

**National Bank of the Kyrgyz Republic**

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**Inflation Report**

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**Bishkek**

## ***Inflation Report***

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The purpose of the publication “Inflation Report” is informing of broad public about the goals and results of the monetary policy. The publication contains the description of inflation developments by its components, by regions, and as a whole, the analysis of inflation factors and inflation forecast for the forthcoming quarter. The report is published quarterly in the Kyrgyz, Russian and English languages.

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

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The Press-Release of the NBKR contains the weekly chronicles of the developments in the National Bank and major data of the financial market. It is published quarterly in the Kyrgyz and Russian languages.

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## 1. CURRENT DEVELOPMENTS

According to the preliminary data of the National statistical committee for the first quarter of 2006, the gross domestic product grew by 2.4 percent concerning the corresponding period of 2005. Growth rate in gross domestic product excluding production of gold-mine combine «Kumtor» made 6.5 percent. The value added in industry reduced by 9.1 percent. The value added registered in agriculture and construction rose by 0.9 and 7.7 percent, respectively. Trade, transport and communications gained 16.1 and 5.0 percent, respectively.

Preliminary trade balance of the Kyrgyz Republic for January - March developed negative and made US128.5 million. The foreign trade turnover in f.o.b. prices grew by 20.7 percent. Export of goods in f.o.b. prices increased by 3.0 percent. Import of goods grew by 34.0 percent. Thus, import of goods from the CIS countries and non-CIS countries increased by 39.4 and 25.6 percent, respectively.

On the end of the first quarter, the money multiplier made 1.4. Velocity developed at a level 4.77 turnover. The monetization made 21.0 percent.

For the first quarter, the average level of interest rates in the inter-bank credit market decreased in comparison with the fourth quarter of 2005 by 0.2 percentage points. Average interest rate on repo operations and inter-bank credit in the national currency reached 3.2 and 3.1 percent, respectively. Average level of profitability on notes of the National bank decreased by 1.4 percentage points and made 3.5 percent.

On the end of March, the average weighted by all kinds of state treasury bills interest rate made 6.7 percent, which is lower in comparison with the beginning of the quarter by 1.5 percentage points. Average yield of state treasury bills for the quarter reduced by 0.8 percentage points and made 7.2 percent.

According to the National statistical committee, inflation

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<sup>1</sup> Estimation of multiplier, velocity and monetisation is based on money aggregate M2X.

in the first quarter of 2006 made 3.0 percent (in the first quarter of 2005 the given parameter grew by 1.3 percent). In second quarter of 2006, the growth rate in consumer prices by 2.5 percent is expected.

## 2. CONSUMER PRICE INDEX AND ITS COMPONENTS

### 2.1. COMPONENTS OF CONSUMER PRICE INDEX

In first quarter, according to the National statistical committee inflation rate made 3.0 percent (in first quarter of 2005 consumer prices rose by 1.3 percent). Dynamics of inflation was mainly determined by seasonal increase in consumer prices during the winter, in particular, on some foodstuffs, gas and firm fuel, and transport services.

#### 2.1.1. Food products

Reduction in output of agriculture by 4.2 percent in 2005 has been strengthened by seasonal increase in prices on food, which made 6.9 percent.

Total grain-crops reduced by 4.5 percent compared with 2004, wheat harvest decreased by 4.8 percent. The potato crop decreased by 16.2 percent, vegetables – by 0.7 percent, berries – by 16.6 percent. Sugar beet crop dropped by 45.0 percent in comparison with 2004.

Decrease in agriculture output led to increase in prices on fruit-and-vegetables by 24.7 percent, vegetables became more dear by 34.1 percent, fruits – by 12.8 percent. For the corresponding period of 2005 fruit and vegetable prices gained 23.9 percent.

As a result of poor harvest of sugar beet there was a slump in production of sugar that caused increase in the prices on sugar and confectionery products by 25.0 percent. The prices under item “oil and fats” grew by 4.6 percent. Also, reduction in prices on milk and dairy products by 3.2 percent was observed.

