

National Bank of the Kyrgyz Republic

**DEVELOPMENT TRENDS
OF THE BANKING SYSTEM**

FIRST HALF OF 2010 (17)

BISHKEK 2010

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Development Trends of the Banking System

The purpose of the "Banking system development trends" is the analysis and assessment of the Kyrgyz banking system development as a financial mediator, detection of obstacles for achieving and supporting of stability, as well as the evaluation of stability components of the banking system of Kyrgyzstan. It is published at the date for January 1 and July 1 in Kyrgyz, Russian and English languages.

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Bulletin of NBKR contains macroeconomic indices of the Kyrgyz Republic by real, financial and foreign-economic sectors, as well as by state finances. Materials of the National statistic committee, Ministry of finances, commercial banks, State Commission under the Government of the Kyrgyz Republic by securities market and the National Bank of the Kyrgyz Republic are used when preparing the bulletin. It is published every month in the Kyrgyz, Russian and English languages.

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Press-release of NBKR contains chronicle of events happening in the National Bank and bank system in general, operational information by financial market. It is published every week in the Kyrgyz and Russian languages.

Regulatory acts of the National Bank of the Kyrgyz Republic

Regulatory acts of the National Bank are published officially in the indicated edition with the purpose of provision of commercial banks and general public with regulatory documents making bank legislation of the Kyrgyz Republic. Expected periodicity of the edition is once a month in the Kyrgyz and Russian languages.

All publications are distributed according to the enumerations approved by the orders of the Chairman of the National Bank of the Kyrgyz Republic and located on the Web-site: <http://www.nbkr.kg>

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INTRODUCTION

In the first half of 2010, the key banking system indicators decreased both in absolute and relative terms due to the social and political events. Nevertheless, in spite of the degradation of some indicators, the banking system managed to avoid systemic crisis. Several timely measures taken by the National Bank, including introduction of special regimes in a number of commercial banks, enabled to prevent deposit outflows and maintain the sustainability and stability of the banking system.

As a whole, the banking system preserves the coefficient of resistance having sufficient liquidity level; therewith, the actual values of capital adequacy with commercial banks surpass the established normative standards. In case of deterioration in general macroeconomic and political situation, the quality of credit portfolio and other banking system indicators are probable to be impaired; however, overall assessment of risks shows that the banking system is able to sustain any additional financial risks in a short-term period.

The growth of indicators in the sector of non-bank financial institutions is marked to continue. For instance, an increase in the volumes of assets and capital in the non-bank financial institutions is observed against some reduction in growth rate of the credit portfolio.

Thus, notwithstanding the negative impact of the internal social and political events on individual indicators of the financial system, it continues to be stable; meanwhile, there is an outreach of the range, and improvement of quality, of the banking and payment services.

I. STATUS OF THE FINANCIAL AND CREDIT SYSTEM OF THE KYRGYZ REPUBLIC

According to the first half of 2010, the aggregate assets of the financial and credit system¹ decreased by 11.7 percent as compared to the corresponding period of 2009, while the increment of this indicator was provided by the non-banking financial institutions.

The financial intermediation indicator, which constitutes the ratio of the total credit portfolio to the gross domestic product (GDP)², decreased against the comparable period of the previous year to make 15.3 percent (Diagram 1.1). As of the first half of 2010, the increment of the financial and credit system's credit portfolio made 6.8 percent³ against the comparable period of 2009.

The banks continued to hold a leading position in the financial and credit system (Diagram 1.2); according to the results of the first half of 2010, their share accounted for 72.3 percent⁴ in the aggregate credit portfolio of the financial and credit system that constituted 3.7 percentage points decrease against the comparable period of 2009.

The ratio dynamics of the volume of special provision for losses (PL) to the volume of credits in the banking system and non-bank financial institutions (NBFI) indicated some deterioration in quality of the credit portfolio of banks (Diagram 1.3). The share of special PL in the NBFI credit portfolio increased in the first half of 2010 to make 2.9 percent; as to the banking system, this value increased by 3.0 percentage points to make 7.2 percent.

In the first half of 2010 there was a decrease in the weighted average interest rates for credits of the commercial banks and non-bank financial institutions against the comparable period of the previous year.

Diagram 1.4 demonstrates the weighted average rates on credits issued by the commercial banks (in the national and foreign currencies) and by the non-bank financial institutions;

Diagram 1.1. Dynamic of Change in the Credit Portfolio (CP) of the Financial and Credit System (FCS), as percentage to GDP

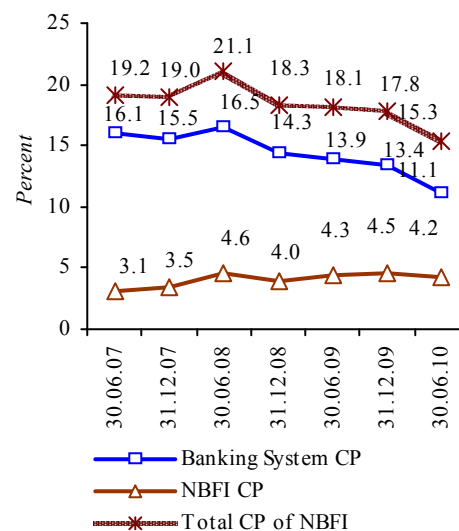
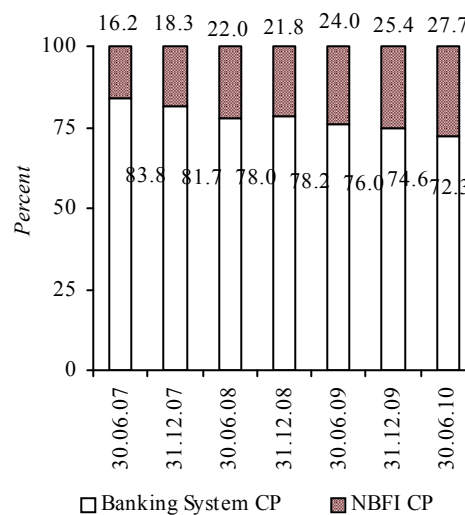


Diagram 1.2. Structure of the Total Credit Portfolio (CP)



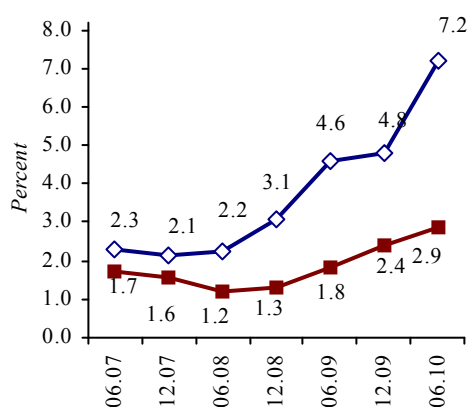
¹ The indicators of the commercial banks and non-banking financial institutions licensed by the NBKR are analyzed herein as the indicators of the financial credits system.

² The data on actual GDP for the recent 12 months is taken.

³ Credit portfolio of the banking system includes the credit portfolio of bankrupt banks.

⁴ According to the Periodic Regulatory Banking Report (PRBR).

Diagram 1.3. Level of Special PL in Credit Portfolios of the Banking System and NBFi



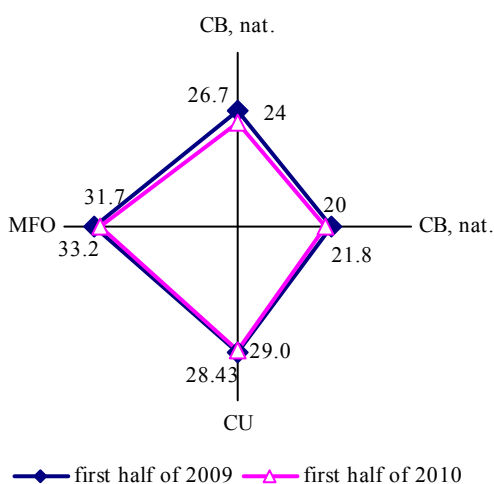
they enable, to some extent, to assess the level and the trend of change in the value of credit resources.

The level of weighted average interest rates for newly issued credits of the commercial banks decreased both in foreign and the national currencies. Thus, in the first half of 2010 the average level of interest rates for the credits in foreign and national currencies decreased by 1.8 percentage points and 2.7 percentage points, correspondingly, against the similar period of 2009.

Therefore, the status of Kyrgyzstan financial and credit system in the reporting period is defined by the:

- decrease in both absolute and relative indicators of the banking system;
- deceleration of the growth rates for some financial intermediation indicators; notably that a considerable deceleration of the growth rates for this indicator was observed in the banking system;
- deterioration of qualitative characteristics of the commercial banks' credit portfolio;
- increase in credit risk as a whole for the banking system.

Diagram 1.4. Weighted Average Interest Rates for Credits of Different FI, percent



Note: CBs, nat. - commercial banks, national currency; CBs, for. - commercial banks, foreign currency; CU - credit unions; MFO - microfinance organizations.

II. STATUS OF THE BANKING SYSTEM

2.1. Banking System Structure

As of the end of the first half of 2010, in the Republic operated 22 commercial banks (including the Bishkek Branch Office of the National Bank of Pakistan), which had 242 branches and 490 savings departments; wherein 15 banks out of those 22 banks with foreign capital share. In 10 of them the foreign capital share accounted for more than 50 percent. All banking institutions of the republic are universal by their type of activity.

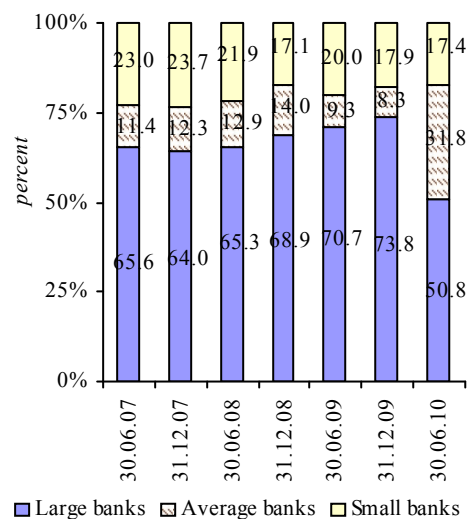
In the first half of 2010, Temporary Management Regime was introduced in 5 commercial banks, and Temporary Closing-Down Regime was applied to 1 commercial bank.

Timely measures taken by the NBKR, including introducing special regimes in number of commercial banks, made it possible to avoid deposit outflow and maintain confidence of the depositors in the banking system. This, in its turn, allowed to prevent the occurrence of any guarantee event; and the necessity to apply to the Deposit Protection Agency, with the purpose to receive indemnity from the Deposit Protection Fund, didn't emerge. As of the end of the first half 2010, the size of the Deposit Protection Fund amounted to 356.5 million of soms.

As a whole for the first half of 2010, the key indicators of the banking system decreased both in absolute and relative terms due to the social and political events in April and June; in particular regarding to assets, liabilities (including deposit base) and capital.

The analysis of the banking system structure in terms of the market segment occupied by the groups of 'large', 'medium' and 'small' banks¹ (Diagram 2.1.1) indicates a considerable decrease in the market share of 'large' banks; their specific

Diagram 2.1.1. Change in the Structure of the Banking System by Groups of Banks



¹ For the purpose of the analysis herein, the term 'large' banks means the banks which share (d_i) in the banking market (average square of the share in aggregate assets, loans, deposits and liabilities) exceeds 10 percent; 'medium' banks have the share from 5 percent to 10 percent, and 'small' banks have the share less than 5 percent.

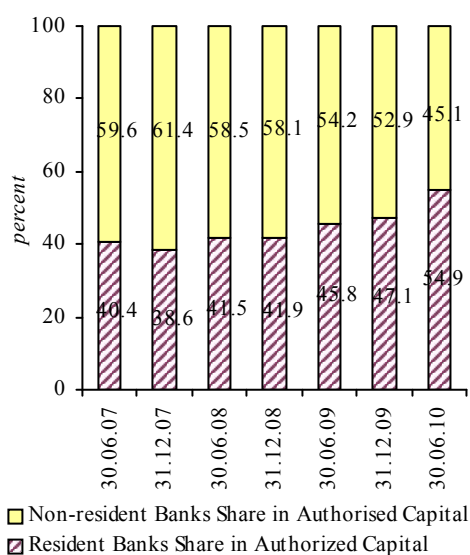
d_i is calculated in compliance with the following formula:

$$d_i = \frac{X_i}{\sum_{i=1}^N X_i} \quad \text{- the share of } i\text{-bank in the banking industry,}$$

where N is the number of the operating commercial banks;

$$X_i = \frac{d_A^2 + d_{kp}^2 + d_A^2 + d_{O\phi}^2}{4} \quad \text{- arithmetic mean of the following indicators: } (d_A^2) \text{ is the square of assets share of } i\text{-bank in the aggregate assets of banks, and, correspondingly, loans } (d_{kp}^2), \text{ deposits, } (d_A^2) \text{ and liabilities } (d_{O\phi}^2).$$

Diagram 2.1.2. Change in the Structure of Authorized Capital of the Banking System



weight decreased by 23 percentage points in the reporting period. The share of 'medium' banks increased by 23.5 percentage points and that of 'small' ones decreased by 0.5 percentage points.

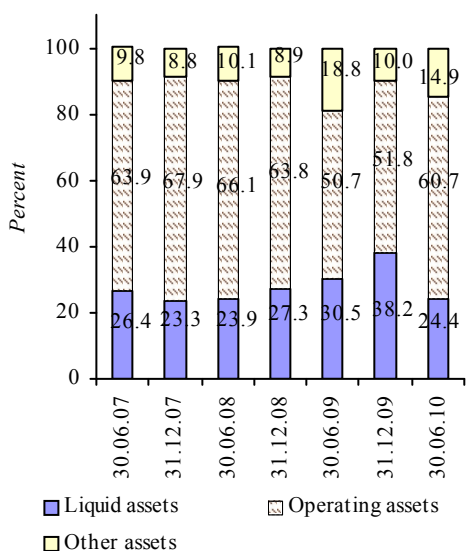
The segment of 'large' banks is comprised by two banks, which hold 50.8% of market share. These banks were qualified as the 'large' ones due to the high share values in the aggregate loans of the banking system that accounted for 31.8 percent, in the aggregate deposit base that accounted for 31.7 percent (less the deposits of banks and other NBFI as well of governmental authorities), and in the aggregate liabilities and assets that accounted for 29.3% and 23.5 % correspondingly.

