

National Bank of the Kyrgyz Republic

Inflation Report

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Inflation Report

Editorial Board:

Chairman: Abdumanapov E.
Board members: Tsiplakova L.
Abdybaly tegin S.
Isakova G.
Chokoev Z.

Editorial Assistant: Bushman Yu.

On the issues related to the contents of the publication, please, contact:

Bishkek, Umetaliev st., 101.

The National Bank of the Kyrgyz Republic

phone: (996 312) 669 059

fax: (996 312) 610 730

e-mail: ybushman@nbkr.kg

On the issues of dissemination of the publication, please, contact:

Bishkek, Umetaliev str, 101

The National Bank of the Kyrgyz Republic

External and Public Relation Division

phone: (996 312) 669 009

fax: (996 312) 610 730

e-mail: aaibalaeva@nbkr.kg

<http://www.nbkr.kg>

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720071, Bishkek, Chuy av., 265, rooms 352, 355

Phone: (996 312) 24-33-35

(996 312) 24-38-01

Fax: (996 312) 24-33-35

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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 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 unit of economic research and analysis of the Economic Department of the National Bank of the Kyrgyz Republic prepare it. Materials of structural subdivisions of the National Bank, as well as of commercial banks, the Ministry of Finance of the Kyrgyz Republic, the National Statistical Committee of the Kyrgyz Republic, the National Commission on Securities Market of the Kyrgyz Republic are used for the purpose of its preparation. It is registered with the Ministry of Justice of the Kyrgyz Republic as of December 27, 1995, registrations certificate № 205. The bulletin is published monthly in the Kyrgyz, Russian and English languages.

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“The Balance of Payments of the Kyrgyz Republic” 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 inform-ing 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.

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“Tendencies of the banking system development” contain the analysis of banking system in the Kyrgyz Republic as the financial intermediary from the point of view of achievement and maintenance stability in banking system. It is published as of January 1 and on July 1 in Kyrgyz, Russian and English languages.

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“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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Bishkek, Umetalieva st., 101.
National Bank of the Kyrgyz Republic
External and Public Relation Division
phone: (996 312) 669 009
fax: (996 312) 610 730
<http://www.nbkr.kg>

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1. CURRENT DEVELOPMENTS OF INFLATION

According to the preliminary data of the National Statistics Committee in the first quarter 2003 gross domestic product increased by 5.2%. The growth in industry production by 7.5% is registered. Industry production excluding gold-mine enterprise "Kumtor" gained 14.9%. The growth recovery is basically caused by positive developments in non-ferrous metallurgy and electric power industry. Agriculture production grew by 2.1%.

In the first quarter of the current year there was favourable foreign trade conditions. Exports increased in a year to the first quarter 2002, while imports reduced, so trade balance became positive.

The tendency of som strengthening against US dollar still continued, but the som real effective rate weakened insignificantly in relation to basket of currencies of the major trading partners. The explanation is difference in consumer price developments in Kyrgyzstan and these countries. However, purchasing power of the national currency remained stable.

Growth rates in monetary aggregates started to slow down. Money supply tendency to grow was caused by operations of the Ministry of Finance, while net sale of a foreign currency by the National bank made 0.9 million US dollars. Demand for the national currency continues to be stable. Sales in foreign exchange by households exceed its purchases in the structure of incomes and expenditures.

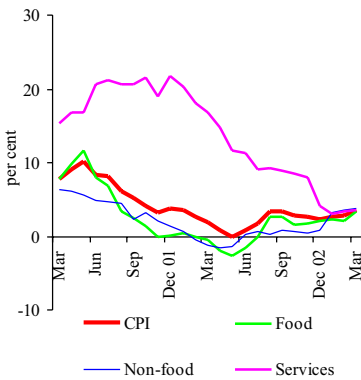
Money market interest rates as well as state T-bill yields were declining affected by high liquidity in banking system and macroeconomic situation. The most of auctions with notes of the National bank were not carried out due to insufficient amount of participants.

Inflation for the first quarter 2003 made two per cent. Growth rates in consumer prices in a year to the same period of 2002 increased. Major reasons for it were the seasonal factor and unbalanced supply and demand for certain foodstuff (meat, a potato, an onions, carrots). Inflation keeps as a whole not monetary character. Value added tax on medicines was cancelled; oil product excises were decreased constraining inflation growth to some extent.

For the second quarter 2003 the outlook for inflation makes 2 - 2.2%. Developments in the exchange rate in future and in money demand are main risk factors for outlook, at the same time there are some uncertainty connected with expected changes in taxation.

