National Bank
of the Kyrgyz Republic

THE FINANCIAL SECTOR STABILITY REPORT OF THE KYRGYZ REPUBLIC

H1 2013

December 2013

Bishkek

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

Founder: National Bank of the Kyrgyz Republic.
The publication is registered with the Ministry of Justice of the Kyrgyz Republic, mass media registration certificate No. 1863 of 08/17/2012

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This publication is the report of the National Bank of the Kyrgyz Republic (NBKR) for the past year. It contains a summary of economic development of the republic and a monetary policy, financial reporting of the NBKR, an overview of NBKR activity, and statistical annexes. It is published in three languages: Kyrgyz, Russian and English.

Bulletin of the National Bank of the Kyrgyz Republic
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Review of Inflation in the Kyrgyz Republic
The publication describes a consumer price behavior in the country and regions. An analysis of main factors of inflation, informs of monetary policy decisions of the National Bank of the Kyrgyz Republic, and provides an inflation forecast for the coming period. It is published quarterly in Kyrgyz, Russian and English.

Press Release of the National Bank of the Kyrgyz Republic
"Press Release of the NBKR" contains a chronicle of events related to the NBKR and the banking system, the basic weekly financial market data and other information for the media, businesses and individuals. It is published weekly in Kyrgyz and Russian languages.

Regulations of the National Bank of the Kyrgyz Republic
The publication is intended for official publication of NBKR regulations to provide regulatory documents and information to commercial banks and the public on activities of the NBKR, and to popularize the banking legislation of the Kyrgyz Republic. It is commonly published once a month in Kyrgyz and Russian.

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PREAMBLE

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

In this publication **financial stability** is a harmonious and smooth operation of financial organizations, financial markets and payment systems enabling to perform functions on financial intermediation even under conditions of financial disbalances and shocks.

Results of monitoring and financial stability analysis are taken into account by the National Bank when forming the main NBKR monetary policy directions, regulation banking activity, and when generating a development strategy for financial institutions of the Kyrgyz Republic.

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

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MAJOR CONCLUSIONS

Financial system of Kyrgyzstan is still harmoniously and smoothly performing its intermediary functions[1]. The results of conducted stress-tests indicate sufficient safety margin of the financial sector for preserving general stability and sustainability in case of significant macroeconomic shocks implementation.

The level of financial intermediary in Kyrgyzstan is characterized by gradual growth. Global financial crisis and its circumstances did not have significant effect on the level of financial intermediary in Kyrgyzstan due to relative isolation of the financial sector in the Kyrgyz Republic.

External financing of real sector dominates over internal financing amid insignificant scale of the financial sector in the Kyrgyz Republic and relatively high interest rates compared to foreign capital markets.

The level of capitalization in the banking sector remains relatively high despite the downward trend. High level of capital adequacy indicates availability of certain potential for further increase in the level of financial intermediary, efficiency of the banking sector operation and provision of "safety cushion" in future.

Influence of real estate market on the banking sector is moderate and limited; however, preserving current trends can pose risks in future. Impact on the banking sector is moderate due to improper development of mortgage lending in Kyrgyzstan and rather low share of mortgage loans in the loan portfolio of banks. Herewith, significant rise in prices for real estate observed in the recent period can pose risks in the future.

System risks in the financial sector are moderate. Currently, moderate system risks are conditioned by improper development of the financial system, limited range of intermediary services, high level of capitalization, as well as relative isolation and weak integration in international financial markets.

Generally, slight increase of the risk level was observed in the banking sector activity. Slight increase of credit, liquidity and concentration risk was observed in the reporting period. Rise of credit risk is conditioned by increase of risk-weighted assets due to increase in lending to the economy. Increase of liquidity risk was due to growth of negative gaps of financial assets and liabilities by maturity. Slight decrease in the share of trade credits occurred in the sectoral structure of loan portfolio, however, some increase of the level of deposits and loans concentration was observed in the banking sector. Changes of market risk (interest rate and currency risks) are insignificant.

Contagion risk in the financial sector is insignificant. It is conditioned by insufficient development of the financial markets, weak inter-bank relations due to insignificant volumes of mutual crediting, as well as securities.

Banking sector is relatively resistant to significant macroeconomic shocks. The results of stress-test indicate that the banking sector can withstand decline in economic growth by 10 percent, as

[1] In the Doing Business rating, 2014, of the World Bank, Kyrgyzstan took the 13th place among 189 countries of the world by the conditions of loans provisions. Developers of this study graded 189 countries by 10 criteria of business activity control: consumption of time and funds for establishment of new business, receipt of license for construction, access to electric power infrastructure, registration of property rights, obtaining of loans, protection of investors' rights, payment of taxes, international trading, securing execution of agreements, bankruptcy procedures.

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well as aggregate impact of shocks (decline in economic growth by 10 percent and devaluation of national currency by 50 percent).

Reverse stress-testing shows sustainability of the banking sector of Kyrgyzstan and insufficient susceptibility to the market risk (currency or interest rate risks). This method enabled revealing threshold level of financial vulnerability, when the level of capital adequacy and current liquidity decreases to the prudential standards set by the NBKR. The results of reverse stress-testing of credit risk show that the level of capitalization decreased to 12-percent threshold level, the share of troubled loans in the loan portfolio should increase approximately from 4.6 percent to 22.3 percent (exclusive of troubled banks).

Liquidity level can decrease to the prudential standard set by the NBKR of 30 percent with massive outflow of individuals' and non-financial enterprises' deposits, approximately 44.4 percent of the total depositary base in the banking sector.

According to analysis it was determined that credit and concentration risks are the major risks in the banking sector of Kyrgyzstan.

External debt of the banking sector and the NBFI system does not create threats for financial stability. The volume of external debt is still moderate. Herewith, part of the external debt of the banks in Kyrgyzstan is accounted for foreign financial institutions being their shareholders. Moreover, 43.5 percent of the total external debt of the banking sector is accounted for two banks. Certain share of the external debt of the NBFI system is concentrated in the loans of the international financial institutions, which are focused on development of private sector on the long-term basis. Such institutional structure of loans characterizes relative debt sustainability and rather low (moderate) risk of capital outflow from the financial sector of Kyrgyzstan.

According to the results of calculations, relatively high level of capitalization potentially enables banking sector of Kyrgyzstan to comply with the requirements to the capital according to Basel II standards. Capital adequacy ratio calculated according to Basel II standards (i. e. taking into account market and operational risks) constituted approximately 19.4 percent. The results of calculations show that only 1 commercial bank does not potentially comply with the requirements to capital within the framework of the system.

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I. MACROECONOMIC AND FINANCIAL ENVIRONMENT

1.1. Macroeconomic Conditions and Risks

Lack of external shocks, saturation of the domestic market with agricultural products and policy of the National Bank focused on restraining excess supply of money to the economy resulted in low inflation rates.

Herewith, presence of macroeconomic risks was observed despite some improvement of macroeconomic situation.

Gross Domestic Product

Generally, current economic situation in the Kyrgyz Republic was characterized as rather favorable. At the end of the first half of 2013, growth in real GDP amounted to 7.9 percent after sharp decrease in the first half of 2012 by 6.9 percent due to decline in production at the largest "Kumtor" gold deposit. In the first half of 2013, high level of activity was observed in the sphere of processing industry amid rehabilitated production of gold and in the construction sector due to increase in the volume of investments into the fixed assets by 6.1 percent. In January-June 2013, GDP deflator was at the level of 4.6 percent. Excluding "Kumtor" gold deposit companies, GDP increased by 5.5 percent based on the results of the first half of 2013 (Table 1.1.1.).

Table 1.1.1. The contribution of individual activities in the growth/decline in GDP
percents

	Share		Growth rate		Contribution in growth	
	January-June		*January-June*		*January-June*	
	2012	**2013**	**2012**	**2013**	**2012**	**2013**
Agriculture, hunting and forestry	12.4	11.1	1.4	1.9	0.1	0.2
Mining	1.0	0.9	21.1	3.4	0.2	0.0
Processing	12.2	13.4	-42.2	25.5	-9.3	3.1
including Kumtor	6.0	7.3	-64.2	45.9	-9.8	2.8
Production and distribution of energy, gas and water	4.0	3.1	13.5	-0.7	0.6	0.0
Construction	4.1	4.4	7.7	15.0	0.3	0.6
Trade, car repairs	15.7	16.1	7.5	8.5	1.1	1.3
Transport and communication	10.2	10.6	8.0	12.3	0.8	1.3
Other	26.1	25.0	1.0	1.0	0.2	0.3
Net taxes on products	14.3	15.4	-6.9	7.9	-0.8	1.1
GDP	**100.0**	**100.0**	**-6.9**	**7.9**	**-6.9**	**7.9**
GDP without Kumtor			**3.4**	**5.5**	**2.9**	**5.2**

Source: NSC, NBKR calculations

In its turn, the current economic growth was not sustainable as it was primarily based on rehabilitation of production output at one enterprise. Such growth does not provide the basis for enhancement of

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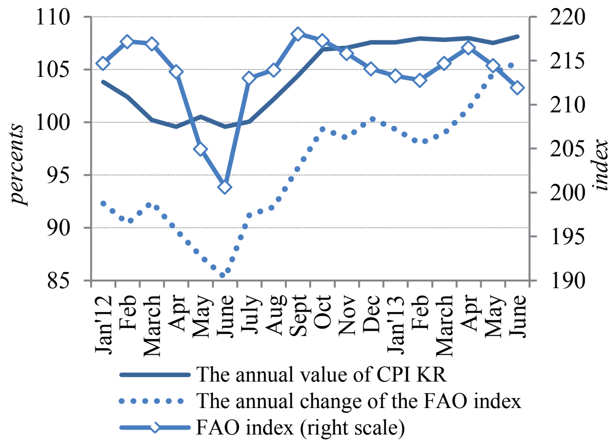
potential for economic growth in the long-term period and does not expand involvement of households and firms in the process of added value formation.

Inflation

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



Improvement was observed in the pricing environment of the world commodity markets for the goods imported by the Kyrgyz Republic.

In June 2013, annual inflation rate constituted 8.1 percent, meanwhile, the same index of 2012 constituted -0.4 percent. According to NSC, annual core inflation was at the level of 8.1 percent, it reflects continuous moderate inflation backdrop in the Kyrgyz Republic.

High dependence of domestic prices for food products on dynamics of world prices is mainly conditioned by high dependence of economy in Kyrgyzstan on imports of food products. Such high dependence of domestic market saturation on external supply significantly decreases macroeconomic stability. Low elasticity of domestic demand for changes of import value increases transmission of external shocks of supply to the inflation rate. Under such conditions measures of monetary policy are significantly restricted.

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State Budget

According to the Central Treasury of the Ministry of Finance of the Kyrgyz Republic, the state budget deficit in January-June 2013 amounted to KGS 1.4 billion or 1.0 percent to GDP (in January-June 2012, the budget ran a deficit of 3.3 percent to GDP). In January-June 2013, the total budget financing from internal sources amounted to KGS 3.4 billion (2.5 percent to GDP) and from external sources - KGS 5.1 billion (3.8 percent to GDP).

Generally, the situation in the budgetary and fiscal sector remained rather difficult. Imbalances existing in the sector of public finance contributed to preservation of “savings-investments” gaps in the economy.

Macroeconomic Risks

The situation around Kumtor Gold Company posed main risk, which ultimately can affect key economic indicators of the country. Provided that physical volumes of gold production and prices in global market for it are changed, volumes of output and export can be adjusted. Moreover, situation at the gold-mining enterprise puts pressure on formation of the resource item of budget. Thus, in January-June 2013, the share of taxes imposed on gross revenue of Kumtor in the operational budget expenses of the government constituted 4 percent or KGS 1.9 billion.

Economy was still significantly dependent on the external factors. Decrease in growth rates of money transfers into the country due to slowdown of economic growth in the countries recipients of migrant workers from Kyrgyzstan and change of conditions in foreign trade can contribute to significant deterioration of economic growth: decrease effective demands, devaluate national currency and, as a result, deteriorate households and firms balances.

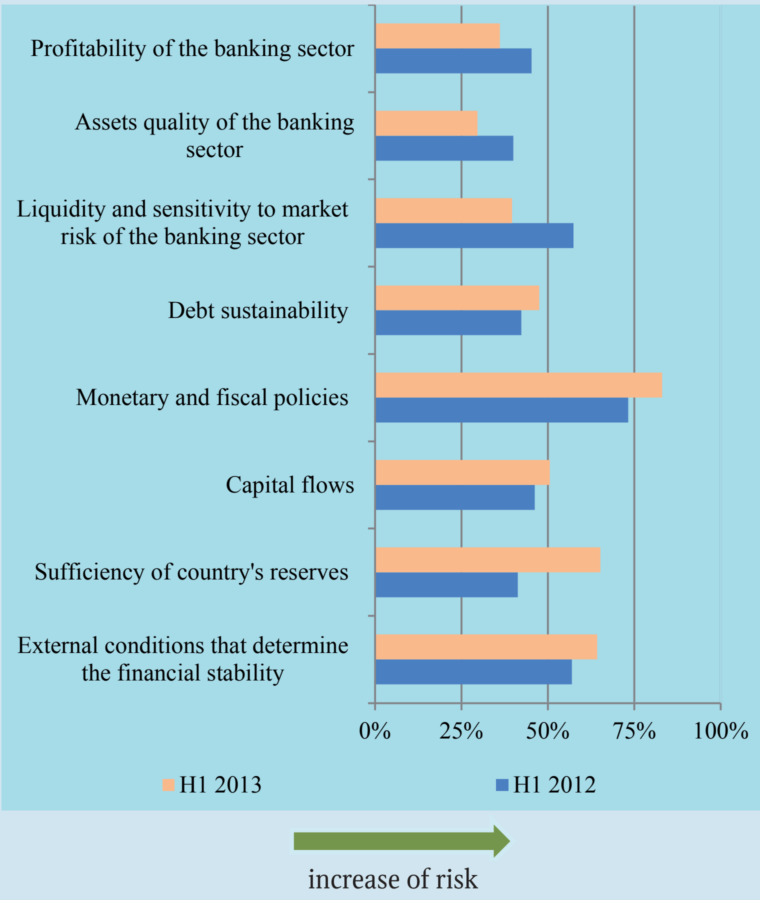
In the segment of public finances, risks are concentrated in the sphere of sources of budget resource item formation and the problem of macro-fiscal vulnerability. In 2013-2014, financing of budget deficit will be implemented primarily by means of external incomes, thereby attracting high risks of budget financing shortfall. Moreover, major share of budget incomes is formed through taxation of consumption, which in case of decrease in population incomes will also result in reduction of consumption.

Preserving stability of prices in the world commodity market and saturation of domestic market with agricultural products will be the major conditions for achieving targets of monetary policy in 2013-2014.

Uneven distribution of budget funds during the year and high share of expenses for current consumption remain one more risk factor, which stimulate inflation.

Box 1. Risk Assessment Map[2]

Graph 1.1.2. Risk assessment map



In the first half of 2013, growth of risk level was observed in the groups of indicators, characterizing external conditions, which affect macroeconomic stability, monetary and fiscal policy and adequacy of reserves in the country. As a result, as of the end of the first half of 2013 the data of the group of indicators occurred in the sphere of risks availability. Risks remained moderate in other groups of indicators.

Increase of risks in the "External conditions affecting macroeconomic stability" was conditioned by decline in economic growth of the major trade and economic partners of Kyrgyzstan-Russia and Kazakhstan, as well as decrease of global prices for gold. In the first half of 2013, the rates of economic growth in Russia and Kazakhstan decreased from 4.5 percent to 1.4 percent and from 5.6 percent to 5.0 percent respectively compared to the same period of 2012. At the end of the first half of 2013, price for gold decreased by 25.4 percent compared to the first half of 2012.

Increase in imports and decrease in the indicator of money supply covered with the NBKR net foreign assets of in the first half of 2013 contributed to increase of risks in the "Adequacy of the country's reserves" group.

Increase of risks level in the "Monetary and fiscal policy" group was due to increase in the ratio of public expenditures to GDP in the first half of 2013 compared to the same period of 2012.

Changes of risk level in the "Capital flows" and "Debt sustainability" groups were not significant

[2] Methodology of risk assessment map is published in the NBKR "The financial sector stability report of the Kyrgyz Republic for the first half of 2012".

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in the first half of 2013. Slight increase of risks in the “Capital flows” group is due to growth of deficit of the current account of the balance of payments.

In the banking sector, growth of depositary base of the banks and decrease in the ratio of short-term loans to short-term deposits became the factors of risks reduction in the “Liquidity and sensitivity to market risk” group.

Improvement in quality of the banking sector assets was due to decrease in sectoral concentration of loan portfolio, reduction in the share of troubled loans, as well as the share of loans in foreign currency in the total volume of loan portfolio.

Growth in the share of net interest income in the gross revenue contributed to reduction of risks characterizing profitability of the banking sector.

Thus, growth of macroeconomic risks was generally observed according to the results of the first half of 2013.

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1.2. Financial Sector Structure

The institutional structure of the financial sector of the Kyrgyz Republic is represented by commercial banks and other financial companies (non-bank financial institutions, insurance companies, investment and pension funds, stock exchanges).

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

Financial institutions	2009	2010	2011	2012	H1 2012	H1 2013
Commercial banks	**22**	**22**	**22**	**23**	**22**	**23**
Other financial companies, including:	**1234**	**936**	**958**	**837**	**918**	**819**
Non-bank financial institutions (NBFI), including:	**1203**	**906**	**931**	**810**	**893**	**791**
Microfinance organizations, including:	359	397	454	320	433	302
microcredit companies	226	266	340	242	337	225
microcredit agencies	129	127	110	74	91	72
microfinance companies	4	4	4	4	5	5
SFBR LLC	1	1	-	-	-	-
Development Fund CJSC	1	-	-	-	-	-
FC CU OJSC	1	1	1	1	1	1
Credit unions	238	217	197	183	189	164
Foreign exchange bureau	372	290	279	306	270	324
Insurance companies	***19***	***19***	***16***	***16***	***14***	***17***
Investment funds	***6***	***6***	***8***	***8***	***8***	***8***
Stock exchanges	***3***	***2***	***1***	***1***	***1***	***1***
Pension funds	***3***	***3***	***2***	***2***	***2***	***2***

Source: NBKR, NSC KR

As of the end of the first half of 2013, assets of the financial sector amounted to KGS 119.4 billion or 37.4 percent to GDP, having increased by KGS 18.1 billion compared to the same period of 2012.

The share of the banking sector in total assets of the financial sector constituted 79.9 percent. The share of NBFIs and other financial companies constituted 18.9 percent and 1.2 percent respectively (Graph 1.2.1).

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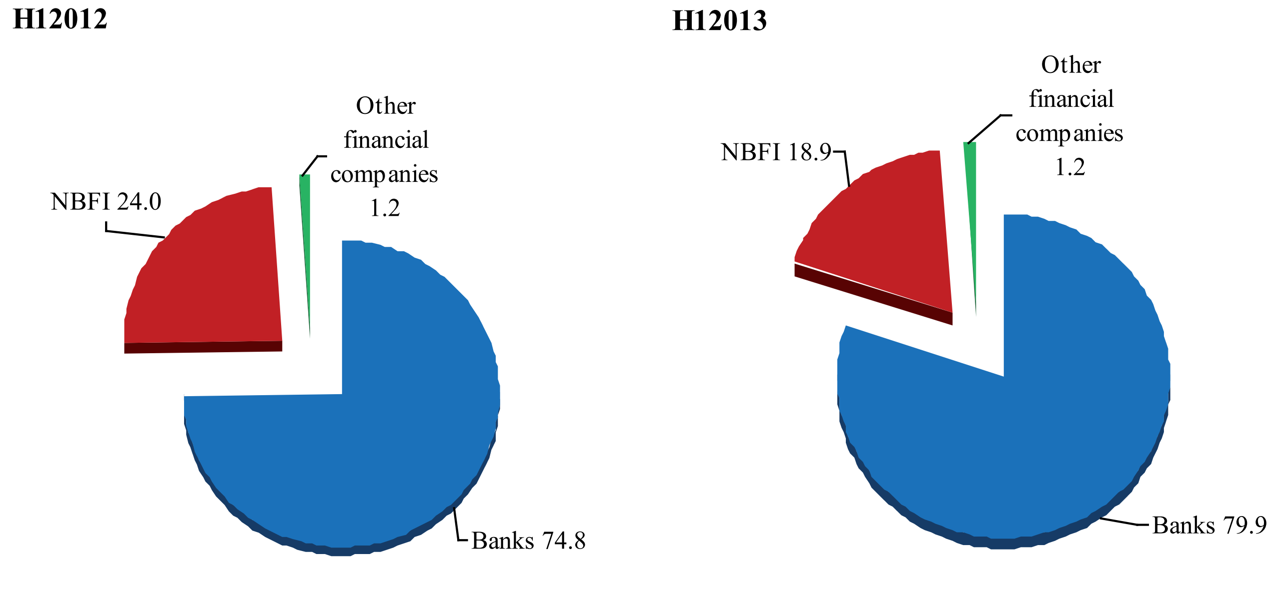
Graph 1.2.1. The institutional structure of assets of the financial sector in Kyrgyzstan
percents



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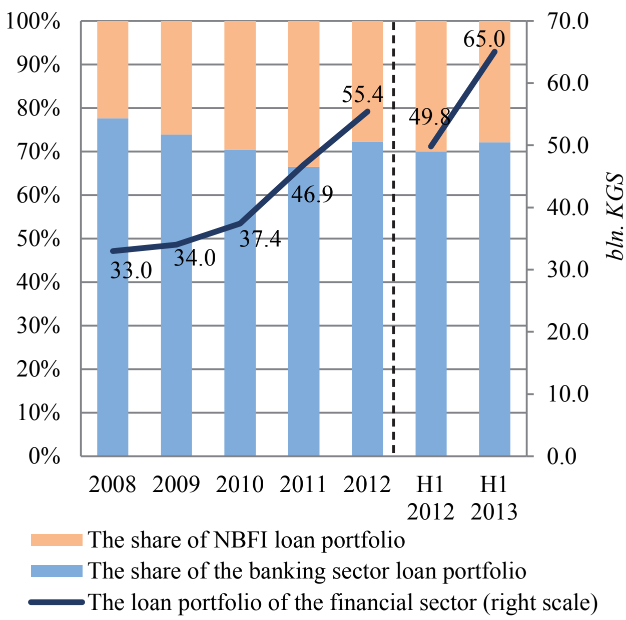
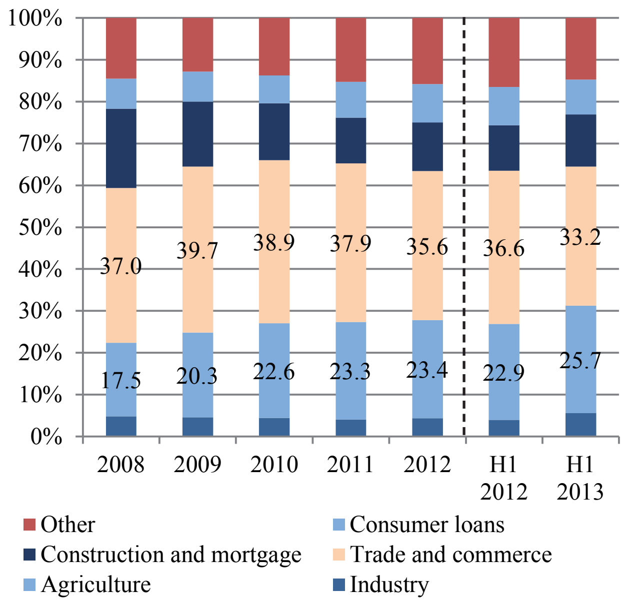
In the first half of 2013, the total loan portfolio of banks and NBFIs increased by 30.6 percent compared to the same period of 2012 and amounted to KGS 65.0 billion or 20.3 percent to GDP. The share of banks' loans in the loan portfolio of the financial sector changed insignificantly and, as of the end of the first half of 2013, constituted 72.1 percent (Graph 1.2.2).

Graph 1.2.2. The structure of the loan portfolio



Source: NBKR

Graph 1.2.3. The sectoral structure of the loan portfolio



Source: NBKR

In the sectoral structure of the financial sector loan portfolio, the concentration of the loan portfolio is still preserved in the trade sector (banks) and agriculture (NBFIs). The total share of the loan portfolio of the financial sector in the aforementioned economies as of the end of the first half of 2013 amounted to 58.9 percent of total loans issued (Graph 1.2.3) or KGS 38.3 billion.

1.3. Financial Markets Condition

Decline of business activity amid growth in the volume of excess reserves average daily index of the commercial banks was observed in the interbank borrowings market. Generally, operation of the interbank market was stable, providing redistribution of liquid funds between commercial banks.

Securities market, presented by ST-bills and ST-bonds, issued by the Ministry of Finance of the Kyrgyz Republic, extended gradually.

1.3.1. Foreign Exchange and Money Markets Conditions

Foreign Exchange Market

In the first half of 2013, domestic foreign exchange market of the Kyrgyz Republic was characterized by relative stability. In the first half of 2013, official exchange rate of the U.S. dollar increased by 1.8 percent to 48.6277 KGS/USD.

Export operations and remittance entering the country were the major source of foreign currency inflow. Seasonal increase in consumption and demand for imported goods became additional factor for support of demand for foreign currency. In this respect, exchange rate risk remains significant in the operations of business entities. U.S. dollar still remains the basis for currency trading. In the first half of 2013, the National Bank minimized significantly its presence in the inter-bank foreign exchange market. Thus, in the first half of 2013, interventions were conducted to the amount of USD 14.7 million (-65.9 percent of the corresponding indicator of 2012).

The volume of operations on purchase-sale of foreign currency in the domestic foreign exchange market amounted to KGS 150.9 billion, having increased by 28.8 percent compared to the first half of 2012.

The total volume of swap transactions conducted in the domestic market and with non-resident banks amounted to KGS 1.7 billion, having increased by 80.8 percent compared to the same indicator in the first half of 2012.

Money Market

The situation in the interbank borrowings market was characterized by decrease of activity compared to the first half of 2012 amid twice increase, up to KGS 2.7 billion, in the volume of excessive reserves average daily index of commercial banks. The largest participants of the money market continued adhering to conservative strategy, preserving high level of liquid funds. Demand for liquidity was mainly due to irregular distribution of excess reserves in the banking sector among dominating banks and other market participants. Generally, operation of market was stable providing redistribution of liquid funds between commercial banks.

In the first half of 2012, the total volume of transactions conducted in the interbank borrowings market constituted KGS 3.3 billion, having decreased by 19.4 percent compared to the same indicator of 2012. The major share of conducted transactions was still accounted for repo transactions. Moreover, at the end of the period under review, the share of repo transactions decreased by 3.6 percentage points to 74.0 percent, due to equivalent increase in the volume of interbank transactions under standard conditions of lending.

Significant growth of "overnight" loans provided to the banks for supporting short-term liquidity by the National Bank was observed in the national currency, its volume increased by 5.4 times to KGS 4.8 billion compared to the first half of 2012.

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Despite the current volatility of the interbank borrowings market, sustainable downward trend of resources value was observed in the interbank market since the beginning of the year. The average weighted interest rate on the interbank loans in the national currency provided in the first half of 2013 amounted to 7.8 percent. Following dynamics of changes in discount rate, average monthly value of "overnight" loans decreased for the first six months of 2013 from 11.9 to 3.5 percent.

