

National Bank of the Kyrgyz Republic

**DEVELOPMENT TRENDS
OF THE BANKING SYSTEM**

FIRST HALF OF 2008 (13)

BISHKEK 2009

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Development Trends of the Banking System

The purpose of publishing the Development Trends of the Banking System is to analyze and evaluate the development of Kyrgyzstan banking system as a financial intermediary, to determine obstacles in terms of achieving and maintaining stability, and to evaluate the Kyrgyzstan banking system stability components. It is published yearly as of January 1, and July 1 in Kyrgyz, Russian and English languages.

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If you have any question regarding the publication content, you may contact us at:

101, Umetalieva Str., Bishkek.
National Bank of the Kyrgyz Republic
Supervision Methodology and Licensing Department
Telephone number: (+996 312) 669 252
Fax number: (+996 312) 656 477
E-mail address: jmamytova@nbkr.kg; nbugubaeva@nbkr.kg

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Bulletin of the National Bank of the Kyrgyz Republic

The NBKR Bulletin includes macroeconomic indices of the Kyrgyz Republic on real, financial, and external sectors of the economy as well as on government finances. While preparing the bulletin the materials of the National Statistics Committee, Ministry of Finance, commercial banks, State Committee under the Government of the Kyrgyz Republic on Securities Market, and National Bank of the Kyrgyz Republic have been used. It is issued on a monthly basis in Kyrgyz, Russian and English languages.

Balance of Payments of the Kyrgyz Republic

This publication contains the recent development trends in the external sector and tables with data on the analytical and neutral forms of payment balance, external trade structure, international reserves, external debt, as well as international investment position of Kyrgyz Republic. It is published on a quarterly basis - in January, May, July, and October.

Inflation Report of the Kyrgyz Republic

The report contains a description of consumer prices dynamics in the republic and its regions, analysis of principle inflation factors, and information on the decisions of the National Bank of the Kyrgyz Republic in the monetary policy area; it also provides inflation forecasts for the upcoming period. It is issued once every three months in the Kyrgyz, Russian and English languages.

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NBKR press-release contains current events of the National Bank and the banking system as a whole and current information on the financial market. It is issued on a weekly basis in the Kyrgyz, Russian and English languages.

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In this publication normative acts of the National Bank are issued on the official basis to provide commercial banks and the population with the normative acts constituting banking legislation of the Kyrgyz Republic. Presumable publication frequency is once a month in the Kyrgyz and Russian languages.

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INTRODUCTION

In H1 2008, there was an expansion of the real economy sector credit financing. Herewith there was kept a growth trend of financial intermediation indicators in the banking system. A considerable supply of liquidity and sufficient level of the commercial banks capital adequacy testify to the banking system adequate stability.

In the reporting period, there was a growth deceleration of corresponding rates of the banking system major indices, especially depositary base. Herewith, the growth of fixed deposits volume testifies to the increase of banks potential for medium and long-term economy financing.

In non-banking financial institutions, there was the credit portfolio growth, reflecting a high demand rate for credit resources on the part of households, small and medium business.

The banking system stability and the growth of real personal income are reflected in the trends of deposits amount and credit financing increase which demonstrates an increase in the confidence about the banking system.

Thus, expected improvement of the banking system stability, strengthening of the commercial banks capital base, volume growth in the economy's real crediting, spread of range and quality improvement of the banking and payment services are favorable economic development factors.

I. THE STATE OF FINANCIAL AND CREDIT SYSTEM IN THE KYRGYZ REPUBLIC

By the end of H1 2008, the aggregate assets of the financial and credit system¹ increased by 44.1 percent as compared to the corresponding period of 2007, moreover the highest increase rates of this index were found in the banking system.

With a significant extension of services range, provided by financial institutions, the principle components of their operating assets are credits.

The indicator of financial intermediation, defined as a ratio of the aggregate credit portfolio to the Gross Domestic Product (hereinafter referred to as GDP)², increased in comparison with the corresponding period of 2007 and constituted 21.1 percent (see Diagram No.1.1). The credits growth rate for the first half year of 2008 constituted 34.2 percent in comparison with the corresponding period of 2008.

Banks continue to hold the leading position in the financial and crediting system (Diagram 1.2). As per results of 2008, their share constituted 78.0³ percent in the aggregate credit portfolio of the financial system, having decreased by 5.8 percentage points in comparison with the corresponding period of 2007.

The dynamics of ratio of special provision for losses (SPL) to the volume of credits in the banking system and the NBFIs (Non-Bank Financial Institutions) shows a deterioration of the credit portfolio's quality (Diagram 1.3). The share of SPL in the NBFIs credit portfolio according to the results of the H1 of 2008 has decreased to 1.2 percent, in the banking system the given indicator increased by 0.1 percentage points and constituted 2.2 percent.

In H1 2008, in comparison with the corresponding period of the previous year, there was a decrease of the weighted average interest rates for credits of commercial banks and on credits of credit unions.

Diagram 1.4 shows the spread of weighted average interest rates on credits issued by commercial banks (in the national and foreign currencies) and by non-bank financial institutions. This spread to a certain extent, allows to assess the level and

Diagram 1.1. Time history of the credit portfolio (CP) of the financial and credit system (FCS), in % to GDP

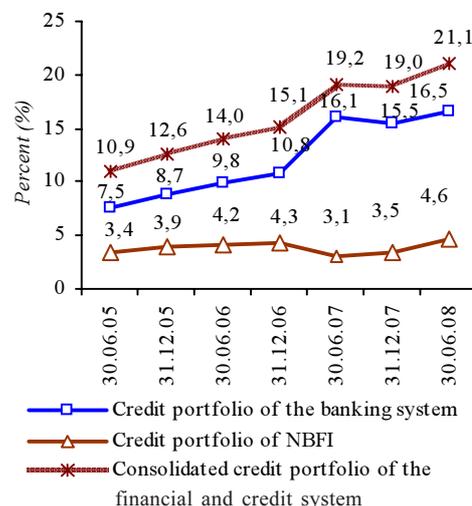


Diagram 1.2. Consolidated credit portfolio structure (CP)

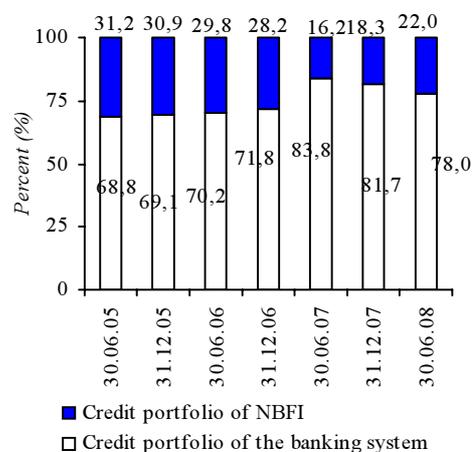
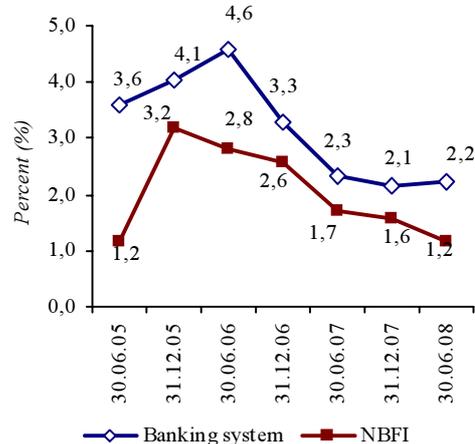


Diagram 1.3. Special PLR ratio in credit portfolio of the banking system and NBFIs

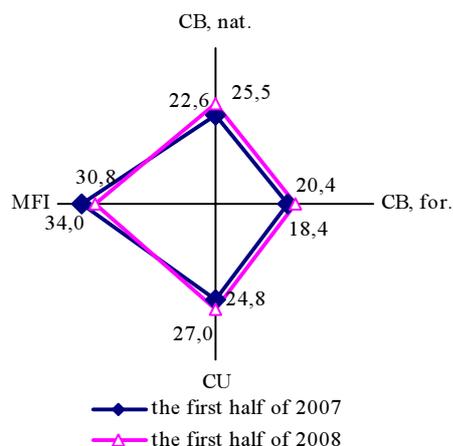


¹ Indicators of commercial banks' and financial institutions licensed by NBKR are analyzed herein as indicators of the financial system.

² The data on the actual GDP for the last 12 months is taken.

³ The credit portfolio of the banking system includes credit portfolios of bankrupt banks.

Diagram 1.4. "Spread" of the weighted-average interest rates of the credits disbursed by financial institutions,
% (percent)



Note: CB, nat. - Commercial Banks, national currency, CB, for. - Commercial Banks, foreign currency, CU - Credit Unions; MFI - Micro-Financing Institutions.

the changes trends in the cost of credit resources. Herewith the diagram 1.4 does not reflect the weighted average rates on credits of pawn offices. As per results of the first half of 2008, this rate constituted 121.3 percent, as per results of the corresponding period of 2007 – 167.9%.

The weighted average interest rates on the newly issued credits by commercial banks in foreign currency and in the national currency has increased. Thus, in the first half of 2008 in comparison with the corresponding period of 2007 the average interest rate on credits in foreign currency has increased by 2.0 percentage points and in the national currency by 2.9 percentage points.

Thus, the state of the financial credit system of Kyrgyzstan in the reporting period is characterized by:

- continuing financial intermediation indicators increase, and a significant growth of this indicator in the banking sector;
- quality improvement in the credit portfolio of non-bank financial institution.

II. STATUS OF THE BANKING SYSTEM

2.1. Structure of banking system

As of the end of the first half of 2007, 22 commercial banks have been operating in the country (including Bishkek branch of Pakistan National Bank) as well as 14 banks having foreign capital share. In 10 of them foreign capital share constituted more than 50 per cent. All banking institutions of the country are universal by their type of activity.

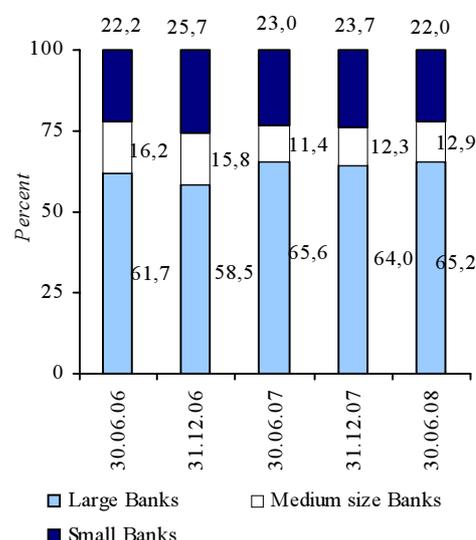
In general, the growth trend in absolute expression of the major activity indicators was maintained in the banking system in the first half of 2008, particularly of assets, credit portfolio and depositary base of commercial banks.

The banking system structure evaluation from the point of view of the market segment occupied by groups of 'large', 'medium' and 'small' banks¹ (Diagram 2.1.1) evidences the increase of 'large' banks' market share, the weight of which increased by 1.2 percentage points in the reporting period. At that, the share of 'medium-size' banks increased by 0.6 percentage points and the share of 'small' banks decreased by 0.3 percentage points.

The segment of 'large' banks is represented by three banks holding 65.2 percent of the market share (out of which 30.9 percent belongs to the largest bank in the Kyrgyz Republic). These banks are referred to the group of 'large' banks by the size of their share in the consolidated deposits base (less deposits of banks and other financial institutions as well as the state agencies deposits) – 39.5 percent and in the consolidated assets of the banking system (39.4 percent). With that, all these three banks belong to the group of major players at the credits market (39.6 per cent).

In the reporting period, the banking system consolidated capital

Diagram 2.1.1. Changes of the banking system structure by bank groups



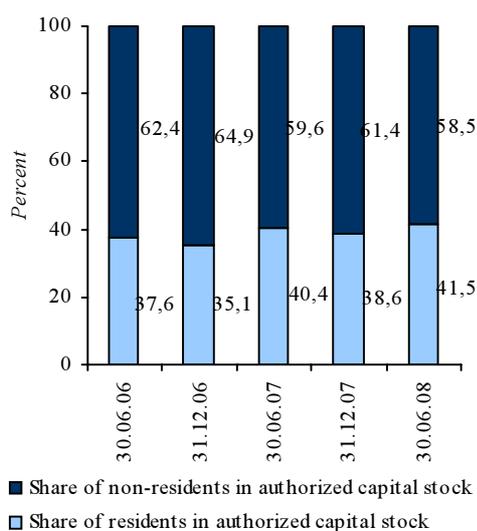
¹ For the purposes of analysis, the present document defines 'large' banks as those, whose presence in the banking market (d_i , an average squared share in the total assets, credits, deposits and capital) exceeds 10%. Medium banks have the presence of 5-10%, and the market presence of 'small' banks is below 5%.

The market presence is calculated using the following formula:

$$d_i = \frac{X_i}{\sum_{i=1}^N X_i} \quad \text{is the share of i-bank in the banking sector,}$$

Where N is the number of operating commercial banks;

$$X_i = \frac{d_A^2 + d_{kp}^2 + d_A^2 + d_{CG}^2}{4} \quad \text{is the arithmetic average of the following: } (d_A^2) \text{ is the squared share of assets of i-th bank in the total bank consolidated assets and correspondingly of credits } (d_{kp}^2), \text{ deposits } (d_A^2) \text{ and liabilities } (d_{CG}^2).$$

Diagram 2.1.2. Change of authorized capital structure of the banking system

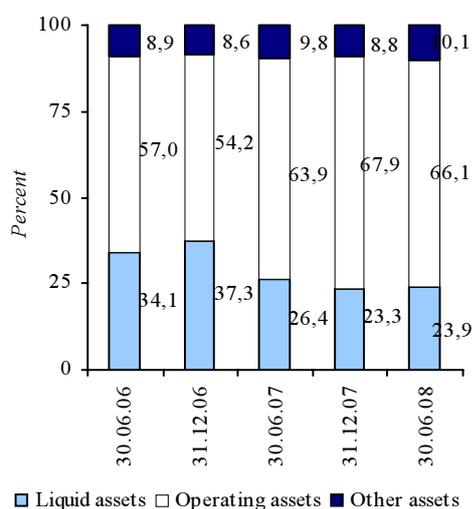
increased by 18.5 percent. The capital growth was determined by the banks increasing their authorized capital (by 885.0 million soms) and by the gained current profit (752.0 million soms).

