

**National Bank of the Kyrgyz Republic**

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**Inflation Report**

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**November 2005**

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**Bishkek**

## ***Inflation Report***

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

### ***Annual Report of the National Bank of the Kyrgyz Republic***

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 publication contains statistics about major macroeconomic indicators and sectors of the Kyrgyz Republic. The bulletin is published monthly in the Kyrgyz. Russian and English languages.

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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 publication contains analysis of banking system efficiency as financial intermediary, and developments in financial stability. It is published in Kyrgyz and Russian semi-annually.

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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 the preliminary data of the National statistical committee for 9 months of 2005 the gross domestic product reduced by 0.4 percent. Gross domestic product excluding value added of the gold-mine combine "Kumtor" rose by 1.2 percent. Industrial output decreased by 9.3 percent. Output in agriculture dropped by 4.1 percent.

The trade turnover in F.O.B. prices increased by 0.1 percent compared with the third quarter of 2004. Exports of goods reduced by 10.2 percent. Imports of the goods rose by 8.4 percent.

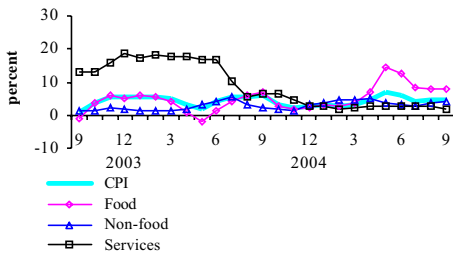
On the end of the third quarter the broad money multiplier describing a degree of financial intermediation, made 1.66 (on the end of the second quarter of the current year - 1.65). Velocity of monetary aggregate M2X decreased to 4.9 revolutions (for the second quarter 2005 - 5.2 revolutions). The monetization of M2X raised from 19.3 up to 20.3 percent of gross domestic product. The ratio of money outside of banks to deposits made 1.1 (on the end of the second quarter of the current year - 1.2). Deposits in foreign exchange grew by 11.1 percent, deposits in national currency gained 21.5 percent.

The average level of interest rates on repo operations for the third quarter made 4.4 percent (for the second quarter 2005 - 4.0 percent), on inter-bank credits in national currency - 4.2 percent (for the second quarter 2005 - 4.3 percent), and the average level of interest rate for notes made 4.9 percent (for the second quarter 2005 - 4.1 percent).

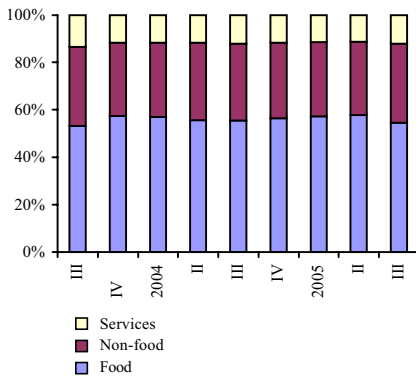
For the third quarter the average yield of 3-month bills made 4.8 percent, that 0.5 percentage points higher in comparison with the second quarter. The average yield of 6- and 12-month bills raised up to 6.2 and 6.6 percent, respectively. Average yield of 18-month bills made 10.1 percent. The average level of interest rates for all kinds of bills made 6.9 percent that exceeds on 1.0 percentage point its value for the beginning of the third quarter.

For the third quarter of 2005 the consumer price index according to the National statistical committee decreased by 1.4 percent. In the fourth quarter of 2005, consumer prices are expected to grow by 2.4 percent.

