

**NATIONAL BANK
OF THE KYRGYZ REPUBLIC**

**Monetary Policy Report
(Review of Inflation of the Kyrgyz Republic).
Quarter 2, 2016**

**Bishkek
August 2016**

Monetary Policy Report (Review of Inflation of the Kyrgyz Republic) is released by the National Bank on a quarterly basis. The objective of this Report is to inform the public about the decisions made by the National Bank in the sphere of monetary policy, 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 of the aforementioned movement is to strengthen the impact of the interest rate channel of the monetary policy, aimed at development of the inter-bank credit resource 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 (Review of Inflation of the Kyrgyz Republic) at the beginning of the third month of each quarter. The schedule of meetings held by the National Bank Board on the size of the policy rate is published on the bank's official website.

Monetary Policy Report (Review of Inflation of the Kyrgyz Republic) for Q2 2016 was approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic No. 36/1 dated August 29, 2016.

Contents

Summary	5
Chapter 1. External Environment	6
1.1. Economic Development of Main Trading Partner Countries	6
1.2. World Commodity and Raw Stock Markets.....	8
Chapter 2. Macroeconomic Development	10
2.1. Demand and Supply in the Commodities and Services Market	10
2.2. External Sector	13
Chapter 3. Monetary Policy.....	15
3.1. Monetary Policy Implementation	15
3.2. Financial Market Instruments	17
3.3. Dynamics of Monetary Indicators	19
Chapter 4. Inflation Dynamics	21
4.1. Consumer Price Index	21
4.2. Comparison of Forecast and Facts.....	22
Chapter 5. Medium-Term Forecast	23
5.1. External Environment Proposals	23
5.2. Medium-Term Forecast	25
Annex 1. Key Macroeconomic Indicators	29
Annex 2. Glossary	30
Annex 3. Abbreviations.....	32

Summary

Downward trend of the inflation rate was still observed in Q2 2016, it was the result of measures taken earlier in the monetary sphere. A decline in prices was primarily observed in the food products group, moreover the annual price indices decreased in other commodity groups. In June 2016, the annual inflation rate was 1.3 percent, the annual average value increased by 0.8 percent compared to the corresponding period in 2015. Low inflation rate was driven by the factors of food products supply: growth of agricultural production in 2015 and in the first half of the current year, the favorable situation in the regional cereals market and the main international food markets. Remaining relatively low domestic demand in the Kyrgyz Republic still had restraining effect on the growth of the general price level.

Slowdown was observed in the economic recession of the country. Moreover, weak external and internal demand for domestic products remained the factors of economic activity decline in the country. In the production sector, a reduction was observed in the manufacturing industry, mainly due to lower production output at the enterprises of the Kumtor Mine. In January-June 2016, economic recession made 2.3 percent, however a decline was not so significant compared to Q1 2016 decreased. In January-June 2016, the economic growth made 1.2 percent excluding enterprises at the Kumtor Mine. Agriculture was the main sector that supported economic growth.

At the end of the first half of 2016, the state budget deficit made KGS 12.4 billion or 7.0 percent to GDP (in the same period of 2015, budget surplus amounted to KGS 4.7 billion or 2.7 percent to GDP). Operating income grew due to inflow of tax revenues and official transfers, meanwhile labor costs, payment of subsidies and social benefits were the main items of expenditure.

At the end of Q2 2016, the balance of payments of the Kyrgyz Republic will form with a positive balance of USD 62.5 million. In Q2 2016, the current account deficit will increase by 88.9 percent to make USD 400.7 million, mainly due to an increase in the trade deficit.

The ambiguous economic situation was observed in the main trading partner countries. In Q2 2016, the economic growth in China remained at the level of Q1 and made 6.7 percent. In Russia, the negative trends were very weak, therefore the economic recession made 0.6 percent. Slight economic growth at the level of 0.1 percent was observed in Kazakhstan.

A trend towards KGS strengthening was observed in the domestic foreign exchange market. In January-June 2016, KGS strengthening made 11.1 percent, in Q2 2016 – 3.6 percent. In Q2 2016, the National Bank participated in currency trading mainly as a net purchaser of the foreign currency in order to smooth the sharp exchange rate fluctuations. Thus, the volume of net purchase amounted to USD 51.0 million in the reporting period.

Chapter 1. External Environment

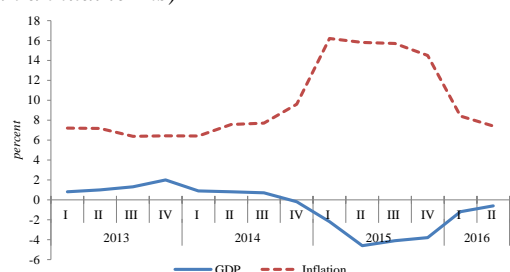
1.1. Economic Development of Main Trading Partner Countries

The situation remained ambiguous in the external economic environment. Positive trends were observed in the economies of neighboring countries; meanwhile the factors restraining economic growth still existed. These factors continued influencing the formation of low external demand for domestic products. The negative trends are still weakening in the economy of Russia, the economy adapts to new economic conditions resulting in decelerating of economic recession, however, the domestic consumer demand remains weak, thereby contributing to a slowdown in the inflation rate. The economy of Kazakhstan was observed in the positive zone as a result of increased investment in fixed assets from the internal sources of financing; meanwhile KZT devaluation still affected the inflation rate.

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

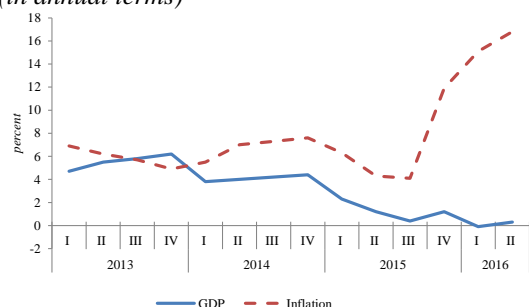
In Q2 2016, the economic recession, which started decelerating since the second half of 2015, was still observed amid improving external economic environment. In Q1, GDP decreased by 1.2 percent compared to the corresponding period in the previous year, meanwhile in Q2, GDP decreased by 0.6 percent. Industrial production, transport and agriculture had the main impact on economic recession decelerating in Russia. Construction and retail trade will have negative impact.

In Q2 2016, the annual inflation rate still demonstrated slowdown and made 7.4 percent in June 2016. Weak domestic demand, the growth of production output of certain food products, and strengthening of the Russian ruble since March 2016 were the main factors of moderate growth in consumer prices.

Kazakhstan

Chart 1.1.2. GDP Growth and Inflation in Kazakhstan

(in annual terms)



Source: RK Statistics Agency, NBKR calculations

At the end of the first half of 2016, the economy of Kazakhstan was observed in the positive zone despite negative impact of the external factors, such as low prices for oil, 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. Thus, within the six month GDP growth in Kazakhstan made 0.1 percent¹. The economic growth was supported by investments in fixed assets from domestic sources, which resulted in the increase in the volume of construction (by 6.6 percent), transport services (by 4.3 percent), agricultural production (by 2.7 percent) and manufacturing industry (by 0.5 percent). Decreased domestic demand due to a reduction in real incomes and high interest rates on credits resulted in a reduction in the volume of trade (-4.9 percent).

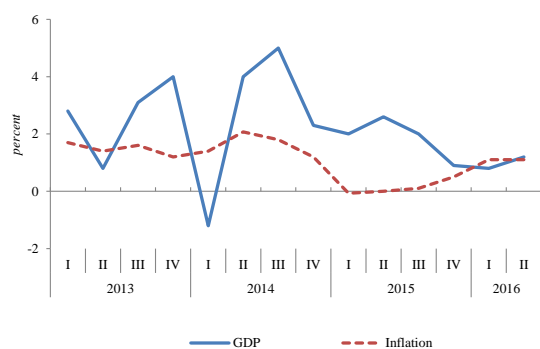
¹According to the statement of the head of the Ministry of National Economy of the Republic of Kazakhstan.

The impact of significant devaluation of the national currency on the domestic prices was still observed in Q2 2016. Such short-term factors such as the growth of world prices for raw sugar and the increase in the cost of regulated services in the sphere of housing and utilities had additional pressure on the increase in prices. In June 2016, the annual inflation rate made 17.3 percent. The prices for food products grew by 14.9 percent, non-food products – by 27.5 percent, services – by 10.3 percent. In Q2 2016, the annual inflation rate was at the level of 16.8 percent.

USA

Chart 1.1.3. 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

Slight slowdown was observed in the U.S. economic growth in the first half of the current year. According to the U.S.

authorities, economic growth made 1.2 percent (compared to the previous quarter in terms of annual growth). In Q2 2016, slow rates of economic growth were primarily due to a significant reduction in the expenditures for purchase of inventory holdings. Meanwhile, stable growth of the consumer expenditures by 4.2 percent was the main factor that supported the activity growth. It is necessary to emphasize a reduction of investments in fixed assets during the last three consecutive quarters, which to some extent is due to

investment reduction in mining and exploration activities amid low prices for oil and the negative effect of reduced exports in the sphere of industry and investment in the previous quarters. However, at the same time, this trend may reflect a decline of the investors' confidence in the U.S. economy and be associated with slow growth of labor productivity thereby resulting in concerns of some analysts.

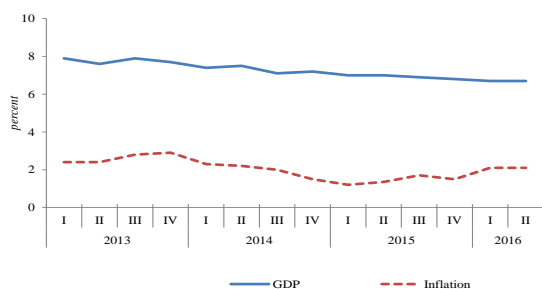
In June of the current year, the inflation rate in the United States remained unchanged at the level of 1.0 percent compared to the previous month. Since June of the previous year, the prices for fuels and energy product group decreased by 9.4 percent primarily due to a decline in the prices for oil. The annual food inflation rate was low at 0.3 percent, meanwhile the prices of other goods and services increased by 2.3 percent. Since March till June of the current year, the basic price index of personal consumption expenditures, which serves a benchmark for the US Federal Reserve System, decreased by 2.0 percent compared to the target level and made 1.6 percent.

