

National Bank of the Kyrgyz Republic

Inflation Report

3 (5)

November 2002

Bishkek

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
Economic Department
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>

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 review is published quarterly in the Kyrgyz, Russian and English languages.

The last date of updating of the data in the given publication: October 31, 2002.

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”.

720040, Bishkek, Bokonbaev Str., 182, rooms 16, 17

Phone: (996 312) 218 373

(996 312) 219 842

Fax: (996 312) 218 373

Circulation 350 copies.

© National Bank of the Kyrgyz Republic, 2002.

The present publication is not subject to copying and dissemination in any forms and by any means without the permission of the National Bank of the Kyrgyz Republic. When reprinting and translating extracts the reference to “Inflation Report” is compulsory.

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 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.

Balance of Payments of the Kyrgyz Republic

“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.

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.

On the issues related to dissemination of the publications of the National Bank of the Kyrgyz Republic, please, contact:

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>
e-mail: aaibalaeva@nbkr.kg

CONTENTS

1. CURRENT DEVELOPMENTS OF INFLATION	5
2. CONSUMER PRICE INDEX AND ITS COMPONENTS	6
2.1. COMPONENTS OF CONSUMER PRICE INDEX	6
2.1.1. FOOD PRODUCTS	6
2.1.2. NON-FOOD PRODUCTS	6
2.1.3. SERVICES	7
2.2. CONSUMER PRICES BY REGIONS	8
3. INFLATION FACTORS	9
3.1. MONETARY AGGREGATES	9
3.1.1. MONETARY BASE	9
3.1.2. AGGREGATE M2	9
3.1.3. AGGREGATE M2X	9
3.2. INTEREST RATES	11
3.2.1. MONEY MARKET INTEREST RATES	11
3.2.2. STATE TREASURY BILLS	11
3.3. EXCHANGE RATE	12
3.4. DEMAND AND SUPPLY	14
3.4.1. NET EXPORTS	14
3.4.2. DOMESTIC DEMAND	16
3.4.2.1. PRIVATE CONSUMPTION	17
3.4.2.2. PUBLIC CONSUMPTION	17
3.4.2.3. INVESTMENT	17
3.4.3. OUTPUT	18
4. MAJOR DECISIONS OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC ON MONETARY POLICY ISSUES	20
4.1. MAJOR DECISIONS OF THE NATIONAL BANK BOARD OF THE KYRGYZ REPUBLIC	20
4.2. MAJOR DECISIONS OF THE MONETARY REGULATION COMMITTEE	20
4.3. INFLATION DURING THE THIRD QUARTER OF 2002 AND OUTLOOK FOR THE FOURTH QUARTER OF 2002	20

1. CURRENT DEVELOPMENTS OF INFLATION

The gross domestic product for January - September 2002 on the preliminary data of the National Statistics Committee decreased by 2.6% in comparison with the corresponding period of the last year. The agriculture regain positive rate of growth, which made 0.9%. Industrial production plunged due to non-ferrous metallurgy and electric power industry.

In the third quarter of the current year, trade balance in F.O.B. prices rebound to negative. Exports of goods reduced by 5.8%, while imports grew by 21.5% in a year. Slump in manufacture of gold was source of export contraction. Growth of imports took place primarily due to investment and consumer goods.

The dollar weakened against som from the beginning of the current year by 3.6%. It is as much as 2.3 percentage points more to compare with the corresponding period of 2001. Though nominal effective rate of the national currency strengthened from the beginning of the current year, the som real effective rate index barely changed.

The tendency of money supply to expand in the third quarter 2002 was kept for all aggregates. Though annual growth of monetary base and aggregate M2 slowed down, nevertheless, they continued to increase. The money supply was caused by operations of the Ministry of Finance and interventions of the National bank in the foreign exchange market. Net purchase of foreign currency by the National bank in the third quarter reduced in comparison with the corresponding period of 2001, while its volume for 9 months exceeded level of the corresponding period of last year by 7.9 million US dollars.

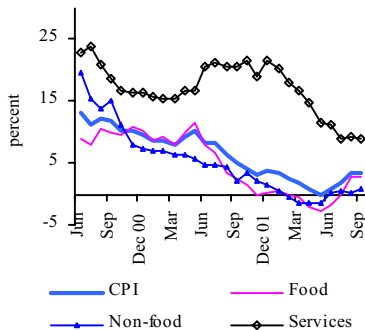
Interest rates of the monetary market and yields in the market of the state T-bills raised in the third quarter of the current year a little. The Ministry of Finance lowered volumes of issue at the end of September.