Aggregate capital of the banking system decreased by 28.9 percent in the reporting period. The decrease was due to the accruals on additional expenses for provision for losses on troubled loans in the banks under the regime of temporary management and closing-down.

The foreign capital share accounted for 45.1 percent in the authorized capital of the commercial banks (as of the end of the second half of 2010 it accounted for 52.9 percent, Diagram 2.1.2).

In the first half of 2010 the overall growth rate of the resident banks' authorized capital amounted to 17.5 percent, while the non-resident banks' authorized capital decreased by 14.3 percent.

Diagram 2.1.3. Change in the Structure of the Banking System Assets



The decrease in the assets of the banking system amounted to (-23.5) percent as of the end of the first half of 2010. It's notable that regarding the change in the aggregate assets structure (Diagram 2.1.3), 60.7 percent of the banks' assets were operating², and their share increased by 8.9 percentage points. The share of liquid assets³ in aggregate assets of the banking system decreased from 38.2 to 24.4 percent. The decrease in this category of assets happened mainly due to the withdrawal of a considerable volume of demand deposits of the non-resident legal entities and, correspondingly, due to the decrease in correspondent accounts in other banks.

The available liquidity in banks that surpasses the normative standards specified by the National Bank allows banks to increase lending to economy at the expense of decreasing the share of liquid assets in required volume.

² 'Operating assets' means the balances on the loan and deposit accounts held with FI as well as securities and other bank placements yielding interest revenue.

³ 'Liquid assets' means the banks' monetary assets in cash departments and correspondent accounts.

The share of 'other' assets increased and amounted to 14.9 percent.

The operations under the Islamic Financing Principles are being continued. As of the end of the first half of 2010, the volume of such operations amounted to 481.0 million of soms (365.1 million of soms as of the end of the second half of 2009).

The analysis of the commercial banks' deposit base as the major source of allocated resources showed the following.

In the first half of 2010 the *deposit base* of the banking system decreased by (-24.3) percent; herewith, the deposit amount decreased to 29.0 billion of soms. In terms of deposits, the share of deposits of individuals accounted to 33.3 percent (8.2 percentage points increase). The amount of deposits of individuals increased by 0.6 percent.

The specific weight of deposits of legal entities made 51.8 percent (9.7 percentage points decrease), while their volume decreased by 36.3 percent.

The rest share (14.9 percent) belongs to the deposits of the Kyrgyz Republic state agencies. The decrease in this deposit category amounted to 15.9 percent

The share of time deposits increased up to 34.3 percent of the banks' total deposit base during the reporting period (Diagram 2.1.4). This, in its turn, enhances the banks' capacity to increase the medium-term and long-term lending to economy. It's notable that the time deposits of individuals decreased by 3.2 percent and their absolute amount made up 5,993.7 million of soms.

In the end of first half of 2010, a decrease in 'dollarization' level of the banking system's deposit base was observed (Diagram 2.1.5). This value amounted to 47.1 percent against 61.7 percent for the second half of 2009. 'Dollarization' level of the deposits of legal entities decreased by 23.7 percentage points and accounted for 48.7 percent of the total deposits of legal entities as of the end of the reporting period. The share of deposits of individuals in foreign currency decreased by 0.5 percentage points and accounted for 59.0 percent of the total deposits of individuals.

The total loan *portfolio*⁴ of the banking system increased by 2.3 percent in the end of first half of 2010 and made up 25.7 billion of soms. However, 'dollarization' level of the commercial

Diagram 2.1.4. Change in the Deposits Structure of Banking System by Maturity of their Attraction

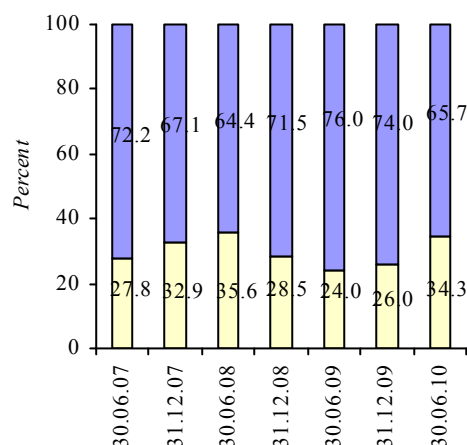


Diagram 2.1.5. Change in the Structure of Banking System Deposits by Types of Currencies

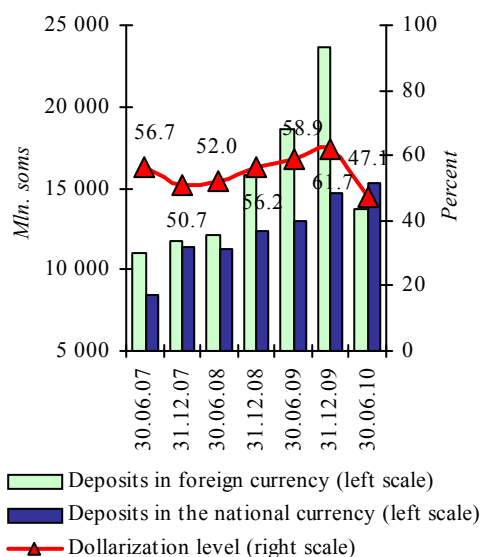
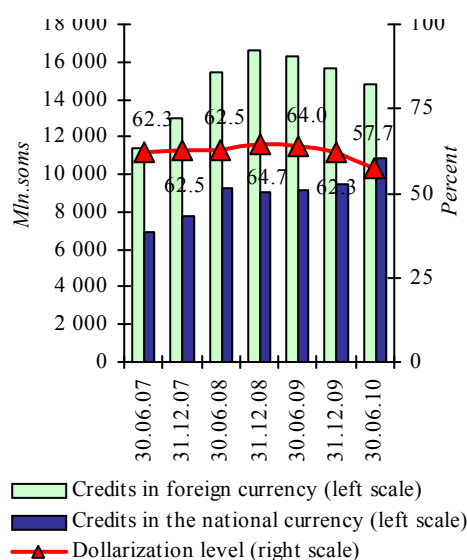


Diagram 2.1.6. Change in the Structure of the Banking System Credit Portfolio by Forms of Currency



⁴ Hereinafter this category shall not include any appropriate discount for all loans as well as the loans extended to banks and other financial institutions. The loans are given with regard for PL.

Diagram 2.1.7. Change in the Banking System Credit Portfolio by Maturity

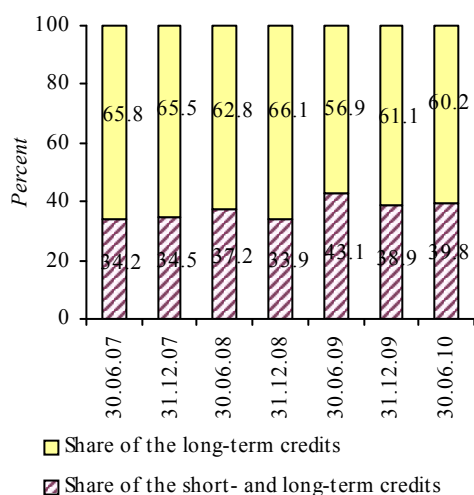


Diagram 2.1.8. Change in the Behaviours of the Interest Rates on Credits in the National Currency

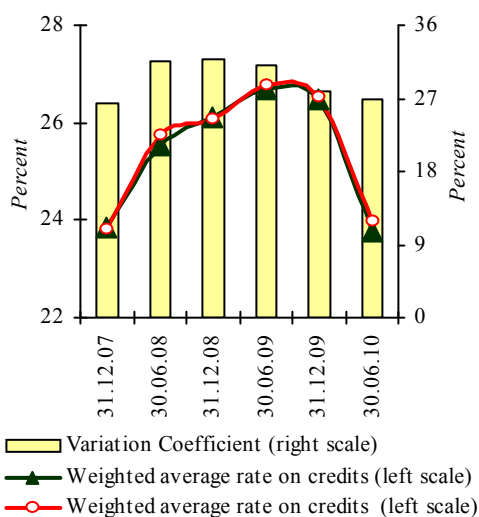
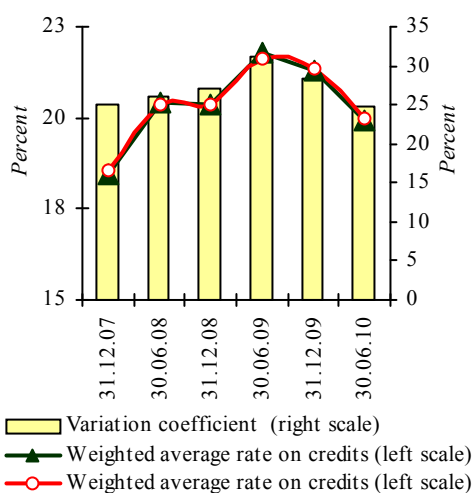


Diagram 2.1.9. Change in the Behaviours of the Interest Rate on Credits in Foreign Currency



banks' loans decreased and made up 57.7 percent as of the end of the reporting period (Diagram 2.1.6)

The share of long-term loans⁵ decreased from 61.1 percent to 60.2 percent, and the increase in absolute amount made up 0.8 percent. Meanwhile, the specific weight of the loans with payment period less than one year slightly increased and remained rather high (39.8 percent, Diagram 2.1.7)

In order to assess the operating interest rates on loans, such characteristics as variation coefficient of interest rates as well as average and average weighted rates on loans were considered.

The interest rates calculated as for 6 months average weighted arithmetic value on loans in the national and foreign currencies amounted to 24.0 percent and 20.0 percent correspondingly. As compared with the first half of 2009, the interest rates on loans in the national currency decreased by 2.5 percentage points, and those in foreign currency also decreased by 1.3 percentage points. The variation coefficient that demonstrate the range of interest rates spread in credit market showed downturn both for loans in the national and foreign currencies. As of the end of the first half of 2010, the average weighted rate on loans both in the foreign and national currencies almost matched to the average rate (Diagrams 2.1.8, 2.1.9).

Therefore, the trends observed in the banking sector in the first half of 2010 were as following:

- decrease in capitalization of the banking system;
- decrease in the banks' deposit base on the whole;
- some decrease in the share of the long-term loans;
- increase in the amount of loan portfolio against a decrease in other key indicators of the banking system (assets, deposits, capital base);
- decrease in the 'dollarization' level of the banking system's deposit base.

⁵ The 'long-term loans' means the loans extended for a period of more than 1 year.

2.2. Risks

2.2.1. Credit Risk

Credit risk is one of the major risks, which goes along with the banking activity. This section covers the active banking operations with a credit risk exposure.

To assess *loan portfolio quality*, the commercial banks use the loan classification scheme¹ that allows to define a potential degree of losses incurred due to credit defaults and to compensate for them on a timely basis by establishing appropriate provisions.

The classified and overdue loans, which are the first signs of deterioration in loan portfolio quality, claim the most attention when assessing the loan portfolio quality. In the first half of 2010 there was an increase in the share of classified and overdue loans in the loan portfolio (Diagram 2.2.1.1). At the same time, the value of assets default risk (the ratio of special PL to loan portfolio) also increased and made 7.2 percent.

Change in the volume of loans categorized as the loans 'under supervision' can be viewed as one of the factors that can influence an increase or a decrease of the credit risk level in future. In the first half of 2010 the specific weight of such loans considerably increased (Diagram 2.2.1.2), and continue occupying a considerable share in the total loan portfolio (17.0 percent).

The banks created the volume of provisions adequate to the adopted loan classification that accounted for 9.6 percent of the total loan portfolio (as of the end of the second half of 2009 this indicator made 6.9 percent).

In the case of deterioration of the classified loans' quality by one category and additional charges on provisions, the predicted level of capital adequacy of the banking system will surpass the established normative level.

Therefore, in general credit risk increased in the banking system.

As of the end of the first half of 2010, the specific weight of the 'net' loan portfolio (outstanding amounts on loans extended

Diagram 2.2.1.1. Change in the Level of Credit Risk in Credit Portfolio of Banking System

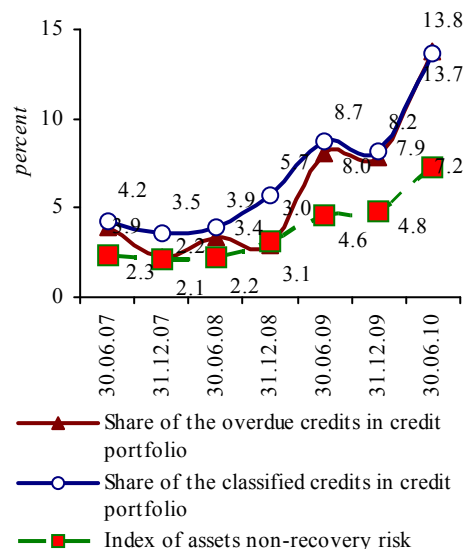
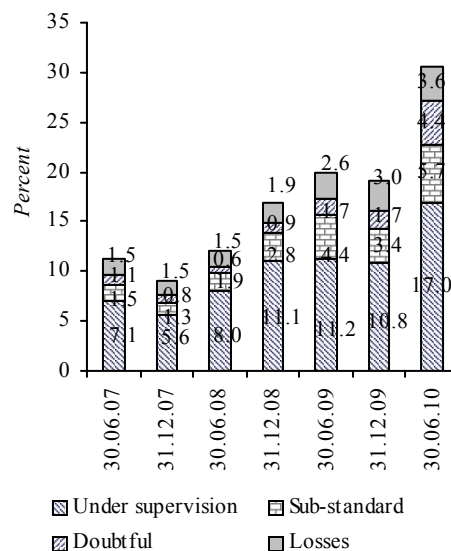
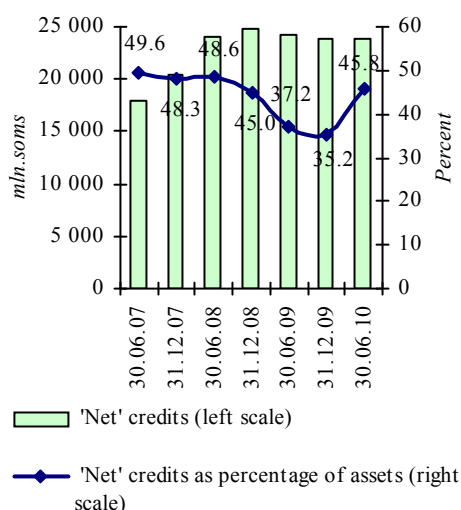


Diagram 2.2.1.2. Change in the Classification of the Banking System Credit Portfolio



¹ In order to assess loan portfolio quality, it was accepted to classify all loans into six categories, depending on current possibilities of a client to meet liabilities of a bank (given in the classification deterioration order): normal, satisfactory, under supervision, sub-standard, doubtful, and losses. The loans falling within the last three categories are used to be referred as 'non-performing' or 'classified' as they have the most negative characteristics in terms of repayment of funds. For each of such six categories, a bank must allocate a provision, which is determined as the percent of the amount of loans extended.

