

**National Bank of the Kyrgyz Republic**

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**Inflation Report**

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**May 2002**

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**Bishkek**

## ***Inflation Report***

Editorial Board:

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

Editorial Assistant: Bushman Yu.

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

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

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

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

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

Phone: (996 312) 218 373

(996 312) 219 842

Fax: (996 312) 218 373

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### ***Annual Report of the National Bank of the Kyrgyz Republic***

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

### ***Bulletin of the National Bank of the Kyrgyz Republic***

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

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

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Bishkek, Umetalieva st., 101.

National Bank of the Kyrgyz Republic

External and Public Relation Division

phone: (996 312) 669 009

fax: (996 312) 610 730

<http://www.nbkr.kg>

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## 1. CURRENT DEVELOPMENTS OF INFLATION

According to the preliminary data of the National Statistics Committee, gross domestic product during the first quarter of 2002 decreased by 2.8% compared with the corresponding period of the previous year. Decrease has been held mainly because of decrease in production at one of the largest mining enterprises. Gross domestic product increased by 1.4% without taking into consideration its production. Growth of agriculture is slightly slowed to 1.4% in comparison with the first quarter of 2001. Construction decreased by 5.4%.

The structure of economy is insufficiently flexible. The capital mobility is restrained due to incompleteness of property rights formation and under-developed financial system.

Domestic demand will not be able to provide required economic development for certain time. The external demand is restrained by inadequate quality of domestic production and current problems concerning with limited access to the world market. Some enterprises carry out business rather successfully at the external markets, however, their number is still small. Exports predominately consist of raw materials.

Trade balance during two quarters in a row has the negative balance resulted from exports had dropped by 2.1% and imports had expanded by 43.5% in the year to the first quarter of 2001. Export slump is mainly connected with contraction in gold and electric power output. Growth of imports is primarily due to the fact that demand of the international anti-terrorist coalition contingent to appear.

According to the preliminary calculations, nominal effective rate strengthened by 10.9% in comparison with March 2001 and the real effective rate strengthened by 3.5%. Nevertheless, the real effective rate decreased by 1.1% from the beginning of the current year. Its small correction was stipulated by the developments of nominal effective exchange rate and prices in the Kyrgyz Republic as well in trade partners during this period. On the whole, the real effective exchange rate demonstrates stability and it does not influence significantly external trade at present.

Money supply has increasing for three-quarters in succession. In the first quarter of 2002, monetary base was the main source for that growth. Monetary base developments were stipulated by operations of the Ministry of Finance. The National Bank has conducted interventions by means of operations with foreign currency and Treasury bills. Monetary base increased by 5%. Aggregate M2X grew by 5.9% outpacing other monetary aggregates.

The tendency of interest rates in money and Treasury bill markets to decline still continues. In the Treasury bills structure, tendency towards securities with longer maturity (6 and 12 months) starts to reveal. Moreover, issue of Treasury bills with one-year maturity is dominated.

The consumer prices increased by 1.1% during the first quarter of 2002. Their annual growth makes up 1.9%. Outlook had supposed that inflation would be 3.9% compared to December 2001. Main reasons for deviation from the fact are connected with weaker than expected domestic demand, changes in seasonal profile of inflation and drastic slump in fuel and lubrication material prices.

It is supposed that recent tendency in consumer price developments is going to continue in the near future. Furthermore, it is expected that revealed decline in physical volume of gold production would be compensated by two factors. Growth of production in industries not connected with the non-ferrous metallurgy as well as more

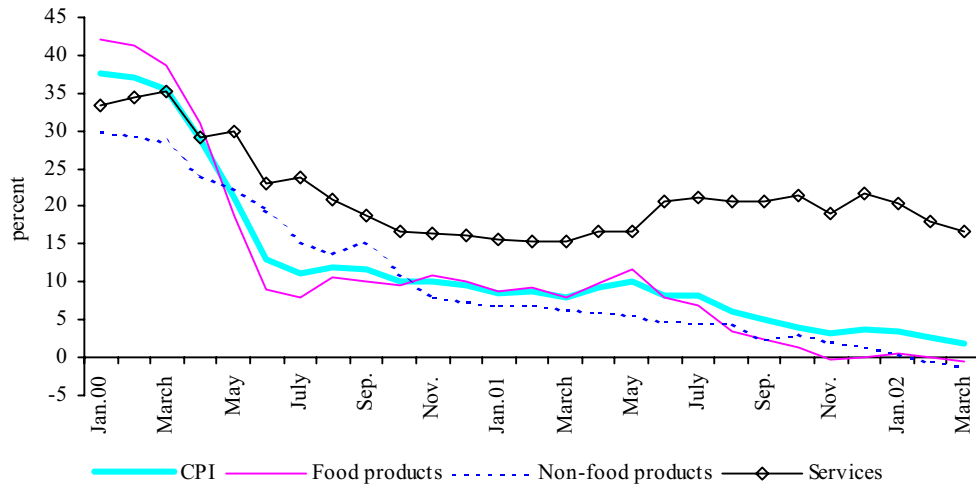
favourable than in the previous year gold prices will be kept further. Also, the tendency of deposits in the banking system to grow is expected to last.

Inflation will be 2.1% in the second quarter of 2002 compared to the first quarter of the current year. Uncertainty connected with outlook is expected to stay at approximately the same level as before. First of all, uncertainty is connected with the situation on the oil market. Other factors worth to note are expenditures of the state budget and seasonal factor whose profile is subject to shift during a year. Inflation expectations are supposed to stay approximately at the previous level as far as there is no reason to grow.

2. CONSUMER PRICE INDEX AND ITS COMPONENTS

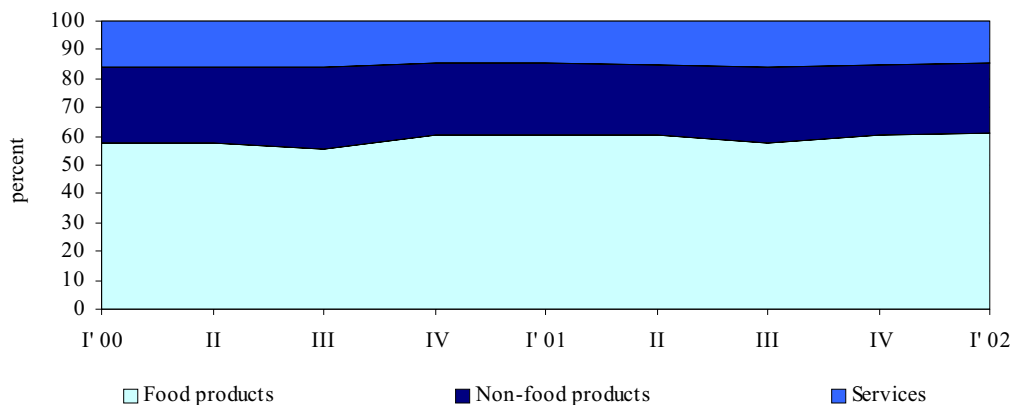
Inflation continues to slow down in the first quarter of 2002. According to the National Statistics Committee, consumer prices grew by 1.1% compared to December 2001 that is less to compare to 2.8% in the first quarter of 2001.

