

**NATIONAL BANK  
OF THE KYRGYZ REPUBLIC**

**Monetary Policy Report  
(Inflation report)  
Quarter 1, 2017**

**Bishkek  
May 2017**

Monetary Policy Report (Inflation report) is released by the National Bank on a quarterly basis. The objective of the Report is to inform the public about the decisions on the monetary policy made by the National Bank, which are based on analysis and forecast of the main inflation factors and assessments of the economic situation development in the external environment and in the Kyrgyz Republic.

### *Monetary Policy in the Kyrgyz Republic*

**The objective of the monetary policy** is to achieve and maintain price stability through appropriate monetary policy.

**The policy rate of the National Bank is the main instrument of the monetary policy.** In 2014, the National Bank moved to a new monetary policy framework - regime of targeting interest rates in order to improve and enhance the effectiveness of the monetary policy. The purpose is to strengthen the impact of the interest rate channel of the monetary policy, aimed at development of the interbank credit market and support for the real sector of economy.

**Quantitative benchmark of the monetary policy is to keep inflation rate within 5-7 percent in the medium term.** Development and implementation of the monetary policy is carried out within the framework of the National Sustainable Development Strategy for 2013-2017 and the Main Directions of the Monetary Policy for the medium term.

**Monetary policy of the National Bank is focused on the future,** as the decisions made in the field of the monetary policy affect the key macroeconomic indicators of the country with a certain lag (about 6-8 quarters). Development of the monetary policy is based on the inflation forecasts for the short and medium term, resulting from consistent and economically reasonable forecast of the economic situation development in the Kyrgyz Republic and in the external environment.

**Communication policy is among the main instruments of the monetary policy conducted by the National Bank.** The National Bank regularly issues press releases and holds press conferences on the monetary policy in order to inform the public and form adequate inflationary expectations among the population. Assessment of the current and expected macroeconomic situation in the country made by the National Bank is published in the Monetary Policy Report (Inflation report) at the beginning of the third month of each quarter. The calendar of the Board meetings on the monetary policy rate of the National Bank is published on the official website of the National bank of the Kyrgyz Republic.

Monetary Policy Report (Inflation report) for Q1 2017 was approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic No. 20/1 dated May 29, 2017.

## Contents

<b>Chapter 1. External Environment .....</b>	<b>5</b>
1.1. Economic Development of the EAEU Countries and the Main Trading Partner Countries.....	5
1.2. Global Commodity Markets .....	8
<b>Chapter 2. Macroeconomic Development.....</b>	<b>11</b>
2.1. Demand and Supply in the Commodities and Services Market .....	11
2.2. External Sector .....	14
<b>Chapter 3. Monetary Policy .....</b>	<b>17</b>
3.1. Monetary Policy Implementation .....	17
3.2. Financial Market Instruments .....	19
3.3. Dynamics of Monetary Indicators .....	22
<b>Chapter 4. Inflation Dynamics.....</b>	<b>24</b>
4.1. Consumer Price Index .....	24
4.2. Comparison of Forecast and Facts.....	25
<b>Chapter 5. Medium-Term Forecast.....</b>	<b>26</b>
5.1. External Environment Proposals .....	26
5.2. Medium-Term Forecast .....	28
<b>Annex 1. Key Macroeconomic Indicators.....</b>	<b>32</b>
<b>Annex 2. Glossary.....</b>	<b>33</b>
<b>Annex 3. Abbreviations .....</b>	<b>35</b>

## Summary

**In Q1 2017 the inflation rate started gradually increasing amid rising external and internal consumer demand.** In the reporting period the average inflation was 1.5 percent, meanwhile at the end of March of the current year annual inflation was 2.8 percent (March 2017/March 2016), whereas the corresponding index in March 2016 formed at 0.5 percent. In the reporting period, increase in the inflation rate was mainly due to rise in prices for tobacco products and services.

Seasonal rise in prices for food products was observed in the period under review. The prices for fruit and vegetables rapidly grew due to slow increase of vegetable production and reduced potato production in Kyrgyzstan in 2016, annual growth in the prices for fruit and vegetables amounted to 30.9 percent in March of the current year.

Taking into account the upward trend in the internal and external demand, as well as balanced assumptions on the internal production of agricultural products and the dynamics of the world prices for food products, the inflation rate is expected to approach the medium-term benchmark range of 5-7 percent in the medium term.

**Relatively high rates of economic growth were observed in the country in the first quarter.** This growth is mainly attributed to the substantial increase in industrial production, primarily due to growth in the volumes of production output at the enterprises of the Kumtor Mine. At the end of Q1 2017, the economic growth in the country amounted to 7.8 percent, GDP growth made 3.9 percent excluding enterprises at the Kumtor Mine. All main sectors of economy excluding construction made a positive contribution to GDP growth. Economic growth was supported by the upward dynamics of remittances inflow and domestic consumption recovery in the country.

**Gradual recovery of the external and internal demand affected the increase of the foreign trade indicators in the country.** At the end of Q1 2017, the import and export of goods increased by 14.3 and 27.9 percent respectively. Finally, the foreign trade turnover<sup>1</sup> increased by 18.7 percent and amounted to USD 1.3 billion. The trade deficit of the country was formed in the amount of USD 373.1 million.

**The fiscal deficit still remains amid rising expenditures of the state budget and lower non-tax revenues.** At the end of Q1 2017, the state budget was executed with a deficit of KGS 0.8 billion, or 0.9 percent to GDP (in the same period of 2016, the budget surplus amounted to KGS 2.7 billion, or 3.4 percent to GDP). The budget deficit was primarily affected by slowdown in revenue growth and rise in labor costs due to increase in the salaries of the technical and junior service personnel.

**A trend towards the national currency strengthening was still observed in the domestic foreign exchange market.** In the reporting quarter, the official USD/KGS exchange rate decreased by 0.9 percent, from KGS 69.2301 to 68.6069 per USD 1.

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<sup>1</sup> The data are given in FOB prices including the NBKR additional estimates

## Chapter 1. External Environment

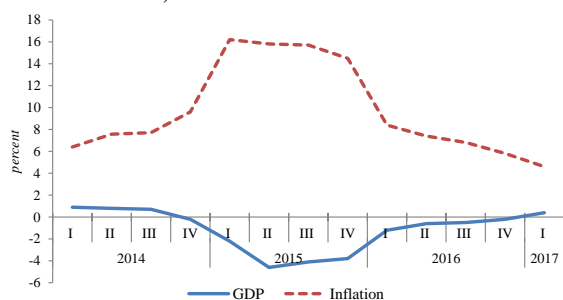
### 1.1. Economic Development of the EAEU Countries and the Main Trading Partner Countries

Gradual recovery of the economic activity was observed in the countries - main trading partners of Kyrgyzstan. In Q1 2017, the economy of Russia still gradually recovered, the inflation rate decelerated more rapidly, approaching the target level of 4 percent. Economic growth in Kazakhstan was supported by the implementation of structural reforms and the state programs, as well as increased production output and export of commodities. The inflationary background in Kazakhstan has been slowing down since the beginning of the year and approaching the target reference points. The economy of the Republic of Belarus was characterized by recovering economic growth amid improving external demand; meanwhile, the inflation rate slowed down due to improvement of the situation in the domestic foreign exchange market. Recovery of economic activity was observed in Armenia; meanwhile, the actual inflation rate accelerated slightly, but was still below the target reference point.

#### Russia

**Chart 1.1.1. The GDP growth and Inflation in Russia**

(in annual terms)



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

**Gradual recovery of the economy in Russia continued in Q1 2017.** Leading indicators calculated by the Eurasian Economic Commission also indicated recovery of the economic activity in Q1 2017. The improvement (compared to the similar period) is characterized by such components of the consolidated leading indicator as transport freight turnover, RTS index<sup>1</sup>, and the real disposable income of the population. According to the preliminary assessment of the Ministry of Economic Development of the Russian Federation (MED RF), in Q1 2017, the annual GDP

growth amounted to 0.4 percent. According to the data of the Russian Federal State Statistics Service, in Q1 2017, the production output in the industry grew by 0.1 percent, in agriculture - by 0.7 percent. In Q1 2017, the retail trade turnover decreased by 1.8 percent compared with the same period of the previous year. In January-March 2017, the volume of paid services rendered to the population decreased by 0.3 percent. In Q1 2017, the real salaries grew by 1.9 percent in annual terms.

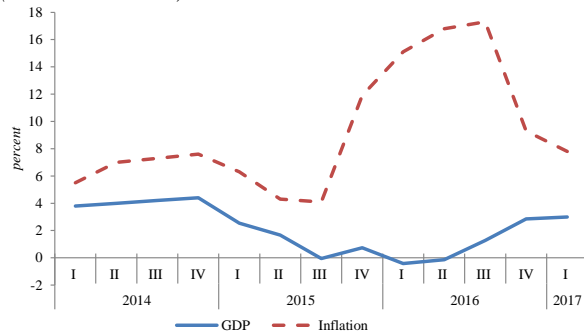
The year-to-date inflation slowed down more significantly than expected and continued approaching the target level of 4 percent. At the end of March, the average annual inflation rate was 4.3 percent, having decreased from 5.4 percent as of the end of 2016. According to the assessment of the Central Bank of the Russian Federation, the slowdown of the inflation rate was more significant than expected due to strengthening of the Russian ruble and good harvest in 2015-2016.

<sup>1</sup> RTS index is the stock index, the main indicator of the Russian stock market, which is calculated on the basis of 50 liquid shares of the largest and most dynamically developing Russian issuers, the types of economic activity thereof are the main sectors of the economy presented in Stock Exchange MCSE JSC

## Kazakhstan

**Chart 1.1.2. The GDP growth and Inflation in Kazakhstan**

(in annual terms)



Source: RK Statistics Agency, NBKR calculations

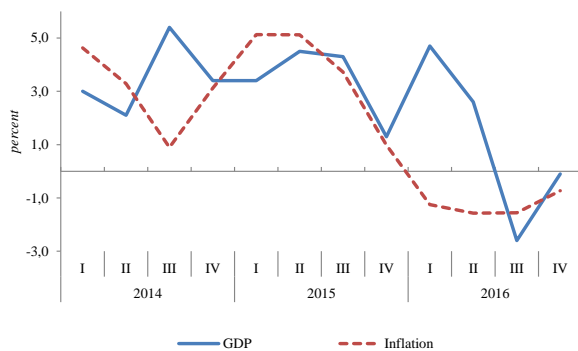
percent).

In Q1 2017, the average annual inflation in Kazakhstan amounted to 7.8 percent against 15.1 percent in the same period of 2016. Exhaustion of the effect of the national currency devaluation in Kazakhstan in 2015, improving the stability and predictability of the situation in the domestic money market, as well as carrying out moderately contractionary monetary policy were the main factors slowing down the inflation rate in Q1 2017.

## Armenia

**Chart 1.1.3. The GDP growth and Inflation in Armenia**

(GDP in annual terms, inflation month to the corresponding month of the previous year)



Source: National Statistical Service of the Republic of Armenia, IA Bloomberg

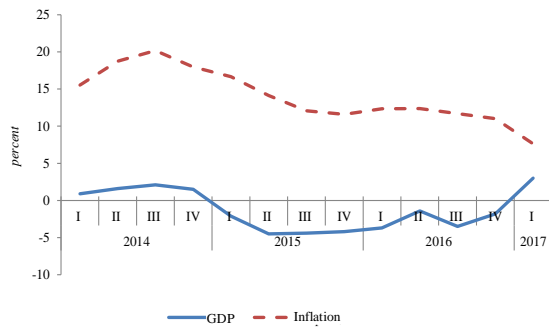
Since the beginning of 2017, the economy in Armenia demonstrated recovery of economic activity, while the actual inflation rate was in the negative zone. According to the National Statistical Service of the Republic of Armenia, in January-March 2017, the index of economic activity in Armenia grew by 6.6 percent compared with the same period in 2016. The economic activity increased due to the industry, as well as the sphere of trade and services. In the reporting period, the industrial output increased by 16.1 percent, growth in the service sector reached 10 percent, while the domestic trade turnover increased by 11.3 percent. Decline in the construction sector amounted to 13.6 percent, in agriculture – to 1.5 percent. According to the budget, GDP growth in Armenia for 2017 was forecasted at the level of 3.2 percent.

