

**International Monetary Fund**

[Kyrgyz Republic](#) and  
the IMF

**Kyrgyz Republic:** Letter of Intent, Memorandum of Economic and  
Financial Policies, and Technical Memorandum of Understanding

**Press Release:**  
[IMF Executive Board  
Completes Fourth  
Review Under the  
PRGF Arrangement  
with the Kyrgyz  
Republic and  
Approves US\\$1.9  
Million Disbursement](#)  
May 21, 2006

April 27, 2007

The following item is a Letter of Intent of the government of Kyrgyz Republic, which describes the policies that Kyrgyz Republic intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Kyrgyz Republic, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

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April 24, 2007

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

Dear Mr. de Rato:

The attached Memorandum of Economic Policies (MEP) describes program implementation to date, sets out the government's economic strategy for the remainder of the program period, and includes program understandings reached with the IMF. Further to our letter of October 17, 2006, reviewing our performance under the program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement approved in February 2005, we are pleased to inform you that all quantitative performance criteria for end-December 2006 were met, some with comfortable margins (Table 1). As indicated in Table 2, the implementation of some of the end-December 2006 and end-March 2007 structural benchmarks under the program has been delayed, owing in part to tensions between the government and parliament that have since been resolved. We are now seeking to expedite the passage of pending economic legislation and to add momentum to financial sector and public financial management reforms.

The Executive Board concluded the third review under the PRGF arrangement on November 3, 2006, and the fourth review is expected to be completed by May 2007. We hereby request disbursement of the SDR 1.27 million tranche upon Board completion of the fourth review.

We believe that the policies specified in the MEP provide a strong basis for sustaining growth in a low-inflation environment and alleviating poverty. We stand ready, nevertheless, to take any additional measures necessary to achieve the program's objectives. The government will continue to provide the Fund with the necessary information for assessing progress in implementing our program, as specified in the Technical Memorandum of Understanding (TMU), and will consult with Fund staff and management on any measures that may be appropriate at the initiative of the government or whenever the Fund requests a consultation.

The government intends to make public this letter and the staff report for the fourth review under the PRGF arrangement. Accordingly, it authorizes the IMF to arrange to post these documents on the Fund's website once the Executive Board completes its review.

Sincerely yours,

/s/

Almaz Atambaev  
Prime Minister  
Kyrgyz Republic

/s/

Marat Alapaev  
Chairman  
National Bank of the Kyrgyz Republic

## MEMORANDUM OF ECONOMIC POLICIES FOR THE KYRGYZ REPUBLIC

### I. RECENT ECONOMIC PERFORMANCE

1. This Memorandum reviews the implementation of the government's economic program supported by the PRGF arrangement approved in February 2005. The government has continued to maintain macroeconomic discipline and adhere to the PRGF-supported program, as evidenced by the observance of all end-December 2006 quantitative performance criteria, in some cases with ample margins (Table 1). However, as tensions with parliament delayed the passage of important legislation, some of the program's structural benchmarks have been missed (Table 2). After a slight contraction in 2005, real GDP grew at 2.7 percent in 2006, dampened by a gold mine accident. Excluding gold, however, output growth rebounded to 5.1 percent, driven by industry, construction and services. Consumer prices increased by 5.1 percent during the year (versus the program's 5.7 percent target), and by 4.3 percent during the 12 months ended February 2007. Owing to a sharp increase in imports and an accident-related shortfall in gold exports, the external current account deficit widened to 16¾ percent of GDP in 2006.

Nevertheless, sizable short-term capital inflows (including errors and omissions that partly reflect unrecorded remittances and shuttle trade re-exports) led to a faster-than-expected buildup in gross reserves, to 3.9 months of projected 2007 imports of goods and services by year's-end.

2. The general government primary deficit before grants, at 2.2 percent of GDP in 2006, was well below expectations, owing to strong revenue gains (particularly from customs duties and VAT on imports). The quasi-fiscal deficit of the electricity sector (measured under the old cost-recovery tariff methodology) declined as planned to 5½ percent of GDP, owing to improved bill collection and a reduction in technical losses and theft.

