

# **Monetary policy report.**

## **(inflation report) the second quarter of 2014**

Approved by Resolution of NBKR  
Board №37/1 as of August 25, 2014

### **Executive summary**

**The National Bank of the Kyrgyz Republic continued introduction of the new operational basis of the monetary policy in the second quarter of 2014.** New short-term refinancing instruments, 7-day credits were introduced in June.

**In the second quarter 2014, consumer price index growth was noted; inflation kept within the landmark identified by the Main directions of the monetary policy for 2014-2017.** Inflation (in annual terms) increased from 6.3 percent by the end of the first quarter of 2014 to 8.5 percent by the end of the second quarter of 2014. Inflation growth was subject to the impact on the internal prices of the effect of acute growth of US dollar exchange rate against Kyrgyz som (KGS) and increase of world prices for some food products.

**The second quarter still observed slowdown of economic growth rates in the country.** GDP growth in January – June 2014 constituted 4.1 percent (in January – March 2014 – 5.6 percent). Economic growth was ensured mainly by the work of the gold minefield “Kumtor”, construction and service rendering sector, as well as moderate growth of other sectors of economy. Without “Kumtor” the volume of GDP growth increased by 2.1 percent. It is expected that by the end of the year GDP growth rates may decrease; however, will increase in the mid-term perspective.

**Insufficient receipts on collected tax and customs duties resulted in moderate policy conducted in respect of expenditures.** At the end of the first half of the year, the state budget deficit constituted 2.3 billion KGS or 1.5 percent to GDP (in January-June 2013, deficit constituted 1.4 billion KGS or 1.0 percent to GDP). The total expenses of the state budget at the end of the first half of the year constituted 43.8 billion KGS (28.9 percent to GDP), having decreased by 3.2 percent or 1.5 billion KGS as compared to the similar indicator of 2013. Insufficient receipt of tax revenues (execution made 91.4 percent) was considerably compensated by receipts from the non-tax revenues and official transfers, which provided increase in the general revenues of the state budget by 5.2 percent or 2.4 billion KGS, up to 49.2 billion KGS (32.4 percent to GDP) as compared to the similar indicator of 2013.

**According to the results of the second quarter 2014 the payment balance of the Kyrgyz Republic resulted in a positive balance in the amount of 47.1 million US dollar.** Current account deficit will decrease to 10.6 percent to GDP and will constitute 61.3 million US dollars, due to reduction of trade balance deficit by 16.4 percent, to 586.1 million US dollars because of outstripping rates of decrease in imports of goods (by 13.0 percent) over their export (by 9.4 percent, taking into account the NBKR additional calculations). Net inflow on private transfers will increase by 4.1 percent.

**Slowdown of economic growth rates was observed in countries – main trade partners.** The growth of economy in China by the end of the second quarter constituted 7.5 percent, in Russia – 1.1 percent, and in Kazakhstan at the end of the half-year period – 3.9 percent. Concerns with regard to increase in outflow of the capital from Russia amplified after aggravation of the geopolitical relationships between Russia, the European Union and the USA that has an adverse effect on the foreign exchange market of Russia.

The National Bank of the Kyrgyz Republic continued to carry out policy of a floating exchange rate, participation in the foreign exchange market was defined in order to smooth sharp currency fluctuations. The net position on currency interventions conducted by the NBKR in the second quarter constituted 3.3 million US dollars. Strengthening of the Kyrgyz som in the second quarter constituted 4.4 percent.

**Decline in the rush and rather stable dynamics of the exchange rate resulted in decrease of dollarization.** Dollarization of deposits according to the results of the second quarter constituted 51.5 percent (it was 54.4 percent in the first quarter), dollarization of the loan portfolio decreased from 54.5 to 52.2 percent.

**Growth rates of monetary base in the second quarter rehabilitated as compared to the first quarter of the current year, in April-June 2014 the monetary base grew by 6.7 percent (average annual rates of monetary base growth in the second quarter constituted 5.0-8.6 percent).** Broad money M2X including deposits in foreign currency increased by 5.5 percent in the second quarter of 2014 as compared with the first quarter of 2014.

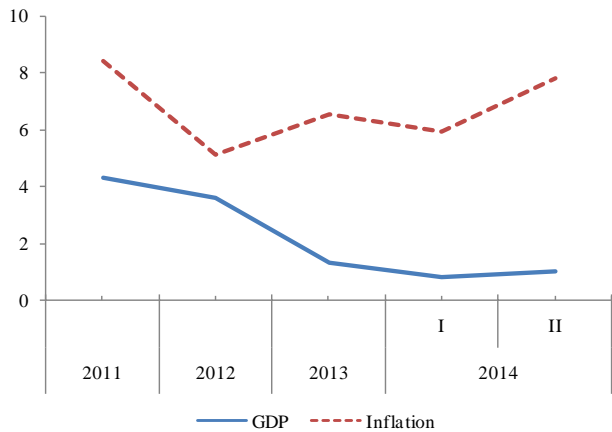
**Forecast prepared based on modeling shows that the inflation will keep growing mainly for the rest of 2014 mainly due to non-monetary factors, such as rise in prices for lubricants, poor harvest, unfavorable weather conditions in the Kyrgyz Republic.** The highest growth of prices is envisaged by the end of 2014 when the inflation will be close to the level of 10.4 percent. Medium-term estimates for inflation are reviewed upwards. New forecast of inflation for the end of 2016 constitutes 6.3 percent (previous forecast in 2014 constituted 10.2 percent and in 2016 – 4.8 percent).

**External environment**

**Economic development of the countries – main trade partners**

**Russia**

**Chart 1. GDP and inflation growth in Russia (percent)**



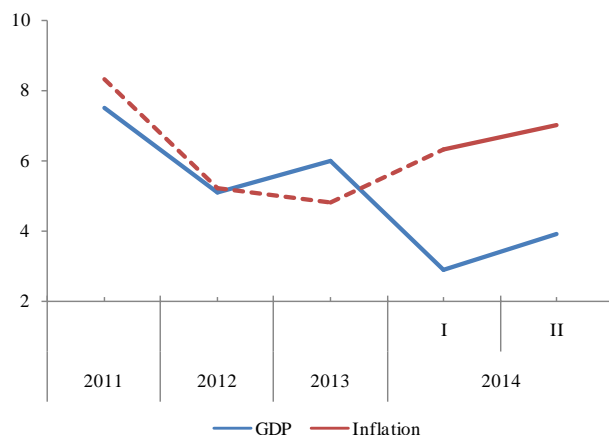
Source: Ministry of Economic Development of the Russian Federation, “Bloomberg” IA

According to preliminary results of the second quarter 2014, despite pessimistic analysts’ anticipations on stagnation of economy in Russia, GDP growth as compared to the second quarter 2013 constituted 1.1 percent. Primarily, industry made positive contribution to GDP growth in the second quarter of 2014. Ongoing crisis in Ukraine, which resulted in further capital outflow, contributed to moderated economic growth. Negative dynamics of investments is still observes, as well as weakening of the rate of Russian ruble.

In the second quarter 2014, average inflation rate accelerated and constituted 7.6 percent against corresponding period of the last year, when inflation rate (in annual terms) constituted 7.2 percent. Inflation rate was primarily affected by growth of prices almost in all sectors of economy, particularly, increase of prices for food products due to weakening of Russian ruble and significant dependence on imported food products.

**Chart 2. GDP and inflation growth in Kazakhstan**

(percent)



Source: Statistic Agency of Kazakhstan

## Kazakhstan

According to preliminary data, GDP in Kazakhstan at the end of the first half of 2014 increased by 3.9 percent as compared to growth by 5.1 percent in the corresponding period of 2013. Crisis in Ukraine, stagnation in Russia, suspending of oil and associated gas extraction at the oilfield “Kashagan” and decrease of industrial output were the main factors of slowdown of economic growth rates in Kazakhstan.

According to the data submitted by the NBKR, except for inflationary surge occurred in February, which resulted from devaluation of the national currency, ordinary price growth rates are currently recovering in Kazakhstan. Thus, inflation in June 2014 constituted 4.8 percent since the beginning of the year, in annual terms – 7.0 percent.

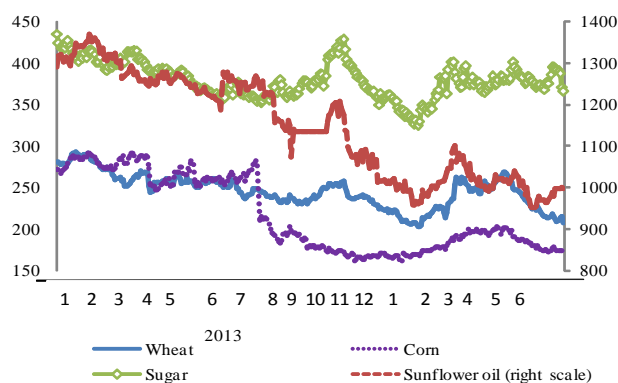
Increase of consumer prices was primarily due to the increase of prices for food and non-food products.

## World commodity markets

### Food market

**Chart 5. Dynamics of prices for food products**

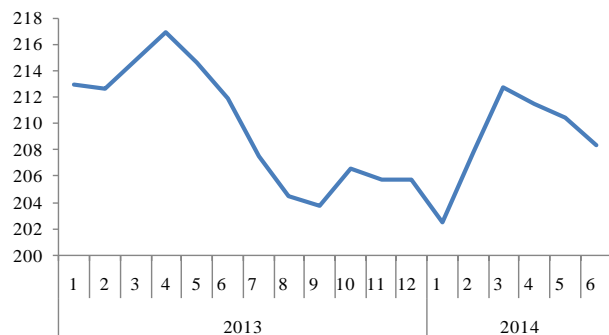
(USD per ton)



Source: NSC KR

**Chart 6. Dynamics of FAO food price index**

(percent)



Source: “Thomson Reuters”IA

Decline in prices for basic goods in the world food market was observed in the second quarter of 2014. Such situation is explained by improved forecasts for production of cereals and vegetable oil in the world in 2014-2015 marketing year (MY), as well as against significant supplies of food products.

