

# KYRGYZ REPUBLIC

## Social and Economic Development in the first half of 2022\*

October 2022

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The materials presented may not coincide with the official opinion of the EDB and the EFSD governing bodies.

October 2022

## **Social and Economic Development in 1H 2022 and Medium-Term Prospective**

### LIST OF ABBREVIATIONS

CA – current account  
CoM KR – Cabinet of Ministers of the Kyrgyz Republic  
CPI – consumer price index  
EAEU – Eurasian Economic Union  
EFSD Project Unit – Project Unit of the Eurasian Fund for Stabilization and Development  
GDP – gross domestic product  
GIR – gross international reserves  
ILO – International Labour Organisation  
KR – Kyrgyz Republic  
MF KR – Ministry of Finance of the Kyrgyz Republic  
NB KR – National Bank of the Kyrgyz Republic  
NSC KR – National Statistical Committee of the Kyrgyz Republic  
PIP – Public Investment Programme  
RF – Russian Federation  
UAE – United Arab Emirates  
US – United States of America  
VAT – value added tax

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**In 1H 2022, the economy of the Kyrgyz Republic achieved high growth rates amid the ongoing recovery in the aftermath of the COVID-19 pandemic, supported by a fiscal stimulus and increased gold production. In March 2022, the economy faced external shocks that led to local currency depreciation and accelerated inflation. The NB KR responded to that by raising the key interest rate by a substantial margin and making currency interventions in order to stabilise prices and the exchange rate. The state budget was executed with a surplus as a result of a significant increase in revenues amid higher revenues from imports and payments related to gold production at the Kumtor mine. Against the background of significant supply of foreign currency deposits, the banking sector built up its foreign currency liabilities and improved its profitability, while its prudential indicators remained at a stable level.**

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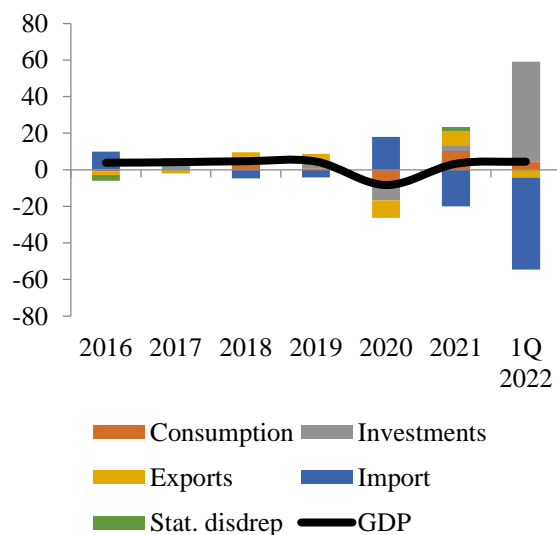
**Real Sector and Labour Market**

**In 1H 2022, the economy of the Kyrgyz Republic (KR) achieved high growth rates driven by stronger domestic demand amid the ongoing recovery in the aftermath of the COVID-19 pandemic, supported by a fiscal stimulus and increased gold production.**

According to the National Statistical Committee of the Kyrgyz Republic (NSC KR), in 1H 2022, the real GDP growth was 6.3%, and net of the gold production at the Kumtor mine it made 3.9%, up from 3.2% in the same period of the previous year due to accelerated economic activity in the services sector against the background of the ongoing economic recovery in the aftermath of the COVID-19 pandemic. Over the past 5 quarters, the economy has enjoyed stable recovery growth, while the GDP is still below the pre-COVID level. The revival of the services sector is partly driven by a substantial inflow of relocated foreign employees and tourists. The domestic demand was further supported by a fiscal stimulus in the form of higher salaries and wages for public sector servants and an increase in capital investment. At the same time, the key factor contributing to the economic growth was higher gold production at the main mines of Kumtor and Jerooy.