3. The NBKR conducted sizable unsterilized intervention in the foreign exchange market in 2006 to mitigate the appreciation of the som. As a result, reserve money growth was faster than planned, but due to continued remonetization of the economy, inflation has remained subdued. Despite the foreign exchange intervention, the som appreciated by 8 percent against the U.S. dollar during the year, but in real effective terms the appreciation was only 1.3 percent, due to the strengthening of the currencies of key trading partners (especially Russia and Kazakhstan). Broad money and credit to the private sector have also increased rapidly, but loan portfolios have remained healthy and bank profitability indicators have improved.

### II. PROGRAM OBJECTIVES AND ECONOMIC POLICIES FOR 2007

4. The government's economic strategy through 2010, based on the Country Development Strategy (CDS) and the Development Program that is being prepared by the new cabinet, focuses on poverty alleviation and private sector-led growth in a low-inflation environment. To that end, the government will continue to maintain macroeconomic stability and deepen financial sector and public financial management reforms. It will also reform the energy and mining sectors and take measures to enhance the business climate, improve the delivery and targeting of social services, and fight corruption. A specific reform agenda, drawing on the CDS and the Joint Country Support Strategy of the World Bank and other donors, will be discussed at a Consultative Group meeting in Bishkek this spring.

5. More specifically, our economic program for 2007 targets real GDP growth of 6½ percent, inflation at 5 percent, and a further gain in net international reserves that would keep end-year reserve coverage at 4 months of projected 2008 imports of goods and services. The external current account deficit would narrow to 12½ percent of GDP (on the back of a recovery in gold exports and continued buoyancy in workers' remittances) and be financed by FDI, other private inflows, and concessional external assistance. To achieve these goals, the overall deficit of the general government will be capped at 3.1 percent of GDP, mostly financed from external sources (Table 1). This will be accompanied by a firm monetary policy and a reduction in the quasi-fiscal losses of the electricity sector. We have also established structural benchmarks on critical financial sector and public financial management reforms through end-2007 (Table 2), and will strive to meet the program benchmarks missed thus far, as discussed below.

6. The government has initiated discussions with the Centerra mining company regarding its current and future operations in the Kyrgyz Republic, including the Kumtor gold mine, and it is counting on a significant increase in receipts. As indicated in Memorandum of Economic Policies for the third review under the PRGF arrangement, we are determined to harness these resources for productive uses in a manner consistent with macroeconomic stability. More specifically, we are seeking passage of a bill before parliament creating a Development Fund that would be sourced mainly from a portion of these additional receipts and possibly by future asset sales. We also reiterate that the utilization of these receipts (either through the public sector investment program or as net lending to the financial sector under the proposed Development Fund) will be fully and transparently reflected in the annual general government budgets approved by parliament and in the Medium-Term Budgetary Framework. As such, they will be fully integrated into the macroeconomic program supported by the PRGF arrangement, so as to safeguard short-term macroeconomic stability and longer-term external viability.

#### **A. Fiscal and Quasi-Fiscal Issues**

7. Fiscal discipline will remain the linchpin of macroeconomic stability. The 2007 budget passed in April is premised on further significant revenue gains, despite a 2 percentage-point reduction in the rate of social fund contributions in April, to 27 percent. The revenue effort will be underpinned by passage of the new tax code and further improvements in tax and customs administration—including further strengthening the Large Taxpayer Unit under the aegis of the State Tax Inspectorate. We are planning to gradually reduce the cascading and distortionary Road and Emergency Fund taxes from 2008, and may advance these cuts if revenue performance significantly exceeds expectations during 2007.

8. The budget also features a sizable increase in public salaries for certain categories (namely, 50 percent for the Interior Ministry and corrections personnel, and 30 percent for social sector employees) that will raise the general government wage bill to 7½ percent of GDP. Moreover, public pensions will be increased by 15 percent in 2007. To forestall an upward drift in the wage bill over the medium-term, while making room for differentiated increases in the remuneration of specialized professionals and senior officials from 2008, the government is launching a civil service reform in 2007 aimed at reducing the civilian workforce. The government will also start designing a pension reform with World Bank assistance, geared at securing the system's longer term viability and encouraging the development of the domestic capital market.

