

EDB MACROREVIEW

JANUARY 2017



**EDB COUNTRIES:
TARGETING LOWER INFLATION**

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INTRODUCTORY WORD BY THE CHIEF ECONOMIST

A Window of Opportunity for Economic Growth and Low Inflation

The beginning of the last year proved to be challenging for the EDB Member States: with oil prices plummeting, both financial markets and exchange rates were highly volatile. Nevertheless, as of the year's end, the countries of the region saw exchange rates stabilize, and, in a number of cases, their national currencies strengthened considerably. Similarly, inflation in the EDB countries reached its historic minimum of 5.8% at the end of 2016 as compared to 12.8% in late 2015. Notably, inflation decreased in all the six EDB Member States, most considerably in the region's biggest economies of Russia and Kazakhstan.

The economic growth situation changed for the better last year as compared to 2015, but looks ambivalent. Last year, economic recession in the EDB countries slowed down from 3.1% in 2015 to 0.5% in 2016; however, economic dynamics worsened in three EDB countries; growth rates higher than 3% were only reached in Kyrgyzstan and Tajikistan, while in other countries they were either negative (Russia and Belarus) or less than 1% per year (Armenia and Kazakhstan).

So, while the EDB countries' growth will probably go positive in 2017, the prospects of a dynamic recovery in the Eurasian region remain moderate, and the search for new growth drivers remains a key issue on the EDB countries' economic agenda. At the annual EDB conference held in November 2016 in Moscow, economic integration was noted as a critical factor for the improvement of the economic dynamics in the countries of the region. In addition to the keynotes of our annual conference, the present publication also includes a special report that emphasizes, in the context of a review of the specifics of Eurasian countries' economic geography, the special role of integration and infrastructure development for the countries of our region.

In 2017, the most probable scenario is continued inertial recovery in the EDB Member States and inflation decreasing as external conditions stabilize. We project a 0.9% growth of the EDB economies, with a further 1.5% acceleration in 2018-2019. And there remain opportunities for reducing inflation that we expect to decrease from 5.8% at the end of 2016 to 4.7% in 2017. Limited demand, stabilized exchange rates and capital flows and a conservative monetary policy in most countries of the region will support the continued downward inflation trend.

In 2017, the budget sector will be the main macroeconomic challenge for the EDB countries, given the growth in debt of the countries of the region (Belarus and Kazakhstan), reduced State budget reserves (the Russian Federation) and sizeable budget gaps in 2016 (Armenia and Kyrgyzstan). For Russia, the current year's main budgetary challenge is the possible exhaustion of the Reserve Fund – at least this is the base scenario underlying the 2017 Budget prepared by the Ministry of Finance. The persistence of State budget imbalances

in most countries of the region will require diversifying sources for funding the budget deficit and streamlining the budgets' expenditure side.

As far as the external background is concerned, the development of the EDB countries stabilized in 2016 amid a growing number of anomalies that were observed in the world economy last year, particularly in developed countries. These anomalies consisted not only and not so much in the very fact of Brexit, the results of the Italian referendum or the U.S. elections but in growing uncertainty in developed countries' markets. Against this backdrop, East Asia strengthened its position even more, as the most dynamic region in the world economy, while uncertainty and risks were mounting in Europe and the US.

Yet increased risks will persist in 2017 in all the key regions of the world economy. In China, there is the problem of growing debt in its banking system and economic growth slowdown. In Europe, the electoral cycle and its repercussions on both the already fragile budget situation in the EU and the health of the European banking system will be an important risk factor. In the US the growth of State budget expenses that may be unleashed by the new administration creates additional risks on top of the uncertainty regarding America's foreign trade policy and how protectionist it will be.

The oil output reduction agreement reached with the OPEC countries in 2016 was an important event for the region's major economies and generated a considerable recovery of petroleum prices. The 2017 focus will now be on the OPEC countries' ability to adhere to their quotas/obligations; historically, the OPEC countries have had great difficulty in observing discipline. Still, the agreement itself mitigates somewhat the risks of a sudden and large-scale fall of oil prices similar to their decline in late 2015 and early 2016.

The stabilization of the external conditions creates a 'window of opportunity' for the EDB countries not only to consolidate last year's positive achievements but also to attain, in a number of cases, new historic levels of key macroeconomic parameters, most notably with respect to inflation. In the current conditions, it is essential to use the considerable slowdown in inflation in order to reduce the inflation expectations and to increase confidence in the national currency, financial system, and the economic policy being pursued. This, in turn, may become a basis for the recovery of economic growth in the region's biggest largest economies, Russia and Kazakhstan, as inflation decreases further and the key interest rates are steadily reduced.

In the field of economic policy, the EAEU countries are just beginning to fully utilize, in the last few years, the potential of regionalism; for now, the agreement between the Eurasian Economic Union Member States and Vietnam, that took effect in 2016, can be recognized as one such achievement. Nevertheless, with the EAEU becoming more active internationally, 2017 may become the year of the EAEU's breakthrough towards a more diversified system of trade alliances; here the Eurasian Economic Union's negotiations with such countries as South Korea, Singapore and Israel will be of key importance.

Yaroslav Lissovolik,

Chief Economist of the 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).

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EXTERNAL CONDITIONS

Economic dynamics still volatile in developing countries

The recovery of the world economy in 3Q 2016 continued with the growth rates accelerating in the US, stabilization in the Euro zone economies and China, and volatility persisting in developing economies. For the year 2016 as a whole, world GDP growth is projected¹ to be 3.1% and then to recover to 3.4% in 2017.

US FRS starts normalizing its monetary policy

The Euro zone GDP growth in 3Q 2016 remained at a level of 1.6% vs. 3Q 2015. Among positive factors, we can identify industrial output growth and low unemployment (the minimal figure since June 2011 was recorded in September 2016). The U.S. economic recovery accelerated somewhat in 3Q 2016, to 1.5% vs. 3Q 2015, which was promoted by growing consumer and public expenses and growing exports. Amid positive labour market data and gradual stabilization of the inflationary process, on 14 December the Fed decided to increase its key rate by 25 basis points, to 0.5–0.75%. A more hawkish Fed rhetoric and plans to increase the key interest up to three times in 2017 create risks of greater volatility returning to the developing markets.

Oil prices growing after production cut arrangements

Relatively stable oil prices observed since the beginning of 3Q 2016 gave way to growth in November and December, driven by expectations of oversupply reduction in 2017, followed by an agreement between energy exporting countries aiming to restore the balance in the world petroleum market and mitigate their existing budgetary problems. The focus in 2017 will be on those countries' ability to adhere to their quotas and obligations. The growth of gold prices observed in January to September 2016 gave way to a fall to their early 2016 level in October to December. The factors behind the price fall were the strengthening of the USD exchange rate as the U.S. economy fared better and the Fed interest rate hike. The persistence of moderate demand in the world commodity markets partly explained the unstable recovery of food prices in September to November 2016.

Gold prices fall to early 2016 level

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
2016	41.9	1253	92.4	1.1	0.4
2017	50.9	1154	93.5	1.1	1.2
2018	53.0	1170	94.7	1.1	2.2
2019	54.8	1191	96	1.1	2.7

Source: Estimates by the authors, EEU

¹ IMF estimates

RUSSIAN FEDERATION



TRENDS

GDP

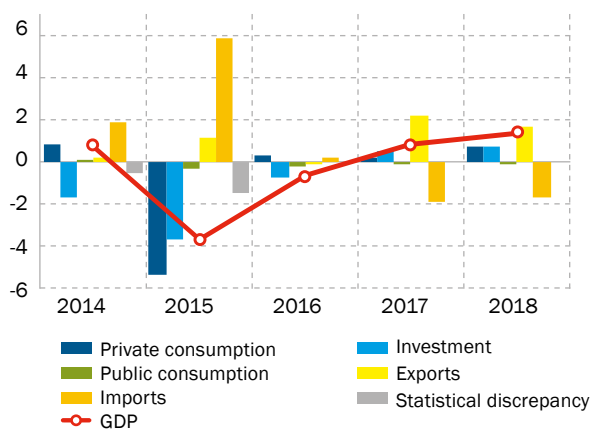
Deceleration of GDP decrease continues into 3Q2016

According to Rosstat (Federal State Statistics Service), the decrease of Russia's GDP in 3Q 2016 decelerated to 0.4% vs. 3Q 2015 (after a 0.6% fall a quarter before). The Bank of Russia estimates quarterly GDP growth, excluding, to have left the negative territory in 3Q 2016. In January to September 2016 GDP decrease was 0.7% year-over-year.

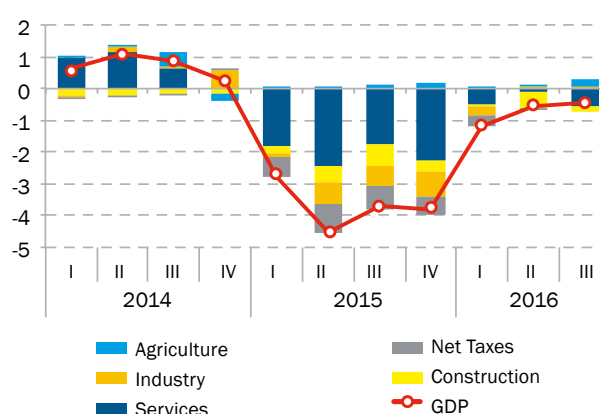
Stable growth of agriculture and unstable industrial output recovery

Industrial output growth in 3Q 2016 returned into the negative area, decreasing by 0.1% versus the respective quarter of 2015, after 1% growth in the previous quarter. Negative dynamics is mainly explained by an unstable manufacturing output recovery. The mining industry has retained stable growth rates. The expectations of accelerated growth in the agricultural sector in the 3rd quarter mentioned in our previous review were validated by 4.7% growth vs. 3Q 2015 (after the first half of the year 2.6% growth), on the back of to a good harvest in the current year. Transport freight turnover continued showing positive dynamics in the 3rd quarter, reaching in September its maximum growth rate recorded in 2016

GDP² 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

² Presented data do not include Rosstat revisions made in January 2017. GDP growth for the year 2015 has been revised from -3.7% to -3%.

Investment and consumer demand remains weak

Consumer demand remained weak in 3Q2016. With real wages growing in 3Q 2016 (growth accelerated to 1.2% vs. 3Q 2015 after zero growth over the first semester) and low unemployment (estimated by the Bank of Russia to be 5.5% adjusted for seasonality) the population's real incomes are still decreasing, as is retail turnover. Investment in fixed assets grew by 0.3% during 3Q 2016 year-over-year, (a 3.9% fall during the preceding quarter) which is attributable to both the low base effect and to the dynamics of the investment activity indicators (slowdown in the decline of the volume of construction and growing investment goods imports).

Leading indicators testify to continued recovery of economic activity

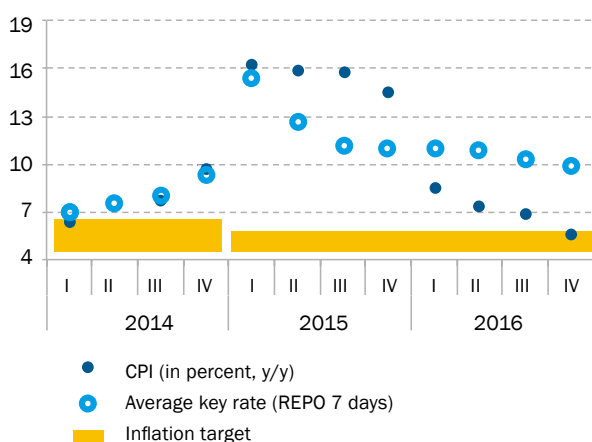
The leading indicators calculated by the EEC show that economic activity in Russia will continue recovering in early 2017. Improvement (as compared to the same period of 2015) is attested to by such components of the Consolidated Leading Indicator (CLI) as oil prices, transport freight turnover and indicators of the Russian stock market.

Inflation

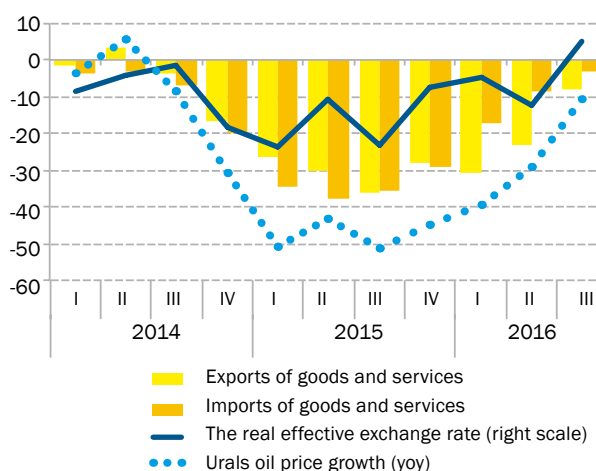
Unstable inflation expectations form main inflation risks

Inflation continued slowing down in September to December 2016. In the period under scrutiny, this was largely driven by such factors as a strengthening rouble, a big harvest and weak domestic demand. According to Bank of Russia estimates, the dynamics in inflation expectations in September to December 2016 was ambivalent, which justifies a continued moderately tight monetary policy. Annual inflation reached 5.4% in December. Persistent demand limitations and the Government's moderately tight monetary policy will continue to exert downward pressure on inflation.

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

Exchange rate

Rouble strengthens as oil prices grow

The RUR nominal exchange rate tended to strengthen into September to November, despite somewhat greater volatility in November resulting from expectations of world market developments after the OPEC meeting. The real effective exchange rate versus foreign currencies strengthened in 3Q 2016 by 3.4% vs. the preceding quarter. On the whole, over January to December 2016 the real effective exchange rate strengthened by 13.4% vs. December 2015

Rouble stays undervalued

We estimate the rouble to be priced below its equilibrium trajectory as of the beginning of 2017 (the real effective exchange rate gap is estimated at 1.8%). So the market situation remains conducive to a moderate strengthening of the Russian currency in the short run.

Low export prices hold back trade balance surplus recovery

As tentatively estimated by the Bank of Russia, the Russian Federation's current account surplus was USD 22.2 billion in January to December 2016 (vs. USD 69 billion in January to December 2015). The continued decrease of the trade balance surplus in September to December 2016 was mainly caused by low Russian commodity prices and increased imports of investment goods. A decrease of the service balance deficit played a compensating role.

Net capital outflows by the Russian private sector in January to November 2016 were estimated by the Bank of Russia at USD 16.1 billion (in January to November 2015, USD 54.1 billion).

Fiscal policy

2016 budget revised to increase deficit to 3.7% of GDP

In November 2016, the law "On Amending the Federal Law 'On the Federal Budget for 2016'" was signed. The law adjusts the parameters of the 2016 State budget in light of the economic conditions as they evolved during that year (the Urals oil price, reduction of inefficient budget spending and its redistribution). As amended, the 2016 federal budget will exhibit a deficit 3.7% of GDP, 0.7% of GDP higher than previously approved.

Budget executed in January to November subject to 2016 parameter adjustments.

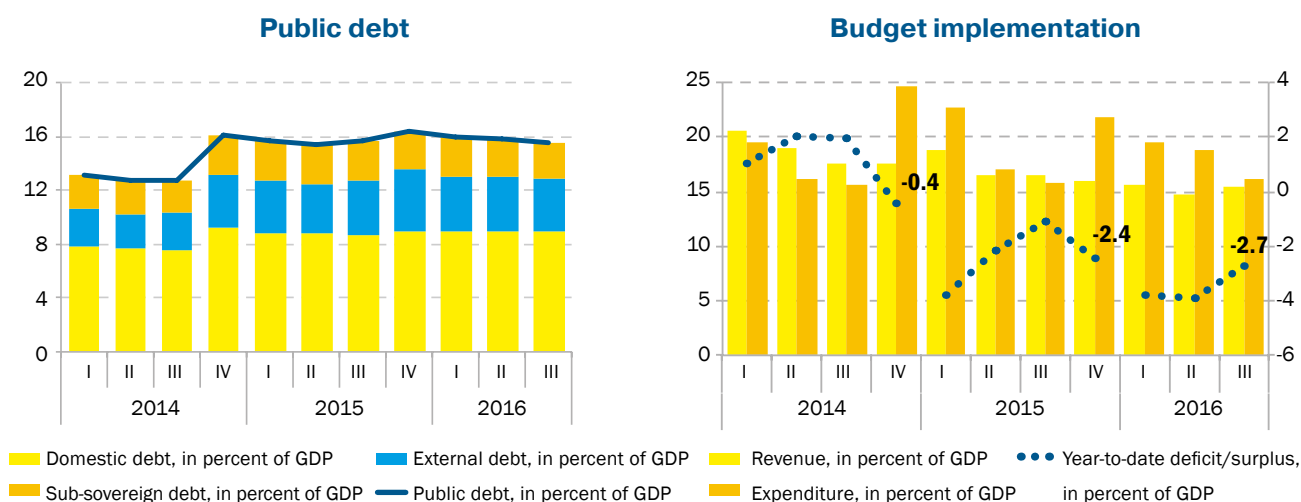
As tentatively estimated by the Ministry of Finance, in January to November 2016 the Russian federal budget posted a deficit of RUR 1.787 trillion, or 2.4% of GDP. The deficit was mainly financed by transfers from the Reserve fund.

