

Statement of the Chairman of the NBKR at the Conference “Short-term Risk Management and Speeding Up Long-Term Economic Growth”

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Dear Ladies and Gentlemen,

I would like to express my gratitude to organizers of the conference for the opportunity to share the visions of the National Bank on the problems of ensuring macro-economic stability. Today, the key source of instability is acceleration of inflation growth rates caused by external factors, first of all – by a significant growth of prices for foodstuff and energy resources.

The NBKR’s monetary policy instruments have an impact on the general level of prices, but are not capable to have an influence on the prices of certain goods and services. The measures undertaken by the National Bank, have an impact on such macroeconomic (common for the whole economy) parameters, as money supply, discount rate, exchange rate, and cannot be applied to certain sectors of the economy or separate categories of citizens. The tasks of regulating prices for certain socially important goods and services, as well as of providing privileges to certain sectors of economy or re-allocating income among subjects of the economy, refer to the area of short-term structural policy. Therefore, given the current conditions, it is important to coordinate efforts of the Government, the National Bank and local government authorities. In this connection we place great hopes on the Interdepartmental Coordination Council consisting of representatives of the management of the Ministry of Finance, the Ministry of Economic Development and Trade, the National Statistical Committee and the National Bank.

Briefly about the measures undertaken by the National Bank in the sphere of the monetary policy to constrain growth in the general level of prices in the republic. In the second half of last year, in connection with an acceleration of inflation, the NBKR started pursuing a tighter monetary policy. The volumes of operations on money supply sterilization have been increased several times compared to the previous year, deposit operations have been introduced. The key instrument to regulate liquidity of the banking system last year was the NBKR’s notes. The volumes of sales of the NBKR’s notes during the second half of last year exceeded 4 billion soms, which is 20 times more than in 2006. As a result of transactions conducted by the NBKR, growth rates of money supply considerably decreased: the money supply in 2007 increased by 38.5 percent and totaled 31.6 billion soms, while in 2006 an increase in the money supply was 47.4 percent.

The measures undertaken by the NBKR to tighten the monetary policy, resulted into not allowing for a more significant splash of inflation caused by a significant growth in prices for staple foods and energy resources, as well as enabled to reduce the potential of price growth and restricted the monetary component of the inflation rate within 3.3 percent. According to our estimates the impact of inflationary expectations of the population on inflation made up 10.7 percent, and the largest contribution to growth in the total level of prices in the reporting year was that of non-monetary factors – 86 percent.

During the current year, due to maintaining high growth rates in the total level of prices the National Bank continues pursuing a tight monetary policy and its measures are aimed at reducing excess liquidity in the banking system, as one of the key conditions to limit the inflation potential. Growth in the money base from the beginning of the year as of June 18 was 0.6 percent, while for a similar period of last year – 6.9 percent.

Under the conditions, mainly of a non-monetary nature of inflation, fighting with the inflation pressure only using monetary methods will be of little effectiveness, or the price of such fighting will be so high, that it will have a negative impact on economy growth. An important factor here is structural changes in the economy, conducting a balanced monetary and fiscal policy. One should also take into account that social consequences of an abrupt growth in prices for food stuff and basic services, in particular for transportation and housing and utility services, in a short- and mid-term run can be extremely negative. In this connection we believe that the government bodies shall immediately find the ways to limit the inflationary pressure on the population.

The government has already envisaged the measures to support vulnerable strata of the population. However, the current situation in the sphere of prices is extraordinary and the government's measures shall be adequate. One can consider, for example, a possibility of when the Government will take over a part of price costs of domestic producers and suppliers of key types of products, together with the measures preventing large-scale export of subsidized products from the republic. At the same time one should pay attention to the fact that these should be the measures of a short-term period, which cannot and should not be applied for a long time.

Qualitative structural changes are required in a mid-term run. One of the tasks here is to create conditions stimulating domestic commodity saturation. Let me speak about several aspects of this challenge.

Our economy is mostly represented by small-scale production, when producers have few incentives and opportunities for renewal of fixed assets, introduction of new technological products and innovations. As a consequence, it becomes more and more difficult for us to compete in terms of labor productivity with neighboring countries – key trade partners of our country.

There is one more aspect – availability of labor resources and the quality of professional training. A high actual level of unemployment is actually higher than the one announced until recent times by official statistics – these are our realities. Washing out of labor resources from the country creates risks that in the nearest

future there would be no one to work in the country. A bright example is an acute shortage of professionally trained personnel required for construction of Kambarata HPPs.

And, finally, one more aspect is the presence of internal administrative barriers, impeding the start up and development of business activities in the country. We are happy that the Government has already started addressing this problem: a new version of the Customs Code has been developed and submitted for consideration to the legislative power; “one stop shop” is being introduced for registration procedures. The outcome of these initiatives in many aspects will depend on the quality of practical implementation of these projects.

Another important mid-term strategic task is transformation of the economy of the country from a consumer format into an investment one. Within the GDP structure, the share of consumption exceeds the GDP per se, and the share of investments is at a low level. The structure and depth of our country’s economy is such, that it does not represent any interest for large foreign capital and large inflows for foreign direct investments can be expected only to those sectors of the national economy, which can be competitive from the regional viewpoint. Under these conditions one shall put a stake on domestic investment opportunities and create conditions for growth in savings in the country.

Once again I would like to note that at present inflation is a key factor for macro-economic stability, which is the basis for ensuring quality long-term economic growth and, consequently, improving well-being of the population. The National Bank, as a monetary regulating body and a financial advisor to the President, the Government and the Jogorku Kenesh will continue taking necessary measures enabling to restrain inflation and maintain financial stability.