

## Monetary Policy Report for the first quarter of 2010

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### Basic Monetary Policy Trends

Due to preservation of inflation risks in the first quarter of 2010 the National Bank maintained emission volumes of NBKR Notes at the level of about Som 1.0 billion. In this case the NBKR discount rate floated at around 1 percent. “Overnight” credits were extended to commercial banks in the amount of Som 550 million. NBKR net sales in the currency market for January-March amounted to US\$ 52.3 million and it is nearly three times lower than in the corresponding period of 2009 – US\$ 149.1 million. The monetary base decreased by 4.2 percent mainly caused by currency interventions of the National Bank, as well as by operations of the Development Fund, performing payback on the NBKR accounts (US\$ 87.7 million and Som 1.081 million).

In the second quarter of 2010 due to the consequences of political events in April and June, the NBKR paid particular attention to the issue of liquidity and stability of the banking system in the outflow of deposits from the banking system along with supervisory tasks. A decline in demand for all types of government securities and earnings growth trend was noted with the reduction of liquidity in the banking system and the deterioration of the situation with the state budget. In April under these conditions the National Bank began to significantly reduce the emission’s volume of NBKR Notes in order to bring the outstanding volume of Notes up to Som 200 million at the end of June 2010 from the level of Som 1.0 billion to the end of March 2010. At the same time, in April the National Bank suspended the auctions on placement of 7 - and 14-day NBKR Notes, placing 28-day NBKR Notes only, to the yield of which the NBKR discount rate is tied. Discount rate began to grow in April and reached 3.5 percent in May. In June its growth stopped and by the end of the month decreased by 2.7 percent. The volume of outstanding “overnight” credits increased by Som 843 million.

In the second quarter of 2010, the domestic foreign exchange market noted a considerable increase in demand for foreign currency in connection with the outflow of foreign currency deposits and lower income from export earnings increased devaluation expectations. In order to smooth out fluctuations of the exchange rate the NBKR increased sales of non-cash US dollars in foreign currency sales. The dollar strengthening tendency on the world markets had an additional pressure on the exchange rate besides domestic demand for foreign currency.

In general, for the first quarter of 2010 the net NBKR sales of US dollars through the interbank foreign exchange sales totaled US\$ 140.2 million (in the first quarter of 2009, net sales totaled US\$ 153.9 million). During the reporting period the share of transactions of the NBKR in total volume of operations through the interbank foreign exchange sales amounted to 48.1 percent as compared with 55.4 percent in the first quarter of 2009. As a whole for the first quarter of 2010 the official dollar exchange rate against Som increased by 6.5 percent amounting to 46.9746 Som/US dollar (in the first quarter of 2009 - by 9.8 percent amounting to 43.2810 Som/US dollar). As a whole for the first quarter of 2010 the monetary base remained almost unchanged amounting to Som 41 billion.

According to the National Statistics Committee (NSC) growth of a consumer price index in the first quarter of 2010 made 4.1 percent (June 2010 against December 2009), annualization made 3.6 percent (June 2010 against June 2009).

The volume of required reserves as a whole for the first quarter of 2010 decreased by 35.6 percent to Som 2.3 billion, in connection with the outflow of deposits and reduction of reserve requirements from 9.5 to 8 percent.

In the reporting period “Special Fund for Banks Refinancing” (SFBR) promoted its activities. Credit portfolio of SFBR increased from Som 66 million at the beginning of the year to Som 129.7 million at the end of June. Credit portfolio of government securities amounted to Som 496.6 million. At the same time to create conditions for the expansion of crediting in May 2010 the base rate was lowered from 8 to 7 percent to determine the cost of credit resources of SFBR. Also a adjustment factor was set for determining the interest rate of SFBR credit facilities at level 1. As a result, the cost of SFBR resources for commercial banks amounted to 7 percent and for the end-user borrowers – from 12 percent (mortgage credit) to 17 percent (microfinance).