Chart 1: Annual Dynamics of CPI



Food products make up the largest share in consumer basket. So, change of its price influence significantly the consumer price index as a whole. Another important factor for food inflation at this time of the year is the seasonal pattern. Supply of food products depends on stocks, which amount is determined by crops of previous year and export conditions. Weaker growth of prices than in the same period of previous year resulted from the good crops in 2001 causing food prices to slow. Since June 2001 the annual food inflation has fallen behind consumer prices.

Chart 2: Structure of CPI



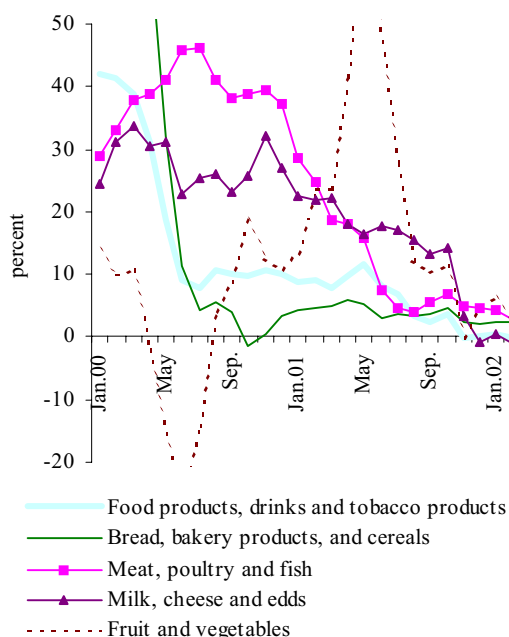
Inflation slowdown has been promoted by oil products price slump connected with constraints of Russia's oil supply to the world market resulting in expanded exports of oil and oil products to the CIS countries. Non-food inflation has fallen behind the consumer prices during the first quarter of the current year. Accelerating of non-food prices, especially for durable goods, is restricted by the low purchasing power of population.

## 2.1. COMPONENTS OF CONSUMER PRICE INDEX

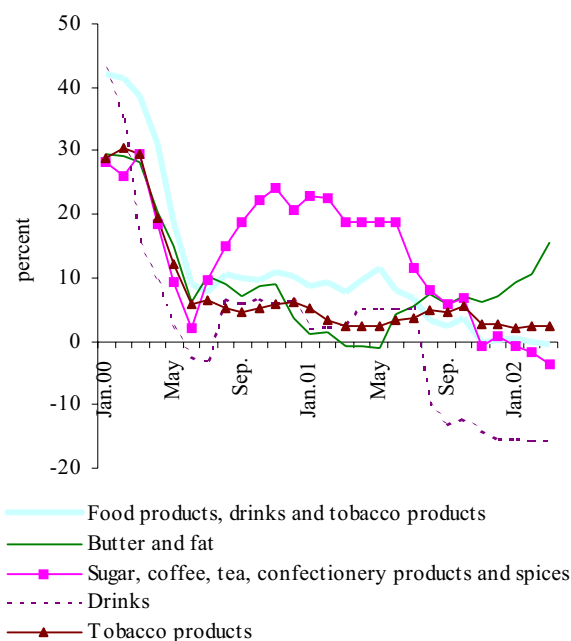
### 2.1.1. FOOD PRODUCTS

Growth on food products by 2.9% was noted during the first quarter of 2002. Seasonal increase in prices for fruits and vegetables, different types of butter and fats made up 25.9 and 3.8%, respectively. Price for meat and milk products, and eggs as well as for sugar and confection went down within the ceiling of 0.6%. Prices for other goods of this group were relatively stable.

**Chart 3a: Annual Development of Prices for Food Products**



**Chart 3b: Annual Development of Prices for Food Products**

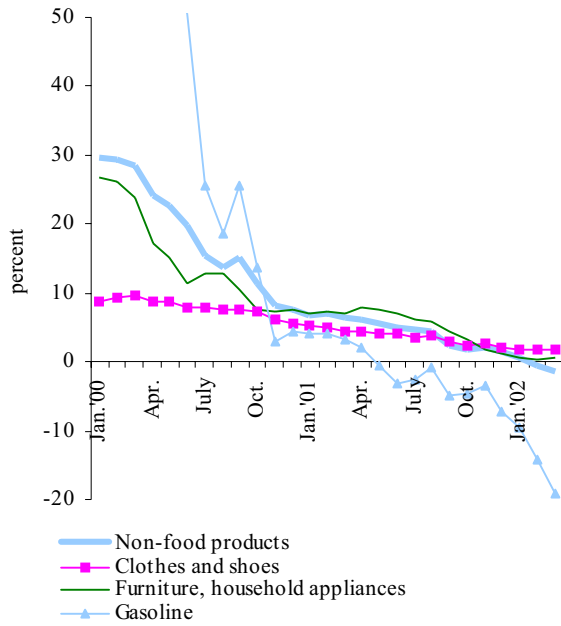


### 2.1.2. NON-FOOD PRODUCTS

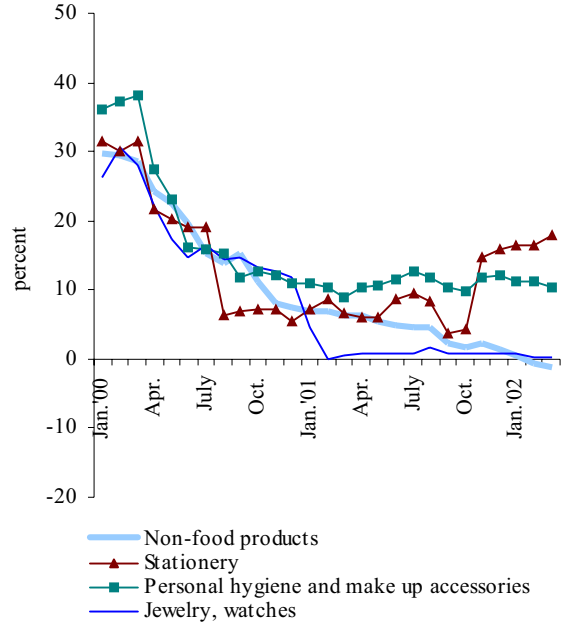
Non-food product prices went down by 2.4% during the first quarter of 2002 mainly as a result of oil product prices slump, which was the most pronounced for gasoline price decreasing by 23.7%. Price for shoes grew by 1.1%. Prices for other non-food products have remained stable. Share of personal hygiene products and stationery in the group of non-food products is relatively small. However, the biggest increase in annual price is observed just on these two items. This fact is likely may be explained by lack of production capacities, substantial share of students among the population and low elasticity of substitution for these goods.



