

Monetary Policy Report for January to September 2009

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Main Monetary Policy Trends

The Main Monetary Policy Guidelines for 2010 set the primary objective to restrain inflation within 7.5 – 9.5 percent. Declared estimate reflects mainly politically motivated forecast of the Government, which was lower than inflation estimate made by the National Bank. The basis of inflation estimate included suppositions that inflationary pressure in the current year would increase against large-scale measures of budget stimulation for the purpose of supporting economic growth, strengthening social protection of the population, and increasing tariffs for electricity and heat energy.

Political events which took place in April and June 2010 and their consequences introduced significant adjustments in terms, character and direction of the monetary policy. Under the conditions of funds outflow from the banking system and the threat of more deeper stagnation against the background of moderate inflation rates during the first months following April the activity of the National Bank was primarily aimed at providing stability in the banking and financial systems, as well as at stimulating economic growth.

Taking into account decrease in the resource base for economy crediting by the commercial banks, the NBKR significantly decreased the volumes of excess liquidity withdrawal through operations in the open market during the 2nd quarter: the volume of Notes in circulation made Som 200 million as of the end of June compared to Som 1.0 billion as of the end of March. Alongside with it, the volume of loans granted by the National Bank in the 2nd quarter 1.5 times exceeded the volume of loans granted in the 1st quarter. In May, the volume of required reserves was reduced for commercial banks from 9.5 to 8 percent. Base rate for the operation of the Special Fund for Banks Refinancing (SFBR) was decreased from 8 to 7 percent for the purpose of economic growth stimulation. Simultaneously, single adjustment factor was set to the base rate for calculation the volume of interest rate on the SFBR credit funds at the level 1. Thus, the National Bank used wide range of instruments to provide financial sector with liquidity.

In the 3rd quarter, taking into account growth of inflationary pressure and potential significant increase of budget expenditures, in August the NBKR introduced adjustments in the monetary program which stipulated stimulation of operations on money supply sterilization. One of the measures taken by the National Bank in this direction was increase the volume of notes in circulation. Thus, the volume of notes in circulation increased from Som 200 million as of the end of June to Som 335.0 million as of the end of September 2010. The NBKR accounting rate for January-September 2010 increased by 1.9 percentage points to 2.8 percent.

NBKR increased sales volume of noncash US\$ through the foreign exchange sales for the purpose of smoothing of sharp exchange rate fluctuations. Generally, for 9 months of 2010, the volume of net US\$ sales held by the NBKR through the interbank foreign exchange sales totaled US\$ 186 million (in the same period of 2009 – US\$ 144 million). Within January-September 2010, the official US\$ exchange rate against Som increased by 5.8 percent to 46.6377 Som/US\$ (in the same period of 2009 – by 10.7 percent to 43.6293 Som/US\$).

Within January-September 2010, the volume of overnight loans was Som 2.2 million compared to Som 5.8 million in the same period of 2009.

Decrease of GDP volumes was by 0.5 percent in real terms in the real sector of economy (in the same period of 2009 growth of GDP was 1.2 percent), excluding “Kumtor” enterprises the decrease was 1.5 percent. Major contribution into GDP decrease was made by such sectors as trade and agricultural production.

According to the preliminary data for 9 months of 2010, the balance of payment formed as positive at the rate of US\$ 32.5 million, while current account deficit amounted to US\$ 350.8 million. Economy rehabilitation in Russia and Kazakhstan had a positive impact on the volume of money transfers of labor migrants, which increased by 18.2 percent compared to the corresponding index of 2009. The volume of total international reserves was US\$ 1 684.6 million as of the end of the accounting period, thereby covering 4.9 months of future import of goods and services.

Higher inflation rates in our republic, as compared to the indices of the countries – major trade partners, stipulated the index growth of Real Effective Exchange Rate (REER) of the Som by 2.4 percent to 105.4 percent since the beginning of the year.