In January-March 2017, consumer prices in Armenia decreased by 0.3 percent compared with January-March 2016. According to the state budget, the inflation rate in Armenia in 2017 was planned at the level of 4 percent ( $\pm 1.5$  percent). Gradual recovery of the internal demand and prices in the international commodity markets in the absence of additional internal and external shocks will continue contributing to further stabilization of the inflation processes.

<sup>1</sup>According to the preliminary data of the Ministry of National Economy of the Republic of Kazakhstan

## Belarus

**Chart 1.1.4. The GDP growth and Inflation in Belarus**  
(in annual terms)

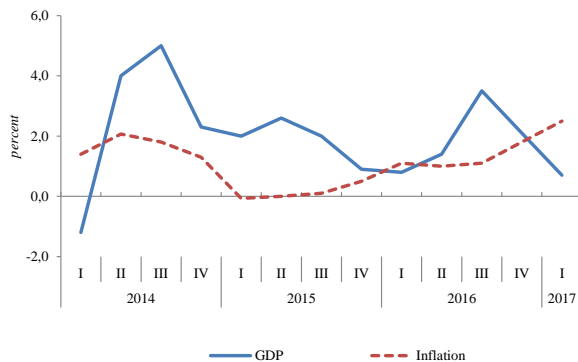


Source: National Statistical Committee of the Republic of Belarus

favorable situation in the domestic foreign exchange market.

## USA

**Chart 1.1.5. The GDP growth and Inflation in the USA**  
(in annual terms)



Source: the U.S. Ministry of Trade, the U.S. Department of Labor, IA Bloomberg

energy sector. Analysts note that low GDP growth in first quarters during the recent years may reflect the problem of seasonal adjustment of the US GDP data.

In March 2017, the inflation rate in the United States amounted to 2.4 percent, having decreased from 2.7 percent in February. The low increase in prices for food products was compensated by high growth rate of the energy prices, while the core inflation amounted to 2.0 percent and remained approximately at this level during the recent months.

In Q1 2017, the economy of the Republic of Belarus demonstrated positive growth amid growing foreign demand. In Q1 2017, GDP growth in Belarus amounted to 0.3 percent<sup>1</sup>. The economic growth was due to increased production output in the manufacturing industry (by 5.1 percent), in the sector of transport (by 3.3 percent) and agriculture (by 1.6 percent).

In Q1 2017, the annual average inflation rate in the Republic of Belarus formed at the level of 7.6 percent against 12.3 percent in the same period of 2016. The inflation rate slowdown was due to the

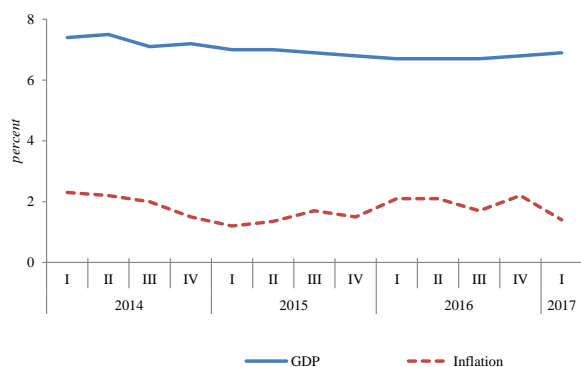
In Q1 2017, economic growth in the United States demonstrated slowdown; the analysts believe that such situation was temporary. According to the preliminary data of the United States authorities, GDP growth in the reporting quarter (in relation to the previous quarter in annual terms) amounted to 0.7 percent, which is lower than 2.1 percent in Q4 2016. Private consumption growth demonstrated significant slowdown. The inventory investments and the Government expenditures decreased, which was partially offset by strong growth of the private investment in fixed assets, particularly in the

<sup>1</sup>According to the preliminary data of the National Statistical Committee of the Republic of Belarus

## China

### Chart 1.1.6. GDP Growth and Inflation in China

(quarter to the corresponding quarter of the previous year)



Source: National Statistics Bureau of the PRC, IA Bloomberg

**Stimulating policy conducted by the Government of China contributed to the temporary acceleration of economic growth.** In Q1 2017, the annual GDP growth rate amounted to 6.9 percent due to acceleration by 0.1 percentage point in the reporting quarter and in Q4 2016. Improvements were noted in many sectors of the economy: growth rates of the industrial production, fixed asset investment, retail sales and exports increased or remained high. Experts believe that this is due to the stimulating fiscal policy of the Government, high growth in lending, improvement in the foreign trade environment and active growth in the real estate sector; however, they

expect the economic growth in China to slow down in subsequent periods.

In Q1 2017, the inflation rate in China decreased, the annual CPI growth rate stood at 0.9 percent in March, which is 0.1 percentage point higher than in February. Low inflation rate was primarily due to a decline in prices for food products, meanwhile moderate rise in prices was observed in other groups of products.

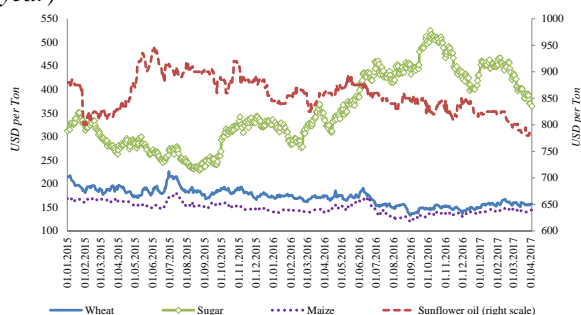
## 1.2. Global Commodity Markets

Dynamics of prices for the main types of food products in the world markets was multidirectional. The increase in prices for some products was not significant and substantial inflationary impact on the prices in Kyrgyzstan by the world markets is not expected. The upward price movements were observed in the oil market; political uncertainty and risks of geopolitical tensions in certain regions of the world resulted in formation of the upward trend in the prices for gold.

### Food Market

#### Chart 1.2.1. Dynamics of Prices for Food Products

(month to the corresponding month of the previous year)



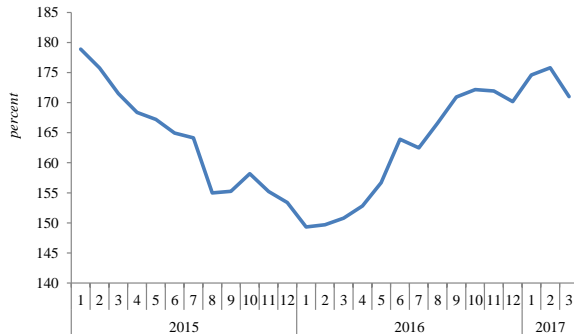
**In Q1 2017, the average prices for grains and vegetable oils have increased and stood higher than in the previous quarter, while the price for sugar decreased.** However at the end of the quarter there was a downward trend in the prices for all main types of food products. At the beginning of the period under review, the quotations for grains grew because of concerns about the adverse weather conditions for the harvest combined with active demand, however thereafter the production forecasts improved and it contributed to lower prices. In

the marketing year 2017/2018, the production of grains is forecasted to decrease compared to the record harvest of the current season of 2016/17, however, it will remain at a rather high level. In January of the current year, the prices in the world markets of sugar grew amid low supply in Brazil, India and South-Eastern Asia, however since February the prices started declining due to lower demand, improved forecasts for production and reduced use of sugarcane for biofuel



production. The prices for palm oil fluctuated depending on the actual level and prospects for production of this product in South-East Asia. Favorable weather conditions and an increase of areas for soy cultivation contributed to reduction of the price index for soybean oil. In Q1 2017, the prices for sunflower oil were characterized by the downward trend.

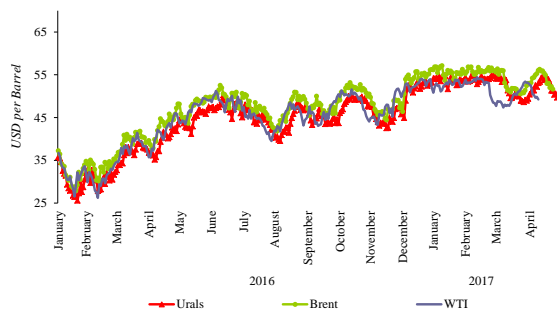
**Chart 1.2.2. Dynamics of FAO Food Price Index**



In Q1 2017, the average value of the FAO food price index increased by 1.3 percent compared to Q4 2016 primarily due to higher prices for grain. Price indexes for many commodity groups increased, except for sugar.

### Energy Market

**Chart 1.2.3. Dynamics of the Oil prices**  
(month to the corresponding month of the previous year)



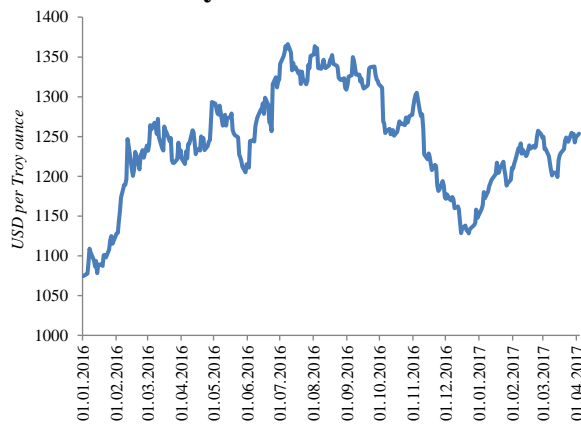
In Q1 2017, recovery dynamics was observed in the world oil prices under the influence of basic and market factors. The Prices for the key oil grades (Brent, WTI, Urals) fluctuated within the range of USD 44.5-57.1 per barrel. In Q1 2017, the average price for Brent crude oil grew by 6.8 percent compared to the previous quarter and amounted to USD 54.6 (the price increased by 55.2 percent compared to the same period of the previous year).

Generally, the rise of the oil prices was observed since the beginning of 2017 upon decision made by the OPEC in November 2016 to decrease oil production. In early March, the prices began to decline due to growth of oil production in the United States, expectations of the OPEC policy change. By the end of the month, there was an increase in prices associated with information on the increase of the FRS key rate amid economic recovery in the United States, which indicated existing demand for energy carriers, as well as the expectations of experts on consumption growth in the nearest future.

Information on oil reserves in the United States, reduction of oil production by the OPEC, geopolitical problems in certain regions of the world remain the main factors influencing the oil price formation. Speculation with the information about the OPEC meeting to be held in Vienna (on May 25 of the current year) had the upward pressure, as many analysts expect that the agreement on reduction of oil production approved earlier will not be amended.

## Gold Market

**Chart 1.2.4. Dynamics of Prices for Gold**



Source: IA Bloomberg

Generally, in Q1 2017, the prices for gold were characterized by the upward trend. The average price for this metal during the period increased by 0.3 percent compared to the last quarter of 2016, when price dynamics was reverse, and amounted to USD 1220.3 per ounce. The quotations for gold during the reporting quarter were sensitive to political and economic risks. Investment demand for gold, as a relatively safe asset during the periods of turbulence, usually grows under the conditions of uncertainty. Changes in the economic policy planned by the authorities of the United States, risks of geopolitical tensions in certain regions of the world, as well as elections in European countries were the sources of uncertainty.

## Chapter 2. Macroeconomic Development

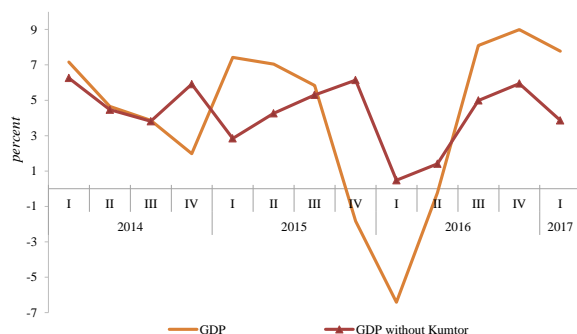
### 2.1. Demand and Supply in the Commodities and Services Market

Rapid economic growth was observed in Q1. Economic growth was primarily conditioned by substantial growth of industrial production and significant increase of the inflow of remittances to the country, which positively affected domestic consumption. All the main sectors of the economy, excluding construction, had a positive contribution to the economic growth.

