



**National Bank
of the Kyrgyz Republic**

**THE FINANCIAL SECTOR
STABILITY REPORT OF THE
KYRGYZ REPUBLIC**

**according to the results
of the first half of 2020**

2020

Bishkek

EDITORIAL BOARD

Chairman	N. Jenish
Board Members	A. Tezekbaeva
	A. Aidarova
	A. Karakozhaev
	E. Lelevkina
	I. Sultankulov
Executive Secretary	M. Abdyrakhmanov

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 August 17, 2012

© National Bank of the Kyrgyz Republic, 2020

This publication may not be copied or redistributed in any form or by any means without authorization of the National Bank of the Kyrgyz Republic. The reference to the publication “Financial Sector Stability Report of the Kyrgyz Republic” is obligatory when copying and translating excerpts.

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

Financial Stability Monitoring Division
National Bank of the Kyrgyz Republic
168 Chuy Avenue, Bishkek, Kyrgyz Republic
Tel.: (+996 312) 61-22-46
Fax: (+996 312) 61-07-30
E-mail: mabdyrahmanov@nbkr.kg

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

Statistical, analytical and calculated data/estimates are given as of June 30, 2020 in this report.

Adjustments to previously published data are possible, and, therefore, a period of 10 years is considered to be “open” due to possible change in accounting methods or historical data used in this publication.

Due to rounding of numbers, mismatch in the last number position is possible when summing up.

Other Publications of the National Bank of the Kyrgyz Republic

Annual Report of the National Bank of the Kyrgyz Republic

This publication is a complete report on the activity of the National Bank for the previous year. It contains assessment of changes in the real, financial and external sectors of economy, the description of decisions and actions of the National Bank in the monetary sphere, in the banking and payment systems, in the non-banking financial-credit organizations; it includes financial statements and general information on the National Bank, as well as the statistical appendices. It is published in the state, official and English languages.

Bulletin of the National Bank of the Kyrgyz Republic

The publication contains the statistical data on key macroeconomic and financial indicators. It is published on the official website of the National Bank in the state, official and English languages.

Monetary Policy Report

The Report informs the public of the decisions made by the National Bank in the monetary policy area based on the analysis and forecast of the key inflation factors and assessment of the economic development in the external and internal environment of the Kyrgyz Republic. It is published on the official website of the National Bank in the state, official and English languages.

Balance of Payments of the Kyrgyz Republic

The publication describes the recent development trends in the external sector and contains the data on the balance of payments, external trade, international reserves, external debt, and the international investment position, as well as the metadata and the information base to draw up the balance of payments. It is published quarterly - in February, June, August, and November in Kyrgyz, Russian and English languages.

Regulatory Acts of the National Bank of the Kyrgyz Republic

These are the regulations, instructions and other regulatory legal acts adopted by the National Bank of the Kyrgyz Republic. The estimated frequency of the journal publication is once a month in the state and official languages.

The publications of the National Bank are distributed according to the approved list, and are also posted on the official website of the National Bank at: www.nbkr.kg/Publications.

CONTENT

PREAMBLE	6
MAJOR CONCLUSIONS	8
I. MACROECONOMIC AND FINANCIAL ENVIRONMENT	9
1.1. Macroeconomic Conditions and Risks.....	9
1.2. Structure of the Financial Sector.....	16
1.3. Financial Markets.....	18
1.4. Real Estate Market.....	21
II. BANKING SECTOR	27
2.1. Major Trends of the Banking Sector Development.....	27
2.2. Banking Sector Risks.....	31
2.2.1. <i>Credit Risk. Credit Risk of the Banks' Clients</i>	31
2.2.2. <i>Liquidity Risk</i>	36
2.2.3. <i>Concentration Risk</i>	37
2.2.4. <i>Currency Risk</i>	38
2.2.5. <i>Interest Rate Risk</i>	40
2.2.6. <i>“Contagion” Risk</i>	41
2.2.7. <i>Country Risk</i>	42
2.3. “Reverse” Stress Testing of the Banking Sector.....	44
2.3.1. <i>“Reverse” Stress Testing of Credit Risk</i>	44
2.3.2. <i>“Reverse” Stress Testing of Liquidity Risk</i>	45
2.3.3. <i>“Reverse” Stress Testing of Market Risk</i>	46
III. NON-BANKING FINANCIAL-CREDIT ORGANIZATIONS	47
3.1. Main Trends.....	47
3.2. Risks of Non-banking Financial-Credit Organizations.....	50
3.3. Stress Testing of NBFCOs Sector.....	54
IV. PAYMENT SYSTEMS	56
V. IMPROVEMENT OF THE FINANCIAL SECTOR REGULATION	59
GLOSSARY	63
LIST OF ABBREVIATIONS	64

PREAMBLE

National Bank of the Kyrgyz Republic has been publishing the Financial Sector Stability Report of the Kyrgyz Republic since 2012. The objective of the Report is to inform the public on the general assessment of the stability and soundness of the financial system of the Kyrgyz Republic.

Financial Stability in this publication means smooth and continuous functioning of financial institutions, financial markets and payment systems enabling to perform functions of the financial intermediation even in conditions of financial imbalances and shocks.

Results of the monitoring and analysis of financial stability are considered by the National Bank in forming the main directions of the National Bank's monetary policy, regulating the banking activity and development of the strategy for financial-credit organizations of the Kyrgyz Republic.

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

LIST OF BOXES

Box 1. Housing Affordability Index	25
Box 2. Stress Testing of Impact from Price Changes in the Real Estate Market on the Banking Sector ...	26
Box 3. The Survey Results of the Commercial Banks Clients	33
Box 4. Results of the Survey of the Commercial Banks' Largest Clients	34
Box 5. Credit and Currency Risks	39
Box 6. Concentration Indices based Assessment of NBFCOs Sector Activity	52

MAJOR CONCLUSIONS

The National Bank made prompt decisions focused on mitigating the negative consequences during the spread of the COVID-19 disease to maintain financial stability in the first half of 2020, meanwhile it positively affected the stability of the financial and credit sector.

In the first half of 2020, economic activity of the Kyrgyz Republic demonstrated negative dynamics. Macroeconomic risks gradually increased amid measures taken to counter the spread of coronavirus disease and temporary restrictions imposed on the economic entities operation

From January till April 2020, the *inflation rate* accelerated amid external and internal consequences of the COVID-19 pandemic. However, by the end of the first half of 2020, there was a slowdown in the growth of prices, in particular for food products, due to a decline in domestic demand and consequences of the restrictions imposed on business activities due to the spread of COVID-19 disease.

There is a slight increase in the financial intermediation indicator despite a decline in economic activity due to introduced regime of the state of emergency/emergency situation.

Liquidity risk, currency risk and concentration risk remain the main risks for the banking sector.

The level of risks in the systemically important payment systems was minimal and was conditioned by the regulatory legal acts provided for by the legislation of the Kyrgyz Republic and measures taken by the National Bank to manage the risks in the payment systems, particularly liquidity risk.

I. MACROECONOMIC AND FINANCIAL ENVIRONMENT

1.1. Macroeconomic Conditions and Risks

There was an acceleration in the inflation rate resulted from a gradual increase in food prices conditioned by the restrictive measures applied to exports of goods in the regional market due to rapid spread of the COVID-19 pandemic from January till April 2020 and its consequences. However, by the end of the reporting period, there was a slowdown in the growth of prices, in particular for food products conditioned by the disinflationary effect of the decline in domestic demand and the consequences of restrictions imposed on business activities due to coronavirus infection.

In the first half of 2020, the dynamics of economic activity in the Kyrgyz Republic was negative. Macroeconomic risks gradually increased after introduction of quarantine measures, as well as the temporary suspension of the economic entities operation.

External Conditions

The macroeconomic indicators of the trading partner countries were still formed amid epidemiological tensions in the world. The volatility of prices in the world food and energy markets carried the risks for business activity in the world and the region as a whole.

In the first half of 2020, GDP of Kazakhstan decreased by 1.8 percent due to the spread of the coronavirus in Kazakhstan and introduction of the internal and external restrictions. The base rate of the National Bank of Kazakhstan was increased from 9.25 percent at the beginning of the year up to 12.00 percent in March 2020 amid deteriorating economic situation in Kazakhstan, a decrease in oil prices, as well as an increase of inflationary risks. However, in April, the National Bank of Kazakhstan decreased the rate down to 9.5 percent, to maintain economic activity and ensure financial stability in the country.

In the first half of 2020, GDP of China decreased by 1.6 percent amid the spread of the coronavirus epidemic. At the same time, a recovery dynamics was observed in the economy by the end of the half-year, thus in Q2 of the current year, GDP increased by 3.2 percent after a significant decrease in Q1 (negative growth by 6.8 percent). Easing of restrictions to prevent infection, as well as a number of stimulus measures taken by the government of China focused on stabilizing the labor market and ensuring social stability contributed to economic recovery in Q2 of 2020. Despite the dynamics of recovery, there are risks and uncertainties for the Chinese economy amid disagreements with the United States and the spread of coronavirus pandemic in the world.

In the reporting period, GDP of Russia decreased by 3.4 percent due to significant decline in oil prices and introduction of the restrictive measures to prevent the spread of coronavirus disease. In these conditions, the government and the Bank of Russia took measures to support the economy and render assistance to the population. As a number of restrictions were lifted by the end of the first half of 2020, economic activity gradually recovered in certain regions of Russia. Inflation in Russia was formed below the target set by the Bank of Russia due to the significant predominance of disinflationary factors. Forecasts for GDP dynamics in Russia in 2020 were revised downward by the international analysts and the government due to changes in the global economy and increased geopolitical risks. The economic recovery in Russian is expected to be gradual and economic growth will be facilitated by easing monetary conditions and gradual recovery of the global economy.

Internal Conditions

Gross Domestic Product

Restrictive measures to prevent the spread of coronavirus disease, taken by the Government of the Kyrgyz Republic since the second half of March 2020, as well as negative external factors had a significant impact on the economic situation. According to preliminary data of the National Statistical Committee of the Kyrgyz Republic, at the end of the first half of 2020, GDP decreased by 5.3 percent (in January-June 2019, there was an increase by 6.4 percent). Increase in production output at the enterprises for the development of gold mining “Kumtor” by 10.2 percent was the main factor of economic support. Excluding the enterprises for the development of gold mining “Kumtor”, GDP decreased by 6.9 percent (in January-June 2019, there was an increase by 2.2 percent). The GDP deflator was formed positive at 2.7 percent, having increased by 6.1 percentage points compared to the same indicator of the first half of 2019.

In the sectoral breakdown, such sectors as trade (-2.3 p.p.), transport (-1.4 p.p.) and construction (-0.6 p.p.) made a negative contribution to economic development.

The growth rate in industrial production slowed down to 0.1 percent compared to the first half of 2019. The growth in the industrial sector was mainly due to an increase in the production output of pharmaceutical products (2.4 times), chemical products (by 10.9 percent), and mining (by 9.8 percent).

Growth of production output in agricultural by 1.6 percent (in January-June 2019 – 2.0 percent) was due to an increase in production of the crop growing (by 2.3 percent) and livestock (by 1.5 percent) sectors.

The volume of gross construction output decreased by 9.1 percent amid reduction of investments in fixed capital by 14.8 percent. The volume of investments financed from internal sources decreased by 8.3 percent, and the investments financed from external sources decreased by 30.0 percent. Decrease of investments in fixed capital was observed in the construction of processing facilities, water supply, cleaning, waste treatment, wholesale and retail trade, transportation and storage of goods, hotels and restaurants, information and communications, education, healthcare, other service activities, as well as housing construction.

Decrease by 8.2 percent in the service sector was mainly due to reduction in the volume of transport activities (by 32.0 percent) and trade (by 15.0 percent). Meanwhile, the growth in the field of information and communications was 0.7 percent (in the first half of 2019, there was a decline by 6.3 percent).

Table 1.1.1. Contribution of Individual Activities in GDP

	Jan-June 2019			Jan-June 2020		
	Share, percent	Growth rate, percent	Contribution in growth, p.p.	Share, percent	Growth rate, percent	Contribution in growth, p.p.
GDP	100	6.4	6.4	100	-5.3	-5.3
Agriculture, forestry and fishery	8.6	2.0	0.2	9.4	1.6	0.1
Industry	20.6	20.3	4.1	25.3	0.1	0.0
<i>Mining</i>	0.9	31.8	0.3	1.1	9.8	0.1
<i>Processing sectors (Processing industry)</i>	16.4	25.2	3.8	20.9	-0.1	0.0
<i>Provision (supply) of electric energy, gas, steam and conditioned air</i>	3.0	-3.0	-0.1	3.0	0.1	0.0
<i>Water supply, waste treatment and processing, receipt of recyclable materials</i>	0.3	10.5	0.05	0.3	-16.5	-0.06
Construction	6.8	5.8	0.4	6.4	-9.1	-0.6
Services	48.7	1.5	0.7	47.9	-8.2	-4.0
<i>Wholesale and retail trade; repair of cars and motor-cycles</i>	15.5	4.3	0.7	14.2	-15.0	-2.3
<i>Transportation activity and storage of cargo</i>	4.3	2.2	0.1	3.1	-32.0	-1.4
<i>Information and communication</i>	2.9	-6.3	-0.20	3.0	0.7	0.02
<i>Other</i>	26.0	0.6	0.2	27.5	-1.3	-0.3
Net (exclusive of subsidies) taxes on products	15.3	6.4	1.1	11.1	-5.3	-0.8

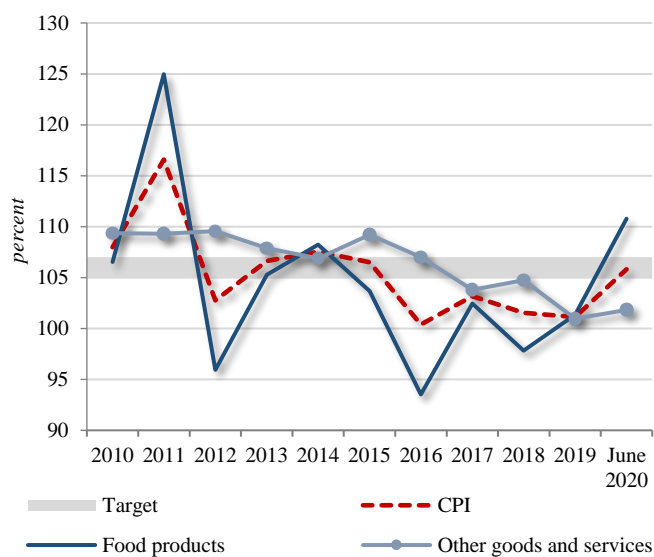
Source: NSC KR

Inflation

External (restrictive measures in several countries) and internal economic consequences of the COVID-19 disease are the main factors of acceleration in price growth in the first half of 2020. Rush demand of the population for goods of first priority and long-term storage products caused by introduction of the emergency situation and the state of emergency in certain regions of the country had additional impact on rise in prices. At the same time, the rise in prices for tobacco products due to planned increase in excise rates had an upward effect on inflation at the beginning of the year. In June 2020, the annual inflation rate fell down to 5.8 percent after reaching 8.6 percent in April of the current year. Slowdown in the inflation rate was mainly due to a decrease in the growth rate of the inflation food component, however the emerging dynamics of inflation was generally in line with the National Bank's expectations.

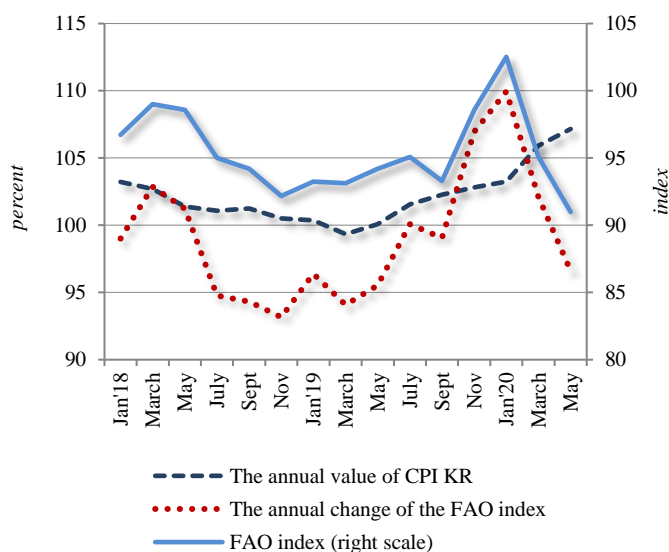
Market inflation remained low during the whole period and constituted 1.6 percent in June, generally being within the National Bank's target of 5-7 percent. The price index for the non-food commodity group and for paid services grew moderately on the main commodity items.

Chart 1.1.1. CPI in the Kyrgyz Republic (cumulatively year-to-date to the corresponding period of the previous year)



Source: NSC KR

Chart 1.1.2. Dynamics of the Kyrgyz CPI and the FAO Index



Source: NSC KR, www.fao.org

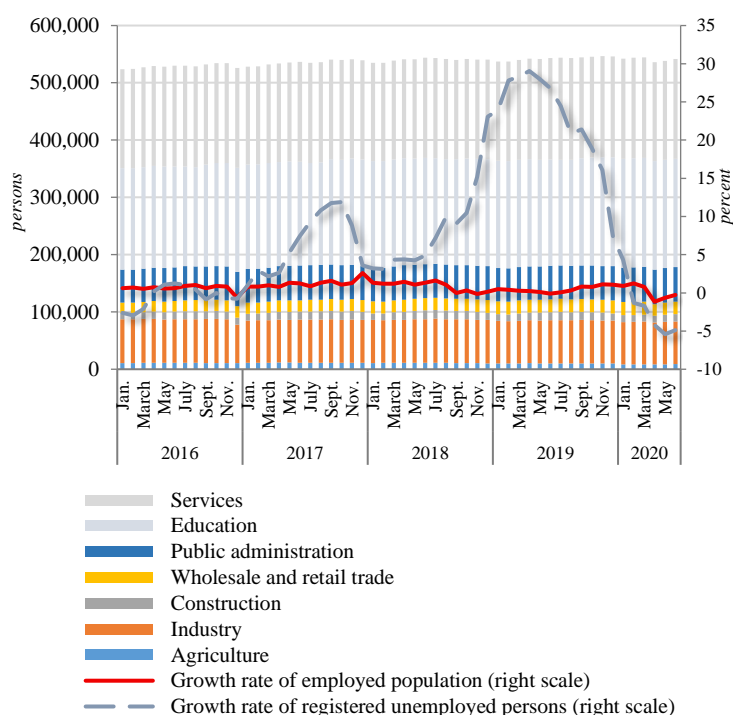
Increase in prices for food products made the main positive contribution to acceleration of the inflation rate, since about half of the consumer basket was occupied by food products (45.4 percent), the prices thereof were very volatile in the reporting period. At the same time, the dynamics of prices for consumer goods and services, exclusive of food products, is relatively stable and is within the National Bank's target of 5-7 percent. Taking into account the actual dynamics of the CPI in the first half of 2020, it can be noted that in the second half of 2020 there may be certain risks regarding the second wave of the coronavirus disease and, as a result, fluctuations in prices for food products. An additional risk of the CPI deviation from the targets is the impact of weather conditions and conditions of import supplies to the Kyrgyz Republic.