State budget deficit for 9 months of 2010 was 3.7 percent of GDP, in the same period of 2009 the it made 0.9 percent of GDP.

The actual inflation rate as of the end of September significantly exceeded declared index. Besides the factors included in the forecast, more significant increase of internal prices for foodstuffs, external price shocks, as well as growth of prices for fuel and lubricants due to introduction of export customs duties and growth of prices for oil products in the world markets had an impact on growth of the total prices level. According to the data of the National Statistics Committee the annual inflation rate as of the end of September of the current year was 12.1 percent as compared to 2.1 percent as of the end of September 2009.

Increase of inflationary pressure against slow down of the economy during the last months sets in front of NBKR a difficult task of macroeconomic risks prioritization. It is necessary to define which of two risks, the risks of inflation burst or the risk of economic decline, is more significant from the point of view of objective fulfillment and issues settlement, imposed on NBKR as the central bank of the country. Currently, the issue on suitability and timeliness of measures taken on stimulating economic growth on the one hand, and on the struggle against acceleration of inflationary rates on the other hand is actively debated at the meetings held by the Committee on Monetary Regulation (CMR). All members of CMR noted the need for taking measures on decreasing inflationary pressure; however, there are different points of view on the fact as to how proactive the NBKR activity should be in this respect. Particularly, the last discussions and voting on the issue of changing base rate for SFBR indicated that three members of CMR considered necessary the fact of preserving it at the current level, two members of CMR expressed the opinion on increasing it.

Behavior of Monetary Indicators

Having increased by 7.4 percent from the beginning of the year, the monetary base totaled Som 44 106.5 million at the end of September 2010 (in the same period of 2009 the increase was 4.9 percent).

The increase in the share of cash in circulation from 87.0 percent at the end of 2009 to 90.7 percent at the end of September 2010 was observed in the structure of monetary base. Thus, the share of funds on the correspondent accounts of commercial banks in the National Bank decreased from 13.0 percent to 9.3 percent.

Money outside banks (M0) totaled Som 38 388.7 million at the end of September 2010, having increased since the beginning of the year by 13.3 percent (in the same period of 2009 the decrease was 0.2 percent).

Money supply (M2) was Som 49 387.0 million at the end of September 2010 and increased as compared to the beginning of 2010 by 13.6 percent (in the same period of 2009 the decrease was 0.5 percent) due to increase in the deposits in national currency by 14.5 percent and the increase in money outside banks by 13.3 per cent.

Having increased by 10.1 percent from the beginning of the year, the volume of broad money (M2X) including deposits¹ in foreign currency was Som 62 909.2 million at the end of the accounting period (in the same period of 2009 the increase was 2.3 percent). The total volume of deposits included in the broad money (M2X) grew by 5.5 percent since the beginning of the year due to growth in the deposits in national currency by 14.5 per cent and the decrease in deposits in foreign currency by 0.8 percent.

Velocity of broad money (M2X) including deposits in foreign currency decreased as compared to the beginning of 2010 from 4.2 to 3.6 percent at the end of the accounting period. Thus, the coefficient of economy monetization calculated on the base of money supply M2X increased compared to the beginning of the year from 26.0 percent to 27.4 percent at the end of the accounting period.

¹ According to the data of the analytical balance of banking system include only the deposits of individuals and legal entities, as well as deposits of other financial and crediting institutions, thus excluding the deposits of the Government and non-residents.

Inflation: Outcome and Trends

In the accounting period of 2010, significant increase in the overall price level was observed in the republic compared to the same index of 2009. According to the data of the National Statistics Committee (NSC), growth of the overall price level was 10.3 percent since the beginning of the year, the same index of the last year developed as negative and was -1.7 percent. 12-month index of inflation (September 2010 against September 2009) was 12.1 percent, while for the same period of the last year – 2.1 percent.

