

Monetary Policy Report for the First Quarter of 2011

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1.1. Basic Monetary Policy Trends

As a whole for the first quarter of 2011 (according to the data of the National Statistic Committee) growth of a consumer price index, characterizing a rate of inflation made 6.4 percent (in annual terms March 2011 against March 2010 the inflation made 20.8 percent), whereas in the corresponding period of 2010 it was 4.8 percent (in annual terms March 2010 against March 2009 the inflation made 4.3 percent). Acceleration of inflation processes in the first quarter occurred due to high rates of price increase for food products such as fruits, vegetables, bakery products, cereals and sugar against increase in prices on the world commodity markets.

Taking into account high inflation rate in the country and preservation of inflation risks in 2011, the NBKR continued to accept measures to tighten the monetary policy. In order to restrict the inflation monetary component in the first quarter of this year, the NBKR increased its operations to sterilize excess liquidity in the banking system: the volume of NBKR notes in circulation increased up to Som 1,165.2 million as of the end of the first quarter 2011 from Som 669.2 million as of the end of 2010; the volume of repo operations on state securities sales increased up to Som 230.8 million from Som 70.8 million as of the end of 2010. The NBKR was gradually increasing the discount rate from 5.5 percent at the beginning of the year to 6.92 percent as of the end of the first quarter.

Within the framework of the monetary policy tightening, from March 14, 2011 the NBKR increased the reserve requirements from 8 to 9 percent from the estimated base and increased from January 01, 2011 the base rate for crediting purposes of the LLC Specialized Fund for Banks Refinancing from 7 to 8, from March 01, 2011 – up to 8.25 percent. As of the end of March 2011. the volume of the SFBR distributed funds made Som 1.8 billion, among them the credit portfolio of SFBR – Som 1.3 billion, including by the project “Loans Available for Farmers” – Som 200.0 million.

In order to prevent sharp fluctuations of the exchange rate, the NBKR in January-March 2011 conducted foreign exchange intervention, the net sale of foreign currency amounted to US\$ 62.5 million (in the corresponding period of 2010 – US\$ 52.4 million). The USD exchange rate against KGS for the first quarter of the current year increased by 0.3 percent from 47.0992 to 47.2448 KGS for 1 US Dollar (in the corresponding period of 2010 increase made 2.6 percent).

A Som for the first quarter of 2011 depreciated against all foreign currencies of the countries–main trade partners that stipulated the decrease of the real effective exchange rate index (REER) of a som by 1.2 percent up to 109.7.

As a whole for the first quarter of 2011 the monetary base decreased by 7.2 percent (in the corresponding period of 2010 decrease made 4.2 percent), that mainly was stipulated by exchange market interventions of the NBKR on foreign-currency sale. Broad money M2X decreased during the reporting period by 3.7 percent to make Som 66.6 billion. Meanwhile, the indicator of the economy monetization increased by 0.5 percentage point and constituted 28.4 percent.

As a whole for the first quarter of 2011 the increase of economic growth rates by 0.4 percent was noted in the economy as compared to the similar indicator in January-March 2010. Meanwhile, the sector of generation and distribution of electricity, gas and water contributed greatly in the GDP

growth.

By the results of the first quarter of 2011 the balance of payments was formed positive at the amount of \$ 27 million. However, significant deficit increase of the current account up to US\$ 121.4 million or up to 4.3 percent to GDP was noted. The volume of gross international reserves in the reporting period increased by 4.9 percent up to US\$ 1.8 billion that covers 4.2 months of the future import of goods and services.

According to the preliminary data of the Central Treasury of the Ministry of Finance, the government budget surplus in January-March 2011 amounted to Som 1.5 billion or 3.2 percent to GDP.

1.2. Dynamics of Monetary Indicators

Monetary base as of the end of March 2011 made Som 45,116.5 million having decreased in the reporting period by 7.2 percent (in the similar period of 2010 decrease made 4.2 percent), mainly due to the NBKR's foreign exchange interventions on foreign currency sales.

