, subject to agreement on detailed conditionality triggers, for relief under the enhanced Highly Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). A comprehensive set of measures should help improve living standards and accelerate progress towards achieving the Millennium Development Goals. This would include measures to enhance governance and transparency,

improve the business climate, foster the development of agriculture and infrastructure, reform the energy and mining sectors, bolster public financial management, and spur economic growth and human development. In order to reflect the interim assistance that will be provided under the HIPC Initiative upon reaching the Decision Point (tentatively, at the turn of the year), the quantitative performance criteria for end-June 2007 established herein will be revised, as needed, at the time of the 4th review under the program to reflect the utilization of these resources.

11. We plan to gradually divest the country's equity in the Centerra mining conglomerate (equivalent at present to some $310 million or about 11.2 percent of GDP). This, in synergy with the fiscal space from debt relief and large projects financed by FDI or private sector borrowing from neighboring countries, is expected to significantly enhance growth prospects. In April 2006, the government issued a resolution prohibiting the sale of Centerra shares without government authorization and specifying that the proceeds from any sales of these shares will be used strictly in accordance with guidelines set by the government. Going forward, the government is determined to harness these resources for productive uses in a manner consistent with macroeconomic stability and absorptive capacity. In this vein, the government will specify —in consultation with parliament—the annual receipts from any sales of Centerra shares to be channeled, through the central government budget, either through the public sector investment program or as net lending to the financial sector (possibly under an investment or development fund). To safeguard macroeconomic stability and the soundness of the banking system, these operations will be fully integrated into the PRGF-supported economic program, including the annual government budget (where they will be treated as net lending or investment outlays) and the monetary program. More immediately, the level and quarterly phasing of these resources and any adjustments that may be warranted to the program for 2007 described in this Memorandum will be reviewed at the time of the 4th review under the PRGF arrangement in early 2007.

A. Fiscal Policy

12. Fiscal discipline has become firmly entrenched over the past several years and will be maintained to underpin low inflation and debt sustainability. While the need to improve social services and infrastructure is pressing, we will carefully prioritize public outlays and strengthen expenditure controls. We will continue to intensify the tax effort by steadfastly improving tax and customs administration and curbing evasion. General government tax receipts are targeted to rise to 20½ percent of GDP in 2007, reflecting the full-year effect of the increase in the nonagricultural land tax rates envisaged in late 2006 and further efforts to strengthen tax enforcement; these measures would more than offset the effect of a 2 percentage-point reduction in the payroll tax (implemented in two steps in April and October) during the year, to 27 percent, bringing it closer to the 25 percent medium-term target. Outlays (excluding net lending) will be capped at 28½ percent of GDP, consistent with an average 10 percent increase in government wages and a rise in central government

investment to 4½ percent of GDP. After the envisaged approval of the HIPC Initiative Decision Point by the Executive Boards of the IMF and the World Bank, we will propose a supplementary budget to parliament reflecting the fiscal space created by interim HIPC Initiative assistance. We also count on a scaling up of concessional external aid, following a consultative group meeting we plan to convene in Bishkek in the coming months.

13. The 2007 budget will also feature a 10 percent average increase in pensions, with an increase in the base pension component in January to bring it to the statutory level of 12 percent of last year's wages. The Social Fund will not make any unprogrammed drawdown in its deposits to finance pension increases beyond those already programmed, and in the event that its revenues significantly exceed expectations, it will then give priority to bringing forward the payroll tax cuts scheduled for April and October 2007. The government reaffirms its commitment not to lower the retirement age, recognizing that any reduction would be inconsistent with the long-term financial sustainability of the pension system. Instead, it will forge a broad-based internal consensus on a comprehensive reform of the pension system to be designed with World Bank assistance, including the phased introduction over a number of years of a fully funded pillar (premised on establishment of an appropriate legal and regulatory framework and development of suitable asset classes that would ensure the security of the funds deposited), as well as a streamlining of social benefits and a broadening in the coverage of social safety nets. This far-reaching reform could include the option of early retirement with reduced pension benefits or an increase in the minimum years of contributions for those seeking retirement.

14. The new Medium-Term Budgetary Framework (MTBF) published in May 2006 outlines the strategy for developing health, education, social protection, agriculture, and transport and communication, along with the broad criteria for identifying sectoral priorities and deepening fiscal decentralization. This should enable better medium-term policy formulation and coordination among ministries, help operationalize the CDS, and provide a sound foundation for annual budget preparation. To focus spending on poverty reduction, a new classification of poverty reducing spending will be included in the next MTBF. In addition, the government will streamline the State Tax Inspectorate (STI) office network, and increase the staff of the LTU, while raising its status to align it with other units that directly report to STI management. The government has prepared an action plan for bolstering public financial management, and continues to refocus reform efforts and enhance the annual budgetary process; this plan will dovetail with the MTBF published in May 2006 and the CDS that will be finalized later this year.

15. In line with a law passed by parliament in 2003, the government is poised to add momentum to fiscal decentralization from 2007, with a view to converging over time to a two-tier system comprising local communities (*aiyl okomotus*) and the central government. The process will be managed carefully to safeguard macroeconomic stability, delineate clear revenue-sharing provisions and expenditure responsibilities at each tier, build local

government capacity, and eliminate local government interference in the appointment of senior management staff of local tax offices and local branches of the ministry of economy and finance. Extensive technical assistance and consultation on key policy issues with the World Bank and other expert agencies will help align the implementation of fiscal decentralization with international best practice.

B. Energy Sector and Quasi-Fiscal Issues

16. As envisaged in the program, the government has submitted in September 2006 an energy sector action plan designed in cooperation with the World Bank. The plan aims to put the sector's financial position on a sound footing, while delivering reliable power supplies for domestic consumers and creating the basis for significant energy exports. To that end, the authorities will seek to bolster utility bill collections, reduce technical losses and theft, increase private sector participation in the sector, and they will adjust electricity tariffs under a preannounced calendar to reach cost-recovery tariff levels by 2010. In this vein, and according to the updated tariff methodology agreed by the authorities with the World Bank, the sector's QFD (an indicative target under the program) is slated to decline to about 5.5 percent of GDP in 2007, from an estimated 7.4 percent this year. As was the case with the unification of the household tariffs earlier this year, future power tariff adjustments will continue to be accompanied by social safety nets to mitigate their effects on the poorer segments of the population.

C. Monetary and Financial Sector Policies

17. Price stability continues to be the overarching objective of the NBKR. The monetary program for 2007, which is premised on further remonetization of the economy and seeks to contain end-period inflation to a range of 4.5–5.0 percent, limits reserve money growth to 22½ percent consistent with broad money growth of 24 percent during the year. To keep liquidity expansion in check, the NBKR will enhance the menu of monetary control instruments, price these instruments flexibly, and maintain the managed exchange rate float. The central bank will limit foreign exchange intervention to smoothing exchange rate fluctuations and securing the programmed international reserve buildup.

18. The NBKR will deepen financial sector reforms with technical advice from the IMF and other donors. It has already introduced a phased increase in the minimum own-funds requirement for banks, to som 60 million ($1.5 million) in January 2006 and som 100 million ($2.5 million) from January 2008. In light of a modest rise in the ratio of nonperforming loans to total commercial bank loans from end-2004 to mid-2006, and partly in response to the NBKR's instructions, commercial banks have increased loan provisioning. Going forward, and in anticipation of a further rapid increase in credit to the private sector, the authorities will step-up bank supervision, especially by closely monitoring financial soundness indicators and taking timely corrective measures if credit quality deteriorates

further. The NBKR will continue to take steps to improve the payments system, including through electronic payment of all public wages and introduction of real time gross settlement and batch clearing systems. The NBKR will also continue to monitor developments and strengthen supervision over nonbank financial institutions according to its current legal responsibilities, seeking particularly to foster orderly development of microfinance.

19. The NBKR is poised to introduce a deposit insurance scheme for small depositors by late 2008, and after passage of enabling legislation in the next several months, the NBKR will communicate to banks the prudential requirements and statutory thresholds on profitability, liquidity and risk levels for their bank participation in the scheme. Conservatorship and subsequent liquidation of troubled banks will continue to be guided strictly by the current legislation on conservatorship, liquidation and bankruptcy of banks. To foster mortgage and other term lending, the government will submit to parliament amendments (drafted by the NBKR) to the civil, housing and land codes, as well as to all the laws governing collateral, strengthening the legal foundations for the use and for the seizure of collateral in cases of default. It will also seek amendments to the civil code to recognize the supremacy of banking legislation in cases of conflict with other laws, and implement regulations for consolidated bank supervision that adequately monitor risks. The NBKR plans a phased transition to international capital measures and standards under Basel-II guidelines, after careful consideration of all prerequisites for its successful adoption and further implementation of the recommendations made in the 2005 assessment of the Basel Core Principles for Effective Banking Supervision. The financial sector development program will be updated and streamlined in light of the recommendations of the joint IMF/World Bank mission that updated the Financial Sector Assessment Program (FSAP) in October 2006.

20. To foster development of the securities market, the volume of government securities available to banks will be further increased. As part of the ongoing phased redemption of government bonds, som 180 million of NBKR-held bonds were redeemed last April, and a further som 200 million will be redeemed in 2007. To reduce the domestic interest cost to the budget, the government will effect the early redemption of som 500 million in its liabilities to the central bank in the next several months. The ministry of economy and finance and the NBKR will propose a specific action plan to simplify the nomenclature of debt instruments, drawing on recommendations of a recent IMF technical assistance mission. At the same time, the authorities will ensure that any further restructuring of government liabilities to the NBKR will not adversely impact the balance sheet of the NBKR.

D. Other Structural Reforms

21. As stressed in the new CDS, eradicating corruption and fostering rapid private sector-led growth and poverty alleviation remain top national priorities. The government is working closely with stakeholders and donors on policies to bolster fiscal management; improve the

efficiency and transparency of the mining sector; and address the nexus of governance and business climate issues. Besides deepening civil service reform, the government will further strengthen institutions tasked with fighting corruption, while toughening law enforcement; reducing opportunities for bribes and rent-seeking, and increasing transparency in public sector operations. Moreover, the government will continue to simplify licensing procedures, streamline regulatory bodies, improve the autonomy and efficacy of the judiciary, and strengthen property rights.

22. The State Committee for Migration and Employment has reviewed the labor code and recommended amendments to simplify hiring procedures. The authorities are considering further measures to improve labor market flexibility, such as liberalizing provisions on reduced working hours and job sharing. They have also approved a national employment policy through 2010 that includes other forms of flexible employment, such as temporary public works programs and creation of employment opportunities for youths, women and the disabled. Enabling regulations for these flexible forms of employment are being prepared in consultation with the International Labor Organization (ILO). Progress in these areas will be discussed at the time of the 4th review under the arrangement.

E. External Debt Management

23. While negotiations to attract large externally financed investments to the Kyrgyz Republic, especially in infrastructure, industry and mining, are well advanced, the public sector will continue to refrain from borrowing or guaranteeing external loans on nonconcessional terms. In addition, any concessional external loans contracted or guaranteed by the public sector will continue to satisfy the minimum 45 percent grant element specified in the program.