China

The rates of the economic growth in China became stable due to the stimulating measures of the Government. According to the official data, in Q2 2016, GDP growth made 6.7 percent in China, having not changed since in Q1. The economic activity was supported by an increase of the public sector investment in fixed assets by 23.5 percent in the first half of the current year compared to the corresponding period of the previous year, meanwhile the growth of private investment slowed down to 2.8 percent, however the total investments increased by 9.0 percent. Moreover, lending to the economy outstripping economic growth in the first half of the year was reflected in the growth of the monetary aggregate M1 at the end of June by 24.6 percent over 12 months, and the monetary aggregate M2 - by 11.8 percent. In Q2 of the current year, stable dynamics of industrial production and retail sales was accompanied by the investment slowdown.

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 inflation rate in China was at a relatively low level of about 1.9 percent. An increase in prices for food products by 3.7 percent in annual terms made a significant contribution to the inflation rate; the prices for to the “transport and communication” group decreased. The inflation rate below the benchmark of “about three percent” set by the PRC Government allows the national authorities easing the monetary policy in order to support economic activity.

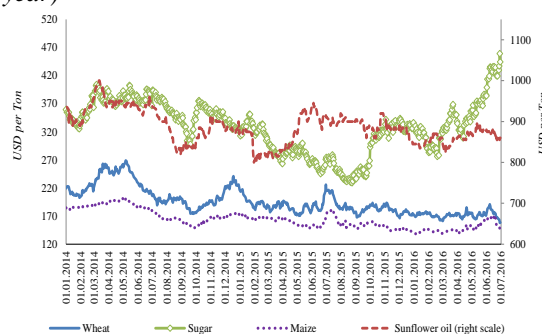
1.2. World Commodity and Raw Stock Markets

The existing favorable conditions in the foreign markets of food products and raw stock materials in general had a restraining impact on the growth of the domestic prices. A significant increase observed in world prices for sugar has some inflation risks for Kyrgyzstan. However, these risks are limited to a small proportion of sugar in the CPI consumer basket of Kyrgyzstan and the stabilization of the situation in other food markets.

Food Market

Chart 1.2.1. Dynamics of Prices for Food Products

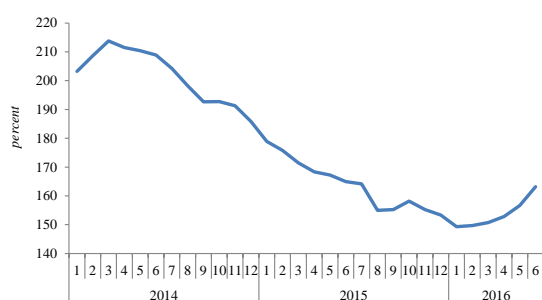
(month to the corresponding month of the previous year)



In Q2 of the current year, the average prices for the most main types of food products increased compared to the previous year.

In the reporting period, the price for sugar increased significantly primarily due to the negative impact of unfavorable for harvest weather conditions: dry weather was in India and other countries of South Asia, and excessive rainfall was observed in the sugar producing region of Brazil. In Q2 of the current year, the average price for sugar increased approximately by 19 percent compared to Q1.

Chart 1.2.2. Dynamic of FAO Food Price Index



Rise of the prices in other food markets was relatively insignificant. The prices for crops were increasing till the middle of June due to reduced maize supply from Brazil and concerns about the harvest reduction in the current season. However, price dynamics turned downward in the second half of the month amid the news about the high crop yield in the United States and the Black Sea region.

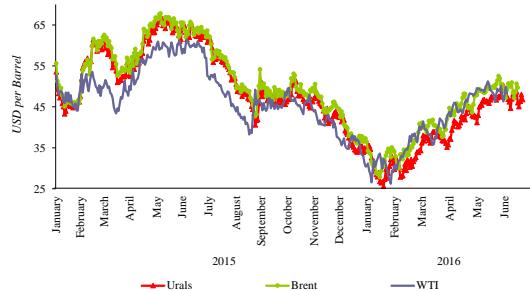
Price situation in the vegetable oil markets remained relatively stable, a decline in demand resulted in an increase in the prices for palm oil at the beginning of the quarter, and thereafter the

price for this product fell under the influence of weakening demand.

Since early 2016, FAO index (Food and agriculture organization) was characterized by upward trend. In Q2 2016, the average index value increased by 5.1 percent compared to Q1 and by 5.6 percent compared to the corresponding quarter of the previous year due to a significant rise in the price for sugar and a slight increase in the price of vegetable oils, crops and meat products.

Energy Market

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



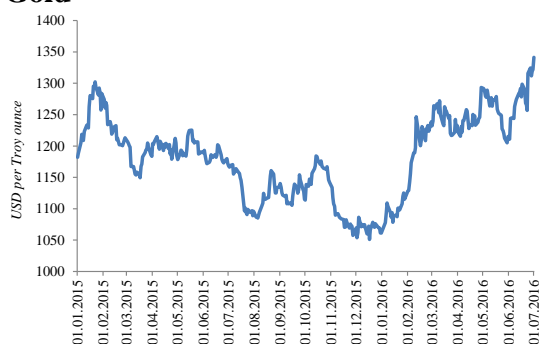
In Q2 2016, the prices in the international oil market demonstrate an upward trend. The prices for the basic oil grades (Brent, WTI, Urals) fluctuated within the range of USD 35.2 - 52.5 per Barrel. The price for Brent oil increased by 33.6 percent compared to the average price in Q1 2016, however this price decreased by 26.0 percent compared to the similar period of the previous year.

The price for oil increased amid supply disruptions due to fires in the mine fields, restless geopolitical situation, an increase of the reserves by China, and a reduction in production of shale oil in the United States. In addition, pushing prices up speculation of market participants on the background of the OPEC meeting and the ECB meeting held in June, meanwhile both meetings were held quietly and remained almost unnoticed, and unsuccessful results of the meetings had only short-term and limited pressure on oil quotations.

Given that the factors that drove oil prices upwards slightly stabilized, there are risks of changes in the price downward, as the structural factors, currency devaluation in the developing countries, as well as the risks of oil supply exceeding demand still exist.

Gold Market

Chart 1.2.4. Dynamics of Prices for Gold



Source: IA Bloomberg

In Q2 2016, upward trend of the prices for gold was still observed. With the release of macroeconomic data, which indicated low rates of growth in the economy and in the US labor market, investors' expectations of further policy conducted by the US monetary authorities were overestimated in favor of the slower rate of increase in the base interest rates set by the US Federal Reserve System compared to the previous expectations. Not so high expected yield of the US securities, accompanied by close to minimum and negative interest rates of other central banks strengthened the investment attractiveness of

investment in gold. The results of the referendum on withdrawal of Great Britain from the European Union, which became a surprise for analysts and investors and increased the uncertainty in the financial markets, became another event contributing to a rise in prices for the precious metal.

Chapter 2. Macroeconomic Development

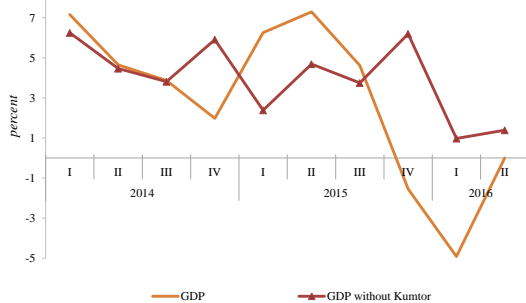
2.1. Demand and Supply in the Commodities and Services Market

Retaining of low production output in the manufacturing industry against reduction in the foreign and domestic demand resulted in a decline of GDP output in the Kyrgyz Republic in Q2 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)



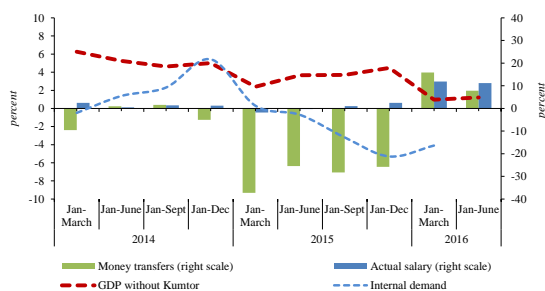
Source: NSC KR

the real GDP in Q2. This trend was observed due to a decrease in the manufacturing industry by 4.1 percent primarily due to a decline in the production output at the Kumtor Mine. The agricultural sector demonstrated growth (2.9 percent), contribution thereof to GDP made 0.3 percentage points

According to Centerra Gold Inc. press release, the Kumtor output decreased by 20.0 percent compared to Q2 2015 (122.1 thousand troy ounces) and amounted to 97.7 thousand troy ounces in Q2 2016, which as before was due to low gold content in mined ore. The 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: The NBKR

Generally, since the beginning of 2016, positive trend is observed in the individuals' remittances made through the money transfer systems: in the first half of the current year, the net inflow in USD equivalent constituted 10.4 percent, in Q2 2016, it increased by 7.8 percent compared with the same period of 2015.

Despite a decrease in the domestic demand, consumption remained the main component within the GDP structure (120.5 percent to GDP).

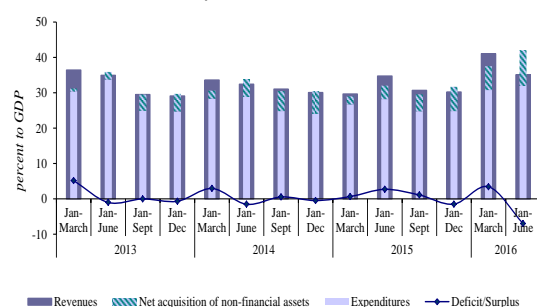
¹ Reference to the data for the earlier period is given due to the lack of data for Q2 2016.

