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Monetary Policy Report

(Review of Inflation of the Kyrgyz Republic).

Quarter 1, 2016

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Summary

A sustainable downward trend in the level of consumer prices was observed in Q1 2016. In March 2016, the annual average inflation rate was 1.2 percent; the annual rate decreased down to 0.5 percent from 3.4 percent at the end of 2015. This was partially due to the decline in the consumer demand, partially – due to the supply factors: the prices for energy carriers in annual terms decreased, and the favorable climatic conditions and good harvest resulted in deflation in the food product group. However, price dynamics remains uneven based on the basket components. In the reporting quarter, the prices for food fell by 6.4 percent and the prices for other commodity groups rose within the range from 6.5 to 11.7 percent compared to the corresponding quarter of 2015.

Economic decrease was observed in the country. At the end of Q1 2016, real GDP fell down to 4.9 percent due to reduced production output at the country's largest gold-mining enterprise. Moreover, weak external and internal demand for domestic products continued to have a negative impact on economic activity in the country. Excluding production at Kumtor enterprises, growth of real GDP was 1.0 percent.

At the end of Q1 2016, the state budget surplus amounted to KGS 2.7 billion or 3.4 percent to GDP (in January-March 2015 budget surplus amounted to KGS 0.5 billion or 0.6 percent to GDP). Financing of the budget spending by 75.3 percent was the main reason for the increase of surplus. Revenues rose by 37.3 percent compared to the same period of 2015 due to implementation of the plan for collection of non-tax revenues by 121.1 percent; the plan for collection of tax revenues was implemented by 95.9 percent.

At the end of Q1 2016, the balance of payments of the Kyrgyz Republic will form with a positive balance of USD 128.1 million. In Q1 2016, the current account deficit will decrease by 41.3 percent to make USD 181.6 million, mainly due to a decline in the trade deficit.

The economic situation remained difficult in the main trading partner countries. In Q1 2016, the economic growth in China was 6.7 percent, economic decrease at the level of 1.4 percent and 0.2 percent, respectively, was observed in Russia and Kazakhstan.

Stable situation with a trend of KGS appreciation at the end of Q1 2016 was observed in the domestic foreign exchange market. The National Bank conducted operations in the foreign exchange market on foreign currency purchase and sale in order to smooth the sharp exchange rate fluctuations. In Q1, net sales in the amount of USD 3.3 million formed on the foreign exchange interventions. The Kyrgyz som appreciated by 7.7 percent during the period under review.

In Q1 2016, the monetary base decreased by 1.3 percent, while the annual value of the monetary base grew by 17.2 percent. Broad money M2X, including deposits in foreign currency, decreased by 5.4 percent to KGS 135.4 billion in the reporting quarter. The annual growth of M2X was 13.1 percent.

Chapter 1. External Environment

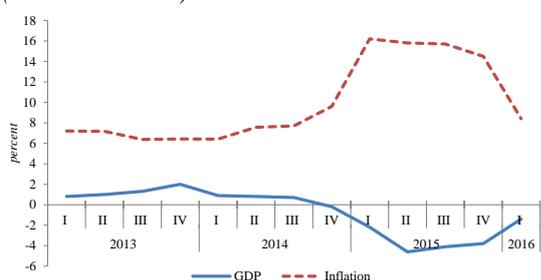
1.1. Economic Development of Main Trading Partner Countries

The difficult economic situation in the main trading partner countries is still regarded as the factor of a decline in the external demand for domestic products. In the economy of Russian, a negative effect of a structural shift in oil prices to the low levels and the sanctions imposed by a number of countries, is likely to be largely absorbed, the fluctuations of the Russian ruble and the inflation rates are among the indicators thereof. In Kazakhstan, the consequences significant devaluation of the Kazakh tenge still have an influence on the inflation in the neighboring country.

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

January-March 2015, the inflation rate was 8.4 percent. The annual inflation rate declined from 9.8 percent in January to 7.3 percent in March. Reduced consumer demand due to existing decline in the real incomes of the population observed since 2014 and transition to the cost-effective consumption had the main restraining influence on the inflation rate. Increase in the supply of cheaper domestic products as a result of import substitution and strengthening of the Russian ruble contributed to slowdown in the inflation rate.

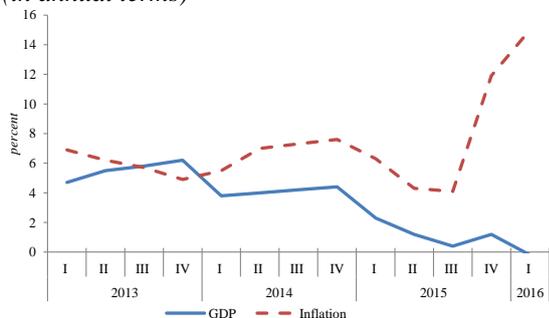
In Q1 of 2016, the economy of Russia continued to be in a state of stagnation; however, the rate of the economic decrease started decelerating since the middle of 2015. At the end of Q1 2016, the economic slowdown in Russia was 1.4 percent. Manufacturing industry (-3.1 percent), services sector (-1.4 percent) and construction (-1.6 percent) were in the negative zone. Agricultural production index showed a positive trend (+2.8 percent).

In Q1 of 2016, the consumer inflation rates slowed down and returned to the level of the pre-crisis period. In January-March 2016 against

Kazakhstan

Chart 1.1.2. GDP Growth and Inflation in Kazakhstan

(in annual terms)



Source: RK Statistics Agency, NBKR calculations

The impact of such factors as low oil prices, a decrease in the external demand due to the slowdown of the economic development in China and the economic recession in Russia, as well as a reduction in the flow of foreign investment, resulted in a decline of the economic growth in Kazakhstan in Q1 2016 by 0.2 percent. The level of industrial output decreased (-0.8 percent), mainly due to reduction in production of oil, coal, iron ore, as well as due to a decline in production output of petroleum derivatives and engineering products. Meanwhile, decreased domestic demand of the population due to the reduction in real incomes of the population and high

credit rates resulted in a decrease in the wholesale and retail trade (-6.0 percent).

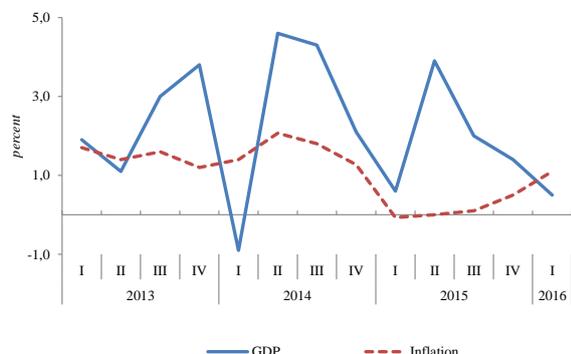
Despite the easing of shocks from the demand side, growth of the inflation rate, observed since the end of Q3 2015, continued in Q1 2016 mainly due to the existing impact of significant depreciation of the national currency after cancellation of the currency corridor on August 20, 2015 and the transition to a floating exchange rate regime. In March 2016, the annual inflation rate was 15.7 percent. The prices for food products grew by 12.7 percent, non-food products – by

26.5 percent, services – by 9.1 percent. In Q1 2016, the annual average inflation was at the level of 15.0 percent.

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

Slowdown of the economic growth in America was observed at the beginning of 2016.

According to the official data, in Q1 of the current year, GDP grew by 0.5 percent in the United States (against the previous quarter, in terms of annual rates). The quarter began with considerable turbulence in the financial markets and was characterized by moderate character of investment and slower growth in the consumer expenditures. Under the circumstances of the relatively low oil prices the volume of investments in mining and exploration activities decreased by 86.0 percent. Expansion of the foreign trade deficit was still observed due to the negative impact of the strong US dollar position on the external demand.

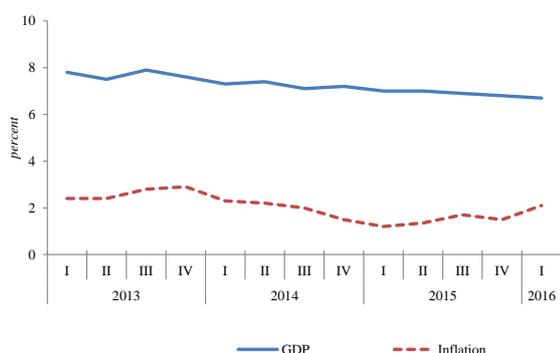
These factors as well as observed decline in the expenses for inventory holdings conditioned a decline in private investment in Q1 by 3.5 percent. Consumer expenditures, being the main driver of growth in the economic activity of the United States, have supported the economic growth; however, the support was not so significant compared to the previous quarters.

CPI growth rate in March 2016 against the corresponding month of the previous year was 0.9 percent, having decreased from 1.0 percent in February. The annual inflation rate is below the benchmark of the US Federal Reserve System of “about 2 percent”, due to a decline in the prices for fuel and energy product group by 12.6 percent since March 2015. The prices for food products rose by 0.8 percent in annual terms, the prices for other goods and services increased by 2.2 percent.

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 rates of slowdown in the economic growth of China became stable due to the positive trends in the real estate sector and investment dynamics.