Decline in prices for cereals observed in the second quarter was primarily due to decrease in prices for wheat and corn, which resulted from favorable perspectives of expected harvest, particularly, in the USA, the European Union and India. Decreased concerns in respect of irregular supplies from Ukraine, one of the largest suppliers of cereals to the world market, were additional factor of downward trend.

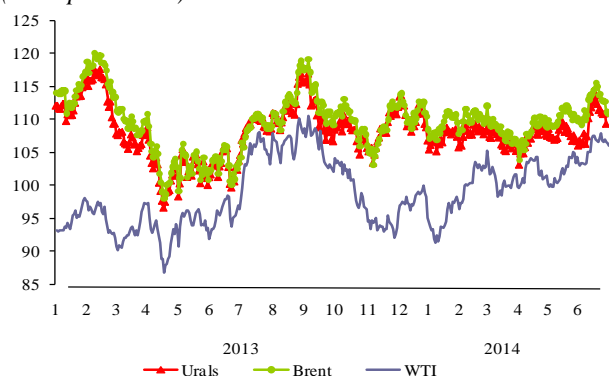
World prices for sugar in the second quarter of the current year demonstrated stable dynamics. Despite the fact that prices were affected by growing supply of sugar from Brazil, concerns about continuous dry weather in Brazil and beginning of monsoon season in India, one of the largest producers and consumers of sugar, became restraining factor for decrease in prices.

On the background of aforementioned facts, the average index of FAO food prices

## Energy market

**Chart 7. Dynamics of oil prices**

(USD per barrel)



Source: "Thomson Reuters"IA

## Gold market

**Chart 8. Dynamics of gold prices (USD per troy ounce)**



Source: "Thomson Reuters"IA

constituted 208.3 points at the end of the second quarter, having decreased by 1.7 percent against the same indicator in 2013.

Prices on the oil market (Urals, Brent, WTI) kept growing in the second quarter and fluctuated within the range 99.6-115.6 USD dollar per barrel. The highest prices were observed in June. Upward trend in the oil market was defined by the following factors:

- Persisting conflict between Russia and Ukraine;
- Still existing interruptions in supplies of oil from Libya;
- Deterioration of geopolitical situation in Iraq.

Nevertheless, there are some prerequisites to some decrease in prices by the end of the year. Decline of demand for oil is expected on part of China and Europe.

World market of gold demonstrated multidirectional dynamics in the second quarter 2014. The average price per quarter constituted 1289.6 US dollar per troy ounce, which is equal to the level of the first quarter.

Rehabilitation of economy in the USA was one of the main factors of decrease in prices for gold. Decline of demand for metal from China and India was another factor having downward pressure on gold.

Upward dynamics of prices was conditioned by decisions made by monetary authorities of the euro region and the USA on base interest rate. Plan of measures against deflation declared by the European Central Bank (ECB) and envisaging decrease of discount rate to 0.15 percent was followed by rise in price for gold. Decision of the U.S. Federal Reserve System in June to retain discount rate for a long period despite growing inflation rates in the USA resulted in further rise in prices for gold. Aggravation of military conflicts in the Middle East and Ukraine became additional reason for rise in prices for gold.

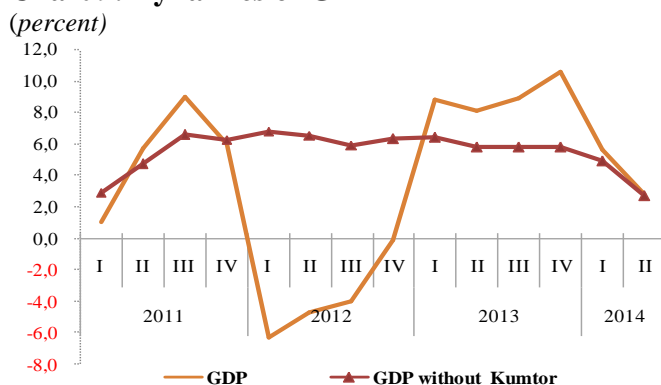
## Macroeconomic development

### Demand and supply on the market of goods and services

#### Demand

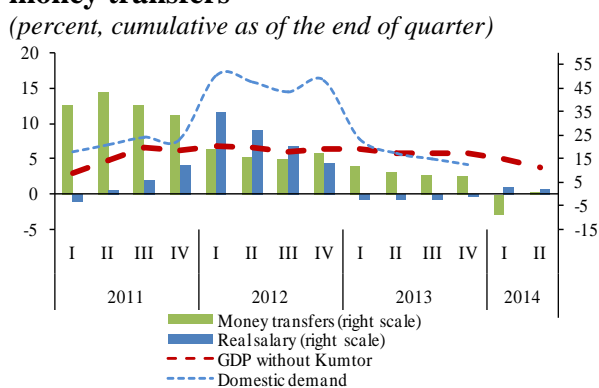
Moderate growth in the first quarter was replaced by slowdown in the economy in the

**Chart 9. Dynamics of GDP**



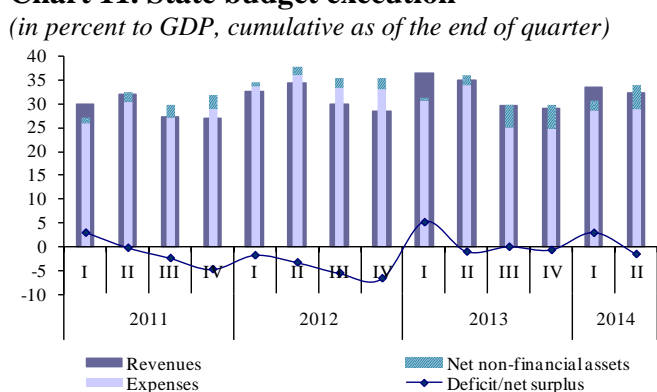
Source: NSC KR

**Chart 10. Dynamics of domestic demand and money transfers**



Source: NSC KR

**Chart 11. State budget execution**



Source: Central Treasury of the Ministry of Finance of the Kyrgyz Republic

second quarter. Such situation is explained by satisfactory growth rates of industry, construction and services sector. Thus, GDP formed positive and constituted 4.1 percent at the end of the first half of the year, meanwhile, GDP growth was 5.6 percent in the first quarter. GDP without taking into account “Kumtor” indices kept slowing down and constituted 3.7 percent at the end of the first half of the year; growth in the first quarter was at the level of 4.9 percent.

According to the press-release of Centerra Gold Inc., production output at the minefield “Kumtor” in the second quarter 2014 increased by 7.6 percent against the second quarter 2013 and constituted 77.9 thousand ounces.

At the end of the first quarter, increase in gross fixed capital formation was observed in the structure of GDP on use primarily due to growth of investments into fixed-capital assets. Meanwhile, slowdown in growth rates of trade resulted in some slowdown of consumption growth rates in the households.

Thus, domestic demand<sup>1</sup> in the first quarter 2014 demonstrated moderate growth rate (+8.7 percent) against the same period of 2013 (+7.8 percent). At the same time, consumption in the structure of GDP remains the main GDP component as before (123.6 percent to GDP) and its ratio against the previous year keeps growing.

According to the results of the second quarter 2014, net inflow of money transfers in US dollars increased by 8.7 percent and constituted 512.5 million US dollar.

Acceleration of expenses is generally observed in the second quarter, it exceeds current inflow of revenues. Thus, according to the data of the Central Treasury of the Ministry of Finance of the Kyrgyz Republic the deficit of the state budget was observed at the end of the first half of 2014, which constituted 2.3 billion KGS (1.5 percent to GDP<sup>2</sup>), however, net surplus in the amount of 2.0 billion KGS or 2.9 percent to GDP was observed at the end of the first quarter of the current year.

General revenues of the state budget increased at the end of the second quarter

<sup>1</sup> Reference to the earlier period data is based by the lack of data for January-March 2014.

<sup>2</sup> The data estimated based on the updated approach to the methods of calculation of budget indicators is presented from September 2013.

**Chart 12. State budget execution***(in percent to GDP, cumulative as of the end of quarter)*

Source: Central Treasury of the Ministry of Finance of the Kyrgyz Republic

2014 as compared to the same indicator of the first quarter, moreover, non-tax revenues made the most significant contribution to growth of revenues, the share thereof in the structure of revenues increased with simultaneous decrease in the share of tax revenues. Thus, growth of non-tax revenues in the second quarter was primarily provided by increase of receipts to the budget in the form of dividends accrued on state-owned shareholding, transfers and grants to the units of the public sector as capital assistance.

State budget revenues were executed by 100.0 percent at the end of the first half of the year, which resulted in compensation of plan overfulfilment on state budget revenues in the first quarter of the current year and failure to fulfil this plan in the second quarter. Insufficient receipt of tax revenues (execution constituted 91.4 percent) was significantly compensated by non-tax revenues, the plan thereon was over-fulfilled (execution constituted 166.9 percent), as well as by official transfers (execution constituted 103.9 percent).

In January-June of the current year, the plan of the State Tax Service on tax collection was executed at the level of 89.4 percent, the plan of the State Customs Service – 93.0 percent.

Funding on protected and unprotected items of budget was executed by 95.9 percent.

