

National Bank of the Kyrgyz Republic

Inflation Report

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Inflation Report

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Publications of the National Bank of the Kyrgyz Republic

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 bulletin is published monthly in the Kyrgyz, Russian and English languages.

Balance of Payments of the Kyrgyz Republic

The publication reflects the latest trends in development of the external sector and contains tables with data in analytical and neutral formats of the balance of payment, the structure of external trade, international reserves, external debt, the methodology and the information base for preparation of the balance of payments, as well as the international investment position of the Kyrgyz Republic. It is published quarterly in January, May, July and October.

Banking System Development Trends

The publication contains analysis of banking system efficiency as financial intermediary, and developments in financial stability. It is published in Kyrgyz and Russian semi-annually.

Statutory acts of the National bank of the Kyrgyz Republic

The purpose of the edition is the official publication of statutory acts of the National bank for informing commercial banks and the public and propagation of the bank legislation of the Kyrgyz Republic. It is published once a month in the Kyrgyz and Russian languages.

Press release of the National Bank of the Kyrgyz Republic

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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1. CURRENT DEVELOPMENTS OF INFLATION

In the first half of 2005, the gross domestic product increased by 2.4 percent on the preliminary data of the National statistical committee. Excluding production of gold-mine combine Kumtor its growth rate made 4.7 percent. Manufacture of industrial output decreased by 9.8 percent. Excluding production of gold-mine combine Kumtor industrial output reduced by 1.3 percent. Agricultural production decreased by 1.1 percent.

The foreign trade turnover in F.O.B. prices increased by 5.1 percent compared to the second quarter of 2004. Exports of goods reduced by 3.5 percent. Imports of goods grew by 12.3 percent.

Quarterly average of the nominal effective exchange rate index decreased by 6.3 percent compared with the second quarter of 2004 that corresponds to strengthening of exchange rate. However, strengthening in annual average (June 05 - June 04 average to June 04 - June 03 average) made 0.2 percent. Quarterly average of the real effective exchange rate became stronger by 1.3 percent, while easing in annual averages by 4.0 percent was observed.

The monetization of economy, estimated for monetary aggregate M2X, raised from 18.4 percent of GDP on the end of the first quarter up to 19.3 percent of GDP on the end of the second quarter of the current year. Velocity of monetary aggregate M2X, designed on the constant exchange rate, decreased up to 5.2 turnovers (on the end of the first quarter its value made 5.4 turnovers). The money outside of banks to deposits ratio decreased and made 1.2 (the given parameter on the end of the first quarter made 1.4). Deposits in a foreign currency grew by 17.5 percent, deposits in the national currency gained 13.2 percent.

Average interest rate on notes of the National bank increased by 0.5 percentage points in comparison with the first quarter of the current year and made 4.1 percent. The average level of interest rates on REPO operations increased by 0.2 percentage points and reached 4.0 percent. Interest rate on interbank credit in the national currency increased a little and made 4.1 percent.

Average yield of 3 month bills made 4.3 percent and increased in comparison with the first quarter by 0.6 percentage points. The average yield of 6-month bills also raised from 4.2 up to

4.8 percent, and average yield of 12-month bills decreased by 0.7 percentage points and made 5.4 percent. Average-weighted interest rate increased by 0.6 percentage points and totalled 5.9 percent.

In the second quarter of 2005, according to the National statistical committee, growth in consumer prices made 2.6 percent. In the third quarter of 2005, the deflation by 2.2-2.3 percent is expected.

2. CONSUMER PRICE INDEX AND ITS COMPONENTS

2.1. COMPONENTS OF CONSUMER PRICE INDEX

In the second quarter of 2005, growth in consumer prices accelerated, and according to the National statistical committee its rose by 2.6 percent. In the second quarter of 2004, consumer prices decreased by 0.3 percent.

The key factor, which has determined dynamics of consumer prices in the second quarter of 2005, was seasonal rise in prices on production of agriculture, in particular, food stuffs. Prices on foodstuffs increased by 6.8 percent. Non-food consumer prices grew by 0.2 percent. The prices for paid services decreased by 0.3 percent.

2.1.1. FOOD PRODUCTS

The price index on articles of food increased by 6.8 percent. Dynamics of the food prices in the second quarter of 2005 was formed under influence of a rise in prices on the following groups of the goods: fruit and vegetables, oil and fats, meat and fish, bread and bakery products.