Following the first quarter of 2010 the banking system showed the decrease of the level of total assets of commercial banks by 23.5 percent, the deposit base – by 23.4 percent and capital – by 28.9 percent. At the same time, the credit portfolio increased by 2.2 percent, however, without the influence of exchange rate the credit portfolio of the banks decreased by 0.7 percent.

As a whole for the first quarter of 2010 the significant increase of economic growth rates was noted by 5.0 percent in comparison with the decrease of economy growth by 2.0 in the first quarter of 2009. The economy growth was stipulated by the production of processing industry and active gold mining as well as by the “low base” effect of the last year.

Based on the preliminary data, in the first quarter of 2010, the balance of payments formed negative at the rate of US\$ 11.5 million (in the first quarter of 2009 – positive US\$ 288 million, including the current account that developed as negative at the rate of US\$ 19.0 million. The flow of remittances of individuals was US\$ 491.8 million that exceeds by 18.2 the corresponding indicator of 2009. The volume of gross international reserves at the end of the reporting period amounted to US\$ 1 568.4 million which covers 4.2 months of future imports of goods and services (in the similar period of 2009, the gross international reserves covered 4.6 months of imports of goods and services ).

### **Dynamics of Monetary Indicators**

The monetary base was Som 41 005.4 million at the end of July 2010, having decreased by 0.1 percent from the beginning of 2010 (in the similar period of 2009 the decrease made 1.6 percent).

The share of cash in circulation had increased in the monetary base structure from 87.0 percent at the beginning of 2010 to 90.1 percent at the end of June 2010. The share of funds in correspondent accounts of commercial banks in the National Bank decreased from 13.0 percent to 9.9 percent, accordingly.

Money outside banks M0 at the end of June 2010 totaled Som 35 341.3 million, having increased by 4.3 percent from the beginning of the year (in the similar period of 2009 the decrease was 5.1 percent).

Money supply M2 was Som 45 916.0 million at the end of June 2010 and increased in comparison with the beginning of 2010 by 5.6 percent due to the increase in money outside banks by 4.3 percent and the increase deposits in national currency by 10.1 percent (in the similar period of 2009 decrease was 4.9 percent).

The volume of broad money M2X, including the deposits<sup>1</sup> in the foreign currency, was Som 57 131.7 million at the end of the reporting period and practically remained unchanged from the beginning of the year (in the similar period of 2009 decrease was 3.8 percent). Although M2X structure was changed: there was an increase in money outside banks by 4.3 percent with a decrease in total deposits included in broad money supply by 6.3 percent, as well as decrease in foreign currency deposits by 17.8 percent with an increase in deposits in national currency by 10.1 percent.

A velocity of broad money M2X, including the deposits in foreign currency decreased in comparison with the beginning of 2010 from 4.2 to 3.8 at the end of the reporting period.

### **Inflation: Outcomes and Trends**

According to the results of the first quarter of 2010, there was an increase of total price level in the republic against the similar indicator of 2009. According to the data of the NSC, the increase of total price level from the beginning of 2010 made 4.1 percent against the increase by 0.6 percent of the similar indicator of the previous year. However, the 12-month value of inflation (June 2010 against June 2009) amounted to 3.6 percent, which is lower than the rate for the similar period of previous year (4.8 percent).

The current price dynamics was formed under the influence of changes in prices for foodstuff, including factor in absence of external shocks at the world food markets (grains and sugar), as well as the dynamics of prices for nonfoods.

**Table 1. Consumer Price Index in the Kyrgyz Republic**

	June 2010 against			January-June against January-June 2009
	May 2010	June 2009	December 2009	
<b>Total goods and services</b>	<b>100.1</b>	<b>103.6</b>	<b>104.1</b>	<b>102.9</b>
of which				
Foodstuff and soft drinks	99.9	99.3	103.4	97.9
Alcoholic and tobacco products	100.5	106.0	104.4	105.9
Nonfoods	100.2	109.2	105.0	110.6
Services	100.5	105.1	104.1	104.0

The price index for foodstuff and soft drinks in annual terms decreased by 0.7 percent. The price dynamics for bakery products was remained under the influence of a sufficiently high evaluation of crops in the country (0.9 million tons), as well as high vested remainders of wheat. Following the first quarter of 2010 meat products increased by 5.8 percent (due to the increased prices for imported production).