#### 2.1.2. Non-food products

The price index on non-food articles in the first quarter of 2006 grew by 1.0 percent. The greatest increase in prices was registered on gas (9.9 percent) and materials for the maintenance and repair of premises (6.4 percent).

Decrease in prices on oil products, especially gasoline and

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

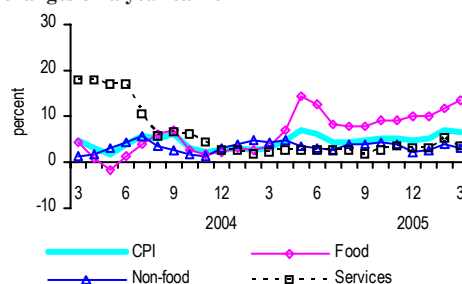


Chart 2.2: Structure of CPI, percent

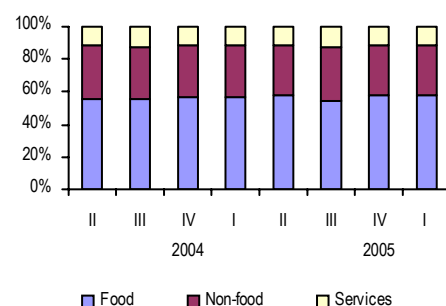


Chart 2.3a: Food Prices, percentage changes on a year earlier

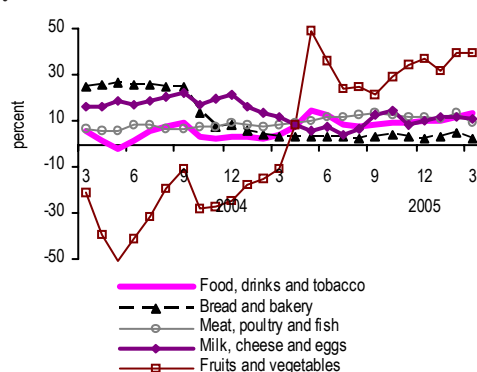


Chart 2.3b: Food Prices, percentage changes on a year earlier

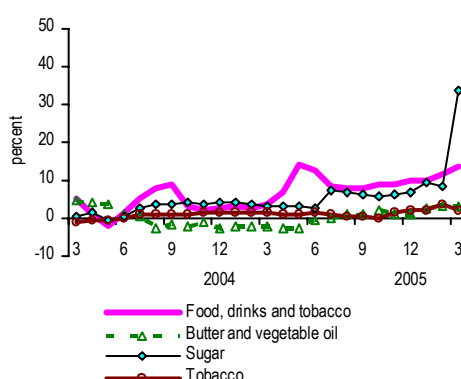


Chart 2.4a: Non-Food Prices, percentage changes on a year earlier



diesel fuel, which became cheaper by 8.4 and 0.9 percent, respectively, was the principal factor that rendered constraining influence on further rise in non-food prices.

### 2.1.3. Services

The price index on paid services in the first quarter of 2006 grew by 0.2 percent. In particular, growth in prices was observed for repair of footwear (by 4.5 percent), services on the organisation of cultural actions (by 2.3 percent), transport services (by 0.8 percent).

