DCC Presentation
Macroeconomic Developments and IMF Program Performance

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Outline

- Macroeconomic Developments
- IMF Program Performance
- Liquidity Loans

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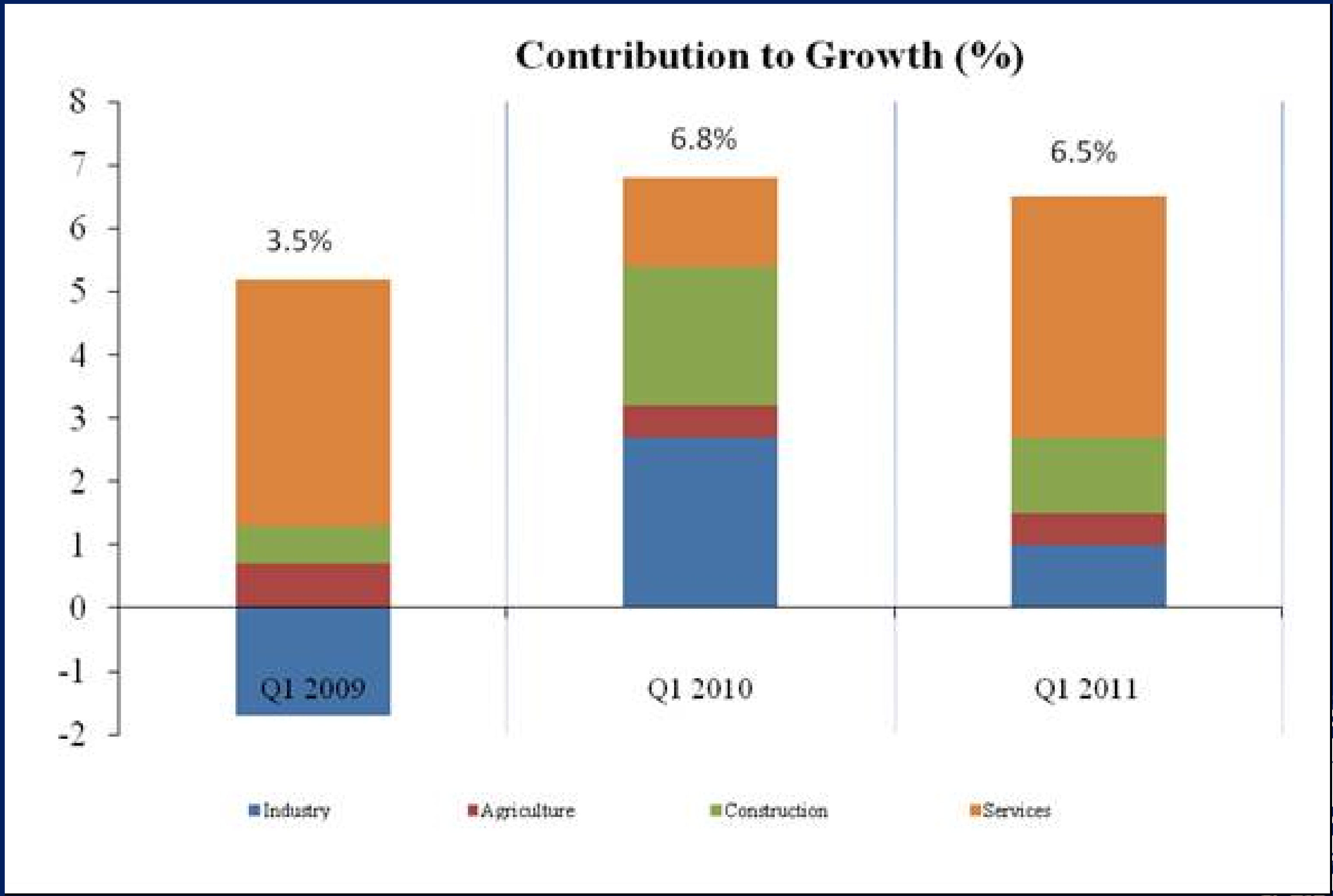
Macroeconomic Developments

Growth of the Economy

- Annual Real GDP growth = 6.5% (preliminary data)
  - Spurred by high growth in services (remittances?)
  - More moderate contributions from construction, agriculture, and industry.
  - Aluminum production increased significantly (49%), but cotton production fell by 9% despite high international prices.