The current level of prices was formed under the impact of the following major factors:

- change in prices for major foodstuffs both under the influence of prices in the world markets (wheat, sugar), and due to seasonal factors (for example, fruit and vegetables, meat and dairy products);
- change in tariff policy for electricity and heat energy;
- increase in prices for fuel and lubricants in the domestic market as a result of changing the terms of the fuel and lubricants supply to Kyrgyzstan and growth of world prices (+21.5 percent).

Table 1. Consumer Price Index in the Kyrgyz Republic

	September 2010 r. against			January-September 2010 against January-September 2009
	August 2010	September 2009	September 2009	
Total goods and services	102.9	112.1	110.3	104.9
of which				
Foodstuffs and soft drinks	105.0	114.4	112.2	101.2
Alcoholic and tobacco products	101.1	108.8	108.0	106.6
Nonfoods	101.9	111.4	109.0	110.6
Services	99.9	109.4	109.1	105.8

In annual terms the prices for foodstuffs increased by 14.4 percent based on the outcome of September 2010 (decrease in prices by 5.4 percent was observed in the corresponding period of 2009).

The prices for sugar increased in annual terms by 20.5 percent according to the outcome of September 2010, which, to some extent, is explained by growth in prices for imported goods (+23.4 percent). However, relatively low price for imported product continued restraining its value in the domestic market in the 3rd quarter of 2010. According to the preliminary data of the GCSKR, the average price for imported sugar was US\$ 703 in September of the current year (-5.8 percent by the 2nd quarter of 2010).

Due to high level of import dependence² the increase in prices for imported meat (+27.8 percent) stimulate growth of prices in the domestic market. The prices for meat products in annual terms increased by 15.1 percent as of the end of September, 2010. Based on the outcome of September 2010, increase in prices by 22.4 percent was observed in the oils and fats market. One of reasons for the current prices behavior was continuing increasing in prices for imported products (+8.6 percent) due to low sunflower yield in the major producing countries.

The prices of alcoholic products in annual terms increased by 5.9 percent. In return, the prices for tobacco products increased by 15.8 percent.

12-month growth of the consumer price index of nonfoods was 11.4 percent.

² There is significant difference between the officially registered and actual data in the statistics on meat export. Thus, according to the investigation carried out by NBKR, WB, and SECO “Examination of cross-border trade and goods re-export being not covered by the official statistics”, daily volume of alive cattle export being undocumented 12 times exceeds officially registered volume in value terms, meat export - 4 145 times. Significant volumes of the actual meat export result in increase of the volume of cheaper products being imported. Based on the investigation data, the major volumes of goods are exported to Kazakhstan, while export of meat in the live weight and intended for slaughter is officially prohibited in Kazakhstan.

Export customs duties on oil and oil products exported from Russia to Kazakhstan being introduced since April 1, 2010 increased the impact of the world prices behavior on energy resources and the value of fuel and lubricants in the republic, as growth of the world futures for oil condition increase in export duties, and vice-versa. Thus, annual growth in prices for fuel and lubricants was 31.8 percent in September 2010, prices for petrol increased by 28.1 percent, prices for diesel fuel – by 61.6 percent.

Growth of price index for paid services in annual terms made 9.4 percent (for the same period of 2009 – by 9.5 percent). Growth of prices for education services was 5.2 percent with the beginning of new academic year. Prices for services in the restaurants and hotels increased by 12.9 percent.

Real sector

According to the preliminary results, in January-September 2010 the volume of GDP in the current prices was Som 144 476.8 million, having decreased in comparison with the same index of 2009 by 0.5 percent in real terms, while in January-September 2009 growth of GDP was 1.2 percent. Excluding enterprises developing the gold mining deposit “Kumtor”, the decrease of GDP made 1.5 percent compared to growth of GDP by 1.9 percent based on the outcome of January-September 2009.

