

REPORT ON MONETARY POLICY FOR THE FIRST QUARTER OF 2009

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Major trends in the monetary policy

In the reporting period, the monetary policy was of the balanced and adequate character, which reflected continuing decrease in the inflation risks in the present year, though remaining at rather high level. To prevent acute fluctuations of the KGS exchange rate, the National Bank of the Kyrgyz Republic, as a response to occurrence of the excess demand for foreign currency, increased its presence in the interbank foreign exchange market. However, depreciation of the national currency in the first quarter of the present year (by 8.15 percent) was much higher than in the first quarter of the past year (by 2.56 percent) and in the fourth quarter of the past year (by 7.5 percent). At that the net sale volume of the foreign currency constituted 145.1 million USD during the reporting period, whereas in the first and fourth quarters of the past year the rates were 79.6 and 31.1 million USD correspondingly.

Decrease in the growth rates of the general prices level in the republic was provided by weakening of the external factors influence as well as by performance of tough monetary policy, starting in autumn of 2007 and continuing during the whole past year, which provided decrease in the monetary supply growth rates and increase in the NBKR discount rate.

According to the National Statistics Committee, the increment rate of CPI index, characterizing the inflation rate, starting from the beginning of 2009 constituted 0.4 percent (March 2009 against December 2008), whereas in the corresponding period of the past year it was 6.1 percent.

In the reporting period, the National Bank of the Kyrgyz Republic reduced the volumes of transactions in the open market, that led to decrease in volume of notes in circulation from 1.6 billion soms of the end of the past year to 0.9 billion soms as of the end of March of the present year. Moreover starting from February of the present year, the National Bank of the Kyrgyz Republic has not performed reverse REPO-transactions. As a result the discount rate decreased from 15.22 percent of the end of the past year to 12.79 percent as of the end of the reporting period. Hereafter the discount rate continued decreasing that created conditions for decrease of commercial banks discount rates and as of the end of May it constituted 9.95 percent.

The monetary base during the reporting period decreased by 15.5 percent (in the corresponding period of the past year the decrease constituted 7.8 percent). The monetary base decrease is an ordinary tendency for the beginning of a year, as a rule related to currency interventions of the National Bank of the Kyrgyz Republic in conditions of seasonal demand increase for foreign currencies. Moreover it should be noted that in the first quarter of the present year, the Kyrgyz Republic Government performed the budget constraint policy, which also influences the reduction of monetary base.

At present, the situation in the foreign exchange market is stabilized, foreign currency demand and supply are balanced, and the National Bank of the Kyrgyz Republic limited its currency interventions (the net sale volume of foreign currency in April of the present year constituted 7.5 million USD, and since the beginning of May the National Bank of the Kyrgyz Republic has not performed currency interventions). From April, there has been registered a considerable growth of monetary base, which was mainly stipulated by increase of the Government expenditures due to grant resources, provided by Russia. Thus within the period from the end of the first quarter till the end of May, 2009, the monetary base increased by 8.3 percent.

Within the reporting period, in the banking system there was a growth of its major indicators. Bank assets increased by 13.6 percent and constituted 62.4 billion soms as of the end of March, 2009. Credit portfolio of banks increased by 0.6 percent and constituted 25.7 billion soms. The volume of deposits as of the end of March 2009, constituted 33.6 billion soms, having

increased by 1.9 percent from the beginning of 2009. The capital of the banking system also increased by 3.7 percent and constituted 13.3 billion soms as of the end of March. Net profit, received by banks within the period of January-March 2009, constituted 371.5 million soms (in the corresponding period of 2008, this rate constituted 351.6 million soms).

According to preliminary data, in the first quarter of 2008, the balance of payments was negative in the amount of 180.7 million USD (in the first quarter of 2008, the balance of payments was also negative and constituted 84.5 million USD). The deficit of current account constituted 9.6 percent to GDP, that is inconsiderably higher than the corresponding rate of 2008. Positive balance of current transfers in the reporting period was formed at the level of 231.6 million USD, that it 5.8 percent lower than the corresponding rate of 2008.