2. CONSUMER PRICE INDEX AND ITS COMPONENTS

Chart 1: CPI and its components, percentage changes on a year earlier



In the first quarter 2003, according to the data of the National Statistics Committee consumer prices grew by 2% in a year to the corresponding period of the 2002, comparing to 0.8% in 2002.

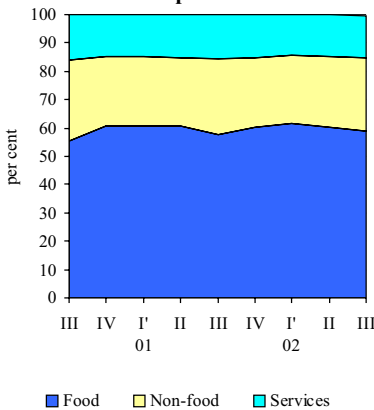
Food products occupy the biggest share in a consumer's basket, not surprisingly, developments in food prices almost entirely determines behaviour of consumer price index. Another essential factor for prices to grow at that period of year is the seasonality, however in the current year its influence was amplified by bad crop of fruits and vegetables in 2002 because of adverse weather conditions.

Slowdown in non-food inflation, which caused significant deceleration in consumer prices in the first quarter 2002, was less pronounced, also its rate lagged behind consumer price index. The rise in non-food prices, especially on durable goods, was restrained by low purchasing power of population.

2.1. COMPONENTS OF CONSUMER PRICE INDEX

2.1.1. FOOD PRODUCTS

Chart 2: Structure of CPI, per cent



Food inflation increased by 3.8%, and fruit-and-vegetable group mostly contributed to that similar to previous years. The prices of the first half of year are defined in many respects by crop in last year. For example, in 2002, fruit-and-vegetable production decreased by 3.5% in comparison with 2001 owing to adverse weather conditions, and contraction in its supply resulted in price growth by 26.6%. Also, meat prices during the first quarter 2003 grew by 4.4%. The growth in sugar and confectionery prices was 4.2%. It is worth to note that decrease in bread and bakery prices started at the fourth quarter 2002 concluded and made

Chart 3a: Food Prices, percentage changes on a year earlier

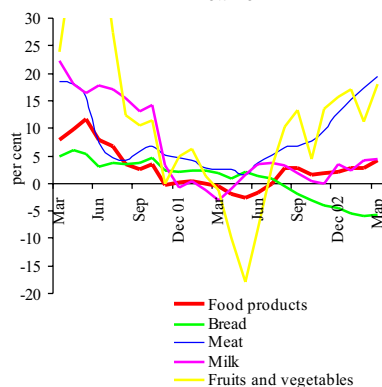
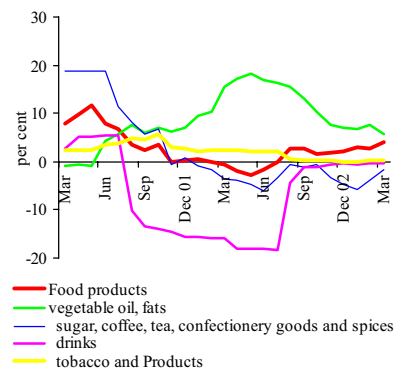


Chart 3b: Food Prices, percentage changes on a year earlier

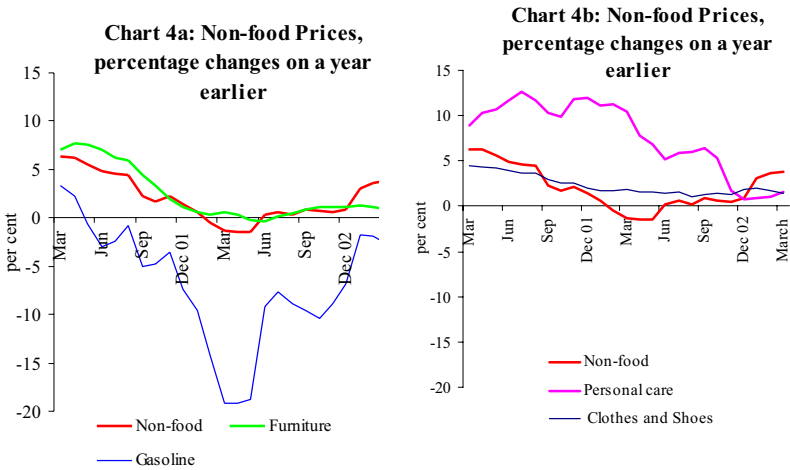


0.6% as result of high grain yield in the Kyrgyz Republic and neighbouring countries. The year-on-year grain prices decreased by 35.3%.