24. As it seeks external debt relief, the government continues to attach utmost importance to safeguarding external debt sustainability, and it will further enhance external debt management institutions and procedures. In particular, it will adopt a new medium-term external debt management strategy (treated as an end-March 2007 structural benchmark), building on the earlier one designed in 2001; the strategy will include maintaining the 45 percent floor on the grant element required on all new public borrowing, and requiring local governments and public enterprises to obtain prior authorization from the ministry of economy and finance to contract any external loans. In addition, the ministry of economy and finance will build capacity on debt management issues; collect loan-by-loan data on public enterprise debts that have hitherto not received government guarantees; and introduce prudential guidelines for issuance of letters of guarantees on concessional external loans.

F. Program Monitoring

25. The program will continue to be monitored through semi-annual reviews. For that purpose, we propose quantitative PCs for end-June 2007, an indicative macroeconomic program through end-2007, and semi-annual indicative targets for reserve money and the electricity sector's QFD. We have also proposed structural benchmarks for March and June 2007 (Table 3). Completion of the fourth review under the PRGF arrangement, scheduled for spring 2007, will require observance of the end-December 2006 quantitative PCs shown in Table 2. Quantitative PCs, program adjustors, data sources, and reporting requirements are defined in the attached Technical Memorandum of Understanding.

Table 1. Kyrgyz Republic: Quantitative Program Targets for 2005–06 1/

(In millions of soms, unless otherwise indicated; eop)

	2005	2006						
	December PCs	March Indicative targets		June PCs			September Indicative Targets	December PCs
	Actual	EBS/06/60	Actual	EBS/06/60	Adj. Target 2/	Actual	EBS/06/60	
I. Performance criteria								
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	416	367	412	412	396	452	413	457
2. Ceiling on net domestic assets of the NBKR (eop stock)	-1,943	-1,566	-1,869	-1,752	-1,055	-1,756	-1,413	-1,469
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	2,757	1,099	61	1,377	…	140	2,541	3,701
4. Cumulative floor on state government tax collections in cash	16,361	3,599	4,063	7933	…	8,742	12,512	17,650
5. Ceiling on the stock of central government budget arrears	0	0	0	0	…	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	…	0	0	0
7. Cumulative floor on payroll collections in cash of the social fund	4,912	1,100	1,250	2,292	…	2,553	3,430	4,823
8. Ceiling on the stock of social fund arrears to the Medical Insurance Fund	0	0	0	0	…	0	0	0
9. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new external debt with maturity of less than one year (continuous, in millions of U.S. dollars)	0	0	0	0	…	0	0	0
10. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of one year or more (millions of U.S. dollars)	0	0	0	0	…	0	0	0
							0	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	0	0	0	…	0	0	0
II. Indicative targets								
1. Ceiling on reserve money (eop stock)	15,466	13,750	15,348	15,549	…	16,965	15,905	17,708
2. Ceiling on the cumulative quasi-fiscal deficit of the electricity sector (in millions of soms)	7,609	...	...	3745	…	3,701	...	6,509
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 3/	(as specified in paragraph 30 of the TMU attached to Country Report No. 06/235)							

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Definitions are provided in the Technical Memorandum of Understanding.

2/ Targets adjusted for the nondisbursement of the EU food security grant ($4.8 million in Q1), the ADB grant ($7.8 million in Q2), and the EU health sector SWAP grant ($4.0 million in Q2).

3/ New concessional loans during the year.

Table 2. Kyrgyz Republic: Quantitative Program Targets for 2006–07 1/

(In millions of soms, unless otherwise indicated; eop)

	2006	2007			
	December	March Indicative Target	June PC	September Indicative Target	December Indicative Target
	Proj.	Proj.	Proj.	Proj.	Proj.
I. Performance criteria					
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	518	572	594	638	661
2. Ceiling on net domestic assets of the NBKR (eop stock)	-2,034	-1,958	-1,465	-1,893	-2,097
3. Ceiling on cumulative primary deficit (excluding grants) of the general government	3,221	589	1,130	2,285	3,461
4. Cumulative floor on state government tax collections in cash	18,431	4,236	9,238	14,634	20,671
5. Ceiling on the stock of central government budget arrears	0	0	0	0	0
6. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	0
7. Cumulative floor on payroll collections in cash of the Social Fund	4,945	1,373	2,706	4,053	5,421
8. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	0	0	0	0	0
9. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new external debt with maturity of less than one year (continuous, in millions of U.S. dollars)	0	0	0	0	0
10. Ceiling on contracting or guaranteeing by the state government, NBKR or any other agency acting on behalf of the state government, of new nonconcessional external debt with maturity of one year or more (millions of U.S. dollars)	0	0	0	0	0
11. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	0	0	0	0
II. Indicative targets					
1. Ceiling on reserve money (eop stock)	19,642	20,617	22,038	23,351	24,065
2. Ceiling on the cumulative quasi-fiscal deficit of the electricity sector (in millions of soms)	…	…	3,822	…	6,633
3. Ceiling on contracting or guaranteeing by the state government or NBKR of new concessional external debt (in millions of U.S. dollars) 2/	…	(as specified in the revised TMU attached herewith)			

Sources: Kyrgyz authorities; and Fund staff estimates and projections.

1/ Definitions are provided in the Technical Memorandum of Understanding.
2/ New concessional loans during the year.

Table 3. Kyrgyz Republic: Structural Conditionality

I. March–December 2006

Structural benchmarks for end-March 2006

- Prepare, in close cooperation with the Fund staff, an action plan for the State Tax Inspectorate to streamline its operations, retrench redundant personnel, and introduce a merit-based pay system. [Observed]

Structural benchmarks and performance criteria (*) for end-June 2006[1]

- Develop a supervisory framework for market, country, and transfer risk as recommended by the September 2004 technical assistance mission of the IMF's Monetary and Financial Systems Department. [Observed]

- Establish an independent audit committee to oversee the external and internal audit functions of the NBKR as recommended by the Safeguards Assessment Report conducted by Finance Department in 2005. [Observed]

- The government will take the appropriate legal steps (accompanied by enabling regulations) to transfer the Centerra shares currently owned by KyrgyzAltyn JSC to the State Property Fund.* [Not Observed]

Structural benchmarks for end-September 2006

- Prepare an action plan to reduce the energy sector's quasi-fiscal deficit in close cooperation with World Bank staff, addressing problems of transmission and distribution losses, payment indiscipline, and tariff adjustment. [Observed]

- Expand the operation of the Large Taxpayers Unit to cover at least 60 percent of tax revenues. [Observed]

Structural benchmarks for end-December 2006

- Conduct an independent review of the NBKR's internal audit function. The review could be performed by the internal audit department of another central bank, and should include a review of the capacity of the NBKR's internal audit division, as recommended by the Safeguards Assessment Report conducted by Finance Department in 2005.

[1] Actions labeled with an asterisk are structural performance criteria.

Table 3 (concluded). Kyrgyz Republic: Structural Conditionality

- Bring KAFC to the point of sale and issue a privatization tender for the company.
- Submit to IMF staff a report prepared by the ministry of labor and social protection recommending measures to improve labor market flexibility.
- Secure approval of legislation that has been already sent to parliament to enhance the NBKR's legal independence and ensure legal protection of its employees in performing official duties.

II. March–June 2007

Structural benchmarks for end-March 2007

- The government will submit to parliament amendments (drafted by the NBKR) to the civil, housing and land codes, as well as to all the laws governing collateral, in order to harmonize provisions on collateralized lending by financial institutions and facilitate collateral seizure in cases of default.
- Approval of the tax code bill that is before parliament.
- The government will adopt a new medium-term external debt management strategy aimed at ensuring external debt sustainability, as described in paragraph 24 of the RMEP.

Structural benchmarks for end-June 2007

- The NBKR will implement regulations for consolidated supervision to monitor risks faced by financial institutions, in line with the recommendations of the 2005 Basel Core Principles for Effective Banking Supervision Assessment.
- The government will introduce a new and detailed budget classification, based on the best practice reporting of government finances (GFS 2001), which will permit monitoring of poverty reducing expenditures in the monthly budget execution reports.

ATTACHMENT III

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The Kyrgyz Republic's performance during the period January 1, 2005–December 31, 2007 under the three-year PRGF-supported program will be assessed by the IMF on the basis of the observance of quantitative performance criteria and structural benchmarks. This updated memorandum and its attached tables define the quantitative performance criteria and indicative targets under program supported by the Poverty Reduction and Growth facility (PRGF) arrangement.[1] This update reflects the changes made to the program as specified in the Memorandum of Economic Policies (MEP) for the third review under the arrangement.

2. The *program exchange rate* of the Kyrgyz som to the U.S. dollar is set at som 39.5 = $1. The corresponding cross exchange rates and program gold price for 2007 are provided in Table 11. For 2006, the program exchange rate of Kyrgyz som to the U.S. dollar, and other currencies, as specified in IMF Country Report No. 06/235, remain unchanged.

I. Quantitative Performance Criteria

3. The quantitative targets (i.e., quantitative benchmarks for end-September 2006 and end-March 2007, and quantitative performance criteria for end-December 2006 and end-June 2007) presented in Tables 1 and 2 of the MEP are defined below.

Floor on net international reserves of the National Bank of the Kyrgyz Republic (NBKR) in convertible currencies

4. The program contains a floor on the stock of net international reserves of the NBKR in convertible currencies. This floor will be calculated as the difference between total gross international reserves and total international reserve liabilities of the NBKR in convertible currencies.

5. Total gross international reserves of the NBKR shall be defined as the NBKR holdings of monetary gold, holdings of SDRs, any reserve position in the IMF, and any holdings of convertible currencies in cash or with foreign banks, and debt instruments (including accrued interest). Amounts pledged as collateral or in swaps or otherwise blocked, capital subscriptions in foreign financial institutions, and illiquid assets of the NBKR are

[1] Central government and republican government are synonymous in this memorandum. State government comprises central and local governments. General government comprises the state government and the Social Fund.

excluded. Also excluded are net forward positions, defined as the difference between the face value of foreign currency denominated NBKR off-balance sheet claims on nonresidents and foreign currency obligations to both residents and nonresidents. In addition, net claims on other Commonwealth of Independent States (CIS) countries are excluded from the floor. For program monitoring purposes, gross international reserves shall be valued at program exchange rates and gold prices.

6. Total international reserve liabilities of the NBKR in convertible currencies shall be defined as outstanding liabilities to the IMF and other convertible currency liabilities to nonresidents with an original maturity of up to and including one year. For program monitoring purposes, total international reserve liabilities shall be valued at the program exchange rates as described in paragraph 2 above. Thus calculated, the stock of net international reserves in convertible currencies amounted to $416 million as of December 31, 2005.

7. The program floors on the NIR of the NBKR in convertible currencies are reported in Table 1 below.

Table 1. Floors on NIR of the NBKR in Convertible Currencies 1/

(In millions of U.S. dollars)

March 31, 2006 (benchmark)	367
June 30, 2006 (performance criterion)	412
September 30, 2006 (benchmark)	413
December 31, 2006 (performance criterion)	457
March 31, 2007 (benchmark)	572
June 30, 2007 (performance criterion)	594

1/ End-of-period stocks.