Consumer prices for the third quarter 2002 decreased concerning the second quarter of the current year by 1.7%. Services, especially, education, were major source of inflation. Seasonal reduction in prices, in particular, on food products, was a little bit less, than for the corresponding period in 2000-2001.

Consumer prices for the fourth quarter according to the forecast of the National bank will increase concerning the third quarter of the current year by 2.4-2.5%. Development of situation around Iraq can render strong influence on the global financial markets and the market of oil. The acceleration of the oil prices is possible, which can affect with some delay the prices of mineral oil in republic. Monetization of economy, most likely, proceeds, though there are certain risks of acceleration in inflation further.

2. CONSUMER PRICE INDEX AND ITS COMPONENTS

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



In the third quarter 2002, the consumer prices index decreased that is typical for this period of year. According to the National Statistics Committee consumer prices reduced for the third quarter 2002 by 1.7%. It is worth to note that for the corresponding period of 2001 inflation decreased by 4.2%.

The food prices decreased by 4.2%, non-food products and services became more expensive by 1.6 and one per cent, respectively. The negative growth rate of inflation in the third quarter is caused by seasonal reduction in agriculture production prices.

2.1. COMPONENTS OF CONSUMER PRICE INDEX

2.1.1. FOOD PRODUCTS

The food prices in the third quarter decreased by 4.2% under influence of seasonal reduction of prices on fruit and vegetables. Unfavourable weather conditions resulted in less crops of berries and vegetables in comparison with the corresponding period of the last year, so seasonal reduction in prices was not as much as usually. The fruit and vegetables prices for the third quarter of 2002 decreased by 31.3%, also bread and bakery products prices contracted by 3.7%, dairy products and eggs became cheaper by 1.4%.

Chart 2: Structure of CPI

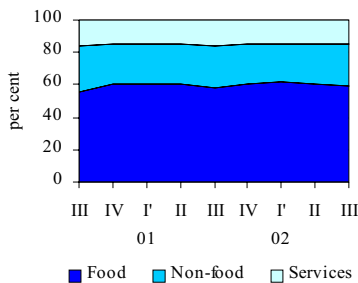


Chart 3a: Food Prices, percentage changes on a year earlier

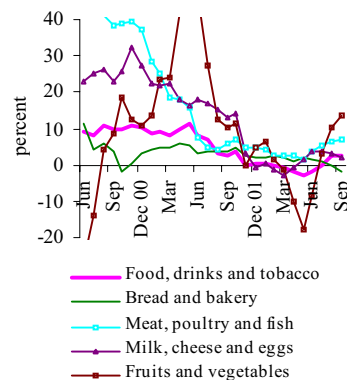
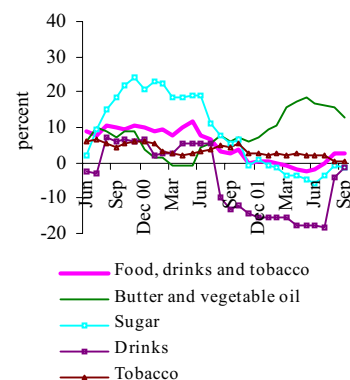


Chart 3b: Food Prices, percentage changes on a year earlier



2.1.2. NON-FOOD PRODUCTS

The price index on non-food products for the third quarter 2002 grew by 1.6% because of rise in oil product prices in July and September. In particular the prices for gasoline grew by 10.8%. Acceleration in the oil product prices, which began in the second quarter 2002, has been quite predictable. The agreement about contraction of the oil

deliveries on the world market between Russia and OPEC that was working in the first quarter 2002 caused significant reduction of prices inside republic. In the second quarter Russia left that agreement, exports to non-CIS surge, so oil prices in Russia had grown. That increase spilled over to oil prices in the Kyrgyz Republic.

Stationary prices up by 17.3% due to demand pressure caused by beginning of new academic year in September. Prices on clothes and footwear, furniture, household devices and personal hygiene grew within range of 0.2 - 0.3%.

Chart 4a: Non-food Prices, percentage changes on a year earlier

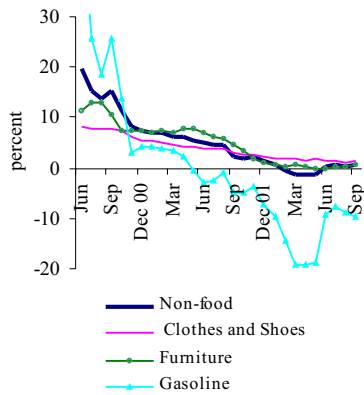
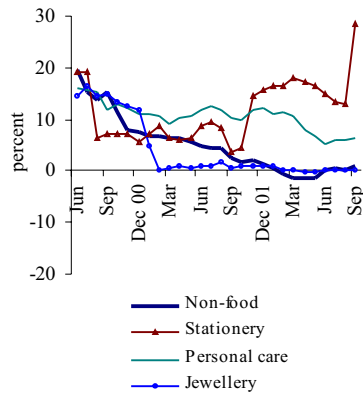


Chart 4b: Non-food Prices, percentage changes on a year earlier



2.1.3. SERVICES

The price index on paid services to the population in many respects is determined by a price policy of natural monopolies. In the third quarter 2002, tariffs for their services did not change. The rise in paid service prices made one per cent. It was caused because education became more expensive by 7%. Transport services prices increased by one per cent in connection with acceleration in oil product prices.

