



**National Bank
of the Kyrgyz Republic**

**THE FINANCIAL SECTOR STABILITY
REPORT OF THE KYRGYZ REPUBLIC**

June 2020

Bishkek

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PREAMBLE

National Bank of the Kyrgyz Republic has been publishing the Financial Sector Stability Report of the Kyrgyz Republic since 2012. The objective of the report is to inform the public of the general assessment on the stability and sustainability of the financial system of the Kyrgyz Republic.

Financial stability in this publication means smooth and continuous functioning of financial institutions, financial markets and payment systems enabling to perform functions of the financial intermediation even in conditions of financial imbalances and shocks.

Results of the monitoring and analysis of financial stability are considered by the National Bank in forming the main directions of the NBKR monetary policy, regulating the banking activity and development of the strategy for financial-credit organizations of the Kyrgyz Republic.

The Financial Sector Stability Report of the Kyrgyz Republic is oriented to financial market participants and the audience interested in the financial stability issues.

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MAJOR CONCLUSIONS

At the end of 2019, the results of macroprudential analysis and financial forecasting indicated at the sustainability of the financial sector in the Kyrgyz Republic.

In 2019, there was a positive trend in economic activity of the Kyrgyz Republic. There are macroeconomic risks, due to low diversification of sales markets and a high degree of integration with the external environment of the trading partner countries.

During 2019, *the inflation rate in the Kyrgyz Republic remained moderately low* amid relatively stable prices in the world food markets and the restrained dynamics of domestic demand.

The results of econometric modeling, financial forecasting and reverse stress tests still reflect the availability of the financial safety margin at the end of 2019 and the ability to withstand certain macroeconomic shocks.

In case of further slowdown in global economic growth, high volatility in the world commodity markets and deterioration of the macroeconomic environment in the countries-main trading partners of the Kyrgyz Republic, some commercial banks may become more vulnerable to various financial risks. However, the significance of these risks did not pose a threat to the stability of the banking system in 2019.

There are no systemic risks in the payment system. At the beginning of 2019, an increased level of risks was registered in the payment system of the Kyrgyz Republic due to the operational risks and blocked accounts of two operators in the retail payment systems. Risks in these payment systems did not entail systemic risk for the payment system and the financial sector as a whole. The National Bank took measures to minimize financial risks in retail payment systems, as well as to revise existing regulatory legal acts on requirements for the operators of the retail payment systems and the payment organizations.

I. MACROECONOMIC AND FINANCIAL ENVIRONMENT

1.1. Macroeconomic Conditions and Risks

During 2019, inflation in the Kyrgyz Republic remained moderately low amid relatively stable prices in the world food markets and the restrained dynamics of internal demand.

In 2019, there was a positive trend in economic activity of the country. Macroeconomic risks are still observed due to low diversification of the sales markets and a high degree of integration with the external environment of the trading partner countries.

At the end of 2019, the state budget was executed with a deficit, meanwhile it decreased compared to the indicator as of the end of 2018 due to the fiscal consolidation policy conducted by the Government of the Kyrgyz Republic.

External Conditions

Economic activity in the main trading partner countries of the Kyrgyz Republic remained moderate amid slowdown in global economic growth. Vulnerability of the global economy amid development of the situation with coronavirus aggravates the risks to business activity related to increase of prices in the world food markets and decrease of prices in the energy market.

At the end of 2019, the economic growth in Kazakhstan made 4.5 percent (against growth by 4.0 percent in 2018) due to high investment, internal and external demand. In turn, the expansion of consumer demand observed during the year conditioned pro-inflationary pressure, and therefore, the base rate in Kazakhstan was increased from 9.00 up to 9.25 percent in September 2019. Pro-inflation risks are due to outbreak of the coronavirus infection, which may also result in economic slowdown in Kazakhstan in 2020.

At the end of 2019, the economic growth in China made 6.1 percent, having decreased from 6.6 percent in 2018 mainly due to existing “trade war” with the United States during the year. Economic growth in China was supported by the expansionary measures taken by the government and steady growth in consumption, which, coupled with rise in prices for meat conditioned by the swine fever outbreak, put pressure on inflation. The main risks in the economy of China are due to the outbreak of a new type of coronavirus in early 2020, the scale thereof is growing every day, affecting the global economy as a whole.

In 2019, economic growth in Russia slowed down, meanwhile in the second half of the year there was a slight recovery in internal demand and increased investments of budget funds, however external demand remained weak amid existing decline in business activity in the world. Moreover, easing of the global financial conditions, weakening of the sanctions rhetoric and low inflation resulted in resumption of capital inflows to Russia. However, in 2020, GDP is expected to decline due to introduced restrictive measures, external demand is expected to decrease amid slowdown in the global economy due to the coronavirus spread, as well as prices for oil are expected to fall down due to weak demand. Meanwhile, measures taken by the Government of the Russian Federation to support the economy and continued implementation of the national projects and other priorities of the Russian economy, as well as easing of the monetary policy by the Bank of Russia, will ensure gradual recovery of economic growth in the country. In the medium term, the inflation rate will make approximately 4 percent, taking into account the current monetary policy of the Bank of Russia.

Internal Conditions

Gross Domestic Product

According to the preliminary data of the National Statistical Committee of the Kyrgyz Republic, at the end of 2019, the economy in the country grew by 4.5 percent (in 2018 – by 3.8 percent). Economic growth was mainly conditioned by increased production output at the enterprises for the development of gold mining “Kumtor” (growth by 14.6 percent). Excluding the enterprises for the development of gold mining “Kumtor”, GDP grew by 3.8 percent (in 2018, by 3.7 percent). The GDP deflator decreased by 4.2 p.p. compared to 2018 and was formed negative at 1.5 percent.

In the sectoral breakdown, all main sectors made the positive contribution to the economic growth, meanwhile, the processing industry (1.2 p.p.), construction (1.0 p.p.) and trade (0.9 p.p.) made the most significant contribution.

The growth in the industrial sector by 6.9 percent compared to the corresponding indicator in 2018 was due to the increase in the production of metal ores, clothes, extraction of crude oil and natural gas, production of basic metals, other non-metallic mineral products, coal extraction, and food products production.

In 2019, an increase in agricultural production by 2.6 percent (in 2018 – by 2.6 percent) was due to an increase in production of crop growing (by 2.6 percent) and livestock sectors (by 2.5 percent).

An increase in construction by 10.6 percent (compared to 7.8 percent in 2018) was due to an increase of investments in fixed capital by 5.8 percent. The volume of investments financed from internal sources increased by 2.5 percent, and investments financed from external sources increased by 14.0 percent. The main volume of investments in fixed capital was forwarded to the construction of facilities related to mining spheres, transport activities, wholesale and retail trade, as well as housing construction

In 2019, increase by 2.9 percent in the services sector was mainly due to growth in trade (by 4.9 percent) and transport activity (by 4.8 percent). Moreover, the information and communication sphere entered the positive zone (an increase by 1.2 percent) after a long recession.

Table 1.1.1. Contribution of Individual Activities in GDP

	2018			2019		
	Share, percent	Growth rate, percent	Contribution in growth, p.p.	Share, percent	Growth rate, percent	Contribution in growth, p.p.
GDP	100	3.8	3.8	100	4.5	4.5
Agriculture, forestry and fishery	11.7	2.6	0.3	12.1	2.6	0.3
Industry	18.5	5.1	1.0	17.9	6.9	1.3
<i>Mining</i>	1.0	-2.1	0.0	1.0	18.4	0.2
<i>Processing sectors (Processing industry)</i>	14.3	5.1	0.8	14.3	8.3	1.2
<i>Provision (supply) of electric energy, gas, steam and conditioned air</i>	2.8	5.3	0.1	2.2	-3.4	-0.1
<i>Water supply, waste treatment and processing, receipt of recyclable materials</i>	0.4	30.0	0.08	0.3	-2.8	-0.01
Construction	9.0	7.8	0.7	9.7	10.6	1.0
Services	46.7	2.8	1.3	46.9	2.9	1.3
<i>Wholesale and retail trade; repair of cars and motor-cycles</i>	17.9	5.7	1.0	18.3	4.9	0.9
<i>Transportation activity and storage of cargo</i>	3.8	2.9	0.1	3.8	4.8	0.2
<i>Information and communication</i>	2.6	-0.9	-0.03	2.6	1.2	0.03
<i>Other</i>	22.4	1.0	0.2	22.3	1.1	0.2
Net (exclusive of subsidies) taxes on products	14.1	3.8	0.5	13.4	4.5	0.6

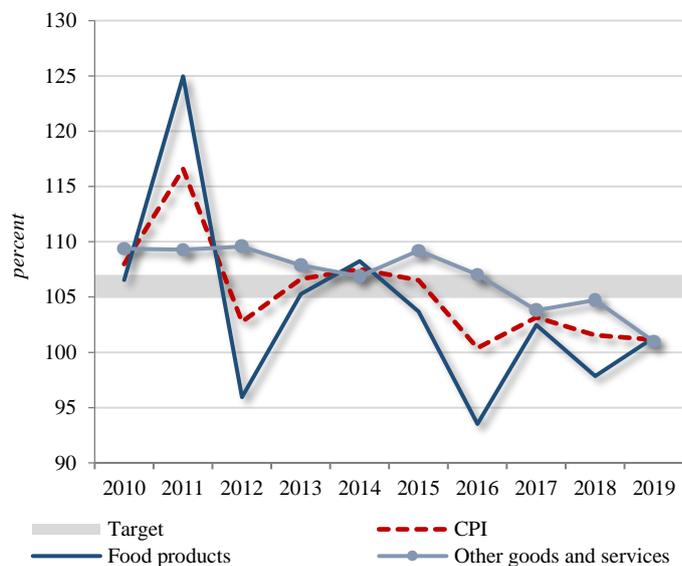
Source: NSC KR

Inflation

During 2019, inflation remained low, there was a gradual increase in prices: from a decrease by 0.7 percent at the beginning of the year up to an increase by 3.1 percent as of the end of the year. The inflation has not exceeded the targets of the National Bank. Price dynamics was formed under the influence of low prices for food products in the first half of the year with gradual acceleration of their growth in the second half of the year. At the same time, rise in prices for tobacco products due to an increase in excise rates in January 2019 resulted in increase of excisable prices and made an upward impact on inflation. Market inflation remained low and constituted 0.4 percent at the end of the year due to moderate consumer demand and lower inflation expectations. The price index for the non-food product group and for paid services was low or moderate.

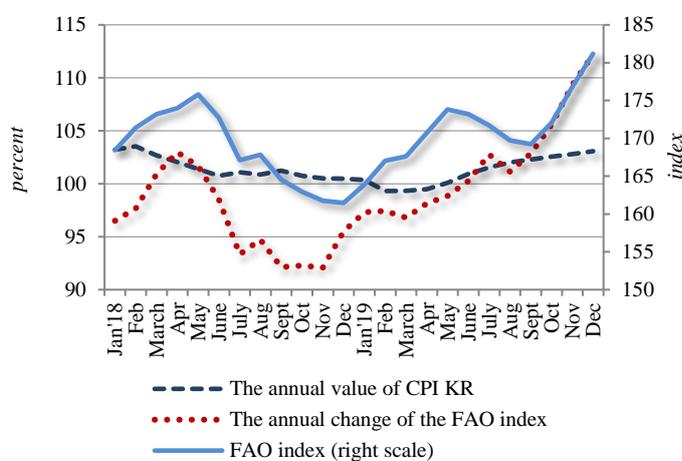
The abovementioned conditions encouraged the National Bank to continue conducting its monetary policy focused on preserving and maintaining economic activity in the country.

Chart 1.1.1. CPI in the Kyrgyz Republic (cumulatively year-to-date to the corresponding period of the previous year)



Source: NSC KR

Chart 1.1.2. Dynamics of the Kyrgyz CPI and the FAO Index



Source: NSC KR, www.fao.org

In 2019, the influence of the food prices dynamics was the most significant, and in the second half of the year, there was increase in prices for all product groups, excluding sugar. The low base of 2018, as well as the world and regional prices for wheat and meat in Q4 contributed to formation of the upward inflation dynamics at the end of 2019. The dynamics of prices for consumer goods and services, excluding food products, was relatively stable and was close to the National Bank's target of 5-7 percent.

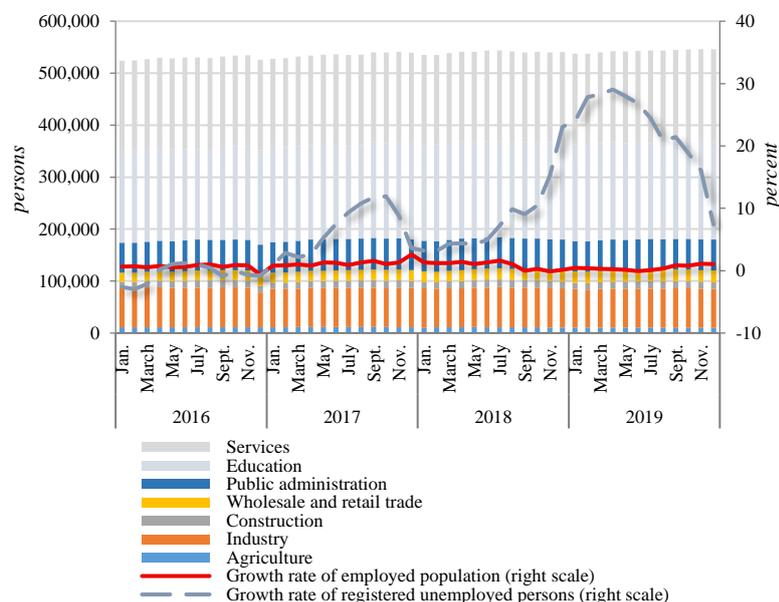
In general, it can be noted that the risks of the CPI deviation from the targets are mainly result from the potential influence of weather conditions on the agricultural production indicators and the possible change in the price level for the main imported food products in the world markets.

At the end of 2019, the FAO Food Price Index, reflecting price movements in the world food markets, demonstrated volatile price dynamics with existing upward trend at the end of Q4. In 2019, the FAO index was formed under the influence of a significant increase in prices for vegetable oils, meat and sugar compared to 2018, as well as a slight increase in prices for dairy products and crops.

In 2019, rise in prices in the external food markets introduced certain inflation risks for Kyrgyzstan.

Labor Market and Wages

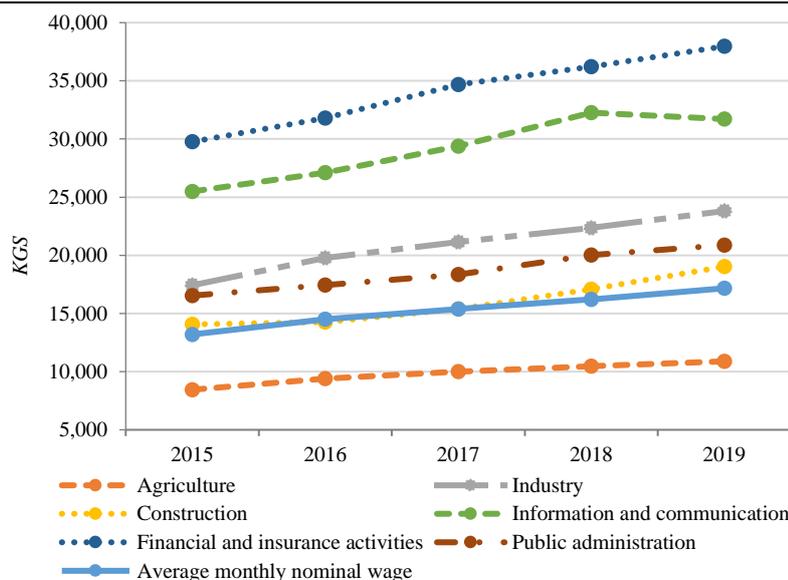
Chart 1.1.3. Number of Officially Employed and Unemployed People



Source: NSC KR

In 2019, the number of registered unemployed people increased by 7.4 percent compared to January 1, 2019, and constituted 76.1 thousand persons. The registered unemployment rate made 3.0 percent of the economically active population.

Chart 1.1.4. Average Monthly Nominal Wages of the Employees at the Enterprises and Organizations by Economic Activity



Source: NSC KR

According to the Ministry of Labor and Social Development of the Kyrgyz Republic, as of January 1, 2019, the number of unoccupied people in search of work registered at the state employment service increased by 5.1 percent compared to the same date in 2019 and constituted 94.2 thousand people.

Education (34.8 percent), services (32.3 percent), industry (13.7 percent) and public administration (10.9 percent) remain the main employment sectors¹ of the able-bodied population. It can be noted that in general, the number of employed population has not significantly changed over the past three years.

In the reporting period, there was a steady growth of wages in the Kyrgyz Republic. In January-December 2019, the average monthly nominal wage per an employee¹ increased by 5.9 percent compared to the same indicator of 2018 and amounted to KGS 17,166. The highest increase in the average monthly wage growth rate was observed in construction (12.2 percent), mining (11.3 percent), activities of the hotels and restaurants (10.9 percent), water supply, waste treatment and processing, receipt of recyclable materials (9.2 percent), education (8.9 percent), professional,

¹ Exclusive of small enterprises.

scientific and technical activities (8.7 percent), as well as real estate operations (6.3 percent). In January-December 2019, real wage increased by 4.7 percent compared to the same period in 2018 (in January-December 2018, the increase was 3.7 percent).

State Budget

In 2019, the government expenditures policy was focused on optimizing expenditures while increasing the revenues, as a result, at the end of the year, the deficit decreased from 1.1 percent to GDP in 2018 and amounted to KGS 0.4 billion or 0.1 percent to GDP.

In general, the reduction in the deficit is the result of the fiscal consolidation policy implemented by the Government of the Kyrgyz Republic. Moreover, the local budgets indicators associated with a significant excess of revenues over expenditures affected the state budget consolidation.

At the end of 2019, public debt increased by 2.5 percent compared to the end of 2018 and amounted to KGS 319.5 billion (USD 4.5 billion) or 54.1 percent to GDP. 83.9 percent thereof (KGS 268.2 billion or USD 3.9 billion) is the state external debt, 16.1 percent (KGS 51.3 billion or USD 736.5 million) is the state internal debt. The funds raised from placement of the government securities are the main sources of domestic financing of the budget deficit. Thus, the policy to increase the issue of government securities and to develop the financial market is still implemented, in particular long-term government securities.

