

Assessment of Monetary Policy in the Kyrgyz Republic

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Abstract

Kyrgyz Republic is a landlocked country located in Asia. This situation makes the economy of the country largely relying on the internal policies made with respect to the fiscal abilities of the country. From 2008 to 2012, the country has recorded challenges with respect to the management of its economy from both internal factors and external variables. The recession is one such external factor that is on record to affected the economy of the country. On the other hand inflation and political instability the position of the country with respect to the GDP and the social welfare of the nationals. This paper assesses the monetary policies adopted by Kyrgyz Republic in an effort to manage its economy. The study focuses on Structure of the Kyrgyz Monetary Policy, Monetary Policy Tools, Monetary Policy Strategies in the Kyrgyz, Kyrgyz Future Objectives of Monetary Policy and ultimately offers recommendation and a conclusion. Through this analysis, intricate details on the situation of the country and the effectiveness of the pursued policies towards their respective purpose is the main focus with the objective monetary policies in the context of relevance and appropriateness. In the course of the report knowledge on monetary dynamics and their effects both internationally and locally are explicated.

Keywords: Kyrgyz republic, Monetary policy, GDP, Social welfare assessment of monetary policy in the Kyrgyz Republic.

1. Introduction

Kyrgyz Republic is a landlocked country located in the eastern parts of Asia. The little known country has a Gross Domestic Product (GDP) of \$2.21 billion with a Gross Domestic Product per capita of US\$430 and an unemployment rate of 9.9 percent. The country has recorded positive trends in social-economic development from the beginning of 2010. The observed growth is because of the recovery of the global economy and an accelerated recovery of the country's economy following the 2009 financial depression. Kyrgyz Republic has recorded significant growth in GDP by 116% with high growth rates in industry of 178.8% and construction sector at 135.1% in the first quarter of 2010.

The country has directed its monetary policy based on the fiscal policy towards improvement of governance and public financial management with specific focus on the management of internal resources and social benefits. The country has observed sequential adjustment in the monetary policy system with review of the economic and social policy after the events in 2010 and 2011. The main objective of these was to stabilize the economy of the country. The country derives its policy based on strategies that are projected to overcome social consequences of an

ill monetary policy and the need for economic stability. This paper is an assessment of the Kyrgyz Republic monetary policy. The report critically analyses the policy formulation and direction in Kyrgyz Republic by assessing the structure of the monetary policy, the tools of monetary policy in Kyrgyz Republic, the monetary policy strategies, and the future objectives of the policies. The study proceeds to make recommendation on the monetary policy of Kyrgyz Republic.

2. Literature Review

The Kyrgyz Republic fiscal statistics indicate that the country recorded a high growth rate in economy of 8.4 percent in 2008. In 2009, the country recorded a slowdown in economic growth a phenomena that affected all the countries around the region. The slowdown was occasioned by the global financial crisis. It is recorded that the GDP volume of the country amounted to Som 196.4 billion 2009 which is a 2.3 percent increment (The Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic, 2012b). The political situation of the country resulted to a sluggish economic growth in 2010 Kyrgyz Republic recorded drop of 1 percent in GDP volume in that year. This incurred a reduction in investment in fixed asset by 2.3 percent. An assessment of the Fiscal policy of the country indicates that in 2008 to 2009 the fiscal policy was inclined towards the reforming of the tax policy. The process was completed 2008 and implemented from January 2009 (The Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic, 2011a). The process reorganized the fiscal policy by making changes such as a decrease in the value added tax (VAT) rate from 20 percent to 12 percent. The total amount of taxes imposed in Kyrgyz Republic was also reduced from 16 to 18 taxation provisions. The policy also made changes in the taxable base for sale tax and made changes with regard to the tax administration among other notable changes that affected the monetary policy. The listed changes are observed to have had the most significant effect on the operation of the government and the facilitation of an increased monetary policy.