In the structure of monetary base there was the increase of a share of cash in circulation from 89.1 percent as of the end of 2010 up to 90.5 percent as of the end of March 2011, accordingly, a share of funds on the correspondent accounts of commercial banks in the National Bank decreased from 10.9 percent to 9.5 percent.

Money outside banks M0 as of the end of the first quarter of 2011 made Som 39,014.4 million having decreased by 5.9 percent (in the similar period of 2010 decrease made 3.9 percent).

Money supply M2 made Som 51,159.4 million as of the end of March 2010 having decreased in the reporting period by 4.8 percent (in the similar period of 2010 decrease made 1.7 percent).

Broad money M2X, including the deposits¹ in the foreign currency for the end of March 2011, made Som 66,647.7 million, having decreased in the reporting period by 3.7 percent (in the first quarter of 2010 decrease by 5.9 percent was noted). Meanwhile, money outside banks in the reporting period decreased by 5.9 percent. Alongside with that, the total deposit volume within the definition of broad money M2X decreased by 0.4 percent, including deposits in the national currency decreased by 1.1 percent, whereas deposits in the foreign currency increased by 0.2 percent. In the structure of broad money M2X a share of deposits in the foreign currency decreased in the reporting period by 0.9 percentage point, up to 23.2 percent, a share of deposits in the national currency decreased by 0.5 percent, up to 18.2 percent, by that a cash component of broad money decreased by 1.4 percentage points, up to 58.5 percent.

From the beginning of the year the indicator of the economy monetization of the Kyrgyz Republic increased by 0.5 percentage point and constituted 28.4 percent as of the beginning of April.

1.3. Inflation: Outcomes and Trends

The increase of the total price level in the Republic as compared to the similar indicator of 2010 was noted in the first quarter of 2011. Thus, according to the data of the National Statistics Committee (NSC), the increase of total price level in the first quarter of 2011 made 6.4 percent

¹ Without taking into account deposits of the Government and non-residents.

against the increase by 4.8 percent of the similar indicator of the last year. Acceleration of inflation processes in the first quarter occurred due to high rates of price increase for food products in view of price bursts on the world commodity markets. Thus, the highest price increase was noted in the group “fruits and vegetables” by 24.4 percent, “bakery products and cereals” by 13.5 percent and sugar by 15.2 percent.

12-month value of inflation (March 2011 against March 2010) made 20.8 percent, whereas for the similar period of last year it made 4.3 percent. The main factors influencing the formation of the total price increase in the Republic were external factors such as significant price increase for wheat and food products imported from Kazakhstan and Russia, increase of export demand on the part of neighboring countries for domestic agricultural production, price increase for construction materials, price increase of imported energy resources.

Table 1. Consumer Price Index in the Kyrgyz Republic

	March 2011 against			January-March 2011 against January-March 2010
	February 2011	March 2010	December 2010	
Total goods and services	102.2	120.8	106.4	120.3
of which				
Food products and soft drinks	103.9	135.3	112.2	132.7
Alcoholic and tobacco products	100.9	113.5	101.2	113.1
Nonfoods	100.6	108.8	101.5	110.3
Services	100.4	111.1	102.1	111.7

According to the results of March 2011, prices for food products increased in annual terms by 35.3 percent (in the corresponding period of 2010 prices in annual terms remained unchanged). Price growth recovery for sugar due to insufficient volume of domestic production and price increase on the world market was observed. In March 2011 price increase for sugar in annual terms made 19.3 percent. The average price for imported sugar in March of this year made US\$ 924.6 per a ton (+11.6 percent by March 2010) according to the data of the NSC KR.

Dependence on import of the economy by food products remains high.

Prices for alcohol and tobacco products in annual terms increased by 6.1 percent and 33.8 percent, accordingly.

