

National Bank of the Kyrgyz Republic

Inflation Report

2 (4)

August 2002

Bishkek

Inflation Report

Editorial Board:

Chairman: Abdumanapov E.
Board members: Tsiplakova L.
Abdybaly tegin S.
Isakova G.
Chokoev Z.

Editorial Assistant: Bushman Yu.

On the issues related to the contents of the publication, please, contact:

Bishkek, Umetaliev st., 101.
The National Bank of the Kyrgyz Republic
Economic Department
phone: (996 312) 669 059
fax: (996 312) 610 730
e-mail: ybushman@nbkr.kg

On the issues of dissemination of the publication, please, contact:

Bishkek, Umetaliev str, 101
The National Bank of the Kyrgyz Republic
External and Public Relation Division
phone: (996 312) 669 009
fax: (996 312) 610 730
e-mail: ybushman@nbkr.kg
<http://www.nbkr.kg>

The purpose of the publication “Inflation Report” is informing of broad public about the goals and results of the monetary policy. The publication contains the description of inflation developments by its components, by regions, and as a whole, the analysis of inflation factors and inflation forecast for the forthcoming quarter. The review is published quarterly in the Kyrgyz, Russian and English languages.

The last date of updating of the data in the given publication: July 31 of 2002.

Founder: The National Bank of the Kyrgyz Republic.

The publication is registered with the Ministry of Justice of the Kyrgyz Republic registration certificate of the mass media №628 as of 02.11.2001.

Prepared for publication and printed by the printing center of the magazine “Banking Gazette”.

720040, Bishkek, Bokonbaev Str., 182, rooms 16, 17

Phone: (996 312) 218 373

(996 312) 219 842

Fax: (996 312) 218 373

Circulation 350 copies.

© National Bank of the Kyrgyz Republic, 2002.

The present publication is not subject to copying and dissemination in any forms and by any means without the permission of the National Bank of the Kyrgyz Republic. When reprinting and translating extracts the reference to “Inflation Report” is compulsory.

Publications of the National Bank of the Kyrgyz Republic

Annual Report of the National Bank of the Kyrgyz Republic

The annual report of the National Bank of the Kyrgyz Republic is a complete report on the work of the National Bank done during the reporting year. It contains a brief description of developments in the real sector of economy, as well as the description of decisions and actions of the National Bank in the monetary sphere. It includes the information on economic development and monetary policy, financial statements, general information about the National Bank, statistical annexes. The report is published in Kyrgyz, Russian and English languages.

Bulletin of the National Bank of the Kyrgyz Republic

“The Bulletin of the NBKR” contains macro-economic indicators of the Kyrgyz Republic on the real sector, financial sector, external sector, information on prices and social indicators. The unit of economic research and analysis of the Economic Department of the National Bank of the Kyrgyz Republic prepare it. Materials of structural subdivisions of the National Bank, as well as of commercial banks, the Ministry of Finance of the Kyrgyz Republic, the National Statistical Committee of the Kyrgyz Republic, the National Commission on Securities Market of the Kyrgyz Republic are used for the purpose of its preparation. It is registered with the Ministry of Justice of the Kyrgyz Republic as of December 27, 1995, registrations certificate № 205. The bulletin is published monthly in the Kyrgyz, Russian and English languages.

Balance of Payments of the Kyrgyz Republic

“The Balance of Payments of the Kyrgyz Republic” reflects the latest trends in development of the external sector and contains tables with data in analytical and neutral formats of the balance of payment, the structure of external trade, international reserves, external debt, the methodology and the information base for preparation of the balance of payments, as well as the international investment position of the Kyrgyz Republic. It is published quarterly in January, May, July and October.

Press release of the National Bank of the Kyrgyz Republic

“The Press-Release of the NBKR” contains the weekly chronicles of the developments in the National Bank and major data of the financial market. It is published quarterly in the Kyrgyz and Russian languages.

On the issues related to dissemination of the publications of the National Bank of the Kyrgyz Republic, please, contact:

Bishkek, Umetalieva st., 101.

National Bank of the Kyrgyz Republic

External and Public Relation Division

phone: (996 312) 669 009

fax: (996 312) 610 730

<http://www.nbkr.kg>

CONTENTS

1. CURRENT DEVELOPMENTS OF INFLATION	5
2. CONSUMER PRICE INDEX AND ITS COMPONENTS	7
2.1. COMPONENTS OF CONSUMER PRICE INDEX	7
2.1.1. <i>FOOD PRODUCTS</i>	7
2.1.2. <i>NON-FOOD PRODUCTS</i>	8
2.1.3. <i>SERVICES</i>	8
2.2. CONSUMER PRICES BY REGIONS	9
3. INFLATION FACTORS	10
3.1. MONETARY AGGREGATES	10
3.1.1. <i>MONETARY BASE1</i>	10
3.1.2. <i>AGGREGATE M2</i>	10
3.1.3. <i>AGGREGATE M2X</i>	11
3.2. INTEREST RATES	12
3.2.1. <i>MONEY MARKET INTEREST RATES</i>	12
3.2.2. <i>STATE TREASURY BILLS</i>	12
3.3. EXCHANGE RATE	14
3.4. DEMAND AND SUPPLY	16
3.4.1. <i>NET EXPORTS</i>	16
3.4.2. <i>DOMESTIC DEMAND</i>	18
3.4.2.1. PRIVATE CONSUMPTION	18
3.4.2.2. PUBLIC CONSUMPTION	18
3.4.2.3. INVESTMENT	18
3.4.3. <i>OUTPUT</i>	19
4. MAJOR DECISIONS OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC ON MONETARY POLICY ISSUES	20
4.1. MAJOR DECISIONS OF THE NATIONAL BANK BOARD OF THE KYRGYZ REPUBLIC	20
4.2. MAJOR DECISIONS OF THE MONETARY REGULATION COMMITTEE	20
4.3. INFLATION DURING THE FIRST QUARTER OF 2002 AND OUTLOOK FOR THE SECOND QUARTER OF 2002	20

1. CURRENT DEVELOPMENTS OF INFLATION

In the second quarter of 2002, the macroeconomic situation has a number of specific moments. The gross domestic product is reducing for the second quarter successively, thus the money supply still grows from second half-year of 2001. However, consumer prices do not show the tendency to acceleration. The exchange rate of the national currency against US dollar not decreased, but even become a little stronger.

