

**NATIONAL BANK
OF THE KYRGYZ REPUBLIC**

**Monetary Policy Report
(Inflation report).
Quarter 3, 2016**

**Bishkek
November 2016**

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 Q3 2016 was approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic No. 46/1 dated November 28, 2016.

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Summary

Downward trend of the inflation rate observed in early 2016 still existed in the reporting period. In September 2016, the general consumer price level declined by 0.3 percent in annual terms (September 2016 /September 2015), meanwhile, at the beginning of the current year the inflation rate amounted to 33.4 percent. In January-September 2016, the average annual inflation rate formed at the level of 0.7 percent. The annual price indices decreased in all commodity groups, the most significant reduction was observed in the group of food products.

The downward trend of the inflation rate resulted from measures taken in the monetary sphere and strengthened external and internal factors (retaining low world and domestic prices for food products and commodities, growth of domestic agricultural production output in the current year). The slow rates of domestic demand recovery is also a factor restraining the inflation rate in the Kyrgyz Republic.

At the end of 2016, CPI growth (period-to-period) is forecasted at 0.5 percent (December 2016/December 2015 - about 0 percent). In the medium term, the annual inflation rate is expected to approach the medium-term benchmark range of 5-7 percent amid low inflationary risks and the current trends of the economic development.

The economy of the country demonstrated positive growth rates. At the end of 9 months of 2016¹, the economic growth in the country amounted to 2.0 percent, however at the end of the first half of 2016, the economic recession amounted to 2.3 percent. GDP growth made 3.1 percent excluding enterprises at the Kumtor Mine. Reduction in the industrial production output still had restraining effect on the economic growth. The agricultural, construction and trade sectors were the main sectors, which made a positive contribution to GDP.

Existing difficult economic situation in the major trading partner countries continued restraining the external demand for domestic products. In January-September 2016, the foreign trade turnover² of the country decreased by 8.8 percent compared to the previous period and amounted to USD 3.8 billion, meanwhile the exports of goods decreased by 13.5 percent, the imports of goods decreased by 6.7 percent. Finally, the trade balance deficit amounted to USD 1.5 billion.

At the end of January-September 2016, the state budget was implemented with a deficit of KGS 16.8 billion or 5.4 percent to GDP (in the same period of 2015, budget surplus amounted to KGS 3.2 billion or 1.1 percent to GDP). The budget deficit was mainly affected by the increase in capital and labor costs, subsidy payments and social allowances.

A trend towards KGS strengthening was observed in the domestic foreign exchange market. In January-September 2016, the national currency strengthened to 10.5 percent. In Q3 2016, the National Bank participated in currency trading only to smooth sharp exchange rate fluctuations. The volume of the National Bank net purchase amounted to USD 12.9 million.

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

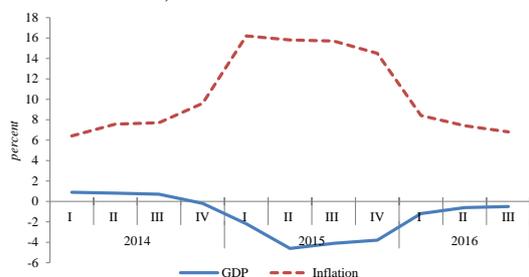
1.1. Economic Development of Main Trading Partner Countries

The situation in the external environment remained multidirectional. Positive trends were observed in the economies of many neighboring countries; meanwhile the impact of the external factors restraining economic growth still existed. In Russia, the domestic demand remained low under the conditions of the decrease in the real incomes of the population, although the rate of GDP reduction slowed down. However, the rise in prices was restrained by such factors as the domestic demand, the Russian ruble strengthening, stabilization of the world prices for food products and energy carriers. In Kazakhstan, under the conditions of weak domestic demand, the economic growth was supported by the increase in capital investment financed from domestic sources; meanwhile, the Kazakh tenge devaluation still influenced the price growth.

Russia

Chart 1.1.1. Growth of GDP and Inflation in Russia

(in annual terms)



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

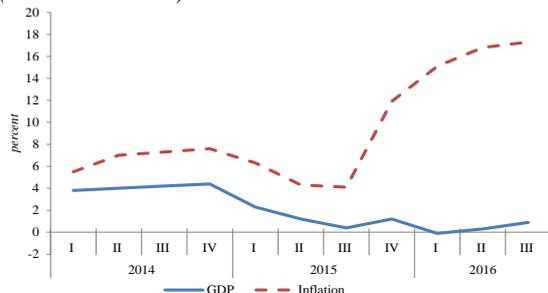
recapitalization of the banks, along with the use of the Reserve Fund resources, facilitated the process of the economy adapting to a decline in the prices for oil and the economic sanctions.

In Q3 2016, the annual inflation rate still demonstrated slowdown and amounted to 6.8 percent. The weak domestic demand, the Russian ruble strengthening, and stabilization of the world prices for food products and energy carriers were the main factors, which restrained growth in prices. Dynamics of the producers' prices for industrial and agricultural products also had downward pressure on the general price level.

Kazakhstan

Chart 1.1.2. Growth and Inflation in Kazakhstan

(in annual terms)



Source: RK Statistics Agency, NBKR calculations

In Q3 2016, stable GDP growth was still observed in Russia: the economic recession in Russia decelerated down to (-)0.5 percent. The negative rates were still observed due to the reduction of the production output in the manufacturing sector, the increase was registered in the mining sector, in generation, transfer and distribution of electricity, gas and water. According to the experts, response measures of the economic policy taken by the Russian Government over the last two years: flexible exchange rate policy, reduction of the budget expenditures in real terms and

The economic growth started recovering in Kazakhstan despite the impact of such restraining factors as volatility in the prices for oil, the slowdown of the economic development in China and the economic recession in Russia. In January-September 2016, GDP growth in Kazakhstan amounted to 0.4 percent¹ due to implementation of the structural reforms and different state programs. The increase in the volume of the production output in the construction sector (by 6.9 percent), in the agriculture (by 4.9 percent) due to growth of crop production (by 7.0 percent) and in the transport sector (by 4.0 percent) made the main contribution to the economic growth.

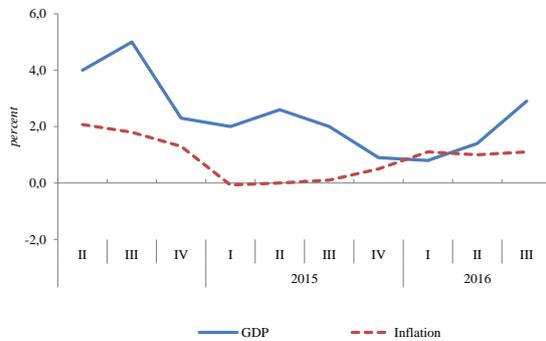
¹According to the preliminary data of the Ministry of National Economy of the Republic of Kazakhstan.

In Q3 2016, the annual inflation rate amounted to 17.3 percent. Persisting impact of the national currency’s significant devaluation on the domestic prices and the rise of import prices with a high share of imported products in consumption were the main inflation factors.

USA

Chart 1.1.3. GDP Growth and Inflation in the USA

(in annual terms)



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

In Q3 of the current year, the U.S. economic growth recovered and compensated to some extent slow growth in the first half of the year. In Q3, the U.S. GDP increased by 2.9 percent compared to the previous period in terms of annual growth, meanwhile, the economic growth amounted to 1.5 percent against the corresponding period in the previous year. Increased consumer expenditures remained among the major drivers of economic activity despite slower growth rate compared to Q2. Exports increased significantly, the economists indicated the significant rise in exports of soybeans among the reasons for it, which was a temporary

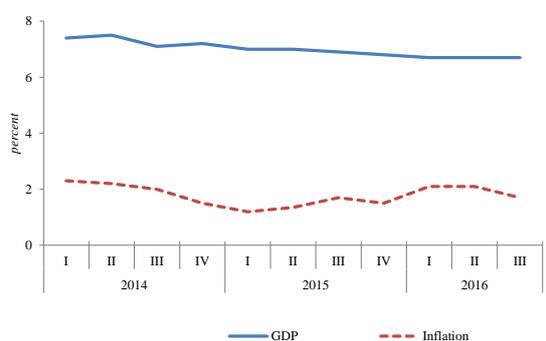
phenomenon; another reason for exports decrease was devaluation of the US dollars since the beginning of the year. The expenditures for purchase of inventory holdings, which had been declining in the previous quarters, increased in Q3.

Growth in the consumer price index in September 2016 to the corresponding month of the previous year amounted to 1.5 percent. Low inflation rate was due to a decline in energy prices by 2.9 percent in annual terms, and a slight decrease in the prices for food products by 0.3 percent. The core personal consumption expenditures price index, which serves as a benchmark for the US Federal Reserve System, stood at 1.7 percent level, which was still lower than the target level of 2.0 percent.

China

Chart 1.1.4. GDP Growth and Inflation in China

(quarter to the corresponding quarter of the previous year)



Source: National Statistics Bureau of the PRC, IA Bloomberg

The rates of the economic growth in China stabilized. In Q1, Q2 and Q3 of the current year, GDP growth in China amounted to 6.7 percent compared to the corresponding quarter of the previous year. To some extent this growth was due to the stimulus measures taken by the authorities of the country. In Q3 of the current year, the public sector investment growth rates exceeded 20 percent, which largely compensated the slowdown in growth of the private investment, meanwhile, lending to the economy increased significantly.

Moreover, increased activity was observed in the real estate market: growth rates of the retail sales increased slightly, industrial

production growth rates declined insignificantly.

In September, the annual increase in the consumer price index in China rose up to 1.9 percent, from 1.3 percent in August, however, it remained markedly below the benchmark of “about three percent” set by the PRC Government. In September, the consumer prices rose by 0.7 percent, largely due to the rise in prices for food products, clothes and footwear.

1.2. World Commodity and Raw Stock Markets

The existing favorable conditions in the foreign markets of food products and raw stock materials in general had a restraining impact on the growth of the domestic prices. Influence from an increase observed in the prices for sugar was limited by insignificant share of this product in the CPI consumer basket. Positive dynamics of prices with certain volatility was observed in the oil market.