Separate banks conducted transactions with non-resident banks besides providing interbank loans in the domestic market. The total volume of transactions with non-resident banks, conducted in the first half of 2013, decreased by 82.5 percent to KGS 4.4 billion.

1.3.2. Securities Market Condition

Securities market, represented by ST-Bills and ST-Bonds, issued by the Ministry of Finance, was increasing gradually. Increase was observed in the volumes of issued ST-Bills and ST-Bonds for the purposes of budget deficit financing. The volumes of ST-Bills increased to KGS 3.3 billion (growth by 36.9 percent), and the sales of ST-Bonds increased to KGS 1.2 billion (growth by 54.8 percent).

The National Bank conducted transactions in the open market to achieve targets of monetary policy. Declared volumes of the NBKR notes issued in the first half of 2013 increased by 41.4 percent, the volume of actual sales amounted to KGS 20.6 billion.

Increase in the supply of ST-Bills and ST-Bonds issued by the Ministry of Finance of the Kyrgyz Republic caused decline in the yield of these instruments. Thus, price indicators of ST-Bills decreased by 2.3 percentage points and constituted 8.7 percent, yield of ST-Bonds remained at the level of the first half of 2012 constituting 15.2 percent, yield of the NBKR notes decreased and constituted 3.0 percent (-5.6 p.p.).

Demand for 2-year ST-Bonds was primarily supported by operation of two dominating investors represented by one of the large commercial banks and institutional investor (more than 90 percent of all ST-Bonds in circulation). Other categories of investors showed lower level of activity in this segment of government securities market, purchasing securities with shorter maturity period.

In the first half of 2013, the total volume of ST-Bills declared emission constituted KGS 3.3 billion (growth by 33.8 percent), ST-Bonds – KGS 830.0 million (decrease by 10.3 percent), NBKR notes – KGS 22.9 billion (growth by 41.4 percent).

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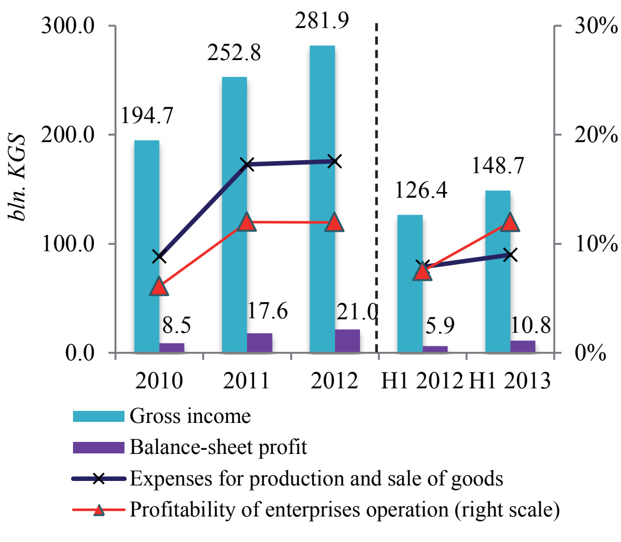
1.4. Corporate Sector

Growth of major financial indicators of the corporate sector was observed in the first half of 2013.

Herewith, internal and external debt of enterprises continued to demonstrate growth increasing debt sustainability risks of the real sector.

Financial Condition of the Corporate Sector Enterprises

Graph 1.4.1. Dynamics of financial indicators of the corporate sector



Source: NSC KR

According to the results of the period under review, the financial results of enterprises were the following:

- gross income increased by 17.6 percent and amounted to KGS 148.7 billion (Graph 1.4.1);
- expenses connected with production and distribution of goods increased by 13.9 percent and amounted to KGS 89.8 billion;
- balance sheet profit increased by 83.0 percent and amounted to KGS 10.8 billion;
- profitability of enterprises operation increased to 11.9 percent.

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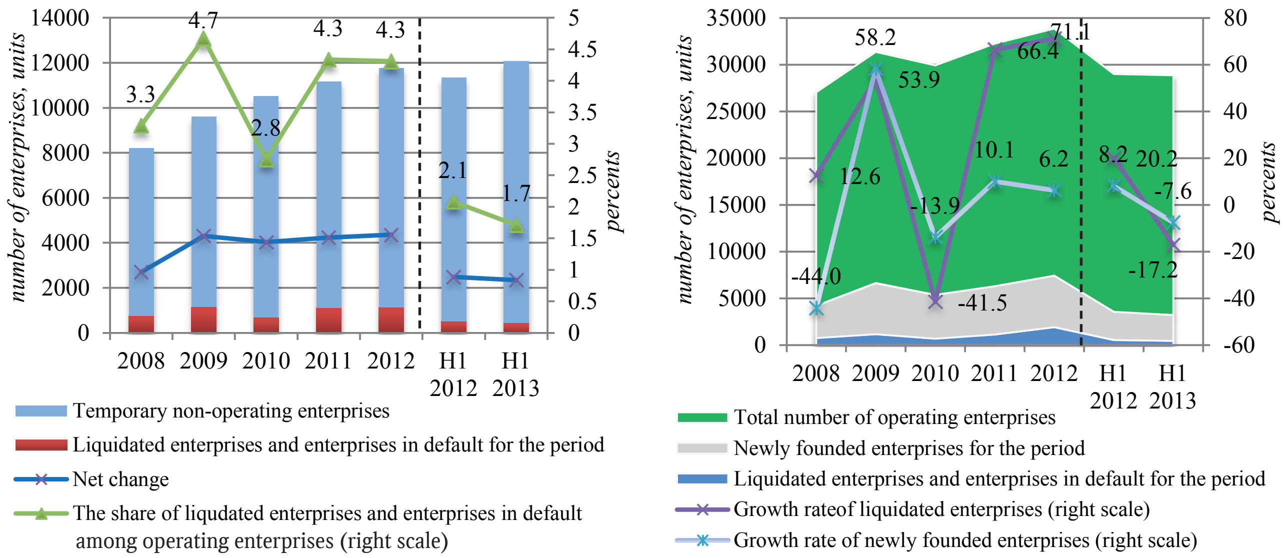
Business Activity of Corporate Sector

Slight slowdown of the corporate sector business activity[3] was observed in the period under review. Particularly, the number of temporary non-operating (idle) enterprises increased (by 7.5 percent compared to the first half of 2012), and the number of newly founded enterprises decreased (by 7.6 percent compared to the same period of 2012, Graph 1.4.2).

[3] Business activity indices in the corporate sector:
Temporary non-operating enterprises is an enterprise in standstill for more than one month;
Net change is a gap between newly founded enterprises and the amount of liquidated enterprises and enterprises in default within a period.

Graph 1.4.2. Business activity of the corporate sector

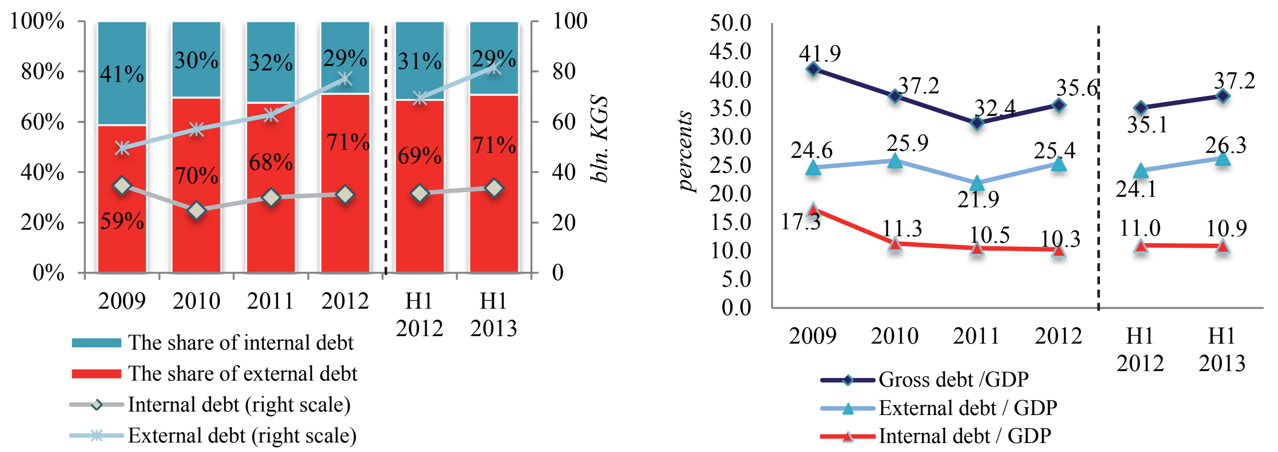


Source: NSC KR, NBKR calculations

Condition of the Internal and External Debt in the Corporate Sector

At the end of the first half of 2013, gross debt of the corporate sector increased by 14.1 percent compared to the corresponding period of 2012 and amounted to KGS 115.5 billion or 37.2 percent to GDP. Growth of the corporate sector gross debt was generally resulted from increase of external debt (Graph 1.4.3).

Graph 1.4.3. Indicators of debt sustainability of the corporate sector



Source: NSC KR

External financing is the major source of the corporate sector financing (Graph 1.4.4).

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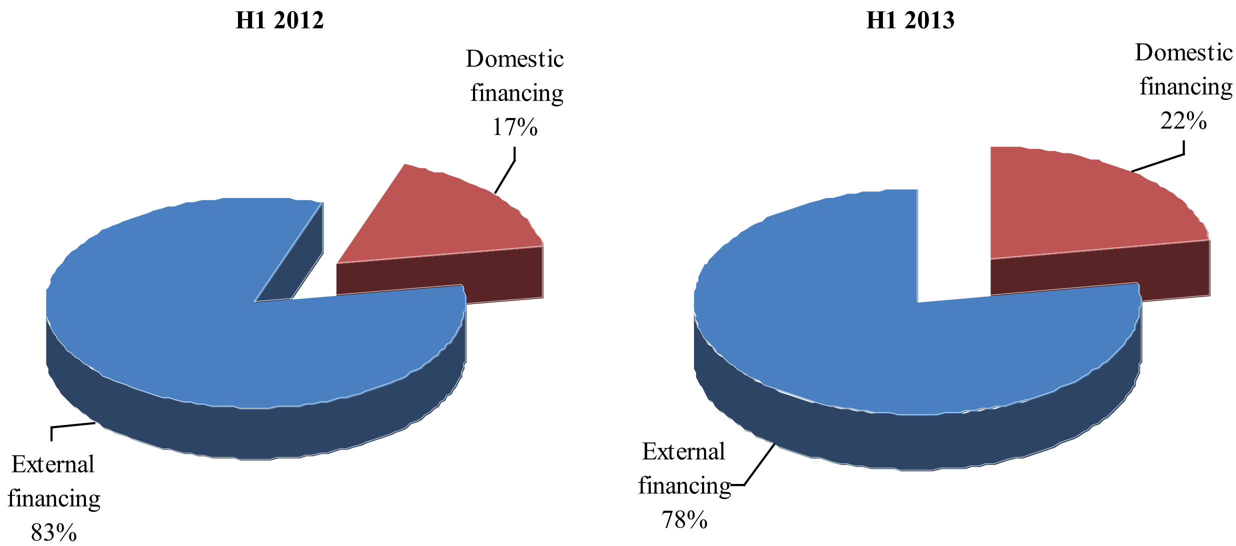
Graph 1.4.4. Financing sources of the corporate sector



Source: NSC KR and NBKR, NBKR calculations

At the end of the first half of 2013, external debt of the corporate sector increased by 17.5 percent and amounted to KGS 81.7 billion or 26.3 percent to GDP compared to the same period of 2012 (Graph 1.4.3).

According to the results of the reporting period, decrease in the share of arrears on the transactions with real estate (geological exploration) was observed in the sectoral structure of the corporate sector external debt due to increase of the mining industry significance. In other sectors of economy, significant changes were not observed (Table 1.4.1).

Table 1.4.1. Structure of external debt of the corporate sector by sectors of economy

	2008	2009	2010	2011	2012	H1 2012	H1 2013
Total, mln. KGS	**33,935.7**	**48,345.1**	**57,017.9**	**62,740.9**	**77,161.4**	**69,552.3**	**81,702.5**
among them, in percent:							
Operations with real estate, renting and provision of services to consumers (exploration)	37.5	44.0	51.5	60.6	52.4	59.1	52.8
Industry:							
- *Processing industry*	29.2	25.2	19.7	17.3	17.1	17.9	15.0
- *Mining industry*	0.7	0.6	0.7	2.4	9.8	3.0	11.4
Transport and communication	13.2	15.4	16.9	11.3	9.5	10.4	8.8
Trade; repair of cars, household articles and personal appliances	8.9	5.6	4.3	4.7	4.7	4.3	6.8
Construction	7.4	7.1	4.4	1.5	4.2	3.1	2.8
Other sectors	3.2	2.1	2.5	2.3	2.2	2.2	2.5

Source: NBKR calculations of the basis of NSC KR data

CONTENT

At the end of the first half of 2013, internal debt of the corporate sector increased by 6.7 percent and amounted to KGS 33.8 billion or 10.9 percent to GDP compared to the corresponding period of 2012.

Significant changes were not observed in the structure of the corporate sector internal debt by sectors of economy (Table 1.4.2).

Table 1.4.2. Structure of internal debt of the corporate sector by sectors of economy

	2008	2009	2010	2011	2012	H1 2012	H1 2013
Total, mln. KGS	**17,920.8**	**23,347.6**	**24,904.2**	**30,009.4**	**31,200.3**	**31,655.1**	**33,168.8**
among them, in percent:							
Trade; repair of cars, household articles and personal appliances	21.6	26	21.5	23.4	24.9	24.5	26.5
Industry:							
- Processing industry	23.8	19.6	23.9	23.1	23.4	22.9	24.1
- Production and distribution of electric energy, gas and water	6.8	4.7	14	11.5	12.7	12.7	11.4
- Mining industry	2.1	1.0	0.7	2.0	1.2	0.9	1.2
Operations with real estate, renting and provision of services to consumers	13.9	19.8	19.1	18.5	15.0	15.5	14.0
Construction	10.8	9.9	7.4	8.4	8.7	9.5	9.5
Transport and communication	13.7	9.3	5.9	4.6	4.4	4.3	4.3
Agriculture	0.7	0.4	0.3	0.8	2.0	1.8	1.8
Other sectors	6.6	9.3	7.2	7.7	7.8	7.9	7.9

Source: NBKR calculations of the basis of NSC KR data

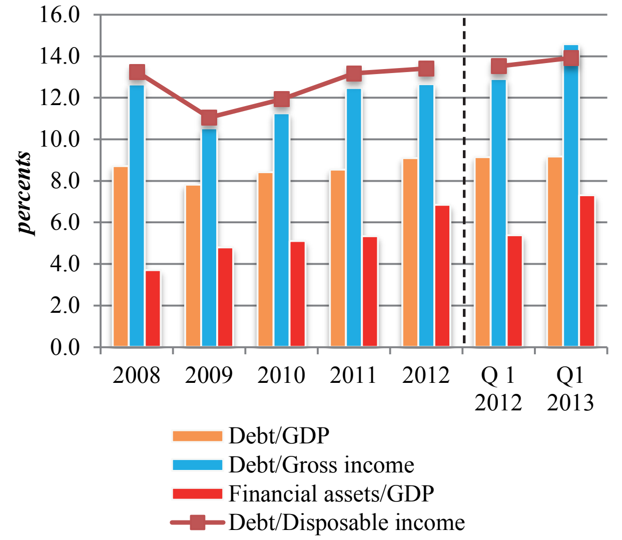
CONTENT

1.5. Household Sector

Some deterioration of the financial soundness indicators in the households was due to growth rates of the population debt to the financial sector exceeding growth rates of their incomes.

Consumer expenditures still prevail in the structure of the population expenditures.

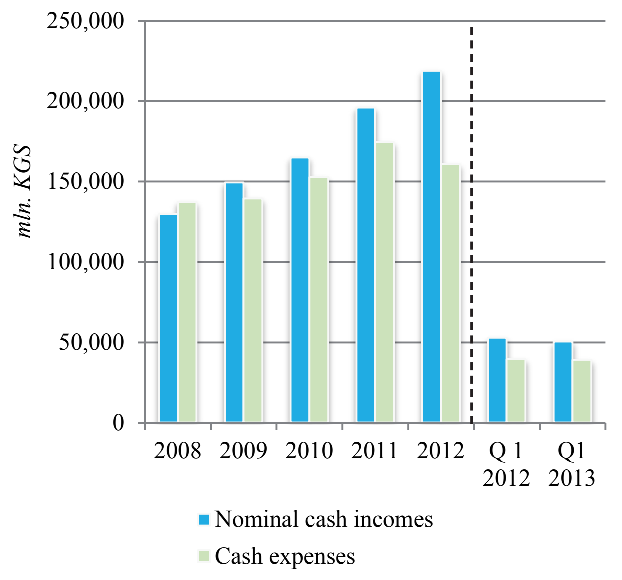
Graph 1.5.1. Financial soundness indicators of households



Source: NSK KR, NBKR calculations

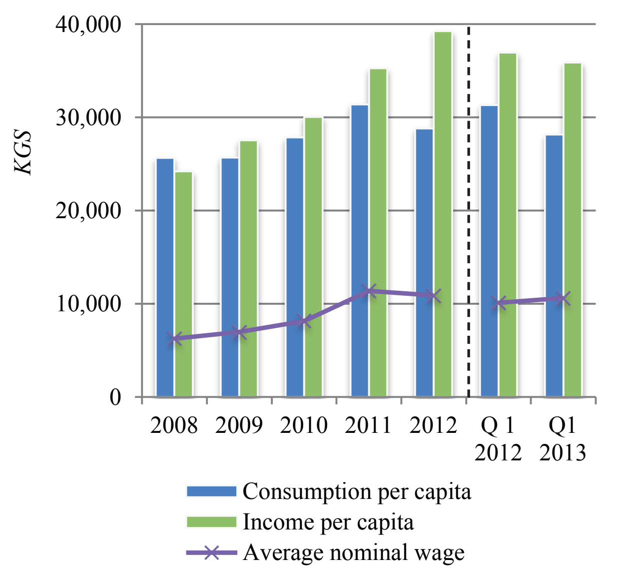
Amid gradual increase of debt burden of the households (Graph 1.5.1), incomes of the household sector also decreased (Graph 1.5.2). Particularly, indices of ratio of households debt to gross and disposable income increased in the period under review from 12.9 percent to 14.6 percent and from 13.5 percent to 13.9 percent respectively compared to the first quarter of 2012.

Graph 1.5.2. Dynamics of households incomes and expenses*



Source: NSC KR

Graph 1.5.3. Factors of financial sustainability of the population balance

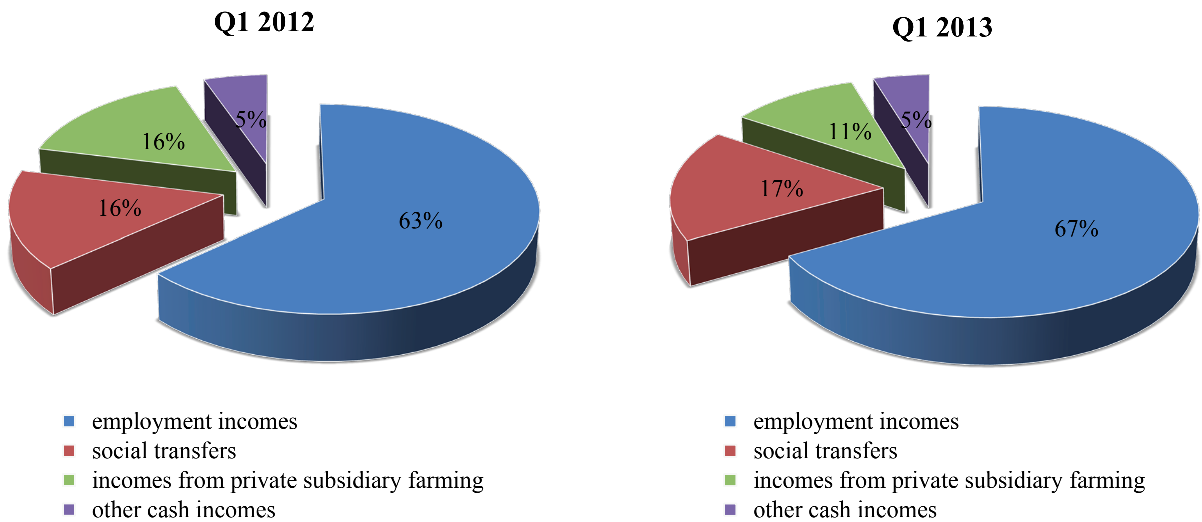


Source: NSK KR, NBKR calculations

The major item of households income still remain incomes received from labor activity, which constituted 67 percent of gross incomes of the population (Graph 1.5.4).

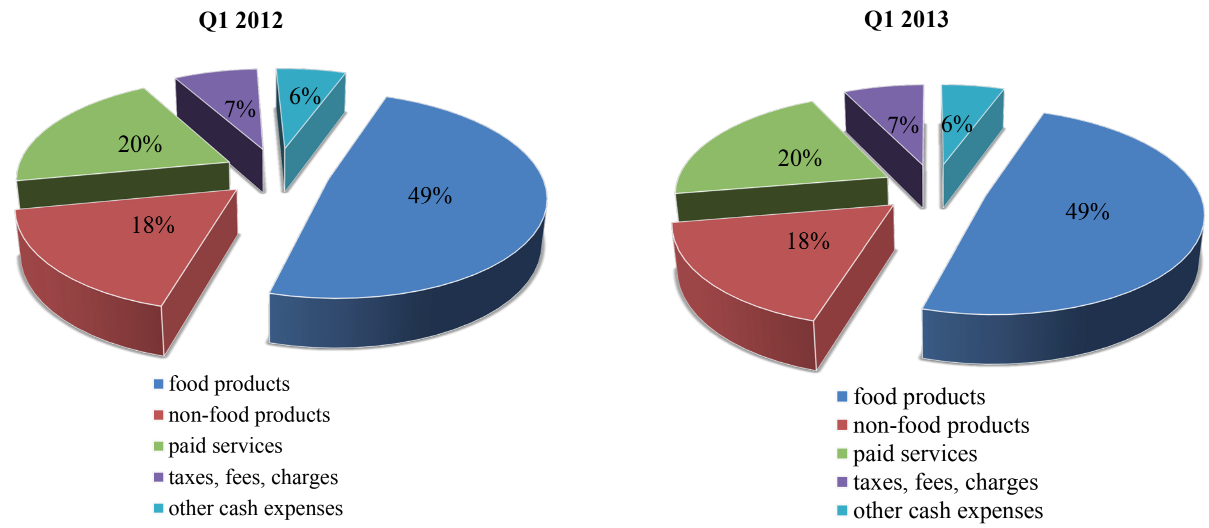
CONTENT

Graph 1.5.4. Structure of households incomes



Source: NSC KR

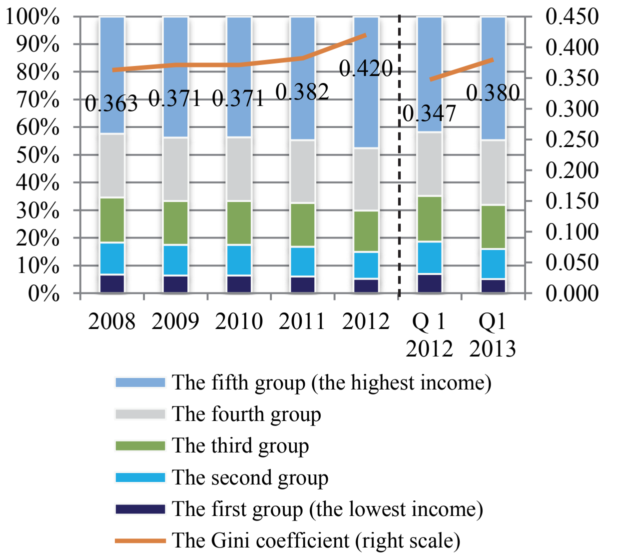
Graph 1.5.5. Structure of households incomes



Source: NSC KR

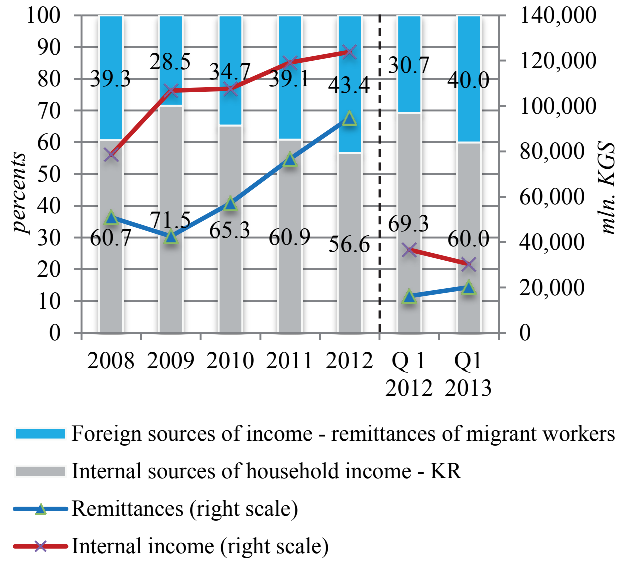
The structure of money incomes of households by quintile groups indicates concentration of incomes in the most advantaged groups, which is confirmed by the Gini coefficient (Graph 1.5.6).

Graph 1.5.6. Structure of population income by quintile groups



Source: NSC KR

Graph 1.5.7. Structure of household income by sources of expenses



Source: NSC KR and NBKR

CONTENT

1.6. Real Estate Market

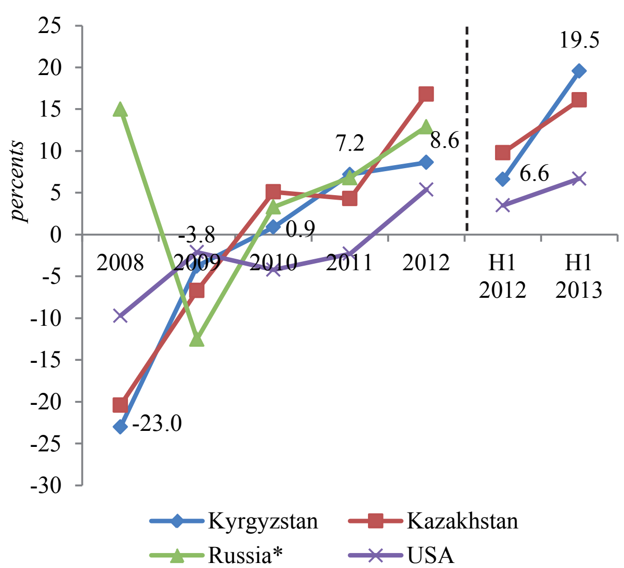
Ongoing high demand for real estate, as well as insufficient supply of new housing contributed to rise in prices in the real estate market.

Growth of prices for real estate caused, in its turn, downward change in housing affordability index, thereby characterizing deterioration of situation, when the population could provide themselves with affordable housing.

Risks for the financial sector on the part of real estate market remain moderate, which is conditioned by improper development of mortgage lending[4] and confirmed by decrease in the volume of classified loans for construction and mortgage.

