

## Monetary Policy Report for 2010

Approved  
Resolution of the NBKR Board  
№ 11/1 dated March 1<sup>st</sup>, 2011

### Basic Monetary Policy Trends

The basis of inflation estimate within 7.5 – 9.5 percent determined in the Main Monetary Policy Guidelines for 2010 comprises expectations that inflationary pressure is to increase on the background of large-scale measures on budget stimulation for providing economic growth, strengthening social protection of the population, and increasing tariffs for electricity and heat energy as well. Primary objective for 2010 was to restrain moderate inflation rates.

Actually, in 2010, the monetary policy focused on several tasks set by internal shocks under conditions of unsteady external environment. Political events occurred in the republic had a significant impact on changes of conditions and character of the monetary policy. Under conditions of systemic crisis risks occurrence in the banking system and the threat of deeper economics stagnation on the background of moderate inflation rates during the first months after April events, the activities of the National Bank were primarily focused on providing stability in the banking and financial systems and support of the economic growth stimulation.

Taking into account decrease in the volume of resource base for the purposes of economy crediting on the part of commercial banks, the National Bank within the 2<sup>nd</sup> quarter considerably decreased the volumes of excessive liquidity withdrawal through operations in the open market: the volume of Notes in circulation was Som 200 million as of the end of June against Som 1.0 billion as of the end of March. Alongside with it, the National Bank increased the volume of operations on banks refinancing, decreased the volume of required reserves for commercial banks from 9.5 to 8 percent.

Since August, the National Bank commenced conducting swap operations with commercial banks on providing liquidity in the national currency to microfinance organizations for their support under conditions of liquidity problems in the banking sector. Generally, the volume of such operations amounted to US\$ 14.7 million or Som 683.5 million for a year.

The operation of the Special Fund for Banks Refinancing (SFBR) on providing financial assets to the banking sector was stimulated for the purposes of economy crediting and liquidity support. Thus, in 2010, the volume of the SFBR distributed funds increased from Som 66.6 million to Som 1 028.1 million as of the beginning of the year. In May, for the purposes of economic growth stimulation, the National Bank decreased basic rate from 8 to 7 percent for the SFBR operation as well as reduced to 1 adjustment branch coefficients to basic rate for calculating interest rate on the SFBR loan funds. At this level it remained till the end of 2010.

Measures taken by the National Bank and the Government of the Kyrgyz Republic intended for crediting stimulation under conditions of difficult domestic and economic situation contributed to gradual rehabilitation of economy crediting growth after recession which occurred in 2009 due to adverse impact of the global crisis. Thus, the rate of loans gain into the economy made 6.3 percent in 2010.

In the 3<sup>rd</sup> quarter, considerable acceleration of inflationary processes was observed due to external price shocks conditioned by climatic cataclysms in the large crops producing countries on the background of growth in prices for energy carriers, resulted in growth of domestic prices for foodstuffs and supported by strengthening of inflationary expectations on the part of the population. Under inflationary conditions of 19.2 percent, growth on consumer prices index was 4.1 percent in the first half-year.

Taking into account inflationary pressure and potential significant budget expenditure growth, the NBKR introduced in August amendments into the monetary policy intended for stimulating operations on money supply sterilization. One of measures taken by the National Bank in this direction was to increase the volume of Notes in circulation. Thus, the volume of notes in

circulation increased from Som 200 million as of the end of June 2010, to Som 669.2 million as of the end of December 2010. The NBKR discount rate increased for 2010 by 4.65 percentage points, to 5.5 percent. Moreover, under conditions of considerable increase in the volume of net expenditure of the Government within the last two weeks of December, the National Bank conducted operations on the STB (State Treasury Bills) sales under REPO conditions to the amount of Som 70.9 million for the purposes of additional withdrawal of the excessive reserves in the commercial banks.

In 2010, the National Bank increased the volume of currency interventions for US\$ sales in order to smooth sharp exchange rate fluctuations. The NBKR net sales of US\$ amounted to US\$ 234.8 million for a year. Meanwhile, the official US\$ exchange rate increased by 6.8 percent against Som, from 44.0917 Som/US\$ to 47.0992 Som/US\$ (in the same period of 2009 – by 11.9 percent).