Inflation: results and tendencies

In the first quarter of 2009, there was a considerable price reduction in comparison with the corresponding period of 2008. According to the National Statistics Committee, the CPI rate increase, characterizing the inflation rate, starting from the beginning of 2009 constituted 0.4 percent (March 2009 against December 2008), whereas it was 6.1 percent in the corresponding period of the past year. On an annualized basis (March 2009 to March 2008), the inflation rate constituted 13.6 percent.

Moderate prices growth for some goods, and in some cases even prices decrease, was the deterrent for inflation dynamics in the reporting period. In 2009, there was continuing process of stabilization and prices decrease for major food products, including grain crops, oil-bearing crops and petroleum products.

Thus stabilization of the situation in the world markets, as well as the anti-inflationary measures, performed by the National Bank of the Kyrgyz Republic and the Kyrgyz Republic Government, provided deceleration in inflation processed in the economy.

Table 1. Consumer price index in the Kyrgyz Republic

	December 2008	March 2009 to February 2009	March 2008	January-March 2009 to January-March 2008
All goods and services	100,4	99,6	113,6	116,2
including				
Food products and non-alcohol beverages	97,7	99,0	110,3	114,9
Alcohol beverages and tobacco products	100,9	100,6	109,0	109,7
Non food products	104,4	100,0	115,8	115,1
Services	102,8	100,5	129,8	133,4

Prices for food products in the first quarter of 2009, as opposed to the corresponding period of the past year, considerably influenced the inflation rate decrease. Thus, since the beginning of the present year, the group “food products and non-alcohol beverages” depreciated by 2.3 percent. The largest depreciation rates were registered for oils and fats as well as for bakery products and cereals. Thus, the decrease in prices for these types of goods constituted 7.9 and 7.4 percent correspondingly. The downward prices trend for bakery products, was mainly provided by stabilization of prices for wheat in the countries-major exporters. According to the National Statistics Committee, in 2008 the volume of 746.2 thousand tonnes of wheat and its conversion products was produced. With the consumption rate of 1.3-1.4 million tonnes, the deficit was covered due to import supplies from Kazakhstan, Russia and Ukraine.

Analysis of the food balance of the Kyrgyz Republic as of 12 months of 2008 showed that in some food product categories there is still import-dependence.

Price index for non-food products in the first quarter of 2009 increased by 4.4 percent. The increase of prices was registered for household articles and household appliances, which constituted 2.9 percent. The main reason for such increase consisted in appreciation of household textile products by 12.8 percent. Also the increase of prices was registered for clothes and footwear by 0.8 percent mainly due to appreciation of materials for clothes production by 18.2 percent.

Within the reporting period, the general prices growth in the economy was provided by the increase in prices for paid services by 2.8 percent. For comparison, in the corresponding period of 2009, paid services appreciated by 6.4 percent.

Dynamics of Monetary Aggregates

Monetary base, calculated in accordance with the current exchange rate constituted 29705.6 million soms as of the end of March 2009, having increased by 15.5 percent from the beginning of the year.

Analysis of the monetary base sources showed that the reduction of monetary base volume in the reporting period was influenced by the decrease of net internal assets of the banking system by 62.6 percent (mainly due to decrease in other articles by 32.2 percent, which was provided by the increase in non-realized income from revaluation of foreign currency and gold) and net foreign assets by 15.4 percent, as a result of the net international reserves reduction (mainly due to the NBKR transaction on foreign currency sale).

The volume of broad money aggregate M2X, including deposits in foreign currency¹, calculated in accordance with the fixed exchange rate constituted 40160.5 million soms as of the end of the reporting period, having decreased by 16.4 percent from the beginning of the year (in the corresponding period of 2008, the decrease constituted 4.6 percent).