Pursuant to the fiscal consolidation measures approved in December 2016 by the Federal Law 'On the Federal Budget for 2017 and for the 2018 and 2019 Planning Period', the federal budget deficit is to be reduced to 3.2%, 2.2% and 1.2% of GDP, respectively. The approved budget envisages the Reserve Fund to be completely exhausted in 2017

Federal budget deficit to be reduced to 1% of GDP in 2019

In 2016, the Russian Ministry of Finance successfully executed a programme for the placement of federal loan bonds worth RUR 1 trillion, and placed Eurobonds worth USD 3 billion.

Internal government debt grew by RUR 0.26 trillion, to RUR 7.6 trillion, in September to November 2016. Foreign debt was USD 51.3 billion in late November 2016, USD 1.3 billion more than at the beginning of the current year.



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

Monetary policy

Central Bank continues a moderately tight monetary policy.

In October to December, the Bank of Russia kept its key rate at the 10%, which was in line with its previously announced intention to sustain the key rate level achieved in September until the end of 2016 in order to consolidate the steady downward trend in inflation. As the Bank of Russia stated, it will consider reducing the key rate in the first semester of 2017 as these downward trends gain more ground.

FORECAST

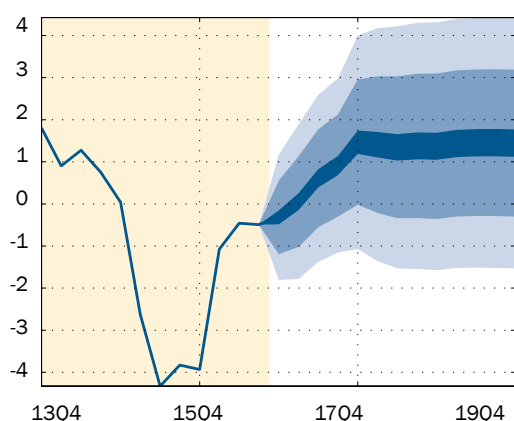
Gradual recovery of economic growth to 1.4% by 2019

In the medium term, economic growth will be supported by internal economic factors as well as external stimuli. The gradual loosening of the monetary policy will support consumer demand recovery. Better lending conditions and lower uncertainty will lead to the recovery of investment activity. Given these trends, continued recovery of economic activity and transition to a positive GDP growth rate, of 0.8% in 2017 with gradual recovery to 1.4% by 2019, are expected in the forecast period. Over 2016, the GDP fall is expected to have slowed down to 0.6%.

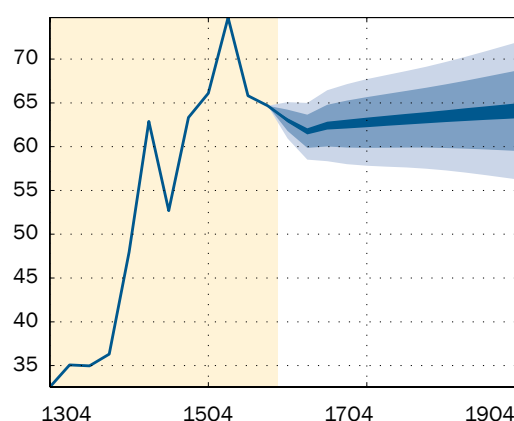
Rouble to strengthen in short term

The projected gradual growth of oil prices and the closure of the existing real effective exchange rate gap will favour rouble strengthen the short run and thus constrain inflation. Yet weak investment activity and the persistent risks of greater capital outflow may prompt a reversal in the exchange rate dynamics. Exchange rate movement risks resulting from oil price reversal due to growing shale oil production in the US also remain significant.

GDP in comparable prices
(growth in percent, y/y)³



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

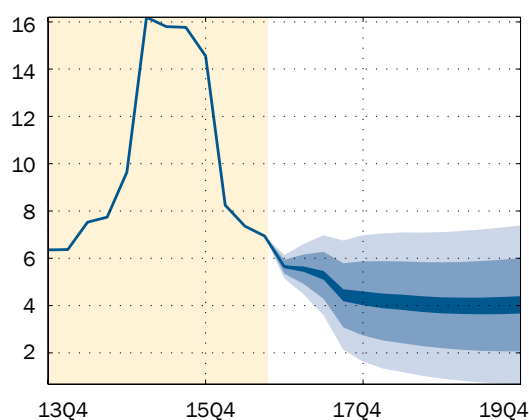


Source: Estimates by the authors, EEC

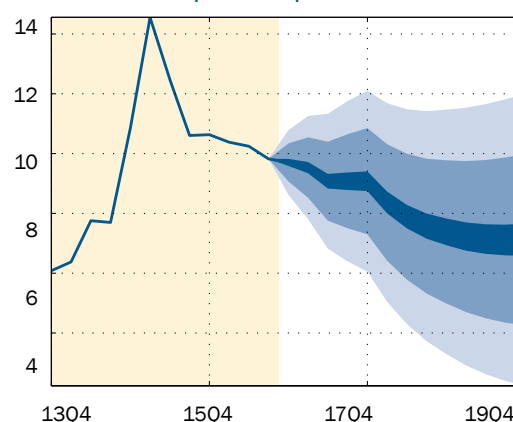
Inflationary processes to develop subject to goals set by Central Bank

The formation of a steady trend towards lower inflation expectations, supported by a moderately tight monetary policy, and the projected strengthening of the rouble and moderate domestic demand will cause inflation to decrease further, to 4.1% in 2017 and 4% in 2018–2019. As inflationary dynamics slows down, the Bank of Russia will resume key rate reductions. We project the next monetary policy loosening steps to be undertaken in 1Q 2017.

CPI, growth in percent as of year-end



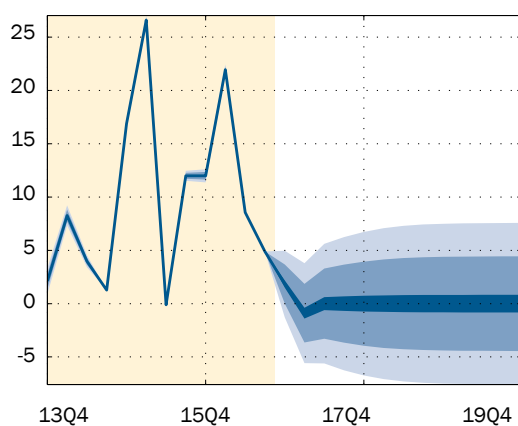
MIACR (Moscow Interbank Actual Credit Rate),
in percent per annum



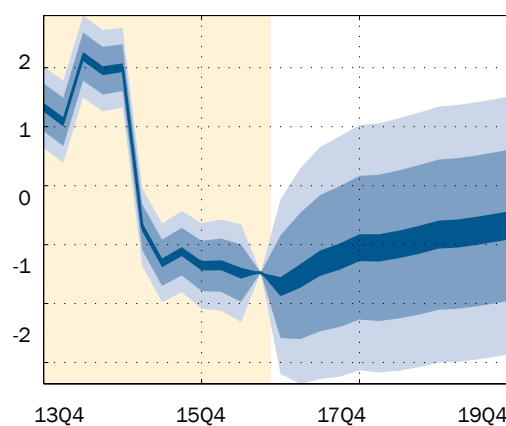
Source: Estimates by the authors, EEC

³ Here and below the ranges of the fan charts correspond to 10%, 50% and 75% confidence intervals.

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

SUMMARY

Forecast for the Major Macroeconomic Indicators of the Russian Federation

	2016	2017	2018	2019
CPI (growth in percent as of year-end)	5.4	4.1	4.0	4.0
GDP in comparable prices (growth in percent, y/y)	-0.6	0.8	1.4	1.4
MIACR (in percent per annum)	10.6	9.6	8.1	7.4
Exchange rate of the national currency against the U.S. dollar (final average for the year)	67.1	62.4	63.2	63.9

Source: Estimates by the authors, EEC

REPUBLIC OF ARMENIA



TRENDS

GDP

GDP growth rates negative over 3rd quarter

Over January to September, Armenia ceded its first half-year's leadership in terms of GDP growth rate among the EDB countries. This was due to a GDP fall in the 3rd quarter by 2.6% year-over-year. The negative movement is due to a considerable fall of gross agricultural output (as the sector was saturated after the big harvest of 2015) and a persistent negative growth rate in construction. The economic activity indicator that was decreasing in July to October to record-low levels of the last six years (7.8% in October 2016 vs. October 2015), returned into positive territory in November, holding out a hope for partial recovery of economic growth by the end of 2016.

Key factors of economic activity in Armenia in 3Q 2016 included:

Export remains Armenia's main growth factor in 2016

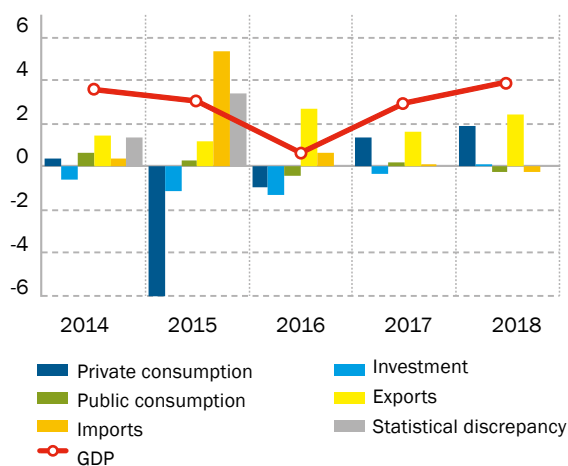
- *on the expenditure side:* exports remained the main driver of economic growth in Armenia. Exports grew by 23.9% in the 3rd quarter vs. 3Q 2015. Over January to September 2016, total exports increased by 19.6% year-over-year while imports declined by 0.8% in the same period. The increasing value of exports to EAEU countries accounts for most of the export growth;

Sharp fall of agricultural output holds back economic activity recovery in Armenia

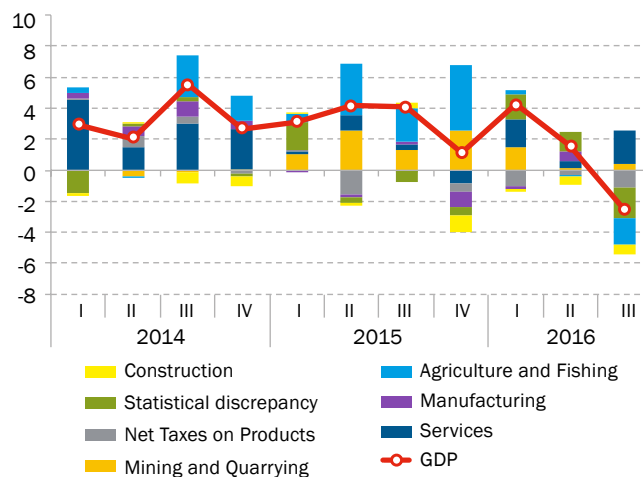
- *on the value added side:* both manufacturing and mining industries contributed economic growth in 3Q 2016 (growth by 4.3% and 12.1%, respectively, vs. 3Q 2015). Construction and agriculture continue showing negative dynamics, with their fall accelerating to 8.5% and 6%, respectively. A slowdown in the retail turnover from 7% y/o/y in July 2016 to 1.1% y/o/y in October) indicates gradual recovery of consumer activity in Armenia.

The output gap remains in negative territory, at -5.5% in 3Q 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)



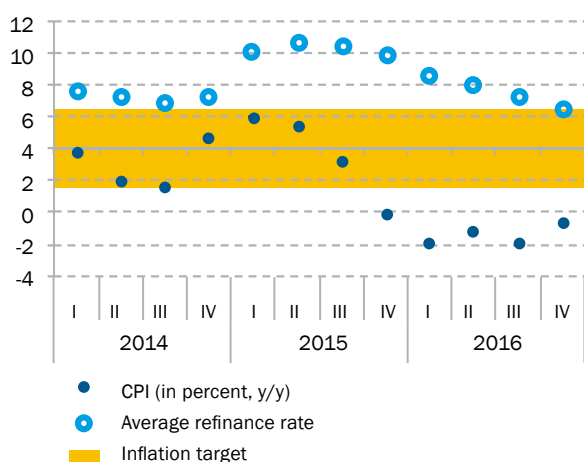
Source: The national statistical agency, EEC, estimates by the authors

Inflation

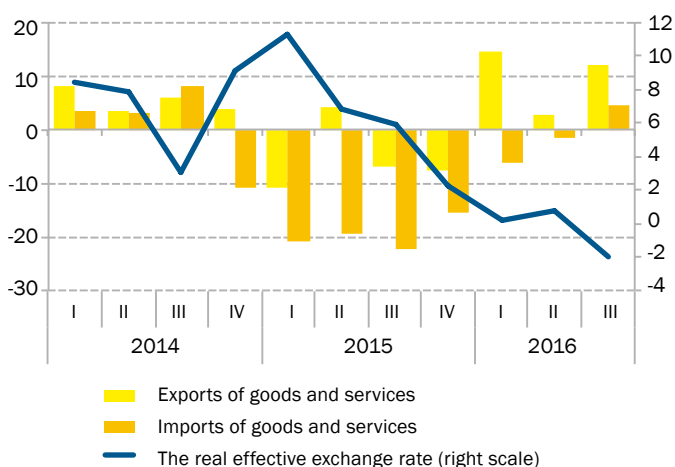
Deviation from inflation target continues decreasing

Expansionary monetary policy pursued since early 2016, and the decrease in external deflationary pressure contributed to a further attenuation in deflation in the Armenian economy in September to December 2016. Annual deflation was 1.1% in December, thus leaving below the Central Bank's target figure level of 4% for 2016.

CPI and the refinancing 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

Exchange Rate

AMD to RUR exchange rate movement makes Armenian goods more competitive abroad

Since the beginning of the current year, the real effective exchange rate of the dram has weakened by 5%, while the nominal rate remained the same compared to the beginning of the year (according to October 2016 data). The Armenian national currency strengthened by 1.5% vs. the U.S. Dollar (November 2016 vs. December 2015) while depreciating by 19.1% vs. the Russian rouble (November 2016 vs. December 2015).

Over 3Q2016, the real effective AMD exchange rate was slightly overvalued (by 1.6%) against its equilibrium level, while the real AMD to USD exchange rate was by 0.3% undervalued.

Decrease in current account deficit supports growth in international reserves

With the physical export volumes growing considerably and the terms of trade improving, the deficit of the current account decreased to USD 110m (1.5% of GDP) in January to September 2016 from USD 185m (2.5% of GDP) in the same period of 2015.

The positive dynamics of the international reserve assets observed since May 2016 continued in August to November. In May to November, the reserve assets grew by USD 668m to increase the reserves level to USD 2.2 billion as of early December 2016, which was due to the central bank's purchases of foreign currency.

Decrease of remittances from Russia slowing down

Remittances from Russia continue to show a deceleration in the decline to 12.7% in January to November 2016 year-over-year (in 2015 they fell by 35.1%, and in the first half year of 2016, by 14.8%). The effect of the decreasing remittances on domestic demand is partly offset by expansionary fiscal policy. The remittances from Russia are expected to gradually shift into growth as economic activity recovers in Russia.

Fiscal policy

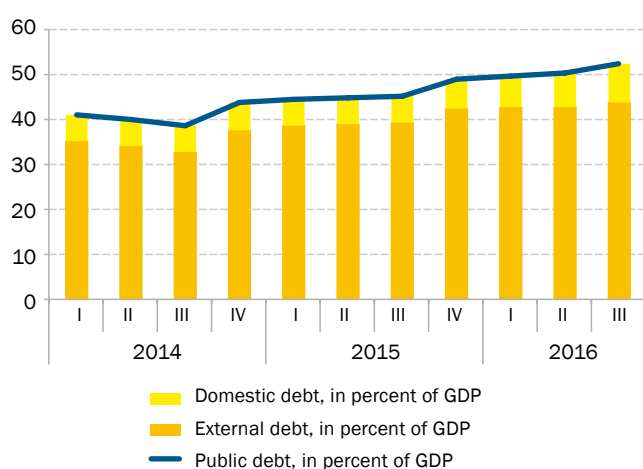
Budget deficit increases over January to September 2016 amid income reduction and growth of social expenses and subsidies

In January to September 2016, the state budget posted a deficit of AMD 93.6 billion, 40% more than in the same period of 2015. The budget's revenue decreased by a total of 0.8% due to smaller revenues from value added tax (an 11.6% decrease in January to September 2016 vs. the same period of 2015) and a decrease of non-tax revenues by 17.8%. The expansion of the budget deficit was partly offset by increases in income tax revenues (by 5.4%) and profit tax (by 28.6%). The budget's total expenses in January to September 2016 increased by 2.2% vs. the same period of 2015 due to higher interest payments on state debt, higher social benefits and pensions, and a considerable growth of subsidies. Deficit growth was contained by reduced capital expenses (-34.6%) and expenses on goods and service purchases (-35.4%). Over 2016, state budget deficit is expected to exceed the 4.1% of GDP level previously planned.

