

NATIONAL BANK OF THE KYRGYZ REPUBLIC

# ANNUAL REPORT

---

2 0 0 8

Bishkek 2009

## ***Report of the National Bank of the Kyrgyz Republic for 2008***

Report of the National Bank of the Kyrgyz Republic for 2008 made pursuant to Articles 8 and 10 of the Law of the Kyrgyz Republic “On the National Bank of the Kyrgyz Republic”.

Report of the National Bank of the Kyrgyz Republic for 2008 approved with the Resolution of the Board of the National Bank of the Kyrgyz Republic No 15/1 of March 25, 2009.

Financial statements for the year ended 31 December 2008, approved with the Resolution of the Board of the National Bank of the Kyrgyz Republic No 18/1 of April 9, 2009.

### **EDITORIAL BOARD:**

**Chairman:**

**Larisa N. Tsyplakova**

**Board Members:**

**Saltanat K. Alybaeva**

**Samat S. Konokbaev**

**Nurgul O. Sadykova**

**Seil A. Urustemov**

**Executive Editor:**

**Altynai K. Aidarova**

On issues, relating to contents of this publication, please, apply to the following address:

Bishkek, 101 Umetaliev Str.  
National Bank of the Kyrgyz Republic  
Macroeconomic and Financial Market Analysis Division  
Phone: (996 312) 669 059  
Fax: (996 312) 610 730  
E-mail: [aaidarova@nbkr.kg](mailto:aaidarova@nbkr.kg)

On issues, relating to dissemination of this publication, please, apply to the following address:

Bishkek, 101 Umetaliev Str.  
National Bank of the Kyrgyz Republic  
External and Public Relations Division  
Phone: (996 312) 669 009  
Fax: (996 312) 610 730  
E-mail: [pr@nbkr.kg](mailto:pr@nbkr.kg)  
NBKR's Web site: [http:// www.nbkr.kg](http://www.nbkr.kg)

## **CONTENTS**

### **Opening Speech of the Chairman of the National Bank**

## **I. ECONOMIC STATUS OF THE KYRGYZ REPUBLIC IN 2008**

### **CHAPTER 1. ECONOMIC DEVELOPMENT OF THE KYRGYZ REPUBLIC IN 2008**

- 1.1. Real Sector of Economy
- 1.2. Public Finance Sector
- 1.3. Balance of Payment of the Kyrgyz Republic
- 1.4. Financial Markets
  - 1.4.1. Foreign Exchange Market
  - 1.4.2. Interbank Credit Market
  - 1.4.3. Securities Market
  - 1.4.4. Deposit and Credit Market

## **II. ACTIVITY OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC IN 2008**

### **CHAPTER 2. MONETARY POLICY**

- 2.1. Monetary Policy Targets and Effects
- 2.2. Monetary Policy Instruments
  - 2.2.1. Foreign Exchange Market Operations
  - 2.2.2. Operations with NBKR Notes and NBKR Discount Rate
  - 2.2.3. REPO Operations
  - 2.2.4. Refinancing of Banks
  - 2.2.5. Reserve Requirements
- 2.3. International Reserves Management

### **CHAPTER 3. OVERVIEW AND REGULATION OF ACTIVITY OF FINANCE AND CREDIT INSTITUTIONS**

- 3.1. Banking System Overview
- 3.2. Overview of Activity of Nonbank Finance and Credit Institutions
- 3.3. Supervision and Regulation of Commercial banks
  - 3.3.1. Licensing
  - 3.3.2. Off-Site Supervision
  - 3.3.3. Inspection
  - 3.3.4. Precautionary Measures of Influence
  - 3.3.5. Development of Regulatory Framework for Bank Regulation and Supervision

### **CHAPTER 4. PAYMENT SYSTEM**

- 4.1. Payment System Development
  - 4.1.1. Clearing Settlements

- 4.1.2. Implementation of State Payment System Development Program
- 4.2. Cash Turnover

## CHAPTER 5. FOREIGN ECONOMIC RELATIONS

- 5.1. Cooperation with International Organizations
- 5.2. Cooperation of with Central (National) Banks

## CHAPTER 6. GENERAL DATA ON ACTIVITY OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC

- 6.1. Structure of the National Bank of the Kyrgyz Republic
- 6.2. Activity of the Board of the National Bank of the Kyrgyz Republic in 2008
- 6.3. Improvement of the Banking Legislation and Performance of Financial Adviser Functions
- 6.4. Internal Audit and Internal Control System
- 6.5. Public Information

## **III. FINANCIAL STATEMENTS OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC FOR 2008**

### CHAPTER 7. FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

- 7.1. Independent Auditor's Report
- 7.2. Balance sheet as of December 31, 2008
- 7.3. Statement of Income and Losses for the year ended December 31, 2008
- 7.4. Statement of Cash Flows for the year ended December 31, 2008
- 7.5. Statement of Changes in Equity for the year ended December 31, 2008
- 7.6. Notes to Financial Statements for the year ended December 31, 2008

## **IV. APPENDICES**

- Appendix 1. Chronology of Major Events in the Monetary Sphere in 2008
- Appendix 2. Statistical Data (Tables and Charts)
- Appendix 3. NBKR's Periodical Publications and Other Information Tools
- Appendix 4. List of Abbreviations

The Annual Report of the National Bank of the Kyrgyz Republic for 2008 is prepared according to the Law “On the National Bank of the Kyrgyz Republic” and describes performance of the bank on achievement and maintenance of price stability in the country, development and strengthening of the banking system and improvement of the payment system to promote long-term economic development of the republic.

The National Bank’s activity was based on intended targets of a Country Development Strategy for 2007-2010 and tasks set by the President of the Kyrgyz Republic.

The past year was significant for the 15<sup>th</sup> anniversary of the country’s national currency. The decision on introduction of the Som taken in 1993 allowed the National Bank to start implementing independent monetary policy. For this period, significant progress was made in strengthening macroeconomic stability and confidence of the population in the country’s own currency.

Under conditions of a persistent negative influence of external price shocks and a global financial crisis that had just started in the year of account, the National Bank, in concert with the Government, implemented the macroeconomic policy directed to restrain inflationary processes in the economy. A tightening of monetary policy, initiated in 2007, allowed in 2008 to create conditions for curbing inflation at a level of the previous year.

The activity of the National Bank was directed to maintain financial stability in the country, to strengthen confidence of the population in the banking system and to increase the level of financial intermediation. Deterioration of financial market condition in the world and in countries - basic trading partners of the republic required adequate measures for minimization of the negative influence of the world crisis on the country’s financial sector.

Much attention was paid to further development of microfinance organizations promoting an increase in access to financial resources for small and medium business, growth of employment and a reduction in the level of poverty in regions.

In the year of account, the National Bank continued working on development of the payment system and an infrastructure essential for effective payments under the State Program on Introduction of Non-Cash Payment System. Performance along this line of the bank’s activity resulted in growth of clearing settlements and availability of payment services.

When preparing this edition, the National Bank traditionally adhered to principles of transparency and full coverage. The report comprises financial statements, confirmed by an independent audit.

Chairman

M. Alapaev

# I

## **ECONOMIC SITUATION IN THE KYRGYZ REPUBLIC**

## **I. ECONOMIC STATUS OF THE KYRGYZ REPUBLIC IN 2008**

### **CHAPTER 1. ECONOMIC DEVELOPMENT OF KYRGYZSTAN IN 2008**

In spite of the fact that rates of economic growth in Kyrgyzstan still exceeded the rates of growth of the world economy, as a whole, a business slowdown was observed in the country in 2008: real GDP growth was 7.6 percent, while in 2007 it was 8.5 percent. An impairment of conditions of trade, output expansion costs and financing, as well as slower growth of real wages reduced noticeably an economic growth potential and affected an investment climate of the country. The economic growth rate was, largely, driven by dynamic development of the sector of services and active gold mining in a manufacturing industry.

Outstripping growth of state budget revenue in comparison with growth of expenditure led to the reduction in a budget deficit compared with 2007.

As a result of impact of external factors, the positive balance of payments decreased 2.8 times in comparison with the previous year.

The financial market situation in the republic developed on impact of monetary policy, which the NBKR implemented under conditions of persistently high rates of inflation and the growing impact of the global financial crisis. The influence of internal and external factors resulted in a change in a direction of a dynamics and the increase in an exchange rate volatility of the national currency, the increase in the level of interest rates in the market, and the reduction in the rates of growth of deposits and credits. In this regard, liquidity in the banking system remained at quite the high level; however, fluctuations of liquidity and its concentration in commercial banks also affected market condition during the year.

#### **1.1. Real Sector of Economy**

The real sector developed under difficult conditions in 2008. Problems in an energy complex and a global rise in food and energy prices had the strong impact on the economy. These factors promoted acceleration in the rates of inflation and the output expansion costs that in turn adversely affected business activity of economic agents and raised uncertainty as to conditions of business activity in the country.

Furthermore, consequences of the financial crisis indirectly influenced the real sector of the Kyrgyz Republic as well. In particular, following the sales slowdown, the essential reduction was observed in trade with the basic trading partners, Russia and Kazakhstan, first of all.

All these turned out to become reasons for a recession in the Kyrgyz economy in 2008. According to NSC preliminary data, GDP made Som 185.0 billion in 2008, having thus increased by 7.6 percent in real terms (in 2007 growth was 8.5 percent). In many ways, growth resulted from continued vigorous activity in trade and in the sphere of transport and communications, as well as by output expansion in the manufacturing industry.

A speedup in the manufacturing industry allowed to partially offset the decrease in the rates of growth in other sectors. If to disregard enterprises that develop a gold ore deposit “Kumtor”, growth of real GDP made 5.4 percent against 9.0 percent in 2007. In 2008, the share of a gross value added of the Kumtor gold deposit enterprises in the total volume of GDP increased to 4.5 percent from 2.7 percent in 2007.

*Gold mining sector*

The volume of per capita GDP amounted to Som 35.1 thousand (US\$ 959.0) and increased by 6.8 percent for the accounting year.

According to year-end performance, a GDP deflator made 21.2 percent against 14.9 percent in 2007.

**Table 1.1.1.**

**Gross Domestic Product in 2008**

	Share, <i>in percent</i>	Growth Rate, <i>in percent</i>	Contribution to Growth Rate, <i>in percentage points</i>
Agriculture, hunting and forestry	25.8	0.7	0.2
Mining	0.4	6.4	0.0
Manufacturing	11.3	23.6	2.3
Generation and distribution of electricity, gas and water	2.2	-7.5	-0.2
Construction	3.1	-10.8	-0.4
Trade, repair of cars articles for personal use	18.6	9.2	1.7
Hotels and restaurants	1.3	13.2	0.2
Transport and communications	8.4	29.7	2.2
Other	15.6	3.4	0.6
Net taxes on products	13.2	7.6	1.0
<b>GDP</b>	<b>100.0</b>	<b>7.6</b>	<b>7.6</b>

*Source: NSC data*

Having increased by 0.7 percent compared with 2007, gross agricultural output totaled Som 112.4 billion in 2008. The share of plant growing in the year under review was 57.0 percent of gross agricultural output. Grain production (post-processing weight) increased by 1.3 percent. Cotton production (raw cotton) in physical terms did not change. A crop of tobacco decreased by 5.6 percent, that of oil-plants – by 11.8 percent and potato - by 2.8 percent. Output of meat increased in cattle farming (live weight) - by 1.9 percent, raw milk - by 2.7 percent, and egg production decreased by 1.2 percent.

*Agriculture*

Industrial output increased by 14.9 percent in physical terms in the year of account. Excluding the Kumtor gold deposit enterprises, industrial output decreased by 2.1 percent.

*Industry*

Growth of industrial output was observed to be most significant in the manufacturing industry, in such sectors, as metal manufacture and hardware (gold extraction), the textile and clothing industry, the food industry, and with regard to production in the sector of electronic and optical equipment. At the same time, there was a downswing in the area of production of some of the construction materials and rubber and plastic articles. Overall, output in the manufacturing industry totaled Som



70.5 billion in 2008, and a volume index was 123.6 percent (in 2006 – 107.5 percent).

The essential downswing was observed in the sector of electricity and in gas and water generation and distribution. Due to reduced generation of electricity resulting from the insufficient level of water in the Toktogul water basin, effective capacity in this sector fell by 7.5 percent compared to the past year, with growth, on the contrary, by 7.8 percent in 2007.

*Energy sector*

Output in the mining industry increased in the accounting year by 6.4 percent, including growth of extraction of fuel and energy mineral resources by 6.5 percent, and output of other mineral resources in physical terms grew by 6.2 percent.

The most dynamically developing sector of services significantly contributed to economic growth: the total of a turnover of trade, car repairs, household products, and articles for personal use increased by 8.8 percent. The volume of services rendered by hotels and restaurants grew by 13.0 percent, those of freight traffic - by 5.6 percent by all types of transport, while the volumes of communication services indicated significant growth – by 45.3 percent.

*Development of the sphere of services*

A downward tendency was observed in investments in fixed assets, whose volume totaled Som 29.2 billion in 2008 and, in real terms, it is by 5.4 percent less than in 2007. Of sources of financing, the largest share is still that of equity capital of companies (mainly, funds of companies with foreign interest) – 27.8 percent of total capital, and investments made by households, whose share was 28.5 percent in the year of account. The share of foreign investments increased from 21.5 percent in 2007 to 30.2 percent in 2008.

*Disinvestment*

The size of a nominal average monthly wage of one worker in the republic<sup>1</sup> was Som 5,422.0 (US\$148.3) and increased by 36.0 percent as compared to 2007, while in real terms the wage increase was 9.2 percent (in 2007 a similar indicator was 19.0 percent).

## **1.2. Public Finance Sector**

Fiscal policy in 2008 was, largely, focused on a tax system reform. The work issued well on a new version of the Tax Code of the Kyrgyz Republic, which was enacted on January 1, 2009. The reduction of the value added tax rate and in the total number of taxes, as well as the tax administration reform could be registered as the key changes in the tax legislation.

*Changes in fiscal policy*

Regarding an issue of improving the statistical service system relating to the public finance sector, the work continued to bring a budget classification in conformity with international standards.

In 2008, according to preliminary data of the Ministry of Finance of the Kyrgyz Republic, the state budget deficit decreased significantly, down to 0.4 percent of GDP from 1.6 percent of GDP in 2007. Compared with growth of state budget

*Budget deficit narrowing*

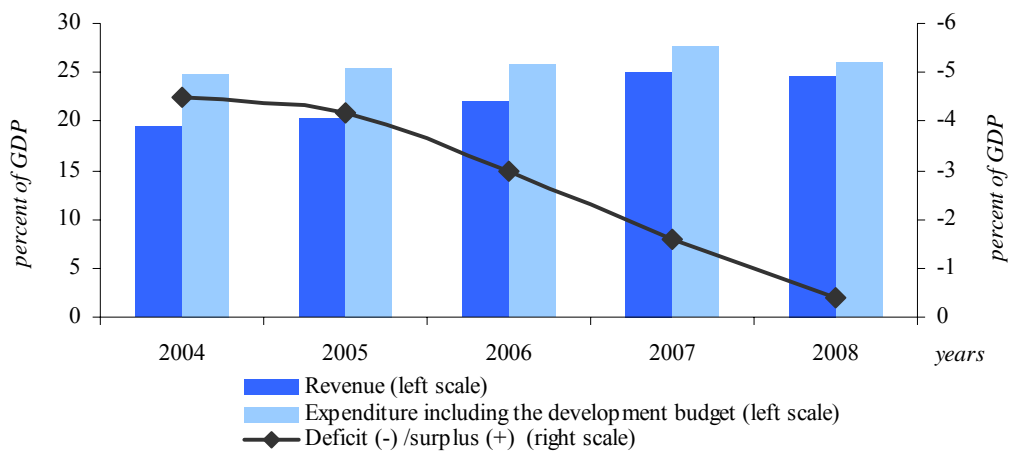
---

<sup>1</sup> KR NSC data excluding small businesses.

expenditure, the state budget deficit was mainly promoted by outstripping growth of revenue in the state budget.

State budget revenues and official transfers increased by 28.0 percent and amounted to Som 45.5 billion in 2008, being 24.6 percent of GDP. Total state budget expenditures in 2008 (including grants as part of the development budget) were Som 48.1 billion or by 22.4 percent larger than the corresponding indicator for 2007. With regard to GDP, expenditures decreased from 27.7 percent to 26.0 percent.

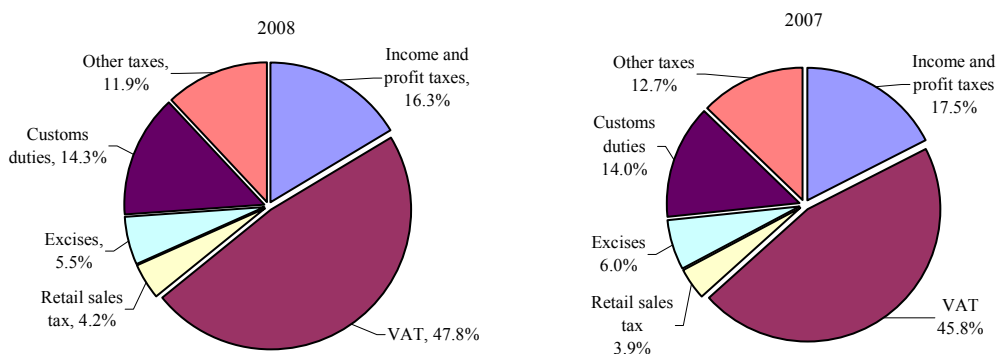
**Chart 1.2.1.**  
Key State Budget Parameters



The basic share (79.0 percent) in state budget revenue was that of tax revenue, whose volume in comparison with the past year increased by 35.3 percent. Total tax revenue was Som 35.9 billion, of which customs and tax bodies provided for 52.0 and 48.0 percent of total tax revenue, accordingly.

*Growth of tax revenue*

**Chart 1.2.2.**  
State Budget Tax Revenue Structure

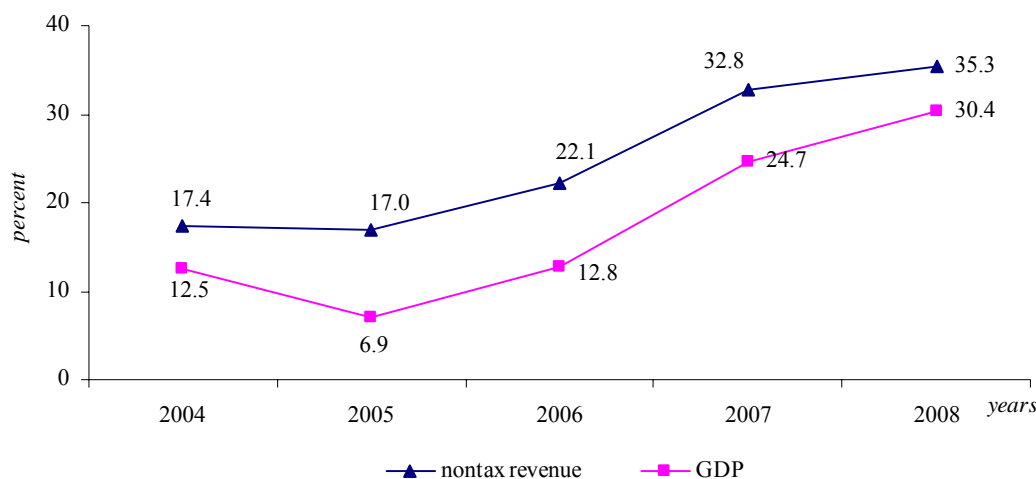


The increase in tax revenue resulted, first of all, from growth of revenue from profit and income taxes on individuals and this speaks for growth of wages and overall, relatively stable, growth of business activity. However, despite increased revenue from taxes on profit and income, indirect taxes continued to be dominating in

the tax revenue structure. In this regard, it should be noted that in 2008 the rates of growth of tax revenue and nominal GDP approximated maximally.

***Chart 1.2.3.***

Growth of Nominal GDP and State Budget Tax Revenues



In the light of the essential rise in food and energy prices, special attention in public expenditure policy was paid to rendering a targeted social support to needy categories of the population, with pensions and wages of civil and municipal servants raised as well. For instance, expenditures for wages and contributions to the Social Fund increased by 36.8 percent and those for social benefits and payments - by 21.0 percent in comparison with 2007.

*Socially oriented public expenditure policy*

In 2008, state budget operational expenditure totalled Som 36.9 billion, being 20.0 percent of GDP.

Budget expenditures for public debt service increased by 0.6 percentage points to 2.7 percent of GDP, including 0.7 percent of GDP of interest payments.

*Growth of debt service expenditure*

State budget expenditure for capital investments, including financing of projects as part of the development budget, was Som 9.5 billion or 5.1 percent of GDP (in 2007 it was 6.0 percent of GDP). As a result of excess of loans to enterprises, financial institutions, and to the population over their repayment, net budget lending totalled Som 650.1 million in 2008.

*Decrease in capital expenditure*

### **1.3. Balance of Payments of the Kyrgyz Republic**

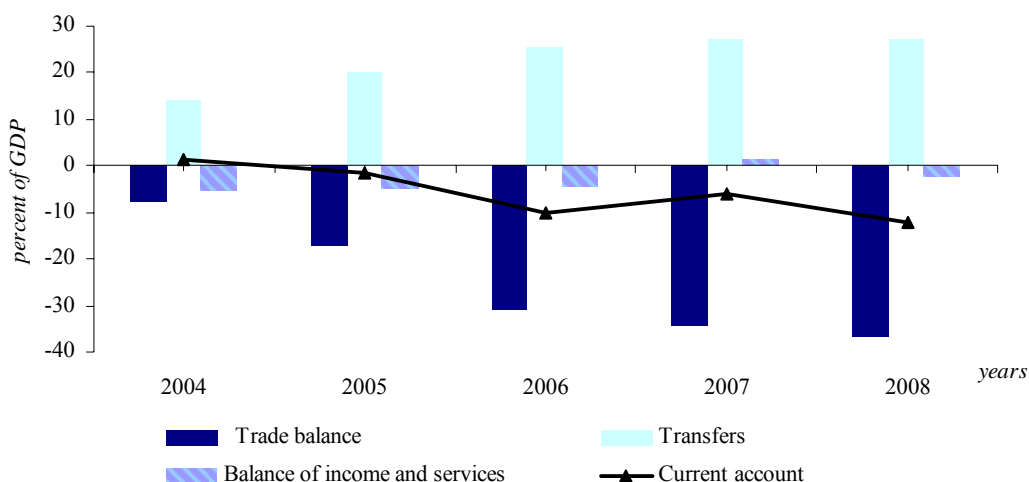
The world economic crisis adversely affected the balance of payments of the Kyrgyz Republic, whose positive balance decreased 2.8 times – down to US\$111.1 million in 2008.

Current income from export of goods and services and transfers did not cover current expenses relating to import of goods and services and income payments to non-residents. As a result, the current account deficit doubled, up to 12.3 percent of GDP.

*Status of current account*

**Chart 1.3.1.**

## Current Account



In 2008, growth of world prices in the commodity markets, of gold and oil prices, in particular, as well as growth of domestic production of gold provided for continued growth of export proceeds by 38.7 percent and import proceeds - by 41.2 percent, thereby resulting in the further increase in a trade gap by 43.8 percent, up to US\$ 1.9 billion.

*Growth of the trade gap*

A 1.6 times advance of rates of growth of import of services compared to the rates of growth of export of services generated the negative balance of services of US\$ 10.9 million (in 2007 this parameter was positive and equal to US\$ 102.1 million). By and large, the structure of international services indicated growth with regard to all types of services, but an item “Travels” underwent the most significant changes, with growth of import having more than tripled. The travels were mainly made to the CIS countries.

Total transfers, including remittances of migrants, increased in the year of account by 33.7 percent relative to 2007 and made US\$ 1.4 billion.

The negative balance of income increased 2.1 times and made US\$ 112.0 million. This increase resulted from growth of income from foreign direct investors’ activities in Kyrgyzstan.

In 2008, the largest share of currency receipts on the financial account fell on foreign direct investments, namely, on credits received from investors. An inflow of foreign direct investment made US\$ 206.7 million and it is less than the value of this parameter in 2007 by 0.7 percent. Foreign loans of public and private sectors of the economy (“Other Investment”) totaled US\$ 64.2 million.

*Status of capital account*

The item “Other Investment” showed the sharp increase in the assets of commercial banks abroad, which made US\$ 115.9 million owing to, mainly, growth of cash assets of residents of the Kyrgyz Republic held on current accounts with the foreign banks. Growth of foreign assets came from also the tenfold increase in accounts receivable of enterprises to non-residents, which is equivalent to US\$ 273.2

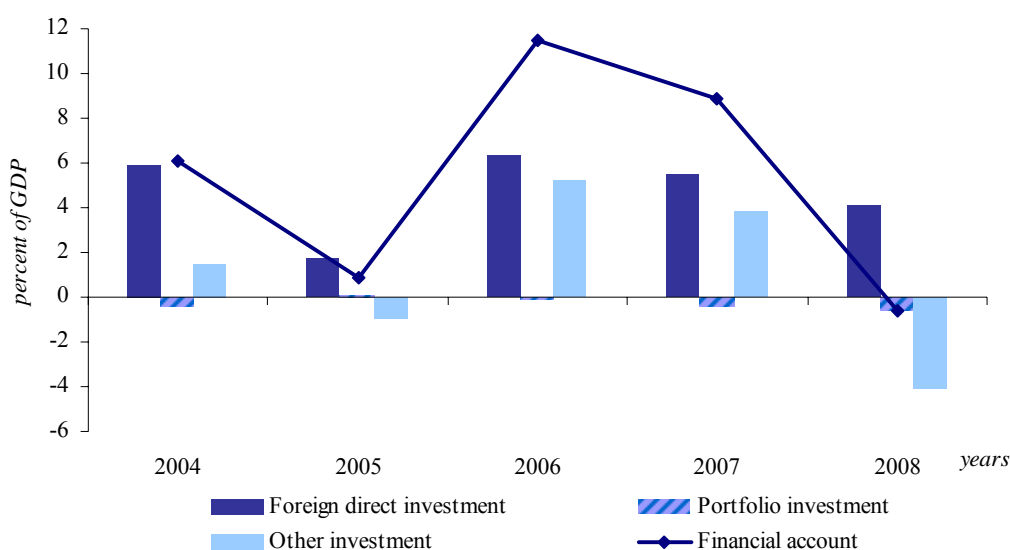
*Growth of foreign assets of residents*

million.

At the same time, accounts payable of domestic enterprises to non-residents grew 6.3 times, up to US\$ 83.8 million. As a result, the item “Other Investment” exhibited excess of foreign assets over liabilities of residents to the external world led to the fact that the positive balance of this item in 2007 turned into the negative value of US\$ 205.4 million as evidenced by a 2008 outcome. This factor predetermined the negative value of the capital and financial account in 2008 that totaled US\$ 90.4 million as against the positive balance of this account in 2007 - US\$ 259.4 million.

### **Chart 1.3.2.**

#### Financial Account



According to the 2008 preliminary outcome, the positive balance of the item “Errors and Omissions” tripled in comparison with 2007 and it testifies to statistical under-recording of export of goods and services or the inflow of capital. With the view of enhancing balance of payments statistics of the Kyrgyz Republic, the National Bank, in concert with the NSC and the State Customs Committee, continued working on increasing coverage and improving statistical data.

*Errors and omissions*

The volume of gross international reserves increased by 4.1 percent and made US\$ 1.2 billion at the end of 2008. The level of the NBKR’s reserve assets corresponded to 3.6 months of cover for the future critical volume of imports of goods and services.

*International reserves*

## **1.4. Financial Markets**

### **1.4.1. Foreign Exchange Market**

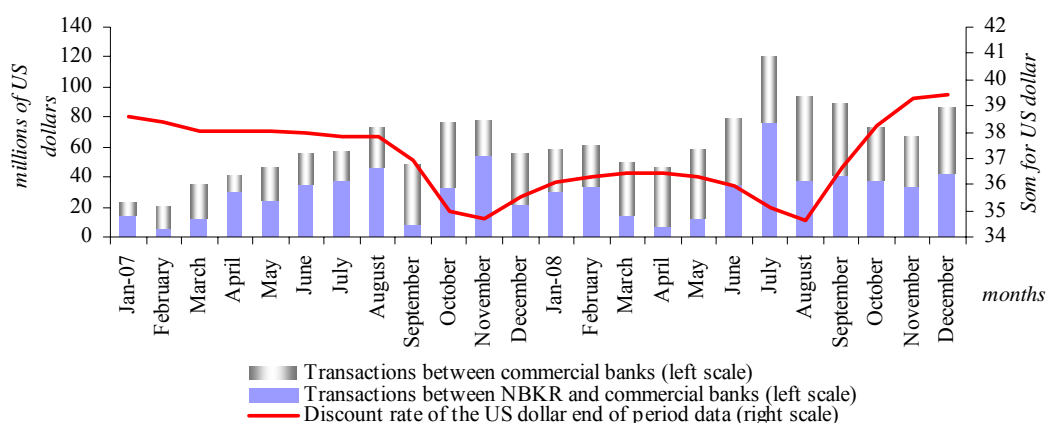
According to 2008 data, for the first time during the recent few years, some

*Basic foreign exchange market trends*

weakening of the national currency was noted against the US dollar in the foreign exchange market of the republic. The direction of the Som exchange rate dynamics changed under conditions of the deepening global financial crisis, which made the balance of payments of the republic worse. Exchange fluctuations observed from the beginning of the year till the end of the summer were, basically, seasonal and indicative of this period. For instance, early in this year, the US dollar exchange rate increased on impact of a strong demand for foreign exchange during this period, however, this tendency, usually short, was still there till May. From May to August, the Som was observed to appreciate in the foreign exchange market in connection with the seasonal increase in the inflow of foreign exchange in the domestic market. The US dollar exchange rate again started to appreciate in September on impact of exchange rate developments in the world markets and further deterioration of the balance of payments of the country. The official US dollar exchange rate grew by 11.0 percent since the beginning of the year, making 39.4181 Som/US\$ 1.00.

**Chart 1.4.1.1.**

Exchange Rate Movement and Total Interbank Foreign Exchange Auction Transactions



The dollar exchange rate mostly increased in the foreign exchange market of the republic in the first quarter. This development was conditioned by the increased demand in the commercial banking system for foreign exchange to make the payments under clients' contracts on imports of goods and services in the context of an import surplus. From end-March till May, the US dollar exchange rate was observed to display fluctuations resulting from the changes in the supply and demand of foreign exchange in the market. In May-August the situation developed on impact of the abundant supply of foreign exchange in the foreign exchange market owing to the seasonal increase in its inflow in the form of remittances and receipts from export of goods and services that determined a prevalence of the downward tendency in the dollar exchange rate during this period. In September, the dollar exchange rate was observed to increase in the foreign exchange market as caused by internal and external factors. The increase in the demand for foreign exchange is, first of all, one of the internal factors, which influenced the dynamics of the dollar exchange rate during this period.

*Year-on-year exchange rate developments*

Appreciation of the US dollar vis-à-vis the basic, European, first of all, currencies in the global markets as a result of measures taken by the US government, as part of combat with the developing financial crisis, could be considered as one of the external factors that had the essential impact on the situation in the foreign exchange market in the country. The situation in the foreign exchange markets of Russia and Kazakhstan indicated growth of the demand for US dollars under conditions of an outflow of capital from Russia and the payments made on foreign loans in the banking system of Kazakhstan, having thus influenced the Som exchange rate developments. At the end of the year the dollar exchange rate continued to grow, however, the rates of its appreciation gradually declined and the change in its rate turned out to be insignificant in December.

