

**NATIONAL BANK
OF THE KYRGYZ REPUBLIC**

**Monetary Policy Report
Quarter 3, 2017**

**Bishkek
November 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 Q3 2017 was approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic No. 2017-II-07/49-1-(ДКП) dated November 27, 2017.

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Summary

In Q3 2017, the inflation rates in Kyrgyzstan remained moderate, the general inflation rate remained at the level of 3.6 percent (0.5 percent in 2016). Relatively low prices for imported food products and restrained demand for non-food products had an impact on the dynamics of the inflation rates.

In Q3, food inflation was close to the general inflation rate and amounted to 3.8 percent. The decline in prices for imported food products was counterbalanced by rise in prices for vegetables due to the low base effect of the previous year.

Noon-food inflation remained relatively low (1.3 percent in annual terms).

Taking into account the persisting 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.

In January-September of the current year, the economic growth in the country remained positive. In January-September 2017, GDP growth made 5.0 percent (in the corresponding period of 2016, increase made 1.5 percent). GDP, excluding the enterprises of the Kumtor Mine, grew by 3.6 percent.

Positive growth rates were observed in industry, agriculture, construction and trade. 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 Q3 2017, the trade balance formed under the impact of decreased exports and increase of imports. Export decreased by 8.7 percent due to reduced supplies of gold, imports increased (by 8.7 percent) due to growth in all functional groups of goods. Finally, trade balance deficit of the country formed in the amount of USD 682.0 million. The foreign trade turnover¹ increased by 3.6 percent and amounted to USD 1.5 billion.

At the end of January-September 2017, the state budget was executed with a deficit at KGS 6.5 billion, or 1.9 percent to GDP (in January-September 2016, the budget deficit amounted to KGS 16.8 billion, or 5.3 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 10.4 percent year-to-date and amounted to KGS 118.2 billion. The volume of the credit portfolio increased by 13.1 percent year-to-date and made KGS 105.7 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

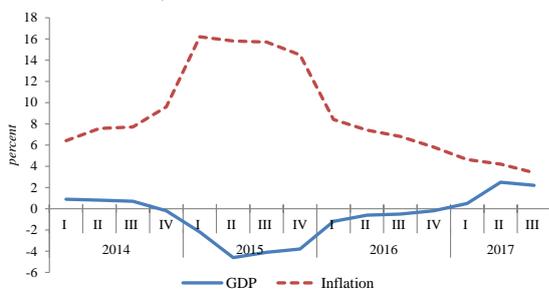
1.1. Economic Development of the EAEU Countries and the Main Trading Partner Countries

The trend of recovery in economic activity remained in the economies of the countries-major trade partners of Kyrgyzstan. In Russia, economic activity is still recovering amid favorable macroeconomic conditions. The economic growth in Kazakhstan was due to increase in the extraction and export of minerals, as well as implementation of structural reforms and Government programs. The inflation rates in Kazakhstan were still within the range of benchmarks. Recovery of economic growth in the Republic of Belarus is still observed amid improving domestic demand, and improvement of the situation in the domestic foreign exchange market has a favorable effect on the inflation rate in the country. The economy of Armenian was characterized by remained high GDP growth; the inflation rate was in the positive zone.

Russia

Chart 1.1.1. GDP growth and Inflation rate in Russia

(in annual terms)



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

The trend of economic recovery continued in Russia in Q2 2017. In Q3 2017, agriculture (due to activation of harvesting operations, yield growth) and industry due to improvement of weather conditions made the main contribution to GDP growth. In January-September 2017, industrial production increased by 1.8 percent, meanwhile, manufacturing industries benefited from it.

According to the estimates of the Ministry of Economic Development of Russia, in Q3 2017, GDP growth was 2.2 percent in annual terms, compared to 2.5 percent in Q2 of the current year, an increase made 1.8 percent

within nine months of 2017. Positive trend was observed in engineering, cargo transportation and consumer durables production. According to the estimates of the Bank of Russia, consumer demand continues growing being supported by increase in real salaries, which resulted from slowdown of the inflation rate.

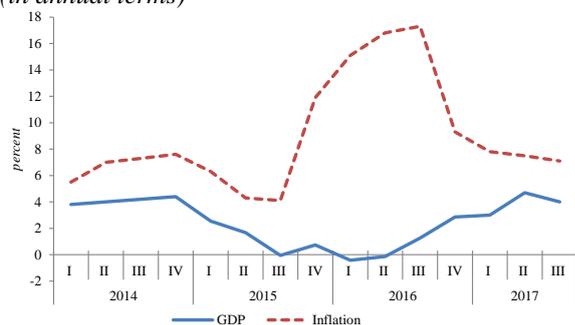
According to the Ministry of Economic Development of Russia, in Q3 of the current year, investments in fixed assets increased by 3.6-4.0 percent in annual terms.

At the end of September, the annual inflation rate was at the level of 3.0 percent. According to the Bank of Russia, deviation of the inflation rate downwards from the forecast is mainly due to the time factors. In September, the decline in the annual rate of increase in food prices was more significant than expected, due to increased supply of agricultural products and a shortage of storage capacity for its long-term storage. Finally, in Q3 2017, the inflation rate was 3.4 percent in the annual terms.

Kazakhstan

Chart 1.1.2. GDP growth and Inflation rate in Kazakhstan

(in annual terms)



Source: RK Statistics Agency, NBKR calculations
communication (by 3.0 percent).

In Q3 2017, the rates of economic growth in Kazakhstan remained, mainly due to increased extraction and export of commodities amid growth in the world oil prices, implementation of structural reforms and Government programs, as well as economic recovery in Russia. Thus, in January-September 2017, economic growth in Kazakhstan formed at the level of 4.3 percent¹. In the sectoral aspect, the main drivers of growth were the sectors of industry (by 8.3 percent), agriculture (by 3.5 percent), transport (by 4.7 percent), trade (by 3.0 percent) and

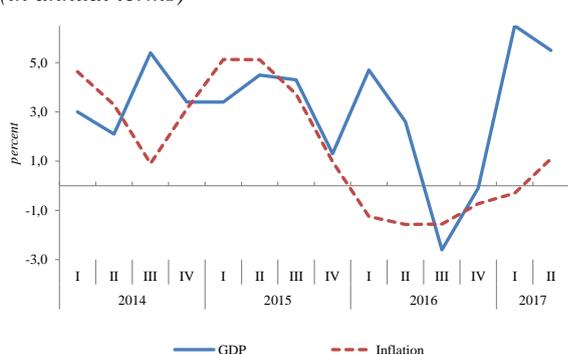
In Q3 2017, the annual average inflation in Kazakhstan amounted to 7.1 percent against 17.3 percent in the same period of 2016. In Q3 2017, inflation slowdown was due to exhausted effect of the national currency devaluation in Kazakhstan, high base of the previous year, as well as holding moderately restraining monetary policy.

Volatile dynamics of the exchange rate of the Kazakh tenge was observed in Q3 2017: thus, in Q3 (from the beginning of July till the end of September 2017), the KZT/USD exchange weakened by 6.4 percent this resulted from excessive demand for foreign currency due to devaluation expectations of the population. According to the National Bank of the Republic of Kazakhstan, in August and September of the current year, under the conditions of insufficient supply of foreign currency, it was sold, and the volume of net interventions respectively amounted to USD 70.0 million and USD 69.7 million.

Armenia

Chart 1.1.3. GDP growth and Inflation rate in Armenia

(in annual terms)



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

Positive dynamics of growth is still observed in the economy of Armenia. According to the National Statistical Service of the Republic of Armenia, in January-September 2017, the index of economic activity grew by 5.1 percent compared to the same period in 2016.

Growth was supported by high export indicators, the recovery of remittances, the revival of investment and higher commodity prices. Within nine months of 2017, growth was observed in industrial production (+11.9 percent) and in domestic trade turnover (+12.5 percent), however, reduction was still observed in the sectors of agriculture and

construction (-9.9 percent).

Within the first nine months of the current year, the volume of foreign trade turnover in Armenia increased by 21.7 percent, meanwhile, trade with the CIS countries increased by 15.0 percent, with the EU countries - by 25.5 percent. The greatest expansion of trade relations

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

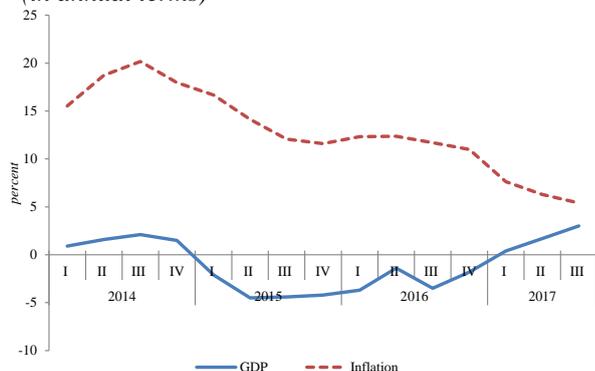
was with Russia and Ukraine. The share of foreign trade turnover of Armenia with the CIS countries was 27.8 percent, the share of trade volume with the EU countries was 25.1 percent.

In January-September of the current year, the inflation rate was 0.6 percent, in September - 1.0 percent in annual terms. According to the forecasts of the Central Bank of Armenia, the inflation rate in Armenia in 2017 will not exceed 2.0 percent.

Belarus

Chart 1.1.4. GDP growth and Inflation rate in Belarus

(in annual terms)



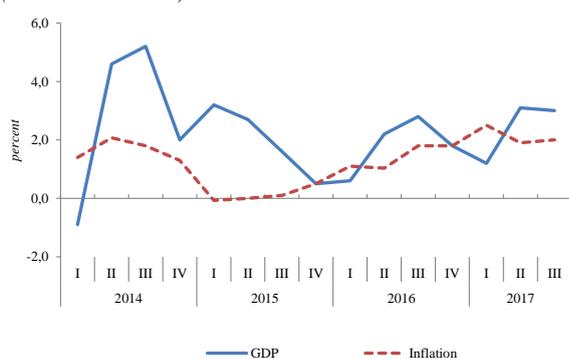
Source: National Statistical Committee of the Republic of Belarus

in the domestic foreign exchange market, as well as a decrease in the intensity of rise in prices and tariffs subject to administrative regulation (indexation of tariffs for housing and utility sector services).