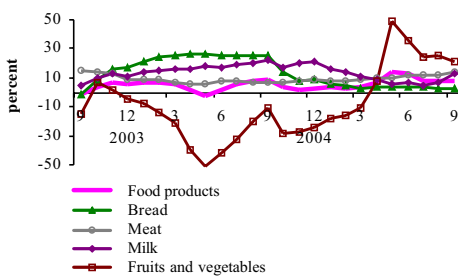
**Chart 2.1: CPI and its components, percentage changes on a year earlier**



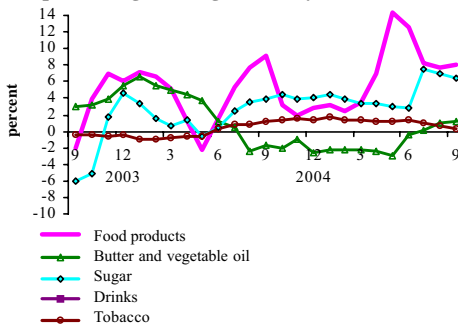
**Chart 2.2: Structure of CPI, percent**



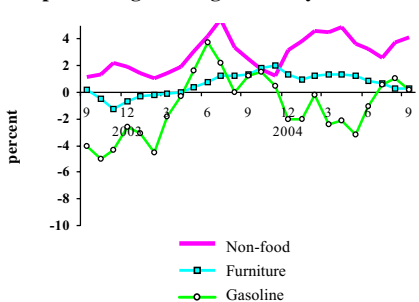
**Chart 2.3a: Food Prices, percentage changes on a year earlier**



**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

In the third quarter of 2005, consumer prices were reducing according to seasonal pattern. According to the information of the National statistical committee consumer price index decreased by 1.4 percent.

In the third quarter of 2005, seasonal reduction in prices on foodstuffs, in particular on agriculture production, caused a deflation. Prices on foodstuffs dropped by 5.5 percent, on non-food items and on paid services increased by 0.6 and 1.5 percent, respectively.

#### 2.1.1. FOOD PRODUCTS

Reduction in prices on "fruit and vegetables", "oil and fat", "bread and bakery products" groups of goods determined food price developments in the third quarter of 2005.

Within the third quarter prices on fruit-and-vegetable dropped by 37.4 percent, including reduction in prices on vegetables, which made 42.9 percent, on fruit - 27.7 percent.

Also, prices on goods group "oil and fat" fall by 0.5 percent, on "fish" group - by 0.4 percent, on "bread and bakery products" group - by 0.2 percent.

Prices on some goods increased simultaneously, in particular, prices on milk and dairy products grew by 10.2 percent, on sugar and confectionery products - by 6.3 percent, on meat and meat products - by 2.3 percent.

#### 2.1.2. NON-FOOD PRODUCTS

The non-food price index grew by 1.5 percent in the third quarter of 2005. The greatest pace demonstrated oil prices, which growth rate made 5.8 percent, gasoline price rose by 6.1 percent, diesel fuel price gained 5.2 percent. Prices on materials for the maintenance and repair of premises increased by 4.0 percent, on printed editions and stationary - by 1.3 percent, gas - by 1.5 percent, lady's wear - by 1.1 percent, children's footwear - by 1.1 percent.

**2.1.3. SERVICES**

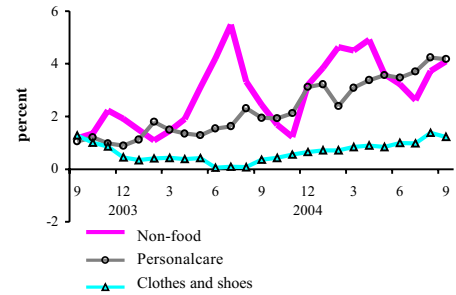
In the third quarter of 2005, the price index on paid services grew by 0.6 percent due to growth in prices on education by 2.6 percent.

**2.2. CONSUMER PRICES BY REGIONS**

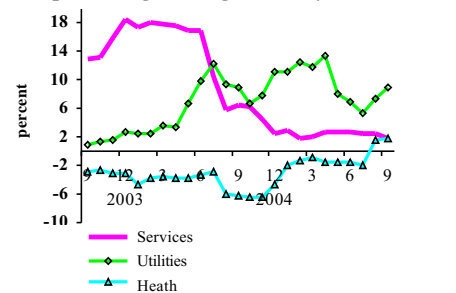
In the third quarter of 2005, consumer prices reduced in all regions. The most reduction in prices manifested Naryn and Issuk-Kul regions where prices decreased by 5.3 and 2.2 percent, respectively. Foodstuff prices dropped by 14.3 and 8.2 percent, respectively. In Naryn region, non-food prices rose by 1.0 percent, on paid services growth rate made 0.2 percent. In Issuk-Kul region, non- food prices grew by 1.2 percent, the prices on paid services increased by 4.2 percent.