Growth of general expenses of the state budget was observed in the second quarter. High share of expenses directed to current consumption remains in the structure of expenses on the economic classification. Expenses for remuneration of labor (salary) and for use of goods and services made the most significant contribution to growth of expenses. Expenses for education, defense, public order and security, as well as social protection made the most significant contribution to growth of expenses in their structure on functional classification.

According to the preliminary data of the Social Fund of the Kyrgyz Republic, at the end of the first half of 2014, budget surplus of the Social Fund constituted 0.9 billion KGS (0.6 percent to GDP) primarily due to receipts in the second quarter, revenues –

**Table 1. Investments in fixed capital by source of funding**

	January-June			
	mln. KGS		share, percent	
	2013	2014	2013	2014
<b>Total</b>	<b>26 002.8</b>	<b>33 503.9</b>	<b>100.0</b>	<b>100.0</b>
<b>Domestic investments</b>	<b>21 244.1</b>	<b>25 849.8</b>	<b>81.7</b>	<b>77.2</b>
Republican budget	586.2	580.5	2.3	1.7
Local budget	129.7	92.3	0.5	0.3
Funds of entities and organizations	13 614.6	16 203.6	52.4	48.4
Bank loans	138.9	97.6	0.5	0.3
Funds of the population including charitable help of the residents of KR	6 774.7	8 875.8	26.1	26.5
<b>Foreign investments</b>	<b>4 758.7</b>	<b>7 654.1</b>	<b>18.3</b>	<b>22.8</b>
Foreign loans	3 563.0	4 385.7	13.7	13.1
Direct foreign investments	610.7	2 995.9	2.3	8.9
Foreign grants and humanitarian aid	585.0	272.5	2.2	0.8

Source: NSC KR



18.6 billion KGS (12.3 percent to GDP), expenses – 17.7 billion KGS (11.6 percent to GDP).

Deficit of the consolidated budget according to the results of the first half of the year constituted 1.4 billion KGS (0.9 percent to GDP); therefore growth rates of expenses exceeded growth rates of revenues (net surplus in the amount of 1.8 billion KGS or 2.6 percent to GDP was observed in the first quarter). Revenues constituted 57.9 billion KGS (38.1 percent to GDP), expenses – 59.3 billion KGS (39.1 percent to GDP).

In January-June 2014, the level of investments implementation in the fixed capital increased by 20.6 percent (in comparable prices) and constituted 33.5 billion KGS in nominal terms (decrease to 5.8 percent was observed in the similar period of 2013).

Sector of industry, including allocation of funds for construction and reconstruction of objects for supply of electric energy, gas, steam and conditioned air, for services of industry, as well as construction and reconstruction of objects for transportation activities and construction of hotels and restaurants are the mains sectors for capital investment.

However, financing of different sectors was primarily performed by means of domestic sources, where the major share was accounted for the funds of enterprises and organizations, as well as the funds of the population, including humanitarian aid of the residents.

In the reporting period, the GDP growth was primarily provided by the construction sector, manufacturing industry and the service sector.

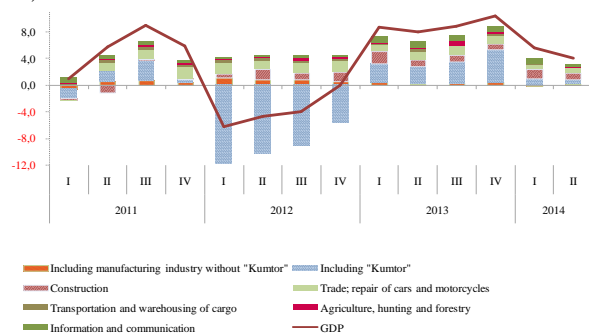
Growth was observed in the industry due to production of base metals and finished metal products, food products (including beverages) and tobacco products, production of refined oil products, generation of electric energy, its supply and distribution. Activities on construction and reconstruction of strategic roads are still implemented in the construction sphere; plant on asphalt concrete manufacture was put into.

Despite increase in planting acreage as

## Supply

### Chart 13. Contribution of main industries to GDP growth

(percent, period/to the corresponding period of the previous year)



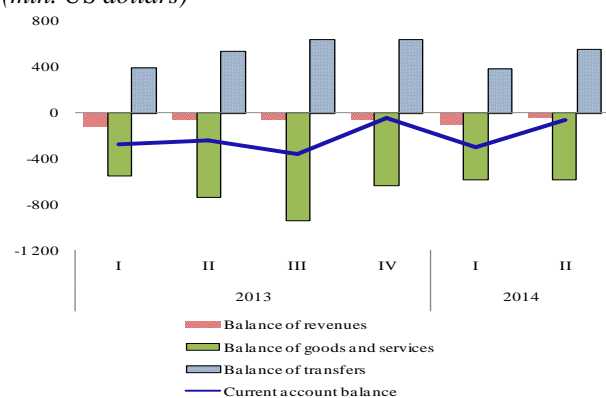
Source: NSC KR

compared to 2013, dry weather and lack of water in the reporting period had an adverse impact on agriculture. Finally, growth rates of crop production within the sector are to decrease according to the results of the year.

## External sector

**Chart 14. Current account**

(mln. US dollars)



Note: According to the preliminary and forecast data taking into account final appraisals on the re-export of oil products and trade carried out by “tourist traders”

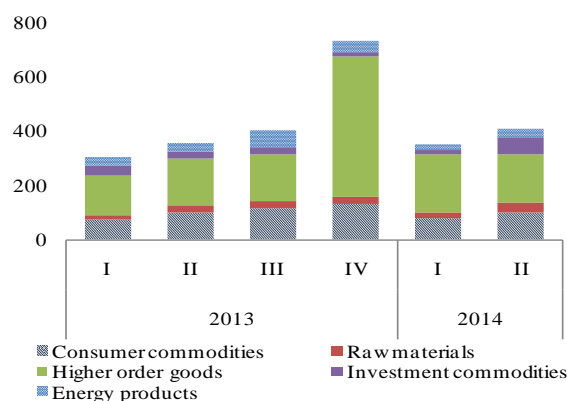
**Table 2. Trade balance of KR<sup>1</sup>**

(mln. US dollars)

	2013		2014		change in %	change in USD
	Q1	Q2	Q1	Q2		
Trade balance	-749,1	-948,5	-632,7	-715,6	-24,6	233
Export (FOB)	335,5	406,4	384,9	462,6	13,8	56,2
Gold	92,8	106,7	168,6	120,7	13,1	14
Import (FOB)	1 084,60	1 355,00	1 017,60	1 178,20	-13,00	-176,80
Oil products	265,1	253,2	207,3	184,4	-27,2	-68,8
For information						
Import in CIF prices	1 175,10	1 467,50	1 102,60	1 273,40	-13,2	-194,2
Trade balance (import in CIF prices)	-839,7	-1 061,10	-717,7	-810,8	-23,6	250,3
Export without gold	242,7	299,7	216,4	341,9	14,1	42,1
Total turnover of goods	1 420,10	1 761,40	1 402,60	1 640,80	-6,80	-120,60

Note: According to the fact data of NSC for May and preliminary data for June without taking into account final appraisal on re-export of oil products and on trade

**Chart 15. Functional structure of the export from the Kyrgyz Republic**



Note: based on the actual data of the NSC for the period of May and preliminary data of the State Customs Service as of June 2014 excluding final appraisals on the re-export of oil products

According to the preliminary forecasts, at the end of the second quarter 2014, the current account deficit would decline to 10.6 percent to GDP and constitute 61.3 million US dollars. Decline will be primarily due to improvements in trade balance.

In the reporting period, the trade deficit of the Kyrgyz Republic is expected to decline to 586.1 million US dollars (decline by 16.4 percent as compared to the same indicator for the second quarter 2013). Trade balance will be formed by the following main factors:

- Reduction of energy product imports by 27.2 percent (by 68.8 million US dollars in absolute terms);

- Reduction of imports excluding energy products by 9.8 percent (by 108.0 million US dollars in absolute terms);

- Increase in gold exports by 13.1 percent (by 14.0 million US dollars in absolute terms);

- Reduction of the NBKR additional calculations on the re-export of oil products to the Republic of Tajikistan and on the trade carried out by “tourist traders” (hereinafter referred to as “the NBKR additional calculations”) by 52.0 and 65.7 million US dollars, respectively;

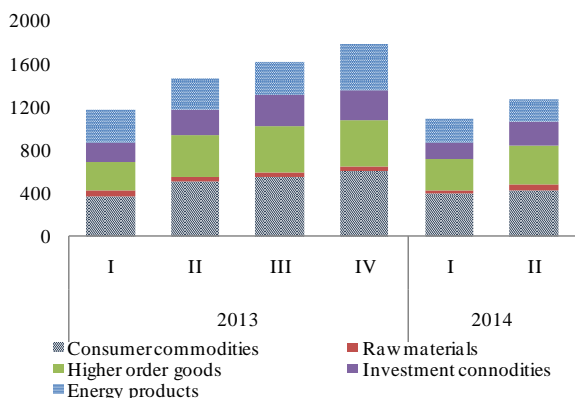
- Growth of exports excluding gold and the NBKR additional calculations by 14.1 percent (by 42.1 million US dollars in absolute terms).

Export of goods (*in FOB prices, including the NBKR additional calculations*) in the second quarter 2014 will constitute 592.1 million USD dollars and decrease by 9.4 percent compared with the same indicator in 2013.

