

Approved by
the Resolution of the Board of the
National Bank
of the Kyrgyz Republic
No.11/1 dated February 29, 2016

Monetary Policy Report

(Review of Inflation of the Kyrgyz Republic)

Quarter 4, 2015

Contents

Summary	2
Chapter 1. External Environment	3
1.1. Economic Development of Main Trading Partner Countries	3
1.2. World Commodity Markets	5
Chapter 2. Macroeconomic Development	7
2.1. Demand and Supply in the Commodities and Services Market	7
2.2. External Sector	10
Chapter 3. Monetary Policy.....	13
3.1. Monetary Policy Implementation	13
3.2. Financial Market Instruments	14
3.3. Dynamics of Monetary Indicators	16
Chapter 4. Inflation Dynamics	18
4.1. Consumer Price Index	18
4.2. Comparison of Forecast and Facts.....	19
Chapter 5. Medium-Term Forecast	20
5.1. External Environment Proposals	20
5.2. Medium-Term Forecast	22

Summary

During Q4 2015, the rate of inflation was within single-digit values and corresponded to the benchmark determined by the Joint Statement of the National Bank and the Government of the Kyrgyz Republic about Economic Policy for 2015 and the Main directions of monetary policy for the medium-term. In December 2015, the annual inflation rate decreased to 3.4 percent from 10.5 percent as of the beginning of the current year. In Q4, the inflation rate was 4.0 percent. A favorable price situation in the world food market as well as lower prices for imported wheat, growth of production output in the agricultural sector inside of the country and, respectively, decrease in prices for fruit and vegetables contributed to diminishing inflationary pressure in the country. The overall prices increased mainly due to rising prices for non-food goods and services (increase in electricity and heating tariffs, rise in price for alcoholic and tobacco products, increase in prices for category of “clothing and footwear” goods).

Economic growth of the country in 2015 was 3.5 percent. In the reporting quarter, the economy growth slowdown in the Kyrgyz Republic was mainly due to the negative rates in the industrial sector, primarily due to decrease of production output at the Kumtor Gold Mine; meanwhile, growth was supported by increase of production output in the agricultural sector and the services and construction sectors. Excluding Kumtor, real growth of GDP was 4.5 percent, which was lower than the comparable indicator of 5.0 percent in 2014.

At the end of 2015, the state budget deficit made KGS 6.3 billion or 1.5 percent to GDP (in 2014, the deficit made KGS 1.9 billion or 0.5 percent to GDP). Revenues increased by 7.3 percent against the same value of 2014; while the overall state budget expenditures increased by 10.1 percent. In 2015, execution of the republican budget revenues amounted to 99.1 percent, which resulted from implementation of the plan for collecting non-tax revenues by 105.8 percent, and tax revenues – by 96.8 percent. Financing of the republican budget expenditure was executed by 109.2 percent.

In Q4 2015, the balance of payments of the Kyrgyz Republic is positive and amounted to USD 13.7 million. Current account deficit will decrease to 8.7 percent to GDP to make USD 225.0 million, which primarily will be caused by negative dynamics of balance of trade developed with the rate of 50.0 percent.

In the main trading partner countries the economy growth slowdown was still observed. In Q4 2015, economic growth of China made 6.9 percent, in Russia decline by 3.7 percent was observed. In 2015, GDP growth in Kazakhstan was 1.2 percent.

The National Bank conducted transactions in the FX market in order to smooth acute fluctuations of exchange rate. In Q4, currency interventions of the National bank resulted in net sales of USD 124.2 million. USD/KGS exchange rate increased by 10.3 percent in Q4.

The monetary base increased by 0.7 percent in Q4; such increase was due to the public finance sector transactions. Broad money M2X including deposits in foreign currency increased by 5.5 percent in the reporting quarter and amounted to KGS 143.1 billion (in annual terms the increase was 14.9 percent).

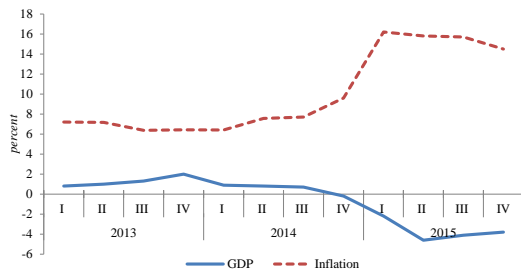
Chapter 1. External Environment

1.1. Economic Development of Main Trading Partner Countries

Russia

Chart 1.1.1. Growth of GDP and Inflation in Russia

(in annual terms)



Source: Ministry of Economic Development of the Russian Federation, IA Bloomberg

The negative impact of the significant drop in oil prices, the ongoing impact of the sanctions imposed by the West against Russia in 2014 amid existing structural problems in the economy of the country, resulted in a decrease of production output almost in all major sectors of the economy, except for the agriculture. According to the estimates of the Ministry of Economic Development of the Russian Federation, in Q4 2015, the economic recession in Russia made 3.8 percent. Generally, in 2015, GDP in Russia decreased by 3.7 percent after growth by 0.6 percent in 2014 according to

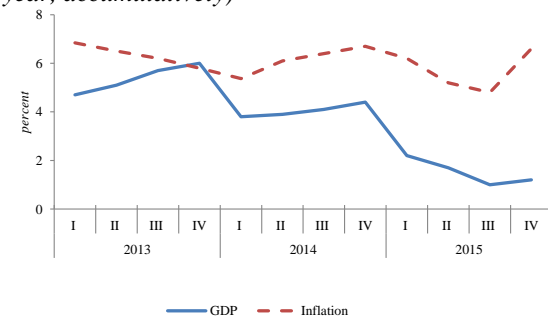
the preliminary data of the Federal State Statistics Service of the Russian Federation.

In 2015, the average inflation rate was 15.6 percent, compared to 7.8 percent in 2014. In Q4, the average inflation rate was below the annual average value by 1.1 percentage points and made 14.5 percent in annual terms against 9.6 percent in the same period of 2014. Significant depreciation of the Russian ruble in December 2015 due to a sharp drop in oil prices; inflation expectations, including those associated with the decision to prohibit the imports of products and services from Turkey; the long-lasting effect of retaliatory sanctions imposed by Russia on the imports of food products from the West were the main factors of growth in consumer prices in Q4. Meanwhile, a reduction in consumer demand and a tight monetary policy of the Central Bank of the Russian Federation were the restraining factors for the inflation rate.

Kazakhstan

Chart 1.1.2. GDP Growth and Inflation in Kazakhstan

(period to the corresponding period of the previous year, accumulatively)



Source: RK Statistics Agency

A drop in oil prices and a decline in demand from China due to a slowdown in the economic growth have become the factors decelerating GDP growth rates, which made 1.2 percent in 2015 against 4.3 percent in 2014 (according to the preliminary data of the Statistics Committee of the Ministry of National Economy of Kazakhstan). The level of industrial output decreased by 1.6 percent due to a decline in the production output by 2.5 percent in the mining industry. A reduction of oil production by 1.7 percent, coal – by 5.0 percent, and iron ore – by 22.0 percent, primarily due to a decline in

demand from China, resulted in a decrease of production output in the mining industry.

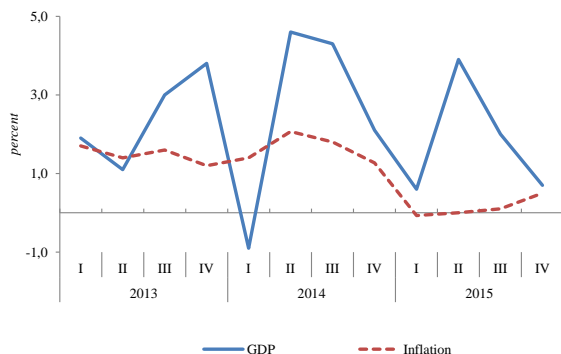
The trend of inflation rate slowdown, which was observed since the beginning of 2015, was replaced by the inflation rate acceleration since the end of Q3 and till the end of the year due to a substantial depreciation of the national currency after cancellation of the currency corridor on August 20 and a transition to a floating exchange rate. In December 2015, the inflation rate in Kazakhstan made to 1.2 percent compared to November 2015, 13.6 percent - in annual terms, 6.6 percent - the average annual value. The prices for food

products increased by 10.9 percent, for non-food products – by 22.6 percent, for services – by 8.1 percent within the year.

USA

Chart 1.1.3. GDP Growth and Inflation in the USA

(in annual terms)



Source: Ministry of Trade of the USA, Department of Labor of the USA, IA Bloomberg

In 2015, the economic growth in the United States was moderate and remained at the level of 2014 at 2.4 percent. During the year, the quarterly growth rates were uneven, in Q4, the economic growth decreased down to 0.7 percent (against the previous quarter in terms of annual rates). The expansion of the foreign trade deficit, due to the strong position of the US dollar, and the reduction in purchased inventories were the main factors decelerating economic growth in Q4. The investments in the exploration and mining works decreased by 38.7 percent due to the ongoing downward trend in the world oil prices. In Q4, the total investments in fixed assets showed a close to zero growth. An

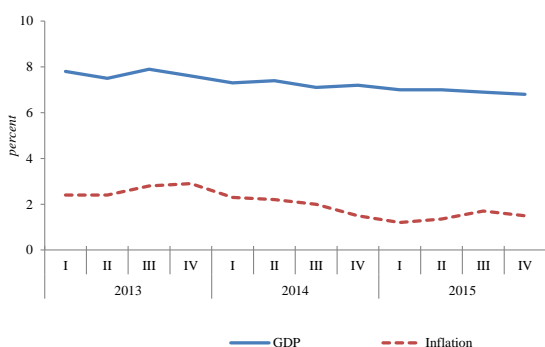
increase in the consumer and government expenditures contributed to an increase in economic activity.

