

EDB MACROREVIEW

JULY 2016



**EAEU COUNTRIES:
GROWTH AFTER ADAPTATION?**

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INTRODUCTION BY CHIEF ECONOMIST

The prolonged search for the “low point” has not yet given us grounds to conclude unambiguously that it is inevitable the EAEU economies will recover soon. However, indicators for the first half of 2016 continue to indicate that the economies are gradually adapting to the shocks that have taken place in the last few years. Negative trends in the economies of EAEU countries, which strengthened amid a fall in commodity prices, have somewhat weakened. The economies started to show an improvement in macroeconomic indicators in the first half of 2016, including:

- an improvement in leading indicators;
- the strengthening of national currencies;
- a decline in inflation expectations; and
- the stabilization of financial markets.

The volume of migrant remittances from Russia began to decline sharply in Q4 2014 amid a significant fall in economic activity in the region; however, the pace of the decline started to slow down a year later. The year-on-year fall in remittances from Russia to other EAEU countries in Q4 2015 exceeded 30%, but the rate of the quarter-on-quarter fall was the lowest in a year. The stabilization of the exchange rates of the national currencies of EAEU countries, and the stabilization of economic dynamics in the region, will contribute to a further slowdown in the fall in remittances.

Despite the recovery in migrant remittances from Russia to Kyrgyzstan in Q1 2016, the fall in remittances from Russia to Armenia and Tajikistan continued. At the same time, this factor was partially offset by a significant rise in exports from Tajikistan, Armenia and Kyrgyzstan to Russia and other EAEU countries. In particular, Armenia's exports to Russia rose by 95.8% year-on-year in January-April 2016 in terms of value, increasing the share of EAEU countries in Armenia's exports from 12% in January-April 2015 to 19.5% in January-April 2016.

The external environment will improve through: a decline in the volatility of the world's financial markets; a fall in capital outflows; and a rise in exports. This will contribute to the stabilization of the exchange rates of national currencies in the region. In turn, this will be a significant factor leading to a further slowdown in inflation and a decline in inflation expectations in EAEU countries. Due to inflationary pressure falling, the central banks of EAEU countries kept unchanged or reduced their base lending rates in the first half of 2016. However, we expect price and exchange rate stabilization in Q2 2016 amid low economic activity to lead to a further softening of the monetary conditions.

The impressive slowdown in inflation in EAEU countries will perhaps be one of the surprises of 2016. We forecast the EAEU countries' inflation to slow from 12.8% to 6.3%. The reduction of the key interest rates may have a positive effect on lending growth, which could provide impetus to a recovery in both investment and household consumption.

As for the medium term, we forecast a recovery in GDP¹ in EAEU countries from -3.1% in 2015 to -0.9% in 2016 and to a positive growth rate of 0.8% in 2017. Therefore despite 2016's uneasy start, the first half of the year provides grounds for cautious optimism about the prospect of a recovery in economic growth and trade. Post tenebras lux!

Yaroslav Lissovolik,

chief economist of the Eurasian Development Bank

¹ The indicator is calculated as a weighted average on the basis of weights reflecting the share of real GDP at PPP in the aggregate GDP of the EAEU member states (source: IMF).

INFORMATION DISCLOSURE

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

In the present review, EDB employs methods that are part 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. Its aim was to meet 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 conduct analysis and forecasting for both a particular EAEU country and the EAEU as a whole.

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

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

EXTERNAL CONDITIONS

The world economy is expected to gradually recover

The growth rate in world GDP will be just over 3% in 2016. Negative trends in the dynamics of world economic growth are related to: instability in the world's financial markets; the continuing recession in a number of countries that are exporters of primary commodities; and the expected slowdown in economic growth in China.

The U.S. Federal Reserve System and the European Central Bank will continue to loosen their monetary policies

The economy of the Eurozone continues to show moderate growth (1.7% in Q1 2016 against Q1 2015). The drivers include: a recovery in consumption amid low interest rates; a rise in lending and wages; and a decline in unemployment. US GDP grew by 2% year-on-year in Q1 2016, continuing a trend towards a slowdown in growth. This was caused by a fall in external demand and a decrease in investment resulting from the fall in the prices of primary commodities.

Prices for major commodities stage a recovery

Following a fall to multi-year lows in January 2016, oil prices rose almost two fold by the end of Q2 2016 amid a greater balance between demand and supply in the oil market. There has also been a gradual recovery in food prices in 2016. Given the expected recovery in demand in world markets, oil prices are forecast to continue to recover. Due to the fall in oil prices and the weakening of the dollar in February 2016, gold prices showed a sharp rise, coming back to the level of early 2015 and staying stable at this level until the end of Q2 2016.

Forecast for major external economic indicators

	Average annual price of URALS oil, in U.S. dollars per barrel	Average annual price of gold, in U.S. dollars per ounce	Food price index, 2010=100	Average annual exchange rate of the euro to the U.S. dollar	Average annual FED funds rate, in percent
2016	40,8	1215	87,7	1,12	0,6
2017	46,8	1231	89,5	1,12	1,8
2018	49,0	1244	91,4	1,11	2,6

Source: Estimates by the authors

RUSSIAN FEDERATION



TRENDS

GDP

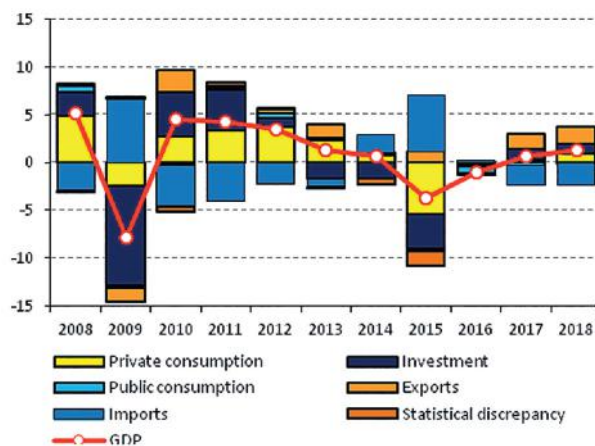
Fall in real GDP slows down, the economy adapts to new conditions

Negative trends in the Russian economy abated slightly in early 2016 after strengthening following the sharp fall in oil prices, while the economy gradually adapted to the new economic conditions. At the same time domestic demand remained weak, reflecting both a contraction of household real income and a fall in investment in the private sector. This should contribute to a fall in inflation in the medium term. According to data from the Russian Federal State Statistics Service, real GDP fell by 1.2% year-on-year in Q1 2016 after a 3.7% fall in 2015. Signs of stabilization started to be seen in the dynamics of GDP in Q3 2015 following a significant fall in Q2 2015. If seasonal factors are not taken into account, GDP growth in Q1 2016 was close to zero compared with Q4 2015.

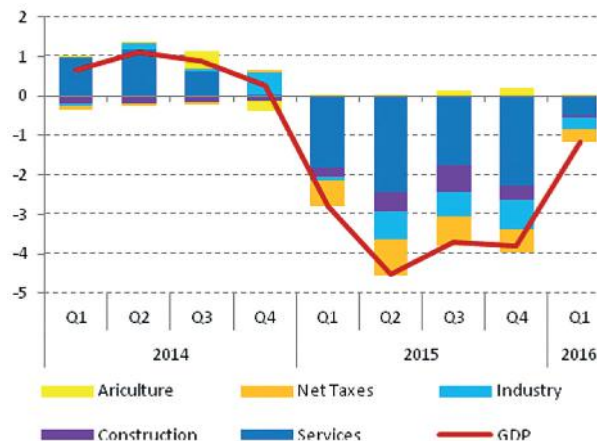
There are signs indicating a recovery in industrial output

Industrial output showed a year-on-year rise in February 2016, for the first time since January 2015, increasing by 1%. Industrial output fell by 0.6% year-on-year in Q1 2016 but rose by 0.5% in April. This also indicated a trend towards a recovery following a 3.4% fall in the industrial output index. The manufacturing sector recorded a rise in output in April 2016, for the first time since 2014, increasing by 0.6% year-on-year. The sector's output was supported by both import substitution programs and an increase in exports. The construction sector's output in April 2016 totaled 392.0 billion rubles, or 84.1% of the output in April 2015.

**GDP growth structure
by expenditure component**
in comparable prices (in percent)



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



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

Output in the construction sector in Q1 2016 was 1.6% lower than in Q1 2015. The dynamics of freight transportation has been in positive territory since Q3 2015. According to preliminary estimates, freight transportation increased by 1.5% year-on-year in Q1 2016.

The dynamics of domestic demand remains weak as a result of an unfavorable external environment and a low level of consumer and investment certainty

Both investment and consumer demand remained weak. Fixed capital investment fell by 4.8% year-on-year in Q1 2016 against a 6.4% year-on-year fall in Q4 2015. However, the improvement in the dynamics of investment was largely due to the low-base effect. The factors determining the weak recovery of domestic demand still included investors' negative expectations relating to both the existence of Western sectoral sanctions and the continued low level of consumer and business certainty. Consumer activity remained modest in the first half of 2016. Retail sales decreased by 4.8% year-on-year in April 2016 and by 5.2% in January-April 2016. According to data from the Bank of Russia, the unemployment rate, adjusted to seasonal changes, rose slightly from 5.5% at the beginning of 2016 to 5.7% in March and April, coming back to its levels in the second half of 2015. The weak dynamics of consumer demand were largely determined by the fall in household real income and also by an increase in the share of savings amid a fall in consumer certainty.

The positive dynamics of leading indicators and the expected improvement in the external conditions imply a recovery in the economy in the medium term

As a result of a moderate rise in oil prices throughout the entire forecast period, as well as the adaptation of the economy to their lower level, demand for domestic products is expected to rise in a number of branches of manufacturing industry because of increased price competitiveness. Leading indicators calculated by the Eurasian Economic Commission suggest some stabilization of the pace of the fall in Russia's GDP in the second half of 2016. The Consolidated Leading Indicator (CLI) has been rising for several months after a period of stabilization in late 2015. This indicates a positive trend in the development of economic activity in the short term. An improvement compared with the respective period in 2015 is evidenced by almost all CLI components that characterize the external, domestic and financial sectors of the economy. An improvement took place in April 2016 in the dynamics of the business certainty index (adjusted for seasonal changes) in the manufacturing and extractive industries.

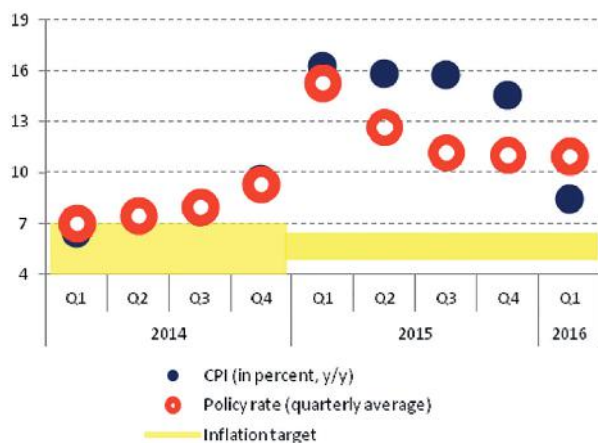
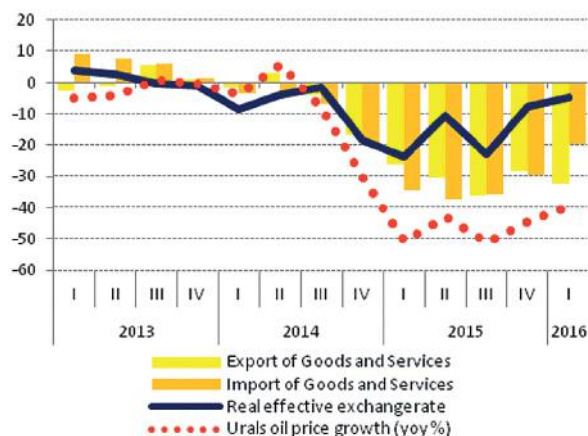
Inflation

Inflation starts to slow down in late 2015

In early 2016 inflation slowed more quickly than expected. A number of domestic and external factors exerted significant downward pressure. They included weaker domestic demand and the fall in world food and energy prices. There was also a fall in pressure on inflation from the expenditure side. In particular, there was a slowdown in the rise in industrial producer prices. The annual growth rate of industrial producer prices was 0.9% in April 2016 against 12.1% in April 2015. In early 2016, there was also a fall in the growth rate of agricultural producer prices, which decreased from 5.7% in January 2015 to 3.7% in January 2016.

Weak demand and tight monetary policy create conditions for a further slowdown in inflation

Annual inflation fell to 7.3% in May. The annual base inflation rate decreased from 8.9% in February to 7.5% in May. Month-on-month inflation, adjusted to seasonal factors, stabilized at relatively low levels. We expect annual inflation to remain at 7.5% in June. Continued restrictions from the demand side and the moderately tight monetary and budgetary policies followed by the Bank of Russia and the government will contribute to a further slowdown in inflation. We predict an annual inflation rate of 6.6% for Q3 2016. The major medium-term risks continue to be related to the uncertain external economic situation and the dynamics of inflation expectations, which the Bank of Russia says remain heightened.

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

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

Exchange rate**The dynamics of oil prices remain a dominant factor in the currency exchange market**

The dynamics of the nominal exchange rate of the Russian ruble have been mainly determined by oil prices since a free floating regime was adopted in mid-2014. The ruble weakened against the U.S. dollar by more than 31% in the period from December 2014 to December 2015. Following a sharp fall at the end of 2014, the ruble regained some of its lost ground, which was helped by a rise in oil prices. The real strengthening of the Russian currency continued throughout the first half of 2015 and led to the real effective exchange rate of the ruble coming close to its equilibrium trajectory at the end of Q2 2015. However, oil prices resumed falling later, which was reflected in the dynamics of the exchange rate. As a result, the real effective exchange rate of the Russian currency fell by 10.8% in 2015.

The ruble remains undervalued

The ruble strengthened almost permanently in early 2016 after the rise in oil prices. The real effective exchange rate of the ruble against foreign currencies rose by 10.9% in Q1 2016 compared with Q4 2015. The ruble was undervalued as of the beginning of the forecast period. We estimate the gap between the real effective exchange rate and its equilibrium trajectory at 17%. Therefore there continue to be conditions in the market for the Russian ruble to strengthen in the short term.