The share of foreign capital in the authorized capital of commercial banks amounted to 58.5 percent (by end of second half of 2007 it was 61.4 percent, Diagram 2.1.2).

The general increment rate of resident banks authorized capital for the first half of 2008 constituted 24.1 percent and the increment of non-resident banks authorized capital constituted 9.7 percent.

The continuing growth of the banks capital base contributes to building a sufficient capacity for further development of the banking system.

The banking system assets increment rate constituted 17.6 percent in the first half of 2008. Considering the change in the total assets structure (Diagram 2.1.3), it should be pointed out that 66.1 percent of banks assets was operating² and their share decreased by 1.8 percentage points. With that, the share of liquid assets³ in the total assets of the banking system increased from 23.3 to 23.9 percent. The increase of the given category of assets was mainly determined by the increase of balances at other banks correspondent accounts by 24.7 percent.

Diagram 2.1.3. Banking system assets structure variation

Sufficient liquidity of banks assets in comparison with the standard established by the NBKR gives the banks an opportunity to increase crediting of the economy by reducing the share of liquid assets.

The share of 'other' assets amounted to 10.1 percent.

Within the framework of the Memorandum of Understanding between the Kyrgyz Republic, Islamic Development Bank and a pilot bank and in accordance with the Presidential Resolution of the Kyrgyz Republic dated July 12, 2006 "On the Pilot Project of Introducing Islamic Financing Principles" operations in Islamic financing principles were carried out in the Kyrgyz Republic. By the end of the first half of 2008, the volume of such operations constituted 260.3 mln. soms (by end of second half of 2007 their volume was 95.7 mln. soms).

For a more detailed examination of changes in the structure of operating assets hereunder the assessment of the banking

² Working assets consist of balances in the accounts of deposits in financial institutions and also securities other bank assets that generate interest profit.

³ Liquid assets include bank funds in cash departments and in correspondent accounts.

system's aggregate *deposits base*⁴ structure is provided as of the major source of the allocated resources, and changes in the credit portfolio.

In the first half of 2008, the banking system's *deposit base* continued increasing. The increment rate constituted 25.1 billion soms. The share of individuals in the deposits structure increased from 27.4 to 29.4 percent. At that, the increment rate of personal deposits constituted 3.8 percent.

The weight of legal entities deposits amounted to 54.4 percent (reduction by 2.9 percentage points). At that, the increment rate of the legal entities deposits volume constituted 6.7 percent.

The remaining share (16.2 percent) belongs to the deposits and credits of state agencies of the Kyrgyz Republic. The given deposits category increment rate constituted 7.8 percent.

In the reporting period the share of fixed deposits increased to 35.6 percent of the total banking deposit base (Diagram 2.1.4). This, in its turn, enhanced the capacity of banks to increase mid-term and long-term financing of economy. Herewith, it should be pointed out that personal fixed deposits increased by 13.5 percent and in the absolute expression they constituted 496.3 million soms, which testifies to the increased confidence of the population to the banking system.

In the first half of 2008, there was a certain increase of 'dollarization' level of the banking system deposit base (see Diagram 2.1.5). The given level constituted 52.0 percent against 50.7 percent at the end of the second half of 2007. The dollarization level of legal entities deposits decreased by 6.9 percentage points and constituted 53.8 percent. The share of personal deposits in foreign currency increased by 3.7 percentage points and constituted 58.9 percent. One of the factors, influencing the personal deposits volume growth in a foreign currency in nominal terms was the increase of USD exchange rate against KGS.

The banking system aggregate *credit portfolio*⁵ in the first half of 2008 increased by 18.5 percent and constituted 24.6 billion soms. With that, the commercial banks credits dollarization level was left unchanged and constituted 62.5 percent by the end of the reporting period (see Diagram 2.1.6).

Diagram 2.1.4. Structural change of deposit structure in the banking system by the dates of attraction

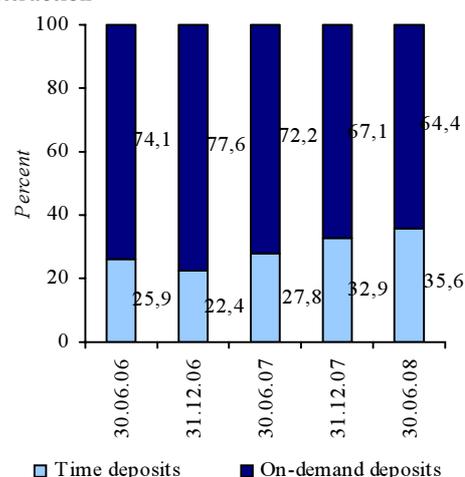


Diagram 2.1.5. Change of the deposit structure of the banking system by types of currency

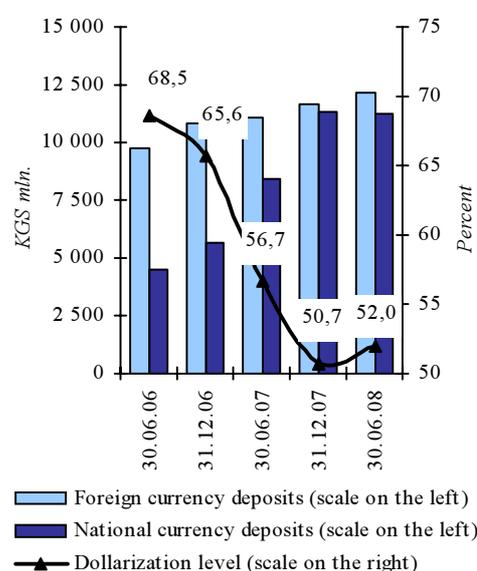
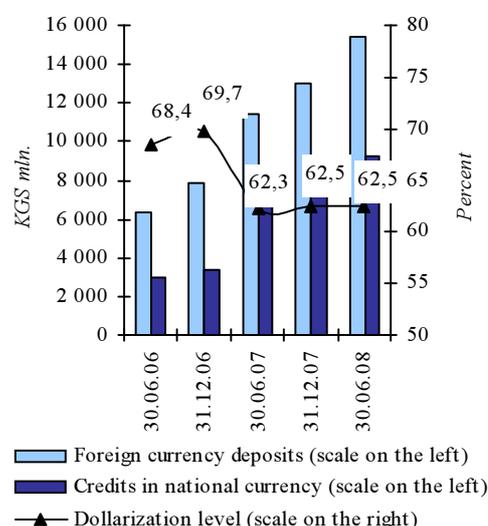


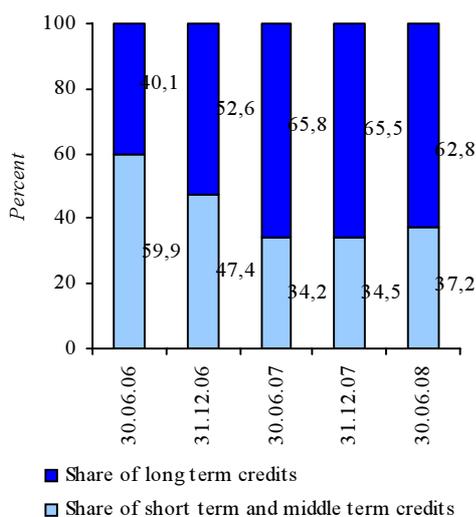
Diagram 2.1.6. Changes in the Banking Systems' Credit Portfolio Structure by Currencies



⁴ The deposit base includes deposits of individuals and legal entities, and also deposits of the Government and other power authorities.

⁵ Herein and hereunder the given category shall not include credits to banks and other financial institutions as well as the corresponding discount.

Diagram 2.1.7. Structural change of the banking system credit portfolio by the dates of allocation



The share of long-term credits⁶ decreased from 65.5 to 62.8 percent in the first half of 2008 and in absolute terms the increment rate constituted 15.5 percent that might be considered to be the one of the economy stabilizing factors. Despite this fact the share of credits with the term of recovery less than one year still remains to be high (37.2 percent), with the increasing trend of their share (see Diagram 2.1.7).

To valuate the credits current interest rates such features as the interest rates fluctuation ratio on credits and average and weighted average rates on credits were examined.

In the first half of 2008 the average rates (estimated as arithmetic mean value for 6 months) on the credits in the national currency constituted 25.7 percent, in a foreign currency – 20.3 percent. In comparison with the second half of 2007 the interest rates on credits in the national currency increased by 1.9 percentage points, and in a foreign currency – by 1.8 percentage points. The fluctuation ratio showing the variation range of interest rates in the credits market increased insignificantly both on the credits in the national currency and in foreign currencies. In the first half of 2008 the weighted average rate on credits in foreign and national currencies was almost equal with the average rate (Diagrams 2.1.8, 2.1.9).

Thus, the following trends were observed in the banking sector over the first half of 2008:

- growth the capitalization in the banking system;
- banks deposit base increase including personal deposits;
- growth of the credit portfolio and total banking system assets;
- the share of customers long-term credits decrease in the banks credit portfolio with their certain growth in absolute terms;
- slowdown of the relative increment rates of the banking system major indicators as a result of indirect influence of external factors;
- ‘dollarization’ level increase in the banking system deposit base.

Diagram 2.1.8. Changes of the Interest Rates Features on Credits in the National Currency

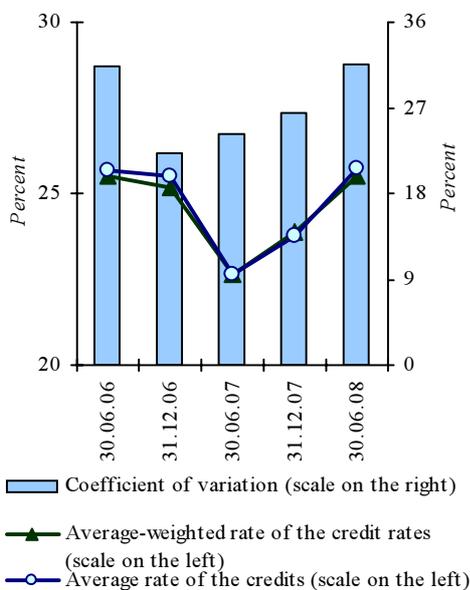
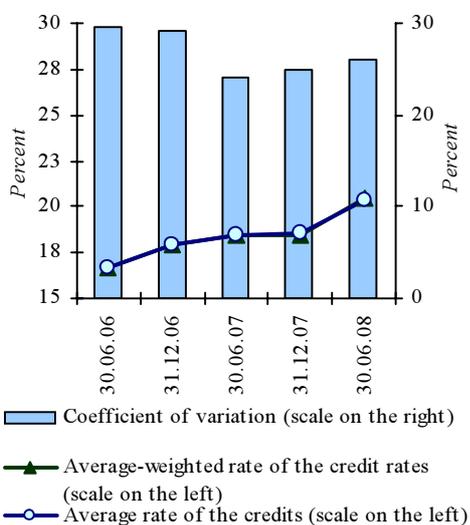


Diagram 2.1.9. Change of the interest rate on credits in foreign currency



⁶ Long-term credits are defined as credits issued for the term over one year.

2.2. Risks

2.2.1. Credit Risk

The credit risk is one of the major risks associated with the banking activity. This section outlines the active bank operations associated with the credit risk.

For the assessment of the *credit portfolio quality*, commercial banks apply the credits classification system¹. This system allows identifying the possible potential losses due to bad credits and their timely mitigation by means of creating appropriate provisions.

When assessing the credit portfolio quality, a special attention should be paid to the classified (non-working) credits, which reflect the first signs of credit portfolio quality deterioration. In the first half of 2008, the share of classified (non-working) and overdue credits in the credit portfolio increased (see Diagram 2.2.1.1). Considering the deterioration in the quality of the credit portfolio during the reporting period, the non-repayment risk level was within acceptable range. However considering the dynamics of the given indicator for the previous periods and a significant growth of the credit portfolio in 2008, there is a probability of banking system credit portfolio quality deterioration in the future.

A change in the volume of credits, classified as ‘supervised’ credits may be regarded as one of the factors, influencing the increase or decrease of the credit risk in the future. The share of such credits increased in the first half of 2008 (Diagram 2.2.1.2), and they continue to be a significant portion of the total credit portfolio (8.0 percent).

Banks created the provisions, adequate to the accepted credits classification, which accounted to 4.3 percent out of the total credits portfolio (by the end of 2007, this index was 4.1 percent).

In the case of the classified credits quality decline and accruing additional reserves, the size of ‘net’ total capital of banks will decrease insignificantly.

Thus, in general the credit risk remained at the acceptable level, however there are factors, which may in the future cause

Diagram 2.2.1.1. Change of credit risk level in credit portfolio of the banking system

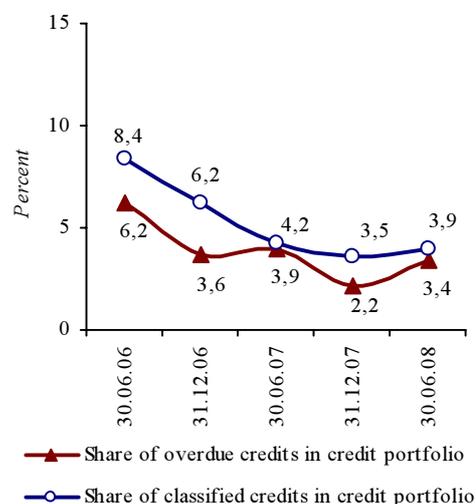
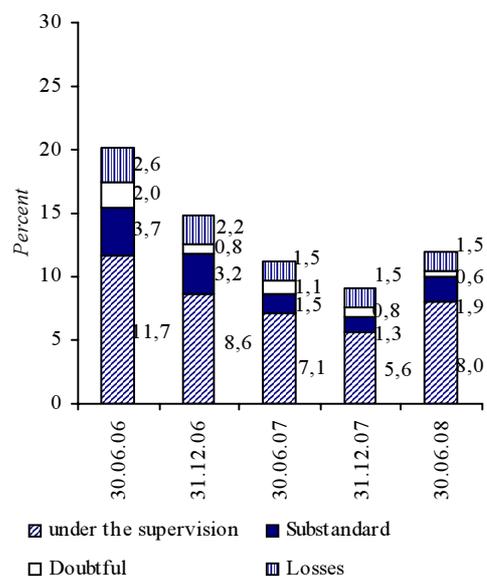
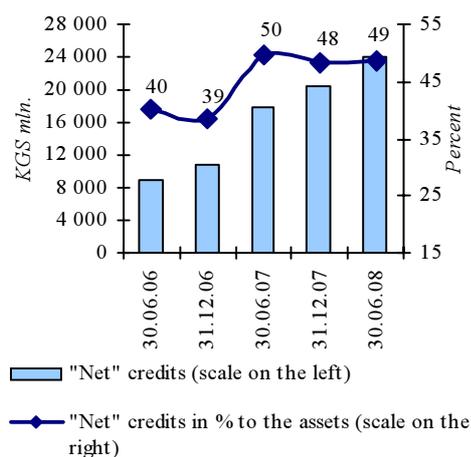


Diagram 2.2.1.2. Change of classification of the banking system credit portfolio



¹ In order to assess the quality of the credit portfolio, all credits are divided into six categories, depending on the current ability of the client to meet its obligations to the bank (they are classified by quality descending): good, satisfactory, supervised, substandard, doubtful, and bad. Credits in the last three categories, having the most negative features from the point of view of repayment, are usually referred to as ‘non-working’ or ‘classified’. The bank must assign a provision for each of the above categories in the amount estimated as percentage of the issued credits.