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

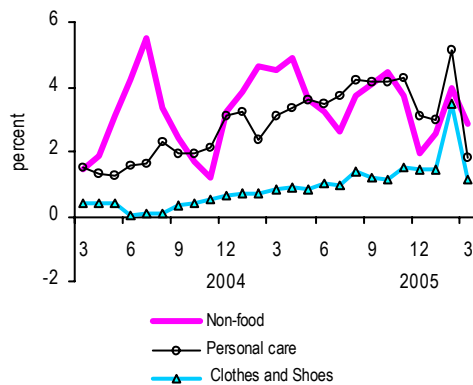


Chart 2.5a: Service Prices, percentage changes on a year earlier

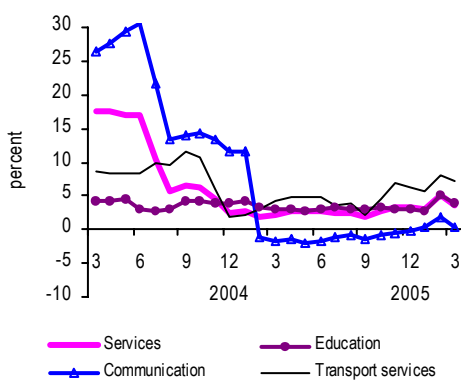
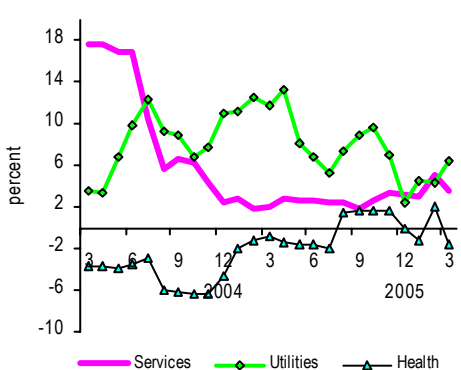


Chart 2.5b: Service Prices, percentage changes on a year earlier





## 2.2. CONSUMER PRICES BY REGIONS

In first quarter, there was an increase in consumer prices in all regions. The greatest inflation was observed in Jalal-Abad *oblast*, where consumer prices grew by 5.1 percent, including growth rate in price on food stuffs (12.9 percent), non-food items (0.2 percent) and services (0.5 percent). Also, consumer prices grew considerably in Osh *oblast*, inflation rate made 4.5 percent, thus, the prices on foodstuffs grew by 10.4 percent, and non-food prices and services gained 1.8 and 1.9 percent, respectively.

The least growth rate in prices was marked in Batken *oblast*, where inflation made 1.9 percent, and it developed as a result of increase in prices on food stuffs by 3.3 percent, on non-food items (by 2.1 percent), on paid services (by 0.4 percent).

Chart 2.6a: Consumer Prices by Oblasts (Regions), percentage changes on a year earlier

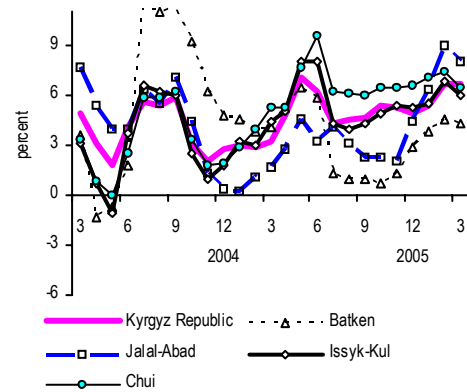
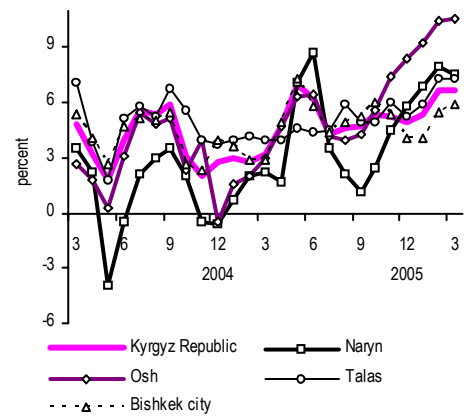


Chart 2.6b: Consumer Prices by Oblasts (Regions), percentage changes on a year earlier

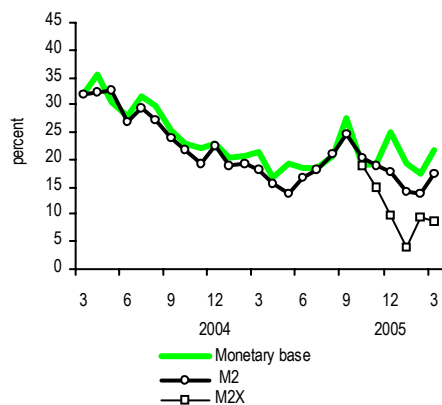


### 3. INFLATION FACTORS

#### 3.1. MONETARY AGGREGATES

##### 3.1.1. Monetary base

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



The monetary base for first quarter reduced by 0.8 percent. Growth rate in monetary base in a year made 21.8 percent.