Fiscal policy

Russia's budget deficit increases in January-April 2016 to 4.3% of GDP

According to data from the Federal Treasury, Russia's budget system deficit in January-April 2016 amounted to 0.7 trillion rubles (2.7% of GDP), compared with a deficit of 3.7% of GDP in January-April 2015. The federal budget had a deficit of 1.1 trillion rubles (4.3% of GDP) against a deficit of 0.9 trillion rubles in January-April 2015. Budget system revenue fell by 4.3% year-on-year in January-April 2016 to total 8.3 trillion rubles (31.7% of GDP), while federal budget revenue dropped by 14.1% to amount to 3.9 trillion rubles (14.9% of GDP).

Public revenue and expenditure decrease because of a decline in oil and gas proceeds and more even spending

The main factor behind the fall in public revenue was a decrease in oil and gas proceeds, while expenditure fell because of more even spending on national defense and security and limited spending on the economy.

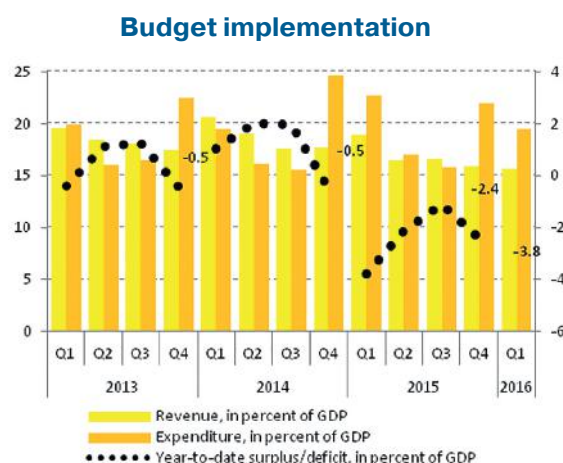
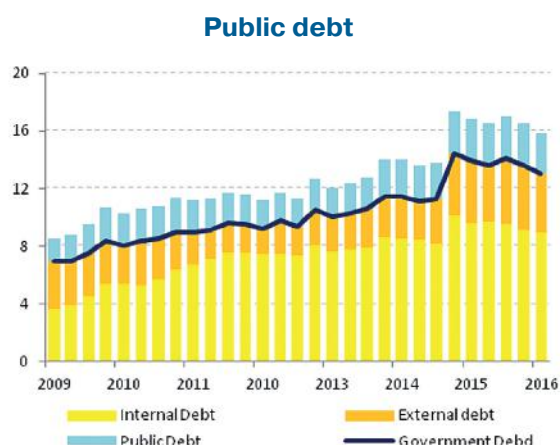
Social spending increased, which was mainly due to an indexation of pensions in February 2016. Public spending was intensified in March and April, which led to a significant increase in the budget deficit. The federal budget deficit was financed through changes to the remaining budgetary resources.

The Finance ministry successfully implements its public borrowing program

The Russian Ministry of Finance successfully implemented its public borrowing program. The net placement of federal bonds in January-April 2016 totaled 185.5 billion rubles. In late May, the Finance ministry also raised \$1.75 billion from the placement of 10-year Eurobonds. The overall public debt amounted to 13.3 trillion rubles as of the beginning of April 2016, slightly decreasing compared with the start of 2016 because of a revaluation of the external debt in foreign currency terms.

The government still has a budget deficit target of 3% for 2016

According to the most recent statements by the Finance ministry, the Russian authorities are still set to limit the budget deficit in 2016 to 3% of GDP. Due to a rise in oil prices, a revision of budget parameters has been postponed until autumn.



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

Monetary policy

Interest rates fall throughout 2015

The interest rate policy of the Bank of Russia in 2015 was moderately tight, which was the necessary condition for the stabilization of inflation and currency depreciation expectations. Interest rates gradually fell throughout 2015 after an upsurge at the end of 2014.

The central bank lowers its base rate in June 2016

The board of directors of the Bank of Russia decided on June 10, 2016 to reduce its base lending rate to 10.50% per annum. It noted the existence of positive trends such as the stabilization of inflation, and a decline in inflation expectations and inflation risks amid signs suggesting that the economy was about to enter a phase of recovering growth. The monetary conditions remain moderately tight, although they have somewhat eased because of a decrease in the liquidity deficit in the banking sector. The real interest rates in the economy continue to be at levels that stimulate savings.

The base rate is forecast to be reduced further in the second half of 2016

In our opinion, the central bank will continue to gradually reduce its base lending rate in the second half of 2016, signaling to the market that the macroeconomic situation is improving and inflation expectations are on the decline.

Liquidity may move from deficit to surplus in 2017

In its statements made in 2016, the Bank of Russia repeatedly noted that a trend existed for a gradual transition from a deficit to a surplus in liquidity in the banking sector, i.e. a trend towards banks depositing resources with the central bank over their demand for refinancing. In a situation where there is a liquidity surplus, the base rate of the central bank becomes a reference point for rates for depositing rather than borrowing. This may result in some easing of the monetary conditions even if the base rate remains unchanged. According to the latest data from the Bank of Russia, the banking sector's transition to a structural surplus in liquidity is forecast to be completed in early 2017. This was initially expected to happen in late 2016.

FORECAST

The external environment remains unfavorable, but the impact of negative shocks is gradually diminishing

The recovery of economic growth will be slower in 2017-2018 than in 2010-2011 due to: the continued Western sanctions, including the ban on the import of technologies for key industries; the continued unfavorable external environment; and low investment activity. Nonetheless, the impact of negative shocks is gradually diminishing. A recovery in stock markets has led to a decrease in capital outflows in the private sector. Given these trends, we expect the fall in GDP to slow to 1% in 2016. Economic growth is forecast to recover in 2017-2018 to between 0.7 and 1.2% following the recession in 2015-2016.

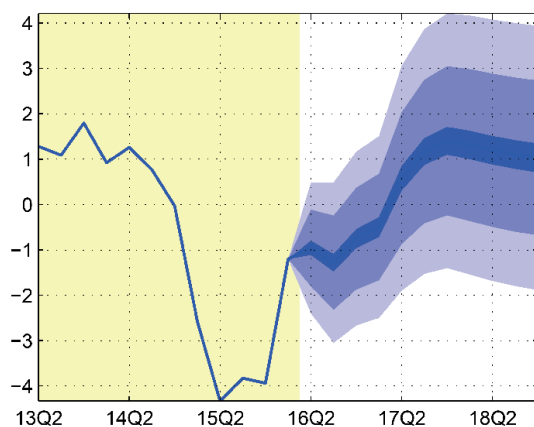
The cyclical and equilibrium components make a negative contribution to the dynamics of output

The fall in output in 2016 will be due to both the dynamics of equilibrium output and the contribution of the cyclical component. The fall in the growth rate of equilibrium output - whose recovery is expected only by 2018 - is caused by: a decline in the equilibrium price of oil; the depreciation of capital assets (investment keeps falling); low prospects for the growth of human capital (reduced financing as a result of budget sequestration); a decrease in the economically active population (possible relief through the inflow of migrants); and technological restrictions (the ban on technology exports to Russia). The big negative contribution of the cyclical component – the output gap will remain in negative territory until mid-2018 – is due to the impact of the cyclical component of oil prices, the continued moderately negative effect of external demand and restrictions on external financing.

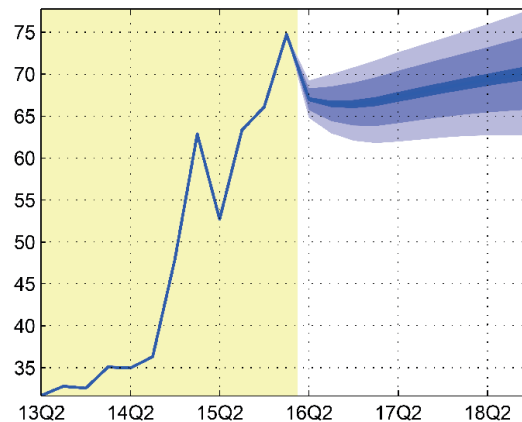
The closure of the gap in the real exchange rate may support demand

On the other hand, oil prices are recovering gradually in the medium term, and there is a closure of the gap in the real exchange rate. This will create conditions in 2016 for the strengthening of the ruble and lead to a partial closure of the output gap. However, the direction of the dynamics of the exchange rate may be reversed by: a continued decline in investment activity; a continued capital outflow; and possible efforts by the Bank of Russia to replenish the international reserves.

GDP in comparable prices
(growth in percent, y/y)²



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

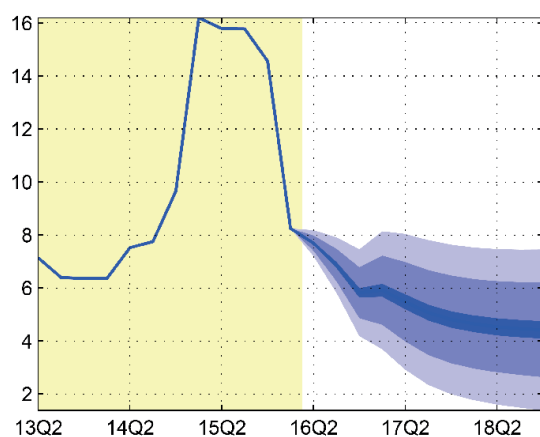


Source: Estimates by the authors

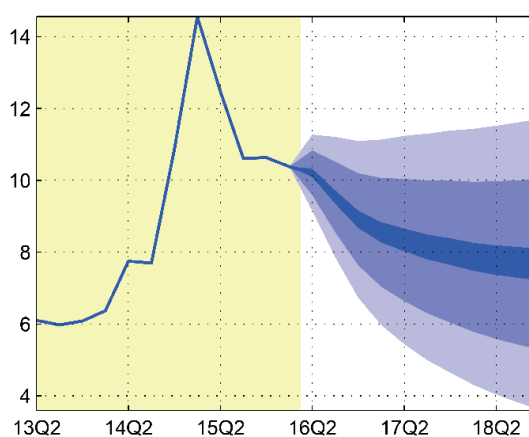
Inflation heads for slowdown

Inflation has been gradually slowing since the start of 2016. The average annual growth rate of consumer prices is forecast to be 7.2% for 2016, which reflects low domestic demand. At the same time inflation may slightly accelerate in the second half of 2016 due to an increase in the prices of utilities. However, the general downward trend in inflation will continue until the end of 2016. If the current direction of monetary policy continues inflation is expected to slow to 5.3% in 2017 and to 4.5% in 2018.

CPI,
growth in percent as of year-end



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



Source: Estimates by the authors

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

SUMMARY

Forecast for Russia's Major Macroeconomic Indicators

	2016	2017	2018
CPI (growth in percent as of year-end)	5,8	4,8	4,4
GDP in comparable prices (growth in percent, y/y)	-1,0	0,7	1,2
MIACR (in percent per annum)	10,3	8,6	8,1
Exchange rate of the Russian ruble against the U.S. dollar (final average for the year)	68,7	67,5	69,5

Source: Estimates by the authors

International organizations' forecasts for Russia's GDP (growth in percent, y/y)

	2016						2017					
	WB	EBRD	EDB	IMF	OECD	Economy ministry	WB	EBRD	EDB	IMF	OECD	Economy ministry
Q1. 15	0,1		0,0	-1,0					0,8			
Q2. 15	-0,3	-1,8		-1,1	0,8	2,3				-1,0		2,3
Q3. 15	-0,6		0,0				1,5		1,1			
Q4. 15		-1,2	0,1	-0,6		0,7			1,1			
Q1. 16	-0,7		-1,6	-1,0		-0,8	1,3		0,8	1,0		
Q2. 16	-1,2	-1,2	-1,0	-1,8	-1,7	-0,2	1,4	1,0	0,7	0,8	0,5	0,8
Fact												

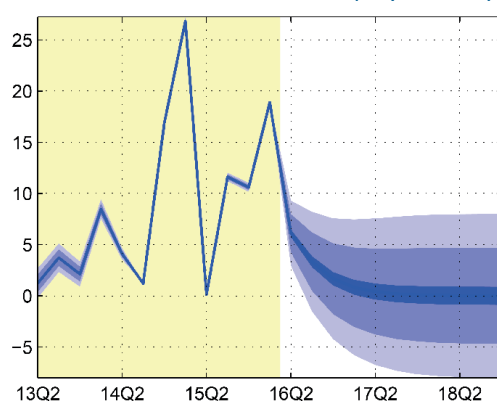
Source: Estimates by the authors, international organizations, the central bank

International organizations' forecasts for inflation in Russia (in percent as of year-end)

	2016						2017					
	EC	WB	EDB	IMF	OECD	Economy ministry	WB	EBRD	EDB	IMF	OECD	Economy ministry
Q1. 15	7,0		8,9						7,4			
Q2. 15	8,0	8,5		5,0						5,0		
Q3. 15			7,3						5,5			
Q4. 15	7,0		9,4	6,0		7,4			7,0	6,0		
Q1. 16	8,5		7,2			9,3		6,2	5,4			
Q2. 16			5,8	8,4	7,3	6,5			4,8	6,5		4,9
Fact												

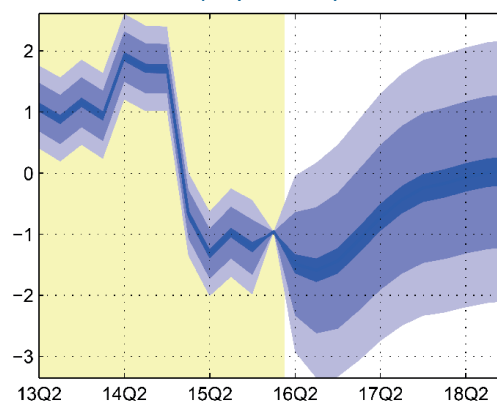
Source: Estimates by the authors, international organizations, the central bank

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



Source: Estimates by the authors

Output gap (in percent)



REPUBLIC OF ARMENIA



TRENDS

GDP

GDP growth accelerates to 4.4% in Q1 2016

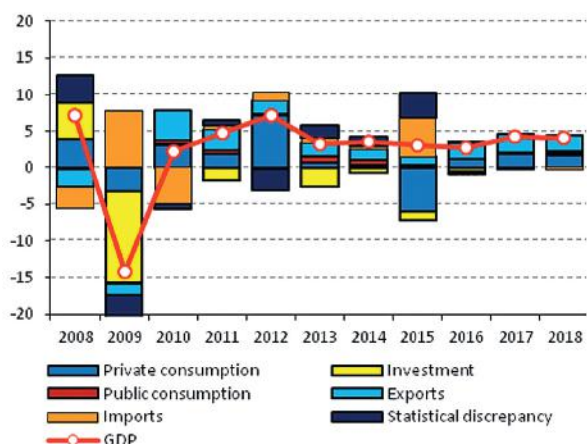
The growth of economic activity and GDP growth in Armenia proved stronger than expected in Q1 2016 amid a slowdown in economic growth in most EAEU countries. Despite unfavorable prices and weak external demand, the build-up of production capacity and an increase in the export of major commodities caused GDP to grow by 4.4% year-on-year in Q1 2016. The Indicator of Economic Activity rose to 6.8% in April 2016 against April 2015, reaching 6% in January-April 2016 in annual terms.