It seems that structural changes occurring in economy is the reason of current situation. Money demand becomes stronger as a result of emerging of small and middle business. The increasing number of people is involving in market relations. To great extent these processes are initiated by development of programs to raise credit and micro-credit to small and middle business as well population. Increasing money demand is evident from monetization of economy. Usually, monetization is connected with growth in deposits, however, it reveals taking into account current condition of the banking system as expansion of monetary base.

The gross domestic product for the first half-year of 2002 on the preliminary data of the National Statistics Committee decreased by 4.9% in comparison with the corresponding period of the previous year. Industry and agriculture mainly caused recession. Agriculture is falling behind to compare with previous year due to the long and rainy spring. Decrease in output of the electric power and of the “Kumtor Operating Company”, large producer in non-ferrous industry, brought about reduction in value added of industry.

Stabilisation of macroeconomic situation in republic promotes growth in incomes of the population. Absence of visible pressure upon the exchange rate of the national currency is the indirect evidence of that the proportion between savings and consumption starts to vary. Partly, there is substitution in consumption in favour of domestic production especially for services. Domestic savings are accumulating in the national currency, which is explaining by the fact that attractiveness of US dollar as a financial asset is decreasing. According to the national accounts the gross savings grew from about 1.4% in 1999 up to approximately 15% of gross domestic product in 2001 (the preliminary estimation).

Nowadays, economy is characterised by significant amount of foreign currency and low degree of monetization. Opportunities to substitute foreign currency and to expand monetization of economy are substantial. But monetization of economy is restrained by a number of circumstances. By virtue of some objective reason share of small-scale manufacture in economy increases. Accordingly, money is not concentrated and it distributed among many economic agents. As a consequence of that fact efficiency of money falls. Besides, backwardness of trading network and financial system slows down an incorporation of money into circulation.

The trade balance in F.O.B. prices has positive balance though its size reduced more than twice in comparison with the corresponding period of 2001. Exports of goods increased by 17.5%, and imports rose by 25.7%. Contraction of exports in gold and the electric power has been compensated by increase in exports of other products. Acceleration of imports has taken place among almost all groups of functional classification of imports, thus it is necessary to note an essential growth in investment products.

The tendency of Som to strengthen which reveals since the first quarter of 2002 is kept. It is worth to note, that sensitivity of exports to the exchange rate is small enough. Constraints for Kyrgyz products concerning exit to external markets play much more important role. The significant part of credits in republic is given out in US dollars. Strengthening of Som means decrease in debt burden for borrowers. Probably, creditors will have the certain losses due to exchange rate differential, at the same time, the return of credits can improve. High

share in structure of small and middle business is occupied with trade activities. The businessmen working in sphere of trade will receive additional profits.

In the second quarter of 2002 the money supply continued to grow. Its dynamics was caused with operations of the Ministry of Finance and interventions of the National bank in the foreign exchange market. Net purchase of foreign currency by the National bank totalled 4.8 million US dollars. For comparison in the second quarter of the last year net purchase made up 1.15 million US dollars.

Monetization of economy is connected with change in liquidity preference. Low inflation and a stable rate of the national currency strengthen demand for the national currency (absolute effect) and result in smaller attractiveness of foreign currency as financial asset (relative effect or substitution effect).

Interest rates of the state T-bills with maturity three months grew a little, however, their share in structure of the state securities very small. Yield of state securities with one-year maturity has decreased. The Ministry of Finance lowered volumes of issue for all types of its securities.

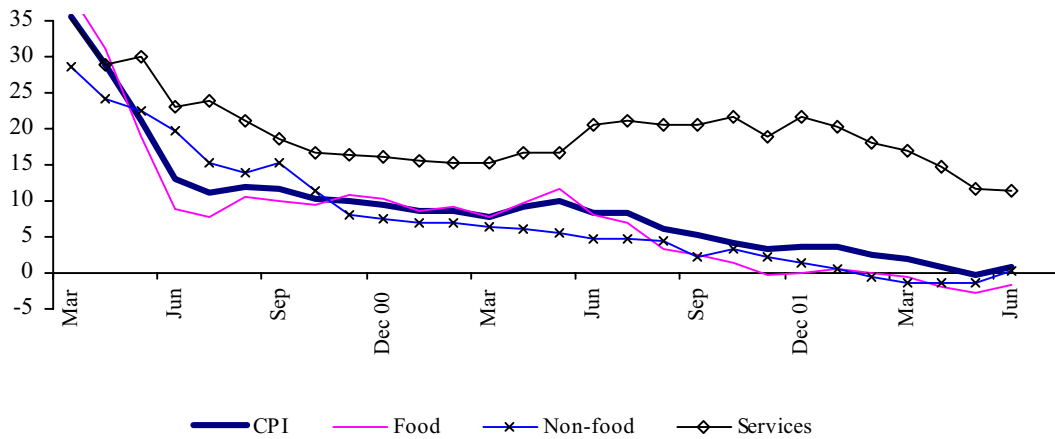
Consumer prices grew for the second quarter of 2002 by 2%, that is the forecast of the National bank almost was completely justified. Major factors of inflation were changed profile of seasonality, upward movement in oil product prices, and weather conditions.

The National bank predicts that consumer prices for the third quarter 2002 will decrease concerning the second quarter of the current year by 1.7-1.8%. Major factors of forecast uncertainty are connected with external and domestic factors. The most important among external factors are developments along world financial markets and dynamics of the oil prices. Domestically inflation will be determined in many respects by the conditions in real sector, specifics of inflation seasonality and stability of monetization in economy.

2. CONSUMER PRICE INDEX AND ITS COMPONENTS

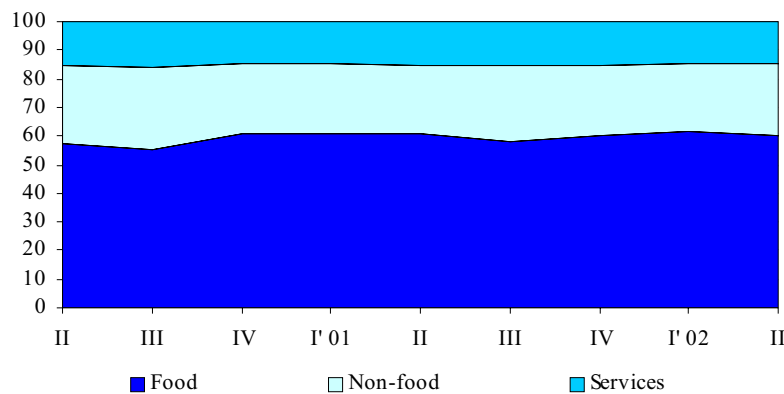
In the second quarter of 2002, the tendency of slowdown of inflation is kept. Consumer prices according to the data of the National Statistics Committee gain 2% for the second quarter of 2002. The prices for food and non-food products rose by 2.3 and 0.9%, respectively. Services became dearer by 2.6%. For corresponding quarter of 2001 inflation made 3%.

