

The National Bank of the Kyrgyz Republic

**THE BANKING SYSTEM
DEVELOPMENT TRENDS**

SECOND HALF OF 2011 (20)

BISHKEK 2012

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Development Trends of the Banking System

The purpose of the "The Banking System Development Trends" is to analyze and assess the development of the banking system of Kyrgyzstan as a financial intermediary, to identify obstacles to achieving and maintaining stability as well as to assess the constituent elements of the stability of the banking system of Kyrgyzstan. Published yearly on January 1 and July 1 in Kyrgyz, Russian and English languages.

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Other publications of the National Bank of the Kyrgyz Republic

Annual Report of the National Bank of the Kyrgyz Republic

Annual Report of the NBKR is a full report on the work carried out by the National Bank for the reporting year and contains a brief description of the results of changes in the functioning of the real sector of economy, as well as the decisions and actions of the National Bank in the monetary sphere. The report includes information on economic development and monetary policy, financial reporting, general information on the National Bank, statistical annexes. Published in Kyrgyz, Russian and English languages.

Bulletin of the National Bank of the Kyrgyz Republic

Bulletin of the NBKR contains macroeconomic indicators of the Kyrgyz Republic of the real, financial and external sectors, as well as public finance. This bulletin uses the materials of the National Statistical Committee, the Ministry of Finance, commercial banks, the State Service for Regulation and Supervision of Financial Markets of the Kyrgyz Republic under the Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic. Published monthly in Kyrgyz, Russian and English languages.

The Balance of Payments of the Kyrgyz Republic

This publication reflects recent trends in the development of the external sector and contains tables with data on the analytical and neutral forms of the balance of payments, the structure of foreign trade, international reserves, external debt and international investment position of the Kyrgyz Republic. Published quarterly in January, May, July and October.

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The report contains a description of the dynamics of consumer prices in the country and its regions, the analysis of the main inflation factors, information on decisions of the National Bank of the Kyrgyz Republic in the field of monetary policy, and presents inflation forecast for the coming period. Published quarterly in Kyrgyz, Russian and English languages.

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Press Release of the NBKR contains a chronicle of events in the National Bank and the banking system as a whole, and current information on the financial market. Published weekly in Kyrgyz and Russian languages.

Regulations of the National Bank of the Kyrgyz Republic

This publication officially publishes regulations of the National Bank in order to provide commercial banks and public with regulatory documents forming the banking legislation of the Kyrgyz Republic. Estimated frequency of publication is once a month in Kyrgyz and Russian languages.

All publications are distributed according to the lists approved by the orders of the Chairman of the National Bank of the Kyrgyz Republic and are posted on <http://www.nbkr.kg>

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INTRODUCTION

In the second half of 2011, an increase in the main indicators of the banking system was observed, in particular, assets, including loans, liabilities, including the deposit base and profitability of commercial banks. At the same time, it is necessary to note a trend in reduction of the financial intermediation level associated with GDP growth ahead of the main indicators of the banking system.

Substantial liquidity cushion and a high level of adequacy of commercial banks' capital indicate a sufficient sustainability of the banking system with respect to adverse shocks, and the availability of certain potential for increasing the level of financial intermediation and the effective functioning of the banking system.

An increase in lending to the real sector of economy was observed in the banking system. At the same time, most of the loan portfolio was for the first time concentrated in the household sector more than in the corporate sector. The continuing trend of increasing long-term loans to customers in the loan portfolio of the banking system also should be noted. In addition, the level of dollarization of banks' loan portfolio continues to decrease. Industry concentration of the loan portfolio in trade still remains.

Positive growth rates of individuals' deposits indicate continued trust of the population to the banking system.

The growth of the loan portfolio continues in the sector of non-bank financial institutions, as evidenced by the high demand for credit resources by households and small and medium businesses. Sustainable growth in the number of borrowers indicates the demand for services of non-bank financial institutions among the population. A sufficiently high share of loans in agriculture is caused by the regional branching of microfinance institutions and by the specifics of credit unions as rural financial institutions.

Thus, in general, the trend in the increase of key indicators of the financial sector of the Kyrgyz Republic was observed in the period under review.

* * * * *

The "NBKR: Development and Prospects" review article is presented in the "Special Issues" section.

I. STATUS OF THE FINANCIAL SECTOR OF THE KYRGYZ REPUBLIC

As of the end of the second half of 2011, the total assets of the financial sector¹ compared to the same period of 2010 increased by 15.4 percent, and by 10.2 percent compared to the first half of 2011. At the same time, the growth of this indicator was observed both in the banking sector, and the system of non-bank financial institutions (NBFIs).

The indicator of financial intermediation, defined as the ratio of the aggregate loan portfolio to gross domestic product (GDP)², declined compared to the same period of last year and amounted to 17.9 percent (Graph 1.1). The growth rates of the credit portfolio of the banking system and NBFIs for the second half of 2011 amounted to 18.4 and 41.9 percent, respectively, compared to the same period of 2010 and 9.2 and 12.6 percent, respectively, compared to the first half of 2011.

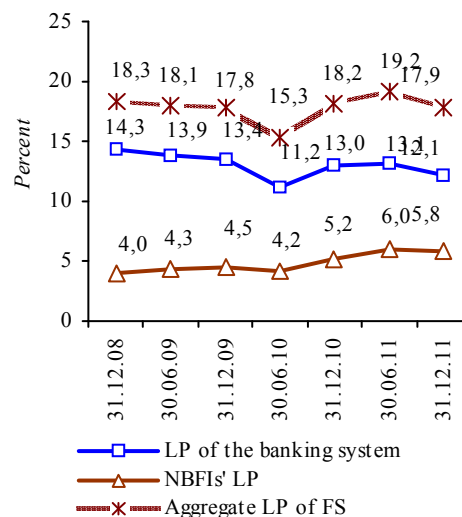
Banks continue to dominate the financial sector (Graph 1.2) and as of the end of the second half of 2011 their share constituted 67.8 percent³ in the aggregate loan portfolio of the financial sector⁴, which is by 3.5 percentage points lower than in the same period in 2010, and by 0.8 percentage points lower compared to the first half of 2011.

The dynamics of the ratio of special reserves to cover potential losses and damages (PL) to the volume of loans of the banking system and NBFIs indicates an improvement in loan portfolio quality (Graph 1.3). Share of special PL in the loan portfolio of NBFIs as of the end of the second half of 2011 decreased and constituted 2.2 percent. In the banking system, this indicator decreased by 1.1 percentage points compared to the first half of 2011 and constituted 6.3 percent.

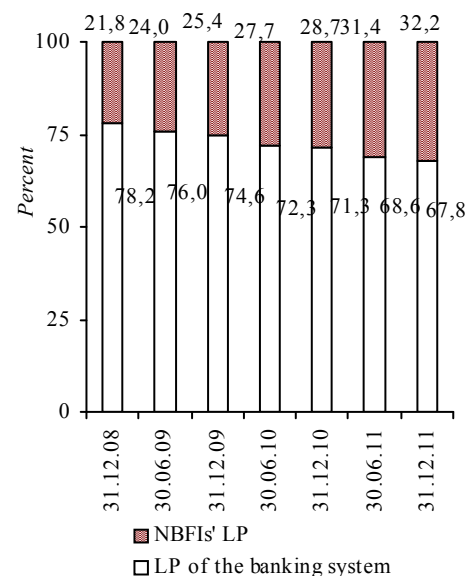
In the second half of 2011, compared to the same period last year, an increase in the weighted average interest rates on loans of commercial banks in national currency and the reduction of loans in foreign currency was observed.

Thus, in the second half of 2011, compared to the same period in 2010, the weighted average interest rate on loans in national

Graph 1.1. Dynamics of changes in the loan portfolio (LP) of the financial sector (FS), as a percentage to GDP



Graph 1.2. The structure of the aggregate loan portfolio (LP)



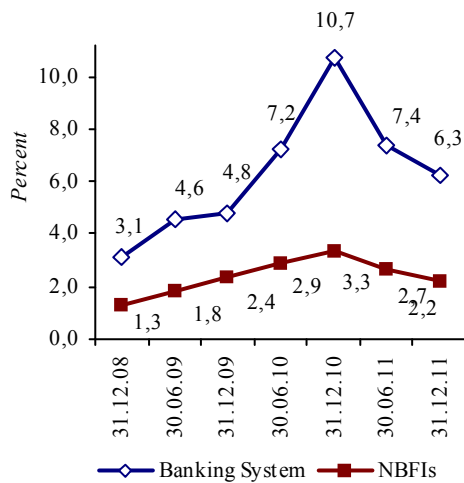
¹ Here the indicators of commercial banks and non-bank financial institutions licensed by the NBKR are considered as the analyzed indicators of the financial sector.

² Data on actual GDP for the past 12 months are taken into account.

³ The credit portfolio of the banking system includes the loan portfolio of bankrupt banks.

⁴ According to the Periodic Regulatory Banking Report (PRBR).

Graph 1.3. The level of specific RCPL in the loan portfolios of the banking system and NBFIs



currency increased by 1.8 percentage points, and decreased by 0.7 percentage points in foreign currency.

As of December 31, 2011, the weighted average interest rate on new loans in national currency amounted to 25.3 percent (an increase by 1.1 percentage points compared to June 30, 2011). The weighted average interest rate on new loans in foreign currency decreased by 0.5 percentage points since the beginning of the second half of 2011, constituting 19.04 percent as of December 31, 2011.

The level of weighted average interest rates on loans of non-bank financial institutions remains quite high. Thus, the weighted average interest rates on IFOs and the CUs constitute 38.3 and 29 percent, respectively.

Thus, the status of the financial sector of Kyrgyzstan in the period under review was characterized by:

- an increase in the volume of assets of the financial sector;
- a decrease in growth in financial intermediation indicators related to GDP growth ahead of the main indicators of the banking system and NBFIs;
- an increase in the share of NBFIs in the aggregate loan portfolio of the financial sector;
- improvement of qualitative characteristics of the loan portfolio of commercial banks and NBFIs..

II. STATUS OF THE BANKING SYSTEM

2.1. Structure of the Banking System

As of December 31, 2011, 22 commercial banks, 254 branches, 531 savings bank and 29 outreach offices have been operating the country, including 13 banks with foreign participation in equity, and 10 banks with foreign participation in the amount than 50 percent. All banking institutions of the country are universal by their activity.

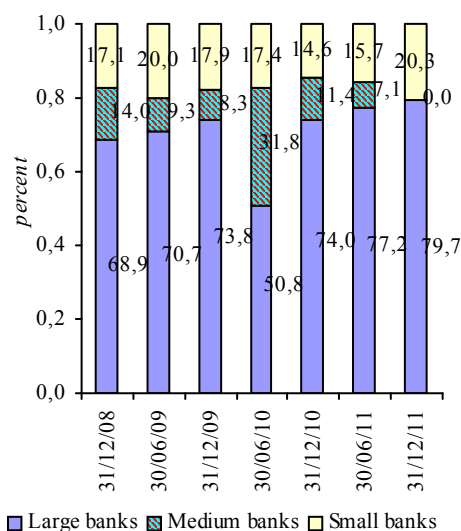
The preservation mode was carried out in four troubled banks: Akyl IACB OJSC, Manas Bank CJSC, KyrgyzCredit Bank OJSC, Issyk-Kul IB OJSC.

Other banks which formed the larger part of the banking system functioned in the normal mode and provided a core set of banking services and products to the population.

In the second half of 2011, the main indicators of the banking system, in particular, assets, liabilities and the deposit base of commercial banks, showed a growth in comparison with the results of the second half of 2010.

Analysis of the structure of the banking system in terms of market segment occupied by groups of "large", "medium" and "small" banks¹ (Graph 2.1.1) indicates a growth of the market share of "large" and "small" banks, whose share grew by 2.5 and 4.6 percentage points, respectively, in period under review. There is an increase of the market share of "large" and "small" banks due to the transfer of the bank from the "medium" group to a group of "small" banks in the banking system, and the growth of considered indicators in absolute terms in the group of "large" banks. As a result, in accordance with the methodology adopted for this analysis as of the end of 2011, there was not a group of "medium" banks in the banking system.

Graph 2.1.1. Changes in the structure of the banking system in by groups of banks



¹ For purposes of analysis, in this publication, the "large" banks are understood as banks, whose share (d_i) in the banking market (the average square of the share in total assets, loans, deposits and liabilities) exceeds 10%, "medium" banks - from 5% to 10 %, and "small" banks - less than 5%.

Calculated as follows:

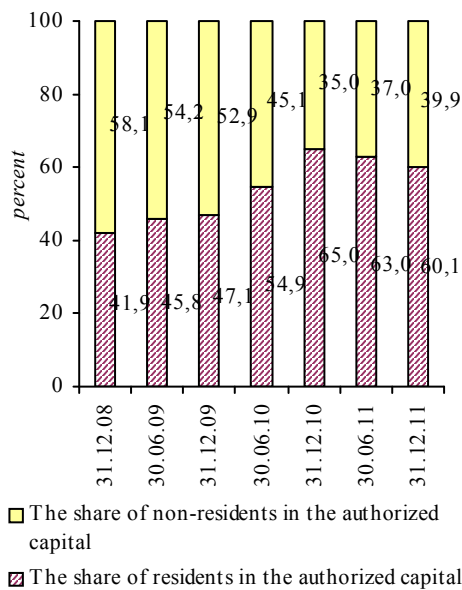
$$d_i = \frac{X_i}{\sum_{i=1}^N X_i} \quad \text{- share of i-bank in the banking sector,}$$

where N is a number of operating commercial banks;

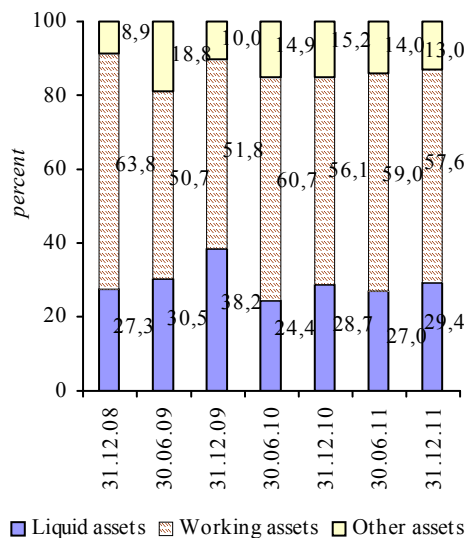
$$X_i = \frac{d_A^2 + d_{kp}^2 + d_L^2 + d_{O\phi}^2}{4} \quad \text{- arithmetic average on the following indicators: } (d_A^2)\text{-}$$

square of the asset share of i-bank banks in total assets and, accordingly, loans (d_{kp}^2), deposits (d_L^2) and liabilities ($d_{O\phi}^2$).

