

The National Bank of the Kyrgyz Republic

**Inflation Report
Third Quarter of 2007**

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Kyrgyz Republic Inflation Report

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This issue contains the description of the consumer price trends in the Kyrgyz Republic and its regions, analysis of major inflation factors, decisions made by the National Bank of the Kyrgyz Republic on monetary policy, and also presents inflation forecast for the upcoming period. It is published on a quarterly basis in Kyrgyz, Russian and English languages.

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Other Publications of the National Bank of the Kyrgyz Republic

Annual Report of the National Bank of the Kyrgyz Republic

This publication is a last year statement of the National Bank of the Kyrgyz Republic (NBKR). It contains brief information about the country's economic development and monetary policy, financial statements of the NBKR, general information about the NBKR, and statistic annexes. It is published in Kyrgyz, Russian and English languages.

Bulletin of the National Bank of the Kyrgyz Republic

This monthly publication contains statistic data for major macroeconomic indicators and sectors of economy of the Kyrgyz Republic. It is published in Kyrgyz, Russian and English languages.

Balance of Payments of the Kyrgyz Republic

Balance of Payments of the Kyrgyz Republic reflects trends of external sector development, data of the payment balance, foreign trade, international reserves, external debt, and international investment position of the Kyrgyz Republic. It is published on quarterly basis in January, May, July, and October in Kyrgyz, Russian and English languages.

Banking System Development Trends

This publication provides an analysis and assessment of the development of Kyrgyz banking system as a financial intermediary, and components of its stability. It is published semiannually in Kyrgyz, Russian and English languages.

Statutory Acts of the National Bank of the Kyrgyz Republic

The objective of this document is to officially publish the statutory acts of the NBKR in order to provide commercial banks and general public with regulatory documents and information about NBKR activities, and to popularize the banking legislation of the Kyrgyz Republic. It is published, as a rule, once a month in Kyrgyz and Russian languages.

Press Release of the National Bank of the Kyrgyz Republic

Press Release of the NBKR contains the description of events related to the National Bank and banking system, major financial market data for the week and other information for mass media, legal entities and individuals. It is published on a weekly basis in Kyrgyz and Russian languages.

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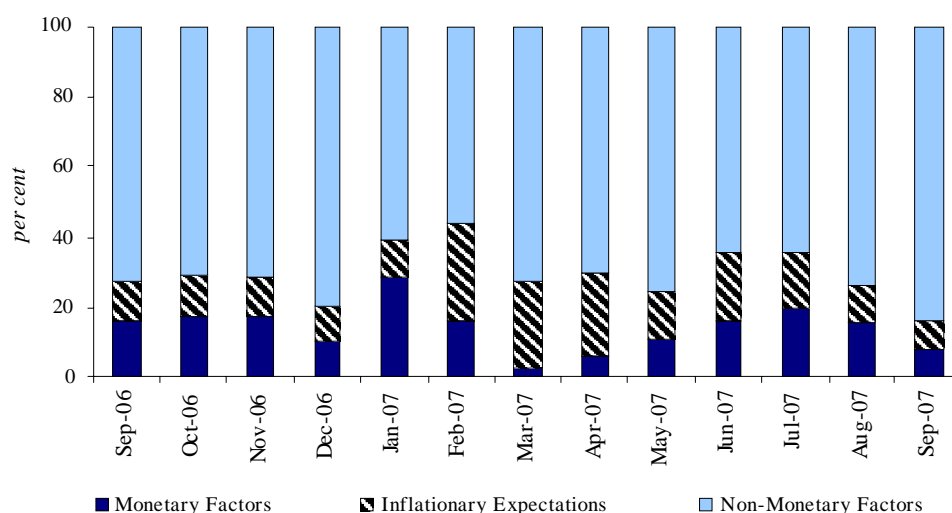
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1. CURRENT TRENDS

The third quarter of 2007 witnessed a rise in consumer prices, which was unusual for this period and happened mostly due to an increase in food prices. According to the KR National Statistics Committee, the inflation¹ since the beginning of 2007 amounted to 10.3% (September 2007 against December 2006).

The general inflation rate was formed by monetary² and non-monetary³ factors. According to estimates of NBKR, the impact of monetary factors, including changes in volume of currency held by the public and the exchange rate of som, amounted to 7.7%. The impact of inflation expectations amounted to 8.4%. The major contribution to the inflation rate – 83.9% – came from the non-monetary factors.

Chart 1.1. Inflation Factors



The dynamics of inflation over the reporting period formed on the ground of abundant supply of foreign currency, high demand for loans, continued growth of economic activities, and increased Government consumption expenditures.

According to the results of Q3 2007, the trade balance deficit totaled USD 276.2 Million. The foreign trade turnover grew due to the increase in both exports and imports.

The KR State Budget was fulfilled with a surplus, which is due to increase in budget incomes, as a result of higher rates of economic growth, and, on the other hand, due to moderate Government consumption. However, government wage costs, allowances and Social Fund transfers continue growing.

The growth of aggregate demand, due to increase in income growth of the population

¹ Change in the consumer price index (CPI).

² The monetary factors contribution is estimated by assessing the effect of changes in the exchange rate of som and non-bank money (M0) on the inflation rate, taking into account time lags and seasonality factor.

³ The non-monetary factors contribution is estimated by assessing the effect of changes in manufacturer prices, prices for bread and baked products, alcohol beverages, gasoline, housing and utility services, communication services, and passenger transportation services on the inflation rate, taking into account time lags and seasonality factor. The contribution of inflationary expectations is estimated by assessing contribution of the inflationary inertia index, i.e. inflation of the prior period adjusted for the influence coefficient.

and activities of business entities, stimulated the growth of consumption and increased demand for loans. In its turn, the rapid growth of GDP and the higher demand for loans resulted in money supply increase which mainly held via the foreign currency channel. In Q3 2007, the growth of monetary base and M2X monetary aggregate amounted 7.5 and 10.1% accordingly.

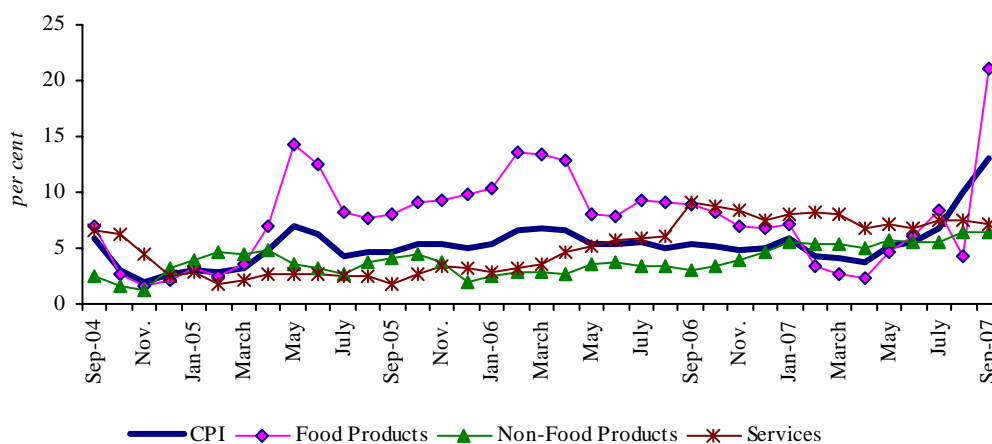
2. CONSUMER PRICE INDEX COMPONENTS

2.1. CPI COMPONENTS

According to the National Statistics Committee, the inflation rate in Q3 2007 amounted to 5.5%, against the decrease of consumer prices by 1.5% in Q3 2006. The growth of CPI, as compared with previous quarter and Q3 2006, amounted to 3.4% and 9.9% accordingly.