Reduction in monetary base on 117.9 million Soms developed as a result of Ministry of Economy and Finance operations, which caused decrease in monetary base on 507.5 million Soms, and operations of the National bank, which promoted increase in monetary base by 389.7 million Soms. Money in circulation reduced by 0.6 percent, thus, growth rate in money in circulation in a year made 13.6 percent.

For first quarter there was some increase in cash in circulation share which grew on 0.2 percentage points and made 86.9 percent. Accordingly, the share of commercial bank balances at the National bank decreased from 13.3 to 13.1 percent.

##### 3.1.2. Aggregate M2

Monetary aggregate M2 increased by 0.6 percent. Growth rate in M2 in a year made 17.3 percent. Deposits in the national currency increased by 6.9 percent, including the gain of transferable deposits made 9.1 percent, other deposits – 2.4 percent. Growth rate in deposits in the national currency in a year made 36.2 percent.

##### 3.1.3. Aggregate M2X

Monetary aggregate M2X grew by 0.9 percent. Its increase took place due to depository base<sup>1</sup> of commercial banks rose by 3.7 percent, thus, cash outside of banks reduced

Structure of monetary aggregate M2X	A share, percent
Cash outside of banks	60.1
Deposits in national currency	14.3
Deposits in foreign currency	25.6
Monetary aggregate M2X	100.0

<sup>1</sup> Including banks, which license is withdrawn, but process of liquidation is not completed yet.

by 0.8 percent. Deposits in foreign exchange increased by 1.9 percent.

Money multiplier for M2X aggregate developed 1.4. Velocity of M2X made 4.77 turnover. The monetization of economy, designed on monetary aggregate M2X, made 21.0 percent.

### 3.2. INTEREST RATES

#### 3.2.1. Money market interest rates

In first half of quarter in all segments of the monetary market the decrease in interest rates caused by high liquidity of bank system was observed. So, profitableness of notes of the National bank to the middle of February decreased on 1.1 percentage points and made 3.0 percent, and the level of interest rates on inter-bank repo operations decreased with 3.4 up to 3.1 percent.

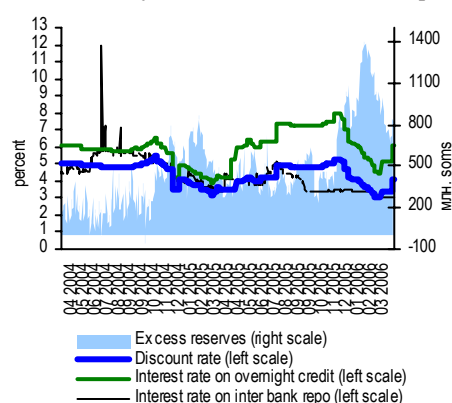
Since second half of February there was a reduction in demand for notes due to weak liquidity of the basic participants of the market and increase in profitableness which by the end of quarter reached 4.1 percent. So, three auctions on accommodation of notes in March did not take place because of weak activity of banks. Rates on inter-bank repo operations up to the end of quarter kept within 3.0-3.1 percent as liquidity in the banking system, though was reducing, but still remained at high level.

While prices on inter-bank credit in the national currency followed interest rates on inter-bank repo operations, however, its volatility was appreciably above. So, the interest rates on credits were fluctuating within 1.5-7.0 percent depending on term of transaction, presence and character of pledge.

On average for a quarter the interest rate in the inter-bank credit market decreased on 0.2 percentage points and on repo operations made 3.2 percent, and on inter-bank credit in the national currency totalled 3.1 percent. The average profitableness of notes decreased on 1.4 percentage points and made 3.5 percent.