The entry of cheaper imported sugar on the domestic market, as well as expectations that the sugar refinery starts working this year influenced the sugar price in the country. Thus, in June this year the price growth for sugar per annum made 33.4 percent throughout the republic against the price growth by 46.4 percent in January of the current year. According to the NSC, the average price for imported sugar in the second quarter of the current year made US\$ 776 per ton (-2.7 percent to the first quarter of 2010).

Prices for alcoholic and tobacco products per annum increased by 4.9 percent and 7.8 percent, accordingly.

12-month growth of the consumer price index of nonfoods was 9.2 percent.

<sup>1</sup> According to the data of analytical balance of the banking system the deposits cover only the deposits of individuals and legal entities, as well as the deposits of other financial institutions, while excluding the Government deposits and the deposits of non-residents.

The price growth was observed for housing services as well, that increased for a year by 8.4 percent. Determining influence for price dynamics by this group of goods was the increase of tariffs for electricity, hot water and centralized heat supply. However, the price growth was decreased for household consumers but remained above the tariff rates in January of the current year. In this regard, there was a slowdown in prices for this group of goods from 27.2 percent (in the first quarter of 2010) to 9.3 percent (in the second quarter of 2010).

There was a decrease in prices for household goods and household appliances that made 3.6 percent.

In the first half of 2010 acceleration of price growth for fuels and lubricants was continued. Thus, prices for gasoline per annum increased by 73.4 percent and diesel fuel by 61.3 percent. The main reasons of the current trends are sowing spring work which started at the beginning of the second quarter and the introduction of the customs duties on petroleum and petroleum products exported from Russia to Kyrgyzstan since 1 April 2010.

Price index for paid services for the reporting period of 2010 increased per annum by 5.1 percent (for the similar period of 2009 by – 18.1 percent). Increase in prices for education services amounted to 1.3 percent, for the services of restaurants and hotels – 1.5 percent, communication services decreased in price by 0.2 percent.

## Real Sector

In January-June of 2010 the nominal GDP volume constituted Som 81 531.2 million, having increased in real terms by 5.0 percent in comparison with the volume in January-June 2009 (in January-June of 2009 the decrease was 2.0 percent). The growth rates of economy were stipulated mainly by industrial production and active exploration of gold mining in January-June of the current year (half of GDP growth was provided by planned increase of the volume of gold mining at “Kumtor” deposit), as well as by low growth rates of the economy in the previous year, caused by decrease in the industry and total slowdown in the services (effect of “low base”). The real growth of GDP constituted 1.5 percent against 0.6 percent in January-June of 2009, except the enterprises on exploration of gold mining “Kumtor”.

**Table 2. Contribution of individual types of activity into increase/decrease of GDP**  
(percents)

	Share in the I quarter 2009	Share in the I quarter 2010	Growth rate in the I quarter 2009	Growth rate in the I quarter 2010	Contribution of of growth in the I quarter 2010	Changing of deflator in the I quarter 2010
Agriculture	14.6	12.8	2.5	0.2	0.0	-3.6
Mining industry	0.7	0.6	9.2	7.5	0.0	-14.1
Processing industry	11.4	17.0	-21.2	49.7	5.6	10.7
Electricity, gas and water generation and distribution	2.0	2.8	-13.0	12.7	0.2	42.1
Construction	4.3	4.4	-9.9	7.2	0.3	6.7
Trade and repair of vehicles,	18.3	15.7	4.6	-9.0	-1.6	4.1
Hotels and restaurants	1.5	1.3	4.4	-8.0	-0.1	1.2
Transport and communication	11.3	11.0	6.9	0.2	0.0	7.3
Other	23.4	22.2	2.1	-0.8	-0.2	5.6
Net taxes on products	12.7	12.2	-1.8	5.0	0.6	1.1
<b>GDP</b>	<b>100.0</b>	<b>100.0</b>	<b>-1.8</b>	<b>5.0</b>	<b>5.0</b>	<b>5.2</b>

Source: NSC data, NBKR adjustments

The main growth of production is accounted for the processing industry, index of physical volume of which constituted 149.7 percent in the first quarter of 2010 against 78.8 percent in the similar period of the previous year. By that a significant production growth was also observed in industries not connected with gold mining such as production of food products, textile and clothing industry, as well as production of other non-metal mineral products.