Table 1.1.2. Main Parameters of the State Budget of the Kyrgyz Republic

	2018		2019	
	billions of KGS	% to GDP	billions of KGS	% to GDP
Total incomes (including sales of non-financial assets)	151.5	26.6	167.2	28.3
including incomes from operational activity	151.5	26.6	167.1	28.3
sale of non-financial assets	0.1	0.0	0.1	0.0
Total expenditures (including purchase of non-financial assets)	157.9	27.7	167.6	28.4
including expenditures for operational activity	129.1	22.7	136.1	23.1
purchase of non-financial assets	28.8	5.1	31.5	5.3
Deficit(-) / Profit (+)	-6.4	-1.1	-0.4	-0.1
Primary deficit (-) / profit (+)	0.8	0.1	7.4	1.2
Budget financing	13.4	2.3	11.2	1.9
External financing	2.0	0.3	2.9	0.5
Internal financing	11.4	2.0	8.2	1.4

Source: MF KR

Macroeconomic Risks

In general, at the end of 2019, the current economic growth was conditioned by the positive growth rate of all main sectors of the economy. The sectors of industry, construction and trade made the main contribution. High industry indicators were based on the results of production output at the enterprises for the development of gold mining “Kumtor”. At the same time, macroeconomic risks were still observed due to existing structural problems in the economy of the Kyrgyz Republic and ambiguous situation in the global economy.

New threats to the economy of the Kyrgyz Republic also bear the risks associated with vulnerability to a long-term epidemic of coronavirus, in particular:

- forced measures to suspend activities of the entrepreneurship, services, agriculture, transport facilities will have a negative impact on the real sector;
- significant inflationary risks arise amid introduction of the quarantine measures in a number of countries. Given these risks and expectations, in 2020, the inflation rate is expected to accelerate

compared to 2019 and may reach a level near the upper limit of the medium-term target range set by the National Bank at 5.0-7.0 percent;

- in 2020, the shortfall in tax and customs revenues to the state budget and an increase in healthcare expenditures and socially significant initiatives will increase the state budget deficit;

- a decrease in economic activity amid measures taken to counteract the spread of coronavirus infection can result in stagnation in the growth of the deposit base of the commercial banks or to a decrease in the volume thereof, which may worsen the ability of the banks to provide loans to the economic sectors of the country.

The degree of negative consequences of the coronavirus pandemic and the global economic recovery will be largely determined by the duration of the pandemic in our region and in the whole world, with the existing risks of new waves of the coronavirus infection spread in the future.

1.2. Structure of the Financial Sector

Institutional structure of the financial sector in the Kyrgyz Republic is represented by the commercial banks and other financial institutions.

Table 1.2.1. Institutional Structure of the Financial Sector
(number of the financial institutions)

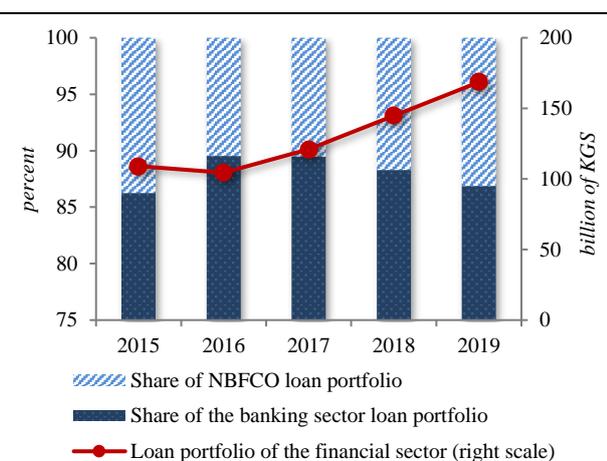
Financial institutions	2015	2016	2017	2018	2019
Commercial banks	24	25	25	25	24
Other financial companies, including:	656	704	688	693	665
Non-banking financial-credit organizations (NBFCO), including:	627	673	657	662	634
Microfinance organizations, including:	172	162	150	142	137
microcredit companies	109	103	96	95	89
microcredit agencies	57	53	47	39	39
microfinance companies	6	6	7	8	9
"FC CU" OJSC	1	1	1	1	1
Credit unions	125	116	110	106	95
Exchange offices	329	394	396	413	401
Insurance companies	17	19	19	19	19
Investment funds	9	9	9	9	9
Stock exchanges	1	1	1	1	1
Pension funds	2	2	2	2	2

Source: CBs, NBFCOs, NSC KR

As of the end of 2019, assets of the banks and the NBFCOs constituted KGS 275.4 billion or 46.7 percent to GDP.

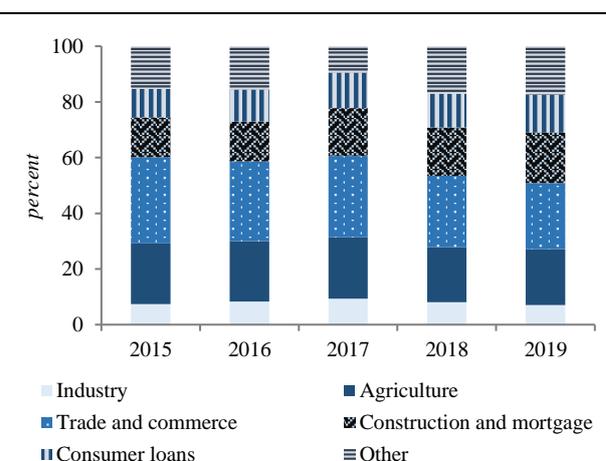
In 2019, the total loan portfolio of the banks and the NBFCOs constituted KGS 168.5 billion or 28.6 percent of GDP. The share of the banks' loans in the loan portfolio of the financial sector decreased by 1.4 p.p. and at the end of 2019 made 86.9 percent (Chart 1.2.1).

Chart 1.2.1. Structure of the Loan Portfolio



Source: CBs and NBFCOs

Chart 1.2.2. Sectoral Structure of the Loan Portfolio in the Financial Sector



Source: CBs and NBFCOs

The high concentration of loans was still observed in the trading sector (banks) and agriculture (NBFcos) within the sectoral structure of the loan portfolio in the financial sector. The aggregate share of the loan portfolio in the financial sector of the aforementioned sectors of the economy at the end of 2019 constituted 43.9 percent of total issued loans and amounted to KGS 74.0 billion (Chart 1.2.2).

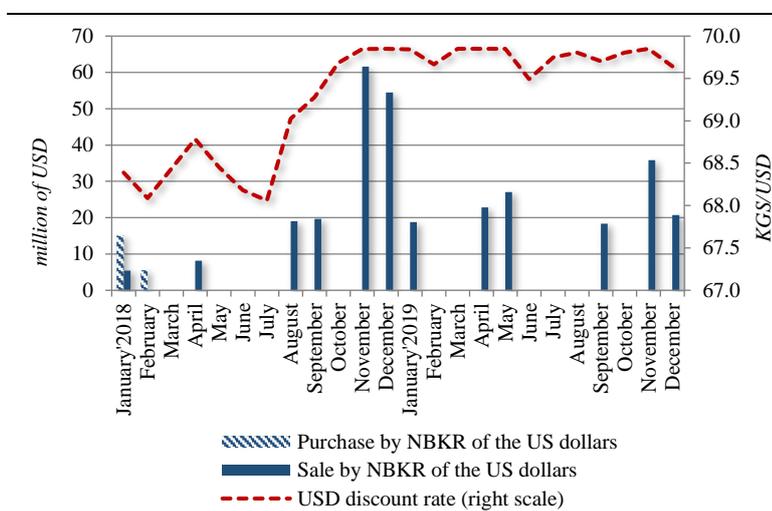
1.3. Financial Markets

In 2019, the situation in the domestic foreign exchange market remained relatively stable, thereby minimizing participation of the National Bank in it. The volume of operations in the money market increased compared to 2018, mainly due to an increase in the volume of repo operations. There was an increase in the activity of participants amid a decrease in the yield in the short-term segment of the government securities market, in the long-term market, on the contrary, there was a slight decrease in activity and yields in all maturities. In 2019, the National Bank actively used notes as a tool to absorb liquidity in the banking system.

1.3.1. Currency and Money Market

Currency Market

Chart 1.3.1.1. Dynamics of Interventions of the NBKR in the US Dollar Market



Source: NBKR

In 2019, the situation in the foreign exchange market was relatively stable, thereby minimizing participation of the National Bank in it. The conjuncture of the domestic foreign exchange market was formed under the influence of the dynamics of the negative foreign trade balance. Moreover, seasonal factors and expectations of the market participants influenced the dynamics of the US dollar exchange rate due to strengthening of the national currencies of Russia and Kazakhstan amid a decrease in capital outflow from the markets of the developing countries under the conditions of global

monetary conditions softened by the developed countries. In 2019, a decrease in the dollarization of the economy was among the indicators of the exchange rate expectations: a decrease in the dollarization of loans and foreign currency deposits of the individuals and legal entities.

During 2019, the policy rate of the US dollar against the Kyrgyz som ranged within KGS 69.3511-69.8500 per one US dollar. At the end of 2019, the policy rate of the US dollar against the Kyrgyz som decreased by 0.3 percent compared to the indicator at the end of 2018 and amounted to KGS 69.6439 per one US dollar.

The National Bank conducted foreign exchange interventions in the interbank foreign exchange market only to smooth sharp exchange rate fluctuations. Thus, in 2019, the net sale of foreign currency decreased by 2.9 percent compared to the indicator of 2018 and amounted to USD 143.45 million. In 2019, the National Bank did not conduct interventions on purchase of foreign currency.

The total volume of operations on purchase and sale of foreign currencies by the participants of the foreign exchange market (including operations with non-residents) increased by 58.6 percent compared to the same indicator in 2018, up to KGS 1,171.4 billion. The increase in the volume of operations was observed on all currencies, meanwhile the turnovers in cash and non-cash US dollars and in Russian rubles in cash increased significantly. Currency operations in exchange bureaus increased significantly (+97.5 percent).

Money Market

Operation of the money market in the country was still stable to facilitate the efficient distribution of financial resources, to provide the lenders with the opportunity to receive profit by investing their money, and to ensure the borrowers' access to short-term financial resources. In 2019, activity in the interbank credit market was high, and the interest rates increased compared to 2018. The interest rates in the money market are among the factors of their formation in the capital market.

In 2019, the volume of operations in the interbank credit market increased significantly compared to the previous year and developed at the highest level since 2014. In 2019, the volume of operations increased by 25.1 percent over the year and amounted to KGS 39.2 billion. Repo operations were mainly conducted in the interbank market, the share thereof made 98.6 percent of the total volume of interbank loans. In 2019, the average weighted rate on the interbank market was 3.02 percent, having increased from 2.38 percent in 2018. The average weighted maturities decreased from 5.2 days to 4.6 days.

In 2019, the volume of repo operations increased by 23.6 percent compared to 2018 and amounted to KGS 38.7 billion. The average weighted rate on repo operations increased from 2.40 percent to 3.02 percent. In 2019, three standard operations were conducted in the national currency with a total volume of KGS 91.2 million (+38.7 percent), 17 standard operations in foreign currency with a total volume of KGS 467.1 million (in 2018, operations were not conducted).

In 2019, the volume of overnight loans provided by the National Bank to support the short-term liquidity of the banks amounted to KGS 286.4 million, having decreased from KGS 18.1 billion in 2018. The volume of funds placed by the commercial banks on overnight deposits amounted to KGS 976.7 billion (+2.1 percent compared to 2018).

1.3.2 Securities Market

During 2019, investors actively used the government securities offered by the Ministry of Finance of the Kyrgyz Republic. The Ministry of Finance of the Kyrgyz Republic borrowed funds in the domestic market to finance the budget by placing ST-Bills and ST-Bonds.

In 2019, the activity of the participants in the ST-Bills market increased from the issuers and the investors. Thus, in 2019, the total supply of ST-Bills at the auctions increased by 2.2 times compared to the same indicator in 2018 and amounted to KGS 6.8 billion due to resumption of the issue of 3- and 6-month ST-Bills. Moreover, the total demand for ST-Bills at the auctions increased by 1.5 times, up to KGS 6.6 billion. The results of auctions, as well as additional placements, showed that the total sales of ST-Bills amounted to KGS 5.4 billion with the weighted average yield of 5.1 percent (in 2018, KGS 2.6 billion with the weighted average yield of 5.6 percent). As a result, at the end of 2019, the volume of ST-Bills in circulation increased by 56.5 percent year-to-date and amounted to KGS 4.1 billion. In 2019, the issuer continued to offer 2-, 3-, 5-, 7- and 10-year ST-Bonds. In 2019, the volume of ST-Bonds supply at the auctions decreased by 12.7 percent, down to KGS 13.2 billion, mainly due to the small issue of 10-year securities. Meanwhile, on the part of the investors, there was a decrease in demand for ST-Bonds in all maturities from KGS 30.1 billion in 2018 down to KGS 12.8 billion in 2019. 7-year ST-Bonds were primarily in demand, the share thereof in the total demand for ST-Bonds was 42.2 percent. The results of the auctions showed that the total volume of ST-Bonds sales, taking into account additional placements, amounted to KGS 11.5 billion, having decreased by 41.0 percent compared to the same indicator of 2018. The total weighted average yield of ST-Bonds decreased from 11.8 percent in 2018 down to 10.3 percent in 2019 due to a decline in yields on all maturities (for the longest maturity of the securities (10 years), the weighted average yield was 13.5 percent, and for 2-year securities – 6.8 percent). At the end of 2019, the volume of ST-Bonds (excluding ST-Bonds nominated in foreign currency) in circulation increased by 14.0 percent year-to-date and amounted to KGS 42.9 billion. The participants conducted operations on ST-Bonds purchase/sale in the amount of KGS 1.1 billion in the secondary market for government securities.

The National Bank placed notes with a maturity of 7-, 14-, 28-, 91- and 182-days to absorb excess liquidity of the banking system. At the same time, the auctions on placement of the National Bank's 14-day notes were conducted only in January and December 2019, and there was a decrease in the activity of the participants in the market of the National Bank's 182-day notes (among the auctions to be held from January to July 2019, only two auctions were actually conducted in February, and the other auctions were declared void due to lack of demand/insufficient number of participants). In 2019, the total demand for the National Bank's notes increased by 13.3 percent (up to KGS 152.3 billion), having exceeded the volume of supply by 2.9 percent. At the same time, the supply of the National Bank's notes increased by 15.2 percent compared to the indicator of 2018, up to KGS 148.0 billion. At the end of 2019, the volume of the National Bank's notes placement increased by 22.6 percent and amounted to KGS 133.7 billion, where the main share fell on 7-day notes. The total weighted average yield of the National Bank's notes amounted to 3.8 percent, having increased by 0.9 p.p. due to the growth of rates on 7-, 14- and 28-day securities. At the end of 2019, the total volume of the National Bank's notes portfolio in circulation increased slightly by 0.2 percent year-to-date, up to KGS 8.1 billion.

1.4. Real Estate Market

At the end of 2019, there was an increase of the price index² in the real estate market of the Kyrgyz Republic due to the rise in prices for individual houses and apartments compared to 2018.

There was also an increase in the average wage level, which favorably affected the housing affordability index, characterizing improvement of the situation with the real estate availability.

Risks to the financial sector from the real estate market remain moderate, which was conditioned by insignificant share of the mortgage loans³ in the total loan portfolio of the banks.

At the end of 2019, an increase in property price index from 6.6 percent to 9.5 percent, as well as the property basis price index from 87.8 percent to 107.9 percent was observed in the Kyrgyz Republic due to growth in prices for individual houses by 21.8 percent and for apartments – by 2.0 percent compared to 2018.

Chart 1.4.1. Price Index Growth Rate in the Real Estate Market

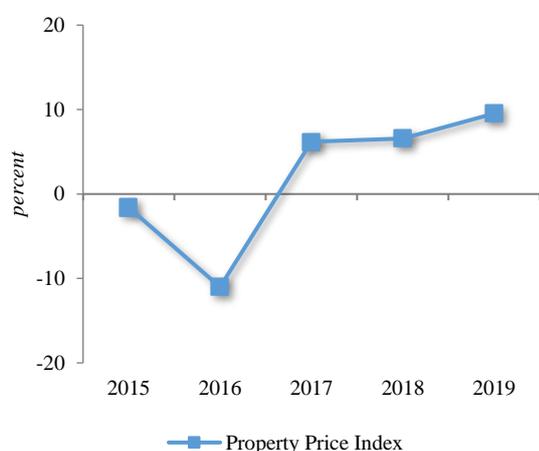


Chart 1.4.2. Basis Price Index Growth Rate in the Real Estate Market⁴



Source: SRS GKR

Source: SRS GKR, NBKR

As of December 31, 2019, the average price for 1 square meter of housing (apartments) in Osh increased by 13.9 percent (up to KGS 35.9 thousand) and in Bishkek, on the contrary, a decrease made 1.9 percent (down to KGS 49.5 thousand) compared to 2018. The average price for 1 square meter of individual houses in Osh increased by 91.3 percent (up to KGS 53.8 thousand), and in Bishkek – by 1.5 percent (up to KGS 50.2 thousand).

In 2019, the number of transactions of the real estate purchase and sale increased by 26.1 percent and amounted to 47,987. The transactions on purchase and sale of the apartments increased

² The Laspeyres index method was used in developing price index for the real estate.

In general, the Laspeyres index is computed as follows:

$$L = (\sum_{i=1}^K QoiPti / \sum_{i=1}^K QoiPoi) * 100, \text{ where}$$

K = number of real estate types;

Qoi = number of real estate of type i in the base period;

Poi = price of real estate of type i in the base period;

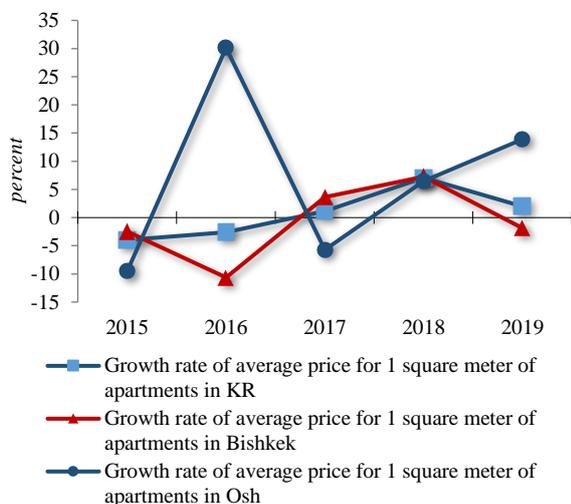
Pti = price of the real estate of type i in the current period.

³ Currently, a mortgage loan is usually a long-term loan extended on security of the title to real estate in the Kyrgyz Republic.

⁴ The year 2010 was taken as the base period.

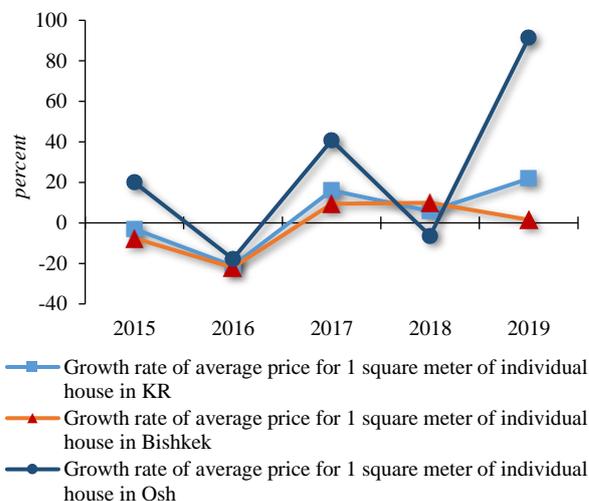
by 16.6 percent and the transactions on purchase and sale of the houses increased by 41.0 percent compared to 2018 and amounted to 27,048 and 20,939, accordingly.