Graph 2.1.2. Changes in the structure of the share capital of the banking system



Graph 2.1.3. Changes in the structure of banking system assets



The segment of "large" banks is represented by four banks, occupying 79.7 percent of the market share.

These banks are classified as "large" based on the high share they occupy in total loans of the banking system - 74.0 percent, 84.1 percent in the total deposit base (excluding deposits of banks and other FIs, as well as deposits of local authorities), 79.0 and 82.0 percent in total assets and liabilities, respectively.

The growth of aggregate capital of the banking system for the second half and since the beginning of 2011 constituted 16.2 and 14.8 percent, respectively.

The share of foreign capital in the aggregate authorized capital of commercial banks constituted 39.9 percent (37.0 percent as of June 30, 2011) (Graph 2.1.2.).

The growth of assets of the banking system at the end of the second half of 2011 constituted 8.7 percent. Considering the changes in the structure of total assets, it is evident that 57.6 percent of bank assets were working², and their share decreased by 1.4 percentage points compared to June 30, 2011. At the same time, the share of liquid assets³ in total assets of the banking system increased by 2.4 percentage points and constituted 29.4 percent (27.0 percent as of June 30, 2011) (Graph 2.1.3).

Liquid assets in excess of regulatory level allowed banks in the 2nd half of 2011 to increase lending to the economy. The share of "other" assets decreased slightly in the 2nd half of 2011 and amounted to 13.0 percent in the total assets of the banking system (14.0 percent as of June 30, 2011).

Conducting transactions in accordance with Islamic principles of banking and finance continues. The volume of active transactions in accordance with Islamic principles of banking (Murabaha, Mudarabah, Shariqa, etc.)⁴ as of the end of the 2nd half of 2011 amounted to 1,119.1 million KGS (991.4 million KGS as of June 30, 2011), i.e. an increase for the 2nd half constituted 12.9 percent.

For a more detailed consideration of the dynamics and the structure of the deposit base⁵ as the main source of resource

² Working assets are balances on accounts of loans, deposits placed in FIs, securities and other interest-bearing placements of banks.

³ Liquid assets are understood as funds of banks in the cashier's offices and on the correspondent accounts.

⁴ See *Regulations on the Transactions Carried Out in accordance with the Islamic Principles of Banking and Finance* approved by the Board of the NBKR.

⁵ For purposes of this analysis, the "deposit base" includes deposits of enterprises and population, as well as deposits and loans from the central governmental bodies, except for deposits and loans from local authorities and deposits of other banks.

allocation and lending to the real sector of the economy the following is observed. In the 2nd half of 2011, the growth in the deposit base of the banking system amounted to 5.1 percent in comparison with June 30, 2011, and the amount of deposits reached 36.9 billion KGS. In the structure of the deposit, the share of private deposits amounted to 43.8 percent (an increase by 3.6 percentage points). At the same time, the growth of the volume of private deposits constituted 8.7 percent compared to June 30, 2011.

The ratio of corporate deposits amounted to 43.3 percent (decrease by 2.3 percentage points). At the same time, in the 2nd half of 2011, there has been some growth in corporate deposits (an increase constituted 0.2 percent compared to June 30, 2011.)

The remaining ratio (12.9 percent) is occupied by the deposits of the central authorities of the Kyrgyz Republic. Reduction of the ratio in the share of the total deposit base of this category of deposits constituted 1.3 percentage points.

During the period under review, there has been a slight increase in the share of fixed-period deposits from 34.5 to 34.9 percent of the total deposit base of banks (Graph 2.1.4.). At the same time, the increase of fixed-period private deposits for the 2nd half of 2011 constituted 7.2 percent and amounted to 0.61 billion KGS in absolute terms.

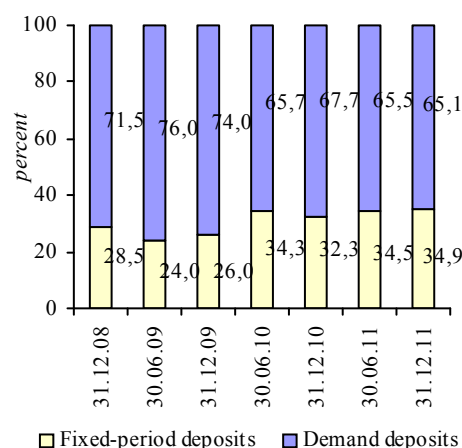
A decrease in the "dollarization" level of the deposit base of the banking system was observed in the 2nd half of 2011 (Graph 2.1.5). This indicator constituted 48.4 percent against 50.9 percent as of the end of the 1st half of 2011. The share of corporate deposits in foreign currency at the end of the period under review decreased by 3.3 percentage points (57.1 percent as of the end of the 1st half of 2011) and constituted 53.8 percent of the total corporate deposits. The share of private deposits in foreign currency as of the end of the 2nd half of 2011 decreased by 3.2 percentage points and constituted 54.7 percent of the total private deposits (57.9 percent as of June 30, 2011).

The aggregate loan portfolio⁶ of the banking system in the 2nd half of 2011 increased by 10.2 percent and constituted 31.1 billion KGS. At the same time, the "dollarization" level of commercial bank loans rose and constituted the 55.2 percent as of December 31, 2011 (Graph 2.1.6).

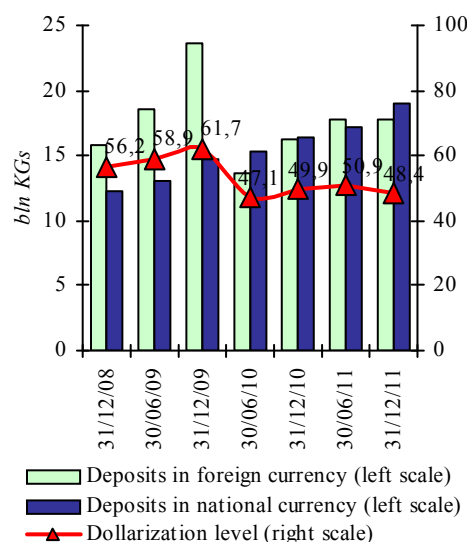
The share of long-term loans increased from 64.5 to 70.0 percent

⁶ Here and henceforth this category does not include the appropriate discount on all loans, and loans to banks and other financial institutions. Loans are issued taking into PL account.

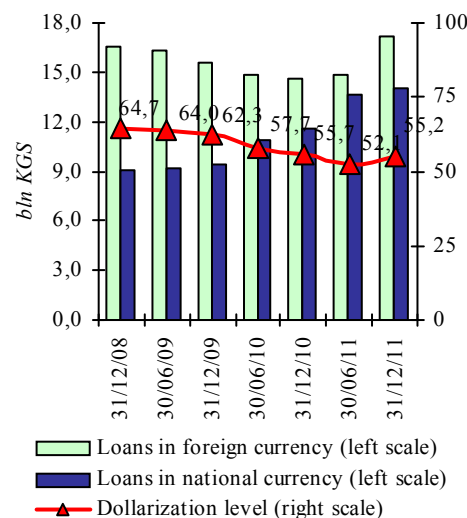
Graph 2.1.4. Changes in the structure of deposits of the banking system by the terms of attracting



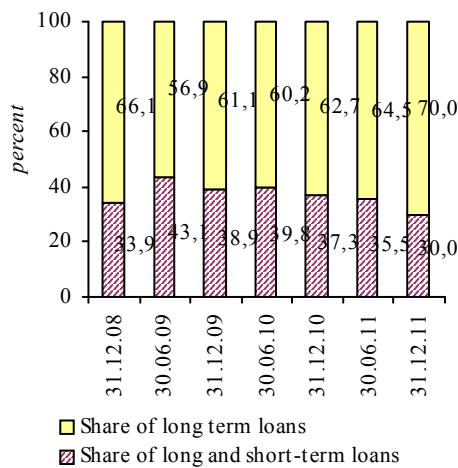
Graph 2.1.5. Changes in the structure of the banking system deposits by currency



Graph 2.1.6. Changes in the structure of the banking system's loan portfolio by currency



Graph 2.1.7 Changes in the structure of the banking system's loan portfolio by maturity

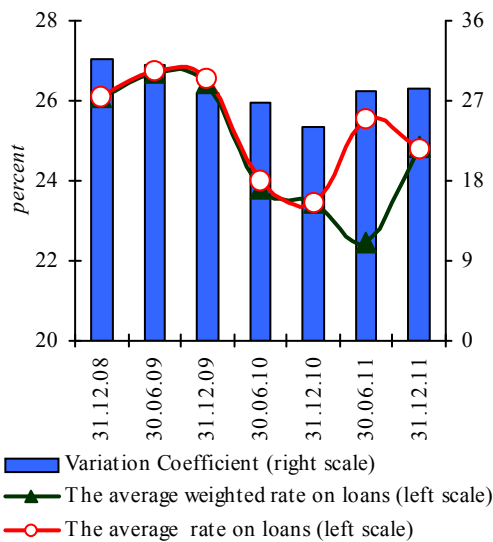


and the growth amounted to 3.4 billion KGS in absolute terms. The ratio of loans with the period of repayment less than one year from the 1st half of 2009 had a trend in decrease and amounted to 30.0 percent of the loan portfolio share of the banking system as of the end of 2011 (Graph 2.1.7).

Characteristics such as variation coefficient of interest rates and the average and weighted average interest rates on loans are considered in order to assess the current interest rates on loans.

In the period under review, average interest rates on issued loans in national currency constituted 25.6 percent, and 20.8 percent in foreign currency. In comparison with the 1st half of 2011, the average interest rate on loans in national currency remained unchanged and decreased by 1.2 percentage points in foreign currency. The variation coefficient indicating the magnitude of the spread in interest rates on the loan market shows a trend in a slight increase in the spread of interest rates on loans both in national currency and in foreign currency. As of the end of the 2nd half of 2011, the average interest rate on issued loans in national currency shows a slight decrease compared with the data on as of June 30, 2011 and was almost equal to the weighted average interest rate, which is associated with the demand for loan proceeds and a larger volume of loans at low interest rates in individual banks.

Graph 2.1.8. Changes in the characteristics of the interest rate on loans in national currency

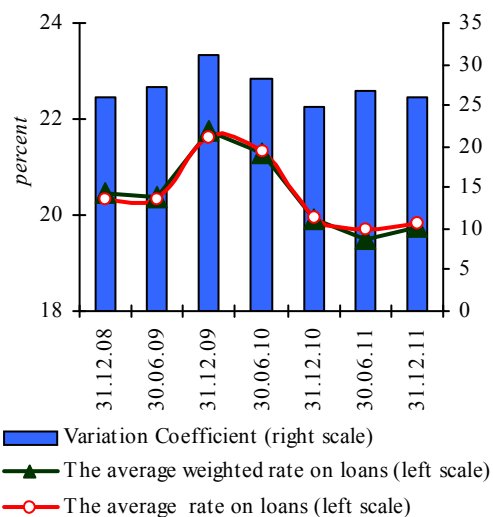


It is noted that as of the end of 2011, the weighted average interest rates on loans in national and foreign currency equaled to the average rates (Graphs 2.1.8, 2.1.9).

Thus, the following trends were observed in the banking sector, as of the end of the first half of 2011 compared to the first half of 2011:

- the growth of total assets;
- increase in the total deposit base of banks;
- growth of the loan portfolio, accompanied by a trend in an increase of the loan "dollarization" indicator;
- increase in the share of long-term loans to customers in the aggregate loan portfolio of banks.

Graph 2.1.9. Changes in the characteristics of the interest rate on loans in foreign currency



2.2. Risks

2.2.1. Credit Risk

Credit risk is one of the major risks that accompany banking activity. This section reviews banking operations that carry credit risk.

To assess the quality of the loan portfolio, commercial banks use a loan classification system¹, which makes it possible to determine the possible level of potential losses from non-repayment of loans and to compensate them in a timely manner through the creation of appropriate reserves.

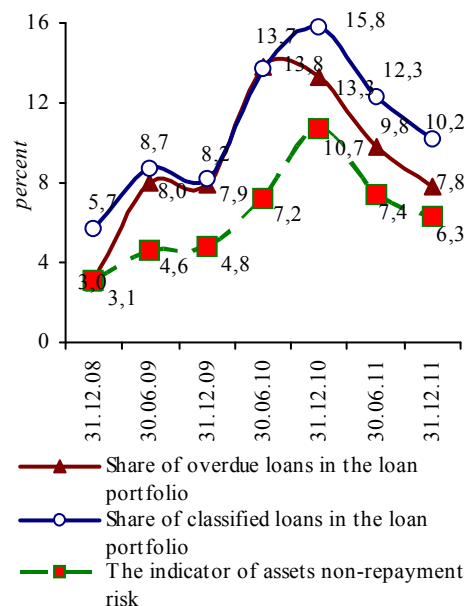
When analyzing the quality of the credit portfolio, classified and overdue loans reflecting the deterioration in loan portfolio quality require the most attention. In the second half of 2011, and in general in 2011, there was a decline in the share of classified and overdue loans in the loan portfolio (Graph 2.2.1.1.). The asset non-repayment risk score (the ratio of specific PL and the loan portfolio) also reduced and constituted 6.3 percent (as of the end of the first half of 2011, this indicator stood at 7.4 percent).

As one of the factors that may influence the increase or decrease of the credit risk level in the future, we can consider the dynamics of loans classified as loans "under observation." The ratio of such loans as of the end of the second half of 2011 fell by 0.2 percentage points (Graph 2.2.1.2) and constituted 9.1 percent. In general, there is a continued trend in the decline of the share of classified loans in connection with the stabilization of the banking system activities after a politically busy 2010.

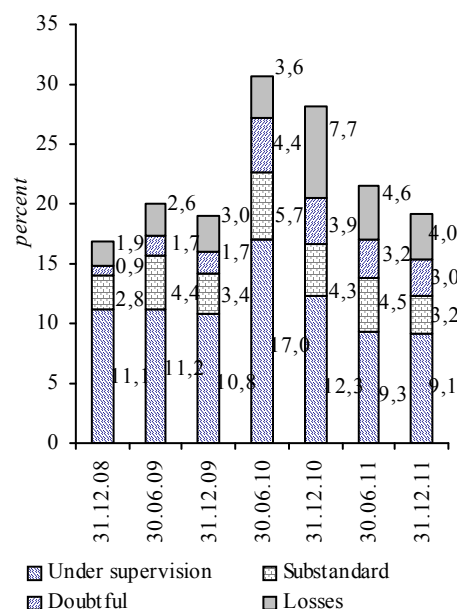
The aggregate amount of reserves created by commercial banks amounted to 8.4 percent of the aggregate loan portfolio (the indicator constituted 9.4 percent as of June 30, 2011).