In order to prevent violent exchange fluctuations, the National Bank sold US dollars through foreign exchange auctions in January to mid-April, while from the second half of April till August it had to purchase US dollars due to changing market conditions. Starting from September, the NBKR participated in the market both as a seller and a purchaser of US dollars, thereby smoothing time gaps in the foreign exchange supply and demand. Totally for 2008, the NBKR's purchases of US dollars totaled US\$ 228.5 million, while its sales of US dollars totaled US\$ 175.6 million. Furthermore, NBKR transactions in the year of account on sales of Euro totaled Euro1.2 million, Russian rubles – Ruble 17.5 million, and Kazakh tenge – Tenge 0.25 million. The NBKR conducted also US dollar encashment transactions with the commercial banks in the amount of US\$ 11.0 million.

*NBKR  
interventions*

**Table 1.4.1.1.**  
Foreign Exchange Purchase/Sale Transactions  
(In millions of soms)

	2007	2008	Rate of Growth, percent
<b>Total volume</b>	<b>144,318</b>	<b>158,348</b>	<b>9.7</b>
including			
<i>Spot operations with foreign currency in non-cash at foreign exchange auctions</i>			
operations with the NBKR	22,600	32,388	43.3
interbank operations	11,907	14,869	24.9
interbank operations	10,693	17,519	63.8
<i>Spot operations with foreign currency in non-cash outside foreign exchange auctions</i>			
operations with the NBKR	2,278	2,041	-10.4
<i>Spot operations with foreign currency in cash</i>			
operations with the NBKR	117,512	119,921	2.1
commercial banks	114	12	-89.7
exchange bureaus	92,286	91,119	-1.3
<i>SWAP operations</i>			
operations with the NBKR	25,113	28,791	14.6
commercial banks	1,928	3,999	107.4
commercial banks	1,761	2,514	42.8
commercial banks	167	1,485	787.8

Growth of the volume of exports and imports and capital transactions and the inflow of foreign direct investments promoted furious activity in the foreign exchange market. For instance, the total of transactions on purchases and sales of foreign exchange in the domestic foreign exchange market equaled Som 158.3 billion in 2008, having thus increased by 9.7 percent against 2007. The increase in the volume of transactions was observed with regard to all currencies, except for the Kazakh tenge. The best part of transactions was conducted in US dollars, whose share

*Forex market  
organization  
by currencies*

in the total of transactions was 66.8 percent, while the share of transactions on purchases and sales of Euro was 6.3 percent, and that of the Russian ruble – 18.1 percent. The share of transactions with the Kazakh tenge decreased from 17.8 percent down to 8.6 percent as a result of the 2.2 times reduction in the volume of operations with the cash Kazakh currency in the commercial banks. The share of operations with other currencies<sup>1</sup> made 0.2 percent.

As before, the basic volume of operations was conducted in a cash segment of the foreign exchange market (75.7 percent in the total of transactions on purchases and sales of foreign currency). As in the past, the significant volume of transactions on purchases and sales of foreign exchange in cash, despite some decrease in their volume, was that of transactions conducted in the commercial banks. Practically all of the transactions in the non-cash segment of the foreign exchange market were conducted in US dollars through the interbank foreign exchange auctions<sup>2</sup>, whose volume grew by 43.3 percent, up to Som 32.4 billion. In this regard, growth was observed both in operations with the NBKR and in interbank operations.

*Cash and non-cash segments of forex market*

In the year of account, the National Bank continued to conduct SWAP operations aimed at sterilizing excess liquidity in the banking system. The volume of SWAP operations more than doubled and made US\$ 129.9 million (Som 4.0 billion) in 2008 compared with 2007. The increase resulted from both the NBKR operations with the commercial banks, and the transactions between the commercial banks. However, despite growth, the share of these operations remains insignificant (2.5 percent of total operations).

*SWAP operations*

The dynamics of the dollar exchange rate at exchange bureaus was similar to its dynamics at the interbank foreign exchange auctions: the 2008 average dollar exchange rate grew by 11.8 percent being Som 39.7217/US\$1.00 at the end of December. The Euro average weighted selling rate at the exchange bureaus made 55.2291 Som/Euro 1.00, having thus grown by 5.8 percent, that of the Kazakh tenge - Som 0.3247/Tenge 1.00, indicating the increase by 11.7 percent. In relation to the Russian ruble, the national currency became stronger by 9.6 percent, having made Som 1.2903/Ruble 1.00.

*Exchange rate dynamics of basic currencies in exchange bureaus*

#### **1.4.2. Interbank Credit Market**

The volume of interbank credits in national and foreign currencies was observed to have increased the interbank market of credit resources in 2008. The primary reasons for growth of interbank lending were those of significant liquidity fluctuations in the whole banking system and in the individual commercial banks, as well as growth of demand in the commercial banking system for financial resources due to more dynamic activities in the market of government securities.

*Basic interbank credit market trends*

Total operations in national currency in the interbank credit market made Som 10.3 billion, having thus increased by 21.9 percent compared with 2007. The basic

*Operations in national currency*

---

<sup>1</sup> British pound, Swiss franc, Turkish lira, Uzbek Sum and Chinese Yuan.

<sup>2</sup> The foreign exchange auctions are held by the National Bank through the Trade and Information Electronic System (TIES).



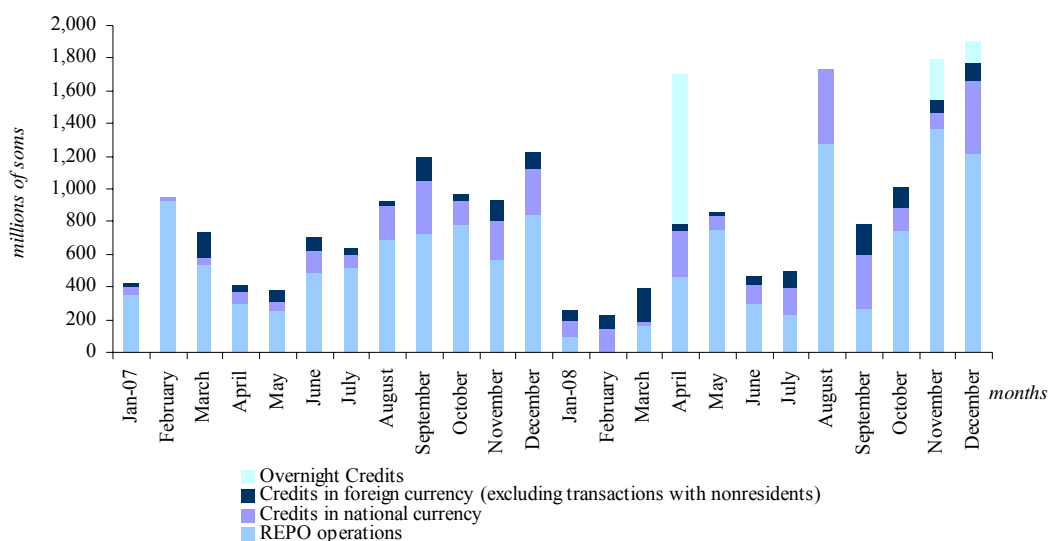
part of loans in soms was concentrated, as before, in the segment of REPO operations though their volume decreased by 1.8 percent down to Som 6.9 billion, with their share in the year of account having decreased from 80.9 to 65.2 percent in comparison with 2007. The volume of transactions in the segment of credit operations in national currency increased by 44.2 percent and made Som 2.4 billion. Furthermore, the National Bank extended the overnight credits, which totaled Som 1.3 billion in 2008.

The situation in the interbank credit market remained relatively stable in the first half of the year and the interest rates of Som credits changed within a narrow range. In the second half of the year, the value of loan proceeds, as well as their volatility increased noticeably on impact of growth of demand and rates in other segments of the domestic financial market. Totally for 2008, the average rate of REPO operations made 8.9 percent, having thus increased by 4.9 percentage points compared with 2007. The level of the average rate of simple interbank credits in national currency grew by 4.4 percentage points and made 7.6 percent, and the average rate of overnight credits made 16.4 percent. The lower level of the rate of credits in national currency in comparison with the rate of REPO operations resulted from high liquidity of collateral funds for individual transactions, with non-cash US dollars serving as collateral inter alia. Average maturity of REPO operations in 2008 in comparison with 2007 grew from 7 to 15 days, while maturity of credits in national currency - from 8 to 65 days.

*Interest rate developments*

#### **Chart 1.4.2.1.**

Total Domestic Interbank Credit Market Transactions



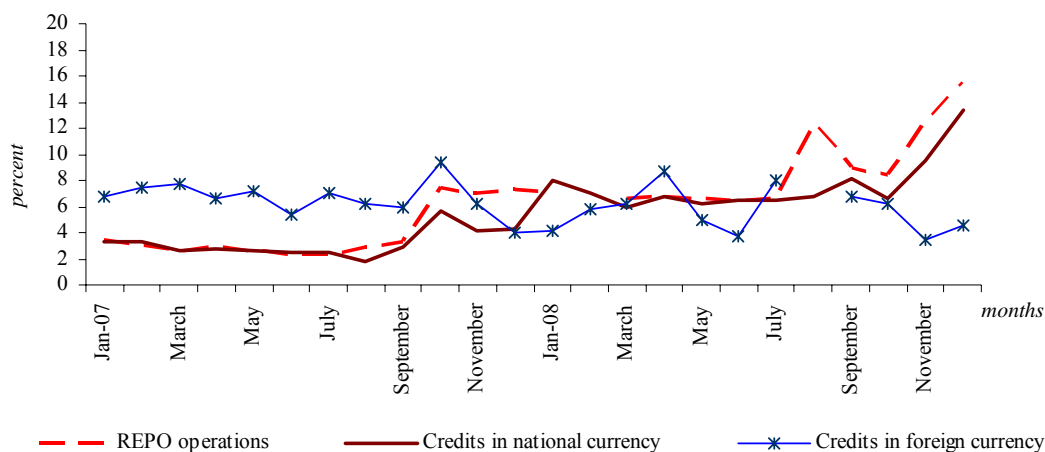
The volume of operations in foreign currency in the domestic interbank credit market increased by 32.1 percent and in soms made Som 1.1 billion in 2008. The share of these operations in the total volume of interbank credits grew from 8.7 up to 10.5 percent. The range of interest rate fluctuations of interbank credits in foreign currency in the year of account increased noticeably, and the rate basically decreased in the second half of the year on impact of the decrease in the FRS rate. As a whole

*Operations in the domestic market in foreign currency*

for the year, the average rate of credits in foreign currency, given in the domestic interbank market, decreased by 1.0 percentage points in comparison with 2007 and made 5.7 percent, while average maturity increased from 69 days to 73 days.

### **Chart 1.4.2.2.**

**Domestic Interbank Credit Market Interest Rate Movement**



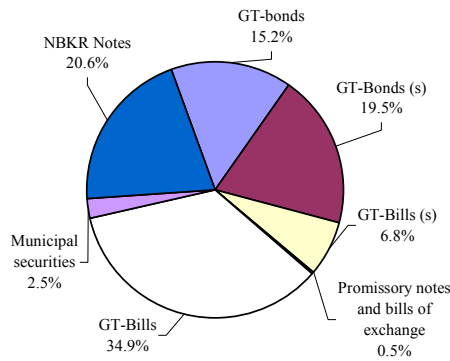
## **1.4.3. Securities Market**

### **1.4.3.1. Government Securities Market**

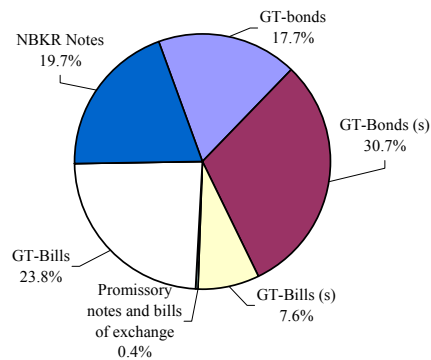
The market of government securities (GS) was represented in 2008 by outstanding Government Treasury Bills (GT-Bills), NBKR Notes, Government Treasury Bonds (GT-Bonds), and Government Securities for Settlement - GT-Bills(s) and GT-Bonds(s), Promissory Notes, Bills of Exchange, and municipal securities. Having increased by 10.7 percent compared to the early year situation, the volume of outstanding government securities totaled Som 8.0 billion at the end of the year under review. Growth of the volume of outstanding government securities resulted from the increase in issues of GT-Bills and the NBKR Notes according to the joint policy of the Ministry of Finance and the National Bank on coordination of actions in the primary market of government securities. As a result, their shares in the total volume of government securities grew from 23.8 percent to 34.9 percent and from 19.7 percent to 20.6 percent, accordingly. At the same time, in 2008 the Ministry of Finance redeemed GT-Bonds and GT-Bonds (s), issued earlier with the view of restructuring debts of the Government of the Kyrgyz Republic to the commercial banks, the nonbank institutions, and the National Bank. As a result, their shares were reduced down to 15.2 and 19.5 percent, accordingly. The volume of GT-Bills (s), emitted when settling the debt of the Government to the NBKR, did not change, and their share in the GS structure decreased down to 6.8 percent. The volume of outstanding Promissory Notes and Bills of Exchange, issued by the Ministry of Finance when restructuring debts of banks and other financial institutions to investors, increased slightly in the year of account. Nevertheless, their share remained insignificant (0.5 percent). In July 2008, the Bishkek city administration issued and placed municipal securities in the amount of Som 200.0 million - their share in the total volume of GS made 2.5 percent.

*Outstanding  
government  
securities*

**Chart 1.4.3.1.1.**  
Structure of Outstanding Government Securities  
2008



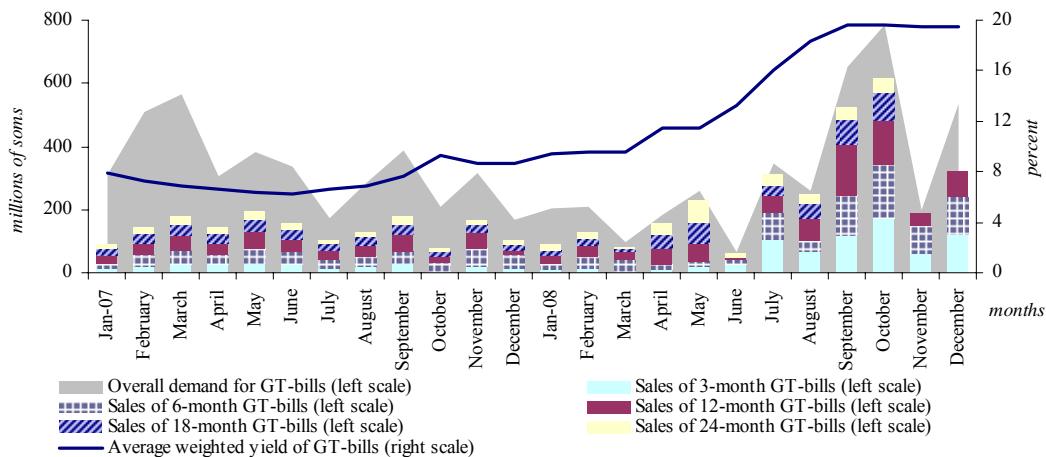
2007



### 1.4.3.1.1. Government Treasury Bills

In 2008, the situation in the primary market of GT-Bills developed substantially on impact of measures for the moderate tightening of monetary policy, adopted by the NBKR under conditions of persistent high rates of inflation, as well as due to liquidity fluctuations and its concentration in the banking system.

**Chart 1.4.3.1.1.1.**  
Demand and Placement of GT-Bills



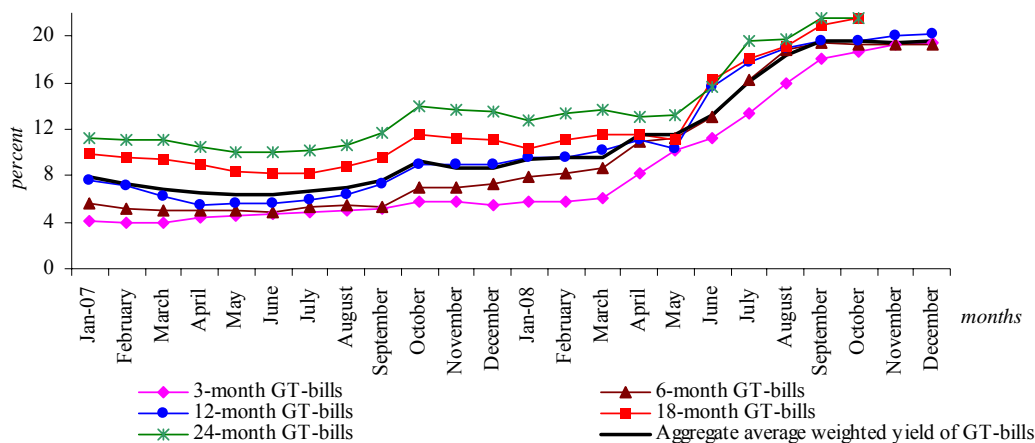
During the period from early year to mid-May, the Ministry of Finance gradually increased the volume of the GT-Bills supply. Then, till mid-July, the weekly supply of Treasury Bills remained at the level of Som 50-55 million. With the high level of excess reserves in the banking system, the demand remained quite stable in the first quarter, and a yield of GT-Bills had been increasing at a slack pace. In April to July 2008 inclusive, the yield and its volatility went up on impact of growth of the yield of NBKR Notes. In this regard, the most appreciable increase in the yield was observed in segments of short-term bills (3 and 6-month GT-Bills). From end-

*Demand and supply in the GT-Bills market*

July to mid-October, the weekly supply of GT-Bills increased, having thus reached Som 210 million. Against the background of increasing excess liquidity in the banking system, the demand for bills increased as well, however, it basically lagged behind their supply, and the certain influence on insufficient growth of demand for GT-Bills was that of reorientation of some of the active participants in the market towards the relatively short-term market of NBKR Notes. This resulted in the further increase in the yield of GT-Bills in all of the segments of the market. In the second half of October, the Ministry of Finance reduced weekly issues of GT-Bills, having changed the structure of their placement: weekly, there were no more than two auctions on placement of 3, 6 or 12-month GT-Bills, and no placement of 18 and 24-month GT-Bills till the end of the year. As a result, the situation in the market flattened out: the rates of growth of yield by all types of GT-Bills decreased noticeably, while the overall average yield by all types of GT-Bills did not almost change for the last three months of the accounting year.

**Chart 1.4.3.1.1.2.**

Average Weighted Yield by All Types of GT-Bills



Overall, the consolidated sales of Government Treasury Bills made Som 3.0 billion for 2008, having thus increased by 78.3 percent against 2007. In this regard, the sales volume of bills with the term to maturity of less than one year increased considerably (3-month - tripled, 6-month - by 73.7 percent and 12-month - by 63.7 percent), and the sales volume of 18 and 24-month GT-Bills increased as well, but to a lesser degree (by 32.8 and 45.6 percent, accordingly). As a result, the share of short-term bills in the structure of sales grew up to 50.4 percent in 2008 from 41.0 percent in 2007. The average yield of Government Treasury Bills grew by 7.3 percentage points up to 14.8 percent for the whole year of 2008.

*Sales and yield of GT-bills*

**Table 1.4.3.1.1.1.**

Issue and Average Annual Yield of GT-Bills

	2007			2008		
	Sales, in millions of soms	Share, percent	Yield, percent	Sales, in millions of soms	Share, percent	Yield, percent
<b>Total</b>	<b>1,687.6</b>	<b>100.0</b>	<b>7.4</b>	<b>2,962.8</b>	<b>100.0</b>	<b>14.8</b>
including:						
3 month GT-bills	245.9	14.6	4.8	730.5	24.7	12.7
6 month GT-bills	442.0	26.2	5.7	761.8	25.7	14.3
12 month GT-bills	461.8	27.4	7.0	744.0	25.1	15.2
18 month GT-bills	312.4	18.5	9.6	405.6	13.7	15.2
24 month GT-bills	225.4	13.4	11.4	321.0	10.8	16.4

\* Data cum volumes of GT-bills, placed via NBKR regional departments

Having made Som 2.7 billion at the end of December, the total volume of outstanding GT-Bills increased by 62.0 percent for 2008, while net financing of the budget through GT-Bills was negative and made a minus of Som 68.8 million, with the 2007 similar parameter being Som 425.5 million. In this regard, duration of bills, outstanding as of the end of the year, decreased down to 214 days from 233 days at the beginning of the year. The commercial banks remained the basic GT-Bills holders in the year of account, though their share decreased for the year from 98.9 percent down to 88.3 percent of the total volume of outstanding GT-Bills. A portfolio of GT-Bills in the banking system increased by 43.5 percent and made Som 2.2 billion for the accounting year. However the number of banks holding GT-Bills decreased from 19 banks down to 16 banks. The share of institutional investors in the total volume of outstanding GT-Bills made 5.3 percent at the end of the year, the share of resident legal entities – 4.7 percent, and the share of individuals – 1.7 percent.

*Volume of  
outstanding  
GT-Bills*

The commercial banks used GT-Bills in the secondary market, mainly, as collateral when conducting the lending operations on REPO terms. However, the volume of interbank operations on REPO terms decreased by 1.8 percent in comparison with 2007. Nevertheless, the volume of purchase/sale operations with GT-Bills prior to redemption in the year of account increased more than 15 times, up to Som 435.4 million. It was basically due to low liquidity at some of the commercial banks, and the banks sold securities available in their portfolio to cover this lack of liquidity. Average maturity of GT-Bills in these transactions made 213 days, and the average annual rate made 11.9 percent.

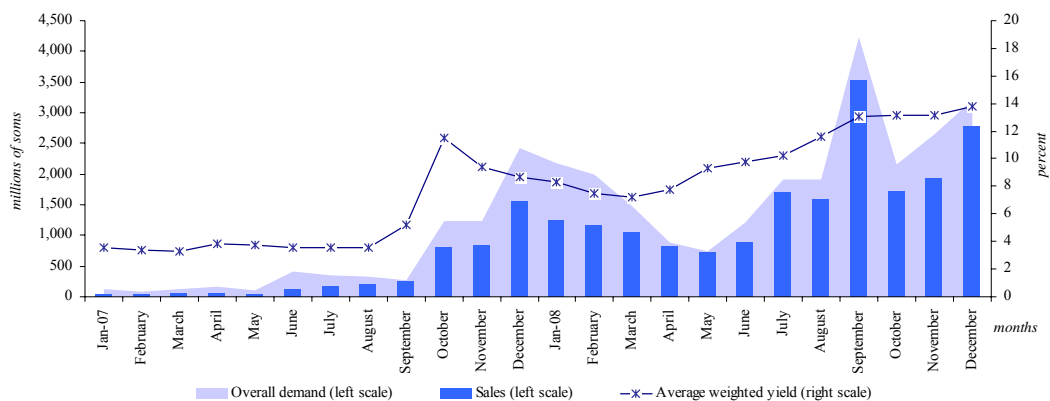
*Operations  
on the  
secondary  
market of  
GT-Bills*

In January to May 2008, the Ministry of Finance held the auctions on placement of 9-month GT-Bills at a trading post of the CJSC “Kyrgyz Stock Exchange” under a pilot project to trade GT-Bills in the share market. The auctions that took place resulted in Som 43.2 million of consolidated sales of these GT-Bills, with the average yield of the last auction being 13.9 percent.

*Placement of  
GT-bills at the  
Stock  
Exchange*

#### **1.4.3.1.2. National Bank Notes**

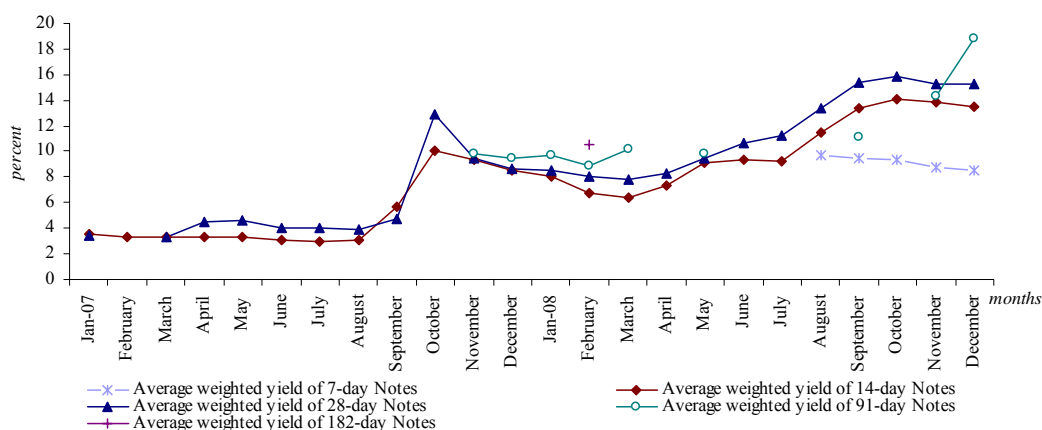
The National Bank placed in the market 14-, 28-, 91- and 182-day NBKR Notes in 2008, and starting from August - 7-day NBKR Notes. Under conditions of persistent high rates of inflation, the NBKR continued to use the notes largely as a tool of a withdrawal of excess liquidity, thereby regulating their supply depending on monetary policy objectives and liquidity in the banking system.

**Chart 1.4.3.1.2.1.****Demand and Placement of NBKR Notes**

In January to July weekly supplied issues of NBKR Notes fluctuated within the range of Som 260-410 million. At the same time, the demand for notes since early year till May decreased against the background of the reduction in the excess reserves of the banking system, then, with growth of liquidity in the banking system, the demand started to increase. In this regard, the demand for NBKR Notes in the market exceeded their supply in the first quarter and resulted in the reduction in their yield during this period. Subsequently, the demand for notes basically lagged behind their supply and the yield of notes started to grow. As part of measures for the moderate tightening of monetary policy, starting from August, the National Bank more than doubled the supply of notes in the context of the persistently high rate of inflation, while making additional placements of Notes. In this regard, largest issues of Notes were in September and December. The demand for NBKR Notes increased as well, however, it lagged behind their supply leading to growth of the yield of 14 and 28-day NBKR Notes. The demand in the segment of 7-day NBKR Notes was quite great owing to a short-term nature of excess liquidity of commercial banks, thereby resulting in the gradual reduction in their yield by the end of the year. For the same reason, the demand for 91 and 182-day NBKR Notes remained modest: only 13 of 28 announced auctions (basically at the beginning and the end of the year) were actually held in the segment of 91-day NBKR Notes in 2008, and only 1 of 13 announced auctions - in the segment of 182-day NBKR Notes.

*Demand, supply and yield in the market of NBKR Notes*

**Chart 1.4.3.1.2.2.****Average Weighted Yield by Types of NBKR Notes**



Overall, placements of notes in the market the National Bank totaled Som 19.1 billion for 2008, their volume being thus increased 4.5 times in comparison with 2007. The average yield by all types of notes made 10.4 percent, having thus grown by 5.1 percentage points compared with 2007, of which the average yield of 7-day notes was 9.2 percent, the average annual yield in the segment of 14-day notes made 10.2 percent, having increased by 5.2 percentage points, and the average annual yield in the segment of 28-day NBKR Notes made 11.6 percent, indicating the increase by 5.8 percentage points compared with 2007. The yield of 91-day NBKR Notes was 11.8 percent on the average for the year, having grown by 2.2 percentage points, and the yield of 182-day notes at only one auction in February made 10.5 percent.

*Sales and yield of NBKR Notes*

The volume of outstanding NBKR Notes was Som 1.7 billion at the end of 2008, indicating growth 15.7 percent compared with the situation at the beginning of the year. The share of commercial banks in the structure of holders of notes was 80.5 percent, those of resident legal entities – 13.5 percent, institutional investors – 5.4 percent, and individuals-residents – 0.6 percent. 17 banks held the NBKR Notes in their portfolio.

*Outstanding NBKR Notes*

#### 1.4.3.2. Corporate Securities Market

An upswing and significant growth of trading volumes were observed in the share market in 2008 (based on official data for 9 months of 2008). Having increased by 66.1 percent in comparison with the similar period of 2007, the volume of auctions at trading posts of the Kyrgyz Stock Exchange, Central Asian Stock Exchange, and the Exchange Trading System totaled Som 5.9 billion for nine months of 2008. The basic trading post of the securities market of the republic is the Kyrgyz Stock Exchange, whose trading volume of auctions totaled Som 3.7 billion in January to September 2008 and increased by 12.0 percent in comparison with the corresponding period of 2007. In 2008, the volumes of auctions at the Central Asian Stock Exchange increased more than 9 times in comparison with January to September 2007 and totaled Som 1.8 billion.

Furthermore, 5 investment funds were the participants in the securities market at the end of September 2008. Their share in financial services was insignificant, with their assets of investment funds remaining at the level of 0.02 percent of GDP.

#### 1.4.4. Deposit and Credit Market

In 2008, the banking system still showed the upward tendency of deposits and credits, with the rates of growth having nevertheless fallen noticeably. Crisis phenomena in the international financial markets influenced essentially aforementioned developments, mainly, in the countries - basic economic partners of the Kyrgyz Republic, first of all, in Russia and Kazakhstan. Furthermore, commercial banking was affected by also the persistently high rates of inflation, deterioration in the terms of foreign trade, and the slowdown of private business in the country. Totally for 2008, a deposit base<sup>1</sup> of the banking system increased by 25.9 percent, having made Som 29.8 billion at the end of the accounting year, and the loan portfolio<sup>2</sup> was Som 26.3 billion, having increased by 22.1 percent. In the year of account, the deposits and credits of problem banks were observed to have decreased. It was promoted by repayment of all deposit liabilities and credits by the Akyl IJSCB connected with the process of its rehabilitation. By end-2008, the total share of banks undergoing rehabilitation in the deposit base decreased from 0.8 percent to 0.6 percent, while the share of credits decreased by 0.3 percentage points and made 2.7 percent of total debts of the banking system on credits.

*Credit and  
deposit  
slowdown*

The reduction of the rates of growth of deposits and credits of the banking system influenced performance of financial intermediation of the banking system. The ratio of the deposit base to GDP was 16.1 percent in 2008 against 16.9 percent in 2007 and the ratio of credit investments to GDP decreased from 15.4 to 14.2 percent. As a result of the slowdown in lending to the economy and outstripping growth of deposits, the credit and deposit balance decreased by 2.8 percentage points and made 88.2 percent.

*Financial  
intermediation*

The deposits continued to grow in the operating commercial banks<sup>3</sup>, with some reduction noticed only in February, August and December of the accounting year. In February and August it was due to the reduction of deposits in national and foreign currencies, and in December – due to the outflow of deposits in national currency. The rates of growth of deposits in national currency were higher during the year. However, starting from October their rates of growth slowed down, while those of deposits in foreign currency started to accelerate and it was basically due to the increase in the demand deposits in foreign currency of enterprises with one of the banks, whose share was significant in this market, as well as due to appreciation of the US dollar at the end of the year. For instance, the Som deposits grew by 11.5 percent and the deposits in foreign currency - by 39.5 percent. As a result of dollarization, the deposit base grew by 5.5 percentage points in 2008, up to 57.6 percent. At the end of 2008, the ratio of deposits in national currency to the volume of cash (M0) made 42.6 percent, having increased by 0.5 percentage points compared with this parameter at the beginning of the year.