Chart 1: CPI and its components, percentage changes on a year earlier



Many factors are contributors to slowdown of inflation. First, the plentiful crop in agriculture in 2001 year in conjunction with difficulties to sell it abroad has restrained prices on foodstuffs to rise in the current year. Second, increase of tariffs in 2002 covered only tariffs for the electric power, while in the last year tariffs for the electric power and hot water supply have been raised. Third, the Som strengthening is marked.

Chart 2: Structure of CPI, percent



2.1. COMPONENTS OF CONSUMER PRICE INDEX

2.1.1. FOOD PRODUCTS

Food inflation rose by 2.3%, thus price changes for foodstuffs under influence of seasonality were mixed. So there was an increase in prices for fruit and vegetables by 7.6%, meat product became more expensive by 6.6%. The prices for oils and fats grew by 4.6%, reduction in prices on dairy product by 7.1% at the same time is marked.

However, the influence of the seasonal factor decreased a little in comparison with the similar period of the last year. For example, the rise in prices for the second quarter of 2001 on fruit-and-vegetable group made 16%. In general, the prices for other foodstuffs remained stable.

Chart 3a: Food Prices, percentage changes on a year earlier

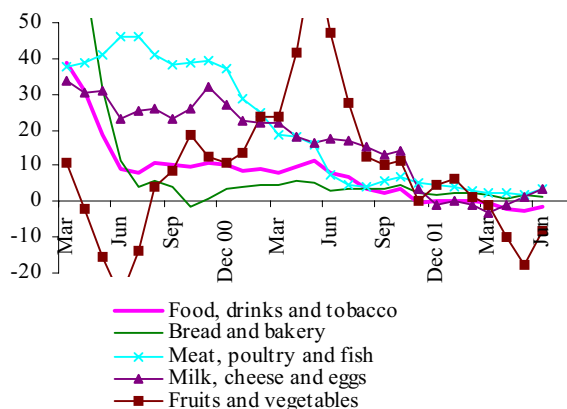
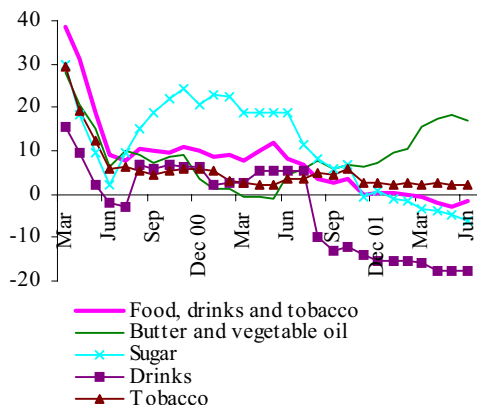


Chart 3b: Food Prices, percentage changes on a year earlier



2.1.2. NON-FOOD PRODUCTS

The price index on non-food products for the second quarter of 2002 increased by 0.9% because of upward movement in oil product prices in June of the current year. In particular, the prices for gasoline accelerated by 17.1% owing to the fact that agreement between Russia and OPEC on reduction of deliveries of oil on the world market due. The prices for other non-food products remained rather stable, in particular, on clothes and footwear. Though there was a strengthening in Som, sellers do not hasten to reduce prices. Prices on man's footwear, furniture, household devices, means of personal hygiene demonstrated insignificant reduction (within 1.2 per cent-range).

Chart 4a: Non-food Prices, percentage changes on a year earlier

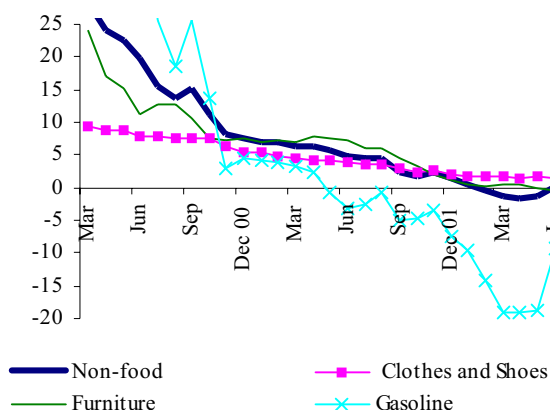
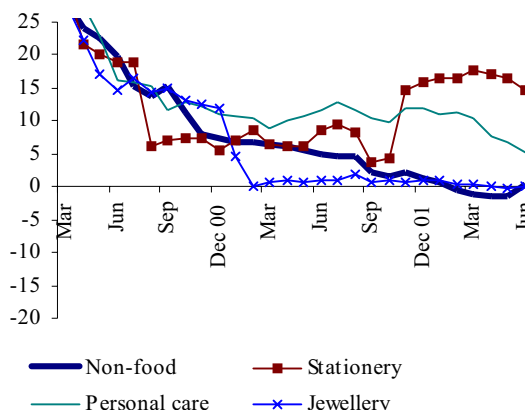


Chart 4b: Non-food Prices, percentage changes on a year earlier



2.1.3. SERVICES

Paid services to population in the second quarter of 2002 became expensive by 2.6% in connection with surge in tariffs for the electric power by 1.3 times. Upward movement in electric power tariffs led to rise in prices on services of housing and utilities. The situation in the given subgroup is substantially determined by

price policy of the natural monopolies which supplying housing and utilities services as well communication services.