Despite increasing pressure on Som, the National Bank managed not just to maintain but increase the volume of international reserves by US\$ 131.7 million or 8.3 percent bringing it up to US\$ 1.7 billion as of the end of December 2010, thereby covering 4.3 months of the goods and services import.

Generally, slowdown in the rates of economic growth was observed by 1.4 percent compared to the previous year (in 2009 GDP growth made 2.9 percent). Meanwhile, such branches as trade, construction, and agriculture had a significant impact on decrease of GDP volume.

Balance of payment in 2010 has formed positive at the rate of US\$ 56.1 million, significant increase of the current account deficit to US\$ 508.5 million or 11.1 percent of GDP was observed according to preliminary data.

The state budget deficit in 2010 was 5.1 percent of GDP, while in 2009 the later was executed with the deficit in 1.5 percent of GDP.

Generally, according to the NSC data, the overall price level growth made 19.2 percent. Inflation processes in our country are generally caused by nonmonetary factors. Thus, according to estimates 9.8 percent out of 19.2 percent of inflation, is a direct contribution of nonmonetary factors, inflationary expectations contribution made 4.8 percent, monetary factors – 4.6 percent.

Higher inflation rates in our republic, as compared to the indices of the countries – major trade partners, caused index growth of the Som Real Effective Exchange Rate (REER) by 8.1 percent, to 111.3 percent.

\*\*\*

Taking into account high level of inflation in the country and maintenance of major inflation risks in 2011, as well as expected high level of the state budget deficit, on December 30, 2011, the MPC (Monetary Policy Committee) took a decision to increase basic rate from 7.0 to 8.0 percent for January 2011, for the purposes of the SFBR crediting within the framework of tightening monetary policy in accordance with “Basic Monetary Policy Guidelines for 2011-2013”.

### **Behavior of Monetary Indicators**

Having increased by 18.4 percent for the accounting year, the monetary base totaled Som 48 597.3 million at the end of December 2010 (in 2009 the increase was 18.9 percent).

Increase in the share of cash in circulation from 87.0 percent at the beginning of 2010 to 89.1 per cent at the end of 2010 respectively was observed in the structure of monetary base. Thus, the share of funds on the correspondent accounts of commercial banks in the National Bank decreased from 13.0 percent to 10.9 percent.

Money outside banks M0 totaled Som 41 471.2 million at the end of 2010, having thus increased by 22.4 percent for the accounting year (in 2009 the increase was 15.3 percent).

Money supply M2 was Som 53 745.4 million at the end of December 2010, having increased by 23.6 percent for 2010 (in 2009 the increase was 13.8 percent), while the deposits in the national currency increased by 27.8 percent.

Having increased by 21.1 percent in 2010, the volume of broad money M2X including deposits<sup>1</sup> in foreign currency totaled Som 69 207.7 million at the end of December 2010 (in 2009 the increase was 17.9 percent). The growth rates of deposits in the national currency was 27.8 percent in 2010, this value exceeded the growth rates of money outside banks (22.4 percent). Thus, the total volume of deposits increased by 19.3 percent, the volume of deposits in foreign currency increased by 13.4 percent.

Increase in the volume of broad money in 2010 was accompanied by increase in the coefficient of economy monetization in the Kyrgyz Republic, that despite increase by 3.9 percentage points for a year remained low – 27.9 percent.

### **Inflation: Outcome and Trends**

Generally, significant increase in the overall price level was observed in 2010 compared to the same index of 2009. According to the data of the National Statistics Committee (NSC), growth of the overall price level was 19.2 percent for 2010, while in 2009 increase was 0.0 percent.

Acceleration of the inflationary development in the economy was caused by high prices in the world and domestic foodstuffs and energy markets due to low volume of agricultural products yield and recovering demand for oil products in the world; change in the tariff policy for electricity and heat energy, partial closure of borders and toughening check-in and check-out procedure on the borders with neighboring states, as well as trade conditions worsening inside the republic due to unstable socio-political situation in the country.

**Table 1. Consumer Price Index in the Kyrgyz Republic**

	December 2010 against		January-December against January-December 2009
	November 2010	December 2009	
<b>Total goods and services</b>	<b>102.4</b>	<b>119.2</b>	<b>108.0</b>
of which			
Foodstuffs and soft drinks	104.2	127.0	106.5
Alcoholic and tobacco products	101.7	112.9	107.8
Nonfoods	100.8	114.2	111.4
Services	101.0	111.9	107.2

The prices for foodstuffs increased by 27.0 percent in 2010 (in 2009 the decrease was 7.4 percent).