*Deposit base*

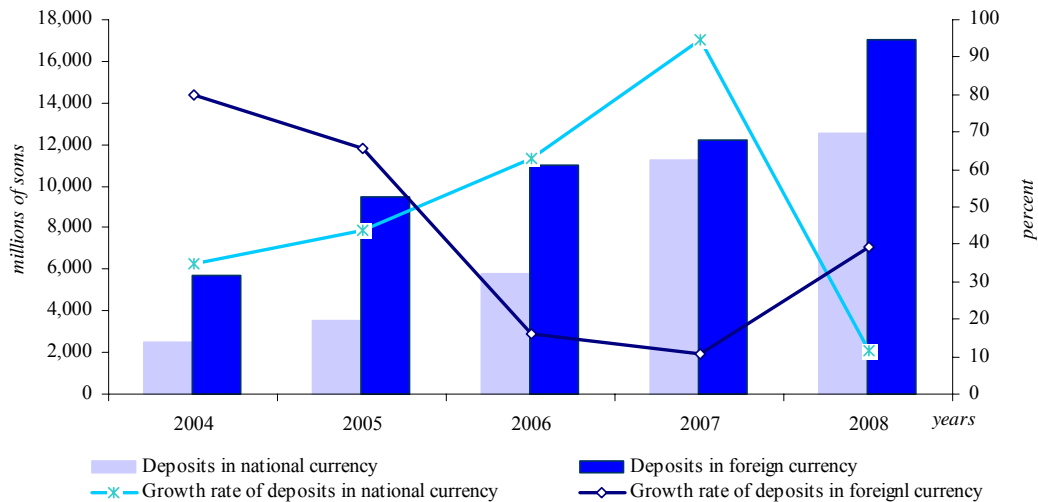
---

<sup>1</sup> Including deposits of Government and financial institutions.

<sup>2</sup> Excluding the discount.

<sup>3</sup> Data are hereinafter based as covering operating commercial banks



**Chart 1.4.4.1.****Deposits in Operating Commercial Banks (end-of-period)**

As before, the basic share of deposits of commercial banks was that of contributions of legal entities. Their share since the beginning of the year grew by 3.3 percentage points up to 76.7 percent. In the accounting year, the volume of these deposits increased by 31.8 percent, with the deposits in foreign currency having grown in their structure by 51.4 percent, and in national currency - by 11.4 percent. The rates of growth of deposits of individuals were considerably low and made 10.4 percent, of which the deposits of the population in national currency increased by 12.1 percent, and in foreign currency - by 8.9 percent.

*Structure of the deposit base*

As a result of outstripping growth of demand deposits in the year of account, the reduction was observed with regard to the time deposits in the term structure of the deposit base. For instance, the share of demand deposits grew by 3.5 percentage points or to 64.6 percent of the deposit base. In the structure of time deposits growth was noted in shares of all of the short-term deposits except for the deposits with maturity of 6 to 12 months. This led to the reduction of duration of the deposit base from 6.6 to 5.2 months, including that of time deposits – from 16.9 up to 14.7 months.

By and large, the average rate of the deposit base in national currency grew by 1.4 percentage points and made 6.0 percent in the accounting year, while the rate of deposit balances in foreign currency decreased by 0.6 percentage points to 1.6 percent.

*Deposit base value*

Having increased by 13.0 percent in comparison with 2007, the deposits, newly accepted by the commercial banks,<sup>1</sup> totaled Som 83.1 billion. This growth was triggered by the increase in the deposits in national currency by 43.1 percent due to, first of all, growth of short-term deposits. In this regard, the increase in the inflow of

*Newly attracted deposits*

<sup>1</sup> Receipts on demand deposits of legal entities are not accounted in the newly accepted deposits.

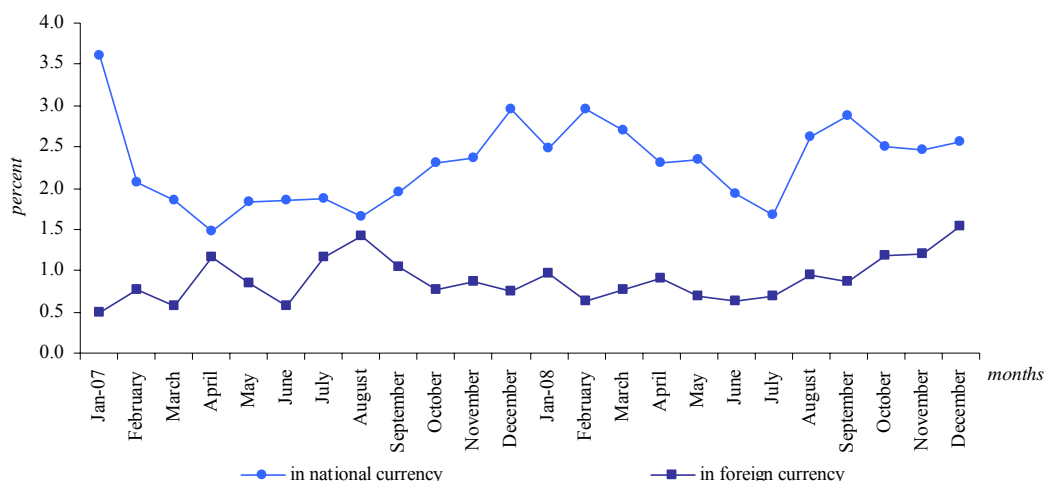
Som deposits was observed in all of the commercial banks, except for one bank. The deposits in foreign currency increased slightly (by 0.1 percent) and totaled Som 51.7 billion.

As compared with 2007, the interest rate of newly accepted deposits in national currency grew on the average for the year by 0.3 percentage points up to 2.5 percent due to growth of rates of demand deposits and the increase in the time deposits. The yield of newly accepted time deposits decreased with regard to practically all of their types, and as a whole for the period it made 6.8 percent, having thus decreased by 0.1 percentage points. The average rate of deposits in foreign currency remained at the level of 2007, having made 0.9 percent. The average annual interest rate of time deposits in foreign currency grew by 0.4 percentage points up to 5.8 percent due to growth of rates of time deposits attracted from the population.

*Interest rate of newly attracted deposits*

#### **Chart 1.4.4.2.**

Interest Rate Developments in Newly Accepted Time Deposits



The reduction of rates of growth of the deposit base of the banking system and the decreasing of financing by the parent banks of banks with foreign capital led to the reduction of the resource base of commercial banks. Furthermore, the high level of uncertainty as to financial condition of borrowers and growth of a credit risk led to the tightening of requirements for the extended credits. As a result, the reduction was observed in the rates of growth of the loan portfolio and in the volume of credits newly extended in 2008. In this regard, in the context of increasing risks and the high rate of inflation the value of financial resources grew and resulted in the increase in the interest rates of credits extended by the commercial banks.

*Credit market*

The increase was observed in credits both in national (by 15.0 percent), and in foreign currency (by 27.5 percent). Higher growth of credits in foreign currency resulted from basically the increase in the US dollar exchange rate vis-à-vis the Som. This influenced growth of dollarization of the loan portfolio by 2.4 percentage points, up to 64.8 percent.

*Loan portfolio*

The term structure of the loan portfolio in the year under review still showed a

*Term structure of the loan portfolio*

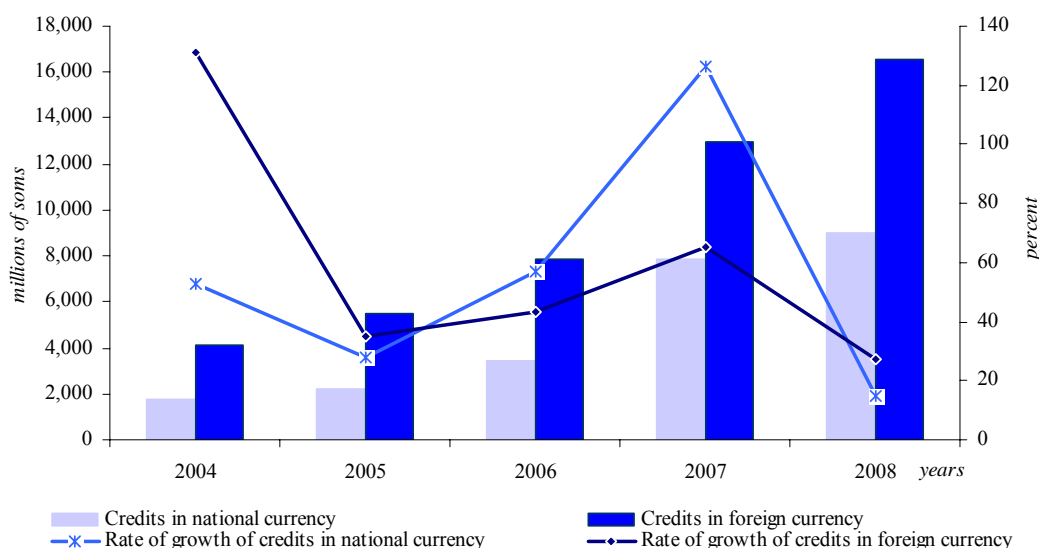
positive upward trend in long-term lending (over one year). As a result, its share in the loan portfolio increased by 2.0 percentage points, to 69.4 percent, at the end of the year. In this regard, the share of credits with shortest maturity in the structure of both short-term and long-term credits increased thereby entailing the decrease in duration of the loan portfolio from 25.2 to 24.8 months at the end of the accounting year.

The increase in the volumes of lending was observed with regard to practically all of the commercial banks, except for three banks that displayed the reduction in lending in foreign currency, in one of them the share of credits in national currency decreased either. The concentration ratio of the loan portfolio of commercial banks grew from 0.09 to 0.10 indicating its low concentration and it is equivalent to sharing of the market by 11 banks. The level of sectoral concentration of the loan portfolio of banks decreased from 0.45 to 0.42, remaining nevertheless still high and indicating the distribution of debt on credits of the majority of banks between approximately the two branches.

*Portfolio  
allocation by  
sectors*

#### **Chart 1.4.4.3.**

Credits in Operating Commercial Banks (end-of-period)

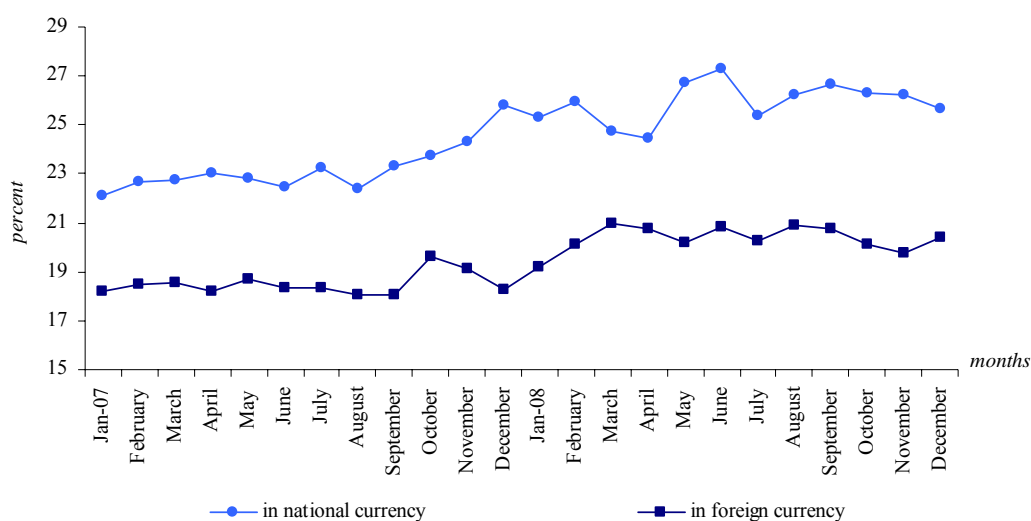


The average annual level of interest rates of credits forming the portfolio of commercial banks in national currency grew by 2.4 percentage points, up to 23.7 percent, in 2008, while in foreign currency the rate grew by 1.4 percentage points and made 19.5 percent. The real interest rate was negative on the average for the year and made (-1.0) percent.

*Loan  
portfolio  
value*

#### **Chart 1.4.4.4.**

Interest Rate Developments in Newly Extended Credits



The volume of newly extended credits decreased in the year of account by 0.6 percent in comparison with 2007, having made Som 24.4 billion, and it was due to the reduction of credits extended in foreign currency by 5.4 percent, thereby making Som 15.3 billion. At the same time, lending in national currency grew by 8.6 percent, up to Som 9.1 billion. In this regard, the dynamics of volumes of extended credits was of the multi-directional nature. In January to April, the volumes of lending were observed to increase, while basically showing the decrease by the end of the year.

*Newly given credits*

In a breakdown by sectors, the flow of newly extended credits was observed to decline in 2008 with regard to mortgage lending (by 56.1 percent) and in industry (by 11.0 percent) in comparison with 2007. At the same time, growth of the volume of credits in agriculture (by 21.8 percent), for trade and commercial operations (by 3.6 percent), for social services (4.9 times), transport (by 16.2 percent), for consumer goals (by 18.7 percent), and in construction (by 14.2 percent). Lending under a category "Other" decreased by 1.3 percent.

*Sectoral structure of newly given credits*

The average level of rates of credits, extended in national currency, increased by 2.7 percentage points and made 25.9 percent in the accounting year. Growth of interest rates was observed with regard to all of the branches of the real sector. The largest increase in the rates was observed in lending to agriculture, for procurement and processing, communications and other credits. The average interest rate of new credits in foreign currency also grew for the period under review (by 1.9 percentage points) and made 20.3 percent. In this regard, growth of rates was observed with regard to all of the branches of the real sector, except for the rates of credits for social services. The consumer credits were the most expensive credits in national and foreign currencies.

*Interest rate of newly given credits*

By the end of 2008, the cumulative loan portfolio of the nonbank finance and credit institutions grew by 52.2 percent and made Som 7.4 billion or 28.9 percent of the loan portfolio of commercial banks, while in 2007 this parameter was 23.4 percent.

**II**

**ACTIVITY  
OF THE NATIONAL BANK  
OF THE KYRGYZ REPUBLIC**

## II. ACTIVITY OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC IN 2008

### CHAPTER 2. MONETARY POLICY

Under conditions of the unimpaired high inflationary potential coupled with the global financial crisis and problems in the energy sector of the country, monetary policy of the National Bank of the Kyrgyz Republic was focused on achievement and maintenance of stability of the general price level, on the one hand, and performance of tasks on maintenance of stability of the finance and banking system and promotion of long-term economic growth of the republic, on the other hand. As a result of agreed measures, undertaken by the National Bank and the Government to regulate liquidity in the banking system, inflation in the Kyrgyz Republic decreased from the mid-year level of more than 30 percent (year-on-year) to the end-year level of 20 percent. In this regard, they succeeded in keeping the positive dynamics of growth of basic parameters of the banking system: growth was observed in the loan portfolio, the deposit base, and own capital of commercial banks.

The international reserves were used with the view of the National Bank's monetary policy, as well as for servicing external liabilities of the Government and the National Bank. The volume of gross international reserves grew to the level of US\$1.2 billion at the end of 2008. The structure of international reserves remained constant, comprising the foreign exchange portfolio, SDR, and the assets in gold.

The reserve assets were invested in highly reliable and liquid tools with the central banks of developed countries, the international financial institutions, and the foreign commercial banks with high credit ratings.

#### 2.1. Monetary Policy Targets and Effects

According to the Statement of the National Bank of the Kyrgyz Republic, adopted at the end of 2007, the following were determined as the basic monetary policy targets for 2008: the reduction of increased inflationary expectations of the population, achievement and maintenance of stability of the general price level, as one of the key conditions of economic growth in the medium term.

Monetary policy was directed to achieve the goals and objectives specified in the Joint Statement of the Government and the NBKR about Basic Economic Policy Guidelines for 2008 and in the "Basic Monetary Policy Guidelines for 2008-2010".

*Monetary  
policy  
targets*

Monetary policy in 2008 was implemented under conditions complicated by deterioration of the economic situation in the countries - basic trade and economic partners - owing to the grave global crisis. The situation in the banking sector of neighboring states led to a restriction on access for the local affiliated commercial banks to external financial resources. The sales slowdown was registered with regard to the domestic products. The downward tendency in the rates of growth of remittances of labor migrants was also observed at the end of the reporting period and this fact, coupled with the above-stated reasons, led to the reduction in the inflow of

*Monetary  
policy  
implementation  
terms*

foreign exchange in the domestic market.

The significant inflationary potential conditioned by high dependence of domestic consumption on import was persistent in the republic.

High excess Som liquidity in the banking system created the excessive demand for foreign exchange, which, under conditions of uncertainty as to development of the external economic environment, instilled some instability in the situation in the domestic foreign exchange market.

In this regard, monetary policy measures in 2008 were directed to satisfy a need for achievement and maintenance of price stability, which is the goal of the NBKR's activity, and to settle several tasks in one go:

- Maintenance of stable operation of the financial and banking sector and the payment system of the republic with the view of promoting long-term economic growth;
- Prevention of violent Som exchange fluctuations as the essential factor to maintain price and financial stability.

Peak growth of the general price level was registered in the middle of 2008, when inflation was 4.3 percent (in June as against the previous month). The NBKR measures directed to sterilize excess liquidity in the banking system with the help of the whole range of monetary policy tools and under favorable external conditions allowed to lower inflation by the end of the year. According to the National Statistics Committee of the Kyrgyz Republic data, growth of the consumer price index, characterizing the rate of inflation, made 20.0 percent by the end of the year (December 2008 to December 2007).

The NBKR Notes remained as the basic tool of sterilization of excess liquidity in the banking system in 2008. The sales of NBKR Notes totaled Som 19.1 billion in 2008 and it is 4.5 times more than their sales in 2007 - Som 4.2 billion. The volume of operations on sale of notes was increased according to a Concept of Tightening Monetary Policy adopted by the NBKR in 2007 due to strengthening of inflationary pressure. At the same time, in comparison with the year before, the volume of reverse REPO operations more than halved and made Som 1.8 billion in 2008.

*Monetary  
policy  
measures*

During the year, the NBKR pursued the policy to prevent violent Som exchange fluctuations and restrict any gamble with foreign exchange – this being most appropriate to maintain price stability and reduce the risks in the financial and banking sphere.

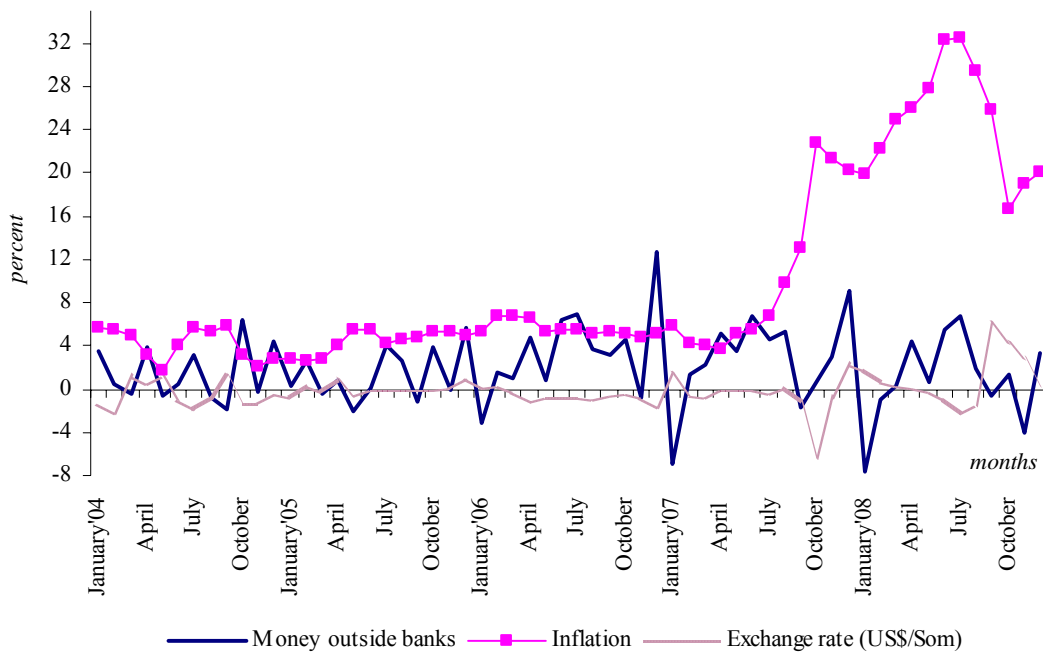
With the view of smoothing violent Som exchange fluctuations, the NBKR conducted operations on the withdrawal of excess foreign exchange from circulation, while continuing to follow the adopted floating exchange rate policy. In 2008, the net purchases of non-cash foreign currency by the National Bank totaled US\$ 53.2 million, with the dollar exchange rate increasing vis-à-vis the Som by 11.0 percent. In

this regard, the major increase in the official dollar exchange rate was registered in the fourth quarter of 2008, driven by the growing demand for foreign exchange due to the strengthening global financial crisis.

The NBKR also conducted the SWAP operations with US dollars, whose volume in the reporting year was Som 2.5 billion, having increased more than 1.4 times in comparison with 2007 (Som 1.8 billion).

**Chart 2.1.1.**

Growth of Money Outside Banks, Exchange Rate and CPI



As a result of NBKR’s monetary policy, money supply growth was more moderate in 2008: the monetary base grew by 11.3 percent and made Som 35.2 billion in 2008 (in 2007 growth of the monetary base was 38.5 percent).

*Monetary base dynamics and structure*

**Table 2.1.1.**

Sources of Base Money (end of period)  
(In millions of soms, at the current exchange rate)



	2007	2008	Growth, in millions of soms	Growth rates, in percent	Impact on base money, in percentage points
Net foreign assets	36,452.1	41,737.1	5,285.0	14.5	16.7
Net international reserves	37,112.4	41,699.9	4,587.6	12.4	14.5
Other foreign assets	-607.8	74.0	681.8	-112.2	2.2
Settlements with CIS countries	-52.4	-36.8	15.6	-29.8	0.0
Long-term foreign liabilities	-2,026.1	-2,099.4	-73.4	3.6	-0.2
Net domestic assets	-2,850.2	-4,486.9	-1,636.7	57.4	-5.2
Net domestic loans	314.3	659.2	344.9	109.7	1.1
Claims to KR Government	216.3	354.6	138.4	64.0	0.4
REPO	-193.2	0.0	193.2	-100.0	0.6
Liabilities of banks	291.2	304.6	13.4	4.6	0.0
Other items	-3,164.5	-5,146.1	-1,981.6	62.6	-6.3
<b>Base money</b>	<b>31,575.9</b>	<b>35,150.8</b>	<b>3,574.9</b>	<b>11.3</b>	<b>11.3</b>
Money outside banks	26,674.7	29,385.1	2,710.4	10.2	8.6
Reserves of commercial banks	4,014.0	4,347.5	333.5	8.3	1.1

Of monetary aggregates, the rate of growth of M2X (M2 + the deposits in foreign currency) was the highest one - 12.6 percent - in the year 2008, while the growth rate of M2 (money outside banks + the deposits in national currency) was the lowest one - by 9.9 percent.

*Monetary  
aggregates*

Having increased by Som 5.4 billion and being much less than its value in 2007 (+33.3 percent or by Som 10.7 billion), the monetary aggregate M2X made Som 48.5 billion by the end of 2008. Growth of the deposit base contributed to growth of broad money by Som 2.7 billion, while growth of money outside banks – by Som 2.7 billion. In this regard, the rates of growth of deposits in foreign currency exceeded the rates of growth of Som deposits.

According to 2008 data, the following changes were observed in the structure of broad money (M2X):

*Broad money  
dynamics and  
composition*

- The share of money outside banks was 60.7 percent (at the end of 2007 – 62.0 percent);

- The share of deposits in national currency was 18.2 percent (at the end of 2007 – 18.8 percent);

- The share of deposits in foreign currency was 21.1 percent (at the end of 2007 – 19.2 percent).

**Table 2.1.2.**

Sources of Money Supply M2X (end-of-period)  
(In millions of soms, at the current exchange rate)

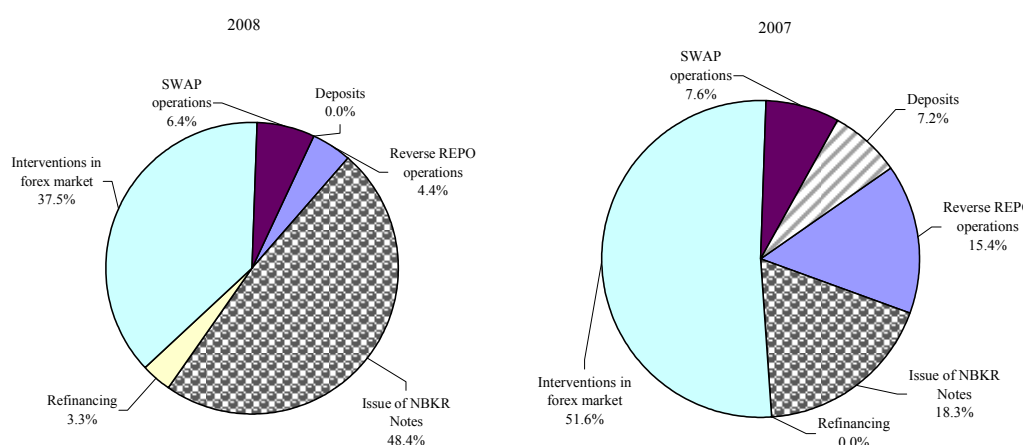
	2007	2008	Growth, in millions of soms	Growth rate, in percent	Impact on M2X, in percentage points
Net foreign assets	35,258.6	39,807.9	4,549.3	12.9	10.6
Net international reserves	35,918.8	39,770.7	3,851.9	10.7	9.0
Other foreign assets	-607.8	74.0	681.8	-112.2	1.6
Settlements with CIS countries	-52.4	-36.8	15.6	-29.8	0.0
Long-term foreign liabilities	-2,026.1	-2,099.4	-73.4	3.6	-0.2
Net domestic assets	9,785.5	10,744.7	959.3	9.8	2.2
Net claims to Government	-1,657.4	-1,613.6	43.8	-2.6	0.1
Claims to other sectors	21,128.9	26,699.5	5,570.6	26.4	12.9
Other items	1,567.7	697.0	-870.7	-55.5	-2.0
<b>Money supply</b>	<b>43,018.0</b>	<b>48,453.2</b>	<b>5,435.2</b>	<b>12.6</b>	<b>12.6</b>
Money outside banks	26,674.7	29,385.1	2,710.4	10.2	6.3
Deposits of other deposit corporations	16,343.3	19,068.1	2,724.8	16.7	6.3
Deposits in national currency	8,093.9	8,824.1	730.2	9.0	1.7
Deposits in foreign currency	8,249.3	10,243.9	1,994.6	24.2	4.6

## 2.2. Monetary Policy Instruments

In the context of the prolonged world economic and financial crisis, the National Bank applied the monetary policy instruments to restrain inflationary pressure and promote long-term economic growth in 2008. When implementing monetary policy, the National Bank aimed to minimize the influence of the monetary factor on inflation by maintaining the optimal rate of growth of money supply. Operations of the National Bank were directed to sterilization of highly excess liquidity in the banking system through, mainly, issues of NBKR Notes. In this regard, the share of these NBKR operations for the accounting year increased to 48.4 percent in comparison with 18.3 percent in 2007. In addition to issues of NBKR Notes, the National Bank withdrew excess liquidity by means of reverse REPO and SWAP operations, however, their shares decreased by 4.4 and 6.4 percent, accordingly, in comparison with 2007.

### Chart 2.2.1.

#### Structure of NBKR Operations



Against the background of the world financial crisis, the trade gap of the republic increased and affected in turn growth of demand for foreign currency in the domestic foreign exchange market. In this regard, insufficient capacity of the

interbank foreign exchange market caused from time to time a temporary foreign exchange supply and demand disbalance in the market. To remove this disbalance and its negative impact on the exchange rate, the National Bank intervened both in purchases and sales of foreign exchange, with the share of interventions in total operations having decreased from 51.6 percent in 2007 to 37.5 percent in 2008.

Under conditions of excess liquidity in the banking system, the demand for monetary resources of the National Bank was insignificant. Totally for the year, the National Bank extended some overnight credits and did not conduct other operations on refinancing (intraday credits, and the direct REPO and SWAP operations). The share of operations on refinancing was 3.3 percent.

Total operations of the National Bank were about Som 39.5 billion in 2008 or by 70.5 percent more than those in 2007 (Som 23.2 billion). In this regard, due to operations of the National Bank the monetary base increased by Som 2.1 billion and it is by 69.1 percent less than in 2007.

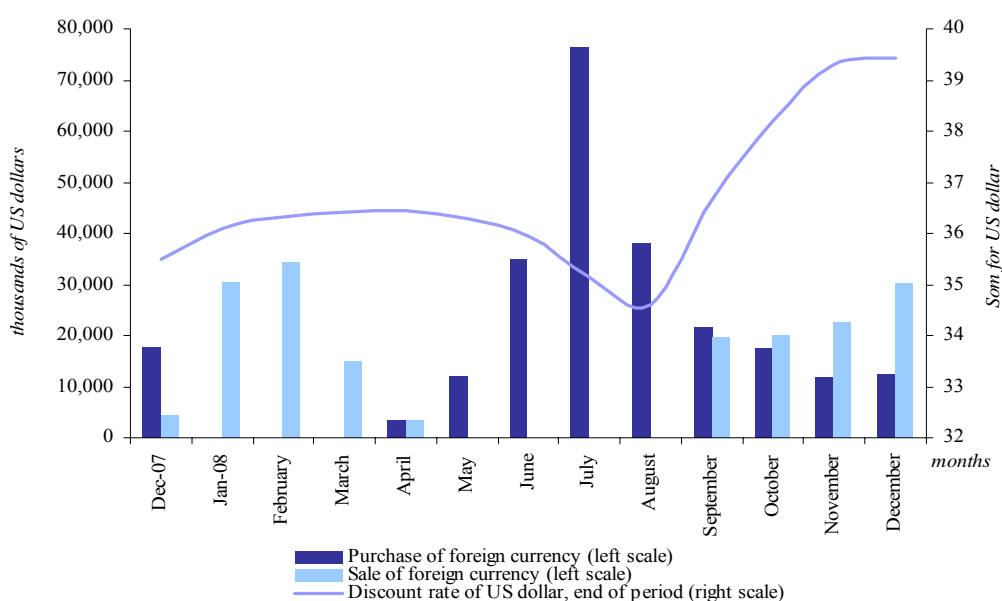
### 2.2.1. Domestic Foreign Exchange Market Operations

In 2008 the National Bank took an active part in the interbank foreign exchange auctions in order to smooth exchange fluctuations and market conditions. For instance, at the beginning of the year the domestic foreign exchange market exhibited seasonal growth of demand for US dollars against the reduced supply of foreign exchange, thereby conditioning growth of the exchange rate. To satisfy the demand for US dollars and smooth exchange fluctuations, the National Bank conducted the operations on sale of foreign exchange in the first quarter. As a result, the exchange rate was stabilized at the level 36.3-36.5 Som/US\$ 1.00 (Som 35.5 /US\$ 1.00 at the beginning of the year).