2.1.2. NON-FOOD PRODUCTS

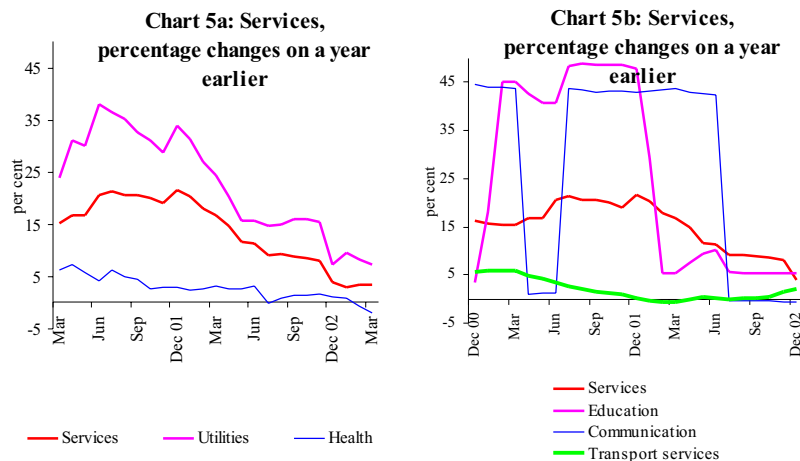
In the first quarter 2003, the non-food price index decreased by 0.6%; there was reduction in fuel prices by 12.1%. Some non-food products became cheaper due to som strengthening and increase in imports. Medicine goods became cheaper by 3.6% as a result of cancellation in the value added tax for those goods.

2.1.3. SERVICES

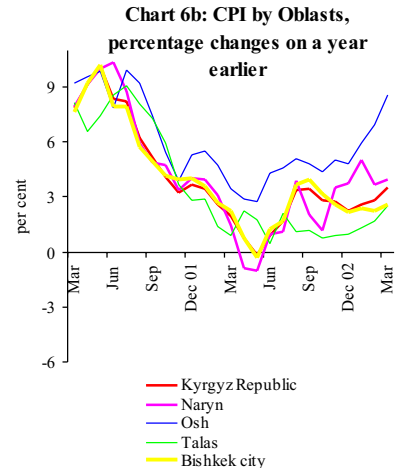
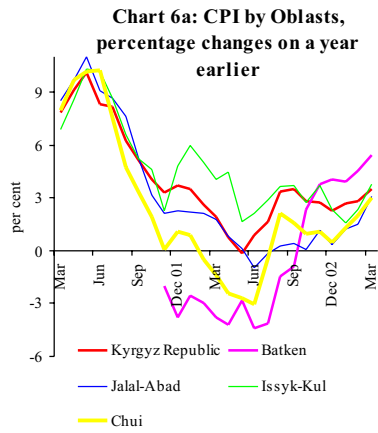


The services price index during the first quarter 2003 grew by 1.3% as a result of growth in railway and road transport services prices by 7.8 and 0.9%, respectively. Some foodstuff prices grew that caused increase in catering by 3.8%.

2.2. CONSUMER PRICES BY REGIONS



Inflation in all regions, excluding city of Bishkek and Talas region, grew faster, than consumer price index. The fastest growth in consumer prices by 3.4 and 2.8%, respectively, was registered in Osh and Jalal-Abad oblasts, south regions of republic.



3. INFLATION FACTORS

3.1. MONETARY AGGREGATES

Money supply in the first quarter 2003 grew owing to expenditures of the Ministry of Finance exceeded revenues, while at the same time operations of the National bank in foreign exchange promoted contraction in money supply, so monetary aggregates growth rates slowed down. Deposits in the banking system still grow, though the major contribution in growth falls at demand deposits, so share of deposits in the national currency increased slightly.

3.1.1. MONETARY BASE¹

The monetary base increased during the first quarter 2003 by 2.8%. Year-on-year growth in monetary base made 39.9%, which was primarily caused by operations of the Ministry of Finance. As of April 1, 2003 gross reserves of the National bank cover 190% of monetary base.

In monetary base structure share of cash in circulation increased from 92.2% at the end of December 2002 up to 94.5% at the end of March 2003. Also, there was a reduction in cash balances share on correspondent accounts of commercial banks in the National bank from about 7.8% at the end of December 2002 up to 5.5% at the end of March 2003. The money in circulation grew by 5.3%.