#### Demand

##### Chart 2.1.1. GDP Dynamics

(quarter to the corresponding quarter of the previous year)

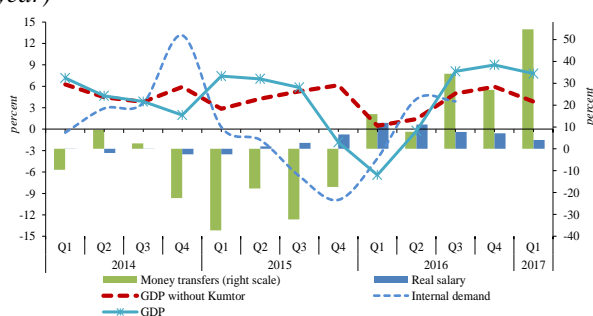


Source: NSC KR

In particular, the Kumtor output increased by 47.5 percent compared to Q1 2016 (86.4 thousand troy ounces) and amounted to 127.4 thousand troy ounces in Q1 2017. Moreover, an increase was observed in production of refined petroleum products (by 45.9 percent), food products (by 37.0 percent) and clothes (by 31.9 percent). The services sector increased due to the growth in the sphere of trade and transport; meanwhile there was the decrease in the sphere of information and communication.

##### Chart 2.1.2. Dynamics of Internal Demand and Remittances

(quarter to the corresponding quarter of the previous year)



Source: NBKR

Positive economic growth was observed in Q1 2017; therewith the domestic demand was supported by the increase in the inflow of remittances to the country, as well as the growth in the real salaries of the population.

Generally, the economic growth observed at the end of Q1 2017 was conditioned by the positive contribution from all main sectors of economy, excluding construction

Positive trend in the industrial sector was primarily due to an increase in the production output at the Kumtor Mine. In

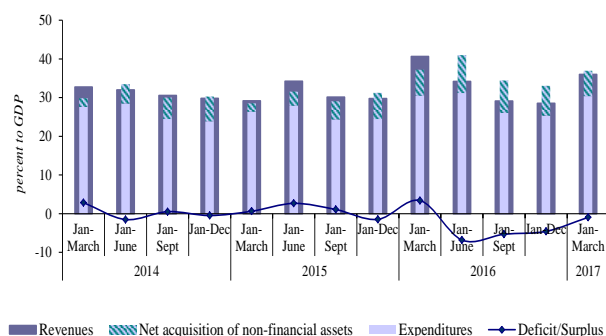
The internal demand was supported by the growth of the real salaries of the population (by 4.0 percent) and the increase in the inflow of remittances. In Q1 2017, the net inflow of individuals' remittances in U.S. dollars through the remittances systems continued its upward trend in 2016 and increased by 54.7 percent compared to the same period of 2016.

## Pulic Finance Sector

In Q1 2017, the state budget deficit amounted to KGS 0.8 billion or 0.9 percent to GDP (in Q1 2016, the budget surplus constituted KGS 2.7 billion or 3.4 percent to GDP).

### Chart 2.1.3. Execution of the State Budget

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



Source: CT MFKR, NBKR

At the end of Q1 2017, the state budget revenues from operating activities decreased by 4.2 percent, or KGS 1.4 billion, compared with the same period of 2016 and amounted to KGS 31.0 billion, or 36.0 percent to GDP. The greatest contribution to the increase in operating income was due to tax revenues (5.9 percentage points). Non-tax revenues made a negative contribution (-5.1 percentage points) primarily due to a decline in interest receipts on budget loans and credits, rents and revenues from the provision of services. Official transfers also made a negative contribution (-7.1 percentage points), mainly due to the receipt of program grants in February 2016.

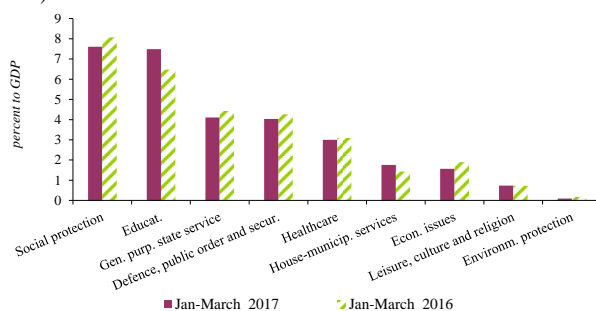
At the end of Q1 2017, the state budget expenditures for operating activities increased in annual rate by 7.7 percent, or KGS 1.9 billion, and amounted to KGS 26.2 billion, or 30.4 percent to GDP. The growth of state budget expenditures was primarily conditioned by the rise in labor costs due to the increase in the salaries of the technical and junior service personnel.

In the structure of expenditures by functional classification, the greatest contribution to the increase in expenditures was made by costs for education, public utilities issues, social protection and health care.

Net outflow of budget funds for operations related to acquisition of non-financial assets amounted to KGS 5.7 billion or 6.6 percent to GDP.

### Chart 2.1.4. Execution of the State Budget

(period to the corresponding period of the previous year)



Source: CT MFKR, NBKR

Execution of the state budget revenues (tax revenues + non-tax revenues + official transfers) amounted to 111.4 percent at the end of Q1 2017, which was insured by implementation of the plan on non-tax revenues collecting. The plan on the official transfers collecting was implemented at the rate of 11.3 percent. The plan on the tax revenues collecting was implemented at the rate of 96.1 percent: the tax collection plan of the State Tax Service was implemented at a rate of 93.9 percent, while the same plan of the State Customs Service was implemented by 100.8 percent.

At the end of 2016, the execution of the state budget expenditures amounted to 75.0 percent. Meanwhile, the expenditure plan on the protected items was executed by 73.4 percent, on the unprotected items – by 67.5 percent.

## Investment

In Q1 2017, the level of implementation of capital investment decreased by 0.7 percent (in comparable prices) compared to the same period of 2016.

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

	Q1			
	2016		2017	
	millions of KGS		share, percent	
<b>Total</b>	<b>17 690,6</b>	<b>17 689,6</b>	<b>100,0</b>	<b>100,0</b>
<b>Internal investment</b>	<b>12 899,6</b>	<b>12 775,1</b>	<b>72,2</b>	<b>57,4</b>
Republican budget	656,2	379,9	2,1	7,5
Local budget	65,1	52,9	0,3	1,0
Funds of enterprises and organizations	5 646,1	6 030,7	34,1	24,6
Banks' credits	23,6	10,8	0,1	0,0
Population funds including beneficent help of KR residents	6 508,6	6 300,8	35,6	24,3
<b>External investment</b>	<b>4 791,0</b>	<b>4 914,5</b>	<b>27,8</b>	<b>42,6</b>
Foreign credit	3 217,6	2 633,1	14,9	28,4
Direct foreign investments	1 217,0	1 777,4	10,0	11,5
Foreign grants and humanitarian aid	356,4	504,0	2,9	2,7

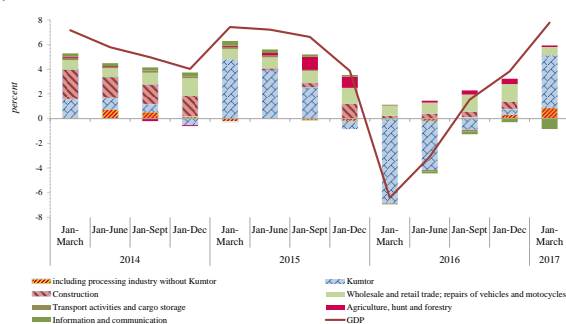
Source: NSC KR

percent) and the funds of enterprises and organizations (by 6.1 percent) was observed in the structure of the sources of financing.

## Supply

**Chart 2.1.5. Input of the Main Sectors in GDP Growth**

(period to the corresponding period of the previous year)



Source: NSC KR

shows significant influence of the Kumtor enterprises on the economy as a whole, including exports.

Deflator was formed at the level of 0.4 percent, having decreased by 4.9 percentage points against the corresponding period of 2016.

A growth in the industrial sector by 35.5 percent was due to an increase in extraction of metal ores (by 4.3 times), production of base metals (by 50.6 percent), production of refined petroleum products (by 45.9 percent), food products (by 37.0 percent) and clothing (by 31.9 percent), as well as due to supply of electric energy, gas, steam and conditioned air (by 17.1 percent). Meanwhile, lag was observed in production of chemical products and other non-metallic mineral products.

A zero value of growth in the construction sector was due to a reduction in the capital investment (-0.7 percent, in comparable prices). Approximately 83.3 percent of the total investment was forwarded to the construction of the facilities for mining operations, supply of electric power, gas, steam and conditioned air, transport activities, hotels, restaurants and housing construction. The investment financed from the domestic sources decreased by 1.7 percent, that from the foreign sources – increased by 7.1 percent.

The most significant decline of capital investment was observed in the construction of educational (by 15.5 times), agricultural facilities (by 2.9 times) and in the transport activities (by 33.3 percent). Meanwhile, capital investment primarily increased in the construction of the facilities for supply of electric energy, gas, steam and conditioned air (by 27.2 percent), water supply, waste treatment and processing (by 2.6 times), as well as the hotels and restaurants (by 4.9 times).

Growth of the direct foreign investment (by 45.0 percent), grants (by 40.5

**In Q1 2017, GDP increased due to a positive dynamics of all main sectors of economy excluding construction.**

According to the preliminary data of the National Statistical Committee of the Kyrgyz Republic, in Q1 2017, GDP growth amounted to 7.8 percent (in Q1 2016, GDP decreased by 6.4 percent). Rapid growth rate was conditioned by the effect of low GDP base of the previous year. Excluding the enterprises of the Kumtor Mine, GDP growth constituted 3.9 percent (in the same period of 2016 growth amounted to 0.5 percent). The difference in growth rates

Growth in agriculture constituted 1.5 percent primarily due to increase in livestock production.

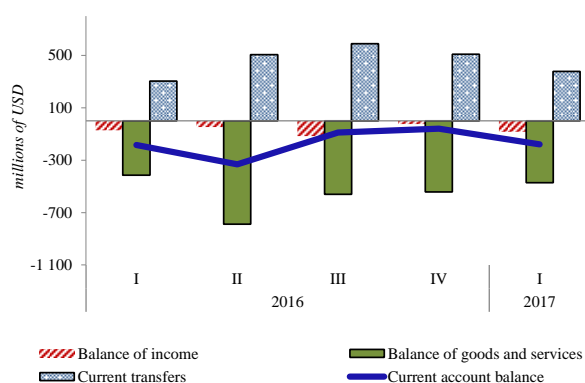
In the reporting period, growth in the trade sector by 3.9 percent was primarily due to increase in the wholesale (by 5.8 percent) and the retail trade (by 4.5 percent).

## 2.2. External Sector<sup>1</sup>

**In Q1 2017, the current account deficit was formed under the influence of the increase in the net inflow of current transfers, as well as the growth in the negative balance of goods and services trade.**

**Chart 2.2.1. Current Account**

(millions of USD)



Note: According to the forecasted and preliminary data.

According to the forecasted and preliminary data, in Q1 2017, the current account deficit decreased down to USD 179.7 million and reached 9.7 percent to GDP.

In the reporting period, the trade deficit of the Kyrgyz Republic increased by 1.6 percent and reached USD 373.1 million. The reporting quarter was characterized by the growth in export and import supplies.

**Table 2.2.1. Trade balance of the Kyrgyz Republic<sup>2</sup>**

(millions of USD)

	2014	2015	2016	2016 Q1	2017* Q1	Change in %	Change in millions of
Trade balance	-2 807,5	-2 240,8	-2 100,7	-367,3	-373,1	1,6	-5,8
Export (FOB)	2 482,7	1 619,0	1 579,3	344,4	440,5	27,9	96,1
Gold	716,9	665,4	701,6	99,3	150,5	51,5	51,2
Import (FOB)	5 290,2	3 859,8	3 680,0	711,8	813,7	14,3	101,9
Energy products	1 041,8	830,0	399,6	88,1	87,8	-0,3	-0,3

\* Preliminary data

Exports of goods (in FOB prices) increased by 27.9 percent to make USD 440.5 million in Q1 2017. In the reporting period, exports were primarily affected by growth in supplies of gold, which have increased by 51.5 percent compared to the corresponding period of 2016. Along with that, exports, excluding gold, increased by 18.3 percent due to a growth in supplies of vegetables and fruits, clothes and clothing accessories, rolled glass and other goods.

In the reporting period, imports of goods (in FOB prices) increased by 14.3 percent and reached USD 813.7 million. The increase in imports was primarily conditioned by supplies of motor cars and vehicles intended for transportation of people, footwear, clothes, etc. The decrease in the value of petroleum products remained in the reporting period due to a

<sup>1</sup> According to the preliminary and forecasted data. In the actual period, the data include the estimates of the NBKR on re-export of petroleum products. Period of comparison is the quarter to the corresponding quarter of the previous year.

