



**National Bank
of the Kyrgyz Republic**

**THE FINANCIAL SECTOR
STABILITY REPORT OF THE
KYRGYZ REPUBLIC**

December 2014

Bishkek

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This publication is released 2 times in a year – in June and December. It is published in three languages: Kyrgyz, Russian and English.

Other publications of the National Bank of the Kyrgyz Republic

Annual Report of the National Bank of the Kyrgyz Republic

This document is an overall report of the National Bank of Kyrgyz Republic (NBKR) for the last year. It contains summary on economic development of the republic and monetary policy, as well as the National Bank financial statements, general information about the NBKR, statistical annexes. It is published in three languages: Kyrgyz, Russian and English.

Bulletin of the National Bank of the Kyrgyz Republic

This monthly informational publication includes statistical data on the basic macroeconomic indicators and economy sectors of the Kyrgyz Republic. It is published in three languages: Kyrgyz, Russian and English.

Balance of Payments of the Kyrgyz Republic

“The Balance of Payments of the Kyrgyz Republic” reflects development trend of the external sector and information about the balance of payment, foreign trade, international reserves, foreign debt and the international position of the Kyrgyz Republic. It is published quarterly in January, May, July and October in Kyrgyz, Russian and English.

Monetary Policy Report (Inflation Report in Kyrgyz Republic)

The purpose of this publication is to provide the public at large with regular information about the objectives and results of monetary policy. This publication contains analysis of environment and macroeconomic situation development in the country, including monetary policy and dynamics of consumer price index, as well as medium-term forecasts for development of the countries-major trading partners, for development of real and external sectors of economy, inflation. It is published quarterly in electronic format in Kyrgyz, Russian and English.

Press-Release of the National Bank of the Kyrgyz Republic

«Press-release of the National Bank» describes current events related to the NBKR and the banking system, the major data on the financial market per a week and other information for mass media, legal entities and individuals. It is published weekly in Kyrgyz and Russian languages.

Statutory Acts of the National Bank of the Kyrgyz Republic

The purpose of the document is to publish statutory acts of the National Bank officially in order to provide commercial banks and public with statutory acts and official information on the National Bank activity, as well as propaganda of the Kyrgyz Republic banking legislation. Presumable publication frequency is once a month in Kyrgyz and Russian languages.

Content

Preamble	5
Major conclusions	7
I. Macroeconomic and Financial Environment	8
1.1. Macroeconomic Conditions and Risks.....	8
1.2. Structure of the Financial Sector.....	12
1.3. Status of the Financial Markets.....	14
1.3.1. Status of the Currency and Money Market	14
1.3.2. Status of the Securities Market	15
1.4. Real Estate Market	16
II. Banking Sector	22
2.1. Major Trends.....	22
2.2. Banking Sector Risks.....	28
2.2.1. Credit risk.....	28
2.2.2. Liquidity Risk.....	35
2.2.3. Risk of Concentration.....	39
2.2.4. Currency Risk.....	39
2.2.5. Interest Risk.....	40
2.2.6. Risk of “Contagion”.....	41
2.2.7. Country Risk.....	41
2.3. “Reverse” Stress Testing of the Banking Sector	43
2.3.1. “Reverse” Stress Testing of Credit Risk	43
2.3.2. “Reverse” Stress Testing of the Liquidity Risk.....	44
2.3.3. “Reverse” Stress Testing of the Market Risk.....	44
III. Non-bank Financial Institutions	46
3.1. Main Trends.....	46
3.2. Risks of Non-bank Financial Institutions.....	49
3.3. Stress Testing of the NBFIs System.....	52
IV. Payment Systems	54
V. Improvement of the Regulation over the Financial Sector	57
Financial Soundness Indicators of the Kyrgyz Republic	59
Glossary and Abbreviations	60

PREAMBLE

National Bank of the Kyrgyz Republic has been publishing the Financial Sector Stability Report of the Kyrgyz Republic since 2012. The objective of the report is to inform the public of the general assessment on the stability and sustainability of the financial system of the Kyrgyz Republic.

Financial stability in this publication means smooth and uninterrupted operation of financial institutions, financial markets and payment systems enabling to perform functions of the financial intermediation even in conditions of financial imbalances and shocks.

Results of the monitoring and analysis of financial stability are considered by the National Bank in forming main directions of the NBKR monetary policy, regulating the banking activity and development of the strategy for financial and credit institutions of the Kyrgyz Republic.

The Financial Sector Stability Report of the Kyrgyz Republic is oriented to financial market participants and the audience interested in the issues of financial stability.

List of boxes

Box 1. Housing affordability index.....	19
Box 2. Stress testing of impact from change in prices in the real estate market on the banking sector	20
Box 3. Results of the survey of the clients of commercial banks.....	33
Box 4. Assessment of “irreducible” (stable) level of demand deposits during the period of 2010 – 9 months of 2014 (“irreducible” balance of deposits)	37
Box 5. Assessment of NBFIs system activity on the basis of concentration indices.....	50
Box 6. Overview of interest rates, net cost and profitability of the NBFIs loans.....	51

MAJOR CONCLUSIONS

On the basis of the results of nine months of 2014, the results of macro prudential analysis, econometric modeling, as well as direct and “reverse” stress tests indicate that the financial sector of the Kyrgyz Republic is evaluated as sustainable and the financial strength is sufficient to withstand certain shocks.

Slowdown of economic growth is observed on the background of existing macroeconomic risks, weak diversification and dependence of the Kyrgyz Republic economy on external factors. Banks obligations to non-residents increased due to a growth in the share of foreign borrowings from Kazakhstan and OECD countries compared to 2013 (the share of the Kyrgyz Republic banks obligations to non-residents increased from 15.0% to 17.9%). The share of placed banks assets of the Russian Federation residents decreased from 4.0 percent to 1.9 percent. Meanwhile, country risk still remains moderate for the banking sector.

The risks related to geopolitical situation in the region can affect the banking sector indirectly through potential deterioration of the macroeconomic environment in the Kyrgyz Republic, particularly, due to possible deterioration in the financial position of the banks clients in the Kyrgyz Republic connected with external economic activity of the Russian Federation residents.

Volatility of the national currency exchange rate did not influence significantly on the stability of the Kyrgyz banking sector in the reporting period. Results of macro-prudential analysis indicate that the national currency weakening observed in the reporting period, besides some increase in the level of dollarization, did not affect significantly on the sustainability of the banking sector. Moreover, stress tests indicate that some banks have become more vulnerable to indirect foreign exchange risk due to possible failure of borrowers to serve loans in the foreign currency. Preservation of current trends can result in further increase of risks.

Decline in stocks of financial strength of the banking sector in the Kyrgyz Republic is observed on the background of active growth of lending to the economy. The results of financial modelling and “reverse” stress tests indicate to a slight decline in stocks of financial strength at the end of 9 months of 2014 compared with the same period of 2013 due to significant growth of lending to the economy and increase of risks in the banking sector of the Kyrgyz Republic.

Slowdown of increase in prices for real estate, as well as slowdown of growth in lending to mortgage services and construction carried out by the banking sector, was observed in the real estate market at the end of 9 months of 2014. The results of stress tests carried out in the commercial banks indicate that the banking sector possesses potential capability to withstand decline in prices for real estate approximately by 28 percent.

According to the results of the reporting period, the payment systems of the Kyrgyz Republic operated normally, the level of system risks in the financial infrastructure was assessed as moderate.

I. MACROECONOMIC AND FINANCIAL ENVIRONMENT

1.1. Macroeconomic Conditions and Risks

Taking into account remained inflation risks, the National Bank carried out monetary policy focused on restriction of inflation monetary component.

Moreover, macroeconomic risks remain due to weak diversification and dependence of economy on external pricing environment and demand.

Gross Domestic Product¹

Slowdown of economic growth, observed since the beginning of the year, continues. At the end of nine months of 2014, GDP growth made 3.0 percent (GDP, excluding companies for the development of gold deposit “Kumtor”, increased by 2.7 percent), meanwhile, GDP growth made 8.9 percent for the same period of the last year (excluding companies for the development of gold deposit “Kumtor”, GDP increased by 5.8 percent). Economic growth is supported by positive contribution into GDP growth from the sector of services (1.3 p.p.), construction (0.9 p.p.) and industry (0.7 p.p.).

Increase in the volumes of industrial output in January-September 2014 by 5.0 percent against the same period of 2013 was due to production growth in all sectors except for mineral resource industry (-7.2 percent). In the structure of manufacturing industry significant growth was observed in production of refined oil products (79.4 percent), food products (including beverages) and tobacco products (9.3 percent), base metals and finished metal products (7.3 percent).

Continuous growth of sustainable activity was observed in the sector of construction in the reviewed period. Growth in this sector made 14.3 percent primarily due to increase in the volumes of performed construction contract works, overhaul and current repairs of buildings and structures.

In the sphere of services, increase was at the level of 2.7 percent due to increase in the sector of trade – by 5.1 percent and information and communication – by 4.1 percent.

In agriculture, decrease made 2.2 percent, which is generally resulted from reduction in crop production output due to unfavorable climate conditions in 2014.

¹ Data on GDP for 9 months of 2014 are preliminary.

Table 1.1.1. The contribution of individual activities in GDP

percent

	January-September					
	2013			2014		
	Share, percent	Growth rate, percent	Contribution in growth, percent points	Share, percent	Growth rate, percent	Contribution in growth, percent points
GDP	100.0	8.9	8.9	100.0	3.0	3.0
Agriculture, forestry and fishery	17.5	3.2	0.6	17.6	-2.2	-0.4
Industry	13.8	25.0	3.5	13.0	5.0	0.7
<i>Mining</i>	0.7	-1.2	-0.01	0.6	-7.2	-0.1
<i>Processing sectors (Processing industry)</i>	11.0	34.9	3.6	10.3	5.4	0.6
<i>Provision (supply) of electric energy, gas, steam and conditioned air</i>	2.0	-3.3	-0.1	1.8	7.2	0.1
<i>Water supply, waste treatment and processing, receipt of recyclable materials</i>	0.2	10.9	0.03	0.2	7.0	0.01
Construction	6.6	16.9	1.0	7.3	14.3	0.9
Wholesale and retail trade; repair of cars and motor-cycles	15.2	7.8	1.2	15.7	5.1	0.8
Transportation activity and storage of cargo	4.9	5.7	0.3	5.2	1.9	0.1
Information and communication	5.3	17.9	0.9	5.1	4.1	0.2
Other	22.0	1.0	0.2	21.9	0.8	0.2
<i>Activity of hotels and restaurants</i>	1.4	12.3	0.2	1.5	7.5	0.1
<i>Financial intermediation and insurance</i>	0.5	4.2	0.02	0.4	-0.6	-0.003
<i>Operations with real estate</i>	2.3	-0.5	-0.01	2.3	3.3	0.07
<i>Professional, scientific and technical activity</i>	1.6	-2.3	-0.04	1.8	0.6	0.01
<i>Administrative and auxiliary activity</i>	0.4	-0.1	-0.0003	0.3	5.7	0.02
<i>State administration and defence; obligatory social security</i>	5.3	-1.4	-0.1	5.6	-2.7	-0.2
<i>Education</i>	5.5	0.9	0.1	5.1	1.8	0.1
<i>Healthcare and social servicing of population</i>	3.5	2.4	0.1	3.2	0.5	0.02
<i>Art, entertainment and rest</i>	0.6	0.7	0.004	0.6	2.4	0.01
<i>Other servicing activity</i>	1.1	3.0	0.03	1.0	-0.7	-0.007
Net (exclusive of subsidies) taxes on products	14.6	8.9	1.2	14.3	3.0	0.4

Source: NSC KR

Slowdown of economic growth was observed since the beginning of the current year. This trend in economy is conditioned by the factor of high GDP base in the last year primarily due to rehabilitation of production at the companies on the development of the gold deposit “Kumtor”, negative growth rates in the agriculture and slowdown in growth of services in the current year.

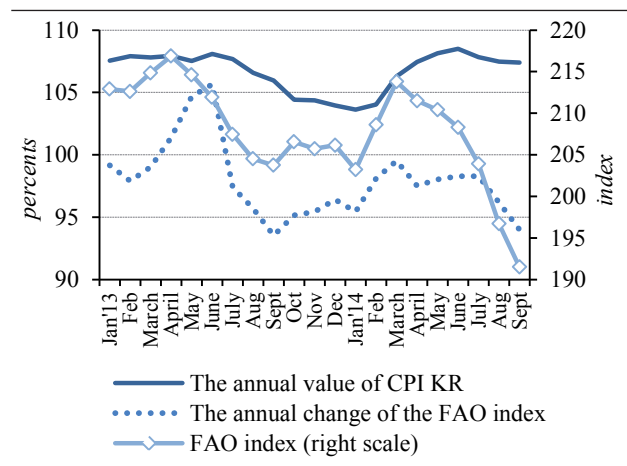
Further economic growth will also be affected by weakening of external environment represented by slowdown of business activity in the countries-major trading partners. Expected slowdown in growth rates of money transfers, reduction in volumes of exported goods and preservation of this trend will have positive effect on the economy of the Kyrgyz Republic in 2014.

Inflation

In January-September 2014, inflationary background in Kyrgyzstan was formed as a result of impact from external and internal factors. At the beginning of the year, acceleration of inflationary processes occurred primarily due to impact of external shocks conditioned by the effect of the U.S. dollar

strengthening, which resulted in increase in prices for imported goods (sugar, bakery products and POL). In the second quarter of 2014, on the background of seasonal factor and late incoming of spring, expressed upward dynamics of price index for fruits, vegetables and bakery products was generally observed in the republic. In July-September 2014, inflation was formed under the influence of prices growth for POL due to increase in selling price in Russia, as well as tariffs and strengthening the U.S. dollar. At the end of January-September 2014 (September 2014 against December 2013), inflation was 5.0 percent (the same indicator in 2013 was 1.6 percent). According to the data of the NSC KR, in September 2014, annual value of inflation constituted 7.4 percent and the annual value of core inflation was at the level of 7.6 percent.

Chart 1.1.1. The dynamics of CPI KR and the FAO index



At the beginning of 2014, the prices in the world food markets were characterized by the upward trend due to unfavorable weather conditions for some crops. However, since the second quarter of 2014, prices for major types of food products started decreasing on the background of sufficient reserves and improved world forecasts for production in 2014-2015 MY. The average value of FAO Food Price Index constituted 205.3 points in January-September 2014, which is by 2.7 percent lower compared with the index of the same period in 2013. Volatile dynamics in the FAO Food Price Index, which reflects changes in the world prices and inflation in our country, is primarily conditioned by decrease in the volumes

of agricultural output in the republic due to unfavorable weather conditions and influence of the national currency devaluation rates on the domestic prices.

State budget

According to the Central Treasury of the Ministry of Finance of the Kyrgyz Republic, state budget surplus at the end of 9 months of 2014 amounted to KGS 1.4 billion or 0.5 percent to GDP² (at the end of January-September 2013 the budget was executed with deficit of KGS 10.4 million or 0.004 percent to GDP). Total financing of the budget was carried out entirely by external sources in the amount of KGS 15.2 billion (5.7 percent to GDP), while in the internal sources negative balance was formed in the amount of KGS 3.5 billion.

Comparable methodologies applied in calculations reflect significant difference between budget revenues and spending in January-September 2014, which, according to the NBKR estimates, amounted to KGS 9.3 billion or 3.5 percent to GDP. Meanwhile, partial loss of tax revenues was compensated by means of increase in non-tax revenues and official transfers, which contributed to plan execution on budget revenues to the full extent.

Macroeconomic risks

Enterprises on the development of gold deposit of “Kumtor” still occupy significant share in the structure of GDP. Moreover, external factors also have significant influence on the dynamics of economic development of the country.

² According to the recommendations of the Accounting Chamber as a result of the audit of the report on execution of the republican budget for 2012, the Ministry of Finance made amendments to the Programme of State Investments in part of re-credited funds which were registered not as expenses from September 2013 but as financial assets and accordingly be reflected in the sources of budget deficit coverage (source: Rationale to the draft Decree of the Government of the Kyrgyz Republic ‘On the draft Law “On amendments to the Law of the Kyrgyz Republic “On the republican budget of the Kyrgyz Republic for 2013 and forecasts for 2014-2015”’).

Slowdown of economic growth was observed in the countries-major trading partners. Concerns regarding decline in prices for oil and increase in capital outflow from Russia strengthened after aggravation of geopolitical relations between Russia and Western countries. Closure of the US quantitative easing program continues influencing stability of the national currency in many countries. Taking into account the dependence on import of the Kyrgyz economy, the dynamics of the U.S. dollar in world currency markets and in the countries-major trading partners creates some risk of inflation in the country.

The country is still significantly dependent on the environment of the world food markets, which increases vulnerability of domestic economy and creates risks for price stability in the Kyrgyz Republic. Despite the current stability of the world food markets, unfavorable weather conditions and escalation of conflicts in separate regions of the world are likely to have negative effect on production of agricultural crops and, in general, on dynamics of world prices for food and raw materials, which will afterwards influence directly on domestic prices.

Moreover, inflationary processes in the Kyrgyz Republic will depend on the degree of influence of non-monetary factors (phased increase of tariffs for public utility services, inflation expectations of the population, when joining the Customs Union, as well as unfavorable situation in the agriculture of the country observed in the current year).

More than half of all state budget revenues are provided at the expense of taxation of foreign economic activity that directly depends on the terms of trade with other countries. Change of trading conditions with the countries-major trading partners may lead to increased risk of formation of budget revenues, strengthened inflationary pressure and increase in prices.

It is expected that in 2014-2015 financing of budget will be carried out at the expense of external receipts.

1.2. Structure of the Financial Sector

Institutional structure of the financial sector in Kyrgyzstan is represented by commercial banks and other financial companies (non-bank financial institutions, insurance companies and investment and pension funds, stock exchanges).

Table 1.2.1. Institutional structure of the financial sector
(number of the financial institutions)

Financial institutions	2009	2010	2011	2012	2013	30.09.2014
Commercial banks	22	22	22	23	24	24
Other financial companies, including:	1234	936	958	837	794	726
<i>Non-bank financial institutions (NBFI), including:</i>	1203	906	931	810	765	697
Financial organizations, including:	359	397	454	320	277	225
micro-crediting companies	226	266	340	242	208	164
micro-crediting agencies	129	127	110	74	65	57
micro-financial companies	4	4	4	4	4	4
LLC "SFRB"	1	1	-	-	-	-
CJSC "Development Fund"	1	-	-	-	-	-
OJSC "FCCU"	1	1	1	1	1	1
Credit unions	238	217	197	183	153	139
Exchange offices	372	290	279	306	334	332
<i>Insurance companies</i>	19	19	16	16	18	18
<i>Investments funds</i>	6	6	8	8	8	8
<i>Stock exchanges</i>	3	2	1	1	1	1
<i>Pension funds</i>	3	3	2	2	2	2

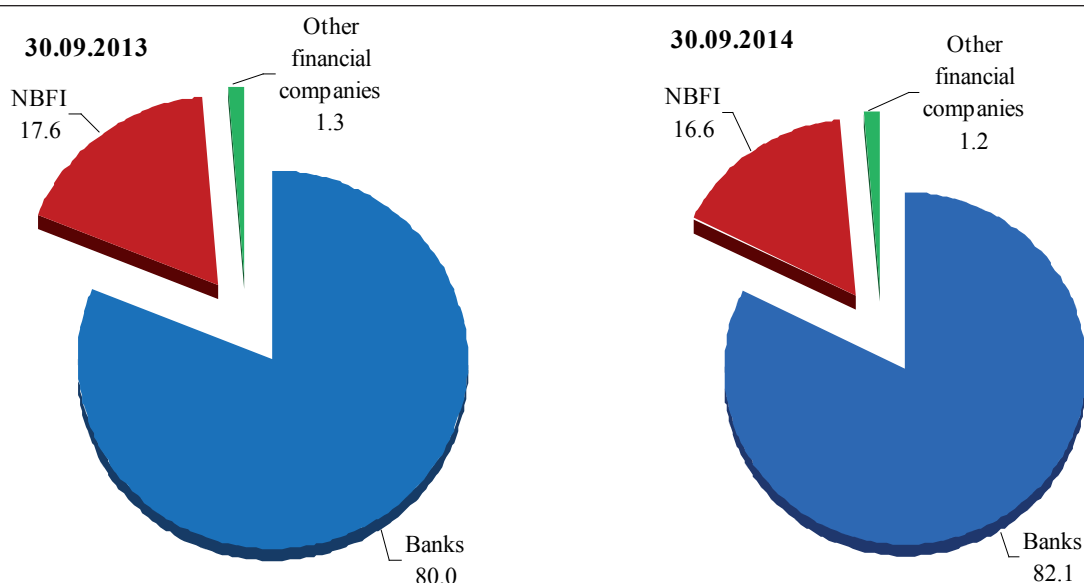
Source: NBKR, NSC KR

As of September 30, 2014, assets of the financial sector constituted KGS 157.3 billion, an increase compared with the same period of 2013 was KGS 27.5 billion.

The banking sector's share in the total assets of the financial sector constituted 82.1 percent. The share of NBFI and other financial companies accounted for 16.6 percent and 1.2 percent, respectively (Chart 1.2.1).

Chart 1.2.1. Institutional structure of the financial sector assets of Kyrgyzstan

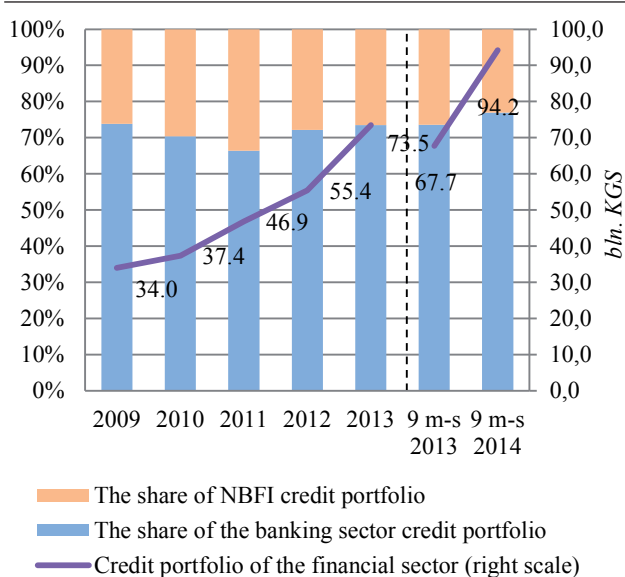
percent



Source: NBKR

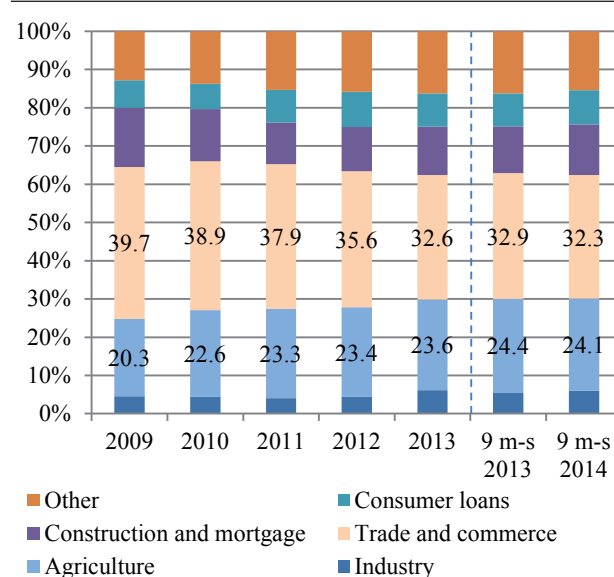
The total credit portfolio of banks and NBFIs for 9 months in 2014 increased by 39.1 percent compared with the same period of 2013 and amounted to KGS 94.2 billion. The share of bank loans in the credit portfolio of the financial sector increased by 3.4 p.p. and as of September 30, 2014 constituted 77.0 percent (Chart 1.2.2).