Chart 1.4.3. Dynamics of Price Changes for Apartments



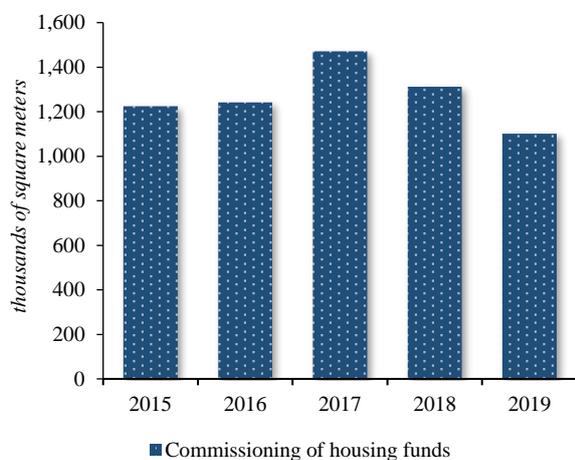
Source: SRS GKR, NSC KR, NBKR

Chart 1.4.4. Dynamics of Price Changes for Individual Houses



Source: SRS GKR, NSC KR, NBKR

Chart 1.4.5. Dynamics of Housing Commissioning and Loan Extended for Construction and Mortgage⁵



Source: SRS GKR, NSC KR, National bank calculations

There was a decrease in the level of commissioning of housing funds. At the end of 2019, the decrease in the aggregate level of commissioning of housing funds constituted 16.1 percent compared to 2018 mainly due to the reduction in the volume of housing funds commissioning in Bishkek and Osh cities (Table 1.4.1).

⁵ Data for the period.

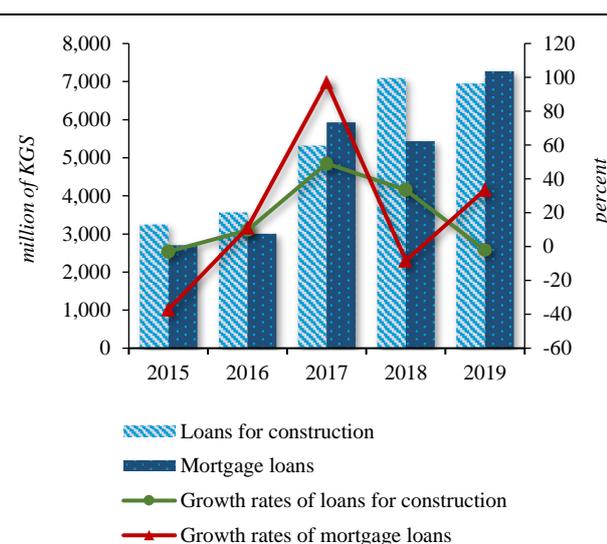
Table 1.4.1. Geographic Structure of Commissioned Housing

	2018		2019	
	Total commissioned area thous. sq.m	Share of total area, %	Total commissioned area thous. sq.m	Share of total area, %
Bishkek city and Chui region	627.7	47.9	410.2	37.3
Osh city and Osh region	287.0	21.9	254.1	23.1
Other regions of KR	396.9	30.3	436.3	39.6
Total	1,311.6	100.0	1,100.6	100.0

Source: NSC KR

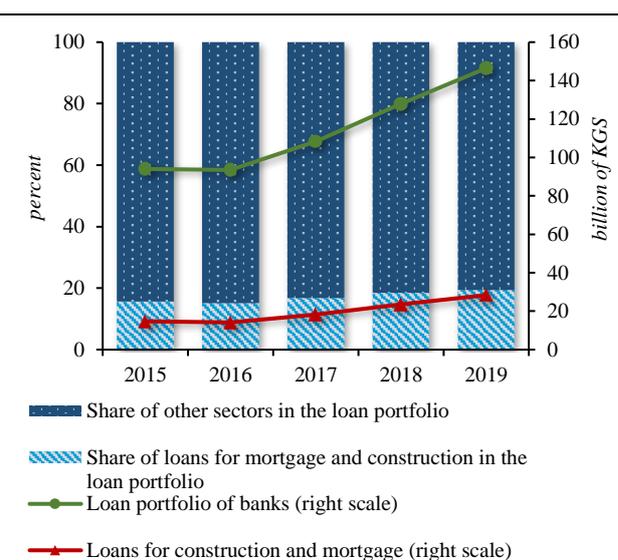
As of December 31, 2019, there was an increase in the volume of extended mortgage loans compared to the same period of 2018. Thus, in 2019, the volume of mortgage loans increased by 33.7 percent and amounted to KGS 7.3 billion, mainly due to the loans extended in the national currency. The volume of loans extended for construction decreased slightly by 2.0 percent and amounted to KGS 6.9 billion. There was an increase in the volume of loans extended in the national currency, and a decrease in the volume of loans extended in foreign currency.

Chart 1.4.6. Loans Extended for Construction and Mortgage⁶



Source: NBKR

Chart 1.4.7. Total Share of Loans for Mortgage and Construction in the Loan Portfolio of Commercial Banks⁷



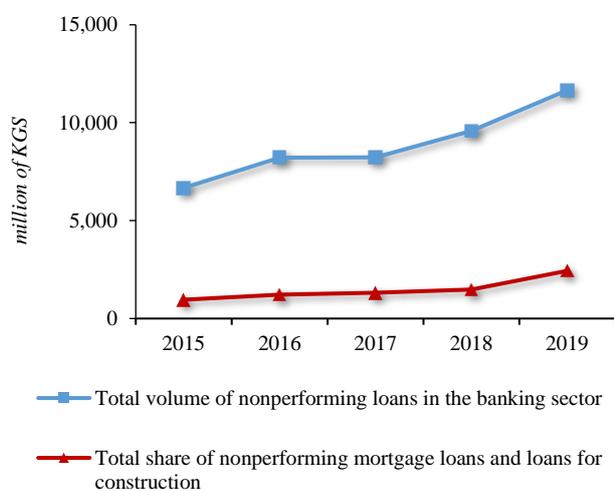
Source: NBKR

⁶ Data for the period.

⁷ Data as of the end of period.

At the end of 2019, residential houses are generally constructed and commissioned at the expense of the population (88.5 percent of the total commissioning)⁸.

Chart 1.4.8. Dynamics of Non-performing Loans



Source: CBs

As of the end of December 31, 2019, the share of loans for construction and mortgage increased slightly (by 0.9 p.p. compared to 2018) and constituted 19.4 percent (Chart 1.4.7) in the total loan portfolio of the commercial banks.

The total volume of non-performing loans for mortgage and construction increased by 64.2 percent and amounted to KGS 2,435.9 million; therefore, the aggregate share of non-performing loans for the aforementioned sectors increased in 2019 by 5.4 p.p. and amounted to KGS 20.9 percent of the total volume of non-performing loans of the banking sector (Chart 1.4.8).

Moreover, the volume of non-performing loans for mortgage and construction in foreign currency increased by 83.6 percent and amounted to KGS 1,801.2 million.

⁸ Social and economic situation of the Kyrgyz Republic, January-December 2019 according to the publication of the National Statistical Committee of the Kyrgyz Republic – Bishkek - P. 93.

Box 1. Housing Affordability Index

As of December 31, 2019, the level of the housing affordability in the Kyrgyz Republic decreased from 6.1 to 5.9 years compared to 2018. This is due to the growth rates of the average monthly nominal wages (growth by 5.8 percent) outrunning the growth rates of real estate prices (growth by 2.0 percent) (Chart 1).

Chart 1. Housing (Apartments) Affordability Index without Minimal Consumer Budget

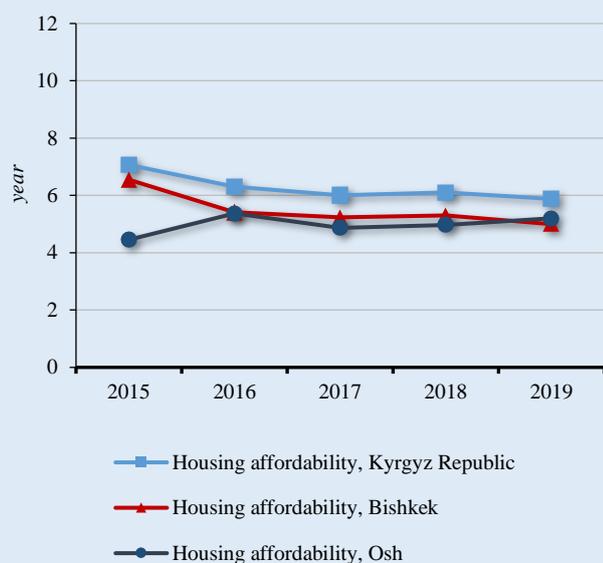
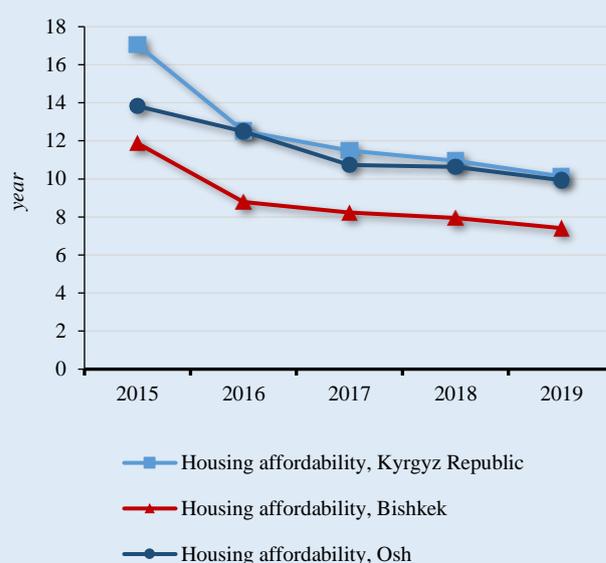


Chart 2. Housing (Apartments) Affordability Index including Minimal Consumer Budget



Sources: NSC KR, SRS KR, NBKR

Sources: NSC KR, SRS KR, NBKR

According to the results of 2019, to purchase an apartment of 54 square meters in the Kyrgyz Republic one should save the average monthly nominal wage of the family, where the income is received by two people, for 5.9 years with other conditions being equal.

According to the results of 2019, a family of three people in the Kyrgyz Republic with the minimum consumer budget of KGS 14,419.0 (42.0 percent of total family income) will need 10.1 years in order to purchase housing (Chart 2).

Box 2. Stress Testing of Impact from Price Changes in the Real Estate Market on the Banking Sector⁹

As of December 31, 2019, the share of loans, secured by pledged real estate, constituted 30.4 percent of the total volume of loans in the loan portfolio of the banks. The volume of pledged real estate (at pledge value) amounted to 67.5 percent of the total collateral of the loan portfolio.

Credit risks of the banking sector are conditioned by possible decrease in the value of pledged real estate below the loan repayment balance and further potential refusal of a borrower from loan repayment.

Stress testing is focused on quantitative assessment of possible losses from outstanding loans and identification of the most vulnerable banks (groups of banks).

Scheme 1. Results of Stress Testing of Impact from Price Changes in the Real Estate Market on the Level of Credit Risk of the Banking Sector

Scenario	Potential losses of the banking sector	Potential losses of large banks	Risk of capital adequacy ratio violation
"Historical" scenario* (decrease in price for real estate by 23% per a year)	-----	-----	1 bank
"Alternative" scenario (decrease in price for real estate by 40% per 2 years)	KGS -0.4 billion	-----	4 banks
"Negative" scenario (decrease in price for real estate by 50% per a year)	KGS -11.2 billion	KGS -5.3 billion	5 banks

* At the end of 2008, prices for real estate in Kyrgyzstan decreased by 23 percent.

In addition to stress test, threshold level of decrease in prices for real estate, when banks potentially suffer losses, was calculated. The banking sector potentially suffers losses if prices for the real estate decrease by 39.7 percent, large banks – by 42.1 percent. The risk of capital adequacy ratio violation by the banking sector, as well as by the large banks, arises when prices for the real estate decrease by 58.0 and 54.0 percent, accordingly.

The possible difference in the estimated value of pledged real estate, which may be less than the market value by approximately 20 percent, was not taken into account by the banks in calculations of the stress test. Taking into account aforementioned facts, prices for real estate can decrease by 20 percent.

⁹ Stress test was conducted on the basis of the commercial banks' data provided in the course of the survey as of December 31, 2019.

II. BANKING SECTOR

Growth of the main indicators of the banking sector: assets, liabilities, capital, deposit base, loan portfolio and indices of financial intermediation was observed at the end of 2019 compared to 2018.

At the end of 2019, systemic risks of the banking sector are estimated as moderate. The banking sector is characterized by a high level of capital adequacy, indicating the availability of the potential to further increase the level of financial intermediation, efficiency and sustainability of the banking sector in the future.

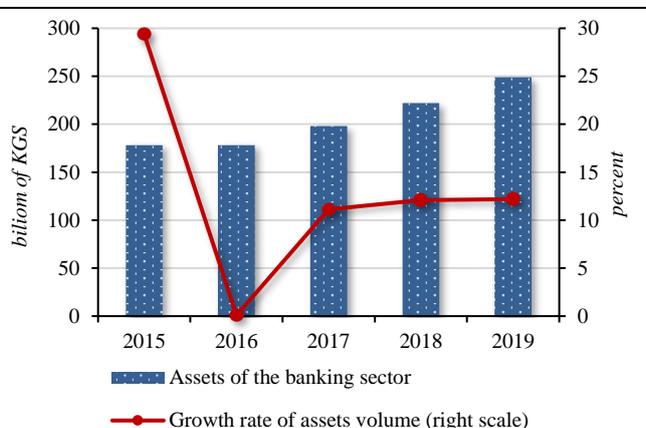
2.1. Major Trends of the Banking Sector

As of December 31, 2019¹⁰, 24 commercial banks (including the Bishkek branch of the National Bank of Pakistan) and 323 of their branches worked in the territory of the Kyrgyz Republic, among which there were 16 banks with foreign participation in the capital, including 11 banks with foreign participation in the amount of more than 50 percent. All banking institutions of the country are universal by the type of business.

Assets

Generally, the growth in the volume of the banking sector assets was observed at the end of 2019. Assets of the banking sector at the end of 2019 amounted to KGS 249.0 billion, having increased by 12.2 percent compared to 2018 (Chart 2.1.1).

Chart 2.1.1. Dynamics of Assets in the Banking Sector



The growth of assets was mainly provided by increase of:

- the loan portfolio by 14.5 percent or KGS 18.6 billion;
- the cash and correspondent accounts by 4.7 percent or KGS 2.5 billion.

The share of loan portfolio in the structure of assets constituted 58.8 percent, having increased by 1.6 p.p. compared to 2018.

Source: NBKR

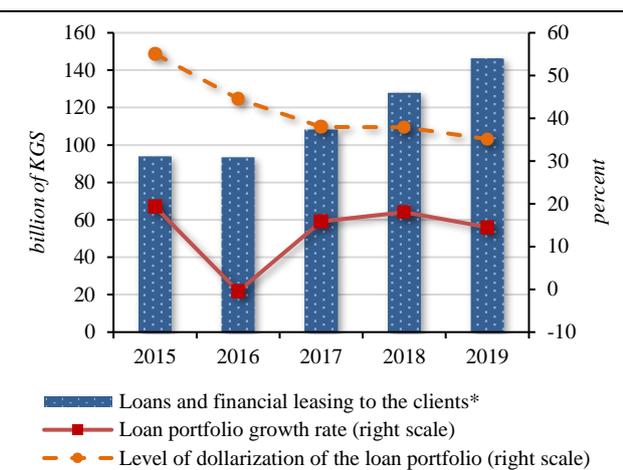
Loan Portfolio

In 2019, growth of the loan portfolio was observed in all sectors of economy.

At the end of 2019, the level of dollarization of the loan portfolio in the banking sector decreased by 2.8 p.p. compared to 2018 and amounted to 35.1 percent (Chart 2.1.2).

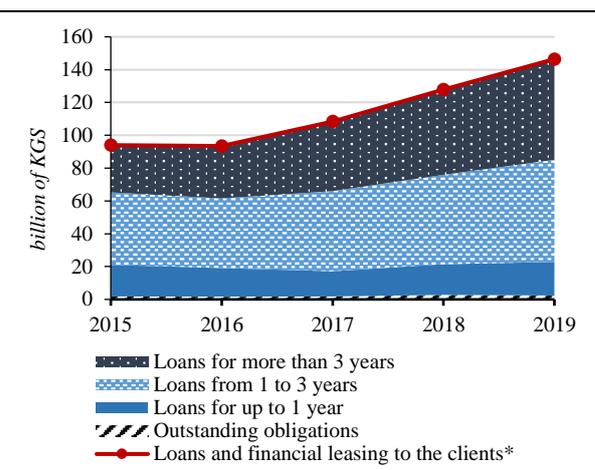
¹⁰ The data are submitted according to periodic regulatory reporting of the commercial banks (PRBR).

Chart 2.1.2. Dynamics of Loan Portfolio in the Banking Sector



* Exclusive of loans provided by FCO and special loan loss provisions
Source: NBKR

Chart 2.1.3. Structure of Loan Portfolio by Maturity



* Exclusive of loans provided by FCO and special loan loss provisions
Source: NBKR

The major shares were accounted for the medium-term loans extended for 1-3 years, which constituted 42.4 percent or KGS 62.1 billion, and for the long-term loans extended for more than 3 years – 41.8 percent or KGS 61.3 billion in the structure of loan portfolio by maturity (Chart 2.1.3).

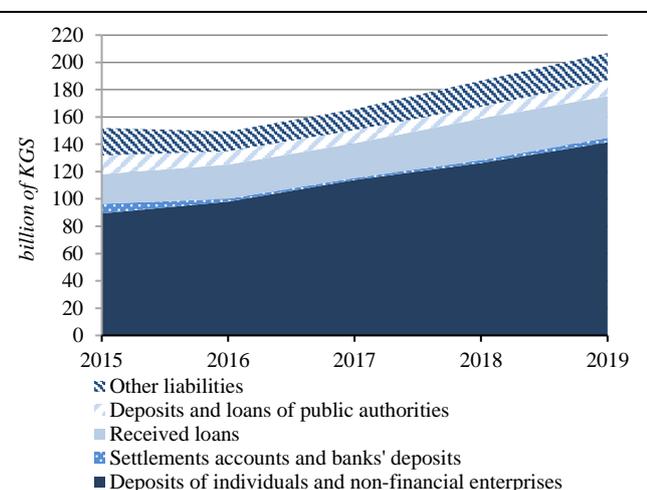
Liabilities

At the end of 2019, liabilities of the banking sector of the Kyrgyz Republic amounted to KGS 206.8 billion, having increased by 10.9 percent compared to 2018.

At the end of 2019, deposits of individuals and non-financial enterprises increased by 11.9 percent and amounted to KGS 141.5 billion (Chart 2.1.4). The share of individuals' and non-financial enterprises' deposits in the banks' liabilities increased by 0.6 p.p. and amounted to 68.4 percent.