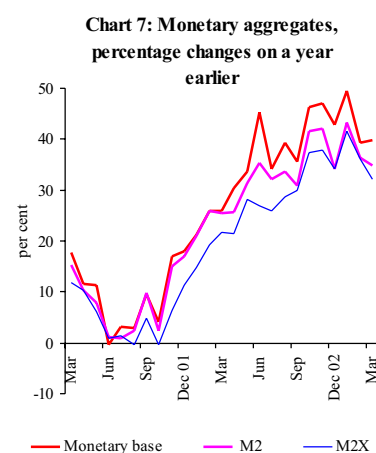
3.1.2. AGGREGATE M2

M2 increased during the first quarter 2003 by 5.5%. Year-on-year M2 increased by 34.8%. The tendency of depositary base to grow continued, so deposits in the national currency increased by 8.3%. Thus, cash balances on settlement accounts of legal persons increased by 6.3%, and time deposits gained 10.8%.

3.1.3. AGGREGATE M2X

M2X under the current exchange rate increased by 4.4%. Growth in broad money resulted due to expansion in cash outside of banks and inflow of deposits to commercial banks. There were changes in the structure of broad money M2X:

- share of cash outside banks increased by 0.2 percentage points and made 62.4%;
- share of deposits in the national currency increased by 0.4 percentage points and totalled 13.4%. Accordingly, share of



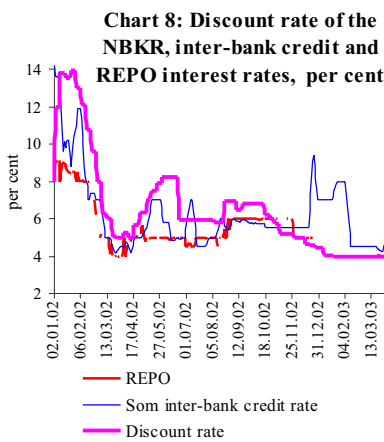
¹ Without taking into consideration the commercial banks deposits in a foreign currency

deposits in foreign currency reduced by 0.6 percentage points in comparison with the fourth quarter 2002.

Growth in broad money M2X during the first quarter 2003 resulted from increase in net foreign assets of banks, and increase in net international reserves of the National bank. Growth in net international reserves was provided by inflows from privatisation, external credits and grants.

3.2. INTEREST RATES

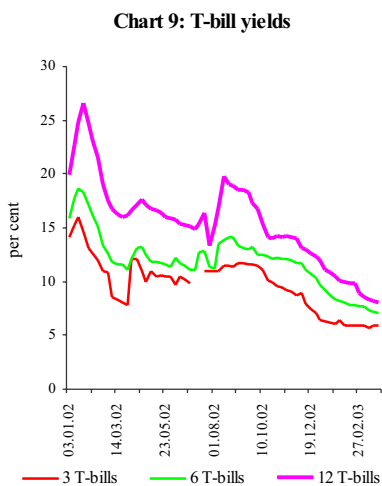
3.2.1. MONEY MARKET INTEREST RATES



In the first quarter 2003, only two auctions in notes of the National bank out of 12 took place. Other auctions have been recognised not taken place in connection with insufficient amount of participants. The number of participants reduced due to note yield was low in comparison with instruments on other segments of the financial market. Yield of notes of the National bank was gradually reducing and at the last auction it reached 4% compared to 4.4% by the beginning of the first quarter 2003.

Transactions in the inter-bank market of credit consists primarily of REPO operations with the state T-bills (settlement). Its interest rate in the beginning of January decreased from 4.5 to 4% and stayed at this level.

Interest rates in the inter-bank credit market in the national currency changed in a wide range depending on different factors like time term of transaction and a kind of pledge, thus the maximal interest rate reached 8%. During first quarter 2003 the interest rate in inter-bank credit in the national currency decreased from 7 to 6%.



Cost of resources in the inter-bank credit market in foreign exchange was changing from 4 up to 12% depending on time term of the transaction and a kind of currency. On the end of the period under report average cost of resources made 6%.

3.2.2. STATE TREASURY BILLS

In the first quarter 2003, situation in state T-bill primary market remained stable. Yield in three-month maturity bills changed insignificantly. High liquidity in banking system promoted gradual decrease in 6- and 12-month bill interest rates. Three-month bill yield decreased by one percentage point and its value achieved 6% at the end of report period. Contraction in 6- and 12-month bills yield by 3.2

and 4.4 percentage points, respectively, was even more. Yields at the end of report period were 7.1 and 8 %, respectively.

3.3. EXCHANGE RATE

Within the first two months 2003 dollar has been subject to usual fluctuations for this period, connected with influence of seasonal factors. In January, the dollar gained 1.5 % in comparison with the beginning of year. The National bank interventions in foreign exchange stabilised situation, and by the end of January the exchange rate of dollar returned to prior level.

