

Monetary Policy Report for 2009

Approved
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Basic Monetary Policy Trends

The Main Monetary Policy Guidelines for 2009-2011 and the Monetary Policy Statement for 2009 set the basic objective of monetary policy implementation, namely, to restrain inflation and maintain stability of a general price level, as one of the basic conditions of steady long-term economic growth. An inflationary pressure in 2009, as a whole, was expected to be lower than in the previous year as associated with both a prospective reduction of an external and domestic demand for domestic output, and with an effect of earlier anti-inflationary measures implemented by the Government and the National Bank, including a tightening of the monetary policy. Thus, a rate of inflation, which is a quantitative criterion of the monetary policy for 2009, was set at a level below 15 percent.

A stabilization tendency in a price situation took shape in the middle of the year in the republic, thereby reducing the inflationary pressure. In this connection, as well as with the view of instilling adequate expectations in business communities and the population that would promote vitalization of economic activities, alongside with the anti-crisis measures of the Government and the National Bank, the Board of the NBKR took in August a decision on a revision of the quantitative monetary policy criterion toward its reduction to a level of no more than 7.5 percent.

As a whole for 2009, according to the data of the National Statistics Committee, growth of a consumer price index describing the rate of inflation was at a zero level (December 2009 against December 2008), whereas for 2008 annual inflation was 20.0 percent.

The reduction of inflation was caused by an absence of price shocks in world markets of food products and energy resources, as well as by the anti-inflationary measures earlier undertaken by the National Bank and the Government. Retardation of inflation in the economy created favorable conditions for mitigation of the monetary policy.

The National Bank reduced in 2009 a supply of NBKR Notes by 14.8 percent to Som 24.7 billion, with the sales volume being Som 20.7 billion.

The National Bank conducted operations on sale of Government securities on REPO terms only in January totaling Som 556.8 million and it is 3 times less than in 2008. In 2009, the National Bank did not conduct other operations on sterilization of excess liquidity in the banking system, such as the reverse swap operations and the operations on attraction of deposits in national currency from the commercial banks.

During 2009, the National Bank gradually reduced the NBKR discount rate, from 15.2 percent at the beginning of the year to 0.9 percent at the end of the year, which was historically the minimum level. The reduction of the discount rate matched the tendency of easing the inflationary pressure.

Growth of a monetary base in 2009 was 18.3 percent (in 2008 – 11.3 percent), caused by the expansionary fiscal policy of the Government.

As a whole for 2009, the official nominal dollar exchange rate against the Som grew by 11.9 percent to 44.0917 Som/US dollar (in 2008 – by 11.0 percent to 39.4181 Som/US dollar). The net NBKR sales of US dollars through the interbank foreign exchange sales totaled US\$ 155.1 million for 2009 (in 2008 net purchases totaled US\$ 53.0 million). The share of NBKR transactions in the total volume of operations through

the interbank foreign exchange sales was 43.9 percent in 2009 as compared to 45.7 percent in 2008.

With a view of increasing commercial banking power and in connection with a commencement of contributions by the commercial banks to the Deposit Insurance Fund, the National Bank lowered reserve requirements from 10 to 9.5 percent in June 2009.

In May 2009, the NBKR established the Special Fund for Banks Refinancing (SFBR). It was one of the measures for minimization of negative consequences of the world financial crisis aimed at maintaining additional resources for refinancing the banking sector by support and assistance to economic entities. The volume of funds extended by the SBRF in 2009 was Som 1 064.4 million.

Under the conditions of a negative impact of the world economic crisis, the commercial banks started to toughen the credit policy in 2009, that together with the reduction of the resource base, the permanent devaluation expectations, as well as with the reduction in the demand for credits among the economic agents led to a slowdown in lending by the commercial banks to the real sector of the economy. As a result, a loan portfolio of commercial banks decreased by 1.5 percent and was Som 25.2 billion. At the same time, lending to the economy by non-bank finance and credit institutions (1.8 times), including lending through credits of the KR Development Fund considerably increased.

According to the outcome for 2009, assets of commercial banks increased by 23.4 percent (in 2008 – by 30.8 percent), and capital by 15.5 percent (in 2008 – by 43.6 percent). The deposit base of operating commercial banks for 2009 increased by 34.0 percent (in 2008 – by 26.1 percent), amounting to at the end of the year Som 39.6 billion.

In 2009 as a whole, essential growth retardation, from 8.4 to 2.3 percent, was observed in the economy compared to the previous year.