**Chart 4a: Annual Development of Prices for Non-Food Products**



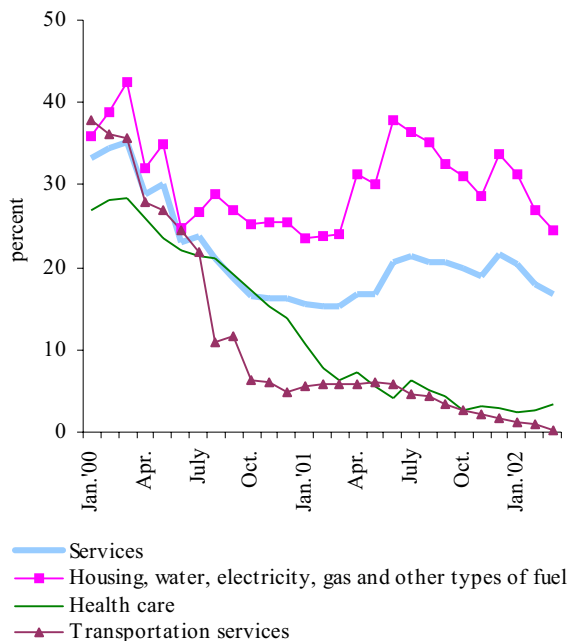
**Chart 4b: Annual Development of Prices for Non-Food Products**



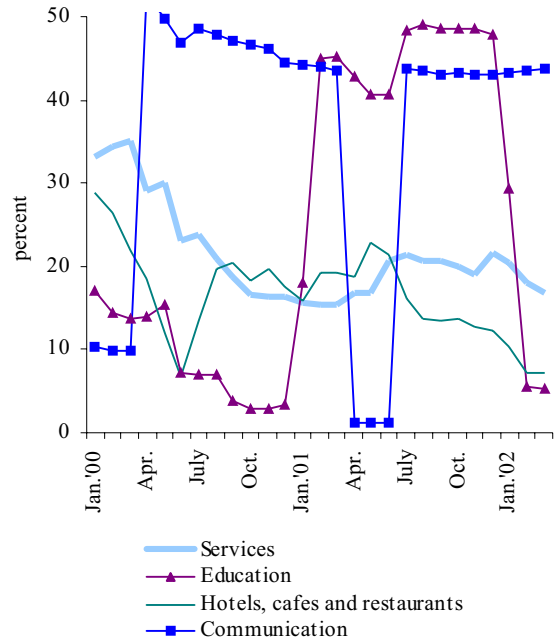
2.1.3. SERVICES

Service prices in the first quarter of 2002 almost unchanged and its growth was 0.1%. Annual growth for power, gas and water consumption has slightly decreased. It is connected with the fact that increase in power tariffs in the middle of March has not been reflected in the paid service price index yet. Another important components of the service inflation are public health, education and communication. The most volatility manifested by communication, which tariff is regulated administratively.

**Chart 5a: Annual Development of Prices for Services**



**Chart 5b: Annual Development of Prices for Services**



## 2.2. CONSUMER PRICES BY REGIONS

In the first quarter of 2002 developments of the regional consumer price indexes was characterised by growth to some extent excluding Chui oblast, where inflation decreased by 0.2%. This fact is explained by seasonal acceleration of food inflation. The biggest growth among the regions is noted in Naryn oblast, where consumer prices grew by 2.4%. Average non-weighted by region consumer prices rose by 1%.

Chart 6a: CPI Development by Oblasts

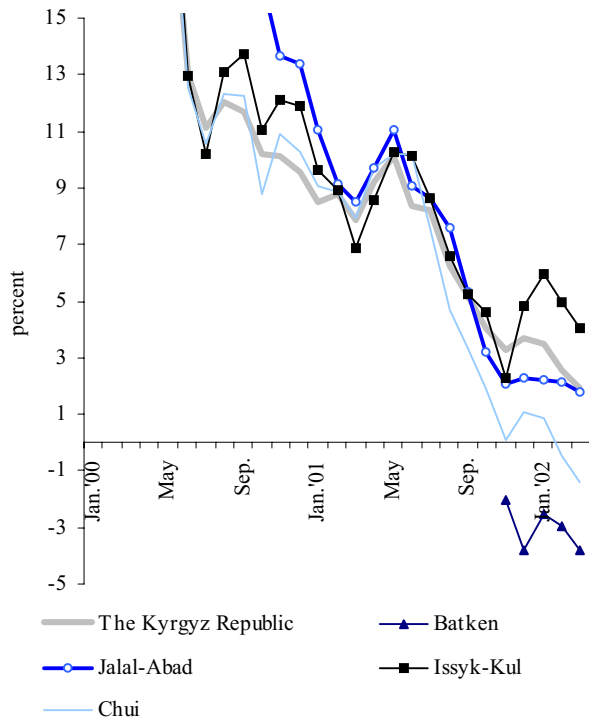
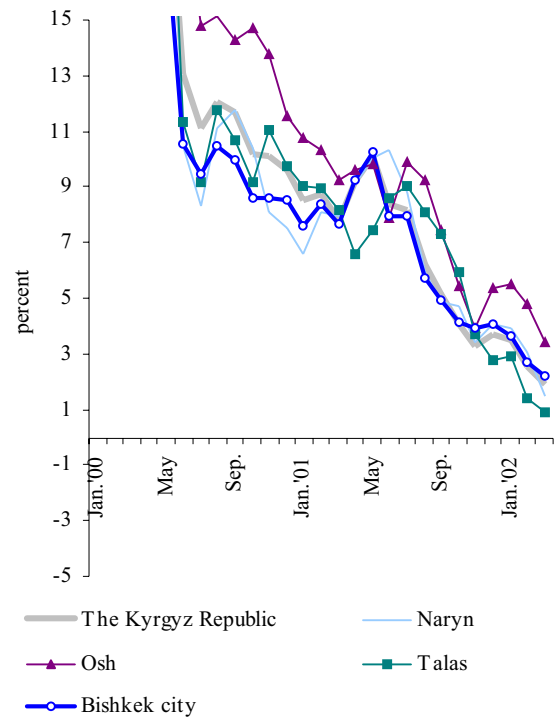