In foreign exchange segment of the domestic inter-bank credit market, in first quarter interest rate were changing

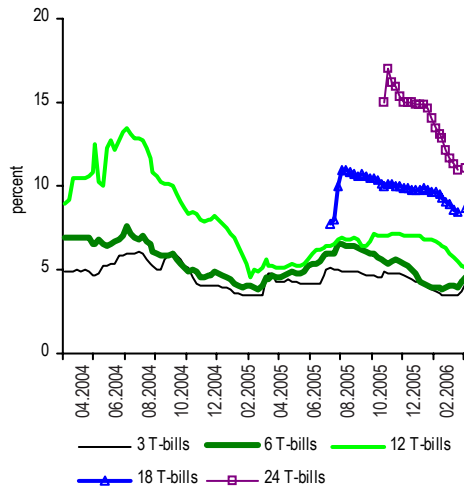
Chart 3.2: Money Market Interest Rates vs. Liquidity



within 4.0 to 7.0 percent depending on term of transaction. Average interest rate for a quarter developed at 5.7 percent, that 0.7 percentage points higher compared with the fourth quarter of 2005.

### 3.2.2. State treasury bills

Chart 3.3: T-bill Yields



The high level of excess reserves in the banking system during all but first quarter promoted decrease in profitableness for all kinds of state treasury bills (T-BILLS). Thus, rate of decrease in profitableness for different kinds of treasury bills developed depending on structure of demand. So, in January the strongest decrease manifested short-term T-BILLS (3- and 6-month), and since end of January more pronounced fall revealed middle term bills (12-, 18- and 24-month). The interest rates on T-BILLS were decreasing till middle of March when as a result of weak liquidity demand on T-BILLS significantly decreased, and demand<sup>1</sup> on some kind of T-BILLS was lacked. Thus, increase in profitableness for all kinds of bills excluding 12-month T-BILLS, that being in strong demand among commercial banks, was marked.

On the end of March the average interest rate for all kinds T-BILLS made 6.7 percent, decreasing in comparison with the beginning of quarter on 1.5 percentage points. The average level of T-BILLS profitableness in first quarter in comparison with the fourth quarter of 2005 decreased on 0.8 percentage points and made 7.2 percent. Thus, reduction in spread between profitableness of bills with the minimal and maximal maturity achieved 7.0 percentage points.

### 3.3. EXCHANGE RATE

The exchange rate of US dollar was fluctuating within 41.0-41.6 Soms a dollar, mainly, as a result of variations of foreign exchanges balances in commercial banks and exchange bureaux. Influence of external factors on development in US dollar exchange rate at domestic market was insignificant. The National bank did not take part in the foreign exchange tenders because foreign exchange market revealed stability.

<sup>1</sup> In March, fourth auction on accomodation of 18- and 24-month T-bills did not take place because of weak demand.

On average for quarter US dollar exchange rate formed at the foreign exchange tenders decreased by 0.39 percent, and the dollar exchange rate in exchange bureaux reduced by 0.55 percent. Thus, the exchange rate of cash in US dollar in exchange bureaux on the average for quarter was lower than exchange rate of cashless US dollar at the inter-bank foreign exchange tenders on 0.06 Soms.

The official US dollar exchange rate for first quarter raised by 0.17 percent. For the corresponding period of 2005 its value decreased by 0.80 percent. At the same time, in comparison with the first quarter of 2005 the amplitude of fluctuations in official US dollar exchange rate appreciably decreased. So, if for first quarter of 2005 the deviation of official US dollar exchange rate from its average made 1.9 percent, in 2006, the deviation reduced and totalled 0.5 percent.

Developments Euro rate at domestic foreign exchange market was, as usual, affected by fluctuations of Euro on international markets. Thus, volatility of Euro in comparison with the fourth quarter of 2005 significantly raised the range of fluctuations increased up to 2.0 from 1.3 Soms. The rate of sale of Euro in exchange bureaux raised by 2.5 percent, and official rate increased by 2.0 percent.

On the preliminary data average index of the real effective exchange rate for January - March decreased by 0.3 percentage points. Average index of the nominal effective exchange rate decreased by 0.6 percentage points.