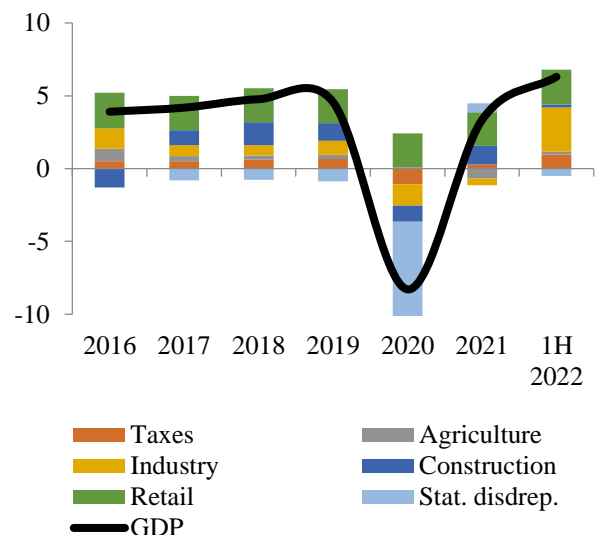
The domestic demand was supported by accelerated consumer and investment activity. The growth of private consumption made a significant contribution to the growth of output of the food industry, retail trade, hotel and restaurant services. Fixed capital investment demonstrated recovery growth in 1H 2022 (+0.9% y-o-y) against the background of a low base of 2021 (a decrease of 13.2% in the first half of the year). The main contributors to the increase in investment were foreign direct investment and foreign loans and credits to the manufacturing industry and power generation, including those financed as part of capital investment under the Public Investment Programme (PIP).

**Figure 1.** Contribution to GDP growth, by use components (p.p., y-o-y)



Source: NSC KR, EFSD estimates

**Figure 2.** Contribution to GDP growth, by production components (p.p., y-o-y)



Source: NSC KR

In terms of production, the GDP growth was mainly driven by the manufacturing industry, contributing 3.1 p.p. (an increase of 20.8% y-o-y); and wholesale and retail trade, contributing 1.0 p.p. (an increase of 6.6%, y-o-y). The growth of the manufacturing industry was shaped by the food industry (2.0 p.p.) and the metal industry (22.7 p.p.). Some sectors of the manufacturing industry experienced a contraction: the production of rubber and plastic dropped by 16% (a contribution of -1.6 p.p.); the chemical products decreased by 34.7% (a contribution of -0.1 p.p.); and the textiles production fell by 2.4% (a contribution of -0.1 p.p.). The production of base metals, which includes gold production at the Kumtor and Jerooy mines, increased by 35.1% y-o-y. The output of food

grew by 12.1%, driven by a recovery in consumer activity and an increase in tourist flows, which also contributed to the growth of retail trade and services; hotel and food service industries. In January–June 2022, the retail trade grew by 11.5% y-o-y in real terms, against an increase of 10.5% in 1H 2021. The volume of services provided by hotels and restaurants increased by 12.3% y-o-y, against a decrease of 4.8% y-o-y in 1H 2021. The acceleration of agricultural production to 2.0%, against a decrease of 0.3% in 1H 2021, was due to an increase in livestock production and successful completion of the sowing campaign.

**The economic recovery had a positive effect on the labour market and incomes of households.** According to an integrated household survey, the unemployment rate fell to 4.8% in 2021 compared to 5.3% in 2020. By June 2022, the number of citizens officially registered as unemployed had declined further (-6.5% in annual terms), reaching 75,200 people (3.1% of the labour force). That was accompanied by an increase in the number of people employed in the formal sector by 0.5% y-o-y in January–June 2022. A positive contribution to employment growth was made by an increase in the number of employees in administration and auxiliary activities (0.17 p.p.); education (0.60 p.p.); and other services (0.23 p.p.), while a negative contribution was made by a decrease in the number of employees in financial services (-0.14 p.p.); scientific and technical services (-0.3 p.p.); and construction (-0.16 p.p.).