The decrease in the volume of broad money aggregate M2X in the reporting period was influenced by reduction of money outside banks by 16.3 percent (in the reporting period of 2008 by 8.4 percent) as well as decrease in the total volume of deposits by 16.5 percent. At that there was decrease in deposits in the national and foreign currencies by 21.5 and 12.0 percent correspondingly. Decrease in deposits was provided by reasons of methodological character of deposits accounting².

Velocity of the broad money aggregate M2X, including deposits in foreign currency as of the end of the reporting period remained unchanged and constituted 4.0.

Real sector

As per results of the first quarter of 2009, the GDP volume constituted 32217.6 million soms, having increased in real terms by 0.2 percent in comparison with the corresponding period of the past year (in the first quarter of 2008, the increase constituted 5.2 percent). Exclusively of enterprises on exploration of gold mining “Kumtor”, the increase in real GDP constituted 0.8 percent against 4.9 percent of January-March 2008. As a whole, from the beginning of the present year, there has been considerable decrease in the economic growth rates in the economy.

¹ According to the information provided by analytic balance of the banking system (include only deposits of legal entities and individuals, as well as deposits of other financial and credit institutions, but excluding deposits of the Government and non-resident individuals).

² A part of deposits, earlier stated as the deposits of non-commercial organization, started to be stated as the deposits of the Social Fund, whereas the deposits of the Social Fund are not included in the deposit base, on the basis of which the broad money aggregate M2X is calculated.

Table 2. Contribution of individual types of activity into increase/decrease of GDP in January (percent)

	Share in 2008	Share in 20089	Growth rates in 2008	Growth rates in 2009	Contribution to increase	Deflator
Agriculture, hunting and forestry	13,7	14,2	1,5	1,5	0,2	15,6
Mineral resource industry	0,4	0,5	-11,4	12,5	0,1	16,9
Processing industry	12,6	9,6	5,0	-18,6	-2,3	5,4
Production and distribution of electric energy, gas and water	4,8	4,3	5,0	-23,8	-1,1	32,5
Construction	1,5	2,1	-37,4	29,0	0,4	17,0
Trade, repair of automobiles and personal demand items	20,9	21,7	5,5	3,1	0,6	13,0
Hotels and restaurants	1,4	1,5	7,2	4,6	0,1	16,6
Transportation and communication	10,0	12,5	25,7	17,8	1,8	19,5
Others	17,0	19,7	3,2	2,5	0,4	27,2
Net taxes for products	17,7	13,9	5,2	0,2	0,0	-11,6
GDP	100,0	100,0	5,2	0,2	0,2	12,3

In the reporting period, the main growth of gross value added was accounted for transportation and communication. In a less degree, the growth was registered in trade and construction. At that the economy growth retardation in comparison with the first quarter of the past year was mainly provided by the production sector. Considerable decrease in production in the processing industry and in the sphere of production and distribution of electric energy, gas and water led to general recession in the production sector. The alarm signal in this situation consists in considerable decrease in the industrial production at enterprises not involved in gold mining.

Favorable condition for development of the situation in real sector was activation of investment activity in the economy. This is explained by increase in construction works volumes in processing industry and in the sphere of production and distribution of electric energy, gas and water.

The main share in the structure of investment to fixed capital was accounted for the performed contractual works, the share of which constituted 66.9 percent in the first quarter of 2009. The priority trends for contribution of investments into the fixed capital were processing industry (24.0 percent out of the total volume of investments to the fixed capital), production and distribution of electric energy, gas and water (by 12.7 percent) and transportation and communication (9.2 percent).

External sector of the economy

In the first quarter of 2009, the deficit of current account balance constituted 9.6 percent to GDP (with regard to additional NBKR estimations – 4.7 percent to GDP), that inconsiderably exceeds the corresponding rate of 2008.

Export surplus of the Kyrgyz Republic for the first quarter of 2009 was negative in the amount of 318.2 million USD (with regard to additional NBKR estimations – 259.0 million USD).