As of the end of second half 2011, the ratio of the "net" credit portfolio (outstanding balances on loans to customers less a created special PL) amounted to 43.7 percent of the total assets of the banking system (Graph 2.2.1.3) increasing by 0.7 percentage points in comparison with June 30, 2011.

Graph 2.2.1.1. Changes in the level of credit risk in the loan portfolio of the banking system

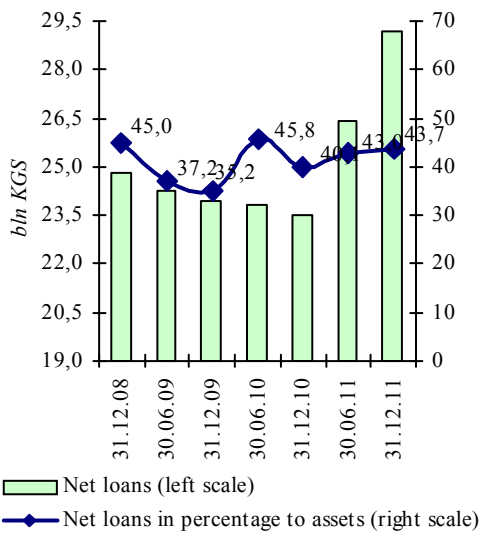


Graph 2.2.1.2. Changing the classification of the loan portfolio of the banking system

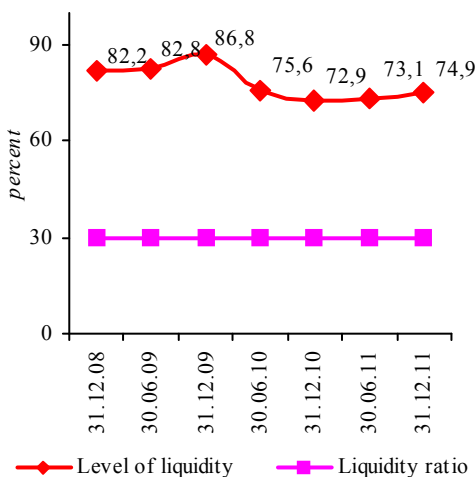


¹ In order to assess the quality of the loan portfolio all loans are usually divided into six categories depending on the customer's current capabilities to fulfill its obligations to the bank (listed in the order of worsening of classification): normal, satisfactory, under supervision, substandard, doubtful and losses. Loans of the last three categories as having the most negative characteristics in terms of the repayment of loans are usually referred to as the "non-working" or "classified." For each of the six categories, the bank must create a reserve defined as the percentage of issued the loans corresponding to this category.

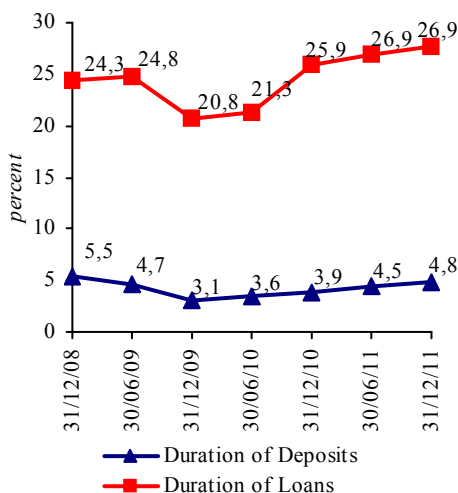
Graph 2.2.1.3. Changes in the level of "net" loans



Graph 2.2.2.1. Dynamics of changes in the estimated value of the current liquidity



Graph 2.2.2.2. Dynamics of changes in duration of loans and deposits of the banking system



In general, decrease of indicators characterizing credit risk was observed in connection with a decrease in the share of classified loans in the loan portfolio of the banking system and the costs of PL.

2.2.2. Liquidity Risk

Confidence of the population in the banking system depends on the timely implementation by banks of their commitments, which suggests the presence of a sufficient level of liquidity in the banks. For regulatory purposes, the liquidity risk is assessed using the economic standard of current liquidity².

The actual level of the *liquidity ratio* of the banking system has remained relatively high throughout 2011. On average, in the banking system, the estimated value of this ratio as of December 31, 2011 constituted 74.9 percent having increased by 1.8 percentage points compared with June 30, 2011 (Graph 2.2.2.1).

The stability of deposits is characterized by a ratio of duration of deposits and loans, as well as by the coefficient of stability of the sources of funds³.

During the period under review, the gap between the average terms of attracting deposits and placing loans decreased by 0.3 months (Graph 2.2.2.2) and as of December 31, 2011 constituted 22.1 months (22.4 months as of June 30, 2011), which indicates the hidden risks of disintermediation⁴, which under certain conditions may complicate the management of liquidity. It is also necessary to note that a certain part of the loans is financed by banks at the expense of other long-term sources other than deposits (capital, long-term borrowing from financial institutions, etc.). To some extent, this fact can reduce the probability of the abovementioned risk.

The Graph 2.2.2.3 shows the variation of the coefficient of stability of the funds sources in comparison with the dynamics of the ratio of deposits to the "net" loan portfolio.

In the second half of 2011, there has been some increase in the share of fixed-period deposits (from 34.5 percent as of June 30, 2011 to 34.9 percent as of the end of the second half of

² The economic standard of the current liquidity is one of the bank's binding standards, established by the NBKR, according to which liquid assets must be at least 30 percent of current liabilities.

³ The coefficient of stability of funds sources is characterized by the shares (in percentage) of fixed-period deposits in total deposits of the banking system.

⁴ Disintermediation is the process of mass withdrawal of deposits by the population before previously agreed period of time due to panic, which may be caused by the escalation of inflation expectations and/or other negative expectations.

2011) in the deposit base which reflected the increase in the resource potential to increase the terms of issued loans which was confirmed by an increase in the share of long-term loans in the loan portfolio of the banking system. Duration of loans in the banking system in the second half of 2011 remained unchanged at the level of 26.9 months (see Graph 2.2.2.2.), which indicates stability in the management of risk upon coordination of terms between the sources and allocation of funds.

The immutability of the ratio of the volume of deposits and the level of "net" loans with a value of 1.1 within 2011 (1.1 as of the end of first half 2011) showed a conservative approach in the use of attracted funds in the 2nd half of 2011, although there was some reserve of liquidity to increase loan transactions (Graph 2.2.2.3.).

The Table 2.2.2.4 provides information on maturities of financial assets and liabilities of banks as of December 31, 2011. In general, the financial liabilities of the banks were covered by financial assets, while the "gap" (the excess of assets over liabilities) amounted to 17.2 billion KGS, and 12.9 billion KGS on loans and deposits.

A negative gap was observed in the period of up to 180 days. At the same time, calculations showed that the cumulative "gap" in terms of assets in a period of up to 180 days (i.e. until the end of the first half of 2012) can constitute "negative" 4.7 billion KGS (or "negative" 6.8 percent) of the corresponding financial assets and require banks to pay special attention to the management of assets and liabilities to meet their financial obligations.

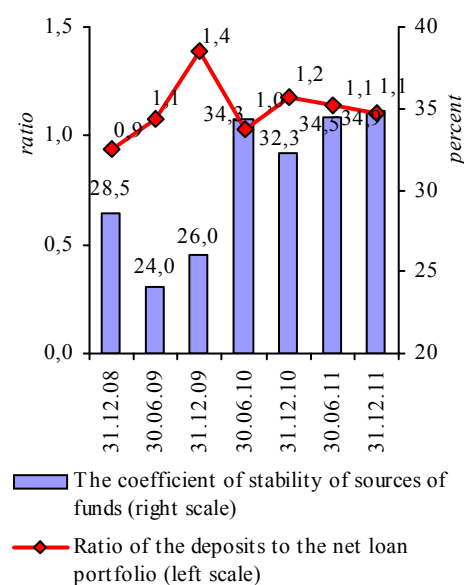
Table 2.2.2.4. The period of maturity of financial assets and liabilities
(mln. KGS)

Name	Maturity					Total
	up to 30 days	31 - 90 days	91 - 180 days	181 - 365 days	more than 365 days	
1. Total financial assets	26 706,6	3 092,4	3 449,1	7 559,2	28 717,8	69 525,2
<i>including loans and financial leases to customers</i>	1 201,4	1 240,8	1 863,7	5 048,1	21 787,8	31 141,8
2. Total financial liabilities	30 041,5	4 260,2	3 663,7	4 910,6	9 443,6	52 319,5
<i>including private deposits and corporate fixed-period deposits</i>	8 204,9	1 937,1	2 242,2	3 535,1	2 326,9	18 246,1
3. Total gap	-3 334,9	-1 167,8	-214,6	2 648,7	19 274,2	17 205,7
<i>including the gap in loans and deposits</i>	-7 003,4	-696,3	-378,5	1 513,0	19 460,9	12 895,7

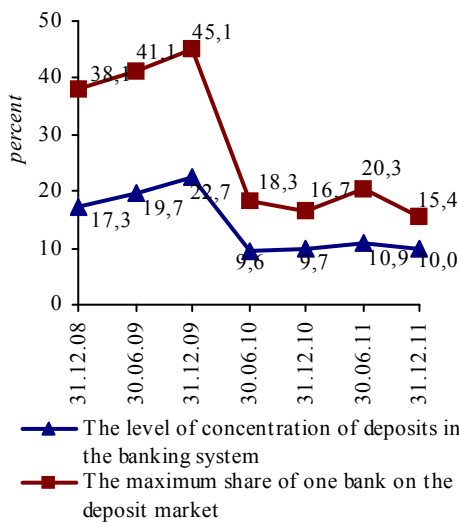
2.2.3. Concentration Risk

Specifics of the concentration of deposits. As can be seen in the Graph 2.2.3.1, in the second half of 2011, there was a

Graph 2.2.2.3. Evaluation of the factors of liquidity of the banking system



Graph 2.2.3.1. Changing the concentration of deposits

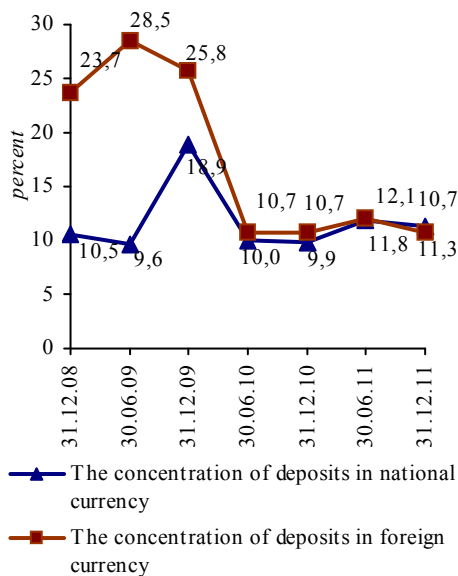


decrease in the concentration of deposits in the banking system and in the maximum share of one bank in the deposit market. The concentration of the deposit market among participants⁵ in terms of a common grading remains "moderate" (10 percent), the maximum share of one bank dropped from 20.3 to 15.4 percent.

The concentration of deposits in national and foreign currencies also decreased from 11.8 to 11.3 percent and from 12.1 to 10.7 percent, respectively (Graph 2.2.3.2).

Assessing the level of concentration in the banking system with a different indicator, "The Share of the Four Major Banks", indicates the immutability of the concentration of deposits of 58.0 percent as of December 31, 2011 (58.1 percent as of the end of the first half of 2011), while the composition of these four major banks in the second half of 2011 remained unchanged.

Graph 2.2.3.2. The concentration of deposits by currency

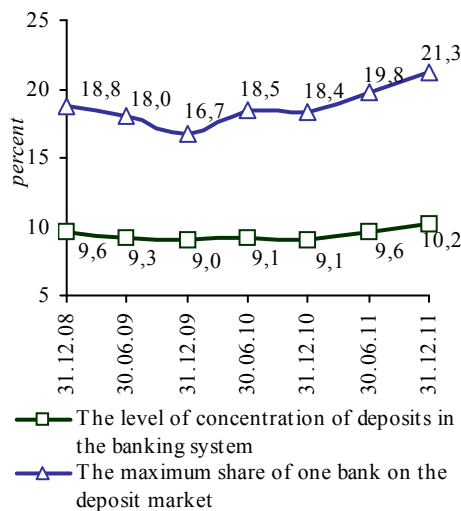


Specifics of the concentration of loans. In the second half of 2011, the growth of the loan portfolio of the banking system affected the level of loan concentration. The maximum share of an individual bank on the loan market has increased from 19.8 to 21.3 percent (Graph 2.2.3.3).

Regarding "The Share of the Four Major Banks" indicator, it may be noted that the concentration of loans in the period under review rose from 52.3 to 54.4 percent, while the composition of these four major banks in the second half of 2011 has not changed.

In the second half of 2011, the rate of concentration of loans in foreign currency rose to 14.2 percent, and decreased by 0.4 percentage points in national currency from 11.3 to 10.9 percent; grading of concentration of loans remained "moderate" in the second half of 2011 (Graph 2.2.3.4).

Graph 2.2.3.3. Changing the concentration of loans



According to the analysis of risk of concentration of loans by sectors of the economy, there was fluctuation of concentration level from "low" to "high" depending on the sector. The level of concentration of loans in sectors "industry" and "other" increased which indicates the intensified lending of individual banks to mentioned sectors in the second half of 2011. The level of concentration of loans has significantly decreased in the sectors of "communication" and "social services", which shows a

⁵ The assessment of the concentration risk as "high", "moderate" or "low" is based on the standard grading of the concentration level. Thus, the concentration risk is "low" if the concentration level constitutes up to 10 percent, "moderate" - from 10 percent to 18 percent, or "high" - more than 18 percent. For example, the concentration index, equal to 50 percent, is equivalent to the presence of 2 participants in the market with equal shares, 33 percent - 3 participants, etc.

reduction in lending to these sectors (Table 2.2.3.5).

A decrease in the share of loans to agriculture and trade was observed in the structure of the aggregate loan portfolio of banks in the second half of 2011, whereas there was growth in "other" loans and loans to "households". A high share of loans to trade, agriculture and mortgage in the structure of the aggregate loan portfolio of banks indicates the relatively high risks of lending to these sectors by individual banks (Table 2.2.3.6).