Exports of gold are expected to grow by 13.1 percent (by 14.0 million US dollars in absolute terms) due to increase in the physical volume of supplies by 31.1 percent and decrease of average actual export price for supplies. Export excluding gold and the NBKR final appraisal will increase by 14.1 percent and constitute 341.9 million US dollars. According to the estimates of the National Bank, this will be affected by growth in exports of aircraft and related equipment, vehicles for cargo



**Chart 16. Functional structure of the import in the Kyrgyz Republic**

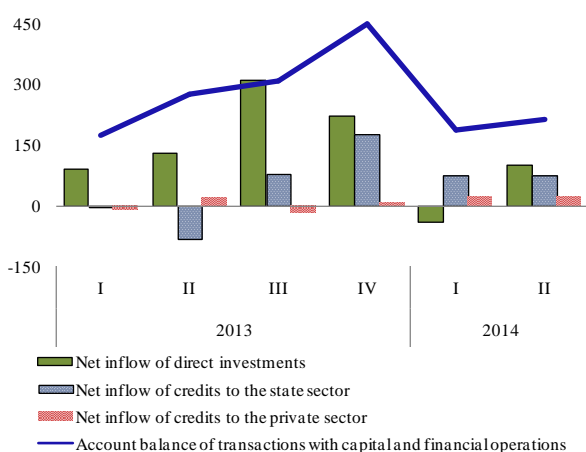


Note: based on the actual data of the NSC for the period of May and preliminary data of the State Customs Service as of June 2014 including final appraisals, excluding additional calculations on the re-export of oil products

**Chart 17. Growth rates of money transfers**  
(percent, quarter to the corresponding quarter of the previous year)



**Chart 18. Account transactions with capital and financial operations**



transportation and special purpose vehicles, jet fuel<sup>1</sup>, tobacco, other inorganic chemicals, milk, cigarettes, vegetables, cotton, etc. Moreover, decrease in supplies of rubber tires, fruits and nuts, rolled glass, cast iron and steel, etc. is expected.

Import of goods (FOB prices) for the reporting period will decrease by 13.0 percent and amount to 1 178.2 million US dollars. The decline in imports will be due to reduced supplies of oil products by 27.2 percent or 70.2 million US dollars (as a result of reduced physical volume of supplies by 25.6 percent and decline in prices by 2.1 percent). Besides, decrease is expected in the supplies of pre-used passenger-cars, medicaments, garments and clothing accessories, vehicles for transportation of cargo and special purpose vehicles, cast iron and steel, jet fuel, wheat flour, etc. Moreover, import of vehicles for construction and mining industry, fruits, inorganic chemicals, etc. is expected to increase.

According to the forecasts, the negative balance of services in the second quarter 2014 will decrease to 0.2 million US dollars, primarily due to increase of the article “travels”.

In the reporting period, negative balance of revenues is expected to decrease by 26.4 percent (to 35.9 million US dollars), which is attributable to the reduction of revenues of foreign direct investors from investing activities in Kyrgyzstan.

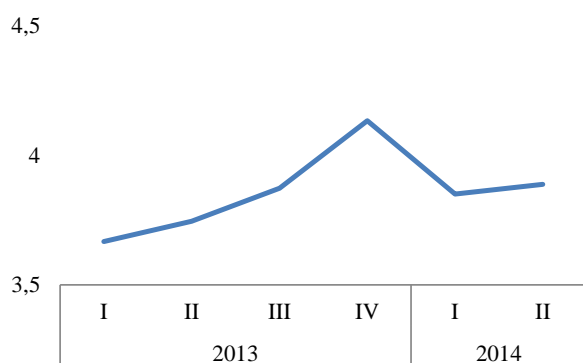
Net inflow of current transfers will form in the amount of 563.6 million US dollars, having increased by 3.3 percent against the similar indicator of the corresponding period in 2013. Rehabilitation of positive dynamics on transfers in the reporting quarter of the current year will be attributable to increase of private transfers, net inflow thereof will increase by 4.1 percent and constitute 564.3 million US dollars.

In the second quarter of 2014, the capital transactions account and financial transactions will form with positive balance of 215.6 million US dollars, which is by 22.1 percent less than the corresponding figure in 2013.

The balance of the capital transactions account is expected to be positive in the amount of 22.4 million US dollars, having decreased by 89.2 percent compared to the corresponding indicator of the similar period in 2013. Significant decrease will be attributable to high

<sup>1</sup> Export of board stock.

**Chart 19. Reserve assets of the Kyrgyz Republic (in months of import using the methods of the IMF)**



base in the second quarter of the last year due to reflection of debt in the amount of 188.9 million US dollars written off by the Russian Federation.

In the reporting period, the financial account surplus will increase by 2.8 times and will be formed in the amount of 193.2 million US dollars. Direct and other investments will have the main influence on the financial account in the reporting period.

Net inflow of direct investments in the republic will constitute 102.3 million US dollars, having decreased by 22.4 percent compared to the corresponding indicator of the second quarter in 2013.

In the reporting period, the balance of the article “other investments” will be positive and constitute 90.9 million US dollars; meanwhile, in the corresponding quarter of 2013 this indicator was negative at the level of 68.3 million US dollars. Decrease in the volume of payments on the principal amount of loan debt in the state sector from 203.1 million US dollars<sup>1</sup> in the second quarter of 2013 to 16.4 million US dollars in the reporting quarter of 2014 will have predominant influence on the specified dynamics, as a result, balance on the residents’ liabilities will be formed positive in the amount of 68.4 million US dollars. Assets of residents in the reporting period are expected to decrease by 22.5 million US dollars primarily due to decrease in the volume of the commercial banks’ assets by 22.0 million US dollars.

Thus, according to the results of the second quarter of 2014, the balance of payments of the Kyrgyz Republic was formed with a positive balance of 47.1 million US dollars. The volume of gross international reserves will cover 3.9 months of future imports of goods and services.

### **Indices of real and nominal effective exchange rate of KGS.**

According to preliminary data, the index of the nominal effective exchange rate (NEER) of the Kyrgyz som since early 2014 increased by 1.4 percent and by the end of June of the current year constituted 113.6. Growth was driven by the strengthening of the Kyrgyz

<sup>1</sup> In the second quarter of 2013, debt in the amount of 188.9 million US dollars, written off by the Russian Federation according to the Agreement entered into between the Government of the Russian Federation and the Kyrgyz Republic on settlement of a debt of the Kyrgyz Republic to the Russian Federation on the loans provided earlier, was taken into account in payments on the loans of the public sector.

**Table 3. Key figures of the exchange rate**

Key figures of the exchange rate

	year (average)		month to the beginning of the year		month to the prev. month	
	2013 (avg.) (January-June)	2014 (avg.) (January-June)	December 2013	June 2014	May 2014	June 2014
REER	111.3	115.0	113.3	117.3	116.2	117.3
NEER	110.6	112.6	112.1	113.6	112.8	113.6
Index of bilateral real exchange rate to CNY	143.4	136.0	139.3	141.7	139.5	141.7
Index of bilateral nominal exchange rate to CNY	74.3	67.8	71.1	68.8	68.1	68.8
Index of bilateral real exchange rate to EUR	145.1	134.0	138.0	138.5	135.0	138.5
Index of bilateral nominal exchange rate to EUR	69.8	61.3	65.3	62.0	60.6	62.0
Index of bilateral real exchange rate to KZT	111.3	115.0	113.3	117.3	116.2	117.3
Index of bilateral nominal exchange rate to KZT	105.6	112.4	105.0	118.1	115.9	118.1
Index of bilateral real exchange rate to RUB	73.1	76.5	74.8	74.4	75.1	74.4
Index of bilateral nominal exchange rate to RUB	109.5	115.3	113.5	111.7	112.7	111.7
Index of bilateral real exchange rate to TRY	123.0	131.7	134.7	130.2	127.5	130.2
Index of bilateral nominal exchange rate to TRY	289.4	316.9	322.4	311.1	305.1	311.1
Index of bilateral real exchange rate to USD	189.5	181.3	189.3	184.8	182.2	184.8
Index of bilateral nominal exchange rate to USD	99.4	91.0	96.9	91.4	90.3	91.4

\* preliminary data

↓ - depreciation of KGS, improvement of competitive ability  
 ↑ - strengthening of KGS, deterioration of competitive ability

som in June 2014 compared with the average rate of December 2013 in relation to the Kazakh tenge by 12.5 percent. Besides, there was devaluation of the Kyrgyz som against the US dollar by 5.7 percent, against the euro by 5.1 percent, against the Turkish lira – by 3.5 percent, the Chinese yuan – by 3.3 percent, the Russian ruble – by 1.5 percent.

Strengthening NEER index of the Kyrgyz som, as well as higher level of inflation in the Kyrgyz Republic has caused increase in the index of the real effective exchange rate (REER), which increased by 3.6 percent since December 2013 and constituted 117.3 by the end of June of the current year.

## Monetary policy

### Implementation of monetary policy

On April 28, May 26 and June 23, the Board of the National Bank resolved to retain discount rate at the level of 6.0 percent. A “corridor” of interest rate around discount rate, which was created by the interest rates on “overnight” deposits and loans, remained intact as well. The process of decision-making was affected by the level of risks balance of decline in the foreign demand on the one part and growth of consumer prices on the other part.

New short-term refinancing instrument – 7-day loan – was put into common use since June 11, 2011.

The economic development scheme, taken as the basis at the meeting, held by the Board of the National Bank in May, envisaged increase of pressure on the exchange rate, increase of interest rate and reduction of the monetary base growth rate in the medium term.

Operations on sterilization of excess liquidity conducted by the National Bank, as well as foreign exchange interventions contributed stabilization of the situation in the foreign exchange market against moderate expenses of the state budget.

