

EDB MACROREVIEW

AUGUST 2017



EURASIAN TRANSMISSION: FROM INTEGRATION TO GROWTH

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INTRODUCTION BY THE CHIEF ECONOMIST

EDB countries: economic outlook improves

The recovery in global commodity prices as well as the weakening currency imbalances had a positive effect on EDB countries' foreign trade flows. Whereas 1Q 2016 saw falling exports of goods and services in all EDB countries except Armenia, positive growth in exports was demonstrated by all EDB countries this year. Remittances coming off the back of revived economic activity in Russia contributed to improving the current account in Armenia, Kyrgyzstan, and Tajikistan. In Kazakhstan, the rising current account deficit was due to growing dividend payments to direct foreign investors.

The recovery in economic activity, accompanied by weakening inflation risks, had a positive impact on the living standards of the population in the region. In 1Q 2017, unlike in the same period last year, real wages started to demonstrate a positive trend in all EDB countries except Kazakhstan, although the rate of decline slowed in that country.

The accelerated economic activity in EDB countries in the first half of 2017 led us to revise our GDP outlook for the full year. We raised our Russian GDP forecast by 0.3 pp to 1.4%, which, in its turn, has driven a higher 2017 GDP forecast for Belarus, up 0.1 pp to 1.4%. There were more considerable changes with respect to Kazakhstan and Armenia. The deferred effect of stimulatory fiscal and monetary policy in 2016 amid a quick recovery in remittances was reflected in consumer demand trends in Armenia in 1H 2017. In these circumstances, we raised Armenia's full-year GDP outlook from 2.9% to 5.2%.

In Kazakhstan, a quicker than expected economic recovery driven by the favourable external economic environment and a more pronounced effect from the completion of new industrial facilities was the basis for the improved GDP outlook for 2017. However, we took a more conservative view of Tajikistan's long-term growth prospects, amid rising inflation risks and increased vulnerability of the banking sector.

In our special report to this edition we again address the topic of the Eurasian countries' economic geography. However, whereas we carried out this analysis on a macro level before, drawing conclusions about possible ways to optimize macroeconomic policy, in the new study we largely analyze these matters on the micro level of industries and companies. The key conclusions highlight the significance of the distance and transport costs factor both for the companies' competitiveness in particular and for economic trends in the country as a whole. According to our estimates, the economic costs of overcoming the distance disadvantages to reach global markets for the largest EDB countries lead to transport costs that considerably exceed developed OECD countries' average indicators.

This, in its turn, requires greater coordination of economic policy as well as development of transport infrastructure – all that will contribute to improved GDP growth in Eurasian countries.

In this regard, amid the recovery in trade and economic growth rates, Eurasian Economic Union (EAEU) countries are taking further steps aimed at improving economic integration. In particular, in the transport and logistics sphere, quarantinable products will be transported within the territory of the EAEU under standardized rules from 1 July 2017. Uniform domestic tariffs have already been established for cargo transportation by rail for the EAEU. In addition, an important step on the way to further integration was the approval by the presidents of the EAEU countries of a key strategic document – *Main Directions and Stages of the Coordinated (Agreed) Transport Policy* – in December 2016. Also worth mentioning is further progress in developing the EAEU through building economic alliances – a joint statement was signed in June between the EAEU and the Republic of India on beginning negotiations on a Free Trade Area agreement.

Yaroslav Lissovolik

Chief Economist, Eurasian Development Bank

INFORMATION DISCLOSURE

This bulletin is the first and only comprehensive macroeconomic review of the member states of the Eurasian Economic Union. The review provides a detailed description of the current internal and external macroeconomic conditions and a forecast that takes into account interlinks between the economies of the region and the external sector.

In the present review, EDP employs methods that are a sort of mainstream economic analysis and forecasting and are successfully used by central banks and leading international financial institutions. The main analysis and forecasting tool used by EDB is an integrated model system (IMS), which is based on a multi-country structural dynamic macroeconomic model of general equilibrium. The IMS was developed and introduced by the EDB Center for Integration Studies in 2013-2014 with a view to meeting the needs of EDB and the Eurasian Economic Commission for analyzing and forecasting the macroeconomic situation in the region. The use of this tool also makes it possible to analyze strategic measures in response to shocks and risks related to the world and national economic systems and changes in prices of primary commodities. An important advantage of the model complex is the opportunity to make analysis and forecasting for both each particular EAEU member country and the integration alliance as a whole.

More detailed information about the structure of the IMS, its main components and its use within the framework of the analyzing and forecasting of the macroeconomic situation can be obtained from a joint report by the EDB Center for Integration Studies and the Eurasian Economic Commission, which is titled "The System of Analysis and Macroeconomic Forecasting" (the full text of the report is available at EDB's website: http://eabr.org/r/research/centre/projectsCII/projects_cii/index.php?id_4=49198&linked_block_id=0).

The present report is for solely information purposes and cannot be viewed as a recommendation to buy or sell securities or other financial instruments. Neither information contained in the present analytical review nor other information related to the subject of this review that can be disseminated in the future cannot be used as a basis for the emergence of any contract. Information contained in the present review and conclusions drawn on its basis was obtained from open sources that EDB considers to be reliable. Despite all the scrupulousness in the preparation of this review, none of the experts, directors, managers, officers or counteragents of EDB gives any guarantee or assurance expressed or implied, and undertakes any responsibility with regard to the reliability, accuracy and fullness of the information contained in the present review. Any information contained in the present review can be changed any time without preliminary notice. None of the members of EDB undertakes the obligation to update, alter or supplement the present analytical review, or notify readers in any way if any of the facts, opinions, estimates, forecasts or assessments changes or loses its meaning.

EXTERNAL CONDITIONS

Solid global economic growth maintained

Stimulatory monetary and fiscal policy continues to support economic activity in developed countries. The improved trading conditions in 2017 for commodity exporting countries compared with the previous year are contributing to a growth recovery in their economies. Nevertheless, risks remain of a slowdown in global economic growth due to increased geopolitical tension, a potential increase in protectionism, increased volatility in the financial markets, and toughened financial conditions in China.

The US GDP growth rate in 1Q 2017 was revised upwards to 2.1% versus 1Q 2016 (compared with the previous estimate of 1.6%). The revision was driven by updated data reflecting a greater increase in household consumption and export expenditure.

US growth estimate for 1Q 2017 revised upwards

The maintained positive trend in labor market indicators together with the gradual increase in consumer spending and fixed capital investments in April – May 2017 prompted the US Fed to increase the base rate by 25 basis points to 1-1.25%. The American regulator expects a further improvement in the labor market, as well as inflation sticking to the targeted 2% level in the medium term.

Ongoing stimulative monetary policy in Eurozone amid slower inflation

According to updated Eurostat estimates, the Eurozone economy in 1Q 2017 grew 1.9% YoY (1.7% according to the previous estimate). Stimulative monetary policy is supporting looser bank lending terms, which, together with increased consumer confidence, reflects that consumer demand is still higher than normal. Favourable financial conditions are creating a background for a further recovery in fixed capital investments, which is also evidenced by a higher manufacturing PMI index and a higher economic expectations indicator in April – May 2017.

After some growth in April 2017, inflation in the Eurozone slowed in May – June 2017 (the growth in June 2017 versus June 2016 was 1.3% according to preliminary Eurostat estimates). The strengthened euro rate and falling oil prices put downward pressure on inflation. Against this background, the ECB left the refinancing rate unchanged in June 2017 and reiterated that the quantitative easing program would be maintained until the end of 2017.

Increase in oil supply by the US puts pressure on prices

Oil prices dropped considerably QoQ in 2Q 2017. Brent traded at USD 50.2 per barrel on average in April – June 2017, which was 7.2% lower than in 1Q 2017. Increased oil reserves in the US, together with higher production volumes in Libya, Nigeria, and Canada, also exerted pressure on oil prices. In this regard, notwithstanding the OPEC agreement extended in late May 2017 to limit production until the end of 1Q 2018, demand and supply in the oil market will balance more slowly than previously expected.

Forecast for major external economic indicators

	Average annual price of URALS oil, in U.S. dollars per barrel	Average annual price of gold, in U.S. dollars per ounce	Food price index, 2010=100	Average annual exchange rate of the euro to the U.S. dollar	Average annual Fed Funds rate, in percent
2017	50.9	1247	94.1	1.1	1.2
2018	52.1	1285	95.2	1.1	2.1
2019	53.2	1308	96.4	1.1	2.7

Source: Estimates by the authors, EEU

REPUBLIC OF ARMENIA



TRENDS

GDP

GDP growth accelerates in 1Q 2017

In 1Q 2017, Armenia's GDP growth rate was 6.5% compared with the same quarter of the previous year, according to preliminary data. Stimulative monetary policy measures in 2016 and 1Q 2017, as well as a considerable increase in the inflow of remittances in 2017, contributed to a recovery in consumer demand. The economic growth of countries which are key trading partners, together with an increase in the global prices of key goods exported by Armenia amid maintained price competitiveness of Armenian goods in foreign markets, all supported exports. The latter's growth rate in physical volumes was 18.2% in 1Q 2017 compared with 1Q 2016.

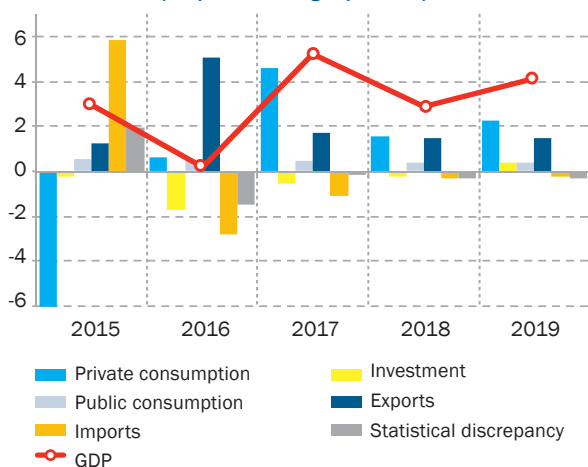
High economic activity maintained in April – May 2017

In May 2017, the economic activity indicator increased compared with the equivalent month of 2016 by 8.9% (in April 2017 the rise was 3.4%). Overall, YoY growth in the economic activity indicator was 6.4% in January – May 2017. The key factors maintaining high economic activity in April – May were:

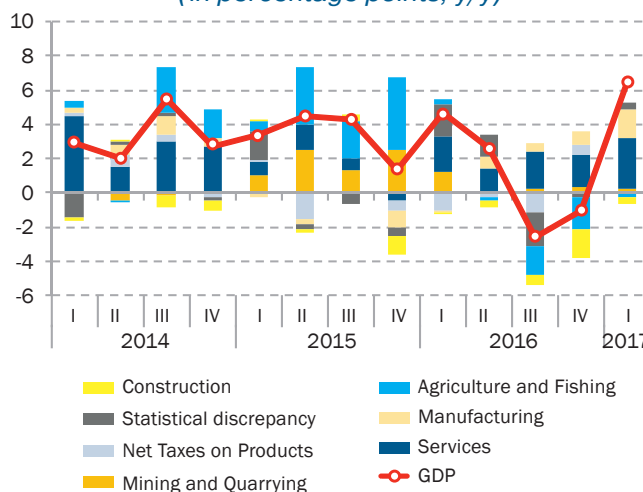
Quick recovery of both domestic and foreign demand, as well as improved trading conditions, stimulate production growth

- *on the use of income side:* more active household lending in drams (the increment for January – May 2017 was 8.3% compared with the same period of 2016, after 0.2% a year before), together with a significant increase in the inflow of labour migrants' remittances, supported consumer demand, which was reflected in both retail turnover trends (9.5% YoY growth in May 2017) and the value of imported goods (61.7% in May 2017 against 2016). Goods exports, supported by the dram's weakened real effective exchange rate and economic recovery in Russia, continued to grow.
- *on the value added side:* the improved trading conditions against a background of growing domestic and external demand helped maintain the high growth rates in manufacturing, trade and services (growth in May 2017 of 20%, 15% and 14.3%, respectively, against May 2016). The construction and agricultural sectors contributed negatively to economic activity trends (reductions in May 2017 of 9.3% and 4.8%, respectively, against May 2016).

GDP growth structure by expenditure component in comparable prices
(in percentage points)



GDP growth structure by production in comparable prices
(in percentage points, y/y)



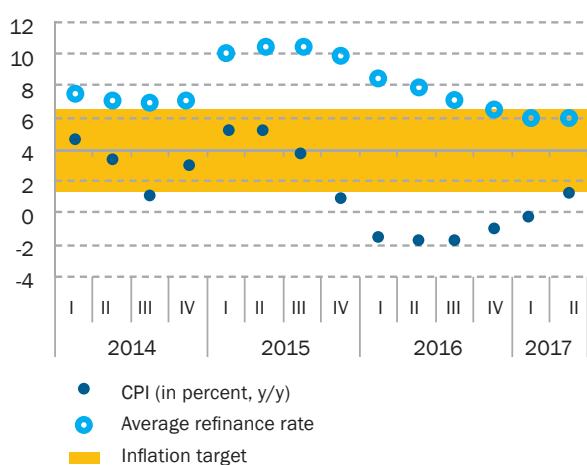
Source: The national statistical agency, EEC, estimates by the authors

Inflation

Stimulative monetary conditions speeding up inflation

A positive annual growth rate in the consumer price index was registered in April, for the first time since November 2015 (1.2% against April 2016). The rate increased further in May to 1.6% compared with May 2016. The accelerated inflation contributed to a recovery in consumer demand, increases in prices for agricultural products, stabilization of inflation expectations, and a weakening in the dram's effective exchange rate. As a result, despite the 0.3% deflation in 1Q 2017, inflation reached plus 0.4% over the first five months of the year compared with the corresponding period of 2016 (deflation was 2.1% in January – May 2016).

CPI and the refinance rate, in percent



External trade and the real exchange rate
(growth in percent, y/y)



Source: The national statistical agency, EEC, estimates by the authors

The core inflation indicator used by the Central Bank of Armenia showed zero change in May 2017 year-on-year, rising above a negative value for the first time since December 2015.

Exchange Rate

Devaluation of the national currency stimulating growth in exports

The nominal effective exchange rate of the dram has weakened by 3.2% since the beginning of 2017 (December 2016 to April 2017). The real effective exchange rate for the same period declined by 1.6%. The real exchange rate of the dram for January – April 2017 depreciated by 3.7% compared with the corresponding period in 2016.

The real effective rate movement together with the recovery in external demand and increasing export prices contributed to growing exports of Armenian goods. The growth rate in January – May 2017 was 20.9% compared with the corresponding period of the previous year.

The nominal exchange rate of the dram to the Russian rouble has weakened by 8.7% since the beginning of the year (December 2016 to May 2017 – in January to May 2017, the depreciation was 23% year-on-year). Against that background, exports of Armenian goods to Russia in January – May 2017 increased by 25.8% compared with January – May 2016. Meanwhile, the dram's nominal exchange rate to the US dollar remained stable in January – May 2017.

Current account deficit decreases

In 1Q 2017, the current account deficit was USD 86.2 million (in 1Q 2016 the deficit was USD 115.9 million). The declining current account deficit was driven by the growing volume of net labour migrants' remittances, an improved services balance (above all, due to construction and information services) and an increase in proceeds on the primary income account. Despite the improvement in the current account, the negative balance of trade in goods in 1Q 2017 was USD 220 million, growing by USD 43.7 million year-on-year (in January – May 2017, the foreign goods trade deficit increased to USD 678.3 million). The increasing negative trade balance is driven by faster growth in goods imports compared with exports amid improving consumer demand in Armenia.

Growth in remittances helps consumer activity recover quickly

The recovery of economic activity in Russia and strengthening of the Russian rouble in April – May 2017 had a further effect on the inflow of individuals' remittances. According to the Central Bank of Armenia, individuals' remittance volumes grew in dollar terms by 23.5% compared with the same period last year. The growth in remittances has a positive effect on consumer demand and is still contributing to a reduction in the current account deficit in the balance of payments.

In January – May 2017, remittances grew by 18.5% year-on-year, including an increase of 17.7% from Russia. The positive Russian economic growth trend is expected to continue in the second half of 2017 and to contribute to a further increase in individuals' remittances to Armenia.

Reduction of international reserve assets

As of the end of May 2017, Armenia's currency reserves amounted to USD 1,982.2 million, down USD 221.9 million from the beginning of the year. The reduction in currency reserves was due to the repayment of foreign liabilities by both banks and corporates.

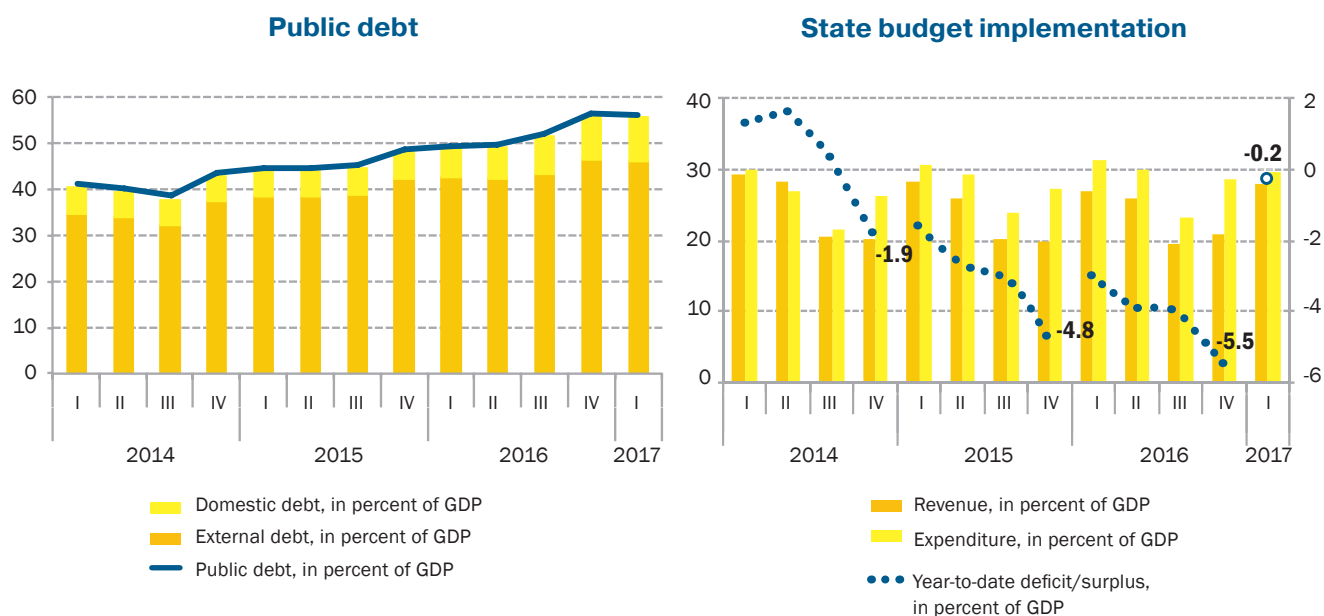
Fiscal Policy**Reduction of budget deficit thanks to growing revenues**

The fiscal policy in January – May 2017 was conservative. The recovery in economic growth is leading to an increase in budget revenues (the increment in January – May 2017 was 7.2% year-on-year), primarily due to growth in proceeds from VAT, excise taxes and payments for use of natural resources. Budget expenses for the same period were almost unchanged: the increase in expenses on state debt servicing and payment for labor was compensated for by reduced economic subsidies and expenses on the acquisition of goods and services.