Chart 6b: CPI Development by Oblasts



Among the other most important factors, by which regional inflation is influenced, we may mention the purchasing power of population and infrastructure availability. Low demand means that there is no sense to supply goods to such regions, so it prevents the consumer prices to rise. Another limiting factor is poor development of housing and municipal services system, educational network and other services. Because of these reasons, consumer prices in almost all regions of the republic is sensible to lesser extent in comparison with the city of Bishkek to administrated increase in tariffs for electricity, housing and municipal services, education and other services.

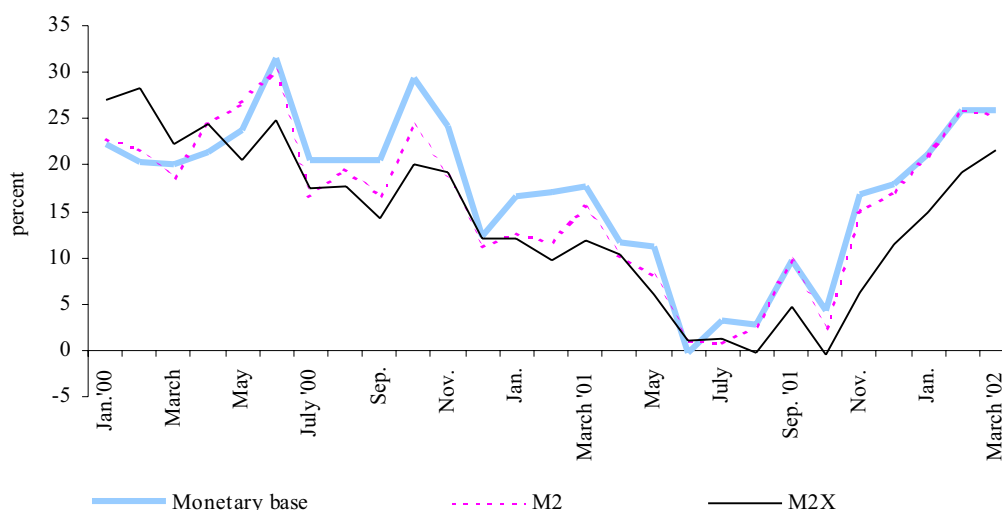
### 3. INFLATION FACTORS

#### 3.1. MONETARY AGGREGATES

In the first quarter of 2002 all monetary aggregates continue to grow. Expenditures of the Ministry of Finance, which caused the growth of the monetary base, were the main reason for money supply to expand.

Tendency of demand deposit interest rate to decline is lasting in deposit market. Low inflation rate supported by money in circulation growth is possible explanation for this situation. Taking into consideration the fact that interest rates on credits have almost not changed, additional reason is that commercial banks are endeavouring to support their margin. Decreasing deposit interest rates do not promote saving mobilisation of population. Also, changes in the legislation aimed to restore taxation of interest accrued on bank deposits have negative effects for savings.

**Chart 7: Annual Development of Monetary Aggregates**



##### 3.1.1. MONETARY BASE<sup>1</sup>

Monetary base increased by 5% during the first quarter of the current year. Annual growth of monetary base was 21.9%. Its acceleration can be explained by low monetary base stock at the base period, which was resulted from payments to serve the external debts.

Main instruments of the monetary policy used by the National Bank in the first quarter of the current year were operations with commercial banks in foreign exchange and credit markets. Net sales of the National bank totalled US \$2.1 million, compared to US \$6.8 million in the first quarter of 2001. As of April 1, 2002 gross international reserves of the National Bank cover 239% of the monetary base. Their volume in dollar term decreased by 1.6% compared with the fourth quarter of 2001.

Share of money in circulation in the structure of the monetary base decreased from 96.6% at the end of December 2001 to 95.2% at the end of March 2002. Money in circulation increased by 3.5% during the first quarter of 2002.

<sup>1</sup> Without taking into consideration the commercial banks deposits in a foreign currency

### 3.1.2. AGGREGATE M2

The monetary aggregate M2 increased by 5% during the first quarter of the recent year. Annual growth of the monetary aggregate M2 totalled to 25.4%. Growth of deposits of banking system in national currency, which has begun in the fourth quarter of the last year, is continued in the first quarter of the recent year and deposits in the national currency increased by 9.8%.

It is necessary to note that deposit growth in operating banks has happened mainly owing to demand deposits and less-than-one-month-term deposits, which are dominating in the structure of deposits. Saving deposit share (deposits with the term of more than one month) is small as before. Some intensification of business activity in the republic is characterised by prevalence of demand deposits and settlement accounts over saving deposits backed up by their growth. At the same time, low propensity of population to save is aggravated by poor development of the financial institutions and insufficient confidence to them.

### 3.1.3. AGGREGATE M2X

The monetary aggregate M2X at the current exchange rate increased by 5.9% during the first quarter of 2002. Foreign currency deposits rose by 9%.

Aggregate M2X consists of net foreign and domestic assets of the banking system. Net foreign assets of the banking system measured in Soms at the current exchange rate increased on account of net international reserves of the National Bank and foreign assets of the commercial banks. Developments of foreign exchange deposits as well its share in the total deposit stock followed the tendencies described with respect to the deposits in national currency.

