

**NATIONAL BANK
OF THE KYRGYZ REPUBLIC**

**Monetary Policy Report
(Inflation report).
Quarter 4, 2016**

**Bishkek
February 2017**

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

Monetary policy in the Kyrgyz Republic

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

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

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

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

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

Monetary Policy Report (Inflation report) for Q4 2016 was approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic No. 8/2 dated February 27, 2017.

Contents

Summary	4
Chapter 1. External Environment	6
1.1. Economic Development of Main Trading Partner Countries	6
1.2. World Commodity and Raw Stock Markets.....	8
Chapter 2. Macroeconomic Development	11
2.1. Demand and Supply in the Commodities and Services Market	11
2.2. External Sector	14
Chapter 3. Monetary Policy.....	17
3.1. Monetary Policy Implementation	17
3.2. Financial Market Instruments	19
3.3. Dynamics of Monetary Indicators	21
Chapter 4. Inflation Dynamics	23
4.1. Consumer Price Index	23
4.2. Comparison of Forecast and Facts.....	24
Chapter 5. Medium-Term Forecast	25
5.1. External Environment Proposals	25
5.2. Medium-Term Forecast	27
Annex 1. Key Macroeconomic Indicators	31
Annex 2. Glossary	32
Annex 3. Abbreviations.....	34

Summary

The low inflation background observed during the whole year still retained in Q4 2016. Average annual inflation in 2016 (January-December 2016 / January-December 2015) reached 0.4 percent, having decreased from 6.5 percent in 2015. In December 2016, the consumer price index decreased by 0.5 percent in annual terms, while in December 2015 it was 3.4 percent. The low inflation in 2016 was mainly caused by food price fall, the rate of price increase in other main commodity groups slowed down as well.

In 2016, the agricultural production of the Kyrgyz Republic continued increasing, which, together with the favorable situation in the world markets of imported staple foods, provided high supply of food products and exerted a downward pressure on domestic prices. The fact that electricity and thermal energy tariffs did not increase, as well as the decline in prices for gas and POL during the year have also contributed to the formation of the low inflation background in 2016.

In the medium term, given the upward trend of domestic demand, scheduled increase in electricity and thermal energy tariffs, as well as balanced prerequisites for domestic agricultural production and dynamics of world food prices, it is expected that the inflation rate will remain within the medium term benchmark of 5-7 percent.

The economy of the Kyrgyz Republic reached a positive path. The downward trend of the country's economic growth, observed since early 2016, has been replaced by positive dynamics in August. Following the results of 2016¹, the country's economic growth increased by 3.8 percent, while GDP growth, excluding enterprises involved in the Kumtor Mine development, reached 3.7 percent. The positive contribution to the GDP growth was made by all major sectors of the economy. Economic growth was supported by upward dynamics of money remittances and recovery of domestic consumption.

Slack external and domestic demand continues causing negative effect on foreign trade indicators of the country. Following the results of 2016, imports of goods decreased by 2.7 percent and exports of goods by 0.7 percent, as a result, the foreign trade turnover² decreased by 2.1 percent and reached USD 5.3 billion. The trade balance deficit amounted to USD 2.1 billion.

Fiscal deficit continues to persist amid the slowdown in flow of revenue and increase in expenditures of the state budget. Following the results of 2016, the state budget was implemented with a KGS 20.9 billion deficit, or 4.6 percent to GDP (in the same period of 2015, the budget deficit amounted to KGS 6.3 billion, or 1.5 percent to GDP). The budget deficit was mainly affected by income growth slowdown, increase in capital and labor costs, subsidy payments and social allowances.

In 2016, KGS continued strengthening against USD at the domestic foreign exchange market. During the year, the national currency strengthened by 8.8 percent. The National Bank participated in currency trading in order to smooth sharp exchange rate fluctuations. The volume of net purchase of foreign currency by the National Bank amounted to USD 29.1 million in 2016.

¹ According to the preliminary data of the NSC KR.

² Preliminary data in FOB prices including additional estimates of the NSC and the National Bank.

Chapter 1. External Environment

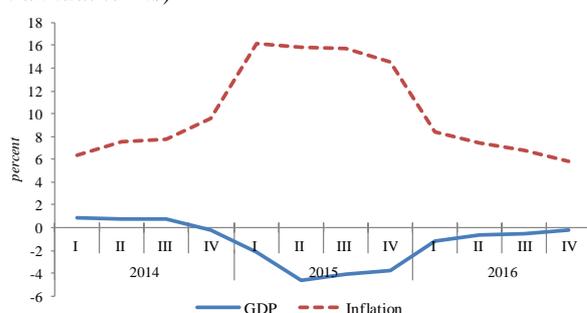
1.1. Economic Development of Main Trading Partner Countries

A gradual recovery of economic activity was observed in the economies of the main trade partners of Kyrgyzstan. Despite the fact that economic growth in Russia remained in negative territory, the rate of decline has been slowing down since the beginning of the year, including Q4 2016: the industrial output continued increasing, the external demand continued growing and import substitution continued developing, the investment activity was gradually recovering. Amid low domestic demand, positive changes in the economy of Kazakhstan were supported by the implementation of structural reforms and government programs. Inflation background in Russia and Kazakhstan slowed down and approached the inflation targets as of the end of the financial year.

Russia

Chart 1.1.1. GDP Growth and Inflation in Russia

(in annual terms)



Source: Ministry of Economic Development of the Russian Federation, Bloomberg News Agency

In 2016, the Russian economy was recovering at a faster pace. In Q4 2016, the annual rate of GDP growth was positive, while according to preliminary estimates of the Russian Federal State Statistics Service, reduction of economic growth in 2016 reached -0.6 percent. Dynamics of GDP components was multidirectional. On the one hand, in the light of growing external demand and development of import substitution, the industrial output continued increasing and investment activity was gradually recovering. On the other hand, consumer demand remained low, after a slight growth in Q3 2016.

Since the beginning of the year, inflation was gradually slowing down and at the end of 2016 amounted to 5.4 percent (December 2016 against December 2015), while the annual average value reached 7.1 percent. According to the Central Bank of Russia, the inflation decline was partly caused by temporary factors, one of which is the RUB strengthening under conditions of the higher-than-expected oil prices, as well as persisting interest of foreign investors to the Russia's financial assets. In addition, the decline in prices for fruits and vegetables was observed amid the high supply.

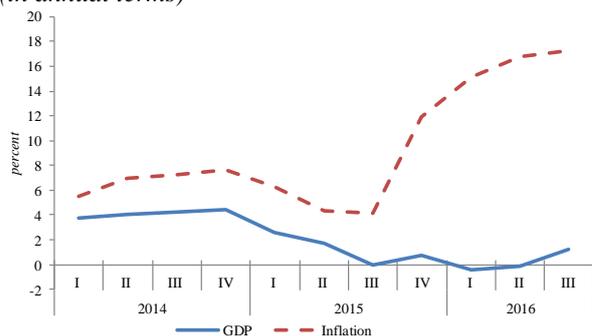
Kazakhstan

Economic growth in Kazakhstan was positive, which, in particular, was related to the implementation of structural reforms and government programs. Kazakhstan's GDP grew by 1.0 percent¹ in 2016; by sectors, the growth was provided by construction (7.9 percent), agriculture (5.5 percent), transport (3.8 percent) and processing industry (0.7 percent).

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

Chart 1.1.2. GDP Growth and Inflation in Kazakhstan

(in annual terms)



Source: RK Statistics Agency, National bank's calculations

depreciation on domestic prices became the main factor of inflation in 2016.

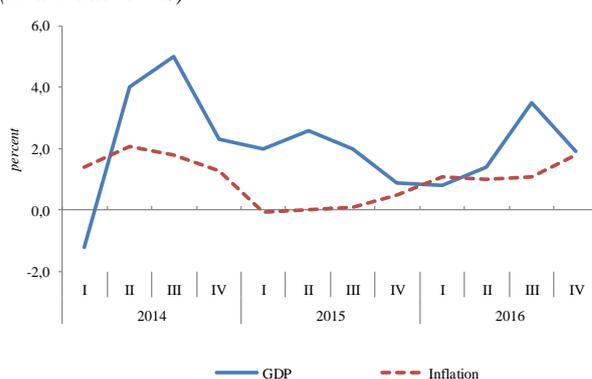
The start of production at Kashagan oil-and-gas field at the beginning of Q4 2016 also made a positive contribution to the growth. Factors constraining the economic growth in 2016 still included the volatility in energy prices and the economic situation in the trading partner countries, including Russia and China.

In Q4 2016, the annual inflation rate in Kazakhstan was 9.3 percent against 11.9 percent in the same period of 2015. At the same time, the annual average inflation rate in 2016 was 14.6 percent. Influence of the national currency's significant

USA

Chart 1.1.3. GDP Growth and Inflation in the USA

(in annual terms)



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

growth was at 1.9 percent in annual terms: dynamics of private investments speeded up significantly.

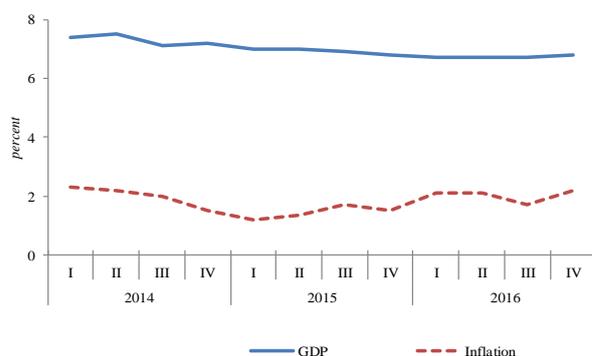
In December 2016, inflation in the USA rose to 2.1 percent in annual terms. The slight decrease in food prices was compensated by 5.4 percent increase in prices for fuel and energy products. Core inflation, excluding the above-mentioned commodity groups, reached 2.2 percent.

China

The rates of economic growth in China slowed down, but still remained rather high. On the whole, in 2016 the country's economy grew by 6.7 percent (against 6.9 percent in 2015), while in Q4 growth rates against the same quarter of the previous year speeded up to 6.8 percent (6.7 percent growth was registered in Q1-Q3).

Chart 1.1.4. GDP Growth and Inflation in China

(quarter to the corresponding quarter of the previous year)



Source: National Bureau of Statistics of PRC, Bloomberg News Agency

Economic activity in the country was supported by accelerated growth of government investments in infrastructure, high level of bank lending and increase in retail sales growth rates. The total volume of investments in fixed assets had a downward trend during the year due to a significant slowdown in private investment growth.

The average annual inflation in China in 2016 was 2.0 percent (1.4 percent in 2015). In December, the annual rate of CPI growth was 2.1 percent.