Chart 1.2.1. Dynamics of Prices for Food Products

(month to the corresponding month of the previous year)

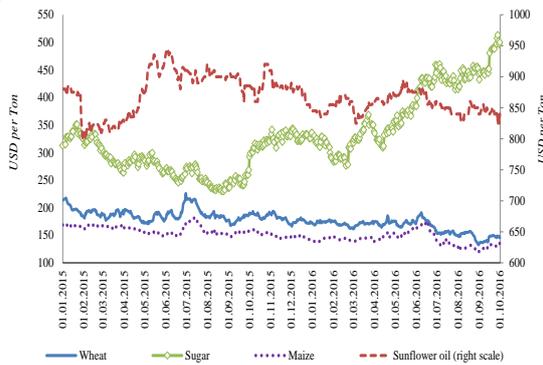


Chart 1.2.2. Dynamics of FAO Food Price Index



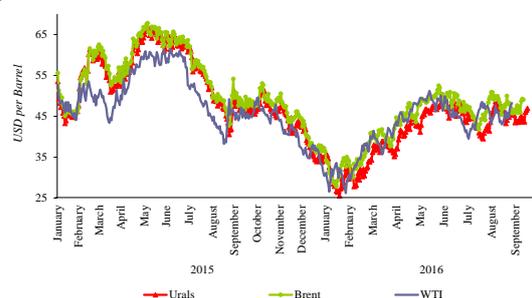
dynamics of the prices for sunflower oil was generally characterized by the downward trend, the prices of rapeseed oil, despite its volatility, were developing sideways.

FAO food price index (Food and agriculture organization) has been increasing since the beginning of the current year, with the exception of a slight decline in July. In Q3, the average index value increased by 5.5 percent compared to Q2 amid a significant rise in the price for sugar, and an increase in prices for sunflower oil, meat and dairy products.

Energy Market

Chart 1.2.3. Dynamics of Prices for Oil

(month to the corresponding month of the previous year)



Food Market

In Q3, dynamics of prices for the main types of food products in the world markets was multidirectional. The prices for grains and sunflower oil were decreasing, the prices for other types of vegetable oils, sugar, meat and dairy products increased.

During the reporting period, the Brazilian real strengthened against the US dollar, therefore the export prices for sugar supplied from Brazil were increasing. Unfavorable weather conditions in the largest sugar producing country, combined with the reports about decreasing sugar supply in Asia also had the upward pressure on the price of this product.

The favorable economic environment in the grains markets resulted in a decrease of the prices for wheat and maize. According to FAO estimates, the world harvest of wheat in the current year was historically high, the harvest of maize was also high. High crops production and higher exports are also expected in Russia and Kazakhstan.

The situation in the vegetable oil market was characterized by an increase in the prices for palm oil and an insignificant rise in the prices for soybean oil due to lower production thereof compared to the forecasts. Meanwhile, the

In Q3 2016, the prices in the international oil market still demonstrated an upward trend, which was observed in Q2 with slight fluctuations at the level of USD 45. The prices for the basic oil grades (Urals, Brent, WTI) fluctuated within the range of USD 39.5 - 50.9 per barrel. In Q3 2016, the average price for Brent oil remained unchanged and amounted to USD 47.0 compared to Q2, however, this price decreased by 8.4 percent compared to the similar period of the previous

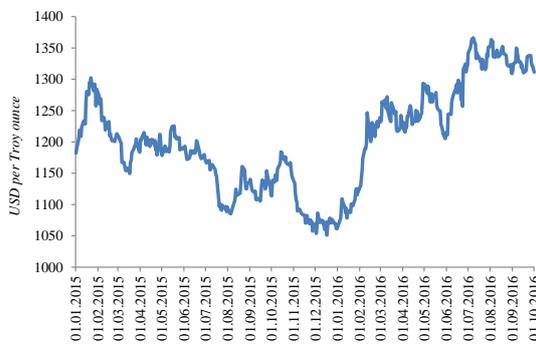
year.

The reporting period started from the rise in prices supported by an increase in demand for oil on the part of China; since September, the prices started decreasing due to seasonal reduction of demand in the United States, which resulted in an increase of the reserves. Meanwhile, the news about the OPEC meeting held in late September 2016 was speculated. The decision of the OPEC members about the reduction of oil production down to 32.5-33.0 million barrels a day, which was a surprise for many market analysts, contributed to further rise in prices since the end of September. The declared range met to the production level, which the cartel indicated at the beginning of the current year, and suggests reducing production down to approximately 700 thousand barrels a day.

The volatile dynamics with slight slowdown trend in the price growth and moderate decline thereof can be expected in the coming period as the geopolitical situation in the world, the results of the President elections in the United States and the current sufficient oil reserves have a significant impact on the price formation in the world energy market.

Gold Market

Chart 1.2.4. Dynamics of Prices for Gold



Source: IA Bloomberg

In Q3 of the current year, the prices for gold remained high. Weak indicators of economic activity in the United States and related market expectations of smooth and careful increase in the base interest rates set by the US Federal Reserve System strengthened the investment attractiveness of gold. Uncertainty with regard to the US President elections supported the quotations of precious metal. Physical demand for gold was relatively low, to some extent, due to the high prices for metal.

Chapter 2. Macroeconomic Development

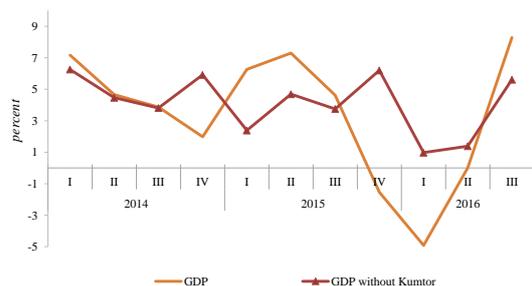
2.1. Demand and Supply in the Commodities and Services Market

Positive economic growth resumed in Q3. Growth of the domestic demand in the first half of the year amid increased inflow of the remittances had a positive impact on the dynamics of economic development in the Kyrgyz Republic. Nevertheless, weak foreign demand for the domestic products is still observed and has a restraining effect on the economic growth.

Demand

Chart 2.1.1. GDP Dynamics

(quarter to the corresponding quarter of the previous year)



Source: NSC KR

In Q3 2016, the rates of economic growth in the country moved to the positive zone from the negative one. Moreover, the decline was still observed in the industrial sector primarily due to reduction in the production output at the Kumtor Mine. In Q3, the upward trend was observed in the domestic demand due to the increase of remittance to the country.

The decline by 0.7 percentage points observed in the industrial sector at the end of nine months of 2016 made a negative contribution to the GDP formation despite growth registered in Q3. This trend in the industrial sector was primarily due to a decline in the production output at the Kumtor Mine. The agriculture, construction and trade sectors demonstrated growth.

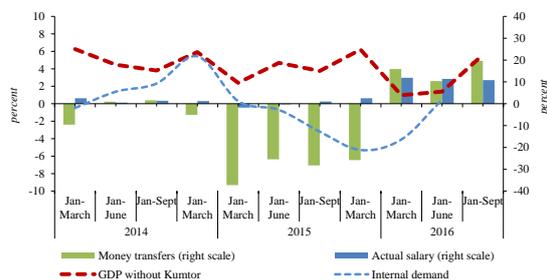
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growth registered in Q3. This trend in the industrial sector was primarily due to a decline in the production output at the Kumtor Mine. The agriculture, construction and trade sectors demonstrated growth.

According to Centerra Gold Inc. press release, the Kumtor output increased by 54.4 percent compared to Q3 2015 (107.5 thousand troy ounces) and amounted to 166.0 thousand troy ounces in Q3 2016.

Chart 2.1.2. Dynamics of Internal Demand and Money Transfers

(period to the corresponding period of the previous year)



Source: The NBKR

The domestic demand¹ entered the positive zone and, according to the preliminary results of the first half of the current year, it increased by 0.5 percent against the corresponding period of 2015. An increase was due to the growth of final consumption (+2.9 percent) and less negative gross savings (-9.3 percent) as a result of a decrease in gross accumulation of fixed assets (-1.5 percent) and change in inventories (-28.5 percent). Moreover, decrease rates slowed down compared to the previous quarter, which was also due to the positive trend of remittances (in

Q2 and Q3 of the current year, growth rate amounted to 7.8 percent and 34.4 percent respectively). Generally, since the beginning of 2016, positive trend is observed in the individuals' remittances made through the money transfer systems: in January-September 2016, the net inflow in USD equivalent increased by 19.6 percent compared with the same period of 2015.

Consumption remained the main component within the GDP structure and constituted 121.1 percent to GDP.

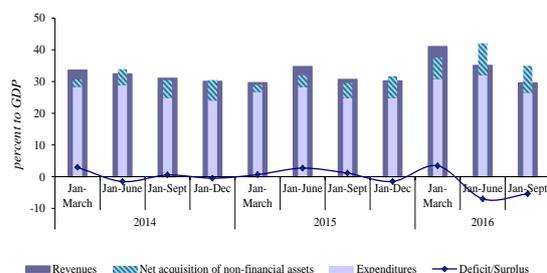
¹ Reference to the data for the earlier period is given due to the lack of data for Q3 2016.

State Finances Sector

In Q3 2016, the state budget was still implemented with a deficit. At the end of nine months of 2016, the state budget was executed with a deficit of KGS 16.8 billion or 5.4 percent to GDP, primarily due to growth of capital expenditures (in the same period of 2015, there was a budget surplus of KGS 3.2 billion or 1.1 percent to GDP).

Chart 2.1.3. Execution of the State Budget

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

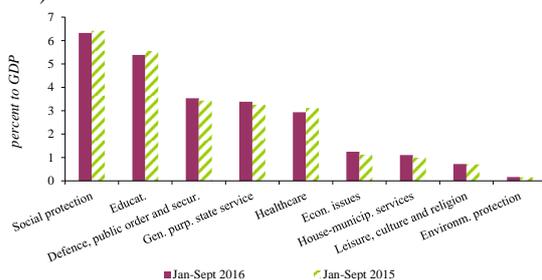


Source: CT MFKR, NBKR

At the end of nine months of 2016, the state budget revenues from operating activities increased by 2.1 percent, or KGS 1.9 billion, compared to the same period of 2015 and amounted to KGS 91.8 billion, or 29.6 percent to GDP. However, the greatest contribution to the increase in operating income was due to tax revenues (9.2 percentage points) and official transfers (1.0 percentage point).