The FAO index (Food Price Index), reflecting price dynamics in the world food markets, in the first half of 2020, was below the value for the same period in 2019. World food commodity prices continued to decrease (during four consecutive months) due to stable stocks and weakening demand due to economic recession conditioned by the COVID-19 disease. In the reporting period, prices for all commodity sub-indices decreased, except for sugar.

There were no certain inflation risks for the Kyrgyz Republic from the world food market.

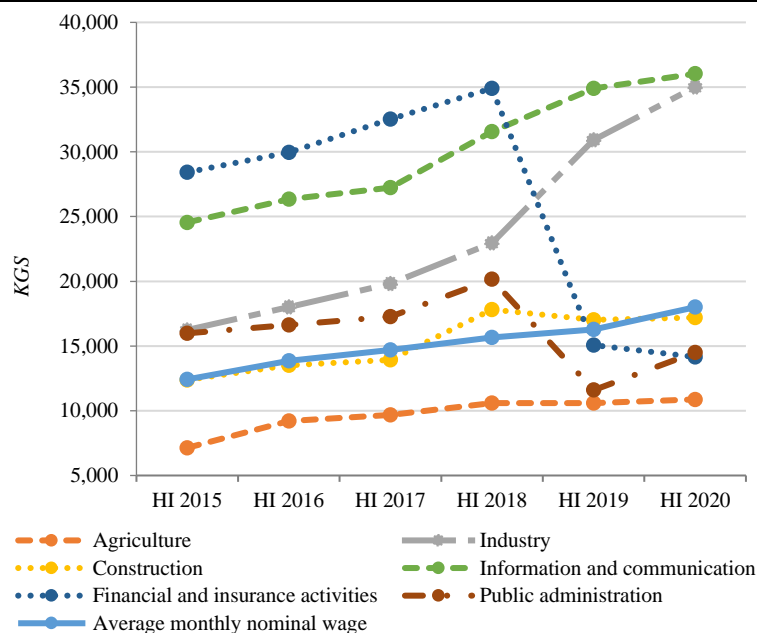
Labor Market and Wages

Chart 1.1.3. Number of Officially Employed and Unemployed People



Source: NSC KR

Chart 1.1.4. Average Monthly Nominal Wages of the Employees at the Enterprises and Organizations by Economic Activity



Source: NSC KR

According to the Ministry of Labor and Social Development of the Kyrgyz Republic, as of July 1, 2020, the number of unoccupied people in search of work registered at the state employment service decreased by 2.1 percent compared to the same date in 2019 and constituted 100.2 thousand people. As of July 1, 2020, the number of registered unemployed people decreased by 4.9 percent compared to the same indicator of 2019 and constituted 78.6 thousand persons. The registered unemployment rate made 3.1 percent of the economically active population.

Education (34.8 percent), services (32.1 percent), industry (13.7 percent) remained the main employment sectors¹ of the able-bodied population. It can be noted that the official data do not indicate that the number of employed population has significantly changed over the past three years.

In the reporting period, there was a multidirectional growth of wages in the Kyrgyz Republic. At the end of the first half of 2020, the average monthly nominal wage per an employee¹ increased by 10.5 percent compared to the same indicator of 2019 and amounted to KGS 18.0 thousand. The largest increase in the average monthly wage growth rate was observed in education (25.1 percent), hotels and restaurants activity (17.9 percent) and in water supply, waste cleaning, treatment and recycling (17.3 percent). During six months of 2020, real wages increased by 4.4 percent compared to the same period of 2019 (in January-June 2019, the increase was 4.3 percent).

¹ Exclusive of small enterprises.

State Budget

In order to mitigate the negative consequences of the COVID-19 disease spread, the Government of the Kyrgyz Republic took measures to form an emergency budget that provides for additional costs for measures to prevent the spread of COVID-19 disease in the healthcare sector, in the law enforcement agencies, as well as in terms of social protection to support the citizens in need. The decline in tax revenues amid slowdown in economic growth conditioned reduction in non-priority expenditures, in particular, in capital expenditures of the ministries and departments, financed from the budget.

At the end of the first half of 2020, the state budget deficit amounted to KGS 16.6 billion or 7.3 percent to GDP. The state budget revenues decreased by 16.7 percent or KGS 12.1 billion compared to the same period in 2019 and amounted to KGS 60.3 billion or 26.4 percent to GDP, meanwhile the state budget expenditures increased by 8.4 percent or KGS 5.4 billion and amounted to KGS 69.8 billion or 30.6 percent to GDP. The net outflow of budget funds for operations on purchase of non-financial assets decreased by 7.9 percent or by KGS 606.5 million compared to the same period of 2019 and amounted to KGS 7.1 billion or 3.1 percent of GDP.

At the end of the reporting period, the public debt increased by 13.6 percent compared to the end of previous year and amounted to KGS 362.8 billion or USD 4.8 billion. The structure of the total debt demonstrates a downward trend in the internal debt and an increase in the external debt due to receipt of financial assistance provided by the international financial organizations in the form of loans to prevent the spread of the coronavirus disease, to support the economy and to cover the budget deficit.

Table 1.1.2. Main Parameters of the State Budget of the Kyrgyz Republic

	Jan-June 2019		Jan-June 2020	
	billions of KGS	% to GDP	billions of KGS	% to GDP
Total incomes (including sales of non-financial assets)	72.5	30.9	60.3	26.4
including incomes from operational activity	72.4	30.9	60.3	26.4
sale of non-financial assets	0.0	0.0	0.0	0.0
Total expenditures (including purchase of non-financial assets)	72.1	30.7	76.9	33.7
including expenditures for operational activity	64.4	27.4	69.8	30.6
purchase of non-financial assets	7.7	3.3	7.1	3.1
Deficit(-) / Profit (+)	0.3	0.1	-16.6	-7.3
Primary deficit (-) / profit (+)	4.2	1.8	-12.4	-5.4
Budget financing	6.7	2.8	27.9	12.2
External financing	-2.6	-1.1	20.3	8.9
Internal financing	9.2	3.9	7.7	3.4

Source: MF KR

Macroeconomic Risks

Severe restrictive measures to prevent the spread of coronavirus disease, taken by the Government of the Kyrgyz Republic since the second half of March 2020, conditioned sharp decline in economic growth. Macroeconomic risks will still be observed in the second half of 2020 amid the second wave of COVID-19. Moreover, there are risks associated with the unstable political situation in the country after the parliamentary elections held in October 2020.

Despite a sharp acceleration in price growth at the beginning of the current year, the growth rate slowed down in June 2020, mainly due to slowed down growth in the volume of food products and decrease in domestic demand. Weak dynamics of real money incomes of the population and expected moderate increase in prices for the world food products are expected to contribute to a moderate increase of the inflation rate by the end of 2020. In general, taking into account the current inflation dynamics, the National Bank expects that the average annual inflation rate in 2020 may reach a level near the upper limit of the target of 5.0-7.0 percent.

Widening of the state budget deficit, the risks of a new wave of diseases in the country and a more protracted recovery of economic activity in the trading partner countries are the risks of slowed down and uneven economic growth in the country and acceleration of the inflation rate in the coming years. In the first half of 2020, the state budget deficit was financed at the expense of external borrowings, which in the long term may have a negative impact on the sustainability of the public debt.

1.2. Structure of the Financial Sector

Institutional structure of the financial sector in the Kyrgyz Republic is represented by the commercial banks and other financial institutions.

Table 1.2.1. Institutional Structure of the Financial Sector
(number of the financial institutions)

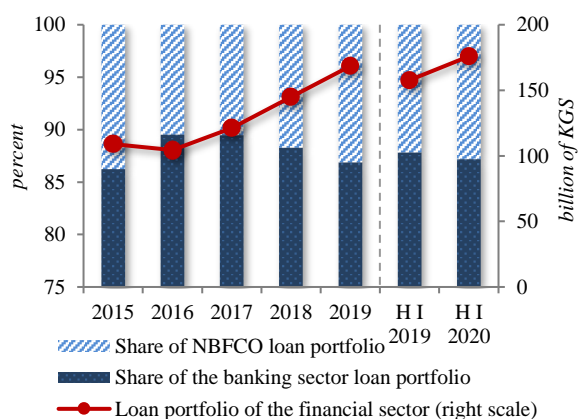
Financial institutions	2015	2016	2017	2018	2019	HI 2019	HI 2020
Commercial banks	24	25	25	25	24	25	23
Other financial companies, including:	656	704	688	695	667	679	657
<i>Non-banking financial-credit organizations (NBFCO), including:</i>	627	673	657	664	636	648	626
microfinance organizations, including:	172	162	150	142	137	139	134
- microcredit companies	109	103	96	95	89	92	87
- microcredit agencies	57	53	47	39	39	39	38
- microfinance companies	6	6	7	8	9	8	9
“FC CU” OJSC	1	1	1	1	1	1	1
Credit bureaus	-	-	-	2	2	2	2
Credit unions	125	116	110	106	95	96	93
Exchange offices	329	394	396	413	401	410	396
Insurance companies	17	19	19	19	19	19	19
Investment funds	9	9	9	9	9	9	9
Stock exchanges	1	1	1	1	1	1	1
Pension funds	2	2	2	2	2	2	2

Sources: CBs, NBFCOs, NSC KR

As of the end of the first half of 2020, assets of the banks and the NBFCOs constituted KGS 294.5 billion or 49.7 percent to GDP.

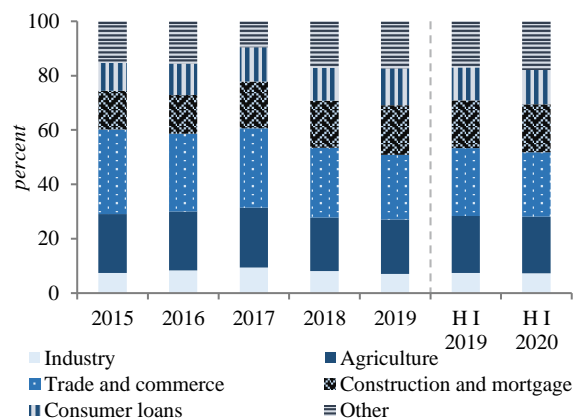
In the first half of 2020, the total loan portfolio of the financial sector constituted KGS 175.9 billion or 29.7 percent of GDP. The share of the banks' loans in the loan portfolio of the financial sector decreased by 0.6 p.p. and at the end of the first half of 2020 made 87.2 percent (Chart 1.2.1).

Chart 1.2.1. Structure of the Loan Portfolio



Source: CBs and NBFCOs

Chart 1.2.2. Sectoral Structure of the Loan Portfolio in the Financial Sector



Source: CBs and NBFCOs

The high concentration of loans was still observed in the trading sector (banks) and agriculture (NBFCOs) within the sectoral structure of the loan portfolio in the financial sector. The aggregate share of the loan portfolio in the financial sector of the aforementioned sectors of the economy at the end of the first half of 2020 constituted 44.5 percent of total issued loans and amounted to KGS 78.2 billion (Chart 1.2.2).

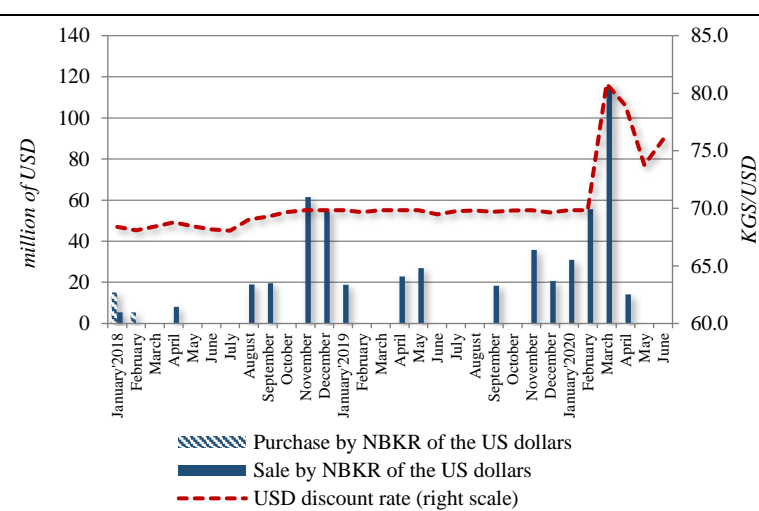
1.3. Financial Markets

During the first half of 2020, the dynamics of the exchange rate in the domestic currency market was formed under the influence of changes in the economic situation in the world and increased volatility in the global financial and commodity markets. The National Bank, adhering to the floating exchange rate regime, conducted foreign exchange interventions only to smooth sharp fluctuations in the exchange rate. The volume of operations in the money market was significantly lower compared to the same period of 2019. The activity of participants decreased slightly in the government securities market. On the contrary, the market of the National Bank's notes demonstrated increased activity of the participants.

1.3.1. Currency and Money Market

Currency Market

Chart 1.3.1.1. Dynamics of Interventions of the NBKR in the US Dollar Market



Source: NBKR

In the reporting period, the factors of the global economy such as the monetary policy conducted by the US Federal Reserve System, changes in external economic conditions in the world amid coronavirus disease, and an increase in geopolitical risks influenced the growth of the USD exchange rate in the Kyrgyz Republic, as well as in many countries. The domestic currency market was among the first to respond to the aforementioned shock changes due to deep integration of the economy of the Kyrgyz Republic into regional trade and economic relations. Finally, volatility in the world financial markets, a decreasing inflow of foreign currency from re-export operations and remittances were objective economic factors that resulted in weakening of the Kyrgyz som in March-April 2020 (to a maximum of KGS 84.8988/USD 1). As risks decreased and business activity slightly recovered upon lifting of restrictive measures taken to combat the spread of coronavirus disease, the exchange rate of the US dollar against the Kyrgyz som stabilized within the range of KGS 73-76/USD 1 by the end of the first half of the year (at the beginning of the period the indicator was KGS 69.5117/USD 1).

During the first half of 2020, the National Bank conducted foreign exchange interventions on sale of foreign currency to smooth significant fluctuations in the exchange rate. The National Bank did not conduct interventions on purchase of foreign currency.

Amid decrease in business activity in the world, the total volume of operations on purchase and sale of foreign currency by the participants of the currency market (including operations with non-residents) decreased by 16.2 percent compared to the same period of 2019 (down to KGS 371.9 billion). In addition, there was a decrease in the volume of operations in all foreign currencies. Most of the foreign exchange operations (90.9 percent) were conducted in the cash segment and mainly in the exchange offices. In the non-cash segment of the currency market, the volume of operations conducted in US dollars increased, meanwhile there was decrease in operations with other currencies.

Money Market

The money market of the country still performed the functions on efficient distribution of financial resources, providing the participants with the opportunity of flexible liquidity management, as well as providing the lenders with the instruments to receive profit by investing their money. In the first half of 2020, activity in the interbank credit market remained relatively high, and the interest rates were higher compared to 2017, 2018 and 2019. The interest rates in the money market are among the factors of their formation in the capital market.

In the first half of 2020, the volume of operations in the interbank credit market amounted to KGS 16.2 billion, which is by 44.2 percent lower compared to the same period of 2019, however, it is still a comparable value compared to other half years in recent years. In the reporting period, the standard operations were not conducted in the national and foreign currencies; therefore activity in the interbank market consisted entirely of repo operations. The average weighted rate in the interbank market significantly increased from 2.64 percent in the first half of 2019, up to 3.70 percent. In general, the volatility of rates was low and comparable to the first half of 2019. The average weighted maturities increased from 3.3 days in the first half of 2019 up to 6.9 days in the first half of 2020.

The volume of overnight loans provided by the National Bank to support the short-term liquidity of the banks amounted to KGS 3,533.7 million in the first half of 2020 (increase by 26 times compare to the same period of 2019). The volume of funds placed by the commercial banks on overnight deposits amounted to KGS 615.3 billion (+43.8 percent compared to the same period in 2019).

1.3.2. Securities Market

In the reporting period, in the domestic market, the Ministry of Finance of the Kyrgyz Republic continued to carry out borrowings in order to finance the republican budget deficit and refinance the government debt. The Ministry of Finance supplied 3-, 6- and 12-month ST-Bills and 2-, 3-, 5- and 7-year ST-Bonds. In the reporting period, the total supply of government securities (ST-Bills and ST-Bonds) decreased by 18.3 percent compared to the same indicator of the previous year and amounted to KGS 7.6 billion. In the structure of borrowings, the volume of ST-Bonds supply predominantly exceeded the volume of ST-Bills supply (the share of ST-Bonds was 82.2 percent, ST-Bills – 17.8 percent).

The reporting period, the supply of ST-Bills slightly decreased and amounted to KGS 1.4 billion. However, the activity of participants in this market increased amid resumption of placement of 3- and 6-month ST-Bills in contrast to the same period of the previous year. It should be noted that 3- and 6-month ST-Bills were supplied only in January of the reporting period, in the remaining months – only 12-month securities. During the first half of 2020, there was an increase in the rates on ST-Bills up to 5.8 percent (+1.1 percentage points) amid an increase in the rates on 12-month securities, formed on an auction basis. The total volume of ST-Bills sales amounted to KGS 1.0 billion (+57.6 percent compared to the same indicator of the previous year), meanwhile the demand amounted to KGS 1.9 billion (+51.6 percent). The volume of ST-Bills in circulation decreased by 76.3 percent year-to-date, down to KGS 973.9 million as of the end of June 2020.

There was a decrease in indicators for all parameters of auctions in the ST-Bonds market, with the exception of a slight increase in the rates (from 9.7 to 10.4 percent). Thus, in the reporting period, the volume of ST-Bonds supplied by the issuer amounted to KGS 6.3 billion (-19.9 percent). In terms of maturities, there was an increase only in the supply of 7-year ST-Bonds. Moreover, the greatest activity of participants was also observed in the market of 7-year ST-Bonds (43.2 percent of the total demand), and the least demand was for 3-year ST-Bonds (10.6 percent), meanwhile there was a significant demand for 5-year ST-Bonds in the same period of 2019. According to the results of the auctions, the volume of ST-Bonds placement decreased by 25.8 percent and amounted to KGS 4.5 billion. At the end of the first

half of 2020, the volume of ST-Bonds² in circulation increased by 5.2 percent year-to-date, up to KGS 45.1 billion. The institutional investors, as before, were the main holders of ST-Bonds (58.0 percent). The ST-Bonds portfolio denominated in foreign currency has not changed year-to-date (USD 49.4 million).

In the secondary market, the government securities participants conducted operations on purchase/sale of ST-Bonds in the amount of KGS 253.7 million. Operations with ST-Bills were not conducted in the secondary market.

Taking into account the preconditions for development of the external environment and the prevailing internal conditions, the activity of the participants in the market of the National Bank's notes increased, in particular, there was an increase in the average auction indicators of supply, demand and sales. In the reporting period, the participants demonstrated demand for 7-, 14-, 28-, 91-day notes (in the same period of the previous year, there was demand for 182-day notes). During the first half of 2020, the investment interest of the commercial banks for 91-day notes decreased significantly due to prevailing high concentration of short-term excess liquidity in the banking system. At the same time, this decrease was offset by an increase in demand for shorter-term notes of the National Bank. An increase in profitability was observed for almost all maturities of this asset.