8. The floor on net international reserves of the NBKR will be adjusted:
(a) upward/downward by 100 percent for any excess/shortfall in net foreign financing defined in paragraph 9 below; (b) upward by 30 percent for any nonprogrammed cash grants; and (c) upward/downward by 100 percent for any excess/shortfall in cash privatization receipts in foreign exchange. Valued at the program exchange rate, the program cash privatization receipts are equivalent to $5 million in each of the fourth quarter of 2006 and

2007. The total adjustment in respect of adjustors (a) and (c) is to be limited to $25 million, valued at the program exchange rate.

9. 'Net foreign financing and cash grants' is defined as balance of payment support loans, plus cash grants to the state government budget, plus any changes in the balance of unused PIP funds held at the NBKR, minus amortization (excluding repayments to the Fund) and interest payments on external debt made by the ministry of economy, and NBKR. This definition applies to the adjustors to both the NIR and the NDA. The program cumulative net foreign financing is given in Table 2. The balance of unused PIP funds was equivalent to $0.03 million as of December 31, 2005.

Table 2. Projected Net Foreign Financing and Cash Grants 1/

(In millions of U.S. dollars)

March 31, 2006	0.8
June 30, 2006	3.9
September 30, 2006	1.6
December 31, 2006	18.4
March 31, 2007	7.7
June 30, 2007	0.5

1/ Cumulative from the beginning of the calendar year.

Ceiling on the net domestic assets of the NBKR

10. Net domestic assets of the NBKR are defined as reserve money of the NBKR (defined below), minus the NBKR's net foreign assets,[2] minus the medium- and long-term NBKR obligations (MLT), minus the counterpart of the loan by the Eximbank of Turkey, minus the counterpart of the EBRD and IDA enterprise loans (Equation 1).

(1) NDA=RM–NFA–MLT–Turkish Loan–EBRD-IDA Enterprise Loan

11. Thus defined, the NBKR's net domestic assets consist of: (a) gross credit to the general government from the NBKR, minus deposits of the general government with the NBKR, minus the counterpart of the loan by the Eximbank of Turkey; (b) gross credit to domestic banks by the NBKR, minus the counterpart of the EBRD and IDA enterprise loans;

[2] The NBKR's net foreign assets consist of net international reserves, as defined in this TMU, plus other foreign assets, plus the net claims on other CIS countries.

and (c) all other net assets of the NBKR (other items net). Thus defined, the stock of the NBKR's net domestic assets amounted to minus som 1,943 million on December 31, 2005.

12. The program ceilings on the NDA of the NBKR are reported in Table 3 below.

Table 3. Ceilings on the NDA of the NBKR 1/

(In millions of soms)

March 31, 2006 (benchmark)	-1566
June 30, 2006 (performance criterion)	-1,752
September 30, 2006 (benchmark)	-1,413
December 31, 2006 (performance criterion)	-1,469
March 31, 2007 (benchmark)	-1,958
June 30, 2007 (performance criterion)	-1465

1/ End-of-period stocks.

13. The ceiling on net domestic assets of the NBKR will be adjusted:
(a) downward/upward by 100 percent of the excess/shortfall in net foreign financing of the state government budget; (b) downward by 30 percent for any nonprogrammed cash grants; and (c) downward/upward by 100 percent of the excess/shortfall of cash privatization receipts. The total adjustment for shortfalls in adjustors (a) and (c) is to be limited to $25 million, valued at the program exchange rate.

Ceiling on the cumulative primary fiscal deficit (before grants) of the general government

14. The general government primary fiscal deficit before grants is defined as the sum of: (a) the change in the stock of net claims of the domestic banking system and nonfinancial institutions—including state-owned enterprises and public companies—and households on the general government; (b) the change in the stock of net claims of the foreign banking system and nonfinancial institutions and households on the general government; (c) net privatization receipts; (d) net foreign loans disbursed to the state government for budgetary support; and (e) net foreign loans disbursed to the general government for project financing. From this total, foreign grants received by the general government and accrued interest on the general government are deducted. The fiscal balance will be measured at the program exchange rates, unless foreign currency denominated assets or liabilities are converted into domestic currency upon receipt or accrual. The ceiling of the cumulative general government primary fiscal deficit will be adjusted upward by the full amount of any excess in program foreign grants.

15. The change in the stock of net claims of the domestic banking system on the general government is defined as the change in the stock of the banking system claims on the general government, less the change in the stock of all deposits of the general government with the banking system. The claims of the banking system on the general government include: (a) bank loans to the general government; (b) securities or bills issued by the general government held by banks, with the exception of those issued in relation with bank rescue operations; and (c) overdrafts on the current accounts of the general government with banks.

16. The program ceilings on the cumulative primary deficit (before grants) of the general government are reported in Table 4 below.

Table 4. Ceilings on the Primary Deficit (before grants) of the General Government 1/

(In millions of soms)

March 31, 2006 (benchmark)	1,099
June 30, 2006 (performance criterion)	1,377
September 30, 2006 (benchmark)	2,541
December 31, 2006 (performance criteria)	3,701
March 31, 2007 (benchmark)	589
June 30, 2007 (performance criteria)	1,130

1/ Cumulative beginning from the beginning of the calendar year.

Cumulative floor on state government tax collections in cash

17. Tax collections in cash correspond to the line "IV. Tax Receipts" in the Treasury Report and comprise the following categories: 1.0 tax on income and profits; 2.0 taxes on goods and services; 3.0 specific taxes on services; 4.0 taxes on property; and 5.0 taxes on international trade. Cumulative tax collections in cash include collections of tax arrears but exclude tax offsets.

18. The program floors for the cumulative state government cash tax collection are reported in Table 5 below.

Table 5. Floors on State Government Cash Tax Collections 1/

(In millions of soms)

March 31, 2006 (benchmark)	3,599
June 30, 2006 (performance criterion)	7,933
September 30, 2006 (benchmark)	12,512
December 31, 2006 (performance criterion)	17,650
March 31, 2007 (benchmark)	4,236
June 30, 2007 (performance criterion)	9,238

1/ Cumulative from the beginning of the calendar year.

Ceiling on the stock of central government budget arrears

19. For the purposes of the program, central government budget arrears are defined as an overdue payment obligation of the republican budget arising since the start of the three-year program period (January 1, 2005) and related to: (a) wages; (b) Social Fund payroll contributions; (c) mandatory transfers to the Social Fund; (d) categorical grants; (e) payments of electricity bills; and (f) allowances to poor families. A payment is defined to be overdue if it remains unpaid after its due date for (c) and (d); for 30 days after its due date for (a) and (b); for 60 days after its due date for (e); and for 40 days after its due date for (f). The program ceilings on the stock of central government budget arrears are zero at each test date.

Ceiling on the stock of Social Fund pension arrears

20. A pension payment by the Social Fund is defined as overdue if it has come due since the start of the three-year program period (January 1, 2005) and remains unpaid for 30 days or more after its due date. The program ceilings on the stock of Social Fund pension arrears are zero at each test date. No new pension arrears will be accumulated.

Floor on the Social Fund payroll tax collections in cash

21. Payroll tax collections in cash correspond to the total cash contributions collected by the Social Fund from both employers and employees for a given period.

22. The program floors for the Social Fund tax collections in cash are reported in Table 6 below:

Table 6. Floor on Social Fund Cash Payroll Tax Collections 1/

(In millions of soms)

March 31, 2006 (benchmark)	1,100
June 30, 2006 (performance criterion)	2,292
September 30, 2006 (benchmark)	3,430
December 31, 2006 (performance criterion)	4,823
March 31, 2007 (benchmark)	1,372
June 30, 2007 (performance criterion)	2,705

1/ Cumulative from the beginning of the calendar year.

Ceiling on the stock of Social Fund arrears to the medical insurance fund

23. Social Fund arrears to the Medical Insurance Fund are defined as overdue transfer obligations of the former to the latter as defined by law and refer to arrears incurred starting January 1, 2005. A transfer is defined to be overdue if the value date of any transfer obligation is more than five business days after the due date. The program ceilings on the stock of Social Fund pension arrears to the Medical Insurance Fund are zero at each test date.

Ceilings on contracting or guaranteeing of new external debt by the state government of the Kyrgyz Republic or the NBKR or any other agency acting on behalf of the state government

24. In connection with the contracting or guaranteeing of external debt by the state government of the Kyrgyz Republic, the NBKR, or any other agency acting on behalf of the state government of the Kyrgyz Republic, "debt" is understood to have the meaning set out in point 9 of the Guidelines on Performance Criteria with respect to External Debt in Fund arrangements (Decision No. 12274-00/85, dated August 24, 2000).[3]

[3] Debt is understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debt can take a number of forms, the primary ones being as follows: (a) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (b) suppliers' credits, i.e., contracts where the supplier permits the

(continued…)

25. External debt ceilings apply to (a) the contracting or guaranteeing of short term external debt (i.e. external debt with an original maturity of less than one year, except normal import-related credits and NBKR reserve liabilities); and (b) contracting or guaranteeing of **nonconcessional** medium- and long-term external debt (i.e., external debt with an original maturity of one year or more). Disbursements by the Fund from the PRGF Trust are excluded from the ceilings on external debt. Also excluded from these external debt ceilings is the contracting or guaranteeing of new external debt that constitutes a rescheduling or refinancing of existing external debt at terms more favorable to the debtor. The limit on the contracting or guaranteeing of short-term external debt is zero on a continuous basis throughout the period of the arrangement. The limit on the contracting or guaranteeing of medium- and long-term nonconcessional external debt is zero as specified in Table 2 of the MEP.

26. For the purposes of the ceiling on contracting and guaranteeing new external debt, any other agency acting on behalf of the state government will in particular include all nonfinancial public enterprises with share capitals of not less than Kyrgyz som 100 million in which the state government holds at least 51 percent of the share capital (The public enterprises listed in Table 12 currently meet the foregoing criteria).

Ceiling on new external payments arrears

27. For the purposes of the program, external payment arrears will consist of all debt-service obligations (i.e., payments of principal or interest) arising in respect of any debt contracted or guaranteed or assumed by the state government of the Kyrgyz Republic, or the NBKR, or any agency acting on behalf of the state government of the Kyrgyz Republic since the Kyrgyz Republic's independence, including, without limitations, unpaid penalties, interest charges or judicially awarded damages associated with these arrears owed by the state government of the Kyrgyz Republic, or the NBKR, or any agency acting on behalf of the state government of the Kyrgyz Republic, on imports received subsequent to independence. The ceiling on new external payment arrears shall apply on a continuous basis throughout the period of the PRGF arrangement.

II. Indicative Targets

obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (c) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. Under the above definition of debt, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Ceiling on reserve money

28. For the purposes of the program, reserve money consists of currency issued by the NBKR and balances on commercial banks' correspondent accounts with the NBKR. The indicative program limits are reported in Table 7 below.

Table 7. Ceilings on Reserve Money 1/

(In millions of soms)

March 31, 2006	13,750
June 30, 2006	15,549
September 30, 2006	15,905
December 31, 2006	17,708
March 31, 2007	20,617
June 30, 2007	22,038

1/ End-of-period stocks.