Thus, in the banking system of the Kyrgyz Republic, in the second half of 2011 in general, there was a decrease of concentration of deposits both in national and foreign currency. There was also a decrease in loans in national currency, and in foreign currency the level of concentration had a tendency to increase. The level of concentration of loans by sectors of the economy on the banking system in general ranges from "low" to "high."

Graph 2.2.3.4. The concentration of loans by currency

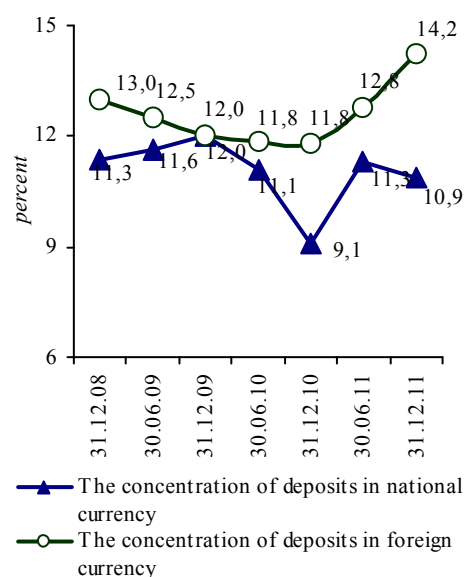


Table 2.2.3.5. The concentration of banks' activities by lending to sectors of the economy *

	31.12.08	30.06.09	31.12.09	30.06.10	31.12.10	30.06.11	31.12.11	Deviation to the previous period (percentage points)
Industry	18,6	15,7	15,8	15,5	18,7	15,8	18,6	2,8
Agriculture	50,3	50,0	48,6	43,9	42,0	38,8	39,2	0,4
Transport	24,3	23,3	20,5	20,7	19,7	20,2	18,6	-1,6
Communication	72,6	67,2	97,3	75,0	73,1	86,9	63,7	-23,2
Trade	11,5	10,9	11,9	11,0	7,1	9,2	9,5	0,3
Procurement and processing	32,7	34,8	39,9	30,9	23,4	35,3	34,9	-0,4
Construction	13,5	12,0	12,0	10,5	10,6	12,3	13,4	1,1
Mortgage	17,9	17,8	19,1	20,6	21,6	24,1	25,2	1,1
Household	11,7	12,2	11,8	11,4	12,1	12,1	10,6	-1,5
Social Services	65,5	40,1	40,6	41,5	41,2	49,1	36,6	-12,5
Other	15,5	16,6	18,0	18,2	18,0	22,1	27,9	5,8

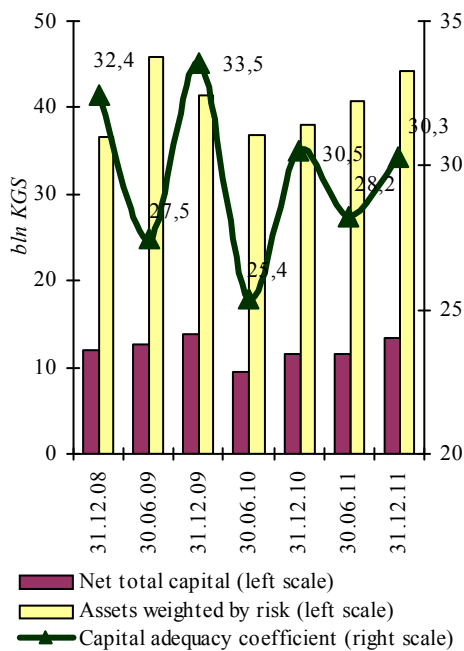
* The concentration is determined by the Herfindahl-Hirschman index, calculated as the sum of the squares of the proportion of banks in total lending to the sector. The concentration index equal to 100% means complete monopolization of a particular market segment, 50% - 2 participants with equal shares, 33% - 3 participants and so on.

Table 2.2.3.6. The structure of banks' loan portfolio by sectors of economy

	31.12.08	30.06.09	31.12.09	30.06.10	31.12.10	30.06.11	31.12.11	Deviation to the previous period (percentage points)
Industry	5,7	6,1	5,5	5,3	5,6	5,7	5,3	-0,33
Agriculture	11,5	12,1	12,2	13,0	12,7	14,0	12,7	-1,25
Transport	1,0	1,0	1,0	1,1	1,3	1,2	1,1	-0,10
Communication	0,5	0,4	0,1	-	0,0	0,0	0,2	0,18
Trade	36,1	38,2	41,5	43,0	43,0	44,7	42,8	-1,85
Procurement and processing	0,5	0,4	0,4	0,3	0,2	0,2	0,2	-0,01
Construction	9,5	8,5	7,7	7,5	7,7	6,1	5,6	-0,48
Mortgage	14,0	13,2	12,3	11,4	10,8	9,6	9,6	-0,09
Household	8,3	7,8	8,0	7,3	7,1	7,7	8,8	1,06
Social Services	0,4	0,2	0,1	0,2	0,3	0,5	0,7	0,13
Other	12,4	12,2	11,2	10,9	11,3	10,2	12,9	2,73
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	x

2.3. The Level of Capital Adequacy

Graph 2.3.1. Changes in the capital adequacy of banking system



All of the risks inherent to banking activities are ultimately reflected in the financial result (as being already manifested in the form of direct losses, as well as having a high proportion of the probability of future losses through the costs of creation of appropriate reserves) and affect the size of the bank's own funds, capital, which characterizes the stability of the bank before potential adverse changes.

With the established minimum capital adequacy standard value at the level of 12.0 percent, this indicator amounted to 30.3 percent (Graph 2.3.1) on average in the banking system as of the end of the second half of 2011. The increase in the capital adequacy of the banking system in the second half of 2011 was caused by the advanced growth of capital compared with growth of assets weighted by risk.

At the same time, the actual level of capital adequacy (30.3 percent) can allow for further increase in the volume of risky and earning assets by 2.5 times without exceeding the acceptable standard level of risk in the activities of other banks.

The aforementioned indicates certain stability of the banking system to adverse shocks in the first half of 2012 and the availability of certain potential to improve financial intermediation and the efficient functioning of the banking system.

2.4. Financial Results

The main indicator of the banking activity profitability is the return on assets (ROA), defined as a ratio of profit to the average level of assets, and return on equity (ROE) defined as a ratio of profit to the average Capital of the First Level.

As of the end of the second half of 2011, in the banking system of the Kyrgyz Republic, the ROA on an annualized basis constituted 3.0 percent (2.7 percent according to the results of the second half of 2011) and the ROE on an annualized basis constituted 17.4 percent (7.1. percent as of the end of 2010).

Based on the main indicators of profitability of the banking system to the average value of assets, there was an increase of interest income (from 9.8 to 10.1 percent) observed, which was caused by the growth of banks' loan portfolio (Table 2.4.1). Increase in banks' loan portfolio in the second half of 2011 amounted to 9.2 percent or 2,614.8 million KGS (28,527 million KGS as of June 30, 2011.).

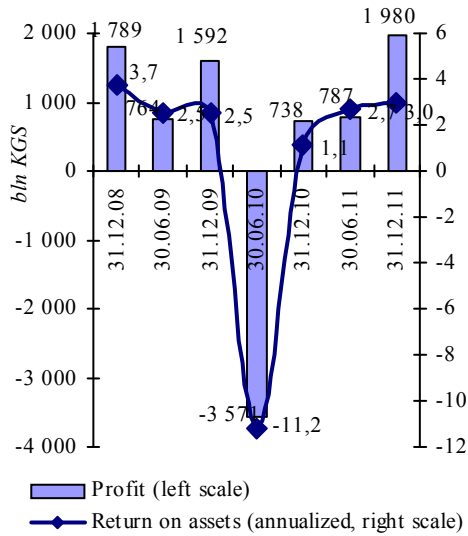
Table 2.4.1. Main indicators of profitability of the banking system (in percent to the average value of assets for the period (half year)

	30.06.09	31.12.09	30.06.10	31.12.10	30.06.11	31.12.11
Interest Income	10,0	9,6	9,3	8,3	9,8	10,1
Interest Expenses	3,6	3,3	2,8	2,3	2,8	2,9
Net Interest Income	6,4	6,3	6,5	6,0	7,0	7,2
Allocation to ALL on Loans	0,9	0,6	2,3	1,1	0,2	0,2
Net Interest Income after Allocation to ALL	5,5	5,7	4,1	4,9	6,8	7,0
Non-interest Income	17,8	16,8	16,7	18,8	25,0	31,3
Non-interest Expenses	13,8	12,5	13,1	15,2	20,6	26,4
Non-credit Operation and Administrative Expenses	6,4	6,8	7,2	6,5	7,8	7,9
Allocation to ALL on Non-credit Operation	0,3	0,3	11,5	0,4	0,3	0,2
Net Profit (Loss) before Tax	2,8	2,8	-11,0	1,5	3,2	3,7
Profit Tax	0,3	0,3	0,2	0,2	0,3	0,4
Net Profit (Loss)	2,5	2,5	-11,2	1,2	2,8	3,0
Average Assets Indicator for period (billion som)	61,6	64,1	63,8	60,9	55,6	58,6

When considering non-interest income and expenses of commercial banks there has been an increase in non-interest income (from 25.0 to 31.3 percent to the average level of assets) and the growth of non-interest expenses (from 20.6 to 26.4 percent). At the same time, the level of operating and administrative costs of banks grew by 0.1 percentage points.

The increase in non-interest income is associated with a significant increase in income from foreign currency transactions. Thus, "net" income from foreign currency transactions as of December 31, 2011, amounted to 1,021.8 million KGS, having increased from June 30, 2011, by 576.9 million KGS, or 129.7 percent.

Chart 2.4.2. Change in Return on Assets

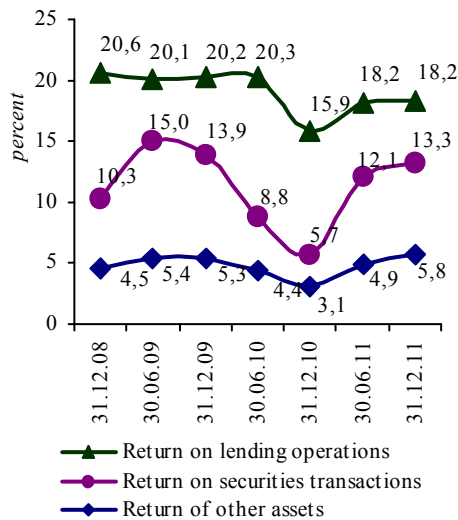


The level of deductions for income tax for the period under review increased from 0.3 percent to 0.4 percent of the average value of assets, while net income for the second half of 2011 amounted to 3.0 percent to the average value of assets.

In absolute terms, net profit of the banking system as of the end of the second half of 2011 constituted 1.98 billion KGS (profit constituted 0.79 billion KGS as of the end of the first half of 2011), and as of the end of 2010, net income constituted 0.74 billion KGS (Graph 2.4.2).

The profitability of the loan portfolio, defined as the ratio of interest income on loans to the average debt balances on loans, remained at the same level of 18.2 percent (Graph 2.4.3), and the profitability on other categories, "securities" and "other assets", increased by 1.2 and 0.9 percentage points.

Graph 2.4.3. Indicators of profitability of certain operations



As of December 31, 2011, the ratio of assets to the number of employees constituted 7.2 million KGS (7.0 million KGS as of June 30, 2011).

Thus, the banking system in the second half of 2011 showed overall profitability despite the losses of troubled banks. At the same time, the level of the average standard of capital adequacy of the banking system reflected the possibility of additional expansion of the active transactions of banks. The factor in improving efficiency of asset utilization could be a further increase in the proportion of income assets.

2.5. Indicators of Financial Intermediation

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

The ratio of deposits¹ to the volume of GDP² as of the end of the second half of 2011 constituted 13.5 percent (15.2 percent as of the end of the first half of 2011 (Graph 2.5.1). A decrease in this indicator is caused by the faster rates of growth of nominal GDP (18.2 percent from the beginning of the year) compared to growth rates of deposits in the banking system (13.9 percent).

The ratio of total loans to customers to GDP was 11.4 percent, having decreased by 0.9 percentage points compared with the results of the first half of 2011 (Graph 2.5.2).

As of December 31, 2011, the loans amounted to 31.1 billion KGS, having increased by 9.2 percent since the beginning of the second half of 2011.

The ratio of debt on loans to the volume of deposits increased by 3.0 percentage points, which is associated with the fast rates of growth of loans, compared to the growth rates of deposits (Graph 2.5.3).

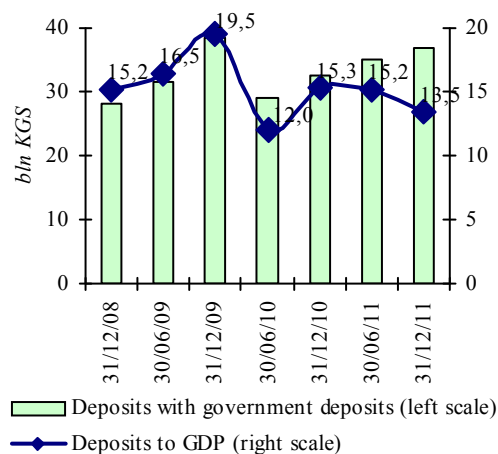
The weighted average interest rate on newly accepted deposits in national currency amounted to 2.25 percent (reduction by 0.83 percentage points compared with June 30, 2011).

The weighted average interest rate on newly accepted deposits in foreign currency decreased by 0.07 percentage points since the beginning of the second half of 2011 and as of the end of the second half of 2011 constituted 0.77 percent.

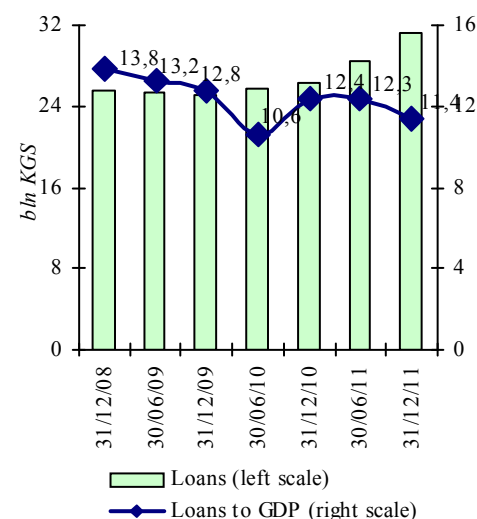
The continuing spread of high interest rates was caused by the influence of a high level of credit risk and unmet demand for loan proceeds.