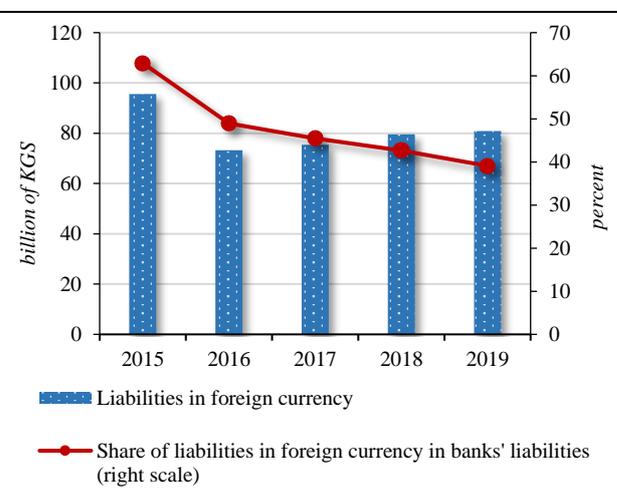
The share of liabilities in foreign currency in the total volume of attracted funds decreased by 1.3 p.p. and amounted to 39.1 percent or KGS 80.9 billion (Chart 2.1.5).

Chart 2.1.4. Structure of Banks' Liabilities by the Reserve Sources



Source: NBKR

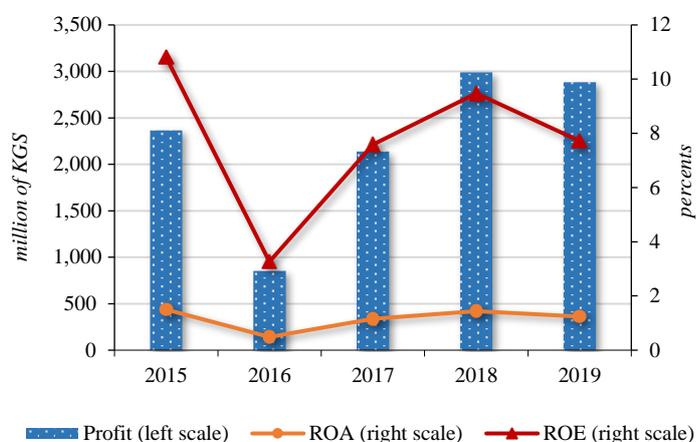
Chart 2.1.5. Banks' Liabilities in Foreign Currency



Source: NBKR

Financial Results

Chart 2.1.6. Profitability Indicators of the Banking Sector



The deterioration of profitability indicators at the end of 2019 was observed compared to 2018 due to increase of administrative expenditures and LLP expenses of the banking sector:

- ROA constituted 1.2 percent;
- ROE formed at 7.7 percent.

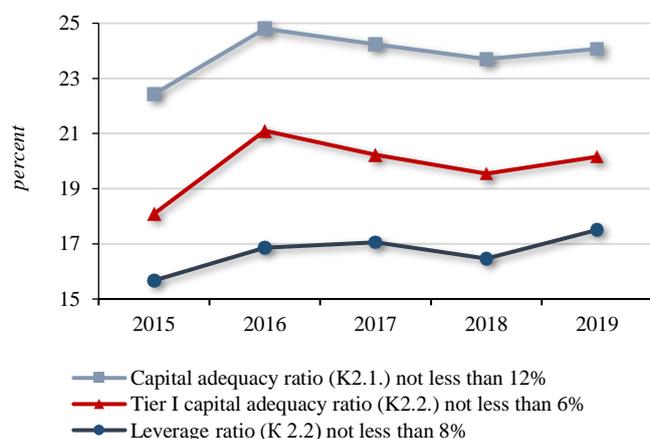
Net profit of the banking sector decreased by 3.6 percent and amounted to KGS 2.9 billion (Chart 2.1.6).

Source: NBKR

Capital Adequacy

With statutory minimum capital adequacy at 12.0 percent, at the end of 2019, this figure amounted to 24.1 percent (Chart 2.1.7), having increased by 0.4 p.p. compared to 2018.

Chart 2.1.7. Dynamics of Capital Adequacy Ratios



At the same time, the actual level of capital adequacy in the banking sector, generally formed according to the results of 2019, can further increase the volume of risky and earning assets by 2.0 times, without exceeding established level of capital adequacy.

The abovementioned information indicates relative stability of the banking sector to negative shocks and the presence of certain potential to increase the level of financial intermediation and efficiency of the banking sector activity in the future.

Source: NBKR

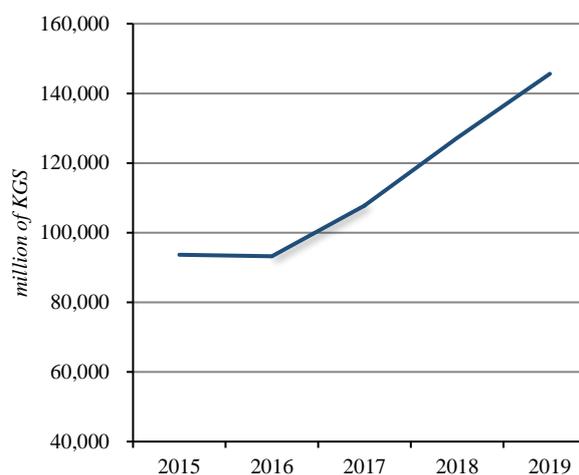
2.2. Banking Sector Risks

2.2.1. Credit Risk. Credit risk of the banks' clients

A credit risk is one of the main risks that accompany banking activity.

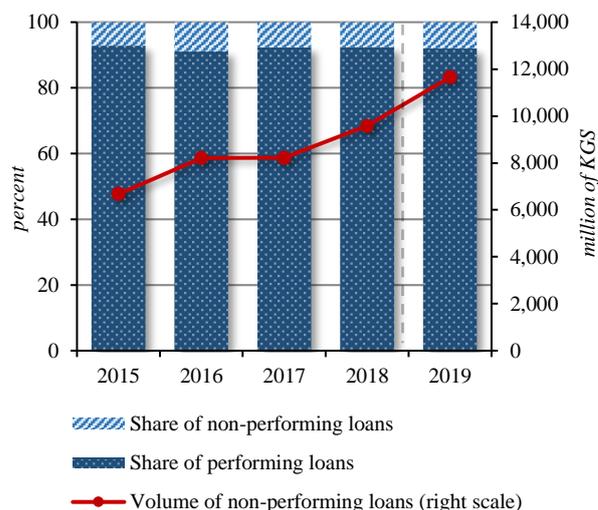
In 2019, the share of non-performing loans in the loan portfolio of banks increased from 7.5 percent up to 8.0 percent compared with 2018 (Chart 2.2.2).

Chart 2.2.1. Dynamics of Loan Portfolio



Source: NBKR

Chart 2.2.2. Loan Portfolio Quality



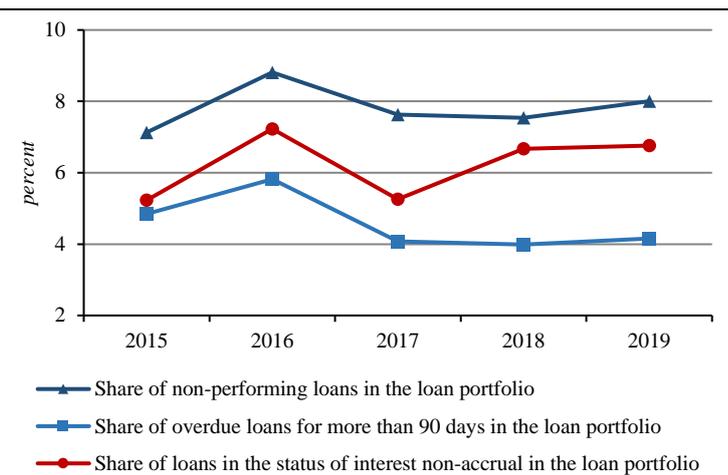
Source: NBKR

In order to assess the quality of the loan portfolio, the commercial banks use a loan classification system¹¹, which contributes to determining the possible level of potential losses from bad loans and compensating them in time through creation of appropriate reserves (Chart 2.2.3).

At the end of 2019, the indicator of the risk of default on assets (the ratio of special loan loss provisions and loan portfolio) increased by 0.4 p.p. compared to 2018 and constituted 4.5 percent.

¹¹ In classification of the loan portfolio, all loans are usually divided into six categories, depending on the client's current capacity to fulfill the obligations to the bank (listed in declining order of classification): normal, satisfactory, under supervision, substandard, doubtful and losses. Loans of last three categories, as having the most negative characteristics in terms of return of loans, are usually attributed to the "non-performing". For each of six categories, the bank has to create a reserve corresponding to this category defined as a percentage of loans issued.

Chart 2.2.3. Indicators of the Loan Portfolio Quality



Aggregate reserves created by the commercial banks increased by 0.2 p.p. compared to 2018 and constituted 6.9 percent of the total loan portfolio. Meanwhile, the share of special loan loss provisions in 2019 constituted 65.5 percent of the total reserves (Chart 2.2.4).

Source: NBKR

Chart 2.2.4. Total and Special Reserves

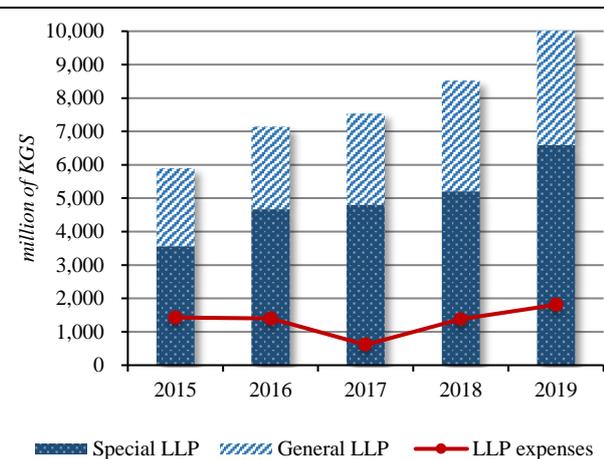
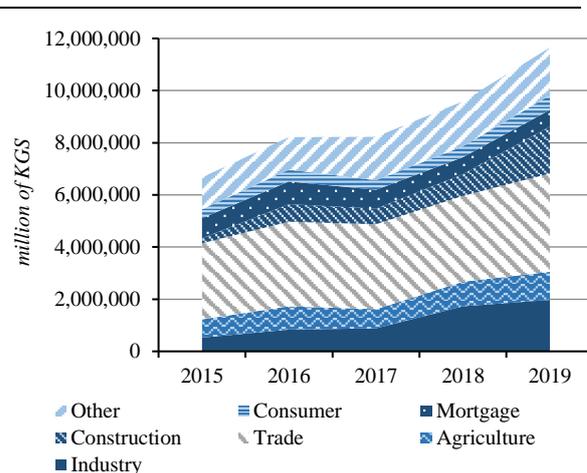


Chart 2.2.5. Volume of Non-performing Loans by Sectors of Economy



Source: NBKR

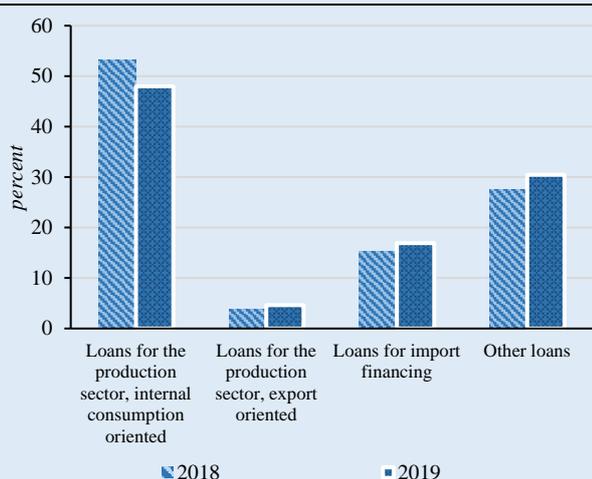
Source: NBKR

As of the end of 2019, the highest concentration of credit risks was still observed in the trade sector of economy (Chart 2.2.5).

Box 3. The Survey Results of the Commercial Banks Clients

At the end of 2019, a significant share of extended loans (48.0 percent of total borrowers' loans) was still concentrated in the production sector of the economy¹², thereby reflecting contribution of the banking sector in creation of the country's GDP, meanwhile, 16.9 percent of issued loans were forwarded for financing of imports (Chart 1).

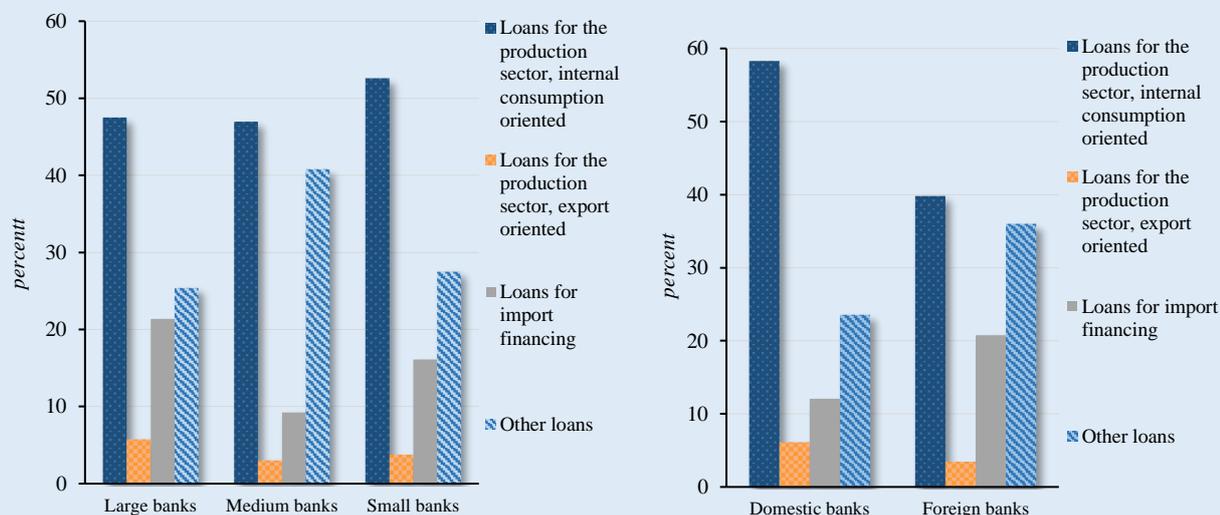
Chart 1 Sectoral Structure of Loans as of December 31, 2019



Source: CBs

Domestic banks forward 58.3 percent of the loan portfolio to the production sector (GDP) and 12.1 percent – to finance imports. Generally, foreign banks also provided loans to the production sector of economy (39.8 percent). In 2019, the share of loans forwarded to finance imports constituted 20.7 percent of the loan portfolio (Chart 2).

Chart 2. Sectoral Structure of Loans by the Groups of Banks as of December 31, 2019



Source: CBs

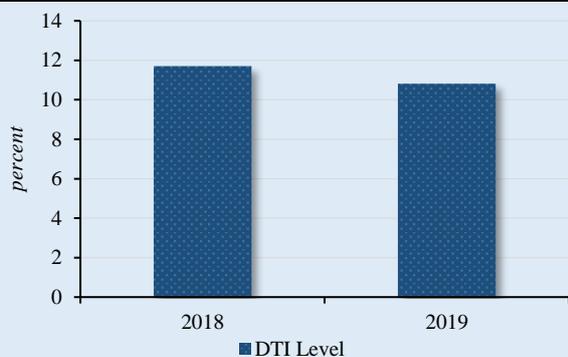
¹² The production sector means the activity of the bank clients connected with the production of goods and services (construction, communication and automobile repair shop services, transport services, real estate leasing, hotels, restaurants, etc.).

Box 4. Results of the Survey of the Commercial Banks' Largest Clients

Borrowers solvency

At the end of 2019, the level of debt burden of 15 banks' largest clients calculated through DTI index¹³, decreased by 0.9 p.p. compared to the same indicator of 2018 and constituted 10.8 percent.

Chart 1. DTI Level on 15 Banks' Largest Borrowers



Source: CBs, NBKR

By the groups of banks, the largest debt burden was observed in the major borrowers of *the small banks* (14.1 percent of the borrowers' basic income) (Table 1). At the same time, the same lowest level of debt burden was observed in the major borrowers of the medium and small banks.

Table 1. Debt Burden of 15 Banks' Largest Borrowers at the end of 2019

	Banking sector	Large banks	Medium banks	Small banks
Loan balance, billions of KGS	35.7	19.5	8.2	7.9
Share of loans in 15 largest borrowers in the total volume of loan portfolio in the banking sector, in %	24.1	23.7	17.8	40.4
Ratio of expenses for loan debt servicing to the borrowers' total income, in %	10.8	14.1	6.2	6.2

Source: CBs, NBKR

In 2019, the level of debt burden in the foreign banks was higher than in the domestic banks (Table 2).

Table 2. Debt Burden in the Domestic and Foreign Banks at the End of 2019

	Domestic banks	Foreign banks
Loan balance, billions of KGS	16.3	19.4
Share of loans in 15 largest borrowers in the total volume of loan portfolio in the banking sector, in %	24.7	23.6
Ratio of expenses for loan debt servicing to the borrowers' total income, in %	4.9	15.9

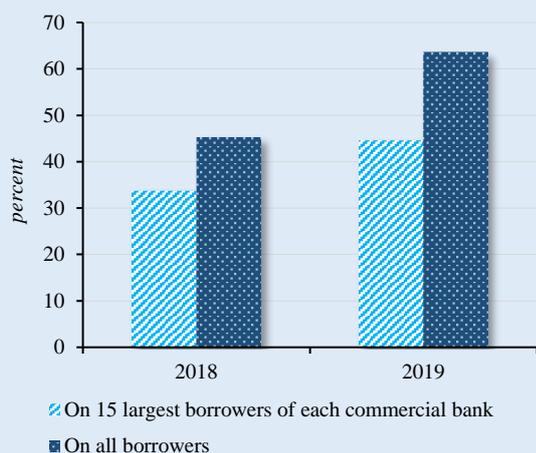
Source: CBs, NBKR

¹³ DTI (debt-to-income) is the ratio of the amount of the borrowers' payments on loans (including the amount of principal and interest payments for the reporting period) to the main annual income of the borrower declared at the time of issuing a loan.