Ceiling on the quasi-fiscal deficit of the electricity sector

29. The quasi-fiscal deficit (QFD) of the electricity sector is defined as cost of production minus cash revenues:

(1) $QFD=Q*MC - R$;

(2) $Q = 1/(1-\ell)*(\sum Ci)$;

(3) $R = (\sum Ci) * T * Ccash$,

where:

Q is the domestic supply (generation plus import minus export) minus normative losses;

MC is the marginal cost of production required for efficient supply of Q;

R is the total cash revenue;

$\sum Ci$ is the sum of consumption by all end-users (households, industry, agriculture, budgetary institutions, and other);

ℓ is the annual average loss rate of excessive (i.e., above normative) technical and commercial losses in percent of Q;

T is the annual weighted average of posted (or nominal) tariffs for end-users; and

Ccash is the ratio of annual average cash collections to total billing to end-users.

30. For the purposes of the program, the marginal cost of production is equal to 2.3 U.S. cents per kilowatt hour for 2006 and 2.66 U.S. cents for 2007, and normative losses (including own-use) are defined as 15 percent of domestic supply. Total billing of end-users is defined as consumption times the posted nominal tariff. The cash collection component is the amount of bills paid in cash to the energy companies, and excludes any form of cash-to-cash settlements, off-sets, barters, or other noncash payments. The indicative ceiling on the quasi-fiscal deficit in the electricity sector is as follows (Table 8).

Table 8. Ceiling on Quasi-Fiscal Deficit of the Electricity Sector 1/

(In millions of soms)

June 30, 2006	3,745
December 31, 2006	6,509
June 30, 2007 2/	3,822
December 31, 2007 2/	6,633

1/ Cumulative from the beginning of the calendar year.
2/ At new cost recovery rate.

Ceiling on contracting or guaranteeing of concessional external debt

31. The annual ceiling on the contracting or guaranteeing of new concessional external debt by the state government of the Kyrgyz Republic or the NBKR or any other agency working on behalf of the state government is set by the U.S. dollar nominal sum of project loan agreements yet to be signed and agreed, plus balance of payments support loans required to fill the external financing gap, as programmed. Pursuant to monitoring this indicative target ceiling, the ministry of economy and finance will provide quarterly information on the total nominal U.S. dollar value of: (a) new project and program loans signed and agreed during the previous three-month period; and (b) new project and program loans planned, but yet to be signed and agreed, during the previous three-month period. The annual indicative ceilings on the contracting or guaranteeing of new medium- and long-term concessional external loans for 2006 are specified in Table 9.

Table 9. Annual Indicative Ceiling on Contracting and Guaranteeing of New Concessional Loans in 2006 and 2007 1/

(In millions of U.S. dollars)

With disbursements beginning in:	Contracted in	
	2006	2007
2006	30	...
2007	83	0
2008	92	0

1/ New concessional loans signed in 2006, excluding contingency amounts.

These ceilings are nominal debt lumped by the year in which their disbursements commenced. For 2006, the limit implies contracting loans of which $30 million will start disbursing in 2006, $83 million in 2007, and $92 million in 2008. The ceiling for contracting and guaranteeing new concessional loans in 2007 will be adjusted upwards by full amount of any shortfall from the ceiling for 2006.

32. For program purposes, a debt is considered concessional if the grant element is at least 45 percent, calculated by using currency specific discount rates based on the Commercial Interest Reference Rates (CIRRs) published by the OECD. The average of the CIRRs over the last 10 years will be used for debts with maturity of at least 15 years and the average CIRR of the preceding six months will be used for shorter maturities.

III. Reporting Requirements Under the Program

33. The government and the NBKR will provide the Fund with the necessary economic and financial statistical data to monitor economic developments and the quantitative targets. In particular, the government and the NBKR will provide the following specific information:[4]

The balance sheet of the NBKR

34. The NBKR will provide to the Fund its balance sheet on a daily basis. The information provided will clearly identify the following items in the definitions specified above: the gross foreign assets and liabilities of the NBKR, decomposed by currency and instrument for the assets and by currency and creditor for the liabilities; the net foreign assets of the NBKR; the net international reserves of the NBKR; medium- and long-term liabilities; the net domestic assets of the NBKR; net credit from the NBKR to the general government; net credit from the NBKR to commercial banks; the balance of unused PIP funds held in the NBKR; other items net; and reserve money. The balance sheet will be provided valued at the actual exchange rate as well as according to the valuation applied under the program, as specified in Section I. The above information will be provided to the IMF Resident Representative and/or transmitted by e-mail to the Fund.

[4] Any correction or revisions to data previously reported should be clearly indicated and documented along with the reasons for revision.

Monetary survey

35. Monthly banking system data, in the form of a monetary survey, will be reported to the Fund by the NBKR within 14 days of the end of the month. The information provided will clearly identify the following items: net foreign assets and net domestic assets of the banking system, medium- and long-term liabilities, net credit from the banking system to the general government, financing provided to the rest of the economy, other items net, and broad money. The monetary survey will be provided valued at the actual exchange rate as well as according to the valuation applied under the program, as specified in Section I.

36. The NBKR will provide monthly data to the Fund within seven days after the end of the month on the amount of holdings of treasury bills, GKOs, state obligations, state bonds, and other securities issued by the state government, differentiated by the following categories of holders: the NBKR, resident banks, resident nonbanks, and nonresidents. The information will be provided in both the book (nominal) value and the actual value, where applicable.

International reserves and key financial indicators

37. The NBKR will provide detailed monthly data within 14 days from the end of the month on the composition of both its gross and net international reserves in convertible currencies and holdings of monetary gold. These data will be provided at two alternative sets of the exchange rates and the gold price: first, at those used to derive the NFA position in the NBKR accounts; second, at those specified in the program (Section I). In addition, weekly reports should be sent to the Fund on (a) exchange rates (including the official and interbank exchange rates), foreign exchange interbank market turnover, and the volume of NBKR foreign exchange sales and purchases in the interbank market and with other parties, on a daily basis; and (b) treasury bill yields and the amount of treasury bill sales and redemptions on a weekly basis every Monday. On the 25th day of the month following the reference month, the NBKR will provide indicators of financial soundness of the banking system, including the ratios of regulatory capital to risk-weighted assets, nonperforming loans to total loans, and return on equity, as well as data on bank deposit and lending rates by maturity.

Banking system data

38. The NBKR will provide detailed bank-by-bank data within 14 days of the end of the month on commercial banks’ compliance with: (a) prudential requirements as well as any penalties, sanctions and other administrative actions imposed on banks; and (b) reserve requirements on a weekly basis.

External debt

39. The ministry of economy, together with the NBKR, will provide monthly information on the disbursements, principal and interest payment—both actual and falling due; on contracting and guaranteeing of medium- and long-term external loans by the state

government and the NBKR; and any stock of outstanding arrears on external debt service payments within 21 days of the end of each month. In addition, the ministry of economy and finance will report the total amount of outstanding government guarantees and external arrears on a monthly basis. While the NBKR will provide the debt service payment data on private debt, the ministry of finance will provide data on debt service on public and publicly guaranteed loans.

Budgetary and extra-budgetary data

40. In addition to the monthly treasury report, the ministry of economy and finance and the Social Fund will report monthly on all their recorded expenditure arrears, in particular on those defined above in this TMU. This information will be provided to the Fund staff within 26 days from the end of each reference month. The ministry of economy and finance will also provide monthly reports on the disbursements and use under the public investment program and budgetary grants with a one-month time lag.

41. The National Agency for Antimonopoly Policy and Competition Promotion (Anti-monopoly-Commission), in consultation with the ministry of economy, and the World Bank, will submit to Fund staff each March and September their semi-annual report on the electricity sector QFD according to the format specified in Table 10 below.

Balance of payments data

42. The NBKR will provide current account and capital account data, including data on foreign trade, services, official and private transfers, foreign investment, and disbursements of public and private loans, on a quarterly basis, with at most a two-month lag. The NBKR will also provide monthly foreign trade data with a two-month lag.

Other general economic information

43. The National Statistics Committee will notify the Fund of the monthly Consumer Price Index by category by the 5th business day of the following month, and convey quarterly GDP estimates within two months of the end of each quarter.

Table 10. Kyrgyz Republic: Electricity Quasi-Fiscal Deficit

	Period
Production (GWh) 1/	
Losses (GWh)	
Loss Rate (in percent) 2/	
Consumption (GWh)	
Tariff ($ct/kWh) 3/	
Cash Collection Rate (in percent)	
Effective Tariff ($ct/kWh) 4/	
cash effective rate	
total effective rate	
Cost Recovery Tariff ($ct/kWh) 5/	
Quasi-Fiscal Deficit	
in percent of GDP	
in $ millions	
in millions of soms	

1/ Generation plus imports minus exports minus normative losses.
2/ Excess technical and commercial losses as percent of production.
3/ Average posted tariff, calculated as quotient of total bill and consumption volume.
4/ Nominal tariff times cash collection rate
5/ Marginal costs, derived from marginal incremental capital cost.

Table 11. Program Cross Exchange Rates

	Currency Names	National Currency/US$	US$/National Currency
SDR		0.6732	1.4853
GBP	UK pound sterling	0.5271	1.8971
DKK	Danish krone	5.8357	0.1714
EUR	Euro	0.7822	1.2785
INR	Indian rupee	46.5000	0.0215
CAD	Canadian dollar	1.1259	0.8882
CNY	Chinese yuan	7.9759	0.1254
KRW	South Korean won	961.5000	0.0010
NOK	Norwegian krone	6.2186	0.1608
TRL	Turkish lira (new)	0.6778	1.4753
SEK	Swedish krona	7.2005	0.1389
CHF	Swiss franc	1.2355	0.8094
JPY	Japanese yen	115.9100	0.0083
AZM	Azerbaijani new manat	1.0854	0.9213
AMD	Armenian dram	399.6600	0.0025
BYR	Belarusian rubel	2142.0000	0.0005
KZT	Kazakh tenge	122.5800	0.0082
LVL	Latvian lats	0.5460	1.8315
LTL	Lithuanian litas	2.6772	0.3735
MDL	Moldovan lei	13.3347	0.0750
RUR	Russian ruble	26.6738	0.0375
TJS	Tajik somoni	3.3790	0.2960
UZS	Uzbek sum	1226.6300	0.0008
UAH	Ukrainian hryvnia	5.0500	0.1980
EEK	Estonian kroon	12.2388	0.0817
AUD	Australian dollar	1.1259	0.8882
	Gold ($/troy ounce)		625.0000

Table 12. List of Public Enterprises Covered under Performance Criteria on Contracting and Guaranteeing New External Debt (¶26 of the TMU).