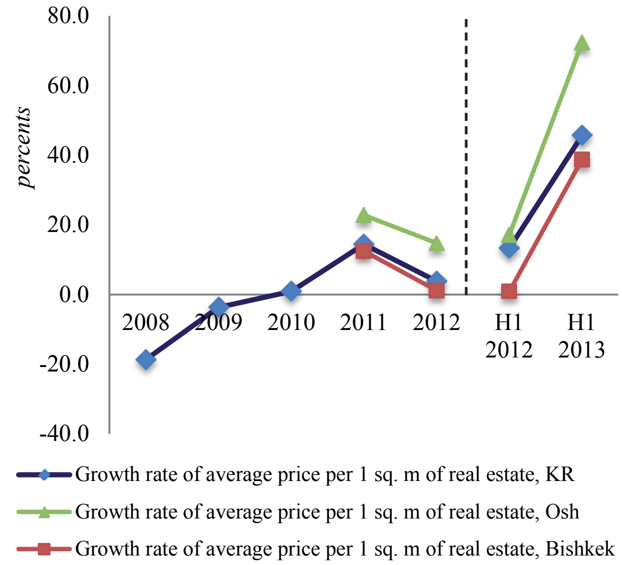
At the end of the first half of 2013, rise in prices for real estate (19.5 percent) was observed compared to the same period of 2012 (Graph 1.6.1). Presence of similar trends should be noted in dynamics of prices in the real estate market of Kazakhstan, Russia and the USA (Graph 1.6.1).

Graph 1.6.1. Comparison of price index in the real estate market of Kyrgyzstan, Kazakhstan, Russia and the USA



Note: Dynamics of growth rates to the same period of the last year
Source: SRS (KR), ARKS (RK), FSSS (RF), Federal Housing Finance Agency (US), NBKR calculations.
** data on RF for H1 2012 and 2013 are not available*

Graph 1.6.2. Dynamics of prices for real estate (flats)

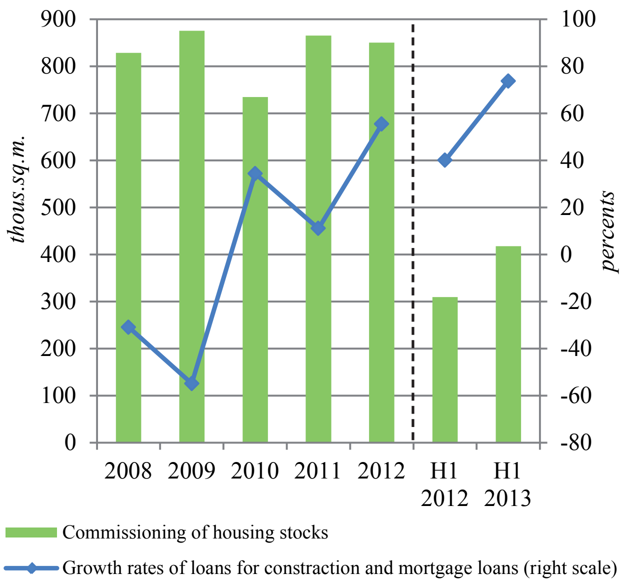


Source: NSC KR and SRS GKR, NBKR calculations
**data on Bishkek and Osh cities until 2010 are not available*

In the first half of 2013, growth rates of price index for flats (growth constituted 45.7 percent compared to the first half of 2012) outran growth rates of general price index for real estate (Graph 1.6.2). The major volume of transactions was still accounted for Bishkek and Osh cities (63.3 percent of the total amount of transactions on purchase and sale of real estate in Kyrgyzstan). At the end of the first half of 2013, average price for 1 square meter of housing in Bishkek and Osh increased by 38.8 and 72,3 percent respectively (Graph 1.6.2).

[4] In Kyrgyzstan, mortgage lending is, as a rule, a long-term loan provided on collateral of the right for real estate ownership.

Graph 1.6.3. Dynamics of housing commissioning and provided loans for construction and mortgage



Source: SRS GKR, NSC KR, NBKR calculations
Note: Data for the period

According to the results of the first half of 2013, increase in total commissioning of housing stock constituted 35.0 percent compared to the same period of the last year (Graph 1.6.3). It should be noted that commissioning of residential property is primarily executed by business entities (98.7 percent of the total residential area).

The major share of commissioned housing is accounted for Bishkek city, Chui region, and Osh city and Osh region (Table 1.6.1).

Table 1.6.1. Geographical structure of commissioned residential property

	H1 2012		**H1 2013**	
	Total commissioned area, thous.sq.m	*Share of total area, %*	*Total commissioned area, thous.sq.m*	*Share of total area, %*
Bishkek city and Chui region	121.8	39.4	151.2	36.2
Osh city and Osh region	90.4	29.2	82.7	19.8
other regions of KR	97.3	31.4	183.9	44.0
Total	**309.5**	**100**	**417.8**	**100**

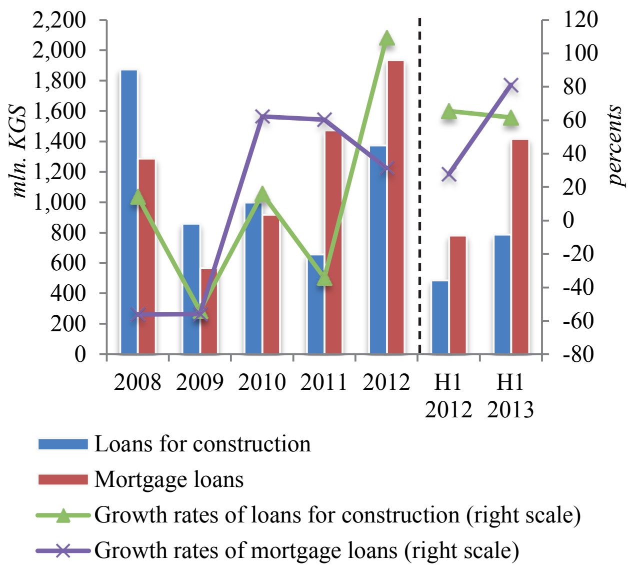
Source: NSC KR

In the first half of 2013, the volume of provided mortgage loans and loans for construction increased by 81.2 and 61.6 percent respectively and amounted to KGS 2.2 billion (Graph 1.6.4).

Thus, at the end of the reporting period, the total volume of loans for mortgage and construction increased by 38.4 percent, compared to the same period of 2012, and amounted to KGS 7.1 billion or 15.0 percent of the total volume of banks' loan portfolio (Graph 1.6.5).

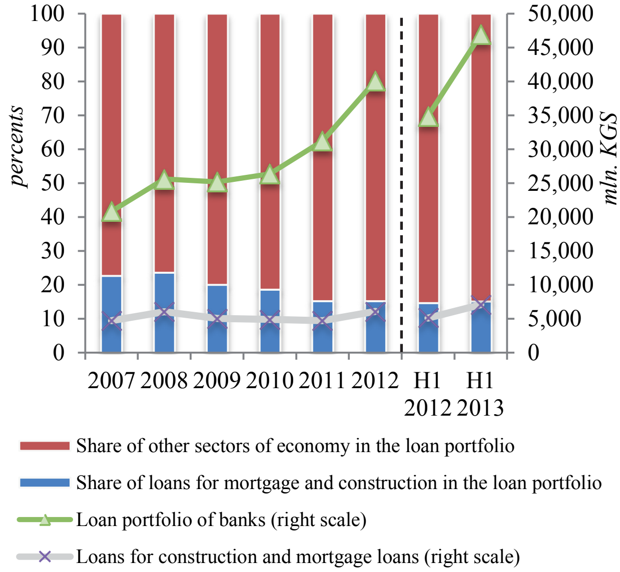
CONTENT

Graph 1.6.4. Loans provided for construction and mortgage



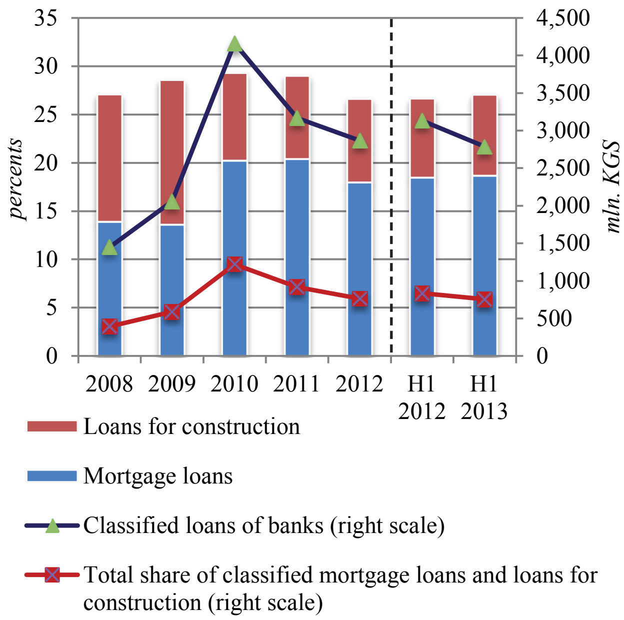
Source: NBKR
Note: Data for the period

Graph 1.6.5. Total share of loans for mortgage and construction in the banks' loan portfolio



Source: NBKR
Note: Data for the period

Graph 1.6.6. Dynamics of classified loans for mortgage and construction



Source: NBKR

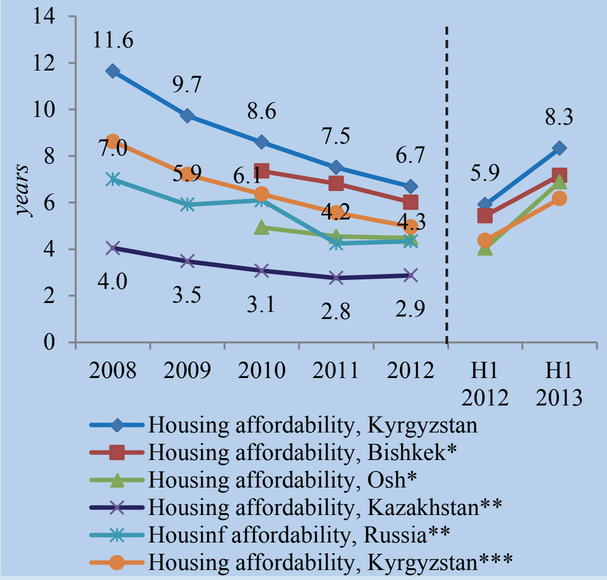
At the end of the first half of 2013, the share of troubled mortgage loans and loans for construction in the total volume of classified loans constituted 27.1 percent or KGS 753.6 million (Graph 1.6.6).

Box 2. Housing Affordability Index

Housing affordability index is the major index of real estate market condition in terms of residential real estate affordability for the population.

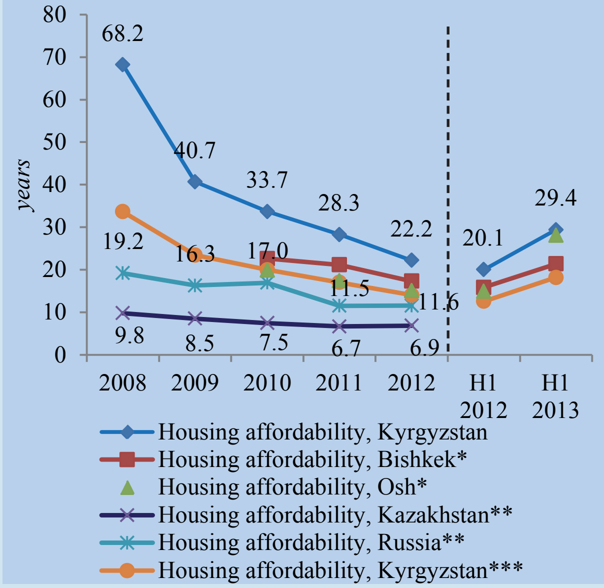
The trend of gradual increase in the level of housing affordability was generally observed in Kyrgyzstan since 2008. Moreover, in the first half of 2013, the situation with housing affordability deteriorated[5] (the value of index is more than 5.1) as growth rates of prices for real estate outran growth rates of average salary (Graph 1.6.7).

Graph 1.6.7. Housing affordability index (flats) exclusive of minimum consumer budget



Source: NSC KR, SRS KR, ARKS, SCS RF, NBKR calculations
** data until 2010 on Bishkek and Osh cities are not available*
*** half-year data on RF and RK are not available*
**** inclusive of non-registable incomes*

Graph 1.6.8. Housing affordability index (flats) exclusive of minimum consumer budget



Source: NSC KR, SRS KR, ARKS, SCS RF, NBKR calculations
** data until 2010 on Bishkek and Osh cities are not available*
*** half-year data on RF and RK are not available*
**** inclusive of non-registrable incomes*

Thus, as of the end of the first half of 2013, in order to buy a flat with the area of 54 square meters in Kyrgyzstan it is necessary to lay up the whole salary for the period of 8.3 years (in 2012 – 6.7 years, and inclusive of non-registrable incomes[6] – 6.0 years).

The best housing affordability index among reviewed countries was observed in Kazakhstan – 2.9 years. In Russia, this index constituted 4.3 years.

At the end of the first half of 2013, 29.4 years[7] is the real period in Kyrgyzstan, necessary for accrual of income and purchase of own real estate, taking into account minimum consumption budget (in 2012 – 22.2 years, and inclusive of non-registrable incomes – 18.2 years), while in Kazakhstan (exclusive of non-registrable incomes in 2012) – 6.9 years and in Russia (exclusive of non-registrable incomes in 2012) – 11.6 years (Graph 1.6.8).

CONTENT

[5] Housing affordability is assessed by means of special index, which is calculated as an average price for 1 square meter of flat multiplied by 54 (the rate of housing per capita according to construction norms and regulation of the Republic of Kazakhstan, the Russian Federation and the Kyrgyz Republic) and divided by the value of salary of two family members per 1 year (average monthly salary multiplied by 12 (number of months)). Categories of coefficient:
1. Affordable level of housing (up to 3),
2. Moderate level of housing unaffordability (3.1 – 4),
3. Average level of housing unaffordability (4.1 – 5),
4. High level of housing unaffordability (more than 5.1).

[6] According to the conclusions made by the working group with regard to study of shadow economy of the Kyrgyz Republic, the level of shadow incomes of the population constituted approximately 35 percent of payroll fund. This study was conducted by NGO "Investment Round Table", Bishkek, December 2012.

[7] Housing affordability index, with regard to minimum consumption budget, is calculated as an average price for 1 square meter of flat multiplied by 54 (the rate of housing per capita according to construction norms and regulation of the Republic of Kazakhstan, the Russian Federation and the Kyrgyz Republic) and divided by difference of the salary value of two family members per 1 year (average monthly salary multiplied by 12 (number of months)) and annual value of minimum consumption budget.

II. BANKING SECTOR

Ongoing growth of financial intermediation on the part of the banks was confirmed by the main indicators of the banking sector outrunning the rates of economic growth.

Growth of major indicators of the banking sector: assets, loan portfolio, resource base, net profit, as well as the results of stress-tests demonstrated strengthening of financial soundness in the banking sector. Herewith, decrease of the profitability indicators of the banking sector was observed amid increase of net profit.

System risks remained moderate despite some increase of risks in the banking sector activity.

2.1. Major Trends

As of June 30, 2013,[8] 23 commercial banks (including the Bishkek branch of the National Bank of Pakistan) and 281 of their branches worked in the territory of the Kyrgyz Republic, among which there are 15 banks with foreign participation in the capital, including 9 banks with foreign participation in the amount of more than 50 percent. All banking institutions of the country are universal by the type of business.

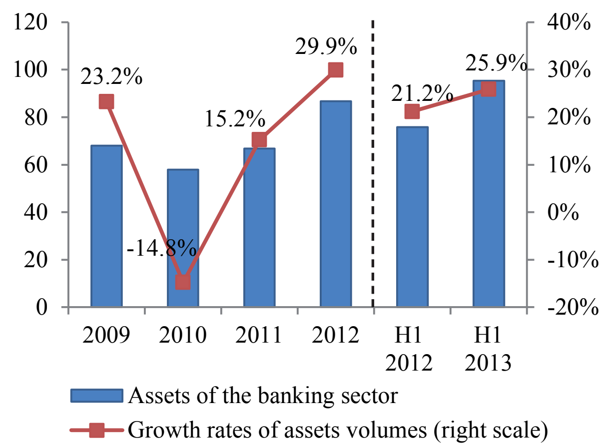
Three troubled banks: Manas Bank CJSC, KyrgyzCredit Bank OJSC, Issyk-Kul IB OJSC operated in the preservation regime.

CONTENT

Assets

Graph 2.1.1. Dynamics of assets in the banking sector

bln. KGS



Assets of the banking sector at the end of the first half of 2013 amounted to KGS 95.4 billion, having increased by 25.9 percent compared to the same period of 2012 (Graph 2.1.1).

Growth of assets in the first half of 2013 was primarily provided by increase of:

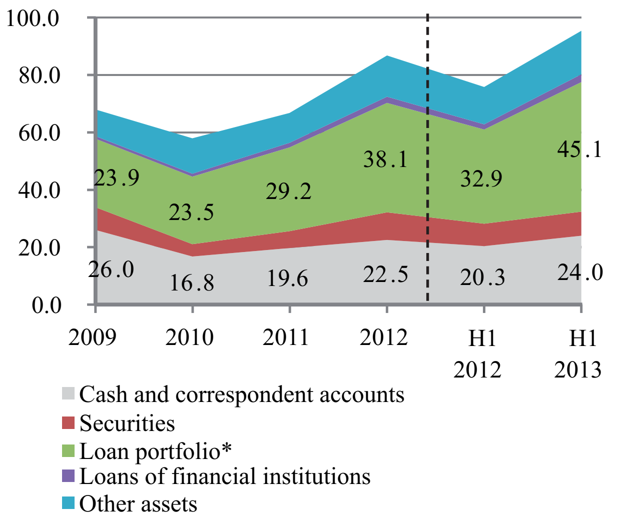
- the loan portfolio by 37.3 percent or KGS 12.3 billion;
- the correspondent accounts and deposits in other banks by 37.9 percent or KGS 3.7 billion.

At the end of the first half of 2013, significant changes were not observed in the structure of the banking sector assets by sectors of economy (Graph 2.1.3). The share of assets placed in the corporate sector – 32.4 percent, as well as in the household sector – 17.3 percent remained relatively high.

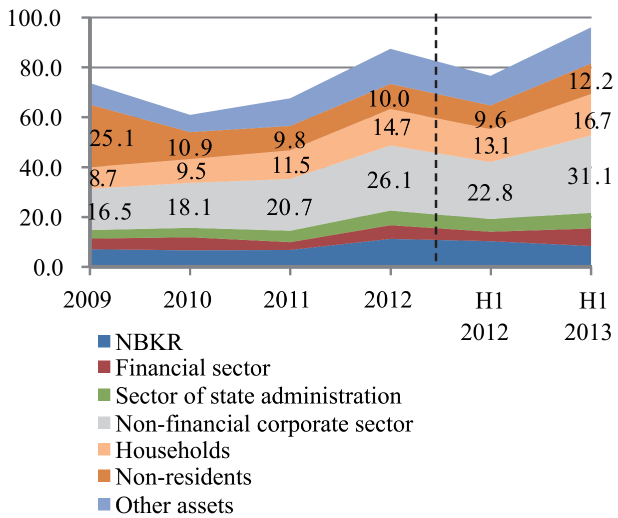
At the end of the first half of 2013, the share of loan portfolio in the structure of assets constituted 47.3 percent, having increased by 3.9 p.p. compared to the first half of 2012. The total share of liquid assets (cash, correspondent accounts and securities) at the end of the first half of 2013 decreased by 3.2 p.p. compared to the first half of 2012 and amounted to 33.9 percent of the total volume of assets or KGS 32.3 billion.

[8] The data are submitted according to periodic regulatory reporting of the commercial banks.

Graph 2.1.2. Change of assets structure in the banking sector
bln. KGS



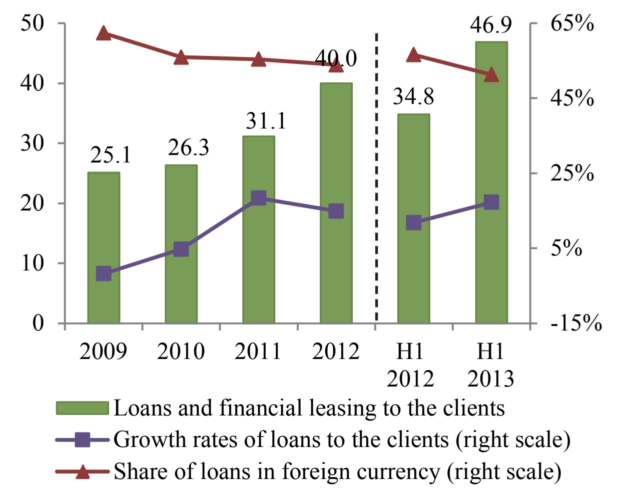
Graph 2.1.3. Institutional structure of assets in the banking sector
bln. KGS



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

Loan Portfolio

Graph 2.1.4. Dynamics of loan portfolio in the banking sector*
bln. KGS



** Exclusive of loans provided by financial institutions*

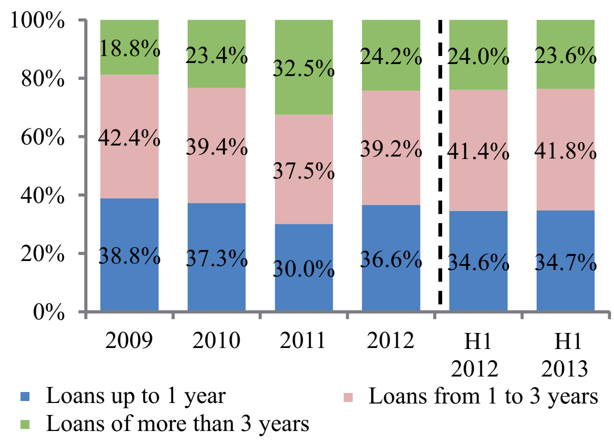
Growth of loan portfolio in the first half of 2013 compared to the first half of 2012 was primarily due to increase in the volume of agriculture and trade sector crediting, as well as banking license received by MFC "Bai Tushum and Partners".

Dollarization of the loan portfolio was characterized by downward trend according to the results of the first half of 2013 (Graph 2.1.4). The share of loans in foreign currency in the first half of 2013 decreased by 5.2 p.p. compared to the first half of 2012 and constituted 51.2 percent.

The major share was still accounted for medium-term loans from 1 to 3 years in the structure of loan portfolio by maturity, which constituted 41.8 percent at end of the first half of 2013 (Graph 2.1.5).

CONTENT

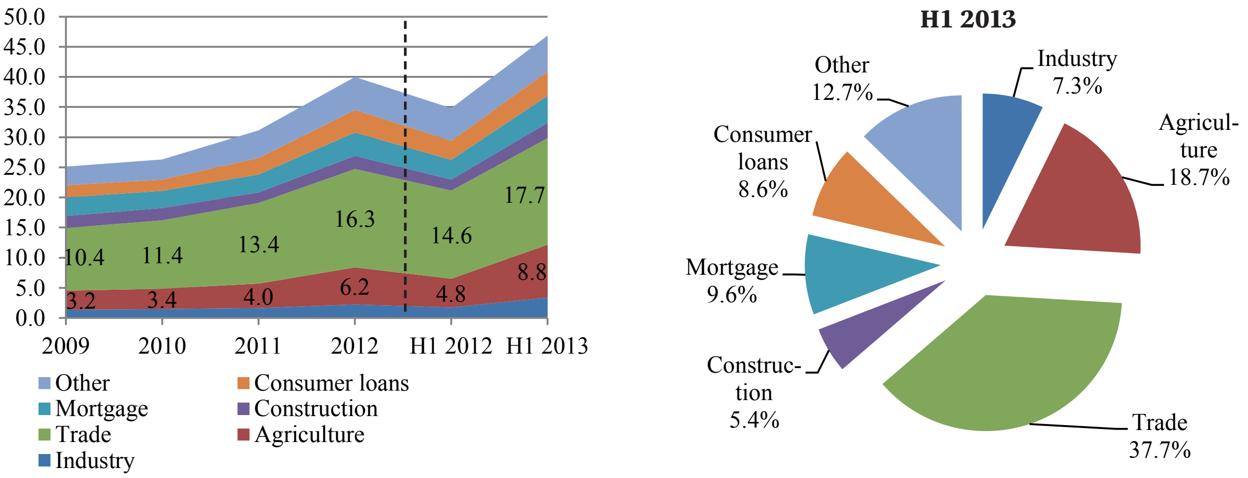
Graph 2.1.5. Change of loan portfolio structure by maturity



Decrease in the trade loans concentration amid increase of lending to the agricultural sector was observed in the sectoral structure of the loan portfolio (Graph 2.1.6). The volume of lending to the agricultural sector at end of the first half of 2013 increased by 1.8 times compared to the same period of 2012 and amounted to KGS 8.8 billion.

Growth of loan portfolio in the agricultural sector was partially provided by implementation of the national program "Agricultural financing".

Graph 2.1.6. Sectoral structure of the banks' loan portfolio
bln. KGS



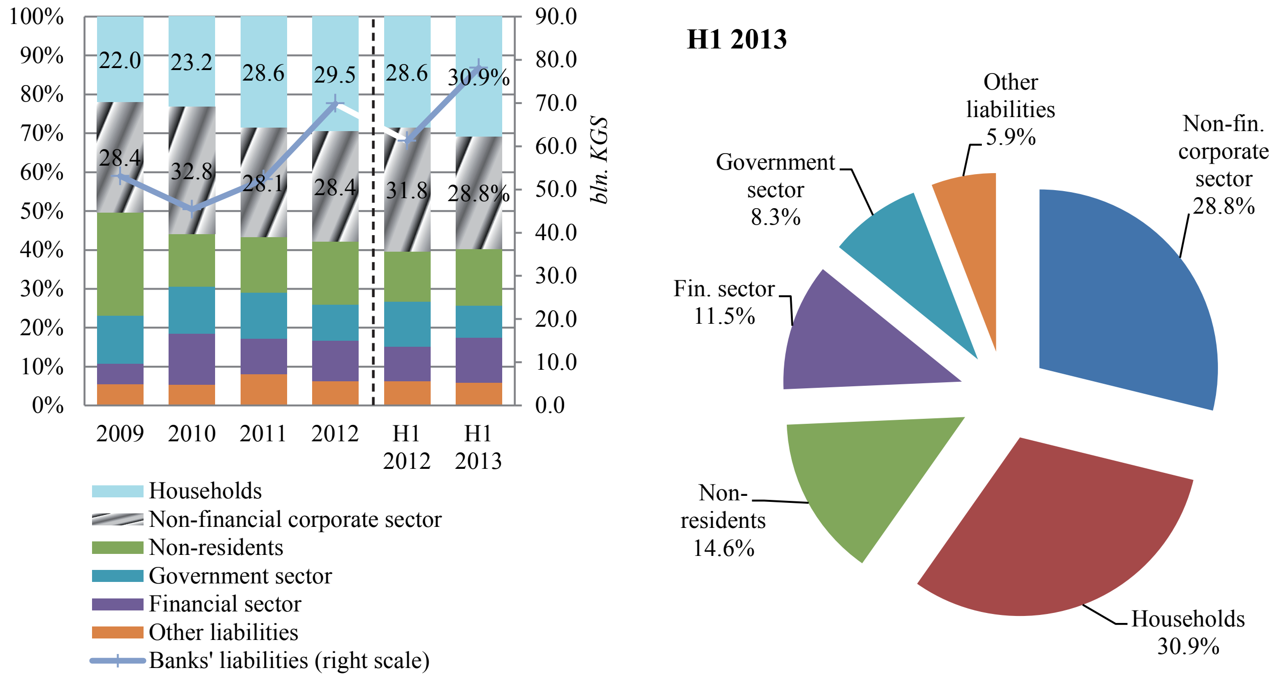
Liabilities. Status of the Banks' External Debt

At the end of the first half of 2013, liabilities of the banking sector amounted to KGS 78.1 billion, having increased by 27.7 percent compared to the same period of 2012.