Salaries and wages grew by 10.5% y-o-y in real terms. The most significant growth of real wages was registered in the arts, entertainment, and recreation (+44.8% y-o-y); health and social services (+45.9% y-o-y); and education (+23.4% y-o-y). Among the key factors contributing to the trend are a scheduled increase in the wage bill for social workers from 1 April 2022 and growth of the services sectors against the background of a higher inflow of relocated foreign employees and tourists.

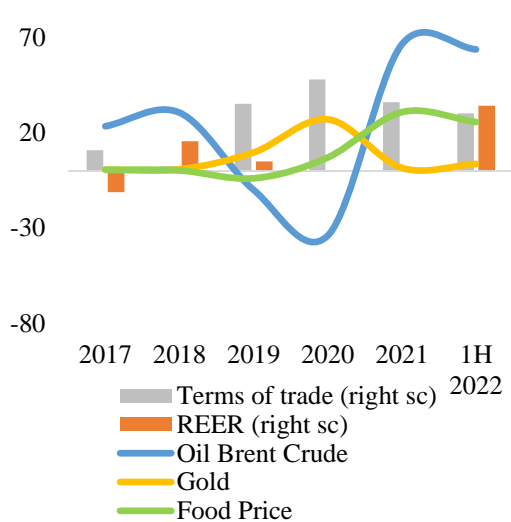
### *External Sector*

**In 1H 2022, the trade deficit grew 2.8 times y-o-y, reaching 79.4% of GDP.** That was driven by a fall in exports of goods by 40.5% y-o-y and an increase in imports of goods by 68.7% y-o-y. The factor contributing to lower exports was a decrease in the volume of gold exports by 99.6% y-o-y due to the fact that the country had been deprived of its status of a “reliable supplier” on the London Stock Exchange of Precious Metals the year before, as a result of delays in gold supplies to counterparts and disputes with Centerra Gold, a Canadian-based company. In 2022, when the dispute was resolved, the status was renewed, however, according to official statistics, gold sales to the UK have not yet been resumed. According to Trade Map, a trade statistics aggregator, the KR's gold exports to China amounted to US \$19.6 million (333.8 kg), to Turkey – US \$4.8 million (108 kg), and to Switzerland – US \$0.7 million (12 kg). Net of gold, exports grew by 52.9% y-o-y, mainly due to higher exports of raw materials and energy products, crop products, clothing and footwear, and household appliances. A recovery in domestic demand, as well as higher import prices, contributed to an increase in import volumes. Rapid growth was observed in imports of textile products (average real growth of 41.4%), mineral products (average real growth of 39.7%), automotive products (average real growth of 41.2), as well as in demand for base metal products.

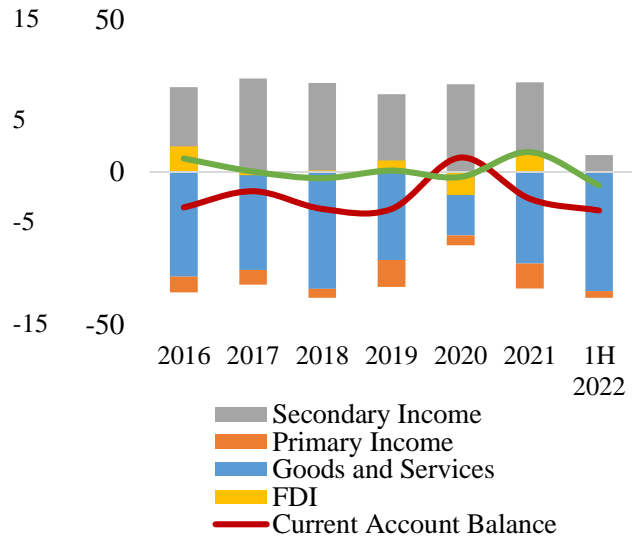
**Net remittances fell by 1.5% y-o-y amid high volatility of the Russian ruble exchange rate in February–March 2022.** There was a sharp drop in remittance inflows by 28.4% y-o-y in March 2022, with Russia's share in total inflows falling from 97% to 91%. However, as the Russian ruble appreciated, the country began to recover its share, which reached 96.4% in June. The increase

in remittance inflows was due to the “card tourism”<sup>1</sup> of citizens from Russia. According to the NB KR, the average increase in foreign currency deposits of non-residents amounted to 31.1% y-o-y in April–June.

