

**NATIONAL BANK
OF THE KYRGYZ REPUBLIC**

**Monetary Policy Report
Quarter 2, 2017**

**Bishkek
August 2017**

Monetary Policy Report 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 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 for Q2 2017 was approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic No. 2017-II-07/38-1-(ДКП) dated August 28, 2017.

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Summary

In Q2 2017, the inflation rate was approaching the lower boundary of the target level and stopped at the level of about 4 percent. At the end of the reporting period, the annual inflation rate was 4.1 percent (1.3 percent in 2016), in Q2, the average inflation rate amounted to 3.9 percent. Rise in prices for food products and services primarily affected dynamics of inflation rate.

In Q2, food inflation gradually increased and amounted to 4.7 percent. This growth was primarily conditioned by the rise in prices for fruit and vegetables due low base of prices in the previous year.

Noon-food inflation remained relatively low (1.2 percent in annual terms).

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

Slight slowdown was observed in economic growth in Q2; however, generally, the situation was positive. GDP growth in the first half made 6.4 percent (in the corresponding period of 2016, decrease made 3.1 percent). This dynamics was primarily due to retaining rapid industrial growth, primarily due to growth in the volumes of production output at the enterprises of the Kumtor Mine. At the end of Q2 2017, the economic growth in the country, excluding enterprises at the Kumtor Mine, amounted to 3.9 percent.

Positive growth rates were observed in industry, agriculture and construction, meanwhile zero growth was observed in the service sector. Improvement of the situation in the major trading partner countries, and increased inflow of migrant workers' remittances had a significant impact on preserving positive economic growth.

In Q2 2017, the trade balance formed under the impact of increased exports and insignificant decrease of imports. Export increased by 31.0 percent due to supplies of gold and other goods, imports decreased by 1.7 percent due to reduction in all functional groups of goods. Finally, trade balance deficit of the country formed in the amount of USD 628.6 million. The foreign trade turnover¹ increased by 5.4 percent and amounted to USD 1.3 billion.

The fiscal deficit formed significantly lower compared to the corresponding period of the previous year. At the end of the first half of 2017, the state budget was executed with a deficit at KGS 4.0 billion, or 2.0 percent to GDP (in the same period of 2016, the budget deficit amounted to KGS 12.4 billion, or 6.9 percent to GDP). The budget deficit reduced primarily due to the increase of the state budget revenues from operating activities amid more moderate growth of the state budget expenditures.

In the period under review, the situation in the domestic foreign exchange market remained relatively stable. Growth of the main indicators was observed in the deposit and credit market. At the end of the period under review, the volume of the depositary base increased by 5.8 percent year-to-date and amounted to KGS 113.3 billion. The volume of the credit portfolio increased by 9.0 percent year-to-date and made KGS 102.0 billion. Positive dynamics was primarily due to the increase in the segment of the national currency.

¹The data are given in FOB prices including the NBKR additional estimates.

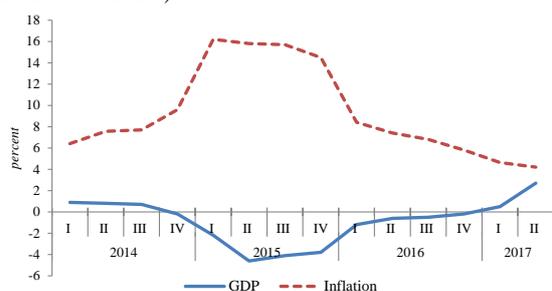
Chapter 1. External Environment

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

The trend of recovery in economic activity remained in the economies of the countries-major trade partners of Kyrgyzstan. Economic recovery in Russia had a positive impact of the EAEU countries. The rates of economic growth in Kazakhstan accelerated due to increased exploitation of mineral resources, implementation of structural reforms and Government programs, as well as increased exports of commodities. The inflation rates in Kazakhstan continue to slow down and are approaching the benchmarks. Economic growth in the Republic of Belarus continues recovering amid improved external demand and slowdown is observed in the inflation rate due to improved situation in the domestic foreign exchange market. The economy of Armenian was characterized by remained high GDP growth; the inflation rate entered the positive zone. The largest countries in the world and the world economy as a whole showed steady growth.

Russia

Chart 1.1.1. The GDP growth and Inflation in Russia
(in annual terms)



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

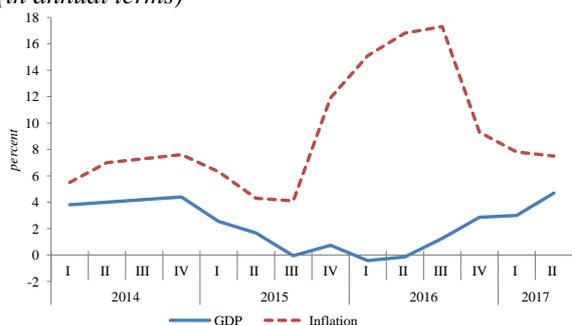
The trend of economic recovery continued in Q2 2017. According to the assessment of the Ministry of Economic Development of Russia, in Q2 2017, annual GDP growth amounted to 2.7 percent against 0.5 percent in Q1 of the current year, growth for the first half of the year amounted to 1.5 percent. The increase in manufacturing activity amid growth in all sectors of industry, the growth of transport cargo turnover, as well as the positive dynamics of construction and turnover of retail and wholesale trade contributed to acceleration of economic growth.

At the end of June, the average annual inflation rate was at the level of 4.3 percent, in annual terms – 3.9 percent. Monthly consumer price growth rate accelerated up to 0.6 percent against 0.1 percent in May of the current year due to a short-term price surge for fruit and vegetables amid adverse weather conditions. Slower growth in the prices for non-food products and services, as well as reduced inflationary expectations had a restraining effect on the overall price level.

Kazakhstan

In Q2 2017, the rates of economic growth in Kazakhstan accelerated, mainly due to increased extraction of mineral resources, implementation of structural reforms and Government programs, as well as due to the growth of commodity exports amid recovery of the world oil prices.

Chart 1.1.2. The GDP growth and Inflation in Kazakhstan
(in annual terms)



Source: RK Statistics Agency, NBKR calculations

national currency devaluation in Kazakhstan in 2015, lower inflation expectations, higher predictability of the situation in the domestic money market, as well as holding moderately restraining monetary policy.

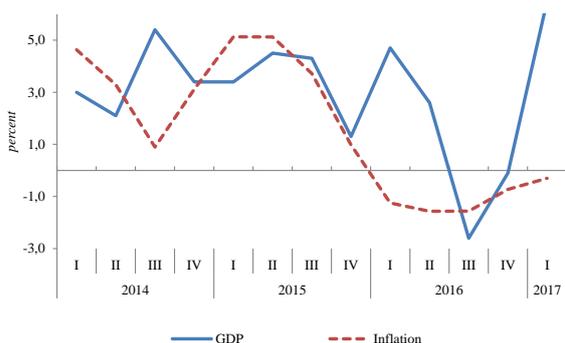
Thus, in the first half of 2017, economic growth in Kazakhstan formed at the level of 4.2 percent¹. In the sectoral aspect, the growth was observed in all major sectors of economy: in industry (by 7.8 percent), in agriculture (by 3.1 percent), in the sector of transport (by 3.9 percent), communication (by 2.5 percent) and trade (by 2.4 percent).

In Q2 2017, the annual average inflation in Kazakhstan amounted to 7.5 percent against 16.8 percent in the same period of 2016. In Q2 2017, inflation slowdown was due to exhausted effect of the

Armenia

Chart 1.1.3. The GDP growth and Inflation in Armenia

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



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

the EAEU countries, the most significant trade links were extended with Kazakhstan and Belarus

At the beginning of Q2 of the current year, the deflationary processes were replaced by the upward trend in the consumer prices in Armenia. In June, the annual inflation rate was 1.1 percent, the average annual value formed at the level of 0.4 percent. The Central Bank of Armenia revised its inflation forecast for the end of 2017 due to expectations of more rapid recovery in the prices for non-food products and services.

In Q2 2017, the trend of economic recovery was still observed in Armenia, the inflation rate entered the positive zone.

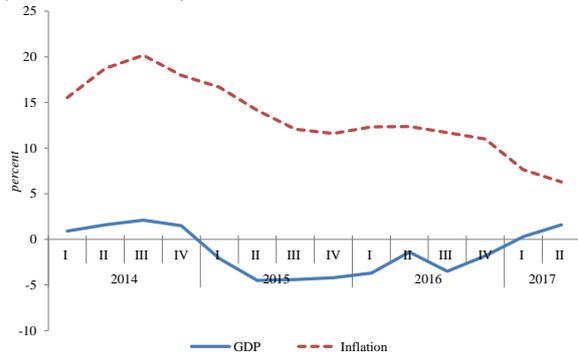
According to the National Statistical Service of the Republic of Armenia, in January-June 2017, the index of economic activity in Armenia grew by 6.1 percent compared with the same period in 2016. Continued rapid growth in the manufacturing sector, trade and services, increased inflow of remittances, as well as gradual recovery of the world prices for metal (the main export commodity of Armenia) allowed the country to occupy one of the first places on economic development among the EAEU countries. The foreign trade turnover increased by 24.0 percent. Among

¹According to the preliminary data of the Ministry of National Economy of the Republic of Kazakhstan.

Belarus

Chart 1.1.4. The GDP growth and Inflation in Belarus

(in annual terms)



Source: National Statistical Committee of the Republic of Belarus

favorable situation in the domestic foreign exchange market, meanwhile, adverse weather conditions observed in Q2 of the current year brought pressure on the growth of consumer prices.

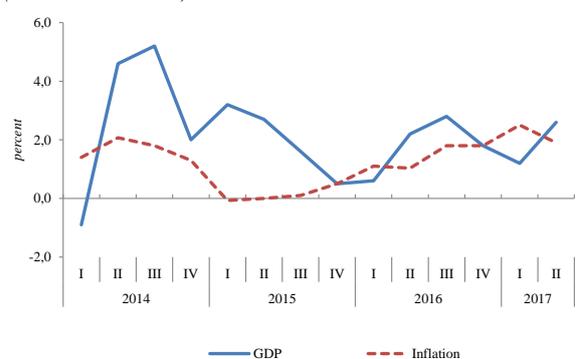
In the first half of 2017, economic growth of the Republic of Belarus remained in the positive zone amid improved external demand. At the end of the half of the year, GDP growth in Belarus amounted to 1.0 percent¹. This growth was due to increased production output in the manufacturing industry (by 5.1 percent), in the sector of transport (by 3.3 percent) and agriculture (by 1.6 percent).

In Q2 2017, the annual average inflation rate in the Republic of Belarus formed at the level of 6.3 percent against 12.4 percent in the same period of 2016. The slowdown in the inflation rate was due to the

USA

Chart 1.1.5. The GDP growth and Inflation in the USA

(in annual terms)



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

headline inflation and the core inflation in the United States decreased and in June 2017, stood at 1.6 and 1.7 percent respectively. The slow increase in prices for food products at the level of 0.9 percent was the reason of relatively low inflation rate. Core private consumption expenditures index, which was a key indicator for the U.S. Federal Reserve System, amounted to 1.5 percent in June of the current year.