Poor harvest of vegetables caused by late terms of carrying out of spring works in 2005 was one of the reasons of acceleration in price growth. According to the National statistical committee in January - June of 2005, vegetable crops decreased by 48.7 percent compared with the corresponding period of 2004. Potato crop dropped by 11.6 percent. The prices for fruit-and-vegetable group grew by 30.2 percent, prices on vegetables rose by 37.7 percent, fruit prices gained 27.6 percent.

Also, prices on meat and meat products grew by 6.5 percent, on fish (4.5 percent), on sugar and confectionery products (1.1 percent), bakery products (1.1 percent). There was a reduction of prices on some goods, in particular, milk and dairy products became cheaper by 10.9 percent.

2.1.2. NON-FOOD PRODUCTS

The price index on articles of food grew by 0.2 percent. The greatest increase of the prices took place on materials for the

Chart 2.1: CPI and its components, percentage changes on a year earlier

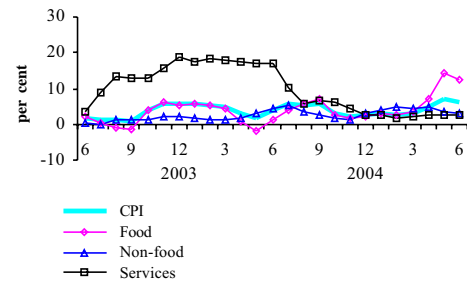


Chart 2.2: Structure of CPI, per cent

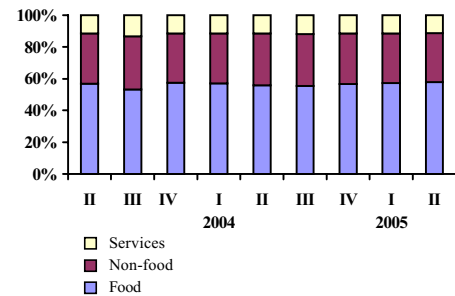


Chart 2.3a: Food Prices, percentage changes on a year earlier

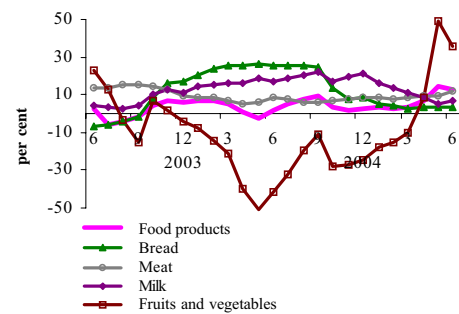


Chart 2.3b: Food Prices, percentage changes on a year earlier

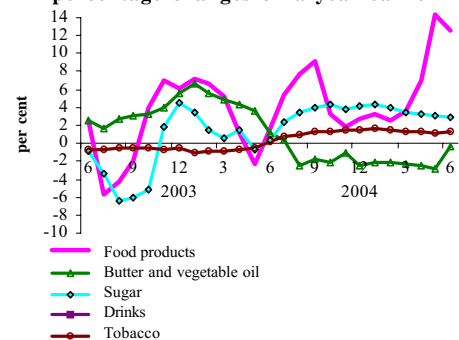


Chart 2.4a: Non-food Prices, percentage changes on a year earlier

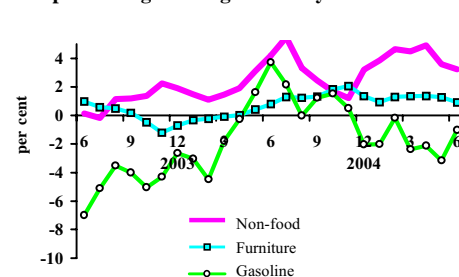
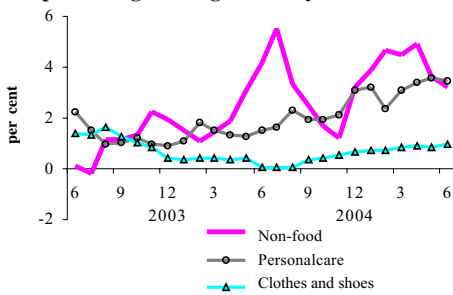


Chart 2.4b: Non-food Prices, percentage changes on a year earlier

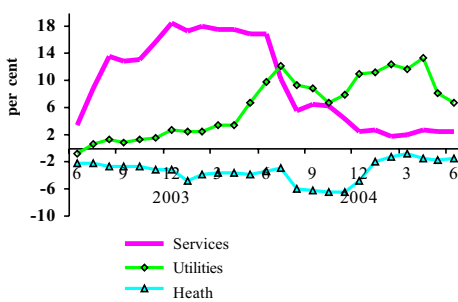


maintenance and repair of premises (by 6.5 percent), lubricating materials (by 4.4 percent), electrohousehold devices (by 1.1 percent). Thus, the prices for coal decreased by 5.0 percent.