State Finances Sector

Since the beginning of Q2 2016, the character of the state budget execution changed and it was implemented with a deficit. At the end of the first half of 2016, the state budget was executed with a deficit of KGS 12.4 billion or 7.0 percent to GDP, primarily due to growth of expenditures for purchase of non-financial assets (in the same period of 2015, there was a budget surplus of KGS 4.7 billion or 2.7 percent to GDP).

Chart 2.1.3. Execution of the State Budget

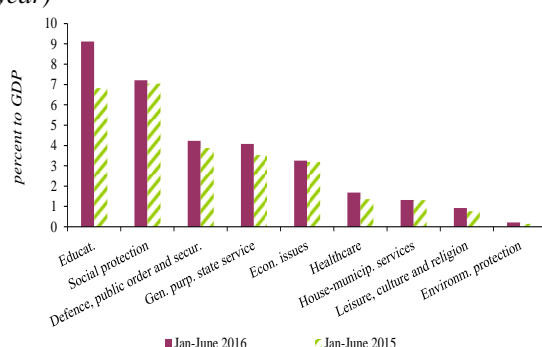
(period to the corresponding period of the previous year, accumulatively)



Source: CT MFKR, NBKR

Chart 2.1.4. Execution of the State Budget

(period to the corresponding period of the previous year)



Source: CC MFKR, NBKR

Execution of the state budget revenues (tax revenues + non-tax revenues + official transfers) amounted to 109.4 percent in the first half of 2016, which was insured by implementation of the plan on collecting non-tax revenues by 134.1 percent, and official transfers - by 8.4 times. The plan on collecting the tax revenues was implemented at the rate of 97.9 percent. The tax collection plan of the State Tax Service was implemented at a rate of 94.7 percent, while the same plan of the State Customs Service was implemented by 104.3 percent. At the end of the first half of 2016, the execution of the state budget expenditures amounted to 78.1 percent. Meanwhile, the expenditure plan on the protected items was executed by 81.3 percent, on the unprotected items – by 62.6 percent.

Investment

In Q2 2016, capital investment increased after a decrease observed in Q1. The level of implementing investment increased by 2.0 percent (in comparable prices) compared to the same period of 2015.

At the end of the first half of 2016, the state budget revenues from operating activities increased by 3.2 percent, or KGS 0.6 billion, compared to the same period of 2015 and amounted to KGS 61.8 billion, or 35.1 percent to GDP. However, the greatest contribution to the increase in operating income was due to tax revenues (8.5 percentage points) and official transfers (4.9 percentage points).

At the end of the first half of 2016, the state budget expenditures for operating activities increased in annual rate by 15.9 percent, or KGS 4.0 billion, and amounted to KGS 56.4 billion, or 32.1 percent to GDP. In the structure of expenditures by economic classification, a high rate of expenditures allocated for current consumption has been retained as before. The largest contribution to the increase in expenditures was made by labor costs (mainly salaries), 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, public services of general purpose, defense, public order and security, economic issues.

Net outflow of budget funds for operations related to acquisition of non-financial assets amounted to KGS 17.7 billion, or 10.1 percent to GDP.

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

	January-June			
	millions of KGS		share, percent	
	2015	2016	2015	2016
Total	37 464,5	39 059,0	100,0	100,0
Internal investment	28 862,8	31 803,7	77,0	81,4
Republican budget	1 359,0	3 127,7	3,6	8,0
Local budget	360,0	260,4	1,0	0,7
Funds of enterprises and organizations	14 737,6	12 522,9	39,3	32,0
Banks' credits	15,6	46,6	0,0	0,1
Population funds including beneficent help of KR residents	12 390,6	15 846,1	33,1	40,6
External investment	8 601,7	7 255,3	23,0	18,6
Foreign credit	6 144,0	3 654,0	16,4	9,4
Direct foreign investments	1 445,0	2 936,4	3,9	7,5
Foreign grants and humanitarian aid	1 012,7	664,9	2,7	1,7

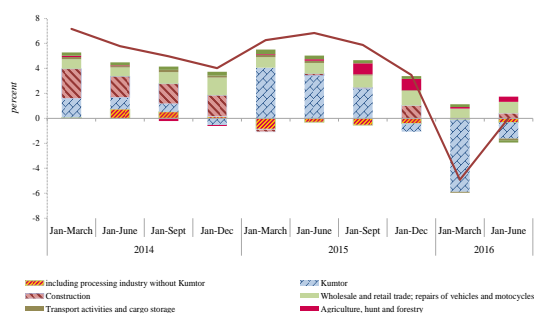
Source: NSC KR

2.3 times, that from the personal funds – by 1.3 times, whereas the investment financed from the local budget decreased by 29.2 percent, that from the funds of the enterprises and organizations – by 16.9 percent), the investment financed from the foreign sources decreased by 17.5 percent (from the foreign credits – by 41.8 percent, that from the foreign grants - by 35.8 percent, from direct foreign investment – increase by 2 times).

Supply

Chart 2.1.5. Input of Main Sectors in GDP Growth

(period to the corresponding period of the previous year)



Source: NSC KR

1.7 times and 1.5 times respectively. Food products output increased by 12.0 percent due to growth in the production of sugar, meat and dairy products, bread and nondurable pastry.

Positive trend in agriculture (2.9 percent) was still observed due to increase in livestock and crop production. In the current year, the harvesting rates exceeded the rates in the last year, growth in the livestock production was due to increase in cattle and poultry numbers.

Within 6 months of the current year, growth in the construction sector made 3.6 percent 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 structures.

The sphere of services increased by 2.1 percent, where the trade sector made the main contribution (0.8 percentage points).

Growth of capital investment was primarily observed in the construction of agricultural facilities and services sector. Moreover, capital investment decreased in the construction of the facilities for mining operations, manufacturing sectors, water supply, water treatment, waste processing, and the healthcare sector.

The volume of investment financed from domestic sources increased by 7.8 percent (among them the investment from the bank loans – by 2.9 times, the state budget – by

In the reporting period, GDP decreased 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 35.8 percent.

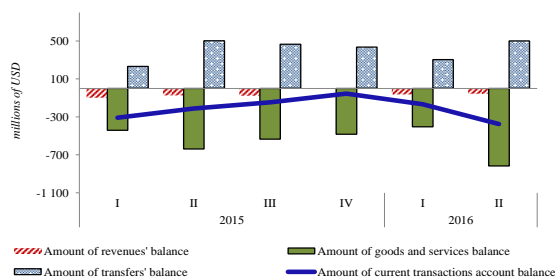
Excluding the enterprises of the Kumtor Mine, a decrease was observed in the production output of the textile sector (by 33.6 percent), in production of clothing (by 24.2 percent) and other non-metallic mineral products (by 14.4 percent). Generated, transferred and distributed electricity decreased by 12.2 percent. Moreover, an increase was observed in extraction of oil and metal ores by

2.2. External Sector¹

In Q2 2016, the current transactions account deficit increased by 77.1 percent due to growth of the trade deficit.

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 Q2 2016, the current account deficit will increase up to USD 375.6 million to make 12.1 percent to GDP.

In the reporting period, the trade deficit of the Kyrgyz Republic will increase by 28.3 percent to make USD 749.7 million. Trade balance will be formed under the influence of the decrease in supplies of exported products due to the reduction in supplies of gold; moreover, it will be formed under the influence of the increase in imports of the country due to the growth in supplies of the goods from the EEU countries.

2.2.1. Trade balance of the Kyrgyz Republic²

(millions of USD)

	2014	2015	2015 Q2	2016 [*] Q2	Change in %	Change in millions of USD
Trade balance	-2 807,5	-1 984,0	-584,6	-694,7	18,8	-110,1
Export (FOB)	2 482,7	1 812,4	419,3	307,7	-26,6	-111,7
Gold	716,9	665,4	155,3	122,5	-21,2	-32,9
Import (FOB)	5 290,2	3 796,4	1 003,9	1 002,3	-0,2	-1,6
Energy products	1 041,8	702,6	170,5	94,3	-44,7	-76,2

* Preliminary data

Exports of goods (in FOB prices) will decrease by 26.6 percent to make USD 307.7 million in Q2 2016. Exports excluding gold will decrease by 29.8 percent, primarily due to a decline in re-exports of the petroleum products and amount to USD 185.2 million. Moreover, the reduction will be observed in supplies of articles of clothing and clothing accessories (by 99.0 percent), vegetables and fruits (by 54.8 percent), other inorganic chemicals, etc.

In the reporting period, imports of goods (in FOB prices) will decrease by 0.2 percent to make USD 1,002.3 million. The decrease in imports will be primarily conditioned by a reduction in supplies of petroleum products by 44.5 percent, light motor vehicles, including previously used cars, by 72.4 percent, medicaments by 61.5 percent, iron and steel by 47.8 percent. Moreover, the increase was observed in supplies of footwear and clothes, woven fabrics, essential oils and etc.

The net inflow of current transfers will be formed at the level of the same period in 2015 to make USD 499.4 million. Decrease in the net inflow of official transfers will be compensated by the net inflow of private remittances, which will increase by 5.3 percent to make USD 496.1 million.

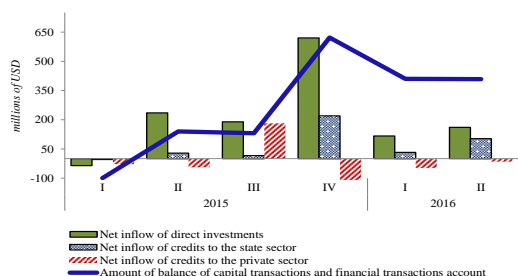
¹ According to the preliminary and forecasted data, in the actual period, the data include the estimates of the NBKR on re-export of petroleum products. Period of comparison is the quarter to the corresponding quarter of the previous year.

