

Monetary Policy Report For the First Half of 2009

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Basic Monetary Policy Trends

A downward tendency in an inflationary pressure created conditions for mitigation of a monetary policy in the accounting period. Substantial growth in the 2nd quarter of Government expenditure in May to June caused growth of the volume of an offer of NBKR Notes with the view of restraining a monetary component of inflation. As a result, the volume of outstanding NBKR Notes for the 2nd quarter increased by 29.3 percent to Som 1.1 billion.

As a whole for the 2nd quarter, the monetary base increased by 14.9 percent (for the similar period of the last year growth made 11.8 percent).

According to the National Statistics Committee, growth of a consumer price index characterizing a rate of inflation, made 0.6 percent from the beginning of 2009 (June 2009 by December 2008), whereas for the similar period of the last year it was 15.2 percent. Annualization (June 2009 by June 2008) of inflation made 4.8 percent.

Stabilization of a situation in world markets of food products and the energy resources, accompanied with downward price adjustments in the markets as well as anti-inflationary measures undertaken by the National Bank and the Government caused retardation of inflationary processes in the economy. For instance, the food price reduction and a moderate rise in prices of nonfoods and services were observed.

The situation in the interbank foreign exchange market stabilized in the 2nd quarter of 2009 and the reduction observed in a demand for US dollars. In this connection, the National Bank noticeably reduced its presence in the foreign exchange market, only periodically concluding transactions, both on purchase and sale of non-cash US dollars with a view of smoothing sharp exchange rate fluctuations and maintaining a balance between a supply of and the demand for foreign exchange in the market. A dynamics of the US dollar exchange rate against the Som was quite stable in the 2nd quarter of 2009. At the beginning of the quarter, the exchange rate increased from Som 42.6 to Som 43.0 for 1 US dollar and by the end of June fluctuated within a narrow range of 43.0-43.4 Som/US dollar. As a whole for the 2nd quarter of 2009, the discount dollar exchange rate against the Som increased by 1.5 percent that is appreciably below the rate of depreciation of a national currency in the 1st quarter of 2009 (8.1 percent). (For comparison: In the 2nd quarter of 2008, the discount US dollar exchange rate decreased, on the contrary, by 1.3 percent against the Som.) The volume of net sales by the NBKR of non-cash US dollars in the 2nd quarter of 2009 totaled US\$ 4.6 million while in the 1st quarter of 2009 it was US\$ 148.4 million, and in the 2nd quarter of 2008 net purchases were US\$ 46.9 million.

Since June 15, the National Bank lowered reserve requirements from 10 to 9.5 percent, therefore, the volume of required reserves decreased by Som 148.9 million, that burden on banks decreased a little bit. The reduction in reserve requirements was also caused by a startup of transfers by commercial banks to a Deposit Protection Fund.

It should also be noted that the Special Fund for Banks Refinancing started to operate on May 11.

The NBKR discount rate for the 2nd quarter of 2009 decreased from 12.8 percent at the end of March to 8.2 percent at the end of June, thereby reflecting, possibly, the reduction in inflationary expectations of market participants.

From the beginning of the 3rd quarter of the current year (as of July 28, 2009), the monetary base increased by 3.8 percent. A change in the monetary base (Som 1 301.1

million) resulted from operations of the Government that increased the monetary base by Som 1 413.4 million and the NBKR operations that reduced the monetary base by Som 112.3 million.

Based on the outcome of the 1st half of 2009 there was growth of basic indicators of banking system, except for a credit portfolio, whose volume contracted by 0.6 percent, having made Som 25.5 billion. Assets of banks increased by 18.6 percent and totaled Som 65.13 billion at the end of June 2009. The deposit base of operating commercial banks at the end of June 2009 increased by 14.3 percent and was Som 33.8 billion. A net profit of a banking system for January-June 2009 was Som 764.1 million (for the similar period of 2008 this indicator totaled Som 752.0 million).

According to the preliminary data, a balance of payments in the 1st half of 2009 developed with a positive value equal to US\$ 249.2 million (in the 1st half of 2008, the similar balance was negative of US\$ 17.7 million). The current account deficit was US\$ 86.3 million and contracted by 4.8 percent of GDP in comparison with 11.4 percent for the similar period of 2008. The positive balance of current transfers in the accounting period developed at a level US\$608.6 million and it is by 6.9 percent less than the value of the 1st half of 2008 (excluding a Russian grant, the decrease in current transfers is 29.9 percent).

Inflation: Outcomes and Trends

For the 1st half of 2009, growth of prices was observed to essentially slow down in comparison with the similar period of 2008. According to the National Statistics Committee, growth of the consumer price index characterizing the rate of inflation made 0.6 percent since early 2009 (June 2009 by December 2008), whereas it was 15.2 percent for the similar period of 2008. Annualization (June 2009 by June 2008) of inflation resulted in 4.8 percent.