Chart 5a: Services, percentage changes on a year earlier

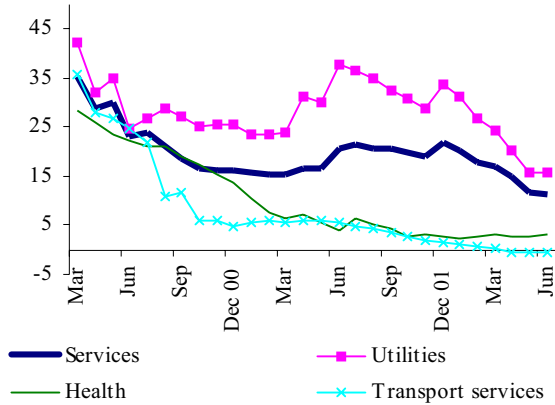
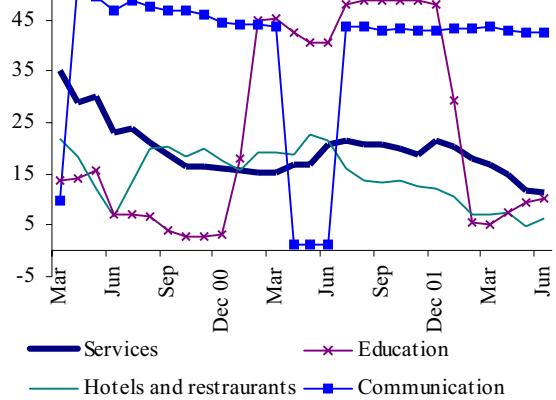


Chart 5b: Services, percentage changes on a year earlier



2.2. CONSUMER PRICES BY REGIONS

In the second quarter of the current year, consumer price rates differ among oblasts. In the majority of regions the growth in prices exceeded republic rate. So, consumer prices in Issyk-Kul oblast gain by 5.7%, in Talas oblast - by 4.2%, in Chu oblast - by 3.1%, in Naryn oblast - by 3%, in Osh oblast – by 2.3% because of significant rise in prices on food products and upward movement in tariffs for the electric power. In Jalal-Abad oblast consumer prices decreased by one per cent due to reduction of prices on foodstuffs by 2.4%.

Chart 6a: CPI by Oblasts, percentage changes on a year earlier

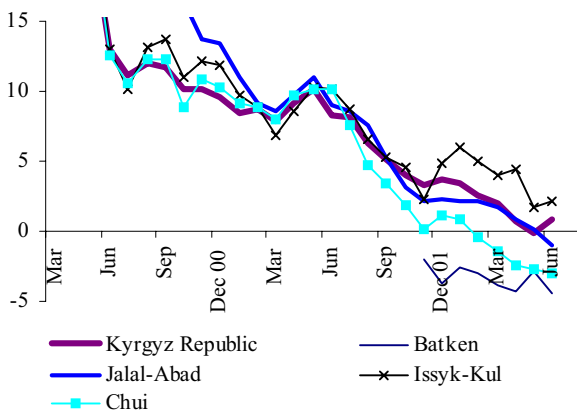
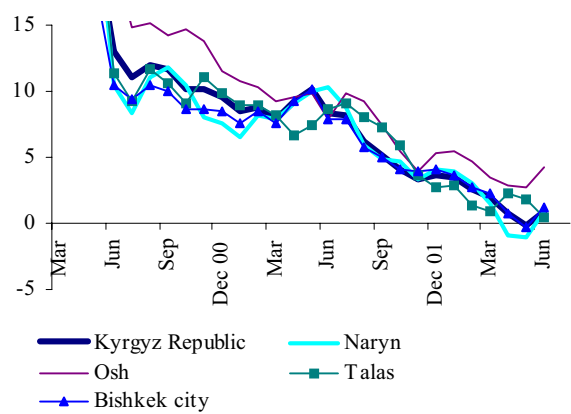


Chart 6b: CPI by Oblasts, percentage changes on a year earlier



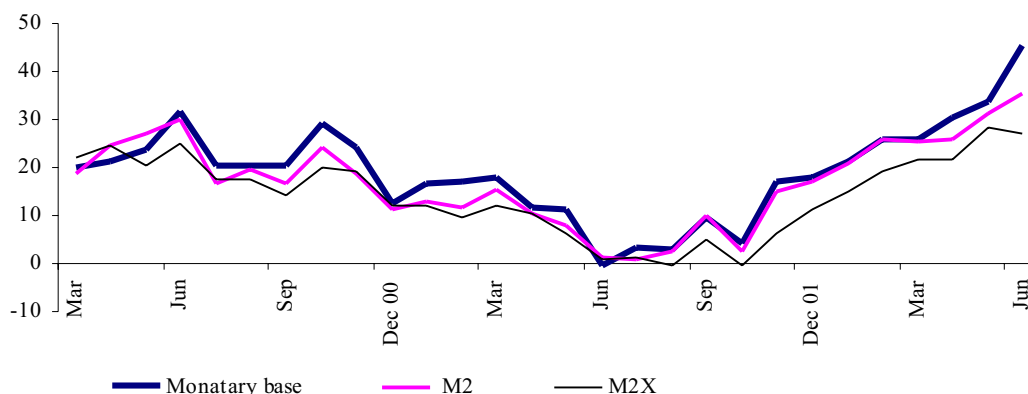
3. INFLATION FACTORS

3.1. MONETARY AGGREGATES

In the second quarter of 2002, monetary aggregates continued to grow. Partly the increase in money supply is connected with a need to compensate monetary compression, which resulted from significant payments concerning with external debt service in the 2001 year. However, this reason even taking in consideration expanding business activity, has exhausted its explanatory potential from the third - beginning of the fourth quarter of 2001. Steady growth of money supply without inflationary pressure testifies changes emerging in economy. They are connected with processes of monetization and dedollarization in economy.

Monetization is caused by development of market relations in republic. There is an expansion of sphere of commodity-and-money circulation. Many people are involving in market relations through microcrediting programs. As a result of such activity formation and accumulation of the capital begin. Besides, demand for the national currency raises as attractiveness of US dollar weakens to some extent.

Chart 7: Monetary aggregates, percentage changes on a year earlier



3.1.1. MONETARY BASE¹

The monetary base increased by 9.5% for the second quarter of 2002. Percentage change on a year earlier in monetary base made 44.6%. Operations of the Government and the National bank were the main determinants of the monetary base developments. The major instruments of the monetary policy were open market operations and credit operations with commercial banks. Net purchase of foreign currency totalled 4.8 million US dollars. As of 2002, 1 July gross international reserves of the National bank cover 199.8% of monetary base.

Money in circulation share still declining in structure of monetary base; its share reduced from about 95.2% at the end of March, 2002 up to 93.1% at the end of June. Money in circulation grew within the second quarter by 7.1%.

3.1.2. AGGREGATE M2

As of 2002, 1 July monetary aggregate M2 increased by 6% in the second quarter. Year-on-year rate in M2 accelerated by 34.7%. Growth of deposits, which began in the fourth quarter of the last year, still continued

¹ Without taking into consideration the commercial banks deposits in a foreign currency

in the second quarter of the current year. Some deposits grew by 2.5%. Thus settlement accounts of legal persons increased by 7.4%, while time deposits decreased by 3.9%.