Low volume of domestic sugar supply, as well as increase in prices for imported sugar conditioned growth of domestic prices. Thus, in 2010, the prices for sugar increased by 22.5 percent in the republic.

The growth in prices for meat in annual terms (+27.9 percent) was observed in the domestic market as a result of growth of prices for forage, the decrease in the volume of domestic production, as well as large volume of underestimated export of domestic production. The growth in prices by 37.8 percent was observed in the oils and fats domestic market in 2010 due to large share of import in the volume of consumption. By-turn, growth of prices for imported oil was caused by drought in Russia, as well as by imposing embargo on the vegetable oil export on the part of Kazakhstan.

In 2010, the prices for alcoholic and tobacco products increased by 12.9 percent.

12-month growth of the consumer price index of nonfoods was 14.2 percent.

<sup>1</sup> Without taking into account the deposits of the Government and non-residents

The price for lubricants in annual terms increased by 31.8 percent: prices for petrol increased by 29.3 percent, prices for diesel fuel – by 51.9 percent.

Growth of price index for paid services at the end of 2010 made 11.9 percent (for 2009 – 4.4 percent). Generally, index growth in this group was conditioned by appreciation of services in the restaurants and hotels by 16.7 percent due to increase in prices for foodstuffs and transport services (+9.2 percent), as well as recreation services (+23.5 percent). Increase in prices for health care services and education was by 23.1 and 5.9 percent respectively.

## Real Sector

According to the preliminary data for 2010, the volume of GDP in the current prices was Som 212 177.4 million, having thus decreased in comparison with 2009 by 1.4 percent (according to the report of the KR NSC, GDP growth was revised and adjusted from 2.3 to 2.9 percent at the end of 2009). Excluding enterprises developing the gold mining deposit “Kumtor”, the volume of GDP decreased by 2.1 percent in January-December 2010 (in 2009 the increase was 3.4 percent). GDP deflator was 6.9 percent in 2010 against 4.0 percent in 2009.

**Table 2. Contribution of individual types of activity into growth/reduction of GDP**  
(percent)

	Share in		Growth rate		Contribution of growth	
	2009	2010	2009	2010	2009	2010
Agriculture	18.8	18.5	6.7	-2.8	1.6	-0.5
Mining	0.5	0.7	7.7	-0.4	0.0	0.0
Manufacturing	14.2	15.9	-9.3	10.1	-1.2	1.4
Electricity, gas&oil generation&distribution	2.2	2.7	-2.6	11.0	0.0	0.2
Construction	6.7	5.7	22.1	-22.8	1.2	-1.5
Trade, repair of vehicles	16.8	16.1	2.3	-6.4	0.4	-1.1
Hotels&restaurants	1.3	1.2	4.2	-9.6	0.1	-0.1
Transport&communication	8.8	9.1	5.1	2.5	0.4	0.2
Other	19.7	19.4	0.9	0.8	0.2	0.2
Net taxes on products	11.0	10.5	2.9	-1.4	0.4	-0.2
<b>GDP</b>	<b>100.0</b>	<b>100.0</b>	<b>2.9</b>	<b>-1.4</b>	<b>2.9</b>	<b>-1.4</b>

Source: NSC data & NBKR adjustments

According to the preliminary data of 2010, the volume of industrial production increased by 9.8 percent compared to 2009. The share of industry in the GDP structure increased from 16.9 percent in 2009 to 19.4 percent in 2010, thus having the largest share in the structure of economy of the Kyrgyz Republic. Excluding enterprises developing the gold mining deposit “Kumtor”, the volume of industrial production made 11.7 percent. Decline in industry reached 8.1 percent at the end of 2009, the volume of industrial production, without taking into account “Kumtor”, decreased by 10.1 percent. Generally, the growth of industrial production in 2010 was caused by low base effect of 2009.

Significant contribution into industrial growth was made by manufacturing sector, the growth of the later, according to the preliminary data of 2010, was 10.1 percent compared to 2009.

Significant contribution into industrial production growth was also made on the part of electricity, gas and water generation and distribution. According to the preliminary data of 2010, the output of this branch increased by 11.0 percent against decline by 2.6 percent at the end of 2009.