Chart 5a: Services, percentage changes on a year earlier

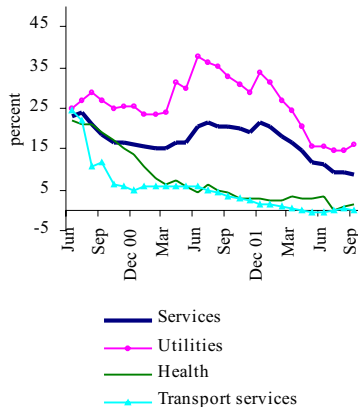
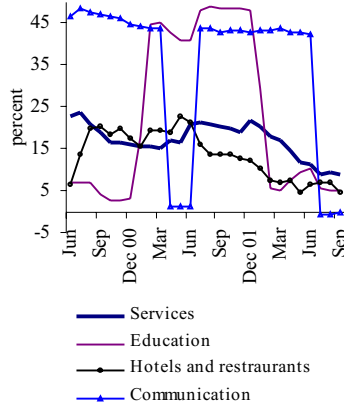
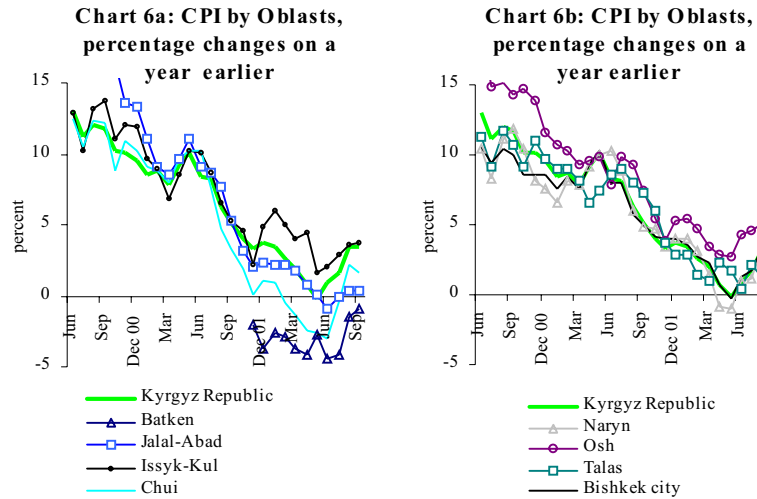


Chart 5b: Services, percentage changes on a year earlier



2.2. CONSUMER PRICES BY REGIONS

In the third quarter of the current year, reduction of prices has been marked in all oblasts of republic. The single exception is Batken oblast where consumer prices grew by 1.1%. In the majority of regions seasonal reduction in prices exceeded CPI growth rate. So consumer



prices decreased in Issuk-Kul, Naryn and Talas oblasts more than by 5.5%. In Jalal-Abad, and Chu oblasts contraction of the prices fluctuated within the range of 2.8 - 3%. In the Bishkek City, capital of republic, consumer prices dropped by less than 1.7%.

3. INFLATION FACTORS

3.1. MONETARY AGGREGATES

In the third quarter of 2002, growth of monetary aggregates was observed. There were interventions of the National bank in foreign exchange as major source of monetary base expansion. Accordingly, the increase in aggregate M2 was caused basically by monetary base. Deposits in the national currency grew insignificantly. Outstripping growth of aggregate M2X resulted from dynamics of sight deposits in foreign currency.

