

**National Bank of the Kyrgyz Republic**

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**Inflation Report**

**1 (15)**

**May 2005**

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**Bishkek**

## ***Inflation Report***

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The purpose of the publication "Inflation Report" is informing of broad public about the goals and results of the monetary policy. The publication contains the description of inflation developments by its components, by regions, and as a whole, the analysis of inflation factors and inflation forecast for the forthcoming quarter. The report is published quarterly in the Kyrgyz, Russian and English languages.

The last date of updating of the data in the given publication: April, 30 of 2005.

Founder: The National Bank of the Kyrgyz Republic.

The publication is registered with the Ministry of Justice of the Kyrgyz Republic registration certificate of the mass media №628 as of 02.11.2001.

Prepared for publication and printed by the printing center of the magazine "Banking Herald of the Kyrgyz Republic".

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Circulation 350 copies.

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The annual report of the National Bank of the Kyrgyz Republic is a complete report on the work of the National Bank done during the reporting year. It contains a brief description of developments in the real sector of economy, as well as the description of decisions and actions of the National Bank in the monetary sphere. It includes the information on economic development and monetary policy, financial statements, general information about the National Bank, statistical annexes. The report is published in Kyrgyz, Russian and English languages.

### ***Bulletin of the National Bank of the Kyrgyz Republic***

The Bulletin of the NBKR contains macro-economic indicators of the Kyrgyz Republic on the real sector, financial sector, external sector, information on prices and social indicators. The bulletin is published monthly in the Kyrgyz, Russian and English languages.

### ***Balance of Payments of the Kyrgyz Republic***

The publication reflects the latest trends in development of the external sector and contains tables with data in analytical and neutral formats of the balance of payment, the structure of external trade, international reserves, external debt, the methodology and the information base for preparation of the balance of payments, as well as the international investment position of the Kyrgyz Republic. It is published quarterly in January, May, July and October.

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The purpose of the edition is the official publication of statutory acts of the National bank for informing commercial banks and the public and propagation of the bank legislation of the Kyrgyz Republic. It is published once a month in the Kyrgyz and Russian languages.

### ***Press release of the National Bank of the Kyrgyz Republic***

The Press-Release of the NBKR contains the weekly chronicles of the developments in the National Bank and major data of the financial market. It is published quarterly in the Kyrgyz and Russian languages.

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## 1. CURRENT DEVELOPMENTS OF INFLATION

On preliminary data of the National statistical committee in the first quarter of 2005 gross domestic product grew by 2.0 percent. Gross domestic product, excluding production of large gold-mine enterprise, increased by 4.8 percent. Industry production declined by 4.7 percent. Industry production, excluding production of large gold-mine enterprise, grew by 6.6 percent. Production of agriculture rose by 1.1 percent.

Foreign trade turnover grew by 16.4 percent compared with corresponding period of 2004. Imports rose by 25.7 percent, exports increased by 4.8 percent. During last two years nominal and real effective exchange rate indexes were relatively stable. Real effective exchange rate slightly depreciated, so price competitiveness does not grow worse.

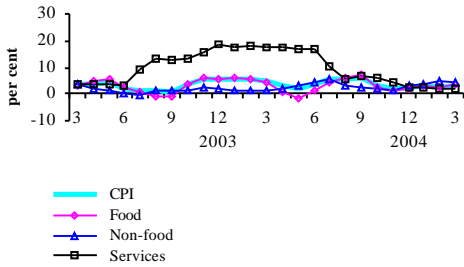
Year-on-year growth rates of monetary base and M2 aggregate continue to fall. Deposit base of commercial banks grew by 1.4 percent compared with the fourth quarter of 2004. Deposits in national currency reduced by 7.1 percent, but deposits in foreign exchange rose by 5.0 percent.

Average level of inter-bank credit contracted from 4.9 to 3.8 percent. Average yield of notes of the National bank also reduced from 4.7 to 3.6 percent. Ten out of 13 auctions on the accommodation of notes taken place.