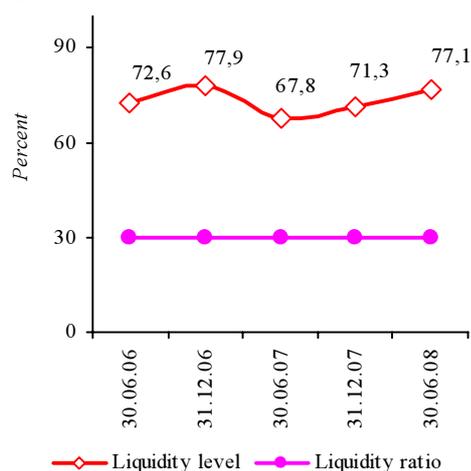
Diagram 2.2.1.3. Level variation of the "net" credits

increase of the indicators characterizing the given risk.

As of the end the first half of 2008 the share of 'net' credit portfolio (balance of debts on credits less the created special Potential Losses Reserve (PLR) on classified credits) accounted for 48.6 percent of the total assets in the banking system (Diagram 2.2.1.3), which increased by 0.3 percentage points in comparison with the previous half year. That led to decrease of a share of other bank assets groups.

To decrease the system credit risk, the resolution on the Credits Register was accepted and put into effect. The creation of the Credits Register was aimed at achieving stability in the operation of the country's banking system, and at ensuring its efficiency, safety and reliability as well as to reduce system risk.

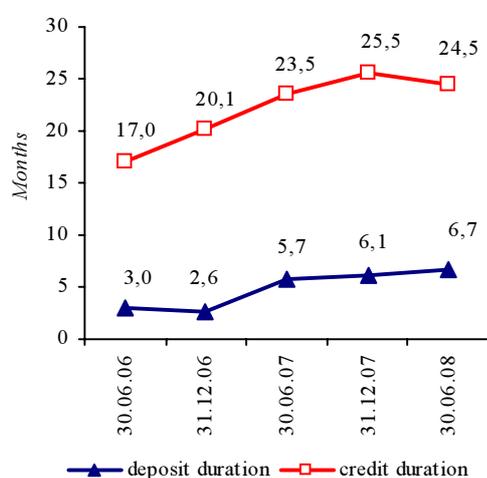
2.2.2. Liquidity Risk

Diagram 2.2.2.1. Time history of current liquidity calculated value

The public trust to the banking system depends on the timely fulfillment of obligations by the banks, which requires a certain level of liquidity available. For regulation purposes the liquidity risk is assessed using the economic standard of current liquidity requirement².

The actual level of the liquidity standard maintained by the banking system is still high. On average, in the banking system the estimated value of this indicator constituted 77.1 percent as of the end of the first half of 2008, increasing by 5.8 percentage points in comparison with the second half of 2007 (Diagram 2.2.2.1).

Exceeding the actual size of the liquidity indicator over the established standard evidences availability of the capacity for further expanding the financial intermediation on the one hand, however on the other hand it reflects insufficient stability of the deposit base. Insufficient stability of deposits is confirmed by the data on changes in the deposits and credits duration as well as by estimation of the funds sources³ stability ratio.

Diagram 2.2.2.2. Dynamics of Changes in the Banking System's Credits and Deposits Duration

Within the reporting period (Diagram 2.2.2.2) the difference between the average terms for attracting deposits and allocation of credits remained high enough, evidencing implicit disintermediation⁴ risks, which could take place in certain banks

² The current liquidity economic standard is one of mandatory requirements established by the NBKR for banks. According to this requirement, the liquid assets must account for at least 30 percent of the current liabilities.

³ Stability ratio of the sources of funds is estimated as the share of time deposits in the total deposits of the banking system (in per cent).

⁴ Disintermediation is the process of mass withdrawal from individuals' deposits prior to the agreed dates due to the panic caused by the escalation of the inflation expectations and/or other negative expectations.

in the course of liquidity management. However it should be noted that a certain part of credits is financed by banks at the expense of other long-term credits other than deposits (capital, long-term borrowings from financial institutions, etc.). The given fact reduced a probability of the above mentioned risks.

In Diagram (2.2.2.3) the changes in the financing sources stability ratio are presented in comparison with the dynamics of the deposit base to the 'net' credit portfolio ratio. The fairly low share of time deposits (35.6 percent according as per results of the first half of 2008) in the deposit base undoubtedly influences the volumes and terms of the issued credits and will complicate the process of liquidity management in the future.

The dynamics of the deposits proportion to credits testifies the efficiency maintenance in using the attracted funds at the level of 2006 year.

In general it should be pointed out that within the reporting period there were no grounds for occurrence of funds shortage to fulfill obligations within the banking system. Alongside with this, the exceeding volume of short-term raised funds had a negative impact on the process of liquidity management and on the credit portfolio.

During the reporting period the funds stability ratio growth was observed, that was related to the increase of fixed-term deposits share.

Table 2.2.2.4 represents the maturity of banks financial assets and banks liabilities as of the end of the first half of 2008. On the whole the banks financial liabilities were offset by their financial assets, with that, the assets surplus over liabilities constituted 11.2 billion soms. The surplus for credits and deposits amounted to 13.3 billion soms. Thus, banks have sufficient assets

Diagram 2.2.2.3. Estimation of the banking system liquidity factors

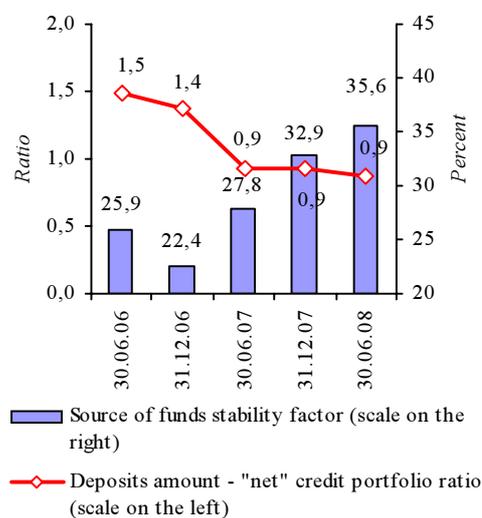
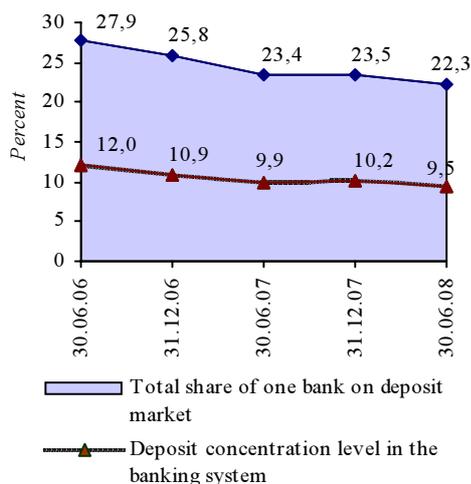
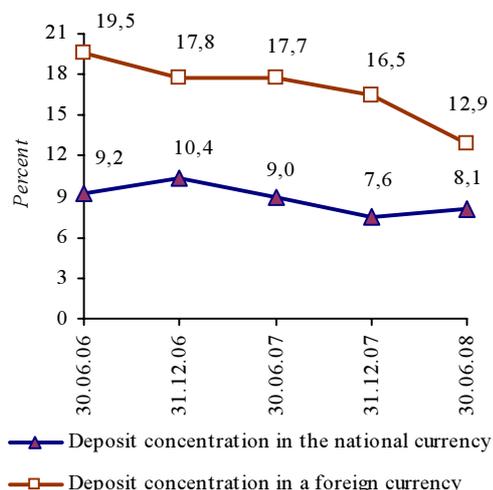
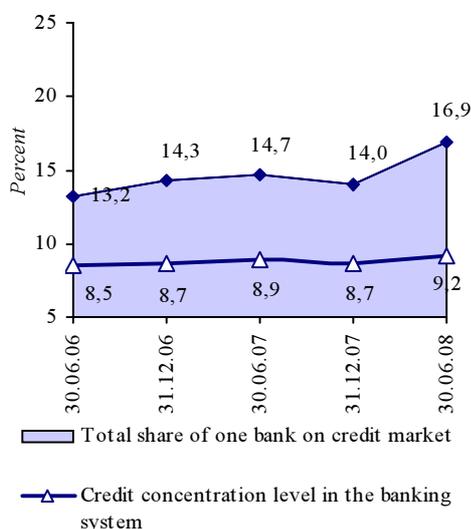


Table 2.2.2.4. Maturity of Financial Assets and Obligations

Description	Maturity					Total
	up to 30 days	from 31 to 90 days	from 91 to 180 days	from 181 to 365 days	more than 365 days	
1. Total financial assets	19 084,0	2 438,9	4 298,3	5 422,0	18 763,1	50 006,4
<i>including credits and financial lease to clients, as well as deposits of physical bodies and time deposits of legal entities</i>	840,9	1 030,3	2 638,2	4 666,6	15 460,8	24 636,8
2. Total liabilities	19 758,3	3 935,1	4 631,2	4 856,1	5 670,7	38 851,5
<i>including deposits of physical bodies and time deposits of legal entities, as well as credit and deposit spread</i>	3 968,2	1 432,1	1 964,1	2 522,5	1 438,0	11 324,9
3. Overall spread	-674,3	-1 496,2	-332,9	565,8	13 092,4	11 154,8
<i>including credit and deposit spread</i>	-3 127,3	-401,8	674,0	2 144,2	14 022,9	13 311,9

Diagram 2.2.3.1. Deposit concentration variation**Diagram 2.2.3.2. Deposits concentration by types of currency****Diagram 2.2.3.3. Credit concentration variation**

to meet their financial obligations. Considering the considerable liquidity level of the banking system as well as the increase of own capital in commercial banks, the negative maturity gap up to 90 days is not likely to significantly influence the performance of financial obligations by the banks.

2.2.3. Concentration Risk

Special features of Deposits Concentration. As is shown on the Diagram 2.2.3.1, in the first half of 2008 there was a further decrease of the deposits concentration in the banking system and of the maximum share of one bank at the deposit market.

The deposits concentration in the national currency increased from 7.6 to 8.1 percent. The deposits concentration in a foreign currency decreased from 16.5 to 12.9 percent. (Diagram 2.2.3.2).

Concentration of the deposits market among participants⁵ is low (below 10 per cent) and has a downtrend.

Assessment of the concentration level in the banking system with the help of another indicator – ‘the share of four large banks’ testifies a certain decrease in the deposits concentration from 51.7 to 48.2 percent.

Special features of credits concentration. In the first half of 2008 the banking system credit portfolio growth was accompanied by the credits concentration increase, assessed both by the maximum share of a bank at the credits market and by the credits concentration rate in comparison with the end of the second half of 2007 (Diagram 2.2.3.3).

In terms of credit concentration, the indicator ‘Share of 4 Major Banks’ from the point of view of credits concentration it can be pointed out that during the reporting period it increased from 47.8 to 49.9 percent, and with that, the composition of these four large banks didn’t change during the second half of 2007.

In the first half of 2008 the indicator of credits concentration in a foreign currency increased from 12.3 to 12.7 percent and in the national currency the given indicator decreased from 11.7 to 10.7 percent (Diagram 2.2.3.4).

Based on the credits concentration risk analysis by the economic

⁵ Assessment of the concentration risk as ‘high’, ‘medium’ or ‘low’ is based on the common gradation of the concentration level. Thus the concentration risk is considered to be ‘low’ if the concentration level is below 10 per cent, ‘medium’ if it is from 10 to 20 per cent and ‘high’ if it is above 20 per cent. So the concentration index equaling to 50 per cent is equivalent to the presence of 2 participants in the market with equal shares and 33 percent is equal to the presence of 3 participants etc.

sectors, there was a fluctuation of from 'low' to 'high' depending on the economic sector.

Based on Tables 2.2.3.6 it should be pointed out that there was a banks activity growth in the area of crediting home economics, construction and social services. High concentration of credits issued for the needs in such areas as communications, agriculture, social services, provision and processing, testifies to high risks of these industries crediting.

Thus, the banking system of the Kyrgyz Republic is generally characterized by a low concentration of deposits in the national currency, moderate concentration of deposits in foreign currency and of credits both in the national and foreign currencies. The credits concentration level by industries generally in the banking system varies from 'low' to 'high' depending on industry. Certain increase of credits concentration indicators by participants of this market is predetermined by the increase of several large commercial banks shares. The given activity is not supported by any considerable changes in the interest rates for the reason of (1) insufficiently high level of competition on the credits market, (2) high demand for credit means and (3) remaining high risks level.