Thus, in the reporting period, the total demand for the National Bank's notes increased by 2.1 times (up to KGS 147.9 billion), while the volume of supply grew by 2.0 times compared to the same period in 2019, up to KGS 140.5 billion. According to the results of the auctions held on placement of the National Bank's notes, the volume of sales of this asset amounted to KGS 130.6 billion (+ 2.1 times), where the main share fell on 7-day notes. As a result, the total volume of the National Bank's notes portfolio in circulation increased by 59.3 percent since the beginning of 2020, up to KGS 12.8 billion.

² Exclusive of the ST-Bonds denominated in foreign currency.

1.4. Real Estate Market

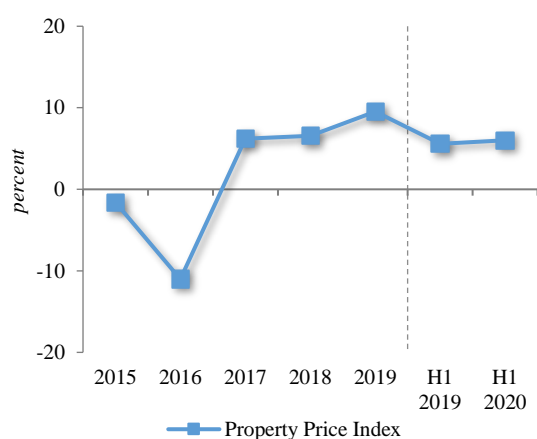
At the end of the first half of 2020, there was an increase of the price index³ in the real estate market of the Kyrgyz Republic due to the rise in prices for individual houses and apartments compared to the first half of 2019.

There was also an increase in the level of the average wage, which positively influenced the housing affordability index.

Risks to the financial sector from the real estate market remain moderate, which was conditioned by insignificant share of the mortgage loans⁴ in the total loan portfolio of the banks.

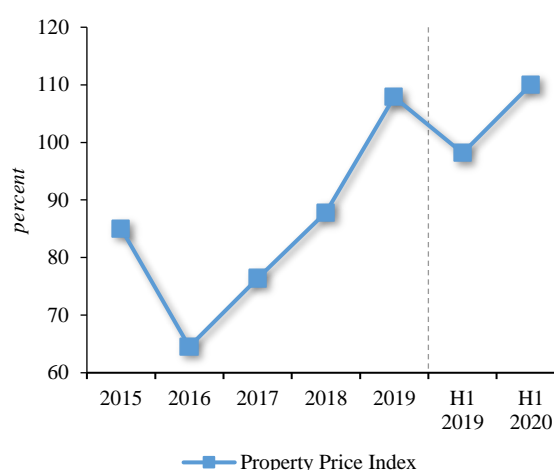
At the end of the first half of 2020, an increase in the property price index from 5.6 percent to 6.0 percent, as well as in the property basis price index from 98.1 percent to 110.0 percent was observed in the Kyrgyz Republic due to growth in prices for individual houses by 6.1 percent and for apartments by 6.0 compared to the first half of 2019.

Chart 1.4.1. Price Index Growth Rate in the Real Estate Market



Source: SRS GKR

Chart 1.4.2. Basis Price Index Growth Rate in the Real Estate Market⁵



Source: SRS GKR, NBKR

As of June 30, 2020, the average price for 1 square meter of housing (apartments) in Osh increased by 9.6 percent (up to KGS 36.4 thousand) and in Bishkek – by 4.7 percent (up to KGS 53.1 thousand) compared to the first half of 2019. The average price for 1 square meter of individual houses in Osh increased by 29.4 percent (up to KGS 52.4 thousand), and in Bishkek, on the contrary, it decreased by 2.8 percent (up to KGS 53.1 thousand).

³ The Laspeyres index method was used in developing price index for the real estate. In general, the Laspeyres index is computed as follows:

$$L = (\sum_{i=1}^K QoiPti / \sum_{i=1}^K QoiPoi) * 100,$$

where

K = number of real estate types;

Qoi = number of real estate of type i in the base period;

Poi = price of real estate of type i in the base period;

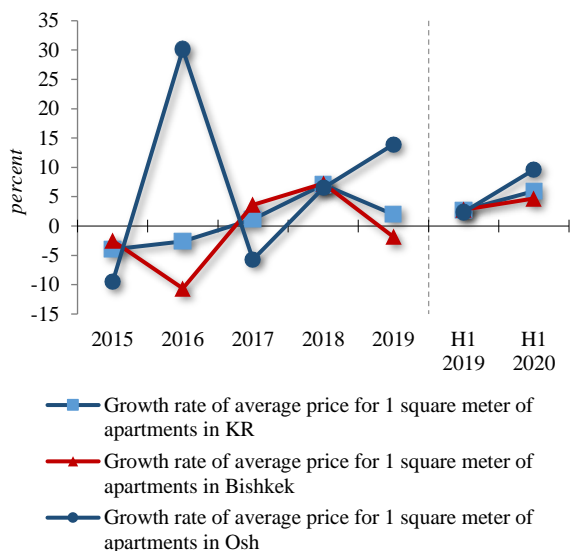
Pti = price of the real estate of type i in the current period

⁴ Currently, a mortgage loan is usually a long-term loan extended on security of the title to real estate in the Kyrgyz Republic.

⁵ The year 2010 was taken as the base period.

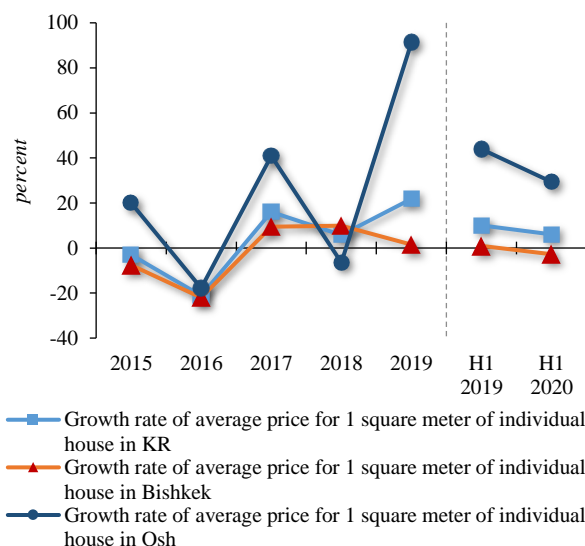
In the first half of 2020, the number of transactions of the real estate purchase and sale decreased by 30.3 percent and amounted to 16,105. The transactions on purchase and sale of the apartments decreased by 31.4 percent and the transactions on purchase and sale of the houses decreased by 29.0 percent compared to the first half of 2019 and amounted to 8,896 and 7,209, accordingly.

Chart 1.4.3. Dynamics of Price Changes for Apartments



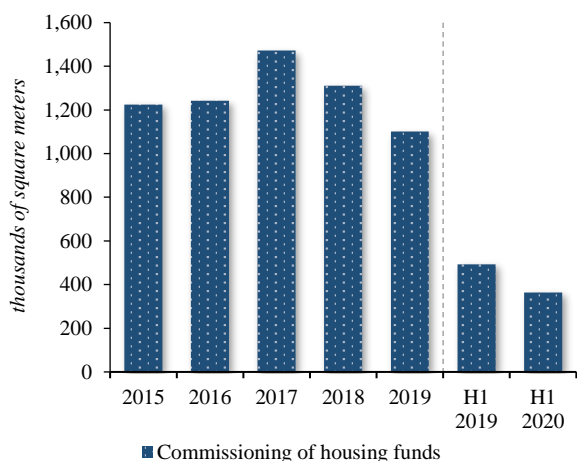
Source: SRS GKR, NSC KR, NBKR

Chart 1.4.4. Dynamics of Price Changes for Individual Houses



Source: SRS GKR, NSC KR, NBKR

Chart 1.4.5. Dynamics of Housing Commissioning and Loan Extended for Construction and Mortgage⁶



Source: SRS GKR, NSC KR, NBKR calculations

There was a decrease in the level of commissioning of housing funds. At the end of the first half of 2020, the decrease in the aggregate level of commissioning of housing funds constituted 26.2 percent compared to the first half of 2019 due to the reduction in the volume of housing funds commissioning in all regions of the country, exclusive of Issyk-Kul and Chui regions (Table 1.4.1).

⁶ Data for the period.

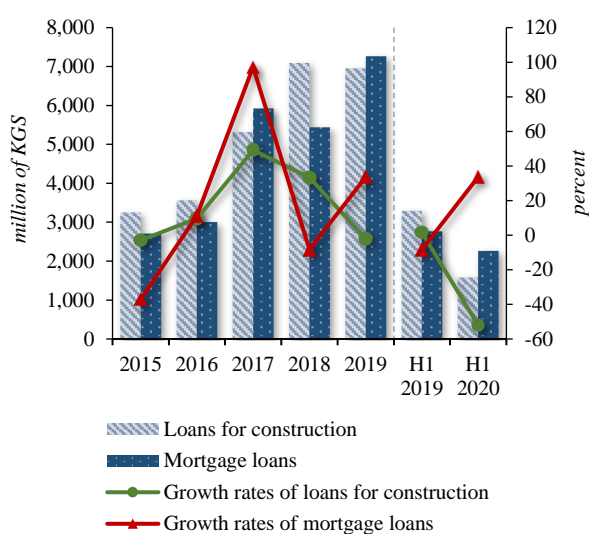
Table 1.4.1. Geographic Structure of Commissioned Housing

	HI 2019		HI 2020	
	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	154.5	31.4	111.5	30.7
Osh city and Osh region	114.8	23.3	68.8	18.9
Other regions of KR	223.1	45.3	183.0	50.4
Total	492.4	100.0	363.3	100.0

Source: NSC KR

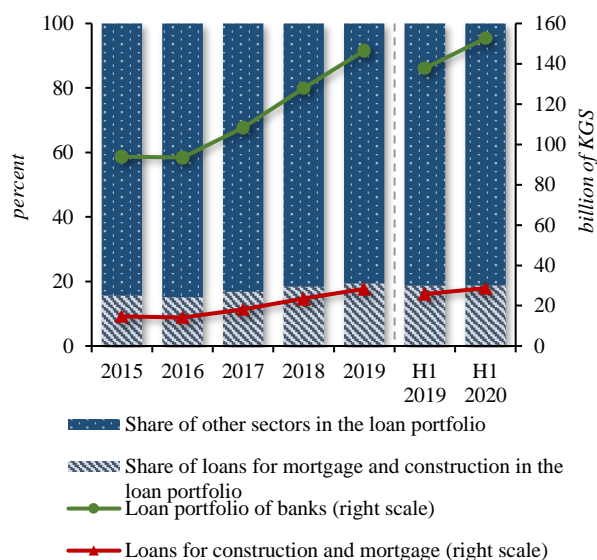
As of June 30, 2020, there was a decrease in the volume of loans issued to finance mortgage loans compared to the first half of 2019. The volume of mortgage loans decreased by 18.0 percent and amounted to KGS 2.3 billion in the first half of 2020. There was a decrease in the volume of loans extended in the national and in foreign currencies. The volume of loans extended for construction decreased by 52.1 percent and amounted to KGS 1.6 billion. The sector of construction demonstrated decrease in the volume of loans extended in foreign currency.

Chart 1.4.6. Loans Extended for Construction and Mortgage⁷



Source: NBKR

Chart 1.4.7. Total Share of Loans for Mortgage and Construction in the Loan Portfolio of Commercial Banks⁸



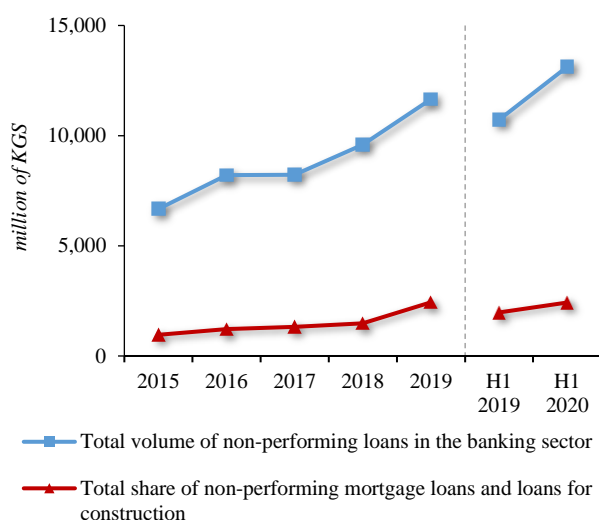
Source: NBKR

⁷ Data for the period.

⁸ Data as of the end of period.

At the end of the first half of 2020, residential houses are generally constructed and commissioned at the expense of the population (98.7 percent of the total commissioning)⁹.

Chart 1.4.8. Dynamics of Non-performing Loans



Source: CBs

As of June 30, 2020, the share of loans for construction and mortgage remained unchanged and constituted 18.8 percent (Chart 1.4.7) in the total loan portfolio of the commercial banks.

The total volume of non-performing loans for mortgage and construction increased by 23.0 percent and amounted to KGS 2,425.0 million; therefore, the aggregate share of non-performing loans in the aforementioned sectors increased by 0.1 p.p. in the first half of 2020 and amounted to KGS 18.5 percent of the total volume of non-performing loans of the banking sector (Chart 1.4.8).

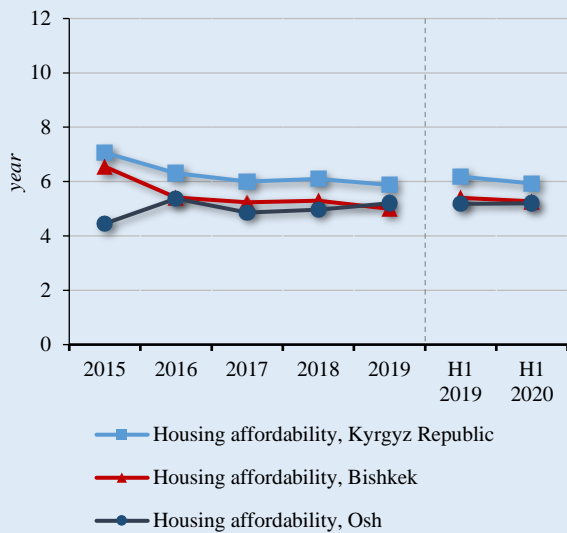
Moreover, the volume of non-performing loans for mortgage and construction in foreign currency increased by 18.4 percent and amounted to KGS 1,472.6 million.

⁹ According to the publication of the National Statistical Committee of the Kyrgyz Republic “Social and economic situation of the Kyrgyz Republic, January-June 2020”.

Box 1. Housing Affordability Index

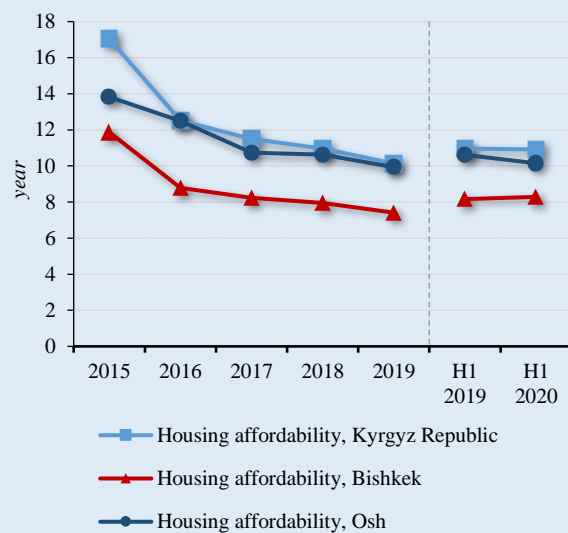
As of June 30, 2020, the housing affordability level in the Kyrgyz Republic decreased from 6.2 to 5.9 years compared to the same date in 2019. This is due to the growth rates of the average monthly nominal wages (growth by 10.5 percent) outrunning the growth rates of real estate prices (growth by 6.0 percent) (Chart 1).

Chart 1. Housing (Apartments) Affordability Index without Minimal Consumer Budget



Sources: NSC KR, SRS KR, NBKR

Chart 2. Housing (Apartments) Affordability Index including Minimal Consumer Budget



Sources: NSC KR, SRS KR, NBKR

According to the results of the first half of 2020, to purchase an apartment of 54 square meters in the Kyrgyz Republic one should save the average monthly nominal wage of the family, where the income is received by two people, for 5.9 years with other conditions being equal.

According to the results of the first half of 2020, a family of three people in the Kyrgyz Republic with the minimum consumer budget of KGS 16,515.6 (42.0 percent of total family income) will need 10.9 years in order to purchase housing (Chart 2).

Box 2. Stress Testing of Impact from Price Changes in the Real Estate Market on the Banking Sector¹⁰

As of June 30, 2020, the share of loans, secured by pledged real estate, constituted 35.1 percent of the total volume of loans in the loan portfolio of the banks. The volume of pledged real estate (at collateral value) constituted 77.7 percent of the total collateral of the loan portfolio.

Credit risks of the banking sector are conditioned by possible decrease in the value of the pledged real estate below the loan repayment balance and further potential refusal of the borrower from loan repayment.

Stress testing is focused on quantitative assessment of possible losses from outstanding loans and identification of the most vulnerable banks (groups of banks).

Scheme 1. Results of Stress Testing of Impact from Price Changes in the Real Estate Market on the Level of Credit Risk of the Banking Sector

Scenario	Potential losses of the banking sector	Potential losses of large banks	Risk of capital adequacy ratio violation*
"Historical" scenario* (decrease in price for real estate by 23% per a year)	-----	-----	1 bank
"Alternative" scenario (decrease in price for realestate by 40% per 2 years)	KGS -6.2 billion	KGS -3.9 billion	4 banks
"Negative" scenario (decrease in price for real estate by 50% per a year)	KGS -20.1 billion	KGS -11.6 billion	6 banks

* At the end of 2008, prices for real estate in Kyrgyzstan decreased by 23 percent.

In addition to stress test, threshold level of decrease in prices for real estate, when banks potentially suffer losses, was calculated. The banking sector potentially suffers losses if prices for the real estate decrease by 33.5 percent, large banks – by 33.4 percent. There is a risk of violation of the capital adequacy ratio by the banking sector, as well as by the large banks when prices for real estate decrease by 54.6 and 49.2 percent, respectively.

Possible difference in the estimated value of collateral real estate, which may be less than the market value by at least 20 percent, was not taken into account in calculations of the stress test. Taking into account aforementioned facts, the threshold level of decline in prices for real estate can increase by 20 percent.

¹⁰ Stress test was conducted on the basis of the commercial banks' data provided in the course of the survey as of June 30, 2020.

II. BANKING SECTOR

Growth of the main indicators of the banking sector: assets, capital, deposit base, loan portfolio and indices of financial intermediation was observed in the first half of 2019.

At the end of the reporting period, systemic risks of the banking sector are estimated as moderate. The banking sector is characterized by a high level of capital adequacy, indicating the availability of the potential to further increase the level of financial intermediation, efficiency and sustainability of the banking sector in the future.

