

# Monetary policy report for the first quarter of 2014

Approved by Resolution of NBKR  
Board No.23/1 as of May 26, 2014

## Executive summary

**The National Bank of the Kyrgyz Republic started introduction of the new operational basis of the monetary policy in the first quarter 2014.** The new basis suggests gradual transition from the use of the volume of monetary base as an operational reference for the use of the rate of discount. The mechanism of identifying the rate of discount was modified; new instruments of the monetary policy were introduced and the existing instruments modified. In mid-term perspective, this should help to strengthen the percentage transmission channel and bring the percentage rates of the banking sector to the rate of discount.

**In the first quarter 2014, consumer price index growth was noted; inflation kept within the landmark identified by the Main directions of the monetary policy for 2014-2017.** Inflation (in an annual expression) increased from 4.0 percent by the end of the fourth quarter 2013 to 6.3 percent by the end of the first quarter 2014. Inflation growth was subject to the impact on the internal prices of the effect of acute growth of US dollar exchange rate against Kyrgyz som (KGS) and increase of world prices for some food products.

**As estimates show, according to the results of the first quarter 2014 the payment balance of the Kyrgyz Republic was resulted in a negative balance in the amount of 124.4 million US dollar.** Short position of the current account decreased by 13.4 percent to GDP and constituted 249.0 million US dollar. Reduction of the trade deficit of the trade balance by 1.6 percent to 600.5 million US dollar is expected. Export of goods (according to FOB, taking into account of pre-estimation on the re-export of oil products) will constitute 471.3 million US dollar and will decrease by 0.6 percent. Import of goods (in FOB prices) will decrease by 1.2 percent and will constitute 1 071.9 million US dollar. Net inflow on current transfers will constitute 385.1 million US dollar (-3.6 percent). Negative dynamics will be due to the reduction of revenues on private transfers; net inflow of the latter will decrease by 8.5 percent and will constitute 366.4 million US dollar.

**Slowdown of economic growth rates was observed in countries – main trade partners.** The growth of China's economy in the first quarter constituted 7.4 percent, Kazakhstan's economy – 2.9 percent, Russia's economy – 0.8 percent. Anticipation related to the increase of the outflow of capital from Russia has become strong after the geopolitical relations between Russian and Ukraine has had been aggravated which lead to acute changes in the Russian currency market. This has increased shock in the internal currency market of previously held devaluation of Kazakh tenge and lead to more significant depreciation of KGS.

**The National Bank of the Kyrgyz Republic has taken a wide range of measures to balance the acute currency fluctuations and remove the speculative make.** Sale of US dollar in the interbank market was conducted, transaction in the open market was actively implemented, some instruments of the monetary policy were adapted to the changing conditions, application of administrative measures was activated, and active information campaign was held. Depreciation of KGS in the first quarter constituted 10.8 percent, rate increased by 54.4813 KGS/US dollars. The volume of currency intervention (sale) of NBKR constituted 198.1 million US dollar.

**Monetary base for the first quarter 2014 decreased by 5.8 billion KGS to 67.4 billion KGS (-7.9 percent).** Wide monetary base M2X that covers deposits in foreign currency in January-March 2014 decreased by 1.9 percent and constituted 118.7 billion KGS.

**The first quarter observed moderate rates of economic growth in the country.** GDP growth in January – March 2014 constituted 5.6 percent (in January – March 2013 – 8.8 percent. Economic growth was ensured mainly by the work of the gold minefield “Kumtor”, construction sector and moderate growth of other sectors of economy. Without “Kumtor” the volume of GDP growth increased by 4.9 percent. GDP deflator was at the level of 2.5 percent. It is expected that by

the end of the year GDP growth rates may decrease; however, will increase in the mid-term perspective.

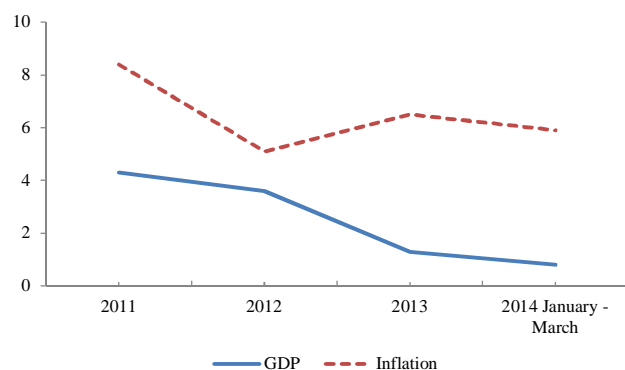
**According to the preliminary data of the Ministry of Finance, as a result of the first quarter 2014 the state budget net surplus will constitute 2.0 billion KGS or 2.9 percent to GDP.** General income of the state budget constituted 22.7 billion KGS (33.6 percent to GDP), having increased by 5.7 percent or to 1.2 billion KGS against the similar indicator for the period of January – March of the last year. General expenditures of the state budget constituted 20.8 billion KGS (30.7 percent to GDP), having increased by 12.4 percent or to 2.3 billion KGS.

**Forecast prepared based on modeling shows that the inflation will keep growing mainly for the rest of the months of 2014 due to the depreciation of KGS.** The highest growth is envisaged by the end of 2014 when the inflation will be close to the level of 10 percent. For the rest of the periods decrease of inflation will take place up to the level close to the target landmark. Average annual meaning of inflation in 2014 will achieve 8.2 percent, in 2015– 7.6 percent, in 2016 – 5.6 percent, in 2017 will decrease up to 4.6 percent.

## External environment

### Economic development of the countries – main trade partners

**Chart 1. GDP and inflation in Russia**



Source: Ministry of Economic Development, “Bloomberg” IA

#### Russia

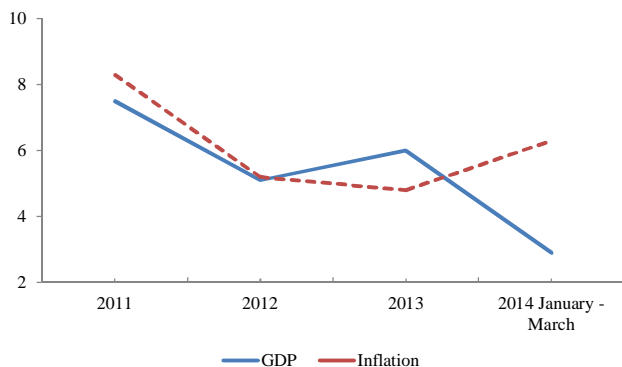
Slowdown of economy persists in Russia. According to the results of the first quarter 2014 based on the preliminary assessment of the Ministry of Economic Development of the Russian Federation, GDP growth as compared to the similar period of the last year did not change and constituted 0.8 percent. Increase of capital outflow by reason of connectedness of Russia with the political crisis in Ukraine contributed to the moderate economic growth which affected the low growth level of industry and negative dynamics of investments to the main capital that influenced the decrease of construction works. Structural problems in the economy persist. Weakening of the rate of Russian ruble was also connected with the outflow of foreign capital from the Russian market.

Inflation rate in March increased to 6.9 percent (in an annual expression), whereas, the inflation rate in March of the previous year constituted 7.0 percent. Growth of prices in the first quarter 2014 strengthened almost in all sectors of economy which was mainly affected by the acute weakening of ruble.

**Chart 2. GDP and inflation in Kazakhstan**

#### Kazakhstan

GDP in Kazakhstan in the first quarter 2014 increased by 2.9 percent against the growth by 4.6 percent for the similar period of 2013. Slowdown of the growth in Kazakhstan affected all sectors except for the construction and agricultural sector. Besides, weakening of the internal demand started in the fourth

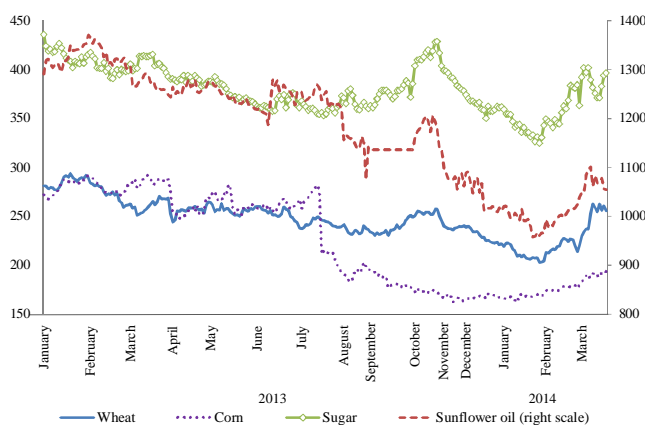


Source: Statistic Agency of Kazakhstan

## World commodity markets

### Food Market

**Chart 3. Dynamics of prices for food products**  
(USD per ton)



quarter 2013 took place.

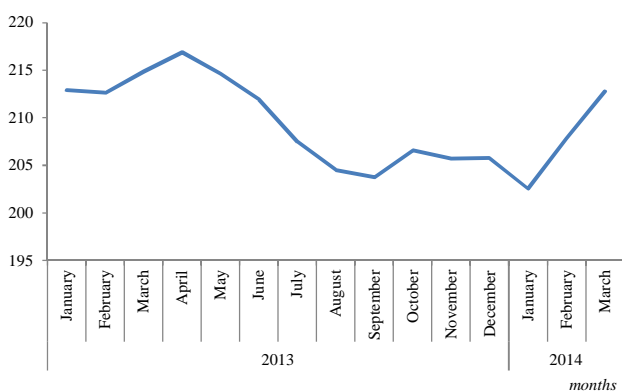
Since early 2014 increase of the growth rates of inflation processes in the country has been noted. Inflation in March 2014 constituted 1.0 percent, in annual terms (March 2013 against March 2014) 6.3 percent.

Increase of consumer prices was due to the increase of prices for the fee-paying services for the population and food products.

Price surge in the world food market for basic goods (cereals, sugar, and vegetable oil) was observed in the first quarter 2014. The price surge is explained by the unfavorable weather conditions for some plantings and geopolitical tensions in the Black Sea Region.