*Forex market condition*

**Chart 2.2.1.1.**

**NBKR Operations at Interbank Forex Auctions**



The supply of foreign exchange in the domestic market increased noticeably in the second and third quarters due to, mainly, the inflow of remittances of labor migrants, as well as due to growth of export proceeds of the mining industry in foreign exchange. During this period, the National Bank purchased mainly excess foreign exchange from the commercial banks. In this regard, the exchange rate was observed to decrease in the summer months, and in September it started to increase. The situation in the domestic foreign exchange market changed because of the increase in the demand for US dollars due to the time gaps between the flows of money receipt and spending as a result of the ongoing world economic and financial crisis. Furthermore, appreciation of the US dollar in the international markets bore certain pressure upon the exchange rate. Growth of the exchange rate in the domestic market was persistent up to the end of the year, and in December its rate decreased noticeably. In this regard, from September to December the National Bank conducted both the purchase and sale operations with foreign currency because of the disbalance between the foreign exchange supply and demand in the domestic foreign exchange market.

Totally for 2008, the National Bank bought US\$ 228.5 million and sold US\$175.6 million. With that, the officially registered dollar exchange rate for the year increased by 11.0 percent, having made Som 39.4181/US\$ 1.00 by the end of the year.

*Volumes of interventions in forex market*

In addition to the operations with US dollars, the National Bank also intervened in the foreign exchange market with other foreign currencies - Euro, Russian rubles, and the Kazakh tenge - with the view of developing and deepening the domestic foreign exchange market.

Alongside with the currency interventions, the National Bank conducted the reverse SWAP operations on sales of US dollars with the view of sterilizing excess liquidity in national currency. The total volume of these transactions made US\$ 69.0 million in the accounting period, having thus increased by 41.1 percent against 2007. The average weighted term of these operations was 55 days (50 days - in 2007).

*Reverse SWAP operations*

**Table 2.2.1.1.**

NBKR Foreign Exchange Operations in Domestic Foreign Exchange Market  
(In thousands of US dollars)

	Q1	Q2	Q3	Q4	Total
<b>2007, total</b>	<b>36,020.0</b>	<b>92,280.0</b>	<b>101,150.0</b>	<b>144,942.4</b>	<b>374,392.4</b>
<i>including:</i>					
purchase of US dollars	16,170.0	88,480.0	88,650.0	88,950.0	282,250.0
sale of US dollars	15,750.0	-	6,000.0	21,200.0	42,950.0
sale of foreign currency (excluding US dollars)	-	-	-	292.4	292.4
SWAP operations in foreign currency (sale)	4,100.0	3,800.0	6,500.0	34,500.0	48,900.0
<b>2008, total</b>	<b>105,548.7</b>	<b>65,818.6</b>	<b>175,928.6</b>	<b>128,248.5</b>	<b>475,544.4</b>
<i>including:</i>					
purchase of US dollars	-	50,600.0	136,300.0	41,600.0	228,500.0
sale of US dollars	79,600.0	3,400.0	19,550.0	73,000.0	175,550.0
purchase of foreign currency (excluding US dollars)	480.7	2.1	78.6	148.5	709.9
sale of foreign currency (excluding US dollars)	1,468.0	316.5	-	-	1,784.5
SWAP operations in foreign currency (sale)	24,000.0	11,500.0	20,000.0	13,500.0	69,000.0

### 2.2.2. Operations with NBKR Notes and NBKR Discount Rate

The NBKR Notes are the government securities, issued for circulation for 7, 14, 28, 91 and 182 days and placed by the National Bank through the auctions and off the auctions, in order to regulate liquidity in the banking system and determine the discount rate. In June 2008 the new version of the Regulation “On Issue, Placement, Circulation and Redemption of Notes of the National Bank of the Kyrgyz Republic” was carried into effect, developed with the view of improving this tool. According to the new Regulation, the NBKR can change issues of notes towards their reduction and increase, proceeding from the monetary policy targets and the state of the developed market. This norm was incorporated into the Regulation in order to reduce the risk of impact of speculative bids on the level of interest rates, as well as to satisfy the higher demand for the NBKR Notes.

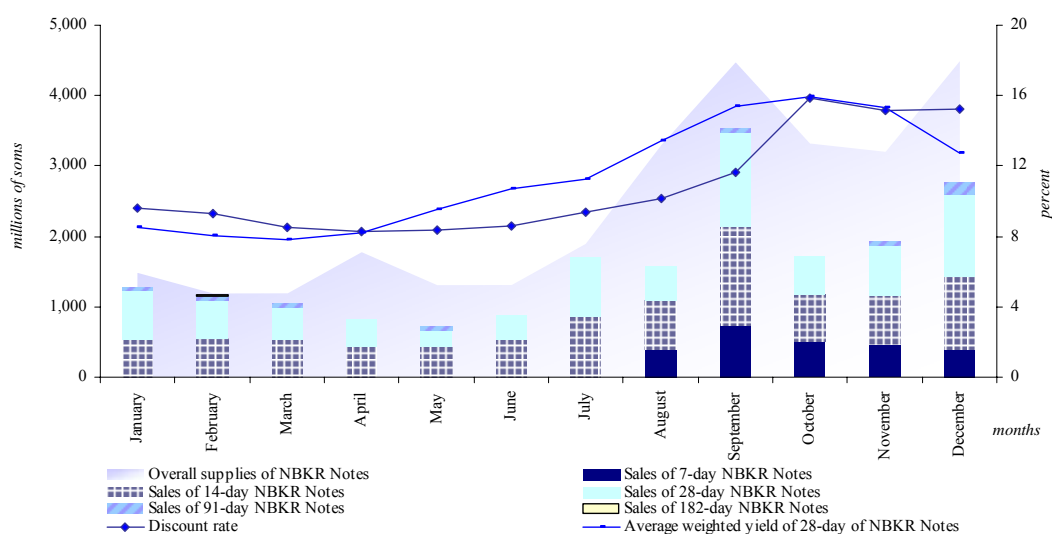
*Changes in  
the regulatory  
framework*

Under conditions of the persistently high rate of inflation, the National Bank continued to use the Notes as the structural tool to withdraw excess liquidity in banks in 2008. As a result, the supply of NBKR Notes increased considerably and made Som 29.0 billion. In this regard, considering the short-term nature of liquidity of banks, in August the National Bank started to conduct the auctions on placement of 7-day NBKR Notes. The sales volume of NBKR Notes increased 4.5 times and made Som 19.1 billion in 2008, with the basic sales volume (84.3 percent) having fallen on 14 and 28-week NBKR Notes.

*Operations  
with NBKR  
Notes*

#### Chart 2.2.2.1.

Sales of NBKR Notes and NBKR Discount Rate Movement in 2008



The discount rate was determined based on the yield of 28-day NBKR Notes, which is the monetary policy tool, and serves as a value reference point of short-term monetary resources. By means of the discount rate the National Bank defines the rates of other monetary policy instruments. Furthermore, the discount rate is used for calculations of fines and penalties for delays in various payments.

*Essence of the discount rate*

From January to September 2008, a mechanism was used to define the discount rate, according to which the value of the discount rate was equated to the average yield of 28-day NBKR Notes for the latest 20 auctions. As a result of the use of this technique, the discount rate was strongly smoothed reacting to market developments with a greater time lag. With the view of enhancing efficiency in the discount rate definition mechanism, in October the NBKR started to define its level as the average value of the yield of 28-day NBKR Notes for the latest 4 auctions. When this new mechanism was implemented, the discount rate grew by 3.6 percentage points and came closer to the yield of 28-day NBKR Notes, making 15.6 percent. At the same time, not to allow significant growth of the value of overnight credits, whose rate is defined based on the discount rate, the factor of its pegging was lowered from 1.5 to 1.2. As a result, the overnight credit rate remained approximately at the same level.

*The change in the discount rate definition mechanism*

The average level of the discount rate in 2008 increased by 5.2 percentage points to 10.8 percent. At the end of December 2008 the NBKR discount rate made 15.2 percent.

### 2.2.3. REPO Operations

The REPO operations are the operations on purchase or sale of government securities with an obligation of their resale or redemption payment within the envisaged period. The National Bank conducts these operations with the view to regulate liquidity in the banking system, proceeding from the monetary policy targets and market condition.

*Essence of REPO operations*

Against the background of the high level of excess reserves in the commercial banks, in 2008, the operations of the National Bank were directed to withdraw short- and mid-term liquidity, by means of selling the government securities on REPO terms (reverse REPO). The Government Treasury Bills for settlement - GT-Bills (s), being part of the NBKR portfolio serves as an object of sale.

The reverse REPO operations were conducted by the National Bank during the whole year. In this regard, due to the change in a pattern of demand, the National Bank reduced maturity of operations stage by stage. For instance, from January to May the National Bank conducted the operations with maturity of 2 months, during the summer period – the operations for 1.5 months, and later – for 1 week.

*Maturity of reverse REPO operations*

The total volume of REPO operations in 2008 halved to Som 1.8 billion compared to the year before. The average term of reverse REPO operations increased from 34 to 35 days, and the average yield of these operations doubled and made 8.9 percent.

**Table 2.2.3.1.**  
NBKR REPO Operations  
(In millions of soms)

	Q1	Q2	Q3	Q4	Total
<b>2007, total</b>	<b>351.8</b>	<b>915.8</b>	<b>1,549.5</b>	<b>745.5</b>	<b>3,562.6</b>
<i>including:</i>					
direct REPO operations	-	-	-	-	-
reverse REPO operations	351.8	915.8	1,549.5	745.5	3,562.6
<b>2008, total</b>	<b>520.5</b>	<b>230.9</b>	<b>517.9</b>	<b>482.0</b>	<b>1,751.3</b>
<i>including:</i>					
direct REPO operations	-	-	-	-	-
reverse REPO operations	520.5	230.9	517.9	482.0	1,751.3

#### 2.2.4. Refinancing of Banks

At the disposal of the National Bank there is a package of tools of refinancing the commercial banks. These are intraday time credits, and overnight, last resort, and other credits.

Under conditions of the high level of excess reserves in the year of account, the commercial banks requested only the overnight credits, extended at the fixed rate, on collateral in the form of government securities with maturity up to 6 months. The overnight credits were extended in April, November, and December to two banks for the total amount of Som 1.3 billion. The average annual rate of overnight credits was 15.0 percent in 2008.

*Overnight credits*

The National Bank took the measures for further improvement of a refinancing facility for the commercial banks. For instance, in December 2008 the new versions of Regulations “On Overnight Credit” and “On One-Day Time Credit of NBKR” inuring in 2009 were adopted in 2008. These new versions regulate the process of extension and repayment of one-day time credits and overnight credits

*Changes in the regulatory framework*

using the automated system in connection with its commissioning.

**Table 2.2.4.1.**

**NBKR Overnight Credits**

*(In millions of soms)*

	Q1	Q2	Q3	Q4	Total
2007	-	-	-	-	-
2008	-	914.5	-	370.0	<b>1,284.5</b>

**2.2.5. Reserve Requirements**

The reserve requirements are one of the tools to regulate the volume of monetary aggregates and represent the sum of funds, which the commercial banks are bound to hold on their correspondent account with the National Bank.

In 2008, the National Bank worked on the issue of improving this tool. For instance, the new version of the Regulation “On Reserve Requirements”, inuring in early 2009, was approved in November. According to the new Regulation, other liabilities were removed from total liabilities and the deposits in foreign currency with maturity of more than 1 year were added to determine the size of reserve requirements. Furthermore, as part of the pilot project on introduction of Islamic principles of financing, amendments were introduced twice in 2008 into the Regulation “On Reserve Requirements for the OJSC “EcoBank” to expand the structure of liabilities used for calculations of reserve requirements. In this regard, the norm of reserve requirements for commercial banks remained at the former level of 10 percent of the average daily amount of liabilities taken for calculations in 2008.

*Changes in the regulatory framework*

Collection of the payment at the rate of the triple NBKR discount rate of the average daily shortfall in the required reserve was envisaged in case of a breach of reserve requirements. The commercial banks were paid compensation equal to the uniform average rate of deposits of commercial banks for an observance of reserve requirements. On October 13, the rate of compensation for the observance of reserve requirements was set up at the zero level following recommendations of a Chamber of Accounts to reduce NBKR expenses and tighten monetary policy under conditions of excess liquidity and the high rate of inflation.

*Payment and compensation for the observance of reserve requirements*

In 2008, the deposits still showed the upward tendency and there was, as a consequence, growth of reserve requirements. By and large, the volume of reserve requirements increased by 22.5 percent to Som 2.6 billion at the end of December. Only one fact of the non-observance of reserve requirements was registered during the year of account. The amount of compensation paid to the commercial banks for the observance of reserve requirements increased by 23.3 percent to Som 42.7 million against the year of 2007 .

**Table 2.2.5.1.**

**Average Daily Level of Reserves of Commercial Banks in National Currency**

*(In millions of soms)*



	Q1	Q2	Q3	Q4
<b>2007, total</b>	<b>2 397,7</b>	<b>2 573,4</b>	<b>2 749,9</b>	<b>3 245,0</b>
<i>including:</i>				
required reserves	1 547,2	1 639,3	1 923,9	2 007,1
excess reserves	850,0	936,1	829,4	1 230,3
<b>2008, total</b>	<b>3 700,1</b>	<b>3 462,4</b>	<b>4 096,5</b>	<b>3 707,2</b>
<i>including:</i>				
required reserves	2 052,2	2 209,9	2 437,9	2 460,5
excess reserves	1 647,9	1 252,6	1 658,6	1 246,7

### 2.3. International Reserves Management

The National Bank managed its international reserves according to “Risk Management Policy in Management of International Reserves”, the Regulations “On Benchmark Portfolio of International Reserves of the National Bank of the Kyrgyz Republic for 2008”, “On Structure of International Reserves of the National Bank of the Kyrgyz Republic” and “On Limits in Management of Investment Asset of International Reserves”.

*Regulatory documents*

Pursuant to the Law “On the National Bank of the Kyrgyz Republic”, the priority tasks of the National Bank in the area of international reserves management are those of maintaining liquidity and ensuring security of international reserves. An income maximization principle in management of international reserves is realized only in case of the strict observance of liquidity maintenance and asset security principles.

*Principles of governance*

Decisions regarding the issues of mapping out the bank investment strategy, portfolio allocation of international reserves, the ratio of risks and yields of investment tools, as well as a choice of bank counterparts were taken by the Board and the Investment Committee of the National Bank. 17 meetings of the Investment Committee were held in 2008 on the issues of management of international reserves. Criteria, requirements and restrictions on counterparts, types of tools, and amounts and maturity of investment were established to minimize the risks arising in reserve asset management.

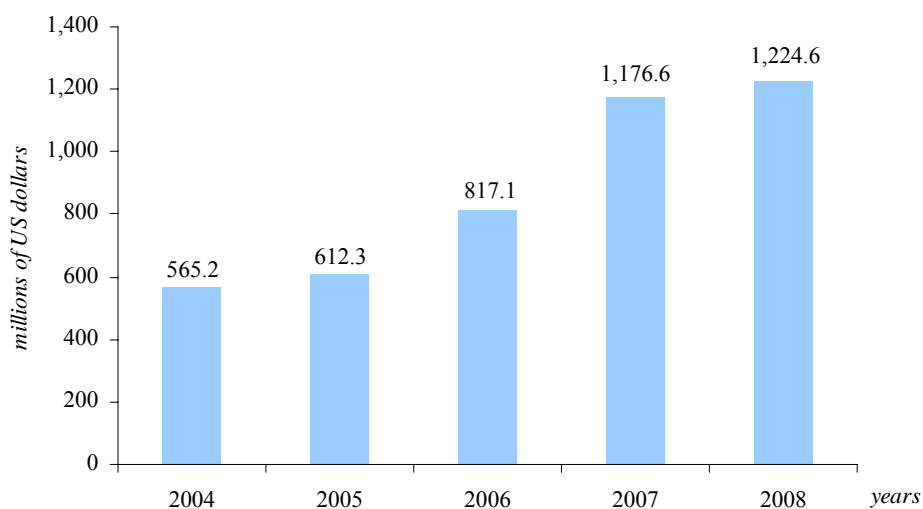
*Power of agencies in decision making*

The structure of international reserves of the National Bank comprises the assets in gold, Special Drawing Rights, and the portfolio of foreign currencies. Total reserves at the end of 2008 were equivalent to US\$ 1.2 billion, having increased for the year by US\$ 48.0 million or by 4.1 percent.

*Structure and volume of IR*

#### **Chart 2.3.1.**

Gross International Reserves of NBKR  
(In millions of US dollars)



The main sources of growth of international reserves in value terms in 2008 were those of exchange transactions of the NBKR conducted in the domestic market, income from management of international reserves, the changes in the exchange rates of portfolios, and the changes in the prices of precious metals. Other sources of growth of assets were those of exchange receipts in favor of the Government and the National Bank from the international financial institutions and the donor countries.

*Sources of IR growth*

The volume of gold, as part of international reserves of the National Bank, remained unchanged in 2008. Growth of the share of SDR in the international reserves was due to the receipts on IMF loans, as well as owing to the purchases of SDR for US dollars according to a schedule of payments for 2008 (NBKR liabilities to the IMF).

*Changes in the IR structure*

***Table 2.3.1.***

Pattern of NBKR Reserve Assets (end of period)  
(In percent)

	2007	2008
Gold	5,9	5,9
Foreign currency portfolio	92,9	89,6
Special Drawing Rights	1,2	4,5
<b>Total</b>	<b>100,0</b>	<b>100,0</b>

In 2008, the foreign exchange portfolio of international reserves of the National Bank comprised: US\$, Euro, Swiss francs, British pounds, Australian and Canadian dollars, as well as Japanese yens, and Russian rubles.

*Structure of foreign exchange portfolio of international reserves and its change*

The structure of the NBKR's foreign exchange portfolio was reconsidered on the quarterly basis and changed depending on global economic development, the international financial market situation, and as adjusted to the foreign exchange structure of foreign liabilities of the Kyrgyz Republic.

In order to maintain the required level of liquidity, as well as to enhance efficiency in management of international reserves, the reserve assets management process was built on the portfolio basis. The division of foreign exchange portfolios into working and investment portfolios provided for maintenance of the optimal yield level of reserves.

*IR structure*

The working capital assets were placed into the most liquid instruments and were used for the payments of the National Bank and the Government in foreign currency and for the operations in the domestic foreign exchange market. The investment portfolio was managed according to the approved benchmark portfolio of international reserves.

*IR allocation*

The National Bank placed the international reserves into the highly reliable and liquid instruments: the securities, time deposits, as well as in the one-day REPO operations. The portfolio of securities of the National Bank comprised the government securities of Australia, Germany, the USA, the short- and mid-term investment tools of the Bank for International Settlements. The time deposits were placed with the international financial institutions and the foreign central and commercial banks.

The international reserves were placed with the central banks of developed countries, the international financial institutions and the foreign commercial banks with the high credit rating established by leading world rating agencies. An analysis of financial markets and a monitoring of performance of counterpart banks were done on the regular basis.

Under conditions of the world financial crisis, the central banks of major developed countries continued liberalizing their monetary policy by means of accessible tools, including through the downward adjustment of key interest rates. As part of measures for stimulation of the economy, the individual central banks lowered the rates down to historical minima. The consequences of these actions were those of the universal decrease in the level of market interest rates that, in turn, influenced the yield of the foreign exchange portfolio of the National Bank, as well as the pattern of placement of international reserves.

**Table 2.3.2.**

Pattern of Placement of NBKR International Reserve Assets (end of period)

(In percent)

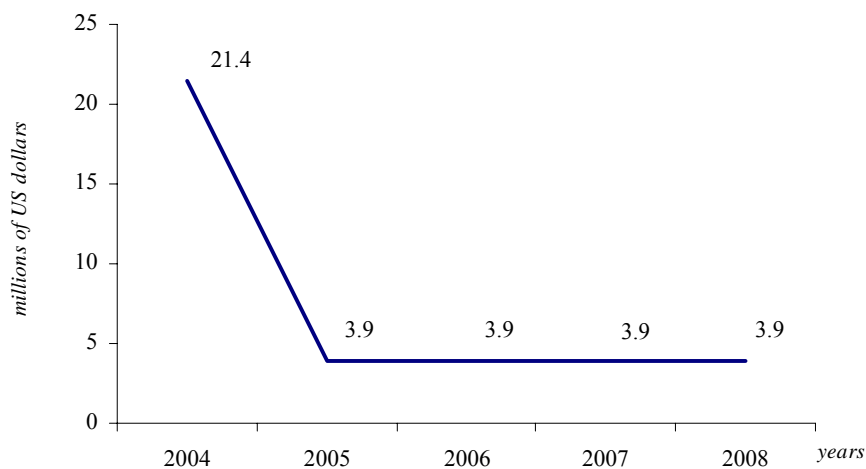
	2007	2008
International financial institutions	44,5	46,3
Central banks	32,6	29,0
Commercial banks	22,7	24,1
NBKR	0,2	0,6
<b>Total</b>	<b>100,0</b>	<b>100,0</b>

The low liquid assets of the National Bank consist of deposits with the JSC "Central Asian Bank for Cooperation and Development" and shareholdings in the Interstate Bank.

**Chart 2.3.2.**

**Low Liquid Asset Developments**

(In millions of US dollars)



As of the end of 2008, the volume of low liquid assets in the structure of international reserves of the NBKR remained unchanged and totaled US\$ 3.9 million as was the case one year earlier.

In 2008 the international reserves were used mainly for the operations in the domestic foreign exchange market, servicing the state external debt of the Kyrgyz Republic and the payment of membership fees and contributions of the Government to the international organizations and integration institutes.

*Use of IR*

### **CHAPTER 3. OVERVIEW AND REGULATION OF ACTIVITY OF FINANCE AND CREDIT INSTITUTIONS**

The world financial crisis indirectly influenced the finance and credit system and resulted in the slowdown in its basic parameters and the increase in the credit risk. The National Bank, in concert with the Government and the commercial banks, conducted the relevant anti-crisis actions directed to further strengthening of the banking system stability and its resistance to the risks and threats, and to improve a bank risk appraisal procedure and the risk management system in the commercial banks.

By and large, development trends in the banking system and in the system of nonbank finance and credit institutions remained positive, thereby leading to improvement of competition, expansion of the spectrum of services, growth of a network of branches and savings banks that in turn promoted the increase in access of the population to financial services. In 2008 the increase was observed in the total number of NFCI and borrowers, the volumes of their assets, and the loan portfolio.

The work was in progress to improve regulatory and legal acts that regulate activities of banks and others NFCI. These acts are a legislative framework for further development of the financial system. For instance, the measures were directed to enhance efficiency in supervision and to establish the adequate risk management system. The Law “On Protection of Bank Deposits” was passed in 2008 and the regulatory and legal framework is developed for introduction of the deposit protection system. The National Bank continued working on improvement of the regulatory framework with the view of implementing the pilot project on introduction of Islamic principles of banking and financing and on the amendments and addenda to the banking legislation directed to ensure equal treatment of all of the participants in the banking sector, as well as on further promotion of Islamic banking in the Kyrgyz Republic. The National Bank, in concert with the commercial banks, developed the Banking Sector Development Strategy till End-2011. Under the “Mid-Term Microfinancing Development Strategy in the Kyrgyz Republic for 2006-2010”, the amendments and addenda were introduced to several acts on the activity of credit unions.

#### **3.1. Banking System Overview**

21 commercial banks<sup>1</sup> (including the Bishkek branch of the National Bank of Pakistan) operated in the territory of the Kyrgyz Republic in 2008. The overview of activities of these institutions is based on revised annual regulatory reports of operating commercial banks for 2007 and preliminary reports for 2008.

*Number of  
commercial  
banks*

The National Bank kept reducing the indirect influence of the world financial crisis on the finance and credit system in order to enhance its stability and resistance to threats and risks and to improve the supervision technique and practice, including an early prevention of problems in the finance and credit institutions licensed by the

---

<sup>1</sup> On November 1, 2008, the JSC “Kyrgyzpromstroibank” joined the JSC “AsiaUniversalBank”.

NBKR.

Jointly with the commercial banks, the National Bank drafted the Banking Sector Development Strategy till End-2011, which was approved on December 30, 2008, by the Coordination Center for Strategic Management of the Kyrgyz Republic. This Strategy is aimed at further growth in financial intermediation, increase in a role of the banking sector in the economy of the Kyrgyz Republic, and maintenance of efficiency, safety and reliability of banking.

*Banking Sector  
Development  
Strategy*

As compared to 2007, the slowdown trends in the basic development parameters took shape in the system of commercial banks in the accounting period. Due to the indirect influence of the world financial crisis on the banking system, the basic efforts of the National Bank were directed to the appraisal of bank risks and implementation of relevant anti-crisis measures, including those taken in concert with the Government and the commercial banks of the Kyrgyz Republic.

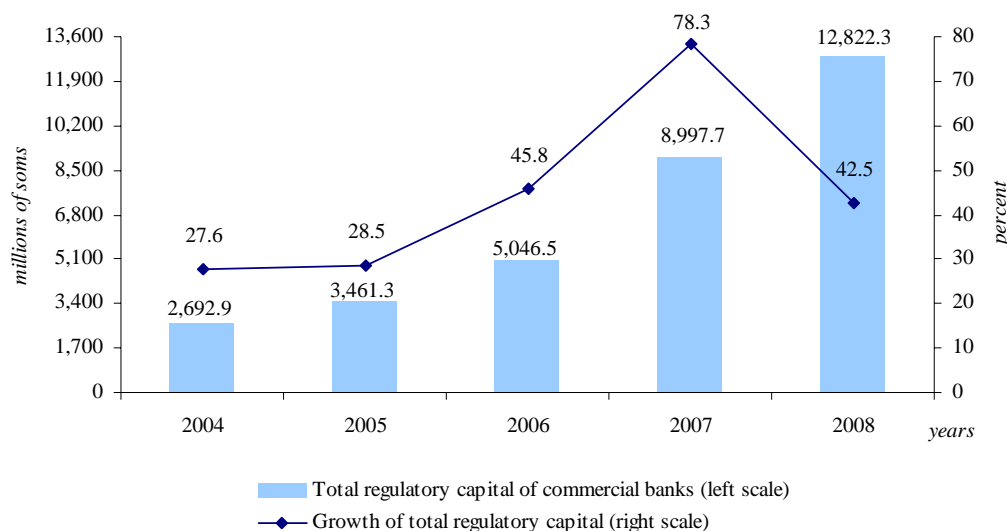
*Slowdown of  
rates of growth*

Total regulatory capital<sup>1</sup> of commercial banks grew by Som 3.8 billion or 42.5 percent amounting to Som 12.8 billion as of the end 2008. In this regard, paid authorized capital<sup>2</sup> increased by 34.6 percent.

*Capital of  
commercial  
banks*

### **Chart 3.1.1.**

Growth of Total Regulatory Capital of Commercial Banks



Total liabilities<sup>3</sup> of commercial banks increased by 27.1 percent in 2008 and made Som 42.1 billion. In this case, the share of liabilities in foreign currency in total liabilities was 67.2 percent (at the end of 2007 – 61.8 percent).

*Liabilities of  
commercial  
banks*

The deposit base of commercial banks continued to increase. At the end of

*Deposit base*

<sup>1</sup> Total regulatory capital of any bank comprises authorized capital, reserves, historical retained earnings (losses), reporting year earnings (losses), and general provisions formed in the bank for the unclassified assets.

<sup>2</sup> This category covers ordinary shares and preference shares.

<sup>3</sup> Total liabilities comprise all of the funds mobilized by the bank.

2008 the volume of deposits of operating commercial banks<sup>1</sup> increased by 21.8 percent and made Som 23.2 billion. The share of legal entities in the structure of deposits increased by 3.0 percentage points and made 70.3 percent of the deposit portfolio of the banking system. The deposits of legal entities increased by Som 3.5 billion or 27.4 percent during the accounting period. The deposits of individuals increased by Som 646.7 million or 10.4 percent during the accounting period. Growth of time deposits both in absolute and relative terms was observed in 2008 in the structure of deposits of individuals.

**Table 3.1.1.**

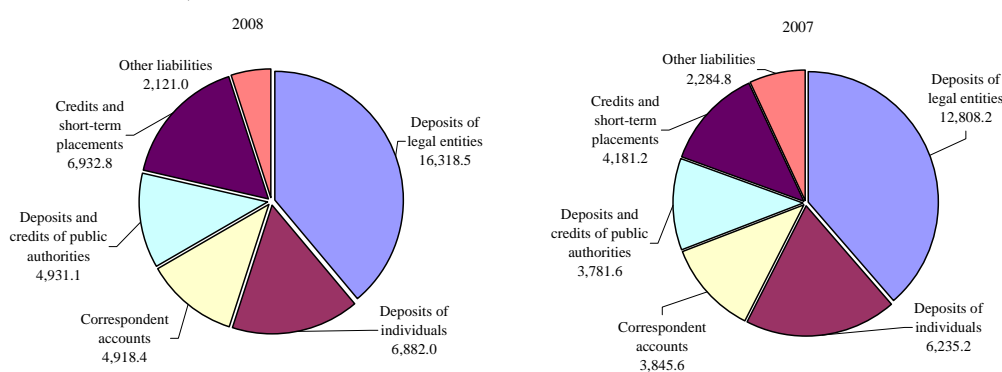
Pattern of Liabilities of Commercial Banks (end of period)

Category of liabilities	2007		2008	
	<i>in millions of soms</i>	share, percent	<i>in millions of soms</i>	share, percent
Demand deposits of legal entities	10,244.8	30.9	13,946.9	33.1
Deposits of individuals	6,235.2	18.8	6,882.0	16.3
Time deposits of legal entities	2,563.4	7.7	2,371.6	5.6
Liabilities to NBKR	13.3	0.0	8.2	0.0
Correspondent accounts	225.9	0.7	39.8	0.1
Deposits of other banks	3,619.7	10.9	4,878.6	11.6
Short-term placements	284.0	0.9	142.6	0.3
Deposits and credits of public authorities	3,781.6	11.4	4,931.1	11.7
Securities issued under REPO agreements	140.8	0.4	170.3	0.4
Received loans	3,756.4	11.3	6,619.9	15.7
Subordinated debt	324.9	1.0	127.5	0.3
Other liabilities	1,946.6	5.9	1,985.3	4.7
<b>Total</b>	<b>33,136.6</b>	<b>100.0</b>	<b>42,103.8</b>	<b>100.0</b>

**Chart 3.1.2.**

Total Liabilities of Commercial Banks (end of period)

(In millions of soms)



In 2008, total assets of banks increased by 30.4 percent and made Som 54.9 billion. In this regard, the assets in foreign currency grew by 34.0 percent, while those in national currency - by 26.5 percent.

Assets

**Table 3.1.2.**

<sup>1</sup> Excluding the government deposits and credits and the deposits of finance and credit institutions.

## Pattern of Assets of Commercial Banks (end of period)

(In percent unless indicated otherwise)

Category of assets	2007		2008	
	in millions of soms	share, percent	in millions of soms	share, percent
Cash	2,088.1	5.0	2,967.2	5.4
Correspondent accounts with the NBKR	4,014.0	9.5	3,835.0	7.0
Correspondent accounts and deposits with other banks	5,069.1	12.0	9,935.1	18.1
Securities portfolio	4,899.0	11.6	5,727.4	10.4
Short-term placements	149.1	0.4	684.2	1.2
Securities purchased on REPO operations	334.2	0.8	257.7	0.5
Loans to finance and credit institutions	1,515.3	3.6	1,770.3	3.2
Lending to clientele	20,797.6	49.4	25,573.6	46.6
Special LLP*	-444.2	-1.1	-759.2	-1.4
Fixed assets	2,250.1	5.3	3,427.6	6.2
Other assets	1,462.2	3.5	1,507.2	2.7
<b>Total</b>	<b>42,134.5</b>	<b>100.0</b>	<b>54,926.1</b>	<b>100.0</b>

\* Special LLP - loan loss provisions on classified credits (substandard, doubtful, &amp; losses).