Insignificant change in the structure of liabilities by sectors of economy was observed in the first half of 2013 (Graph 2.1.7). Moreover, dynamics of the liabilities structure since 2010 has been characterized by growth of the households' deposits share in the banks' liabilities. As a result, at the end of the first half of 2013, households' funds have become the major source of attracted banks' resources.

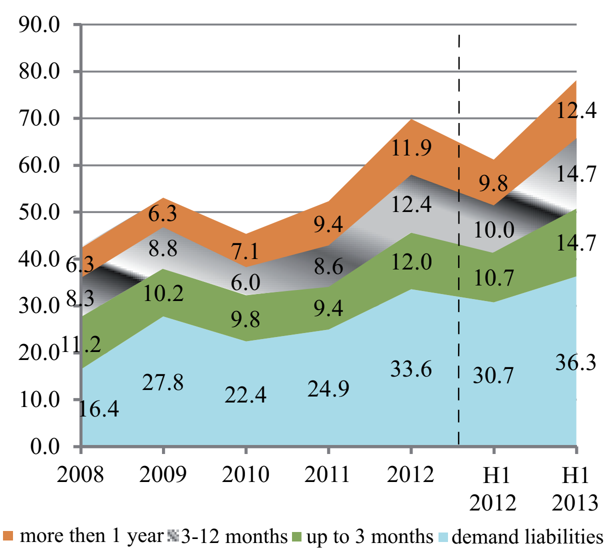
CONTENT

Graph 2.1.7. Structure of the banking sector liabilities by sectors of economies in Kyrgyzstan



Graph 2.1.8. Structure of the banking sector liabilities by maturity

bln. KGS



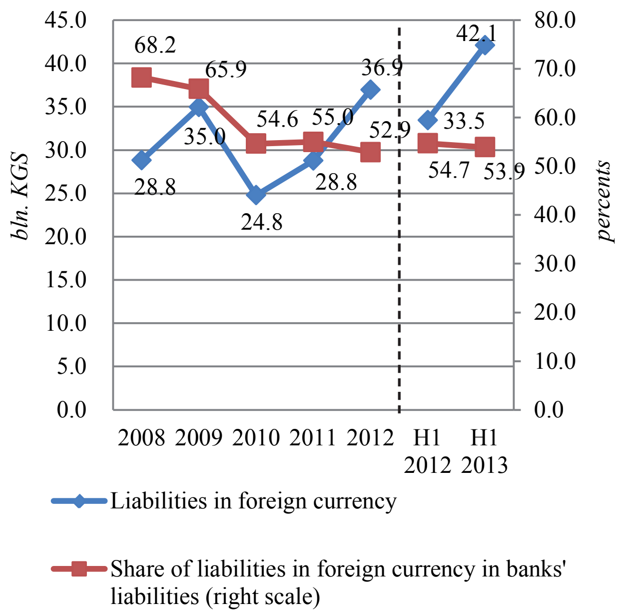
As of the end of the first half of 2013, demand liabilities increased by 18.0 percent compared to the same period of the last year and amounted to KGS 36.3 billion or 46.4 percent of the total volume of banks' liabilities (Graph 2.1.8).

Liabilities with maturity of more than 1 year increased by 27.3 percent and amounted to KGS 12.4 billion or 15.9 percent of the total volume of banks' liabilities. Herewith, the volume of long-term liabilities (more than 3 years) decreased by 13.6 percent and amounted to KGS 3.5 billion. Finally, the share of banks' long-term liabilities in the total volume of liabilities decreased from 6.6 percent (as of the end of the first half of 2012) to 4.4 percent.

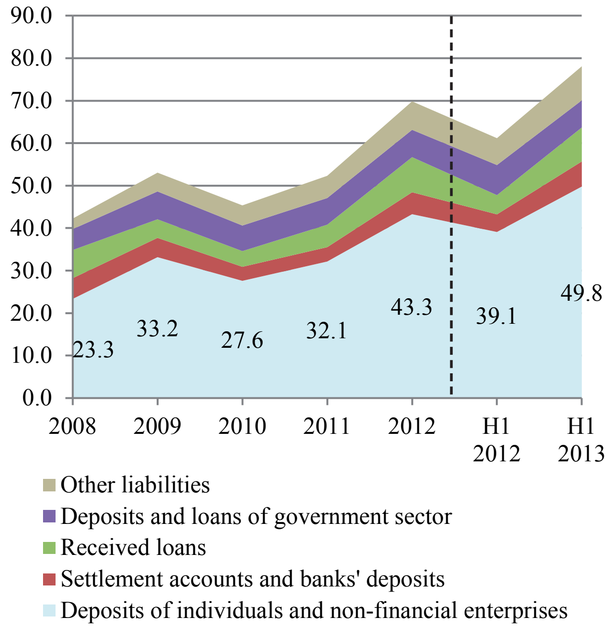
The share of liabilities in foreign currency in the total volume of attracted funds changed insignificantly and at the end of the first half of 2013 amounted to 53.9 percent of KGS 42.1 billion (Graph 2.1.9).

CONTENT

Graph 2.1.9. Dynamics of the banking sector liabilities in foreign currency



Graph 2.1.10. Structure of banks' liabilities by the reserves sources
bln. KGS



CONTENT

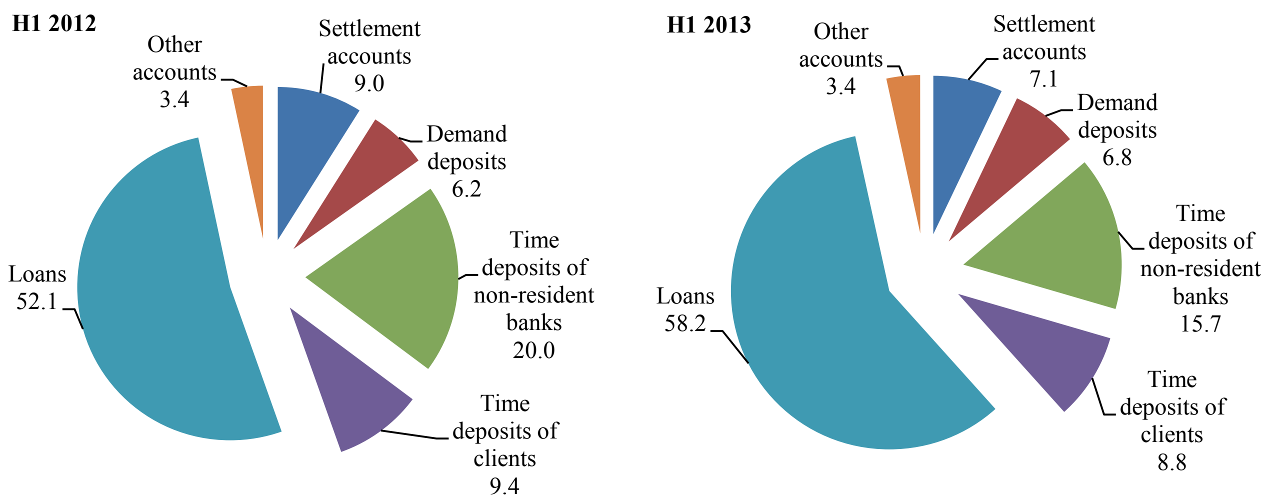
Deposits of individuals and non-financial enterprises increased by 27.4 percent in the first half of 2013 and amounted to KGS 49.8 billion (Graph 2.1.10). The share of deposits of individuals and non-financial enterprises in banks' liabilities changed insignificantly and at the end of the reporting period constituted 63.8 percent.

Increase in the share of time deposits from 34.3 to 38.4 percent was observed in the structure of deposits of individuals and non-financial enterprises, which was primarily conditioned by growth of individuals' deposits, their share increased from 47.9 to 51.9 percent.

Status of the Banks' External Debt

Liabilities of banks to non-residents in the first half of 2013 increased by 42.8 percent compared to the same period of 2012 and amounted to KGS 11.6 billion or 14.6 percent of the total liabilities in the banking sector.

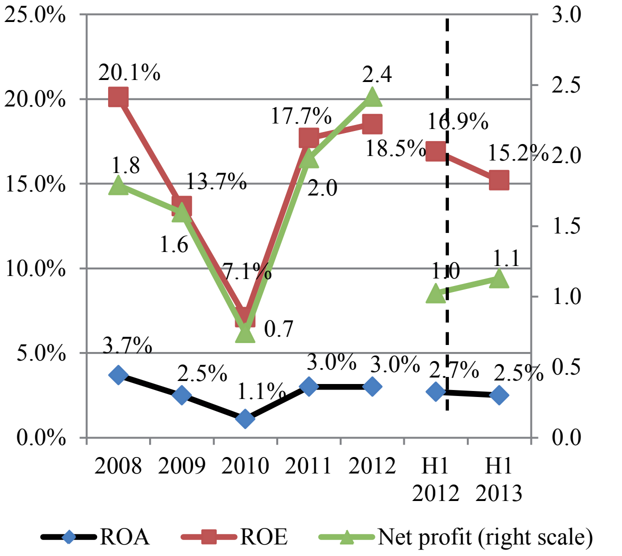
Graph 2.1.11. Structure of banks' liabilities to non-residents
percents



The major share of the banking sector liabilities to non-residents (43.5 percent or KGS 5.1 billion) is attributed to two banks. Foreign loans are provided to these banks by international financial institutions, being shareholders of these banks. According to creditors, the remaining part of loans from non-residents is rather diversified.

Financial Results

Graph 2.1.12. Indices of the banking sector profitability



The main indicator of banking profitability is the rate of return on assets (ROA), defined as the ratio of profits to the average level of assets, and the rate of return on equity (ROE), defined as the ratio of profits to average amount of Tier I regulatory capital.

Insignificant decrease of profitability indicators was observed at the end of the first half of 2013 compared to the first half of 2012 (Graph 2.1.12):

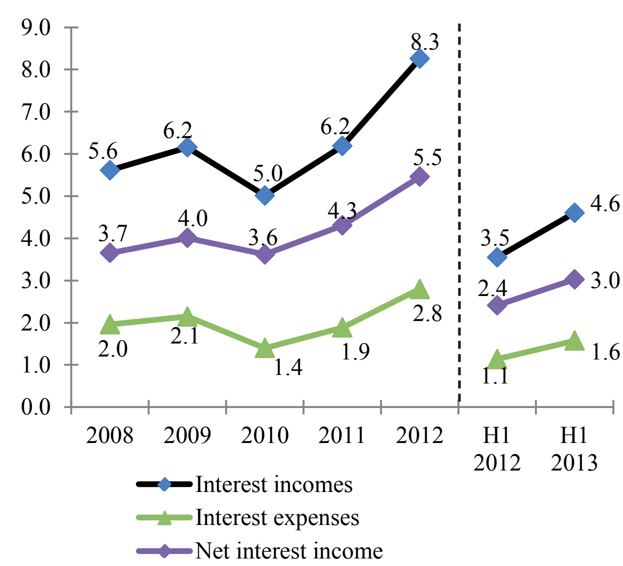
- ROA decreased from 2.7 percent to 2.5 percent;
- ROE decreased from 16.9 percent to 15.2 percent.

Net profit of the banking sector increased by 10.4 percent, compared to the same period of 2012, and amounted to KGS 1.1 billion.

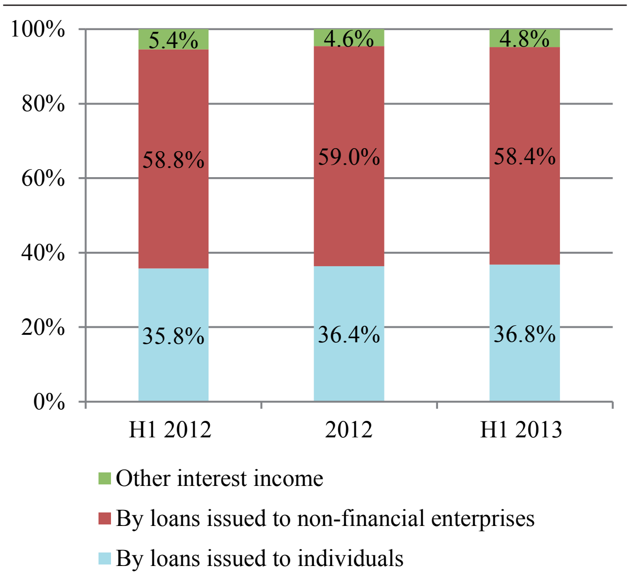
In the first half of 2013, net interest income increased by 25.4 percent compared to the same period of 2012 to KGS 3.0 billion, as growth rates of interest incomes outran interest expenses of the banking sector (Graph 2.1.13).

Graph 2.1.13. Dynamics of net interest income in the banking sector

bln. KGS



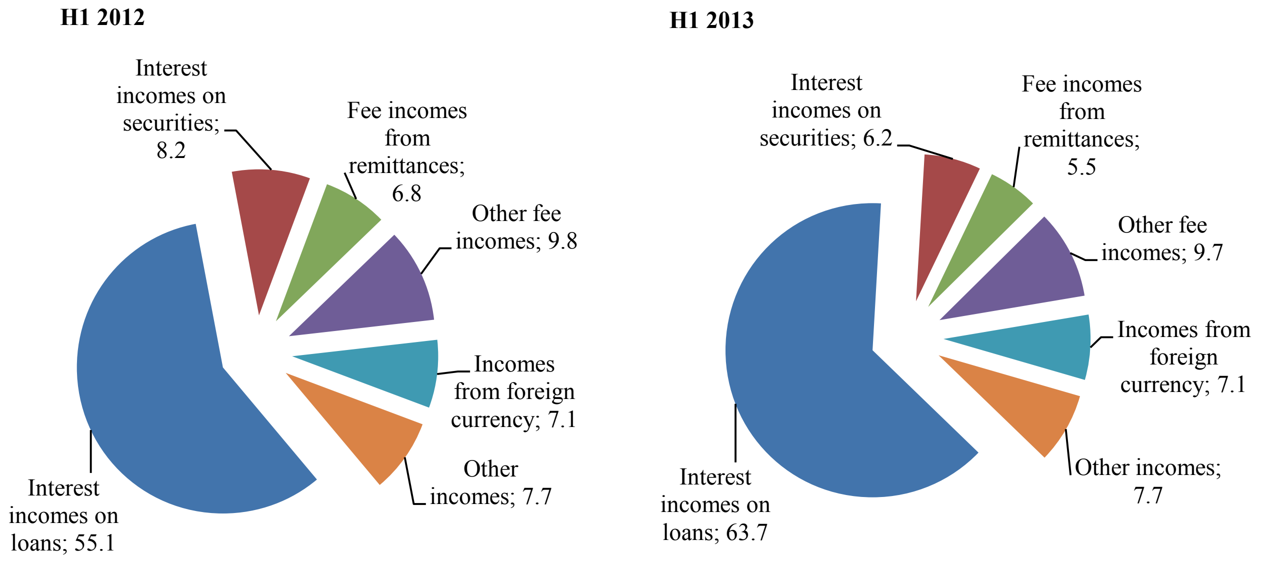
Graph 2.1.14. Structure of interest incomes in the banking sector



In the first half of 2013, the share of interest incomes on loans in the total volume of the banking sector loans increased from 55.1 percent (in the first half of 2012) to 63.7 percent (Graph 2.1.15).

CONTENT

Graph 2.1.15. Structure of the banking sector incomes
percents

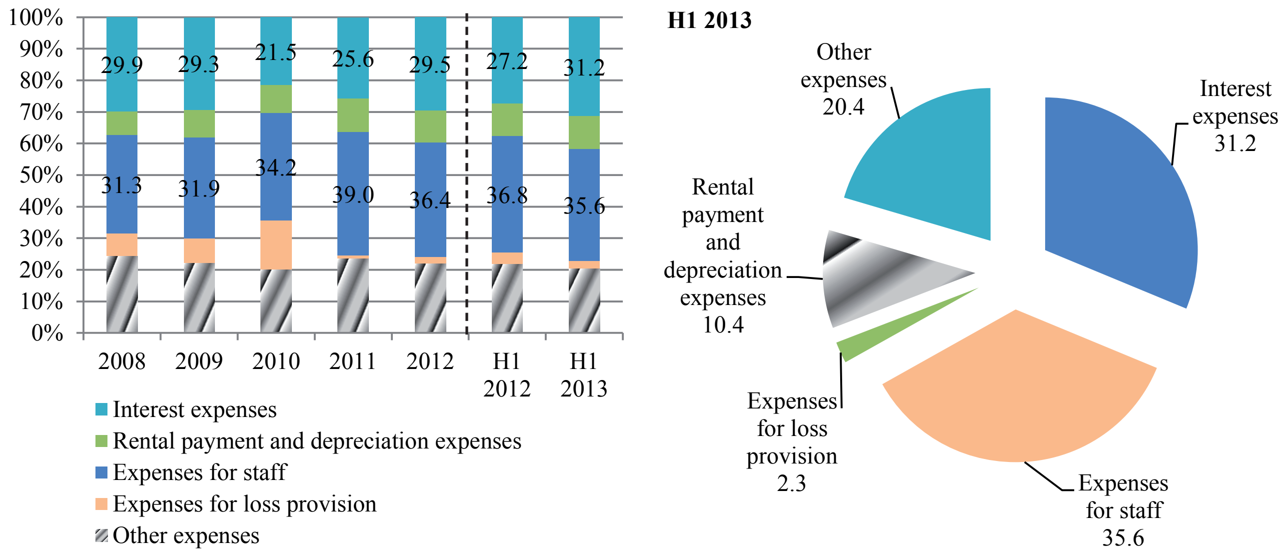


In the first half of 2013, expenses of banks increased by 20.7 percent compared to the same period of 2012 and amounted to KGS 5.0 billion.

Increase of interest expenses of banks, caused by growth of banks' interest-bearing liabilities, was by 38.6 percent compared to the first half of 2012 and amounted to KGS 1.6 billion or by 31.2 percent of the total expenses in the banking sector.

CONTENT

Graph 2.1.16. Structure of expenses in the banking sector
percents

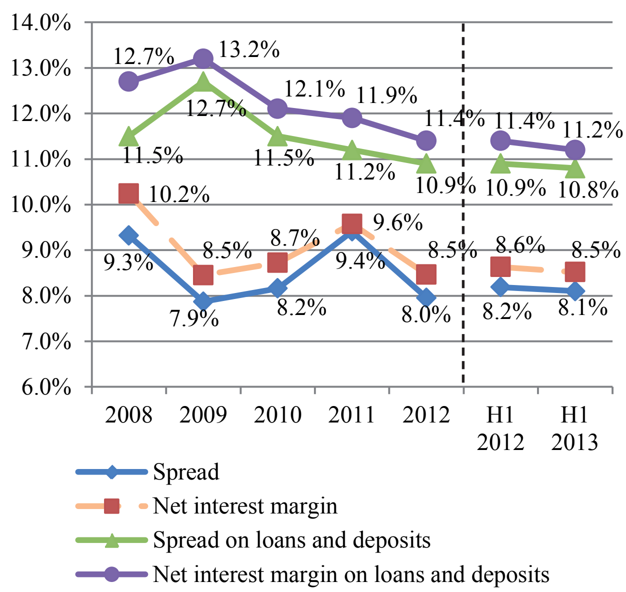


Non-interest expenses of banks increased by 14.0 percent compared to the first half of 2012 and at the end of the reporting period amounted to KGS 3.4 billion.

The major share was still attributed to expenses for staff in the structure of expenses (Graph 2.1.16). Herewith, in the first half of 2013, banks' staff profitability[9] decreased from 66.7 percent to 62.9 percent compared to the same period of 2012.

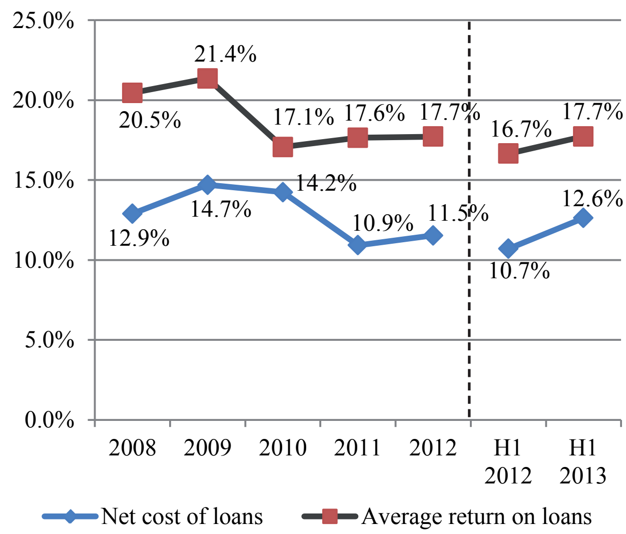
[9] *Staff profitability* is calculated as a ratio of net profit to expenses for staff.

Graph 2.1.17. Spread and net interest margin



Significant changes in the indicators of spread and net interest margin[10] (reflecting banks' management efficiency of interest assets and liabilities) was not observed in the reporting period (Graph 2.1.17). As of the end of the first half of 2013, these indicators constituted 8.1 and 8.5 percent respectively.

Graph 2.1.18. Net cost and average return of loans



In the first half of 2013, cost of banks loans[11] constituted 12.6 percent, having increased by 1.9 p.p. compared to the same period of the last year. At the end of the first half of 2013, the average loan profitability[12] also increased from 16.7 percent to 17.7 percent compared to the first half of 2012 (Graph 2.1.18).

Thus, gap between average profitability and cost of loan constituted up to 5.1 percent, i.e. interest margin, received by the banks on loans, decreased.

CONTENT

Indicators of Development till the End of 2013 Forecasted by the Banks

According to business-plans of the commercial bank, the banks expect growth of the main indicators of the banking sector at the end of 2013.

Generally, according to the results of the first half of 2013, indicators planned by the banks were performed; excluding loan portfolio, plan thereof has been performed by 97 percent (Graph 2.1.20).

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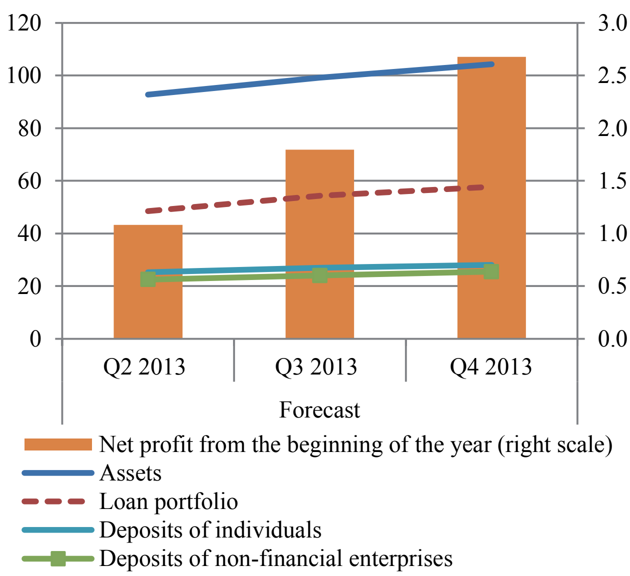
[10] $$Spread = \frac{\text{Interest incomes}}{\text{Earning assets}} - \frac{\text{Interest expenses}}{\text{Paid liabilities}}$$

$$Net\ interest\ margin = \frac{\text{Interest incomes - Interest expenses}}{\text{Earning assets}}$$

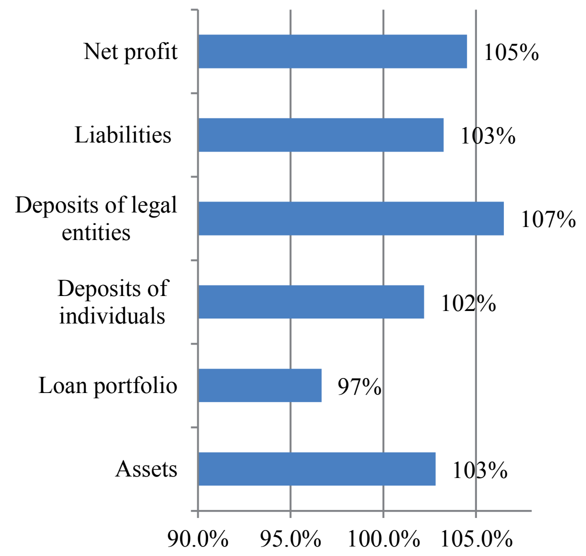
[11] $$\text{Net cost of banks' loans} = \frac{\text{Gross expenses - Non-credit incomes}}{\text{Average annual loan portfolio}}$$

[12] $$\text{Average loan profitability} = \frac{\text{Interest incomes on loans}}{\text{Average annual loan portfolio}}$$

Graph 2.1.19. Forecast indices of assets, loans and deposits
bln. KGS

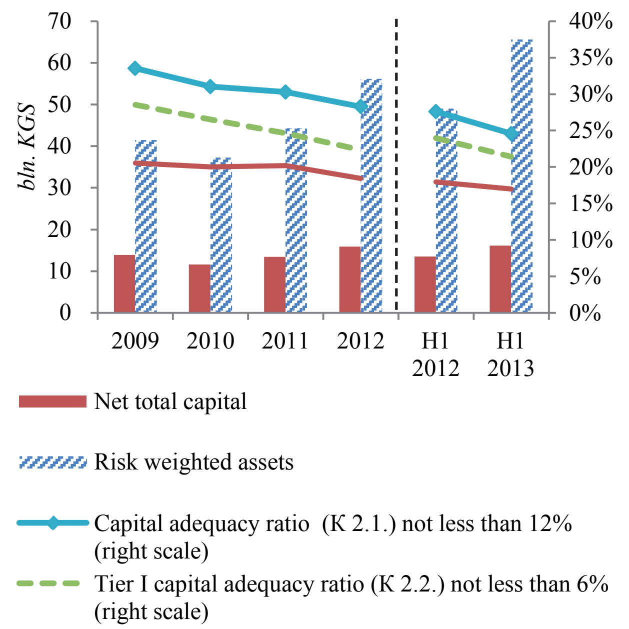


Graph 2.1.20. Implementation of plan for the first half of 2013



Capital Adequacy

Graph 2.1.21. Dynamics of capital adequacy ratios in the banking sector



All risks inherent in banking are eventually reflected in the financial result (as already being manifested in the form of direct losses, and a high proportion of the probability of future losses, through costs for creation of appropriate reserves) and affect the volume of the bank's equity, capital that characterizes stability of the bank to potential adverse changes.

With statutory minimum capital adequacy at 12.0 percent, for the first half of 2013, this figure amounted to 24.6 percent (Graph 2.1.21).

Decrease of capital adequacy was due to growth rates of risk weighted assets and off-balance sheet liabilities (33.9 percent) outstripping net total capital (19.2 percent).

At the same time, the actual level of capital adequacy can further increase the volume of risky and earning assets, without exceeding the acceptable level of risk in activities of the whole banking sector.