JSC Electrical Stations
JSC National Electrical Grid of Kyrgyzstan
JSC Kyrgyzaltyn
JSC Kyrgyztelecom
JSC International Airport Manas
JSC Severelectro
JSC National Air Company
JSC Jibek Jolu
JSC Bishkek Teploset
JSC Kyrgyzneftegas
JSC Bishkek Machinery Plant
JSC Kadamjai Antimony Plant
JSC Jalal-Abadelectro
JSC Kyrgyzgas
JSC Kara Balta Mining Plant
JSC Vostokelectro
JSC Oshelectro
State JSC Kyrgyzgasmunaizat

INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

Staff Report for the 2006 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Structural Performance Criterion

Prepared by Middle East and Central Asia Department
(in cooperation with other departments)

Approved by David Owen and Scott Brown

October 19, 2006

Annex

ANNEX I. KYRGYZ REPUBLIC—FUND RELATIONS

(As of September 30, 2006)

I. **Membership Status:** Joined: 05/08/1992; Article VIII

II. **General Resources Account**	**SDR Million**	**Percent of Quota**
Quota	88.80	100.00
Fund Holdings of Currency	88.80	100.00
Reserve Position	0.00	0.01

III. **SDR Department**	**SDR Million**	**Percent of Allocation**
Holdings	4.31	N/A

IV. **Outstanding Purchases and Loans**	**SDR Million**	**Percent of Quota**
PRGF Arrangements	110.35	124.27

V. **Latest Financial Arrangements**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PRGF	03/15/2005	03/14/2008	8.88	3.80
PRGF	12/06/2001	03/14/2005	73.40	73.40
PRGF	06/26/1998	07/25/2001	73.38	44.69

VI. **Projected Payments to Fund**
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	3.23	16.12	14.80	14.73	16.24
Charges/Interest	0.28	0.50	0.41	0.34	0.26
Total	3.51	16.61	15.21	15.06	16.49

VII. **Status of HIPC and MDRI Assistance:** The Board considered the preliminary HIPC document on October 13, 2006. The decision point paper is expected to be presented for Board's consideration in early 2007.

IX. Safeguards Assessments

Under the Fund's safeguards assessment policy, the National Bank of the Kyrgyz Republic (NBKR) is subject to an assessment with respect to the PRGF arrangement, which was approved on March 15, 2005. An updated safeguards assessment of the NBKR was completed on October 14, 2005. The assessment found that the NBKR's safeguards framework has been strengthened since the previous assessment completed in 2002. However, a number of areas were identified where further steps would solidify the progress achieved, which include improving oversight of the audit processes and the internal control systems by establishing an audit committee, strengthening the legal framework for NBKR's autonomy, and enhancing the NBKR's internal audit function.

X. Exchange Rate Arrangements

The currency of the Kyrgyz Republic has been the som (100 tyiyn =1 som) since May 15, 1993. The Kyrgyz Republic's exchange regime is classified as a managed float with no preannounced path for the exchange rate. The NBKR publishes daily the exchange rate of the som in terms of the U.S. dollar, which is determined in the interbank foreign exchange market. The Kyrgyz Republic maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions maintained for security reasons relating to the restriction of financial transactions and the freeze of accounts of certain individuals or organizations associated with terrorism pursuant to (i) relevant UN Security Council resolutions and (ii) the list of current terrorist organizations designated by the U.S. Secretary of State. The authorities are in the process of notifying these measures to the Fund pursuant to Executive Board decision No. 144-(52/51).

XI. Article IV Consultations

The Kyrgyz Republic is on the 24-month consultation cycle. The last Article IV consultation discussions were held in August–October 2004 and were completed by the Executive Board on November 19, 2004. At the same time, the Executive Board considered the staff's Ex Post Assessment of Longer-Term Program Engagement.

XII. FSAP Participation and ROSC Assessment

FSAP missions were held in May and September 2002, and the discussions were concluded during the 2002 Article IV consultation. A ROSC Fiscal Transparency mission was held in March 2001 and the ROSC Fiscal Transparency Module was published on March 13, 2002. A ROSC Data mission was held in November 2002 and the ROSC Data Module was published on November 10, 2003.

XIII. Resident Representative

The seventh resident representative of the Fund in the Kyrgyz Republic, Mr. McHugh, took up his post in Bishkek in late September 2006.

ANNEX II. KYRGYZ REPUBLIC—RELATIONS WITH THE WORLD BANK GROUP
(As of August 31, 2006)

1. The last CAS covering FY03–06 has been completed in July 1st of this year and at present World Bank Country team jointly with four development partners (ADB, DFID, SWISS, and UN Agencies) is developing a Joint Country Support Strategy (JCSS) which will cover the period FY 07–10. JCSS will be based on the government's Country Development Strategy (equivalent of PRSP –) which sought to capitalize on major reforms to date while maintaining a reform and growth course that will reduce poverty and enhance prospects for debt sustainability.

2. **International Development Association (IDA)**. Since the Kyrgyz Republic joined the World Bank in September 1992, it has received commitments of $776 million for 38 IDA-funded projects, out of which $587 million have already been disbursed. Out of 19 operations totaling $480 million completed so far, seven structural adjustment credits provided quick disbursing support for the government's economic reform programs in privatization, enterprise restructuring, agricultural policy, financial sector, public sector resource management, pension reform and energy reform. Twelve investment operations supported reform and rehabilitation of the telecommunications sector, social safety nets, health, rural finance, private enterprises and livestock development.

3. The active Bank portfolio in the Kyrgyz Republic comprises 19 operations with total commitments of $254 million, of which $107 million (58 percent) remains to be disbursed. Two projects: Village Investment Project and Reducing Technical Barriers for Entrepreneurship and Trade have been approved by Board and became effective in FY07. In addition to the country portfolio, the Kyrgyz Republic also benefits from the regional HIV/AIDS project.

4. Until the new JCSS is approved, the World Bank Group's operational objective for the next six months is to continue supporting the ongoing government's efforts to improve energy sector performance, the business environment, the banking sector, governance, public expenditure management, intergovernmental finance, the pension system, social protection, health, water and sanitation, and agriculture, and to enhance the portfolio performance. It will continue assisting the government with economic sector work and capacity building.

5. **International Finance Corporation (IFC).** The IFC strategy in Kyrgyz Republic focuses on institution and capacity building through investment and technical assistance to promote private sector development, especially small and medium-size enterprises (SMEs), and support the transformation into a market-based economy. IFC's portfolio in Kyrgyzstan stood at $15 million with 77% in financial markets, 9% in general manufacturing and 14% in agribusiness. The amount of total investments made to Kyrgyz economy since 1996 reached $56.19 million.

Building upon IFC's initial investment in the financial sector, the Demir Kyrgyz International Bank, IFC has played an instrumental role in establishing the largest bank in the country, the Kyrgyz Investment and Credit Bank, with a $1.4 million equity investment. IFC developed a strategic partnership with FINCA by investing a $1.0 million in a fund to support micro enterprises. This investment was accompanied by technical assistance to FINCA to facilitate its transformation and to the government to develop the appropriate regulatory framework. The largest investment in the existing portfolio is the Kumtor gold mine, with additional investments in a packaging plant Altyn-Ajydar. In 2002, under the Small Enterprise Fund (SEF) procedure, IFC disbursed a direct investment into a pasta plant (Akun) in the amount of $1.4 million. The IFC Board also approved in May 2002 a micro and small enterprise facility for Central Asia, with IFC investment of $45 million. In the same year, the Central Asia Small Enterprise Fund (CASEF) was set up in collaboration with other lenders. The fund will provide equity, quasi-equity, and debt financing, as well as technical and managerial assistance to growth-oriented SMEs. To date IFC has provided credit lines to local banks as AKB Kyrgyzstan, Ineximbank and Kazcommertsbank for the total amount of $5 million. With financial support from the Swiss Government, IFC draws upon the resources of the Private Enterprise Partnership to advise on improving the business environment, provide training and support services for SMEs, continue past efforts to develop leasing activities, and support agribusiness for local and export markets. In January 2006 IFC signed an agreement to provide $2.2 million financing package to Micro Credit Agency Bai-Tushum, one of Kyrgyzstan's leading micro lending institution.

IFC has completed about 14 technical assistance projects with funding for the total amount of $2.2 million in the areas of: (a) institutional and capacity building in the financial sectors including leasing, microfinance; (b) creating favorable business environment for SMEs; (c) improvement of investment climate; and (d) developing capacity building for tourism. In 2005 IFC launched two technical assistance projects to improve legal, regulatory and tax framework for housing finance and leasing. It is also planed to start a regional technical assistance project to improve corporate governance in enterprises of Central Asia.

6. **Multilateral Investment Guarantee Agency (MIGA).** MIGA has supported private sector development in the Kyrgyz Republic by extending guarantees to foreign direct investments in four projects in the manufacturing, services, and mining sectors. Three are currently outstanding—two related to airport services at Manas airport and a now defunct airline. There is an on-going legal dispute between the investors and the Government involving these two contracts. At the request of both parties MIGA has offered to mediate. One related to the Kumtor gold mine. The total amount of foreign direct investment facilitated by MIGA guarantees is over $360 million. MIGA has also provided capacity building in foreign investment techniques to the State Committee on Foreign Investments and Economic Development, under an initiative supported by the Swiss Government. MIGA plans to continue to assist the development of the Kyrgyz Republic through its guarantee program and capacity building. Data on the Kyrgyz Republic are also featured in MIGA's Privatization Link service, which connects potential investors to information on companies slated for divestiture via the Internet.

7. **World Bank contacts:**

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ANNEX III. KYRGYZ REPUBLIC—RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ADB)

(As of August 31, 2006)

1. The Kyrgyz Republic became a member of the ADB in 1994 and began receiving assistance in the same year. The country has received 25 loans and 1 grant for a total amount of $604 million (as of August 31, 2006). Seven out of the 25 loans are program loans totaling $199.5 million provided to support policy reforms to facilitate the transition to a market economy. The remaining 18 are project loans and one project grant totaling $404.5 million provided to support various investment activities. At present, ten loans with approved loan amount of $200.8 million are ongoing. These loans have an undisbursed balance of $118.0 million as of August 31, 2006. All these loans were provided on concessional terms from the Bank's special fund resources—Asian Development Fund (ADF).

2. ADB's average annual lending level during 2002 and 2003 was $15.25 million. This was much lower than the lending levels in the past, largely due to the government's policy of restrained borrowings as part of its debt strategy. This strategy envisages a reduction in the size of the largely externally funded PIP from about 6 percent of GDP in 2001 to about 3 percent of GDP by 2005. ADB's annual lending began with $40 million in 1994 and reached the peak level of $89.2 million by 1997. Thereafter, lending levels fell slightly and hovered between $65 million and $75 million through 2001. The level of assistance for the block of two year 2005–06 was $60.8 million. The allocation for the block of two years 2007–08 is determined at $46 million. This program will be reviewed, based on the availability of ADF funds and the rules governing grants, to make it consistent with the Government's debt reduction strategy and the limits on the PIP. In addition, ADB had provided 64 technical assistance (TA) projects amounting to $37.5million as of today. Of these, 17 are project preparatory TAs amounting to $11.3 million and the remaining 47 TAs for $26.2 million are advisory TAs for capacity building, policy advice, institutional strengthening and training. The Kyrgyz Republic has also received five JFPR Grants amounting to $4 million.

3. The performance of ADB's portfolio is generally satisfactory, although one loan was rated at risk. The scarcity of budgetary resources, and ceilings on the externally funded PIP constituted the biggest risks to the country portfolio. ADB and the World Bank have thus sought the removal of quarterly disbursement ceilings, which delay project implementation. In August 2005, IMF agreed to be more flexible in determining annual targets for the PIP, which is expected to improve portfolio performance.

4. ADB's assistance to the country has sought to support the development objectives of the government's National Poverty Reduction Strategy by fostering growth and providing selective support for the social sectors. ADB's strategy for 2006–08 supports government

approach to poverty reduction and accomplishment of Millennium Development Goals. In particular, ADB's social sector projects aim to improve access to pre-school and basic education, primary vocational education, and maternity and child health services for the poor.