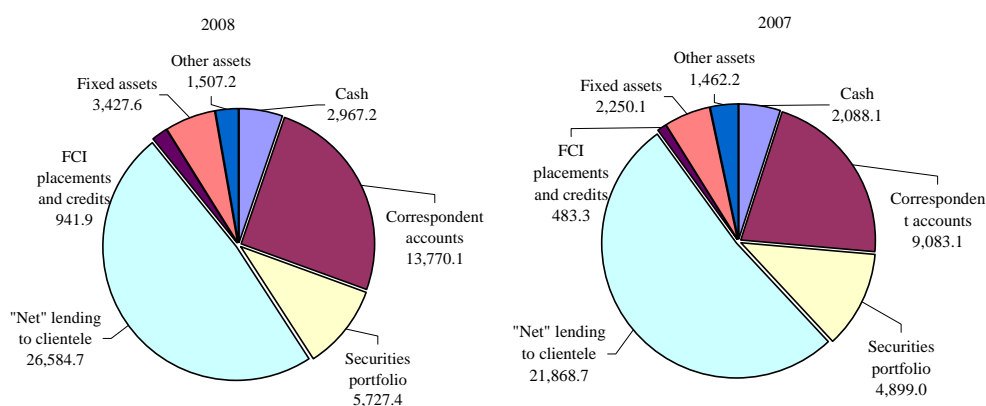
The volume of highly liquid assets placed by the commercial banks as cash assets and short-term placements, on the correspondent accounts with other banks and the NBKR, as well as in the form of deposits, increased in the aggregate by 53.9 percent during the accounting period and as of the end of 2008 this category of assets made Som 17.4 billion. The rates of growth of balances of credits to clients<sup>1</sup> were observed to decrease in the accounting period (23.0 against 84.1 percent, accordingly) in comparison with 2007.

Highly liquid assets

**Chart 3.1.3.**

## Total Assets of Commercial Banks (end of period)

(In millions of soms)



The volume of total net lending<sup>2</sup> increased by 21.6 percent in 2008 and made Som 26.6 billion at the end of 2008. Its share in total assets of banks decreased by 3.5 percentage points and made 48.4 percent in comparison with the end of 2007.

Net lending

<sup>1</sup> Credits to customers are credits and financial lease to customers (this category does not cover credits to finance and credit institutions) net of accrued discount.

<sup>2</sup> Net lending to customers are credits and financial lease to customers and finance and credit institutions net of loan loss provisions, as well as accrued discount.



According to the regulatory reports of banks, the share of unclassified<sup>1</sup> assets was 96.9 percent of assets subject to classification, while the share of classified<sup>2</sup> assets – 3.1 percent. Quality of the loan portfolio of the banking system worsened in 2008 – 5.3 percent was the share of classified credits against 3.5 percent at the end of 2007. Because of the slowdown in lending in 2008 against 2007, the decrease in the share of the loan portfolio in assets and the increase in the volume and share of classified credits in the total of the loan portfolio, the National Bank kept working to estimate the credit risks and to improve the risk management system in the commercial banks.

*Quality of assets and loan portfolio*

**Table 3.1.3.**

**Classification of Assets and Off-Balance Sheet Liabilities**

*(In percent unless indicated otherwise)*

Category	2007	2008
<b>Total unclassified</b>	<b>97.5</b>	<b>96.9</b>
<i>including:</i>		
Standard	41.2	47.2
Satisfactory	53.1	43.9
Under watch	3.2	5.8
<b>Total classified</b>	<b>2.5</b>	<b>3.1</b>
<i>including:</i>		
Substandard	0.9	1.5
Doubtful	0.5	0.5
Losses	1.0	1.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>
<b>Total, in millions of soms</b>	<b>36,455.2</b>	<b>49,800.7</b>

**Table 3.1.4.**

**Classification of Credits to Clients**

*(In percent unless indicated otherwise)*

Category	2007	2008
<b>Total unclassified</b>	<b>96.5</b>	<b>94.7</b>
<i>including:</i>		
Standard	4.4	3.8
Satisfactory	86.5	80.0
Under watch	5.6	10.9
<b>Total classified</b>	<b>3.5</b>	<b>5.3</b>
<i>including:</i>		
Substandard	1.3	2.4
Doubtful	0.8	1.0
Losses	1.5	1.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>
<b>Total, in millions of soms</b>	<b>20,797.6</b>	<b>25,573.6</b>

The resource base of commercial banks (fixed assets) increased, having amounted to Som 3.4 billion (growth by 52.3 percent) at the end of 2008. The level of

*Fixed assets*

<sup>1</sup> The unclassified assets (credits) comprise assets (credits) referred to standard assets, satisfactory assets and assets under watch.

<sup>2</sup> The classified assets (credits) comprise assets (credits) referred to substandard assets, doubtful assets and losses.

capitalization continued to increase, the credit work continued to be improved further, and the new types of banking services were developed in the year of account.

Income and expenses of commercial banks, both interest (76.6 percent and 105.3 percent, accordingly) and non-interest income (by 45.5 percent and 66.8 percent, accordingly), continued to grow in 2008. Having increased by 20.4 percent as compared to 2007, net operational income of banks totaled Som 2.1 billion for 2008.

*Income  
and  
expenses*

**Table 3.1.5.**

**Composition of Income and Expenses**

*(In millions of soms)*

Category	2007	2008
Total interest income	3,853.0	5,605.1
Total interest expenses	1,174.2	1,959.0
Net interest income	2,678.8	3,646.1
Loan loss provisions (on credits)	150.3	378.8
Net interest income after LLP	2,528.4	3,267.3
Total non-interest income	2,968.4	11,280.6
Total non-interest expenses	3,783.8	12,485.5
Net operating income (loss)	1,713.0	2,062.3
Loan loss provisions (on other assets)	-3.7	23.2
Net income (loss) before taxes	1,716.7	2,039.1
Profit tax	166.2	198.4
Net profit (loss)	1,550.5	1,840.7

Totally for 2008 deductions of banks for reserves to cover contingent losses and losses from credit operations made Som 378.8 million and it is 2.5 times more than the value of this parameter in 2007.

The banking system closed the year of 2008 with a net profit of Som 1.8 billion, while the financial result of 2007 was Som 1.6 billion (growth by 18.7 percent).

The status of the banking sector in the year under review remained stable. The world financial crisis influenced the banking system indirectly in the form of the slowdown in its basic parameters compared to 2007. Nevertheless, the basic parameters of the banking system showed the positive growth dynamics. The following changes were observed in commercial banking:

*Banking  
system  
development  
outcome*

- Strengthening of the capital base of commercial banks, as the basis for banking expansion, and the factor promoting financial stability of banks and confidence of creditors and depositors in these banks (growth by 42.5 percent);

- Growth of the volume of deposits attracted from both the enterprises and the population (growth by 21.8 percent);

- Growth of basic commercial banking parameters (the assets increased by 30.4 percent and the liabilities - by 27.1 percent);

- The slowdown of key commercial banking system parameters compared with 2007;

- The slowdown of parameters that characterize the level of financial intermediation of the commercial banking system: the ratio of assets, credits to clients and deposits (including the Government deposits and credits) to annual nominal GDP. At the end of the year under review these ratios were 29.7 percent, 13.8 percent and 15.2 percent, accordingly (at the end of 2007 – 30.1 percent and 14.9 percent and 16.3 percent, accordingly).

- Growth of the volume and the share of classified credits in the total loan portfolio (from Som 0.7 billion or 3.5 percent, accordingly, in 2007 to Som 1.3 billion or 5.3 percent, accordingly, in 2008), i.e., the status of the loan portfolio deteriorated;

- Growth of funds raised in foreign currency and their placement by banks;

- Based on the outcome of 2008, a return on assets (ROA) decreased by 0.5 percentage points and was 3.8 percent, while the return on equity (ROE) decreased by 5.7 percentage points making 20.7 percent.

### **3.2. Overview of Activity of Nonbank Finance and Credit Institutions**

In the financial year, the National Bank continued taking actions on development of the NFCI system, whose primary activity was that of micro-lending.

For the purpose of further implementation of the Medium-Term Microfinance Development Strategy of the Kyrgyz Republic for 2006-2010, the measures were implemented to improve the legal framework of credit unions, and, as part of this work, the Law “On Amendments and Addenda to Selected Acts of the Kyrgyz Republic” was adopted in the part pertaining to activities of credits unions. With this Law, the amendments and addenda were introduced to the following laws: "On Credit Unions", “On Cooperatives” and to the Civil Code. A draft of this law was prepared by a working group that had representatives of the NBKR and associations of credit unions as its members.

*MTMDS  
implementation  
measures*

On February 12 and July 4, the working group on monitoring progress in implementation of the Medium-Term Microfinance Development Strategy of the Kyrgyz Republic for 2006-2010 held its meetings to review performance under an Action Plan on implementation of this Strategy.

During 2008, the NBKR continued working on improvement of the regulatory and supervisory framework to regulate the activity of nonbank finance and credit institutions that resulted in:

*Improvement of  
the regulatory  
and legal  
framework*

- The amendments and addenda were introduced to the Temporary Regulation “On Establishing Microcredit Companies and Microcredit Agencies in the Kyrgyz

Republic”, which provide for setting the minimal qualifying requirements for positions of a manager and a chief accountant, as well as the changes concerning grounds for the withdrawal of certificates;

- The amendments and addenda were introduced to the Regulation “On Precautionary Measures and Sanctions Applied by NBKR to Microfinance Organizations” in order to enhance efficiency in the process of regulation and supervision over the MFO activity;

- The amendments and addenda were introduced to the Regulation “On Licensing Credit Unions” concerning availability of information systems satisfying the minimal requirements set for those credit unions that pretend a right to attract the deposits from the participants in the credit unions;

- The Regulation “On Periodic Regulatory Report of the Credit Union” is developed to improve supervisory functions;

- The amendments and addenda were introduced to the Regulation “On Financial Statements and Disclosure Requirements for Nonbank Institutions Licensed by the National Bank of the Kyrgyz Republic”, according to which the requirements are established for the microfinance companies and credit unions entitled to mobilize the deposits in the part of submission of financial statements.

The amendments and addenda were introduced to the Regulation “On Procedure for Exchange of Foreign Currency in Cash in the Kyrgyz Republic” to apply the requirements for the exchange bureaus on data collection and transfer an authorized public agency and to harmonize the Regulation with the Law “On Anti-Money Laundering and Combating the Financing of Terrorism”.

In 2008, NFCI continued to grow in their number and promoted growth of microfinancial services. As of the end of 2008, the system of nonbank institutions subject to licensing and regulation by the NBKR comprised: specialized finance and credit institution - FCSDCU; 248 credit unions; 291 microfinance organizations (including 2 microfinance companies, 170 microcredit companies and 119 microcredit agencies); 196 pawnshops and 353 exchange bureaus.

*NFCI  
structure*

The increase was observed in 2008 in the total number of NFCI, in the volumes of their assets and the loan portfolio. This speaks for, first of all, the demand for the NFCI services, and for the fact that the legislative framework provides for quite liberal requirements as to their establishing and activities.

**Table 3.2.1.**

Number of NFCI and Exchange Bureaus

Title	2004	2005	2006	2007	2008
FCSDCU	1	1	1	1	1
Microfinance organizations (MFC, MCC & MCA)	104	136	168	233	291
Credit unions	305	320	305	272	248
Lombards	116	140	148	181	196
Exchange bureaus	266	260	263	318	353

The NBKR issued 404 licenses and 96 certificates in 2008 to NFCI, including re-registration at the expiration of the license period of exchange bureaus. For the non-observance of requirements of regulatory and legal acts the NBKR withdrew 31 licenses and 31 certificates, and cancelled 347 licenses and 7 certificates due to expiration of their validity or termination of their activity.

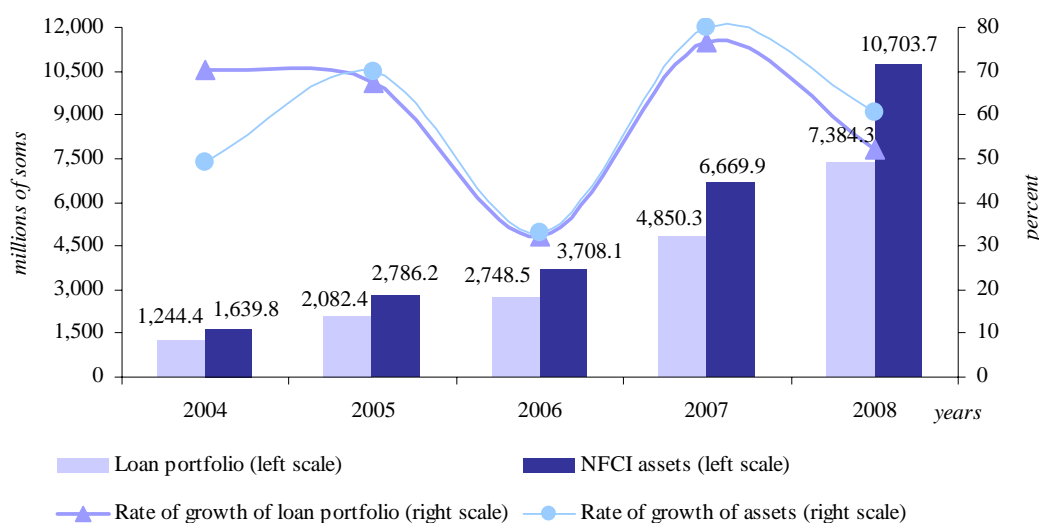
*Licensing*

According to the regulatory reports, the NFCI cumulative assets for the year of account increased by 60.5 percent<sup>1</sup> and as of December 31, 2008, totaled Som 10.7 billion. Microlending is the basic direction of the NFCI activity. The size of the NFCI loan portfolio increased by 52.2 percent and made Som 7.4 billion in the year of account in comparison with 2007, while the number of borrowers increased by 47.4 percent and totaled 255.7 thousand people.

*Assets and credit portfolio*

### **Chart 3.2.1.**

**NFCI Total Assets and Loan Portfolio**



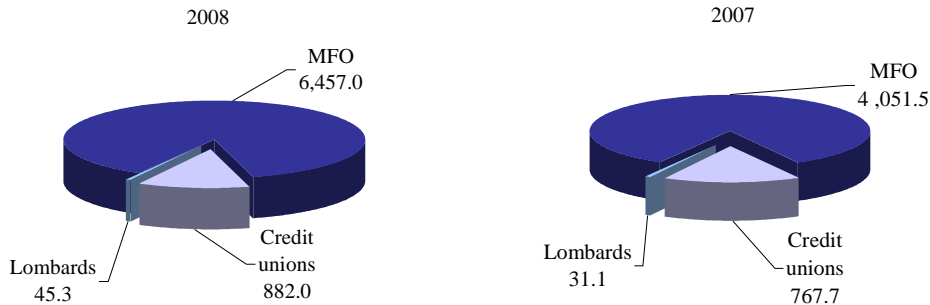
The share of microfinance organizations increased in the NFCI cumulative loan portfolio from 83 to 87 percent, and the share of credit unions decreased from 16 to 12 percent in the accounting period.

*Loan portfolio by NFCI*

<sup>1</sup> The NFCI system data are given excluding the FCSDCU loan portfolio, because the loans were given to the credit unions, which on-lent them further.

**Chart 3.2.2.**

Loan Portfolio by NFCI Types (end of period)  
(In millions of soms)



In the year of account, as in the previous one, the largest volume of the NFCI loan portfolio is placed in the Osh oblast and in Bishkek.

**Table 3.2.2.**

NFCI Loan Portfolio by Oblasts (end of period)  
(In millions of soms)

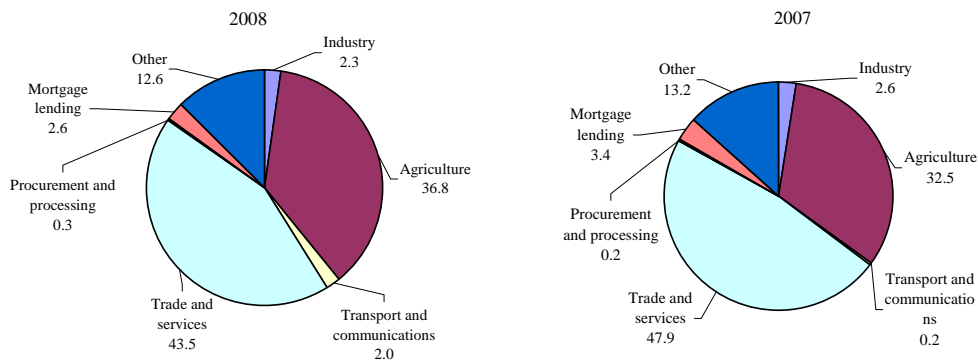
	2007	2008
Bishkek	1,033.1	1,396.7
Batken oblast	281.2	670.6
Jalalabat oblast	635.9	1,101.4
Issyk-Kul oblast	593.5	849.9
Naryn oblast	233.8	406.5
Osh oblast	1,268.0	1,787.6
Talas oblast	376.7	559.7
Chui oblast	428.1	612.0

The share of agriculture increased in the cumulative NFCI loan portfolio from 32.5 to 36.8 percent in comparison with 2007, and growth was also observed in the share of credits for transport and communications - from 0.2 to 2.0 percent, while the share of credits for trade decreased from 47.9 to 43.5 percent.

*NFCI loan portfolio by sectors of economy*

**Chart 3.2.3.**

Loan Portfolio by Sectors of Economy (end of period)  
(in percent)

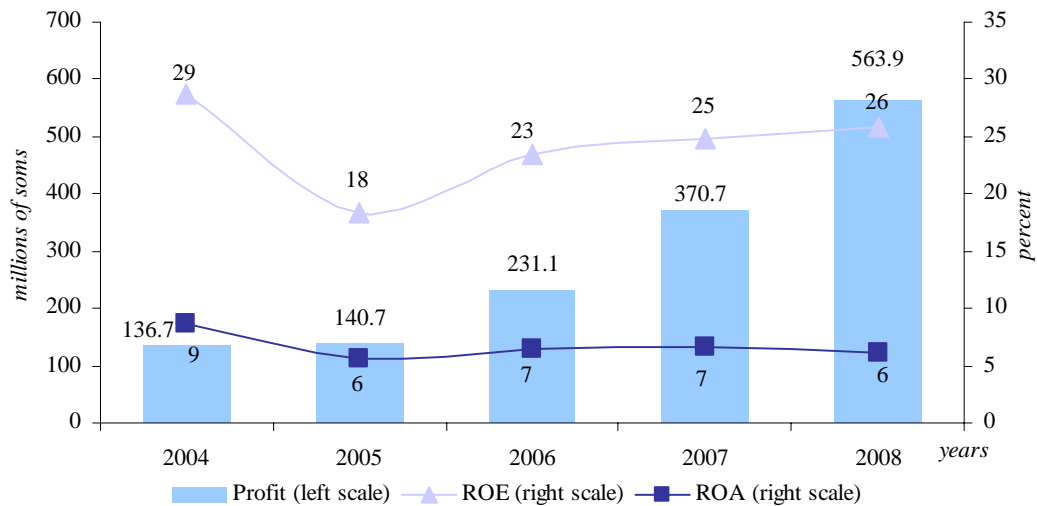


In 2008, the cumulative net profit of NFCI increased by 52.1 percent and amounted to Som 563.9 million, and some growth was observed in the return on equity (ROE), with the reduction in return on assets (ROA).

*NFCI profit*

**Chart 3.2.4.**

NFCI Net Profit and ROA and ROE coefficients



In the accounting period the interest rates of extended credits with regard to all types of NFCI decreased, except for the credit unions.

**Table 3.2.3**

Average Weighted Interest Rates of Credits  
(in percent)

	2004	2005	2006	2007	2008
Microfinance organizations	28.0	33.5	33.5	32.9	32.4
FCSDCU	17.1	16.9	15.1	14.3	13.5
Credit unions	28.7	26.8	25.9	25.8	28.0
Pawnshops	162.1	153.6	149.5	167.9	132.3

The most significant rates of growth of the loan portfolio were observed in the

*MFO*

MFO system in the year of account. For instance, the cumulative MFO loan portfolio increased by 59.4 percent and amounted to Som 6.5 billion at the end of 2008.

The number of MFO borrowers increased by 56.0 percent and totaled 222.3 thousand people in the year under review. In terms of repayment, the MFO loan portfolio consists of basically mid- and short-term credits with the term to maturity of 3 years.

The analysis of the MFO loan portfolio showed that trade remains the basic branch of lending – its share was 45.2 percent (at the end of 2007 – 50.8 percent) of the cumulative loan portfolio, that of agriculture – 35.2 percent (as of December 31, 2007 – 29.2 percent). The main sources of growth of the MFO loan portfolio were those attracted funds from the international financial institutions, and widening of MFO capital.

The cumulative loan portfolio of credit unions increased by 14.9 percent in 2008 and at the end of the year amounted to Som 882.0 million. In the composition of the loan portfolio of credit unions, the basic share of credits fell on agriculture – 50.6 percent and trade – 33.4 percent (in 2007 – 50.8 and 33.5 percent, accordingly). The number of borrowers of credit unions decreased in 2008 to 9.1 percent and totaled 18.8 thousand people as of December 31, 2008. The reduction in the number of borrowers of credit unions is due to the reduction in the number of credit unions resulting from, first, the withdrawal of licenses of some of the credit unions for a violation of the legislation and the NBKR's regulatory requirements, and as a result of self-liquidation of some of the credit unions, and, secondly, on completion in 2006 of the project of the Asian Development Bank on development of credit unions in Kyrgyzstan titled "Rural Financial Institutions", which was launched in 1997. On completion of this project, the credit unions felt a need for other sources of financing. The upward tendency is observed in foreign loans from other FCI, as well as in the deposits attracted from the participants. For instance, for 2008, the liabilities to other FCI doubled and totaled Som 120.6 million, and the volume of deposits attracted from the participants in the credit unions increased 3.3 times and amounted to Som 18.2 million.

*Credit unions*

During 2008, the NBKR issued additional licenses to four credit unions to attract the deposits from the participants. The total number of credit unions with the deposit licenses reached ten units as of December 31, 2008.

The loan portfolio of pawnshops totaled Som 45.3 million at the end of 2008, with the basic share falling on the consumer credits.

*Pawnshops*

In 2008, the NBKR inspected 362 exchange bureaus as part of its work on licensing private entrepreneurs and legal entities conducting swap operations, including the work on re-registration upon the expiration of the license period. Furthermore, the NBKR, both independently and jointly with the Financial Police Service at the Government, the State Tax Committee and the Public Prosecutor offices conducted fourteen thorough inspections (spot-checks) of exchange bureaus in Bishkek, regional centers and a resort zone of the Issyk-Kul lake with the view of

*Inspection of  
exchange  
bureaus*



revealing unlicensed activities and violations of rules of exchange of foreign currency in cash. Based on inspection results, the NBKR considered 87 cases on administrative offences in the sphere of exchange of foreign currency in cash and imposed administrative penalties totaling Som 129.5 thousand, of which Som 122.0 thousand is paid, and the cases on unpaid penalties are directed to Court.

### 3.3. Supervision and Regulation of Commercial Banks

#### 3.3.1. Licensing

During the reporting period, the banking system of the Kyrgyz Republic still exhibited the upward tendency in authorized capital, though the rates of growth, in comparison with 2007, slightly decreased. Paid authorized capital of commercial banks totaled Som 7.8 billion by the end of 2008, having thus increased by 25.7 percent in comparison with 2007, with the increase in authorized capital of banks being 61.3 percent. The increase in authorized capital for the accounting year was due to the retained profit earned in 2007, as well as due to the inflow of new investments. As of the end of 2008, the share of foreign capital in authorized capital of the banking system made 58.1 percent. With the view of strengthening stability, safety and reliability of the banking system, and confidence of a society in banking institutions in view of rates of growth of assets of the banking system, a Resolution “On Minimum Authorized Capital for Newly Opened Banks” was issued, according to which the minimal size of authorized capital for the newly opened commercial banks (including the capital requirement for branches of nonresident banks) is set at no less than Som 600 million.

*Authorized capital of banks*

Two banks were reorganized in the reporting year through a take-over of the OJSC “Kyrgyzpromstroibank” by the OJSC “AsiaUniversalBank”. Furthermore, the National Bank gave its consent to a start-up of the affiliated company and the purchase by the bank of control stock of companies, engaged in financing.

During the year of 2008, the licenses of some of the banks were re-issued due to the change in their titles. In connection with the changes in the structure of shareholders of the CJSC “INEXIMBANK” it was renamed into the CJSC “BTA Bank”. Furthermore, due to the full license to conduct the bank operations and granting the status of the bank to the OJSC “Settlement Savings Company”, it was renamed into the OJSC “RSK Bank”. After the CJSC “JSCB “Insan” underwent rehabilitation, this bank was renamed into the CJSC “Manas Bank”.

*Change of banking licenses*

The work was done in the year under review on rehabilitation of banks, which are currently undergoing bankruptcy proceedings: a prior approval got a request of a special administrator of the JSCB “Adil” for the rehabilitation procedure to be applied to this bank; according to the decision of the Bishkek Inter-District Court, the banking license of the IJSCB “AkyI” was restored, but suspended until an investor completes implementing the action plan of its rehabilitation.

*Rehabilitation of bankrupt banks*

With the view of satisfying fully the needs of countrymen in banking services, a number of restrictions in the bank license of the OJSC “Aiyl Bank” were removed.

*Removal of restrictions on banking licenses*

Due to lifting the restrictions, a list of services the bank renders in the remote regions was expanded, and there emerged an opportunity of remittances and involvement of the bank in the state payment system development program, and of issuance of credit and payment cards.

***Table 3.3.1.1.*****Multi-Branch and Savings Banking Development**

	Number of branches		Number of savings offices	
	2007	2008	2007	2008
Bishkek	38	49	136	167
Batken oblast	13	13	20	28
Jalalabat oblast	37	39	54	63
Issyk-Kul oblast	32	36	19	22
Naryn oblast	17	17	4	3
Osh oblast	36	38	68	93
Talas oblast	9	9	2	3
Chui oblast	33	32	34	39
<b>Total:</b>	<b>215</b>	<b>233</b>	<b>337</b>	<b>418</b>

During the whole accounting period growth was observed in the number of branches and savings offices of banks thereby expanding access of the population in the regions of the country to banking services. For instance, in 2008 the commercial banks opened 81 savings-banks and 18 branches, including 8 branches in the remote areas of the republic.

*Branches and savings offices*

**3.3.2. Off-Site Supervision**

The National Bank exercises off-site (remote) supervision over the activity of commercial banks by monitoring, analyzing reports and auditing findings, with all these providing for the early prevention of contingent problems in their activities and allows maintaining stability of the banking system.

*Off-site supervision*

Off-site supervision over activity of commercial banks was based on the appraisal of risks inherent in banking. The below given valuation of basic risks is based on the adjusted annual regulatory reports of operating commercial banks for 2007 and preliminary reports for 2008.

Solvency of commercial banks is characterized by the level of total capital adequacy to cover contingent losses.

*Solvency*

In 2008, the net risk assets<sup>1</sup> increased by Som 8.1 billion, and net total capital<sup>2</sup> was augmented by Som 3.0 billion. The share of risk assets in total assets of the banking system as of the end of 2008 made 66.7 percent (67.8 percent – at the end of 2007).

<sup>1</sup> The credit risk weighted assets and the off-balance sheet liabilities of commercial banks.

<sup>2</sup> The estimate that covers shareholder capital of the bank, financial performance in the reporting and previous years, built-up reserves less investments in subsidiaries and capital of other finance and credit institutions. It is used for calculation of prudential norms established by the NBKR.

**Table 3.3.2.1.**

## Total Capital Adequacy of Commercial Banking System (end of period)

	2007	2008
Net total capital, <i>in millions of soms</i>	8,898.1	11,926.9
net risk assets, <i>in millions of soms</i>	28,566.5	36,621.6
Total capital adequacy ratio, <i>percent</i>	31.1	32.6
Total capital adequacy requirement (not less), <i>percent</i>	12.0	12.0

Expansion of authorized capital, as well as funds listed as additional capital in commercial banks, led to growth of total capital of the banking system, with outstripping growth registered in net total capital as compared to growth of net risk assets (34.0 percent and 28.2 percent, accordingly). It had its impact on the increase in the total capital adequacy ratio and testifies to improvement of financial stability of banks as to their resistance to external shocks. In 2008, growth of capital resulted from growth of reserves and retained profit of banks, and the inflow of new foreign investments.

*Expansion of capital*

*The credit risk* is estimated based on the classification of assets and off-balance sheet liabilities<sup>1</sup>. The credit risk, calculated as the ratio of loan loss provisions to total assets bearing the risk of credit losses, increased and made 2.9 percent at the end of 2008 as compared to the end of 2007. By end-2008, the overdue assets totaled Som 974.3 million or made 2.0 percent of all of the assets bearing the risk of credit losses. At the end of 2008 this parameter was 1.3 percent or Som 491.3 million.

*Credit risk*

*The exchange risk* is considered from the point of view of contingent losses of the bank due to changes in values of its assets and liabilities in foreign currency when exchange rate changes. This risk is assessed as the ratio of assets and liabilities in foreign currency, as well as their shares in total assets or liabilities of commercial banks. The assets of the banking system in foreign currency were Som 29.2 billion or 53.1 percent of total assets by end-2008. The liabilities of commercial banks in foreign currency were Som 28.3 billion or 67.2 percent of total liabilities. At the same time, the open foreign currency position of the banking system at the end of 2008 was short totaling Som 388.5 million or being 3.3 percent of net total capital of the banking system. At the end of 2007, the aggregate foreign currency position of the banking system was long totaling Som 314.2 million or being 3.5 percent of net total capital of the banking system.

*Exchange risk***Table 3.3.2.2.**

## Assets and Liabilities of Commercial Banks in Foreign Currency (end of period)

*(In millions of soms)*

<sup>1</sup> The data are given in section 3.1. "Banking System Overview", table 3.1.3. "Classification of Assets and Off-Balance Sheet Liabilities".

	2007	2008
Assets in foreign currency	21,762.3	29,161.0
Liabilities in foreign currency	20,490.6	28,292.4

Note:

At the NBKR's discount rate as of end-2008 – Som 39.4181 for US\$ 1.00

At the NBKR's discount rate as of end-2007 – Som 35.4988 for US\$ 1.00

The liquidity risk is considered from the point of view of coverage of liabilities by assets in each maturity interval that enables to estimate the need for funds in case of a mismatch between the assets and the liabilities in the context of maturity. The 2008 analysis of liquidity risks of commercial banks shows that the negative gap in maturities of assets and liabilities was noted with regard to maturities up to 90 days, however, this being the case, the positive gap by maturities of more than 90 days shows that the banks have long-term sources of coverage of their liabilities.