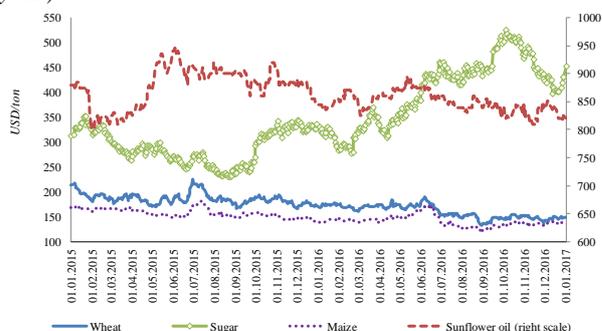
1.2. World Commodity and Raw Stock Markets

The world markets of the majority of foodstuffs imported by Kyrgyzstan enjoyed a favorable price situation. Sugar prices rose, but the influence of this factor was limited by the saturation of the domestic market and a small share of sugar in the CPI basket. The oil market faced an upward price movement; decrease in the investment demand led to the formation of the downward trend for the price of gold.

Food Market

Chart 1.2.1. Dynamics of Prices for Food Products

(month to the corresponding month of the previous year)



In 2016, the global food market, **excepting the sugar market, remained relatively stable, the prices were “flat”**. A slight downward price dynamics was registered in the markets of main food commodities during the year; in Q4 2016, the situation in these markets remained stable. An exception was the sugar market, since the sugar price rose significantly in 2016 and was characterized by price volatility in Q4.

As during the whole year, the sugar price in Q4 was formed under the influence of weather conditions, fluctuations of the Brazilian Real and the increased use of sugarcane for biofuel production instead of sugar. In particular, the increase in sugar prices in 2016 was mainly explained by the impact of the natural climatic phenomenon El Niño¹ at the beginning of the year.

¹ El Niño is a natural phenomenon, occurring every 2-7 years and characterized by heavy rains in South America (up to floods) and droughts in South and Southeast Asia, which has a negative impact on agricultural crops.

Chart 1.2.2. Dynamics of FAO Food Price Index



The high yield of cereals in the world, including Russia and Kazakhstan, was the reason for the decline in prices for wheat and maize in 2016. At the same time, in Q4, there was a partial recovery of prices as a result of the backdrop of high demand, some decrease in supply of high-quality wheat in the world markets and concerns about the deterioration of weather conditions.

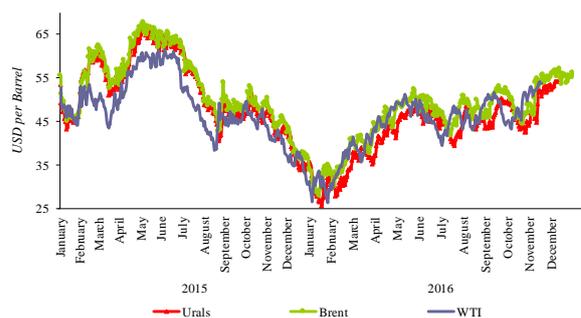
Prices for vegetable oils showed a multidirectional dynamics. Palm and soybean oil rose in price in Q4 due to low supply, while the price of sunflower oil,

which is the most important vegetable oil for the Kyrgyz market, went down.

In 2016, the average value of FAO food price index was 1.5 percent lower than that in 2015; during 2016, the index was increasing mainly due to growing prices of sugar and some vegetable oils. In Q4, FAO food price index rose by 2.9 percent, as compared to Q3.

Energy Market

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



In Q4 2016, as during the whole year, oil price continued growing. The influence of fundamental factors in the oil market has been balanced, an oil price dynamics is continued to be determined by market conditions.

In Q4 2016, prices for the basic oil grades (Urals, Brent, WTI) ranged within USD 42.5-56.9 per barrel. The average price for Brent crude oil rose by 9.1 percent in Q4 2016 compared to the

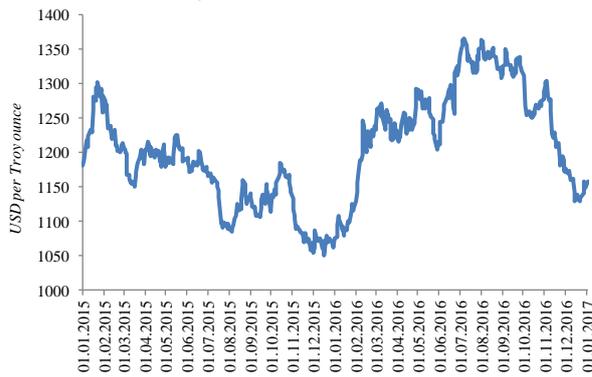
previous quarter and amounted to USD 51.4 (compared to the same period of 2015, the price has increased by 15.7 percent). On an average, in 2016 the price of Brent crude oil was USD 45.4 per barrel, having decreased by 14.6 percent as compared to 2015.

In the reporting period, the main event for the global energy market was the OPEC decision to reduce oil production, which caused the price rise. For the first time in eight years, OPEC decided not to freeze, but cut oil production by 1.2 million barrels a day down to 32.0 million barrels a day. The agreement comes into force since January 1, 2017 and will be valid until the next OPEC summit, scheduled for May 27, 2017.

However, despite the OPEC decision to curtail oil production, there are still risks that price behavior will change amid the increase in shale oil production in the United States, together with a favorable and stimulating domestic policy, as well as the possible non-observance of obligations to cut production by oil producers amid the current geopolitical situation in the world.

Gold Market

Chart 1.2.4. Dynamics of Prices for Gold



Source: Bloomberg News Agency

In Q4 2016, gold prices fell by 8.8 percent compared to the previous quarter, which was mainly caused by factors of the investment demand for the metal. According to the results of presidential elections in the USA, the likelihood that the new Administration would pursue a stimulating economic policy has increased, and the US Federal Reserve rate was raised in mid-December 2016. The increase in basic rate and outlook of the US economy's further growth increase the yield of the country's securities, which are the investment alternatives.

At the same time, the increase in the US Federal Reserve rates in 2016 was occurring at a slower pace than expected. In addition, the referendum in the UK on leaving the EU caused the volatility in the financial markets, which boosted the demand for gold as an asset that retains its value in times of uncertainty. As a result, the average price for the precious metal increased by 7.7 percent compared to 2015.

Chapter 2. Macroeconomic Development

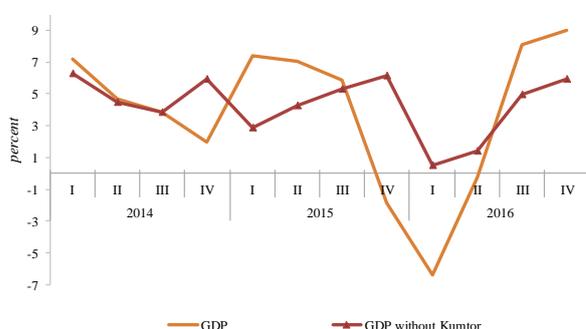
2.1. Demand and Supply in the Commodities and Services Market

In Q4, economic recovery in the country continued, which allowed to reach positive economic growth at the year-end. The economic growth was supported by the increased inflow of remittances in the country and expansion in budgetary expenditures, which had an impact on the recovery of domestic consumption. Continuing weak external demand had a restraining effect on the situation improvement. Favorable weather conditions, together with the agricultural credit subsidization policy, had a positive impact on agricultural production. After two consecutive years of decline, the industrial sector has entered the growth path at the year-end.

Demand

Chart 2.1.1. GDP Dynamics

(quarter to the corresponding quarter of the previous year)

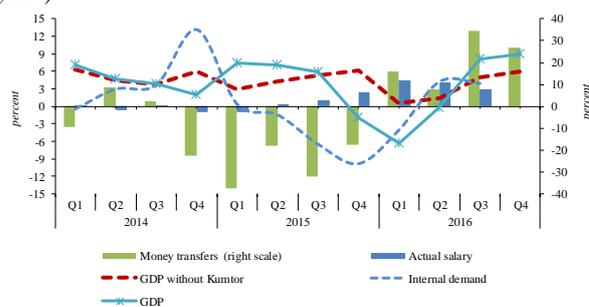


Source: NSC KR

production performance at the Kumtor gold mine. In particular, the production at the Kumtor mine in Q4 2016 made 200.8 thousand ounces, having increased by 53.7 percent in comparison with Q4 2015 (130.6 thousand ounces). In total, in 2016 551.0 thousand ounces of gold were produced at the enterprise that is 5.8 percent more than in 2015 (520.7 thousand ounces). Excluding the production at the Kumtor mine, the growth in production of refined oil products (by 44.4 percent), mining operations (by 20.1 percent), as well as food products (including drinks) and tobacco products (by 12.1 percent) was observed. The service sector increased due to the growth in the field of trade, meanwhile the reduction in transport activities and cargo storage, as well as information and communication fields was observed.

Chart 2.1.2. Dynamics of Domestic Demand and Remittances

(quarter to the corresponding quarter of the previous year)



Source: National Bank

In Q4 2016, the economic growth rate continued the upward dynamics of Q3, and the increase in inflow of remittances and the active fiscal policy made positive impact on domestic demand.

Generally, the current economic growth as of the end of 2016 was caused by positive input from all main sectors of economy. At the same time, within nine months a recession in the industry was observed, which made positive input to GDP only by the end of the year. Such dynamics of industry indicators was caused, mainly, by

Domestic demand remains positive and, according to preliminary results of nine months of 2016, it increased by 1.8 percent in comparison with the same period of 2015¹. The growth was due to the increase in final consumption (+3.2 percent), as well as the slowdown of decline of gross accumulation indicator (-3.2 percent), which improved through the growth of capital accumulation (+0.2 percent).

The increase in inflow of money remittances also influenced on the improvement of domestic demand dynamics. In 2016, the net inflow of individuals'

¹ Reference to the data for the earlier period is given due to the lack of data for Q4 2016.

remittances in USD, performed through money transfer systems, increased by 21.6 percent in comparison with the same period of 2015.

Consumption remained the main component in GDP structure, having amounted to 112.8 percent to GDP as of the end of nine months of 2016.

Public Finance Sector

In 2016, the Government of the Kyrgyz Republic pursued the stimulating fiscal policy. As of the end of the year, the state budget deficit amounted to KGS 20.9 billion or 4.6 percent to GDP (in 2015, the budget deficit amounted to KGS 6.3 billion or 1.5 percent to GDP).