Diagram 2.2.3.4. Credit concentration by types of currency

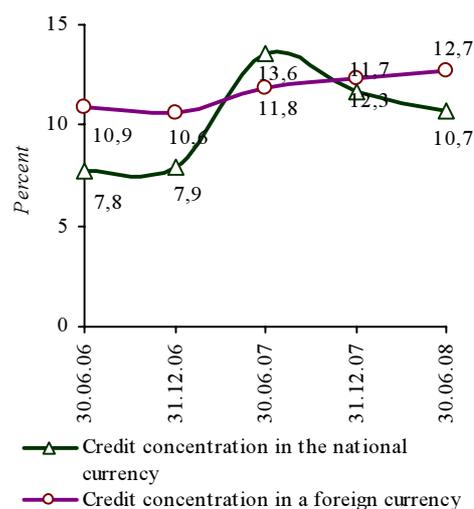


Table 2.2.3.5. Concentration of banks activities by crediting of economy sectors (in percent)*

	30.06.2006	31.12.2006	30.06.2007	31.12.2007	30.06.2008	Deviation (in percentage points)
Industrial production	20.2	23.1	20.1	22.0	20.6	-1.4
Agriculture	20.1	19.8	60.7	56.3	49.1	-7.2
Transport industry	15.7	23.2	27.0	22.1	25.5	3.4
Communications	48.8	87.4	81.7	88.5	74.7	-13.8
Retail	9.1	8.7	8.4	8.5	10.2	1.7
Procurement and processing	55.1	58.1	45.9	37.5	32.2	-5.3
Construction	21.9	19.2	17.0	16.7	14.6	-2.1
Loans on mortgage	28.4	20.2	20.4	18.2	16.8	-1.4
Private households	16.3	14.8	15.7	13.9	13.1	-0.8
Social services	12.0	27.7	24.7	44.1	58.9	14.8
Other	18.0	11.6	13.8	14.6	15.5	0.9

* Concentration is based on Herfindahl index, which is calculated by adding index share squares in total volume of crediting in the sector. The concentration index of 100% implies complete monopolization of a certain market segment, 50% implies 2 participants with equal shares, 33% - 3 participants etc.

Table 2.2.3.6. Banks credit portfolio structure by economic sectors
(in percent)

	30.06.2006	31.12.2006	30.06.2007	31.12.2007	30.06.2008	Deviation (in percentage points)
Industrial production	12.7	11.0	7.7	6.8	6.2	-0.6
Agriculture	3.0	3.3	13.1	12.2	11.9	-0.3
Transport industry	0.9	0.7	0.7	0.7	1.0	0.3
Communications	0.1	1.6	0.9	0.6	0.3	-0.3
Retail	44.7	40.9	36.8	37.9	36.7	1.2
Procurement and processing	0.8	1.0	0.8	0.6	0.5	-0.1
Construction	6.1	5.8	6.1	6.8	7.8	1.0
Loans on mortgage	8.6	14.3	14.9	15.8	13.9	-1.9
Private households	8.7	8.1	7.6	6.6	8.4	1.8
Social services	0.1	0.1	0.1	0.1	0.4	0.3
Other	14.3	13.2	11.3	11.9	13.0	1.1
Total:	100.0	100.0	100.0	100.0	100.0	x

2.3. Capital Adequacy Level

All inherent risks typical for banking activity ultimately affect the financial result of this activity (as already appearing in the form of direct losses as well as high probability of potential losses through costs of establishing relevant reserves) and influence the bank equity size – its capital. Therefore, equity size characterizes bank stability against current and future negative changes in the internal and external environment.

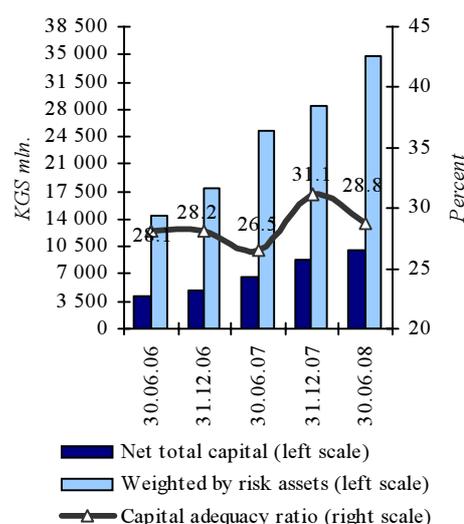
In financial analysis of the bank, the main characteristic of its reliability is compliance of the capital size with the scope and nature of the performed transactions (capital adequacy ratio). Sufficient capital forms a certain ‘air bag’, which allows the bank to remain solvent and maintain the population trust. In this regard the policy of a bank in the capitalization area should be aimed at maintaining such a level of the capital, adequate to cover potential losses caused by various bank risks.

At the established minimum capital adequacy standard of 12.0 per cent, on average this indicator remains high enough in the banking system and as per results of the first half of 2008 it constituted 28.8 percent (see Diagram 2.3.1). The decrease was caused by higher growth rates of the risk-weighted assets increment (by 22.2 percent) in comparison with the net total capital of the banking system (by 13.0 percent).

Herewith, the actual capital adequacy rate (28.8 percent) allows increasing the volume of risk and earning assets almost in two times without exceeding of the risk level in the banking system activity.

All mentioned above demonstrates resistance of the banking system to negative shocks. Besides, there is a potential for increasing the financial intermediation level and performance efficiency of the banking system in the future.

Diagram 2.3.1. The Banking System's Capital Adequacy Indicators Changes



2.4. Financial results

The main indicator of the banking activity profitability is the return on assets (ROA), defined as a ratio on profit to the average level of assets and return on equity (ROE) defined as a ratio of profit to the average Capital of the First Level.

In the banking system of the Kyrgyz Republic as per results of the first half of 2008, the return on assets (ROA) on an annualized basis constituted 3.4 percent (according to the results of the second half of 2007 it was 4.3 percent) and the return on equity (ROE) on an annualized basis constituted 18.0 percent (according to the results of the second half of 2007 it was 26.4 percent).

When examining the major indicators of the banking system profitability to the average size of assets a decrease of the net interest income was observed (from 7.4 to 7.2 percent), which took place due to a high growth of interest expenditures compared to a growth of interest income (Table 2.4.1).

Table 2.4.1. Major Indicators of Banking System profitability for the half year period
(in percent)

	31/12/06	30/06/07	31/12/07	30/06/08
Total interest income	10.9	11.8	10.7	11.2
Total interest expenditures	3.0	3.5	3.3	4.0
Net interest income	7.9	8.2	7.4	7.2
Deductions to PLR (Potencial losses reserves) (on credits)	1.2	0.9	0.5	0.8
Net interest income after deductions to PLR	6.8	7.3	6.9	6.4
Total non-interest income	9.8	8.5	10.3	9.0
Total non-interest expenditures	3.6	3.0	5.1	4.1
Other transactions and administrative costs in total	8.8	8.1	7.3	7.6
Deductions to PLR (on production asset)	0.3	-0.1	0.0	0.0
Net income (loss) before taxes	3.9	4.7	4.8	3.7
Income tax	0.4	0.4	0.4	0.4
Net income (loss)	3.5	4.3	4.3	3.4
Average value of assets for a period (KGS bln.)	18.2	26.5	35.8	44.6

While considering the non-interest income and expenditure of commercial banks, there was noted a decrease of non-interest income (from 10.3 percent to 9.0 percent to the average assets level) as well as of the non-interest expenditures (from 5.1 percent to 4.1 percent). The level of operational and administrative expenses of banks increased by 0.3 percentage points that became one of the decreasing factors of the general indicator of assets profitability in the reporting period.

The level of income tax deductions was left in the amount of 0.4 percent, thus the net profit constituted 3.4 percent to the average value of assets for the period (half year).

In the absolute expression the net profit of the banking system constituted 0.75 billion soms according to the results of the first half of 2008, whereas as per results of the first half of 2007 it was 0.64 billion soms (Diagram 2.4.2).

Profitability of the credit portfolio, determined as the proportion of interest income on credits against average value of debt balances, increased by 0.2 percentage points and constituted 19.4 percent by the end of the first half of 2008 (Diagram 2.4.3).

As of the end of the first half of 2008, the proportion of assets to the number of employees constituted 5.9 mln. soms (as of the end of the second half of 2007 it was 5.5 mln. soms). This is determined by a comparatively high increment of assets, which constituted 17.6 percent, whereas the number of employees increased by 8.5 percent.

Thus, profitability indicators of the banking activity generally demonstrate a positive dynamics and improvement of the banking system attractiveness from the point of view of additional investments. With that, a high level of the average capital adequacy standard testifies to the possibility of additional expansion of the bank active transactions range. On the other hand the efficient use of assets may be considerably increased by reduction of the low-income assets.

Diagram 2.4.2. Variation in return on assets

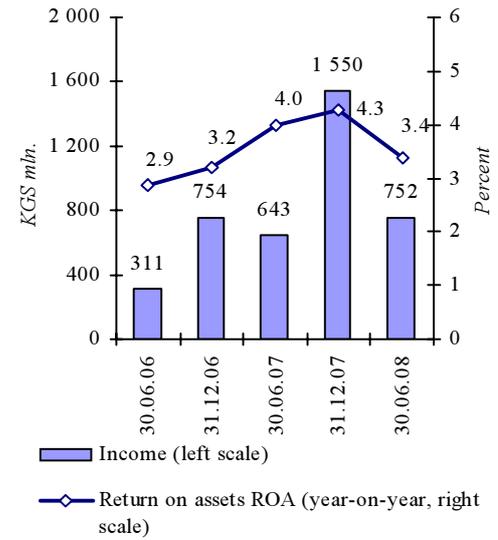
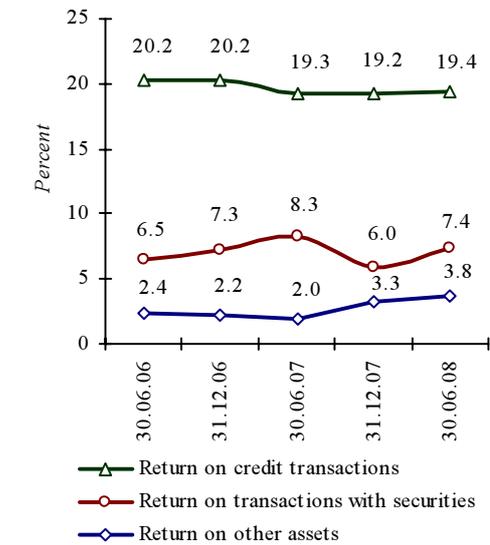
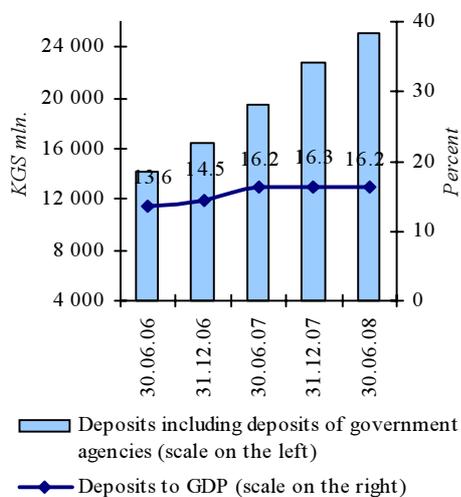


Diagram 2.4.3. Changes in the Assets Profitability



2.5. Indicators of Financial Intermediation

Diagram 2.5.1. Deposits volume dynamics and deposits ratio to GDP



The role of the banking sector as a financial intermediary, accumulating financial resources for their further distribution between economy branches, directly depends on the development level and efficiency of banks performance.

The ratio of deposits volume¹ to GDP² as of the end of the first half of 2008 constituted 16.2 percent (16.3 percent, Diagram 2.5.1). Insignificant decrease of the given indicator was caused by a low growth rate for deposits (10.1 percent) in comparison with GDP growth rate (16.2 percent) during the reporting period.

During this period the credit portfolio continued growing. At that, the increment rate of credits (18.5 percent) surpassed the increment rate of the deposits volume (10.1 percent).

The proportion of the total volume of credits issued to clients against GDP volume constituted 15.9 percent, decreasing by 1.0 percentage points in comparison with the end of the second half of 2007 (Diagram 2.5.2).

As of the end of the first half of 2008 the volume of issued credits constituted 24.6 billion soms, which exceeded the credits volume issued as of the end of the second half of 2007 by 18.6 percent

In the structure of credits to customers the highest increment rate was observed for credits issued to individuals (52.8 percent), such branches as construction (32.5 percent) and trade (14.2 percent). The credit volume increment rate in agriculture constituted 13.6 percent.

The proportion of debts on credits to the deposits volume constituted 98.1 percent, against 91.1 percent of the second half of 2007 (Diagram 2.5.3).

In the first half of 2008 the weighted average interest rate on the newly issued credits in the national currency constituted 27.3 percent (increase by 1.4 percentage points in comparison with the second half of 2007). The interest rate on the newly issued credits in a foreign currency increased by 2.5 percentage points and constituted 20.8 percent in the first half of 2008.

The maintained high spread of interest rates on credits and deposits in the Kyrgyz Republic was determined by the following factors:

Diagram 2.5.2. Credit volumes dynamics and ratio of credits to GDP

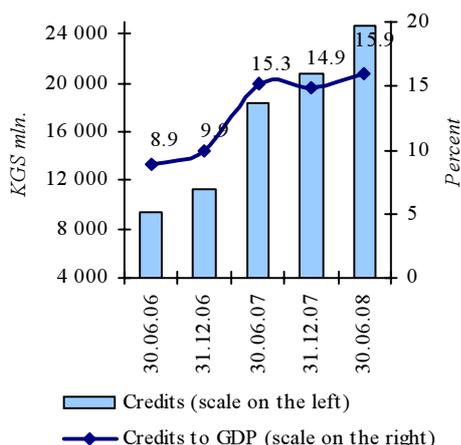
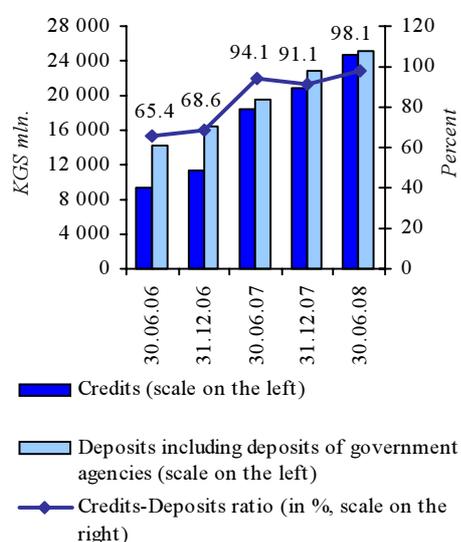


Diagram 2.5.3. Dynamics of credit ratio to deposits



¹ In the given section deposits mean deposits of entities and population and other state agencies of the Kyrgyz Republic.