During the second quarter, the National Bank conducted the following monetary operations:

- The NBKR conducted operations of purchase and sale of US dollars the interbank foreign exchange market, thus, net sale of the foreign currency constituted 3.3 million US dollars;
- Volume of the NBKR notes in circulation at the end of the second quarter constituted 3 011.7 million KGS;
- Volume of 7-day loans provided in the second quarter constituted 400 million KGS;
- Average daily volume of “overnight” deposits constituted 585.8 million KGS, the gross volume – 32 804.0 million KGS;
- Average daily volume of “overnight” loans totaled 603.1 million KGS, the gross volume – 35 336.5 million KGS;
- Outstanding balance of commercial banks on refinancing loans by the end of June 2014 constituted 1 872.4 million KGS.
- Purchase of gold by the National Bank on the domestic market constituted 251.7 million KGS.

Finally, the exchange rate of the Kyrgyz som entrenched by 4.4 percent at the end of the second quarter of 2014, the volume of monetary base constituted 71.9 billion KGS, having

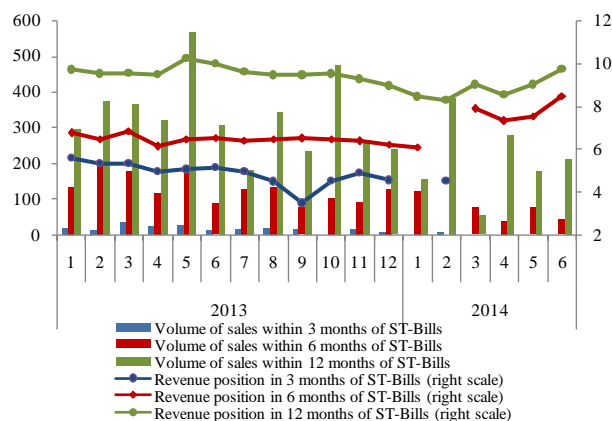
increased by 6.7 percent against to the first quarter of the current year, by 7.5 percent - against the second quarter of 2013.

## Monetary policy instruments

### Government securities market

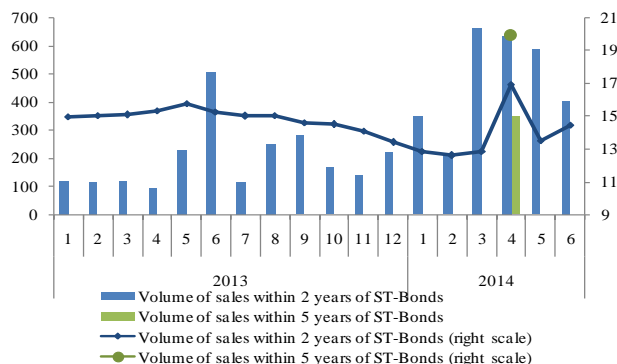
**Chart 20. Dynamics of ST-Bills sale and revenue position**

(mln. KGS, percent (right scale))



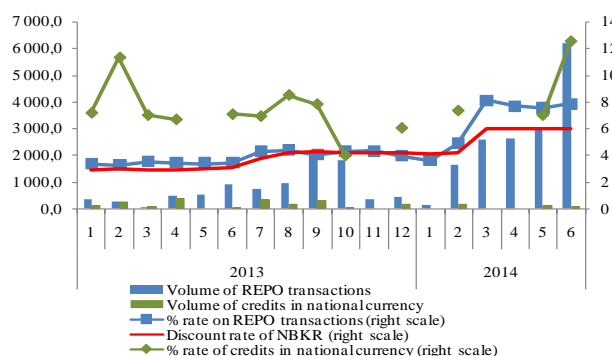
**Chart 21. Dynamics of ST-Bonds sale and revenue position**

(mln. KGS, percent (right scale))



**Chart 22. Activity in the interbank market of credit resources**

(mln. KGS, percent (right scale))



### ST-Bills

ST-Bills volume in circulation by the end of the reporting period amounted to 3.4 billion KGS, having decreased by 27.9 percent since the beginning of the year. The total volume of announced issuance of bills for April-June 2014 amounted to 1.2 billion KGS, having decreased by 29.0 percent in comparison with the same period in 2013. Sales volumes decreased (-34.1 percent) due to decline in the volume of demand (-39.9 percent). In the second quarter, the volume of sales constituted 834.2 million KGS. In April-June 2014, downward trend in average monthly yield of ST-Bills remained almost in all segments of securities placed in the market. Thus, the overall weighted average revenue position of ST-Bills in April-June 2014 was 8.8 percent (-0.1 percentage points).

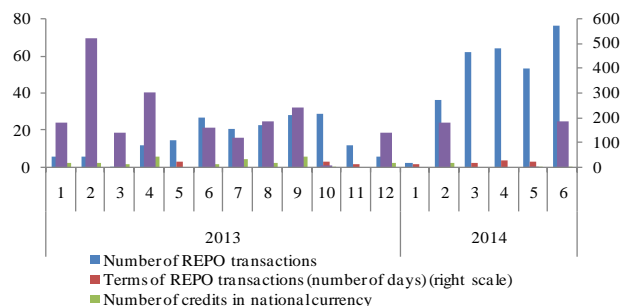
### ST-Bonds

The volume of ST-Bonds in circulation amounted to 7.1 billion KGS at the end of June 2014, having increased by 23.4 percent from the beginning of the year. Announced volume of ST-Bonds issue for April-June 2014 amounted to 2.1 billion KGS, having increased by 2.4 times compared to the same indicator of 2013. With the increase of demand (3.5 times) and sales (also 2.0 times), there was a reduction of the level of average weighted revenue position. The volume of sales in the second quarter of 2014 amounted to 1.6 billion KGS. Thus, in the reporting period, the average weighted revenue position of the two-year ST-Bonds was 13.6 percent, having decreased by 1.8 percentage points compared with the same period in 2013, 5-year ST-Bonds – 19.9 percent.

### Interbank market of credit resources

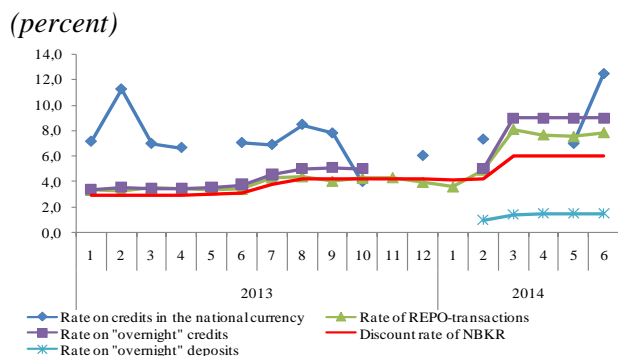
Activity of commercial banks in this segment of the market has increased significantly as is evidenced by the following data. The total volume of loans in the national currency provided in the second quarter of 2014 constituted 47.3 billion KGS due to an

**Chart 23. Dynamics of transactions in the interbank market of credit resources**

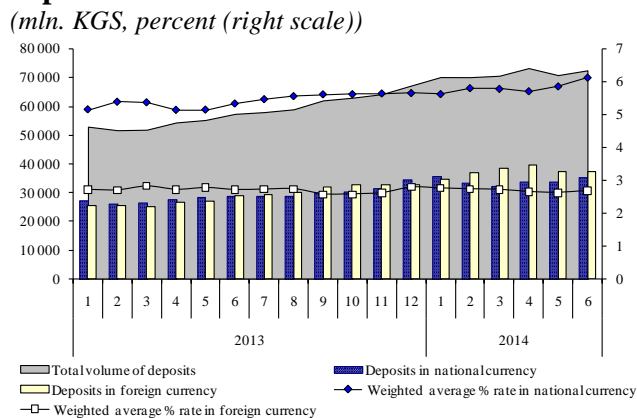


increase in the volume of “overnight” loans by 7.9 times, up to 35.3 billion KGS (average weighted rate of 9.0 percent), as well as of credits provided on REPO terms by 6.4 times, up to 11.8 billion KGS (average weighted rate of 7.7 percent). The volume of loans in the national currency issued on standard conditions fell to 182.8 million KGS. In the second quarter of 2014 average weighted interest rate on these transactions amounted to 9.8 percent.

**Chart 24. NBKR rates and interbank transactions (percent)**



**Chart 25. Dynamics of commercial bank deposits (mln. KGS, percent (right scale))**



### Deposit market

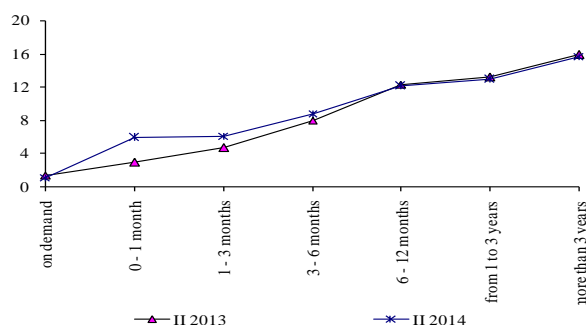
At the end of June 2014, the amount of deposit base of commercial banks constituted 72.6 billion KGS, having increased by 7.8 percent from the beginning of the year. This increase affected deposits in foreign currency (by 13.9 percent, up to 37.4 billion KGS) and deposits in the national currency (by 2.0 percent, up to 35.1 billion KGS).

Under the influence of a factor of strengthening the US dollar, the dollarization of deposits increased from 48.8 percent to 51.5 percent.

Long-term credits in the national currency attracted interest of depositors in the second quarter of 2014.