Chart 2.1.3. Execution of the State Budget
(period to the corresponding period of the previous year, accumulatively)



Source: Central Committee of MFKR, National Bank

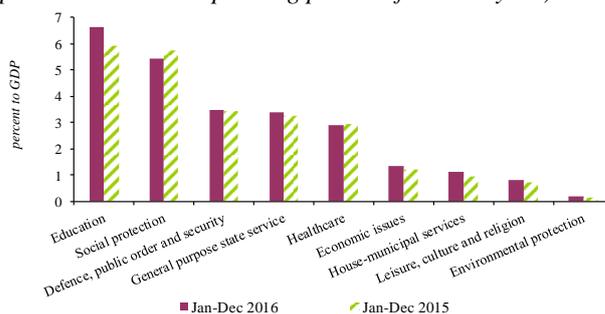
Following the results of 2016, the state budget revenues from operating activities increased by 1.9 percent or KGS 2.5 billion in comparison with the similar indicator in 2015 and amounted to KGS 130.6 billion or 28.5 percent to GDP. At the same time, the largest input to the growth of operating income was provided by tax revenues (7.1 percentage points) and official transfers (0.4 percentage points). The non-tax revenues made negative input (-5.7 percentage points) that was, mainly, due to the receipt of one-time non-tax revenues in the form of state enterprises' dividends, receipts from tender on "Dzheruy" gold deposit, sales of frequency coverage to mobile network operators and others in 2015.

Following the results of 2016, the government budget expenditures from operating activities amounted to KGS 115.9 billion or 25.3 percent to GDP, having increased by 10.2 percent or KGS 10.7 billion in annual term. The growth of the government budget expenditures was connected, mainly, with the growth of capital expenditures on the World Nomad Games, the financing of hippodrome reconstruction in the Issyk Kul region, the reconstruction of the highway Balykchi-Tamchy-Cholpon-Ata-Korumdu, the capital repairs of the highway Bishkek – Manas International Airport, and the meeting of Council of Heads of Governments of the SCO member states.

The largest input to the growth of current expenses was made by expenses for remuneration of labor, payments of subsidies and social benefits. The expenses for education, general-purpose public services, defense, public order and safety, and housing-and-municipal issues made the largest input to the growth of expenditures by functional classification.

The net outflow of budgetary funds for transactions on acquisition of non-financial assets amounted to KGS 35.5 billion or 7.8 percent to GDP.

Chart 2.1.4. Execution of the State Budget
(period to the corresponding period of the last year)



Source: Central Committee of MFKR, National bank

Following the results of 2016, the execution of revenues of the republican budget (tax revenues + non-tax revenues + official transfers) amounted to 95.4 percent that was provided by the execution of plan for collection of non-tax revenues for 115.7 percent, official transfers for 103.0 percent. The plan for collection of tax revenues was executed for 92.3 percent: the State Tax Administration executed the plan for tax collection for 92.5 percent, the State

Customs Service - for 91.9 percent. Following the results of 2016, the expenditure side of the republican budget was executed for 80.0 percent. At the same time, the plan for protected expenditures was executed for 83.6 percent, on the unprotected expenditures – for 65.3 percent.

According to the preliminary data of the Social Fund of the Kyrgyz Republic, as of the end of 2016, the surplus of the Social Fund budget (taking into account the pension fund balance as of the beginning of year) amounted to KGS 2.3 billion or 0.5 percent to GDP. The revenues of the Social Fund budget (taking into account the pension fund balance as of the beginning of year) amounted to KGS 44.7 billion or 9.8 percent to GDP, having increased by 7.3 percent in comparison with the similar indicator in 2015. The expenditures of the Social Fund budget increased by 6.5 percent and amounted to KGS 42.4 billion or 9.2 percent to GDP in comparison with the similar indicator in 2015.

Investments

In 2016, the level of implementation of investments in fixed capital increased by 3.8 percent (in comparable prices) in comparison with 2015.

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

	2015		2016	
	millions of KGS		share, percent	
Total	127 321,8	133 383,7	100,0	100,0
Internal investment	74 860,5	76 617,6	58,8	57,4
Republican budget	4 931,4	10 000,4	3,9	7,5
Local budget	1 263,1	1 329,7	1,0	1,0
Funds of enterprises and organizations	37 482,9	32 758,6	29,4	24,6
Banks' credits	1 274,4	49,5	1,0	0,0
Population funds including beneficent help of KR residents	29 908,7	32 479,4	23,5	24,3
External investment	52 461,3	56 766,1	41,2	42,6
Foreign credit	34 365,9	37 839,9	27,0	28,4
Direct foreign investments	14 748,8	15 288,9	11,6	11,5
Foreign grants and humanitarian aid	3 346,6	3 637,3	2,6	2,7

Source: NSC KR

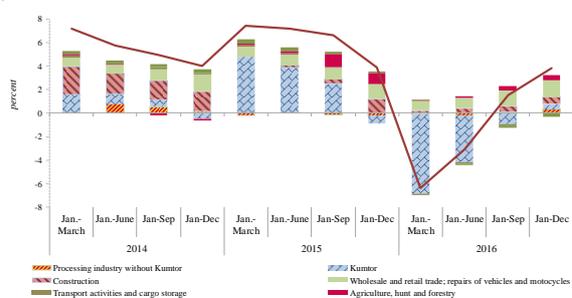
(by 1.8 times), facilities of transport activities and cargo storage (by 37.8 percent).

In structure of financing sources, the increase in the investments in fixed capital financed by external sources is caused by the growth of foreign credits (by 9.0 percent) and grants (by 7.6 percent); by internal sources – at the expense of funds of the republican (by 2.0 times) and local budgets (by 4.3 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

indicator in 2015.

The growth of the industrial sector by 5.2 percent was caused, mainly, by the increase in production of precious metals (by 5.0 percent), extraction of metal ores (by 2.3 times), production of refined oil products (by 44.4 percent) and food products (by 16.7 percent). At

The growth of investments was observed practically in all industries except for the construction of facilities of processing productions, education and healthcare facilities. The considerable growth can be noted in implementation of funds designated for the construction of hotels and restaurants (by 3.4 times), objects of art, entertainment and leisure (by 2.7 times), facilities of water supply, waste treatment and processing (by 2.4 times), facilities of wholesale and retail

trade (by 1.8 times), facilities of transport activities and cargo storage (by 37.8 percent).

In structure of financing sources, the increase in the investments in fixed capital financed by external sources is caused by the growth of foreign credits (by 9.0 percent) and grants (by 7.6 percent); by internal sources – at the expense of funds of the republican (by 2.0 times) and local budgets (by 4.3 percent).

Despite the restrained growth rates of economy during the first half of 2016 year, at the year-end the GDP increased at the expense of positive input of all economy sectors.

According to the preliminary data of the National Statistics Committee of the Kyrgyz Republic, in 2016, the growth rate of economy made 3.8 percent (in 2015, the growth was 3.9 percent), excluding the Kumtor mine, the GDP growth made 3.7 percent (in 2015 – 4.9 percent). The deflator amounted to 2.5 percent that is 0.9 percentage points less than the similar

the same time, the reduction in textile production (by 12.6 percent), production of apparel (by 20.0 percent), other nonmetallic mineral products (by 8.4 percent), supply of electricity, gas, steam and conditioned air (by 3.5 percent) continued.

The growth of the construction sector by 7.4 percent was due to the growth of the volume of investments in fixed capital in 2016 (+ 3.8 percent in comparable prices). About 74.0 percent of the total amount of investments were directed to the construction of facilities on mineral extraction, the supply of electric power, gas, steam and conditioned air, the transport activities and the housing construction. The volumes of investments financed by internal sources increased by 1.5 percent; by external sources – by 7.1 percent.

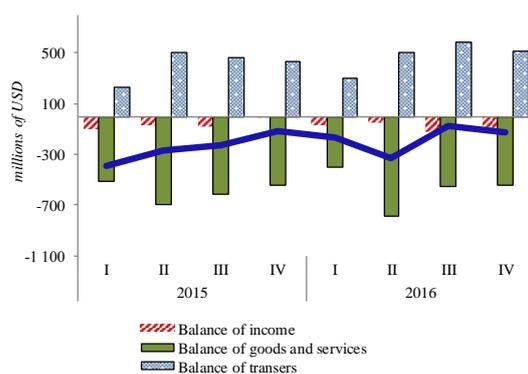
Favorable weather conditions along with the subsidy policy of agricultural credits positively affected the production of agricultural products. As a result, the growth of the agricultural industry made 3.0 percent that is caused by the increase in both crop production, and livestock production.

The growth of trade in the reporting period by 7.6 percent is caused, mainly, by the increase in the growth of volumes of retail (by 8.3 percent) and wholesale (by 6.6 percent) trade.

2.2. External Sector¹

Chart 2.2.1. Current Account

(millions of USD)



Note: According to preliminary and forecast data.

Increase in negative balance of services and income promoted the increase in deficit of the current account by 10.4 percent in Q4 2016. At the end of 2016, the deficit of the current account made USD 695.8 million that is 30 percent less than indicator of 2015 (decrease to 10.5 percent to GDP).

According to forecast and preliminary data, in Q4 2016, the current account deficit will increase to USD 124.1 million and will make 10.5 percent to GDP.

In the reporting period, the deficit of trade balance of the Kyrgyz Republic will decrease by 8.5 percent and will make USD

467.4 million. The trade balance will form under the influence of increase in export of gold and decrease in import of oil products.

2.2.1. Trade Balance of the Kyrgyz Republic²

(millions of USD)

	2014	2015	2015 Q4	2016 * Q4	Variation in %	Variation in millions of
Trade balance	-2 807,5	-2 176,3	-510,7	-467,4	-8,5	43,3
Export (FOB)	2 482,7	1 606,2	478,3	496,3	3,8	18,0
Gold	716,9	665,4	147,4	256,0	73,6	108,6
Import (FOB)	5 290,2	3 782,5	989,0	963,7	-2,6	-25,3
Energy products	1 041,8	808,0	234,8	124,1	-47,2	-110,7

* Preliminary data

¹ Taking into account the NSC KR additional estimates for agricultural products (until 2016) and mutual trade with the EEU countries (since Q3 2015) and the NBKR estimates.

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

² The data on external trade are given taking into account the NSC KR additional estimates for agricultural products (prior to 2016) of and mutual trade with the EEU member states (since Q3 2015) and the estimates of the NBKR.