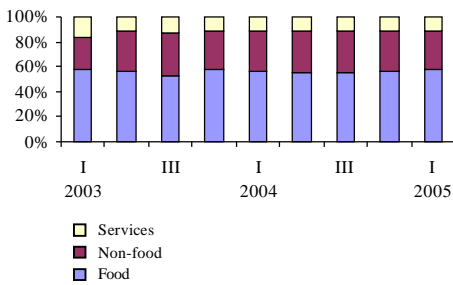
Average yield of 3-month T-bill reduced on 1.1 percentage points and made 3.7 percent. Average yield of 6-month T-bill also reduced on 0.8 percentage points and reach 4.2 percent. Average yield of 12-month T-bill declined from 8.6 to 6.1 percent. Average weighted yield declined by 1.6 percentage points and made 5.3 percent.

In first quarter, according to the National statistical committee consumer price index increased by 1.7 percent (in first quarter of 2004, inflation made 1.3 percent). Inflation outlook for the second quarter of 2005 is 2.0-2.1 percent.

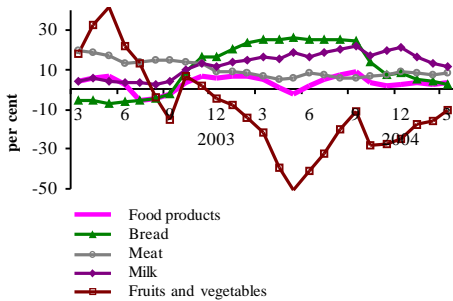
**Chart 2.1: CPI and its components, percentage changes on a year earlier**



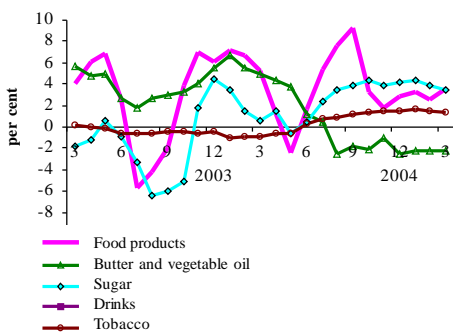
**Chart 2.2: Structure of CPI, per cent**



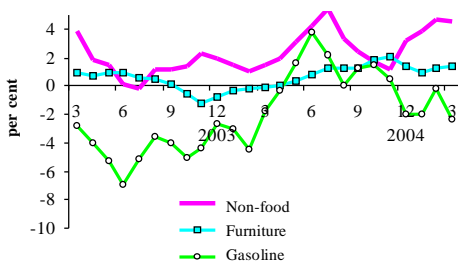
**Chart 2.3a: Food Prices, percentage changes on a year earlier**



**Chart 2.3b: Food Prices, percentage changes on a year earlier**



**Chart 2.4a: Non-food Prices, percentage changes on a year earlier**



## 2. CONSUMER PRICE INDEX AND ITS COMPONENTS

### 2.1. COMPONENTS OF CONSUMER PRICE INDEX

There was some acceleration of inflation in the first quarter in the comparison with a similar period of 2004. According to the National statistical committee consumer price index increased by 1.7 percent (in first quarter of 2004, inflation made 1.3 percent).

Acceleration was basically caused by seasonal growth for food products. Food inflation gained 4.5 percent, non-food inflation made 0.2 percent, service prices increased by 0.2 percent.

#### 2.1.1. FOOD PRODUCTS

Prices on food products were highly affected by development in prices on following groups: "fruits and vegetables", "butter and fat", "meat and fish", "bread". Usually prices grew at that period of year as a result of exhausting stocks of agricultural products. Prices on "fruits and vegetables" grew by 23.9 percent, prices on vegetables rose by 25.5 percent, and prices on fruits raised by 19.4 percent. In 2004, there were good crops (4.2 percent growth in potatoes, 9.5 percent growth in vegetables, 23.9 percent growth rate in fruits). So, acceleration in prices was stipulated by increasing in export by 38.7 percent in 2004).

