

EDB MACROREVIEW

NOVEMBER 2017



HEADING FOR LOW DOLLARIZATION

CONTENTS

Introduction by the Chief Economist	2
Information disclosure	4
External Conditions	5
Republic of Armenia	7
Republic of Belarus	14
Republic of Kazakhstan	22
Kyrgyz Republic	29
Russian Federation	35
Republic of Tajikistan	42
Special Report. 12 th Conference of the Eurasian Development Bank	47
Special Report. Implementation of Economy Dedollarization Measures in EDB Member States	58

INTRODUCTION BY THE CHIEF ECONOMIST

EDB Member States: Need to Activate Domestic Growth Drivers

The global background for the economic recovery of EDB member states has improved this year, in many ways due to rising oil prices and an improved economic growth outlook in the major centers of the global economy. This vision of global trends was largely consistent with the cautious optimism expressed at the macroeconomic discussion held at the annual EDB conference on October 31, which drew international financial institutions to discuss growth recovery prospects for the global economy.

The special report included in this quarterly publication, which reviews the opinions of international financiers at the EDB conference, highlights the upgraded IMF outlook for the Chinese and global economies along with economic growth improvements in the Eurozone, partly attributable to the implementation of a set of structural reforms. Against the backdrop of significant improvements in economic growth in the EU and economic stabilization in China, risks stemming from the USA and the economic policy of the Trump Administration are seen as the most substantial risk factors next year. Apart from intensifying protectionism, higher interest rates, and a high level of debt, uncertainty and the risk of an inconsistent economic policy could become a major source of instability for financial markets.

In the longer term, the biggest challenge for the global economy consists of the lingering imbalances that have contributed to crises over the past decade. They primarily include the high levels of inequality both within and among countries. Notably, such inequality of incomes is in many ways exacerbated by the unequal involvement of different groups of countries in global integration processes. In this regard, the continuing paradox in the global economy is that the majority of countries that most need economic integration (such as the poorest nations or developing countries without access to the sea) are the most disadvantaged in terms of participation in regional or global economic unions or “clubs”.

In the category of developing countries without access to the sea, the average number of free-trade zone (FTZ) agreements is merely 2.5 (based on WTO integration data), while this indicator is three times higher (7.5) for the remaining countries. If one compares the indicators of the least developed nations and the developed economies (as defined by the World Bank), the gap is even more striking: the average number of FTZ agreements for the least developed nations is 0.3 vs. 14.7 for the most developed countries (a more than 40-fold difference).

In the face of the continuing global imbalances and risks at the key centers of the global economy, EDB member states need to use their internal growth drivers, primarily those aimed at utilizing the potential for amassing investments. Possible drivers of this kind include a weaker monetary policy by reducing the benchmark interest rates of central banks, higher effectiveness of government infrastructure spending, and structural measures to boost labor productivity.

As part of another special report accompanying this macro overview, we focus particular attention on the dedollarization of the economies of EDB member states as yet another factor contributing to improvements in the regional economic environment. The level of dollarization has been declining this year in all EDB member states, in many ways due to the stabilization of exchange rates, lower inflation, improved economic activity and regained trust in the national currencies. Among the EDB member states, the most noticeable reductions in the level of dollarization (measured as the share of foreign currency deposits within the structure of the broad money supply) have been recorded in Belarus, Kazakhstan, and Kyrgyzstan (the level of dollarization was close to 30% by mid-2017 in Kyrgyzstan, Kazakhstan, and Russia). Such positive trends will contribute to a more effective monetary policy in the regional economies, more conducive conditions to support lower inflation, as well as conditions aiding stronger financial stability.

Against the backdrop of improving regional trends in economic growth and mutual trade, we have revised our GDP growth forecasts for the EDB member states in 2017-2019. The appreciable acceleration of GDP growth in Russia beginning in the 2nd quarter of 2017 along with improvements in both foreign and domestic macroeconomic conditions have prompted an upgrade of our GDP growth forecast for 2017, from 1.4% to 1.7%. The preservation and continued improvement of external conditions for the Russian economy is shifting the balance of risks toward higher growth rates. Improvements in the Russian economic performance have delivered a boost to the economies of other EDB countries: the GDP growth forecasts for 2017 have been upgraded for Belarus, from 1.4% to 1.8%, Kyrgyzstan, from 3.7% to 4.0%, Tajikistan, from 6.2% to 7.2%, and Kazakhstan, from 3.4% to 3.7%.

Whether or not the mid-term outlook improves for the countries in the region will in many ways depend on their ability to tap into the potential of domestic growth drivers. In this regard, one of the biggest questions of the coming year will be the scope of the reform program in the Russian Federation, which should be formulated following a discussion of a number of competing projects.

Yaroslav Lissovolik

Chief Economist, Eurasian Development Bank

INFORMATION DISCLOSURE

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

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

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

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EXTERNAL CONDITIONS

Global economic recovery continues

The global economy will grow by 3.6% in 2017 (vs. 3.2% in 2016), according to revised IMF estimates. Stimulative monetary and fiscal policies have supported economic growth in the developed nations this year. Growing external demand, rising oil prices, and better domestic financial conditions have contributed to a cyclical recovery of the economies of commodity-exporting countries. The primary risks of a global economic growth slowdown include uncertainty surrounding US fiscal policy, the terms of Brexit, and intensifying trade protectionism.

Fallout from hurricanes dampened 3Q 2017 economic activity in the USA

2Q 2017 GDP growth in the US came to 2.2% y-o-y, with 1Q 2017 GDP growth revised to 2%. This economic acceleration is attributable to growing investment pools, higher household consumption on goods and services, and declining imports. Economic growth is expected to have slowed in 3Q 2017 due to the adverse impact on production and consumption from the Harvey, Irma, and Maria hurricanes in a number of American states. The Fed believes that the inclement weather conditions will have a temporary effect on economic activity.

US consumer prices in September 2017 grew by 2.2% y-o-y, compared with 1.7% and 1.9% in July and August 2017, respectively. The uptick in US inflation in August-September 2017 is due to rising energy (primarily gasoline) prices, which are largely attributable to recovering global oil prices and the fallout from the hurricanes. Excluding food and energy, annual inflation has remained stable at around 1.7% since May 2017.

Gradual normalization of US monetary policy with retention of stimulative monetary conditions

The Fed kept the benchmark interest rate unchanged at 1-1.25% at the September meeting and announced the beginning of the Federal Reserve System's balance sheet normalization program. The Fed plans to sell USD 10 billion worth of securities from its balance sheet on a monthly basis. The Fed expects inflation to gradually approach the target level as the temporary factors diminish and domestic economic conditions further improve in the medium term.

The seasonally adjusted 2Q 2017 Eurozone GDP rose 2.3% from the same quarter in 2016, with 1Q 2017 GDP revised to 2%. Domestic demand remains the primary driver of economic growth in the Eurozone, supported by steadily growing personal incomes, improving financial conditions, and the still high level of consumer and investor confidence.

Eurozone economic growth stabilizes

According to preliminary Eurostat estimates, Eurozone inflation in September 2017 remained unchanged from August at 1.5% y-o-y. The slight acceleration of inflation in August-September 2017 (from 1.3% in June-July 2017) is mainly attributable to growing energy costs against the backdrop of rising oil prices. The strengthening nominal exchange rate of the euro in 2017 exerted downward pressure on consumer price trends. Seeing how inflation remains short of the target, the European Central Bank decided in September 2017 to maintain the benchmark interest rate and net asset purchases in the amount of EUR 60 billion per month at their current levels.

Oil prices supported by US data

Oil prices grew noticeably in 3Q 2017. Brent crude sold for USD 51.7 in July-September 2017, or 3% higher compared to the previous quarter (and up 12.9% y-o-y). Higher oil prices were driven by rising global demand, shrinking inventories and slowing oil production in the USA. As before, the primary risks are the potential failure to extend the OPEC agreement to cut production against the backdrop of production growth in a number of its member states (including Libya and Nigeria) and a faster-than-predicted economic slowdown in China.

The World Bank Commodity Metals Price Index rose 9.4% in 3Q 2017 from the previous period (or 26.5% y-o-y), which was largely driven by a gradual recovery in global demand. Against the background of a weakening dollar in July-September 2017, gold prices rose 1.6% from 2Q 2017.

Forecast for major external economic indicators

	Average annual price of URALS oil, in U.S. dollars per barrel	Average annual price of gold, in U.S. dollars per ounce	Food price index, 2010=100	Average annual exchange rate of the euro to the U.S. dollar	Average annual Fed Funds rate, in percent
2017	50.7	1261	94.9	1.1	1.1
2018	52.0	1301	96.2	1.1	1.8
2019	53.1	1323	97.3	1.1	2.3
2020	54.1	1348	98.5	1.1	2.6

Source: Estimates by the authors, EEU

REPUBLIC OF ARMENIA



TRENDS

GDP

High economic activity continued in 2Q 2017

2Q 2017 GDP growth was 5.5% y-o-y (vs. 6.5% growth in 1Q 2017), according to preliminary estimates. GDP growth was driven by household consumption (up 9.3% from 2Q 2016) and additionally supported by a gradual easing of lending terms, higher real incomes, and a growing influx of remittances from migrant workers.

Higher consumer demand combined with gradually increasing volumes of bank lending to private sector businesses contributed to a slowdown in the decline of gross fixed capital formation. Improved terms of trade against the background of accelerating growth in the primary trade partner nations contributed to further growth in physical export volumes (up 22.5% in 2Q 2017 from 2Q 2016). Still, net exports continued to drag down GDP growth due to the even higher growth in physical import volumes (up 29.7% in 2Q 2017 from 2Q 2016) against the background of recovering domestic consumer activity.

Adverse weather conditions caused an economic slowdown in July-August 2017

Growth in economic activity slowed in August 2017, up by 2.4% y-o-y, or 4.6 percentage points less than in July 2017. The indicator rose 5.5% in January-August 2017 from the comparable period in 2016 (6.2% in January-July).

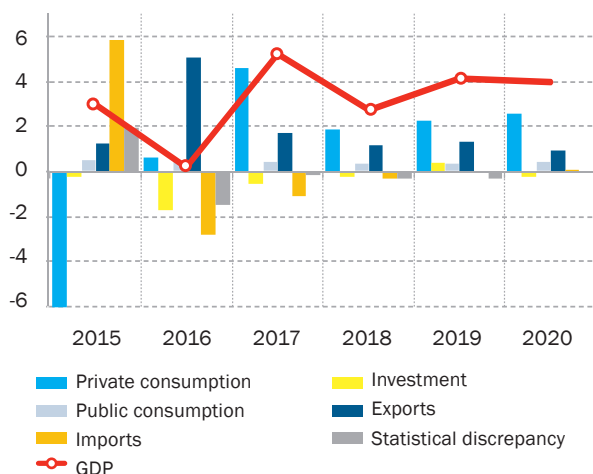
The chief factor behind this economic activity slowdown was the shrinking agricultural output (down 25% in August 2017 from August 2016) due to adverse weather conditions. The construction industry continued to make a negative contribution to the economic activity trend (down 5.1% in August 2017 from August 2016).

The manufacturing industry, commerce, and services continue to exert a positive effect on economic activity against the backdrop of the ongoing recovery in both external and domestic demand (up 10.9%, 12.4%, and 15.5% in August 2017 y-o-y, respectively).

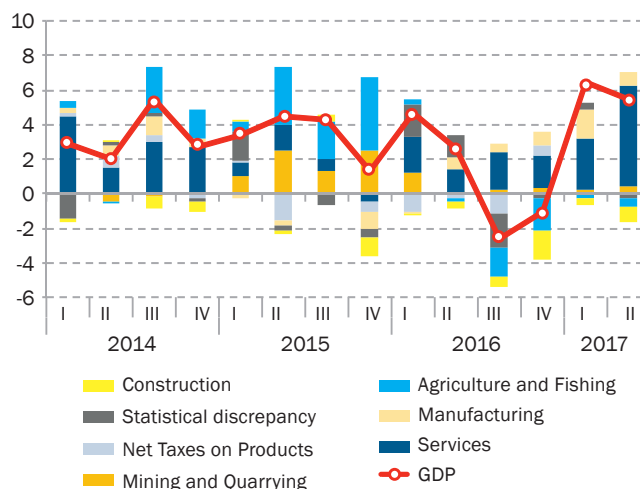
Continued expansion of consumer demand

In terms of income spending, strong consumer demand persists: retail sales rose 5.9% in August 2017 from August 2016. Decreasing interest rates for consumer loans denominated in drams continue to exert a stimulative effect on consumer activity, which is manifested in growing household lending (up 14.2% in August 2017 from August 2016) and remittances from migrant workers. Export volumes in money terms continued to grow at a high rate in July-August 2017 (up 21.8% in August 2017 from August 2016), supported by a weakening of the real effective exchange rate of the dram and acceleration of economic activity in trade partner countries.

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)



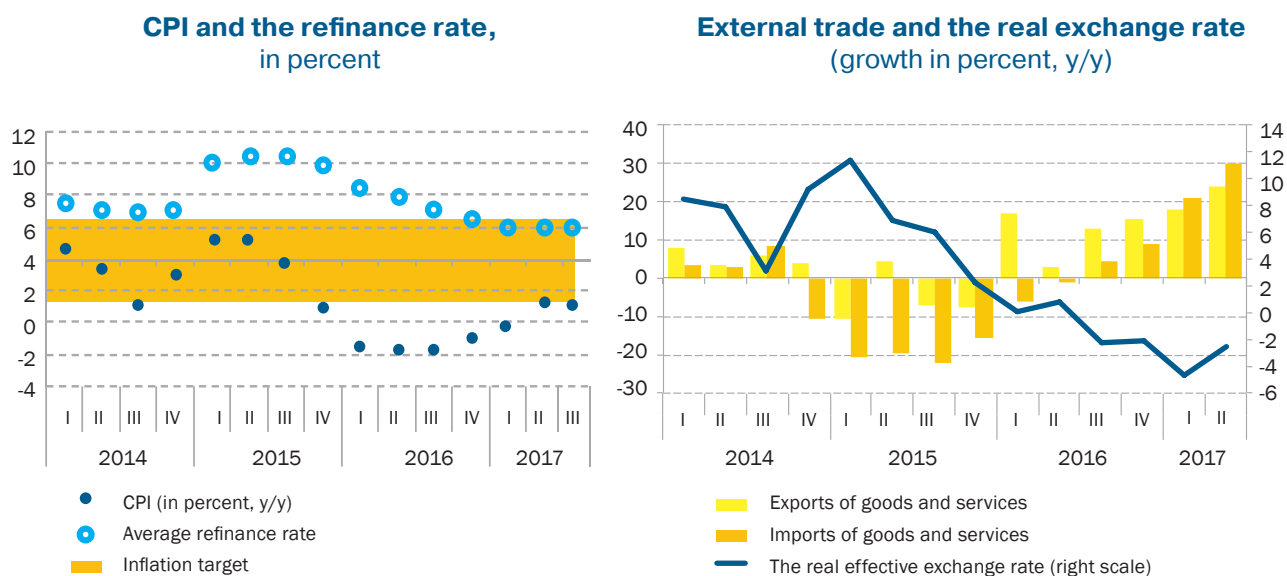
Source: The national statistical agency, EEC, estimates by the authors

Inflation

Inflation slowdown caused by temporary factors

After the 2Q 2017 uptick in annual inflation, consumer price index growth slowed in July-August 2017. August inflation was 0.9% vs. August 2016 (June inflation was 1.1% vs. June 2016). Slower growth in prices for agricultural products was the primary factor behind this inflation trend in the summer months.

Core inflation (net of changes in prices for seasonally volatile goods and regulated services) accelerated in July-August 2017 (up 1.5% in August 2017 from August 2016 vs. a 0.3% increase in June), which was aided by the continuing dampening of the disinflationary effect of domestic demand. The steady growth in core inflation since the beginning of 2017 is indicative of a favorable recovery trend in inflationary processes. This will gradually bring the inflation rate to the lower limit of the target range in 2018.



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

Exchange Rate

Weaker real effective exchange rate

The real effective exchange rate of the dram weakened by 3.1% in July 2017 vs. July 2016. The real exchange rate devalued by 3.5% in January-July 2017 from the comparable period in 2016. The nominal effective exchange rate of the dram weakened by 0.9% in July 2017 from July 2016 (or by 0.1% in January-July 2017 from the comparable period in 2016).

The devaluation of the real effective exchange rate of the dram, together with rising external demand and export prices, continue to stimulate exports from Armenia. Export volumes in money terms grew by 21.7% in January-August 2017 from the comparable period in 2016. Against the background of rapidly growing consumer activity in Armenia, imports have been rising at a faster rate than exports (up 26% in January-August 2017 y-o-y), contributing to a widening negative balance of trade (USD 1,114.2 million in January-August 2017 vs. USD 855.3 million in January-August 2016).

The devaluation of the Armenian dram against the Russian rouble (18.1% in January-August 2017 y-o-y) along with growing domestic demand in Russia have driven growth in Armenian exports to the Russian market, which increased by 36.6% in money terms in January-August 2017 from the comparable period in 2016. Imports from Russia also increased, fueled by rapidly growing economic activity in Armenia (up 22.8% in January-August 2017 y-o-y).

Improved current account

The current account showed a surplus of USD 20.9 million in 2Q 2017 (vs. a deficit of USD 42.2 million in 2Q 2016). The improvement in the 2Q 2017 current account from the comparable period in 2016 is attributable to the growing influx of primary income (mainly reinvested earnings) and secondary income. The widening trade balance deficit continued to exert a negative effect on the current account due to a steady increase in imports against the background of rising household consumption.

Growing remittances from migrant workers

The rapid recovery in the Russian economy contributed to continued growth in remittances from migrant workers. Remittances in dollar terms rose by 19.8% in July-August 2017 (including an 18.8% increase in money transfers from Russia) from the comparable period in 2016, according to the Central Bank of Armenia. In the first eight months of 2017, money transfers grew by 17.5% y-o-y overall (including a 16.6% increase in money transfers from Russia). The growing volume of remittances from migrant workers in 2017 is one of the factors behind the rapid recovery in economic activity, above all consumer demand, and also has a favorable effect in terms of reducing the current account deficit.

Growth in international reserves through borrowings

International reserves amounted to USD 2,176.4 million at the end of August 2017, up by USD 160 million from June 2017. Foreign-currency loans mobilized by the government contributed to the growth in gold and foreign currency reserves.

Fiscal Policy**Continuation of restrained fiscal policy**

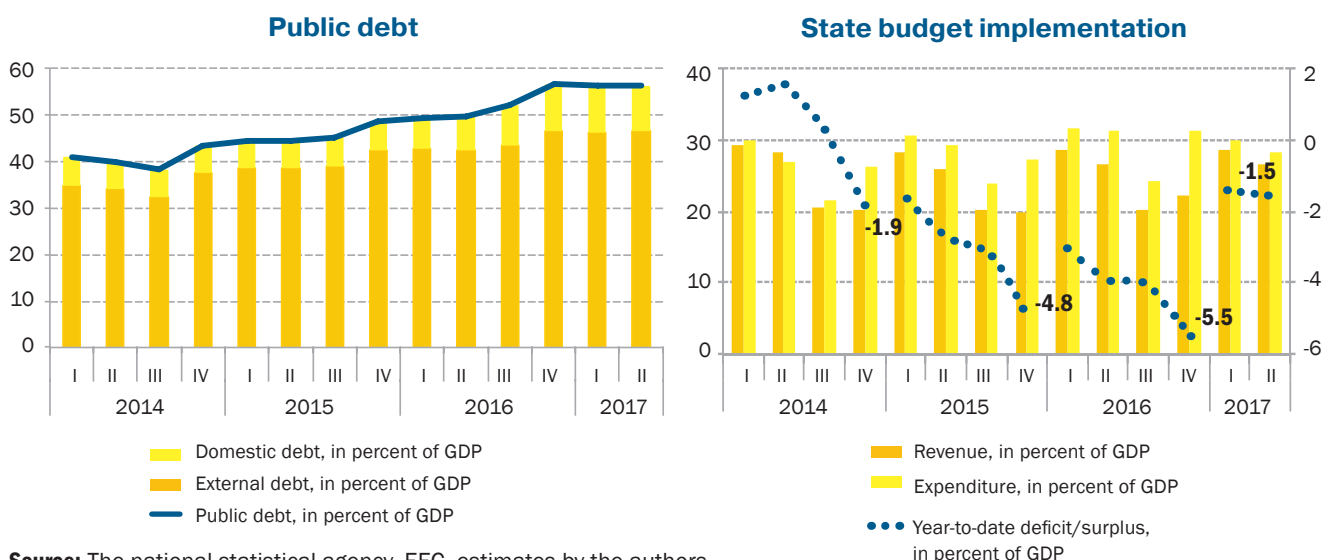
The state budget posted a deficit of 71.7 billion drams in January-August 2017, or 54.5 billion drams less than in the comparable period of 2016 (a deficit of 126.2 billion drams). The budget deficit has been declining owing to both growing budget revenue (5.1% up in January-August 2017 y-o-y) and lower spending (down 2% in January-August 2017 y-o-y).