Chart 1.2.2. The structure of the credit portfolio



Source: NBKR

Chart 1.2.3. The sectoral structure of the credit portfolio



Source: NBKR

The concentration was still observed in the trading industry (banks) and agriculture (NBFI) within the sectoral structure of the credit portfolio of the financial sector. The aggregate share of the credit portfolio of the financial sector in the above-noted sectors of the economy at the end of 2013 constituted 56.4 percent of total issued loans (Chart 1.2.3) or KGS 53.4 billion.

1.3. Status of the Financial Markets

The situation in the domestic foreign exchange market remained relatively volatile. The NBKR carried out interventions in order to smooth out exchange rate jumps.

The market of interbank borrowings was characterized by increase of activity against decrease of a daily average indicator of excess reserves of the commercial banks. In general, the interbank market functioned sustainably, ensuring redistribution of liquidity among commercial banks.

Securities market represented by the state treasury bills and bonds issued by the Ministry of Finance of the Kyrgyz Republic varied in different directions.

1.3.1. Status of the Currency and Money Market

Currency market

The exchange rate of the US dollar was increasing in the currency market of the Kyrgyz Republic during nine months of 2014. It was conditioned by internal and external factors. The internal factors are increase of demand for foreign currency, slowdown in growth rates of export and money transfer inflows. Global strengthening of the US dollar, slowdown of economic growth rates in Russia (major trading partner), significant changes of the Russian ruble and Kazakh tenge exchange rates were regarded as external factors.

According to the results of the reviewed period the official exchange rate of the US dollar increased since the beginning of the year by 10.7 percent, from 49.1894 to 54.5202 KGS/USD.

In the reporting period, the effect of external shocks and speculative pressure was compensated by interventions and measures of the NBKR, which restricted sharp fluctuations of the national currency exchange rate.

Export operations and remittances to the country remained the main sources of foreign exchange inflow. The main currency of external trade remained the US dollar.

In the reviewed period, the National Bank carried out foreign exchange market interventions on selling of the US dollar to the amount of USD 311.4 million and purchase of foreign currency to the amount of USD 20.5 million in order to smooth out sharp fluctuations of the US dollar exchange rate. The volume of bank operations on purchase and sale of foreign currency in the domestic market amounted to KGS 420.6 billion, having increased by 57.7 percent compared with the same indicator of 2013.

The total amount of swap operations performed in the domestic market, as well as with non-resident banks reached KGS 10.8 billion having increased by 4.7 times compared with the same indicator of 2013.

Money market

The situation in the interbank borrowings market was characterized by increased activity in acquisition of loans on repo terms compared with the same period of 2013 against decrease of the daily average volume of excess reserves of commercial banks up to KGS 1.1 billion. The activity of commercial banks increased in the interbank market of credit resources due to change in the basis of carrying out monetary policy. Demand for liquidity was mainly due to uneven distribution of excess reserves in the banking sector between the market participants. Overall, the market functioned stably, ensuring redistribution of liquidity among commercial banks at the expense of inter-bank transactions.

The total volume of transactions made in the interbank credit market in January-September 2014 amounted to KGS 39.3 billion, an increase by 5 times against the same indicator of 2013. The main part of committed transactions still accounted for repo transactions. Besides, the volume of transactions in the national currency on standard credit terms decreased (up to KGS 443.4 billion).

The NBKR continued improving monetary policy instruments, additional instruments on liquidity management, particularly overnight deposits, were introduced.

Significant increase of demand for overnight loans from the commercial banks was observed in the reviewed period. The volume of these loans aimed at support of short-term liquidity in the national currency increased by 6.6 times, up to KGS 51.0 billion compared with 2013 (average weighted interest rate – 8.5 percent).

In addition to providing interbank loans in the domestic market, some banks conducted operations with non-resident banks. The total volume of transactions with non-resident banks committed in the reviewed period increased by 2 times up to KGS 15.7 billion (KGS 7.7 billion in 2013).

1.3.2. Status of the Securities Market

Securities market represented by the state treasury bills and bonds, issued by the Ministry of Finance of the Kyrgyz Republic changed in different directions according to the indicators of volumes and profitability dynamics.

The state treasury bills market consisted of 3-, 6- and 12-month securities, the total volume of supply decreased up to KGS 4.1 billion (-10.4 percent), sales on this segment decreased up to KGS 2.3 billion (-48.3 percent). Finally, the weighted average revenue of these securities increased by 0.4 percentage points, up to 8.9 percent.

2- and 5-year state treasury bonds were issued in the reviewed period. The total volume of issued ST-Bonds constituted KGS 3.3 billion, an increase by 2.4 times compared to the indicator for the same period of 2013. Thus, the total weighted average revenue decreased up to 14.2 percent.

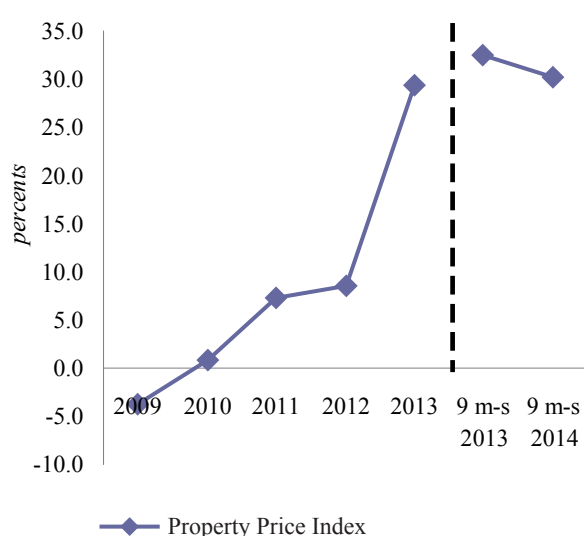
1.4. Real Estate Market

The real estate market experienced slowdown of the price index growth rates³, including slowdown in growth of prices for detached houses (slowdown by 60.8 p.p.) and flats (slowdown by 12.5 p.p.).

Ongoing increase in real estate prices influenced the deterioration of housing affordability index, characterizing the deterioration with self-sustainment of affordable real estate.

Risks to the financial sector from the real estate market remain moderate due underdeveloped mortgage credit lending⁴.

Chart 1.4.1. Price index growth rate in the real estate market



At the end of 9 months of 2014, a decrease in growth rate of property price index compared with 2013 was observed in Kyrgyzstan (Chart 1.4.1).

Source: SRS KR

As of September 30, 2014, by the end of 2013 the price growth rates for 1 square meter of housing (flat) in Bishkek and Osh constituted 14.9 percent and 29.3 percent, respectively, compared with 2013 (Chart 1.4.2). By the end of 2013 the average price of 1 square meter of detached houses in Bishkek and Osh grew by 8.5 percent and 63.9 percent, respectively (Chart 1.4.3).

³ Laspeyres index method was used in developing the index of real estate price. In general, the Laspeyres index is computed as follows:

$$L = \left(\frac{\sum_{i=1}^K Q_{oi} P_{ti}}{\sum_{i=1}^K Q_{oi} P_{oi}} \right) * 100,$$

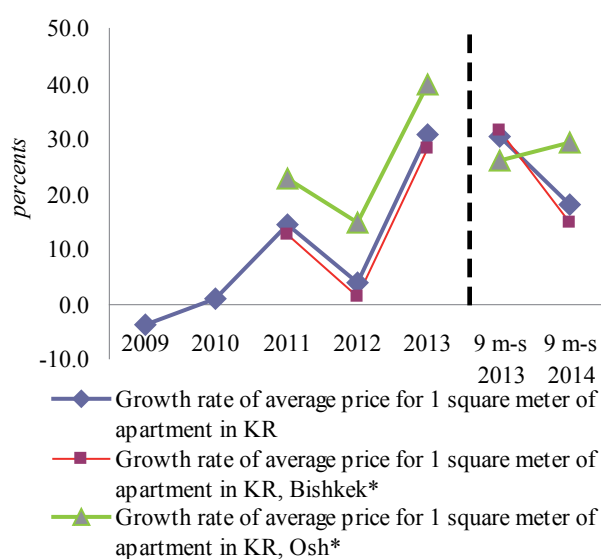
where K = number of type of real estate;

Q_{oi} = number of real estate of type i in the base period;

P_{oi} = price of real estate of type i in the base period;

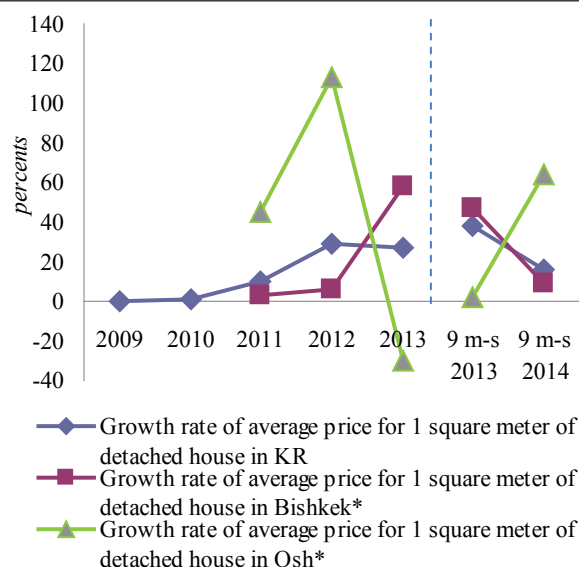
P_{ti} = price of the real estate of type i in the current period.

⁴ In conditions of the Kyrgyz Republic, mortgage credit lending means, as a rule, a long term credit provided under the collateral for the real estate property right.

Chart 1.4.2. Dynamics of change in prices for flats


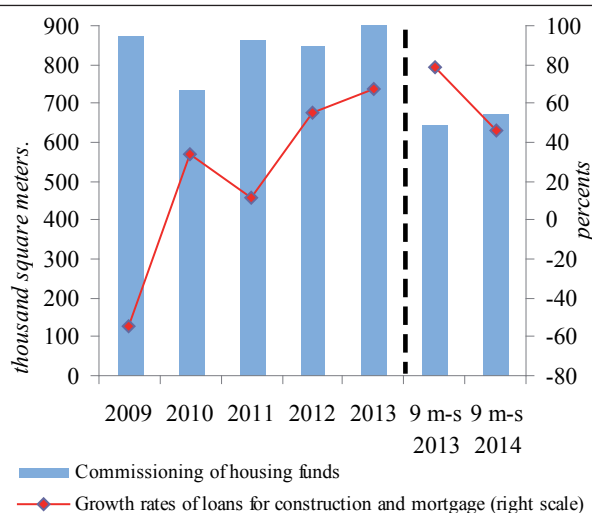
Source: SRS GKR, NSC KR, NBKR calculations

*data on Bishkek and Osh cities up to 2010 are not available

Chart 1.4.3. Dynamics of change in prices for detached houses


Source: SRS GKR, NSC KR, NBKR calculations

*data on Bishkek and Osh cities up to 2010 are not available

Chart 1.4.4. Dynamics of housing commissioning and provided loans for construction and mortgage


Source: SRS GKR, NSC KR, NBKR calculations

Note: data for the reporting period

At the end of 9 months of 2014, the increase in the aggregate level of commissioning of housing funds constituted 4.4 percent compared with 2013 (Chart 1.4.4).

The main share of commissioned housing accounted for Bishkek, Chui oblast and Osh city of Osh oblast (Table 1.4.1).

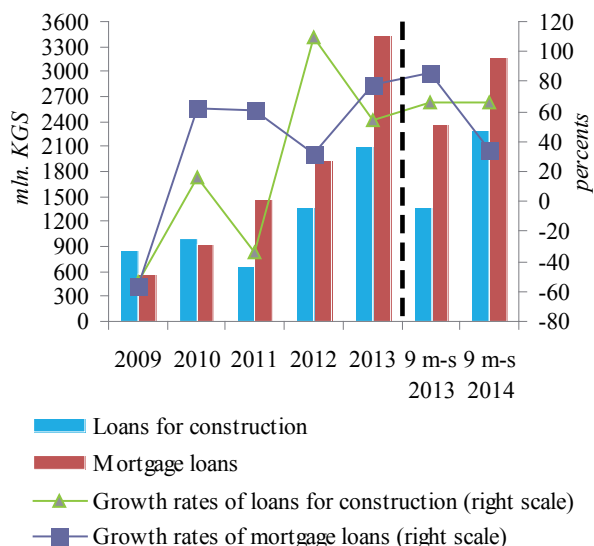
Table 1.4.1. Geographic structure of commissioned housing

	Sept. 13		Sept. 14	
	Total commissioned area thous. sq.m	Share of total area, %	Total commissioned area thous. sq.m	Share of total area, %
Bishkek city and Chui oblast	309.5	47.9	253.0	37.5
Osh city and Osh oblast	157.5	24.4	137.1	20.3
Other oblasts of KR	179.8	27.8	285.4	42.3
Total	646.8	100	675.5	100

Source: NSC KR

In the reporting period, the volume of mortgage loans and loans to finance the construction rose by 34.4 and 66.3 percent, respectively, compared with the same period of 2013 and constituted KGS 5.5 billion (Chart 1.4.5).

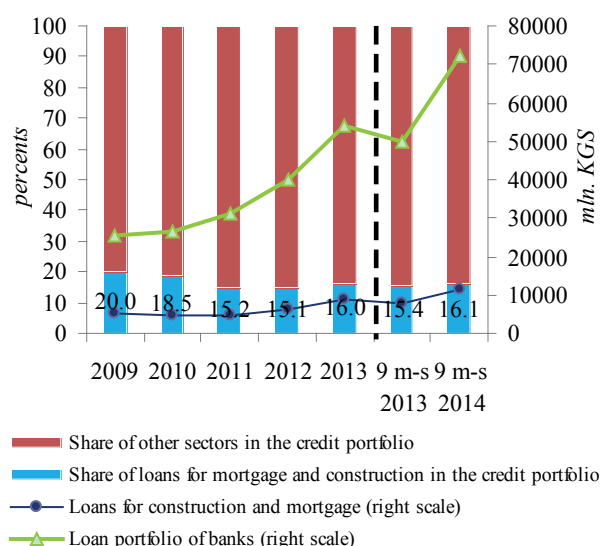
Chart 1.4.5. Loans provided for construction and mortgage



Source: NBKR

Note: data for the reporting period

Chart 1.4.6. Total share of loans for mortgage and construction in the credit portfolio of commercial banks

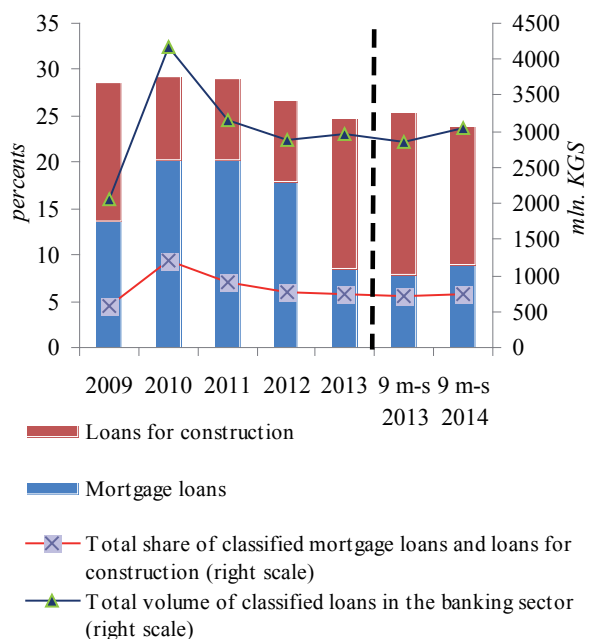


Source: NBKR

Note: data for the reporting period

As of September 30, 2014, total loans for mortgages and construction grew by 51.0 percent compared with 2013, amounting to KGS 11.7 billion or 16.1 percent of the total credit portfolio of commercial banks (increase by 0.7 p.p. compared with 2013, Chart 1.4.6).

Chart 1.4.7. Dynamics of classified loans for mortgage and financing of construction



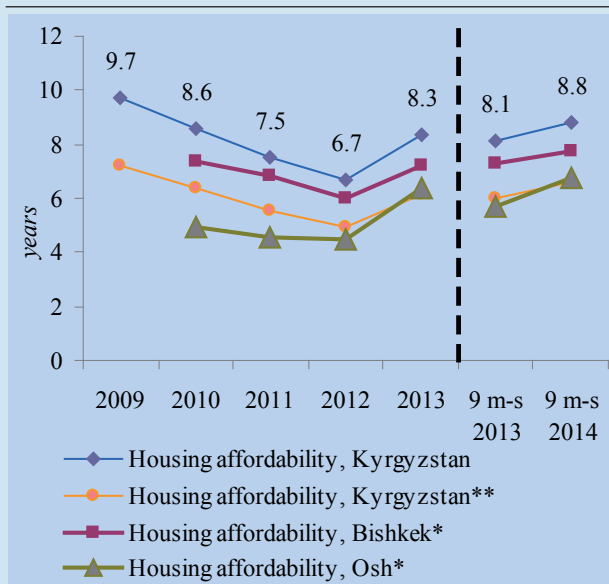
Source: NBKR

As of September 30, 2014, the share of total gross troubled mortgage and construction loans in total classified loans increased by 0.9 p.p. compared with 2013 and amounted to 24.0 percent or KGS 730.0 million (increase by KGS 6.8 million, Chart 1.4.7).

Box 1. Housing affordability index

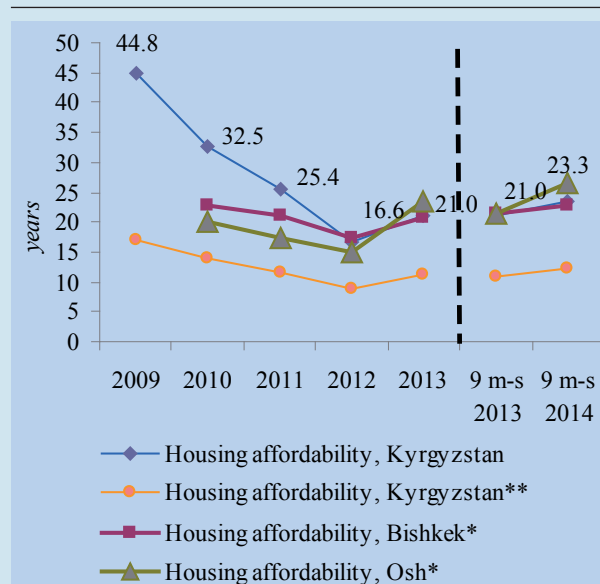
As of September 30, 2014, the situation with housing affordability in the Kyrgyz Republic deteriorated (index value increased by 0.7 years) compared with the same period of 2013. This is due to growth in property prices over the growth rates of average wages (Chart 1.4.8).

Chart 1.4.8. Housing (flats) affordability index without minimal consumer budget



Sources: NSC KR, NBKR calculations
 * data up to 2010 on Bishkek and Osh are not available
 ** including non-registered income

Chart 1.4.9. Housing (flats) affordability index including minimal consumer budget



Sources: NSC KR, NBKR calculations
 * data up to 2010 on Bishkek and Osh are not available
 ** including non-registered income

According to the results of 9 months of 2014, to acquire an apartment of 54 square meters in Kyrgyzstan one should save all wages for 8.8 years (including unrecorded income⁵ – 6.6 years).

By the end of the reporting period, a family in Kyrgyzstan with the minimum consumer budget of 14875.1 KGS (62.2 percent of total family income) will need 23.3 years (including unrecorded revenues – 12.3 years, Chart 1.4.9) in order to procure housing.

⁵ According to the conclusions of the Working Group on the research of the black economy of the Kyrgyz Republic, the level of shadow income of the population constituted around 35 percent of the wages fund. This research was held by the Public Association “Investment Roundtable”, Bishkek, December 2012.

Box 2. Stress testing of impact from change in prices in the real estate market on the banking sector⁶


As of June 30, 2014, the share of loans, secured by pledged real estate, constituted 91.7 percent of the total volume of loans in the credit portfolio of banks.

Credit risks for the banking sector are conditioned by potential refusal of a borrower from loan repayment if the value of pledged real estate declines below loan repayment balance.

Stress testing is focused on assessment of possible losses from outstanding loans and identification of the most vulnerable banks to potential change in prices for real estate.

The loans, issued by the banks and secured by pledged real estate, are divided into 5 groups depending on the amount of loan repayment balance to the total amount of issued loan (Scheme 1.4.1).

Scheme 1.4.1. Loans issued by the banks and secured by pledged real estate as of June 30, 2014

<i>Loan repayment balance⁷</i>		less than 20%	20 - 40%	40 - 60%	60 - 80%	more than 80%	Total
<i>Total amount of loan⁸</i>							
Loan repayment balance, <i>mln. KGS</i>		955.1	4,048.5	11,205.4	21,873.8	29,490.4	67,573.2
Total volume of pledged real estate, <i>mln. KGS</i>		7,487.4	14,808.7	24,954.4	36,369.4	40,353.9	123,973.7

⁶ Stress testing was conducted on the basis of data provided by the commercial banks by means of the survey as of June 30, 2014.

⁷ Includes the balance of the principal amount of a loan and interest as of June 30, 2014.

⁸ The amount of a loan includes the amount of issued loan plus accrued interest for the whole loan term.

Scheme 1.4.2 provides the results of considered stress test scenarios:

Scheme 1.4.2. Results of stress testing of credit risk for the banking sector

	<u>Banking sector</u>	<u>Large banks</u>	<u>Vulnerable banks</u>
1) "Negative" scenario Price for real estate ↓ by 40 percent for a year	Decrease in value of pledged real estate below the amount of loan repayment balance by <u>KGS 5.3 billion</u>	Decrease in value of pledged real estate below the amount of loan repayment balance by <u>KGS 1.0 billion</u>	7 banks, including 1 bank from the group "large" banks
2) "Historical" scenario* Price for real estate ↓ by 23 percent for a year	Decrease in value of pledged real estate below the amount of loan repayment balance by <u>KGS 1.0 billion</u>	-----	3 banks
3) "Alternative" scenario Price for real estate for 2 years ↓ by 40 percent (by 20 percent for a year)	Decrease in value of pledged real estate below the amount of loan repayment balance by <u>KGS 1.6 billion</u>	-----	5 banks

* At the end of 2008, prices for real estate in Kyrgyzstan decreased by 23 percent.

In addition to stress test, average decline in prices for real estate, when banks suffer losses, was calculated, which constituted 28 percent as of June 30, 2014. Threshold level of decline in prices for real estate in respect of large banks constituted 35 percent.

Relatively more vulnerable banks are 3 banks, which are likely to suffer losses if prices for real estate decline by 18-21 percent.

Scheme 1.4.3. Comparative analysis of the results of conducted stress test with stress test as of February 01, 2013

	Stress test as of June 30, 2014:	Stress test as of February 01, 2013:
Banking sector:	Scenario 1: - KGS 5.3 billion; Scenario 2: - KGS 1.0 billion; Scenario 3: - KGS 1.6 billion	Scenario 1: - KGS 5.5 billion; Scenario 2: ----- Scenario 3: - KGS 2 billion
Large banks:	Scenario 1: - KGS 1.0 billion Scenario 2 and 3: ----- Vulnerable banks: 1 bank	Scenario 1: - KGS 3.9 billion Scenario 2 and 3: ----- Vulnerable banks: 1 bank
Separate banks:	Most vulnerable banks: 3 banks; Vulnerable banks: 4 banks, 1 bank from the group "large" banks	Most vulnerable banks: 2 banks; Vulnerable banks: 3 banks, 1 bank from the group "large" banks
A marginal decrease in estate property prices for the banking sector:	28 percent	26 percent

Thus, insignificant growth of the banking sector sustainability to possible decline in prices for real estate was observed compared to the results of stress test conducted earlier as of February 01, 2013.

II. BANKING SECTOR

Generally, development of the banking sector was characterized by growth of lending volume on the background of some diversification of the credit portfolio. Growth of major indicators of the banking sector: assets, credit portfolio, resource base and net profit were observed.

Growth of financial intermediation on the part of the banks remained on the background of the main indicators of the banking sector outrunning the rates of economic growth.