The least reduction of prices is marked in the Osh region (0.9 percent). The prices for foodstuffs decreased by 3.3 percent, non-food prices rose by 0.5 percent, paid services - by 1.6 percent.

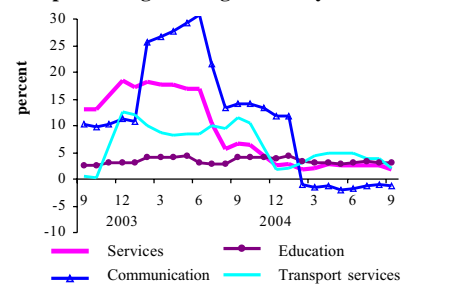
**Chart 2.4b: Non-food Prices, percentage changes on a year earlier**



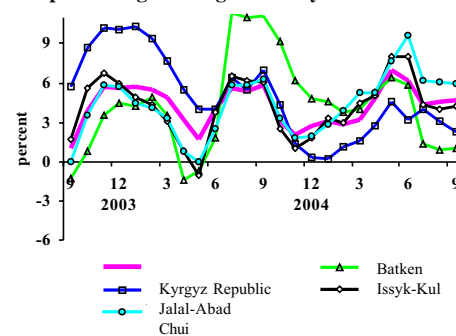
**Chart 2.5a: Services, percentage changes on a year earlier**



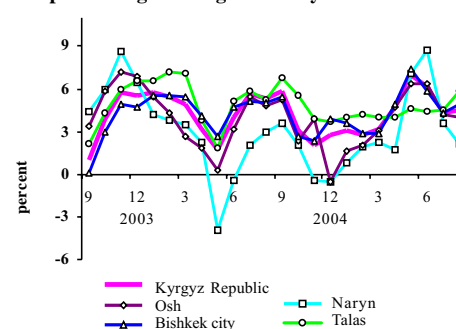
**Chart 2.5b: Services, percentage changes on a year earlier**



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



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

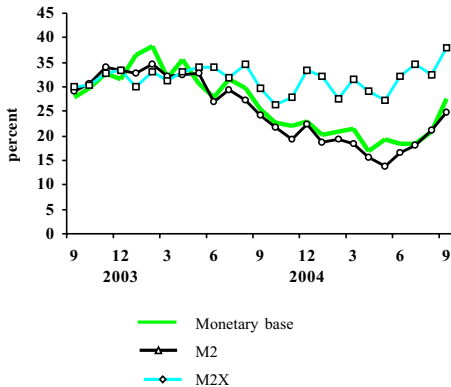


### 3. INFLATION FACTORS

#### 3.1. MONETARY AGGREGATES

##### 3.1.1. MONETARY BASE

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



The monetary base increased by 8.8 percent for the third quarter of 2005. Thus, due to operations of the National bank the monetary base has grown on 1201.7 million Soms. The basic contribution to growth of monetary base rendered operations of the National bank at the domestic foreign exchange market. Financing of embassies by the Ministry of Finance and surplus of the state budget promoted reduction in monetary base on 82.0 million Soms. In a year (September-on-September) the monetary base increased by 27.6 percent.

For the third quarter the of money in circulation gained 5.5 percent (for the third quarter of 2004 - 0.3 percent), and in a year (September-on-September) it grew by 18.6 percent (in a 2004 year (September-on-September) it rose by 23.3 percent).

On the end of the third quarter the share of cash in circulation decreased up to 88.2 percent (on the end of the second quarter its made 91.0 percent). Share of commercial bank balances on correspondent accounts in the National bank increased to 11.8 percent.