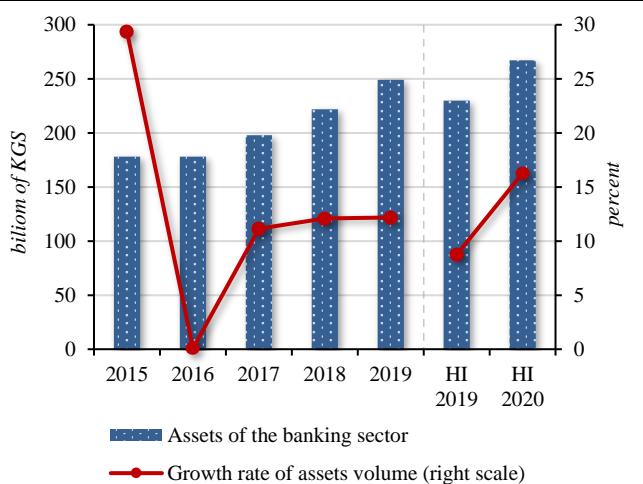
2.1. Major Trends of the Banking Sector Development

As of June 30, 2020¹¹, 23 commercial banks (including the Bishkek branch of the National Bank of Pakistan) and 322 of their branches worked in the territory of the Kyrgyz Republic, among which there were 16 banks with foreign participation in the capital, including 11 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.

Assets

Generally, the growth in the volume of the banking sector assets was observed at the end of the first half of 2020. At the end of the reporting period, assets of the banking sector amounted to KGS 267.2 billion, having increased by 16.3 percent compared to the first half of 2019 (Chart 2.1.1).

Chart 2.1.1. Dynamics of Assets in the Banking Sector



Source: NBKR

The growth of assets was mainly provided by increase of:

- the loan portfolio by 10.7 percent or KGS 14.8 billion;
- the cash and correspondent accounts by 23.1 percent or KGS 12.4 billion.

The share of loan portfolio in the structure of assets constituted 57.4 percent, having decreased by 2.9 p.p. compared to the first half of 2019.

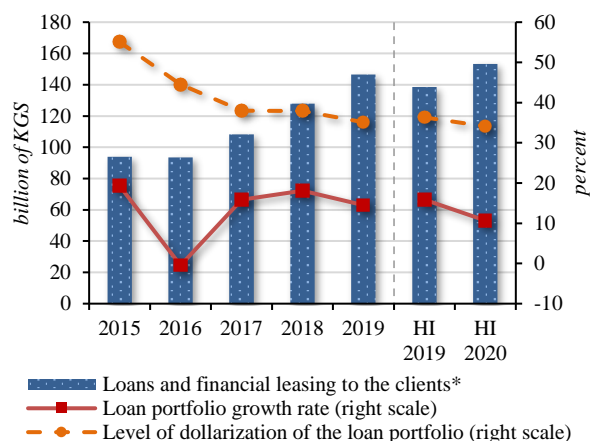
¹¹ The data are submitted according to periodic regulatory reporting of the commercial banks (PRBR).

Loan Portfolio

In the first half of 2020, growth of the loan portfolio was observed in all sectors of economy.

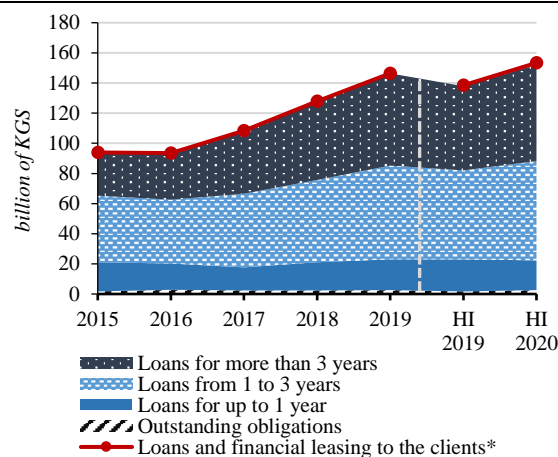
At the end of the reporting period, the level of dollarization of the loan portfolio in the banking sector decreased by 2.2 p.p. compared to the same period of 2019 and amounted to 34.2 percent.

Chart 2.1.2. Dynamics of Loan Portfolio in the Banking Sector



* Exclusive of loans provided by FCO and special loan loss provisions
Source: NBKR

Chart 2.1.3. Structure of Loan Portfolio by Maturity



* Exclusive of loans provided by FCO and special loan loss provisions
Source: NBKR

In the structure of loan portfolio by maturity, the major shares are accounted for medium-term loans issued for 1-3 years, which constituted 43.0 percent or KGS 65.9 billion, and for the long-term loans issued for more than three years, which constituted 41.6 percent or KGS 63.8 billion (Chart 2.1.3).

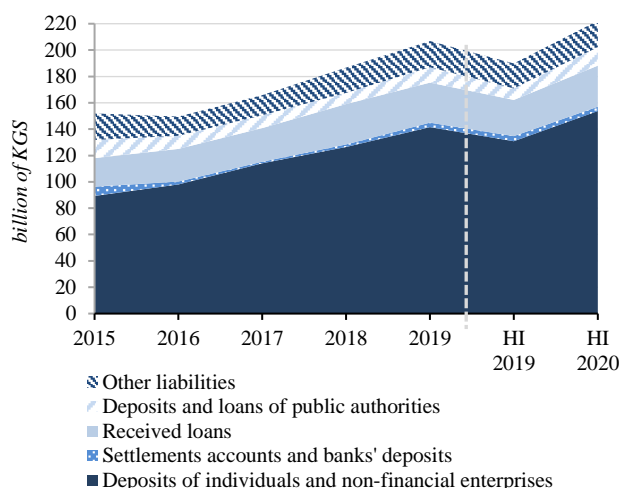
Liabilities

At the end of the first half of 2020, liabilities of the banking sector of the Kyrgyz Republic amounted to KGS 222.3 billion, having increased by 17.1 percent compared to the same period of 2019.

At the end of the reporting period, deposits of individuals and non-financial enterprises increased by 17.5 percent and amounted to KGS 153.8 billion (Chart 2.1.4). The share of individuals' and non-financial enterprises' deposits in the banks' liabilities increased by 0.2 p.p. and amounted to 69.2 percent.

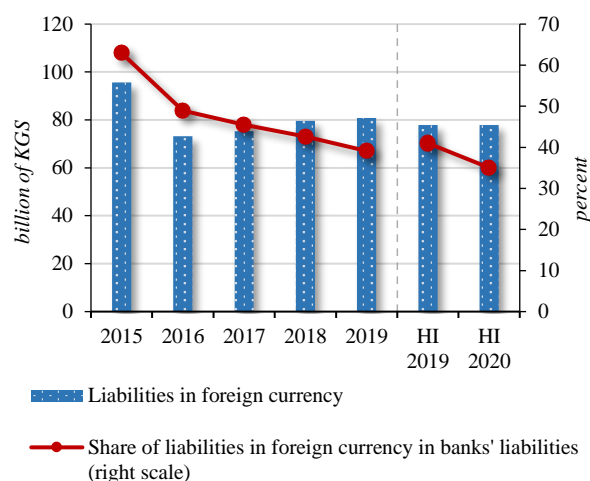
The share of liabilities in foreign currency in the total volume of attracted funds decreased by 6.0 p.p. and amounted to 35.0 percent or KGS 77.9 billion (Chart 2.1.5).

Chart 2.1.4. Structure of Banks' Liabilities by the Reserve Sources



Source: NBKR

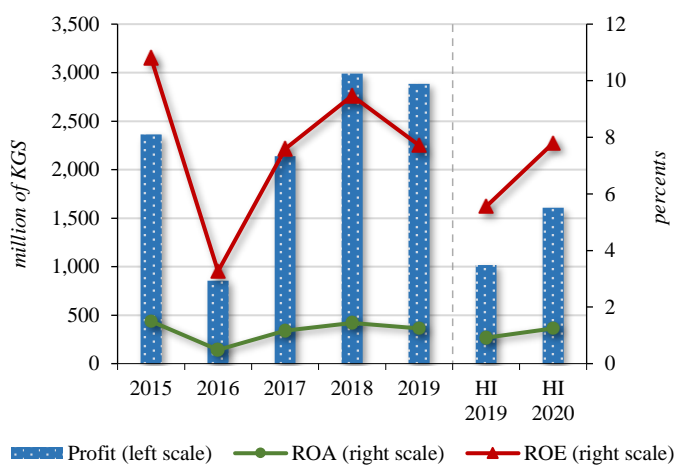
Chart 2.1.5. Banks' Liabilities in Foreign Currency



Source: NBKR

Financial Results

Chart 2.1.6. Profitability Indicators of the Banking Sector



Source: NBKR

At the end of the first half of 2020, the improvement of profitability indicators was observed compared to the same indicator of 2019 due to growth of the banking sector profitability:

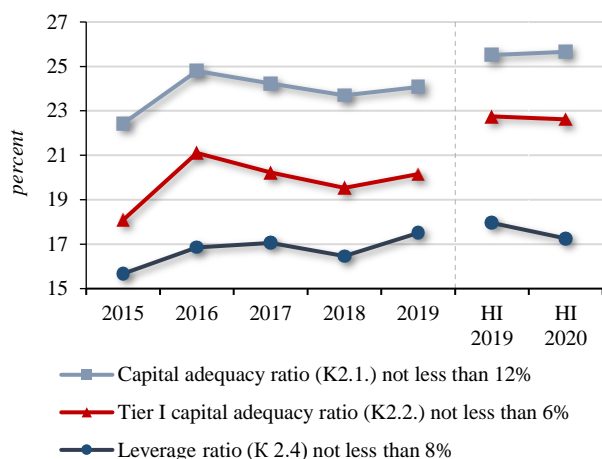
- ROA constituted 1.2 percent;
- ROE formed at 7.8 percent.

Net profit of the banking sector increased by 58.0 percent and amounted to KGS 1.6 billion (Chart 2.1.6).

Capital Adequacy

With statutory minimum capital adequacy at 12.0 percent, at the end of the first half of 2020, this figure increased by 0.1 p.p. compared to the same period of 2019 and amounted to 25.7 percent (Chart 2.1.7).

Chart 2.1.7. Dynamics of Capital Adequacy Ratios



At the same time, the actual level of capital adequacy in the banking sector, generally formed according to the results of the first half of 2020, can further increase the volume of risky and earning assets by 2.0 times, without exceeding established level of capital adequacy.

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 activity in the future.

Source: NBKR

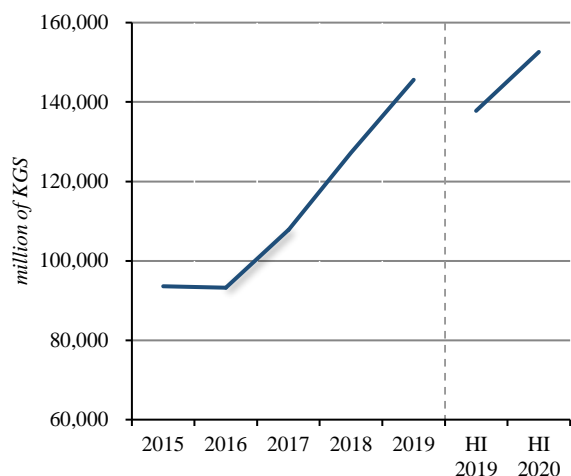
2.2. Banking Sector Risks

2.2.1. Credit Risk. Credit Risk of the Banks' Clients

A credit risk is one of the main risks that accompany banking activity.

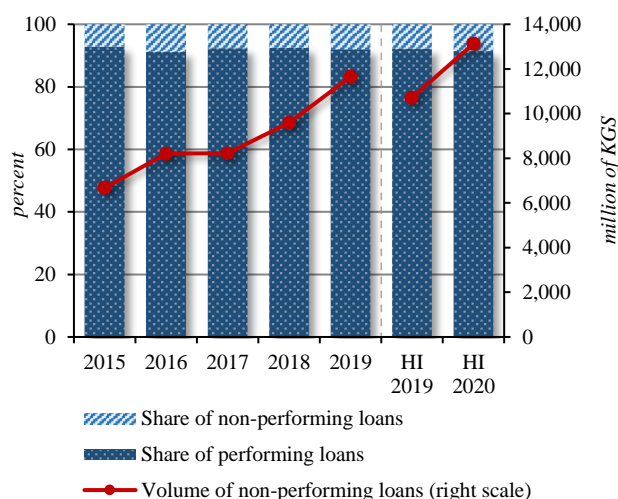
In the reporting period, the share of non-performing loans in the loan portfolio of banks increased from 7.8 percent to 8.6 percent compared with the first half of 2019 (Chart 2.2.2).

Chart 2.2.1. Dynamics of Loan Portfolio



Source: NBKR

Chart 2.2.2. Loan Portfolio Quality



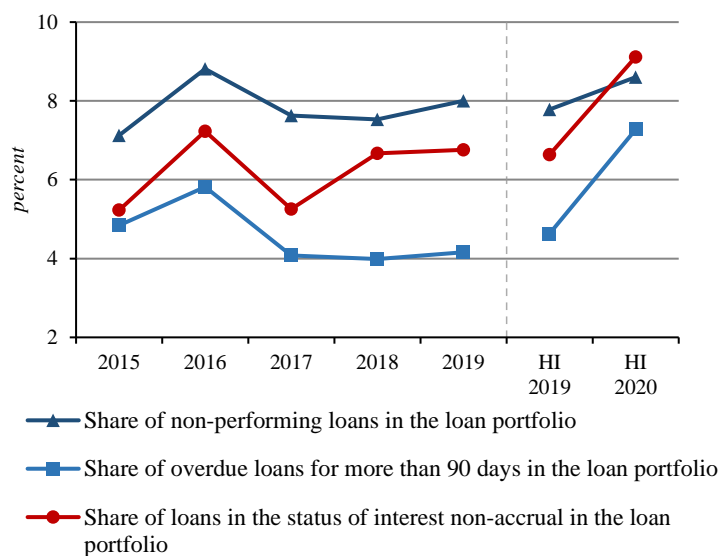
Source: NBKR

In order to assess the quality of the loan portfolio, the commercial banks use a loan classification system¹², which contributes to determining the possible level of potential losses from bad loans and compensating them in time through creation of appropriate reserves (Chart 2.2.3).

The indicator of the risk of default on assets (the ratio of special loan loss provisions and loan portfolio) increased by 0.7 p.p. compared to the first half of 2019 and constituted 5.0 percent.

¹² In classifying 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-performing". For each of six categories, the bank has to create a reserve corresponding to this category defined as a percentage of loans issued.

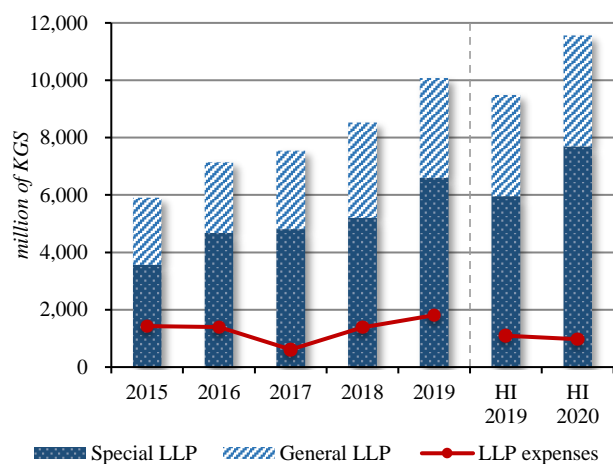
Chart 2.2.3. Indicators of the Loan Portfolio Quality



Aggregate reserves created by the commercial banks increased by 0.7 p.p. compared to the first half of 2019 and constituted 7.6 percent of the total loan portfolio. Meanwhile, the share of special loan loss provision in the first half of 2020 constituted 66.5 percent of the total reserves (Chart 2.2.4).

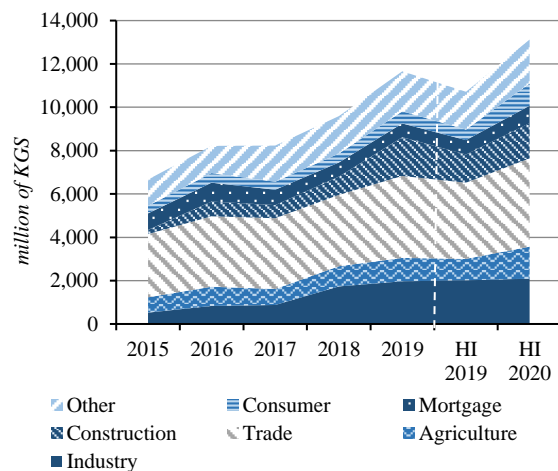
Source: NBKR

Chart 2.2.4. Total and Special Reserves



Source: NBKR

Chart 2.2.5. Volume of Non-performing Loans by Sectors of Economy



Source: NBKR

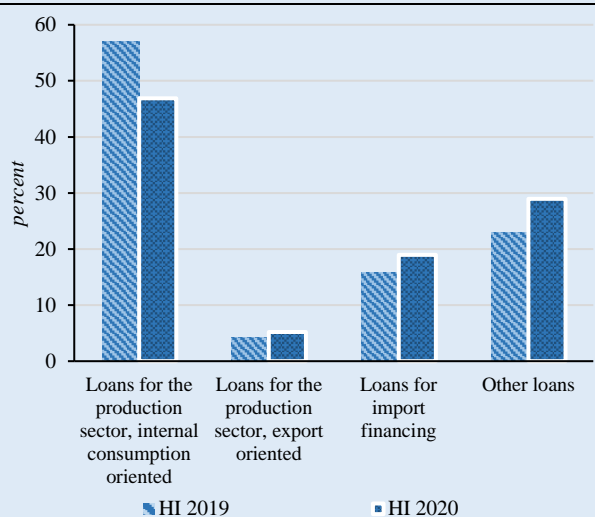
As of the end of the first half of 2020, the highest concentration of credit risks was still observed in the trade sector of economy (Chart 2.2.5).

CONTENT

Box 3. The Survey Results of the Commercial Banks Clients

At the end of the reporting period, a significant share of extended loans (46.9 percent of total borrowers' loans) was still concentrated in the production sector of the economy¹³, thereby reflecting contribution of the banking sector in creation of the country's GDP, meanwhile, 19.0 percent of issued loans were forwarded for financing of imports (Chart 1).