3.1.3. AGGREGATE M2X

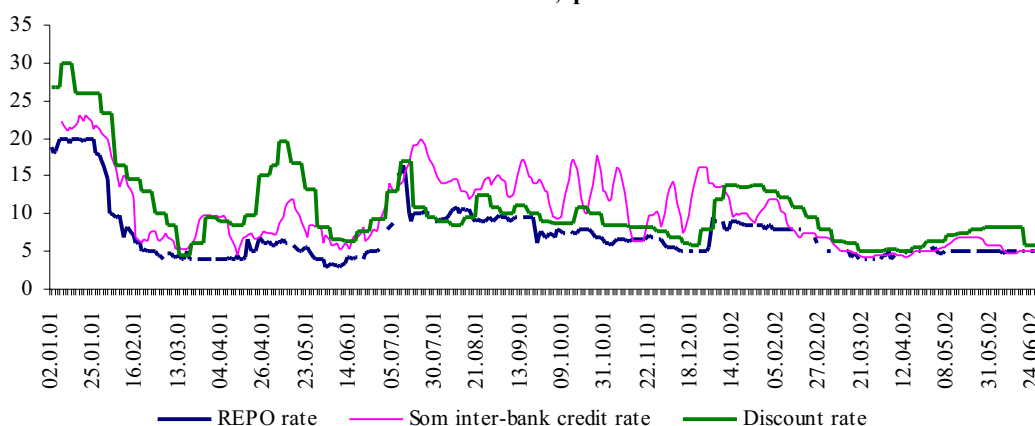
The monetary aggregate M2X under the current exchange rate for the second quarter increased by 1.7%. Growth rate of aggregate M2 outstrips growth rate of M2X because decrease in deposits in foreign currency by 9% was observed. M2X developments were formed under influence of contraction in net foreign assets and growth in net domestic assets of the banking system.

3.2. INTEREST RATES

3.2.1. MONEY MARKET INTEREST RATES

In the beginning of the second quarter of 2002, significant fluctuations of liquidity in the banking system were observed. There was some increase in costs of resources in the national currency so rates on REPO operations and credits in the national currency reached 6.3 and 6%, respectively. Since second decade of May reserves in the banking system have started to increase and were kept at a high level up to the end of the second quarter. Interest rates under inter-bank credits in the national currency and to REPO operations were in rather narrow range. For REPO operations its yield fluctuated from 4.5 up to 5%, and under credits in the national currency cost of resources changed within margins from 4.3 up to 5%.

Chart 8: Discount rate of the NBKR, inter-bank credit and REPO interest rates, per cent



The discount rate of the National bank practically during all second quarter (from second half of April and till last decade June) showed the tendency of growth from 5 up to 8.3%. Only in the third decade of June the discount rate was slightly reduced and made 5.9%. As a whole for a quarter value of the discount rate increased from 5% by the beginning up to 5.9% on the end of the second quarter. Rates on REPO operations have increased from 4 up to 4.5%, and under inter-bank credits in the national currency there was a growth with 4.6 up to 5%.

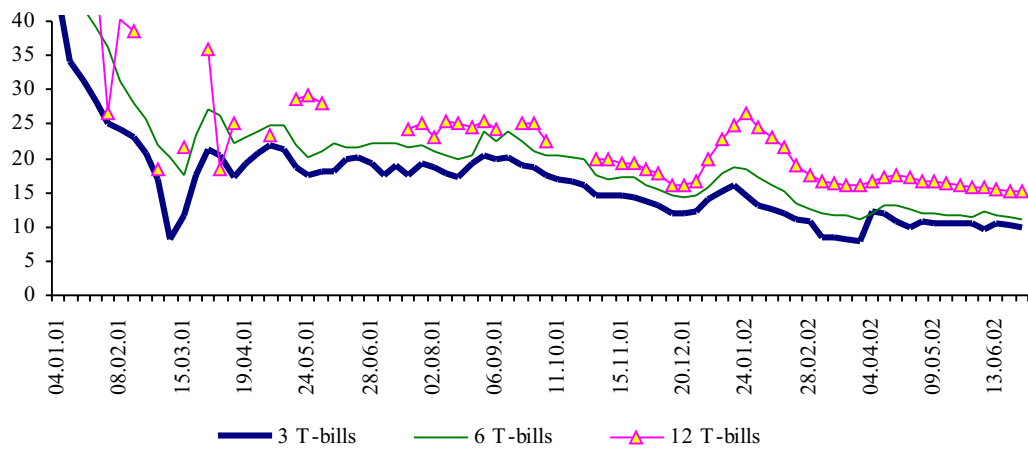
3.2.2. STATE TREASURY BILLS

In the beginning of the second quarter of 2002, growth of yield in the primary market of the state T-bills for all kinds of state papers were marked. Rates of the T-bills with the term of maturity three-, six- and twelve months rose from 7.9 up to 12.2%, from 11.1 up to 12.1%, from 16.1 up to 16.6%, accordingly. That situation speaks about low level of in the banking system liquidity.

Further the Ministry of Finance has lowered volumes of issue of the T-bills and there was some improvement in price conjuncture on auctions. Growth of liquidity in the banking system in the second decade of May keeping at high level up to the end of the second quarter have brought about steady tendency of reduction in yield for six-month and twelve-month T-bills. Interest rates on the T-bills for maturity three months changed insignificantly.

As a whole for the second quarter yield on the T-bills with term of the maturity three months has increased from 7.9% by the beginning of a quarter up to 9.9% for the end of quarter. Six-month T-bill's yield practically has not changed. Twelve-month T-bill's yield reduced from 16.1 up to 15.2%. The average interest

Chart 9: T-bill yields, per cent

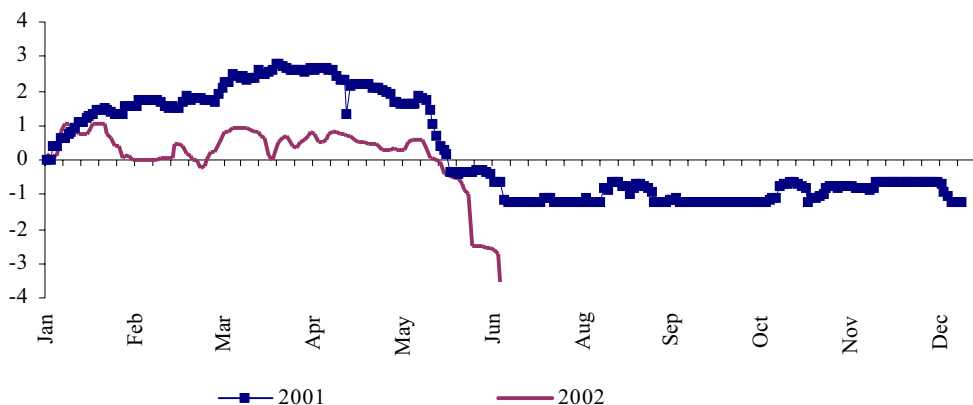


rate weighted by all kinds of the T-bills increased from 13.3% for the beginning up to 13.7% on the end of quarter.