**Figure 3. Terms of trade (in %, y-o-y)**



**Figure 4. Balance of payments (in % of GDP)**



Source: World Bank, national authorities, EFSD estimates

Source: NB KR, NSC KR, EFSD estimates

**The exchange rate of the local currency was under pressure and, thus, highly volatile due to external shocks and increased domestic demand for imported goods, as well as due to the Russian ruble appreciation.** The nominal exchange rate of the Kyrgyz som to the US dollar depreciated by 14% in January–March – with most of the depreciation (15.5% y-o-y) occurring in late February and mid-March – or by 5.8% y-o-y in 1Q 2022. In 1Q 2022, the NB KR made interventions to stabilise the exchange rate, selling foreign exchange for a total amount of US \$217.6 million. As the exchange rate stabilised, the NB KR started purchasing foreign exchange in 2Q 2022. Those operations totalled US \$190.7 million. In 2Q, the exchange rate of the local currency against the US dollar began to appreciate: it appreciated by 6.2% during the first half of the year and depreciated by 1.4% in annual terms. The local currency appreciated due to the effects of the measures taken by the NB KR<sup>2</sup> and the Russian ruble appreciation against the US dollar in 2Q 2022. As a result, at end-June 2022, the gross international reserves of the NB KR, taking into account the currency revaluation, amounted to US \$2.6 billion, having decreased by 11.5% since the beginning of the year, and covered 4.1 months of this year's imports.

<sup>1</sup> Due to the sanctions imposed on Russia, the cards of international payment systems Visa and MasterCard, issued by Russian banks, stopped functioning. Therefore, Russian citizens rushed to open accounts with foreign banks in other countries.

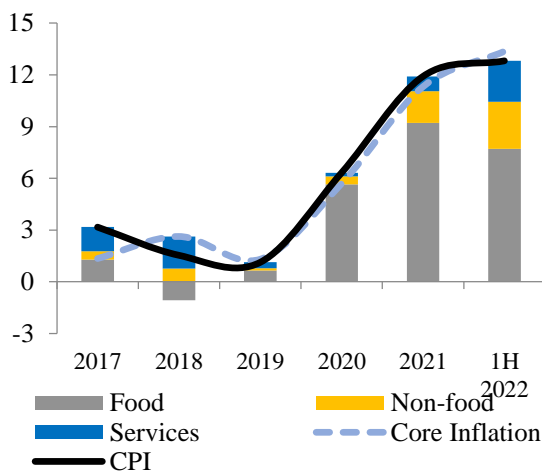
<sup>2</sup> In order to support the exchange rate, the NB KR introduced a temporary ban on exports of US dollars by financial and credit institutions and households, established a market-based regime for the formation of the official exchange rate of the Russian ruble to the Kyrgyz som, and temporarily reduced the volume of transactions and the purchase exchange rate of the Kazakhstani tenge for banks.

***Inflation and Monetary Policy***

**The exchange rate depreciation and rising world prices for food and raw materials, as well as the unstable situation in the global economy, put further upward pressure on consumer prices.** In 1H 2022, the inflation was 12.8% y-o-y (against 11.2% in December 2021). The main driver of inflation was growth of food prices (the contribution of food products amounted to 7.7 p.p.) due to their increase in global commodity markets against the background of geopolitical tensions and disruptions of trade and supply chains. In 1H 2022, there was a strong increase in prices for those commodity groups, which have a high share of import or imported components. There was a significant increase in prices for sugar (26.5% y-o-y), dairy products (19.4% y-o-y), seafood (19.5% y-o-y), bakery products (17.2% y-o-y), fuels and lubricants (46.7% y-o-y), and construction materials (17.4% y-o-y). At the same time, against the background of rising salaries and wages, the contribution of non-food products to inflation increased, reaching 2.7 p.p., while the core inflation accelerated to 13.3% y-o-y (against 10.9% in December 2021).