Diagram 2.2.1.3. Change in the Level of 'Net' Credits

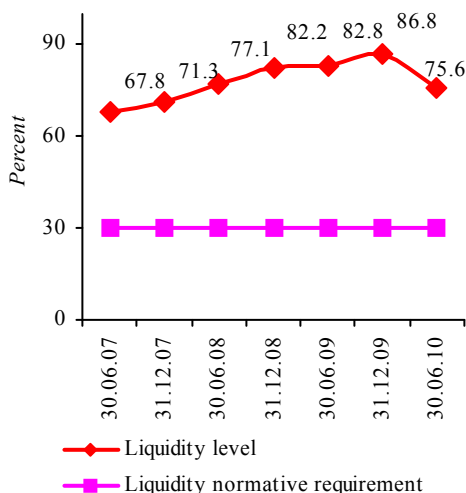


to clients less the allocated specific provision for potential losses on the classified loans) increased by 10.6 percentage points compared to the previous half-year and amounted to 45.8 percent of the aggregate assets of the banking system (Diagram 2.2.1.3). Herewith a considerable decrease in cash resources took place, in particular, in the funds on NOSTRO accounts of individual domestic banks in correspondent banks.

2.2.2. Liquidity Risk

People's confidence in the banking system depends on timely meeting by banks of their obligations; this implies the availability of sufficient liquidity within banks. With the purpose of regulation, liquidity risk is estimated in accordance with the economic standards of current liquidity².

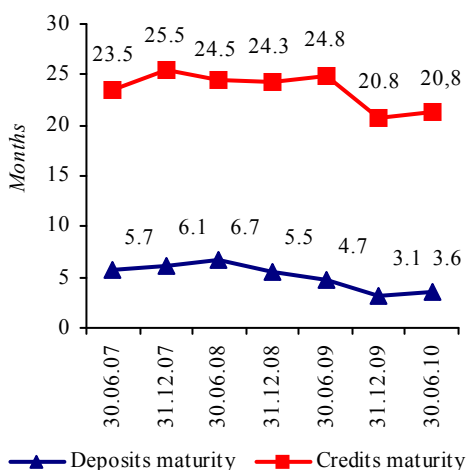
Diagram 2.2.2.1. Dynamic of Change in the Calculating Value of the Current Liquidity



Actual level of the liquidity indicator maintained by the banking system remained rather high. On the average for the banking system, the estimated value of such indicator as of the end of the first half of 2010 made up 75.6 percent, having decreased by 11.2 percentage points as compared with the end of the second half of 2009 (Diagram 2.2.2.1).

Insufficient stability of deposits was proved by the data on change in the maturity of deposits and loans as well as by calculating the stability coefficient of the sources of funds³.

Diagram 2.2.2.2. Dynamic of Change in the Maturity of the Banking System Credits and Deposits



During the reporting period (Diagram 2.2.2.2) the gap between the average terms for attracting deposits and for placing loans decreased, though it remained high; this suggests the latent disintermediation⁴ risks that may occur in some banks in the process of liquidity management. Nevertheless, it's necessary to take into account that a certain part of loans is financed by banks from other long-term sources different from the deposits (capital, long-term borrowings from the financial institutions, etc). This fact decreases the potential exposure to the above mentioned risks.

Diagram 2.2.2.3 demonstrates a change in stability coefficient for the sources of funds compared to the dynamics of the deposit base ratio to the 'net' loan portfolio. The share of time deposits was noted to grow (from 26.0 to 34.3 percent as a result of the first half-year of 2010) in the deposit base; and indicates

² Economic standards of current liquidity is one of the regulations specified by the NBKR, which is obligatory for meeting by banks; according to it, the liquid assets should be at least 30 percent of the short-term liabilities level.

³ Stability coefficient for the sources of funds is defined by a share (as a percentage) of time deposits in the total amount of deposits of the banking system

⁴ Disintermediation is a process of mass withdrawal of deposits by population prior to the specified term due to the panic caused by escalation of inflationary expectations and/or other negative expectations.

availability of certain capacity to increase the terms of loans extended and stabilizes the process of liquidity management.

In the first half-year of 2010 there was an increase in the stability coefficient of financial assets (Diagram 2.2.2.3.). Correspondence of deposit volumes and the amount of 'net' loans indicates a trend for efficient and targeted use of the attracted funds by banks as compared to 2009 level.

As a whole, it can be noted that, in spite of the impact of known political events occurred in April and June 2010, there was no lack of funds to fulfill any unexpected or premature requirements to liabilities.

Table 2.2.2.4 shows data on the maturity of the financial assets and liabilities of banks as of the end of the first half of 2010. As a whole, the financial liabilities of banks were covered by the financial assets; the gap (excess of assets over liabilities) amounted to 6.07 billion of soms, including 13.44 billion of soms for loans and deposits. Therefore, the banks held enough assets to meet their financial liabilities. Meanwhile, a negative gap was observed in the period of up to 90 days; this will require the banks to pay a special attention to assets and liabilities management to meet their financial liabilities in the short-term period.

Diagram 2.2.2.3. Assessment of the Liquidity Factors of the Banking System

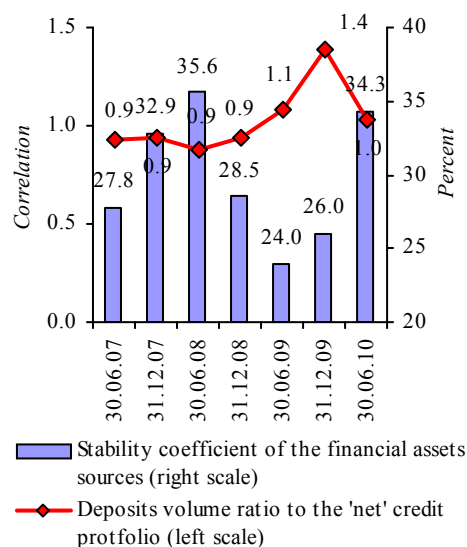
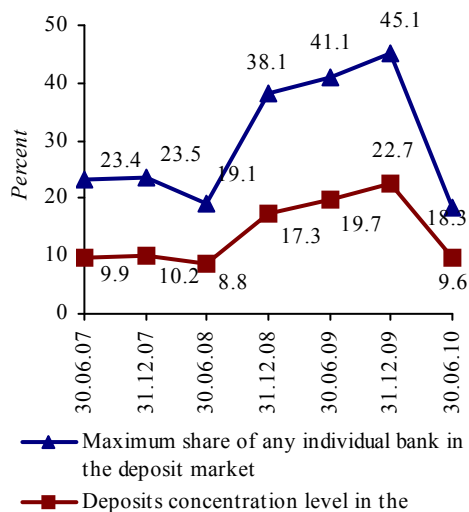
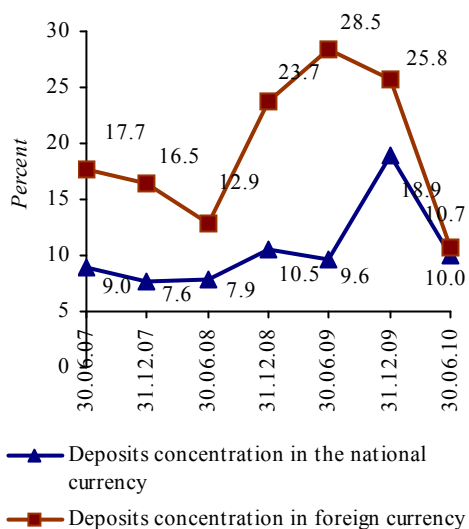
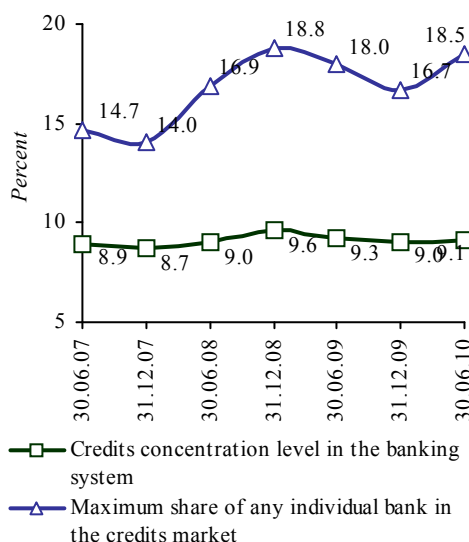


Table 2.2.2.4. Maturity of Financial Assets and Liabilities (mln.soms)

Title	Repayment period					Total
	up to 30 days	from 31 to 90 days	from 91 to 180 days	from 181 to 365 days	more than 365 days	
1. Total financial assets	22 438.7	2 872.3	3 834.2	7 102.5	22 885.6	59 133.3
<i>including credits and finance lease for clients</i>	1 234.0	1 417.9	2 534.9	5 042.1	15 477.9	25 706.7
2. Total financial liabilities	25 725.0	12 268.8	2 813.2	5 951.3	6 307.5	53 065.9
<i>including deposits of individuals and time deposits of legal entities</i>	3 126.2	3 137.2	1 743.2	2 342.1	1 916.9	12 265.6
3. Total spread	-3 286.3	-9 396.5	1 021.1	1 151.2	16 578.1	6 067.4
<i>including the spread for credits and deposits</i>	-1 892.2	-1 719.4	791.6	2 700.0	13 561.0	13 441.1

Diagram 2.2.3.1. Change in the Deposits Concentration**Diagram 2.2.3.2. Deposits Concentration by the Forms of Currency****Diagram 2.2.3.3. Change in the Credit Concentration**

2.2.3. Concentration Risk

Special Features of Deposits Concentration. Diagram 2.2.3.1 demonstrates that in the first half of 2010 the level of deposits concentration in the banking system and maximum share of the one bank in the deposit market sharply decreased. Concentration of deposit market among the participants⁵ became 'low' (lower than 10 percent) in terms of generally accepted gradation, and maximum share of the one bank decreased from 45.1 percent to 18.3 percent.

At the same time, deposit concentration in the national currency sharply decreased from 18.0 percent to 10.0 percent, while deposit concentration in foreign currency decreased from 25.8 percent to 10.7 percent (Diagram 2.2.3.2). The above stated indicates the enhancement of business competition in deposit market for attracting clients by banks.

Assessment of the concentration level in the banking system using another indicator - 'The share of four large banks' - also indicates the decrease in deposit concentration from 65.2 percent to 52.7 percent; whereas the composition of these four large banks remained unchanged in the first half of 2010.

Special Features of Loans Concentration. In the first half of 2010 an increase in the loan portfolio of the banking system was accompanied by an increase in the loans concentration. Meanwhile, the maximum share of an individual bank in the loan market increased compared to the end of the second half of 2009 (Diagram 2.2.3.3)

As for the indicator of the 'Share of Four Large Banks', it can be noted that in the reporting period the loans concentration increased from 50.9 percent to 51.5 percent, whereas the composition of these four large banks remained unchanged in the first half of 2010

In the first half of 2010 the value of loans concentration in foreign currency decreased from 12.0 percent to 11.8 percent; as for the national currency it decreased from 12.0 percent to 11.1 percent (Diagram 2.2.3.4)

According to the results of analysis of loans concentration risk in sectors of economy, there was a fluctuation from 'average'

⁵ Assessment of concentration risk as 'high', 'average' or 'low' is based on generally accepted gradation of the concentration level. Thus, concentration risk is deemed to be 'low' where the concentration level makes up to 10 percent; 'moderate' risk makes from 10 percent to 18 percent, and 'high' risk makes more than 18 percent. For example, the concentration index equaling to 50 percent is equivalent to the presence at the market of 2 participants with equal shares; where it amounts to 33 percent, then there are 3 participants, etc.

to 'high' level of concentration depending on a sector (Table 2.2.3.5).

Based on the data of Table 2.2.3.6, some increase in trade and agriculture loans in the structure of total loan portfolio of banks can be noted.

High concentration of loans extended for the needs of agriculture, trade and mortgage indicates the high credit risk exposures in these sectors by individual banks.

Therefore, as a whole in the banking system of the Kyrgyz Republic, there was sharp decrease in concentration of the deposits both in the national and foreign currencies. As to the loans both in the national and foreign currencies, the concentration level decreased as well but remained 'moderate'. Loan concentration level by the sectors of economy, as a whole for the banking system, varied from 'average' to 'high' depending on a sector. A considerable decrease in the indicators of deposits concentration in terms of participants of this market resulted from a decrease in the share of a bank falling under the 'large' banks category.