9. In keeping with the fiscal decentralization mandated by parliament, the 2007 budget is framed in two-tiers (the central and local governments). To maintain overall fiscal discipline, the government will continue to help local authorities build capacity and it will clearly demarcate revenue and expenditure competencies at both tiers. In particular, the government will take measures to transfer the financial and economic bodies of the local governments under the jurisdiction of the ministry of finance, in order to maintain economic stability. Moreover, the government will continue to enhance public financial management with assistance from the World Bank, the IMF and the UK Department for International Development (DfID). In particular, it will track pro-poor spending in the monthly budget report from mid-2007 (in accordance with a new state-of-the-art (GFS 2001) budget classification); submit to parliament an internal audit law consistent with best international practice; and ensure that the State Agency on Public Procurement and Material Reserves does not participate directly in the procurement process. Further, the government will refine the Medium-Term Budgetary Framework (MTBF) to yield sectoral MTBF ceilings directly and transparently linked to annual budgets, and it will strengthen the annual budget process by including functional, economic and administrative summaries in the budget bill. The government will foster transparency in public sector operations, and to better equip the Ministry of Finance to take the lead in implementing this broad reform agenda, it is considering measures to strengthen the role of the Ministry of Finance.

10. To help deliver reliable and sustainable long-term energy supply for domestic use and exports, the government has developed a rehabilitation plan for the energy sector with support from the World Bank. The plan includes a medium-term tariff policy framework (MTTF) featuring phased adjustments in electricity tariffs under a pre-announced calendar to cost recovery levels by 2010, accompanied by social safety nets to cushion the effect of the adjustment on the poor. The MTTF also envisages actions to boost utility bill collections and to reduce technical losses and theft. In this vein, and consistent with the MTTF and the new cost-recovery methodology agreed with the World Bank, the electricity sector's quasi-fiscal deficit (an indicative program target) is slated to decline to 5½ percent of GDP in 2007, from an estimated deficit of 7½ percent in 2006 under the same methodology. The government will also encourage private participation in the energy sector, and will continue to provide professional management of electricity companies, including transparency in appointing senior managers, improved financial reporting, and performance contracts between these companies' management and executive boards. The Ministry of Industry, Energy and Fuel Resources is tasked with formulating and reviewing energy sector policy and enhancing the sector's regulatory framework.

## **B. Monetary and Financial Sector Policies**

11. Price stability remains the overarching goal of monetary policy. The NBKR will seek to contain inflation at 5 percent during the year and, premised on further remonetization, the monetary program sets limits on the expansion of its net domestic assets consistent with reserve money growth of 25 percent and broad money growth of 30 percent. To keep liquidity expansion in check, the NBKR will further enhance its indirect monetary control instruments, price these instruments flexibly, and maintain the managed exchange rate float that has served the country well. The NBKR will limit foreign exchange intervention to smoothing exchange rate fluctuations and securing the programmed buildup in international reserves. To enhance the credibility of macroeconomic policy, thereby bolstering investor confidence, every effort will be

made to secure passage of pending legislation to strengthen the NBKR's autonomy. Meanwhile, we expect the independent review of the NBKR's internal audit function (a pending end-December 2006 structural benchmark) to be completed shortly with assistance from the Swiss National Bank, as part of the ongoing efforts to enhance the accountability of the NBKR.

12. Several measures have been introduced in recent years to strengthen the financial system, especially regarding supervision, the payment system, and curtailment of money laundering and the financing of terrorism. The authorities will introduce further measures to strengthen financial intermediation and pave the way for introduction of a mandatory deposit protection system for small depositors in 2008. In anticipation of a further rapid credit expansion, they will step up supervision (including through strict enforcement of procedures for tracking market, operational and country risks), and clearly delineate the supervisory responsibilities of the Service for Supervision and Regulation of Financial Market (SSRFM), while establishing a framework to share information between the SSRFM and the NBKR. Meanwhile, the SSRFM will strengthen supervision of insurance companies and financial institutions operating in the stock exchange. To enhance the payments system, the NBKR will make the real-time gross settlement (RTGS) system fully operational by end-2007, and the government will submit to the parliament enabling legislation to enhance flexibility in the use of bank accounts (including demand deposits) for settlement purposes by legal entities and physical persons. Furthermore, to ensure finality of bank resolution, the government will secure passage of amendments to the bank bankruptcy law modifying provisions introduced last September that allowed reinstatement of insolvent and liquidated banks.