Macroeconomic Developments

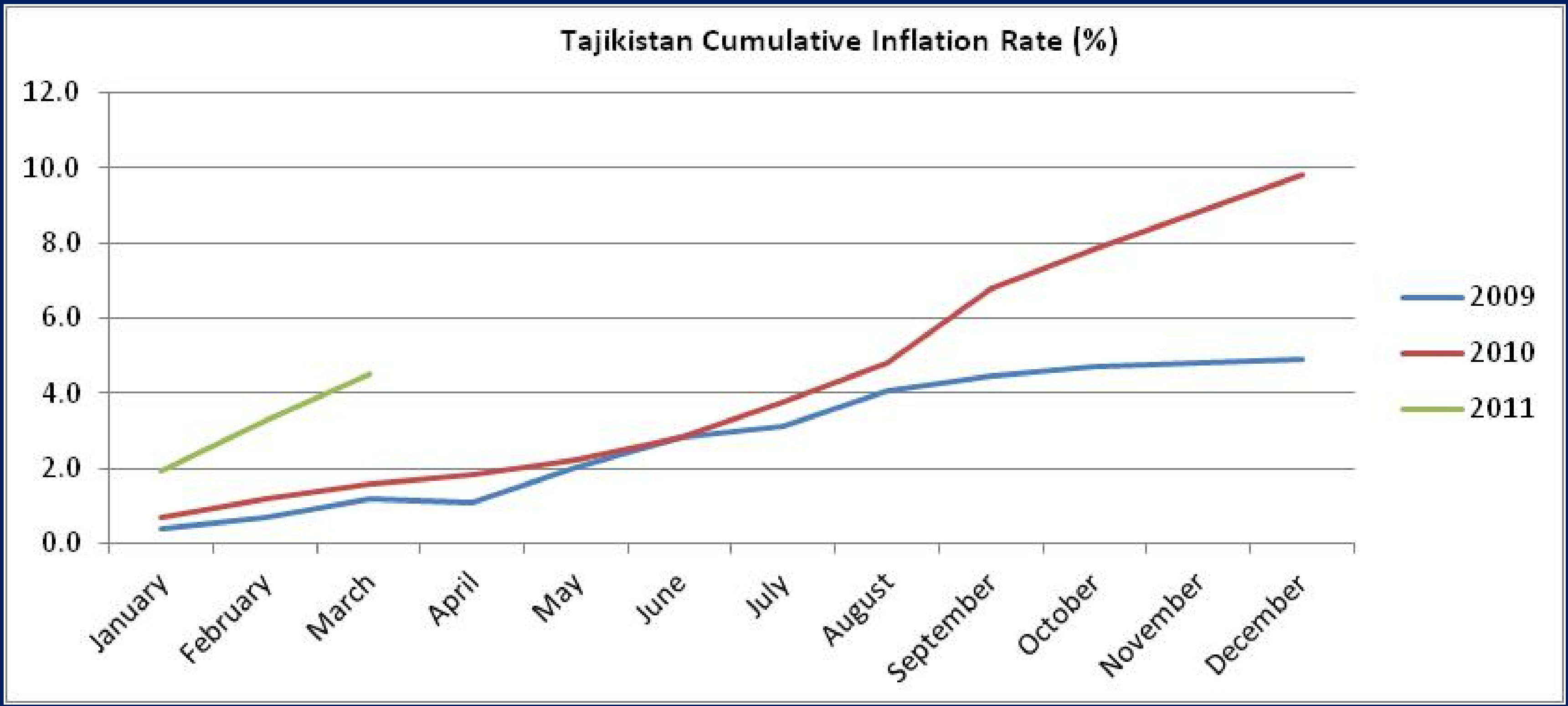


Macroeconomic Developments

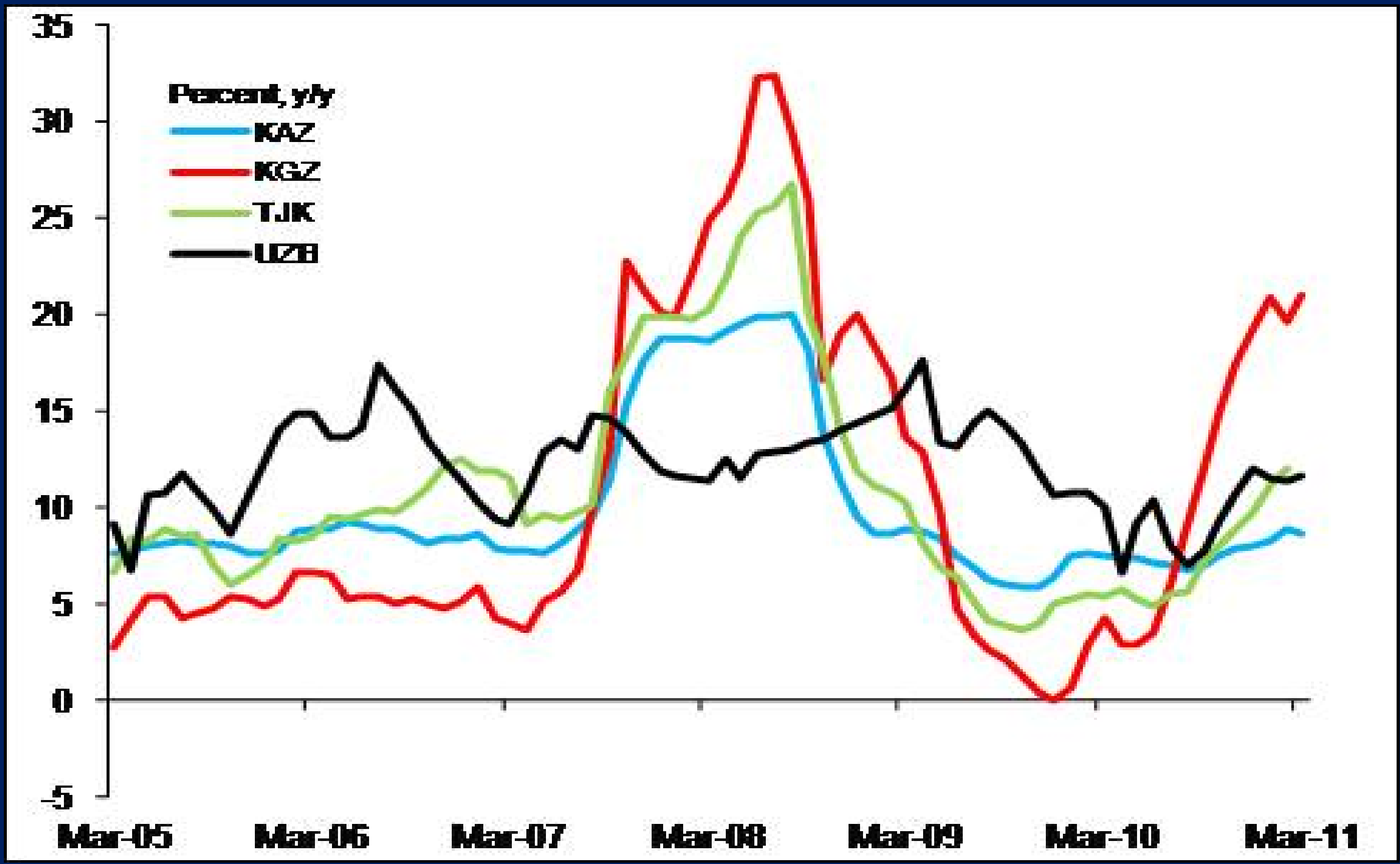
Inflation

- Annual Headline CPI Inflation = 13.0%
  - Food prices up by 9.5% (wheat & flour prices increase by 51.9%)
  - No second round effects seen in preliminary data.
  - Core inflation (CPI excluding fuel, energy & food) is 1.3%.