In December 2015, the annual inflation rate was 0.7 percent. A decrease in prices for fuel and energy product group by 12.6 percent in annual terms was the main factor of low inflation in the United States. The prices for food products rose by 0.8 percent and an increase in the prices for other goods and services showed an upward trend in 2015 and made 2.1 percent in December.

China

Chart 1.1.4. GDP Growth and Inflation in China

(quarter to the corresponding quarter of the previous year)



Source: National Statistics Bureau of the PRC, IA Bloomberg

The economic situation in China showed an ongoing slowdown of economic growth and a transformation of economic structure. In 2015, GDP growth in China was formed at the level of 6.9 percent, which generally corresponds to the government's benchmark of “about seven percent”, however, is below the value of the previous year (7.3 percent). In Q4 2015, GDP growth in China made 6.8 percent compared to the corresponding quarter of the previous year. Slowdown of economic growth in China was primarily due to a slower growth of industrial output, investments in fixed capital and, in particular, investments in the housing sector. Meanwhile, new engines of economic growth

became more significant: the share of the service sector exceeded 50 percent to GDP and contribution of the final consumption to economic growth increased significantly and made 66.4 percent.

CPI growth in December 2015 was formed at the level of 1.6 percent in annual terms; average annual inflation was 1.4 percent in 2015. Inflation rate in China was lower than the government's benchmark by “about three percent” due to low growth of prices in the commodity groups related to housing, transportation and fuel.

1.2. World Commodity Markets

Food Market

Chart 1.2.1. Dynamics of Prices for Food Products

(month to the corresponding month of the previous year)

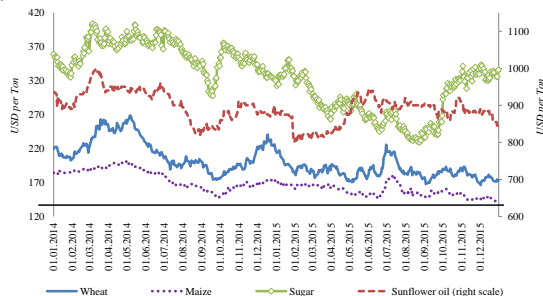
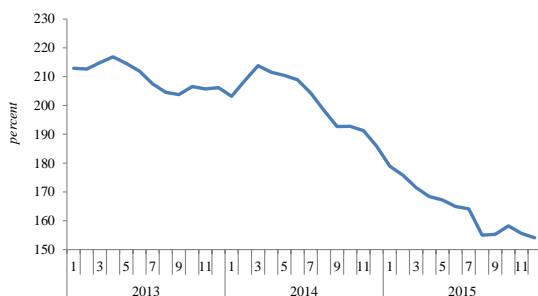


Chart 1.2.2. Dynamic of FAO Food Price Index

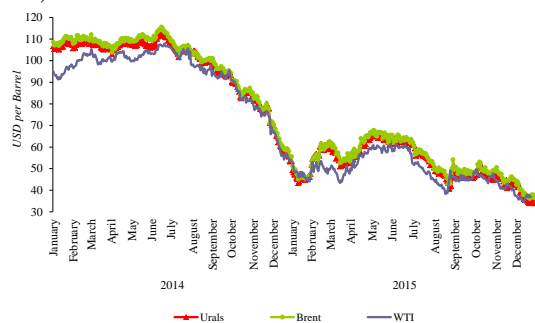


Abolition of export duties on wheat in Argentina also contributed to a decrease in prices.

In Q4, the average FAO food price index (Food and agriculture organization) decreased by 17.9 percent against the same quarter of the previous year to make 156.0 points. In 2015, the average price index decreased by 18.7 percent compared to 2014. A decrease in food prices was due to large stocks of food products, weak demand in the international markets and global strengthening of the US dollar.

Chart 1.2.3. Dynamics of Prices for Oil

(month to the corresponding month of the previous year)



Energy Market

Generally, a volatile dynamics accompanied by a downward trend was observed in the energy market throughout 2015.

In Q4 2015, the prices for the basic oil grades (Brent, WTI, Urals) fluctuated between the range of USD 33.9 - 53.0 per barrel. A decrease in the prices during the period under review was due to the excess of oil supply over demand in the international energy

¹El Niño is a natural phenomenon that occurs at intervals of 2-7 years and is characterized by increased rainfall in South America (up until the flood) and drought in South and South-East Asia, which had a negative impact on crop yields.

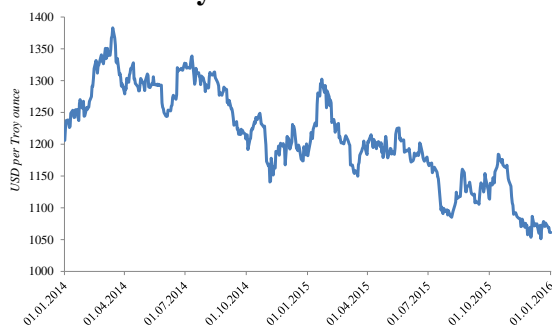
market, the geopolitical situation in the world, the US dollar strengthening and the OPEC decisions made in December 2015 on maintaining the volume of oil production.

In 2015, the average price of Brent oil grade decreased by 46.3 percent compared to the price of 2014 to make USD 53.3 per barrel.

The US Department of Energy worsened its forecasts with regard to the prices for oil in the second half of 2016 from USD 59 to USD 39 per barrel in its report in January. In 2016, the oil market is full of many uncertainties (either stagnation of the prices for oil at low levels (USD 30-40 per barrel) or a slight increase up to approximately USD 60 per barrel are expected), including new supplies from Iran, the growth rate of global consumption and the response of oil producers outside OPEC to decrease in prices. The updated forecast assumes a more significant reduction of oil production in the major shale basins.

Gold Market

Chart 1.2.4. Dynamics of Prices for Gold



Source: IA Bloomberg

was formed at the minimum levels for several years due to the absence of data on the weak world economy and the US positive macroeconomic data in the FED statement. In December 2015, the price for gold did not change significantly after the adoption of the US FED decision to raise the funds rate, suggesting that the decision was largely rooted in the established price.

In 2015, the general prices for gold showed a downward trend with the periods when increased financial risks associated with cancellation of CHF binding to EUR, quantitative easing in the euro-zone and with the fall of stock indices in China resulted in increase of prices.

At the end of Q4, there was a decline in prices for gold. At the beginning of the period under review, prices for gold increased slightly amid the news about the United States economy, decreasing investors' confidence in the possibility to increase the US FED funds rate in 2015. An increase of the FED funds rate, directly affecting the profitability of investments in the USA, results in increase of demand for the US currency, which has a negative impact on the price for gold. Since mid-October, the price of gold decreased and

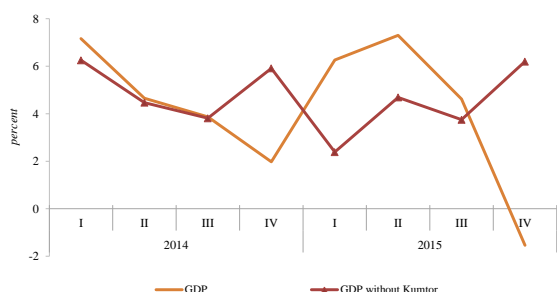
Chapter 2. Macroeconomic Development

2.1. Demand and Supply in the Commodities and Services Market

Demand

Chart 2.1.1. GDP Dynamics

(quarter to the corresponding quarter of the previous year)



Source: NSC KR

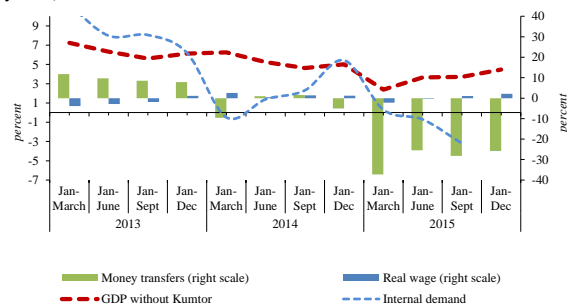
made a positive contribution to the economic growth.

Despite the decline in the real growth in Q4, generally, in 2015, the real economic growth in Kyrgyzstan was positive and constituted 3.5 percent (4.0 percent in 2014), excluding Kumtor, the increase made 4.5 percent (5.0 percent in 2014) on the background of decelerating external environment.

According to Centerra Gold Inc. press release, the Kumtor output decreased by 55.2 percent compared to Q4 2014 (291.6 thousand troy ounces) and amounted to 130.6 thousand troy ounces in Q4 2015, which primarily resulted from a relatively uniform quarterly gold production throughout the year in contrast to the previous years, when the largest volume of gold was produced in the last quarter of the year.

Chart 2.1.2. Dynamics of Internal Demand and Money Transfers

(period to the corresponding period of the previous year)



Source: NSC KR, NBKR

compared with the previous year.

However, consumption remained the main component within the GDP structure (108.5 percent to GDP).

State Finances Sector

At the end of 2015 the state budget was executed with a deficit of KGS 6.3 billion or 1.5 percent to GDP, whereas, according to the data of the Central Treasury of the

In 2015, the economic growth decreased, but was still positive under the conditions of continued slowdown in the economic growth of the trading partner countries, reduced remittances and, consequently, weakened domestic demand.