² In estimate, the data on the nominal GDP for the last 12 months is taken.

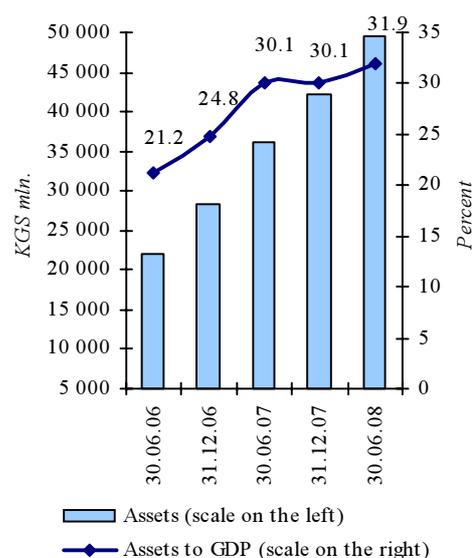
- Insufficiently high level of concentration on the credit market;
- High demand for credit means;
- Remaining high level of risks.

In terms of the level of financial intermediation, there was a growth of the ratio of total assets to GDP (Diagram 2.5.4). Thus, based on the results of the first half of 2008 the given ratio amounted to 31.9 percent, whereas at the end of the second half of 2007 it was 30.1 percent.

Despite the steady increase during the last several years some indicators of financial intermediation are still low, thus there is a potential for further development and increasing efficiency of the banking system operation.

The general VaR (value at risk) of the banks showed that in a short-term period there would not be any considerable financial losses. However in case of further growth of economy crediting, the risk of credit portfolio deterioration may still be remaining.

Diagram 2.5.4. Assets volume dynamics and ratio of assets to GDP



III. NON-BANKING FINANCIAL INSTITUTIONS

3.1. State of Non-Banking Financial Institutions System

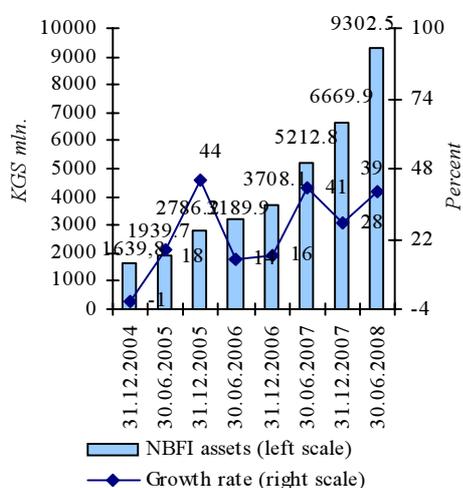
The system of non-banking financial institutions (NBFI) includes the following institutions under the supervision and regulation of NBKR (Diagram 3.1.1):

- Financial Company for Support and Development of Credit Unions (FCSDCU);
- Credit unions (CU);
- Micro-financing institutions (MFI), including micro-financing companies (MFC), micro-credit companies (MCC), and micro-credit agencies (MCA);
- Pawnshops;
- Exchange offices.

Table 3.1.1. Dynamics of Non-Banking Financial Institutions

Description	2003	2004	2005	2006	2007	30.06.2008
KAFC (Ayil Bank) ¹	1	1	1	1	-	-
FCSDCU	1	1	1	1	1	1
Microfinance institutions	72	104	136	168	233	265
Credit Unions	303	305	320	305	272	266
Pawn shops	108	116	140	148	181	187
Exchange offices	261	266	260	263	318	356
Total	746	793	858	886	1005	1075

Diagram 3.1.1. Dynamics of NBFI Total Assets



There was an increase of the number of NBFI, their assets volume and credit portfolio. It can be explained by demand for NBFI services as well as by rather liberal legislative requirements for their establishment and activity.

According to the submitted regulatory report as of the first half of 2008, the increment of NBFI total assets (Diagram 3.1.1) constituted 39 percent. As of June 30, 2008, their volume amounted to 9,302.5 million soms.² Whereas, the increment rate of NBFI owned capital constituted 16 percent and NBFI joint liabilities constituted 49 percent.

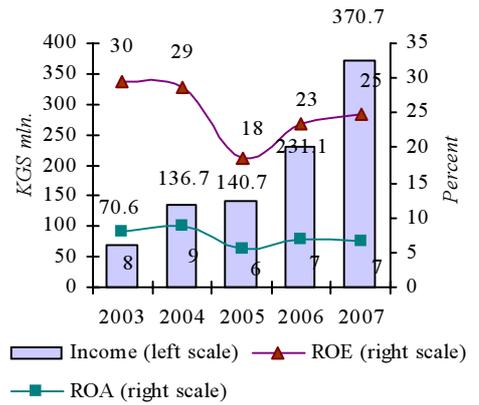
As per results of the first half of 2008, the consolidated profit

¹ OJSC KAFC on December 27, 2006 was reorganized into JSC "Ayil Bank" and from now on it is added to the commercial banks' system.

² Hereinafter the assets and credit portfolio of NBFI are mentioned without the credit portfolio of FCSDCU that is included into the assets of credit unions.

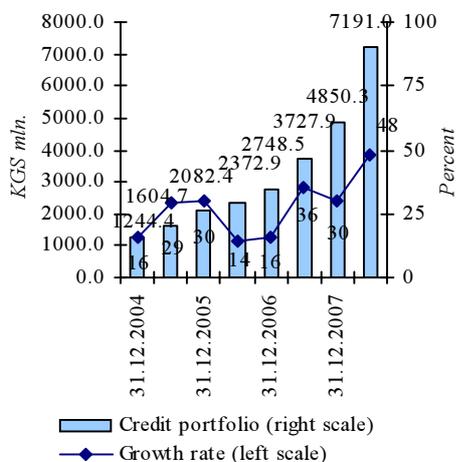
of NBFİ increased by 97.3 percent in comparison with the first half of 2007 (or by 167.6 million soms) and constituted 339.8 million soms. That was related to the volume increase of the main income assets of NBFİ – credit portfolio, mainly due to expansion of share of large MFI.

Diagram 3.1.2. ROA and ROE index trend of NBFİ



3.2. Structure and Dynamics of the Credit Portfolio

Diagram 3.2.1. Credit portfolio trend of NBFI



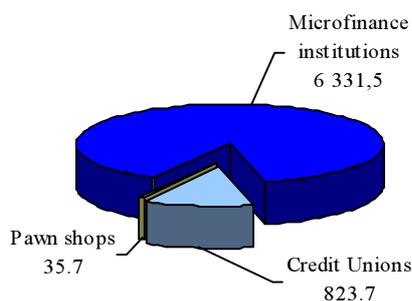
One of the main activities of NBFI is lending. NBFI credit portfolio has had a stable growth trend over the recent years (Diagram 3.2.1).

Within the first half of 2008, the NBFI consolidated credit portfolio increased by 2,340.7 million soms or by 48 percent and constituted 7,191.0 million soms.

During the reporting period, the share of credit portfolio in the NBFI total assets increased from 72.7 percent as of December 31, 2007, to 77.3 percent as of June 30, 2008.

The growth of NBFI credit portfolio volume was accompanied by the increase of the number of borrowers by 47 388 individuals or by 27.3 percent that is up to 220 909 borrowers (as of December 31, 2007 – 173 521 individuals).

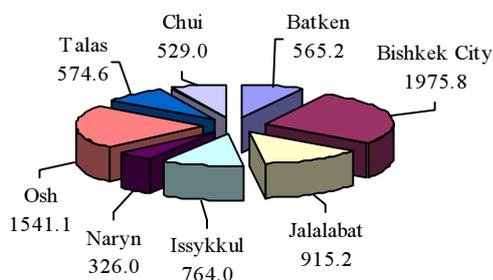
Diagram 3.2.2. Aggregated credit portfolio by types of NBFI
(KGS mln.)



In the structure of consolidated credit portfolio of non-banking financial institutions (Diagram 3.2.2) 88.0 percent is accounted for the credits of micro-financing institutions; 0.5 percent - the credits of pawnshops, and 11.5 percent - the credits of credit unions.

The trends of credit portfolio volume change by sectors and regions reflects the consistency of NBFI preferences. Thus, by oblasts (Diagram 3.2.3) the major share of credit portfolio belongs to Osh Oblast and Bishkek city. Generally, the level of regional activity is high in the South of the country and in the capital due to higher population density and its economic activities in the sectors of agriculture and trade.

Diagram 3.2.3. Aggregated credit portfolio of NBFI by oblast
(KGS mln.)



In the first half of 2008, the largest amount of NBFI credits was directed to the retail sector- 34.7 percent and agricultural sector – 33.9 percent (Diagram 3.2.4).

3.3. Major Risks

The NBFI credit portfolio is mainly concentrated in the retail sector as well as in agricultural sector and business related to the agricultural sector and due to that reason located in the country side. Credits to this sector are accompanied by high risks due to their dependence on climate and natural conditions as well as on rather low income of rural population.

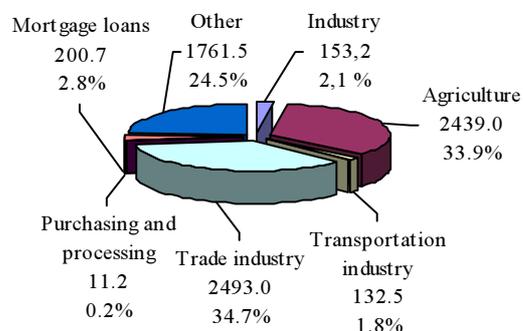
There was a seasonal increase of the credit share to agricultural production from 32.5 to 33.9 percent.

Another risk factor is concentration. The major share of credit portfolio belongs to 6 large MFI, created and performing their activity due to foreign donors' investments. The share of these MFI credit portfolios constituted 74.5 percent out of the total consolidated credit portfolio of NBFI. The growth trend of NBFI may be explained by an increasing volume of foreign investments.

The interest rates for non banking financial institutions was remained high enough due to a continued strong demand for these types of credits on the part of the population as well as to NBFI objective to cover the existing high risks. However, at the same time there was a certain decrease of interest rates on some types of NBFI.

Over the reporting period, the average interest rate for NBFI credits constituted: 13.7 percent for FCSCDU (14.3 percent in the second half of 2007); 30.8 percent for MFI (32.9 percent in the second half of 2007); 27.0 percent for CU (against 25.8 percent in the second half of 2007), and 121.3 percent for pawnshops (against 167.9 percent in the second half of 2007).

Diagram 3.2.4. Aggregated credit portfolio of NBFI by economy branches (KGS mln.)



IV. PAYMENT SYSTEM

Table 1. List of Banks Servicing Money Transfer Systems

Money Transfer System	Commercial Bank name
Western Union	OJSC BANK-BAKAI, OJSC Dos-Kredobank, OJSC IB Issyk-Kul, CJSC BTA Bank, CJSC Kyrgyz Investment Credit Bank, OJSC Kyrgyz Credit Bank, OJSC Kyrgyzpromstroibank, OJSC Kazkommertsbank Kyrgyzstan, OJSC Halyk Bank Kyrgyzstan, OJSC Commercial Bank KYRGYZSTAN, CJSB Tolubai, OJSC Ecobank, OJSC ATFBank-Kyrgyzstan, OJSC AsiaUniversalBank, CJSC DKIB, OJSC FinanceCreditBank KAB, CJSC Manas Bank
Money Gram	OJSC Settlement and Savings Company, CJSC Kyrgyz Investment Credit Bank, OJSC FinanceCreditBank KAB
Contact	OJSC Russian-Kyrgyz AMANBANK, CJSC Bank of Asia, OJSC Dos-Kredobank, OJSC IB Issyk-Kul, CJSC BTA Bank, OJSC Halyk Bank Kyrgyzstan, OJSC Commercial Bank KYRGYZSTAN, OJSC Kyrgyzpromstroibank, OJSC ATFBank-Kyrgyzstan, OJSC Kyrgyz Credit Bank, CJSC Manas Bank
Anelik	OJSC AsiaUniversalBank, OJSC IB Issyk-Kul, CJSC BTA Bank, CJSC Kyrgyz Investment Credit Bank, OJSC Kyrgyz Credit Bank, OJSC Kyrgyzpromstroibank, OJSC Commercial Bank KYRGYZSTAN, OJSC Ecobank, OJSC FinanceCreditBank KAB, CJSC DKIB
VIP Money transfer	OJSC Dos-Kredobank, OJSC Russian-Kyrgyz AMANBANK, OJSC IB Issyk-Kul, OJSC AsiaUniversalBank, OJSC Kyrgyz Credit Bank, OJSC Ecobank, OJSC ATFBank-Kyrgyzstan, OJSC FinanceCreditBank KAB, CJSC Manas Bank
Migom	OJSC Russian-Kyrgyz AMANBANK, CJSC Bank of Asia, CJSC BTA Bank, OJSC IB Issyk-Kul, OJSC Kyrgyz Credit Bank, OJSC FinanceCreditBank KAB, CJSC Manas Bank
Strana Express	OJSC The Settlement and Savings Company
Bystraya Pochta	CJSC BTA Bank, OJSC Kyrgyz Credit Bank, OJSC The Settlement and Savings Company

4.1. Banking Products, Rates and Services

Nowadays, the growing competition compels the banks seeking the ways for saving their own costs, expanding assortment and upgrading quality of the services rendered to their clients. In this respect, the market of banking services in the Kyrgyz Republic develops rapidly, and commercial banks provide a wide range of banking services to the population and organizations.

The rates in the banking services market are established in compliance with the internal strategy of each bank with regard to the market conditions.

Within the reporting period there were some changes in rates for the banking services in comparison with the first half of 2007 that related to prices increase in the market and introduction of new crediting types. Among cash-settlement service, new services like “bank-client” were introduced.