Economic growth in the USA was moderate. In Q2 2017, the U.S. economic growth was 2.6 percent (against the previous quarter in terms of annual rates), having accelerated from 1.2 percent in Q1. In Q2, increased private consumer expenditures played a major role in the growth of activity. Growth of investment in equipment and buildings, particularly in the field of mining and exploration continued, which reflected improved prospects for the energy sector of the United States. Export growth in Q2 outpaced growth in imports, Government expenditures increased insignificantly.

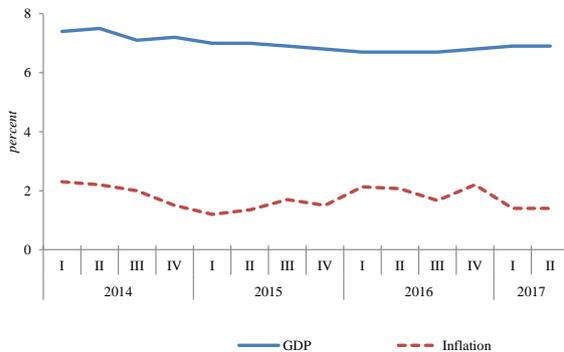
In the period under review, the

¹According to the preliminary data of the National Statistical Committee of the Republic of Belarus.

China

Chart 1.1.6. The GDP growth and Inflation in China

(quarter to the corresponding quarter of the previous year)



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

at a low level and amounted to about 1.5 percent in June, meanwhile, the benchmark of the Government was set at “about three percent”. Low inflation rate was primarily due to a decline in prices for food products and slow growth of prices in the “transport and communication” group.

Economic situation in China remained stable. In the first half of 2017, PRC GDP rose by 6.9 percent, which is 0.2 percentage points higher compared to the growth rate of 2016. The economy of China was supported by stimulating Government policy and the general recovery of activity in the world and regional economy. All major sectors of economy showed stable growth. The increase in lending to the real sector had a positive effect in the short term; however, growing corporate debt is one of the major risks for the financial stability, and for the economy of China as a whole.

In Q2, the inflation rate in China was

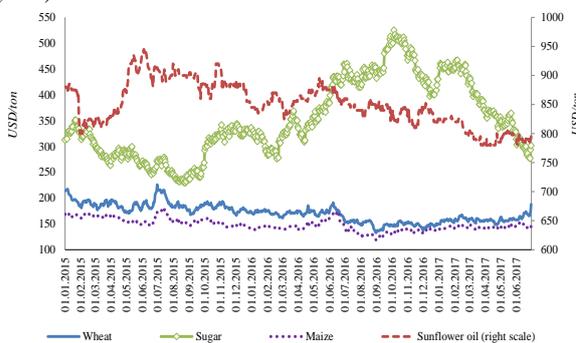
1.2. Global Commodity Markets

The prices for main food products imported by Kyrgyzstan showed mixed trends, the price for grains increased. However, significant inflationary impact on the price level in Kyrgyzstan from the world food markets is not expected. Generally, the prices in the gold markets were characterized by the sideways trend, decrease in the prices was observed in the oil markets.

Food Market

Chart 1.2.1. Dynamics of Prices for Food Products

(month to the corresponding month of the previous year)



In Q2 2017, multidirectional dynamics of the prices for major goods was observed in the world food markets. Increase in the prices for wheat was observed throughout the quarter and accelerated at the end of June. This was due to the influence of unfavorable weather conditions on the forecasts of production of this crop. At the end of Q2, the prices for wheat increased by 19.8 percent compared to the end of Q1. In the marketing year 2017/2018, the production of grain is forecasted to decrease compared to the record harvest of the season of 2016/17, however, it will be somehow compensated by high carry-

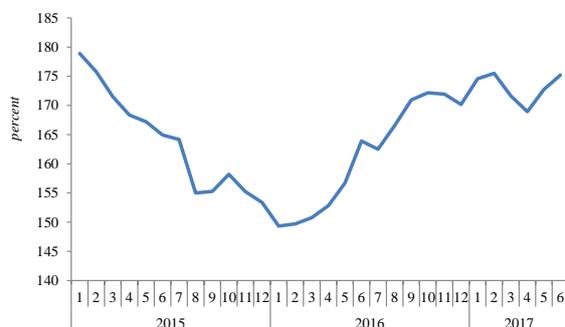
over stocks.

In Q2 2017, the prices for sugar decreased by 18.4 percent due to higher than expected sugar production, devaluation of the currency in Brazil, which stimulated export from this country, and relatively weak demand for imports. According to the estimates of the specialized

institutions, sugar production in major producing countries is expected to increase in the marketing year 2017/2018; meanwhile the total sugar production can reach record levels.

The prices in the vegetable oil markets were quite stable. Slight upward price trend was observed due to active demand and favorable forecasts for consumption.

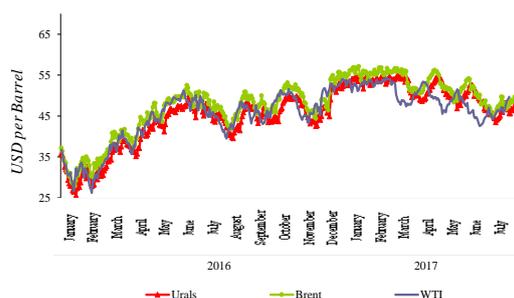
Chart 1.2.2. Dynamics of FAO Food Price Index



In Q2 2017, the average value of the FAO food price index decreased by 0.9 percent compared to Q1. The decline in the prices for sugar and vegetable oil was compensated by increased prices for meat and dairy products. The average price index for crops increased insignificantly by 0.7 percent.

Energy Market

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



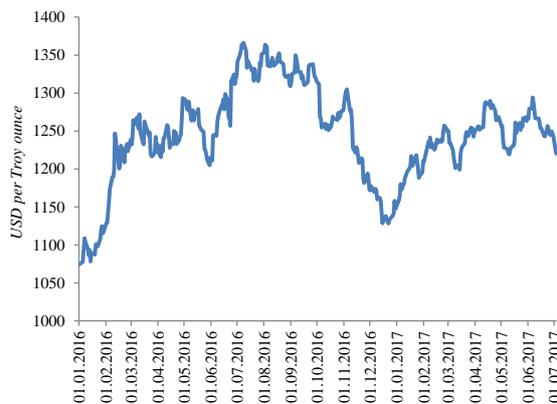
In Q2 of 2017, the world oil prices decreased under the influence of fundamental and market factors. The prices for the basic oil grades (Brent, WTI, Urals) fluctuated within the range of USD 42.5-56.2 per barrel. In Q2 2017, the average price for Brent crude oil decreased by 6.9 percent compared to the previous quarter and amounted to USD 50.9 (the price increased by 5.5 percent compared with the same period of the previous year).

Generally, the downward trend in the prices for oil was observed since the beginning of Q2 2017 due to significant oil stock in the United States and increase in the supply of oil. Moreover, speculative expectations of the market participants of the OPEC policy change on the eve of the OPEC meeting to be held in Vienna in May and expectations of the increase in the key rates by the U.S. FRS in June amid improving economy of the United States provided had the short-term pressure on the oil quotations. According to the results of the OPEC meeting held in Vienna, it was decided to preserve earlier agreement, and in June, the U.S. FRS resolved to raise key rates. Both events did not have a significant impact on oil quotations.

Information on oil reserves in the United States, implementation of agreements made within the framework of the OPEC by the countries, and geopolitical problems in certain regions of the world remain the main factors influencing the price formation.

Gold Market

Chart 1.2.4. Dynamics of Prices for Gold



Source: IA Bloomberg

likelihood of the rates being raised by the European Central Bank and the Bank of England was increased. Consequently, the expected increase in yield of the alternative investment directions had the downward pressure on gold quotations. In Q2, the average price for gold increased by 3.1 percent compared to Q1, when the price dynamics was characterized by the upward trend.

In Q2, dynamics of prices for gold was not stable; it was generally characterized by the sideways trend. Elections in the UK, complex political processes in the United States and instability in Qatar created uncertainty, which increased the demand for gold as an asset that retains its value during periods of turbulence. However, the influence of these factors during the period under review was offset by other factors.

Largely expected by analysts raising of the base rate occurred at the meeting held in June by the U.S. FRS. Forecasts of economic growth in the United States improved; the

Chapter 2. Macroeconomic Development

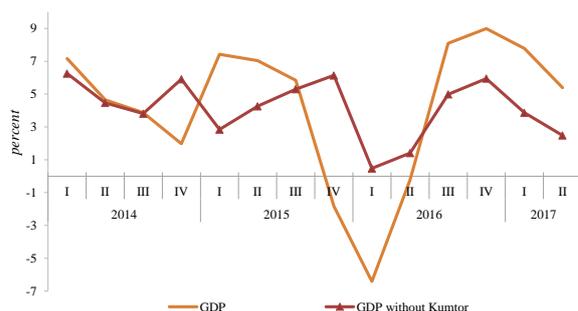
2.1. Demand and Supply in the Commodities and Services Market

Positive dynamics of economic growth was still observed in Q2. Economic growth was primarily conditioned by industrial production, by the sector of construction and trade. A decrease was observed in the sector of information and communication. Capital investment increased primarily due to the foreign sources of financing.

Demand

Chart 2.1.1. GDP Dynamics

(quarter to the corresponding quarter of the previous year)



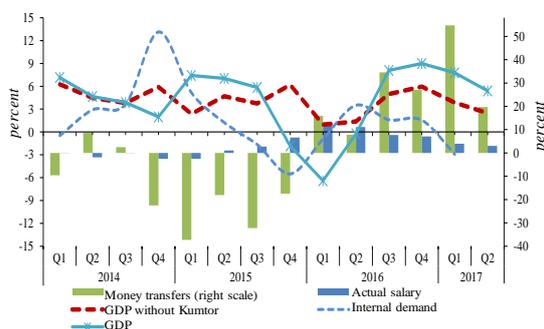
Source: NSC KR

production output at the Kumtor Mine. In particular, the Kumtor output increased by 41.9 percent compared to Q2 2016 (97.7 thousand troy ounces) and amounted to 138.6 thousand troy ounces in Q2 2017.

According to Centerra Gold Inc. press release, at the end of Q2 the company revised upwards its annual forecasts for 2017 on the production output at the Kumtor Mine from earlier expected 455-505 troy ounces up to 525-555 troy ounces due to development of the field with high gold content in mined ore.

Chart 2.1.2. Dynamics of Internal Demand and Remittances

(period to the corresponding period of the previous year)



Source: NBKR

(since the beginning of 2017) and increased by 19.7 percent compared with the same period of 2016.

In general, rapid economic growth was observed at the end of the first half of 2017. Positive dynamics remained in the inflow of the migrant workers' remittances. Moderately low inflation rates contribute to the growth in the real salaries of the population.

Generally, the economic growth observed at the end of Q2 2017 was conditioned by the positive contribution from all main sectors of economy, excluding the sector of information and communication.