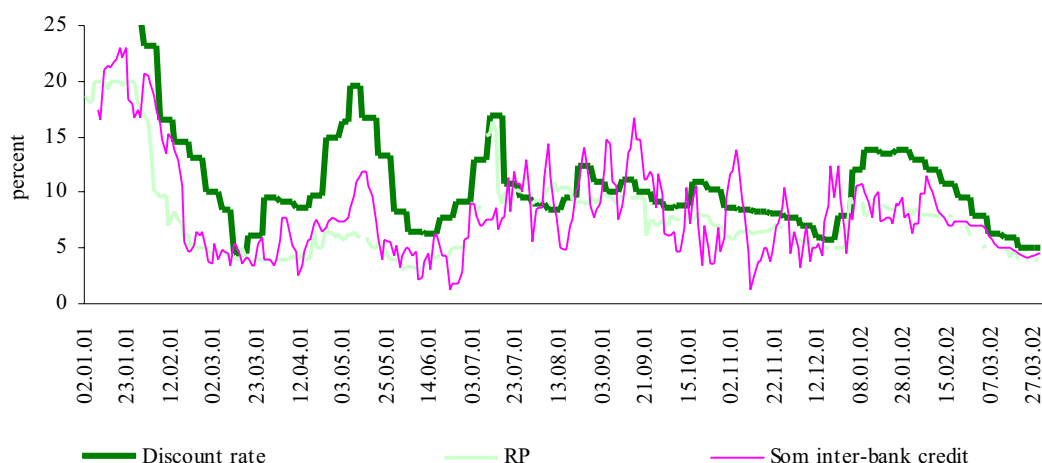
## 3.2. INTEREST RATES

### 3.2.1. MONEY MARKET INTEREST RATES

At the beginning of the first quarter of 2002 liquidity in the banking system has been characterised by significant fluctuations. It resulted that interest rates in all segments of money market picked up temporary. The discount rate of the National Bank increased to 13.9%, REPO interest rate reached 9.5%, while cost of credit in the inter-bank credit market in national currency achieved 18%. However, at the end of January due to the active interventions conducted by the National Bank in the open market liquidity in banking system stabilised and stayed at sufficiently high level by the end of quarter. As a result, in February and March, low interest rates was observed in the market.

As a whole for the first quarter of 2002, the discount rate decreased from 8% at the beginning of the quarter to 5% at the end of the quarter. The inter-bank credit market interest rates in national currency and REPO operations rates dropped from 18 to 4.6% and from 9.5 to 4%, respectively.

**Chart 8: Discount rate of the NBKR, inter-bank credit and repo interest rates**



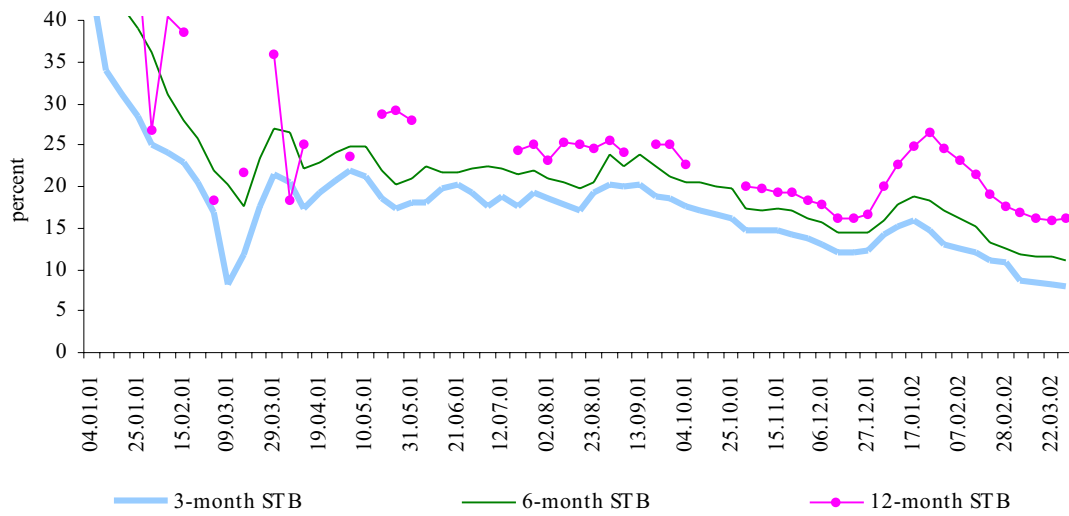
To smooth the liquidity fluctuations in the banking system in the first quarter of 2002 the National Bank actively used all available financial instruments such as overnight credit, REPO operations with securities of the commercial banks as well as SWAP operations with foreign currency.

### 3.2.2. STATE TREASURY BILLS

In the first quarter of 2002 primary market in State Treasury bills (STB) has developed under the influence of liquidity and seasonal factors. Seasonal surge in demand for foreign currency and significant fluctuations of the bank liquidity caused demand for the state securities to become weak. As a result, bill yields grew in the first half of January. The yield of securities with three-month maturity rose to 16%. Yield of securities with six- and twelve-month maturity reached 18.7 and 26.6%, respectively.

Stabilisation in foreign exchange market and increase in liquidity of the commercial banks have positively affected further Treasury bill market. In February and March, demand in securities increased, which entailed yields in all segments of the STB primary market to decrease continuously. As a whole, yield of three-month

**Chart 9: Yield of the state treasury bills**



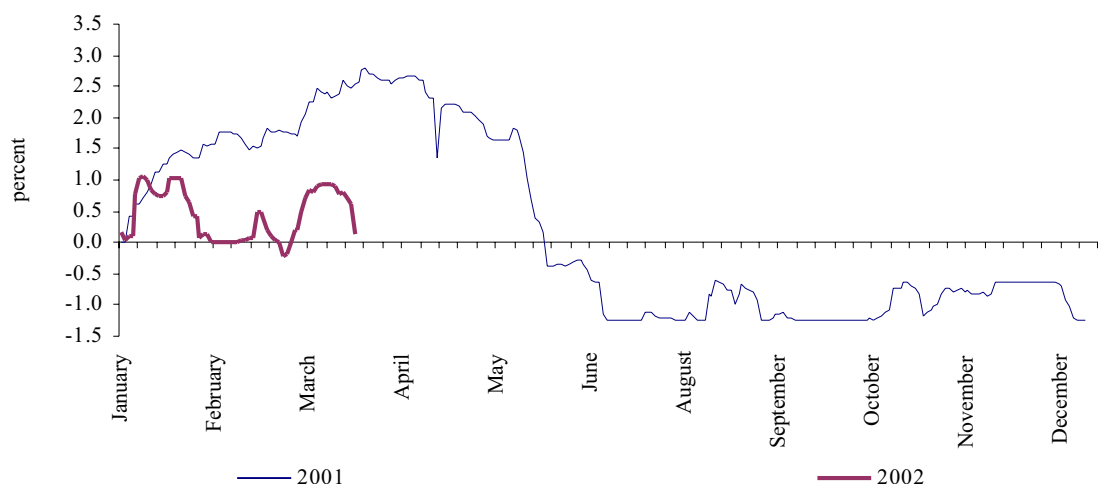
STB decreased to 7.9% for the first quarter of 2002. Yields in six- and twelve-month STB declined to 11.1 and 16.1%, respectively. Average weighted STB interest rate dropped to 13.3% at the end of the first quarter of 2002 from 15.2% at the beginning of the first quarter.