Rising consumer demand in January-August 2017 contributed to growing VAT and excise revenue (up 5.1% and 33% from January-August 2016, respectively), while the growing output of the mining industry translated into higher mineral tax revenue (up 64.7% from January-August 2016). Lower budget spending is due to a scale-back of subsidies and transfers to the economy, as well as lower spending on goods and services (down 9.5%, 11.5%, and 11.5%, respectively, in January-August 2017 y-o-y).

Growing sovereign debt servicing costs

Armenia's sovereign debt rose by USD 118.7 million (or 1.9%) in July-August 2017 to USD 6,259.5 million (or around 56.5% of GDP). The country's growing debt obligations are mainly due to an increase in both foreign and domestic public debt (by USD 64.6 million and USD 40 million, respectively). Public debt has grown by USD 317.4 million since the beginning of 2017.

The Armenian Ministry of Finance estimates¹ that public debt may reach USD 6.7 billion, or 58.8% of GDP, by the end of 2017, and USD 7 billion (60% of GDP) in 2018.



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

Monetary Policy

Refinancing rate remains unchanged

The Central Bank of Armenia kept the refinancing rate at 6% in 3Q 2017 against the background of growing core inflation and continuing strong consumer demand. The Central Bank estimates that this refinancing rate will help achieve the target inflation rate in the medium term.

A reduction in bank lending interest rates in January-August 2017 translated into more lending to private sector businesses and households. Loans denominated in drams rose by 24.1% in August y-o-y, with loans to the private sector up 34.6% and households up 14.2% (up 15%, 19.8%, and 8.4%, respectively, in January-August 2017 y-o-y).

¹ <https://news.am/rus/news/411717.html>

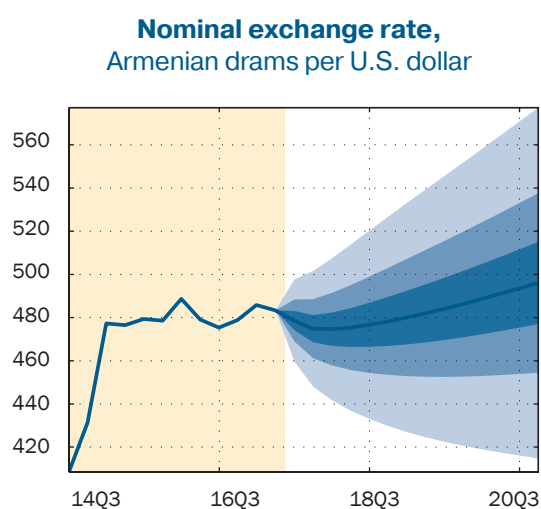
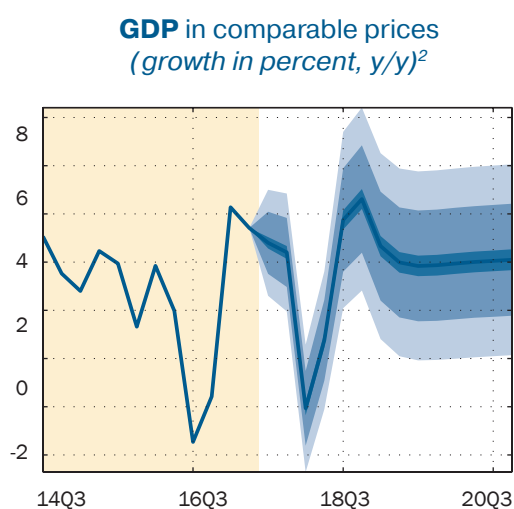
Dollarization of financial contracts gradually declining

Dollarization of residents' bank deposits stood at 57.2% in August 2017, down 4.9% y-o-y or 3.1% since the beginning of 2017. Term deposits of households showed the fastest reduction in the rate of dollarization (down 5.6% in August y-o-y) due to attractive interest rates for deposits denominated in the national currency against the backdrop of a steady drop in US dollar exchange rate (the difference between interest rates for deposits in drams and foreign currencies is over 5 percentage points). Dollarization of loans to residents is also declining. It was 62.3% in August 2017, down 4.2% y-o-y or 2.4% since the beginning of 2017. Despite the reduction in financial dollarization, its level remains fairly high compared to that in other Eurasian Economic Union member states, which hinders the effective operation of the transmission mechanism of monetary policy.

FORECASTS

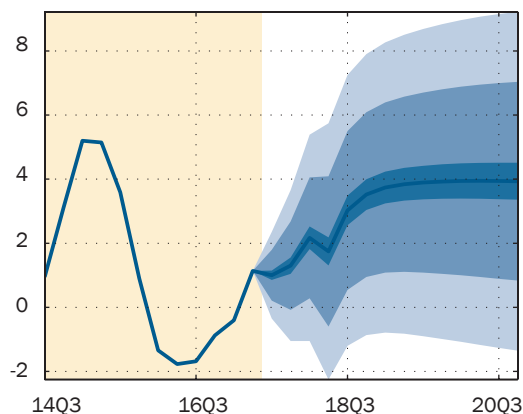
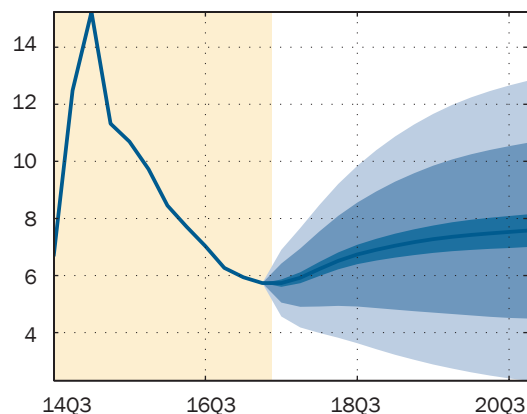
Economic growth supported by monetary policy measures

Monetary conditions are continuing to exert a stimulative effect on economic activity in 4Q 2017, contributing to the gradual ramp-up of GDP to its potential level in the medium term. Considering the need to ensure stable public debt, the restrained fiscal policy will continue in the short term. Over a longer time span, the greater stability of the fiscal sector will most likely have a favorable effect on investor confidence and the flow of investments into the Armenian economy. Achieving high and stable economic growth in the medium to long term calls for continued implementation of measures aimed at export diversification, stimulation of competition, and improvement of labor market conditions.



Source: Estimates by the authors, EEC

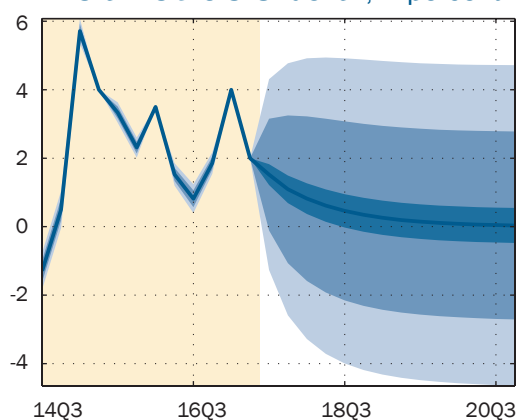
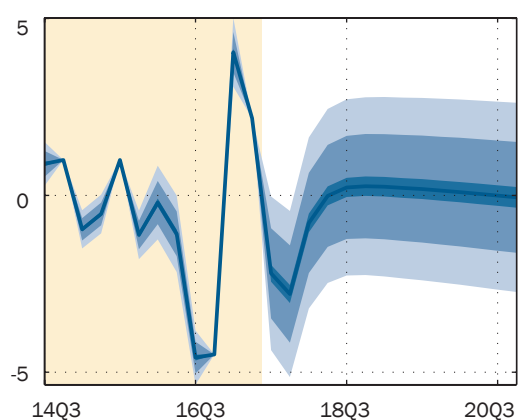
² Here and below the ranges of the fan charts correspond to 10%, 50% and 75% confidence intervals.

CPI (growth in percent as of year-end)**Interbank REPO rate (in percent per annum)**

Source: Estimates by the authors, EEC

Higher inflation toward the end of 2017

Temporary factors that exerted downward pressure on consumer prices in the summer months of the current year are expected to dissipate toward the end of 2017. Strong consumer demand, growing real incomes, and continued stabilization of economic agents' inflationary expectations will somewhat increase the inflation rate to 1.3% at the end of 2017, which will subsequently stabilize at the target level in 2018-2020.

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

	2017	2018	2019	2020
CPI (growth in percent as of year-end)	1.3	3.5	3.9	4.0
GDP in comparable prices (growth in percent, y/y)	5.2	2.7	4.1	4.0
Interbank repo rate (in percent per annum)	6.0	6.8	7.5	7.8
Exchange rate of the national currency against the U.S. dollar (final average for the year)	481	476	483	492

Source: Estimates by the authors, EEC

REPUBLIC OF BELARUS



TRENDS

GDP

Accelerating economic growth in 3Q 2017

The Belarusian economy demonstrated accelerating economic growth at the beginning of the second half of 2017, partly due to the low reference levels of 2016 and the gradual recovery in crude oil shipments from Russia. Preliminary Belstat estimates show annual GDP growth rose to 1.7% in January-August, from 1% in January-June 2017. A gradual recovery in economic growth has been discernible since the beginning of this year. Annual GDP growth accelerated to 1.7% in 2Q 2017 from 0.4% in 1Q 2017.

The key factors behind the growing economic activity in Belarus include:

Steady recovery in consumer demand

- *In terms of income spending:* Household consumption demonstrated an upward trend in 2Q 2017, for the first time since 2015, up 2.7% from the comparable period in 2016 (vs. a 0.6% drop in 1Q 2017 y-o-y). This growth has been recorded against the background of retail sales volumes consistently rising since March 2017. Retail sales growth accelerated to 7.8% in August 2017 from August 2016, which is the highest level since 2014 and could indicate a continued recovery trend in household consumption through the end of 2017.

Consumer demand will be supported in 2H 2017 by growing real household disposable income against the background of an increase in the minimum wage for Category I employees in the third quarter and further government plans to raise nominal wages.

Weak investment activity

There are still no signs of a steady recovery in investment activity. Despite the upticks of investments in fixed assets in some months of this year, the overall reduction in January-August came to 0.1% from the comparable period in 2016 (vs. a 19% decline in 2016 from 2015).

Net exports of goods and services continue to make a positive contribution to GDP growth, fueled both by economic recovery in Russia and a generally favorable export market.

Manufacturing industry as the primary driver of economic growth

- In terms of added value:* Manufacturing industry growth rates have been consistently positive since the beginning of 2017. After the 0.4% decline in 2016, industrial output increased by 4.3% and 7.9% in 1Q and 2Q 2017, respectively, from the comparable periods in 2016. A high growth rate is also expected in 3Q, with recorded July-August growth of 6.1% y-o-y. The recovery in external demand and gradual buildup of domestic demand have supported output growth in virtually all sectors of the manufacturing industry. In 2H 2017, industrial output growth also received support from the recovery of output volumes in the petroleum industry (up 16.3% in August y-o-y) against the background of low reference levels of 2016, when Russia scaled back its crude oil shipments.

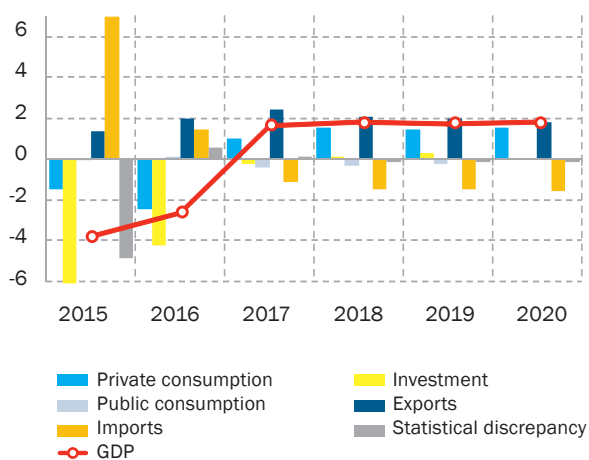
Rescheduling of harvesting operations caused a great deal of volatility in agricultural output trends in July-August (25.1% growth in August y-o-y vs. a 14.5% decline in July y-o-y). Agricultural output in January-August 2017 increased by 3.7% overall from the comparable period in 2016.

Growth in agriculture despite adverse weather conditions

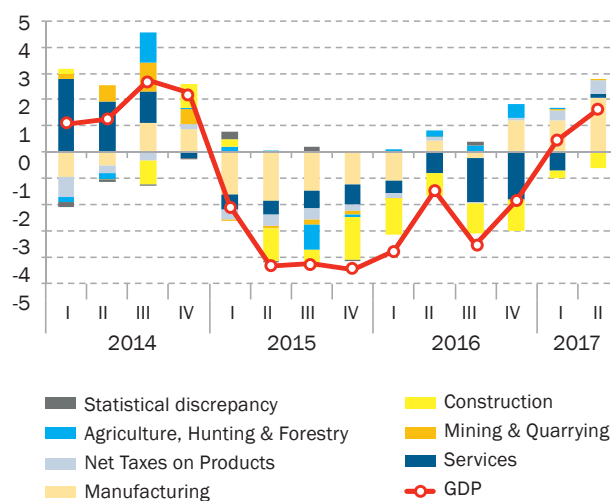
The construction industry continued to make a negative contribution to economic growth, down 7.7% in January-August 2017 from the comparable period in 2016.

The output gap, or the difference between economic activity and potential GDP, remains negative at minus 0.8% in 3Q 2017.

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



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



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

Economic activity to remain unchanged in the short term

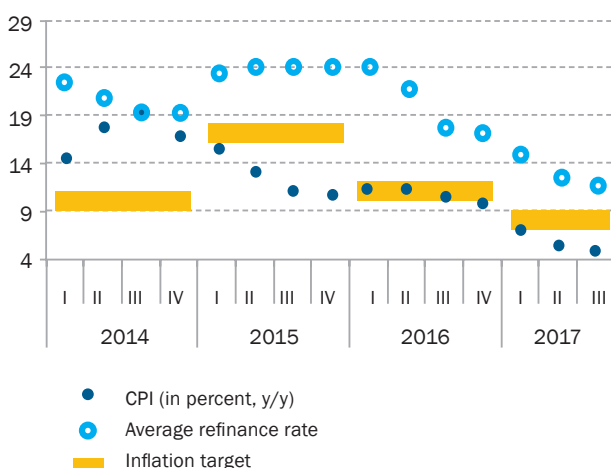
The leading indicators calculated by the Eurasian Economic Commission signal that economic activity will continue toward the end of 3Q and at the beginning of 4Q 2017 at the level of June-July 2017. The trends in indicators including revenue from business and other activities, the fuel and energy price index, and anticipated changes in demand for manufacturing products, contributed to the unchanged outlook in the calculation of leading indicators.

Inflation

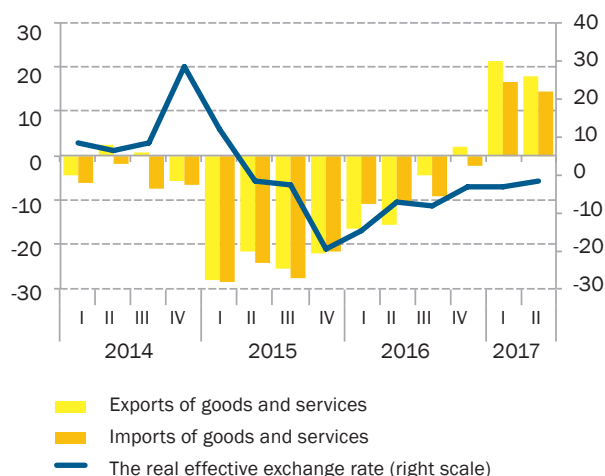
Lowest annual inflation on record

Inflation continued to slow in 3Q 2017, decreasing to a historic annual low in September of 4.9% vs. the National Bank's inflation target of no more than 9% at the end of 2017. Annual core inflation slowed to 4%. The share of goods in the consumer basket whose prices rose by less than 5% y-o-y continued to increase and stood at 67% in August 2017 (vs. 23% in August 2016).

CPI and the refinancing rate
(in percent)



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



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

Exchange Rate

Lower net supply of foreign currency

The foreign exchange market demonstrated a reduction in the net supply of foreign currency in July-September 2017. The chief factors behind this trend have been the growing demand for foreign currency from businesses and a slight reduction in the volume of net supply from the population, which amounted to USD 453.7 million in July-September (USD 1,587.4 million since the beginning of the year) and is still supported by the willingness of the population to maintain a required level of consumption.

Growing demand from businesses is partly due to the need to repay liabilities denominated in foreign currency (as of the start of October, banks' receivables due from non-financial entities decreased by USD 461 million, or 4.1%, since the beginning of the year).

Improved price competitiveness of manufacturers

The real effective exchange rate of the Belarusian rouble in January-August 2017 decreased by 2.9% y-o-y. The primary factor behind this change was the reduction in the two-way real exchange rate of the Belarusian rouble to the Russian rouble by 8.5%, which has made Belarusian goods more competitive in the Russian market.

Current account surplus in 2Q 2017

The current account for 2Q 2017 showed a surplus of USD 227.2 million (vs. USD 102.6 million in 2Q 2016). As a result, the current account deficit decreased to USD 614.7 million for January-June (vs. USD 1,378.1 million in the comparable period of last year). The balance of trade in goods and services, which stood at USD 412.7 million in January-June, made a positive contribution for the second quarter in a row. The balance of trade improved in 1Q 2017 both owing to the 12% reduction in the deficit of the balance of trade in goods and a 40.1% increase in the surplus of the balance of trade in services from the comparable period in 2016. Transportation services and services subsumed under the "telecom, computer, and IT" group remain the primary drivers behind the surplus, collectively accounting for over 64% of all service exports.

Growth in international reserves

The National Bank continued to increase international reserves in July-September, which amounted to USD 7,266.7 million at the beginning of October. Reserves increased by USD 705.7 million in 3Q 2017 thanks to a sovereign loan from the Russian Government, export duties levied on oil and petroleum products, growing foreign currency balances in correspondent accounts of banks with the National Bank, as well as proceeds from the sale of foreign currency bonds by the National Bank.

Fiscal Policy

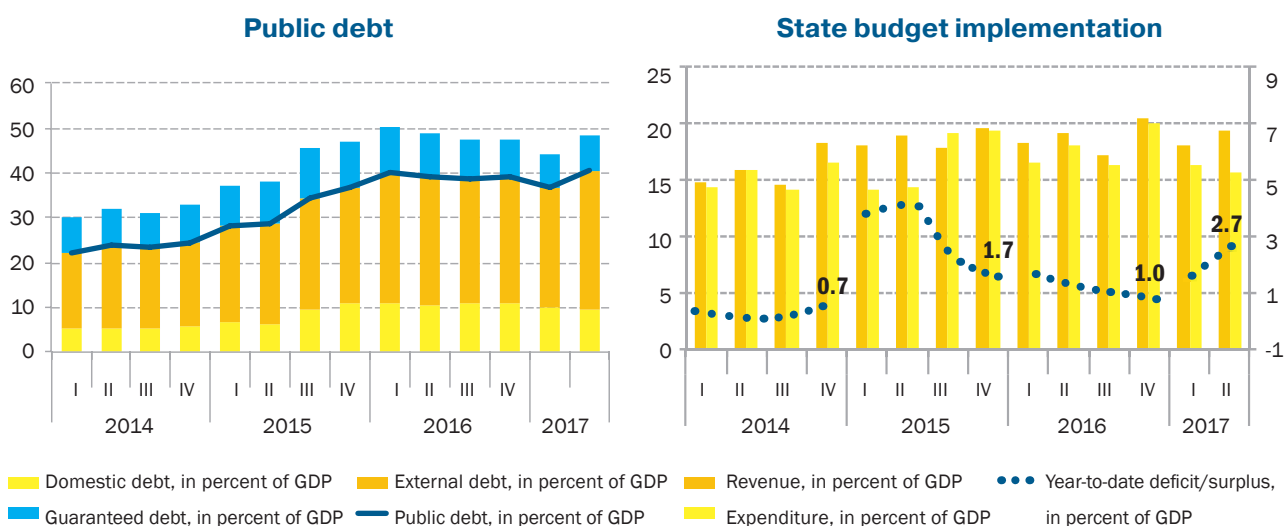
Budget spending may increase in the remaining months of 2017

The surplus of the republican budget in January-August 2017 amounted to RUB 2.6 billion, or 3.9% of GDP (vs. a surplus of 1.5% of GDP in the same period of last year). Budget revenue was up 12.9% and spending decreased by 2.9% y-o-y. The republican budget surplus is planned at RUB 955.3 million in 2017 in order to service both domestic and foreign debt.

Therefore, a somewhat more expansionist fiscal policy is possible in the remaining months of 2017 against the background of the need to meet the 2017 budget targets, which will additionally support the economic recovery.