Security of the borrowers' loans

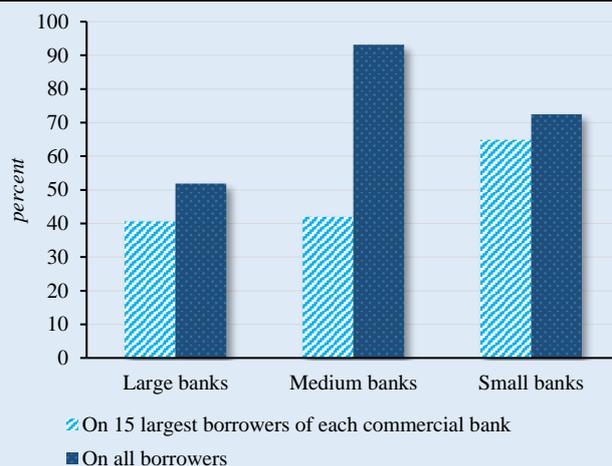
At the end of 2019, the LTV actual level¹⁴ in the banking sector amounted to 63.7 percent. The existing level of collateral indicates a relatively high level of the loans secured by the pledged property (Chart 2).

Chart 2. LTV Level on All Borrowers and on 15 Largest Borrowers of Each Commercial Bank



Source: CBs, NBKR

Chart 3. LTV Level on All Borrowers and on 15 Largest Borrowers by the Banks' Groups as of December 31, 2019



Source: CBs, NBKR

Meanwhile, the LTV value in the large banks is lower than in the small and medium banks and in the banking sector as a whole (Chart 3).

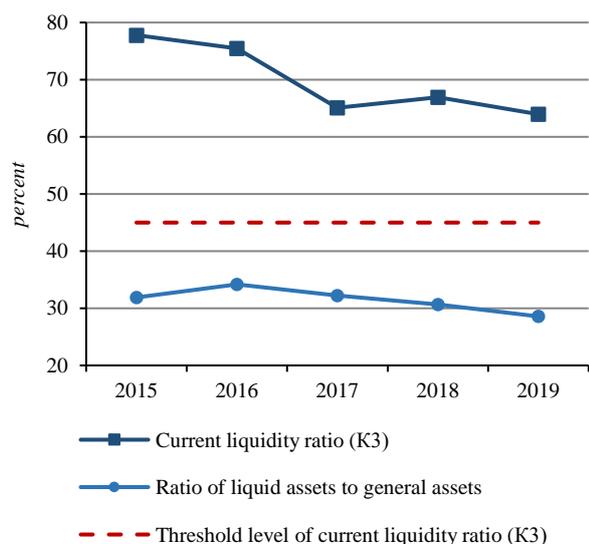
¹⁴ LTV (loan-to-value ratio) is the ratio of issued loans to the value of collateral.

2.2.2. Liquidity Risk

Public confidence in the banking sector depends on the timely implementation of obligations by the banks, which suggests availability of sufficient liquidity in the banks. For regulatory purposes, liquidity risk is assessed using economic current liquidity ratio¹⁵.

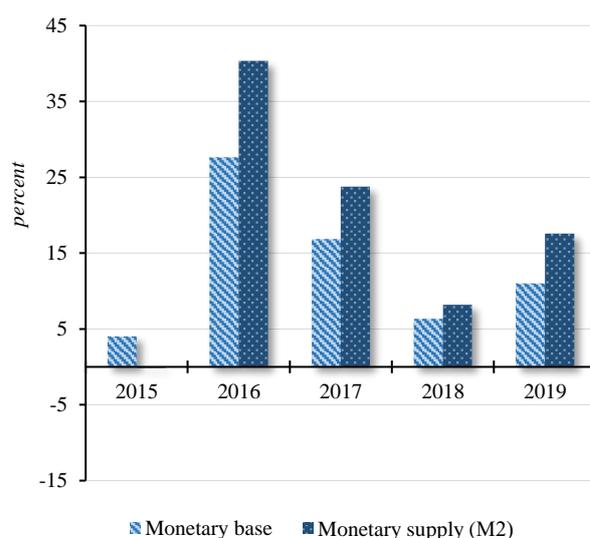
At the end of 2019, current liquidity ratio decreased from 66.9 percent (as of the end of 2018) down to 64.0 percent (Chart 2.2.15).

Chart 2.2.15. Liquidity Indicators in the Banking Sector



Source: NBKR

Chart 2.2.16. Growth Rates of Money Supply (M2) and Monetary Base



Source: NBKR

Liquidity ratio of the banking sector decreased due to excess of current liabilities over liquid assets growth rates.

Table 2.2.1. Maturity of Financial Assets and Liabilities
as of December 31, 2019, millions of KGS

Name	Maturity					Total
	up to 1 month	1-3 months	3-6 months	6-12 months	more than 12 months	
Total financial assets including loans and financial leasing to the clients	84.881	10.853	13.344	24.248	126.027	259.353
Total financial liabilities including deposits of individuals and time deposits of legal entities	103.227	10.637	17.238	26.782	44.944	202.828
Gap	-18.345	216	-3.894	-2.534	81.083	56.525
Including on loans and deposits	-36.276	-389	-287	-116	82.886	45.817

¹⁵ Economic current liquidity ratio is one of the mandatory standards for the bank established by the National Bank, according to which the liquid assets (for calculation of this indicator including funds of banks in cash and correspondent accounts) must be at least 45 percent of short-term liabilities.

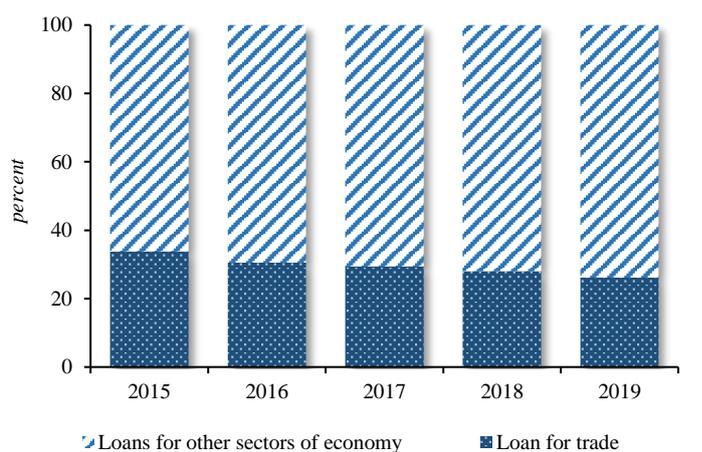
2.2.3. Concentration Risk

Concentration of the Largest Sources of Financing

The results of “reverse” stress testing show that some banks could not withstand the shock related to outflow from one to five large clients¹⁶, meanwhile the liquidity ratio decreases below the threshold level of 45 percent.

Loan Concentration

Chart 2.2.17. Sectoral Concentration of the Loan Portfolio



Source: CBs, NBKR

Potential default from one to five largest borrowers¹⁷ in separate banks may decrease regulatory capital below economic standard of the National Bank.

Decrease of the level of trade loans concentration was observed in the sectoral structure of loan portfolio amid increase of lending to all sectors. At the end of 2019, the share of loans for trade decreased from 28.0 percent down to 26.2 percent (Chart 2.2.17).

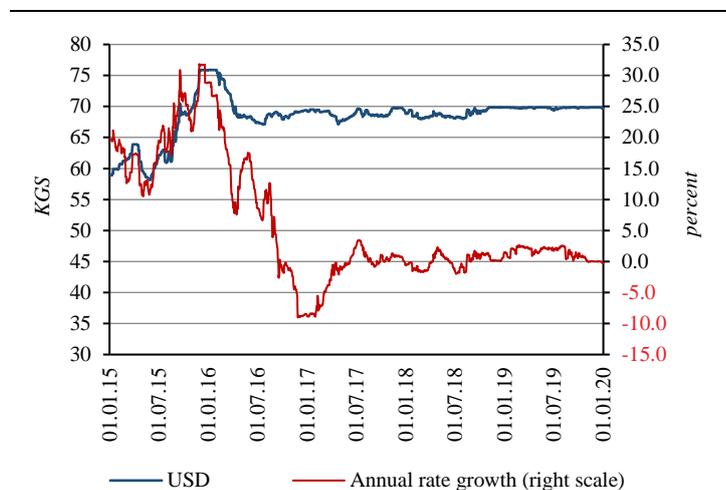
¹⁶ The largest sources of financing (LSF) are the funds of creditors and depositors (received loans, settlement accounts, demand deposits and time deposits).

¹⁷ Total debt of five largest borrowers of the bank is meant.

2.2.4. Currency Risk

At the end of 2019, the annual average level of *currency risk* in the banking sector was moderate.

Chart 2.2.18. Dynamics of USD/KGS Nominal Exchange Rate



In general, the banks kept open currency positions of assets and liabilities within the limits set by the prudential standards of the National Bank of the Kyrgyz Republic.

In 2019, the risk of currency position overestimation in the banking sector was minimum (VaR: 0.1–1.6 percent of the net total capital, Chart 2.2.19), i.e. the banks adhered to a conservative policy in dealing with foreign currency and were weakly exposed to currency risk.

Source: NBKR

Chart 2.2.19. Dynamics of Open Currency Position (OCP) and Revaluation Risk (VaR) in percent of NTC

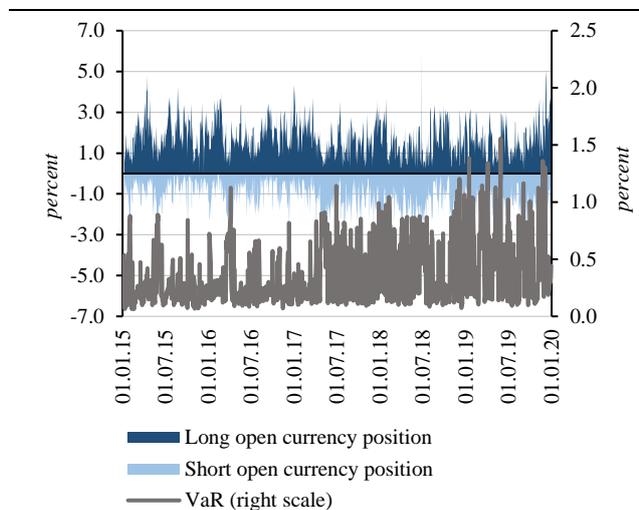
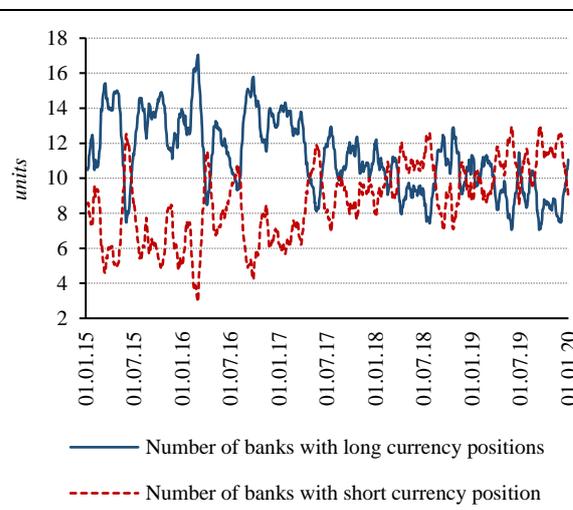


Chart 2.2.20. Currency Position of the Banks



Source: NBKR

Source: NBKR

Box 5. Credit and Currency Risks

At the end of 2019, 22.3 percent of the total loan portfolio was accounted for the loans, which were repaid in foreign currency, while the income of the borrowers was generated in the national currency (Chart 1). This volume of the loan portfolio was potentially exposed to credit and currency risks.

The impact made by the currency risk on the credit risk is given in Chart 2 that displays the proportion of non-performing loans by groups of loans:

- Group 1 – 15.8 percent, where basic incomes of the borrower are generated in the national currency, and the loans are repaid in foreign currency;
- Group 2 – 5.4 percent, where basic incomes and loans payable by the borrower, are in the same currency;
- Group 3 – 31.4 percent, where basic incomes of the borrower are generated in foreign currency, and the loans are repaid in the national currency.

Chart 1. Loan Portfolio by Groups of Loans¹⁸

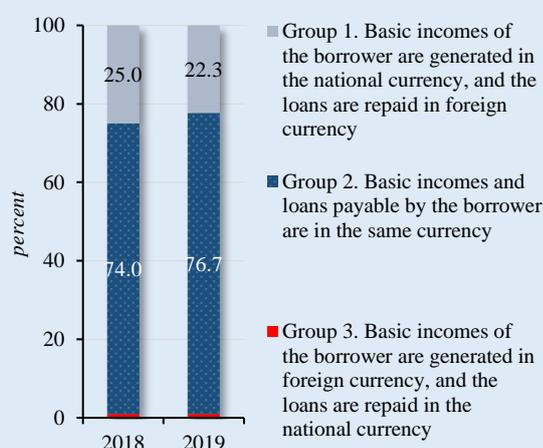
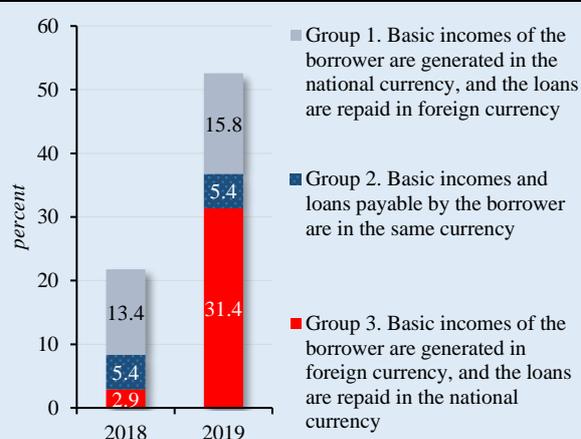


Chart 2. Share of Non-performing Loans by Groups of Loans¹⁹



Source: CBs, the volume of loan portfolio is specified exclusive of overdraft loans.

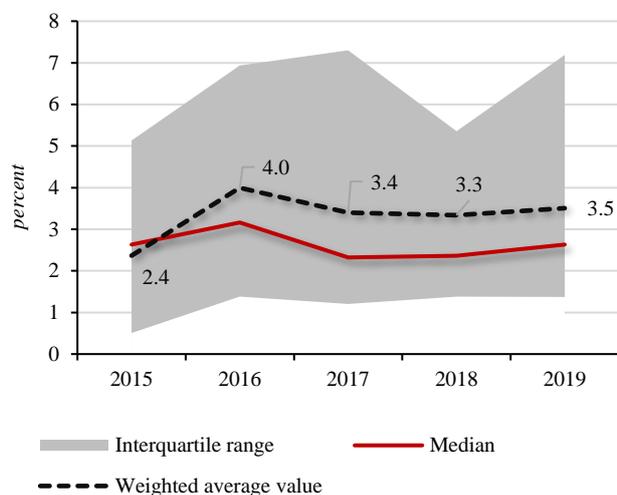
¹⁸ Breaking of loans into groups is presented in this chart. For example, the volume of loans for Group 1 as of December 31, 2019 amounted to KGS 32.2 billion or 22.3 percent of the total loan portfolio (KGS 144.7 billion).

¹⁹ This chart shows the shares of non-performing loans in the loan portfolio by each group of loans. For example, the volume of non-performing loans for Group 1 as of December 31, 2019 amounted to KGS 5.1 billion or 15.8 percent of the total loan portfolio for Group 1 (KGS 32.2 billion).

2.2.5. Interest Rate Risk

At the end of 2019, there was a slight increase of the interest rate risk in the financial sector.

Chart 2.2.21. Dynamics of Interest Rate Risk (VaR) in percent of NTC

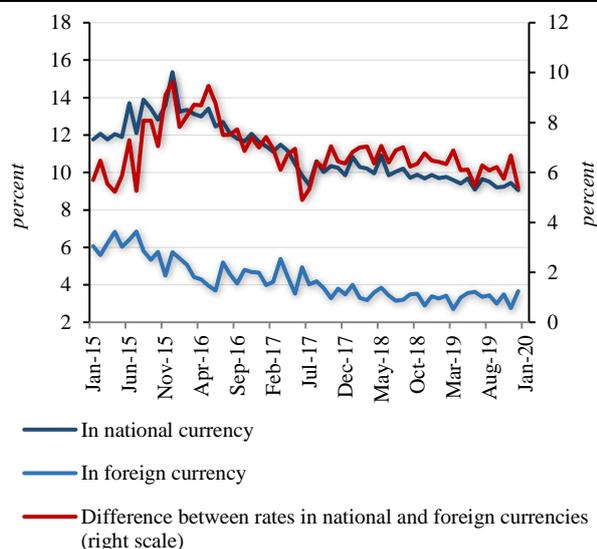


Slight increase of interest rate risk (VaR) from 3.3 percent up to 3.5 percent of net total capital was caused by decrease of gaps by maturities between financial assets and liabilities vulnerable to interest rates dynamics.

Average value of interest rate risk during the period of 2010 – 2019 was within accessible limits (2.4 - 4.0 percent of net total capital).

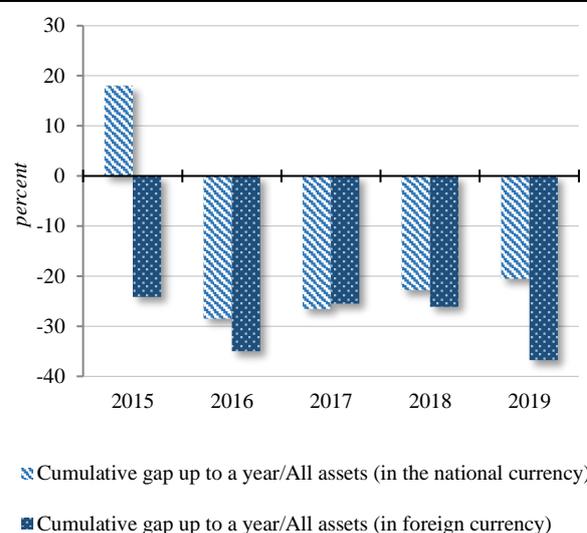
Source: NBKR

Chart 2.2.22. Dynamics of Average Weighted Interest Rate of Individuals' Time Deposits



Source: CBs, NBKR

Chart 2.2.23. Cumulative Gap of Assets and Liabilities Exposed to Interest Rate Risk



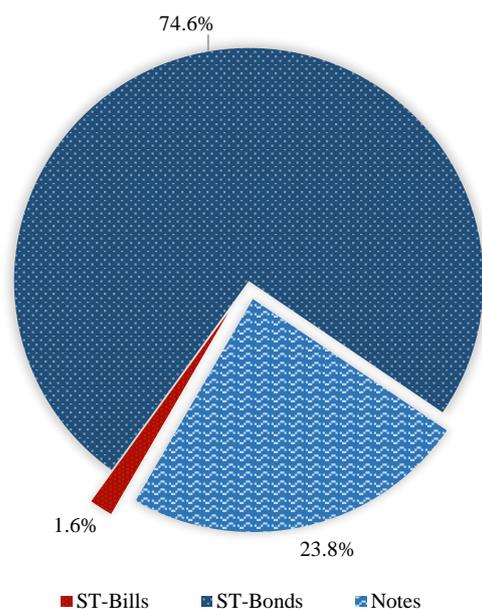
Source: NBKR

2.2.6. “Contagion” Risk

The purpose of this analysis is to assess the “contagion” risk in case of interbank lending, which can set off chain reaction upon occurrence of problems with liquidity.

At the end of 2019, the volume of interbank transactions amounted to KGS 38.8 billion²⁰.