USA

Chart 1.1.5. GDP growth and Inflation rate in the USA

(in annual terms)



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

business investment, despite some slowdown, demonstrated moderate growth.

In Q3, the inflation rate increased after slowdown in the summer of the current year, in September, the CPI growth was 2.2 percent. Growth of the inflation rate is mainly due to acceleration in the growth rates of energy prices, the core inflation was at the level of 1.7 percent since May of the current year.

In Q3 2017, the upward trend remained in the economic growth of the Republic of Belarus on the background of economic rehabilitation in Russia and improvement of external demand. At the end of nine months of 2017, GDP growth in Belarus amounted to 1.7 percent¹. This growth was due to increased production output in the manufacturing industry (by 6.1 percent), in the sector of trade (by 2.0 percent) and agriculture (by 1.7 percent).

In Q3 2017, the annual average inflation rate in the Republic of Belarus formed at the level of 5.4 percent against 11.7 percent in the same period of 2016. The slowdown in the inflation rate was due to the favorable situation

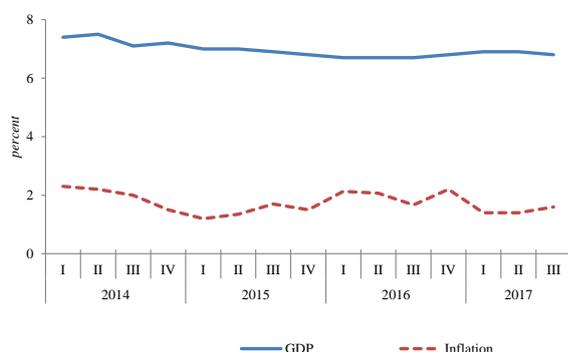
In Q2 and Q3 of the current year, economic growth in the USA was moderate to high. In Q3 2017, the U.S. economic growth was 3.0 percent after growth by 3.1 percent in Q2. The indicators for Q3 exceeded analysts' expectations and are a positive result in the light of the natural disasters that occurred in the USA and damaged the economy in this period. At the same time, analysts note that GDP growth in the reporting period was largely supported by high rate of private investments in inventories that have a cyclical effect on GDP dynamics. Without this factor, the dynamics of economic activity in the USA was moderate but stable. Indicators of domestic consumption and

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

China

Chart 1.1.6. GDP growth and Inflation in China

(quarter to the corresponding quarter of the previous year)



Source: National Statistics Bureau of the PRC, IA Bloomberg

During the recent months, the inflation rate in China remained at the level of 1.5 percent and constituted 1.6 percent in September of the current year. In September, the food group experienced deflation in annual terms, which had a restraining effect on the CPI growth. The inflation rate was below the benchmark of the PRC authorities set at the level of about three percent, which provides the People's Bank of China with an opportunity to conduct an expansionary policy to support economic activity.

Slight slowdown was observed in economic growth in China, however, generally, the economic indicators were stable. In Q3 2017, the annual rate of GDP growth was 6.8 percent, which is slightly lower than 6.9 percent in the first half of the current year. High rates of lending by the state-owned banks, government investment in infrastructure and export growth - all this generally supported economic activity in the country. However, these indicators slowed down in the reviewed quarter due to the policy of the PRC authorities to restrain the risks of financial stability. Sustainable growth was observed in the sectors of retail sales, industry and real estate.

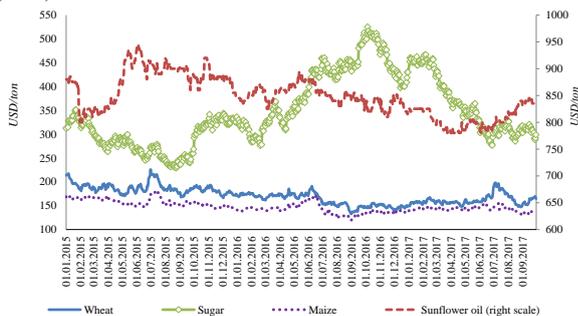
1.2. World Commodity and Raw Stock Markets

The price dynamics for basic food products imported by Kyrgyzstan were multidirectional in the world markets. The risks of inflationary influence on domestic prices from the world markets are moderate. Prices for gold were slightly higher than in the previous quarter, as well as an upward price movement was observed in the oil market.

Food Market

Chart 1.2.1. Dynamics of Prices for Food Products

(month to the corresponding month of the previous year)

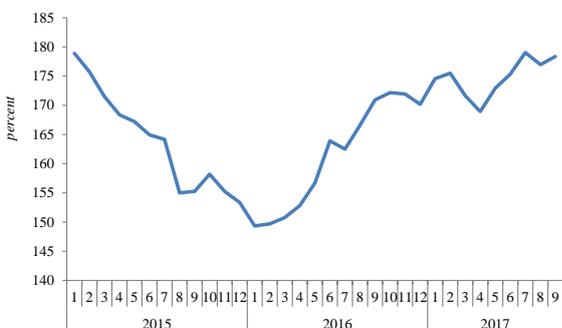


In Q3 2017, multidirectional dynamics of the prices for major goods were observed in the world food markets. After a sharp increase at the end of Q2 and at the beginning of Q3 due to unfavorable weather conditions in North America, prices for wheat declined in July and August. High production of grain in the Black Sea region contributed to the decline in prices. The harvest of grain in Russia in this season will be high and will result in a high export supply. Deteriorating forecasts for grain production in some regions of the Southern Hemisphere resulted in a slight increase of prices in September.

Prices for sugar had volatile dynamics; however, generally, they were characterized by the “sideward” trend. Since the beginning of the year, the prices for this product in the world markets declined due to higher production in the main producing countries compared to forecasts. During the reviewed quarter, the sugar market was characterized by sufficient supply and restrained demand.

In the markets of vegetable oils, including sunflower oil, in the reviewed quarter, there was an increase in prices due to deteriorating conditions for production and forecasts. In Russia, sunflower oil production is expected to be at the level of 2016 or slightly higher.

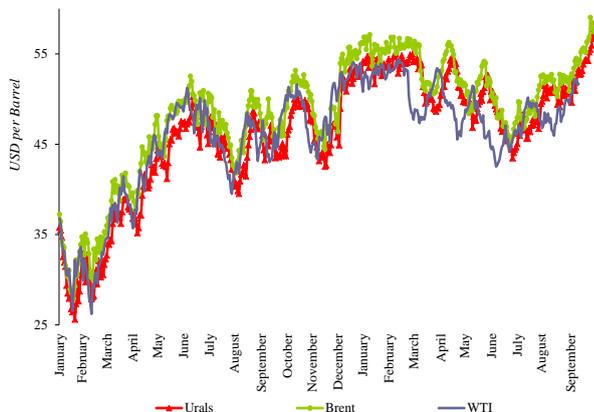
Chart 1.2.2. Dynamics of FAO Food Price Index



In Q3 2017, the average value of the FAO food price index increased by 3.3 percent compared to the previous quarter and was at a maximum level since Q4 2014. Rise in prices for dairy products and crops primarily contributed to increase in the food price index, and to a lesser extent - meat products and vegetable oils.

Energy Market

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



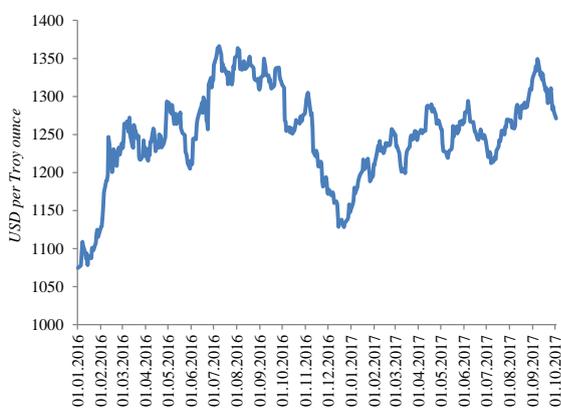
In Q3 of 2017, the world oil prices were characterized by the upward trend under the influence of market and fundamental factors. The prices for the basic oil grades (Brent, WTI, Urals) fluctuated within the range of USD 44.2-59.0 per barrel. In Q3 2017, the average price for Brent crude oil increased by 2.7 percent compared to the previous quarter and amounted to USD 52.2 (the price increased by 11.0 percent compared to the same period of the previous year).

In general, since the beginning of Q3 2017, the dynamics of oil prices was supported by information about the reduction of oil reserves in the United States, the expansion of USA sanctions against Venezuela, the disruptions in the work of the largest oil field in Libya, the assessments of the OPEC+ Technical Committee on the implementation of Vienna agreement (94.0 percent in July) and because of a series of hurricanes, which resulted in temporary suspension of some refineries in the USA.

Information on oil reserves in the United States, data about demand from China, implementation of agreements made within OPEC by the countries, and geopolitical problems in certain regions of the world are still the main factors influencing the oil pricing.

Gold Market

Chart 1.2.4. Dynamics of Prices for Gold



Source: IA Bloomberg

In Q3, prices for gold were higher compared to the previous quarter. In Q3 of the current year, the average price for gold increased by 1.7 percent compared to the previous quarter. At the same time, the prices for metal showed multidirectional dynamics during the reviewed quarter. In July and August of the current year, the increase in prices for gold was due to intensification of geopolitical tensions around North Korea, thereby increasing the demand for gold as an asset, which retains its value in times of instability. Moreover, the increase in quotations was supported by a decrease in the likelihood of a tighter monetary policy of the US Federal Reserve System due to

slowdown of the inflation rate in the USA. However, since early September, a decline in prices in the gold market was observed due to a decrease in geopolitical tensions, changes in assumptions about the policy of US monetary authorities and speculative sales of gold in order to receive profit after price increase in the previous months.