Price surge for cereals resulted in an acute jump of prices for wheat and corn due to the uncertainty in relation to the supplies from Ukraine – one of the largest suppliers of cereals into the world market. Additionally, unfavorable weather conditions in USA may become the reason of poor harvest of wheat.

**Chart 4. Dynamics of FAO food prices index**



Upward rise in future prices for sugar and vegetable oil was formed mainly under the impact of dry weather in Brazil and in South-East Asia.

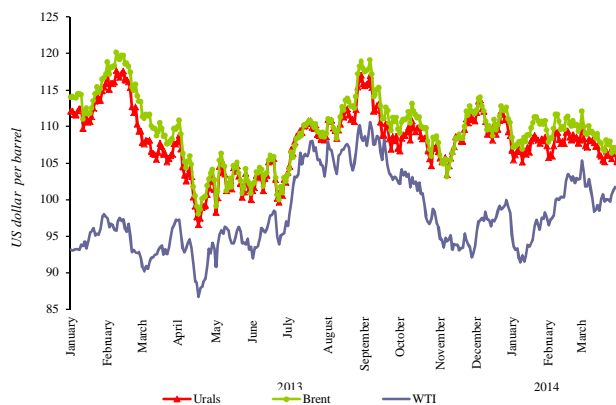
Despite significant rise of food prices in the first quarter of the current year, the average index of FAO food prices was lower against the similar period of the previous year– 207.7 points against 213.5 points.

## The energy market

**Chart 5. Dynamics of oil prices**  
(USD per barrel)

Prices of basic grades of oil (Urals, Brent, WTI) in January-March 2014 fluctuated at the range of 99-109 US dollar per barrel. The situation in the oil market was defined by the following factors:

- Closure of the USA quantitative easing (QE) program which is the fundamental factor affecting the price pressure on future prices.
- Geopolitical tensions in the Black Sea



Region affected the price surge.

- Cold weather in the north-east of USA which caused increase of using fuel oil.
- Closure of some oil refinery that affected the reduction of oil resources.
- Fall of the oil production in Libya that is connected with the persisting protests of armed militants who have blocked the work of important energy sites in Libya from summer 2013, including fields and oil loading ports in the east of the country.

## Gold market

**Chart 6. Dynamics of gold prices**  
(USD per troy ounce)



Rise of world prices for gold was noted in the first quarter of 2014; the average price per quarter constituted 1291.6 US dollar per troy ounce.

The main reason of the significant rise of prices was the tense political situation in Ukraine. Thus, the gold attractiveness as the reliable asset without direct links with certain government or a country increased and preconditioned the rising price trend.

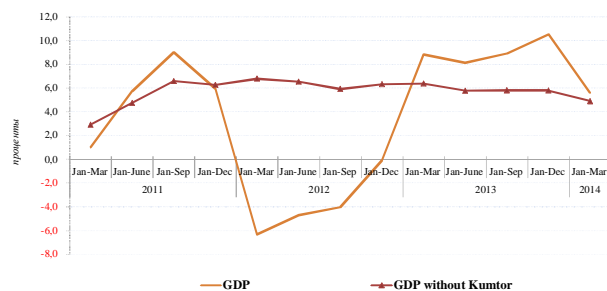
The rise of prices was also caused by the concerns of investors regarding the pace of economic redevelopment in USA. In particular, reduction of unemployment in the country turned out to be slower than expected.

Low rates of redevelopment of economies of the developing countries and weakening of their national currencies, high level of demand on part of China additionally affected the world gold market.

## Macroeconomic Development Supply and demand on the market of goods and services

### Demand

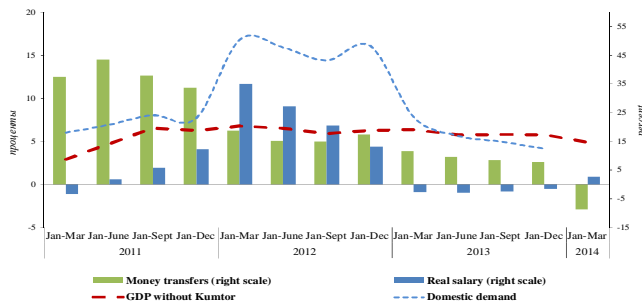
**Chart 7. Dynamics of GDP**  
(period /to the corresponding period of the previous year)



Moderate growth of GDP of Kyrgyzstan at the level of 5.6 percent (in January-March 2013– 8.8 percent) was observed in the first quarter 2014. The economic growth was provided mainly by the work of the gold minefield “Kumtor”, construction sector as well as the moderate growth of other sectors of economy. GDP without taking into account “Kumtor” indices increased by 4.9 percent (in January – March 2013– 6.4 percent). GDP deflator kept at the level of 2.5 percent against 3.5 percent in general for the period of 2013.

**Chart 8. Dynamics of domestic demand and money transfers**

Slowdown of growth rates of money transfers according to the results of the year (growth constituted 7.9 percent), as well as



Source: National Bank of the Kyrgyz Republic □

decrease in the level of real salary to 1.6 percent based on the results of 2013 lead to the reduction of the increase of household expenses in consumptive use by 5.1 percent. In its turn, as a result of insufficient inflow of foreign capital in combination with the above mentioned factors, rates of gross savings increase in 2013 slowed down at 4.1 percent, whereas, in 2012 the increase of the same indicator constituted 42.4 percent. Thus, domestic demand<sup>1</sup> in 2013 showed slow growth rates (+4.2 percent) against 2012 (+16.1 percent). At the same time, consumption in the structure of GDP remains the main GDP component as before (112.7 percent to GDP) and its ratio against the previous year keeps growing.

According to the results of the first quarter 2014, net inflow of money transfers in US dollar decreased by 8.8 percent and constituted 320.5 million US dollar, whereas the inflow in 2013 constituted 11.8 percent. At the same time, the growth rate of inflow in ruble through the transfers kept positive at the level of 9.5 percent.

**Chart 9. State Budget Execution**

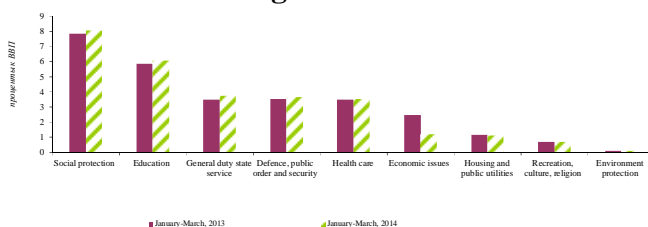


Source: Central Treasury of the Ministry of Finance of the Kyrgyz Republic, National Bank of the Kyrgyz Republic

According to the preliminary data of the Central Treasury of the Ministry of Finance of the Kyrgyz Republic as of the first quarter 2014, the net surplus of the state budget constituted 2.0 billion KGS (2.9 percent to GDP<sup>2</sup>) (according to the results of the first quarter 2013– 4.9 percent to GDP).

General revenues of the state budget constituted 22.7 billion KGS (33.6 percent to GDP) having increased by 5.7 percent or to 1.2 billion KGS as compared to the similar indicator as of January-March 2013. The significant growth of operational revenues was due to the tax yield (5.1 para.), contribution of nontax revenues composed 4.6 percentage points, and the official transfers contributed negatively in the amount of 3.9 percentage points.

**Chart 10. State Budget Execution**



Source: Central Treasury of the Ministry of Finance of the Kyrgyz Republic, National Bank of the Kyrgyz Republic

General expenses of the state budget constituted 20.8 billion KGS (30.7 percent to GDP) having increased by 12.4 percent or to 2.3 billion KGS against the same indicator for the period of January-March 2013.

<sup>1</sup> Reference to the earlier period data is based by the lack of data for January-March 2014.

<sup>2</sup> The data estimated based on the updated approach to the methods of calculation of budget indicators is presented from September 2013.

**Table 1. Investments in fixed capital by source of funding**

	January - March			
	mln.KGS		share, percent	
	2013	2014	2013	2014
<b>Total</b>	<b>10 400,5</b>	<b>14 663,7</b>	<b>100,0</b>	<b>100,0</b>
<b>Domestic investments</b>	<b>8 812,4</b>	<b>10 339,0</b>	<b>84,7</b>	<b>70,5</b>
Republican budget	92,8	62,3	0,9	0,4
Local budget	25,9	4,0	0,2	0,0
Funds of entities and organizations	5 513,2	5 476,5	53,0	37,4
Bank loans	117,4	17,7	1,1	0,1
Means of the population including charitable help of the residents of KR	3 063,1	4 778,5	29,5	32,6
<b>Foreign investments</b>	<b>1 588,1</b>	<b>4 324,7</b>	<b>15,3</b>	<b>29,5</b>
Foreign loans	1 104,2	3 055,1	10,6	20,9
Direct foreign investments	232,5	1 221,4	2,3	8,3
Foreign grants and humanitarian aid	251,4	48,2	2,4	0,3

*Source: National Statistics Committee of the Kyrgyz Republic*

High share of expenses directed at the current consumption remains in the structure of expenses on the economic classification. Increase in the share of the expenses for the payment of labor, subsidies and social benefits by 4.4 percentage points was observed in the reporting period.

According to the preliminary data of the Social Fund of the Kyrgyz Republic, budget deficit of the Social Fund achieved 0.2 billion KGS (0.3 percent to GDP), revenues – 8.7 billion KGS (12.9 percent to GDP), expenses – 8.9 billion KGS (13.2 percent to GDP).

Net surplus of the consolidated budget according to the results of the reporting period constituted 1.8 billion KGS (2.6 percent to GDP). Revenues constituted 26.9 billion KGS (39.7 percent to GDP), expenses – 25.1 billion KGS (37.1 percent to GDP).

In January-March 2014, the level of implementation of investments in the fixed capital in real terms increased by one third and constituted 14.7 billion KGS in nominal terms (decrease by 8.0 percent was noted in the similar period of 2013).

The volume of investments to the main capital on account of external sources of financing increased 2.6 times, internal sources by 11.0 percent. The main volume (more than 88 percent of the general volume of investments) was directed to the construction of sites on mining of mineral deposits, manufacturing industry and housing construction.