5. The allocation of ADF resources to the country is based on the government's attainment of performance targets (triggers) in five areas: (a) making steady progress in macroeconomic management and structural reforms in the financial sector, and customs administration; (b) making progress in prioritizing on-going PIP projects; (c) adhering to the national debt reduction strategy; (d) finalizing the NPRS; and (e) implementing a package of legal and judicial reforms for improving the investment climate for the private sector. Accordingly, based on performance, allocation for the Kyrgyz Republic for 2005 and beyond would range between \$14.4 million and \$32 million based on the availability of ADF resources. ADB's annual investment levels averaged \$57.3 million during 1994–2004 and fell down to \$30.4 per year on average in 2005–06. From 2005 onward, up to 50 percent of ADF assistance to the country will be in the form of grants.

6. ADB coordinates its activities closely with the EBRD, IMF, IsDB, World Bank, the UN System, and bilateral donors at all levels of development cooperation. There have been significant strides forward in aid coordination since the last CG meeting held in Bishkek in November 2002, when both the Government and the donors agreed to focus on improving significantly coordination efforts. Since then efforts are being made to share sectoral and operational information and better coordinate lending and technical assistance activities. Since 2003, ADB and World Bank, which together account for over 75 percent of the PIP, conducts a joint portfolio review. The Kyrgyz Republic is one of the partnership countries selected for harmonization of donor procedures at the Rome conference on harmonization held in February 2002.

7. The Kyrgyz Resident Mission, which plays a pivotal role in aid coordination, is participating in the working group set up by the Government to identify areas for harmonization of donor procedures. The areas identified for harmonization in the immediate future are: (a) procedures for procurement of goods and services; (b) financial management and monitoring of projects; and (c) project implementation units. World Bank and ADB procurement documentation has been harmonized in these areas.

8. Starting from September 2005, ADB together with other major bilateral and multilateral agencies (DFID, SDC/seco, UN, and WB) providing assistance to the Kyrgyz Republic is developing a joint Country Support Strategy for the period 2007–10 to improve donor harmonization and alignment, and ensure more consolidated donor assistance to the country.

ANNEX IV. KYRGYZ REPUBLIC—RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of August 31, 2006)

1. The EBRD facilitates the transition to a market-based economy through its direct support for private sector investment and key infrastructure, and targeted technical assistance. Under its recently introduced Early Transition Countries' Initiative (ETCI), which is of particular relevance to the Kyrgyz Republic, the Bank is introducing innovative instruments, and will consider smaller, more difficult projects. The ETCI also foresees technical cooperation (TC) to support investment development.

2. According to the Strategy for the Kyrgyz Republic approved in November 2004, the Bank's priorities for the period of 2004–06 are to: (a) foster the private sector; (b) strengthen the financial sector; (c) provide support for essential infrastructure; and (d) strengthen the policy dialogue to improve the investment climate and support reform efforts.

3. As of 30 June 2006, the Bank had approved 39 projects (including restructurings) including EUR 766.7 million of investment out of which the Bank had financed 23 percent for a gross commitment of EUR 174.1 million. During the past three years, the Bank expanded its activities in the financial sector to include:

The Kyrgyz Micro and Small Enterprises Financing Facility (MSEFF). As of 30 June 2006, more than $108 million (cumulative) had been disbursed to 52,833 small and medium-size enterprises via six participating local commercial banks. The bank has now signed credits with non banking institutions—Bai-Tushum, KAFC and FINCA.
Equity investments in Ineximbank, Demir Bank, and KICB.
Expansion of Trade Facilitation Program (TFP). Four banks are participants in the TFP.

In 2004, the Bank signed a cofinancing facility of $4 million to KICB. This new ETC product is provided to meet financing needs of emerging medium-sized private companies. The first sub loan agreement has been signed on December 26, 2005 for EUR 450,000.

Other activities of the Bank include:
Five investments (equivalent to $3.1 million) via the Direct Investment Facility.
$20 million loan and $10 million sub debt, since converted into $17 m equity participation in Centerra Gold (the Bank's senior loan have been fully repaid).
Loan to Hyatt-Regency Hotel, $6.3 million in 1997.
Loan to Interglass plant, $6 million in 2004.
Loan to Limatex (cotton-processing plant in Djalal-Abad), $1 million in 2005.
Loan to Raduga Invest (resort on Issyk-Kul lake), $6 million in 2005.
Although the Bank is currently unable to provide loans with sovereign guarantee the Bank continues to monitor public sector projects:

Modernization of the telecommunications network ($7.9 million).
Two projects to upgrade electricity transmission networks in Issyk-Kul and Talas regions ($63 million combined).

4. The Bank also implements grant-funded TC to support its investment portfolio, including the financial sector (including MSFF consultants among others), natural resources/environment, agribusiness and infrastructure. Recent TCs include:

In telecoms, to advise on key reforms, including inter-capacity access arrangements;
Training for judges in commercial law;
Investor protection reform initiative;
Roll out of the Business Advisory Service and Turn Around Management programs, providing consulting services to viable businesses.

5. Finally, the Bank maintains an active dialogue with the government. For example, the Bank was instrumental in founding the International Business Council, which is devoted to working with the government on improving the investment climate. The Bank also has provided guidance on legal reforms, such as the newly revised Law on Pledge.

ANNEX V. KYRGYZ REPUBLIC—TECHNICAL ASSISTANCE PROVIDED BY THE FUND, FEBRUARY 2003–AUGUST 2006

Dept.	Subject/Identified Need	Timing	Counterpart
FAD	Improving the Effectiveness of the Large Taxpayer Unit	February 24–March 7, 2003	Ministry of finance
	Treasury Management Information System	July 21–29, 2003	Ministry of finance
	VAT on agriculture	November 3–11, 2003	Ministry of finance
	Priorities for Tax Administration Reform	July 22–August 5, 2004	Ministry of finance
	Supporting Tax Administration Reform and installing new Expert Advisor	January 16–28, 2006	Prime minister's office
MFD	Review of the Capital Adequacy and Dividend Arrangements for the National Bank of the Kyrgyz Republic	August 18–28, 2003	National Bank of the Kyrgyz Republic
	Review of Debt Restructuring Operation and 2003 Financial Reporting	October 28–November 10, 2003	National Bank of the Kyrgyz Republic
	Monetary Operations, Banking System Development, and Central Bank Autonomy	September 13–23, 2004	National Bank of the Kyrgyz Republic
	Review of NBKR Debt Restructuring Arrangements, Options for Deepening Financial Markets and Amendments to the NBKR Law	December 7–18, 2004	National Bank of the Kyrgyz Republic
	Payments System	January 25–February 7, 2005, April 12–25, 2005, and October 18–27, 2005, February 20–March 5, 2006	National Bank of the Kyrgyz Republic
	Bank Supervision and Regulation	February 23–March 8, 2005, May 18–28, 2005, July 17–28, 2005, October 02–13, 2005, January 15–26, 2006, February 12–23, 2006, March 20–30, 2006	National Bank of the Kyrgyz Republic
	FSAP update	September 4–15, 2005	National Bank of the Kyrgyz Republic
	AML/CFT	April 19–25, 2006	National Bank of the Kyrgyz Republic
	Government Securities/Money Markets	August 25–30, 2006	National Bank of the Kyrgyz Republic

ANNEX V. KYRGYZ REPUBLIC—TECHNICAL ASSISTANCE PROVIDED BY THE FUND, FEBRUARY 2003–AUGUST 2006

Dept.	Subject/Identified Need	Timing	Counterpart
LEG	Update of the AML/CFT Legislation (jointly with MFD)	February 5–11, 2004	National Bank of the Kyrgyz Republic
	Review of Bank Legislation	March 1–4, 2004 April 26–May 6, 2004	National Bank of the Kyrgyz Republic
	Review of Tax Legislation	July 27–August 5, 2004	Ministry of finance
	Assisting in drafting Tax Code	December 4–10, 2005	Prime minister's office
STA	SDDS Subscription	January 28–February 5, 2004	National Statistical Committee
	Balance of Payments Statistics	March 15–29, 2004	National Bank of the Kyrgyz Republic
	Monetary and Financial Statistics	April 27–May 11, 2004	National Bank of the Kyrgyz Republic

List of Resident Advisors

MFD	Banking Supervision/Restructuring Advisor	Mr. Svartsman	January 2004–January 2005
MFD	Public Debt Policy and Management	Mr. Azarbayejani	December 2002–December 2004

ANNEX VI. KYRGYZ REPUBLIC—STATISTICAL ISSUES

General framework

1. Data provision is adequate for surveillance. The three institutions responsible for collecting, compiling and disseminating macroeconomic statistics—the National Statistics Committee (NSC), the ministry of economy and finance (MOF), and the National Bank of Kyrgyz Republic (NBKR)—have legal and institutional environments that support statistical quality, and their respective staff are well versed in current methodologies. Unlike staff resources, however, computer and financial resources are generally not commensurate with current needs and therefore constrain statistical development, especially for the NSC.

2. The NSC maintains a comprehensive and regularly updated web site with data that largely incorporate international methodological recommendations and adequate coverage and timeliness (http://www.stat.kg). In February 2004, following improvements in compilation and dissemination of the reserves template and external debt data, the Kyrgyz Republic subscribed to the SDDS.

3. A data ROSC mission in November 2002 assessed the data dissemination practices against the GDDS and undertook an in-depth assessment of the quality of national accounts, prices, government finance, monetary, and balance of payments statistics. The mission concluded that the quality of the Kyrgyz Republic's macroeconomic statistics had improved significantly in the last few years. The authorities had established a good track record of implementing recommendations of past technical assistance missions in statistics and had demonstrated commitment to pursue plans and programs to further improve their statistics. The mission recommended that a program of regular intersectoral consistency checks be introduced to reduce the sometimes significant, unexplained discrepancies between the government finance, monetary, and balance of payments datasets. The authorities' response to the data module ROSC (posted on the IMF website (www.imf.org/external/np/rosc) includes an update on the status of implementation of the ROSC mission's recommendations.

National accounts

4. In general, dissemination of national accounts statistics is timely. Technical assistance has been received from the IMF, EUROSTAT, OECD, the World Bank, and bilateral donors. While significant progress has been made in improving the national accounts estimation process, problems persist regarding the quality of the source data, due mainly to excessively tight collection deadlines associated with the national accounts release schedule. Efforts are needed to improve the quality of the source data for quarterly GDP estimates. Moreover, subannual national accounts statistics are still prepared on a cumulative basis rather than by discrete time periods. Difficulties also remain in properly estimating the degree of underreporting, especially in the private sector. To improve the coverage and reliability of primary data, work has been undertaken to introduce sampling procedures.

Improved sampling procedures have been adopted for household surveys and new report forms are being introduced for the enterprise survey. The NSC has established a division of sample surveys, which would assist in improving the sampling techniques.

Prices, wages, and employment

5. The concepts and definitions used in the consumer price index (CPI), which has been published since January 1995, are broadly consistent with international standards. The price index covers all urban resident households of all sizes and income levels, but excludes rural households, which comprise the majority of the population. The ROSC mission recommended that the authorities expand the coverage of the CPI to include rural households.

6. The producer price index (PPI), which has been published since October 1996, is compiled broadly in accordance with international standards, although its coverage needs to be improved. The coverage of the PPI was broadened in May 1997 and is expected to be further expanded in the coming years.