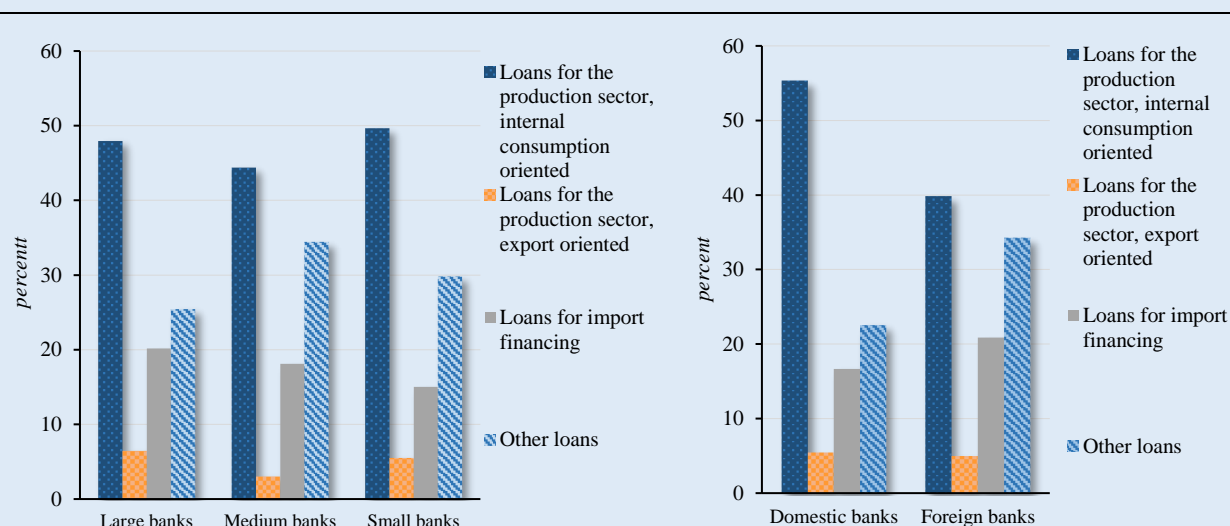
Chart 1. Sectoral Structure of Loans as of June 30, 2020



Source: CBs

Domestic banks forwarded 55.4 percent of the loan portfolio to the production sector (GDP) and 16.7 percent – to finance imports. Generally, foreign banks also provided loans to the production sector of economy (39.9 percent). In the first half of 2020, the share of loans forwarded to finance imports constituted 20.9 percent of the loan portfolio (Chart 2).

Chart 2. Sectoral Structure of Loans by the Groups of Banks as of June 30, 2020



Source: CBs

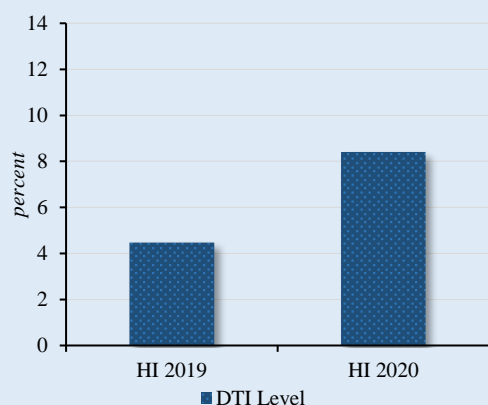
¹³ The production sector means the activity of the bank clients connected with the production of goods and services (construction, communication and automobile repair shop services, transport services, real estate leasing, hotels, restaurants, etc.).

Box 4. Results of the Survey of the Commercial Banks' Largest Clients

Borrowers solvency

At the end of the first half of 2020, the level of debt burden of 15 banks' largest clients calculated through DTI index¹⁴ increased by 3.9 p.p. compared to the same indicator in the first half of 2019 and constituted 8.4 percent.

Chart 1. DTI Level on 15 Banks' Largest Borrowers



Source: CBs, NBKR

By the groups of banks, the largest debt burden was observed in the major borrowers of the *large banks* (10.9 percent of the borrowers' basic income) (Table 1). At the same time, the lowest level of debt burden was observed at the same level in the major borrowers of the medium banks and constituted 5.5 percent.

Table 1. Debt Burden of 15 Banks' Largest Borrowers at the end of the first half of 2020

	Banking sector	Large banks	Medium banks	Small banks
Loan balance, <i>billions of KGS</i>	38.3	21.6	11.5	5.3
Share of loans in 15 largest borrowers in the total volume of loan portfolio in the banking sector, <i>in %</i>	24.7	24.8	21.7	34.7
Ratio of expenses for loan debt servicing to the borrowers' total income, <i>in %</i>	8.4	10.9	5.5	9.6

Source: CBs, NBKR

In the first half of 2020, the level of debt burden in the foreign banks was higher than in the domestic banks (Table 2).

Table 2. Debt Burden in the Domestic and Foreign Banks at the end of the first half of 2020

	Domestic banks	Foreign banks
Loan balance, <i>billions of KGS</i>	16.3	22.0
Share of loans in 15 largest borrowers in the total volume of loan portfolio in the banking sector, <i>in %</i>	23.2	26.0
Ratio of expenses for loan debt servicing to the borrowers' total income, <i>in %</i>	5.7	12.1

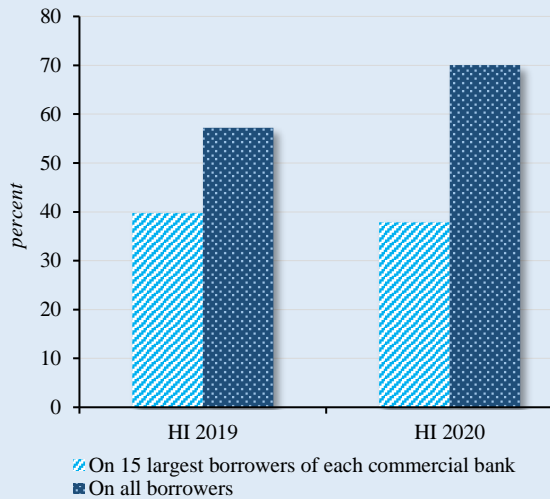
Source: CBs, NBKR

¹⁴ DTI (debt-to-income) is the ratio of the amount of the borrowers' payments on loans (including the amount of principal and interest payments for the reporting period) to the main annual income of the borrower declared at the time of issuing a loan.

Security of the borrowers' loans

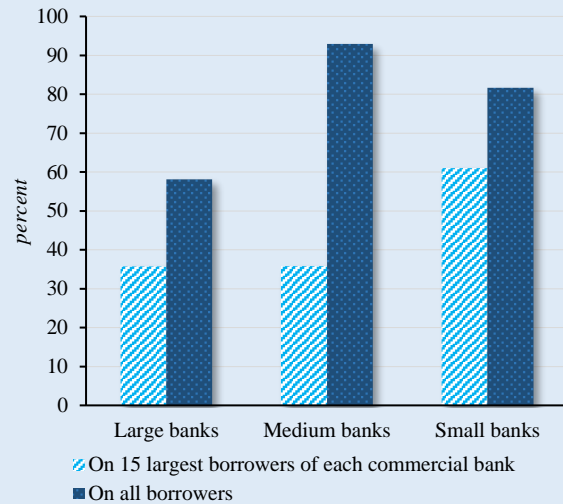
At the end of the first half of 2020, the LTV actual level¹⁵ in the banking sector amounted to 70.1 percent. The existing level of collateral indicates a relatively high level of the loans secured by the pledged property (Chart 2).

Chart 2. LTV Level on All Borrowers and on 15 Largest Borrowers of Each Commercial Bank as of June 30, 2020



Source: CBs, NBKR

Chart 3. LTV Level on All Borrowers and on 15 Largest Borrowers by the Banks' Groups as of June 30, 2020



Source: CBs, NBKR

Meanwhile, the LTV value in the large banks is lower than in the small and medium banks and in the banking sector as a whole (Chart 3).

¹⁵ LTV (loan-to-value ratio) is the ratio of issued loans to the value of collateral.

2.2.2. Liquidity Risk

Public confidence in the banking sector depends on the timely implementation of obligations by the banks, which suggests availability of sufficient liquidity in the banks. For regulatory purposes, liquidity risk is assessed using economic current liquidity ratio¹⁶.

At the end of the first half of 2020, current liquidity ratio decreased slightly from 64.8 percent (as of the end of the first half of the previous year) to 63.2 percent (Chart 2.2.6).

Chart 2.2.6. Liquidity Indicators in the Banking Sector

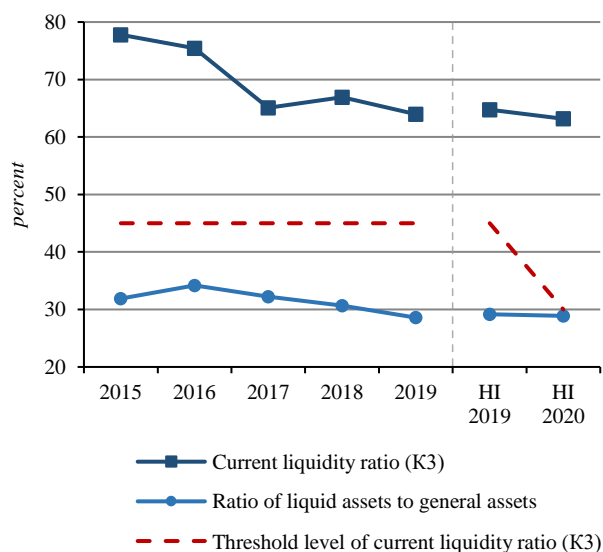
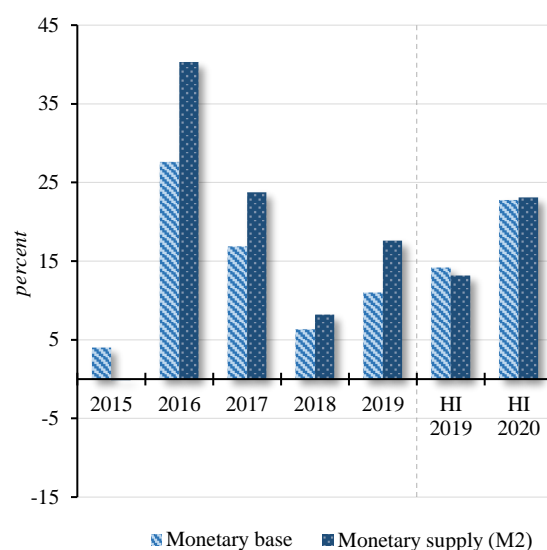


Chart 2.2.7. Growth Rates of Money Supply (M2) and Monetary Base



Source: NBKR

Source: NBKR

Liquidity ratio of the banking sector decreased due to excess of current liabilities over liquid assets growth rates.

Table 2.2.1. Maturity of Financial Assets and Liabilities
as of June 30, 2020, millions of KGS

Name	Maturity					Total
	up to 1 month	1-3 months	3-6 months	6-12 months	more than 12 months	
Total financial assets	101,556	10,559	13,478	23,668	131,332	280,592
including loans and financial leasing to the clients	8,893	6,147	9,932	20,422	107,218	152,611
Total financial liabilities	117,909	11,109	20,354	26,336	43,398	219,107
including deposits of individuals and time deposits of legal entities	49,505	7,762	12,139	18,571	18,284	106,261
Gap	-16,354	-550	-6,876	-2,669	87,934	61,485
including on loans and deposits	-40,612	-1,615	-2,207	1,851	88,933	46,350

¹⁶ Economic current liquidity ratio is one of the mandatory standards for the bank established by the NBKR, according to which the liquid assets (for calculation of this indicator including funds of banks in cash and correspondent accounts) must be at least 45 percent of short-term liabilities. Since April 1, 2020, the current liquidity ratio is temporarily set at the level of at least 30 percent of short-term liabilities.

2.2.3. Concentration Risk

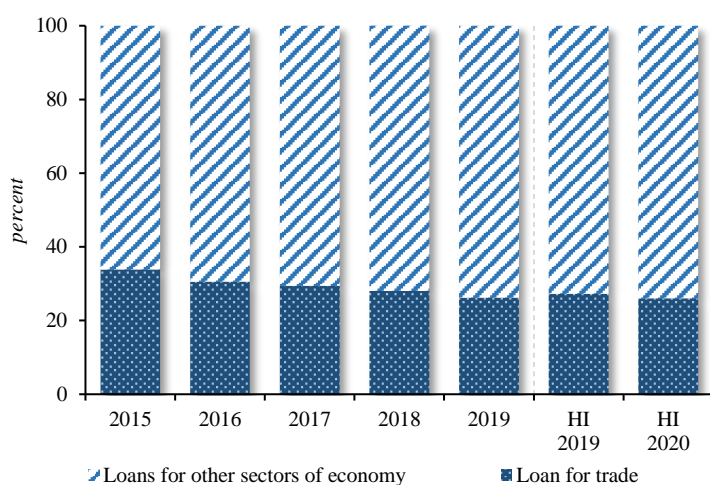
Concentration of the Largest Sources of Financing

The results of “reverse” stress testing show that some banks could not withstand the shock related to outflow from one to five large clients¹⁷, when the liquidity ratio decreases below the threshold level of 30 percent.

Loan Concentration

Potential default from one to five largest borrowers¹⁸ in separate banks may decrease regulatory capital below economic standard of the NBKR.

Chart 2.2.8. Sectoral Concentration of the Loan Portfolio



Decrease of the level of trade loans concentration was observed in the sectoral structure of loan portfolio amid increase of lending to all sectors. At the end of the first half of 2020, the share of loans for trade decreased from 27.2 percent to 26.0 percent (Chart 2.2.8).

Source: CBs, NBKR

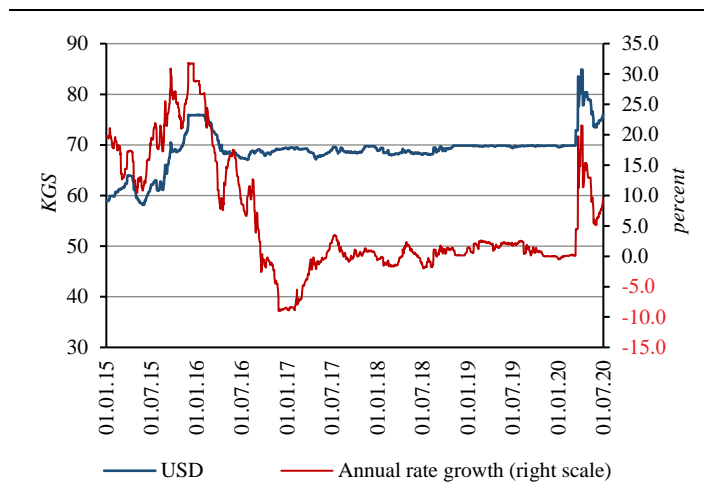
¹⁷ The largest sources of financing (LSF) are the funds of creditors and depositors (received loans, settlement accounts, demand deposits and time deposits).

¹⁸ Total debt of five largest borrowers of the bank is meant.

2.2.4. Currency Risk

At the end of the reporting period, the annual average level of *currency risk* in the banking sector was at a moderate level.

Chart 2.2.9. Dynamics of USD/KGS Nominal Exchange Rate

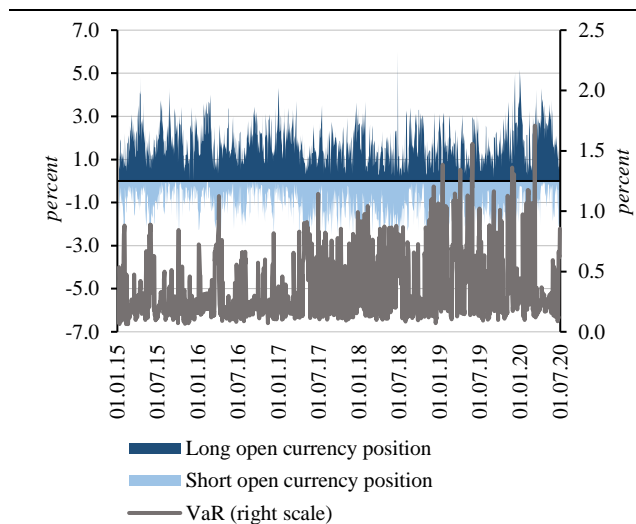


Source: NBKR

In general, the banks kept open currency positions of assets and liabilities within the limits set by the prudential standards of the National Bank of the Kyrgyz Republic.

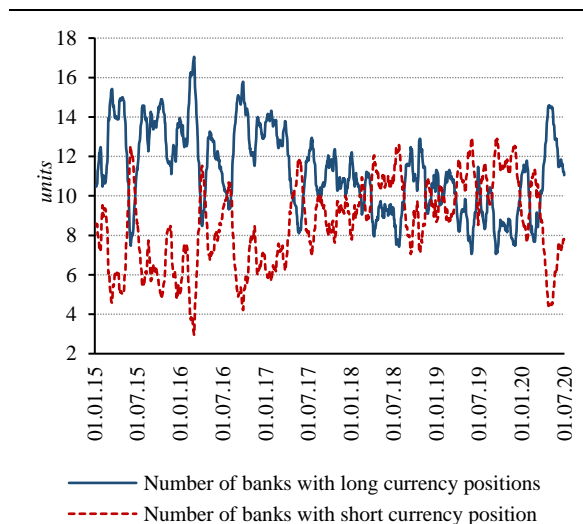
In the first half of 2020, the risk of currency position overestimation in the banking sector was minimum (VaR: 0.1–1.6 percent of the net total capital, Chart 2.2.10) i.e. the banks adhered to a conservative policy when conducting operations with currency and were weakly exposed to currency risk.

Chart 2.2.10. Dynamics of Open Currency Position (OCP) and Revaluation Risk (VaR) in percent of NTC



Source: NBKR

Chart 2.2.11. Currency Position of the Banks



Source: NBKR

Box 5. Credit and Currency Risks

At the end of the first half of 2020, 21.0 percent of the total loan portfolio was accounted for the loans, which were repaid in foreign currency, while the income of the borrowers was generated in the national currency (Chart 1). This volume of the loan portfolio was potentially exposed to credit and currency risks.

The impact made by the currency risk on the credit risk is given in Chart 2 that displays the proportion of non-performing loans by groups of loans:

- Group 1 – 15.3 percent, basic incomes of the borrower are generated in the national currency, and the loans are repaid in foreign currency;
- Group 2 – 6.5 percent, basic incomes and loans payable by the borrower are generated in the same currency;
- Group 3 – 23.0 percent, basic incomes of the borrower are generated in foreign currency, and the loans are repaid in the national currency.

Chart 1. Loan Portfolio by Groups of Loans¹⁹

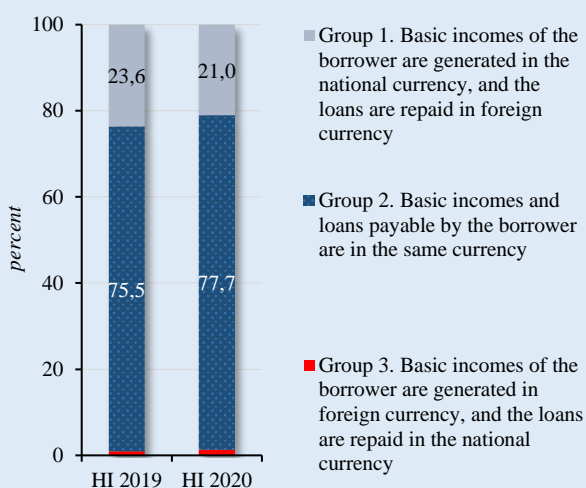
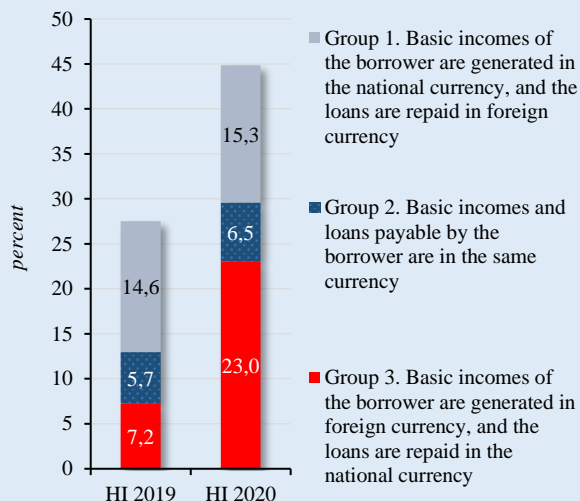


Chart 2. Share of Non-performing Loans by Groups of Loans²⁰



Source: CBs, the volume of loan portfolio is specified exclusive of overdraft loans.