As a result, the state budget deficit was AMD 40.1 billion in January – May 2017, down AMD 30.2 billion (or 43%) YoY. According to the budget rule, the budget deficit in 2017 must not exceed AMD 152 billion.

Rise in public debt requires continued moderate fiscal policy in medium term

Armenia's public debt as of the end of May 2017 was USD 6.1 billion, increasing in April – May 2017 by 1.6% (growth was 2.6% since the beginning of the year, or USD 152.9 million). The growth in public debt was primarily due to higher debt liabilities of the government and the Central Bank (77.7% of the overall debt increase since the beginning of the year).



Source: The national statistical agency, EEC, estimates by the authors

Monetary Policy

Stimulative monetary conditions remain

Amid accelerating inflation in April – May 2017 and continued recovery in consumer demand, the Central Bank of Armenia left the base rate unchanged at 6%. Taking into account the time lag between taking monetary policy measures and their effect on the economy, the influence of the considerable reduction of interest rates in 2016 on inflation and economic activity is expected to continue into subsequent quarters.

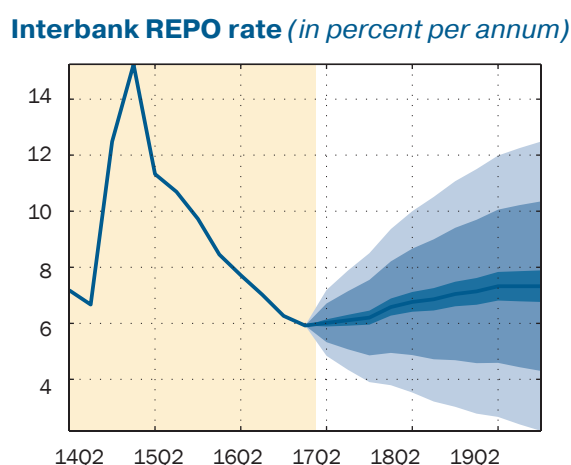
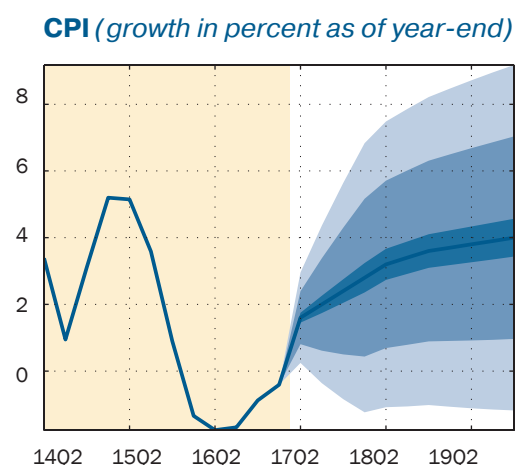
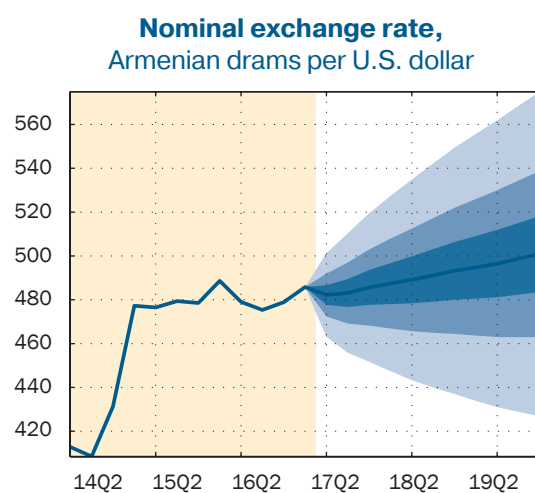
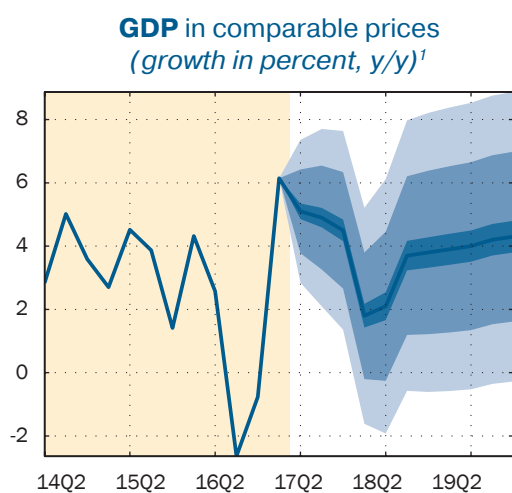
Dollarization level remains high

The high yield on deposits in drams compared with foreign currency deposits has contributed to a gradual reduction in the economy's dollarization. The dollarization level of residents' bank deposits as of the end of May 2017 was 58.7%, dropping by 3.1 pp YoY, including a decline in dollarization of households' term deposits of 5.2 pp. However, despite the declining dollarization of the economy, its level still remains high, limiting the effectiveness of current monetary policy.

FORECASTS

Acceleration in economic growth in 2017

On the back of the recovery in consumer demand in the first half of the year, we have revised our GDP forecast for 2017 upwards, to 5.2%. The stimulative nature of monetary policy amid continued low inflation expectations will contribute to a further reduction in interest rates on the loan market and persistent strong consumer demand growth in 2017. The expected continuing economic recovery of key trading partners will have a positive effect on export volumes and remittance flows into the country. The structural policy measures aimed at improving the business environment, stimulating exports and increasing the effectiveness of fiscal policy, will contribute to an increase in potential growth rates in the medium term. As a result, the growth rate in Armenia's GDP will stabilize at 4.0% by 2019.



Source: Estimates by the authors, EEC

¹ Here and below the ranges of the fan charts correspond to 10%, 50% and 75% confidence intervals.

**Accelerated
inflation and gradual
achievement of the
target level**

Further inflation growth is expected, assuming there are no domestic or external shocks in the second half of 2017. On the back of the recovery in economic activity, the impact of deflation on domestic demand will gradually weaken, which will help inflation to approach the bottom of the target range in 2017 and remain within the target level in the medium term. The downward effect on price growth from the conservative fiscal policy will remain in 2017, however, in the medium term, the likely positive effect of the fiscal consolidation on faith in government policy and investment flows into the Armenian economy will result in a neutralization of the deflation effect.

SUMMARY

Forecast for the Major Macroeconomic Indicators of the Republic of Armenia

	2017	2018	2019
CPI (growth in percent as of year-end)	2.3	3.6	4.0
GDP in comparable prices (growth in percent, y/y)	5.2	3.0	4.1
Interbank repo rate (in percent per annum)	6.2	7.1	7.8
Exchange rate of the national currency against the U.S. dollar (final average for the year)	484	490	497

Source: Estimates by the authors, EEC

REPUBLIC OF BELARUS



TRENDS GDP

Continued growth recovery

The recovering economic growth in the Republic of Belarus continued in April – May 2017. According to preliminary Belstat estimates, Belarusian GDP in January – May 2017 increased by 0.9% year-on-year, after an annual increment of 0.3% in 1Q 2017. The growth in economic activity was supported by a gradual recovery in both domestic and external demand amid continued easing of monetary conditions.

The key factors behind the positive economic trends in Belarus are:

Consumer demand shows signs of recovery

- *on the use of income side:* a gradual recovery in retail turnover, growth in which reached its highest value for several years in May at 2.9% compared with May 2016. Against that background, 2Q 2017 consumption expenditure is expected to turn positive after the decline slowed to 0.6% year-on-year in 1Q this year (versus a drop of 2.9% for 2016 as a whole). Recovery in retail is still held back by the continued reduction in real available monetary income of the population, which fell by 1.5% year-on-year in January – April 2017.

Fixed capital investments continued to show mixed trends in April – May 2017. The growth in investments was 0.1% YoY in May, after a 9.5% drop the month before. Such surges can be explained by the completion of projects in the energy sector and road construction, despite ongoing low industrial investment amid the high debt level and weak borrower solvency. Overall, fixed capital investments in January – May 2017 dropped by 5.5% year-on-year, after a drop of 22.4% in the same period of 2016.

**Industrial recovery
after significant drop**

Net exports of goods and services, where a considerable role is played by the economic recovery in Russia and the favourable external economic conditions, with growing goods and commodity markets, had a positive impact on GDP growth in 2017.

- *on the value added side:* the greatest positive contribution to GDP in April – May 2017 was from the processing industry, where production volumes increased in May by 9.3% compared with May 2016 (up 7.9% in April 2017). The gradual recovery in the Russian economy helped the Belarusian processing industry to partially compensate for the losses from declining Russian oil supplies in January – April 2017.

The bad weather in May impacted agricultural trends, where the growth in March – April 2017 was replaced by a 5.1% year-on-year drop. At the same time, the weather factor resulted in high production growth in electricity, gas, steam, and hot water supply (8.1% year-on-year growth in May).

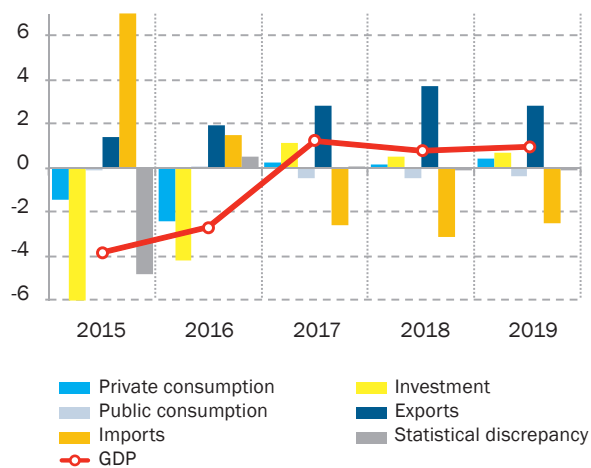
**Construction still
in recession**

The high growth rate in freight turnover remained in April – May 2017. Overall growth for January – May was 4.4% compared with January – May 2016 (versus a drop of 0.3% a year before). The positive trend in the transport industry was driven both by an increase in the volume of cargo transportation due to resumed potassium fertilizer and energy resource supplies, and the overall economic recovery.

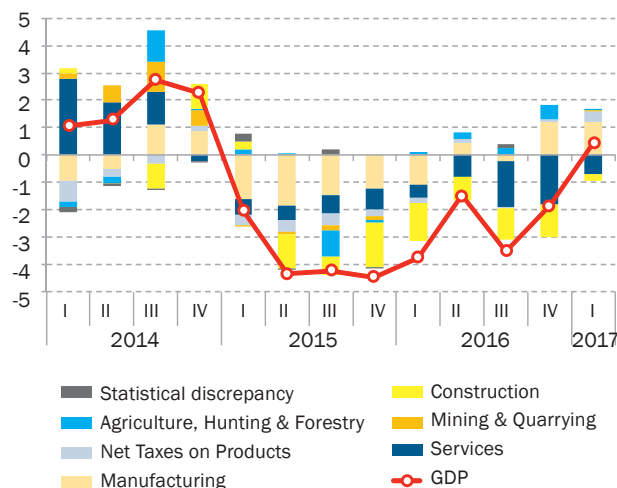
GDP continues to be negatively impacted by construction, which dropped 6.9% year-on-year in January – May 2017.

The output gap, i.e. the difference between economic activity and the potential GDP level, remains negative, at minus 0.8% in 2Q 2017.

GDP growth structure by expenditure component in comparable prices
(in percentage points)



GDP Growth Structure by Production
in comparable prices
(in percentage points, y/y)



Source: The national statistical agency, EEC, estimates by the authors

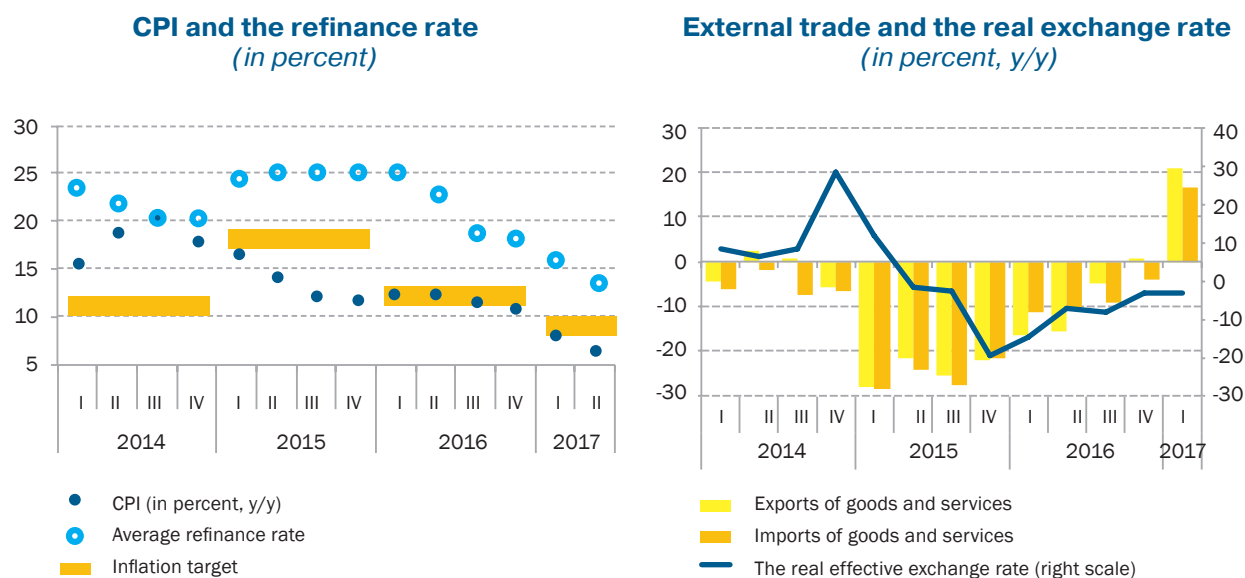
Leading indicators testify to improved economic activity

The leading indicators calculated by the EEC testify to a continued recovery in economic activity in the Republic of Belarus in late 2Q- early 3Q 2017. The trends in freight turnover and fuel and energy commodity prices both contributed to the improvement in the leading indicators.

Inflation

Reduction in inflation to level below the Belarus National Bank's target

The slowing inflationary processes of early 2017 continued into the 2nd quarter. Inflation in June 2017 was 6.5% YoY, in line with the National Bank's target for the December 2017 vs December 2016 level to be contained to 9%. Some pressure on the price level started to appear from consumer goods in June, however, amid the unfavorable weather conditions and growth in global food prices. The core inflation trend, which remains lower than the growth in the overall consumer price index, provides assurance to the National Bank that inflation will remain within target. Weak consumer activity, the relatively stable national currency and, according to the National Bank's estimates, the gradual slowdown in inflationary expectations, remain the main factors stabilizing inflationary processes.



Source: The national statistical agency, EEC, estimates by the authors

Exchange Rate

Forex market remains stable

The forex market in January – June 2017 witnessed a slight excess of foreign currency supply over demand. The population continues to provide a net supply of foreign currency, amounting to USD 1,133.7 million in 1H 2017. The existing situation in the forex market was largely driven by reduced purchases of currency by the population due to falling real income, as well as their desire to maintain the required level of consumption by using savings.

Producers' competitiveness improves

The above situation in the Belarus forex market, in the absence of considerable external shocks, has contributed to stabilization of the BYR exchange rate. The real effective BYR rate in January – May 2017 dropped by 3.0% year-on-year. Moreover, the reduction in the real effective rate occurred mainly due to a combination of real depreciation versus the Russian rouble totalling 10.8% and strengthening against the EUR and USD, by 17% and 12%, respectively. The reduction of the real effective exchange rate of the BYR calculated from the industrial producers price index was stronger in the same period, at 8.6%, which accords a greater competitive advantage to domestic producers versus foreign enterprises. The slowdown in inflationary processes considerably supported a reduction in the real rate.

Positive balance of payments trend in 1Q 2017

The current account showed a deficit of USD 867.9 million in 1Q 2017 (versus USD 1,482 million a year before). The goods and services balance grew in January – March to USD 210.6 million, from minus USD 68.8 million in January – March 2016. It was mainly driven by growth in the net export of services, which increased by 40.4% in 1Q 2017 compared with the same period of 2016. Additionally, we highlight the improvement in trading conditions: the export price growth rates were considerably higher than the import price rates, including for non-energy goods. Compared with January – March 2016, average export prices grew by 21.5%, versus import prices rising by 13.8%. At the same time, 1Q 2017 saw growth in physical volumes of imports (7.4% YoY) at a rate exceeding the export increment (1.6% YoY).

Growth in international reserves amid high payments on both domestic and external liabilities

Despite the considerable obligations of the National Bank and the Government of the Republic of Belarus to service forex debt, the National Bank is managing to gradually build up international reserves. As of early July 2017, international reserves amounted to USD 6,561 million, increasing by USD 1,544.9 million in the 2Q. The main increase in the reserves occurred in June 2017, which was due to the receipt of funds by the Finance Ministry from the sale of Eurobonds totalling about USD 1,400 million, as well as the receipt of the fourth tranche of the EFSD facility, totalling USD 300 million.