Sovereign external debt grows to 30% of GDP

Sovereign foreign debt in dollar terms increased from USD 13.9 billion as of June 1, 2017 to USD 15.7 billion as of September 1, or 30% of GDP. The government has mobilized USD 2.7 billion in external loans since the beginning of the year, primarily by offering eurobonds, mobilizing resources from the Eurasian Fund for Stabilization and Development, and the Russian government and banks. A total of USD 697.8 million has gone toward foreign public debt repayment since the beginning of 2017. Domestic public debt as of September 1 has decreased by 8.7% since the beginning of the year (taking into account currency movements) to reach RUB 9.3 billion. Overall public debt as of September 1, 2017 was 39.3% of GDP.



Nominal interest rates on the banking services market also showed a downward trend. Average interest rates for new term deposits of private customers in the national currency decreased from 8.2% in 2Q 2017 to a historic low of 6.4% in July-August. Average interest rates on new bank loans to private customers in the national currency decreased to 12.6% in July-August 2017, from 14.4% in 2Q 2017. Loan rates for legal entities also decreased, from 13.9% in 2Q to 12.2% in July-August 2017.

Growing local currency lending

The volume of lending in local currency continued to grow following the relaxation of lending terms in 2H 2017. As of October 1, the amount of banks' receivables due from private customers in the national currency increased by 7.4% in 3Q (or by 15.6%, or RUB 1,129.3 million since the beginning of 2017). Banks' receivables due from non-financial entities in the national currency increased by 8.9% in 3Q (or by 9.4%, or RUB 868.1 million since the beginning of 2017).

Increasing measures to reduce dollarization of the economy

The National Bank continues to implement a set of measures aimed at reducing the dollarization of the economy. The share of foreign-currency deposits was 74.5% of the total at the beginning of 2016 vs. 70.2% at the beginning of 2017, and was down to 68.2% at the beginning of October 2017. The gradual stabilization of the foreign exchange market and a series of regulatory measures contributed to this positive trend. One of the latest measures was the decision to increase the share of remittances by banks and non-bank credit and finance institutions to the mandatory reserve fund from 11% to 15% of foreign-currency deposits. The situation in the credit market is similar. Banks' loan receivables due from non-financial entities in foreign currencies have decreased by 2.6% as of early September since the beginning of the year, while those denominated in the national currency have increased by 5%. Foreign-currency loans are not extended to private customers. Additional measures are being implemented to limit the use of foreign currencies in payments within the Republic of Belarus, including payments for insurance policies under personal insurance contracts denominated in a foreign currency, or the use of foreign currencies to pay for air transportation or medical services provided to individuals.

FORECASTS**Inflation to remain low in 2017**

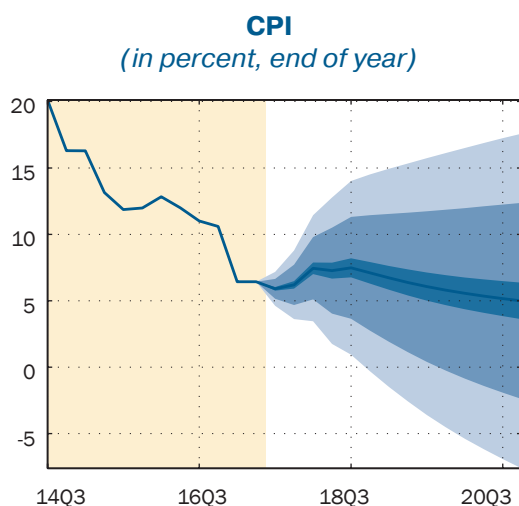
Against the background of inflationary processes slowing to historic lows, the forecast for the end of 2017 has been revised to 5.6% from the previously predicted 8%. Meanwhile, the factors that will accelerate inflation in Q4 2017 remain unchanged. They include the recovery in consumer confidence against the background of growing wages and lending, the planned increase in utility rates, and the continuing high inflationary expectations as estimated by the National Bank.

Certain risks of acceleration in inflationary processes remain thanks to the increasing volume of cash in circulation and transferable deposits, as well as the faster growth in manufacturing prices, agricultural producer prices, and prices in the construction industry despite the depressive state of the construction sector. In the absence of any external or domestic shocks, inflationary processes are expected to progress within the National Bank target range in 2018-2020.

Continued reduction in interest rates

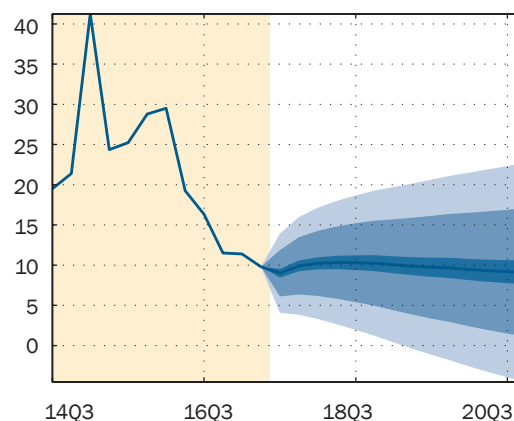
Stabilization of the inflation rate within the target range will contribute to a continued reduction in nominal interest rates in 2018-2020. Given a target inflation rate of 5%, the level of neutral interest rates is estimated at 9-9.5%.

The Belarusian rouble is expected to gradually devalue in the medium term given the general downward trend exhibited by currencies in emerging markets.



Interest rate on overnight interbank loans

(in percent per annum)



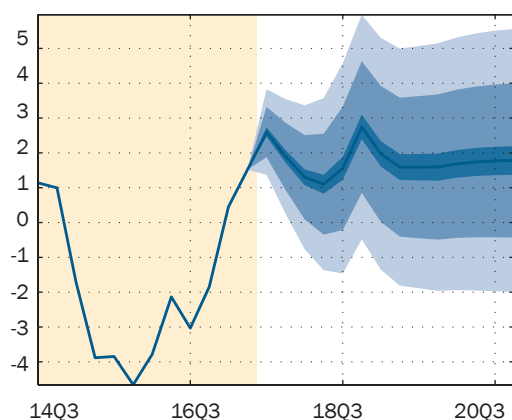
Source: Estimates by the authors, EEC

Economic growth at near-potential rates

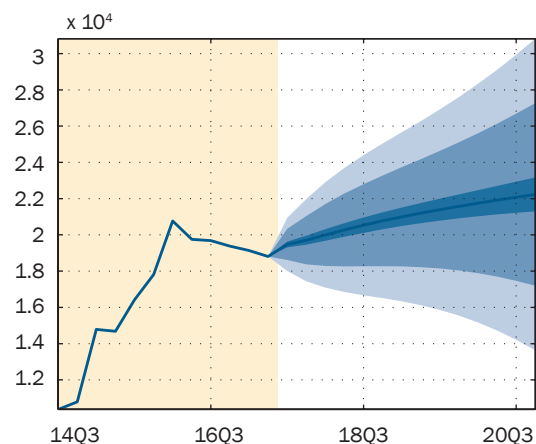
The faster-than-expected economic growth in 3Q 2017 was at the core of the 2017 growth forecast revision from the previously predicted 1.4% to 1.8%. As a result, annual GDP growth is expected at 2.2% in Q4 2017, which is a fairly high indicator compared to the growth rates achieved in recent years, but is still lower than the Q3 2017 growth of 2.8% based on preliminary estimates.

Growth recovery will be restrained in the medium term by the existing structural limitations of the economy. GDP will grow at a 1.7% rate in 2018-2020. The 2018-2020 forecast has been slightly revised due to an improvement in the expectations of economic growth in Russia, the country's primary trade partner. Meanwhile, monetary policy will continue to support the recovery in consumer demand and a gradual recovery in investment activity by businesses.

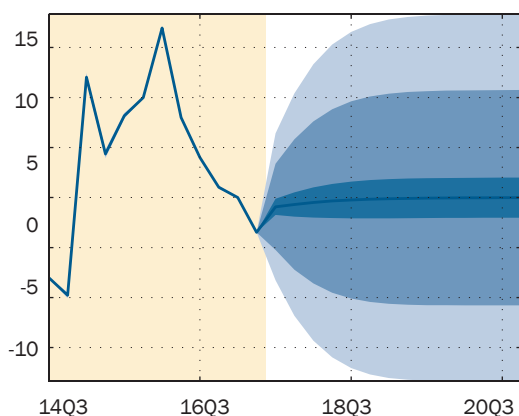
GDP in comparable prices
(growth in percent, y/y)



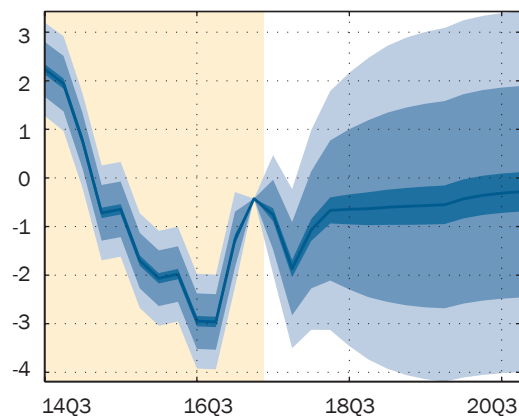
Nominal exchange rate,
Belarusian rubels per U.S. dollar



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



Output gap,
in percent



Source: Estimates by the authors, EEC

SUMMARY

Forecast for the major macroeconomic indicators of the Republic of Belarus

	2017	2018	2019	2020
CPI (growth in percent, end of year)	5.6	7.1	5.8	5.0
GDP in comparable prices (growth in percent, y/y)	1.8	1.8	1.7	1.7
Interest rate on overnight interbank loans (in percent per annum)	10.0	10.3	9.8	9.3
Exchange rate³, Belarusian rubels per U.S. dollar (final average for the year)	1.928	2.040	2.129	2.199

Source: Estimates by the authors, EEC

³ The exchange rate of the new (post-redemption) rubel.

REPUBLIC OF KAZAKHSTAN



TRENDS GDP

Accelerating GDP growth in 2Q 2017

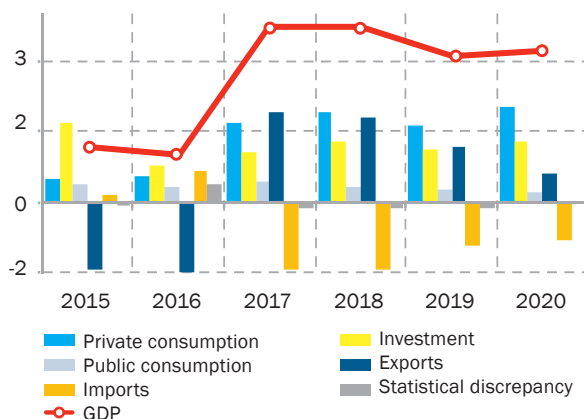
Despite the downward trend in global oil prices in 2Q 2017, the external economic situation was more favorable compared to the same time last year. This reinforced the positive impulse from the new Kashagan field, where commercial production began in Q4 2016. GDP grew by 4.8% in 2Q 2017 from Q2 2016 (by 3.6% in 1Q 2017 y-o-y).

Growth driven by extractive industries

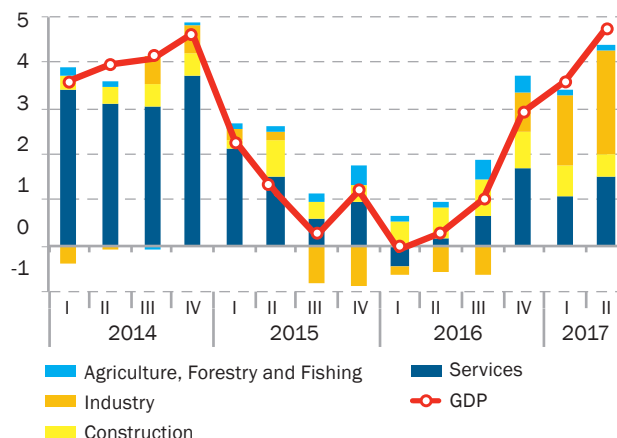
Economic activity in Kazakhstan was generally shaped by the following key factors:

- *In terms of value added:* The manufacturing industry continues as the major growth driver, led by mining (+13.0% y-o-y) and, to a lesser degree, by processing industries (+5.8% y-o-y). The traditional growth driver – retail trade – has yet to recover to its pre-crisis level. In the face of declining real average monthly wages, retail trade has taken a second seat to “transportation and warehousing” in shaping the growth dynamics of the service sector. The implementation of government measures to support the economy has ensured a consistently positive contribution of the construction industry to the GDP trend.
- *In terms of incomes:* According to a preliminary estimate of indicators adjusted for the GDP deflator, wages finally showed a positive growth in 2Q 2017 (up 1.6% from 2Q 2016), and the positive contribution of net income to GDP increased.

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



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



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

Leading indicators signal continued economic growth

Market surveys conducted by both the Statistics Committee of the Kazakh Ministry of the National Economy and the National Bank of Kazakhstan indicate that respondents expect demand for final goods to continue growing in 3Q 2017 across all sectors of the economy. The Statistics Committee also mentioned positive job creation expectations in industry. The stable growth in investments makes up for the weak credit impulse by satisfying domestic demand. The headline leading indicator calculated by the Eurasian Economic Commission also signals continued growth in the cyclical component, as evidenced by positive expectations from agents of the industrial sector and the stock market.

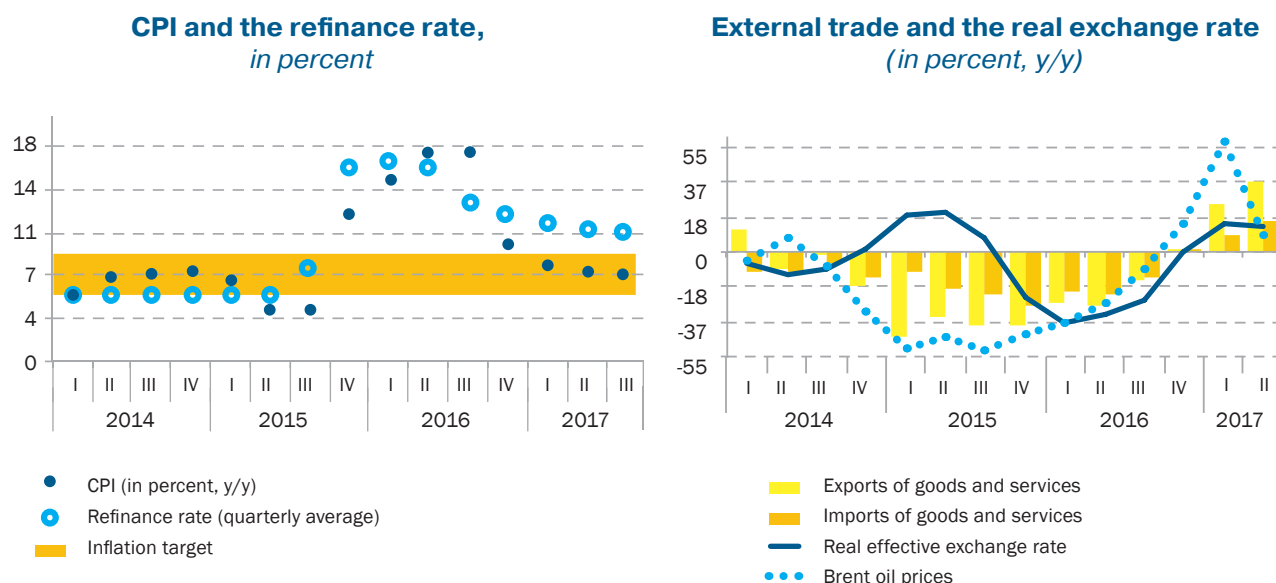
Inflation

Annual inflation stabilizes at 7.5%

Annual inflation remained at a steady level of 7.5% over all three months of 2Q 2017. Further slowdown in inflation was held back by the food component (9.7% vs. 2Q 2016), which was due to a short-term agricultural product supply shock. In the face of a stronger tenge, annual inflation in the non-food sector continued to slow and stood at 7.7% toward the end of 2Q 2017. Limited growth in utility rates (4.7% vs. 2Q 2016) restricted overall inflation growth.

Inflation slowdown

Seasonal price reductions slowed the annual inflation rate in July-September 2017. The consumer price index (CPI) grew by 7.1% y-o-y in September 2017. A little less than half of respondents in the inflationary expectations survey published by the National Bank of Kazakhstan expect moderate price growth in the short term and believe the inflation rate will remain at the current level in the coming year (38% of respondents).



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

External Sector

Balance of payments surplus

The effect of the stronger real effective exchange rate of the tenge was offset in full by the favorable price situation in the international oil and metals market, which supported growth in the nominal export volume (up 43.5% vs. 2Q 2016). Despite moderate growth in the import volume in US dollars terms (19.1% y-o-y), the trade balance surplus increased by 2.4 times from 2Q 2016.

The National Bank of Kazakhstan estimates that the launch of commercial production at the Kashagan field has boosted export revenue while also increasing the income earned by direct foreign investors. Dividend payouts to direct foreign investors increased by almost a quarter, which played a key role in creating the current account deficit (4.2% of GDP in 2Q 2017).

More than one half of dividends received by foreign investors was reinvested in the Kazakh economy. Foreign currency revenue earned by the financial account in 2Q 2017 consisted of an influx of direct and portfolio foreign investments (including through the redemption of short-term foreign securities in which the government of Kazakhstan had invested previously). These operations made up for the outflow of foreign currency due to deposits by the corporate sector and households with foreign banks.

Fiscal Policy

Budget deficit in 2Q 2017

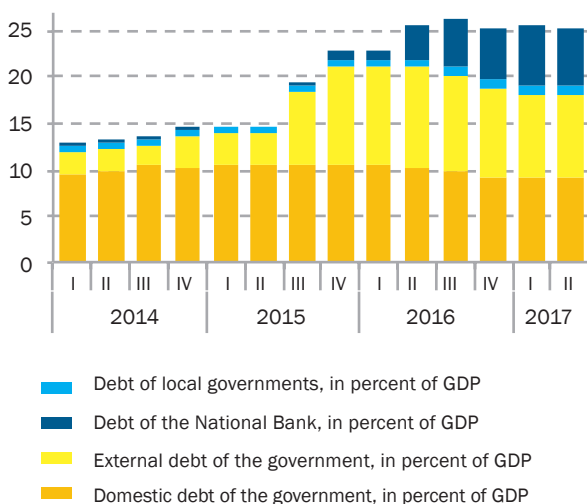
The state budget deficit amounted to 0.7% of GDP in 2Q 2017 (vs. a deficit of 0.3% of GDP in 2Q 2016). Budget revenue grew at a faster rate (18.0% vs. 2Q 2016) than budget spending (16.6% y-o-y). Despite the growth in tax revenue (13.8% y-o-y), its share in the structure of revenue decreased by 2.2 percentage points to 59.9%. The share of incoming transfers increased by 7.2 percentage points to 36.7%.

On the expenditure side, more than a half of all expenditures went toward education, healthcare, and social expenditures (55.2% of total spending). Investment spending in the public sector increased by 1.7 times from 2Q 2016. The rising expenses on acquiring financial assets are partly attributable to the government's efforts to rehabilitate the financial system. The non-oil deficit was 10.2% of GDP in 2Q 2017.

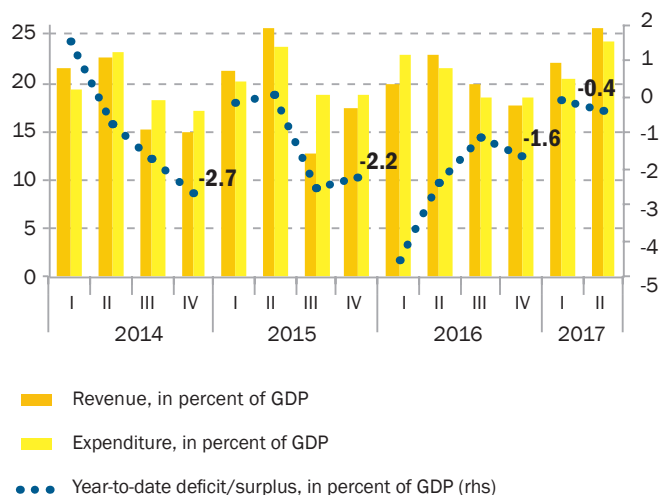
Moderate debt level in the public sector

Public debt rose by 3.5% since the beginning of 2017 to KZT 11.8 billion (24.1% of GDP) as of July 1, 2017. Public debt increased mainly through the issuance of medium-term state treasury bills as part of the initiative to institute a risk-free yield curve, and also via domestic debt of the National Bank through the issuance of notes to sterilize surplus liquidity.

Public debt



State budget implementation



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

Monetary Policy

Base interest rate lowered from 11.0% to 10.5% in 2Q 2017

In the face of stabilization of the domestic and foreign economic environments, the National Bank of Kazakhstan lowered its base interest rate from 11.0% to 10.5% in 2Q 2017. The TONIA rate mostly fluctuated around the lower limit of the interest rate range, reflecting a structural surplus of tenge liquidity. This in turn caused an increase in the volume of National Bank notes with maturity periods of 7, 28, 91, 182, and 364 days in circulation. In June 2017, faced with excessive volatility of the tenge to US dollar exchange rate, the National Bank of Kazakhstan intervened in the domestic foreign exchange market for the first time since August 2016 to satisfy excessive demand for US dollars and sold USD 101 million worth of foreign currency.