Kyrgyz Republic suffered in the context of the balance of payment from the effects of the global economic crisis. The balance of payment is a monetary factor that evaluates the relationship between the amount of money spent abroad by a nation and the income because of the received money from foreign countries. The balance of payment also referred to as the Statement of International Transaction includes two principle accounts, which are the current account, made up of exporting and importing account. The current account is purposed to track activities within the trading environment. The other facets of the account are the money paid by foreign investors and the various transactions that the government expects no returns. The other account is the capital account (The Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic, 2012a). The capital account is essential in the tracking of loans given to foreigner and the loans that the citizens have received. The balance of payment situation is a financial portrait of a country to the international market. The balance of account is an indicator of the credit worthiness of a country.

Kyrgyz Republic balance of payment resulted to a deficit in current account increase to 13.6 percent to the country's 2008 GDP. The external surplus also increased by 73.0 percent

translating to a significant drop in the balance of payment valuation. The external surplus amounted to a total of US\$83.3 million in that year. In 2009, Kyrgyz Republic formed a current account at a deficit of 2.4 to the GDP translating to a positive balance of the capital and the financial account by a 250% increase to US\$389.9 million (Monetary Policy Report for 2011, 2012). Similar trend was exhibited by the external surplus that increased by 2.7 times its previous value. The gross international reserve volume of Kyrgyz Republic covered its future reserves for 4.6 months of imports of goods and services.

The deficit of the current account has been managed according to 2010 statistics that indicate level of 9.3 percent to GDP, based on the National Bank of Kyrgyz Republic calculation the indicator will be valued at 5.9 percent to GDP. This is a significant improvement from the 2.4 percent recorded in 2009. The trade balance deficit is recorded to have increased by 18.9 percent, which if taken by the National Bank of Kyrgyz Republic calculation will increase, by 20.3 percent. An analysis of Kyrgyz Republic real and nominal effective exchange rates of the domestic currency Som increased by 7.8 percent against the 2007 value (The Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic, 2011b). The decrease in the nominal effective exchange rate did not affect the inflation rate since the inflation remained low despite the decrease in the nominal effective exchange rate.

From the analysis, it is also evident that in as much as the currency of the trading collaborates of Kyrgyz Republic were strengthening against Som; the low inflation levels of these countries had an upward effect on the index of real effective exchange rate. From the observation, a smoothening of the influence of the exchange rate was recorded. From these events, the Som's real effective exchange rate increased by 3.3 percent year to date within the year 2010.

3. Structure of the Kyrgyz Monetary Policy

The monetary policy of Kyrgyz Republic is based on the government and the National Banks efforts towards development and implementation of measures that aim at recovery of macroeconomic stability. The monetary policy is aimed at curbing the monetary factors of inflation. To address the issue, the monetary policy is structured to include formation of adequate inflationary expectation with the need for a restored confidence in the banking system (The Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic, 2011b). Kyrgyz Republic policy is structured in sectors that define the monetary measurable parameters.

The main sector is the real sector. The real sector infers to the activities that contribute towards Kyrgyz Republic GDP. The activities listed in contribution towards the Kyrgyz Republic GDP are listed to be as shown below.

Table 1: The Policy Structural Inclination of Kyrgyz Republic

	Ration		Growth rate		Contribution in Growth	
	Q1-2011	Q1-2012	Q1-2011	Q1-2012	Q1-2011	Q1-2012
Agriculture, hunting and forestry	8.5	11.4	0.4	1.0	0.0	0.1
Mining Industry	0.7	0.9	26.6	-3.7	0.1	0.0
Processing Industry	23.1	13.2	-4.3	-42.7	-1.0	-9.8
Electricity, Gas and Water Generation, Distribution	5.4	5.6	27.7	24.0	1.6	1.3
Construction	3.1	3.4	-20.7	12.0	-0.7	0.4
Trade; Repair of Motor Vehicles	16.2	16.7	-4.1	6.8	-0.6	1.1
Transportation and Communication	10.0	10.7	12.9	8.2	1.2	0.8
Other	21.2	23.1	-0.2	1.0	0.0	0.2
Net Taxes on Products	11.8	15.0	0.6	-6.8	0.1	-0.8
GDP	100.0	100.0	0.6	-6.8	0.6	-6.8
GDP Excluding Kumtor	82.1	91.7	2.1	4.5	1.8	3.7