Stabilization of the situation in the world markets of food products and energy resources as well as the anti-inflationary measures undertaken by the National Bank and the Government caused retardation of inflationary processes in the economy. For instance, the food prices were observed to drop, while the prices of nonfoods and services were noted to moderately increase.

Table 1. Consumer Price Index in the Kyrgyz Republic

	June 2009 against			Jan.-June 2009 against
	December 2008	May 2009	June 2008	Jan.-June 2008
Total goods and services	100.6	99.5	104.8	112.5
of which				
Foodstuffs and soft drinks	96.4	98.0	96.8	108.8
Alcoholic and tobacco products	103.6	101.6	107.4	108.4
Nonfoods	106.2	101.1	115.3	115.2
Services	103.6	100.3	118.1	129.1

A price behavior of food products for the first six months of 2009 had an essential impact on the decrease in a general price level. For instance, the group of goods classified as “food products and soft drinks” went down in value by 3.6 percent, and annualization (against June 2008) showed the reduction by 2 percent. The prices in the 1st half of the year decreased with regard to such groups of goods, as bakery products and groats (-8.3 percent), oils and fats (-14.1 percent), fruits and vegetables (-1.9 percent). The reduction of prices of imported products and a weakening of the domestic and external demand, with the sufficient supply, were major factors of a drop in prices in this group of goods.

The prices of alcoholic and tobacco products increased by 5.0 percent and 0.8 percent, accordingly.

The price index of nonfoods grew by 6.2 percent for the 1st half of 2009.

The rise in price of marketed services by 3.6 percent also contributed to the general rise in prices in the economy, for comparison – the marketed services rose in price by 17.9 percent for the similar period of 2008.

Dynamics of Monetary Aggregates

The monetary base, calculated at the current exchange rate, totaled Som 34 134.0 million at the end of June 2009, having thus contracted by 2.9 percent since the beginning of the year (while in the similar period of 2008 the monetary base increased by 3.0 percent).

Money outside banks M0 at the end of June 2009 was Som 27 894.7 million, having decreased by 5.1 percent since the beginning of the year while in the similar period of 2008 showing the increase by 1.6 percent.

While indicating growth in the similar period of 2008 by 6.2 percent, monetary aggregate M2 at the end of June 2009 totaled Som 36 328.5 million and contracted in comparison with its volume in early-2009 to 4.9 percent due to the reduction of money outside banks and the decrease in deposits in national currency by 4.4 percent.

Having decreased since the beginning of the year by 5.5 percent, the volume of broad money M2X, including the deposits¹ in foreign currency and calculated at the fixed exchange rate, was Som 45376.6 million at the end of the accounting period, while in the corresponding period of 2008 broad money increased by the contrary by 8.4 percent.

The reduction of the volume of broad money M2X in the accounting period was triggered by the reduction of money outside banks by 5.1 percent (broad money in the similar period of 2008 increased by the contrary by 8.4 percent) and by the decrease in the total amount of deposits, as part of broad money, by 6.3 percent, of which the deposits in foreign currency - by 4.4 percent and the deposits in national currency - by 7.9 percent conditioned by a change in a methodology of accounting the deposits².

A velocity of broad money M2X including the deposits in foreign currency at the end of the accounting period was 4.2 (at the beginning of 2009 it was 4.1).

Real Sector

Based on the outcome of the 1st half of 2009, the volume of GDP was Som 74 049.0 million, having increased in real terms in comparison with the similar period of 2008 by 0.3 percent (in the 1st half of 2008 real growth was 6.1 percent). Excluding enterprises developing a gold mine deposit “Kumtor”, real growth of GDP was 1.3 percent, against 5.5 percent in January-June 2008. As a whole, essential growth retardation has been observed in the economy since the beginning of the current year.

¹ According to a monetary survey of the banking system, the deposits cover only the deposits of individuals and legal entities, as well as the deposits of other finance and credit institutions, while excluding the Government deposits and the deposits of nonresidents.

² Since January 1, 2009, the commercial banks moved to their own chart of accounts. With that, part of the deposits, earlier reflected as the deposits of commercial banks, are now reflected as the deposits of the Social Fund, while the deposits of the Social Fund are not part of the deposit base that is used to calculate broad money M2X.