The extractive industry and the services sector are major drivers of growth in Q1 2016

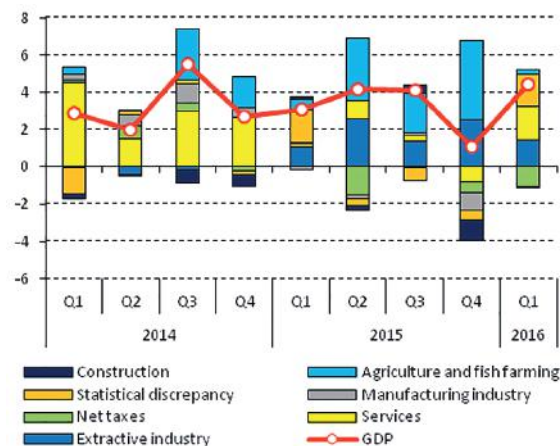
The major factors behind economic activity in Armenia were:

- *from the standpoint of the expenditure approach:* the growth rate of exports continued to be high. They increased by 26.2% year-on-year in Q1 2016, whereas imports fell by 5%. EAEU countries accounted for most of the rise in exports in January-April 2016. Exports to Russia jumped by 95.8% year-on-year in terms of value, increasing the share of EAEU countries in the total volume of Armenia's exports from 12.5% in January-April 2015 to 19.5% in January-April 2016;
- *from the standpoint of the value-added approach:* a negative contribution was made to GDP growth by the dynamics of wholesale and retail trade, which fell by 1.9% year-on-year in Q1 2016. Also economic activity decreased in the construction sector (-2.4%) and in the manufacturing industry (-1.8%). A positive contribution to economic growth was made by the agricultural sector with a 3.8% year-on-year increase in output and the extractive industry with an increase of 36.4%.

GDP growth structure by expenditure component
in comparable prices (in percent)



GDP growth structure by production
in comparable prices (in percent)



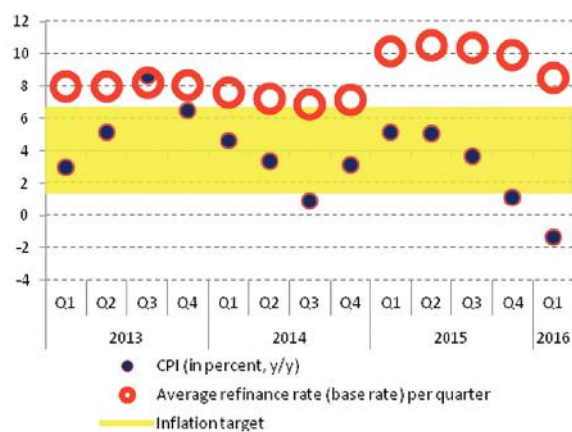
Source: The national statistical agency, EEC, estimates by the authors

Inflation

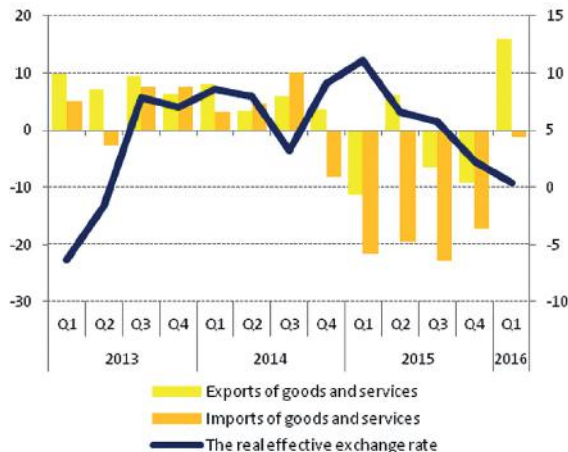
The deviation of the actual inflation rate from the target increases in January-May 2016

Deflationary pressure continued to be exerted on the Armenian economy by: the external economic environment, determined by a fall in the prices of primary commodities and food; a weak recovery in consumer activity; and low prices of agricultural produce. As a result, the country had an annual deflation rate of 2.1% in May 2016. The actual inflation was below the central bank's target level of 2.5 to 5.5%.

CPI and the refinance rate
(in percent)



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



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

Exchange rate

Trends that took place in 2015 continue in early 2016

The nominal and real effective exchange rates of the dram fell by 2.0% and 2.9%, respectively, in January-April 2016. At the same time the dram strengthened by 0.9% against the U.S. dollar, but weakened by 5.2% against the Russian ruble compared with December 2015. This led to a recovery in the competitiveness of the exporting sector of the Armenian economy in the Russian market. Cash remittances from Russia fell by 13% year-on-year in January-May 2016 against a 44% year-on-year decrease in January-May 2015. The international reserves shrank by \$208.2 million (12.0%) from the beginning of 2016 to \$1,532.0 million in May 1, 2016.

The real effective exchange rate of the dram in Q1 2016 was slightly overvalued (by 1.7%) against its equilibrium exchange rate, but it was undervalued (by 3.5%) against the U.S. dollar, and had the potential to rise.

Fiscal policy

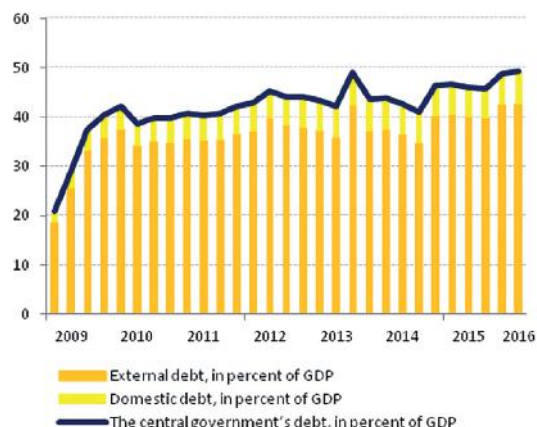
Economic activity declines in sectors determining public revenue

The government's fiscal policy continued to be expansionist in Q1 2016. The state budget had a deficit of 31.1 billion drams, which was financed from domestic sources. The rise continued in social and public service spending. The achievement of the revenue target in Q1 2016 was influenced by unfavorable external and domestic factors. They included a 25.9% year-on-year fall in imports and a 2.2% year-on-year decrease in output in the construction sector. Armenia is expected to have a state budget deficit equal to 3.5% of GDP in 2016.

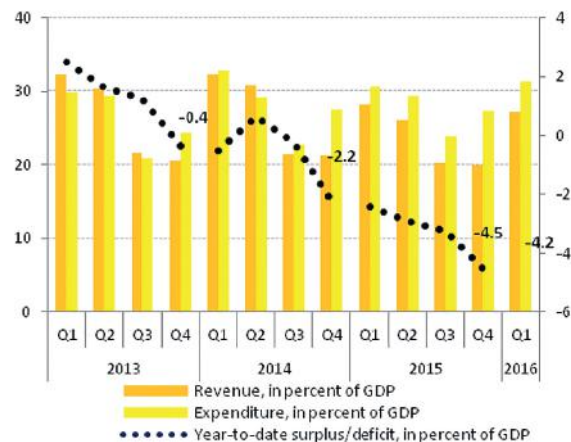
The public debt grows to 50.1% of GDP

Armenia's public debt grew by 3.8% from January 2016 to \$5,270.6 million at the end of May. The increase was largely due to a 2.7% rise in external public debt. As a result, the debt burden on the economy grew to 50.1% of GDP from 48.7% of GDP at the end of 2015. The excess over the established limit of 50% of GDP for public debt increases macroeconomic risks, and limits the room for fiscal maneuvers for absorbing domestic and external shocks.

Public debt



State budget implementation



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

Monetary policy

Interest rates are reduced in January-May 2016 with a view to stimulating economic activity

Since January 2016, amid weak domestic demand and deflation in the economy, the Central bank's monetary policy was aimed at easing monetary conditions in order to maintain economic activity and alleviate deflationary pressure. The monetary authorities reduced the refinance rate three times in January-May 2016, from 8.75% to 7.75%. The interest rates on the instruments of liquidity management in the banking sector were reduced accordingly. The authorities are expected to continue to follow the same policy in the remaining part of 2016.

The economy continues to have a high degree of dollarization

It should be noted that given the current circumstances, the risk continues of an increased degree of dollarization. This degree, measured by the share of residents' deposits in foreign currency in the total volume of residents' deposits, amounted to 62.9% at the end of April 2016. Given this fact, the monetary authorities say that they will be cautious in easing the monetary conditions.

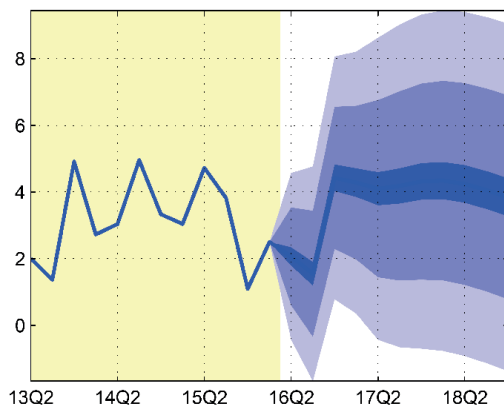
Forecast

Economic growth will recover amid a gradual rise in domestic demand

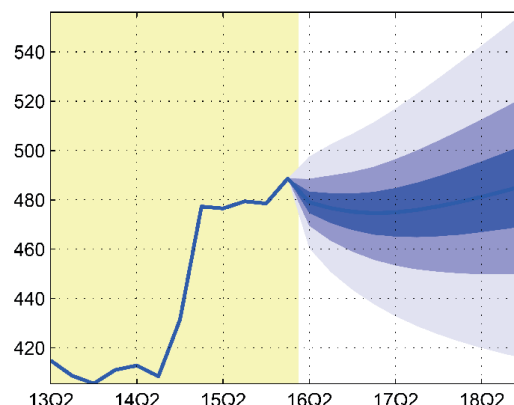
The recession in Russia will hold back the recovery of consumer demand despite a rise in real wages in the public and private sectors. This is due to a fall in revenue from major sources and in the volume of cash remittances from abroad. Given the weak domestic demand, the rise in output in the extractive industry and the increase in exports will remain major drivers of economic growth throughout 2016. The authorities aimed to expand lending to create a basis for sustainable economic growth by: further reducing the refinance rate to 7.75% in May 2016 to stimulate domestic demand; and with measures taken to encourage investment.

Given the rise in the Indicator of Economic Activity, Armenia's GDP is expected to grow by 2.6% in 2016. The GDP growth rate is predicted to rise to 4.2% in 2017 and 4.1% in 2018 as domestic demand increases and infrastructure projects are carried out.

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



Nominal exchange rate,
Armenian drams per U.S. dollar

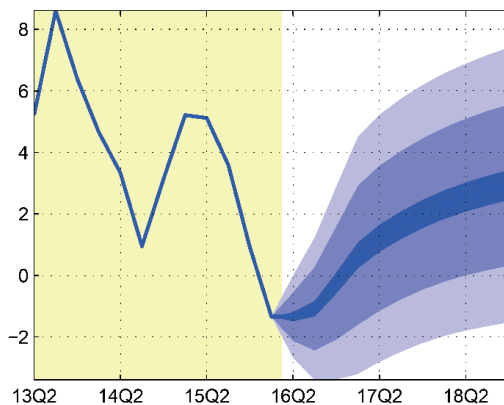


Source: Estimates by the authors

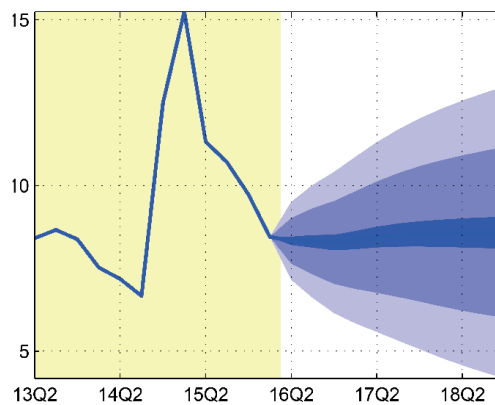
Inflation is expected to gradually rise to the target level of the central bank

The dynamics of consumer prices are influenced by the long-lasting fall in energy and food prices. Inflation is expected to accelerate but continue to be below the band of deviations set by the central bank throughout the remaining part of 2016. If there are no new external shocks, consumer prices will have a negative growth rate of -0.3% in 2016. Inflation is expected to accelerate to 2.0% in 2017 and 2.9% in 2018 as a result of: stronger domestic demand; a gradual fall in the real effective exchange rate of the dram; and a rise in the price of imported primary commodities and goods.