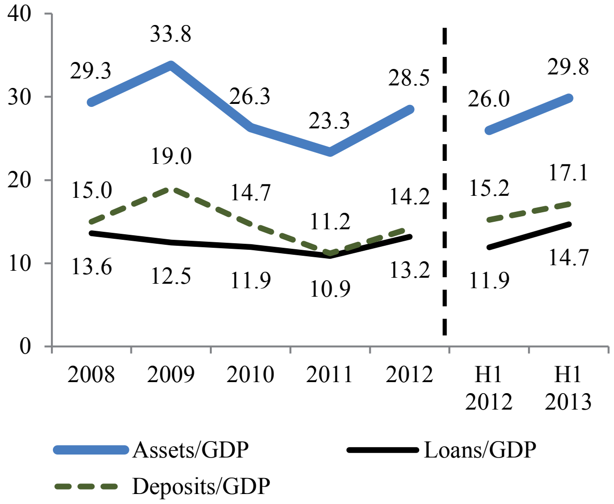
The abovementioned information indicates relative stability of the banking sector to negative shocks and the presence of certain potential to increase the level of financial intermediation and efficiency of the banking sector operation in future.

CONTENT

Financial Intermediation

Graph 2.1.22. Indicators of financial intermediation

percents



Note: Loans exclusive of financial institutions loans. Deposits exclusive of deposits of financial institutions and government authorities

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

According to the results of the first half of 2013, growth of financial intermediation was still observed that is confirmed by growth rates of major indicators in the banking sector outstripping economic growth. Financial depth of the banking sector was resulted from rapid growth in the amount of borrowers and depositors.

At the end of the first half of 2013, increase of financial intermediation indicators in the banking sector of the Kyrgyz Republic compared to the first half of 2012 was the following:

- Assets to GDP – from 26.0 percent to 29.8 percent;
- Loans to GDP – from 11.9 percent to 14.7 percent;
- Deposits to GDP – from 15.2 percent to 17.1 percent.

2.2. Assessment of the Banking Sector Risks

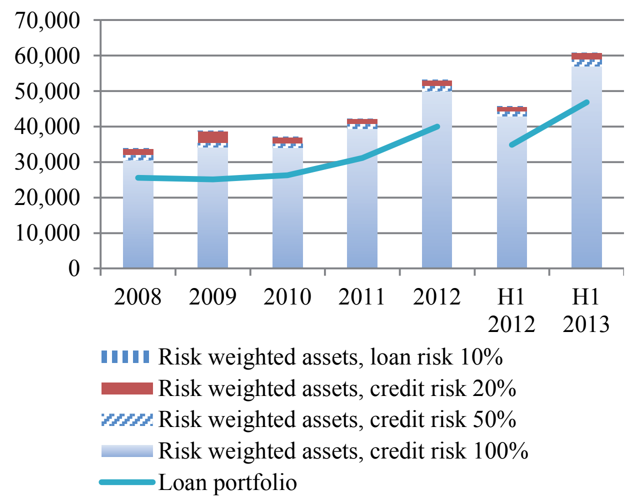
2.2.1. Credit Risk

A credit risk is one of the main risks that accompany banking. Banking transactions, comprising credit risk, are considered in this section.

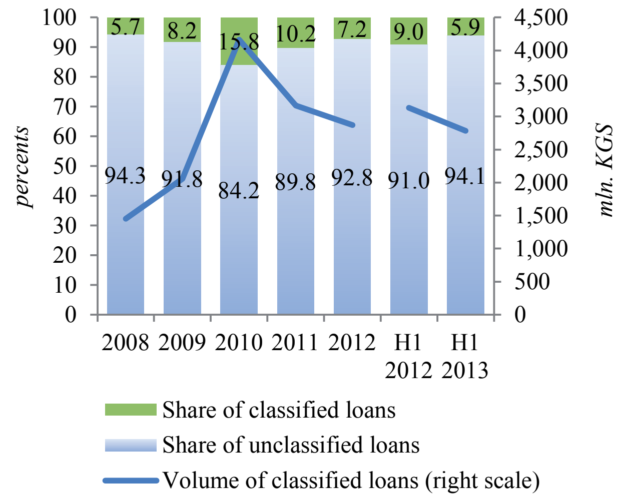
Generally, slight increase of credit risks in the banking sector was observed despite improvement in the quality of loan portfolio.

Increase of credit risk is due to growth in risk weighted assets due to rise of economy crediting.

Graph 2.2.1. Structure of risk weighted assets, *mln. KGS*



Graph 2.2.2. Loan portfolio quality



CONTENT

In order to assess the quality of the loan portfolio, the commercial banks use a loan classification system[13], which contributes to determining the possible level of potential losses from bad loans and compensating them in time through creation of appropriate reserves.

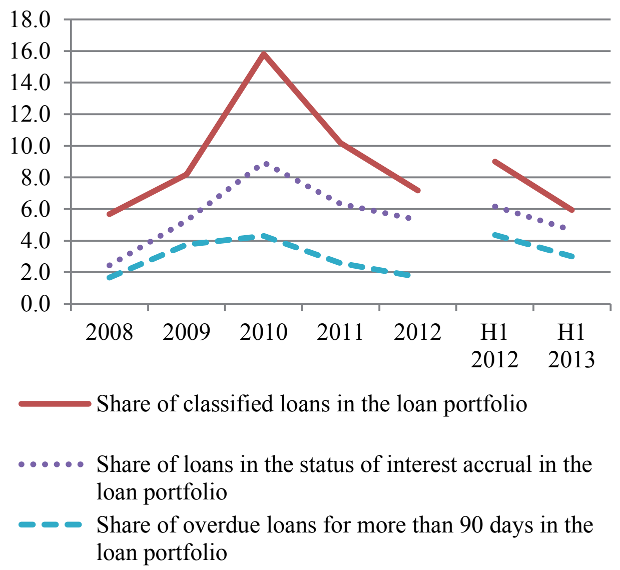
Classified and non-performing loans, reflecting the first signs of deterioration in the quality of loan portfolio, require particular attention during analysis of the loan portfolio quality. In the first half of 2013, there was decrease in the share of classified and non-performing loans, as well as loans placed in a non-accrual status compared to the same period of 2012 (Graph 2.2.3).

At the end of the first half of 2013, the risk of default on assets (the ratio of special loss provisions[14] and loan portfolio) constituted 3.7 percent.

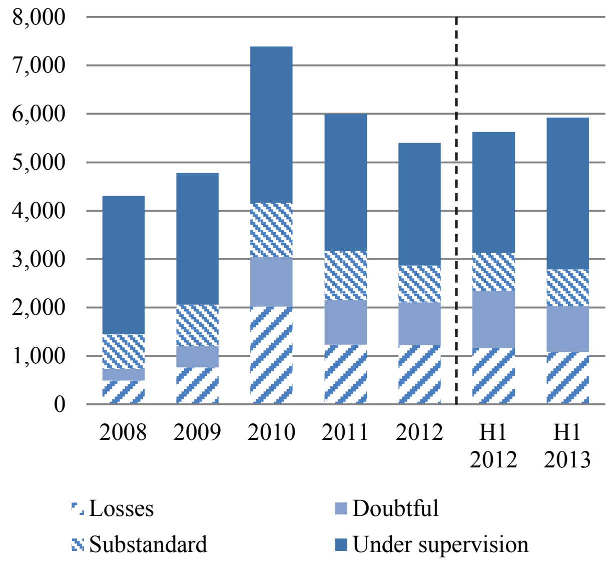
[13] In order to assess the quality of the loan portfolio, all loans are usually divided into six categories, depending on the client's current capacity to fulfill the obligations to the bank (listed in declining order of classification): normal, satisfactory, under supervision, substandard, doubtful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

[14] Special reserves are created on "classified" assets, total reserves – on "non-classified" assets of the bank.

Graph 2.2.3. Indicators of the loan portfolio quality
percents



Graph 2.2.4. Change of loan portfolio classification in the banking sector
mln. KGS

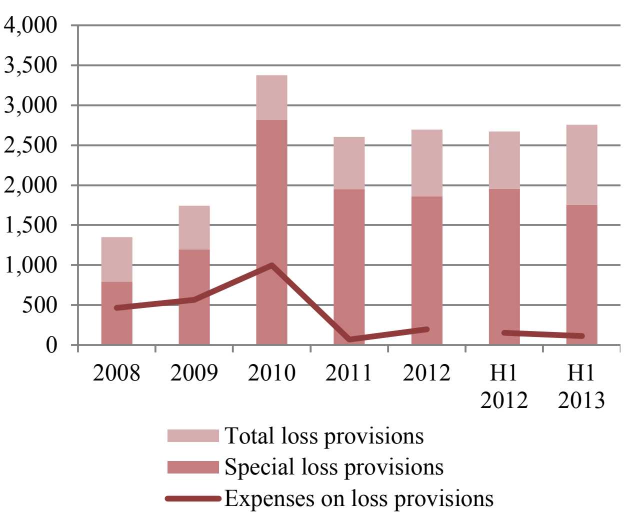


The dynamics of loans classified as loans "under supervision" are considered as one of the factors that may influence increase or decrease of the loan portfolio quality in the future. The share of such loans in the first half of 2013 decreased by 0.5 percentage points of the total loan portfolio and constituted 6.7 percent.

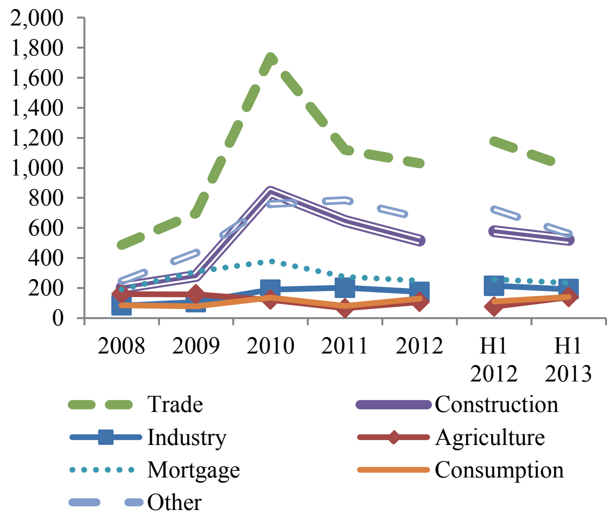
Aggregate reserves created by the commercial banks constituted 5.9 percent of the total loan portfolio (in the first half of 2012 this index constituted 7.7 percent). In the first half of 2013, the share of special loan loss provision constituted 63.7 percent of the total reserves (Graph 2.2.5).

CONTENT

Graph 2.2.5. Total and special reserves
mln. KGS



Graph 2.2.6. Volume of classified loans by sectors of economy
mln. KGS

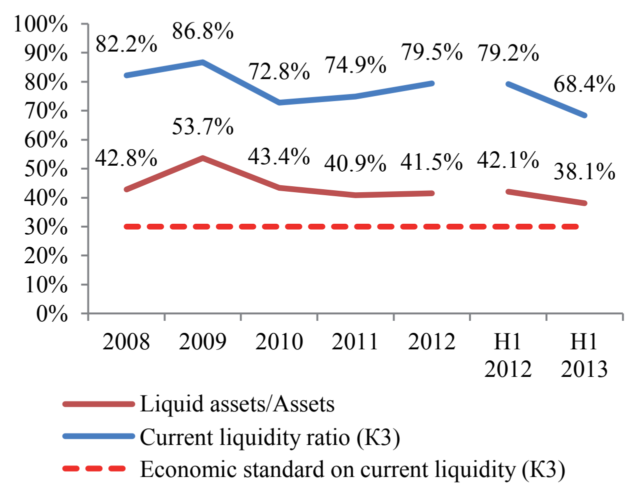


Total decrease in the volume of classified loans was observed in many sectors of economy. At the end of first half of 2013, the highest concentration of credit risks is observed in the trade and construction sectors of economy (Graph 2.2.6).

2.2.2. Liquidity Risk

Population's confidence in the banking sector depends on the prompt fulfillment of obligations by the banks, provided that the banks are provided with sufficient liquidity. For regulatory purposes, *liquidity risk* is estimated by prudential standard of current liquidity[15].

Graph 2.2.7. Liquidity indicators



Significant decline of current liquidity ratio from 79.2 percent to 68.4 percent was observed at the end of the first half of 2013 compared to the first half of 2012 (Graph 2.2.7). Decrease in liquidity level is conditioned by decrease in the share of liquid assets and increase in the ratio of loan portfolio due to expansion of lending to the economy.

Herewith, actual level of liquidity ratio supported by the banking sector has still been remaining rather high more than twice exceeding set prudential standard.

Table 2.2.1. shows information on maturities of the banks' financial assets and liabilities as of the first half of 2013. Generally, negative gap (financial liabilities exceeding financial assets) was observed on maturities of up to 1 year. Due to available gaps of assets and liabilities, banks still kept significant volume of low-yielding high-liquidity assets in the structure of assets.

Table 2.2.1. Cumulative gap[16] by maturity of assets and liabilities

(mln. KGS)

Total	Instant	up to 1 month	up to 3 months	up to 1 year	up to 3 years	Grand total
Total financial assets	20,552	35,619	40,625	59,358	98,168	98,168
Total financial liabilities	30,951	43,783	50,950	65,663	78,102	78,102
Gap (gap interval)	-10,399	-8,164	-10,325	-6,304	20,067	20,067
Gap in % of assets	-10.6%	-8.3%	-10.5%	-6.4%	20.4%	20.4%
Gap in % of net total capital	-64.5%	-50.6%	-64.1%	-39.1%	124.5%	124.5%

in foreign currency	Instant	up to 1 month	up to 3 months	up to 1 year	up to 3 years	Grand total
Total financial assets	11,722	19,918	22,215	28,104	46,168	46,168
Total financial liabilities	15,230	23,652	27,404	35,320	42,095	42,095
Gap (gap interval)	-3,508	-3,735	-5,189	-7,216	4,073	4,073
Gap in % of assets	-7.6%	-8.1%	-11.2%	-15.6%	8.8%	8.8%
Gap in % of net total capital	-21.8%	-23.2%	-32.2%	-44.8%	25.3%	25.3%

[15] Prudential standard of current liquidity is one of liabilities for fulfillment of standards established by the NBKR according to which liquid assets (for calculation of this indicator comprising the funds of the banks in cashier's offices and in correspondent accounts) should be at the level not less than 30 percent from short-term liabilities.

[16] *Cumulative gap* is the amount of possible expenses for support of solvency, estimated for each range of maturity.

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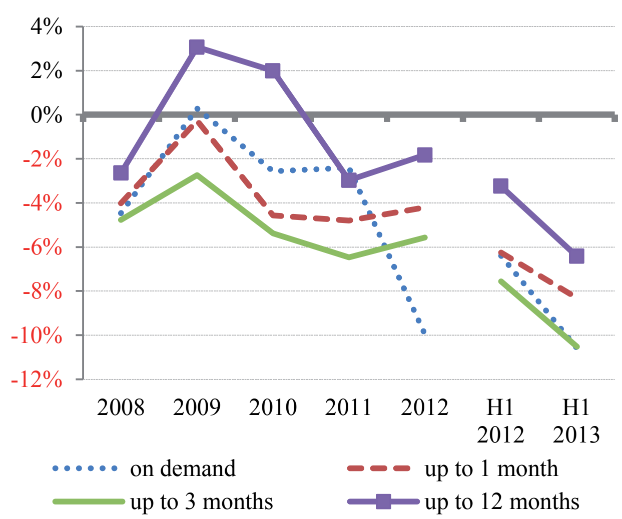
in national currency	Instant	up to 1 month	up to 3 months	up to 1 year	up to 3 years	Grand total
Total financial assets	8,830	15,702	18,410	31,254	52,000	52,000
Total financial liabilities	15,720	20,131	23,546	30,343	36,006	36,006
Gap (gap interval)	-6,890	-4,429	-5,136	912	15,994	15,994
Gap in % of assets	-13.3%	-8.5%	-9.9%	1.8%	30.8%	30.8%
Gap in % of net total capital	-42.7%	-27.5%	-31.9%	5.7%	99.2%	99.2%

Table 2.2.2. Maturity of financial assets and liabilities
(mln. KGS)

Name	Maturity					Grand total
	up to 1 month	1- 3 months	3-6 months	6-12 months	more than 12 months	
Total financial assets	35,619	5,005	6,341	12,393	38,810	98,168
Including loans and financial leasing to the clients	2,216	2,327	4,104	7,600	30,633	46,880
Total financial liabilities	43,783	7,166	7,086	7,627	12,439	78,102
Including deposits of individuals and fixed deposits of legal entities	13,690	4,088	5,051	4,479	3,565	30,873
Gap	-8,164	-2,161	-746	4,766	26,371	20,067
Including on loans and deposits	-11,475	-1,761	-948	3,121	27,068	16,007

In the reporting period, negative cumulative gap increased on all categories of maturity. Herewith, the largest gaps on maturities between financial assets and liabilities are observed in "demand" (-10.6 percent of the assets volume) and "up to 3 months" (-10.5 percent of the assets volume, Graph 2.2.8) categories.

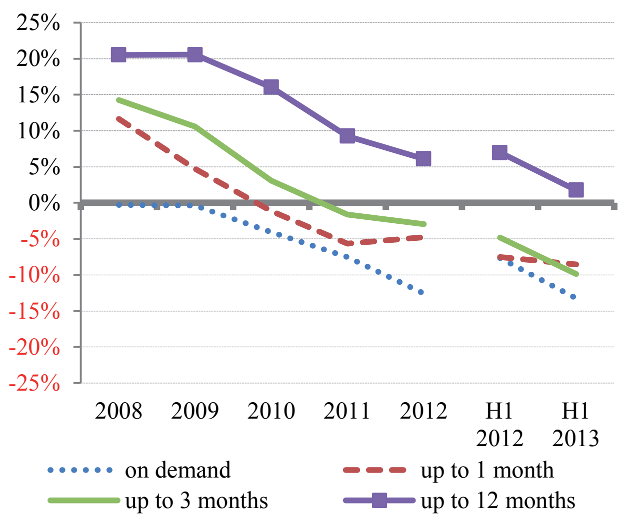
Graph 2.2.8. Cumulative gap,
in percents of the total volume of assets



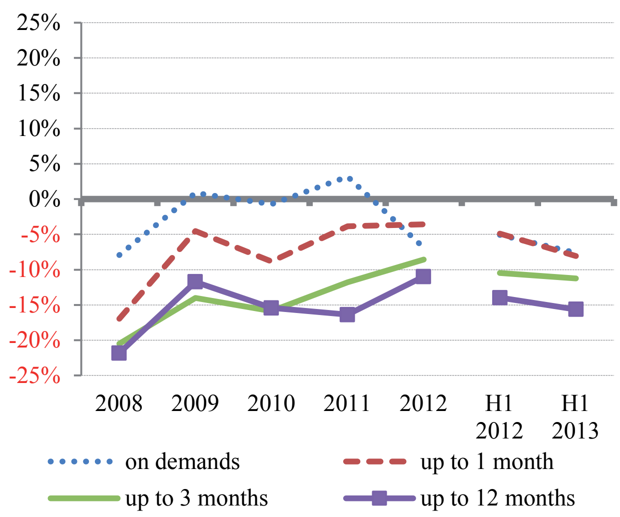
Commercial banks started to place more short-term liabilities into medium-and long-term assets causing increase of negative cumulative gap of liabilities.

CONTENT

Graph 2.2.9. Cumulative gap in national currency,
in percents of the total volume of assets



Graph 2.2.10. Cumulative gap in foreign currency,
in percents of the total volume of assets



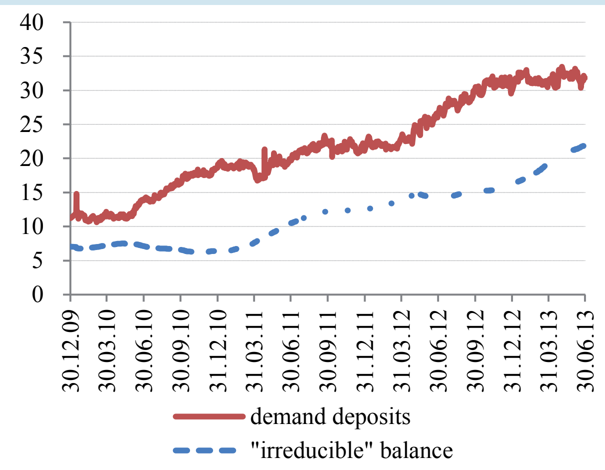
Box 3. Assessment of Stable "Irreducible" Level of Demand Deposits during the Period 2009 – June 2013[17] ("Irreducible" Balance of Deposits)

The purpose of determining the "irreducible" level of deposits is to reveal volumes of banks' demand deposits, which are permanently at banks' disposal and will be used in assessment of so called "excess liquidity".

At the end of the period under review, demand deposits of commercial banks are characterized by low volatility. Graphs show that the levels of demand deposits will reasonably unlikely (99 percent[18]) to decrease below indicators of so called "irreducible" balances[19] (Graph 2.2.11).

As of the end of the first half of 2013, minimum stable level of demand deposits constituted KGS 19.7 billion (Graph 2.2.11). Herewith, the average difference between total level of demand deposits and "irreducible" level constituted KGS 10.2 billion during the period 2009 – June 2013.

Graph 2.2.11. Volume of "irreducible" demand deposit balances
bln. KGS



As of the end of the first half of 2013, the share of minimum "stable" volume of demand deposits constituted 67.1 percent in eleven banks, unstable part constituted 32.9 percent respectively. Interquartile range of minimum "stable" level of demand deposits varied from 54.9 percent to 70.8 percent (Graph 2.2.12).

Due to socio-political events in Kyrgyzstan in 2010, the average level of "irreducible" balances of deposits in the total volume of demand deposits decreased significantly from 60 percent to 30 percent (Graph 2.2.12).

[17] Exclusive of deposits of troubled banks.
[18] For security purposes credibility level of 99 percent was chosen.
[19] Volumes of "irreducible" balances of commercial banks are calculated on the basis of demand deposit daily balances since 2009 as the difference between arithmetical average and 2.33 of standard deviations (μ - $2.3\ \sigma$).

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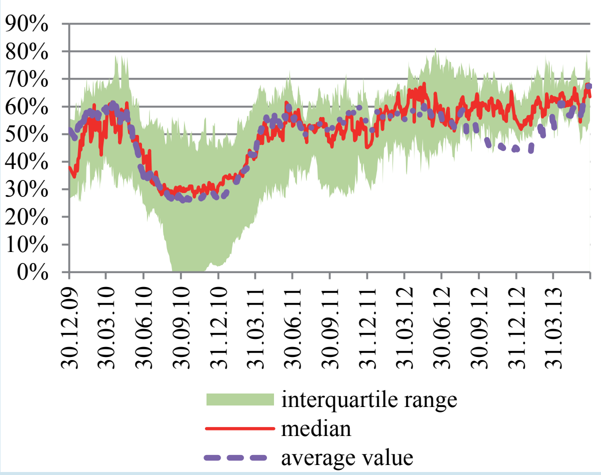
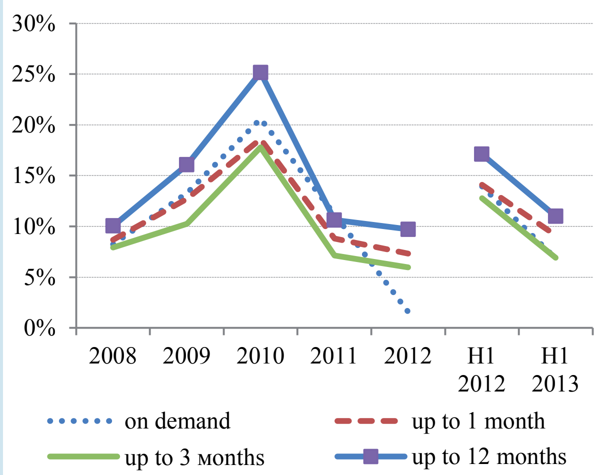
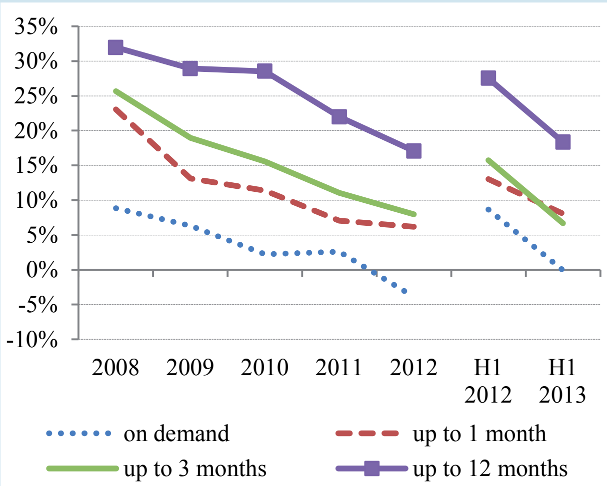
Graph 2.2.12. Share of "irreducible" balances in demand deposits



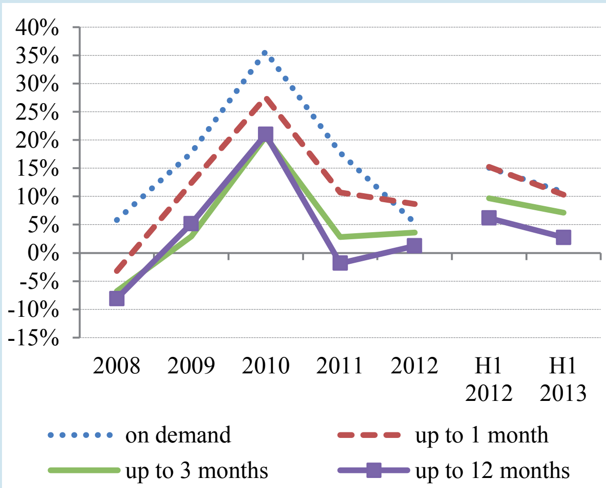
Graph 2.2.13. Cumulative gap
in percents of the total volume of assets



Graph 2.2.14. Cumulative gap in national currency, *in percents of the total volume of assets*



Graph 2.2.15. Cumulative gap in foreign currency, *in percents of the total volume of assets*



Thus, exclusive of "irreducible" balance of demand deposits, the gap on maturities between financial assets and liabilities varied from negative to positive (Graph 2.2.13).

2.2.3. Risk of Concentration

Generally, as of the end of the first half of 2013, slight increase of *concentration risk* was observed compared to the same period of 2012.

Deposit Concentration

Potential outflow of funds possessed by five large depositors in six banks can decrease the level of current liquidity below economic standard established by the NBKR (30 percent).

As of the end of the first half of 2013, the total volume of indebtedness of five large depositors[20] by banks constituted 29.6 percent of the total deposits in the banking sector.

According to the results of stress-testing, six banks did not withstand shock connected with outflow

[20] The amount of debt of five large depositors of the bank is meant.

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of five large depositors (liquidity ratio decreases below 30 percent): 2 large banks, 3 medium banks and 1 small bank.

Loan Concentration

Potential default of five large depositors[21] in five banks can reduce regulatory capital below set economic standard.

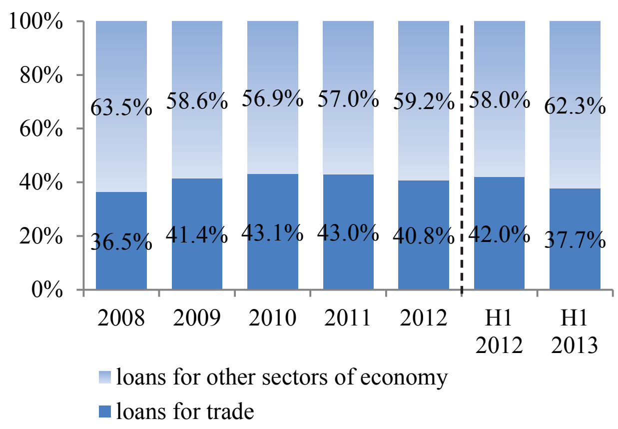
As of June 30, 2013, total debt of five large borrowers by banks constituted 11.9 percent of the total loan portfolio in the banking sector. The highest concentration level of five large borrowers by banks was observed in three banks.