Liquidity risk

**Table 3.3.2.3.**

**Assets and Liabilities by Maturities**

(In millions of soms)

2007*	Terms in days					Total
	0-30	31-90	91-180	181-365	more than 365	
Financial assets	16,408.5	1,319.5	2,547.4	5,249.1	16,349.5	<b>41,874.0</b>
Financial liabilities	17,728.8	3,078.8	2,239.0	5,122.0	4,939.9	<b>33,108.5</b>
Amount of excess of financial assets over financial liabilities	-1,320.3	-1,759.4	308.4	127.2	11,409.6	<b>8,765.5</b>
In percent, total to financial assets	-3.2%	-4.2%	0.7%	0.3%	27.2%	<b>20.9%</b>

\* - data as of December 31, 2007, inclusive

2008**	Terms in days					Total
	0-30	31-90	91-180	181-365	more than 365	
Financial assets	21,786.0	2,883.1	3,769.1	5,669.5	21,684.0	<b>55,791.6</b>
Financial liabilities	23,993.5	3,418.0	3,726.8	4,426.8	6,538.8	<b>42,103.8</b>
Amount of excess of financial assets over financial liabilities	-2,207.5	-534.9	42.3	1,242.7	15,145.2	<b>13,687.8</b>
In percent, total to financial assets	-4.0%	-1.0%	0.1%	2.2%	27.1%	<b>24.5%</b>

\*\* - data as of December 31, 2008, inclusive

The analysis of basic risks indicates the fact of them being at the acceptable level. At the same time, it should be noted that there are potential hazards connected with the resources attracted by commercial banks from other countries and in the external financial markets. Therefore, in case of continuation and strengthening of the world financial crisis and deepening of any crisis phenomena in the economy of these countries or in the external financial markets, the risks of the outflow of attracted financial assets and the loss of liquidity of commercial banks would become stronger. The National Bank regularly traces the development trends in the banking sector of Kyrgyzstan and other countries, as well as in the external financial markets in order to undertake the necessary actions on minimization of negative developments of the world financial crisis and to take, in addition, the relevant anti-crisis measures,

involving inter alia the commercial banks.

### **3.3.3. Inspection**

Activities of all of the commercial banks were thoroughly inspected as part of regulation and supervision over the activity of commercial banks aimed at assessing their financial position and the observance of requirements of the banking legislation in 2008. In addition, during the year of account, target inspections of commercial banks were conducted in some of the commercial banks as to the issue of the observance of requirements of the National Bank, including the issues of AML/CFT, asset quality ratings, and the cash-based operations.

*Inspection*

The findings of these inspections in the year under review showed that, overall, the banks have the adequate management systems and demonstrate quite an adequate level of risk management.

The banks were inspected according to requirements of the banking legislation of the Kyrgyz Republic, which assume the detailed analysis of existing risks (credit, operational, currency, liquidity, and market risks, etc.) in the commercial banks and finance and credit institutions. When conducting field inspections, special attention was paid to the issues of assessing the bank management process, as well as to essentiality of risks by activity categories and operations.

Inspections were on going within the whole year of account on the issues of both anti-money laundering and combating the financing of terrorism.

### **3.3.4. Precautionary Measures of Influence**

The decisions on the precautionary measures and sanctions vis-à-vis commercial banks and finance and credit institutions, licensed by the NBKR, are directly taken by both the NBKR's Banking Supervision Department and the NBKR's Supervision Committee. 41 notes of warning and 2 instructions were delivered to the commercial banks in 2008. The issues of operations of 9 commercial banks were considered at 17 meetings of the NBKR's Supervision Committee and 2 commercial banks were imposed fines as a result of these meetings.

*Precautionary measures of influence*

### **3.3.5 Development of Regulatory Framework for Bank Regulation and Supervision**

In 2008, the National Bank continued working on improvement of the regulatory framework in the area of banking supervision and regulation, aimed at enhancing efficiency in the banking supervision system and development of the banking system of the Kyrgyz Republic, implementation of basic banking supervision principles of the Basel Committee on Banking Supervision, and harmonization of prudential norms with the banking legislation. In this connection special accent was put on the issues of forming the adequate risk management system, increasing transparency of the banking system, developing corporate governance in the banks, and preventing the operations on money laundering.

*Basic guidelines of regulatory framework*

The amendments and addenda were approved for the Regulation “On Prudential Norms and Requirements, Mandatory for Commercial Banks and Finance and Credit Institutions Licensed by the National Bank of the Kyrgyz Republic”. These amendments and addenda establish the requirements of the preliminary approval by the National Bank of investments of commercial banks in capital of any nonbank organization at the rate of 10 percent and more of net total capital and the procedure of calculating the maximal size of investments into bank premises, established by the Law “On Banks and Banking in the Kyrgyz Republic”.

*Prudential norms and requirements*

To improve the regulatory framework in the area of licensing the activity of banks, the amendments and addenda were introduced to the Regulation “On Licensing the Activity of Banks”, providing some clarifications on the issues of purchasing significant holdings of shares, approving candidacies of officials, and establishing independent structural units. Furthermore, the list of international rating agencies, whose ratings are taken into account when considering the issues of signing on the market, was expanded.

*Licensing of activities of banks*

The Regulation “On Corporate Governance in Commercial Banks of the Kyrgyz Republic” was approved for quality improvement of corporate governance in the banks and realization of corporate governance principles developed by the Basel Committee on Banking Supervision. The Regulation specifies basic components of effective corporate governance including:

*Corporate governance*

- Distribution of authority, terms of reference, accountability and responsibility between the bank management units;
- Definition of professional ethics standards;
- Prevention of conflicts of interests;
- Maintenance of transparency in bank management.

For the purpose of harmonizing with the banking legislation, approved were the new versions of the Regulations “On Direct Banking Supervision” and “On Provisional Bank Management Guidelines”, which give the grounds for these measures of influence, as well as the procedure for appointment, terms of reference, and duties of NBKR’s authorized staff, commencement and termination of direct banking supervision and provisional administration. Due to the need for bringing the Regulation “On Enforcement Measures Applied to Banks and Other Finance and Credit Institutions” in conformity with the legislation of the Kyrgyz Republic, the amendments and addenda were introduced to this document. The amendments and addenda on imposition of penalties on official and affiliated people of the bank, the decision-making procedure with regard to recovery of penalties in cash from the bank, as well as the penalty imposition for the non-observance of reserve requirements.

*Enforcement Measures*

As part of the action plan aimed at implementing the FATF 40+9

recommendations approved by the President of the Kyrgyz Republic and according to the Law “On Anti-Money Laundering and Combating the Financing of Terrorism”, the National Bank approved the amendments and addenda to the Regulation “On Minimal Internal Control Implementation Requirements for Commercial Banks and Other Finance and Credit Institutions Licensed by NBKR, Aimed at Combating Financing of Terrorism and Anti-Money Laundering”, the Interim Instruction “On Work with Deposits”, and the Regulation “On Procedure for Exchange of Foreign Currency in Cash”. The requirements are set in these regulatory and legal acts for the banks on strengthening control over the clients classified as the clients, exposed to higher risks, identifying the risks relating to introduction of new banking products, establishing in the contracts on correspondent relations the duties and powers with regard to the measures applied for the AML/CFT objectives. Furthermore, the new requirements to fix and transfer information on exchange of foreign currency in cash, including information on the clients, are established for the exchange bureaus of authorized banks, to the authorized public agency.

*Anti-money  
laundering and  
combating the  
financing of  
terrorism*

In 2008 the National Bank adopted the amendments and addenda to the Regulation “On Periodic Regulatory Bank Report” because of the amendments introduced to the Chart of Accounts of commercial banks and other FCI in the Kyrgyz Republic and to the Regulation “On Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic”. The amendments and addenda were also introduced to the Regulation “On Periodic Regulatory Bank Report” to describe the risk and provide for automation of commercial bank data collection, processing and the analysis by oblasts of the Kyrgyz Republic. During the accounting period, the amendments and addenda were made to the Guidelines on Filling the Periodic Regulatory Bank Report in view of the approved amendments and addenda of this report.

*Periodic  
regulatory  
bank  
reporting*

According to the terms of the second tranche under the Banking Sector and Capital Market Development Program of ADB, in view of the ADB technical adviser’s recommendation on the size of the country risk reserve, as well as the recommendations of the Basel Committee for Banking Supervision, the amendments and addenda were approved for the Regulation “On Minimal Requirements of Country Risk Management in Commercial Banks and Other Finance and Credit Institutions Licensed by the National Bank of the Kyrgyz Republic”.

*Risk  
management*

The Regulation “On Calculations of Effective Interest Rate when Disseminating Information on Banking Services Fee Rate” was approved with the view of specifying the procedure for calculations of interest rates of credits and deposits on the exact, annual, effective, comparable basis when disseminating information on the rate of the fee for banking services

*Effective  
interest rate*

As part of the Action Plan on Implementation of Recommendations of the IMF and WB Joint Mission on Improvement of Observance of Basic Basel Principles of Banking Supervision, the amendments were approved to the Regulation “On Minimal External Audit Requirements for Banks and Other Finance and Credit Institutions Licensed by the National Bank of the Kyrgyz Republic”.

*External audit  
of banks*

The joint Resolution of the Governmental and the NBKR approves the Decision-Making Procedure for Implementation of Systemic Bank Rehabilitation Measures”. This document was developed according to the Law “On Preservation, Liquidation and Bankruptcy of Banks” and with the view of reacting effectively and timely and of decision-making on implementation of measures for rehabilitation of the systemic bank.

*Systemic bank  
rehabilitation  
measures*

Under the Memorandum of Understanding between the Kyrgyz Republic, the Islamic Development Bank, and the OJSC “EcoBank” on introduction of Islamic principles of financing and banking in the Kyrgyz Republic, as well as in pursuance of the Decree of the President of the Kyrgyz Republic “On Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic”, during the year of 2008, the National Bank drafted and got the approval for the draft laws “On Amendments and Addenda to the Law “On the National Bank of the Kyrgyz Republic” and “On Amendments and Addenda to the Law “On Banks and Banking in the Kyrgyz Republic”, and approved the following:

*Islamic  
financing  
principles*

- Addenda to the Resolution of the Board of the National Bank of the Kyrgyz Republic “On the Regulation “On Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic”;

- The Regulation “On Financial Statements Formulation Requirements for OJSC “EcoBank” on Outcome of Operations Conducted under Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic”;

- The amendments and addenda to the Chart of Accounts in the commercial banks and other FCI for the OJSC “EcoBank”.

On May 7, 2008, the President of the Kyrgyz Republic signed the Law “On Protection of Bank Deposits”. Adoption of this law is one of the important and essential stages in the reform of the banking system. Enforcement of this law assumes creation in the country of the deposit insurance system, whose goal is to protect the deposits of the least solvent citizens, strengthen confidence in the banking system, and maintain its stability. With the view of enforcing the Law “On Protection of Bank Deposits”, the National Bank did the following work:

*Deposit  
protection  
system*

- Approval of candidate requirements for positions of Members of the Board of Directors and other positions in the Deposit Protection Agency;

- Approval of the Regulation “On Procedure for Submission of Bank Application for Participation in the Deposit Protection System and Consideration by the National Bank of the Kyrgyz Republic”;

- Approval and delivery to the Deposit Protection Agency for agreement of the “Technique of Defining the Initial Size of the Deposit Protection Fund and the Contribution Rate for Commercial Banks to the Deposit Protection Fund”;

- Development and approval by ministries and departments of the Regulation



“On the Deposit Protection Agency of the Kyrgyz Republic”, which is approved with the Government Resolution;

- Development of the Rules of the Board of Directors of the Deposit Protection Agency of the Kyrgyz Republic, which is approved by the Board of Directors of the Deposit Protection Agency;

- Determination of the DPF target size, which made Som 132.7 million. The government paid the initial contribution Som 35.0 million to the DPF projected in the republican budget for 2008. The commercial banks started to make the quarterly payments to the DPF in the fourth quarter of the year of account and the payments by the banks totaled Som 1.9 million by the end of 2008;

- Approval of the DPS membership procedure;

- Development of amendments and addenda to the Law “On Banks and Banking in the Kyrgyz Republic” and to the Tax Code of the Kyrgyz Republic;

- Development of the Regulation “On the Deposit Protection Fund Contribution Calculations Procedure”, which was approved with the Government Resolution;

- The Memorandum of Cooperation between the NBKR and the Deposit Protection Agency of the Kyrgyz Republic was drafted.

Furthermore, by the end of the accounting period, the National Bank had drafted the bill “On Amendments and Addenda to the Law “On Protection of Bank Deposits”, providing for the essential increase in the amount of compensation for the guaranteed deposits - from Som 20 thousand to Som 100 thousand. According to this bill, the Government made the lump sum payment to the DPF, making 100.0 percent of the amount of the target value of the Fund, including the share of commercial banks. In this regard, prior to repayment of shares of commercial banks paid by the Government to the DPF, the payments of banks will be channeled by the Deposit Protection Agency to the republican budget as repayment of the amount paid by the Government to the DPF.

## CHAPTER 4. PAYMENT SYSTEM

In 2008, the NBKR continued establishing the modern integrated national payment system, which is called to provide for establishment of the base infrastructure essential for development of the modern banking system as part of development of financial intermediation, as well as to enhance efficiency in payment services. Special attention was paid to the issue of expanding the spectrum of retail business. As a result, the use of such a promising tool of non-cash payments, as payment cards became active, the number of banks, which render the services for making the regular payments, increased. To ensure accessibility of banking services to the population, the commercial banks continued to actively develop the infrastructure of retail payments, including the use of an ATM (Automatic Teller Machine) and terminal network.

The important line of activity of the National Bank is to timely satisfy the needs of the economy of the republic for cash. The demand for cash in 2008 developed on impact of consumer market development and persistent growth of small and medium business. The commercial banks distributed their cash assets according to the needs of the financial market. In turn, the NBKR regulated a currency mix and exercised control over meeting the need of the economy for the required denominations of banknotes in national currency.

### 4.1. Payment System Development

#### 4.1.1. Non-Cash Payments

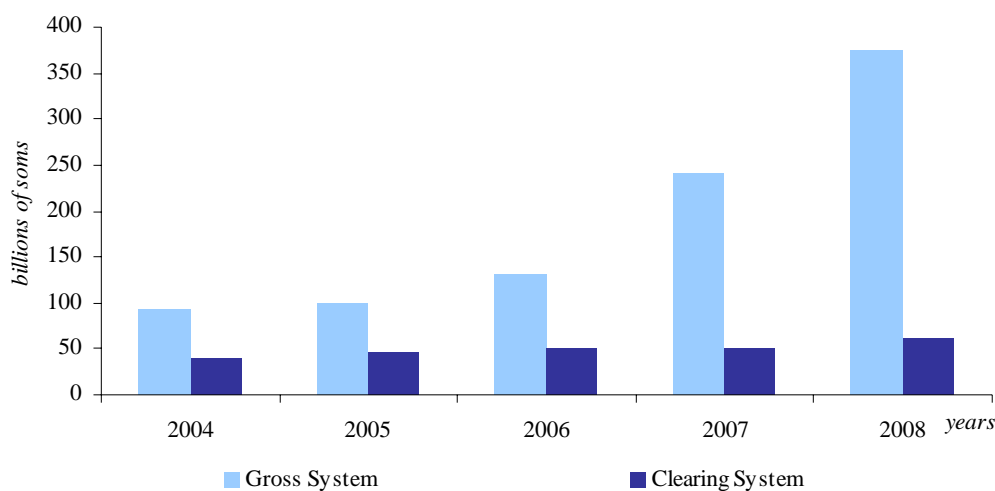
The NBKR, the commercial banks, including their branches, the Central Treasury of the Ministry of Finance, and the Interstate Bank were the participants in the interbank payment systems in the Kyrgyz Republic as of the end of 2008. The interbank payment systems are represented by the gross settlement system, the bulk clearing system (BCS), and the system of settlements with the use bank payment cards.

*Interbank  
payment  
systems*

The positive trends were observed in the payment system in 2008. Overall, 2,591,844 payments totaling Som 463.8 billion were made through the interbank payment systems. The volume of payments increased by 32.8 percent or by Som 142.8 billion as compared to 2007.

#### Chart 4.1.1.1.

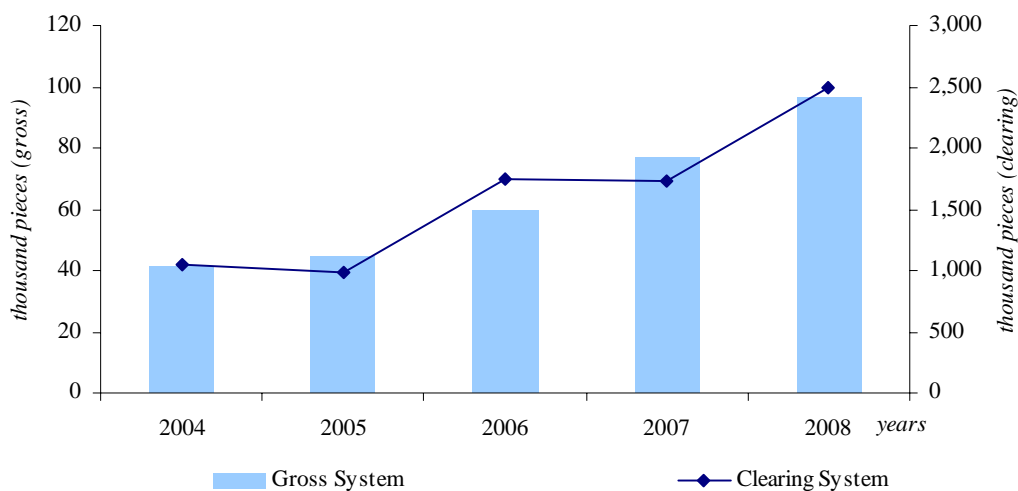
Volume of Payments through Interbank Payment Systems (end of period)



The number of gross payments increased against 2007 by 25.6 percent, and the number of clearing payments - by 44 percent.

**Chart 4.1.1.2.**

Number of Payments through Interbank Payment Systems (end of period)



In 2008, there was still the trend of active use of such tools of non-cash payments, as payment cards. The commercial banks actively developed the programs on expansion of services in the area of issuing and servicing the payment cards of local, international systems, and the national Elkart system.

*Bank payment cards*

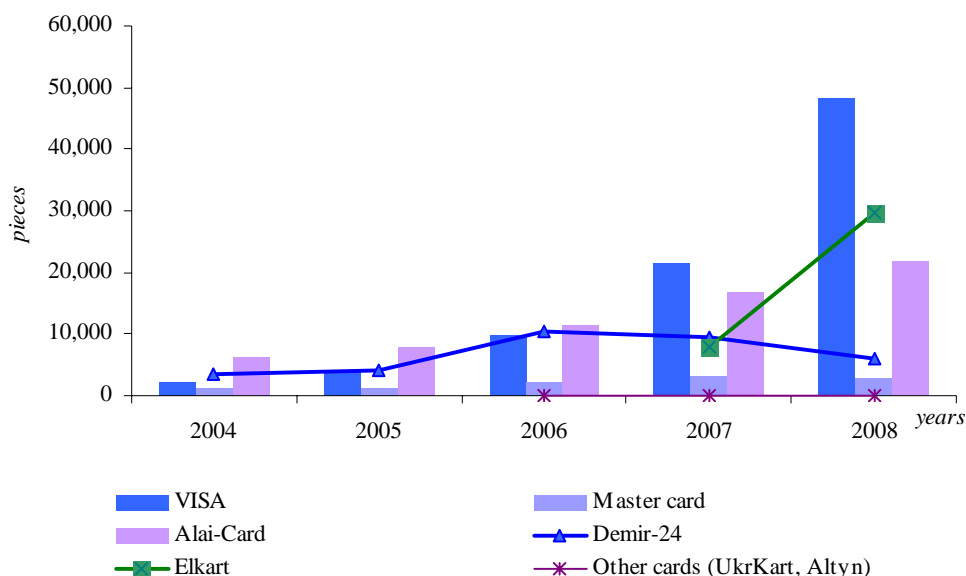
At the end of the reporting year, the services for issuing, acquiring, and the settlement-cash services were rendered to the clients with the use of bank cards by 19 of 21 banks of the republic, of which emitters and acquirers of international payment cards were 11 banks, 3 banks serviced the payment cards through the local systems, and 16 banks - via the integrated national system.

In comparison with 2007, the total number of the emitted cards increased by 42 percent and made 101,383 payment cards. The increase was driven by growth of the number of card holders due to basically attraction of staffs of enterprises and organizations under the salary payment projects that resulted in issues of 72,157 cards, of which 36,927 were the cards of the Elkart national system, which was 4.4 times more than in 2007.

*Emission of cards*

### **Chart 4.1.1.3**

Growth of Number of Bank Payment Cards (end of period)



The total card-based operations made Som 6.8 billion and increased by 38.3 percent compared to 2007. Som 4.4 billion was channeled via the international systems and it is by 40 percent more than the volume of operations conducted for the year of 2007. The volume of operations conducted through the local systems totaled Som 1.8 billion and it is by 17.4 percent more than in 2007. The total operations conducted via the Elkart national system in 2008 was Som 642.8 million.

*Operations with the use of cards*

The increase in the number of emitted cards and of operations with their use testifies to accelerating efforts in the market of bank payment cards.

The operations on the cash withdrawal were the most preferable among card holders. The volume of operations on the cash withdrawal with the use of payment cards amounted to Som 6.6 billion, while the volume of transactions in the trade and service network using the cards made Som 259.2 million.

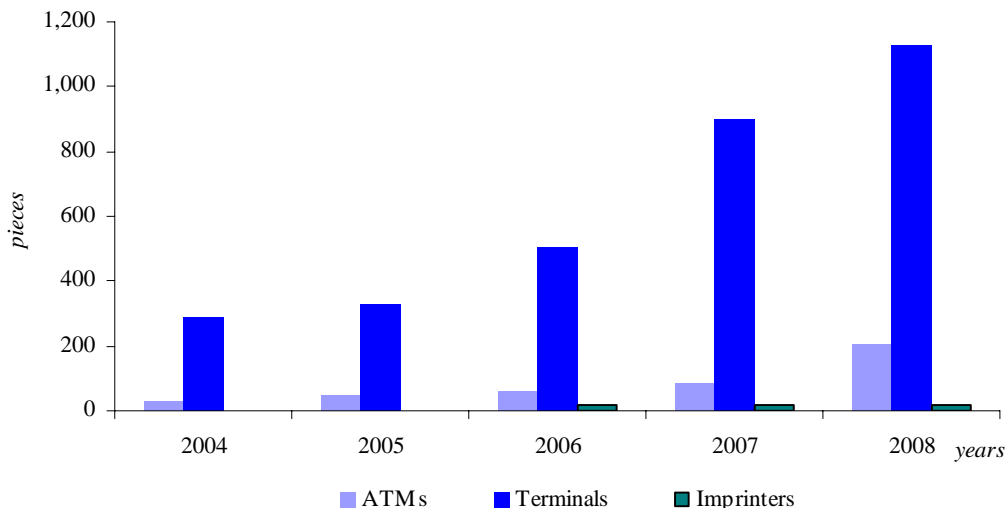
Overall, 1,589,248 card-based operations were conducted in 2008 and it is by 32 percent more than in 2007. Of these operations, 781,138 operations were conducted via the international systems and it is by 43.3 percent more than in 2007. 566,796 operations were conducted through the local systems being by 5.4 percent less than in 2007. 241,234 operations were conducted via the national Elkart system in 2008.

To attract and increase the clientele base, the commercial banks dynamically expanded the network of terminals in public places. The total number of operating terminals and ATMs by systems is as follows:

- The Alai-Card system - 126 terminals (of which 34 terminals provide for receipt of the Gold Crown cards for servicing) and 11 ATMs;
- The Demir 24 system - 131 terminals and 11 ATMs;
- The Elkart system - 281 terminals and 82 ATMs;
- The international systems - 561 terminals, 17 imprinters and 70 ATMs.

Thus, the bank payment cards are accepted for servicing by 174 ATMs, 17 imprinters, and 1,099 terminals installed in the public places throughout the whole territory of the republic.

**Chart 4.1.1.4.**



#### **4.1.2. Implementation of the State Payment System Development Program**

In 2008, the NBKR continued working on actualization of guidelines of the State Program of Measures to Introduce the Non-Cash Payment System and Establish the Infrastructure that Could Ensure Efficient Payment Execution in the Kyrgyz Republic for 2003-2008.

For instance, the actions on development of the bulk clearing system, on introduction of new payment tools of this system, and the salary projects were taken during the year under this program. Software for processing the direct debiting payments was prepared in the Severelectro Energy Company, Bishkekvodokanal Water Supply Company, and the Bishkek Municipal Telephone Station as part of the

second stage of the pilot direct debiting project. In this connection, the Rules were developed for the payments in the form of direct debiting in the BCS.

The work was also done on implementation of the project on establishing the Real-Time Gross Settlement System, which is designed to provide ways of transferring large payment amounts with minimal risks, and to ensure quick ways of transferring cash related to the activity of financial markets. Based on the successful acceptance testing outcome, on June 20, 2008, the system was accepted for commercial operation. A General Agreement “On the Procedure and Rules of Payments in the RTGS System” was signed, as well as contracts on a discharge of mutual obligation between the NBKR and the participants of the system. Upon acceptance of the system, software was tested on interaction between the RTGS and the integrated interbank processing center.

*Real-time  
gross  
settlement  
system*

To establish and develop the intergrated interbank processing center, the work was done in 2008 to integrate the system with the local payment systems and the international payment system “VISA”. The CJSC “Interbank Processing Center” performs the operator functions on monitoring and exercising control over the processing of transactions, calculations of net positions of participants, the transfer of a file of net positions to the BCS, the preparation and transfer of standard reports for the commercial banks.

*Integrated  
interbank  
processing  
center*

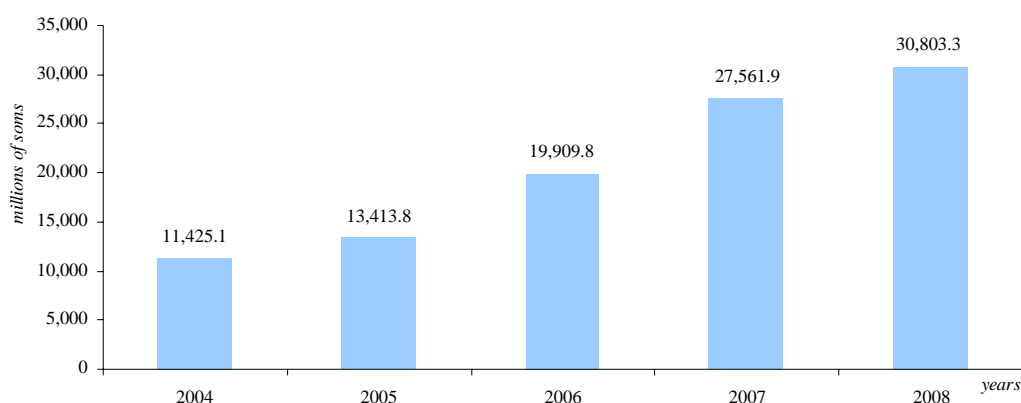
#### 4.2. Cash Turnover

The important direction in the activity of the National Bank is to timely satisfy the needs of the economy of the Republic for cash.

In 2008, the total amount of currency in circulation increased by 11.8 percent and was Som 30.8 billion.

##### Chart 4.2.1.

Developments in Currency in Circulation (end of period)



Growth of money in circulation is connected with the persistent need of the economy for cash and the increase in the state social package payments.

*Money in  
circulation*

Collectibility of cash in the cash departments of commercial banks was 99.7 percent in 2008 (in 2007 – 97.7 percent).

Receipt of cash in the cash departments of commercial banks totaled Som 240.8 billion in 2008, being by 44.3 percent more than in 2007, issuance of cash from the cash departments of commercial banks increased by 41.5 percent and made Som 241.6 billion.

**Table 4.2.1.**

**Movement of Cash via Cash Departments of Commercial Banks**

	Receipt, in millions of soms		Issue, in millions of soms		Collectibility, in percent	
	2007	2008	2007	2008	2007	2008
Total	166,794.3	240,759.4	170,715.6	241,567.2	97.7	99.7
city of Bishkek	116,129.3	158,597.0	108,457.1	149,201.7	107.1	106.3
Batken oblast	1,718.6	2,942.2	4,190.4	6,296.2	41.0	46.7
Jalalabat oblast	10,039.4	16,165.2	15,035.9	22,992.9	66.8	70.3
Issykkul oblast	4,416.0	7,236.9	6,128.2	8,823.6	72.1	82.0
Naryn oblast	1,120.6	2,109.3	2,798.8	3,422.4	40.0	61.6
city of Osh	21,463.9	36,428.3	19,008.6	29,758.4	54.5	122.4
Osh oblast	2,915.2	4,786.3	5,350.8	8,388.9	112.9	57.1
Talas oblast	1,326.8	2,180.7	3,035.5	3,518.0	43.7	62.0
Chui oblast	7,664.5	10,313.5	6,710.3	9,165.1	114.2	112.5

For 2008, the Cash Department of the National Bank received Som 32.2 billion and it is by 48.2 percent more than in 2007 and issued at the same time Som 35.4 billion, which is by 20.6 percent more than in 2007.

*Receipt and issue of cash in NBKR cash office*

Based on the analysis of money denominations, the work was continuously done to maintain optimal stocks of required denominations of banknotes in circulation, and the new banknotes were issued into circulation and unfit currency was withdrawn from circulation for destruction.

*Banknotes by denomination*

Banknotes by denomination were stable as a whole, with the most significant change in their shares noted with regard to the Som 1000 banknote.

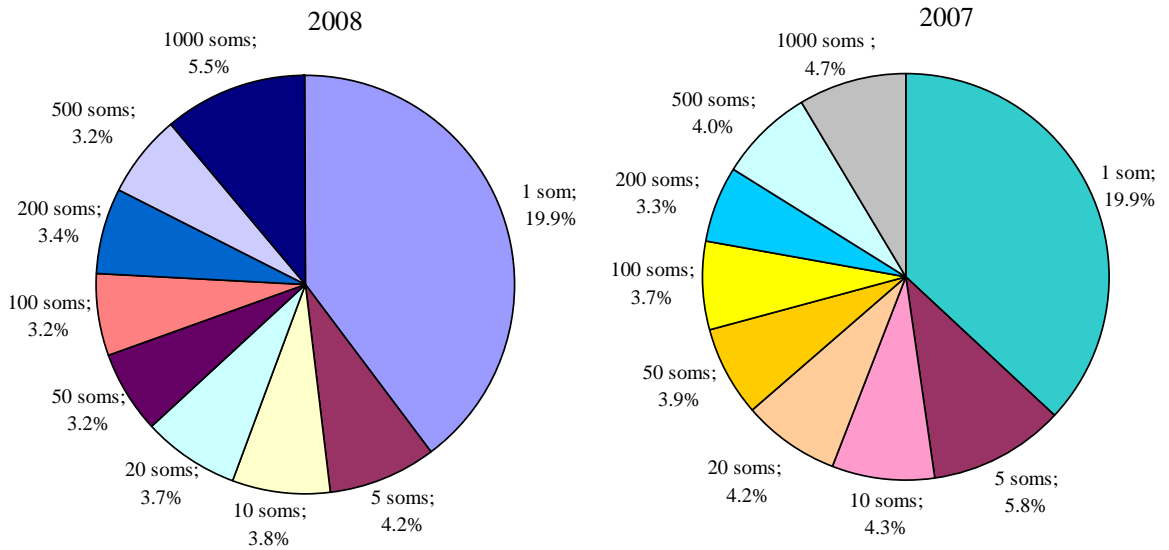
**Table 4.2.2.**

**Denominations of Banknotes in Circulation (end of period)  
(percentage share of the total amount of money in circulation)**

Denomination	below 5 soms	10 soms	20 soms	50 soms	100 soms	200 soms	500 soms	1 000 soms	Total
2007	0.8	0.5	1.0	2.3	4.6	8.2	24.8	57.8	100.0
2008	0.7	0.4	0.9	1.9	3.9	8.0	19.1	65.1	100.0

**Chart 4.2.2.**

**Denominations of Banknotes in Circulation in Sheets (end of period)**



In 2008, the NBKR issued silver collection coins “Burana”, the coins of a series “Kyrgyzstan on the Great Silk Road” and “Bishkek” of the series “Capitals of EurAsEC Countries”, as well as the copper-nickel coins “Burana”, “Tashrabat”, “Uzgen Architectural Complex”, devoted to the Great Silk Road, and uncut sheets of third issue banknotes at face value of Som 20, 50, 100, 500, and 1 000. On January 1, 2008, the circulating coins were issued at face value of 10 and 50 tyins and 1, 3, and 5 som and the collection coin at face value of 1 tyin.