According to the authorities of the PRC, in Q1 of the current year, GDP growth made 6.7 percent, having declined from 6.8 percent in Q4 2015. Recovery of the real estate market, where increase in sales and rise in the prices for new housing were registered, contributed to increase in the volume of investments in this sector by 6.2 percent in January-March of the current year compared to the corresponding period of the previous year.

In general, the growth rate of investment in fixed assets and industrial production in Q1 showed an upward trend. Moreover, increased lending to the economy was the factor supporting growth of economic activity. The volume of newly granted loans in Q1 of the current year increased by 25.3 percent compared to Q1 of the previous year and money supply M2 at the end of March rose by 13.4 percent within twelve months.

In March 2016, the annual CPI growth was 2.3 percent, having not changed compared to the level registered in February. The increase in prices for food products by 6.0 percent made a significant contribution to the inflation rate; in particular, there was a high rise in the prices for

fresh vegetables and meat products. The decline in the price index was registered in the product group, including transport and fuel. The annual inflation rate remains below the benchmark established at the level of “about three percent”.

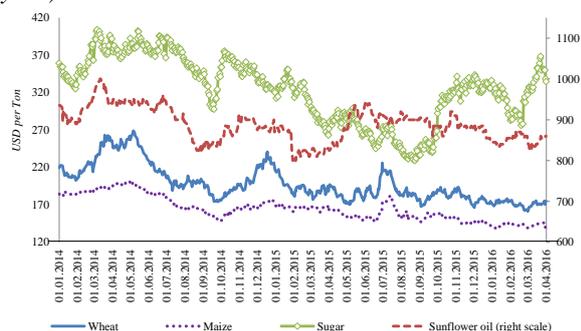
1.2. World Commodity and Markets

The existing favorable conditions in the foreign markets of food products and raw materials in general had a restraining impact on the growth of the domestic prices, given the high proportion of imports in the food product group and the significant share of food products of around 47 percent in the CPI basket.

Food Market

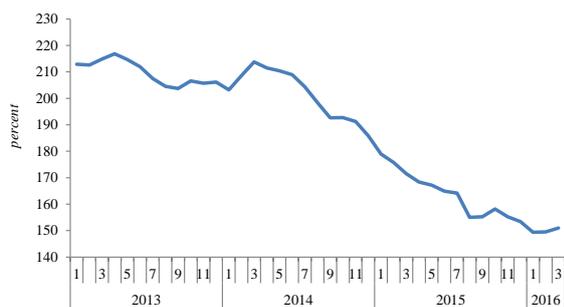
Chart 1.2.1. Dynamics of Prices for Food Products

(month to the corresponding month of the previous year)



sugar. On the background of the impact of these factors, the prices for sugar in the international markets were at a relatively high level. Among major vegetable oils, rise in prices for the palm oil was the most significant, which had the upward impact on the soybean oil quotations. The impact of the El Niño phenomenon was demonstrated in dry weather in Asia, which caused deterioration in the prospects for palm oil production in Malaysia and Indonesia. During the reporting quarter, the prices for sunflower oil demonstrated weak downward development.

Chart 1.2.2. Dynamic of FAO Food Price Index



14.5 percent compared to Q1 2015. In January-March of the current year, slight increase in the index was mainly due to rise in the prices for sugar and vegetable oils.

A stable price situation was observed in the markets of the main food products. Meanwhile, the impact of the El-Niño phenomenon¹, along with other factors, caused price volatility in the sugar market and rise in the prices for some vegetable oils.

El Niño caused dry weather in the countries of Asia producing sugar, excessive rainfall in southern regions of Brazil, and delays in harvesting of sugar cane. Moreover, increase was observed in use of sugar cane for the purposes of biofuel production instead of sugar, which had a downward impact on production and supply of

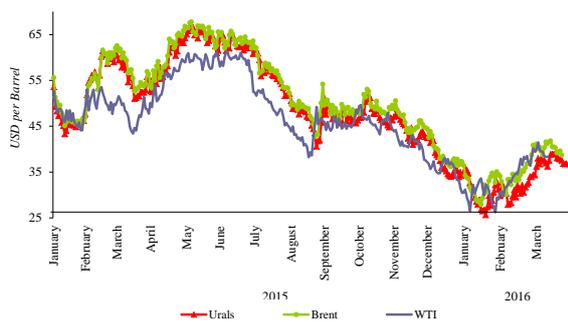
In January-March of the current year, the situation in the cereals markets was stable, generally, the prices declined slightly. The prices for wheat decreased against the positive estimates of yield and expectations of sufficient supply in the coming period combined with smoothing demand. The prices for maize also declined slightly due to favorable weather conditions in South America and an increase of planted acreage in the United States.

In Q1 of the current year, the average FAO index (Food and agriculture organization), with weak upward dynamics, decreased by 3.6 percent compared to the previous quarter and by

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 has a negative impact on crop yields.

Energy Market

Chart 1.2.3. Dynamics of Prices for Oil
(month to the corresponding month of the previous year)



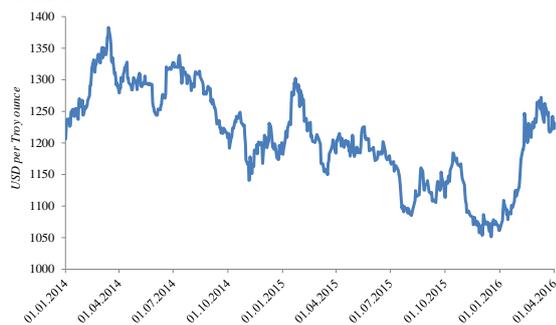
In Q1 2016, the prices in the international oil market demonstrate an upward trend. The prices for the basic oil grades (Brent, WTI, Urals) fluctuated within the range of USD 26.2 - 41.8 per Barrel. Upward dynamics of oil prices in the international energy market was due to speculation of the market participants amid news about possible agreement to reduce oil production necessary to mitigate decline of the price for crude oil. Meanwhile, the US oil and gas producers continued to reduce production amid low prices and an oversupply in the international raw

materials markets.

Despite the current upward price movements in the international energy market, there are such structural constraints of price increase as slowdown of the economies of the oil importers, weakening of the currencies of the developing countries, the excess of oil supply over demand, and unstable geopolitical situation in certain regions of the world.

Gold Market

Chart 1.2.4. Dynamics of Prices for Gold



Source: IA Bloomberg

In Q1 of the current year, the prices for gold increased significantly compared to the minimum for many years reached at the end of 2015. The decline in prices in the previous quarter was due to rise of the US FRS rate in December and expectations of further increases in 2016, which improved the investment attractiveness of the United States securities that are an alternative to gold investment direction. However, in Q1 of 2016 amid the statistics on the United States economy, the probability of a slower rise in the rates in the current year increased compared to the previous forecasts. Moreover, high turbulence in

the financial markets of the United States and China was observed during the reporting quarter, the euro-zone interest rate was decreased to zero level, while in Japan, the base rate remained negative. In these circumstances, the risks of financial losses and a decrease in securities income increased investment demand for gold and supported the increase in metal prices. A relatively low demand for physical gold, experienced in the countries of Asia had constraining influence on growth of quotations.

Chapter 2. Macroeconomic Development

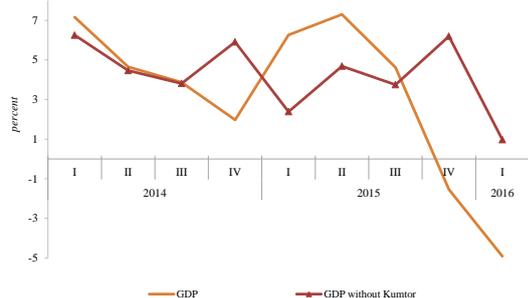
2.1. Demand and Supply in the Commodities and Services Market

The decrease of production output at Kumtor, the largest gold-mining enterprise of the country, with reduction in the foreign and domestic demand resulted in a decline of gross domestic product output in the Kyrgyz Republic in Q1 2016. Since the beginning of the current year, an increase was observed in the volume of remittances to the country.

Demand

Chart 2.1.1. GDP Dynamics

(quarter to the corresponding quarter of the previous year)



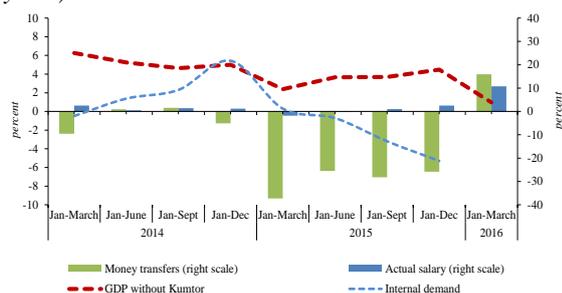
Source: NSC KR

In Q1, an economic decrease was due to the negative rates in the industrial sector, where a decline in the production output at the Kumtor Mine had a significant influence. Moderate growth in the service sector and agriculture made a positive contribution. Finally, in Q1 2016, real GDP decreased by 4.9 percent (increase by 6.3 percent in the same period of 2015), the enterprises of the Kumtor Mine an increase was 1.0 percent (2.4 percent in January-March 2015).