¹⁹ Breaking of loans into groups is presented in this chart. For example, the volume of loans for Group 1 as of June 30, 2020 amounted to KGS 31.9 billion or 21.0 percent of the total loan portfolio.

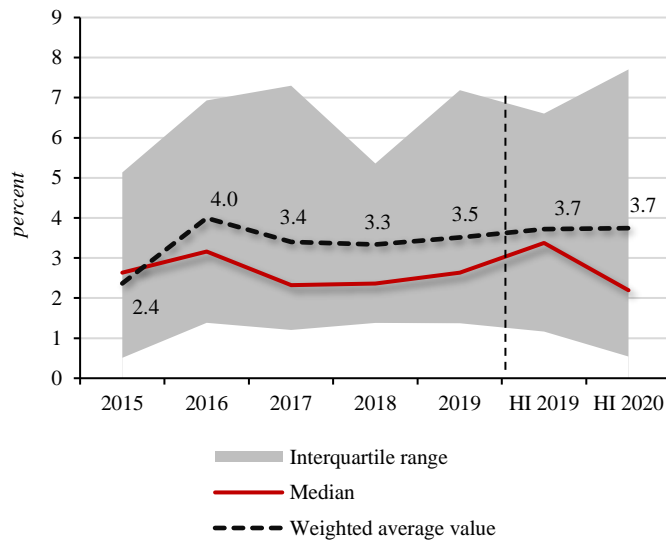
²⁰ This chart shows the shares of non-performing loans in the loan portfolio by each group of loans. For example, the volume of non-performing loans for Group 1 as of June 30 2020 amounted to KGS 4.9 billion or 15.3 percent of the total loan portfolio for Group 1 (KGS 31.9 billion).

2.2.5. Interest Rate Risk

At the end of the reporting period, there was no change in the *interest rate risk* of the financial sector.

Average value of interest rate risk during the period of 2010 – 2019 was within accessible limits (2.4-4.0 percent of net total capital).

Chart 2.2.12. Dynamics of Interest Rate Risk (VaR)
in percent of NTC



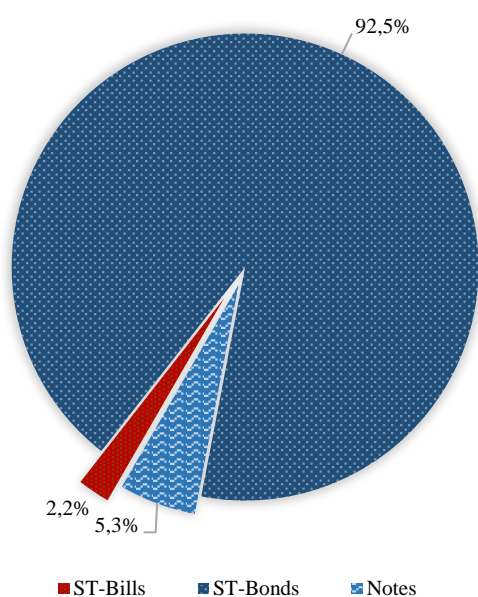
Source: NBKR

2.2.6. “Contagion” Risk

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

At the end of the first half of 2020, the volume of interbank transactions amounted to KGS 16.2 billion²¹.

Chart 2.2.13. Distribution of Interbank Loan Transactions Made during the First Half of 2020 between Resident Banks, Depending on Collateral



Source: NBKR

The loans in the interbank market are generally covered by collateral in the form of highly liquid government securities (Chart 2.2.13) in the banking sector of Kyrgyzstan.

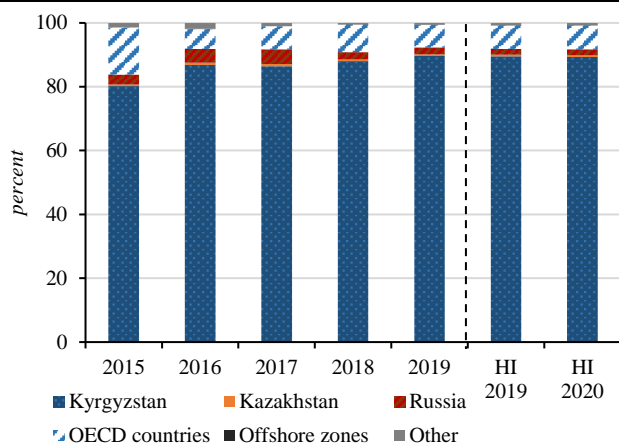
In general, the probability of the “contagion” risk materialization in the interbank credit market of the country is minimal, which is caused by highly liquid collateral.

²¹ The total volume of transactions made between the resident banks during the first half of 2020 is meant here.

2.2.7. Country Risk²²

As of June 30, 2020, the aggregate volume of disposed assets of non-residents constituted KGS 30.3 billion or 10.7 percent of total banking sector assets. The highest concentration of placement was observed in the OECD countries²³ – 7.5 percent or KGS 21.3 billion of total assets in the banking sector of the Kyrgyz Republic.

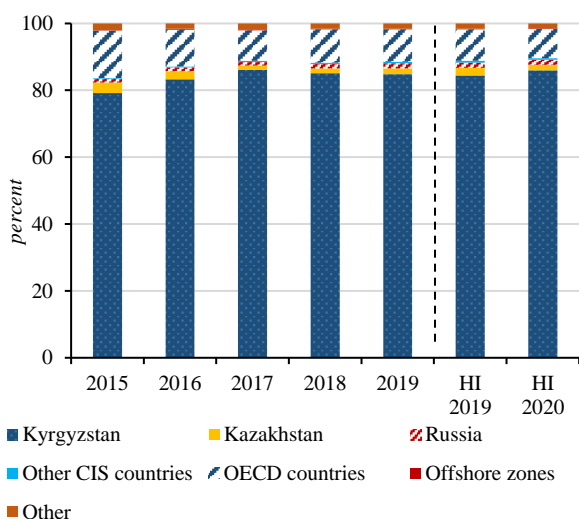
Chart 2.2.14. Geographic Structure of Assets



Source: NBKR

the banking sector were accounted for the OECD countries, 1.6 and 1.6 percent – for Russia and Kazakhstan, accordingly (Chart 2.2.15).

Chart 2.2.15. Geographic Structure of Liabilities

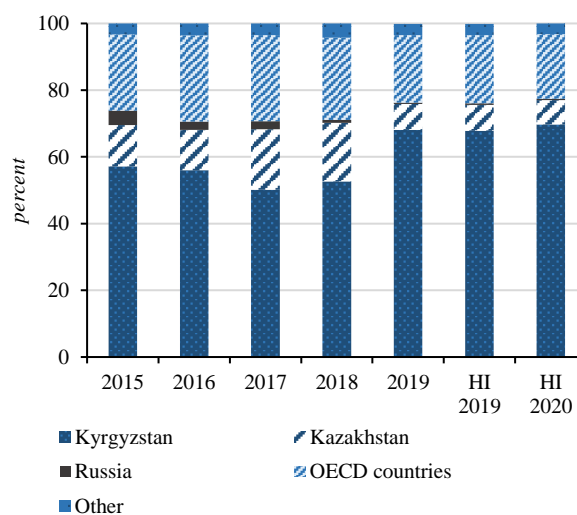


Source: NBKR

The main share of the assets placed abroad was focused on correspondent or deposit accounts and constituted KGS 28.8 billion or 95.0 percent of total placed assets of non-residents.

At the end of the first half of 2020, banks' liabilities to non-residents of the Kyrgyz Republic totaled KGS 30.7 billion or 14.0 percent of the total liabilities of the banking sector. Significant volume of the resources was drawn by the non-resident banks in the form of loans and deposits, which amounted to KGS 29.5 billion or 96.1 percent of the total liabilities to non-residents. 8.7 percent of the total liabilities in

Chart 2.2.16. Authorized Capital by Countries



Source: NBKR

²² Data of the commercial banks.

²³ Organization for Economic Cooperation and Development (OECD) is an international economic organization of developed countries where the principles of representative democracy and free market economy are recognized.

At the end of the first half of 2020, foreign capital amounted to KGS 9.2 billion or 30.3 percent of the total authorized capital of the banking sector (KGS 30.5 billion). The main share of foreign capital is distributed among (Chart 2.2.16):

- residents of the OECD countries – 19.3 percent;
- residents of Kazakhstan – 7.3 percent;
- residents of Russia – 0.4 percent.

2.3. “Reverse” Stress Testing of the Banking Sector

2.3.1. “Reverse” Stress Testing of Credit Risk²⁴

Maximum allowable share of “performing” loans²⁵ in the loan portfolio, which upon categorized as “non-performing” loans can reduce the CAR (capital adequacy ratio) down to the threshold level of 12 percent, is calculated by means of the “reverse” stress testing of the credit risk.

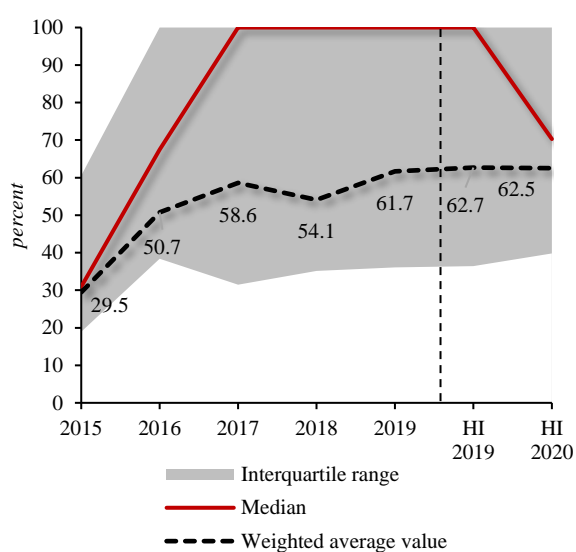
This method allows detecting a buffer stock of capital (net total capital) of banks, which can cover the additional allocations to LLP in connection with the transformation of “performing” loans into the category of “non-performing” loans²⁶.

Moreover, the maximum growth rate of “non-performing” loans, where capital adequacy (K2.1) will be reduced to the threshold level of 12 percent, can be calculated by means of this method.

Based on the results of the “reverse” stress testing of the banking sector as of June 30, 2020, the maximum allowable share of “performing” loans, transferring to the category of “non-performing” in the banking sector, amounted to approximately 62.5 percent (Chart 2.3.1).

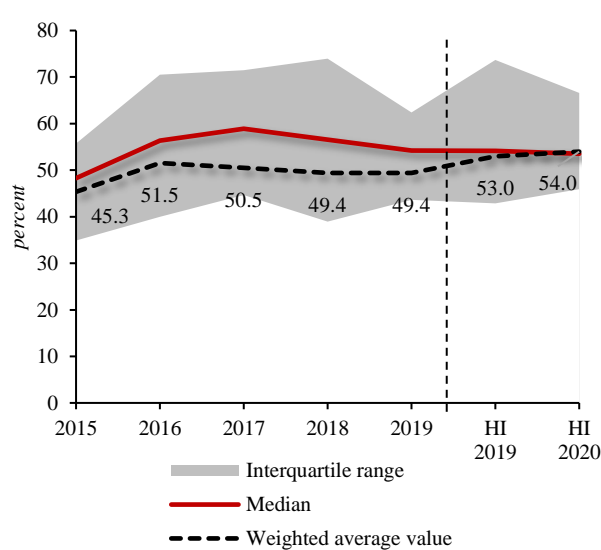
Thus, the banking sector can sustain a significant deterioration in the quality of the loan portfolio, which may require the creation of additional LLP approximately up to 54.0 percent of net total capital (Chart 2.3.2).

Chart 2.3.1. Maximum Possible Share of “Performing”²⁷ Loans that May Become “Non-performing” Loans²⁸
percent of performing loans



Source: NBKR

Chart 2.3.2. Additional LLP, in Creating thereof CAR Decreases to 12 Percent
percent of NTC



Source: NBKR

²⁴ Exclusive of troubled banks.

²⁵ Exclusive of “normal” loan category, which are risk free.

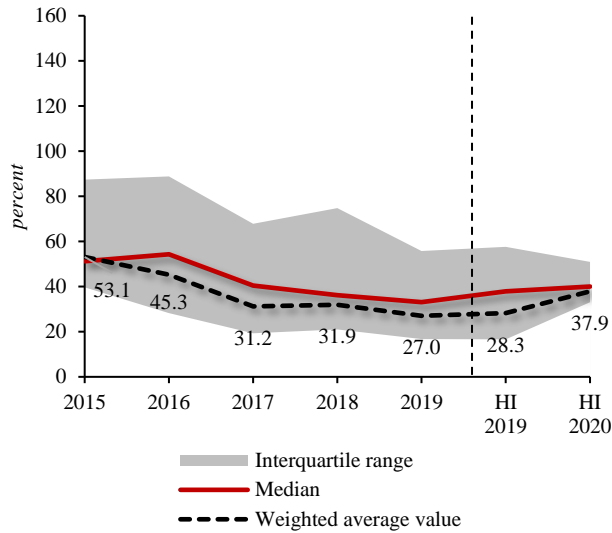
²⁶ Herewith, transition of “performing” loans to the category of “non-performing” loans is fulfilled smoothly by three categories (“substandard”, “doubtful” and “losses”).

²⁷ Exclusive of “normal” loan category, which are risk free.

²⁸ When CAR decreases to the threshold level of 12 percent.

2.3.2. “Reverse” Stress Testing of Liquidity Risk

Chart 2.3.3. Scope of Potential Outflow of Deposits when K3 May Drop to 30 Percent, percent of clients’ total deposits



Source: NBKR

The reserve of liquid assets, which can cover a massive outflow of deposits of the clients’ total deposit base, without violating the NBKR prudential standard on the current liquidity, was calculated for the evaluation of the liquidity risk in the banking sector.

Shock is the maximum volume of the outflow of the individuals’ and non-financial enterprises’ deposits, which may reduce the liquidity ratio down to the threshold level of 30 percent.

The results of the “reverse” stress testing show (Chart 2.3.3), that as of the end of the first half of 2020 the actual amount of liquid assets of the banking sector was able to cover the deposits outflow of an average of 37.9 percent of the clients’ total deposit base (Table 2.3.1).

2.3.3. “Reverse” Stress Testing of Market Risk

The results of the “reverse” stress testing of the market risk indicate that the banking sector as of the end of the first half of 2020 has little sensitivity to the interest rate and currency risks.

Interest Rate Risk

Scenario 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 the “reverse” stress testing indicate little sensitivity of the banking sector to the direct interest rate risk. Decrease of the average interest rates on loans by 16.4 p.p. can reduce the level of capital adequacy ratio to 12 percent (Table 2.3.1).

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

Currency Risk (Revaluation Risk)

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

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

Calculations of the “reverse” stress testing indicate that the banking sector is characterized by low risk of assets and liabilities revaluation and confirms availability of low sensitivity to currency risk (Table 2.3.1).

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

The results of stress testing indicate that the commercial banks can stand the impact of currency risk (Table 2.3.1).

Table 2.3.1. General Results of the “Reverse” Stress Tests as of June 30, 2020

		Banking sector
Credit risk		
Scenario 1	Share of performing loans transferring to the category of "non-performing" loans, <i>in percent</i>	62.5
Interest rate risk		
Scenario 1	Decrease of weighted average interest rate on loans, when CAR declines to 12%, <i>in percentage points</i>	16.4
Currency risk		
Scenario 1	Growth rate of USD/KGS (\pm) exchange rate, when CAR decreases to 12%, <i>in percent</i>	change of currency rate by 100 percent (KGS/USD)
Scenario 2	Growth rate of USD/ KGS (\pm) exchange rate, when net profit decreases to zero level, <i>in percent</i>	
Liquidity risk		
Scenario 1	Outflow of clients' deposit and received loans of the total deposits and loans, when current liquidity ratio declines to 30%, <i>in percent</i>	37.9

III. NON-BANKING FINANCIAL-CREDIT ORGANIZATIONS

In general, the state of the non-banking financial-credit organizations (NBFCOs) system is assessed as stable. Increase of major indicators: assets, loan portfolio, resource base is observed. Stress test results indicate that the credit risk of the NBFCOs system is moderate.

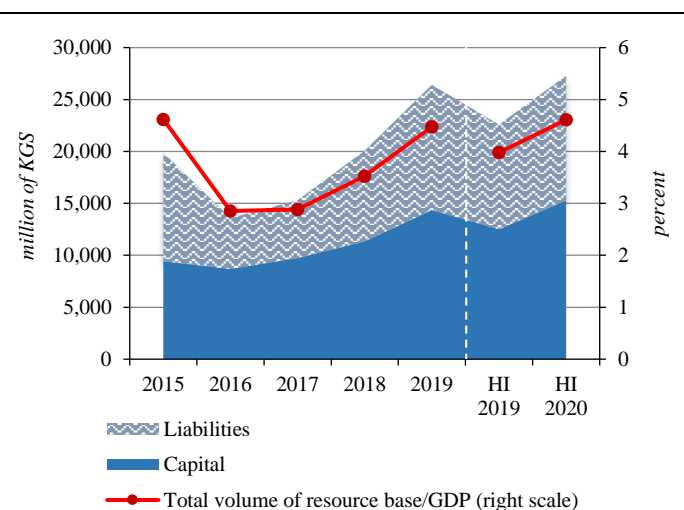
The weighted average interest rates on loans of the microfinance organizations and credit unions decreased compared to the first half of 2019.

3.1. Main Trends

The system of non-banking financial-credit organizations subject to licensing and regulation by the National Bank as of June 30, 2020 in the Kyrgyz Republic, included: the specialized financial and credit institution – “FCCU” OJSC; 93 credit unions, 134 microfinance organizations (including 9 microfinance companies, 87 microcredit companies and 38 microcredit agencies), and 396 exchange offices and 2 credit bureaus.