2.1.3.SERVICES

In the second quarter of 2005, the price index on paid services decreased by 0.3 percent. Services on tailoring and hairdressing rose by 1.2 and 0.5 percent, respectively.

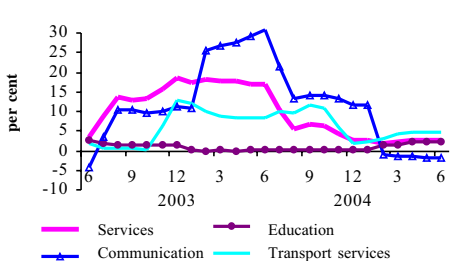
Chart 2.5a: Services, percentage changes on a year earlier



2.2. CONSUMER PRICES BY REGIONS

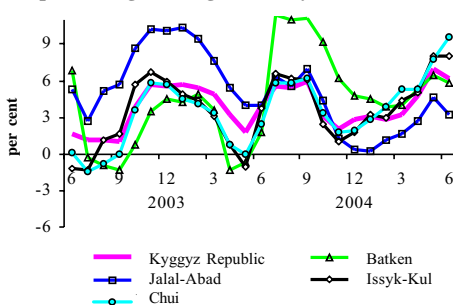
In the second quarter of 2005, there was an increase in consumer prices in all regions of republic, excluding one. The greatest increase in prices has been marked in Issyk-Kul and Naryn oblasts, where inflation gained 4.7 and 5.1 percent, respectively. The prices for food stuffs grew by 11.0 and 16.1 percent, thus, non-food prices in Naryn oblast decreased by 2.6 percent, and the prices for paid services did not change. In Issyk-Kul oblast, food prices grew by 0.8 percent, and the prices for paid services - by 1.6 percent.

Chart 2.5b: Services, percentage changes on a year earlier



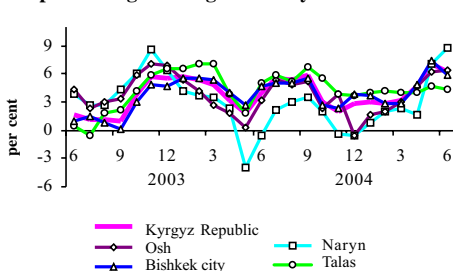
In Osh, Chu, Batken oblasts and Bishkek City consumer prices gained 2.5-3.4 percent. The increase in food prices was in a range of 5.2-10.0 percent in these regions. The non-food prices in the Osh oblast and Bishkek City grew by 0.6 and 0.8 percent, and in Chu and Batken oblasts they decreased by 0.9 and 2.3 percent, respectively. In Osh oblast, paid services became more expensive by 2.5 percent. The price index on paid services in Bishkek City decreased by 1.2 percent, and in Chu and Batken oblasts service prices did not change.

Chart 2.6a: CPI by Oblasts, percentage changes on a year earlier



In Talas oblast, consumer prices price grew by 1.0 percent. The food prices grew by 3.3 percent, non-food prices decreased by 0.7. The prices on paid services grew by 0.5 percent.

Chart 2.6b: CPI by Oblasts, percentage changes on a year earlier



Decrease in consumer prices by 0.1 percent has been marked in Jalal-Abad oblast. Food prices grew by 2.2 percent, non-food prices fell by 2.5 percent. The prices for paid services did not change.

3. INFLATION FACTORS

3.1. MONETARY AGGREGATES

3.1.1. MONETARY BASE

During the second quarter of 2005 the monetary base increased by 1.3 percent. The basic contribution to monetary base growth rendered the operations, which have been carried out by the National bank. So, monetary base rose by 161.6 million Soms, out of which 121.6 million Soms fall to the National bank operations. Due to transactions in foreign exchange the monetary base grew on 231.6 million Soms, while open market operations sterilised 167.3 million Soms. Operations of the Ministry of Finance resulted in the monetary base growth, which totalled 40.0 million Soms. Thus, budgetary operations (excess of expenditures over revenues) increased monetary base by 104.5 million Soms. At the same time, other payments, including financing of embassies of the Kyrgyz Republic in foreign countries, reduced monetary base on 64.5 million Soms. For 12 months monetary base gained 18.3 percent.