### 3.3. EXCHANGE RATE

In January, strengthening in demand of commercial banks and population for foreign currency was observed in foreign exchange market. Fluctuations of exchange rate taken place at this time were connected with small market deepening. Exchange rate in the foreign exchange market achieved Som 48.2 per US dollar and increased in comparison with the beginning of the current year by 1.1%. In January, to smooth volatility in foreign exchange the National Bank intervened through selling foreign exchange by the amount of US \$2 million. Furthermore, the National Bank sold US \$350 thousand outside the trade-information-electronic-system. Dollar weakened to Som 47.7416 at the end of January.

In February, demand for foreign exchange had declined seasonally due to lower business activity of economic entities was observed. US dollar fluctuated insignificantly in foreign exchange market within the range from 47.7 to Som 47.9322. The commercial banks preferred to sell non-cash US dollars to the National Bank, sales totalled US \$1.5 million.

**Chart 10: Growth Rate of the US Dollar Exchange Rate in the Market for 2001-2002**

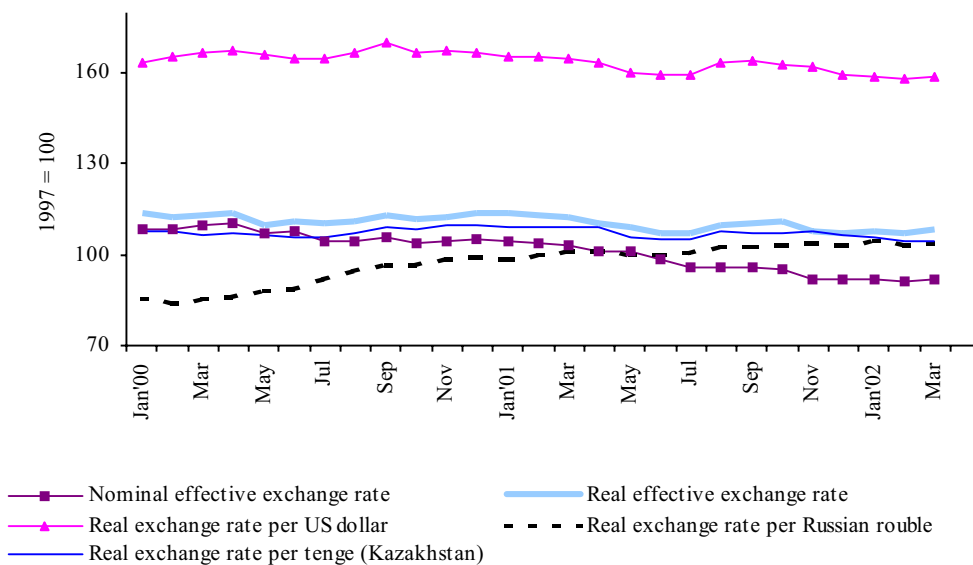


In March, the beginning of spring-field works caused demand for fuel and oil products to rise, which transformed in demand to foreign exchange. US dollar appreciated to Som 48.1521. The National Bank carried out interventions selling foreign exchange to the commercial banks by the amount of US \$1.2 million. So, the US dollar had weakened to Som 47.7683 by the end of March.

During the first quarter of 2002, US dollar had strengthened against Som by a half of per cent, compared to 2.5% in the first quarter of 2001. Operations conducted in the inter-bank foreign exchange market in the first quarter of 2002 totalled US \$14.4 million, which is less by US \$0.4 million than in the corresponding period of the last year. Transactions of the National bank with commercial banks totalled US \$9.1 million that is 63.3% out of total transactions on foreign exchange market.

According to the preliminary estimations of the National Bank, index of nominal effective exchange rate had not changed compared to December 2001, however, som appreciated against major trade partners' currencies by 10.9% in comparison with March 2001. Consumer prices in Kyrgyzstan grew slower than average

**Chart 11: Exchange rate indices**



weighted inflation in major trade-partner-countries that caused some increase of real effective exchange rate index. According to the preliminary calculation of the National Bank, the real effective exchange rate index increased by 1.1% compared to December of the last year, which means that som had depreciated. At the same time, real effective rate of som appreciated by 3.5% in comparison with March 2001. On the whole, the real effective exchange rate index remains to be stable.



### 3.4. DEMAND AND SUPPLY

Income of population and retail turnover increasing demonstrated that the domestic demand was lasting. Furthermore, growth of imports resumed, which is partially connected with demand of international anti-terrorist coalition contingent to appear.

But there are some signs that domestic demand is going to become weaker. The current stance of the state budget and decreasing of investment activity has supported that conclusion. Lack of consumer credit also contributes to limit the consumer demand. Administrative increasing of electric power tariffs eroded to some extent incomes of population.

On the other hand, external debt restructuring within the Paris Club is capable to support the domestic demand. Participation in humanitarian assistance to Afghanistan as well residence of international anti-terrorist coalition contingent works in the same direction.

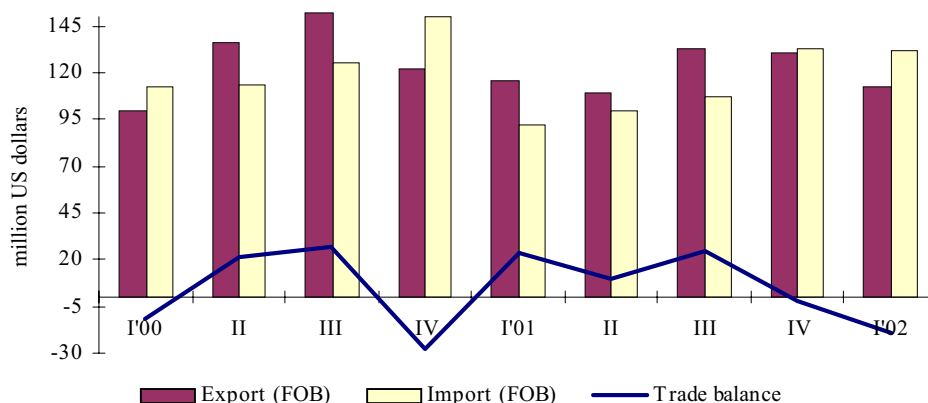
Another factor that stimulated current consumption to rise is decreasing attractiveness to put savings into banks due to revisions in tax code directed to tax interest accrued on deposits in the banks. There is an uncertainty, which one out of these tendencies - increasing or decreasing in domestic demand - will finally outweigh.