3.3. EXCHANGE RATE

The situation in the foreign exchange market in the second quarter of 2002 developed under influence of external and domestic factors. In April, some increase in foreign currency demand connected with growing settlements payments on contracts of commercial bank’s clients have led to substantial fluctuations of Som against US dollar in the foreign exchange market. Fluctuations of the weighted average rate occurred in a range from 47.7 up to 48.1 Som per US dollar.

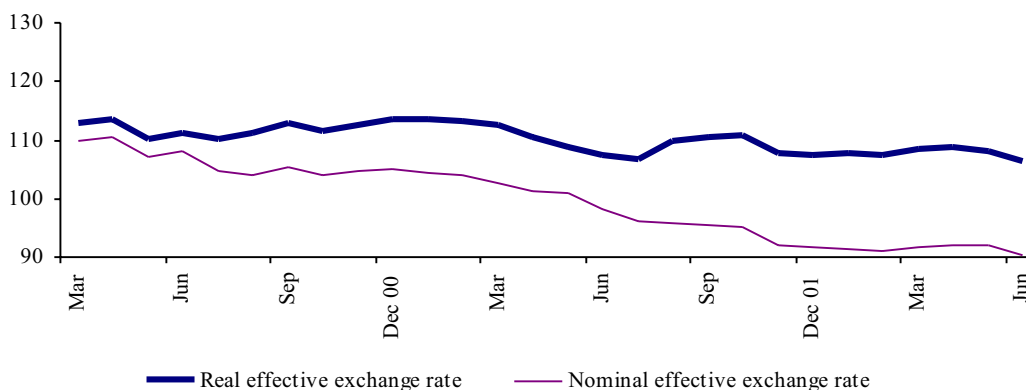
Chart 10: Cumulative change in exchange rate (Som per US dollar), per cent



In first two decades of May the situation in the foreign exchange market remained stable and US dollar depreciated primarily as a result of significant cut in payments made by commercial banks from the side of its clients. However, in the third decade of May growth in banking system liquidity and increase in expenditures of some commercial banks caused tightness in the foreign exchange market, so US dollar appreciated to some extent. At the end of May the demand for Som because tax payments due increased and Som strengthened.

US dollar weakened significantly in June, particularly in its second half, as a consequence of turmoil emerging in international financial markets. In addition, in summer, Som demonstrates annually seasonal strengthening in the foreign exchange market of republic. Official US dollar in June weakened by 3.6%. Thus, for the second quarter the exchange rate of Som become stronger by 3.8%, and as a whole for the first half-year it appreciated by 3.3%. In 2001, the Som has become stronger by 2.9 and 0.5%, respectively.

Chart 11: Som effective exchange rate indices, 1997 = 100



The Som nominal effective index in the second quarter of 2002 has decreased by 1.4% that means Som's strengthening. The Som strengthen in relation to currencies of the CIS and non-CIS countries excluding the Swiss franc, the English pound and the Japanese yen.

The Som real effective index also was relatively stable, its value decreased by 0.8% in comparison with the beginning of the current year. The Som real effective rate strengthen against CIS, while it depreciated against non-CIS currencies by 1.4%.

3.4. DEMAND AND SUPPLY

Reduction in price level, which is not connected to seasonality, refers as a deflation. Its reason is suppressed demand, therefore, manufacturers are compelled to reduce their prices. If it is a case for long time there are negative effects for development of economy, and Japanese economy is an example.

Difficulties to sell abroad of republic significant part of domestically produced agricultural production resulted in low prices in 2001 year. Restricted demand inside republic in many respects is connected to existing structure of economy. Despite of the small population living in republic, potential to enlarge domestic demand is far from being exhausted. Trade penetrating into the most remote areas of republic promotes commodity and money circulation. More and more people are involving in market relations. Accordingly, there is an expansion of demand for goods, and money demand is increasing also.

The abundant supply of some products is not a consequence of high productivity. However, development of industrial potential is based on necessity to deepen degree of agriculture product processing and to exit on foreign markets. In turn, to solve these tasks it is necessary to attract investments into economy. Thus, it seems that the domestic investor should be equally desired as foreign one.

Domestic savings are source of investment activity. However, transformation of savings in the investment does not happen automatically. Keeping stable macroeconomic situation promotes increase in incomes of population and savings. However, till now there are no effective mechanisms to accumulate and apply it.

To give additional momentum to investment process it is necessary to determine precisely role of the government and private business. Attraction of credits under the state guarantees is the least effective form of the organisation of investment process. The acceleration of investment process is connected with creation of transparent and equal for all game rules, conditions for development of the financial market and its participants.

Gross domestic product decreased second quarter in a row. Slump in production of “Kumtor Operating Company ” and electric power industry are major reasons of deterioration in the industry. Agriculture demonstrates negative growth rate as a result of unusual weather conditions observed in the current year.

3.4.1. NET EXPORTS

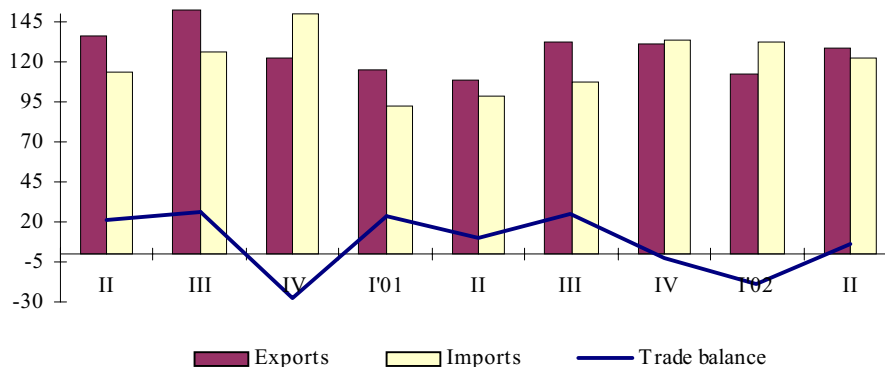
The trade balance of the Kyrgyz Republic on the preliminary data in the second quarter of 2002 remained positive though it reduced in comparison with the similar period of the previous year by 58%. The foreign trade turnover grew by 21%, thus it increased with Commonwealth Independent States (CIS) and non-CIS countries by 16 and 26%, respectively.