Reduction of dollarization

The National Bank of Kazakhstan's consistent monetary policy and transparent communications policy are reinforcing the public's trust in the national currency, as evidenced by changes in the savings habits of households. The gradual easing monetary conditions implemented by the National Bank of Kazakhstan since May 2016 has had an effect on the deposit market that is demonstrating a downward trend in weighted average interest rates of deposits in the national currency.

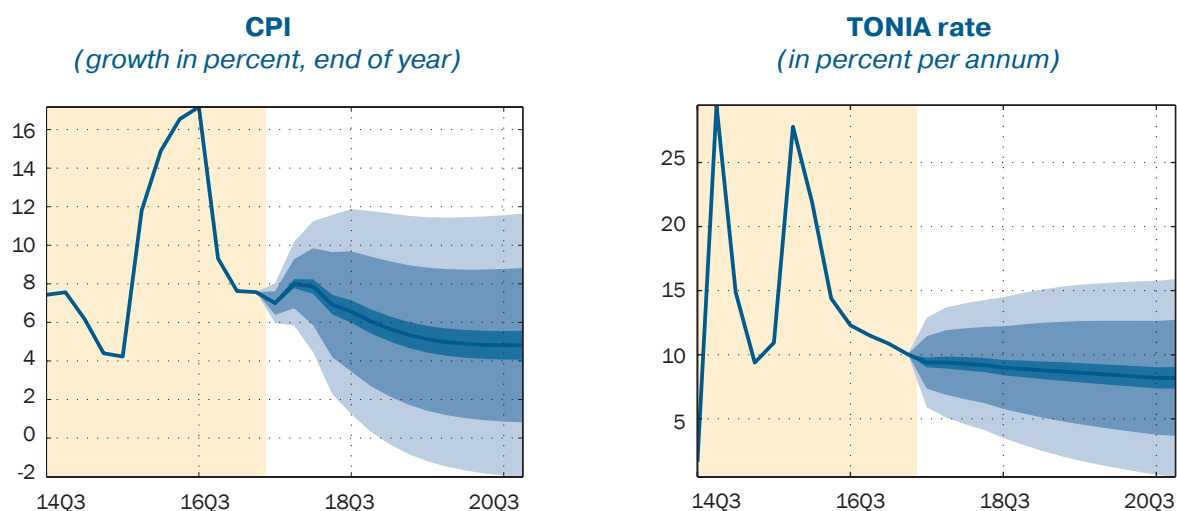
Despite the lower returns on national currency deposits, they remain an attractive investment option. The share of household deposits in foreign currency decreased from 62.2% at the end of 2016 to 57.1% at the end of August 2017. The weighted average interest rate for issued loans is following a sideways trend in the credit market in the face of the persistent risks of a growing share of nonperforming loans.

FORECASTS

Inflation to remain within the target range

Increased volatility of the tenge in the domestic foreign exchange market along with the short-term growth in global food prices will exert upward pressure on the CPI toward the end of 2017. The annual CPI growth rate will approach the upper limit of the 6.0-8.0% target range set for 2017.

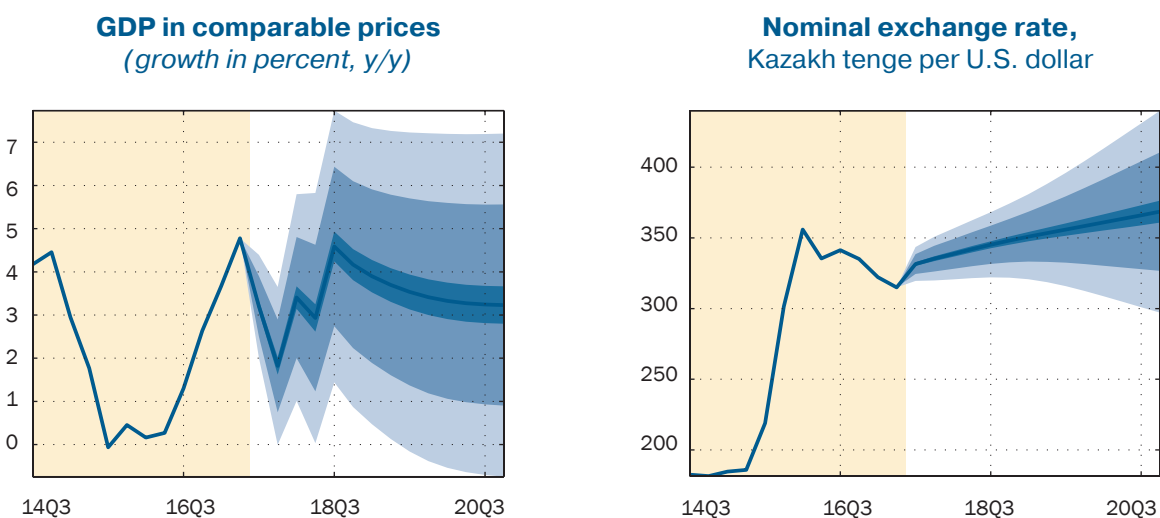
The depletion of the effect of short-term shocks in foreign food markets, which is expected to occur in 2018, together with a tight monetary policy that has stabilized inflationary expectations, will help keep the inflation rate within the target range for 2018, which has been set at 5.0-7.0%. The inflationary environment in trade partner countries will not have a significant effect on import prices.



Source: Estimates by the authors, EEC

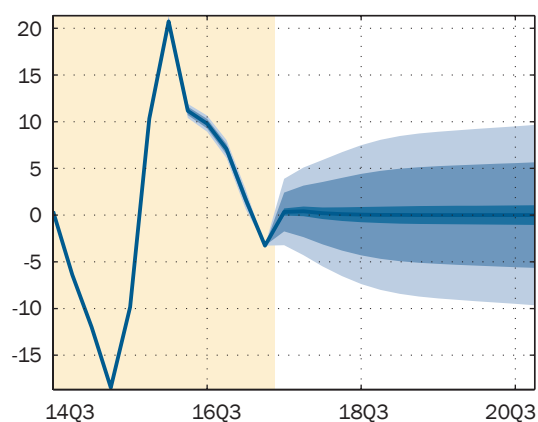
Gradual growth in the long term

The launch of commercial production at the Kashagan field will play a key role in accelerating economic growth through 4Q 2017. Government measures to rehabilitate the financial sector are expected to be implemented in 2018, and growing lending volumes in the banking sector will support economic growth. The external situation both in global energy and metals markets and in the primary trade partner countries will positively influence economic growth in Kazakhstan, thereby complementing the fiscal policy measures that will continue to have a stimulative effect in the medium term, although the fiscal impetus will diminish over time.

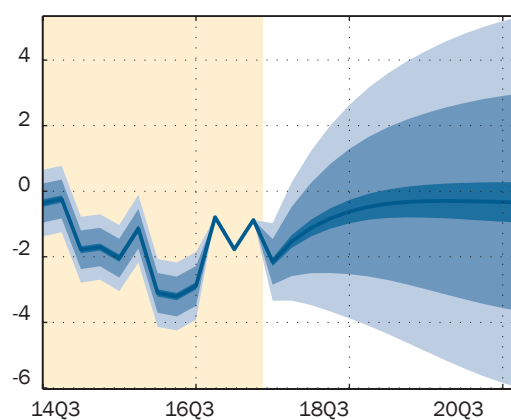


Source: Estimates by the authors, EEC

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



Output gap, in percent



Source: Estimates by the authors, EEC

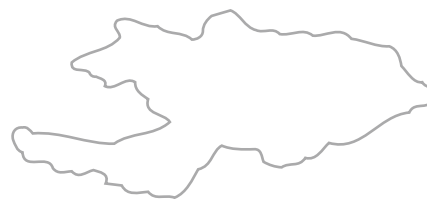
SUMMARY

Forecast for the major macroeconomic indicators of the Republic of Kazakhstan

	2017	2018	2019	2020
CPI (growth in percent, end of year)	7.7	6.6	5.7	4.9
GDP in comparable prices (growth in percent, y/y)	3.7	3.7	3.1	3.2
TONIA rate (in percent per annum)	9.9	9.1	8.7	8.3
Exchange rate of the national currency against the U.S. dollar (average for the year)	326	344	358	370

Source: Estimates by the authors, EEC

KYRGYZ REPUBLIC



TRENDS

GDP

Low base effect diminishing

The manufacturing industry of Kyrgyzstan, led by the gold mining sector, has been contributing to high GDP growth for the fourth quarter in a row. Economic growth is slowing as the low base effect diminishes. 2Q 2017 GDP growth was 5.4% y-o-y (vs. 7.8% in 1Q 2017 y-o-y).

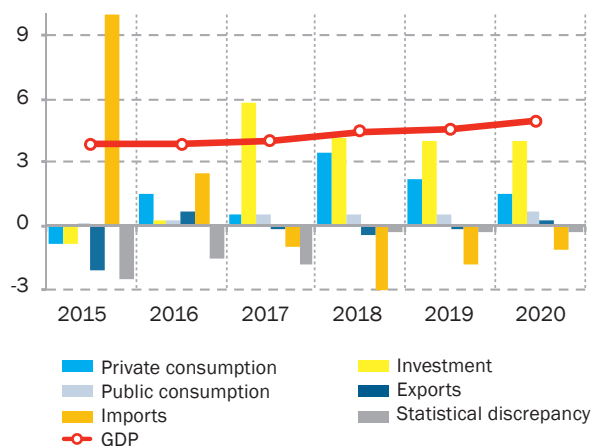
The economic performance in Kyrgyzstan has been shaped by the following key factors:

Gold mining sector as the core growth driver

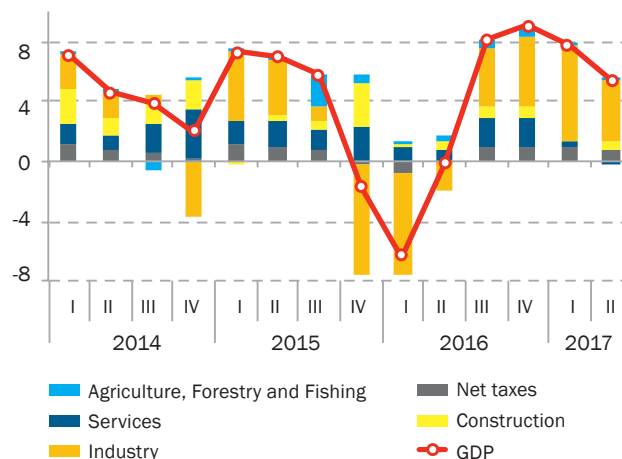
- *In terms of value added:* Processing industries continue to make a dominant albeit declining contribution to GDP growth. The leading role here belongs to the production of gold ingots that rose by more than 40% y-o-y in 2Q 2017. In the mineral extraction industry, the production of metallic ores has been a fast-growing sector since the end of 2014. However, due to its low share of GDP, this sector has so far made a limited contribution to the growth rate (0.7 percentage points in 2Q 2017). The construction industry rejoined the growth drivers in 2Q 2017 (up 8.3% from 2Q 2016). The volume of services rendered has declined by 0.4% y-o-y, which is in many ways due to the reduction in the volume of services in the IT and telecom industries. This sector has been showing a downward trend since 2Q 2016, which is partly due to unresolved corporate issues at some of the telecom sector players and the growth in popularity of telecom capabilities of Internet resources.
- *In terms of expenditure:* According to preliminary estimates of the National Statistics Committee of Kyrgyzstan, exports of goods and services are the key growth driver, while domestic demand has exercised a limited effect on the GDP growth rate.

The output gap was negative in 2Q 2017 and is estimated at -1.8%.

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



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



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

Leading indicators point to the short-term nature of the high growth rate

GDP growth slowed to 5.0% y-o-y in January-September 2017. The headline leading indicator calculated by the Eurasian Economic Commission signals that the cyclical component of growth will continue on an upward growth at the end of 3Q and at the beginning of 4Q 2017. Positive expectations in the construction industry and recovering consumer demand will contribute to this trend. An upward growth in investments is making up for the shortage of credit impulse, which remain weak despite the recovery in lending volumes.

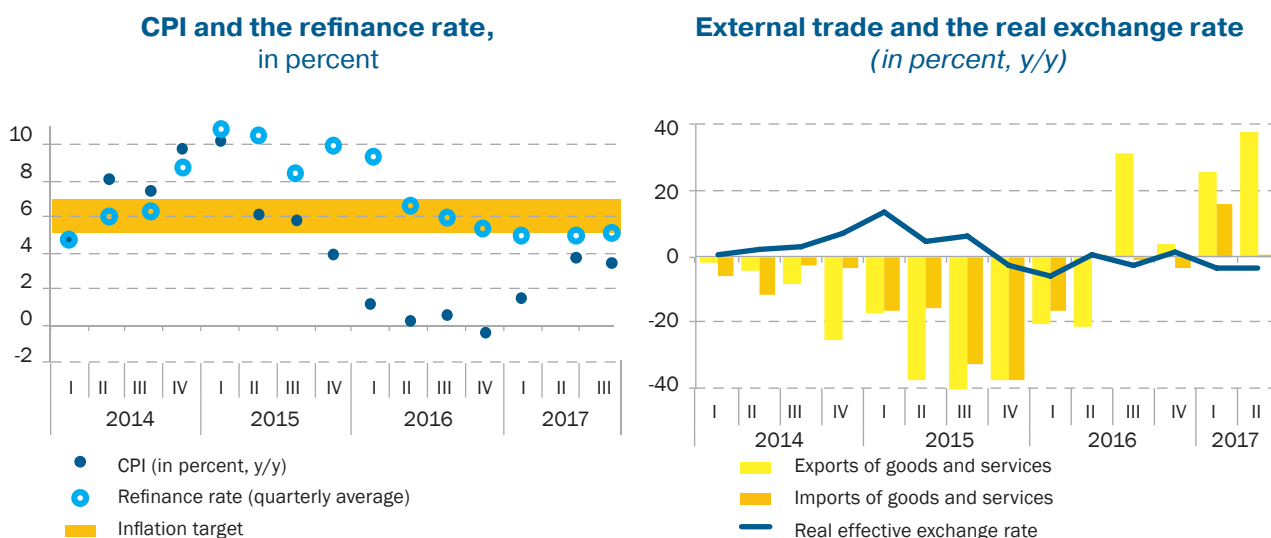
Inflation

Inflation remains below the 5.0-7.0% target range

The food sector left the deflation zone in 2Q 2017 (up 4.7% y-o-y). This is attributable to the supply shock in agricultural products in 1Q 2017 and partly due to the low base effect of 2016. The low annual inflation rate in the non-food sector (1.2% in 2Q 2017 on average) came against a background of the som's strengthening against the US dollar as part of a consistent trend between January and May 2017. The high inflationary background in the service sector (7.1% y-o-y) is attributable to higher charges for telecom, healthcare, and education services. In 2Q 2017, annual inflation accelerated to 3.9% y-o-y on average (vs. 1.6% y-o-y in 1Q 2017 on average).

Inflation slowdown

Once fruit and vegetables from the new crops arrived on the market in September 2017, the monthly inflation rate returned to the deflation zone, thereby slowing the annual inflation rate. The 12-month inflation rate in September 2017 stood at 3.3%.



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

External Sector

Decreasing current account deficit

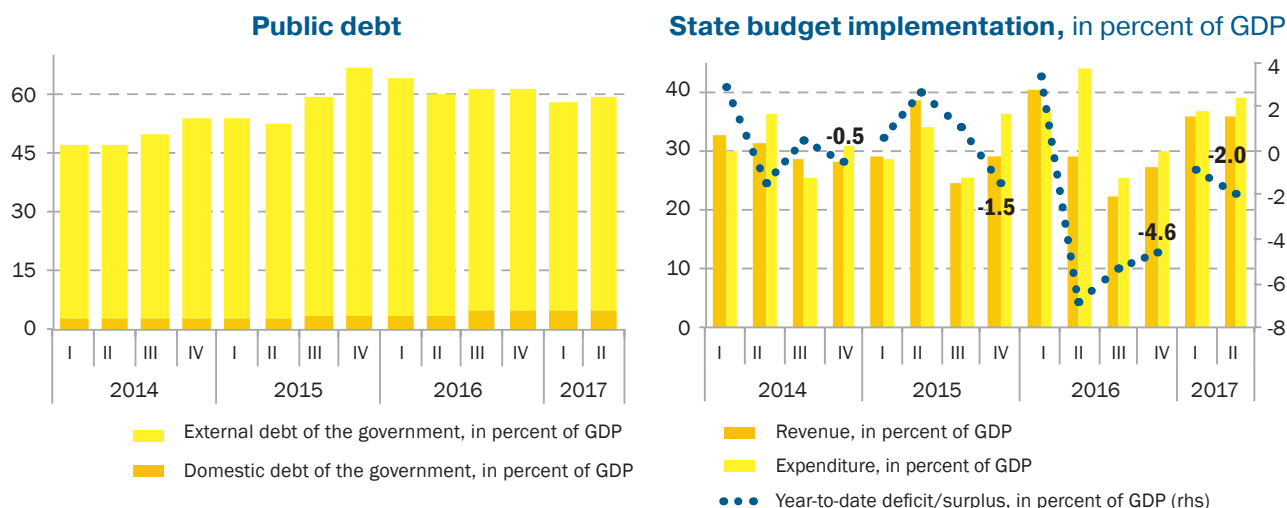
The depreciation of the real effective exchange rate of the som in 2Q 2017 compared to 2Q 2016 is mostly attributable to the real devaluation of the som against the basket of Eurasian Economic Union member states' currencies (11.5% y-o-y). Meanwhile, the som strengthened against the basket of other currencies by 7.7% y-o-y in real terms. Improved price competitiveness has been one of the factors driving exports to CIS member states (up 47.0% from 2Q 2016). The 30% increase in exports to non-CIS countries is mostly due to gold exports to Switzerland. The nominal volume of imports in dollar terms remained roughly at the level of 2Q 2016. As a result, the trade deficit decreased in 2Q 2017, according to preliminary estimates. In addition, a more than one-quarter increase in remittances from migrant workers also contributed to a reduction in the current account deficit to 7.4% of GDP (vs. 14.7% of GDP in 2Q 2016). The net inflow of direct foreign investment has more than offset the foreign currency outflow in current account transactions.

Fiscal Policy

Budget deficit in 2Q 2017

The budget deficit in 2Q 2017 amounted to 2.9% of GDP (vs. 14.9% of GDP in 2Q 2016). While in 1Q 2017 growth on the revenue side of the budget was recorded only in tax revenue, in 2Q 2017 the sources of revenue were complemented by increasing non-tax proceeds (by 1.7 times y-o-y) and the growing volume of incoming transfers (by 3.5 times y-o-y). This shifted the state budget revenue growth into positive territory (+31.9% y-o-y in 2Q 2017). Growth in current spending decreased to 2.9% y-o-y, while the net outflow of funds due to investments in non-financial assets declined by 28.0% y-o-y.

Public debt had risen by 4.3% since the beginning of 2017 to 293.6 billion soms (59.4% of GDP) as of July 1, 2017 (vs. 61.4% of GDP as of December 2016). The improvement in relative indicators of the external debt performance is attributable to GDP growth.



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

Monetary Policy

Stance of monetary policy remains unchanged

The National Bank of Kyrgyzstan kept the refinancing rate unchanged at 5.0% in 2Q 2017. Money market rates fluctuated near the lower limit of the interest rate range set at 0.25%, which reflects a surplus of liquidity in the system. Despite the structural surplus, the National Bank continued the practice of refinancing the banks. The total supply of credit resources amounted to 15.0 billion soms, while demand from commercial banks was at the level of 4.5 billion soms. A loan of 23.0 million soms was extended to international organizations founded by Kyrgyzstan jointly with other states within the Eurasian Economic Union framework. In the face of the som's strengthening against the US dollar, the National Bank of Kyrgyzstan intervened in the domestic foreign exchange market as a net buyer of foreign currency, buying USD 16.2 million in 2Q 2017.