Table 2. Contribution of Specific Activities to Growth/Reduction of GDP
(Percent)

	Share in Aug.-Sept. 2009	Share in Jan.-Sept. 2010	Growth rate Jan.-Sept. 2009	Growth rate Jan.-Sept. 2010	Contribution of growth Jan.-Sept. 2010	Changing Deflator Jan.-Sept. 2010
Agriculture	24.2	22.6	4.9	-3.4	-0.8	2.2
Mining	0.6	0.6	3.2	5.9	0.0	-5.2
Manufacturing	10.7	13.4	-12.6	18.1	1.9	11.9
Electricity, gas & water generation & distribution	1.7	2.4	-8.1	11.5	0.2	30.1
Construction	4.9	4.8	-2.9	-3.0	-0.1	6.8
Trade, repairs of vehicle	16.4	15.1	5.3	-8.7	-1.4	6.5
Hotels and restaurants	1.4	1.2	4.8	-13.6	-0.2	3.7
Transport and communication	9.5	9.7	5.7	0.4	0.0	7.4
Other	19.0	19.4	1.5	-0.1	0.0	8.1
Net taxes and products	11.4	10.9	1.2	-0.5	-0.1	2.1
GDP	100.0	100.0	1.2	-0.5	-0.5	6.4

Source: NSC data & NBKR adjustments

In the accounting period, the volume of industrial production increased by 16.7 percent in physical terms compared to January-September 2009 (decline by 11.4 percent was observed in January-September 2009). Excluding enterprises developing the gold mining deposit “Kumtor” the volume of industrial production increased by 15.6 percent in physical volume as compared to the volume of January-September in the previous year, while decrease by 10.8 percent was observed in the same period of 2009.

Significant growth of industrial production is observed in the manufacturing enterprises.

Considerable increase of production is observed in the branch of electricity, gas and water production and distribution as well. Based on the outcome of January-September 2010 the output of this branch increased by 11.5 percent against the decrease by 8.1 percent in January-September 2009.

Within January-September 2010, total output of agricultural products decreased by 3.4 percent in physical volume.

The trend towards decreasing trade operations turnover continued in the accounting period. Based on the outcome of January-September 2010 the decrease of added value in trade made - 8.7 percent against the increase by 5.3 percent in January-September, 2009. The decrease in the trade operations turnover was conditioned both by worsening terms of trading with the countries-major trade partners, and by negative impact of events which took place in the republic.

According to the outcome of the accounting period the level of assimilation of investment capital into the fixed assets decreased by 2.7 percent compared to the same index of 2009, while investments into the fixed assets increased by 9.5 percent based on the outcome of January-September 2009. The decrease in the rates of investments growth into the fixed assets is mainly conditioned by decrease in the volume of investments into the energy industry against completed construction of the Hydro-Electric Power Station “Kambar-Ata-2” and other large projects.

External Economic Sector³

According to the outcome for January-September 2010, current account deficit made US\$ 350.8 million, which corresponds to 8.8 percent of GDP (the same index of 2009 was 6.9 percent).

According to the data of the accounting period, the volume of foreign trade turnover in FOB prices increased by 8.2 percent as compared to the corresponding index in the same period in 2009. Alongside with it, more dynamic growth of export supplies (11.4 percent) compared to growth of import (6.5 percent) had restraining impact on growth of trade deficit; the level of the later remained almost the same in comparison with the same period of 2009 and was US\$ 890.1 million.

Increase in the volumes of foreign exchange receipts on the current transfers was observed in the period under review, this was conditioned by considerable growth of remittances of labor migrants (18.2 percent). As before, the significant volume of cash inflow is received from the CIS countries (more than 94.9 percent), where the largest number of labor migrants from Kyrgyzstan is concentrated. Alongside with it, considerable decrease of money grants inflow was observed in the public sector⁴.

According to the outcome of the accounting period, the capital and financial account developed with surplus at the rate of US\$ 161.1 million, decrease made 57.2 percent compared to the same index of the relevant period in 2009.