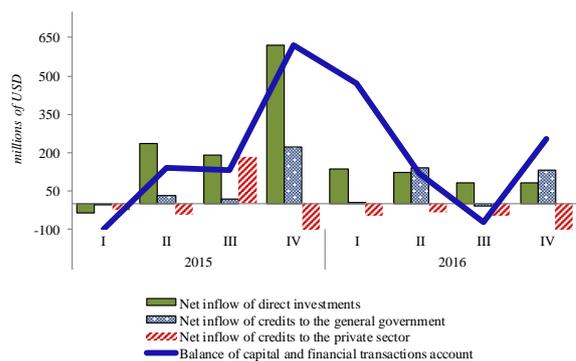
In Q4 2016, exports of goods (in FOB prices) will increase by 3.8 percent and will make USD 496.3 million. In the reporting period, the dynamics of exports will be affected by the growth of supply of gold, which was 1.7 times less in comparable quarter in 2015. At the same time, the decrease in exports excluding gold will be noted, which will make 27.4 percent due to the decrease in articles of clothing and clothes accessories by 35.7 percent, vegetables, fruit by 13.5 percent and other goods.

In the reporting period, imports of goods (in FOB prices) decreased by 2.6 percent and made USD 963.7 million. The decrease in imports will occur generally due to the reduction of supply of oil products by 71.9 percent (due to both the decrease in physical volume and the prices), special purpose motor vehicles by 83.6 percent, wheat and mangcorn flour by 68.1, etc. At the same time, the increase in footwear and apparel by 40.5 percent, woven fabrics by 29.7 percent, essential oils by 7.0 percent and others was observed.

In the reporting period, the inflow on the current transfers will exceed the indicator of the same period in 2015 and will make USD 508.0 million. This growth will be provided with positive dynamics on net inflow of private transfers, which will increase by 23.7 percent and will make USD 472.4 million.

In Q4 2016, the deterioration in negative balance of income is predicted, the balance of which is expected at the level of USD 90.2 million that is more than the level of the corresponding quarter in 2015; the negative balance of services is predicted at the level of USD 74.5 million.

Chart 2.2.2. Capital and Financial Account



The decrease in inflow of direct investments will cause the decrease in positive balance on the capital and financial account. The capital and financial account will have positive balance of USD 252.6 million that is 59.4 percent less than in Q4 2015. The balance of capital account is expected positive of USD 25.2 million. In the reporting period, the positive balance of financial account, as expected, will make USD 227.4 million.

The net inflow of direct investments to the country is predicted by 87.1 percent less than in the same period of last year and will consists of USD 79.7 million. In the reporting quarter, the balance of the item “Other investments” will be positive of USD 147.6 million due to the reduction of residents’ assets abroad, along with the growth of liabilities to nonresidents.

The net inflow of direct investments to the country is predicted by 87.1 percent less than in the same period of last year and

Thus, at the end of Q4 2016, the balance of payments of the Kyrgyz Republic will be positive of USD 58.4 million. The volume of gross international reserves will cover 4.1 months of future import of goods and services.

less than in the same period of last year and

Indexes of KGS real and nominal effective exchange rate.

Table 2.2.2. Exchange Rate Key Indicators

	year (average)		%	to the beginning of the year (as of the end of)			
	2015 (avg) (January-December)	2016 (avg) (January-December)		December 2015	December 2016 *		
REER (real effective)	115.6	113.0	-2.3	108.9	112.4	3.2	↑
NEER (nominal effective)	108.8	112.0	2.9	103.9	111.9	7.7	↑
RBER (real bilateral exchange rate) to CNY	84.7	80.8	-10.6	74.4	85.8	15.3	↑
NBER (nominal bilateral exchange rate) to CNY	66.4	64.5	-14.5	57.6	67.9	17.9	↑
RBER to EUR	116.6	107.3	-6.3	102.8	114.3	11.1	↑
NBER to EUR	85.5	78.8	0.0	74.0	83.4	12.7	↑
RBER to KZT	112.1	141.7	1.1	129.7	136.3	5.1	↑
NBER to KZT	105.9	152.1	1.7	130.9	150.3	14.8	↑
RBER to RUR	138.2	131.4	21.7	130.8	122.4	-6.4	↓
NBER to RUR	142.8	144.8	31.8	137.4	136.7	-0.5	↓
RBER to USD	96.0	87.3	-11.1	82.8	88.8	7.2	↑
NBER to USD	71.7	65.7	-16.5	60.5	66.4	9.6	↑

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

As of the end of Q4 2016, the increase in nominal and real effective exchange rates in comparison with December 2015, is noted. According to the preliminary data, since the beginning of 2016, the index of nominal effective exchange rate (NEER) of KGS increased by 7.7 percent and made 111.9 as of the end of December 2016. The index increase was

caused by strengthening¹ of KGS in December 2016, in comparison with average exchange rate for December 2015, against: CNY (Chinese yuan) by 17.9 percent, KZT (Kazakh tenge) by 14.8 percent, EUR by 12.7 percent and USD by 9.6 percent. Despite the higher level of inflation in the trading partner countries², the increase of NEER index was caused by the growth of index of real effective exchange rate (REER), which increased by 3.2 percent since December 2015, and made 112.4 as of the end of 2016.

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

² In 2016, inflation in the Kyrgyz Republic formed negative at the level of 0.5 percent, whereas an average inflation rate in the major trading partner countries made 3.9 percent according to the preliminary calculations.

Chapter 3. Monetary Policy

3.1. Monetary Policy Implementation

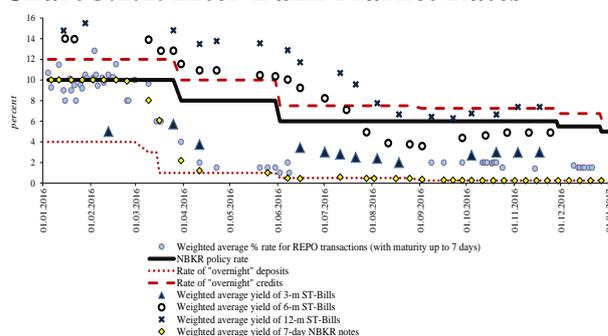
Within 2016, under the conditions of slackening economic growth of the country the National Bank implemented accommodative monetary policy taking into consideration the actual decreasing trend of inflation and its restrained forecasts. This direction of monetary policy continued in Q4 2016. In order to support the positive rate of economic growth, the National Bank continued to decrease the policy rate that contributed to the reduction of money market interest rates. Retaining of sufficiently high level of excess liquidity in the banking system was a complementary factor of reduction of money market rates.

In 2016, the National Bank reduced the policy rate four-times from 10 to 5 percent: two times in Q4 2016 – since November 29 the policy rate was reduced from 6.00 to 5.50 percent, since December 27 – up to 5.00 percent. These decisions were made in order to support the economic activity in the country amid low inflationary pressure.

The National Bank lowered the upper boundary of the interest rate corridor – the rate on “overnight” credits – in order to strengthen the impact of the interest rate channel of monetary mechanism. In Q4 2016, the rate on “overnight” credits was reduced by 100 basis points to 6.25 percent. The lower boundary of the interest rate corridor – the rate on “overnight” deposits – was retained at the level of 0.25 percent.

The implementation of the selected direction of monetary policy upon retaining of excess liquidity in the banking system caused the decrease in short-term money market rates. During the reporting period, the money market rates were generally within the interest rate corridor.

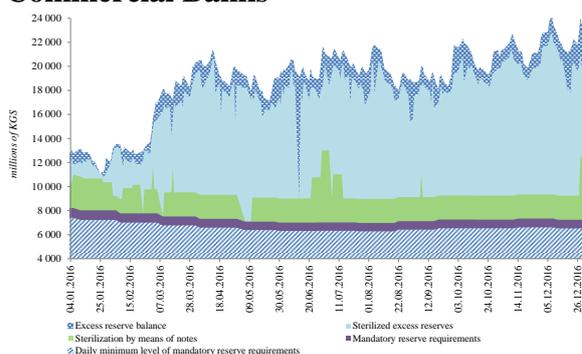
Chart 3.1.1. Inter-Bank Market Rates



In Q4 2016, the weighted average rates in the interbank credit resource market were retained at the level of 2.32 percent, which is 3.47 basis points lower than the average policy rate of the National Bank for the reporting quarter. The yield of the National Bank instruments in the open market was at the lower boundary of the interest rate corridor – the rate on “overnight” deposits.

The interest rates on short-term government securities also correlated with the trend of the National Bank policy rate and moved within the National Bank interest rates corridor.

Chart 3.1.2. Excess Reserves of the Commercial Banks



In Q4 2016, the commercial banks continued to increase the excess liquidity, the average daily volume of which increased by KGS 1.5 billion and amounted KGS 14.3 billion prior to operations on sterilization for the quarter conducted by the National Bank.

Excess liquidity in the banking sector resulted in increased demand of the commercial banks for the National Bank notes. In Q4, the gross sales of notes amounted to KGS 29.2 billion, increased by 12.5 percent compared to the corresponding value in Q3, and by 5.4 and 7.1 percent in Q2 and Q1 respectively. The increased demand of commercial banks caused the reduction of yield on

the National Bank notes (by the end of the Q4 2016, the yield on the 7-day notes was 0.24 percent, on the 14-day notes – 0.42 percent).

At average, KGS 10.6 billion of excess liquidity was absorbed daily through the free funds placed by the commercial banks on “overnight” deposits in the National Bank within the Q4 2016, which is higher compared to the previous quarters.

Generally, during the reporting quarter, the average daily volume of sterilization operations of the National Bank amounted to KGS 12.7 billion.

In 2016, the National Bank provided the economy with credit resources for a total amount of KGS 6.1 billion in order to expand crediting of the real sector of economy under the conditions of decline in economic activity in the country.

Table 3.1.1. National Bank Credit Transactions

	2015	2016
<i>For commercial banks</i>		
- within credit auctions	1 475.0	1 440.0
- within participation in the Kyrgyz Republic Government policy on converting of real estate credits in foreign currency into national currency		1 914.2
- “overnight” credits	26 663.3	2 045.6
<i>For other companies</i>		
- for international organizations established by the Kyrgyz Republic in cooperation with other states within the Eurasian Economic Union.	1 200.0	678.2

In Q4 2016, the situation at the domestic foreign exchange market was relatively stable. At the domestic foreign exchange market in the reporting quarter the increase of USD exchange rate against KGS by 1.9 percent was observed amid the excess of demand over supply for foreign currency. In the reporting period the National Bank participated as a net seller of foreign currency in the domestic foreign exchange market (the volume of net sales in Q4 2016 amounted to USD 31.5 million) in order to smooth sharp exchange rate fluctuations.

Generally, during 2016 the net purchase amounted to USD 29.1 million. In 2016, the national currency strengthened by 8.8 percent.