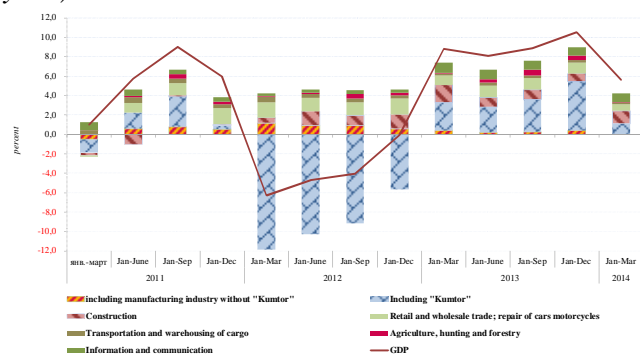
The level of implementation of investments in the fixed capital on the sites of manufacturing industry increased 2.6 times in the first quarter 2014 against the same indicator in the period of January-March 2013 and their share in the general volume of investments increased by 10.3 percentage points (85.8 percent of investments was directed to the construction of sites for the production of oil products in Kara-Balta town). Financing was mainly through the foreign loans (85.8 percent) and funds of the entities and organizations (12.6 percent).

## Proposal

In the reporting period, the GDP growth was ensured mainly due to the increase of



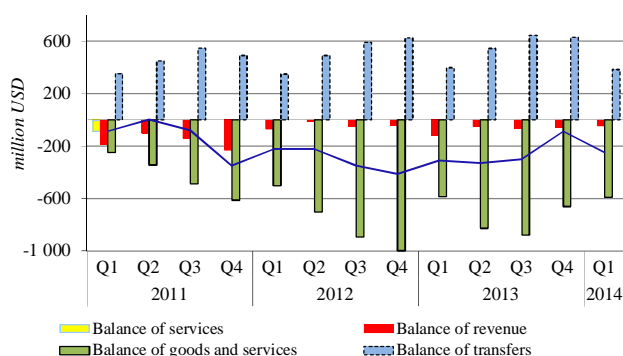
**Chart 11. Contribution of the main industries to the GDP growth**  
(period / to the corresponding period of the previous year)



Source: National Statistics Committee of the Kyrgyz Republic

## External sector

**Chart 12. Current account**



Note: According to the preliminary and forecast data taking into account final appraisal on re-export of oil products in 2012-2013 and on services

**Table 2. Trade balance of KR<sup>1</sup>**  
(million US dollars)

Trade balance	2012	2013	2013 / 3 months	2014 / 3 months*	change in %	change in USD
<b>Export (FOB)</b>	-3210,6	-3565,2	-749,1	-669,8	-10,6	79,3
Gold	1954,4	2048,4	335,5	402,0	19,8	66,6
<b>Import (FOB)</b>	562,3	736,8	92,8	168,6	81,6	75,7
Oil products	5165,1	5613,6	1084,6	1071,9	-1,2	-12,7
<b>For information</b>	1046,0	1180,4	254,9	282,6	10,9	27,7
Import in CIF prices	5576,3	609,8	1175,1	1163,5	-1,0	-11,6
Trade balance (import in CIF prices)	-3621,8	-4021,3	-839,7	761,5	-9,3	78,2
Export without gold	1392,1	1311,7	242,7	233,5	-3,8	-9,2
Total turnover of goods	7119,5	7662,0	1420,1	1473,9	3,8	53,9

Note: According to the preliminary and forecast data taking into account final appraisal on re-export of oil products in 2012-2013 and on services

the added value in the construction sector (+24.7 percent), manufacturing industry (+7.8 percent), supplies sector (provision) of energy, gas, vapor, and conditioned air (+12.6 percent) and service sector (+3.3 percent). Besides, the growth of agriculture where the physical volume of production increased by 1.2 percent.

According to the forecasts, in the first quarter of 2014 the current account deficit would decline to 13.4 percent to GDP and reach 249.0 million US dollars. Decline will be due to improvements in trade balance and revenues.

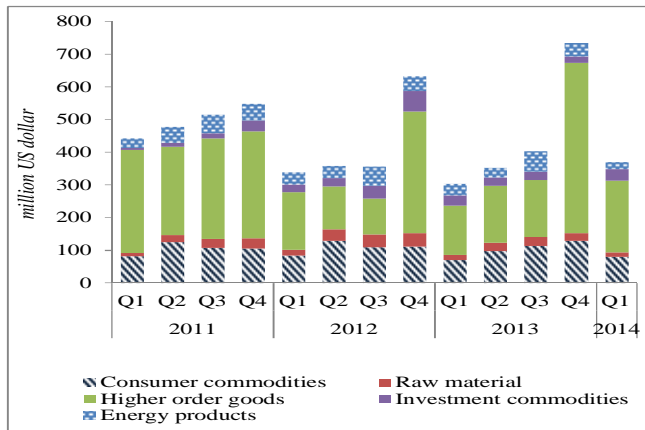
In the reporting period, the trade deficit is expected to decline by 1.6 percent to 600.5 million US dollars (excluding additional calculation of re-exports of petroleum, the decline made up 10.6 percent to 669.8 million US dollars). Trade balance will be formed by the following main factors:

- Increase in gold exports by 81.6 percent;
- Reduction of imports excluding energy products by 4.3 percent;
- Reduction of the re-export of certain goods (revaluation National Bank);

Exports of goods in the first quarter of 2014 is 471.3 million US dollar and will decrease by 0.6 percent compared with the same period in 2013 (excluding the additional calculation of exports, it constituted 402.0 million US dollar and increased by 19.8 percent).

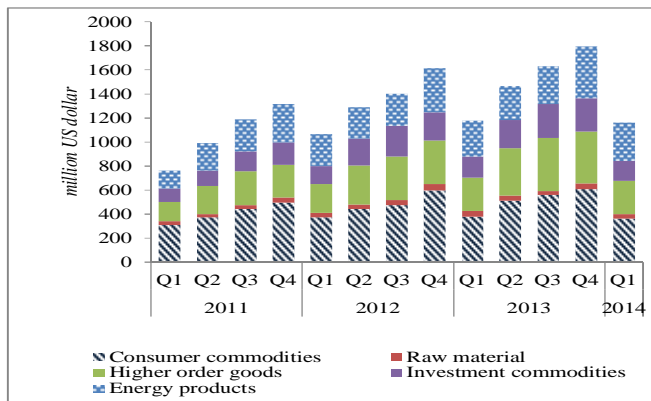
The volume of exports of gold is expected to grow by 81.6 percent (75.7 million US. dollars in absolute terms). Exports excluding gold and revaluation of oil products will decline by 3.8 percent and reach the level of 233.5 million US dollars. According to the estimates of the National Bank, this will be affected by the growth of exports of vegetables, ores and concentrates of precious metals, milk and dairy products, cotton, jewelry and parts thereof, etc. Along

**Chart 13. Functional structure of the export in the Kyrgyz Republic**



Note: based on the actual data of the NSC for the period of February and preliminary data of the State Tax Service as of March 2014 excluding final appraisals on the re-export of oil products

**Chart 14. Functional structure the import in the Kyrgyz Republic**



Note: based on the actual data of the NSC for the period of February and preliminary data of the State Tax Service as of March 2014 excluding final appraisals on the re-export of oil products

**Chart 15. Increase rate of net inflow of money transfers of labor migrants**



with this, reduction in the supply of vehicles for transport of goods and special purpose vehicles, jet fuel, other inorganic chemicals, rolled glass, fruit and nuts, etc. is expected.

Imports of goods (FOB prices) for the reporting period decreased by 1.2 percent and amounted to 1 071.9 million US dollar. The decline in imports is due to the reduced supply of vehicles for transport of goods and special purpose vehicles, garments and clothing accessories, coffee, tea, cocoa and their products, mechanical shovels, excavators and shovel loaders, shoes etc. Increase of oil imports will be observed, the volume of which increased by 10.9 percent or 27.7 million US dollar (due to the increase in the volume of supplies by 21.4 percent and reduction of prices by 8.7 percent).

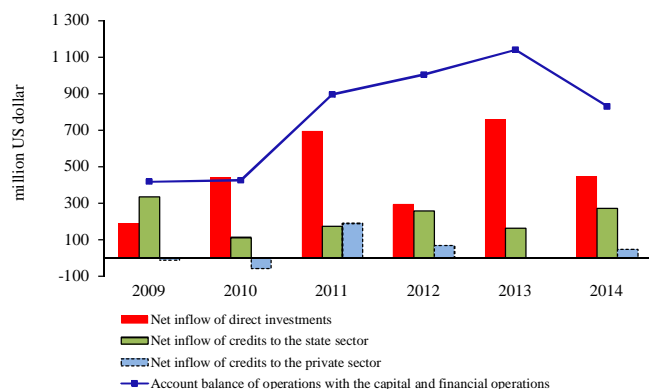
Balance of services (including final appraisal of the article “Travels”) for the reporting period is expected positive and constituted 10.4 million US dollar.

In the reporting period, decrease of the negative balance of income by 63.7 percent (to 43.9 million US dollars) is expected, which is attributable to the reduction of revenues of foreign direct investors from investing activities in Kyrgyzstan.

Net inflow of current transfers formed at 385.1 million US dollars, which is by 3.6 percent below the 2013 indicator. Negative dynamics is caused by decrease of income from private transfers, net inflow of the latter will decrease by 8.5 percent and reach 366.4 million US dollars.



**Chart 16. Account transactions with capital and financial operations**



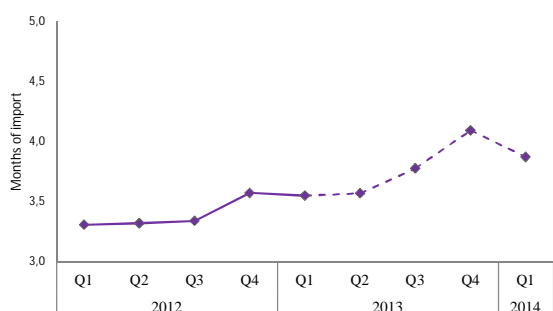
In the first quarter of 2014, the capital transactions account and financial transactions formed with positive balance of 165.0 million US dollars, which is by 5.3 percent less than the corresponding figure in 2013.