Positive trend in the industrial sector was primarily due to an increase in the

production output at the Kumtor Mine. In particular, the Kumtor output increased by 41.9 percent compared to Q2 2016 (97.7 thousand troy ounces) and amounted to 138.6 thousand troy ounces in Q2 2017.

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The domestic demand¹, according to the preliminary results of Q1 of the current year, decreased by 2.9 percent against 2016. A reduction was due to slightly positive final consumption (+0.2 percent) and negative gross savings (-14.2 percent) as a result of a decrease in gross accumulation of fixed assets (-3.4 percent) and change in inventories (decrease by 19.3 times).

Meanwhile, the growth was observed in the real salary of the population (in January-May 2017, the growth made 3.2 percent) and in the inflow of remittances. In Q2 2017, the net inflow of the individuals' remittances in USD equivalent made through the money transfer system kept growing

¹ Reference to the data for the earlier period is given due to the lack of data for Q2 2017.

State Finances Sector

In the first half of 2017, the state budget deficit amounted to KGS 4.0 billion or 2.0 percent to GDP (in the first half of 2016, the budget deficit constituted KGS 12.4 billion or 6.9 percent to GDP). The primary state budget deficit (excluding interest payment for servicing the state debt) amounted to KGS 1.1 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)



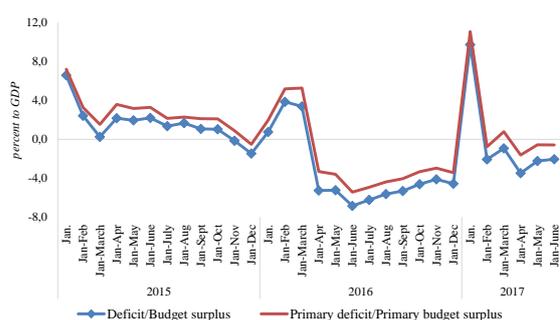
Source: CT MFKR, NBKR

The state budget revenues from operating activities increased by 13.1 percent or KGS 8.1 billion compared to the same period of 2016 and amounted to KGS 69.9 billion or 36.0 percent to GDP. Tax revenues remain the main income producing item, the contribution thereof to the increase in operating income made 6.5 percentage points. Non-tax revenues also made a significant contribution – 4.1 percentage points. The contribution of payments for social needs and official transfers made 2.1 and 0.4 percentage points respectively.

At the end of the reporting period, the state budget expenditures for operating activities increased in annual rate by 5.0 percent or KGS 2.8 billion and amounted to KGS 59.3 billion or 30.6 percent to GDP. The growth of state budget expenditures was primarily conditioned by the increase in costs for purchase of goods and services in the health care sphere and interest payment of the credits and loans. In the structure of expenditures by functional classification, the greatest contribution to the increase in expenditures was made by costs for health care, social protection and education.

Net outflow of budget funds for operations related to acquisition of non-financial assets amounted to KGS 14.6 billion or 7.5 percent to GDP. Capital expenditures were primarily directed for roads repair, purchase of buildings and constructions.

Chart 2.1.4. Budget Deficit
(period to the corresponding period of the previous year, accumulatively)



Source: CT MFKR, NBKR

Execution of the state budget revenues (tax revenues + non-tax revenues + official transfers) amounted to 111.9 percent at the end of the first half of 2017. Shortfall of forecasted official transfers in the reporting period was compensated by over-fulfillment of the plan on non-tax revenues. The execution of the state budget expenditures amounted to 78.3 percent. Meanwhile, the expenditure plan on the protected items was executed by 79.3 percent, on the unprotected items – by 66.3 percent.

Investment

In the first half of 2017, the upward trend in the capital investment remained. The level of implementing investment increased by 4.1 percent (in comparable prices) compared to the same period of 2016.

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

	January-June			
	2016	2017	2016	2017
	millions of KGS		share, percent	
Total	41 659,0	43 668,2	100,0	100,0
Internal investment	31 803,7	30 057,9	76,3	73,4
Republican budget	3 127,7	2 044,8	7,5	4,7
Local budget	260,4	338,5	0,6	0,8
Funds of enterprises and organizations	12 522,9	15 165,5	30,1	34,7
Banks' credits	46,6	791,4	0,1	1,8
Population funds including beneficent help of KR residents	15 846,1	13 717,7	38,0	31,4
External investment	9 855,3	11 610,3	23,7	26,6
Foreign credit	6 254,0	6 860,2	15,0	15,7
Direct foreign investments	2 936,4	3 527,5	7,1	8,1
Foreign grants and humanitarian aid	664,9	1 222,6	1,6	2,8

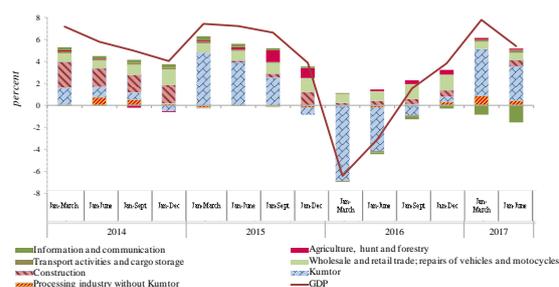
Source: NSC KR

Compared to January-June 2016, the volume of capital investment financed from domestic sources increased by 0.1 percent, that from the bank loans – by 16.9 times, from the local budget – by 29.1 percent, that from the funds of the enterprises and organizations – by 20.2 percent, meanwhile, the investment financed from the republican budget decreased by 1.5 times, that from the personal funds – by 14.0 percent. The investment financed from the foreign sources increased by 17.0 percent that from the foreign grants and humanitarian aid – by 1.8 times, from direct foreign investment – increase by 19.3 percent, from the foreign loans – by 8.9 percent.

Supply

Chart 2.1.5. Input of Main Sectors in GDP Growth

(period to the corresponding period of the previous year)



Source: NSC KR

The difference in growth rates shows significant influence of the enterprises at the Kumtor Mine on the economy as a whole, including exports.

Deflator was formed at the level of 1.1 percent, having decreased by 6.6 percentage points against the corresponding period of 2016.

The sectors of industry (5.2 percentage points), trade (0.7 percentage points), construction (0.3 percentage points) and agriculture (0.1 percentage point) made the main positive contribution to the economic growth, meanwhile, the sector of communication (-1.2 percentage points) made a negative contribution to the economic growth.

In the reporting period, growth in agriculture constituted 1.2 percent due to increase in livestock production.

Growth of capital investment was primarily observed in the construction of real estate facilities (by 7.2 times), hotels and restaurants (by 3.2 times), agricultural facilities (by 88.1 percent) and the facilities for supply of electric energy, gas, steam and conditioned air (by 34.8 percent). Meanwhile, capital investment decreased in the construction of educational (by 88.1 percent), agricultural and forestry facilities (by 39.7 percent) and the facilities of the wholesale and retail trade (by 24.0 percent).

In the first half of 2017, GDP increased due to a positive dynamics in all main sectors of economy excluding the sector of information and communication.

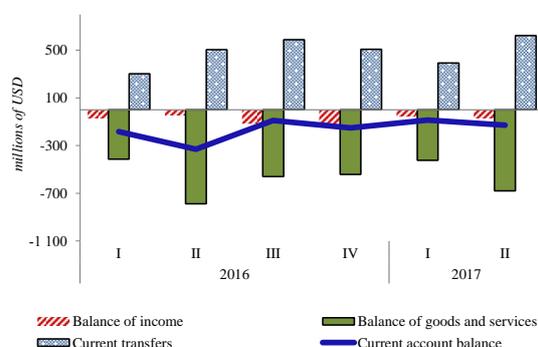
According to the preliminary data of the National Statistics Committee of the Kyrgyz Republic, in the reporting period, GDP growth amounted to 6.4 percent. The effect of low GDP base in the corresponding period of 2016 conditioned rapid growth rates of the economy in the first half of the current year. Excluding the enterprises of the Kumtor Mine, GDP growth constituted 3.1 percent.

2.2. External Sector¹

In Q2 2017, the current account deficit was formed under the influence of the increase in the net inflow of current transfers, as well as the decrease in the negative balance of goods and services trade.

Chart 2.2.1. Current Account

(millions of USD)



Note: According to the preliminary and forecasted data

According to the forecasted and preliminary data, in Q2 2017, the current account deficit decreased down to USD 126.8 million and equated to 6.5 percent of GDP.

In the reporting period, the trade deficit of the Kyrgyz Republic decreased by 14.4 percent to USD 628.6 million. This trend was conditioned by the growth of exports due to the increase in the supplies of gold and due to the decrease of imports.

2.2.1. Trade balance of the Kyrgyz Republic²

(millions of USD)

	2014	2015	2016	2016 Q2	2017* Q2	Change in %	Change in millions of
Trade balance	-2 807,5	-2 240,8	-2 100,7	-734,2	-628,6	-14,4	105,6
Export (FOB)	2 482,7	1 619,0	1 579,3	283,8	371,9	31,0	88,1
Gold	716,9	665,4	701,6	122,5	170,0	38,8	47,5
Import (FOB)	5 290,2	3 859,8	3 680,0	1 018,0	1 000,4	-1,7	-17,5
Energy products	1 041,8	830,0	399,6	113,0	101,9	-9,8	-11,1

* Preliminary data

In the reporting period, exports of goods (in FOB prices) increased by 31.0 percent to USD 371.9 million. Exports were primarily affected by growth in supplies of gold, which have increased by 38.8 percent compared to the same quarter of 2016. Along with that, exports, excluding gold, increased by 25.2 percent primarily due to a growth in supplies of footwear, clothes and clothing accessories, fruits and vegetables, rolled glass and other goods.

In Q2 2017, imports of goods (in FOB prices) decreased down to USD 1,004.4 million. This trend was primarily conditioned by a decrease in the value of petroleum products due to a reduction in the physical volume of supplies. Moreover, in the reporting quarter, the increase was observed in imports of such goods as fabrics, medicines, fertilizers, footwear, constructions from iron and steel, etc. Imports, excluding petroleum products, decreased by 0.7 percent compared to Q2 2016 amounted to USD 898.5 million.

In the reporting period, the net inflow of current transfers was formed above the level of the same period in 2016 by 23.5 percent. Recovery of the Russian economy and

¹ According to the preliminary and forecasted data, including additional estimates of the National Bank of the Kyrgyz Republic. Period of comparison is the quarter to the corresponding quarter of the previous year.

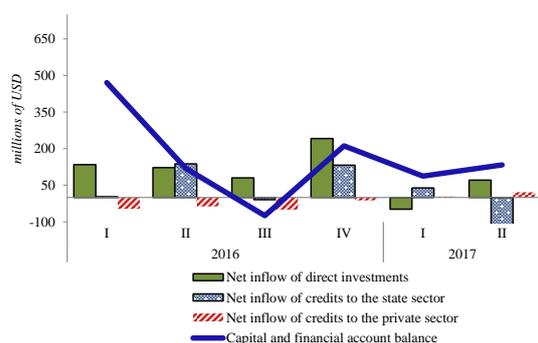
² The data are given taking into account the NSC KR additional estimates for agricultural products (till 2017) and mutual trade with the EAEU member states (since Q3 2015) and the estimates of the NBKR.

improvement of working conditions for migrant workers in Russia contributed to the positive dynamics of the net inflow of private transfers, which constituted USD 586.8 million.