Chart 2.1.4. Execution of the State Budget

(period to the corresponding period of the previous year)



Source: CT MFKR, NBKR

At the end of nine months of 2016, the state budget expenditures for operating activities increased in annual rate by 13.2 percent, or KGS 9.6 billion, and amounted to KGS 82.2 billion, or 26.5 percent to GDP. The state budget expenditures increased primarily due to holding of the World Nomad Games, financing the hippodrome reconstruction in the Issyk-Kul region, reconstruction of the road Balykchy-Tamchy-Cholpon-Ata-Korumdu, capital repairs of the road Bishkek-Manas International Airport and the meeting of the Council of Heads of Governments of the Shanghai Cooperation Organization (SCO) Member States. The largest contribution to the increase in the current expenditures was made by labor costs (mainly salaries), payment of subsidy and social allowances. In the structure of expenditures by functional classification, the

greatest contribution to the increase in expenditures was made by costs for education, public services of general purpose, defense, public order and security, economic issues.

Net outflow of budget funds for operations related to acquisition of non-financial assets amounted to KGS 26.3 billion, or 8.5 percent to GDP.

Execution of the state budget revenues (tax revenues + non-tax revenues + official transfers) amounted to 104.2 percent at the end of nine months of 2016, which was insured by implementation of the plan on collecting non-tax revenues by 125.9 percent, and official transfers - by 4.8 times. The plan on collecting the tax revenues was implemented at the rate of 96.7 percent. The tax collection plan of the State Tax Service was implemented at a rate of 94.6 percent, while the same plan of the State Customs Service was implemented by 100.4 percent. At the end of nine months of 2016, the execution of the state budget expenditures amounted to 79.7 percent. Meanwhile, the expenditure plan on the protected items was executed by 82.8 percent, on the unprotected items – by 66.6 percent.

Thus, the risk of inflationary pressures from the state finances sector still remains: at the end of 2016, according to the draft Law “On introducing amendments to the Law of the Kyrgyz Republic “On the state budget for 2016 and the forecast for 2017-2018”, a deficit is expected in the amount of KGS 22.1 billion or 4.9 percent of GDP.

Investment

In January-September 2016, the level of implementing capital investment increased by 8.1 percent (in comparable prices) compared to the same period of 2015.

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

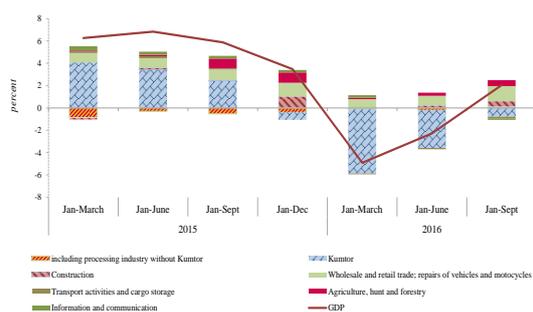
	January-September			
	millions of KGS		share, percent	
	2015	2016	2015	2016
Total	64 317,7	70 847,7	100,0	100,0
Internal investment	49 129,5	51 532,8	76,4	72,7
Republican budget	2 874,3	7 628,1	4,5	10,8
Local budget	753,5	731,8	1,2	1,0
Funds of enterprises and organizations	25 006,7	20 136,4	38,9	28,4
Banks' credits	1 069,9	46,6	1,6	0,1
Population funds including beneficent help of KR residents	19 425,1	22 989,9	30,2	32,4
External investment	15 188,2	19 314,9	23,6	27,3
Foreign credit	7 027,3	11 650,5	10,9	16,4
Direct foreign investments	6 535,5	5 852,2	10,2	8,3
Foreign grants and humanitarian aid	1 625,4	1 812,2	2,5	2,6

Source: NSC KR

The volume of capital investment financed from domestic sources increased by 2.9 percent compared to January-September 2015. An increase of the capital investment financed from the state budget by 2.6 times, that from the personal funds – by 1.2 times made the positive contribution from the domestic sources, meanwhile, the investment financed from the credits issued by the banks decreased by 23.3 times, that from the funds of the enterprises and organizations – by 21.0 percent, from the local budget – by 4.6 percent. The investment financed from the foreign sources increased by 24.8 percent, that from an increase of the foreign credits – by 1,6 times, from the direct foreign grants – by 9.4 percent, however, the investment financed from the direct foreign investment, on the contrary, decreased by 11.8 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

was formed at the level of 3.4 percent, having increased by 0.8 percentage points against the corresponding period of 2015.

A decline in the industrial sector by 4.4 percent was due to a reduction of the production output in the textile sector (by 30.3 percent), in production of clothing (by 15.8 percent), precious metals (by 10.7 percent) and other non-metallic mineral products (by 7.9 percent). Generated, transferred and distributed electricity decreased by 8.3 percent. Moreover, an increase was observed in extraction of metal ores (by 1.8 times), oil (by 33.1 percent), in production of refined petroleum products (by 26.2 percent), food products (by 9.4 percent), rubber and plastic products (by 9.5 percent). Excluding the enterprises of the Kumtor Mine growth in the industrial sector amounted to 1.6 percent compared to the same period of 2015.

Growth of capital investment was primarily observed as before in the construction of agricultural facilities, in the construction and reconstruction of the facilities for supply of electric energy, gas, steam and conditioned air, waste processing and services sector.

Moreover, investments increased in the construction of the facilities for art, entertainment and recreation.

Meanwhile, capital investment decreased in the construction of the facilities for manufacturing sectors, mining operations, and the healthcare sector.

In the reporting period, GDP increased mainly due to a positive contribution of all sectors of economy excluding the industrial sector related to a decline in the production output at the Kumtor Mine.

According to the preliminary data of the National Statistics Committee of the Kyrgyz Republic, in January-September 2016, the economic growth rate amounted to 2.0 percent (in January-September, 2015, the economic growth rate was 5.9 percent), excluding the enterprises of the Kumtor Mine, GDP growth constituted 3.1 percent (in the same period of 2015 growth increased to 3.7 percent). Deflator

In January-September 2016, growth in the construction sector amounted to 7.8 percent due to increase in the capital investment by 8.1 percent (in comparable prices). The investment financed from the domestic sources increased by 2.9 percent, that from the foreign sources – by 24.8 percent.

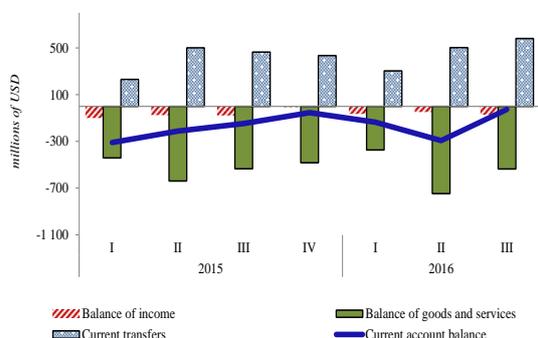
Growth in agriculture constituted to 3.3 percent due to increase in livestock (by 2.2 percent) and crop production (by 4.4 percent).

In the reporting period, growth in the trade sector by 7.9 percent compared to the same period of 2015 was due to increase in the sales of motor fuel (by 12.5 percent) and in the retail trade (by 7.9 percent).

2.2. External Sector¹

In Q3 2016, the current account deficit decreased by 82.3 percent due to decline of the trade deficit.

Chart 2.2.1. Current Account
(millions of USD)



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

According to the forecasted and preliminary data, in Q3 2016, the current account deficit will decrease down to USD 26.1 million to make 8.1 percent to GDP.

In the reporting period, the trade deficit of the Kyrgyz Republic will decrease by 18.9 percent to make USD 490.0 million.

Trade balance will be formed under the influence of the increase in supplies of exported products due to the growth in supplies of gold; as well as under the influence of the decrease in imports due to the reduction in supplies of the petroleum products.

2.2.1. Trade balance of the Kyrgyz Republic²

(millions of USD)

	2014	2015	2015 Q3	2016 * Q3	Change in %	Change in millions of USD
Trade balance	-2 807,5	-1 984,0	-604,5	-490,0	-18,9	114,5
Export (FOB)	2 482,7	1 812,4	412,7	481,6	16,7	68,9
Gold	716,9	665,4	106,4	223,8	110,3	117,4
Import (FOB)	5 290,2	3 796,4	1 017,2	971,5	-4,5	-45,7
Energy products	1 041,8	702,6	181,1	67,8	-62,6	-113,3

* Preliminary data

Exports of goods (in FOB prices) will increase by 16.7 percent to make USD 481.6 million in Q3 2016. In the reporting period, exports will be primarily affected by growth in supplies of gold, which have increased by more than two times compared to the corresponding period of 2015. Along with that, exports, excluding gold, will decrease and make 15.8 percent due to a decline in exports of tobacco, plastics and other goods.

In the reporting period, imports of goods (in FOB prices) will decrease by 4.5 percent to make USD 971.5 million. The decrease in imports will be primarily conditioned by a

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

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

reduction in supplies of petroleum products (due to a reduction in the physical volume and in the prices), iron and steel, medicaments, etc. Moreover, the increase will be observed in supplies of footwear and clothes, woven fabrics, essential oils and etc.

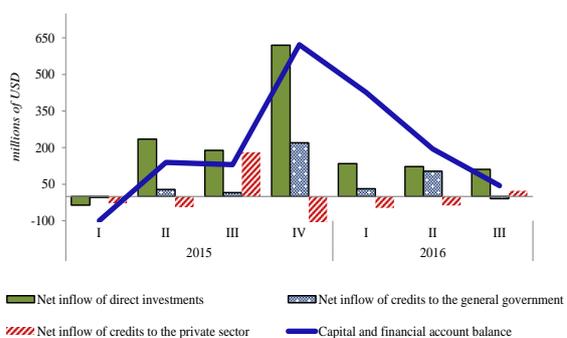
In the reporting period, the inflow of current transfers will be formed above the level of the same period in 2015 to make USD 580.4 million. The increase will be provided by the positive dynamics on the net inflow of private transfers, which will increase by 31.7 percent to make USD 575.5 million.

According to the forecasts, the negative balance of income will improve to form at the level of USD 67.5 million, which is lower by 12.7 percent than the level of Q3 2015. The negative balance of services is expected at the level of USD 45.6 million.