Reduction in dollarization

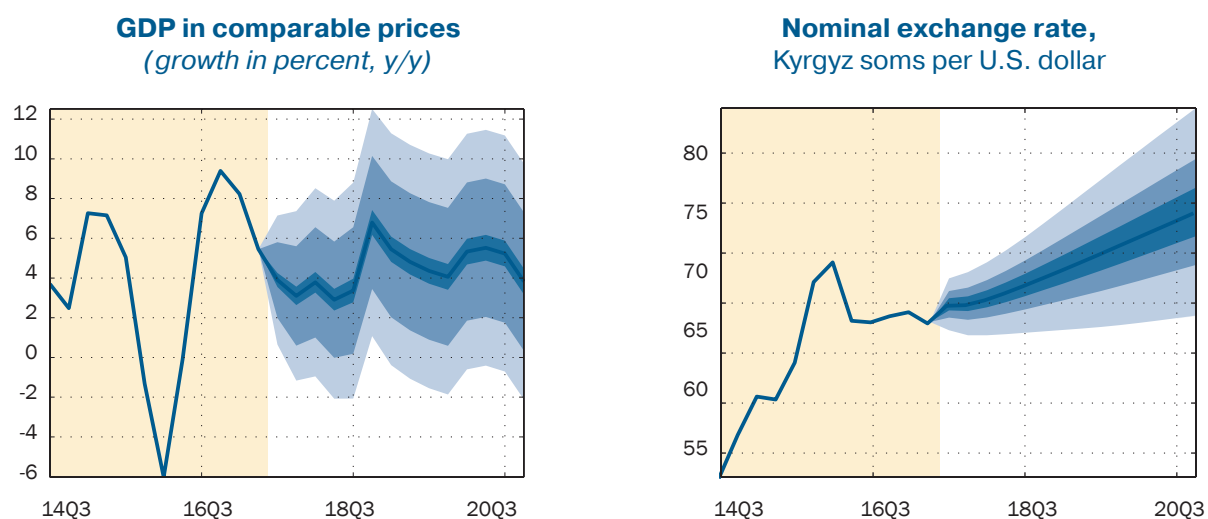
Commercial bank deposits at the end of August 2017 increased by 8.5% compared with the beginning of 2017, due to a 14.8% increase in national currency deposits, while foreign currency deposits increased by a mere 2.5%. Deposit dollarization has decreased by 2.8 percentage points to 48.2% since the beginning of 2017.

The loan portfolio of commercial banks at the end of August 2017 rose by 12.2% compared with the beginning of 2017, mostly due to an increase in loans extended in the national currency (21.2%), while foreign currency loans increased at a far more moderate rate (1.1%).

FORECASTS

Acceleration in inflation

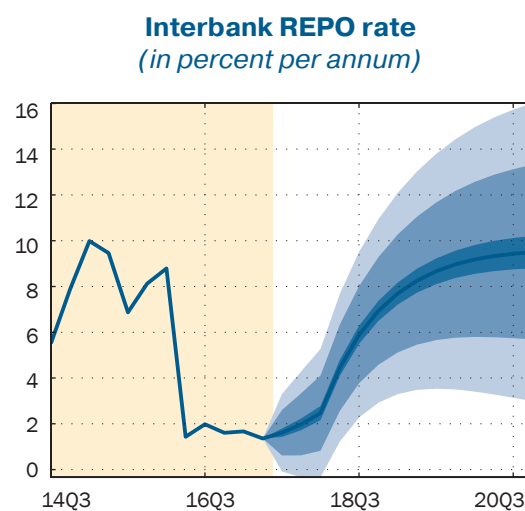
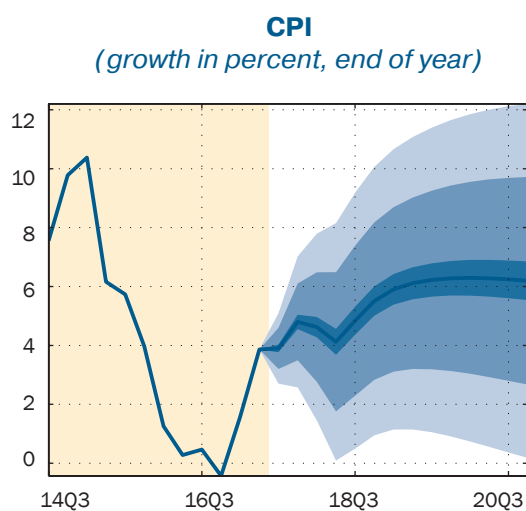
Even though inflation slowed in 3Q 2017, CPI growth is expected to pick up pace in the medium term. The drivers behind this are the growing domestic demand supported by the inflow of remittances from migrant workers and fiscal incentives. The inflationary background in trade partner countries will not have a significant effect on import prices. Inflationary risks are contained in the uncertainty over electricity and heat tariffs policy, expansive monetary conditions, and high sensitivity to price fluctuations in global food and energy markets. The anticipated inflationary risks call for a tightening of monetary conditions given the need to keep the inflation rate within the established target range of 5.0-7.0%.



Source: Estimates by the authors, EEC

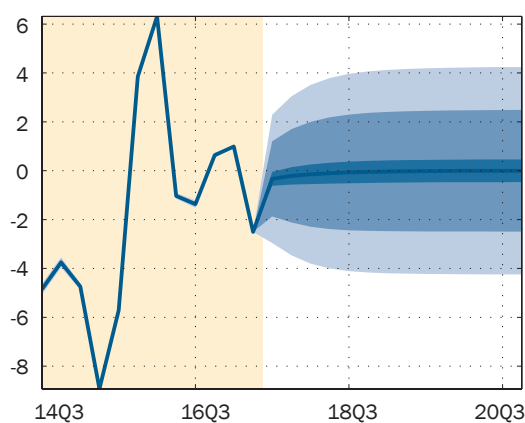
Slowing growth in 2H 2017

Improved gold output forecasts for 2017 caused the 2017 GDP growth estimates to be upgraded. While in early 2017 Kumtor predicted an almost 13% output reduction in 2017, gold output will decline by a mere 2.5% in 2017, according to revised forecasts. That said, the assumption that intra-annual growth rates will slow in 2H 2017 still applies, considering the cyclical nature of production at Kumtor. New background suggests that gold output will continue to decline in 2018, but that development will begin in 2019 at another major field that will shift the gold output growth back into positive territory. Fiscal policy measures will support economic activity over the forecast horizon. Despite the optimism about economic recovery in the major trade partner countries, external demand will still be limited.

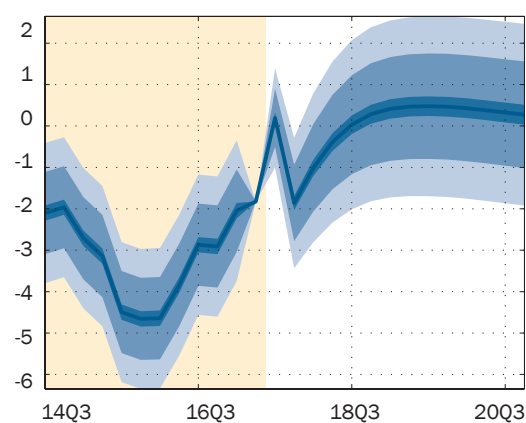


Source: Estimates by the authors, EEC

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



Output gap, in percent



Source: Estimates by the authors, EEC

SUMMARY

Forecast for the major macroeconomic indicators of the Kyrgyz Republic

	2017	2018	2019	2020
CPI (growth in percent, end of year)	3.9	5.5	6.3	6.2
GDP in comparable prices (growth in percent, y/y)	4.0	4.4	4.6	4.9
Interbank repo rate (in percent per annum)	1.7	5.1	8.8	9.8
Exchange rate of the national currency against the U.S. dollar (average for the year)	69.3	71.5	74.6	77.9

Source: Estimates by the authors, EEC

RUSSIAN FEDERATION



TRENDS

GDP

Steady recovery in economic growth

Russia demonstrated a steady recovery in economic growth in April-August 2017. According to the Federal Service for State Statistics (Rosstat), economic growth in 2Q 2017 was 2.5% y-o-y (vs. 0.5% y-o-y growth in 1Q 2017). Preliminary estimates of the Ministry of Economic Development indicate that the high rate of economic growth continued in July and August (with y-o-y growth of 1.8% and 2.3%, respectively). As a result, GDP growth in January-August 2017 is estimated at 1.7% y-o-y. These trends prompted a certain upward revision of the GDP growth forecast for 2017.

Increased investment activity in 2Q 2017

Two of the chief drivers of economic growth in 2Q 2017 have been improvements in investment activity and a recovery in inventory reserves. According to Rosstat, investments in fixed assets in 2Q 2017 increased by 6.3% y-o-y (vs. a 2.3% increase y-o-y in 1Q 2017). This positive trend received a great deal of support from the implementation of investment projects including the Kerch Bridge and the Power of Siberia gas pipeline. The expectations of growing demand for products in the manufacturing industry caused an increase in their inventories in 2Q 2017. As a result, the total growth in gross accumulation in 2Q 2017 was 14.8% y-o-y (vs. a 0.1% increase y-o-y in 1Q 2017).

3Q construction volume growth remains at a high level

After the dissipation of the effect of one-time factors in Q2 2017, investment activity in 3Q 2017 continued to receive support from the construction industry, which demonstrated annual growth of more than 7% in July-August. This trend can be attributed to more active mortgage lending against the backdrop of a gradual decline in the cost of credit resources.

The continuing increase in retail sales recorded in April - August (from 0.4% y-o-y in April to 1.9% y-o-y in August) against the background of growth in real incomes and lending is an indication of a steady recovery in consumer demand.

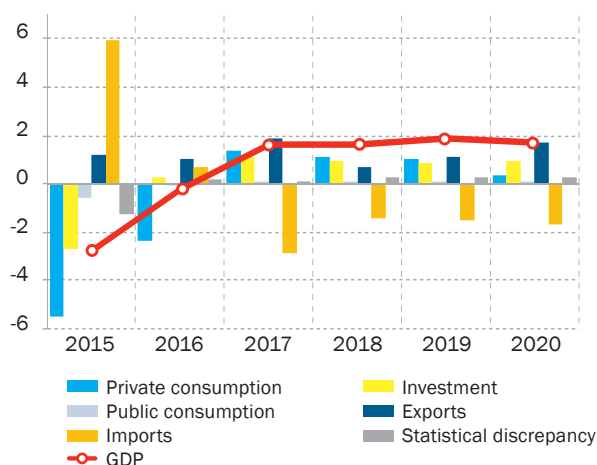
Recovery in consumer demand

The slowdown in manufacturing industry growth in July-August to 1.1-1.5% after 3.5% y-o-y growth in 2Q against the backdrop of increasing inventories could be an indication that demand is recovering at a somewhat slower pace than manufacturers expected in 2Q 2017. In January-August 2017, manufacturing industry output increased by 1.9% overall from the comparable period in 2016 (up 1.3% from the year before).

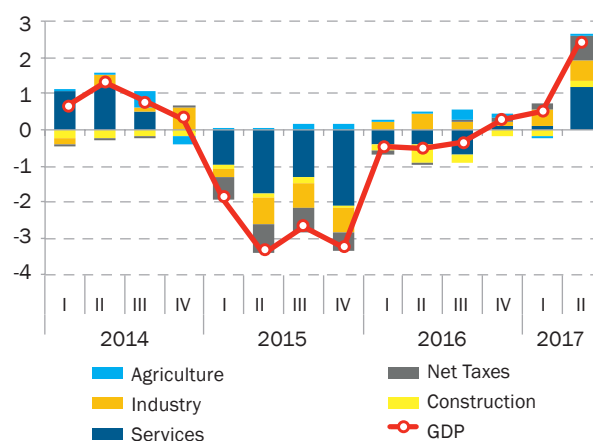
Weather conditions shape the trends in agriculture

The rescheduling of harvesting operations due to adverse weather conditions resulted in somewhat volatile trends in agriculture (growth in the summer months varied from -2.9% y-o-y to 4.7% y-o-y). In January-August 2017, agricultural output increased by 1.5% overall from the comparable period in 2016 (up 4.7% from the year before).

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



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



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

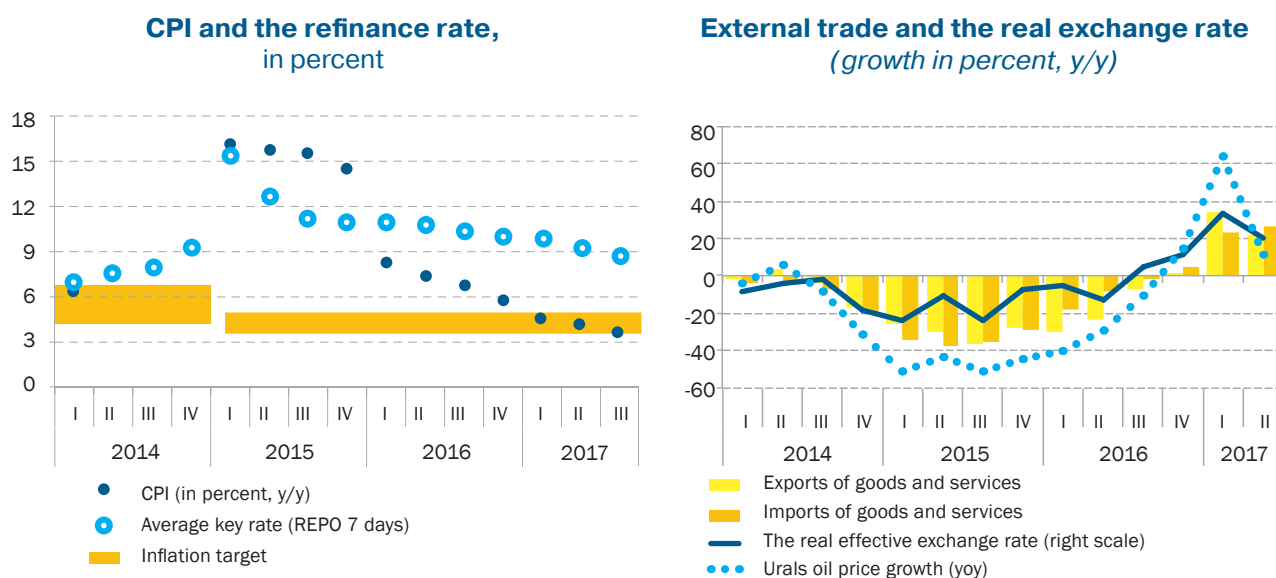
Leading indicators signal a steady recovery trend

According to leading indicators calculated by the Eurasian Economic Commission, economic activity is not expected to increase in the late 3Q – early 4Q 2017. Virtually all components of the headline leading indicator, which incorporates the external, domestic, and financial sectors of the economy, signal that the situation will remain unchanged.

Inflation

Inflation at historic lows

The annual inflation rate in September slowed to a historic low of 3%. The gradual reduction in July-September 2017 below the 4% Central Bank target resulted from the considerable reduction in fruit and vegetable prices following a good crop and a slight shift in seasonal factors. Trends in the rouble exchange rate and the gradual reduction in inflationary expectations also had a restraining effect on the level of prices during the period. The Central Bank estimates that inflationary expectations remain at a high level and create the key risk of an acceleration in inflationary processes. The inflation rate is expected to remain below 4% until the end of 2017 under the effect of the above-mentioned factors.



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

Exchange Rate

Conditions for a moderate rouble devaluation persist

The devaluation of the Russian rouble in the second half of June was followed by a period of its stabilization (July-August) at fairly high levels recorded in 2017 and the strengthening of the rouble in September on the back of rising oil prices despite the capital outflow recorded in September.

According to our estimates, the Russian rouble remained overpriced in 3Q 2017 compared to its equilibrium trajectory (the gap between the official and real effective exchange rate is estimated at about 3.5%). As a result, conditions for a moderate devaluation of the Russian currency persist on the market.

The current account demonstrated a somewhat volatile trend in June-September, which can be attributed to changes in global prices for the primary commodities exported by Russia and the growing imports of services. The current account surplus in January-September 2017 was USD 26.6 billion (vs. USD 15.3 billion in the comparable period of 2016), according to preliminary estimates of the Bank of Russia.

Abrupt growth in capital outflows in September 2017

The continued interest on the part of international investors in Russian securities translated into a net inflow of capital in June-August 2017 in the amount of some USD 7.5 billion, according to Central Bank estimates. However, the Central Bank has estimated capital outflows in the first nine months of 2017 at USD 21 billion, which indicates an abrupt increase in capital exodus in September by some USD 8.9 billion and can be attributed to volatility in the Russian banking sector.

Fiscal Policy

Considerable reserve for an increase in budget spending by the end of 2017

The federal budget deficit in January-August 2017 amounted to RUB 404 billion, or 0.7% of GDP (vs. a deficit of RUB 1,445 billion, or 2.7% of GDP, in the comparable period of 2016). Growing oil and gas revenue on the back of higher oil prices has been one of the primary factors behind the improvement in the budget balance in 2017 compared to 2016. As a result, after the first eight months of the year Russia had a considerable reserve (of some RUB 1.5 trillion) for an increase in budget spending in order to reach the budget deficit target of RUB 1.9 trillion, or 2.1% of GDP, by the end of the year. An expansionist fiscal policy in the remaining months of 2017 will additionally support the recovery in economic activity.

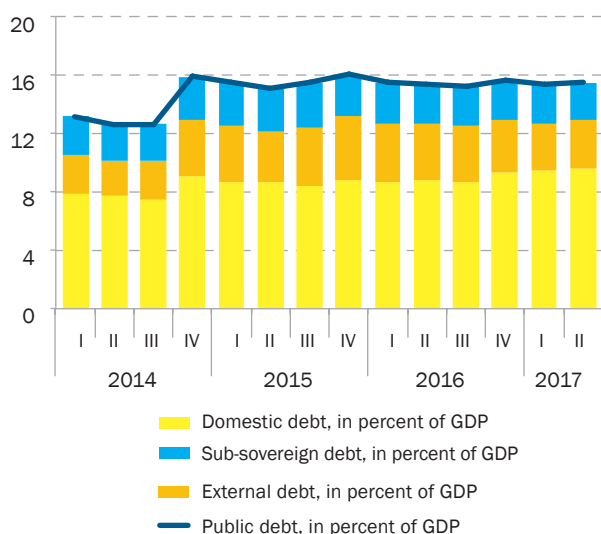
Offering of USD 3 billion worth of eurobonds

Russia's international bond debt increased by USD 3 billion in June-August. This follows the offering of Russian sovereign eurobonds with maturity periods of 10 and 30 years by the Ministry of Finance. Ten-year bonds worth USD 1 billion came with a 4.25% yield, while thirty-year bonds worth USD 2 billion came with a 5.25% yield. Taking into account debt repaid to former Comecon member states, foreign debt as of the beginning of September amounted to USD 51.1 billion (vs. USD 48.5 billion as of early June 2017).

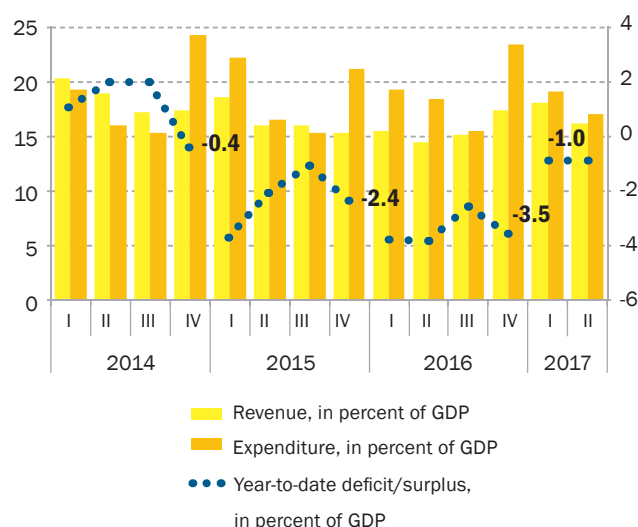
Growing domestic public debt

The domestic borrowing program is being implemented successfully against the background of a steady growth in demand for federal treasury bonds. Domestic public debt in June-August increased by RUB 260 billion (or by RUB 737 billion since the beginning of 2017) to RUB 8.74 trillion as of the beginning of September.

Public debt



Budget implementation



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

Monetary Policy

Continuation of a moderately tough monetary policy

After the growth in inflationary pressure recorded in June, the Russian Central Bank suspended its policy of benchmark interest rate cuts in July, which was accompanied by tougher rhetoric from the regulator and more moderate market expectations as to the short-term prospects of interest rate cuts. Monetary conditions were further relaxed in September. With the inflation rate decreasing below the target, the Central Bank lowered the interest rate by 0.5 percentage points to 8.5% from September 18. The restrained interest rate cuts are attributable to what the Central Bank believes to be high inflationary expectations.

FORECASTS

Annual GDP growth rate to reach 1.7-1.9% in the medium term

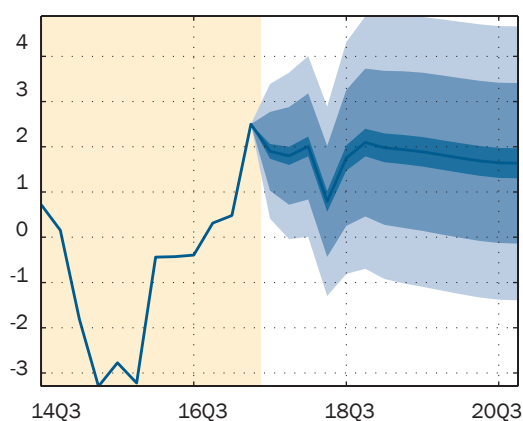
The economic growth recorded after the first eight months of 2017 somewhat exceeded our expectations, which justified an upward revision of the 2017 GDP growth forecast to 1.7% (from the previous forecast of 1.4%). In the remaining months of this year, additional growth drivers will come from growing consumer demand and investment activity against the background of more relaxed monetary conditions and potential incentives through the budget policy. In the medium term, annual GDP growth will amount to 1.7-1.9% and will mostly be shaped by domestic economic factors, while foreign demand will remain neutral. The institution of the budget rule beginning in 2018 will make the economy more stable in the face of potential external shocks.