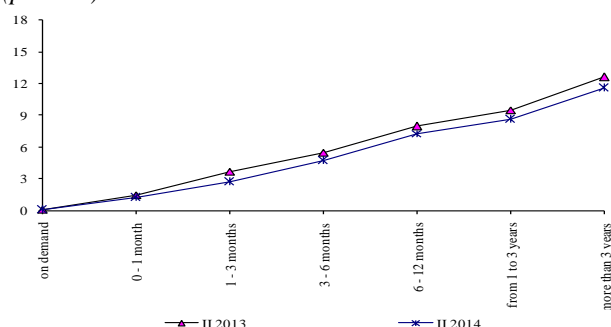
In April-June 2014, the average weighted interest rate on newly accepted deposits in the national currency constituted 2.1 percent, having decreased by 0.2 percentage points compared to the same period in 2013, interest rate on deposits in foreign currency remained unchanged at 0.8 percent. The average weighted interest rate on newly accepted demand deposits in the national currency was 1.1 percent, having decreased by 0.3 percentage points compared to the same period in 2013, on fixed deposits – increased by 1.6

**Chart 26. Rates on new deposits in the national currency by priority rank (percent)**



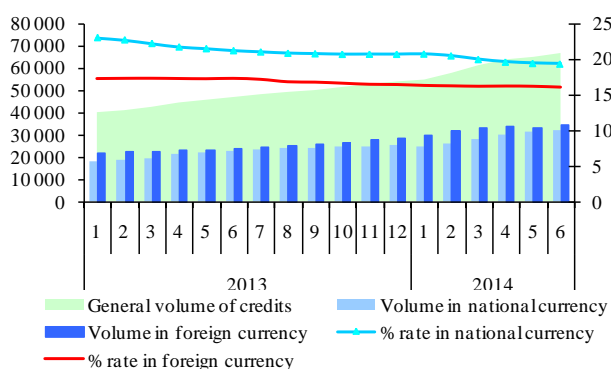
**Chart 27. Rates on new deposits in foreign currency by priority rank**

(percent)



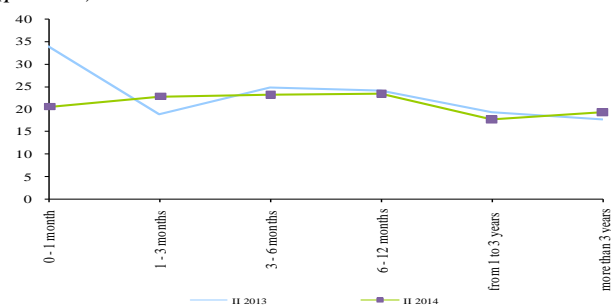
**Chart 28. Dynamics of credit exposure of commercial banks at the end of the period**

(mln. KGS, percent (right scale))



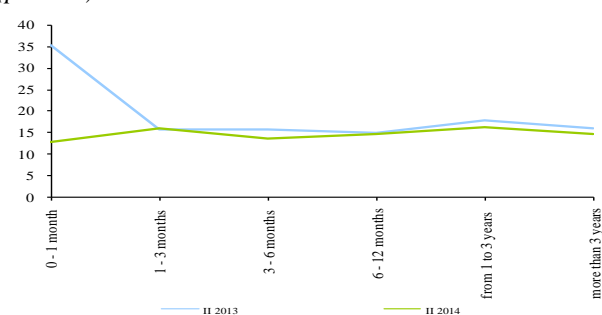
**Chart 29. Rates on new credits in the national currency by priority rank**

(percent)



**Chart 30. Rates on new credits in foreign currency by priority rank**

(percent)



percentage points, to 10.1 percent. Interest rate on newly accepted deposits in foreign currency was unchanged compared to the same period in 2013 at 0.1 percent, on fixed deposits – remained unchanged as well at 5.9 percent.

### Credit market

In April-June 2014, lending by commercial banks kept upward trend due to the issuance of foreign currency as well as national currency loans. One of the factors in credit growth was the implementation of the project “Financing of Agriculture-2” at the end of the reporting period, the volume of provided loans amounted to 4.0 billion KGS. At the end of June 2014, the loan portfolio of commercial banks constituted 66.8 billion KGS, having increased from the beginning of the year by 23.7 percent. Loans in the national currency constituted 31.9 billion KGS, having increased by 27.5 percent, and in foreign currency – 34.8 billion KGS in KGS equivalent (+20.4 percent).

At the end of the reporting period, the dollarization of the loan portfolio was 52.2 percent, having decreased from the beginning of the year by 1.4 percentage points.

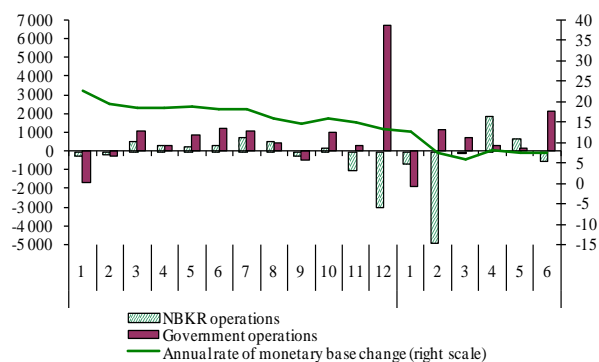
In April-June 2014, the average weighted interest rate on newly provided loans in the national currency decreased by 1.7 percentage points and constituted 18.7 percent, in foreign currency – by 5.0 percentage points, to 14.7 percent.

The share of overdue loans at the end of the reporting period constituted 2.9 percent (-0.4 percentage points from the beginning of the year), the share of extended loans – 3.9 percent (+0.7 percentage points).



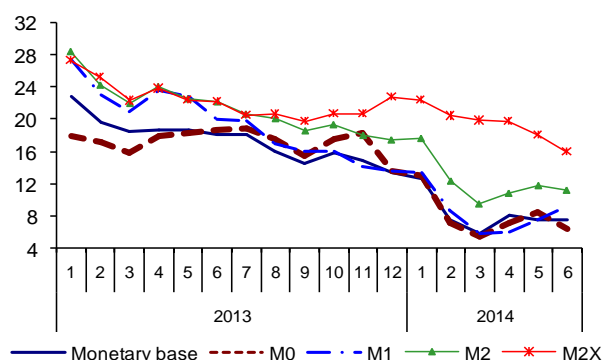
## Dynamics of monetary indicators

**Chart 31. Contribution of the Government and the NBKR operations to the change of monetary base**



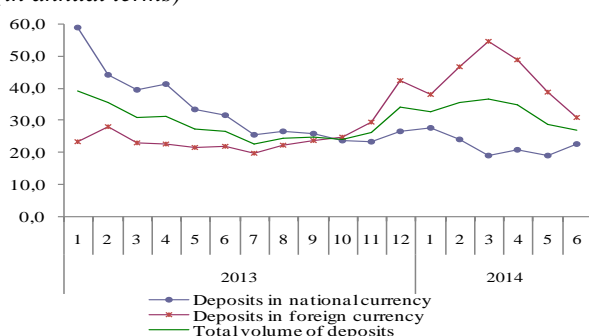
**Chart 32. Nominal growth rates of monetary aggregates**

(in annual terms)



**Chart 33. Dynamics of deposits included in M2X**

(in annual terms)



## Monetary base

In June 2014, monetary base in annual terms compared to June 2013 increased by 7.5 percent or 5.0 billion KGS, and as of July 1 it constituted 71.9 billion KGS. Operations of the Government and the National Bank affected the increase on the monetary base in the second quarter by 2.6 and 2.0 billion KGS respectively.

## Monetary aggregates

According to the results of the second quarter of 2014, nominal growth rates of monetary aggregates in annual terms ranged from 6.3 to 15.9 percent (from 18.7 to 22.2 percent in the similar period of 2013).

Broad money M2X, which includes deposits in foreign currency increased by 5.5 percent in the second quarter (in the second quarter of 2013 – by 9.1 percent), meanwhile, growth constituted 7.5 percent as compared to the similar indicator of 2013.

Increase in the volume of deposits<sup>1</sup>, which in the second quarter increased by 2.4 percent (in the second quarter of 2013 – by 10.3 percent), became the main reason of increase in M2X index. Meanwhile, in the structure of M2X, the deposits in the national currency increased by 10.1 percent, however, the deposits in foreign currency decreased by 3.6 percent (growth of deposits in the national and foreign currency by 6.8 and 13.9 percent, respectively, was observed in the similar period of 2013). The volume of money outside banks increased by 8.9 percent (in the comparable period of 2013 – by 8.0 percent). Excluding the impact of exchange rate change<sup>2</sup> total deposits increased by 5.3 percent in the second quarter (in the second quarter of 2013 – by 9.6 percent).

Expansion of credits to economy, which in the second quarter of 2014 increased by 7.7 percent (in the second quarter of 2013 – by 11.9 percent), contributed to growth of broad money.

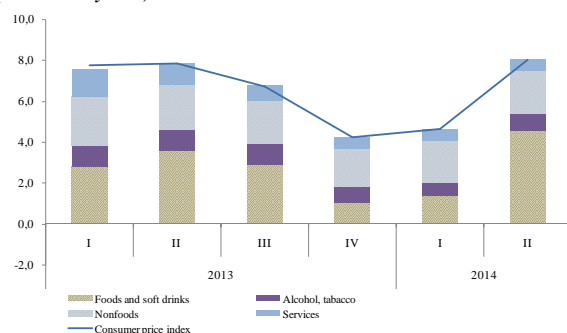
<sup>1</sup> Excluding deposits of the Government and non-residents.

<sup>2</sup> Constant (scheduled) exchange rate: 47.0992 KGS/1USD.