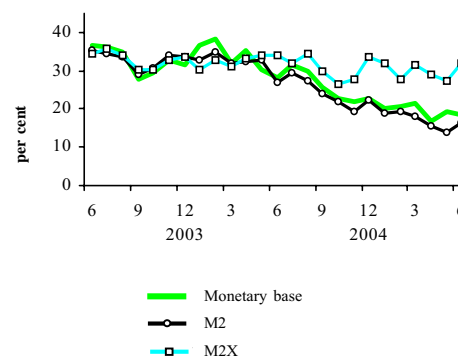
In the second quarter, money in circulation decreased by 1.0 percent, thus, for 12 months given monetary aggregate grew by 12.8 percent that is much lower than in corresponding period of 2004. So, for the second quarter of 2004 of money in circulation grew by 4.0 percent, for 12 months it gained 27.3 percent.

In structure of monetary base, share of cash in circulation decreased to 91.0 percent on the end of June from 93.1 percent on the end of March. Share of commercial bank balances on correspondent accounts in the National bank increased from 6.9 up to 9.0 percent.

3.1.2. AGGREGATE M2

During the second quarter of 2005 the monetary aggregate M2 increased by 1.2 percent. For 12 months monetary aggregate M2 increased by 16.5 percent. Deposits in the national currency increased by 13.2 percent, including transferable deposits that gained 18.7 percent (in the second quarter of 2004, there was a decrease by 5.4 percent), and other deposits - by 1.3 percent (in the second quarter of 2004 it gained by 4.5 percent). For 12 months the increase in deposits in the national currency made 36.1 percent (for the similar period of 2004 it growth rate made 24.2 percent).

Chart 3.1: Monetary aggregates, percentage changes on a year earlier



3.1.3. AGGREGATE M2X

Growth in monetary aggregate M2X by 6.2 percent was caused by increase in depositary base¹ of commercial banks by 16.3 percent. Dynamics of depositary base changed in comparison with the first quarter of the current year. Growth in foreign currency deposits accelerated to 17.5 percent (5.0 percent in the first quarter), and growth in national currency deposits renewed and made 13.2 percent after 7.1 percent decline in the first quarter. In the second quarter of 2004, deposits in foreign currency increased by 16.0 percent, and deposits in the national currency reduced by 2.1 percent.

There were following changes in structure of monetary aggregate M2X:

- the share of cash outside of banks decreased up to 53.1 percent (57.5 percent as of 01.04.05);
- the share of deposits in the national currency grew up to 12.1 percent (11.4 percent as of 01.04.05);
- the share of deposits in foreign currency increased up to 34.7 percent (31.1 percent as of 01.04.05).

The multiplier of broad money increased and made 1.65 as of July 1 of 2005. While its value on the end of 2004 and the end of the first quarter of the current year made 1.56 and 1.57, respectively. The monetization of economy, estimated for monetary aggregate M2X, raised from 18.4 percent of GDP on the end of the first quarter up to 19.3 percent of GDP on the end of the second quarter of the current year. Velocity of monetary aggregate M2X, designed on the constant exchange rate, decreased up to 5.2 turnovers (on the end of the first quarter its value made 5.4 turnovers). The money outside of banks to deposits ratio decreased and made 1.2 (the given parameter on the end of the first quarter made 1.4). Deposits in a foreign currency grew by 17.5 percent, deposits in the national currency gained 13.2 percent.

3.2. INTEREST RATES

3.2.1. MONEY MARKET INTEREST RATES

In the beginning of the second quarter, interest rate on credit in the national currency in the interbank credit market decreased a little, but it still exceeded 3.5 percent level, which developed before increase at the end of March. Interest rates

¹ Including banks, which license is withdrawn, but process of liquidation is no completed yet.

on REPO operations fluctuated within the 4.0-4.3 percent range and some commercial banks revealed strong demand for monetary resources. In May - June, interest rate in the interbank credit market changed within 4.1-3.8 percent range, depending on liquidity and term of transactions. However, at last days of quarter some large banks manifested deficiency of liquidity, therefore, REPO rates increased up to 4.5-5.5 percent.