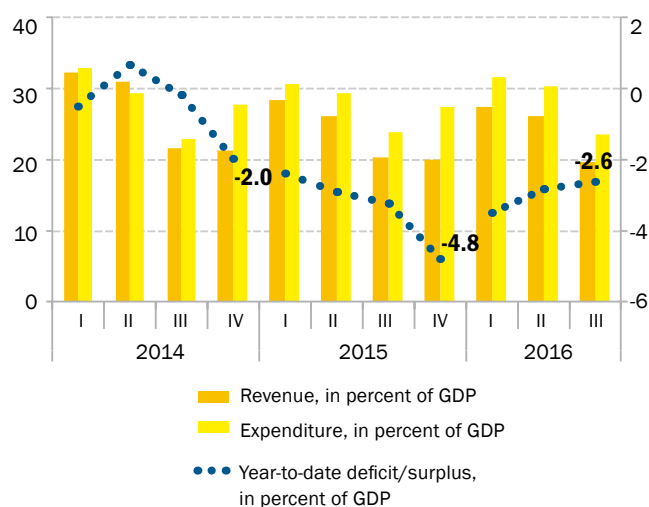
Public debt grows to 52.9% of GDP as of late November 2016

The Armenian public debt continued its upward movement in September to November 2016 to reach USD 5596.3 m as of late November. This increases the debt level to 52.9% of GDP (from 48.2% of GDP at the end of 2015 and 51.9% of GDP in late August 2016). The increase of public debt continued due to both foreign and domestic debt growth. The main sources of the growth were state bonds denominated in national and foreign currency.

Public debt



State budget implementation



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

Monetary policy

Interest rates declining further in order to reduce deflationary overhang

In order to boost economic activity and alleviate deflationary pressure, the Central Bank opted to reduce its key rate again, by 0.25 pp to 6.25% since 27 December. Since May 2016, the Central Bank reduced the rate six times, from the level of 8.75% to 6.25%. In the absence of additional internal and external shocks, the Central Bank may continue its policy of softening monetary conditions.

The degree of dollarization remains high

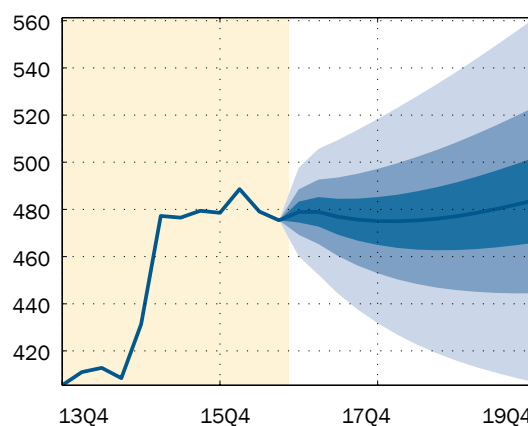
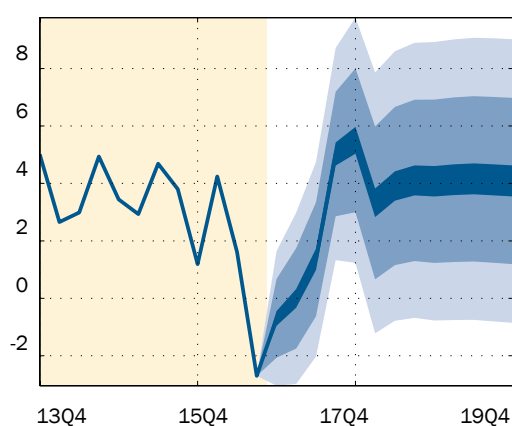
Another important development is the trend towards lower dollarization of the economy. If calculated as the share of residents' deposits in foreign currency in the total volume of deposits, the dollarization level was 60.1% at the end of November 2016 (65% at the end of November 2015).

FORECAST

Gradual recovery of economic growth to 4.1% in 2019

Gradual recovery of domestic demand, as a result of the expansionary monetary and fiscal policy pursued in 2015–2016, as well as the measures taken by the Government to stimulate exports and investment, will help accelerate economic growth in Armenia in 2017–2019. The economic growth rate will increase to 2.9% in 2017 and 3.9% in 2018, as domestic demand recovers and economic stimulus programmes are implemented. In 2016, GDP growth is expected to be 0.6%, which is lower than our previous forecast for 2016 mainly due to the fall of gross agricultural output that was deeper than expected.

GDP in comparable prices (growth in percent, y/y) Nominal exchange rate, Armenian drams per U.S. dollar

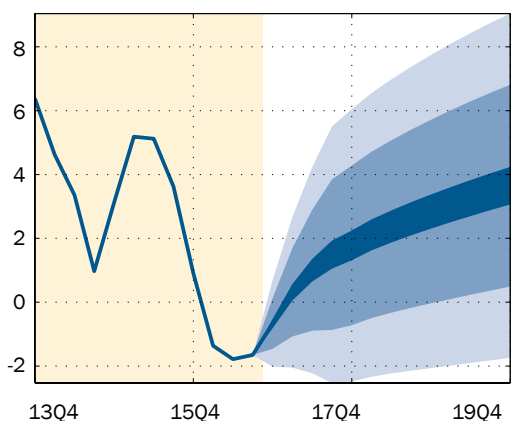


Source: Estimates by the authors, EEC

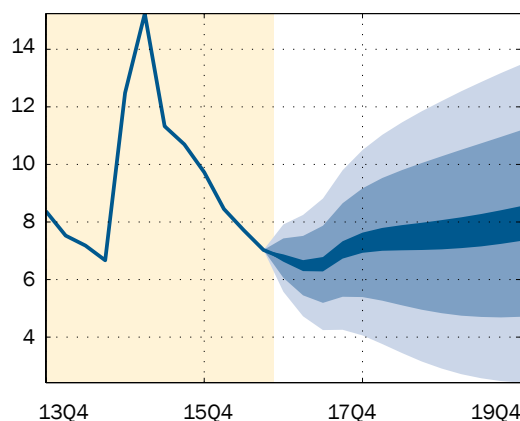
4% inflation target to be attained by 2019 if there are no more shocks

Increased domestic demand and higher prices of imported commodities and other goods will cause the inflationary dynamics to pick up further in 2017–2018. The restoration of the price level in 2017 will be constrained by the planned reduction of the gas and electricity tariffs, the inflation expectations that the Central Bank estimates to be low, and the fiscal policy planned to be restrictive. In the absence of new shocks, price growth is expected to be 1.8% and 2.8% in 2017-2018, respectively.

CPI (growth in percent as of year-end)

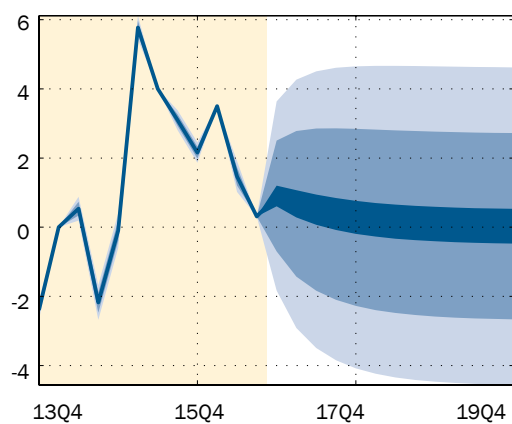


Interbank REPO rate (in percent per annum)

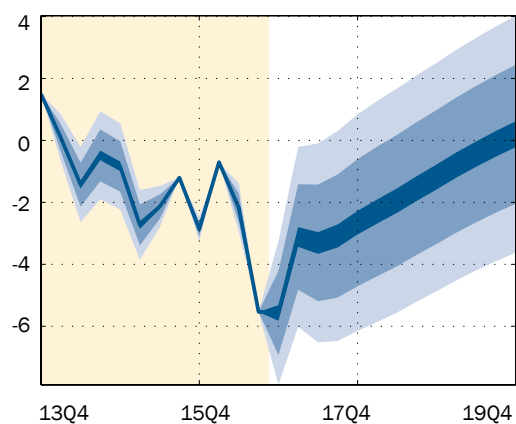


Source: Estimates by the authors, EEC

The dram'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 Armenia

	2016	2017	2018	2019
CPI (growth in percent as of year-end)	-1.1	1.8	2.8	3.7
GDP in comparable prices (growth in percent, y/y)	0.6	2.9	3.9	4.1
Interbank repo rate (in percent per annum)	7.8	7.1	7.8	8.1
Exchange rate of the national currency against the U.S. dollar (final average for the year)	480	477	476	481

Source: Estimates by the authors, EEC

REPUBLIC OF BELARUS



TRENDS

GDP

GDP decline rate still at 2.7% in January to November 2016

The Belarusian economy continues showing negative growth rates. According to preliminary data from the National Statistical Committee (Belstat), Belarusian GDP decreased by 2.7% in January to November 2016 year-over-year. Output was still declining amid weak domestic and external demand and a conservative monetary and fiscal policy.

Businesses adapting to protracted income fall situation

Key factors behind the low economic activity in Belarus included:

- *on the expenditure side:* the household real disposable income kept decreasing. In January to October, it fell by 7.3% as compared to the same period in 2015. Against this backdrop, there was a more significant fall in household consumption expenditure. Thus, in 3Q 2016 household consumption expenditure decreased by 6.1% year-over-year (down 2.1% a quarter before, and down 2.4% in 2015). Given the deposit growth noted in the 3Q-4Q 2016, we can suppose that the population has switched to a saving behaviour pattern instead of trying to keep spending as usual.

High debt burden on companies and their solvency that still remains low with the current price of credit resources, amid growing financial status deterioration risks, remain the main factors behind the investment decline. In 3Q 2016, gross fixed capital formation dropped by 20.9% as compared to the same period in 2015;

Industrial output recovers despite oil refining decline

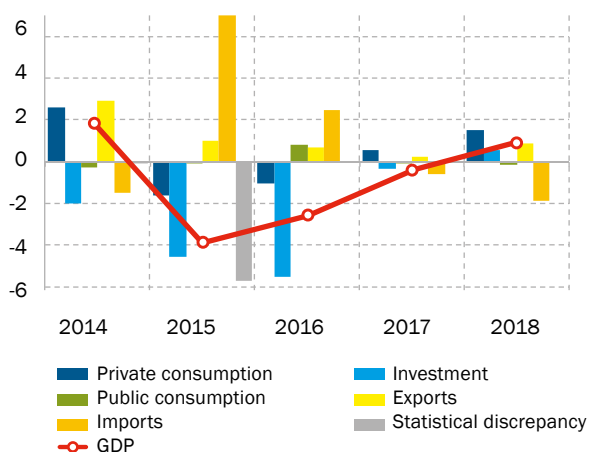
- *on the value added side:* decreasing oil refining volumes will remain a deterrent factor to industrial output recovery until the end of 2016. Nevertheless, after a fall in the Q3, industrial output dynamics returned into positive territory, showing the last two years' maximum growth rate of 5.1% vs. November 2015. Notable among the main growth factors are positive dynamics of potash fertiliser output, resulting from new contracts, and some growth in the machine building industry, largely due to the preceding year's low comparative benchmark. In January to November 2016, industrial output fall decreased to 0.9% year-over-year (from a 1.8% fall in January to August 2016).

The dynamics stays negative in construction and trade, that saw a minus 16.2% and minus 7.2% fall, respectively, in January-November 2016.

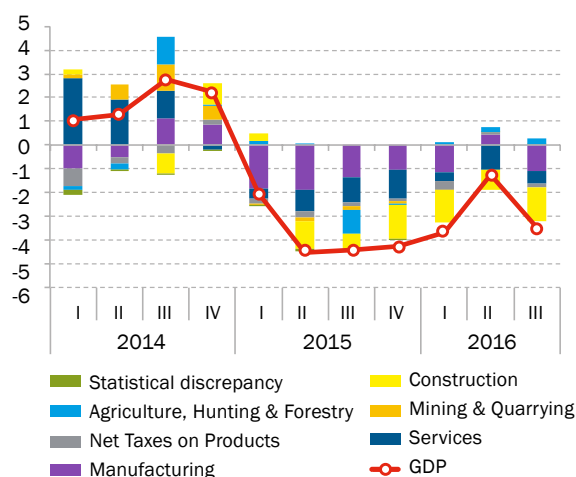
Growth in agriculture in September and November showed recovery dynamics, 3,4% in January to November 2016 as compared to the same period in 2015, after a 2,2% fall in January to August 2016.

The output gap, a measure of the difference between economic activity and the potential GDP level, remains in negative territory, at -3.9% in 3Q 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

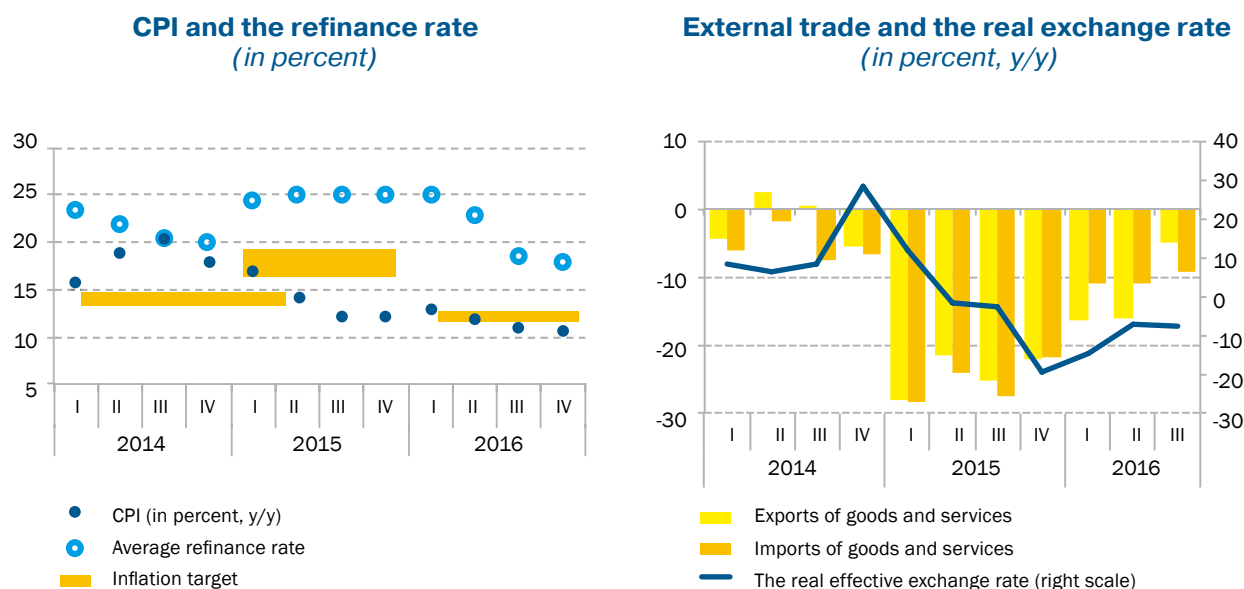
Dynamics in leading indicators testifies to worsening economic outlook in short term

The leading indicators calculated by the EEC point to deterioration in economic conditions in the Republic of Belarus in early 2017. A worsening of conditions (as compared to the same period in 2015) is reflected in the components of the Consolidated Leading Indicator (CLI) such as the share of overdue debt in clients' and banks' debts on loans and other transactions in national currency and the incomes from entrepreneurial and other activities.

Inflation

Inflationary dynamics within National Bank's targets for 2016

In December 2016, inflation was 10.6% year-over-year while the National Bank's inflation target was 12% for the whole 2016. The main stabilizing factors for inflationary dynamics were a slowdown in consumer activity and relative stability of the national currency amid a restrictive monetary and fiscal policy. The recovery of the population's demand for credit resources with the real interest rates as high as they are now, may indicate persistently high inflation expectations.



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

Exchange Rate

Forex market remains stable

The situation in the foreign exchange market of Belarus remained stable in September to November 2016. The absence of external shocks and the surplus of foreign currency supply over demand by the population promoted the stabilization of the exchange rate of the Belarusian ruble. According to estimates by the National Bank, the real effective exchange rate of the Belarusian ruble slightly strengthened in September to November 2016, returning to its level of the beginning of the year. Both inflation slowdown and the strengthening of the nominal effective Belarusian ruble exchange rate contributed to the strengthening of its real exchange rate, while real exchange rate vs. the U.S. Dollar remains undervalued by the 2.2%.

Improved price competitiveness and Russian demand for exports help improve trade balance

The current account showed a small surplus of USD 223.4m in 3Q 2016, and the goods and services balance grew to the last few years' record figure of USD 576.4m. The improvement of the current account was driven by resumed supplies of potash fertilisers, general improvement of the export prices, increase of exports to non-CIS countries, and improvement of the trade balance excluding energy and potash, which resulted from the growth of physical volumes of both investment and consumer goods, mainly to Russia. Overall, from January to September 2016, the current account deficit was USD 1.36 billion, or 3.9% of GDP (in January to September a deficit of USD 0.96 billion, or 2.3% of GDP, was observed).

Growth of international reserves during 2016

Despite the Belarussian National Bank's and Government's considerable foreign currency debt service obligations, the National Bank manages to gradually increase its international reserves. At the end of 2016, the international reserve assets amounted to USD 4927.2m, after increasing by USD 440.8m and 172.2m in 3Q 2016 and 4Q 2016, respectively; and the total growth since the beginning of the year was USD 751.3m. The increase of the reserves in 3Q 2016 was mainly driven by greater foreign currency supply from the population and revenues from the sale of bonds.