The increase of the residents' assets abroad and the reduction of the liabilities to the non-residents will result in the decrease of the positive balance on the capital and financial account.

Capital and financial account will decrease by 54.0 percent against Q3 2015 to be formed with a positive balance of USD 60.0 million. Capital account balance is expected to form positive in the amount of USD 15.7 million. In the reporting period, the positive balance of the financial account is expected to amount USD 44.3 million.

Chart 2.2.2. Capital and Financial Account



Net inflow of direct investments to the country is forecasted to decrease by 43.8 percent compared to the same period of the last year to make USD 106.5 million. In the reporting period, the balance of “other investments” item will be formed negative to make USD 62.2 million primarily due to the growth of the foreign assets of the banking and real sector of economy. Along with that, the liabilities to non-residents are expected to decrease by USD 67.0 million compared to the same period of 2015. This trend will be formed by the decrease in the liabilities of

both the private and the state sector.

Therefore, at the end of Q3 2016 balance of payments of the Kyrgyz Republic will be formed with a negative balance to make USD 16.9 million. Gross international reserves will cover 4.4 months of the future imports of goods and services.

Indexes of Real and Nominal Effective Exchange Rate of KGS

Table 2.2.2. Key Values for Exchange Rate

	year (average)			month to beginning of the year (as of the end of month)		
	2014 (aver.) (January- December)	2015 (aver.) (January- December)	%	December 2015	September 2016	*
REER	110,0	115,1	4,6	108,4	110,2	1,7
NEER	99,2	106,1	6,9	101,4	108,6	7,1
RBER to CNY	94,8	84,7	-10,6	74,4	81,3	9,2
NBER to CNY	78,1	66,4	-14,9	57,6	65,7	14,1
RBER to Euro	109,7	116,6	6,5	102,8	105,7	2,8
NBER to Euro	85,5	85,5	0,0	74,0	78,5	6,1
RBER to KZT	110,9	112,1	1,1	129,7	140,7	8,5
NBER to KZT	104,1	105,9	1,7	130,9	153,4	17,2
RBER to RUR	113,6	138,2	21,7	130,8	127,1	-2,8
NBER to RUR	108,3	142,8	31,8	137,4	142,4	3,7
RBER to USD	107,9	96,0	-11,1	82,8	87,2	5,2
NBER to USD	85,8	71,7	-16,5	60,5	66,6	10,0

* preliminary data
 ▼ - Som devaluation, competitiveness improvement
 ▲ - Som strengthening, competitiveness deterioration

At the end of Q3 2016, the index of nominal and real effective exchange rate is expected to increase compared to December 2015. According to the preliminary data, the index of nominal effective exchange rate (NEER) of KGS increased by 7.1 percent from the beginning of 2016 and amounted to 108.6 by the end of September 2016. The increase in the NEER index was due to KGS strengthening¹ in September 2016 compared to the average exchange rate for December 2015 against: the Kazakh tenge – by 17.2 percent, the Russian

ruble – by 3.7 percent, the Chinese yuan – by 14.1 percent, the US dollar – by 10.0 percent, and the euro – by 6.1 percent.

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

Despite higher level of inflation in the trading partner countries¹, the increase in the NEER index caused growth in the index of real effective exchange rate (REER), which has increased by 1.7 percent from December 2015 and amounted to 110.2 at the end of September 2016.

¹ For January to September 2016, the inflation in the Kyrgyz Republic formed negative at the level of 2.4 percent, whereas an average inflation rate in the major trading partner countries made 2.8 percent according to the preliminary calculations.

Chapter 3. Monetary Policy

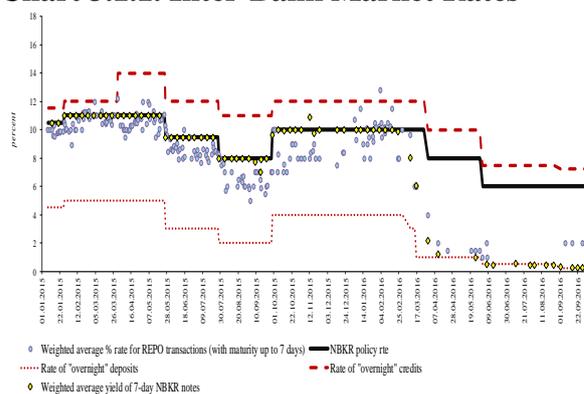
3.1. Monetary Policy Implementation

The major trends, identified in early Q2 of the current year, were still observed in the monetary sector during the reporting period. Generally, the banking system was characterized by the high level of excess liquidity. Under these conditions, in Q3 the monetary policy was implemented in order to form equilibrium money supply providing for achievement of inflation targets in the medium term. The National Bank interest rate policy was implemented amid low inflation rates in order to support measures stimulating the real sector of economy.

In the reporting period, the policy rate of the National Bank was kept unchanged at 6.00 percent upon significant downward revision in Q1 and Q2 of the current year. The National Bank made these decisions in order to create conditions for supporting positive economic growth. The rates of the interest rate corridor were changed: at the end of Q3 2016, the rate on “overnight” deposits was set at the level of 0.25 percent (the previous value – 0.50 percent), the rate on “overnight” credits – 7.25 percent (the previous value – 7.50 percent).

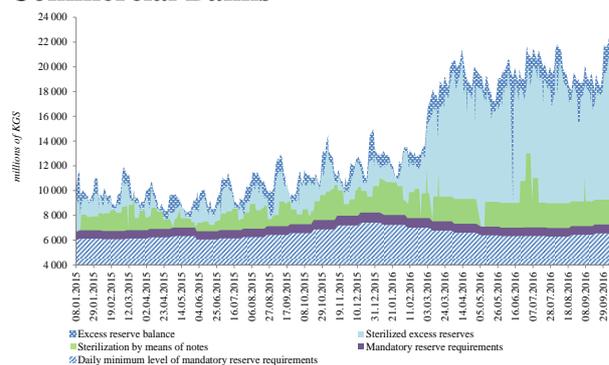
Easing monetary policy conditions on interest rate by the National Bank, as well as the excess liquidity in the banking sector resulted in the downward trend of the interest rates in the money market.

Chart 3.1.1. Inter-Bank Market Rates



In Q3 2016, short-term interest rates of the money market correlated with the trend of the National Bank policy rates. By the end of Q3 2016, the yield on the National Bank instruments in the open market, the yield on the short-term Government securities, as well as the rate of the interbank credit market were within the limits of the interest rate corridor set by the National Bank, reflected strengthening the impact of the interest rate channel of the monetary policy.

Chart 3.1.2. Excess Reserves of the Commercial Banks



In Q3 2016, the average daily volume of the commercial banks’ excess liquidity prior to the operations on sterilization conducted by the National Bank amounted to KGS 12.8 billion, having increased by 4.0 percent compared the corresponding value in Q2 and by 1.9 times – compared to the corresponding value in Q1.

In the context of retained excess liquidity in the banking system during Q3 2016, an increased demand of the commercial banks for the National Bank notes was observed, thereby conditioned the decrease of the yield of notes down to 0.27 percent by the end of the reporting period (at the end of Q1 and Q2, the yield of notes was 2.18 and 0.45 percent respectively). At the end of the reporting period, the volume of sales of notes decreased by 6.3 percent compared to the corresponding value of Q2 and by 4.8 percent – compared to the same value of Q1.

Sterilization of excess liquidity was carried out through the funds of the commercial banks placed on “overnight” deposits in the National Bank. Total amount of “overnight” deposits in the reporting period exceeded the value of the second quarter by 9.5 percent, the first quarter – by 2.6 times. In the reporting period, the total volume of “overnight” deposits

increased by 9.5 percent compared to the corresponding value in Q2, and by 2.6 times – the same value in Q1.

Generally, in the reporting quarter, the average daily volume of sterilization operations through “overnight” deposits amounted to KGS 9.0 billion, through the 7-day notes of the National Bank – KGS 2.0 billion.

The volume of credit operations conducted by the National Bank decreased since April 2016 due to the sufficient liquidity in the banking system. Generally, in Q3 2016, in order to support positive economic growth the National Bank provided with the credit resources in the amount of KGS 431.0 million, thereof KGS 370.0 million were provided within the credit auctions to the commercial banks participating in the project “Financing of agriculture – 4” and the credit in the amount of KGS 61.0 million was issued to the international organizations established by the Kyrgyz Republic jointly with other states within the framework of the EEU. The main volume of credit operations in the amount of KGS 5.4 billion was conducted by the National Bank in Q1 2016, in Q2 2016 – KGS 130.0 million. Meanwhile, there was no demand for the “overnight” credits of the National Bank in Q2 and Q3 2016 (in Q1, the volume of “overnight” credits amounted to KGS 2.0 billion).

In Q3 2016, the National Bank conducted foreign currency sale and purchase operations in order to smooth sharp exchange rate fluctuations in the interbank foreign exchange market. Since the beginning of the current year, the total volume of the foreign currency net purchase amounted to USD 60.6 million, moreover, in Q3, the net purchase amounted to USD 12.9 million. Generally, KGS liquidity was increased by KGS 817.4 million in Q3 due to the operations conducted in the interbank foreign exchange market.