In first half of April, the discount rate kept at 3.5 percent level since first two auctions on accommodation of 28-day notes of the National bank did not take place in connection with insufficient amount of participants. Weak activity of banks in the primary market of notes has been connected to decrease in liquidity in banking system. Since second half of April liquidity of banking system and demand of banks for notes raised. Thus, interest rate of notes increased up to 4.0 percent. In May - June, interest rate of notes changed in 4.0-4.3 percent range.

Since April 8 the interest rate on overnight credit² increased up to 5.3 percent in comparison to 4.2 percent by the end of March because the the National bank raised factor up to a 1.5 level (before its value made 1.2). On the end of the second quarter the overnight interest rate developed at 6.29 percent level.

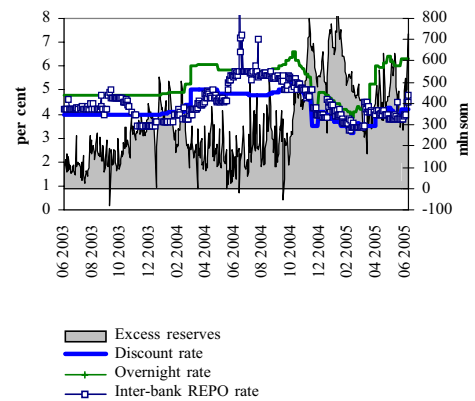
Quarterly average interest rate of notes made 4.1 percent that is 0.5 percentage points higher in comparison with the first quarter. The average interest rate on REPO operations increased by 0.2 percentage points and reached 4.0 percent. Interest rate on interbank credit in the national currency increased up to 4.1 percent from 3.8 percent in the first quarter of 2005.

In the second quarter, in foreign exchange interbank credit market the average interest rate decreased on 1.2 percentage points and made 3.4 percent. This was promoted by reduction of the average maturity of transactions from 81 till 20 days and strengthening in US dollar exchange rate in the world market. Thus, the range of interest rate fluctuations reduced to 1.5-4.5 percent in comparison to 3.6-11.0 percent range in the first quarter.

3.2.2. STATE TREASURY BILLS

In the beginning of the second quarter, increase in yield on T-bills with three and six month maturity, which began at the end

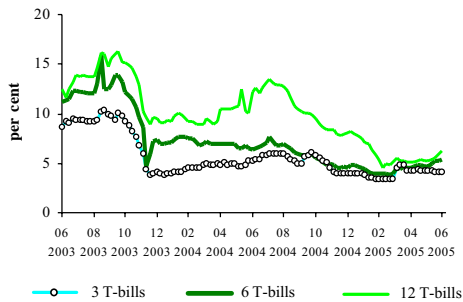
Chart 3.2: Money market interest rates vs. liquidity, per cent



² Interest rate on overnight credit is determined as a product of factor times discount rate.

of March, was still kept. But from second half of April and up to the end of May yields on T-bills for all maturities decreased and stabilized. Thus, the spread between interest rates on T-bills for different maturities reduced to 0.4-0.5 percentage point range. So, narrow sparseness of rates testifies strong demand on 6- and 12-month's bills.

Chart 3.3: T-bill yields

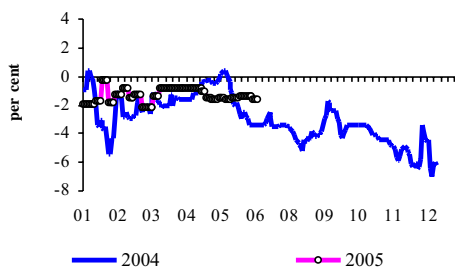


In June, in 6- and 12-month bill segments situation worsened due to decrease in liquidity at banks - the basic participants of auctions. Also, acceleration of inflation in May influenced interest rates of bills. So, in June, interest rates on 6- and 12-month bills rose, while the basic participants of auctions gradually increase the declared prices and interest rate on 3 month bills decreased a little in June.

In the second quarter, the average interest rate of 3 month bills made 4.3 percent and increased in comparison with the first quarter by 0.6 percentage points. The average interest rate of 6-month bills also raised from 4.2 up to 4.8 percent, while average interest rate of 12-month bills decreased on 0.7 percentage points and made 5.4 percent. On the end of June the average level of interest rates by all kinds of bills made 5.9 percent, that on 0.6 percentage points exceeded a level of rates by the beginning of a quarter.