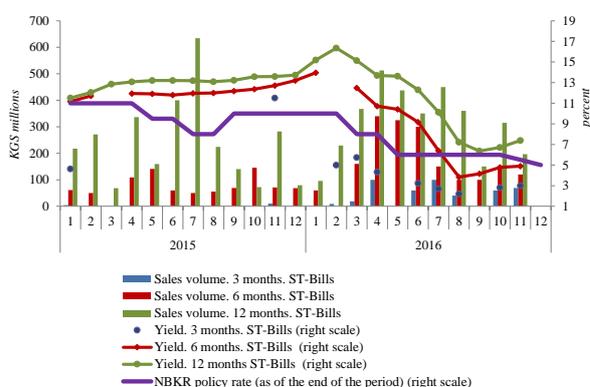
Monetary Policy Measures in Q4 2016

The decisions on the size of the National Bank policy rate were made	<p>The decision to decrease the policy rate by 50 basis points up to 5.50 percent was made on November 28, 2016. The boundary of the interest rate corridor were changed: the rate on “overnight” credits decreased from 7.25 to 6.75 percent, the rate on “overnight” deposits decreased remained unchanged at the level of 0.25 percent.</p> <p>The decision to decrease the policy rate by 50 basis points up to 5.00 percent was made on December 26, 2016. The rate on “overnight” credits decreased from 6.75 to 6.25 percent, the rate on “overnight” deposits remained unchanged at the previous level.</p>
The National Bank issued credits to the international organizations established by the Kyrgyz Republic in cooperation with other states within the Eurasian Economic Union.	The volume of credit resources amounted to KGS 137.2 million.

3.2. Financial market instruments

Government Securities Market

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



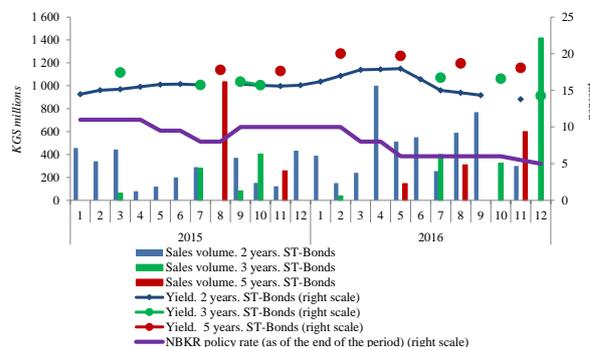
State Treasury Bills (ST-Bills)

In Q4 2016, a decline in ST-Bills yield in the primary market of government securities, which were within the limits of the interest rate corridor, was observed.

In October and November 2016, the Ministry of Finance of the Kyrgyz Republic suggested placing of 3-, 6- and 12-month ST-Bills in the primary market, as before. At the same time, in December 2016, the Ministry of Finance of the Kyrgyz Republic did not conduct auctions on placement of

bills in accordance with the plan. The gross volume of the announced emission of ST-Bills at the auctions in Q4 2016 amounted to KGS 986.0 million, having decreased by 50.9 percent compared to the same period in 2015. Upon the growth in demand for all types of state treasury bills by 2.4 times, the gross sales volume increased by 33.4 percent. The total average weighted yield of ST-Bills for the quarter decreased by 10.3 percentage points up to 2.9 percent.

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



State Treasury Bonds (ST-Bonds)

In the reporting period the sales volumes of 3- and 5-year state treasury bonds, maintaining a relatively high securities yield, continued to accumulate.

The total volume of the announced ST-Bonds emission in Q4 2016 amounted to KGS 2.3 billion, having decreased by 24.3 percent compared to the same period in 2015.

At the same time, the demand for long-term securities increased by 3.8 times, and the volume of actual sales (including additional placements) in Q4 amounted to KGS 2.6 billion, having increased by 78.1 percent. The predominance of sales volumes over the amount of the announced emission resulted from additional placements, the volume of which in the reporting period amounted to KGS 400.0 million.

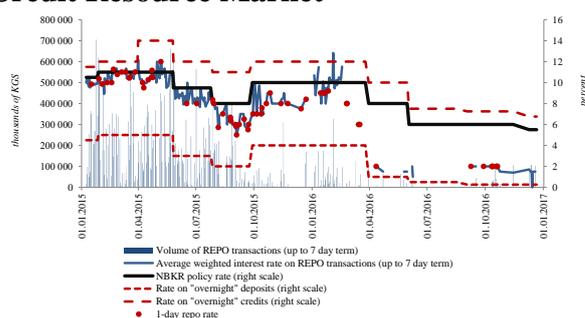
In the reporting period, the average weighted yield retained at 15.7 percent, having reduced slightly compared to the same period in 2015 (-0.4 percentage points).

Interbank Credit Resource Market

Generally, during 2016, the downward trend in the participants' activity in the interbank credit resource market was observed.

The high level of excess liquidity in the banking system influenced on the interbank crediting indexes. Since the beginning of 2016, a decrease of volumes of transactions and the cost of borrowing in the interbank credit market was observed, which was due to the decrease in demand for interbank credit resources.

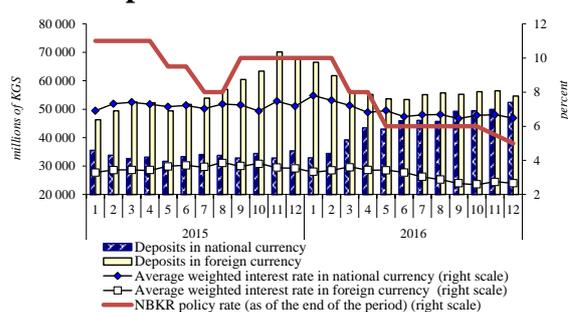
Chart 3.2.3. Dynamics of Rates and Volume of Repo Transactions in the Interbank Credit Resource Market



noticed. In Q4 2016, the total volume of credits in national currency in the domestic interbank credit market increased by 3.4 percent. Since the end of Q3 2016, the activity on repo transactions, the volume of which was 6.2 times higher than in Q3 2016, became more intense again. The decrease in demand for credit resources caused the decrease of market rates, approaching the lower limit of interest rate corridor set by the National Bank.

Deposit Market

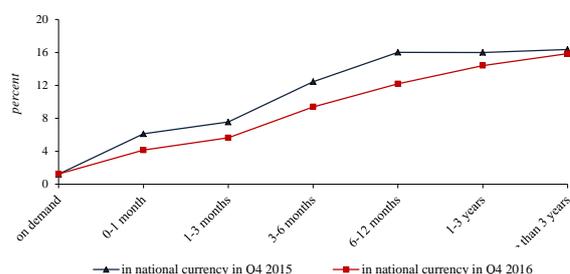
Chart 3.2.4. Dynamics of Commercial Banks Deposits



contrary, the deposit base in foreign currency decreased by 1.1 percent down to 54.7 billion in KGS equivalent. The dollarization of deposits (adjusted for the policy rate at the beginning of the year) decreased for the quarter by 2.3 percentage points to 53.3 percent.

The volume of new deposits in Q4 amounted to KGS 138.3 billion, having increased by 15.3 percent compared to the same period in 2015. At the same time, the deposits in national currency increased up to KGS 72.4 billion (+25.5 percent), in foreign currency – up to KGS 66.0 billion (+6.0 percent).

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



The total volume of transactions in 2016 was 80.9 percent lower compared to 2015. The average weighted rate on credit resources also declined, while in January 2016 the rate was 11.02 percent, in December it amounted to 1.54 percent.

At the same time in Q4 2016, a slight recovery in activity of market participants after significant reduction in Q3 (volume of transactions was 2.6 times higher than in Q3 2016, the average rate for the reporting quarter decreased to 2.32 percent from 3.76 percent in Q3) was

Since the end of Q3 2016, a transfer of negative growth rates of deposit base into the positive zone was observed.

The volume of deposit base of commercial banks at the end of Q4 2016 amounted to KGS 107.1 billion, having increased by 2.4 percent for the quarter, mainly due to the increase of deposits in national currency by 6.3 percent up to KGS 52.4 billion that corresponds to growth trends in gross capital formation in GDP (in Q3 – KGS 38.5 billion, in Q2 – KGS 31.9 billion, in Q1 – KGS 16.8 billion). On the

The average weighted interest rate on new deposits in the national currency in Q4 2016 amounted to 2.38 percent (-0.40 percentage points compared to the same period of 2015); on deposits in the foreign currency - 0.55 percent (-0.42 percentage points). The average weighted rate on the time deposits in the national currency in the reporting period amounted to 11.79 percent (-2.13 percentage points), in the foreign – 4.71 percent (-0.62 percentage points).

Credit Market

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

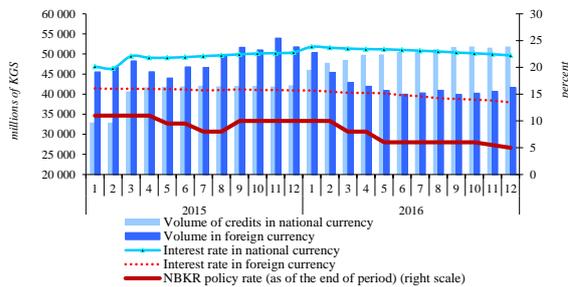
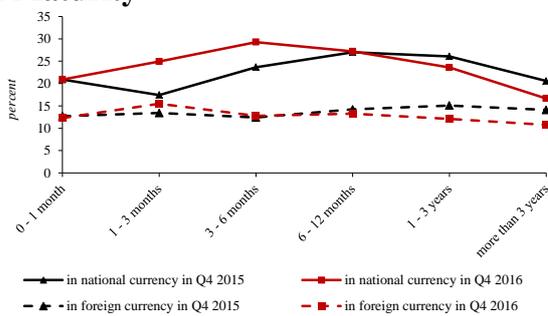


Chart 3.2.7. Rates of New Credits in National and Foreign Currency in Terms of Maturity



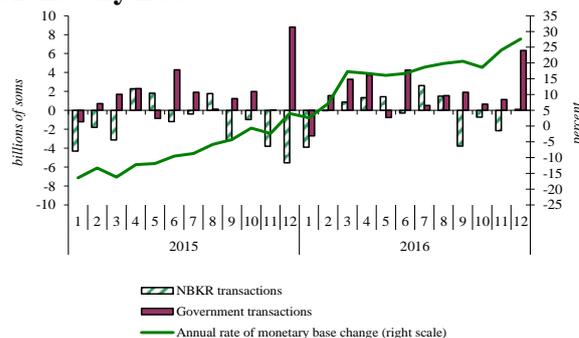
In Q4 2016, the commercial banks continued to increase the volume of credits both in national and in foreign currency against the background of the decrease of credit portfolio interest rates. The volume of credit portfolio of commercial banks at the end of Q4 2016 amounted to KGS 93.5 billion, having increased by 2.1 percent for the quarter. Whereby, the credits in the national currency increased by 0.3 percent and amounted to KGS 51.9 billion, and in foreign currency - by 4.4 percent and amounted to 41.6 billion in KGS equivalent. The dollarization of credits (adjusted for the official exchange rate at the beginning of the year) increased by 0.5 percentage points for the quarter up to 46.8 percent at the end of the year.