Resources

Chart 3.1.1. Dynamics of NBFCOs Liabilities and Capital

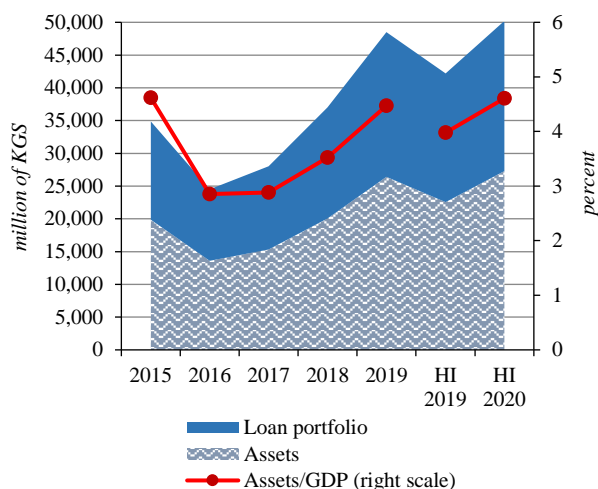


At the end of the reporting period, NBFCOs liabilities increased by 19.6 percent compared to the first half of 2019 and were formed in the amount of KGS 12.0 billion. NBFCOs capital demonstrated an increase by 21.9 percent and totaled KGS 15.3 billion (Chart 3.1.1).

Source: NBKR

Assets

Chart 3.1.2. Dynamics of NBFCOs Assets and Loans



Source: NBKR

within the maturity structure of the loans provided by NBFCOs, however the share of long-term loans remained unchanged. (Chart 3.1.3).

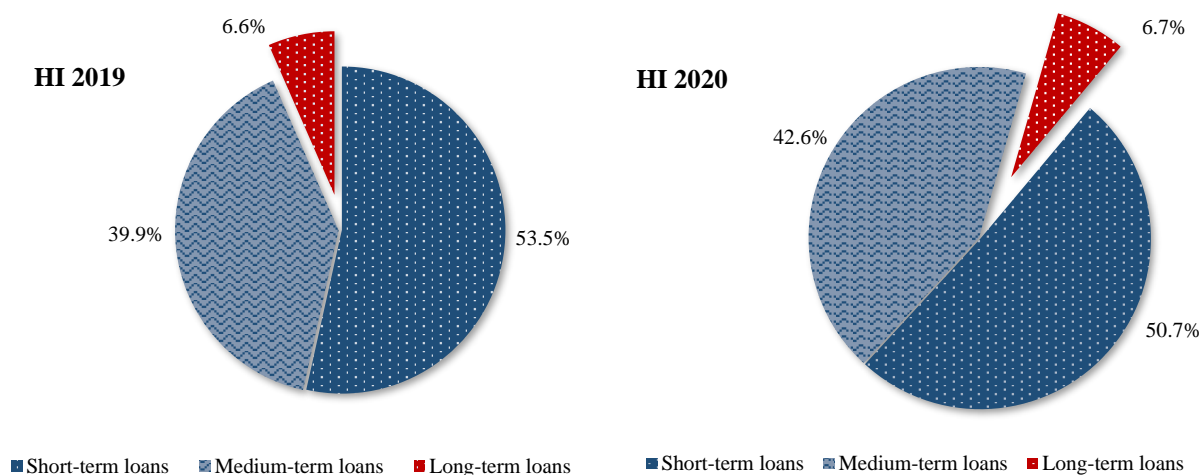
According to periodic regulatory reporting, the total assets of NBFCOs in the first half of 2020 increased by 20.9 percent and amounted to KGS 27.3 billion²⁹. This increase was due to growth in the loan portfolio of NBFCOs (Chart 3.1.2).

Lending remains the main activity of NBFCOs. As of June 30, 2020, the loan portfolio of NBFCOs increased by 16.9 percent and was formed in the amount of KGS 22.9 billion.

At the end of the reporting period, the number of borrowers increased by 4.8 percent compared to the first half of 2019 and amounted to 429,279 borrowers.

During the reporting period, there was a decrease in the share of short-term credit resources and an increase in the share of medium-term loans

Chart 3.1.3. Structure of the NBFCOs Loan Portfolio by Maturity³⁰



Source: NBKR

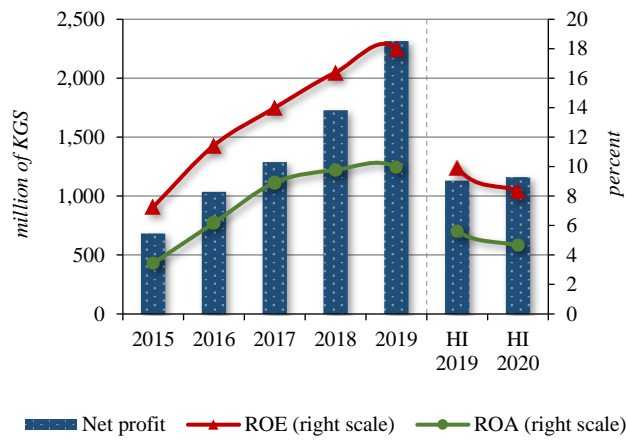
The main regions where the major share of NBFCOs loan portfolio is concentrated (71.9 percent of the total loan portfolio) are Bishkek city, Chui, Osh and Jalal-Abad regions, which is due to the highest level of business activity in these regions of the republic.

²⁹ Exclusive of "FCCU" OJSC.

³⁰ Data for the period.

Revenue Position³¹

Chart 3.1.4. Dynamics of NBFCOs Revenue Position³²



At the end of the first half of 2020, net profit of NBFCOs increased by 2.6 percent compared to the same indicator in 2019 and amounted to KGS 1.2 billion. As of the first half of 2020, ROA decreased by 1.0 p.p. and amounted to 4.7 percent. ROE decreased by 1.6 p.p. and constituted 8.4 percent (Chart 3.1.4).

Source: NBKR

³¹ ROA and ROE indices are provided in annual terms.

³² Exclusive of “FCCU” OJSC.

3.2. Risks of Non-banking Financial-Credit Organizations

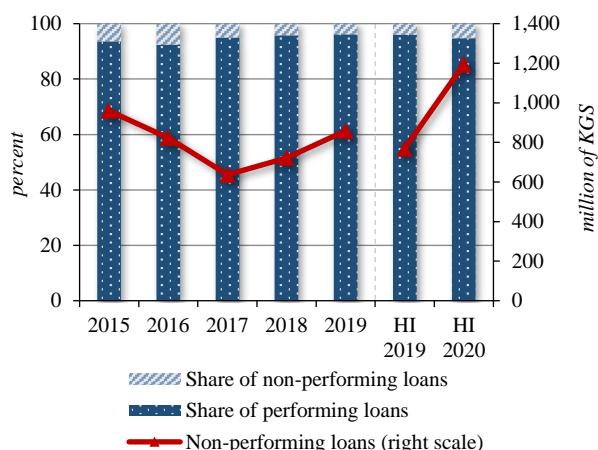
Major risk factors of the activities of NBFCOs are the quality of the loan portfolio, sectoral and institutional concentration, as well as status of the NBFCOs external debt.

Quality of the NBFCOs Loan Portfolio

As of the end of the reporting period, the share of non-performing loans in the loan portfolio of NBFCOs constituted 5.3 percent, meanwhile, their nominal volume increased by KGS 425.0 million or 55.2 percent compared to the first half of 2019 (Chart 3.2.1).

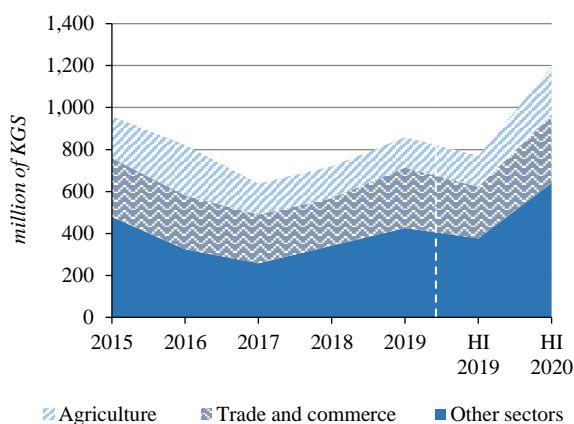
At the end of the first half of 2020, the structure of NBFCOs non-performing loans demonstrated slight increase in the share of defaulting loans issued to agriculture (by 0.1 p.p.), and decrease in the share of defaulting loans to trade (by 4.9 p.p.) compared to the first half of 2019. The share of defaulting loans issued to agriculture and trade in the total non-performing loans of NBFCOs constituted 19.4 and 27.0 percent, respectively (Chart 3.2.2).

Chart 3.2.1. Quality of NBFCOs Loan Portfolio



Source: NBKR

Chart 3.2.2. Structure of NBFCOs Non-performing Loans by Sectors of Economy



Source: NBKR

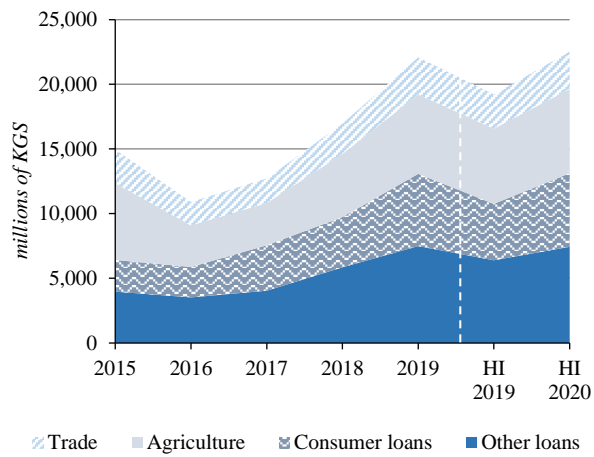
Sectoral Concentration

NBFCOs loan portfolio is concentrated in the sphere of agriculture (28.9 percent of NBFCOs total loans), as well as consumer loans and trade (25.3 percent and 12.9 percent of the total loan portfolio, accordingly, Chart 3.2.3). Lending of agriculture is associated with significant dependence on climate conditions.

Institutional Concentration

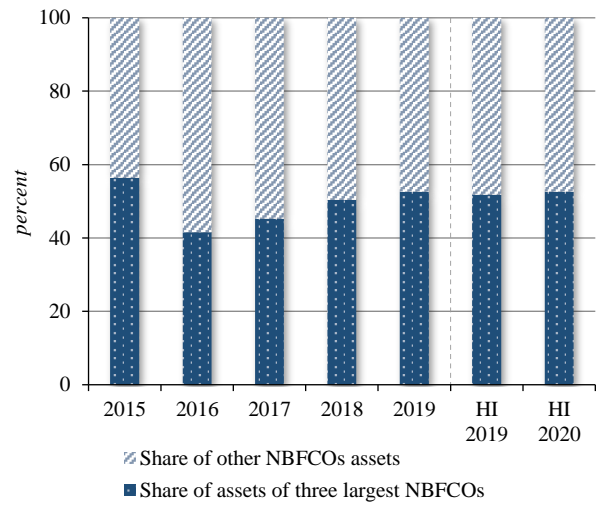
According to the results of the reporting period, the share of assets of three largest NBFCOs increased by 0.8 p.p. compared to the first half of 2019 and amounted to 52.6 percent of the total assets of NBFCOs sector (Chart 3.2.4).

Chart 3.2.3. Sectoral Structure of NBFCOs Loan Portfolio



Source: NBKR

Chart 3.2.4. Institutional Structure of NBFCOs Assets



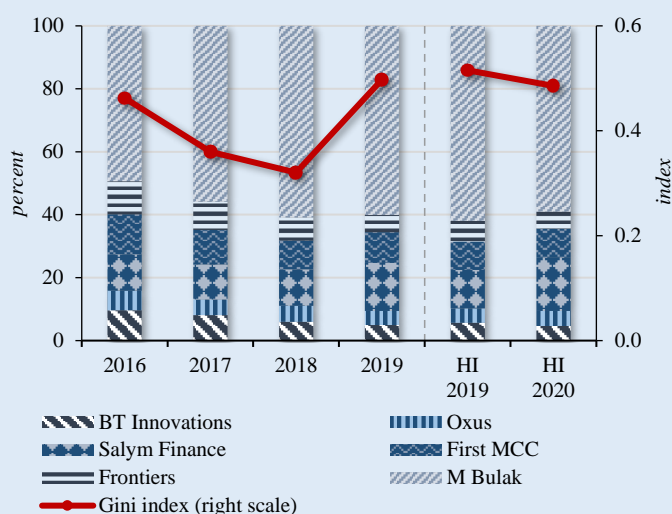
Source: NBKR

Box 6. Concentration Indices based Assessment of NBFCOs Sector Activity³³

The Herfindahl-Hirschman Index

Herfindahl-Hirschman³⁴ index was calculated for the purposes of concentration risk analysis in the NBFCOs sector. As of the end of the first half of 2020, Herfindahl-Hirschman index for the NBFCOs sector constituted 1,459.5 points. According to the rule of thumb³⁵, resulting value indicates availability of moderate concentration of NBFCOs assets or moderate concentration of microfinance market.

Chart 1. Dynamics of the Gini Index and Assets of 6 Largest NBFCOs



The Gini Index

The Gini index was calculated for estimating the uniformity of the NBFCOs assets distribution. As of June 30, 2020, the index value constituted 0.49 with a simultaneous decrease of concentration level (Chart 1).

Source: NBKR

³³ Concentration indices are calculated on the basis of data submitted by 6 largest NBFCOs.

³⁴ $H = \sum_{i=1}^n (share_i)^2$.

³⁵ 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.

External Debt Status of NBFCOs

As of the end of the reporting period, the external debt of NBFCOs amounted to USD 72.5 million. Major part of the external debt of NBFCOs are loans provided by the foreign financial-credit organizations (93.9 percent of total external debt of NBFCOs), and the rest (6.1 percent) are loans of the international financial institutions.

At the end of the first half of 2020, external debt of the largest NBFCOs increased by 15.5 percent compared to the first half of 2019 and amounted to USD 67.2 million.

3.3. Stress Testing of NBFCOs Sector

Stress Testing of the NBFCOs Credit Risk

Stress testing was conducted to assess the effect of deterioration of the loan portfolio quality on the NBFCOs sector.

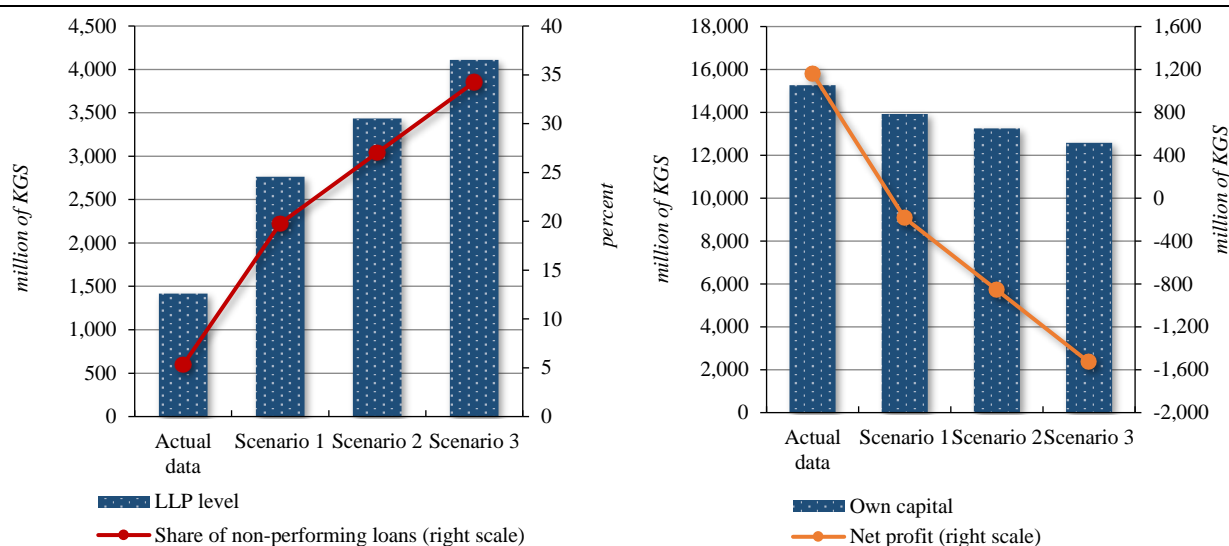
Three scenarios were considered when conducting stress testing:

- scenario 1: 50% of loans transition from one category to another;
- scenario 2: 75% of loans transition from one category to another;
- scenario 3: 100% of loans transition from one category to another.

The transition of loans from one category to another occurs uniformly by such categories as: “standard”, “under supervision”, “substandard”, “doubtful” and “losses”.

The level of loan loss provisions³⁶ in the loan portfolio of NBFCOs increased from 94.9 to 189.8 percent, depending on the scenario in conducting this stress testing (Chart 3.3.1).

Chart 3.3.1. Results of Stress Testing of the Credit Risk as of June 30, 2020



Source: NBKR

It should be noted that the deterioration of the loan portfolio quality entails a gradual decline in equity and net profit of NBFCOs. In case of the first, second and third scenario implementation, the NBFCOs will experience losses in the amount of KGS 184.5; 857.2 and 1,530.0 million, accordingly (Chart 3.3.1).

³⁶ MFOs create general and special loan loss provisions for relevant categories of classifications implementing the following allocations indicated in percentage from the amount of assets:

- Standard, in % - from 0 to 5;
- Assets under supervision, in % - 10;
- Substandard, in % - 25;
- Doubtful, in % - 50;
- Losses, in % - 100.

Table 3.3.1. Results of Stress Testing of the Credit Risk, percent

	Share of non-performing loans in the loan portfolio of NBFCOs
Scenario 1: transition of 50% of loans from one category to another	19.8
Scenario 2: transition of 75% of loans from one category to another	27.0
Scenario 3: transition of 100% of loans from one category to another	34.2

Source: NBKR

Implementation of the first scenario may result in an increase in the share of non-performing loans in the loan portfolio of NBFCOs by 14.5 p.p., to the level of 19.8 percent. In the case of the second scenario, non-performing loans may increase by 21.7 p.p., to the level of 27.0 percent, and in the implementation of the third scenario – by 28.9 p.p. and may reach the level of 34.2 percent.

IV. PAYMENT SYSTEMS

The level of risks in the systemically important payment systems was minimal and was determined by the legislation of the Kyrgyz Republic, regulatory legal acts and the measures taken by the National Bank to manage the risks in payment systems, particularly liquidity risk.

In the reporting period, the National Bank took appropriate measures focused on upgrading the systemically important payment systems, minimizing operational and financial risks in the payment infrastructure and retail payment systems by revising the requirements for the operators of the retail payment systems and payment organizations.

Effective and uninterrupted payment system is one of the main factors, which determine stability of the financial sector in the country.

As of June 30, 2020, the payment system of the Kyrgyz Republic included the following components:

1. Large Value Payment System of the National Bank – Real Time Gross Settlement (RTGS);

2. Systems of Retail Payments: the System of Batch Clearing of Small Retail and Regular Payments (SBC), Systems of Payment Cards Settlement, Money Transfer Systems, E-money Payment Systems;

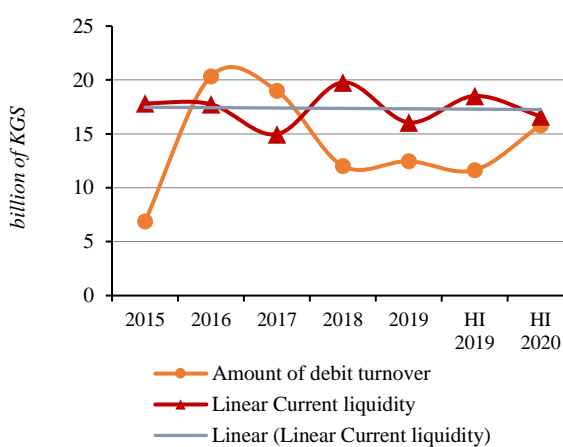
3. Payment Messages Receiving and Processing Infrastructure (SWIFT Service Bureau, Interbank Communication Network (hereinafter – ICN).