Small growth in food prices in first quarter of 2004, when food prices rose by 4.3 percent, was unusual. In average fruits-and-vegetables grew by 28.9 percent in first quarter during 2001-2003 years.

Amongst foodstuffs also increased prices on fish (4.5 percent), butter and fat (2.1 percent), meat and meat products (1.4 percent), bread product and croup (1.3 percent). Prices on milk and milk products decreased on 3.2 percent, sugar and pastries (0.4 percent), tobacco products (0.3 percent).

#### 2.1.2. NON-FOOD PRODUCTS

Non-food price index grew by 0.2 percent. The most price increase by 6 percent observed on instruments, building materials (2.3 percent), medicines (1.8 percent), footwear (1.3

CONSUMER PRICE INDEX AND ITS COMPONENTS

percent). Prices on lubricants fell by 4.7 percent, coal (4.4 percent).

2.1.3. SERVICES

Service price index raised by 0.2 percent. Hairdresser's service prices grew by 3.3 percent, pre-school founding (2.2 percent), sewing cloths (1.9 percent), organisation of cultural events (1.4 percent).

2.2. CONSUMER PRICES BY REGIONS

Consumer prices grew in all regions. The biggest growth rate was observed in Chu oblast, where prices gained 3.4 percent, food inflation made 7.6 percent, non-food inflation was 1.5 percent and service prices rose by 0.3 percent. In Osh, Issuk-Kul, Naryn and Talas oblasts, growth rates of consumer prices fluctuated within range of 2.2-2.9 percent, and food inflation fluctuated within range of 4.1-7.4 percent.

In Batken oblast, the slowest inflation rate (0.5 percent) was registered, food inflation made 3.3 percent, while non-food products became cheaper by 2.3 percent.

In Bishkek City, inflation made 1.2 percent, food inflation was 3.0 percent, non-food inflation - 0.2 percent, services - 0.1 percent. In Jalal-Abad oblast, consumer prices increased by 1.8 percent, food inflation made 6.7 percent, non-food good prices declined by 1.6 percent, prices on services did not change.

Chart 2.4b: Non-food Prices, percentage changes on a year earlier

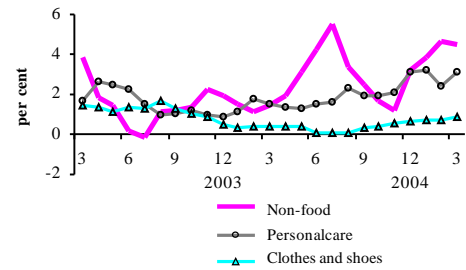


Chart 2.5a: Services, percentage changes on a year earlier

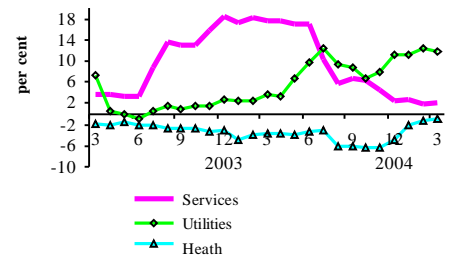


Chart 2.5b: Services, percentage changes on a year earlier

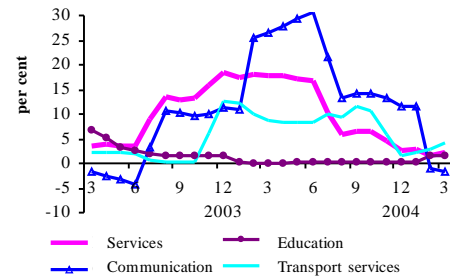


Chart 2.6a: CPI by Oblasts, percentage changes on a year earlier

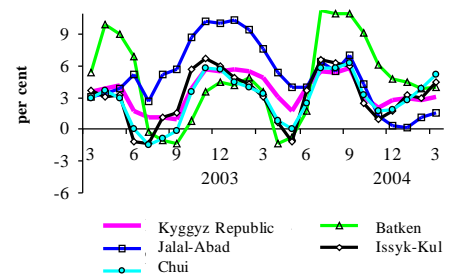
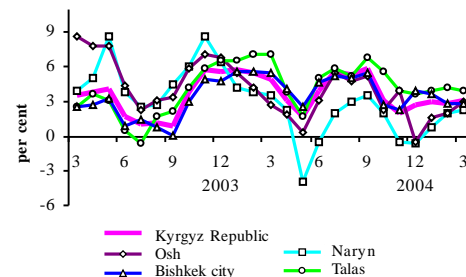