The significant increase of production is also observed in the industry of generation and distribution of electricity, gas and water. According to the results for January-June of 2010

production of this sector increased by 12.7 percent against decrease by 13.0 percent in January-June of 2009.

In the mining industry production increased by 7.5 percent.

Gross agricultural production for January-June of 2010 amounted to Som 27 348.9 million and physical volume of production increased by 0.2 percent.

During past two months of the first quarter of 2010 in the service sector there was a significant drop, as a result the contribution of these sectors to economic growth was negative in the reporting period,. The rate of growth (value added) in the trade was significantly decreased and made -9.0 percent against 4.6 percent growth in January-June of 2009. In transport and communication industry the growth of gross value added amounted to 0.2 percent against 6.9 percent in the similar period of 2009.

During the reporting period, investment in fixed capital increased by 2.7 percent and amounted to Som 13 180.6 million, both due to internal sources of financing and income from foreign direct investment.

The volume of gross output in construction in the corresponding quarter made Som 11 261.9 million, which is 7.2 percent more than in January-June of the previous year.

### **External Economic Sector<sup>2</sup>**

According to the preliminary data of the first quarter of 2010, reduction in the deficit of goods and services by 26.7 percent resulted in reduction in the current account deficit to 2.0 percent to GDP.

The volume of foreign trade turnover in FOB prices for the first quarter of 2010 increased by 11.8 percent as compared to that of 2009. It should be noted that the growth of exports was largely achieved by the increase in supplies of gold in 2.1 times<sup>3</sup> and uranium-containing chemicals<sup>4</sup> by 15.7 percent. The increase in the value of oil imports from the CIS countries was observed in the main commodity classification of import operations, due to increase of their prices by 50.7 percent, while the physical volume of revenues decreased by 15.7 percent as compared to the similar period of 2009.

In the corresponding period there was a reduction of foreign exchange receipts on current transfers, which was due to significant decline of cash grants income in the public sector<sup>5</sup>. The volume of remittances of migrant workers had a positive dynamics and increased by 18.2 percent.

For the reporting period, the capital and financial account formed positive in the amount of US\$ 201.1 million and decreased by 21.4 percent as compared with the corresponding figure in 2009. During the reporting period there was a significant increase of direct foreign investments, which for the reporting period amounted to US\$ 175.5 million, of which US\$ 111.1 million are reinvested profits.

As a result of the reporting period, balance of payments formed negative in the amount of US\$ 11.5 million (in the similar period of 2009 – formed positive in the amount of US\$ 288 million). The volume of gross international reserves at the end of the reporting period amounted

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<sup>2</sup> This section is based on preliminary data.

<sup>3</sup> This increase occurred due to growth of physical volume of gold export by 68.2 percent and increase in prices by 25.5 percent. Exports excluding gold in the reporting period amounted to US\$ 506.8 million, exceeding the base period index by 1.9 percent.

<sup>4</sup> In the reporting period the export of uranium-containing chemicals accounted for 85.9 percent of total volume of raw produce export.

<sup>5</sup> The high level of the base period. Reference: In 2009, there was a big flow of grant funds from the Government of the Russian Federation in the amount of US\$150.0 million.

to US\$1 568.4 million, which covers 4.2 months of imports of goods and services (in the same period in 2009 the gross international reserves covered 4.6 months of imports of goods and services).