Against the backdrop of the existing structural and institutional restrictions, the overall global background remains fairly favorable. Additional sources of growth need to be found, as long as they do not undermine the current macroeconomic stability achievements.

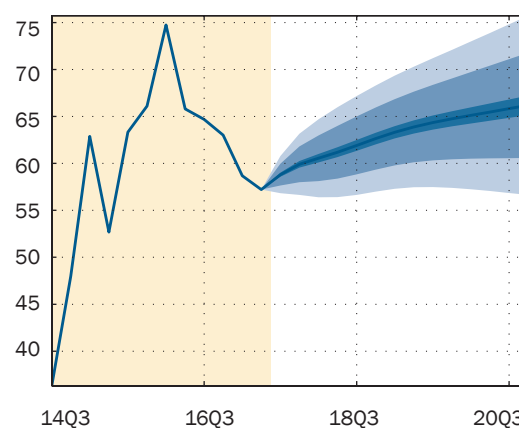
A balanced monetary policy

The anticipated closure of the existing gap between the official and real effective exchange rates will result in a weaker rouble in the short term. The potential impact on inflation will be partly eliminated by the continuing moderately tough monetary policy.

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

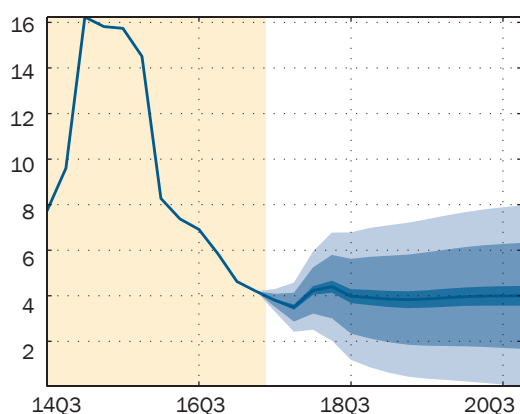


Nominal exchange rate,
Russian rubles per U.S. dollar

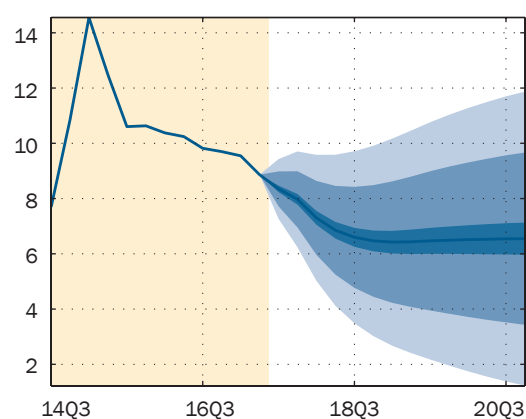


Source: Estimates by the authors, EEC

CPI, growth in percent
as of year-end

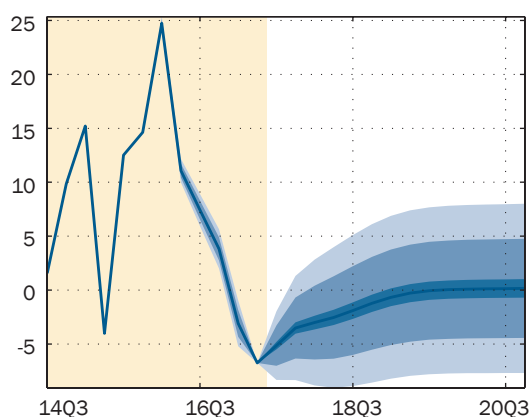


MIACR (Moscow Interbank Actual Credit Rate),
in percent per annum

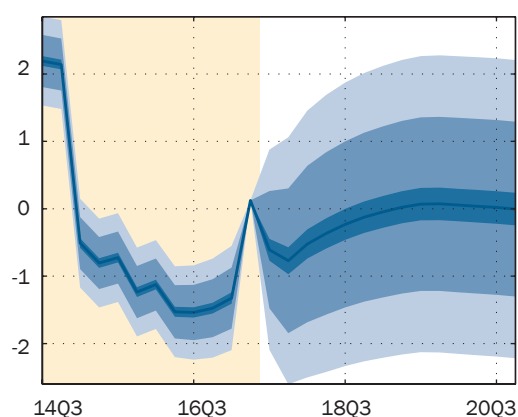


Source: Estimates by the authors, EEC

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



Output gap, in percent



Source: Estimates by the authors, EEC

Inflation to remain below 4% in 2017

In light of the annual inflation rate slowing to a historic low of 3% in September, the 2017 inflation forecast has been revised downward to 3.1% (from the previous level of 3.8%). A continued recovery in economic activity and improving consumer demand on the back of growing wages and lending will contribute to a slight acceleration of inflationary processes in the remaining months of 2017. Barring any shocks, the inflation rate will stabilize at 4% in the medium term if the current downward trend in inflationary expectations continues.

Benchmark interest rate to decline to 6.7% in the medium term

If the low inflation rate continues until the end of 2017, further benchmark interest rate cuts to 8% are likely this year. As inflationary expectations decrease and stabilize at a level conducive to maintaining inflation at about 4%, the Central Bank refinancing rate is expected to decrease to a neutral level of 6.5-7% (based on Eurasian Development Bank estimates).

SUMMARY

Forecast for the Major Macroeconomic Indicators of the Russian Federation

	2017	2018	2019	2020
CPI (growth in percent as of year-end)	3,1	3,9	4,0	4,0
GDP in comparable prices (growth in percent, y/y)	1,7	1,7	1,8	1,7
MIACR (in percent per annum)	9,1	7,0	6,8	6,8
Exchange rate of the national currency against the U.S. dollar (final average for the year)	58,6	61,6	64,1	65,6

Source: Estimates by the authors, EEC

REPUBLIC OF TAJIKISTAN



TRENDS

GDP

GDP growth slowdown

The uncertainty surrounding sources of funding resulted in a slowdown of economic growth in Tajikistan. 2Q 2017 GDP growth was 5.5% y-o-y (vs. 6.5% in 1Q 2017 y-o-y).

Growth sources remain in manufacturing industry

Economic activity in Tajikistan was shaped by the following key factors:

- *In terms of incomes:* Nominal wage growth (up 25.8% from 2Q 2016) was complemented by the growth in the net inflow of remittances from migrant workers (up 21.3% y-o-y in dollar terms). In the face of the shrinking portfolio of bank loans to households (-6.0% since the beginning of 2017) and the accelerating inflation rate, the nominal growth of the above-mentioned income sources has supported the households capacity to pay.
- *In terms of value added:* 2Q 2017 growth was driven by the manufacturing industry (up 23.2% from 2Q 2017), agriculture (up 8.5% y-o-y), and retail (up 4.2% y-o-y). The key factor that restricted 2Q 2017 GDP growth was a reduction in the volume of work completed in the construction industry, which was accompanied by a decline in investments.

The output gap was negative in 2Q 2017 and estimated at -0.8%.

Conditions exist for faster growth

The successful USD 500 million debut eurobonds placement in the international market in September 2017 to fund the construction of the Rogunskaya hydropower plant could support a recovery in investment growth in the near future.

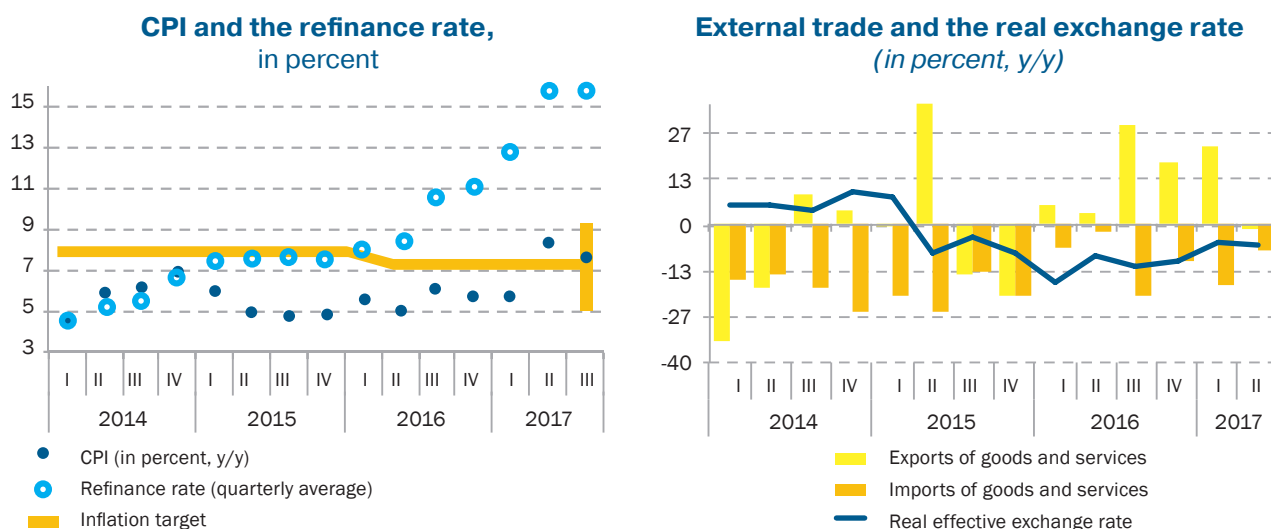
Inflation

Accelerating inflation in 2Q 2017

The supply shock of gasoline and fruit and vegetables, together with the exchange rate shock in early 2017, was compounded by a new spiral of devaluation in late May 2017, all of which contributed to an acceleration in inflation. While in 1Q 2017 the inflation rate was 6.1% y-o-y, it accelerated to 8.6% y-o-y in 2Q 2017. Overall CPI growth was driven by fast inflation in food and gasoline prices. Growth slowed in prices for basic durable goods, which is an indication of the postponed demand of households for non-food goods.

Inflation slowdown in 3Q 2017

The stabilization of the domestic foreign exchange market at the start of the summer and a more marked seasonal decline in prices for root crops reversed the upward inflation trend in 3Q 2017.



Source: The national statistical agency, estimates by the authors

External Sector

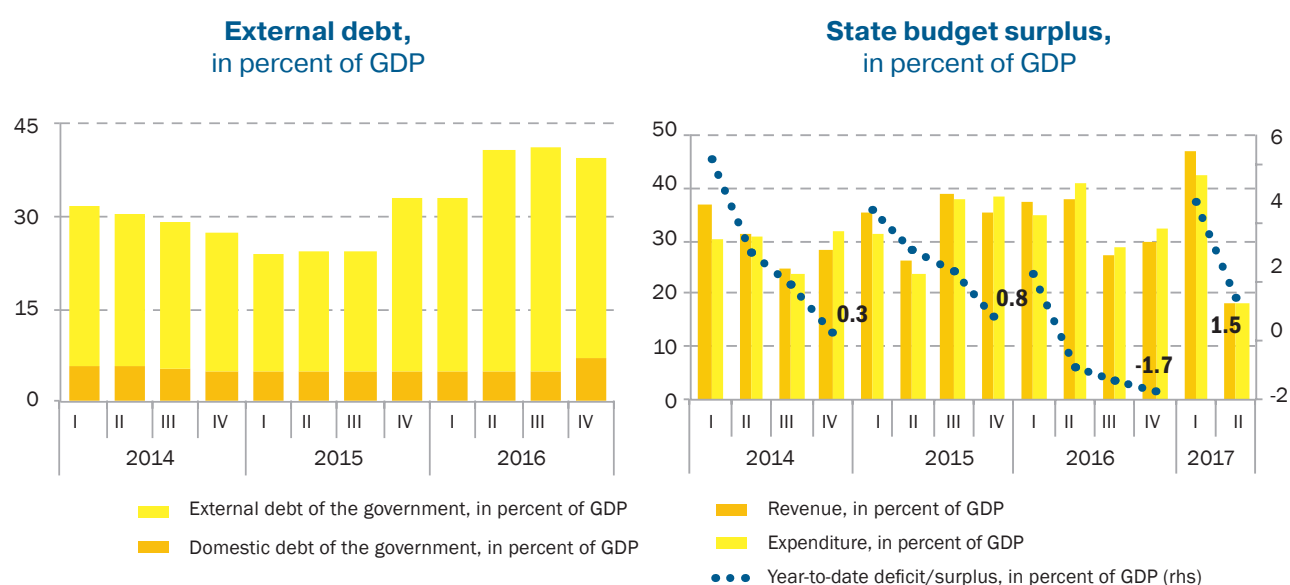
Decreasing current account deficit

The effective exchange rate of the somoni devalued by 5.8% in 2Q 2017 y-o-y. However, the improvement in price competitiveness was offset by the fluctuations in precious metals exports, whose contribution to the annual drop in overall exports amounted to 17.9 percentage points. A deeper reduction in imports of goods and services (down 7.4% from 2Q 2016) reduced the trade deficit. Meanwhile, positive growth in primary and secondary incomes (attributable mostly to the increase in remittances from migrant workers) reduced the current account deficit. Net capital outflow from direct foreign investments was caused by the payment of debt principal to international parent companies. Capital inflow into the country was driven by operations with debt instruments, including in the form of trade credit.

Fiscal Policy

Budget surplus

The budget surplus in January-June 2017 amounted to 1.5% of GDP, while in the comparable period of 2016 the state budget posted a deficit of 0.9% of GDP. Budget revenue increased by 23.3% from January-June 2016, mainly due to growing tax revenue (up 11.9% y-o-y) and revenue from other sources (up by 1.7 times). The public spending growth rate decreased to 4.0% y-o-y, mostly due to a 30% reduction in state investments in the fuel and energy industry. Investments in this industry increased by 2.2 times during the same period last year.



Source: The national statistical agency, estimates by the authors

Monetary Policy

Refinancing rate kept at 16.0%

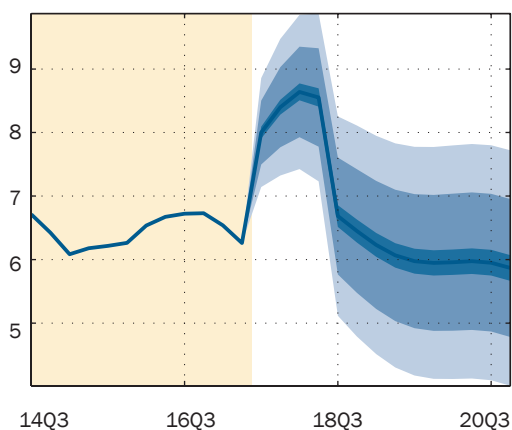
The continuing devaluation pressure combined with low international reserves and accelerating inflation prompted the National Bank of Tajikistan to keep its refinancing rate at 16.0%. Despite the measures taken to rehabilitate the banking sector, the key indicators still signal the presence of risks in the system. As of the end of June 2017, the share of non-performing loans in the total credit portfolio had decreased by 2.8 percentage points since the beginning of 2017 to 55.4%. Against a background of an outflow of deposits (down 2.2% since the beginning of 2017), the credit portfolio decreased by 3.8% from end December 2016.

FORECASTS

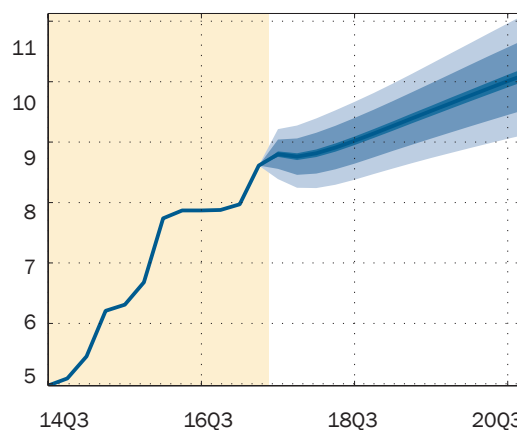
High investment activity supported economic growth

The plans of the Tajikistan government to finish construction of the Rogunskaya hydropower plant have received a further impetus. Along with the normalization of Tajik-Uzbek relations, the USD 500 million raised in the international capital market will enable the Italian contractor to not only eliminate the schedule slippage but also complete construction of the first stage of the Rogunskaya hydropower plant in 2018. This gives reason to believe that the investment component will yet again become a key growth driver. The recovery in the Russian economy will support domestic consumer demand through money transfers from migrant workers. At the same time, a poor banking sector performance could adversely affect economic growth in the medium term.

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



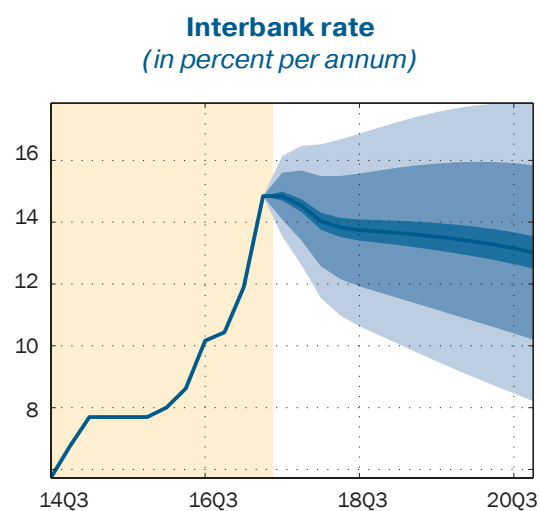
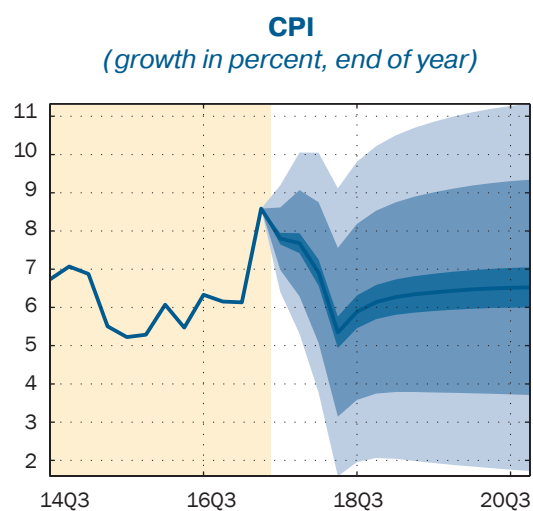
Nominal exchange rate,
Tajik somoni per U.S. dollar



Source: Estimates by the authors

Inflation to remain within the target range of $7.0 \pm 3\%$

The pro-inflationary shocks in 1H 2017 were offset by deflationary factors in the second half of the summer of 2017. Meanwhile, stabilization in the domestic foreign exchange market has taken the pressure off domestic prices. The outlook for the price situation in foreign markets does not carry any marked inflationary risks either. The recovery in domestic consumer demand will primarily have an effect on basic durable goods (including footwear and clothing), where a low inflationary background is discernible. In light of this, the overall CPI growth will be limited, and inflation will vary within the new target range of $7.0 \pm 3\%$.



Source: Estimates by the authors

SUMMARY

Forecast for the main macroeconomic indicators of the Republic of Tajikistan

	2017	2018	2019	2020
CPI (growth in percent, end of year)	7.7	6.1	6.5	6.5
GDP in comparable prices (growth in percent, y/y)	7.2	7.3	6.1	6.0
Interest rate on interbank loans (in percent per annum)	15.1	14.7	14.3	14.0
Exchange rate , somoni per U.S. dollar (average for the year)	8.5	9.0	9.5	9.9

Source: Estimates by the authors, EEC

SPECIAL REPORT.

12th CONFERENCE OF THE EURASIAN DEVELOPMENT BANK

Y.D. Lisovolik, Ph.D. (economics), A.S. Kuznetsov, A.R. Berdigulova

Issues of Eurasian integration were discussed, as is now traditional, at the annual EDB conference in October. This year's conference focused on finding new drivers for Eurasian integration, and discussed ways to promote integration in finance, investments, infrastructure, foreign trade and humanitarian cooperation. A plenary session titled *Eurasian Integration: Stagnation or Growth?* also touched on the subject of pursuing closer international cooperation within the EEU framework. A breakout session titled *Challenges and Prospects for Economic Growth. Views of Chief Economists* featured a discussion of inequality within and between countries that is holding back global economic growth. The idea that infrastructure should be developed as a key factor instrumental to overcoming the geographic restrictions faced by Eurasian countries and as a means of transforming the regional geography into a comparative advantage was a recurring topic during both sessions.

PLENARY SESSION: EURASIAN INTEGRATION: STAGNATION OR GROWTH?

The first stage of Eurasian economic integration is now over, having heralded breakthroughs across a whole range of issues. A single customs space, an elaborate system of institutions, and a common labor market have all been created. The Eurasian Union is now embarking on a strategically important period that calls for a great deal of patience and dedication. The plenary session participants discussed current progress and future prospects of integration processes.