According to the results of stress-testing, 3 large and 2 medium banks did not withstand the shock connected with default from 1 to 5 large borrowers, when CAR[22] decreases below 12-percent threshold level.

Table 2.2.3. Risk of loan concentration of five banks

	Number of large borrowers, which default Can decrease CAR below 12%
Large banks:	
Bank 1.	2
Bank 2.	3
Bank 3.	4
Medium banks:	
Bank 1.	1
Bank 2.	3

Graph 2.2.16. Sectoral concentration of the loan portfolio



Decrease of the level of trade loans concentration was observed in the sectoral structure of loans portfolio amid increase of lending to the agricultural sector. Based on the results of the first half of 2013, the share of loans for trade decreased from 42.0 percent to 37.7 percent (Graph 2.2.16)

2.2.4. Market Risk and Risk of "Contagion"

Market risk is represented by currency and interest rate risks.

Currency Risk

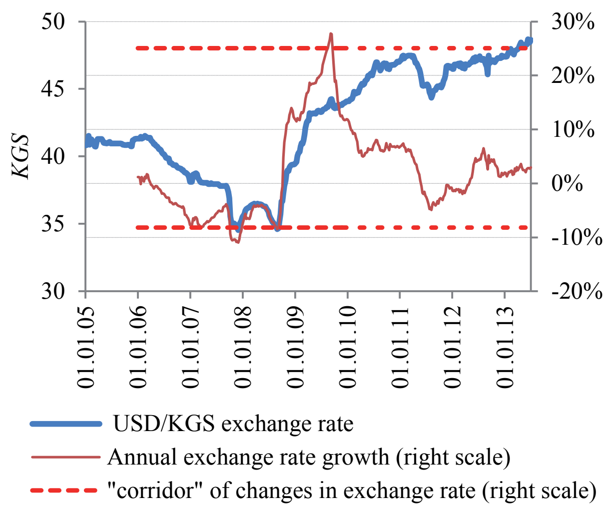
At the end of the first half of 2013, insignificant increase of currency risk in the banking sector was observed compared to the same period of 2012 (from 0.4 percent to 0.6 percent of net total capital).

21 Total debt of five large borrowers of the bank is meant.
22 It should be not less than 12 percent according to the NBKR prudential standard.

Increase of currency risk was conditioned by rise in an open currency position of the commercial banks.

Despite increase, direct currency risk remains generally at the low level. Herewith, there is a risk of the currency risk transformation into the loan risk through pressure put on debt burden of the borrowers, potentially affecting 41.9 percent of the banks' loan portfolio (Box 4).

Graph 2.2.17. Dynamics of USD/KGS nominal exchange rate



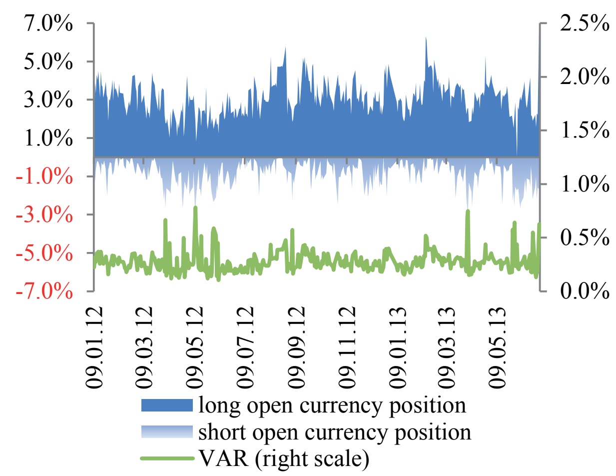
Generally, banks hold open currency positions of assets and liabilities within the limits of the NBKR economic standards.

The risk of currency position overestimation in the banking sector is minimum (VAR: 0.1-0.5 percent of the net total capital, Graph 2.2.18).

Generally, the foreign currency position of fourteen banks in U.S. dollars in the first half of 2013 was long, and, respectively, the currency position of five banks was short (Graph 2.2.19).

Graph 2.2.18. Dynamics of open currency position (OCP) and revaluation risk (VAR)*

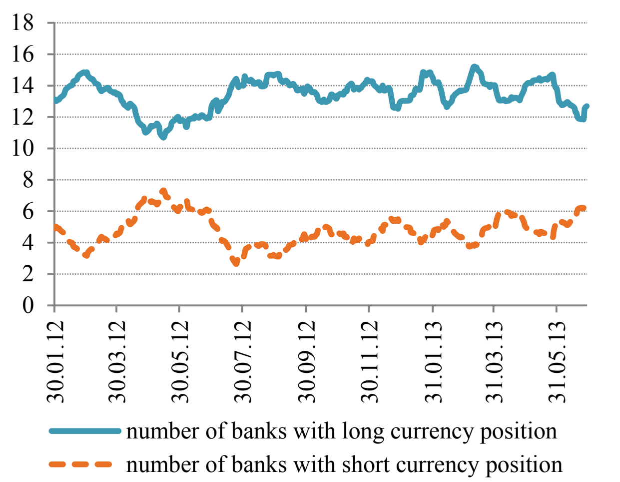
in percents of NTC



* *exclusive of troubled banks*

Graph 2.2.19. Currency position of the banks*

units



* *exclusive of troubled banks*

CONTENT

Box 4. Evaluation of Currency Risk Effect on Debt Burden of a Borrower (Indirect Currency Risk)

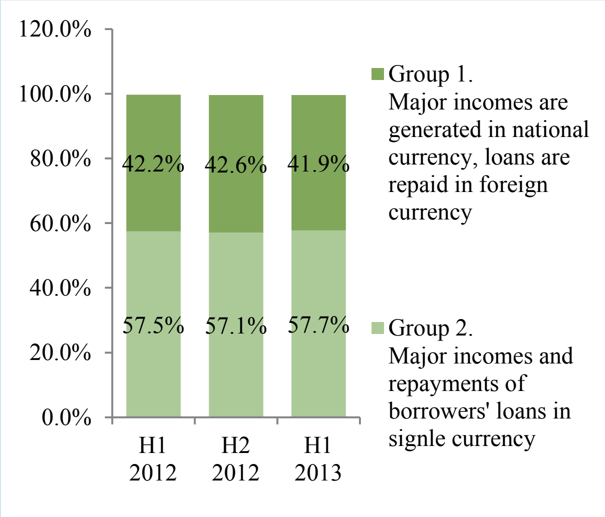
As of the end of the first half of 2013, 41.9 percent of the total volume of loan portfolio was attributed to loans repaid in foreign currency, while incomes of borrowers were generated in national currency (Graph 2.2.20). Consequently, this volume of loan portfolio is potentially exposed to credit risk through influence of currency risk (so called indirect currency risk).

Indirect confirmation of currency risk influence on the credit risk is given in Graph 2.2.21, which shows the shares of classified loans by groups of loans:

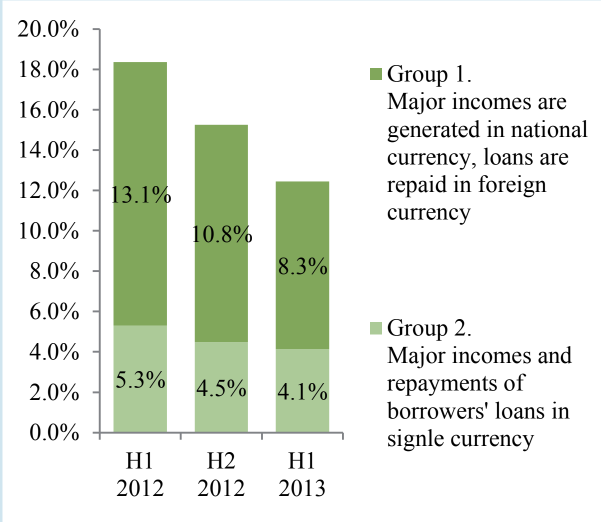
– Group 1 – 8.3 percent, major incomes of a borrower are generated in national currency, while loans are repaid in foreign currency;

– Group 2 – 4.1 percent, major incomes and loans to be repaid by a borrower in a single currency.

Graph 2.2.20. Loan portfolio by loan groups*



Graph 2.2.21. Share of classified loans by loans groups*



* Graph does not comprise Group 3 "Major incomes of borrowers are generated in foreign currency, loans are repaid in national currency", due to insignificant share of loan portfolio in this group (0.4 percent of the total loan portfolio as of the first half of 2013).

Graph 2.2.21 shows that the loans quality from Group 1 is more than twice lower compared to the loans from Group 2.

Thus, Group1 (major incomes of a borrower are generated in national currency, loans are repaid in foreign currency) is exposed to indirect currency risk most of all.

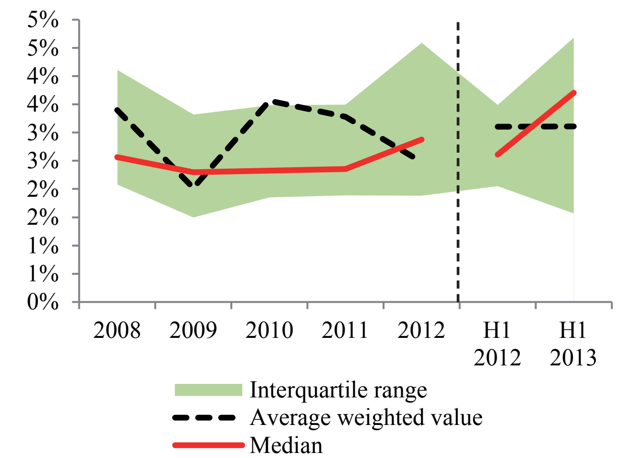
CONTENT

Interest Risk

At the end of the first half of 2013, despite slight increase of interest risk, its level was still registered at a rather low level.

Graph 2.2.22. Dynamics of interest rate risk (VaR)

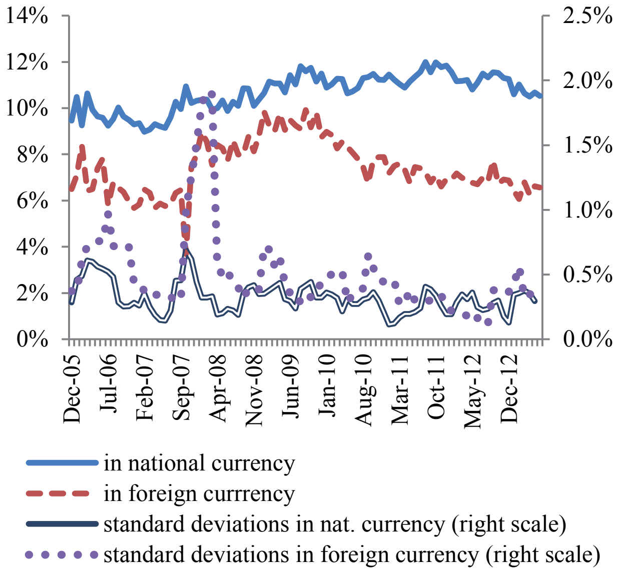
in percents of NTC



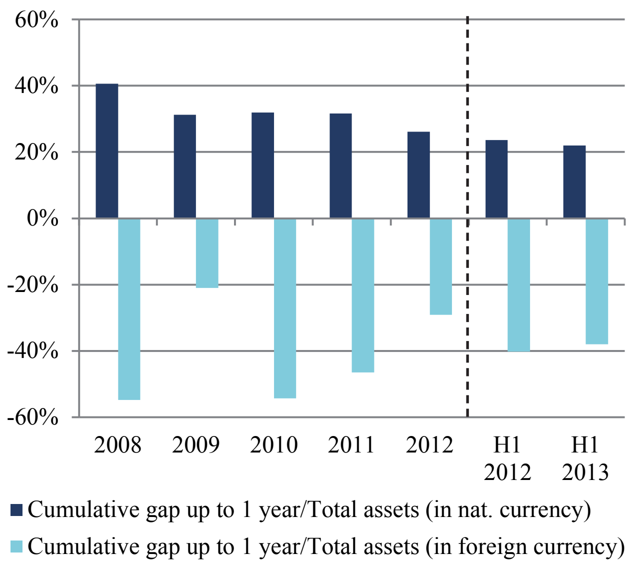
Increase of interest rate risk (VAR) from 2.6 percent to 3.0 percent of net total capital (or from 20.5 percent to 21.9 percent of net profit) was resulted from increase of gaps by maturities between financial assets and liabilities vulnerable to interest rates dynamics.

Average value of interest rate risk during the period of 2008 – the first half of 2013 was within accessible limits (2-4 percent of net total capital).

Graph 2.2.23. Dynamics of average weighted interest rate of individuals' time deposits



Graph 2.2.24. Cumulative gap of assets and liabilities exposed to interest rate risk



Risk of "contagion"

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

According to the results of the first half of 2013, 4 banks were revealed in the banking sector, where ratio of debt to the banks to the total capital exceeded 50 percent.

One bank, unable to fulfill CAR threshold level, will suffer in case of insolvency of borrowing banks; thereafter "contagion" chain will be broken.

In general, the quantitative risk assessment of the banking sector from insolvency by banks in the absence of significant volume of securities and relatively small volumes of mutual crediting indicates low level of "contagion" risk in the banking sector.

CONTENT

Box 5. Assessment of Potential Compliance of the Banking Sector in Kyrgyzstan to the Requirements for Capital According to "Basel II" Standards (Inclusive of Market and Operational Risks)

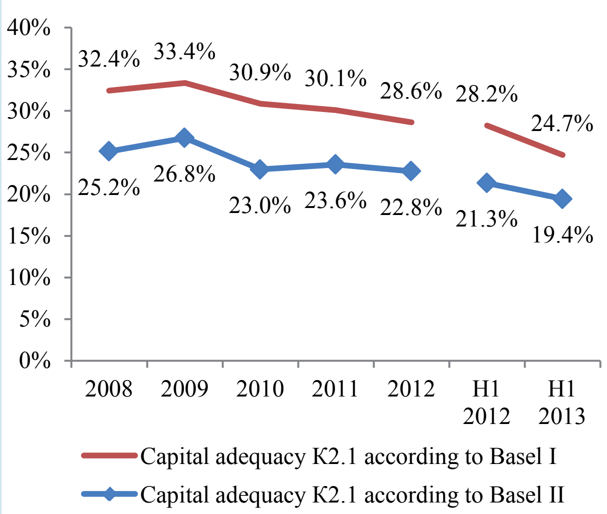
Calculation of capital adequacy K2.1 is made according to the following formula: [23]

$$K2.1. = \frac{NTC}{CR+8{,}33*(MR+OR)}$$, where

CR – Credit risk-weighted assets;
MR – Capital required at market risk;
OR – Capital required at operational risk.

[23] Exclusive of troubled banks.

Graph 2.2.25. Capital adequacy (K2.1) according to Basel I and II



As of the end of the first half of 2013, capital adequacy ratio (K2.1) according to Basel II standards, i.e. inclusive of market and operational risks, constituted 19.4 percent. Herewith, the actual level of the current value of the capital adequacy ratio exclusive of market and operational risks (according to Basel I) constituted 24.7 percent (Graph 2.2.25).

Moreover, according to the results of the first half of 2013, estimated volume of required capital at operational risk according to Basel II amounted to KGS 1.5 billion, estimated volume of capital at market risk amounted to KGS 0.6 billion.

2.3. Stress Testing

2.3.1. Macro-stress Testing on Macro-Economic Shocks Impact on the Banking Sector[24]

Generally, rather high current capitalization enables the banking sector to withstand influence of analyzed scenarios of macroeconomic shocks. Herewith, three banks do not withstand the scenario of GDP negative growth rate by 10 percent. Five banks do not withstand the scenario of GDP negative growth rate by 10 percent accompanied by devaluation of the national currency by 50 percent.

This macro-stress testing (on the basis of econometric model) is focused on assessment of banking sector sensitivity in case of implementation of macroeconomic shocks resulting in materialization of credit risks and risk from change in exchange rate of the national currency.

The following scenarios were considered for the purposes of assessment of macro-economic shocks influence on sufficiency of banks' capital:

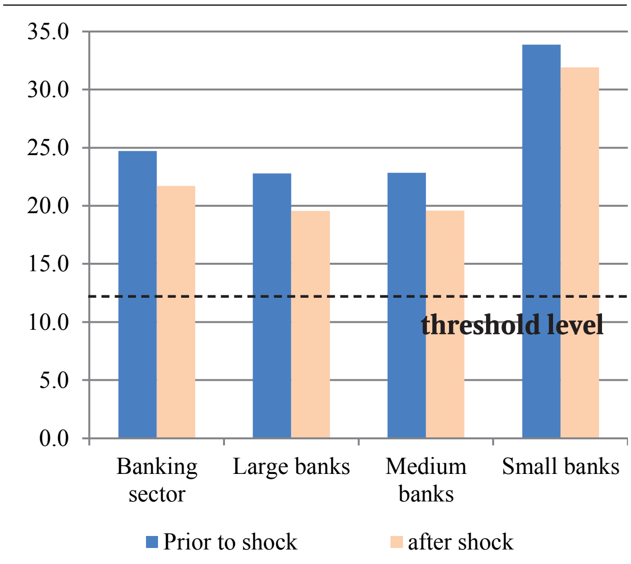
Scenario 1 – GDP negative growth rate will constitute 5 percent;

Scenario 2 – GDP negative growth rate will constitute 10 percent;

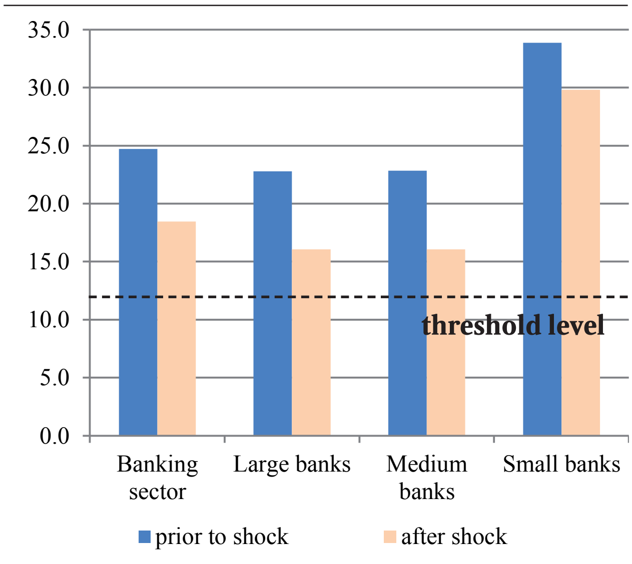
Scenario 3 – GDP negative growth rate will constitute 10 percent and will be accompanied by decrease of KGS exchange rate by 50 percent.

In case of "Scenario 1" implementation (Graph 2.3.1) capital adequacy ratio (CAR) of the banking sector can decrease from 24.7 percent (as of the end of the first half of 2013) to 21.7 percent (Table 2.3.1). All banks withstand circumstances of this scenario implementation.

Graph 2.3.1. Impact of "*Scenario 1*" on capital adequacy ratio
percents



Graph 2.3.2. Impact of "*Scenario 2*" on capital adequacy ratio
percents

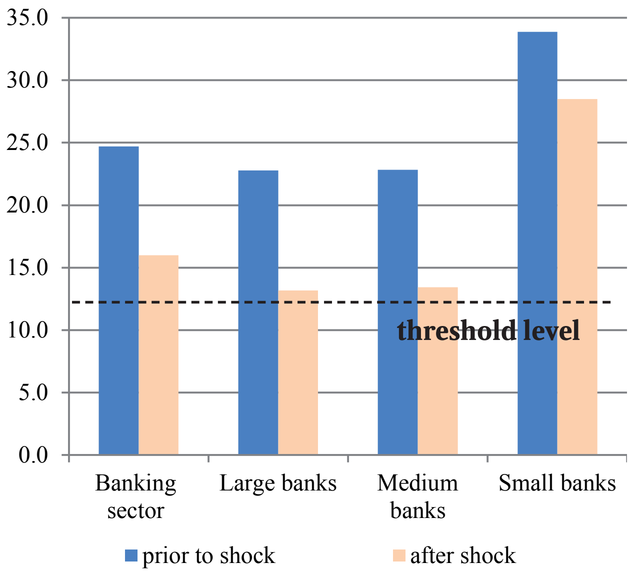


In case of "Scenario 2" implementation, CAR of banks can decrease by 5.6 p.p., up to 19.1 percent (Graph 2.3.2). Herewith, CAR on groups of large and medium banks can decrease up to 16.8 percent (Table 2.3.1). Three banks do not withstand shock scenario, the share thereof in the total volume of assets in the banking sector as of the end of the reporting period constituted 16.8 percent.

[24] Exclusive of troubled banks.

CONTENT

Graph 2.3.3. Impact of "Scenario 3" on capital adequacy ratio
percents



Implementation of "Scenario 3" can result in decrease of CAR by 8.0 p.p., up to 16.7 percent. Moreover, large and medium banks are the most vulnerable (Graph 2.3.3), which CAR can decrease up to 14.0 and 14.2 percent respectively (Table 2.3.1). Five banks do not withstand this shock, the share thereof in the total assets of the banking sector as of the end of the first half of 2013 constituted 44.1 percent.

Table 2.3.1. Results of stress testing on impact of macroeconomic shocks on CAR
percents

	Banking sector	Large banks	Medium banks	Small banks
Scenario 1 – GDP negative growth rate will constitute 5 percent	21.7	19.6	19.6	31.9
Scenario 2 – GDP negative growth rate will constitute 10 percent	19.1	16.8	16.8	30.2
Scenario 3 – GDP negative growth rate will constitute 10 percent and will be accompanied by decrease of the KGS exchange rate by 50 percent	16.7	14.0	14.2	28.9

2.3.2. Results of "Reverse" Stress Testing of Credit, Liquidity and Market Risks[25]

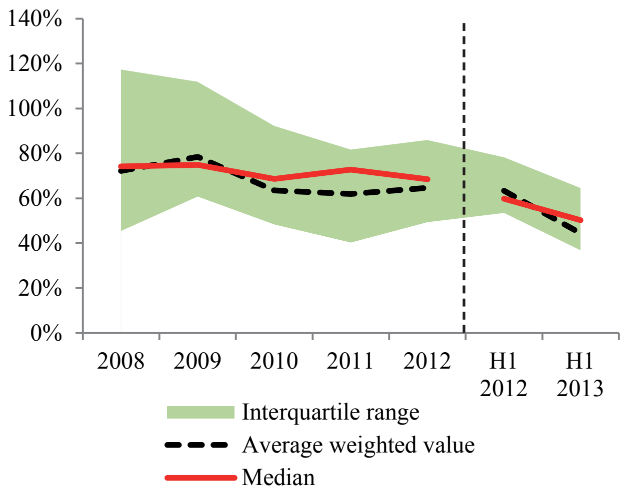
Method of "reverse" stress testing, which allows determining ultimate change of risk factor, resulting in decrease of the capital adequacy and liquidity to the minimum limits of the NBKR economic standards, was used for estimating safety margin available in the banking sector under the influence of credit, interest rate and currency risks.

The results of "reverse" stress testing show that the level of capital adequacy in the banks and the current liquidity reserves were still sufficient, thereby indicating significant sustainability of the banking sector.

[25] Exclusive of troubled banks.

"Reverse" Stress Testing of Liquidity Risk

Graph 2.3.4. Volume of deposits outflow, when K3 decreases up to 30 percent
in percents of the total volume of clients' deposits



The reserves of liquidity assets, capable of covering massive outflow of the population's and non-financial enterprises deposits without infringing the NBKR economic standard on current liquidity, was calculated for assessment of liquidity risk in the banking sector.

Shock is a maximum outflow of individuals and non-financial enterprises deposits, which can decrease the liquidity ratio up to the threshold level of 30 percent.

The results of stress testing indicate (Graph 2.3.4), that at the first half of 2013, the actual volume of liquid assets in the banking sector can cover approximately 44.4 percent of outflow of the total volume of population's and non-financial enterprises deposits (Table 2.3.2).

"Reverse" Stress Testing of Credit Risk

The "reverse" stress testing of credit risk was used to calculate the maximum permissible share of "unclassified" loans[26] in the loan portfolio, which can decrease CAR to the threshold level of 12 percent upon transition to the category of "unclassified" loans.

This method allows to determine the reserves of banks' buffer stock (net total capital), which can cover additional allocations to loss provisions, due to transition of "unclassified" loans to the category of "classified" loans[27].

Moreover, this method allows calculating maximum growth rate of classified loans, when capital adequacy (K2.1) will decrease to the threshold level of 12 percent.

At the end of the first half of 2013, the results of the "reverse" stress testing showed that the maximum permissible share of "unclassified" loans transiting to the category of "unclassified" loans in the banking sector constituted approximately 31.9 percent (Graph 2.3.5).

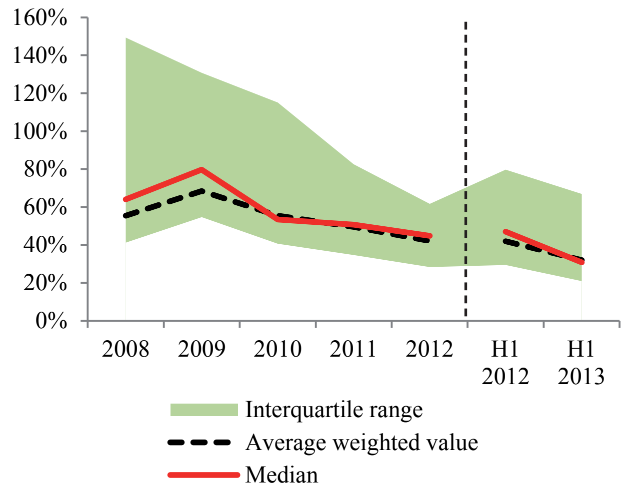
Thus, the banking sector can withstand significant deterioration of the loan portfolio quality in order to cover thereof it will be necessary to create additional loss provision approximately up to 51.4 percent of the net total capital (Graph 2.3.6).

CONTENT

[26] Exclusive of loans from "normal" categorye, which are classified as risk-free.
[27] Herewith, transition of "operating" loans to the category of "classified" loans is fulfilled smoothly by three categories ("substandard", "doubtful" and "losses").

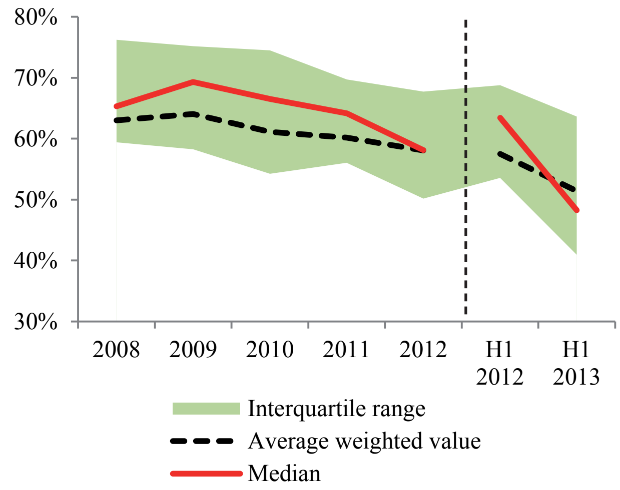
Graph 2.3.5. Maximum permissible share of "operating"[28] loans transiting to "classified" loans[29]

in percents of unclassified loans



Graph 2.3.6. Additional loss provisions, in creating thereof CAR decreases to 12 percent

in percents of NTC



There are two banks, the most exposed to the credit risk, for which transition of approximately 9.3 percent of loans to the category of "unclassified loans" can decrease CAR to the threshold level of 12 percent.