The balance of the capital transactions account is expected to be positive in the amount of 10.9 million US dollars, having decreased by 36.2 percent compared to the comparable measure of 2012.

In the reporting period, the financial account surplus decreased by 1.9 percent and will be formed in the amount of 154.1 million US dollars. The main influence on the balance of the financial account in the reporting period will be direct and other investments.

Net inflow of direct investments in the republic will be 109.1 million US dollars, and will exceed the comparable figure in 2013 to 20.0 percent.

**Chart 17. Reserve assets of the Kyrgyz Republic**



During the reporting period, net capital inflow under “other investments” will decrease by 36.1 percent and amount to 44.9 million US dollars. Predominant influence on the specified dynamics will be the decrease of residents’ assets by 33.8 million US dollar that will be caused by the reduction of receivables of enterprises. Liabilities of residents in the reporting quarter will increase by 11.1 million US dollars, predominantly due to net inflows of loans.

Thus, in the first quarter of 2014, the balance of payments of the Kyrgyz Republic was formed with a negative balance of 124.4 million US dollars. The volume of gross international reserves will cover 3.9 months of future imports of goods and services.

### **Indices of real and nominal effective exchange rate of KGS**

According to preliminary data, the index of the nominal effective exchange rate (NEER) of Kyrgyz som since early 2014 increased by 0.6 percent and by the end of March constituted 112.9.

Growth was driven by the strengthening

**Table 4. Key figures of the exchange rate**

	2011 (avg) 2012 (avg) 2013 (avg)			%	month to the previous month (by the end of month)				
					February 2014	March 2014	%		
REER	112.0	110.7	112.0	1.2	↑	113.8	115.2	1.2	↑
NEER	114.3	113.2	111.6	-1.4	↓	112.9	112.9	0.0	↑
Index of bilateral real exchange rates to yuan	149.8	143.7	141.3	-1.7	↓	133.3	129.8	-2.6	↓
Index of bilateral nominal exchange rates to CNY	80.7	77.4	73.2	-5.4	↓	68.3	65.4	-4.2	↓
Index of bilateral real exchange rates to EUR	134.9	144.2	142.3	-1.3	↓	134.9	127.9	-5.2	↓
Index of bilateral nominal exchange rates to EUR	68.4	72.8	68.4	-6.0	↓	63.0	58.7	-6.9	↓
Index of bilateral real exchange rates to KZT	112.0	110.7	112.0	1.2	↑	113.8	115.2	1.2	↑
Index of bilateral nominal exchange rates to KZT	106.7	106.5	105.5	-1.0	↓	111.1	112.7	1.4	↑
Index of bilateral real exchange rates to RUB	73.0	74.1	73.6	-0.7	↓	76.7	80.7	5.2	↑
Index of bilateral nominal exchange rates to RUB	107.9	112.1	111.5	-0.6	↓	116.5	121.2	4.0	↑
Index of bilateral real exchange rates to TRY	125.4	124.8	126.9	1.6	↑	137.1	130.4	-4.9	↓
Index of bilateral nominal exchange rates to TRY	279.0	294.2	301.9	2.6	↑	331.9	312.6	-5.8	↓
Index of bilateral real exchange rates to USD	187.7	184.5	188.1	2.0	↑	182.8	174.8	-4.4	↓
Index of bilateral nominal exchange rates to USD	103.4	101.5	98.5	-2.9	↓	93.1	87.7	-5.8	↓

Preliminary data

↓ - depreciation of KGS, improvement of competitive ability  
 ↑ - strengthening of KGS, deterioration of competitive ability

of KGS in March 2014 compared with the average rate of December 2013 in relation to the Kazakh tenge by 7.3 percent and the Russian ruble - by 6.8 percent.<sup>1</sup> Along with this, there was impairment of KGS against the euro by 10.2 percent, against the US dollar - 9.5 percent and the Chinese yuan - 8.1 percent.

Along with strengthening NEER index, high level of inflation<sup>2</sup> in the Kyrgyz Republic has caused increase in the index of the real effective exchange rate (REER), which increased by 1.5 percent since December 2013 and constituted 115.2 by the end of March this year.

## Monetary policy

### Implementation of monetary policy

The National Bank introduced a new monetary policy framework in the first quarter 2014. The new framework implies a gradual shift of the monetary policy from a quantitative indicator in the form of a monetary base to the price index in the form of a percentage rate. The mechanism of determination of the discount rate with reference to the yield of 28-day notes of the National Bank to be established by the decisions of the Board of National Bank was changed. The mechanism of determining the interest rates on “overnight” loans was changed, which ceased to be in conjunction with a discount rate coefficient and shall be now defined by the decisions of the Monetary Regulation Committee. In February, a new monetary instrument was introduced – “overnight” deposits. A “corridor” of interest rates was set around discount rate, the lower boundary of which was the rate on “overnight” deposits, and the top was the rate on “overnight” loans.

By the decision of the National Bank Board as of 25 February, the discount rate was set from 1 March at a rate of 6.0 percent. Monetary Regulation Committee decided in February to set rates on “overnight” deposits and “overnight” loans in the amount of 1.0 percent and 9.0 percent respectively. In early March, as one of the measures aimed at stabilizing the situation in the currency market, the rate on “overnight” deposits was raised to 1.5 percent.

The National Bank Board decided on March 24 and April 28 to keep interest rates unchanged at a rate of 6.0 percent. The decision took into account the risk of external demand reduction in external demand, on the one hand, and the growth of consumer prices, on the other hand.

The economic development scheme taken as the basis at the February meeting of the Board of National Bank envisaged increase of pressure on the exchange rate, increase of interest rate and reduction of the rate of growth of the monetary base in the medium term.

The actual pressure in the foreign exchange market under the influence of the second external shock (the effect of drastic changes in the Russian financial markets in early March due to the aggravation of geopolitical relations between Russia and Ukraine, which has reinforced the effect of prior-stage devaluation of the Kazakh tenge) turned out to be deeper. Depreciation of KGS in the first quarter of 2014 was 10.8 percent, the rate rose to 54.4813 KGS/US dollar.

<sup>1</sup> The data on nominal bilateral exchange rate of KGS is presented as a basic period for the calculation of the index is used for 2000

<sup>2</sup> Inflation in KR for January-March 2014 constituted 3.4 percent, whereas, the average level of inflation in countries-main trade partners constituted 2.5 percent according to the preliminary data.

Foreign exchange interventions conducted by the National Bank and operations on sterilization of excess liquidity, adapting to the situation of individual instruments of monetary policy along with an active information campaign will smooth sharp currency fluctuations in the first quarter. Positive balance of the state budget also contributed to the work of National Bank aimed to stabilize the situation.

During the first quarter, the National Bank held the following monetary operations:

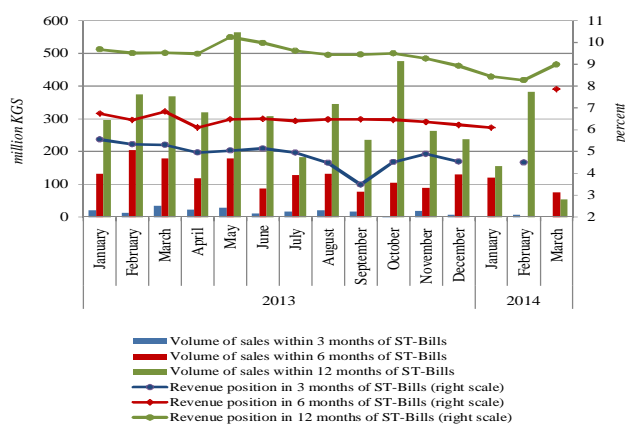
- The National Bank conducted foreign exchange intervention on the sale of foreign currency in the amount of 198.1 million US dollars, including 2.8 million US dollars in cash as a form of consignment the interbank foreign exchange market;
- Volume of NBKR notes in circulation at the end of the first quarter constituted 3 080.1 million KGS;
- Average daily volume of “overnight” deposits constituted 770.7 million KGS, the gross volume - 10 790 million KGS (since 17 February);
- Average daily volume of “overnight” loans totaled 246.9 million KGS, the gross volume - 4 196.5 million KGS (since 17 February);
- Outstanding balance of commercial banks on refinancing loans by the end of March 2014 constituted to 672.4 million KGS.

At the end of the first quarter of 2014 the monetary base amounted to 67.4 billion KGS, its reduction for the quarter was 7.9 percent.

## Monetary policy instruments

### Government securities market

**Chart 18. Dynamics of ST-Bills sale and revenue position**



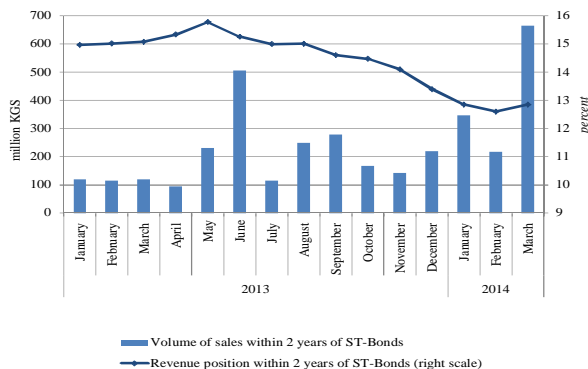
### ST-Bills

ST-Bills volume in circulation by end of the period amounted to 4.0 billion KGS, having decreased by 13.2 percent since the beginning of the year. The total volume of the announced issuance of bills for January-March 2014 amounted to 1.5 billion KGS, having decreased by 5.0 percent in comparison with the same period in 2013. With increasing volumes of demand (7.4 percent) and lower sales volumes (-54.8 percent) their downward trend in average yield of STB in all segments placed on the market of securities continued. Thus, the overall weighted average revenue position of STB in January-March 2014 was 8.0 percent (-0.5 percentage points).