Table 2. The contribution of separate kinds of activity to growth/decrease of GDP in January-June (Percent)

	Share in 2008	Share in 2009	Growth rate 2008	Growth rate 2009	Contribution to growth	Deflator
Agriculture	16.1%	16.2%	2.4%	2.1%	0.3%	8.7%
Mining	0.4%	0.5%	-6.6%	8.6%	0.0%	23.3%
Manufacturing	12.1%	9.8%	9.5%	-21.3%	-2.6%	14.2%
Electricity, gas & water generation & distribution	2.9%	2.9%	-0.5%	-13.0%	-0.4%	25.3%
Construction	2.3%	3.1%	-27.6	28.5%	0.7%	13.3%
Trade; vehicle repairs	20.2%	20.7%	6.6%	3.4%	0.7%	9.2%
Hotels and restaurants	1.4%	1.4%	10.0%	4.3%	0.1%	11.9%
Transportation and communication	9.7%	11.5%	29.4%	10.8%	1.0%	18.2%
Other	18.4%	21.2%	3.1%	2.2%	0.4%	24.6%
Net taxes on products	16.5%	12.7%	6.1%	0.3%	0.0%	-15.6%
GDP	100.0%	100.0%	6.1%	0.3%	0.3%	10.0%

Growth retardation since early-2009 was, mainly, due to negative growth in industry. The essential drop in production in manufacturing industry and in the sector of electricity, gas and water generation and distribution led to the general drop in industry. A disturbing signal in this situation is that of the significant decrease in industrial production at the enterprises, which are not engaged in extraction of gold.

Compared with the period of January to June 2008, the volume of investments in fixed capital increased 1.4 times in January to June 2009. One of the principal factors of such growth is that of significant growth of the volume of investments in hydropower projects, whose share in total investment in fixed capital was 10.3 percent.

External Economic Sector

According to the preliminary data, the current account deficit for the 1st half of 2009 was US\$ 86.3 million and contracted by 4.8 percent of GDP in comparison with 11.4 percent for the similar period of 2008 (including NBKR adjustments – 0.3 percent of GDP).

The trade balance of the Kyrgyz Republic developed negative of US\$ 596.6 million (including the NBKR adjustments - US\$516.5 million).

The balance of services developed negative of US\$ 48.7 million and in comparison with the similar period of the last year contracted by 43.7 percent.

The balance of income developed with the negative value at a level of US\$ 49.6 million and in comparison with the 1st half of 2008 decreased by 26.1 percent owing to the reduction of income of direct foreign investors from investment activity in the Kyrgyz Republic.

The positive balance of current transfers in the considered period developed at the level of US\$ 608.6 million that is less by 6.9 percent than the value of the first half of 2008 (excluding the Russian grant, the decrease in current transfers was 29.9 percent).

The positive balance of the capital and financial account for the 1st half of 2009 increased by 32.5 percent in comparison with the similar period of 2008 and totaled US\$ 149.8 million. The capital account developed with the positive balance equal to US\$ 30.6 million in comparison with its negative value of US\$ 3.9 million in the similar period of 2008. This positive balance developed due to technical assistance and commodity grants. The balance of the financial account also developed positive – at the rate of US\$119.3 million, having slightly increased by 2.0 percent.

As a whole, according to the preliminary data, the balance of payments in the 1st half of 2009 developed with the positive value of US\$ 249.2 million (in the 1st half of 2008 the similar balance was negative of US\$ 17.7 million).

Public Finance Sector

According to the Central Treasury of the Ministry of Finance total revenue and received official transfers in the state budget totaled Som 20 387.7 million or were 35.2 percent of GDP in January to May 2009. In comparison with the corresponding period of the previous year³, the rates of growth were halved, having made 22.6 percent against 46.4 percent in 2008, and, as a whole, this corresponds to the actual average annual level since 2005.

The positive rates of growth were caused by receipt of official transfers from foreign organizations and states, in particular, from the Russian Federation; while tax and non-tax revenue were reduced and, accordingly, negatively contributed to general growth of budget revenue, estimated at 2.2 percentage points (in January to May 2008 - (+45.9) percentage points).

Total state budget expenditure for operational activity was Som 17 389.3 million in January to May 2009, having thus increased by 32.6 percent or by Som 4 276.0 million.

Growth of budget expenditure was caused by the increase in payments classified as “Labor Remuneration” and “Use of Goods and Services” by 37.2 and 24.9 percent, accordingly, and this, on the aggregate, provided for the contribution to general growth of budget expenditure by 20.4 percentage points.

Besides the increase in operating expenses in the accounting period, essential growth was also observed in budgetary allocations for the operations on purchases of non-financial assets (including the operations in the following groups: fixed capital, stocks, land and other nonproductive assets), which represent capital expenditure of the Government. A net outflow of monetary resources on these operations totaled Som 2 863.0 million or was 4.9 percent of GDP (in January to May 2008 it was Som 1 643.8 million or was 3.1 percent of GDP).

Financial Sector

Banking System

As of June 30, 2009, 22 commercial banks operated in the territory of the Kyrgyz Republic.