According to the preliminary data, the total output of agricultural products decreased by 2.8 percent in real terms in 2010 against the growth by 6.7 percent at the end of 2009.

In 2010, the volume of trade operations<sup>2</sup> decreased by 6.4 percent compared to the similar index of 2009 (in 2009 the volume of the trade increased by 2.3 percent). The main reasons of the decrease in the volume of trade operations were the consequences of political events in 2010.

<sup>2</sup> Calculated on the basis of added value.

Meanwhile, gradual rehabilitation of economic activity was observed in this branch: thus, the increase in the volume of trade operations by 7.8 percent was observed in the republic in December 2010 compared to December 2009.

In 2010, the reduction in the volume of investments (9.8 percent) into the fixed assets was caused by the decrease in assimilated funds at the sites of manufacturing sector, electricity, gas and water generation and distribution, in the sphere of hotels and restaurants construction.

### **External Economic Sector**<sup>3</sup>

According to the outcome of 2010, the volume of KR foreign trade turnover in FOB prices increased by 7.5 percent and made US\$ 4 846.3 million in value terms. Generally, the volume of goods turnover with far-abroad countries increased by 10.5 percent, while, growth of such index with the CIS countries made 4.8 percent. Trade balance deficit increased by 25.5 percent at the end of 2010 and amounted to US\$ 1.4 billion.

Increase in the volumes of foreign exchange receipts on the current transfers was observed in the period under review, this was conditioned by considerable growth of transfers of labor migrants (23.6 percent). Alongside with it, considerable decrease of monetary grants inflow was observed in the public sector<sup>4</sup>.

Despite growth of monetary receipts on the current transfers, the increase in goods and services balance deficit, as well as considerable outflow on “incomes” article led to deteriorating in the current account state. According to the performance in 2010, the current account deficit was US\$ 508.5 million, that corresponds to 11.1 percent to GDP (the same index of 2009 made 2.4 percent).

The capital and financial transactions account has formed with positive balance and made US\$ 227.9 million, and it is less than appropriate parameter in 2009 by 60.2 percent.

Balance of payment according to the performance of the period under review formed positive at the rate of US\$ 56.1 million. The volume of gross international reserves was US\$ 1 718.9 million as of the end of the accounting period, thereby covering 4.3 months of future import of goods and services.

According to the preliminary data, the index of the Som Nominal Effective Exchange Rate (NEER) decreased by 6.3 percent since the beginning of 2010 and was 116.4 percent as of the end of December 2010. Decrease was caused by Som depreciation in respect of many currencies of major trade partners. Thus, the exchange rate of Som decreased by 7.2 percent against Kazakh Tenge, against Chinese Yuan – by 6.3 percent, Russia Ruble – by 2.3 percent, and Euro – by 4.3 percent in December, 2010 compared to December, 2009.

Despite Som NEER depreciation against the currencies of major trade partners, lower level of inflation<sup>5</sup> in the countries – major trade partners had the impact on the Index of Real Effective Exchange Rate (REER) in the increasing direction. Thus, the Som REER increased by 8.1 percent since the beginning of the year and was 111.3 percent as of the end of December 2010.

### **Public Finance Sector**

In 2010, social and economic instability conditioned slowdown of economic activity in the country, decline in the growth rates of tax receipts, increase in the volume of state expenditure for social protection, capital construction and repair works, and, as a consequence, considerable increase in the state budget imbalance.

According to the preliminary data of the Central Treasury of the Ministry of Finance, the state budget deficit in 2010 was Som 10.8 billion or 5.1 percent of GDP (in 2009 the budget was

---

<sup>3</sup> Preliminary data.

<sup>4</sup> It is connected with high level of basic period. For reference only: in 2009 the Government of the Russian Federation granted funds to the amount of US\$ 150.0 million.

<sup>5</sup> The KR annual inflation value (December 2010 against December 2009) was 19.2 percent, while, according to preliminary calculations, the average inflation rate of the countries – major trade partners was 3.4 %.

performed with a deficit at the rate of 1.5 percent of GDP). The state budget deficit was Som 15.1 billion or 7.1 percent of GDP without taking into account funds received from the gross revenue tax of “Kumtor”. Total state budget financing in the period under review was Som 13.0 billion, domestic financing thereof made Som 6.4 billion, foreign financing – Som 6.5 billion.