² The data are given taking into account the NSC KR additional estimates for agricultural products and mutual trade with the EEU member states (since Q3 2015) and the estimates of the NBKR.

According to the forecasts, the negative balance of services will increase by 2.2 times and will be formed at the level of USD 121.7 million in Q2 2016. The negative balance of revenues is expected at the level of USD 58.6 million, which is lower than the level of Q2 2015.

The inflow of credit resources to the public sector will result in the increase of the positive balance on the capital transactions and financial transactions account. In Q2 2016, the capital transactions and financial transactions account will increase by 3.0 times against Q2 2015 to be formed with a positive balance of USD 408.6 million. The balance of capital account is expected to form positive in the amount of USD 56.5 million. In the reporting period, the positive balance of the financial account is expected to amount USD 352.1 million.

Chart 2.2.2. Capital Transactions and Financial Transactions Account



Net inflow of direct investments to the country is forecasted to decrease by 31.4 percent compared to the same period of the last year to make USD 161.2 million. In the reporting period, the increase in inflow on other investments will have the most significant influence on the financial account. The positive balance of “other investments” item will make USD 190.9 million; it will primarily result from the increase of the liabilities to non-residents due to the growth of credit funds inflow to the

public sector. Meanwhile, the residents’ assets abroad are expected to decrease by USD 132.8 million primarily due to the reduction of foreign assets by the commercial banks.

Therefore, at the end of Q2 2016 the Kyrgyz Republic balance of payments will be formed with a positive balance to make USD 49.0 million. The volume of gross international reserves will cover 4.6 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 beginning of the year (as of the end of month)				month to the previous month (as of the end of month)			
	2014 (aver.)		%	December 2015		June 2016		May 2016		June 2016	
	January-December	January-December		December 2015	June 2016	May 2016	June 2016	May 2016	June 2016		
REER	110.0	115.1	4.6	108.4	114.1	5.3	113.0	114.1	1.0	1.2	
NEER	99.2	106.1	6.9	101.4	111.1	9.6	109.8	111.1	1.2	1.2	
RBER to CNY	94.8	84.7	-10.6	74.4	82.7	11.1	81.4	82.7	1.6	1.6	
NBER to CNY	78.1	66.4	-14.0	57.6	65.7	14.1	64.8	65.7	1.5	1.5	
RBER to Euro	109.7	116.6	6.3	102.8	108.9	5.9	107.3	108.9	1.5	1.5	
NBER to Euro	85.5	85.5	0.0	74.0	80.0	8.1	78.8	80.0	1.5	1.5	
RBER to KZT	110.9	112.1	1.1	129.7	143.9	10.9	141.9	143.9	1.4	1.4	
NBER to KZT	104.1	105.9	1.7	130.9	154.6	18.0	151.7	154.6	1.9	1.9	
RBER to RUR	113.6	138.2	21.0	130.8	132.5	1.3	131.9	132.5	0.4	0.4	
NBER to RUR	108.3	142.8	31.8	137.4	146.3	6.5	145.2	146.3	0.8	0.8	
RBER to USD	107.9	96.0	-11.1	82.8	89.2	7.7	89.0	89.2	0.5	0.5	
NBER to USD	85.8	71.7	-16.3	60.5	67.6	11.7	67.2	67.6	0.5	0.5	

↑ - preliminary data
 ↓ - Some devaluation, competitiveness improvement
 ↕ - Some strengthening, competitiveness deterioration

At the end of Q2 2016, the index of nominal and real effective exchange rate is expected to increase compared to December 2015. According to the preliminary data, the index of nominal effective exchange rate (NEER) of KGS increased by 9.6 percent from the beginning of 2016 and amounted to 111.1 by the end of June 2016. The increase in the NEER index was due to KGS strengthening¹ in June 2016

compared to the average exchange rate for December 2015 against: the Kazakh tenge – by 18.0 percent, the Russian ruble – by 6.5 percent, the Chinese yuan – by 14.1 percent, the US dollar – by 11.7 percent, and the euro – by 8.1 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 (REER), which has increased by 5.3 percent from December 2015 and amounted to 114.1 at the end of June 2016.

¹ 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.

² For January to June 2016, the inflation in Kerygz Republic formed negative at the level of 1.7 percent, whereas an average inflation rate in the major trading partner countries made 2.3 percent according to the preliminary calculations.

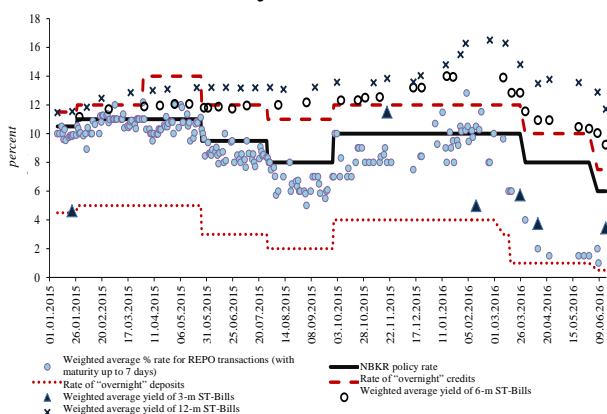
Chapter 3. Monetary Policy

3.1. Monetary Policy Implementation

In Q2 2016, the National Bank managed to continue the policy on decreasing its key interest rate aimed at supporting the real sector of economy due to retaining low rates of the actual inflation and its moderate forecasting dynamics for the medium term. Monetary policy was implemented in order to form equilibrium money supply providing for achievement of inflation targets in the medium term amid remaining high level of banking liquidity.

Amid retaining poor indicators of economic growth and low inflation rate in the country, in Q2 2016, the National Bank made one-time decrease of the policy rate. Since May 31, 2016, the National Bank policy rate was set as 6.00 percent, which is lower by 2.0 percentage points than the previous value, and remained at this level till the end of the reporting period. In the reporting period, the National Bank continued conducting the policy of strengthening the interest rate channel by reducing the difference between the policy rates. The rate on “overnight” credits was retained at the level of 7.5 percent (the previous value – 10.0 percent), the rate on “overnight” deposits – 0.5 percent (the previous value – 1.0 percent).

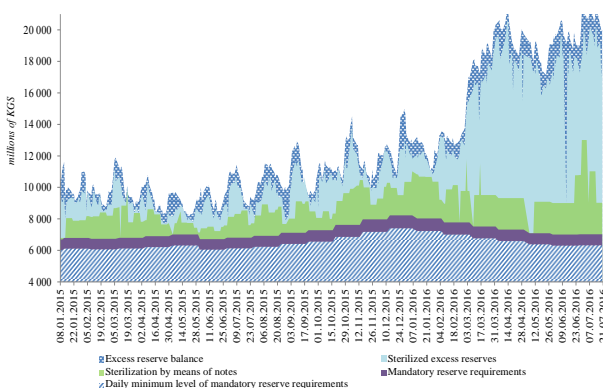
Chart 3.1.1. Money Market Rates



In Q2 2016, short-term interest rates of the money market correlated with the National Bank policy rates development trend and demonstrated the downward trend by the end of the reporting period. Such behavior of the money market rates was primarily due to availability of rather high level of excess liquidity in the banking sector.

In the reporting period, the average daily volume of the banking system excess reserves prior operations on sterilization was formed at KGS 12.3 billion (after operations on sterilization – KGS 1.6 billion), having increased by 5.2 times compared to the corresponding value of 2015. At the end of the reporting period, the level of excess liquidity prior operations on sterilization made KGS 14.7 billion (after operations on sterilization – KGS 2.9 billion).

Chart 3.1.2. Excess Reserves of the Commercial Banks



Excess liquidity retained in the banking system during Q2 2016 resulted in increased demand of the commercial banks for the National Bank notes thereby decreasing the yield of these notes. In Q2 2016, the demand for 7-day notes of the

National Bank increased by 1.1 times compared to the corresponding value on Q1 2016 and by 4.6 times – compared to Q2 2015. In Q2 2016, the average weighted yield on 7-day notes decreased from 2.18 down to 1.44 percent.

Excess liquidity was absorbed through the auctions of the National Bank notes and the funds placed by the commercial banks on “overnight” deposits in the National Bank. In the reporting period, the total volume of accepted “overnight” deposits increased by 2.4 times

compared to the corresponding value in Q1 2016, meanwhile the average daily volume of placement constituted KGS 8.7 billion.

On the background of slowdown in the economic activity of the country, monetary conditions easing in respect to the interest rate policy was accompanied by lending operations carried out by the National Bank in order to stimulate real sector of the economy. Generally, the National Bank provided funds in the amount of KGS 3.5 billion in order to support positive rates of economic growth in the first half of 2016. Moreover, the funds were issued to the commercial banks in the amount of KGS 1.1 billion within the framework of credit auctions and KGS 1.9 billion – within the framework of implementing the Program of the Kyrgyz Republic Government on conversion of the mortgage credits in foreign currency into the national currency. The National Bank also issued credits in the amount of KGS 480.0 million to the international organizations established by the Kyrgyz Republic in cooperation with other states within the framework of the EEU. Moreover, in the middle of Q2 2016, the funds in the amount of KGS 2.9 billion with the repayment period of up to 1 year, which were previously issued within the framework of credit auctions, were extended by the commercial banks.

In Q2 2016, the trend of KGS strengthening (+3.6 percent) was observed in the domestic foreign exchange market. In Q2 2016, the National Bank participated as a net purchaser of the foreign currency in the amount of USD 51.0 million in order to smooth sharp exchange rate fluctuations. In the reporting period, KGS liquidity was increased by KGS 3.5 billion due to currency interventions.