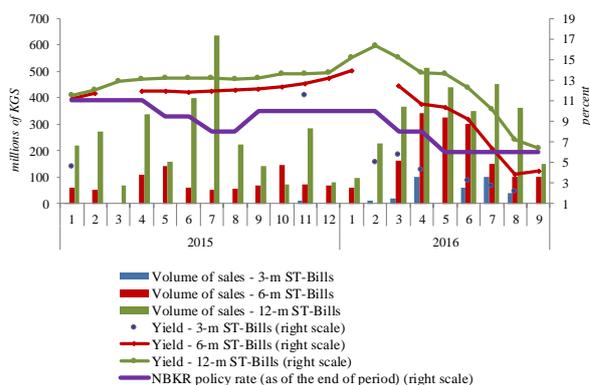
Monetary Policy Measures in Q3 2016

<p>The decisions were made on the monetary policy rate of the National Bank of the Kyrgyz Republic</p>	<p>The decision to keep the policy rate unchanged at 6.00 percent was made on August 29, 2016. The rates of the interest rate corridor were changed: the interest rate on “overnight” credits decreased from 7.50 percent to 7.25 percent, the interest rate on “overnight” deposits decreased from 0.50 percent to 0.25 percent.</p> <p>The decision to keep the policy rate unchanged at 6.00 percent was made on September 26, 2016. The interest rates on “overnight” credits and deposits remained unchanged.</p>
<p>The decision to conduct the credit auction was taken.</p>	<p>The credit auction for refinancing of the banks participating in the project “Financing of Agriculture – 4” was conducted on August 17, 2016.</p> <p>The volume of supply for the credit resources amounted to KGS 500.0 million. However, due to KGS excess liquidity in the banking system the demand from the commercial banks amounted to KGS 370.0 million. According to the results of the credit auction, the weighted average interest rate made 7.31 percent.</p>
<p>The National Bank issued credits to the international organizations established by the Kyrgyz Republic jointly with other states within the framework of the Eurasian Economic Union.</p>	<p>The volume of credit resources amounted to KGS 61.0 million.</p>

3.2. Financial Market Instruments

Government Securities Market

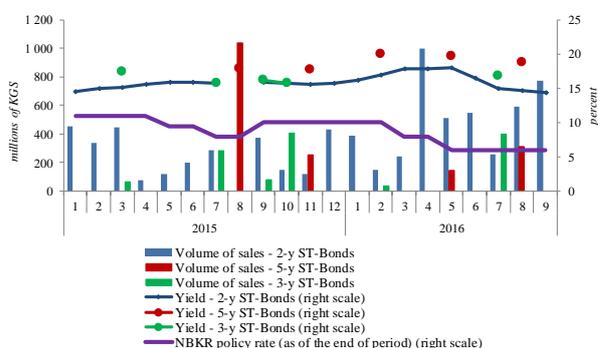
Chart 3.2.1. Dynamics of ST-Bills Sales Volumes and Yield



period of 2015.

The actual sales volume also increased (+23.7 percent) on the background of an increase in the demand volume (by 2.2 times). The volume of demand exceeded the volume of supply by 2.7 times. In Q3 2016, the actual sales volume exceeded the volume of the announced emission and amounted KGS 1.5 billion. Three auctions among the ones suggested by the Ministry of Finance were declared void due to lack of demand and insufficient quantity of the participants. The total weighted average yield of ST-Bills amounted to 6.3 percent (-6.6 percentage points).

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



of demand. The weighted average yield decreased slightly down to 15.5 percent (-1.0 percentage point) in the period under review.

ST-Bills

Since Q2 2016, the volume of ST-Bills placed in the primary Government securities market started increasing against the comparable period of 2015.

The Ministry of Finance of the Kyrgyz Republic suggested placing 3-, 6- and 12-month ST-Bills in the primary market in Q3 2016. The total volume of the announced emission of the bills at the auctions amounted KGS 1.4 billion, having decreased by 16.9 percent against the comparable

ST-Bonds

The sales volumes of ST-Bonds continued increasing in the reporting period.

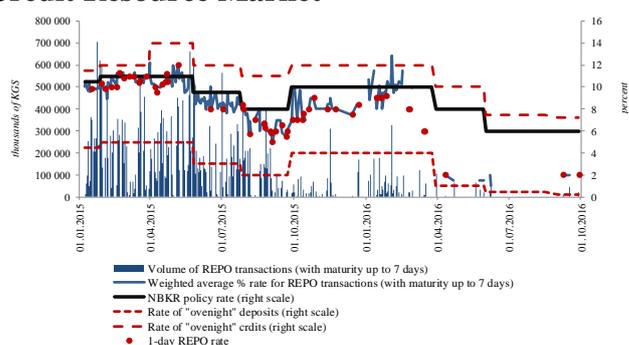
The announced volume of ST-Bonds emission at the auctions amounted KGS 1.6 billion in Q3 2016, having decreased by 24.7 percent against the comparable period of 2015.

In the reporting period, the volume of actual sales (including additional placements) constituted KGS 2.3 billion, the volume of supply exceeded the volume

Interbank Credit Resource Market

Sufficient liquidity accumulated in the banking system affected the indicators of the inter-bank lending. Since the beginning of 2016, the volumes and the weighted average interest rates in the inter-bank credit resource market decreased due to a decline in the demand for inter-bank credit resources. In January-September 2016, the total volume of the transactions in the inter-bank credit resource market amounted to KGS 5.1 billion, having decreased by 83.6 percent against the comparable value of 2015.

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



In Q3 2016, the downward trend was still observed in the participants' activity in the interbank credit resource market. The total volume of the transactions made in the reporting period decreased by 62.6 percent against the comparable value in Q2 2016 and by 92.7 percent against the comparable value in 2016 and constituted KGS 497.4 million.

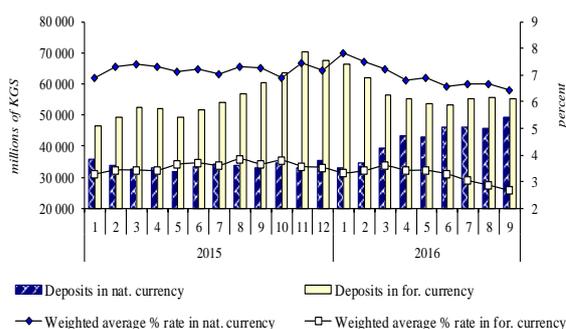
The total volume of credits in the national currency in the inter-bank credit resource market constituted KGS 350.0 million in the reporting period. Meanwhile, in September 2016, the volume of REPO transactions increased and constituted KGS 147.4 million, however, these transactions were not made in July and August.

The total volume of credits in the national currency in the inter-bank credit resource market constituted

The market rates also decreased, having approached the lower boundary of the interest rate corridor set by the National Bank, amid a decline in the demand for credit resources. In Q3 2016, an average rate on credits in the national currency amounted to 4.1 percent, on REPO transactions – 1.8 percent.

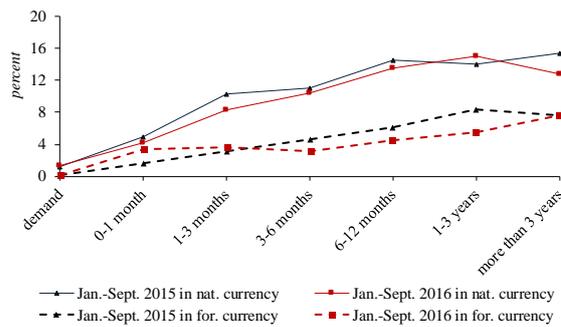
Deposit Market

Chart 3.2.4. Dynamics of Commercial Banks Deposits



Negative growth rates of the deposit base observed since the beginning of the year became positive in September 2016. The volume of the commercial banks' deposit base increased by 1.7 percent year-to-date to make KGS 104.6 billion as of the end of Q3 2016. The deposits in foreign currency decreased by 18.1 percent down to KGS 55.3 billion. The deposits in the national currency increased by 39.4 percent up to KGS 49.3 billion. Dollarization of the deposits (adjusted taking into account the policy rate at the beginning of the year) decreased by 4.1 percentage points at the end of the reporting quarter.

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



1.32 percentage points).

Credit Market

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

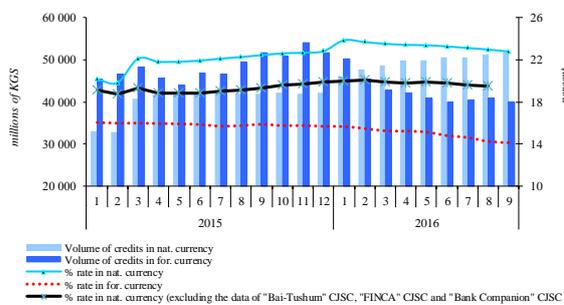
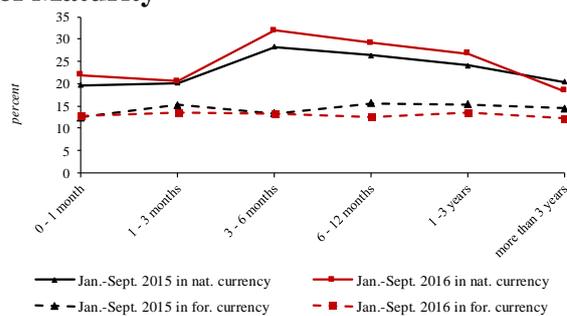


Chart 3.2.7. Rates of New Credits in National and Foreign Currency in Terms of Maturity



period (+1.6 percentage points year-to-date), while the share of prolonged credits increased up to 10.4 percent (+5.6 percentage points).

In Q3 2016, weighted average interest rate on new deposits in the national currency made 2.25 percent (-0.14 percentage points against the same period of 2015); this rate on the deposits in foreign currency made 0.55 percent (-0.49 percentage points). In the reporting period, an weighted average interest rate on the fixed-term deposits in the national currency made 12.16 percent (-1.13 percentage points), while this rate in foreign currency made 4.61 percent (-

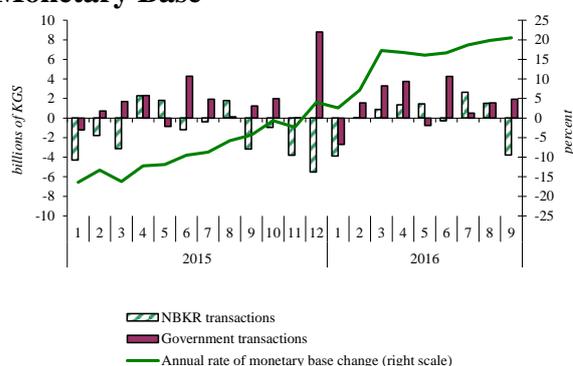
The credit portfolio of the commercial banks decreased mainly due to a reduction of its foreign currency. At the end of the reporting period, the volume of credit portfolio of the commercial banks decreased by 2.5 percent year-to-date and amounted to KGS 91.6 billion. Meanwhile, the volume of the credit portfolio in the national currency increased by 22.6 percent and amounted to KGS 51.7 billion. The volume of credit portfolio in foreign currency decreased by 22.9 percent year-to-date and amounted to KGS 39.9 billion. Dollarization of the credits (adjusted taking into account the policy rate at the beginning of the year) decreased by 2.5 percentage points.

An weighted average interest rate for new credits in the national currency increased by 0.21 percentage points, to make 25.16 percent, while this rate in foreign currency decreased by 1.90 percentage points down to 12.23 percent.