Banks apply various methods for charging commission fees for the same type of services:

- Fixed rates for single transactions;
- Rates, established depending on the transaction amount or the account balance;
- Payment for the period, regardless of the number and the amount of the conducted transactions;
- Pursuant to the agreement.

Generally, the rates of services provided by the banks are almost identical despite the variances in the price range for certain types of services in commercial banks.

For the moment the most popular services are settlement and cash services, documentary transactions, cashless settlements, securities transactions, credit issuing transactions and banking cards servicing.

Commercial banks applying the most advanced and modern technologies, when providing settlement and cash services, often propose to open accounts free of charge. In the reporting period, the rates for this service were re-regarded in 4 banks: CJSC “Demir Kyrgyz International Bank”, LLP “Raschetno-sberegatelnaya kompania”, LLP “Kyrgyzpromstroibank” and CJSC “Manas bank” both for reduction purposes and for opening of an account free of charge. Other banks charge

commission fees from 100 soms to 1000 soms for opening an account in the national currency, and from 100 soms to 2000 soms for opening an account in a foreign currency.

In addition, commercial banks perform the following transactions on behalf of their clients for a commission fee:

- collection, letter of credit, and transfer transactions;
- provision of banking accept and avail for debt liabilities;
- purchase and sale of securities, currencies and precious metals on behalf of the clients;
- brokerage in allocating of stocks and bonds;
- collection services;
- accounting services, consulting and credit card services.

Within the reporting period, the cost of services of issuance (opening) of letter of credit constituted about 0.1-0.25 percent depending on its sum.

Within the reporting period the highest commission fee for issuance of banking guarantee was 7 percent out of its sum.

The service “Money transfer without opening an account” is also of a high demand among population. The main advantage of money transfer systems are fast and safe money transfers to any part of the world for legal entities and individuals without opening an account (table 1). The rates of money transfers system are established depending on the type of money transfer system and within a limit of 1.5 to 4.3 percent out of the transfer sum.

One of the most popular types of electronic commerce is internet-banking. Standard set of services provided by internet-banking include a complete set of services on the client’s account: any cashless payments, purchase and sale of currencies, payment for municipal services, payment for mobile and telephone connection and the possibility to check the status of the account. People prefer this service due to considerable timesaving. The cost of connection to the system of internet-banking depends on the accessing.

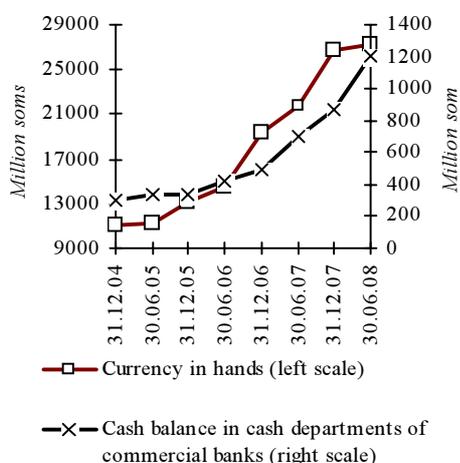
In the Kyrgyz Republic, the services of internet-banking are provided by the following banks: OJSC “AsiaUniversalBank”, OJSC RK “Amanbank”, OJSC “Bank-Bakai”, OJSC “Dos-Kredobank”, OJSC “Demir Kyrgyz International Bank”, OJSC “Kyrgyzpromstroibank”, CJSC “AKB Tolubai”, CJSC “Manas Bank”.

Table 1. Continue

UNIstream	OJSC AsiaUniversalBank, OJSC Russian-Kyrgyz AMANBANK, CJSC Bank of Asia, CJSC DKIB, OJSC Dos-Kredobank, CJSC BTA Bank, OJSC Halyk Bank Kyrgyzstan, OJSC Kyrgyz Credit Bank, OJSC Commercial Bank KYRGYZSTAN, OJSC Kyrgyzpromstroibank, CJSC Tolubai, OJSC Ecobank, OJSC ATFBank-Kyrgyzstan, OJSC FinanceCreditBank KAB, OJSC Settlement and Savings Company, CJSC Manas Bank
Xpress Money	OJSC Russian-Kyrgyz AMANBANK, OJSC AsiaUniversalBank
Inter Express	OJSC Dos-Kredobank, OJSC IB Issyk-Kul, OJSC Commercial Bank KYRGYZSTAN, CJSC BTA Bank, OJSC Ecobank
Blizko	OJSC Russian-Kyrgyz AMANBANK, CJSC BTA Bank, OJSC Kyrgyz Credit Bank
Allyur	OJSC AsiaUniversalBank, OJSC Russian-Kyrgyz AMANBANK, OJSC Ecobank
Privat Money	OJSC AsiaUniversalBank
Zolotyz korona	OJSC AsiaUniversalBank
Faster	CJSC BTA Bank
Travelex	OJSC Ecobank, OJSC FinanceCreditBank KAB

4.2. Cash Flows and Non-Cash Transactions

Diagram 4.2.1. Dynamics of money in circulation



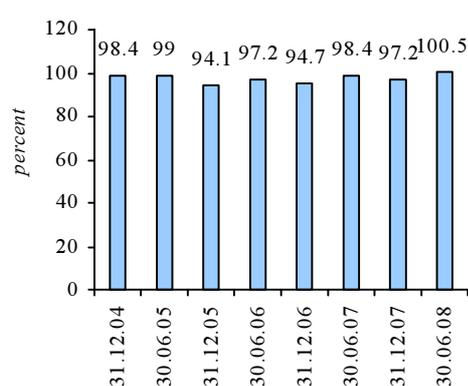
The total amount of *money in circulation* made 28 417.9 million soms, as of July 1, 2008. In comparison with the first half of 2007, the increase of money in circulation increased by 5 931.3 million soms or by 26.4%.

As of the latest day of the reporting period, cash departments of commercial banks had 1 204.8 million soms, which accounted for 4.2 percent out of the total amount of money in circulation.

The dynamics of money in circulation is provided in Diagram 4.2.1.

The increase of money in circulation was related to a steady demand of economy for cash and an increase of public social payments by the government.

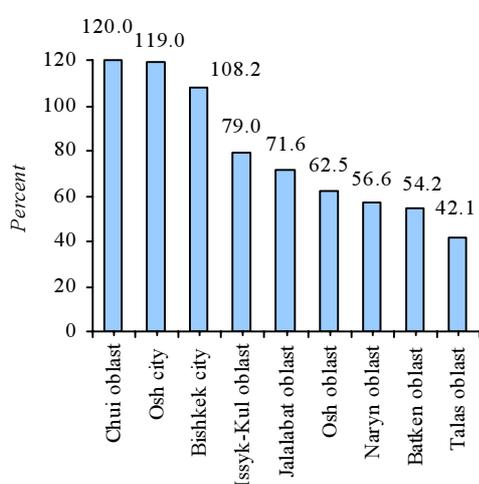
Diagram 4.2.2. Index of cash recovery



The return of cash to cash departments of commercial banks for the first half of 2008 constituted 100.5 percent that is 2.1 percentage points higher than in the first half of 2007. The indicators of cash assets recovery are presented in the Diagram 4.2.2.

Over the first half of 2008, the highest indicator of cash recovery amounted to 120.0 percent in Chui Oblast; the lowest indicator was in Batken Oblast that is 42.1 percent (See Diagram 4.2.3). Cash return in Bishkek city constituted 108.2 percent. The high indicators of cash return in the city of Bishkek and Chui Oblast imply the concentration of banking and financial institutions as well as commercial and industrial entities in the capital of Kyrgyzstan and Chui Oblast. The high rate of cash return in Osh is determined by a more saturated consumer market. However, in Osh oblast, cash return rate is low. On the whole for the country, the cash return changed considerably in comparison with the first half of 2007.

Diagram 4.2.3. Index of cash recovery in the view of oblasts



In general in the republic in the view of oblasts, cash return changed considerably in comparison with the first half of 2007.

In the first half of 2008, commercial banks cash departments received 105 233.4 million soms, that was 37 101.6 million more than in the first half of 2007.

In the first half of 2008, cash departments of commercial banks issued 104 656.9 million soms, that was 35 399.1 million soms more than in the first half of 2007.

The change in indicators of cash accepting, issuance and return

of cash to cash departments of commercial banks is presented in Diagram 4.2.4.

Non Cash Transactions

According to the results of the first half of 2008, 755 300 payments were conducted via the payment systems of the Kyrgyz Republic for the total amount of 179 525.9 million soms. The number of payments increased by 57.8 percent in comparison with the first half of 2007, but the number of payments decreased by 10.8 percent (see the Diagram 4.2.5).

The increase in the volume of interbank transactions was caused by strengthening of the banking system in general, by intensification of financial markets activity and retail sale market.

Currently, in the Kyrgyz Republic there are two payment systems that perform inter-bank payments: gross system and the system of package clearing.

The system of package clearing provides the banks with services of centralized processing of multiple payments on the clearing basis, i.e. multilateral offsetting for all liabilities of the banks, that allows them to manage effectively the liquid funds to perform settlements. As for the gross system, it provides the option to perform final payments for net positions according to the results of the clearing session. It is aimed at making the immediate settlements for financial market transactions, immediate payments, etc.

System of Gross Payments

In the first half of 2008, the gross system processed 41 823 payments for the amount of 153 164.3 million soms. In comparison with the corresponding period of the previous year, the volume of payment increased by 67.6 percent and the number of payments increased by 19.5 percent (see Diagram 4.2.6.).

The volume of payments in the clearing system increased by 17.7 percent in comparison with the corresponding period of 2007 and constituted 26 361.7 million soms. The total number of payments constituted 713 457, that is 12.2 percent less than in the corresponding period of 2007 (see Diagram 4.2.7).

In the regional structure in terms of quantity and volume of clearing payment as per results of the first half of 2008, the leading positions belonged to the Chui oblast and Bishkek city. Their share constituted 74.2 percent of the total volume and 70.5 percent of the total number of clearing payments.

Diagram 4.2.4. Receipt, issuance and recovery of cash to commercial banks

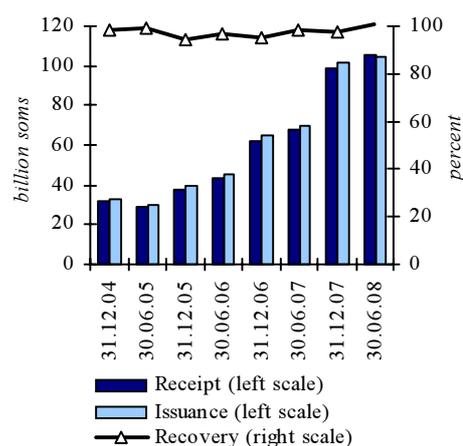


Diagram 4.2.5. Dynamics of volumes and number of payments of interbank transactions

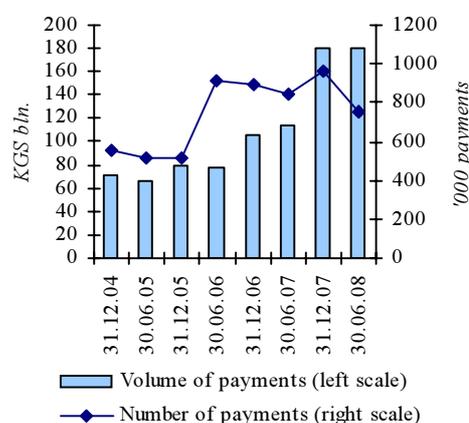


Diagram 4.2.6. Dynamics of volumes and number of payments in gross system

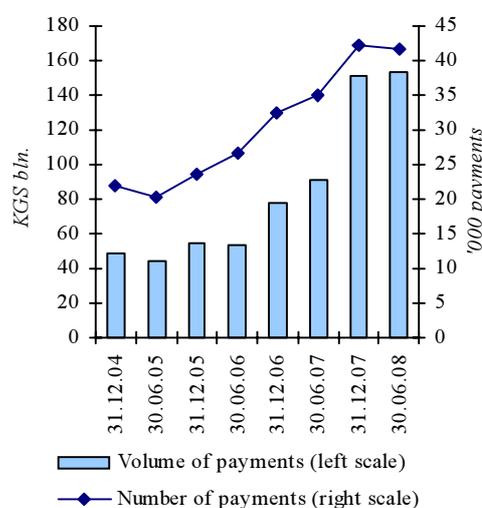
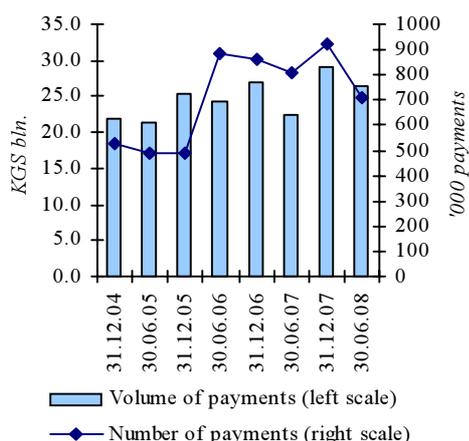


Diagram 4.2.7. Dynamics of volumes and number of payments in clearing system

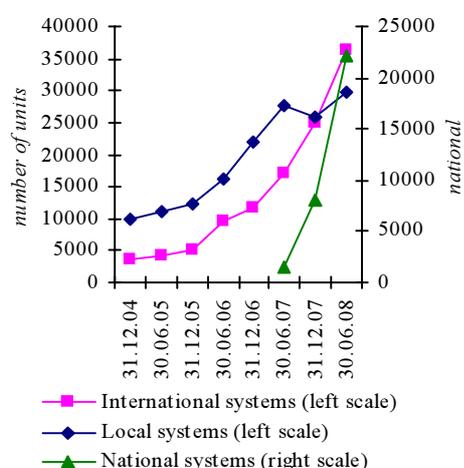
In comparison with the corresponding period of 2007, there was a certain decrease of the number of payments in all oblasts of the republic.

Bank Cards Payment Systems

As of June 30, 2008 the services on emission, acquiring and cash-settlement with the use of bank cards, were provided by 19 banks out of 22 financial-credit institutions. 16 banks are emitters and issue cards of the international systems (9 banks), of local systems (4 banks) as well as the unified national system (16 banks).