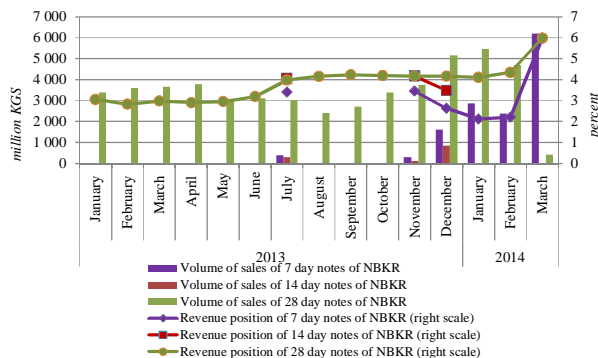
**Chart 19. Dynamics of ST-Bonds sale and revenue position**

### ST-Bonds

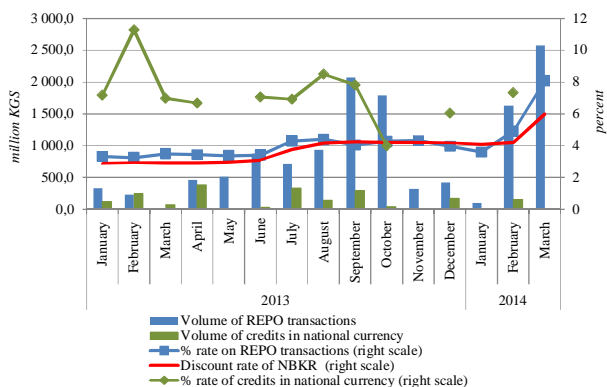
The volume of ST-bills in circulation amounted to 5.9 billion KGS at the end of March 2014, having increased from the beginning of the year by 3.1 percent. Announced volume of issue for January-March 2014 amounted to 571.0 million KGS, having increase by 22.5 percent compared to the same period in 2013. With the increase of demand (4.2 times) and sales (60.4 percent),



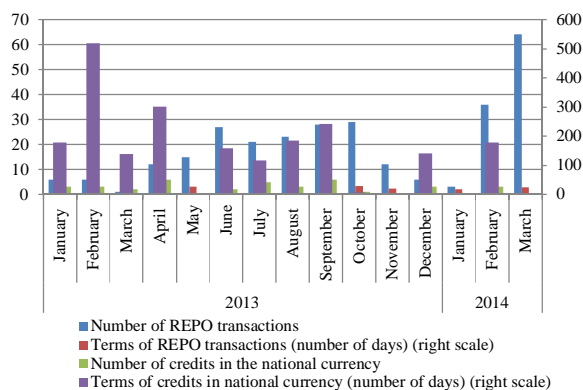
**Chart 20. Dynamics of the NBKR Notes sale and revenue position**



**Chart 21. Activity in the interbank market of credit resources**



**Chart 22. Dynamics of transaction in the Interbank market of credit resources**



there was a reduction of the level of weighted average revenue position. Thus, the weighted average revenue of the two-year ST-bills for the period was 12.8 percent, having decreased by 2.3 percentage points compared with the same period in 2013.

### Notes of National Bank of the Kyrgyz Republic

The volume of notes in circulation by the end of March 2014 amounted to 3.1 billion KGS, having decreased nearly twice since the beginning of the year. Total volume of issue of notes of the National Bank in the reporting period constituted 31.5 billion KGS, with an increase by 2.8 times compared to the same period in 2013. In January-March 2014 the volume of demand (83.5 percent) and sales (2.0 times) increased. The weighted average yield of notes National Bank in the reporting period in 2014 was 4.4 percent compared to 3.0 percent in the same period of 2013.

The weighted average revenue position of notes of the National Bank in the reporting period in 2014 was 4.4 percent compared to 3.0 percent in the same period of 2013.

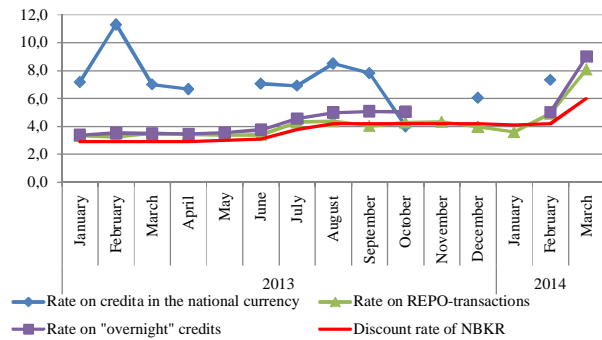
Changing the framework of the monetary policy and conditions of the auction led to the approximation of rates on 7-day notes of the National Bank to the discount rate of the National Bank equal to 6.0 percent. Weighted average revenue position on 7-day notes increased from 2.11 percent at the end of 2013 to 5.99 percent at the end of March 2014.

### Interbank market of credit resources

Activity of commercial banks in this segment of the market has increased significantly. The total volume of loans constituted 8.7 billion KGS due to an increase of the volume of overnight loans in 14.1 times, up to 4.2 billion KGS (weighted average interest rate for the first quarter was 7.0 per cent), as well as credits on repo for 7.4 times up to 4.3 billion KGS (weighted average rate of 5.5 percent). The volume of loans in the national currency issued on

standard conditions fell to 155.8 million KGS. Weighted average interest rate on these transactions amounted to 7.3 percent.

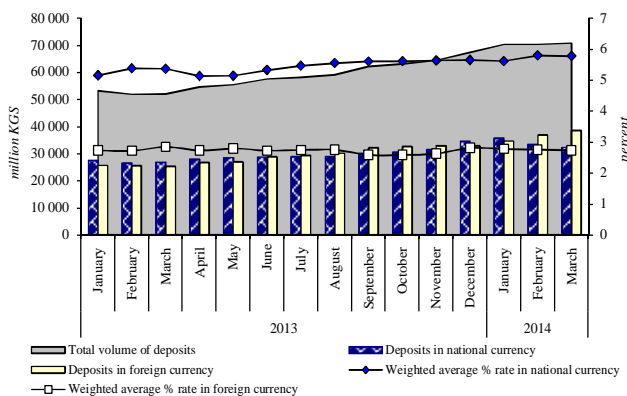
**Chart 23. NBKR rates and interbank transactions (percent)**



### Deposit market

In general, the development of the deposit market in the first quarter of 2014 was characterized by movement "in the outset". As a result, the amount of the deposit base of commercial banks at the end of March 2014 constituted 70.7 billion KGS, having increased by 5.1 percent from the beginning of the year. This increase affected foreign currency deposits (17.2 percent to 38.5 billion KGS in equivalent). Deposits in national currency decreased (by 6.5 percent) to 32.2 billion KGS. Under the influence of a factor of strengthening the US dollar, the dollarization of deposits increased from 48.8 percent to 54.4 percent.

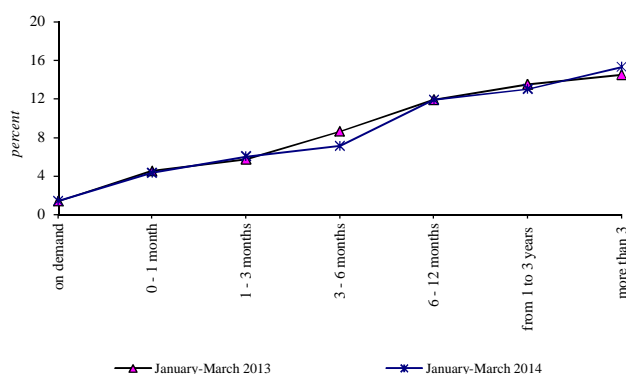
**Chart 24. Dynamics of commercial bank deposits**



The share of deposits in the structure of the deposit base increased slightly from 42.1 percent to 42.2 percent since the beginning of the year.

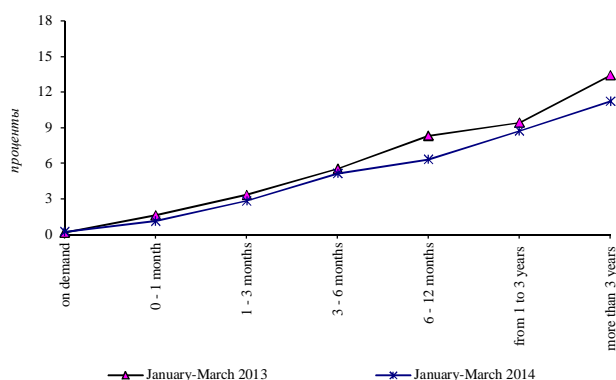
Indicator duration of total deposit base decreased to 4.2 months, the duration of fixed deposits decreased from 11.4 to 10.9 months.

**Chart 25. Rates on new deposits in the national currency by priority rank**

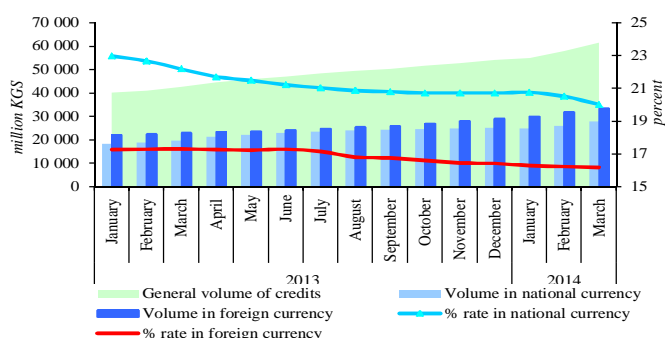


The weighted average interest rate on newly accepted demand deposits in local currency compared to the same period in 2013 was unchanged at 1.4 percent, on fixed deposits - fell to 8.9 percent (-1.4 percentage points); foreign exchange rate on demand deposits rose to 0.2 percent (0.1 percentage points), on fixed deposits - fell to 5.4 percent (-0.7 percentage points).