The high growth of prices for food commodities – such as milk and bakery products, oil and fats and meat – and some kinds of paid services (like educational services and catering) determined the general level of prices. The annual inflation rate reached 13.1%. In this case, the increase in prices for goods accounted for 13.8%, and service prices went up by 7.1%.

Charter 2.1. Annual dynamics of inflation and its components



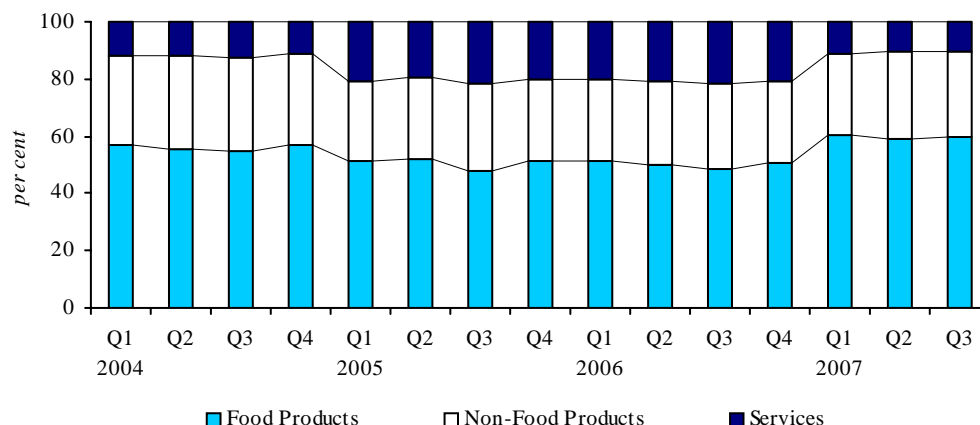
In the reporting period, the growth of prices for the group of food commodities and soft drinks became a main reason for the CPI growth. The growth in prices for this group amounted to 9.1%, which is 13.5 percentage points higher as compared with 3Q 2006, while the seasonality factor did no help to control the inflation rate growth. The development of prices for food was mainly determined by external price shocks, such as rise in world prices for grains, vegetable oil and dairy products.

It's noteworthy that the share of food commodities in the consumer basket accounts for about 60%.

The changes in the world demand and supply structure strongly stimulated the rise in prices in the world markets. In the view of increase in food consumption in India and China, the supply of food remains almost the same. The great impact comes from highest rise in costs of energy resources (oil, for instance), which obviously causes a rise in price for fuels for agricultural machinery and food and forage deliveries.

The prices behavior is also highly affected by international production of bioetanol fuel which is usually produced from corn, rye, sugar and palm oil.

Chart 2.2. CPI Structure



Moreover, the demand in the current year witnessed a significant decrease in supply of wheat due to huge harvest losses in such major exporters such as Canada and Australia.

As a result, in August 2007, Kyrgyzstan observed drastic rise in prices for the group of bakery products and grains. In September the growth continued and amounted to 33.8% in Q3 2007. The prices for bread and first grade flour went up by 49.8 and 41.3% accordingly. This was also caused by a decrease in crop capacity and reduction of crop areas in KR, which resulted in steady decline in gross harvest of grains. Production of grains (as initially weighed) as of October 1, 2007 reduced by 5.8% compared with the same period of 2006, including 18.0% for wheat. An estimated contribution of this group in general growth of consumer prices accounted for 5.2 percentage points.

The change in the grains market had its effect on a derivative production. For example, due to rise of grains prices the cost of forage went up, which in turn caused a growth of

Reference:

(1) The KR Government (resolution No 504, dated October 23, 2007) adopted a state program On Development of wheat seed-farming for 2008-2010 and the Action Plan for the implementation of the Program. The decision is aimed at the improvement of work conditions for seed-farming entities producing and selling pedigree wheat seeds; at the increase of wheat production; at the improvement of yield and avail properties of seeds; and at providing farmers with high quality sowing wheat seeds.

(2) The KR Government adopted Resolution No 474, dated October 18, 2007 On Emergency Measures for Provision of Market with Food Wheat, Flour and Vegetable Oils. The Resolution stipulates value added tax rate of 10% for imported food wheat, flour and vegetable oil; production and deliveries of flour, baked products and vegetable oil.

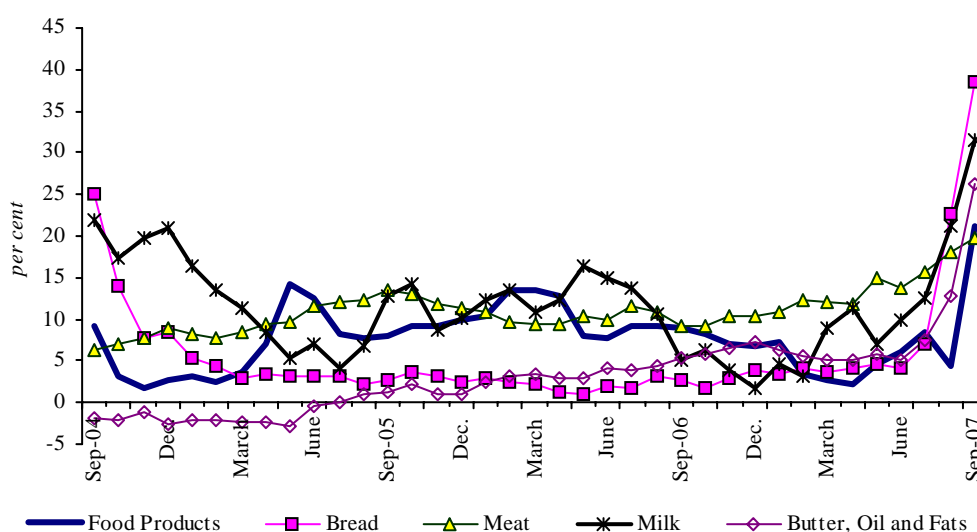
(3) The Government Resolution No 448, dated October 5, 2007 stipulates a temporary VAT rate of 0% for 50 thousand tons of food wheat imported by The National Fund of Material Reserves under The National Agency for Governmental Purchases and Material Reserves of The KR Government.

prices for meat production and eggs. Therefore, in 2007 Q3, increase in prices for meat products amounted to 6.9% (against 1.6% in 2006 Q3) and a slight growth in production of meat did not help. The growth in price for fish amounted to 1.7%.

The Q3 2007 also observed growth acceleration in prices for a group of milk products, cheese and eggs. In the reporting period, prices for these goods rose by 20.4%, which is quite significant against a 7% price decrease of Q2 2007 and 0.7% of Q3 2006. According to the estimates, this group of goods contributed 0.7 percentage points to the general growth in consumer prices.

The prices for oil and fats went up by 20.6%, against 0.8% in Q2 2007 and 2.4% in Q1. That contributed 0.4 percentage points to the general growth.