According to Centerra Gold Inc. press release, the Kumtor output decreased by 49.0 percent compared to Q1 2015 (170.7 thousand troy ounces) and amounted to 86.4 thousand troy ounces in Q1 2016, which was due to low gold content in mined ore. Low production output in Q1 2016 corresponds to the company's forecasts.

Chart 2.1.2. Dynamics of Internal Demand and Money Transfers

(period to the corresponding period of the previous year)



Source: NBKR

According to the preliminary results of 2015, the domestic demand¹ decreased by 5.3 percent against 2014. The downward trend remained during the whole 2015 due to a reduction in the components of final consumption (-5.8 percent) by means of a decline in households consumption (-6.5 percent), a decrease in gross savings (-4.9 percent) and a significant decline in inventories (-87.3 percent). A negative contribution was also made by a reduction of individuals' remittances in 2015. However, since the beginning of 2016, positive trend is observed in the individuals' remittances through the money transfer systems: in Q1 2016, the net inflow in USD equivalent increased by 15.9 percent compared with the same period of 2015.

Despite a decrease in the domestic demand, consumption remained the main component within the GDP structure (105.7 percent to GDP).

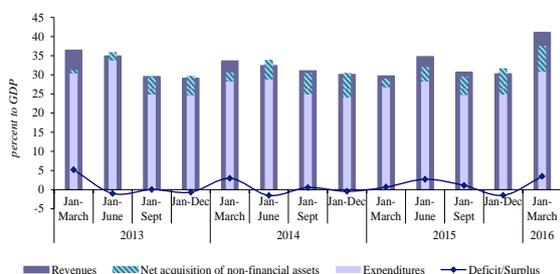
¹ Reference to the data for the earlier period is given due to the lack of data for Q1 2016.

State Finances Sector

In Q1 2016, the state budget was executed with a surplus of KGS 2.7 billion or 3.4 percent to GDP, in the same period of 2015, there was a budget surplus of KGS 0.5 billion or 0.6 percent to GDP.

Chart 2.1.3. Execution of the State Budget

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

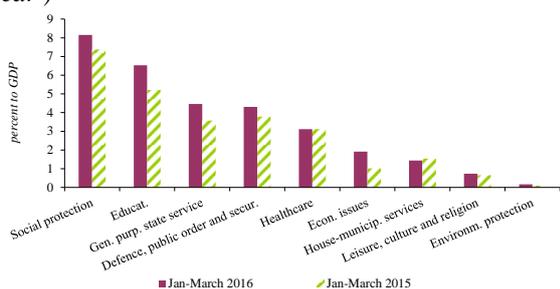


Source: CT MFKR, NBKR

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 other costs (scholarship, interest payments), labor costs (mainly salaries), 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, economic issues, public services of general purpose, and social protection.

Chart 2.1.4. Execution of the State Budget

(period to the corresponding period of the previous year)



Source: CC MFKR, NBKR

amounted to 112.5 percent in Q1 2016, which was insured by implementation of the plan for collecting non-tax revenues by 121.1 percent, and official transfers - by 7.7 times. The plan on collection of the non-tax revenues was implemented at the rate of 95.9 percent. The tax collection plan of the State Tax Service was implemented at a rate of 92.1 percent, while the same plan of the State Customs Service was implemented by 104.6 percent. At the end of Q1 2016, the execution of the state budget expenditures amounted to 75.3 percent. Meanwhile, the expenditure plan on the protected items was executed by 75.1 percent, on the unprotected items – by 62.6 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, exclusive of the monetary funds of the State Pension Savings Fund) amounted to KGS 0.7 billion, or 0.9 percent to GDP, at the end of Q1 2016. Revenues of the Social Fund budget (inclusive of the Pension Fund balance as of the beginning of the year) amounted to KGS 10.0 billion or 12.7 percent to GDP, having increased by 7.6 percent against to the comparable value of 2015. Expenditures of the Social Fund budget increased by 6.9 percent against the comparable value of 2015 and amounted to KGS 10.2 billion, or 12.9 percent to GDP.

Investment

In Q1 2016, investment in fixed assets decreased. The level of implementing investment in fixed assets decreased by 0.7 percent (in comparable prices) compared to the same period of 2015.

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

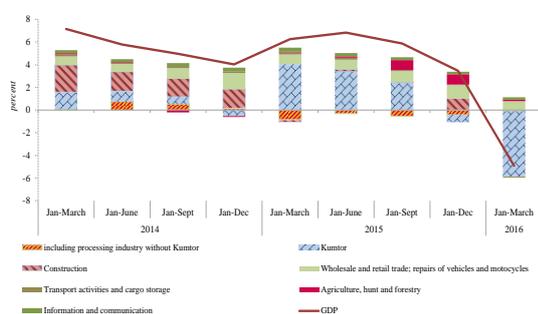
	January-March		share, percent	
	2015	2016	2015	2016
Total	16 312.0	16 590.6	100.0	100.0
Internal investment	12 008.1	12 899.7	73.6	77.8
Republican budget	156.3	656.2	1.0	4.0
Local budget	57.1	65.1	0.3	0.4
Funds of enterprises and organizations	6 413.7	5 646.1	39.3	34.0
Banks' credits	12.6	23.6	0.1	0.2
Population funds including beneficent help of KR residents	5 368.4	6 508.7	32.9	39.2
External investment	4 303.9	3 690.9	26.4	22.2
Foreign credit	3 297.5	2 117.6	20.2	12.8
Direct foreign investments	527.6	1 217.0	3.2	7.3
Foreign grants and humanitarian aid	478.8	356.3	3.0	2.1

Source: NSC KR

personal funds – by 18.4 percent), whereas the investment made from external sources decreased by 16.2 percent (from the foreign credits – by 37.3 times) compared to the same period of 2015.

Supply

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



Source: NSC KR

1.7 times) and production of petroleum products (by 30.7 percent).

Positive trend in agriculture (+1.5 percent) in Q1 was due to increase in production of livestock products.

A slight growth of 0.1 percent was observed in the construction sector with zero input in GDP growth due to increase in the scope of performed construction contracted works and other capital works and expenses, as well as capital and current repair of buildings and constructions.

The trade sector (0.8 percentage points) made the main contribution in the sphere of services (1.2 percentage points).

2.2. External Sector¹

In Q1 2016, the current transactions account deficit decreased by 9.7 percent to GDP due to the reduction of the trade deficit.

In the reporting period, investment in fixed assets were mainly directed to the construction of agricultural facilities, mining and services sector. Moreover, there was a decrease in investment in fixed assets directed to the housing construction, construction of manufacturing, trade and education facilities.

The volume of investment in fixed assets financed from domestic sources increased by 4.9 percent (the investment from the state and local budget increased by 4.1 times, that from the

In Q1 2016, real GDP decreased in the country mainly due to a decline in the production output at the Kumtor Mine.

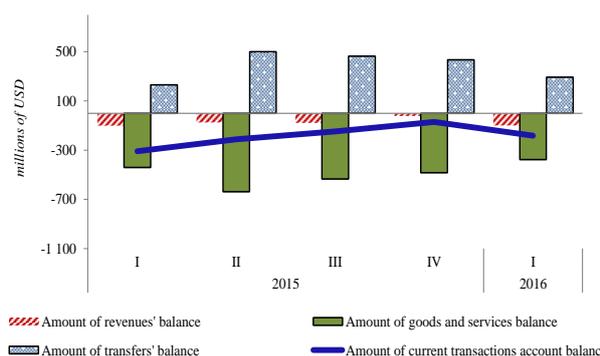
A decrease in the industrial sector was primarily due to a decline in the production output of the precious metals by 47.4 percent.

Excluding the enterprises of the Kumtor Mine, significant decrease was observed in the production output of other non-metallic mineral products (-26.5 percent), in the textile sector (-6.0 percent). Generated, transferred and distributed electricity decreased by 8.9 percent. Moreover, in Q1 2016, an increase was observed in extraction of other mineral resources (by 4.3 times), oil (by 1.7 times), metal ores (by

¹ 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.

Chart 2.2.1. Current Transactions Account

(millions of USD)



Note: According to the forecasted and preliminary data, the data on foreign trade are given taking into account the NSC KR additional estimates for agricultural products and mutual trade with the EEU countries (since Q3 2015) and the estimates of the NBKR

According to the forecasted and preliminary data, in Q1 2016, the current account deficit will decrease by 41.3 percent and amount to USD 181.6 million.

In the reporting period, the trade deficit of the Kyrgyz Republic is expected to decrease by 12.6 percent to make USD 301.7 million. Trade balance will be formed under the influence of the following factors:

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

2.2.1. KR Trade Balance¹

(millions of USD)

	2014	2015	2015 Q1	2016 [*] Q1	Change in %	Change in millions of
Trade balance	-2 909,5	-1 984,0	-345,1	-301,7	-12,6	43,3
Export (FOB)	2 380,7	1 812,4	503,4	377,9	-24,9	-125,6
Gold	716,9	665,4	256,2	100,0	-61,0	-156,2
Import (FOB)	5 290,2	3 796,4	848,5	679,6	-19,9	-168,9
Energy products	1 041,8	702,6	226,0	93,1	-58,8	-132,9

* Preliminary data

Exports of goods (in FOB prices) will decrease by 24.9 percent to make USD 377.9 million in Q1 2016. Exports excluding gold will increase by 12.4 percent and amount to USD 277.9 million. Increase in exports excluding gold was due to the NSC KR estimates in the individuals sample survey on mutual trade conducted and registered since the Kyrgyz Republic entry the EEU, which were recorded in the official statistics.