For January to June 2009, the banks made current profit totaling Som 764.1 million, with 20 banking institutions having the positive financial result of Som 774.3 million and 2 commercial banks incurred losses of Som 10.2 million for the accounting period received. 22 commercial banks carried out their activity in the similar period of 2008, and profit according to the outcome of their activity was Som 752.0 million. The assets of the commercial banks for January to June 2009 increased by 18.6 percent, while their capital increased by 5.5 percent.

³ Further in the text, unless otherwise stipulated, the comparison will be made against the corresponding period of the previous year.

In the 1st half of 2009, the deposit base⁴ of the operating commercial banks grew by 14.3 percent, having totaled Som 33.8 billion at the end of June. Growth of the deposit balances was observed both in a segment of deposits in national currency - by 15.9 percent to Som 14.5 billion at the end of the period, and in the segment of deposits in foreign currency - by 13.1 percent to Som 19.3 billion. In this regard, the volume of deposits in US dollars, whose share in the deposit base in foreign currency was the basic one, grew by 3.3 percent in nominal terms.

In the 1st half of 2009, a loan portfolio of operating commercial banks, under the conditions of a slowdown in economic activity in the country and a conduct of the moderate lending policy contracted by 0.6 percent, having made Som 25.5 billion at the end of June. The reduction of debts on loans was connected with the reduction of the volumes of lending in foreign currency by 1.7 percent (to Som 16.3 billion), while lending in national currency increased by 1.4 percent. This being the case, the reduction was observed in a currency mix of the loan portfolio with regard to the credits extended in US dollars (whose share is 95.9 percent in total credits in foreign currency), whereas the balances of credits other currencies showed the increase (in Euro – by 2.8 percent, in Rubles – 30.8 times).

The average interest rate of credits, forming the loan portfolio in national currency, increased by 0.7 percentage points since the beginning of the year to 24.4 percent, while in foreign currency – by 0.4 percentage points to 19.9 percent.

Non-bank Finance and Credit Institutions Licensed by NBKR

The system of non-bank finance and credit institutions of the Kyrgyz Republic at the end of the accounting period counted 1 178 non-bank institutions:

- FCSDCU - 1;
- LLC “SFRB” - 1
- Credit unions - 238;
- Microcredit companies - 197;
- Microcredit agencies - 127;
- Microfinance companies - 3;
- Pawnshops - 226;
- Exchange bureaus - 385.

Table 3. Loan Portfolio of Non-bank Finance and Credit Institutions

(In millions of soms).

	12/31/2007	6/30/2008	12/31/2008	6/30/2009*
NFCI Loan portfolio**	4 850.3	7 191.0	7384.3	8 329.8

*Preliminary data

**The data are presented excluding the FCSDCU (because the FCSDCU credits are extended to the credit unions).

⁴ Including the deposits of the Government and financial institutions.

Other Financial Institutions

The total number of tenders on trading platforms of three stock exchanges in the 1st half of 2009 contracted by 53.7 percent and totaled Som 1 787.6 million in comparison with the 1st half of 2008. The reduction of the total share trading volume resulted from the reduction in the total volume of transactions on the trading platforms of the Joint-Stock Company “Kyrgyz Stock Exchange” (whose share is 63.2 percent of total transactions) by 63.3 percent to Som 1 130.5 million and the Joint-Stock Company “Central Asian Stock Exchange” by 28.8 percent to Som 519.1 million. The volume of exchange tenders on the trading platform of the Joint-Stock Company “Stock Exchange of Kyrgyzstan – BTC” in the 1st half of 2009 increased 2.7 times to Som 138.0 million in comparison with the similar period of 2008. The basic volume in the total share trading was that of the transactions in the primary market (67.7 percent) that made Som 1 210.2 million.

6 joint-stock investment funds operated on the securities market at the end of the 1st half of 2009, with their share in the area of rendering the financial services remains insignificant: the assets of investment funds remain at the level of 0.02 percent of GDP (based on the outcome of 2008).

19 insurance companies were engaged in insurance activity in the securities market of the republic at end-May 2009, with two of them being the reinsurance companies and 7 having non-resident shareholders. The total assets of insurance organizations were Som 770.6 million for 5 months of 2009, having thus practically doubled in comparison with the similar period of 2008, total own capital was Som 683.4 million, having increased 2.2 times.

The two non-state pension funds are registered now in the market: the NPF “Kyrgyzstan”, engaged in its activity since 1994 and the NPF “Jany Azia”, licensed on May 26th of 2009 and still not operating currently. The size of assets of the Kyrgyzstan NPF at the end of May 2009 was Som 16.6 million, thereby indicating the increase by 7.1 percent for the whole year, and the number of its participants, who concluded contracts of voluntary pension insurance was 2 304 persons (of whom 442 persons get pensions).