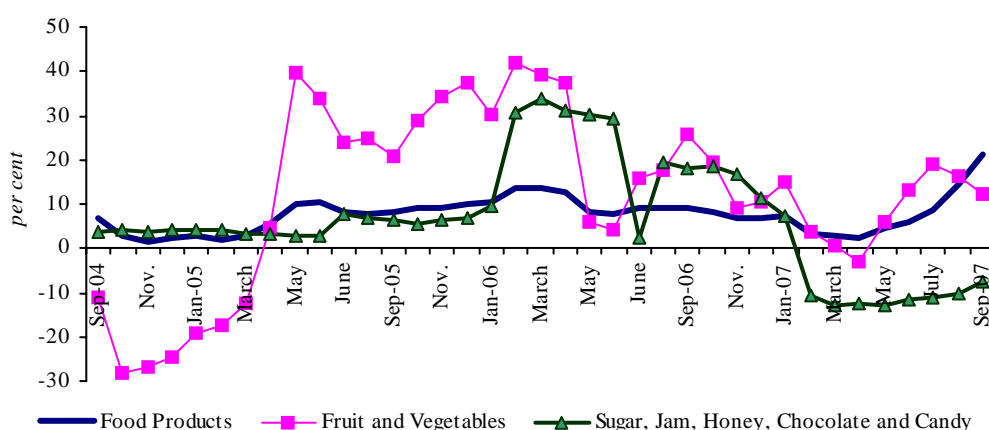
Chart 2.3a. Annual dynamics of prices for food products



In comparison with corresponding period of 2006, Q3 2007 had almost no changes in the market of fruits and vegetables. Thus, the deflation in Q3 2006 amounted for 24.5% against 25.2% in Q3 2007.

The decrease of sugar price appeared, most probably, as a correction for its drastic rise in Q1 2006. In comparison with Q3 2006, the price for sugar of the reporting quarter lowered by 17.9% (against its rise by 30.6% in Q3 2006, if compared with Q3 2005).

Chart 2.3b. Annual dynamics of prices food products

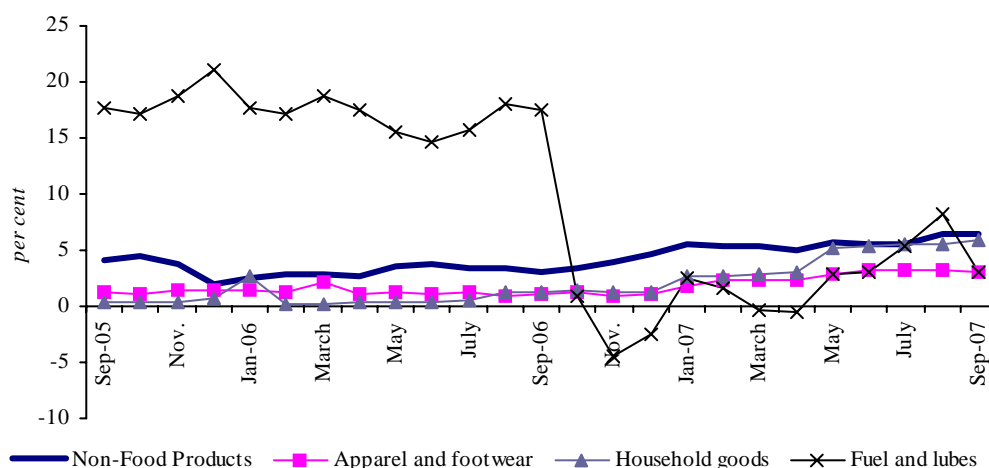


Over the reporting period, prices for alcohol and tobacco goods rose by 0.9% (against 0.4% in Q3 2006).

In Q3 2007, the CPI for non-food products went up by 1.8%. A trend of rising price for fuels and lubricants was observed beginning from May 2007; therefore the growth in price for these goods over Q3 2007 amounted to 8.1% (including 8.6% for gasoline, and 6.2% for diesel). This is due to an increase in wholesale and retail prices for fuels and lubricants brought to the domestic market by one of the major suppliers, reflecting the rise in sale prices of the manufacturers.

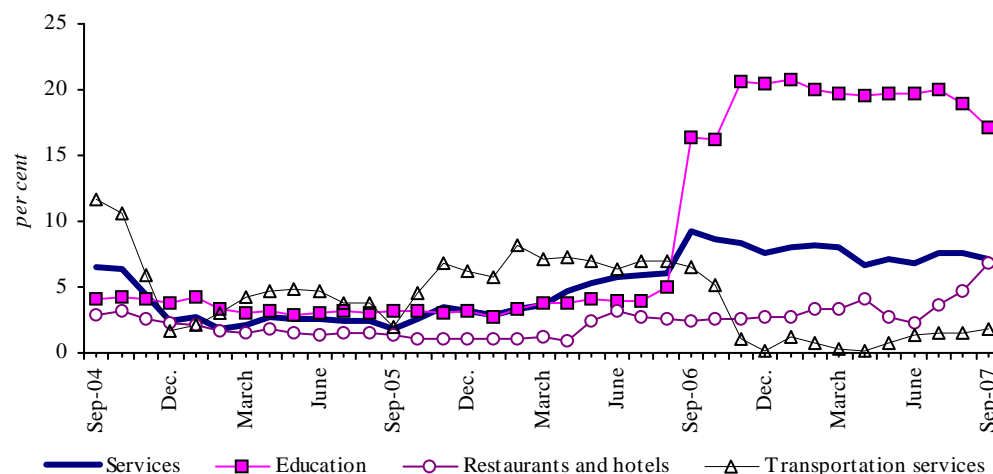
The price growth rate for household repair and maintenance materials began to slow down in the third quarter. In Q2 and Q3 2007, the prices rose by 20.5% and 2.2% accordingly. However, in comparison with Q3 2006, they rose by 28.1%, which reflects high internal and external demand for such goods. According to NSC, the growth in total gross construction volume in the period from January to September 2007 amounted to 39.2% as compared with the same period of 2006, while the export of construction materials over the nine months of 2007 increased by 41.4%.

Chart 2.4. Annual dynamics of prices for non-food products



The CPI for paid services grew by 4.2% in the third quarter of 2007 (against 3.9% in Q3 2006). In the reporting period, the highest rise in prices – by 12.5% – occurred in

Chart 2.5. Annual dynamics of prices for paid services



the education sector, reflecting the beginning of a school year. The service prices of restaurants and hotels rose by 4.5%.

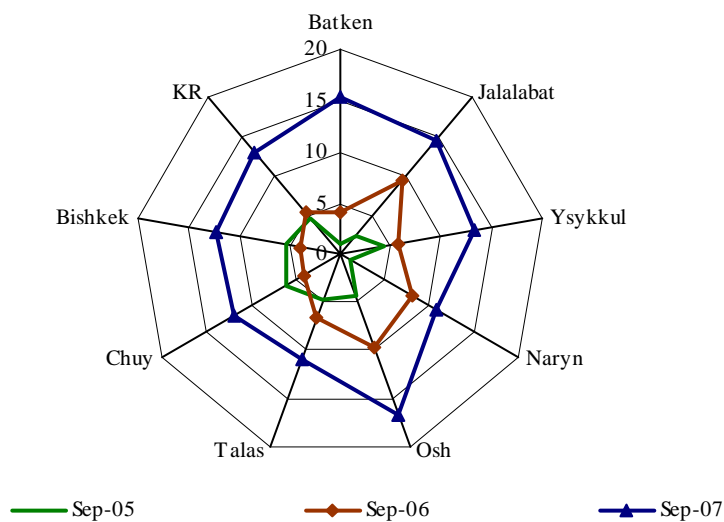
On an annualized basis, the CPI for services grew by 7.1%. Increase in prices for education, restaurants and hotels rose by 17.1 and 6.8% accordingly.

2.2. CONSUMER PRICE DYNAMICS IN REGIONS

Over Q3 2007 the price growth was observed in all KR regions. The highest rise occurred in Jalalabat (8.8%), Osh (7.4%) and Batken (6.2%) oblasts, mainly due to increase in price for the food commodities.