3.3. EXCHANGE RATE

Chart 3.4: Cumulative change in exchange rate (Som per US dollar)



In first half of April, strong demand of commercial banks on US dollar at the foreign exchange market kept because of needs of clients and outflow of deposits. The interventions of the National bank satisfied the raised demand on foreign exchange, so exchange rate stabilized at 41.3 Soms per US dollar. Since last decade of April balances of commercial banks in foreign exchange were increasing due to export receipts, and demand on foreign exchange reduced. So, US dollar exchange rate decreased gradually to 41.0 Soms per US dollar.

In May - June, the exchange rate at the currency tenders was stable, changing in 41.0 up to 41.1 Soms / US dollar range. Thus, the supply of foreign exchange by commercial banks essentially exceeded demand for it. Besides, some commercial banks sold foreign currency with the purpose to get liquidity in Soms.

The official exchange rate for the second quarter decreased

by 0.8 percent and made 40.9614 Som / US dollar (decrease in the corresponding period of 2004 made 1.3 percent).

Exchange rate of euro against Som within the second quarter decreased due to weakening of euro on external markets. For the second quarter the official rate of euro decreased by 7.7 percent.

Quarterly average of the nominal effective exchange rate index decreased by 6.3 percent compared with the second quarter of 2004 that corresponds to strengthening of exchange rate. However, strengthening in annual average (June 05 - June 04 average to June 04 - June 03 average) made 0.2 percent. Quarterly average of the real effective exchange rate became stronger by 1.3 percent, while easing in annual averages by 4.0 percent was observed.

3.4. DEMAND AND SUPPLY

3.4.1. EXTERNAL DEMAND

According to preliminary data external trade balance of the Kyrgyz Republic for the second quarter of 2005 developed negative and totalled 67.4 million US dollars. The external trade turnover in F.O.B. prices made 420.8 million US dollars, that is 5.1 percent higher compared with the corresponding period of 2004.

Exports of goods in F.O.B. prices reduced by 3.5 percent in comparison with the similar period of the 2004. Thus, exports of gold decreased by 30.3 percent. Exports excluding gold grew by 18.6 percent.

According to functional classification delivery of the investment goods increased by 70.8 percent, consumer goods - by 34.6 percent, energy - by 24.4 percent. The basic items were aviation kerosene, spare parts and the equipment of automobiles, an electric equipment, plastic products, trunks, glass, sugar, mineral waters. Exports of raw material decreased by 26.1 percent, and delivery of intermediate goods dropped by 24.0 percent mainly due to reduction in exports of gold.

For the second quarter of 2005 exports in the non-CIS countries decreased by 20.7 percent. The basic partners on exports to the non-CIS countries were the United Arab Emirates (34.2 percent out of total), Canada (6.8 percent), China (6.3 percent). The gold, mineral oil, aluminium, spare parts and the equipment

Chart 3.5: Som effective exchange rate indices

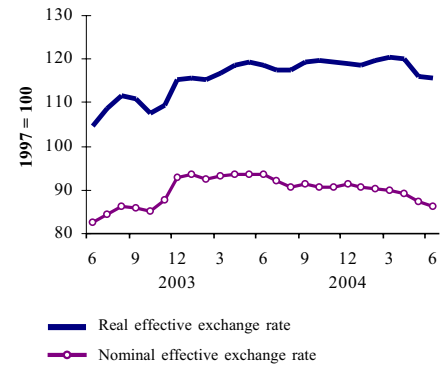
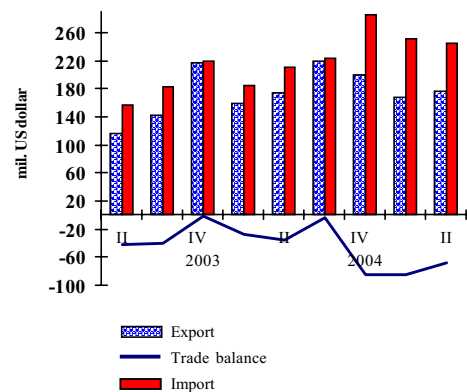


Chart 3.6: Trade balance



of automobiles, a metal breakage, electric lamps, tools, fabrics, trunks were basic items of exports to these countries.