From the supply side, the gross domestic product slowed down and it even declined taking into consideration the production of “Kumtor Operating Company”. The achievement of sustainable economic growth is stipulated in many respects by potential to entry to the external market. But recent structure of economy is weakly adapted to it. Low effectiveness and productivity characterise the economy. The mobility of resources is highly restricted.

#### 3.4.1. NET EXPORTS

According to the preliminary data, the external trade balance of the Kyrgyz Republic stayed to be negative in the first quarter of 2002 due to imports surged by 43.5%, while exports decreased by 2.1% in the year to the corresponding period. External trade turnover increased by 18%. Trade turnover with the Commonwealth Independent States (CIS) and non-CIS rose by 24 and 13.5%, respectively.

**Chart 12: Trade Balance**



Exports of goods (F.O.B.) decreased by 2.1%. Exports to CIS decreased by 8.3%, while exports of goods and services to non-CIS increased by 0.7%. Gold exports decreased by 25.7%. It is necessary to note that exports excluding gold rose by 24.7% led by export to China, Turkey and the USA.

Shares of all groups in the functional structure of exports, except the intermediate goods containing gold item, manifested growth. The contribution of intermediary goods declined from 57 to 44.5%. The shares of raw materials and consumer goods totalled 27.5 and 16%, respectively.

Exports to Non-CIS made up 72% in the geographic structure. Exports of gold had been reoriented to Switzerland, so Germany's share plunged almost to zero. Among non-CIS, the biggest export share is contributed to Switzerland, China, Turkey and the USA. Increasing exports to the USA is connected with the residence of international anti-terrorist coalition contingent in the Kyrgyz Republic. In case of Turkey exports is stipulated by vegetables. Exports to the CIS are going on to contract. Among CIS, main partners are Russia, Kazakhstan and Uzbekistan.

According to the preliminary data, imports of goods (F.O.B.) increased by 43.5% in comparison with corresponding period of the previous year. Imports from the CIS and non-CIS increased by 45.4 and 40.7%, respectively.

Growth of all items in functional structure of imports had happened. The investment goods and power supply revealed the highest growth rates. To be specific it is connected with expansion of financing of the State Investment Program and demand to oil products by international anti-terrorist coalition contingent to appear.

Kazakhstan holds the biggest share in the geographic distribution of imports, which totalled 23.3%. Russia's import share made up 15.7%. Among non-CIS countries, major suppliers of goods are China, the USA, Germany and Turkey, as before.

### 3.4.2. DOMESTIC DEMAND

According to the data provided by the National Statistics Committee cash incomes of population increased by 7.8% in the year to the first quarter of 2001. The cash expenditures increased by 7% compared to the first quarter of 2001.

Expenditures of the state budget increased by 25.2% in comparison with corresponding period of 2001. At the same time, budget expenditures planned were not executed by the amount of Som 0.8 billion taking into consideration special funds.

According to the preliminary data provided by the National Statistics Committee, investment in capital decreased in real terms by 11% against the relevant period of 2001. The tendency of investment financed by foreign credit to decline still continues. At the same time, investment in capital financed through enterprises, organisations and population funds increased further.

#### 3.4.2.1. PRIVATE CONSUMPTION

Wealth consists of different types of assets held by households. Money balances, bank deposits, government and corporate securities, real estate and equipment may be picked out among them. Current consumption may depend either on current income and wealth or the both one. Forms of dependence may be different.

According to theory of permanent income households use wealth as a buffer. Under the favourable economic situation or, in other words, at the phase of economic growth, as a rule, employment and incomes expands. Households being aware of the fact that the growth phase will be followed by contraction are more inclined to save at that moment. During the recession they are able to utilise savings to maintain their consumption level.

To what extent this theory is applicable to Kyrgyzstan? It seems that consumption behaviour of poor and rich groups of population differs significantly. The poor are not always able to cover even their current expenditures. Practically they have not any financial component of wealth. It has two results. First, they have no savings to transfer into consumption and there is no access to consumer credit for them. Second, current income and self-subsistence economy restrains their consumption.

Households with higher income have possibilities to save. But propensity to save is still sufficiently low. In part, that situation is connected with the financial system stance and performance of economy on the whole. Also, backward consumer culture, which is typical character of developing economy, is worth to take into consideration. Lack of confidence between different economic agents undermines financial inter-mediation, which is base for demand to expand.

In this connection, development of land market is very important. Drawing of lands into economic turnover as a financial asset will help to determine market price of land and that will promote economy to grow not only from the supply side or production side, but also from demand side. Development of land market is long-term task, which has structural character, but first results may be expected in near future.

#### 3.4.2.2. PUBLIC CONSUMPTION

State budget revenues during the first quarter of the current year increased by 14.1% compared with the first quarter of the last year. State budget expenditures increased by 25.2%. Budget expenditures were executed less than expected by the amount of Som 0.8 billion (including expenditures at expense of special funds), which means that domestic demand to decline. First, it means that some goods and services were not purchased. Second, pension payments, salary payments for budget organisations have been postponed. Lower than expected budget spending has not only direct effect; domestic demand dropped to the larger amount than sum of cut expenditures as a result of multiplier effect.

In March, the Government and the National Bank has held negotiations with Paris club creditors. So, the parties agreed to restructure debt payments to the members of Paris club, which are due up to 2004. In 2002, significant budget resources will be released, which may be used to solve social problems as well to develop the economy.

#### 3.4.2.3. INVESTMENT

In the first quarter of 2002, according to the information recently released by the National Statistics Committee, investment decreased by 11% in the real term compared with the first quarter of 2001. At the same time, investment in capital financed through enterprises, organisations and population funds increased further.

Efforts to improve investment climate do not bring about expected results yet. Investments are necessary to replace backward fixed assets, introduce new technology, and improve the product quality. However, a good deal of investment attracted into the country carries definite risks. They are connected with a growth of debt burden, which is necessarily to serve, and sharp capital outflow is possible. There is risk to overvalue real

exchange rate of the national currency, which undermines the competitiveness of economy. Negative effects connected with drastic growth of money supply under the conditions of underdeveloped financial system are also possible.