The results of stress-tests indicate moderate level of risks in the banking sector.

2.1. Major Trends

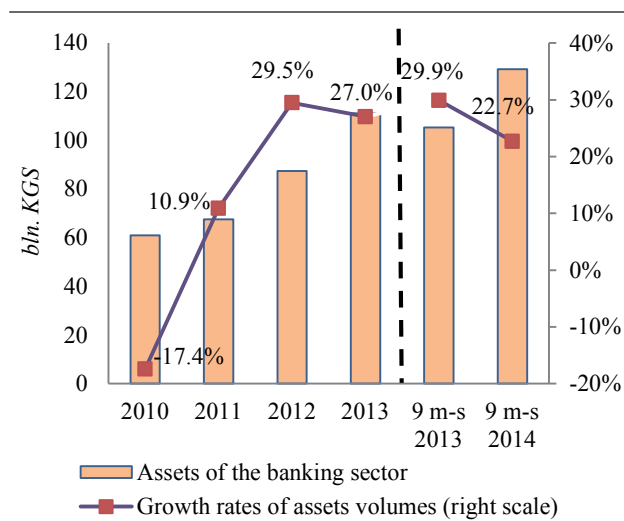
As of September 30, 2014⁹ 24 commercial banks (including the Bishkek branch of the National Bank of Pakistan) and 292 of their branches worked in the territory of the Kyrgyz Republic, among which there are 16 banks with foreign participation in the capital, including 10 banks with foreign participation in the amount of more than 50 percent. All banking institutions of the country are universal by the type of business.

Two banks: Manas Bank CJSC, Issyk-Kul IB OJSC operated in the preservation regime, KyrgyzCredit CJSC operated in the regime of temporary administration.

Assets

Generally, growth in the volume of all types of the banking sector assets was observed at the end of the reporting period. Assets of the banking sector at the end of 9 months of 2014 amounted to KGS 129.2 billion, having increased by 22.7 percent compared to the same period of 2013 (Chart 2.1.1).

Chart 2.1.1. Dynamics of assets in the banking sector



Growth of assets was primarily provided by increase of:

- the credit portfolio by 44.7 percent or KGS 22.4 billion;
- the correspondent accounts and cash by 5.3 percent or KGS 1.4 billion.

The share of credit portfolio in the structure of assets constituted 56.1 percent, having increased by 8.6 p.p. compared to the same period of 2013.

At the end of 9 months of 2014, significant changes were not observed in the structure of the banking sector assets by sectors of economy (Chart 2.1.3).

The total share of liquid assets (cash, correspondent accounts and securities) at the end of 9 months of 2013 decreased by 5.7 p.p. compared

to the same period of 2013 and amounted to 27.1 percent of the total volume of assets or KGS 35.0 billion.

⁹ The data are submitted according to periodic regulatory reporting of the commercial banks.

Chart 2.1.2. Change of assets structure in the banking sector

bln. KGS

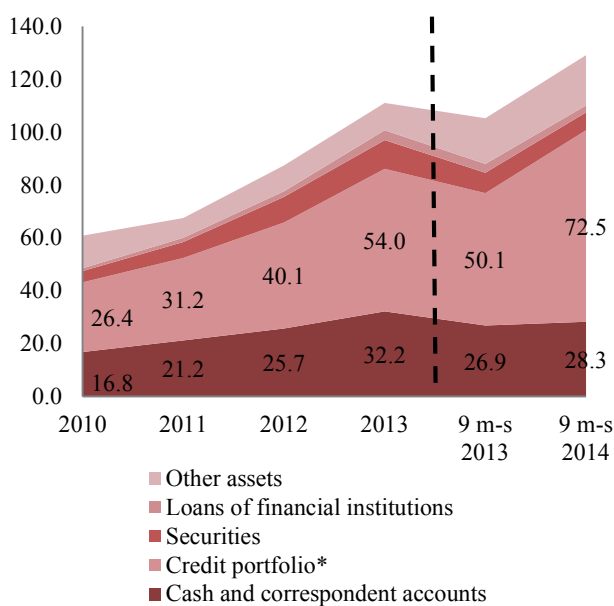
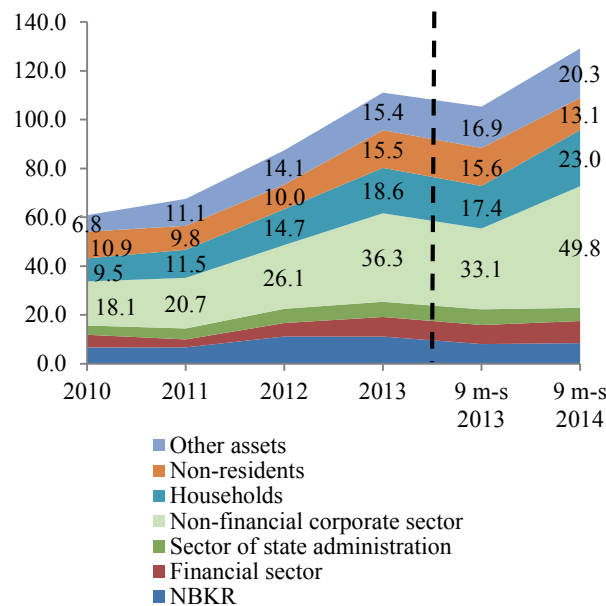


Chart 2.1.3. Institutional structure of assets in the banking sector

bln. KGS



* Loans and financial leasing to the clients exclusive of special loss provisions

Credit portfolio

Growth of banks' credit portfolio at the end of 9 months of 2014 was primarily due to increase in the volume of agriculture and trade sector crediting.

At the end of 9 months of 2014, the level of dollarization of the credit portfolio in the banking sector increased by 3.9. p.p. compared to the same period of 2013 and amounted to 55.4 percent (Chart 2.1.4).

Chart 2.1.4. Dynamics of credit portfolio in the banking sector

bln. KGS

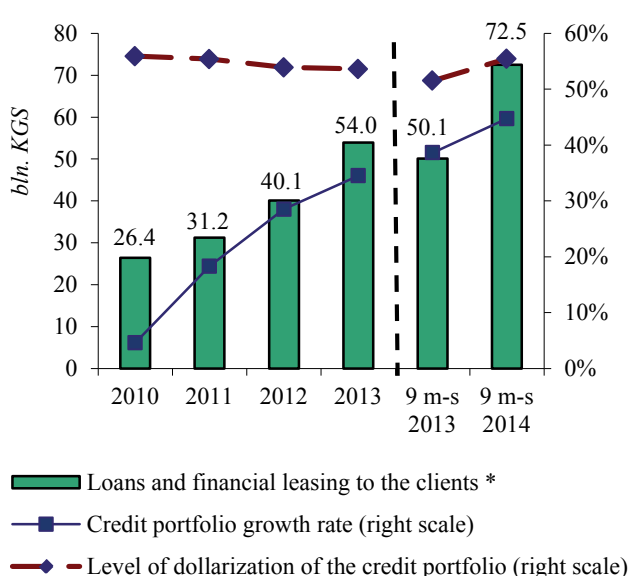
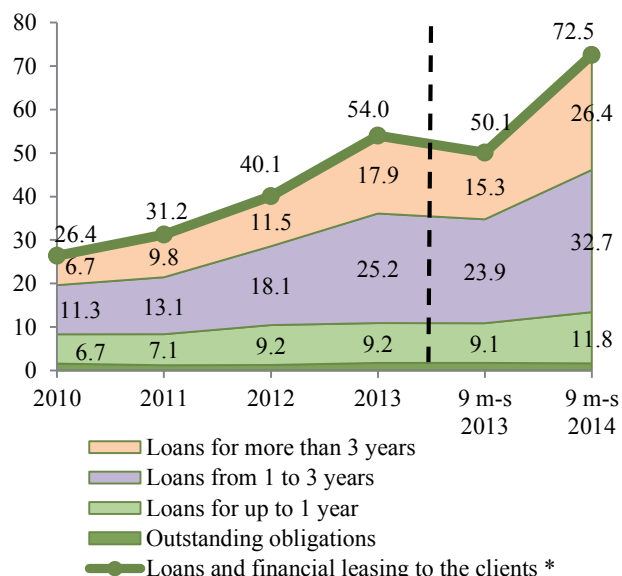


Chart 2.1.5. Structure of credit portfolio by maturity

bln. KGS

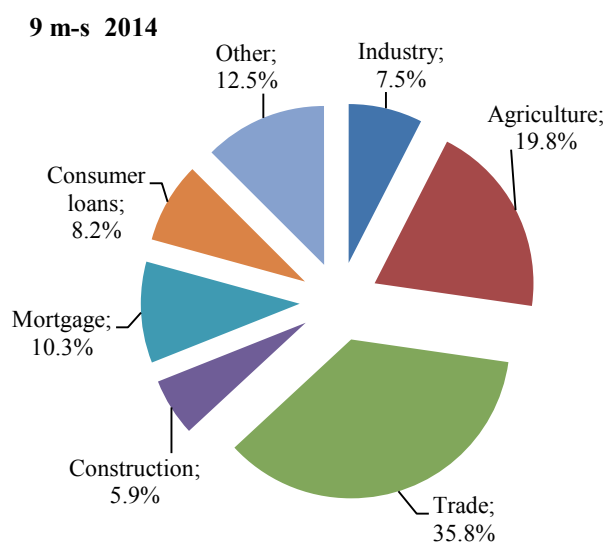
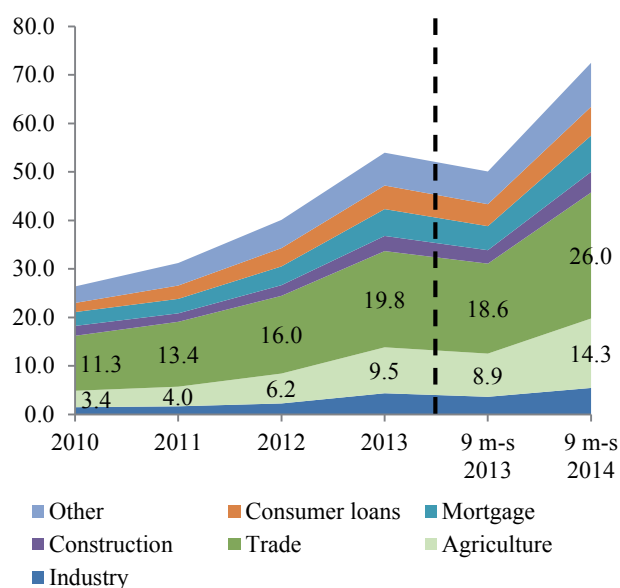


*Excluding loans provided by FCI and special loss provisions

The major share was accounted for medium-term loans from 1 to 3 years in the structure of credit portfolio by maturity, which constituted 45.1 percent at end of 9 months of 2014 (Chart 2.1.5).

Chart 2.1.6. Sectoral structure of the credit portfolio

bln. KGS



Decrease in the share of loans to the trade as well as outstripping growth rates of lending to agricultural sector over growth rates of lending to the trade was observed in the sectoral structure of the credit portfolio (Chart 2.1.6). Thus, the share of lending to trade in the credit portfolio at the end of 9 months of 2014 decreased from 37.0 percent to 35.8 percent compared to the same period of 2013. The share of agricultural sector loans increased from 17.8 percent to 19.7 percent. The volume of lending to the agricultural sector at the end of 9 months of 2014 increased by 1.6 times compared to the same period of 2013 and amounted to KGS 14.3 billion.

Liabilities

At the end of 9 months of 2014, liabilities of the banking sector amounted to KGS 109.2 billion, having increased by 24.0 percent compared to the same period of 2013.

Decrease in the share of households' and non-financial enterprises' funds were observed in the institutional structure of liabilities (Chart 2.1.7). Moreover, households' funds remained the major source of attracted banks' resources.

Chart 2.1.7. Institutional structure of liabilities

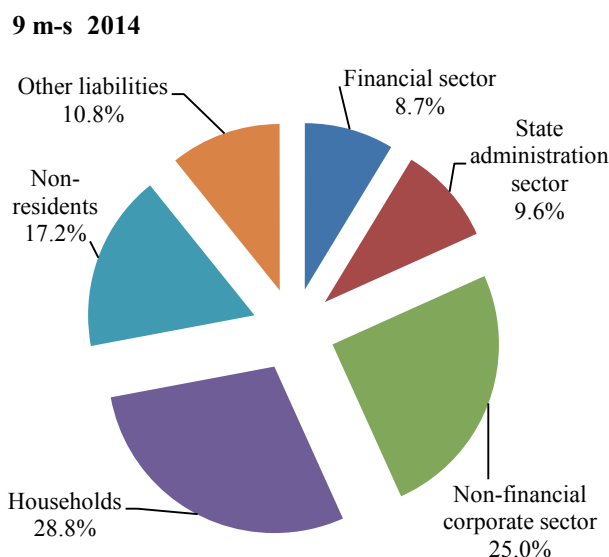
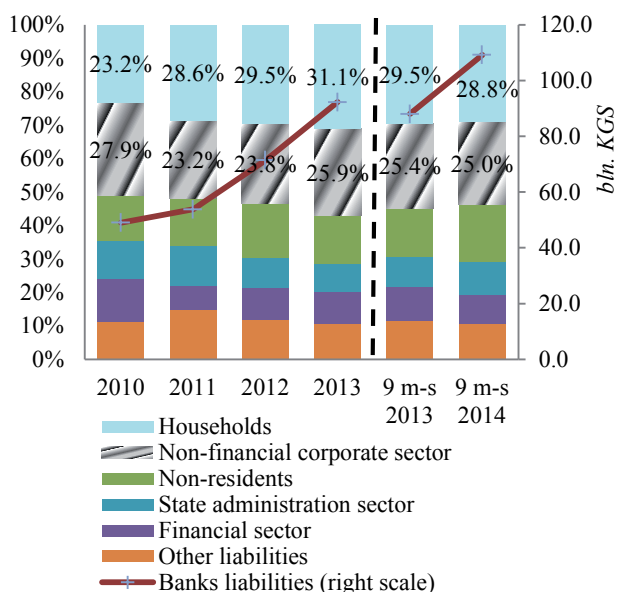
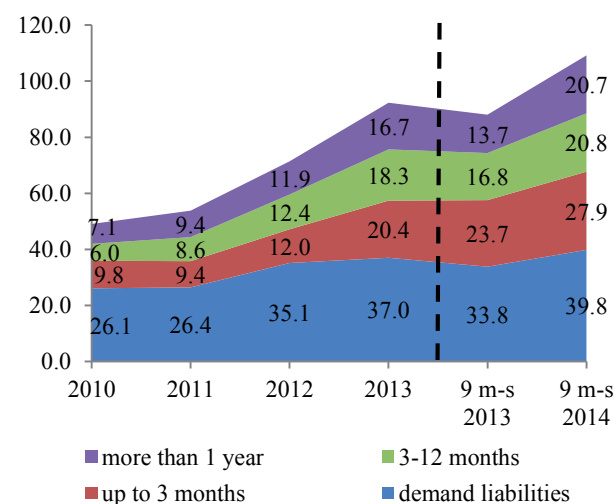


Chart 2.1.8. Structure of the banking sector liabilities by maturity

bln. KGS



As of September 30, 2014, demand liabilities amounted to KGS 39.8 billion (the share of demand liabilities decreased from 38.4 percent as of September 30, 2013 to 36.4 percent). Liabilities with maturity of more than 1 year increased by 51.1 percent and amounted to KGS 20.7 billion or 19.0 percent of the total volume of banks' liabilities (Chart 2.1.8).

The share of liabilities in foreign currency in the total volume of attracted funds increased by 2.1 p.p. and amounted to 57.3 percent or KGS 62.6 billion (Chart 2.1.9).

Chart 2.1.9. Banks' liabilities in foreign currency

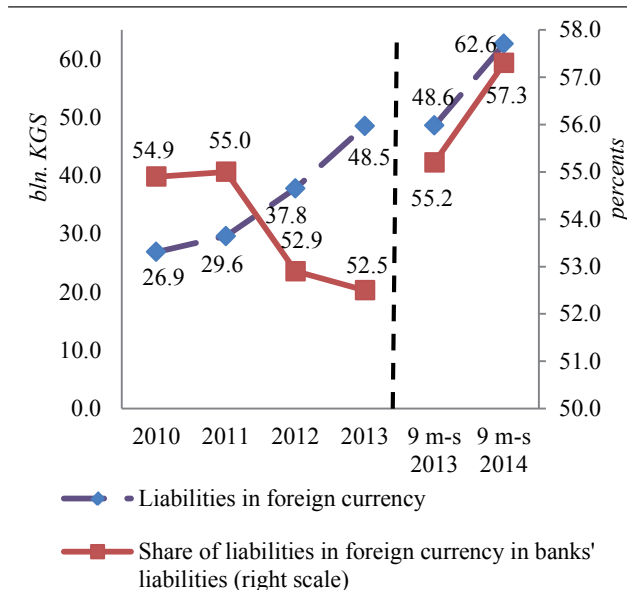
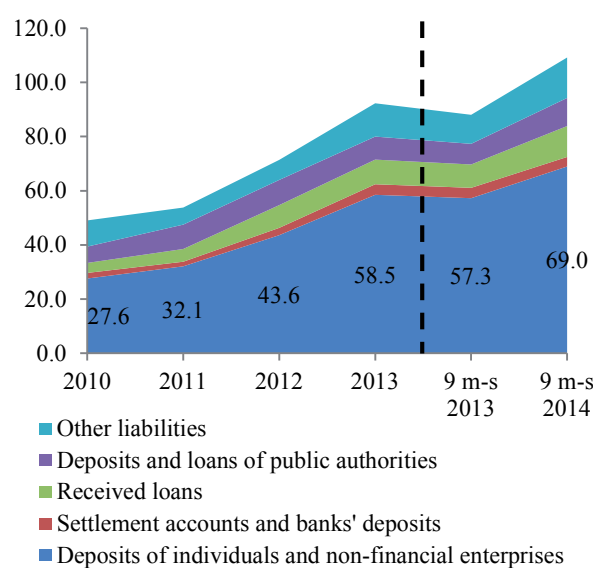


Chart 2.1.10. Structure of banks' liabilities by the reserves sources

bln. KGS



Deposits of individuals and non-financial enterprises increased by 20.4 percent at the end of 9 months of 2014 and amounted to KGS 69.0 billion (Chart 2.1.10). The share of deposits of individuals and non-financial enterprises in banks' liabilities decreased by 1.9 p.p. and constituted 63.1 percent.

Financial results¹⁰

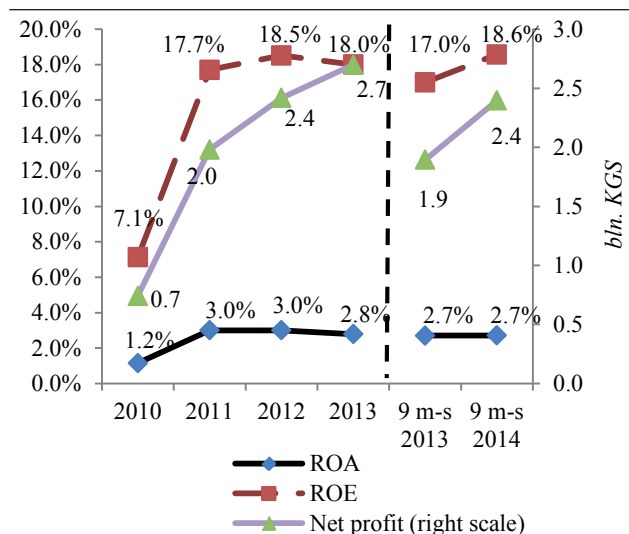
Generally, insignificant increase of profitability indicators¹¹ at the end of 9 months of 2014 was observed compare to the same period of 2013 (Chart 2.1.11):

- ROA did not change and constituted 2.7 percent;
- ROE increased by 1.5 p.p. and constituted 18.6 percent.

¹⁰ For the purposes of this publication the main indicator of profitability of the banking activity is rate of return on assets (ROA), defined as the ratio of profits to average assets, as well as the rate of return on equity (ROE), defined as the ratio of profits to the average size of the regulatory capital of the 1 level.

¹¹ ROA, ROE indicators are presented in annual terms.

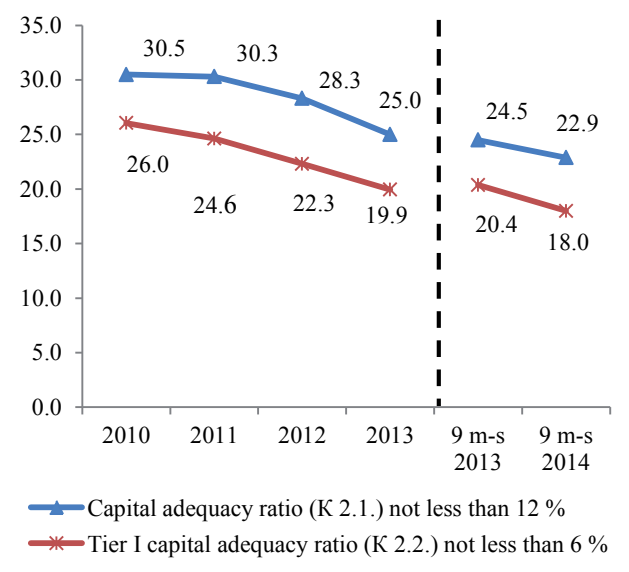
Chart 2.1.11. Indices of the banking sector profitability for the period



Net profit of the banking sector increased by 26.3 percent, compared to the same period of 2013, and amounted to KGS 2.4 billion.

Capital adequacy

Chart 2.1.12. Dynamics of capital adequacy ratios percent



With statutory minimum capital adequacy at 12.0 percent, at the end of 9 months of 2014, this figure amounted to 22.9 percent (Chart 2.1.21), having decreased by 1.6 p.p compared to the same period of 2013.

Decrease of capital adequacy was due to growth rates of risk weighted assets and off-balance sheet liabilities (+30.8 %) outstripping net total capital (+22.2 %).

At the same time, the actual level of capital adequacy in the banking sector generally formed according to the results of 9 months of 2014 can further increase the volume of risky and earning assets by 1.9 times, without exceeding established level of capital adequacy.

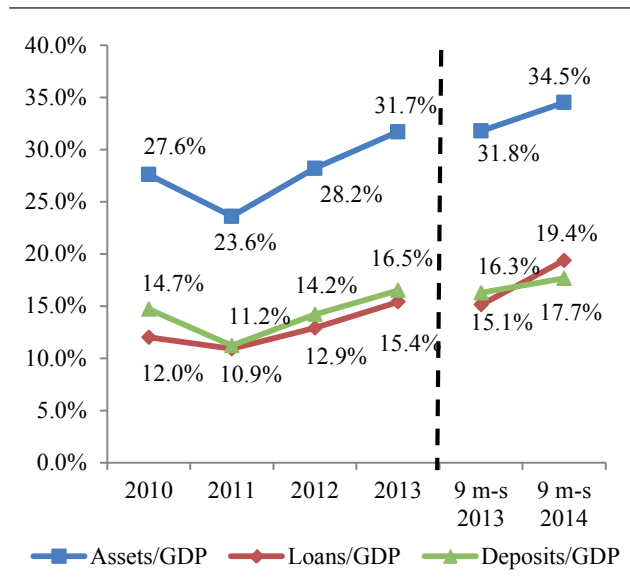
The abovementioned information indicates relative stability of the banking sector to negative shocks and the presence of certain potential to

increase the level of financial intermediation and efficiency of the banking sector operation in future.

CONTENT

Financial intermediation of the banking sector

Chart 2.1.13. Indicators of financial intermediation



The role of the banking sector as a financial intermediary, accumulating financial resources for their further redistribution among creditworthy borrowers and sectors of the economy, directly depends on the level of development and efficiency of banks.

According to the results of 9 months of 2014, growth of financial intermediation was still observed (Chart 2.1.13). However, growth rates of major indicators in the banking outstrip economic growth. Dynamic growth in the amount of borrowers and depositors was observed in the banking sector of the Kyrgyz Republic.