Chapter 2. Macroeconomic Development

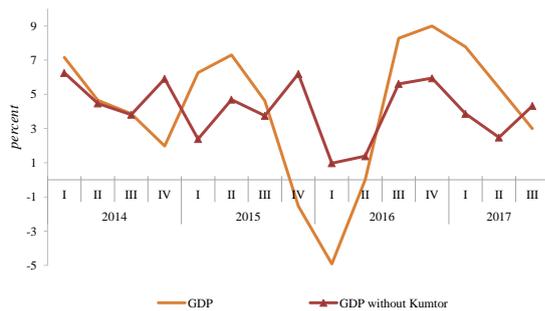
2.1. Demand and Supply in the Commodities and Services Market

Positive dynamics of economic growth was still observed in Q3. Economic growth was primarily conditioned by an increase in the sector of industry, construction and trade. The increase in the inflow of remittances also had a positive impact on the economy of the Kyrgyz Republic. At the same time, the continuing decline was still observed in the information and communication sector.

Demand

Chart 2.1.1. GDP Dynamics

(quarter to the corresponding quarter of the previous year)

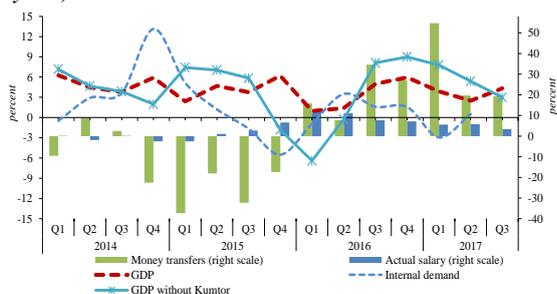


Source: NSC KR, calculations: NBKR

According to Centerra Gold Inc. press release, in Q3 2017 the production output at the Kumtor Mine decreased by 16.5 percent (compared to Q3 2016 (166.0 thousand troy ounces)) and amounted to 138.6 troy ounces.

Chart 2.1.2. Dynamics of Internal Demand and Money Transfers

(quarter to the corresponding quarter of the previous year)



Source: NSC KR, calculations: NBKR

In general, positive dynamics of the individuals' remittances made through the money transfer systems was observed since the beginning of 2017: in January-September 2017, net inflow in USD equivalent increased by 26.2 percent compared to the same period of 2016.

State Finances Sector

In January-September 2017, the state budget deficit amounted to KGS 6.5 billion or 1.9 percent to GDP (in January-September 2016, the budget deficit constituted KGS 16.8 billion

¹ Reference to the data for the earlier period is given due to the lack of data for Q3 2017.

or 5.3 percent to GDP). The primary state budget deficit (excluding interest payment for servicing the state debt) amounted to KGS 2.0 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)



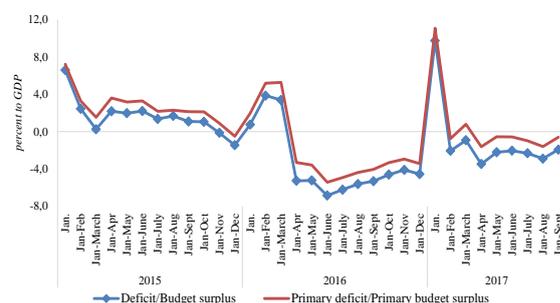
Source: CT MFKR, NBKR

At the end of the reporting period, the state budget expenditures for operating activities increased in annual rate by 6.0 percent, or KGS 4.9 billion, and amounted to KGS 87.1 billion, or 26.0 percent to GDP. The functional structure of current expenditures reflects mainly the social orientation: the greatest contribution to the increase was made by the budget expenditures for health care, social protection and education.

Net outflow of budget funds for operations related to acquisition of non-financial assets amounted to KGS 26.3 billion or 7.9 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

borrowings – by 93.1 percent.

Investment

In January-September 2017, the level of implementing investment in fixed assets increased by 4.0 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-September		share, percent	
	2016	2017	2016	2017
	millions of KGS			
Total	75 647,7	79 215,8	100,0	100,0
Internal investment	51 532,9	55 142,1	68,1	69,6
Republican budget	7 628,1	4 814,6	10,1	6,1
Local budget	731,8	848,9	1,0	1,1
Funds of enterprises and organizations	20 136,4	26 060,2	26,6	32,9
Banks' credits	46,6	1 354,7	0,0	1,7
Population funds including beneficent help of KR residents	22 990,0	22 063,7	30,4	27,8
External investment	24 114,8	24 073,7	31,9	30,4
Foreign credit	16 450,5	16 391,2	21,8	20,7
Direct foreign investments	5 852,1	5 503,4	7,7	6,9
Foreign grants and humanitarian aid	1 812,2	2 179,1	2,4	2,8

Source: NSC KR

The state budget revenues from operating activities increased by 16.5 percent, or KGS 15.2 billion, compared to the same indicator of 2016 and amounted to KGS 107.0 billion, or 31.9 percent to GDP. More than half of all incomes are accounted for tax revenues; growth thereof was mainly supported by an increase in revenues from income and profit taxes, as well as VAT. Moderate growth was also observed on other income producing items (non-tax revenues, received transfers, contributions/deductions for social needs).

Execution of the state budget revenues (tax revenues + non-tax revenues + official transfers) amounted to 105.8 percent at the end of January-September 2017. Shortfall of forecasted tax revenues in the reporting period was compensated by over-fulfillment of the plan on non-tax revenues and official transfers. The execution of the state budget expenditures amounted to 74.9 percent. Meanwhile, the expenditure plan on the protected items was executed by 78.0 percent, on the unprotected items - by 59.5 percent, on repayment of obligations related to internal and external

Growth of capital investment was still primarily observed in the construction of manufacturing facilities, in the construction and reconstruction of the facilities for supply of electric energy, gas, steam and conditioned air, hotels and restaurants, as well as the healthcare facilities.

Meanwhile, capital investment decreased in the construction of water supply, waste cleaning and processing facilities, the facilities of education, art, entertainment and recreation.

Compared to January-September 2016, the volume of capital investment financed from domestic sources increased by 6.2 percent, that

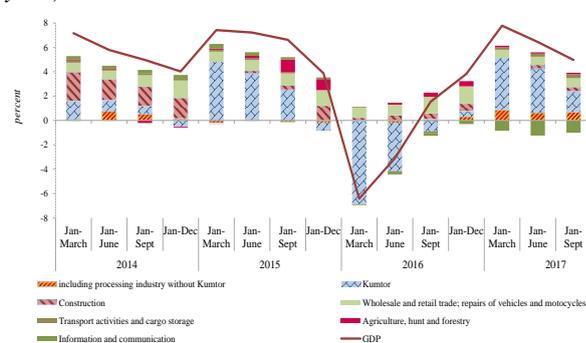
from the bank loans – by 28.8 times (funds were mainly directed to the construction of wholesale and retail trade facilities, hotels and restaurants), that from the funds of the enterprises and organizations – by 28.5 percent, from the local budget – by 15.2 percent, meanwhile, the investment financed from the republican budget decreased by 37.3 percent, that from the personal funds – by 4.7 percent. The investment financed from the foreign sources decreased by 0.9 percent, that from the direct foreign investment – by 6.6 percent, from the foreign loans – by 1.1 percent, meanwhile the investment financed from the foreign grants and humanitarian aid increased by 19.4 percent.

The major volume of foreign grants and humanitarian aid was directed to finance the construction of healthcare, art, entertainment and recreation facilities, as well as the facilities of agriculture, forestry and fishery.

Supply

Chart 2.1.5. Input of Main Sectors in GDP Growth

(period to the corresponding period of the previous year)



Source: NSC KR, calculations: NBKR

against the same indicator for nine months of 2016.

The sectors of industry (3.5 percentage points), trade (0.7 percentage points) and construction (0.4 percentage points) made the main positive contribution to the economic growth, meanwhile, the contribution of the sector of information and communication (-1.0 percentage point) remained negative.

Long-lasting decline in the sector of communication within nine months of 2017 reached the level of 23.6 percent due to a decrease in revenues received from provision of mobile services.

In the reporting period, GDP increased mainly due to a positive contribution of all 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 January-September 2017, GDP growth amounted to 5.0 percent (in January-September 2016, growth made 1.5 percent). Excluding the enterprises of the Kumtor Mine, GDP growth constituted 3.6 percent (in the same period of 2016, growth made 2.7 percent).

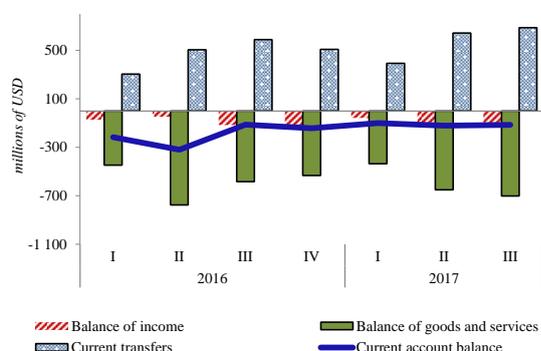
GDP deflator constituted 1.2 percent, having decreased by 3.0 percentage points

2.2. External Sector¹

In Q3 2017, the current account deficit decreased under the influence of the increase in the net inflow of private transfers despite increased 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 Q3 2017, the current account deficit decreased down to USD 114.5 million to make 6.8 percent to GDP.

In the reporting period, the trade deficit of the Kyrgyz Republic increased by 22.3 percent to make USD 628.0 million. This trend was conditioned by the decline in exports of gold and growth of imports.