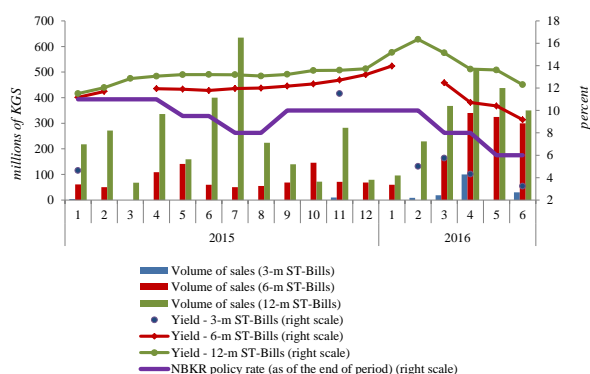
Monetary Policy Measures in Q2 2016

<p>The decisions were made on the size of the National Bank policy rate</p>	<p>The decision to decrease the policy rate by 200 basis points from 8.00 to 6.00 percent was made on May 31, 2016. The rates of the interest rate corridor were reduced. The interest rate on “overnight” credits decreased from 10.0 percent to 7.5 percent, the interest rate on “overnight” deposits decreased from 1.0 percent to 0.5 percent.</p> <p>The decision to preserve the size of policy rate unchanged at 6.00 percent was made on June 27, 2016. The interest rates on “overnight” credits and deposits remained unchanged.</p>
<p>The National Bank issued credits to the international organizations established by the Kyrgyz Republic in cooperation with other states within the framework of the Eurasian Economic Union.</p>	<p>The credit resources were issued in the amount of KGS 130.0 million.</p>

3.2. Financial Market Instruments

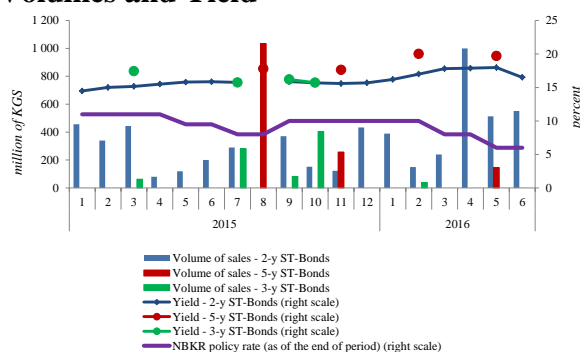
Government Securities Market

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



exceeded the volume of the announced emission and made KGS 2.4 billion. Two auctions among the ones suggested by the Ministry of Finance were declared void due to lack of demand. The total average weighted yield of ST-Bills amounted to 11.0 percent (-1.8 percentage points). In the reporting period, the average weighted yield was directed towards the policy rate.

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



demand. The average weighted yield increased slightly (+1.94 percentage points) up to 17.7 percent in the period under review.

ST-Bills

The Ministry of Finance of the Kyrgyz Republic suggested placing 3-, 6- and 12-month ST-Bills in the primary market in Q2 2016. The total volume of the announced emission of the bills at the auctions made KGS 1.9 billion, having increased by 34.8 percent against the comparable period of 2015.

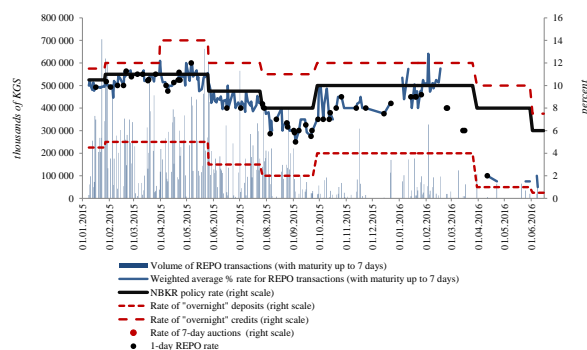
The actual sales volume also increased (by 3 times) on the background of an increase in the demand volume (by 2 times). In Q2, the actual sales volume

ST-Bonds

In Q1, 2- and 5-year securities were suggested for placing in the primary State Treasury Bonds market. The announced volume of ST-Bonds emission at the auctions made KGS 1.1 billion in Q2 2016, having increased by 1.2 percent against the comparable value of 2015.

In the reporting period, the volume of actual sales (including additional placements) made KGS 2.2 billion, the volume of supply exceeded the volume of

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

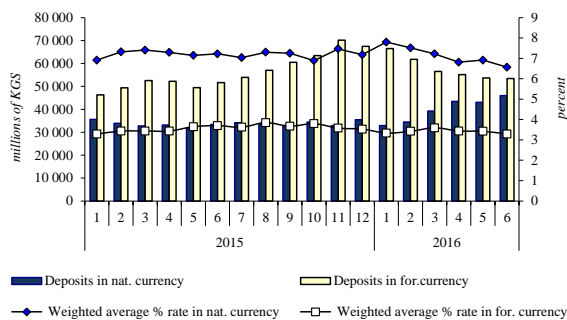


In Q2 2016, the downward trend was still observed in the participants' activity in the interbank credit resource market due to retaining high level of excess liquidity in the commercial banks. The total amount of the transactions made in the reporting period decreased by 88.7 percent against the comparable value of 2015 and constituted KGS 1.3 billion. The market rates 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 Q2 2016, an average rate on credits in the national currency made 5.2 percent, on REPO transactions – 1.6 percent.

Inter-Bank Credit Resource Market

In Q2 2016, the downward trend was still observed in the participants' activity in the interbank credit resource market due to retaining high level of excess liquidity in the commercial banks. The total amount of the transactions made in the reporting period decreased by 88.7 percent against the comparable value of 2015 and constituted KGS 1.3 billion. The market rates decreased, having approached the lower boundary of the interest rate corridor set by the National

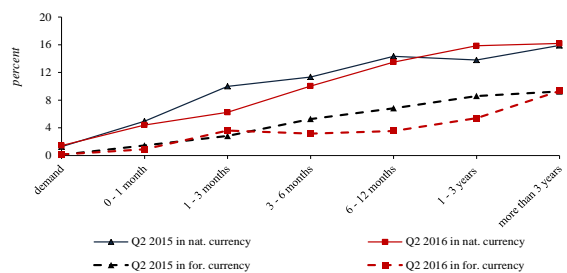
Chart 3.2.4. Dynamics of Commercial Banks Deposits



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 3.3 percent year-to-date to make KGS 99.4 billion as of the end of Q2 2016. The deposits in foreign currency decreased by 20.8 percent down to KGS 53.4 billion. The deposits in the national currency increased by 30.0 percent up to KGS 46.0 billion. Excluding changes in the exchange rate, the deposit base increased by 3.1 percent at the end of the quarter.

Chart 3.2.5. Rates of New Deposits in National and Foreign Currency in Terms of Maturity



interest rate on the fixed-term deposits in (+0.36 percentage points), while this rate (-2.43 percentage points).

In Q2 2016, an average weighted interest rate on new deposits in the national currency made 2.58 percent, having increased by 0.15 percentage points against the same period of 2015; this rate on the deposits in foreign currency increased by 0.64 percent (-0.56 percentage points). In the reporting period, an average weighted in the national currency made 12.86 percent in foreign currency made 3.97 percent

Credit Market

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

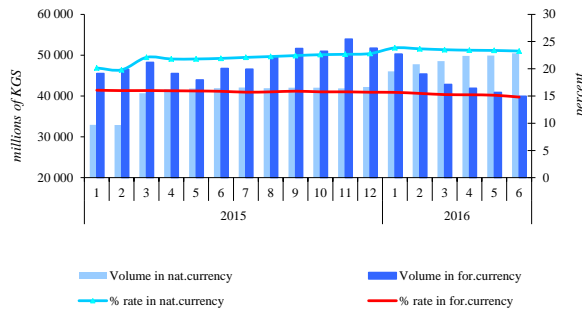
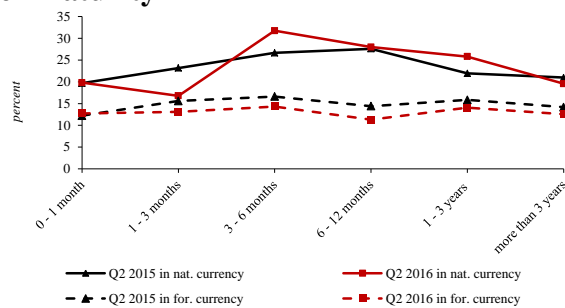


Chart 3.2.7. Rates of New Credits in National and Foreign Currency in Terms of Maturity

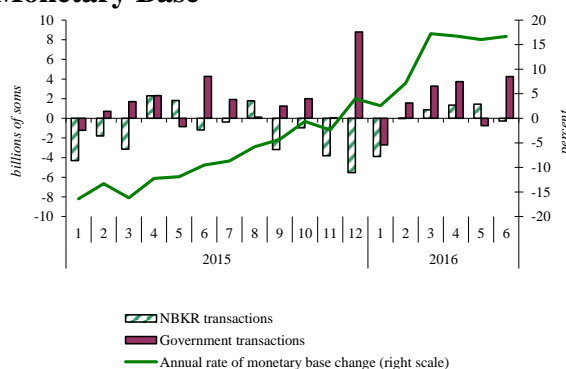


24.45 percent, while this rate in foreign currency decreased by 1.40 percentage points down to 12.90 percent.

The share of overdue credits remained at a comparatively low level and constituted 3.6 percent late in the reporting period (+1.7 percentage points year-to-date), while the share of prolonged credits made 10.6 percent (+5.7 percentage points).

3.3. Dynamics of Monetary Indicators

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



KGS 75.9 billion. In June, the annual growth of the monetary base made 16.7 percent.

In Q2 2016, the credit portfolio of the commercial banks decreased mainly due to a reduction of its foreign currency component. At the end of Q2 2016, the volume of credit portfolio of the commercial banks decreased by 3.8 percent year-to-date and amounted to KGS 90.4 billion. Meanwhile, the volume of the credit portfolio in the national currency increased by 19.6 percent and amounted to KGS 50.5 billion. The volume of credit portfolio in foreign currency decreased by 22.8 percent year-to-date and amounted to KGS 39.9 billion. Excluding changes in the exchange rate the credit portfolio in foreign currency increased by 1.5 percent.