The RTGS functioned normally during the first half of 2020.

The level of financial risks in the RTGS remained low due to high level of liquid funds on the participants' accounts in relation to the turnovers in the system (liquidity ratio was 1.1 and the turnover ratio was 1.0). Average daily volume of liquid assets of participants showed decrease by 10.2 percent (compared to the same period of 2019) and amounted to KGS 16.6 billion (Chart 4.1).

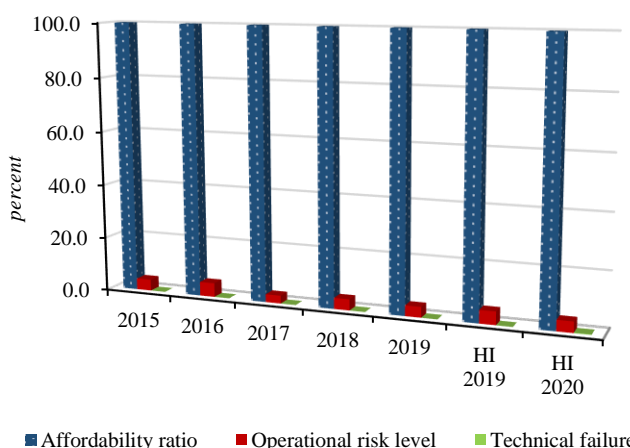
During the first half of 2020, the RTGS affordability ratio remained high and constituted 99.8 percent; meanwhile, the level of operational risk, taking into account prolongation of the transaction day, was 4.0 percent.

Chart 4.1. Dynamics of Changes of Daily Average Indicator of Payment Volumes and Liquidity in the RTGS



Source: NBKR

Chart 4.2. Ratio of Affordability and Operational Risk in the RTGS



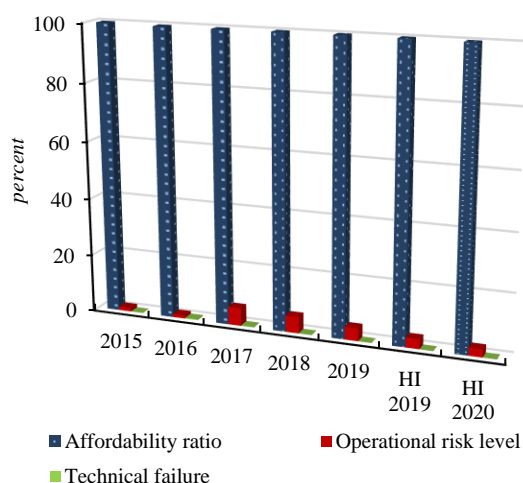
	2015	2016	2017	2018	2019	HI 2019	HI 2020
Technical failure, %	0.0	0.0	0.0	0.0	0.0	0.0	0.2
Affordability ratio, %	100.0	100.0	100.0	100.0	100.0	100.0	99.8
Operational risk level, %	4.1	5.2	2.9	4.1	3.9	4.9	4.0

Source: NBKR

The RTGS is a systemically important payment system, failures thereof can cause serious shocks for the banking system and the whole financial system.

In functioning of the **SBC** the level of financial risks in the reporting period was also low. Reserves exhibited by the participants to cover a debit net position were 5.5 times higher than the required level. According to the results of the SBC operation monitoring, the system affordability ratio remained high and amounted to 100.0 percent in the first half of 2019. Meanwhile, the level of operational risk was 2.8 percent (Chart 4.3) due to extending the operating procedure upon request of the system participants and minor failures.

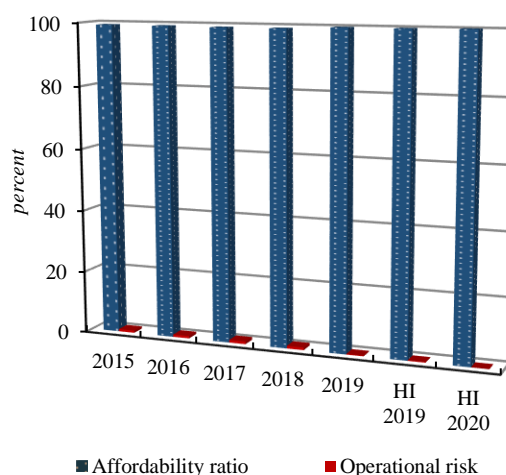
Chart 4.3. Ratio of Affordability Index and Operational Risks in the SBC



	2015	2016	2017	2018	2019	HI 2019	HI 2020
Technical failure, %	0.0	0.3	0.2	0.0	0.0	0.0	0.1
Affordability ratio, %	100.00	99.7	99.8	100.0	100.0	100.0	100.0
Operational risk level, %	1.2	1.2	6.2	5.8	4.5	3.4	2.8

Source: NBKR

Chart 4.4. Ratio of Affordability Index and Operational Risk in the SIPC



	2015	2016	2017	2018	2019	HI 2019	HI 2020
Affordability ratio, %	99.3	99.2	99.1	99.2	99.8	99.8	100.0
Operational risk, %	0.7	0.8	0.9	0.8	0.2	0.2	0.0

Source: NBKR

Systems of Bank Payment Cards Settlements. As of July 1, 2020, six international payment card systems and the national system “Elcart” operated in the Kyrgyz Republic.

There was a positive trend in the level of bank cards penetration in recent years. Thus, the total number of payment cards in circulation as of July 1, 2020 increased by 12.5 percent compared to the same period last year and amounted to 3,039.7 thousand.

The total number of ATMs and POS-terminals installed throughout the republic amounted to 1,771 and 11,518, respectively (among them: 9,336 POS-terminals were installed in the trade and service outlets and 2,182 POS-terminals - in the branches of the commercial banks). The number of ATMs increased by 9.3 percent, and POS-terminals – by 6.0 percent compared to the first half of last year.

In the reporting period, all 23 commercial banks worked with the national system “Elcart”. The results of operation monitoring and analysis indicated that the system affordability ratio was 100.0 percent, and the level of operational risks in the system, taking into account technical failures, was minimal (Figure 4.4).

In terms of the international payment card systems, currently, the commercial banks work with the international payment systems such as Visa, Mastercard, American Express, Union Pay, Zolotaya Korona and Mir.

Money transfer systems. During the first half of 2020, receipt and transfer of international remittances without opening an account in the commercial banks was carried out by means of 9 international money transfer systems (Table 4.1.).

Table 4.1. Distribution of Flows among International Money Transfer Systems

Money transfer system	Incoming		Outgoing	
	Share of the total number, in %	Share of the total volume, in %	Share of the total number, in %	Share of the total volume, in %
Zolotaya Korona	76.0	73.2	78.9	81.7
Unistream	2.8	4.4	1.6	3.0
Western Union	17.5	14.6	5.7	6.0
CONTACT	2.2	4.3	12.9	8.1
Money Gram	1.0	2.1	0.9	1.2
Other	0.5	1.4	0.0	0.0
Total	100.0	100.0	100.0	100.0

Source: NBKR

Regarding **local money transfers**, relatively even distribution among five local money transfer systems is currently observed, the banks of the Kyrgyz Republic are operators thereof.

At the end of the first half of 2020, the exchange of cross-border financial messages was carried out through the SWIFT network, bank-client services.

The results of monitoring over the functioning of the Kyrgyz Republic payment system during the first half of 2020 showed that all significant payment systems functioned normally and did not cause any systemic risk for the financial system of the country.

Nine commercial banks were the e-money issuers as of the end of July 1, 2020 within the **e-money payment systems**. There is an annual stable increase in e-money indicators due to simplicity and ease of use thereof. As of the end of the first half of 2020, the number of e-wallets increased by almost two times compared to the same period in 2019 and amounted to 2.8 million wallets. The activity of e-wallets users is also growing steadily year by year.

V. IMPROVEMENT OF THE FINANCIAL SECTOR REGULATION

In the reporting period, development of the regulatory legal framework governing the activities of the financial-credit organizations was mainly focused on maintaining stability in the banking and financial systems of the country and protecting the rights of the financial services consumers, due to the situation caused by the COVID-19 pandemic and its spread in the Kyrgyz Republic.

1. The Board of the National Bank adopted the Resolution “On introduction of amendments into some regulatory legal acts of the National Bank of the Kyrgyz Republic on commission fees and other payments” No. 2020-P-12/8-8-(NPA) on February 26, 2020 to ensure fair approach when the banks set commission fees and other payments within the framework of loans issuing.

2. The Board of the National Bank adopted the Resolution “On temporary rules to regulate the activities of the financial-credit organizations due to the COVID 19 disease” No. 2020-P-12/13-1-(BS) on March 18, 2020.

According to this Resolution, the commercial banks and NBFCOs:

- are prohibited to charge and collect commission fees and other payments related to revision of the loan agreement terms;

- are prohibited to impose and levy penalties, including forfeit (fines/charges), from the borrowers for non-performance/improper performance of obligations;

- are recommended to provide a deferral for payments of issued loans for at least three months;

- are allowed not to worsen the category of loan classification when the terms of loan agreements are changed;

- information on overdue payments transferred to the credit bureaus should not be included as negative credit information and the reasons for delays should be taken into account.

3. On March 23, 2020, the Board of the National Bank adopted the Resolution “On the procedure for operation and regulation of the activities implemented by the banks, non-banking financial-credit organizations and other legal entities supervised by the National Bank of the Kyrgyz Republic upon introduction of an emergency situation in the territory of the Kyrgyz Republic due to the spread of the COVID-19 disease” No. 2020-P-12/14-1- (BS).

This document was developed to determine measures for operation of the banks, non-banking financial-credit organizations and other entities supervised by the National Bank during introduction of an emergency regime in the Kyrgyz Republic due to the spread of the COVID-19 disease to ensure uninterrupted provision of financial services to the population and protection of the bank personnel.

4. The Board of the National Bank adopted the Resolution “On some temporary decisions of the National Bank of the Kyrgyz Republic on establishment of the prudential standards and requirements mandatory for the commercial banks and non-banking financial-credit organizations of the Kyrgyz Republic” No. 2020-P-12/15-7-(NPA) on March 24, 2020 to reduce the risk of non-compliance with certain prudential standards and requirements by the banks.

The Resolution:

- suspended a number of resolutions recently adopted by the Board of the National Bank on calculation of the total capital adequacy ratio, leverage and liquidity coverage ratio, taking into account the new standards, were suspended;

- suspended the regulatory legal act on disclosure of information on the commercial banks' activities;

- relaxed the requirements for liquidity ratios, as well as for the level of weighting the credit risk on loans extended in foreign currency;

- increased the time threshold, if being exceeded the banks must create 100% reserves for accrued interest on loans, from 90 to 270 days.

5. On March 24, 2020, the Board of the National Bank adopted the Resolution “On introduction of amendments into the Resolution of the Board of the National Bank of the Kyrgyz Republic “On some regulatory legal acts of the National Bank of the Kyrgyz Republic” No. 52/4 dated June 30, 2010” No. 2020-P-12/15-6-(NPA) due to the need to revise the standards upon sharp decrease in the portfolio of the banks’ group loans that actively extend loans to the joint liability groups, and occurrence of a risk of non-compliance with the standards in future.

6. Amendments to some regulatory legal acts of the National Bank regarding operations with securities conducted by the financial-credit organizations were approved by the Resolution of the Board of the National Bank No. 2020-P-12/15-5-(NPA) on March 24, 2020. The requirements for acquisition and classification by the banks of the securities owned by the issuers-residents of the Kyrgyz Republic were lowered in the regulatory legal acts of the National Bank in order to develop the securities market.

7. On March 25, 2020, the Board of the National Bank adopted the Resolution “On introduction of amendments into some regulatory legal acts of the National Bank of the Kyrgyz Republic” No. 2020-P-12/16-3-(NPA) regarding establishment of the requirements to the commercial banks for lending on security of the warehouse certificates.

In order to minimize the risks when extending the loans secured by the warehouse certificates, the Resolution established the minimum requirements:

- to the issuer of the security (warehouse), providing services on products storage in the warehouses with released (issued) warehouse certificate;
- to the documentation to conduct analysis of the borrower’s solvency;
- to quarterly monitoring of seasonal fluctuations in prices for agricultural products, analysis of the impact of changes in prices for products (goods) on the cost of collateral;
- to classification of the assets secured by the warehouse certificates within the framework of financing;
- to the documentation for assessing the collateral quality.

8. On March 30, 2020, the Board of the National Bank adopted the Resolution “On the procedure for operation and regulation of the activities conducted by the banks, non-banking financial-credit organizations and other legal entities supervised by the National Bank of the Kyrgyz Republic upon introduction of a state of emergency in the territory of the Kyrgyz Republic due to the spread of the COVID-19 disease” No. 2020-P-12/19-1-(BS).

This document was developed to minimize the risks in the activities conducted by the commercial banks, non-banking financial-credit organizations and other legal entities supervised by the National Bank in case of mass infection of the population in a state of emergency amid epidemic of infectious diseases.

9. The Board of the National Bank adopted the Resolution “On the time frames for submitting the reports by the commercial banks and non-banking financial-credit organizations of the Kyrgyz Republic to the National Bank of the Kyrgyz Republic” No. 2020-P-12/20-1-(NPA) on April 3, 2020 to maintain stability of the banking and financial systems in the country.

The Resolution is related to extension of the deadlines for submission of the reports by the banks and non-banking financial-credit organizations (FCOs) to the National Bank and is focused on reducing the risks of non-compliance by the FCOs with the requirements of the National Bank on reporting issues in a timely manner.

10. The Board of the National Bank adopted the Resolution of the Kyrgyz Republic “On extension of the terms of audit, approval, submission and publication of the bank’s financial statements” No. 2020-P-12/23-1-(BS) on April 16, 2020 in view of introduction of a state of emergency in certain territories of the Kyrgyz Republic due to the spread of the COVID-19 disease.

11. On April 29, 2020, the Board of the National Bank adopted the following resolutions:

1) “On additional temporary measures to regulate the activities of the commercial banks in the Kyrgyz Republic” No. 2020-P-12/25-6-(NPA), focused on softening and temporarily suspending the execution of the National Bank’s certain requirements by the commercial banks and protecting the rights of the banking services consumers.

The Resolution prior to adoption of the relevant decision by the Board of the National Bank for the commercial banks:

- relaxed the requirements for monitoring the borrowers' loans by reducing the frequency of conducting thereof. At the same time, payment monitoring should be conducted for consumer loans, implying an analysis based on payments made on the loan;

- suspended execution of the requirement for movable property monitoring;

- gave an opportunity to issue consumer loans to the borrowers in the national currency, provided that certain conditions are observed;

- allowed, when issuing loans, not to require the registration documents (certificates, patents) issued by the state authorities from the individual entrepreneurs;

- allowed not to demand from the individual entrepreneurs, when opening a bank account, a certificate on tax registration of a taxpayer issued by the tax service. A similar relief was provided to the legal entities (residents) when opening an account to receive a loan under the programs related to the issuance of preferential unsecured loans for the small and medium-sized businesses;

2) "On temporary rules for classification of the assets and implementation of the commercial banks' appropriate deductions to ensure loan loss provisions" No. 2020-P-12/25-7-(NPA), which will allow the banks to redistribute the costs, to mobilize resources for lending to the business entities and the population and to ensure the stable functioning of the banking system.

The Resolution establishes indulgences for classification of the assets, the quality of which has deteriorated or deteriorates due to the spread of coronavirus disease, as well as for classification of the loans that will be issued within the framework of targeted government programs or programs focused on restoring/revitalizing the activities of the business entities and the population in the country.

12. On May 13, 2020, the Board of the National Bank adopted the Resolution "On the procedure for identifying and verifying clients in the remote mode" No. 2020-P-12/27-1-(NPA), which outlines the procedure for remote identification and verification of the clients via video communication, as well as other channels of interaction with the clients.

Principles of Islamic Finance

1. Amendments were approved in some regulatory legal acts of the National Bank by the Resolution of the Board of the National Bank No. 2020-P-12/8-7-(NPA) on February 26, 2020 to clarify some issues of corporate governance in the banks conducting operations according to the principles of Islamic finance, and preparation of financial statements by the banks that have an “Islamic window”.

2. Amendments concerning operations of the financial-credit organizations conducting operations in accordance with the principles of Islamic finance, with the securities, and on credit risk management were approved in some regulatory legal acts of the National Bank by the Resolution of the Board of the National Bank No. 2020-P-12/15-5-(NPA) on March 24, 2020 to develop the Islamic securities market and create equal conditions for market participants.

3. Amendments focused on determining the procedure for calculating an open position and monitoring compliance with the limits of an open position in precious metals by the Islamic banks and the banks having an “Islamic window” were approved in the Instruction “On the procedure to observe the limits of open foreign exchange position by the banks conducting operations in accordance with the principles of Islamic banking and finance” by the Resolution of the Board of the National Bank No. 2020-P-12/39-2-(NPA) on July 8, 2020.

GLOSSARY AND ABBREVIATIONS

A *bank deposit* is the amount of money, accepted by a financial-credit organization under contract from another person on the terms of repayment, payment and maturity. Deposits can be time 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 re-payment 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.

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.

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.

Macprudential analysis is an assessment and monitoring of strong sides and vulnerable spots of the financial system taken as a whole.

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

A *securities market* is organized exchanges and structures (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.

Stress tests are methods used for assessment of portfolios vulnerability with respect to significant changes in the macroeconomic situation or exceptional but possible events.

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.

LIST OF ABBREVIATIONS

CAR – Capital Adequacy Ratio
CB – Commercial Bank
CPI – Consumer Price Index
FAO – Food Agriculture Organization of the United Nations
FCCU (“FCCU” OJSC) – “Financial Company of Credit Unions” OJSC
FCO – Financial-Credit Organization
GDP – Gross Domestic Product
KR – Kyrgyz Republic
LLP – Loan Loss Provisions
LSF – Large Sources of Financing
MF KR – Ministry of Finance of the Kyrgyz Republic
MFO – Microfinance Organization
NBFCOs – Non-banking Financial-Credit Organizations
NBKR – National Bank of the Kyrgyz Republic
NSC KR – National Statistical Committee of the Kyrgyz Republic
NTC – Net Total Capital
OCP – Open Currency Position
OECD – Organization for Economic Cooperation and Development
OJSC – Open Joint-Stock Company
p.p. – percentage points
PRBR – Periodic Regulatory Bank Reporting
ROA – Return on Assets
ROE – Return on Equity
RTGS – Real Time Gross Settlement System
SBC – System of Batch Clearing
SIPC – Single Inter-bank Processing Center
ST-Bills – State Treasury Bills
ST-Bonds – State Treasury Bonds
USA – United States of America
VaR – Interest Rate Risk