CPI (growth in percent as of year-end)



Interbank repo rate (in percent per annum)



Source: Estimates by the authors

SUMMARY

Forecast for the Major Macroeconomic Indicators of the Republic of Armenia

	2016	2017	2018
CPI (growth in percent as of year-end)	-0,3	2,0	2,9
GDP in comparable prices (growth in percent, y/y)	2,6	4,2	4,1
Interbank repo rate (in percent per annum)	8,7	8,8	8,9
Exchange rate of the Armenian dram against the U.S. dollar (final average for the year)	480	476	482

Source: Estimates by the authors

International organizations' forecasts for Armenia's GDP (growth in percent, y/y)

	2016						2017					
	ADB	WB	EBRD	EDB	IMF	Central Bank	ADB	WB	EBRD	EDB	IMF	Central Bank
Q1. 15		3,7		2,2				4,1		3,2		
Q2. 15		2,7	1,0		0,0	1,6–2,6		3				
Q3. 15				3,6						3,8		
Q4. 15			2,0	1,6	2,2					3,6	2,7	
Q1. 16	2,0	2,2		1,9		1,5–2,6	2,3	2,8		3,9		3,0–4,5
Q2. 16		1,9	2,0	2,6	1,9			2,8	2	4,2	2,5	
Fact												

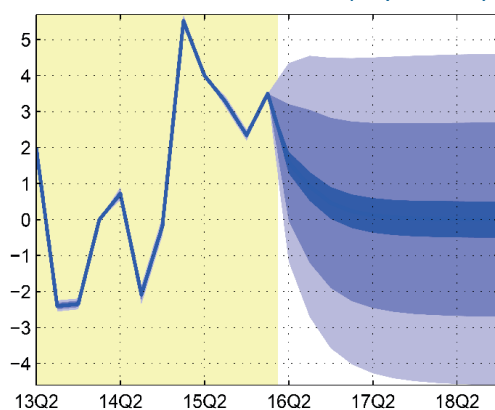
Source: Estimates by the authors, international organizations, the central bank

International organizations' forecasts for inflation in Armenia (in percent as of year-end)

	2016				2017			
	ADB	EDB	IMF	Central Bank	ADB	EDB	IMF	Central Bank
Q1. 15		4,0				3,5		
Q2. 15			4,0	2,5–5,5			4,0	
Q3. 15		4,0				4,2		
Q4. 15		3,9	4,0			3,8	4,0	
Q1. 16	3,8	1,5		1,0–2,5	4,0	3,1		
Q2. 16		-0,3	2,6			2,0	4,0	
Fact								

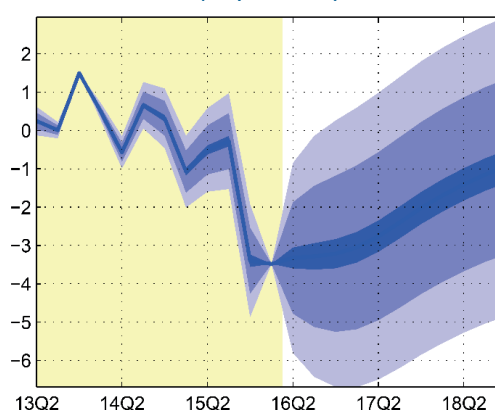
Source: Estimates by the authors, international organizations, the central bank

The dram's real exchange rate gap vis-a-vis the U.S. dollar (in percent)



Source: Estimates by the authors

Output gap (in percent)



REPUBLIC OF BELARUS



TRENDS

GDP

GDP falls year-on-year in January-May 2016 amid the lack of opportunities for stimulating the economy

Belarus' GDP fell by 2.8% year-on-year in January-May 2016. This contraction occurred amid weak domestic demand and low demand from the countries that are major trading partners. At the same time the fiscal and monetary authorities were unable to pursue an expansive macroeconomic policy.

Major factors behind the fall in economic activity in Belarus were:

- *from the standpoint of the income approach:* there was a 6.9% year-on-year decrease in household real disposable money income in January-April 2016 due to the rigid peg of the rise in wages to the rise in labor productivity;

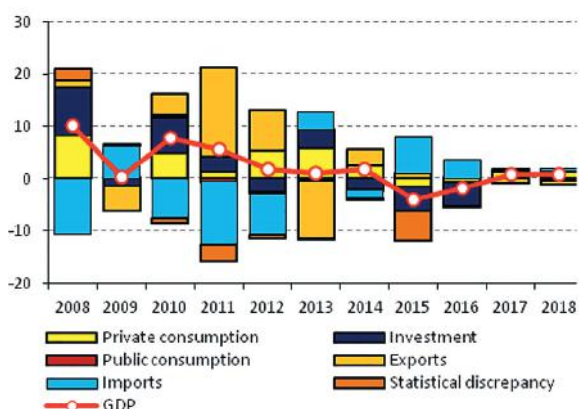
The fall in output slows down in most economic sectors

- *from the standpoint of the expenditure approach:* there was a contraction of gross fixed capital formation in Q1 2016 (down 21.7% compared with Q1 2015) and household final consumption expenditure (down 1.1% year-on-year);
- *from the standpoint of the value-added approach:* there was: a fall in industrial output (-2.5% year-on-year) in January-April 2016; a fall in construction (-22.2%) and retail sales (-2.7%); and a year-on-year rise in agricultural output (+1.5%) compared with January-April 2015. However, it should be noted that industrial output in April 2016 was 2.9% higher than that in April 2015, which was the first year-on-year increase since the end of 2014.

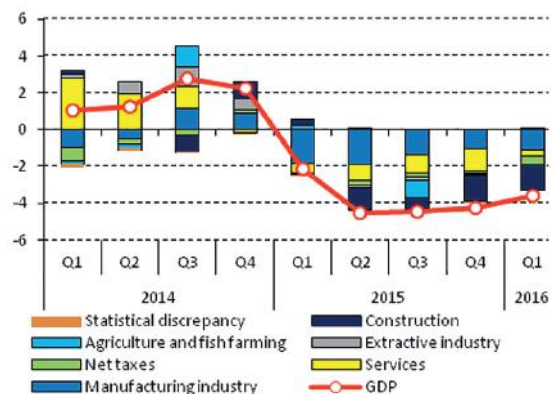
Continued high interest rates on loans impede investment

The annual fall in fixed capital investment slowed to 18.9% in April 2016 from 27.8% in March. Fixed capital investment fell by 24% year-on-year in January-April 2016. The output gap (the difference between actual GDP and potential GDP) remained negative at -4% in Q1 2016.

GDP growth structure by expenditure component in comparable prices (in percent)



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



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

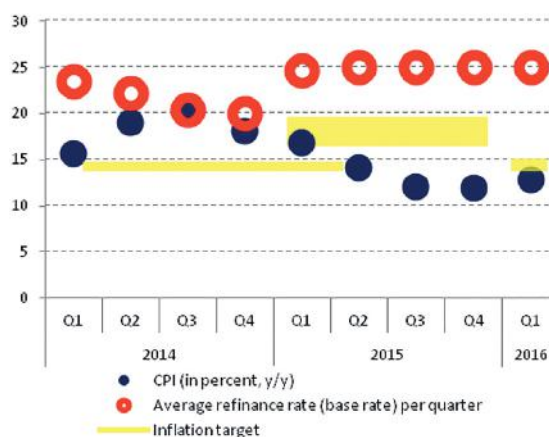
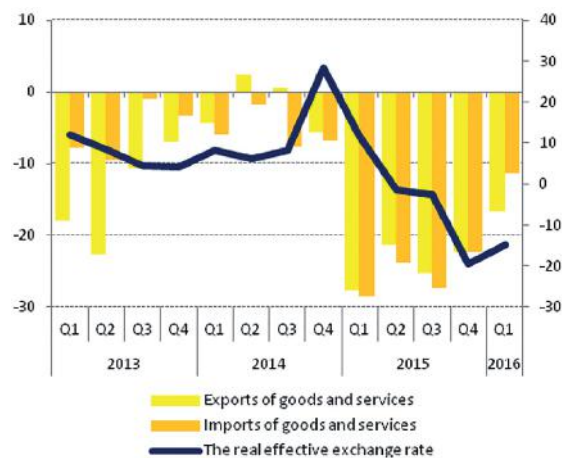
Leading economic development indicators show positive dynamics

Leading indicators calculated by the Eurasian Economic Commission continued to show a slowdown in Belarus' GDP fall in Q2 2016. The overall leading indicator had risen for six months in a row, which suggested an upward trend in the dynamics of economic activity in the short term.

Inflation

A rise in the regulated prices of services and excise taxes makes it more difficult to meet the inflation target

The annual inflation rate stood at 12.4% in May 2016. Since December 2015 consumer prices have risen by 7.0%, whereas the government had projected a 12% increase for the year 2016 as a whole. The overall rise in consumer prices was mainly due to an increase in the price of utilities, which took place in February. Other major factors behind inflationary pressure in January-May 2016 included: an increase in the rates of indirect taxes on certain categories of goods (motor fuel, cigarettes and telecommunications services); and a fall in the nominal exchange rate of the Belarusian rubel in early 2016. The actual rise in consumer prices jeopardizes the objective of limiting 2016's inflation to 12%.

CPI and the refinance 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

The situation in the exchange market stabilizes in early 2016 due to the external sector's positive dynamics

In January 2016, the nominal effective exchange rate of the Belarusian rubel fell again under pressure from the exchange rate of the Russian ruble. This led to a 3.8% decrease in its value compared with December 2015. Simultaneously, the international reserves of Belarus shrank by \$149 million. In late February, the situation in Belarus's currency exchange market started to stabilize and the Belarusian rubel grew stronger amid a rise in world oil prices and the strengthening of the Russian ruble. The flexible exchange rate system helped maintain the real effective exchange rate of the Belarusian rubel close to its fundamental level. This had a positive effect on the competitiveness of the exporting sector of the economy and reduced inflation expectations. The current account deficit in Q1 2016 was equal to 14% of GDP against 10% of GDP in Q1 2015. The foreign capital inflow was not sufficient to finance the current account balance in Q1 2016, which caused the international reserves to decrease by \$282.2 million. In the period from February to May, the international reserves grew by \$244.8 million after the country received the first loan tranche of \$500 million from the Eurasian Fund for Stabilization and Development.

Fiscal policy

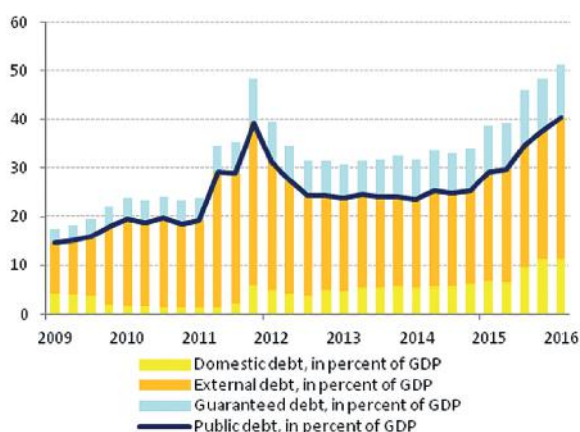
A decrease in revenue requires expenditure consolidation

The state budget continued to have a surplus, which amounted to 723.5 million new (post-redenomination) rubel (2.5% of GDP) in January-April 2016. The government plans to preserve a state budget surplus in 2016 to meet domestic and external liabilities. This requires reduced expenditure given the existing changes in the external environment.

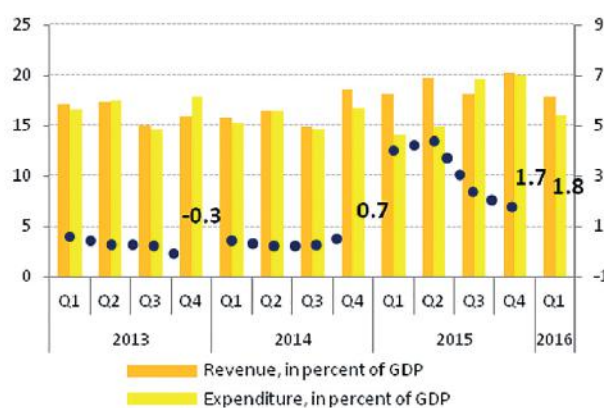
External public debt grows, while domestic debt decreases insignificantly

External public debt in dollar terms increased by 5.2% to \$13.1 billion as of May 1, 2016. The main driver of this was the first loan tranche of \$500 million from the Eurasian Fund for Stabilization and Development. Domestic public debt decreased by 2.6% since January 2016. Public debt, which includes the central government's debt and the debts guaranteed by the central government, amounted to 48.3% of GDP as of May 1, 2016. The possible increase in public debt to the established limit of 50% of GDP requires additional measures to streamline the budget, especially its expenditure segment.

Public debt



State budget implementation



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

Monetary policy

Interest rates fall amid a slowdown in inflation in April-May 2016

The interest rate policy of the National Bank remained largely restrictive in early 2016, which was the necessary condition for stabilizing inflation and currency depreciation expectations. However, a slowdown in inflation in April-May 2016 allowed the National Bank to reduce the refinance rate and, subsequently, the interest rates on loans and deposits in the banking sector for the purpose of stimulating economic activity. The National Bank lowered its refinance rate twice in April and May, from 24 to 22%, and then the rate was reduced further to 20% on July 1.

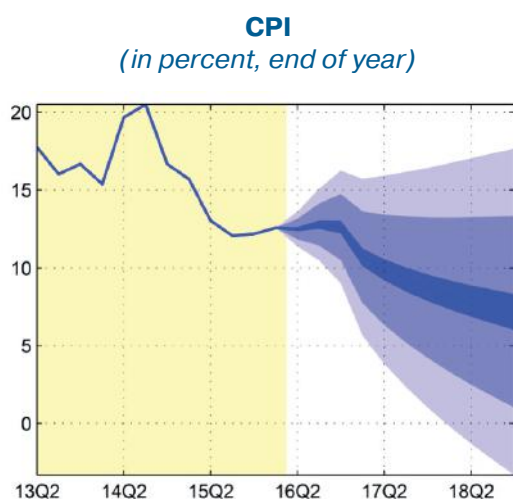
The degree of dollarization of the economy remains high

The degree of dollarization of the economy remains high despite a decrease in Q2 2016. In May 2016, foreign currency accounted for 75% of the total amount of deposits and about 58% of the total amount of loans. The government maintained high real interest rates on rubel deposits to keep them more attractive than deposits in foreign currency.

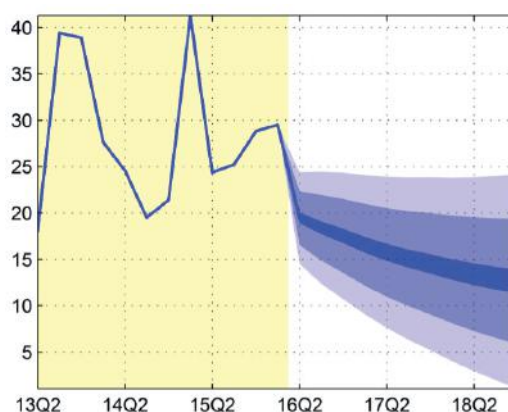
FORECAST

Weak domestic demand limits the rise in inflation

Low economic activity in the countries that are Belarus' main trading partners is expected to hold back the recovery of both domestic and external demand in 2016. A decline in the volatility of energy prices in world markets in the second half of 2016 will ensure the stabilization of the Russian ruble in the international currency exchange market. This may become an important factor for the stabilization of the Belarusian rubel. In turn, this will: reduce inflation expectations; prevent the consumer price index from rising in excess of the projected level; and help improve the macroeconomic situation. EDB forecasts an inflation rate of 12.6% for 2016 (December on December), which is slightly higher than the target level of Belarus' monetary authorities. Inflation is expected to slow to 8.8% in 2017 and 7.4% in 2018. The Belarusian rubel is predicted to gradually weaken in the medium term amid a general downward trend in the value of the currencies of developing economies.