In the reporting period, imports of goods (in FOB prices) will decrease by 19.9 percent to make USD 679.6 million. The decrease in imports will be conditioned by a reduction in supplies of petroleum products due to the drop in the average contract prices, the reduction in the physical volume of supplies and the decline of imported passenger cars.

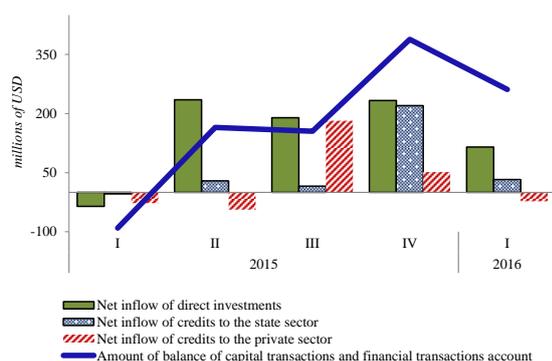
The net inflow of current transfers will increase by 27.1 percent to make USD 294.3 million. A positive trend on transfers will be mainly due to the increase in the inflow of private remittances, the net inflow thereof will increase by 11.4 percent to make USD 253.9 million.

According to the forecasts, the negative balance of services will decrease by 22.0 percent and will be formed at the level of USD 74.7 million in Q1 2016. The negative balance of revenues is expected at the level of USD 99.5 million, which corresponds to the level of Q1 2015.

The inflow of direct and other investments in Kyrgyzstan will result in the increase of the positive balance on the capital transactions and financial transactions account. In Q1 2016, the capital transactions and financial transactions account formed with a positive balance of USD 261.4 million, against the negative value at the level of USD 90.4 million at the end of Q1 2015. The balance of capital account is expected to form positive in the amount of USD 12.6 million (the increase by 31.4 percent). In the reporting period, the balance of the financial account is expected to form positive in the amount of USD 248.8 million.

¹ The data are given taking into account the NSC KR additional estimates for agricultural products and mutual trade with the EEU countries (since Q3 2015) and the estimates of the NBKR.

Chart 2.2.2. Capital Transactions and Financial Transactions Account



In the reporting period, the increase in the inflow of direct and other investments will have the most significant influence on the financial account.

Net inflow of direct investments in the country is forecasted at the level of USD 115.0 million. In the reporting period, the positive balance of “other investments” item will make USD 124.9 million, primarily due to the decrease of the residents’ assets abroad by USD 131.0 million. Meanwhile, the residents’ liabilities to the external world will decrease by USD 6.1 million primarily due to the trade credits.

Therefore, at the end of Q1 2016 the Kyrgyz Republic payment balance will be formed with a positive balance to make USD 128.1 million. The volume of gross international reserves will cover 4.8 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)			th to the previous month (as of the end of mo.		
	2014 (aver.)	2015 (aver.)		December 2015	March 2016	*	February 2016	March 2016	*
	(January-December)	(January-December)							
REER	117.3	122.9	4.8	116.2	121.3	4.3	123.1	121.3	-1.5
NEER	114.4	122.6	2.7	117.5	124.8	6.2	125.0	124.8	-0.1
RBER to CNY	135.0	120.6	-4.6	106.0	109.0	2.8	106.6	109.0	2.2
NBER to CNY	66.3	56.4	-9.4	48.9	51.8	5.9	50.4	51.8	2.7
RBER to Euro	137.1	145.8	3.7	128.6	129.6	0.8	127.5	129.6	1.7
NBER to Euro	61.8	61.8	0.0	53.5	54.8	2.3	53.0	54.8	3.4
RBER to KZT	107.6	108.8	6.9	125.9	137.4	9.1	140.5	137.4	-2.2
NBER to KZT	112.1	114.1	6.3	141.0	160.4	13.7	161.7	160.4	-0.8
RBER to RUR	80.1	97.4	8.7	92.2	96.4	4.5	102.0	96.4	-5.5
NBER to RUR	121.5	160.1	9.0	154.1	166.5	8.0	173.7	166.5	-4.2
RBER to USD	180.1	160.2	-4.3	138.3	142.1	2.8	139.3	142.1	2.0
NBER to USD	89.1	74.4	-9.5	62.9	65.9	4.8	63.7	65.9	3.4

* preliminary data

↓ - Som devaluation, competitiveness improvement
 ▲ - Som strengthening, competitiveness deterioration

At the end of Q1 2016, the index of nominal and real effective exchange rate increased compared to December 2015.

According to the preliminary data, the index of nominal effective exchange rate (hereinafter referred to as “NEER”) of KGS increased by 6.2 percent from the beginning of 2016 and amounted to 124.8 by the end of March 2016. The increase in the NEER index was due to KGS strengthening¹ in March 2016 compared to the average exchange rate for December 2015 against: the Kazakh tenge – by 13.7 percent, the Russian ruble – by 8.0 percent, the Chinese yuan – by 5.9 percent, the US dollar – by 4.8 percent,

and the euro – by 2.3 percent.

Despite higher level on inflation in the trading partner countries², the increase in the NEER index caused growth in the index of real effective exchange rate, which increased by 4.3 percent from December 2015 and amounted to 121.3 at the end of March 2016.

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.

² For January to March 2016, the KR inflation formed negative at the level of 1.2 percent, whereas an average inflation rate in the major trading partner countries made 0.5 percent according to the preliminary calculations.

Chapter 3. Monetary Policy

3.1. Monetary Policy Implementation

Under the conditions of continuing low inflation in the country due to the stable dynamics of prices in the foreign commodities markets, reduced risks of excessive pressure on the exchange rate, taking into account the forecasts for future price developments the National Bank in the period under review decided it possible to decrease its key interest rates.

In Q1 of the current year, the Board of the National Bank twice considered the issue of the National Bank policy rate. In view of the continuing uncertainty with regard to the impact of negative external factors on macroeconomic indicators and on the exchange rate, the policy rate remained unchanged at 10.00 percent until March 2016. Since March 29, 2016, taking into account low growth rates of the general price level, reduced risks of excessive pressure on the exchange rate, slowdown of economic activity in the country, the policy rate was decreased by 200 basis points to 8.00 percent. The rates of the interest “corridor” were reduced: the interest rate on “overnight” credits was decreased from 12.0 percent to 10.0 percent, the interest rate on “overnight” deposits – from 4.0 percent to 1.0 percent.

Dynamics of the policy rates predetermined the direction of rates changes in the interbank credit market, which were mainly within the limits of the “interest” corridor. In Q1 2016, decreased activity was observed in the domestic interbank credit market, the volume of transactions declined by 73.7 percent compared with the same value of 2015. Excess reserves were accumulated in the banking system, the main volume thereof (82.2 percent) was concentrated in 6-7 banks. In Q1 2016, the average daily level of excess reserves in the banking system amounted to KGS 6.7 billion, compared with KGS 3.1 billion in Q1 2015 and KGS 4.2 billion in Q4 2015. High excess liquidity conditioned increased demand for the National Bank's notes by the commercial banks, which resulted in decrease of their yield, which at the end of Q1 was 2.18 percent. There was increase in the amounts of funds that commercial banks placed on “overnight” deposits in the National Bank.

The National Bank carried out credit operations within the framework of monetary policy for the purpose of maintaining and financing the real sector of economy under the conditions of economic activity slowdown. In Q1, the total volume of credits provided to the commercial banks amounted to KGS 3.3 billion. The commercial banks were also provided with the opportunity to extend the repayment period up to 1 year for the previously issued funds in the amount of KGS 3 billion within the framework of credit auctions, whereof KGS 1.09 billion were extended till the end of March 2016.

In Q1 2016, USD/KGS exchange rate remained stable in the domestic foreign exchange market with a slight downward trend. Participation of the National Bank in the foreign exchange market was aimed at smoothing sharp exchange rate fluctuations. In the reporting period, the National Bank carried out US dollar sales transactions to the total amount of USD 77.4 million (including cash in the amount of USD 13.1 million), as well as US dollar purchase transactions to the amount of USD 74.2 million. The total volume of withdrawn KGS liquidity due to currency interventions amounted to KGS 571.9 million. In Q1 2016, KGS appreciated by 7.7 percent

In the reporting quarter 2016, the inflation rate was 1.2 percent compared with the corresponding quarter of the previous year, in March, the general price level declined by 0.61 percent in annual terms.