According to the outcome of the period under review, the balance of payment developed as positive at the rate of US\$ 32.5 million. The volume of total international reserves as of the end of the accounting period was US\$ 1 684.6 million, thereby covering 4.9 months of future import of goods and services.

According to the preliminary data, the index of Nominal Effective Exchange Rate (NEER) of the Som decreased by 4.9 percent since the beginning of the year and was 118.1 percent as of the end of September 2010. Decrease was conditioned by currencies strengthening of the major trade partners against the Som. Thus, in September 2010 the average exchange rate of the Kazakh Tenge against the Som decreased by 6.9 percent compared to the average exchange rate of December 2009, the Chinese Yuan – by 6.9 percent, the US\$ - by 6.0 percent, the Russian Ruble – by 2.3 percent. The Euro devaluation against the Som by 6.9 percent was observed as well.

Despite exchange rate strengthening of the major trade currencies against the Som, lower inflation rate⁵ in the partner countries had the impact on the Index of Real Effective Exchange Rate (REER) in the increasing direction, thus, smoothing the influence of exchange rate. Thus, the Som REER increased by 2.4 percent since the beginning of the year and was 105.4 percent as of the end of September 2010

Public Finance Sector

According to the Central Treasury of the Ministry of Finance, the state budget deficit in January-September, 2010 was Som 5.4 billion or 3.7 percent of GDP (in January-September 2009 the budget was executed with a deficit at the rate of 0.9 percent of GDP).

In January-September 2010 total state budget revenue from operational activity was Som 40.6 billion or 28.1 percent of GDP. Compared to the previous year, the rates of growth were reduced, amounting to 2.8 percent against 21.8 percent in January-September 2009, and it is in general much lower than the current mid-year level for the recent five years.

Total state budget expenditure for operational activity in January-September 2010 was Som 41.9 billion, having increased by 22.1 percent or by Som 7.6 billion.

According to the functional classification of budget expenditures growth in expenditures was observed by the following groups: social protection (2.1 times), defence, public order and security (by 26.8 percent), economic issues (by 24.1 percent), public health (by 9.6 percent), environmental protection (by 9.6 percent), housing and public utility services (by 4.2 percent), and education (by 3.5

³ Preliminary data.

⁴ It is connected with high level of base period. For reference only: Large volume of funds at the rate of US\$ 150.0 million was granted by the Government of the Russian Federation in 2009.

⁵ The inflation rate in KR within January-September of the current year was 10.3 percent, while, according to preliminary calculations, the average inflation rate in the countries – major trade partners was 2.4 percent.

percent). State budget expenditures were reduced according to the Article “Public Services of General Purpose ” (by 1.6 percent).

A net outflow of budget funds on the operations on purchases of nonfinancial assets (including the operations by the following groups: fixed capital, stocks, and land) was Som 4.0 billion or 2.8 percent of GDP (in January-September 2009 – Som 6.3 billion or 4.6 percent of GDP).

Financial Sector

Banking System⁶

22 commercial banks⁷ and 244 branches of commercial banks operated in the territory of the Kyrgyz Republic as of September 30, 2010⁸.

The loss of the KR banking system in the accounting period amounted to Som 4 205.3 million. 22 commercial banks operated within the same period of 2009, net profit based on the results of their activity was Som 1 144.3 million. Decrease in the level of commercial banks assets by 18.6 % and capital – by 32.9 % was observed as well.

Deposit market was suffered significant changes during the accounting period. Deposit base growth was observed in the system of commercial banks in the 1st quarter of 2010 and made 9.9 percent as of the end of March; the volume of foreign exchanges deposits increased by 11.0 percent, the volume of the deposits in national currency - by 8.0 percent. Deposit base decreased significantly due to the events which took place in April and subsequent deposits outflow from the accounts of non-residents. However, later the situation became stable and deposits growth recovered, although its rates remained low. The volume of deposit base totaled Som 32.8 billion as of the end of September, having decreased by 17.1 percent since the beginning of the year. This decrease was conditioned by reduction in the volume of foreign exchange deposits by 30.9 percent to Som 17.1 billion (excluding changes in the rate of the Som against US\$, the decrease made 34.2 percent), while the volume of deposits in national currency increased by 5.9 percent to Som 15.7 billion. Thus, the level of deposit base dollarization decreased from 61.3 to 52.2 percent as of the end of September.