Market risk (interest rate and currency risks)

Generally, the results of "reverse" stress testing of the market risk indicate that in the first half of 2013, the banking sector is generally characterized by insignificant sensitivity to direct interest rate and currency risks.

Interest Risk

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

The results of stress testing indicate insignificant sensitivity of the banking sector to direct interest rate risk. Decline of the average level of interest rates on loans by 16.7 percentage points can decrease capital adequacy to the level of 12 percent (Table 2.3.2).

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

The results of stress testing show that upon decrease of interest rates on loans by 4.8 percentage points, net profit of the commercial banks decreases to the zero level (Table 2.3.2).

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

Currency risk (revaluation risk)

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

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

[28] Exclusive of "normal" loan category.
[29] When CAR decreases to the level of 12 percent.

Calculations of the stress testing indicate that the banking sector is characterized by low risk of assets and liabilities revaluation. So that the loss from balance revaluation could decrease capital adequacy to the threshold level, increase/decrease level of the USD/KGS exchange rate should be 978.1 percent, which confirms availability of low sensitivity to direct currency risk (Table 2.3.2).

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

The results of stress testing indicate that with increase/decrease of the USD/KGS exchange rate by 142.2 percent net profit of the commercial banks declines to the zero level (Table 2.3.2).

Table 2.3.2. General results of "reverse" stress tests: as of June 30, 2013

		Banking sector	Large banks	Medium banks	Small banks	Foreign banks	Domestic banks
Credit risk							
Shock 1	Share of unclassified loans transferring to the category of «classified» loans, *in percent*	31.9	25.5	27.9	70.2	37.0	27.7
Interest rate risk							
Shock 1	Decrease of interest rate on loans, when CAR declines to 12%, *in percentage points*	16.7	13.3	14.9	36.4	18.9	14.8
Shock 2	Decrease of interest rate on loans, when net profit declines to the zero level, *in percentage points.*	4.8	7.3	2.3	2.7	7.4	2.6
Currency risk							
Shock 1	Growth rate of USD/KGS (±) exchange rate, when CAR declines to 12%, *in percent*	978.1	1,249,7	659.5	1,309.0	1,809.7	643.7
Shock 2	Growth rate of USD/ KGS (±) exchange rate, when net profit declines to the zero level, *in percent*	142.2	335.1	52.8	51.7	349.4	58.8
Liquidity risk							
Shock 1	Outflow of clients' deposit share of the total deposits, when current liquidity ratio declines to 30%, *in percent*	44.4	41.9	41.6	61.0	41.9	47.7

2.3.3. Stress Testing of Credit Risk in the Banking Sector

Stress testing was conducted on the basis of econometric model characterizing dynamics of bad loans share in the loan portfolio and the factors affecting it.

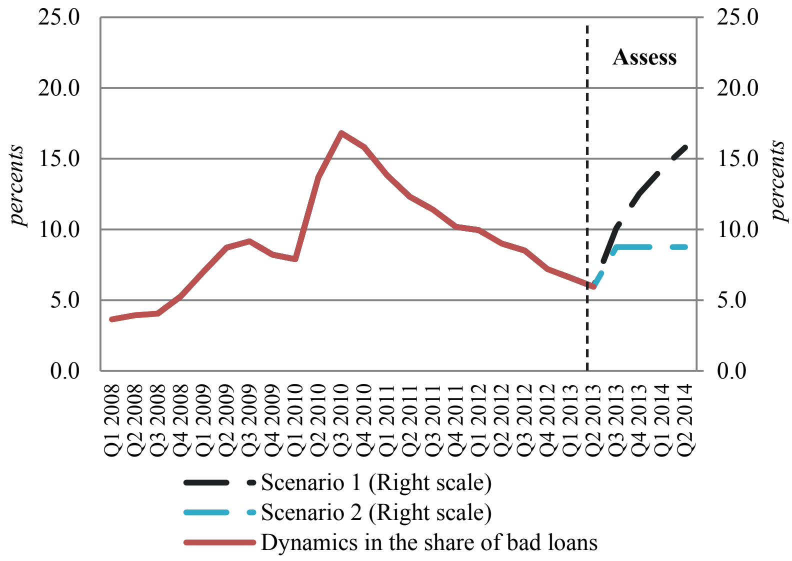
The following scenarios were analyzed in order to assess impact of the bank financial variables on dynamics of the bad loans share in the loan portfolio of the banking sector:

1) *Reduction of loans share in the assets by 10 percent, which is accompanied by growth of leverage (ratio of assets to net total capital) by 150 percent during the year.*

Increase in the share of bad loans in the loan portfolio by 9.9 percentage points, up to the level of 15.8 percent, can become the result of this stress scenario implementation.

CONTENT

Graph 2.3.7. Assessment of dynamics in the share of bad loans



2) Decrease of loans in the banking sector by 10 percent.

Increase in the share of bad loans by 2.8 percentage points, up to the level of 8.7 percent can become the result of this stress scenario implementation.

Table 2.3.3. Results of stress testing of credit risk in the banking sector
percents

	Share of bad loans in the loan portfolio
Scenario 1 – decrease of loans share in assets by 10 percent and growth of leverage by 150 percent	15.8
Scenario 2 – decrease of loans in the banks by 10 percent	8.7

CONTENT

III. NON-BANK FINANCIAL INSTITUTIONS

Generally, the NBFI system operates smoothly and sustainably. The share of bad loans in the non-banking sector remains rather low (3.4 percent of the total loan portfolio).

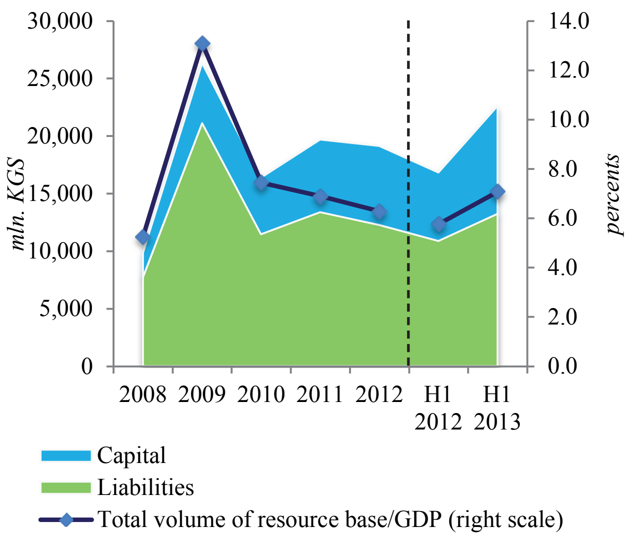
Institutional concentration remains high (67.2 percent of micro-financial market is attributed to the share of three largest NBFI).

The trend of gradual decrease in average weighted interest rate on loans continues as one of its reasons is reduction of the NBFI credit resources cost value.

As of June 30, 2013, the system of non-bank financial institutions in the Kyrgyz Republic subject to licensing and regulation by the NBKR included: specialized financial institution – "FCCU" OJSC; 153 credit unions; 278 microfinance institutions (including 4 microfinance companies, 2010 microcredit companies and 64 microcredit agencies) and 334 foreign exchange bureaus.

Resources

Graph 3.1. Dynamics of NBFIs liabilities and capital

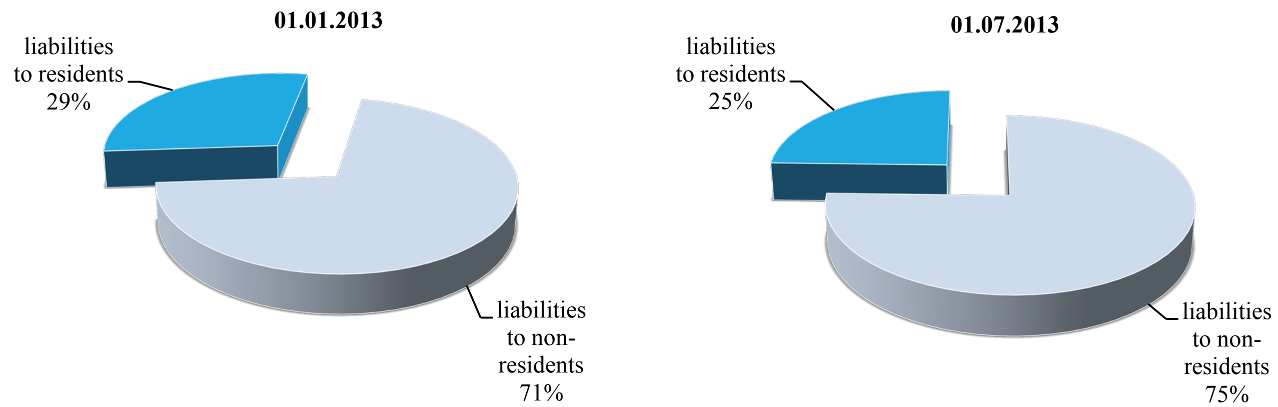


Source: NBKR
Note: starting from the end of 2012 data are submitted exclusive of BTiP

At the end of the first half of 2013, NBFIs liabilities increased by 23.0 percent compared to the same period of the last year and formed in the amount of KGS 13 391.2 million. In the reporting period, the NBFIs capital increased by 55.5 percent compared to the first half of 2012 and amounted to KGS 9 239.7 million (Graph 3.1). Growth of resource base is primarily conditioned by increase of the NBFI authorized capital and total reserves, as well as external financing of the non-banking sector.

The main volume of the NBFIs resource base is still attributed to the loans received from non-residents (Graph 3.2).

Graph 3.2. Structure of NBFIs liabilities

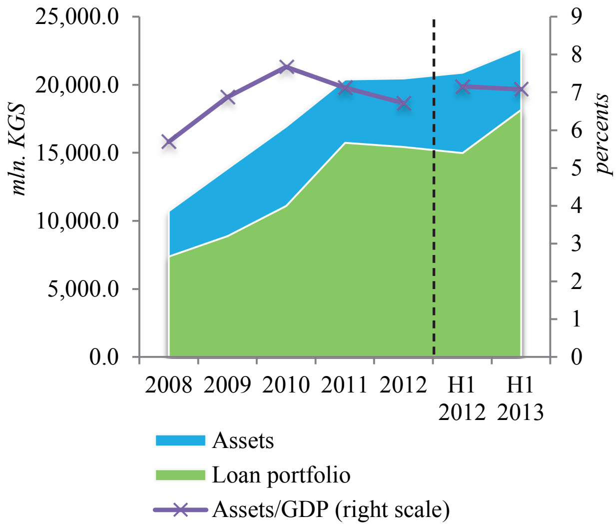


Source: NBKR

CONTENT

Assets

Graph 3.3. Dynamics of NBFIs assets and loans



Source: NBKR
Note: starting from the end of 2012 data are submitted exclusive of BTiP

According to the periodic regulatory reporting, total assets of NBFIs[30] increased in the reporting period by 8.5 percent compared to the first half of 2012 and amounted to KGS 22 630.8 million. This growth was conditioned by increase of NBFIs loan portfolio (Graph 3.3).

Lending is the main sphere of NBFIs activity. According to the results of the reporting period, growth of NBFIs loan portfolio constituted 21.1 percent and formed in the amount of KGS 18 144.1 million (Graph 3.3).

As of the end of the first half of 2013, the number of borrowers constituted 460 787 people (decrease by 3.9 percent compared to the same period of 2012).

CONTENT

Table 3.1. Structure of NBFIs assets

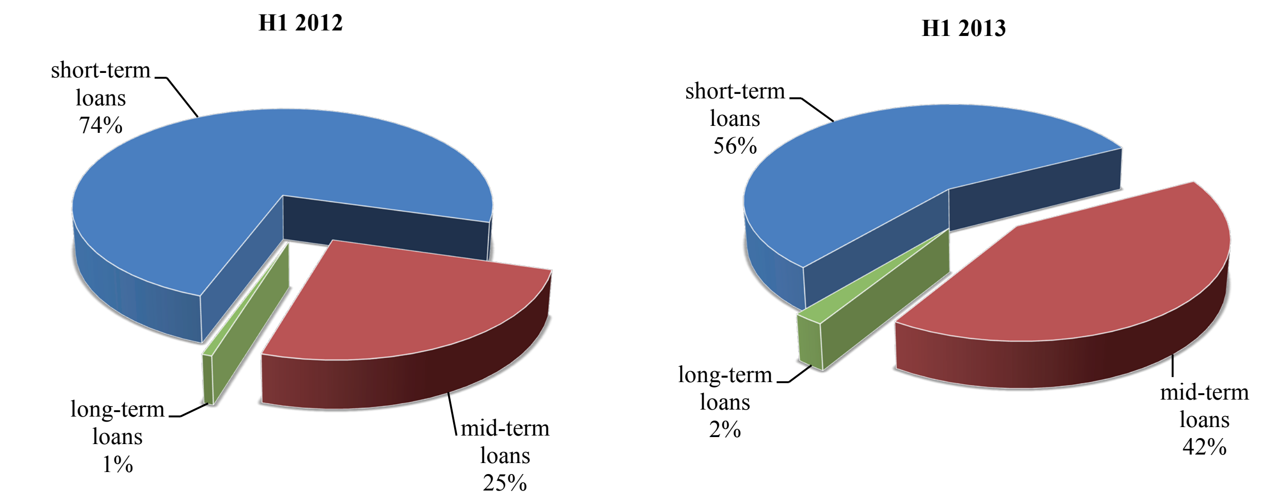
	2011		2012		H1 2012		H1 2013	
	mln. KGS	*share, %*	*mln. KGS*	*share, %*	*mln. KGS*	*share, %*	*mln. KGS*	*share, %*
a. Financial assets, including:	18,231.9	89.5	19,597.8	95.9	19,607.1	94.0	20,554.5	90.8
credits and loans*	*15,730.4*	*86.3*	*15,405.5*	*78.6*	*12,036.4*	*61.4*	*17,724.5*	*86.2*
correspondent accounts of commercial banks	*1,383.1*	*7.6*	*2,265.1*	*11.6*	*18.5*	*0.1*	*149.9*	*0.7*
deposits in commercial banks	*789.1*	*4.3*	*1,131.1*	*5.8*	*2,963.2*	*15.1*	*2,357.9*	*11.5*
other financial assets	*329.3*	*1.8*	*796.1*	*4.1*	*4,589.0*	*23.4*	*322.2*	*1.6*
b. Non-financial assets, including:	2,136.8	10.5	842.6	4.1	1,255.4	6.0	2,076.3	9.2
fixed capital	*832.5*	*39.0*	*744.9*	*88.4*	*656.3*	*52.3*	*672.4*	*32.4*
other non-financial assets	*1,304.3*	*61.0*	*97.7*	*11.6*	*599.1*	*47.7*	*1,403.9*	*67.6*
Total assets	**20,368.7**	**100.0**	**20,440.4**	**100.0**	**20862.5**	**100.0**	**22630.8**	**100.0**

Source: NBKR
** exclusive of loss provisions*

Loans provided by NBFIs are still short-term. Herewith, decrease in the share of short-term loans at the end of the first half of 2013 was observed on the background of increase in the share of mid-term loans (Graph 3.4).

[30] Hereinafter, in order to avoid double counting, data on the NBFIs system are given excluding “FCCU” OJSC, as loans are provided by credit unions, which re-credited thereof.

Graph 3.4. Structure of MBFIs loan portfolio by maturity



Source: NBKR

The Osh, Jalal-Abad and Chui regions, as well as the city of Bishkek are the main regions, where the bulk of the NBFIs loan portfolio is concentrated (65.4 percent of the total loan portfolio) (Table 3.2).

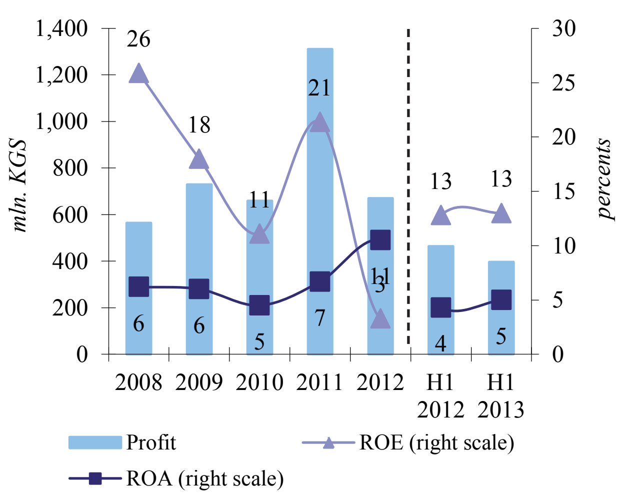
Table 3.2. Geographic structure of NBFIs loan portfolio

	H1 2012		H1 2013	
	mln. KGS	*share, %*	*mln. KGS*	*share, %*
Bishkek city and Chui region	4,684.8	31.3	5,974.3	32.9
Jalal-Abad region	2,326.8	15.5	2,714.3	15.0
Osh region	2,633.2	17.6	3,172.7	17.5
Batken region	1,287.9	8.6	1,731.5	9.5
Issyk-Kul region	1,415.8	9.5	1,797.5	9.9
Naryn region	1,099.0	7.3	1,180.3	6.5
Talas region	1,020.0	6.8	1,398.3	7.7
beyond KR boundaries	513.2	3.4	175.2	1.0
Total	**14,980.7**	**100.0**	**18,144.1**	**100.0**

Source: NBKR

Profitability

Graph 3.5. Dynamics of NBFIs profitability indices*



Source: NBKR
** Exclusive of FCCU*

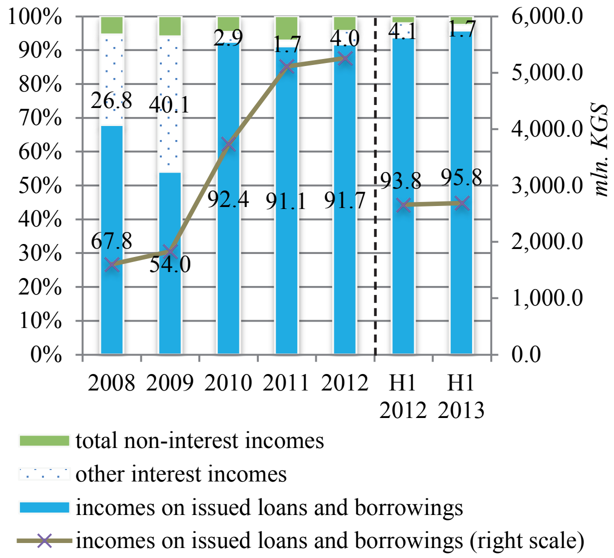
At the end of the first half of 2013, the NBFIs total profit decreased by 14.5 percent compared to the same period of 2012 and amounted to KGS 396.3 million (Graph 3.5). Changes of the ROA and ROE coefficients are insignificant at the end of the reporting period.

Incomes on provided credits and loans, which amounted to KGS 2 688.2 million, remain the most significant item in formation of NBFIs incomes (Graph 3.6).

Increase in the expenses for staff and expenses on received credits and loans was observed in the structure of NBFIs expenditures (Graph 3.7).

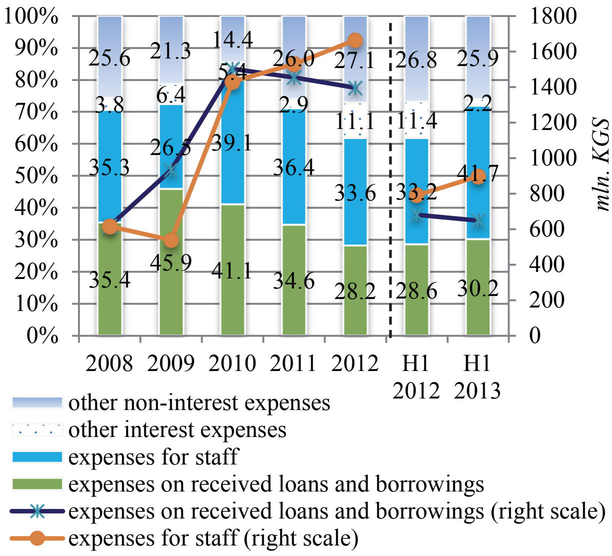
CONTENT

Graph 3.6. Structure of NBFIs expenditures



Source: NBKR

Graph 3.7. Structure of NBFIs expenses



Source: NBKR

Main Risks

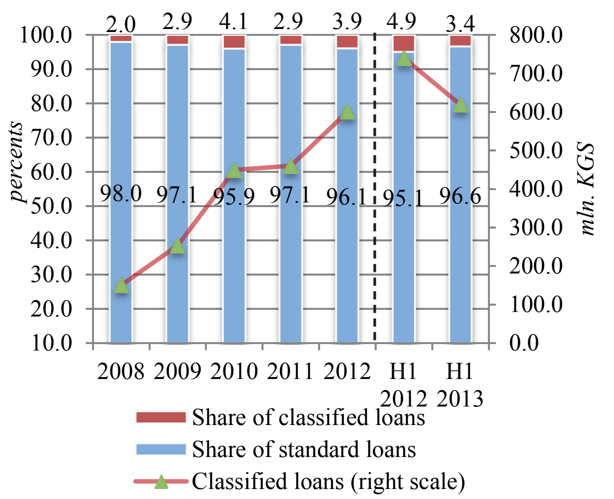
The quality of loan portfolio, sectoral and institutional concentration, and the status of the NBFIs external debt are the main risk factors for coherent operation of NBFIs.

Quality of NBFIs Loan Portfolio

Within the period under review, slight improvement of loan portfolio quality was observed amid increase of loan portfolio and decrease of bad loans nominal volume (decrease by KGS 121.4 million or 16.4 percent, Graph 3.8).

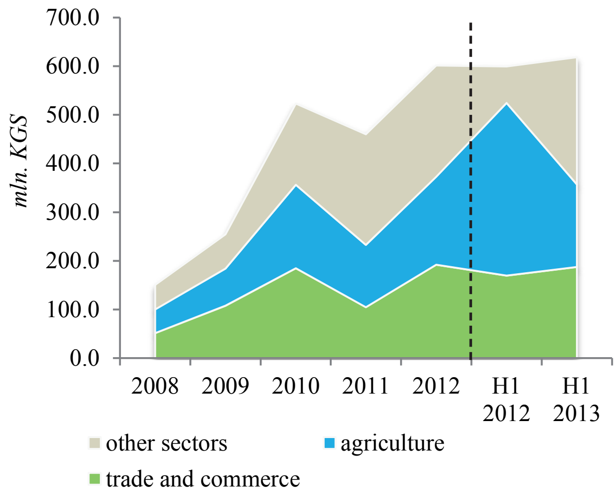
At the end of the first half of 2013, the share of non-performing agricultural loans reduced in the structure of NBFIs classified loans (by 52.1 percent compare to the same period of 2012), and the share of non-performing trade loans increased (by 10.3 percent) in the total volume of NBFIs classified loans (Graph 3.9).

Graph 3.8. Quality of NBFIs loan portfolio



Source: NBKR

Graph 3.9. Structure of NBFIs classified loans by sectors of economy



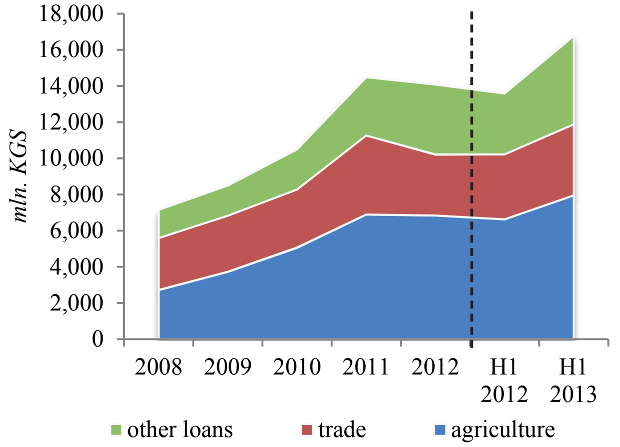
Source: NBKR

CONTENT

Sectoral Concentration

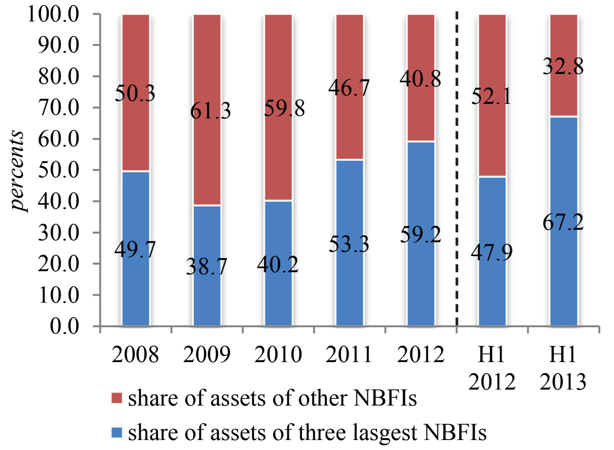
NBFIs loan portfolio is still concentrated in the agricultural sector (43.8 percent of the total volume of NBFIs loans) and trade (23.9 percent of the total volume of loan portfolio, Graph 3.10). Lending to the agricultural sector is connected with high risks due to dependence on environmental conditions and relatively low incomes of the population living in the remote regions of the republic.

Graph 3.10. Sectoral structure of the NBFIs loan portfolio



Source: NBKR
Note: Data as of the end of the period

Graph 3.11. Institutional structure of NBFIs loans



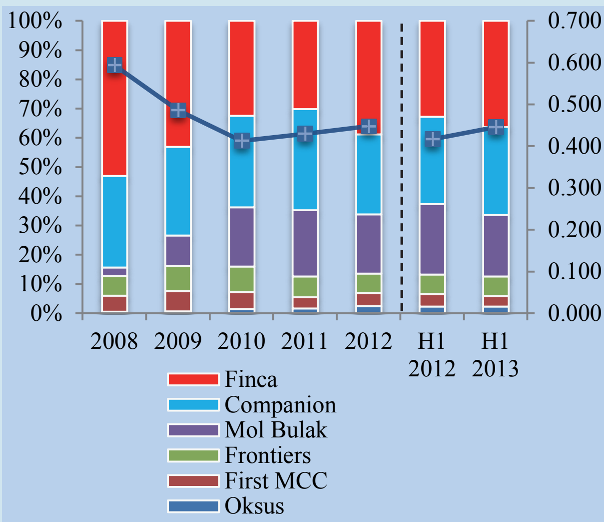
Source: NBKR

Institutional Concentration

At the end of the first half of 2013, the share of assets in three largest NBFIs constituted 67.2 percent of the total volume of assets in the NBFIs system (Graph 3.11).

Box 6. Assessment of NBFIs System Activity on the Basis of Concentration Indices[31]

Graph 3.12. Dynamics of the Gini index and assets of 6 largest NBFIs



Source: NBKR

– ***The Herfindahl-Hirschman Index***

Herfindahl-Hirschman index[32] was calculated for the purposes of concentration risk analysis in the NBFIs system. At the end of the first half of 2013, Herfindahl-Hirschman index for the NBFIs system constituted 2 738.2 points. According to the rule of thumb[33], resulting value indicates availability of significant concentration of NBFIs assets or high concentration of microfinance market. Thus, microfinance market of the Kyrgyz Republic is characterized by oligopolistic nature.

– ***The Gini Index***

The Gini index was calculated for estimating the uniformity of NBFIs assets distribution among microfinance organizations. At the end of the first

[31] Concentration indices are calculated on the basis of data submitted by 6 largest NBFIs.