Exports to the CIS countries for the second quarter 2005 increased by 28.2 percent. Large export partners among the countries CIS were Russia (14.0 percent out of total exports), Kazakhstan (22.0 percent), Tadjikistan (4.8 percent). The electric power, cement, sugar, glass and products from it, products from plastic, waters mineral were basic export goods in these countries.

Imports of the goods in F.O.B. prices for the second quarter 2005 grew by 12.3 percent in comparison with the similar period of 2004. Growth rate of imports from the CIS and non-CIS countries totalled 12.0 and 12.9 percent, respectively.

Growth of imports occurred in all groups of functional classification, except raw materials. High growth rate demonstrated imports of energy products (27.6 percent) and the intermediate goods (18.0 percent), as well mineral oil, trunks, fertilizers, asbestos, plastic.

The basic partners on imports among CIS countries were Russia (32.3 percent out of total imports), Kazakhstan (16.7 percent), Uzbekistan (5.5 percent), and among non-CIS countries - the USA (8.5 percent), China (7.5 percent).

3.4.2. DOMESTIC DEMAND

3.4.2.1. PRIVATE CONSUMPTION

On the preliminary data of the National statistical committee during January - May the wages increased by 15.9 percent. Real wages gained 11.3 percent. The turnover of trade grew by 11.0 percent.

3.4.2.2. PUBLIC CONSUMPTION

Revenues of the state budget in the first half-year of 2005 rose by 11.2 percent compared with the corresponding period of 2004 year. Expenditures of the state budget increased by 11.1 percent. Assignment for wages grew by 16.1 percent. Subsidies to the state enterprises increased by 9.2 percent. Assignment on capital investment and repair decreased by 10.9 percent.

3.4.2.3. INVESTMENT

For the first half-year of 2005, according to the operative information of the National statistical committee, investment into fixed capital (construction, reconstruction, expansion and modernisation of objects) reduced by 17.8 percent.

3.4.3. OUTPUT

On the preliminary data of the National statistical committee in the second quarter of 2005 the gross domestic product increased by 2.4 percent. Excluding production of gold-mine combine Kumtor it gained 4.7 percent. Industrial output decreased by 9.8 percent. Excluding production of gold-mine combine Kumtor industrial output reduced by 1.3 percent. Agricultural production decreased by 1.1 percent.

4. MONETARY POLICY DECISIONS

4.1. BOARD DECISIONS

1. The statement of Board " About colletarell on overnight credit of the National bank of the Kyrgyz Republic " № 16/14 as of May 19.

Since July1 of 2005, according to the specified statement securities of the Kyrgyz Republic placed through the National bank, which due not later than last day of quarter in which overnigh credit was issued, are accepted as colletarell.

2. The statement of Board " About the exchange rate of US dollar used for calculation of reserve requirements " № 17/1 as of May 30.

Since May 30 till October 2 of 2005 exchange rate for estimation of reserve requirements is established at 41.0 Soms per US dollar.

4.2. MONETARY REGULATION COMMITTEE DECISIONS

The monetary regulation committee carries out operative decisions in monetary sphere. Decisions are accepted by committee weekly and based on results of an estimation of the situation developing in the financial markets.

The sales volume of 28-day maturity notes on weekly auctions established at 4.0 million Soms.

The total amount of foreign exchange interventions of the National bank increased more than 2 times and made 16.6 million US dollars in comparison with the first quarter. In April, the the National bank basically sold foreign currency, and in May and June the National bank bought it. The interventions of the National bank totalled 11.5 million US dollars. Net purchase during the second quarter of 2005 made 6.3 million US dollars (in the first quarter net sale made 5.6 million US dollars).

The National bank, maintaining liquidity in the banking system and smoothing sharp fluctuations in interest rates of money market, issued overnight credit to commercial banks, which total amount increased by 46.7 percent and made 1.57 billion Soms. The National bank also carrying out SWAP operations,

which totalled 40.4 million Soms that by 60.2 percent more than in the first quarter.

4.3. INFLATION OUTLOOK FOR THIRD QUARTER OF 2005

Major factors, which were considered at an estimation of dynamics of consumer prices in the third quarter of 2005, are:

- seasonal reduction of food prices;
- increase in mineral oil prices in countries - suppliers.

In the third quarter of 2005, the deflation by 2.2-2.3 percent is expected.