In the reporting period, a growth of volume of credits both in national and foreign currencies was observed. Thus, the volume of new credits in the national currency in Q4 2016 amounted to KGS 13.0 billion, having increased by 16.6 percent compared to the same period in 2015; in the foreign currency – 10.8 billion in KGS equivalent (+28.4 percent). In 2016, the total volume of these credits in national currency in 2016 amounted to KGS 59.1 billion (+51.5 percent) and in foreign currency decreased by 6.5 percent down to KGS 36.9 billion.

In Q4 2016, the average weighted interest rate on new credits in the national currency decreased by 1.90 percentage points compared to the same period in 2015 and amounted to 22.52 percent; in foreign currency – by 2.48 percentage points up to 11.48 percent. The share of overdue loans in the credit portfolio as of the end of Q4 amounted to 2.9 percent (+0.4 percentage points for the quarter), the share of extended credits – 4.8 percent (-1.2 percentage points for the quarter).

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

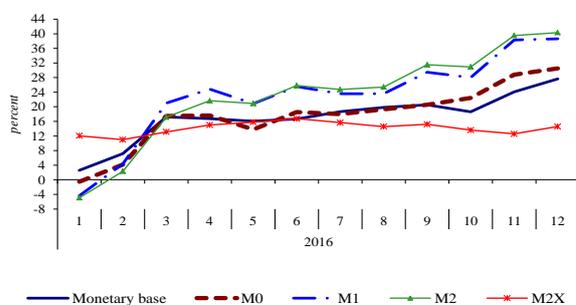
Generally, in 2016, the monetary base showed high growth rates, which were significantly higher than in the last five years. From the beginning of the year the monetary base increased by 27.6 percent to KGS 85.6 billion. The expenses of the Government of the Kyrgyz Republic, credit and foreign exchange transactions of the National Bank made the main input to the growth of reserve money.

For Q4 2016 the volume of monetary base increased by KGS 5.4 billion. During the reporting period the share of reserves of other depository corporations in the structure of

the monetary base increased from 12.0 percent to 12.6 percent, while the share of active money decreased from 88.0 percent to 87.4 percent. The increase in the monetary base during the reporting quarter was influenced by the Government's transactions for KGS 8.1 billion, transactions of the National Bank reduced it to KGS 2.8 billion.

Chart 3.3.2. Nominal Growth Rates of Monetary Aggregates

(in annual terms)



Monetary Aggregates

During 2016 a dynamic growth of monetary aggregates in national definition was observed resulted from the increase of currency outside banks and deposits in national currency.

In Q4 2016, the upward trend of monetary aggregates accelerated.

In Q4 2016, the high growth rates of deposits in the national currency by 10.4 percent and currency outside banks by

6.8 percent influenced on the increase of narrow money supply (M1) by 7.9 percent and broad money (M2) by 8.2 percent.

At the end of the reporting quarter the monetary aggregates M1 and M2¹ amounted to KGS 97.7 billion (annual growth was 38.6 percent) and KGS 115.4 billion (annual growth was 40.3 percent) respectively.

The increase of deposits in the national currency (growth for the reported quarter was 10.4 percent; annual growth – 58.2 percent) mostly was due to the growth of the total volume of deposits of other depositary corporations (hereinafter – the ODC) up to KGS 94.7 billion (growth for the reporting quarter was 3.6 percent; annual growth – 5.2 percent). At the same time, the deposits in the national currency showed decrease (decrease for the reporting quarter by 2.1 percent, annual decrease – by 20.2 percent).

As of the end of December 2016, the broad money M2X, including the deposits in the foreign currency, retained at the level of KGS 164.0 billion. The positive growth rate of the ODC deposits² and currency outside banks – M0 (growth for the reporting quarter was 6.8 percent; annual growth– 30.5 percent) influenced directly on the growth trend of broad money M2X (increase for the quarter was 4.9 percent, annual growth – 14.6 percent). The annual growth of monetary aggregate M2X was 20.6 percent excluding change in currency exchange rate.

The total volume of credit to the economy³ for the reporting quarter increased by 1.8 percent, amounting to KGS 95.4 billion at end of period mostly due to increase in both credits in the national currency and credits in the foreign currency (in 2016 the total volume of credit to the economy decreased by 19.7 percent; this indicator increased by 4.9 percent per year excluding change in currency exchange rate).

The economy monetization indicator⁴ continues to grow. The economy monetization factor, calculated according to M2X, reached 32.2 percent, having increased from 30.0 percent at the beginning of 2016 (increase from 18.3 percent to 21.2 percent by M2 aggregate for the year). The easing of the monetary policy and, consequently, the outstripping growth of money supply in relation to GDP growth resulted in the increase of monetization factor.

¹ Includes currency outside banks and deposits of individuals, legal entities and other financial institutions in the national currency excluding deposits of the Government and non-residents.

² Deposits of individuals, legal entities and other financial institutions excluding deposits of the Government and non-residents.

³ Credits to individuals, legal entities and other financial institutions excluding credits to the Government and non-residents.

⁴ Monetization factor is calculated as the ratio of moving average of broad money to the annual nominal GDP. When calculating the moving average, the average value for 12 previous months is taken.

Chapter 4. Inflation Dynamics

In 2016, the inflationary pressures was weak, the consumer prices growth was close to zero in annual term. The main reason was the restrained consumption, the saturation of domestic market with consumer commodities of lower prices, the favorable situation in international food markets.

4.1. Consumer Price Index

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

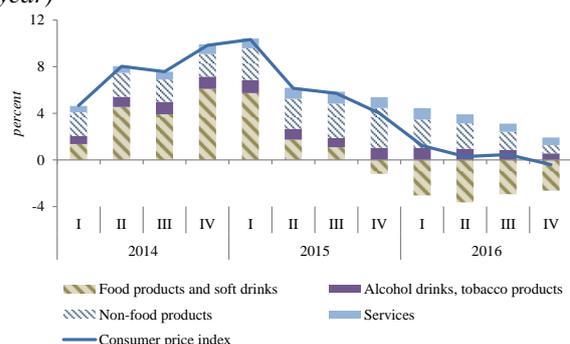


Chart 4.1.2. Dynamics of Food Product Prices' contribution to Annual CPI
(month to the corresponding month of the previous year)

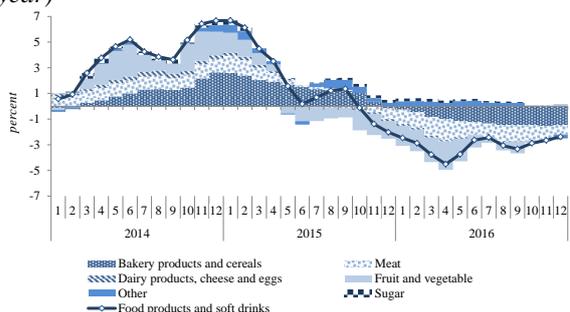
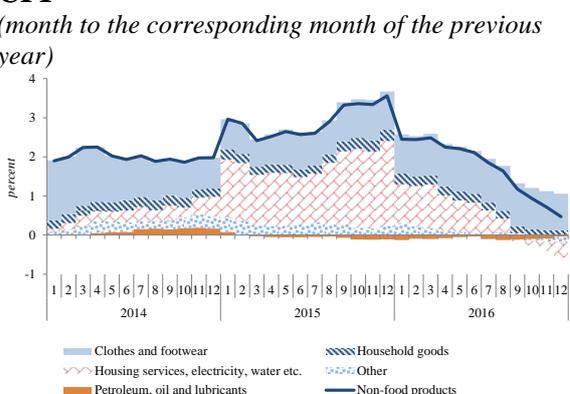


Chart 4.1.3. Dynamics of Non-Food Products Prices' contribution to Annual CPI
(month to the corresponding month of the previous year)



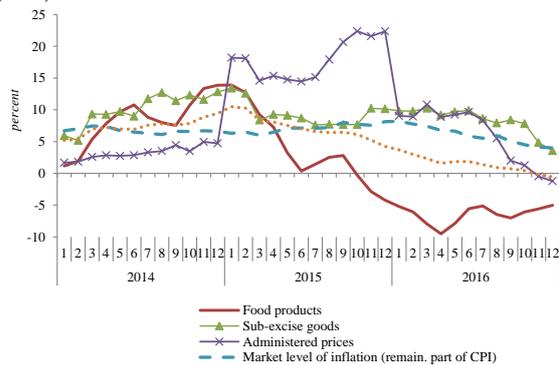
During the entire 2016 the inflation was low. The average annual price growth amounted to 0.4 percent in 2016. In December 2016, the total level of prices decreased by 0.5 percent, and in Q4 the annual price growth amounted to -0.4 percent.

The low inflation is mainly explained by the cheapening of food products compared to 2015. Food products and non-alcoholic drinks have a large share (about 47 percent) in the CPI basket, therefore the price fluctuations in this group have significant impact on the total price level. In 2016, the growth of production of main food products continued in the agriculture of the country; a stable price dynamics was observed in international markets of food products imported by Kyrgyzstan. These factors provided a high level of supply of food products. In Q4 2016, the food products price index decreased by 5.6 percent compared to the corresponding quarter in 2015. In this group the price decreased for bread, meat products and to a lesser extent vegetable oils and fats.

The other important factor of low inflation was the reduction of price index in groups “housing services, water, electricity, gas and other types of fuel” and “transport”. In Q4 2016, the tariffs for electricity and heat energy showed zero growth in annual terms. The tariffs for gas were revised downward in KGS due to the strengthening of KGS. In addition, in October-December 2016, the prices for petroleum, oil and lubricants, as well as for transport services were lower compared to the corresponding period in 2015.

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

(month to the corresponding month of the previous year)



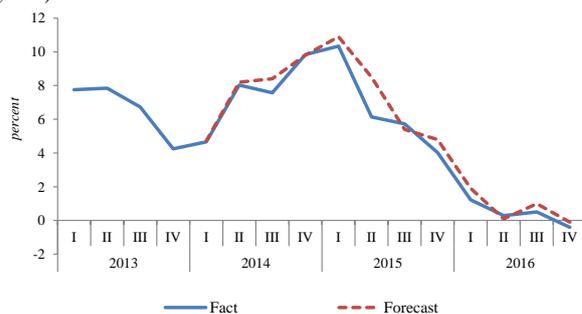
A stable dynamics of prices for clothes and shoes lent support to inflation. In Q4 2016, the alcoholic beverages and tobacco products increased in price by 6.5 percent in annual terms. The price growth for health services and communication services accelerated. In total, the prices for services rose by 4.4 percent from Q4 2015.