Monetary Policy Measures in Q1 2016

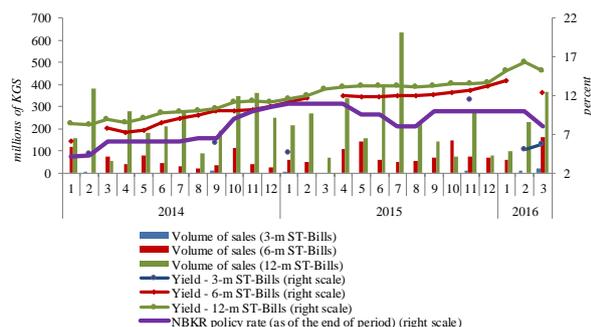
The decisions were made on the National Bank policy rate	The decision to keep the policy rate unchanged at 10.00 percent was made on February 29, 2016. The interest rate on “overnight” credits remained at the level of 12.00 percent, the interest rate on “overnight” deposits was decreased down to 3.00 percent. Since March 29, 2016, the policy rate was decreased
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	by 200 basis points, from 10.00 to 8.00 percent. The rates of the interest “corridor” were reduced. The interest rate on “overnight” credits decreased from 12.0 percent to 10.0 percent, the interest rate on “overnight” deposits decreased from 3.0 percent to 1.0 percent.
Amendments were introduced in the regulations on mandatory reserves	Cash balances of the funds in the national currency in ATMs of the commercial banks were included in calculation of mandatory reserves. This measure was aimed at providing the commercial banks with the possibility to release liquidity in KGS for subsequent expansion of lending in the national currency.
The decision to conduct credit auction was taken	On March 01, 2016, the credit auction was held to provide funds to the commercial banks for the period of 6 months with the possibility of subsequent prolongation. By the results of the credit auction, the average weighted interest rate was 10.14 percent. The amount of issued funds totaled KGS 1.07 billion.
The National Bank participated in implementation of the Program launched by the Government of the Kyrgyz Republic on conversion of mortgage credits issued in foreign currency into the national currency.	The credits in the amount of KGS 1.9 billion were issued to the commercial bank within the framework of this Program.

3.2. Financial Market Instruments

Government Securities Market

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

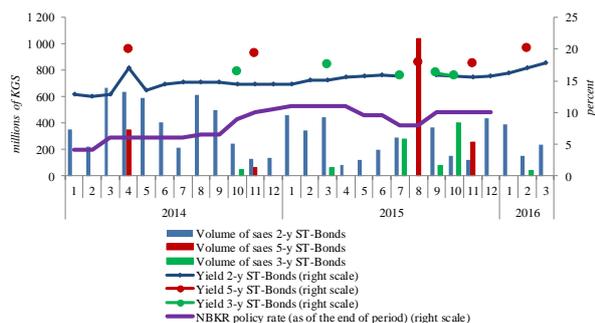


ST-Bills

The Ministry of Finance of the Kyrgyz Republic suggested 3-, 6- and 12-month ST-Bills in the primary market in Q1 2016. The total volume of the announced emission of the bills at the auctions was KGS 1.2 billion, having decreased by 27.2 percent against the comparable period of 2015. The volume of securities in circulation increased by 4.5 percent year-to-date and amounted to KGS 3.4 billion as of the end of the period.

The actual sales volume also increased (+9.3 percent) on the background of an increase in the demand volume (+13.3 percent). In Q1, the actual sales volume was less than the volume of the announced emission and made KGS 734.3 million. Six auctions were declared void due to lack of demand. 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 15.0 percent (+ 2.9 p.p.).

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



made KGS 818.8 million as the volume of supply exceeded the volume of demand. The average weighted yield increased slightly (+1.63 p.p.) up to 17.21 percent in the period under review.

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

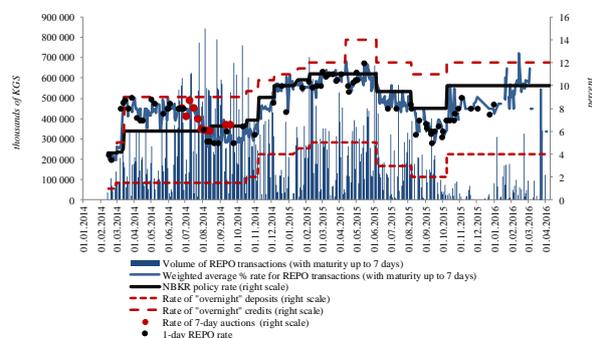


Chart 3.2.4. Rates of NBKR and Inter-Bank Transactions

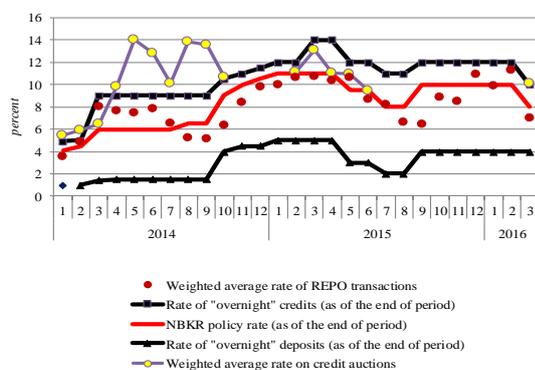
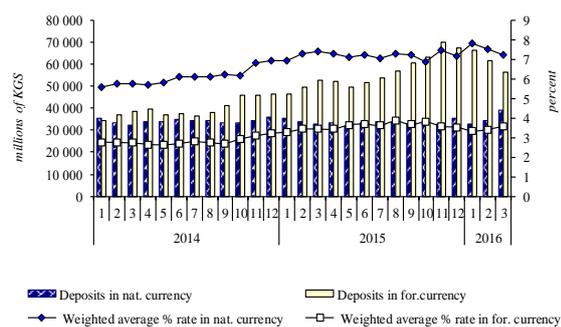


Chart 3.2.5. Dynamics of Commercial Banks Deposits



ST-Bonds

In Q1, 2- and 5-year securities were suggested in the primary State Treasury Bonds market. As of the end of the reporting year, the volume of ST-Bonds in circulation decreased by 4.1 percent year-to-date to make KGS 9.6 billion. The announced volume of ST-Bonds emission at the auctions made KGS 1.7 billion in Q1 2016, having increased by 19.5 percent against the comparable value of 2015.

In the reporting period, the volume of actual sales (including additional placements)

Inter-Bank Credit Resource Market

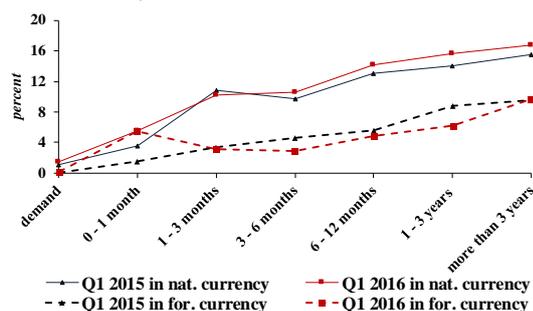
In Q1 2016, the demand for resources in the interbank market decreased and there was a decline in repo transactions due to the high volume of liquidity in the banking system. The average weighted rate on all issued resources in the interbank credit resource market was 10.5 percent, those on repo transactions was 9.44 percent.

Generally, the rates of the interbank market on transactions up to 7 days were within the interest rate corridor set by National Bank. The rates direction corresponded to the dynamics of the policy rate.

Deposit Market

Deposit market was characterized by a decline in the volume of attracted resources, mainly due to a decrease of foreign currency component. The volume of deposit base of the commercial banks decreased by 6.9 percent year-to-date to make KGS 95.8 billion as of the end of Q1 2016. The deposits in foreign currency decreased by 16.3 percent down to KGS 56.5 billion. The deposits in the national currency increased by 11.0 percent up to KGS 39.3 billion. The deposit base decreased by 2.3 percent year-to-date excluding changes in the exchange rate.

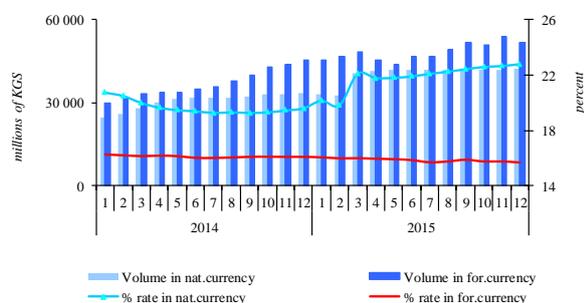
Chart 3.2.6. Rates of New Deposits in National and Foreign Currency in Terms of Maturity



In Q1 2016, an average weighted interest rate on new deposits in the national currency was 2.46 percent, having increased by 0.19 percentage points against the same period of 2015; the rate on the deposits in foreign currency increased by 0.74 percent (-0.40 percentage points). In the reporting period, an average weighted interest rate on the fixed-term deposits in the national currency was 13.14 percent (+1.20 percentage points), while those in foreign currency made 5.05 percent (-0.88 percentage points).

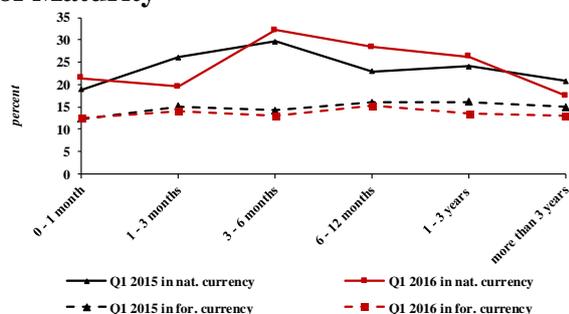
Credit Market

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



In Q1 2016, the credit portfolio of the commercial banks decreased mainly due to a reduction of its foreign currency component. At the end of Q1 2016, the volume of credit portfolio of the commercial banks decreased by 2.7 percent year-to-date and amounted to **KGS 91.4 billion**. Meanwhile, the volume of the credit portfolio in the national currency increased by 15.0 percent and amounted to KGS 48.5 billion. The volume of credit portfolio in foreign currency decreased by 17.2 percent year-to-date and amounted to KGS 42.8 billion, excluding changes in the exchange rate the credit portfolio in foreign currency decreased by 12.8 percent.