Macroeconomic Developments



Macroeconomic Developments

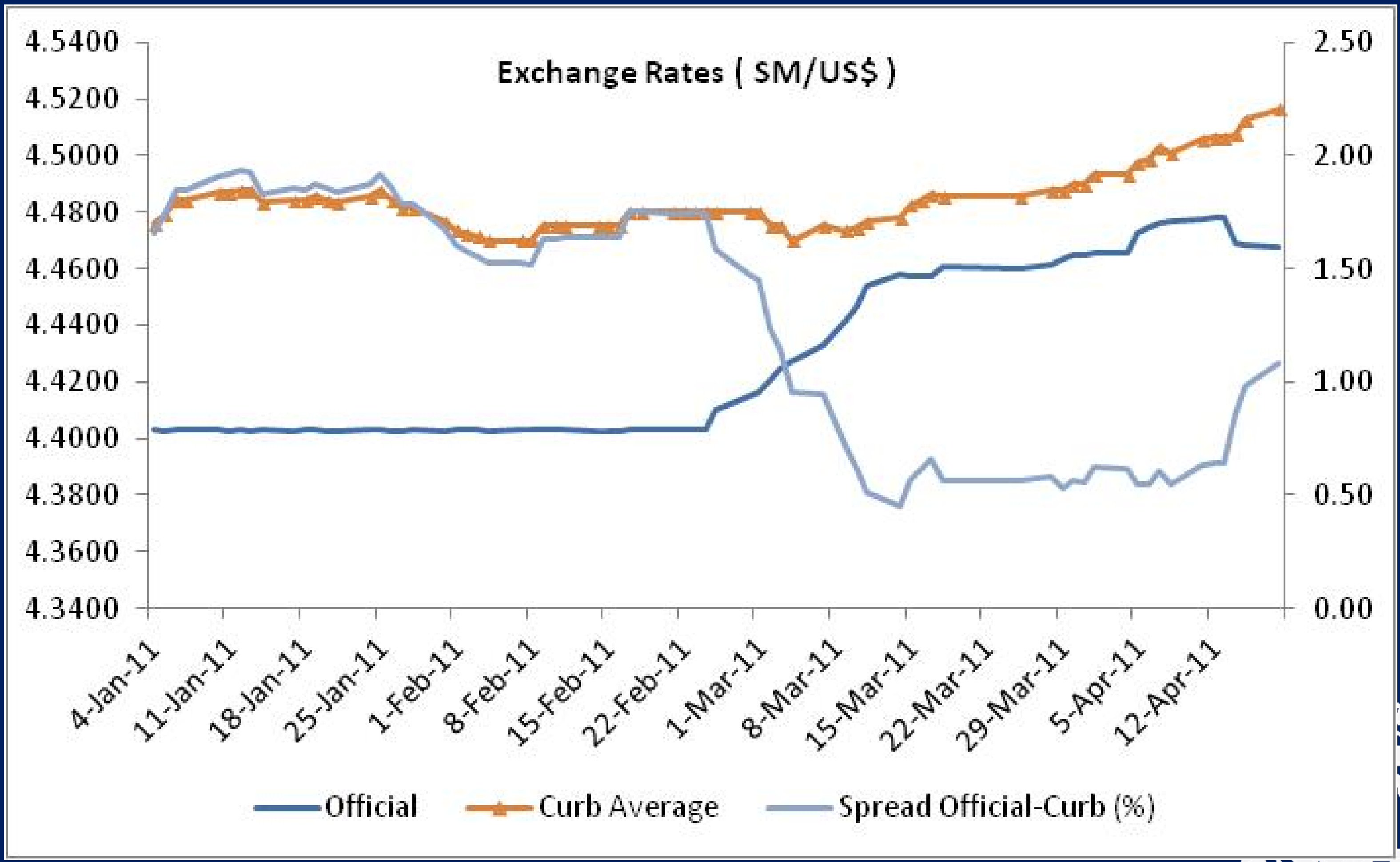


Macroeconomic Developments

Monetary Developments

- Exchange-rate gradually depreciating, reducing the spread between official and market rates.
- NBT refinancing rate increased from 8.25% to 9.0%. Little effect on other interest rates, reflecting low interest rate pass-through.
- Average T-bill and NBT-bill rates at 7.25% and 8.24%. Average lending rates around 20-22%.
- Liquidity loans declined to SM 200 million at end-March, after peaking in January – helped reduce excessive money growth.
- International reserves increased by US$ 26 million in the first quarter of 2011, boosted by rising gold prices.

Macroeconomic Developments



Macroeconomic Developments

- Bank asset quality and profitability slightly improved in the first quarter 2011.
- But capital position and liquidity levels continue to be a significant problem.
- Credit to the private sector is sluggish and growing less than in previous quarters—albeit from a very low base.
- Agricultural lending declined 18 percent on an annual basis--likely reflecting alternative non-bank financing.

Macroeconomic Developments

Fiscal Developments

- Tax revenues over-performed targets by around 7% in the first quarter of 2011.
- Taxes on international trade (sales tax and import duties) are over-performing mainly because of cotton and aluminum, while excises and other internal indirect taxes are lagging.
- Grants and external loans financing PIPs are in line with quarterly targets.
- Budget execution of expenditures is at 90 percent for the first quarter of 2011. Data for the first two months indicate lagging social spending vis-à-vis targets.

Macroeconomic Developments

• External Sector Developments

- Trade balance deteriorated by US$142 million (2.1% of GDP), on account of higher imports.

- Imports were boosted by:
  - High international prices for food (mostly grains) and fuel (partly because of higher export duties from Russia).
  - Positive base effect from 2010 Uzbek rail blockade.

- Exports rose, but less than imports. Boosted by high cotton prices (not volume) and aluminum volume (not prices given tolling fee).