Diagram 2.2.3.4. Credit Concentration by Forms of Currency

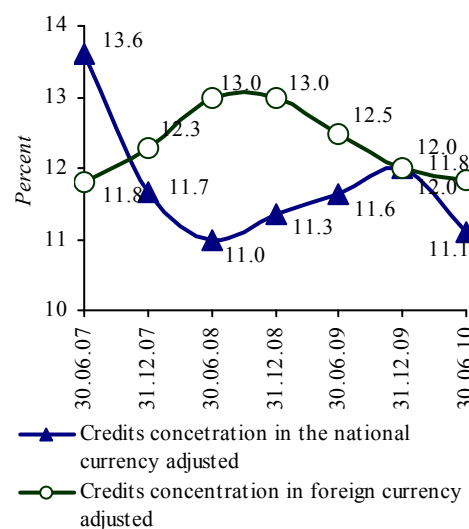


Table 2.2.3.5. Concentration of Banks Activities by Lending to Sectors of Economy*

	31.12.07	30.06.08	31.12.08	30.06.09	31.12.09	30.06.10	Deviation to the previous period (in percentage points)
Industry	22.0	20.6	18.6	15.7	15.8	15.5	-0.3
Agriculture	56.3	49.1	50.3	50.0	48.6	43.9	-4.7
Transport	22.1	25.5	24.3	23.3	20.5	20.7	0.2
Communication	88.5	74.7	72.6	67.2	97.3	75.0	-22.3
Trade	8.5	10.2	11.5	10.9	11.9	11.0	-0.9
Procurement and processing	37.5	32.2	32.7	34.8	39.9	30.9	-9.0
Construction	16.7	14.6	13.5	12.0	12.0	10.5	-1.5
Mortgage	18.2	16.8	17.9	17.8	19.1	20.6	1.5
Private households	13.9	13.1	11.7	12.2	11.8	11.4	-0.4
Socials services	44.1	58.9	65.5	40.1	40.6	41.5	0.9
Others	14.6	15.5	15.5	16.6	18.0	18.2	0.2

* Concentration should be defined in accordance with the Herfindal-Hirshman index, which is calculated as the sum of squares of banks' shares in total volume of lending in a sector. The concentration index of 100 percent means full monopolization of a specific market segment; 50 percent means the presence of 2 participants with equal shares; 33 percent implies 3 participants, etc

Table 2.2.3.6. Banks Loan Portfolio Structure by Sectors of Economy

	31.12.07	30.06.08	31.12.08	30.06.09	31.12.09	30.06.10	Deviation to the previous period (in percentage points)
Industry	6.8	6.2	5.7	6.1	5.5	5.3	-0.2
Agriculture	12.2	11.9	11.5	12.1	12.2	13.0	0.8
Transport	0.7	1.0	1.0	1.0	1.0	1.1	0.1
Communication	0.6	0.3	0.5	0.4	0.1	-	-0.1
Trade	37.9	36.7	36.1	38.2	41.5	43.0	1.5
Procurement and processing	0.6	0.5	0.5	0.4	0.4	0.3	-0.1
Construction	6.8	7.8	9.5	8.5	7.7	7.5	-0.2
Mortgage	15.8	13.9	14.0	13.2	12.3	11.4	-0.9
Private households	6.6	8.4	8.3	7.8	8.0	7.3	-0.7
Socials services	0.1	0.4	0.4	0.2	0.1	0.2	0.1
Others	11.9	13.0	12.4	12.2	11.2	10.9	-0.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	x

2.3. Capital Adequacy Level

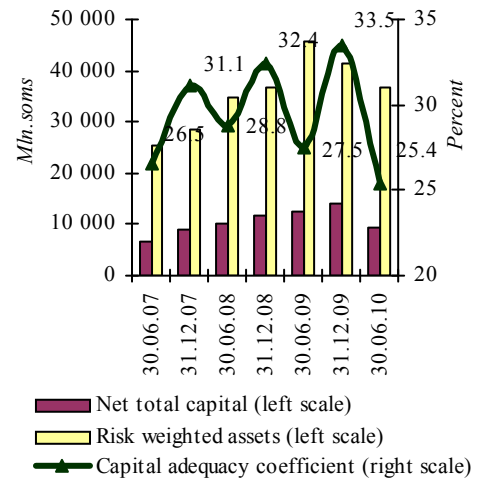
All risks inherent in the banking activity eventually impact the financial results (both already occurred as direct losses and those having high likelihood of losses in future through the costs incurred due to creating relevant provisions) and influence the amount of own funds of a bank - its capital that characterizes bank's stability in case of any potential negative changes.

Under the specified minimum value of capital adequacy of 12.0 percent, this value, on the average for the banking system, amounted to 25.4 percent for the first half of 2010 (Diagram 2.3.1). The decrease in capital adequacy level of the banking system occurred due to considerable losses incurred by some commercial banks.

Actual level of capital adequacy allows additionally increase the volume of risky and income-generating assets by almost 2 times, without surpassing the acceptable level of risk in the activity of other banks.

The above mentioned indicates the relative stability of the banking system to the negative shocks and availability of some capacity for increasing the level of financial intermediation and efficiency of the banking system operation in future.

Diagram 2.3.1. Change in the Capital Adequacy Values of the Banking System



2.4. Financial Results

A main indicator of the banking activity profitability is the return on assets (ROA) coefficient, which is defined as the ratio of the gained profit to the average level of assets, as well as the return on equity (ROE) coefficient is defined as the ratio of the gained profit to the average amount of the Tier 1 Capital.

Table 2.4.1. Key Indicators of Banking System Profitability
(in percentage points to the average value of assets for the period (the half-year))

	31.12.08	30.06.09	31.12.09	30.06.10
Total interest yield	11.6	10.0	9.6	9.3
Total interest expense	4.0	3.6	3.3	2.8
Net interest yield	7.5	6.4	6.3	6.5
PL charges (for credits)	0.8	0.9	0.6	2.3
Net interest yield less PL charges	6.7	5.5	5.7	4.1
Total non-interest yield	23.3	17.8	16.8	16.7
Total non-interest expense	17.8	13.8	12.5	13.1
Other total operat. and administ. expense	8.0	6.4	6.8	7.2
PL charges (for other assets)	0.0	0.3	0.3	11.5
Net income (loss) prior to taxation	4.2	2.8	2.8	-11.0
Income tax	0.4	0.3	0.3	0.2
Net profit (loss)	3.8	2.5	2.5	-11.2
Average value of assets for the period (bln. soms)	48.5	61.6	64.1	63.8

In the first half of 2010, in the banking system of the Kyrgyz Republic, ROA amounted to (-11.2) percent year-on-year (2.5 percent for the second half of 2009); ROE amounted to (-58.0) percent year-on-year (13.6 percent for the first half of 2009).

As to the key indicators of the banking system profitability to the average value of assets, there was an increase in the net interest income (from 6.3 percent to 6.5 percent) that occurred due to a greater increase in the interest incomes compared to the interest expenses (Table 2.4.1)

When considering the non-interest incomes and expenses of the commercial banks, there was decrease in the non-interest incomes (from 16.8 percent to 16.7 percent to the average level of assets) and increase in the non-interest expenses (from 12.5 percent to 13.1 percent). The level of the operational and administrative expenses of banks increased by 0.4 percentage points.

The level of assignments of taxes on profit remained the same, and thus, the net profit amounted to 2.5 percent to the average value of assets for the first half of 2010.

In the absolute terms the net loss of the banking system

amounted to 3.57 billion of soms in the first half of 2010, while in the first half of 2009 it amounted to 1.59 billion of soms (Diagram 2.4.2).

Loan portfolio yield defined as the ratio of interest income on loans to the average value of the outstanding amounts on extended loans increased by 0.1 percentage points and amounted to 20.3 percent as of the end of the first half of 2010 (Diagram 2.4.3).

As of the end of the first half of 2010, the ratio of assets to the number of the commercial banks' employees amounted to 5.7 million of soms (7.4 million of soms as of the end of the second half of 2009). It was connected with the decrease in assets, which made (-23.5) percent, whereas the number of the commercial banks' employees increased by 0.1 percent.

Therefore, in the first half of 2010, the banking system was unprofitable on the whole, and these losses were connected solely to the losses of troubled banks. The rest banks were profitable in the first half of 2010. At the same time, the level of the average value of capital adequacy requirement indicates the opportunity for additional extension for the banks' active transactions. The efficiency of assets usage can be significantly enhanced by further decrease of the share of low-profit-generating assets.

Diagram 2.4.2. Change in the Return on Assets

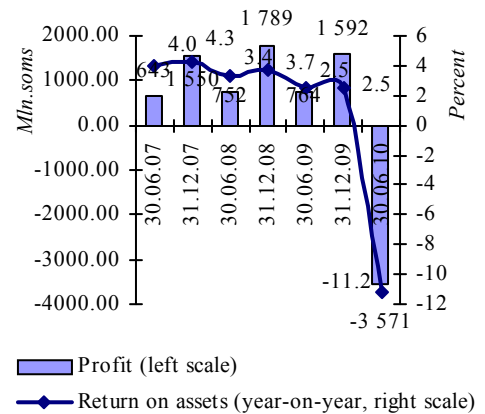
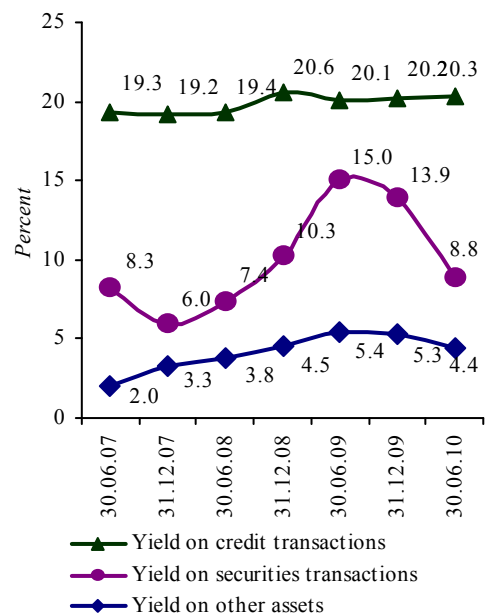
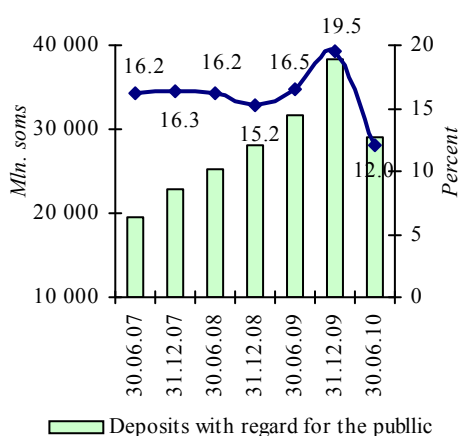


Diagram 2.4.3. Earning Yield on Separate Types of Transactions



2.5. Financial Intermediation Indicators

Diagram 2.5.1. Deposits Volumes Dynamic and Deposits Ratio to GDP

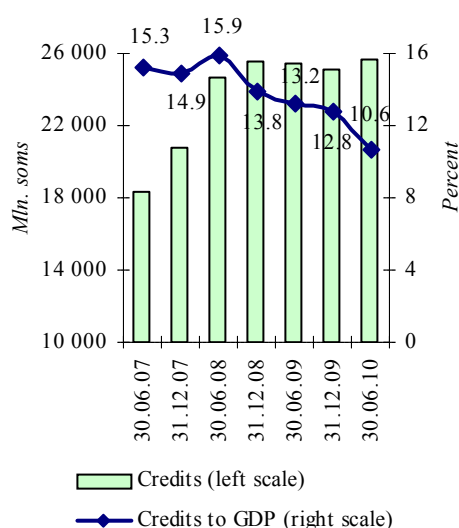


The role of the banking industry as the financial intermediary that accumulates financial resources for their further allocation between the sectors of economy directly depends on the development level and operation efficiency of banks.

The ratio of deposits volume¹ to the GDP² volume amounted to 12.0 percent as of the end of the first half of 2010 (19.5 percent for the second half of 2009, Diagram 2.5.1). The decrease in this indicator was caused by the negative growth rates of deposits (-23.6 percent) compared to the growth rates of GDP (23.1 percent).

The ratio of the overall volume of loans extended to clients to the GDP volume decreased by 2.2 percentage points compared to the same indicator for the end of the first half of 2009 and amounted to 10.6 percent (Diagram 2.5.2).

Diagram 2.5.2. Credits Volume Dynamic and Credits Ratio to GDP

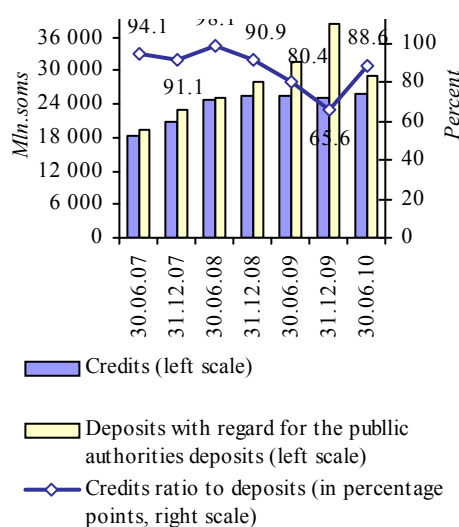


As of the end of the first half of 2010, the volume of loans amounted to 25.70 billion of soms that was by 2.3 percent higher than the volume of loans as of the end of the second half of 2009.

In terms of loans extended to clients, the biggest growth was noted in the loans extended to agriculture (7.4 percent), trade (6.6 percent), and the loans falling within the 'other loans' category (0.3 percent).

The ratio of outstanding loans to deposit volumes amounted to 88.6 percent against 65.4 percent for the second half of 2009; this was connected with a considerable decrease in deposits and some increase in loans (Diagram 2.5.3).