ADVANTAGES OF INTEGRATION

Speaking of the positive aspects of institutional transformation within the Union, Eurasian Economic Commission Board Chairman **Tigran Sarkisyan** highlighted the structural changes and growing volumes of mutual trade and investments that show that integration is progressing despite the challenges encountered along the way.

“Integration is one of the five key elements that determine the future and the rate of economic growth of both Russia in particular and EEU member states in general.”

A. Kudrin

Alexey Kudrin, Deputy Chairman of the Economic Council under the Russian President, estimated that in order for Russia to achieve annual growth of 3-4% given the existing structural constraints, non-commodity exports should be doubled from USD 109 billion in 2016 to USD 200-220 billion in 2024. In light of this, one of the priorities involves supporting exports and eliminating any barriers in their way as far as possible, through simplified foreign exchange controls and customs formalities, and the unification of trade relations both within the EEU and with third countries. In this context, integration acts as the primary vehicle of international trade, new technologies and services. To quote **Alexey Kudrin**, integration is one of the five key elements that determine the future and the rate of economic growth of both Russia in particular and EEU member states in general. According to the estimates quoted, if all trade restrictions (including non-tariff regulation) were removed, Armenia would add 6.5% to its current GDP growth, Belarus – up to 12%, Kyrgyzstan – 7.5%, and Kazakhstan and Russia – up to 1%.

Tigran Sarkisyan believes that diversification of the economy and economic growth can be stimulated by properly structured trade and economic relations, including those with third countries. With this in mind, the session participants highlighted the priority aspects for expansion of economic cooperation. The number-one spot belongs to China, where trade cooperation is viewed both in terms of institutional and trade/economic relations and in the form of traditional free-trade zone agreements. It is followed by Vietnam, where a free-trade zone agreement took effect early this year. Other countries in the order of priority are Singapore, Iran, India, Egypt, and Israel, where the process is currently at the negotiation stage. “These are the primary tracks we have launched, these seven directions carry what I believe to be formidable potential for both economic growth and modernization of the Eurasian Union,” **Mr. Sarkisyan** said.

In his presentation, Eurasian Development Bank Chairman **Dmitry Pankin** highlighted the positive aspects and challenges involved in implementing the Silk Road project with China. On the one hand, given the current transportation cost per container, there is a potential for continued growth in container flows without any major new investments as part of trans-Eurasian transit across Russia, Kazakhstan, and Belarus (China - EU - China) to reach 200,000 FEU (40-foot containers) in 2020, i.e. threefold in the space of three years. On the other hand, the Chinese government's subsidies for exports by rail are the main reason behind the annual doubling of the number of container trains and volumes of container cargo between China, the EEU, and the EU in 2013-2016. What is now effectively a zero-percent rate for container transportation across China from several provinces in Central China has contributed to a swift changeover in Chinese exporters' cargo flows from seaports to rail transport. Against this background, there is a risk that China might scale back its subsidies.

“Infrastructure always comes with new growth and connects cities. This has an effect on workforce mobility and the placement of industrial facilities.”

A. Kudrin

Another important aspect of trans-Eurasian transit is the lagging infrastructure development of the Polish railway system, where the infrastructure and the fleet of locomotives need to be upgraded and renewed. While container trains travel at a fairly acceptable rate of speed (45-50 km/h on average) through the EEU member states, their speed slows down drastically to 18-20 km/h in Poland. The EU also imposes a number of restrictions on the length of container trains, which in some cases requires rebuilding trains at the border. “Without a doubt, we must consider the vast Chinese market and this powerful economy. Yet I believe that hoping that we can make a living from Chinese transit and reap dividends off it is wishful thinking,” **Dmitriy Pankin** summarized.

Alexey Kudrin pointed not only to the transit potential for the EEU countries from the China – EU transport infrastructure but also to the development of connections between our regions. Infrastructure always comes with new growth and connects cities. This has an effect on workforce mobility and the placement of industrial facilities.

INTEGRATION IN THE MONETARY SECTOR

According to **Ksenia Yudaeva**, First Deputy Chairperson of the Bank of Russia, low inflation is a precondition for the wider use by countries of national currencies in both mutual and domestic payments. Current trends in the EEU member states are seen as an important vector in this direction. Low inflation, growing trust in national currencies, and improving macroeconomic stability will generally promote continued dedollarization of the economies of EEU member states.

Alexey Kudrin pointed out that in light of its record-breaking price fluctuations over a short period of time the Russian rouble is not a convenient payment currency as of yet and lags the dollar and euro in this regard. The rouble's positions as an international payment currency will strengthen further in the event of low inflation as Russia reduces its oil dependency.

Participants observed that the ongoing policy of sanctions (particularly new sanctions that prohibit Russian companies from doing business not just with the USA, but with the rest of the world) creates risks for foreign currency transactions and could accelerate the introduction of the rouble in international payments.

PROSPECTS FOR DIGITAL TRANSFORMATION

“Digital transformation is an obvious global trend.”

T. Sarkisyan

Speaking of the digital transformation in the EEU space, Russian Deputy Foreign Minister **Alexander Pankin** mentioned the adoption in 2017 of the major aspects of implementation of the digital agenda up to 2025. Under this document, innovative projects will maximally cover the industry-specific, cross-industry, and infrastructure sectors.

Mr. Sarkisyan contributed to confirm that government leaders of the EEU member states have already approved the procedure for implementing this digital agenda, which defines the implementation mechanisms of the major aspects. The first initiative of fundamental importance involves creating a mega database, exchanging data, creating cross-industry digital platforms, etc.

STAGNATION OR GROWTH

“I believe that integration is a process. There will never come a day when everybody says: that’s it – we have integrated. There will still be areas that require continued efforts.”

A. Pankin

Plenary session participants remarked that the rate of integration in the Eurasian space has slowed somewhat. New challenges have appeared on the agenda. For example, Dmitry Pankin pointed out an acute shortage of synchronization among the efforts of EEU member states in implementing transboundary infrastructure projects and when it comes to planning in general. There are situations in practice where infrastructure projects are implemented in a non-synchronized manner, which drastically reduces the effectiveness of business operations within the Union framework and limits any prospects for growth. Countries launch certain infrastructure projects on their own at a time when they are *de facto* parts of international transport corridors. In this context, participants pointed out the importance of efforts launched by the Eurasian Economic Commission to analyze the transport projects being contemplated by the EEU member states.

“The number-one task today is expanding the scope of the commission’s authority in order to ensure that the commission is also accountable.”

T. Sarkisyan

Tigran Sarkisyan expressed the view that time has shown that creating a supranational body to promote integration in the region is a necessary, albeit insufficient measure. Yet when an agency is not authorized to enforce laws, conflicts are bound to arise between countries over the different interpretations of the provisions of the integration association. This is where the conflict between short-term interests of national governments and long-term goals of an integrated association comes to the fore. Therefore, the number-one task today is expanding the scope of the commission’s authority in order to ensure that the commission is also accountable.

“Cooperation in the humanitarian sector could become the next stage of further integration.”

Dmitriy Pankin

Alexey Kudrin seconded this position, stating that the EEU has accumulated a great deal of problems and that this integration association has reached a certain milestone. The approaches that used to generate growth have been mostly exhausted. There is a need for new steps and new ideas today: “In this context I support the idea of increasing the role of supranational bodies and delegating more authority to them.”

According to **Natalia Korzhova**, President of the Financial Academy of the Ministry of Finance of the Republic of Kazakhstan, a need has formed in the field of humanitarian cooperation and development of human capital to reach a level of education that would enable today’s graduates from master’s degree or Ph.D. programs to come and either teach the next generation or train professionals for whom there is currently a large market demand, financial analysts, manufacturing industry experts, and other forward-looking people who understand where the EEU and other integration associations will find themselves in the future.

BREAKOUT SESSION: CHALLENGES AND PROSPECTS FOR ECONOMIC GROWTH. VIEWS OF CHIEF ECONOMISTS

Representatives of international and regional financial development institutions presented their vision of current macroeconomic trends both in the world and in specific regions. A key topic for the breakout session was the issue of inequality within and between countries, which holds back global economic growth. Discussion participants pointed out that the causes of this phenomenon extend beyond the traditional concept of income-based inequality. It is also important to address no less fundamental factors of inequality such as geography and different transportation costs for producers of countries with and without access to the sea.

“The paradox of the global economy is that countries that require economic integration more than others experience a shortage of integration partnerships.”

Y. Lissovolik

According to **Yaroslav Lissovolik**, Chief Economist of the EDB, the issue of inequality of economic integration (when the regions that most need integration are least involved in the processes of globalization of international trade) has received insufficient attention both in economic research and macroeconomic discussions. This phenomenon should be studied through the prism of the “continentality” concept. The World Bank estimates that higher transportation costs cause the GDP of countries without access to the sea to grow at a rate that is 1.5% slower, and to have a 30% smaller goods turnover compared to maritime countries. Countries without access to the sea (excluding EU and EFTA countries) have 2.5 free-trade zone agreements on average, while maritime countries have 7.5 FTAs (according to the WTO database). If you consider all types of integration agreements, the difference between the two groups of countries is still more than twofold (countries without access to the sea have 4 agreements on average vs. 9 agreements for maritime countries).

If one compares countries with high and low incomes (as defined by the World Bank), it turns out that the average number of FTAs in low-income countries is 0.3, vs. 14.7 in rich economies (a more than 40-fold difference). The difference between the two groups of countries in terms of the total number of integration agreements (including FTAs) is more than 10-fold.

Countries without access to the sea account for roughly one-fifth of WTO members. At the same time, thirty percent of non-WTO members have no access to the sea.

These facts are graphic evidence that continental countries and/or developing countries in need of integration have a low level of involvement in integration associations.

Such conditions give rise to the need to create new integration mechanisms that would be more inclusive of countries with low incomes or no access to the sea. One example of such an integration project is China's One Belt One Road (OBOR), which encompasses 69 countries. This project aims to develop infrastructure and reduce transportation costs in the continental Eurasian space. The OBOR is unique in that more than 30% of all countries of the world and 75% of Eurasian countries without access to the sea have joined the project.

Another example is the Eurasian Economic Union (EEU): none of its member states except Russia has access to the sea. And even Russia is a predominantly continental type of economy with an acute shortage of port capacity.

“Infrastructure development is a key factor instrumental to overcoming the geographic restrictions.”

Y. Lissovolik

Integration, including through the creation of transport infrastructure, is one of the primary ways to overcome geographic restrictions faced by Eurasian countries, which in turn requires an economic policy focused on long-term macroeconomic stability.

In this context, the current macroeconomic parameters of the EDB member states create favorable conditions for a new round of integration. The recovering economic growth, declining inflation and interest rates create good conditions to implement integration projects in the region.

“Economic integration can be preserved only by unfailing decisiveness in rectifying macroeconomic imbalances, no matter how painful this process may be.”

R. Strauch

The European Union's experience in overcoming the crisis and approaches to integration into the global economic space were presented by Rolf Strauch, Chief Economist of the European Stability Mechanism. The Eurozone, being the world's largest and most open economy, has more successfully addressed the challenges of the global economic crisis than the USA and Japan. In terms of the foreign trade turnover of goods and services, the openness of the Eurozone increased from 50% of GDP in 1995 to over 80% of GDP in 2016. Exports, including internal trade between member states, acted as a driver of economic growth that enabled the Eurozone to recover from the global crisis sooner than other developed countries.

According to forecasts, exports will continue to play a key role in the foreseeable future. The primary success factors have been the political will and staunch determination to implement reforms aimed at eradicating the causes that provoked the crisis, along with the striving to re-balance the economies within the Eurozone, however painful this process may be. Owing to the fiscal consolidation implemented as part of the ESM program, the fiscal and external positions of the Eurozone are currently evaluated as stable.

“Strengthening of the economy’s structural integration is a guarantee of a country’s successful integration into the global economic space.”

In the context of integration into the global economic space, the Eurozone faced the challenge of raising both structural and price competitiveness. Eurozone countries worked hard to eliminate barriers that prevented the development of free enterprise and to remove obstacles in the way of commodity and capital flows. Competitiveness indexes are graphic evidence of the success of this policy. The Eurozone is home to a third of the world’s most competitive economies. Structural reforms aimed at improving the conditions for doing business have reinforced the positions of the EU in world globalization trends.

R. Strauch

The capabilities of Eurozone countries are somewhat limited in terms of regulation of price competitiveness. The EU lost its price competitiveness during the global crisis. Restoring it required lowering production costs, which has been rather painful for some of the EU member states. Price competitiveness has now recovered to the pre-crisis level, which has improved the positions of the Eurozone compared to China and the USA.

As regards the inequality of economies, an important conclusion drawn from the way the Eurozone countries have overcome the crisis is the inclusive nature of the recovery that happened on equal terms for all EU members. The major factors have been the all-encompassing nature of the job creation process and a more equal distribution of incomes in the Eurozone countries as opposed to the USA, for example. The European model for overcoming the crisis has proven to be successful from the point of view of those who lost in the globalization process.

Continued plans to reinforce integration in the Eurozone include an initiative to distribute risks among countries. If shocks are asymmetrical, there should be either government or market mechanisms capable of balancing out the inequalities among countries. Market mechanisms are private capital flows, funding, and private sector financing, which implies creating a banking union (a single oversight agency and a single mechanism for dispute resolution). In addition, a single capital market for transboundary investments is currently at the formative stage.

The creation of a fiscal union as one of the ways to reduce inequality between countries in Europe is an issue that remains to be discussed in the context of stepping up European integration efforts.

“The growth prospects of the global economy inspire optimism.”

G. Di Bella

Global economic growth forecasts were presented by **Gabriel Di Bella**, chief of the International Monetary Fund mission in Russia. According to the IMF World Economic Outlook published in October, the current period is favorable for the global economy. In the wake of the global crisis, most countries of the world have started to demonstrate positive growth; the Eurozone is experiencing a dynamic economic recovery; US economic growth is strengthening; and economic activity in Japan is recovering. Among the emerging economies, Russia has demonstrated faster economic growth. The economic growth forecast for China has also been upgraded. Low inflation in the Eurozone and the US is still cause for some concern. The risks are relatively balanced and do not raise concerns in the short term. Risks of a deterioration predominate in the medium term. In this context, the economies should use this window of opportunity to build buffers and implement those economic policy measures that are hardest during economic downturns.

Demographic factors play a growing role in the context of fiscal position planning. The demographic situation in the world varies greatly from region to region: developed nations are demonstrating a trend toward an aging population, which gives rise to a number of challenges for these countries: the need to increase labor participation rate, changes in the structure of consumption, and a growing burden on the budget. In countries with emerging markets, the demographic factor will make a positive contribution to economic growth for several decades.

The IMF has revised the global economic growth forecast upwards for the first time in a long while. The growth rates in the Eurozone, USA, and emerging markets are higher under the baseline scenario compared to the previous forecast.

“The discernible growth in the cyclical component limits the effectiveness of monetary policy and increases the risks of labor productivity stagnation.”

G. Di Bella

A highlight of the current cyclical growth phase is that economic activity is recovering under the conditions of low inflation. Inflation still remains below central bank targets. This poses risks in terms of the effectiveness of monetary policy in matters of stimulation of economic activity.

Stagnation of labor productivity is yet another feature of the current recovery phase. There is a lot of talk about robotization, a digital economy, and development of the FinTech industry. The paradox is that despite all of these innovations introduced since the beginning of the world crisis, the overall productivity of the factors of production demonstrates weak growth. Such modest growth in labor productivity is expected to continue in the foreseeable future, and per capita growth will be lower than the level achieved in 1995-2005.

Despite all the optimism, risks of higher financial instability are present on the forecast horizon. High economic growth in China was partly fueled by excessive expansion of lending, which increases the risk that China may not achieve the target of doubling its GDP by 2020.

Another aspect of risk relates to the Eurozone and the US, where monetary policy is normalizing at a slower-than-expected rate. In light of this, the risks of acceleration of normalization of monetary conditions in the USA and Eurozone could cause elevated volatility in the financial markets of emerging economies caused by the turnaround of capital flows.

Additional risks are contained in the possible deregulation of the financial system of developed countries. A great deal of progress has been achieved in the wake of the economic crisis in terms of increasing the stability of the banking sector, amassing capital, and introducing macro-prudential oversight. After this tremendous amount of work, deregulation of the financial sector would represent a major step back that would bring high risks with it.

The growing protectionist sentiments that seek to protect national interests by closing the borders along with geopolitical disagreements could also undermine this global growth.

“Improving the quality of public spending on infrastructure will help overcome the problems of Russia’s continentality.”

G. Di Bella

As for Russia, to secure stable growth in the medium term, the implemented macroeconomic policy measures such as the introduction of the fiscal rule and the transition to inflation targeting should become an integral part of economic policy and be implemented consistently in order to ensure stability of the macroeconomic environment. Demographics are a challenge for Russia, which requires a decisive reform of the pension system. Russia’s continentality and high level of logistical costs also impose restrictions on economic growth opportunities. In this case, integration into global trade and ensuring a more uniform distribution of incomes by improving government spending on infrastructure and social needs will help to overcome the problems of inequality.

Apurva Sanghi, the World Bank’s Leading Economist in the Russian Federation, discussed the **findings of the World Bank study titled *Competitiveness of Cities***. According to the study, over 80% of global economic activity is generated in cities. More than one half of the world population lives in urbanized districts. Even though Russia is experiencing a declining rate of population growth, the country’s urbanization is on the rise.

The World Bank has created a database of the world's 750 largest cities. An analysis of data from these cities was used to determine which cities grow at the fastest rate. Since the early 2000s, roughly three-quarters of the cities analyzed have been growing more quickly than their respective national economies. Competitive cities demonstrate high economic growth, job creation, and income growth. The top 75 cities in the ranking achieved average GDP growth of 13.5% versus 4.5% in other cities between 2000 and 2006. The average annual rate of new job creation exceeded 9% and income growth – 10%. Factors such as the availability of natural resources, or being a capital city or a port town are not decisive when it comes to accelerating GDP growth.

For example, the Turkish city of Gaziantep does not have natural resources, and is not a capital city or a port town. However, light industry enterprises in Gaziantep export their products to 175 countries of the world. Exports increased tenfold in just 11 years from USD 620 million in 2002 to USD 6.2 billion in 2013. This city ranked ninth in the global ranking of economic growth between 1999 and 2009. Average GDP growth was 6.3% and average employment growth was 3.6% between 2005 and 2012.

What factors enable the city to join the most competitive cities in the world? First: long-term sustainable growth is ensured by stable growth of employment in two or three sectors that create a commercial product, rather than in retail or the public services sector. The second factor is the effective governance structure of the urban municipality. Third: competitive cities focus on transforming strategies into real actions through strategic budgeting and solving problems as they arise during the implementation of plans. Notably, such factors as leadership skills of the city's mayor or fiscal incentives do not play a key role in helping cities achieve the status of the most competitive cities in the world.

Natalia Orlova, Chief Economist with Alfa-Bank, presented her own vision of the **prospects for Russian economic growth and the risks that curb its quality growth.**

Against a background of a global economic recovery, the Russian economy also started demonstrating positive growth. For the first time since 2014, the Russian economy has grown by 1.5% in the first half of the year. Alfa-Bank estimates that GDP growth will amount to 1.5-2.0% by the end of 2017. Despite the major structural shifts in the economy, the achievements of macroeconomic policy can be described as successful: the transition to a floating exchange rate and more stringent controls over government spending. Inflation is expected to be 3.0% in 2017.

“Positive achievements of Russia’s macroeconomic policy are complicated by the unequal growth structure.”

N. Orlova

The flip side of macroeconomic policy success is the structure of economic growth, which reflects an unequal distribution of incomes and unequal development of specific Russian regions. In past decades, growth was recorded in the majority of economic sectors and regions of Russia, whereas the current recovery of investments is driven almost 90% by three regions: the city of Moscow due to the renovation of the city; the Crimea, where a major infrastructure facility is under construction; and the Far East, which utilizes Chinese investments in the oil and gas industry. The consumer sector is also demonstrating uneven growth. The number of people living below the poverty line has been rising since 2013.

Presently, some 19-20 million Russians have incomes that place them below the poverty line. This presents new challenges for fiscal policy. While in previous decades the budget involved redistributing revenue from the oil industry to other sectors of the economy, there is presently a need to redistribute incomes from the middle class to the most vulnerable groups of the population. It is expected that the year 2018 will see the implementation of fair mechanisms for the redistribution of fiscal cash flows in order to reduce the inequality of incomes.

On the one hand, Russia has been showing strong macroeconomic achievements. On the other hand, risks attributable to the structure of growth are present. In 2008, when the global financial crisis broke out, many economists claimed that Russia had sufficient strength in reserves to withstand the pressure of the crisis wave. Time has shown, however, that macroeconomic stability is an essential albeit insufficient condition for stable economic growth. The level of potential growth of the Russian economy has declined from 6.0% to 1-2% between 2008 and 2017. This means that a balanced macroeconomic policy should be complemented by structural reforms.