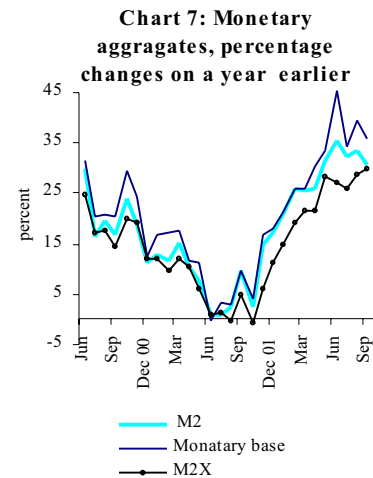
3.1.1. MONETARY BASE¹

The monetary base increased for the third quarter by 10.1%. As a whole for 9 months of the current year the growth of the monetary base made 26.6%. The monetary base was formed by operations of the Ministry of Finance and interventions of the National bank in the foreign exchange market. Net purchase of US dollars in the third quarter of the current year made 9.2 million dollars and decreased in comparison to 10.7 million dollars for the corresponding period of 2001. From the beginning of the current year net purchase by the National bank of US dollars increased by 7,9 million dollars concerning 9 months of the last year. As of October, 1, 2002 gross international reserves of the National bank cover 204.5% of monetary base.

Money in circulation share slightly increased from about 93.1% on the end of June, 2002 to 94.4% on the end of September, 2002. The money in circulation grew within the third quarter by 11.7%.

3.1.2. AGGREGATE M2

Monetary aggregate M2 increased in the third quarter by 8.9%. Broad money (aggregate M2) grew by 21.7% for nine months of the current year. Deposits gained 2.6% percentage points in the structure of aggregate M2. Thus demand deposits contracted by 10.1% in comparison with the second quarter of the current year. Probably, demand deposits behaviour could be explained by reduction in interest rates offered by banks. Interest rates for demand deposits in national currency came very close to interest rates for corresponding demand deposits in foreign currency.



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

3.1.3. AGGREGATE M2X

The aggregate M2X under the current exchange rate for the third quarter of the current year increased by 11.7%. There were following changes in broad money M2X structure to compare with second quarter. Cash outside of banks share down to 62.2% from 62.7%, deposits in national currency share dropped to 12.9% from 14.5%, and deposits in foreign currency share up to 24.9% from 22.8%.

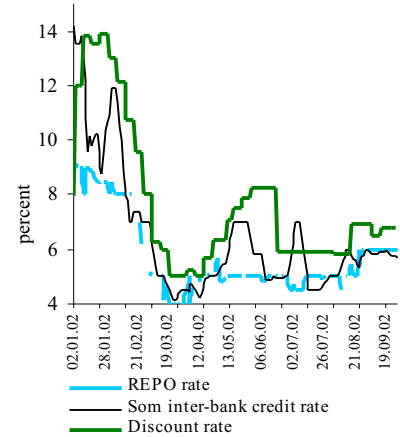
3.2. INTEREST RATES

3.2.1. MONEY MARKET INTEREST RATES

In July - beginning of August, inter-bank credit interest rates remained low and fluctuated in rather narrow range from 4.5 up to 5%. However, since the second decade of August and up to the end of September, excess reserves in commercial banks has been subject to significant fluctuations that led costs of monetary resources in national currency to grow, and then REPO interest rate up to 6%.

Low level of competition still kept on segment of the National bank's notes. In the third quarter, only four auctions out of 12 was recognised to take place. Two of them took place in August and another two were held in September. Discount rate, as a whole for third quarter, up from about 5.9 to 6.8%, rates on REPO operations interest rate up from 4.5 to 6%, and inter-bank credits in the national currency interest rate up from 5 to 6%.

Chart 8: Money market interest rates



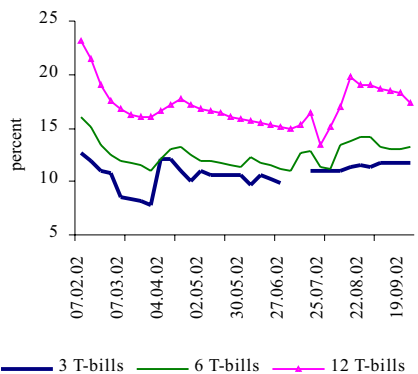
3.2.2. STATE TREASURY BILLS

Yield for state T-bills was basically formed by volumes of the securities issued by the Ministry of Finance on auctions. Demand for the state T-bills kept stable in July.

In July and August, demand on the state T-bills weakened, and there was growth in yield for papers of all types of maturity. The Ministry of Finance reduced issue volumes on two last auctions in August and in September that caused practically continuous reduction in T-bill yields.

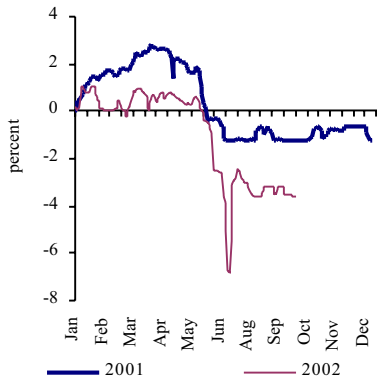
As a whole for the third quarter there was upward movement for T-bill yields: three months T-bill interest rate up from 9.9 to 11.7%; six months T-bill interest rate up from 11.1 to 13.2%; twelve months T-bill interest rate up 15.2 to 13.3%. The weighted average interest rate increased from 13.7 to 15.3%.