Chart 2.6b: CPI by Oblasts, percentage changes on a year earlier

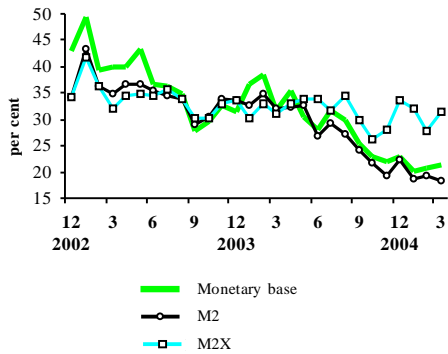


### 3. INFLATION FACTORS

#### 3.1. MONETARY AGGREGATES

##### 3.1.1. MONETARY BASE

**Chart 3.1: Monetary aggregates, percentage changes on a year earlier**



In first quarter, monetary base<sup>1</sup> rose by 1.8 percent or by 222.75 mln. Som. Operations of the Ministry finance contributed 440.29 mln. Som. basically as difference between expenditures and revenues of state budget (on the balance of the National bank). The operations of the National bank were directed on the reduction of the monetary base, which totalled 217.54 mln. Som. Year-on-year increase of monetary base gained 21.4 percent. Money in circulation for first quarter gained 2.7 percent, year-on-year basis it grew by 18.5 percent.

In the structure of monetary base, share of cash increased from 92.3 percent on the end of 2004 to 93.1 percent. Funds of commercial banks at the National bank decreased from 7.7 to 6.9 percent.

##### 3.1.2. AGGREGATE M2

Broad money in the national currency grew by 0.8 percent. Year-on-year growth of M2 aggregate rose by 18.3 percent. Deposits in the national currency reduced by 7.1 percent. Year-on-year increase of deposits in the national currency made 17.7 percent.

##### 3.1.3. AGGREGATE M2X

Monetary aggregate M2X, which includes deposits in foreign currency under the current exchange rate, increased by 2.1 percent, which was due to growth in currency outside banks by 2.6 percent and in deposit base of commercial banks<sup>2</sup>, which rose by 1.4 percent.

Deposits in the national currency reduced by 7.1 percent, while deposits in foreign exchange rose by 5 percent.

There were following changes in M2X structure:

- share of money outside of banks increased to 57.7 percent (57.4 percent on 01.01.05);

<sup>1</sup> Excluding foreign exchange deposits in banks.

<sup>2</sup> Including banks, which license is withdrawn, but process of liquidation is not completed yet.



## INFLATION FACTORS

- share of deposits in national currency reduced to 11.5 percent (12.6 percent on 01.01.05);
- share of deposits in foreign exchange enlarged to 30.8 percent (30.0 percent on 01.01.05.).

Money multiplier, which characterises a current condition of financial intermediation, practically did not change. Velocity of broad money M2X, which include deposits in foreign currency at constant exchange rate, reduced from 5.7 before 5.4. Monetisation raised from 17.5 to 18.4 percent of GDP. Relation of money outside of banks to deposits practically did not change.

## 3.2. INTEREST RATES

### 3.2.1. MONEY MARKET INTEREST RATES

High liquidity in the banking system at the beginning of first quarter promoted a reducing in interest rates in all segments of money market. By the end of February interest rate on repo operations reached 3.45 percent, the National note yield made 3.19 percent, but overnight rate reduced to 3.83 percent. During almost all March interest rate on repo operations stayed at 3.45 percent, note yield was 3.5 percent. In last decade of March surplus reserves in commercial banks contracted due to outflow of deposits, and demand for borrowed funds increased. As a result inter-bank interest rates in national currency by the end of the quarter raised to 4.5-6.0 percent. Activity of commercial banks at auctions of notes reduced, and last two auctions of March were recognised not taken place because of the insufficient amount of participants.