Source: Social and Economic Bulletin of the Kyrgyz Republic, January-August 2012, Bishkek, www.stat.kg

The table below shows the policy structural inclination of Kyrgyz Republic. From the table it is evident that the processing industry is allocated the highest ratio for the past two years. The activity has however recorded reduction in growth levels and contribution in growth. Electricity, gas, and water generation and distribution has the highest growth rates for the two years of analysis. The variation in growth rates of the two activities with respect to the others is significant. The table is an explication of the activities that inform the fiscal position of Kyrgyz Monetary policy structure. The assessment being performed in ration, growth rate, and contribution in growth illustrates the positioning of the various activities within Kyrgyz economy.

The other facet of the monetary policy is the external economic sector. The balance of payment of the country articulately infers the external economic sector. The balance of payment reflects the external perception of the country by the international market (The Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic, 2011a). The external economic sector is essential because it relates to the international trading partners and financial partners of Kyrgyz Republic. The external factors of the economy are essential not only in the monetary inclination of the external economy but also affects internal monetary factors of Kyrgyz.

The public finance sectors forms the third fundamental factor of the monetary policy. The public finance includes the state budget ability to meet its obligation. An incurred deficit in the budgetary allocation infers that external or internal sources will be pursued to balance the required monetary demands. The social fund, which is purposed for the welfare of the nationals, is a fund that caters for Kyrgyz population (Monetary Policy Report for 2011, 2012). Other issues in the monetary structure within this facet that affect the economy of the country are the labour budget, healthcare, education, and social protection. These facets indirectly determine the economy of the country.

The financial sector is another structural factor of the monetary policy. The financial sector or the banking system determines the fiscal standing of Kyrgyz. The performance of the banks facilitates the key operations such as processing and manufacturing, agriculture among other funded economic activities of Kyrgyz. The inflow of deposit and the provision of loans are the main indicators of assessing the performance of this sector. Kyrgyz also has non-bank financial institutions that operate to offer financial services. These institutions are defined to be essential in the sector for the provision of services to the unbanked population.

4. Kyrgyz Monetary Policy Tools

The main instruments of the Kyrgyz monetary policy include open markets operations. These are the regulatory instruments of the level of liquidity within the banking sector. This tool include operations such as Auctions to sell the NBKR's notes, Operations on the secondary market, NBKR's report operations and Purchase of government securities under "outright" conditions. Another tool is the NBKR's deposit operations. The deposit operations allow the withdrawal of excessive liquidity from the banking system within the national currency. This process is executed by attracting funds on the NBKR's deposit account under special conditions such as recurrence, payment, and urgency. The bank announces maximum rate for deposits auctions with the deposit operations performed on a fix rate basis for all the participants.

Discount rate as a tool allows the use of a major benchmark in the process of determining the value of monetary resources in the specific economy. It should be noted that the size of the discount rate is connected to the yield of the last four auctions within 28-day notes established on the weekly auctions on placement (The Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic, 2012b). Another instrument of consideration is the reserve requirement, which is a regulator of the monetary aggregate volume, banking credit and demand for liquidity with the aim of reducing the level of risk in the banking sector. The operations of banks re-financing or crediting is also an instrument with a direct impact on money supply. The tool is used for the adjustment of the level of reserves within the commercial banks to manage a deficit. Operations such as Last instance credit, "Overnight" (*credit and intraday credit are used*). The Operations in the foreign exchange market through Foreign exchange interventions, NBKR's swap auctions and NBKR's reverse swap operations are used as operations with foreign exchange in the interbank market to manage the monetary values.