Diagram 2.5.3. Dynamic of Credits Ratio to Deposits



As of the end of the first half of 2010, the average weighted interest rate on newly extended loans in the national currency amounted to 23.6 percent (2.8 percentage points decrease compared to the first half of 2009). The interest rate for newly extended loans in foreign currency decreased by 0.9 percentage points to make 19.8 percent as of the end of the first half of 2010.

The remaining high spread of the interest rates on loans and deposits in the Kyrgyz Republic was conditioned by the impact of the following factors:

¹ For the purposes of this section the term 'deposits' mean the deposits of enterprises and population as well as the deposits and loans of the Kyrgyz Republic state agencies.

² The data on nominal GDP for the last 12 months are used for the calculation.

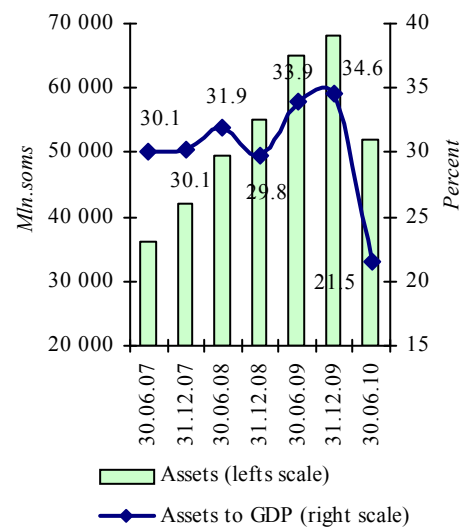
- continuing high level of credit risk;
- high demand for credit funds.

In terms of financial intermediation level, it is necessary to note a considerable decrease in the value of the aggregate assets ratio to GDP (Diagram 2.5.4). Thus, for the end of the first half of 2010 this ratio made 21.5 percent (34.6 percent as of the end of the first half of 2009).

The existing level of financial intermediation still has comparatively low values; therefore, it is necessary to continue taking measures by the Government of KR, the NBKR and commercial banks for the further development and enhancement of efficiency of the banking system operation.

However, in a view of potential deterioration of general macroeconomic and political situation as well as high level of exchange rates volatility, certain worsening of loan portfolio quality and other indicators of banks' activity is possible.

Diagram 2.5.4. Assets Volume Dynamic and Ratio of Assets to GDP



III. NON-BANKING FINANCIAL INSTITUTIONS

3.1. State of the Non-Banking Financial Institutions System

The system of non-bank financial institutions (NBFI) includes the following institutions liable to the NBKR supervision (Table 3.1.1):

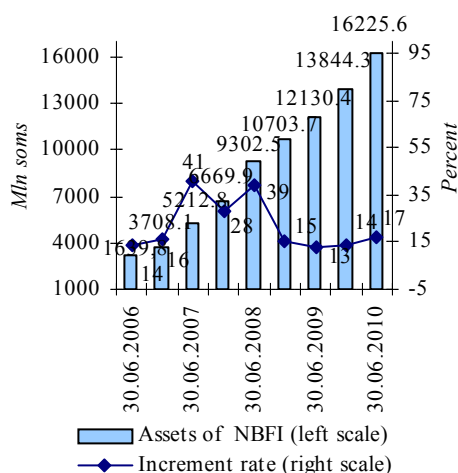
- Financial Company for Support and Development of Credit Unions (LLC FCSDCU);
- Special Fund for Banks' Refinancing (LLC SFBR)
- credit unions (CU);
- microfinance organizations (MFO) that involve microfinance companies (MFC), micro-credit companies (MCC) and micro-credit agencies (MCA);
- exchange bureaus.

Table 3.1.1. Trends of the Non-Bank Financial Institutions Quantity

Name	2005	2006	2007	2008	30.06.2009	2009	30.06.2010
CUFC (Ayil Bank) ¹	1	1	-	-	-	-	-
LLC SFBR ²	-	-	-	-	1	1	1
CJSC Development Fund ³	-	-	-	-	-	1	-
FCSDCU	1	1	1	1	1	1	1
MFO	136	168	233	291	327	359	380
Credit Unions	320	305	272	248	238	238	229
Pawn Shops	140	148	181	196	226	231*	
Exchange Bureaus	260	263	318	353	385	372	336
Total	858	886	1005	1089	1178	1203	947

* Data as of 01.09.2009, licensing was canceled from 08.09.2009.

Diagram 3.1. 1. 1. Trends of NBFI Total Assets exclusive of the Development Fund



The decrease in the NBFI quantity was observed due to the decrease in the number of credit unions and exchange bureaus. Besides, due to cancellation of pawn shops licensing, their recording in the NBFI register NBKR was ceased.

According to the submitted regulatory reports for the first half of 2010, the increment of the total NBFI assets (Diagram 3.1.1.1.) amounted to 17.2 percent, and, as of June 30, 2010, their volume amounted to Soms 16,225.6 million, whereas the total assets increment as compared with the similar period of 2009 amounted to 33.8 percent.

¹ The OJSC CUFC was reorganized into the OJSC Ayil Bank on December 27, 2006; due to this fact, it was taken into account in the commercial banks' system.

² LLC SFBR was established on May 6, 2009.

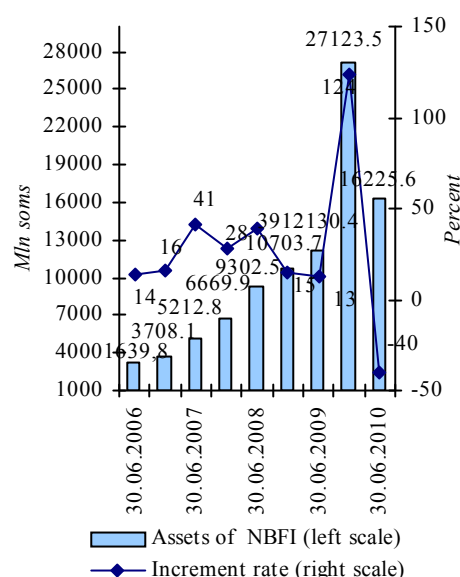
³ The license was revoked on May 7, 2010.

Adjusted for the Development Fund assets, which was closed in accordance with the Decree of the Temporary Government of the Kyrgyz Republic *On Liquidation of the CJSC Development Fund of the Kyrgyz Republic* No. 31 dated April 30, 2010, the total NBFI assets (Diagram 3.1.1.2.) decreased by 40.2 percent.

For the first half of 2010 the increment of the NBFI's own capital (with the exception of the Development Fund) equal to 17.9 percent; whereas NBFI joint liabilities decreased by 21.7 percent. As compared with the similar period of 2009, the increment of NBFI own capital equal to 98.2 percent, while NBFI joint liabilities amounted to 14.1 percent.

For the first half of 2010 the NBFI consolidated profit equal to Soms 359.9 million. The profit level of the current year by 15.3 percent higher than the profit level of the first half of 2009 (Soms 425.0 million). It was connected with an increase in the volume of the special provision for losses on loans.

Diagram 3.1.1. 2. Trends of the NBFI Total Assets inclusive of the Development Fund



⁴ The NBFI system data were submitted without regard for the FCSDCU and SFBR credit portfolio since the credits were issued to FCI that re-credited them.

3.2. Loan Portfolio Structure and Trend

Diagram 3.2.1.1. Trends of NBFi Credit Portfolio Exclusive of the Development Fund

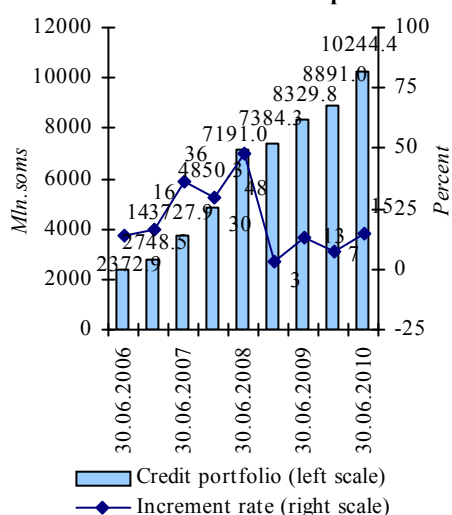


Diagram 3.2.1.2. Trends of NBFi Credit Portfolio Inclusive of the Development Fund

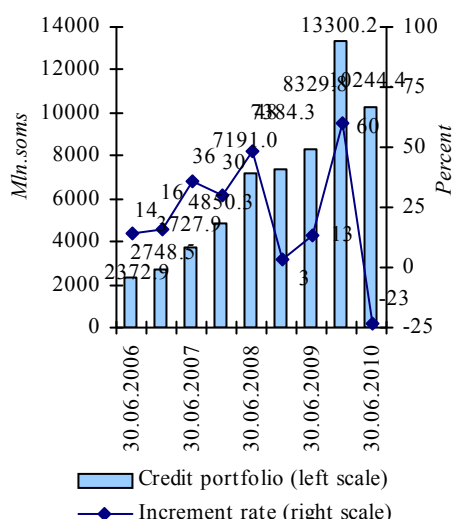
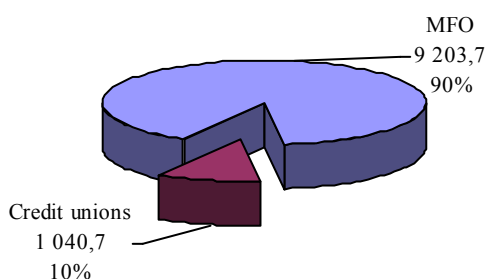


Diagram 3.2.2. Total Credit Portfolio by NBFi Types (mln. soms)



Lending is a main area of the non-bank financial institutions' activity.

For the recent years, the NBFi loan portfolio had a growth trend (Diagram 3.2.1.1.)¹. For the first half of 2010 the total NBFi loan portfolio increased by Soms 1,353.4 million, or 15.2 percent, and equal to Soms 10,244.4 million. The growth of the total portfolio in absolute amount equal to Soms 1,914.6 million, or 23.0 percent, compared with the similar period of 2009.

Adjusted for the Development Fund loan portfolio, the NBFi's total loan portfolio decreased by Soms 3,055.8 million, or by 23.0 percent (Diagram 3.2.1.2.).

In the reporting period, the share of the loan portfolio in the NBFi total assets decreased from 68.7 percent as of June 30, 2009, to 63.1 percent as of June 30, 2010 (the loan portfolio share in the total assets equal to 49.0 percent as of December 31, 2010).

The increase in the number of NBFi borrowers was by 43,127 people, or by 13.8 percent, and equal to 356,622 people against the similar period of 2009.

In the structure of the NBFi total loan portfolio (Diagram 3.2.2.), 90.0 percent composed by the loans of microfinance organizations, and 10.0 percent by the loans of CU.

The trend of change in the volumes of loans by sectors and regions reflected the sustainability of NBFi's borrowers preferences. Thus, in the breakdown of the regions (Diagram 3.2.3.) the major share of the loan portfolio belongs to the Osh Oblast and Bishkek. As a whole, the highest activity was observed in the country's south and in the capital due to the higher population density and its economic activity in the agriculture and trade sectors.

In the first half of 2010 the largest volume of NBFi loans was provided for agriculture (47.1 percent) as well as for trade and service sectors (33.7 percent) (Diagram 3.2.4.). Sufficiently high share of loans in agriculture sector was predetermined by the MFO regional branching and the specific features of the credit unions' activity as rural financial institutions. Loans concentration in trade sector was related to the specificity of NBFi activity: small loans, as a rule, provides for short-terms and had high rates that conditioned their orientation to the sectors with higher capital turnover.

¹ Data without regard for the Development Fund. Hereinafter the NBFi assets and credit portfolio were indicated without regard for the FCSDCU and SFBR, which had been re-credited into the assets of credit unions and commercial banks.

3.3. Major Risks

NBFI loan portfolio was concentrated mainly in agriculture and in the business related to it and located in rural area, as well as in trade. Such lending was accompanied by high risks due to the dependence from weather and climatic conditions and to rather low income of rural population.

There was the seasonal increase in the share of loans in agriculture from 28.0 percent to 47.1 percent year-to-date.

Another risk factor consisted in concentration. 7 large MFOs, which were established and performed their activity due to the funds of foreign donors, held a principal share of the credit portfolio. The credit portfolio share of these MFOs accounted for 83.1 percent of the NBFI total credit portfolio. The NBFI growth trend was conditioned by the increasing volume of outward investment on the part of donors.

Interest rates of the non-bank financial institutions loans remain at a rather high level due to the remaining high demand for these types of services on the part of the population as well as due to the NBFI endeavor to cover the existing high risks and expenses related to the issue and servicing of credits.

Table 3.3.1. Weighted Average Rates for Credits of the Non-Bank Financial Institutions (as a percentage)

Name	30.06.2009	31.12.2009	30.06.2010
FCSDCU	14.4	14.6	15.1
SFBR		11.0	
Development Fund		3.5	
Microfinance organizations	33.2	34.5	31.7
Credit unions	29.0	29.5	28.4
Pawn offices	122.8	*	*

* No data due to the licensing pawn offices cancelation

Diagram 3.2.3. NBFI Total Credit Portfolio by Oblasts (mln. soms)

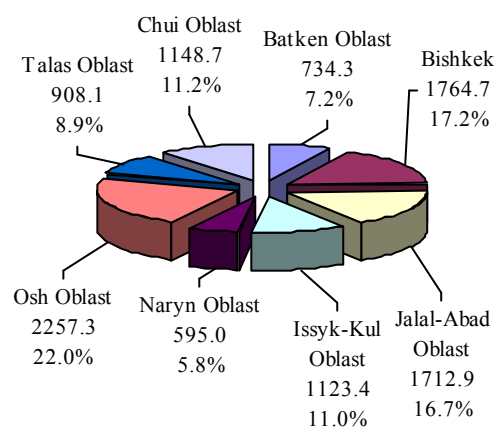
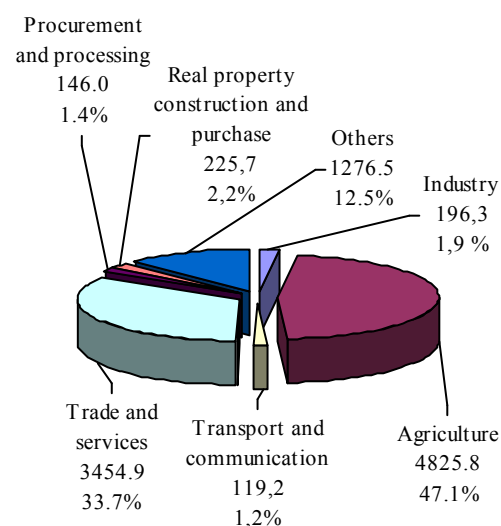


Diagram 3.2.4. NBFI Total Credit Portfolio by Sectors of Economy (mln. soms)



IV. PAYMENT SYSTEM

4.1. Payment System Structure

Payment system constitutes an interrelated system of technologies, procedures, payment instruments and money transfer systems that provides monetary circulation. Subject to the types of the payments effected, the systems can be categorized as the large-value payment systems and the retail payment systems.