The share of overdue credits constituted 3.5 percent late in the reporting

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 2016, the upward trend of reserve money in the economy was still observed, which was affected by the Government expenditures and the operations carried out by the National Bank in the interbank foreign exchange market. Generally, in the reporting period, monetary base increased by 5.7 percent (KGS 4.3 billion) and amounted to KGS 80.2 billion at the end of the Q3 2016. The annual growth of the monetary base made 20.5 percent. At the end of the

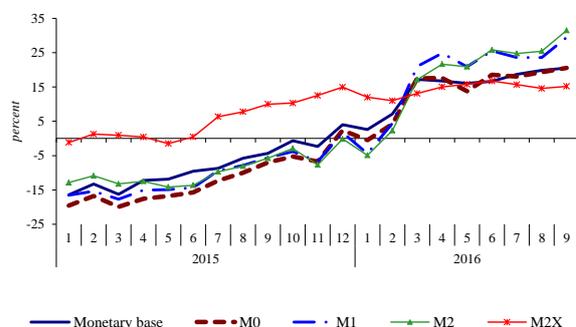
reporting period, the structure of the monetary base was as follows:

- the share of money in circulation made 88.0 percent;
- the share of reserves of other deposit corporations made 12.0 percent.

The Government operations increased the monetary base by KGS 4.0 billion and the National Bank operations – by KGS 0.3 billion.

Chart 3.3.2. Nominal Growth Rates of Monetary Aggregates

(in annual terms)



Monetary Aggregates

The upward trend in the monetary aggregates was still observed in Q3 2016.

Positive growth rates of the deposits in the national currency (+9.4 percent) and the increase of the volume of money outside banks (+6.0 percent) contributed to growth of the monetary aggregates M1 and M2¹ (+6.6 percent and +7.3 percent). At the end of the reporting period, the volumes of the monetary aggregates M1 and M2 constituted KGS 90.5 billion and KGS 106.7 billion respectively. In the annual terms, the

monetary aggregates M1 and M2 increased by 29.4 and 31.5 percent respectively.

At the end of the reporting period, broad money supply M2X constituted KGS 156.3 billion, having increased by 6.5 percent over the period. The annual growth of M2X constituted 15.2 percent, excluding the exchange rate changes – 16.8 percent. In the reporting period, broad money supply changed due to the growth of monetary aggregate M0 and the total volume of the deposits².

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

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

Chapter 4. Inflation Dynamics

During the reporting period, the inflation rate was at close to zero level due to the low prices for food products. This was the result of increased agricultural production output in the country and the favorable situation in the world markets and the wheat markets of Kazakhstan and Russia. Moreover, the monetary policy conducted by the National Bank also had the restraining effect on the price level in Q3 of the current year.

4.1. Consumer Price Index

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

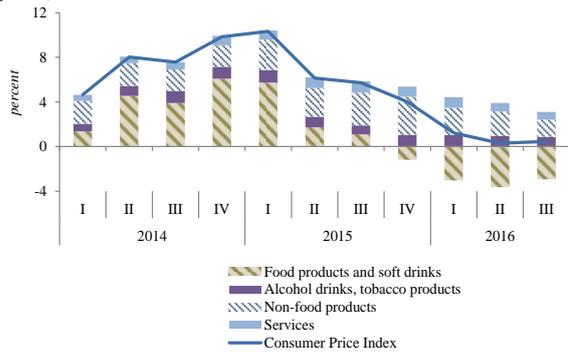


Chart 4.1.2. Dynamics of Food Prices' contribution to Annual CPI
(month to the corresponding month of the previous year)

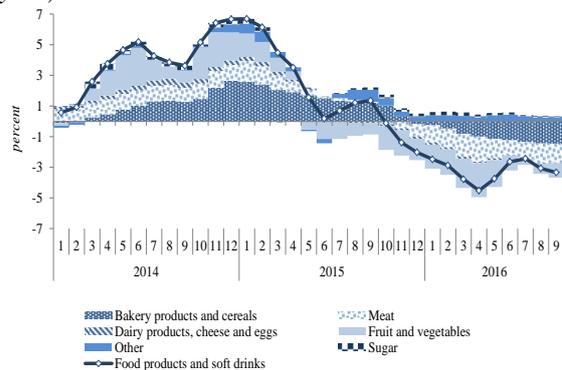
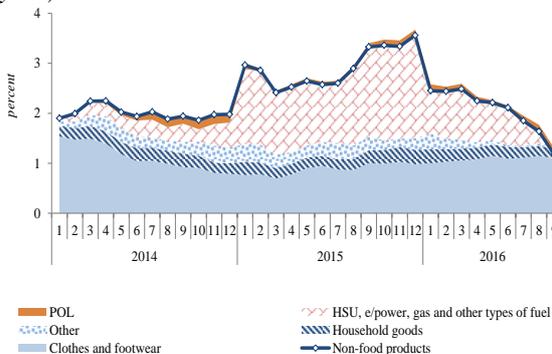


Chart 4.1.3. Dynamics of Non-Food Prices' contribution to Annual CPI
(month to the corresponding month of the previous year)



In Q3 of 2016, the annual inflation rate remained close to zero. CPI growth compared to the same quarter of the previous year increased slightly: from 0.3 percent in Q2 to 0.5 percent in Q3.

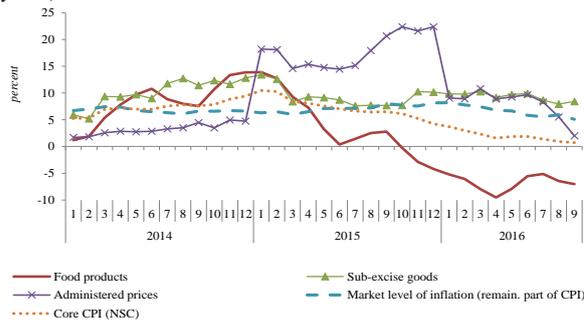
Low prices for food products remained the main factor of the weak inflationary pressure, despite a decline of the negative annual growth in this group in Q3 compared to Q2. In Q3 of the current year, prices for food products and soft drinks decreased by 6.2 percent in the annual terms. Prices for meat, bakery products, fruit and vegetables decreased significantly due to such factors as an increase in agricultural production output in Kyrgyzstan and favorable situation in the wheat market in Kazakhstan and Russia. Slight increase in the prices of certain products observed in the world markets did not have significant inflationary pressure on the dynamics of prices in Kyrgyzstan. Low domestic demand and the effect of the monetary policy conducted by the National Bank in the previous periods had the overall downward impact on the prices in the country.

Rise in prices for clothes and footwear made the most significant contribution in price growth of the non-food products group. In Q3, annual price index growth in the group “housing services, water, electricity, gas and other types of fuels” decreased significantly due to lack of the increase in the tariffs for electricity and heating and the decrease in prices for construction materials. In July-September, price growth for household goods and appliances slowed down, prices for petroleum, oil and lubricants declined compared to the corresponding period of the previous year. Annual price growth for non-food products amounted to 5.3 percent in the reporting period.

In Q3 2016, prices for alcohol drinks and tobacco products increased by 10.0 percent compared to the corresponding period of the previous year. The price index for paid

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

(month to the corresponding month of the previous year)



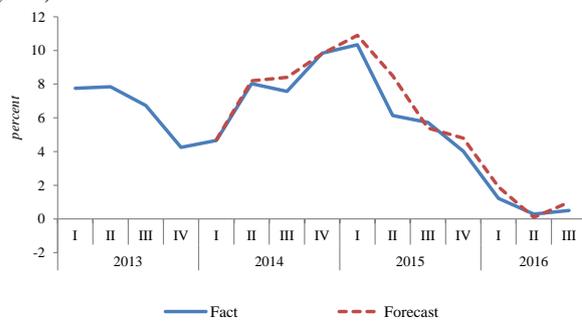
services increased by 4.6 percent. Growth in prices for the service of the educational institutions, restaurants and hotels slowed down in this group, meanwhile, an increase was observed in prices for communication services.

According to the data of the NSC KR, in Q3 2016, the core inflation decreased down to 1.0 percent from 1.8 percent in Q2 of the current year.

4.2. Comparison of Forecast and Facts

Chart 4.2.1. Actual and Forecasted CPI Values

(quarter to the corresponding quarter of the previous year)



In Q3, actual inflation rate of 0.5 percent was lower than the forecasted level set at 1.0 percent. Such situation developed primarily due to slower reduction of negative growth in prices for food products in annual terms against expectations. Moreover, the annual increase of administrative prices was below the forecasted level due to the revision of the tariff policy for electricity and heating.

Chapter 5. Medium-Term Forecast

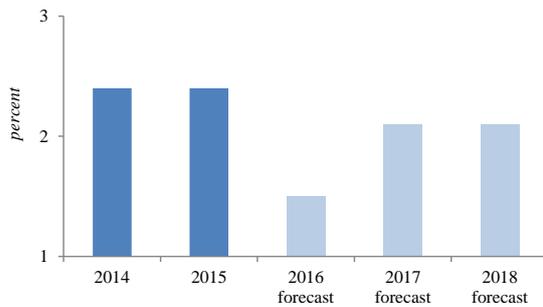
5.1. External Environment Proposals

5.1.1. Development Forecast of Major Trading Partner Countries

USA

Chart 5.1.1.1. Real GDP Growth in the USA

(year to year)



Source: IA Bloomberg

After slowdown of the economic growth in the USA, economic recovery is expected in the current and in the consecutive years. Slowdown of the economic growth was largely due to decreased investments in the mining exploration, shafts and wells amid low prices for oil. The negative contribution of this factor is forecasted to decrease. Domestic consumption will continue demonstrating moderate growth due to improved situation in the labor market. Restraining effect of weak external demand on exports is expected to be observed. In 2017-2018, GDP growth in the

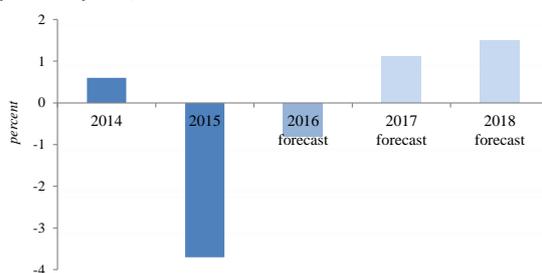
United States is forecasted to be at the level of two percent after an increase by 1.5 percent in 2016. Slow growth of the economically active population and labor productivity have a restraining effect on potential economic growth.