2.2.1. Trade balance of the Kyrgyz Republic²

(millions of USD)

	2014	2015	2016	2016 Q3	2017* Q3	Change in %	Change in millions of
Trade balance	-2 807,5	-2 240,8	-2 136,5	-557,7	-682,0	22,3	-124,4
Export (FOB)	2 482,7	1 619,0	1 607,9	451,9	415,7	-8,0	-36,1
Gold	716,9	665,4	701,6	223,8	124,3	-44,5	-99,5
Import (FOB)	5 290,2	3 859,8	3 744,4	1 009,5	1 097,8	8,7	88,3
Energy products	1 041,8	830,0	467,4	90,1	117,9	30,8	27,8

* Preliminary data

In the reporting period, exports of goods (in FOB prices) decreased by 8.0 percent to make USD 415.7 million. Exports were primarily affected by decrease in supplies of gold by 44.5 percent compared to the same quarter of 2016. Along with that, exports, excluding gold, increased and made 27.8 percent primarily due to a growth in supplies of footwear, clothes and clothing accessories, fruits and vegetables, rolled glass and other goods.

In Q3 2017, imports of goods (in FOB prices) increased up to USD 1,097.8 million. This trend was conditioned by growth in the supplies of petroleum products and in the imports of other goods on the background of an increase in the internal demand. 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 energy products, increased by 6.6 percent compared to Q3 2016 to make USD 979.9 million.

In the reporting period, the net inflow of current transfers was formed above the level of the same period in 2016 by 17.0 percent. Recovery of the Russian economy and improvement of working conditions for migrant workers in Russia contributed to the positive dynamics of the net inflow of private transfers, which constituted USD 675.9 million.

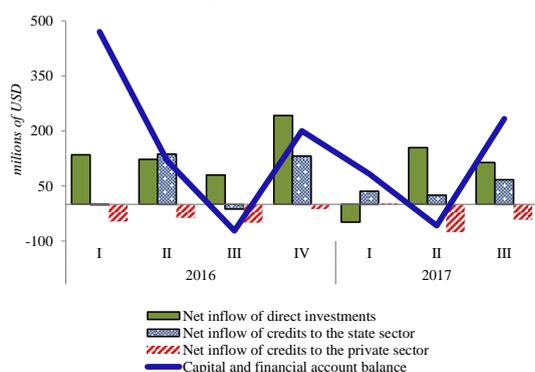
¹ According to the preliminary and forecasted data, including additional estimates of the National Bank of the Kyrgyz Republic. Period of comparison is the quarter to the corresponding quarter of the previous year.

² The data on the foreign trade 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.

Negative balance of other components of the current account also decreased. Thus, the balance of services deficit decreased down to USD 20.3 million, and the deficit of “income” item decreased down to USD 99.7 million.

According to the preliminary and forecasted estimates of the National Bank of the Kyrgyz Republic, the capital inflow on the capital and financial account will cover current account deficit in Q3 2017. The capital inflow of the capital account formed in the amount of USD 27.0 million, the balance of the financial account formed in the amount of USD 205.7 million.

Chart 2.2.2. Capital and Financial Account



Net inflow of direct investments to the country is forecasted at the level above 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 91.6 million conditioned by the growth of the foreign liabilities of the residents due to the increase of loans attracted by the state sector. Along with that, the foreign assets of the residents are expected to decrease compared to the same period of 2016. The increase in the net inflow of loans primarily to

the state sector was observed in the reporting period.

Therefore, at the end of Q3 2017 balance of payments of the Kyrgyz Republic was formed with a positive balance to make USD 63.5 million. Gross international reserves covered 4.7 months of the future imports of goods and services¹.

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)		month to the beginning of the year (as of the end of month)			
	2015 (aver.) (January-December)	2016 (aver.) (January-December)	%	December 2016	September 2017	*	%	
REER	115,7	113,7	-1,7	113,1	111,3	-1,6	↓	↓
NEER	108,9	112,8	3,5	112,7	111,1	-1,4	↓	↓
RBBER to CNY	84,7	80,8	-4,6	85,8	82,9	-3,5	↓	↓
NBBER to CNY	66,4	64,5	-3,0	67,9	65,1	-4,1	↓	↓
RBBER to Euro	116,6	107,2	-8,0	113,3	102,6	-9,5	↓	↓
NBBER to Euro	85,5	78,8	-7,9	83,4	74,5	-10,7	↓	↓
RBBER to KZT	112,1	141,7	26,4	136,7	135,6	-0,8	↓	↓
NBBER to KZT	105,9	152,1	43,6	150,3	153,0	1,8	↑	↑
RBBER to RUR	138,2	131,4	-4,9	122,8	115,4	-6,0	↓	↓
NBBER to RUR	142,8	144,8	1,5	136,7	128,0	-6,4	↓	↓
RBBER to USD	96,0	87,2	-9,1	88,5	89,2	0,8	↑	↑
NBBER to USD	71,7	65,7	-8,3	66,4	67,0	0,9	↑	↑

* preliminary data

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

At the end of Q3 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 1.4 percent from the beginning of 2017 and amounted to 111.1 by the end of September 2017. The decrease in the NEER index was due to KGS devaluation² in September 2017 compared to the average exchange rate for December 2016 against: the euro – by 10.7 percent, the Russian ruble – by 6.4 percent, the Chinese yuan – by

4.1 percent.

Despite lower level of inflation in the trading partner countries³, the decrease in the NEER index caused decline in the index of real effective exchange rate (REER) by 1.6 percent, which amounted to 111.3 at the end of September 2017.

¹ Taking into account non-convertible currencies.

² 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.

³ In Q3 2017, the inflation in the Kyrgyz Republic formed at the level of 2.1 percent, whereas an average inflation rate in the major trading partner countries made 2.3 percent according to the preliminary calculations.

Chapter 3. Monetary Policy

3.1. Monetary Policy Implementation

Taking into account the actual and forecasted dynamics of the inflation rate for the medium term, the direction of the monetary policy carried out by the National Bank was retained during Q3 2017.

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

In order to provide more effective withdrawal of the commercial banks' excess liquidity, in Q3 2017, 91-day notes of the National Bank were additionally offered in the market.

Interest Rate Policy of the National Bank

During Q3 2017, the National Bank, taking into account expected dynamics of the inflation rate for the medium-term period, continued conducting the policy of monetary easing by keeping unchanged its interest rate policy aimed at maintaining economic growth. 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

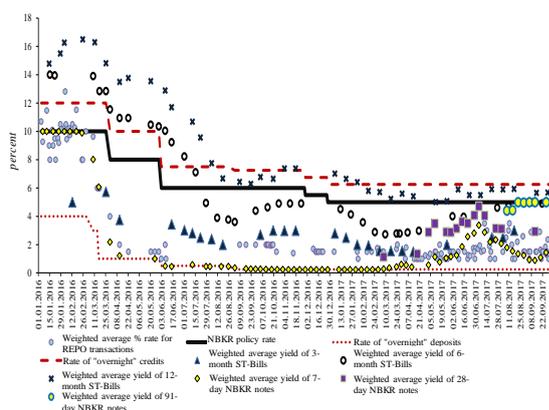
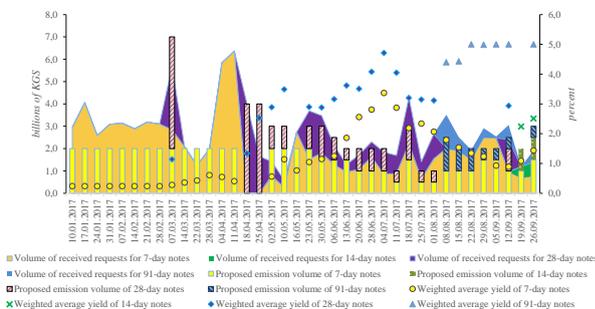


Chart 3.1.2. National Bank Notes



In Q3 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 5.76 percent for the quarter. During the quarter, the weighted average yield on 91-day notes was approximately 4.83 percent, on 28-day notes – 3.34 percent (in Q2 2017 – 2.71 percent), on 7-day notes – 1.79 percent (in Q2 2017 – 1.16 percent).

There was a slowdown in the rate of lowering interest rates on the credit portfolio of the commercial banks. This slowdown was mainly due to a decrease in the impact of measures taken for monetary policy easing. At the end of the reporting period, the weighted average interest rate of the credit portfolio decreased by 0.5 percentage points compared to the end Q2 and made 16.5 percent (in Q2, the decrease was 0.8 percentage points).

The decrease was observed on the rates of the fixed-term deposits in the national currency. The rates declined mainly due to the decrease of the rates on the deposits with the

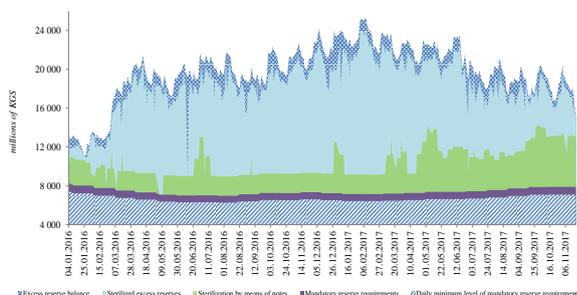
term from 6 months to 3 years, the share thereof in the total volume of the fixed-term deposits in the national currency made 60.0 percent. During the period under review, the weighted average interest rates on the fixed-term deposits in the national currency declined by 0.4 percentage points and amounted to 12.2 percent at the end of the reporting quarter (in Q2 the decrease made 0.4 percentage points).

Situation with Liquidity of the Commercial Banks

The volume of excess liquidity of the commercial banks slightly decreased in the reporting quarter. In Q3 of the current year, the average daily volume of the commercial banks' excess liquidity prior to the operations on sterilization amounted to KGS 11.5 billion, having decreased by KGS 3.0 billion compared to Q2 (in the same period of 2016, this indicator made KGS 12.8 billion). Meanwhile, the average daily volume of the commercial banks' excess liquidity upon the operations on sterilization made KGS 1.4 billion in the reporting period.

Taking into account existing level of 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 Q3 2017, the volume of excess liquidity absorbed on a daily basis decreased by KGS 3.1 billion compared to Q2 and reached KGS 10.0 billion. The decrease of excess liquidity was mainly accompanied by the reduction of the average daily volume of placements of "overnight" deposits by KGS 2.9 billion, meanwhile the average daily volumes of notes decreased only by KGS 0.3 billion.