At the end of 9 months of 2014, increase of financial intermediation indicators in the banking sector of the Kyrgyz Republic compared to the same period of 2013 was the following:

- Assets to GDP – from 31.8 percent to 34.5 percent;
- Loans to GDP – from 15.1 percent to 19.4 percent;
- Deposits to GDP – from 16.3 percent to 17.7 percent.

2.2. Banking Sector Risks

2.2.1. Credit risk¹²

A credit risk is one of the main risks that accompany banking.

At the end of 9 months of 2014, insignificant increase of credit risks was observed in the banking sector. Increase of credit risk is due to growth in risk weighted assets due to rise of economy crediting (Chart 2.2.1).

At the end of 9 months of 2014, the volume of classified loans in the banking sector increased by KGS 190.9 million or 6.7 percent compared to the same period of 2013. Meanwhile, the share of classified loans in the credit portfolio of banks decreased by 1.5 p.p. compared to the same period of 2013 and constituted 4.2 percent (Chart 2.2.2).

Chart 2.2.1. Structure of risk weighted assets,
mln. KGS

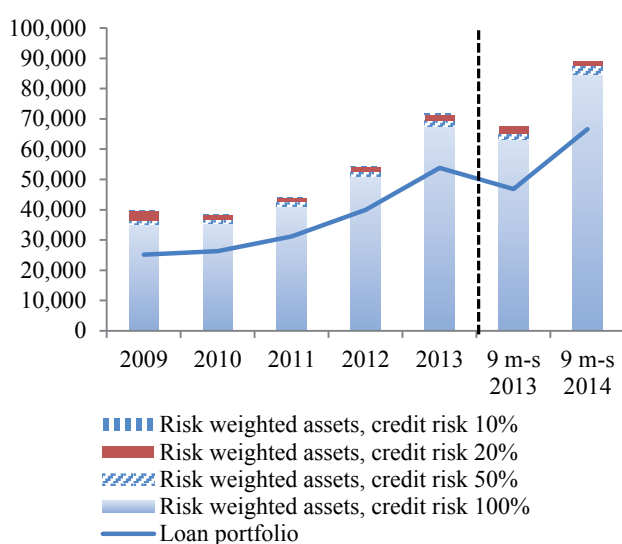
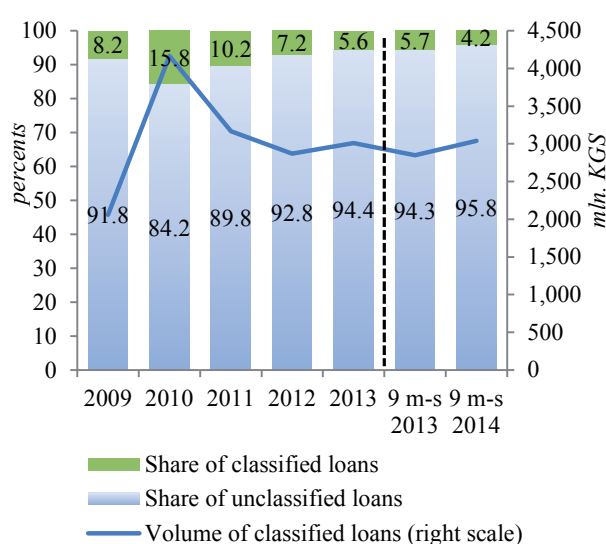


Chart 2.2.2. Credit portfolio quality



In order to assess the quality of the credit portfolio, the commercial banks use a loan classification system¹³, which contributes to determining the possible level of potential losses from bad loans and compensating them in time through creation of appropriate reserves.

Classified and non-performing loans, reflecting the first signs of deterioration in the quality of credit portfolio, require particular attention during analysis of the credit portfolio quality. In the reporting period, there was gradual slowdown in the share of classified and non-performing loans, as well as loans placed in a non-accrual status (Chart 2.2.3).

At the end of 9 months of 2014, the risk of default on assets (the ratio of special loss provisions and credit portfolio) constituted 2.8 percent.

¹² Banking transaction, carrying credit risk, are considered within the framework of this section.

¹³ In order to assess the quality of the credit portfolio, all loans are usually divided into six categories, depending on the client's current capacity to fulfill the obligations to the bank (listed in declining order of classification): normal, satisfactory, under supervision, substandard, doubtful and losses. Loans of last three categories, as having the most negative characteristics in terms of return of loans, are usually attributed to the "non-operating" or "classified". For each of six categories, the bank has to create a reserve corresponding to this category defined as a percentage of loans issued.

Chart 2.2.3. Indicators of the credit portfolio quality
percent

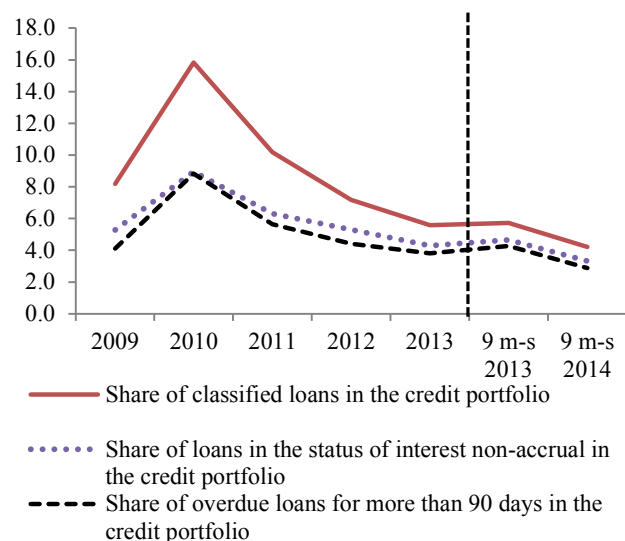
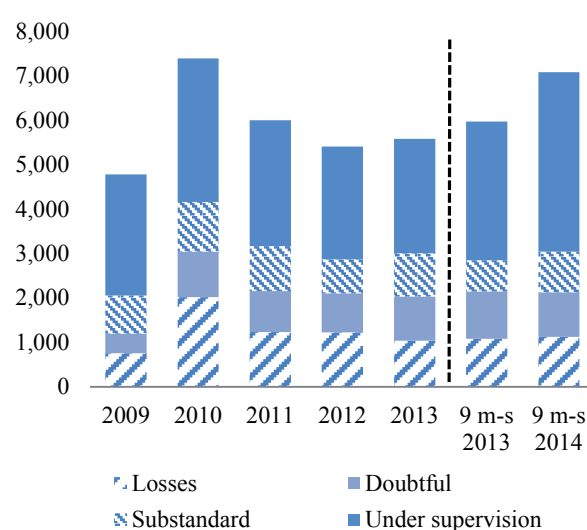


Chart 2.2.4. Change of credit portfolio classification in the banking sector
mln. KGS



Change in the volume of loans classified as loans “under supervision” is among the factors that may influence increase or decrease of the credit portfolio quality in the future (Chart 2.2.4). The share of such loans in the reporting period decreased by 0.6 p.p. of the total credit portfolio and constituted 6.1 percent.

Aggregate reserves created by the commercial banks constituted 4.7 percent of the total credit portfolio (as of September 30, 2013 this index constituted 5.7 percent). Meanwhile, the share of special loan loss provision as of September 30, 2014 constituted 55.3 percent of the total reserves (Chart 2.2.4).

Chart 2.2.5. Total and special reserves,
mln. KGS

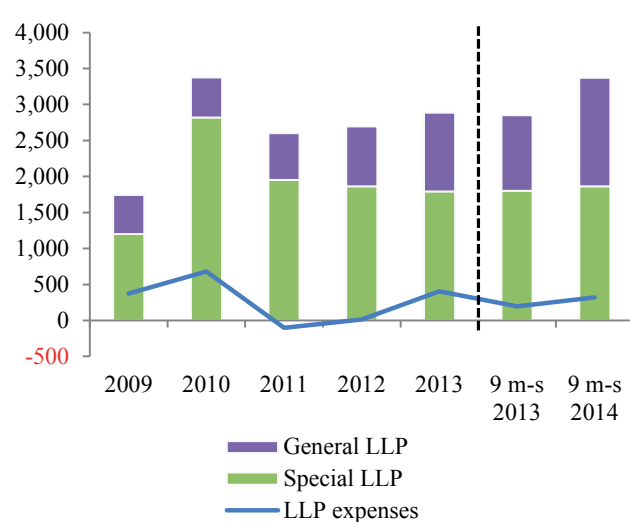
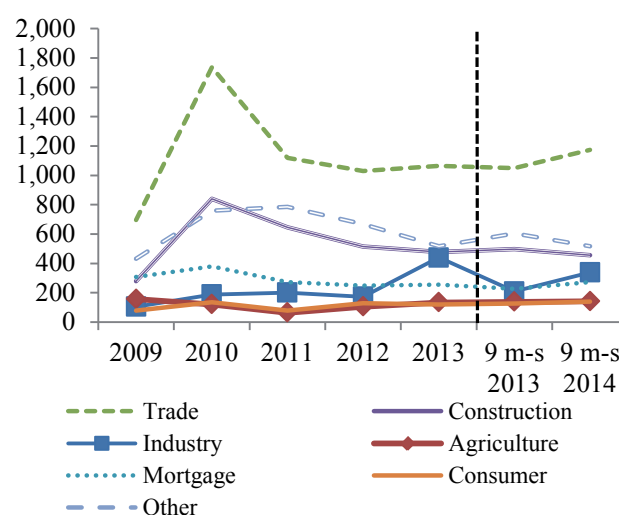


Chart 2.2.6. Volume of classified loans by sectors of economy,
mln. KGS

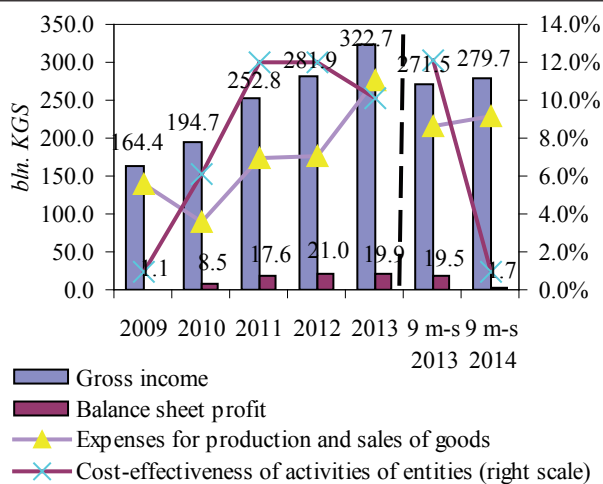


At the end of 9 months of 2014, significant changes in the volume of classified loans by sectors of economy was not observed, except for increase in the volume of classified loans in the industrial sector by KGS 129.6 million (due to increase in the volume of classified loans in one bank), as well as in the sphere of trade by KGS 124.0 million (Chart 2.2.6).

As of the end of September 30, 2014, the highest concentration of credit risks was still observed in the trade and construction sectors of economy.

Financial status of corporate sector

Chart 2.2.7. Results of the financial activity of the entities



Source: NSC KR

At the end of 9 months of 2014, there was decrease in the balance sheet profit and profitability of enterprises on the background of remained trend towards growing debt of the corporate sector compared to the same period of 2013.

At the end of the reporting period, the following financial results of the enterprises operating in the corporate sector were marked (Chart 2.2.7):

- gross profit increased by 3.0 percent and amounted to KGS 279.7 billion;
- expenses for production and sales increased by 6.3 percent and constituted KGS 229.0 billion;
- balance sheet profit decreased by 11.5 times and constituted KGS 1.7 billion;

- business profitability dropped to 0.9 percent.

Decrease of balance sheet profit and profitability of enterprises is due to significant increase in losses of unprofitable enterprises.

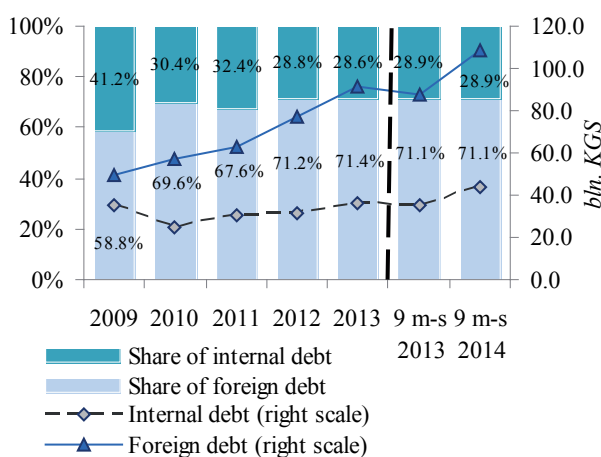
Gross debt of the corporate sector¹⁴ at the end of 9 months of 2014 increased by 24.8 percent compared to the same period of 2013 and amounted to KGS 153.1 billion or 40.9 percent to GDP.

Foreign debt of the corporate sector at the end of 9 months of 2014 increased by 24.7 percent compared to the same period of 2013 and formed at the rate of KGS 108.9 billion or 29.1 percent to GDP (Chart 2.2.8 and 2.2.9).

At the end of 9 months of 2014, *internal debt* of the enterprises in the corporate sector increased by 24.8 percent compared to the same period of the last year and amounted to KGS 44.2 billion or 11.8 percent to GDP. As of September 30, 2014, the internal debt of the corporate sector was as follows:

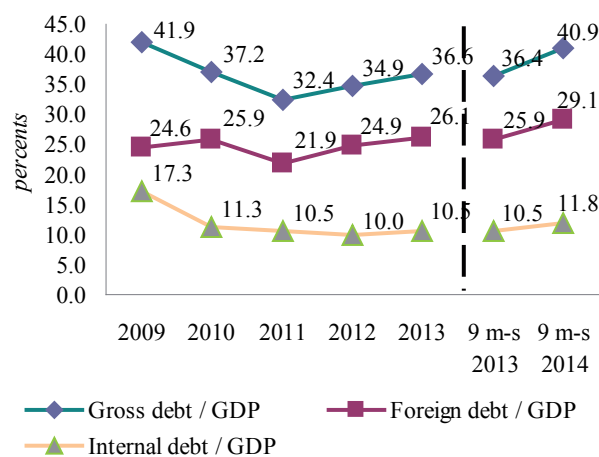
- to the banking sector – KGS 39.9 billion;
- to the NBF system – KGS 1.7 billion;
- accumulated debt on other loans and borrowings – KGS 2.6 billion.

Chart 2.2.8. Dynamics of foreign and internal debt of corporate sector



Source: NSC KR, NBKR calculations

Chart 2.2.9. Indicators of debt sustainability of corporate sector



¹⁴ According to NSC KR. Debt of enterprises does not include the loans of entities received under the guarantee of the Government of the Kyrgyz Republic.

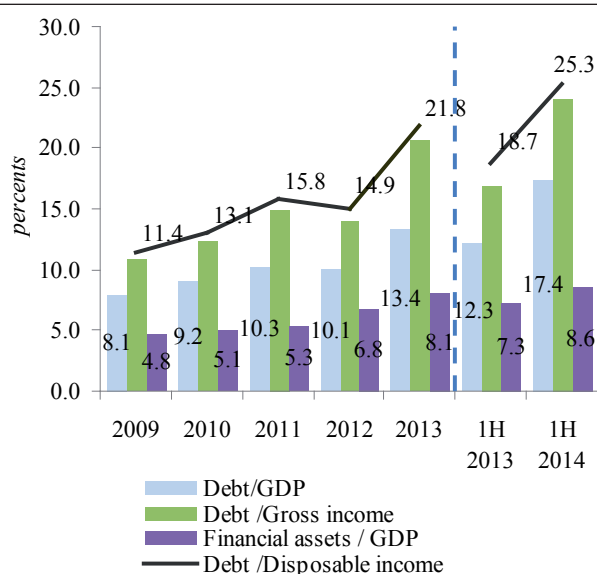
Financial status of households¹⁵

There was a slight deterioration in the financial stability of households due to growth of household debt to the financial sector over the growth of their incomes.

Growth of debt sustainability indicators at the end of the reporting period was due to the increase of loans granted by banks and NBFIs to the population (Chart 2.2.10). As of September 30, 2014, the ratio of household debt to gross and disposable incomes compared with the same indicator at the end of 9 months of 2013 increased from 16.9 percent to 24.1 percent and from 18.7 percent to 25.3 percent respectively.

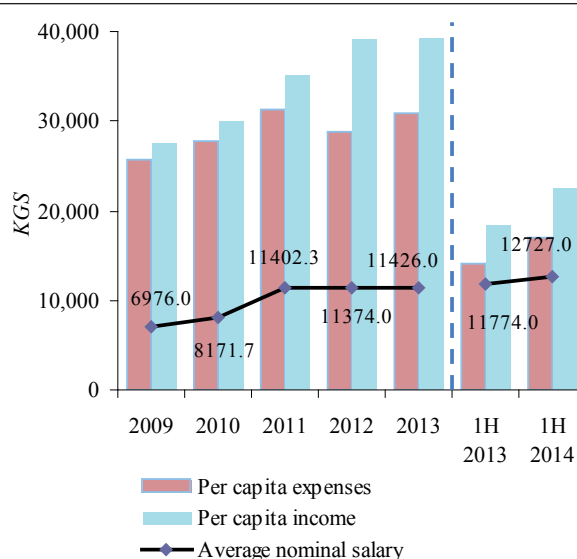
Chart 2.2.10. Financial sustainability indicators of households

percent



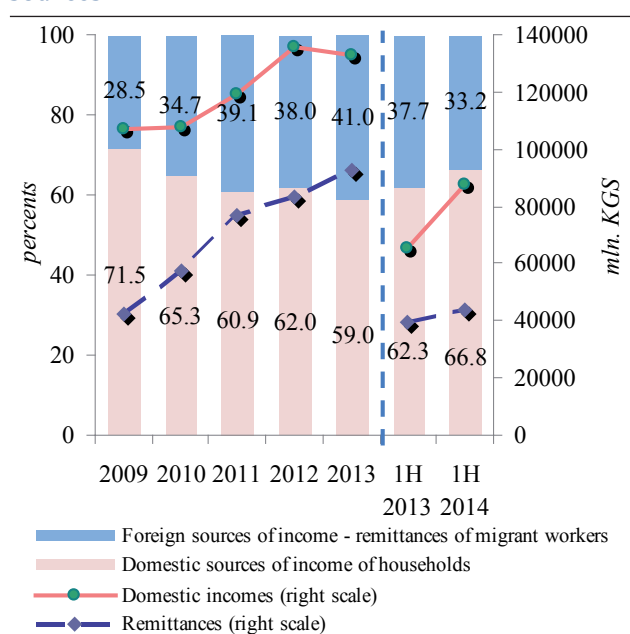
Source: NSC KR, NBKR calculations

Chart 2.2.11. Factors of financial balance sustainability of the population



Source: NSC KR

Chart 2.2.12. Structure of households' income by sources



Source: NSC KR and NBKR

The main share in the structure of household income fell under the labor income in the 1st half of 2014, which constituted 67.7 percent of disposable income of the population.

At the end of the 1st half of 2014, the share of remittances decreased by 4.5 p.p. to 33.2 percent of gross income of the population (Chart 2.2.12). However, remittances of labor migrants were still an important source of household income.

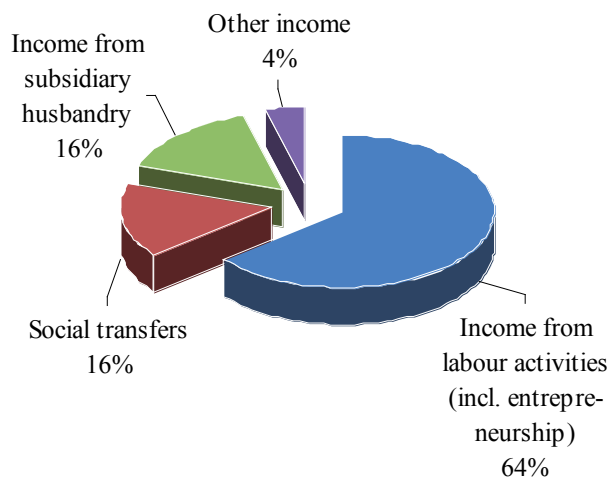
In the structure of household expenditures the main share was given to consumption (Chart 2.2.14), which restrained growth of savings and costs for investment purposes.

Significant share of consumer spending that constituted 84.3 percent of total expenditure in the 1st half of 2014 may influence the ability of households to meet their obligations in the case of revenues reduction.

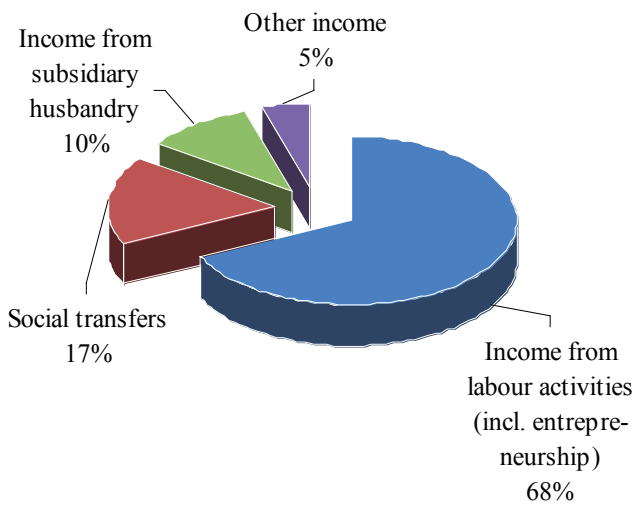
¹⁵ According to the official statistics data of NSC KR based on the random sampling method of households' survey. Data on households statistics as of 9 months of 2014 are not available in the NSC KR.

Chart 2.2.13. Revenue structure of the population

1 H 2014



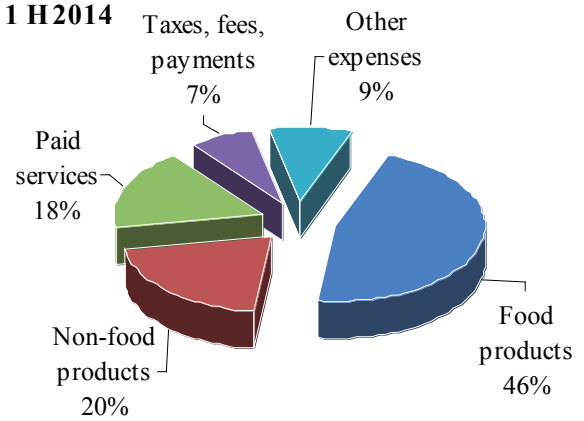
1 H 2013



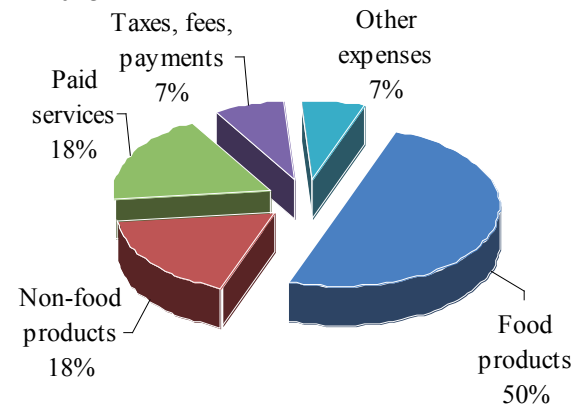
Source: NSC KR

Chart 2.2.14. Expenditure structure of the population

1 H 2014



1 H 2013



Source: NSC KR

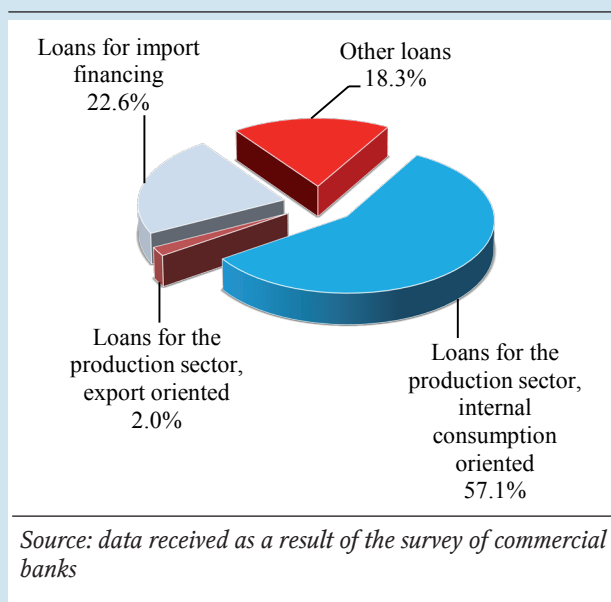
Box 3. Results of the survey of the clients of commercial banks¹⁶

In general, the level of debt-to-income of the borrowers (DTI¹⁷) and the provision of the loan-to-value ratio (LTV¹⁸) was at a sufficient level, which further indicates a moderate level of credit risk in the banking sector.