As of the end of the reporting period, the credit portfolio dollarization, with regard to the exchange rate fluctuations, decreased by 1.7 percentage points year-to-date to make 47.1 percent.

An average weighted interest rate for new credits in the national currency increased by 1.82 percentage points, to make

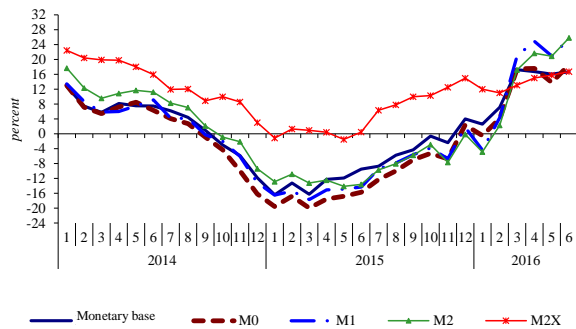
Monetary Base

In Q2 of 2016, the upward trend of reserve money changed primarily due to the currency interventions of the National Bank and the Government expenditures. Generally, in Q2 2016, monetary base increased by 14.7 percent (KGS 9.7 billion), meanwhile, the Government operations increased the monetary base by KGS 7.2 billion and the National Bank operations - by KGS 2.5 billion. As of the end of the reporting period, the monetary base was formed in the amount of

Monetary Aggregates

Chart 3.3.2. Nominal Growth Rates of Monetary Aggregates

(in annual terms)



In Q2 of the current year, positive upward trend was observed in the nominal rates of the banking system monetary aggregates. In Q2 2016, the increase of the deposits in the national currency (+18.7 percent) contributed to stable growth of the monetary aggregates M1 and M2¹ (+17.8 and +16.9 percent), which, at the end of Q2, constituted KGS 84.9 billion and KGS 99.4 billion respectively. In the annual terms, the monetary aggregates M1 and M2 increased by 25.5 and 25.8 percent respectively. The

total volume of deposits of other deposit corporations in the structure of money supply M2X increased by 3.7 percent in Q2 to make USD 85.6 billion.

In Q2 2016, growth of broad money (+8.4 percent) up to KGS 146.8 billion was primarily due to the increase in the volume of money outside banks (M0), the rate of growth thereof was 15.7 percent. In the reporting period, monetary aggregate M2X increased by 16.7 percent, excluding the exchange rate changes – by 14.3 percent.

¹ Includes cash outside banks and deposits of individuals, legal entities and other financial institutions in the national currency excluding 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)

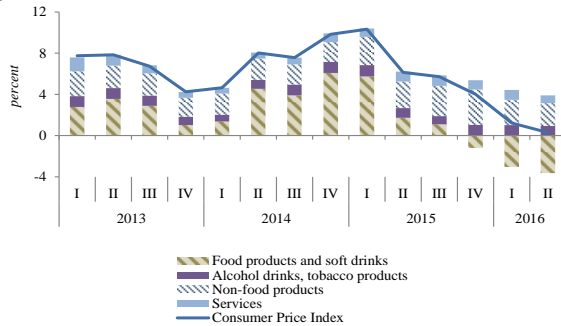


Chart 4.1.2. Dynamics of Food Product Price Input in Annual CPI
(month to the corresp. month of the previous year)

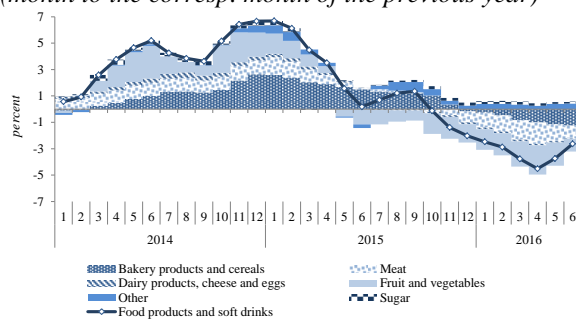


Chart 4.1.3. Dynamics of Non-Food Products Price Input in Annual CPI
(month to the corresponding month of the previous year)

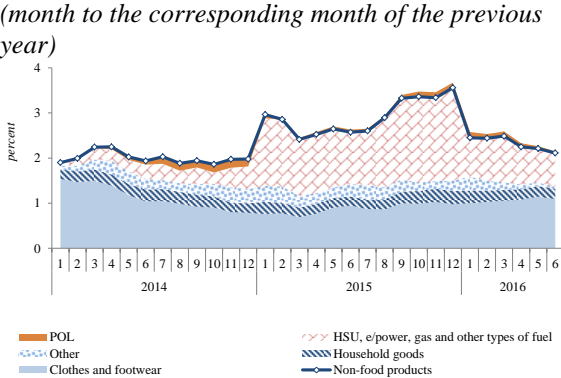
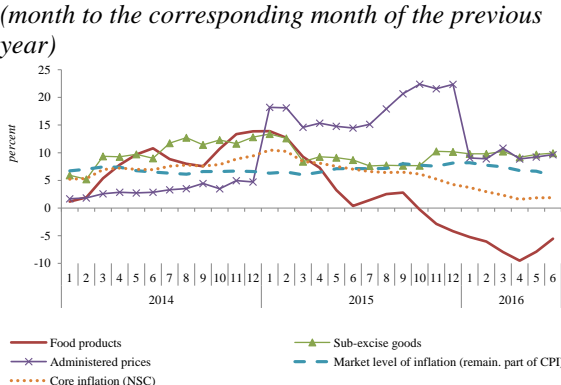


Chart 4.1.4. Dynamics of Consumer Price Index by Groups of Commodities
(month to the corresponding month of the previous year)



In Q2 of the current year, slowdown was still observed in the inflation rate. According to the data of the NSC KR, CPI growth compared to the same quarter of the previous year decreased down to 0.3 percent from 1.2 percent registered in Q1 2016.

In Q2 2016, the annual rates of price growth decreased in all major groups of commodities, however further decline in prices for food products made the most significant contribution to mitigation of the inflation rate. Prices for food products and soft drinks decreased by 7.7 percent compared to Q2 2015, meanwhile a decrease made 6.4 percent in Q1 of the current year. Prices for fruits and vegetables (-24.3 percent), meat (-11.8 percent) and bakery products (-6.3 percent) decreased significantly in the reporting period compared to the previous year. This decrease was conditioned by such factors as an increase in agricultural production output in 2015 and early 2016, a decline in export prices for wheat in Kazakhstan and relatively low domestic demand in our country.

In the reporting period, annual price growth for alcohol drinks and tobacco products made 10.8 percent, having decreased from 11.7 percent in Q1.

The inflation rate in the non-food products group decreased from 8.5 percent in Q1 to 7.6 percent in Q2. Annual price index growth for “housing services, water, electricity, gas and other types of fuels” in this group decreased by 2.3 percentage points compared to Q1 primarily due to a decline in prices for cement and gas. Moreover, price slowdown was observed in the group “household goods and appliances”, non-food inflation was supported by an increase in prices for clothes and footwear.

In Q2 2016, the price index for paid services increased by 5.2 percent compared to the similar quarter of the previous year, having decreased by 1.3 percentage points compared to growth in Q1 of the current

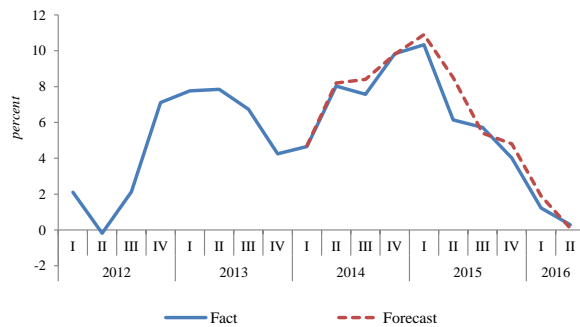
year. A decline in the price index for paid services of the restaurants and hotels made the most significant contribution to slowdown of the inflation rate in this group, therefore a significant decline was observed in prices for the services for public catering, meanwhile, an increase was observed in prices for communication services.

According to the data of the NSC KR, in Q2 2016, the core inflation decreased to 1.8 percent from 3.0 percent in Q1 of the current year.

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 Q2, actual inflation rate significantly exceeded the forecasted one. Forecast for the inflation rate was set at 0.1 percent, meanwhile an actual value made 0.3 percent. Discrepancy with the forecast was due to less significant decline in prices for food products against expectations. Generally, the actual inflation rate on goods and services excluding food products was close to the forecasted value.

Chapter 5. Medium-Term Forecast

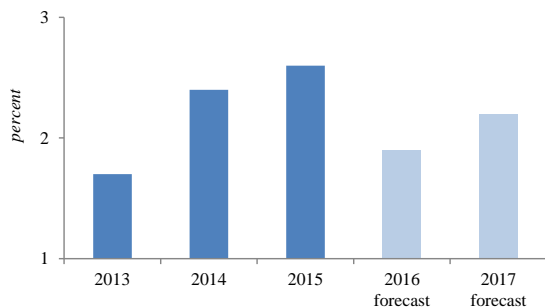
5.1. External Environment Proposals

5.1.1. Development Forecast of Major Trading Partner Countries

USA

Chart 5.1.1.1. Real GDP Growth in the USA

(year to year)



Source: IA Bloomberg

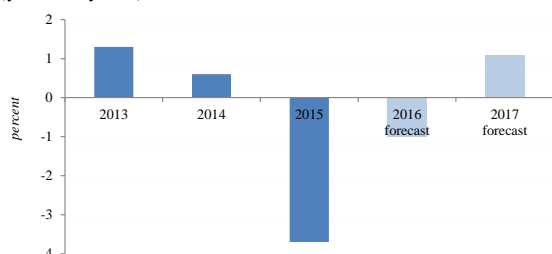
weakening of the US currency since the beginning of the year, therefore it will have a positive impact on industry and investment. Risks for investment growth are associated with low profits in the corporate sector and uncertainties including those about the president election in the USA. Stable upward trend is forecasted in consumer expenditures, this trend is expected to support economic growth.