Exports of goods in F.O.B. prices in the second quarter of 2002 increased by 17.5%. Reduction of exports to the CIS made 9%, while exports in non-CIS grew by 35.4%. There was decrease in exports of gold by 7.4%. Exports of other items excluding gold surges by 37.4% that is caused by growth of exports in the USA and China.

According to the functional structure of exports in the second quarter of the current year there was an increase in shares of products of all functional groups but intermediate and energy products. Exports of consumer goods increased by 51.4% due to electric lamps, vegetables, sugar and garments. Expansion of raw material exports by 79% was because of increase in cotton's exports by 117%. Exports of cattle skins increased more

than twice. Almost in four and a half of time exports of leather from skins of animals increased. Exports of breakage and waste products of non-ferrous metals were restored.

Chart 12: Trade balance, mil. US dollar



The non-CIS countries keep leading positions in share of exports of goods in geographic distribution, which makes 68.4%. The biggest volume of exports, besides Switzerland, where gold is mainly exported, refers the USA, China and Turkey. Exports to the USA have considerably grown that in many respects is caused by exports of oil products for the international anti-terrorist coalition contingent and gold. The increase in exports to Turkey is due to cotton, kerosene, vegetables, and nuts. Exports to China increased in more than three times compared with the corresponding period of previous year due to skins and leather of animals, breakage and waste products of non-ferrous metals. In the second quarter of this year Kyrgyzstan started to exports gold to the United Arab Emirates, which volume totalled 26.7% out of gold exported in the second quarter of 2002.

Russia, Kazakhstan, and Uzbekistan continue to remain the basic major consumers of exports among CIS. Exports of products to Russia grew by 19.2% basically due to cotton, tobacco, and garments. Exports to Uzbekistan and Kazakhstan reduced by 66.9 and 5.1%, respectively, because significant decline of electric power deliveries for them. Exports to Tadjikistan increased more than twice due to sugar, construction materials.

Imports of products in F.O.B. prices on the preliminary data grew by 25.7%. Imports of products from CIS and non-CIS increased by 38.1 and 12.9%, respectively.

According to the functional structure of imports in the second quarter of the current year there was an increase in all items but intermediate products. The investment products and raw material demonstrated highest growth rates. Imports of investment products increased almost twice. Tractors, the mining equipment, lorries, the equipment of communication, the machine and the equipment electric special purpose provided growth in that category. Imports in energy products increased by 18.2%, that particularly are connected with maintenance of needs of the international anti-terrorist coalition contingent in mineral oil.

The CIS share has 52.4% in geographic distribution of imports. Russia and Kazakhstan occupy the biggest shares. Imports from Russia grew by 55.5% due to automobile gasoline, kerosene, automobiles cargo, trunks for lorries and buses, machines and mechanisms for the maintenance of roads. From Kazakhstan imports surged by 55.7% due to wheat, cigarettes and kerosene. Among the non-CIS countries the major suppliers of products, as before, are China, the USA, Germany and Turkey.

3.4.2. DOMESTIC DEMAND

Employment is one of the most important parameters of domestic demand. As a rule, employment tend to expand on the increasing phase of business cycle, incomes of households grow. Accordingly, it is possible to expect strengthening of domestic demand. As the basic share of consumption falls at consumer goods, demand for them also raises.

Employment reduced in recession, hence, domestic demand is contracted. Though the business cycle in economy of republic is not established yet, influence of employment on demand, certainly, plays very important role. The transition shock has brought about to unemployment in the latent and apparent forms. The population frequently participates in partial employment or works in several places. There is migration, when people work abroad on partial or constant basis. All this substantially complicates monitoring of employment in republic.

According to the National Statistics Committee, as of 01July, 2002, the registered unemployment has increased in the year to the corresponding date of the last year by 5.2%. As far not all being unemployed are registered it is possible to assume, that supply exceeds demand in labour market.

The production of households in countryside has predominantly short-scale character. Accordingly, the most part of their production is consumed directly by households and does not get on market. So, participation of such households in circulation products and money is small. That is why, on the one hand, they do almost not influence the supply of products, on the other hand, they do not reveal demand for goods.

3.4.2.1. PRIVATE CONSUMPTION

On the preliminary data of the National Statistics Committee monetary incomes of the population grew by 2.5% in comparison with the first half-year of 2001. Thus, the real disposable income increase by 0.5%. A monetary outlay of the population increased by 0.2% in comparison with the first quarter of 2001. In real terms disposable incomes rose by 0.4%. Retail trade grew by 12.1% comparing with the first half-year of 2001.

3.4.2.2. PUBLIC CONSUMPTION

Revenues and expenditures of the state budget increased by 14.6 and 13%, respectively, in comparison with the first half-year of 2001. Expenditures on payroll payments grew by 12.2%. Capital investments and repair from budget's funds surged by 52.5%. Grants to the state enterprises increased by 36.2%.

3.4.2.3. INVESTMENT

According to the preliminary information of the National Statistics Committee the capital investments reduced by 2.9% in the first half-year of 2002 in real terms in comparison with the corresponding period of the last year. The tendency in capital investments to increase due to means of population and enterprises and to decline due to foreign funds continued.

Final consumption according to the national accounts for 2000 and the preliminary data on gross domestic product by use for 2001 show the tendency of slowdown of growth. Accordingly, gross savings increase. So, in 1999, for the first time it become positive and amounted 1.3% of gross domestic product, in 2000, gross savings have reached 14.4% of GDP. According to preliminary estimations for 2001 their value exceeds 15% of gross domestic product.

3.4.3. OUTPUT

The conditions in real sector remain mixed. In the first half-year of 2002, for the various reasons there was slump in agricultural and industrial production. The added value in agriculture decreased by 7.5% in comparison with the corresponding period of the previous year. Drop in manufacture is basically caused by weather conditions. The rainy and long spring brought about later maturing of a crop. Thus the biggest damage has been put to berry's production.