5. Monetary Policy Strategies in the Kyrgyz Republic

The monetary strategy has the primary aim of maintaining low inflation rates. The policies specifically the 2012 to 2014 are formulated with the objective of establishing moderate inflation levels with a broader objective of having sustainable economic growth. The government has maintained tight monetary policy strategy with the objective of sterilizing excess liquidity. The country over the past years has seen an increase in the level of circulatory notes. This affected the economy of the country. Measures aimed at establishing a balance in liquidity have been pursued. The country has also observed an increased budgetary deficit. The country has formulated policies aimed at developing a balance in the inflation levels are maintaining a manageable deficit.

Kyrgyz position in the international economy is important. The position of the country in the international economy not only affects the balance of the country fiscal plan but also enables reduced levels of borrowing and budgetary balance. Kyrgyz Republic through its international market strategy aims at balancing the country's payment balance. Kyrgyz Republic is a landlocked country. The economies of its neighbors' largely affect its economy (Monetary Policy Report for 2011, 2012). The country aims at developing policies that not only strengthen its currency but also encourages high performing economic activities of the country. The need for improvement of the performance of the currency will enable the country stabilize its commerce with its neighbors.

The National Bank focuses on recovering the banking system. The national bank as a supervisor of the commercial banks is involved in the development of the banking code, improvement of regulatory and normative base on the issues that relate to supervision of the existing and formed commercial banks, development of risk-oriented supervision and the defining of a separate element of risk. The policies developed are expected to nurture the growth of microfinance sector and an increased number organizations that offer microfinance services.

6. Kyrgyz Future Objectives of Monetary Policy

The Kyrgyz future objectives of monetary policy will be guided towards provision of the real GDP growth rate no less than 6.3%. This growth rate is projected to facilitate an increased GDP of the country that will allow Kyrgyz meet budgetary needs and economic growth. Another key objective is reduction of inflation to 10% on average within three years. Inflation has been a major problem affecting Kyrgyz. A reduction in the inflation levels is projected to be of significant benefit to Kyrgyz because of the economic recovery potential held in the management of inflation levels.

Kyrgyz future are aimed at the maintenance of the budget deficit within the range of 8.7% to GDP. Kyrgyz has had budgetary deficits in the past. This has subjected the country to borrowing from external and internal sources. This objective is a road map towards the country's attainment of economic empowerment by managing to fund its budget. Growth of the average

monthly salary rate by 18.0% is an objective of the policy that is aimed to enhance the social lives of the nationals (Monetary Policy Report for 2011, 2012). Processing industry is the highly ranked activity but has minimal growth. The future objectives of the policy are to enable growth of the industrial sector production by 4.21%. Attainment of this objective will have a positive impact on the economy of the country. Other noted objectives are growth of agricultural production by 4%, growth of the construction sector by 27.3%, growth of the services sector at least by 5.4% and complete and timely execution of all social government guarantees. These objectives are projected to have the ability of transforming Kyrgyz Republic economically and improving the country's GDP.

7. Recommendations and Conclusion

Kyrgyz Republic monetary policy focused on the macro-economic policy should aim at improving the provision or real GDP growth rate. A sustainable growth rate will facilitate the development of other facets of monetary policy such as inflation. However, inflation should be addressed as an independent facet by the National Bank. A reduction of the inflation level is healthy and mandatory for a land locked country like Kyrgyz Republic. The country is at a compromised position if it cannot suffice to address its budgetary allocations. The deficit in the budget not only hinders the operations of other enabling institution but also portrays a bad fiscal picture of the country.

Other factors such as sectorial growth should be enhanced for a confident monetary operational strategy. An assessment of the main economic activities portrays Kyrgyz Republic as a country with an assortment of activities with varied indices in growth and ration. A stimulus package for the declining sectors is recommended for recovery of the nation's economy. Kyrgyz Republic should make specified objectives for the various sectors and pursue their implementation with emphasis on targeting the international market.

Acknowledgement

Researcher would like to thank the authorities of the National Bank of the Kyrgyz Republic.

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