<sup>2</sup> The data are given taking into account the NSC KR additional estimates for agricultural products (till 2017) and mutual trade with the EAEU member states (since Q3 2015) and the estimates of the NBKR.



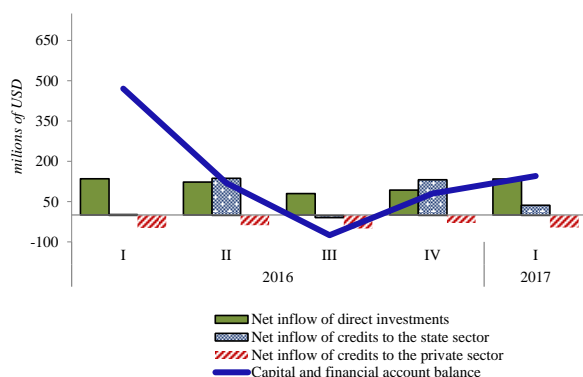
reduction in the physical volume of supplies. Imports, excluding energy products, increased by 16.4 percent compared to Q1 2016 to make USD 725.8 million.

**In the reporting period, the inflow of current transfers was formed above the level of the same period in 2016 and reached USD 377.0 million.** The increase was provided by the positive dynamics on the net inflow of private transfers, which increased by 44.0 percent and reached USD 378.6 million.

According to the forecasted and preliminary data, the negative balance of income increased up to the level of USD 84.0 million in Q1 2017, which is higher than the level of the same quarter of 2016. The negative balance of services was formed at the level of USD 99.5 million.

**The increase of the residents' assets abroad and a slight increase of the liabilities to the non-residents on other investments will result in the decrease of the positive balance of the capital and financial account.** Thus, capital and financial account will decrease by 69.1 percent against Q1 2016 to be formed with a positive balance of USD 145.4 million. Capital account balance is expected to form positive in the amount of USD 50.6 million. In the reporting period, the positive balance of the financial account is expected to make USD 94.9 million.

**Chart 2.2.2. Capital and Financial Account**



Net inflow of direct investments to the country is forecasted at the level of the same period of the last year reaching USD 134.4 million. In the reporting period, the balance of "other investments" item will be negative in the amount of USD 39.5 million primarily due to the growth of the foreign assets of the residents. Along with that, the liabilities to non-residents are expected to increase slightly compared to the same period of 2016 due to the growth of credits attracted by the state sector. The trend of the

increase in payments of the principal amount by the enterprises on previously attracted credits has been observed, and as a result, balance of credit liabilities of the private sector is expected to be negative in the reporting period.

Therefore, at the end of Q1 2017 balance of payments of the Kyrgyz Republic was formed with a negative balance of USD 21.9 million. Gross international reserves covered 4.4 months of the 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 the beginning of the year (as of the end of month)		*
	2015 (aver.) (January-December)	2016 (aver.) (January-December)		December 2016	March 2017	
REER	115,7	113,5	-2,0	112,9	110,3	-2,3
NEER	108,9	112,3	3,0	112,1	108,7	-3,1
RBER to CNY	84,7	80,8	-4,6	85,8	86,9	1,3
NBER to CNY	66,4	64,5	-3,0	67,9	67,7	-0,3
RBER to Euro	116,6	107,2	-8,0	113,3	114,5	1,0
NBER to Euro	85,5	78,8	-7,9	83,4	82,7	-0,9
RBER to KZT	112,1	141,7	26,4	136,7	128,7	-5,9
NBER to KZT	105,9	152,1	43,6	150,3	142,4	-5,2
RBER to RUR	138,2	131,4	-4,9	122,8	115,9	-5,6
NBER to RUR	142,8	144,8	1,5	136,7	127,5	-6,7
RBER to USD	96,0	87,2	-9,1	88,5	89,6	1,3
NBER to USD	71,7	65,7	-8,3	66,4	66,4	0,1

\* preliminary data  
 ▼ - Som devaluation, competitiveness improvement  
 ▲ - Som strengthening, competitiveness deterioration

**At the end of Q1 2017, the index of nominal and real effective exchange rate decreased compared to December 2016.**

According to the preliminary data, the index of nominal effective exchange rate (NEER) of KGS decreased by 3.1 percent from the beginning of 2017 and amounted to 108.7 by the end of March 2017. The decrease in the NEER index was due to KGS devaluation<sup>1</sup> in March 2017 compared to the average exchange rate for December 2016 against: the Russian ruble – by 6.7 percent, the

<sup>1</sup> The data are given for nominal bilateral exchange rate of KGS; the year of 2010 is used as the base period for calculation of the index.

Kazakh tenge – by 5.2 percent, the euro – by 1.0 percent.

Low level of inflation in the trading partner countries<sup>1</sup> and the decrease in the NEER index caused decline in the index of real effective exchange rate (REER) by 2.3 percent, which amounted to 110.3 at the end of March 2017.

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<sup>1</sup> In Q1 2017, the inflation in the Kyrgyz Republic formed at the level of 2.1 percent, whereas an average inflation rate in the major trading partner countries made 1.3 percent according to the preliminary calculations.



## Chapter 3. Monetary Policy

### 3.1. Monetary Policy Implementation

Significant easing of the monetary conditions undertaken in 2016 contributed to neutralization of the deflationary pressures. Since the beginning of 2017, dynamics of the inflation rate was characterized by the upward trend and was within the expected values. Taking into account the aforementioned facts, the conditions for carrying out the monetary policy were retained during Q1 2017.

Behavior of the money market participants to a greater extent was explained by rather high level of excess liquidity retained in the banking system. The rates of the money market varied within interest rate corridor set by the National Bank.

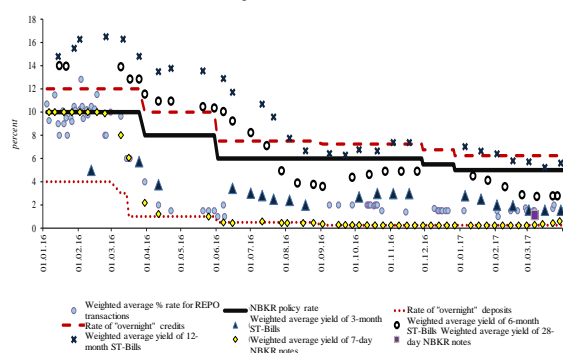
Taking into account forecasted dynamics of the inflation rate for the medium term, as well as in order to maintain the real sector of the economy, in Q1 2017, the National Bank continued conducting operations on refinancing of the banks.

#### Interest Rate Policy of the National Bank

The National Bank kept unchanged its interest rate policy aimed at maintaining economic growth, taking into account expected dynamics of the inflation rate in the medium term. In Q1 2017, the policy of monetary easing, which was initiated in Q2 2016, was continued. In the reporting period, the National Bank's policy rate remained at the level of 5.00 percent. The rates of the interest rate corridor remained unchanged: the upper level of the interest rate corridor (the rate on “overnight” credits) – 6.25 percent, the lower level (the rate on “overnight” deposits) – 0.25 percent.

In the reporting period, the monetary policy was implemented under the conditions of maintaining excess liquidity in the banking sector. The availability of excess liquidity in the commercial banks resulted in further decline in the interbank credit market; meanwhile, the commercial banks demonstrated increased demand in the Government securities market.

**Chart 3.1.1. Money Market Rates**



Generally, the money market was characterized by slight downward trend in the interest rates, which fluctuated within the limits of the interest rate corridor set by the National Bank. In Q1 2017, the weighted average interest rates on all short-term instruments was formed below the policy rate set by the National Bank, except for the yield on the 12-month ST-Bills, which made approximately 6.15 percent for the quarter. Dynamics of yield on the

National Bank instruments in the open market was characterized by the upward trend due to increased volume of supply. In March 2017, 28-day notes were also supplied in the market along with the auctions of the National Bank 7-day notes. In the reporting period, the weighted average yield on all types of the National Bank notes increased by 0.12 percentage points compared to the lower limit of the interest rate corridor and made 0.37 percent.

Measures taken previously to ease the monetary conditions in respect of the interest rate policy contributed to the decrease of the end market rates on credits, which reflects strengthening impact of the interest rate channel within the transmission mechanism. In the reporting quarter, the weighted average interest rates of the credit portfolio in the commercial banks decreased by 0.63 percentage points at the end of the reporting period and amounted to 17.69 percent.

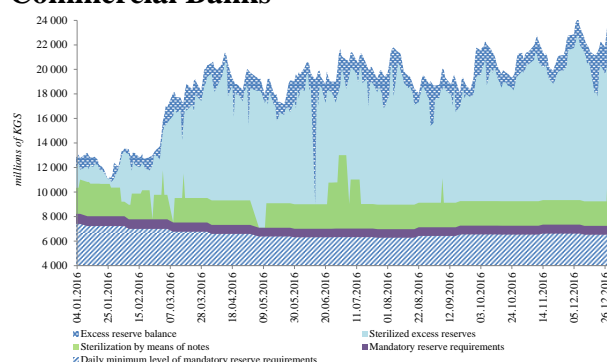
Moreover, the decrease in the rates on the time deposits of the commercial banks in the national currency was observed. The weighted average interest rates on the deposits in the

national currency declined by 0.48 percentage points during the quarter and amounted to 13.02 percent at the end of the reporting quarter.

### Situation with Liquidity of the Commercial Banks

In Q1 2017, the average daily volume of the commercial banks' excess liquidity prior to the operations on sterilization conducted by the National Bank amounted to KGS 16.0 billion, having increased by KGS 1.7 billion compared to the last quarter of 2016 and by 2.4 times compared to the same period of 2016. Under such circumstances, the volumes of operations on sterilization conducted by the National Bank were increased through the auctions of the National Bank notes and placement by the commercial banks of their available funds on "overnight" deposits with the National Bank.

**Chart 3.1.2. Excess Reserves of the Commercial Banks**



In Q1 2017, the volume of excess liquidity absorbed on a daily basis increased by KGS 1.8 billion compared to the previous reporting period and reached KGS 14.6 billion.

### Credit Policy of the National Bank

In the reporting period, in order to expand lending to the real sector of economy and to maintain positive economic growth the National Bank continued providing credit resources. In Q1 2017, the National Bank provided the economy with the credit resources in the total amount of KGS 549.5 million, thereof KGS 500.0 million were provided within the credit auctions for the purpose of refinancing the banks participating in implementation of the State program "Financing of agriculture-5". The credit in the amount of KGS 49.5 million was issued to the international organizations established by the Kyrgyz Republic jointly with other states within the EAEU.

### Foreign Exchange Policy of the National Bank

In Q1 2017, the situation in the domestic foreign exchange market was relatively stable. Strengthening of the national currency was still observed. In the reporting period, amid slight exceeding of demand for foreign currency over its supply, the National Bank participated in the domestic foreign exchange market as a seller of foreign currency in order to smooth sharp fluctuations of the exchange rate, the total volume of sales amounted to USD 17.7 million. Generally, during the quarter, strengthening of the national currency amounted to 0.9 percent.

### Monetary Policy Measures in Q1 2017

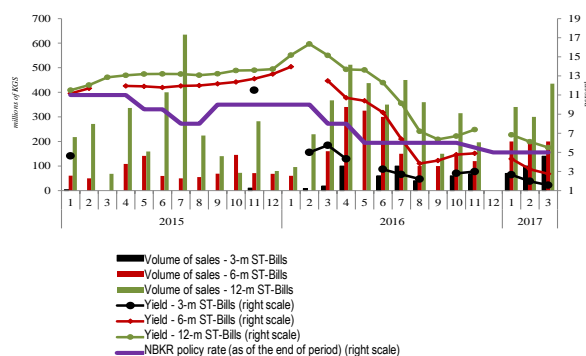
<p>The decisions were made on the monetary policy rate of the National Bank of the Kyrgyz Republic.</p>	<p>The Board of the National Bank twice considered the issue on the size of the policy rate of the National Bank – on February 27 and March 27, 2017. Finally, the decisions were made to keep the policy rate unchanged at 5.00 percent.</p>
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	The rates of the interest rate corridor remained unchanged: the interest rate on “overnight” credits was 6.25 percent, the interest rate on “overnight” deposits - 0.25 percent.
The decisions to conduct the credit auctions were made.	The National Bank announced credit auctions 6 times for the purposes of the banks refinancing, as well as for financing of the banks participating in the project “Financing of Agriculture – 5”. 2 auctions were held out of announced 6 ones. The total volume of supply for the credit resources amounted to KGS 3.9 billion, the demand from the commercial banks amounted to KGS 1.2 billion. In the reporting period, the commercial banks were provided credits to the amount of KGS 500.0 million. The weighted average interest rate on these credits made 5.11 percent.
The National Bank issued credits to the international organizations established by the Kyrgyz Republic jointly with other states within the framework of the Eurasian Economic Union.	The volume of credit resources amounted to KGS 49.5 million.