Bishkek observed a rise by 5.0%, while its food prices rose by 8.9%.

Chart 2.6. Annual dynamics of inflation by oblasts



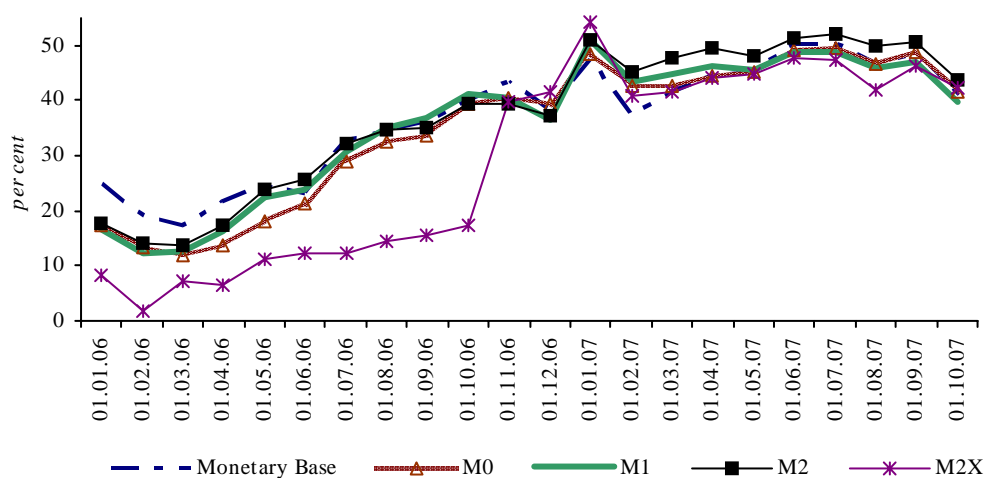
3. INFLATION FACTORS

3.1. MONETARY AGGREGATES

By the end of Q3 2007, the annual nominal growth rates of monetary aggregates remained almost unchanged as compared with the end of 2006 Q3 (September 2006 against September 2005), except for broad money M2X.

The dynamics of M2X differs from that of other aggregates due to changes effective November 2005 according to which the deposits of non-residents must now be excluded from M2X.

Chart 3.1. Annual nominal growth rate of monetary aggregates



3.1.1 Monetary base¹

In the third quarter of 2007, the monetary base amounted to 27,407.6 Million soms, having increased by 7.5% in nominal terms, and by 1.9% in real terms. By the end of September 2007, the annual growth of monetary base amounted to 40.9% in nominal terms and 24.7% in real terms.

The change in the monetary base (4,608.8 Million soms since the beginning of 2007) was primarily stimulated by the National Bank transactions which enlarged the reserve money by 6,597.8 Million soms, mostly due to currency interventions by NBKR (6,320.8 Million soms). The government transactions reduced the volume of monetary base by 2,004.6 Million soms, chiefly due to the excess of national income over expenditures of the state budget by 1,796.5 Million soms.

Compared to the beginning of 2007, the monetary base had witnessed increase in cash in circulation from 87.3% up to 88.8%, as of the end of September 2007. Therefore, the share of commercial banks' funds in correspondent accounts with NBKR reduced from 12.7% to 11.2%.

In the reporting period, money in circulation increased by 8.2% and totaled 24,333.3

¹ Regardless of commercial banks deposits with NBKR in foreign currency.

Million soms as of October 1, 2007. On the annualized basis, the growth rate of currency in circulation totaled 42.3% as of the end of September 2007, which exceeded the growth rates of the previous year (by 39.5% as of September 2006 against September 2005).

3.1.2. M2 Aggregate

By October 1, 2007, the M2 monetary aggregate totaled 30,125.1 Million soms. The increase of M2 aggregate in Q3 2007 amounted to 8.3% in nominal terms and 2.7% in real terms. By the end of September 2007, the annualized M2 monetary aggregate increased by 43.7% in nominal terms and by 27.2% in real terms.

The increase in M2 monetary aggregate over the Q3 2007 was caused by the growth of currency held by the public by 8.2% and deposits in the national currency by 8.9%. At the same time, the growth of transferable (demand) deposits and other (time) deposits amounted to 7.5% and 11.2% accordingly. At the end of September 2007, the annualized growth of deposits in the national currency accounted for 51.2%, which exceeded the growth rates of the comparable period of 2006 (39.0%).

3.1.3. M2X Aggregate

The M2X monetary aggregate which includes deposits in foreign currency increased by 10.1% and totaled 38,537.3 Million soms as of October 1, 2007 (against 34,995.6 Million soms as of July 1, 2007).

Over the reporting period, the growth of broad money was caused by the growth of the deposit base² of commercial banks³ by 13.3% and the growth of currency held by the public by 8.2%. At the same time, deposits in foreign currency increased by 17.1%, and their annualized volume went up by 32.3% (September 2007 against September 2006). For comparison, in Q3 2006, this index increased by 10.8%, but on the annualized basis a decrease by 20.2% was observed (September 2006 to September 2005).

As compared with the beginning of 2007, the structure of M2X monetary aggregate changed as follows:

- the share of currency held by the public increased from 60.0% to 60.8% (62.1% as of July 1, 2007);
- the share of deposits in the national currency grew from 14.5% to 17.0% (17.2% as of July 1, 2007);
- the share of deposits in foreign currency reduced from 25.5% to 22.2% (20.7% as of July 1, 2007).

The broad money multiplier which indicates the level of financial intermediation decreased

² Starting on October 01, 2005, a revised Chart of Accounts was adopted for commercial banks. Now it includes the residential status. Consequently, amendments were made to the method of accounting for non-residents' deposits and credits which are now recognized as obligations and requirements for non-residents (according to the methods and guidelines for monetary and financial statistics).

³ Including commercial banks which had their licenses revoked but which are still going through the liquidation process.

as compared with the beginning of 2007, and amounted 1.406 as of October 01, 2007 (against 1.373 as of January 01, 2007).

The circulation rate of M2X broad money including deposits in foreign currency at the fixed exchange rate amounted to 4.0 as of October 01, 2007 (against 4.5 as of January 01, 2007). The economy monetization ratio calculated based on M2X monetary aggregate amounted 25.2% (against 22.4% as of January 01, 2007).