##### 3.1.2. AGGREGATE M2

Monetary aggregate M2 increased by 6.5 percent during the third quarter of 2005. For a year (September-on-September) M2 increased by 24.8 percent. Deposits in national currency increased for the third quarter by 21.5 percent. Transferable deposits gained 11.0 percent (in the third quarter of 2004 the growth rate made 10.8 percent), and other deposits increased by 47.8 percent (in the third quarter of 2004 it gained 0.8 percent). For a year (September-on-September) the gain of deposits in national currency made 54.1 percent (in the third quarter of 2004 the gain made 28.6 percent).

##### 3.1.3. AGGREGATE M2X

The monetary aggregate M2X including deposits in foreign currency, increased by 9.5 percent (under the current exchange rate). Depository base of commercial banks<sup>1</sup> rose by 13.8 percent, while growth rate of deposits in national currency (21.5 percent) outstripped growth rate of deposits in foreign currency (11.1 percent). Cash outside of banks increased by

<sup>1</sup> Including banks, which license is withdrawn, but process of liquidation is not completed yet.



## INFLATION FACTORS

5.7 percent. For a year (September -on-September) monetary aggregate M2X grew by 37.9 percent.

In structure of monetary aggregate M2X there were following changes:

- the share of cash outside of banks made 51.3 percent (as of 01.07.05 - 53.1 percent);
- the share of deposits in national currency made 13.4 percent (as of 01.07.05 - 12.1 percent);
- the share of deposits in a foreign currency made 35.3 percent (as of 01.07.05 - 34.7 percent).

On the end of the third quarter the broad money multiplier describing a degree of financial intermediation made 1.66 (on the end of the second quarter of the current year - 1.65). Velocity of monetary aggregate M2X decreased to 4.9 revolutions (for the second quarter 2005 - 5.2 revolutions). The monetization of M2X raised from 19.3 up to 20.3 percent of gross domestic product. The ratio of money outside of banks to deposits made 1.1 (on the end of the second quarter of the current year - 1.2).

### **3.2. INTEREST RATES**

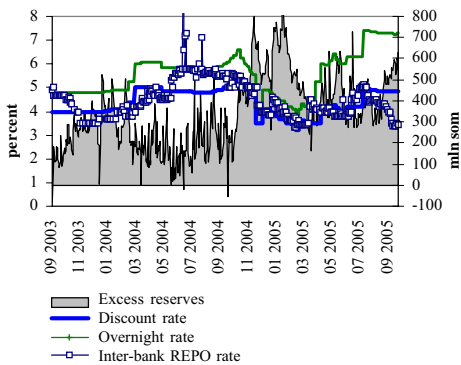
#### **3.2.1. MONEY MARKET INTEREST RATES**

In the beginning of the third quarter liquidity in banking system was decreasing, and demand for borrowed resources was increasing. In the inter-bank credit market in two decades of July interest rates on repo operations were increasing and on the end of this period it made 5.1 percent (by the beginning of the third quarter - 4.5 percent). As far as liquidity of banking system began to increase, price of borrowed resources start to reduce. Thus, by the end of September the interest rate on repo operations decreased to 3.4-3.5 percent.

The range of fluctuations of interest rates on credit in national currency at the inter-bank market, which amounted 0.5-7.0 percent, was determined by reliability of the borrower and presence of pledge.

Within first two decades of July discount rate of the National bank, which size is formed on the basis of 28-day note interest rate, kept at 4.2 percent as first two auctions in July have not taken place in connection with insufficient amount of participants. Weak liquidity in banking system explained low activity of commercial banks at auctions on accommodation of 28-day National bank notes in the beginning of the third quarter. From the second half of July liquidity and demand of banks for notes have started to raise, thus, interest rate notes has reached a level of monetary market rates and made 5.0

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

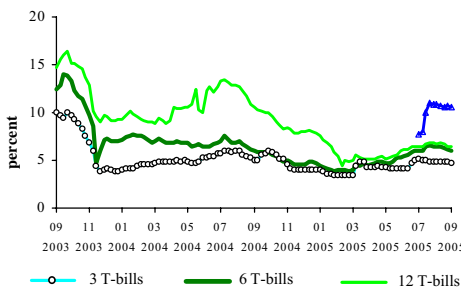


percent. In August - September, the discount rate stayed at 4.8-4.9 percent.