As per results of the first quarter of 2009, the balance of income was formed negative at the level of 26.6 million USD and in comparison with the first quarter of 2008 it decreased by 48.9 percent. The decrease was provided by decrease in negative balance of income from direct investments by 24.8 million USD due to increase in volumes of re-invested profit, received by direct foreign investors.

In the reporting period the positive balance of current transfers was formed at the level of 231.6 million USD that is 5.8 percent lower than the corresponding rate of 2008. The decrease was provided by reduction of revenues from money transfers of labor migrants by 21.4 million USD.

According to preliminary data, the positive balance of transactions with the capital and financial transactions in the first quarter of 2009 increased by 2.4 percent in comparison with the

corresponding period of 2008 and constituted 107.0 million USD. Account of transactions with the capital was formed with positive balance in the amount of 41.1 million USD in comparison with the negative balance of 5.7 million USD in the corresponding period of 2008. Positive balance was formed due to receipt of technical assistance and grants in the form of goods. The balance of financial account also formed with positive value in the amount of 65.9 million USD and in comparison with the first quarter of 2009, it increased by 32.0 percent.

In general, according to preliminary data, the balance of payments in the first quarter of 2009 was negative in the amount of 180.7 million USD (in the first quarter of 2008, the balance of payments was negative in the amount of 84.5 million USD).

Sector of state finances

According to data, provided by the Central Treasury of the Ministry of Finance, in January-February 2009, the overall income and received official transfers of the state budget constituted 6391.1 million soms or 31.8 percent to GDP. At that growth rates decreased considerably, in comparison with the corresponding period of the past year³, constituting 10.3 percent to 48.3 percent of 2008.

Moreover such growth rates were mainly provided by proceeds of official transfers from foreign organizations and states whereas their tax revenues increased inconsiderably by 2.5 percent and their estimating deposit into increment of budget incomes constituted 2.0 percentage points (in January-February 2008 – 34.7 percentage points).

Overall expenditures of the state budget for operational activity in January-February 2009, constituted 5924.6 million soms, having increased by 76.8 percent. In relation to GDP, operational expenditures constituted 29.4 percent to GDP, whereas in the corresponding period of the past year – 18.6 percent to GDP. Such considerable growth of budget expenditures was provided by the increase in payments for such categories as “remuneration of labor” and “utilization of goods and services” by 62.4 and 88.6 percent correspondingly, which in the aggregate provided contribution to the general increase in the budgetary expenditures by 43.7 percentage points.

Besides the increase in current expenses in the reporting period there was a considerable growth of budget deductions on transaction of acquisition of non-financial assets (including transactions on such groups as fixed assets, reserves, land and other non-produced assets), which are the capital expenses of the Government. Net outflow of money on such transactions constituted 614.5 million soms or 3.1 percent to GDP (in January-February 2008 – 36.6 million soms or 0.2 percent to GDP).

In general as a result of exceed of the Government monetary assets outflow over their proceeds in January-February 2009, the state budget (exclusive of expenditures within the framework of development budget) for the first time since 2007 was formed with the deficit of 147.9 million soms or 0.7 percent to GDP (in the corresponding period or 2008, the surplus constituted 13.4 percent to GDP).

Financial sector

Banking system

As for March 31, 2009, 21 commercial banks were operating on the Kyrgyz Republic territory.

In the first quarter of 2009 the banks received the current profit in the amount of 371.5 million soms. At that all 19 commercial banks had positive financial result in the amount of 376.1 million soms and 2 commercial banks had negative profit in the amount of 4.7 million soms in the reporting period. In the corresponding period of 2008, 22 commercial banks were operating in the

³ Hereinafter, if otherwise is not specified, correlation will be performed in comparison with the corresponding period of the past year.

republic and the income constituted 351.6 million soms as per results of their activity. In the reporting period the assets of commercial banks increased by 13.6 percent and the capital increased by 3.7 percent.