Fiscal policy

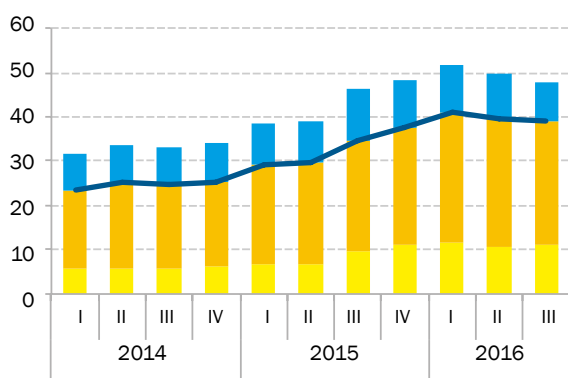
Budget remains in surplus in January to November 2016

The Belarussian authorities continue maintaining a surplus balance of the Republic's budget (in January to October 2016 the surplus was 1.4 billion roubles, or 1.6% of GDP). Among the pressures on the State budget in the second half of 2016 decreased revenues from customs duties for exported oil products due to smaller output (reduced supplies of crude oil from Russia) played a notable role. The maintenance of the surplus is supported by a set of measures implemented by the Government to reduce the budget's expenditures.

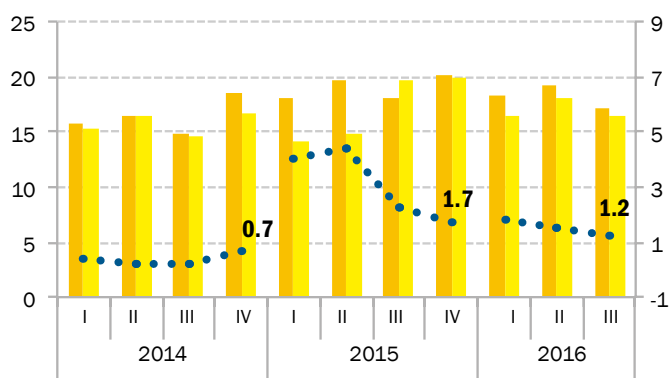
Public debt growth in 2nd half of 2016

As of 1 December 2016, sovereign foreign debt was USD 13.5 billion, up from USD 13.3 billion as of 1 August (including exchange rate fluctuations). The main source of foreign debt growth in the period under scrutiny were loans received from the government and banks of the Russian Federation and from China's banks. Domestic public debt increased by 7.4% between 1 August and 1 December 2016. Its main growth factor was the placement of State foreign currency bonds. On the whole as of 1 December, public debt (the central Government debt and that guaranteed by the central Government) amounted to 48% of GDP.

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

Conditions for meeting inflation target still exist

The slowdown in inflation and the need for financial stability led the National Bank to keep its key rate at 18% in 4Q 2016. Amid a structural surplus of liquidity in the banking sector and weak demand for credit resources, the average interest rate of the overnight inter-bank market in national currency decreased from 14.3% in September to 11% in November 2016. In addition, the nominal rates of the loan and deposit market were also declining. The average interest rates on new bank time deposits of individuals in national currency decreased from 16.1% in 3Q 2016 to 14.5% in October–November. The average interest rates on new bank loans to individuals were 24.4% and 20.8% in the Q2 and Q3, respectively, and 18.8% in October and November. The decrease of the loan interest rates promoted lending in national currency.

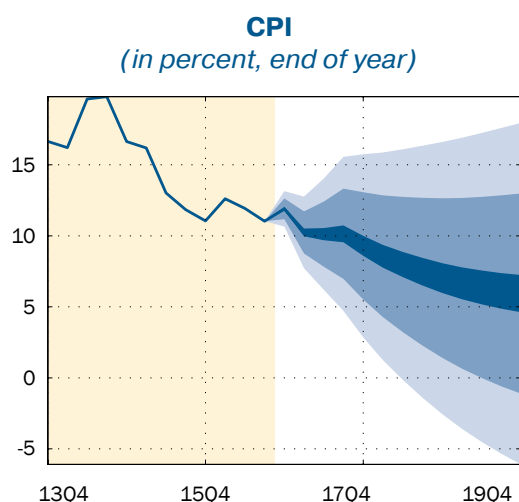
Dollarization of economy decreasing

The maintenance of a positive difference between return on deposits in national and foreign currency as the population gradually regains confidence in the Belarusian ruble is conducive to the de-dollarization of the economy. Thus, in early December 2016, the dollarization level was 70.3% (as regards deposits of individuals and legal entities), 4.2 percentage points down since early 2016.

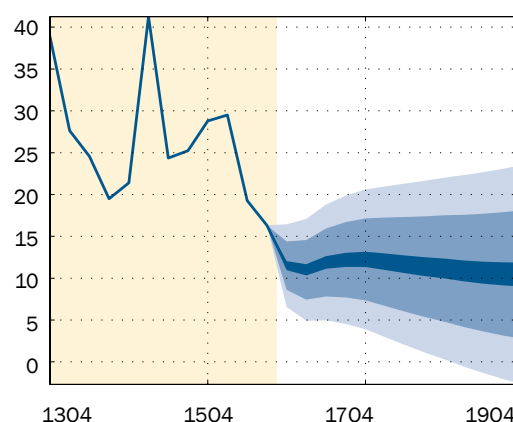
Forecast

Inflation to stay within national bank target for 2016 and decline in 2017–2019

The utility tariffs that are to be raised further and the high and persistent inflation expectations will be the main sources of inflation pressure in early 2017. However, as the year 2016 showed, a balanced monetary policy and the absence of external shocks can mitigate such inflation surges and keep the inflation dynamics within the National Bank's target. In 2017, inflation is projected to be 9.3% (December vs. previous December) and then decrease to 7.0% in 2018 and to 6.0% in 2019. The further stabilization of the Russian ruble exchange rate, as the oil prices progressively recover as projected, will have a continued positive effect on the Belarusian ruble's dynamics. Its nominal exchange rate to USD is expected to strengthen somewhat in the short run, which will facilitate the closure of the existing positive real exchange rate gap. In the medium term, the Belarusian ruble is expected to gradually weaken amid the general weakening of the currencies of developing economies.



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



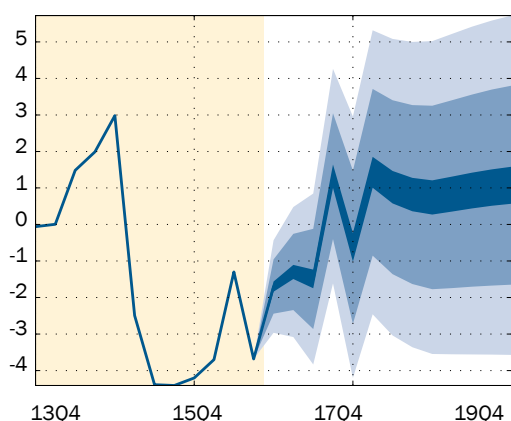
Source: Estimates by the authors, EEC

Economic growth to resume with domestic demand recovery in absence of external shocks

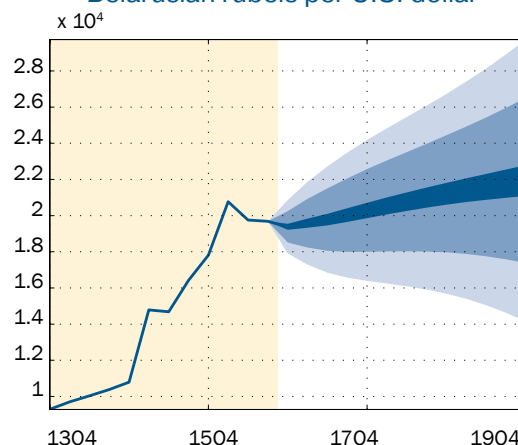
The monetary and fiscal policies, that remain restrictive, will be an important growth recovery constraint in the medium term. External constraints include the lack of agreement with Russia on crude oil supplies for 2017. These will combine to keep the economic growth rate negative in 2017, at (-0.5%) level. Going forward, as a looser monetary policy allows domestic demand to recover, the GDP growth rate will increase to 1% in 2018. In 2016, GDP fall is expected to reach 2.6%. In the current economic conditions, economic growth recovery in the medium term will be limited to a potential level of 1–1.2% due to structural limitations existing in the economy.

As inflation slows further, the monetary authorities are expected to take measures in the field of interest rate policy to ensure a reduction in nominal rates on loans and deposits in the banking sector to stimulate economic activity.

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

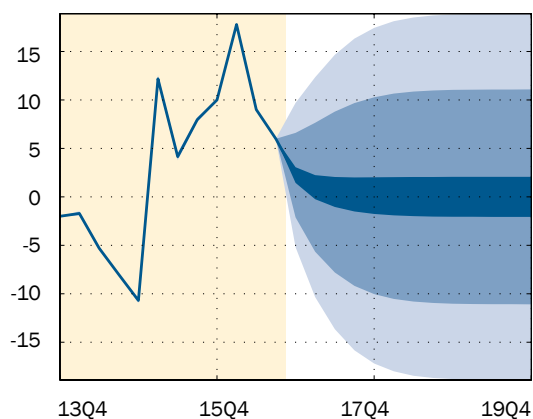


Nominal exchange rate,
Belarusian rubels per U.S. dollar

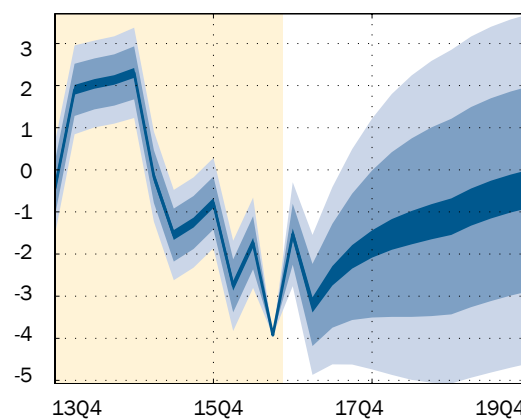


Source: Estimates by the authors, EEC

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

	2016	2017	2018	2019
CPI (growth in percent, end of year)	10.6	9.3	7.0	6.1
GDP in comparable prices (growth in percent, y/y)	-2.6	-0.5	1.0	1.0
Interest rate on overnight interbank loans (in percent per annum)	19.2	11.8	11.5	10.6
Exchange rate⁴, Belarusian rubels per U.S. dollar (final average for the year)	1.989	1.992	2.087	2.167

Source: Estimates by the authors, EEC

⁴ The exchange rate of the new (post-redenomination) rubel.

REPUBLIC OF KAZAKHSTAN



TRENDS

GDP

Accelerating GDP growth in 3Q 2016

In 3Q 2016, the economy of Kazakhstan was still driven by the fiscal impulse and infrastructure development programmes that not only mitigated the short-term volatility surges in the external markets but also strengthened domestic business activity. According to the tentative results of 3Q 2016, GDP grew by 1.0% y-o-y (0.3% in 2Q 2016).

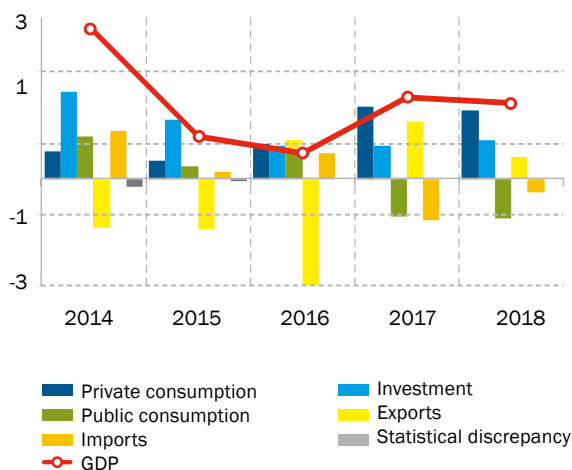
Key factors affecting the economic activity in Kazakhstan included:

Negative contribution of industrial sector over-compensated by positive dynamics in other sectors

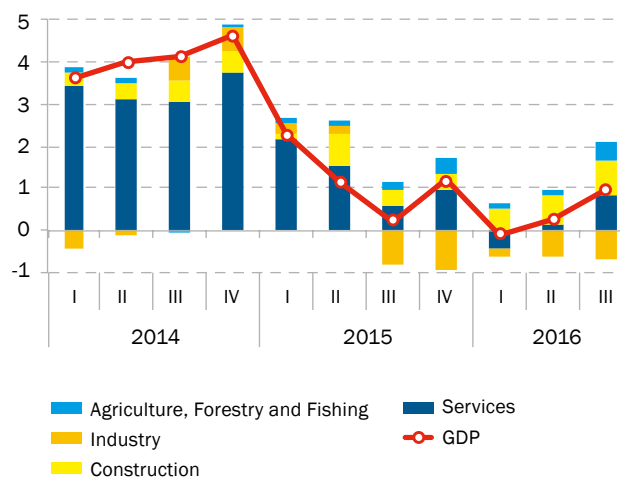
- *on the value added side:* output decrease in the industrial sector (-3.5% as compared to 3Q 2015) has been observed for five consecutive quarters, being largely caused by decreasing mining output. Stronger positive dynamics in the service sector (1.6% y-o-y) and high and stable growth in the construction sector (7.4% y-o-y) not only offset the negative contribution of the industrial sector but also helped strengthen the upward dynamics of economic growth. The economy got an additional impetus in its agricultural sector, where annual growth rates accelerated from 2.2% in 2Q 2016 to 9.4% in 3Q 2016;
- *on the income side:* according to a tentative estimate of the indicators adjusted for the consumer price index, in 3Q 2016 the downward trend in labour income continued (-5.8% vs. 3Q 2015), while net profit and taxes on production contributed positively to GDP;
- *on the expenditure side:* 3Q 2016 saw recovery of external demand (2.4% y-o-y), continued limited growth of domestic consumption (1.1% y-o-y) and expansion of investment demand (4.1% y-o-y).

The output gap in 3Q 2016 was in negative territory and was estimated at -1.7%.

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 agencies, EEC, estimates by the authors

Leading indicators point to continued growth of economic activity

Accelerated growth of the short-term economic indicator in October and November 2016 (partly caused by the Kashagan oil and gas deposit being launched into operation) and the stable dynamics of the business confidence index signal that the business activity will continue to improve into 4Q 2016. The continued upward trend of economic growth in the short run is also reflected in the leading indicators calculated by the EEC. This is driven by growing employment in the industrial sector, a favourable price environment in the world oil market, stabilization of the situation in Russia, and by businesses' improving expectations.

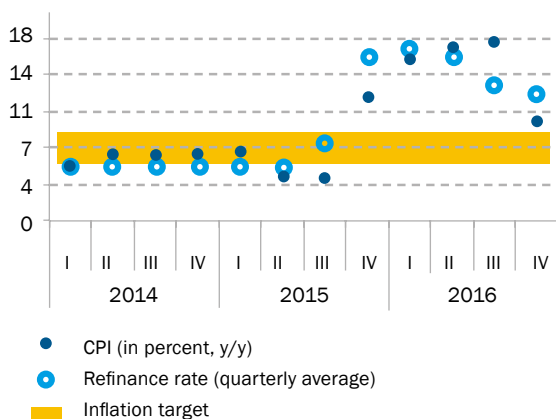
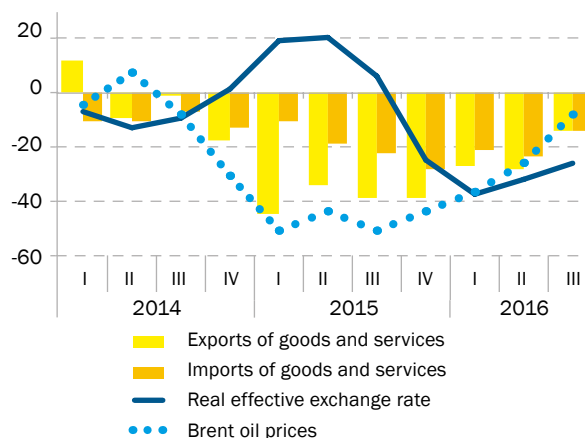
Inflation

Annualized inflation peaks in 3Q2016

Annualized inflation reached its peak of 17.3% in 3Q 2016. Short-term exchange rate shocks that occurred in July and August 2016 did not affect the continued reversal of the consumer price index dynamics. The slowdown in 12-month inflation was noted in all the sectors: over September 2016, annual price growth slowed down by 1.2 pp as compared to July 2016 – in respect of both foodstuffs and non-food items, and by 0.9 pp in the service sector.

Inflation approaching the upper threshold of target

In October to December 2016, the decrease of the annualized consumer price index became more pronounced and was rapidly approaching the upper threshold of the 6–8% target corridor. In November 2016, for the first time over 12 months, all the sectors of consumer inflation left the double-digit area. The general price level growth in December was 8.5% y-o-y.

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

Source: The national agencies, EEC, estimates by the authors

Exchange rate

Short-term shocks fail to translate into exchange rate movement

Despite increased volatility in the domestic foreign exchange market in July and August 2016, the real index of the Kazakhstan tenge in 3Q 2016 remained virtually the same as in 2Q 2016. In nominal terms, the effective tenge exchange rate depreciated by 1.1% as compared to 2Q 2016. On a year-on-year basis, the weakening of the real effective tenge exchange rate slowed down to 25.6% (vs. 3Q 2015). The formation of currency demand and supply was still being affected by the continued decrease of the current account deficit. The high and stable inflow of foreign direct investment (a 4.5 fold growth as compared to 3Q 2015) over-compensated the increased capital outflow resulting from funds placement into foreign short-term debt instruments.