The challenges of deeper integration and economic inequality discussed at the plenary and breakout sessions, respectively, can hardly resolve themselves. In the context of an improving macroeconomic environment, now is a suitable time to implement reforms aimed both at stepping up integration and overcoming the factors of inequality. A special role in this process is reserved for development banks and other international financial institutions. At the same time, it is essential to understand that the elimination of imbalances with the help of the government and international institutions should not undermine the effectiveness of market forces.

SPECIAL REPORT. IMPLEMENTATION OF ECONOMY DEDOLLARIZATION MEASURES IN EDB MEMBER STATES

Ya.D. Lisovolik, Ph.D. (economics), A.S. Kuznetsov, A.R. Berdigulova, K.S. Ivanova

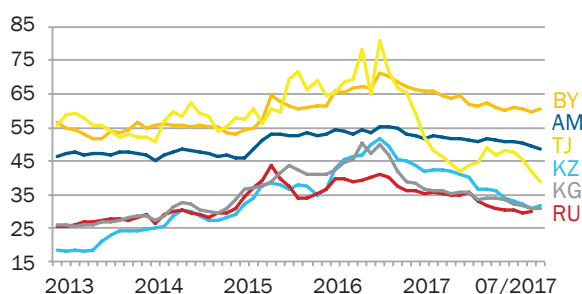
A highly dollarized economy is a distinctive feature of countries in the EDB region. This imposes constraints on the effectiveness of monetary and fiscal policies, exposes the economy to external shocks, and increases both the risks of financial instability and inflationary risks, sensitivity to which increases as the level of dollarization rises.

After studying the evolution of this phenomenon in some of the EDB member states in 2005-2015, a number of experts have concluded that the elevated level of dollarization is caused by: high inflation and exchange rate management instruments (hard peg, crawling bands, etc.), macroeconomic volatility (especially as regards inflation), and a fear of a floating exchange rate. One of the underlying macroeconomic factors behind dedollarization is a flexible exchange rate policy that makes the exchange rate more volatile than price fluctuations, along with the implementation of measures aimed at curbing and stabilizing inflation relative to an acceptable target level⁴. The string of events occurring in the foreign exchange and monetary sectors of EDB member states in 2014-2015 resulted in a spike in dollarization, which eventually gave way to dedollarization of the regional economies.

DOLLARIZATION TRENDS

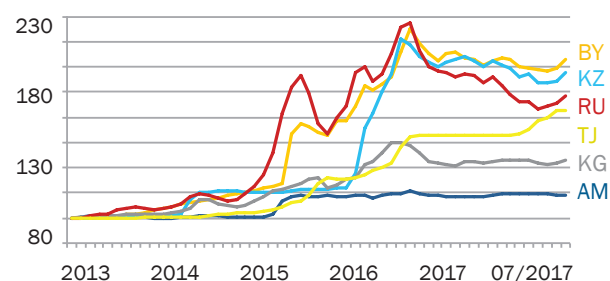
The rapid devaluation of national currencies between 2014 and 2016 was accompanied by a growing share of foreign currency deposits within the structure of the broad money supply in all EDB member states (Chart 1). At the end of 2015, the highest level of dollarization of deposits was recorded in Tajikistan, and the lowest in Russia, at 41.1% (the share of foreign currency deposits within the structure of the broad money supply).

Chart 1. Share of foreign currency deposits within the structure of the broad money supply (%)



Source: Central Banks, calculations by the authors

Chart 2. Changes in national currency exchange rates relative to the US dollar (2013 = 100)



Source: Central Banks, calculations by the authors

⁴ Demidenko, M. Dollarization: Causes and Possible Solutions / M. Demidenko, N. Mironchik, A. Kuznetsov // Banking Bulletin. 2016. December. pp. 3-10.

It stands to mention that the share of foreign currency deposits increased due both to changes in the savings preferences of economic agents in favor of instruments denominated in foreign currencies and to the effect of revaluation caused by the weakening of national currencies against the US dollar.

External shocks faced by EDB member states in 2014-2015 forced the monetary authorities of some countries in the region to change their approach to monetary policy. The central/national banks of Russia (in late 2014) and Kazakhstan (in mid-2015) announced a transition to inflation targeting and a floating exchange rate. The National Bank of Belarus switched to monetary targeting in early 2015, allowing the exchange rate to reflect market forces. The central/national banks of Armenia, Kyrgyzstan, and Tajikistan kept their old approaches to monetary policy while trying to limit exchange rate volatility using available tools. Countries with sufficient international reserves resorted to foreign currency interventions to support the exchange rate of the national currency. A number of central/national banks raised their benchmark interest rates and changed the mandatory reserve assets ratios⁵. Some central/national banks complemented their economic levers to support the exchange rate with administrative measures.

Regardless of whether or not approaches to monetary policy were changed, the level of dollarization showed a discernible downward trend in the economies of all EDB member states as the pressure on their domestic foreign exchange markets eased up. The level of dollarization decreased from 71% in January 2016 to 60.4% in July 2017 in Belarus, and from 51.6% in January 2016 to 31.8% in July 2017 in Kazakhstan (Chart 1).

MEASURES TAKEN

The primary measures to bring down the level of dollarization of the economies of Eurasian Economic Union member states are systematized in Table 1.

Most of the countries in question have typically resorted to active dedollarization measures that directly stimulate the use of the national currency. Such measures include:

- Higher differentiation of mandatory reserve assets ratios. In Belarus, for example, the reserve assets ratio for foreign currency deposits of banks has increased twofold to 15% since the beginning in 2017 while being lowered by 3.5 percentage points to 4% for deposit liabilities denominated in roubles;
- Higher differentiation in the prudential requirements and facilitation of the conversion of foreign currency receivables into the national currency. Armenia and Belarus have adopted more stringent approaches to the classification of foreign currency liabilities for calculating the special reserve for assets exposed to credit risks. Kyrgyzstan has prohibited the issuance of US dollar-denominated loans to households. Individuals may take out a foreign-currency loan in Kazakhstan only if they have income in the currency of the loan;

⁵ Center for Integration Studies Report No. 44 *Fluctuations of Exchange Rates in the Eurasian Economic Union in 2014-2015: Analysis and Recommendations* / Center for Integration Studies Report No. 44 // Eurasian Development Bank. 2017. July. pp. 1-80.

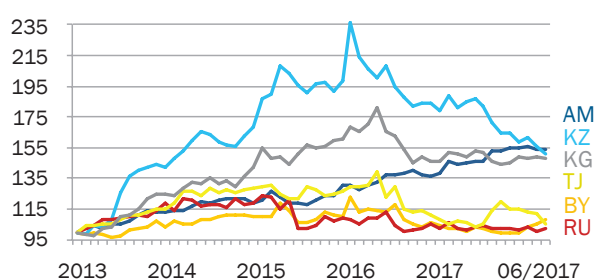
- Launch of an extensive campaign to bring about a transition to universal use of the national currency as a means of exchange and payment. Most EEU member states have prohibited the practice of denominating prices, tax rates, utility rates and other payable fees in foreign currencies or have instituted tighter controls over pricing. Belarus has stopped issuing new and prolonging existing permits to use foreign currency as payment for air transportation and medical services provided to individuals. Kazakhstan has instituted new e-commerce rules: the e-commerce intermediary must set prices for goods exclusively in the national currency. Kyrgyzstan and Kazakhstan have prohibited setting prices for goods and services in so-called “conventional units”.

Among the passive measures designed to ensure a favorable market situation and create conditions favoring changes in the structure of future cash flows, the following merit special note:

- Phasing out practices that encourage the use of foreign currencies to the detriment of the national currency: public borrowing predominantly in the national currency (Armenia); and transition to the practice of applying different taxation conditions to deposits in national and foreign currencies (Belarus);
- Stimulation of the development of the institution of foreign exchange risk hedging (Belarus);
- Improvement of the infrastructure and gradual liberalization of the domestic foreign exchange market in the majority of countries in question.

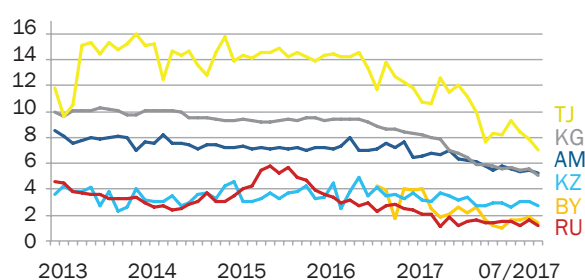
In terms of the measures taken, the EDB member states provisionally fall into either a group of countries that have ensured a more flexible foreign exchange rate in addition to other economy dedollarization measures (Belarus, Kazakhstan, and Russia) or a group of countries that have actually restricted changes to their nominal exchange rates (Armenia, Kyrgyzstan, and Tajikistan).

Chart 3. Changes in foreign currency deposits⁶ (US dollars), 2013=100



Source: Central Banks, calculations by the authors

Chart 4. Interest rates for foreign currency deposits for a term of 1 year or more (%)



Source: Central Banks, calculations by the authors

⁶ Analysis is based on an assumption that foreign currency deposits in EEU countries are entirely denominated in US dollars.

PRELIMINARY CONCLUSIONS

If one excludes the factor of currency movements, it becomes obvious that countries in the former group have made greater progress than countries in the latter group (Chart 3). Even though foreign currency deposit interest rates in Tajikistan decreased in July 2017 to 7.0% from 16.0% (the highest level over January 2013-June 2017), the dollarization growth rate started to accelerate in the latter half of 2016. While foreign currency deposit interest rates have decreased in Russia and Kazakhstan less drastically, the dollarization rate in these countries has declined more appreciably from the 2013 level. Foreign currency deposits in Kazakhstan in August 2015 amounted to 236% of the 2013 level vs. a mere 149% of the 2013 level in July 2017.

Despite the reduction in interest rates for foreign currency deposits in Armenia, the volume of foreign currency deposits has been rising steadily since 2013 (if one excludes the factor of foreign currency movements). The Armenian dram is the only regional currency to have demonstrated relative stability since early 2015. Despite the fact that the Armenian monetary authorities have a longer experience with inflation targeting compared to the other countries in the region, their monetary policy has a number of features that you will not normally see in inflation targeting in its pure form. Efforts to curb foreign exchange rate fluctuations combined with other factors create preconditions for high dollarization⁷. If central banks try to curb inflation by maintaining their national currencies, their exchange rates will be less variable than the inflation rate. Under such conditions, foreign currencies will yet again become more attractive, meaning that the desired effect will not be achieved.

If one excludes the factor of currency movements, Kyrgyzstan experienced a significant slowdown of the dollarization growth rate in the first months of nominal strengthening of the national currency, which later gave way to stagnation. Administrative measures aimed at bringing down the level of dollarization in Kyrgyzstan were accompanied by measures to curb volatility in the exchange rate of the national currency.

Belarus experienced a substantial reduction in foreign currency deposits, mainly deposits of households, in 2016. This was caused both by the dedollarization measures taken and the striving of the population to maintain their customary standard of living in the face of shrinking real disposable incomes by spending their foreign currency savings. Foreign currency deposits of private customers with Belarusian banks virtually stopped decreasing in the first half of 2017. Meanwhile, the growth in foreign currency deposits recorded in April - June 2017 as shown in Figure 4 is attributable exclusively to the resolution of the oil and gas dispute between Belarus and Russia: Gazprom Transgaz Belarus deposited some of the funds received from the Belarusian Government as payment of the debt owed for Russian gas imports in foreign currency accounts with Belgazprombank.

⁷ Demidenko, M. *Dollarization: Causes and Possible Solutions* / M. Demidenko, N. Mironchik, A. Kuznetsov // *Banking Bulletin*. 2016. December. pp. 3-10.

CONCLUSIONS AND RECOMMENDATIONS

While it is still too soon to draw conclusions about the impact of structural factors on the level of dollarization in EDB member states, preliminary results of the past year and a half so far support the proposition that a policy of a flexible foreign exchange rate and the implementation of measures aimed at curbing and stabilizing inflation are among the underlying factors behind the reduction in the level of dollarization. Having switched to a floating exchange rate and implemented measures to stabilize inflation, Russia and Kazakhstan so far demonstrate better progress in lowering the level of dollarization. Meanwhile, other EDB member states – while implementing a more or less similar set of administrative measures aimed at dedollarization of the economy – achieved less progress in reducing the dollarization of savings while attempting to curb the volatility of the national currency.

Subsequent dedollarization measures in the EEU member states should be subdivided into three groups (corresponding to the above-mentioned features).

Measures of the **first order** – strategic measures – aim to improve the macroeconomic environment by achieving low and stable inflation and subsequently gradually increasing the flexibility of the exchange rate. These are the priority measures for EDB member states, since it was specifically the historically high level and volatility of inflation and the use of a pegged exchange rate during periods of foreign exchange market turbulence that acted as the primary causes of high dollarization in the countries of this integration association. Unless the priority measures are implemented effectively, there is a high risk that all subsequent dedollarization measures will not have the desirable positive outcomes.

Measures of the **second order** are passive. They are meant to create conditions that would limit the adverse effects on the economy, which may result from an incomplete implementation of the first-order measures. This group of measures should contribute to the convergence of the actual dollarization level to a level consistent with the objectives of the ongoing monetary policy. According to a joint study by the EEC and the EDB Center for Integration Studies, passive measures are more focused on credit operations of banks, since private deposit trends take shape under the influence of reasons and conditions that are often unrelated to the level of interest rates⁸.

Measures of the **third order** (active measures) complement the above-mentioned measures and are directly aimed at stimulating the use of the national currency. Without effective implementation of first-order and second-order measures, the third-order measures will – at best – have no meaningful effect on the dollarization level. At worst, they can destabilize the financial system. According to Demidenko et al. (2016), “measures of the third order are meant, first, to guard the most vulnerable segments from foreign exchange risks and, second, to render unacceptable a banking model based on the mechanical transfer of foreign exchange risks to customers”⁹.

⁸ *Monetary Policy of EEU Member States: Current Conditions and Coordination Prospects. Moscow: EEC, St. Petersburg: EDB Center for Integration Studies. 2017. 148 pp.*

⁹ *Demidenko, M. Dollarization: Causes and Possible Solutions / M. Demidenko, N. Mironchik, A. Kuznetsov // Banking Bulletin. 2016. No. 12 (641). pp. 3-10.*

Table 1. Measures taken by EDB member states in the monetary and foreign exchange sectors

	Basis of monetary policy	Foreign exchange regime	Other measures aimed at dedollarization
Armenia	Inflation targeting regime preserved	Managed floating exchange rate preserved	- Public debt securities are issued inside the country in the national currency; - The interest rate range has been narrowed and new instruments instituted for short-term liquidity management; - Differentiated rates are used for reserve assets ratios in respect of liabilities denominated in national and foreign currencies, and the dram is used as the currency of the reserves; - Net open position limits denominated in a foreign currency are regulated; - The largest banks are monitored for any foreign currency position mismatches; - The weight of foreign currency assets is increased in credit risk calculations; - National currency deposits enjoy a more substantial insurance guarantee; - It is prohibited to set prices and issue loans denominated in foreign currencies.
Belarus	Transition to a monetary targeting regime	Transition from national currency pegging to a foreign currency basket to a continuous order matching auction	- Increasing the ratio of placements for banks and non-bank credit and finance institutions with the mandatory reserve fund (reserve assets ratio) from 11% to 15% on foreign-currency deposits; - Discontinuing the practice of issuing new and prolonging existing permits to use foreign currency as payment for air transportation and medical services provided to individuals; - Discontinuing the issuance of new and renewal of existing individual permits for insurance companies to receive premium payments in foreign currencies under personal life insurance contracts, including additional pension insurance contracts. - The Government and the National Bank approved an economy dedollarization plan in early 2017. It provides for measures aimed at reducing the use of foreign currencies in payments between contracting parties and payments of duties, taxes and other charges, or as the equivalent measure of value when setting tariffs, rates, and prices. The core measures of the approved plan should be implemented in 2017-2018.

Kazakhstan	Transition to an inflation targeting regime	Transition from a crawling band to a managed floating exchange rate	• The amount of compensation guaranteed to depositors by the Kazakhstan Deposit Guarantee Fund has been increased from 5 million tenge to 10 million tenge; • A phased increase in the maximum interest rate recommended by the Kazakhstan Deposit Guarantee Fund for private deposits from 9% to 14% for tenge deposits, and a reduction from 4.5% to 2% per annum for foreign currency deposits; • Following the transition to the floating exchange rate, a mechanism was instituted for compensating private depositors with deposits in the national currency for the currency difference; • Individuals who have not received income in a specific foreign currency over the past six months are prohibited from taking out mortgage loans in that foreign currency; • Measures have been instituted to discourage banks from issuing foreign currency loans by obligating them to increase capital; • The profit margin has been increased: the profit margin between foreign currency sale and purchase rates is 6 tenge for the US dollar and 7 tenge for the euro; • New e-commerce rules have been instituted: the e-commerce intermediary must set prices for goods exclusively in the national currency; • Prohibition of the practice of setting prices for goods and services in so-called “conventional units”.
Kyrgyzstan	Mixed monetary policy regime preserved	Managed floating exchange rate preserved	• Program to convert mortgage loans denominated in foreign currencies into soms; • Prohibition to issue consumer, mortgage or other loans to households in dollars; • Prohibition of the practice of setting prices for goods and services in so-called “conventional units”.
Russia	Transition to inflation targeting regime	Transition from a crawling band based on the dual-currency basket to a managed floating exchange rate	• Reserve assets ratio: for liabilities in the Russian currency – 5.0%; for liabilities in a foreign currency – 7.0%.

Tajikistan	Foreign exchange rate targeting regime preserved	Foreign exchange rate targeting regime preserved	• All foreign exchange kiosks that are not owned by commercial banks have been closed; • More stringent controls have been instituted to make sure commercial transactions in Tajikistan are carried out exclusively in somoni; • Money transfers arriving in Russian roubles are issued to beneficiaries in somoni only; • Commercial banks are obligated to sell one half of foreign currency (rouble) revenue obtained via money transfers on the interbank market; • The official exchange rate may not deviate from the weighted average exchange rate set from trading on the interbank and intra-bank markets by more than +/- 1.5%.
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GLOSSARY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

LIST OF ABBREVIATIONS

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

Major macroeconomic indicators of the EDB member countries

	2014	2015	2016	2017 F	2018 F	2019 F	2020 F
Armenia							
CPI (growth in percent as of year-end)	4.6	-0.1	-1.1	1.3	3.5	3.9	4.0
GDP in comparable prices (growth in percent, y/y)	3.6	3.0	0.2	5.2	2.7	4.1	4.0
Interbank repo rate (in percent per annum)	7.25	10.1	7.8	6.0	6.8	7.5	7.8
Exchange rate , the national currency against the U.S. dollar (final average for the year)	416	478	480	481	476	483	492
Belarus							
CPI (growth in percent as of year-end)	16.2	12.0	10.6	5.6	7.1	5.8	5.0
GDP in comparable prices (growth in percent, y/y)	1.7	-3.8	-2.6	1.8	1.8	1.7	1.7
Interest rate on overnight interbank loans (in percent per annum)	23.2	29.9	19.2	10.0	10.3	9.8	9.3
Exchange rate , the national currency against the U.S. dollar (final average for the year)	1.02	1.59	1.989	1.928	2.040	2.129	2.199
Kazakhstan							
CPI (growth in percent as of year-end)	7.4	13.6	8.5	7.7	6.6	5.7	4.9
GDP in comparable prices (growth in percent, y/y)	4.2	1.2	1.1	3.7	3.7	3.1	3.2
TONIA (in percent per annum)	10.6	15.7	15.6	9.9	9.1	8.7	8.3
Exchange rate , the national currency against the U.S. dollar (final average for the year)	180	223	342	326	344	358	370
Kyrgyz Republic							
CPI (growth in percent as of year-end)	10.5	3.4	-0.5	3.9	5.5	6.3	6.2
GDP in comparable prices (growth in percent, y/y)	4.0	3.9	3.8	4.0	4.4	4.6	4.9
Interbank repo rate (in percent per annum)	6.8	9.0	3.7	1.7	5.1	8.8	9.8
Exchange rate , the national currency against the U.S. dollar (final average for the year)	53.7	64.5	69.9	69	72	75	78
Russia							
CPI (growth in percent as of year-end)	11.4	12.9	5.4	3.1	3.9	4.0	4.0
GDP in comparable prices (growth in percent, y/y)	0.7	-2.8	-0.2	1.7	1.7	1.8	1.7
MIACR (in percent per annum)	8.5	12.8	10.6	9.1	7.0	6.8	6.8
Exchange rate , the national currency against the U.S. dollar (final average for the year)	38.4	60.9	67.1	58.6	61.6	64.1	65.6
Tajikistan							
CPI (growth in percent as of year-end)	6.1	5.8	6.1	7.7	6.1	6.5	6.5
GDP in comparable prices (growth in percent, y/y)	6.7	6.0	6.9	7.2	7.3	6.1	6.0
Interest rate on interbank loans (in percent per annum)		20.4	9.8	15.1	14.7	14.3	14.0
Exchange rate , the national currency against the U.S. dollar (final average for the year)	4.9	6.2	7.8	8.5	9.0	9.5	9.9

Source: National statistical agencies, estimates by the authors



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