Fiscal Policy**National budget in surplus**

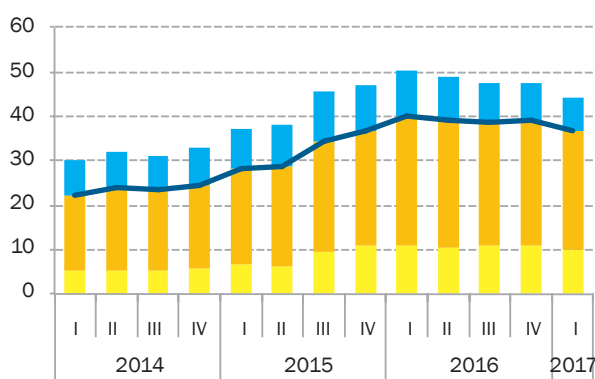
The Belarusian government continues to run a national budget surplus. In January – May 2017, it amounted to BYR 1,393.2 million, or 3.6% of GDP, almost twice the level of the same period in 2016. This was driven by 9.6% YoY revenues growth in the reporting period (mainly VAT and income from foreign economic activities), with expenditures growing by 0.1%. The authorities plan to keep the Republic's budget in surplus in 2017, at BYR 1,483.7 million, so that payments on both domestic and external liabilities can be made.

Public debt to GDP ratio requires additional budget rationalization measures

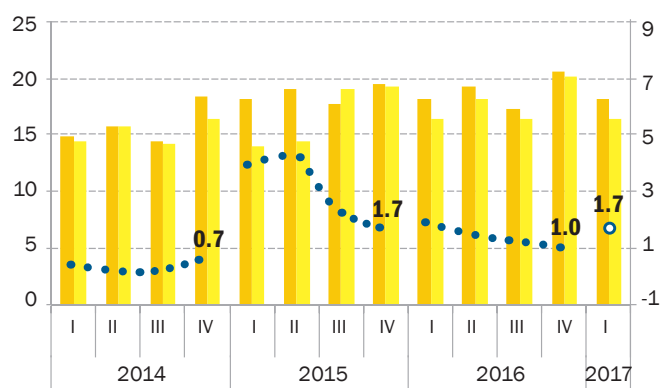
State external debt in dollar terms increased from USD 13.6 billion as of 1 April 2017 to USD 13.9 billion as of early June, amounting to 27.7% of GDP. Overall, Belarus has procured state loans totalling USD 595 million since the beginning of the year, mainly by borrowing from EFSD, the Russian government and banks, as well as the IBRD and Chinese banks.

Alongside that, despite the payments under external obligations, the Finance Ministry's USD 1,400 million Eurobond placement and receipt of the USD 300 million fourth tranche of the EFSD facility in June will result in considerable growth in state external debt, which will exceed 30% of GDP. Domestic state debt as of 1 July dropped by 8.7% since the beginning of the year as a result of exchange rate changes, reaching BYR 9.3 billion. Overall, state debt was 37.6% of GDP as of 1 June 2017.

Public debt



State budget implementation



■ Domestic debt, in percent of GDP
 ■ External debt, in percent of GDP
 ■ Revenue, in percent of GDP
 ●●● Year-to-date deficit/surplus, in percent of GDP
■ Guaranteed debt, in percent of GDP
— Public debt, in percent of GDP
■ Expenditure, in percent of GDP

Source: The national statistical agency, EEC, estimates by the authors

Monetary Policy

Sustained credit conditions backing our inflation outlook and supporting financial stability

The slowdown in inflationary processes and the need to maintain financial stability drove the National Bank to reduce the refinancing rate to 13% in 2Q 2017. It then decided to decrease it further – to 12% from 19 July.

Amid a structural liquidity surplus in the banking sector and weak demand for loans, the average one-day interbank market rate in the national currency remained at 10.4% in April – May. In June, the interbank lending rate was 8.7%, while interbank loan and deposit volumes in the national currency dropped significantly.

Moreover, nominal interest rates in the loan and deposit markets decreased. The average interest rate for new term bank deposits of individuals in the national currency dropped from 12.3% in 1Q 2017 to 8.7% in April – May. The average interest rates for new bank loans to individuals in the national currency dropped from 17.1% in 1Q 2017 to 14.7% in April – May 2017. The same rates for corporate loans saw a greater decline: from 17.7% in 1Q to 14.2% in April – May 2017.

The falling loan rates stimulated lending in the national currency, mainly due to individual consumer lending. As of 1 June, bank lending to individuals (including in foreign currency) had grown by 3.3% since the beginning of the 2nd quarter (and by 5.3% since the beginning of the year), or by BYR 244.7 million (versus growth of BYR 140.4 million in 1Q).

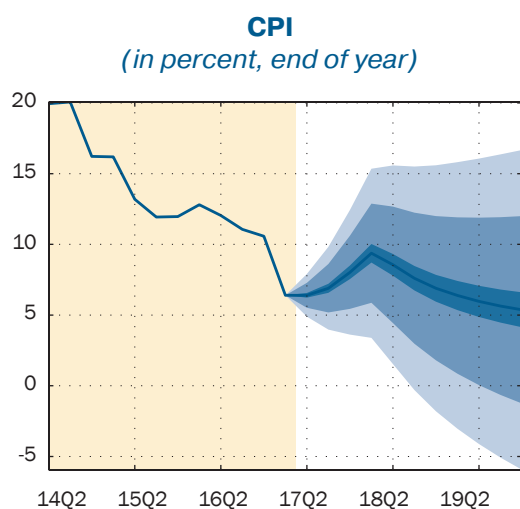
Dollarization remains high

As of early June 2017, the share of currency deposits in the overall structure (including the population) dropped to 69.6% (the retail figure was 74.1%), from 70.2% (the retail figure was 76.3%) as of the beginning of the year. In order to strengthen the measures aimed at further dedollarization of the economy, the National Bank has decided to increase the deduction requirement for both banks and non-banking financial institutions to mandatory reserve funds from funds raised in foreign currency, from 11% to 15% as of 1 July 2017. The changed reservation requirement will help increase the attractiveness of savings in BYR compared with foreign currency savings, and reduce excessive liquidity in the banking system.

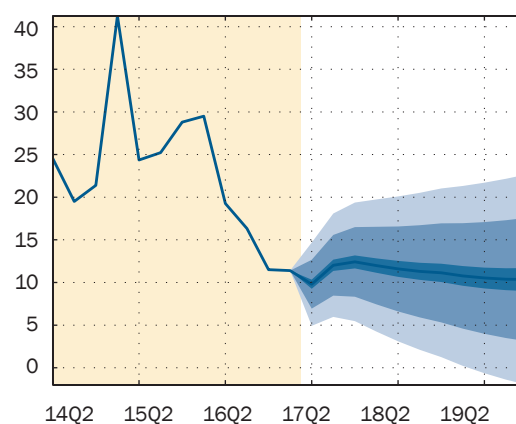
FORECASTS

Inflation below the National Bank's target for 2017

Amid the intensive slowdown of inflationary processes in 1H 2017, we have somewhat revised our inflation forecast for the end of the current year – from 8.6% to 8.0%. The acceleration in inflation in 2H 2017 from the current 6.5% level will be driven by the recovery in consumer demand, growing tariffs for utility services, and a gradual weakening of the nominal exchange rate. A worse harvest due to this year's weather and the subsequent growth in food prices will have an additional impact on inflation. The continued balanced monetary policy will keep inflation within the targets for the whole forecasted period. We forecast inflation in 2018 – 2019 at 6.8% and 5.9%, respectively.



Interest rate on overnight interbank loans
(in percent per annum)

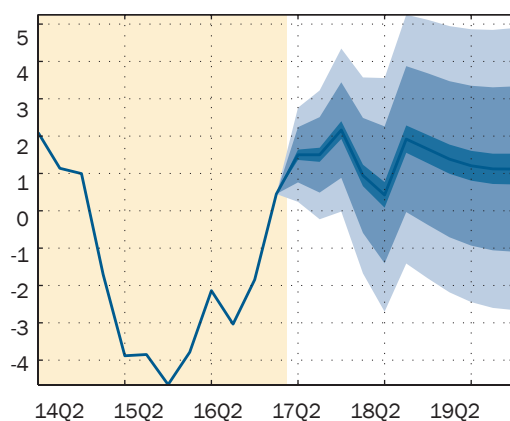


Source: Estimates by the authors, EEC

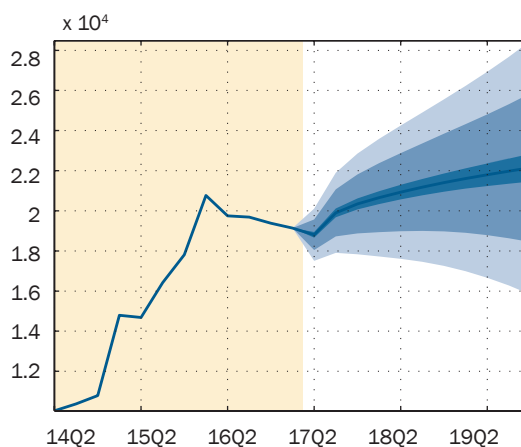
Acceleration in economic growth in 2017

Our raised economic growth forecast for 2017, from 1.3% to 1.4%, is driven by better growth expectations for Russia, the key trading partner. As noted in our previous review, the recovery in crude oil supplies from the low base of the second half of 2016 will promote accelerated growth in both manufacturing and energy exports. Monetary policy will continue to support a recovery in consumer demand. At the same time, the weak investment activity by businesses is set to continue until the end of the year. Amid these factors, we expect GDP to grow by 1.4%. In the medium term, the growth recovery will be restrained by significant structural limitations in the economy, leading to GDP growth in 2018 – 2019 of 1.2%.

GDP in comparable prices
(growth in percent, y/y)

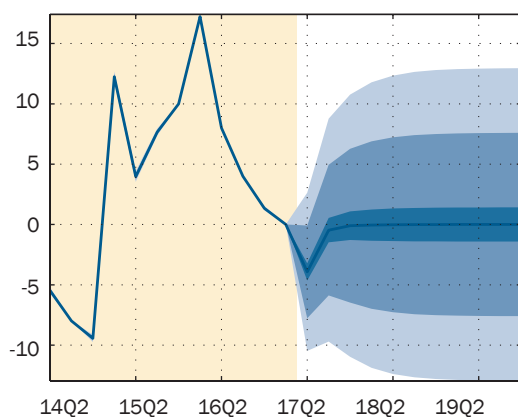


Nominal exchange rate, Belarusian rubels per U.S. dollar

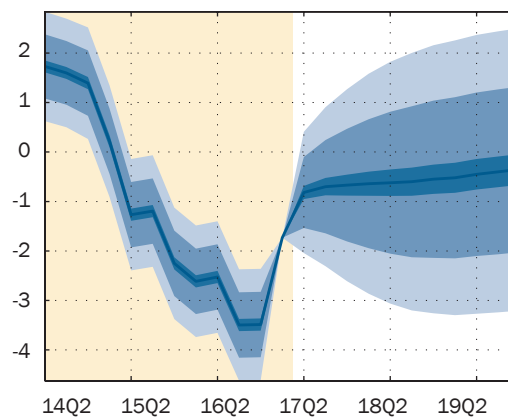


Source: Estimates by the authors, EEC

The Belarusian rubel's real exchange rate gap vis-a-vis the U.S. dollar, in percent



Output gap, in percent



Source: Estimates by the authors, EEC

SUMMARY

Forecast for the major macroeconomic indicators of the Republic of Belarus

	2017	2018	2019
CPI (growth in percent, end of year)	8.0	6.9	5.8
GDP in comparable prices (growth in percent, y/y)	1.4	1.2	1.2
Interest rate on overnight interbank loans (in percent per annum)	11.4	11.5	10.5
Exchange rate², Belarusian rubels per U.S. dollar (final average for the year)	1.954	2.104	2.189

Source: Estimates by the authors, EEC

² The exchange rate of the new (post-redemption) rubel.

REPUBLIC OF KAZAKHSTAN



TRENDS

GDP

GDP growth accelerates in 1Q 2017

Stabilization of the external economic background, the recovery in global oil and metal prices in late 2016 – early 2017, as well as the launch of the Kashagan deposit in 4Q 2016, added momentum to the government's stimulative measures that started in 2016. GDP has grown for a third consecutive quarter. In 1Q 2017, GDP grew by 3.8% YoY (2.3% YoY in 4Q 2016).

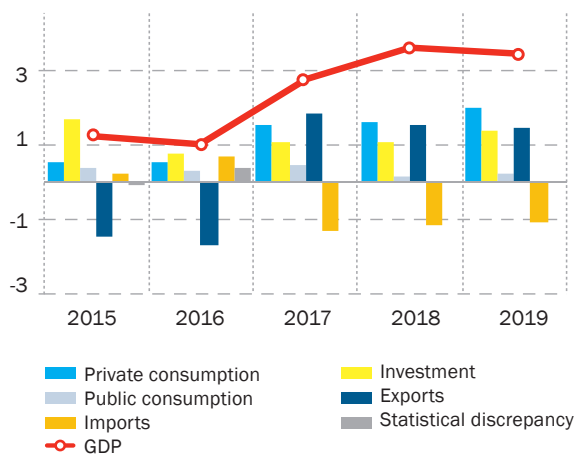
The growth momentum was driven by the mining sector

Overall, economic activity in Kazakhstan was driven by the following key factors:

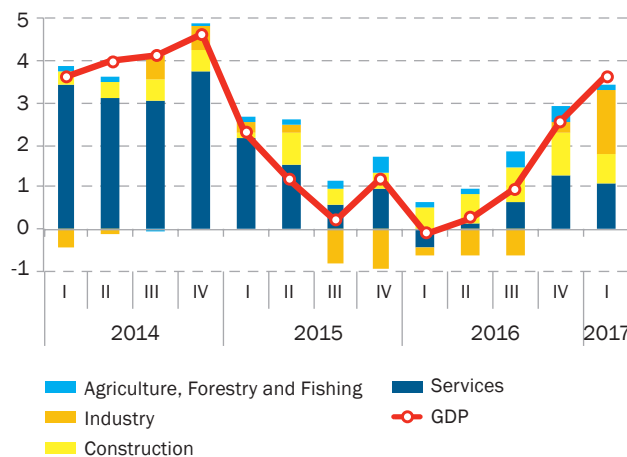
- *on the value added side:* the production revival in metallurgy and oil refining was driven by growth in oil, coal and ore production. As a result, the growth in the industrial production index in 1Q 2017 was 6.3% YoY (1.1% in 4Q 2016). The strong contribution of the construction sector (7.1% versus 1Q 2016) was driven by the government's support measures. Against a background of limited consumer activity, the service sector has not yet recovered to pre-crisis levels (2.0% YoY versus 1Q 2016).
- *on the income side:* according to preliminary estimates adjusted by GDP deflators, 1Q 2017 saw salaries stabilize (-0.1% versus 1Q 2016) as well as a positive contribution to GDP from net profit and production taxes.

The output gap in 1Q 2017 was negative and we estimate it at -1.8%.

GDP growth structure by expenditure component in comparable prices
(in percentage points)



GDP growth structure by production in comparable prices
(in percentage points, y/y)



Source: The national statistical agency, EEC, estimates by the authors

Leading indicators point to continued growth in economic activity

The faster growth in the short-term economic indicator in April – May 2017 to 7.3% YoY implies that business activity continued to grow in 2Q 2017. The consolidated leading indicator calculated by the EEC forecasts an acceleration in economic activity in the republic in the late 2nd - early 3rd quarters of 2017. That is evidenced by positive shifts in the external economic environment, improved expectations about the level of business in manufacturing, and the optimistic mood of trading firms. The household survey on economic prospects carried out by the National Bank of the RoK also evidences positive expectations among economic agents.

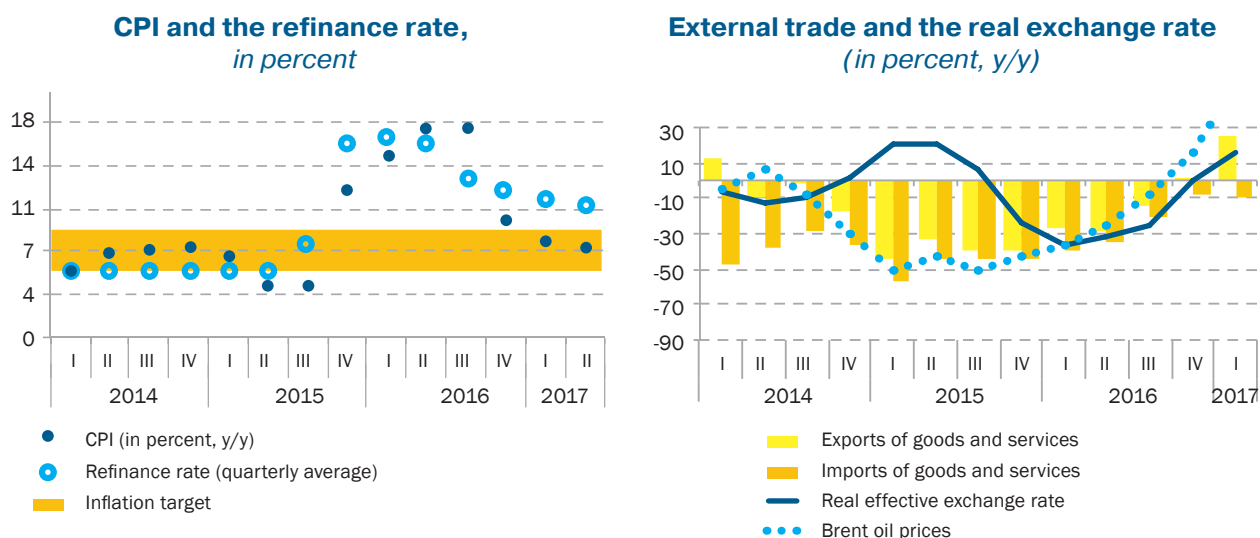
Inflation

In 1Q 2017 inflation was within the target range

In 1Q 2017, inflation was largely driven by the short-term supply shock in the food markets (9.4% YoY). Inflation in the non-food sector slowed with every month that passed, amounting on average to 8.9% YoY for the 1st quarter of 2017. The limited growth in service tariffs (4.8% versus 1Q 2016) kept down overall price growth. Inflation in 1Q 2017 reached 7.8% YoY, within the target range of 6.0-8.0%.

Inflation has stabilized

In April – May 2017, the inflation slowdown in the non-food sector continued amid strengthening of the tenge. The momentum set by the short-term supply shock led to 9.7% price growth for food. As a result, inflation was 7.5% YoY as of the end of the 2Q 2017.