*Issue of numismatic & circulating coins into circulation*

Totally, 113 counterfeit banknotes were revealed in 2008 (in 2007 - 144 banknotes) and in terms of value they made Som 49,480 (0.0002 percent of the total amount of money in circulation).

The National Bank held twenty three seminars for cashiers of finance and credit institutions on training in the banknote authenticity features on the basis of the Training Center of the Union of Banks of Kyrgyzstan.



## CHAPTER 5. FOREIGN ECONOMIC RELATIONS

International activity of the National Bank of the Kyrgyz Republic in 2008 was determined by the need for further strengthening of cooperation with the central (national) banks of non-CIS and CIS countries, and with the international organizations. Cooperation of the National Bank with the central banks developed both on the bilateral and on multilateral basis under the operating integration unions. The NBKR continued working on development of mutual relations with the international financial and nonfinancial institutions.

### 5.1. Cooperation with International Organizations

In 2008, the National Bank of the Kyrgyz Republic continued its cooperation with the International Monetary Fund, Islamic Development Bank and other international organizations under programs of technical support, consultative assistance, information exchange, and improvement of the regulatory and legal framework.

*Cooperation  
with the  
IMF*

Relationships with the IMF were basically directed in 2008 to consultations and attraction of technical assistance (TA) on topical questions of NBKR's activity. In particular, the IMF TA mission visited the Kyrgyz Republic in February 2008 on introduction of Islamic principles of banking and financing to consider the legislative, regulatory, and supervisory issues of accounting and their conformity with the Sheriat under the pilot project on introduction of Islamic principles of financing.

During the IMF TA missions on reforming the payment system, the IMF expert on retail payments consulted the NBKR and the banks on the issues of increasing the clearing settlements based on the current situation under the Banking and Payment System Modernization Project.

In March 2008, the National Bank of the Kyrgyz Republic, in cooperation with the IMF and under financial support of the Swiss Bureau on Cooperation in the Kyrgyz Republic, completed implementing a supervisory component of the AML/CFT project. The following was done during the first phase of the project: the issues of improving a methodology of banking and nonbanking supervision were considered with a view of implementing the recommendations of the Eurasian group on introduction of AML/CFT in Kyrgyzstan and identifying the risks in the course of the payment system's functioning; the recommendations were given as to the need for the analysis of an emergence and use of new technologies of financing the terrorism and money laundering with the view of their prevention. Based on the findings of studies of these issues, the amendments and addenda were introduced to the NBKR's regulatory documents that regulate the AML/CFT issues. The seminars were also organized for the staff of the supervisory block and the meeting was held with the experts on the AML/CFT issues.

Upon successful completion by the Kyrgyz Republic of the next three-year PRGF program (Poverty Reduction and Growth Facility) in May 2008, the National Bank and the Government of the Kyrgyz Republic held a number of meetings with

the IMF missions to determine the further ways of cooperation with this international organization. The result of these negotiations was the statement about the new program of economic cooperation under the ESF program (Exogenous Shock Facility). On December 10, 2008, the Executive Board of the IMF approved the ESF Program for the Kyrgyz Republic. This facility is the new IMF initiative that gives the countries greater flexibility in their reaction to external economic challenges as compared to the PRGF program. Under this program, the Kyrgyz Republic will be given SDR 66.6 million on favorable terms (about US\$ 100 million), of which SDR 16.7 million was already received on December 23, 2008.

In May 2008, under the regional IMF TA project on public debt management in Central Asia and Azerbaijan, the representatives of the National Bank of the Kyrgyz Republic took part in the seminar on the following subject: “Training and Auxiliary Guide on Public Debt Management in Central Asia and Azerbaijan”.

On June 23, 2008, Executive Directors, representing the Swiss group of countries in the World Bank and International Monetary Fund, visited the Kyrgyz Republic. In the context of this visit, the meetings were held with the NBKR management and the top management of the country, during which the parties discussed the current macroeconomic situation in Kyrgyzstan and the issues of further cooperation of Kyrgyzstan with the World Bank and the IMF.

*Cooperation  
with the  
World Bank*

On March 31, 2008, the management of the NBKR met with a delegation of the International Financial Corporation. The issues on the agenda introduced for discussion comprised the strategy of the Corporation in the financial and banking sectors of the republic, the amendments to the Tax Code, a VAT exemption for the leasing operations, in particular, as well as the issue of privatization of the OJSC “Aiyl Bank”.

Cooperation of the NBKR with the Asian Development Bank under the Banking Sector and Capital Market Development Program ended in 2008. According to the report of the regular ADB mission in the Kyrgyz Republic, the NBKR met at the end of the accounting period all of the conditions of the second tranche envisaged in the Reform Matrix under this program.

*Cooperation  
with the Asian  
Development  
Bank*

The National Bank continued its cooperation with the Islamic Development Bank in the accounting period. The meetings were held in May 2008 between the NBKR management and the representatives of the mission of the Islamic Development Bank. A possibility of involving the commercial banks and other finance and credit institutions of the Kyrgyz Republic in the IDB projects on microfinancing and financing of small and medium business were discussed during the negotiations.

*Cooperation  
with the  
Islamic  
Development  
Bank*

As part of TA on introduction of Islamic principles of banking and financing, the NBKR staff took part in the seminars organized by the IDB in the year under review, namely, in the First International Seminar “Islamic Finances – Banking and Insurance”, which was held in June 2008 in the city of Kazan, “Islamic Financing Principles” - in November 2008 in the city of Kuala Lumpur.

On February 27, 2008, the scientific and practical conference “Inflation Issues and Steady Economic Growth” was organized by the National Bank jointly with the Administration of the President of the Kyrgyz Republic. The participants in the conference actively discussed the issues most topical for economies in transition. The objective of this conference was to discuss the problems of inflation and economic growth and work out the relevant recommendations on maintenance of financial stability. The representatives of the donor community, central banks, organizations and departments of the republic, and scientific circles and high schools of the republic, as well as the independent experts took part in the work of the conference.

*Conference  
“Inflation  
Issues and  
Steady  
Economic  
Growth”*

On June 26, 2008, a session was held in the National Bank of the Kyrgyz Republic on the following subject: “Macroeconomic Policy/Mitigation of Inflationary Shocks” as part of the conference “Management of Short-Term Risks and Acceleration of Long-Term Economic Growth”, organized by the World Bank in concert with the Government of the Kyrgyz Republic. The reports, devoted to the issues of growth of the world food prices, were heard during this session. The representatives of international financial institutions, as well as the public institutions and departments of the Kyrgyz Republic took part in the conference.

The NBKR representatives took part in the 4<sup>th</sup> political forum in Krakow (Poland) on the issues of the legislation and regulation of microfinancing and made a presentation on the status and the development problems of nonbank finance and credit institutions in Kyrgyzstan. The forum was organized by the Microfinance Center for Eastern Europe and CIS countries (Poland) with the help of CGAP (the Consultative Group of Assistance to Poor - a consortium of international donors). The Krakow Political Forum held biannually is a platform for the exchange of experience and the discussion of an outlook for microfinancing in the East European and CIS countries in view of the world tendencies in this area. Such subjects, as legal regulation of microfinance institutions, the impact of the world financial crisis, the outlook for the use of payment terminals, and protection of consumers of microfinancial services and other issues were considered at the forum.

*Forum on  
issues of the  
legislation and  
regulation of  
microfinancing*

In 2008, the National Bank continued cooperation under the EurAsEC. The NBKR was actively involved in the work of a Council of Heads of Central (National) Banks of EurAsEC States-Participants. Implementing the decisions of the Council, the work was promoted with the central banks of states-participants in the EurAsEC on the issues of monetary policy, the outlook for the banking sector and banking supervision, interaction between the national payment systems, printing of banknotes, development of the numismatic market, issue of memorable and collection coins, combat with coinage offence, personnel development, and on other issues. Cooperation was developed further with the central banks in the area of staff training, and, in particular, the Program of Professional Training of Personnel of Central (National) Banks of EurAsEC States-Participants was approved for 2009.

*Cooperation  
within the  
EurAsEC  
framework*

In December 2008, the NBKR management took part in the joint session of the Council on Financial and Economic Policy of EurAsEC States-Members and the Council of Heads of Central (National) Banks of EurAsEC States-Participants. The

session was, mainly, devoted to the issue of overcoming the consequences of the world financial crisis. Furthermore, the working group was established to develop the Joint Action Plan on overcoming the consequences of the world financial crisis, with the representatives of the National Bank being its members as well.

The regular 36<sup>th</sup> and 37<sup>th</sup> sessions of the Interstate Bank were held in April and December of the period under review in Moscow. The following questions were considered during these sessions: on the audit of the Interstate Bank financial statements as of December 31<sup>st</sup> of 2007 conducted by the auditor company “PricewaterhouseCoopers”, on approval of the budget for 2008, and on ISB performance for 9 months of the accounting period. They also discussed the results of the inspection of the ISB and its lending status, conducted by the working group in June 2008, with the representative of the NBKR being its member.

*Cooperation  
within the  
ISB  
framework*

The NBKR experts took part in the work of the 14<sup>th</sup> session of the Interstate Monetary Committee which took place on December 4, 2008, in Moscow. The agenda, among the key questions, covered the issue of discussing the draft agreement on information and analytical cooperation between the central banks of the CIS states-participants. Under the Action Program on realization of the Concept of Cooperation and Coordination of Monetary Activity of Commonwealth States-Participants, approved with the Decision of the Council of Heads of CIS Governments of September 15, 2004, the issue was discussed as to assigning the ISB to perform the functions of a specialized institute of the Payment Union to conduct the settlements between the central (national) banks based on multilateral clearing and operations in the foreign exchange markets, to manage information and reference data, and to perform other functions in the interests of the Payment Union. The work was done to consider an opportunity of creating the payment and settlement system on the basis of national currencies of CIS states-participants.

*Cooperation  
within the  
IMC  
framework*

## **5.2. Cooperation with Central (National) Banks**

In 2008, the National Bank of the Kyrgyz Republic continued cooperating with the central (national) banks of some of the states under the technical and consultative assistance programs, as well as on the issues of the exchange of experience and personnel development.

During the year under review, the training visits were arranged for the bank staff in the National Bank of Switzerland on the issues of supervision of the payment system, management of human resources and accounting. Furthermore, in August 2008, the representatives of the National Bank of Switzerland organized the seminar in Bishkek for the Board Members of the National Bank of the Kyrgyz Republic and advised the bank staff on monetary policy. In September the SNB expert visited the NBKR and consulted on the issue of modernization of the interbank market trading posts.

*Cooperation  
with the  
NBS*

The NBKR continued to cooperate with the Deutsche Bundesbank on consultative assistance in the area of a cash turnover and professional training of the NBKR staff. For instance, the seminar was organized in October 2008 for the staff of

*Cooperation  
with the  
Deutsche  
Bundesbank*

the National Bank on the following subject: “Monetary and Financial Stability”. In September 2008, the Deutsche Bundesbank experts consulted on the issues of budgeting and planning, as well as on the issue of monetary operations.

As part of technical cooperation with the National Bank of Poland, training on probation was organized for the staff of the National Bank of the Kyrgyz Republic in the National Bank of Poland at the end of 2008. During these periods of probation the staffs of both banks exchanged their experience on the issues of managing human resources, and accounting. The staff of the NBKR also familiarized itself with the budgetary process in the National Bank of Poland.

*Cooperation  
with the  
National  
Bank of  
Poland*

The NBKR staff took part in the seminar on the payment and settlement systems organized by the European Central Bank in September 2008 for the central banks in the city of Frankfurt am Main. A number of issues were discussed at the seminar covering the risks in the payment systems, the role of central banks in supervision of payment and settlement systems, and schemes of payments with the use of payment cards. Experience and practice of European and American countries in construction of the effective system of interaction between the payment systems and the systems of settlements on the operations conducted in the financial markets were analyzed in the course of collaboration with other central banks. Plans of central banks of EU countries-participants were also studied in the part of a transition to the TARGET-2 system (the new Euro system service for the real time settlements on securities in the Central Bank of Europe). The questions of improving the methodology of supervision of the payment system, developing the statutory acts on regulation of trans-border payments and other questions were studied either.

*Cooperation  
with the  
European  
Central Bank*

The relations with the National Bank of Malaysia developed successfully in the reporting year and resulted in a signing of the Memorandum of Understanding between the National Bank of the Kyrgyz Republic and the National Bank Negara of Malaysia in July 2008. This Memorandum provided for the exchange of experience and consultative assistance in the area of banking supervision, as well as the issue of future training for the NBKR staff.

*Cooperation  
with the  
Negara Bank*

The representatives of the State Development Bank of China were on the familiarization visit in the republic in April 2008. The goal of this visit was to make themselves acquainted with the current macroeconomic situation and the status of the banking and financial sectors of the Kyrgyz Republic. The issues were also discussed as to contingent cooperation between the SBDC and the NBKR.

*Cooperation  
with the  
Bank of  
China*

The delegation of the National Bank of China (NBC - the representatives of the NBC branch in Urumchi) visited the National Bank of the Kyrgyz Republic in May 2008. The circle of questions covered investment policy and the investment legislation of the Kyrgyz Republic, as well as the opportunity of opening the correspondent accounts with the commercial banks of the Kyrgyz Republic, currency regulation and prospects for the use of the Chinese Yuan and the Kyrgyz Som in the transactions between the individuals and the legal entities, as well as the issue of establishing working contacts between the NBKR and the NBC branch in Urumchi.

The representatives of the National Bank of the Kyrgyz Republic took part in the meetings of the Club of Governors of Central Banks organized by the Bank of Albania and the Central Bank of Bosnia and Herzegovina, which performed the functions of the Club Secretariat past year. The participants in these meetings discussed the issues of the status of banking and financial systems of countries under conditions of instability in the world financial markets, as well as the topical question of activities of central banks in the area of monetary policy, the basic banking sector development trends, and development of payment systems.

*Participation  
in the  
meetings of  
the Club of  
CB Governor*

In March 2008 the Bank of France organized an international symposium attended by heads of central banks, and by the financial institutions and the international organizations. This symposium was devoted to such issues, important for activities of central banks, as globalization, inflation, and modern monetary policy aspects. Participation in this symposium was productive from the point of view of the exchange of views and experience, and of establishing the new business contacts, and cooperation.

*Cooperation  
with the  
Bank of  
France*

One of the important aspects of foreign economic relations of the National Bank is that of the relations with the Central Bank of the Russian Federation. In December 2008, the NBKR staff took part in the meeting of the working group on comparison of data on mutual trade in goods and services for 2006-2007. Furthermore, the Central Bank of the Russian Federation is regularly furnished by the National Bank with information on the recent developments in the financial and banking sectors of the Kyrgyz Republic and the status of the balance of payments.

*Cooperation  
with the  
CBRF*

The NBKR staff was on the training visit in the Central Bank of the Russian Federation in May 2008 on the following subject: "Balance of Payments Parameters Not Covered by Statistics and Issues of Real Effective Exchange Rate and Balance of Payments. Various issues - the BOP compilation technique, the problems of assessment of unregistered operations, and the procedure to calculate and analyze the real effective exchange rate – were discussed during the meeting with the staff of the Balance of Payments Department of the Bank of Russia.

Under the Cooperation Agreement in the area of training personnel of central (national) banks of EurAsEC states-participants in 2008, the staff of the National Bank of the Kyrgyz Republic participated in the programs of the exchange of experience and personnel development in the central (national) banks of Russia, Armenia, Belarus, Tajikistan and Kazakhstan.

*Cooperation  
with CBs within  
the EurAsEC  
framework*

The NBKR staff took part in the international banking conference on safety: "Comprehensive Security Enforcement in Credit and Financial Sphere", which was organized by the Central Bank of the Russian Federation in June 2008 in Volgograd.

Through the whole year of 2008, with the view of organizing the exchange of experience, the Inter-Regional Training Center of the Central Bank of the Russian Federation (Tula) conducted the seminars, attended by also the NBKR staff, on various aspects of the activity of central banks.

*Public  
information in  
the regions*

During 2008, cooperation on personnel training continued with the non-CIS central (national) banks, France, Holland, England, Germany, Italy, Japan, Serbia and other countries, in particular, with the NBKR staff taking training on probation and participating various seminars there.

## **CHAPTER 6. GENERAL DATA ON ACTIVITY OF THE NATIONAL BANK OF THE KYRGYZ REPUBLIC**

### **6.1. Structure of the National Bank of the Kyrgyz Republic**

As of December 31, 2008, the NBKR's organizational structure comprised 25 central staff departments, 5 regional departments and the NBKR Representative Office in the Batken oblast.

*NBKR  
organization  
structure*

The committees and commissions operate at the National Bank on the ongoing basis. By the end of 2008, there were 7 committees, 8 commissions and 7 editorial boards in the National Bank, as well as the supervisory board to exercise control over the activity of the Republican Collection Department.

During 2008, the organizational structure of the National Bank underwent the following changes:

a) The Cash Circulation Office of the Cash Emission Division of the Cash Management Department was reorganized into the Central Cash Circulation Division of the Cash Emission Division of the Cash Management Department;

b) The Financial Reporting and Control Division of the Accounting and Reporting Department was reorganized into the Financial Reporting and Methodology Division of the Accounting and Reporting Department;

c) The Group for Uninterrupted Activity of NBKR was established in the Security and Information Security Department;

d) The Cash Operations Group was closed and the Cash Circulation Division was formed in the Osh Regional Department of the NBKR.

To maintain the open, transparent, equal, and fair approach, the system of a competitive selection of staff is applied when employing the new staff. This allows to ensure the selection of the most qualified specialists in view of their professional training, and to provide for the appropriate level of realization of the tasks and functions assigned to the National Bank. Announcements of competitions for vacancies are published on a web-site of the NBKR and in the mass media.

*Competitive  
selection*

63 competitions were held in 2008, of which 60 were open and 3 were the internal competitions, with 9 competitions held in the regional departments. Totally, 471 people participated in the competitions. 54 people were recruited to work at the NBKR based on the results of these competitions.

As part of cooperation with high schools of the country aimed at training the contingent staff, 62 students of higher educational institutions of the Republic practice-worked at the NBKR's departments in the year of account.

As of the end of the reporting year, NBKR's accountable strength of staff amounted to 600 people, including 512 people employed as the central staff and 88

*Authorized  
staff size*



people working at the regional departments and at the Batken Representative Office. Of this number, the female staff made 309 people as central staff members and 46 people – the staff of regional departments and the Batken Representative Office. The number of banking specialists totaled 419 people, of which 379 specialists as central staff and 40 people – in regional departments and the Batken Representative Office. Of this number of specialists, 96.4 percent or 404 people are those with higher education and 4 hold scientific degrees of candidates of sciences.

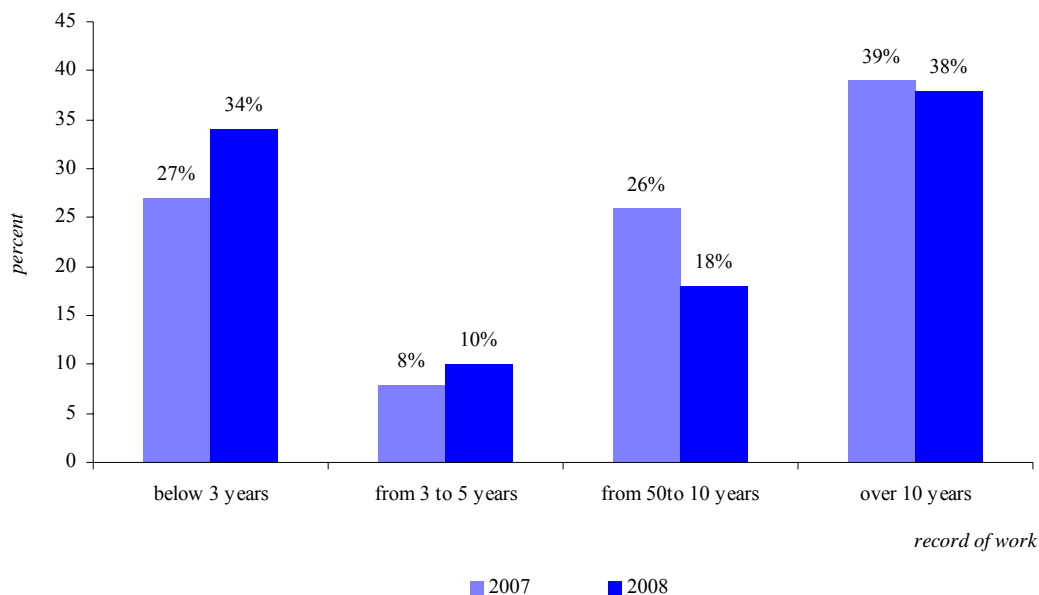
Despite the undertaken organizational measures, in the context of the developing financial system of the Republic and strong competition in the labor market in this sphere, the situation remains strained with regard to the outflow of the qualified staff of the National Bank to the commercial financial agencies. The turnover of staff was 19 percent in 2008 (in 2007 – 17 percent).

Proceeding from this, the National Bank implements the measures for creation of competitive working conditions for its staff, including those for labor remuneration.

The staffing structure by record of work and age are described in charts 6.1.1, and 6.1.2, correspondingly.

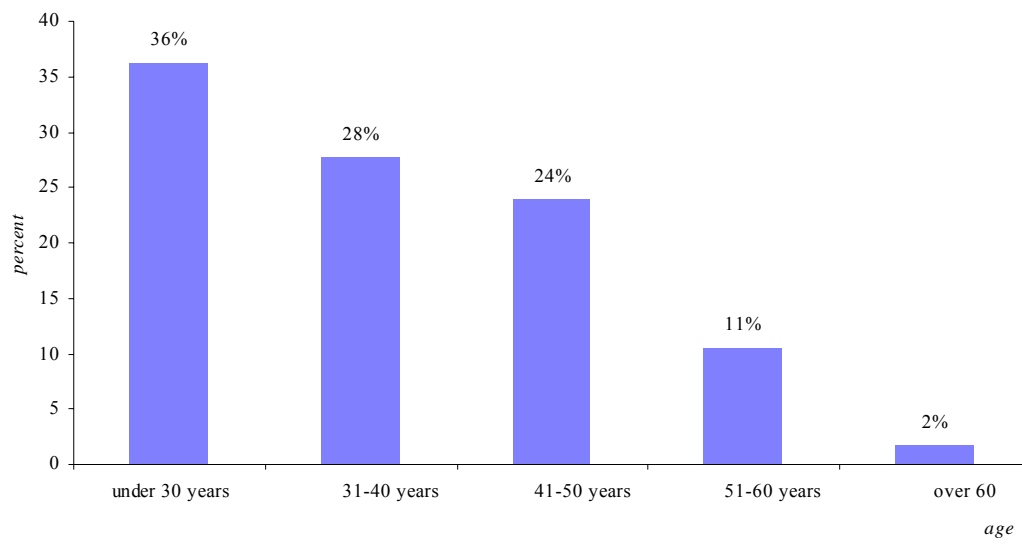
**Chart 6.1.1.**

Staffing Structure by Record of Work

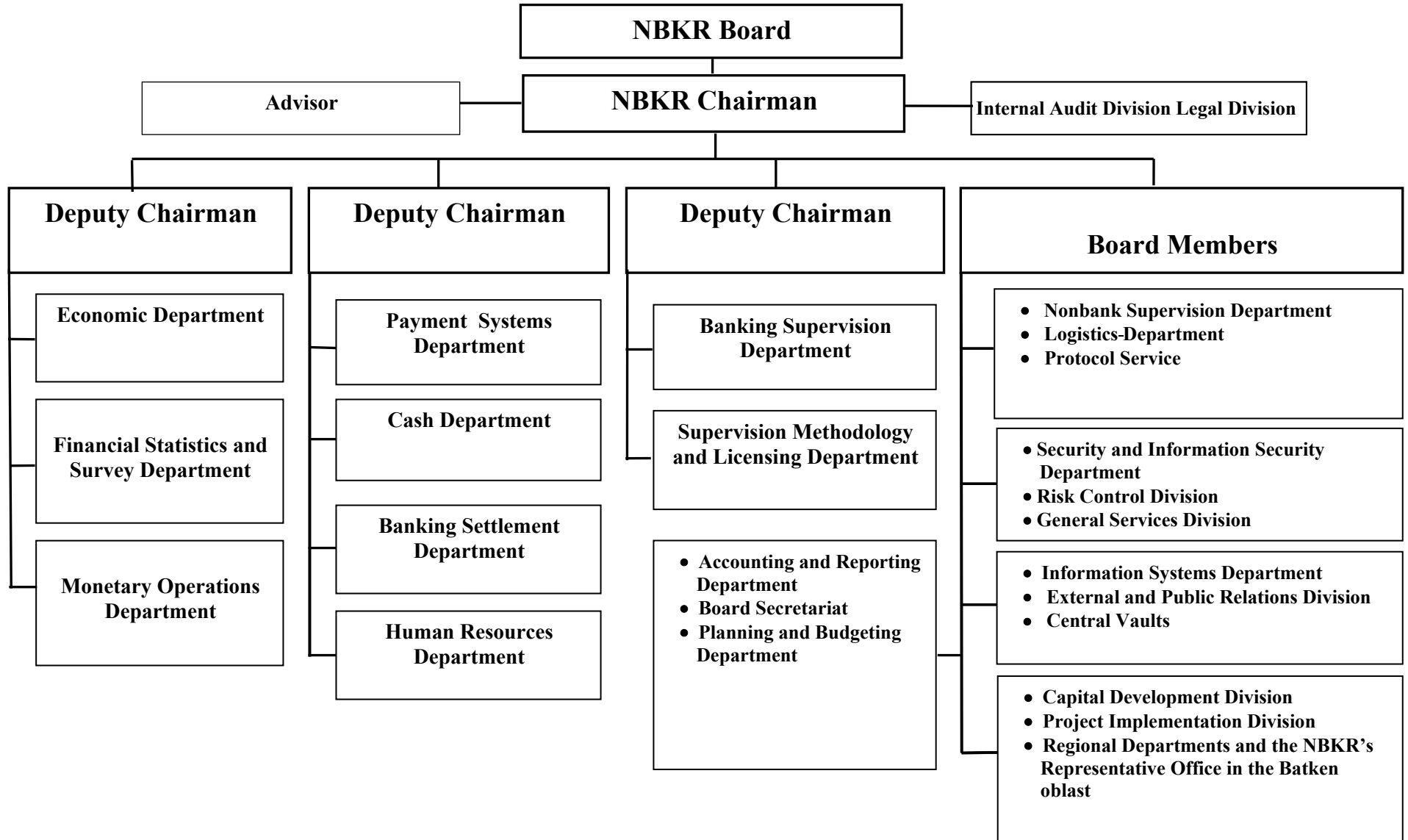


**Chart 6.1.2.**

Staffing Structure by Age



## Organization Chart of the National Bank of the Kyrgyz Republic



## Key Functions of Departments of the National Bank of the Kyrgyz Republic

Board	It is a superior collegial body of management of the National Bank of the Kyrgyz Republic, which determines the guidelines of its activity, including monetary policy, the decision-making on maintenance of stability in the banking and payment systems, and on other issues that come within the terms of reference of the Board as established by law.
Economic Department	Develops proposals on monetary policy and on its implementation; studies the situation in the real, financial, fiscal and external sectors of the economy.
Monetary Operations Department	Makes the assessment and performs the analysis, identifies the trends and factors of developments in the financial markets in order to effectively coordinate the open market operations and conduct the operations on the financial markets.
Financial Statistics and Survey Department	Collects monetary and financial market statistics and processes real sector and public finance statistical data; compiles the balance of payments; and provides expert support on the external debt issues.
Banking Supervision Department	Organizes supervision over banking and finance and credit institutions, licensed and regulated by the NBKR, over the observance of prudential norms and requirements, as well as over the observance of the legislation of the Kyrgyz Republic; and studies the situation in the banking sector.
Supervision Methodology and Licensing Department	Issues the banking licenses, develops and improves the methods of supervision and regulation of the activity of commercial banks and other finance and credit institutions, licensed and regulated by the NBKR.
Nonbanking Supervision Department	Organizes supervision and licensing of the activity of microfinance institutions, credit unions, pawn-shops and exchange bureaus, licensed and regulated by the NBKR.
Cash Department	Satisfies the needs of the economy of the Republic for cash, provides for cash circulation, and promotes implementation of anti-counterfeiting actions.
Central Vaults	Provides for safety of banknotes, coins and values in a vault, transports values between the NBKR departments, processes cash and destructs unfit currency.

Bank Settlement Department	Provides for the uninterrupted functioning of interbank settlement systems.
Information Systems Department	Provides for conformity of the information system with the NBKR's Development Strategy and its needs, and ensures its maintenance.
Payment Systems Department	Develops and implements the actions on maintenance of the effective operation the payment system, its reliability and safety.
Accounting and Reporting Department	Maintains accounting of operations and values and makes the NBKR's financial statements; develops the documents to regulate the bank accounting; and exercises internal control over the accounting transactions.
Human Resources Department	Performs the manpower deployment; organizes staff training and professional development; works out and implements work progress report for the NBKR staff.
Planning and Budgeting Department	Organizes and enforces NBKR's planning and budgeting; ensures control over the use of NBKR's financial resources.
General Services Division	Provides for the effectiveness of the NBKR's system of the flow of documents and records management, including control over execution.
External and Public Relations Division	Informs the public of goals, tasks, functions and results of the NBKR's activity; cooperates with the external organizations and the mass media.
Internal Audit Division	Inspects and estimates the operating internal control system in the NBKR and works out the recommendations on its improvement.
Capital Development Division	Provides for organization of capital construction and reconstruction of the NBKR's buildings and structures.
Risk Control Division	Exercises risk-control over the transactions conducted in the financial markets; and develops the recommendations on their improvement.
Project Implementation Division	Provides for implementation of credit lines as part of cooperation with the international organizations.

Board Secretariat	Provides for organizational support of the work of the Board of the NBKR.
Protocol Service	Provides for organization and implementation of official entertainment, administrative and public relations events.
Security and Information Security Department	Provides for safe functioning of the National Bank of the Kyrgyz Republic; and organizes technical protection of the National Bank.
Logistics Department	Provides for logistics, transportation services; servicing of buildings and structures.
Legal Division	Provides for comprehensive enforcement of the NBKR's activity, development and promulgation of the banking legislation.
Regional Departments and the NBKR's Representative Office	Provide the commercial banks and their branches with cash; undertakes the actions on supervision of the observance of the banking legislation by the banks and finance and credit institutions, whose activity is licensed by the NBKR, as well as performs the functions as established by law.