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



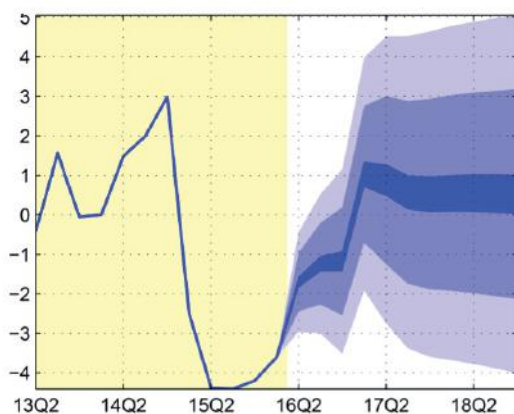
Source: Estimates by the authors

Weak external and domestic demand and tight fiscal policy hold back growth recovery

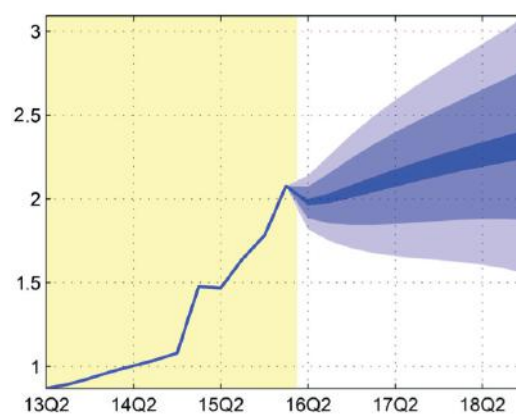
Moderately tight monetary and fiscal policies, and also the weak recovery of economic activity are domestic factors that hold back the rise in output in 2016. At the same time the fiscal authorities have limited opportunities to borrow for maintaining economic growth. A fall in the revenue of the real sector of the economy will make it impossible to effectively borrow in the domestic market. Therefore the decision of the Eurasian Fund for Stabilization and Development to provide a loan of \$2 billion is of great importance for Belarus.

The additional funding will contribute to the recovery of economic growth and facilitate market reforms aimed at ensuring sustainable growth. EDB expects Belarus' GDP fall to slow to -1.9% in 2016. GDP is expected to resume growth and increase by 0.5% in 2018. Coming out of the recession will be delayed in the event of further deterioration of the external environment. Due to a significant slowdown in potential economic growth, there is a risk of the recession being followed by a long period of economic stagnation. As inflation slows down in 2016, to boost economic activity the monetary authorities are expected to take measures in the field of interest rate policy to reduce the nominal interest rates on loans and deposits.

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



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



Source: Estimates by the authors

SUMMARY

Forecast for the major macroeconomic indicators of the Republic of Belarus

	2016	2017	2018
CPI (growth in percent, end of year)	12,6	8,7	7,2
GDP in comparable prices (growth in percent, y/y)	-1,9	0,8	0,5
Interest rate on overnight interbank loans (in percent per annum)	21,2	15,5	13,2
Exchange rate³, Belarusian rubel per U.S. dollar (final average for the year)	2,03	2,14	2,28

Source: Estimates by the authors

International organizations' forecasts for Belarus' GDP (growth in percent, y/y)

	2016					2017				
	WB	EBRD	EDB	IMF	ME RB	WB	EBRD	EDB	IMF	ME RB
Q1. 15	2,0		2,2					2,4		
Q2. 15	-1,0	0,0		-0,1		2,0			0,2	
Q3. 15	-1,0		0,7			1,0		0,9		
Q4. 15		-1,0	0,6	-2,2				1,2	0,6	
Q1. 16	-0,5		-2,0		0,3	1,0		1,5		
Q2. 16	-3,0	-3,0	-1,9	-2,7		-1,0	1,0	0,8	0,4	
Fact										

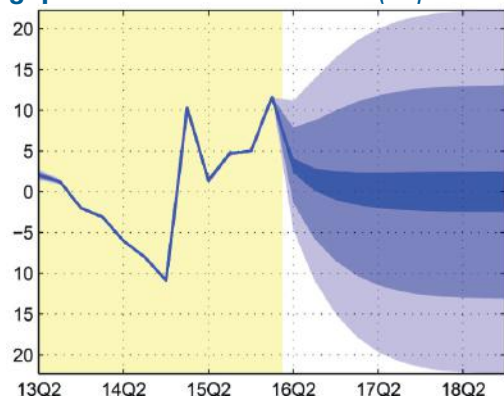
Source: Estimates by the authors, the World Bank, the European Bank for Reconstruction and Development, the International Monetary Fund, the National Bank

International organizations' forecasts for inflation in Belarus (in percent, end of year)

	2016				2017			
	WB	EDB	IMF	ME RB	WB	EDB	IMF	ME RB
Q1. 15		17,9				13,1		
Q2. 15	16,4		18,1		14,7		16,5	
Q3. 15		11,8				8,7		
Q4. 15	15,2	10,2	12,3		13	8	11,6	
Q1. 16		13,4		12,0		9,1		
Q2. 16		12,6	13,6			8,7	12,1	
Fact								

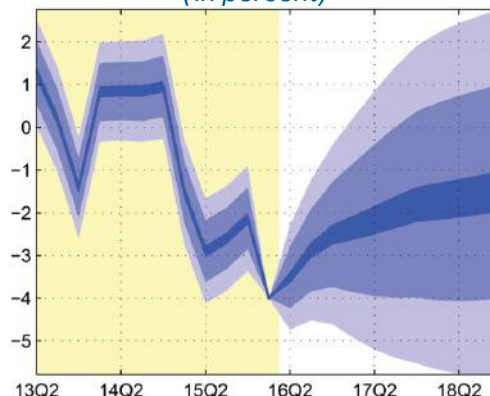
Source: Estimates by the authors, the World Bank, the European Bank for Reconstruction and Development, the International Monetary Fund, the National Bank

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



Source: Estimates by the authors

Output gap (in percent)



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

REPUBLIC OF KAZAKHSTAN



TRENDS

GDP

GDP falls year-on-year in Q1 2016 amid an unfavorable external environment

Kazakhstan's GDP was preliminarily estimated to have fallen by 0.2% in Q1 2016, compared with a growth of 2.3% in Q1 2015. This was due to: deterioration of the terms of trade; the continued fall in the world prices of oil and metals; weaker external demand; and a slowdown in the rise in domestic demand.

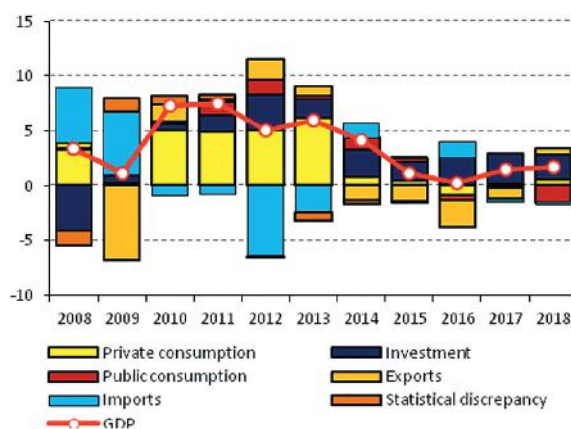
Major economic sectors show negative growth rates

The main factors behind the fall in economic activity in Kazakhstan were:

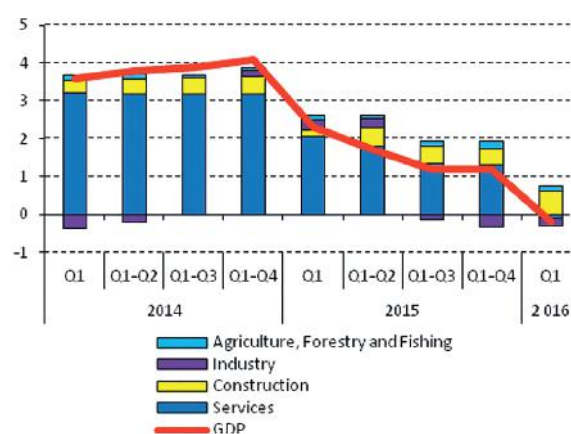
- *from the standpoint of the income approach:* there was a 0.3% year-on-year decrease in household real income as a result of a surge in inflation, which was due to the depreciation of the national currency.
- *from the standpoint of the expenditure approach:* there was a 2.7% decrease in average real pay in 2015, which was followed by a fall in the growth rate of domestic demand to 1.4%, while the rise in fixed capital investment accelerated to 4.1%.
- *from the standpoint of the value-added approach:* there was a deterioration of the situation in the energy commodity market and a decline in business activity in China and Russia. This led to a 0.8% fall in industrial output in Q1 2016 primarily due to a decrease in the extractive industry's output. The physical volume of wholesale and retail trade fell by 3.1% year-on-year in the period. Output increased by 2.9% in the agricultural sector and 6.0% in the construction sector.

The output gap was in negative territory in Q1 2016: it was estimated at -1.9% at the beginning of Q2 2016.

GDP growth structure by expenditure component in comparable prices (in percent)



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



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

The dynamics of economic activity continue to be negative at the beginning of Q2 2016

The short-term economic indicator⁴, which reflects trends in the economic development of Kazakhstan, was 99.1% year-on-year in January-April 2016. This was a consequence of a 1.4% year-on-year fall in industrial output. However, there were signs of a recovery of economic activity in other sectors. In January-April 2016, output rose by 2.6% in the agricultural sector and by 6.3% in the construction sector compared with January-April 2015.

Economic growth is expected to recover amid a rise in investment

Positive dynamics were shown by fixed capital investment, which increased by 14.9% year-on-year in January-April 2016. The share of investment in construction and repairs in the technological structure of investment grew by 3.7%.

⁴ 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 a nation's GDP.

Leading indicators of economic development show positive dynamics

The dynamics of the overall leading indicator⁵ show a recovery of GDP growth in Q2 2016. Nonetheless, given the available data for April, this recovery is weak. An improvement compared with Q2 2015 is suggested by: indicators for the external sector and the sentiment of investors; the exchange rate of the tenge against the Russian ruble; and the KASE and RTS indices. The natural gas production index delivered a negative contribution to the overall leading indicator.

Inflation**Annual inflation accelerates to 15.7% in Q1 2016, exceeding the National Bank's target level**

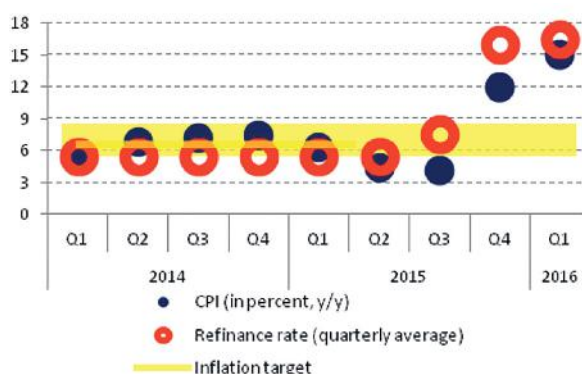
Annual inflation accelerated to 15.7% at the end of Q1 2016 from 13.6% in December 2015, thus significantly exceeding the National Bank's target level. However, the intensity of the acceleration of inflation decreased in Q1 2016. The determinative factors included the stabilization of the exchange rate of the tenge amid the start of a recovery of oil prices and a continued tight monetary policy. It should be noted that the industrial producer price index fell by 3.3 % in January-April 2016, exerting downward pressure on the price of consumer goods.

The exchange rate pass-through effect continues into Q2 2016

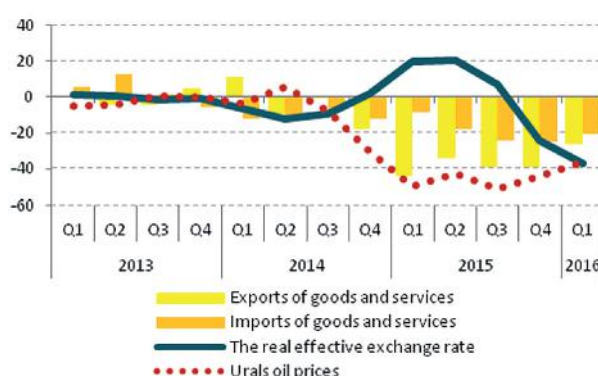
Inflation continued to increase in Q2 2016. The annual inflation rate rose from 16.3% in April 2016 to 16.7% in May. The main drivers of the rise in prices included: services (primarily utilities and transport services); food products; and the delayed effect of the currency depreciation that took place in late 2015 and early 2016. The depreciation of the tenge is expected to continue to have an impact on end prices throughout Q2 2016. The National Bank has set an inflation target of 6 to 8% for 2016.

⁵ Eurasian Economic Commission. *Leading Indicators for EAEU Member States: Forecast for the Period until July 2016*, eurasiancommission.org.

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

A decline in currency depreciation pressure leads to stabilization in the exchange market

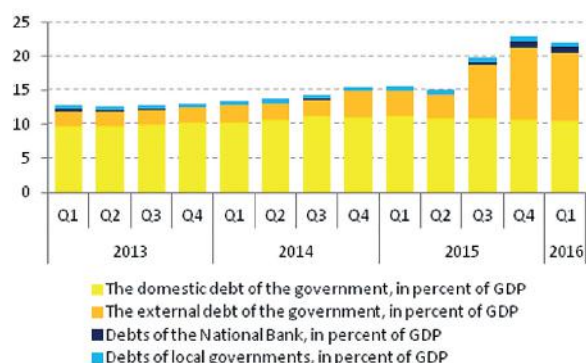
The decrease in currency depreciation pressure led to some stabilization in the domestic exchange market. This caused the fall in the nominal effective exchange rate of the tenge to slow to 13.4% in Q1 2016 from 27.3% in Q4 2015 (in comparison with Q3 2015). The real effective exchange rate of the tenge fell by 8.2% in quarterly terms. Nonetheless, the current account deficit grew to 3.5% of GDP in Q1 2016 as a result of a significant decrease in the volume of exports of goods and services. An increase in direct investment was offset by an outflow of portfolio investments. As a result, the financial account deficit in Q1 2016 turned out to be higher than in Q1 2015. Due to the balance of payments deficit in Q1 2016, the international reserves contracted by \$1.0 billion. However, the reserves started to recover in March due to the stabilization of the exchange rate of the tenge and a rise in oil prices.