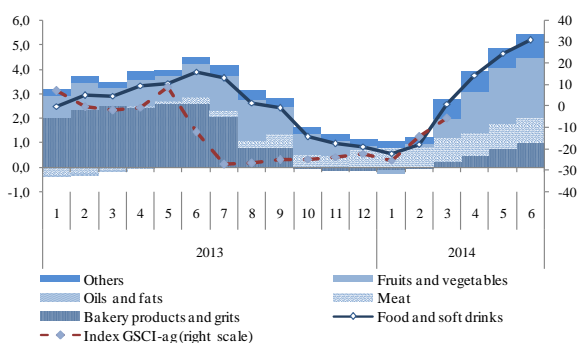
## Dynamics of inflation

### Consumer price index

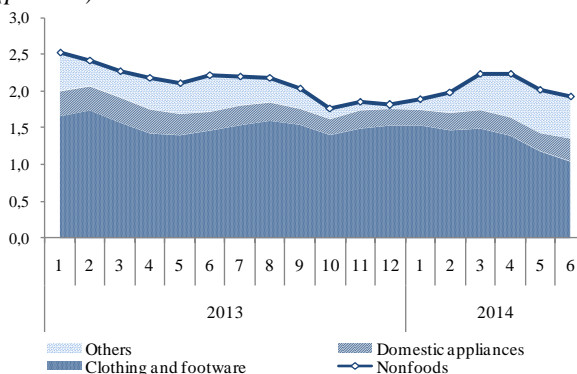
**Chart 34. Dynamics of CPI structure**  
(percent, quarter to the corresponding quarter of the previous year)



**Chart 35. Dynamics of the contribution of food prices to the annual CPI**  
(percent)



**Chart 36. Dynamics of the contribution of nonfood prices in the annual CPI**  
(percent)



According to the National Statistics Committee, in the second quarter of 2014, inflation was 8.0 percent (second quarter of 2014/ second quarter of 2013); the similar indicator of 2013 was at the level of 7.8 percent. Annual value of inflation (June 2014 against June 2013) constituted 8.5 percent.

Rise in prices for food products made the major contribution to formation of inflation in the second quarter of 2014. Late coming of spring, insufficient reserves of domestic wheat during sowing season in the country, seasonal rise in prices for fruit and vegetables, as well as the effect of strengthening the US dollar exchange rate conditioned upward dynamics of food inflation in the country during the reporting period.

In the second quarter of the current year, index of prices for food products increased by 9.4 percent. Rise in prices for fruit, vegetables and bakery products had primary impact on price formation in this group of goods. Growth of prices for meat by 10.6 percent contributed to growth of the general level of prices.

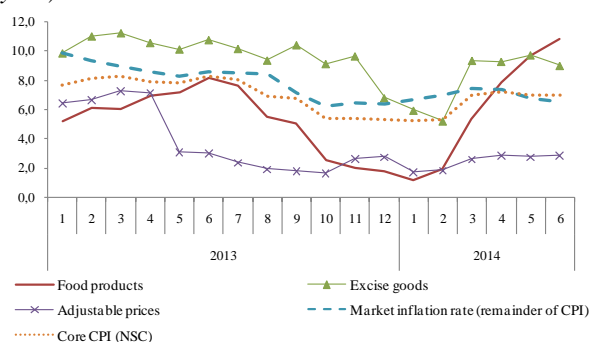
Impact of seasonal factor and late coming of spring in the republic in the second quarter of 2014 (compared to the second quarter of 2013) conditioned expressed upward dynamics of price index, prices for fruit and vegetables increased by 29.1 percent, meanwhile, in the similar period of 2013 growth of price index constituted 15.7 percent. Prices for fruit increased by 22.3 percent, vegetables – by 31.6 percent. Among regions, the most significant rise in prices was observed in the south of the republic, while traditional moderate dynamics of price growth was in other regions.

In the second quarter on the current year, prices for dairy products grew by 10.9 percent, having increased by 3.6 percentage points against the similar indicator of 2013.

Decline in the consumer price index of commodity group “oils and fats” by 4.3 percent on the background of rich harvest of oil-bearing crops in Russia and Ukraine, major importers of these products in Kyrgyzstan, had restraining influence on the rise of the general price level.

Increase in the price index for non-food products in the second quarter of 2014 constituted 7.1 percent against the second quarter of 2013. The largest contribution to the rise in prices for non-food products was made by groups of goods

**Chart 37. Dynamics of consumer price index by commodity groups**  
(percent, to the corresponding month of the previous year)



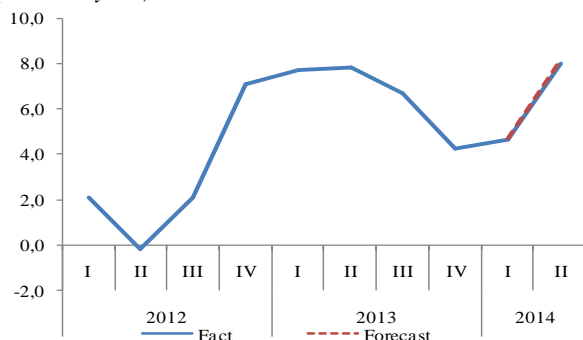
“clothing and footwear”, which rose by 10.7 percent. Price for household items and appliances rose 6.8 percent. The cost of fuel and lubricants grew by 7.8 percent, including increase in prices for gasoline and diesel fuel.

The increase in prices for paid services in the second quarter of 2014 constituted 4.2 percent (in the second quarter of 2013 - 7.8 percent). Increase in the index in this group was mainly due to higher price of recreation services (+6.7 percent) and education (+6.0 percent). The restraining factor in rising prices in this group was the reduction of prices for hotel and restaurant services by 0.9 percent.

Growth rates of core inflation calculated by the method of the NSC of KR constituted 7.1 percent in the second quarter of 2014 against the second quarter of 2013.

### Comparison of forecast with the fact

**Chart 38. Actual and projected value of the CPI**  
(percent, quarter to the corresponding quarter of the previous year)



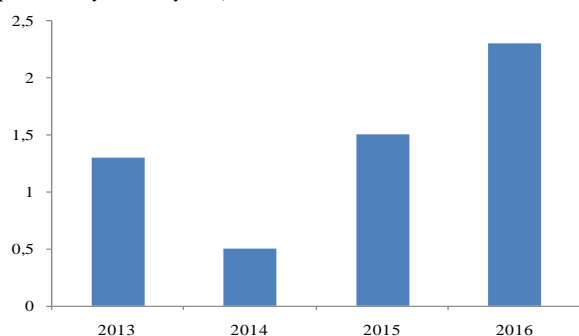
Acceleration of the inflation rate was observed in the second quarter of the current year. The average quarterly inflation was lower of the forecasts by 0.2 percentage points and constituted 8.0 percent (second quarter of 2014 / second quarter of 2013). Observed growth of the general price level, besides the effect of devaluation of the Kyrgyz som, was conditioned by internal factors, such as increase in prices for fruit and vegetable products due to cold and late spring, and rise in prices for bakery products against insufficient stocks.

## Medium-term forecast

### Assumptions about the environment

### Forecast of development of the countries - main trade partners

**Chart 40. Real GDP growth of Russia**  
(percent, year to year)



Source: IMF

### Russia

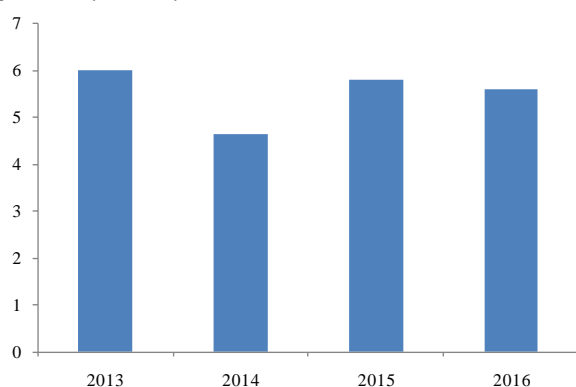
Ongoing slowdown in economic development in the current year contributed to revision of forecasts on growth of economy in Russia for 2014. The factors restraining economic growth, such as passive investment activity, structural problems in the economy as a whole, and also strengthening of capital outflow due to involvement of Russia into political crisis in Ukraine, still exist.

Thus, taking into account moderate growth rates in the second quarter, forecasts for GDP

growth of the Russian Federation were revised towards softer slowdown compared to the previous forecast: from 0.2 percent to 0.5 percent in 2014, and with expected moderate rehabilitation of the economy in Russia by 2016 (up to 2.3 percent instead of 2.1 percent).

Change in the exchange rate of the Russian ruble will still depend on outflow of foreign assets, which will be strengthened by expected reduction of the FRS program on "quantitative mitigation", growth of interest rates in the USA, and risks connected with toughening sanctions on the part of the USA and the European Union.

**Chart 41. Real GDP growth of Kazakhstan**  
(percent, year to year)



Source: "Bloomberg"IA

## Kazakhstan

According to forecasts of "Bloomberg", GDP growth for 2014-2016 in the Republic of Kazakhstan was reconsidered towards decrease (4.65, 5.8 and 5.6 percent, respectively), which is conditioned by delay in commencement of mining operations at the oil field "Kashagan"; decrease in demand for goods exported from Kazakhstan due to slowdown of economic growth in the main trade partner – Russia and lower growth rates of industrial output. According to the draft forecast for social and economic development of the Republic of Kazakhstan, the real economic growth in 2015-2019 is expected at the level of 5-6.6 percent.

Forecasts for inflation in 2014 changed towards decrease to 6.8 percent as a result of decline in economic activity in Kazakhstan and statement made by the NBKR that there were no prerequisites for the second wave of devaluation. According to the official forecast of the National Bank of the Republic of Kazakhstan, parameters for inflation by the end of the year (taking into account devaluation) will remain within the corridor of 6-8 percent as was expected earlier.