The payment system of the Kyrgyz Republic (the national payment system) constitutes an aggregate of payment systems that operate on the territory of the Kyrgyz Republic to transfer monetary assets in compliance with the Kyrgyz Republic Law; their operators may be both residents and non-residents of the Kyrgyz Republic.

As of July 1, 2010 the following components of the payment system operated in the Kyrgyz Republic:

1. The System of Large-Volume Payments of the National Bank - Real-Time Gross Settlement System (RTGSS);
2. Clearing Payment System - the System of Package Clearing of Small Retail and Regular Payments (SPC);
3. Bank Card Payment Systems;
4. Money Transfer Systems;
5. Trans-Boundary Payment Systems.

Table 4.1.1. List of Banks Servicing the Money Transfer Systems

Names of Commercial Banks	Money Transfer Systems
OJSC Asia Universal Bank	UNIstream, Western Union, Money Gram, Contact, Anelik, Lider, Migom, Xpress Money, InterExpress, Allyur, Zolotaya Korona
OJSC RK Amanbank	UNIstream, Western Union, Money Gram, Contact, Anelik, Lider, Migom, Xpress Money, InterExpress, Allyur, Zolotaya Korona, Blizko, Private Money
CJSC Bank of Asia	Western Union, Contact, Anelik, Lider, Migom, UNIstream, Zolotaya Korona, Blizko
OJSC Bank-Bakai	Western Union, Money Gram, Contact, Anelik, Lider, Migom, UNIstream, Allyur, Zolotaya Korona
CJSC Demir Kyrgyz International Bank	Western Union, Anelik, UNIstream
OJSC Dos-Kredobank	Western Union, Contact, Anelik, Lider, Migom, UNIstream, InterExpress, Blizko, Allyur, Zolotaya Korona
OJSC IB Issyk-Kul	Western Union, Money Gram, Contact, Anelik, Lider, Migom, Bystraya Pochta, UNIstream, Blizko, Allyur, Private Money, Zolotaya Korona
CJSC BTA Bank	Western Union, Money Gram, Contact, Anelik, Lider, Migom, Bystraya Pochta, UNIstream, InterExpress, Blizko, Zolotaya Korona, Caspian
OJSC Halyk Bank Kyrgyzstan	Western Union, Contact, Lider, Migom, UNIstream
CJSC KIKB	Western Union, Lider
OJSC Kazkommertsbank Kyrgyzstan	Western Union, Bystraya Pochta
OJSC Kyrgyzcredit-Bank	Western Union, Contact, Anelik, Lider, Migom, Bystraya Pochta, UNIstream, Blizko, Zolotaya Korona, Allyur
OJSC KB Kyrgyzstan	Western Union, Zolotaya Korona, Contact, Lider, Migom, Bystraya Pochta, UNIstream
OJSC RSK Bank	Western Union, Lider, Migom, UNIstream
CJSC AKB Tolubai	Western Union, Zolotaya Korona, Contact, Lider, Migom, UNIstream, Blizko
OJSC Ecobank	Western Union, Contact, Anelik, Lider, Migom, UNIstream, Allyur
OJSC ATF Bank-Kyrgyzstan	Western Union, Contact, Lider, Migom, Bystraya Pochta, Zolotaya Korona, UNIstream
BB NB of Pakistan	Western Union
OJSC FinanceCredit Bank KAB	Western Union, Contact, Anelik, Lider, Migom, UNIstream, Faster, Coinstar (Travelex), Money Gram
CJSC Manas Bank	Western Union, Contact, Lider, UNIstream

4.2. Banking Products, Rates and Services

The rate policy of commercial banks is aimed at outreach of a wide range of payment services to population and facilitation of access to any rendered services with view of increasing the number of clients and developing business competition.

Banks apply different approaches to charging payment for the same services:

- fixed rates for single transactions;
- rates prescribed subject to the amount of an operation or the balance on an account;
- charge for a period regardless of the number or an amount of the operations performed;
- other mechanisms complied to the conditions of any agreements concluded.

The most popular services are as follows: settlement and cash services, documentary transactions, non-cash transfers, securities transactions, credit issue operations and payment cards service

Upon the clients' instructions, commercial banks perform the following transactions for commission fees:

- collection, documentary credit and transfer operations;
- providing bank acceptance and aval for debt liabilities;
- purchase and sale of securities, currency and precious metals;
- intermediation in floating shares and bonds;
- encashment services;
- services for the accounting purposes, providing consulting and credit cards services.

In the reporting period, the value of the service for issuing (opening) a letter of credit made from 0.1 percent to 0.25 percent on average, subject to the amount of the letter of credit

In the first half of 2010, 17 banks provided services for issuing banking guarantee. The value of this service depended on the amount and type of a pawn; in the reporting period the commission fees for issuing banking guarantee made from 0.3 to 7 percent.

Commercial banks provided services within 17 types of international money transfer systems (Table 4.1.1).

The price of connecting to the Internet banking system depended on the way of accessing. The following banks provided the services of Internet banking in the reporting period: the OJSC *RK Amanbank*, the CJSC *Demir Kyrgyz International Bank*, the CJSC *ACB Tolubai*, the OJSC *FinansCreditBank CAB*, the OJSC *Kazkommertsbank Kyrgyzstan*, the OJSC *UniCreditBank*.

4.3. Cash Flows and Non-Cash Transactions

4.3.1. Cash flows

The total amount of *money in circulation* increased by Soms 7,381.4 million (or by 25.0 percent) against the comparable period of 2009 and amounted to Soms 36,942.8 million as of July 1, 2010.

Soms 1,543.2 million were in the cash departments of the commercial banks that accounted for 4.2 percent of the total amount of money in circulation. Diagram 4.3.1.1. shows the dynamic of money in circulation.

The growth of money in circulation was connected with the increase in welfare transfers by government and sustainable demand of economy in cash assets.

Return of cash assets to cash departments of the commercial banks amounted to 99.7 percent in the first half of 2010 that was by 1.1 percentage points lower than for the first half of 2009. The decrease in the return of cash assets was associated with an increase in cash money withdrawal from the cash departments of commercial banks. Diagram 4.3.1.2 demonstrates the values of cash assets return.

In the first half of 2010 the highest value of cash assets return amounted to 111.3 percent (for the Osh Oblast); the lowest value made 56.0 percent (for the Naryn Oblast) (Diagram 4.3.1.3.). Cash assets return amounted to 110.7 percent for Bishkek and 108.8 percent for the Chui Oblast. The high values of cash assets return in Bishkek and the Chui Oblast reflected the concentration of banking and financial institutions as well as trade and industrial enterprises in the capital of the republic and in the Chui Oblast. The high value of cash assets return in the Osh Oblast was associated with more saturated consumer market, though, in general, the percent of cash assets return was low for the Osh Oblast. The cash assets return in the context of oblasts changed considerably compared to the first half of 2009.

Therefore, the increase in cash money in circulation was conditioned by a sustainable growth of demand for cash assets on the part of economic entities and expansion of the commodity and service market serviced by means of cash money.

4.3.2. Non-Cash Transactions

In the first half of 2010 there were effected 999,063 payments for the total amount of Soms 206,789.1 million through the

Diagram 4.3.1.1. Dynamic of Money in Circulation

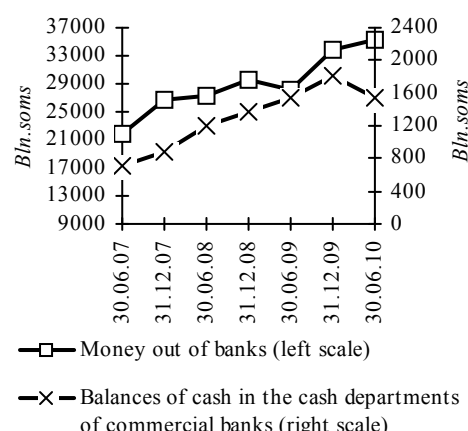


Diagram 4.3.1.2. Receipt and Issue of Cash Money and Their Return to Cash Departments of Commercial Banks

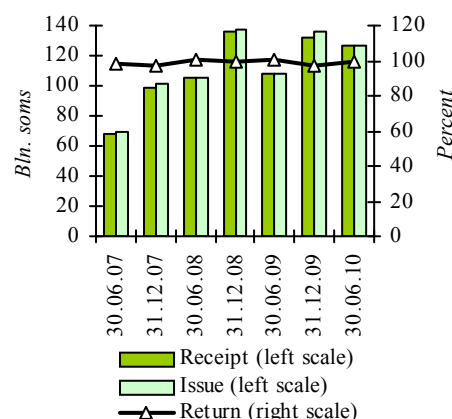


Diagram 4.3.1.3. Indicator of Cash Return by Oblasts

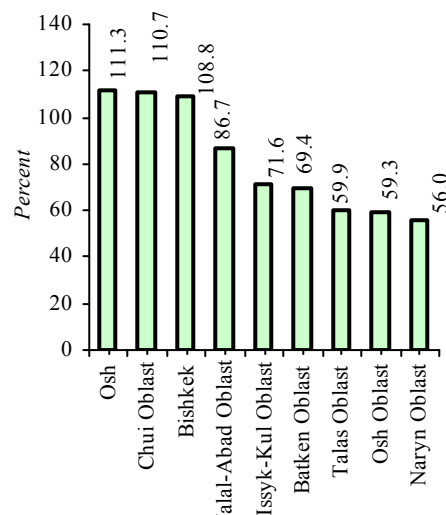


Diagram 4.3.2.1. Dynamic of Volume and Quantity of Inter-Bank Payments

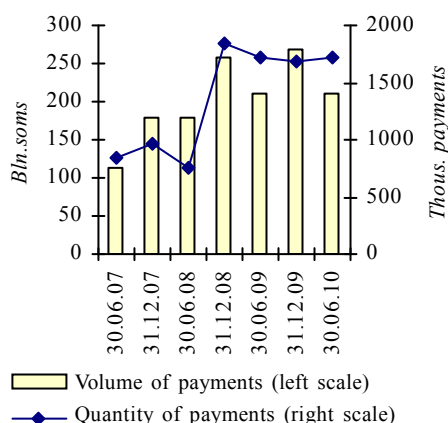


Diagram 4.3.2.2. Dynamic of Volumes and Quantity of the Incoming and Outgoin Payments of ÖË

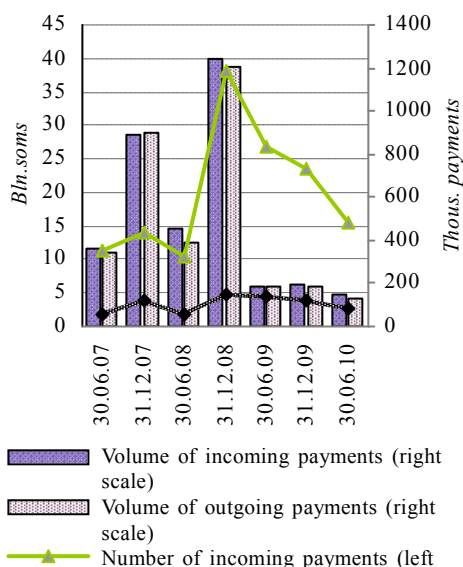
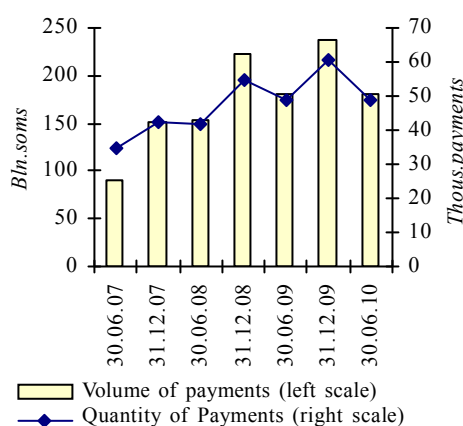


Diagram 4.3.2.3. Dynamic of Volume and Quantity of Payments in the Gross System



payment systems of the Kyrgyz Republic. As compared to the values for the first half of 2009, the volume of payments decreased by 1.2 percent, while the number of payments decreased by 42.0 (Diagram 4.3.2.1). At the same time, for the first half-year, the incoming volume of budgetary payments decreased by 21.2 percent and, as compared to the similar period of the previous year, it decreased by 18.3 percent; whereas the outgoing volume of budgetary payments decreased by 29.2 percent for the first half-year and by 19.4 percent against the comparable period of the previous year (Diagram 4.3.2.2.).

In the first half of 2010, 55,289 payments for the amount of Soms 180,401.4 million were effected through the gross settlement system of the National Bank. The volume of payments increased by 0.3 percent, and the amount of payments increased by 12.2 percent against the comparable period of the previous year (Diagram 4.3.2.3.). The volume of payments effected through the clearing payment system decreased by 10.5 percent against the comparable period of the previous year and amounted to Soms 26,387.7 million. The overall number of payments made 943,774 payments; it was by 43.5 percent less than for the comparable period of 2009 (Diagram 4.3.2.4.).