Other components of the current account also formed with a negative balance. Thus, the balance of services deficit decreased compared to the same period of 2016, however, the deficit of “income” item increased up to 71.4 percent.

According to the preliminary and forecasted estimates of the National Bank of the Kyrgyz Republic, the capital inflow on the capital and financial accounts excessively covered decreased current account deficit in Q2 2017. The positive balance of the capital account formed in the amount of USD 27.9 million, the balance of the financial account formed in the amount of USD 103.4 million.

Chart 2.2.2. Capital and Financial Account



Net inflow of direct investments to the country is forecasted at the level below the level of the same period of the last year. In the reporting quarter, the balance of “other investments” item will be formed positive to make USD 32.8 million conditioned by the growth of the foreign liabilities of the residents due to the increase of credits attracted by the state and private sector. Along with that, the foreign assets of the residents are expected to increase compared to the same period of 2016. The trend of the increase in payments of the principal amount on the

credits previously attracted by the state and private sector was still observed. Therefore, at the end of Q2 2017 balance of payments of the Kyrgyz Republic was formed with a positive balance of USD 68.0 million. Gross international reserves covered 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 the beginning of the year (as of the end of month)		*
	2015 (aver.) (January-December)	2016 (aver.) (January-December)		December 2016	June 2017	
REER	115,7	113,5	-2,0	112,9	110,2	-2,4
NEER	108,9	112,3	3,0	112,1	108,5	-3,2
RBER to CNY	84,7	80,8	-4,6	85,8	87,6	2,0
NBER to CNY	66,4	64,5	-3,0	67,9	67,7	-0,2
RBER to Euro	116,6	107,2	-8,0	113,3	110,9	-2,2
NBER to Euro	85,5	78,8	-7,9	83,4	79,6	-4,6
RBER to KZT	112,1	141,7	26,4	136,7	129,6	-5,3
NBER to KZT	105,9	152,1	43,6	150,3	144,5	-3,8
RBER to RUR	138,2	131,4	-4,9	122,8	114,9	-6,4
NBER to RUR	142,8	144,8	1,5	136,7	127,4	-6,8
RBER to USD	96,0	87,2	-9,1	88,5	90,7	2,5
NBER to USD	71,7	65,7	-8,3	66,4	67,2	1,3

* preliminary data
 ↓ - Som devaluation, competitiveness improvement
 ↑ - Som strengthening, competitiveness deterioration

4.6 percent, the Kazakh tenge – by 3.8 percent.

Despite lower level of inflation in the trading partner countries², the decrease in the NEER index caused decline in the index of real effective exchange rate (REER) by 2.4 percent, which amounted to 110.2 at the end of June 2017.

At the end of Q2 2017, the index of nominal and real effective exchange rate decreased compared to December 2016. According to the preliminary data, the index of nominal effective exchange rate (NEER) of KGS decreased by 3.2 percent from the beginning of 2017 and amounted to 108.5 by the end of June 2017. The decrease in the NEER index was due to KGS devaluation¹ in June 2017 compared to the average exchange rate for December 2016 against: the Russian ruble – by 6.8 percent, the euro – by

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 In Q2 2017, the inflation in the Kyrgyz Republic formed at the level of 2.7 percent, whereas an average inflation rate in the major trading partner countries made 1.9 percent according to the preliminary calculations.

Chapter 3. Monetary Policy

3.1. Monetary Policy Implementation

Since the beginning of 2017, dynamics of the inflation rate was characterized by the upward trend and was within the values expected by the National Bank. Taking into account the actual and forecasted dynamics of the inflation rate for the medium term, the conditions for carrying out the monetary policy were retained during Q2 2017.

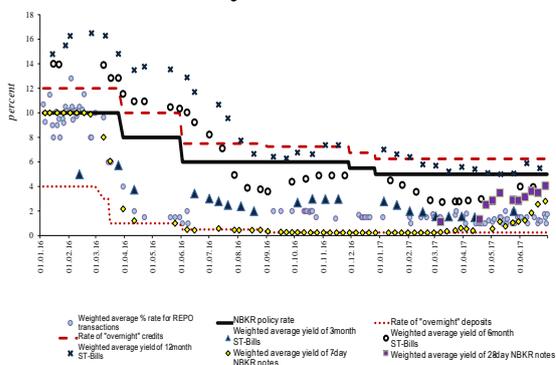
Generally, the situation in the banking system was characterized by retaining high level of excess liquidity; the dynamics thereof was characterized by the slight downward trend by the end of the reporting quarter. In this respect, gradual increase in the activity of the market participants was observed in the inter-bank credit resource market during the reporting quarter. The rates of the money market varied within interest rate corridor set by the National Bank.

Taking into account forecasted dynamics of the inflation rate for the medium term, as well as in order to maintain positive rates of economic growth, in Q2 2017, the National Bank increased the volumes of operations on refinancing of the banks.

Interest Rate Policy of the National Bank

During Q2 2017, the National Bank, taking into account expected dynamics of the inflation rate, continued conducting the policy of monetary easing aimed at maintaining economic growth by keeping it unchanged. In the reporting period, the National Bank's policy rate remained at the level of 5.00 percent. The rates of the interest rate corridor also remained unchanged: the upper level of the interest rate corridor (the rate on “overnight” credits) – 6.25 percent, the lower level (the rate on “overnight” deposits) – 0.25 percent.

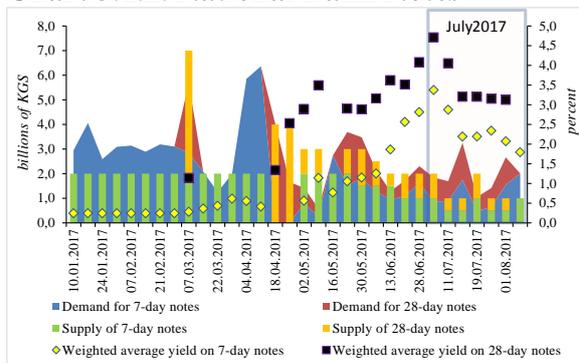
Chart 3.1.1. Money Market Rates



The short-term interest rates of the money market varied within the interest rate corridor set by the National Bank due to monetary easing conditions maintained by the National Bank. However, the rates of the money market were characterized by slight volatility and had a tendency of approaching the policy rate.

In Q2 2017, the weighted average interest rates on all short-term instruments were formed below the policy rate set by the National Bank, except for the yield on the 12-month ST-Bills, which made approximately 5.35 percent for the quarter. The yield of the National Bank notes was the most volatile in the money market due to additional placement of the National Bank notes with the maturity of 28 days. In the reporting quarter, the weighted average yield on 28-day notes made approximately 2.71 percent (in Q1 2017 – 1.14 percent), on 7-day notes – 1.16 percent (in Q1 2017 – 0.30 percent).

Chart 3.1.2. National Bank Notes



Note: shaded area refers to Q3 2017

Measures taken by the National Bank to smooth the conditions of the monetary policy result in long-lasting decline of interest rates on the commercial banks' credits. In Q2,

the weighted average interest rates on the new credits of the commercial banks decreased by 1.02 percentage points compared to Q1 of the reporting quarter and made approximately 16.25 percent.

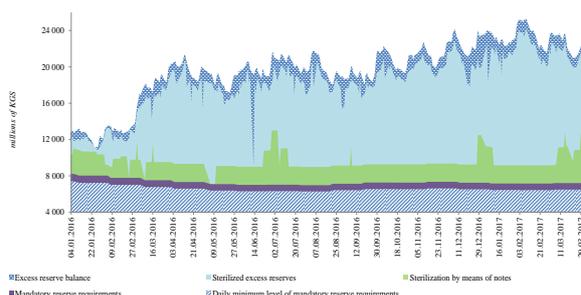
Moreover, the decrease was observed on the rates of the commercial banks' deposits, primarily, on the demand and fixed-term deposits. The weighted average interest rates on the fixed-term deposits in the national currency declined by 0.13 percentage points during the quarter and amounted to 9.54 percent at the end of the reporting quarter, the rates of the demand deposits decreased by 0.18 percentage points, down to 1.83 percent.

Situation with Liquidity of the Commercial Banks

In Q2 2017, the average daily volume of the commercial banks' excess liquidity prior to the operations on sterilization conducted by the National Bank amounted to KGS 14.5 billion, having decreased by KGS 1.5 billion compared to Q1 2017, however, having increased by KGS 2.2 billion compared to the same period of 2016. Meanwhile, excess liquidity of the commercial banks decreased by the end of the quarter primarily in the last decade of June, when the average daily volume of excess liquidity made KGS 13.1 billion.

Amid existing excess liquidity in the banking system the National Bank conducted operations on absorbing excess liquidity through the auctions of the National Bank notes and placement by the commercial banks of their available funds on "overnight" deposits with the National Bank.

Chart 3.1.3. Excess Reserves of the Commercial Banks



In Q2 2017, the volume of excess liquidity absorbed on a daily basis decreased by KGS 1.4 billion compared to the previous reporting period and reached KGS 13.1 billion. Meanwhile, in the reporting period absorbed excess liquidity increased due to the notes of the National Bank. In Q1 of the current year KGS 2.7 billion were absorbed by means of the notes, while, in Q2, the average daily level of excess liquidity withdrawal by means of the National Bank

notes made KGS 4.3 billion.

Credit Policy of the National Bank

In the reporting period, in order to expand lending to the real sector of economy and to maintain positive economic growth the National Bank increased the volumes of provided credit resources: the economy was provided with the credit resources in the total amount of KGS 4.2 billion, KGS 4.1 billion were provided to the commercial banks within the credit auctions. Moreover, the credit in the amount of KGS 23.0 million was issued to the international organizations established by the Kyrgyz Republic jointly with other states within the EAEU.

Foreign Exchange Policy of the National Bank

The situation in the domestic foreign exchange market was relatively stable. Slight strengthening of the national currency was observed at the beginning of the quarter; afterwards the exchange rate of the Kyrgyz Som became equal to the average values of the previous quarter. In the reporting period, amid slight exceeding of supply of foreign currency over its demand, the National Bank participated in the domestic foreign exchange market as a purchaser of foreign currency in order to smooth sharp fluctuations of the exchange rate, the

volume of purchase amounted to USD 16.2 million. Generally, during the quarter, the exchange rate decreased by 0.5 percent.