### 3.4.3. OUTPUT

Low income of households, high transportation costs to supply products to the external market, poor quality and high costs of local manufacturers are the main restrictions to accelerate output from demand side. The output structure and composition of goods for exports are practically unchanged for long time. Inflexible structure of production in most cases connected with low mobility of factors of production. Capital does not accumulate in the most efficient branches of industry yet.

A few enterprises managed to enter and survive at the external market. Tough competition forces them to expand production and cut prices on their products. There is practically no such competition in domestic market. To some extent low purchasing power of population prevents to improve the quality of the production. Price competition is achieved primarily by technology violation (handicraft industry) or evading tax and customs procedures.

Protective policy of some neighbouring countries has restrained demand for exports. Participation in humanitarian assistance to Afghanistan as well residence of international anti-terrorist coalition contingent is able to stimulate some demand.

According to the preliminary estimates of the National Statistics Committee, gross domestic product during the first quarter of 2002 decreased by 2.8% in the year to the first quarter of 2001. Price-deflator index made up 105.7%. Without taking into consideration the enterprise “Kumtor Operating Company”, gross domestic product increased by 1.4%. Industrial production and construction decreased by 11.9 and 5.4%, respectively. Growth of agriculture slowed to 1.4%.

Physical volume index of industrial production totalled 88.1% compared with the first quarter of 2001, but excluding production of the “Kumtor Operating Company” it has not been changed. Among different types of economic activities “Metallurgy industry” and “Generation and distribution of electricity, gas and water” manifested the biggest fall. Slowdown in production of metallurgy was stipulated by decrease in extraction of metal from ores. Electricity generation at the hydroelectric power stations decreased by 11.8%, which is connected with low water level at the Toktogul water-storage reservoir. Partially, it was compensated by the growth of electricity generation at the thermal electric power stations.

Those branches of industry that oriented toward consumer market had been the best performers. Physical volume index of food production increased by 5.4%. Output of dairy products and their processing, confectionery and distillery was increasing as before. Production of sugar has re-appeared and pronounced significant growth (more than 10 times) compared with the corresponding period of previous year, which is stipulated by processing of the imported raw materials. At the same time, production of beer, tobacco, meat and by-products, preserved vegetables and macaroni is decreasing.

Decline in production was observed in machine building. However, growth of some types of production was registered. Thus, incandescent lamps and electric heater production was growing. Growth of output of colour TV and computers, though their volume is small, may be noted among the consumption goods. Registered

in 2001 growth of output of equipment for trade and catering, food kettles, refrigerated display equipment slightly reduced in the first quarter of 2002.

Production of construction materials was mixed. Physical volume index in that branch of industry amounted 99.9%. Output of heat-insulation materials, bricks, lime carbonate significantly decreased in comparison with the similar period of the last year. At the same time, output of concrete, prefabricated construction elements made of concrete and cement increased.

Among the non-food products it is necessary to note the textile and clothing manufactures. Output of washed wool, cotton fabrics, non-woven fabrics, clothes, hosiery and boxcalf goods increased. As a whole the growth rate was 51.2%.

In construction the growth appeared to be negative by 5.4%. It was stipulated by decrease in investment. Growth index in services made up 102.4% of which trade and freight transportation indices made up 105.4% and 102.2%, respectively.

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

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

The National Bank's Board adopted the following resolutions concerning monetary policy in the first quarter of 2002.

- The Board Resolution No. 14/3 of March 27, 2002 "On amendments to the Regulations "On overnight credit" made by the National Bank of the Kyrgyz Republic". Overnight credit is an instrument of monetary policy used by the National Bank to support the stable liquidity of the banking system. According to this resolution, procedures aimed to set up interest rate of overnight credit had been changed. Thus, interest rate of overnight credit has been pegged to the discount rate of the National Bank times coefficient by the amount of 1.2, while previously it was set up by the Monetary Regulation Committee's decision;
- The Board Resolution No. 15/4 of March 31, 2002 "On basic guidelines of the payment system development in the Kyrgyz Republic for 2002-2005". Realisation of this resolution directed to the clearing operations to increase, to make payment services more available for population and to improve recent payment system. The concrete tasks are determined and the business plan is approved to achieve those tasks.

##### 4.2. MAJOR DECISIONS OF THE MONETARY REGULATION COMMITTEE

The Monetary Regulation Committee monitors money market, compliance of criteria established by the National Bank within the "Poverty Reduction and Growth Facility" Program, carry out decision-making on current management of liquidity. The Monetary Regulation Committee makes decisions on the weekly basis.

The major instruments of the monetary policy applied by the Monetary Regulation Committee in the first quarter of 2002 were spot and swap operation with foreign exchange and REPO operations. The Monetary Regulation Committee takes into consideration the situation in the banking system and monetary policy indicators to determine composition of operations and its volumes in financial market. Operations conducted had been directed to support liquidity of the banking system and smooth the fluctuations of som exchange rate against US dollar.

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

Domestic demand was supported by private consumption during the first quarter of 2002. Investment in real terms decreased compared with the fourth quarter of 2001 as well as corresponding period of the previous year. Budget expenditures were realised at the less extent than planned that is expected to cause decrease in domestic demand. Acceleration of imports, which is considered to be a result of consumer preferences, brings about slowdown of the gross domestic product. On the whole, the demand was accumulated previously and at present reduction in the gross domestic product and budget expenditures promote domestic demand to slow. Definite slowdown of domestic demand has been compensated by the stability of the exchange rate, slight growth in real disposable incomes, expansion of monetary aggregates and aggravating incentives to save. Significant slump of fuel and oil products prices supported by the less pronounced growth in prices compared with customary seasonal pattern stimulated slowdown of consumer price.

The National Bank produced outlooks for inflation during 2000-2001, which had regularly been exceeding actual values of consumer prices growth. It reflects the conservative position of the National Bank, which pronounces upper bound of the expected inflation and does not aim to prevent inflation expectations artificially by underestimating of forecast. At the same time, the National Bank forecasts are based on available actual information. To put realistic tasks and to attain them is prerequisite condition to build reputation for macroeconomic policy in general and bodies responsible to formulate and realise this policy. Nevertheless, problems concerning improvement in quality and accuracy of forecasts are on the agenda, the National Bank tries to do its best and this work will be continued in future.

Inflation will be 2.1% in the second quarter of 2002 compared to the first quarter of the current year.