12-month growth of consumer price index for nonfoods made 8.8 percent. Decrease of prices for housing services that went down in value for the year by 7.8 percent was observed; decrease of tariffs for electricity, gas and other kinds of heating in annual terms by 10.7 percent became the determining factor of prices dynamics by this group of goods. The cost of fuels and lubricants in annual terms increased by 16.1 percent: prices for gasoline increased by 14.9 percent, for diesel fuel - by 29.6 percent. Deceleration of annual price increase rates due to duty-free import of oil products from Russia and Kazakhstan is being observed by this commodity group.

Price index for paid services in the considered period increased per annum by 11.1 percent (for the similar period of 2010 it increased by 3.6 percent). Index growth in this group occurred mainly due to appreciation of services of restaurants and hotels by 18.7 percent. It is connected with the increase of food products cost as well as transport services (+11.4 percent) and services of recreation organization (+20.3 percent). Increase of price rates for public health and education services by 7.7 and 7.6 percent, accordingly, was observed.

1.4. Real Sector

According to the preliminary data, the GDP volume in current prices made Soms 46,586.1 million for January-March, having increased in real terms by 0.4 percent in comparison with the similar indicator of 2010, whereas in January-March of 2010 the GDP volume increased by 16.8 percent. Without considering the enterprises on gold mining at “Kumtor” deposit the GDP volume in January-March 2011 increased by 1.8 percent (according to the results of the first quarter of 2010 the increase of the similar indicator constituted 8.9 percent). The GDP deflator, according to the preliminary data, for the first quarter of 2011 was at the level of 14.0 percent against 2.9 percent in January-March of 2010.

Table 2. Contribution of individual types of activity into increase/decrease of GDP
(percents)

	Ration		Growth rate		Contribution in growth	
	Q1 2010	Q1 2011	Q1 2010	Q1 2011	Q1 2010	Q1 2011
Agriculture	9.1	8.8	2.1	0.5	0.2	0.0
Mining industry	0.5	0.7	-5.3	26.6	0.0	0.1
Processing industry	22.0	22.8	105.5	-6.0	13.5	-1.3
Electricity, gas and water generation and distribution	5.1	4.5	16.4	27.3	0.6	1.4
Construction	3.4	3.3	2.7	-11.8	0.1	-0.4
Trade	16.4	16.9	0.9	-4.2	0.2	-0.7
Hotels and restaurants	1.3	1.3	2.5	-7.0	0.0	-0.1
Transportation and communication	10.3	10.3	1.5	8.3	0.2	0.9
Other	20.2	19.5	-0.8	2.2	-0.2	0.4
Net taxes on products	11.7	12.0	16.8	0.4	2.2	0.0
GDP	100.0	100.0	16.8	0.4	16.8	0.4

Source: NSC data, NBKR adjustments

According to the preliminary data, for the first quarter of 2011 the physical volume of industrial products increased by 0.8 percent. Without considering the enterprises on gold mining at “Kumtor” deposit the growth of industrial production constituted 7.8 percent. According to the results of January-March 2010 the growth of industrial production reached 79.4 percent and the volume of industrial production without considering “Kumtor” increased by 44.6 percent.

Dynamics decrease of the processing industry production volume in January-March 2011 is stipulated by a high base of the first quarter of 2010. Thus, according to the preliminary data, for the first quarter of 2011 the volume of production in the processing industry decreased by 6.0 percent as compared to the similar indicator of 2010 against the decrease of production at the enterprises of “Kumtor” deposit, that is, in its case, stipulated by planned gold production decrease in the first quarter of 2011. By that the production growth in the export-oriented sectors is observed in the processing industry: textile and clothing industry, and production of other non-metal mineral products (construction materials).

According to the preliminary data, the sector of generation and distribution of electricity, gas and water contributed significantly in the GDP growth in January-March of 2011. The production volume in this industry increased by 27.3 percent that is stipulated by the growth of electricity production by 33 percent and services by electricity distribution by 24 percent.

Gross output of agricultural production, according to the preliminary data, in January-March 2011 increases in real terms by 0.5 percent against the increase by 2.1 percent by the results of the first quarter of 2010.