According to the statistics of the NSC KR, in Q4 2016, the core inflation amounted to -0.1 percent compared to the corresponding quarter in previous year, having decreased from 1.0 percent in Q3 2016.

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 Q4 2016, inflation was lower than expected. According to forecasts the CPI growth rate was expected to amount to -0.1 percent compared to Q4 2015, meanwhile the actual value was -0.4 percent. The discrepancy is explained mainly by lower price growth for administered and excise goods. At the same time the dynamics of food prices was generally in line with expectations, and the market inflation was relatively stable and decreased to a lesser extent than expected.

Chapter 5. Medium-Term Forecast

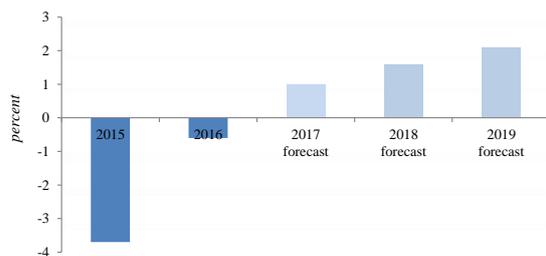
5.1. External Environment Proposals

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

The economy of Russia is recovering: following 2017 the growth rate of Russia's GDP is expected at the level 1.0-1.1 percent. In addition to external impulses, the internal economic factors will support the economic growth in the medium term. The data of economic enquiries show a positive trend in business and households that will support the recovery processes in the economy of Russia in the future. According to estimates of the Bank of Russia, the increase in actual salary will contribute to gradual

improvement of consumer activity.

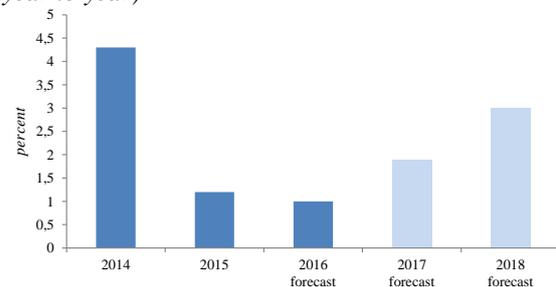
According to the forecast of the Bank of Russia, taking into account the decision on maintaining of the key rate at the level of 10 percent and maintaining of moderately tight monetary policy, the annual inflation will slow down to the target level of 4 percent by the end of 2017 and will retain at this level in the future.

Nevertheless, the foreign policy and foreign economic uncertainty remains at high level that could have a negative impact on the exchange rate and inflation expectations. Maintaining of moderately tight monetary conditions will limit the inflationary risks, including the short-term risks in connection with the beginning of purchases of foreign currency by the Ministry of Finance of Russia in the foreign exchange market.

Kazakhstan

Chart 5.1.1.2. Real GDP Growth in Kazakhstan

(year to year)



Source: IA Bloomberg, international financial institutions

The higher economic growth of Kazakhstan in 2016 (exceeded the forecast) resulted in adjustment of expectations for the development of economy of Kazakhstan in 2017. Under conditions of more favorable oil prices for Kazakhstan and continuation of production at Kashagan Oil and Gas Field, and the effective implementation of the governmental anti-crisis program, the expected economic growth of economy of the country will amount to 2.2 percent in 2017 (instead of previous 1.9 percent) and to about

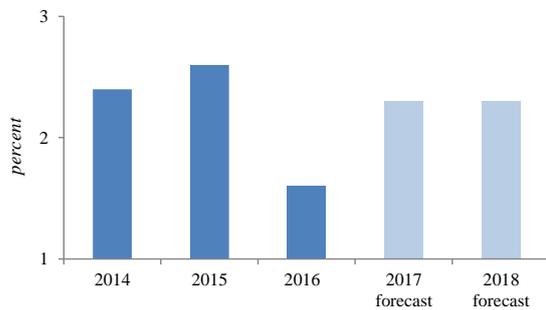
3.0 percent in 2018.

In 2017, in case of the absence of negative price shocks, the inflation is forecasted to slow down, particularly due to the high base in 2016: the inflation is expected in the corridor 6.0-8.0 percent and by the end of 2017 the average annual inflation will amount to about 7.5 percent.

USA

Chart 5.1.1.3. Real GDP Growth in the USA

(year to year)



Source: IA Bloomberg

The US GDP growth rate is forecasted to recover above two percent.

The new administration announced its intentions to stimulate economic activity by decreasing taxes and increasing government expenditures, particularly on infrastructure. There is some uncertainty about the details, scope and effect of stimulating policy remains, but financial and international institutions revised forecasts for activity growth upwards. At the same time, it is noted that the possible complication of foreign trade with major trading partners carries certain risks, and the trend of reduction of number of

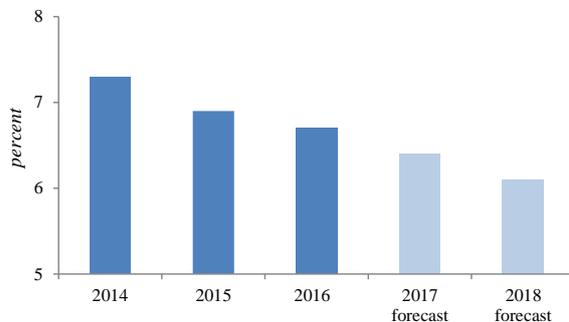
working-age population, and low productivity growth rates will keep restraining the economic growth.

According to forecasts, the inflation in 2017-2018 will be at the level of 2.4 percent that is higher than previous forecasts and significantly higher than the inflation rate for 2016 (1.3 percent). The increase in demand within the stimulating policy, not secured with manufacturing capabilities, can accelerate inflation processes.

China

Chart 5.1.1.4. Real GDP Growth in China

(year to year)



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

The slowing of economic growth in China is expected due to the high indebtedness of local companies and possible deterioration of terms of foreign trade.

The risks associated with the high level of indebtedness of companies probably will result in the balanced approach of the authorities to achieve the objectives for economic growth. The government will continue to implement structural economic reforms aimed at enhancing the role of services sector and the domestic market as the engine of growth, to optimize economy from side of supply and to reduce excess

capacity in some industries. In addition, there are concerns about the possible complications of foreign trade relations with the United States. The economy of China is forecasted to grow by 6.4 percent in 2017 and by 6.0 percent in 2018.

According to forecasts, the inflation will grow compared to 2015 and will amount to about 2.2 percent that is below the government's target objective of "about three percent".

5.2. Medium-Term Forecast

Assumptions on the development of external conditions and internal business environment for Q4 2016 to the utmost complied with the baseline scenario approved at the meeting of the Board of the National Bank in November 2016.

Thus, no significant changes were observed in the oil products market, and the average price fluctuated at around USD 50 per barrel. Taking into account the decision of OPEC to reduce oil production made on November 30, 2016, as well as the risks from supply and demand in the world oil market, the average oil price is expected to be USD 54 per barrel in 2017.

The food market is stable that is evidenced by the FAO Food Price Index. The risks remain in sugar market from supply side.

The faster recovery of economies of Russia and Kazakhstan in Q4 2016 enabled to improve forecasts of economic development of these countries. In this context there remain the expectations of growth of remittances inflow in the medium term.

Generally, the expectations and forecasts on the external parameters did not change significantly compared to the previous forecast. The expectations on the external environment are the key assumptions in the elaborated forecasts. These expectations include forecasts of world research agencies/institutions, official authorities and expert opinions.

Dynamics of the oil prices determine the scenarios and forecasts on macroeconomic parameters for the medium term in the countries-main trading partners. This dynamics will have a significant impact on the volume of capital inflows into the country from exports and remittances received, the dynamics of the exchange rate and domestic demand.

The processes of regional integration and further adaptation of the economy to the EEU conditions will continue in the medium term. The tariff and tax policy will have a significant impact on achievement of monetary policy benchmarks in the medium term.

According to the baseline scenario, the current trends in the world market of hydrocarbons and foods will still be observed in 2017. In 2017, the average price for Brent oil will be around USD 54 per barrel.

Under conditions of higher prices in the world sugar market, the food markets (FAO index) were a bit adjusted upward and will continue their sideways trend in the medium term. In 2017, the average FAO index will be about 175.0 points. The relation of supply and demand in the grain market in the current marketing year will prepare conditions to maintain prices for grain in the world market at the current level.

In 2017, despite the structural restrictions, the growth of Russia's economy will amount to 1.0 percent by the end of the year. The inflation will continue to slow down and at average will amount to 4.5 percent in absence of external shocks. In 2017, the GDP in Kazakhstan is expected to grow by about 2.2 percent and the inflation is expected to slow down gradually up to 7.5 percent at average by year.

Thus, according to estimates the situation in the external environment has neutral influence on the internal price level, herewith the risks are shifted towards growth from the second half of 2017.

The uncertainty with regard to the fiscal policy remains in the medium term. A gradual budget consolidation is supposed in accordance with the draft law "On republican budget for 2017 and forecast for 2018-2019".

Following 9 months of 2016, a recovery of domestic consumption is observed. Private consumption is largely formed by the increase of remittance inflows volume and growth of actual salary. According to the base scenario, the balance of remittances will increase up to 13.6 percent in 2017. The increase of remittance inflows will support domestic demand in the medium term.

In 2017, the inflation will tend to the lower limit of 5-7 percent target in the medium term, considering the estimates of development of external environment and internal

conditions. The gradual recovery of prices for food and energy in the world and in the region, as well as domestic and foreign consumer demand are expected to be the main inflation drivers. In addition, the inflation inertia will be supported by fiscal policy measures, the expansion of real income of population, including through growing remittances and relatively stable inflation expectations of population.

The real economy in Kyrgyzstan in 2017 will demonstrate moderate growth. The GDP gap will be negative and will have a deflationary impact during 2017.

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



At the end of 2017, the real GDP growth will be about 3.5 percent; the growth will be about 4.8 percent excluding Kumtor.

The increase in production output at the enterprise of the Kumtor Mine exploration will be lower than the output indicator in 2016. In the sectoral structure, the economic growth will be supported by the agriculture (by means of livestock and crop production), and the sectors of trade and construction.

In 2018, the real GDP growth rates will be about 4.7 percent; the growth excluding Kumtor will be about 5.2 percent.

The inflation value in the baseline scenario in the medium term will reach the benchmark level of 5-7 percent. At the end of 2017, the inflation level (period to period) will be 3.1 percent (December 2017/December 2016 – about 5.0 percent). In 2018, the average inflation value will be around 5.5 percent.