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



As of the end of the reporting period, the credit portfolio dollarization, with regard to the exchange rate fluctuations, increased by 0.2 percentage points year-to-date to make 48.9 percent.

An average weighted interest rate for new credits in the national currency increased by 1.72 percentage points, to make 24.42 percent, while for those in foreign

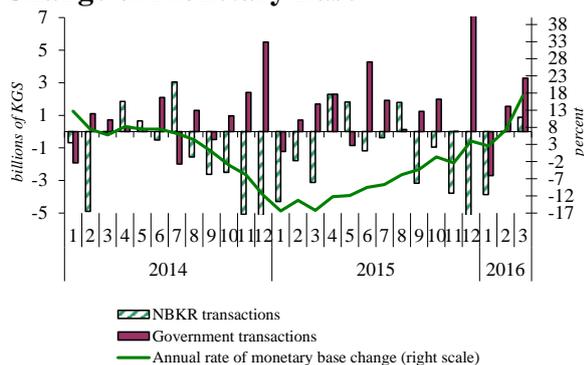
currency decreased by 1.44 percentage points down to 13.12 percent. The share of overdue credits remained at a comparatively low level and accounted for 2.5 percent late in the reporting period (+0.6 percentage points year-to-date), while the share of prolonged credits made 5.4 percent (+0.6 percentage points).

3.3. Dynamics of Monetary Indicators

Monetary Base

In Q1 of the current year, sterilization operations and interventions of the National Bank made the main contribution to the reduction of reserve money. This was due to an increase of excess liquidity in the banking system and the situation in the foreign exchange market in January 2016, when there was an increased demand for foreign currency.

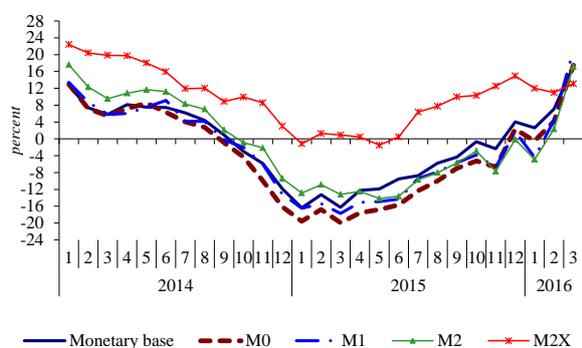
Chart 3.3.1. Contribution of the Government's and NBKR transactions to Change of Monetary Base



Monetary base decreased by 1.3 percent year-to-date, or by KGS 892.0 million, to make KGS 66.2 billion at the end of the reporting quarter. The monetary base increased by 17.2 percent in annual terms. In Q1, due to the operations of the National Bank the monetary base decreased by KGS 3.0 billion, the operations of the Kyrgyz Republic Government increased the monetary base by KGS 2.1 billion.

Chart 3.3.2. Nominal Growth Rates of Monetary Aggregates

(in annual terms)



Monetary Aggregates

Nominal rates of changes in monetary aggregates had an upward trend in Q1 2016 due to growth of the deposits in the national currency in the banking system. In the reporting quarter, narrow money (M1) and broad money in the national currency (M2) increased by 2.4 and 3.4 percent respectively, money outside banks (M0) reduced by 0.4 percent. In the annual terms, there monetary aggregates increased by 21.0, 17.2 and 17.5 percent respectively.

Broad money M2X including deposits in foreign currency decreased by 5.4 percent in the reporting period, meanwhile, in annual terms the

increase was 13.1 percent. Excluding changes in the exchange rate the decrease was 1.8 percent (in annual terms the increase was 9,8 percent). Decrease in the volume of the deposits in foreign currency¹ by 17.2 percent in Q1 (in annual terms the increase was 6.9 percent) made the main contribution to the reduction of M2X. The deposits in the national currency, on the contrary, increased by 10.3 percent (in annual terms the increase was 16.6 percent).

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)

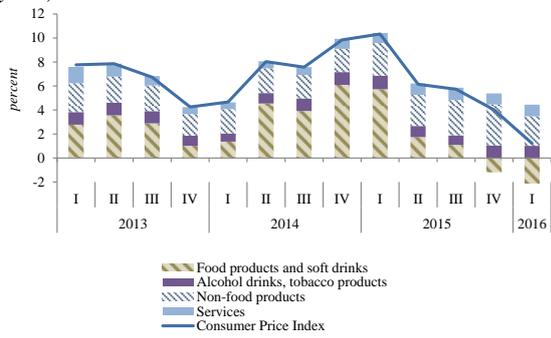


Chart 4.1.2. Dynamics of Food Products Price Input in Annual CPI
(month to the corresponding month of the previous year)

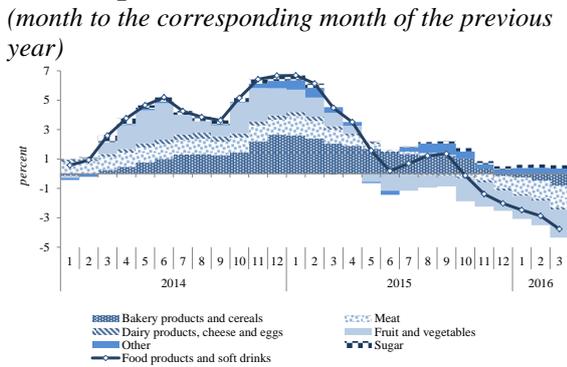


Chart 4.1.3. Dynamics of Non-Food Products Price Input in Annual CPI
(month to the corresponding month of the previous year)

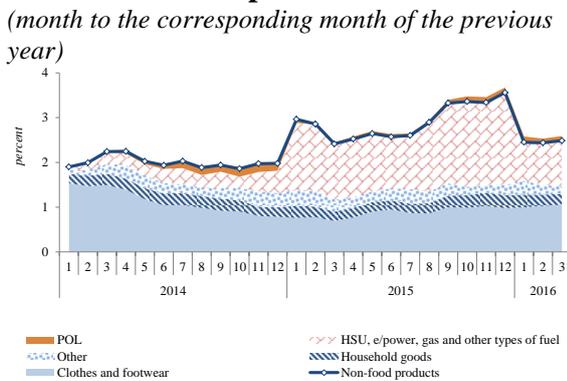
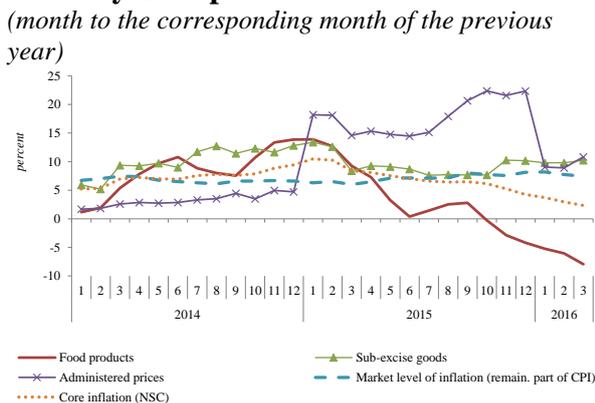


Chart 4.1.4. Dynamics of Consumer Price Index by Groups of Commodities
(month to the corresponding month of the previous year)



education services – by 8.8 percent.

In Q1 of the current year, a decrease in the inflation rate continued due to a decline in prices for food products. According to the data of the NSC KR, CPI growth was 1.2 percent in Q1 2016 compared to the same quarter of the previous year, having decreased from 4.0 percent in the previous quarter and from 9.8 percent in the same quarter of 2015.

Low inflation rate in Q1 of the current year was due to a decline in the prices for food by 6.4 percent compared to the corresponding quarter of the previous year; meanwhile an increase of prices in other groups of commodities was rather high - ranging from 6.5 to 11.7 percent. A decline in prices for food products was due to the production growth in the agricultural sector in Kyrgyzstan in 2015 by 6.2 percent, an increase in the livestock production at the beginning of the current year, favorable situation in the international food markets and a decrease in export prices for wheat in Kazakhstan. In Q1, the prices for fruits, vegetables and meat products decreased significantly by 24.8 and 11.6 percent, respectively, in annual terms, there was also a decline in prices for bakery and dairy products. There was an increase in prices for sugar, fats and oils, which are mainly imported goods.

Increase in prices for non-food products was 8.5 percent, having decreased compared to the previous quarters, largely due to the decreased contribution to inflation by the tariffs for housing services and utilities. During the reporting quarter, the upward pressure of rise in tariffs for electricity on annual increase of the price index in December 2014, which was reflected in the CPI in January 2015, was mitigated. Rise in prices for clothes and footwear by 9.3 percent in annual terms and an increase of price indices for the commodity group “housing services, water, electricity, gas and other types of fuel” and “household goods and appliances” by 11.2 and 6.6 percent, respectively, made a contribution to the increase of prices in the non-food products group.