Chart 9: T-bill yields



3.3. EXCHANGE RATE

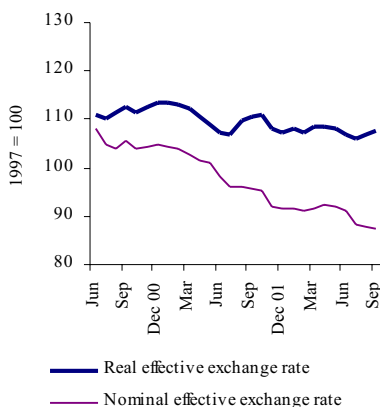
Chart 10: Cumulative change in exchange rate (Som per US dollar)



In the first days of July, dollar continue to drop against Som in the foreign exchange market that were caused by significant depreciation of dollar in the world financial markets and seasonal acceleration of foreign currency inflow into republic. The exchange rate dropped to 44.5 Som per dollar from the beginning of July. However, since July, 5, some participants of foreign exchange market manifested speculative activity that led demand for foreign currency to rise and it render strengthening of dollar in exchange bureaux. Besides during this period in the world financial markets some correction of dollar against other currencies took place. All these factors caused strengthening of dollar and it up to 46.3 Soms in the inter-bank foreign exchange market. The National bank intervened at this time, so strengthening of dollar slowed and situation stabilised. In the second decade of July, bank's demand for foreign currency in order to settle payments of clientele grew again. To satisfy this demand the National bank carried out interventions, which stabilised market. In the third decade of July, reduction in dollar prevailed.

In first half of August, the situation in the inter-bank foreign exchange market remained stable and fluctuations of rate were insignificant: from 46 to 46.1 Soms for US dollar. However, since second half of August, bank's demand for foreign currency in order to settle payments of clientele increased and dollar rose to 46.2 Som per dollar. The National bank carried out interventions selling non-cash US dollars. So, in last days of August, dollar came back to 46 Som.

Chart 11: Som effective exchange rate indices



However, since the beginning of September the dollar increased to 46.2 Som because outflow of currency exceeded inflow. Situation changed significantly from the second decade of September when substantial inflow of foreign currency due to exports of goods and services caused extension of foreign currency supply and dollar returned to 46 Soms. In the third quarter, Som became stronger by 0.3%, and as a whole for nine months it appreciates against dollar by 3.6% to compare to 0.7 and 1.3%, respectively, for the corresponding periods of 2001.

In the third quarter, som nominal exchange index decreased by 4 percentage points relatively the beginning of 2002 that means strengthening of the national currency. Nominal strengthening of som has been compensated by higher weighted average inflation in major

trading partners, so som real effective exchange rate index according preliminary assessments barely changed by 0.2 percentage points relative to December, 2001. The real exchange rate index against CIS decreased by 1.8 percentage points.

3.4. DEMAND AND SUPPLY

Quiet inflation for relatively long period is a sign that effective demand approximately corresponds to the effective supply of products and services. So, inflation characterises internal balance. Exchange rate of the national currency is an indicator of external balance of economy. Nominal strengthening of the national currency reflects the fact that inflow of foreign currency exceeds its outflow.

The current situation reveals that market economy has been emerged during years of transformation in republic. This sector satisfies domestic demand, so dependence on imports somewhat decreased. At the same time, it is impossible to recognise the current condition of demand quite satisfactory. It is due to existing significant rate of unemployment. The reason of unemployment on supply side is the massive retirement of fixed capital having place during transformation period for different reasons. Deficiency of the industrial capital does not allow employing available labour completely. On demand side potential of exports and limited access to world markets are constraints.

Besides it is worth to mention that the economy of republic is not quite market. There is significant sector, which is poorly involved in market relations. In order economy continue to monetise, aggregate supply and demand to expand it is necessary to enlarge market sector of. In turn it will stimulate development of the market, strengthening of financial intermediation, developing of industrial and financial capital and its mobility.

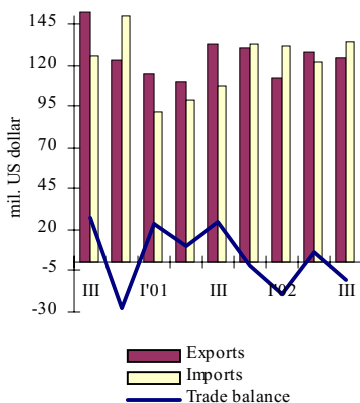
3.4.1. NET EXPORTS

On the preliminary data the trade balance of the Kyrgyz Republic in the third quarter 2002 developed with deficiency at rate of 10 million US dollars. The trade balance worsened in comparison to positive 21.5 million US dollars in corresponding period of 2001. The foreign trade turnover increased by 6.6%. Trade turnover with CIS and non-CIS increased by 3.2 and 10.1%, respectively.