The unified national system of payments that uses Elcart bank payment cards is developing within the framework of the project on establishing the Unified Interbank Card Processing Center. 16 commercial banks are the participants of the Elcart System. ICPC LLP provides services on issuance and acquiring of Elcart cards in accordance with the bilateral contractual relations and carries out activities on development of the infrastructure for accepting and servicing Elcart cards. The NBKR provides services on cards processing, estimation of net positions and making final settlements. Commercial banks, in their turn, carry out the activity for attraction of new clients and propose flexible rates for the population, including those individuals who have a low income.

Currently in Bishkek city, the Elcart cards are accepted and serviced by 15 automated teller machines and 222 terminals, out of them 189 terminals are installed in branches and savings departments of commercial banks on issuance of monetary means and 43 terminals in trade-service centers in Bishkek, Chui, Osh, Jalalabat, Batken, Issyk-Kul, Naryn and Talas oblasts. In total, commercial banks have issued 22 221 cards of the national payment system "Elcard".

Diagram 4.2.8. Dynamics of emitted cards number

In the first half year, there was noted an intensification in the market of payment cards, which was demonstrated by the increasing number of issued cards and by the number of transaction with the use of the cards. Thus, the total number of issued cards constituted 88 424 as of July 30, 2008, that is 47.4% higher than in the corresponding period of 2007 (Diagram 4.2.8).

The total number and volume of transactions conducted via cards against the similar period of 2007 increased by 50.6% and 64.2% correspondingly (Diagram 4.2.9).

Just as before, the main share of transactions belonged to the area of cash withdrawals with the use of automated teller

machine and terminals. The share constituted 2 716.1 mln soms of the total transaction volume, and the turnover in retail and service enterprises constituted 125.1 mln soms. It was mainly related to the increase of the number of card holders within the payroll projects and more active use of them as payment means. These factors also showed that conversion money into cash has become more regular operation and constituted 95.6 percent of the total operations volume.

One of the privileged directions in the of banking development strategy was implementation of the ‘payroll’ projects based on cards of international, local and national systems. Due to these projects, banks have reached a notable growth of cards issuance and transaction volumes. It allows them to make an important step towards strengthening the banks positions in the bank cards market.

In the first half of 2008, measures on realization and expansion of the ‘payroll’ projects on the basis of cards of the international, local and national systems, were performed by 22 commercial banks.

In total the banks sold 55 826 cards within the framework of 577 projects, which constituted 63.1 percent out of the total number of issued cards.

Commercial banks continued developing the infrastructure of cards acceptance and servicing. Thus, the total number of active terminals as of June 30, 2008 was as follows:

- 114 terminals for ‘Alay-Card System’, out of which 15 terminals provided acceptance and servicing the card ‘Zolotaya Korona’, and 10 cash machines;
- 120 terminals and 20 cash machines for Demir 24 System;
- 2 imprinters for the Union Card System;
- 222 terminals and 15 cash machines for Elcard System;
- 559 terminals, 15 imprinters and 72 cash machines for international systems.

Cross-Border Payments including Travel Checks

As of June 30, 2008 in the Kyrgyz Republic 22 banks (including NBKR) were the SWIFT system members. 16 banks operated through the general-purpose interface of SWIFT NBKR MAU¹ of, and 6 banks work independently.

The analysis of SWIFT payments demonstrated a certain decrease of indicators both of incoming payments and outgoing

Diagram 4.2.9. Dynamics of volume and number of transactions with the use of bank cards

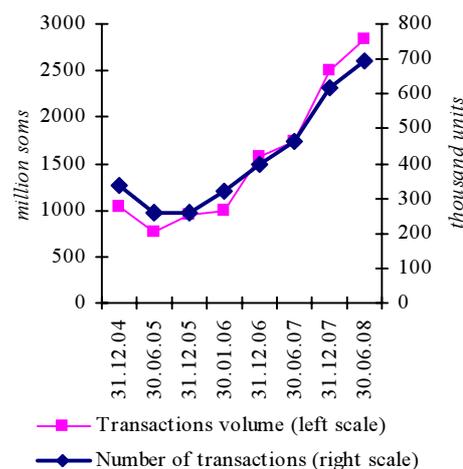
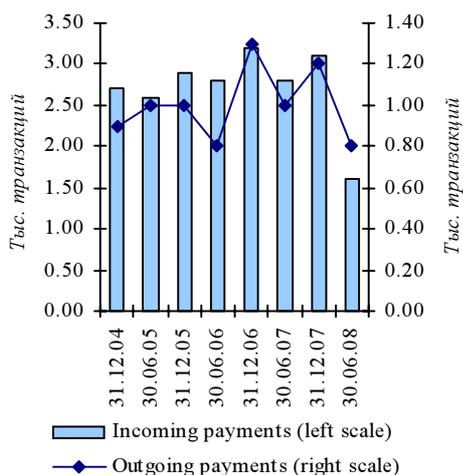


Diagram 4.2.10. SWIFT transactions dynamics



payments. Thus, for the first half of 2008, the number of outgoing payments constituted 804 and incoming payments constituted 1 659 payments that were by 21.6 percent and 41.6 percent correspondingly lower than in the first half of 2007 (Diagram 4.2.10). At the same time the analysis of SWIFT system payments volume showed an increase both for incoming and outgoing payments amount in all types of currencies. The main share of payments is processed in US dollars.

The services on travel checks operations were provided by 11 out of 22 of commercial banks of the Kyrgyz Republic. The number of transactions with the use of travel checks in the first half of 2008 constituted 1 803 transactions with the total volume of 34 275.3 thousand soms, i.e. in comparison with the corresponding period of 2007 the number of transactions increased by 7.4 percent and the volume of transactions also increased by 12.0 percent. This fact demonstrates that the primary users of travel checks are non-residents of the Kyrgyz Republic. Among local population of the Kyrgyz Republic travel checks are still not in demand due to their specificity.

During the reporting period, the cash flow was executed via two types of travel checks: American Express and personal checks of various banks, among which American Express Checks were traditionally in a high demand. Thus, for instance, 1 717 transactions with the use of these checks were conducted in the first half of 2008, for the amount of 28 949.9 million soms that constituted 95.2 percent and 84.5 percent correspondingly out of the total amount and volume of performed transactions.

¹ NBKR SWIFT Multiple Access Unit

V. STATE OF REAL ECONOMY SECTOR

5.1. Households

In the first half of 2008, the monthly average nominal salary rate throughout the republic (exclusive of small businesses) constituted 4976 soms (or 137.5 USD) and in comparison with the corresponding period of 2007 this rate increased by 35.4 percent. Herewith, there was a certain growth deceleration of this index in real terms, which constituted 7.8 percent (in the first half of 2007 – 26.0 percent). The major factor for the salary rate change was the economic activity enhancement. Salary rate increase took place in almost all types of economic activity, but the largest increase was registered in the sphere of public administration, building and construction as well as in the sphere of real estate operations, renting and consumer services. In general, within the reporting period, the average rate throughout the republic remained lower than the salary rate of employees of financial sector, sector of transportation and communication, production and distribution of energy, water and gas as well as in the sphere of real estate operations, renting and consumer services. The least salary rate was registered in the agricultural sector, medical care and education.

The minimum consumer budget in January-June 2008 increased by 1.4 times in comparison with the corresponding period of the previous year (from 2 601.4 to 3 540.4 soms). Thus, the ratio of the monthly average salary to the given index constituted 140.5 percent.

5.1.1. Liabilities to Financial Institutions

The amount of liabilities of the private household sector to the banking system over the past three years increased by 4.4 times, and in comparison with the beginning of the year it increased by 17.8 percent, which constituted 6 209.1 million soms by the end of the first half of 2008. Herewith, despite continuing predominance of credits in a foreign currency in the structure of individuals liabilities, their share considerably decreased from 70.0 to 60.0 percent as a result of a rapid volume growth of the credits in the national currency. As per results of the first half of 2008, credits in the national currency constituted 2 484.8 million soms, increasing by 57.3 percent from the beginning of the year whereas the foreign exchange liabilities constituted 3 724.4 million soms, increasing by 0.9 percent.

The total amount of credits issued to private households in the first half of 2008 constituted 1 436.6 mln soms, increasing by

Diagram 5.1.1.1. Liabilities of individuals to banks

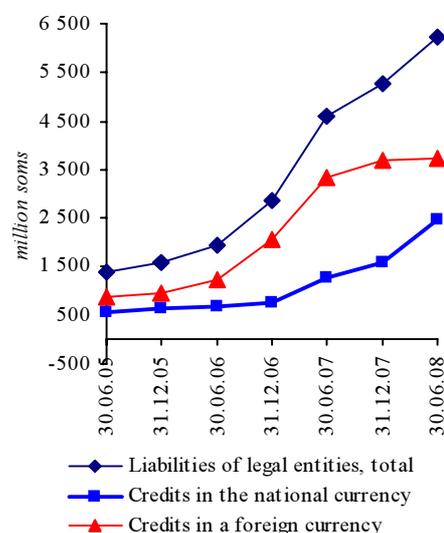
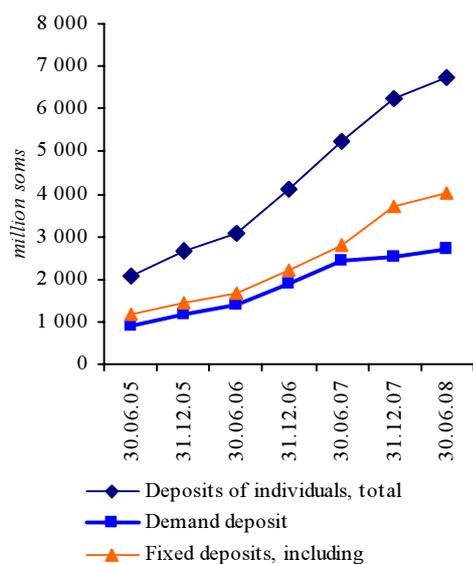


Diagram 5.1.2.1. Deposits of individuals



10.6 percent in comparison with the corresponding period of 2007. Their share in the total amount of issued credits increased from 10.3 to 11.3 percent.

5.1.2. Personal savings

In the first half of 2008, there was still kept a tendency for personal deposits volume growth in commercial banks. From the beginning of a year, the deposits growth rate constituted 7.9 percent, including the deposits of population in the national currency – by 11.6 percent and in a foreign currency - by 5.0 percent. Deposits growth rate in the national currency was mainly provided by the domestic demand growth for the national currency in the condition of the economy dollarization decrease. As a result of a rapid growth of deposits in the national currency in the structure of population deposits, the share of deposits in a foreign currency decreased by 53.7 percent from 61.3 percent of the corresponding period of the previous year.

5.2. Corporate Sector

5.2.1. Liabilities to Financial Institutions

As of July 2008, on the territory of the Kyrgyz Republic there were 436 economic entities that number is by 11.0 percent higher than in the corresponding period of the previous year. As before in the structure of economic entities farm households (66.8 percent) and individual entrepreneurs (26.8 percent) prevailed, and among legal entities – small enterprises, which are centered in Bishkek city, prevailed.

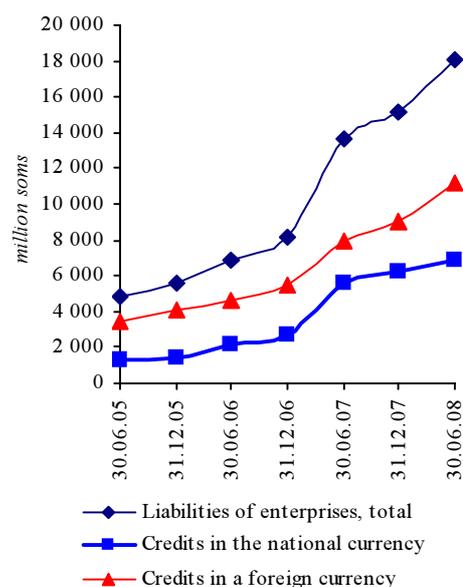
In general in the republic, there was a growth tendency for newly registered and liquidated economic entities. In the period from May 1 to June 30, 2008, in accordance with the Provision “On the procedure of interaction between public agencies of state (accounting) registration (re-registration) of legal entities, branches and representative offices on the principle of «single window», the state statistical bodies registered more than 670 legal entities, their branches and representative offices.

In the first half of 2008, there was an increase of aggregate indebtedness of enterprises and organizations¹. By the end of the reporting period, its amount constituted 18 065.8 million soms, increasing by 18.8 percent in comparison with the beginning of the year (Diagram 5.2.1.1), including credits in a foreign currency by 24.4 percent and in the national currency – by 10.8 percent.

In the period of January-June 2008, there was a certain increase of newly issued credits by commercial banks. Herewith, the growth rate of credits shifted into low gear in comparison with the first half of the previous year. Thus, the volume of credits flow increased just by 0.1 percent in comparison with the first half of 2007 (while in the corresponding period of 2007 the increment constituted 76.3 percent) and constituted 12 659.5 million soms. In terms of economy branches, there was a decrease of flow of newly issued credits: to real estate mortgage (by 55.1 percent) and to production sector (15.1 percent), as a result their shares decreased from 12.9 to 5.8 percent and from 6.7 to 5.7 percent correspondingly. Herewith, the number credits to agricultural sector, trade sector and commercial transactions as well as to building and social services, increased.

The weighted average interest rate for newly issued credits in the national currency in the first half of 2008 constituted 25.7 percent, increasing by 3.1 percentage points in comparison with

Diagram 5.2.1.1. Dynamics of accrued expenses of the corporate sector to commercial banks

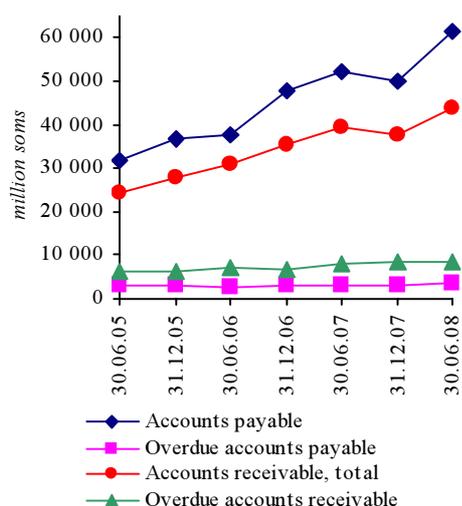


¹ The arrears of legal entities on balance sheet data of commercial banks.

the first half of 2007. With that, the increase of interest rates was registered in almost all industries of the real sector excluding credits for social services. The lowest interest rates of credits in the national currency were for real estate mortgage (on average within the reporting period – 20.3 percent). The real interest rate of credits in the national currency in the first half of the year constituted (-2.0) percent (in the corresponding period of 2007 it constituted 17.1 percent), which can be explained by the inflation rate acceleration (on an annualized basis).