In February, demand for foreign currency in the inter-bank market reduction was weak. The dollar exchange rate at the inter-bank foreign exchange auctions within that month fluctuated slightly.

In first half of March, there was unusual for that period of time weakening of dollar, which was mainly caused by easing of dollar in global financial markets connected with expectations of investors which were formed by development of situation in Iraq. Another reason of that was unbalanced foreign exchange position of commercial banks. Decreased som liquidity and long position of banks in foreign currency led to strengthening of som against US dollar. Uncertain situation in the global financial markets created favourable conditions for various sort of gamble in the domestic foreign exchange market. March, 17, the start date of military actions against Iraq declared by the President the USA provoked speculative attack on US dollar in exchange agencies of republic. That is why dollar weakened sharply during March 17-18 in inter-bank foreign exchange and exchange agencies. The National bank conducted operations by purchasing US dollars that stabilised situation at market.

Dollar weakened against som during the first quarter 2003 by 1.1%, compared to 0.5% gain of dollar in corresponding period of the last year. The trade-weighted som for the first quarter 2003 became stronger concerning the corresponding period of 2002 by 6%.

However the real effective som weakened by 1.6% because of nominal strengthening appeared to be insufficient to compensate inflation in major trading partners.

3.4. DEMAND AND SUPPLY

In the first quarter 2003, unusual situation in economy was observed. Som became stronger, while inflation grew to some extent. Previously,

Chart 10: Cumulative change in exchange rate (Som per US dollar)

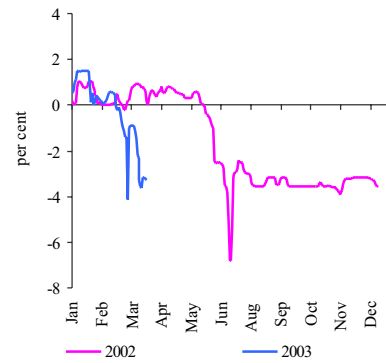
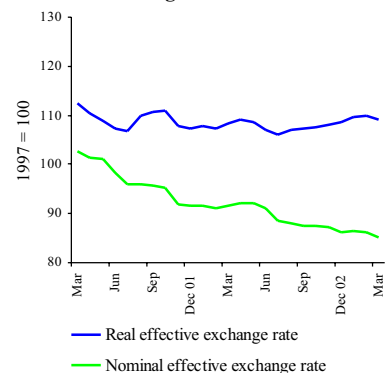


Chart 11: Som effective exchange rate indices



in general, growth in consumer prices was connected with weakening of the national currency. So one can make a conclusion that in economy some changes occurred.

Inflow of foreign currency to economy conducts to strengthening the national currency. If national currency is strengthening not only in nominal, but also in real terms, according to the economic theory the economy starts to lose competitiveness at external markets. Usually, inflow of foreign currency is linked to presence of the certain kind of raw material, for example, oil, which price manifested upward movements. Thus the sectors producing, for example, mechanical engineering goods or electronics badly suffer. That situation received the name of the "Dutch" disease because Holland was the first who faced with such event.

The economy of Kyrgyzstan faces with inflow of foreign currency during last years. The reasons for its occurrence are not so simple. It is obvious, that volumes of imports were considerably reduced as a result of easing the national currency per 1998-1999. Prices for gold - the major product of exports - recently shows the tendency to increase, however there were negative accidents, which led to serious contraction of gold exports. The price for electric energy, which is delivered under interstate agreements, is fixed. In 2002, these two positions revealed a significant slump in production and exports. Nevertheless, inflow of a foreign currency took place. There is a question about consequences of it for Kyrgyz economy.

If the National bank is purchasing a foreign currency that is a monetisation of foreign currency inflow, the money supply will grow otherwise the national currency starts to become stronger against a foreign currency. Expansion of money supply creates threat of acceleration in consumer prices. Excessive strengthening of the som could undermine competitiveness of exports. Such effects are well known from the economic theory, however conducting analysis it is necessary to take into account specificity of economy and the current situation in Kyrgyzstan.

Idea that any expansion in money supply is fatal because it immediately conducts to inflation acceleration is oversimplified. Money supply and inflation interacts through money demand. If money demand is weak, indeed, under such conditions growth in money supply inevitably causes rise in prices. The mechanism is very simple, people aspire to get rid of money start to spend them in order to purchase goods and services, causing thus additional demand which results in upward movement in prices and higher price level in general.