Fiscal policy

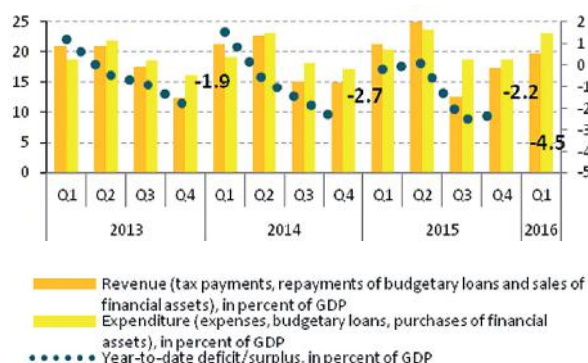
The state budget moves from a surplus in Q1 2015 to a deficit in Q1 2016.

The state budget had a deficit amounting to 4.5% of GDP in Q1 2016 compared with a surplus equal to 0.2% in Q1 2015. The actual deficit in fact matched the expected level because both revenue and expenditure met the projected figures. However, the revenue projection was adjusted to reflect an increase in VAT revenue and the decreased contribution of transfers from the National Fund of Kazakhstan. State budget expenditure in Q1 2016 was 28.2% higher than in Q1 2015, but this was a temporary increase considering the budget parameters for 2016. The state budget deficit was mainly financed from domestic sources and is expected to amount 1.6% of GDP in 2016.

Public debt



State budget implementation



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

The relative indicators of external debt improve in Q1 2016

Public debt grew by 1.4% in Q1 2016 to a total of \$26.9 billion (14.5% of GDP) as of April 1, 2016. The dollar equivalent of domestic public debt (debts of the government and the National Bank) decreased by 2.5% to \$14.2 billion as of April 1. At the same time the external debt of the government of Kazakhstan in fact remained unchanged at \$12.7 billion.

Monetary policy

The National Bank starts a round of loosening monetary policy

In May 2016 the National Bank of Kazakhstan lowered its base rate by 200 basis points to 15.0%. A liquidity surplus amid the decreased dollarization of the economy led to a decline in the interest rates in the financial market to a level equal to the lower boundary of the base rate band. This prompted the National Bank to implement a more active policy regarding liquidity management in the banking sector. Commercial banks' claims on the economy decreased – if not adjusted to the exchange rate difference – because of both low economic activity and high interest rates. On the other hand, the latter factor was determinant for the dynamics of the volume of bank deposits in tenge, which, in its turn, influenced the growth rate of the M3 money supply.

FORECAST

Inflation is expected to stabilize in Q3-4 2016

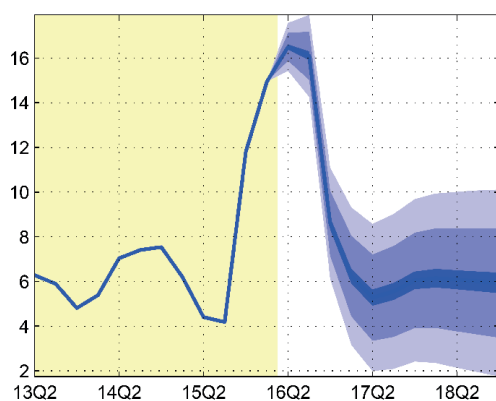
The depreciation of the national currency will continue to have an impact on inflation throughout Q2 2016. Given the low base of Q1-2 2015, inflation will reach its peak in Q2 2016. The fading impact of the exchange rate pass-through effect and weak domestic demand in the second half of 2016 will lead to a slowdown in inflation. Its annual rate will fall to 8.5% by the end of 2016. Inflation will slow to 5.5 to 6.0% in 2017-2018 due to: the continued negative output gap; the continued relatively low food prices in the world market; and the stabilization of the exchange rate of the tenge.

Monetary policy is expected to be tight in 2016

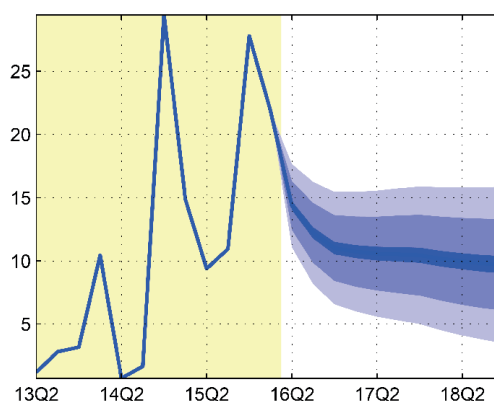
The monetary authorities will have to keep interest rates in the financial market at a high level because of the need to increase the attractiveness of assets denominated in tenge. This is a result of: the high degree of dollarization; the increased risk premium; and heightened inflation expectations. Monetary policy is expected to be loosened gradually as inflation stabilizes.

The exchange rate of the tenge is expected to appreciate slightly in 2016 as a result of a decline in inflation expectations. Afterwards, the tenge will be gradually weakening amid the lack of a significant rise in oil prices and the general downward trend in the exchange rates of the currencies of developing economies.

CPI
(growth in percent, end of year)



TONIA
(in percent per annum)



Source: Estimates by the authors

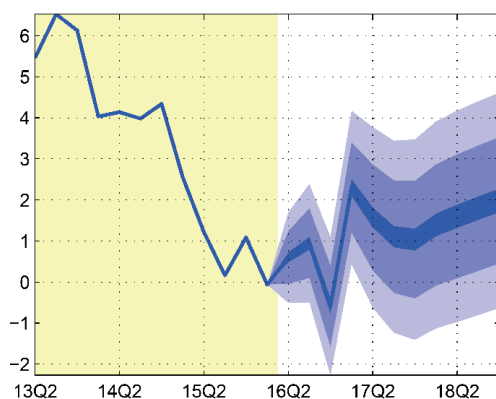
The use of off-budgetary resources for supporting the economy will help keep economic growth in positive territory in the remaining part of 2016

The depreciation of the tenge will continue to have a positive effect on manufacturing industry in the remaining part of 2016. A 30 to 40% pay increase in the government-funded sector at the beginning of 2016 became an additional factor supporting domestic demand. The government plans to implement a new economic stimulus policy titled Nurlı Zhol (The Bright Path) in 2016 within the framework of a plan of anti-crisis measures. It also plans to provide additional extra-budgetary funds amounting to 2.8% of GDP, which may lead to an extra, 0.4% increase in GDP in 2016. However, the expected fall in the physical volume of oil production and the long-lasting low oil prices will cause a further decrease in export revenue and a decline in domestic demand in the remaining part of 2016. GDP is expected to grow by 0.2% in 2016.

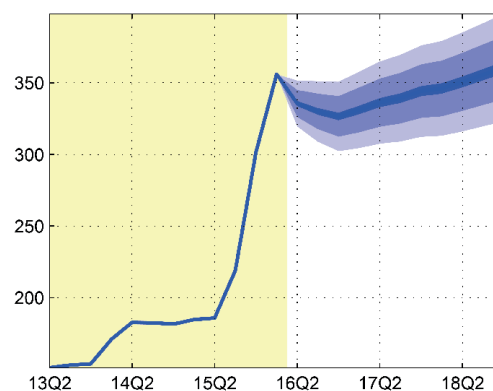
A slow recovery of prices of primary commodities will prevent the country from regaining the 2010-2014 GDP growth rates in the medium term

Exports and private consumption are expected to rise in 2017-2018 amid: a recovery of external demand from Russia and the European Union; a gradual rise in oil prices; and the start of the exploitation of an offshore oil and gas field in the Caspian Sea. The implementation of government programs aimed at supporting infrastructure investment and a 2015-2019 industrial innovation development program will contribute to the acceleration of economic growth. At the same time the probability of oil prices standing at a level of \$40 to \$50 per barrel for a significant period of time would limit the ability of fiscal policy to stimulate domestic demand. Given these circumstances, budgetary consolidation is expected to increase in the medium term and GDP is forecast to grow by 1.5 to 1.7% a year in 2017-2018.

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



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



Source: Estimates by the authors

SUMMARY

Forecast for the major macroeconomic indicators of the Republic of Kazakhstan

	2016	2017	2018
CPI (growth in percent, end of year)	8,6	6,1	5,9
GDP in comparable prices (growth in percent, y/y)	0,2	1,5	1,7
TONIA rate (in percent per annum)	14,9	10,6	9,9
Exchange rate of the Kazakh tenge against the U.S. dollar (average for the year)	337	338	353

Source: Estimates by the authors

International organizations' forecasts for Kazakhstan's GDP (growth in percent, y/y)

	2016						2017					
	ADB	WB	EBRD	EDB	IMF	MNE RK	ADB	WB	EBRD	EDB	IMF	MNE RK
Q1. 15		3,2		3,7				4,7		4,6		
Q2. 15		2,8	2,0		3,1			3,9			4,8	
Q3. 15		2,9		2,1		2,1		4,1		2,2		3,6
Q4. 15			1,5	1,7	2,4	2,1				2,3	3,8	3,6
Q1. 16	0,7	1,1		0,8		0,5	1,0	3,3		1,8		
Q2. 16		0,1	1,1	0,2	0,1			1,9	2,4	1,5	1,1	
Actual												

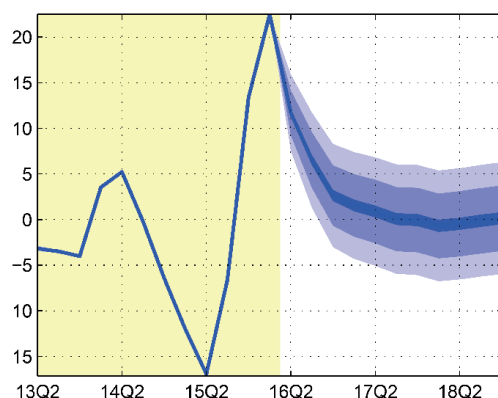
Source: Estimates by the authors, international organizations, national agencies

International organizations' forecasts for inflation in Kazakhstan (in percent, end of year)

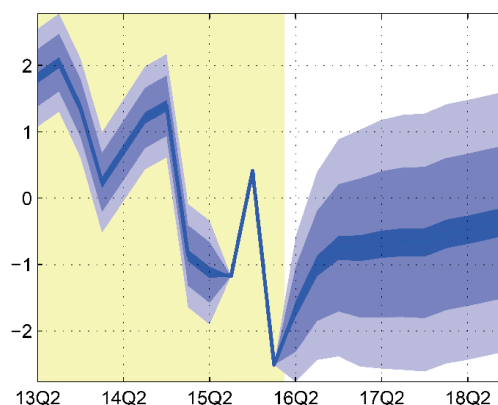
	2016					2017				
	ADB	WB	EDB	IMF	MNE RK	ADB	WB	EDB	IMF	MNE RK
Q1. 15			5,9					6,6		
Q2. 15	7,8	7,8		5,4			8,5		5,7	
Q3. 15			6,5					6,3		
Q4. 15			11,0	8,0	6,0–8,0			5,8	7,0	6,0–8,0
Q1. 16	12,6		8,6			4,6		6,0		
Q2. 16			8,6	13,1				6,1	9,3	
Actual										

Source: Estimates by the authors, international organizations, national agencies

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

KYRGYZ REPUBLIC



TRENDS

GDP

Kyrgyzstan's GDP falls in Q1 2016

The recession that began in Q4 2015 continued in early 2016. Kyrgyzstan's GDP fell by 4.9% year-on-year in Q1 2016, which was primarily due to a decrease in gold production. Other sectors continued to be under the influence of an unfavorable external economic situation and tight monetary policy. As a result, growth in the economic sectors that are not related to gold production slowed from 4.5% in 2015 to 2.1% in Q1 2016.

Major factors behind the fall in economic activity in Kyrgyzstan were:

Domestic demand falls, output decreases in the gold and textile industries

- *from the standpoint of the income approach⁶*: there was a 1.7% year-on-year decrease in household real disposable money income as a consequence of a fall in migrant remittances in Q4 2015 in some terms;
- *from the standpoint of the expenditure approach⁷*: there was a contraction of domestic consumer demand, especially household consumption, which decreased by 6.5% in 2015. At the same time cash remittances from abroad rose by 15.9% in Q1 2016 amid low inflation. This suggested that there might be a recovery in household real income and domestic consumer demand. It should be noted that the upward trend in the volume of remittances from abroad was largely due to the liberalization of the conditions of employment for the citizens of the Kyrgyz Republic who are employed in the other member countries of the Eurasian Economic Union;
- *from the standpoint of the value-added approach*: there was a 25.7% decrease in output in the industrial sector, which was caused by a fall in gold production and the textile industry's output. In addition, a slowdown in economic activity took place in the agricultural, retail and construction sectors.

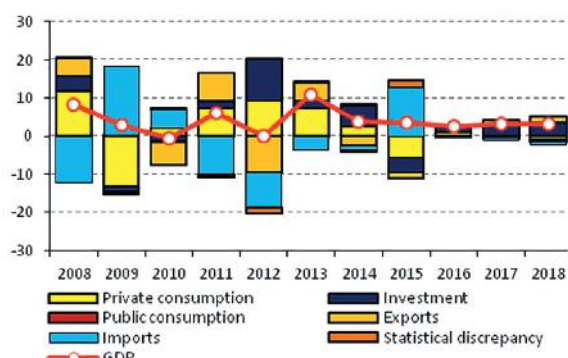
⁶ as of 2015

⁷ as of 2015

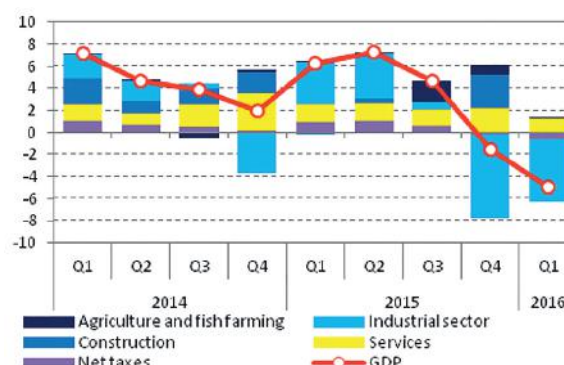
In Q1 2016 the output gap remained negative at -1.4%.

In a survey of the economic activity of industrial companies, which was conducted in Q1 2016, the share of managers noting a decline in demand for their companies' products was 22.6% (compared with 21.6% in Q4 2015) and the share of managers expecting a rise in solvent demand was 6.2% (against 8.8% in Q4 2015).