3.2. INTEREST RATES

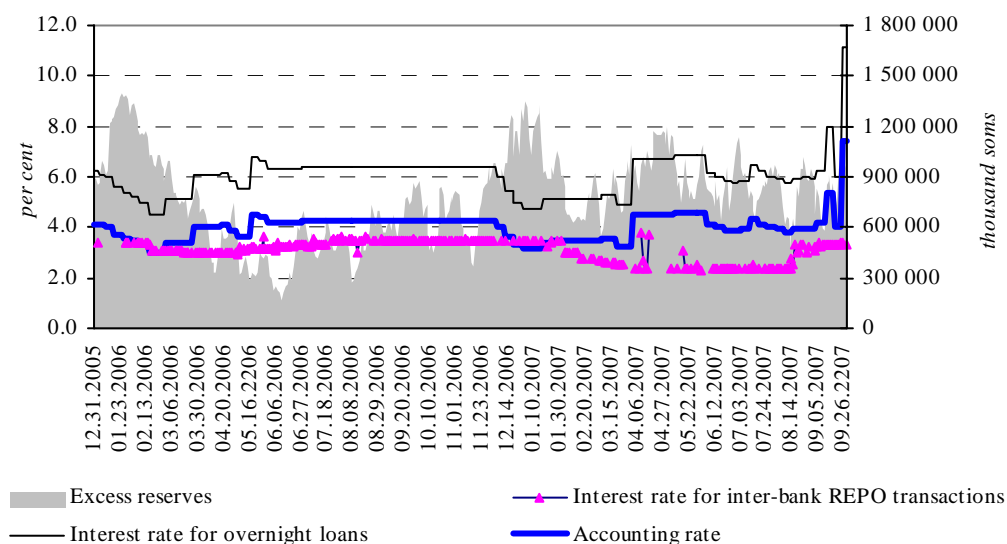
3.2.1. Money market

Despite the significant fluctuations, liquidity in the banking system remained high over Q3. The situation in the segment of general loans over the first half of the reporting period was stable. The interest rates for loans in national currency remained at 2.4–2.5% level. However, in mid-August the rates went up. The interest rate in the segment of REPO transactions increased on average by 0.2 percentage points within the reporting period as compared with the first quarter, and amounted 2.9%. The cost of loans in national currency decreased by 0.2 percentage points, down to 2.4%, reflecting the zero interest transactions made based on foreign currency collateral (such transactions did not take place over Q2). In comparison with Q3 2006, the average interest rate of both REPO transactions and general loans in national currency decreased by 0.7 and 0.2 percentage points, respectively.

Interest rates in the foreign exchange segment fluctuated within the range of 1.0% to 9.0%, depending on transaction term and kind of collateral. In the reporting period, the average cost of general loans remained unchanged and amounted to 6.4%. In comparison with the corresponding quarter of the last year, the interest rates of these loans had increased by 2.0 percentage points, mostly due to the extension of loan terms.

Over Q3 2007, the NBKR started using its own notes as a tool to withdraw excessive

Chart 3.2. Money market interest rate dynamics



liquidity. Beginning from the end of July, the volume of notes offered by NBKR increased from 32 Million soms to 150 Million soms per week. However, the demand of commercial banks for these notes remained moderate. Sometimes the volume of declared issues significantly exceeded the volume of bids. That resulted in the instability which was followed by a significant increase of notes' yield by the end of the period. Over Q3 2007, the average yield of 14-day notes amounted to 3.9%, increasing by 0.7 percentage points as compared with Q2 2007, while the rates of 28-day decreased by 0.1 percentage points down to 4.2%. At the same time, the interest rate pegged to the yield of 28-day notes amounted to 7.4% by the end of the period, and rose by 3.6 percentage points as compared with the beginning of Q3 2007.

At the end of Q3 2007, the interest rate for overnight credits initially set to 1.5 times discount rate amounted 11.1%. The NBKR performed no transactions for refinancing commercial banks by means of «overnight» loans in the reporting period.

In the reporting quarter, NBKR conducted REPO transactions on STB(s) sales in order to withdraw excessive liquidity out of the banking system, making reverse REPO contracts with the commercial banks for the amount of 1,549.5 Million soms. In comparison with the previous quarter, the volume of REPO transactions increased 1.7 times, and their weighted average rate rose by 0.5 percentage points up to 4.2%. The maturity of transactions remained unchanged (30 days).

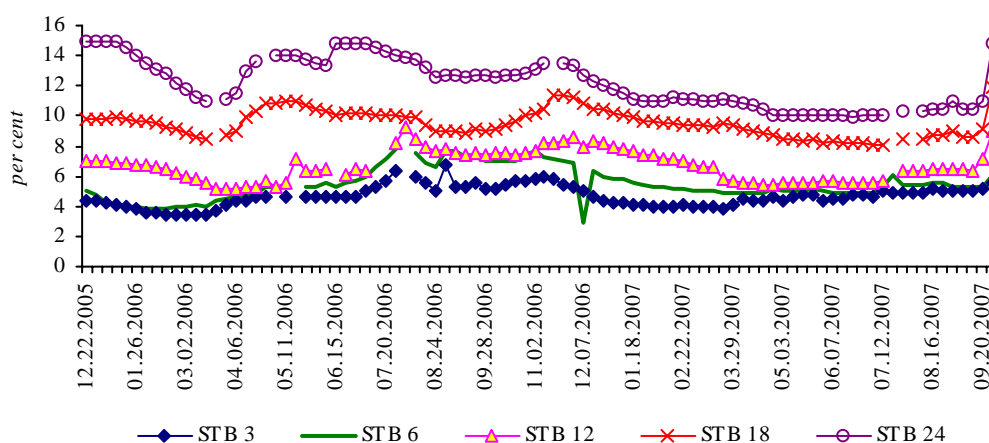
NBKR continued attracting deposits from commercial banks. The volume of deposits, in comparison with Q2, decreased and totaled 472.0 Million soms. NBKR conducted deposit transactions for 7 days (interest rate – 1.8%) and one month (2.0%).

NBKR also conducted reversed swap transactions which totaled 6.5 Million soms, withdrawing 246.2 Million soms of excessive liquidity. An average maturity of these transactions amounted 62 days.

3.2.2. State treasury bills

In Q3 2007, the situation in the primary STB market remained stable. Only at the end of the period there was a significant growth in the bills' yield for all market segments,

Chart 3.3. STB Yield dynamics



which reflected an increase in STB issuance volumes and a rise of interest rates in the primary market of NBKR notes.

The weighted average yield of STB amounted 7.1%, having increased by 0.6 percentage points as compared with the previous quarter. The highest yield growth was observed in the segment of 12-month STB.

In comparison with Q3 2006, the overall yield of STB decreased by 3.2 percentage points, while the decrease in average yield was observed for all segments of STB market.

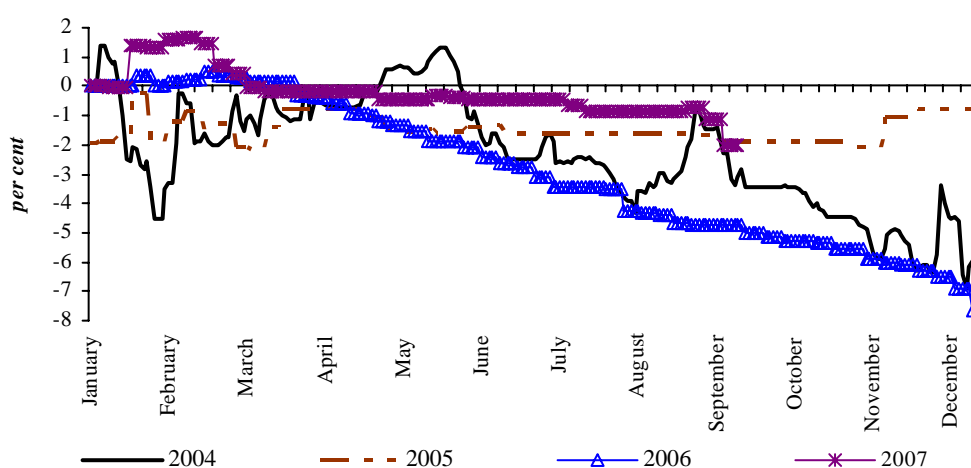
3.3. EXCHANGE RATE

In the third quarter of 2007, the money exchange market observed an excessive supply of foreign currency, mostly caused by an increase in deposits and money transfers of migrant labor. In order to smooth market conditions, NBKR conducted purchases of USD, which resulted in the fluctuation of US dollar exchange rate in a narrow range in July and August. However, at the beginning of September the exchange rate of the American currency started to drop rapidly, affected by its excessive supply and a decline of US dollar against other world currencies.

At the end of Q3, the weighted average dollar exchange rate amounted to 36.7924 soms per US dollar, having decreased by 3.1% over the quarter. The dollar selling rate in exchange offices has decreased by 4.6% and amounted 36.2242 Soms per US dollar at the end of Q3.