From the perspective of the financial intermediation level, there was a decrease in indicator of the ratio of total assets to GDP (Graph 2.5.4). Thus, as of the end of the second half of 2011, this ratio constituted 24.4 percent, while as of the end of the first half of 2011 - 26.6 percent.

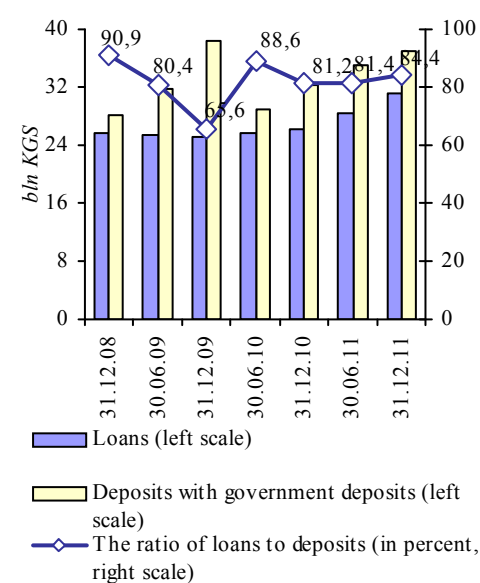
Graph 2.5.1. Dynamics of deposits and the ratio of deposits to GDP



Graph 2.5.2. Dynamics of loans and the ratio of loans to GDP



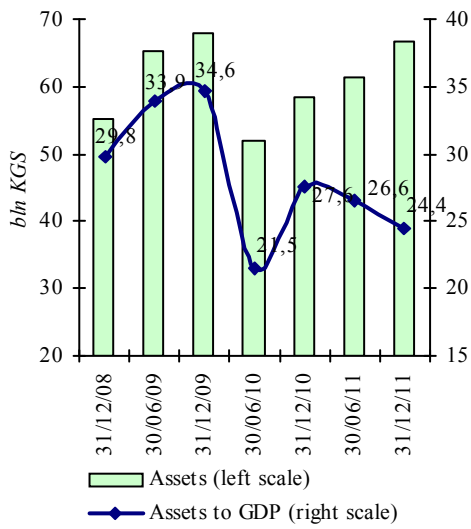
Graph 2.5.3. The dynamics of loans to deposits ratio



¹ In this section, deposits are referred to as deposits of enterprises and population, as well as deposits of governmental bodies of the Kyrgyz Republic.

² Data on nominal GDP over the past 12 months are used in calculation.

Graph 2.5.4. Dynamics of assets and the ratio of assets to GDP



The existing level of indicators of financial intermediation still has a relatively low value, and therefore, there is a possibility of further expansion of the active transactions of the banking system.

Some safety margin available in commercial banks suggests that the banking system can withstand moderate shocks in the short-run.

III. NON-BANK FINANCIAL INSTITUTIONS

3.1. The status of non-bank financial institutions

The system of non-bank financial institutions (NBFIs) includes the following institutions subject to regulation by the National Bank (Table 3.1.1):

- The Financial Company for Support and Development of Credit Unions (FCSDCU LLC);
- Credit Unions (CUs);
- Microfinance Institutions (MFIs), including Microfinance Companies (MFCs), Microcredit Companies (MCCs), and Microcredit Agencies (MCAs);
- Exchange offices.

Table 3.1.1. Dynamics of the number of non-bank financial institutions

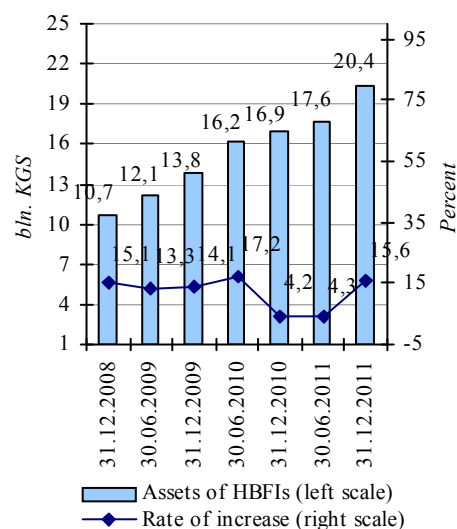
Name	2008	2009	2010	30.06.2011	2011
SFRB Ltd.	-	1	1	1	-
Development Foundation CJSC	-	1	-	-	-
FCSDCUs	1	1	1	1	1
MFIs	291	359	397	424	454
Credit Unions	248	238	217	207	197
Pawnshops*	196	231	-	-	-
Exchange offices	353	372	290	274	279
Total	1089	1203	906	907	931

* Data as of 01/09/2009. Licensing revoked on 08/09/2009.

An increase in the total number of NBFIs is observed due to the increasing number of microfinance institutions.

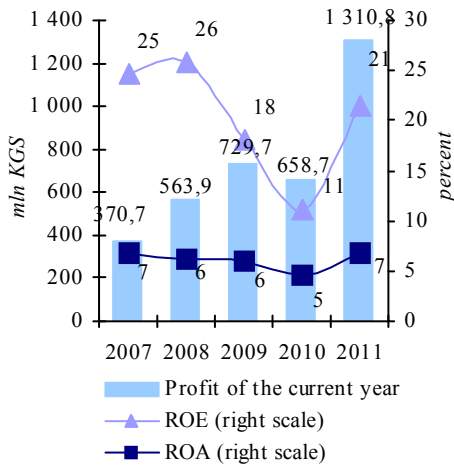
According to the call reports as of December 31, 2011, total assets of NBFIs constituted 20.4 billion KGS¹ (without counterpart assets and liabilities on hedging instruments of foreign exchange risk of MFIs) and in comparison with the first half of 2011 (17.6 billion KGS subject to counterpart assets and liabilities on hedging instruments of foreign exchange risk of MFIs on as of June 30, 2011) increased by 15 percent or 2.7 billion KGS (Graph 3.1.1), and the growth of NBFI assets for 2011 totaled 3.5 billion KGS or 20 percent (16.9 billion KGS as of December 31, 2010, without counterpart assets and liabilities on hedging instruments of foreign exchange risk of MFIs). As

Graph 3.1.1. Dynamics of aggregate assets of NBFIs



¹ Hereinafter, in order to avoid double-entry accounting, assets and the loan portfolio of NBFIs are indicated excluding FCSDCU, which is placed in credit unions.

Graph 3.1.2. Dynamics of ROA and ROE indicators for the NBFIs



of the end of the second half of 2011, the reduction in equity capital of NBFIs amounted to 17.0 percent, total liabilities of the NBFIs increased by 18 percent. Compared with the end of 2010, the reduction in equity capital of the NBFIs amounted to 4 percent in connection with the liquidation of the "Specialized Fund for the Refinancing of Banks" LLC, and total liabilities of the NBFIs increased by 17 percent.

As of the end of 2011, aggregate profit of NBFIs² constituted 1,310.8 million KGS. The level of profitability of NBFIs grew by almost 2 times compared to 2010 (625.1 million KGS). The main reason for the growth was the increase in the loan portfolio of NBFIs, and a decrease in the special reserve for losses and losses on loans.

² The aggregate profit of NBFIs is shown without FCSDCU.

3.2. The Structure and Dynamics of the Loan Portfolio

The main focus of non-bank financial institutions is lending. The NBFIs' loan portfolio tends to increase in recent years (Graph 3.2.1).

For the second half of 2011, the aggregate loan portfolio of NBFIs increased by 1.7 billion KGS or 13.0 percent, and constituted 15.7 billion KGS. At the same time, the increase in the total portfolio in absolute terms compared with the end of 2010 (the loan portfolio constituted 11.1 billion KGS as of the end of December 31, 2010) constituted 4.6 billion KGS or 42 percent

In the period under review, the share of the loan portfolio in total assets of NBFIs decreased from 79 percent to 77 percent as of December 31, 2011, from the beginning of the year the share of the portfolio increased by 11 percentage points (as of December 31, 2010, the share of the loan portfolio in total assets amounted to 66 percent).

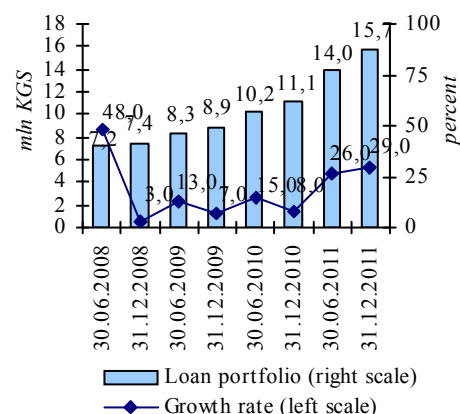
In comparison with 2010, there was an increase in the number of borrowers in the NBFIs by 89,475 people, or 23 percent, to 480,685 people. Compared with the first half of 2011, growth in the number of borrowers constituted 10 percent, or 43,435 people. Steady growth in the number of borrowers indicates the relevancy of MFIs' services among the population.

In the structure of the aggregate loan portfolio of NBFIs (Graph 3.2.2), 92 percent account for loans of microfinance institutions, and 8 percent for loans of CUs.

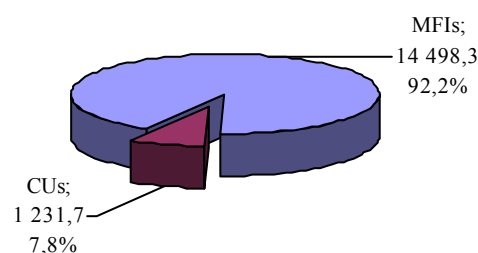
The dynamics of changes in the loan portfolio by sectors and regions reflects the stability of the NBFIs preferences. Thus, the main share of the loan portfolio accounts by regions (Graph 3.2.3) for Osh and Jalal-Abad regions and Bishkek. In general, the activity is highest in the south of the country and in the capital due to higher population density and its economic activity in agricultural and trade sectors.

In 2011, the largest volume of NBFi loans was directed to agriculture - 44 percent, as well as to trade and services - 28 percent (Graph 3.2.4). A sufficiently high share of loans in

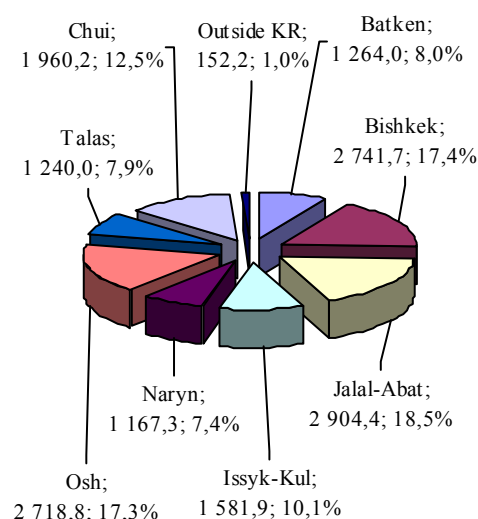
Graph 3.2.1. Dynamics of the loan portfolio of NBFIs



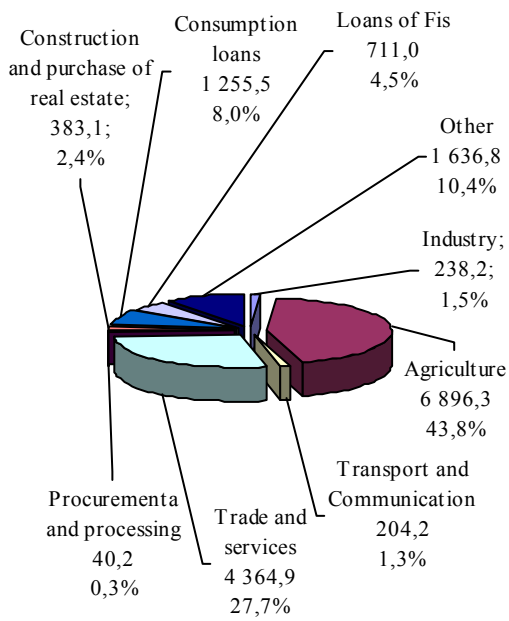
Graph 3.2.2. The total loan portfolio by type of NBFIs (million KGS)



Graph 3.2.3. The aggregate loan portfolio of NBFIs by regions (million KGS)



Graph 3.2.4. The aggregate loan portfolio of NBFIs by sector (million KGS)



agriculture is caused by regional branching of MFIs and specifics of credit unions as rural financial institutions. The concentration of loans in trade is dictated by the specifics of NBFIs: small loans are usually short-term and have high rates, which determines a focus on sectors with higher turnover of funds.

3.3. Main Risks

The NBFIs' loan portfolio is concentrated mainly on agriculture and business associated with it and located in rural areas, as well as on trade. Lending to this sector is associated with high risks because of dependence on climatic and weather conditions and relatively low incomes of the rural population.

There was a slight decrease in the share of loans to agriculture, which has decreased from 45.6 percent to 43.8 percent since the beginning of the year.

Another risk factor is concentration. The main share of the loan portfolio is occupied by 7 large MFIs, established and operating by foreign donors. The share of the loan portfolio of these MFIs is 84.5 percent of the aggregate loan portfolio of NBFIs. The growth trend of NBFIs is caused by the increasing volume of foreign investment.

Interest rates on loans of non-bank credit institutions remain at the sufficiently high level due to continuing high demand for these types of loans from the population, as well as the intention of the NBFIs to cover existing high risks and costs associated with issuing and servicing of loans.

IV. THE PAYMENT SYSTEM

4.1. The Structure of the Payment System

Payment system constitutes an interrelated system of technologies, procedures, payment instruments and money transfer systems ensuring the circulation of money. Depending on the types of carried out payments, the systems are divided into systems of large payments and retail payments systems.

The payment system of the Kyrgyz Republic (the national payment system) constitutes an aggregate of payment systems that operate on the Kyrgyz Republic territory and transfer monetary assets in compliance with the Kyrgyz Republic legislation, operators of which may be residents or nonresidents of the Kyrgyz Republic.

At the end of the second half of 2011, the following payment systems functioned in the Kyrgyz Republic:

1. The system of large payments of the National Bank - The Real Time Gross Settlement System (RTGS).
2. The system of clearing payments - The System of Bulk Clearing System for small retail and regular payments (BCS).
3. The payment card system.
4. Money remittance systems.

4.2. Banking products, tariff rates and services

The tariff policy of commercial banks is aimed at expanding the range of payment services to the public and easier access to the provided services in order to increase the number of customers and develop competition.