7. Progress has been made in computing unit value indices for imports and exports. Work continues with regard to computation of these indices using a standard index presentation and the development of an export price index. However, problems in customs administration have led to incomplete coverage of trade and the lack of an appropriate valuation system. Moreover, the data processed by customs have suffered due to the use of an outdated computer software system.

8. Problems exist in the compilation of the average wage, especially with respect to the valuation of payments in kind and the coverage of the private sector. Monthly and annual data are not comparable because of different coverage and classifications. These problems extend to employment data as well. The coverage of unemployment includes an estimate of unregistered unemployed.

Fiscal accounts

9. The scope of central government statistics falls short of international standards because it excludes data for the Social Fund and the externally financed Public Investment Program (these data are published separately). Other limitations involve the exclusion of financial transactions with domestic banks and the discrepancies between the deficit and financing data. While revenue and expenditure data generally accord with the *GFSM 1986*, there are misclassifications in both categories (for example, some nontax revenues are classified as taxes, and certain expenditure items are misclassified in the budget and treasury

accounts). Monthly GFS data for *IFS* publication have been reported up to June 2006. Annual GFS data however, are reported for the *GFS Yearbook,* with the latest data being for 2005, covering budgetary central government and local government operations.

10. The provision of data on public external debt service has improved. Data on actual debt service, guaranteed debt service, outstanding debt and revised debt projections, are provided on a monthly basis. The quality (including timeliness) of external debt data is adequate. The External Debt Division of the MOF is now solely responsible for monitoring external debt, and this division has benefited from on-site training provided by a Swiss-financed long-term consultant and the computerization of its database.

Monetary sector

11. The 2002 data ROSC mission found that: (a) the residency criterion was not uniformly applied, as the currency denomination was used to classify some transactions with foreign and domestic units; (b) deposits with banks in liquidation were included in broad money; and (c) source data did not provide sufficient information for a more detailed sectoral breakdown (e.g., subsectorization of nonbank institutions as recommended in the *Monetary and Financial Statistics Manual (MFSM)*).

12. An STA mission on monetary and financial statistics visited Bishkek during April 27–May 11, 2004 to (a) follow up on the implementation of the ROSC mission's recommendations; (b) expand the institutional coverage of the broad money survey; and (c) assist the NBKR in implementing the methodology in the *MFSM*. This mission found that the NBKR had made substantial progress in implementing the ROSC mission's recommendations pertaining to monetary statistics. To address the outstanding issues, the mission further recommended that the NBKR (a) improve the basic source data to allow for proper classification of the transactions with foreign and domestic units; (b) fully implement the *MFSM*'s methodology concerning accrual accounting; (c) exclude deposits with banks in liquidation from monetary aggregates and classify them as restricted deposits; and (d) set up a working group to follow up on consistency between monetary and balance of payments statistics. The mission also recommended expanding the current broad money survey to include the accounts of credit unions and microfinance companies.

13. Monthly monetary data for IFS publication are reported on a regular and timely basis. Since December 2002, monetary data have been reported electronically to STA. In 2005, the NBKR began reporting its monetary data to STA using Standardized Report Forms, which are designed in accordance with the *MFSM*'s methodology.

External sector

14. Data on the balance of payments and international investment position are compiled and disseminated on a quarterly basis. The 2002 data ROSC mission noted that the compilation of balance of payments statistics broadly follows the *Balance of Payments Manual, Fifth Edition (BPM5)*. The NBKR has good arrangements with other agencies to ensure timely data flow. However, because of legal issues related to secrecy provisions, high value transactions cannot be verified with respondents, limiting the ability to cross-check the accuracy of data. Although the data collection program has been expanded in the recent past, coverage deficiencies remain with respect to trade, services, and foreign direct investment. The NBKR enterprise surveys lack an up-to-date register and have inadequate coverage of enterprises, particularly those in free economic zones. There is also a need to improve compilation procedures for achieving temporal consistency of data, and investigating and reconciling discrepancies.

15. The NSC conducts a quarterly sample survey for the estimation of shuttle trade, and uses customs records on the number of people crossing the border with CIS countries to derive the sample. However, the high value limits applied for free import of goods by individuals have fostered a large shuttle trade, which has complicated estimation of this activity.

16. An STA mission on balance of payments statistics was in Bishkek during March15–29, 2004 in response to the authorities' request for technical assistance to address compilation issues, and to assess training needs. The mission noted that while improvements have been made in several areas, further improvements were needed in the international transactions reporting system; data sampling methods; and data validation and coverage, particularly on trade, services, private sector external debt and foreign direct investment. The mission developed a questionnaire for collecting data on foreign direct investments and provided guidelines on the collection of data on external debt.

APPENDIX VI. KYRGYZ REPUBLIC: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(as of September 29, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality – Accuracy and reliability[8]
Exchange Rates	9/15/06	9/18/06	D	D	W		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	9/15/06	9/18/06	M	M	M		
Reserve/Base Money	9/15/06	9/18/06	D	D	M	LO, O, LO, LO	LO, O, O, LO, LO
Broad Money	8/31/06	9/18/06	M	M	M		
Central Bank Balance Sheet	8/15/06	9/18/06	D	D	M		
Consolidated Balance Sheet of the Banking System	8/31/06	9/18/06	M	M	M		
Interest Rates[2]	9/08/06	9/18/06	W	W	W		
Consumer Price Index	8/31/06	9/08/06	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	7/31/06	9/15/06	M	M	Y	O, LNO, LO, O	LO, O, O, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	7/31/06	9/15/06	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	3/31/06	7/2106	M	M	Y		
External Current Account Balance	6/30/06	8/14/06	Q	Q	Q	LO, LO, LO, LO	O, LO, LO, LO, LO
Exports and Imports of Goods and Services	8/31/06	9/08/06	Q	Q	Q		
GDP/GNP	8/31/06	9/08/06	M	M	M	O, O, LO, O	LO, LO, LO, O, O
Gross External Debt	6/30/06	9/29/06	M	M	Y		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign and domestic financing only.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC (published on November 2003, and based on the findings of the mission that took place during November 2002) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative
November 3, 2006

The following information has become available since the staff report was issued on October 20, 2006. It does not change the thrust of the staff appraisal.

1. Economic activity has continued to rebound, with year-on-year real GDP growth of 3.2 percent through September. Output growth excluding the Kumtor gold mine (which suffered a serious accident) exceeded 6 percent, led by construction and services. Twelve-month inflation in September edged up to 5.3 percent. Faced with buoyant remittances and short-term capital inflows, the National Bank has continued its active unsterilized foreign exchange intervention. As a consequence, reserve money growth accelerated to 43 percent in the 12 months ending October and gross official reserves now stand at $730 million or 4.3 months of projected 2007 imports of goods and services. Bank credit to the private sector expanded by 51 percent in the 12 months ending September.

2. Tax collections through September rose well above program projections, sparked by a rapid increase in receipts from import transactions; receipts from domestic taxes grew much slower. Budgetary execution to date has been in line with the program. The first reading of the 2007 budget bill planned for September has been delayed to November and the government plans to submit a revised bill in late November, with input from a brief Fund staff visit planned shortly. The authorities have indicated that the phased fiscal decentralization slated to start next year has been postponed, pending progress in capacity building and clearer definition of central and local government fiscal competencies.

3. Preliminary data show that end-September 2006 indicative targets have been met with margins, except for the ceiling on reserve money. The authorities met the end-September structural benchmark on formulation (in close cooperation with World Bank staff) of an energy sector action plan, but the plan continues to be debated inside the government and will likely be revised in consultation with Bank staff. As described in the staff report, the current version features phased tariff hikes and supporting measures to improve bill collections and reduce technical losses and theft, with a view to curtailing the electricity sector's quasi-fiscal deficit. Contrary to earlier indications, the authorities missed the benchmark on expanding coverage of the Large Taxpayers Unit, which only amounted to 56 percent of total tax revenue versus the target of 60 percent.

4. The authorities have just increased the minimum wage to som 340 ($8.70) a month effective January 1, 2007, from the level of som 100 that has been in place for many years. The upcoming staff visit will discuss the implications of this unexpected measure (e.g., on indexation of tax brackets and deductions).

5. Negotiations are underway with Uzbekistan on its proposal to raise the export price of natural gas from $55 per thousand cubic meters effective January 2007; Uzbekistan's asking price ($100 per tcm) would further widen the Kyrgyz Republic's external current account deficit by 1 percent of GDP in 2007.

6. The recent joint Fund/Bank FSAP update mission found the financial system resilient to external shocks in light of its strong capital base. It left specific recommendations to deepen financial sector reforms, and cautioned against the proposed consolidation of financial sector supervision under the fledgling State Agency for Financial Supervision and Reporting.

7. World Bank and Fund staff will initiate discussions shortly with the authorities on Completion Point triggers under the enhanced HIPC Initiative. Meanwhile, the government has intensified its internal outreach effort on the HIPC process to address widespread concerns from civil society and parliament.

INTERNATIONAL MONETARY FUND
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January 8, 2007

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with the Kyrgyz Republic

On November 3, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the 2006 Article IV consultation with the Kyrgyz Republic.[1]

Background

The authorities have maintained macroeconomic discipline in recent years, despite a challenging political environment. The overall fiscal deficit of the general government has declined from 5 percent of GDP in 2003 to 3.9 percent in 2005 and it is targeted to decline further to 3.2 percent of GDP in 2006. The external current account deficit has widened over the past two years, to an estimated 11 percent of GDP in 2006, despite a surge in workers' remittances. The deficit is being financed by a rise in the net capital and financial account balance, resulting in a healthy buildup in gross official reserves to about 4.3 months of projected 2007 imports of goods and services at present.

Economic activity is rebounding in 2006, with year-on-year real GDP growth of 3.2 percent through September, after a slight contraction in 2005; output growth excluding the Kumtor gold mine (which suffered a serious accident) exceeded 6 percent, led by the construction and services sectors. From 2003 to 2005, per capita GDP in U.S. dollar terms rose by one-fourth and the poverty rate fell from 50 percent of the population to 44 percent.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Despite the 2005 rescheduling of the Kyrgyz Republic's debt by the Paris Club of official creditors, the country's external debt burden remains high. Debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative is expected to alleviate that burden and create fiscal space in the coming years for scaling up poverty-reducing outlays, to assist in meeting the Millennium Development Goals. Social spending has already increased from 14 percent of GDP in 2003 to an estimated 15½ percent in 2006.

Inflation, which has remained in the 3-5 percent range in recent years, is projected to rise slightly to just under 6 percent during 2006. Remonetization has gathered pace in recent years, but the financial system remains relatively shallow by international standards. Comprehensive financial reforms are under way and are slated to gain momentum under the Fund-supported program. The Kyrgyz Republic continues to maintain a managed exchange rate float. Active unsterilized central bank intervention in the foreign exchange market since early 2006 in response to a surge in workers' remittances and short-term capital inflows has fanned monetary expansion, and the authorities will need to tighten monetary policy in the period ahead to keep inflation in check.

Executive Board Assessment

Directors commended the Kyrgyz government for maintaining economic stability and pressing ahead with reforms, despite the challenging political environment. Directors welcomed the government's commitment to build further on these achievements under the economic program for 2007. This will involve continued prudent fiscal and monetary policies and structural reforms to improve the climate for private sector-led growth and poverty reduction.