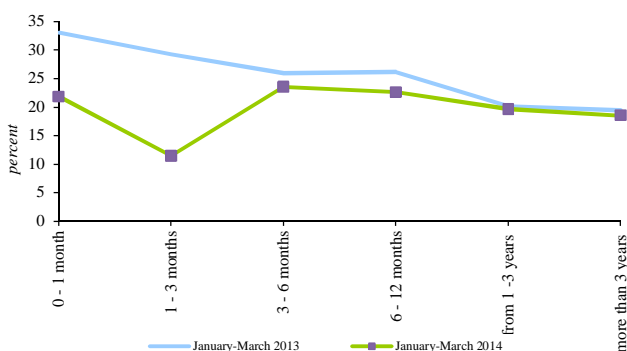
**Chat 26. Rates of new deposits in foreign currency by priority rank**



**Chart 27. Dynamics of credit exposure of commercial banks at the end of the period**



**Chart 28. Rates of new credits in the national currency by priority rank**



### Credit market

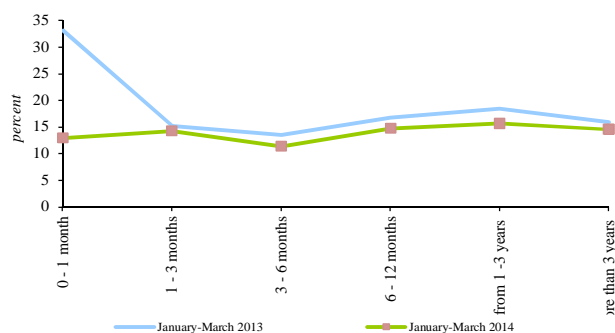
Lending by commercial banks in the first quarter of 2014 kept upward trend due to the issuance of foreign currency as well as national currency loans. One of the factors in credit growth was the implementation of the project “Financing of Agriculture-2” at the end of the reporting period, the volume of loans for this project amounted to 1.7 billion KGS. As a result, in general, the loan portfolio of commercial banks at the end of March 2014 constituted 61.3 billion KGS, having increased from the beginning of the year by 13.7 percent. Loans in national currency constituted 27.9 billion KGS, having increased by 11.5 percent, and in foreign currency - 33.4 billion KGS in KGS equivalent (+15.5 percent). At the end of the reporting period, the dollarization of the loan portfolio was 54.5 percent having increased from the beginning of the year by 0.9 percentage points.

The share of long-term and short-term loans has not changed in the fixed structure of the loan portfolio of banks in national currency compared to the beginning of the year. The share of short-term loans (less than one year) was 21.1 percent, while the share of long-term loans amounted to 78.9 per cent.

Duration indicator of new loans in the national currency since the beginning of the year fell from 26.5 to 25.4 months, in foreign currency - by 1.3 percentage points to 28.2 percent at the end of the period

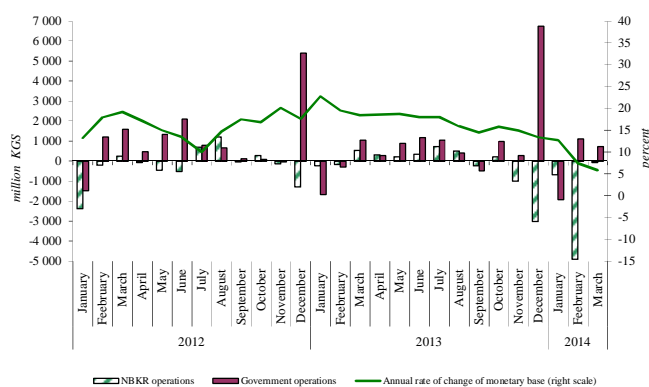


**Chart 29. Rates of new credits in foreign currency by priority rank**

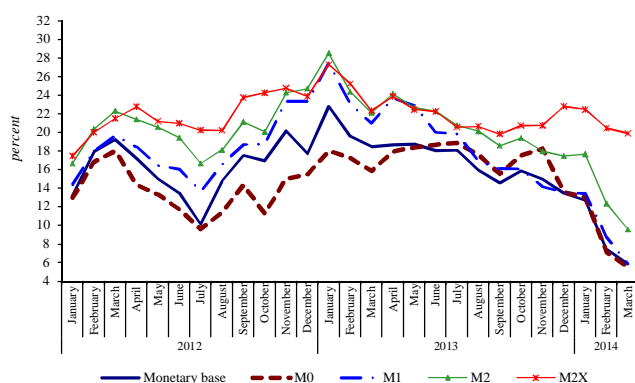


### Dynamics of monetary indicators

**Chart 30. Contribution of the Government and the NBKR operations to the change of monetary base**



**Chart 31. Nominal growth rates of monetary aggregates (in annual terms)**



under review.

The weighted average interest rate for January-March 2014 on new loans in national currency decreased to 19.6 percent (-1.8 percentage points), in foreign currency - to 14.6 percent (-5.4 percentage points).

### Monetary base

Monetary base in January-March 2014 compared to the beginning of the year decreased by 7.9 percent (5.8 billion KGS) and as of April 1 it constituted 67.4 billion KGS (in the same period in 2013 a decline made up 1.2 percent). Transactions of the National Bank in the foreign exchange and open markets affected the reduction of the monetary base that reduced it by 5.7 billion KGS, government transactions have contributed to the reduction of reserve money by 0.1 billion KGS.

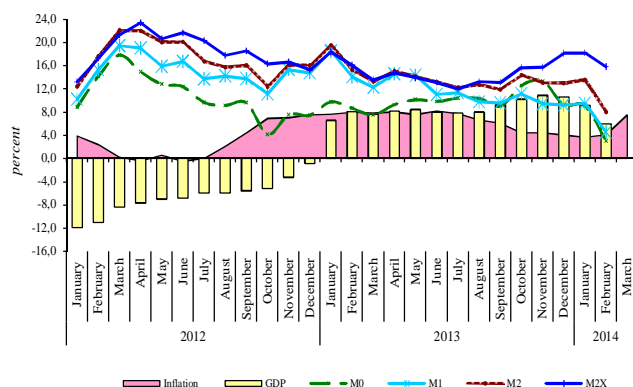
However, in the first quarter 2014, the National Bank also conducted operations on the purchase of gold in the domestic market at 193.8 million KGS; funds within the credit auctions for refinancing at 360.0 million KGS were selected.

### Monetary Aggregates

Nominal growth rates of monetary aggregates in annual terms in the first quarter of 2014 ranged from 5.4 to 19.9 percent at the end of the first quarter 2013 - from 15.8 to 22.3 percent, which was reflected on slowing real annual growth rates of monetary aggregates.

Broad money M2X which includes deposits in foreign currency decreased by 1.9 percent and constituted 118.7 billion KGS (in the same period in 2013, M2X increased by 0.5 percent) in January-March 2014. Reduction of money outside of banks (by 9.2

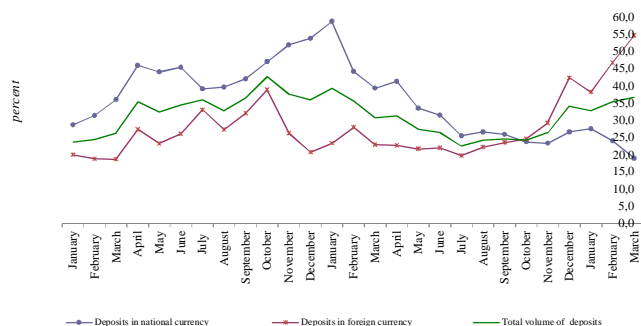
**Chart 32. Inflation, real growth rate of money aggregates and GDP**



**Table 4. Dynamics of monetary indicators**

	1 Q 2013		1 Q 2014	
	Million KGS	March 2013/ March 2012	Million KGS	March 2014/ March 2013
Monetary base	63 699,0	-1,2	67 384,3	-7,9
Money in circulation	56 699,7	-2,7	60 409,1	-9,8
Currency in hands (M0)	53 323,3	-2,2	56 227,5	-9,2
Narrow money (M1)	68 453,9	-2,5	72 441,4	-9,1
Supply of money (M2)	76 365,4	-1,4	83 651,5	-8,0
Supply of money (M2X)	98 991,0	0,5	118 663,8	-1,9
Deposits included in M2X	45 667,7	3,9	62 436,3	5,8
Credits to the economy	44 103,5	4,9	64 302,3	12,4

**Chart 33. Dynamics of deposits including in M2X**  
(in annual terms)



percent, to 56.2 billion KGS) was observed in the structure of M2X in January-March which was offset by an increase in deposits,<sup>1</sup> which constituted 5.8 percent up to 62.4 billion KGS, including the increase of deposits in foreign currency amounted to 16.9 percent and the deposits in national currency decreased by 5.6 percent. Excluding the impact of exchange rate changes,<sup>2</sup> total deposits grew by 6.0 percent.

Along with the increase in net foreign assets of the banking system, expansion of credit activities of commercial banks was observed.

Credit to the economy in the first quarter 2014 increased by 12.4 percent, while foreign currency loans increased by 15.1 percent, in the national currency - by 9.7 percent (in the same period in 2013 – 6.3 and 3.4 percent, respectively). Excluding the impact of exchange rate, credit to the economy grew by 6.9 percent.

In terms of sectors, loans to non-financial corporations showed the most rapid growth; its growth was 8.0 percent at the end of the first quarter 2014. Loans to other resident sectors grew by 4.5 percent while loans to other financial corporations reduced by 0.3 percent (in the same period in 2013 - 3.6 and 28.3 percent, respectively).

As a result of the more rapid growth in the money supply relative to the GDP growth, the economy's monetization ratio, calculated according to money aggregate of M2X from January to March 2014 increased from 30.8 percent at the beginning of the year up to 31.5 percent. Thus, the velocity of money calculation according to M2X in the first quarter 2014 decreased from 3.24 at the beginning of the year up to 3.17.