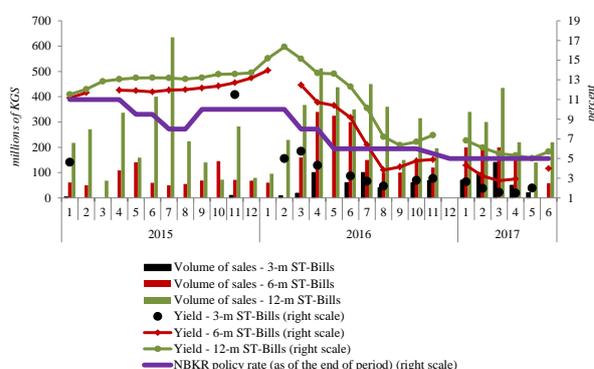
Monetary Policy Measures in Q2 2017

<p>The decisions were made on the size of the National Bank policy rate</p>	<p>The Board of the National Bank twice considered the issue on the size of the policy rate of the National Bank – on May 29 and June 27, 2017. Finally, the decisions were made to keep the policy rate unchanged at 5.00 percent.</p> <p>The rates of the interest rate corridor remained unchanged: the interest rate on “overnight” credits was 6.25 percent, the interest rate on “overnight” deposits - 0.25 percent.</p>
<p>The decisions to conduct the credit auctions were made</p>	<p>The National Bank announced credit auctions ten times for the purposes of the banks refinancing. Five auctions were held out of announced ten ones. The total volume of supply for the credit resources amounted to KGS 15.0 billion, the demand from the commercial banks amounted to KGS 4.5 billion.</p> <p>In the reporting period, the commercial banks were provided credits to the amount of KGS 4.1 billion. The weighted average interest rate on these credits made 5.02 percent.</p>
<p>The National Bank issued credits to the international organizations established by the Kyrgyz Republic jointly with other states within the framework of the Eurasian Economic Union</p>	<p>The volume of credit resources amounted to KGS 23.0 million.</p>

3.2. Financial Market Instruments

Government Securities Market

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



ST-Bills

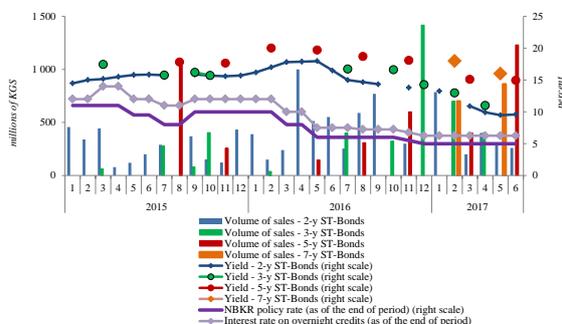
In Q2 2017, yield downward trend was still observed in the primary government securities market, approaching the lower boundary of the interest rate corridor.

In Q2 2017, the demand for 3-and 6-month ST-Bills decreased compared to the same period of 2016. Thus, as a result of auctions the total volume of placement decreased by 64.6 percent, to make KGS 858.5 million.

The activity of participants at the auctions also decreased during the reporting period. Generally, the number of participants decreased from 17 down to 10 participants.

The high level of excess reserves in the banking system contributed to gradual decrease of ST-Bills yield of any maturity. Thus, the overall weighted average yield of ST-Bills declined by 6.7 percentage points down to 4.3 percent compared to the same period of 2016.

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

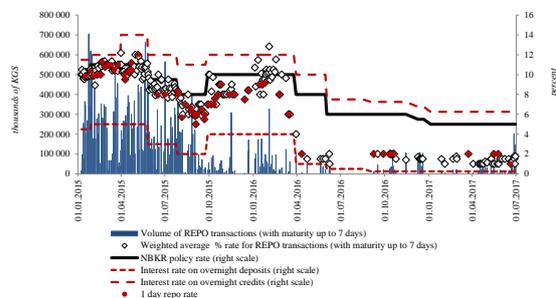


amount of announced emission due to additional placements; the volume thereof amounted to KGS 860.0 million in the period under review.

Generally, the number of participants increased insignificantly from 11 to 13.

Inter-Bank Credit Resource Market

Chart 3.2.3. Dynamics of Rates and Volume of Repo Transactions in the Inter-Bank Credit Resource Market



than 7 days). The average maturity of the transactions in the national currency was 63 days (during the period under review, the transactions maturity varied from 7 to 201 days).

Meanwhile, in general, the market capacity did not change significantly compared to Q2 2016. Thus, the total volume of credits in the national currency issued under standard conditions in the domestic inter-bank credit resource market amounted to KGS 176.0 million (-20.0 percent).

The market rates also decreased, having approached the lower boundary of the interest rate corridor set by the National Bank, amid low demand for credit resources. Thus, in Q2 2017, an average rate on credits in the national currency amounted 3.1 percent (-4.7 percentage points), on REPO transactions – 1.5 percent (-0.1 percentage points).

ST-Bonds

Gradual decrease of yield was observed in the ST-Bonds market.

In Q2 2017, the volumes of ST-Bonds¹ placements continued increasing (including additional placements) (by 56.1 percent, up to KGS 3.5 billion) with gradual decline in the yield on all maturities due to excess of demand for ST-Bonds over supply thereof. In the reporting period, the total weighted average yield was formed at the level of 12.9 percent (-4.7 percentage points).

The sales volumes exceeded the

Slight recovery in the activity of this market segment was observed since the end of 2016 amid easing monetary policy.

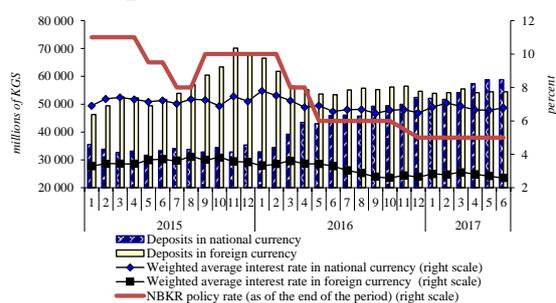
Since the end of 2016, the activity on the REPO transactions increased again and the volume of placements on these credits increased by 41.8 percent, to make KGS 1.6 billion compared to Q2 2016.

During the period under review, the REPO transactions in the inter-bank credit resource market were mainly short-term, with an average maturity of 7 days during the quarter (including the transactions of more

¹ Within the limits of the Government Debt Management Strategy for 2016-2018.

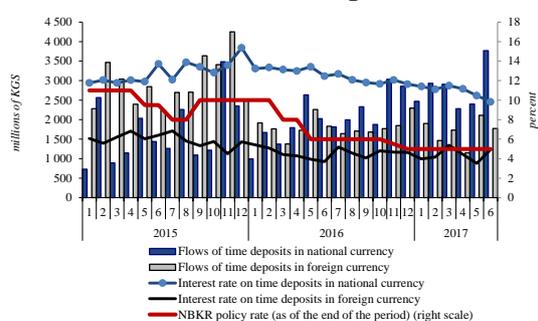
Deposit Market

Chart 3.2.4. Dynamics of Commercial Banks Deposits



54.5 billion. Dollarization of the deposits (adjusted taking into account the policy rate at the beginning of the year) decreased by 5.2 percentage points year-to-date, to make 48.1 percent.

Chart 3.2.5. Dynamics of Commercial Banks' Time Deposits Flows



Meanwhile, the interest rates on the fixed-term deposits in the national currency continued the downward trend. In the reporting period, an average weighted interest rate on the fixed-term deposits in the national currency made 10.48 percent (-2.47 percentage points) due to a decrease of all rates by maturity, excluding the deposits of up to one month. Thus, in Q2, duration on the flows of the fixed-term deposits in the national currency increased by 0.2 months, up to 1.6 months compared to the same period of 2016. The weighted average interest rate on the fixed-term deposits in foreign currency constituted 4.30 percent (+0.32 percentage points) due to the increase of the rates on the deposits from 3 to 6 months. In the reporting period, duration on the flows of the fixed-term deposits in foreign currency amounted to 1.4 months (-0.2 months).

In Q2 2017, the upward trend of the deposit base with prevailing inflow of the deposits in the national currency was still observed in the deposit market.

At the end of the reporting period, the volume of the commercial banks' deposit base increased by 5.8 percent year-to-date to make KGS 113.3 billion due to increase of the deposits in the national currency by 12.2 percent up to KGS 58.8 billion. The deposits in foreign currency on the contrary decreased by 0.4 percent down to KGS

Flows of the deposits in the national currency exceeded those in foreign currency by 39.0 percent and amounted to KGS 72.8 billion; meanwhile, the deposits in foreign currency made KGS 52.4 billion.

In Q2 2017, an average weighted interest rate on new deposits in the national currency made 2.71 percent (+0.09 percentage points against the same period of 2016), this rate on the deposits in foreign currency made 0.59 percent (-0.05 percentage points).

Meanwhile, the interest rates on the fixed-

Credit Market

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

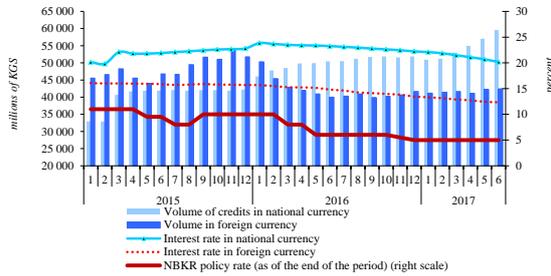
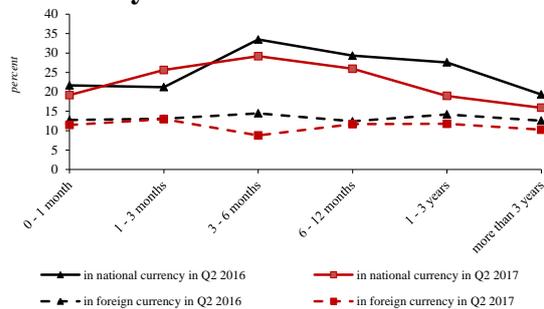


Chart 3.2.7. Rates of New Credits in National and Foreign Currency in Terms of Maturity



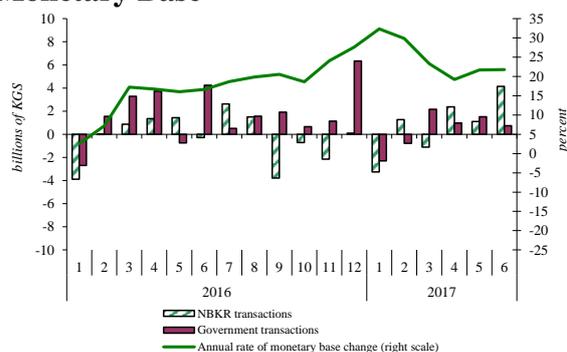
portfolio. In Q2 2017, the volume of new credits in the national currency increased by 4.5 percent compared to the same indicator of 2016 and amounted to KGS 19.9 billion and those in foreign currency made KGS 9.8 billion (+7.2 percent).

The weighted average interest rate for new credits in the national currency decreased by 7.14 percentage points compared to the same indicator of 2016, to make 19.22 percent, this rate in foreign currency decreased by 2.68 percentage points down to 10.21 percent.

In the reporting period, there was slight improvement in the quality of the credit portfolio. Thus, the share of overdue credits in the credit portfolio constituted 2.6 percent late in the reporting period (-0.3 percentage points year-to-date), while the share of prolonged credits decreased by 0.5 percentage points year-to-date to make 4.4 percent.