Chart 2.2.24. Distribution of Interbank Loan Transactions Made during 2019 between Resident Banks, Depending on Collateral



Source: NBKR

The loans in the interbank market are generally covered by collateral in the form of highly liquid government securities (Chart 2.2.24) in the banking sector of the Kyrgyz Republic.

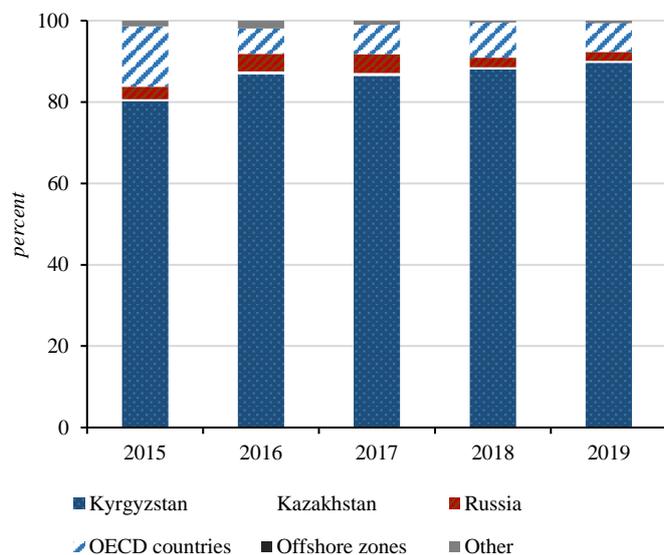
In general, the probability of the “contagion” risk materialization in the interbank credit market of the Kyrgyz Republic is minimal, which is caused by highly liquid collateral.

²⁰ The total volume of transactions made between the resident banks during 2019 is meant here.

2.2.7. Country Risk²¹

In general, as of December 30, 2019, the volume of disposed assets of non-residents constituted KGS 27.1 billion or 10.4 percent of total banking sector assets. The highest concentration of placement was observed in the OECD countries²² – 7.1 percent or KGS 18.6 billion of total assets in the banking sector of the Kyrgyz Republic.

Chart 2.2.25. Geographic Structure of Assets

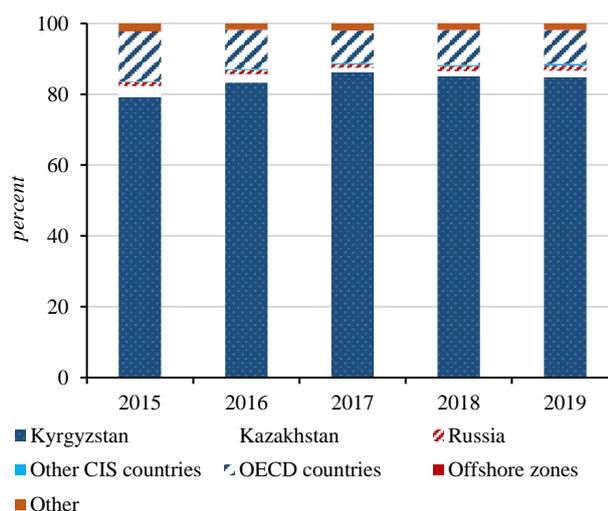


Source: NBKR

The main share of the assets placed abroad was focused on correspondent or deposit accounts and constituted KGS 24.5 billion or 90.3 percent of total placed assets of non-residents.

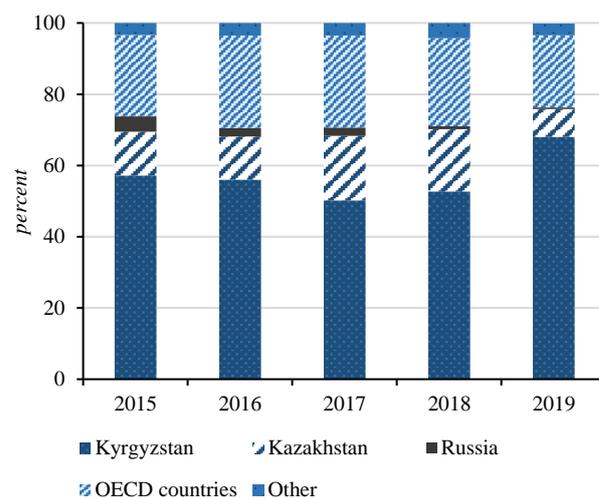
At the end of 2019, banks' liabilities to non-residents of the Kyrgyz Republic totaled KGS 30.8 billion or 15.2 percent of the total liabilities of the banking sector. Main volume of the resources was drawn from non-resident banks in the form of loans and deposits, which amounted to KGS 29.7 billion or 96.5 percent of the total liabilities to non-residents. 9.6 percent of the total liabilities in the banking sector were accounted for the OECD countries, 1.8 and 1.5 percent – for Russia and Kazakhstan, accordingly (Chart 2.2.26).

Chart 2.2.26. Geographic Structure of Liabilities



Source: NBKR

Chart 2.2.27. Authorized Capital by Countries



Source: NBKR

²¹ Data given by the commercial banks.

²² Organization for Economic Cooperation and Development (OECD) is an international economic organization of developed countries that recognize the principles of representative democracy and free market economy.

At the end of 2019, foreign capital amounted to KGS 9.1 billion or 31.9 percent of the total authorized capital of the banking sector (KGS 28.6 billion). The main share of foreign capital is distributed among (Chart 2.2.27):

- residents of the OECD countries – 20.4 percent,
- residents of Kazakhstan – 7.7 percent,
- residents of Russia – 0.4 percent.

2.3. “Reverse” Stress Testing of the Banking Sector

2.3.1. “Reverse” Stress Testing of Credit Risk²³

Maximum allowable share of “performing” loans²⁴ in the loan portfolio, which upon categorized as “non-performing” loans can reduce the CAR (capital adequacy ratio) down to the threshold level of 12 percent, was calculated by means of the “reverse” stress testing of the credit risk.

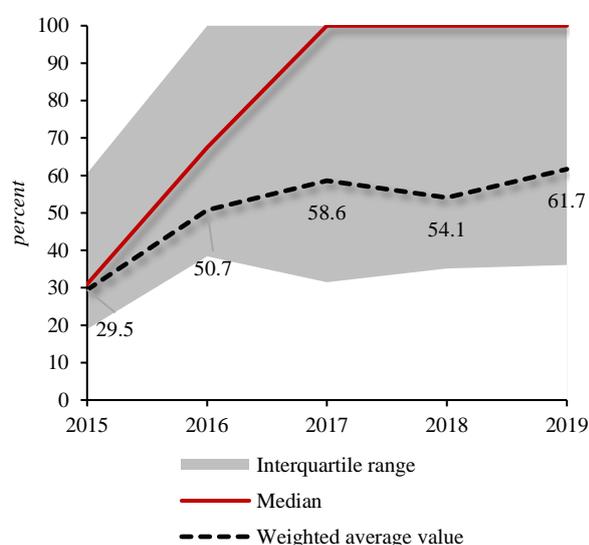
This method allows detecting a buffer stock of capital (net total capital) of banks, which can cover the additional allocations to LLP in connection with the transformation of “performing” loans into the category of “non-performing” loans²⁵.

Moreover, the maximum growth rate of “non-performing” loans, where capital adequacy (K 2.1) will be reduced to the threshold level of 12 percent, can be calculated by means of this method.

Based on the results of the “reverse” stress testing of the banking sector as of December 31, 2019, the maximum allowable share of “performing” loans, transferring to the category of “non-performing” in the banking sector, amounted to approximately 61.7 percent (Chart 2.3.1).

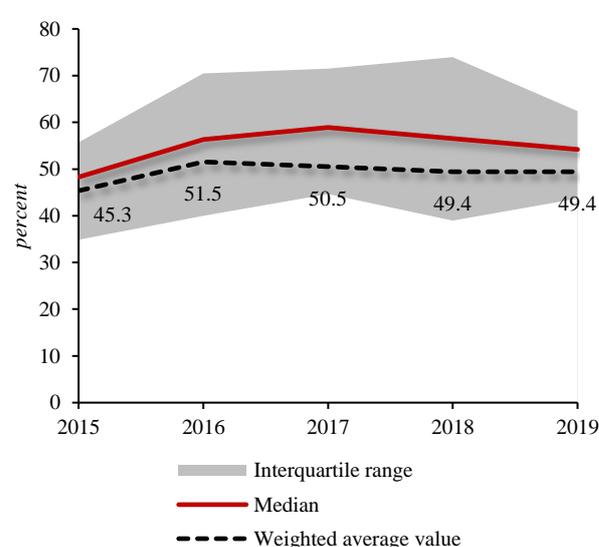
Thus, the banking sector can sustain a significant deterioration in the quality of the loan portfolio, which may require the creation of additional LLP approximately up to 49.4 percent of net total capital (Chart 2.3.2).

Chart 2.3.1. Maximum Possible Share of “Performing”²⁶ Loans that May Become “Non-performing” Loans²⁷
percent of performing loans



Source: NBKR

Chart 2.3.2. Additional LLP, in Creating thereof CAR Decreases to 12 Percent
percent of NTC



Source: NBKR

²³ Exclusive of troubled banks.

²⁴ Exclusive of “normal” loan category, which are risk free.

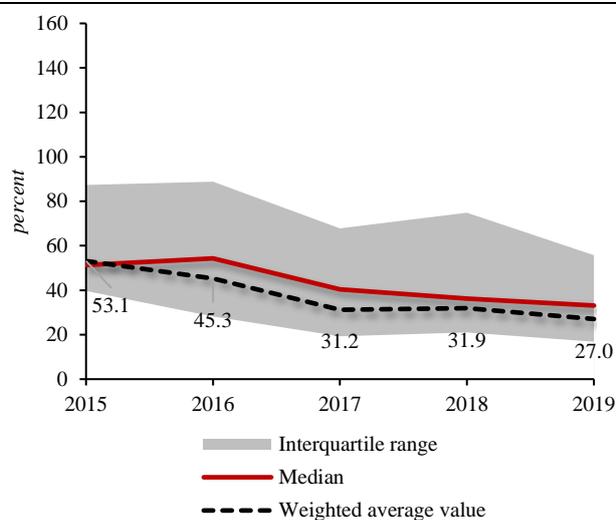
²⁵ Herewith, transition of “performing” loans to the category of “non-performing” loans is fulfilled smoothly by three categories (“substandard”, “doubtful” and “losses”).

²⁶ Exclusive of “normal” loan category, which are risk free.

²⁷ When CAR decreases to the threshold level of 12 percent.

2.3.2. “Reverse” Stress Testing of Liquidity Risk

Chart 2.3.3. Scope of Potential Outflow of Deposits when K3 May Drop to 45 Percent, percent of clients’ total deposits



Source: NBKR

The reserve of liquid assets, which can cover a massive outflow of deposits of the population and non-financial enterprises, without violating the NBKR prudential standard on the current liquidity, was calculated for the evaluation of the liquidity risk in the banking sector.

Shock is the maximum volume of the outflow of the individuals’ and non-financial enterprises’ deposits, which may reduce the liquidity ratio down to the threshold level of 45 percent.

The results of the “reverse” stress testing show (Chart 2.3.3), that as of the end of 2019 the actual amount of liquid assets of the banking sector was able to cover the outflow of an average of 27.0 percent of total deposits of the population and non-financial enterprises (Table 2.3.1).

2.3.3. “Reverse” Stress Testing of Market Risk

In general, the results of the “reverse” stress testing of the market risk indicate that the banking sector as of the end of 2019 has little sensitivity to the interest rate and currency risks.

Interest Rate Risk

Scenario 1 – decrease of average weighted interest rate on loans, when the level of capital adequacy decreases to the threshold level (12 percent).

The results of the “reverse” stress testing indicate little sensitivity of the banking sector to the direct interest rate risk. Decrease of the average interest rates on loans by 16.6 p.p. can reduce the level of capital adequacy ratio to 12 percent (Table 2.3.1).

Generally, the results of the “reverse” stress testing show that the banking sector is characterized by low level of interest rate risk.

Currency Risk (Revaluation Risk)

Maximum increase level of the KGS/USD exchange rate, which will influence capital adequacy and net profit, was calculated for valuation of the currency risk in the banking sector.

Scenario 1 – maximum increase level of the KGS/USD exchange rate, when the level of capital adequacy (K2.1) declines to the threshold level (12 percent).

Calculations of the “reverse” stress testing indicate that the banking sector is characterized by low risk of assets and liabilities revaluation and confirms availability of low sensitivity to currency risk (Table 2.3.1).

Scenario 2 – maximum increase level of the KGS/USD exchange rate, when net profit of the commercial banks decreases to zero level.

The results of stress testing indicate that the commercial banks can stand the impact of currency risk (Table 2.3.1).

Table 2.3.1. General Results of the “Reverse” Stress Tests as of December 31, 2019

		Banking sector
Credit risk		
Scenario 1	Share of performing loans transferring to the category of "non-performing" loans, <i>in percent</i>	61.7
Interest rate risk		
Scenario 1	Decrease of weighted average interest rate on loans, when CAR declines to 12%, <i>in percentage points</i>	16.6
Currency risk		
Scenario 1	Growth rate of USD/KGS (\pm) exchange rate, when CAR decreases to 12%, <i>in percent</i>	Commercial banks overcome the effect of the currency risk (change of currency rate by more than 100 percent)
Scenario 2	Growth rate of USD/ KGS (\pm) exchange rate, when net profit decreases to zero level, <i>in percent</i>	
Liquidity risk		
Scenario 1	Outflow of clients' deposit and received loans of the total deposits and loans, when current liquidity ratio declines to 45%, <i>in percent</i>	27.0

III. NON-BANKING FINANCIAL-CREDIT ORGANIZATIONS

In general, the state of the non-banking financial-credit organizations (NBFCOs) system is assessed as rather stable. Increase of major indicators: assets, loan portfolio, resource base is observed. Stress test results indicate that the credit risk of the NBFCOs system is moderate.

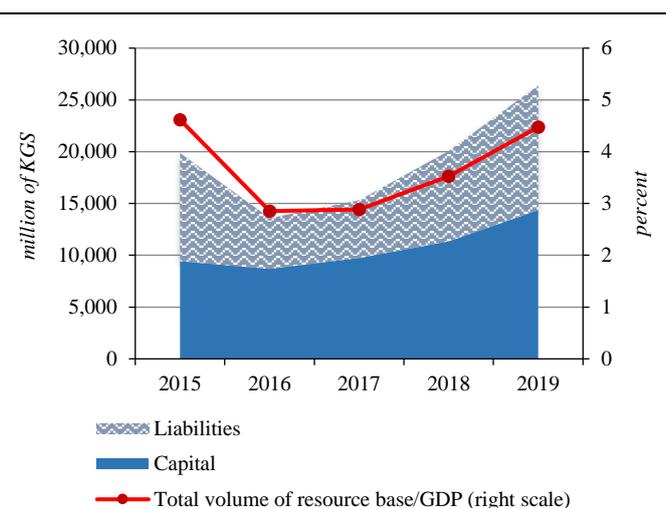
The weighted average interest rates on loans of the microfinance organizations and credit unions decreased compared to 2018.

3.1. Main Trends

The system of non-banking financial-credit organizations subjected to licensing and regulation by the National Bank as of December 31, 2019 in the Kyrgyz Republic included: the specialized financial-credit organization – “FCCU” OJSC; 95 credit unions; 137 microfinance organizations (including 9 microfinance companies, 89 microcredit companies and 39 microcredit agencies) and 401 exchange offices.

Resources

Chart 3.1.1. Dynamics of NBFCOs Liabilities and Capital

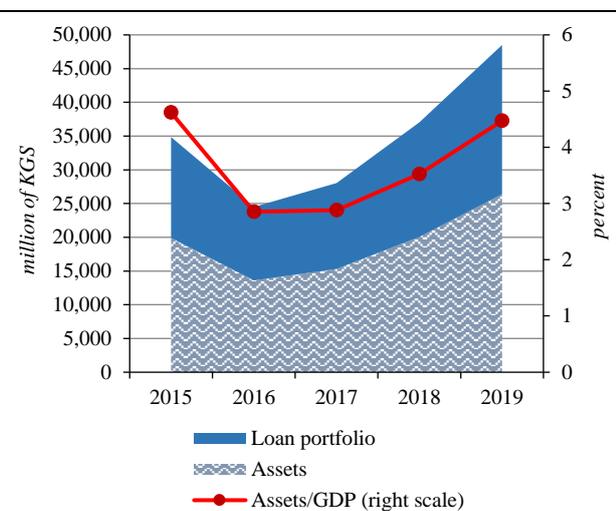


At the end of 2019, NBFCOs liabilities increased by 38.2 percent compared to 2018 and were formed in the amount of KGS 12.0 billion. As of December 31, 2019, NBFCOs capital increased by 26.6 percent and totaled KGS 14.4 billion (Chart 3.1.1).

Source: NBKR

Assets

Chart 3.1.2. Dynamics of NBFCOs Assets and Loans



Source: NBKR

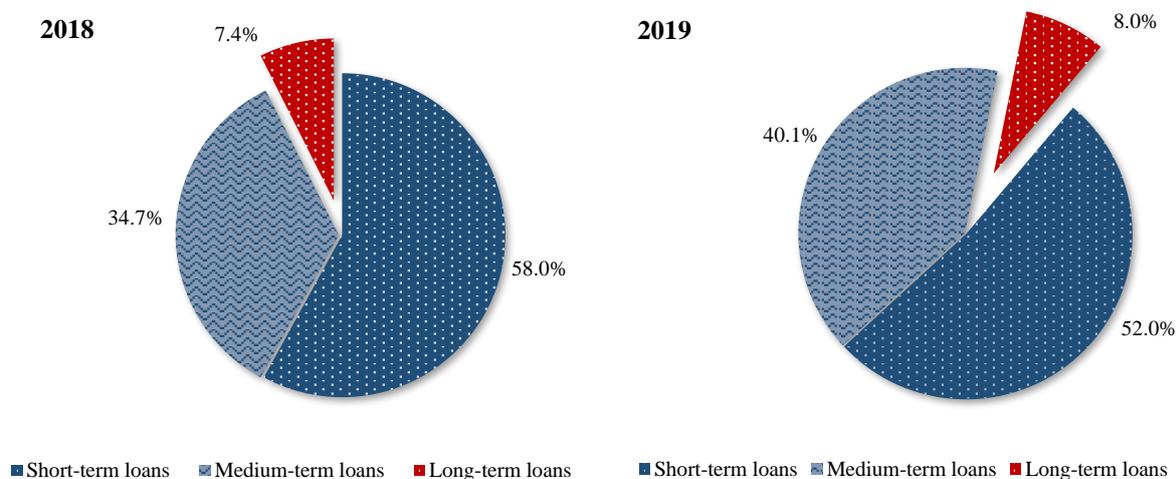
According to periodic regulatory reporting, the total assets of NBFCOs in 2019 increased by 31.6 percent and amounted to KGS 26.4 billion²⁸. This increase was due to growth in the loan portfolio of NBFCOs (Chart 3.1.2).