A significant portion of the loans (57.1%) given to borrowers is used in the manufacturing sector of the economy, thereby creating contribution to the country's GDP.

Sectoral focus of borrowers activity

Chart 2.2.15. Sectoral structure of loans as of June 30, 2014



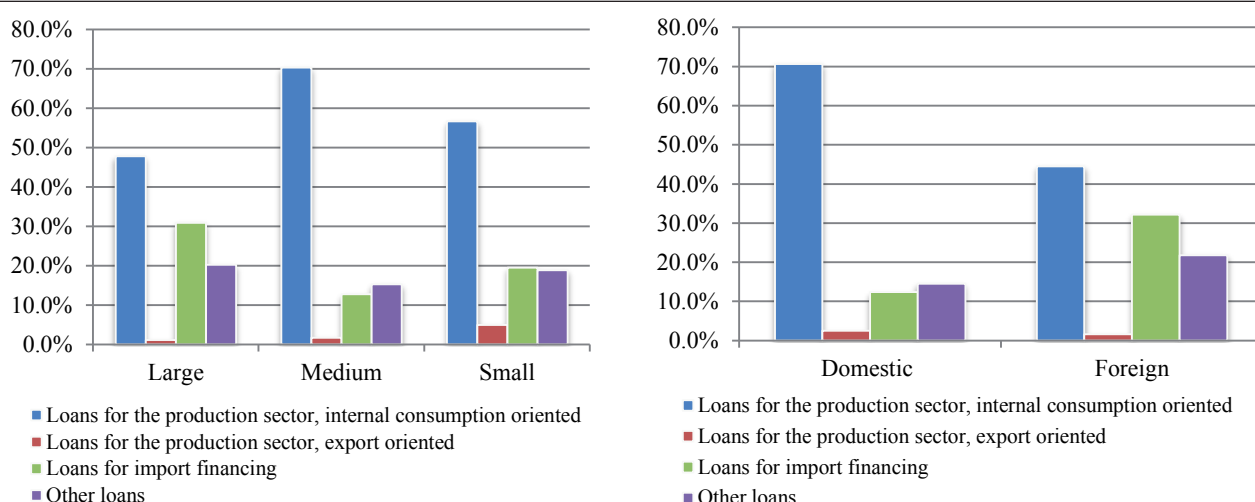
The major share of loans at the end of the 1st half of 2014 was still concentrated in the manufacturing sector¹⁹ of economy (57.1 percent of total borrowers' loans). The share of loans financing the imports amounted to 22.6 percent (Chart 2.2.15).

¹⁶ According to the information received as a result of the survey of banks at the end of the 1st half of 2014 (72.4% was covered of the total volume of credit portfolio in the banking sector of the KR).

¹⁷ DTI (debt-to-income) – the ratio of payments to borrowers on loans (including principal and interest payments during the reporting period to the declared one (announced or declared) at the time of the loan issuance to the principal annual income of the borrower.

¹⁸ LTV (loan-to-value ratio) – the ratio of issued loans to the value of collateral. The data include information on loans and collateral of borrowers. Low level of LTV of banks implies a high level of coverage of bank loans with collateral. Conversely, high LTV means low level of coverage of bank loans with collateral.

¹⁹ The production sector means the activity of the bank clients connected with the production of goods and services.

Chart 2.2.16. Sectoral structure of loans by the groups of banks and forms of ownership as of June 30, 2014


Source: data received as a result of the survey of commercial banks, NBKR calculations

Paying capacity of borrowers

Debt burden of largest clients of banks calculated by DTI indicator according to the reporting period constituted 58.2 percent.

Table 2.2.1. Debt burden of clients of the banks as of June 30, 2014

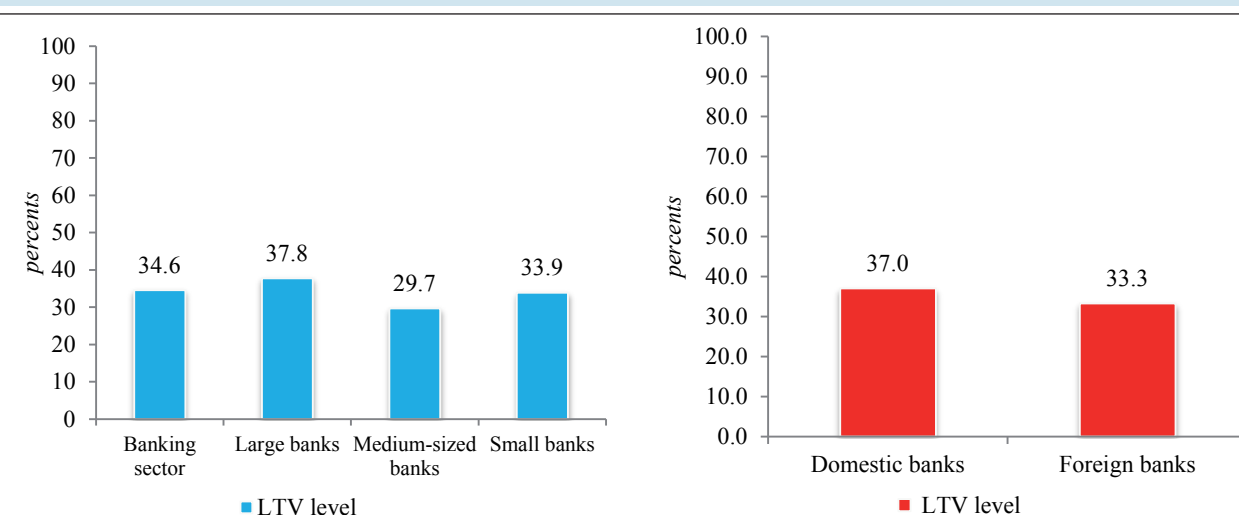
	Banking sector
Balance of debt under credit, billion KGS	48,312.5
Share of loans of the largest borrowers* in the total volume of the credit portfolio, in %	68.4
Ratio of expenses for debt maintenance on loans to the aggregate income of borrowers, in %	58.2

Source: data received as a result of the survey of commercial banks, NBKR calculations

* amount of loans more than KGS 1 million

Provision status of the borrowers' loans

At the end of the 1st half of 2014, the actual level of LTV in the banking sector of Kyrgyzstan amounted to 34.6 percent. The existing level of collateral reflects relatively high level of loans provision with collateralized property in the banking sector of the Kyrgyz Republic (Chart 2.2.17).

Chart 2.2.17. LTV level in the banking sector as of June 30, 2014


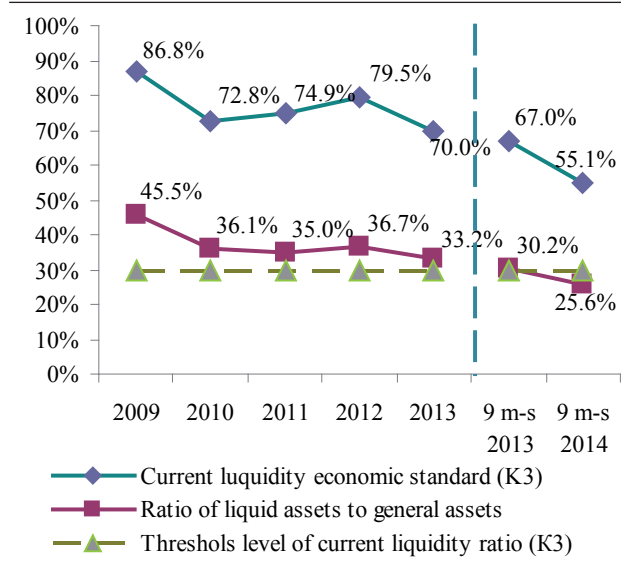
Source: data received as a result of the survey of commercial banks, NBKR calculations

2.2.2. Liquidity Risk

Public confidence in the banking sector depends on the timely implementation of obligations by banks, which suggests availability of sufficient liquidity in the banks. For regulatory purposes, *liquidity risk* is assessed using economic current liquidity ratio²⁰.

At the end of 9 months of 2014, current liquidity ratio decreased from 67.0 percent (as of September 30, 2013) to 55.1 percent (Chart 2.2.18).

Chart 2.2.18. Liquidity indicators in the banking sector



Decrease in the level of liquidity was due to the decrease of liquid assets and an increase in the proportion of the credit portfolio due to expansion of lending to the economy.

In terms of the groups of banks, significant decrease of liquidity at the end of 9 months of 2014 was observed in the large and small banks (Scheme 2.2.1).

Scheme 2.2.1. Current liquidity ratio (K3) by the groups of banks

	9 months 2013	9 months 2014
Large banks	59.2 %	45.4 %
Medium banks	67.8 %	64.4 %
Small banks	90.0 %	72.2 %

At the end of 9 months of 2014, short-term financial liabilities increased up to 1 year with relatively stable volume of short-term financial assets. Finally, this dynamics contributed to increase of negative gap between financial assets and liabilities of the banks with a maturity period of up to 1 year.

The most significant gaps by maturity were still observed in the “demand” category (Table 2.2.2), therefore the banks kept a substantial amount of low-income high quality liquid assets in the structure of assets.

²⁰ Economic *current liquidity* ratio is one of the mandatory standards for the bank established by NBKR, according to which the liquid assets (for calculation of this indicator including funds of banks in cash and correspondent accounts) must be at least 30 percent of short-term liabilities.

Table 2.2.2. Cumulative gap²¹ by maturity of financial assets and liabilities, as of September 30, 2014
mln. KGS

Total	demand	up to 1 month	up to 3 months	up to 1 year	up to 3 years	Grand total
Total financial assets	26,854	43,227	48,878	69,576	129,155	129,155
Total financial liabilities	38,028	58,412	64,667	84,572	104,420	104,420
Gap (gap interval)	-11,174	-15,186	-15,789	-14,996	24,735	24,735
Gap in % of assets	-8.7%	-11.8%	-12.2%	-11.6%	19.2%	19.2%
Gap in % of net total capital	-59.9%	-81.4%	-84.6%	-80.4%	132.6%	132.6%

in foreign currency	demand	up to 1 month	up to 3 months	up to 1 year	up to 3 years	Grand total
Total financial assets	15,771	25,973	27,716	35,664	66,844	66,844
Total financial liabilities	22,086	32,778	36,046	47,044	58,768	58,768
Gap (gap interval)	-6,315	-6,806	-8,330	-11,380	8,076	8,076
Gap in % of assets in foreign currency	-9.4%	-10.2%	-12.5%	-17.0%	12.1%	12.1%
Gap in % of net total capital	-33.8%	-36.5%	-44.6%	-61.0%	43.3%	43.3%

in national currency	demand	up to 1 month	up to 3 months	up to 1 year	up to 3 years	Grand total
Total financial assets	11,083	17,254	21,161	33,912	62,311	62,311
Total financial liabilities	15,942	25,634	28,620	37,528	45,652	45,652
Gap (gap interval)	-4,858	-8,380	-7,459	-3,616	16,659	16,659
Gap in % of assets in national currency	-7.8%	-13.4%	-12.0%	-5.8%	26.7%	26.7%
Gap in % of net total capital	-26.0%	-44.9%	-40.0%	-19.4%	89.3%	89.3%

Table 2.2.3. Maturity of financial assets and liabilities, as of September 30, 2014
mln. KGS

Name	Maturity					Grand total
	up to 1 month	1-3 months	3-6 months	6-12 months	more than 12 months	
Total financial assets	43,227	5,651	7,154	13,544	59,579	129,155
Including loans and financial leasing to the clients	3,217	3,291	4,851	11,065	49,872	72,297
Total financial liabilities	58,412	6,254	8,473	11,432	19,848	104,420
Including deposits of individuals and fixed deposits of legal entities	19,755	3,754	4,706	7,188	5,443	40,846
Gap	-15,186	-603	-1,319	2,112	39,731	24,735
Including on loans and deposits	-16,538	-463	145	3,877	44,429	31,450

²¹ Cumulative gap is the amount of possible expenses for support of solvency, estimated for each range of maturity.

Box 4. Assessment of “irreducible” (stable) level of demand deposits during the period of 2010 – 9 months of 2014²² (“irreducible” balance of deposits)

The purpose of determining the “irreducible” level of demand deposits is to reveal volumes of banks’ demand deposits, which are permanently at banks’ disposal (“irreducible” balance²³) and are used in assessment of so called “excess liquidity”.

Chart 2.2.19 shows that in the reporting period, demand deposits of commercial banks²⁴ had a fairly weak volatility. At the end of 9 months of 2014, the volume of demand deposits increased by KGS 2.9 billion compared to the same period of the last year and amounted to KGS 38.7 billion. “Irreducible” balance of demand deposits increased, and at the end of 9 months of 2014 amounted to KGS 28.9 billion or 74.7 percent of the total volume of demand deposits (Chart 2.2.20).

Chart 2.2.19. Volume of “irreducible” balances of demand deposits

bln. KGS

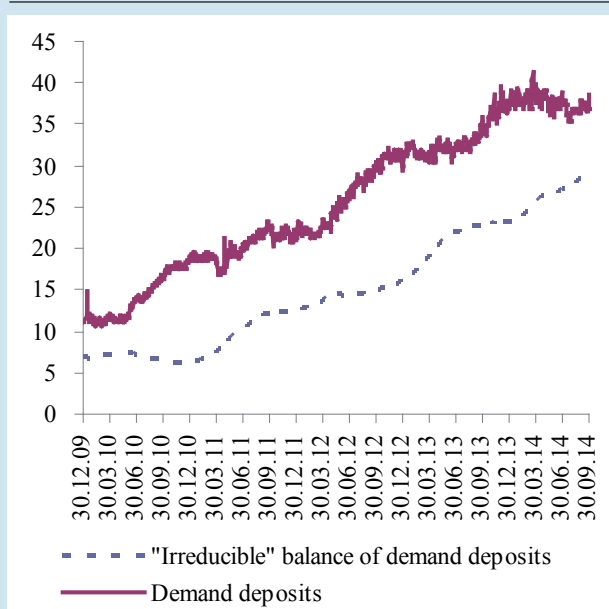
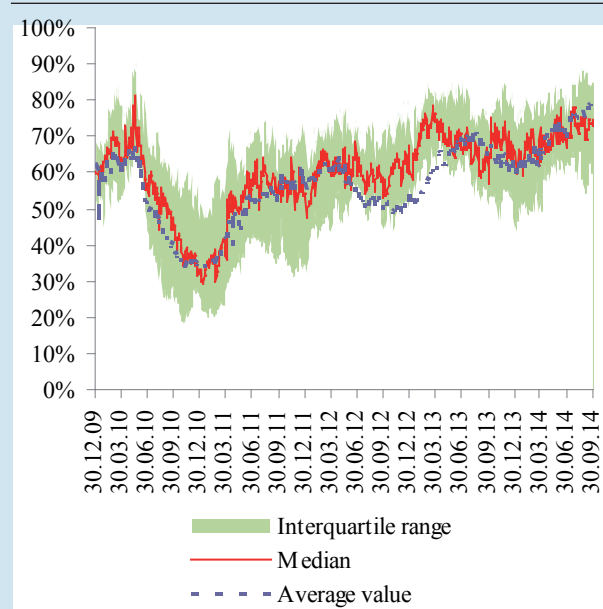


Chart 2.2.20. Share of “irreducible” balances in demand deposits



“Unstable” level of demand deposits constituted 25.3 percent respectively.

Divided by the banks, the interquartile range²⁵ of minimum “stable” level of demand deposits at the end of 9 months of 2014 constituted 57.4-81.1 percent of the total volume of demand deposits (Chart 2.2.20).

Taking into account “irreducible” balance of demand deposits, the cumulative gap between the maturities changed from negative to positive (Scheme 2.2.2). Thus, taking into account “irreducible” balance, financial assets exceeded financial liabilities of banks.

²² Conducted calculations did not include demand deposits and settlement accounts of troubled banks, as well as relatively new banks possessing restricted historical data series for analysis.

²³ Volumes of “irreducible” balances of commercial banks are calculated on the basis of demand deposit daily balances since 2010 as the difference between arithmetical average and 2.33 of standard deviations. Credibility level of 99 percent was chosen in the calculations.

²⁴ Including settlement (current) accounts.

²⁵ Share of “irreducible” balance of demand deposits ranged among the banks from the largest to the smallest. Interquartile range reflects the smallest and the largest shares.

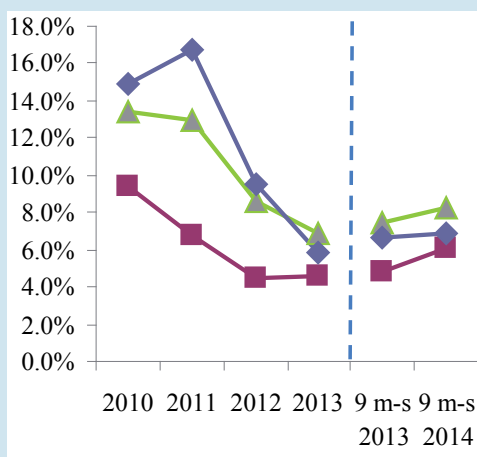
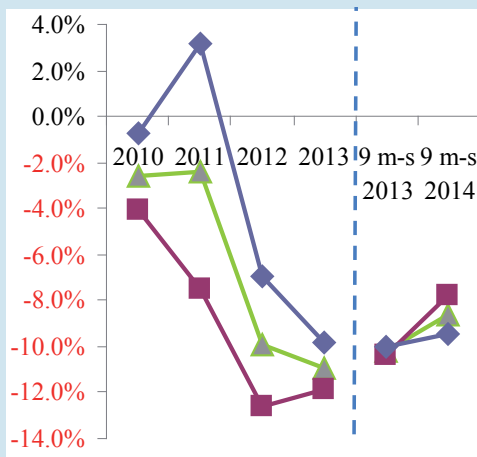
Scheme 2.2.2. Cumulative gap by maturities (exclusive and inclusive of “irreducible” balances of demand deposits)
percent of the total assets

Maturities

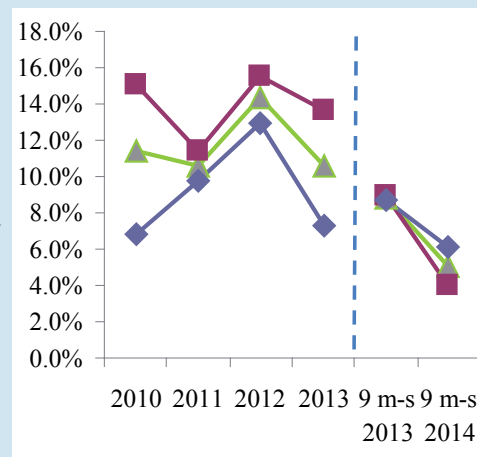
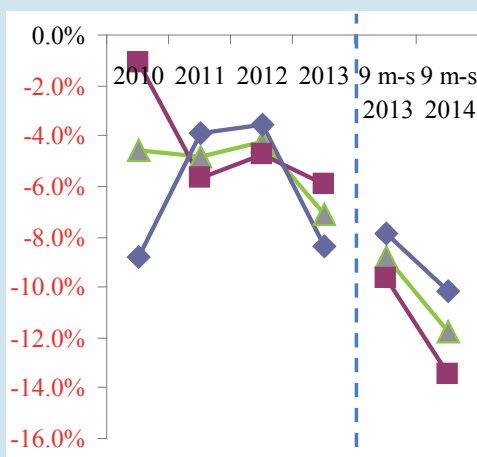
Exclusive of “irreducible” balance

Inclusive of “irreducible” balance

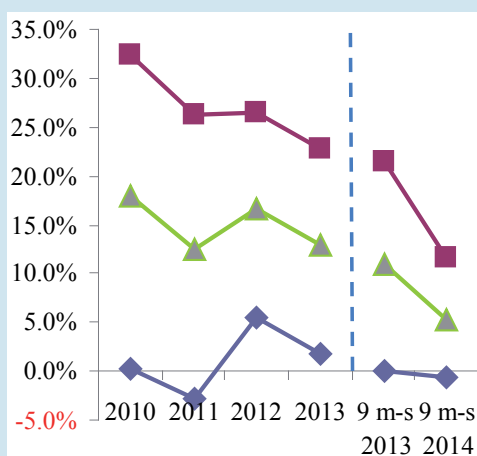
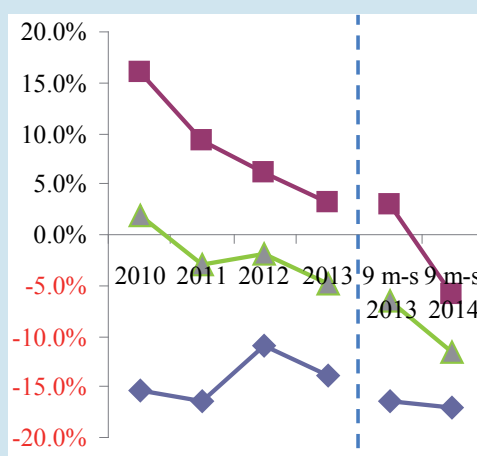
Demand:



Up to 1 month:



Up to 12 months:



▲ General ■ in national currency ◆ in foreign currency

CONTENT

2.2.3. Risk of Concentration

Generally, as of September 30, 2014, slight increase of *concentration risk* was observed compared to the same period of 2013.

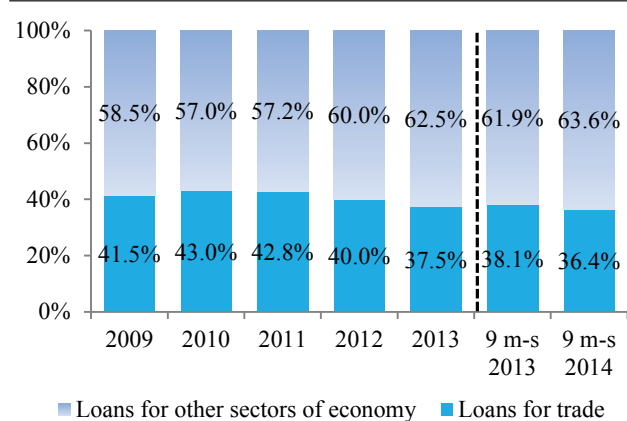
Concentration of the largest sources of financing

The results of stress testing show that some banks did not manage to withstand shock related to outflow of funds of the largest sources of financing²⁶ (liquidity ratio decreases below 30-percent threshold).

Loan concentration

According to the results of stress-testing, potential default of the largest borrowers²⁷ in separate banks may decrease regulatory capital below economic standard of the NBKR.