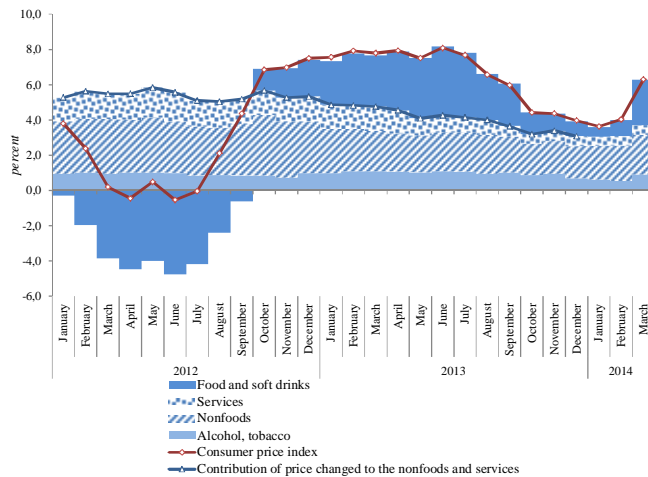
Broad money M2X multiplier characterizing the degree of financial intermediation has increased from 1.653 at the end of 2013 to 1.759 at the end of March 2014 due to an increase in foreign currency deposits in the amount of broad money

<sup>1</sup> According to the analytical balance of bank system includes only deposits of physical and legal entities as well as deposits of other financial institutions; deposits of the Government and deposits of non-residents are excluded thereof.

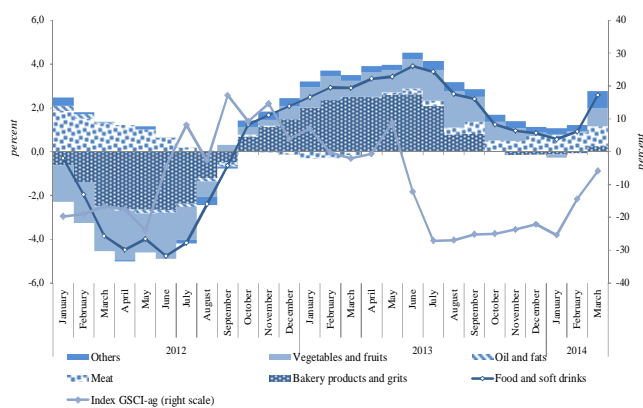
<sup>2</sup> Regular (programme) exchange rate: 47.0992 KGS/US dollar.

## Dynamics of Inflation Consumer price index

**Chart 34. Dynamics of annual CPI structure (to the corresponding month of the previous year)**



**Chart 35. Dynamics of the contribution of food prices to the annual CPI**



**Chart 36. Dynamics of the contribution of nonfood prices in the annual CPI**

According to the National Statistics Committee, CPI inflation (March 2014 against March 2013) was 6.3 percent in March 2014, which is lower than in 2013 (7.8 percent).

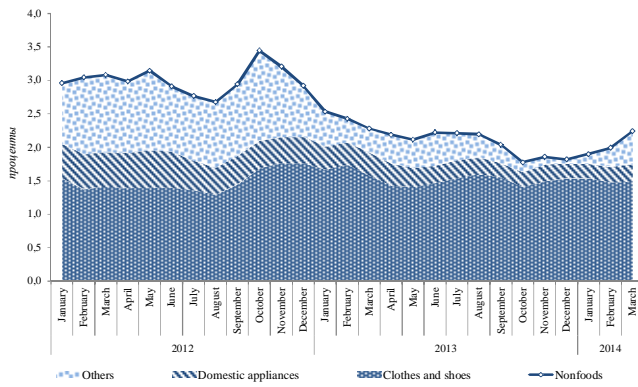
In general, external conditions and internal seasonal factors predetermined an upward trend of the overall price level in the first quarter of 2014. Political tensions in Ukraine and the associated uncertainty for the supply of food products from Ukraine, the rise in world prices for some food products due to adverse weather conditions in major producing countries, as well as the strengthening of the US dollar led to higher prices of imported goods in the Kyrgyz Republic.

Growth in consumer food prices in March 2014 was 5.4 percent in annual terms. The largest contribution to the rise in prices of this group of products was the rise of prices for fruit and vegetables, which amounted to 11.1 percent in annual terms, including price for fruit rose by 23.9 percent, and vegetables - by 6.4 percent. Increase in meat prices by 9.7 percent in annual terms also contributed significantly to the increase in the general price level. Prices for bread and cereals, a group which accounts for the largest share in the structure of food products, rose by 1.4 percent in annual terms according to the results in March 2014, including wheat flour increased by 2.4 percent. Besides, there was an increase in sugar prices by 16.2 percent, while there was a decrease noted by 8.0 percent last year.

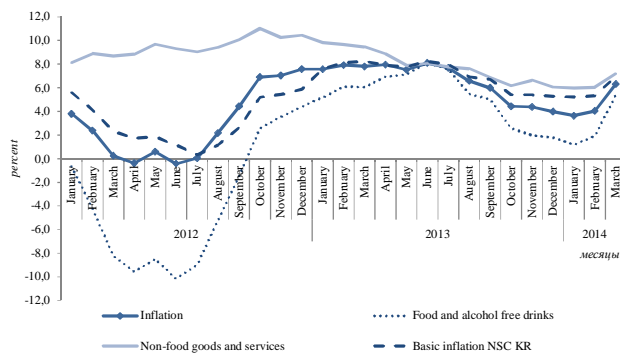
In annual terms, price of milk products increased by 6.9 percent in March of this year, which is by 1.3 percentage points higher than in 2013.

Decline in the consumer price index of commodity group “oils and fats” by 3.6 percent on the background of high crop of oilseeds in Russia and Ukraine, major importers of these products in Kyrgyzstan, had a moderating influence on the rise of the general price level.

Increase in the price index for non-food goods in annual terms constituted 7.7 percent. The largest contribution to the rise in prices for industrial goods was made by groups of

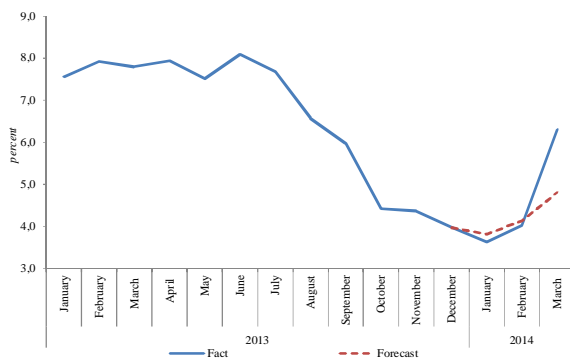


**Chart 37. Dynamics of Consumer price index (to the corresponding month of previous year)**



**Comparison of forecast with the fact**

**Chart 38. Actual and projected value of the CPI (to the corresponding month of previous year)**



goods “clothing and footwear”, which rose by 13.2 percent. Price of household items and appliances rose 6.9 percent. The cost of fuel and lubricants in annual terms grew by 2.1 percent, including increase in prices of gasoline as well as diesel fuel.

The increase in prices for paid services in annual terms amounted to 4.0 percent in March (March 2013 - 10.0 percent). Increase in the index in this group was mainly due to higher price of recreation services (+6.1 percent) and education (+6.0 percent). The restraining factor in rising prices in this group was the reduction of prices of hotel and restaurant services by 0.7 percent.

Acceleration of the rate of growth of the annual value of core inflation calculated by the method of the NSC of KR was observed in the first quarter of 2014 from 5.2 percent in January to 7.0 percent in March 2014.

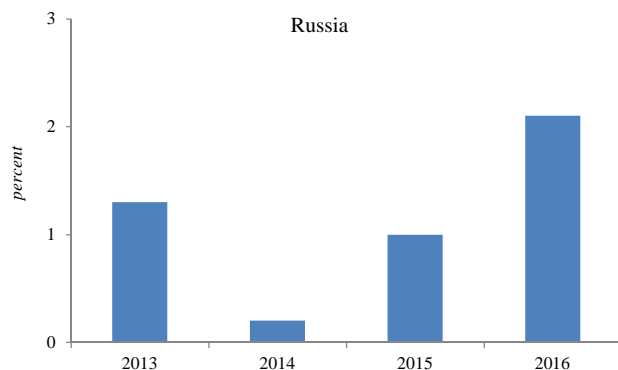
Acceleration of the inflation rate was observed in the first quarter of this year. The average quarterly inflation was higher of the forecasts by 0.4 percentage points and 4.7 percent (Q1 2014 / Q1 2013). In annual terms, the actual level of inflation (March 2013/ March 2014) was 6.3 percent instead of the projected 4.65 percent. One of the main reasons for the acceleration of inflation in the period under review, in addition to a seasonal increase in prices for some food products, is the strengthening of the US dollar due to the impact of external shocks. As a result, depreciation of KGS led to the rise of prices of imported goods, such as sugar, rice, wheat and fuel.

## Medium-term forecast

### Assumptions about the environment

#### Forecast of development of the countries - main trade partners

**Chart 39. Real GDP growth of Russia**  
(year to year,%)



Source: IMF

Revised forecasts of international organizations suggest a slowdown in global economic recovery in 2014

#### Russia

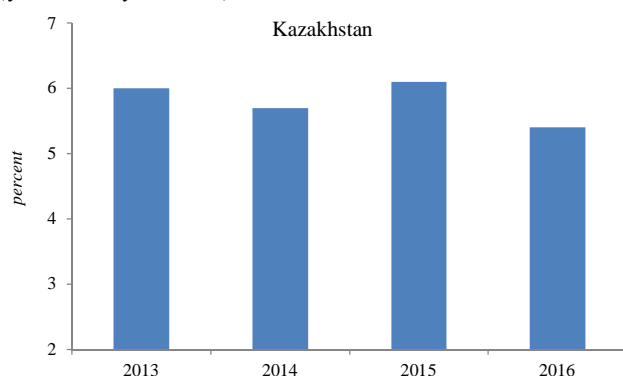
The economic slowdown in Russia in 2013 persisted in early 2014, which contributed to the revision of forecasts for economic growth in Russia for 2014. Previous constraints to economic growth, such as passive investment activity, structural problems in the economy as a whole were complemented by strengthening of capital outflows due to Russia's involvement in the political crisis in Ukraine.

Thus, the assumptions for economic growth in 2014 have been adjusted to the level of 0.2 percent instead of 1.3 percent; for 2015-2016 at an average of 1.5 percent instead of 2.3 percent.

Changing of the Russian ruble, as before, will depend on the outflow of foreign assets, which will be strengthened by the expected reduction of the program of "quantitative easing" (QE) of the Federal Reserve System, interest rate increase in the United States.