3.3. Dynamics of Monetary Indicators

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



Build-up of the credit portfolio with significant increase in the volume of credits in the national currency in respect of the balances and the flows was observed amid growth of the deposits in the banking system. The interest rates on the new credits decreased in all sectors amid growth of lending in the national currency.

At the end of the reporting period, the volume of credit portfolio of the commercial banks increased by 9.0 percent year-to-date and amounted to KGS 102.0 billion due to the growth in the national currency by 14.8 percent, to make KGS 59.6 billion. The volume of the credit portfolio in foreign currency increased by 1.8 percent year-to-date and amounted to KGS 42.4 billion. Dollarization of the credits decreased by 2.9 percentage points year-to-date to make 41.6 percent at the end of the reporting period.

The flows of the credits issued in the national and in foreign currency increased amid increasing deposit base and credit

Monetary Base

In Q2 2017, the annual growth rates of the monetary base were rather high (approximately at the level of 20.9 percent), having increased by 4.4 percentage points against the values of the previous year. In Q2 of the current year, monetary base increased due to the operations of the Government of the Kyrgyz Republic and the National Bank. Among the operations of the Government of the Kyrgyz Republic, the monetary base increase was affected by the excess of the Government expenditures over

its revenues. In Q2 2017, monetary base increased by 13.3 percent, meanwhile, the contribution of the Government operations to the growth of monetary base made +4.0 percentage points (KGS 3.2 billion), the contribution of the National Bank operations made +9.3 percentage points (KGS 7.6 billion). In June, the annual growth of monetary base made 21.8 percent.

The structure of monetary base did not change significantly. In the reporting period, the share of reserves of other deposit corporations made 10.3 percent, meanwhile, the share of money in circulation was 89.7 percent (at the end of Q1 2017 - 11.0 percent and 89.0 percent respectively).

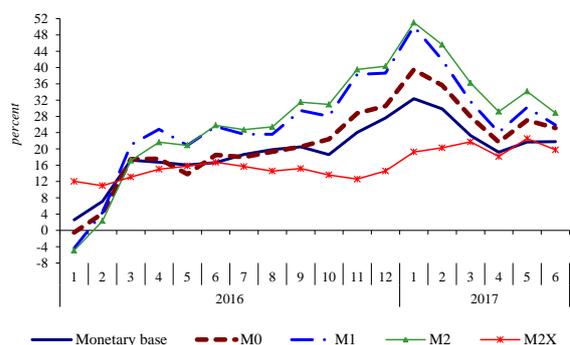
Monetary Aggregates

Generally, in the reporting quarter, all monetary aggregates continued the upward trend, which was primarily determined by an increase of cash outside banks. The annual growth rates of monetary aggregates also exceeded the values of the previous year.

In the reporting quarter, money outside banks increased by 13.2 percent, meanwhile, this indicator decreased by 2.4 percent in the previous quarter. During the period under review, the monetary aggregate (M1) increased by 12.6 percent. This aggregate changed due to the increase of money outside banks as well as the increase of transferable deposits in the national currency by 11.1 percent.

Chart 3.3.2. Nominal Growth Rates of Monetary Aggregates

(in annual terms)



In Q2, monetary aggregate M2 increased by 10.5 percent. Meanwhile, monetary aggregate M2X demonstrated the first growth among monetary aggregates, having increased by 6.6 percent during the quarter to make KGS 175.8 billion at the end of June 2017. In June 2017, the annual growth rates of monetary aggregates exceeded the values of the previous year and made as follows: monetary aggregate M1 – 25.9 percent, M2 – 28.8 percent, M2X – 19.8 percent.

In the reporting quarter, the total volume of credits to the economy¹ increased by 7.9 percent and amounted to KGS 104.1 billion at the end of period, primarily due to the growth of credits in the national currency by 12.4 percent (contribution to growth +7.03 percentage points), credits in foreign currency increased by 2.1 percent (contribution +0.92 percentage points). The annual growth of credits to the economy made 12.7 percent, excluding the exchange rate changes this indicator increased by 11.9 percent during the year.

¹ Credits of individuals, legal entities and other financial institutions, excluding credits of the Government of the Kyrgyz Republic and non-residents.

Chapter 4. Inflation Dynamics

In Q2, the inflation rate was at the level of approximately 4 percent. Since 2016, the core components of inflation started decreasing gradually from 7-8 percent and stopped at the level of 4-5 percent in the period under review. Food inflation was on the contrary in the negative zone since Q4 2015 and increased up to 4.7 percent in the reporting period. Growth rates in prices for major commodity groups inside these categories were divergent due to different dynamics in supply of certain goods.

4.1. Consumer Price Index

Chart 4.1.1. Dynamics of CPI Structure

(quarter to the corresponding quarter of the previous year)

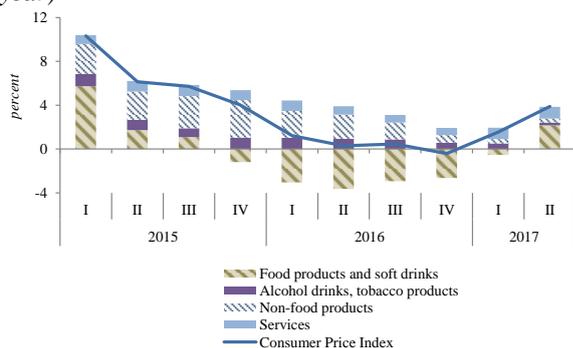


Chart 4.1.2. Dynamics of Food Prices' Contribution to Annual CPI

(month to the corresp. month of the previous year)

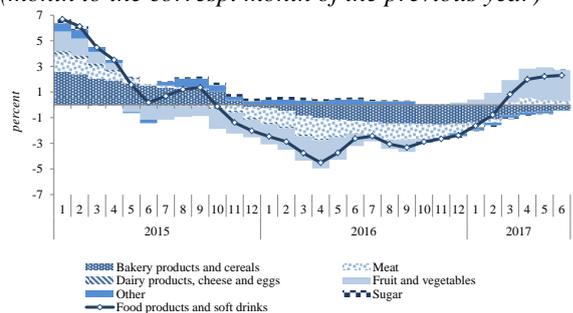
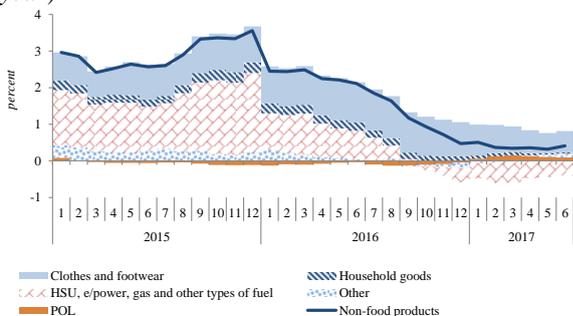


Chart 4.1.3. Dynamics of Non-Food Prices' Contribution to Annual CPI

(month to the corresponding month of the previous year)



Upon rise in Q1, the inflation rate was at the level of approximately 4 percent in Q2 2017. Annual CPI growth amounted to 4.1 percent in June, the average value was 3.9 percent in Q2. Slowdown was observed in the core components of the inflation.

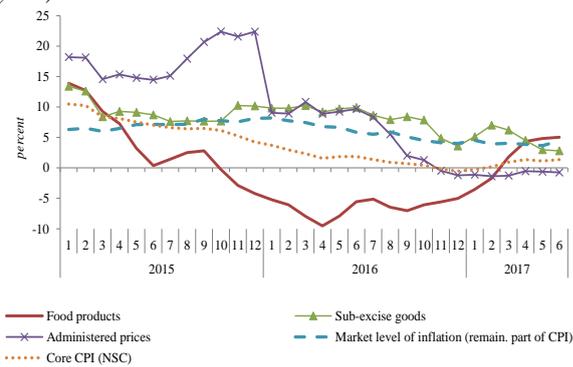
Food inflation increased since the beginning of the year and stood at 4.7 percent in Q2, meanwhile, rise in prices inside this group was not identical. Rise in prices for fruits and vegetables had significant upward impact on the inflation rate, on the one hand, this was conditioned by the effect of low base of the previous year, on the other hand, by inflationary change in the balance of demand and supply in Q2 of the current year. The annual rise in prices for vegetables of the new harvest started decreasing upon delivery thereof in the markets. The effect of high production of grains in the trading partner countries and in the world during the previous year remained: prices for bakery products and cereals were below the value of the corresponding period in the previous year. Increase in prices for meat and dairy products was not high due to remaining positive dynamics in the livestock industry of Kyrgyzstan.

In Q2, non-food inflation remained at the low level and amounted to 1.2 percent. Weak inflationary pressure was wide-ranging: rise in prices in all major groups was not high compared with the average values during the last years. Besides fundamental factors, such as weak demand, decrease of inflationary expectations and steady exchange rate of the main foreign currencies, existing effect of high coal supply in autumn and winter of 2016-2017 and zero rise in tariffs for electricity in 2017 had a restraining impact of the inflation rate in this group.

The prices for tobacco products increased significantly due to the rise in excise

Chart 4.1.4. Dynamics of Consumer Price Index by Groups of Commodities

(month to the corresponding month of the previous year)



duties at the beginning of the year.

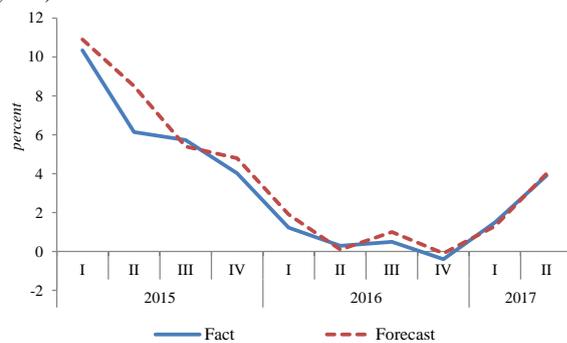
In Q2 of the current year, the prices for paid services rose by 7.1 percent; this rise was primarily supported by the increase in tariffs for communication services.

In Q2 2017, core inflation index calculated by the NSC KR amounted to 1.3 percent, having increased from 0.3 percent in Q1.

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)



Difference between actual inflation rate and the forecasted level was insignificant. According to the National Bank forecasts, in Q2 2017, the inflation rate was expected at the level of 4.0 percent, meanwhile, the actual inflation rate was 3.9 percent. Seasonal decrease in prices for fruit and vegetables started later compared to expectations, such situation had upward impact on the actual inflation rate against forecasts. On the other hand, it was compensated by the impact of weak demand on prices.