The inflation rate in the United States will increase due to gradual decline of the negative effect of year-on-year decrease in energy prices. The inflation rate is forecasted to be at the level of above 2 percent in 2017-2018, respectively, and, thus, it will approach the benchmark of the US Federal Reserve System.

Russia

Chart 5.1.1.2. Real GDP Growth in Russia

(year to year)



Source: IA Bloomberg

Moderate recovery of the prices for oil from the minimum values observed in Q1 2016 and improvement of the macroeconomic indicators contributed to enhanced assessment of the Russian economy made by the leading rating agencies. In 2016, slowdown of economic recession in Russian is expected at 0.8 percent from 3.7 percent in 2015, as well as weak recovery of economic growth in 2017-2018 by 1.1 percent and 1.5 percent respectively. Improvement of the external demand and recovery of the internal demand amid gradual

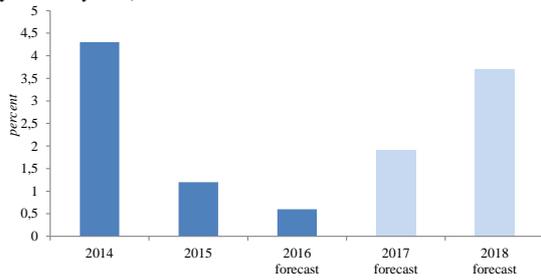
easing of monetary conditions and diminishing of uncertainty will contribute to the increase of economic activity in the medium term. Meanwhile, existing sanctions regime will still have a restraining effect, as well as on imported technologies in the key sectors of economy.

According to the forecasts, the average annual inflation rate will be about 7.0 percent at the end of 2016 due to moderately tight monetary policy, weak domestic demand and a relatively stable exchange rate dynamics. Increased inflation expectations and possible changes in savings behavior of the population remain the key risks for the inflation rate acceleration. However, the overall downward trend of the inflation rate will continue until the end of the year. The inflation rate is expected to decrease down to 5.5 percent in 2017 and to 5.2 percent in 2018 provided that the monetary policy trend observed in 2017-2018 is supported.

Kazakhstan

Chart 5.1.1.3. Real GDP Growth in Kazakhstan

(year to year)



Source: IA Bloomberg, international financial institutions

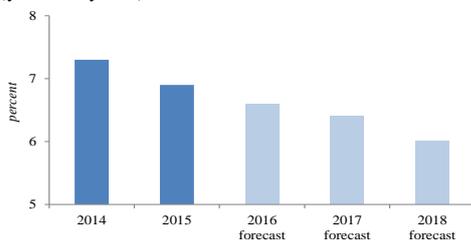
before, recovery of economic growth is expected due to forecasted rise of oil prices, uninterrupted production at Kashagan Oil and Gas Mine and the effective implementation of the State Anti-Crisis Program.

In Q4 2016, sharp slowdown in the inflation rate, which is likely to be at the level of about 8.0 percent by the end of the year, is expected due to exhausted national currency devaluation effect and decreased inflationary expectations of the population. In 2017, in the case of the absence of adverse price shocks, the trend of inflation rates slowdown will still be observed as well as due to the high base in 2016, and the average annual inflation rate will be amounted approximately to 6.5 percent.

China

Chart 5.1.1.4. Real GDP Growth in China

(year to year)



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

supported by a decrease in the households' savings rate and an increase in disposable income and it will contribute to economic growth. Business investment will probably grow slowly due to measures taken by the authorities to reduce overcapacity. High and increasing debt of the enterprises is among the main risks for the country. According to the forecasts, GDP growth in china will amount to 6.6 percent in 2016 and will slow down to 6.4 percent in 2017.

Average annual inflation rate in China is expected to amount to approximately two percent in 2016 and in the subsequent years it will be a little above the level of 2 percent, which is below the benchmark set by the authorities of the country at the level of about 3.0 percent.

Forecasts for the economic development in Kazakhstan in 2016 were slightly adjusted upwards taking into account the data of actual economic growth in January-September 2016, as well as the start-up of production at Kashagan Oil and Gas Mine at the beginning of Q4 2016.

Taking into account existence of the previous adverse external and internal conditions, the Kazakhstan economic development forecast for 2016 was increased up to 0.6 percent instead of 0.2 percent. In 2017-2018, as

Gradual slowdown of economic growth will continue in China amid the structural reforms of the Government aimed at increasing the role of domestic consumption and the service sector as drivers of growth as opposed to the exports, investment and industry. International and financial institutions emphasize that the reforms implemented by the PRC authorities have achieved certain results. According to the forecasts, domestic consumption will be

5.2. Medium-Term Forecast

In Q3, the economy of the Kyrgyz Republic developed within the framework of the trends, which closely corresponded to the baseline scenario, approved at the meeting held by the National Bank Board in August 2016.

Thus, prices for petroleum products were not expected to demonstrate significant change and will remain approximately at the level of USD 44 per Barrel of oil in 2016. The actual price for oil amounted to USD 43.0 during three quarters of 2016.

Risks from the supply and demand in the international oil market are unlikely to have a sustainable effect on the market environment in the short term. The relatively sustainability in the oil market allows preserving the current forecasts for the average oil price in 2016 and 2017 at the level of USD 44 and USD 55 per Barrel.

The meeting of the OPEC member states, where the issues on specific oil production limits for each member state will be considered (only general limits within the range of 32.5-33 million Barrels per day have been agreed during the informal meeting held in September) is scheduled on November 30, 2016. The decisions to be made amid existing uncertainty with respect to the issue on implementation of the agreement for reduction of oil production, may have upward and downward affect on oil price dynamics.

Generally, the food market still remains at the moderately low levels, and the upward movement of the food price index calculated by the Food and Agricultural Organization of the United Nations was conditioned by the gradual increase in price for sugar. Prices for other food products fluctuate within a narrow range.

The monetary policy conducted by many central banks in the region will be focused on decreasing the inflation rate and will be moderately toughening till the target ranges of the inflation rate have been achieved and stabilized.

In Q3 2016, economic growth in Russia and Kazakhstan was relatively stable therefore the forecasts for economic development in these countries were adjusted upwards. Such situation will result in stable inflow of remittances in the medium term.

Relatively stable situation in the hydrocarbons market and adaptation of the economies in Russia and Kazakhstan to changed conditions of trade will result in gradual and moderate appreciation of the national currencies in the medium term.

Generally, expectations and forecasts on the external parameters were not changed significantly compared to the previous forecasts. Expectations on the external environment are the key assumptions in developed forecasts. These expectations include the forecasts of the international research agencies/institutions, official authorities, and expert assessments.

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

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

The current trends in the international hydrocarbons and food market will still be observed in 2017 according to the baseline development scenario in terms of external environment. In 2016, the average price for Brent oil will be USD 44 per Barrel; in 2017, this price will fluctuate at the rate of approximately USD 54 per Barrel.

On the background of higher prices in the international sugar market, the food markets (FAO index) were adjusted upwards and will continue sideways development in the medium term. In 2016, the average FAO index value will be about 160.4 points and will increase up to 169.3 points in 2017. Demand-and-supply situation in the crops market in the current marketing year forms the conditions for relatively low crops prices in the world market.

In 2017, despite existing structural restrictions, the economy of Russia will enter the zone of growth to increase by 1.1 percent at the end of the year. The inflation rates will still decrease and the annual average inflation rate will make 5.5 percent in the absence of external

shocks. In 2017, GDP is expected to increase by 2.0 percent in Kazakhstan and the average inflation rate will gradually decrease down to 6.5 percent.

Thus, assessment of the situation in the external environment indicate neutral impact thereof on the domestic price level, meanwhile, the risks are shifted upwards in the second half of 2017. In 2017, in confirmation of the aforementioned facts, the external inflation rate index will be positive, with a gradual increase in the second half of 2017.

Uncertainty was observed in respect of the fiscal policy in the medium term. The draft Law “On the state budget for 2016 and the forecast for 2017-2018” stipulates gradual fiscal consolidation.

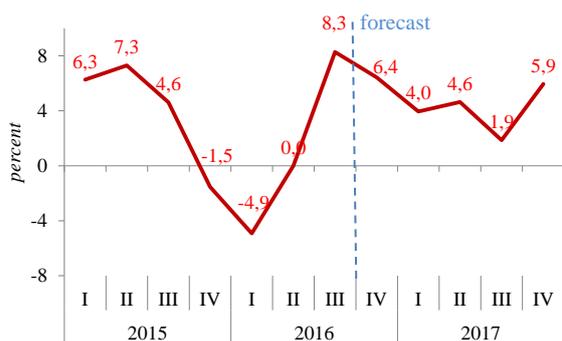
Moreover, in 2017, the teachers’ salaries are scheduled to be increased by 15.0 percent. At the end of 2017, the amount of the guaranteed minimum income is expected to increase by 10.0 percent, as well as the size of the monthly benefit for low-income families with children in accordance with the Development program for social protection of the population.

In the first half of 2016, internal consumption recovered and resulted in imports rehabilitation. Private consumption was largely formed by a substantial increase **in the inflow of remittances in 2016**. Thus, according to the baseline scenario the net remittances will increase by 20.6 percent in 2016. In 2017, upward trend in the inflow of remittances will still be observed. Increase in remittances inflow will support internal demand in the medium term and increase imports.

Taking into account the assessments of the external and internal environment in 2016, the inflation rate will converge in the medium term to the benchmark level of 5-7 percent. Relatively low prices for food and energy products in the world and in the region, moderate internal and external consumer demand and relatively stable development of the nominal exchange rate will be the main factors restraining the inflation rate. On the other hand, inflationary upward inertia will be supported by the fiscal policy measures, increased real incomes of the population, including by means of growing remittances and relatively stable inflation expectations of the population.

In 2017, the real sector of economy in Kyrgyzstan will show moderate growth. GDP gap will be negative and will have deflationary effect during 2017.

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



At the end of 2016, real GDP growth will be approximately 3 percent, excluding Kumtor, an increase will make approximately 3.7 percent. The increase of the production output at the enterprises of the Kumtor Mine will not exceed the indicators of 2015. By sectors, the economic growth will be supported by agriculture (due to livestock and crop production) and the services and construction sectors.