Directors welcomed the progress made in updating the Country Development Strategy (CDS) with ample civil society participation, and extending it to 2010. They considered the reform agenda outlined in the CDS as a good roadmap to achieve the Millennium Development Goals and exploit fully the promising growth potential in a low-inflation environment. They urged the authorities to work toward the steadfast implementation of these reforms, building on intensive outreach to domestic stakeholders and with support from the international community.

Directors noted that, while fiscal prudence has become entrenched, further improvements in tax administration will be essential to underpin fiscal consolidation. In particular, it will be important to complete the 2006 tax reform, secure prompt passage of the tax code before parliament, and resist pressures to dilute the programmed reforms in the tax administration agencies. Directors encouraged the authorities to continue enhancing public financial management, especially the budgetary process and the tracking and targeting of pro-poor spending within a context of overall expenditure restraint. They took positive note of the authorities' intention to phase in the planned fiscal decentralization carefully and build local government capacity, in order to forestall a loss of fiscal control.

Directors welcomed the programmed payroll tax cuts, which would foster job creation and legalization of the informal economy. However, Directors expressed concern about the adverse fiscal consequences of the proposed reduction in the retirement age. They called on the authorities to forge a broad consensus in favor of a comprehensive pension reform aimed at safeguarding fiscal stability and promoting domestic savings.

Directors took note of the joint Fund/World Bank debt sustainability analysis, which highlights the Kyrgyz Republic's heavy external debt burden. They noted that debt relief under the HIPC Initiative and Multilateral Debt Relief Initiative is expected to create fiscal space for scaling-up poverty-reducing outlays, while underpinning debt sustainability. Directors, however, also underscored that the government should persevere in its efforts to improve debt management, continue refraining from nonconcessional borrowing, avoid the accumulation of contingent liabilities, and ensure that externally funded investments are of the highest caliber. They also underlined the need to align carefully any additional spending financed by asset sales or new external loans with the program's macroeconomic framework to help safeguard macroeconomic stability and debt sustainability.

Directors commended the authorities' success in keeping inflationary pressures in check, but expected that a tightening of the monetary stance would be necessary to avert a spike in inflation, in light of the recent easing in liquidity conditions and the envisaged hikes in utility tariffs. They considered it appropriate for the central bank to maintain the managed exchange rate float, while allowing for greater nominal exchange rate flexibility if the trend toward a further real appreciation of the som persists. Directors saw scope for additional increases in policy interest rates and a further broadening of monetary control instruments to keep liquidity expansion in check.

Directors welcomed the resilience of the Kyrgyz financial system to external shocks, and the authorities' plans to deepen financial sector reforms, building on the findings of the recent Financial Sector Assessment Program update. They encouraged the National Bank to continue strengthening banking supervision, especially in light of the rapid credit growth. Directors looked forward to the prompt passage of the pending bill to increase the National Bank's autonomy as a key step to bolster confidence and the credibility of monetary policy.

Directors supported the authorities' intention to resolve governance weaknesses and discourage rent-seeking behavior, both of which have diverted scarce resources and depressed productivity growth over the years. In this context, they cautioned that an active industrial policy could hamper the efforts in this area, and weaken the tax effort as well. Directors stressed the need to improve the business climate to nurture private sector-led growth—including by streamlining the regulatory framework, simplifying licensing and other administrative procedures, and fostering regional integration. They urged the authorities to implement steadfastly the energy sector plan to reduce the sector's large quasi-fiscal deficits and provide reliable power supplies for the domestic and export markets. Directors stressed that progress on structural reforms will also remain key to strengthening and diversifying the export base, thereby reducing the vulnerability to external shocks.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Kyrgyz Republic: Selected Economic Indicators, 2001-06

	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2005 Actual	2006 Proj.
Real GDP (growth in percent)	5.3	0.0	7.0	7.0	-0.6	4.0
GDP per capita (in U.S. dollars)	308	322	381	435	473	528
Consumer prices (percent change, eop)	3.7	2.3	5.6	2.8	4.9	5.7
Unemployment rate	7.8	8.6	8.9	9.0	9.7	...
Poverty rate (consumption approach)	56	55	50	46	44	...
General government finances (in percent of GDP) 1/						
Total revenue and grants	20.4	22.8	22.2	23.1	24.3	24.9
Total expenditure (including net lending)	26.0	28.1	27.0	27.5	28.2	28.1
Overall fiscal balance (cash basis)	-5.2	-5.6	-4.9	-4.5	-3.9	-3.2
Primary balance excluding grants	-4.4	-5.1	-3.9	-3.9	-2.8	-2.9
Banking sector 2/						
Broad money (percent change, eop)	12.2	35.1	34.5	33.6	25.5	35.1
Credit to private sector (in percent of GDP)	3.8	4.0	4.7	7.0	8.0	10.5
Reserve money (percentage change)	32.5	42.9	31.6	22.9	24.9	27.0
Interest rate 3/	33.2	24.8	23.0	24.3	25.7	...
External sector						
Current account balance (in percent of GDP)	-1.5	-5.0	-4.1	-3.4	-8.3	-11.0
Export growth (percent change)	-2.1	14.2	16.4	26.6	-0.1	16.9
Import growth (percent change)	-9.9	28.0	15.7	28.8	23.9	27.9
Gross official reserves (million USD) 4/	230	317	359	544	609	721
Gross reserves (months of imports, eop)	3.6	4.3	3.8	4.7	4.1	4.2
External public debt outstanding (in percent of GDP) 5/	100	82	98	88	79	72
Exchange rates						
Exchange rate (soms per U.S. dollar, average)	48.4	46.9	43.7	42.6	41.0	...
Real effective exchange rate Index (1995=100) (percentage change) 6/	0.0	1.8	-0.6	-3.2	1.2	...

Sources: Kyrgyz authorities; and IMF staff estimates and projections.

1/ General government comprises state government and Social Fund finances. State government comprises central and local governments.
2/ Projections are based on program exchange rates specified in the TMU.
3/ Weighted average interest rate on som-denominated loans.
4/ Gross reserves exclude international reserves of the NBKR that are pledged or blocked.
5/ Excluding obligations of the Kumtor gold mine.
6/ A positive sign indicates appreciation.

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November 3, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under the Kyrgyz Republic's PRGF Arrangement and Approves US$1.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the third review of the Kyrgyz Republic's performance under its economic reform program supported by a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. In completing the review, the Board approved the authorities' request for a waiver for the nonobservance of the structural performance criterion on the transfer of the ownership interest of KyrgyzAltyn JSC in Centerra Gold Inc. to the State Property Fund.

The IMF's Executive Board approved the three-year arrangement on February 23, 2005 (see Press Release No. 05/40) for an amount equivalent to SDR 8.88 million (about US$13.2 million). Completion of this review will enable the Kyrgyz Republic to draw an amount equivalent of SDR1.27 million (about US$1.9 million), bringing total disbursements under the arrangement to the equivalent of SDR 5.07 million (about US$7.5 million).

Following the Executive Board discussion of the Kyrgyz Republic's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair made the following statement:

"The authorities of the Kyrgyz Republic are to be commended for maintaining economic stability and pressing ahead with reforms, despite the challenging political environment. The economic program for 2007 seeks to preserve macroeconomic stability and deepen structural reforms.

"While fiscal prudence has become entrenched, further improvements in tax administration and public financial management are essential to underpin fiscal consolidation. The programmed payroll tax cuts, aimed at fostering job creation and legalization of the informal economy, are welcome. The authorities should now strive to forge a broad consensus on a comprehensive pension reform that would safeguard fiscal stability and promote domestic savings. Steadfast implementation of energy sector reforms will be key to reducing the sector's large quasi-fiscal deficit.

"Monetary policy will need to remain vigilant to avert a spike in inflation, in light of the easing in liquidity conditions over the past months. The current managed float exchange rate system continues to serve the country well, and the National Bank's plans to broaden monetary control instruments to keep liquidity expansion in check, deepen financial sector reforms, and improve bank supervision are welcome. Prompt passage of the bill to increase the National Bank's autonomy would bolster confidence and the credibility of monetary policy.

"Going forward, it will remain important that the authorities persevere with their efforts to tackle governance issues, enhance the business climate and social protection, and further advance debt management, so as to improve the prospects for a rapid and sustained improvement in living standards," Mr. Kato said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in each country's Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Statement by Thomas Moser, Executive Director for Kyrgyz Republic
Sadriddin Djienbekov, Advisor to Executive Director
November 3, 2006

1. On behalf of our Kyrgyz authorities, we would like to thank the staff for their support and the constructive policy dialogue. The Kyrgyz authorities have continued to maintain macroeconomic discipline and implement the structural reforms supported by the PRGF arrangement, in spite of the very challenging political environment. All quantitative performance criteria and end-June structural benchmarks were met, with tax collection running above and the fiscal deficit below program projections. The authorities have also, in close cooperation with the World Bank, formulated an energy sector action plan, and the program's half-year target for the energy sector's quasi-fiscal deficit (QFD) was met with some margin.

2. The authorities are determined to continue their prudent fiscal policy. In line with staff advice, they intend to carefully phase in the fiscal decentralization mandated by parliament and they have delayed for the time being the implementation of the process, while they proceed to build capacity and seek a clearer definition of fiscal competencies. The government has also suspended the implementation of the parliament-mandated reduction in the retirement age and sought World Bank assistance to design a broader pension reform. In addition, the government has intensified its outreach effort on the HIPC Initiative and requested a ROSC mission on fiscal transparency.

3. The recent increase in the monthly minimum wage from som 100 to 340 is mainly a technical and symbolic measure, virtually without fiscal implications. The effective monthly minimum wage paid by the government remains at som 450 a month, and all the budget calculations, including the wage bill and pension benefit projections under the PRGF-supported program, have used a minimum wage of som 450. The increase will not influence labor market conditions either, because the average monthly minimum wage paid in the private sector (around som 1000) is substantially higher than the new minimum wage.

4. The authorities are asking for a waiver for nonobservance of the structural performance criterion on the transfer of the shares in the Centerra Canadian mining conglomerate (held by the Kyrgyzaltyn SOE) to the State Property Fund, based on a legal finding that the transfer would not be feasible. To effectively fulfill the spirit of the missed performance criterion, the government has issued a resolution prohibiting the sale of Centerra shares without government authorization and specifying that the proceeds from any sales of these shares will be used strictly in accordance with guidelines set by the government. The annual receipts from any sales of Centerra shares will be channeled through the central government budget.

5. Monetary policy is currently complicated by very strong inflows of workers' remittances and private capital inflows and continued remonetization. The National Bank has allowed the exchange rate to appreciate and gradually increased policy interest rates. To keep liquidity expansion in check, the NBKR will enhance its menu of monetary control

instruments. The NBKR further intends to deepen financial sector reforms with technical advice from the IMF and other donors. The authorities remain committed to make every effort to secure approval of legislation before parliament to enhance the NBKR's legal independence and legal protection for its employees in performing official duties.

6. The staff has been very helpful in discussing with our authorities the Kyrgyz Republic's new Country Development Strategy, which was approved recently by the government. The upcoming discussions with World Bank and Fund staff on Completion Point triggers under the HIPC Initiative will provide further opportunity for the government to attend to the recommendations and concerns raised by the staff.