In 2010, state budget revenue from operational activity was Som 57.4 billion or 27.0 percent of GDP. Compared to 2009, the rates of growth, having remained positive, decreased and made (+)3.7<sup>6</sup> percent against (+)21.6 percent, generally, the later value is lower than the established mid-year level for the last five years.

In 2010, the volume of tax receipts inflow made Som 39.4 billion, having thus increased by 9.0<sup>7</sup> percent or by Som 3.3 billion, compared to the same index of 2009. The share of tax receipts in the total volume of state budget revenue from operational activity increased by 3.3 p.p., compared to 2009 and amounted to 68.6 percent. Tax receipts provided contribution into increase of the state budget revenue from operational activity by 5.9 percent.

In 2010 non-tax receipts made Som 11.0 billion, having thus increased by 21.4 percent compared to 2009. Non-tax receipts provided contribution into increase of the state budget revenue from operational activity by 3.5 percent.

The official transfers received in 2010 made Som 7.0 billion, having thus decreased by 30.9 percent or by Som 3.2 billion compared to the same index of 2009. Decrease in the volume of official transfers has made negative contribution into the growth rates of the state budget revenue from operational activity by (-)5.7 percent.

The policy of state expenditure was as usual focused on complete and timely financing of social guarantees and liabilities of the state before its citizens.

Total state budget expenditure for operational activity in 2010 was Som 61.6 billion, having thus increased by 23.1<sup>8</sup> percent or Som 11.5 billion.

According to the functional classification of budget expenditures, growth in expenditures was observed in the period under review by the following groups: social protection (2.0 times), economic issues (by 34.9 percent), defence, public order and security (by 32.6 percent), recreation, culture and religion (by 12.9 percent), public health (by 10.4 percent), education (by 4.3 percent), housing and public utility services (by 2.6 percent). State budget expenditures were reduced in respect of such articles as “Environment protection” (by 2.4 percent) and “State authorities of social significance” (by 1.7 percent).

Significant increase in the volume of expenditure for social protection was conditioned by payment of an indemnity for public utility services and electricity to the most vulnerable citizens, by increase of pension (basic component – by 25.0 percent, insurance component – from Som 100 to Som 500 depending on the pension amount) and benefits for the veterans of the Great Patriotic War.

The state debt as of November 30, 2010, was Som 129.3 billion, internal debt – Som 120.8<sup>9</sup> billion. The state debt within 11 months of 2010 increased by 9.8 percent or by Som 11.5 billion (US\$ 246.4 million).

## **Financial Sector**

### ***Banking System***

22 commercial banks<sup>10</sup> (including Bishkek branch of the National Bank of Pakistan) and 211 branches of commercial banks operated in the territory of the Kyrgyz Republic as of December 31<sup>st</sup>, 2010.

---

<sup>6</sup> The state budget revenue from operational activity decreased by 4.0 percent in real terms.

<sup>7</sup> Increased by 1.0 percent in real terms.

<sup>8</sup> Increase by 14.0 percent in real terms.

<sup>9</sup> NBKR data (US\$ 1 = Som 46.86 as of 30.11.10)

<sup>10</sup> OJSC “AsiaUniversalBank” was excluded from the banking system since November 1, 2010, according to court decision on initiation of bankruptcy procedure and winding up conservation regime (according to Resolution

The profit of the KR banking system in the accounting period amounted to Som 738.0 million. 22 commercial banks operated in the same period of 2009, net profit based on the results of their activity was Som 1 596.5 million.

In 2010, aggregate assets of the banking system decreased by 13.8 percent or by Som 9.4 billion and made Som 58.6 billion, the capital – by 15.7 percent or by Som 2.3 billion, to Som 12.6 billion. Taking into account data adjustment of OJSC “AUB” in accordance with actual financial situation the decrease of aggregate assets made 6.4 percent.

The volume of deposit base of operating commercial banks was Som 34.1 billion, having thus decreased by 14.0 percent within a year. Deposit base increased by 40.4 percent without taking into account the deposits of OJSC “AUB” and “Zalkar Bank”. The volume of deposits in the national currency increased by 10.1 percent to Som 16.3 billion (without taking into account OJSC “AUB” and “Zalkar Bank” – by 47.8 percent). The volume of deposits in foreign currency decreased by 28.4 percent and amounted to Som 17.7 billion (when excluding OJSC “AUB” and “Zalkar Bank”, their volume of deposits in foreign currency increased by 34.8 percent). The volume of deposits in foreign currency decreased by 32.5 percent, the total volume of deposits - by 16.5 percent without taking into account changes of US\$ exchange rate.