GDP growth structure by expenditure component in comparable prices
(in percent)



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



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

Recovery of economic growth may take a long time

Available data for April-May 2016 suggest that the recovery of economic activity in the sectors that are not related to gold production may be protracted and unstable. The year-on-year fall in Kyrgyzstan's GDP slowed to 4.0% in January-May 2016, while the non-primary commodity sectors showed a rise of 0.5%. The relatively low growth rates in the agricultural and construction sectors were offset by a fall in output in the textile industry and a decrease in the production of electricity and natural gas.

Data for January-May 2016 suggest signs of a recovery of investment

Fixed capital investment increased by 0.3% year-on-year in January-May 2016 following a 0.7% fall in Q1 2016. The recovery of investment took place amid the emergence of an upward trend in the some monetary aggregates. The annual growth of the aggregates moved from negative to positive territory in February 2016 for the first time in 16 months. The annual growth rate of the M2 money supply was 21.6% in April 2016 compared with a fall of 12.5% in April 2015.

Inflation

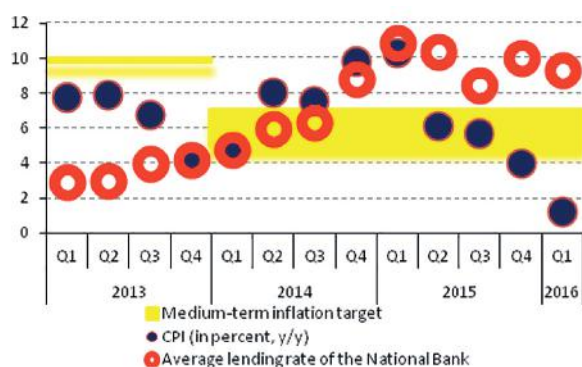
Inflation slows down sharply in Q1 2016

Annual inflation slowed to 1.2% by the end of Q1 2016 compared with 3.9% at the end of Q4 2015. Due to the global fall in prices of energy resources and food, the exchange rate pass-through effects were partially offset by a decrease in the domestic prices of fuel and foodstuffs. Also, a factor behind the sharp slowdown in inflation in the economy of Kyrgyzstan was the monetary authorities' intention to limit the volatility of the exchange rate of the som by making active interventions in the interbank currency exchange market throughout 2014-2015; and keeping the base lending rate at a high level.

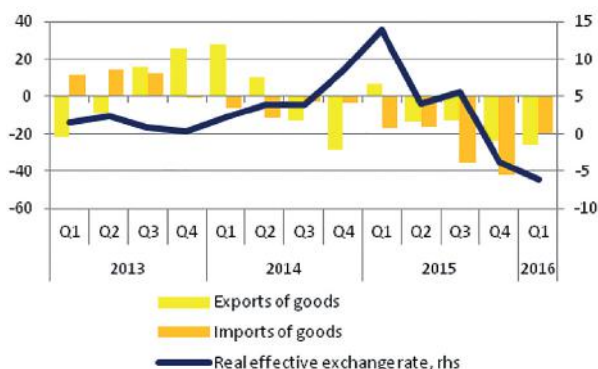
Inflation continues to slow down in Q2 2016

In January-April 2016 inflation slowed to 0.7% year-over-year. In May the consumer price index was 98.2% compared with December 2015. The falling fuel and food prices remained deflationary factors and will probably determine the general inflation situation throughout Q2 2016. It should be noted that the base inflation was still higher than the target level of 5.0 to 7.0%.

CPI and the refinance 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

Depreciation pressure on the domestic currency exchange market fades away in Q1 2016

Depreciation pressure on the domestic currency exchange market faded away in Q1 2016. The nominal effective exchange rate of the som rose by 3.6% compared with Q4 2015. As the inflation rate in Kyrgyzstan was lower than that in Russia and Kazakhstan, the strengthening of the som in real terms was less significant at 2.2%. Despite a deterioration of the price competitiveness of Kyrgyzstan's commodity manufacturers, the export of goods other than gold rose by 43.5% year-on-year in Q1 2016. The export of goods to CIS countries increased by 22.5% year-on-year in terms of value, while exports to EAEU countries rose by 22.8%. This was due to a 2.2-fold increase in the export of goods to Russia.

Amid a continued downward trend in imports the foreign trade deficit shrank to \$372.6 million from \$453.9 million in Q1 2015. A rise in cash remittances also contributed to the decrease in the current account deficit. The decline in pressure on the domestic currency exchange market was also due to the emergence of a downward trend in the dollarization of the economy in Q1 2016. All these factors allowed the National Bank to switch from net seller to net buyer in the exchange market. The international reserves grew by 9.4% by the end of Q1 2016 compared with December 2015.

The som strengthens by 10.0% against the U.S. dollar in January-May 2016

The lack of shocks in external financial markets amid a recovery of world oil prices led to a further rise in the exchange rate of the som to the U.S. dollar. The strengthening of the som against the dollar accelerated from 5.1% in March to 10.0% in May compared with January 2016. As a result, the National Bank managed to increase the net volume of foreign currency purchases from \$9.8 million in Q1 2016 to \$30.3 million in April-May 2016. This made it possible to replenish the international reserves, which grew by \$17.2 million in April and May.

Fiscal policy

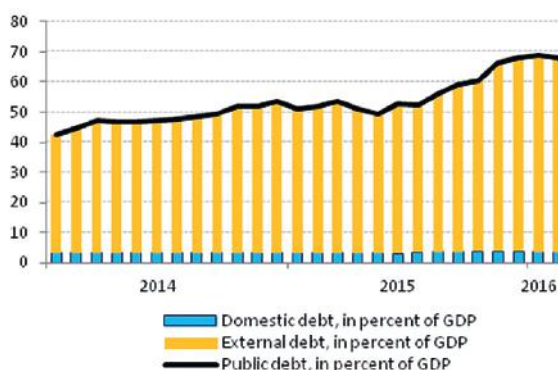
The state budget has a surplus equal to 3.4% of GDP in Q1 2016

The state budget had a surplus equal to 3.4% of GDP in Q1 2016. Budget revenue rose by 37.3% year-on-year, which was largely due to: a transfer of the National Bank's profit to the budget; external transfers; and customs duty within the framework of the EAEU. Expenditure rose by 14.2% year-on-year, which was caused by: acquisitions of non-financial assets; an increase in wage and social security spending; a rise in expenses related to the servicing of the external public debt; and an increase in subsidies to the economy. Despite the existence of a budget surplus, the government made external borrowings to finance its public investment program. This caused the external public debt to grow by 1.2% by April 1, 2016 in dollar terms.

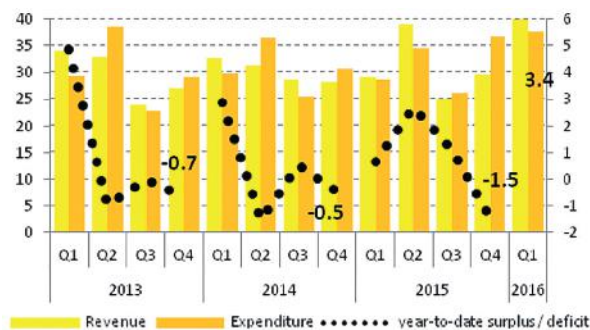
The state of public finances deteriorates in January-April 2016

The situation of the state budget changed sharply in April 2016 and became less favorable. Revenue fell by 31.0% year-on-year amid: a 22.4% year-on-year rise in current expenditure; and an increase in expenses on purchases of non-financial assets to implement public investment programs, which increased 3.8-fold compared with April 2015. The state budget thus had a deficit equal to 5.4% of GDP in January-April 2016.

Public debt



**State budget implementation
(in percent of GDP)**



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

Monetary policy

The National Bank continues to loosen its monetary policy in May 2016

Due to a decline in domestic and external depreciation pressure and also an increased risk of deflation, the National Bank decided to reduce its base lending rate by 2 percentage points to 6.0% on May 31, 2016.

Interest rates in the interbank loan market in January-May 2016 stood close to the lower boundary of the interest rate band set by the National Bank. There was a downward trend in interest rates on repo deals. The weighted average interest rate on repo transactions fell from 9.96% in January 2016 to 1.51% in May. This fall was due to: a rise in surplus liquidity, which occurred as a result of the National Bank's activities to buy foreign currency; issuing loans to both commercial banks for a period of up to six months through loan auctions and to international organizations established by the Kyrgyz Republic together with other states within the framework of the EAEU; as well as activities related to the conversion of mortgage loans from foreign currencies into the national currency.

FORECAST

The external environment will cause weak economic growth and low inflation

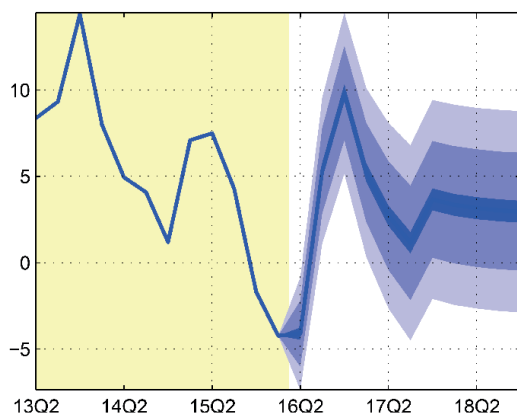
The external economic environment in the remaining part of 2016 will be characterized by the low growth rate of the world economy and a slow recovery in prices in the global energy and food markets.

Economic growth will slow to 1.5% in 2016

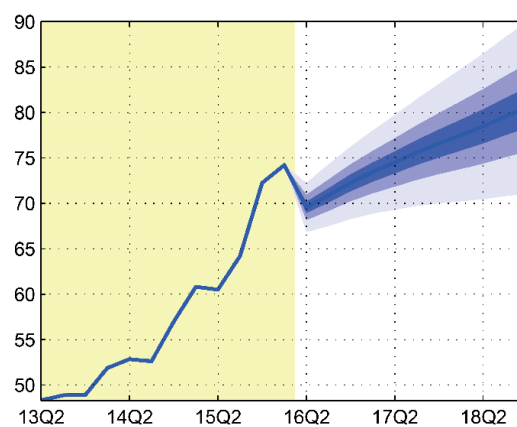
The decline in economic activity in the countries that are the main trading partners of Kyrgyzstan will lead to a fall in both domestic and external demand for Kyrgyz products. In particular, the predicted 3.6% rise in the volume of migrant remittances in 2016 will be reflected in limited domestic consumer demand. The recession in Russia and the slowdown in economic growth in Kazakhstan will affect the volume of Kyrgyz exports to those countries. In addition, the nominal volume of export revenue will be determined by the low growth rate of world gold prices.

The domestic factors that may hold back economic growth include: the rather tight monetary policy followed by the National bank in late 2015 and early 2016; and the low growth rate of gold production. The depreciation of the som in Q4 2015 made it possible to alleviate the growing pressure, improve the foreign trade balance and increase the price competitiveness of Kyrgyz products. An additional impetus to domestic demand will be given in 2016 and 2017 by the planned increase in the consolidated budget deficit. Kyrgyzstan's economic growth is expected to slow to 1.5% in 2016 and stabilize at 3.2% in 2017 and 2018.

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



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

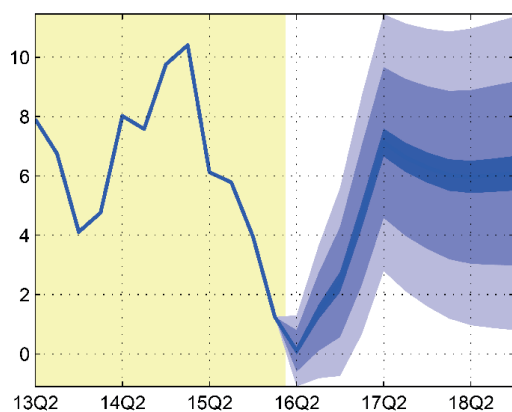


Source: Estimates by the authors

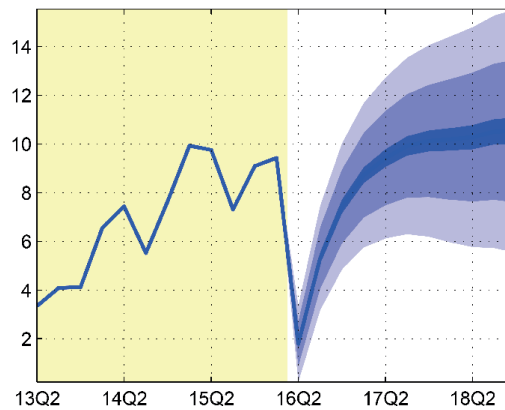
Inflation is expected to stay within the target band in 2017-2018

The government is expected to raise electricity and heating prices by 20 to 30% in 2017-2018. However, the tight monetary policy, weak domestic demand and the low world fuel and food prices will help prevent the inflation rate from exceeding the target band of 5 to 7%.