Credit Policy of the National Bank

In the reporting period, the National Bank did not conduct credit auctions; meanwhile, the credits in the amount of KGS 180.0 million were issued to the commercial banks from the earlier approved resources.

Foreign Exchange Policy of the National Bank

The situation in the domestic foreign exchange market was stable. Slight volatility of the exchange rate was observed at the beginning of the quarter; in general, the national currency strengthened by 0.7 percent within the quarter. In the reporting period, the National Bank participated in the domestic foreign exchange market as a purchaser and a seller of foreign currency in order to smooth sharp fluctuations of the exchange rate, the volume of net sales amounted to USD 3.8 million.

Monetary Policy Measures in Q3 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 August 28 and September 25, 2017. Finally, the decision was 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 National Bank issued</p>	<p>Credit auctions were not conducted in the reporting</p>

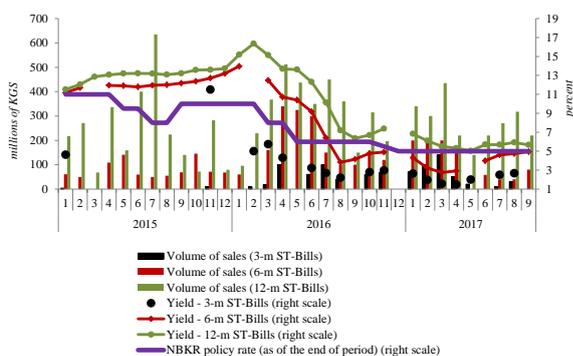
credits to the commercial banks from the funds, which were approved earlier.

period. The commercial banks were provided with credits to the amount of KGS 180.0 million from the earlier approved funds. The weighted average interest rate on these credits made 5.00 percent.

3.2. Financial Market Instruments

Government Securities Market

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



ST-Bills

In Q3 2017, yield downward trend was still observed in the primary government securities market.

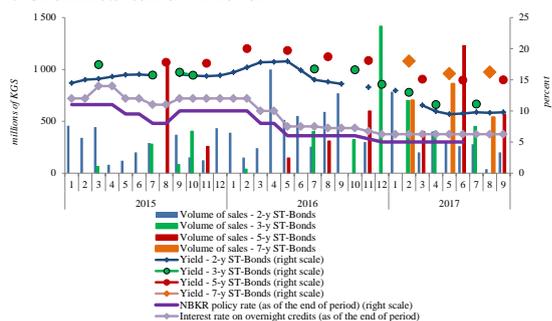
At the end of Q3 2017, the demand for ST-Bills decreased significantly compared with the same period of 2016, therefore, the volume of securities placement decreased down to KGS 1.0 billion (-30.5 percent). At the same time, the ratio of the sales volume taking into account additional placement was as follows: the share of 3-month ST-Bills was 4.0 percent (-5.7 percentage points compared to the same

period of 2016), 6-month ST-Bills – 15.9 percent (-8.3 percentage points) and 12-month ST-Bills – 80.2 percent (+13.9 percentage points).

The activity of participants at the auctions also decreased, generally, the number of participants decreased from 19 down to 11 participants.

Relatively high level of excess reserves in the banking system contributed to gradual decrease of ST-Bills yield of any maturity, excluding insignificant growth of yield of 3-month ST-Bills by 0.1 percentage point. Thus, the overall weighted average yield of ST-Bills declined by 0.8 percentage points down to 5.5 percent compared to the same period of 2016.

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



ST-Bonds

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

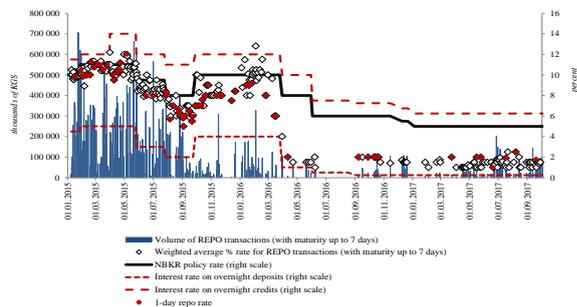
In Q3 2017, growth in the volume of placement (including additional placements) was replaced by reduction in the ST-Bonds sales (by 10.8 percent, down to KGS 2.1 billion) with gradual decrease in the yield no all maturities due to excess of demand for ST-Bonds over supply thereof. In the reporting period, the total weighted

average yield was formed at the level of 13.2 percent (-2.3 percentage points).

The sales volumes exceeded the amount of announced emission due to additional placements of ST-Bonds; the volume thereof amounted to KGS 300.0 million in the period under review. Meanwhile, 12 participants were present in the ST-Bonds market as in the same period of 2016.

Interbank market of credit resource

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



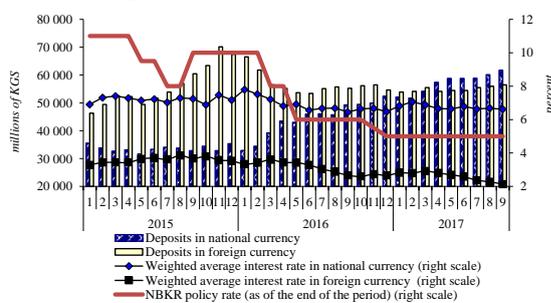
REPO transactions in the interbank credit resource market were mainly conducted with the maturity of up to 7 days (20 transactions from 67 - with the maturity of more than 7 days) to the total amount of KGS 1.5 million.

Moreover, in the reporting quarter, standard transactions in the national currency were conducted twice to the amount of KGS 79.6 million at the rate of 4.0 percent with the maturity of 203 days and to the amount of KGS 50.0 million at the rate of 6.8 percent with the maturity of 7 days. Standards transactions in foreign currency were not conducted in the current quarter like in the corresponding quarter of 2016.

Thus, the market capacity increased significantly (+6 times) compared to Q3 2016. In Q3 2017, on the background of increase in demand for interbank credit resources, an average rate on credits in the national currency amounted to 5.1 percent (+0.9 percentage points), on REPO transactions - 2.2 percent (+0.4 percentage points).

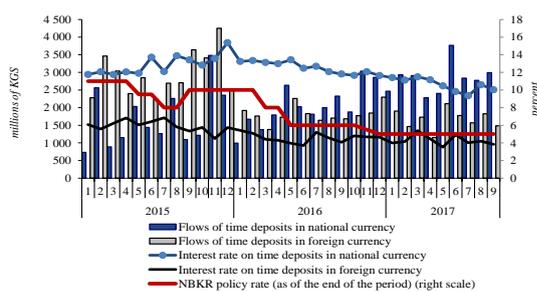
Deposit Market

Chart 3.2.4. Dynamics of Commercial Banks Deposits



made insignificant contribution at the rate of 3.3 percent, up to KGS 56.5 billion. Dollarization of the deposits decreased by 3.3 percentage points year-to-date, to make 47.8 percent.

Chart 3.2.5. Dynamics of Commercial Banks' Time Deposits Flows



maturity with the share of 46.2 percent and 29.7 percent respectively.

In the interbank market of credit resource, there was an upward trend on the background of growing demand, followed by a slight increase in the interest rates in this segment of the market.

In the reporting quarter of the current year, the activity on the REPO transactions increased significantly, where the volume of these credits increased by 19 times, up to KGS 2.8 billion compared to the same indicator of Q3 2016.

During the period under review, the

In Q3 of the current year, the upward trend of the deposit base, due to attraction of the resources in the national currency, was still observed in the deposit market.

At the end of September 2017, the volume of the commercial banks' deposit base increased by 10.4 percent year-to-date to make KGS 118.2 billion mainly due to increase of the deposits in the national currency by 17.8 percent up to KGS 61.7 billion. However, the deposits in foreign currency

made insignificant contribution at the rate of 3.3 percent, up to KGS 56.5 billion. Dollarization of the deposits decreased by 3.3 percentage points year-to-date, to make 47.8 percent.

In the reporting period, the resources attracted in the national currency exceeded the ones in foreign currency by 21.0 percent and mounted to KGS 71.7 billion, meanwhile the currency component was KGS 59.2 billion.

Thus, in terms of maturity of new deposits in the national currency, the main share accounted for the deposits from 1 to 3 years (31.8 percent) and from 6 to 12 months (39.2 percent), in foreign currency the major share accounted for deposits with the same

In Q3 2017, an average weighted interest rate on new deposits in the national currency made 2.66 percent (+0.40 percentage points against the same period of 2016), this rate on the deposits in foreign currency made 0.53 percent (-0.05 percentage points). 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 decreased down to 9.99 percent (-2.20 percentage points) due to a decrease of all rates by maturity from 1 month to 3 years. Moreover, in Q3, duration on the flows of the 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 4.01 percent (-0.60 percentage points) due to the decrease of the rates on the deposits from 3 months to 3 years and more. In the reporting period, duration on the flows of the deposits in foreign currency amounted to 1.6 months (+0.2 months).

Credit Market

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

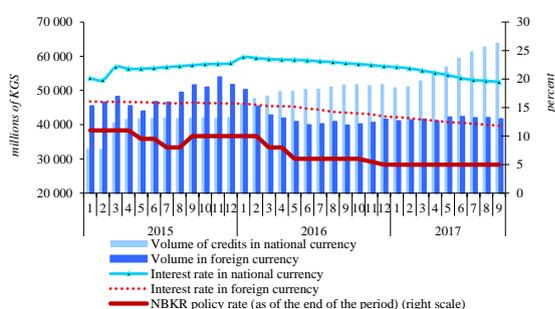
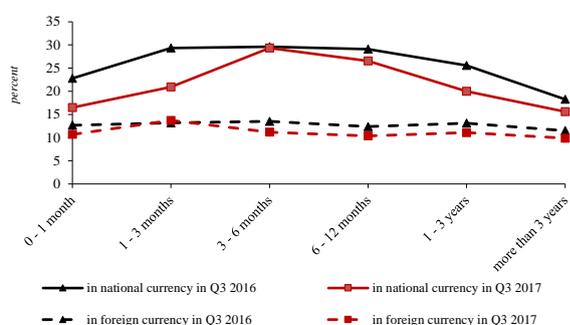


Chart 3.2.7. Rates of New Credits in National and Foreign Currency in Terms of Maturity



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 decrease of the interest rates in the commercial banks on all sectors of economy.