The sales turnover of trade operations in January-March 2011 decreased by 4.2 percent in comparison with the similar indicator of 2010 (in January-March of 2010 the growth of trade

volume constituted 0.9 percent). The principal causes of trade operation volume decrease are the consequences of political instability in 2010 and deterioration of trade conditions with the countries–main trade partners against the creation of the Customs Union.

The volume of investments in the fixed capital, according to the preliminary data for the first quarter of 2011, decreased in real terms by 9.8 percent in comparison with the similar indicator of 2010 (in January-March 2010 the similar indicator decreased by 10.4 percent). The decrease of investment volumes in the fixed capital in the first quarter of 2011 was caused by the decrease of assimilated funds at the objects of agriculture, generation and distribution of electricity, gas and water, hotels and restaurants, transportation and communication.

1.5. External Economic Sector

According to the results of the first quarter of 2011 foreign trade turnover KR in FOB prices increased by 11.9 percent and in value terms constituted US\$ 1,214.9 million. The growth dynamics of trade relations of Kyrgyzstan both with CIS countries and far-abroad countries was similar, by that their ratios in the total volume of foreign trade operations constituted 44.4 and 56.6 percent, accordingly.

Export of goods (in FOB prices) in the first quarter of 2011 made US\$ 486.7 million, having increased by 4.2 percent in comparison with the first quarter of 2010. Import of goods in FOB prices in the first quarter of 2011 increased by 17.6 percent and constituted US\$ 728.3 million.

In the considered period the increase of foreign exchange receipts by the current transfers was observed that was caused by significant growth of money transfer volumes of labor migrants (by 30.8 percent), as well as receipts of money grants to the Government sector (by 38.8 percent). In spite of the growth of money receipts by the current transfers, the increase of the deficit of goods and services by 43.7 percent as well as the increase of deflux by the article “profits” by 52.6 led to deterioration of the current account condition. By the results of the first quarter of 2011, current operation account deficit was US\$ 121.4 million that corresponds to 4.3 percent to GDP.

By the results of the first quarter of 2011 the account of operations with the capital and financial operations formed positive in the amount of US\$ 108.9 million that exceeds the corresponding indicator of 2010 by US\$ 77.0 million.

Thus, according to the results of the first quarter of 2011 the balance of payments was formed positive in the amount of US\$ 27 million. The volume of gross international reserves as of the end of the reporting period made US\$ 1,803.4 million that covers 4.2 months of the future import of goods and services.

According to the preliminary data, the index of nominal effective exchange rate (NEER) of Som from the beginning of this year decreased by 4.8 percent and as of the end of March made 110.7. The decrease was caused by depreciation of Som against the majority of currencies of the main trade partners. Thus, Som in March 2011 as compared to December 2010 depreciated against the Russian Ruble by 8.9 percent, Chinese Yuan – by 2.3 percent, Kazakh Tenge – by 2.1 percent, US Dollar – by 1.0 percent and Euro – by 6.1 percent.

In spite of the lower inflation rate² in countries-partners, depreciation NEER of Som to currencies of the main trade partners brought prevailing pressure on the index of real effective exchange rate (REER) toward decrease, hence, smoothing inflation influence. Thus, REER of Som

² Inflation rate in KR in January-March made 6.4 percent, whereas the average inflation rate of the countries–main trade partners, according to the preliminary calculations, made 2.6 percent.

from December 2010 decreased by 1.2 percent and as of the end of March 2011 made 109.7.

1.6. Public Finance Sector

According to the preliminary data of the Central Treasury of the Ministry of Finance, the state surplus in January-March 2011 made Som 1.5 billion or 3.2 percent to GDP (for January-March 2010 the budget was executed with the surplus in the amount 2.7 percent to GDP). By that without considering the funds from the total income tax of “Kumtor” the state budget deficit made Som (-)0.6 billion or Som (-)1.2 percent to GDP. Total financing of the state budget for the reporting period made Som 2.4 billion: among them the internal financing made Som 2.1 billion, external financing – Som 0.4 billion.