CPI
(growth in percent, end of year)



Interbank repo rate
(in percent per annum)



Source: Estimates by the authors

SUMMARY

Forecast for the major macroeconomic indicators of the Kyrgyz Republic

	2016	2017	2018
CPI (growth in percent, end of year)	2,4	6,0	5,9
GDP in comparable prices (growth in percent, y/y)	1,5	3,2	3,1
Interbank repo rate (in percent per annum)	6,2	9,7	10,7
Exchange rate of the Kyrgyz som against the U.S. dollar (average for the year)	71,7	74,8	78,6

Source: Estimates by the authors

International organizations' forecasts for the Kyrgyz Republic's GDP (growth in percent, y/y)

	2016							2017						
	ADB	WB	EBRD	EDB	IMF	NB KR	ME KR	ADB	WB	EBRD	EDB	IMF	NB KR	ME KR
Q1. 15	2,0	4,0				7,0			5,0					
Q2. 15		3,2	3,1		3,4	3,8	4,1		4,0			5,2		3,4
Q3. 15	2,0					2,3	5,2							3,9
Q4. 15			3,9		3,6	4,0						4,6	3,5	
Q1. 16	1,0	4,2		2,8		2,5		2,0	3,4		3,2			
Q2. 16		3,4	1,0	1,5	3,5	1,2			3,1	2,6	3,2	2,7	5,7	
Actual														

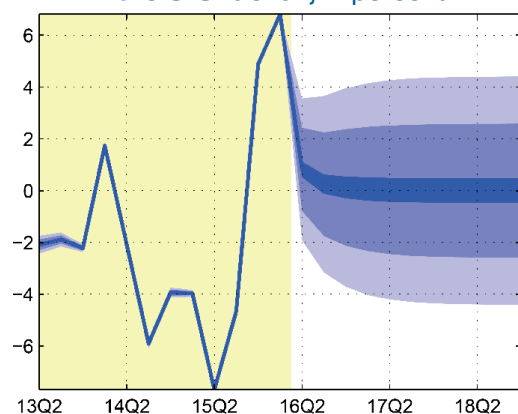
Source: Estimates by the authors, international organizations, national agencies

International organizations' forecasts for inflation in the Kyrgyz Republic (in percent, end of year)

	2016					2017					
	ADB	EDB	IMF	NB KR*	ME KR	ADB	EBRD	EDB	IMF	NB KR*	ME KR
Q1. 15	10,0			3,9							
Q2. 15			8,6	9,4	9,4				7,1		8,5
Q3. 15	11,5			7,9	7,9						8,3
Q4. 15			9,0	6,7					6,7		
Q1. 16	10,0	3,5		3,0		8,0		4,6		3,2	
Q2. 16		2,4	5,5	1,3				6,0	6,9	5,7	
Actual											

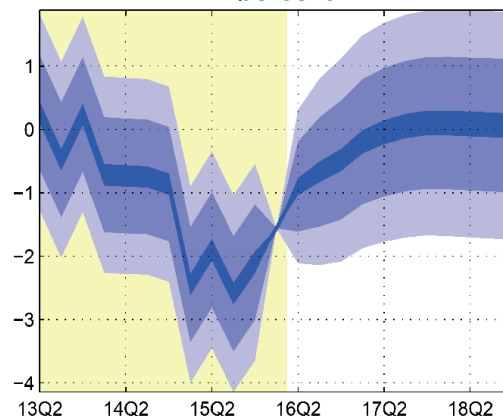
Source: The national statistical agency, estimates by the authors; *- annual average

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



Source: Estimates by the authors

Output gap, in percent



REPUBLIC OF TAJIKISTAN



TRENDS

GDP

Strong investment activity supports economic growth

Year-on-year GDP growth in the Republic of Tajikistan accelerated from 5.3% in Q1 2015 to 6.5% in Q1 2016. The economic growth was supported by strong investment activity, which reduced the influence of an unfavorable external environment. The main factors behind economic growth in Tajikistan included:

- *from the standpoint of the income approach:* there was a 0.2% decrease in household real disposable money income in Q1 2016 due to a fall in cash remittances from migrant workers in Russia, which was in recession. According to data from the central bank of Russia, the net volume of remittances sent to Tajikistan by money transfer systems dropped 3.5-fold compared with Q1 2015.
- *from the standpoint of the value-added approach:* there was support for economic growth from output in the construction and industrial sectors, which increased by 18.3% and 13.1%, respectively. A slowdown in economic activity took place in the agricultural sector and retail trade.

Economic growth continues to be strong

Weak external demand, determined by the fall in migrant remittances, was offset in January-May 2016 by high growth rates in the construction, industrial and agricultural sectors. In addition, a 42.5% year-on-year increase in exports in May 2016 helped export revenue in January-May 2016 to get into positive territory. This also contributed to the continued high economic growth rate. It is most likely that these factors will continue to provide support to economic growth.

Inflation

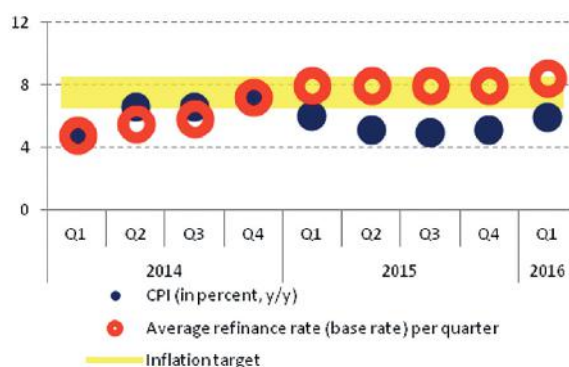
The consumer price index rises 6.0% year-on-year in Q1 2016

The average annual growth rate of inflation in Q1 2016 was 6.0%. Currency depreciation shocks, which were reflected in the domestic prices of non-food goods, were offset by an unfavorable situation in the global price of food and energy.

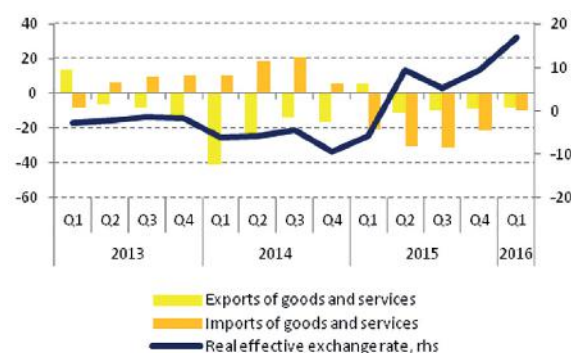
Inflation gradually declines

The second round effect of the currency depreciation shock, which took place in late 2015 and early 2016, continued in April-May 2016. This led to acceleration of the rise in prices of non-food consumer goods. The growth rate of food prices fell, which was a determining factor behind a decline in overall inflation. Inflation was 5.7% in January-May 2016.

CPI and the refinancing rate
(in percent)



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



Source: The national statistical agency, estimates by the authors

Exchange rate

The exchange rate of the somoni stabilizes at 7.8% against the U.S. dollar

The Tajik somoni depreciated by 14.8% against the U.S. dollar and by 7.6% against the Russian ruble in Q1 2016 in comparison with January 2016. The real effective rate of the somoni fell by 8.4%. However, this favorable factor for the country's exports was offset by the low world price of cotton and aluminum, the main export items of Tajikistan. This led to an 8.2% year-on-year decrease in the volume of exports. Imports fell by 9.9% year-on-year in Q1 2016 due to weak domestic consumer demand resulting from the decrease in migrant remittances.

The exchange rate of the somoni was fixed at 7.8 somoni per U.S. dollar in April-May 2016. This was most likely due to the National Bank's efforts aimed at replenishing the international reserves, which were growing in March-April 2016.

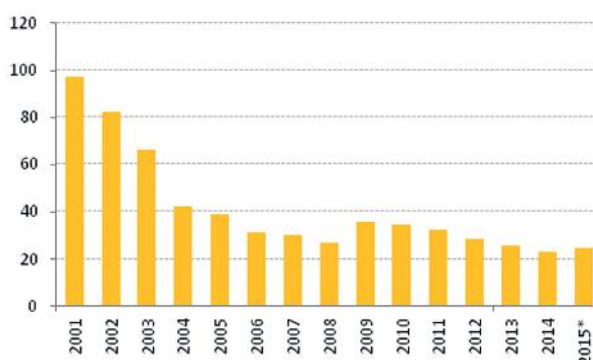
In addition, the stabilization of the situation in the domestic currency exchange market was helped by an increase in export revenue in May 2016. The export of transport vehicles increased 8.3 times year-on-year in January-May 2016, while the export of optical and medical instruments jumped 16.1 times. The export of mineral products increased by 13.5% and the export of finished food products rose by 130%.

Fiscal policy

The state budget has a surplus in Q1 2016

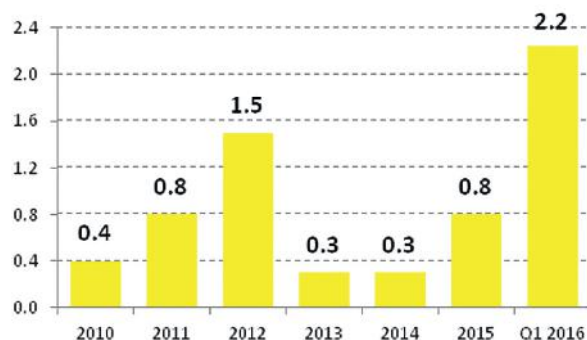
The state budget had a surplus amounting to 2.2% of GDP in Q1 2016. State budget revenue rose by 17.7% year-on-year, mainly due to an increase in tax revenue. State budget expenditure was determined by an increase in public investment in the fuel and energy sector. The government renovated, modernized and built power generating facilities in cooperation with international partners under a state program aimed at ensuring the country's energy independence. Another important expenditure item that made a major contribution to the increase in public spending related to the financing of the state governance sector. State budget expenditure rose by 26.5% year-on-year in Q1 2016.

External debt,
(in percent of GDP)



* data as of October 1, 2015

State budget surplus,
(in percent of GDP)



Source: The national statistical agency, estimates by the authors

The state of public finances deteriorates in April 2016

The public finances sector posted a deficit of 112.8 million somoni in January-April 2016 as a consequence of acceleration of the year-on-year growth of expenditure to 34.8%. This was primarily due to an increase in public investment.

Monetary policy

The interest rate policy of the National Bank is viewed as restrictive

The interest rate policy of the National Bank of Tajikistan is viewed as restrictive. Although the National Bank's refinance rate had been kept at 9.0% since March 1, 2016, the interest rate on loans issued to support liquidity remained at 18.0% from March to May 2016 and the weighted average interest rate on interbank loans was 24.42% in May 2016.

The growth of the M3 money supply accelerated to 14.1% compared with December 2015 following a decrease of 4.1% in January 2016.

FORECAST

Domestic consumer demand will remain weak

The economy of Tajikistan will continue to be under the influence of the unfavorable external environment in the forecast period. The continuing recession in Russia poses the main risk to the country's GDP growth, and may lead to a fall in export revenue and the volume of migrant remittances. In addition, a contraction of domestic consumer demand could lead to a further slowdown in growth in the services sector and a continued low volume of consumer imports. The unfavorable price backdrop in the world aluminum, cotton and gold markets will lead to a fall in revenue from the export of these commodities despite the government's intention to increase the physical volume of their output. An additional risk may be posed by the continuing cycle of an increase to the federal funds rate of the US Federal Reserve System, as this may worsen the terms of external financing.

A rise in Chinese investment partially compensates for the contraction of consumer demand

Investment from China will be a major driver of economic growth. Given statements made at a session of China's National People's Congress in March 2016, the Chinese government plans to increase direct investment abroad by 10% in 2016 despite the expected slowdown in economic growth. A special role in the overall flow of direct investment abroad belongs to the Silk Road Economic Belt project, which includes Tajikistan geographically.

The contraction of domestic demand will be compensated for by strong investment activity throughout 2016. As a result, Tajikistan's GDP will grow by 6.4% in 2016 and inflation will accelerate to 7.5% amid the depreciation of the national currency.

SUMMARY

Forecast for the main macroeconomic indicators of the Republic of Tajikistan

	2016	2017	2018
CPI (<i>growth in percent, end of year</i>)	7,5	7,9	7,9
GDP in comparable prices (<i>growth in percent, y/y</i>)	6,4	6,7	5,0
Interest rate on interbank loans (<i>in percent per annum</i>)	9,8	12,2	12,7
Exchange rate , Tajik somoni per U.S. dollar (<i>average for the year</i>)	8,0	8,6	9,1

International organizations' forecasts for Tajikistan's GDP (*in percent, y/y*)

	2016						2017					
	ADB	WB	EBRD	EDB	IMF	MEDT RT	ADB	WB	EBRD	EDB	IMF	MEDT RT
Q1. 15		5,3						6,2				
Q2. 15		4,4	3,8		4,1			5,2			5,0	
Q3. 15						7,2						7,2
Q4. 15			4,5		3,4						4,1	
Q1. 16	3,8	4,8		4,3			4,0	5,5		5,0		
Q2. 16		4,0	4,5	6,4	3,0			4,8	4,1	6,7	3,5	
Actual												

Source: Estimates by the authors, international organizations, national agencies

International organizations' forecasts for inflation in the Republic of Tajikistan (*growth in percent, end of year*)

	2016				2017			
	ADB	EDB	IMF	MEDT RT	ADB	EDB	IMF	MEDT RT
Q1. 15								
Q2. 15			6,5				6,4	
Q3. 15				7,0				7,7
Q4. 15			6,5				6,4	
Q1. 16	8,5	10,8			7,5	9,0		
Q2. 16		7,5	9,2			7,9	8,5	
Actual								

Source: Estimates by the authors, international organizations, national agencies

APPENDIX

GLOSSARY

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.

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.

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 central 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 smooth 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.

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 foreign trade turnover with the domestic country.

Output gap. Deviation of GDP from potential output, expressed as a percentage. Characterizes the balance between demand and supply and may be regarded as an aggregate indicator of the effect which the demand factors have on inflation. If the actual output is larger than the potential output (positive output gap), all else equal, inflation is expected to accelerate. A negative output gap is an indicator of an expected slowdown in price growth.

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.

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 share of foreign trade turnover 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.

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 the central bank's refinancing transactions and its liquidity-absorbing transactions.

The KASE index is the ratio of market prices of the shares, included in the representative list of the index on the date of its execution, to the shares prices of this list on a particular date, which is weighted by market capitalization, taking into account shares held in free float.

The RTS Index is a free-float capitalization-weighted index of 50 Russian stocks traded on the Moscow Exchange in Moscow, Russia calculated in the US dollars. The list of stocks is reviewed every three months by the RTS Information Committee.

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
BCPI	Base Consumer Price Index
CB RA	Central Bank of the Republic of Armenia
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
DSGE	Dynamic Stochastic General Equilibrium
EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EDB	Eurasian Development Bank
EDB/CIS	Center for Integration Studies of Eurasian Development Bank
EEC	Eurasian Economic Commission
EU	European Union
FRS	Federal Reserve System of the United States
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
IMS	Integrated Model System
IMF	International Monetary Fund
IPPI	Industrial Producer Price Index
ITR	Inflation Targeting Regime
KASE	Kazakhstan Stock Exchange Joint-Stock Company
ME KR	Ministry of Economy of the Kyrgyz Republic
ME RB	Ministry of Economy of the Republic of Belarus
MED RF	Ministry of Economic Development of the Russian Federation
MEDT RT	Ministry of Economic Development and Trade of the Republic of Tajikistan
MNE RK	Ministry of National Economy of the Republic of Kazakhstan
NB KR	National Bank of the Kyrgyz Republic
NB RB	National Bank of the Republic of Belarus
NB RK	National Bank of the Republic of Kazakhstan
OECD	Organization for Economic Cooperation and Development
PPI	Producer Price Index
SNA	System of National Accounts
RTS	Russia Trading System
WB	World Bank