At the end of the reporting period, the volume of credit portfolio of the commercial banks increased by 13.1 percent year-to-date and amounted to KGS 105.7 billion due to the growth in the national currency by 23.4 percent, to make KGS 64.0 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. The volume of the credit portfolio in foreign currency increased insignificantly (+0.3 percent) year-to-date and amounted to KGS 41.7 billion. Moreover, dollarization of the credits decreased by 5.1 percentage points year-to-date to make 39.5 percent at the end of the reporting period.

In Q3 2017, the volume of new credits in the national currency increased by 18.3 percent compared to the same indicator of 2016 and amounted to KGS 18.2 billion and those in

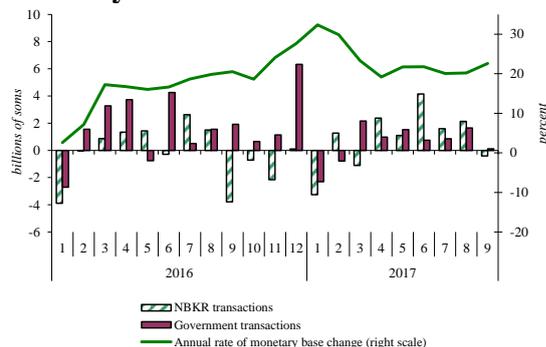
foreign currency, on the contrary, decreased down to KGS 8.8 billion (-2.2 percent).

In Q3 of the current year, the weighted average interest rate for new credits in the national currency decreased by 5.56 percentage points compared to the same indicator of the last year, to make 19.23 percent, this rate in foreign currency decreased down to 10.28 percent (-1.95 percentage points).

There was slight improvement in the quality of the credit portfolio on the background of growth of the credit portfolio. Thus, the share of overdue credits in the credit portfolio constituted 2.3 percent late in the reporting period (-0.6 percentage points year-to-date), while the share of prolonged credits decreased by 0.6 percentage points year-to-date to make 4.2 percent.

3.3. Dynamics of Monetary Indicators

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



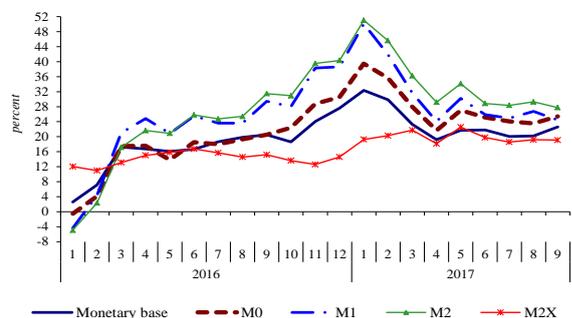
Monetary Base

In Q3 2017, the annual growth rates of the monetary base were approximately at the level of Q2 (20.9 percent), having increased by 1.2 percentage points compared to the same period of 2016. In Q3 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 revenues thereof.

In Q3 2017, monetary base increased by 6.4 percent, meanwhile, the contribution of the Government operations to the growth of monetary base made +2.8 percentage points (KGS 2.6 billion), the contribution of the National Bank operations made +3.6 percentage points (KGS 3.3 billion). In September, the annual growth of monetary base made 22.6 percent.

The structure of monetary base did not change significantly. At the end of the reporting period, the share of reserves of other deposit corporations made 10.8 percent, meanwhile, the share of money in circulation was 89.2 percent (at the end of Q2 2017 - 10.3 percent and 89.7 percent respectively).

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



Monetary Aggregates

Generally, in the reporting quarter, all monetary aggregates continued the upward trend, which was primarily determined by an increase of money outside banks.

In the reporting quarter, money outside banks increased by 6.3 percent, meanwhile, the annual growth of this indicator made 25.4 percent at the end of the quarter. During the period under review, the monetary aggregate M1 increased by 5.4 percent (annual growth at the end of the period made

24.4 percent), M2 increased by 6.4 percent (annual growth made 27.8 percent).

During the quarter, monetary aggregate M2X increased by 5.9 percent and made KGS 186.1 billion at the end of the quarter under review. The monetary aggregate, except for the money outside banks, increased due to the growth of deposits in the national currency by 6.7 percent and in foreign currency by 4.3 percent. At the end of the period under review, the annual growth rates of M2X made 19.1 percent.

In the reporting quarter, the total volume of credits to the economy¹ increased by 3.8 percent and amounted to KGS 108.1 billion at the end of period, primarily due to the growth of credits in the national currency by 7.2 percent. In the reporting period, credits in foreign currency decreased by 1.0 percent. The annual growth of credits to the economy made 15.2 percent, excluding the exchange rate changes this indicator increased by 15.3 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

The inflation rates in Kyrgyzstan remained restrained, in the period under review inflation slowed down. Rise in prices for major commodity groups was below the benchmarks primarily due to relatively low prices for imported food products and a restrained demand for non-food products.

4.1. Consumer Price Index

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

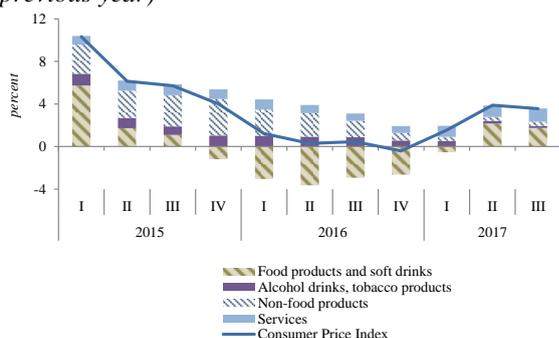


Chart 4.1.2. Dynamics of Food Prices' Contribution to Annual CPI
(month to the corresp. month of the previous year)

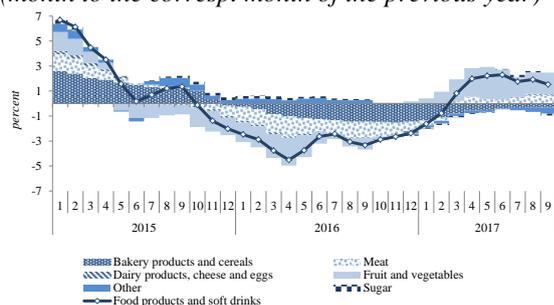
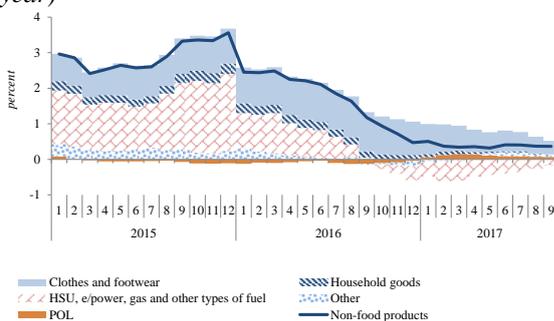


Chart 4.1.3. Dynamics of Non-Food Prices' Contribution to Annual CPI
(month to the corresponding month of the previous year)



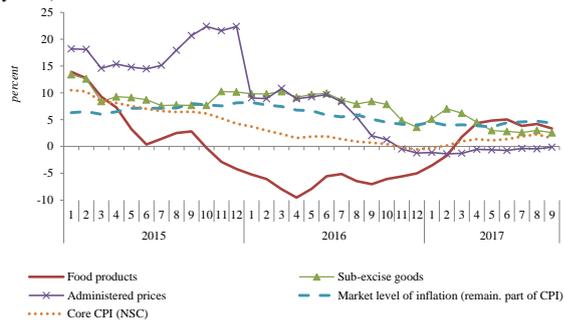
In Q3 of the current year, the inflation rate in Kyrgyzstan remained relatively low. In the period under review, the annual inflation rate was 3.6 percent, having slightly decreased from 3.9 percent in Q2. Favorable conditions in the external food markets, low increase in energy prices, as well as restrained consumer demand for non-food products were the main factors holding back the inflation rate.

The increase in prices for food products was close to the general level of the inflation rate and amounted to 3.8 percent. In this product category, prices decreased for products in the import-dependent groups, such as bakery products, vegetable oils and sugar. Generally, the situation in the world markets of basic food products did not have significant inflationary impact on the prices in Kyrgyzstan.

High grains production in the countries of the region and stability in the foreign exchange market of Kyrgyzstan also had a positive effect. Moreover, low imported inflation in the food group was counterbalanced by a significant annual increase in prices for vegetable due to the low base of the previous year and a moderate rise in price for meat products.

Indicators of the consumer market reflected a restrained demand for non-food products in Kyrgyzstan. According to the National Bank estimates, market inflation rate and the core components of the inflation, demonstrated an annual increase at the level of about 4.5 percent, whereas in previous years, these indicators were at the level of 7-8 percent. Stable situation in the foreign exchange market, a zero increase in tariffs for electricity, and lower prices for coal compared to the previous year had an effect on non-food inflation. In light of these factors, prices for non-food products rose by 1.3 percent in annual terms. In the quarter

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

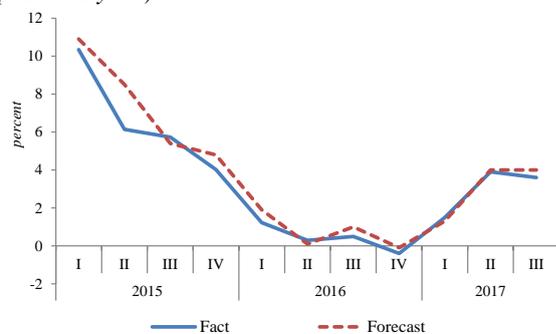


under review, the prices for alcohol drinks and tobacco products increased by 2.3 percent due to weak demand for alcohol drinks. Prices for paid services increased by 8.3 percent, which was mainly supported by higher tariffs for communication services.