Exports of goods in F.O.B. prices reduced by 5.8%. Exports to CIS decreased by 11.1%, while exports to non-CIS dropped by 1.5%. Exports of gold in the third quarter decreased from 53.9 to 29.6 million US dollars. Exports excluding gold grew by 21.2%.

There was growth among all functional groups in functional structure of exports, except for intermediate products and energy products. So,

Chart 12: Trade balance



exports of consumer goods, raw materials and investment products increased by 92.7, 50.9 and 15.1%, respectively. Exports of intermediate products still occupy the biggest share due to gold. Raw materials, an energy products, consumer and investment product follows in the functional structure.

Significant expansion of consumer goods in exports took place due to such items as lamps, electric goods and garments, plastic products, vegetables. Among raw material group in functional structure significant growth rates were registered fore some goods. So, exports of large horned livestock skins surged by 270%, cotton fibres increased by 83%, waste products and a breakage of aluminium and ferrous metals grew by 11 and 30%, respectively. Also, exports of some inorganic chemistry products significantly expanded. Exports of investment products grew by 15% due to spare parts and the equipment of automobiles, buses, optical devices. Exports of intermediate products fall by 39.9% that has been caused by contraction gold sales abroad by 26.5%.

Non-CIS continue to prevail in geographic distribution of exports of goods, its share makes 57%. But, Switzerland's share in exports plunged to 2% in the third quarter 2002 instead of the biggest share in corresponding period of 2001, which Switzerland have occupied due to gold import. The explanation is that since the second quarter of the current year, Kyrgyzstan started to export gold to the United Arab Emirates, and in the third quarter, United Arab Emirates made 91.9% out of total gold exports of Kyrgyzstan. Thus, the United Arab Emirates, China, the USA and Turkey were among the biggest importers from Kyrgyzstan.

Export of goods to China increased from 5.3 up to 13.2 million US dollars in comparison with the corresponding period of 2001 owing to increase in export of skins and leather of animals, non-ferrous breakage and waste products, automobiles (second-hand). Export of goods in the USA made 9 million US dollars of which more than 91% are made with kerosene. As a whole, exports to the non-CIS decreased by 5.2%, while in exports to CIS plunged by 11.2%. Russia, Kazakhstan, and Uzbekistan continue to remain major importers among CIS. Exports of goods to Tadjikistan surged almost fourfold due to exports of a print production, synthetic fibres yarn, a goffered sheet and slate, pumps centrifugal. Exports of goods to Russia grew by 48.4%. Exports to Uzbekistan and Kazakhstan reduced by 45 and 23.4%, respectively, that reveals significant contraction in deliveries of the electric power.

Imports of goods in F.O.B. prices by the preliminary data grew by 21.5%. The increase in imports took place from the countries CIS and a non-CIS by 16.7 and 27.9%, respectively. Major factors of import expansion are: 1) needs of antiterrorist coalition; 2) increase in humanitarian help.

All items, except intermediate products, in functional structure of imports increased. Investment and consumer goods revealed the highest rates of growth. Imports of investment goods increased almost twofold due to such kinds of products as tractors, the mining equipment, lorries, communication equipment, machines and the electric equipment for special purposes. Imports in energy products grew by 24.6%.

In a geographic distribution of imports, CIS has 51.3% out of all imports. Russia and Kazakhstan have the biggest share among exporters to Kyrgyzstan. Imports from Russia grew by 20%, imports from Kazakhstan increased by 35.5%. Among non-CIS major suppliers of products, as before, were the USA, China, Germany and Turkey.

3.4.2. DOMESTIC DEMAND

Degree of marketability in production is factor, which primarily determine at the present stage of development of economy of Kyrgyzstan the capability of domestic demand to expand that should stimulate development of output and increase in incomes of the population. For example, almost half of agriculture output is produced at personal subsidiary plots, which basically work on maintenance of own needs.

Producing goods for market render expansion of circulation of goods, strengthening of money demand and development of domestic market. Specialisation in production that is still emerging promotes increase in productivity and commodity supply.

Expansion of marketability in industrial sector is connected to improvement of management quality, gradual cut of direct and indirect subsidies and grants, curtailment to a minimum different kinds of non-monetary settlements, formation of market instruments to control economy by state.