At the end of the reporting period, the official exchange rate of dollar amounted to 36.8994 Soms per US dollar, having decreased by 2.8% over the quarter.

Chart 3.4. Change in US dollar Exchange Rate



The behavior of euro exchange rate in the cash segment of domestic foreign exchange market, as usual, mostly repeated the patterns in the external markets. From the beginning of Q3 till mid-August, the selling rate of euro in the exchange offices fluctuated within the range of 51.0 – 52.3 soms per euro, and then the strengthening trend prevailed.

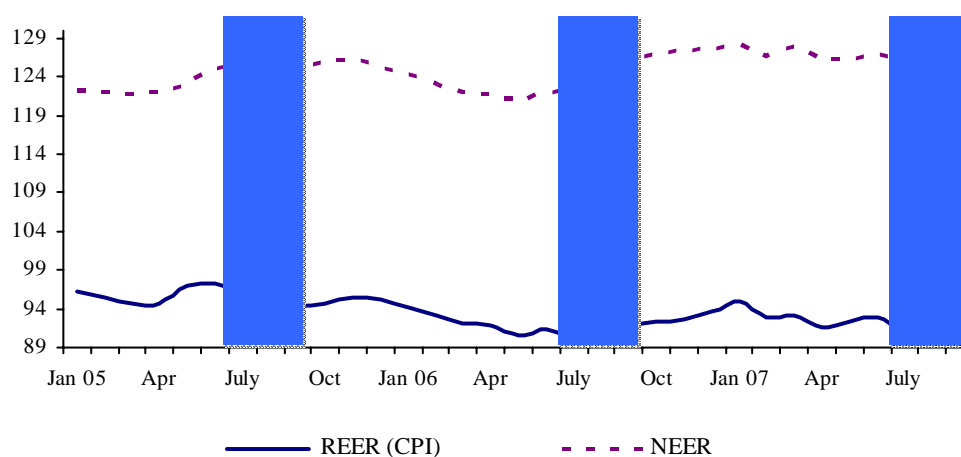
Only in the last week of September it started decreasing. An overall euro selling rate in the exchange offices rose by 1.6% and amounted to 52.136 soms per euro at the end of September. Having increased by 2.7% over Q3, the official exchange rate amounted 52.3 soms per euro at the end of the period.

In the 2007 Q3, the average nominal effective exchange rate (NEER) of som increased by 1.8% as compared with the corresponding period of 2006. At the end of September, the NEER index amounted to 126.6. Generally, over the nine months of 2007, the average nominal effective exchange rate had increased by 3.2%.

In the third quarter of 2007, the average real effective exchange rate (REER) of som increased by 2.8% as compared with the corresponding period of 2006, and by 1.2% as compared with the previous quarter. At the end of September 2007, the REER index amounted to 95.5. Over the nine months of 2007, the average real effective exchange rate increased by 1.4% in comparison with the same period of 2006.

The increase in the average real effective exchange rate was due to a higher inflation rate in Kyrgyzstan as compared with the main trade partners, and to a strengthening of som exchange rate. In Q3 2007, the inflation rate amounted to 5.5% in Kyrgyzstan, while Russia and Kazakhstan had 1.8% and 3.8% accordingly. At the same time, the exchange rate appreciated against tenge and dollar by 2.1% and 0.7% accordingly, and depreciated against ruble by 0.7%.

Chart 3.5. Indices of Real Effective Exchange Rate (REER) and Nominal Effective Exchange Rate (NEER)
Index 2000=100



3.4. DEMAND AND SUPPLY

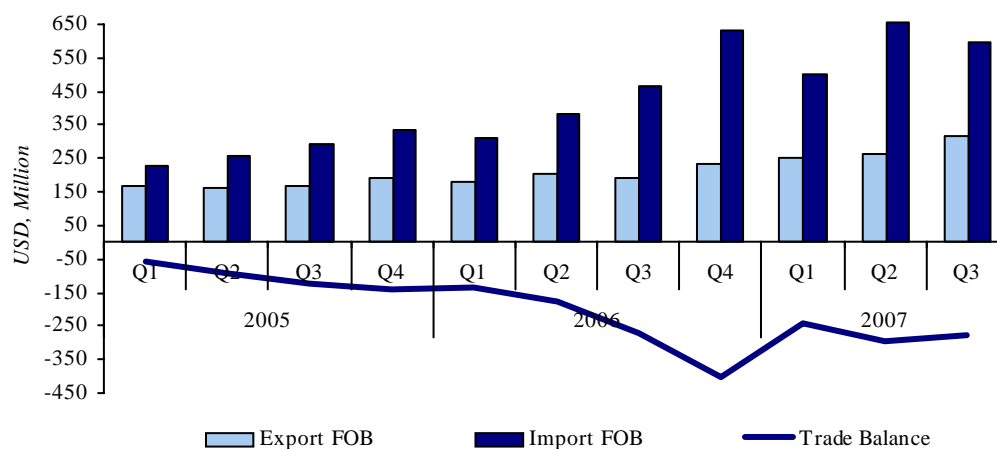
3.4.1. External demand

According to the current data, the trade balance of the Kyrgyz Republic in the third quarter of 2007 totaled USD 276.2 Million against USD 270.9 Million in the same quarter of 2006.

In the reporting period, the foreign trade turnover in FOB prices amounted to USD 912.9 Million, having increased by 38.2%. The turnover with CIS and non-CIS countries

increased by 45.0 and by 31.2% respectively, which reflected the growth of both imports and exports.

Chart 3.6. Trade Balance



Over Q3, the exports FOB of goods totaled USD 318.4 Million, which was by 63.3% greater than in the comparable period of 2006. This growth reflected an increase in supply of goods to CIS and non-CIS countries by 69.9% and 56.0% respectively. The export of gold in value terms totaled USD 62.4 Million, which is 37.2% higher than in Q3 2006. The exports net of gold went up by 71.3%.

The major shares of the exports functional structure were taken by intermediate goods (29.0%), energy products (28.1%), and consumer goods (25.9%). Overall, the Q3 observed growth in all export items. The most significant growth (2.5 times) was observed for energy products, which reflected the growth in re-export of petroleum products to trade partners.

The 55.4% share of CIS countries played a dominating role in the geographic structure⁴ of exports. The export of goods to these countries increased by 70.5% and totaled USD 174.3 Million. The major consumers of Kyrgyz exports were: Kazakhstan (40.6% of total exports for CIS countries), Russia (32.4%), and Uzbekistan (21.8%). The major goods exported to these countries were electric power, cement, Portland cement, dairy products, apparel, rolled glass, and fresh fruit.

Exports to non-CIS countries increased by 57.4% and totaled USD 140.4 Million. Switzerland, China and Afghanistan were the major partners in export transactions. The supplies to Switzerland increased by 36.8% and totaled USD 62.7 Million, reflecting a growth in export of gold. The exports for China grew up 2.8 times and amounted to USD 30.2 Million, Afghanistan – 22.6% and USD 17.8 Million, accordingly. The latter was due to the re-export of diesel oil and gasoline.

Imports FOB of goods in the reporting quarter increased by 27.6% as compared with the same period of 2006, and totaled USD 594.5 Million. The volume of imports from CIS and non-CIS countries increased by 33.9 and by 21.6% respectively.

⁴ According to NSC and NTC, regardless of NBKR data.

In the functional structure⁵ of imports CIF the growth trend remained for all import items. The major share of imports belonged to energy products (28.4% of the entire volume of import), investment (26.3%) and consumer goods (25.9%).