In Q4, a decline in the real economic growth was due to the negative rates in the industrial sector, where a decline in the production output at the Kumtor Mine had a significant negative influence. The agriculture, service sector and construction

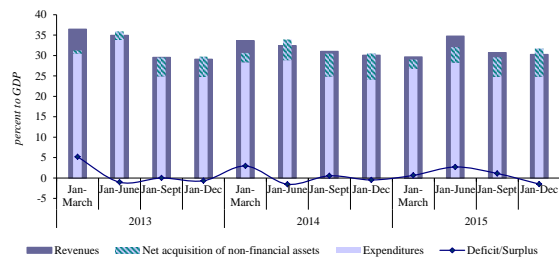
During nine months of 2015, the domestic demand¹ kept demonstrating downward trends and decreased by 3.2 percent against the same period of 2014 due to a reduction in the components of final consumption (-0.8 percent), a decrease in gross savings (-11.4 percent) by means of the significant decline in inventories (-65.5 percent) and a reduction of gross fixed assets (-3.9 percent). A negative contribution was also made by the reduction of individuals' remittances. Thus, according to the preliminary data, the net inflow of remittances in USD decreased by 25.8 percent

¹ Reference to the data for the earlier period is given due to the lack of data for 2015.

Ministry of Finance of the Kyrgyz Republic, there was a budget deficit of KGS 1.9 billion, or 0.5 percent to GDP in 2014.

Chart 2.1.3. Execution of the State Budget

(period to the corresponding period of the previous year, accumulatively)



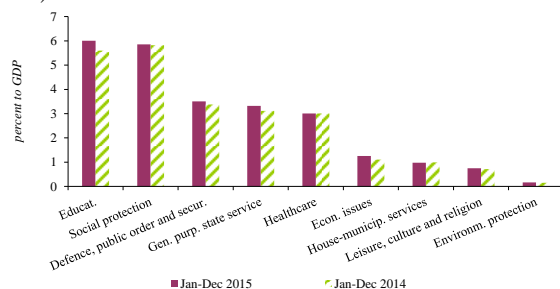
Source: CT MFKR, NBKR

In 2015, under the conditions of slowdown in the revenues growth there was an increased burden on the state funds due to increased level of labor costs, expenditures for goods and services. In 2015, the state budget revenues from operating activities increased by 7.3 percent, or KGS 8.7 billion, compared to the same period of 2014 and amounted to KGS 128.1 billion, or 30.3 percent to GDP (in 2014, revenues from operating activities increased by 17.3 percent). Herewith the greatest contribution to the increase in operating income was due to non-tax revenues received in Q2 and Q4 2015.

At the end of 2015, the state budget expenditures for operating activities increased in annual rate by 10.1 percent, or KGS 9.7 billion, and amounted to KGS 105.3 billion, or 24.8 percent to GDP. In the structure of expenditures by economic classification, a high rate of expenditures allocated for current consumption has been retained as before. The largest contribution to the increase in expenditures was made by labor costs (mainly salaries), purchase and use of goods and services, payment of subsidy and social allowances. In the structure of expenditures by functional classification, the greatest contribution to the increase in expenditures was made by costs for education, state services of general purpose, social protection, defense, public order and security, economic issues. As before, the acceleration trend in the expenditure growth was observed towards the end of the year, which strengthens the inflationary effect of the budget deficit growth. Thus, in Q4, the total budget expenditures grew by 19.6 percent compared to the corresponding quarter of the last year (an average growth of the total budgetary expenditures for the previous three quarters

Chart 2.1.4. Execution of the State Budget

(period to the corresponding period of the previous year)



Source: CT MFKR, NBKR

amounted to 7.1 percent). Net outflow of budget funds for operations related to acquisition of non-financial assets amounted to KGS 29.2 billion, or 6.9 percent to GDP. Execution of the state budget revenues (tax revenues + non-tax revenues + official transfers) amounted to 99.1 percent in 2015, which was insured by implementation of the plan for collecting non-tax revenues by 105.8 percent, and official transfers - by 104.4 percent. The plan on collection of the tax revenues was implemented at the rate of 96.8 percent. The tax collection plan of the State Tax Service was implemented at a rate of 96.5 percent, while the same plan of the State Customs Service was implemented by 97.1 percent. At the end of 2015, the execution of the state budget expenditures amounted to 109.2 percent. Meanwhile, the expenditure plan on the protected items was executed by 104.6 percent, on the unprotected items – by 122.3 percent.

amounted to 7.1 percent).

Net outflow of budget funds for operations related to acquisition of non-financial assets amounted to KGS 29.2 billion, or 6.9 percent to GDP.

Execution of the state budget revenues (tax revenues + non-tax revenues + official transfers) amounted to 99.1 percent in 2015, which was insured by implementation of the plan for collecting non-tax revenues by 105.8 percent, and official transfers - by 104.4 percent. The plan on collection of the tax revenues was implemented at the rate of 96.8 percent. The tax collection plan of the State Tax Service was implemented at a rate of 96.5 percent, while the same plan of the State Customs Service was implemented by 97.1 percent. At the end of 2015, the execution of the state budget expenditures amounted to 109.2 percent. Meanwhile, the expenditure plan on the protected items was executed by 104.6 percent, on the unprotected items – by 122.3 percent.

According to preliminary data of the Social Fund of the Kyrgyz Republic, the budget surplus of the Social Fund (inclusive of the pension fund balance as of the beginning of the year) amounted to KGS 1.9 billion, or 0.4 percent to GDP, at the end of 2015. Revenues of the Social Fund budget (inclusive of the pension fund balance as of the beginning of the year) amounted to KGS 41.6 billion or 9.8 percent to GDP, having increased by 7.8 percent against

the comparable value of 2014. Expenditures of the Social Fund budget increased by 5.6 percent against the comparable value of 2014 and amounted to KGS 39.8 billion, or 9.4 percent to GDP.

Investment

In 2015, the level of implementing investment in fixed assets increased by 8.0 percent (in comparable prices) compared to 2014.

Table 2.1.1. Capital Investment by Sources of Financing
(millions of KGS, percent)

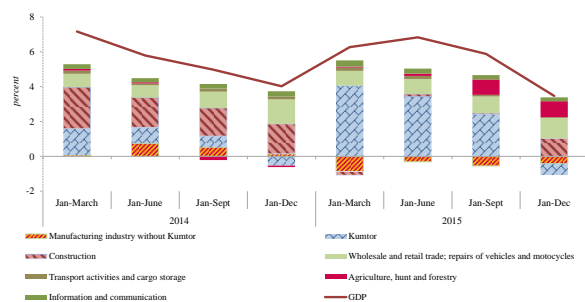
	January-December			
	millions of KGS		share, percent	
	2014	2015	2014	2015
Total	107 884,6	120 878,9	100,0	100,0
Internal investment	65 629,5	69 826,6	60,8	57,8
Republican budget	3 257,3	4 374,2	3,0	3,6
Local budget	935,7	1 219,9	0,9	1,0
Funds of enterprises and organizations	36 243,6	36 829,5	33,6	30,4
Banks' credits	1 089,4	1 072,0	1,0	0,9
Population funds including beneficent help of KR residents	24 103,5	26 331,0	22,3	21,8
External investment	42 255,1	51 052,3	39,2	42,2
Foreign credit	30 318,6	37 048,7	28,1	30,6
Direct foreign investments	9 339,2	11 840,3	8,7	9,8
Foreign grants and humanitarian aid	2 597,3	2 163,3	2,4	1,8

Source: NSC KR

The volume of investment in fixed capital financed from domestic sources increased by 2.6 percent (among them the investment from the state and local budget increased by 1.3 times, that from the personal funds – by 5.4 percent), whereas the investment made from external sources increased by 16.3 percent (from the foreign credits and direct foreign investments – by 1.2 times) compared to 2014.

Supply

Chart 2.1.5. Input of Main Sectors in GDP Growth
(period to the corresponding period of the previous year)



Source: NSC KR

reduction in the output of chemical products (-36.4 percent), the production of motor vehicles (-29.5 percent), machinery and equipment (-25.9 percent) and in the textile sector, the manufacture of clothes and footwear, leather and other leather products (-11.3 percent).

Significant decrease compared to the level of 2014 was observed in the textile sector (by 21.2 percent), apparel (by 17.6 percent), rubber and plastic products (by 12.8 percent), other non-metallic mineral products (by 10.9 percent) and electricity generation (by 12.2 percent).

The trade sector made the main contribution in the sphere of services (1.2 percentage points).

In the reporting period, investments in fixed assets were mainly directed to the industrial sector, the agriculture and services sector. There was a significant increase in the investments in fixed capital directed to the manufacturing industry (by 1.5 times), among them the investments for construction of facilities dealing with production of petroleum products increased by 2.0 times, the investments for construction of art, entertainment and recreation facilities increased by 1.5 times.

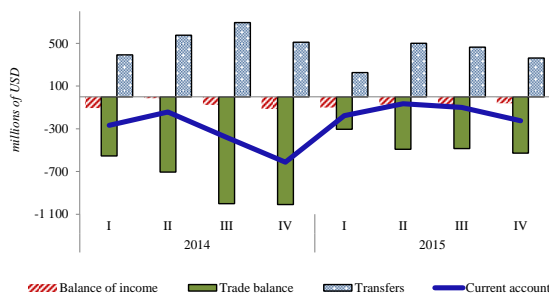
In 2015, GDP positive growth was due to positive contribution of all sectors of economy excluding industry.

In 2015, significant growth was observed in the agricultural sector (+6.2 percent) with contribution in GDP of 0.9 percentage points due to increase in production of crops, vegetables and potatoes, as well as livestock products.