According to the preliminary data of the Social Fund of the Kyrgyz Republic, the surplus of the Social Fund for the first quarter of 2011 made Som 1.3 billion or 2.7 percent to GDP, revenues – Som 6.2 billion or 13.3 percent to GDP, expenditures – Som 5.0 billion or 10.7 percent to GDP.

In January-March 2011 the revenues of the state budget from the operational activity made Som 15.2 billion or 32.5 percent to GDP. In comparison with the similar indicator of January-March 2010 the growth rates decreased, having made 9.1 percent that as a whole is lower than the formed average annual rate for the last five years.

Total state budget expenditures for operational activity for January-March 2011 made Som 13.1 billion, having increased by 8.8³ percent or by Som 1.1 billion.

In accordance with the functional classification of budget expenditures in the reporting period the growth of expenditures was observed by the following groups: for defense, public order of safety (by 47.6 percent), for social protection (by 25.0 percent), for rest, culture and religion (by 16.1 percent), for the state services of common purposes (by 12.5 percent) and for public health (by 5.3 percent). Expenditures of the state budget decreased by the following groups: for economic issues (by 20.3 percent), for environment protection (by 7.0 percent), for housing and communal services (by 1.4 percent) and for education (by 0.2 percent).

As of the end of December 2010. the state debt made Som 131.6 billion, among them the internal debt is Som 8.4 billion, and external debt is Som 123.2⁴ billion. The state debt in 2010 increased by 11.7 percent or by Som 13.8 billion (UD\$ 293.3 million) in comparison with the similar indicator as of the end of 2009. Credit funds in the amount of US\$ 140.1 million were used in 2010 from the external sources.

Percentage payments on servicing of the state debt in January-March 2011 constituted Som 481.6 million (in January-March 2010 – Som 415.0 million), among them the ratio of payments by the internal and external debt constituted, accordingly, 25.1 or 74.9 percent from total percentage payments. In comparison with the similar indicator for January-March 2010 percentage payments by the external debt decreased by 3.4 times or by Som 254.6 million, and by internal debt they decreased by 60.9 percent or by Som 188.0 million.

In the reporting period net flow of budget funds for operations on acquisition of non-financial assets (including operations by the following groups: fixed assets, reserves, land) made Som 582.6 million or 1.3 percent to GDP (in January-March 2010 – Som 792.8 million or 1.9 percent to GDP).

³ In real terms they decreased by (-)9.5 percent

⁴ Data is calculated by NBKR (as of 31/12/10 US\$ 1 = Som 47.0992)

1.7. Financial Sector

Banking System

As of March 31, 2011⁵, 22 commercial banks⁶ (including the Bishkek Branch of the National Bank of Pakistan) and 246 branches of the commercial banks operated in the territory of the Kyrgyz Republic.

In spite of the problems taking place in 2010 in the banking system, as of March 31, 2011 it showed profitable activity – as a whole net profit in the amount of Som 368.2 million was received. 22 commercial banks operated in the similar period of 2010 and net profit based on their activity was Som 416.2 million. As of March 31, 2011 the total assets of the banking system increased by 1.6 percent from the beginning of the year to make Som 58.9 billion.

The situation on the market of deposits remained stable. Within the first quarter of 2011 the deposits of commercial banks were increasing, though by relatively low rates. Thus, the volume of the deposit base of the commercial banks as of the end of the first quarter of 2011 made Som 34.2 billion, having increased from the beginning of the year by 0.4 percent. By that the increase was provided by the growth of the foreign-currency component of the deposit base in 1.4 percent, whereas the deposits in Soms decreased by 0.7 percent. As a result of foreign-currency deposits growth the dollarization of the deposit base increased insignificantly from 52.1 to 52.6 percent as of the end of March.