Chapter 5. Medium-Term Forecast

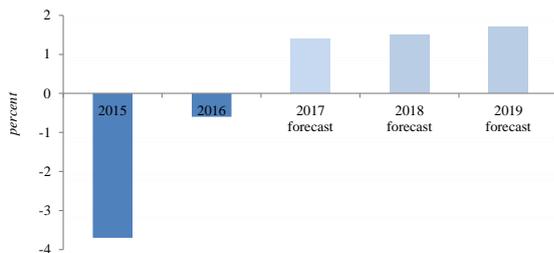
5.1. External Environment Proposals

5.1.1. Development Forecast of Major Trading Partner Countries

Russia

Chart 5.1.1.1. Real GDP Growth in Russia

(year to year)



Source: IA Bloomberg

Forecast for economic growth in Russia was slightly adjusted upwards: GDP growth rate is expected at the level of 1.4 percent. More stable prices for oil and improvement of financial conditions will contribute to economic growth. Recovery in consumer demand amid forecasted increase in real salaries and incomes of the population is expected to give a significant support to GDP growth in the country. Gradual easing of monetary policy and strengthening investors' confidence will have a positive impact on the

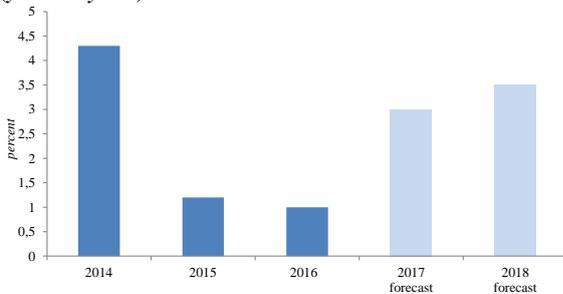
dynamics of investment in fixed assets.

Despite the fact that CPI growth in June was formed above the expectations of the Bank of Russia, low rates of price growth in Q1 and deflation forecasted in August enable the Bank of Russia to keep forecasting inflation rate at the level of 4.0 percent in 2017.

Kazakhstan

Chart 5.1.1.2. Real GDP Growth in Kazakhstan

(year to year)



Source: IA Bloomberg, international financial institutions

Forecasts for economic growth in Kazakhstan in 2017-2018 improved due to higher than anticipated actual data for the first half of 2017. Economic growth in the country was adjusted up to 3.0 percent in 2017 (instead of the previously expected 2.6 percent), in 2018 – up to 3.5 percent (previously 3.0 percent were expected). In the second half of 2017, according to the head of the Ministry of the National Economy of the Republic of Kazakhstan, the economy of Kazakhstan will develop under the conditions of uncertain

external factors and exhausted impact of the low base effect on economic growth in the corresponding period of 2016. However, economic growth in Kazakhstan in 2017-2018 will be ensured by increasing domestic consumption amid growth in real salaries, capital investment in the framework of implementation of Government programs for economy support and diversification, extraction and production of mineral resources. Meanwhile, the increase in imports of consumer and investment goods as a result of increased internal demand will be a restraining factor for GDP growth.

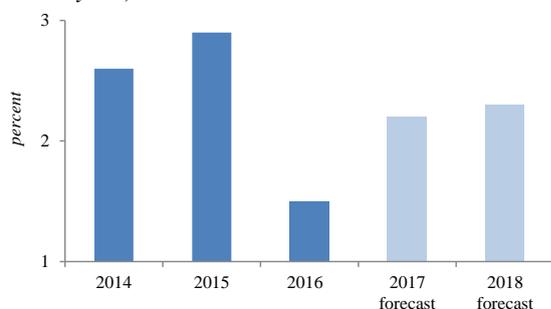
In 2017, the trend of the inflation rate slowdown is forecasted with absence of adverse price shocks, as well as due to higher base in 2016 it is expected that the inflation rate will be within the range of 6.0-8.0 percent and by the end of 2017 the average annual inflation rate will

be approximately 7.5 percent. In 2018, the inflation rate is expected to begin its smooth entry into the target corridor of 5-7 percent.

USA

Chart 5.1.1.3. Real GDP Growth in the USA

(year to year)



Source: IA Bloomberg

Economic growth in the USA is forecasted to be moderate in the medium term. Growth forecast for 2017 remained at the level of 2.2 percent; forecast for 2018 was reduced down to 2.3 percent, as according to experts, the likelihood of implementation of the plans of the government authorities of the country for fiscal expansion, are lower compared to previous forecasts. The economic policy of the United States represents uncertainty in respect of GDP growth prospects and depending on the policy, GDP growth rates may be above and below the forecast. Improvement of the situation on the labor

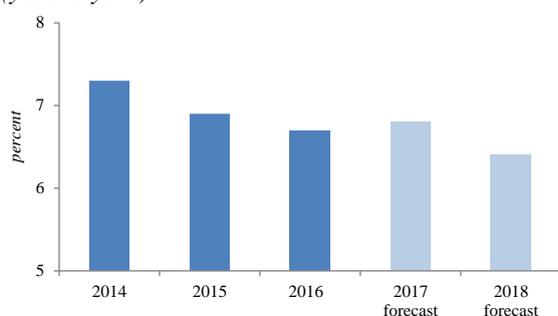
market will support private consumption.

Analytical institutions suggest that emerging trend of economic slowdown will be temporary and the inflation rate in the United States will be slightly above two percent in the medium term.

China

Chart 5.1.1.4. Real GDP Growth in China

(year to year)



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

Despite improved forecasts, slowdown of the economic growth will continue in China in the medium term. Taking into account significant growth of economy in the first half of the year, think tanks revised upwards forecasts for GDP growth in China. In 2017, GDP growth is expected at the level of 6.8 percent, which is higher than 6.7 percent in 2016; in 2018, GDP growth is expected at the level of 6.4 percent. The trend of economic slowdown in China accompanies the reforms of the country's authorities in order to move towards more sustainable development model based on domestic consumption. Regulatory measures to

reduce financial risks and eliminate imbalances in the economy also contribute to slowdown in economic growth

According to analysts, lower than anticipated inflation rate in the first half of 2017 will be temporary, and over the next quarters, inflation rate is expected to recover up to about two percent. At the end of 2017, the average annual inflation rate will amount to 1.7 percent, and in 2018, it will be at the level of about 2.2 percent

5.2. Medium-Term Forecast

Assumptions about development of the external environment and internal conditions in Q2 2017 to the greatest extent were consistent with the baseline scenario, approved at a meeting of the Board of the National Bank held in May 2017.

Thus, significant changes were not observed in the petroleum products market and the average price fluctuated at the level above USD 50 per one barrel. According to the estimates the situation in the energy carriers market will remain stable in the coming years; meanwhile, taking into account slight downward trend in the world prices for oil, forecasts for average price for oil in 2017 was slightly adjusted downwards from USD 54 to USD 51 per barrel.

Generally, in Q2 2017, dynamics of the world food markets remained stable, in April-June of the current year, FAO index of the food products increased from 170 to 175 points, however, it remained within the fluctuation range since the beginning of the current year.

Growth of optimism in respect of economic activity recovery in the trading partner countries of Kyrgyzstan allowed adjusting towards improvement the forecasts for economic development in these countries. Expectations of increased inflow of remittances in the medium term remain in such situation.

Taking into account stable development of the world economy and lack of shocks in the world commodity markets, generally, external parameters of macroeconomic forecast remained unchanged. Under the conditions of economy of Kyrgyzstan the external sector parameters are the key assumptions in developed forecasts. Parameters of the external sector are set on the basis of forecasts made by the world research agencies/institutes, official organs of the countries, expert evaluations.

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

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

In 2017, the baseline scenario assumes the continuation of current trends in the world commodity market in the short term and commencement of the upward trend in prices in 2018. In 2017, the average price for Brent crude oil grade will make approximately 51 USD per barrel.

In 2017, the food markets (FAO index) will remain stable and will continue its sideways movement. In 2018, prices for food products will remain stable; however inflationary potential of the food market will increase compared with the current year. In 2017, the average of the FAO index will make approximately 177.0 points, in 2018, FAO index is expected at the level of 182.0 points. Taking into account the ratio of supply and demand in the grains market and the current forecasts for yield in 2017-2018 marketing year, prices in the world grains market are expected to grow; meanwhile, the general situation in the market will remain stable.

In 2017, despite existing structural constraints and strengthened sanctions pressure, the Russian economy will move into an area of growth, which at the end of the year will amount to 1.4 percent. The inflation rate will continue slowing down and its average value for the year will make 4.0 percent in the absence of external shocks. In 2017, GDP is expected to increase by approximately 3.0 percent in Kazakhstan and the annual average inflation rate is expected to slow down gradually to 7.5 percent.

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

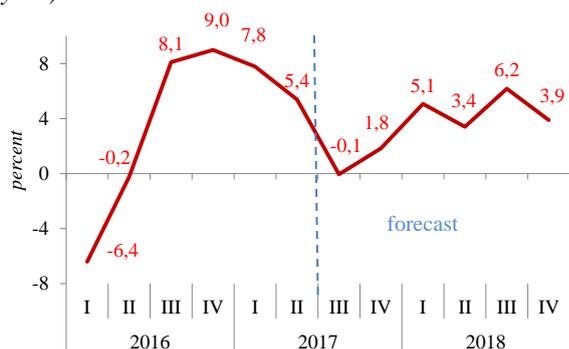
Uncertainty in the fiscal policy is still observed in the medium term. The Draft Law “On the republican budget for 2017 and forecast for 2018-2019” stipulates gradual fiscal consolidation.

Taking into account the assessments of the external environment and the internal conditions development in 2017 in the medium term, the inflation rate will focus on the lower border of target within the range of 5-7 percent. Gradual recovery in prices for food products and energy carriers in the world and in the region, as well as growth of the aggregate demand are expected to be the main drivers of inflation rate. In addition, the inflationary inertia will still be supported by measures of the fiscal policy, increased incomes of the population, including by means of growing money transfers and relatively stable inflation expectations of the population.

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

Chart 5.2.1. Forecast of Real GDP

(quarter to the corresponding quarter of the previous year)



approximately 5.1 percent.

Baseline inflation in the medium term will reach the low level of the target range of 5-7 percent. At the end of 2017, the inflation rate (period to period) will reach 3.4 percent (Dec 2017/Dec. 2016 – approximately 5.0 percent). In 2018, the average inflation value will be about 5.3 percent.

Chart 5.2.2. Inflation Forecast

(quarter to the corresponding quarter of the previous year)



According to the results of 2017, the real GDP growth will amount to 3.1 percent; the growth excluding the enterprises of the Kumtor Mine will be approximately 3.7 percent. The increase in production at the enterprises of the Kumtor Mine is expected at the level of production output in 2016. In the sectoral aspect, the economic growth will be supported by the sectors of agriculture (due to livestock and crop production), trade and construction.

In 2018, the real GDP growth rate will make approximately 4.6 percent, excluding Kumtor, the growth will amount to

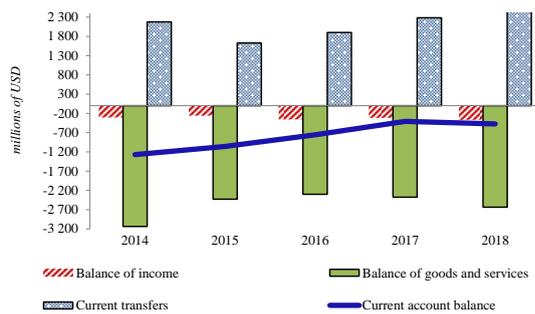
Within the framework of current forecast session we retained expectations for reversal of the downward inflation trend. Taking into account growth of the inflationary pressure from increasing aggregate demand and expectation of slight rise in prices in the world commodity markets, price movement in the medium term demonstrates growth and will focus on the target inflation values (5-7 percent).