#### Kazakhstan

**Chart 40. Real GDP growth of Kazakhstan**  
(year to year, %)



Source: "Bloomberg" IA

According to IMF forecasts, GDP growth for 2014-2015 in Kazakhstan was found downward (5.7 percent and 6.1 percent, respectively) due to delayed launch of Kashagan oil field due to damage of the pipeline; low demand from emerging markets and low growth rates in the mining sector.

In addition, it is expected that the regulation of prices, announced after the devaluation will negatively impact on the investment plans of large state enterprises.

In the short and medium term, prospects of economic development will depend on the preservation of macroeconomic stability, which in turn depends on the policy of spending of oil revenues on the basis of established rules and sustainable development of the financial sector.

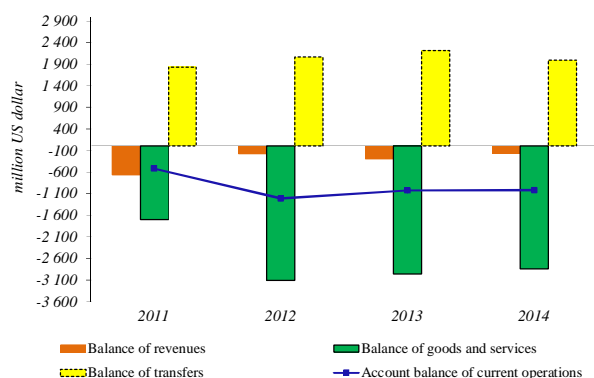
The annual inflation rate in 2014, according to the IMF, will go beyond the



“corridor” announced by the government in the amount of 6.0-8.0 percent and 9.2 percent. In 2015, inflation will be 7.5 percent.

## Payment balance forecasts

**Chart 41. Current account operations**



In 2014 the current account deficit is projected at 14.0 percent of GDP and slightly decreased as compared with 2013 (0.2 percentage points).

The current account deficit will be formed under pressure of reducing the volume of private transfers. However, improvement in the deficit of goods and services, along with a reduction in the outflow of the item “revenue” will have a positive impact on the current account.

Given the projected slowdown in the economies of the host countries of migrant workers, decline in remittances is expected. Thus, according to the results of 2014, decrease in the net inflow of private transfers at 10.7 percent with a nominal capacity of 1923.8 million US dollar is projected.

Possible slowdown of economies of major trading partners creates certain prerequisites to the decrease of external demand, which will result in reduction of exports by 9.7 percent.<sup>1</sup> At the same time, sustainable work of gold companies will increase exports of gold by 1.9 percent to 750.7 million US dollars (while maintaining world prices at 1200 US dollar for troy ounce).

Given the trend established in the first quarter, as well as a possible reduction in domestic demand due to the rise in price of imports, decrease in revenues from consumer and investment goods<sup>2</sup> is forecasted, which generally affect the import decline at the level of 5.3 percent. At the same time, due to the decline in world oil prices, slight reduction in oil imports in absolute terms is forecasted. Thus, according to the results of 2014, decline in the trade balance deficit by 2.1 percent to 3 150.8 million US dollar is forecasted.

Traditionally, financing of the current account deficit will be implemented through the capital inflows in the financial account, primarily due to foreign direct investments (446.1 million US dollars) and external loans (319.6 million US dollars).

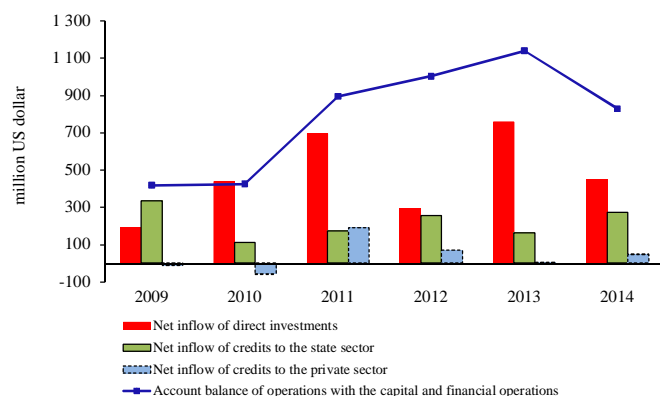
As a result, the overall balance of payments was negative at the level of 233.1 million US

<sup>1</sup> Decrease will constitute 5.5 percent without taking into account gold and final appraisal of oil products

<sup>2</sup> Decrease of mainly re-exported goods positions is forecasted



**Chart 42. Financing of the payment balance**



## Medium-term forecast

**Chart 43. GDP forecast, % quarter/corresponding quarter of the previous year**

dollars. Coverage level of reserve assets of the National Bank will remain at a safe level (3.5 months of imports).

Deterioration of the trade balance of the country due to more dynamic growth of import deliveries is projected for 2015-2017, against the growth of export earnings. At the same time, growth of the inflow of current transfers is envisaged at an average of 5.0 percent per year. Thus, the current account deficit in the medium term is projected at around 16 - 17 percent to GDP.

Financing of the current account deficit will be implemented through the flow of credits at an average of 250.0 million US dollars and foreign direct investments at the level of 440.0 million US dollars.

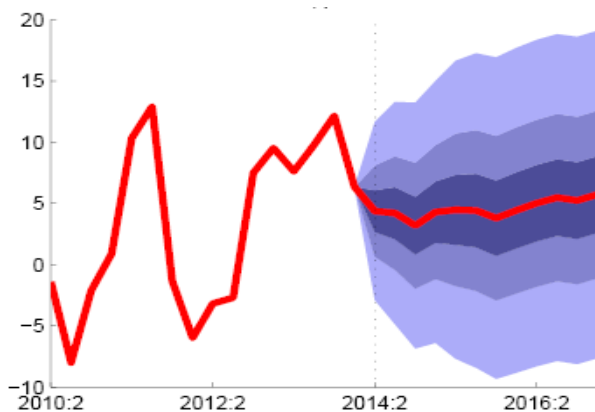
In general, the overall balance of payments in the medium term is projected negative (average 70.0 million US dollars); at the same time the criterion of adequacy of reserve assets to cover imports of goods and services is forecasted at a safe level (an average of 3.2 months of imports).

The developed forecast of the balance of payments of the Kyrgyz Republic for 2014 - 2017 keeps a number of uncertainties and risks:

- uninterrupted work on the development of “Kumtor” deposit;
- volatility of world prices for gold and oil;
- deterioration of the economic situation in the countries - trade partners;
- shortfall in the planned volume of foreign loans to the public sector;
- changes in the terms of trade with the countries - major trade partners.

## Development of real sector of the economy

On the background of weakening external demand, the economy of Kyrgyzstan will experience downward pressure on economic growth in the medium term perspective. It is expected that decline in exports and in remittances caused by the slowdown in economic growth of Russia and Kazakhstan will be the basis of such dynamics. The real effective exchange rate of KGS strengthened due to the fact that a more significant devaluation of currencies against the US dollar



is observed in countries - major trade partners.

Forecasting through the models gives the assessment of the economic growth in 2014 at 4.2 percent, with a gradual increase of the rate in the medium term. The main contribution to economic growth is expected due to the service sector, moderate growth is associated with a slowdown in trade, the construction sector - with the launch of projects for the construction and reconstruction of objects of strategic importance, as well as from the agriculture sector. In 2017, economic growth in the country may reach 5.6 percent. A slight decline is expected in the manufacturing industry due to lower levels of gold production at “Kumtor”.

Thus, inflationary pressure will be low from the aggregate demand side. However, the deterioration in the trade balance and the reduction of foreign exchange risks keep the risks of devaluation of the national currency, including as a result of strengthening currencies of developed countries due to the recovery of their economies.

### **Inflation**

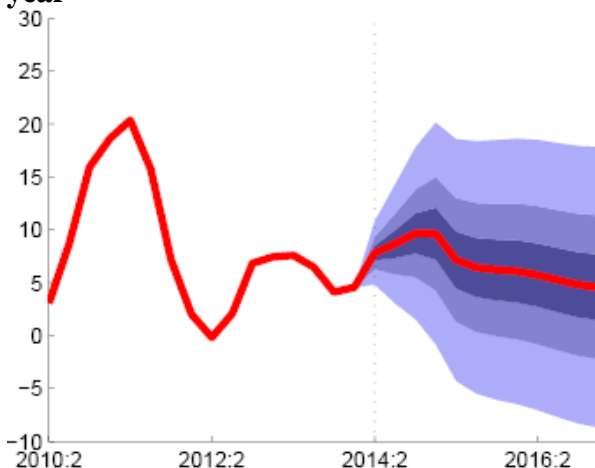
The inflation rate in 2014 will increase due to the impact of the factor of rapid and deeper devaluation of the national currency, which was the result of currency devaluations in neighboring countries at the beginning of this year. Effect of foreign exchange shock on the rise of domestic prices will fully be reflected the end of 2014 and then will gradually decline. Thus, the average inflation rate in the fourth quarter of 2014 will be 10.2 percent.

Increase in inflation in 2014 will be mainly due to the acceleration of growth in food prices; at the same time, besides the Kyrgyz currency depreciation, which will be a major factor in accelerating inflation, certain contribution to the development of inflationary processes will be observed by a more rapid rise in food prices on world markets in the second quarter of 2014. Annual average inflation in 2014 will be 8.2 percent.

In subsequent years, a slowdown in inflation will be due to mainly lower growth rates of imported inflation on food and non-food inflation slowdown. Thus, the average annual inflation will constitute 7.6 percent in 2015, in 2016 - 5.6 percent and in 2017 it will drop to 4.6 percent on average per year.

According to the forecasts, favorable

**Chart 44. Inflation forecast, % quarter/corresponding quarter of the previous year**



situation will be in the world market of oil products, since a decline in oil prices is envisaged in the nearest future, due to which the contribution of this factor to the increase in non-food inflation from the outside world will be relatively weak.

Prices in the world food market will rise before the end of the forecast period.

Circulation in the gold market will develop around the downtrend and in general, the price of gold will decline in the forecast period; as a result, the export revenue on this item of export will decrease and inflow of foreign exchange will decrease respectively. At the same time, the latter will largely depend on the dynamics of remittances.