In the geographical structure⁵ of imports CIF the shares of CIS and non-CIS countries amounted to 56.2 and 43.8% respectively. The major CIS import suppliers were: Russia (67.6% of total imports from CIS countries), Kazakhstan (19.0%), Ukraine (6.0%) and Uzbekistan (5.6%). Ukraine had increased supplies almost 2.5 times thanks to iron production, chocolate, and machinery equipment. China and USA remained major non-CIS importers; their shares in non-CIS imports amounted 35.2% and 22.4% accordingly. US imports recorded a notable growth of more than 2.5 times, which totaled USD 67.6 Million. This reflects an increase in supplies of aircraft parts. China's imports increased by 67.0% and totaled USD 106.4 Millions. China mainly supplies communication equipment, tools, commercial vehicles and furniture.

3.4.2. Internal demand

3.4.2.1. Private consumption

The consumption structure of GDP observed a continuous trend of increase in household expenditures for final consumption. Accelerated growth in private consumption is an evidence of increasing of consumers' activity and, as a result, growth in disposable income of the citizens, which was caused by an increase in remittances for the last two years. Rise of wages also makes a positive impact on the growth of income. In the period from January to September 2007, the nominal month wages picked up by almost one third compared with the same period of 2006, which was 23.6% in real terms.

In addition, the number of registered unemployed citizens, as of October 01 2007, decreased by 3.1% as compared with that of the same date in 2006. That also facilitated a general growth of population income.

3.4.2.2. Government expenditures

In the reporting quarter, the current consumption constituted a major share in the expenditures. That is expected to cause changes mostly in the cash segment of money supply in Kyrgyzstan. Wage expenditures and transfers to the Social Fund of KR constituted 37.9% of budget funds, increasing by 5.9 percentage points as compared with the same period of 2006. The share of social allowances and subsidies remained decently high (17.6%).

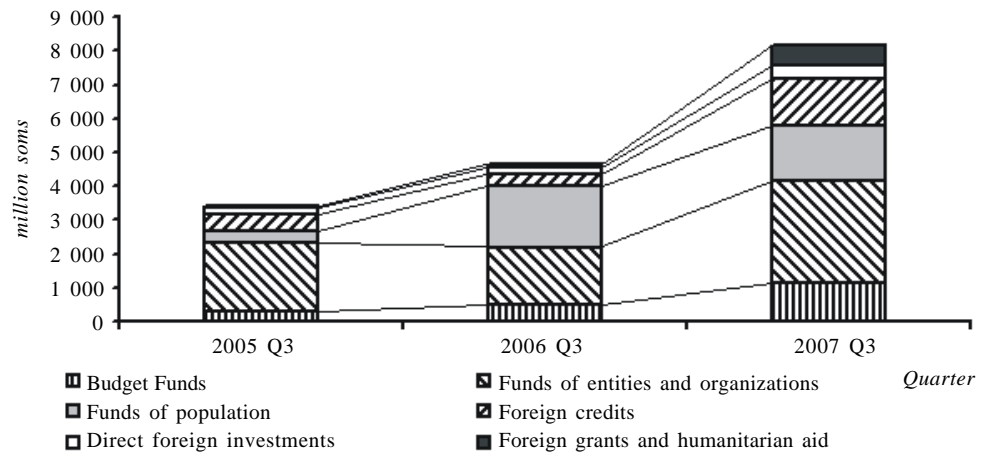
In the period from January to September 2007 as compared with the similar period of 2006, the state budget income (adjusted for CPI) and expenditures increased in real terms by 28.3% and 4.3% accordingly. The surplus of funds within the reporting period (excluding Public Investment Program) totaled 2,492.2 Million soms, which constituted 2.5% of GDP.

⁵ Imports CIF including charters and additional adjustments amounted to 627.3 Million US dollars, and the trade balance deficit was 308.9 Million US dollars.

3.4.2.3. Investments

Capital investments increased 1.7 times over Q3 as compared with the third quarter of 2006, and totaled 8,153.3 Million soms. The major share belonged to subcontract works the volume of which almost doubled as compared with Q3 2006. The capital investments were mainly financed out of entities' equity and funds of population. Also the Q3 noticed increase in investments on the side of budget funds and foreign sources (mostly foreign loans).

Chart 3.7. Structure of capital investments

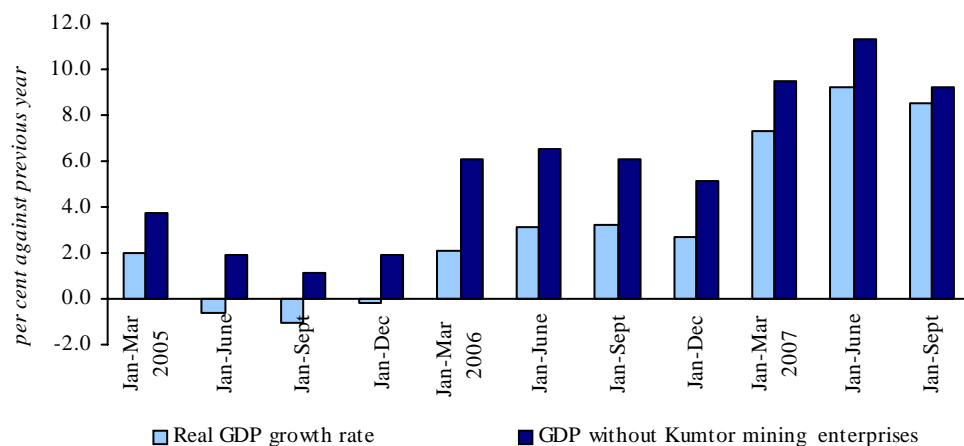


The largest share in the total volume of realized investments belonged to housing construction (24.9%), mining industry (14.3%), transportation and communications (13.4%).

3.4.3. Gross domestic product

The period from January to September 2007 witnessed an upraise of economic activities in KR. According to the preliminary estimates of the National Statistics Committee, the growth rate of real GDP amounted for 8.5% in the period from January to September 2007 (against 2.7% in the period from January to September 2006). Real GDP grew up due to an increase in real production volume in the following economic sectors: transportation and communications – by 39.1% (2,031.6 Million soms); retail – by

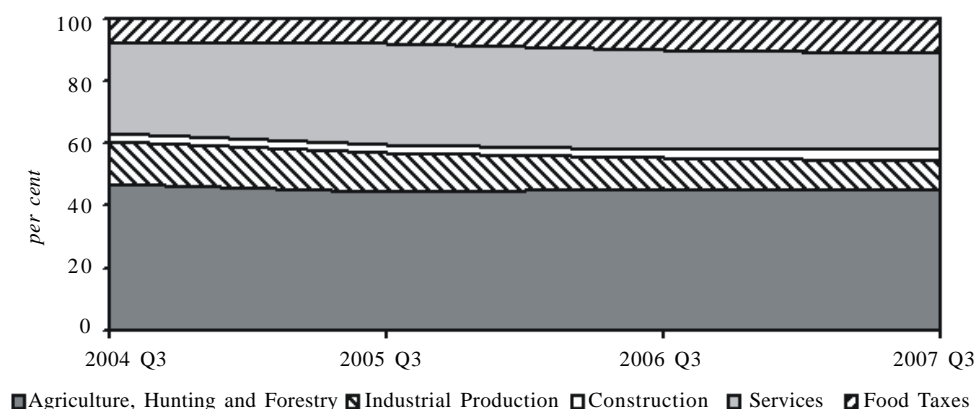
Chart 3.8. Real GDP Growth



11.7% (1,716.0 Million soms); industrial production – by 6.3% (768.2 Million soms); and construction – by 39.2% (707.2 Million soms). The growth of GDP (net of Kumtor gold mining entities) in real terms amounted to 9.2% against 5.5% in the period from January to September 2006.