There was a decrease by 4.2 percent in the industrial sector primarily due to a decline in the production output of the precious metals (by 8.2 percent) at the enterprises of the Kumtor Mine. There was also a significant

2.2. External Sector

Chart 2.2.1. Current Account
(millions of USD)



In Q4 2015, the current account deficit decreased to 8.7 percent to GDP due to the reduction of the trade deficit. According to the forecasted and preliminary data of Q4 2015, the current account deficit decreased by 63.3 percent against Q4 2014 and amounted to USD 225.0 million (excluding additional estimates the deficit was USD 248.7 million). In the reporting period, the trade deficit of the Kyrgyz Republic is expected to decrease by 50.0 percent to make

USD 447.6 million¹. Trade balance will be formed under the influence of the following factors:

- the decrease in imports due to the reduction in deliveries of passenger cars (including previously used cars), and due to the decline in the value of energy products.
- the reduction in supplies of the main export goods, such as gold, products of the sewing industry and agriculture.

2.2.1. KR Trade Balance

(millions of USD)

	2013	2014	2014 Q4	2015 * Q4	Change in %	Change in millions of USD
Trade balance	-2 744,3	-2 942,5	-894,9	-447,6	-50,0	447,2
Export (FOB)	2 869,3	2 347,6	706,2	479,2	-32,1	-227,0
Gold	736,8	716,9	314,4	147,4	-53,1	-166,9
Import (FOB)	5 613,6	5 290,2	1 601,0	926,8	-42,1	-674,2
Energy products	1 186,7	1 041,8	327,6	125,0	-61,9	-202,7

Exports of goods (in FOB prices) decreased by 32.1 percent to make USD 479.2 million in Q4 2015. Supplies of gold are expected to decrease by 66.4 percent due to the reduction in the physical volume and value. In 2014, the export volumes of gold were not uniform within the year and the main volume was accounted for the end of 2014.

Exports excluding gold have decreased by 15.3 percent and amounted to USD 331.7 million. This trend will be conditioned by a decrease in supplies of vegetables and fruits (by 45.7 percent), jet fuel (by 51.4 percent), garments and clothing accessories (by 96.5 percent). In the reporting period, the supplies of ores and concentrates of nonprecious metal concentrates and other inorganic materials will be almost terminated (decrease by 98.6 and 99.6 percent, respectively). At the same time, the increase is expected in the supplies of such groups as “flight vehicles, spare parts and accessories of motor cars” and “footwear”.

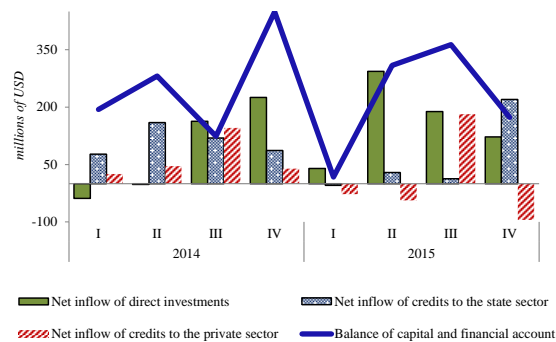
In the reporting period, imports of goods (in FOB prices) decreased by 42.1 percent to make USD 926.8 million. This trend was conditioned by a reduction in supplies of petroleum products due to the drop in the average contract prices and the reduction in import of passenger cars. Moreover, there will be a decrease in supplies of livestock products (by 95.6 percent), pharmaceuticals (by 58.9 percent), cereals (by 89.1 percent) and cigarettes (by 89.3 percent). Besides, the decrease will be observed in supplies of textile fabrics (by 71.3 percent), garments and clothing accessories (by 19.8 percent) and footwear (by 3.3 times).

¹Hereinafter the data are given taking into account the NSC additional estimates for agricultural products and mutual trade with the EEU countries (Q3 2015) and the estimates of the NBKR on re-export of petroleum products and activities of the tourist traders.

The net inflow of current transfers will decrease by 29.0 percent to make USD 362.7 million. In the reporting quarter of 2015, a negative trend on transfers will be mainly due to the decrease in the inflow of private remittances, the net inflow thereof will decrease by 27.5 percent to make USD 335.6 million.

According to the forecasts, a balance of services will be formed negative at the level of USD 79.7 million and will decrease by 31.0 percent in Q4 2015. The negative balance of revenues is expected to decrease by 47.1 percent (down to USD 60.3 million) due to a reduction in income of other foreign investors gained from investment activity in Kyrgyzstan.

Chart 2.2.2. Capital and Financial Account



The decrease in the current account deficit will be accompanied by the reduction of the positive balance on the capital and financial account. In Q4 2015, the capital and financial account formed a positive balance of USD 155.7 million, having decreased by 65.3 percent compared to Q4 2014. The balance of capital account is expected to become positive in the amount of USD 37.9 million. In the reporting period, positive balance of the financial account is expected to decrease by 70.8 percent to make USD 122.8 million. A decrease in the inflow

of the direct and other investments will have a main influence on the financial account in the reporting period.

Net inflow of direct investments in the republic is forecasted to be lower than level of Q4 2014 by 45.2 percent. In the reporting period, the positive balance of “other investments” item will make USD 11.1 million. In the reporting period, the residents’ liabilities will decrease by USD 101.1 million or 52.8 percent compared to Q4 2014. The increase in payments on previously attracted funds of the private sector was the main factor of decrease in the rates of liabilities inflow. The residents’ assets in Q4 2015 are forecasted to increase by USD 90.0 million.

Therefore, at the end of Q4 2015 balance of payments of the Kyrgyz Republic will be formed positive and make USD 13.7 million. The volume of gross international reserves will cover 4.9 months of future imports of goods and services.

Indexes of Real and Nominal Effective Exchange Rate of KGS

Table 2.2.2. Key Values for Exchange Rate

	year (average)			month to beginning of the year (as of the end of month)		
	2013 (aver.) (Jan-Dec)	2014 (aver.) (Jan-Dec)	%	December 2014	December 2015 *	%
REER	117.3	122.9	4.8	128.8	116.4	-9.6
NEER	114.4	122.6	2.7	122.6	117.1	-4.5
RBER to CNY	133.9	120.6	-5.3	130.6	106.2	-18.7
NBER to CNY	64.8	56.4	-11.5	61.3	48.9	-20.2
RBER to Euro	139.6	145.8	-2.0	143.1	128.6	-10.2
NBER to Euro	61.8	61.8	-9.7	61.4	53.5	-12.8
RBER to Japanese yen	216.0	216.0	2.2	254.4	204.9	-19.4
NBER to Japanese yen	83.6	83.6	1.0	90.9	71.0	-21.9
RBER to KZT	107.5	122.9	6.8	103.1	126.0	22.3
NBER to KZT	111.3	114.1	5.5	105.0	141.0	34.3
RBER to RUR	86.2	97.4	17.0	103.6	92.3	-10.9
NBER to RUR	131.9	160.1	18.3	158.5	154.1	-2.7
RBER to Turkish lira	128.9	133.4	1.5	128.2	119.9	-6.5
NBER to Turkish lira	308.2	324.4	2.1	300.3	295.4	-1.6
RBER Ukrainian hryvnia	140.4	140.4	14.5	177.0	147.1	-16.9
NBER Ukrainian hryvnia	178.9	178.9	21.3	235.8	269.3	15.2
RBER to USD	178.2	160.2	-5.4	176.0	138.7	-21.2
NBER to USD	86.6	74.4	-12.1	82.1	62.9	-23.4

* preliminary data

↓ - Som devaluation, competitiveness improvement

↑ - Som strengthening, competitiveness deterioration

In Q4 2015, the real and nominal effective exchange rates of KGS decreased compared to December 2014. According to the preliminary data, the index of nominal effective exchange rate (hereinafter referred to as “NEER”) of KGS decreased by 4.5 percent from the beginning of 2015 and amounted to 117.1 by the end of December 2015. The decrease in the index was due to KGS depreciation¹ in December 2015 compared to the average exchange rate for December 2014 against: the US dollar – by 23.4 percent, the Japanese yen – by 21.9 percent, the Chinese yuan – by 20.2 percent

¹ The data are given for nominal bilateral exchange rate of KGS; the year of 2000 is used as the base period for calculation of the index.

and to the Russian ruble – by 2.7 percent. KGS appreciation was observed against other currencies: the Kazakh tenge – by 34.3 percent, the Ukrainian hryvnia – by 15.2 percent.

The decrease in the NEER index and the high level of inflation¹ in the trading partner countries caused a decrease in the index of real effective exchange rate by 9.6 percent from December 2014 and amounted to 116.4.

¹ For January to December 2015, the KR inflation amounted to 3.4 percent, whereas an average inflation rate in major trading partner countries made 9.3 percent according to preliminary calculations.

Chapter 3. Monetary Policy

3.1. Monetary Policy Implementation

In Q4, the Board of the National Bank made decisions for keeping policy rate unchanged at 10.00 percent. In Q4, the rates of the interest “corridor” remained unchanged as well: the rates of overnight deposits – 4.00 percent and those of overnight credits – 12.00 percent. The balance of risks related to a decrease in external demand on the one hand, and the pressure on the exchange rate and dynamics in consumer prices on the other, was taken into account when making the decisions.

The scenario of economic development assumed as a basis at the NBKR Board meeting held in November 2015 implied preserving the policy rate unchanged, enhancement of pressure on the exchange rate and decrease in inflation rate by the end of 2015 by means of the food component.

According to actual data, in Q4 2015 KGS depreciated by 10.3 percent; the annual inflation rate made 3.4 percent by the end of 2015.

In Q4, the National Bank took measures to decrease the dollarisation of credits and deposits and to stimulate the use of the national currency. Differentiated values of the MRR (mandatory reserve requirements) were introduced for the liabilities in the national and foreign currencies for the commercial banks (since October 5, 2015), according to which the volume of the mandatory reserves on the liabilities in the national currency was set at 8.5 percent, in foreign currency - 9.5 percent. Thereafter, since December 14, the volume of the mandatory reserves on the liabilities in the national currency was decreased down to the level of 4.0 percent; the volume of the mandatory reserves on the liabilities in foreign currency was increased up to 12.0 percent.