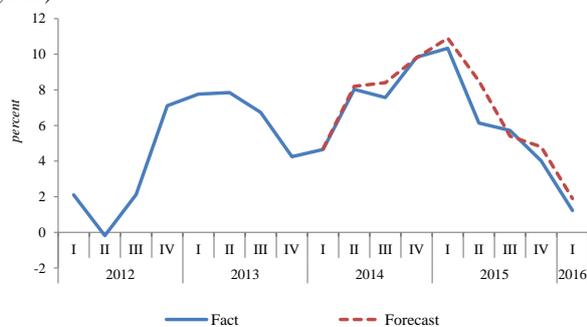
In Q1, prices for alcohol drinks and tobacco products increased by 11.7 percent, the price index for paid services rose by 6.5 percent, mainly due to growth in prices for the services of restaurants and hotels by 13.5 percent and

According to the data of the NSC KR, the core inflation was 3.0 percent in Q1 of the current year against the corresponding quarter of 2015.

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 of the current year, actual inflation rate was lower than the forecasted one. The annual increase in the CPI during the reporting quarter was 1.2 percent, having decreased by 0.7 percentage points compared to the forecasts. Significant decline in prices for food compared to the anticipated ones was a major factor of differences in the facts and the forecasts. The difference between the forecasts and the facts on goods and services, excluding food, was insignificant: the actual value was 0.2 percentage points lower than the forecasted one.

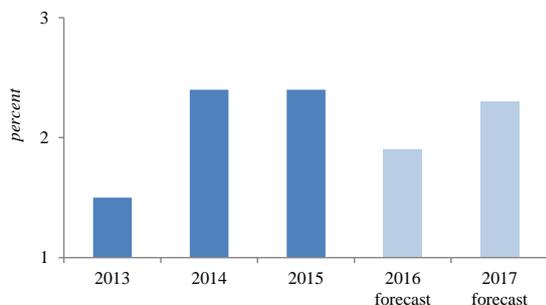
Chapter 5. Medium-Term Forecast

5.1. External Environment Proposals

5.1.1. Development Forecast of Major Trading Partner Countries

USA

Chart 5.1.1.1. Real GDP Growth in USA
(year to year)



Source: IA Bloomberg

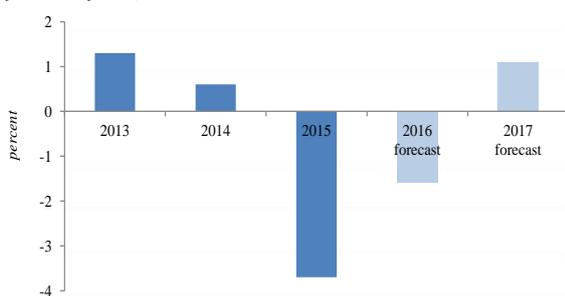
of private consumption. According to the estimates of the information provided by the information and financial agencies, the moderate economic growth is expected till the end of 2016 and the annual expansion of activity is expected at the level, which is slightly below two percent. Moderate GDP growth is also expected in the subsequent years.

According to the forecasts, the dynamics of the inflation rate in the USA will rise in 2016-2017 due to reduced negative contribution to the annual CPI growth of decline in prices for the fuel and energy product group. In 2016, the average annual inflation rate is expected at the level of 1.3 percent, in 2017 – 2.2 percent.

After slowdown of the economic growth in Q1 of the current year, growth recovery is expected in the subsequent periods. In Q1, slow growth was mainly due to turbulence in the financial markets and the corresponding risks and uncertainty for the investors, the negative impact of weak external demand for corporate income and investments to the industry. The economic situation in the short and medium term will be determined by the improvement of the situation in the labor and the real estate markets, the expected recovery of private investment and strengthening

Russia

Chart 5.1.1.2. Real GDP Growth in Russia
(year to year)



Source: IA Bloomberg

1.6 percent, in 2017, growth is expected at the level of 1.1 percent. The economy in Russia has already adapted to operation under the conditions of sanctions and low oil prices, but the risks of further prolongation of sanctions in 2017 remain, it may result in decline of economic confidence and delay in investment recovery. According to the forecasts of the international financial institutions and the experts interviewed by the Information Agency Bloomberg, in 2016, the average annual inflation rate would be decreased down to 7.0 percent from 15.6 percent in 2015. The risks of the inflation exceeding the objective of the Central Bank of Russia at 4 percent in 2017 are still high due to existing uncertainty in the fiscal policy, slow decline of inflation

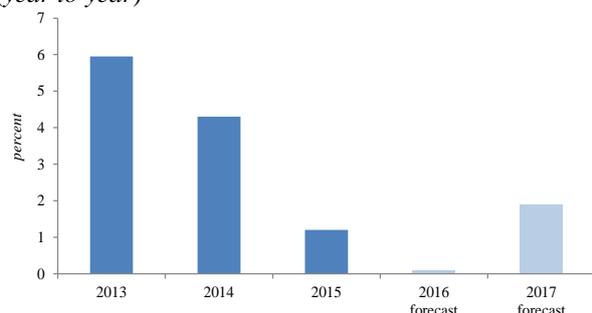
Prospects for the positive economic development still depend on the oil prices; meanwhile, their dynamics remains unstable. However, the opportunities for sustainable growth in the medium and long term will be determined by the direction of economy structural adjustment measures. The experts emphasize the current positive slowdown in the inflation rates and a decline of inflation expectations in Russia, while the negative factors contributing to the onset of the recession in the country are still observed. In 2016, economic decrease in the Russian Federation is expected at the level of around

expectations and possible termination of temporary favorable factors. According to the experts, the inflation rate in 2017 is expected at the level of 5.5 percent.

Kazakhstan

Chart 5.1.1.3. Real GDP Growth in Kazakhstan

(year to year)



Source: IA Bloomberg, international financial institutions

Forecasts for the economic development in Kazakhstan in the medium term were worsened due to the influence of such constraining factors as low oil prices, decline of internal and external demand. According to the experts of the international financial institutions, in 2016, slowdown is expected in all sectors of the economy, which stimulated growth in 2015, due to reduction in state funding, deterioration in the credit availability and decline in real incomes of the population. The forecast for the economic development in Kazakhstan in 2016 was decreased to 0.1 percent. In 2017, growth is

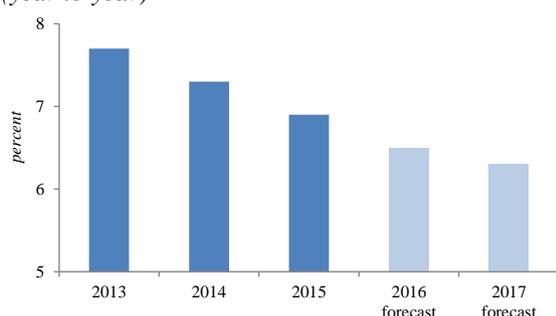
expected at the level of 1.9 percent as a result of expected improvement in oil prices development, scheduled setting to work of Kashagan Oil and Gas Mine, and implementation of the State Anti-Crisis Program.

According to the expert estimates, the average inflation rate in 2016 is expected at the level of 13-14 percent due to persisting high annual inflation rates, the major contribution to growth thereof is made by the effect of devaluation of the national currency due to the large share of imports in consumption. However, this effect is almost exhausted and the inflation rate, which by the end of the year may be at the level of 8.0 percent, can be observed due to declined inflation expectations, as well as reduced consumer demand as a result of the decline in real income in the second half of 2016. In 2017, the trend of slowdown in the inflation rates will still be observed due to the high base in 2016 and the average annual inflation rate will be at the level of about 5.0 percent.

China

Chart 5.1.1.4. Real GDP Growth in China

(year to year)



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

The rate of slowdown in economic growth of China will correspond to the benchmarks selected by the government authorities and the expectations of international institutions. This slowdown partially results from such fundamental factors as the reduction in the number of the working-age population observed since 2012, the government reforms aimed at implementation of the structural changes in the economy, and the slowdown in growth rates with the increase in per capita income. These factors also comprise the impact of slower than anticipated growth in the world

economy and the high level of debt to GDP. In 2016, GDP growth rates are expected to decrease to 6.5 percent from 6.9 percent in 2015, primarily due to investment slowdown to the industries with excess production capacity, which will only be partially compensated by the government investments to the infrastructure. In 2017, economic growth will reach 6.3 percent.

Inflation rate in China in 2016-2017 will be at the level of about two percent, which is below the government benchmark set for the current year at the level of “about three percent”.

5.2. Medium-Term Forecast

At the meeting of the Board of the National Bank held in February, under the conditions of significant uncertainty, the baseline version was approved as the main scenario, which stipulates lower prices for oil (about USD 30 per Barrel), retaining of uncertainties in the short-term period in the foreign exchange market in Russia and Kazakhstan, reduced inflow of remittances and more optimistic forecasts of external demand.

The actual change of the external environment indices developed according to the scenario close to the optimistic variant involving the stabilization of prices for energy carriers at the level of around USD 40 per Barrel, reduced pressure on the Russian ruble and Kazakh tenge.

The relative stabilization of the situation in the energy market was taken into account in the updated forecast: for the baseline version the forecasts for the oil prices were raised to USD 40 per Barrel. The forecasts for economic growth in Russia and Kazakhstan in 2016 were adjusted. The situation in the foreign exchange market develops in the sideways trend with fluctuations in a narrow range towards both strengthening and weakening of the national currency.