In case of money demand does not meet, growth in money supply does not conduct to rise in consumer prices. There are completely

different sources of money demand, it is possible to mention some of them: increasing credibility for the national currency; expansion of business activity and successful development of microfinancing and microcrediting programs. Irrespective which specific sources of money demand really occurs, it is obvious that money demand exists.

And about competitiveness of exports it is possible to tell following. First, raw products prevail in the structure of exports. Almost all prices of them are not elastic in relation to the real effective rate of the national currency. Foreign trade is heavily limited by trading barriers. Second, even if it would be not so, the real effective rate of a som, despite of strengthening in nominal terms, is stable enough during last two-three years. Hence, these problems need to be solved at the government (removal of trading barriers) and the enterprise level (using competitive advantages of cheap labour comparing with trade partners and curtailment of production costs, instead of manipulation with the exchange rate.

The analysis shows that though the money supply growth was significant in 2002, inflation in the first quarter 2003 being bigger than in a year to corresponding period of 2002 has not monetary character. The fact that consumer prices in the city of Bishkek and Chu oblast lagged behind inflation is indirect evidence to that statement.

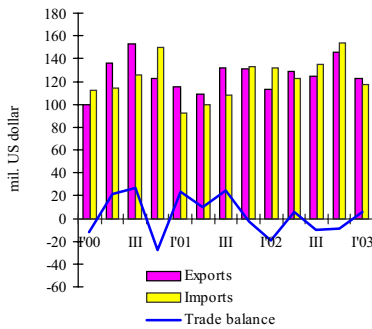
Inflation in regions is an indicator whether supply and demand is balanced. And though the greatest contribution to the inflation level falls at the city of Bishkek and Chu oblast (region), it is necessary to take into account on development of consumer prices in regions too. For example, consumer prices growth for Osh oblast is typically higher compared with inflation in republic.

The condition in manufacturing in the first quarter 2003 improved to some extent, which is basically connected to rebound in production of electric power industry and gold mine combine "Kumtor". Also, growth is registered in agriculture, despite of cold rainy spring in the current year.

3.4.1. NET EXPORTS

According to the preliminary data the trade balance of the Kyrgyz Republic for January-March 2003 with positive balance at a rate of 5.3 million US dollars developed, whereas for the corresponding period of 2002 its deficiency by 10.6 million US dollars was observed. Improvement in the trade balance was formed by increase in export deliveries by 4.5% and by reduction of imports by 9.1%. Accordingly, trade turnover decreased by 2.6%. Thus, the reduction in turnover was registered with the CIS as well non-CIS countries by 2.9 and 2.3%, respectively.

Chart 12: Trade balance



Exports of goods in F.O.B. prices increased by 4.5%. Exports in CIS grew by 25%, while exports in non-CIS countries decreased by 4.1% due to decline in deliveries of tobacco, sugar and raw cotton. Exports of gold increased by 18.2%.

Among all functional groups of exports excluding consumer and intermediate goods there was contraction. Consumer and intermediate goods increased by 26.4 and 21.4%, respectively. In the first quarter 2003, total share in given products made 68.5%.

Non-CIS countries occupy 64.7% in geographical structure of exports and the biggest flows were directed to China, Switzerland and United Arab Emirates. Exports to the CIS increased by 24.7%. Therefore CIS share gained to 35.3% compared to 29.9% in the first quarter 2002. The major trade partners are Russia, Kazakhstan and Uzbekistan who cumulatively occupies 28.5% out of Kyrgyz exports in the first quarter 2003.

Imports of goods F.O.B. prices on the preliminary data reduced by 9.1%. Growth of imports from non-CIS countries was insignificant and totalled 0.4%. Whereas imports from the CIS decreased by 15.5%.

Basic items in imports of goods under report period were consumer and investment products, which occupies more than half out of total imports. Imports in consumer goods gained 30.3%. Other functional groups revealed decrease. For example, imports of raw materials reduced approximately by one quarter. Contraction in energy products in the first quarter 2003 by 7.5% was caused by reduction in deliveries of oil from Kazakhstan and natural gas from Uzbekistan.

CIS share in geographic distribution of imports was 52.8%. Kazakhstan, Russia and Uzbekistan remain to be major suppliers of goods in republic, though imports from Kazakhstan and Uzbekistan reduced by 13.7 and 34.3%, respectively, due to slowdown of inflow in medicines, tobacco products and the communication equipment occurred in the first quarter 2003 in comparison with the similar period of 2002. China, the USA, Germany and Turkey were the main trade partners among the non-CIS countries. Those countries occupy approximately 25% out of total imports of goods for period under report.