In early 4Q 2016 exchange rate dynamics was determined by fundamental factors

In the autumn months of 2016, the KZT to USD exchange rate was being driven primarily by fundamental factors exclusively. On the one hand, no significant shocks occurred in the domestic foreign exchange market, and, on the other hand, starting from September 2016 the National Bank of Kazakhstan was no longer present in the domestic forex market.

Fiscal policy

The state budget posts a deficit in nine months of 2016

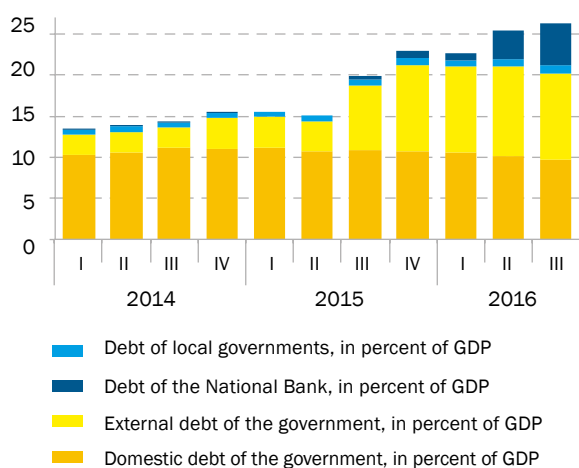
According to preliminary data for nine months of 2016, the State budget posted a deficit of 1.1% of GDP (over nine months of 2015, the deficit had been 2.5% of GDP). The recovery of business activity was reflected in the structure of the budget's income side, where tax revenues grew by 34.3% as compared to 9m2015), while transfers from the reserve funds decreased by 4.6% y-o-y. The annual growth of outlays over nine months of 2016 was 12.9% (4.0% in the same period of 2015).

Expenditures increased due to growth of current expenses and a near doubling of allocations channelled into the economy as part of anti-crisis measures and development programmes. The amount of interest payments on earlier loans grew as well.

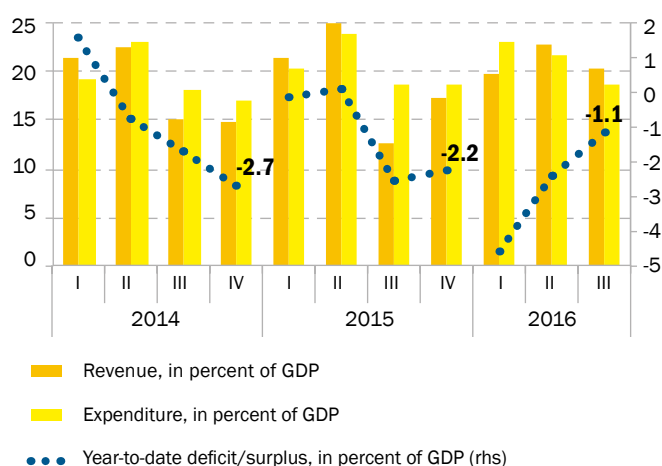
Moderate debt in public sector

Public debt grew by 26.6% over nine months of 2016 (as compared to the beginning of the year) to total USD 33.6 billion (25.5% of GDP) as of 1 October 2016. Public debt grew mainly on account of foreign loans and due to the growth of the National Bank's domestic debt whose share began increasing rapidly in the last two quarters.

Public debt



State budget implementation



Source: The national agencies, EEC, estimates by the authors

Monetary policy

In October and November 2016, the National Bank continued reducing its key rate

Although inflation in October and November 2016 was approaching the target's upper threshold rather quickly, in the autumn months of 2016 the National Bank of Kazakhstan used the tactics of careful monetary regulation, reducing the base rate only by 50 basis points at a time, while in the spring and summer months it has done so in 200 bp reductions. In its statement, the regulator signals that the inflation risks still exist in the medium term, which limits the prospect of quick interest rate reductions in the future.

In August to November 2016, money market rates continued moving near the lower boundary of the base rate corridor, thus pointing to excess liquidity conditions and leading the National Bank to increase the volume of notes in circulation.

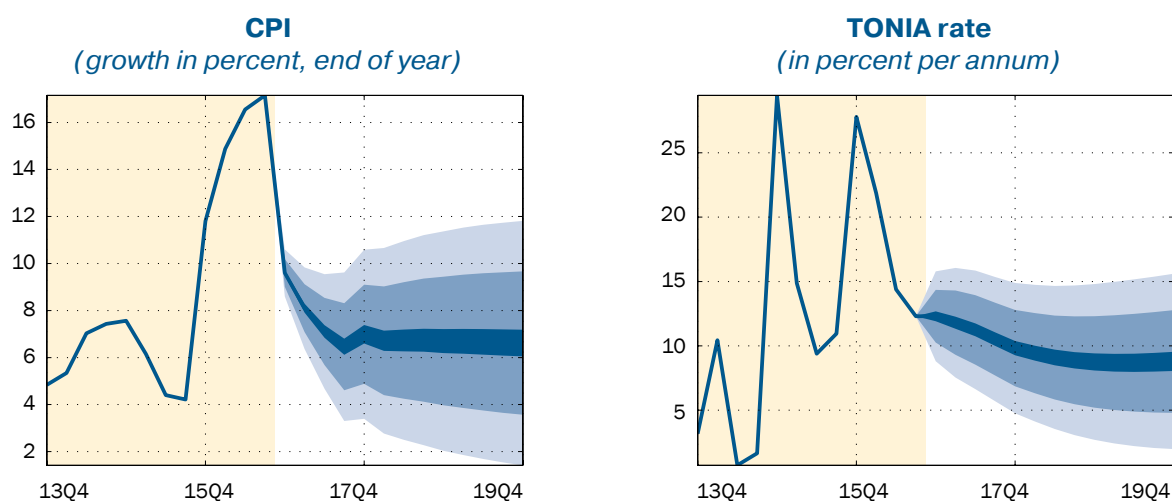
FORECAST

Inflation to come into target corridor

The moderately tight monetary policy will cause inflation to approach the upper threshold of the 6.0–8.0% target corridor over 2016, and in 2017–2018 the consumer price index will move within the target range. This will also be driven by limited growth in domestic consumer demand and by relatively low food prices in the world markets. Kazakhstan's exchange rate dynamics is not expected to become a source of inflation pressure.

Tight monetary policy in 2016

Notwithstanding the favourable inflation outlook, the risks of external shocks (intensified capital outflow from developing markets, or price fluctuations in world energy markets) remain significant, which necessitates the maintenance of a moderately tight monetary environment in the short term with the base rate to be steadily reduced as the external risks moderate and the transmission channels strengthen.



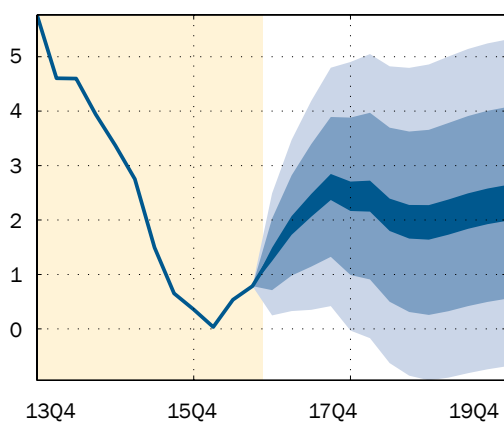
Source: Estimates by the authors, EEC

Government investment policy to support growth in the medium term

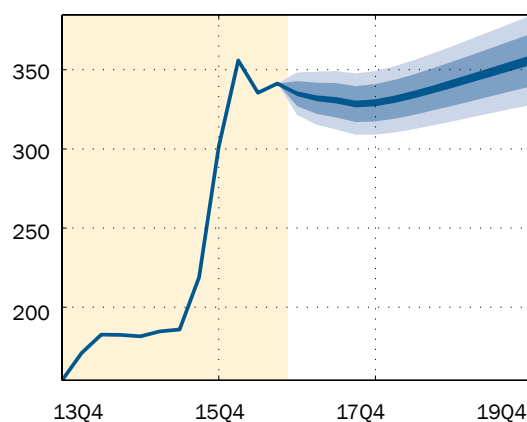
The implementation of Kazakhstan Government's and National Bank's package of anti-crisis measures, stabilization of the external background and launch of the Caspian shelf oil and gas deposit all contributed to quicker revival of the economy and its accelerated growth in the second half of 2016. Growth is expected to be 0.7% in 2016.

In the medium term, the Government's investment policy, accompanied by reforms aimed at planned transformation of the economy, will be the basis of economic growth. The budgetary innovation policy is based on the 'overlap' principle, with some programmes ("Business Roadmap 2020", "Agribusiness-2020") launched while others ("Astana EXPO -2017", "Universiade-2017") are still at their final stage. On the other hand, the probable fluctuation of oil prices around the USD 50–55 per barrel corridor for an extended period will limit the fiscal policy's ability to stimulate domestic demand. Under these circumstances, budget consolidation is to strengthen in the medium term, and GDP is forecast to grow annually by 2.1–2.3% in 2017–2018.

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

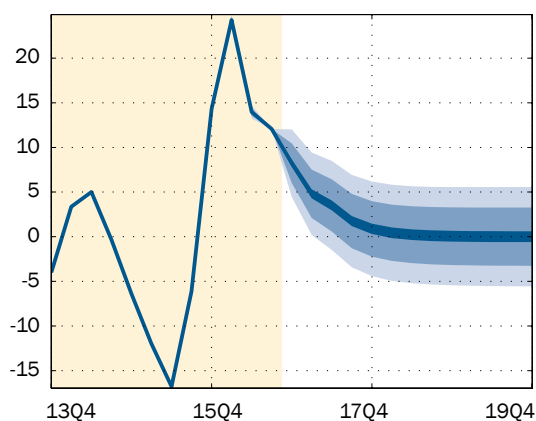


Nominal exchange rate,
Kazakh tenge per U.S. dollar

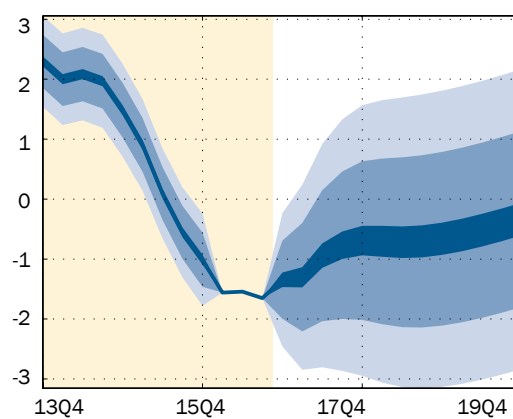


Source: Estimates by the authors, EEC

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

	2016	2017	2018	2019
CPI (growth in percent, end of year)	8.5	7.0	6.7	6.6
GDP in comparable prices (growth in percent, y/y)	0.7	2.3	2.1	2.2
TONIA rate (in percent per annum)	15.2	10.8	9.0	8.7
Exchange rate of the national currency against the U.S. dollar (average for the year)	342	330	336	351

Source: Estimates by the authors, EEC

KYRGYZ REPUBLIC



TRENDS

GDP

Growth accelerates in 3Q 2016

Structural imbalances in the Kyrgyz economy continue to result in an uneven annual pattern of business activities. In 3Q 2016, GDP growth accelerated to 8.3% y-o-y (in 2Q 2016 zero growth had been observed). The 3Q 2016 indicators overcompensated the negative dynamics of the first half of 2016 year, thus over nine months of 2016 GDP grew by 2.0% year-over-year.

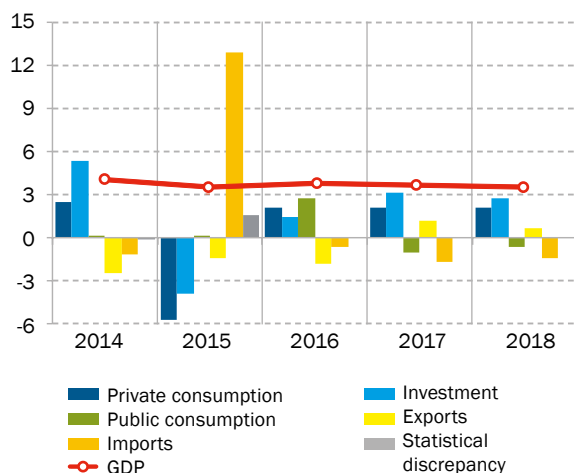
Gold production recovers; retail trade performs well

Key factors impacting economic activity in Kyrgyzstan included:

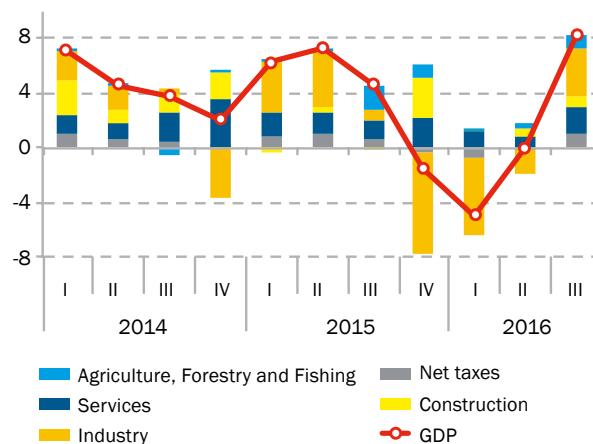
- *on the value added side:* in 3Q 2016 all economic sectors in aggregate went positive, with the greatest contribution from the industrial sector (3.5 pp), which was due to a 1.6 fold growth of gold production (as compared to 3Q 2015). High retail trade performance provided growth in the service sector (4.4% y-o-y). Economic growth was also supported by increased volumes in the construction industry (13.1% y-o-y) and agriculture (3.5% y-o-y);
- *on the income side:* despite a low inflation background, the net remittance inflow growth rate that halved in 2Q 2016 resulted in a deceleration of real incomes growth to 4.1% annualized (in 1Q2016, 6.3% y-o-y);
- *on the expenditure side:* in 2Q 2016 domestic consumer demand has strengthened (5.1% y-o-y), investment demand recovered (0.9% y-o-y) and external demand continued its decline (-6.1% y-o-y).

In 3Q 2016, the output gap went positive and reached +0.8%.

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 agencies, EEC, estimates by the authors

Leading indicators signal a slowdown in growth

The 11 months' GDP growth was 3.2% year-over-year, but the market indicators signal that such a rapid growth is short-lived and will probably slow down in the near future. The findings of the survey of industrial enterprises' business activities over 3Q 2016 conducted by the National Statistics Committee of the Kyrgyz Republic show some worsening of businesses' expectations. Besides, the leading indicators calculated by the EEC also show that the rising dynamics of economic growth rates will slow down in the short term, which is due to a slowdown in the growth rate of lending to the construction and consumer sectors.

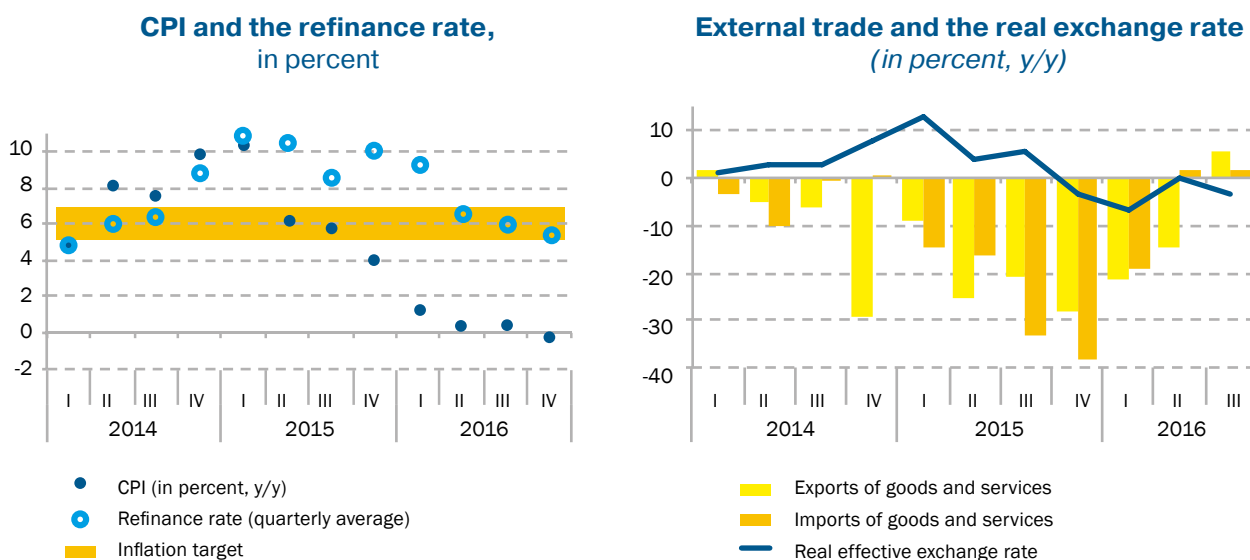
Inflation

Inflation stays low in 3Q 2016

A weak price environment in the world food and energy markets and a more stable situation in the domestic foreign exchange market remain the key factors that keep the annual inflation dynamics below the target. In 3Q 2016, general price growth was 0.5% (as compared to 3Q 2015). The service and non-food prices grew by 5.9% y-o-y, while deflation was observed in the consumer goods group (a 6.2% decrease as compared to 3Q 2015).