Gradual increase of the inflation rate is expected in the USA in the course of diminishing the effect of decrease in prices for fuels in the previous years. In 2016, the average annual inflation rate is forecasted at 1.3 percent, in the subsequent periods it will rise slightly above two percent.

Russia

Chart 5.1.1.2. Real GDP Growth in Russia

(year to year)



Source: IA Bloomberg

separate sectors of economy in Russia, till January 31, 2017, as well as low investment activity and still existing uncertainty in the international oil market. According to the forecasts of the international financial institutions and experts interviewed by IA Bloomberg, in 2016, the average annual inflation rate can decrease down to 7.0 percent from 15.6 percent in 2015. The inflation rate is expected to continue decreasing primarily due to weak consumer demand,

After slowdown of the economic growth in the USA in the current year, moderate rates of activity growth are expected in the medium term. Influence of the factors, which had restraining pressure on an increase of activity in the first half of the current year, is likely to be temporary or these negative trends will diminish in the future periods. The temporary factors include reduced costs for purchase of the inventory holdings, which made the most significant negative contribution to GDP growth in Q2 of the current year. In Q2 2016, export dynamics was characterized by the upward trend amid

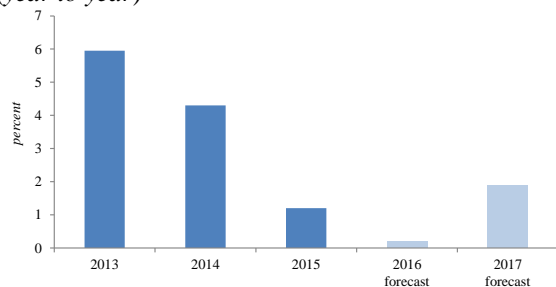
In 2016, slowdown of economic recession in Russian can be expected due to weakened influence of the negative trends along with slight improvement in the dynamics of the main macroeconomic indicators. In 2016, slowdown of economic recession in Russia is expected at 1.0 percent from 3.7 percent in 2015. Rehabilitation of economic growth is expected in Russia in the medium term; however the rates thereof are likely to be slower compared with 2010-2011. Such expectations are conditioned by prolongation of economic sanctions, related to

lower indexation rates of regulated prices and tariffs, as well as good harvest expected in the current year. According to the experts, the inflation rate is expected at 5.5 percent in 2017. Nevertheless, uncertainty in respect of the budgetary policy in the medium term is the main risk, which can influence the development of the situation in the Russian economy. Lack of the necessary measures to consolidate the state budget can be a prerequisite for realization of the inflationary risks and slowdown of economic activity in the long run.

Kazakhstan

Chart 5.1.1.3. Real GDP Growth in Kazakhstan

(year to year)



Source: IA Bloomberg, international financial institutions

Medium-term forecasts for the economic development in Kazakhstan were adjusted taking into account actual data on the economic growth in the first half of 2016. However, forecasts for economic growth in Kazakhstan in 2016 remained at the level close to zero (0.2 percent instead of 0.1 percent) due to remaining impact of previous adverse external and internal factors. In 2017-2018, recovery of economic growth is still expected due to forecasted rise in prices for oil, start-up of production at Kashagan Oil

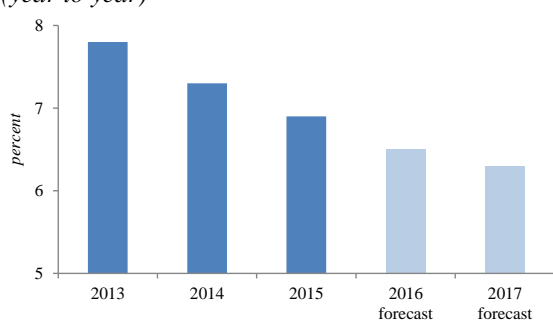
and Gas Mine and effective implementation of the State Anti-Crisis Program.

In the second half of 2016, slowdown in the inflation rate, which is likely to be at the level of about 8.0 percent by the end of the year, is expected due exhausted national currency devaluation effect, decreased inflationary expectations of the population, and reduced consumer demand. In 2017, in the absence of adverse price shocks, the trend of slowdown in the inflation rates will still be observed as well as due to the high base in 2016, and the average annual inflation rate will make approximately 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

Gradual slowdown of economic growth will continue in China. Ongoing restructuring of the economy, the slowdown trend in GDP growth with an increase in per capita income and reduction in the number of the working-age population have a restraining effect on the activity growth. However, the authorities will continue using stimulating measures to achieve the targeted growth rate of the economy set in 2016 within the range of 6.5-7.0 percent. Stable dynamics is forecasted in final consumption, slowdown of the private investment will be compensated by

the public investment to some extent. According to the forecasts made on the basis of the financial institutions surveys, the economic growth in China will develop at the level of about 6.5 percent in 2016 and will slow down to 6.3 percent in 2017.

Inflation rate in China is expected at the level, which is significantly below China government benchmark set at the level of 3.0 percent. This value will make 2.0 percent in the current and the next year with subsequent growth of up to 2.5 percent in 2018.

5.2. Medium-Term Forecast

At the meeting of the Board of the National Bank held in May, the baseline version was approved as the main scenario, which stipulates average prices for oil at the level of USD 41 per Barrel, moderate USD depreciation in the foreign exchange markets of Russia and Kazakhstan, stable remittances flow at the level of 2015 and more optimistic forecasts for external demand.

In Q2, the actual dynamics of the main indicators in the world markets and in countries - main trading partners developed according to the intermediate scenario: between the baseline and optimistic versions. Thus, the prices for energy carriers stabilized, slight increase was observed in the prices for gold and sugar, pressure for the Russian ruble and Kazakh tenge reduced. Generally, assessments of development processes in Russia and Kazakhstan in the short term were revised upward due to aforementioned factors.

Generally, expectations and forecasts on the external parameters were not changed significantly with regard to the previous forecast. It should be noted that basic adjustments affected forecasted increase in gold prices, this forecast was revised upward (approximately from USD 1,100.0 to USD 1,272.3 per troy ounce in 2016). This forecast was revised due to rise in demand for these safe assets amid uncertainties and instability in the international financial markets (primarily due to the decision of Great Britain to withdraw from the European Union).

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, and expert assessments.

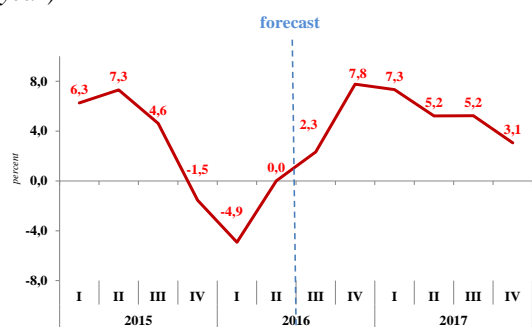
Dynamics of the prices for oil determine the scenarios and forecasts on macroeconomic parameters for the medium term in the countries-main trading partners. This dynamics will have a significant impact on the volume of capital inflows into the country from exports and remittances received from the migrant workers, 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. Tariff and tax policy will have a significant impact on achievement of monetary policy benchmarks in the medium term.

The current trends in the international hydrocarbons and food market will still 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 44 per Barrel. On the background of higher prices in the international sugar market, the food markets (FAO index) were adjusted upward and will continue sideways development in the medium term. In 2016, the average FAO index value will be about 156.2 points against 164.0 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 for crops are not expected. Thus, the supply of food products and hydrocarbons in the foreign market is expected to have slight deflationary pressure on the internal price level. In witness of the aforementioned facts, in Q3 2016, external inflation rate will be slightly negative with gradual transition to the positive zone and further growth till the middle of 2017.

In 2016, GDP in Russia is expected to decrease by 1.0 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 is expected at the rate of 13.7 percent in Kazakhstan.

Chart 5.2.1.1. Forecast of Real GDP
(quarter to the corresponding quarter of the previous year)



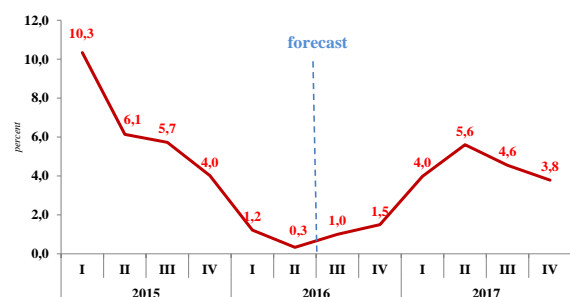
supported by the agriculture (by means of livestock and crop production), the service and the construction sectors (by means of roads reconstruction and hippodrome construction) in the Issyk-Kul region.

In 2017, real GDP growth will be at the level of 5.0 percent. By the end of 2016, GDP negative gap will be eliminated and since the beginning of 2017, GDP positive gap will be observed due to included budgetary parameters according to the current law on the budget.

In 2016, the inflow of USD remittances according to the baseline scenario will increase slightly compared to the level of 2015: expected growth will make 4.9 percent. Increase in remittances inflow will support internal demand in the medium term and increase imports.

The inflation rate in the baseline scenario in the medium term will be primarily at the benchmark level of 5-7 percent. At the end of 2016, CPI growth (period to period) will be 1.0 percent (December 2016 to December 2015 - 1.8 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 5.2.1.2. Inflation Forecast
(quarter to the corresponding quarter of the previous year)



The real economy in Kyrgyzstan in 2016 will demonstrate moderate dynamics. At the end of the year, the real GDP growth will be about 2.1 percent, the growth excluding Kumtor will be 2.4 percent. The increase in production output at the enterprises of the Kumtor Mine will not exceed the indicators of 2015, however, in contrast with 2015 the production will not be uneven within a year with a maximum share of production output (approximately 50 percent) in Q4 2016. In the sectoral structure, the economic growth will be

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 at the level of 5.7-6.8 percent in 2016 with gradual decrease towards the middle of 2018.