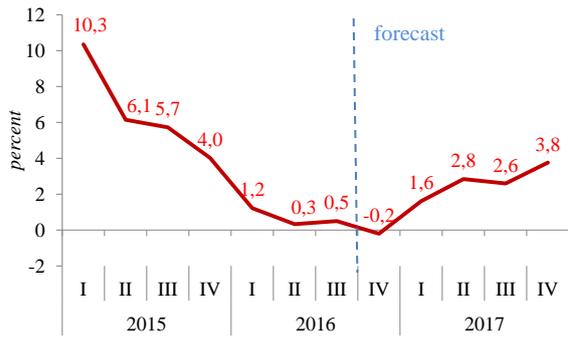
In 2017, real GDP growth will make approximately 4 percent, excluding Kumtor, an increase will make approximately 5

percent.

The inflation rate in the baseline scenario in the medium term will be below the benchmark level of 5-7 percent. At the end of 2016, CPI growth (period to period) will be 0.5 percent (December 2016 to December 2015 – approximately 0 percent). In 2017, the average inflation rate will be approximately 3 percent.

Chart 5.2.1.2. Inflation Forecast

(quarter to the corresponding quarter of the previous year)



the non-food inflation rate was observed from Q3 2016. Historically, the average value of non-food inflation rate made approximately 8 percent over the last five years. In Q3, the non-food inflation rate index made 5.5 percent and it will continue decreasing approximately down to 3 percent in Q4 2016.

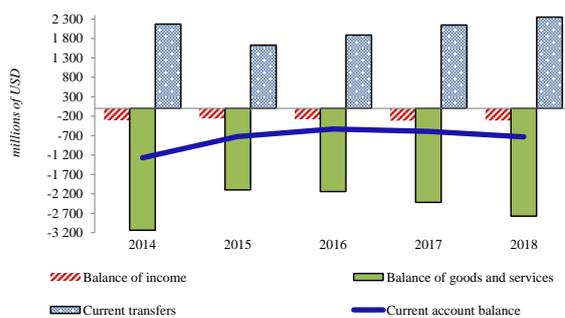
“Medium-term tariff policy of the Kyrgyz Republic on electricity and heating for 2014- 2017” will have a significant impact on the consumer prices development.

Thus, the electricity tariffs for less than 150 kWh consumption will remain unchanged, while tariffs for 150 – 700 kWh consumption will be increased by 29.8 in 2017. The tariffs for heating and hot water will be increased by 18.2 percent starting April 1, 2017.

In 2016, the economic situation in the trading partner countries and restrained economic growth of the country remain the factors determining the external sector development in the Kyrgyz Republic. Positive trend in the net inflow of current transfers and reduced deficit of the trade balance will result in the decrease of the current account deficit down to 8.3 percent to GDP (USD 531.5 million).

Chart 5.2.1.3. Forecast Data on Current Account

(millions of USD)



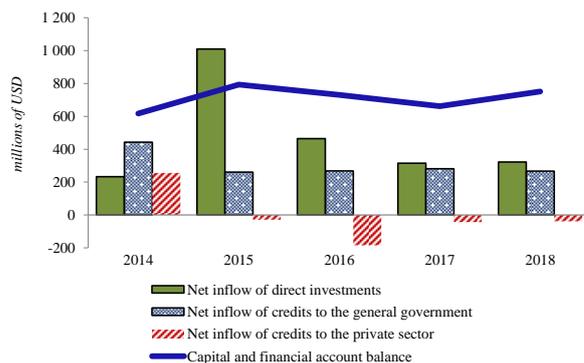
In the forecast period, the export is expected to decrease by 5.6 percent. A decrease in gold production at the Kumtor Mine in 2016 and a decline in the world prices for precious metal will have the most significant impact on exports dynamics. Taking into account existing negative export dynamics excluding gold during nine months of 2016, this index is expected to decrease by 9.9 percent at the end of 2016.

A decline in the world prices for petroleum products compared to 2015, as well as retaining low domestic

demand in 2016 will have the main influence on the dynamics of the country’s imports. The decrease in the supplies of petroleum products will be the main factor for the reduced imports from the EEU countries. The forecasted import decline based on the results of the year was adjusted to 3.2 percent amid dynamics formed in the actual period of 2016.

Chart 5.2.1.4. Forecast Data on Capital and Financial Account

(millions of USD)



The forecast of decrease in the net inflow on “current transfers” item was revised upwards to 15.6 percent compared to the level of the previous year. The forecast was revised due to more favorable trend of increase in the migrant workers’ remittances during nine months of 2016 compared to the expectations made at the beginning of the year. Finally, the forecast of the net inflow of private transfers was adjusted upwards to 19.1 percent.

In 2016, the capital and financial account was formed under

the influence of reduced direct investment inflow and increased inflow of other investments. The decline of direct foreign investments was due to significant investment from Russia in 2015 (contributions to the equity of the Russian-Kyrgyz Development Fund, as well as investments in gold deposits), the volume thereof was much lower in 2016. Inflow of other investment is forecasted in the amount of USD 134.3 million due to the return of foreign assets to the country, as well as due to the increase in liabilities to the non-residents. Expected decline in the net inflow of the private sector’s external credits in 2016 will still be observed mostly due to increased volume of servicing the previously attracted credits.

Thus, balance of payments at the end of 2016 is expected to be positive in the amount of USD 248.8 million; meanwhile, international reserve assets¹ is expected to cover 4.1 months of the future imports of goods and services.

Generally, the economic rehabilitation expected in the major trading partner countries in 2017 and 2018 contributed to improvement of the forecasted external sector indices forecasts in the country. Restoration of the positive dynamics of current transfers and more significant growth of imports compared to exports will result in formation of the current account at the rate of 9.1 percent to GDP in 2017 and 11.5 percent in 2018. Adaptation of the Kyrgyz Republic to the business conditions within the framework of the EEU and recovery of the domestic demand, which will result in the increase of the trade balance deficit by approximately 14.8 percent, will contribute to the positive results in the foreign trade.

Rehabilitation of the economic growth in Russia and Kazakhstan, as well as stability in the foreign exchange markets thereof will have a positive impact on the inflows of private transfers, which will increase by 15.1 percent in 2017 and by 10.9 percent in 2018.

Capital inflow on the capital and financial account is expected to decline, the basic amount of funds on this account will be provided by the inflow of foreign direct investments, as well as the loans to the public sector.

Balance of payments in 2017-2018 is expected to be positive in the amount of approximately USD 74.4 million. Gross 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 2016-2017 has the following risks:

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

¹ In accordance with the IMF 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)

Indicator	Unit of measure	2015				2016		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
1. Demand and supply¹ (real growth rates, if otherwise is not indicated)								
Nominal GDP, per quarter	mln. KGS	80 709,7	92 915,4	120 251,0	129 759,4	78 799,0	97 238,1	134 046,1
GDP	%	6,3	7,3	4,6	-1,5	-4,9	0,0	8,3
GDP, excluding Kumtor	%	2,4	4,7	3,7	6,2	1,0	1,4	5,6
Domestic consumption	%	1,2	0,3	-2,9	-16,2	0,2	5,3	-
Investment	%	-3,4	-7,5	-18,1	6,1	-23,2	0,4	-
Net export	%	-13,2	-5,8	-34,6	-40,5	0,2	16,4	-
<i>GDP production:</i>								
Agriculture	%	0,6	1,6	7,3	10,2	1,5	3,9	3,5
Industry	%	20,3	26,9	6,2	-37,5	-25,1	-11,4	29,7
Construction	%	-3,2	6,7	-0,2	35,1	0,1	6,2	13,1
Services	%	3,2	3,0	3,4	4,6	2,5	1,8	4,4
including trade	%	5,2	5,2	6,6	8,0	4,8	5,3	11,6
2. Prices²								
CPI	%	110,3	106,1	105,7	104,0	101,2	100,3	100,5
CPI, in annual terms as of the end of period	%	108,5	104,5	106,4	103,4	100,5	101,3	99,7
Core inflation	%	109,7	107,6	106,5	105,2	103,0	101,8	101,0
<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
Non-food products	%	112,2	110,4	109,0	111,6	111,7	110,8	110,0
Alcohol drinks and tobacco products	%	109,5	108,9	110,1	111,8	108,5	107,6	105,3
Services	%	106,0	106,9	107,4	106,6	106,5	105,2	104,6
<i>CPI, classified by character:</i>								
Excisable goods	%	111,4	109,0	107,7	109,4	110,0	109,6	108,3
Regulated prices	%	116,9	114,9	117,9	122,1	109,6	109,3	105,2
Market inflation rate (the rest of CPI)	%	106,3	106,9	107,4	107,8	107,8	106,4	105,5
3. External sector³ (in percent to GDP)								
Trade balance	%	-36,1	-35,8	-33,7	-30,4	-31,4	-33,8	-31,5
Current account	%	-17,7	-19,2	-17,3	-11,1	-8,7	-10,2	-8,1
Export of goods and services	%	45,1	42,6	41,7	40,7	40,1	39,4	39,2
Import of goods and services	%	86,0	83,3	78,2	72,8	72,4	74,0	73,3
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
5. Monetary sector (real growth rates, if otherwise is not indicated)								
Policy rate of the National bank, as of the end of period	%	11,00	9,50	10,00	10,00	8,00	6,00	6,00
Rate of "overnight" deposit, as of the end of period	%	5,00	3,00	4,00	4,00	1,00	0,50	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
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
<i>of which:</i>								
of REPO transactions	%	10,50	9,96	7,14	9,45	9,44	1,59	1,76
of credits in national currency	%	15,00	18,00	-	11,62	13,25	7,84	4,11
of credits in foreign currency	%	1,41	-	-	-	-	-	-
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
Monetary base	%	-16,2	-9,5	-4,3	4,0	17,2	16,7	20,5
Money outside banks (M0)	%	-19,9	-15,7	-7,0	2,3	17,5	18,6	20,6
Monetary aggregate (M1)	%	-17,7	-14,3	-5,6	1,7	21,0	25,5	29,4
Narrow money supply (M2)	%	-13,2	-13,6	-5,7	-0,1	17,2	25,8	31,5
Money supply (M2X)	%	0,9	0,5	10,0	14,9	13,1	16,7	15,2

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 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