Based on the preliminary data, in 2009, the balance of payments formed positive at the rate of US\$ 251.7 million (in 2008 – US\$ 83.8 million), including the current account that developed as negative at the rate of US\$ 25.3 million. The volume of current transfers was US\$ 1 194.8 million and decreased by 19.1 percent as a result of the reduction by 30.1 percent of the volumes of receipts from labor migrants. The volume of total international reserves at the end of 2009 was US\$ 1 588.2 million, thereby covering 4.1 months of future import of goods and services.

Inflation: Outcome and Trends

According to the outcome for 2009, price deceleration was observed in the republic in comparison with a similar parameter of 2008. According to the data of the National Statistics Committee, the 12-month value of inflation (December 2009 against December 2008) was 0.0 percent, whereas for the similar period of the previous year it was 20.0 percent.

Reasons for retardation of inflation in the economy were those of absence of price shocks in the world markets of food products and energy resources, weakening of domestic and external demand, as well as the anti-inflationary measures undertaken by the National Bank and the Government.

Table 1. Consumer Price Index in the Kyrgyz Republic

	December 2009 against		January-December 2009 against
	December 2008	November 2009	January-December 2008
Total goods and services of which	100.0	100.9	106.8
Foodstuffs and soft drinks	92.6	101.4	101.1
Alcoholic and tobacco products	105.2	100.5	107.6
Nonfoods	110.4	100.7	113.4
Services	104.4	100.2	118.1

A food price behavior had the essential impact on the decrease in the general level of consumer prices. For instance, in 2009 there was the price reduction with regard to the food products and soft drinks (-7.4 percent).

The year-over-year prices of alcoholic and tobacco products increased by 7.2 percent and 1.2 percent, accordingly.

12-month growth of the consumer price index of nonfoods was 10.4 percent, including the year-on-year oil prices increased by 14.7 percent.

Growth of prices of paid services was 4.4 percent (in 2008 the paid services grew in price by 34.4 percent). Growth of prices of education services was 1.8 percent, those of public health services – by 10.7 percent; and the communication services fell in price by 7.2 percent.

Behavior of Monetary Indicators

Having increased by 18.3 percent from the beginning of the year, the monetary base was Som 41 587.7 million at the end of 2009 (in 2008 the increase was 11.3 percent).

Money outside banks M0 totaled Som 33 882.3 million at the end of 2009, having thus increased since the beginning of the year by 15.3 percent (in 2008 the increase was 10.2 percent).

Money supply M2 was Som 43 490.0 million at the end of 2009 and increased as compared to early-2009 by 13.8 percent (in 2008 the increase was 9.9 percent) due to the increase in money outside banks by 15.3 percent and the increase in the deposits in national currency by 8.9 percent.

The volume of broad money M2X increased from the beginning of the year by 17.9 percent and at the end of the accounting period was Som 57 126.4 million (in 2008 the increase was 12.6 percent). The increase in the volume of broad money M2X in the accounting period was due to the impact of growth of money outside banks by 15.3 percent and the 21.9 percent increase in the total volume of deposits¹ being part of broad money², as well as due to the increase in the deposits in foreign currency by 33.1 percent and the deposits in national currency by 8.9 percent.

¹ Since January 1, 2009, so far as the commercial banks moved to their own chart of accounts, the amendments were introduced into a methodology of accounting the deposits, according to which the deposits, earlier reflected as the deposits of noncommercial organizations, are now reflected as the deposits of the Social Fund, while the deposits of the Social Fund do not constitute part of the deposit base that is used to calculate broad money M2X.

² According to a monetary survey of the banking system, the deposits cover only the deposits of individuals and legal entities, as well as the deposits of other finance and credit institutions, while excluding the Government deposits and the deposits of nonresidents.

Velocity of broad money M2X including the deposits in foreign currency was 4.2 at the end of the accounting period (at the beginning of 2009 – 4.1).

Real Sector

According to the preliminary results for 2009, the volume of GDP was Som 196 423.1 million, having thus increased in comparison with 2008 by 2.3 percent in real terms (according to the specified data real growth was 8.4 percent in 2008). Excluding enterprises developing the gold mining deposit “Kumtor”, real growth of GDP was 2.9 percent, against 6.5 percent in 2008.

As a whole, compared to the previous year, essential growth retardation was observed in the economy in 2009.