4.2. Comparison of Forecast and Facts

Chart 4.2.1. Actual and Forecasted CPI Values

(quarter to the corresponding quarter of the previous year)



In Q3 2017, the actual inflation rate was slightly below the forecasted level. Rise in prices was forecasted at the level of approximately 4.0 percent; meanwhile the actual inflation rate was 3.6 percent, primarily due to lower food inflation against expectations.

Chapter 5. Medium-Term Forecast

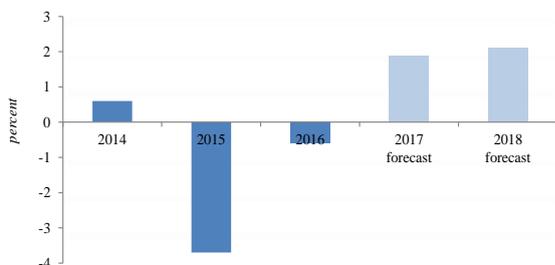
5.1. External Environment Proposals

5.1.1. Development Forecast of Major Trading Partner Countries

Russia

Chart 5.1.1.1. Real GDP Growth in Russia

(year to year)



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

In 2017, GDP growth is expected at the level of 1.9 percent instead of 1.4 percent according to the previous forecast. This was due to the higher economic growth registered in Q2 and Q3 of the current year compared to expectations.

More stable prices for oil, stable exchange rate of the Russian ruble and favorable financial conditions will contribute to economic growth. Further increase of salaries in Q4 of the reporting year is expected to contribute to further growth of consumer demand and to give support to GDP growth in

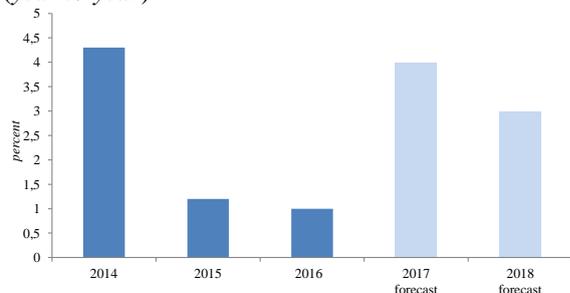
the country.

Despite slowdown in the CPI in Q3, the inflation rate, according to the Bank of Russia estimates, will approach the target level of 4.0 percent as the time factors are exhausting. Depending on the significant deviation of the inflation rate from the target and the dynamics of economic activity from the forecast, the Bank of Russia allows further easing of the monetary policy, which will have a positive effect on the dynamics of investments in fixed assets.

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 improved due to higher than anticipated actual data for 9 months of 2017. Economic growth in the country was adjusted up to 4.0 percent in 2017 (instead of the previously expected 3.0 percent). Provided that growth factors remain unchanged in 2018, an increase by 3.0 percent is expected, instead of 3.5 percent (due to the high base of 2017). In Q4 2017, according to experts, economic indicators can significantly slow down under the influence of technical and seasonal factors. At

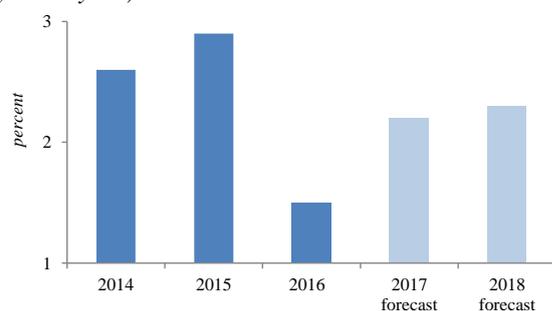
the same time, the economic growth of Kazakhstan in the medium term and in the absence of shocks will be supported by an increase in the volume of extraction, production and export of mineral resources, as well as through the growth of domestic consumption on the background of increased investment in fixed assets in the framework of implementing the state programs for support and diversification of the economy.

In 2017, the trend of the inflation rate slowdown is forecasted with absence of adverse price shocks. The inflation rate is expected within the range of 6.0-8.0 percent and by the end of 2017 the average annual inflation rate will be approximately 7.4-7.6 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

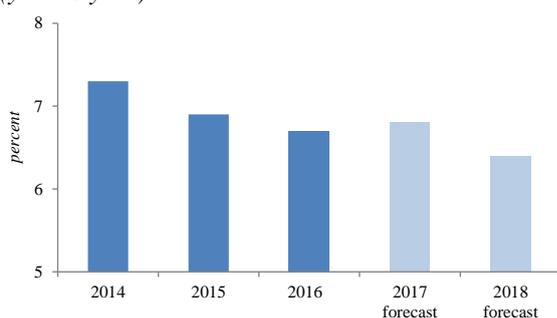
the population will have a restraining effect on the economy.

The inflation rate in the USA is forecasted to be slightly higher than the rate of two percent in the coming years.

China

Chart 5.1.1.4. Real GDP Growth in China

(year to year)



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

by 2020 and the government can apply stimulus measures, particularly public investment, to achieve economic goals.

According to the forecasts, gradual rise in the inflation rate is expected in China, in 2018-2019, it will be at the level of about 2.2 percent.

5.2. Medium-Term Forecast

Assumptions about development of the external conditions and internal environment in Q3 2017 to the greatest extent were consistent with the baseline scenario, approved at a meeting of the Board of the National Bank held in August 2017 года.

Thus, significant changes were not observed in the petroleum products market and the average price fluctuated at the level of approximately USD 52 per one barrel. According to the estimates, provided that the current balance of production and consumption of oil and the emerging trend in the world financial market remain unchanged, the world energy market will remain stable in the medium term, the average price for Brent oil in 2018-19 is expected at the level of USD 53-56 per barrel.

Generally, in Q3 2017, dynamics of the world food markets remained stable, in July-September of the current year, FAO index of the food products fluctuated within the range from 177 to 179 points. In the nearest future, significant price fluctuations are also not expected in the

Economic growth in the USA will remain moderate. In the labor market, the situation is still improving, decrease of unemployment level will stimulate the growth of salaries, thereby supporting consumer expenditures. There is a high confidence in the prospects for the economy among entrepreneurs and consumers. This factor is a positive condition for investment activity. Uncertainty comes from the plans of the US authorities for tax reform. Implementation thereof may be an incentive for the growth of consumer activity and business investment. Moreover, the slow growth of labor productivity and the aging of

Slowdown of economic growth is expected to continue in China during the coming years. The authorities of the country carry out structural economic reforms and take measures to combat environmental pollution and to restrain financial risks, which contributes to slowdown in the growth of activity. The economy of China is in the process of transformation from a development model based on investments and export, to increasing the role of domestic consumption and services as the main drivers of growth. At the same time, China has set the goal of doubling real GDP in 2010

world food markets, until the end of the current 2017-18 MY, FAO index is expected at the level of about 180 points.

The strengthening of economic growth trend is observed in the countries - trading partners of Kyrgyzstan, therefore preservation of the current growth in the inflow of remittances are taken into account in the short term.

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. Taking into account the current dynamics of prices and the stability of prospects in the world commodity and raw materials markets, the stability of non-monetary inflation factors can be expected in the near future.

Changes in the tariff and tax policies, as well as some changes in the conditions of the external trade will have certain impact on the key macroeconomic indicators in the medium term.

Prospects for economic growth in the countries - trading partners of Kyrgyzstan continue strengthening on the background of stability in the world commodity markets. The forecast for economic growth in Russia in 2017-2018 is adjusted upward: in 2017, GDP in Russia is expected to increase by 1.9 percent, in 2018 – by 2.1 percent. In 2017, economic growth in Kazakhstan is expected at the level of 4.0 percent, in 2018 – by 2.9 percent. The inflation rate in Russia and Kazakhstan will still slow down and in the near future it will remain within the target levels.

Thus, the assessment of the price dynamics in the world commodity markets and the prospects for economic growth in the trading partner countries form a positive background for the economy of Kyrgyzstan.

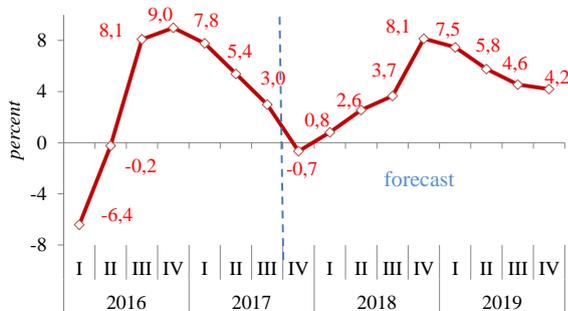
Uncertainty in the fiscal policy decreases in the medium term. The Draft Law “On the republican budget for 2017 and forecast for 2018-2019” stipulates gradual fiscal consolidation.

Taking into account the assessments of the external environment and the internal conditions development in 2017 in the medium term, the inflation rate will approach the upper border of target within the range of 5-7 percent. Recovery in prices for food products and energy carriers in the world and in the region, as well as growth of the aggregate demand will 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 remittances and relatively stable inflation expectations of the population.

In 2017, the real sector of the economy of Kyrgyzstan will demonstrate moderate growth. GDP gap will form negative and will still have deflationary impact during 2017-2018.

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



According to the results of 2017, the real GDP growth is expected at 3.2 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 4.2 percent, excluding

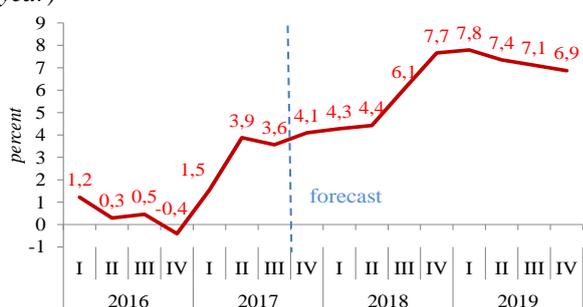
Kumtor, the growth will amount to approximately 5.1 percent.