Signs of deflation appear in October to December 2016

Continued deflation in the food sector and a slowdown in the service and non-food goods price growth rates led to reduced dynamics of the general price level starting from September 2016. On average, the consumer price index decreased by 0.3% y-o-y in October to December 2016.



Source: The national agencies, EEC, estimates by the authors

Exchange Rate

Exchange rate dynamics reversed in 3Q 2016

In 3Q2016, the Kyrgyz som no longer tended to strengthen vs. the U.S. Dollar. Starting from August 2016, the KGS–USD currency pair has taken a sideways trend. The som effective exchange rate depreciated nominally by 0.2% and by 1.3% in real terms as compared to 2Q 2016. Annualized REER depreciation accelerated to 3.5% (as compared to 3Q 2015), which resulted from low inflation and a decrease of the annual NEER growth rate to 1.4% y-o-y. The recovery of goods and services export growth (5.8% y-o-y), resulting from resumed gold supplies, and an increased inflow of remittances (34.4% y-o-y), helped reduce the current account deficit over 3Q 2016. An increased demand for foreign exchange was observed in the financial account of the balance of payments, which was partially covered from the National Bank's gold and foreign exchange reserves.

Kyrgyz som steadily depreciating vs. USD

In October–November 2016 and in early winter the foreign exchange market saw a continued steady depreciation trend of the som vs. the U.S. Dollar. The factors that limited the som depreciation rate included interventions by the National Bank of the Kyrgyz Republic, with net foreign currency sales amounting to USD 31.5 million.

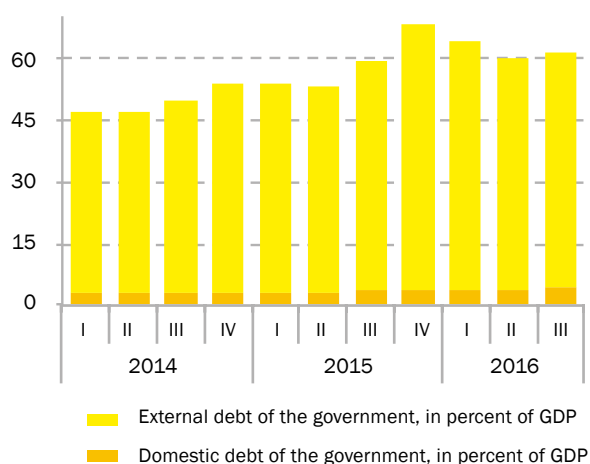
Fiscal Policy

State budget deficit above 5% of GDP

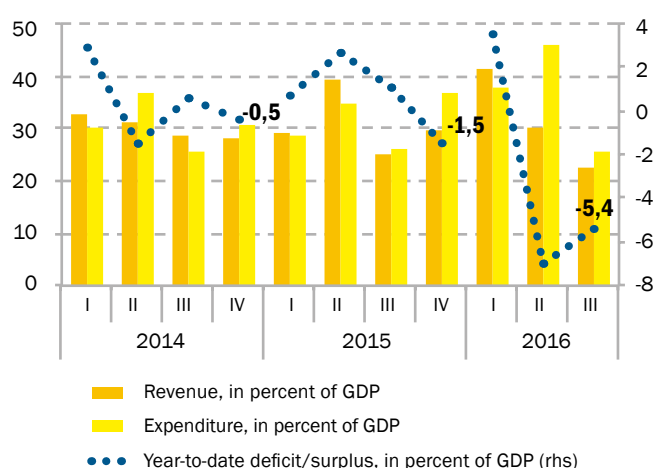
A lower growth rate in capital expenses made it possible to reduce the state budget deficit from 6.9% of GDP in the first semester of 2016 to 5.3% of GDP over nine months of 2016. The transition to the practice of more prudent capital spending was undertaken as the budget's income side growth slowed down (2.1% as compared to nine months of 2015) and the current expense obligations had to be met, whose annual growth from January to September 2016 was 13.2% y-o-y.

In 10 months of 2016, the limitations on the revenue side worsened (the State budget's revenue side shrank by 0.3% y-o-y), leading the Government to consolidate its capital expenses and thus improve its fiscal position (the budget deficit declined to 4.6% of GDP).

Public debt



State budget implementation, in percent of GDP



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

Monetary Policy

National Bank continues loosening its monetary policy in November 2016

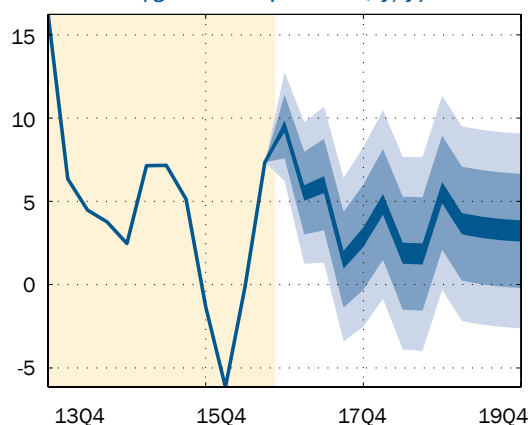
The slowdown in inflation of the non-food goods segment, accompanied by deflation in the food sector, were some of the causes for a round of easing the monetary conditions. A persistent liquidity surplus widened the spread (some 400 basis points) between the policy rate and the 7-day REPO rate (an operational monetary policy benchmark) and lowered activity in the inter-bank market limiting commercial banks' demand for the National Bank's credit resources.

FORECAST

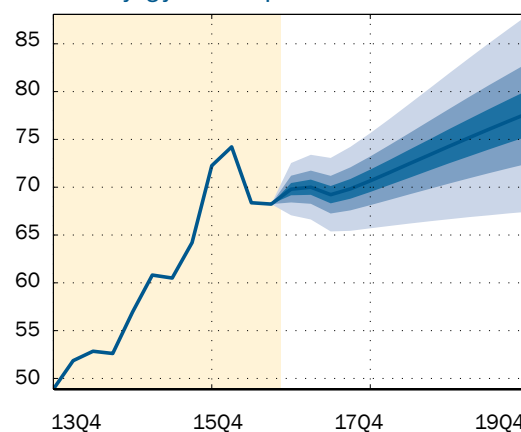
Inflation to remain low

The monetary conditions that have remained tight over an extended period and the external economic environment factor, with grain and oil prices remaining at low levels, will affect the economic dynamics in the first semester of 2017. Inflation will get an additional impetus in the second half of 2017, as the decisions to raise tariffs will be implemented. In 2017, the consumer price index movement is expected to enter the inflation target interval of 5.0–7.0% and will stay in that range in the medium term.

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



Nominal exchange rate,
Kyrgyz soms per U.S. dollar

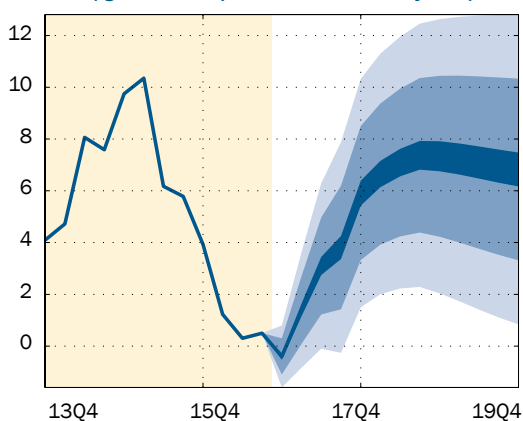


Source: Estimates by the authors, EEC

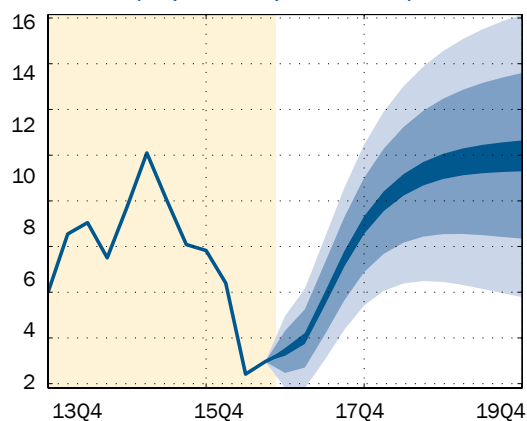
External environment to determine business conditions

The recovery of economic activities in Kyrgyzstan's main trade partners will have a positive influence on the domestic consumer demand via remittance channels and export revenue growth. Volatility of the annual GDP dynamics is expected to be driven by raw materials sectors. Thus, as projected by producers in the gold mining sectors, 30% of the planned 2017 output will be produced in 4Q 2017. The economy will also be stimulated by fiscal measures. The magnitude of the fiscal impulse will decline going forward and will be limited to the amount of loans attracted under the development programmes of international financial institutions.

CPI
(growth in percent, end of year)

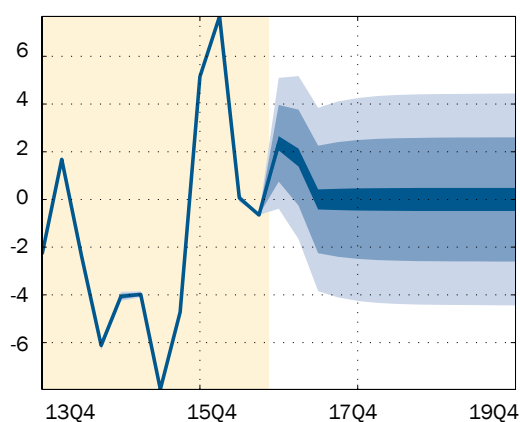


Interbank REPO rate
(in percent per annum)



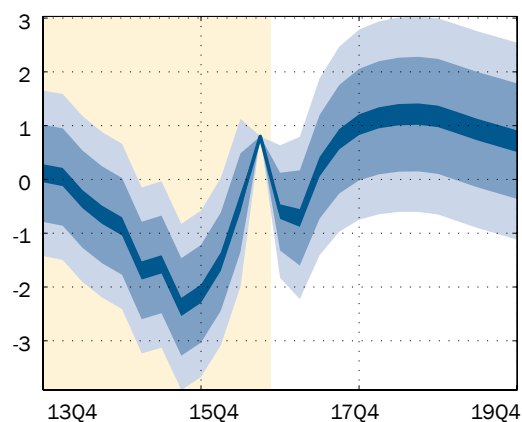
Source: Estimates by the authors, EEC

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



Source: Estimates by the authors, EEC

Output gap, in percent



SUMMARY

Forecast for the major macroeconomic indicators of the Kyrgyz Republic

	2016	2017	2018	2019
CPI (growth in percent, end of year)	-0.5	5.9	7.3	6.8
GDP in comparable prices (growth in percent, y/y)	3.8	3.6	3.5	3.4
Interbank repo rate (in percent per annum)	1.8	4.6	9.2	10.4
Exchange rate of the national currency against the U.S. dollar (average for the year)	70.2	69.9	72.9	76.5

Source: Estimates by the authors, EEC

REPUBLIC OF TAJIKISTAN



TRENDS

GDP

Active investment growth supporting increased economic activity

In 3Q 2016, the GDP growth rate in the Republic of Tajikistan was 6.9% year-over-year (6.7% in 2Q 2016), supported by strong investment activity funded from the foreign investment inflow and the accumulation in sovereign foreign debt increase.

The main factors behind economic growth in Tajikistan included:

- *on the income side:* over nine months of 2016, the growth of the real disposable income has accelerated to 7.4% y-o-y (in the first semester of 2016 they grew by 5.4% y-o-y);
- *on the value added side:* in 3Q 2016, the economic growth was supported by growing volumes in the construction sector (28.2% y-o-y), industrial sector (24.1% y-o-y), and retail trade (14.8% y-o-y). A slowdown in economic activity in agriculture in 3Q 2016 (0.6% y-o-y), was partly caused by an early summer and an early start of field works (growth of 15.2% in 2Q 2016).

Inflation

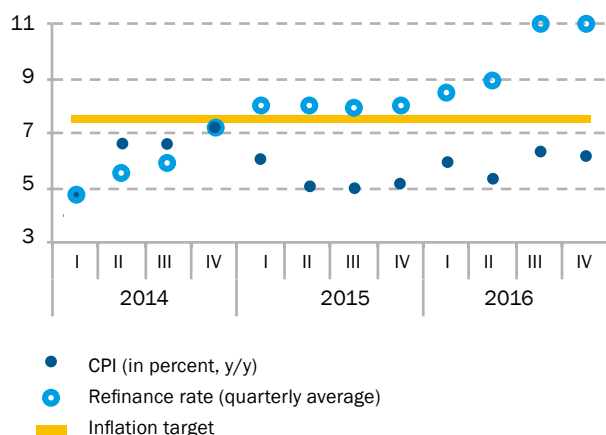
In 3Q 2016, CPI grew by 6.3% y-o-y

Inflation accelerated in 3Q2016. While the 2Q2016 average growth of the consumer price index was 5.3% year-over-year, in the 3rd quarter it grew by 6.3%, which was caused by a short-term rise in prices and tariffs for transport services, educational services, and liquid gas.

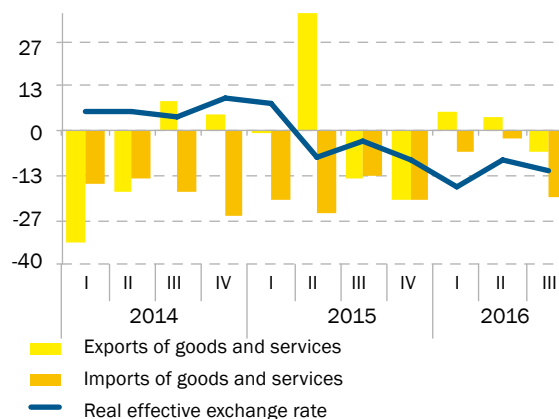
Inflation remains moderate

From October to December 2016, tariff policy factors were still affecting inflation. In particular, the transport service tariffs were lowered, but the electricity tariffs were increased. Inflation in the tradable goods sector was developing in the absence of internal or external shocks.

**CPI and the refinance rate,
in percent**



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



Source: The national agencies, estimates by the authors

Exchange Rate

Exchange rate fixed at 7.8 per USD

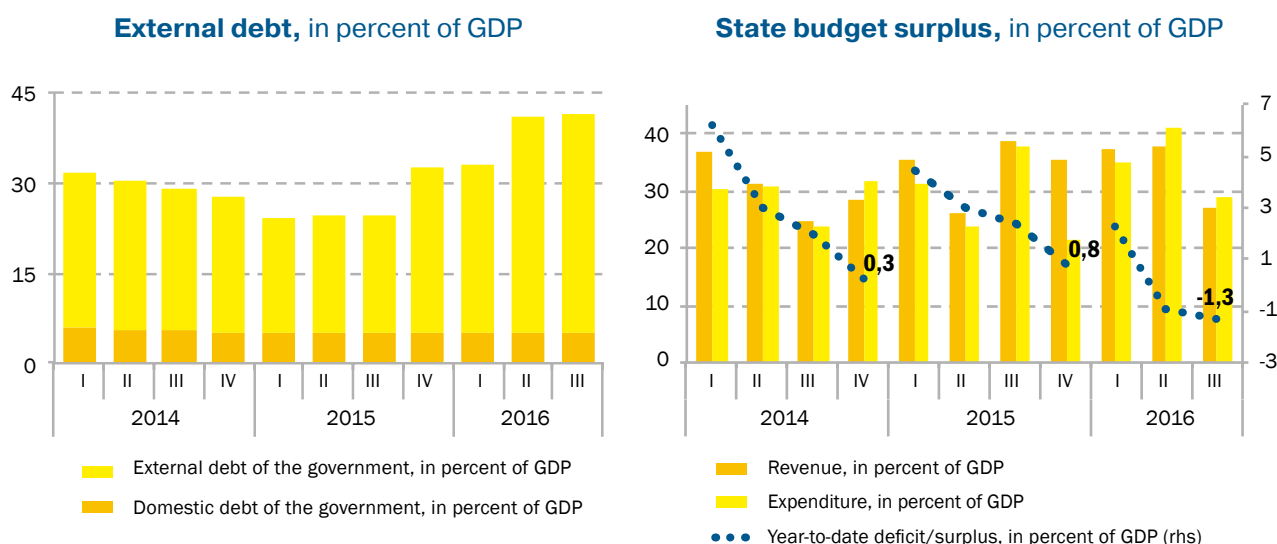
On a year-on-year basis, in 3Q 2016 the depreciation of the somoni real effective exchange rate accelerated to 12.0%, and in quarterly terms the somoni real effective exchange rate strengthened by 1.3% as compared to 2Q 2016. This partially resulted from restrictions in the fluctuations of the tajik somoni to USD exchange rate, which has been rigidly set at 7.8 somoni per U.S. Dollar for 11 months while the deficit of the current account expanded. The latter's condition is mainly driven by a decreasing inflow of remittances (by 9.4% in 3Q 2016 vs. 3Q 2015, according to the Russian Central Bank). While the goods and services balance deficit was covered by the inflow of foreign direct investment, the shortfall in remittance receipts created a gap between demand and supply in the domestic foreign exchange market. Currency regulation was conducted through administrative control measures, supplemented by economic measures that made the Tajikistan National Bank's reserve assets decrease by USD 32.6m in September 2016.