At the same time, the GDP structure remained almost unchanged. Agriculture had the largest share which decreased by 1.8 percentage points down to 29.2%. The share of retail increased from 18.1% to 18.6% and the share of transportation and communications increased by 1.8 percentage points up to 8.2%. The industrial production over Q3 constituted 14.8% of the GDP.

Charter 3.9. GDP Structure



4. MAJOR DECISIONS ON MONETARY POLICY

4.1. MAJOR DECISIONS OF THE BOARD

The following is the list of decisions made by the NBKR Board during the third quarter of 2007:

1. On August 22, 2007, the Board reviewed and adopted The Report of Monetary Policy over the First Half of 2007. (NBKR Board Resolution No 38/1).
2. On August 27, 2007, the Board reviewed and adopted The NBKR Declaration on Target Guidelines for the Monetary Policy in 2007. (NBKR Board Resolution No 40/1).
3. On August 27, 2007, the Board reviewed and adopted the Draft of KR Government and NBKR Resolution On Joint Statement of KR Government and NBKR on the Target Guidelines for the Monetary Policy in 2007. (NBKR Board Resolution No 40/2).
4. Pursuant to the Resolution No 385/40/2 of the KR Government and NBKR dated August 30, 2007, the Board adopted The Joint Statement of the KR Government and NBKR Board on Inflation Control Priorities, and approved The Inflation Control Plan in KR.
5. On September 19, 2007 the Board discussed the following issues and adopted appropriate resolutions:
 - 5.1. Resolution 42/1, On Revisions and Amendments to the Regulation on Issuing, Placing, Circulating, and Repaying NBKR notes. These revisions and amendments were made in order to expand the range of instruments required to regulate liquidity in the banking system. The resolution is effective upon its publication, after it has been registered in the KR Ministry of Justice. (Registration No 95-07 as of October 17, 2007).
 - 5.2. Resolution 42/2, On the Pledge for Overnight and Intraday Loans of the NBKR. In order to increase the range of securities used as a pledge for overnight and intraday loans, the Board made a decision to accept government securities with maturity up to six months placed through the NBKR (STB, NBKR Notes) as of the loan date. The Resolution is effective as of its publication date.
 - 5.3. Resolution 42/3, On the NBKR Discount Rate, effective November 8, 2007. In order to further improve the mechanism for defining the accounting rate of the National Bank of the Kyrgyz Republic, the NBKR Board made a decision to adopt as the discount rate an average yield of 28-day NBKR Notes for the latest 20 NBKR Notes auctions, unless otherwise defined by the NBKR Board. The Resolution instituted a weekly update of the NBKR discount rate.
 - 5.4. Pursuant to the NBKR Resolution No 43/7 dated September 25, 2007, On the US Dollar Exchange Rate for Mandatory Reserve Requirements, the fixed US dollar exchange rate for obligatory reserve payments within

the period from October 2007 to May 2008 is set at 37.0 soms per US dollar.

4.2. MAJOR DECISIONS OF THE MONETARY REGULATION COMMITTEE

The Monetary Regulations Committee (hereinafter – “the Committee”) develops and adopts current decisions required for monetary regulations. The decisions are made weekly, based on the assessed monetary market situation. The Committee determines volumes of transactions considering: the position of the banking system and situation in the fiscal area. The Committee will also consider monetary policy targets in the framework of projects aimed at poverty reduction and facilitation of the economic growth. These targets are specified in the NBKR Statement on Monetary Policy for 2007 and Major Guidelines of the Monetary Policy for 2007-2009.

Committee Recommendations:

1. In order to withdraw excessive liquidity, it is recommended to conduct auctions for the sales of securities under REPO terms. The sales of STB(s) over the reporting period amounted to 1,549.5 Million soms.
2. Considering overall liquidity of the banking system, NBKR increased the recommended volume of sales for 14-day and 28-day Notes in the weekly auctions from 32 to 150 Million soms. All thirteen declared auctions for 14-day and 28-day Notes were conducted within the reporting period. The demand almost 1.5 times exceeded the sales volume.

A weighed average yield of 14-day Notes increased from 3.07% as of the end of June 2007 up to 6.28% as of the end of September 2007 (against 2.92%, as of the end of December 2006), while the yield of 28-day notes increased from 3.86% as of the end of June 2007 up to 7.43% as of the end of September 2007 (against 3.15% as of the end of December of 2006).

The NBKR discount rate used to define and regulate market refinancing rates was still defined as the 28-day NBKR Notes yield.

3. In order to improve prompt liquidity management in the banking system, the NBKR adopted a new instrument for the regulation of interest rates and the withdrawal of excess liquidity: time deposits of commercial banks in the NBKR.

In the reporting period, commercial banks made 21 deposit transactions in the amount of 472.0 Million soms at the rates of 1.8% and 2.0% with the maturity of 7 days and 1 month accordingly.

4. The third quarter observed a significant increase in the yields across the STB market segments as follows:
 - 3-month bills – from 4.80% (as of the end of June) to 5.62% (as of the end of September);
 - 6-month – from 4.95% to 6.05%;

- 12-month – from 5.61% to 9.06%;
 - 18-month – from 8.14% to 11.91%;
 - and 24-month – from 10.01% to 14.82%;
5. The NBKR continued to follow its policy of the floating exchange rate. The Bank's activity in the foreign exchange market was aimed at smoothing drastic fluctuations of the exchange rate of som to US dollar.

The net purchases of US dollars totaled 85.7 Million. It's noteworthy that the NBKR acted as a buyer of foreign currency in July, August, and in the end of September (USD 88.7 Million), and as a seller in the beginning of September (USD 3.0 Million). In the reporting period (in the beginning of September), the NBKR conducted sales in the amount of USD 1.5 Million and consignment in the amount of USD 1.5 Million.

In the reporting quarter, the official exchange rate of som to US dollar went up by 2.8% (and by 3.21% as compared with the beginning of 2007) and, at the end of September, amounted to 36.8994 soms per US dollar (against 38.1238 soms per US dollar as of the end of December 2006).

6. In order to control liquidity in the banking system, in the event of demand on the part of commercial banks, it was recommended to conduct reverse SWAP transactions with foreign currency. The volume of SWAP transactions in the reporting period totaled 6.5 Million soms.

4.3. INFLATION PROJECTIONS FOR THE FOURTH QUARTER OF 2007

Over the nine months of 2007, the inflation rate amounted 10.3% and exceeded the target for 2007. The target inflation rate was based on the assumption of a seasonal decline in prices for fruit and vegetables, meat and dairy products, and, on the other hand, a moderate increase in prices for main food commodities like bakery products and oils. However, the high dependence of domestic economy on the world price situation and its low resistance to external price shocks have stimulated an accelerated growth of inflation rate in Kyrgyzstan.

An increase in household income became another factor which contributed to the growth of inflation rate. This was in part caused by growing social expenditures of the government budget.

Considering the data available as of the date of this report, October already witnessed a spike of prices for food commodities, especially for baked products, dairy products, oils and fats. The price situation in the market for food commodities is projected to stabilize in November and December, resulting from the efforts of NBKR and the KR Government.

Based on the NBKR projections, the growth of consumer price index in the fourth quarter of 2007 is expected to be within 10.0%, even considering a spike of prices in October (in the fourth quarter of 2006, the inflation rate amounted to 2.5%).