Forecast for the Balance of Payments in 2017-2018¹

Dynamics of the balance of payments indices for the actual period and change in the forecast for gold mining had impact on revision of indices on the external sector for 2017 compared to the previous forecast. The current account is expected to decrease down to 5.8 percent to GDP. This trend will be determined by the outrunning exports growth against imports, as well as by the growth in inflow of the migrant workers' remittances.

¹ The forecast was made taking into account additional estimates of the National Bank of the Kyrgyz Republic.

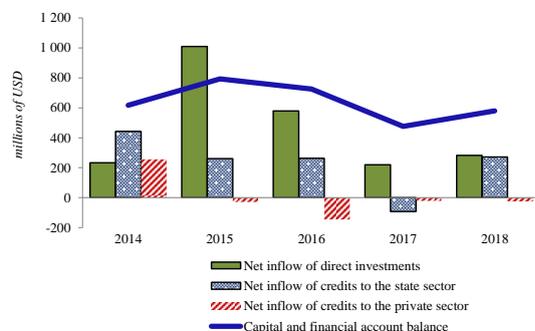
Chart 5.2.3. Forecast Data on Current Account
(millions of USD)



of imports in the country; growth thereof is expected at the level of 5.1 percent. Forecast for imports excluding energy products is expected at the level of 4.6 percent. Expected retaining of the world prices for petroleum products will be higher than the level of 2016 due to prolongation of the agreement on restriction of oil production between OPEC and non-OPEC states and will result in growth in the value of petroleum products.

Growth in the net inflow of private transfers within the actual period will be higher against expectations therefore forecasted growth of indicator in 2017 was increased up to 20.1 percent. This trend will be determined by the rehabilitation of the economic growth in Russia and Kazakhstan, by the stability in their foreign exchange market and by the increase in the quality of migrant workers labor conditions in the host country, therefore remittances to the country are expected to increase.

Chart 5.2.4. Forecast Data on Capital and Financial Account
(millions of USD)



payments on previously attracted credits and the increase in the inflow of new credits.

Thus, the forecasted level of the current account deficit, financing thereof through the capital inflows on the capital and financial account and expected level of the international reserve assets will condition formation of the positive balance of payments in the amount of USD 101.5 million. Meanwhile, international reserve assets² are expected to cover 4.2 months of the future imports of goods and services.

Expectations that development of the economic situation in 2017 will provide favorable conditions for sustainable economic rehabilitation in 2018 still exist. However, revised forecasts for balance of payments indices in 2017 had adjusting impact on the

According to the last press release published by Centerra Gold Company, forecast for gold mining in 2017 was revised, therefore the National Bank adjusted upwards forecast for exports up to 7.7 percent. Increase in the exports is expected at the level of 17.0 percent under the influence of recovering external demand for the domestic products, as well as the gradual adaptation to the conditions of trade within the EAEU (including removing non-tariff barriers).

Recovery in the internal demand will have a significant influence on the dynamics

In 2017, capital inflows on the capital and financial account are expected to be lower than the level of 2016. The amount of the one-time write-off of the Kyrgyz Republic debt to the Russian Federation in the amount of USD 240.0 million will impact the dynamics of the account indices in 2017. Capital inflows on the financial account are primarily expected on the item “direct investment”. Balance on the item “other investment” will be formed negative primarily under the influence of reduction in the foreign obligations of the public sector due to writing-off the Russian credit. The net outflow on the private sector credits is expected to decrease compared to 2016 due to reduced

² In accordance with the IMF methodology, only assets in convertible currencies (US dollar, euro, pound sterling, Japanese yen, Swiss franc, Australian dollar and Canadian dollar) are included in the international reserve assets.

trend for development of the external sector in 2018. Existing positive dynamics of current transfers, smaller growth in imports and exports compared to the previous forecasts will result in formation of the current account at a rate of 6.4 percent to GDP. Adaptation of the Kyrgyz Republic to the business conditions within the framework of the EAEU and existing growth trend in the internal demand will impact formation of foreign trade indices. Thus, more significant growth of imports against exports will determine increase of the trade balance deficit by 11.6 percent.

Progressive recovery of the economies in Russia and Kazakhstan, provided that their national currencies remain stable, will have a positive impact on the inflows of private transfers, the growth rate thereof will be at the level of 10.5 percent. Capital inflow on the capital and financial account is expected to increase, 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 and private sector. Meanwhile, the upward trend in servicing previously borrowed loans is still observed. General balance of payments in 2018 is expected to be positive in the amount of USD 104.3 million. International reserve assets will cover 4.0 months of the future imports of goods and services.

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

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

Annex 1. Key Macroeconomic Indicators

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

		2015				2016				2017	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
1. Demand and supply/1											
<i>(real growth rates, if otherwise is not indicated)</i>											
Nominal GDP, per quarter	<i>mln. KGS</i>	80 709,7	92 915,4	120 251,0	129 759,4	78 799,0	97 238,1	134 046,1	142 595,8	86 143,1	107 752,2
GDP	%	6,3	7,3	4,6	-1,5	-4,9	0,0	8,3	9,0	7,8	5,4
GDP, excluding Kuntor	%	2,4	4,7	3,7	6,2	1,0	1,4	5,6	5,9	3,9	2,5
Domestic consumption	%	1,7	-2,0	-0,5	-1,3	0,4	3,8	2,0	1,4	0,2	
Gross accumulation	%	19,6	11,8	-5,3	-16,3	-5,3	2,7	0,1	2,3	-14,2	
Net export	%	-2,9	-1,6	-28,5	-29,8	8,8	3,5	15,9	-27,2	-23,5	
<i>GDP production:</i>											
Agriculture	%	0,6	1,6	7,3	10,2	1,5	3,9	3,5	6,6	1,5	1,0
Industry	%	20,3	26,9	6,2	-37,5	-25,1	-11,4	29,7	30,9	35,5	27,4
Construction	%	-3,2	6,7	-0,2	35,1	0,1	6,2	13,1	7,6	0,0	8,3
Services	%	3,2	3,0	3,4	4,6	2,5	1,8	4,4	3,4	0,5	-0,4
including trade	%	5,2	5,2	6,6	8,0	4,8	5,3	11,6	7,0	3,9	4,0
2. Prices/2											
CPI	%	110,3	106,1	105,7	104,0	101,2	100,3	100,5	99,6	101,5	103,9
CPI, in annual terms as of the end of period	%	108,5	104,5	106,4	103,4	100,5	101,3	99,7	99,5	102,8	104,1
Core CPI	%	109,7	107,6	106,5	105,2	103,0	101,8	101,0	99,9	100,3	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	93,8	94,4	98,8	104,7
Non-food products	%	112,2	110,4	109,0	111,6	111,7	110,8	110,0	102,4	101,3	101,2
Alcohol drinks and tobacco products	%	109,5	108,9	110,1	111,8	108,5	107,6	105,3	106,5	105,7	102,8
Services	%	106,0	106,9	107,4	106,6	106,5	105,2	104,6	104,4	106,9	107,1
<i>CPI, classified by character:</i>											
Excisable goods	%	111,4	109,0	107,7	109,4	110,0	109,6	108,3	105,4	106,1	103,4
Regulated prices	%	116,9	114,9	117,9	122,1	109,6	109,3	105,2	99,8	98,7	99,4
Market inflation rate (the rest of CPI)	%	106,3	106,9	107,4	107,8	107,8	106,4	105,5	104,2	104,2	104,0
3. External sector/3											
<i>(in percent to GDP)</i>											
Trade balance	%	-37,1	-37,7	-36,4	-34,3	-34,8	-36,9	-34,4	-31,8	-31,4	-29,1
Current account	%	-18,7	-21,1	-21,2	-16,2	-13,6	-14,7	-11,6	-10,1	-9,7	-5,8
Export of goods and services	%	44,1	40,8	39,1	37,9	38,1	37,9	38,5	36,7	37,2	38,6
Import of goods and services	%	86,0	83,4	79,3	75,1	75,2	77,0	75,5	71,6	71,3	69,6
4. USD exchange rate, as of the end of period											
	<i>com</i>	63,8736	62,0788	68,8359	75,8993	70,0158	67,4860	67,9346	69,2301	68,6069	69,1367
5. Monetary sector											
<i>(real growth rates, if otherwise is not indicated)</i>											
NBKR policy rate, as of the end of period	%	11,00	9,50	10,00	10,00	8,00	6,00	6,00	5,00	5,00	5,00
Rate of "overnight" deposit, as of the end of period	%	5,00	3,00	4,00	4,00	1,00	0,50	0,25	0,25	0,25	0,25
Rate of "overnight" credit, as of the end of period	%	14,00	12,00	12,00	12,00	10,00	7,50	7,25	6,25	6,25	6,25
Average interest rates of the operations in the interbank credit market, per quarter	%	10,28	10,02	7,14	9,66	10,50	2,70	3,76	2,32	2,08	1,65
<i>of which:</i>											
of REPO transactions	%	10,50	9,96	7,14	9,45	9,44	1,59	1,76	1,61	1,56	1,50
of credits in national currency	%	15,00	18,00	-	11,62	13,25	7,84	4,11	2,67	2,11	3,10
of credits in foreign currency	%	1,41	-	-	-	-	-	-	2,0	-	4,00
Weighted average yield of 7-day notes, as of the end of period	%	11,00	9,50	9,67	10,00	2,18	1,44	0,27	0,24	0,61	2,81
Weighted average yield of 28-day notes, as of the end of period	%	-	-	-	-	-	-	-	-	1,14	4,08
Monetary base	%	-16,25	-9,52	-4,34	4,01	17,24	16,65	20,53	27,63	23,31	21,79
Money outside banks (M0)	%	-19,9	-15,7	-7,0	2,3	17,5	18,6	20,6	30,5	28,0	25,1
Monetary aggregate (M1)	%	-17,7	-14,3	-5,6	1,7	21,0	25,5	29,4	38,6	31,7	25,9
Narrow money supply (M2)	%	-13,2	-13,6	-5,7	-0,1	17,2	25,8	31,5	40,3	36,2	28,8
Money supply (M2X)	%	0,9	0,5	10,0	14,9	13,1	16,7	15,2	14,6	21,7	19,8

¹ Estimates of the National Bank of the Kyrgyz Republic on the basis of the data provided by the National Statistics Committee of the Kyrgyz Republic

² Source: National Statistics Committee of the Kyrgyz Republic

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

Annex 2. Glossary

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

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

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

Deposits included in M2X are the deposits of individuals 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 the discount government securities, issued in circulation by the National Bank of the Kyrgyz Republic. By decision of the Monetary Regulation Committee of the National Bank the notes can be issued for 7, 14 and 28 days. The notes profitability is set to be equal to the policy rate as of the auction day.

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 of the Kyrgyz Republic 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 one year. The emitter of ST-Bonds is the Ministry of Finance of the Kyrgyz Republic. 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
LA	Lending to Agriculture
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