Table 2. Contribution of Specific Activities to Growth/Reduction of GDP in 2009 (Percent)

	Share in 2008	Share in 2009	Growth rate in 2008	Growth rate in 2009	Contribution of growth, 2009	Changing of Deflator, 2009
Agriculture	23.5	22.1	0.9	7.4	1.7	-8.5
Mining	0.5	0.6	9.1	4.7	0.0	17.5
Manufacturing	13.2	12.5	21.2	-7.8	-1.0	7.3
Electricity, gas&water generation&distribution	1.4	1.7	-7.4	-1.3	0.0	26.4
Construction	5.3	5.7	10.8	6.3	0.3	7.0
Trade, repairs of vehicles	16.3	16.4	9.6	1.8	0.3	3.1
Hotels&restaurants	1.3	1.4	13.3	4.0	0.1	5.6
Transportation&communication	7.9	9.1	31.1	5.1	0.4	15.1
Other	17.4	19.3	3.2	1.5	0.3	14.3
Net taxes on products	13.1	11.1	8.4	2.3	0.3	-13.5
GDP	100.0	100.0	8.4	2.3	2.3	2.1

Source: NSC data & NBKR adjustments

A high crop yield in agriculture became a principal cause of the increase in the rates of growth of GDP. At the same time, consequences of the crisis in the world economy had the strong impact on economic growth in Kyrgyzstan. The slowdown in growth of the economy in 2009 was caused by, mainly, a decline in industrial production. In this regard, the significant decline in industrial production was observed at the enterprises which were not engaged in extraction of gold. Growth impairment was also observed in trade and transport and communications. A drop in production in manufacturing and in the sector of generation and distribution of electricity, gas and water led to a general recession in industry.

The favorable tendency in the economy is that of appreciable growth of investment activity. In the accounting year, the volume of investments in fixed capital increased by 19.7 percent and was Som 38 690.5 million. One of the principal causes of such growth is that of significant growth of the volume of investments at hydropower sites, whose share in a composition of total investments in fixed capital is 10.7 percent.

External Economic Sector

Based on the preliminary data, in 2009, the current account developed as negative at the rate of US\$ 25.3 million (positive, in view of NBKR adjustments - US\$ 116.0 million).

The economic recession in developed countries and the decrease in the international prices in the primary commodity markets affected the volumes of foreign trade operations of the Kyrgyz Republic. For instance, the foreign trade turnover of the country decreased by 22.3 percent and was US\$ 4 373.4 million in 2009. A trade gap was

US\$ 1 139.4 million and decreased by 39.4 percent (in view of NBKR adjustments - US\$ 998.1 million).

The volume of current transfers was US\$ 1 194.8 million and decreased by 19.1 percent as a result of the 30.1 percent reduction in the volumes of foreign exchange receipts from the labor migrants. The reduction of transfers of labor migrants is, first of all, connected with a deterioration of the economic situation in Russia, with the basic mass of labor migrants from Kyrgyzstan concentrated there. In April 2009 grants at the rate of US\$ 150.0 million were received from the Government of the Russian Federation.

Based on the preliminary data, the capital and financial account developed as positive for the period under review – at the rate of US\$ 327.8 million as against its negative value in 2008 in the volume of US\$ 7.6 million caused by, mainly, substantial growth of the positive balance of the financial account, whose volume was US\$ 309.6 million.

According to the outcome for the period under review, the balance of payments formed positive at the rate of US\$ 251.7 million. The volume of total international reserves at the end of the accounting period was US\$ 1 588.2 million, thereby covering 4.1 months of future import of goods and services.

Public Finance Sector

According to the Central Treasury of the Ministry of Finance, the state budget deficit in 2009 was Som 2 923.3 million or 1.5 percent of GDP (in 2008 the budget was executed with a surplus at the rate of 0.8 percent of GDP). This being the case and excluding the grants received from the foreign states, the state budget deficit was Som 13 086.3 million or 6.7 percent of GDP.

In 2009 total revenue and the official transfers received in the state budget were Som 55 322.1 million or 28.2 percent of GDP. Compared to the previous year, the rates of growth were reduced, amounting to 21.6 percent as against 28.0 percent in 2008, and it is in general a bit lower than the current mid-year level for the recent five years.

Total state budget expenditure for operational activity in 2009 were Som 50 034.3 million, having thus increased by 35.4 percent or by Som 13 090.3 million.

Besides the increase in operating expenditure in the accounting period, growth was observed in the budget transfers on the operations on purchases of non-financial assets (including the operations by the following groups: fixed capital, stocks, and land). A net outflow of money resources on these operations was Som 8 211.1 million or 4.2 percent of GDP (in 2008 – Som 6 970.9 million or 3.7 percent of GDP).

Financial Sector

Banking System

22 commercial banks³ operated in the territory of the Kyrgyz Republic as of December 31, 2009⁴. The banks earned net profit at the rate of 1 592.0 million Som for 2009 (22 commercial banks operated in 2008, and their record showed their profit totaling Som 1 789.4 million). The assets of commercial banks increased by 23.4 percent and capital - by 15.5 percent in 2009.