- Trade balance likely financed by higher remittances (not yet published), which are also supporting growth of services.

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IMF Program Performance

- Seven out of eight end-December quantitative performance criteria were met – including accumulation of international reserves, and ceiling on fiscal deficit.
- The exception was zero-ceiling on external loan arrears.
- Since the amount of arrears were small, cleared quickly, and have had no material impact on assessment of program performance, a waiver is proposed.
- Remedial actions also underway. The debt department at the MOF is building capacity through technical assistance (including recent WB DEMPA mission).

IMF Program Performance

- DCC partners can cooperate with the IMF to ensure the MOF continues to:
  - Build capacity.
  - Improve loan guarantees-related policies.
  - Abide by the concessionality criteria (minimum 35% grant element).
- Two indicative targets were also missed.
  - Floor on social and poverty-related expenditure was missed as wage increases for civil servants on health and education were capped at 10% (as opposed to 15% budgeted).
  - Ceiling on loans to banks for liquidity purposes.

IMF Program Performance

- Program end-December benchmarks also met.
  - Submit to Parliament NBT law and bankruptcy law for credit institutions.
  - Publish at the MOF website, Roghun quarterly reports of uses and sources of funds (including contractors' details).
  - End-March benchmark on banks' submission of time bound action plans to the Supervision Department at the NBT, to become fully compliant with prudential standards.
  - Publish at the MOF website, the 2008 and 2009 audited financial statements of Roghun postponed to June 2011 on technical difficulties.
- Staff-level agreement on completion of the 4th review under the ECF. Board meeting scheduled for May 11, 2011 (potential disbursement of roughly US$ 20 million).
- Going forward, structural benchmarks for completion of 5th review will focus on tax policy, financial sector and governance at the NBT and SOEs.