Fiscal Policy

State budget in deficit in 3Q 2016

The State budget deficit was 1.3% of GDP in January to September 2016. The budget's revenues increased by 16.0% in January to September as compared to the same period in 2015 and structurally consisted mainly of foreign loans and grants and special receipts of budget-funded organizations. On the other hand, tax revenue growth remained moderate, at a level of 4.1%. The expenditure side grew by 30.0% (as compared to ten months of 2015), which was supported by the Government's high investment activity. In particular, the budget's expenses on the financing of the fuel and energy complex increased by a factor of 1.6 over nine months of 2016 year-over-year.

While the growth in outlays is still outstripping, the trend towards slower growth of the revenue side continued into October 2016, leading to a budgetary imbalance in the whole year 2016.



Source: The national agencies, estimates by the authors

Monetary Policy

Monetary policy parameters unchanged

After raising its key rate in July 2016, the National Bank of Tajikistan kept it stable in the remaining part of the year. High growth of somoni money supply continues in the economy. In November 2016, the M2 money aggregate grew by 59.8% (as compared to beginning of 2016). That partly resulted from the outflow of deposits in foreign currency into those in national currency or into the somoni cash stock. The banking system's credit portfolio as of late November 2016 decreased by 7.4% as compared to December 2015. Share of non-performing loans increased to 58.7% as of end of September 2016 (37.8% as of end of 2015)

FORECAST

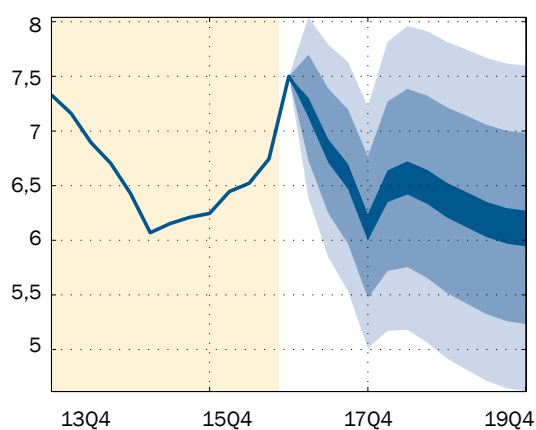
High investment activity to support economic growth

The Chinese investment factor (China accounts for 62% of all foreign direct investment into Tajikistan) will play an important role for economic growth in the medium term. The bilateral programme of economic co-operation until 2020 envisages China's active participation in Tajikistan's infrastructural projects (including funding for the construction of a transit pipeline). The implementation of the investment projects will offset the consequences of the decrease in remittances.

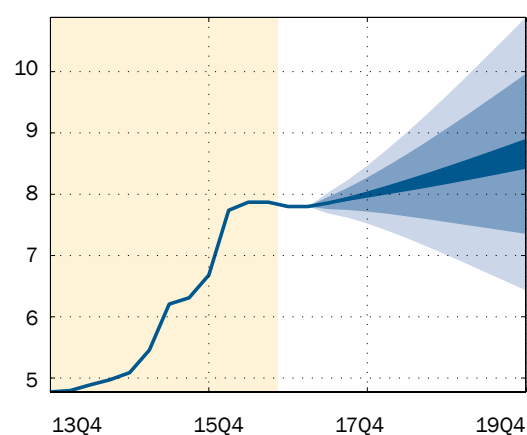
Inflation dynamics stable around 7%

Inflation in the mid-term will head towards the 7.0% target, which results from divergent factors: on the one hand, steady depreciation of the somoni and, on the other hand, a relatively favourable situation in the international food markets.

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

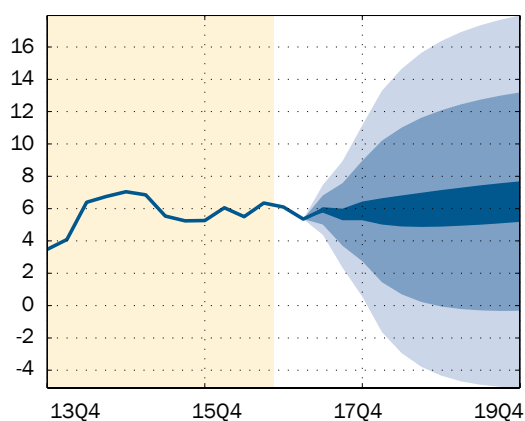


Nominal exchange rate,
Tajik somoni per U.S. dollar

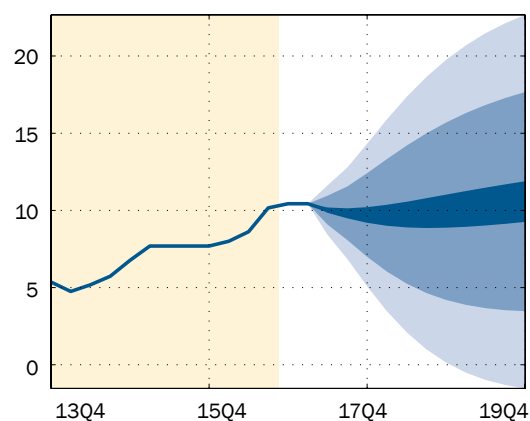


Source: Estimates by the authors

CPI
(growth in percent, end of year)

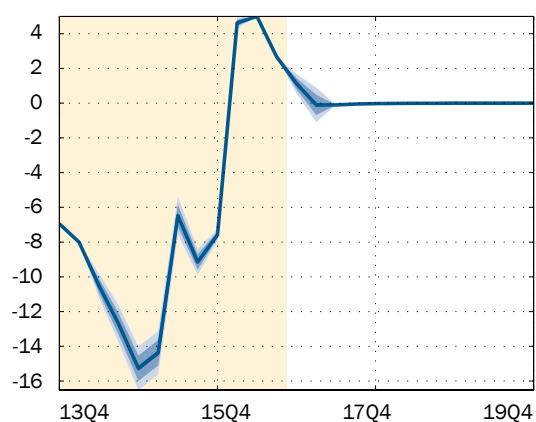


Interbank rate
(in percent per annum)



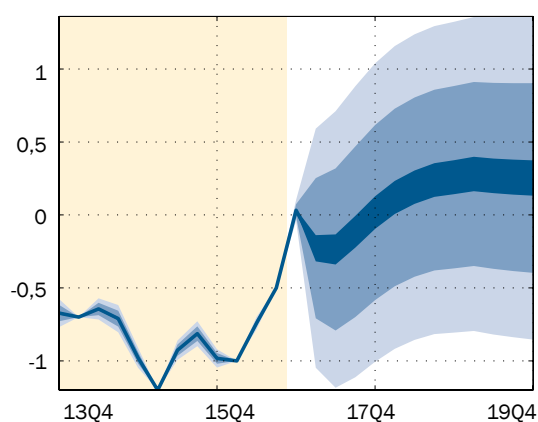
Source: Estimates by the authors

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



Source: Estimates by the authors

Output gap, in percent



SUMMARY

Forecast for the main macroeconomic indicators of the Republic of Tajikistan

	2016	2017	2018	2019
CPI (growth in percent, end of year)	6.1	5.9	6.0	6.4
GDP in comparable prices (growth in percent, y/y)	6.9	6.7	6.5	6.2
Interest rate on interbank loans (in percent per annum)	9.8	10.5	10.3	10.9
Exchange rate , somoni per U.S. dollar (average for the year)	7.8	7.9	8.2	8.5

Source: Estimates by the authors

SPECIAL REPORT.

11TH CONFERENCE OF THE EURASIAN DEVELOPMENT BANK

PLENARY SESSION, ECONOMIC REFORMS IN EAEU COUNTRIES, WAYS OF DEVELOPMENT AND CO-ORDINATION

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

The annual EDB conferences have become a forum for discussing Eurasian integration issues. Economic integration is not only one of the most promising sources of economic growth for the countries of the region but also an important generator of economic reforms. Are reforms undertaken in the EAEU countries, and how can we improve their quality to achieve economic growth? The answers to these and other questions were given at the plenary session on Economic Reforms in EAEU Countries, Ways of Development and Co-ordination of the 11th Conference of the Eurasian Development Bank, held on November 11, 2016.

REMOVING BARRIERS: UNREALIZED GROWTH AREAS IN EDB COUNTRIES

‘There is a huge potential for economic growth in the Eurasian space that is not being exploited yet’.

T. Sarkisyan

Tigran Sarkisyan, Chairman of the Board of the Eurasian Economic Commission, believes economic integration to be not only one of the most promising sources of economic growth for the region but also an important generator of economic reforms. He sees a serious potential for economic growth in the countries of the Eurasian Union that consists in the removal of barriers, restrictions and exceptions, and in creating favourable conditions for free movement of goods, services, capital, and labour. That is why the removal of the barriers existing among EAEU countries is a priority task of this newly established supranational authority.

Another possible source of growth is the adoption of new standards. After assessing the depth of the gap between economic reforms in individual countries of the Eurasian Economic Union, we can determine points and directions of the structural reforms that can potentially boost economic growth in the region.

Given the limited resources, we should, firstly, identify the priority reform trajectories. Secondly, develop normative documents to regulate how exactly all those changes must occur and what new incentives should be introduced. Thirdly, form new skills by means of active dialogue with the real sector aiming to explain the new rules and by motivating the real sector to change its behaviour amid the new realities. Only in this case shall we fully capitalize on our economic potential.

‘In our forum, we must devise tools that will enable us to bring our positions together, to consider the exporters’ interests and capabilities that exist in our countries.’

T. Sarkisyan

In the case of the Eurasian community, this means economic reforms in its five countries, where the creation of a single legal space and harmonization of the economic rules are still crucial tasks. If the EAEU countries have different inflation levels and different exchange rate regimes, this obviously creates additional obstacles for forming a single economic space and single market. So, co-ordination of economic policies in the Eurasian Union States will benefit continued economic growth in each individual member country.

Building a single digital information space is seen to harbour significant potential for both integration and economic growth. Complementing these tasks is the formation of a single foreign economic policy that makes it possible to bring the five countries’ positions together as they negotiate with other trade partners.

‘It has quite often so happened in history that the international factor became a powerful opportunity to overcome a downturn.’

Dj. Otorbaev

Forming a single foreign economic policy is an especially relevant task with respect to China. **Djoomart Otorbaev** is convinced that the Eurasian integration process needs to be integrated with the Silk Road project. China’s integration processes follow the clear economic logic of promoting Chinese products into the global markets. Participation in this project potentially opens tremendous opportunities for the EAEU countries.

‘Trade development is a growth driver, for this is an exchange of technologies and modern goods.’

A. Kudrin

Alexey Kudrin, Deputy Chairman of the Economic Council under the President of Russia, stated that the formation of the Eurasian Union was a factor of joint growth for its member countries. EAEU countries have encountered significant headwinds, e.g. after devaluation in Russia and its GDP fall, trade inside the Union decreased by a third, which again shows that instability of some macro indicators may adversely affect the union’s potential growth. Trade development is a growth driver, for this is an exchange of technologies and modern goods. When this exchange decelerates, growth momentum loses its vigour.

‘Efficient functioning of financial institutions based on the best international practice can help bring integrative co-operation to a qualitatively new level.’

V.Nebenzya

According to **Vasily Nebenzya**, Deputy Minister of Foreign Affairs of Russia, there is demand, mainly the developing economies, for reforming of the international currency and financial system and for bringing it into line with the real balance of power in the world economy. Formation of new financial institutions, such as the New Development Bank or the Asian Infrastructure Development Bank, the operation of the Eurasian Development Bank and the increased efficiency of the International Investment Bank, the Black Sea Trade and Development Bank and other regional financial organizations, are to enhance the role of developing economies in decision-making in the international finance.

In his opinion, the EAEU has been a success as a regional integration arrangement and it is based on the principles of equality, transparency, non-discrimination, mutual respect and consideration of its participants’ interests. The EAEU was established in order to strengthen trade and economic co-operation in the ex-USSR region, but it is open and committed to harmonization with other regional organizations. Negotiations are now under way on the establishment of free trade areas with 15 countries, and 50 countries have expressed their desire to negotiate such arrangements. The first free trade agreement has been concluded with Vietnam, and a trade and economic agreement with China is now being negotiated. There is a great potential for developing EAEU integration with the European Union, but Europe does not seem willing to engage for now, the Deputy Minister said.

MICROECONOMIC TRANSFORMATIONS AN ADDITIONAL GROWTH ENGINE

‘We have not yet fully engaged the microeconomic factors in the Eurasian land space.’

A. Kudrin

Without diminishing the significance of macroeconomic reforms as factors of economic growth, **Alexey Kudrin** points out that the world economy is now shifting its emphasis to microeconomics. In a successful economy, enterprises not only create new goods, they create a continuous model of an innovative economy. Competitive economies create a model of constant change. It follows that EAEU countries’ enterprises can become much more competitive by using modern governance models.

Most countries are deciding today what is better – to improve their infrastructure, to increase R&D funding or to improve governance, which will solve the key problems at both the public and the corporate level. The latter trend is increasingly important for many states, including Germany, the US, and Great Britain; and the EAEU countries should not lag behind if they are to tap into new economic growth opportunities.

STRUCTURAL REFORM OR SHORT-TERM MACRO POLICY MEASURES

‘It is essential to understand that economic growth is mainly a function of human capital and investment quality rather than quantity’.

M. Oreshkin

In looking for drivers of steady and long-term growth, it is important to understand that fiscal or monetary stimuli for the economy are only efficient in the context of anchored inflation expectations. Otherwise, monetary easing may trigger economic recession. For example, in the 1970s the US was trying to achieve a situation of full employment via monetary policy. As a result, in the early 80s the country faced high inflation and chronic lack of credit. The Reaganomics embarked upon in the 80s included, as a key measure, reduction of inflation, which helped the country achieve stable economic growth already in the early 90s.

Maxim Oreshkin, Deputy Minister of Finance of the Russian Federation, believes that in the Russian context, massive investment in the form of stimulus of the economy from the State budget is ridden with serious limitations. It is essential to understand that economic growth is mainly a function of human capital and investment quality rather than quantity.

ONGOING REFORMS IN EAEU COUNTRIES

‘The most important result is that consensus on the chief goal of maintaining macroeconomic balance has been reached in both society and government.’

D. Krutoy

According to **Dmitry Krutoy**, Deputy Minister of the Economy of Belarus, the Republic has worked hard to overcome the imbalances in the economy accumulated in the past years. Among other measures, one can note the switch to exchange rate flexibility, structural reform of deposits, reduction of directed lending and State property reform. He also pointed to the active co-operation with international financial organizations – EDB, IMF, EBRD and the World Bank.

‘The main goal of the 100 Steps programme is to intensify the integrative processes in the organizations that are priority ones for Kazakhstan and among which the single economic space is the indisputable priority.’
N. Korzhova

Natalya Korzhova, Executive Secretary of the Ministry of Finance of Kazakhstan, pointed out that Kazakhstan’s economic policy places an emphasis on improving the country’s investment climate. This is meant not only to obtain financial resources but, first and, foremost, to get new technology, training, and experience in reforming the industries. Incentives for bringing new technology are provided via another wave of privatization that is underway in Kazakhstan.

The economic development strategy in Kazakhstan is being developed on a stage-by-stage basis, as the goals set are achieved and the country needs to address the new challenges it faces. Thus, the nation’s new plan ‘100 Specific Steps’ sets a more ambitious goal of Kazakhstan becoming one of the world’s Top 30 developed States.

For the group of oil and gas exporting countries the timely decision to create the oil fund made it possible not only to prevent the economy from overheating but also to mitigate the crisis phenomena. As Natalya Korzhova noted, owing to the savings in the National Fund the Government of Kazakhstan can fulfil its obligations and conduct social payments from the budget in crisis periods.

‘Luckily we still have the Reserve Funds.’
M. Oreshkin

Maxim Oreshkin concurs and states that the existence of sovereign funds enables the Russian Government to pursue a more balanced fiscal policy.

Summing up the conference, we can note that the participants considered the promotion of integration in the Eurasian land space as a factor of economic growth in the countries of the Union. At the macro level, the growth drivers were identified in the removal of the existing barriers between countries, improved co-ordination of macroeconomic policy and harmonization of the economic environment. Priority should be given to structural reforms, while economic stimulus through monetary or fiscal easing should be measured and judicious. Additional stimulus for economic growth can also be found at the micro level, by involving the business community in the creation of a continuous innovative model of the economy and improving corporate governance.

SPECIAL REPORT.

ECONOMIC GEOGRAPHY OF EURASIAN COUNTRIES

Dr.Sc. (Economics) (EDB) Ya.D. Lissovolik, A.S. Kuznetsov (EDB), A.R. Berdigulova (EDB), N.A. Cernov (Diplomatic Academy of the RF Ministry of Foreign Affairs)

Eurasian countries are endowed with a unique geography that differs from other regions in the global economy and determines the specifics of economic development and integration in the Eurasian space. The unique geography of Eurasia was mentioned by Lev Gumilyov in his last paper, *Rhythms of Eurasia*, in which as he noted that many Eurasian countries were distant from oceans. 'We should say that of all the land that there is on our planet, Eurasia is the most 'continental' region, a giant territory that is remote from all the oceans and seas...' (Gumilyov, 2004). The present paper attempts to assess the significance of the "continentality" and economic geography factors, described by the "early Eurasian" school of thought, from today's perspective – particularly in terms of their significance for economic development and integration of Eurasian countries.