Baseline inflation in the medium term will reach the upper level of the target range of 5-7 percent. At the end of 2017, the inflation rate (period to period) will reach 2.9 percent

(Dec 2017/Dec. 2016 – approximately 4.5 percent). In 2018, the average inflation value will be about 5.5 percent.

Chart 5.2.2. Inflation Forecast

(quarter to the corresponding quarter of the previous year)



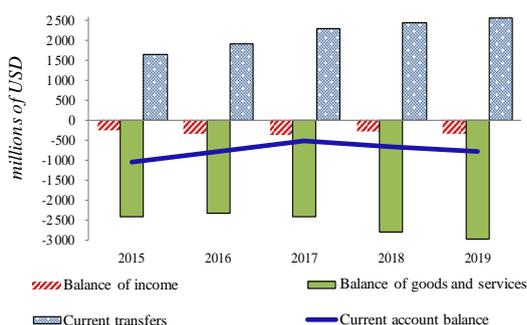
Reversal of the downward inflation trend is still expected on the background of price recovery in the world commodity markets. Taking into account growth of the inflationary pressure from increasing aggregate demand and inflationary expectations, price movement in the medium term will demonstrate growth 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 for 2017 was revised taking into account expectations in respect of export volumes. Growth of exports is forecasted at the rate of 1.5 percent by the end of the year, the forecast of imports is also adjusted downward. The current account deficit is expected at 7.3 percent to GDP at the end of the year primarily due to the positive dynamics of the migrant workers' remittances.

Chart 5.2.3. Forecast Data on Current Account

(millions of USD)



Positive dynamics of export growth excluding gold is still observed, however, the rate of growth will slow down to 4.4 percent. This dynamics will be due to the decrease in the fourth quarter of the deliveries of such commodity items as vegetables, fruits, dairy products, clothing, footwear, rolling glass, etc., which are mainly supplied to the markets of Russia and Kazakhstan. The forecast for gold exports in 2017 was not significantly changed.

Taking into account possible difficulties with import supplies, the growth of imports is expected at the level of 4.5

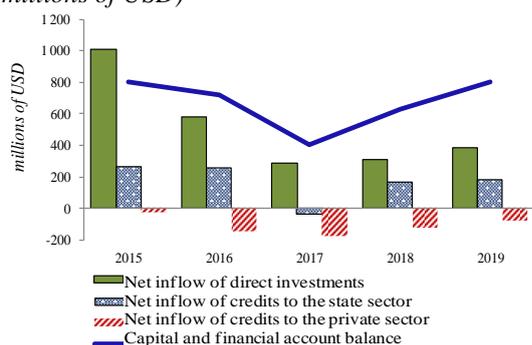
percent, supported by domestic demand. Forecast for imports excluding energy products is expected at the level of 4.7 percent. The physical volumes of petroleum products supply to the country were revised with the growth of the world prices for them, therefore, by the end of the year, the import of petroleum products is expected to be lower than the level of the previous year.

Forecasts for growth in the inflow of private transfers in 2017 will remain at the level of 21.0 percent due to favorable trend of the increase in the migrant workers' remittances within the actual period. This trend will be determined by the rehabilitation of the economic growth in Russia, by the stability in their foreign exchange market and by improvement of migrant workers' labor conditions in the host country.

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

Chart 5.2.4. Forecast Data on Capital and Financial Account

(millions of USD)



In 2017, along with the decrease of the current account deficit, 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 capital account 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 loans is expected to increase compared to 2016 due to reduced payments on previously attracted loans, and the significant decrease in the inflow of new loans.

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 71.5 million. Meanwhile, international reserve assets¹ are expected to cover 4.3 months of the future imports of goods and services.

Revised forecasts for balance of payments indices in 2017 had adjusting impact on the trend for development of the external sector in 2018 and 2019. Exports for 2018 are expected to decrease below the level of 2017 by 6.2 percent. Preservation of the upwards trend in internal demand will have a positive impact on the growth of imports by 6.3 percent.

Thus, in 2018, the growth of imports and the decline in exports will determine an increase in the trade balance deficit by 15.3 percent. In elaborating the development of foreign trade indicators for 2019, the National Bank forecasts an increase in imports by 5.1 percent and in exports by 6.6 percent. The dynamics of current transfers for 2018 and 2019 is expected to remain positive, current transfers are forecasted to increase by 7.0 and 4.7 percent, respectively.

Thus, taking into account the above mentioned facts, the current account will increase in 2018 and 2019 by 9-10 percent to GDP.

In order to finance the expected increase in the current account deficit, a corresponding capital inflow is required on the financial account, which will be provided by an increase in foreign liabilities. 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, according to the National Bank of the Kyrgyz Republic estimates, the upward trend in servicing previously borrowed loans is still observed. General balance of payments in 2018 is expected to be negative in the amount of USD 37.3 million, in 2019, positive balance is expected in the amount of USD 13.7 million. International reserve assets will cover 3.9 months of the future imports of goods and services.

The elaborated forecast of the balance of payments of the Kyrgyz Republic for 2018-2019 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.

¹ 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.

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	Q3
1. Demand and supply¹												
<i>(real growth rates, if otherwise is not indicated)</i>												
Nominal GDP, per quarter	млн сомов	80 778,2	94 092,2	123 446,1	132 172,9	79 596,7	101 100,4	134 734,5	142 595,8	86 143,1	107 752,2	141 088,6
GDP	%	7,4	7,0	5,8	-1,8	-6,4	-0,2	8,1	9,0	7,8	5,4	3,0
GDP, excluding Kuntor	%	2,8	4,3	5,3	6,1	0,5	1,4	5,0	5,9	3,9	2,5	4,3
Domestic consumption	%	1,7	-2,0	-0,5	-1,3	0,4	3,8	2,0	1,4	0,2	0,7	
Gross accumulation	%	19,6	11,8	-5,3	-16,3	-5,3	2,7	0,1	2,3	-14,2	0,0	
Net export	%	-2,9	-1,6	-28,5	-29,8	8,8	3,5	-15,9	-27,2	-23,5	-13,9	
<i>GDP production:</i>												
Agriculture	%	1,0	2,5	8,6	5,8	0,3	2,5	2,3	6,6	1,5	1,0	0,6
Industry	%	24,9	24,4	7,4	-36,5	-27,7	-10,6	30,9	30,9	35,5	27,4	7,8
Construction	%	-0,5	5,8	8,4	34,5	4,0	8,8	8,0	7,6	0,0	8,3	5,7
Services	%	3,0	3,2	3,3	4,6	2,1	1,5	4,5	3,4	0,5	-0,4	2,0
including trade	%	3,5	3,4	-0,4	-2,6	5,0	5,3	11,6	7,0	3,9	4,0	4,5
2. Prices²												
CPI	%	110,3	106,1	105,7	104,0	101,2	100,3	100,5	99,6	101,5	103,9	103,6
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	103,3
Core CPI	%	109,7	107,6	106,5	105,2	103,0	101,8	101,0	99,9	100,3	101,3	101,9
<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	103,8
Non-food products	%	112,2	110,4	109,0	111,6	111,7	110,8	110,0	102,4	101,3	101,2	101,3
Alcohol drinks and tobacco products	%	109,5	108,9	110,1	111,8	108,5	107,6	105,3	106,5	105,7	102,8	102,3
Services	%	106,0	106,9	107,4	106,6	106,5	105,2	104,6	104,4	106,9	107,1	108,3
<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	102,7
Regulated prices	%	116,9	114,9	117,9	122,1	109,6	109,3	105,2	99,8	98,7	99,4	99,7
Market inflation rate (the rest of CPI)	%	106,3	106,9	107,4	107,8	107,8	106,4	105,5	104,2	104,2	104,0	104,6
3. External sector³												
<i>(in percent to GDP)</i>												
Trade balance	%	-37,1	-37,7	-36,4	-34,3	-35,4	-37,2	-35,2	-32,4	-31,6	-29,7	-31,2
Current account	%	-18,7	-21,1	-21,2	-16,2	-14,1	-15,1	-12,3	-12,0	-10,0	-6,9	-6,8
Export of goods and services	%	44,1	40,8	39,1	37,9	38,3	38,2	38,8	37,1	37,6	38,4	37,6
Import of goods and services	%	86,0	83,4	79,3	75,1	75,8	77,7	76,4	72,6	71,9	70,1	70,7
4. USD exchange rate, as of the end of period												
	сo.m	63,8736	62,0788	68,8359	75,8993	70,0158	67,4860	67,9346	69,2301	68,6069	69,1367	68,6585
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	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	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	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	2,33
<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	2,19
of credits in national currency	%	15,00	18,00	-	11,62	13,25	7,84	4,11	2,67	2,11	3,10	5,06
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	1,44
Weighted average yield of 28-day notes, as of the end of period	%	-	-	-	-	-	-	-	-	1,14	4,08	2,94
Weighted average yield of 91-day notes, as of the end of period	%	-	-	-	-	-	-	-	-	-	-	5,00
Monetary base	%	-16,25	-9,52	-4,34	4,01	17,24	16,65	20,53	27,63	23,31	21,79	22,60
Money outside banks (M0)	%	-19,9	-15,7	-7,0	2,3	17,5	18,6	20,6	30,5	28,0	25,1	25,4
Monetary aggregate (M1)	%	-17,7	-14,3	-5,6	1,7	21,0	25,5	29,4	38,6	31,7	25,9	24,4
Narrow money supply (M2)	%	-13,2	-13,6	-5,7	-0,1	17,2	25,8	31,5	40,3	36,2	28,8	27,8
Money supply (M2X)	%	0,9	0,5	10,0	14,9	13,1	16,7	15,2	14,6	21,7	19,8	19,1

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 Q3 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 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 the period from 7 to 364 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