In December 2015, the Board of the National Bank decided to reduce the volume of the mandatory reserves on the liabilities in the Armenian drams, Belarussian roubles, Kazakh tenges, Chinese yuans and Russian rubles down to 4.0 percent taking into account close trade relations of the Kyrgyz Republic with China and the EEU countries, and in order to stimulate the transition of population and economic agents to the settlements in the national currencies of those countries.

The analyzed period demonstrated an increase in excess liquidity (before sterilization) both compared to Q3 2015 and to similar indicator of 2014. For instance, in the reporting quarter of 2015, the average daily level of excess reserves in the banking system amounted to KGS 4.2 billion compared to KGS 2.3 billion in Q4 2014 and KGS 3.6 billion in Q3 of the current year. In this respect the National Bank carried out transactions to sterilize excess liquidity. The average daily volume of sterilization due to issuance of the National Bank notes in Q4 amounted to KGS 1.7 billion against KGS 0.6 billion in Q4 2014. The average daily volume of overnight deposits amounted to KGS 1.8 billion (in Q3 2015 – KGS 1.3 billion; in Q4 2014 – KGS 0.9 billion).

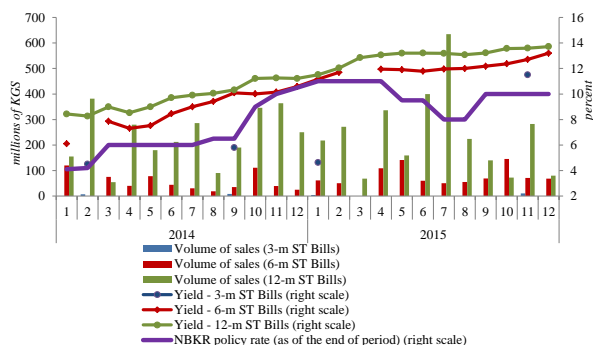
In Q4 2015, there was the pressure on KGS exchange rate; such situation required the National Bank participation in the foreign exchange market. The National Bank carried out US dollar sales transactions in total amount of USD 124.2 million, including cash in the amount of USD 8.35 million; finally, the total volume of withdrawn KGS liquidity due to currency interventions amounted to KGS 9.1 billion (in Q3 2015 – KGS 2.3 billion);

In Q4, in order to facilitate the implementation of the Project for Financing of Agriculture-4, the National Bank decided to provide the commercial banks with the opportunity to further prolong previously provided funds within the framework of credit auctions up to 1 year; the total volume thereof makes approximately KGS 3.1 billion.

3.2. Financial Market Instruments

Government Securities Market

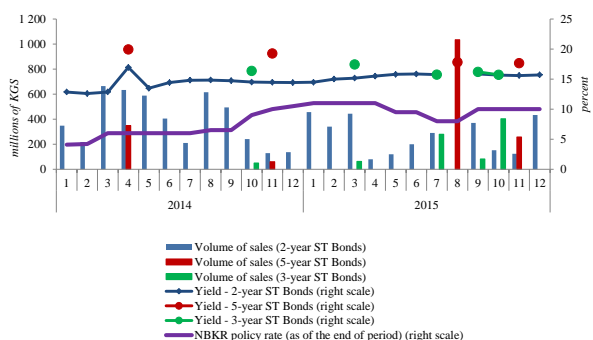
Chart 3.2.1. Dynamics of ST-Bills Sales Volumes and Yield



of the end of the period.

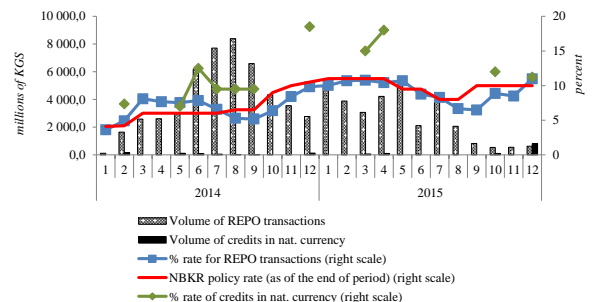
The sales volume decreased (-35.8 percent) on the background of a decrease in the demand volume (-71.4 percent). In Q4, the sales volume made KGS 728.6 million. In the reporting period the average monthly yield of ST-Bills increased in all segments of securities placed in the market. The total average weighted yield of ST-Bills amounted to 13.2 percent (+ 2.1 p.p.).

Chart 3.2.2. Dynamics of ST-Bonds Sales Volumes and Yield



In the reporting period, the volume of sales (including additional placements) increased by 2.4 times to make KGS 1.5 billion. The average weighted yield increased (+1.0 p.p.) up to 16.1 percent in the period under review.

Chart 3.2.3. Activity in the Interbank Credit Resource Market



the bank market, as well as the transactions on the overnight credits and deposits, and the credit auctions of the National Bank) made KGS 121.3 billion in the reporting period.

ST-Bills

The Ministry of Finance of the Kyrgyz Republic suggested placing 3-, 6- and 12-month bills in Q4. The total volume of the announced emission of the bills at the auctions made KGS 2.0 billion in October to December 2015 having increased by 55.5 percent against the comparable period of 2014. The volume of securities in circulation increased by 10.0 percent year-to-date and amounted to KGS 3.4 billion as

ST-Bonds

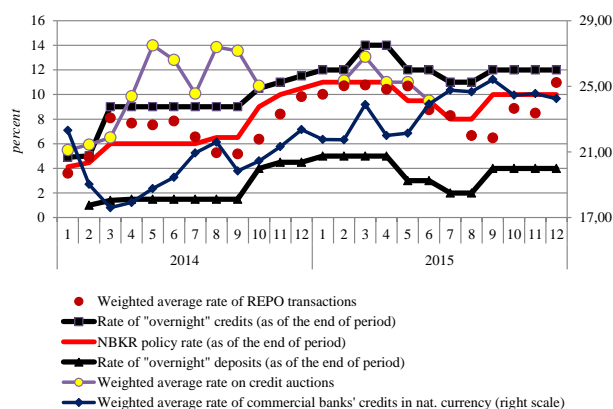
In Q3, the State Treasury Bonds (ST-Bonds) market was presented by 2-, 3- and 5-year securities. As of the end of the reporting year, the volume of ST-Bonds in circulation increased by 40.3 percent year-to-date to make KGS 10.0 billion. The announced volume of ST-Bonds emission at the auctions made KGS 3.0 billion in Q4 2015, having increased by 4.5 times against the comparable value of 2014.

Inter-Bank Credit Resource Market

In Q4 2015, the volume of transactions conducted in the inter-bank market decreased due to slowdown in activity of the main participants. The volume of overnight deposits placed in the National Bank, however, amounted to KGS 117.9 billion (+2.1 times).

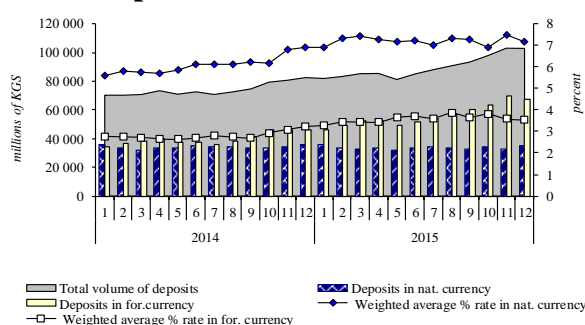
Thus, the total volume of KGS transactions (the transactions in the inter-

Chart 3.2.4. Rates of NBKR and Inter-Bank Transactions



In accordance with the monetary policy under implementation, the National Bank did not conduct credit auctions, whereas the overnight credits in the reporting period were granted in the amount of KGS 809.0 million (-85.6 percent).

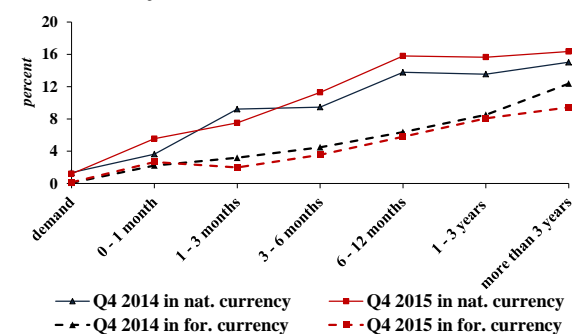
Chart 3.2.5. Dynamics of Commercial Banks Deposits



Deposit Market

The upward trend was observed in the deposit market. The volume of deposit base of the commercial banks increased by 24.6 percent year-to-date to make KGS 102.9 billion as of the end of Q4 2015. The deposit base increased by 6.3 percent year-to-date excluding changes in the exchange rate. The deposits in foreign currency increased by 45.1 percent up to KGS 67.5 billion. The deposits in the national currency decreased by 1.8 percent down to KGS 35.4 billion.

Chart 3.2.6. Rates of New Credits in National and Foreign Currency in Terms of Maturity

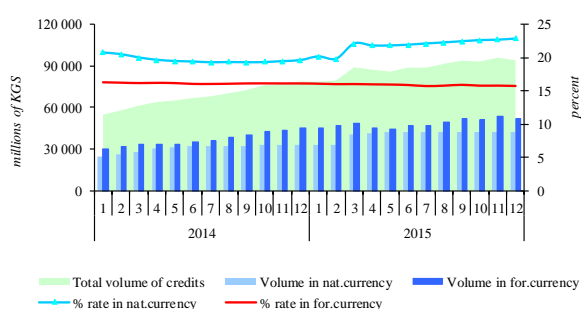


In Q4 2015, the weighted average interest rate for new deposits in the national currency made 2.78 percent, having decreased by 0.04 percentage points against the same period of 2014; the rate on the deposits in foreign currency decreased to 0.97 percent (-0.11 percentage points). In the reporting period, a weighted average interest rate on the fixed-term deposits in the national currency made 13.91 percent (+1.41 percentage points), while interest rate on those in foreign currency made 5.33 percent (-0.86 percentage points).

on those in foreign currency made 5.33 percent (-0.86 percentage points).