### 3.2. Financial Market Instruments

#### Government Securities Market

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



#### ST-Bills

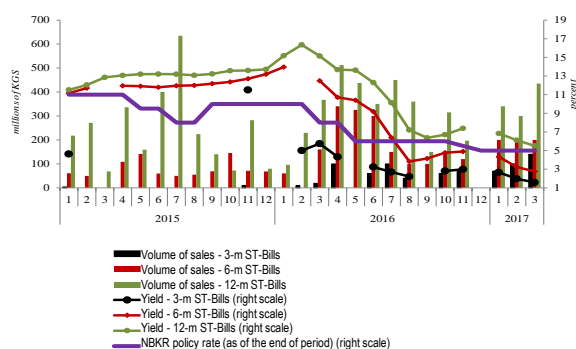
**In Q1 2017, yield downward trend was still observed in the primary Government securities market, approaching the lower boundary of the interest rate corridor.**

All auctions announced by the Ministry of Finance were held, as a result, overall volume of placement increased by 2.1 times and reached KGS 2.0 billion. Demand for this type of securities increased due to growth in resources of the market participants.

The activity of participants at the auctions increased during the reporting period. Generally, the number of participants increased by 4 times, the average number increased from 2 up to 5 participants for auction.

The high level of excess reserves in the banking system contributed to gradual decrease of ST-Bills yield of any maturity. Thus, the overall weighted average yield of ST-Bills declined from 5.8 down to 4.6 percent during the quarter.

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

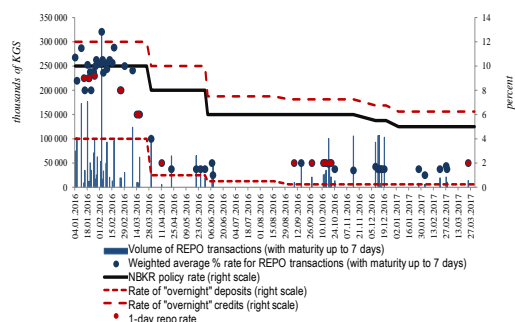


additional placements; the volume thereof amounted to KGS 450.0 million in the period under review.

Generally, the number of participants increased by 5.5 times, the average number of participants increased from 3 to 8.

### Interbank Credit Market

**Chart 3.2.3. Dynamics of Rates and Volume of Repo Transactions in the Interbank Credit Market**



transactions in national currency was 55 days.

Meanwhile, the market capacity decreased compared to Q1 2016. Thus, the total volume of credits in the national currency issued under standard conditions in the domestic interbank market amounted to KGS 271.9 million (-70.4 percent). Activity on REPO transactions increased since the end of Q3 2016; however, the volume of placement on these credits decreased by 92.5 percent and amounted to KGS 175.5 million compared to Q1 2016.

The market rates also decreased, having approached the lower boundary of the interest rate corridor set by the National Bank, amid a decline in the demand for credit resources. In Q1 2016, an average rate on credits in the national currency amounted to 2.1 percent (-11.1 percentage points), on REPO transactions – 1.6 percent (-7.9 percentage points).

### ST-Bonds

In the reporting period, the issuer offered to extend the maturity of placed ST-Bills up to 7 years.

In Q1 2017, the volumes of ST-Bills continued increasing (by 3.4 times, up to KGS 2.8 billion), with gradual decline in the yield on all maturities due to lower risks for market participants. The total weighted average yield was formed at the level of 14.0 percent (-3.2 percentage points).

The sales volume exceeded the amount of announced emission due to

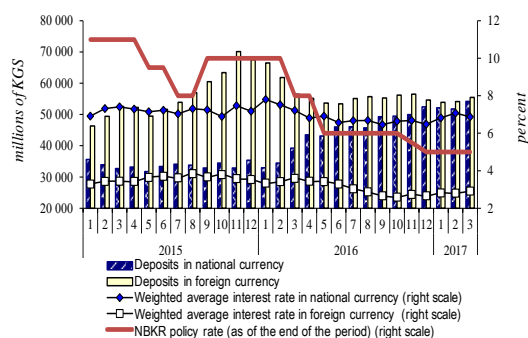
Slight recovery in the activity of the commercial banks was observed in the interbank credit market since the end of 2016.

Generally, the trend of low activity continued due to the high level of excess liquidity in the banking system, amid easing monetary policy.

During the period under review, the REPO transactions in the interbank credit market were mainly short-term, with an average maturity of 12 days during the quarter. The average maturity of the

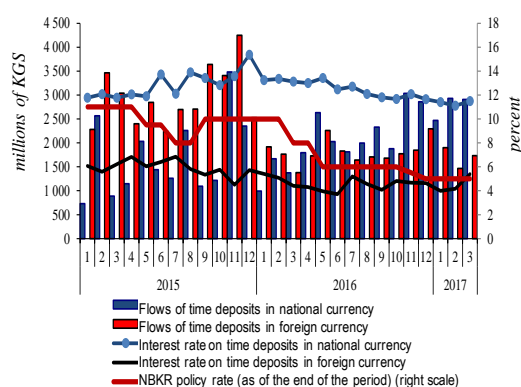
## Deposit Market

**Chart 3.2.4. Dynamics of Commercial Banks Deposits**



deposits in foreign currency also increased by 1.5 percent up to KGS 55.5 billion. Dollarization of the deposits decreased by 0.5 percentage points year-to-date and made 50.6 percent.

**Chart 3.2.5. Dynamics of Commercial Banks' Time Deposits Flows**



11.34 percent (-1.90 percentage points), the decrease fluctuated within the range of 13-11 percent year-to-date. The weighted average interest rate on new time deposits in foreign currency made 4.51 percent (-0.46 percentage points) year-to-date. During Q1, the rate in foreign currency increased by 1.40 percentage points due to slight growth in the value of issued short-term deposits.

The flows of time deposits in the national currency increased since 2016. Since the beginning of 2016, the overall level of the weighted average interest rates on time deposits flows declined with decreasing policy rate of the National Bank. The share of time deposits amounted to 39.5 percent (+2.1 percentage points year-to-date) at the end of Q1 2017. Duration index of time deposits amounted to 12 months, having decreased by 0.1 month year-to-date.

In Q1 2017, an increase of the deposit base with prevailing inflow of the deposits in the national currency was observed in the deposit market.

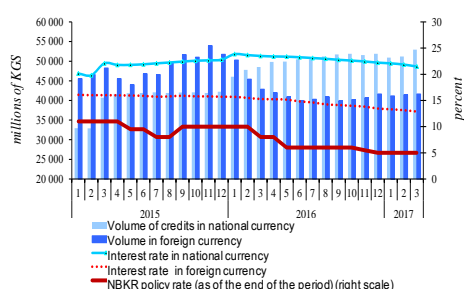
At the end of the reporting period, the volume of the commercial banks' deposit base increased by 2.4 percent year-to-date and made KGS 107.1 billion due to increase of the deposits in the national currency by 3.4 percent up to KGS 54.2 billions, which corresponds to the upward trend of the gross capital formation in GDP structure. The

Flows of time deposits in the national currency exceeded those in foreign currency by 23.9 percent and amounted to KGS 8.3 billion; meanwhile, flows of time deposits in foreign currency made KGS 5.1 billion.

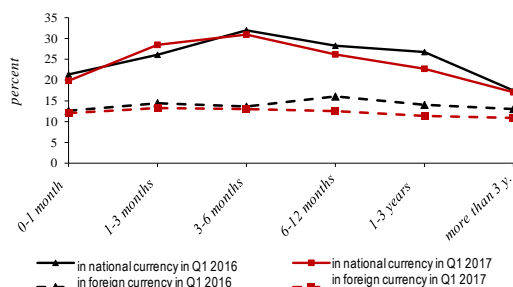
In Q1 2016, the weighted average interest rate on new deposits in the national currency made 3.04 percent (+0.61 percentage points against the same period of 2016); this rate on the deposits in foreign currency made 0.89 percent (+0.14 percentage points). In the reporting period, the weighted average interest rate on new time deposits in the national currency made

## Credit Market

**Chart 3.2.6. Dynamics of Commercial Banks Credit Debt as of the End of the Period**



**Chart 3.2.7. Rates of New Credits in National and Foreign Currency in Terms of Maturity**



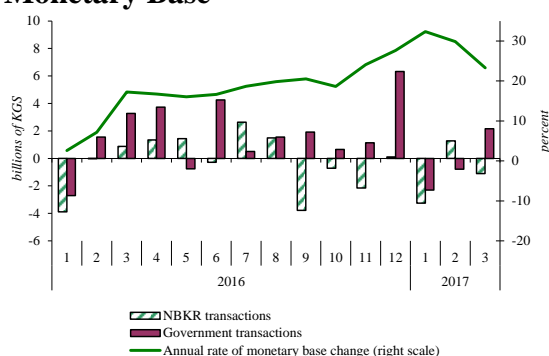
KGS 14.2 billion (+21.3 percent) and those in foreign currency made KGS 9.3 billion (+16.4 percent).

The weighted average interest rate for new credits in the national currency decreased by 3.00 percentage points and made 21.45 percent, this rate in foreign currency decreased by 1.91 percentage points down to 11.28 percent.

In the reporting period, there was slight improvement in the quality of the credit portfolio. The share of overdue credits in the credit portfolio constituted 2.8 percent late in the reporting period (-0.1 percentage point year-to-date), the share of prolonged credits decreased by 0.2 percentage points year-to-date and made 4.7 percent.

### 3.3. Dynamics of Monetary Indicators

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



beginning of 2017 due to the operations of the Government and the National Bank. Among the operations of the Government the excess of the Government revenues (including net

In the reporting period, the deposits in the banking system grew amid build-up of the credit portfolio with significant increase in the volume of credits in the national currency in respect of the stocks and the flows.

At the end of the reporting period, the volume of credit portfolio of the commercial banks increased by 1.1 percent year-to-date and amounted to KGS 94.5 billion due to growth of credits in the national currency by 2.0 percent up to KGS 52.9 billion. The volume of the credit portfolio in foreign currency remained unchanged year-to-date and amounted to KGS 41.6 billion. Dollarization of the credits decreased by 0.5 percentage points year-to-date and made 44.0 percent at the end of the year.

The flows of the credits issued in the national and in foreign currency increased amid increasing deposit base and credit portfolio. In Q1 2017, the volume of new credits in the national currency amounted to

### *Monetary Base*

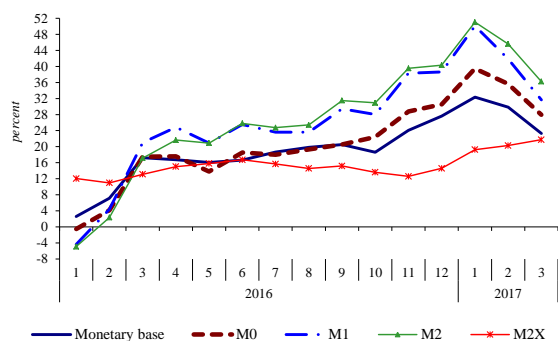
Since the beginning of 2017, there was a downward trend in the annual growth rates of the monetary base, meanwhile, the growth rates of the current year remain above the values of the previous year. This dynamics is mainly due to a slight decline of money in circulation since the beginning of 2017 (-2.6 percent) and the decrease of mandatory reserve requirements (-0.6 percent). By the sources of formation, the monetary base decreased since the



income from the import customs duties) over expenditures thereof contributed to the decrease of the monetary base. Among the operations of the National Bank the foreign currency sales, repayment of the principal amount on the earlier issued credits, as well as the deposits of the National Bank were the main factors affecting the decrease of the monetary base. The Government operations decreased the monetary base by KGS 0.9 billion, while the National Bank operations reduced the monetary base by KGS 3.1 billion. Generally, in Q1 2017, the volume of the monetary base decreased by 4.7 percent. At the end of March 2017, the annual growth of the monetary base amounted to 23.3 percent, having decreased from 27.6 percent year-to-date.