Source: The national statistical agency, EEC, estimates by the authors

Exchange Rate

Tenge exchange rate improves

In 1Q 2017, the effective exchange rate of the tenge strengthened both in nominal (8.9%) and in real (14.9%) terms compared with 1Q 2016. In addition, compared with the CIS currencies, the REER weakened by 7.7% YoY, while the NEER weakened by 8.6% YoY. That partially stimulated growth in Kazakhstani exports to the EDB countries totalling 41.2% (versus 1Q 2016). The improvement in the tenge's REER relative to the currencies of the non-CIS countries was offset by the favourable situation in the global stock markets. The export growth to non-CIS countries was 29.0% YoY. Overall, the positive balance of goods and services doubled compared with 1Q 2016. The expansion of the current account deficit in dollar terms in 1Q 2017 was driven by the doubling in dividend payments to direct foreign investors. Those were more than covered by the net inflow of foreign direct investments. In 1Q 2017, the current account deficit was 4.5% of GDP (4.7% of GDP in the preceding year).

Increased tenge volatility in mid-2Q 2017

The strengthening of the KZT vs the USD continued in April 2017. In May, the increased volatility in global oil prices impacted the domestic currency market. May saw surges in the KZT - USD exchange rate. As soon as the situation in the global oil market stabilized, the tenge started to regain its position. The National Bank of the RoK allowed the market to reach a new equilibrium level, there being no currency interventions in April – May 2017.

Fiscal Policy

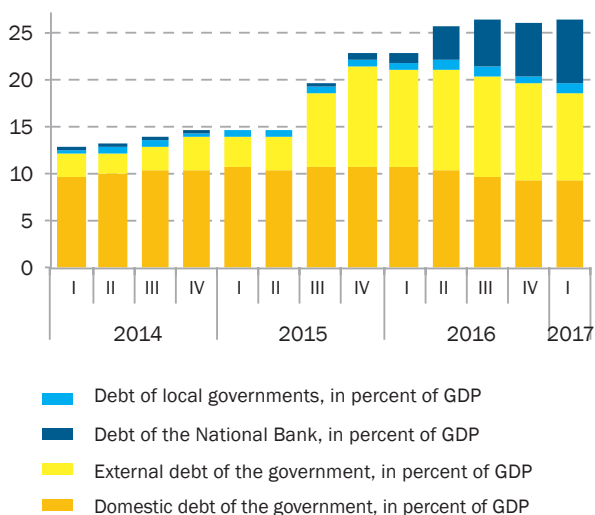
State budget in deficit in 2016

Despite the higher-than-anticipated growth in budget revenues, expenditures in nominal terms increased only marginally compared with the previous year. That led to a relatively balanced budget in 1Q 2017, with a deficit of just 0.1% of GDP (4.5% in 1Q 2016). The non-oil deficit was 6.1% of GDP, while 25% growth in budget revenues was primarily driven by the receipt of the targeted transfer from the National Fund to support the recovery in the banking system (58.7% growth compared with 1Q 2016). Tax revenues grew by 14.3% YoY. The increase in pensions and benefits in January 2017 increased social security expenses by 11.5% versus 1Q 2016. The latter was more than compensated for by reduced financing for other budget items. As a result, budget expenditures declined by 0.7% YoY.

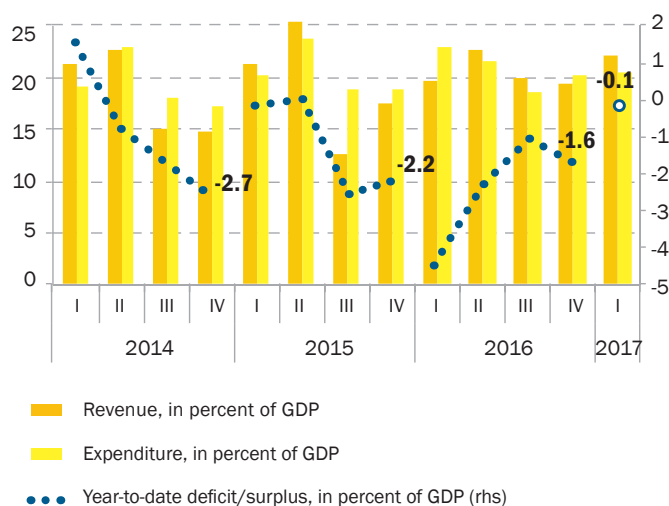
Moderate state debt

The state debt increased in 1Q 2017 by 4.4% compared with the start of the year, to reach KZT 11.9 billion (25.5% of GDP). It increased mainly due to growth in domestic debt (2.3% compared with the start of the year) and National Bank debt (27.0%), which has arisen due to the initiative to build a risk-free yield curve.

Public debt



State budget implementation



Source: The national statistical agency, EEC, estimates by the authors

Monetary Policy

Base rate reduced from 12.0% to 11.0%

Against a background of the stabilizing domestic and foreign economic environment, the National Bank of the RoK reduced the base rate from 12.0% to 11.0% in 1Q 2017. The TONIA rate varied within the set range, reflecting high volatility in the first half of the first quarter, which was driven by demand for tenge liquidity by money market players. Against a background of excessive liquidity, in order to keep the money market rate within the set range, the National Bank of the RoK continued to increase the volume of notes outstanding.

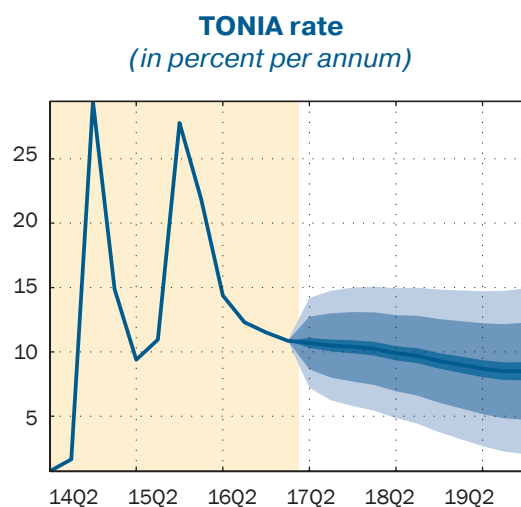
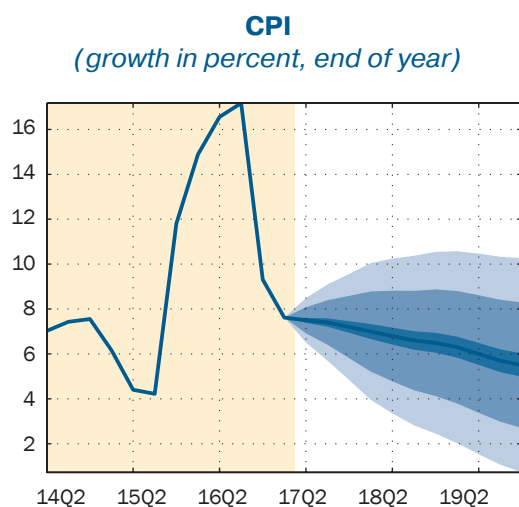
FORECASTS

Inflation to be within the target range

Despite the short-term MoM surge in prices, the population's expectations of price changes in the next 12 months have improved. The strengthening of the tenge observed in 1Q 2017 will also restrain price growth in the short-term. Annual inflation may increase marginally in 2H 2017 due to the low base of 2H 2016. Nevertheless, inflation will most probably remain within the target range of 6.0 - 8.0% till the end of 2017. The neutral inflation background in the partner countries and favourable price conditions in global exchange markets will strengthen the downward inflation trend in the short-term. In 2018, it should reach the new target of 5.0 - 7.0%.

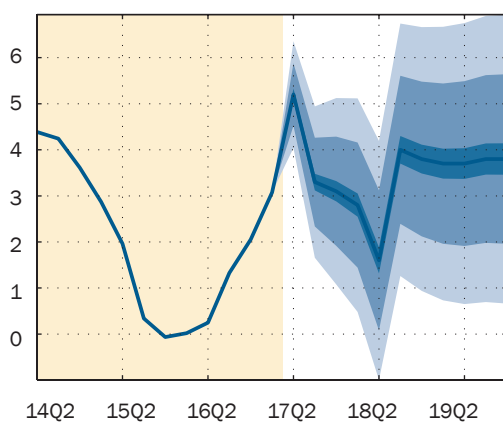
Solid long-term growth

The acceleration in GDP growth in 1Q 2017 was partially driven by the low base. Some economic slowdown is expected in the second half of 2017. In the long-term, assuming the absence of additional shocks, the effect of fundamental factors will allow the Kazakhstan economy to achieve sustainable growth of about 4.0% a year.

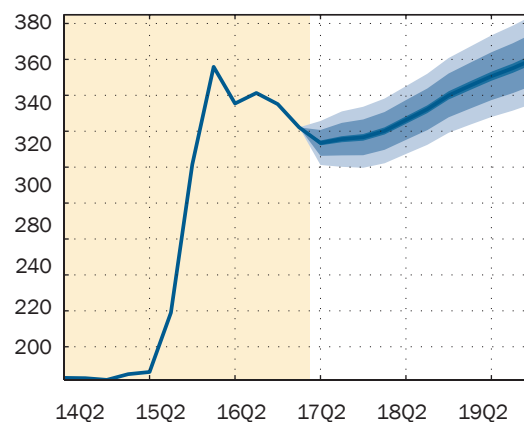


Source: Estimates by the authors, EEC

GDP in comparable prices
(growth in percent, y/y)

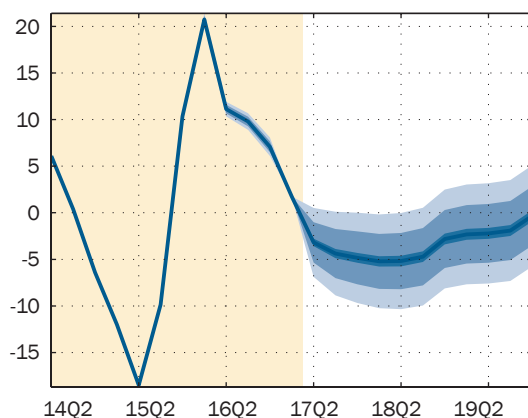


Nominal exchange rate,
Kazakh tenge per U.S. dollar

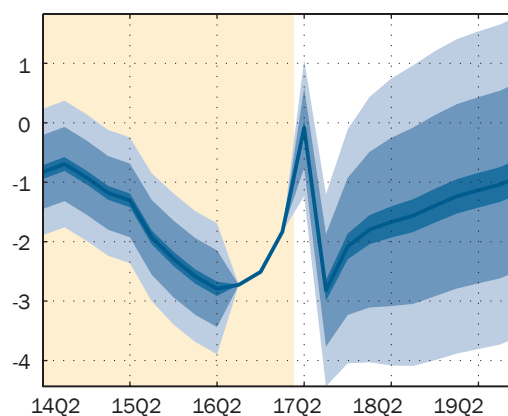


Source: Estimates by the authors, EEC

The Kazakh tenge's real exchange rate gap
vis-a-vis the U.S. dollar, in percent



Output gap,
in percent



Source: Estimates by the authors, EEC

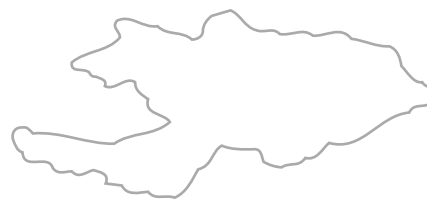
SUMMARY

Forecast for the major macroeconomic indicators of the Republic of Kazakhstan

	2017	2018	2019
CPI (growth in percent, end of year)	7.2	6.5	5.5
GDP in comparable prices (growth in percent, y/y)	3.4	3.1	3.7
TONIA rate (in percent per annum)	10.5	10.0	8.9
Exchange rate of the national currency against the U.S. dollar (average for the year)	317	327	348

Source: Estimates by the authors, EEC

KYRGYZ REPUBLIC



TRENDS

GDP

High growth rates due to low base

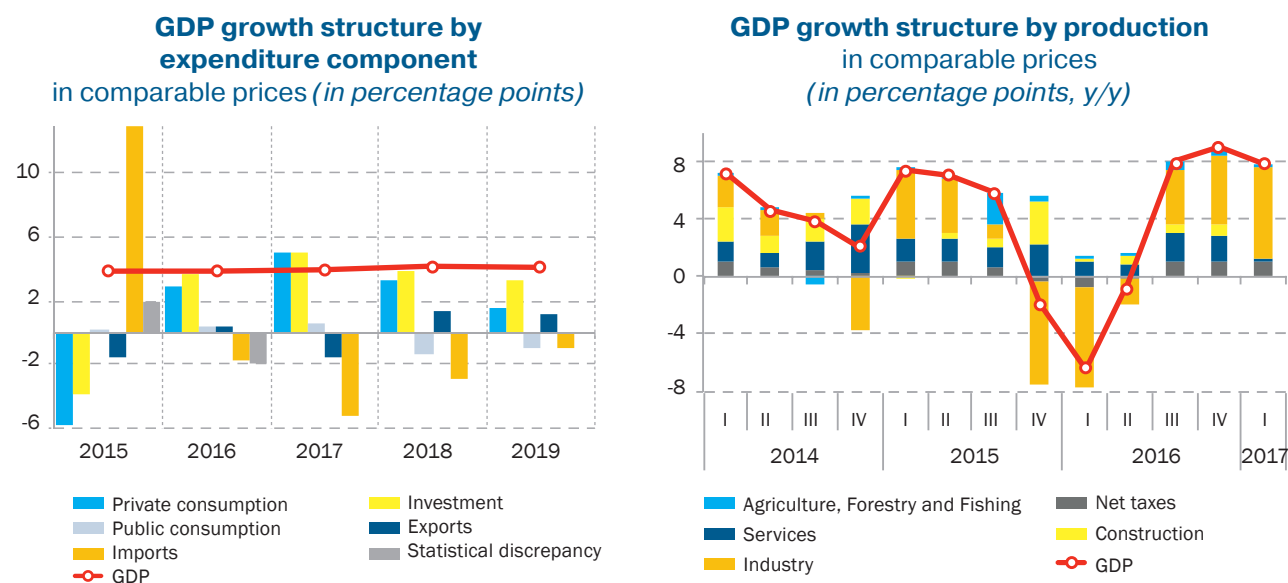
The high gold production volumes in Kyrgyzstan drove the acceleration in GDP growth to 7.8% in 1Q 2017 compared with 1Q 2016. The acceleration in growth in other industrial production occurred amid weakening REER imbalances. The declining production in a number of processing industries, partially driven by the overvalued Kyrgyz som, changed to surging growth in 1Q 2017.

The industrial sector is a key growth driver

The main factors driving economic activity in Kyrgyzstan included:

- *on the value added side:* high production indicators in 1Q 2017 were recorded both in gold extraction and production (50.1% YoY), and in other industrial sectors (23.8% YoY). The contribution of other sectors to GDP growth was less significant. Near-zero growth was registered in the construction and services sectors. Despite the positive growth rates in trade and transport, the negative trend in telecoms limited growth in the services sector. Agricultural output grew by 1.5% YoY.
- *on the income side:* Real money income grew (by 5.2% YoY) against the low inflation background, with a high growth rate in net remittances (21.6% YoY in 2016).

The output gap was in positive territory in 1Q 2017, estimated at +1.2%.



Source: The national statistical agency, EEC, estimates by the authors

Leading indicators evidence the short-term nature of the high growth rate

GDP growth slowed to 6.8% year-on-year in January – May 2017. The consolidated leading indicator calculated by the EEC evidences that the high growth rates will remain in the short-term, supported by the external economic environment and improved purchasing power of the population. However, in 1H 2017, after the low base effect is exhausted, growth is expected to slow.

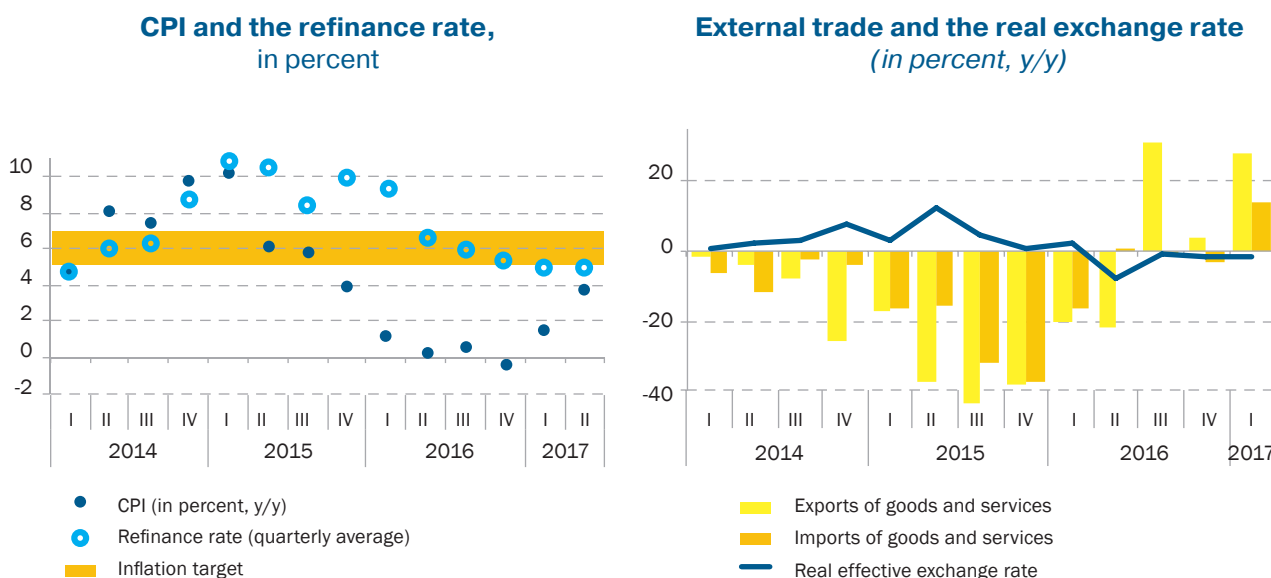
Inflation

Moving out of the deflation zone

The increase in excise taxes on tobacco products and tariffs for communications services, healthcare and education pushed annual CPI back to positive in the first months of 2017. The supply shock in the fruit and vegetable market interrupted the year-and-a-half deflation in the production segment, laying the basis for acceleration of the overall price level. On average, for 1Q 2017, inflation accelerated on an annualized basis to 1.6% YoY (-0.4% YoY on average for 4Q 2016).