In the regional context, the Chui Oblast and Bishkek were the leaders by the number and volume of the clearing payments in the first half of 2010; the volume of clearing payments in them made 70.1 percent, while their amount made 64.2 percent.

Regional profile of payments in the interbank payment system showed that the largest share of payments by volume (92.5%) and quantity (70.2%) fell within the Chui Oblast and Bishkek.

4.3.3. Bank Card Payment System

As of the end of the first half of 2010, 21 out of 22 commercial banks of the republic provided the emission, acquiring, and the settlement and cash services to clients using bank payment cards; 11 of the commercial banks were the emitters that issued the cards of international systems, 3 banks were the emitters of local systems as well as 14 banks were the emitters of the integrated national system *Elkart*.

In the reporting period, the cards of the integrated national system *Elkart* were accepted and serviced by 128 cash machines installed throughout Bishkek and by 452 terminals; among them 396 terminals were installed in branches and savings departments of the commercial banks as well as 56 terminals were installed in the trade-and-service facilities and in the public spaces around Bishkek as well as in the district

and regional centers.

As of July 1, 2010, the commercial banks issued 74,367 cards of the national payment system *Elkart*, as a whole.

During the first half of 2010 there was an activation in the payment cards market; an increase in the number of emitted cards and transactions with their use was indicative of this. Thus, the overall number of emitted cards made 193,216 as of July 1, 2010, that constituted the 13.1 percent increase against the comparable period of the previous year (Diagram 4.3.3.1.).

The overall number and volume of the transactions performed with cards increased by 45.8 percent and 38.5 percent, correspondingly, against the comparable period of 2009 (Diagram 4.3.3.2.).

As before, the principal share of the effected transactions fell within the withdrawal of monetary assets through cash machines and terminals; their volume accounted for Soms 6,081.8 million of the total volume of transactions, while their turnover in the retail-and-service enterprises amounted to Soms 148.2 million. These data indicate that converting money into cash constituted more regular and demanded type of transactions and accounted for 97.6 percent of the overall volume of transactions with use of cards

One of the priority areas of banks development strategy is increasing the number of bank accounts and implementing the 'payroll' projects on the basis of the international, local and national systems using cards. Due to these very projects, the banks achieve a sound increase in the cards emission and transactions volumes; this allows to make progress towards strengthening the position of banks in the bank cards market

In the first half of 2010, 21 commercial banks made arrangements to implement and expand the 'payroll' projects on the basis of cards of the international, local and national systems.

In total, the banks serviced 98,552 cards within 839 'payroll' projects, which accounted for 51.0 percent of the total number of the cards issued.

Commercial banks continue developing the infrastructure for accepting and servicing cards. Thus, as of July 1, 2010, the overall number of the operating terminals and cash machines amounted to:

- 128 cash machines and 452 terminals for the integrated national system *Elkart*. As a result of the integration of

Diagram 4.3.2.4. Dynamic of Volume and Quantity of Payments in the Clearing System

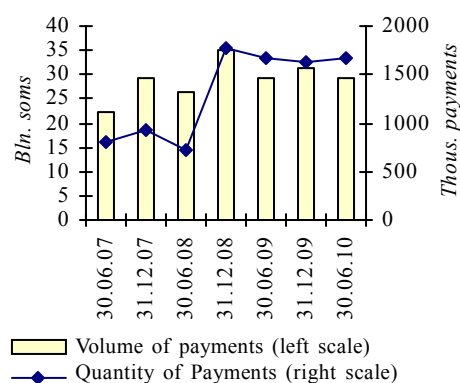


Diagram 4.3.3.1. Dynamic of Emitted Cards Quantity

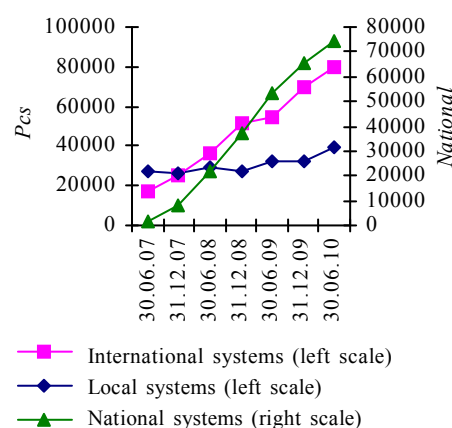
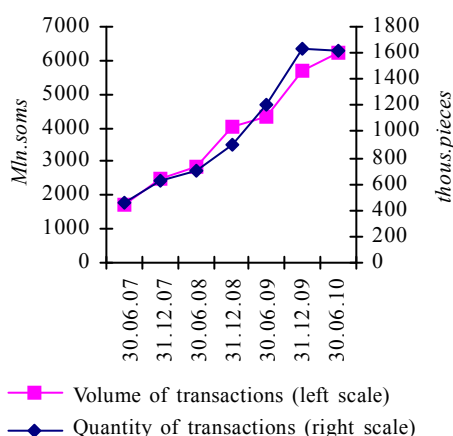


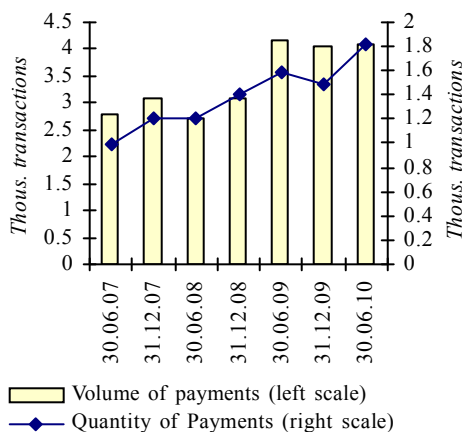
Diagram 4.3.3.2. Dynamic of Volume and Quantity of Transactions using Bank Cards

the settlement systems that use payment cards, all the cash machines of the international systems and 46 terminals of the local system *Alai-Card* accepted the national payment card *Elkart* for servicing.

- 109 cash machines and 613 terminals for the international systems
- 31 cash machines and 169 terminals for the *Alai-Card* system.

Thus, the bank payment cards were accepted for servicing by 268 cash machines and 1,234 terminals installed in public places all over the country.

4.3.4. Trans-Boundary Payments including Travel Cheque Transactions

Diagram 4.3.4.1. Dynamic of Transactions in the SWIFT System

As of the end of the first half of 2010, 22 banks of the Kyrgyz Republic (including the National Bank) were the SWIFT System members. 17 banks (including NBKR) operated through the general-purpose interface of SWIFT NBKR MAU, 5 banks were connected independently, and 1 bank operated through its head office in Kazakhstan - OJSC Kazkommertsbank Kyrgyzstan.

In the first half of 2010, the number of the outgoing payments amounted to 1,810, and the incoming payments made 4,087, which constituted 2.2 percent decrease and 13.0 percent increase, correspondingly, compared to the first half of 2009 (Diagram 4.3.4.1.). The principal share of payment volumes by currency nominal values was effected in US dollars.

7 out of 22 commercial banks of the Kyrgyz Republic provided services for the travel cheque transactions. In the first half of 2010, the number of transactions using travel cheques amounted to 936 with the total volume of Soms 13,970.3 thousand. Non-residents of the Kyrgyz Republic have still remained the main consumers of the travel cheques.

V. STATE OF REAL SECTOR

5.1. Private Households

In the first half of 2010, the monthly average nominal wages made Soms 6,618 (or USD 146.5 subject to the monthly average value of US dollar official rate) and against the comparable indicator of the first half of 2009 increased by 9.4 percent in real terms against 5.2 percent in the first half of the previous year.

An increase in salary was marked in all types of economic activities, but the greatest one was in agriculture, mining industry and construction. The salary of the employees of financial sphere, sectors of transport and communication, production and distribution of electric power, gas and water considerably exceeded the average republican level. Its lowest level was marked for agriculture, healthcare institutions, education, and in for sphere of public utilities and social services.

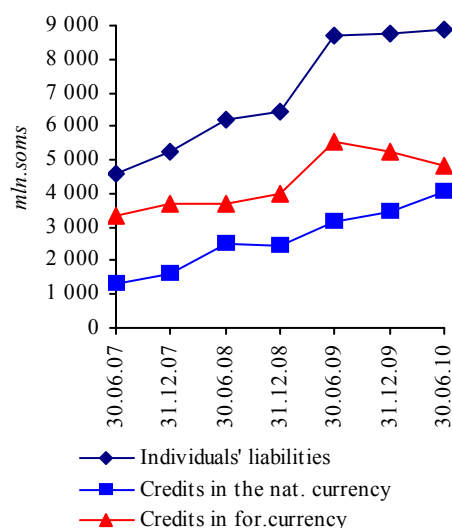
The value of the cost of living amounted to Soms 3,433.9 in the first half of 2010 and decreased by 9.1 percent against the comparable period of 2009. The ratio of monthly average wages to this indicator increased from 155.7 to 192.7 percent.

5.1.1. Liabilities to the Banking System

In the first half of 2010, the amount of the private households' liabilities to the banking system increased by 1.6 percent to make Soms 8.9 billion as of the end of June. The individuals' indebtedness under credits in the national currency increased by 16.4 percent to make Soms 4.0 billion, while the indebtedness under credits in foreign currency decreased by 8.1 percent down to Soms 4.9 billion in equivalent. As a result, the specific weight of credits in foreign currency decreased from 60.3 to 54.5 percent in the structure of individuals' liabilities.

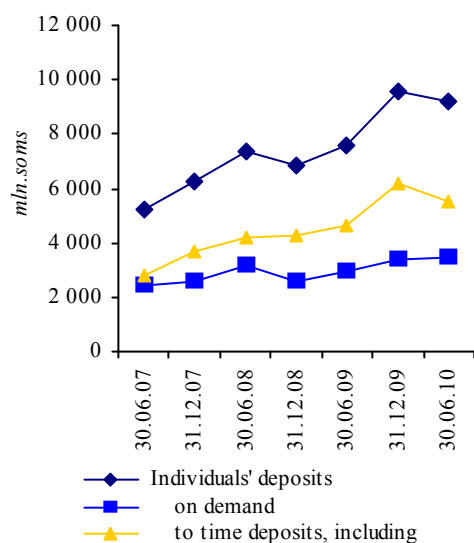
The overall amount of credits issued to private households for consumer purposes decreased by 15.8 percent against the volume of the first half of the previous year and made Soms 813.1 million in the reporting half-year, while their share in the overall volume of the issued credits decreased from 9.9 to 7.2 percent.

Diagram 5.1.1.1. Individuals Liabilities to Banks
(as of the end of the period)



5.1.2. Personal Savings

Diagram 5.1.2.1. Deposits of individuals
(as of the end of the period)



Due to the instable situation in the country, there was an outflow of individuals' deposits from the commercial banks in the reporting period. The overall volume of individuals' deposits decreased by 4.5 percent year-to-date to make Soms 9.2 billion as of the end of the half-year (Diagram 5.1.2.1). Meanwhile, personal deposits in the national currency increased by 0.8 percent up to Soms 4.0 billion, whereas the deposits in foreign currency decreased by 8.2 percent down to Soms 5.2 billion in som equivalent (excluding the influence of changes in exchange rate, the deposits in foreign currency decreased by 18.6 percent). As a result, there was marked a reduction of the specific weight of deposits in foreign currency in the structure of personal deposits that made 54.5 percent in the reporting half-year against 58.5 percent as of the end of the previous half-year.

5.2. Corporate Sector

5.2.1. Liabilities to the Banking System

As of June 30, 2010, 472.5 thousand economic entities operated in the country to make 6.1 percent increase against the comparable indicator for the end of 2009. As before, peasant (farm) households (56.8 percent) and individual entrepreneurs (36.5 percent) prevailed in the structure of economic entities.

In the first half of 2010, there was marked an increase in the aggregate indebtedness of enterprises and organizations¹ to the commercial banks. As of the end of the reporting period its volume increased by 2.1 percent and amounted to Soms 16.8 billion (Diagram 5.2.1.1).

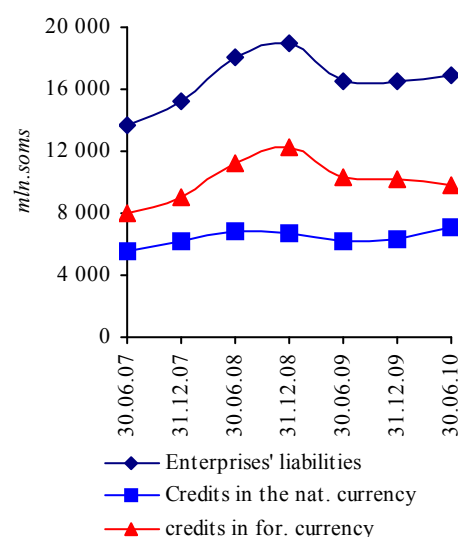
The volume of newly granted credits increased by 15.5 percent against the similar indicator of the first half of 2009 to make Soms 11.2 billion that was conditioned by the 31.6 percent increase in credits granted in the national currency, which amounted to Soms 6.0 billion. Credit financing in foreign currency increased by 1.3 percent up to Soms 5.2 billion.

In the context of sectors, an increase in the flow of newly granted credits was associated with the increase in credit financing of trade (by 21.3 percent); this provided a contribution into an overall increment of credit financing at the level of 11.7 percent; herewith a decrease in consumer crediting was marked (by 15.8 percent), and its negative contribution into increment made minus 1.6 percent.

In the reporting period the average level of rates for credits issued in the national currency decreased by 2.8 percentage points to make 24.0 percent. The decrease in interest rates was marked for many branches of real sector; however, the greatest increase was in credit financing of trade, transport and communication as well as in consumer crediting and credits in procurement and processing.