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



The downward dynamics of inflation in 2016 caused by low prices in the market of energy and food, as well as the restrained internal and external demand, is forecasted to shift to upward dynamics since the beginning of 2017. Thus, the food deflation will be replaced with inflation in Q2 2017. The slowing of inflation inertia for non-food commodities observed in the second half of 2016 will be replaced with upward dynamics. The implementation of “Medium term tariff policy of the Kyrgyz Republic for electric and heat energy for 2014-2017” will contribute to

inflation in the second half of 2017.

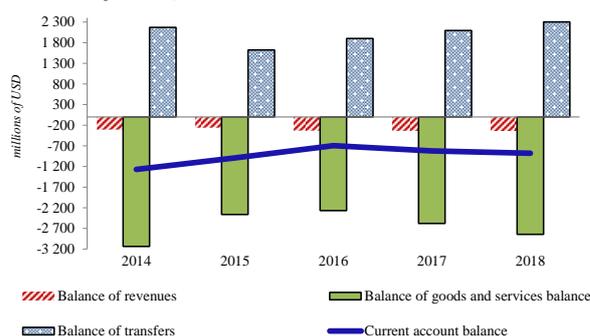
Balance of Payment Forecast for 2017-2018¹.

In 2017, the recovery of economic activity in the trading partner countries and the moderate economic growth will be the factors determining the external sector development of the Kyrgyz Republic. The activity of foreign trade transactions through larger increase in imports than exports will cause an increase in the current account deficit to 11.8 percent of GDP, despite the positive trend in the net inflow of current transfers.

¹ Forecast was made taking into account the additional estimates of the National Bank.

Chart 5.2.3. Forecast Data on Current Transactions Account

(millions of USD)



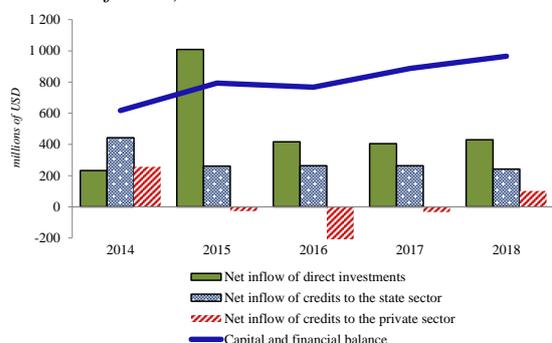
In the forecast period, export is expected to decrease by 2.2 percent. According to gold producer's forecasts, a decrease in gold production at the Kumtor Mine is expected in 2017, which will become the reason of gold exports reduction along with the decrease of world prices for precious metal. However, the exports growth excluding gold is expected at about 16.2 percent in 2017 due to the recovery of external demand for domestic products, as well as gradual adaptation to trade terms within the EEU.

The recovering of domestic demand will have a major impact on the imports dynamics of the country, the growth of which is expected at about 10.1 percent. The expected increase in the world prices for oil products regarding 2016 will increase the cost of oil volume. Under the influence of the factors above, the growth of imports excluding energy products will be 8.5 percent.

The growth rates recovery of the economies of Russia and Kazakhstan, as well as the stability of the currency market will have a positive impact on the volume of inflow of private transfers. As a result, the growth of net inflow of private transfers is expected to be 13.4 percent more than in 2016.

Chart 5.2.4. Forecast Data on Capital and Financial Account

(millions of USD)



The current account deficit in 2017 will cause the need in financing by increasing the capital inflow on the capital and financial transactions. The increase in inflow on capital transfers¹ and other investments is expected. The increase in liabilities to non-residents will be the main growth factors of other investments. As a result of reduction of payments on previous credits, along with the increase in inflow of new credits, a reduction of net outflow of credits to the private sector in terms of 2016 is expected. The inflow of direct investments

is forecasted at USD 405.0 million, which is comparable to the level in 2016.

Thus, the amount of the payment balance at the end of 2017 is expected to be positive in the amount of USD 65.1 million, meanwhile, the index of international reserve assets² is expected to cover 3.9 months of future imports of goods and services.

Generally, the economic development trends in 2017 will contribute to stable recovery of economy in 2018. Maintaining of the positive dynamics of current transfers, larger growth of imports as compared with exports will provide the current transactions account in the amount of 11.5 percent to GDP. The expected adaptation of the Kyrgyz Republic to the business conditions within the EEU and retaining of domestic demand growth trend will increase trade balance deficit by 7.1 percent.

Progressive recovery of the economies of Russia and Kazakhstan will have a positive impact on the volume of inflows of private transfers, the growth rate of which will amount to 10.8 percent.

¹ Growth will be ensured through the increase in volume of grants within the Public Investment Program

² In accordance with the IMF methods, only assets in convertible currencies are included in the international reserve assets.

The increase of capital inflow on the capital and financial transactions account is expected, the major share of funds on this account will be provided by the inflow of foreign direct investments, as well as the loans to the public sector.

The total amount of the payment balance in 2017 is forecasted to be positive in the amount of USD 87.8 million. Total international reserve assets will cover 4.1 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:

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

Annex 1. Key Macroeconomic Indicators

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

Indicator	Unit of measure	2015				2016			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1. Demand and supply¹ (real growth rates, if otherwise is not indicated)									
Nominal GDP, per quarter	mln. KGS	80 778,2	94 092,2	123 446,1	132 172,9	79 596,7	101 100,4	134 734,5	142 595,8
GDP	%	7,4	7,0	5,8	-1,8	-6,4	-0,2	8,1	9,0
GDP, excluding Kuntor	%	2,8	4,3	5,3	6,1	0,5	1,4	5,0	5,9
Domestic consumption	%	1,2	0,3	-2,9	-16,2	0,2	5,3	3,5	-
Investment	%	-3,4	-7,5	-18,1	6,1	-23,2	0,4	5,3	-
Net export	%	-13,2	-5,8	-34,6	-40,5	0,2	16,4	-7,5	-
<i>GDP production:</i>									
Agriculture	%	1,0	2,5	8,6	5,8	0,3	2,5	2,3	6,6
Industry	%	24,9	24,4	7,4	-36,5	-27,7	-10,6	30,9	30,9
Construction	%	-0,5	5,8	8,4	34,5	4,0	8,8	8,0	7,6
Services	%	3,0	3,2	3,3	4,6	2,1	1,5	4,5	3,4
including trade	%	5,2	5,4	6,7	9,1	5,0	5,3	11,6	7,0
2. Prices²									
CPI	%	110,3	106,1	105,7	104,0	101,2	100,3	100,5	99,6
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
Core inflation	%	109,7	107,6	106,5	105,2	103,0	101,8	101,0	99,9
<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
Non-food products	%	112,2	110,4	109,0	111,6	111,7	110,8	110,0	106,5
Alcohol drinks and tobacco products	%	109,5	108,9	110,1	111,8	108,5	107,6	105,3	102,4
Services	%	106,0	106,9	107,4	106,6	106,5	105,2	104,6	104,4
<i>CPI, classified by character:</i>									
Excisable goods	%	111,4	109,0	107,7	109,4	110,0	109,6	108,3	105,4
Regulated prices	%	116,9	114,9	117,9	122,1	109,6	109,3	105,2	99,8
Market inflation rate (the rest of CPI)	%	106,3	106,9	107,4	107,8	107,8	106,4	105,5	104,2
3. External sector³ (in percent to GDP)									
Trade balance	%	-37,1	-37,6	-35,6	-33,3	-34,7	-37,2	-35,7	-34,2
Current transaction account	%	-18,7	-21,0	-20,4	-15,2	-13,3	-14,9	-12,6	-13,3
Export of goods and services	%	44,1	40,7	38,9	37,7	37,5	36,9	37,5	35,5
Import of goods and services	%	86,0	83,3	78,4	73,9	74,2	76,2	75,4	72,6
4. USD exchange rate, as of the end of period									
	KGS	63,8736	62,0788	68,8359	75,8993	70,0158	67,4860	67,9346	69,2301
5. Monetary sector (real growth rates, if otherwise is not indicated)									
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
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
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
Average interest rates of operations in the interbank credit market, per quarter	%	10,28	10,02	7,14	9,66	10,50	2,70	3,76	2,32
<i>of which:</i>									
of REPO transactions	%	10,50	9,96	7,14	9,45	9,44	1,59	1,76	1,61
of credits in national currency	%	15,00	18,00	-	11,62	13,25	7,84	4,11	2,67
of credits in foreign currency	%	1,41	-	-	-	-	-	-	10,0
Weighted average yield of 7-day notes, as of the end of period	%	11,00	9,50	9,67	10,00	2,18	1,44	0,27	0,24
Monetary base	%	-16,2	-9,5	-4,3	4,0	17,2	16,7	20,5	27,6
Money outside banks (M0)	%	-19,9	-15,7	-7,0	2,3	17,5	18,6	20,6	30,5
Monetary aggregate (M1)	%	-17,7	-14,3	-5,6	1,7	21,0	25,5	29,4	38,6
Narrow money supply (M2)	%	-13,2	-13,6	-5,7	-0,1	17,2	25,8	31,5	40,3
Money supply (M2X)	%	0,9	0,5	10,0	14,9	13,1	16,7	15,2	14,6

1/ Estimate indicators of the National Bank of the Kyrgyz Republic are based on the data of the National Statistics Committee of the Kyrgyz Republic

2/ Source: National Statistics Committee of the Kyrgyz Republic

3/ Indexes are calculated on the basis of sliding annual data, including the last 4 quarters. The Q4 data 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 and external factors and the administratively established tariffs is excluded from the calculation of the inflation rate.

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

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

Inflation is the upward trend in the general price level within the certain period of time, which is determined based on the calculation of the value 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 liquidity level: M0; M1; M2; M2X.

M0 – currency outside banks.

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

M2 – M1 + time deposits 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 national currency.

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

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

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

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

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

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

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

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

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

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

Annex 3. Abbreviations

CBRF	Central Bank of the Russian Federation
CPI	Consumer Price Index
GDP	Gross Domestic Product
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
IBCRM	Inter-bank credit resource market
KR	Kyrgyz Republic
NBKR	National Bank of the Kyrgyz Republic
NBRK	National Bank of the Republic of Kazakhstan
NEER	Nominal effective exchange rate
NSC	National Statistics Committee
OPEC	Organization for Petroleum Exporting Countries
POL	Petroleum, oil, lubricants
PRC	People's Republic of China
REER	Real effective exchange rate
ST-Bills	State Treasury Bills
ST-Bonds	State Treasury Bonds
USA	United States of America