The important element to enlarge circulation of goods is development of trade. Formation of the wholesale markets serves to concentrate resources. Expansion and deepening of trade between regions of

republic could serve for trade development. Nowadays, trade basically is concentrated in capital of republic.

As far as process of expansion and deepening of market economy develops, opportunities to increase incomes of population also improve. Income growth provides opportunity to save, which is necessary to transform into credit and investments. Accumulation of critical weight of resources should lead to formation of the capital market. The capital market allows to accumulate monetary resources and to carry out flow of the capital toward effective proprietors. Thus, the self-amplifying circuit should start to function: monetization of economy - deepening of monetary and credit markets – emerging of stock exchange market.

3.4.2.1. PRIVATE CONSUMPTION

On the preliminary data of the National Statistics Committee incomes of population grew by 7% in comparison with January - September 2001. Thus the real disposable income grew by 4.5%. Expenditures of population increased by 5.8%. Retail trade turnover grew by 9.6%.

3.4.2.2. PUBLIC CONSUMPTION

Revenues and expenditures of the state budget increased by 19.1 and 26.8%, respectively, in comparison with 9 months 2001. Thus the salary and wages payments gained 19.1%. Capital investments and repair from budget increased by 53.3%. Grants to the state enterprises grew by 26.6%.

3.4.2.3. INVESTMENT

According to the operative information of the National Statistics Committee capital investments reduced by 13.3% in real terms in comparison with January - September 2001. There are restrictions for investment potential to increase from supply and demand sides. On supply side it is worth to note backwardness of the financial market and deficiency of financial capital. On demand side the constraint is that many manufacturers do not meet requirements of market economy. Therefore now the small and average enterprises, which do not demand the big capital investments, are actively developing.

The increase in investments is a strategic task. Strong efforts to improve an investment climate and attractiveness of Kyrgyzstan economy are made. Many efforts aimed at improvement of legislation,

creation of infrastructure to attract investments, reduction of restrictions and obstacles on the way of entrepreneur activities.

However, the specifics of different types of investors should be taking into account when investment programs are developing. The primer interest of strategic investors is opportunities to extend activity and to capture new markets. In addition to scale of the potential market, existence of high culture of manufacturing, high level of labour force and developed infrastructure are extremely important for them.

The investors who are carrying out direct investments pay attention first of all to objects of venture financing. Their motivation is to purchase some firm with the purpose to increase its capitalisation and resale in some years.

Portfolio investors are attracted by sound companies that capable to meet steadily obligations. Taking into account of specific features of the investor provides efficiency in attraction of investments. In this connection building capacities and mobilisation of domestic resources becomes rather actual too. It is necessary to create actively conditions for portfolio and venture investors that follows from above mentioned typology of the investor.

3.4.3. OUTPUT

The gross domestic product for 9 months 2002 reduced by 2.6%. Agriculture regain positive growth rate of 0.9%. The slump in production caused by weather conditions, stopped. More grain is collected in comparison with the corresponding period of 2001. Cotton and tobacco of production curtailment was observed connected with an adverse price conjuncture. Manufacture of berries and fruit decreased also.

In livestock industry, the tendency of milk and eggs production to acceleration still kept. Meat production in live weight increased to some extent in a year to corresponding period of 2001. There was decline in production of wool.

Industry slumped by 17.3%. Similar the second quarter, recession basically is caused by of non-ferrous metallurgy and electric power industry. Reduction in gross added value of non-ferrous metallurgy is due to accident at the “Kumtor of Operating of Company”, the biggest enterprise of this branch. Output of non-ferrous metallurgy and electric power industry plunged by 32 and 16.9%, respectively.

In the third quarter of 2002, according to the National Statistics Committee 4.2 thousand new legal and physical persons were registered. Agriculture share is 39.4% out of total. The trade share makes 25.5%, services and manufacturing occupies 9.2 and 7.4%, 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 made decision to establish US dollar exchange rate for calculation of required reserve during the period from September 30, 2002 till June 01, 2003 at 46.5 Soms that was accepted by the resolution № 41/3 from September 27, 2002. The given exchange rate is applied for calculation of obligatory required reserve for deposits in foreign currency.

4.2. MAJOR DECISIONS OF THE MONETARY REGULATION COMMITTEE

In the third quarter 2002, the Committee on monetary regulations (CMR) carried out operations in the market with the purpose of liquidity management. In July and since second decade of August, CMR decided to carry out reverse REPO operations with state restructuring loan bonds in order to sterilise excess liquidity. In second half of August - September 2002 interventions by purchasing foreign currency were actively carried out to satisfy demand of banks in national currency. In the third quarter, the National bank applied such instruments as credits «overnight» and SWAP operations with foreign currency. Similar to the second quarter, a number of auctions for notes of the National bank have been recognised as not taken place because inappropriate number of participants.