Inflation to accelerate

The effect of the supply shock remained during the first months of 2Q 2017. Prices for vegetables grew 1.6 times year-on-year on average in April – May 2017. Inflation continued to accelerate to the lower threshold of the 5.0-7.0% target. At the end of May 2017, 12-month inflation was 4.8%.



Source: The national statistical agency, EEC, estimates by the authors

Exchange Rate

Nominal exchange rate strengthened year-on-year

The nominal effective exchange rate of the som strengthened by 3.1% in 1Q 2017 versus 1Q 2016. In real terms, the som depreciated by 1.5% due to the low annual inflation compared with that in those countries which are the key trading partners. The real bilateral KGS-RUR rate depreciated by 6.5% versus 1Q 2016. That partially contributed to doubled growth in goods exports from Kyrgyzstan to Russia. Overall, exports increased by 18.7% YoY, while the 55% (versus 1Q 2016) rise in remittances drove a recovery in imports, which grew on an annualized basis by 14.3%. According to preliminary estimates, the current account deficit in 1Q 2017 dropped to 9.7% of GDP.

Trend now changed: exchange rate depreciating

In April 2017, the strengthening of the KGS versus the USD intensified, which caused the National Bank of the Kyrgyz Republic to intervene in the domestic currency market. The volume of absorbed foreign currency in April 2017 was USD 16.2 million. In early May, the KGS - USD trend turned to depreciation against a background of high volatility in the markets of the key trading partners, Russia and Kazakhstan, where the national currencies started to devalue due to falling oil prices.

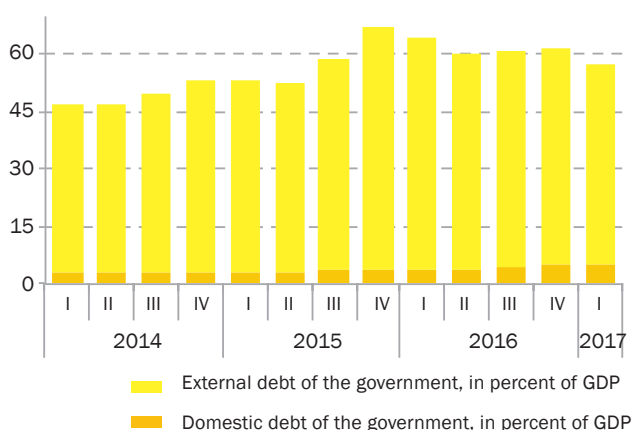
Fiscal Policy

Budget in deficit in 1Q 2017

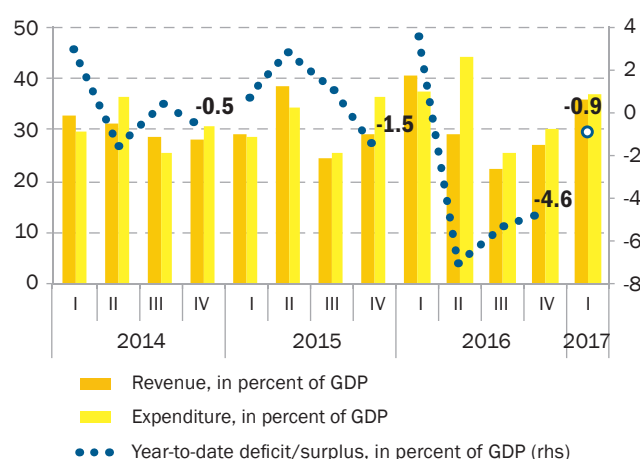
The budget deficit in 1Q 2017 reached 0.9% of GDP (the budget surplus was 3.4% of GDP a year before). Despite the fact that tax revenues grew by 9.4% YoY, the reduction in other levies and transfers drove a 4.1% decline in budget revenues compared with 1Q 2016. Current expenses grew by 7.7% YoY, partially due to an increase in salaries of state employees. Expenses on purchases of non-financial assets increased by 5.3%.

Public debt grew by 0.7% compared with the beginning of 2017 to reach KGS 285.5 billion as of 1 April 2017 (57.6% of GDP, versus 61.4% of GDP at the end of 2016). The improved external debt ratio was driven by GDP growth.

Public debt



State budget implementation, in percent of GDP



Source: The national statistical agency, EEC, estimates by the authors

Monetary Policy

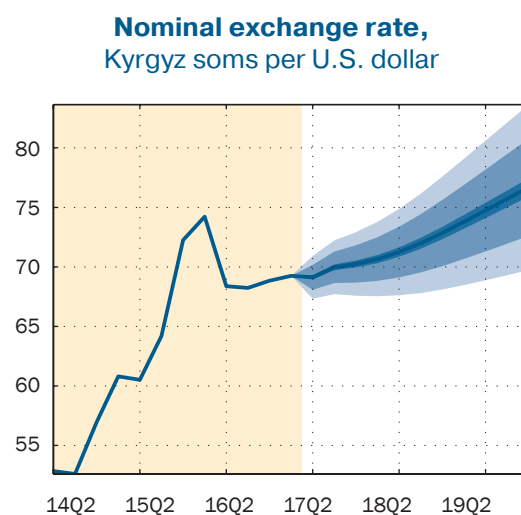
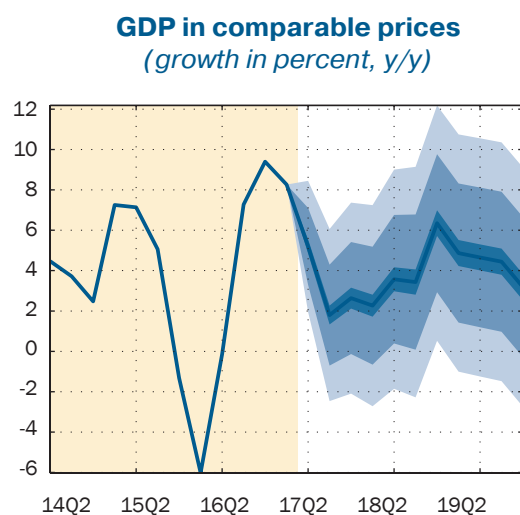
Monetary policy unchanged

The National Bank of the Republic of Kyrgyzstan left the reference rate unchanged at 5.0% in 1Q 2017. Money market rates varied near the lower threshold of the set 0.25% range, which reflects the surplus liquidity in the system. Additional evidence of the structural som surplus comes from the low level of activity in the interbank lending market and investment of excess soms in the government securities market. That, in its turn, drove a reduced yield on Ministry of Finance securities. Despite the structural deficit, the National Bank continued to refinance the banks under the Financing of Agriculture - 5 project, and it also issued another loan to the Russian-Kyrgyz Development Fund.

FORECASTS

Inflation to accelerate

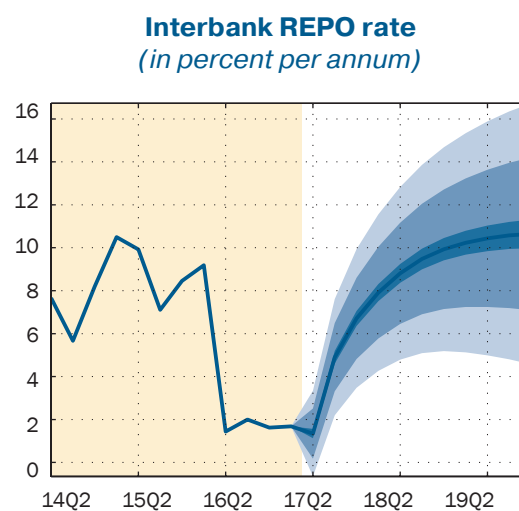
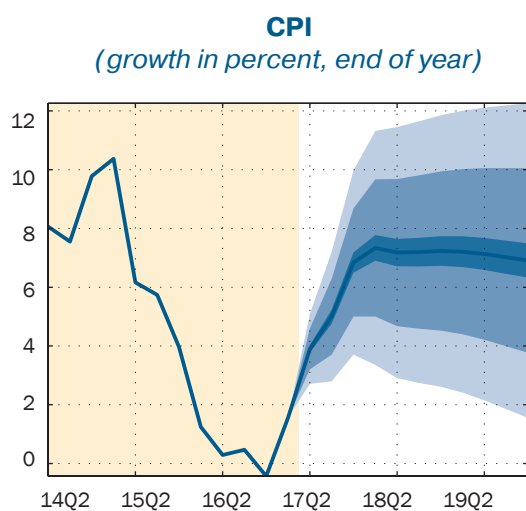
As the period of low prices in the energy and food markets is coming to an end, the deflationary trends in Kyrgyzstan are expected to cease and inflation should reach its target range of 5-7% as early as this year. In the following years it will move near the upper threshold of the range, which will be partly caused by a loose fiscal policy. As far as the monetary sector is concerned, the future inflation background is being supported by the current mildly negative real interest rate, with the money market rate (1.3% on average for 1Q 2017) differing from the base rate (5.0% at the end of 1Q 2017).



Source: Estimates by the authors, EEC

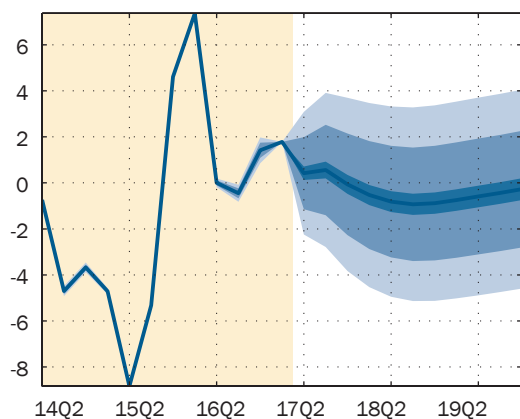
Growth slowing in 2H 2017

The high growth rate in 1Q 2017 was partially driven by the low base effect. Moreover, gold output is expected to shrink in 2017, therefore, economic growth is forecasted to slow in 2H 2017. In the long-term, the improved growth prospects of the key trading partner countries will support the domestic economy through both foreign trade and remittances. The economy will gain additional impetus from the fiscal sector.

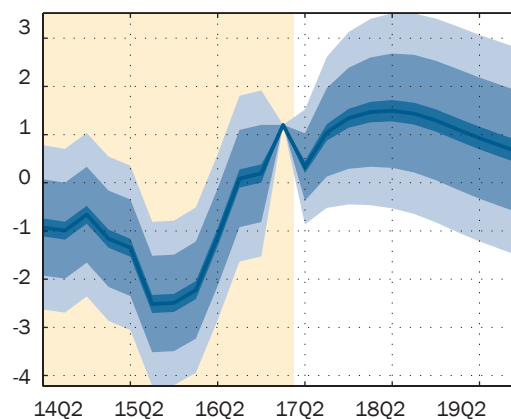


Source: Estimates by the authors, EEC

The som's real exchange rate gap vis-a-vis the U.S. dollar, in percent



Output gap, in percent



Source: Estimates by the authors, EEC

SUMMARY

Forecast for the major macroeconomic indicators of the Kyrgyz Republic

	2017	2018	2019
CPI (growth in percent, end of year)	6.8	7.2	6.9
GDP in comparable prices (growth in percent, y/y)	3.7	3.9	4.1
Interbank repo rate (in percent per annum)	4.0	9.0	10.6
Exchange rate of the national currency against the U.S. dollar (average for the year)	69.6	71.7	75.2

Source: Estimates by the authors, EEC

RUSSIAN FEDERATION



TRENDS

GDP

GDP trend remains positive

The Russian economy has continued to recover in 2017. According to Rosstat, GDP growth in 1Q 2017 was 0.5% YoY (0.3% the quarter before). The positive trend was driven by the growth in both exports and domestic demand, supported by a gradual recovery in consumer sales. However, the increase in imports restrained the growth recovery amid strengthening of the Russian rouble.

Economic growth accelerating in 2Q 2017

Economic growth continued to hasten in 2Q 2017. The Ministry of Economic Development estimates annual GDP growth to have accelerated from 1.4% in April to 3.1% in May, which was largely due to the continued recovery in domestic demand. The Ministry estimated GDP growth at 2.9% YoY in June 2017. Consumer activity remains moderate, but is tending towards a sustainable recovery. The positive growth in salaries since February 2017 and low unemployment level contributed to a positive retail turnover trend (for the first time since 2014). The growth in retail turnover in April and May was 0.1% YoY and 0.7% YoY, respectively. Investment activity and the solvency of businesses continued to improve amid the exchange rate trend in April – May 2017 that was favourable for imports.

Positive tendencies in industrial production

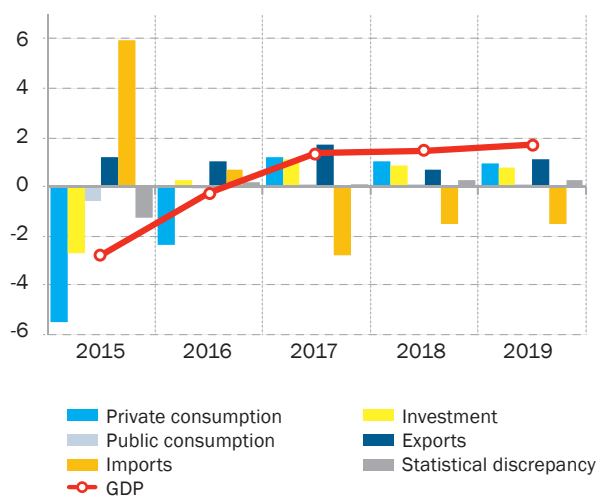
The increase in industrial production volumes in April – May 2017 was driven by growth in most sectors. In May, the growth rates reached 5.3% compared with May 2016, the highest value in recent years. Overall, output volumes increased by 1.7% in January – May 2017 compared with the same period of 2016 (1.1% a year before).

Weather suppressing agricultural growth

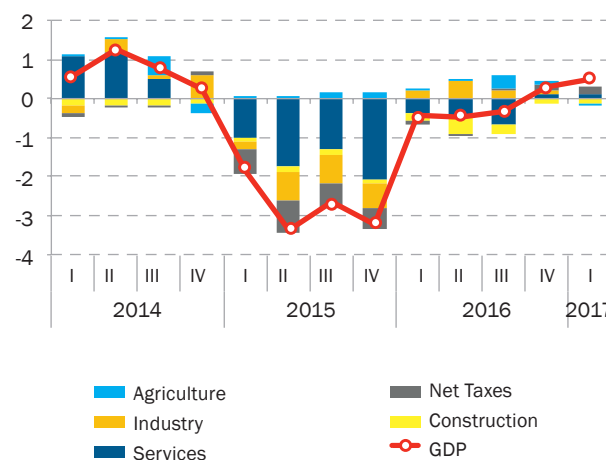
Moderate growth in agriculture, at a level of 0.7% YoY, remained in April to May 2017, without exceeding the 1Q 2017 growth rate. The key factor limiting growth was the weather, which has brought the risk of a poor overall harvest for the current year.

The recovery in economic activity is also evidenced by the freight turnover growth rates, which have reached their highest values for the past six years (9.5% in May 2017 versus May 2016).

GDP³ growth structure by expenditure component in comparable prices
(in percentage points)



GDP growth structure by production in comparable prices
(in percentage points, y/y)



Source: The national statistical agency, EEC, estimates by the authors

Positive trend in the leading indicators

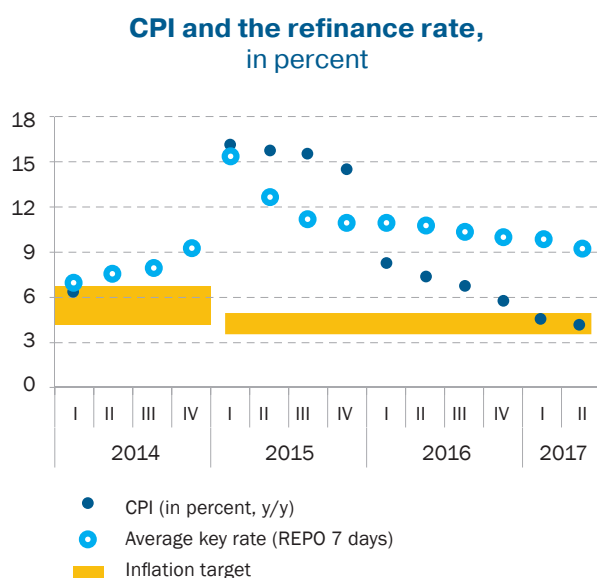
The leading indicators calculated by the EEC evidence the continued upward trend in economic growth in early 3Q 2017. The leading indicators were positively affected by expectations of an improvement in the processing industry, oil price movements, and high freight turnover growth.

³ The data was provided prior to the revision by Rosstat in January 2017 of GDP dynamics. GDP growth for 2015 was revised from -3.7% to -3%.

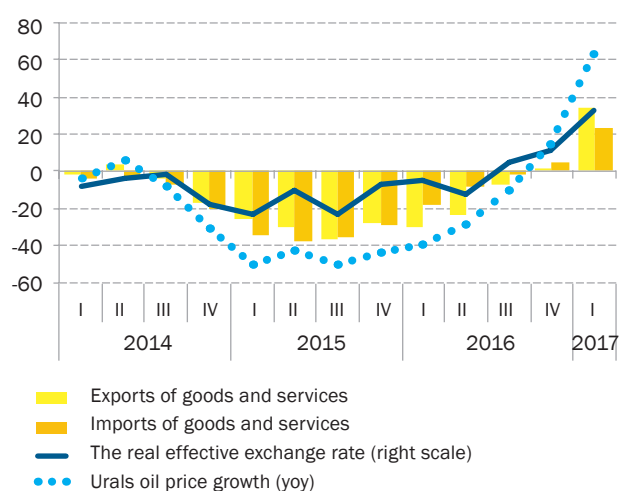
Inflation

Inflation stabilized at the target level

Modest consumer demand, together with the RUR exchange rate trend and decreased inflation expectations, contributed to the stabilization of annual inflation in April – May 2017 at 4.1%. Some acceleration in food inflation amid weather anomalies in the spring months was noted in May, and was even sharper in June, becoming the key factor behind the acceleration of annual inflation to 4.4%. Weather may continue to impact food prices in the second half of 2017. An additional factor making it tougher to reduce inflation is a possible weakening of the national currency amid resumed volatility in global markets. The government's moderately tight monetary policy will contribute to keeping inflationary processes within the targets of the Central Bank.



External trade and the real exchange rate (growth in percent, y/y)



Source: The national statistical agency, EEC, estimates by the authors

Exchange Rate

Mixed exchange rate trends in 2Q 2017

The exchange rate trend in 2Q 2017 was mixed. In April – May, the rouble rate was supported by the increased interest of foreign investors in financial assets and significant sales of forex revenue by exporters.