3.4.2. DOMESTIC DEMAND

The domestic demand is determined by developments of final consumption and investment activity. Final consumption consists of several components. Autonomous consumption reflects the minimal

requirements of households, which is more or are less stable and do not depend on a level of the current income and other parameters. However the level of autonomous consumption can be higher or is lower, depending on cultural traditions, psychological installations and level of economic development. Ever the economic development is higher, ever the bigger minimal set of products and services. Measures carried out in republic managed to reduce poverty. In 2002, poverty decreased in comparison with 2001 by 3.2 percentage points to 45.6%. So, reduced poverty promotes some increase upward movement in autonomous consumption.

Growing household incomes positively affected that component of final consumption, which depends on income level. Thus marginal propensity to consume did not increase, because excess demand for goods connected with fear of high inflation or weakening of the national currency managed to bring down. Partly, propensity to save which could have various motives is observed. Someone saves up for "black" day, to someone funds are necessary for purchase of durable goods or real estate, and someone saves money to open own business.

Correlation between final consumption and interest rates is almost invisible now. According to the economic theory decrease in interest rates means that allocation of funds in financial assets becomes less attractive. Two different alternatives are possible: increase in consumption will happen, or population will hold free money on hands. Apparently, the latter is the case now. On the one hand, the credibility level for banking system and decreasing yields in bank deposits did not promote growth in deposits. On the other hand, there are no signs of sharp growth in consumer expenditures.

It is worth to analyse a foreign currency role. Not a secret that though the great bulk of the commodity turnover is served by the national currency, a part of transactions is carried out in foreign currency. It means, that alongside with strengthening of demand for the national currency demand for a foreign currency is kept. Prevalence deposits and credits in foreign exchange is an illustration of the given fact. The foreign currency can carry out different functions like means of payment, storehouse of purchasing power and financial asset.

The situation in the international financial markets led to weakening of US dollar against major currencies. Also, som against dollar was strengthening. There are some experts, which predict sharp decrease in dollar against euro. So, attractiveness of US dollar as the financial asset bringing the income became weaker. The motive to store savings in US dollars as an asset, which keeps the purchasing power during long-term intervals of time, is subject to uncertainty and risks associated with potential fluctuations in exchange rates. And though in general

households still trust in dollar, in the first quarter 2003 sales of a foreign currency by the population exceeded its purchase. Apparently, households still keeping a part of the savings in foreign exchange cash, but they are reluctant to escalate its amount.

3.4.2.1. PRIVATE CONSUMPTION

On the preliminary data of the National Statistics Committee households' incomes grew by 11.3% in comparison with 2002. Thus the real disposable income grew by 7.9%. Households' expenditures increased by 9.5%. Retail trade grew by 10.6%.

3.4.2.2. PUBLIC CONSUMPTION

Incomes of the state budget in comparison with the first quarter 2002 practically remained at the same level. it's grew by 1.3%. Thus expenditures of the state budget were reduced by 3.7%. Wages outlays gained 2.2%, while significant curtailment in expenditures connected to state enterprise grants, capital investments and repair were registered. So, grants for state enterprises decreased by 70.3%. Capital investments and repair out of state budget were by 45.6% less, than for the corresponding period of 2002.

3.4.2.3. INVESTMENTS

According to the operative information of the National Statistics Committee capital investments for first quarter 2003 reduced by 10.5% in comparison with January - March 2002. Capital investments were primarily financed out of funds of enterprises and households, and external resources.

3.4.3. OUTPUT

The gross domestic product for the first quarter 2003 increased by 5.2%. Agriculture gained 2.1%. Industry surged by 7.5%, and without taking into account output of manufacture gold-mine enterprise "Kumtor" industry production growth was even more, it increased by 14.9%. It is worth to note strong growth in food-processing industry, electric energy industry and machine building. According to the National Statistics Committee it is registered 8.3 thousand new businesses and 64.5% out of total was formed in agriculture. The share of newly busi-nesses in trade, services and manufacturing industry makes up 15.2, 5.7 and 4.1%, respectively.

4. MAJOR DECISIONS OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC ON MONETARY POLICY ISSUES

4.1. MAJOR DECISIONS OF THE NATIONAL BANK BOARD OF THE KYRGYZ REPUBLIC

The Board of the National bank in the first quarter 2003 approved following decisions:

- The resolution of the Government of the Kyrgyz Republic and the National bank of the Kyrgyz Republic № 56 from February 12, 2003 " About the joint statement of the Government of the Kyrgyz Republic and the National bank of the Kyrgyz Republic about financial and social economic policy for 2003".