In the third quarter, the interest rate on overnight credit, which size is estimated on the basis of discount rate, reached its maximum since the beginning of year, having made of 7.4 percent at the end of July. It is necessary to note the National bank has changed conditions of granting of the given credit. So, since July 1 commercial bank is obliged to show a pledge (state securities) in order to get overnight credit.

The average level of interest rates on repo operations for the third quarter made 4.4 percent (for the second quarter 2005 - 4.0 percent), on inter-bank credits in national currency - 4.2 percent (for the second quarter 2005 - 4.3 percent), and the average level of interest rate for notes made 4.9 percent (for the second quarter 2005 - 4.1 percent).

**Chart 3.3: T-bill yields**

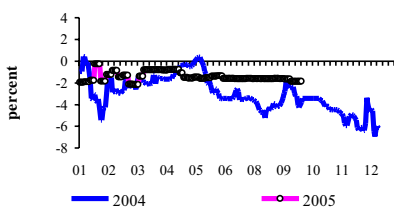


The average level of interest rates of the inter-bank credit market in foreign currency for the third quarter rose by 1.0 percentage point and made 4.4 percent due to increase in the average term of transactions from 20 to 115 days. Thus, the range of fluctuations of interest rates increased and made 0.0-11.0 percent (in the second quarter of the current year - 1.5-4.5 percent).

**3.2.2. STATE TREASURY BILLS**

Decrease in liquidity in the majority of commercial banks in July and first half of August at the primary market caused increase in interest rates. But, if the Ministry of Finance not reduced accommodation of 6- and 12-month bills, growth in yields were more significant. At the end of July the Ministry of Finance start to accommodate bills with 18-month maturity. At the first auction its yield made 7.7 percent, and it began to rise later on. Thus, yield of 18-month bills grew more compared with yields for securities with smaller term of maturity, because of extension in accommodation by the Ministry of Finance. Since the end of August and till the end of quarter insignificant decrease in yield of all kinds of bills was observed due to growth of liquidity in banking system.

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



For the third quarter the average yield of 3-month bills made 4.8 percent, that 0.5 percentage points higher in comparison with the second quarter. The average yield of 6- and 12-month bills raised up to 6.2 and 6.6 percent, respectively. Average yield of 18-month bills made 10.1 percent. The average level of interest rates for all kinds of bills made 6.9 percent that exceeds on 1.0 percentage point its value for the beginning of the third quarter.

**3.3. EXCHANGE RATE**

In the third quarter, excess supply of US dollar was observed. The reason was inflow of deposits in foreign exchange and remittances from abroad, reduction in payments of clients of banks, seasonal increase in proceeds from exports of goods and services. The National bank intervened actively purchasing foreign exchange in order to smooth exchange rate fluctuations. Thus during the most part of the third quarter the exchange rate kept stability at the inter-bank currency tenders at 41.0 Soms a US dollar level. Only in the beginning of the second decade of September it decreased to 40.9 Soms a US dollar and stayed at that level.

For the third quarter the official US dollar exchange rate decreased by 0.3 percent (for the third quarter of 2004 decrease made 0.4 percent. The range of fluctuations of official US dollar exchange rate in the third quarter has made 0.12 Soms.

The exchange rate of Euro within the third quarter manifested strong fluctuations, which reflected it developments on international markets. So, steady decrease in Euro against Som that observed within the second quarter in exchange bureaux rebounded in the beginning of the third quarter. Euro was still growing till beginning of September. In September, Euro exchange rate in exchange bureaux was reducing and it decreased by 0.8 percent for third quarter. At the same time the official rate of Euro for the third quarter by 0.3 percent.

On the end of September, the nominal effective exchange rate decreased by 7.6 percent in comparison with the end of December of 2004. Its average value from January till September, 2005 decreased by 5.6 percent compared with corresponding period of 2004.