Banks use different approaches to charging for services:

- fixed rates for conducting a single transaction;
- rates established depending on the amount of transactions or account balance;
- charge for a period regardless of the number or an amount of performed operations;
- other mechanisms complied to the agreement conditions.

The most popular services are as follows: settlement and cash services, documentary transactions, non-cash transfers, securities transactions, credit issue operations and payment cards service.

Upon the clients' instructions, commercial banks perform the following transactions:

- collection, documentary credit and transfer transactions;
- provision of banking acceptance and aval on debts;
- transactions with credits and deposits;
- purchase and sale of securities, currencies, precious metals;
- intermediation in allocations of stocks and bonds;
- encashment services;

Table 4.2.1. List of Bank Servicing Money Transfer System

Name of the Commercial Bank	Money Transfer System
Amanbank Russian Kyrgyz OJSC	UNistream, Contact, Anelik, Leader, Migom, Xpress Money, InterExpress, Allure, Zolotaya Korona, Blizko, Private Money.
Aiyl Bank OJSC	Contact, UNIstream, Migom, Leader, Western Union, Money Gram, InterExpress, Anelik, Zolotaya Korona, Faster.
Akyl Invest Bank OJSC	UNIstream, Migom, Contact, Leader.
Bank of Asia CJSC	Western Union, Money Gram, Contact, Anelik, Leader, Migom, UNIstream, InterExpress, Blizko, Zolotaya Korona, Faster.
Bank Bakai OJSC	Western Union, Money Gram, Contact, Migom, UNIstream, Zolotaya Korona, Bystraya Pochta.
Demir Kyrgyz International Bank CJSC	Western Union, Anelik, UNIstream.
Dos- CredoBank OJSC	Western Union, Contact, Anelik, Leader, Migom, UNIstream, InterExpress, Coinstar, Blizko, Allure, Bystraya Pochta, Zolotaya Korona
Issyk- Kul Investbank OJSC	Western Union, Money Gram, Contact, Anelik, Leader, Migom, Bystraya Pochta, UNIstream, Blizko, Allure, Private Money, Zolotaya Korona.
BTA Bank CJSC	Western Union, Money Gram, Contact, Anelik, Leader, Migom, Bystraya Pochta, UNIstream, InterExpress, Blizko, Zolotaya Korona, Caspian, Faster.
Halyk Bank Kyrgyzstan OJSC	Western Union, Contact, Leader, Migom, UNIstream, Zolotaya Korona.
KICB CJSC	Western Union, Contact, Leader, UNIstream, Migom, Blizko, Anelik, Zolotaya Korona.
Kazkommertsbank Kyrgyzstan OJSC	Western Union, Bystraya Pochta.
KyrgyzCreditBank OJSC	Western Union, Money Gram, Contact, Anelik, Leader, Migom, Bystraya Pochta, UNIstream, Blizko, Zolotaya Korona, Allure.
Kyrgyzstan CB OJSC	Western Union, Money Gram, Zolotaya Korona, Contact, Leader, Migom, Bystraya Pochta, Anelik, UNIstream, Inter Express, Faster.
RSK Bank OJSC	Western Union, Money Gram, Leader, Migom, UNIstream, Bystraya Pochta, Strana Express, Anelik, Zolotaya Korona.
Tolubai JSCB CJSC	Western Union, Zolotaya Korona, Contact, Anelik, Migom, UNIstream, Blizko
EcoIslamicBank OJSC	Western Union, Contact, Anelik, Leader, Migom, UNIstream, Inter Express, Allure, Bystraya Pochta, Zolotaya Korona, Coinstar.
UniCreditBank OJSC	Western Union, Blizko, Leader, Migom, Bystraya Pochta, Zolotaya Korona, UNIstream.
Bishkek Branch of Pakistan National Bank	Western Union.
FinansKreditBank JSCB OJSC	Money Gram, Contact, Anelik, Leader, Express Money, Migom, Privat Money, UNIstream, Inter Express, Faster, Coinstar, Blizko, Allure, Bystraya Pochta, Salam, Zolotaya Korona, BTF- Soyuz
Manas Bank CJSC	Western Union, UNIstream, Contact, Leader, Zolotaya Korona, Migom.

- accounting services, consulting and card services

In the reporting period, the cost of service for the issuance (opening) of a letter of credit constituted an average of 0.1 to 2.5 percent, depending on the amount of the letter of credit.

In second half of 2011, 22 banks provided the service of issuance of a bank guarantee. The cost of this service depended on the amount and type of the a pawn, and in the reporting period, a fee for issuing a bank guarantee ranged from 0.1 to 8 percent.

Commercial banks provided services on 21 type of international money transfer systems (Table 4.2.1).

The cost of connection to the Internet banking system depended on the method of providing access. The following banks provided the services of Internet banking during the reviewing period: Amanbank Russian Kyrgyz OJSC, Demir Kyrgyz International Bank CJSC, Tolubai JSCB CJSC, FinansCreditBank JSCB OJSC, Kazkommertsbank Kyrgyzstan OJSC, UniCredit Bank OJSC, Bank Bakai OJSC, DosCredoBank OJSC, Issyk-Kul Investbank OJSC, BTA Bank OJSC, Kyrgyz Investment Credit Bank CJSC, KyrgyzCreditBank OJSC, Kyrgyzstan Commercial Bank OJSC, Manas Bank CJSC.

4.3. Cash and Cashless Transactions

4.3.1. Cash Flow Cycles

The total amount of money in circulation as of December 31, 2011 amounted to 49,866.9 million KGS, and increased by 6 576.6 million KGS, or 15.2 percent, compared with the corresponding period in 2011.

2 541.6 million KGS, which constituted 5.1 percent of the total money in circulation, was in the cashiers' offices of commercial banks. The dynamics of money in circulation is represented on the Graph 4.3.1.1.

The increase of money in circulation is facilitated by an increase in government payments on the social package and a stable need of the economy in cash.

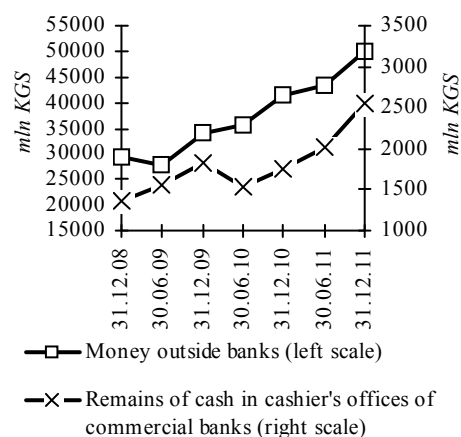
The repayment of cash to the cashier's offices of commercial banks in the second half of 2011 amounted to 99.8 percent, which is by 1.6 percentage points more than in the second half of 2010. The increase in the repayment of cash is associated with the increased cash proceeds from cashier's offices of commercial banks. Indicators of repayment of cash are included in the Graph 4.3.1.2.

The highest rate of repayment of cash in Bishkek in the second half of 2011 constituted 110.8 percent and 105.1 percent in Chui oblast. In Osh, repayment of cash constituted 104.4 percent. The lowest rate of repayment of cash was in the Osh region, 61.2 percent (Graph 4.3.1.3.). The high rate of repayment of cash in Bishkek and Chui region is associated with concentration of banking and financial institutions, retail and industrial businesses in the capital and Chui region. In Osh, a high rate of repayment of cash is associated with a more congested consumer market, although, in general, the percentage of cash repayment in the Osh region is low. Compared with the second half of 2010, repayment of cash by regions in the country as a whole has not changed significantly.

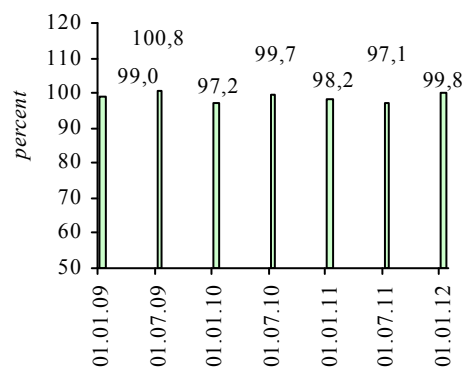
In the second half of 2011, cash offices of commercial banks received 248,970.3 million KGS, which is by 76,688.8 million KGS more than in the second half of 2010.

In the second half of 2011, cash offices of commercial banks issued 249,534.7 million KGS, which is by 74,019.0 million KGS more than in the second half of 2010.

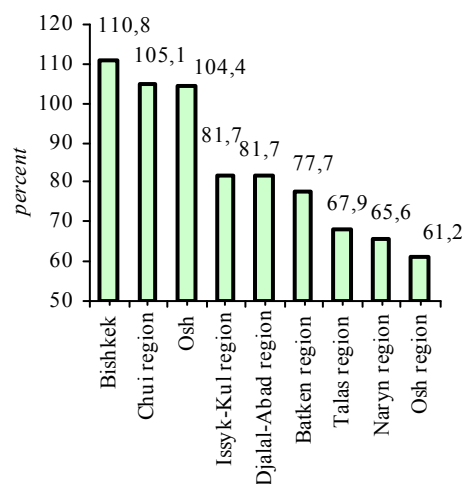
Graph 4.3.1.1. The dynamics of money in circulation



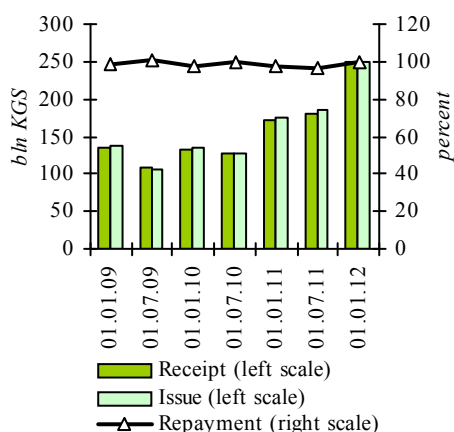
Graph 4.3.1.2. The indicator of repayment of cash by half year



Graph 4.3.1.3. The indicator of repayment of cash by regions



Graph 4.3.1.4. Receipt, issue of cash and their repayment to cashier's offices of commercial banks



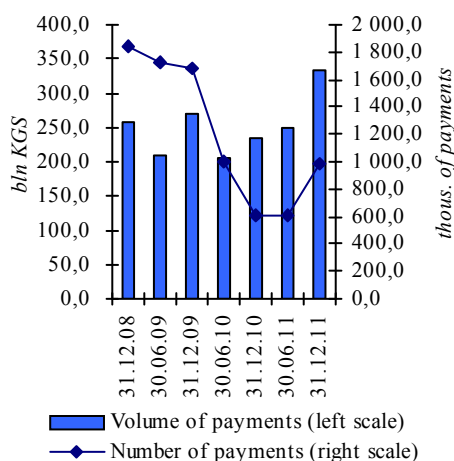
Changes in proceeds, cash disbursements and cash repayment to the cashier's offices of commercial banks are shown in the Graph 4.3.1.4.

Thus, the growth of money in circulation is caused by strong growth in demand for cash from the businesses and the expansion of the market of goods and services served by cash.

4.3.2. Non-cash Flows

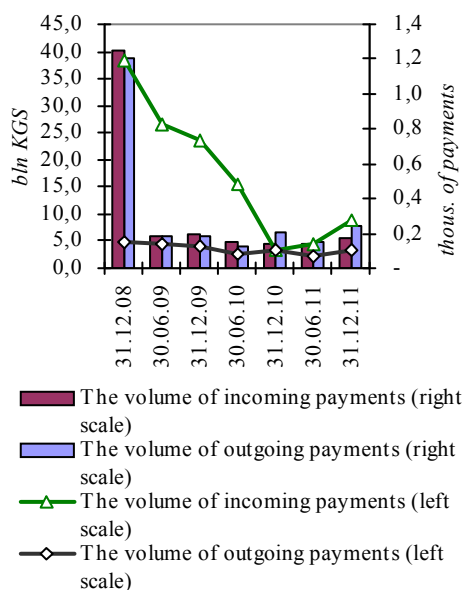
As per results of the first half of 2011, there were processed 992 112 payments in aggregate amount of 334.4 billion soms through the payment systems of the Kyrgyz Republic. In compare to indicator of the second half of 2010, the value of payments increased by 42.6 percent, the volume of payment increased by 63.0 percent (chart 4.3.2.1).

Graph 4.3.2.1. The dynamics of volume and number of interbank payments



The volume of incoming payments of the Central Treasury has increased in the second half of 2011 by 22.7 percent compared with the first half of 2011 and by 25.6 percent in comparison with the same period in 2010. The volume of outgoing payments of the Central Treasury increased during the second half of 2011 by 66.0 percent compared to the first half of 2011 and by 16.4 percent compared to the same period in 2010 (Graph 4.3.2.2.).

Graph 4.3.2.2. Dynamics of volumes and number of incoming and outgoing payments of the Central Treasury



In the first half of 2011, 76 901 payments for the amount of 298.1 billion soms were effected through the gross settlement system of the National Bank of the Kyrgyz Republic. As compared to the corresponding period last year, the value of the payments increased by 47.1 percent and the volume of payments increased by 25.4 percent (chart 4.3.2.3.).

The value of payments, effected through the clearing system increased by 13.8 percent as compared to indicator of the second half of 2010 and constituted 36.3 billion soms. The overall volume of payments was 915 211, it was by 67.2 percent more than for the comparable period of 2010 (chart 4.3.2.4.).

In the regional context of payments in the inter-bank payment system, the largest shares by value (91.4 percent from the total value) and volume (75.5 percent from the total volume) were concentrated on the Chui region and Bishkek city.

4.3.3. Systems of settlements by bank payments cards

As of December 31, 2011, the services of issuing, acquiring, and cash management services to customers via bank payment cards were provided by 21 of the 22 commercial banks, of which nine banks were the issuers of cards of international

systems, 4 banks - cards of local systems, and 17 banks - cards of the Elkart unified national system.

During the reviewing period, the cards of the national system Elcard were serviced by 164 ATMs (automated teller machines) installed throughout Bishkek and by 674 terminals; among them 448 terminals were installed in branches and savings departments of the commercial banks as well as 226 terminals were installed in the trade-service centers and in the public places around Bishkek as well as in the region and district centers.

As of January 1, 2011 commercial banks issued 51 902 payment cards of national system Elcard.

During the second half of 2011 there was an activation in the payment cards market; an increase in the number of issue cards and transactions with their use was indicative of this. Thus, the overall volume of issuing cards made 271 107 as of January 1, 2010, that constituted the 20.4 percent increase against the comparable period of the previous year (Chart 4.3.3.1.).