The structure of monetary base did not change significantly. In the reporting period, the share of reserves of other deposit corporations made 11.0 percent, meanwhile, the share of money in circulation was 89.0 percent (at the end of 2016 - 13.0 percent and 87.0 percent respectively).

**Chart 3.3.2. Nominal Growth Rates of Monetary Aggregates**  
(in annual terms)



During the period under review, the narrow money supply (M1) decreased by 2.7 percent due to the reduction of money outside banks as well as the decrease of transferable deposits in the national currency by 3.6 percent. Meanwhile, in the reporting quarter, money supply M2 demonstrated a slight increase by 0.3 percent due to growth in the volume of other deposits in the national currency. Generally, in the reporting period, the deposits in the national currency grew by 17.3 percent (by 61.6 percent in annual terms).

At the end of March 2017, broad money supply M2X, which includes deposits in foreign currency, increased by 0.5 percent year-to-date and constituted KGS 164.9 billion. M2X increased due to growth of the deposits in the national currency, as well as the rise in the foreign currency component of the deposits (+1.0 percent). In the annual terms, M2X grew by 21.7 percent, excluding the exchange rate fluctuations – by 23.4 percent.

In the reporting quarter, the total volume of credits to the economy<sup>1</sup> increased by 1.1 percent and amounted to KGS 96.4 billion, primarily due to the growth of credits in the national currency by 1.9 percent, however, the volume of credits in foreign currency remained unchanged. The annual growth of credits to the economy made 2.7 percent, excluding the exchange rate changes this indicator increased by 4.0 percent during the year.

The indicator of the economy monetization continues increasing. Economy monetization ratio<sup>2</sup> calculated on the basis of M2X increased from 32.2 percent as of the beginning of 2017 up to 33.2 percent (this indicator, calculated on the basis of monetary aggregate M2 increased from 21.2 percent up to 22.7 percent during the quarter). Stimulating monetary policy and, as a result, growth of the money supply relative to the GDP growth resulted in increase of the monetization ratio.

<sup>1</sup> Credits of individuals, legal entities and other financial institutions, excluding credits of the Government and non-residents

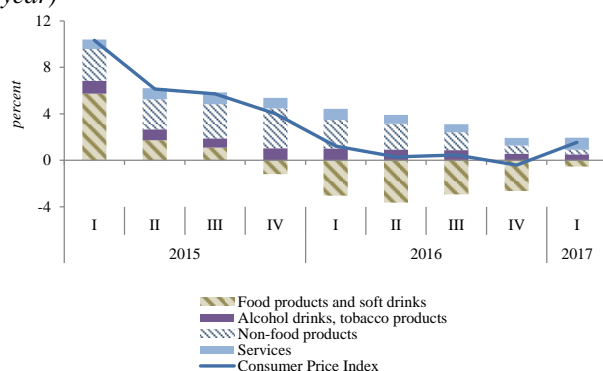
<sup>2</sup> Monetization ratio is calculated as a ratio of moving average value of broad money to the nominal GDP in annual terms. When calculating moving average value, the average value over the previous 12 months is taken

## Chapter 4. Inflation Dynamics

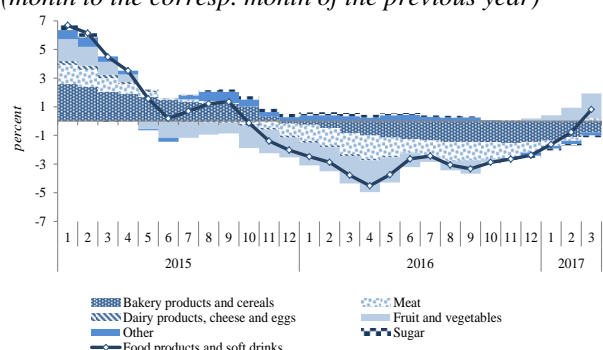
In Q1 2017, the inflation rate started recovering, primarily due to the increase in the prices of fruit and vegetables because of the low base in the previous year. However, the inflation rate remained relatively low to a certain extent due to the significant supply of certain goods.

### 4.1. Consumer Price Index

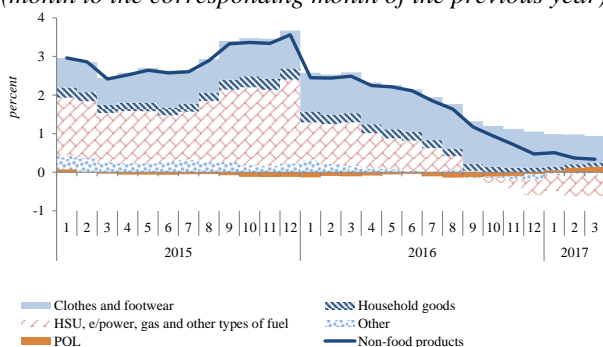
**Chart 4.1.1. Dynamics of CPI Structure**  
(quarter to the corresponding quarter of the previous year)



**Chart 4.1.2. Dynamics of Food Prices' Contribution to Annual CPI**  
(month to the corresp. month of the previous year)



**Chart 4.1.3. Dynamics of Non-Food Prices' Contribution to Annual CPI**  
(month to the corresponding month of the previous year)



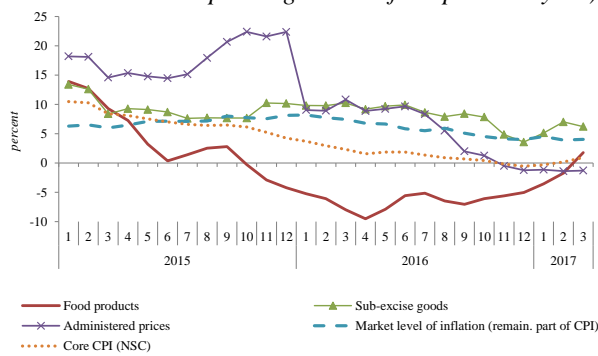
In January-March 2017, the inflation rate in Kyrgyzstan started increasing. Its average value for quarter stood at the level of 1.5 percent, meanwhile, in March, the annual inflation rate was 2.8 percent. Recovery of public consumption amid increasing salaries and the inflow of remittances, as well as the effect of the low base in 2016 accelerated the inflation rate.

Seasonal rise in prices for food products was observed in the reporting quarter, however, the annual price index in this group decreased by 1.2 percent compared to Q1 2016, which was the main reason for low inflation rate. Decrease in prices for bakery products amid high cereal crop in the world, including in Kazakhstan and Russia, made the negative contribution to food inflation. Prices for fruit and vegetables grew rapidly due to small increase of vegetable production and a decrease of potato production output in Kyrgyzstan in 2016, the annual growth in prices for these products amounted to 30.9 percent in March of the current year. In the reporting period, prices for sugar, oils and fats decreased in the annual terms, prices for meat products started growing.

In Q1 2017, non-food inflation slowed down to 1.3 percent due to sustainable decrease in price for several products amid market saturation with such products at lower prices, for example decline in prices for coal, slow growth in prices for clothes and footwear, household goods and appliances. The tariffs for gas decreased due to strengthening of the Kyrgyz som exchange rate. Moreover, prices for construction materials declined compared to the corresponding period of the previous year given the low growth of activity in the construction sector. Rise in prices for POL made the upward contribution to the inflation rate. In the reporting quarter,



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



increase in prices for the group “alcohol drinks and tobacco products” amounted to 5.7 percent, which was supported by the rise in excise duties on tobacco products.

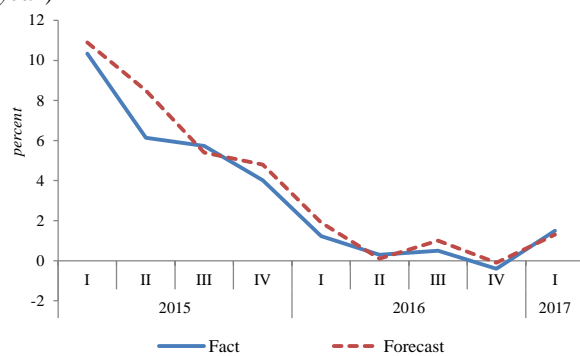
The price index for paid services rose by 6.9 percent, mainly due to increase in prices for communication, healthcare and education services.

In Q1 of the current year, core inflation amounted to 0.3 percent, having increased from -0.1 percent in the previous quarter.

## 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)



**In Q1 2017, difference between actual inflation rate and the forecasted level set by the National Bank was insignificant and amounted to +0.2 percentage points.** Such situation developed primarily due to more rapid recovery in prices for food products and in particular for fruits and vegetables compared to expectations.

## Chapter 5. Medium-Term Forecast

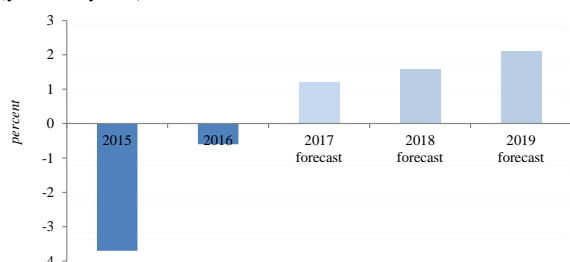
### 5.1. External Environment Proposals

#### 5.1.1. Development Forecast of Major Trading Partner Countries

##### Russia

**Chart 5.1.1.1. Real GDP Growth in Russia**

(year to year)



Source: IA Bloomberg

Leading indicators demonstrate dynamics of the continuing recovery of the Russian economy: GDP growth rate in Russia is expected at the level of 1.2 percent at the end of 2017. Expert forecasts were prepared taking into account preserved sanctions regime against Russia till 2020, and given that the OPEC agreement on reduction of oil production will be valid till mid-2017. Preserving the policy of inflation targeting at the level of 4 percent, the

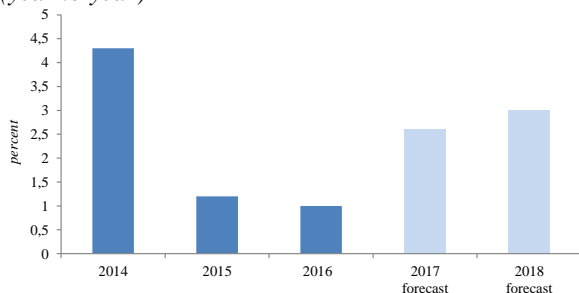
introduction of the fiscal rule at the level of the price for oil in the amount of USD 40 per barrel, indexing the main tariffs at the level not exceeding the inflation rate and the capital outflow from the Russian Federation at the level of USD 8-10 billion in 2017 and 2018 respectively and its deceleration in 2019-2020 down to USD 6 billion are among the fundamental factors of forecast.

According to the updated forecast of the Ministry of Economic Development of the Russian Federation, the inflation rate can reach its target of 4 percent in May and by the end of the year will probably fall down to 3.8 percent. The Central Bank of the Russian Federation also notes that the inflation rate in Russia can reach 4 percent before the end of the year and may also fall below the target by the end of the year.

##### Kazakhstan

**Chart 5.1.1.2. Real GDP Growth in Kazakhstan**

(year to year)



Source: IA Bloomberg, international financial institutions

The actual data for Q1 2017 conditioned the adjustment of expectations for economic development of Kazakhstan in 2017. Under the conditions of rising domestic consumption amid growth in real salaries, the increase of investment in fixed assets within the framework of the implementation of the state programs for support and economic diversification, as well as growth in the mining and production of mineral resources (effect of Kashagan) growth of the national economy was revised

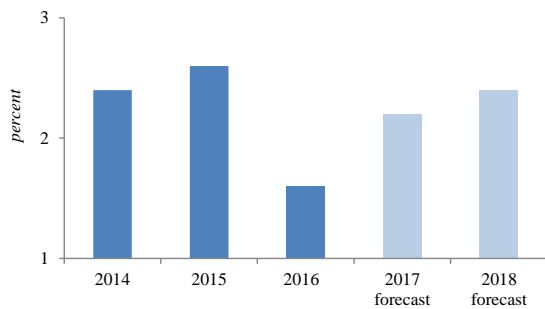
up to 2.6 percent in 2017 (instead of 1.9 percent), in 2018 - at the level of 3.0 percent.