The index of nominal effective exchange rate (NEER) of Som from the beginning of the year decreased by 1.9 percent and at the end of June 2010 made 121.8. Decrease was caused by strengthening of the main trade partners' currencies to Som. Thus, the average rate of Kazakhstan tenge in June 2010 in comparison with the average rate for December 2009 increased against Som by 6.1 percent, the Chinese Yuan – by 4.9 percent, US Dollar – by 4.8 percent, Russian Rouble – by 0.3 percent. In this regard, depreciation of Euro to Som was observed by 12.6 percent.

Despite the strengthening of exchange rates of major trading currencies to Som, the growth of REER was mainly stipulated by lower level of inflation<sup>6</sup> in the countries – main trade partners, thereby smoothing out the impact of the exchange rate. Thus, the index of real effective exchange rate (REER) of the Som since the beginning of this year, almost unchanged and at the end of June 2010 amounted to 103.3.

### **Public Finance Sector**

According to the Central Treasury of the Ministry of Finance, the state budget deficit in the first quarter of 2010 was Som 1.3 billion or 1.6 percent to GDP (in the first quarter of 2009 the budget was executed with a budget surplus at the rate of 0.8 to GDP). At the same time excluding funds received from the tax on Kumtor gross income, the state budget deficit amounted to Som 4.1 billion or 5.1 percent to GDP.

Total state budget expenditures for operational activity in the first quarter of 2010 were Som 27.0 billion or 33.1 percent to GDP. Compared to the previous year the growth rates decreased and amounted to 0.6 percent against 27.8 percent in the first quarter of 2009, that as a whole is lower than average annual level for the last five years.

Total state budget expenditures for operational activity in the first quarter of 2010 were Som 26.2 billion, having increased by 18.1 percent or by Som 4.0 billion.

In accordance with the functional classification of budget expenditures in the reporting period the growth of expenditures was observed by the following groups: for social protection (by 2.2 times), for economic issues (by 18.5 percent), for housing and public services (by 9.7 percent), for defense, public order and safety (by 9.4 percent), for education (by 8.7 percent), for health (by 2.4 percent). Sharp increase of expenditures for social protection is connected with compensation payments to poorer groups of the population due to increase of tariffs for communal services and for electricity from the beginning of 2010. Expenditures of the state budget decreased by the following groups: for environmental protection (by 2.6 percent) and for the general state services (by 10.2 percent).

Total state budget financing for the reporting period made Som 3.2 billion; of which domestic financing constituted Som 2.3 billion, external financing – Som 0.8 billion.

In the reporting period the net flow of budget funds on the operations on purchases of non-financial assets (including operations by the following groups: fixed assets, reserves, lands) made Som 2.1 billion or 2.6 percent to GDP (in the first quarter of 2009 – Som 4.0 billion or 5.4 percent to GDP).

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<sup>6</sup> Inflation rate in the Kyrgyz Republic for January-June of the current year amounted to 4.1 percent, while the corresponding figure of the main trade partners amounted to 1.8 percent, according to preliminary estimates.

## **Financial Sector**

### **Banking System**

As of June 30, 2010<sup>7</sup>, 22 commercial banks<sup>8</sup> operated in the territory of the Kyrgyz Republic (including Bishkek Branch of the National Bank of Pakistan) and 242 branches of the commercial banks.

On the results of the first quarter of 2010 the banking system of the Kyrgyz republic had a negative profit in the amount of Som 3 571.1 million (in the similar period of 2009 net profit amounted to Som 761.1 billion). In the reporting period the assets of commercial banks decreased by 23.5 percent, with a decrease in deposits by 24.3 percent and capital of the banking system decreased by 28.9 percent.

In the first quarter of 2010 in connection with April events happened in the country of the current year, a significant outflow of deposits from the accounts in commercial banks was noted. The main outflow occurred in the accounts of non-residents in foreign currency. Thus, in January-June of 2010 balances in the deposit accounts at the banks decreased by 23.4 percent amounting to Som 30.3 billion. The reduction was influenced by decrease of the deposits in foreign currency by 39.8 percent amounting to Som 14.9 billion, whereas the deposits in national currency increased by 4.1 percent amounting to Som 15.4 billion. At the same time excluding the influence of the change in the rate of the U.S. dollar<sup>9</sup> from the beginning of the year, deposit base decreased by 25.0 percent. As a result of reducing the balance of deposits in foreign currency the level of dollarization of the deposit base declined by 13.4 percentage points and amounted to 49.1 percent as compared with the beginning of the year.