For 2009 as a whole, the deposit balances increased by 34.0 percent, amounting to Som 39.6 billion at the end of December. Having increased for the year by 45.5 percent to

³ Starting from May 31, 2009, the LLC IJSCB “AkyI” was integrated into the banking system, whose license was restored and issued on February 27, 2009, as a result of its rehabilitation.

⁴ The data everywhere in the text as of December 31, 2009, are given as covering that day inclusive.

Som 24.8 billion, the foreign exchange part of deposits of commercial banks made the basic contribution to growth of deposit balances, (excluding the impact of exchange rate developments, growth was 31.4 percent). In this regard, the deposits in national currency grew by 18.4 percent, amounting to Som 14.8 billion at the end of 2009.

The average level of interest rates of newly accepted deposits in national currency was 2.8 percent, having thus increased in comparison with the corresponding parameter of 2008 by 0.4 percentage points. The value of newly attracted deposits in foreign currency grew for the period by 0.8 percentage points to 1.7 percent.

In 2009 the slowdown in economic activity in the country and increased risks were adversely affected credit activity of commercial banks. It was reflected in the reduction in lending to the real sector by the banks, as well as in the increase of the value of credits. For the year the loan portfolio of operating commercial banks decreased by 1.5 percent to Som 25.2 billion (excluding the impact of the change in the rate of the Som⁵, the loan portfolio decreased by 7.6 percent).

Having increased as compared to the corresponding parameter of 2008 by 0.7 percentage points, the interest rate of extended credits in national currency was 26.7 percent on the average for the period. The average rate of credits in foreign currency was 21.5 percent, having thus increased by 1.1 percentage points

Non-bank Finance and Credit Institutions Licensed by NBKR

The system of non-bank finance and credit institutions (NFCI) of the Kyrgyz Republic had 972 non-bank institutions at the end of the accounting period (at the end of 2008 the number of non-bank institutions was 1 089):

- FCSDCU – 1;
- LLC “Development Fund of the Kyrgyz Republic” – 1;
- LLC “SFBR” – 1;
- Credit unions – 238;
- Microcredit companies – 226;
- Microcredit agencies – 129;
- Microfinance companies – 4;
- Exchange bureaus – 372.

Table 3. NFCI Loan Portfolio
(In millions of soms)

	12/31/2008	12/31/2009
NFCI Loan portfolio	7 384.3	13 366.9

The data are presented excluding the FCSDCU (since the FCSDCU credits are given out to the credit unions).

Other Financial Institutions

The total volume of tenders on trading platforms of three stock exchanges was Som 5 168.2 million in 2009, having decreased by contrast to the given parameter by 44.1 percent for 2008. The decline in the volume of tenders was noted with regard to all of the trading platforms. The volume of transactions on the trading platform of the Joint-Stock Company “Kyrgyz Stock Exchange” was reduced by 29.5 percent to Som 2 951.2 million, at the Joint-Stock Company “Central Asian Stock Exchange” – by 61.3 percent to Som 1 733.8 million and the volume of exchange tenders on the trading platform of the Joint-

⁵ The early year discount exchange rate of the US dollar.

Stock Company “Stock Exchange in Kyrgyzstan – BTS” was reduced by 17.6 percent and was Som 483.2 million. The basic volume of transactions in the structure of the volume of tenders fell, as before, on the Joint-Stock Company “KSE” (45.2 percent).

At the end of 2009 five joint-stock investment funds operated in the securities market, as well as two unit investment trusts, whose share in the financial services remains insignificant: the assets of investment funds were 0.01 percent of GDP at the end of 2009.

19 insurance companies, of which two reinsurance companies, as well as 7 companies with participation of non-residents were engaged in insurance activity in the market of the republic at the end of the year. Total assets of insurance organizations were Som 865.5 million for 12 months of 2009, having thus increased in comparison with 2008 by 58.1 percent, ownership capital also increased by 50.8 percent to Som 708.8 million.

As of January 9, 2009⁶, there were two non-public pension funds in the republic: the NPF “Kyrgyzstan” and the NPF “Jany Azia” (that got a license as of May 26, 2009, and yet not engaged in its activity). The size of assets of the NPF “Kyrgyzstan” as of January 9, 2009 was Som 17.0 million, having thus increased for the year by 13.8 percent, and the number of its participants, who concluded contracts on a voluntary pension fund scheme, was 2 333 people (of which 486 persons get pensions), that is by 437 person, or by 23.0 percent more than as of end-August 2008.

⁶ The earlier data are presented owing to their absence on results of 2009.