Credit Market

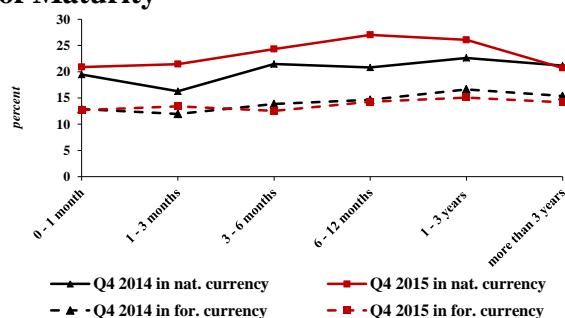
Chart 3.2.7. Dynamics of Commercial Banks Credit Debt as of the End of the Period



In Q4 2015, the credit portfolio continued to grow due to the credits issued both in the national and foreign currencies. One of the sources for credit resources was implementation of the Project for Financing of Agriculture-3. In the reporting period, the volume of credits issued within the framework of this Project made KGS 544.5 million.

As of the end of the reporting period, the volume of credit portfolio of the

Chart 3.2.8. Rates of New Credits in National and Foreign Currency in Terms of Maturity



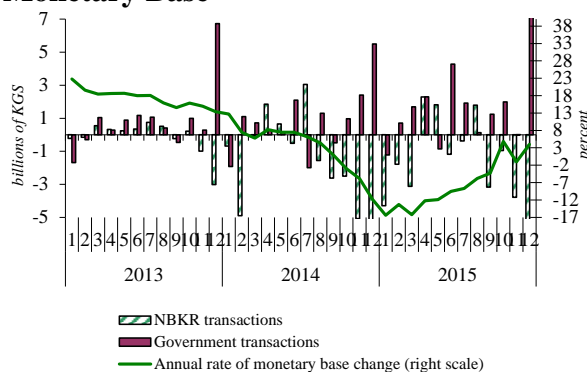
account changes in the exchange rate, decreased by 4.5 percentage points year-to-date to make 48.7 percent.

The weighted average interest rate for new credits in the national currency increased by 3.04 percentage points, to make 24.42 percent, while for those in foreign currency decreased by 1.19 percentage points down to 13.96 percent.

The share of overdue credits accounted for 1.9 percent at the end of the reporting period (-0.2 percentage points year-to-date), while the share of prolonged credits made 4.8 percent (+1.8 percentage points).

3.3. Dynamics of Monetary Indicators

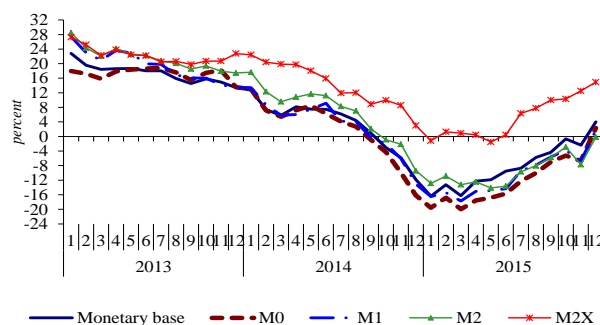
Chart 3.3.1. Input of the Government's and NBKR's Transactions in Change of Monetary Base



base growth was conditioned by an increase in budget expenditures for salaries to the employees of budgetary organizations and social payments. In Q4, the transactions of the Kyrgyz Republic Government increased the monetary base by KGS 10.8 billion, while operations of the National Bank reduced the monetary base by KGS 10.3 billion; KGS 9.1 billion thereof was sterilized by the transactions in the foreign exchange market.

Chart 3.3.2. Nominal Growth Rates of Monetary Aggregates

(in annual terms)



commercial banks increased by 19.3 percent year-to-date and amounted to KGS 94.0 billion. The credit portfolio increased by 4.6 percent, without taking into account the impact of the exchange rate. Meanwhile, the credits in the national currency increased by 26.5 percent to make KGS 42.2 billion, while those in foreign currency made KGS 51.7 billion (+14.0 percent).

As of the end of the reporting period, the credit portfolio dollarization, taking into

Monetary Base

Traditionally, there was an increase in budget expenditures at the end of the year; therefore the money supply was increased due to the transactions carried out by the Government of the Kyrgyz Republic. Monetary base increased by 0.7 percent, or by KGS 0.5 billion, to make KGS 67.1 billion in the reporting quarter of 2015. The monetary base increased by 4.0 percent in annual terms. The impact of the Kyrgyz Republic Government's transactions on the monetary

Monetary Aggregates

Nominal rates of changes in monetary aggregates had an upward trend in Q4 2015 due to growth of the deposits in the banking system. In the reporting quarter, narrow money (M1) and broad money in the national currency (M2) increased by 0.7 and 1.4 percent respectively compared to the previous quarter of the current year, money outside banks (M0) reduced by 1.3 percent (in

annual terms (December 2015 / December 2014) these monetary aggregates decreased by 4.4, 4.9 and 0.5 percent respectively).

In the reporting quarter, broad money M2X, that comprises deposits in foreign currency, increased by 5.5 percent (in annual terms the increase made 14.9 percent). The growth of deposits¹ by 10.0 percent in Q4 (in annual terms growth made 23.9 percent) determined increase in broad money M2X.

Meanwhile, deposits in foreign currency included in broad money M2X increased by 11.5 percent (in annual terms the increase was 44.4 percent), deposits in the national currency increased by 6.8 percent (in annual terms the decrease of 4.4 percent was observed).

¹Excluding deposits of the Government and non-residents.

Chapter 4. Inflation Dynamics

4.1. Consumer Price Index

Chart 4.1.1. Dynamics of CPI Structure
(quarter to the corresponding quarter of the previous year)

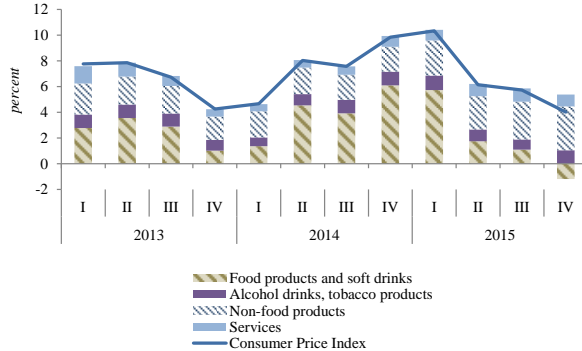


Chart 4.1.2. Dynamics of Food Products Price Input in Annual CPI

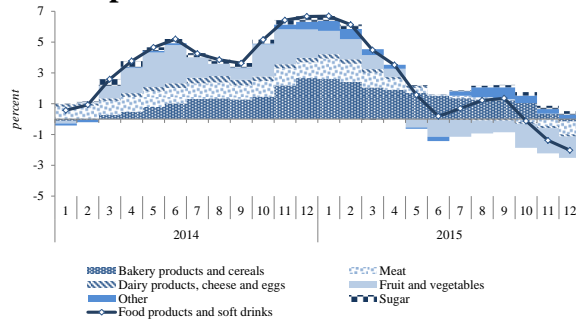


Chart 4.1.3. Dynamics of Non-Food Products Price Input in Annual CPI

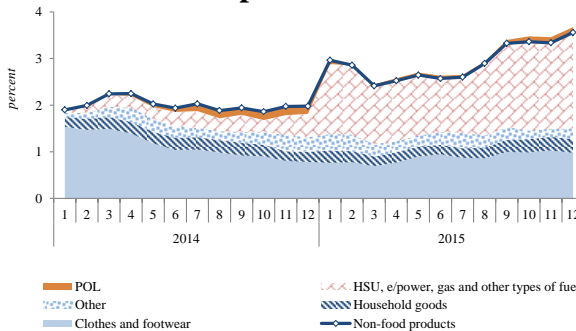
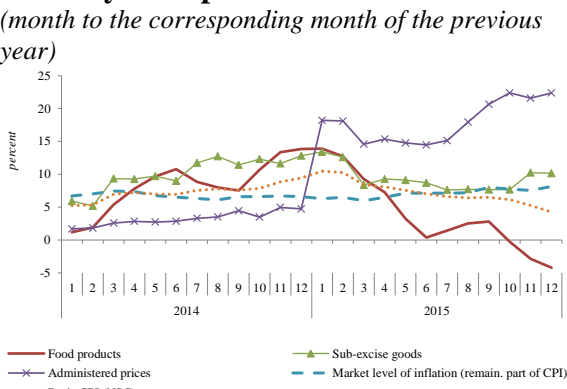


Chart 4.1.4. Dynamics of Consumer Price Index by Groups of Commodities
(month to the corresponding month of the previous year)



In Q4 2015, there was easing in the inflationary pressure. According to the National Statistical Committee of the Kyrgyz Republic (hereinafter referred to as the “NSC KR”), CPI growth made 4.0 percent in Q4 2015 compared to the same quarter of the previous year, while the similar indicator of 2014 was at the level of 9.8 percent. Annual inflation rate (December 2015 against December 2014) amounted to 3.4 percent.