For first quarter, average level of interest rates for inter-bank credit fell from 3.8 to 4.9 percent. Average yield of the National bank notes also reduced from 4.7 to 3.6 percent.

Average interest rate for inter-bank credit in foreign exchange slightly increased and made 4.6 percent. Increasing of interest rates was observed basically for credits within 3 - 6 month maturity. So fluctuations in interest rates enlarged to 3.6-11.0 percent range compared to 3.1-6.5 percent range in fourth quarter of 2004.

### 3.2.2. STATE TREASURY BILLS

The reduction in yield was observed at the state T-bill market, especially for securities with 12-month maturity. So its yield

Chart 3.2: Money market interest rates vs. liquidity, per cent

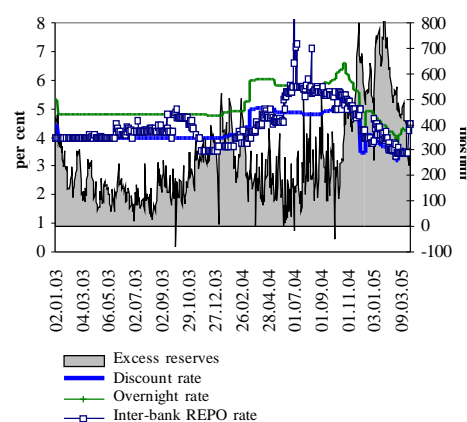
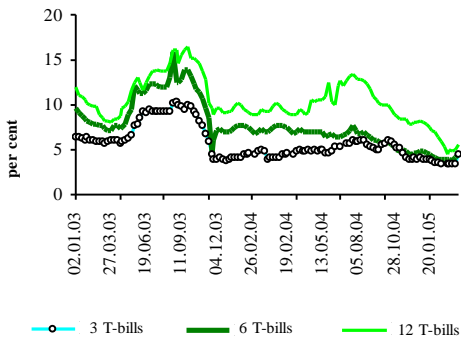


Chart 3.3: T-bill yields

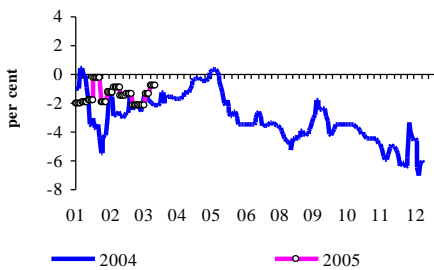


approached to interest rates of securities with 3- and 6-month maturity.

In first quarter, average interest rate for 3-month maturity reduced by 1.1 percentage points and made 3.7 percent. 6-month T-bill interest rate also reduced by 0.8 percentage points and made 4.2 percent. 12-month T-bill interest rate fell from 8.6 to 6.1 percent. Average weighted interest rate for all types of securities declined by 1.6 percentage points from the beginning of quarter and made 5.3 percent.

### 3.3. EXCHANGE RATE

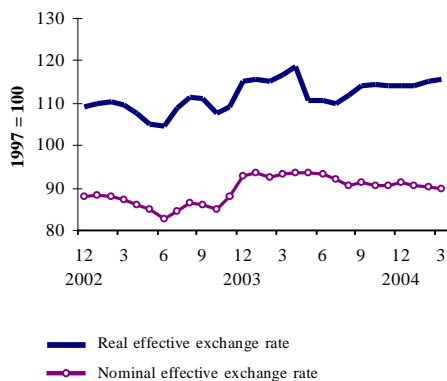
Chart 3.4: Cumulative change in exchange rate (Som per US dollar)



The exchange rate of US dollar at the domestic market during the first quarter was more stable compared with the corresponding period of 2004 and it was basically influenced by internal factors. Exchange rate fluctuations of US dollar were connected with the strong demand of households as well commercial banks on foreign exchange. Inflow of foreign exchange due to exports as well as influx of deposits basically compensated increasing demand in the banking system. However, at the end of quarter demand on foreign exchange increased significantly caused by deposit outflow. The National bank carried out interventions to meet excess demand and to stabilise exchange rate fluctuations at that period.