Reduction in contribution of the trade balance to the current account balance

The situation somewhat changed in the second half of June, however, after oil prices dropped to their lowest levels this year, another change in interest rates by the Russian Central Bank and the Fed, and the latter's comments on further monetary policy. The nominal RUR - USD rate weakened in the second half of June, returning to the level of early 2017.

According to provisional Bank of Russia estimates, the country's current account balance was plus USD 27 billion in January – May 2017, significantly increasing versus USD 16.1 billion the year before. However, the surplus gradually declined in April – May 2017 amid a reduction of the trade surplus caused by the slowing growth in exports, while import growth remained the same.

Conditions for moderate rouble weakening remain

We estimate that the Russian rouble was priced above its equilibrium trajectory in 2Q 2017 (the real effective exchange rate gap is estimated at 5.5%). Therefore, the market situation still favours a moderate weakening in the Russian currency.

Capital outflow slowing

The net outflow of capital by the private sector slowed considerably following growth in 1Q 2017, driven by banking sector operations. In May, the net outflow of capital by the private sector dropped to its lowest level this year, to reach USD 1.4 billion (USD 15.4 billion in 1Q 2017).

Fiscal Policy

Revision of the planned budget deficit for 2017 from 3.2% of GDP to 2.1% of GDP

The additional income driven by oil prices exceeding those built into the budget in January – May 2017 have led to a considerable reduction in the federal budget deficit and, as a result, to a downward revision of the expected full-year deficit, from 3.2% of GDP to 2.1%. As provisionally estimated by the Ministry of Finance, the federal budget posted a deficit of RUR 564 billion in January – May 2017, or 1.7% of GDP (4.3% of GDP in January – May 2016). The latest budget amendments for 2017 include revising the oil price outlook from USD 40 to USD 45.6, which will contribute RUR 1.19 trillion in increased revenues compared with the previous 2017 budget.

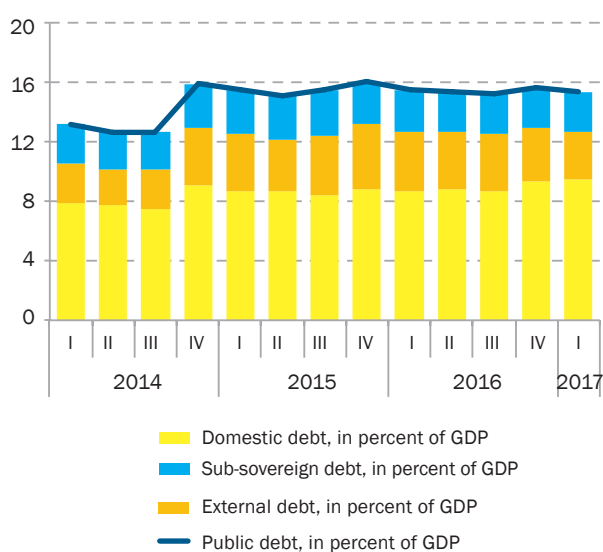
Finance Ministry significantly reduced currency operations in the domestic market

Foreign currency purchases by the Ministry of Finance in the domestic market⁴ that started in February 2017 had experienced considerable changes by the end of 2Q. Aggregate funds allocated for purchasing foreign currency dropped from RUR 131.1 billion in February to RUR 74.3 million roubles in June, which was primarily driven by the reduction in oil prices. In 2017, according to the Finance Minister⁵, the volume of additional oil and gas revenues allocated for purchasing foreign currency will be RUR 623 billion.

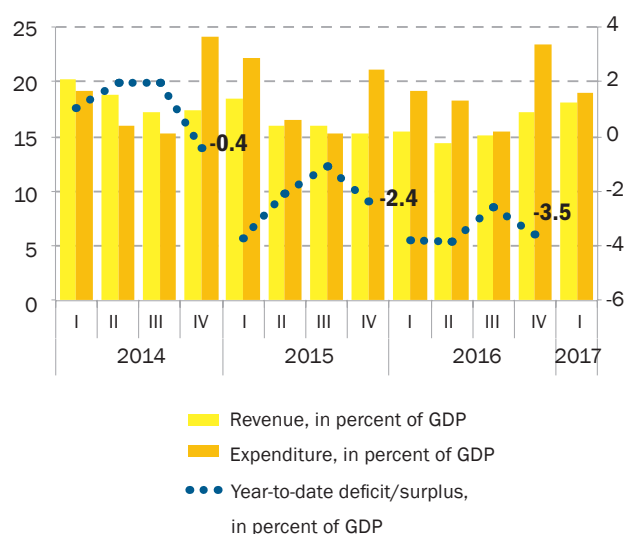
Growth in domestic public debt but reduction in external debt

Against a background of the domestic borrowing program, the volume of domestic public debt for April – May grew by RUR 0.17 trillion (up RUR 0.47 trillion since the beginning of 2017) and reached RUR 8.48 trillion as of early June. External public debt as of early June was USD 48.5 billion, dropping by USD 2 billion for April – May due to the redemption of a forex bond in April.

Public debt



Budget implementation



Source: The national statistical agency, EEC, estimates by the authors

⁴ Conversion of the additional oil and gas revenues (revenues resulting from Urals oil prices above USD 40 per barrel) and their deposit in the Reserve Fund. Press release of the Russian Ministry of Finance dated 25 January

⁵ Report by Finance Minister Anton Siluanov at a government meeting.
https://www.minfin.ru/ru/press-center/?id_4=34781&area_id=4&page_id=2119&popup=Y#ixzz4m95XqrAx

Monetary Policy

Monetary policy remains moderately tight

Against a background of stabilized inflationary processes in April – May 2017, the Central Bank reduced the key rate at its meeting on 16 June by 0.25 pp to 9%. This marks the third reduction in the rate since the beginning of the year. Monetary policy remains moderately tight, which will encourage further stabilization of inflationary processes. Monetary conditions may be eased in 2H 2017, depending on whether inflation can be retained within the target level. Against a tougher external background, the Central Bank decided to keep the key rate unchanged at 9.0% in July.

FORECASTS

Recovery of economic growth to 1.1% in 2017

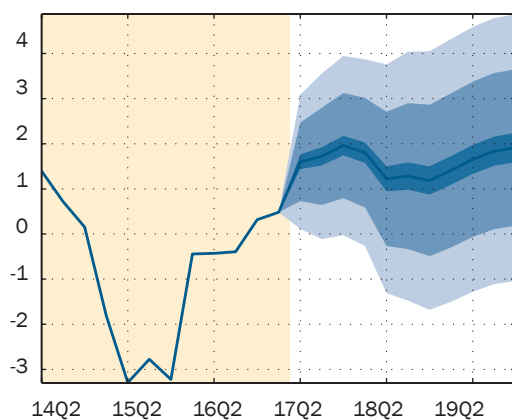
We have somewhat raised our Russian economic growth forecast for 2017, due to the quicker than expected economic recovery in the first half of the year. This is expected to result in 1.4% GDP growth over 2017 as a whole, and to a further gradual recovery to 1.7% in 2019. Domestic factors will remain the key growth drivers in the medium term. No considerable contribution is expected from external demand in the forecasted period. The gradual recovery in both consumer and investment activity will be supported by eased monetary conditions.

The projected closure of the existing real effective exchange rate gap will be conducive to rouble weakening in the short term. Its possible inflation impact will be partially offset by continuing moderately tight monetary policy.

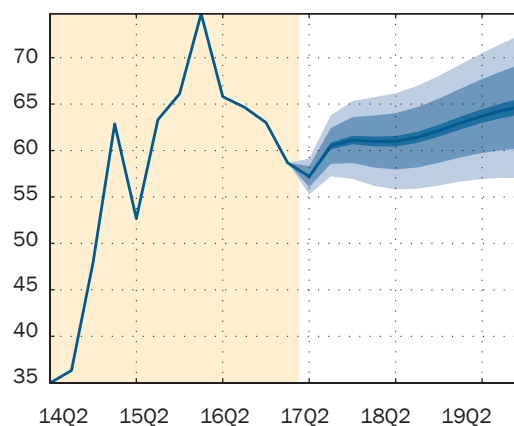
Risks of inflation missing FY target

The significant drop in oil prices in recent months has demonstrated that risks to the recovery in the economy and to the downward inflation trend remain. Together with a possible weakening of the rouble should volatility resume in global markets, an additional negative factor impacting the growth recovery and reduced inflation may be a worsened harvest due to weather conditions this year, leading to growth in food prices.

GDP in comparable prices
(growth in percent, y/y)

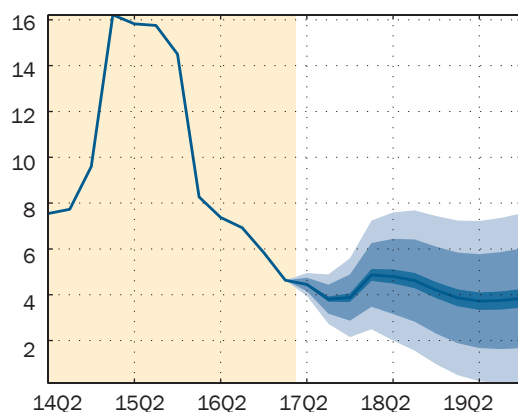


Nominal exchange rate,
Russian rubles per U.S. dollar

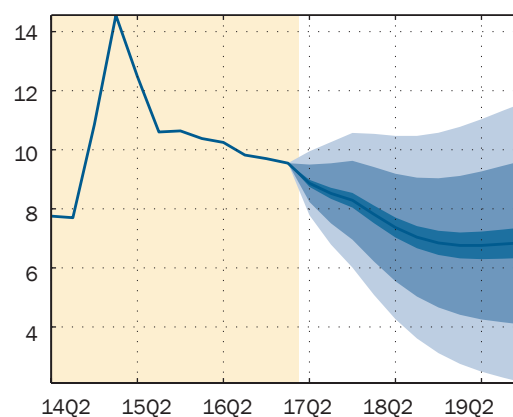


Source: Estimates by the authors, EEC

CPI, growth in percent
as of year-end

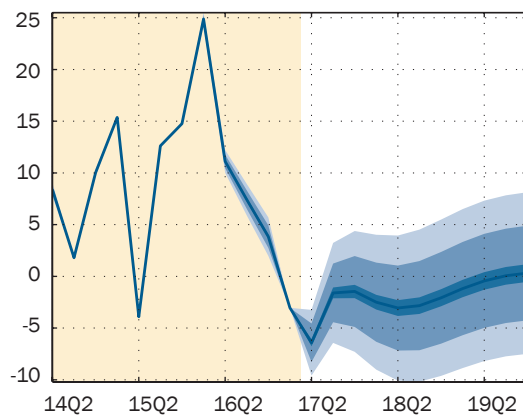


MIACR (Moscow Interbank Actual Credit Rate),
in percent per annum

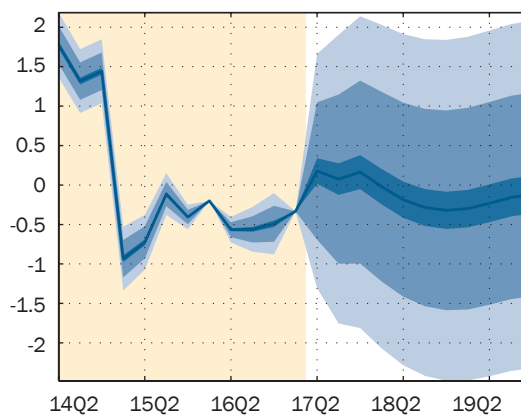


Source: Estimates by the authors, EEC

The ruble's real exchange rate gap
vis-a-vis the U.S. dollar, in percent



Output gap,
in percent



Source: Estimates by the authors, EEC

Inflation to remain within the Central Bank's targets

If there are no shocks, and the trend towards lower inflationary expectations remains, supported by a moderately tight monetary policy with domestic demand still weak, inflation should decrease further, to 3.9% in 2017, and then stabilizing at the 4% level in 2018-2019. As inflation decelerates, the Bank of Russia will continue to reduce its key rate, which will give additional impulse to the recovery in lending and economic activity.

SUMMARY

Forecast for the Major Macroeconomic Indicators of the Russian Federation

	2017	2018	2019
CPI (growth in percent as of year-end)	3.9	4.1	4.0
GDP in comparable prices (growth in percent, y/y)	1.4	1.5	1.7
MIACR (in percent per annum)	9.2	7.5	7.3
Exchange rate of the national currency against the U.S. dollar (final average for the year)	59.4	61.4	64.0

Source: Estimates by the authors, EEC

REPUBLIC OF TAJIKISTAN



TRENDS

GDP

GDP growth at 6.5% in 1Q 2017

Economic activity in Tajikistan continues to be driven by the strong foreign investment of previous years. GDP growth was 6.5% YoY in 1Q 2017.

The main factors behind economic growth in Tajikistan in 1Q 2017 included:

- *on the income side:* nominal growth in wages at 19.0% compensated for the acceleration in annual inflation, resulting in 12% growth in real wages. Recovery in the net inflow of remittances (1.3% YoY according to the Russian Central Bank) relieved the pressure on households, for whom transfers from labor migrants dominate the income structure.
- *on the value added side:* the growth drivers in 1Q 2017 were the construction sector, up 20.0% versus 1Q 2016, and manufacturing (19.4% YoY). Growth in the extraction industry (43.4% YoY) is the key driver in the industrial sector: output in the processing industry grew by 12.8% YoY. The agricultural and retail sectors grew at a moderate pace, by 4.3% and 3.0%, respectively.

Growth momentum led by the construction and industrial sectors

The output gap was in negative territory in 1Q 2017, estimated at -0.7%.

The reduction in investments in January – May 2017 and falling corporate lending by the banking sector amid its declining stability create uncertainty over short-term economic growth prospects. Weak freight turnover trends in the first five months of 2017 also evidence increased probability that economic growth will decelerate.

Inflation

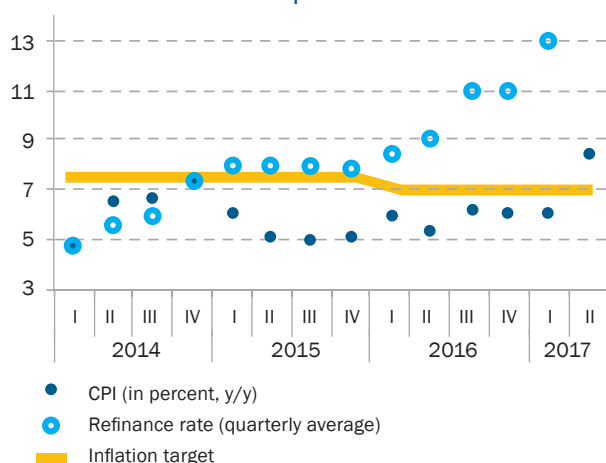
7.0% target is exceeded

Growth in the somoni-denominated money supply, driven by both the limited strengthening of the TJS - USD rate in the second half of 2016 and the withdrawal of deposits from troubled banks, led to an inflationary overhang by the end of 2016. The decision to allocate public funds to support a number of banks triggered the uncoiling of the devaluation - inflation spiral. The devaluation of the somoni translated into an inflationary trend, which reached 7.3% YoY by the end of 1Q 2017, thus exceeding the 7.0% target.

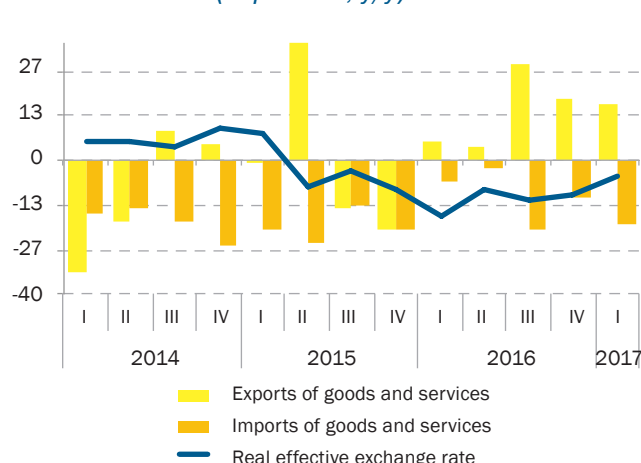
Inflation to accelerate

Inflation continued to accelerate in the first months of 2Q 2017, due to devaluation of the somoni and a supply shock in the fruit and vegetable market. By the end of the 2nd quarter of 2017, inflation had reached 9.0% YoY amid TJS - USD devaluation of 12% on an annual basis.

CPI and the refinance rate, in percent



External trade and the real exchange rate (in percent, y/y)



Source: The national statistical agency, estimates by the authors

External sector

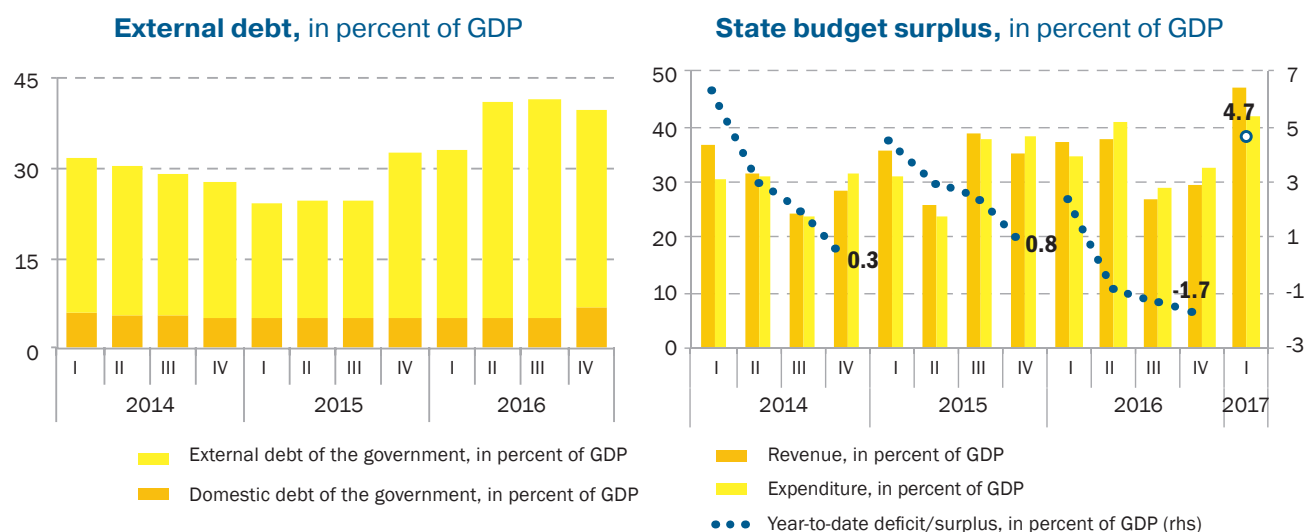
Exports growing while imports decline

The somoni's real effective exchange rate depreciation in 1Q 2017 reached 4.8% YoY. That partially stimulated goods exports, which grew by 16.9% YoY (a reduction by 8.2% YoY was recorded a year before). Declining goods imports (down 19.4% YoY) and a recovery in net remittances had a positive effect on the current account. Net capital inflows to the financial account will be mainly driven by the inflow of foreign direct investment.