13. The government remains committed to the privatization of the Kyrgyz Agricultural Finance Corporation, which has since been transformed into a Rural ("Ayil") Bank to enhance its growth potential. The government is studying two options for privatizing the Ayil Bank, namely (a) issuing a privatization tender under the current paid up capital, or (b) inviting private investors to raise the banks' capital and formulate a business plan conducive to subsequent disposal of the government's shares on more attractive terms. The government will decide on the preferred route by end-April 2007, in consultation with the World Bank, the Asian Development Bank (AsDB) and the European Bank for Reconstruction and Development (EBRD).

14. To help mobilize the significant domestic savings needed to underpin rapid growth, the government will foster development of the capital market and ensure its effective supervision. In this connection, and to encourage mortgage and other term lending, it will submit to parliament amendments to the civil, housing and land codes, and to the laws governing collateral, strengthening the legal foundations for using and seizing collateral in cases of default. We will continue the phased redemption of government bonds against a similar amount of government deposits at the central bank, redeeming some 200 million in 2007 for reissue to banks, and will simplify the nomenclature of public debt instruments. The authorities will ensure that any restructuring of government liabilities to the NBKR will not adversely impact the balance sheet of the NBKR.

### **C. Other Structural Reforms**

15. As part of our ongoing agenda to improve the business climate and strengthen the legal foundation for private property, we reaffirm our commitment to the blueprint outlined in the

CDS to boost private sector-led growth. In particular, we will promote transparency and efficiency in public administration, and in order to enhance the business environment, we will continue to simplify licensing procedures, streamline regulatory bodies, improve the autonomy and efficacy of the judiciary, and propose legal steps to strengthen property rights. These reforms will be supported by technical (and possibly financial) assistance from multilateral and bilateral donors involved in these areas.

#### **D. Program Monitoring**

16. The program will continue to be monitored through semi-annual reviews. For that purpose, we have set quantitative performance criteria (PCs) for end-December 2007 (along with proposed modifications to the end-June PCs established during the third review), and semi-annual indicative targets for reserve money and the electricity sector's quasi-fiscal deficit. We will make every effort to comply with the missed structural benchmarks for end-December 2006, and have set benchmarks for end-September and end-December 2007 (see Table 2). To better align the fiscal stance with the overarching goal of securing debt sustainability, we will henceforth treat the overall deficit of the general government as the key fiscal indicator that will be treated as a PC under the program. Completion of the fifth review later this year will hinge on observance of the end-June 2007 quantitative PCs outlined in Table 2. Detailed definitions and reporting requirements for all quantitative PCs and data sources are presented in the attached Technical Memorandum of Understanding.

Table 1. Kyrgyz Republic: Quantitative Program Targets for 2005–07 1/

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

	2005	2006			2007	
	December	December			June	Dec.
	Actual	EBS/06/60 2nd Review	EBS/06/134 3rd Review	Act.	Rev. Prog.	Prog.
<b>I. Performance criteria</b>						
1. Floor on net international reserves of the NBKR in convertible currencies (eop stock, in millions of U.S. dollars)	416	457	518	606	658	787
2. Ceiling on net domestic assets of the NBKR (eop stock)	-1,943	-1,469	-2,034	-2,559	-1,094	-1,769
3. Ceiling on cumulative primary deficit of the general government	3,229	3,701	3,221	2,459	...	...
4. Ceiling on cumulative overall deficit of the general government	...	...	...	...	1,665	3,937
5. Cumulative floor on state government tax collections in cash	16,361	17,650	18,431	19,981	10,246	23,141
6. Ceiling on the stock of central government budget arrears	0	0	0	0	0	0
7. Ceiling on the stock of Social Fund pension arrears	0	0	0	0	0	0
8. Cumulative floor on payroll collections in cash of the Social Fund	4,912	4,823	4,945	5,528	2,864	5,738
9. Ceiling on the stock of Social Fund arrears to the Medical Insurance Fund	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 less than one year (continuous, in millions of U.S. dollars)	0	0	0	0	0	0
11. 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
12. Ceiling on accumulation of new external payment arrears (continuous, in millions of U.S. dollars)	0	0	0	0	0	0
<b>II. Indicative targets</b>						
1. Ceiling on reserve money (eop stock)	15,466	17,708	19,642	22,806	24,177	28,499
2. Ceiling on the cumulative quasi-fiscal deficit of the electricity sector (in millions of soms)	7,609	6,509	6,509	6,127	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 TMU)

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

1/ Definitions are provided in the TMU.