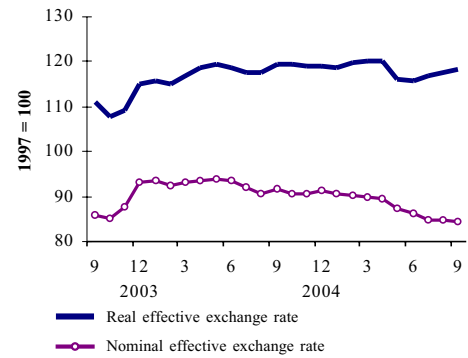
From the beginning of 2005, the index of real effective exchange rate decreased by 0.7 percent, while its average value increased by 0.4 percent.

**3.4. DEMAND AND SUPPLY**

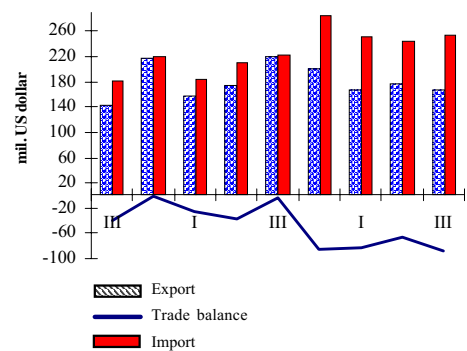
**3.4.1. EXTERNAL DEMAND**

Preliminary trade balance of the Kyrgyz Republic for the third quarter of 2005 has developed negative and amounted 86.8 million US dollars (in the third quarter of 2004 trade balance deficiency developed at 48.0 million US dollars). The foreign trade turnover in F.O.B. prices made 423.2 million US dollars, that is 0.1 percent higher compared with corresponding period of 2004. The foreign trade turnover with the CIS countries increased by 16.8 percent while turnover with the non-CIS countries decreased by 16.9 percent.

**Chart 3.5: Som effective exchange rate indices**



**Chart 3.6: Trade balance**



Exports of goods in F.O.B. prices reduced by 10.2 percent in comparison with the corresponding period of 2004. Reduction has taken place due to decrease in export of goods in the non-CIS countries, which amounted 23.1 percent. Thus reduction in exports was observed under basic articles, including gold. Exports of gold have decreased by 19.3 percent in comparison with the corresponding period of 2004. Excluding gold and electric power exports reduced by 5.5 percent.

Strong growth in exports for investment goods was marked and it amounted 53.8 percent. Machines and the equipment, an electric equipment, transformers were the basic kinds of export groups. At the same time exports of raw material decreased by 38.7 percent, energy - by 18.1 percent, the intermediate goods - by 11.3 percent and consumer goods - by 2.4 percent.

The share of non-CIS countries in exports reduced in comparison with the corresponding period of 2004 from 60.6 up to 51.4 percent. The share of exports to the CIS countries increased with 39.4 up to 48.6 percent. The share of exports to Kazakhstan (from 15.2 up to 25.1 percent) increased considerably. Exports to Russia reduced by 12.7 percent therefore the share of export to Russia decreased with 17.4 up to 16.9 percent.

Imports of the goods in F.O.B. increased by 8.4 percent. That growth taken place as a result of extended deliveries by 20.3 percent from countries CIS and decrease from non-CIS countries by 9.3 percent. Mineral oil deliveries increased by 55.3 percent, basically due to a rise in prices.

Imports were growing in all groups of functional structure. Basic articles of import were machines and the equipment, machine tools, accumulators, automobiles of special purpose, devices, medicines, pharmaceutical production, products from the leather, textile products and washing-up liquids.

The share of CIS countries in imports increased from 59.8 up to 62.9 percent and the share of the non-CIS countries reduced with 40.2 up to 37.1 percent. Imports from Russia (for 54 percent), Ukraine (16.3 percent), Byelorussia (45 percent) increased considerably. At the same time imports of goods from Kazakhstan declined by 17.6 percent. China, the USA and Germany remain to be the basic partners on imports among non-CIS countries.

### **3.4.2. DOMESTIC DEMAND**

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

For January - August on the preliminary data of the National statistical committee the wages increased by 16.5 percent. In real terms it gained 12.0 percent. The trade turnover grew by 14.4 percent during 9 months of 2005.