[32] $H = \sum_{i=1}^{n}(\text{share}i)$ ^2

[33] The following rule of thumb was used for determining the level of market concentration:
- index value is below 0.1 (or 1,000) – insignificant market concentration,
- index value is from 0.1 to 0.18 (or from 1,000 to 1,800) – average market concentration,
- index value is above 0.18 (or 1,800) – high market concentration.

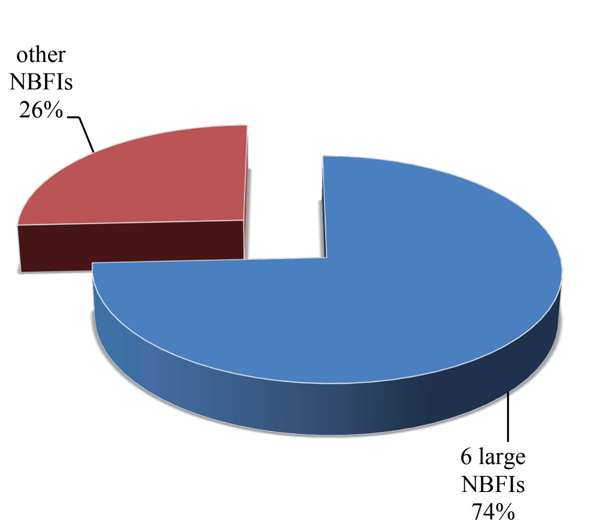
CONTENT

half of 2013, the value of index amounted to 0.446, indicating moderate distribution of assets among the largest microfinance institutions. Herewith, increase of concentration level (by 0.029 points) was observed compared to the first half of 2012 (Graph 3.12).

Status of NBFIs External Debt

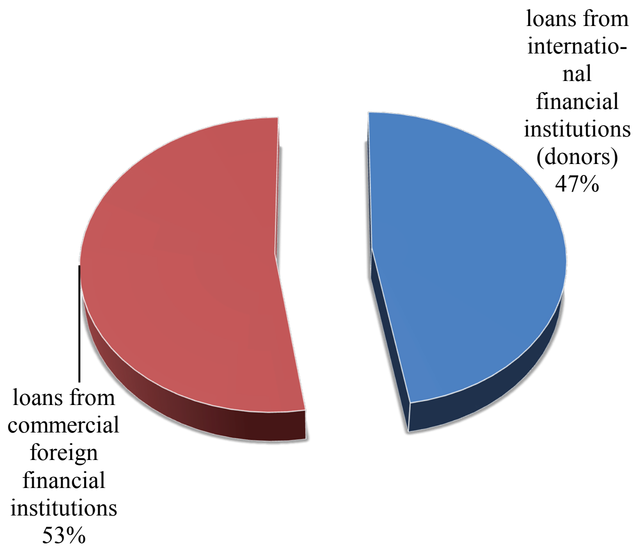
As of the end of the first half of 2013, the volume of NBFIs external debt amounted to KGS 10 097.9 million. Six largest NBFIs, established and funded by international financial institutions have significant share in the institutional structure of NBFIs external debt (Graph 3.13). More than half of the NBFIs external debt (Graph 3.14) is attributed to the loans provided by commercial foreign financial institutions (53 percent of the total amount of NBFIs external debt), the balance – to the loans provided by international financial institutions (47 percent of the total volume of NBFIs external debt), its purpose is to develop private sector on a long-term basis.

Graph 3.13. Institutional structure of NBFIs external debt



Source: NBKR

Graph 3.14. Structure of NBFIs external debt



Source: NBKR

According to the data submitted by six largest NBFIs, peak of payments for servicing the external debt is accounted for 2014 (Table 3.3).

Table 3.3. Forecast of servicing and the volume of NBFIs external debt
(mln. USD)

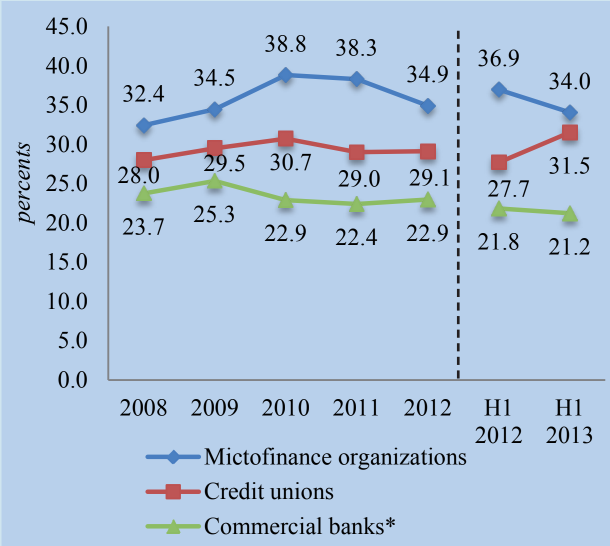
	2013	2014	2015	2016	2017	2018
External debt servicing (major amount and interest)	47.7	86.4	79.1	33.3	21.4	23.2
Volume as of the end of the period	156.2	132.6	162.6	102.1	38.0	41.0

Source: NBKR
Note: Data on 6 largest NBFIs

CONTENT

Box 7. Overview of Interest Rates, Cost Value and Profitability of the NBFIs Loans

Graph 3.15. Dynamics of average weighted interest rates on NBFIs loans

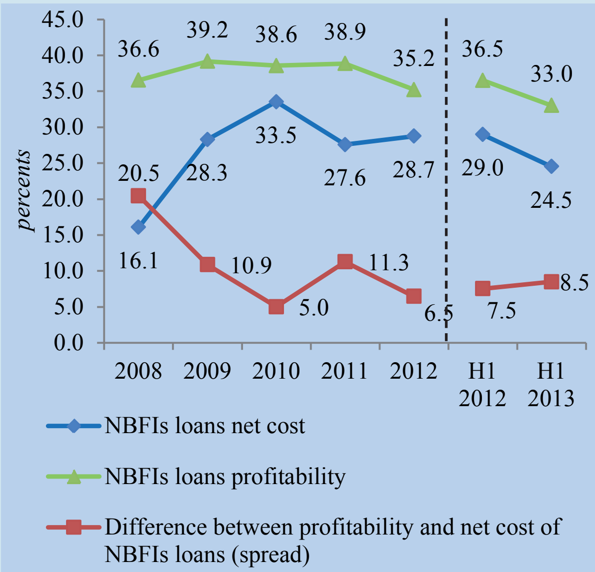


Source: NBKR
**interest rates of CB in national currency*

Interest rates on NBFIs loans remain the highest in the domestic capital market. However, downward trend of interest rates on NBFIs loans was observed in the reporting period. In the period under review, the average weighted interest rates decreased by 2.9 p.p. compared to the first half of 2012 (Graph 3.15).

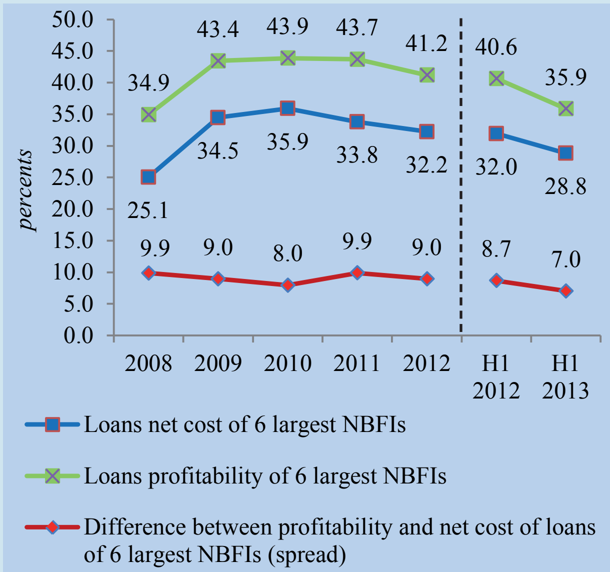
Since 2010, net cost[34] of NBFIs credit resources decreased significantly from 33.5 percent to 24.5 percent, which was conditioned by decrease of loans net cost in six largest NBFIs (Graph 3.16 and Graph 3.17). Herewith, net cost of loans in six largest NBFIs exceeded average net cost of loans in the NBFIs system as a whole.

Graph 3.16. Dynamics of net cost and profitability of NBFIs credit resources



Source: NBKR

Graph 3.17. Dynamics of net cost and profitability of credit recources of 6 largest NBFIs



Source: NBKR

Growth rates of annual average loan portfolio exceeding growth rates of gross expenses were the main reason for decrease of loans net cost in six largest NBFIs.

Growth rates of annual average loan portfolio exceeding growth rates of interest incomes in the reporting period affected decrease of NBFIs loan profitability[35].

[34] Loans net cost or breakeven point = (Gross expenditures – Non-credit incomes) / Annual average loan portfolio.
[35] Loan profitability is calculated as a ratio of interest incomes to loan portfolio.

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IV. PAYMENT SYSTEMS

During the reporting period, the complex of measures aimed at minimizing the financial and operational risks in the important payment systems, establishment of clear rules of access to the systems by the participants, ensuring continuity of the system operation through control of the payment infrastructure operation, allowed minimizing the impact of risks of payment systems on the stability of the financial sector.

Current rather low levels of financial risks of the systemically important payment systems was due to the sufficient level of liquidity of the participants, as well as relatively low level of operational risks.

As of the end of the first half of 2013, the following components of payment system functioned in the Kyrgyz Republic:

1. Interbank Payment System of the National Bank – the Gross Settlement System in Real Time (GSSRT);
2. Clearing Payments System – the System of Batch Clearing of Small Retail and Regular Payments (SBC);
3. Systems of Payment Cards Settlement;
4. Money Transfer Systems.

In order to minimize the risks of negative impact of emergencies in the systemically important payment systems on the individual participants and the financial system as a whole, the National Bank has identified the basic requirements for the payment system operation and personnel work in emergency situations (power supply, hardware or software malfunctions, failures of system communication channels, violation of the rules of system operation, unauthorized access to the system, etc.)

Moreover, the current rules of payment systems operation allow minimizing the negative impact on continuity of the payment system operation, bankruptcy or financial problems of one of the participants. If one of the participants has problems with the system, operators of payment systems conducted transactions in accordance with the law of the Kyrgyz Republic “On conservation, liquidation and bankruptcy of the banks”, the requirements of the regulations “On the procedure for banking and payment transactions by the banks of the Kyrgyz Republic in carrying out preservation and bankruptcy procedures”, as well as rules, internal procedures and agreements between the parties and operators.

This complex of measures contributed to provision of normal operation mode of the systematically important payment systems of Kyrgyzstan in the first half of 2013.

The level of financial risks in the GSSRT remained low due to remaining high index of liquid funds with regard to turnovers in the system. At the end of the first half of 2013, the liquidity ratio[36] in the GSSRT increased by 4.3 percent compared to the same period of 2012 and was 4.4, thereby resulting in increase of the current liquidity volume possessed by the participants by 24.1 percent.

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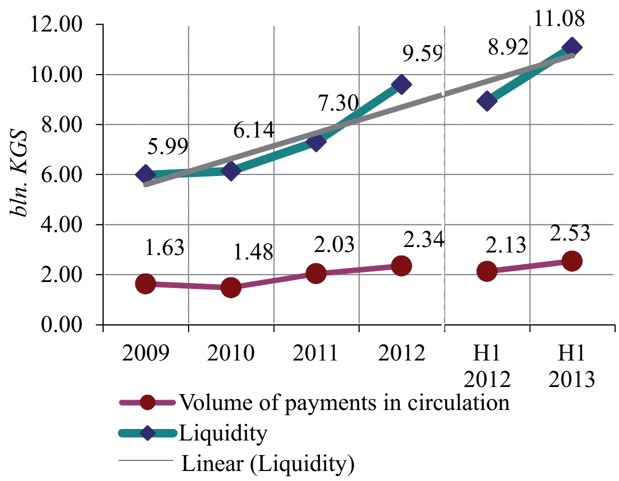
[36] Liquidity ratio characterizes sufficiency of liquid funds on the accounts of system participants for making payments and settlements.

Graph 4.1. Dynamics of average daily indicator of payment volumes and liquidity in the GSSRT



Source: NBKR calculations

Payments in queue and outstanding payments for insufficiency of participants' funds[37] are the indicators of possible financial risks in the GSSRT system. 160 payments in queue were registered in the first half of 2013 (Table 4.1.). Average downtime of payment in queue within the GSSRT system was 49 minutes.

Registered payments in queue did not pose any financial risks for other participants, as they were connected with time gaps between crediting the amounts to the correspondent account of a participant and forwarding of payment to the system.

Table 4.1. Aggregate data on payments in the GSSRT

Name	2009	2010	2011	2012	H1 2012	H1 2013	Growth (%)	Increase
Payments in queue:								
- Quantity	46	40	204	215	116	160	37.9	44.0
- Total time *(minutes)*	1,987	1,312	6,904	11,469	6,734	7,803	15.9	1,069.0
Outstanding payments for lack of liquidity:								
- Quantity	2	3	8	4	3	4	33.3	1.0
- Volume *(mln. KGS)*	185.4	22.0	32.3	1.3	1.3	9.5	-	8.2

Source: NBKR calculations

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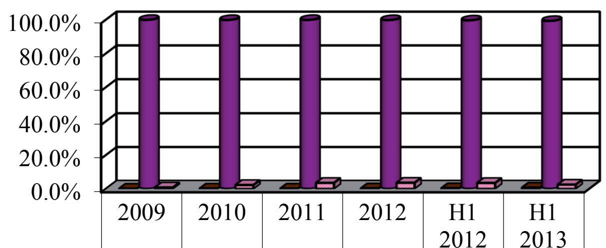
Graph 4.2. Ratio of affordability and operational risk in the GSSRT



	2009	2010	2011	2012	H1 2012	H1 2013
Technical failure	0.10%	0.17%	0.13%	0.22%	0.40%	0.72%
Affordability ratio	99.90%	99.83%	99.87%	99.78%	99.60%	99.28%
Level of operational risk	0.83%	2.30%	3.57%	3.63%	3.51%	2.52%

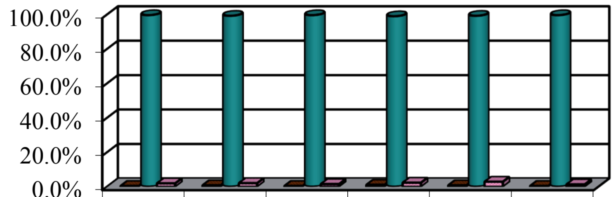
Source: NBKR calculations

Taking into account extension of the trading day, as a risk factor, and registered technical failure, the average value of affordability ratio[38] in the GSSRT constituted 99.28 percent in the reporting period. The level of operational risk constituted 2.52 percent, having increased by 0.99 percent compared to the same index of the last year.

In SBC, the participants allocated more funds for the final settlements than was actually needed, which provided high level of liquidity by the participants of the system. In the first half of 2013, reserves of the participants for the provision of net debit position 2.6 times exceeded the required level.

[37] Such situation occurs in case of the participants' insufficient funds in the correspondent account opened in the National Bank.
[38] Affordability ratio is an indicator, characterizing system affordability as a possibility of access to available services and information for system users upon their request. System shutdown due to technical failures, power outages, late opening or early closure of the system trading day reduce the time of access to the system.

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



	2009	2010	2011	2012	H1 2012	H1 2013
Technical failure	0.39%	0.76%	0.40%	1.03%	0.76%	0.40%
Affordability ratio	99.61%	99.24%	99.60%	98.97%	99.24%	99.60%
Level of operational risk	1.94%	2.05%	1.49%	2.30%	2.85%	1.31%

Source: NBKR calculations

In the first half of 2013, the affordability ratio in SBC remained high and constituted 99.60 percent. The level of operational risk in the system decreased and constituted 1.31 percent.

In the SWIFT multi-user point (MUP SWIFT), the level of system affordability in the reporting period remained high and constituted 98.37 percent, which was conditioned by scheduled preventive maintenance and failures in MUP SWIFT operation. The National Bank, as an operator of MUP SWIFT, informed banks-participants about the problem beforehand for minimization of financial risks, so that the banks could use alternative communication channels for sending emergency messages. The level of operational risks in MUP SWIFT remained low (0.18 percent).

The level of Elcat system affordability in the first half of 2013 constituted 99.05 percent, operational risk – 0.95 percent.

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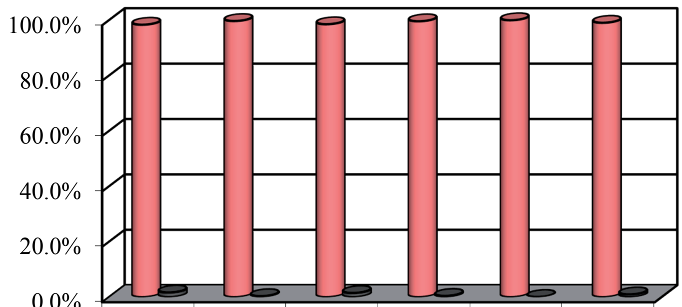
Graph 4.4. Ratio of affordability index and operational risk in the Unified Interbank Processing



	2009	2010	2011	2012	H1 2012	H1 2013
Affordability ratio	98.35%	99.68%	98.52%	99.58%	99.97%	99.05%
Operational risk	1.65%	0.32%	1.48%	0.42%	0.03%	0.95%

Source: NBKR calculations

The penetration level of bank payment cards remained rather low, despite positive upward trend in the number of issued payment cards. The total number of issued payment cards as of the end of the first half of 2013 constituted 541.8 thousand, having increased by 74.8 percent compared to the same period of 2012.

Low level of the population's financial literacy, insufficient stimulation and provision of information to the population about offered services and banking products with use of payment cards, as well as insufficient provision with peripheral devices in the regions are the reasons for low level of payment cards penetration.

Within the framework of implementation of the State program on increase of non-cash payments and settlements in the Kyrgyz Republic during 2012-2017 (joint resolution of the Government of the Kyrgyz Republic and the NBKR №289/5/1 dated 14.05.2012), the commercial banks conduct operations on expansion of infrastructure for servicing bank payment cards in the regions. Total number of operating terminals and ATMs as of the end of the first half of 2013 constituted 715 ATMs and 2 751 terminals, having increased by 24.6 percent and 24.0 percent respectively compared to the same period of 2012.

V. IMPROVEMENT OF THE CONTROL OVER THE FINANCIAL SECTOR

The National Bank took measures on improvement of regulatory and legal base governing the activity of the banks and non-bank financial institutions supervised by the National Bank, to enhance the effectiveness of the banking supervision system, develop the banking system and microfinance sector of the Kyrgyz Republic, as well as to bring regulations in compliance with amendments introduced in the banking legislation and international standards.

Licensing of the Banks Operation

During the reporting period, the National Bank adopted amendments and additions to the Regulation "On licensing of bank's operation" to provide efficiency of operations on banks licensing. Introduced amendments and additions referred to the procedure of funds flowing from the foreign banks to the Kyrgyz Republic for the purposes of formation or increasing the authorized capital of the resident banks, as well as to the agreement procedure in respect of the banks' office holders, acquisition and disposal of the banks' shares, optimization of information related to branches and savings funds of the commercial banks for its publication on the official website of the National Bank.

Moreover, microfinance and microcredit companies (MFC/MCC) were given a simultaneous opportunity to receive (issue) banking licenses, as well as to obtain a permit of the National Bank for re-registration of existing affiliates of MFC/MCC into bank branches for continuous operation of MFC/MCC transformed into commercial bank.

Intensification of Transparency and Safety of Banks

The National Bank approved a number of regulatory documents aimed at intensification of transparency and security of banking activities. Thus, the amendments to the Instruction "On requirements to the operations of banks with insiders and affiliated entities" were approved, they were primarily focused on establishing requirements to the operations on providing inside employees of the bank with loans for purchase or construction of housing. Established were the requirements to conditions for provision of loans to inside employees regarding the decision made by the Board of Directors on providing loans to insiders and affiliated entities of the bank, taking into account the opinion of the bank's risk manager on the risk associated with conducting aforementioned operation, the requirement to the banks in case inside employees of the bank violate lending terms, minimum requirements to the contents of the internal document on loans provided to the bank's employees.

Changes and amendments to the Regulation "On minimum requirements for the external audit of the banks and other financial institutions licensed by the National Bank of the Kyrgyz Republic" were adopted to reduce bank risks, increase transparency and security of the banks and microfinance companies, attracting deposits, as well as to improve control.

Protection of Financial Services Consumers

Regulation "On minimum requirements for credit risk management for microfinance institutions, not attracting deposits" was approved in order to protect the rights/interests of MFO clients, improve financial/legal literacy of MFO clients and transparency of MFO operation, as well as reduce high debt ratio of borrowers.

Within the framework of antitrust regulation improvement and protection of financial services consumers, the National Bank approved amendments introduced to the policy and basic principles of antitrust regulation, development of competition and protection of consumer right in the market of banking services in the Kyrgyz Republic rendered by the commercial banks and other financial institutions, licensed and regulated by the National Bank. Moreover, the Regulation "On minimum requirements to the pricing policy of the banking services and services rendered by microfinance organizations" was approved.

Enforcement Measures

Amendments and additions to some legal acts of the National Bank of the Kyrgyz Republic regarding the issues on taking enforcement measures in respect of the banks, microfinance institutions and credit unions were approved within the framework of improvement of regulatory and legal acts of the National Bank on the issues of enforcement measures use, as well as for the purpose of bringing them in conformity with the Code on Administrative Responsibility.

Risk Management

Amendments and additions introduced into the Regulation "On the Periodic Regulatory Bank Report", according to which the Periodic Regulatory Bank Report is supplemented by section 37, were approved by the National Bank in order to reduce the risks associated with lending activity of the commercial banks. Under this section, the commercial banks will submit data on loans provided to the borrowers to the National Bank. The National Bank will use this information for supervisory purposes, including for identifying high debt ratio of the banks' borrowers.

Preventing Operations on Anti Terrorist Financing and Money Laundering

Appropriate amendments and additions introduced to the relevant regulatory and legal acts of the National Bank were approved in order to establish the requirements for internal control on the ATF/ML issues in the microfinance companies, as well as for bringing in conformity with the legislation of the Kyrgyz Republic on the ATF/ML issues.

Regulation of Non-Bank Financial Institutions

Within the framework of improvement of regulatory and legal acts of the National Bank, amendments were introduced into the provisional rules for regulation of microfinance companies operation in the territory of the Kyrgyz Republic, providing for the requirements to the microfinance companies, attracting deposits, on conducting transactions with insiders and affiliated entities in accordance with the Instruction "On requirements to operations of the microfinance companies, attracting deposits, with insiders and affiliated entities", as well as to the maximum risk level on transactions with insiders and affiliated entities.

Due to the change of the procedure of the periodic regulatory report submission by the microfinance organizations and credit unions to the National Bank, amendments and additions were introduced to some legislative acts of the National Bank, relating to periodic regulatory reporting.

For stable and sustainable operation of the microfinance institutions and supporting their capital base at an appropriate level in order to cover credit risks, enhance the reliability and provide safety of the microfinance system in general, as well as to enhance public confidence in financial institutions, taking into account the rate of assets growth of the microfinance and microcredit companies, amendments were introduced into the Regulation "On establishment of microcredit companies and microcredit agencies", and into the provisional rules on regulation of microfinance companies operation in the territory of the Kyrgyz Republic, regarding increase in the amount of MFO microcredit, in case of complying with established rules and conditions (no more than 10 percent of the authorized capital), but not more than KGS 3 000 000 (three million) (or the equivalent in foreign currency).

Islamic Principles of Financing

A number of regulatory and legal acts were adopted for the purposes of complying with the Law "On amendments introduced in the Laws "On the National Bank of the Kyrgyz Republic" and "On amendments introduced in the law of the Kyrgyz Republic "On banks and banking activities in the Kyrgyz

Republic" approved for providing equal conditions for all participants of the banking sector, as well as creating conditions for promotion of Islamic banking in the Kyrgyz Republic. Approved documents refer to the issues of reducing banking risks, when the banks and microfinance companies, attracting deposits, conduct operations according the Islamic principles of banking and financing.

The System of Deposit Protection

In the first quarter of 2013, amendments and additions were introduced in the Methodological instructions on keeping a database with the bank's liabilities to a borrower, for the purpose of improvement of maintaining the database of the commercial bank for record keeping on deposits of individuals subjected to compensation in compliance with the Law of the Kyrgyz Republic "On protection of bank deposits".

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Financial Soundness Indicators of the Kyrgyz Republic[39]

(in percent)

	2010	2011	2012	H1 2013
Banking sector				
Indicators of the capital adequacy				
Regulatory capital to assets, weighted by risk	31.0	30.3	28.3	24.6
Tier I capital to assets, weighted by risk	26.5	24.6	22.3	21.4
Equity to total assets	21.7	21.6	19.7	18.2
Ratio of classified loans to equity	33.1	21.9	16.8	16.0
Equity to total liabilities	27.7	27.6	24.4	22.2
Quality of assets				
Ratio of classified loans to loan portfolio	15.8	10.2	7.2	5.9
Loan loss provisions to loan portfolio	10.7	6.3	4.7	3.7
Loan loss provisions to classified loans	67.7	61.6	64.9	62.9
Ratio of currency loans to loan portfolio	55.7	55.2	53.7	51.2
Returns indicators				
ROA	1.1	3.0	3.0	2.5
ROE	7.1	17.7	18.5	15.2
Interest margin to total income	48.9	45.0	44.7	43.7
Spread between reference rate on deposits and loans	8.2	9.4	8.0	8.1
Liquidity indicators				
Ratio of high liquid assets to total assets	36.1	35.0	36.8	33.9
Ratio of high liquid assets to short-term liabilities	72.8	74.9	80.0	68.4
Sensitivity to market risk				
Ratio of net foreign exchange position to equity	-10.3	4.1	2.4	-4.0
Other financial corporations**				
Ratio of assets to total assets of the financial system	22.3	23.0	18.8	18.9
Ratio of assets to GDP	7.7	7.1	6.7	7.1
Corporate sector (medium- and large-sized enterprises)				
Return on assets (ROA)	2.9	5.9	6.7	n/a
Return on equity (ROE)	6.2	12.7	16.3	n/a
Ratio of total liabilities to equity (leverage)***	2.2	2.1	2.1	n/a
Current liquidity ratio	1.3	1.4	1.4	n/a
Households sector				
Ratio of the households' debt to GDP	8.4	8.5	9.1	n/a
Ratio of households' debt to disposable income	11.9	13.2	13.4	n/a

Source: NBKR, NSC KR, calculations: NBKR
** - classified loans are non-performing loans*
*** - other financial corporations are presented by NBFIs*
**** - equity of the corporate sector is represented exclusive of shares*

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[39] Indicators of financial sustainability are calculated according to the methodology of the IMF ("Instruction on identification of financial soundness indicators", IMF, 2007).

Glossary and Abbreviations

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

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

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

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

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

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

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

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

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

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

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

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

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

Disposable income is income that goes to private consumption and is free from tax. Personal

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disposable income is the difference between personal income and the amount of taxes or, appropriately, is the sum of consumption and the amount of savings.

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

A *securities market* is organized exchanges and structures such as securities depository companies, accounting and clearing houses, as well as other companies that provide services related to the activities of the exchange. This category includes depositories and electronic clearing systems, the activity of which is ensured by financial corporations, and national self-regulatory organizations of oversight over the activities of stock exchanges and related institutional units or their regulation.

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

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

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

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