The average weighted interest rate for new credits in foreign currency decreased by 1.7 percentage points to make 20.0 percent. At the same time, the decrease was marked for credits in almost all branches of real sector. The lowest rates of credits in foreign currency were for the branches of procurement and processing (16.4 percent), construction (18.9 percent) and social services (9.7 percent).

Diagram 5.2.1.1. Dynamic of the Corporate Sector Indebtedness to Commercial Banks
(as of the end of the period)



¹ Legal entities' indebtedness according to balance sheets of commercial banks.

5.2.2. State of the Accounts Receivable and Accounts Payable²

The volume of the accounts receivable of the real sector's enterprises and organizations amounted to Soms 51.8 billion as of the end of June 2010, which constituted the 15.8 percent decrease as compared to its volume as of the end of 2009 (Diagram 5.2.2.1).

The greatest decrease in the volume of accounts receivable was observed in the branches of agriculture (by 93.8 percent), in the sphere of production and distribution of electric power, gas and water (by 38.7 percent) and construction (by 31.6 percent). However, the greatest specific weight in the overall volume of accounts receivable was marked for the enterprises of processing industry (22.7 percent), trade (19.5 percent) and those dealing with real estate operations (22.4 percent).

The volume of overdue accounts receivable decreased by 45.9 percent against the volume as of the end of 2009 to make Soms 4.6 billion. The share of overdue accounts receivable accounted for 8.8 percent in the overall volume. Out of the total volume of the overdue accounts receivable, 66.6 percent fell within the debts to enterprises dealing with production and distribution of electric power.

As a result of the first half of 2010, the accounts payable made Soms 62.1 billion, which constituted the 19.7 percent decrease as compared to the volume of the end of 2009. The decrease in the indebtedness occurred mainly due to the decrease in debts of the enterprises of processing industry (by Soms 3.4 billion), production and distribution of electric power, gas and water (by Soms 3.8 billion) and construction (by Soms 4.2 billion).

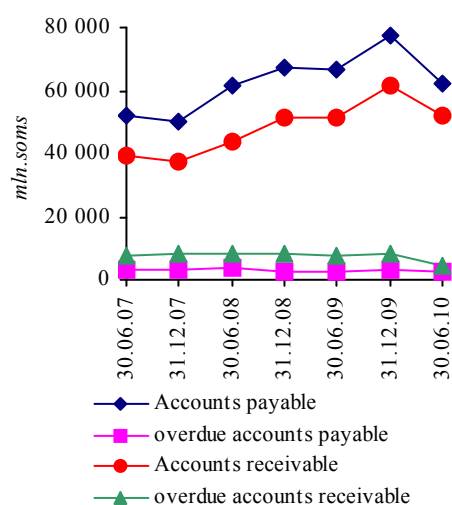
The volume of overdue accounts payable decreased by 25.2 percent, while its share in the overall amount of accounts payable decreased by 4.2 percent as of the beginning of 2010 down to 3.9 percent as of the end of the first half of 2010.

5.2.3. Financial Results³

As a result of the first half of 2010, the income of the real sector enterprises made Soms 13.4 billion, while in the comparable period of 2009, the loss in the amount of Soms 2.7 billion was marked.

Diagram 5.2.2.1 Dynamic of Accounts Payable and Accounts Receivable of the Corporate Sector

(as of the end of the period)



² According to the preliminary data of NSC KR, exclusive of the organizations engaged in rendering financial services.

³ According to preliminary data of NSC KR.

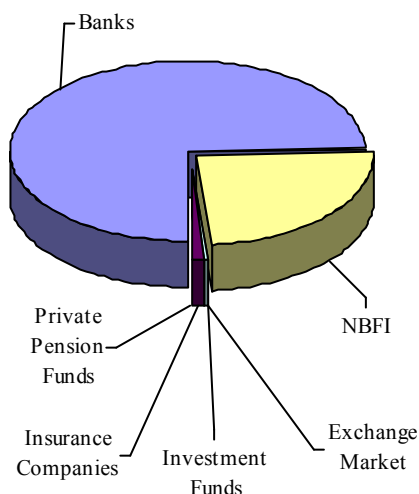
The major volumes of operational profit were obtained by the enterprises of processing industry, production and distribution of electric power, gas and water as well as by the enterprises of transport and communication. Material losses were incurred by the agricultural enterprises.

VI. FINANCIAL SYSTEM DEVELOPMENT TRENDS

This section covers the main development trends of the financial system of the Kyrgyz Republic as well as its influence on the country's economy as a whole.

In the first half of 2010, the negative social and political events that took place in the country in the second quarter affected the situation in the financial sector. As a result of instable situation there was a deceleration of economical activity in the country and worsening of economical attractiveness of the country for investors. This also was accompanied by the deterioration in indicators of commercial banks' performance due to a considerable outflow of deposits from banks and decrease in confidence of population. With view of stabilization of the economic situation in the country, the Provisional Government of the Kyrgyz Republic adopted the 'Plan of Primary Measures for Stabilization of the Social and Economic Situation in the Country until 2011'.

Diagram 6.1. Assets of the Financial System (as of the end of June 2010)
(millions of Soms)



Currently, the financial sector of the country is presented by such financial institutions as banks, non-bank financial institutions (credit unions, microfinance organizations, pawn offices, specialized FI, etc), stock exchange markets, insurance companies, pension and investment funds (Diagram 6.1).

The banking system plays a dominant role in the financial sector of the country. At the same time, the significance of the non-bank financial institutions sector increases in the sphere of providing credit resources. This is conditioned by a high demand for loans as well as by rather simplified NBF requirements to borrowers. However, other sectors of the financial institutions still remain underdeveloped and make insignificant portion in provision of financial services.

In January to June 2010, the positive growth trend of key indicators of the banking system changed into the opposite one. This was noted in a considerable decrease in deposit base of the commercial banks, decrease in assets and capitalization of banks.

Meanwhile, the credit activity of NBF continued its growth¹, and acceleration in credit portfolio growth rates was marked herewith.

¹ Exclusive of the Development Fund.

In the conditions of the remaining currency risks and increasing credit risks occurred as a result of April and May events, the banks continued to pursue a soft credit policy. For instance, some post-crisis recovery of credit financing that took place in the first quarter of 2010 was suspended in April and May and was continued later. At the same time, the commercial banks continued decreasing the share of credits, nominated in foreign exchange. At the same time increase of the som loans was observed. Therefore, the ratio of newly granted credits to GDP, as the indicator of the financial intermediation level, made 13.8² percent.

The volume of credit portfolio increased by 15.2 percent³ in the non-bank financial institutions sector in the first half of 2010.

The overall volume of the auctions on the trading floors of three stock exchange markets decreased by 65.9 percent in January to June 2010 and amounted to Soms 610.5 million. The decrease in the overall amount of auctions was observed on all the trading floors: in the CJSC *Kyrgyz Stock Exchange* (83.5 percent, down to Soms 187.1 million), in the CJSC *Central Asian Stock Exchange*, (by 24.4 percent, down to Soms 392.6 million), and the CJSC *Stock Exchange of Kyrgyzstan - BTS* (by 77.6 percent, down to Soms 30.9 million).

As of the end of the period, seven incorporated investment funds operated in the securities market, but their share in rendering financial services remained inconsiderable: as a result of the half-year the investment funds' assets made 0.01 percent to GDP.

The performances of the insurance companies and non-government pension funds also testified to poor development of these financial system segments and their minor influence on the country's economy

As of the end of the year, 19 insurance companies performed insurance activity in the republican market, while two of them were the reinsurance companies, and seven operated with non-residents participation. The instability, observed in the country, caused some decrease in the activity of the insurance companies. In addition, growth of the liquidity risk was observed in insurance companies, being serviced in the banks, subjected to temporary management. As a result, the overall assets of the insurance companies decreased by 2.9 percent in the half-year and amounted to Soms 840.1 million; while their total capital decreased by 4.9 percent to make Soms 674.4 million. The

Diagram 6.2. Credit Portfolio of Commercial Banks and Non-Bank Financial Institutions

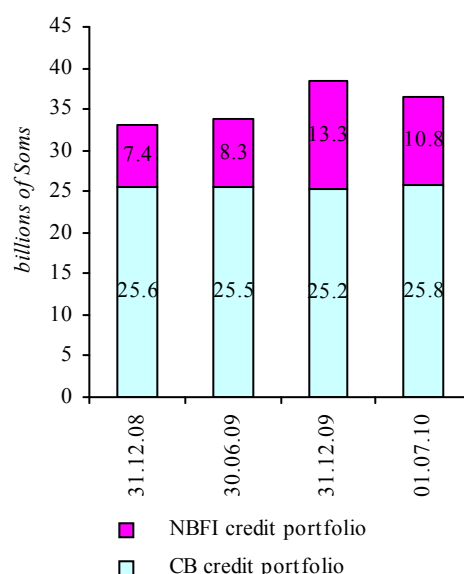
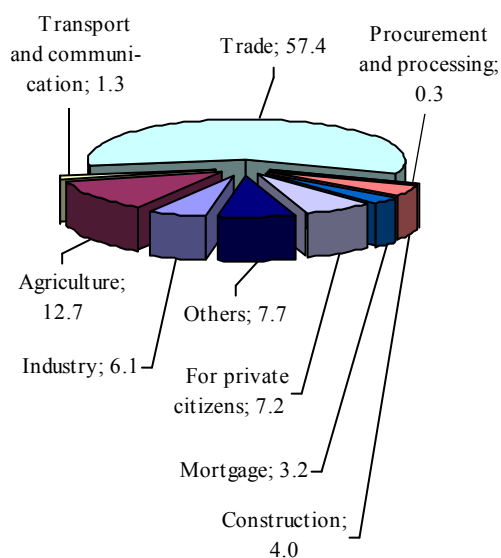


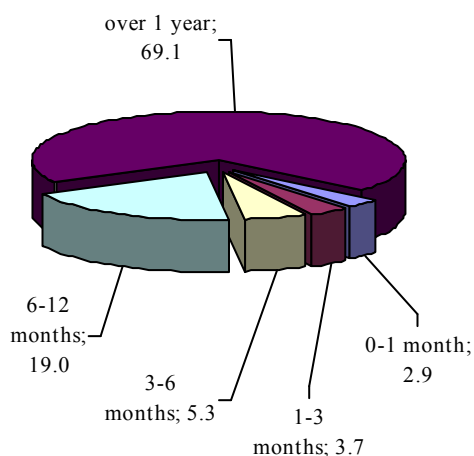
Diagram 6.3. Credit Financing of the Branches of Economy by Commercial Banks in the First Half of 2010 (percent)



¹ To GDP for the first half of 2010.

² Exclusive of the Development Fund credits.

Diagram 6.4. Structure of Credits Issued by Commercial Banks in the First Half of 2010 by Maturity
(percent)



ratio of the insurance companies' assets to GDP increased by 0.4 percent against 0.3 percent as of the beginning of the year.

At present, the two non-governmental pension funds have been registered in the market of the republic: the NGPF *Kyrgyzstan* that have operated since 1994 and the NGPF *Jany Asia* that obtained license on May 26, 2009, and has not operated yet. The amount of the NGPF *Kyrgyzstan* assets increased by 7.8 percent year-to-date and made Soms 23.6 million as of the end of May 2010. There was a positive trend of increase in the number of payers of insurance contributions and recipients of pension in NGPF *Kyrgyzstan*. As of June 1, 2010, the total number of the NGPF participants, who entered into the agreements for voluntary pension provision, amounted to 2,377 people; this constituted the 33 people, or 1.4%, increase as compared to the beginning of 2010.

VII. SPECIAL ISSUES

Implementation of the System for Countering Terrorism Financing and Legalization of Ill-Gotten Profits (Money Laundering) in the Kyrgyz Republic

The CTF/ML System was established in Kyrgyzstan in compliance with the Law of the Kyrgyz Republic *On Countering Terrorism Financing and Legalization of Ill-Gotten Profits (Money Laundering)* (hereinafter as the KR Law On CTF/ML adopted in November 2006) and FATF recommendations. This KR Law On CTF/ML focuses on establishing the system of protecting economic entities of the Kyrgyz Republic against influence and loss occurred due to the activity of organized criminality and terrorist organizations; the Law is the main part of the legislative framework of CTF/ML System in the Kyrgyz Republic.

From the effectiveness date of the Law *On CTF/ML*, the National Bank developed the regulatory and legal framework that applies to *CTF/ML* issues for commercial banks and non-bank financial institutions; at the current stage, the activity to improve the regulatory and legal acts is implemented, which specifies the key requirements related to organization of internal control on CTF/ML in commercial banks and non-bank financial institutions.

In compliance with the Law *On CTF/ML*, the National Bank of the Kyrgyz Republic acting as a supervisory body, which regulates the activity of banks, supervises the observance of the Law *On CTF/ML* as to recording, keeping and submitting the information about transactions and operations, liable to obligatory control, to the authorized public authority represented by the State Service for Financial Intelligence of the Kyrgyz Republic (SSFI KR).

In compliance with the Law *On CTF/ML*, the commercial banks as the entities that provide data shall be obliged to provide data on any alert cases to the State Service for Financial Intelligence of the Kyrgyz Republic (SSFI KR).

Since 2008 the National Bank has assessed the banks' system for countering terrorism financing and legalization of ill-gotten profits (money laundering) (CTF/ML), within the comprehensive audits, and supervised the submission of all data on any alert cases to the SSFI. As a result of the audits, the instructions on improving the CTF/ML system, elimination of any detected violations are made with a letter sent to the SSFI.

According to the data of the periodic regulatory bank reporting submitted by all the commercial banks, in 2009 the banks addressed to the SSFI 2,646,948 notifications about alert cases to undertake reasonable measures. In the first half of 2010, the total number of notifications received by the SSFI from the commercial banks amounted to 253,165.

At present the NBKR has concluded cooperation agreements covering the issues of interaction in the field of CTF/ML with central banks of other countries, including the Central Bank of the Russian Federation, the National Bank of the Republic of Belarus, the National Bank of Ukraine, the National Bank of China, the Central Bank of Cyprus, etc.