## 6.2. Activity of the Board of the National Bank of the Kyrgyz Republic in 2008

According to the Law “On the National Bank of the Kyrgyz Republic”, the Board is the superior body of management of the National Bank and approves the guidelines of its activity. The Board is the collegial body. The Board Members are appointed by the President of the Kyrgyz Republic as advised by the NBKR Chairman for the period of seven years. The Chairman of the National Bank, who is elected by the Jogorku Kenesh of the Kyrgyz Republic as advised by the President of the Kyrgyz Republic for the period of seven years, is in charge of the work of the Board.

*General information about activity of the Board of the NBKR*

The Board considers and defines monetary policy, solves the issues of banking supervision and payment system development, approves the regulatory acts and the annual report, establishes the procedure for issuing new samples and denominations of banknotes and the procedure for the withdrawal of banknotes and coins from circulation. According to the Regulation of the Board of the National Bank, the Board also considers other issues within its terms of reference, such as: extension of credits of last resort, issue, recall or suspension of banking licenses, initiation and application of bankruptcy proceedings, and introduction of provisional administration, as well as other issues.

During the reporting period, the Board of the NBKR acted according to the approved annual and quarterly policy plans. In 2008, 51 meetings were held and 469 issues were considered, with 250 resolutions on these issues.

Starting from the beginning of 2008, the National Bank undertook the actions on enhancement of the role of quarterly board meetings on the monetary policy issue. In particular, the content of the document submitted to the Board for discussion and a format of decision-making were amended: in 2008, in addition to consideration of the monetary policy report for the past period, the Board started approving the monetary program for the forthcoming period, which, together with the recommendations on monetary policy serves as the target for the Monetary Regulation Committee in the decision-making on the open market operations. In order to improve coordination of monetary policy measures with fiscal and trade and investment policies, the representatives of the Administration of the President of the Kyrgyz Republic and the heads of the Ministry of Finance and the Ministry of Economic Development and Trade were invited in 2008 to participate in the quarterly board meetings and took active part in the monetary policy document discussions.

*Consideration  
of monetary  
policy issues*

Based on the analysis of the current situation in the monetary sphere and the forecast of development in the real, fiscal and external sectors, as well as in view of the ongoing structural reforms in the country, at the end of 2008, the Board adopted the Monetary Policy Statement for 2009, which sets out the quantitative inflation target.

At the end of 2008, the Board approved the “Basic Monetary Policy Guidelines for 2009-2011” that sets out the NBKR’s medium-term monetary policy goals. When developing this document, the world financial and commodity market trends were taken into account as well as new conditions of implementation of monetary policy at the current transition stage, small scales and the high degree of openness of the economy of the Kyrgyz Republic.

Under the Action Plan on control of inflation, information on the situation in the world commodity and primary and financial markets, as well as in the domestic market was monthly considered at the Board information meetings.

The Board of the National Bank sets out the common objectives and principles of international reserves management, the investment strategy, and approves the regulatory documents. According to the Law “On the National Bank of the Kyrgyz Republic”, international reserves are managed with provision for maintenance of liquidity and safety of reserve assets.

Annually, the Board of the NBKR considers and approves the benchmark portfolio of investment assets. The approval of benchmark portfolio parameters allows minimizing the financial risks arising in the course of management of international reserves. Also, as part of the task of minimizing the arising risks, the Board of the NBKR considered and approved the Regulation “On Structure of International Reserves” on the quarterly basis.

For performance evaluation of management of international reserves, the Board of the NBKR considers and approves annually the report on management of international reserves, for instance, the report on management of international reserves for 2007 was considered in the 1<sup>st</sup> quarter of 2008.

Totally, 43 Resolutions were adopted on the monetary policy issues in 2008.

The Board paid great attention in 2008 to the issues of developing and strengthening the banking system of the republic, considered the questions of supervision and regulation of commercial banking, as well as the issues of enhancing confidence in the afore-mentioned measures. Information on the commercial banking system development trends was considered on the quarterly basis, including financial stability of commercial banks and a monitoring of system risks.

*Consideration  
of issues of  
supervision over  
bank and  
nonbank  
institutions*

For the purposes of further growth of financial intermediation, the increase in the role of the banking sector in the economy of the Kyrgyz Republic, maintenance of efficiency, safety and reliability of banking, the Board considered in 2008 the draft of the Banking Sector Development Strategy till the end of 2011.

The Board of the NBKR considered an appeal of one the commercial banks relating to the prudential measure of influence imposed on this bank and the size of the penalty for the violation.

As part of further improvement of the regulatory framework in the area of banking supervision and in order to bring it in conformity with the legislation of the Kyrgyz Republic, as well as to harmonize banking supervision with the international standards and the Basel Principles of Banking Supervision, the Board of the NBKR adopted the Resolution on the amendments and addenda to a number of regulatory and legal acts: “On Prudential Norms and Requirements, Mandatory for Commercial Banks and Finance and Credit Institutions Licensed by NBKR”, “On Measures of Influence Applied to Banks and Some Other Finance and Credit Institutions, Licensed by NBKR”, “On Minimal Country Risk Management Requirements for Commercial Banks and Other Finance and Credit Institutions Licensed by NBKR”, “On Periodic Regulatory Bank Report”. Furthermore, the Board approved the new versions of the Regulations “On Corporate Governance in Commercial Banks of the Kyrgyz Republic”, “On Direct Banking Supervision” and “On Provisional Bank Management Guidelines”.

In order to reduce the risk of instability and unreliability of the financial position of microcredit agencies and microcredit companies, the amendments and addenda were introduced to the Temporary Regulation “On Establishing Microcredit Companies and Microcredit Agencies in the Kyrgyz Republic”.

To enhance efficiency in regulation and supervision of MCA and MCC activities, the amendments and addenda were introduced to the Regulation “On Precautionary Measures and Sanctions Applied by NBKR to Microfinance Organizations”. In addition, in 2008, the Board considered the draft of amendments and addenda to the Law “On Microfinance Organizations”, directed to their further



development.

According to the NBKR's action plan on implementation of FATF recommendations in the Kyrgyz Republic, with the view of anti-money laundering and combating the financing of terrorism, the Board approved the amendments and addenda to the Regulation "On Minimal Internal Control Implementation Requirements for Commercial Banks and Other Finance and Credit Institutions Licensed by NBKR", the Interim Instruction "On Work with Deposits" and the Regulation "On Procedure for Exchange of Foreign Currency in Cash in the Kyrgyz Republic".

Under the Memorandum of Understanding between the Kyrgyz Republic, Islamic Development Bank, and the OJSC "EcoBank" on introduction of Islamic principles of financing and banking, as well as in pursuance of the Decree of the President of the Kyrgyz Republic "On Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic", the Board of the NBKR introduced the addenda to the Resolution of the Board of the NBKR "On the Regulation "On Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic" and approved the Regulation "On Financial Statements Formulation Requirements for OJSC "EcoBank" Based on Results of Operations Conducted under Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic".

In pursuance of the Decree of the President "On Further Measures for Introduction of Industry of Islamic Financial Services in the Kyrgyz Republic", the Board approved the draft Laws "On Amendments and Addenda to Laws "On the National Bank of the Kyrgyz Republic" and "On Banks and Banking in the Kyrgyz Republic".

Due to effectiveness of the Law "On Protection of Bank Deposits", the Board adopted the Regulation "On Procedure for Submission of Bank Application for Participation in the Deposit Protection System and Consideration by the National Bank of the Kyrgyz Republic", the candidate requirements for positions of Members of the Board of Directors and other positions in the Deposit Protection Agency, and approved candidacies of representatives of the National Bank in the Board of Directors of the Deposit Protection Agency of the Kyrgyz Republic.

With the view of strengthening confidence of the population in the banking system, the bill "On Amendments and Addenda to the Law of the Kyrgyz Republic "On Protection of Bank Deposits" was approved with the Resolution of the Board of the NBKR providing for the essential increase in the amount of compensation for the guaranteed deposits – from Som 20 thousand to Som 100 thousand.

The Regulation "On Calculations of Effective Interest Rate when Disseminating Information on Banking Services Fee Rate" was approved with the Resolution of the Board of the NBKR in order to determine the procedure for calculations by the commercial banks and other finance and credit institutions of interest rates of credits and deposits in reliable, annual, effective, comparable

calculations when disseminating information on the rate of the fee for banking services.

As part of the task to improve the functions of supervision over the activity of nonbank finance and credit institutions, the Board approved the Regulations “On Periodic Regulatory Report of Credit Union” and the amendments and addenda to the Regulation “On Licensing of Credit Unions”.

17 Resolutions were adopted as a whole for the accounting year on activities of individual commercial banks and other FCI, licensed by the NBKR. Overall, the Board adopted 26 Resolutions on the regulatory framework that regulates commercial banking. These were both the new statutory acts, and the amendments introduced to the earlier adopted statutory acts.

According to item 3 of the Law “On the National Bank of the Kyrgyz Republic”, fulfillment of functions in the payment system area is directed to maintenance of the effective and uninterrupted functioning of the payment system.

*Consideration  
of the payment  
system issues*

Assuming the supervisory role in a policy-making on the general structure and the functioning of the payment system of the Kyrgyz Republic, the Board of the National Bank carried out the work on regulation of the payment system of the country. For instance, during 2008, the Board of the NBKR adopted a number of resolutions directed to development of the market of retail payments: “On the Draft of the Decree of the President of the Kyrgyz Republic “On Measures for Increasing Transparency of Circulation of Money and Application of Innovative Technologies in Finance Management in the Kyrgyz Republic for 2008-2010”; “On Addenda to the Law “On licensing”; “On Addenda to The Regulation “On Licensing Payment Services Using E-Cash as Prepaid Cards”.

In 2008 the Board also approved the “Rules of Supervision over Payment System of the Kyrgyz Republic”, the amendments and addenda to the Regulation “On Periodic Regulatory Bank Report”, the amendments and addenda to “The State Classifier of the Payments Turnover”, “The Basic Payment System Development Guidelines for the Kyrgyz Republic for 2009-2011”.

Progress in implementation of projects within the framework of the State Program of Measures to Introduce the Non-Cash Payment System and Establish the Infrastructure that Could Ensure Efficient Payment Execution in the Kyrgyz Republic for 2003-2008 was considered on the quarterly basis, as well as the reports on the current status of the payment system.

Totally, 24 resolutions were adopted with regard to the payment system in 2008.

The board considered the general questions and the questions of the NBKR’s internal activity. 33 resolutions were adopted concerning the regulatory framework of the NBKR and 100 – on the NBKR’s internal activity. 219 issues were considered at the board meetings as information reports.

*Other issues*

### **6.3. Improvement of Banking Legislation and Performance of Financial Adviser Functions**

The National Bank continued its work on improvement and development of the banking legislation of the Kyrgyz Republic in 2008.

A number of amendments and addenda were introduced to the banking legislation of the Kyrgyz Republic in the accounting period, in particular:

- The amendments were introduced to the Law “On the National Bank of the Kyrgyz Republic” with the view of optimizing the legislative rules for activity of the National Bank, establishing its legal status, increasing the role of the National Bank in economic development of the republic, and bringing the norms of this Law in conformity with the Constitution of the Kyrgyz Republic;

- The Law “On Banks and Banking in the Kyrgyz Republic” was amended in order to promote the increase in capitalization of banks, increase the opportunity of their involvement in development of the economy of the republic, establish the requirement for the banks concerning the need to appropriately inform their clients of the level of interest rates, commissions and other additional expenses incorporated into the cost of banking services, and of a number of other changes.

The amendments to the Civil Code of the Kyrgyz Republic, envisaging the strengthening of flexibility of the use of bank accounts (including the demand deposits) for the settlements between the individuals and legal entities came into force in 2008.

*Adopted  
amendments*

The Law “On Protection of Bank Deposits” came into force in the year of account, and its development and adoption was one of the priority directions in development of the banking system in the republic. This Law was developed with the view of implementing the system of protection of deposits of individuals and strengthening confidence of the population in the banking system.

The Law “On Amendments and Addenda to Several Acts on Activity of Credit Unions” envisaging the amendments to the Civil Code, to the Laws “On Credit Unions” and “On Cooperatives” was adopted in order to further improve credit union activities.

In pursuance of the Decree of the President of the Kyrgyz Republic No 146 of April 22, 2008, “On Further Measures for Introduction of Industry of Islamic Financial Services in the Kyrgyz Republic” and the Government Resolution of the Kyrgyz Republic No 361 of July 2, 2008, “On Introduction of Industry of Islamic Financial Services in the Kyrgyz Republic”, and for the purposes of establishing the appropriate legislative framework of banking according to the Islamic principles of banking and financing, the National Bank drafted the laws “On Amendments and Addenda to the Law “On the National Bank of the Kyrgyz Republic” and “On Banks

*Proposed  
amendments*

and Banking in the Kyrgyz Republic”.

The National Bank developed the bill “On Amendments and Addenda to the Law “On the National Bank of the Kyrgyz Republic”, providing for the increase in the size of authorized capital of the bank until it reaches the adequate (sufficient) level and until its stability is strengthened.

In pursuance of the Decree of the President of the Kyrgyz Republic No 5 of January 8, 2009, “On Measures for Maintenance of Stability of the Banking System of the Kyrgyz Republic”, the National Bank drafted the Law “On Amendments and Addenda to the Law “On Protection of Bank Deposits”, providing for the increase in the size of compensation for the deposits paid at maturity guaranteed up to Som 100 thousand.

The bills developed by the National Bank are regularly placed on the official website of the NBKR for public discussion.

The National Bank participated in the work of interdepartmental groups along the following directions:

- Development of regulatory and legal acts relating to implementation of Islamic principles of financing in the Kyrgyz Republic;
- Development of republican measures for implementation of the National Housing Development Program in the Kyrgyz Republic for 2008-2010;
- Development of regulatory and legal acts, directed to introduction of the one-window principle in the system of state registration of legal entities and individual entrepreneurs;
- Development of statutory acts on development of mortgage lending;
- Inventory of regulatory and legal acts of the Kyrgyz Republic, etc.

*Involvement  
in the work of  
inter-  
departmental  
groups*

The work continued in 2008 on improvement of the regulatory framework regulating activities of banks and other finance and credit institutions, licensed and regulated by the NBKR.

To improve the regulatory and legal framework for activities of banks and other finance and credit institutions, licensed and regulated by the National Bank, the following Resolutions were issued:

- On Minimal Size of Authorized Capital for Newly Opened Banks (Resolution of the Board of the NBKR No 6/3 of February 13, 2008);
- On Regulation “On Corporate Governance in Commercial Banks of the Kyrgyz Republic” (Resolution of the Board of the NBKR No 13/4 of March 26, 2008);

*RLA  
improvement*

- On the New Version of the Regulation “On Issue, Placement, Circulation and Redemption of Notes of the National Bank of the Kyrgyz Republic” (Resolution of the Board of the NBKR No 18/4 of April 25, 2008);

- On Approval of Rules of Exercising Supervision of the Payment System of the Kyrgyz Republic (Resolution of the Board of the NBKR No 22/11 of May 28, 2008);

- On the New Version of the Regulation “On Direct Banking Supervision” (Resolution of the Board of the NBKR No 22/4 of May 28, 2008);

- On Candidate Requirements for Positions of Members of the Board of Directors and Other Positions in the Deposit Protection Agency (Resolution of the Board of the NBKR No 22/8 of May 28, 2008);

- On the Regulation “On Financial Statements Formulation Requirements for the OJSC “EcoBank” on Outcome of Operations Conducted under Pilot Project on Introduction of Islamic Principles of Financing in the Kyrgyz Republic” (Resolution of the Board of the NBKR No 25/5 of June 27, 2008);

- On Approval of Rules of Conducting Payments in the Form of Direct Debiting in the Bulk Clearing System” (Resolution of the Board of the NBKR No 30/6 of July 30, 2008);

- On Approval of the Regulation “On Signs of Fitness for Use as Currency and Rules of Exchange of Banknotes and Coins of the Kyrgyz Republic” (Resolution of the Board of the NBKR No 33/5 of August 27, 2008);

- On Approval of the Regulation “On Calculations of Effective Interest Rate when Disseminating Information on Banking Services Fee Rate” (Resolution of the Board of the NBKR No 33/4 of August 27, 2008);

- On the Regulation “On Provisional Bank Management Guidelines” (Resolution of the Board of the NBKR No 36/5 of September 30, 2008);

- On the New Version of the Regulation “On Reserve Requirements” (Resolution of the Board of the NBKR No 42/3 of November 26, 2008);

- On Amendments and Addenda to Various Regulatory and Legal Acts of the National Bank Regulating Activity of Banks and Other Finance and Credit Institutions, Licensed and Regulated by the NBKR.

The work continued in the year of account with the Ministry of Justice of the Kyrgyz Republic on the issues of registration of NBKR’s regulatory and legal acts, implementation of specific items of the lawmaking action plan of the Government and examination of draft statutory acts and constituent documents of finance and credit institutions licensed and regulated by the NBKR.

*RLA  
registration*

In pursuance of requirements of the Law “On the National Bank of the Kyrgyz Republic”, the regulatory and legal acts developed by public authorities and covering the banking and financial system of the republic were examined in the reporting year.

In the year of account, the following draft laws were examined: “On National Financial Market Regulation and Supervision Service of the Kyrgyz Republic”, “On Venture Activity”, “On Amendments and Addenda to the Law “On the Development Fund of the Kyrgyz Republic”, “On State and Private Partnership”, “On the Draft of the Housing Code of the Kyrgyz Republic”, “On the Chamber of Accounts of the Kyrgyz Republic”, “On the Securities Market”, “On the Central Depository of Securities” and other bills directed to the NBKR for examination and approval.

*Examination  
of draft laws*

In 2008 the National Bank examined and prepared a number of drafts of the Government Resolutions of the Kyrgyz Republic: “On Establishing State Insurance Company”, “On Implementation of Measures for Simplification of State Regulation of Entrepreneurial Activity”, “On the Strategy of Industrial and Innovative Development of the Kyrgyz Republic till 2015”, “On Improvement of Strategic Management in Executive Agencies”, “On the State Business Development Program in the Kyrgyz Republic for 2009-2011”, “On Approval of the List of Basic Economic Stability Indicators of the Kyrgyz Republic”, “On the Concept of Establishing the Central Depository of Securities”, “On Construction of Multi-Storey Apartment Houses”, “On the Public Debt Management Strategy of the Kyrgyz Republic for 2009-2011”, “On Approval of the Draft Trade Development Strategy of the Kyrgyz Republic till 2014” and other drafts.

*Examination  
of RLA*

In fulfillment of its financial adviser functions of the President, the Jogorku Kenesh and the Government, the National Bank carried out the following work in 2008:

*Fulfillment of  
financial  
advisor  
functions*

- Consultative assistance to the Government of the Kyrgyz Republic when preparing and considering the draft of the republican budget;
- Regular provision of information for the President, the Jogorku Kenesh and the Government on the monetary policy implementation issues, and on the status of banking and payment systems;
- Provision of analytical information on financial market condition;
- Review of bills and other regulatory and legal acts and the decisions on the financial and banking issues or the jurisdiction of the National Bank;
- Involvement in the development and implementation of a number of state programs.

Provision of recommendations to the Government in relation to membership of the Kyrgyz Republic in the international and interstate institutions and examination

*Examination  
of agreements*

of the following international contracts, agreements on the financial or banking issues:

- The draft Agreement on Investment Promotion and Protection between the members of the Organization of the Islamic Conference;
- The draft Agreement on Investment Promotion and Protection between the Governments of the Kyrgyz Republic and the United Arab Emirates;
- The draft Agreement on Investment Promotion and Protection between the Government of the Latvian Republic and the Government of the Kyrgyz Republic;
- The draft Agreement on Investment Promotion and Protection between the Governments of the Kyrgyz Republic and Japan;
- The draft Agreement on Investment Promotion and Protection between the Governments of the Kyrgyz Republic and Italy;
- The draft Agreement on Investment Promotion and Protection between the Government of the Slovak Republic and the Government of the Kyrgyz Republic, as well as other drafts of agreements and other documents developed as required by membership of the Kyrgyz Republic in the CIS, EurAsEC, SCO and other international organizations.

As the financial agent of the Government of the Kyrgyz Republic, the National Bank continued servicing the accounts of the Government.

#### **6.4. Internal Audit and Internal Control System**

According to the Law “On the National Bank of the Kyrgyz Republic”, internal audit of the NBKR is conducted by its Internal Audit Division, which is the integral part of the internal control system.

The activity of internal audit division of the NBKR is based on the International Standards of Internal Audit and Standards of Internal Auditing Practice.

*Legal  
framework*

Performance evaluation of the NBKR’s internal control system is based on the principles recommended by the Basel Committee on Banking Supervision.

As part of the work on optimization of the organizational structure of the NBKR, at the beginning of 2008, the Internal Audit Division was assigned the additional function of conducting audits.

Planning of audit and review inspections of 2008 was done through the analysis of operational risks inherent in the activity of any central bank. Proceeding from the results of audit and review inspections and in order to reduce the risks, internal auditors and inspectors gave 211 recommendations directed to improvement of activities of structural units and the internal control system. The recommendations

*Consolidation  
of activities*

accepted for implementation allow minimizing the risks inherent in activity of the bank.

The work continued in 2008 on implementation of the Deloitte & Touché auditing company's recommendations regarding improvement of activity of the NBKR's internal audit service under the earlier conducted independent review of its activity.

According to the Risk Management Concept, the internal audit division, in concert with the Committee on Risks, considered the updated cards on risk management. The cards submitted for consideration as to risk management of NBKR's structural units are directed to identify the risks and develop measures for their minimization, thereby eventually aiming at enhancing efficiency in the activity of the NBKR.

*Interaction  
with the Risk  
Committee*

In 2008, the Audit Committee of the NBKR, whose members are three independent experts, whose activity is not connected with that of the NBKR, and two Board Members of the NBKR, had eight meetings to consider the issues and take the decisions on its terms of reference according to the assigned tasks and functions. The primary goals of the Committee are to adequately apply the accounting standards, to exercise supervision over quality of financial statements, to assist in development of the effective internal control system, and to maintain relations with external auditors and interaction with the internal audit division.

*Interaction  
with the Audit  
Committee*

The same way as in the previous years, cooperation of internal audit services of CIS and Baltic central banks continued within the framework of annual advisory meetings directed to implementation and use of the advanced practice of arranging audits. The issues relating to development of internal audit services of CIS and Baltic central banks were discussed at the meeting of the Advisory Council chaired by the National Bank of the Republic of Tajikistan. Chairmanship at the next meeting of the Advisory Council of 2009 was transferred to the National Bank of the Republic of Georgia.

*Activity under  
the CIS and  
Baltic  
Advisory  
Council*

## **6.5 Public Information**

In 2008, as in the previous years, the National Bank of the Kyrgyz Republic continued its work on enhancement of transparency of its activity, informing the public of activities of the National Bank and explain financial and banking sector developments in the republic. The public was informed by means of informative, statistical, and analytical issues, placement of data on the web-site of the NBKR, publications in the mass media, regular television and radio broadcasts, briefings and press conferences with involvement of the NBKR management, as well as the informative and educational programs.

*Transparency  
of activity*

The NBKR management regularly gave the mass media and the public briefings and held the press conferences, devoted to the most prominent aspects of bank's activity. Special attention was paid in the year of account to the issues of monetary policy, supervisory activity, the payment system reform, international

*Informing the  
mass media  
about the  
NBKR activity*



reserves management, impacts of the world financial crisis, and other issues.

The monetary policy issues were covered by holding the traditional monthly press conferences involving the NBKR management. Practice of preparing handouts for the mass-media representatives including a chronicle of basic events in NBKR' activity and the basic macroeconomic parameters was developed further in the accounting period. A press release was issued in December on the results of the discussion by the Board of the NBKR of monetary policy effects and the draft of the monetary program for the forthcoming period.

The NBKR continued to inform the public of progress in implementation of the State Program on Introduction of Non-Cash Payment System in 2008. Separate columns in the television broadcast "Natsbank Soobschayet" and in the radio broadcast "Uluttuk Bank Bildiret" were devoted to this subject and provided an explanation for the State Program goals and objectives and described progress in implementation of individual components of the Payment System Modernization Project. The progress report on implementation of the State Program was published in the official NBKR's publications, on the web-site of the NBKR and in the mass-media. The actions taken by the bank were covered in the NBKR's Press Release.

*Non-cash  
payment  
system*

With the view of informing the public and popularizing the national card "Elkart", a new section "Integrated Interbank Processing Center" was opened in the section "Payment System" on the web-site of the NBKR to regularly update the list of trading and servicing enterprises serving the Elkart card. Information on the number of servicing outlets is provided on the regular basis in the Press Release of the NBKR, as well as in the television and radio broadcasts.

*Elkart*

The questions concerning the issue of regulating commercial banking and the lawmaking activity of the NBKR were brought to the notice of the public by means of basically the publications in the Press Release of explanations for the regulatory and legal acts adopted by the NBKR. The topical issues of banking sector development were discussed on pages of domestic analytical magazines. Furthermore, the press conferences were organized involving the representatives of the Administration of the President of the Kyrgyz Republic in cases of signing by the President of some of the orders concerning maintenance of the bank deposit protection system.

*Banking  
system  
development*

Much attention was paid to promotion of new banking products, namely, to implementation of Islamic financing principles. An interview was organized in May 2008 in a telecast devoted to Islamic principles of financing. Answers to the questions made during this telecast were published in the Press Release of the NBKR in the column "The NBKR Public Chamber Answers Your Questions".

*Islamic  
financing  
principles*

The progress report on the actions taken under the Mid-Term Microfinancing Development Strategy in the Kyrgyz Republic for 2006-2010 was covered in the Press Release of the NBKR, the telecast "Natsbank Soobschayet" and the radio broadcast "Uluttuk Bank Bildiret"; information on development of credit unions and the need for accelerating efforts of credit unions in their practice of attracting the

*Development  
of  
microfinancing*

resources of their participants and on the measures undertaken by the National Bank for creating the progress report in their activity

Due to issue of circulating coins in January 2008, the National Bank launched an information campaign and the following was done as part of this campaign: information was placed in the printed media; hire of video clips was arranged on TV; calendars and posters with a picture and description of characteristics of circulating coins were printed and disseminated; addresses of NBKR experts and specialists of its regional departments were arranged on national and local TV and radio.

Circulating  
coins

The National Bank made the presentation on the souvenir collection banknotes in the form of uncut sheets in the mass-media and to the public, and started to sell them to the population. Issue and sale of uncut sheets of banknotes is practiced by many central (national) banks.

The briefing was given in December of the accounting year on issuance of memorable collection coins of the series “Kyrgyzstan on the Great Silk Road” and the memorable collection coin “Bishkek” of the series “Capitals of EurAsEC Countries”.

Numismatic  
coins

The collection coins of the series “Kyrgyzstan on the Great Silk Road” are devoted to the most ancient monuments of the Great Silk Road - a tower of Burana, Tashrabad, and the Uzgen Architectural Complex, located in the territory of Kyrgyzstan.

The subject of the 15<sup>th</sup> anniversary of national currency - the Kyrgyz Som - took a special place in NBKR’s information activity. As part of the 15<sup>th</sup> anniversary of introduction of national currency, the meeting of NBKR Chairman was held with the students of leading high schools of the country at the Kyrgyz-Russian Slavic University. The Chairman of the National Bank described at this meeting a history of national currency and stages of its development and answered the numerous questions of students; the NBKR Deputy Chairman gave a lecture on NBKR roles and functions as the central bank of the country.

Som is the  
face of  
Kyrgyzstan

A number of thematic articles on national currency, prepared by the staff of the National Bank were published in the republican press; hire of video clips was organized on TV; a banner is placed on the official web-site of the NBKR with information on the celebration of the 15<sup>th</sup> anniversary of the national currency.

In concert with the Kyrgyz radio, the cycle of live programs devoted to the anniversary of the Som, was organized to tell, in detail, about historical and economic preconditions of introduction of own national currency in the Kyrgyz Republic, about the cash turnover; about the basic monetary policy instruments and the role of the NBKR in implementation of this monetary policy; and about the Som banknote security features and issue of circulating coins, etc.

The NBKR management and staff informed radio listeners in their live radio broadcast of progress in implementation of the State Program on Introduction of Non-

Cash Payment System and answered the questions concerning the process of organizing cash and non-cash payments, the salary projects, and the outlook for development of the payment system of the republic, as well as described the commercial banking system development trends. They also answered the questions of radio listeners on lending and interest rates, mechanisms of the deposit protection system, enlargement of the spectrum of services provided by the commercial banks, and the outlook for development of the banking system as a whole.

The integral part of the work on maintenance of interaction of the National Bank with the population is that of activity of the Public Chamber, which functions both in the central office of the NBKR, and in each regional department and the Batken Representative Office of the bank. Its activity is focused, first of all, on: consultative assistance and provision of information to the population on all of the issues appertaining to the National Bank; the meetings of the public with the NBKR management and experts on the topical issues of the banking and financial sphere; the work with written requests and bids (totally, about nine thousand requests were received in 2008, of which the number of written requests made 919).

Public  
Chamber

The major subjects of written requests received by the National Bank during 2008 were those of data requests for the official exchange rates of foreign currencies vis-à-vis the Kyrgyz Som and the discount rate fixed by the NBKR, the procedure for opening nonbank finance and credit institutions, as well as the procedures of exchanging worn currency, arranging the cash turnover, and purchasing the GT-Bills.

Furthermore, the NBKR experts prepare and give consultations concerning the procedure of receipt of credits for various objectives, including mortgage lending, explanations of “bank-client” legal mutual relations, regulations of bank and nonbank institutions, the procedure of repaying the deposits and savings deposits by the bankrupt banks, arranging the cash turnover, sending remittances, explaining the specific monetary policy issues, foreign exchange market condition, the questions concerning the gold and foreign exchange reserves, external debt, as well as the impacts of the world financial crisis on the banking system of the country.

The National Bank was visited by deputies of the Jogorku Kenesh of the Kyrgyz Republic, the members of its Committee for Economy, Budget and Finance. Parliamentarians met with the NBKR management, familiarized themselves with activities of some of the leading structural units, the functioning of the NBKR’s automated trading systems for conducting the operations in the interbank foreign exchange market and the secondary market of government securities, as well as with the process of destruction of worn currency.

Meetings and  
seminars

In 2008, the NBKR continued holding the traditional familiarization seminars on the following subjects: “Role and Functions of the NBKR as the Central Bank of the Country”. These seminars were held for the students of economic faculties of higher educational institutions, and excursions were organized on NBKR’s numismatic exhibits. The objective of the seminar is to explain to the public National Bank’s activity, its role in monetary policy implementation, as well as to increase the level of understanding of economic processes by the population.

The NBKR's regional departments continued undertaking the actions as part of the traditional information and educational campaign called "Som is the Face of Kyrgyzstan". The experts of the Jalalabat, Naryn, Osh and Talas Regional Departments gave pupils of secondary schools and the students of high schools various lectures about the national currency, about security features of the Som, and combat with coinage offence, about the procedure of exchanging worn currency, arranging the cash turnover, and about the banking system of the Kyrgyz Republic. Competitions were offered for the best composition and the best painting on the following subject: "History of the National Currency". The Naryn Regional Department organized a radio quiz about the national currency. Information posters about the procedure of exchanging worn national currency are disseminated throughout all of the oblasts of the republic.