In Q4 2015, a decrease in the inflation rate resulted from the downward trend in the prices for the food products. Prices for food products were conditioned by the growth of the domestic production in the agricultural sector and establishing of the export prices for wheat in Kazakhstan at a relatively low level and favorable situation in the international food markets. In Q4 2015, the price index for food products and soft drinks decreased by 2.5 percent compared to the same quarter of 2014 (in Q4 2014, the price growth made 12.6 percent). Decrease in prices for fruits and vegetables by 24.5 percent, which took place primarily due to a good harvest in the agriculture, made a significant input in decline of the food inflation. Moreover, there was a decrease in prices for meat (-4.2 percent) and dairy (-5.5 percent) products. The growth rates of prices for bakery products and cereals decreased significantly and made 2.2 percent. KGS depreciation against USD had an upward pressure on the prices for imported goods. The prices for sugar increased by 6.5 percent compared to the same quarter of the previous year.

Among the main product categories, there was a relatively high increase in the prices for non-food products by 11.8 percent; the prices for alcohol drinks and tobacco products grew by 11.6 percent. The increase in the price index for the group “housing services, electricity, gas and other types of fuel” by 21.1 percent, which was primarily due to rise in the tariffs for electricity and heating, had a significant

effect on the non-food inflation. USD appreciation resulted in an increase of the prices for clothes and footwear by 9.0 percent. A decrease in prices for petroleum, oil and lubricants by 15.9 percent had a restraining effect on the inflation rate.

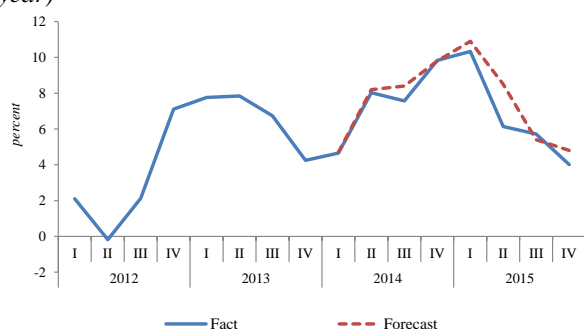
Annual growth in prices for paid services made 6.6 percent in Q4 2015 (in the same period of 2014 – 6.1 percent). Increase in prices of this group was primarily due to the rise in prices for the services of hotels and restaurants (+16.2 percent), education (+8.6 percent) and leisure (+8.7 percent).

According to the data of the NSC KR, the base inflation made 5.2 percent in Q4 2015 against Q4 2014.

4.2. Comparison of Forecast and Facts

Chart 4.2.1. Actual and Forecasted CPI Values

(quarter to the corresponding quarter of the previous year)



Actual inflation rate was lower than the forecasted one. In Q4 2015, CPI increased by 4.0 percent compared to the corresponding quarter of the previous year, which is 0.8 percentage points lower than the forecasted value. The price dynamics in the both food and non-food products groups were less significant compared to the forecasted ones due to higher actual production in the agriculture, favorable external conjuncture, and lower prices for imported goods compared to the forecasted ones.

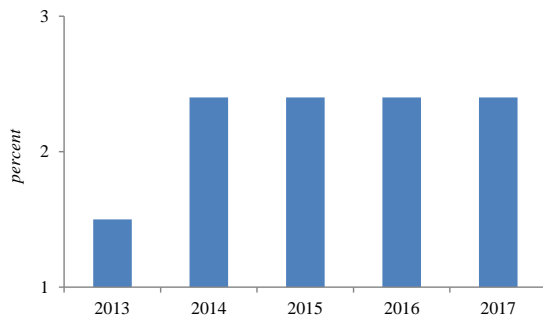
Chapter 5. Medium-Term Forecast

5.1. External Environment Proposals

Development Forecast of Major Trading Partner Countries

USA

Chart 5.1.1. Real GDP Growth in USA
(year to year)



Source: IA Bloomberg

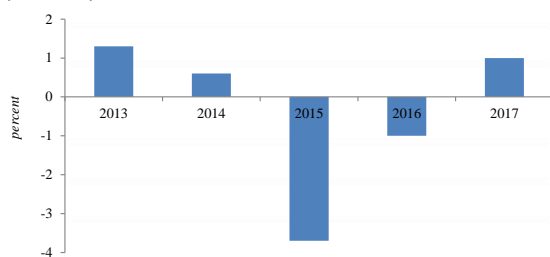
In the medium term, according to the forecast, the economic growth in the USA will still be moderate. In 2016-2017, GDP growth in the USA is expected at approximately 2.4 percent, which is comparable with the values of the previous years. Growth of activity will be primarily supported by sustainable dynamics of consumer expenses amid a favorable situation in the labor market and the low prices for energy carriers, which release funds for consumption. Cost of financing, which is still low, will have a positive impact on the

economic activity. An increase in the interest rates is expected to be smooth in the USA. A negative impact of the US dollar strong position on exports and industrial production will have a restraining effect on the economic growth.

With diminishing negative growth of prices for the fuel and energy products in the annual terms, the inflation rate in the USA will grow from the level close to zero in 2015 to 1.6 percent in 2016 and above two percent in the following years.

Russia

Chart 5.1.2. Real GDP Growth in Russia
(year to year)



Source: IA Bloomberg

Forecast for the economic growth in Russia in 2016 was worsened, primarily due to preserved low prices for hydrocarbons and the influence of geopolitical factors. In 2016, economic slowdown in the Russian Federation is expected at approximately 1.0 percent, instead of the previously forecasted decline of 0.3 percent. In 2017, the growth is expected at 1.2 percent. The effects of the conservative

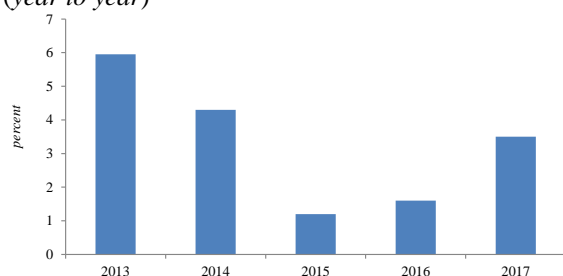
fiscal policy, in view of the reduced income from oil and gas exports, and the tight monetary policy may have a negative impact on the economic and investment activity of the population, as well as to result in the acceleration of inflation rates in the medium term. On the other hand, the reduced domestic demand will have a restraining effect on the inflation rates. Thus, in 2017, the inflation rate can decrease to 6.7 percent from the average level of 15.6 percent in 2015.

Dynamics of the prices for energy carriers will primarily determine the rates of economic growth recovery, the inflation and the value of the Russian ruble in 2016-2017.

Kazakhstan

Chart 5.1.3. Real GDP Growth in Kazakhstan

(year to year)



Source: IA Bloomberg, international financial institutions

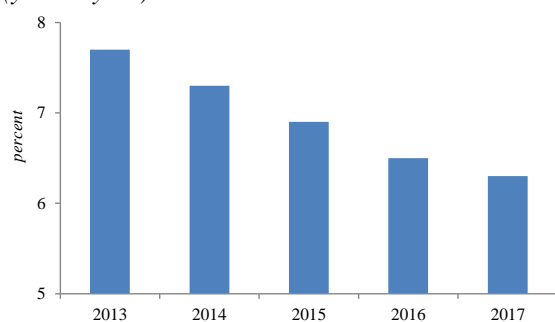
Russia, Brazil, Turkey), which will restrict their demand for the products manufactured in Kazakhstan. According to the forecasts of experts interviewed by Bloomberg information agency, GDP growth in Kazakhstan is expected to reach 1.6 percent in 2016, 3-4 percent - in 2017.

According to the expert estimates, the inflation rate is expected at 12-13 percent in 2016 and 5 percent in 2017. Among the inflation risks, the experts allocate a substantial share of imports in consumption together with a transition to free foreign exchange regime and free pricing in the economy. The persistence of high inflation estimates in 2016 is due to the fact that prices will be adjusted for some time after KZT depreciation, however, in Q4 2016, the inflation rate is likely to decrease down to 8-9 percent and this trend will continue in 2017 due to a lack of expectations for further sharp depreciation of KZT, moderate growth in consumer demand and slow growth of the money supply/lending. In 2016, the National Bank of Kazakhstan expects inflation at the level of 8 percent.

China

Chart 5.1.4. Real GDP Growth in China

(year to year)



Source: National Bureau of Statistics of the PRC, IA Bloomberg

will be conditions for further slowdown in investment growth and industrial production. Meanwhile, the positive dynamics of the final consumption and the possibilities of the country authorities on activity stimulation will support the economic growth of 6.5 percent in 2016, with a further slowdown in the subsequent years.

Dynamics of the inflation rate is forecasted to be upward. Its average annual value will increase from 1.4 percent in 2015 to 2.0 percent in 2017.

Forecast for the economic development in Kazakhstan in 2016 are limited by the existing adverse external background. First of all, it is a suppressed environment and low prices in the commodity markets, including the oil market, which is main for Kazakhstan. Secondly, it is the fall of the stock markets in the developed as well as developing countries. Thirdly, it is a sharp slowdown in the global economic growth, as well as under the effect of specific issues in the largest developing countries (China,

China, Russia, Brazil, Turkey), which will restrict their demand for the products manufactured in Kazakhstan. According to the forecasts of experts interviewed by Bloomberg information agency, GDP growth in Kazakhstan is expected to reach 1.6 percent in 2016, 3-4 percent - in 2017.