For the first quarter US dollar exchange rate reduced by 0.8 percent. In the first quarter of 2004, it reduced by 2.18 percent.

Chart 3.5: Som effective exchange rate indices



Fluctuations in euro exchange rate, excluding last decade of March, at the domestic foreign exchange market were strongly correlated with US dollar developments at the international markets. During first quarter, euro exchange rate in exchange bureau reduced by 1.4 percent, its official rate reduced by 5.1 percent.

In first quarter, some strengthening in nominal and real effective exchange rates were registered. So, average nominal effective index reduced by 2.9 percent compared with corresponding period of 2004. Average real effective exchange rate index reduced by 0.8 percent. Nevertheless, nominal and real effective exchange rates stay sufficiently stable.

### 3.4. DEMAND AND SUPPLY

#### 3.4.1. EXTERNAL DEMAND

On preliminary data there was negative trade balance which totalled 84.2 million US dollar for the first quarter 2005. Foreign trade turnover in F.O.B. prices grew by 16.4 percent compared with corresponding period of 2004.

Export of goods in F.O.B. prices increased by 4.8 percent. Export of gold enlarged by 0.7 percent. Excluding gold growth rate was 7.7 percent. In functional structure of export, there was growth in deliveries of energy products and consumer goods by 46.9 21.5 percent, respectively. Reduction in deliveries for investment goods, raw materials and intermediate goods was observed. It made 6.0 percent, 2.5 percent, and 1.1 percent, respectively due to contraction in deliveries of gold, equipment, fertilisers and other items.

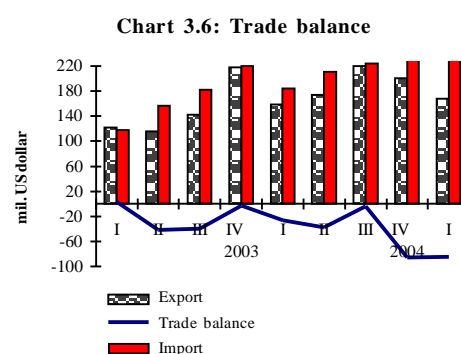
Exports in non-CIS countries reduced by 2.5 percent. Main consumers of Kyrgyz exports were United Arab Emirates (30.3 percent out of non-CIS export), Switzerland (11.4 percent), Canada (4.2 percent), China (3.5 percent).

Export in CIS country grew by 12 percent. Main consumers of Kyrgyz exports amongst CIS countries were Russia (22.3 percent out of export in CIS countries), Kazakhstan (10.7 percent), Tadjikistan (3.2 percent) and Uzbekistan (2.1 percent).

On preliminary data import of goods (in prices F.O.B.) increased by 25.7 percent. There were significant increase in import from CIS as well non-CIS countries by 27.2 and 23.8 percent, respectively.

Imports grew all groups of the functional structure, except raw materials. The biggest growth rate were observed for investment goods (168.9 percent), energy products (67.3 percent) and intermediate goods (41.5 percent). The most contribution fell on equipment, medicines and other items.

Main suppliers from CIS countries were Russia (26.2 percent out of total imports), Kazakhstan (15.8 percent), Uzbekistan (6.6 percent), and Ukraine (5.7 percent). Main suppliers from non-CIS countries were USA (8 percent), China (5.1 percent) and Germany (4.8 percent).



### **3.4.2. DOMESTIC DEMAND**

#### **3.4.2.1. PRIVATE CONSUMPTION**

On preliminary data of the National statistical committee for January-March salary is enlarged by 14,5 percent. Real growth rate increased by 11.8 percent. Trade turnover grew by 14.3 percent.