### 3.4. DEMAND AND SUPPLY

#### 3.4.1. External demand

Preliminary trade balance of the Kyrgyz Republic for January – March developed negative and made US128.5 million in comparison with US57.1 million in January – March of 2005. The trade turnover in f.o.b. prices grew by 20.7 percent in relation to corresponding period of 2005. Thus, turnover increased with CIS countries as well non-CIS countries.

Export of goods in f.o.b. prices increased by 3.0 percent.

Chart 3.4: Cumulative Change in US dollar Exchange Rate, percent

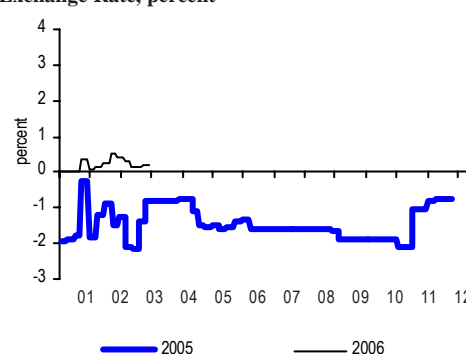
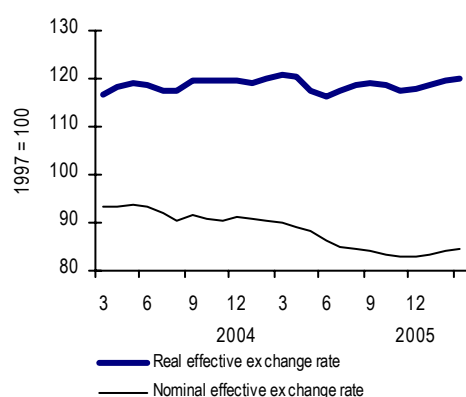


Chart 3.5: Effective Exchange Rate Indices



Without taking into account gold and electric power export of goods grew by 10.4 percent. However, in the first quarter export of raw material decreased by 20.8 percent, also, export of the intermediate goods reduced by 2.7 percent. Reduction in raw material export was connected to significant reduction in deliveries of mercury, tobacco and cotton. Decrease in export of goods on “the intermediate goods” basically was connected to reduction in deliveries of gold. Thus, value and physical value of gold export fall by 8.6 and 29.0 percent, respectively. For other articles of classification growth has been marked. Basically, the increase in export was caused by increase in deliveries of investment goods and energy by 80.4 and 30.0 percent, respectively.

For January - March, export to non-CIS countries increased by 3.3 percent, and deliveries in CIS countries rose by 7.5 percent. The share of export to non-CIS countries was still reducing, and for first quarter it made 58.6 percent. Accordingly, the share of export to CIS countries increased and made 41.4 percent. Among CIS countries the increase in export took place to Tadjikistan, Kazakhstan and Uzbekistan. Deliveries to Russia, Belarus and Ukraine reduced. Afghanistan, the Great Britain, Turkey, Switzerland were non-CIS countries, where export deliveries increased considerably.

On the preliminary data import of goods in f.o.b. prices for January – March grew by 34.0 percent. Import to CIS countries increased by 39.4 percent, and deliveries from non-CIS countries grew by 25.6 percent.

In first quarter, growth for all articles of functional classification was observed. The most substantial growth rate in import, which made 66.4 percent, was observed for «energy» article. The import of mineral oil, which occupies 50 percent of import deliveries of «energy», increased by 70.0 percent and its physical value rose by 35.8 percent. Also, «energy» article occupies in first quarter the biggest share out of import of goods, which makes 35.2 percent, that exceeds the level for corresponding period of 2005 on 7.0 percentage points.

The deliveries from CIS countries gained 36.3 percent, while import from non-CIS countries grew by 28.8 percent.