In 2017, the trend of the inflation rate slowdown is forecasted with absence of adverse price shocks, as well as due to higher base in 2016: it is expected that the inflation rate will be within the range of 6.0-8.0 percent and by the end of 2017 the average annual inflation rate will be approximately 7.5 percent.

## USA

**Chart 5.1.1.3. Real GDP Growth in the USA**

(year to year)



Source: IA Bloomberg

burden on business had a positive impact in improving the stock indexes and the indexes of consumer and investment confidence in the economy. Meanwhile, the prospects for the implementation of these measures contain uncertainty for economic growth.

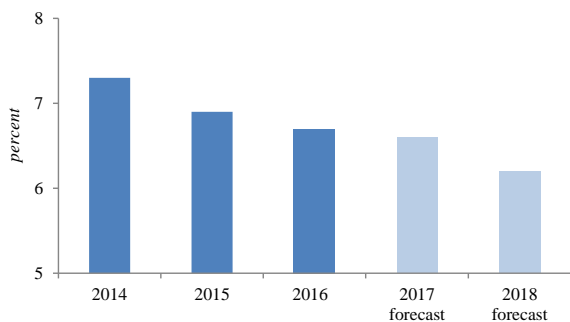
The inflation rate in the United States is forecasted at the level slightly above two percent, which is higher than 1.8 percent in 2016. Higher inflation rate will be supported by increases in prices for energy products after low prices in 2016, as well as higher prices in the groups associated with health services and housing.

**Forecasts for economic growth in the United States remain at the level of above two percent.** In Q1 2017, slowdown in GDP growth was largely due to the temporary factors. Thereafter, a decline of the unemployment rate and rise in the salaries will support increase of the private consumption. Business investment growth is expected to continue, meanwhile, a negative balance in the foreign trade would continue making negative contribution to GDP growth in the United States. The plans of the government authorities to conduct stimulating fiscal policy and to reduce the regulatory

## China

**Chart 5.1.1.4. Real GDP Growth in China**

(year to year)



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

for 2017 and 2018 were revised by 0.1 and 0.2 percentage points higher up to 6.6 and 6.2 percent respectively.

The average annual inflation rate in China is forecasted to be at the level slightly above two percent; meanwhile the benchmark of the Government was “about three percent”. In 2017, the increase in the general price level will amount to 2.4 percent, in 2018 - 2.3 percent.

**In China the slowdown of the economic growth will probably continue, but will be slower than previously anticipated.** Slight acceleration of economic growth in recent quarters was a result of supportive policies conducted by the Government of the country. Meanwhile, the efforts taken to restrain high growth of activity in the real estate sector and to ensure the stability of the financial system will contribute to reducing the growth rates in the nearest future. In light of the greater-than-expected Government measures to support the economy, China's GDP growth forecasts

## 5.2. Medium-Term Forecast

Assumptions about development of the external environment and internal conditions in Q1 2017 to the greatest extent were consistent with the baseline scenario, approved at a meeting of the Board of the National Bank held in February 2017.

Significant changes were not observed in the petroleum products market and the average price fluctuated at the level above USD 50 per one barrel. According to the estimates there are no substantial fundamental imbalances in the world oil market; therefore the forecasts for oil can be kept in 2017 at the level of USD 54 per barrel.

Stability is observed in the food market, which is evidenced by the index of the Food and Agriculture Organization of the United Nations.

In Q1 2017, faster economic recovery in Russia and Kazakhstan allowed adjusting the forecasts for economic development in these countries towards improvement. Expectations of growth of the inflow of remittances in the medium term were kept against this background.

Generally, the expectations and forecasts on the external parameters in comparison with the previous forecast did not change significantly. Expectations on the external environment are the key assumptions in developed forecasts. These expectations include the forecasts of the global research agencies/institutions, official authorities of the countries and expert estimates.

Dynamics of the oil prices defines the scenarios and forecasts of the macroeconomic parameters of the major trading partner countries for the medium term. The later will have a significant impact on the volume of capital inflows into the country from exports and from remittances, the dynamics of the exchange rate and the internal demand.

The tariff and tax policies will have a great impact on the achievement of the monetary policy targets in the medium term.

**In 2017, the baseline scenario assumes the continuation of current trends in the world market of hydrocarbons and food products.** In 2017, the average price for Brent crude oil grade will fluctuate around 54 USD per barrel.

Amid declining prices in the world market of sugar and sunflower oil, the food markets (FAO index) were adjusted downwards and will continue its sideways movement in the medium term. In 2017, the average of the FAO index will make approximately 175.0 points. In the current marketing year, the ratio of supply and demand in the grains market forms the conditions for maintaining the prices for grains in the world market at the current levels.

In 2017, despite existing structural constraints, the Russian economy will move into an area of growth, which at the end of the year will amount to 1.2 percent. The inflation rate will continue slowing down and its average value for the year will make 4.4 percent in the absence of external shocks. In 2017, GDP is expected to increase by 2.6 percent in Kazakhstan and the annual average inflation rate is expected to slow down gradually to 7.6 percent.

Thus, the assessment of the situation in the external environment suggests the neutral impact thereof on the internal price level.

Uncertainty in the fiscal policy is still observed in the medium term. The Draft Law “On the republican budget for 2017 and forecast for 2018-2019” stipulates gradual fiscal consolidation.

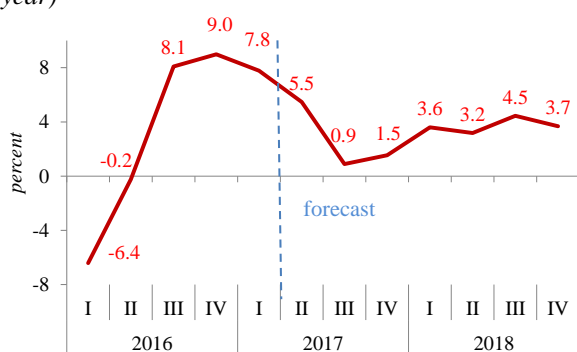
Evaluations at the end of 2016 show recovery in the domestic consumption. Private consumption was formed to a large extent by increased inflow of remittances and growth of real salaries. According to the baseline scenario, the balance of transfers in 2017 will increase up to 13.5 percent. The increased inflow of remittances will support internal demand in the medium term.

Taking into account the assessments of the external environment and the internal conditions development in 2017 in the medium term, the inflation rate will be inclined to the lower border of target within the range of 5-7 percent. Gradual recovery in prices for food

products and energy carriers in the world and in the region, as well as that of the internal and external consumer demand are expected to be the main drivers of inflation rate. In addition, the inflationary inertia will be supported by measures of the fiscal policy, increased real incomes of the population, including by means of growing remittances and relatively stable inflation expectations of the population.

**In 2017, the real sector of the economy of Kyrgyzstan will demonstrate moderate growth.** GDP gap will be negative and will have weak deflationary impact during 2017.

**Chart 5.2.1. Forecast of Real GDP**  
(quarter to the corresponding quarter of the previous year)



According to the results of 2017, the real GDP growth will amount to 3.3 percent; the growth excluding Kumtor will be approximately 4.6 percent. The increase in production at the enterprises of the Kumtor Mine will be below the indicator of 2016. In the sectoral aspect, the economic growth will be supported by the sectors of agriculture (due to livestock and crop production), trade and construction.

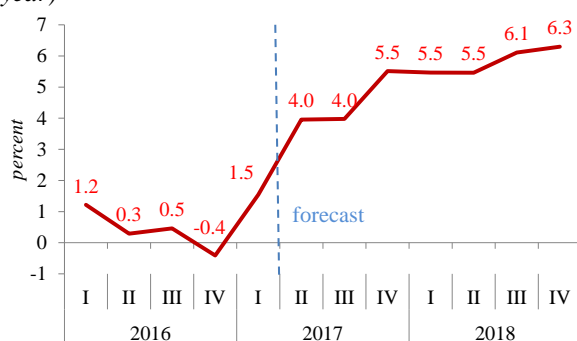
In 2018, the real GDP growth rate will make approximately 3.8 percent, excluding Kumtor, the growth will amount

to approximately 4.5 percent.

**Baseline inflation in the medium term will reach the target range of 5-7 percent.**

At the end of 2017, the inflation rate (period to period) will make 3.7 percent (Dec 2017/Dec. 2016 – approximately 5.0 percent). In 2018, the average inflation value will be about 5.8 percent.

**Chart 5.2.2. Inflation Forecast**  
(quarter to the corresponding quarter of the previous year)



Expectations about changes in the downward trend of the inflation rate in 2016 were implemented amid recovery of the upward dynamics in the market of food products and energy carriers, as well as the inflow of remittances of migrant workers since the beginning of 2017.

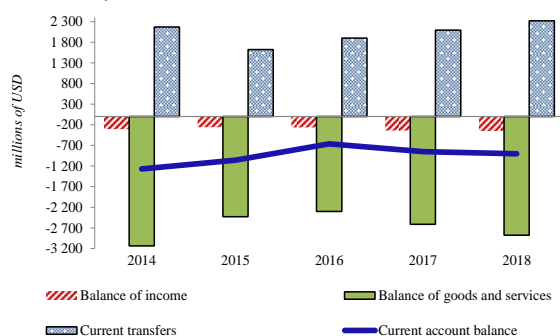
### Forecast for the Balance of Payments in 2017-2018<sup>1</sup>.

**In 2017, the factors determining development of the external sector in the Kyrgyz did not change significantly compared to the previous forecast. Recovery of the economic activity is expected in the trading partner countries, as well as the moderate growth of the economy in the country.** Despite the positive trend of the net inflow of current transfers, more rapid growth in imports compared to exports will result in increase of the current account deficit up to 12.2 percent to GDP.

<sup>1</sup> The forecast was made taking into account additional estimates of the National Bank of the Kyrgyz Republic

**Chart 5.2.3. Forecast Data on Current Account**

(millions of USD)



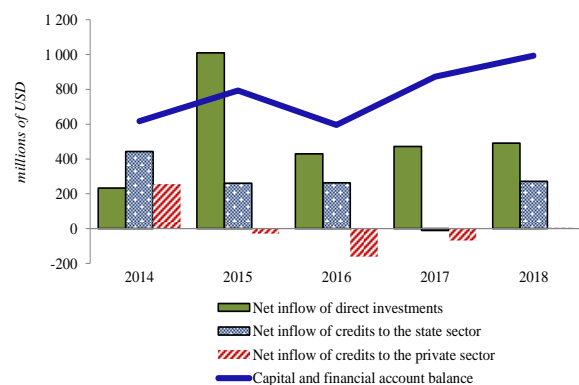
previous year, such situation, along with a decline in the world prices for the precious metal, will cause the decrease in exports of gold.

**Recovery in the internal demand will have a significant influence on the dynamics of imports, which are expected to grow up to 10.0 percent.** The trend of growth of imports in the first three months of the year allows to forecast slightly higher growth of import excluding energy products up to 9.2 percent. Expected increase in the world prices for petroleum products against 2016 will result in growth in the value of petroleum products.

**Expected growth in the inflow of private transfers will remain at the level of 13.5 percent compared to 2016.** This trend will be determined by the gradual recovery of the economic growth in Russia and Kazakhstan, by the stability in their foreign exchange markets and by the increase in the quantity of migrant workers in the host country.

**Chart 5.2.4. Forecast Data on Capital and Financial Account**

(millions of USD)



**Increase in the exports by 2.9 percent is expected under the influence of recovering external demand for the domestic products, as well as the gradual adaptation to the conditions of trade within the EAEU (including the removal of non-tariff barriers).** This increase will be provided by exports excluding gold, which at the end of the year will form at the level of 17.0 percent. According to the forecasts of the gold company, the gold production is expected to decrease at the Kumtor Mine in 2017 year compared to the

**Financing of the expected current account deficit in 2017 will result in an increase of capital inflows on the capital and financial account.** Additionally, the forecast for this account was adjusted to the amount of the one-time write-off of the Kyrgyz Republic debt to the Russian Federation in 2017 in the amount of USD 240.0 million. Capital inflows on the financial account are primarily expected on the item “direct investment”, the volume thereof will be comparable to the level of the previous year. Balance on the item “other investment” will be formed primarily under the influence of reduction in the

foreign liabilities of the public sector due to writing-off the Russian credit. The net outflow on the private sector credits is expected to decrease compared to 2016 due to reduced payments on previously attracted credits, and the increase in the inflow of new credits.