A gradual slowdown in economic growth will continue in China. Slight slowdown in the economic growth is acceptable for the Government in light of the reforms carried out in the country in order to transfer to a more sustainable growth model based on the higher role of domestic consumption and the services sector in the economy. Measures taken by the Government to reduce excess capacity, to suppress debts of the regional authorities and to reduce the risks associated with the shadow banking sector,

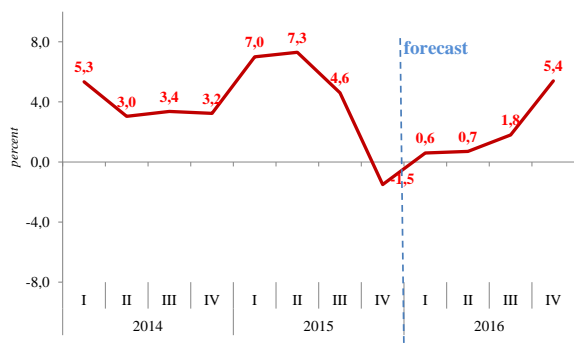
will be conditions for further slowdown in investment growth and industrial production. Meanwhile, the positive dynamics of the final consumption and the possibilities of the country authorities on activity stimulation will support the economic growth of 6.5 percent in 2016, with a further slowdown in the subsequent years.

Dynamics of the inflation rate is forecasted to be upward. Its average annual value will increase from 1.4 percent in 2015 to 2.0 percent in 2017.

5.2. Medium-Term Forecast

Chart 5.2.1. Forecast of Real GDP

(quarter to the corresponding quarter of the previous year)



According to the baseline scenario, the current trends will exist in the world hydrocarbons and food market in 2016. In 2016, the average price for oil will make USD 30 per Barrel, the sideways trend will still be observed in the food markets (FAO index) without significant changes and the annual average index value will be about 158.6 points against 164.1 points in 2015.

Dynamics of the oil prices will determine the economic growth and dynamics of the consumer prices in Russia and Kazakhstan. With these parameters in the

world commodity market, the GDP in Russia is expected to decrease by 1 percent; the inflation rate is expected to make 8.6 percent. The economic growth in Kazakhstan is forecasted at 1.8 percent and the inflation rate - at 12.1 percent.

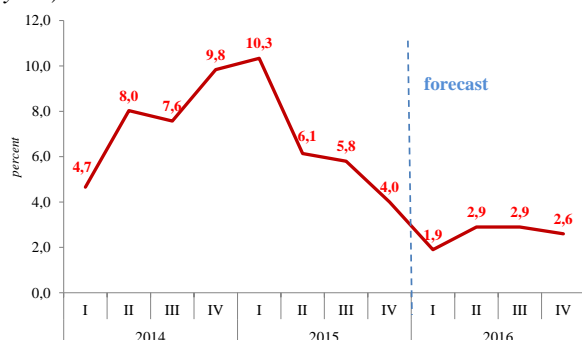
Development of the real economy in Kyrgyzstan in 2016 will demonstrate a positive, but more moderate dynamics of the economic growth. At the end of the year, the real GDP growth will be about 2.4 percent, the growth excluding Kumtor will be 2.7 percent. The increase in production at the enterprises of the Kumtor Mine will not exceed the indicators of 2015, the production output will amount to Troy ounce 480-530 thousand per year, however, in contrast with 2015, the production will be uneven within a year with a maximum share of production (approximately 40 percent) in Q4 2016. In the sectoral structure, a moderate growth is expected in agriculture, trade and construction sectors. In 2017, real GDP growth is expected at the level of 4.3 percent.

Negative GDP gap is expected during the whole year, it will have a deflationary pressure on the rate of consumer price dynamics. In Q1 2016, the annual GDP growth will make 0.6 percent, while the average inflation rate will be 1.9 percent.

In 2016, the inflow of USD remittances will remain in the negative zone; however, the rates of decrease will become slower. Generally, the inflow of migrant workers' remittances from abroad will decrease by almost 10 percent, meanwhile, the most significant reduction will be observed in the first half of the current year: approximately -13.5 and -22.1 percent in Q1 and Q2 respectively. The decrease in the inflow of remittances in the short term will be one of the factors for the reduction in the internal demand and the purchasing power of the population.

Chart 5.2.2. Inflation Forecast

(quarter to the corresponding quarter of the previous year)



According to the inflation forecast in the baseline scenario, in 2016, the slowdown is expected in the inflation processes amid low prices in the energy and food market and the deflationary pressures from the low demand in the country. In the short term, the prices are expected to decrease on the background of the expected good harvest in the world food market and in Kazakhstan, which is the main country supplying wheat in our country. According to the preliminary estimates, the growth of the annual average consumer price

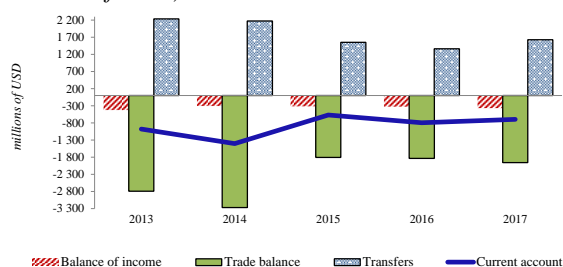
index (period to period) will not exceed 3 percent; meanwhile, the growth can make 1.9 and 2.9 percent respectively in Q1 and Q2.

Mid-term inflation forecast takes into account the tariff policy of the Government approved by the Government decree on “Mid-term tariff policy of the Kyrgyz Republic on electricity and heating for 2014-2017”. The electricity tariffs will increase by 21.0 percent in 2016 and by 29.8 percent in 2017 in case of electricity consumption of 700 kWh or less. The tariffs for heating and hot water will increase by 20.4 percent and 18.2 percent respectively since April 1, 2016 and 2017.

In 2016, the economic situation in the region and the indicators of economic growth in Kyrgyzstan will become the factors determining the status of the balance of payments. The expected increase in the deficit of the current account will make 13.1 percent to GDP (USD 795.7 million). This trend will be due to the decrease in the net inflow of current transfers and the worsened trade deficit.

Chart 5.2.3. Forecast Data on Current Account

(millions of USD)



In the forecast period, the export is expected to decrease by 12.3 percent due to the decline in external demand. The expected decline in gold production at the Kumtor Mine in 2015 and a decline in the world gold prices will also have a negative impact on the country exports. The decline of exports excluding gold is expected at 12.6 percent.

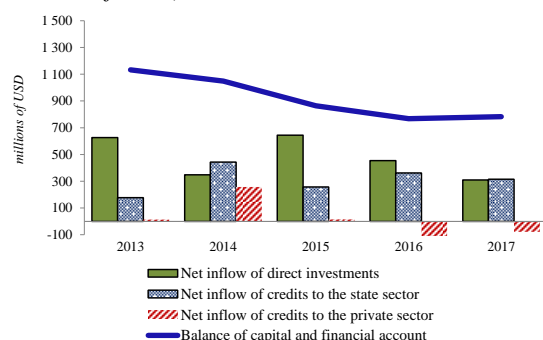
A decline in the world prices for petroleum products, as well as the expected low aggregate demand in 2016 will have the main influence on the dynamics of imports. Moreover, the high import cost due to a high level of the tariffs rates after joining the Eurasian Economic Union will be the main factor for the reduced imports from the third countries. Finally, the forecasted import decline will reach 6.5 percent.

In the forecast period, net inflow on “current transfers” item is expected to decrease by 12.1 percent compared to the level of the previous year. Despite the current negative trend of economic development in the Russian Federation, the improvement of the conditions of stay for the domestic migrant workers in the EEU countries will contribute to an increase of the RUB remittances inflow. However, further fluctuations of the RUB exchange rate can have an absorptive effect and result in a reduction of the USD remittances.

A decline in the economic activity will also affect the financing of the current account deficit due to the capital inflows on the capital and financial account, which is expected to decrease to 11.1 percent.

Chart 5.2.4. Forecast Data on Capital and Financial Account

(millions of USD)



Inflow of direct foreign investments and net inflow of the external credits are expected to decrease due to the expected reduction of credits inflow and maintaining of high service volumes on the funds previously raised by the private sector. An increase in the capital account is forecasted due to the inflow of grant funds from the Russian Federation and the Republic of Kazakhstan, submitted within the framework of joining the EEU by the Kyrgyz Republic.

Thus, the balance of payments at the end of 2016 is expected to be negative in the amount of USD 27.7 million; meanwhile, the reserve assets are expected to cover 4.6 months of the future imports of goods and services.

In 2017, the economic rehabilitation in the region and expected stabilization of the national currency exchange rates of the major trading partner countries to the US dollar will contribute to the improvement of the external sector indicators in the Kyrgyz Republic.

The current account is forecasted to improve up to 11.4 percent to GDP due to the restoration of current transfers positive growth rates. Significant import growth (by 4.6 percent) compared to export growth (by 2.9 percent) will result in an increase of the trade balance. Adaptation of the Kyrgyz Republic to the business conditions within the framework of the EEU will also be a positive result in the foreign trade.

Rehabilitation of the economic growth in Russia and Kazakhstan, as well as expected stabilization of the currency exchange rates in these countries will have a positive impact on the inflows of private transfers, which will increase by 19.6 percent.

Capital inflow on the financial account is expected to decline. As before, the basic amount of funds on the financial account will be provided by the inflow of foreign direct investments, as well as the loans to the public sector.

The total amount of the payment balance at the end of 2017 is expected to be positive in the amount of USD 88.9 million. Reserve assets will cover 4.5 months of the future imports of goods and services.

The forecast of the balance of payments of the Kyrgyz Republic for 2016-2017 has the following risks:

- the risks associated with the Kumtor Mine exploration;
- volatility in the world prices for oil;
- deterioration of the economic situation in the trading partner countries;
- incomplete disbursement of the planned amounts of foreign loans to the public sector;
- volatility in the exchange rate of the major trading partner countries.