Chart 2.2.21. Sectoral concentration of the credit portfolio

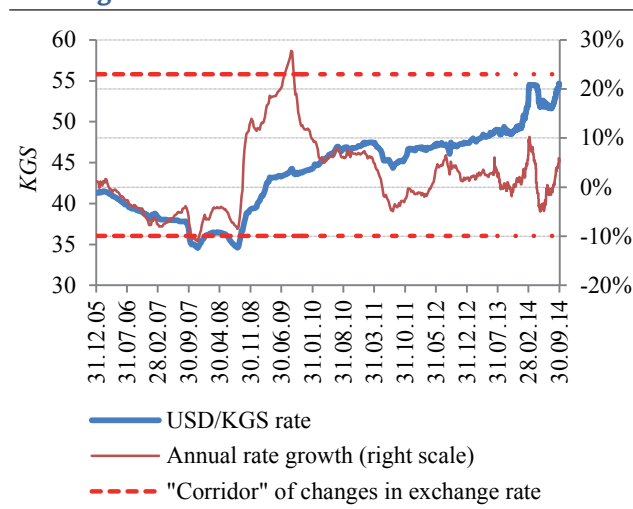


Insignificant decrease of the level of trade loans concentration was observed in the sectoral structure of credit portfolio amid increase of lending to the agricultural sector. Based on the results of 9 months of 2014, the share of loans for trade decreased from 38.1 percent to 36.4 percent (2.2.21).

2.2.4. Currency Risk

At the end of 9 months of 2014, direct currency risk was at a moderate level.

Chart 2.2.22. Dynamics of USD/KGS nominal exchange rate



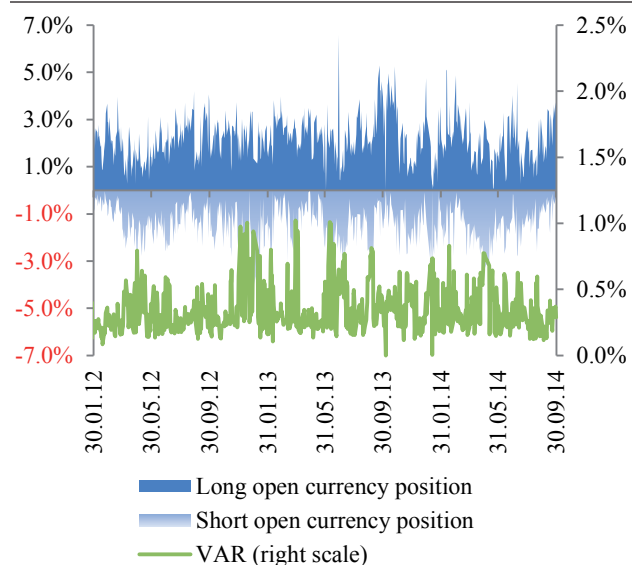
The risk of currency position overestimation in the banking sector is minimum (VAR: 0.1–0.9 percent of the net total capital, Chart 2.2.23).

Banking sector is insignificantly subjected to direct currency risk due to balanced currency structure of banks' assets and liabilities.

²⁶ The largest sources of financing (LSF) are the funds of creditors and depositors (received loans, settlement accounts, demand deposits and fixed deposits), including funds of the government sector.

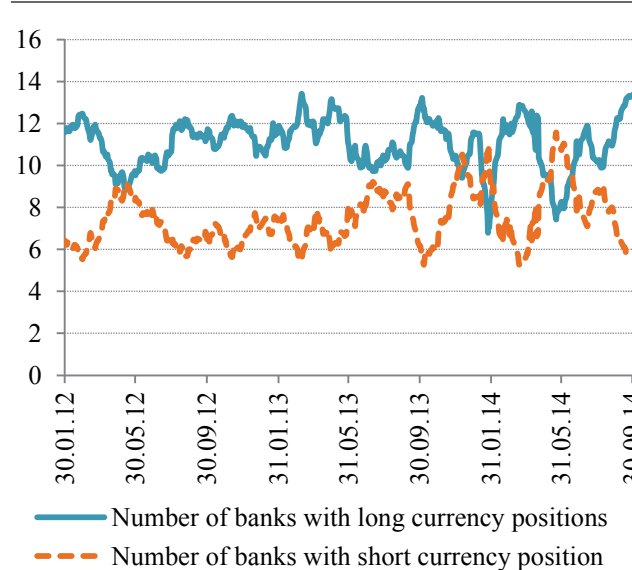
²⁷ Total debt of five largest borrowers of the bank.

Chart 2.2.23. Dynamics of open currency position (OCP) and revaluation risk (VAR)*, in percent of NTC



*exclusive of troubled banks

Chart 2.2.24. Currency position of the banks*, units

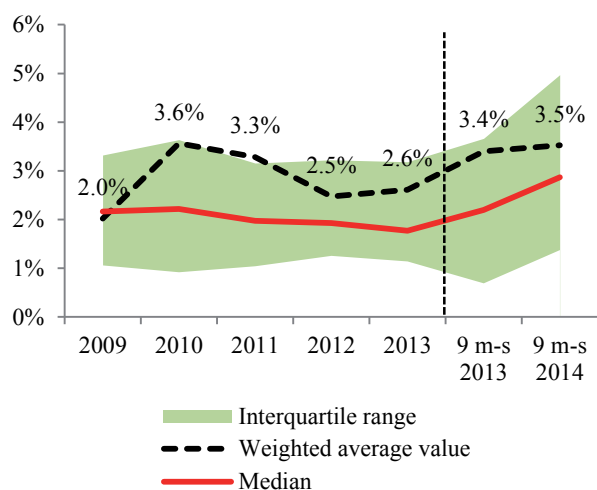


*exclusive of troubled banks

2.2.5. Interest Risk

At the end of 9 months of 2014, interest risk was moderate.

Chart 2.2.25. Dynamics of interest rate risk (VaR) in percent of NTC



Increase of interest rate risk (VAR) from 3.4 percent to 3.5 percent of net total capital was resulted from increase of gaps by maturities between financial assets and liabilities vulnerable to interest rates dynamics.

Average value of interest rate risk during the period of 2009 – nine months of 2014 was within accessible limits (2-4 percent of net total capital).

CONTENT

Chart 2.2.26. Dynamics of average weighted interest rate of individuals' time deposits, in percent

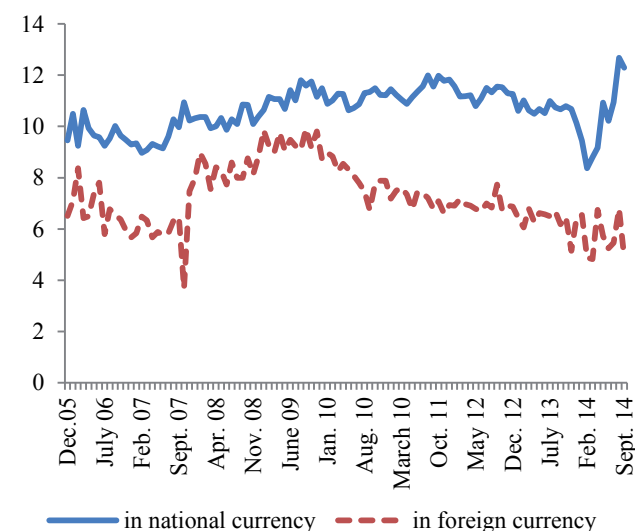
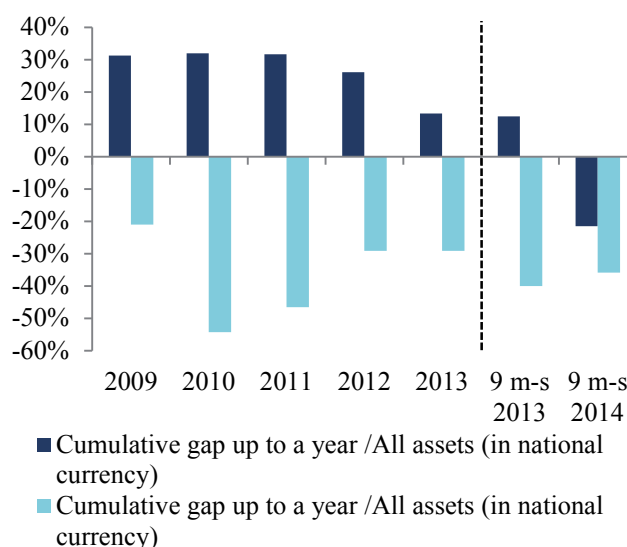


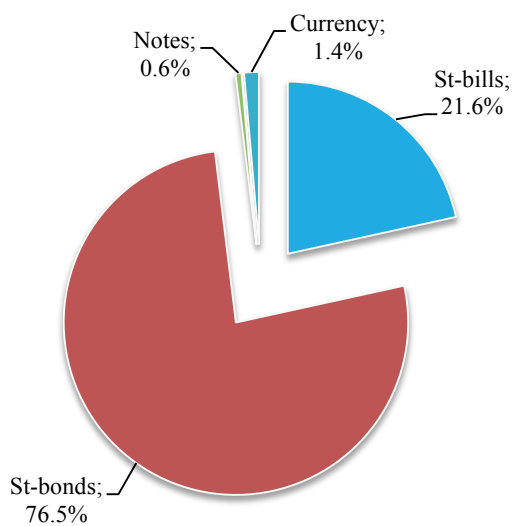
Chart 2.2.27. Cumulative gap of assets and liabilities exposed to interest rate risk



2.2.6. Risk of “Contagion”

The purpose of this analysis is to assess the risk of “contagion” in case of interbank lending, which can set off chain-reaction upon occurrence of problems with liquidity.

Chart 2.2.28. Distribution of interbank loan transactions made during 9 months of 2014 between resident banks, depending on collateral



The loans in the interbank market are covered by collateral in the form of highly liquid government securities or foreign exchange (Chart 2.2.28) in the banking sector of Kyrgyzstan. Kyrgyz Banks did not grant interbank loans without collateral.

As of September 30, 2014, eight banks were the borrowers in the interbank credit market, the transaction of which was performed in the form of swap operations. Other commercial banks in Kyrgyzstan had no mutual debts.

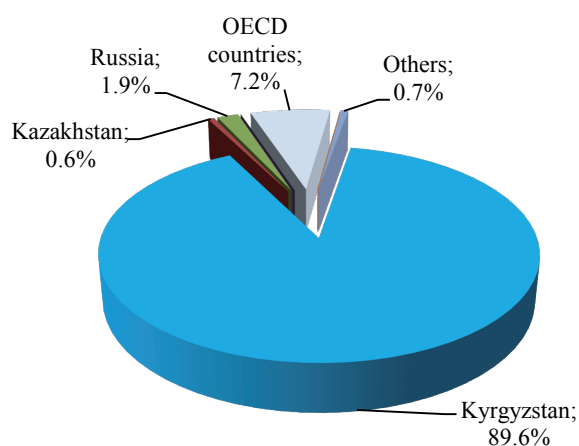
In general, the contagion risk in the interbank credit market of Kyrgyzstan was insignificant.

2.2.7. Country Risk

The banking sector of the Kyrgyz Republic as of September 30, 2014 remained poorly integrated in the global financial markets.

The volume of disposed assets of non-residents constituted KGS 13.4 billion or 10.4 percent of total banking sector assets. The highest concentration of dispositions was observed in the OECD countries – 7.2 percent of total assets (Chart 2.2.29).

Chart 2.2.29. Geographic structure of assets as of September 30, 2014



The main share of the assets placed abroad focused on of correspondent or deposit accounts constituted KGS 12.3 billion or 91.7 percent of total disposed assets of non-residents.

Meanwhile, 84.5 percent of total assets disposed aboard accounted for 7 banks.

At the end of 9 months of 2014, banks' liabilities to non-residents of the Kyrgyz Republic totaled KGS 18.7 billion or 17.9 percent of the total liabilities of the banking sector of the Kyrgyz Republic. Main volume of the resources was drawn from non-resident banks in the form of loans and deposits amounted to KGS 13.4 billion or 71.7 percent of the total liabilities to non-residents.

In terms of urgency of liabilities to non-residents, the main share accounted for the medium-term loans as before.

As of September 30, 2014, 84.1 percent of the total volume of liabilities drawn from non-residents accounted for 7 banks.

Chart 2.2.30. Geographic structure of liabilities as of September 30, 2014

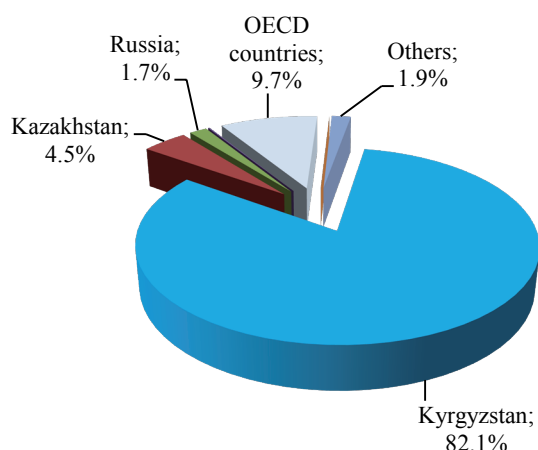
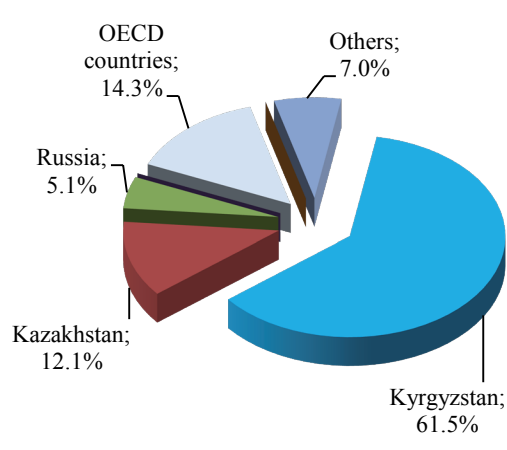


Chart 2.2.31. Authorized capital by countries as of September 30, 2014



At the end of 9 months of 2014, foreign capital amounted to KGS 3.9 billion or 35.4 percent of the total authorized capital of the banking sector. The main share of foreign capital fell under (Chart 2.2.31):

- residents of OECD countries – 14.3 percent;
- residents of Kazakhstan – 12.1 percent;
- residents of Russia – 5.1 percent.

CONTENT

2.3. “Reverse” Stress Testing of the Banking Sector

2.3.1. “Reverse” Stress Testing of Credit Risk²⁸

This method allows detecting a buffer stock of capital (net total capital) of banks, which can cover the additional allocations to LLP in connection with the transformation of “unclassified” (performing) loans into the category of troubled loans²⁹. “Reverse” stress testing allows calculating the growth rate of classified (troubled) loans under which the capital adequacy (K2.1) will drop to the threshold level of 12 percent.

The results of calculations using the aforementioned method show that as of September 30, 2014 the possible share of “unclassified” (performing) loans, which can become troubled, constituted approximately 23.3 percent (Chart 2.3.1).

Thus, the banking sector has the potential to sustain a significant deterioration in the quality of the credit portfolio, which may require the creation of additional LLP approximately up to 45.9 percent of net total capital (Chart 2.3.2).

Chart 2.3.1. Maximum possible share of “performing”³⁰ loans that may become “classified” loans³¹

in percent of unclassified loans

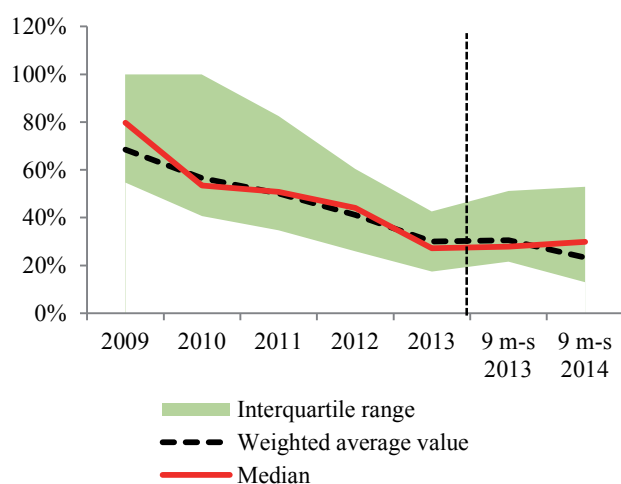
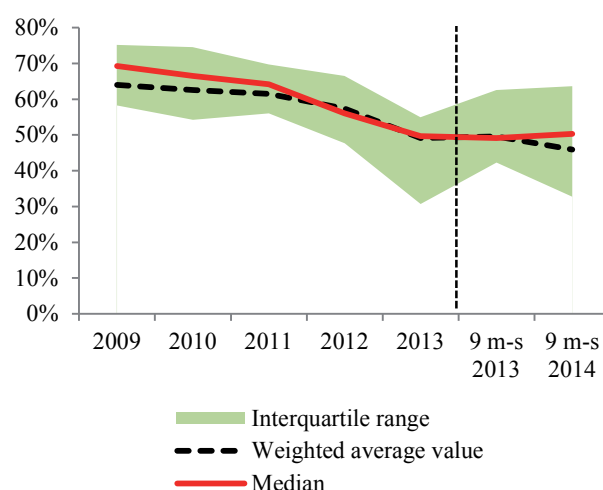


Chart 2.3.2. Additional LLP, in creating thereof CAR decreases to 12 percent

in percent of NTC



²⁸ Exclusive of troubled banks.

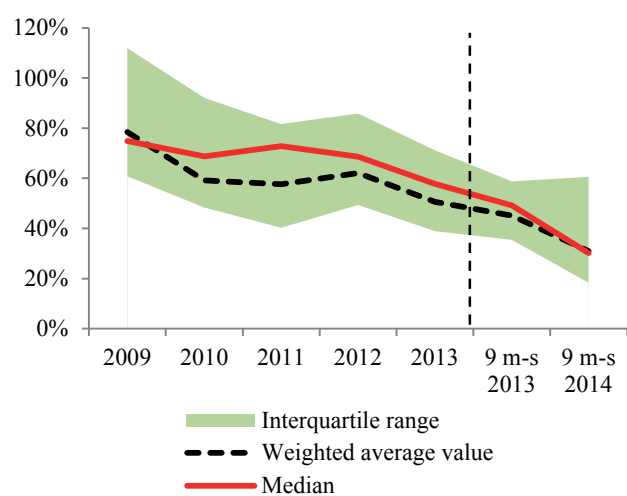
²⁹ Herewith, transition of “performing” loans to the category of “classified” loans is fulfilled smoothly by three categories (“substandard”, “doubtful” and “losses”).

³⁰ Exclusive of “normal” loan category.

³¹ When CAR decreases to the level of 12 percent.

2.3.2. “Reverse” Stress Testing of the Liquidity Risk

Chart 2.3.3. Scope of potential outflow of deposits when K3 may drop to 30 percent
in percent of the total volume of clients’ deposits



Reserve of liquid assets that can potentially cover the outflow of deposits of population and non-financial enterprises was calculated to assess the risk of banking sector liquidity, without compromising economic standard of the National Bank on current liquidity:

Shock – the maximum amount of the outflow of deposits of individuals and non-financial companies, which may reduce the liquidity ratio to the threshold level of 30 percent.

The results of the “reverse” stress testing show (Chart 2.3.3), that as of September 30, 2014 the actual amount of liquid assets of the banking sector was able to potentially cover the outflow of an average of 30.9 percent of total deposits of population and non-financial enterprises (Table 2.3.1).

2.3.3. “Reverse” Stress Testing of the Market Risk

In general, the results of the “reverse” stress testing of the market risk indicate that the banking sector as of September 30, 2014 had little sensitivity to the direct interest rate and currency risks.

Interest risk

Shock 1 – decrease of average weighted interest rate on loans, when the level of capital adequacy decreases to the threshold level (12 percent).

The results of the reverse stress tests indicate little sensitivity of the banking sector to the direct interest rate risk. Decrease of the average interest rates on loans by 18.5 p. p. can reduce the level of capital adequacy ratio to 12 percent (Table 2.3.1).

Shock 2 – decrease of average weighted interest rate on loans, when net profit of the commercial banks declines to the zero level.

The results of the “reverse” stress testing show that upon decrease of interest rates on loans by 14.4 p. p., net profit of the commercial banks decreases to the zero level (Table 2.3.1).

Generally, the results of the “reverse” stress testing show that the banking sector is characterized by low level of interest rate risk.

Currency risk (revaluation risk)

Maximum increase/decrease level of the U.S. dollar exchange rate, which will influence capital adequacy and net profit, was calculated for valuation of the currency risk in the banking sector.

Shock 1 – maximum increase/decrease level of the USD/KGS exchange rate, when the level of capital adequacy (K2.1) declines to the threshold level (12 percent).

Calculations of the “reverse” stress testing indicate that the banking sector is characterized by low risk of assets and liabilities revaluation and confirms availability of low sensitivity to direct currency risk (Table 2.3.1).

Shock 2 – maximum increase/decrease level of the USD/KGS exchange rate, when net profit of the commercial banks decreases to the zero level.

The results of stress testing indicate that with increase/decrease of the USD/KGS exchange rate by 519.3 percent, net profit of the commercial banks drops to the zero level (Table 2.3.1).

Table 2.3.1. General results of the “reverse” stress tests as of September 30, 2014

		Banking sector
Credit risk		
Shock 1	Share of unclassified loans transferring to the category of “classified” loans, <i>in percent</i>	23.3
Interest risk		
Shock 1	Decrease of interest rate on loans, when CAR declines to 12%, <i>in percentage points</i>	18.5
Shock 2	Decrease of interest rate on loans, when net profit declines to the zero level, <i>in percentage points</i>	14.4
Currency risk		
Shock 1	Growth rate of USD/KGS (\pm) exchange rate, when CAR declines to 12%, <i>in percent</i>	Commercial banks overcome the effect of the direct currency risk (change of currency rate for more than 100 percent)
Shock 2	Growth rate of USD/ KGS (\pm) exchange rate, when net profit declines, <i>in percent</i>	
Liquidity risk		
Shock 1	Outflow of clients’ deposit share of the total deposits, when current liquidity ratio declines to 30%, <i>in percent</i>	30.9

III. NON-BANK FINANCIAL INSTITUTIONS

In general, the state of the system of NBFIs is assessed as rather stable. An increase in the basic indicators, in particular, assets, credit portfolio and resource base and net income is observed. The share of troubled loans in the non-banking sector remains low. Stress test results indicate that the credit risk of the NBFIs is moderate.

There is a high concentration of institutional assets of NBFIs (67.0 of the microfinance market accounted for by the three largest NBFIs), showing a tendency to increase the risk concentration.

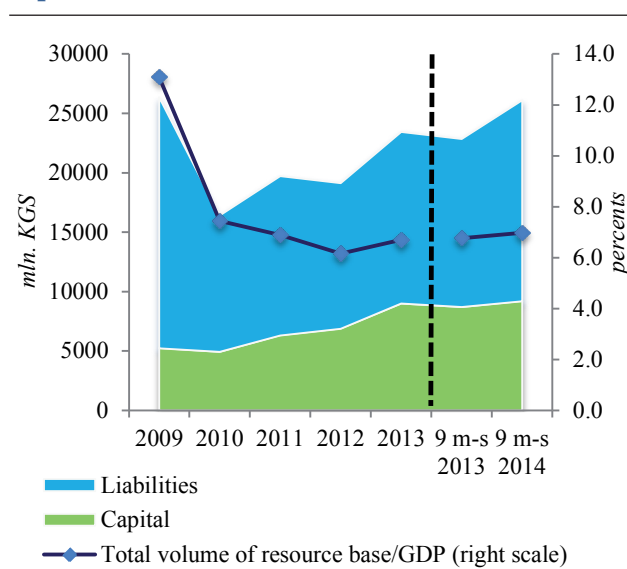
The trend of gradual decline in the weighted average interest rate on loans (MFI - by 0.9 p.p. compared to the same period of 2013, CU – by 0.7 p.p.).

3.1. Main Trends

The system of non-bank financial and credit institutions subjected to licensing and regulation by the National Bank as of September 30, 2014 in the Kyrgyz Republic included: a specialized financial institution - OJSC “FCCU”; 139 credit unions; 225 microfinance institutions (including 4 microfinance companies, 164 microcredit companies and 57 microcredit agencies) and 332 exchange offices.