The total number and the volume of conducted transactions with the use of cards relative to their number and volume in the same period in 2010 increased by 57.5 percent and 69.7 percent, respectively (Graph 4.3.3.2.).

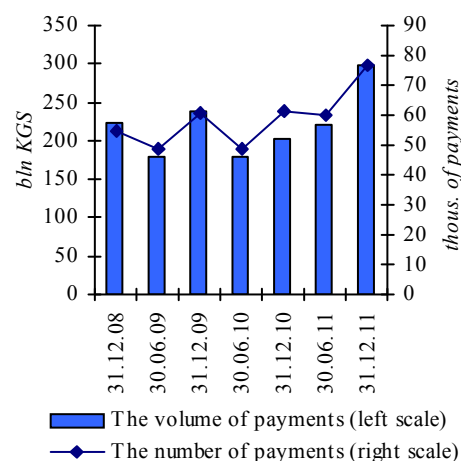
As before, the principal share of the effected transactions fell within the withdrawal of monetary assets ATM and terminals; their value accounted for 13.5 billion soms of the total volume of transactions, while their turnover in the retail-and-service enterprises amounted to 642.0 million soms. These data indicate that converting money into cash constituted more regular and demanded type of transactions and accounted for 95 percent of the overall volume of transactions with use of cards.

One of the priority areas of banks development strategy is increasing the number of bank accounts and implementing the 'payroll' projects on the basis of the international, local and national cards systems. Due to these very projects, the banks achieve a sound increase in the cards emission and transactions value; this allows to make a considerable progress towards strengthening the position of banks in the bank cards market.

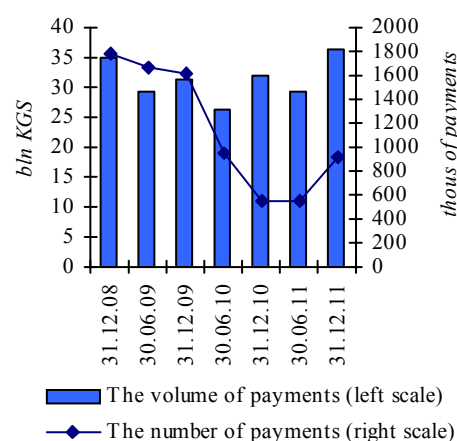
In the second half of 2011, 21 commercial banks made arrangements to implement and expand the 'payroll' projects on the basis of the international, local and national cards systems.

Commercial banks continued to develop the infrastructure for reception and handling of cards. Thus, as of January 1, 2012 the total number of active terminals and ATMs was as follows:

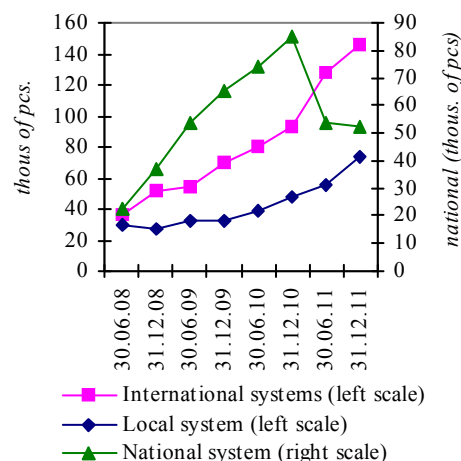
Graph 4.3.2.3. The dynamics of volume and number of payments to gross system

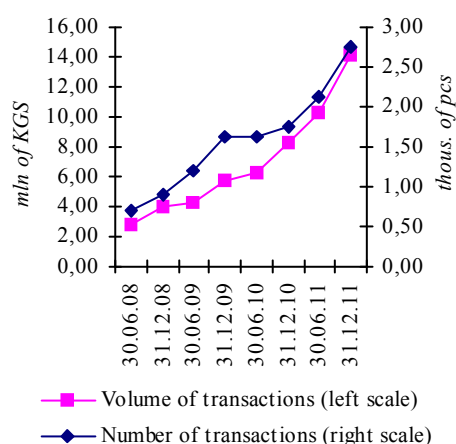


Graph 4.3.2.4. The dynamics of volumes and number of payments in the clearing system



Graph 4.3.3.1. Dynamics of the number of issued cards



Graph 4.3.3.2. Dynamics of volumes and number of transactions using bank cards

- 164 ATMs and 674 terminals -Elcard system;
- 214 ATMs и 1,113 terminals - international systems;
- 82 ATMs и 235 terminals - Alai Card system .

Thus, bank payment cards were accepted by 460 ATMs and 2022 kiosks located throughout the country.

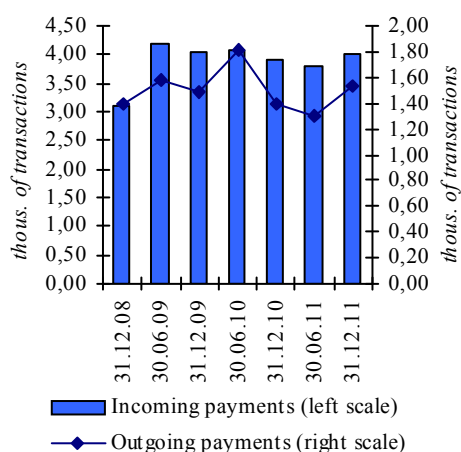
4.3.4. Trans-Boundary Payments including Travel Cheque Transactions

As of the end of second half of 2011, the members of the SWIFT community were 21 commercial banks and the NBKR in the Kyrgyz Republic. 17 banks (including NBKR) operated through the Center of multiple access SWIFT (CMA SWIFT). 3 banks were connected independently, and 1 bank operated though its head office in Kazakhstan - OJSC "Kazcommerzbank Kyrgyzstan".

During the second half of 2011, the number of outgoing payments constituted 1,532, incoming payments - 3,996, these figures increased by 17.7 percent and 5.3 percent respectively compared to the first half of 2011, and increased in comparison with the same period of 2010 by 9.3 percent and 2.6 percent respectively (Graph 4.3.4.1.).

The principal share of payment value in currency nominal values was accounted in US dollars.

7 of 22 commercial banks of the Kyrgyz Republic provided services for the travel cheque transactions. In the second half of 2011, the 2 305 number of transactions using travel cheques amounted with the total value of 39.1 million soms. Non-residents of the Kyrgyz Republic have still remained the main consumers of the travel cheques.

Graph 4.3.4.1. Dynamics of transactions by SWIFT system

V. THE STATUS OF THE REAL SECTOR

5.1. Households

The average monthly nominal salary per employee in 2011 (excluding small businesses) constituted 9,352 KGS (which is equivalent to 202.7 U.S. Dollars on average official rate of the U.S. Dollar in 2011) having increased in real terms by 12.2 percent (5.8 percent in 2010).

The increase in salaries in 2011 compared to the same period was observed in all types of economic activity, but the most significant was in education and healthcare, where salaries of employees have increased from May 2011. There is a continued trend of the excess over the average level of salaries of employees of financial activity, transportation and communication, production and distribution of electricity, gas and water throughout the country. The lowest level of salaries is in education, healthcare, agriculture, and the provision of community, social and personal services.

In the reporting period, there was an increase in remittances of individuals through money transfer systems: according to the preliminary data, total net inflows in 2011 increased compared with that of 2010 by 25.2 percent and constituted 1,505.4 million U.S. dollars.

The living minimum in 2011 constituted 4,390.0 KSG having increased by 20.2 percent compared to the same indicator of 2010. The ratio of the average monthly wage to the living minimum decreased from 226.9 to 213.0 percent.

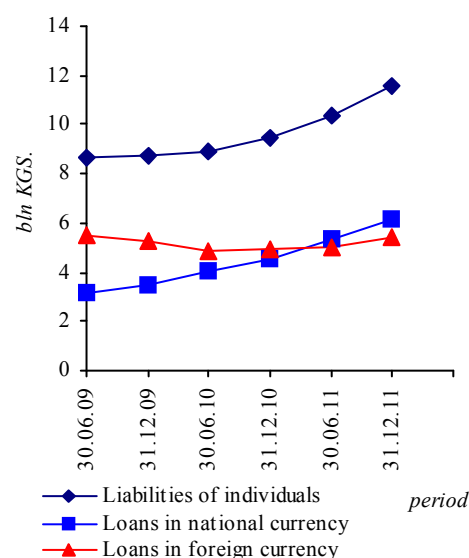
5.1.1. Liabilities to the Banking System

The amount of liabilities of the household sector to the banking system in 2011 constituted 11.6 billion KGS having increased by 22.2 percent compared with the same indicator of 2010 (Graph 5.1.1.1).

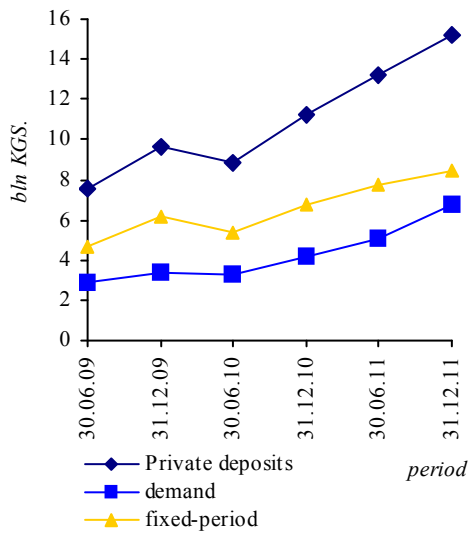
The loan debt of individuals in national currency increased by 35.4 percent totaling 6.1 billion KGS, the loan debt in foreign currency grew by 10.1 percent to 5.5 billion KGS in KGS terms. The proportion of loans in foreign currency in the structure of liabilities of individuals decreased from 52.3 to 47.1 percent.

The total amount of loans to households for consumption purposes in 2011 constituted 3.3 billion KGS, and compared

Graphic 5.1.1.1. The liabilities of individuals to banks



Graph 5.1.2.1. Private deposits



with the volume in 2010 increased by 72.3 percent, and their share in the total volume of loans increased from 8.3 to 10.3 percent.

5.1.2. Personal Savings

As of the end of 2011, the total amount of private deposits constituted 15.2 billion KGS, having increased over the year by 35.4 percent (Graph 5.1.2.1). At the same time, deposits of the population in national currency grew by 52.7 percent to 7.4 billion KGS, and by 22.3 percent to 7.8 billion KGS in KGS equivalent in foreign currency. The share of deposits of the population in foreign currency at the end of 2011 was 51.3 percent, having decreased by 5.5 percentage points compared to the same indicator of 2010.

5.2. Corporate Sector

5.2.1. Liabilities to the Banking System

On December 31, 2011, there were 505.1 thousand of existing businesses on the territory of the Kyrgyz Republic, which is by 6.0 percent more compared to January 1, 2011. As before, the structure of businesses was dominated by country (farmer) households and individual entrepreneurs.

In 2011, there was an increase of total debt of enterprises and institutions¹ to commercial banks. At the end of the period, its volume constituted 20.2 billion KGS, having increased by 18.4 percent in comparison with the volume at the end of 2010 (Graph 5.2.1.1).

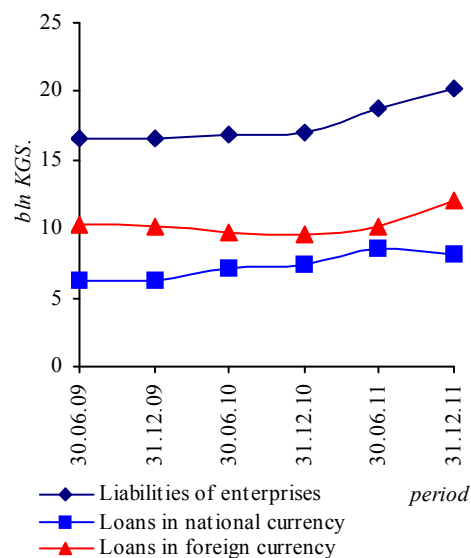
The volume of new loans in 2011 increased by 39.8 percent, amounting to 31.9 billion KGS, compared to the same indicator of 2010; the volume of loans in national currency increased by 26.9 percent and amounted to 15.2 billion KGS; in 2011, lending in foreign currency increased by 54.0 percent to 16.7 billion KGS.

In the sector section, there was an increase in lending to most sectors of the economy (except for the construction and transport sectors). Accordingly, the structure of loans changed: the share of loans for trade constituted 54.3 percent (-0.1 percentage points), for agriculture - 11.8 percent (-0.8 percentage points), consumer loans - 10,3 percent (2.0 percentage points), mortgage loans - 4.6 percent (+0.6 percentage points), for industry - 4.4 percent (-1.0 percentage points). The proportion of loans for procurement and processing, transport, communications and social services constituted 0.3 percent in total. The share of "other" loans constituted 10.6 percent (+2.0 percentage points).

In most sectors of the economy, interest rates on new loans both in national and foreign currencies decreased. In general, in 2011, the weighted average interest rate on loans constituted 21.5 percent (-0.4 percentage points); it has not changed including on loans in national currency and constituted 23.8 percent, while in foreign currency it decreased by 0.2 percentage points, reaching 19.6 percent.

The reduction of rates on loans in national currency was noted

Graph 5.2.1.1. The dynamics of the corporate sector debt to commercial banks

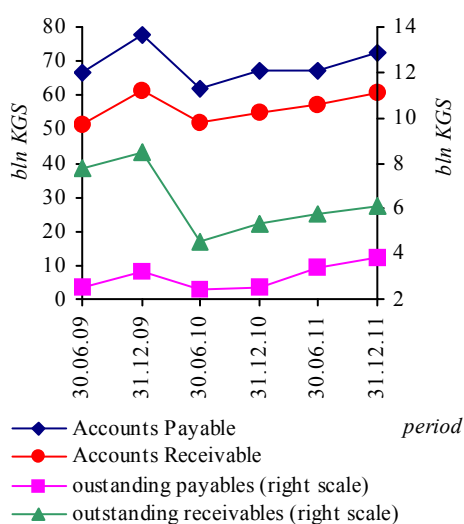


¹ Debt of legal entities on balance sheets of commercial banks.

in all sectors, except for loans for trade and consumer purposes. Loans in national currency at the lowest rates were granted for procurement and processing, mortgage (15.5 and 20.1 percent respectively on average for the period), the highest rates were on loans for the transport sector and consumer loans (24.9 and 29, 9 percent, respectively). Loans in foreign currency at the lowest rates were granted for the procurement and processing (12.9 percent on average for the period), while at the highest rates they were granted for consumer purposes (an average of 22.0 percent).