The weighted average interest rate of credits in a foreign currency increased by 1.9 percentage points in comparison with the corresponding period of 2007 and constituted 20.3 percent. The rate increase was registered in almost all industries of economy. The lowest interest rates of credits in a foreign currency were for building and construction (on average within the reporting period – 17.7 percent).

Diagram 5.2.2.1 Dynamics of accounts payable and receivable of the corporate sector



5.2.2 The State of Accounts Receivable and Accounts Payable²

There was kept a tendency for the growth of accounts receivable³ of enterprises and organizations of the economy real sector, the volume of which constituted 43 961.05 million soms as of June 30, 2008, increasing by 17.0 percent or by 6 392.5 million soms in comparison with the beginning of the year. (see Diagram 5.2.2.1).

The largest increment rate of accounts receivable volume was registered at fishery enterprises (by 7.7 times) and public administration (by 2.8 times). Herewith the largest share in the total volume of accounts receivable belonged to enterprises of production and distribution of energy, gas and water as well as enterprises of processing industry (29.9 and 19.2 percent correspondingly).

The volume of overdue accounts receivable decreased by 2.1 percent in comparison with the beginning of the year and constituted 8 358.1 million soms as of June 30, 2008 (or 19.0 percent out of the total volume of accounts receivable). The main share of overdue accounts receivable belonged to enterprises of production and distribution of energy, gas and water (71.3 percent) as well as enterprises of processing industry (18.0 percent).

As per results of the first half of 2008, accounts payable

² Excluding organizations providing financial services.

³ According to the data of the NSC of the KR.

constituted 61 435.6 million soms, increasing the given index of the beginning of the year by 23.1 percent. Increase was mainly provided by accounts payable growth of enterprises of transportation and communication (by 4 110.9 millions soms) and trade enterprises (by 1 862.5 million soms). Accounts payable of agricultural enterprises sector and education sphere decreased by 63.9 and 25.8 percent correspondingly.

Despite increase of overdue accounts payable volume by 21.0 percent in comparison with the beginning of the year, its share out of the total volume of accounts payable continued decreasing and constituted 5.9 percent (as of the end of 2007 – 6.0 percent).

5.2.3. Financial Results

Against economic activity growth, the indices of enterprises financial results grew up as well. Thus, operational profit of the real sector enterprise constituted 5 848.9 million soms in the first half of 2008, increasing by 41.1 percent in comparison with the corresponding period of the previous year.

Furthermore in the period of January - June 2008 enterprises and organizations of the economy real sector (excluding companies engaged in crop production and cattle breeding) received balance profit in the amount of 4 499.2 mln soms, and the volume of income received by enterprises within the analyzed period constituted 95 939.6 million soms.

The major volumes of income from operational activity were received by enterprises of processing industry (42.0 percent out of the total sum), of transportation and communication (37.8 percent), of trade, repair of vehicles, household goods and personal demand items (28.0 percent). Losses were registered in the sphere of production and distribution of energy, gas and water (in the amount of 711.2 million soms) and building (in the amount of 85.8 million soms). The share of cost-effective enterprises in the total number of accounted enterprises within the reporting period changed inconsiderably and constituted 34.2 percent. These enterprises received the profit in the amount of 8 671.3 million soms, including the enterprises of processing industry – 2 604.3 million soms (30.0 percent out of the total income of cost-effective enterprises), organizations of transportation and communication – 2 408.6 million soms (27.8 percent) and enterprises of trade, repair of vehicles, household goods and personal demand items – 1 863.7 million soms (21.5 percent).

The share of losses of unprofitable enterprises for the first half of 2008 constituted 4 172.1 million soms. Their share constituted

37.3 percent out of the total number of accounted enterprises. The largest losses sums were accounted for enterprises of electric energy production and distribution (1 318.0 million soms).

In geographic distribution, the largest balance profit in the reporting period was received by enterprises of Bishkek city, and the less balance profit was accounted for Osh city (or 3 568.6 and 137.7 million soms correspondingly).

VI. TRENDS OF THE BANKING SYSTEM DEVELOPMENT

This Section discusses some fundamental characteristics and basic development trends of the financial system of the Kyrgyz Republic, as well as its impact on the economy of the country in general.

At present the financial sector of the Kyrgyz Republic is represented by such financial institutions as banks, non-banking financial institutions (credit unions and micro-financing institutions), stock exchanges, insurance companies, pension and investment funds, and pawn offices.

Financial sector plays an increasingly significant role in achievement of macroeconomic stability and economic growth in the country. Adequate strengthening of banking legislation and provision of effective control and regulation has a positive effect on further development of the financial system of Kyrgyzstan, as well as on the enhancement of its stability against external risks. At present, the banking system continues to dominate in the country financial sector. The banking system performs the function of accumulation and redistribution of spare funds in the economy.

With the existence of the high demand for credit resources, the sources to satisfy the demand besides bank funds are the resources of non-banking financial sector, especially micro-credit institutions, as well as the funds used by enterprises on reciprocal crediting within the real sector.

In the first half of 2007 there was a continuing positive tendency of the expansion of the resource base of banks and non-banking financial institutions at the expense of deposits base growth, banking system capitalization, NBFIs assets increase, and the inflow of foreign investments in the financial sector of the economy

The growth of banking system deposits base, that is the main source of credit resources, was accompanied by the advanced growth rate of deposits in the national currency, deposits of individuals against the growth of deposits of organizations and businesses.

Among positive tendencies that emerged in the first half of 2008 there was a decrease of the demand deposits number. However in the structure of fixed deposits, the share of long-term deposits decreased, as a result, the duration of deposits base decreased by 0.7 percentage points and constituted 5.9 months by the end of the reporting period.

Diagram 6.1. Credit portfolio of commercial banks and non-banking financial institutions

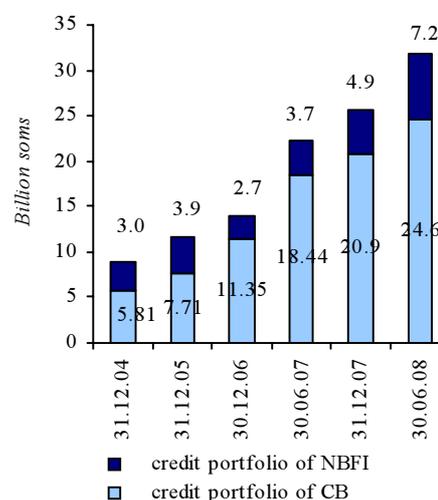


Diagram 6.2. Crediting of economy by commercial banks in the 1 half of 2008 (percent)

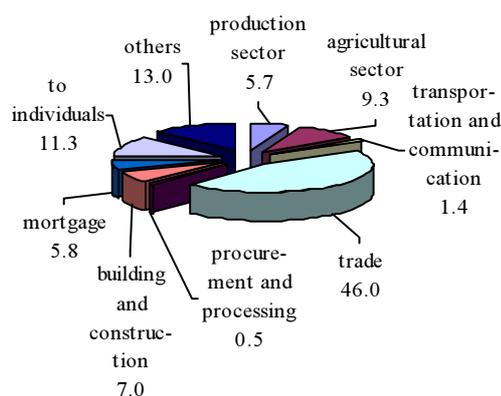


Diagram 6.3. Structure of credits issued by commercial banks in the first half of 2008 by maturity (percent)

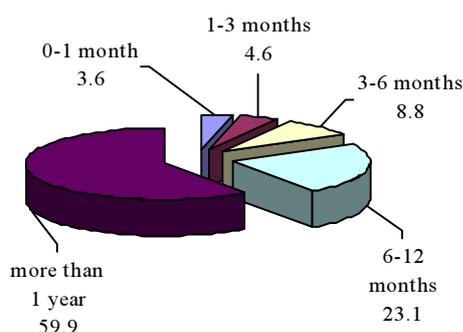
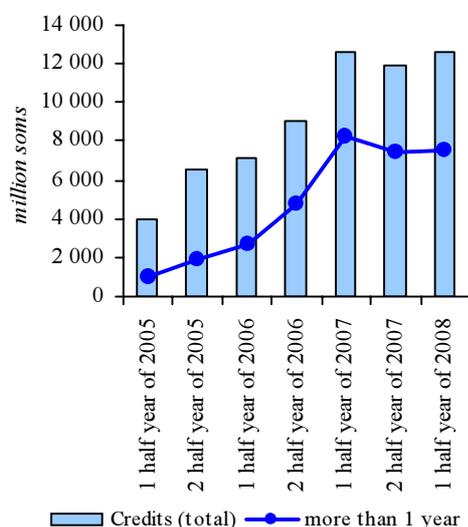


Diagram 6.4. Growth Rates of Long-Term Credits



In the first half of 2008, in the conditions of the resource base increase and the credit funds demand growth, there was a continuing positive economic trend of the credit value growth (Diagram 6.1) both in banking system and in non-bank financial institutions, however growth rates of the economy crediting volume shifted into low gear. In general in the first half of 2008, the growth of consolidated credit portfolio of commercial banks and of non-banking financial institutions constituted 23.8 percent.

Meanwhile, in the reporting period, the credits value growth rate, issued by commercial banks, was considerably lower in comparison with the non-banking sector. Thus, the volume of credits, issued by commercial banks, in the first half of 2008 was remained on the level of the first half of 2008 and constituted 12.7 bln soms. The ratio between issued credits and GDP constituted 19.4¹, while the given index for the first half of 2007 constituted 25.4² percent.

The highest share out of the total volume of the credits issued by banks in the first half of 2008 still belongs to trade sector – 46.0 percent. Other shares belong to consumer’s credits (11.3 percent), credits to agriculture sector (9.3 percent), to construction sector (7.0 percent), to industrial sector (5.7 percent) and mortgage credits (5.3 percent). Share of credits to transport and communication, procurement and processing constituted 1.9 percent and to “others” – 13.0 percent (Diagram 6.2.)

In the structure of commercial banks credits by their maturity, the volume of fixed credits decreased and constituted 59.9 percent out of the total credits volume in the reporting period (in the first half of 2007, the share of long-term credits constituted 65.8 percent).

Credit portfolio of non banking financial institutions in the first half of 2008 increased by 48.3 percent whereas in the first half of 2007 it decreased by 22.6 percent. The major flow of credits issued by NBFIs in the reporting period was directed to the trade sector (34.7 percent) and agricultural sector (33.9 percent). The structure of credits by industries changed in comparison with 2007 – the share of credits issued to the trade sector decreased; the share of credits issued to the agricultural sector inconsiderably increased; and the share of “other” credits considerably increased.

Securities market at this time is still less-developed. The current state of the securities market is characterized by insufficient

¹ To GDP for the first half of 2008.

² To GDP for the first half of 2007.

corporate capital market development that is even more obvious against relatively more developed market of government securities. However, there was a considerable growth of activity and trade volumes in the stock markets

The main trading board of the republic securities market is CJSC “Kyrgyz Stock Exchange”, where the volume of stock-exchange trade constituted 3.1 billion soms in the first half of 2008, increasing by 25.2 percent in comparison with the first half of 2007. The volume of stock-exchange trade at the trading board of CJSC “Central Asian Stock Exchange” increased almost in 3 times in comparison with the first half of 2007.

The total volume of stock-exchange trade at the trading boards of CJSC “Kyrgyz Stock Exchange”, CJSC “Central Asian Stock Exchange” and CJSC “Stock Exchange Trading System” constituted 3.9 billion soms in the reporting period, increasing by 40.8 percent in comparison with the first half of 2007. (Diagram 6.5).

The indexes of investment funds as before testify to their insignificant impact on the economy of the republic. The assets of investment funds to GDP constituted 0.02 percent by the end of 2007.

Another sector providing important financial services is the insurance services market. Insurance companies besides insurance services also perform investment activities. These services contribute to the strengthening of capital market and attraction of financial resources for corporate investments in economy. The ratio of insurance companies’ assets to GDP constituted 0.3 percent in 2007.

Insurance services were provided by 17 companies on the internal market as of the end of the first half of 2008. Herewith there was an improvement of general indicators of the insurance companies’ activity. Thus if in 2004-2006, there was a decrease of assets and insurance contributions volume, then in 2007 there was a significant increase of these indices. In the first half of 2008 the number of concluded insurance contracts increased by 21.6 percent in comparison with the first half of 2007, and the number of insurance contributions increased by 30.0 percent.

Diagram 6.5. Volume of stock-exchange trade for the first half year of 2008
(million soms)

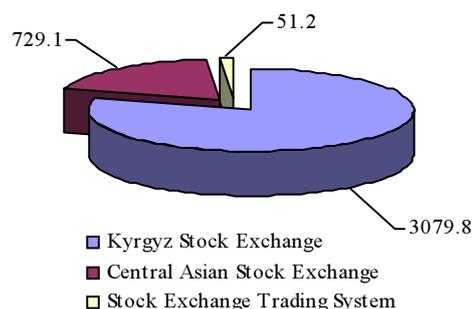


Diagram 6.6. Dynamics of assets and income of investment funds

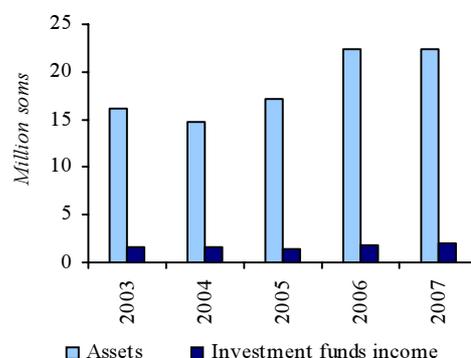


Diagram 6.7. Major indices of insurance companies activity