“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,

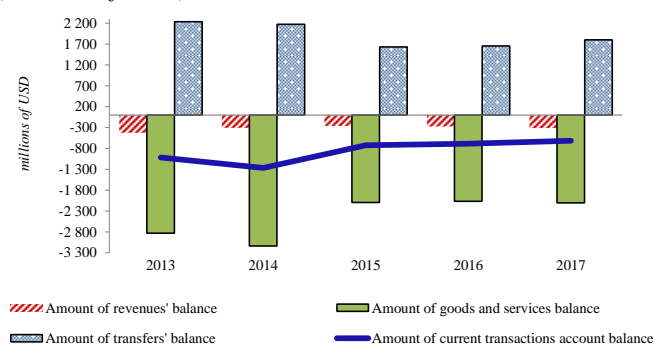
if the electricity consumption by the population constitutes up to 150 kWh, if the electricity consumption is from 150 kWh to 700 kWh, the tariffs are expected to increase by 29.8 percent in 2017. The tariffs for electricity and heating will increase by 18.2 percent since April 1, 2017.

In 2017, the average inflation rate will make 4.5 percent; meanwhile, the food component will decrease down to 1.7 percent and the non-food component – down to the level of 5.7 percent. During the year, the inflation rates are expected to be more even within the range of 3.8-5.6 percent. Price background is expected to be favorable in the foreign commodities markets.

GDP gap will be positive and will have moderate inflationary effects during 2017. Generally, GDP is expected to increase by 4.9 percent, excluding Kumtor, an increase will make 5.9 percent within the reporting year.

In 2016, the economic situation in the trading partner countries and restrained economic growth of the country remain the factors determining the external sector development in the Kyrgyz Republic¹. Positive trend in the net inflow of current transfers, reduced deficit of balance of services and deficit of trade balance remaining at the level of 2015 will form the deficit of the current transactions account at the level of 10.9 percent to GDP (USD 684.9 million) at the end of 2016.

Chart 5.2.1.3. Forecast Data on Current Transactions Account
(millions of USD)



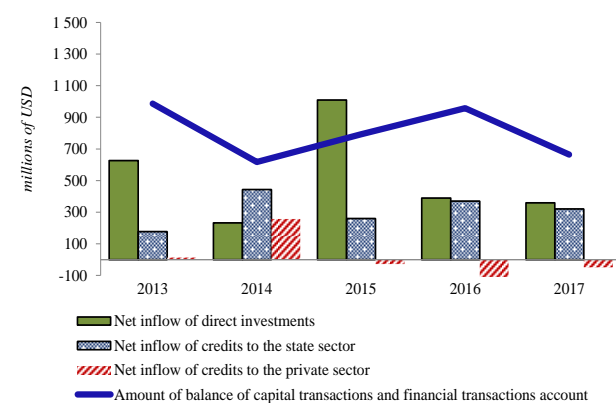
In the forecast period, the export is expected to decrease by 5.5 percent. A decrease in gold production at the Kumtor Mine in 2016 and a decline in the world prices for precious metal will have the most significant impact on exports dynamics. Taking into account existing negative export dynamics excluding gold in the first half of 2016, this index is expected to decrease by 1.4 percent at the end of the year.

2015, as well as retaining low domestic demand in 2016 will have the main influence on the dynamics of the country's imports. High import cost due to a high level of the tariff rates after joining the Eurasian Economic Union will be the main factor for the reduced imports from the third countries. The forecasted import decline was adjusted to 2.1 percent amid dynamics formed in the first half of 2016.

A decline in the world prices for petroleum products compared to

The forecast of decrease in the net inflow on "current transfers" item was revised upwards by 1.4 percent compared to the level of the previous year. The forecast was revised due to more favorable trend of increase in the migrant workers' remittances in the first half of 2016 compared to the expectations made at the beginning of the year. Finally, the forecast of the net inflow of private transfers was adjusted upwards by 4.2 percent.

Chart 5.2.1.4. Forecast Data on Capital and Financial Transactions Account
(millions of USD)



In 2016, inflow of "other investments" retains its significant influence on increase of the positive balance on the capital and financial transactions account, which is expected to rise by 20.8 percent.

the service volumes on the previously raised credits. Inflow of direct investments is forecasted to decrease by 61.3 percent.

The trend existing in early 2016 was characterized by more significant decrease of foreign assets abroad therefore a reduction in assets was adjusted to the amount of USD 301.5 million. A reduction of net inflow of the external credits to the private sector expected in 2016 is still observed primarily due to increase in

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

Thus, the amount of the payment balance at the end of 2016 is expected to be positive in the amount of USD 263.6 million; meanwhile, the index of the international reserve assets¹ is expected to cover 4.5 months of the future imports of goods and services.

Generally, the economic rehabilitation expected in the major trading partner countries in 2017 contributed to improvement of the external sector indices in the country. Restoration of the positive dynamics of current transfers will contribute to improvement of the current transactions account up to 10.0 percent to GDP. With exports growth by 3.4 percent and imports – by 2.5 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 stability in the foreign exchange markets thereof will have a positive impact on the inflows of private transfers, which will increase by 11.8 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 47.2 million. Total international reserve assets will cover 4.6 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 major trading partner countries.

¹ In accordance with the IMF methods, 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.

Annex 1. Key Macroeconomic Indicators

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

Indicator	Unit of measure	2015				2016	
		Q1	Q2	Q3	Q4	Q1	Q2
1. Demand and supply							
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
Real GDP, per quarter	<i>mln. KGS</i>	73 798,2	90 472,5	122 278,5	128 046,0	76 740,9	92 920,4
GDP growth rate	%	6,3	7,3	4,6	-1,5	-4,9	0,0
GDP growth rate, excluding Kumtor	%	2,4	4,7	3,7	6,2	1,0	1,4
Domestic consumption	%	1,2	0,3	-2,9	-16,2	0,2	-
Investment	%	-3,4	-7,5	-18,1	6,1	23,2	-
Net export	%	-13,2	-5,8	-34,6	-40,5	0,2	-
<i>GDP production:</i>							
Agriculture	%	0,6	1,6	7,3	10,2	1,5	3,9
Industry	%	20,3	26,9	6,2	-37,5	-25,1	-11,4
Construction	%	-3,2	6,7	-0,2	35,1	0,1	6,2
Services	%	3,2	3,0	3,4	4,6	2,5	1,8
including trade	%	5,2	5,2	6,6	8,0	4,8	5,3
2. Prices							
CPI	%	110,3	106,1	105,7	104,0	101,2	100,3
CPI (in annual terms as of the end of period)	%	108,5	104,5	106,4	103,4	100,5	101,3
<i>CPI by main groups of goods and services:</i>							
Food products	%	111,9	103,6	102,2	97,5	93,6	92,3
Non-food products	%	112,2	110,4	109,0	111,6	111,7	110,8
Alcohol drinks and tobacco products	%	109,5	108,9	110,1	111,8	108,5	107,6
Services	%	106,0	106,9	107,4	106,6	106,5	105,2
<i>CPI, classified by character:</i>							
Excise goods	%	111,4	109,0	107,7	109,4	110,0	109,6
Regulated prices	%	116,9	114,9	117,9	122,1	109,6	109,3
Market inflation rate (residual CPI)	%	106,3	106,9	107,4	107,8	107,8	106,4
Core inflation (NSC)	%	109,7	107,6	106,5	105,2	103,0	101,8
3. External sector							
Trade balance/GDP	%	-17,7	-19,2	-17,3	-11,1	-9,2	-12,1
Current transaction account/GDP	%	-36,1	-35,8	-33,7	-30,4	-31,9	-34,5
Export of goods and services/GDP	%	33,5	31,5	30,1	27,8	26,6	25,3
Import of goods and services/GDP	%	69,5	67,3	63,8	58,2	58,6	59,6
4. USD exchange rate, as of the end of period							
	<i>KGS</i>	63,8736	62,0788	68,8359	75,8993	70,0158	67,4860
5. Monetary sector							
NBKR policy rate, as of the end of period	%	11,00	9,50	10,00	10,00	8,00	6,00
Rate of "overnight" deposit, as of the end of period	%	5,00	3,00	4,00	4,00	1,00	0,50
Rate of "overnight" credit, as of the end of period	%	14,00	12,00	12,00	12,00	10,00	7,50
Average rate of REPO transactions, per quarter	%	10,50	9,96	7,14	9,45	9,44	1,59
Average rate in the inter-bank credit market, per quarter	%	10,28	10,02	7,14	9,66	10,50	2,70
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
Monetary base	%	-16,2	-9,5	-4,3	4,0	17,2	16,7
Money outside banks (M0)	%	-19,9	-15,7	-7,0	2,3	17,5	18,6
Monetary aggregate (M1)	%	-17,7	-14,3	-5,6	1,7	21,0	25,5
Narrow money supply (M2)	%	-13,2	-13,6	-5,7	-0,1	17,2	25,8
Money supply (M2X)	%	0,9	0,5	10,0	14,9	13,1	16,7

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 and legal entities, as well as the deposits of other financial institutions, however, the deposits of the Government and non-residents are excluded.

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 degrees of liquidity: M0; M1; M2; M2X.

M0 – cash in hands.

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

M2 – M1 + time deposits in the 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 balance of trade 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 one of the types of short-term government obligations, issued to bearer. The government short-term discount securities of the National Bank of the Kyrgyz Republic for 7, 14, 28, 91 and 182 days issued in the book-entry form.

Other depositary 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 the basic reference point 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 emitter of ST-Bills. Placing issues of ST-Bills is made through weekly auctions conducted by the National bank of the Kyrgyz Republic. Direct participants enjoy 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 emitter 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
ECB	European Central Bank
EEU	Eurasian Economic Union
EU	European Union
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 Statistics Committee
OPEC	Organization for Petroleum Exporting Countries
POL	Petroleum, oil, lubricants
PRC	People's Republic of China
REER	Real effective exchange rate
ST-Bonds	State Treasury Bonds
ST-Bills	State Treasury Bills
USA	United States of America