The share of CIS countries made 61.7 percent out of total import and it increased on 1.4 percentage points. Import of goods from Russia grew considerably – by 98.9 percent, basically, due to increase in deliveries of mineral oil, which made 64.0 percent out of import Russia. Deliveries from China increased by 157.8 percent, basically, deliveries of consumer goods, which occupies almost 93.0 percent out of total import from this country. Growth in deliveries from Netherlands by 43.4 percent was caused by increase in import of the equipment, lorries, spare parts for machines and the equipment, computer facilities and parts, chemical production. At the same time reduction of deliveries from Kazakhstan, Ukraine, the USA, Germany and Switzerland was observed.

### 3.4.2. Domestic demand

#### 3.4.2.1. Private consumption

On the preliminary data of the National statistical committee for February the wages increased by 15.5 percent. In real terms it gained 8.2 percent. The turnover of trade for first quarter grew by 13.8 percent.

#### 3.4.2.2. Public consumption

The revenues of the state budget for first quarter concerning the corresponding period of 2005 increased by 15.4 percent, salary payments grew by 24.1 percent. Expenditures of the state budget increased by 16.2 percent. Subsidies to the state enterprises grew by 15.9 percent. Capital investments and decreased by 41.1 percent.

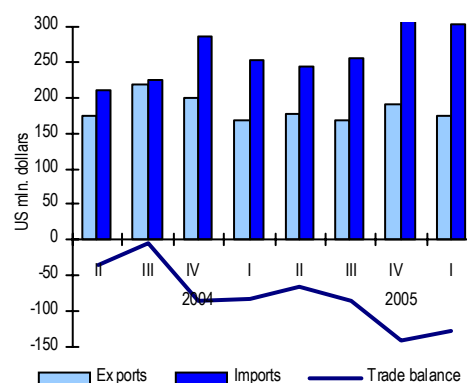
#### 3.4.2.3. Investment

For January - March according to the operative information of the National statistical committee investment into fixed capital (construction, reconstruction, expansion and modernisation of objects) increased by 2.9 percent concerning the corresponding period of 2005.

### 3.4.3. Output

On the preliminary data of the National statistical committee for first quarter the gross domestic product grew by 2.4 percent concerning the corresponding period of

Chart 3.6: Trade Balance



2005. Its gain without taking into account production of gold-mine combine «Kumtor» made 6.5 percent. The total value added of industry reduced by 9.1 percent. The value added in agriculture and construction rose by 0.9 and 7.7 percent, respectively. In trade, transport and communications the growth rate of value added made 16.1 and 5.0 percent, respectively.



## **4. MONETARY POLICY DECISIONS**

### **4.1. BOARD DECISIONS**

On January 11, 2006 the Board have listen the information «Of preliminary results of activity of the National bank of the Kyrgyz Republic in 2005».

The Board determined for 2006 the basic directions of the National bank activity:

- to meet inflation target;
- to promote further increase in financial intermediation of the banking system;
- to expand access of population in remote regions to financial services;
- to promote the bill «About counteraction to financing of terrorism and legalisation (washing up) of the incomes received in the criminal way» and continuation of work on performance of the stipulated actions on introduction of system of protection of deposits;
- to finalise creation of system of batch clearing and uniform inter-bank processing centre within the realisation of the state program on introduction of system of non-cash payments;
- to render assistance to the Government on the further reduction of the state external debt of the Kyrgyz Republic.

On March 2, 2006 the Board of the National bank of the Kyrgyz Republic considers and takes into account «The Report on monetary policy for 2005» (statement <sup>1</sup> 5/4).

### **4.2. MONETARY REGULATION COMMITTEE DECISIONS**

In first quarter, nine out of thirteen auctions on accommodation of 28-day notes are recognised taken place.

With a view of withdrawal of excess liquidity from banking system carrying out of auctions on sale of securities on conditions of repo operations under the rates, which are not exceeding the rates in the inter-bank market and for the term of up to 6-month was recommended. The

sale of T-BILLS (reconstructed) in first quarter totalled 85.0 million Soms.

The National bank did not carry out operation with foreign exchange in domestic market.

#### **4.3. INFLATION OUTLOOK FOR SECOND QUARTER OF 2006**

The National bank assumes that in the second quarter of 2006 consumer prices growth rate will be 2.5 percent.