Lending remains the main activity of NBFCOs. As of December 31, 2019, the loan portfolio of NBFCOs increased by 30.3 percent and was formed in the amount of KGS 22.1 billion.

At the end of 2019, the number of borrowers increased by 20.7 percent compared to 2018 and amounted to 439,521 borrowers.

There was a decrease in the share of short-term credit resources and an increase in the share of medium-term and long-term loans within the structure of the loan maturity provided by NBFCOs in 2019 (Chart 3.1.3).

Chart 3.1.3. Structure of the NBFCOs Loan Portfolio by Maturity²⁹



Source: NBKR

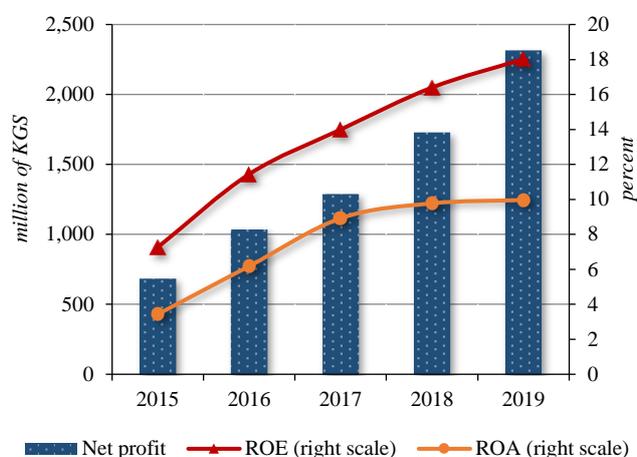
The main oblasts where the major share of NBFCOs loan portfolio is concentrated (72.3 percent of the total loan portfolio) are Bishkek city, Chui, Osh and Jalal-Abad oblasts, which is due to the highest level of business activity in these oblasts of the republic.

²⁸ Exclusive of "FCCU" OJSC.

²⁹ Data for the period.

Revenue Position³⁰

Chart 3.1.4. Dynamics of NBFCOs Revenue Position³¹



At the end of 2019, net profit of NBFCOs increased by 34.0 percent compared to 2018 and amounted to KGS 2.3 billion. In 2019, ROA increased by 0.2 p.p. and amounted to 10.0 percent. ROE increased by 1.6 p.p. and constituted 18.0 percent (Chart 3.1.4).

Source: NBKR

³⁰ ROA and ROE indices are provided in annual terms.

³¹ Exclusive of “FCCU” OJSC.

3.2. Risks of Non-banking Financial-Credit Organizations

Major risk factors of the activities of NBFCOs are the quality of the loan portfolio, sectoral and institutional concentration, as well as status of the NBFCOs external debt.

Quality of the NBFCOs Loan Portfolio

At the end of 2019, the share of non-performing loans in the loan portfolio of NBFCOs constituted 3.9 percent, meanwhile, their nominal volume increased by KGS 138.6 million or 19.2 percent compared to 2018 (Chart 3.2.1).

At the end of 2019, the structure of NBFCOs non-performing loans demonstrated decrease in the share of defaulting loans issued to agriculture (by 4.3 p.p.) and increase in the share of defaulting loans issued to trade (by 2.1 p.p.) compared to 2018. The share of defaulting loans issued to agriculture and trade in the total non-performing loans of NBFCOs constituted 16.9 and 33.5 percent, respectively (Chart 3.2.2).

Chart 3.2.1. Quality of NBFCOs Loan Portfolio

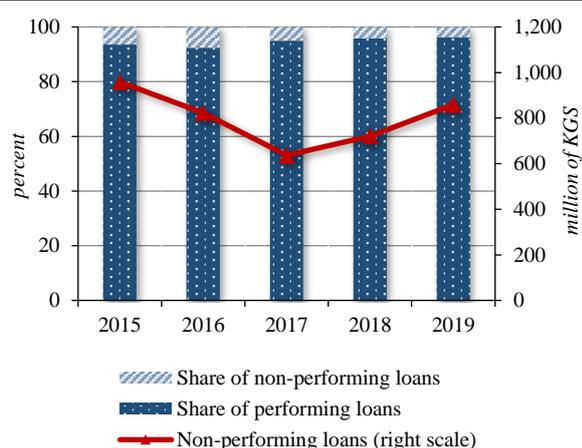
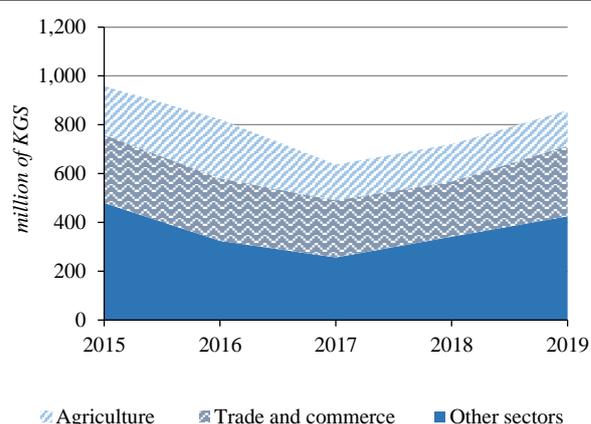


Chart 3.2.2. Structure of NBFCOs Non-performing Loans by Sectors of Economy



Source: NBKR

Source: NBKR

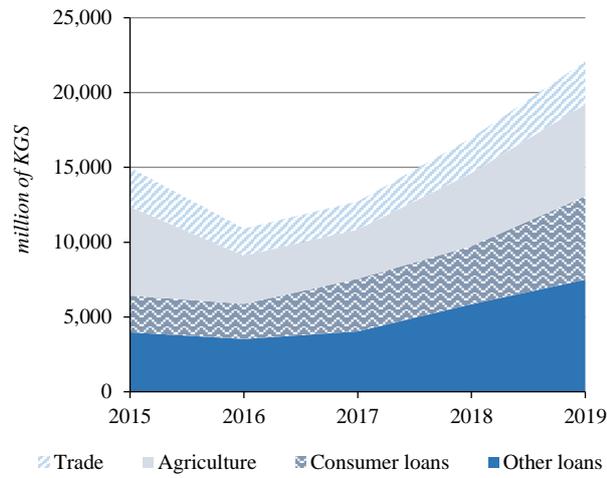
Sectoral Concentration

NBFCOs loan portfolio is concentrated in the sphere of agriculture (27.7 percent of NBFCOs total loans), as well as consumer loans and trade (25.3 percent and 13.1 percent of the total loan portfolio, accordingly, Chart 3.2.3). Lending of agriculture is associated with a high risk because of their dependence of climate conditions.

Institutional Concentration

At the end of 2019, the share of assets of the three largest NBFCOs increased by 2.2 p.p. compared to 2018 and amounted to 52.5 percent of the total assets of NBFCOs system (Chart 3.2.4).

Chart 3.2.3. Sectoral Structure of NBFCOs Loan Portfolio



Source: NBKR

Chart 3.2.4. Institutional Structure of NBFCOs Assets



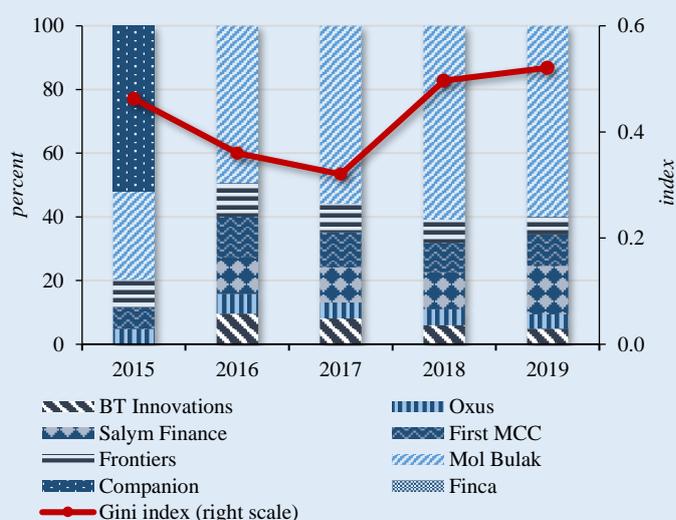
Source: NBKR

Box 6. Concentration Indices based Assessment of NBFCOs System Activity³²

The Herfindahl-Hirschman Index

Herfindahl-Hirschman index was calculated for the purposes of concentration risk analysis in the NBFCOs system³³. As of the end of 2019, Herfindahl-Hirschman index for the NBFCOs system constituted 1,527.2 points. According to the rule of thumb³⁴, resulting value indicates availability of moderate concentration of NBFCOs assets or moderate concentration of microfinance market.

Chart 1. Dynamics of the Gini Index and Assets of 6 Largest NBFCOs



The Gini Index

The Gini index was calculated for estimating the uniformity of the NBFCOs assets distribution. As of the end of 2019, the index value constituted 0.52 with simultaneous increase of concentration level (Chart 1).

Source: NBKR

³² Concentration indices are calculated on the basis of data submitted by 6 largest NBFCOs.

³³ $H = \sum_{i=1}^n (share\ i)^2$.

³⁴ The following rule of thumb was used for determining the level of market concentration:

- index value is below 0.1 (or 1,000) – insignificant market concentration,
- index value is from 0.1 to 0.18 (or from 1,000 to 1,800) – average market concentration,
- index value is above 0.18 (or 1,800) – high market concentration.

External Debt Status of NBFCOs

As of the end of 2019, the external debt of NBFCOs amounted to USD 84.9 million. Major part of the external debt of NBFCOs are loans provided by the foreign financial-credit organizations (97.3 percent of the total external debt of NBFCOs), and the rest (2.7 %) are loans of the international financial institutions.

At the end of 2019, external debt of the largest NBFCOs increased by 29.3 percent compared to 2018 and amounted to USD 73.4 million.

3.3. Stress Testing of NBFCOs System

Stress Testing of the NBFCOs Credit Risk

Stress testing, in which the effect of deterioration of the loan portfolio quality on the NBFCOs system as a whole is calculated, was conducted.

Three scenarios were considered when conducting stress testing:

Scenario 1: 50% of loans transition from one category to another;

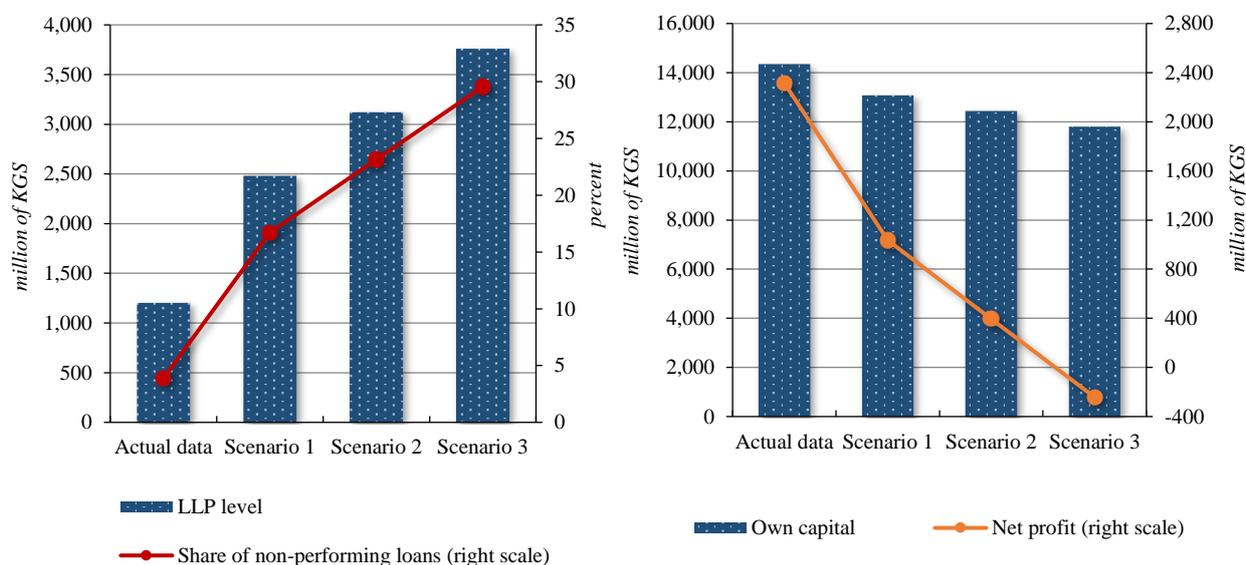
Scenario 2: 75% of loans transition from one category to another;

Scenario 3: 100% of loans transition from one category to another.

The transition of loans from one category to another occurs uniformly by the following categories: “standard”, “under supervision”, “substandard”, “doubtful” and “losses”.

The level of loan loss provisions³⁵ in the loan portfolio of NBFCOs increased from 106.3 to 212.6 percent, depending on the scenario in conducting this stress testing (Chart 3.3.1).

Chart 3.3.1. Results of Stress Testing of the Credit Risk as of December 31, 2019



Source: NBKR

It should be noted that the deterioration of the loan portfolio quality entails a gradual decline in equity and net profit of NBFCOs. In case of the first and second scenario implementation, the NBFCOs remain profitable, however, profit decreases from KGS 1,036.2 down to KGS 396.8 million, accordingly. The NBFCOs may experience losses in the amount of KGS 242.7 million due to implementation of the third scenario (Chart 3.3.1).

³⁵ MFOs create general and special loan loss provisions for relevant categories of classifications implementing the following allocations indicated in percentage from the amount of assets:

- Standard, in % - from 0 to 5;
- Assets under supervision, in % - 10;
- Substandard, in % - 25;
- Doubtful, in % - 50;
- Losses, in % - 100.

Table 3.3.1. Results of Stress Testing of the Credit Risk, percent

	Share of non-performing loans in the loan portfolio of NBFCOs
Scenario 1: transition of 50% of loans from one category to another	16.7
Scenario 2: transition of 75% of loans from one category to another	23.1
Scenario 3: transition of 100% of loans from one category to another	29.6

Source: NBKR

Implementation of the first scenario may result in an increase in the share of non-performing loans in the loan portfolio of NBFCOs by 12.8 p.p., to the level of 16.7 percent. In the case of the second scenario, non-performing loans may increase by 19.2 p.p., to the level of 23.1 percent, and in the implementation of the third scenario – by 25.7 p.p. and may reach the level of 29.6 percent.

IV. PAYMENT SYSTEMS

The period from the end of January to the first half of March 2019 was characterized by an increase in the level of risk in the payment system of the Kyrgyz Republic due to operational risks and blocked accounts and assets of two operators of the payment acceptance systems in favor of third parties. These circumstances entailed delay in making payments and final settlements with the participants and the agents of these systems. The identified risks did not entail a systemic risk for the financial system.

In 2019, due to the identified risks, the National Bank took measures aimed at updating the systemically important payment systems, minimizing operational and financial risks in the payment infrastructure and retail payment systems by reviewing the requirements for the operators of the retail payment systems and payment organizations.

In general, during 2019, the level of risks in the systemically important and significant payment systems was minimal and was due to the existing sufficient level of liquidity provided for in the systems by the risk management tools.

Effective and uninterrupted payment system is one of the main factors, which contribute to stability of the financial sector in the country.

As of December 31, 2019, the following components of the payment system were operating in the Kyrgyz Republic:

1. Large Value Payment System of the National Bank – Real Time Gross Settlement System (RTGS).

2. Retail Payments Systems: the Bulk Clearing System (BCS), Cards Payment Systems, Money Transfer Systems, e-money payment systems.

3. Financial Messages Inerchange Infrastructure (SWIFT Service Bureau, Interbank Communication Network (hereinafter – ICN)).

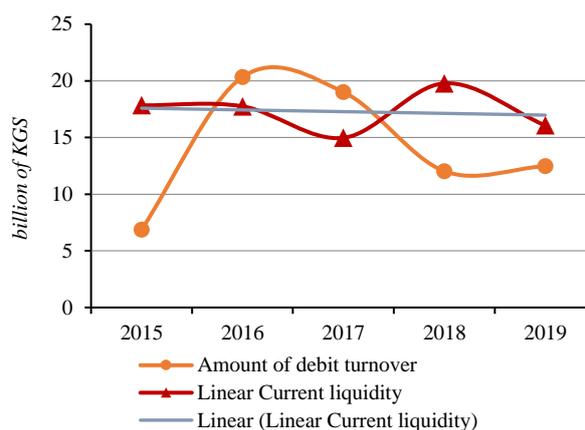
The RTGS functioned normally during 2019.

The level of financial risks in the **RTGS** remained low due to high level of liquid funds on the participants' accounts in relation to the turnovers in the system (liquidity ratio was 1.3 and the turnover ratio was 0.8). Average daily volume of the participants' liquid assets showed decrease by 18.78 percent (compared to 2018) and amounted to KGS 16.1 billion (Chart 4.1).

During 2019, the RTGS affordability ratio remained high and constituted 100.0 percent; meanwhile, the level of operational risk (taking into account prolongation of the transaction day) was 3.9 percent.

The RTGS is a systemically important payment system, failures thereof can cause serious shocks for the banking system and the whole financial system.

Chart 4.1. Dynamics of Changes of Daily Average Indicator of Payment Volumes and Liquidity in the RTGS



Source: NBKR

In functioning of the **SBC** the level of financial risks in 2019 was also low. Reserves exhibited by the participants to cover a debit net position were almost 5 times higher than the required level. According to the results of the SBC operation monitoring, the system affordability ratio remained as high as in 2018 and amounted to 100.0 percent during 2019. Meanwhile, the level of operational risk was

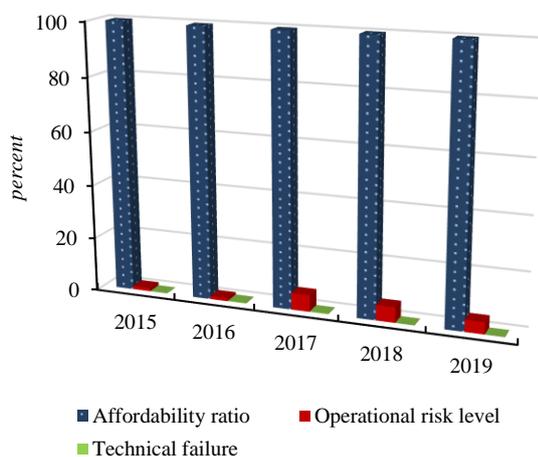
4.5 percent (Chart 4.3) due to extending the operating procedure upon request of the system participants and listed below failures.

Systems of Bank Payment Cards Settlements. As of January 1, 2020, five international payment card systems, the national system “Elcard” and co-badged cards “Elcard-UPI”³⁶ operated in the Kyrgyz Republic.

In 2019, 23 commercial banks worked with the national system “Elcard”. The results of operation monitoring and analysis indicated that the system affordability ratio was 99.8 percent, and the level of operational risks in the system, taking into account technical failures, was 0.2 percent (Chart 4.4).

Money transfer systems. During 2019, receipt and transfer of international remittances without opening an account in the commercial banks was carried out by means of nine international money transfer systems (Table 4.1).