#### **3.4.2.2. PUBLIC CONSUMPTION**

State budget revenues for the first quarter grew by 11.8 percent concerning the corresponding period of 2004. State budget expenditures increased by 19.8 percent. Outlays grew by 19.2 percent. Subsidies to state enterprises increased by 44.4 percent. Means directed on capital investments and repair rose by 51.4 percent.

#### **3.4.2.3. INVESTMENT**

According to the operative information of the National statistical committee investment into fixed capital (construction, reconstruction, expansion and technical rearmament of objects) contracted by 2.0 percent in the first quarter. Herewith, share of investment in equipment is 22.5 percent out of total investment.

### **3.4.3. OUTPUT**

On preliminary date of the National statistical committee gross domestic product grew by 2.0 percent in the first quarter. Its growth excluding Kumtor gold-mine combine increased by 4.8 percent. Industry production contracted by 4.7 percent, but its growth rate excluding Kumtor gold-mine combine totalled 6.6 percent. Production and distribution of electrical energy, gas and water grew by 6.4 percent. Production in food industry reduced by 13.3 percent. Agriculture grew by 1.1 percent.

## **4. MONETARY POLICY DECISIONS**

### **4.1. BOARD DECISIONS**

Temporary provision "On the credit of the National bank for liquidity maintenance in the banking system" was approved (Statement № 7/2 as of March 28, 2005). This document determined the order of granting and redeeming a credit, given by the National bank to commercial bank for ensuring of banking system stability, maintenance of liquidity and stability of commercial banks. Commercial banks can get given credit within March, 28 - June, 30 of 2005. The size limit of credit for each bank is equal to deposit stock and accrued percent of physical persons in the national currency as of March, 28 of 2005. This credit facility can be used by commercial banks only for ensuring the payments on deposits in the national currency with physical persons. The interest rate on the credit equal to the half of the National bank discount rate.

### **4.2. MONETARY REGULATION COMMITTEE DECISIONS**

The monetary regulation committee carries out operative decision-making in monetary sphere. Committee accepts decisions weekly.

The volume of accommodation of 28-day's notes of National bank on one auction has been established at a level 4 million Som with provision for the total liquidity in the banking system. Ten out of 13 auctions were taken place.

Monetary base contracted by 204.83 and 85.57 mln. Som, respectively, as a result of the National bank operations on foreign exchange and open markets. Foreign exchange interventions conducted by the National bank totalled 8.1 mln. US dollar out of which banks bought 6.8 mln. US dollar. Herewith the share of the National bank operations on the inter-bank foreign exchange market contracted from 51.3 to 29.3 percent compared with previous quarter.

Reduction in banking system liquidity level at the end of quarter has stipulated a growing activity of commercial banks on the inter-bank credit market. Overnight credit borrowed by banks enlarged and formed 1065.3 mln. Som. The National bank gave overnight credit, conducted swap and repo operations with banks for the reason of maintenance liquidity in the banking

system and smoothing of sharp interest rate fluctuations of money market at last days of March.

The monetary regulation committee carries out operative decision-making in monetary sphere. Committee accepts decisions weekly.

In fourth quarter, the National bank carried out REPO operations, interventions on purchasing foreign exchange, and it also gave banks overnight credits to maintain liquidity in the banking system, as well to prevent sharp fluctuations of interest rates at the money market. Foreign exchange interventions of the National bank were directed on smoothing of sharp fluctuations of the national currency exchange rate.

The National bank set sale's volumes for 28-day note auctions at 4 million soms level, 12 out of 13 auctions were recognised taken place. Banks reduced overnight borrowing from the National bank from 3698.4 million soms in the third quarter to 977,7 million soms in the fourth quarter. The purchase of foreign currency by the National bank totalled 27,2 million US dollars.

#### **4.3. INFLATION OUTLOOK FOR SECOND QUARTER OF 2005**

The basic assumptions for inflation outlook are:

- price growth on main consumer goods will be moderate;
- high volatility on international markets will be saved. Average prices on oil and gold, as well as dollar exchange rate against main currencies is not expected to reduce. Inflation outlook for the second quarter of 2005 is 2.0-2.1 percent.