The level of deposit base dollarization decreased from 61.3 to 52.1 percent within a year due to reduction in the volume of foreign currency deposits.

In 2010, the loan portfolio volume in commercial banks increased by 4.6 percent and made Som 26.4 billion. The growth in the volume of loans was conditioned by increase of loans in the national currency by 22.2 percent, to Som 11.7 billion, while the volume of loans in foreign currency decreased by 6.1 percent and made Som 14.7 billion. Without taking into account the impact of US\$ exchange rate dynamics decrease in the volume of loans in the foreign currency made 11.8 percent, the total loan portfolio increased by 1.1 percent.

Trade remained the main sphere of crediting. Increase in the volumes of crediting was observed in the sphere of agriculture. The share of loans granted into the sphere of transport, communication, procurement, processing and social services remained insignificant.

In 2010, the average interest rate on newly granted loans in the national currency decreased by 2.9 p.p. compared to 2009 and made 23.7 percent, in foreign currency – by 1.7 p.p., to 19.8 percent. Despite decrease of interest rates and acceleration of inflation, the value of real interest rate on loans in the national currency remained rather high – 15.2 percent (in 2009 – 16.6 percent).

### ***Nonbank Finance and Credit Institutions Licensed by NBKR***

The system of nonbank finance and credit institutions of the Kyrgyz Republic had 906 nonbank institutions<sup>11</sup> at the end of 2010 (at the end of 2009 the number of nonbank institutions was 972), among them:

- FCSDCU - 1
- Special Fund for Banks Refinancing (SFBR) - 1
- Microfinance organizations - 397
- Credit unions - 217
- Exchange bureaus - 290.

### ***Other Financial Institutions***

The total volume of tenders on trading platforms of three stock exchanges (Closed Joint-Stock Company “Kyrgyz Stock Exchange”, Closed Joint-Stock Company “Stock Exchange in Kyrgyzstan – BTS”, Closed Joint-Stock Company “Central Asian Stock Exchange”) was Som 1 237.4 million. The decline in the volume of tenders made 69.4 percent and was noted with regard to all of trading platforms: the volume of transactions on the trading platform of the Closed Joint-Stock Company “Kyrgyz Stock Exchange” was reduced by 83.3 percent to Som 436.1

---

№83/1 of the NBKR Board dated 1.11.2010). OJSC “Zalkar Bank” was introduced into the banking system since 24.12.2010 according to Resolution №91/1 of the NBKR Board dated 16.12.2010.

<sup>11</sup> Without taking into account pawn shops, as their licensing has been terminated since September 8, 2009.

million, at the Closed Joint-Stock Company “Central Asian Stock Exchange”<sup>12</sup> – by 58.9 percent to Som 392.6 million, and the volume of transactions on the trading platform of the Closed Joint-Stock Company “Stock Exchange in Kyrgyzstan – BTS” was reduced by 14.9 percent to Som 408.8 million.

19 insurance companies, of which 2 reinsurance organizations, as well as 7 companies with participation of non-residents operated in the republic as of December 1<sup>st</sup>, 2010. Total ownership capital of insurance organizations was Som 691 million as of November 1<sup>st</sup>, 2010, having thus decreased in comparison with the beginning of the year by 3.0 percent. Total assets amounted to Som 852 million, having decreased by 2.0 percent. Liabilities (including insurance reserves) decreased by 11.0 percent as of the same date and made Som 140.7 million.

Currently, there are two non-public pension funds in the Kyrgyz Republic: the NPF “Kyrgyzstan” and the NPF “Jany Asia” (that got a license as of May 26, 2009 and yet not engaged in its activity). The volume of assets of the NPF “Kyrgyzstan” as of the end of November, 2010, was Som 25.5 million, having thus increased for eleven months of 2010 by 16.5 percent, the volume of their aggregate capital was Som 7.3 million, having thus increased by 45.7 percent.

---

<sup>12</sup> Data as of April 2, 2010.