In general in the first quarter of 2009 the deposit base of acting commercial banks increased by 2.5 percent and constituted 30.3 billion soms as of the end of the quarter. However, the growth of the deposits residuals was due to increase in volume of deposits in foreign currency in KGS expression (by 5.3 percent up to 17.9 billion soms), which was related to increase of USD exchange rate: deposits in USD (more than 90.0 percent in the deposit base in the foreign currency) in USD expression decreased. Residuals of deposits in the national currency decreased by 1.3 percent up to 12.4 billion soms as of the end of the reporting period.

In the first quarter of 2009, the credit portfolio of acting commercial banks increased by 0.6 percent and constituted 25.8 billion soms as of the end of March. At that the credits in the national currency decreased by 1.5 percent and constituted 8.9 billion soms, whereas the credits in foreign currency increased by 1.8 percent and constituted 16.9 billion soms. The increase in volume of credits residues in foreign currency in KGS equivalent was related to increase in USD exchange rate: in nominal value the credits residues in USD (about 96.0 percent of the overall volume of credits in foreign currency) decreased.

The weighted average interest rate on credits in the national currency, constituting the acting commercial banks portfolio, increase from the beginning of the year by 0.4 percentage points to 24.1 percent, and in foreign currency – by 0.6 percentage points up to 20.1 percent.

Non-banking financial and credit institutions, licensed by the National Bank of the Kyrgyz Republic

The system of non-banking financial and credit institutions of the Kyrgyz Republic included 1104 non-banking institutions as of the end of the reporting period:

- Financial Company on Support and Development of Credit Unions – 1;
- Credit Unions – 241;
- Micro-credit companies – 182;
- Micro-credit agency – 118;
- Micro-financial companies – 2;
- Pawn-shops – 204;
- Exchange offices – 356.

Table 3. Credit portfolio of non-financial credit institutions
(million soms).

	31.12.2007	31.03.2008	31.12.2008	31.03.2009
Credit portfolio of non-financial credit institutions	4850,3	4051,2	7384,3	7392,7

Other financial institutions

In the first quarter of 2009, the gross volume of competitive tendering on trade platforms of three stock exchanges in comparison with the first quarter of 2008 decreased by 14.5 percent and constituted 1596.1 million soms. The decrease in the gross volume of competitive tendering was influenced by the decrease in the volume of bargains performed on the trade platform of CJSC “Kyrgyz Stock Exchange”, which forms 67.1 percent out of the total volume of bargains, by 39.7 percent up to 1070.8 million soms. At the same time there was further growth of volume of trade competitive tendering on the trade platforms of the CJSC “Central Asian Exchange Market” – in

5.8 times up to 441.4 million soms and CJSC “Stock Exchange of Kyrgyzstan – BTS” in 6.3 times up to 83.8 million soms.

As of the end of the first quarter of 2009, activity in the securities market was performed by 6 joint-stock investment funds and 2 share investment funds, the share of which in provision of financial services remains inconsiderable: assets of investment funds are at the level of 0.02 percent to GDP (as per results of 2008).

Another sector, providing important financial services, however remaining inconsiderable, is the market of insurance services. As of the end of February 2009, insurance activity in the republic market was performed by 18 insurance companies, among them one reinsurance company (“Insurance Reserve”) as well as 7 companies with participation of non-residents. Aggregate assets of insurance companies within 2 months of 2009, constituted 641.4 million soms, having increased by 89.5 percent in comparison with the corresponding period of 2008, the aggregate owned capital increased by 87.8 percent and constituted 526.2 million soms.

Also, at present in the republic there is one non-governmental pension fund “Kyrgyzstan”, the amount of pension deposits of which constituted 13.3 million soms as of the end of 2008, having increased by 4.9 percent and the number of its participants, concluded the contracts of voluntary retirement insurance, constituted 1855 people (432 of whom receive pensions).