5.2.2. The State of Accounts Receivable and Accounts Payable²

Graph 5.2.2.1 Dynamics of receivables and payables of the corporate sector



The volume of accounts receivable of enterprises and organizations of the real sector of the economy at the end of 2011 constituted 60.7 billion KGS, which is by 11.0 percent more than the indicator of the end of 2010 (see Graph 5.2.2.1).

The greatest reduction in accounts receivable was noted in the agricultural sector (by 13.0 times), education (53.2 percent), and mining (50.3). At the same time, the highest proportion in the total amount of receivables is occupied by manufacturing firms (24.6 percent), sector of transactions with real estate (19.2 percent) and trade (18.7 percent).

The volume of outstanding accounts receivable at the end of 2011 grew by 15.1 percent and constituted 6.1 billion KGS compared to the same period at the end of 2010. The share of outstanding accounts receivable in its total amount constituted 10.0 percent. 45.8 percent of the total outstanding accounts receivables accounted for the debts to enterprises on the production and distribution of electricity.

Accounts payable at the end of 2011 constituted 72.3 billion KGS, which is by 7.7 percent more compared to the amount at the end of 2010. The increase in payables was observed mainly due to increase in the payables of agricultural enterprises (by 6.2 times or by 351.4 million KGS), manufacturing (by 14.5 percent or 2.2 billion KGS), mining (by 65.9 percent or 458.6 million KGS).

The volume of outstanding accounts payable at the end of 2011 constituted 3.9 billion KGS and increased by 57.1 percent compared with the indicator at the end of 2010, while its share in the total volume of accounts payable increased from 3.7 percent to 5.3 percent. In the structure of outstanding accounts

² According to preliminary data of the NSC of the KR, excluding organizations providing financial services.

³ According to preliminary data of NSC KR.

payable, the largest share accounts for manufacturing firms (43.8 percent), trade (17.8 percent) and the production and distribution of electricity, gas and water (11.1 percent).

5.2.3. Financial Results³

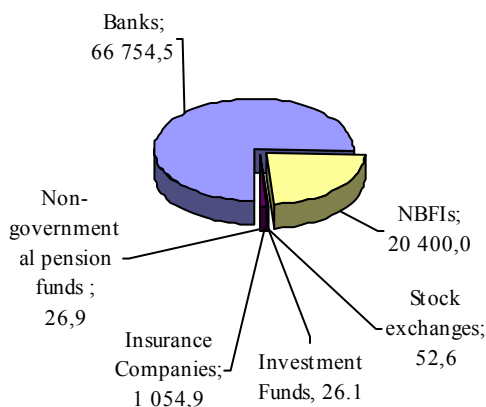
At the end of 2011, operating profit of the real sector enterprises constituted 42.5 billion KGS. The main volumes of operating profit were obtained by manufacturing, transport and communications, trade enterprises, and enterprises of production and distribution of electricity, gas and water. Losses in the amount of 28.2 million KGS were suffered by enterprises in the financing sphere (exchange offices and pawnshops) and education.

³ According to preliminary data of the NSC of the KR.

VI. TRENDS IN THE DEVELOPMENT OF THE FINANCIAL SECTOR

Currently, the country's financial sector is represented by institutions such as banks, non-bank financial institutions (credit unions, microfinance institutions, exchange offices, etc.), stock exchanges, insurance companies, pension and investment funds (Graph 6.1).

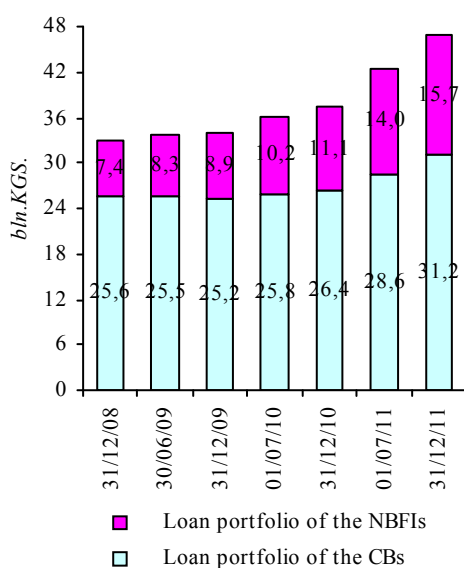
Graph 6.1. The assets of the financial system as of January 1, 2012
(million KGS)



In 2011, the situation in the financial market was formed during the sustainable economic growth in countries that are major trading partners of the Kyrgyz Republic, an increase in domestic consumption, and the reduction of the costs of loan proceeds. In addition, the mechanism of state support and the development of agriculture has been successfully implemented in the period under review through the implementation of the "Affordable Loans to Farmers" Project in which this sector received 565 million KGS in the form of the concessional purpose loans. In 2011, the level of financial intermediation, expressed as the ratio of bank loans to GDP, was formed at a rate of 11.7 percent (in 2010, this figure constituted 10.4 percent).

Banks continue to dominate, occupying 66.5 percent of the aggregate loan portfolio of the financial and credit system as of the end of 2H 2011, which is by 3.9 percentage points lower than in 2010 (-0.7 percentage points compared to the first half of 2011).

Graph 6.2. The loan portfolio of commercial banks and nonbank financial institutions



In 2011, there was a steady trend of reduction in the share of the outstanding debts and rescheduled loans in the total loan portfolio of the banking system, determining its qualitative characteristics. At the same time, the banks' loan portfolio by sectors divided as follows at the end of the period under review. In comparison with the beginning of 2011, a slight decrease by 0.1 percentage points (up to 42.8 percent) occurred in the share of loans for trade, which occupied a largest portion of the loan portfolio. Proportions of mortgage loans also reduced from 10.8 to 9.6 percent, construction - from 7.7 to 5.6 percent, industry - by 0.3 percentage points to 5.3 percent. However, the proportion of agricultural loans remained unchanged at 12.7 percent, while the proportion of consumer loans in the total volume rose by 1.7 percentage points to 8.8 percent. Loans for transport, communications, procurement and processing and social services, as before, constituted a small share, in total of about 2.2 percent. The proportion of "other" loans for the year increased from 11.3 to 12.9 percent.

In 2011, there was a steady growth in the deposit base, characterized by the absence of significant changes in its structure. Deposits in commercial banks showed a moderate increase, mainly due to relevant changes in the indicators of demand deposits and fixed-period deposits. At the same time, dollarization of the deposit base in the reporting period decreased due to a more dynamic growth of its som component.

In 2011, 1,953 deals with securities (+23.2 percent) totaling 1.6 billion KGS were concluded on the stock market of the country, which is by 11.4 percent higher than the same indicator in 2010.

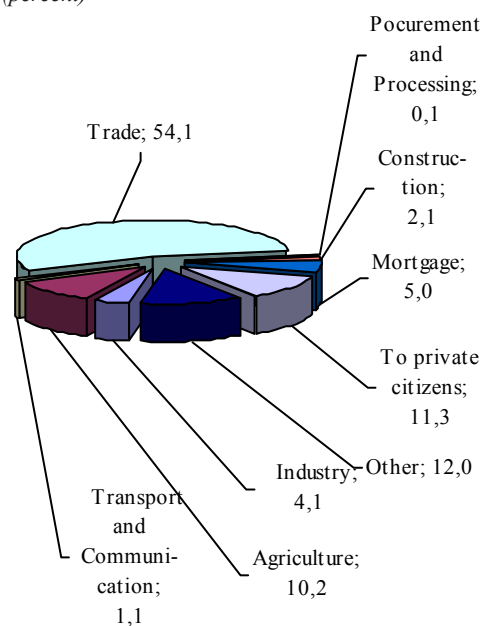
The Government continued the gradual placement of government securities through the trading floor of a single stock exchange in the reporting period within the further development of the government securities market.

As of December 31, 2011, 14 insurance companies, including two reinsurance companies, as well as 5 companies with the participation of non-residents, have been operating in the Kyrgyz Republic. The size of insurance premiums for 2011 increased by 33.3 percent to 709.2 million KGS in comparison with the previous year. In terms of types of insurance, a significant proportion of the total portfolio of insurance products is taken by property insurance. Total assets of insurance companies as of January 1, 2012 constituted 1.1 billion KGS, having increased in comparison to the same indicator of the previous year by 11.9 percent.

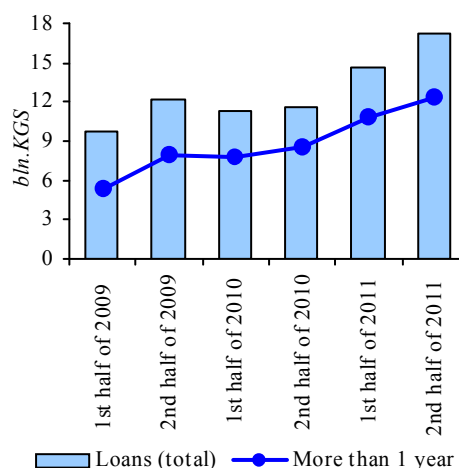
The ratio of assets of insurance companies formed as of the end of 2H 2012 to GDP constituted 0.4 percent.

At the end of 2011, one non-government pension fund, the Kyrgyzstan NGPF, was operating on the market. The main activity of the Kyrgyzstan NGPF is a supplementary voluntary pension provision for citizens on the basis of pension contracts. In 2011, there was a trend in the increase of the pension funds, constituting 21.2 million KGS as of January 1, 2012, which is by 16.0 percent more compared with the beginning of the year. At the same time, the size of the assets of the Kyrgyzstan NGPF has increased since the beginning of the year by 12.5 percent to 26.9 million KGS. In connection with the completion of contracts the total number of depositors decreased by 14 people, and the number of pension recipients increased from 441 to 459 people for the year. As of January 1, 2012 the total number of the NGPF participants, who have signed contracts for voluntary pension schemes, amounted to 2326 people.

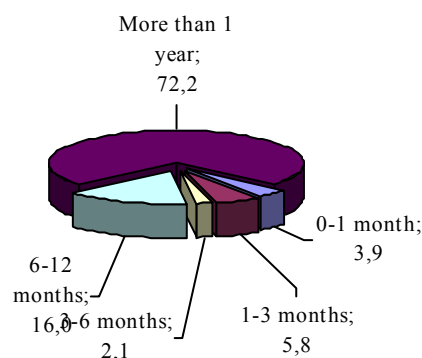
Graph 6.3. Lending to sectors of economy by commercial banks in the 2nd half of 2011 (percent)



Graph 6.4. Dynamics of the volume of new loans for the period and long-term loans of commercial banks



Graph 6.5. The structure of loans granted by commercial banks in the 2nd half of 2011 at maturity (percent)



VII. SPECIAL ISSUES

20 Years of the NBKR: Development and Prospects

This year, the National Bank of the Kyrgyz Republic is celebrating its twentieth anniversary.

In 20 years, the National Bank has come a long way of development. National currency was introduced, a two-tier banking system was created, the rules regulating the activities of commercial banks in accordance with the Basel principles were defined, a national payment system was established, international accounting standards in financial institutions were implemented.

Over the years, the economy of the country and its financial sector has undergone various hardships. Recent history has not been easy for the National Bank. In the 1990s, it formed the banking system, in 1998, Asian crisis, a default in Russia and the Russian ruble devaluation occurred, and in 2007-2008, the world faced financial crisis. The National Bank carried out its activity in conditions of instability; the most difficult task was to find a balance between measures stimulating the economy and curbing inflation at an acceptable level. Today, the National Bank, as always, plays a key role in the economic development of Kyrgyzstan.

On December 14, 2011, the Board of the National Bank approved "Main Trends of the Monetary Policy for 2012-2014," according to which the actions of the National Bank in the medium term will be aimed at curbing the monetary component of inflation. The accompanying problem of the National Bank is the implementation of joint plans of the Government and the National Bank to create the basic conditions for sustainable economic development. The main objective of the monetary policy of the National Bank is to keep moderate inflation rates at 8 percent on average for the period in the absence of shocks. At the same time, the conducting of the monetary policy of the National Bank will be based on expected trends in the development of the real, fiscal and external sectors of the economy.

One of the main objectives of the National Bank for 2012-2014 is a further increase in the effectiveness of monetary policy, including through the improvement of the interest channel of the transmission mechanism, the development of financial markets and increased competition in the banking sector. The National Bank will retain the policy of floating exchange rates. In order to improve the capabilities of the National Bank to achieve goals and intermediate targets of the monetary policy, economic research will be continued.

For the period of 2012-2014 within the development of payment systems, the National Bank in conjunction with commercial banks plans to continue the implementation of measures aimed at the development of the retail market, stimulating activity of operating infrastructure for widespread implementation of remote services, including through computer technologies, mobile payments and payment and prepaid cards.

In order to improve the functioning of financial markets, the National Bank will take measures to organize the market place, reduce financial risks and provide the participants of the financial markets with opportunities for the settlements on a "DVP" basis.

The National Bank intends to facilitate the integration of automated trading systems operators with the Real Time Settlement Gross System (RTSGS) to ensure timely final settlement of transactions in financial markets. In order to identify and minimize the potential for systemic risk, late settlements in

the payment system due to abnormal situation in the system, as well as the entry of new operators using innovative technologies and systems in the market, the National Bank will continue to strengthen oversight of the payment system.

Oversight of the National Bank will focus on implementation of tasks defined by law, namely, to ensure efficiency, safety and soundness of the banking system of the country to facilitate long-term economic growth. The priority is to restore confidence in the financial system of the country, contributing to the mobilization of domestic resources.

The National Bank will be guided by the Banking Sector Development Strategy up to 2014 and the Strategy for Microfinance Development for 2011-2015 in coordination with the Government of the Kyrgyz Republic and other participants of the financial system of the country.

Successful implementation of these strategies will contribute to:

- enhancing the role of the banking sector in the economy of the country;
- strengthening financial stability and transparency of the banking sector;
- increasing the investment attractiveness of the banking sector;
- further growth of the main indicators of the banking system of the Kyrgyz Republic.

In order to increase public confidence in the banking system, the National Bank will work to further develop the deposit protection scheme in conjunction with the Agency for the Protection of Deposits of the Kyrgyz Republic.

The development and adoption of the Banking Code will allow reforming the banking legislation, ensuring consolidation of all the fundamental laws governing the activities of the National Bank, commercial banks and other organizations whose activities are licensed and regulated by the National Bank

NBKR started creating a system of monitoring financial stability of the Kyrgyz Republic. Information about the risks/real threats and strengths of the country's financial system, as well as assessment of the macroeconomic costs will taken into account when developing measures to reduce/minimize the risks and threats in the banking and financial system as a whole.