Fiscal Policy

Budget surplus

The budget surplus was 4.7% of GDP in 2016, while in the preceding year it was 2.2%. Budget revenues grew by 41.8% compared with 1Q 2016, primarily due to 9.5% YoY growth in tax proceeds and 2.7 times growth in other revenues. The 35.7% YoY increase in public expenditure was driven by the financing of social programs, as well as the fuel and energy complex.



Source: The national statistical agency, estimates by the authors

Monetary Policy

Refinancing rate increased

With the gold and foreign exchange reserves low and the banking sector increasingly troubled, the National Bank of Tajikistan has attempted to use all available leverage to limit the devaluation of the somoni against the US dollar. Together with the effect of the administrative measures taken to support the exchange rate, the National Bank of Tajikistan increased the refinancing rate twice, from 11.0% to 16.0%, during the 1st quarter. Nevertheless, the high build-up rate of the somoni-denominated money stock (53% compared with 1Q 2016) is driving a tendency towards devaluation of the somoni against the US dollar. Total banking system loans as of the end of March 2017 dropped by 1.3% compared with the start of 2017. The share of bad loans (including interbank loans) was 50.8% as of the end of March 2017.

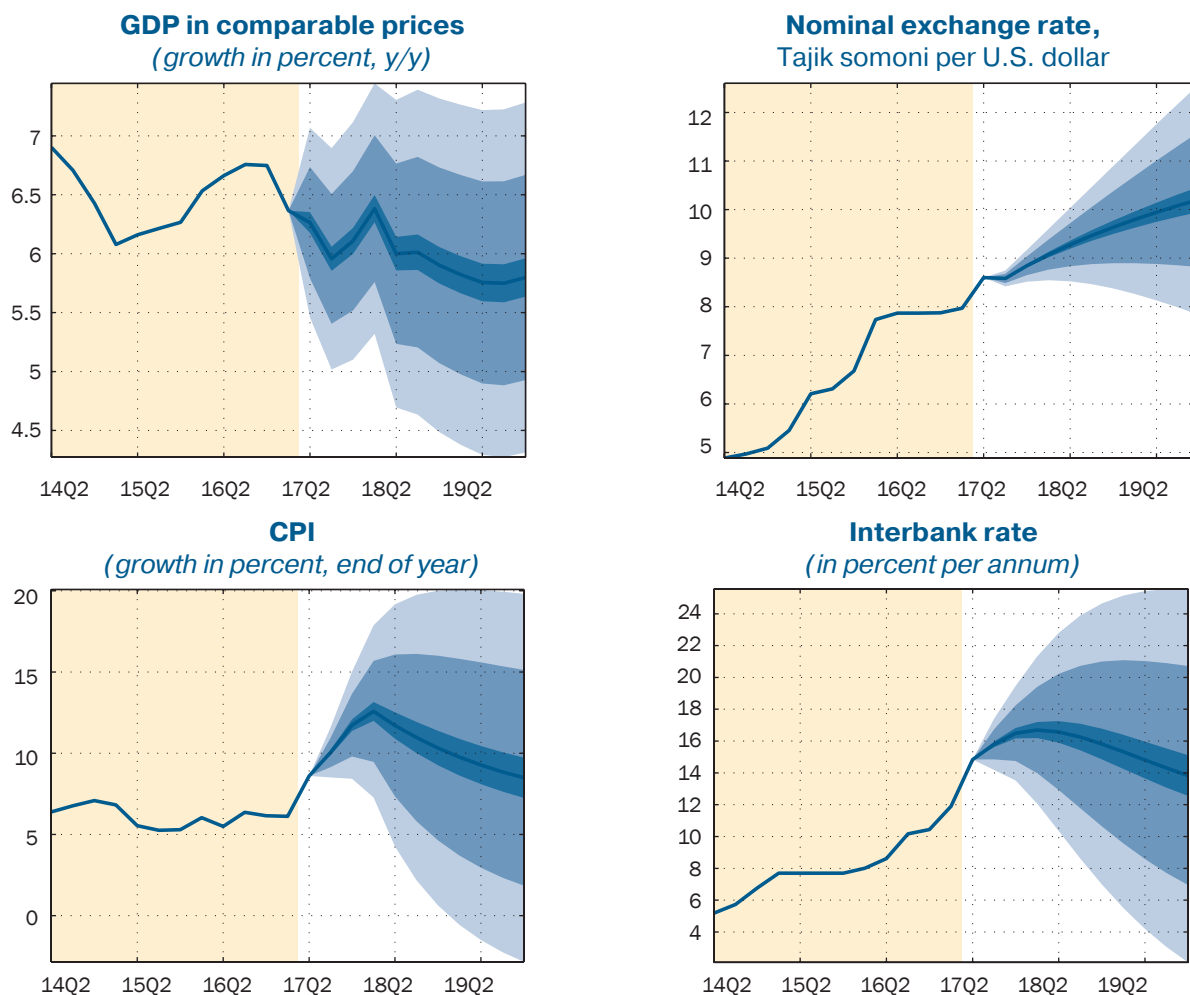
FORECASTS

Economic growth to slow

We expect Tajikistan's real GDP growth to decelerate in the next three years. Despite the improving foreign economic background, which should contribute to growing remittances, domestic factors will keep economic activity constrained. Accelerating inflation and the weak banking sector may affect economic growth in the medium term.

Inflation acceleration in 2017

The devaluation shock that occurred in early 2017 together with the accelerated growth in the money supply will be reflected in higher inflation, which will be above the 7.0% mid-term target.



Source: Estimates by the authors

SUMMARY

Forecast for the main macroeconomic indicators of the Republic of Tajikistan

	2017	2018	2019
CPI (growth in percent, end of year)	11.7	10.3	8.5
GDP in comparable prices (growth in percent, y/y)	6.2	6.1	5.8
Interest rate on interbank loans (in percent per annum)	15.9	17.7	15.7
Exchange rate , somoni per U.S. dollar (average for the year)	8.5	9.4	10.0

Source: Estimates by the authors

SPECIAL REPORT.

MICROECONOMICS OF THE EURASIAN GEOGRAPHY

Y.D. Lissovolik, Dr.Sc. (Economics); A.S. Kuznetsov; A.R. Berdigulova

In our special report *Economic Geography of the Eurasian Countries*⁶ on the importance of countries' geographic position, we noted that the continentality of the region has significant consequences for economic development, including GDP and turnover growth.

The key factor in the imbalances between the continental and coastal regions⁷ is the significant difference in transportation costs. In EDB countries, high transport expenses are driven by the particular regional location of key production facilities and the higher cost of carriage by land than by sea.

If goods are exported, their transportation expenses within the exporting country are sustained primarily by the producer. Therefore, the profit gained by the companies differs significantly depending on their remoteness from the ocean. For EDB countries, that is manifestly illustrated when the transport expenses of large regional exporting companies are compared with those of producers from oceanic states. In this report, we briefly identify the key geographic factors impacting economic development both at the country level and at the micro-level of industries and companies.

TRANSPORT COSTS: DIFFERENCES BETWEEN THE COUNTRIES

Transportation distance is significant for a country's competitiveness. That is evidenced by an OECD study [2008], which shows that despite the progress of transport and communications technology in trade-related industries, which has resulted in a considerable reduction in transport costs, the distance factor still plays a significant role. The study confirms that an increase in the transportation distance by 10% results in a reduction of trading volumes by about 10%. According to estimates contained in the work, access to global markets has a significant impact

⁶ https://eabr.org/upload/iblock/026/ekonomicheskaya_geografiya_stran_evrazii_yanvar_2017.pdf

⁷ Unlike the traditional UN definition "landlocked countries", the terms "continental" and "oceanic countries" are used in this work. According to L.A. Bezrukov, the continentality of a country refers to the remoteness (proximity) of the key production facilities to sea or ocean ports with all-year navigation, adjusted to take account of domestic waterways accessible to sea-going vessels. Thus, according to the UN definition, Russia belongs to the category of states with access to the sea. However, according to Bezrukov's classification, Russia is an "ultracontinental" country.

on economic activity and makes an important contribution to the GDP per capita level. Thus, Australia and New Zealand bear the greatest losses from their geographic position – about 10% of GDP per capita compared with the average level of the OECD countries. The greatest positive contribution to GDP from access to global markets is noted in Belgium and the Netherlands – about 6%. We came up with our own estimates for Russia and Kazakhstan using the same calculation methodology [Herve Boulhol et al, 2008]. As the results show, the losses for Russia and Kazakhstan from their geographic location are significantly greater than the average for the European countries and the USA.

Table 1. Contribution of geography to GDP per capita*, difference in %

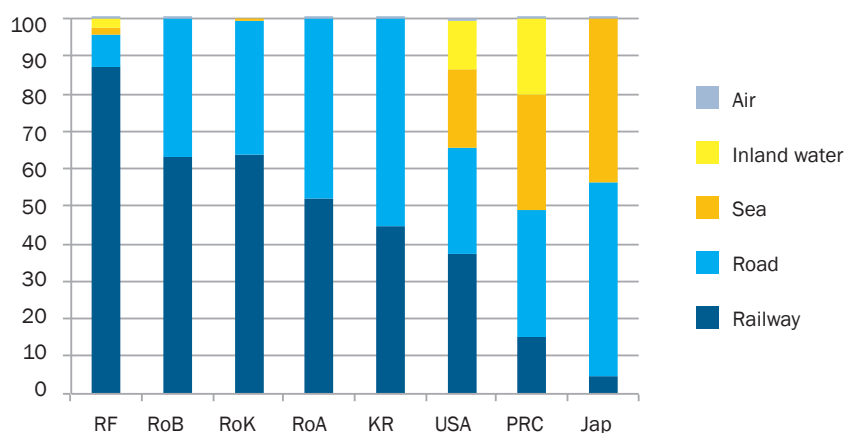
Country	Deviation in %	Country	Deviation in %
Australia	-10.6	Ireland	0.6
New Zealand	-10.1	Italy	1.3
Kazakhstan**	-7.4	Austria	1.8
Russia**	-4.6	Canada	2.1
Greece	-3.7	Denmark	2.2
Portugal	-2.7	Japan	3
Finland	-2.4	Switzerland	3.3
Norway	-1.5	France	3.4
Sweden	-1.4	UK	3.8
Spain	-1.2	The Netherlands	5.6
USA	-0.3	Belgium	6.7

* Taking Australia as an example, the table should be read as follows: the degree of access of Australia to global markets results in a reduction of GDP per capita by 11.8% compared with the average value of the countries considered in this example.

** EDB estimates

Source: OECD, authors' calculations

Railway transportation has the greatest share of EAEU countries' cargo turnover. In Russia, its share in 2015 excluding pipeline transport was 87%. Domestic transportation accounts for more than 60% of overall cargo turnover, while export shipping accounts for about 30% and transit traffic accounts for about 2%. By contrast, sea transport accounts for the highest share in oceanic countries.

Fig. 1. Turnover split by transport type* (%)

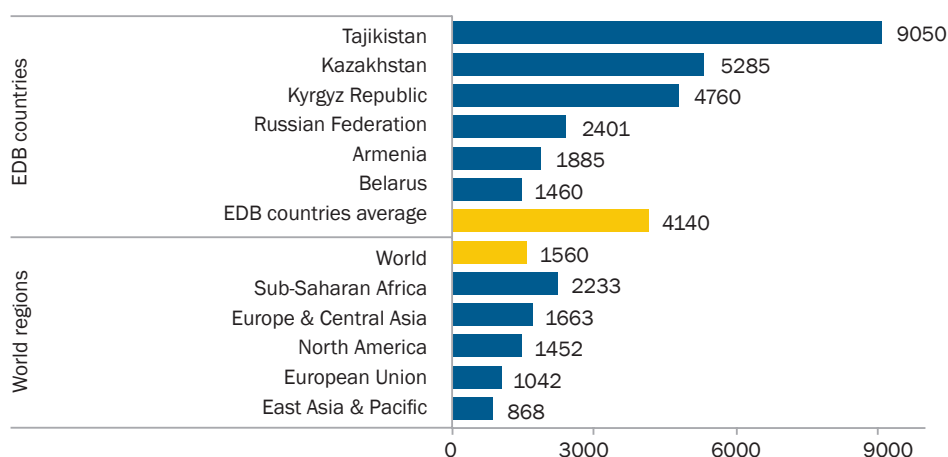
* excluding pipeline transport, data for the Russian Federation is for 2015; data for RoB, RoA, RoK, KR, USA and China is for 2014; data for Japan is for 2012.

Source: Federal Statistics Service of the Russian Federation, authors' calculations

Therefore, an important criterion when comparing producers' transport costs from continental and oceanic countries is the cost of transportation per unit of product by sea or land. For example: the freight price from Australia to China is USD 9 / ton, and that from Brazil to China is USD 22 / ton. The cost of transshipment at ports is USD 2-4 / ton. The railway tariff for coal and ore transportation from Siberia to Far-Eastern ports was over USD 35 / ton in 2014, while for steel it was over USD 100 / ton. The cost of transshipment in Russian ports is USD 12-18 / ton⁸.

The significant difference between the cost of sea and land transportation given the already highlighted dominance of land transport in the cargo turnover of the EDB countries versus the high importance of sea transport for the coastal states demonstrates that domestic producers face worse conditions when competing in the global market. Thus, according to World Bank data, Tajikistan faced the highest shipping cost of export cargo in the world in 2014, at USD 9,050 per container. The ten countries with the highest transportation costs per container also included Kazakhstan (USD 5,285 per container), and Kyrgyzstan (USD 4,760 per container). The cost of delivering exports in five of the six EDB countries exceeds the average global level of USD 1,650 per container.

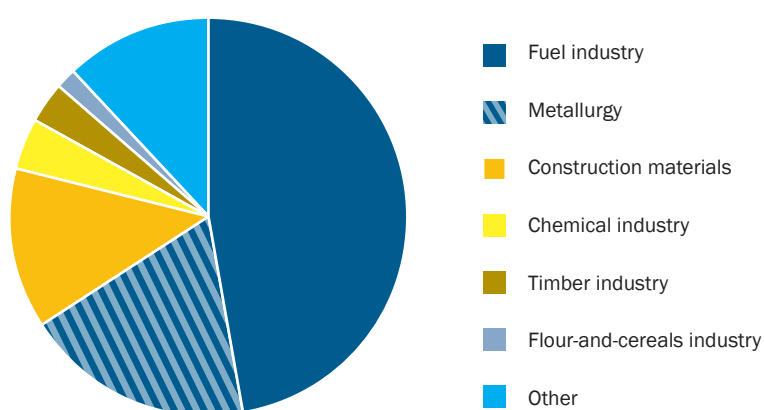
⁸ <http://carnegie.ru/commentary/2015/10/13/ru-61592/ijpy>

Fig. 2. Export delivery cost, USD per container in 2014

Source: World Bank estimates taken from the Doing Business survey

PRODUCTION LOCALIZATION AND CARGO TURNOVER STRUCTURE BY INDUSTRY

The significance of the transport costs factor differs depending on the industry, and largely depends on the specific weight of the costlier types of cargo, including railway transport. In Russia, railway is mainly used by the fuel industry, metallurgy, and the construction materials industry (fig. 3).

Fig. 3. Structure of railway cargo transportation in Russia, 2015

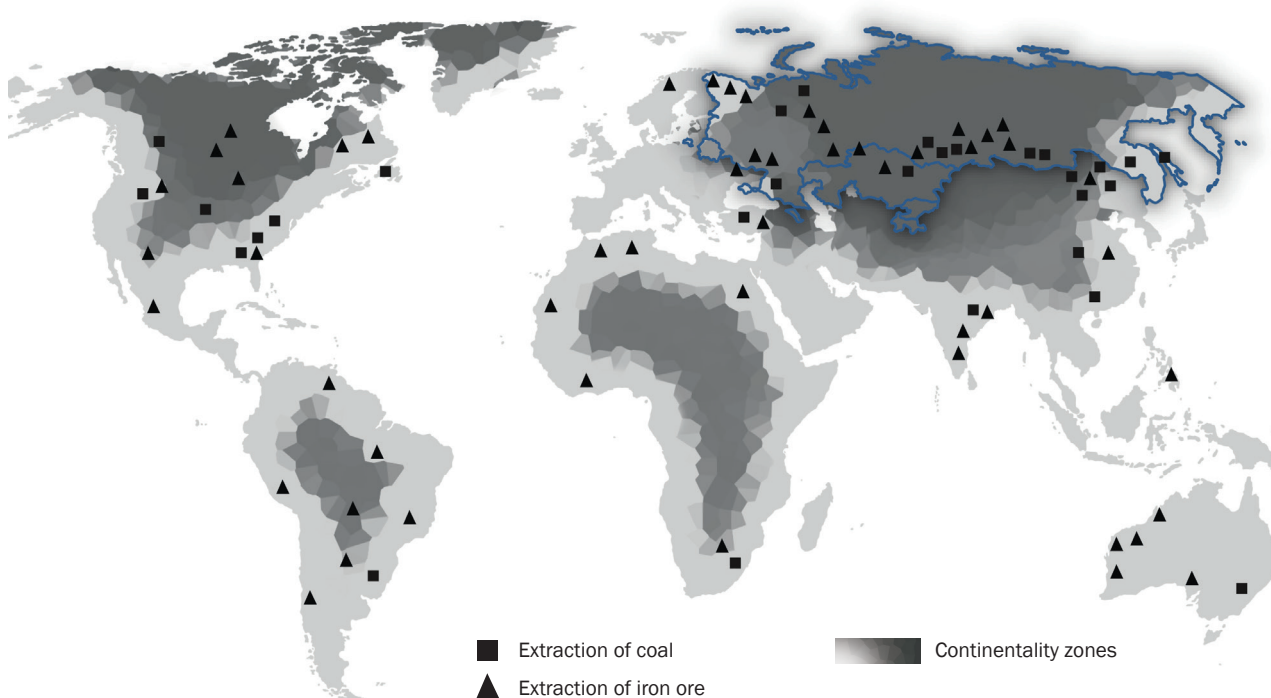
Source: Federal Statistics Service of the Russian Federation, authors' calculations

Coal accounts for the single greatest share of railway cargo transportation (26%)⁹, with more than half of extracted coal exported. Russia was the world's third-largest coal exporter in 2014 with 11%¹⁰. Power station coal dominates Russian coal exports – its share accounts for 87%¹¹. About 80% of power station coal reserves in Russia are located in Western and Eastern Siberia. Therefore, most Russian coal deposits are located far from sea access (the distance to the nearest port is 3.5 - 4.5 thousand km).