THE UNIQUENESS OF EURASIAN ECONOMIC GEOGRAPHY

As regards the EAEU countries, the unique geography of its member countries consists not only in their inland geographic location but also in the extreme nature, to an extent, of their "continentality" and separation from ocean spaces:

- Belarus is the biggest land-locked country in Europe (with the longest land border);
- Kazakhstan is the world's biggest land-locked country;
- Kyrgyzstan and Tajikistan share the third and fourth places among the world's land-locked countries located at the highest average elevations above sea level (with the first/second places shared by Bhutan and Nepal);
- Armenia is the only country of Western Asia (which includes the Middle East and Transcaucasia as defined by the United Nations) without access to sizeable water space (Azerbaijan has access to the Caspian Sea);
- Russia is the world's biggest country with the longest land border;
- Kazakhstan and other Republics of the former USSR constitute one of the world's largest groups of land-locked countries (one of the world's biggest 'inaccessibility areas' comprising individual States with no outlet to the sea): in his works, Pyotr Savitsky (1997) noted the unique combination of the region's enormous area and remoteness from the coasts: 'The scale of Semirechye's (region in Central Asia) remoteness from the coasts are unheard of in the rest of the world'.

In Eurasia, four of the five EAEU countries (five of the six EDB Member States) have no access to World Ocean spaces, which necessitates the creation of transport corridors and strengthening of inter-regional ties so that the distance barriers can be overcome.

The unique degree of the continentality of Eurasian geography is illustrated, in a way, by the fact that the world's continental 'inaccessibility pole', the place situated farthest from the coastline than anywhere else on the Earth, is in Eurasia. The continental 'inaccessibility pole' (46°17'N 86°40'E) is located in the Junngar Basin, 2645 km away from the nearest sea and 320 km from Urumqi City, Xinjiang Uighur Autonomous Region, China. Interestingly, the continental 'inaccessibility pole' is located near the intersection of the borders of four States: Mongolia, the Russian Federation, Kazakhstan, and China, of which two are land-locked.

GLOBAL TRENDS: WHAT CONTINENTALITY MEANS FOR TRADE

Land-locked countries account for some 20% of the total number of countries in the world (43 out of 193). According to the World Bank, their share is much higher among low-income countries: 20 out of 54 low-income countries have no access to the sea, while only three out of 35 high-income countries are land-locked.

In the context of the last few decades, the reduction of import barriers in the process of globalization resulted in rising contribution of transportation costs to the total costs of foreign economic activities. According to existing estimates, the continentality of a country's 'economic climate' has considerable consequences for the dynamism of its economic development (Arvis, 2010):

- land-locked countries have on average 30% lower trade turnover than countries with access to the sea;
- continentality reduces a country's growth rate by 1.5% as compared to coastal countries;
- continental countries have relied on IMF support for a longer time than coastal countries.

Like Savitsky did some 100 years ago, Western researchers have noted the dual negative impact on continental countries' foreign trade, resulting from a high level of both import and export costs. In this connection, Jeffrey Sachs noted in a paper co-authored in 1998 that this 'double disadvantage' (as termed by Savitsky) seriously hinders continental countries in employing a re-export model of economic development.

The main negative factor for continental countries as compared to coastal regions is their higher transportation costs, as land transportation turns out to be much costlier than maritime transport. The distance factor differs for countries with and without access to the sea: as estimated by Limao and Venables (2001), with each additional 1000 km of distance a land-locked country incurs transportation costs seven times as high as those borne by coastal countries. As estimated by Hummels (2001), the change of the transportation costs per unit of distance change was 0.46 for air transport, 0.39 for rail and 0.22 for maritime transport (Behar & Venables, 2010).

After comparing country statistics of foreign trade on CIF and FOB terms, Radelet and Sachs (1998) established that land-locked countries' transportation costs exceed those of coastal economies by 50%. Other estimates

indicate that the share of transportation costs in total imports may reach 10–20% for countries without access to a seacoast, while for developed countries and the US this figure is 4.7% and 2.2%, respectively (Arvis, 2010).

Another indicator of the importance of distance and transportation costs for trade flows is the interpretation of the distance coefficient in the gravity model of individual groups of countries. Thus, Brun et al (2002) demonstrate a more negative distance factor (-1.3) for trade among the poorest countries as compared to that for trade among the most affluent economies (-0.7). Geography may be responsible for some of this difference of coefficients, as the poorest countries include a significant number of economies without access to ocean spaces.

As applicable to the Eurasian countries, our calculations based on the gravity model also indicate that continentality increases the role of the distance factor with respect to trade flows. Annex to this paper contains gravity model data on Russian exports that indicate the distance factor's high value and statistical significance in Russian exports (-1.4 and more negative values in some modifications of the model). The coefficient's value in a comparable model for Kazakhstan turns out much higher in absolute terms, as expected for a continental country without access to an ocean space, while for countries that have sea access the coefficient is well below 1 in absolute terms (as are the existing estimates of this factor for the world economy in general).

According to estimates by Irwin and Tervio (2002), geographical factors account for 30–40% of the changes of the share of countries' trade in their GDP. Also significant is the role of economic regulation factors, including customs regulation and development of infrastructure. Of all types of infrastructure, port capacity development gives the greatest impetus to trade growth (Nordas and Piermartini, 2004). According to Limao and Venables (2001), the improvement of transport infrastructure from the worst 25% countries' to the best 25% ones' eliminates more than half of the costs faced by land-locked countries. On the other hand, the deterioration of port infrastructure ratings from the best 25% countries' to the worst 25% ones' increases the transportation costs by 12% and is equivalent to a 60% increase of the distance to international markets (Behar & Venables, 2010).

WAYS TO OVERCOME RESTRICTIONS: INTEGRATION AND INFRASTRUCTURE DEVELOPMENT

In addition to the development of transport infrastructure, foreign economic policy, particularly regional integration, can play an important role in the neutralization of the factor of remoteness from ocean spaces. Due to the continentality of Eurasian geography, economic integration becomes an even more crucial task for Eurasian countries than for those with access to the World Ocean and with lower costs of delivering their products to the world markets. This is what the early Eurasian school of thought discussed, especially Pyotr Savitsky as he wrote that 'those countries and regions that can predominantly use maritime transport due to their location are much less dependent on distance in their international and inter-regional exchange processes than countries focused mainly on continental transportation in their economic life' (Savitsky, 1997).

According to Savitsky, the solution is to create continental land spaces representing a complex of complementary economic systems that fill the continental space with mutual trade flows: "But doesn't there open an opportunity for 'continental areas' to eliminate, at least partially, the adverse implications of 'continentality' – while

avoiding the isolation of a subsistence economy? The method for eliminating them ... lies in building economic complementarity among the separate but spatially adjacent areas of the continental world, in their development resulting from their interconnection." Nearly 100 years ago (in a paper written back in 1921) Savitsky was already pointing to regional co-operation and integration as factors of overcoming geographic limitations. Among the main positive factors of regional integration in overcoming continental isolation, one can mention the following:

- lowering the inter-country customs and other barriers for each country's access to the major ports and world markets;
- standardization and simplification of transport regulation with a view to reducing the transportation costs of delivering goods to coastal regions;
- pooling resources for building and funding joint transport corridors to coastal regions;
- the strengthening of integration in the Eurasian land space, particularly in the EAEU, improves inland Eurasian countries' / regions' ability to integrate into global logistical chains and mega-regional blocs like the Silk Road, that connect the inland regions with the coastal regions of Europe and Asia;
- Creation of conditions promoting co-operation among sub-regions (including border areas) (microregionalism).

As regards the evolution of the Eurasian Economic Union, one of the key dividends of integration for all its member States is exactly the possibility to surmount of the spatial and inter-country barriers for purposes of reducing the costs of continental isolation and entering the world markets through access to coastal regions. This agenda is especially relevant for Central Asian countries, given the region's remoteness from all ocean spaces. Broadening access to the world commodity markets requires both the creation of new continental links and access to ocean spaces. For the EAEU countries, such access to the 'World Ocean' can be provided by either the Russian Far East as part of the EAEU itself or by the PRC's Silk Road logistical chain that gives the continental countries access to East Asian and West European markets.

Finally, as regards the macroeconomic policy being pursued, intense development of the continental space by means of infrastructure development requires a stable environment for attracting investment. Such a system of economic policy rules (both monetary and budgetary) should lay to be the foundation of longer-term planning horizons and for funding long-term investment projects, that are especially important for the Eurasian countries.

Also in view of the geography factors, greater co-ordination of the economic policies among countries of the land-locked region becomes essential. Behar and Venables (2010) stress a high degree of interdependence between neighbouring land-locked countries and note that the transport costs and trade flows are quite sensitive to swings in neighbouring States' economic policies (Behar and Venables, 2010). Such co-ordination can be considerably enhanced by both regional integration processes and efforts undertaken by international organisations'.

Thus, in 2002 the UN General Assembly decided to convene in 2003 an International Ministerial Meeting of Landlocked and Transit Developing Countries and Donor Countries and International Financial and Development

Institutions on Transit Transport Cooperation'⁵. The first International Ministerial Conference of Landlocked and Transit Developing Countries (Almaty, Kazakhstan, 28–29 August 2003) adopted the Almaty Programme of Action that determined the main lines of those developing countries' co-operation in overcoming the limitations and obstacles in the areas of transit, trade, and logistics⁶.

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⁵ http://www.un.org/ru/documents/decl_conv/declarations/almaty_midterm.shtml

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APPENDIX

The Gravity Model: Assessing the Distance Factor for the Russian Economy

The influence of the factors of distance and access to ocean spaces and other economic geography factors is often assessed using the gravity model. This model is based on an analogy with the gravity law of physics, stating, as applicable to international trade, that foreign trade flows ($TRADE_{ij}$) are proportional to the product of the national economies' GDPs, M_i^β and M_j^γ , and inversely proportional to the distance between the countries ($DIST_{ij}^\delta$):

$$TRADE_{ij} = G \frac{M_i^\beta \cdot M_j^\gamma}{DIST_{ij}^\delta},$$

This model presents the volume of trade between countries as a function of macroeconomic variables, such as GDP, income level, population, area, etc., and transportation cost indicators such as distance, market access terms, trade agreements, participation in regional integration arrangements, etc. Depending on the purposes of the study, other factors affecting trade may be included, such as a common border, common currency, common history, etc.

The gravity model of Russia is additionally complicated by the calculation of distance that is usually taken to be the distance between capitals of countries. Given Russia's enormous area, different methods can be used to adjust the distance to its trade partners, but one of the simplest and most efficient ones is to introduce an additional variable ($BORDER_i$), equal to '1' if Russia and her trade partner share a common border and to '0' otherwise.

The model for Russia is also extended by introducing variables that describe countries' access to the World Ocean ($OCEAN_i$) and ex-USSR member status ($USSR_i$). The gravity model of Russia's foreign trade thus takes on the following form:

$$\ln(TRADE_{it}) = \alpha + \beta \ln(GDP_{Rus_t}) + \gamma \ln(GDP_{Partner_{it}}) + \delta \ln(DIST_i) + \varepsilon_1 BORDER_i + \varepsilon_2 OCEAN_i + \varepsilon_3 USSR_i$$

We see significant trade flows as being most relevant for the study; accordingly, this analysis took into account trade flows greater than USD 100 thousand only, as smaller flows are usually unstable and non-systematic.

The calculation results are presented below. To analyse changes in the effect of different factors on Russia's foreign trade we made separate calculations for the first and second halves of the period under scrutiny. As Russia is a major oil exporter, it seems important to examine changes in the gravity model of Russian external trade excluding trade in mineral fuel, oil and oil distillates, and bituminous substances and mineral tallow, i.e. Group 27 in the Harmonized System of the Customs Union.

Our findings suggest that the trade partner's GDP and the distance between the countries have the greatest effect on Russian exports. The rise of the coefficient describing the trade partner's GDP increases in the second half of

the period being studied. This means that the factor affects exports even more, which may be due to growing re-orientation of Russian exports towards countries with more sizeable markets.

The existence of a common border has a positive effect on total exports over the period being examined, but its statistical significance declines if non-fuel export dynamics is analysed. Along with a high statistical significance of the distance coefficient, the value of the distance coefficient has decreased considerably in 2010–2015 as compared to 2004–2009.

Finally, and in line with the theoretical and empirical data, the factor of the trade partner's access to the ocean is also positive in our model, which means that Russia exports more to such countries than to others, other things being equal. The respective coefficient for general export is positive and statistically significant for the 2004–2015 period and for 2010 to 2015. But if we look at the exports excluding oil and oil products, this variable is statistically insignificant in 2004–2009, but becomes statistically significant in 2010–2015.

Table 1. Russian Export Gravity Model Calculation

Variable	Variable coefficient value (export volume ≥ USD 100 thousand)					
	Total export volume			Export excluding mineral fuel, oil and oil products		
	2004–2015	2004–2009	2010–2015	2004–2015	2004–2009	2010–2015
ln(GDPRus)	0.10 (0.09)	0.06 (0.16)	0.51 (0.27)	-0.14 (0.09)	-0.07 (0.15)	0.32 (0.24)
ln(GDPPartner)	0.95 (0.02)	0.92 (0.03)	0.99 (0.03)	0.91 (0.02)	0.89 (0.03)	0.93 (0.02)
ln(DIST)	-1.40 (0.06)	-1.50 (0.09)	-1.30 (0.09)	-1.13 (0.06)	-1.29 (0.08)	-0.97 (0.08)
BORDER	0.35 (0.18)	0.36 (0.25)	0.34 (0.24)	0.20 (0.16)	0.23 (0.23)	0.17 (0.21)
OCEAN	0.36 (0.10)	0.16 (0.16)	0.53 (0.14)	0.10 (0.09)	-0.06 (0.19)	0.24 (0.12)
USSR	2.17 (0.18)	2.01 (0.37)	2.31 (0.25)	2.43 (0.16)	2.20 (0.24)	2.64 (0.22)
Number of observations (sample volume)	1860	916	944	1843	908	935
Determination factor, R ²	0.72	0.71	0.73	0.73	0.72	0.74
F statistics	796	376	422	812	383	440

Source: The authors' own calculations.

Note: standard errors are shown in brackets. Shown in bold type are impact coefficients of variables that are statistically significant according to Student's *t*-criterion with a significance level of 10%.

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
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	2018	2019
Russia						
CPI (<i>growth in percent as of year-end</i>)	11.4	12.9	5.4	4.3	4.0	4.0
GDP in comparable prices (<i>growth in percent, y/y</i>)	0.7	-3.0	-0.6	0.8	1.4	1.4
MIACR (<i>in percent per annum</i>)	8.5	12.8	10.6	9.6	8.1	7.4
Exchange rate , the national currency against the U.S. dollar (<i>final average for the year</i>)	38.4	60.9	67.1	62.4	63.2	63.9
Armenia						
CPI (<i>growth in percent as of year-end</i>)	4.6	-0.1	-1.1	1.8	2.8	3.7
GDP in comparable prices (<i>growth in percent, y/y</i>)	3.6	3.0	0.6	2.9	3.9	4.1
Interbank repo rate (<i>in percent per annum</i>)	7.25	10.1	7.8	7.1	7.8	8.1
Exchange rate , the national currency against the U.S. dollar (<i>final average for the year</i>)	416	478	480	477	476	481
Belarus						
CPI (<i>growth in percent as of year-end</i>)	16.2	12.0	10.6	9.3	7.0	6.1
GDP in comparable prices (<i>growth in percent, y/y</i>)	1.7	-3.9	-2.6	-0.5	1.0	1.0
Interest rate on overnight interbank loans (<i>in percent per annum</i>)	23.2	29.9	19.2	11.8	11.5	10.6
Exchange rate , the national currency against the U.S. dollar (<i>final average for the year</i>)	1.02	1.59	1.989	1.992	2.087	2.167
Kazakhstan						
CPI (<i>growth in percent as of year-end</i>)	7.4	13.6	8.5	7.0	6.7	6.6
GDP in comparable prices (<i>growth in percent, y/y</i>)	4.1	1.2	0.7	2.3	2.1	2.2
TONIA (<i>in percent per annum</i>)	10.6	15.7	15.2	10.8	9.0	8.7
Exchange rate , the national currency against the U.S. dollar (<i>final average for the year</i>)	179.5	222.8	342	330	336	351
Kyrgyz Republic						
CPI (<i>growth in percent as of year-end</i>)	10.5	3.4	-0.5	5.9	7.3	6.8
GDP in comparable prices (<i>growth in percent, y/y</i>)	4.0	3.5	3.8	3.6	3.5	3.4
Interbank repo rate (<i>in percent per annum</i>)	6.8	9.7	1.8	4.6	9.2	10.4
Exchange rate , the national currency against the U.S. dollar (<i>final average for the year</i>)	53.7	64.5	70.2	69.9	72.9	76.5
Tajikistan						
CPI (<i>growth in percent as of year-end</i>)	6.1	5.8	6.1	5.9	6.0	6.4
GDP in comparable prices (<i>growth in percent, y/y</i>)	6.7	6.0	6.9	6.7	6.5	6.2
Interest rate on interbank loans (<i>in percent per annum</i>)		20.4	9.8	10.5	10.3	10.9
Exchange rate , the national currency against the U.S. dollar (<i>final average for the year</i>)	4.9	6.2	7.8	7.9	8.2	8.5

Source: National statistical agencies, estimates by the authors



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