Resources

Chart 3.1.1. Dynamics of NBFIs liabilities and capital



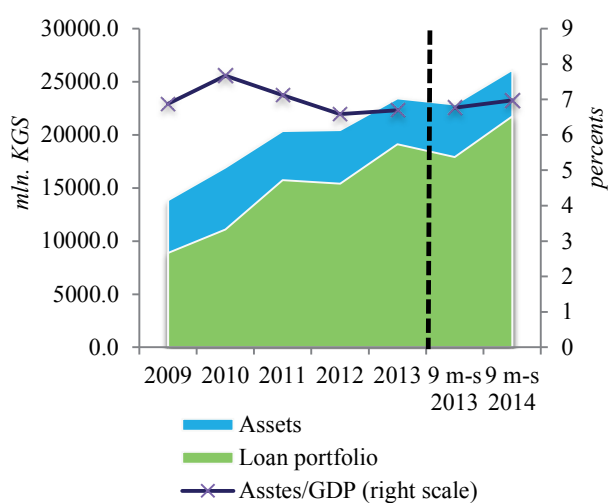
Source: NBKR

Note: since 2012 data are specified exclusive of “Bai-Tushum” Bank

As of September 30, 2014, NBFIs liabilities increased by 19.5 percent and were formed at the amount of KGS 16 914.5 million. NBFIs capital in the reporting period increased by 5.9 percent and totaled KGS 9 195.8 million (Chart 3.1.1). Resource base growth was mainly due to the increase in the share of authorized capital and general reserves of NBFIs, as well as increased external financing of the non-banking financial sector.

The main volume of the resource base of the NBFIs falls under the loans received from non-residents (as of September 30, 2014 the share of these loans constituted 87.0 percent, for the same period of 2013 this share constituted 86.0 percent).

Assets

Chart 3.1.2. Dynamics of NBFIs assets and loans


Source: NBKR

Note: since 2012 data are specified exclusive of "Bai-Tushum" Bank

According to periodic regulatory reporting, the total assets of NBFIs in the reporting period increased by 14.3 percent and amounted to KGS 26 110.3 million. This growth was due to increase in the credit portfolio of NBFIs (Chart 3.1.2).

The main activity of NBFIs remains lending. At the end of the reporting period, the credit portfolio of NBFIs increased by 21.4 percent and was formed in the amount of KGS 21 726.5 million (Table 3.1.1).

As of September 30, 2014, the number of borrowers increased by 0.9 percent compared to the same period of 2013 and amounted to 448 188 borrowers.

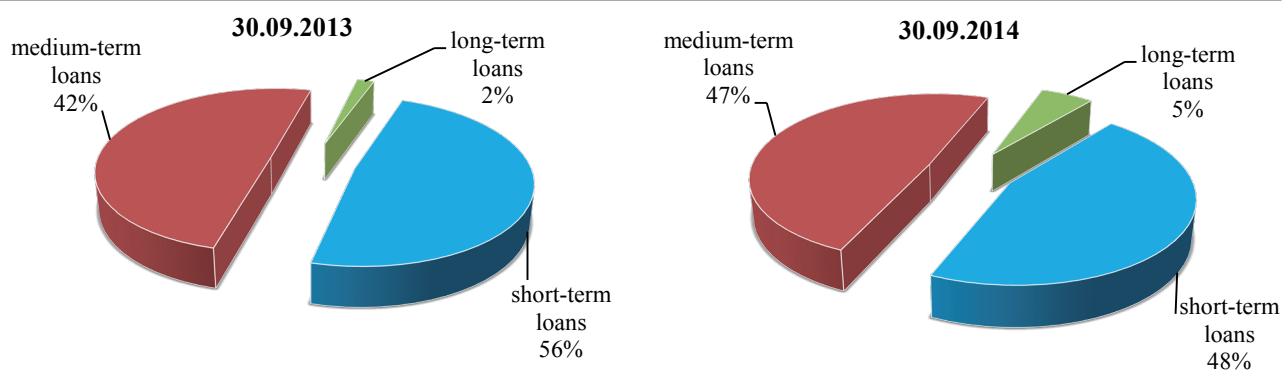
Table 3.1.1. Structure of assets in NBFIs

	30.09.2013		30.09.2014	
	mln. KGS	share, %	mln. KGS	share, %
Financial assets, including:	21,051.6	92.2	23,957.7	91.8
<i>net loans and borrowings*</i>	17,901.4	78.4	21,726.5	83.2
<i>correspondent accounts in commercial banks</i>	1,473.4	6.5	849.4	3.3
<i>deposits in commercial banks</i>	1,008.7	4.4	715.9	2.7
<i>other financial assets</i>	668.1	2.9	666.0	2.6
Non-financial assets, including:	1,791.2	7.8	2,152.6	8.2
<i>fixed assets</i>	733.1	3.2	817.5	3.1
<i>other non-financial assets</i>	1,058.1	4.6	1,335.2	5.1
Total assets	22,842.8	100.0	26,110.3	100.0

Source: NBKR

* Exclusive of LLP

There have been slight changes in the structure of the loan maturity provided by NBFIs. As of September 30, 2014, an increase in the share of medium-term credit resources and the decline in short-term loans were observed (Chart 3.1.3).

Chart 3.1.3. Structure of the NBFIs credit portfolio by maturity


Source: NBKR

Note: data for the period

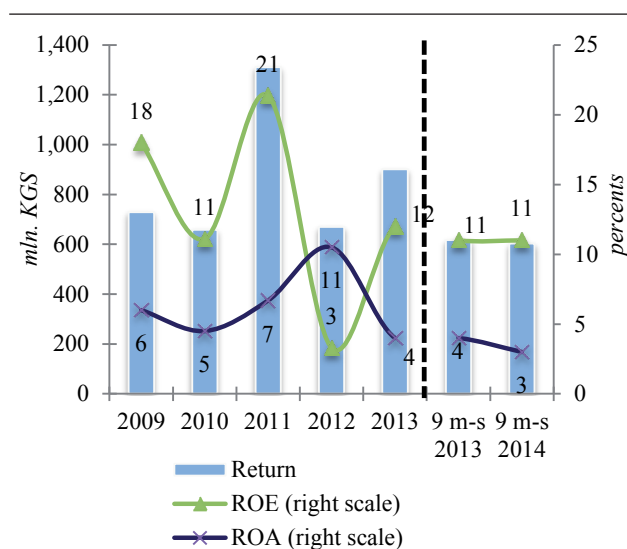
The main oblasts where the major share of credit portfolio of NBFIs is concentrated (66.0 percent of total credit portfolio) are Bishkek city, Chui, Osh and Jalal-Abad oblasts (Table 3.1.2), with is due to the highest level of business activity in these oblasts of the republic.

Table 3.1.2. Geographic structure of the NBFIs credit portfolio

	30.09.2013		30.09.2014	
	mln. KGS	share, %	mln. KGS	share, %
Bishkek city and Chui oblast	5,704.3	31.9	7,138.1	32.9
Jalal-Abad oblast	2,742.8	15.3	3,575.4	16.5
Osh oblast	2,924.1	16.3	3,612.8	16.6
Batken oblast	1,615.8	9.0	1,761.1	8.1
Issyk-Kul oblast	1,645.6	9.2	1,978.3	9.1
Naryn oblast	1,073.2	6.0	1,390.3	6.4
Talas oblast	1,012.7	5.7	1,176.5	5.4
Outside Kyrgyzstan	1,182.8	6.6	1,094.0	5.0
Total	17,901.4	100.0	21,726.5	100.0

Source: NBKR

Revenue position³²

Chart 3.1.4. Dynamics of NBFIs revenue position*


Source: NBKR

*exclusive of FCCU

As of September 30, 2014 net profit of NBFIs decreased by 2.3 percent compared to the same period of 2013 and amounted to KGS 604.0 million. ROA at the end of the reporting period decreased by 1 p.p. and amounted to 3.0 percent, ROE did not change and constituted 11.0 percent (Chart 3.1.4).

³² ROA and ROE indices are provided in annual terms.

3.2. Risks of Non-bank Financial Institutions

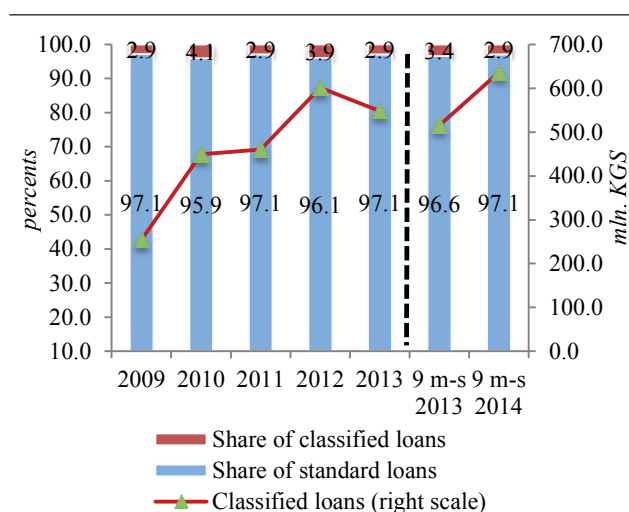
Major risk factors of the activities of NBFIs are the quality of the credit portfolio, industrial and institutional concentration, as well as status of the external debt of NBFIs.

Quality of the credit portfolio of NBFIs

Increase in the nominal volume of troubled loans was observed in the period under review (an increase by KGS 120.8 million or 23.4 percent compared to the same period of 2013, Chart 3.2.1).

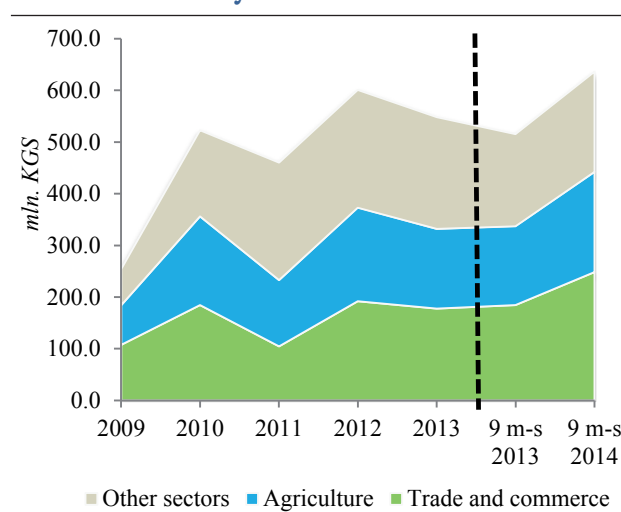
As of September 30, 2014, the structure of NBFIs classified loans noted increase in the share of non-performing loans for trade (by 3.3 p.p. compared to the same period of 2013), as well as agricultural loans (by 0.8 p.p.) of the total classified loans of NBFIs (Chart 3.2.2).

Chart 3.2.1. Quality of NBFIs credit portfolio



Source: NBKR

Chart 3.2.2. Structure of NBFIs classified loans by sectors of economy



Source: NBKR

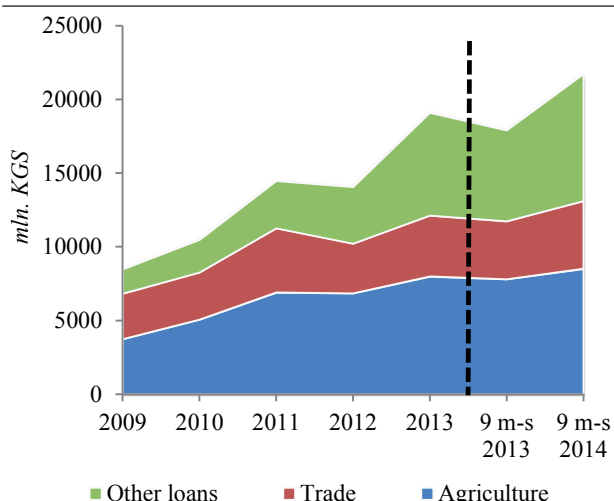
Sectoral concentration

NBFI credit portfolio is concentrated in agriculture (39.1 percent of NBFIs total loans) and trade (21.2 percent of the total credit portfolio, Chart 3.2.3). Lending of agriculture is associated with a high risk because of their dependence on climatic conditions and low level of the population income in the remote oblasts of the republic.

Institutional concentration

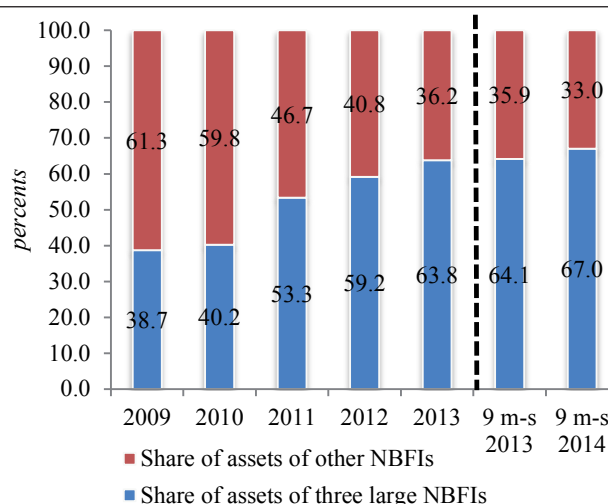
As of September 30, 2014, the share of assets of the three largest NBFIs increased by 2.9 p.p. compared to the same period of 2013 and amounted to 67.0 percent of the total assets of NBFIs system (Chart 3.2.4).

Chart 3.2.3. Sectoral structure of NBFIs credit portfolio



Source: NBKR

Chart 3.2.4. Institutional structure of NBFIs assets



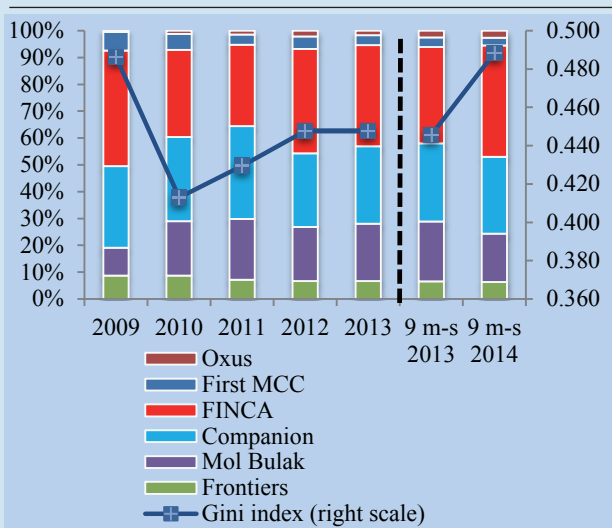
Source: NBKR

Box 5. Assessment of NBFIs system activity on the basis of concentration indices³³

— **The Herfindahl-Hirschman Index**

Herfindahl-Hirschman index was calculated for the purposes of concentration risk analysis in the NBFIs system³⁴. As of September 30, 2014, Herfindahl-Hirschman index for the NBFIs system constituted 2 927.3 points. According to the rule of thumb³⁵ resulting value indicates availability of significant concentration of NBFIs assets or high concentration of microfinance market.

Chart 3.2.5. Dynamics of the Gini index and 6 largest NBFIs



Source: NBKR

— **The Gini Index**

The Gini index was calculated for estimating the uniformity of NBFIs assets distribution. As of September 30, 2014, the index value constituted 0.488, which reflected the moderate distribution of assets among the largest microfinance institutions. Meanwhile, the concentration level almost did not change (Chart 3.2.5).

³³ Concentration indices are calculated on the basis of data submitted by 6 largest NBFIs.

³⁴ $H = \sum_{i=1}^n (\text{share}_i)^2$

³⁵ The following rule of thumb was used for determining the level of market concentration:

- index value is below 0.1 (or 1,000) – insignificant market concentration,
- index value is from 0.1 to 0.18 (or from 1,000 to 1,800) – average market concentration,
- index value is above 0.18 (or 1,800) – high market concentration.

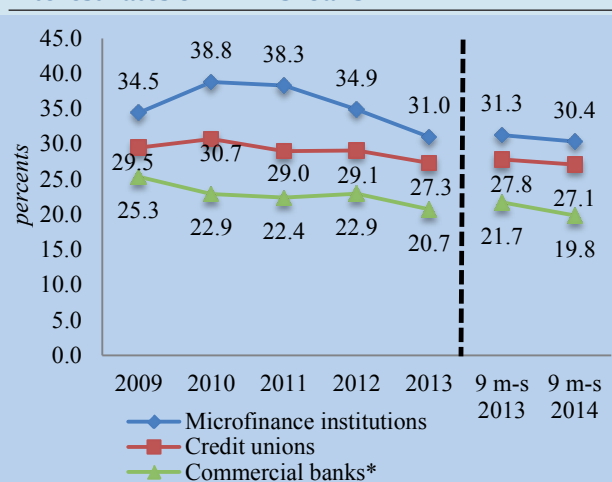
External debt status of NBFIs

As of September 30, 2014, the external debt of NBFIs amounted to USD 244.7 million. In the institutional structure of the external debt of NBFIs, a substantial proportion falls under the six largest NBFIs established and funded by international financial institutions. More than half of the external debt of NBFIs are loans provided by the international financial institutions (54.0 percent of total external debt of NBFIs), and the rest are loans of foreign commercial financial institutions (46.0 percent of total external debt of NBFIs).

As of September 30, 2014, external debt of 6 largest NBFIs increased by 19.5 percent compared to the same period of 2013 and amounted to USD 242.3 million.

Box 6. Overview of interest rates, net cost and profitability of the NBFIs loans

Chart 3.2.6 Dynamics of weighted average interest rates on NBFIs loans



Source: NBKR

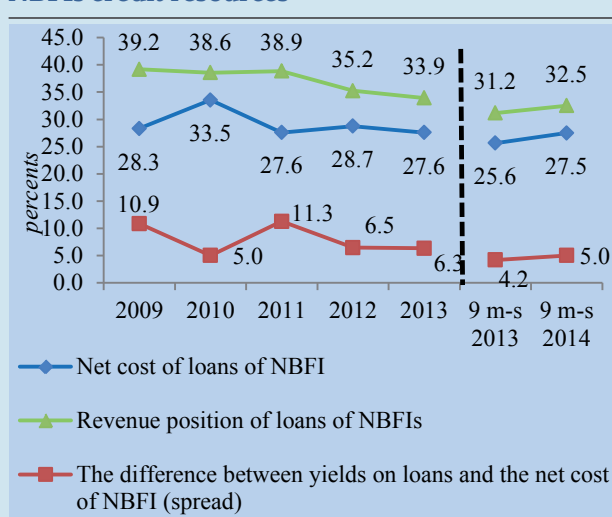
*Interest rates are presented in the national currency

In the reporting period the tendency of decrease of interest rates on NBFIs loans was observed. The weighted average interest rates of MFIs decreased by 0.9 p.p., and CU – by 0.7 p.p. (Chart 3.2.6).

As of September 30, 2014, the cost value³⁶ of loan resource of NBFIs increased by 1.9 p.p., due to increase in the net cost of six largest NBFIs loans by 3.6 p.p. (Charts 3.2.7 and 3.2.8).

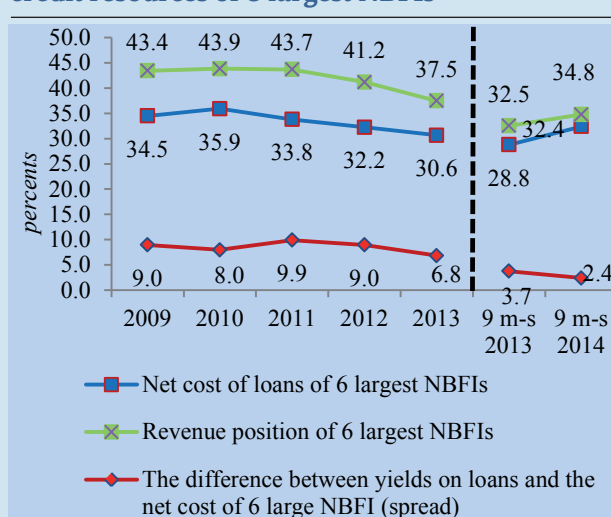
Meanwhile, the net cost of the largest NBFIs loans exceeded average cost value of loans in the NBFIs system in general.

Chart 3.2.7. Dynamics of net cost and yield of NBFIs credit resources



Source: NBKR

Chart 3.2.8. Dynamics of net cost and yield of credit resources of 6 largest NBFIs



Source: NBKR

Growth rates of the interest incomes exceeding growth rates of the annual average credit portfolio affected increase of NBFIs loan profitability³⁷.

³⁶ Loans net cost or breakeven point = (Gross expenditures – Non-credit incomes)/ Annual average credit portfolio.

³⁷ Loan profitability is calculated as a ratio of interest incomes to annual average credit portfolio.

3.3. Stress Testing of the NBFIs System

Stress testing of the NBFIs credit risk

Sensitivity analysis in which the effect of deterioration of the credit portfolio quality on the system of NBFIs as a whole is computed was conducted.

Three scenarios were considered when conducting stress testing:

Scenario 1: 50% of loans transition from one category to another;

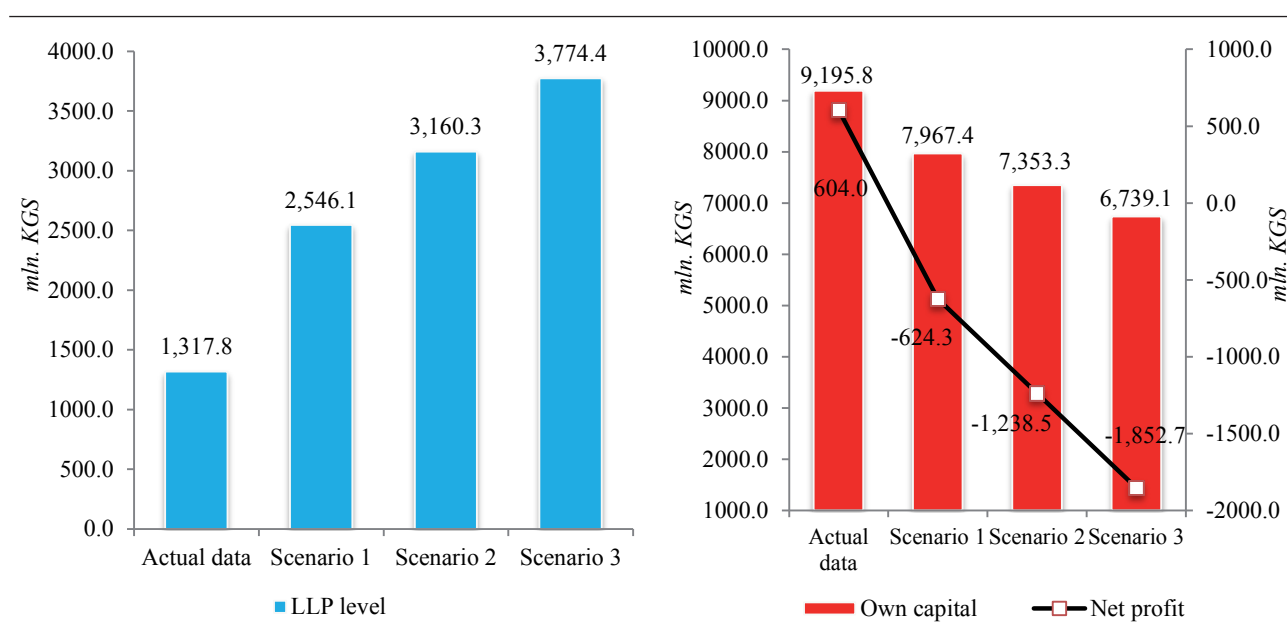
Scenario 2: 75% of loans transition from one category to another;

Scenario 3: 100% of loans transition from one category to another.

The transition of loans from one category to another occurs uniformly by the following categories: “standard”, “under supervision”, “substandard”, “doubtful” and “losses”.

The level of LLP³⁸ in the credit portfolio of NBFIs increased from 93.2 to 186.4 percent, depending on the scenario in conducting the stress testing (Chart 3.3.1).

Chart 3.3.1. Results of stress testing of the credit risk as of September 30, 2014



Source: NBKR, NBKR calculations

It should be noted that the deterioration of the credit portfolio quality entails a gradual decline in equity and net profit of NBFIs. In the case of the first scenario, the NBFIs become unprofitable and suffer losses in the amount of KGS 624.3 million. Implementation of the second and third scenario may result in increase of losses up to KGS 1 238.5 million and KGS 1 852.7 million respectively (Chart 3.3.1).