The weighted average interest rate on newly accepted deposits in the national currency at the mean by the first quarter of 2011 made 2.0 percent, and by the deposits in the foreign currency – 1.1 percent, having decreased in comparison with the similar indicator for January-March 2010 by 0.5 percentage point.

In the first quarter of 2011 the tendency of economy crediting growth and interest rate decrease for credit resources continued. The increase of agriculture crediting influenced the main contribution in the growth of the credit portfolio of banks, mainly, as a result of activization of LLC Special Fund for Banks Refinancing, the credit portfolio of which increased for the quarter by Som 256.7 million or by 25.0 percent up to Som 1.3 billion and the average weighted rate made 6.6 percent.

The credit portfolio volume of commercial banks as of the end of the first quarter of 2011 made Som 26.7 billion, having increased from the beginning of the year by 1.4 percent. Herewith, the credit volume in Som increased by 5.2 percent up to Som 12.3 billion. The volume of credits issued in the foreign currency as of the end of the first quarter made Som 14.5 billion in the equivalent that is lower than its volume for the beginning of the year by 1.6 percent. The weighted average interest rate by credits of the banks in the national currency for the quarter decreased by 0.4 percentage point up to 22.5 percent and in the foreign currency – by 0.1 percentage point up to 19.2 percent.

Credits for trade held, as before, the main share in the credit portfolio of the banks by sectors. Meanwhile, the increase of the agriculture share was noted. Credits for the sectors of transportation, communication, procurement and processing and social services, as before,

⁵ Data is given according to regulative reporting of commercial banks.

⁶ OJSC “AsiaUnivarsalBank” was excluded from the structure of the banking system since November 01, 2010: due to the court decision on the initiation of bankruptcy proceedings and termination of laid-up mode (according to the NBKR Board Resolution No.83/1 as of 01/11/2010).

OJSC “Zalkar Bank” was included in the banking system since 24/12/2010 in compliance with the NBKR Board Resolution No. 91/1 as of 16/12/2010.

constituted insignificant share.

Due to the acceleration of inflation rates the value of a real interest rate by credits in the national currency made 1.8 percent (in the first quarter of 2010 it was 21.7 percent).

Non-banking Financial and Credit Institutions Licensed by NBKR

The system of non-banking financial and credit institutions of the Kyrgyz Republic by the end of March 2011 included 866 non-banking institutions⁷ (in the corresponding period of 2010 the number of non-banking institutions was 953), among them:

- FCSDCU – 1;
- SFBR – 1;
- Credit unions – 211;
- Micro-crediting companies – 277;
- Micro-crediting agencies– 116;
- Micro-financing companies – 4;
- Exchange bureaus – 256.

Table 3. Credit Portfolio of NFCU⁸ (million soms)

Name of NFCU	31.03.2010	31.12.2010	31.03.2011
FCSDCU	407.14	461.10	466.09
SFBR	65.16	1,028.07	1,284.76
Development Fund (DFKR) ⁹	4,522.03	-	-
Micro-financing organizations ¹⁰ (MCC/MCA)	-	6,126.32	-
MFC ¹¹	3,296.16	3,821.96	4,196.17
Credit agencies	964.89	1,139.73	1,161.36
Pawnshops	-	-	-
TOTAL		11,088.01	
TOTAL (without DFKR)		11,088.01	

⁷ Without considering pawnshops as their licensing was ceased from September 8, 2009

⁸ Data is presented without considering FCSDCU and SFBR (as credits of FCSDCU are given to the credit agencies and SFBR – to commercial banks).

⁹ The license of CJSC “Development Fund of the Kyrgyz Republic” No. 4 dated 02.09.2009 has been withdrawn from May 7, 2010 by the NBKR Resolution 29/1 as of 07.05.2010 based on the Decree of PGKR No. 31 as of 30.04.2010.

¹⁰ Systematic regulative reporting of MCC and MCA is submitted on the half-yearly basis.

¹¹ Bai-Tushum has been transformed into MFC from September 2009.