On the whole, for the first quarter of 2010 the credits in foreign currency decreased by 5.2 percent (the decline made 9.9 percent, excluding the impact of the change in exchange rate of foreign currency for the period) and constituted Som 14.9 billion. As the credits in national currency increased by 14.3 percent and amounted to Som 10.9 billion at the end of June.

The volume of newly extended loans by commercial banks increased by 15.5 percent amounting to Som 11.2 billion (in the first quarter of 2009 there was a decrease by 23.0 percent).

The weighted average interest rate on credits in national currency amounted to 24.0 percent, having decreased by 2.8 percentage points as compared to January-June of 2009 and on credits in foreign currency – by 20.0 percent, having decreased by 1.7 percentage points.

### ***Non-banking financial and credit institutions, licensed by NBKR***

The system of non-banking financial and credit institutions of the Kyrgyz Republic by the end of June 2010 included 947 non-banking institutions<sup>10</sup> (at the end of June of 2009 the number of non-banking institutions was 972).

- FCSDCU – 1
- LLC “Special Fund for Banks Refinancing” – 1
- Microfinance companies - 380
- Credit agencies - 229
- Exchange beuraus - 336

Credit portfolio<sup>11</sup> of non-banking financial and credit institutions<sup>12</sup> at the end of the reporting period was Som 10 244.3 million.

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<sup>7</sup> The data are presented in accordance with regulatory reporting of commercial banks.

<sup>8</sup> Since May 31, 2009 in the banking system of the Kyrgyz Republic was included OJSC IJSCB “Akyl” whose license was reinstated and issued on February 27, 2009 in connection with the rehabilitation.

<sup>9</sup> In the currency structure of the deposit base, U.S. dollar currency deposits occupy 91.0 percent

<sup>10</sup> Excluding data on the pawn shops, as since September 8, 2009 the licensing was stopped.

### ***Other financial institutions***

The total volume of tenders on trading platforms of three stock exchanges in January-June of 2010 was Som 610.5 million, having decreased by 65.8 percent in comparison with the first quarter of 2009. Decrease in the volume of tenders was observed on all trading platforms. The volume of transactions on the trading platform of the Joint Stock Company “Kyrgyz Stock Exchange” decreased by 83.5 percent to Som 187.1 million, at the JSC “Central Asian Stock Exchange” – by 24.4 percent to Som 392.6 million and the volume of exchange tenders on the trading platform of the Joint Stock Company “Stock Exchange of Kyrgyzstan – BTS” decreased by 77.6 percent to Som 30.9 million. At that the basic volume of transactions in the structure of the volume of tenders fell, as before, on the Joint Stock Company “Central Asian Stock Exchange” – 64.3 percent.

As of July 1, 2010, 19 insurance companies operated in the securities market of the republic, two of them – reinsurance companies, as well as 7 companies with the participation of non-residents. Total assets of insurance organizations as of end of May 2010 constituted Som 804.9 billion, having decreased from the beginning of the year by 7.0 percent, own capital also decreased by 7.7 percent and made Som 654.4 million.

At present there are two non-public pension funds in the Kyrgyz Republic: NPF “Kyrgyzstan” and NPF “Jany Asia” (that received license as of May 26, 2009 and yet not engaged in its activity). The size of assets of the NPF “Kyrgyzstan” as of the end of May 2010 made Som 23.6 million, having increased for 5 years by 7.8 percent and the volume of their overall capital amounted to Som 5.0 million, having remained unchanged.

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<sup>11</sup> The data is presented without FCSCU, SFBR (as the credits of FCSCU are given to credit agencies and SFBR to commercial banks.

<sup>12</sup> Reporting of MFC is given on the half-year basis.