2/ New concessional loans during the year.

**Table 2. Kyrgyz Republic: Structural Conditionality**

**I. September–December 2006**

**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. [Not observed]
- Bring KAFC to the point of sale and issue a privatization tender for the company. [Not observed]
- Submit to IMF staff a report prepared by the ministry of labor and social protection recommending measures to improve labor market flexibility. [Observed]
- 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. [Not observed]

**II. March–December 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. [Not observed]
- Approval of the tax code bill that is before parliament. [Not observed]
- 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 MEP for the third review under the arrangement. [Not observed]

**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 2 (Concluded). Kyrgyz Republic: Structural Conditionality****Structural benchmarks for end-September 2007**

- Submit to IMF staff a written Memorandum of Understanding agreed between the NBKR and the Service for Supervision and Regulation of Financial Market (SSRFM), delineating the specific supervisory responsibilities of the SSRFM and establishing modalities for information-sharing between them, as recommended by the FSAP update mission.
- Submit to parliament an internal audit law for government agencies in line with best international audit practices, in order to establish an appropriate framework for internal public sector controls.

**Structural benchmarks for end-December 2007**

- To ensure finality of bank resolution, the government and the NBKR will secure parliamentary approval of further amendments to the bank bankruptcy law modifying the provisions introduced in September 2006, which allowed reinstatement of banks that are insolvent and in the process of liquidation.
- Submit to IMF staff a best-practice, time-bound action plan to modernize customs administration, including greater selectivity of customs control based on risk criteria and expanding post-clearance audits.
- Submit to parliament enabling legislation to enhance flexibility in the use of bank accounts (including demand deposits) for settlement purposes by legal entities and physical persons.

## KYRGYZ REPUBLIC: TECHNICAL MEMORANDUM OF UNDERSTANDING

### III. INTRODUCTION

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.<sup>1</sup> This update reflects the changes made to the program as specified in the Memorandum of Economic Policies (MEP) for the fourth review under the arrangement.

2. The program exchange rate of the Kyrgyz som to the U.S. dollar is set at som 38.5 = \$1. The corresponding cross exchange rates and program gold price for 2007 are provided in Table 11.

### IV. QUANTITATIVE PERFORMANCE CRITERIA

3. The quantitative targets (i.e., quantitative benchmarks for end-March and end-September 2007, and quantitative performance criteria for end-June and end-December 2007) presented in Table 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 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.

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<sup>1</sup> Central government and republican government are synonymous in this memorandum. The State government comprises central and local governments. The general government comprises the state government, the Social Fund, and the Development Fund that was established on [date].

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 \$605.8 million as of December 31, 2006.

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)

September 30, 2006 (benchmark)	413
December 31, 2006 (performance criterion)	457
March 31, 2007 (benchmark)	572
June 30, 2007 (performance criterion)	658
September 30, 2007 (benchmark)	709
December 31, 2007 (performance criterion)	787

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 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 Finance, and the 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 \$36.16 thousands as of December 31, 2006.

**Table 2. Projected Net Foreign Financing and Cash Grants 1/  
(In millions of U.S. dollars)**

September 30, 2006	1.6
December 31, 2006	18.4
March 31, 2007	0.8
June 30, 2007	-11.6
September 30, 2007	13.6
December 31, 2007	-1.4

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,<sup>2</sup> 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).

$$(1) \quad NDA = RM - NFA - MLT - \text{Turkish Loan} - \text{EBRD-IDA Enterprise Loan}$$

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; 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 2,559 million on December 31, 2006.

<sup>2</sup> 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.

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)**

September 30, 2006 (benchmark)	-1,413
December 31, 2006 (performance criterion)	-1,469
March 31, 2007 (benchmark)	-1,958
June 30, 2007 (performance criterion)	-1,094
September 30, 2007 (benchmark)	-1,332
December 31, 2007 (performance criterion)	-1,769

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 overall deficit of the general government**

14. The overall deficit of the general government 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 including from Centerra share sales; (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. 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.