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

Revenues of the state budget for 9 months of 2005 increased by 10.7 percent concerning the corresponding period of 2004, growth in salaries made 19.9 percent. Expenditures grew by 12.0 percent. Grants to the state enterprises increased by 13.1 percent. On capital investments and repair it has been directed means by 7.3 percent less, than for the corresponding period of 2004.

#### **3.4.2.3. INVESTMENT**

For January - September according to the operative information of the National statistical committee, investment into fixed capital (construction, reconstruction, expansion and modernisation of objects reduced by 12.5 percent concerning the corresponding period of 2004.

### **3.4.3. OUTPUT**

The National statistical committee released preliminary information that gross domestic product during January - September reduced by 0.4 percent. Excluding gold-mine combine "Kumtor" it grew by 1.2 percent. The value added in industry decreased by 9.3 percent. The value added in agriculture reduced by 4.1 percent. Thus value added gained in construction (1.6 percent), trade (10.2 percent), transport and communications (7.0 percent).

## 4. MONETARY POLICY DECISIONS

### 4.1. BOARD DECISIONS

1. The statement of Board №21/2 as of June 29 " About the order of carrying out SWAP auctions by the National bank of the Kyrgyz Republic" (Registered by Ministry of Justice of the Kyrgyz Republic; №95-05 as of June 27) has come into force. The purpose of carrying out SWAP auctions is maintenance of short-term liquidity in banking system.

2. The statement of Board NBKR №24/2 as of July 27 " About Amendments in Regulation " About the overnight credit of the National bank of the Kyrgyz Republic " (Registered by Ministry of Justice of the Kyrgyz Republic; №100-05 as of August 08) has come into force. The amendments aimed at putting in accordance with mortgage legislation of the Kyrgyz Republic. Since July 1 the overnight credit should be secured on compulsory basis. The additional position provided the penalty, which commercial bank should pay in default case, and its amount.

3. The statement of Board №24/1 as of July 27 " About the project of Regulation "About the intraday credit of the National bank of the Kyrgyz Republic" (№103-05 as of August 19 by Ministry of Justice of the Kyrgyz Republic) came into force. The regulation defines the general conditions and the order of granting by the National bank of the Kyrgyz Republic of the intraday credit to commercial banks and other financial - credit establishments of the Kyrgyz Republic licensed by the National bank.

4. The Board has taken into account the report " On monetary policy for 1st half of 2005 " (August 18).

5. The Board has considered questions at September 14:  
" About Amendments in Regulation " About obligatory reserve requirements " (the statement of Board №28/1) - the document is in a process of registration by the Ministry of Justice of the Kyrgyz Republic;

" About new edition of Regulation " About release, accommodation, circulation and repayment of the National bank notes " (the statement of Board №28/2) - the document was registered by the Ministry of Justice of the Kyrgyz Republic, but it had not been published yet.

6. According to the statement of Board № 30/2 as of September 28 "About the exchange rate of dollar used for calculation of obligatory reserve requirements" exchange rate of the US dollar applied for calculation of obligatory reserve requirements from October 3, 2005 till June 4, 2006 is established at 41.0 Soms per US dollar.

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

The monetary regulation committee carries out operative decisions in monetary sphere. Decisions are accepted by committee weekly and based on results of an estimation of the situation developing in the financial markets.

In the third quarter, taking into account the liquidity conditions in banking system recommended volume for sale of the National bank notes on weekly auctions with 28-day maturity made 4.0 million Soms. Six out of 13 auctions taken place.

As a result of high liquidity in banking system and new regulations, which provided obligatory security for applying overnight credit facility and came into force with July 1, commercial banks did not apply overnight credit.

The National bank carried out interventions with foreign exchange in order to smooth sharp fluctuations of the exchange rate. The net purchase of the National bank made 26.2 million US dollars compared to 6.3 million US dollars in the second quarter.

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

Consumer price outlook takes into account seasonal pattern of food prices, developments of oil prices in countries - suppliers. Consumer prices are expected to grow by 2.4 percent.