4.3. INFLATION DURING THE THIRD QUARTER OF 2002 AND OUTLOOK FOR THE FOURTH QUARTER OF 2002

At present economy consists of three segments. First, large industrial enterprises, which were transformed into corporations with stocks, nevertheless, in many of them participation and degree of influence of the state are great enough. Though they work in market conditions, their behaviour is not always meets market requirements. In particular, financial parameters like profit, non-payments reveal it. In part, given situation is connected by that they continue to render services under the prices below costs. At the same time, not only ageing of fixed capital causes the high level of the costs in prices, but also by condition of management at these enterprises.

Private business, which is represented basically by subjects of small and middle business, is actively emerged. It is possible to assume that their contribution is comparable with the large enterprises. Anyway, in spite of slump in production registered by the National Statistics Committee the indicators describing internal and external balance - inflation and the exchange rate - show positive dynamics. This sector demonstrates competition and absence of monopoly. In other words, the private sector represents to greatest degree market economy.

The separate attention is worth to pay for agriculture. The land market just starts to appear. The significant share of production still falls at personal subsidiary farms, which are carried out with small-scale marketability. It is characterised by low efficiency. To the great extent it has non-monetary character.

The market economy can theoretically exist in conditions of barter. However, it is hardly to imagine such economy in modern time. The market economy demands advanced commodity and monetary circulation. In process of the development the monetary economy turns into credit economy that is when there is need for expansion of manufacture, and own funds do not any more suffice.

The suggested typology of real sector is helpful to estimate the current level and tendencies of economy monetization in the near future. Critical parameters for monetization are speed of expansion and strengthening of market sector. Development of the land market is the main direction for it. Transformation of land into market good is necessary to raise efficiency of agriculture production, and to include additional source of economic growth.

To build up effective ownership is hardly possible to imagine without creation of the financial market. Today crediting is carried out through the international lines, banks and the microcredit organisations. They promote increase of production, however, only capital mobility is able to provide efficiency. It is obvious, that acceleration of money demand and transformation of monetary resources into the capital are interrelated and it represents capital supply. Demand for capital is determined by its marginal efficiency. To make decision investor need information concerning market value of firm. Stock market where corporate shares and bonds are circulated is badly needed.

Bank credit by virtue of different reasons, at present, cannot satisfy even demand for operating capital, and nothing to say

about long-term investments into fixed capital. In this connection, developments of corporate bonds market are necessary. Corporate bonds in some cases have number of advantages under bank credit. Bonds issue does not change ownership, promotes market reputation of firm and increase transparency of its activity.

From this point of view it is possible to consider the current situation in economy. Money supply growth reflects monetization, which began in republic a little bit later, than in CIS. There is no danger of inflation and pressure upon exchange rate of the national currency, while money in circulation corresponds to commodity circulating at market.

Strengthening of the national currency reflects that fact, that inflow of foreign currency exceeds its outflow. It is connected to significant reduction in payments concerning external debt service as a result of it re-structuring. One additional source of foreign currency inflow is transfers of citizens of the republic working abroad. The steady tendency of barter contraction in external trade operations is observed. In the third quarter, the National bank carried out interventions in the foreign exchange, which were aimed at prevention of sharp decrease in dollar exchange rate as far as excessive strengthening of national currency conducts to loss of competitiveness of exports. Besides, the National bank increased international reserves.

The increase in money supply was transformed into deposit growth. It is necessary to note, growth of deposits is represented by settlement accounts that reflects strengthening of business activity and partial exit from shadow economy as settlements are carried out through the banking system avoiding transactions in cash. Among this category of deposits foreign currency prevails that reflects preference of economic agents. In a category of savings deposits the low credibility to the banking system is kept. If it were positive attitude of population to banks deposits inflow will be more pronounced. Steady growth of money supply, low inflation and low demand for foreign currency are favourable factors for expansion of issue of the state T-bills for maturity with maximum available terms of maturity. Also, issue of bonds in the national currency with two - three years maturity is possible.

As was supposed in the *Inflation Report* for second quarter the agriculture regain positive rates of growth for 9 months. Recession in industry still kept though rates of decrease slowed.

Consumer prices for the fourth quarter according to the forecast of the National bank will increase concerning the third quarter of the current year by 2.4-2.5%. Development of a situation concerning Iraq can render strong influence on the world financial markets and oil prices. Change in oil prices could with some delay affect prices in republic. Monetization, most likely, will continue, though there are certain risks of acceleration of inflation further.