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 overall deficit of the general government are reported in Table 4 below.

**Table 4. Ceilings on the Operations of the General Government 1/**

(In millions of soms)

	Primary Deficit (before grants)	Overall Deficit
September 30, 2006 (benchmark)	2,541	...
December 31, 2006 (performance criteria)	2,541	...
March 31, 2007 (benchmark)	589	...
June 30, 2007 (performance criteria)	...	1,666
September 30, 2007 (benchmark)	...	2,773
December 31, 2007 (performance criteria)	...	3,937

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 )**

September 30, 2006 (benchmark)	12,512
December 31, 2006 (performance criterion)	17,650
March 31, 2007 (benchmark)	4,236
June 30, 2007 (performance criterion)	10,246
September 30, 2007 (benchmark)	16,293
December 31, 2007 (performance criterion)	23,141

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)**

September 30, 2006 (benchmark)	3,430
December 31, 2006 (performance criterion)	4,823
March 31, 2007 (benchmark)	1,372
June 30, 2007 (performance criterion)	2,863
September 30, 2007 (benchmark)	4,276
December 31, 2007 (performance criterion)	5,736

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).<sup>3</sup>

<sup>3</sup> 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 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

(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) and the Development Fund.

#### **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.

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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.

### III. INDICATIVE TARGETS

#### 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)

September 30, 2006	15,905
December 31, 2006	17,708
March 31, 2007	20,617
June 30, 2007	24,177
September 30, 2007	25,918
December 31, 2007	28,499

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:

$$(1) \text{ QFD} = \text{Q} * \text{MC} - \text{R};$$

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

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

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;

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

$\ell$  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

Cash 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 2.8 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, barter, 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 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 2007 are specified in Table 9.

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

With disbursements beginning in	In millions of U.S. dollars
2007	106
2008	11

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 2007, the limit implies contracting loans of which \$106 million will start disbursing in 2007 and \$11 million in 2008.

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.

#### **IV. 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:<sup>4</sup>

##### **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.

##### **Monetary survey**

<sup>4</sup>Any correction or revisions to data previously reported should be clearly indicated and documented along with the reasons for revision.

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 Finance, 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 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 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 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. The Development Fund will also submit a monthly report including its balance sheet and its deposits in the NBKR and the rest of the financial system.

41. The Ministry of Industry, Energy and Fuel Resources, in consultation with the Ministry of Finance, and the World Bank, will submit to Fund staff each March and September a 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**

<b>Currency Names</b>		<b>National Currency/US\$</b>	<b>US\$/National Currency</b>
SDR		0.6653	1.5032
GBP	UK pound sterling	0.5099	1.9611
DKK	Danish krone	5.6646	0.1765
EUR	Euro	0.7597	1.3163
INR	Indian rupee	44.2580	0.0226
CAD	Canadian dollar	0.8616	1.1606
CNY	Chinese yuan	7.8065	0.1281
KRW	South Korean won	929.8488	0.0011
NOK	Norwegian krone	6.2800	0.1592
TRL	Turkish lira (new)	0.7080	1.4125
SEK	Swedish krona	6.8770	0.1454
CHF	Swiss franc	0.8193	1.2206
JPY	Japanese yen	118.8954	0.0084
AZM	Azerbaijani new manat	1.1474	0.8715
AMD	Armenian dram	363.4299	0.0028
BYR	Belarusian rubel	2139.9832	0.0005
KZT	Kazakh tenge	126.9947	0.0079
LVL	Latvian lats	0.5360	1.8657
LTL	Lithuanian litas	2.6304	0.3802
MDL	Moldovan lei	12.9049	0.0775
RUR	Russian ruble	26.3796	0.0379
TJS	Tajik somoni	3.4265	0.2918
UZS	Uzbek sum	1237.7857	0.0008
UAH	Ukrainian hryvnia	5.0500	0.1980
EEK	Estonian kroon	11.8873	0.0841
AUD	Australian dollar	0.7907	1.2641
	Gold (\$/troy ounce)		635.0000

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

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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