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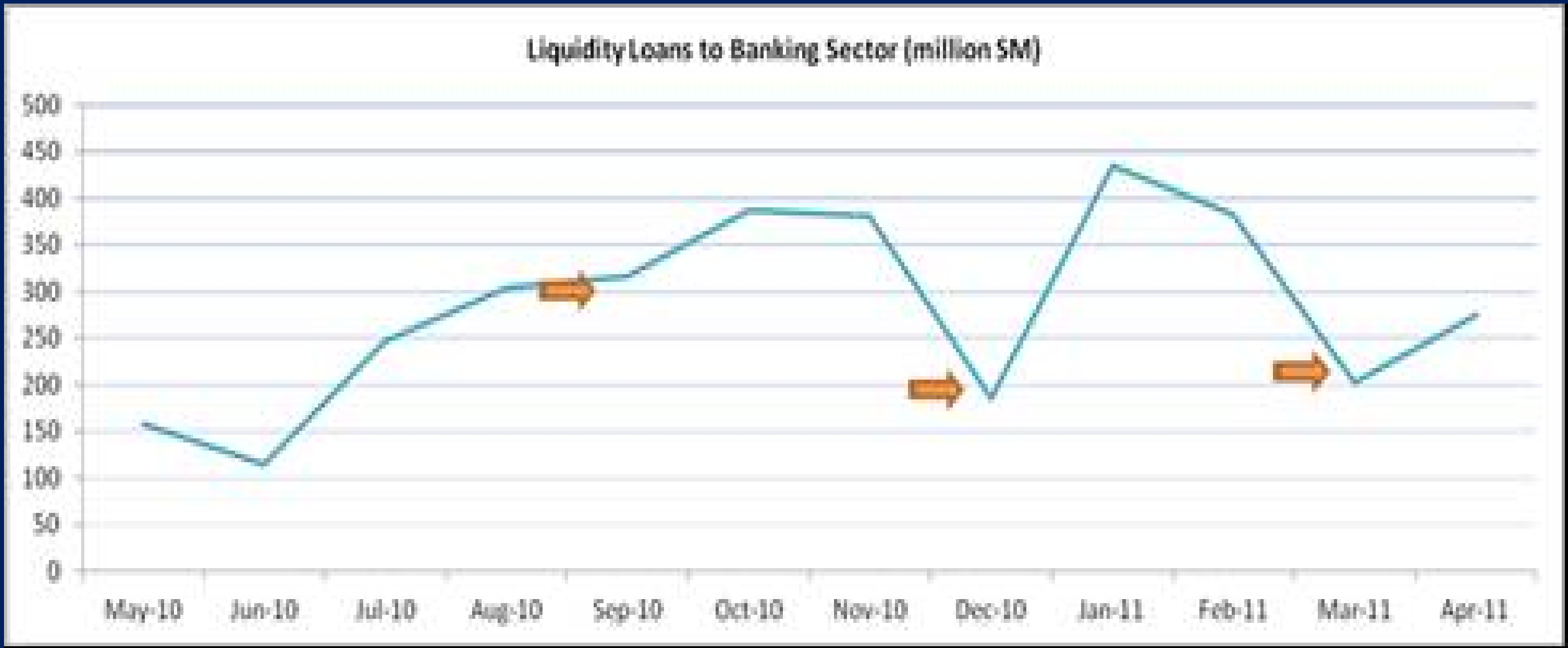
Liquidity Loans



Liquidity Loans

- Liquidity loans to the banking sector breached end-December IT, and peaked at SM 450 million in January.
- Key issue in recent mission – IMF insisted on tighter conditions for liquidity loans. Lending dropped in March, but is now rising again.
- Several reasons for containing these loans:
  - Inflation via higher money supply
  - Balance sheet risks to the NBT with possible fiscal implication
  - Development of interbank loans market
  - Banks need to cut “umbilical cord” with the NBT

Liquidity Loans

- But banks are susceptible to political interference and banks' balance sheets are significantly deteriorated because of Roghun shares, politically-related lending, and cotton Treasury bonds at lower than market rates.
- As such, pressure from banks on the NBT is likely to continue given their weak position, but the NBT needs to keep its policy stance firmly.
- Ultimately, banks should be able to lend on a commercial basis, gradually recovering from past practices, and start supporting intermediation and growth.

The End

TO BE CONTINUED NEXT QUARTER…