The tasks for social and economic policy as well key macroeconomic targets were determined for 2003. Also, the Plan of joint actions of the Government KR and National bank KR aimed at securing macroeconomic stabilisation is authorized;

- The resolution of the Government of the Kyrgyz Republic and the National bank of the Kyrgyz Republic № 171 from March 28, 2003 "About transfer of 100% of open joint-stock company shares "Settlement - savings company " from the National bank of the Kyrgyz Republic to the Government of the Kyrgyz Republic ".

The National bank transferred 100% of open joint-stock company shares " Settlement - savings company " to the Government KR on behalf of the State committee of the Kyrgyz Republic on management of the state property and attraction of direct investments. Ministry of Finance KR released and transferred to the National bank the state securities as payment for the given shares.

4.2. MAJOR DECISIONS OF THE MONETARY REGULATION COMMITTEE

For the first quarter 2003 the National bank carried out operations on purchase of US dollars totalled 3 millions, while foreign exchange sales amounted 3.9 million US dollars, thus, net sale made 0.9 million US dollars. The National bank concluded SWAP operations purchasing US dollars to amount of 460 thousand US dollars.

The committee monetary regulations (CMR) recommended reducing issue of the National bank notes in the period of low liquidity in the banking system. When liquidity in the banking system was high in

February 2003 REPO operations was carried out with state T-bills of settlement.

4.3. INFLATION DURING THE FIRST QUARTER OF 2003 AND OUTLOOK FOR THE SECOND QUARTER OF 2003

In the first quarter 2003, consumer prices grew faster in comparison with the corresponding period of 2002. Current situation was developed being affected by different factors. Seasonal rise in price of foodstuffs remains to be major factor. The misbalance between supply and demand for certain food items brought about additional contribution in inflation growth. Expected introduction of new taxes could form some inflationary expectations.

Strengthening of som against US dollar in nominal terms reduces to some extent attractiveness of export operations due to reducing yield of export operations. However that factor does not play an essential role now. First, elasticity of exports and exchange rate is weak enough. Second, the level of wages in Kyrgyzstan is much less, than in the basic trading partners that gives competitive advantages for our exports. Moreover the real exchange rate of som is stable and does not create problems for the foreign trade operations. Serious obstacles for expansion of exports are trading barriers. At the same time, different country experience shows, that is impossible to penetrate at once at foreign markets. It is necessary to start with developing and deepening at home market.

The condition of domestic demand shows, that general reduction in imports is accompanied by growth in imports of consumer goods, which manifests the limited opportunities of domestic production.

Broad money in the first quarter of the current year was increasing a little bit slowly than in 2002. In part it is connected with net sale of foreign currency on the part of the National bank. However demand for a foreign currency is subject to influence on the part of the international financial markets. Not surprisingly easing of US dollar was revealed in the foreign exchange market inside republic. Growth of deposits is still continuing though the most of change falls at demand deposits. Uncertainty concerning future developments in US dollar led to expansion of interest concerning euro, however operations with this currency still far less than with US dollar.

It is necessary to note that strengthening of the national currency raises its attractiveness as means of savings. Nevertheless, there is no any a reason for catastrophic forecasts concerning US dollar. Thus occurrence of euro should render beneficial effect on the financial

market of republic. The financial system, in which alternative assets are in circulation, is much steadier, than system, in which operations are concentrated in one asset.

As a whole the macroeconomic situation develops on a background of restoration of growth of gross domestic product. Thus it is necessary to note that fact that growth rates for the first quarter 2003 without taking into account output in gold-mine enterprise are higher than with it. The positive trade balance promotes stability of the national currency.

Growth rate of consumer prices for the second quarter 2003 is predicted at level of 2-2.2%. Whether there is a danger of acceleration in inflation? Consumer prices growth is connected with current misbalance between supply and demand for certain food items, marginal propensity to consume does not increase much. There is not any inflationary pressure caused by money supply growth. Also, strengthening of the national currency promotes restraint for inflation as well inflationary expectations.

Some increase in inflation in 2003 was predicted by the National bank. But, excessive strengthening of som is undesirable, thus maintenance of stability of the real effective rate remains actual. Contradictions between the exchange rate and inflation are not present, though it is possible in the future.

As it was marked in the previous releases of Inflation Report, developments in inflation reject an opportunity of deflation. Thus it is important to understand, what "low inflation" does it mean as concept. Strictly speaking, maintenance of stability of the prices means a zero growth of consumer prices. Nevertheless, from the practical reasons nobody and nowhere in the world does aim to such target. Under current level of development of Kyrgyz economy "low inflation" corresponds to the level about 4-5%.