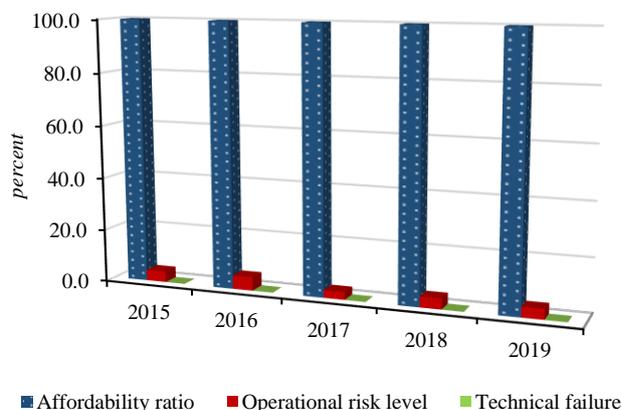
Chart 4.3. Ratio of Affordability Index and Operational Risks in the SBC



	2015	2016	2017	2018	2019
Technical failure, %	0.0	0.3	0.2	0.0	0.0
Affordability ratio, %	100.00	99.7	99.8	100.0	100.0
Operational risk level, %	1.2	1.2	6.2	5.8	4.5

Source: NBKR

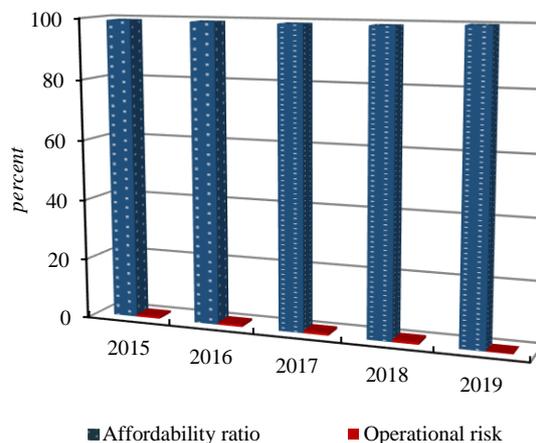
Chart 4.2. Ratio of Affordability and Operational Risk in the RTGS



	2015	2016	2017	2018	2019
Technical failure, %	0.0	0.0	0.0	0.0	0.0
Affordability ratio, %	100.0	100.0	100.0	100.0	100.0
Operational risk level, %	4.1	5.2	2.9	4.1	3.9

Source: NBKR

Chart 4.4. Ratio of Affordability Index and Operational Risk in the SIPC



	2015	2016	2017	2018	2019
Affordability ratio, %	99.3	99.2	99.1	99.2	99.8
Operational risk, %	0.7	0.8	0.9	0.8	0.2

Source: NBKR

³⁶ In accordance with the Regulation “On Bank Payment Cards in the Kyrgyz Republic”, a co-badged card is a card issued within the framework of two payment systems. Thus, Elcard-UPI is serviced in the territory of the Kyrgyz Republic according to the rules of the Elcard system, and Union Pay - outside the country.

Table 4.1. Distribution of Flows among International Money Transfer Systems

Money transfer system	Incoming		Outgoing	
	Share of the total number, in %	Share of the total volume, in %	Share of the total number, in %	Share of the total volume, in %
Zolotaya Korona	83.4	74.4	82.8	81.8
Unistream	6.3	9.2	2.3	6.1
Western Union	6.6	7.6	4.9	4.6
CONTACT	2.4	4.6	9.1	6.3
Money Gram	0.8	1.9	0.8	1.1
Other	0.6	2.2	0.1	0.1
Total	100.0	100.0	100.0	100.0

Source: NBKR

Regarding **local money transfers**, relatively even distribution among five local money transfer systems is currently observed, the banks of the Kyrgyz Republic are operators thereof.

At the end of 2019, the exchange of cross-border financial messages was carried out through the SWIFT network and the bank-client services, meanwhile the main flow was processed in the SWIFT telecommunication network.

SWIFT is the main channel for the banking system to securely exchange cross-border financial messages with its correspondent banks. Since January 1, 2019, the National Bank established the SWIFT Service Bureau that meets the SWIFT requirements to minimize the dependence of the banks on the foreign service bureaus and reduce the financial burden.

Currently, the National Bank and 15 commercial banks of the Kyrgyz Republic work through the SWIFT Service Bureau.

The results of monitoring over the functioning of the Kyrgyz Republic payment system during 2019 show that all significant payment systems functioned normally and did not cause any systemic risk for the financial system of the country.

V. IMPROVEMENT OF THE FINANCIAL SECTOR REGULATION

During 2019, improvement of the regulatory legal framework governing the activities of the banks, including those operating in accordance with the principles of Islamic banking and finance, was aimed at reducing banking risks, expanding access to banking services, as well as creating opportunities for remote servicing of the population by the financially and credit organizations.

The National Bank carried out work to bring regulatory legal acts in line with the legislation of the republic and the international standards to ensure safety and reliability of the banking system, maintain the capital base of the banks and increase the competitiveness of the banking sector within the framework of building a common financial market for the EAEU.

1) The Board of the National Bank of the Kyrgyz Republic adopted the Resolution “On introduction of amendments into some regulatory legal acts of the National Bank of the Kyrgyz Republic” No. 2019-P-12/11-1-(NPA) on March 14, 2019 to ensure safety and reliability, as well as to maintain the capital base of the banking system necessary to cover banking risks.

The Resolution defines the authority of the Supervisory Committee of the National Bank of the Kyrgyz Republic in establishing the value of the index “capital buffer” for all commercial banks.

2) The Regulation “On minimum requirements for liquidity risk management in the commercial banks of the Kyrgyz Republic” was approved by the Resolution of the National Bank Board No. 2019-P-12/17-3-(NPA) on March 29, 2019 to properly manage liquidity risk in accordance with the standards of the Basel Committee on Banking Supervision.

This regulatory legal act provides the requirements for the system, structure and process for managing liquidity risk to ensure an adequate internal control system in the commercial banks.

3) On April 10, 2019, the National Bank adopted the Resolution of the Board of the National Bank of the Kyrgyz Republic “On introduction of amendments into some regulatory legal acts of the National Bank of the Kyrgyz Republic” (in the Regulations “On the temporary administration” and “On liquidation procedure of the banks”).

These amendments were introduced to bring them into line with the legislation (the Laws of the Kyrgyz Republic “On the National Bank of the Kyrgyz Republic, banks and banking activity”, “On enactment of the Law of the Kyrgyz Republic “On the National Bank of the Kyrgyz Republic, banks and banking activity” and the Civil Code of the Kyrgyz Republic).

The following amendments were introduced by the aforementioned Resolution:

- a clarification has been made regarding remuneration of the Temporary Administrator appointed to the bank in cases when the bank where the Temporary Administrator is appointed does not have liquid funds for remuneration;

- the terms for consideration and provision of information by the Temporary Administrator have been revised;

- the procedure for determining remuneration to the liquidator, which is established by the court as agreed by the National Bank, has been changed;

- the procedure for provision of the funds and the types of administrative expenditures at the expense of the National Bank’s own funds during banks liquidation is provided

4) The Board of the National Bank adopted the Resolution “On introduction of amendments into the following regulatory legal acts of the National Bank of the Kyrgyz Republic” No. 2019-P-12/20-2-(NPA) on April 15, 2019 within the framework of providing assistance in implementation of the Affordable Housing 2015-2020 Government Program of the Kyrgyz Republic and development of the mortgage securities market:

- the Regulation “On prudential standards and requirements binding on the commercial banks of the Kyrgyz Republic”;

- the Instructions for determining the capital adequacy ratios of the commercial banks in the Kyrgyz Republic;

- the Regulation “On classification of the assets and related contributions to the loan loss provisions”.

5) Amendments and additions were approved to some regulatory legal acts of the National Bank by the Resolution of the Board of the National Bank No. 2019-P-12/22-4-(NPA) on April 24, 2019, namely:

- the banks were provided with the possibility to use a credit rating system in lending activities, which contributes to optimization of the banks’ activities on loans extending;

- classification of collaterals for loans was introduced;

- the possibility was envisaged for the banks to accept guarantees/sureties as full security for loans.

The adopted amendments and additions are aimed at expanding the availability of financing in the republic.

6) The Board of the National Bank of the Kyrgyz Republic adopted the Resolution “On introduction of amendments into some regulatory legal acts of the National Bank of the Kyrgyz Republic” regarding the use of e-signature No. 2019-P-12/32-3-(NPA) on June 19, 2019 to limit the risks of individual operations, as well as to clarify the relationship between the banks and other supervised organizations providing remote services.

The adopted amendments are aimed at expanding the possibilities for remote servicing of the population by the financial and credit organizations.

Moreover, the procedure has been determined for technologies currently used by the commercial banks, such as Internet banking, mobile banking, e-wallets and other electronic interaction technologies that have codes, passwords and other identifiers to implement legally significant actions with limited risks for certain operations. Meanwhile, the users of the remote service systems, if there is an agreement on the recognition of an electronic signature as an identifier, will have the opportunity to open additional accounts/deposits, to receive loans for certain amounts, as well as other operations requiring mandatory presence of a paper contract or signature. Thus, conditions will be created for identified users to receive banking and payment services without additional visits to the financial institution where they are served.

7) Amendments and additions were adopted to some regulatory legal acts by the Resolution of the National Bank Board No. 2019-P-12/34-3-(NPA) on June 28, 2019 to bring the regulatory acts of the National Bank in line with the international standards “Basel III: a global regulatory framework for more resilient banks and banking systems” of the Basel Committee on Banking Supervision.

Amendments and additions revised the capital structure of the banks and calculation of the capital adequacy ratios, and introduced a new prudential standard in accordance with the international standards of Basel III. Moreover, criteria have been established with the individual elements of capital to meet them.

The Resolution also contains amendments and additions aimed at improving the forms of the periodic regulatory banking report and the corporate governance system in the banks.

8) New versions of the Provisions “On consolidated supervision” and “On periodic regulatory consolidated reporting” were adopted by the Resolution of the National Bank Board No. 2019-P-12/34-4-(NPA) on June 28, 2019 to improve the regulatory legal acts of the National Bank, taking into account the risk-based approach in supervision, as well as international practice of regulation and supervision of the banking groups. The specified regulatory legal acts are aimed at improving supervision of the banking groups, identifying the risks and impact that a banking group has on its participants, as well as on the composition of the report submitted by the banks to the regulator.

9) New revisions of the following regulatory legal acts were adopted by the Resolution of the National Bank Board No. 2019-P-12/42-1-(NPA) on August 14, 2019 due to adoption of new legislation on counter-terrorism financing and anti-money laundering:

1. The Regulation “On minimum requirements for arrangement of internal control in the commercial banks to counter the financing of terrorism and legalization (laundering) of criminal proceeds”;

2. The Regulation “On procedure for conducting exchange operations with foreign currency in cash in the Kyrgyz Republic”.

The Resolution also introduced relevant amendments and additions into 16 regulatory legal acts of the National Bank. The decision entered into force on November 1, 2019.

These regulatory legal acts establish the requirements for implementation of the internal control program in the banks for CTF/AML, and for applying a risk-based approach by the banks when conducting a due diligence of a client for the operations subject to monitoring and reporting to a financial intelligence agency and other issues.

10) the resolution “On introduction of amendments into the Resolution of the Board of the National Bank of the Kyrgyz Republic “On approval of the Regulation “On licensing the activities of banks” No. 2017-P-12/23-1-(NPA)” dated June 8, 2017 was adopted by the Board of the National Bank of the Kyrgyz Republic on August 21, 2019 to provide the residents of the remote regions of the country with accessible banking services, as well as to resolve the issues related to processing of the personal data provided to the National Bank, as part of the licensing procedures.

The Resolution contains the procedure for implementing the activities of the commercial banks’ mobile offices and obtaining consent from the persons providing personal data for processing thereof and transfer to third parties, as well as questions on regulation of the rules for connectedness and affiliation of the companies.

11) The following decisions were approved by the resolutions of the National Bank Board on October 30, 2019 to improve the regulatory legal acts of the National Bank in terms of managing market risk (interest rate risk) and bringing them in line with the international standards of the Basel Committee on Banking Supervision:

- The Regulation “On requirements for disclosing information on the activities of a commercial bank,” according to which the banks determined by the National Bank Board must publish on their official website the quarterly and annual reports containing qualitative and quantitative information on capital adequacy, corporate governance and risk management in the bank;

- Amendments and additions to some regulatory legal acts of the National Bank of the Kyrgyz Republic. These amendments and additions disclose the procedure for the commercial banks of the Kyrgyz Republic to determine the degree of banking portfolio exposure to the interest rate risk and provide for revision of the gap analysis methodology as part of the interest rate risk assessment, as well as are focused to eliminate duplication on information disclosure.

12) The Resolution “On the main directions of digital transformation of the banking services in the Kyrgyz Republic for 2020-2021” No. 2019-P-12/56-2-(BS) was adopted by the National Bank Board on November 15, 2019.

This document is designed to create and expand conditions for digital technologies development in the banking sector to contribute to provision of the high-quality and affordable banking services to a wider range of the consumers.

The National Bank, as the body that determines the policy for development of the banking system, has identified the main areas of development of the digital banking technologies that can be taken into account by the market participants to organize their own activities and to further develop business processes.

13) Within the framework of bringing the regulatory acts of the National Bank in line with the international standards of the Basel Committee on Banking Supervision, in particular Basel II and III, reducing the banking risks and within the framework of further harmonization of the legislation of the EAEU member states, the following was approved by the resolutions of the National Bank Board on December 27, 2019:

- The procedure for determining the level of capital required to cover operational risks of the banks;

- Amendments to a number of the regulatory legal acts of the National Bank on the issue of calculating the total capital adequacy ratio, taking into account operational risks, leverage ratio, as well as liquidity indicators in foreign currency;

- the Regulation “On prudential standards and requirements binding on the commercial banks of the Kyrgyz Republic”;

- the Regulation “On calculation of the liquidity coverage ratio of the commercial banks”.

Principles of Islamic Finance

1. The Resolution No. 2019-P-12/19-3-(NPA) was adopted of the Board of the National Bank on April 10, 2019 to reduce the risks in the activities of banks operating in accordance with the principles of Islamic banking and finance, and to encourage the banks to participate in the government programs related to financing of agriculture and export-oriented and import-substituting enterprises.

The Recommendations on provision of financing in accordance with the principles of Islamic banking and finance for agricultural development were approved by the Resolution of the National Bank Supervisory Committee No.16/6 on May 8, 2019. The recommendations are developed in the form of a brief guide for the financial and credit organizations of the Kyrgyz Republic on use of the Islamic financial products to finance various agricultural sectors in the country.

2. The Instruction for working with bank accounts, bank deposit accounts (deposits) opened in accordance with the principles of Islamic banking and finance was approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic No. 2019-P-12/31-2-(NPA) on June 13, 2019 to establish the minimum requirements for the mode of working with the bank accounts, bank deposit accounts (deposits) opened in accordance with the principles of Islamic banking and finance, and the procedure for conducting operations thereon.

GLOSSARY

A bank deposit is the amount of money, accepted by a financial-credit organization under contract from another person on the terms of repayment, payment and maturity. Deposits can be time and demand. Demand deposits are made without specifying the shelf life, and time deposits are made for a certain period.

A bank loan is money provided by a bank for a fixed period under the terms of re-payment and payment of loan interest.

A foreign exchange market is a market in which the purchase/sale of foreign currencies is made. By the economic content, it is a sector of the money market, where supply and demand for a specific product such as currency are balanced. According to its purpose and form of organization, it is a set of specific institutions and mechanisms that in concert provide an opportunity to freely sell and/or buy domestic and foreign currency on the basis of supply and demand.

A money market is a market in which there is the giving and receiving of funds in the form of loans and securities for a short term within the range of participants.

Return on securities is the ratio of the annual return on the security to its market price; the rate of return received by the owner of the security.

The housing affordability index is an indicator of the state of the housing market in terms of the possibility of acquiring apartments by the people. It is calculated as the ratio of the average market value of a standard apartment (total area of 54 sq. m.) to the average annual income of a family of three (two adults and a child).

The payment system affordability index is a measure of the availability of the system as access to services and information for users of the system on their demand. Downtime of the system due to technical failures, power outages, late opening or early closing of the trading day of the system reduce the time to access the system.

The liquidity ratio of payment systems characterizes sufficiency of liquid funds in the accounts of the participants of the system for the payments and settlements.

Macroprudential analysis is an assessment and monitoring of strong sides and vulnerable spots of the financial system taken as a whole.

Minimum consumer budget is the cost of a set of minimum benefits and services to the subsistence minimum.

A securities market is organized exchanges and structures (securities depository companies, accounting and clearing houses), as well as other companies that provide services related to the activities of the exchange. This category includes depositories and electronic clearing systems, the activity of which is ensured by financial corporations and national self-regulatory organizations of oversight over the activities of stock exchanges and related institutional units or their regulation.

Stress tests are methods used for assessment of profiles vulnerability with respect to significant changes in the macroeconomic situation or exceptional but possible events.

An unemployment rate is the percentage of the actual number of unemployed to the total economically active population.

Financial assets include equity instruments and units/shares of investment funds, debt instruments, derivatives, stock options for employees and monetary gold.

LIST OF ABBREVIATIONS

ADB	– Asian Development Bank
CAR	– Capital Adequacy Ratio
CB	– Commercial Bank
CPI	– Consumer Price Index
CTF/AML	– counter-terrorism financing and anti-money laundering
EAEU	– Eurasian Economic Union
FAO	– Food Agriculture Organization of the United Nations
FCCU (“FCCU” OJSC)	– “Financial Company of Credit Unions” OJSC
FCO	– Financial-Credit Organization
GDP	– Gross Domestic Product
GS	– Government Securities
HUS	– Housing and Utilities Sector
KR	– Kyrgyz Republic
KSE	– Kyrgyz Stock Exchange
LLP	– Loan Loss Provisions
LSF	– Large Sources of Financing
MF KR	– Ministry of Finance of the Kyrgyz Republic
MFO	– Microfinance Organization
NBFCOs	– Non-banking Financial-Credit Organizations
NBKR	– National Bank of the Kyrgyz Republic
NBRK	– National Bank of the Republic of Kazakhstan
NLA	– Normative Legal Acts
NSC KR	– National Statistical Committee of the Kyrgyz Republic
NTC	– Net Total Capital
OCP	– Open Currency Position
OECD	– Organization for Economic Cooperation and Development
OJSC	– Open Joint-Stock Company
POL	– Petroleum, Oil, Lubricants
p.p.	– percentage points
PRBR	– Periodic Regulatory Bank Reporting
RF	– Russian Federation
RK	– Republic of Kazakhstan
ROA	– Return on Assets
ROE	– Return on Equity
RTGS	– Real Time Gross Settlement System
SBC	– System of Batch Clearing
SIPC	– Single Inter-bank Processing Center
SRS GKR	– State Registration Service under the Government of the Kyrgyz Republic
ST-Bills	– State Treasury Bills
ST-Bonds	– State Treasury Bonds
S	– Securities
USA	– United States of America
VaR	– Interest Rate Risk