Thus, the forecasted level of the current account deficit, financing thereof through the capital inflows on the capital and financial account and expected level of the international reserve assets will determine formation of the positive balance of payments in the amount of USD 25.5 million. Meanwhile, international reserve assets<sup>1</sup> are expected to cover 3.7 months of the future imports of goods and services.

<sup>1</sup> In accordance with the IMF methodology, only assets in convertible currencies (US dollar, euro, pound sterling, Japanese yen, Swiss franc, Australian dollar and Canadian dollar) are included in the international reserve assets

**The forecast for development of the external sector in 2018 was not significantly amended. Trends for development of the economic situation in 2017 will provide favorable conditions for sustainable economic recovery in 2018.** Existing positive dynamics of current transfers, larger growth in imports compared to exports will result in formation of the current account at a rate of 11.8 percent to GDP. Expected adaptation of the Kyrgyz Republic to the business conditions within the framework of the EAEU and existing growth trend in the internal demand will determine the increase in the trade balance deficit by 12.3 percent.

Progressive recovery of the economies of Russia and Kazakhstan, provided that their national currencies remain stable, will have a positive impact on the inflows of private transfers, the growth rate thereof will be at the level of 8.6 percent. Capital inflow on the capital and financial account is expected to increase, the significant amount of funds on this account will be provided by the inflow of foreign direct investments, as well as by loans to the public and private sector. Balance of payments in 2018 is expected to be positive in the amount of USD 84.4 million. International reserve assets will cover 3.9 months of the future imports of goods and services.

The designed forecast of the balance of payments of the Kyrgyz Republic for 2017-2018 has the following risks:

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

# Annex 1. Key Macroeconomic Indicators

(quarter to the corresponding quarter of the previous year, if otherwise is not indicated)

		2015				2016				2017
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>1. Demand and supply<sup>1</sup></b>										
<i>(real growth rates, if otherwise is not indicated)</i>										
Nominal GDP, per quarter	<i>mln. KGS</i>	80 709,7	92 915,4	120 251,0	129 759,4	78 799,0	97 238,1	134 046,1	142 595,8	86 143,1
GDP	%	6,3	7,3	4,6	-1,5	-4,9	0,0	8,3	9,0	7,8
GDP, excluding Kuntor	%	2,4	4,7	3,7	6,2	1,0	1,4	5,6	5,9	3,9
Domestic consumption	%	1,2	0,3	-2,9	-16,2	0,2	5,3	3,5	-	-
Gross accumulation	%	-3,4	-7,5	-18,1	6,1	-23,2	0,4	5,3	-	-
Net export	%	-13,2	-5,8	-34,6	-40,5	0,2	16,4	-7,5	-	-
<i>GDP production:</i>										
Agriculture	%	0,6	1,6	7,3	10,2	1,5	3,9	3,5	6,6	1,5
Industry	%	20,3	26,9	6,2	-37,5	-25,1	-11,4	29,7	30,9	35,5
Construction	%	-3,2	6,7	-0,2	35,1	0,1	6,2	13,1	7,6	0,0
Services	%	3,2	3,0	3,4	4,6	2,5	1,8	4,4	3,4	0,5
including trade	%	5,2	5,2	6,6	8,0	4,8	5,3	11,6	7,0	3,9
<b>2. Prices<sup>2</sup></b>										
CPI	%	110,3	106,1	105,7	104,0	101,2	100,3	100,5	99,6	101,5
CPI, in annual terms as of the end of period	%	108,5	104,5	106,4	103,4	100,5	101,3	99,7	99,5	102,8
Core inflation	%	109,7	107,6	106,5	105,2	103,0	101,8	101,0	99,9	100,3
<i>CPI by main groups of goods and services:</i>										
Food products	%	111,9	103,6	102,2	97,5	93,6	92,3	93,8	94,4	98,8
Non-food products	%	112,2	110,4	109,0	111,6	111,7	110,8	110,0	102,4	101,3
Alcohol drinks and tobacco products	%	109,5	108,9	110,1	111,8	108,5	107,6	105,3	106,5	105,7
Services	%	106,0	106,9	107,4	106,6	106,5	105,2	104,6	104,4	106,9
<i>CPI, classified by character:</i>										
Excisable goods	%	111,4	109,0	107,7	109,4	110,0	109,6	108,3	105,4	106,1
Regulated prices	%	116,9	114,9	117,9	122,1	109,6	109,3	105,2	99,8	98,7
Market inflation rate (the rest of CPI)	%	106,3	106,9	107,4	107,8	107,8	106,4	105,5	104,2	104,2
<b>3. External sector<sup>3</sup></b>										
<i>(in percent to GDP)</i>										
Trade balance	%	-37,1	-37,7	-36,4	-34,3	-34,8	-36,9	-34,4	-31,8	-31,1
Current account	%	-18,7	-21,1	-21,2	-16,2	-13,6	-14,7	-11,6	-10,1	-9,7
Export of goods and services	%	44,1	40,8	39,1	37,9	38,1	37,9	38,5	36,7	37,4
Import of goods and services	%	86,0	83,4	79,3	75,1	75,2	77,0	75,5	71,6	72,3
<b>4. USD exchange rate, as of the end of period</b>										
	<i>KGS</i>	63,8736	62,0788	68,8359	75,8993	70,0158	67,4860	67,9346	69,2301	68,6069
<b>5. Monetary sector</b>										
<i>(real growth rates, if otherwise is not indicated)</i>										
NBKR policy rate, as of the end of period	%	11,00	9,50	10,00	10,00	8,00	6,00	6,00	5,00	5,00
Rate of "overnight" deposit, as of the end of period	%	5,00	3,00	4,00	4,00	1,00	0,50	0,25	0,25	0,25
Rate of "overnight" credit, as of the end of period	%	14,00	12,00	12,00	12,00	10,00	7,50	7,25	6,25	6,25
Average interest rates of the operations in the interbank credit market, per quarter	%	10,28	10,02	7,14	9,66	10,50	2,70	3,76	2,32	2,08
<i>of which:</i>										
of REPO transactions	%	10,50	9,96	7,14	9,45	9,44	1,59	1,76	1,61	1,56
of credits in national currency	%	15,00	18,00	-	11,62	13,25	7,84	4,11	2,67	2,11
of credits in foreign currency	%	1,41	-	-	-	-	-	-	2,0	-
Weighted average yield of 7-day notes, as of the end of period	%	11,00	9,50	9,67	10,00	2,18	1,44	0,27	0,24	0,61
Weighted average yield of 28-day notes, as of the end of period	%	-	-	-	-	-	-	-	-	1,14
Monetary base	%	-16,25	-9,52	-4,34	4,01	17,24	16,65	20,53	27,63	23,31
Money outside banks (M0)	%	-19,9	-15,7	-7,0	2,3	17,5	18,6	20,6	30,5	28,0
Monetary aggregate (M1)	%	-17,7	-14,3	-5,6	1,7	21,0	25,5	29,4	38,6	31,7
Narrow money supply (M2)	%	-13,2	-13,6	-5,7	-0,1	17,2	25,8	31,5	40,3	36,2
Money supply (M2X)	%	0,9	0,5	10,0	14,9	13,1	16,7	15,2	14,6	21,7

<sup>1</sup> Estimates of the National Bank of the Kyrgyz Republic on the basis of the data provided by the National Statistics Committee of the Kyrgyz Republic

<sup>2</sup> Source: National Statistics Committee of the Kyrgyz Republic

<sup>3</sup> Coefficients were calculated on the basis of the sliding annual data for the last 4 quarters. Data for Q4 are preliminary



## Annex 2. Glossary

**Balance of payments** is a report, which reflects aggregate economic transactions between the residents and non-residents within a certain period of time.

**Consumer price index** reflects changes in the prices for goods and services purchased by the standard consumers for non-production purposes. This index is among inflation rate measures, which is based on comparing the value of basic goods basket consumed by the population and weighted in accordance with the share of these goods in the aggregate consumption.

**Core inflation** is inflation, which excludes short-term, structural and seasonal changes of prices: the growth in prices of goods due to the seasonal, the external factors and the administratively established tariffs is excluded from the calculation of the inflation rate.

**Deposits included in M2X** are the deposits of individuals, legal entities and other financial institutions, except the deposits of the Government and non-residents.

**Dollarization** is extensive use of the US dollars in the domestic currency circulation of the country, which possess own national currency.

**Inflation** is the upward trend in the general level of prices within the certain period of time, which is determined based on the value calculation for the basket of goods and services weighted by the structure of consumer expenditures of the standard household. The consumer price index is an indicator, which characterizes the inflation rate in the Kyrgyz Republic.

**Monetary aggregate** is the money supply classified according to the liquidity level: M0; M1; M2; M2X.

**M0** – currency outside banks.

**M1** – M0 + residents' transferable deposits in national currency.

**M2** – M1 + residents' time deposits in national currency.

**M2X** – M2 + settlement (current) accounts and residents' deposits in foreign currency.

**Monetary base** is the obligations of the National Bank on cash in circulation, and the obligations of the National Bank to other depository corporations in the national currency.

**Net balance of payments** is a difference between receipts from the foreign countries and payments transferred to the foreign countries.

**Net trade balance** is a difference between the cost of export and import.

**Nominal effective exchange rate (NEER) index** is a weighted average value of the nominal exchange rates, which excludes the price tendency in the country under review with respect to the prices in the trading partner countries.

**Notes** are short-term discount government securities issued by the National Bank. The notes of the National Bank can be issued with maturity of 7, 14 and 28 days by decision of the Monetary Regulation Committee of the National Bank. The maximum yield of notes is set to the National Bank's policy rate at the date of the auction.

**Other depository corporations** are all resident financial corporations, except for the central bank, which main activities are aimed at financial intermediation and which issue obligations included into the national definition of the broad money stock (M2X).

**Policy rate** is a monetary policy tool, which represents an interest rate set by the central bank and is used as a major benchmark when determining the value of monetary resources in the economy.

**Real effective exchange rate (REER) index** represents the weighted average value of the nominal effective exchange rates adjusted by the value corresponding to the relative change in prices in the trading partner countries. REER is determined by calculation of the weighted real exchange rates of the currency in the country with respect to the currencies of the main trading partner countries.

**REPO transactions** are the operations on purchase/sale of the government securities in the secondary market with an obligation of their resale/repurchase on a certain date in the future at the pre-agreed price.

**State Treasury Bills** are the short-term (3-, 6-, 12-month) discount government securities of the Government of the Kyrgyz Republic. The Ministry of Finance is the issuer of ST-Bills. The ST-Bills allocation is performed in the form of weekly auctions conducted by the National Bank of the Kyrgyz Republic. Direct participants possess the right to participate in the auctions. The owners of ST-Bills of the Kyrgyz Republic can be both the legal entities and the individuals. The admission of foreign investors to the market of ST-Bills is not limited. The transactions in the secondary market of ST-Bills are conducted through the electronic trading system of the National Bank of the Kyrgyz Republic, which allows the participants to conduct transactions on purchase/sale of ST-Bills from their workplaces.

**State Treasury Bonds** are the long-term government securities of the Government of the Kyrgyz Republic with the interest income (coupon) and maturity over 1 year. The issuer of ST-Bonds is the Ministry of Finance. The National Bank of the Kyrgyz Republic is the general agent servicing the issues of ST-Bonds.

### **Annex 3. Abbreviations**

CBRF	Central Bank of the Russian Federation
CPI	Consumer Price Index
EAEU	Eurasian Economic Union
ECB	European Central Bank
EU	European Union
FA	Financing of agriculture
FAO	Food and Agricultural Organization of the United Nations
FOB	Cost at the exporter's border (Free on Board)
FRS	US Federal Reserve System
GDP	Gross Domestic Product
IBCRM	Inter-bank credit resource market
KR	Kyrgyz Republic
NBKR	National Bank of the Kyrgyz Republic
NBRK	National Bank of the Republic of Kazakhstan
NEER	Nominal effective exchange rate
NSC	National Statistical Committee
OPEC	Organization for Petroleum Exporting Countries
POL	Petroleum, oil, lubricants
PRC	People's Republic of China
REER	Real effective exchange rate
ST-Bills	State Treasury Bills
ST-Bonds	State Treasury Bonds
USA	United States of America