³⁸ MFIs create general and special LLPs for relevant categories of classifications implementing the following allocations indicated in percentage from the amount of assets:

- Standard- from 0% to 5%
- Assets under supervision – 10%
- Substandard - 25%
- Doubtful - 50%
- Losses - 100%

Table 3.3.1. Results of stress testing of the credit risk, percent

	Share of classified loans in the credit portfolio of NBFIs
Scenario 1: transition of 50% of loans from one category to another	7.1
Scenario 2: transition of 50% of loans from one category to another	9.2
Scenario 3: transition of 100% of loans from one category to another	11.2

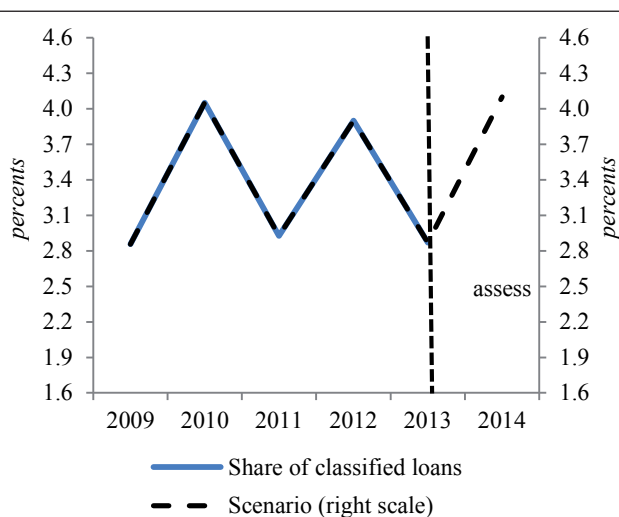
Source: NBKR, NBKR calculations

Implementation of the first scenario may result in an increase in the share of troubled assets in the credit portfolio of NBFIs by 4.2 p.p., to the level of 7.1 percent. In the case of the second scenario, troubled loans may increase by 6.3 p.p., to the level of 9.2 percent, and in the implementation of the third scenario – by 8.3 p.p. and may reach the level of 11.2 percent.

Stress testing of the loan risk of NBFIs based on the econometric model

This stress test was carried out on the basis of an econometric model, which characterizes the dependence of NBFIs classified loans on macroeconomic factors.

Chart 3.3.2. Dynamics of NBFIs troubled loans



Source: NBKR

In order to assess the impact of macroeconomic shocks on the dynamics of the NBFIs classified loans share the following scenario was considered:

- Reducing the rate of GDP growth by 10 percent.

An increase in the share of troubled loans in the credit portfolio by 1.2 p.p., up to the level of 4.1 percent may occur in the process of this scenario implementation.

IV. PAYMENT SYSTEMS

In the reporting period, a set of measures taken in the reporting period aimed at minimizing the financial and operational risks in the important payment systems, ensuring smooth functioning of the system through controlling the operation of the payment infrastructure helped to minimize the impact of potential risks on financial sector stability.

The level of financial risks of systemically important payment systems was minimum and conditioned by remaining high level of liquidity on the correspondent accounts of the participants in the National Bank, as well as updating of equipment in order to decrease operational risks and increase of profitability.

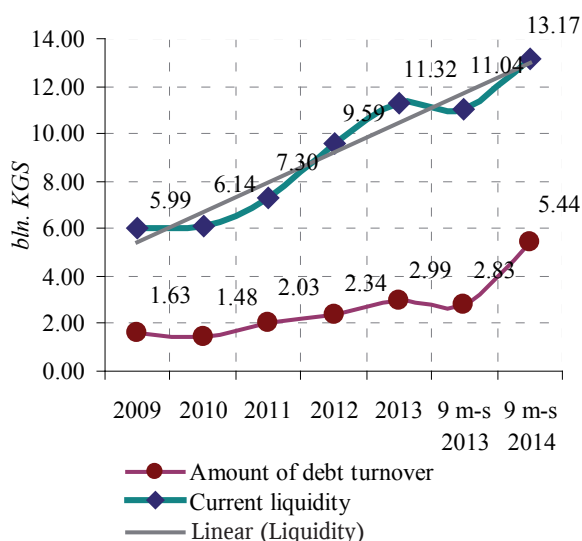
Effective and safe payment and settlement system is one of the main factors, which determine stability of the financial sector in the country.

As of October 1, 2014, the following components of the payment system were operating in the Kyrgyz Republic:

1. Interbank Payment System - Real Time Gross Settlement (RTGS)
2. Clearing Payments System - the System of Batch Clearing of Small Retail and Regular Payments (SBC)
3. Systems of Payment Cards Settlement
4. Money Transfer Systems

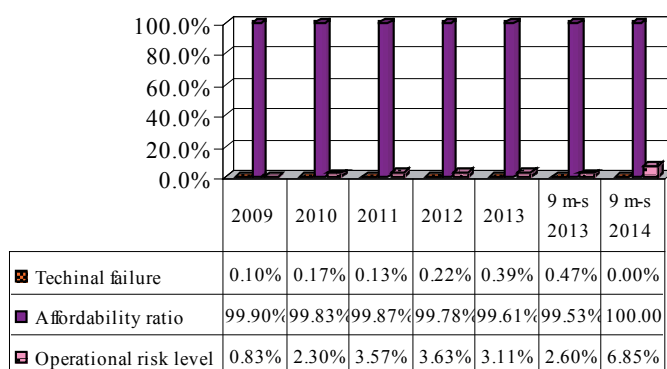
Over the past 9 months of 2014, **RTGS** functioned normally.

Chart 4.1. Dynamics of changes of daily average indicator of payment volumes and liquidity in the RTGS



Source: NBKR calculations

Chart 4.2. Ratio of affordability and operational risk in RTGS



Source: NBKR calculations

The level of financial risk in RTGS remained low due to high level of liquidity in relation to the turnover in the system (liquidity ratio was 2.42, the turnover ratio – 0.41). Average daily volume of liquid assets of participants during 9 months of 2014 showed an increase by 19.27 percent (compared to the same period of 2013) and amounted to KGS 13.17 billion.

The analysis of RTGS operation showed that affordability ratio³⁹ in the reporting period constituted 100.0 percent, having increased by 0.5 percentage point compared to the indicator of the same period of 2013; and the level of operational risk, taking into account prolongation of the transaction day, constituted 6.85 percent. It is necessary to note that RTGS is a systematically important payment system and updating of RTGS equipment was carried out in August 2014, as well as productive capacity was increased in order to provide smooth functioning of this system.

Besides, *payments in queue and outstanding payments for insufficiency of participants' funds*⁴⁰ are the indicators of possible financial risks in the RTGS. 505 payments in queue were registered during 9 months of 2014 (Table 4.1.) from 5 participants of the system to the total amount of KGS 5 billion 774 million.

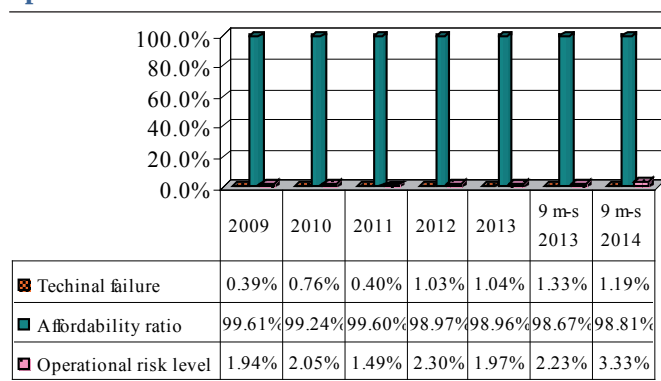
Table 4.1. Summary data on payments of RTGS

Name	2009	2010	2011	2012	2013	9 m-s 2013	9 m-s 2014	Growth (%)	Increase
Payments in queue:									
- Quantity	46	40	204	215	210	201	505	2.5	304.0
- Total time (<i>minutes</i>)	1,987	1,312	6,904	11,469	10,730	10,527	1,629	-84.5	-8,898.0
Outstanding payments for lack of liquidity:									
- Quantity	2	3	8	4	7	4	6	50.0	2.0
- Volume (<i>mln. KGS</i>)	185.4	22.0	32.3	1.3	17.2	9.5	715.1	75.3	705.6

Source: NBKR calculations

Fixed payments in queue did not entail financial risks to other participants, as they were related to the time lag between the receipt of funds from the correspondent account of the participant and sending payment system. In accordance with the rules of the system, in case of lack of liquidity of the individual participants, these payments are automatically rejected by the system at the end of the trading day.

Chart 4.3. Ratio of affordability index and operational risk in SBC



Source: NBKR calculations

In the SBC the level of financial risks in the reporting period was low. Reserves exhibited by the participants to cover a debit net position were 2.6 times higher than the required level. According to the results of monitoring of the SBC system functioning, the system accessibility index in the reporting period remained high and constituted 98.81 percent, meanwhile, by extending the work schedule and technical failures, operational risk level was 3.33 percent, having increased by 1.10 percentage points. *Updating of the SBC equipment* was carried out in May 2014, in order to decrease operational risks.

Systems of Bank Payment Cards Settlements. As of October 01, 2014, 5 international card payment systems and the national system “ElCart” of payment cards settlements operated in the Kyrgyz Republic.

Penetration level of bank payment cards remains rather low, as on average only every 5th person

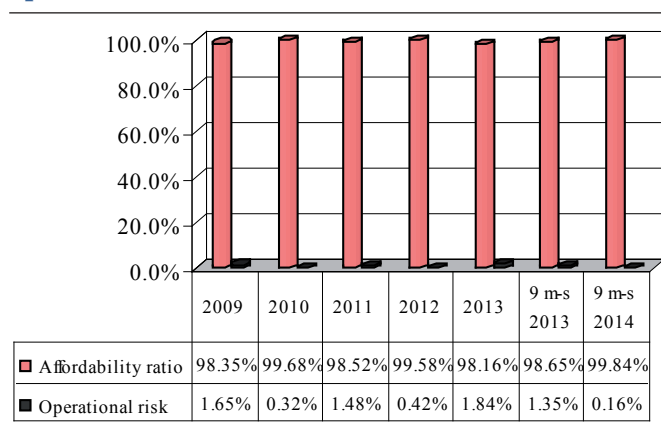
³⁹ *Affordability ratio* is an indicator, characterizing system affordability as a possibility of access to available services and information for system users upon their request. System shutdown due to technical failures, power outages, late opening or early closure of the system trading day reduce the time of access to the system.

⁴⁰ Such situation occurs in case of lack of participants' funds on the correspondent account opened in the National Bank.

in has a map (taking into account the fact that the number of capable of working and adult capable of working population is 3.881 million people). At the same time, there was a positive trend of increasing in the number of issued payment cards. Thus, the total number of bank payment cards in circulation as of October 01, 2014, amounted to 847 253 units. The number of cards increased by 47.3 percent compared to the same period of 2-13.

Commercial banks offered diverse range of additional banking services through using credit cards at affordable rates. However, the reasons for low level of the payment cards penetration are insufficient stimulation and informing the public about the services offered and bank products with the use of payment cards, as well as insufficient provision of peripheral devices in the remote oblasts of the republic.

Chart 4.4. Ratio of affordability index and operational risk in UIP



Source: NBKR calculations

Within the framework of implementation of the State program on increase of non-cash payments and settlements in the Kyrgyz Republic during 2012-2017 (joint resolution of the Government of the Kyrgyz Republic and the NBKR №289/5/1 dated 14.05.2012), the commercial banks conduct operations on expansion of infrastructure for servicing bank payment cards in the remote oblasts of the republic.

Thus, the total number of operating terminals and ATMs as of October 01, 2014 constituted 953 ATMs and 4 382 terminals (thereof: 3 250 terminals are installed in the points of sale and trade and 1 132 terminals are

installed in the branches and savings offices of the commercial banks), installed in the territory of the whole republic (compared to the same period of the last year the number of ATMs increased by 26.2 percent, and terminals - by 53.2 percent).

In the national system “ElCart”, 23 commercial banks provided service to the clients during 9 months of 2014. The system affordability index constituted 99.84 percent, and the level of operational risks, taking into account technical failures in the system, constituted 0.16 percent, which shows stable operation of the national system “ElCart”.

In respect of ***the international settlement systems by means of payment cards***, currently, commercial banks operate with such international payment systems as Visa, MasterCard, American Express, Union Pay and Zolotaya Korona.

In respect of the amount and number of transactions, the largest share accounts for such systems as Visa (65.18 and 62.92 percent respectively) and Zolotaya Korona (34.15 and 36.77 percent respectively).

During 9 months of 2014, receipt and transfer of money without opening an account in the commercial banks was carried out by means of 22 ***international money transfer systems***.

Number and volume of incoming payments compared to the previous period showed growth, which by the number of remittances constituted 6.77 percent, and by the volume – 13.19 percent (KGS 95.57 billion). Increase of indices was observed in the number (by 36.59 percent) and the volume (by 7.23 percent) of remittances transferred abroad. The total volume of outgoing remittances amounted to KGS 23.67 billion.

The main share of received and transferred remittances/payments accounted for such systems as Zolotaya Korona, Leader, Unistream, Contact and Western Union.

In the reporting period, ***cross-border payments*** were carried out through different communication channels, however, the main flow of financial messages accounted for SWIFT telecommunication network (more than 90 percent of the total number and 87 percent of the total volume of payments).

V. IMPROVEMENT OF THE REGULATION OVER THE FINANCIAL SECTOR

In the reporting period the National Bank of Kyrgyz Republic took measures on improvement of regulatory and legal base regulating the activity of financial and credit institutions. Special attention was given to the issues of foreign exchange risks management in the activity carried out by the banks and non-bank financial and credit institutions, as well as bringing normative legal acts in compliance with amendments in legislation of the Kyrgyz Republic.

Risk management in the banks

The Resolution of the National Bank Board, according to which limits of open currency positions of the banks were temporarily, from February 18 till March 1, 2014, lowered, was adopted on February 17, 2014 in order to minimize foreign exchange risks of commercial banks.

Additions to the Regulation “On classification of assets and corresponding allocations to loan loss provision” were approved for reducing indirect foreign exchange risks in the course of loan provision to the clients in foreign currency, whose income is generated in the national currency. According to these additions, the loans provided in foreign currency are classified as “assets under supervision” with reserve of 5 percent, if the amount of regular loan repayments by the borrower-individual, including individual entrepreneurs without formation of a legal entity, in foreign currency constitutes more than 40 percent of his/her total income for the same period. Meanwhile, his/her total income in foreign currency constitutes less than 50 percent of the total income.

Regulatory reporting of banks

Within the framework of improving the form of periodic regulatory reporting of banks, as well as on the consolidated basis, amendments and additions were introduced in the Regulations “On periodic regulatory reporting of banks” and “On periodic regulatory consolidated reporting”.

Other issues

In order to provide the banks with the right to lease idle bank premises, amendments and additions were approved in the Regulation “On individual transactions/operations of the commercial banks and microfinance companies with real estate in the Kyrgyz Republic”.

Amendments and additions were introduced into some regulatory legal acts of the National Bank related to the activity of the exchange offices and exchange bureaus with a view of cancellation of requirement on application of cash register machines by the banks according to the Decree of the Kyrgyz Republic Government, as well as for the purposes of bringing in compliance with the laws of the Kyrgyz Republic on the issues of CTF/AML.

Regulation of non-bank financial institutions

The National Bank approved a set of normative legal acts regulating the procedure of observing the limits of open currency positions of micro-finance companies and credit unions in order to bring thereof in compliance with the legislative acts of the Kyrgyz Republic regulating activity on non-bank financial institutions and in order to minimize the currency risks of micro-finance companies and credit unions.

Taking into account applications of the microfinance companies which do not attract deposits, the term of coming into force for the Instruction for the microfinance companies, is extended till January 01, 2015.

Moreover, amendments were introduced to some normative legal acts regulating activity of the micro-finance organizations in order to receive information about the structure of equity of this organizations.

Islamic principles of financing

A number of normative legal acts regulating activity of non-bank financial institutions was approved due to adopted additions to the Laws “On micro-finance organizations in the Kyrgyz Republic” and “On credit unions” aimed at development of the islamic principles of financing. These normative legal acts are aimed at establishment of prudential standards, requirements on credit risk management, drawing up regulatory reporting and recommendations on accounting obligatory for micro-finance organizations and credit unions. The requirements related to regulatory capital and banking operations were reconsidered in order to further improve normative legal acts regulating activity of the Islamic banks and the banks having “Islamic window”.

Financial Soundness Indicators of the Kyrgyz Republic⁴¹*(in percents)*

	2010	2011	2012	2013	9 m-s 2013	9 m-s 2014
Banking sector						
<i>Indicators of the capital adequacy</i>						
Regulatory capital to assets, weighted by risk	30.5	30.3	28.3	25.0	24.5	22.9
Tier I capital to assets, weighted by risk	26.5	24.6	22.3	19.9	20.4	18.0
Equity to total assets	21.7	21.6	19.7	19.3	17.8	17.3
Ratio of classified loans to equity	33.1	21.9	16.8	13.8	15.1	13.8
Equity to total liabilities	27.7	27.6	24.4	23.3	21.6	20.8
Quality of assets						
Ratio of classified loans to credit portfolio	15.8	10.2	7.2	5.5	6.8	4.8
Loan loss provisions to credit portfolio	10.7	6.3	4.7	3.3	3.6	2.5
Loan loss provisions to classified loans	67.7	61.6	64.9	59.6	63.2	61.3
Ratio of currency loans to credit portfolio	55.7	55.2	53.7	53.6	51.6	55.4
Returns indicators						
ROA	1.1	3.0	3.0	2.8	2.7	2.7
ROE	7.1	17.7	18.5	18.0	17.0	18.6
Interest margin to total income	48.9	45.0	44.7	44.1	47.3	45.6
Spread between reference rate on deposits and loans	8.2	9.4	8.0	7.7	8.2	8.0
Liquidity indicators						
Ratio of high liquid assets to total assets	36.1	35.0	36.8	38.8	30.2	25.6
Ratio of high liquid assets to short-term liabilities	72.8	74.9	80.0	70.0	66.5	55.1
Sensitivity of market risk						
Ratio of net foreign exchange position to equity	-10.3	4.1	2.4	4.9	3.3	10.2
Other financial corporations*						
Ratio of assets to total assets of the financial system	22.3	23.0	18.7	17.2	17.9	16.6
Ratio of assets to GDP	7.7	7.1	6.6	6.7	6.8	7.0
Corporate sector (medium- and large-sized enterprises)						
Return on assets (ROA)	2.9	5.9	6.7	5.5	7.2	0.6
Return on equity (ROE)	6.2	12.7	16.3	16.4	21.5	1.8
Ratio of total liabilities to equity (leverage)**	2.2	2.1	2.1	2.1	2.1	2.2
Current liquidity ratio	1.3	1.4	1.4	1.3	1.4	1.3
Households sector						
Ratio of the households' debt to GDP	8.4	8.5	9.1	13.4	12.3	17.4
Ratio of households' debt to disposable income	11.9	13.2	13.4	21.8	18.7	25.3

Source: NBKR, NSC KR, calculations: NBKR

*- other financial corporations are presented by NBFIs

** - equity of the corporate sector is represented exclusive of shares of Centerra Gold Company

⁴¹ Financial soundness indicators are calculated according to the methodology of the IMF ("Instruction on identification of financial soundness indicators", IMF, 2007).

GLOSSARY AND ABBREVIATIONS

A *bank deposit* is the amount of money, accepted by a financial and credit institution under contract from another person on the terms of repayment, payment and maturity. Deposits can be term and demand. Demand deposits are made without specifying the shelf life, and time deposits are made for a certain period.

A *bank loan* is money provided by a bank for a fixed period under the terms of repayment and payment of loan interest.

A *foreign exchange market* is a market in which the purchase/sale of foreign currencies is made. By the economic content, it is a sector of the money market, where supply and demand for a specific product such as currency are balanced. According to its purpose and form of organization, it is a set of specific institutions and mechanisms that in concert provide an opportunity to freely sell and/or buy domestic and foreign currency on the basis of supply and demand.

A *money market* is a market in which there is the giving and receiving of funds in the form of loans and securities for a short term within the range of participants.

Deposit institutions are financial corporations, except the central bank, the main activity of which is to accept deposits and subsequently place these funds on their behalf.

Household is an individual or a group of individuals who live together, run a joint household, combine all or part of their income and property and who consume certain types of goods and services (mainly, housing and food). Households may exercise any economic activity, including the production.

Return on securities is the ratio of the annual return on the security to its market price; the rate of return received by the owner of the security.

Duration is the weighted average term to maturity of the instrument. It can be used as a measure of the sensitivity of the cost of financial assets to interest rate changes, but not as maturity as such.

The housing affordability index is an indicator of the state of the housing market in terms of the possibility of acquiring apartments by the people. Calculated as the ratio of the average market value of a standard apartment (total area of 54 sq. m.) to the average annual income of a family of three (two adults and a child).

The payment system affordability index is a measure of the availability of the system as access to services and information for users of the system on their demand. Downtime of the system due to technical failures, power outages, late opening or early closing of the trading day of the system reduce the time to access the system.

The liquidity ratio of payment systems characterizes sufficiency of liquid funds in the accounts of the participants of the system for the payments and settlements.

Macro prudential analysis is an assessment and monitoring of strong sides and vulnerable spots of the financial system taken as a whole.

Minimum consumer budget is the cost of a set of minimum benefits and services to the subsistence minimum.

Living wage is the valuation of the minimum set of benefits and services that are equal to the value of the minimum consumer basket, necessary for the preservation of human life and his/her health, and the amount of required payments and fees.

Disposable income is income that goes to private consumption and is free from tax. Personal disposable income is the difference between personal income and the amount of taxes or, appropriately, is the sum of consumption and the amount of savings.

A *real interest rate* is the nominal interest rate adjusted for inflation.

A *securities market* is organized exchanges and structures such as securities depository companies, accounting and clearing houses, as well as other companies that provide services related to the activities of the exchange. This category includes depositories and electronic clearing systems, the activity of

which is ensured by financial corporations and national self-regulatory organizations of oversight over the activities of stock exchanges and related institutional units or their regulation.

Stress tests are methods used for assessment of profiles vulnerability with respect to significant changes in the macroeconomic situation or exceptional but probable events.

An *unemployment rate* is the percentage of the actual number of unemployed to the total economically active population.

Financial assets include equity instruments and units/shares of investment funds, debt instruments, derivatives, stock options for employees and monetary gold.

A *financial market* is defined as a market in which economic actors sell and purchase financial claims in accordance with the established rules of behavior of participants.

ADB	– Asian Development Bank
GDP	– Gross Domestic Product
SRS GKR	– State Registration Service under the Government of the Kyrgyz Republic
POL	– Petroleum and Oil
GS	– Government Securities
CJSC	– Closed Joint-Stock Company
CPI	– Consumer Price Index
CAR	– Capital Adequacy Ratio
KR	– Kyrgyz Republic
KSE	– Kyrgyz Stock Exchange
IMF	– International Monetary Fund
MY	– Marketing Year
MF KR	– Ministry of Finance of the Kyrgyz Republic
MFO	– Microfinance Organization
NBKR	– National Bank of the Kyrgyz Republic
NSC KR	– National Statistical Committee of the Kyrgyz Republic
NBFIs	– Non-Bank Financial Institutions
NGS	– Non-Government Securities
OJSC	– Open Joint-Stock Company
OECD	– Organization for Economic Cooperation and Development
RK	– Republic of Kazakhstan
LLP	– Loan Loss Provisions
RF	– Russian Federation
CIS	– Commonwealth of Independent States
SFBR	– Specialized Fund for Banks Refinancing
USA	– United States of America
FAO	– Food Agriculture Organization of the United Nations
FCCU	– Financial Company of Credit Unions
FI	– Financial Institution
CBRF	– Central Bank of the Russian Federation
NTC	– Net Total Capital