To the slump in industrial production electric power industry and "Kumtor Operating Company" brought the basic contribution. Contraction of gold output was a result of lower than expected concentration of metal in ore. To some extent decline in real output of gold production is compensated by increase in prices in the world market. Deficiency of water in the Toktogul reservoir was one of the reasons on which release of electric energy decreased. Without taking into account "Kumtor Operating Company", drop in industrial production totalled 3.8%. The value added in industry decreased by 13.6%. Gross domestic product declined almost by 5%.

At the same time, according to the National Statistics Committee processes of formation of new units conducting economic activities are developing. Only in the second quarter of the current year 7.5 thousand new legal and physical units were registered. The predominant share, which totalled to 62.8%, falls on agriculture. The trade makes 15.8% out of total, granting of services and industry gives 6.4 and 4%, respectively.

4. MAJOR DECISIONS OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC ON MONETARY POLICY ISSUES

4.1. MAJOR DECISIONS OF THE NATIONAL BANK BOARD OF THE KYRGYZ REPUBLIC

Joint Resolution of the Government and the National bank №396, as of 21 June 2002 “About settlement of financial mutual relations between the Government of the Kyrgyz Republic and the National bank of the Kyrgyz Republic ” aimed at re-structuring debts of the Government owing to the National bank was accepted.

The General agreement on settlement of financial mutual relations between the Government and the National bank was accepted by the resolution of the National bank №26/9, as of 24 June 2002. The principles incorporated in the given Agreement will improve quality of assets of the National bank without imposing additional expenditures on the republican budget. As a result of re-structuring the National bank will get an additional market instrument - the state T-bills (settlements). That instrument will replace government re-structuring loan bonds, and it can be used for purposes of monetary policy. Yields of the state T-bills (settlement) will be determined on auctions of the state T-bills.

4.2. MAJOR DECISIONS OF THE MONETARY REGULATION COMMITTEE

In the second quarter of 2002, the Committee on monetary regulations (CMR) made decisions concerning application of different instruments of the monetary policy such as SPOT and SWAP operations with foreign currency, on delivery of credits «overnight», carrying out of REPO operations on purchase and sale of the state securities. SPOT and SWAP operations with foreign currency were most actively applied.

In April, deficiency of banking system liquidity was observed. Accordingly, operations in the market on maintenance of liquidity were carried out. For this purpose credits «overnight», SWAP operations with foreign currency and REPO operations were used. Also the CMR has made the decision to renew a REPO operation with government re-structuring loan bonds.

In May - June, under the recommendation of the CMR of the SPOT and SWAP operations with foreign currency were actively carried out. As a whole, SPOT operations promoted increase of banking system liquidity. However, in June, the National bank carried out sale of a foreign currency aimed at withdrawal of liquidity. SWAP operations have been directed on satisfaction of short-term demand for Som resources. The favourable macroeconomic conditions provided to increase the international reserves of the National bank. In June, a number of auctions on accommodation of notes of the National bank are recognised not taken place.

4.3. INFLATION DURING THE FIRST QUARTER OF 2002 AND OUTLOOK FOR THE SECOND QUARTER OF 2002

Year-on-year money supply growth starting since second half-year of the previous year, has not accelerated inflation, and the exchange rate of the Som even appreciated. Thus, according to preliminary estimations of the National Statistics Committee there was decrease in gross domestic product.

The tendency settled in economy seems to be unusual. Strengthening in demand in combination with reducing supply should, and that was repeatedly observed many times previously, promote inflation to accelerate and the national currency to depreciate.

In *Inflation Report* for the first quarter of the current year it was marked that there are number of factors promoting strengthening and easing of domestic demand. Previously expansions of money supply with a small lag in one-and-half or two months brought about consumption and demand for a foreign currency to surge. Macroeconomic developments for the first half-year of 2002 show that in republic for the first time for many years (1) supply and demand in domestic market of goods approximately corresponds each other, anyway, there is no significant deviations of these variables; (2) monetization and dedollarization start to emerge in economy. In other words, demand for the national currency is increasing, while demand for foreign currency is reducing.

Balanced supply and demand in many respects is caused by positive changes, which have taken place in the field of regulation of expenditures of the budget. Alongside with it the tendency of development of small and middle business, which is supported by practice of microcrediting, is kept. Involving of agricultural population in entrepreneur activity renders positive influence not only from the supply side, but from demand side as well. Development of commodity and money circulation in countryside, certainly, results in strengthening of money demand.

Savings is the important precondition for strengthening of investment activity, however, it does not occur automatically. Under condition of deepening of the financial market and strengthening of financial intermediaries the savings will start to be transformed into investments that will promote the further improvement of economy.

The National bank does not aimed to fix exchange rate of the national currency that, as experience of financial crises for some time past show, results in negative consequences. Formally the reason for strengthening of Som are events in the international financial markets and presence of the international anti-terrorist coalition contingent. Certainly, these both circumstances are important. However, economy's stance and its exports potential in middle term determine strength or weakness of the national currency.

In short term there are following tendencies. The long and rainy spring led to the fact that seasonal reduction in prices on food products is less pronounced in comparison with the previous years. However, it is possible to expect that colder than usually spring will not lead to curtailment of production in whole year. Plentiful rains promote substantial increase of productivity of grain crops, which is basic representative of plant growing. The crop of vegetables, probably, will be approximately at level of the last year.

Situation changed in the international market of oil brought about upward movement in oil prices in domestic market. However, it is possible to expect that in the near future the oil product prices will stabilise.

Rather stable macroeconomic situation in Russia and Kazakhstan render favourable influence on economy of Kyrgyzstan. The unstable condition in the international share markets does not render any essential influence on Kyrgyzstan's economy as a whole. Fluctuations of exchange rates of dollar and Euro have psychological character. Strengthening of Euro is more likely the positive factor for economy as the external debts of republic is mainly expressed in the US dollar equivalent. Inside republic it is possible to expect some improvement of

credit returns and acceleration of the profit of traders. Some recession in electric power industry, probably, will be compensated in the third - fourth quarter as stock of water in reservoir steadily increases.

The National bank predicts that consumer prices for the third quarter 2002 will decrease concerning the second quarter of the current year by 1.7-1.8%. Major factors of uncertainty of the forecast are connected to external and domestic factors. Among external factors the most important are development in world financial markets and dynamics of the oil prices. Domestically inflation will be determined in many respects by the conditions in real sector, specifics of inflation seasonality and stability of monetization in economy.