Expectations on external environment are the key assumptions in elaborated forecasts. These expectations are based on the forecasts of the world research agencies/institutions, official authorities, expert assessments.

Scenarios and forecasts on macroeconomic parameters for the medium term are based on assumptions about the prices for food products in the international markets and the status of the economies in the trading partner countries, which is determined by dynamics of the prices for oil. This dynamics will determine the volume of capital inflows into the country from exports and received remittances, the dynamics of the exchange rate and domestic demand.

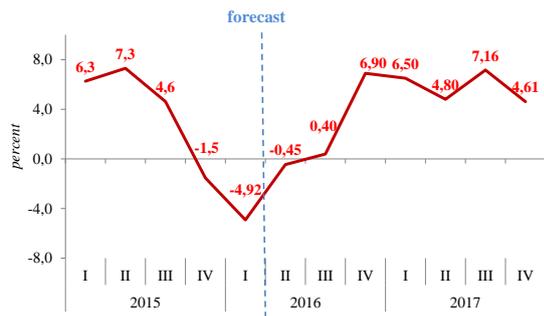
The processes of regional integration and further adaptation of the economy to the EEU conditions will continue in the medium term. Practical implementation of tax and tariff policies, measures of which can be taken into account in the forecasts in adopting appropriate regulatory legal acts, has a significant impact on the actual values of macroeconomic indicators.

The current trends in the international hydrocarbons and food market will be observed in 2016-2017 according to the baseline development scenario in terms of external environment. In 2016, the average price for Brent oil will be USD 40 per Barrel, the sideways trend with a narrow range without significant changes will be observed in the food markets (FAO index). In 2016, the average FAO index value will be about 151.1 points against 164.1 points in 2015. Given the optimistic forecasts for the expected harvest in 2016-2017 MY and for the beginning of the planting season in Russia and Kazakhstan, currently, risks of price surge are not expected. The expected effect of external demand for the domestic economy will be weakly deflationary.

In Q2 and Q3 2016, external inflation rate will be negative with a transition to the positive zone and further gradual growth in Q4 2016.

In 2016, GDP in Russia is expected to decrease by 1.6 percent, the inflation rate will make 7.0 percent. Slightly positive GDP growth is expected at the level of 0.1 percent and the inflation rate is expected to increase by 13.5 percent in Kazakhstan. Dynamics of the US dollar value in Kazakhstan and Russia was reviewed compared with the forecast for weaker US dollar throughout 2016 made in February.

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



real GDP growth is expected at the level of 5.7 percent. GDP gap will remain negative throughout 2016, which is conditioned by reduced external demand and low volume of remittances.

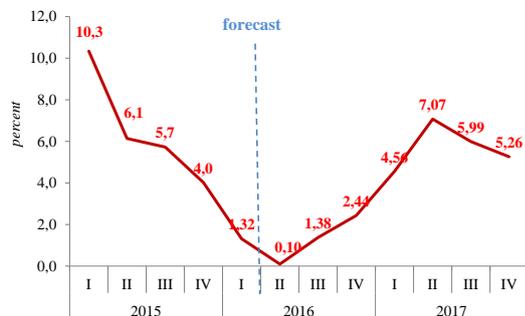
In 2016, the inflow of USD remittances according to the baseline scenario will remain at the level of 2015. Insignificant inflow of remittances in the short term will be one of the restraining factors for the internal demand and the purchasing power of the population.

According to the last data of the NSC KR¹, significant reduction of the final consumption was in Q4 2015. Thus, reduction made 4.7 percent in Q4 compared to the corresponding quarter of 2014 year and was below the total GDP (89.5 percent), such situation was not observed since Q2 2010.

In 2016-2017, negative GDP gap will have deflationary pressure on the consumer prices development index.

The inflation rate in the baseline scenario in the medium term will be at the level below and within the target value with an upward trend until the middle of 2017. At the end of 2016, CPI (period to period) will be 1.3 percent (at the end of the year December to December - 3.5 percent). Slowdown of inflation processes in 2016 is observed amid low market prices in the energy and food market, as well as the deflationary pressure from the low internal and external demand.

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



Throughout 2016, food CPI will be in the negative zone, however, the rates of decline will become slower. Moving into the area with positive growth is expected in 2017. Meanwhile, the non-food inflation rate index remains relatively high (7.8-8.9 percent in 2016) with gradual decrease towards the end of 2017.

“Mid-term tariff policy of the Kyrgyz Republic on electricity and heating for 2014-2017” will have a significant impact on the consumer prices development. Thus, the electricity tariffs are not expected to increase, if

the electricity consumption by the population constitutes up to 150 kWh, if the electricity consumption is from 150 kWh to 700 kWh, the tariffs are expected to increase by 21.0 percent in 2016 and 29.8 percent in 2017.

In 2017, the inflation rate will recover to the target values of 5-7 percent in the baseline scenario. The average value of the CPI growth will make 5.7 percent, meanwhile, the food

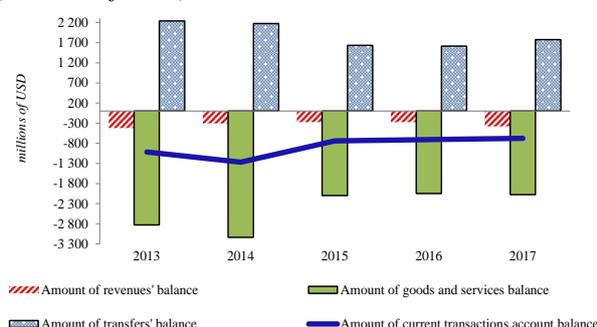
¹ As of May 24, 2016.

component will rise and reach 5.3 percent and the non-food component, on the contrary, will decrease and will be at the level of 6.1 percent. During the year, growth rates are expected to be more even within the range of 4.6-7.1 percent. Price background is expected to be favorable in the foreign commodities markets.

GDP gap will be negative and will have deflationary impact during 2017. Generally, GDP is expected to increase by 5.7 percent, excluding Kumtor, an increase will make 6.5 percent within the reporting year.

In 2016, the economic situation in the main trading partner countries and restrained economic growth in Kyrgyzstan will become the factors determining the status of the balance of payments¹. The deficit of the current transactions account is expected at the level of 11.0 percent to GDP (USD 708.5 million). This trend will be due to the decrease in the net inflow of current transfers and reduced deficit of balance of services and trade balance.

Chart 5.2.3. Forecast Data on Current Transactions Account
(millions of USD)

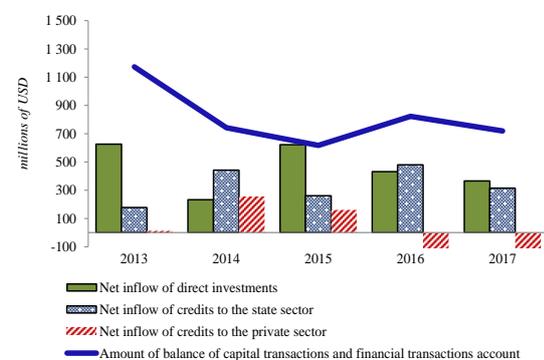


In the forecast period, the export is expected to decrease by 4.2 percent due to the expected decline in gold production at the Kumtor Mine in 2016 and a decline in the world prices. Meanwhile, the recovery of the external demand from the major trading partner countries will have a positive impact on exports excluding gold (growth at the rate of 6.0 percent). **A decline in the world prices for petroleum products, as well as the expected low domestic 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 2.8 percent.

In the forecast period, expected decline of the official transfers' inflow will result in decrease of the net inflow on "current transfers" item by 1.2 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 private transfers' inflow by 1.3 percent.

Chart 5.2.4. Forecast Data on Current Transactions Account
(millions of USD)



Inflow of other investments in Kyrgyzstan will result in increase of the positive balance on the capital and financial transactions account, which is expected to increase by 33.2 percent.

Inflow of direct foreign and portfolio investments is expected to decrease. Moreover, net inflow of the external credits to the private sector is expected to decrease due to increase in the service volumes on the previously raised funds.

Thus, the amount of the payment balance at the end of 2016 is expected to be positive in the amount of USD 166.9 million; meanwhile, the index of the international reserve assets is expected to cover 5.0 months of the future imports of goods and services.

In 2017, the economic rehabilitation in the major trading partner countries is expected to contribute to the improvement of the external sector indices.

¹ Forecast was made taking into account the adjustments on re-export of petroleum products.

Restoration of the positive dynamics of current transfers will contribute to improvement of the current transactions account up to 10.5 percent to GDP. With exports growth by 4.5 percent and imports – by 2.3 percent, the trade balance deficit is expected to remain at the level of 2016. Adaptation of the Kyrgyz Republic to the business conditions within the framework of the EEU will be a positive result in the foreign trade.

Rehabilitation of the economic growth in Russia and Kazakhstan, as well as lack of devaluation effect will have a positive impact on the inflows of private transfers, which will increase by 13.3 percent.

Capital inflow on the capital and financial transactions account is expected to decline, the basic amount of funds on this 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 43.8 million. Total international reserve assets will cover 4.9 months of the future imports of goods and services.

The elaborated 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 main trading partner countries.