In the second half of the XX century, many countries moved their key production facilities from the continental part of the mainland to the coastal zone. At the same time, Russia (the USSR) saw a massive move into deep mainland regions, driven by the relative isolation of the economy from the outer world and the need to explore natural resources in Siberia and the Urals. In doing so, most republics, including Russia, lost access to key ice-free ports following the USSR's collapse (Bezrukov, 2006).

Russia's mining complexes are located in the continental part of Eurasia, far from the large ocean ports. Exports from the Mikhailovsky mining and processing facility, which belongs to Russian metals and mining company Metalloinvest, are dispatched through the ports of the Black and Baltic seas (over 900 km by rail and ca. 1,200 km by rail, respectively).

Fig. 4. Location of the key coal and iron ore mining complexes



Source: Authors, based on L.A. Bezrukov's work, annual reports of mining and processing facilities.

⁹ *Transport and communications in Russia, 2016. Federal State Statistics Service*

¹⁰ *Fuel and Energy Complex of Russia 2015, June 2016, <http://ac.gov.ru/files/publication/a/9162.pdf>*

¹¹ *Fuel and Energy Complex of Russia 2015, June 2016, <http://ac.gov.ru/files/publication/a/9162.pdf>*

At the same time, Australia's ore deposits are located about 500 km from the Indian Ocean, while the distance from Brazilian mines to the Atlantic Ocean is 500 - 900 km by rail.

The distances Russian coal covers by rail are among the longest in the world, and the longest in respect of exports. At the same time, Russia's direct competitors (Australia, South Africa, South America, and Indonesia) export by sea. In Australia, for example, no coal mining is more than 300 km from the port. By contrast, the main export volumes in Russia are supplied from the Kuzbass, the transportation leg exceeding 3.5 thousand km. Even the commissioning of the East Siberian and Yakut deposits will not change the disadvantage in transport costs significantly. Therefore, transport is high in the structure of the industry's costs: it accounts for 50-60% of the power station coal price and 30-40% or more of the coking coal price. For comparison: transport costs in the oil industry account for less than 10% of the price, while in the aluminum industry the share is 10-20%, and that in metallurgy is slightly less than 20%¹².

Therefore, coal transportation within Russia is unique in terms of its scale, is a fairly inflexible direct cost, and cannot be changed in the near future. As a result, according to Kuzbass Fuel Company data for 2016, at the lowest export price of USD 49 per ton the producer earns USD 8-9 net of costs¹³.

TRANSPORT INTENSITY OF COMPANIES

The above difference in transport expenses significantly impacts the structure of expenses and competitiveness of companies. Thus, Metalloinvest is the world's second-largest company in terms of iron ore reserves after Brazilian Vale. Kazakhstani ERG is seventh, after Australian BHP Billiton and Rio Tinto, and North-American Cliffs Natural Resources and FMG. The metals and iron ore markets are mainly focused on China. Currently, that country consumes almost half of global iron ore exports. Russia and Kazakhstan share a common border with the main global consumer, but their aggregate weight in Chinese imports of iron ore barely reaches 1%. Australia's share in the overall volume of Chinese iron ore imports is 42%, while Brazil accounts for 14%¹⁴.

If the ore is supplied to the Chinese border from the Kursk magnetic anomaly's mining facilities by rail, it travels 4-7 thousand km, depending on the chosen route. Australian ore has to cross the ocean and travel more than 9 thousand km, while Brazilian ore travels almost 22 thousand km to reach a sea port in China. Despite their geographic remoteness from the global iron ore consumption centers, four companies – Vale, BHP Billiton, Rio Tinto, and FMG – account for 72% of the global iron ore trade. Russian company Metalloinvest supplies 66% of the extracted ore to the domestic market, while it exports just 19% to European countries and 10% to Asia¹⁵.

¹² <http://expert.ru/siberia/2013/22/put-uglya/>

¹³ EDB industry review

¹⁴ The calculations were based on UN comtrade database statistics

¹⁵ Annual report of Metalloinvest for 2015

Despite Russia and Kazakhstan's competitive advantage – continentally neighbouring the largest target market – the absence of an effective transportation and logistics system together with dependence on land transportation means that Russia and Kazakhstan face limitations to their mining enterprises' export potential. Due to a number of factors, rail transportation is not profitable, so sea carriage is preferred. According to JOC.com calculations, the cost of transportation of a 40' container by rail is about USD 8 thousand. Transportation of the same container by sea would cost about USD 3 thousand¹⁶.

Table 2. Calculation model for determining the export prices and profit of iron ore producers (sellers) exporting to China in FY 2013/2014, USD/ton¹⁷

Indicators		Russia	Brazil	Australia
Aggregate costs				
1.	Production cost	22	22	22
2.	Cost of railway transportation to the exporter's border	40	10	17
3.	Total costs (3 = 1+2)	62	32	39
Export price FOB				
4.	Global price	116	116	116
5.	Cost of railway transportation to the exporter's border	0	19	10
6.	Export price (FOB) (6=4-5)	116	97	106
Profit				
7.	Profit from export (7=6-3)	54	65	67
8.	Total expenses (8=3+5)	62	51	49

Source: the table represents the authors' expert estimates based on materials from information agencies and statements by mining company executives published in the press. The global price for iron ore is the average for 2013 - 2014 according to WB data.

Note: The iron ore extraction cost in Russia does not take account of ore quality (the need to enrich it to ore concentrate with 65-70% Fe content).

¹⁶ <http://www.rbc.ru/politics/15/12/2015/56703a6d9a7947f88a89ae7d>

¹⁷ The table is built using the methodology contained in *Continental-oceanic dichotomy in international and regional development* [L.A. Bezrukov, 2006]

While there is a surplus of iron ore in the Russian market (about 25%)¹⁸, and the export price exceeds the prices of competitors from Brazil and Australia, its integration into the global market will be limited by the high transport costs. Sharing a common border with China, Russian producers can supply that country by land, while Chinese importers do not incur expenses paying for sea freight. When setting the export price, the Brazilian and Australian companies exporting ore to China must take into account the additional sea freight expenses. On the other hand, relying only on expensive railway transportation, Russian producers have to bear high expenses. The aggregate transport expenses per ton for Brazilian and Australian producers resulting from railway and sea carriage are around 30% lower than those incurred by Russian iron ore exporters. Therefore, although the export price of Russian suppliers when delivering to China is higher than that of competitors from Australia and Brazil, expenses incurred by Russian mining and metallurgy exporters were USD 62 per ton of iron ore in 2013/2014, while for oceanic producers they were USD 50 (Table 2).

WAYS TO OVERCOME THE DISTANCE DISADVANTAGE

Development of transport infrastructure is of paramount importance for the economy of the EDB countries in light of their territory and the location of the main facilities. Development of the domestic railway and port infrastructure, the creation of transcontinental Eurasian transport corridors, and a reduction in the average transportation distance by optimizing the added value chain may make a positive contribution to reducing producers' transport expenses.

In addition, measures aimed at increased added value of the output are among the possible strategies for changing export infrastructure from a raw materials focus towards high-tech and science-intensive products, which are relatively less dependent on the transport component in the price structure.

One of the economic measures to address transport costs could be to launch companies with government support and significant capital in countries with lower production and product turnover costs¹⁹.

The creation of logistics corridors between EDB countries will help reduce transport costs thanks to economies of scale and will contribute to a transition from inter-industry to intra-industry trade, the development of which, in its turn, will be a key factor in overcoming the distance disadvantages. The role of transport distances and costs in the global natural resources trade is empirically significant [World Bank, 2008]; moreover, their role intensifies with time. Research by the World Bank and other international organizations evidences that transportation distance remains a significant factor in global trade, and that its effect on global trade has not just declined in a number of cases in recent decades, but is actually growing²⁰. That, in its turn, requires developing competitiveness-building strategies at the levels of national economies and separate businesses, which would take into account the importance of the geographic factor and distance disadvantages.

¹⁸ <https://www.metalbulletin.ru/analytics/ores/628/>

¹⁹ L.A. Bezrukov. *Continental-oceanic dichotomy in international and regional development*, page 46

²⁰ http://siteresources.worldbank.org/INTWDRS/Resources/477365-1327525347307/8392086-1327528510568/WDR09_12_Ch06web.pdf

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GLOSSARY

Basis point. A common unit of measure for interest rates and other percentages in finance. One basis point is equal to one hundredth of 1%, or 0.01%.

Consumer Price Index (CPI). The CPI characterizes changes over time in the general level of prices of goods and services that are purchased by households for non-productive consumption. It is an indicator for changes in the value of a fixed set of consumer goods and services in the current period compared with the previous (base) one. The CPI is calculated by the national statistical agency on the basis of data about the actual structure of consumer expenses, and therefore is the main indicator of the cost of living faced by households.

Core inflation. Inflation measured on the basis of the core consumer price index (Core CPI), which excludes changes in prices of certain goods and services regulated by the government, as well as the prices of goods and services that are subject to seasonal changes, such as fruits, fuel, passenger transport services, telecommunications services and most utilities.

Dollarization. The share of foreign currency deposits and loans in the total volume of deposits and loans in the banking sector.

Floating exchange rate regime. The International Monetary Fund describes a floating exchange rate as a largely market determined rate. The floating exchange rate regime implies that the centrally bank does not set targets and lets the rate be determined by market factors. However, the central bank reserves the right to purchase foreign currency to replenish the international reserves and make direct or indirect interventions to influence the exchange market to moderate the volatility of the exchange rate and prevent undue fluctuations.

Inflation targeting regime. A monetary policy regime envisaging that the main priority of the central bank is to ensure price stability. This involves the public announcement of numerical targets for inflation, with an institutional commitment by the central bank to achieve these targets. The monetary authorities influence the economy through changes in interest rates. Monetary policy decisions are primarily made on the basis of forecasts for economic development and the dynamics of inflation. An important component of the inflation targeting regime is that the public is regularly informed about measures taken by the central bank, which ensures its accountability for achieving its inflation objectives.

KASE Index. A free-float capitalization-weighted index that is the main index of the Kazakhstan Stock Exchange (KASE). The index is the ratio of the market prices of the stocks on the KASE Index list on the date of listing to their prices on a particular date.

Managed float exchange rate regime. In a managed float exchange rate regime, the central bank does not influence trends in the dynamics of the national currency's exchange rate that are determined by fundamental macroeconomic factors. The regulator does not impose fixed restrictions on the exchange rate of the national currency and does not set target levels. The central bank smoothes out fluctuations in the exchange rate to ensure the gradual adaptation of economic entities to changes in the external economic situation.

Monetary policy transmission mechanism. A process of influencing the economy and, primarily, the dynamics of prices through monetary policy decisions, including the central bank's decisions with regard to changes in the interest rates on its transactions. The most important channel of monetary policy transmission is the interest rate channel, whose influence is based on the impact of the central bank's policy on the interest rates at which economic entities can deposit or obtain funds and its impact on decisions on consumption, saving and investment, and thereby on the level of overall demand, economic activity and inflation.

Nominal effective exchange rate. A measure of the value of a country's currency against a weighted average of foreign currencies. The rate compares the local currency against a basket of the currencies of the country's most important trading partners, as well as the world's major currencies. The value of foreign currencies in the basket are weighted according to the share of trade with the domestic country.

Real effective exchange rate. The weighted average value of a country's currency against a basket of foreign currencies, adjusted for the effects of inflation. The weights are determined by comparing the relative trade balance of a country's currency against each country represented in the basket. A country's real effective exchange rate is derived by taking the average of the bilateral real exchange rates between the country and its trading partners and then weighting it using the share of each partner in the total volume of trade. The real effective exchange rate reflects changes in the competitiveness of a country's goods against the goods of its major trading partners.

RTS (Russia Trading System) Index. A free-float capitalization-weighted index of 50 Russian stocks traded on the Moscow Stock Exchange, calculated in U.S. dollars. The list of stocks is reviewed every three months by the RTS Information Committee. The RTS Index value is calculated in a real-time mode. The index was introduced on September 1, 1995 with a base value of 100.

Output gap. An indicator of the difference between the actual output of an economy and the maximum potential output, expressed as a percentage of GDP. The output gap characterizes the ratio between demand and supply and is an aggregated indicator of the impact of demand on inflation. A country's output gap can be either positive or negative. A positive output gap indicates that the actual output is higher than the economy's recognized maximum-capacity output. A positive output gap is a sign of an acceleration in the rise in prices, whereas a negative output gap indicates a slowdown in inflation.

Potential (inflation-neutral) output. The overall level of output in an economy that can be produced and sold without creating conditions for changes in the rise in prices. The level of inflation-neutral output is not linked to any specific level of inflation and only indicates the existence or non-existence of conditions for its acceleration or deceleration.

Short-Term Economic Indicator of Kazakhstan. An instrument used to measure economic activity, which provides periodic tracking of economic trends generally at frequencies of more than once a year and is based on changes in the output indices of major sectors such as agriculture, industrial production, construction, trade, transportation and telecommunications. These sectors account for 67 to 68% of the nation's GDP.

Structural liquidity deficit of the banking sector. The banking sector's state characterized by lending organizations' steady need to obtain liquidity through transactions with the central bank. A structural liquidity surplus means that lenders have a steady need to deposit resources with the central bank. The estimated level of a structural liquidity deficit or surplus is the difference between the debts in the central bank's refinancing transactions and its liquidity-absorbing transactions.

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
CB RA	Central Bank of the Republic of Armenia
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
Core CPI	Core Consumer Price Index
DSGE	Dynamic Stochastic General Equilibrium
EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EDB	Eurasian Development Bank
EDB/CIS	Center for Integration Studies of Eurasian Development Bank
EEC	Eurasian Economic Commission
EFSD	Eurasian Fund for Stabilisation and Development
EU	European Union
FRS	Federal Reserve System of the United States
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
IMS	Integrated Model System
IMF	International Monetary Fund
IPPI	Industrial Producer Price Index
ITR	Inflation Targeting Regime
KASE	Kazakhstan Stock Exchange
MEKR	Ministry of Economy of the Kyrgyz Republic
MERB	Ministry of Economy of the Republic of Belarus
MEDRF	Ministry of Economic Development of the Russian Federation
MEDTRT	Ministry of Economic Development and Trade of the Republic of Tajikistan
MNERK	Ministry of National Economy of the Republic of Kazakhstan
NBKR	National Bank of the Kyrgyz Republic
NBRB	National Bank of the Republic of Belarus
NBRK	National Bank of the Republic of Kazakhstan
OECD	Organization for Economic Cooperation and Development
PPI	Producer Price Index
RTS	Russian trade system
SNA	System of National Accounts
WB	World Bank

Major macroeconomic indicators of the EDB member countries

	2014	2015	2016	2017 F	2018 F	2019 F
Armenia						
CPI (growth in percent as of year-end)	4.6	-0.1	-1.1	2.3	3.6	4.0
GDP in comparable prices (growth in percent, y/y)	3.6	3.0	0.2	5.2	3.0	4.1
Interbank repo rate (in percent per annum)	7.25	10.1	7.8	6.2	7.1	7.8
Exchange rate , the national currency against the U.S. dollar (final average for the year)	416	478	480	484	490	497
Belarus						
CPI (growth in percent as of year-end)	16.2	12.0	10.6	8.0	6.9	5.8
GDP in comparable prices (growth in percent, y/y)	1.7	-3.8	-2.6	1.4	1.2	1.2
Interest rate on overnight interbank loans (in percent per annum)	23.2	29.9	19.2	11.4	11.5	10.5
Exchange rate , the national currency against the U.S. dollar (final average for the year)	1.02	1.59	1.989	1.954	2.104	2.189
Kazakhstan						
CPI (growth in percent as of year-end)	7.4	13.6	8.5	7.2	6.5	5.5
GDP in comparable prices (growth in percent, y/y)	4.2	1.2	1.0	3.4	3.1	3.7
TONIA (in percent per annum)	10.6	15.7	15.6	10.5	10.0	8.9
Exchange rate , the national currency against the U.S. dollar (final average for the year)	180	223	342	317	327	348
Kyrgyz Republic						
CPI (growth in percent as of year-end)	10.5	3.4	-0.5	6.8	7.2	6.9
GDP in comparable prices (growth in percent, y/y)	4.0	3.9	3.8	3.7	3.9	4.1
Interbank repo rate (in percent per annum)	6.8	9.0	3.7	4.0	9.0	10.6
Exchange rate , the national currency against the U.S. dollar (final average for the year)	53.7	64.5	69.9	69.6	71.7	75.2
Russia						
CPI (growth in percent as of year-end)	11.4	12.9	5.4	3.9	4.1	4.0
GDP in comparable prices (growth in percent, y/y)	0.7	-2.8	-0.2	1.4	1.5	1.7
MIACR (in percent per annum)	8.5	12.8	10.6	9.2	7.5	7.3
Exchange rate , the national currency against the U.S. dollar (final average for the year)	38.4	60.9	67.1	59.4	61.4	64.0
Tajikistan						
CPI (growth in percent as of year-end)	6.1	5.8	6.1	11.7	10.3	8.5
GDP in comparable prices (growth in percent, y/y)	6.7	6.0	6.9	6.2	6.1	5.8
Interest rate on interbank loans (in percent per annum)		20.4	9.8	15.9	17.7	15.7
Exchange rate , the national currency against the U.S. dollar (final average for the year)	4.9	6.2	7.8	8.5	9.4	10.0

Source: National statistical agencies, estimates by the authors



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