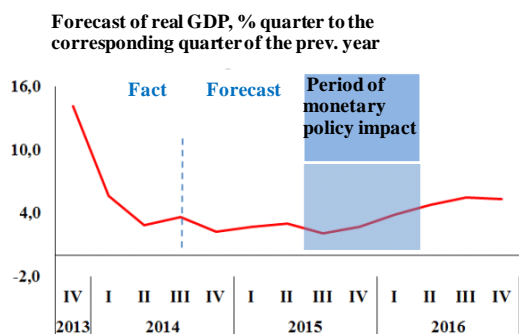
## Medium-term forecast

### Baseline scenario

**Chart 43. Baseline scenario:**

### Development of real sector of the economy

There are assumptions about slowdown of economic growth in medium term perspective stated in the Monetary policy report (Inflation report) for May. Output at the minefield Kumtor, having reached its maximum, will not have significant contribution to the GDP dynamics. Expectations that slowdown of economic growth



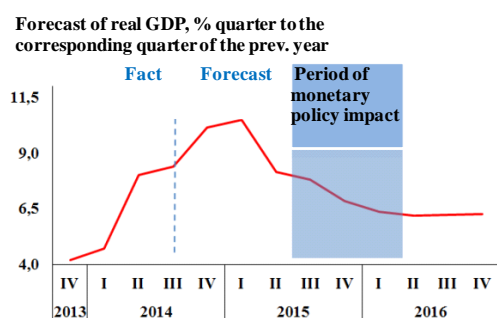
observed in Russia, the main trade partner of Kyrgyzstan, will last to the third quarter of 2016 didn't change. This situation will primarily affect inflow of the money transfers, slowdown thereof will result in decrease of the domestic consumer demand. Besides, decrease in business activity in the countries - main trade partners will restrain export supplies. Stronger exchange rate of the Kyrgyz som as compared to the currencies of the countries - main trade partners still remains another reason for slowdown in export supplies in the medium-term perspective. Nevertheless, in 2016, economic growth accelerated due to rehabilitation of external demand and weakening of the Kyrgyz som exchange rate in real terms.

Results of the first and second quarters of 2014 show that actual exchange rate of the Kyrgyz som in real terms was overestimated, while predictive estimates made in May indicated that it was stable. Taking into account the aforementioned fact, the forecast of economic growth in the Kyrgyz Republic in 2014 was reconsidered to the downside: in 2014 - from 4.2 to 3.4 percent, in 2015 - from 4.3 to 2.6 percent and in 2016 - from 5.3 to 5.0 percent.

### Inflation

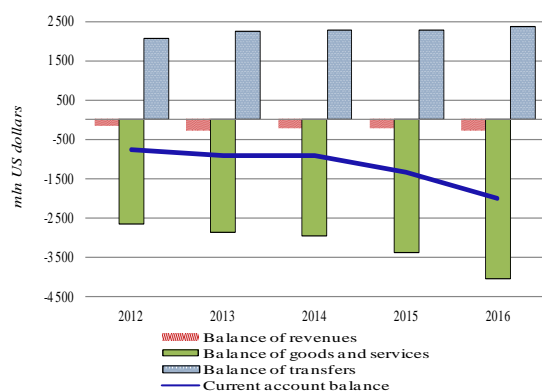
There are assumptions concerning downward trend of prices for oil of the Brent grade. However, taking into account geopolitical problems, the world prices for oil in the medium-term perspective increased as compared with the forecasts made in May. There are also assumptions about the trend of the world prices for food products. However, in view of favorable weather conditions in the countries supplying crops, the world prices for the food products will be below than the forecasted level until the end of 2014. Influence of secondary effect of currency shock is supposed to have full impact on growth of the internal prices by the end of 2014 and afterwards will gradually decline. In addition to it there were new factors, which will accelerate dynamics of inflation. In particular, adverse weather conditions in Kyrgyzstan, observed in the current year, resulted in growth of risks of increase of internal prices for food. Gradual increase of tariffs for housing services and electricity will contribute to formation of inflation in the subsequent three years. Acceleration of rise in prices for gasoline and diesel fuel on the domestic market is one more factor which was taken into account. Besides, inflationary expectations increased against news about rapid

Chart 44. Baseline scenario:



joining of Kyrgyzstan to the Customs Union. Thus, inflation by the end of 2014 will make 10.4 percent, instead of earlier forecasted level of 10.2 percent. Medium-term estimates on inflation were also reconsidered towards increase. Thus, the new forecast of inflation for the end of 2016 constitutes 6.3 percent, whereas according to the previous estimates the inflation will develop at the level of 4.8 percent.

**Chart 45. Current account operations**



### Balance of payments

In 2014, deficit of the current account is expected at the level of 12.5 percent to GDP, which is 0.2 percentage points less compared to the similar index of the previous year.

Current account deficit will be formed under pressure of the trade balance. Moreover, insignificant improvement, which will have positive impact on the current account deficit, is expected on other articles of the current account.

Slowdown of economic growth in the countries - main trade partners forecasted in the current year will create conditions for decrease in external demand, which will result in reduction of export supplies by 12.9 percent<sup>1</sup>. Besides, sustainable operation of gold mining companies will enable to increase export supplies of gold by 7.0 percent (to 789.9 million US dollars)<sup>2</sup>.

Reduction in receipts of energy products, consumer and investment goods<sup>3</sup> is expected taking into account the trends, which have developed at the end of the first half of 2014, and also possible decrease in domestic demand due to expensive imported goods, all aforementioned facts will affect decrease in import at the level of 4.0 percent.

Thus, increase of trade balance deficit by 4.7 percent (to 2 946.4 million US dollars) is expected according to the results of 2014.

Slowdown in inflows of private transfers to 0.3 percent is expected taking into account forecasted slowdown of economic growth in the countries, which host labor migrants<sup>4</sup>. At the same time, inflow of monetary grants in the state sector is expected to increase, which will contribute to growth of official transfers by 35.0 percent. Thus, increase in the net inflow of the current transfers at the level of 1.6 percent, with the nominal volume of 2 273.9 million US dollars is expected at the end of

<sup>1</sup> Excluding gold and additional calculations of the Financial Statistics and Review Department, export decreased by 2.7 percent.

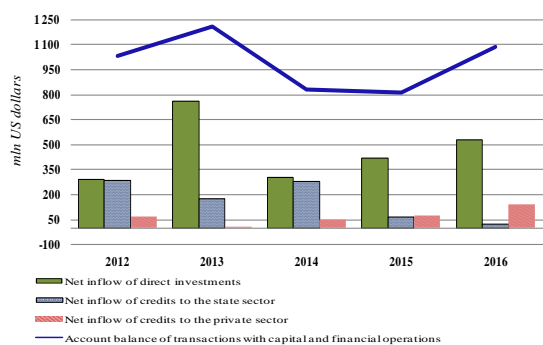
<sup>2</sup> If the world prices are retained at the level of 1 277.4 US dollars per troy ounce.

<sup>3</sup> Decrease is expected primarily in respects of re-exported goods positions.

<sup>4</sup> Slowdown of economic development in Russia is expected at the level of 0.5 percent.



**Chart 46. Funding of balance of payments**



2014.

Generally, financing of the current account deficit will be carried out by means of capital inflow on the financial account, first of all, due to receipts of external loans (332.5 million US dollars) and direct foreign investments (301.9 million US dollars).

As a result, the general balance of payments will develop negative at the level of 65.9 million US dollars. Level of the NBKR reserve assets covering will remain at the safe level (3.8 months of import).

Deterioration of the trade balance of the country conditioned by decrease in export receipts and growth of import supplies is forecasted in 2015-2016.

Average decrease in volumes of export (taking into account the NBKR additional calculations) is expected at the level of 1.5 percent, which will be mainly conditioned by decrease in the volume of final appraisals on re-export of oil products to the Republic of Tajikistan and on trade carried out by “tourist traders”. Moreover, forecasted reduction of prices for gold will result in decrease of the total precious metal exports approximately by 1.7 percent. Besides, risks of further toughening conditions of trade with the countries of the Customs Union, and of decrease in external demand still exist, they are expected to become a restraining factor for export of the basic goods.

Rehabilitation of positive growth rates of import (approximately 8.3 percent) is expected in the forecasted period. Growth will be provided by increase in imports of all groups of goods, except for energy products, import thereof remains at the level of previous years against decrease in the world prices for oil products.

Rehabilitation of economic growth in Russia and Kazakhstan will contribute to retaining of positive dynamics of private transfers approximately at the level of 4.1 percent. Thus, significant decrease in the monetary grants, received by official sector, will contribute to moderate inflow of funds under the article “current transfers”.

Thus, current account deficit is expected at the level of 17.3 percent to GDP in 2015 and 23.5 percent to GDP in 2016.

Financing of the current account deficit will be carried out due to inflow of direct foreign investments approximately at the level of 473.3 million US dollars and the credits - at the level of 154.1 million US dollars.

Generally, the total balance of payments in the medium-term period is expected to be negative (approximately 102.9 million US dollars), meanwhile, the criterion for reserve assets sufficiency to cover import of goods and services is forecasted at the safe level (at the average 3.2 months of import).

The developed forecast of the balance of payments of the Kyrgyz Republic for 2014 - 2016 contains the following risks:

- possible interruption of work on the development of “Kumtor” deposit;
- volatility of world prices for gold and oil;
- changes of the economic situation in the countries - trade partners;
- shortfall in the planned volume of foreign loans to the public sector;
- changes in the terms of trade with the countries - major trade partners.