Within 9 months of 2010, the volume of loan portfolio in the commercial banks increased by 5.0 percent to Som 26.5 billion as of the end of September. This growth was resulted from increase in the volume of credits in the national currency by 21.8 percent to Som 11.6 billion. The volume of credits denominated in foreign currency decreased by 5.3 percent to Som 14.8 billion within the period under review (excluding the impact of US\$ exchange rate development, the decrease was 10.1 percent).

It should be noted that credit market dynamic was multidirectional within the accounting period. Thus, growth in the loan portfolio was observed in the 1st quarter of 2010. Decrease in crediting was observed during the first two months of the 2nd quarter due to increased risks resulted from the events which took place in April. However, activation in the credit activity of banks could be observed by the end of the 2nd quarter. Later the situation in the market steadied and the volume of crediting was increasing during the 3rd quarter.

The average level of banks rates on credits in national currency decreased by 2.7 percentage points and made 24.0 percent, this index in foreign currency made 22.1 percent (- 1.0 percentage points).

Nonbank Finance and Credit Institutions⁹ *Licensed by NBKR*

The system of nonbank finance and credit institutions of the Kyrgyz Republic had 934 nonbank institutions¹⁰ at the end of June 2010 (at the end of September 2009 the number of nonbank institutions was 1 192):

⁶ Data are submitted taking into account changes in AUB balance, conditioned by adjusting its balance to the actual financial situation.

⁷ Since May 31, 2009, the Open Joint-Stock Company IJSCB “Akyl” was involved in the banking system of the Kyrgyz Republic; the license of which was revalidated and issued on February 27, 2009 due to rehabilitation.

⁸ The data were submitted according to the regulatory reporting of commercial banks.

⁹ Pawnshops licensing was ceased since September 8, 2009.

- FCSDCU – 1
- Special Fund for Banks Refinancing (SFBR) – 1
- Microfinance organizations – 385
- Credit unions – 225
- Exchange bureaus – 322.

Other Financial Institutions

The total volume of tenders on trading platforms of three stock exchanges was Som 1 027.7 million in January-September 2010, having decreased by contrast to the given parameter by 70.3 percent for the relevant period of 2009. The decline in the volume of tenders was noted with regard to all of the trading platforms: the volume of transactions on the trading platform of the Closed Joint-Stock Company “Kyrgyz Stock Exchange” was reduced by 2.3 percent to Som 375.7 million, at the Closed Joint-Stock Company “Central Asian Stock Exchange”¹¹ – by 55.8 percent to Som 392.6 million and the volume of transactions on the trading platform of the of the Closed Joint-Stock Company “Stock Exchange in Kyrgyzstan – BTS” was reduced by 42.8 percent and was Som 259.4 million.

19 insurance organizations, of which two reinsurance organizations, as well as 7 companies with participation of non-residents, operated in the republic as of October 1st, 2010. Total assets of insurance organizations were Som 846.0 million as of the end of August, 2010, having decreased in comparison with the beginning of the year by 2.3 percent, ownership capital decreased by 4.7 percent to Som 675.3 million.

Currently, there are two non-public pension funds in the Kyrgyz Republic: the NPF “Kyrgyzstan” and the NPF “Jany Azia” (that got a 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 September, 2010 was Som 25.3 million, having thus increased for ten months of the current year by 15.7 percent, the volume of their aggregate capital was Som 7.3 million, having increased by 45.7 percent.

¹⁰ Without regard to pawnshops, as it licensing was ceased on September 8th 2009.

¹¹ Data are submitted as of April 2nd, 2010.