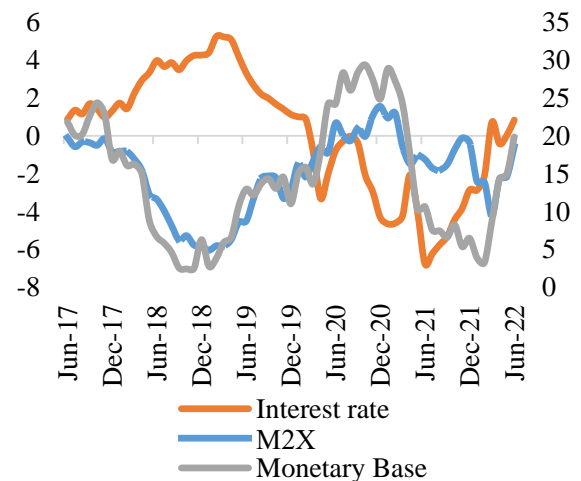
**To curb the inflation and reduce the impact of external shocks, the NB KR tightened the monetary conditions, raising the key rate on three occasions in 1Q 2022 – from 8% to 14%.** By decisions of the NB KR dated 31 January, 28 February, and 10 March 2022, the key rate was raised by 50 bps, 150 bps, and 400 bps, respectively. That helped to minimise negative effects of external shocks on the evolution of inflation. In addition to the key rate, the interest rate band was also adjusted: the overnight deposit rate, which is the lower boundary, was raised to 12.0%, and the overnight lending rate, which determines the upper boundary, went up to 16.0%. In 2Q 2022, the NB KR kept the key rate at 14.0%, taking into account persistent pro-inflationary risks, including lower supply of food on world markets and disruptions of supply chains. Against the background of the monetary policy tightening, the broad money increased by 6% starting from the beginning of this year.

**Figure 5. Inflation (in %, y-o-y)**



Source: NSC KR

**Figure 6. Monetary indicators (in %, y-o-y, rhs base money, in %, y-o-y)**



Source: NB KR, NSC KR

**Budget Sector and Public Debt**

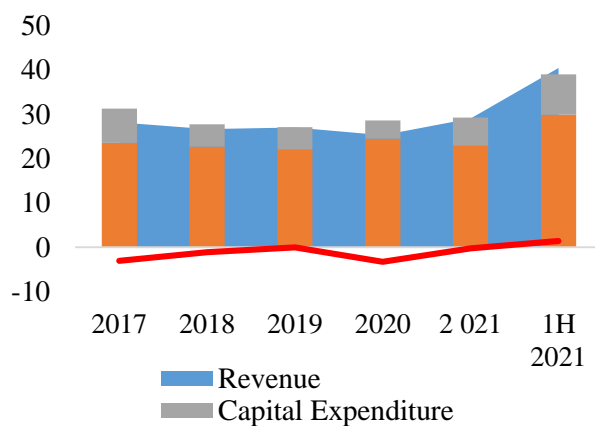
**State budget revenues grew owing to higher volumes of import and revenues from the Kumtor mine for previous years, along with the implementation of automated tax and customs procedures.** The main contributors to the state budget revenues in 1H 2022 were tax payments (31.2% of GDP against 23.8% a year earlier), in particular, revenues from the Kumtor mine in the amount of 6.0% of GDP (against 1.2% in 1H 2021), including revenues for the development of the mineral resource base (4.6% of GDP); as well as VAT revenues from imports from countries outside the EAEU (6.9% of GDP against 3.2% a year earlier); personal income and profit taxes (5.6% of GDP against 4.7%). Grants received amounted to 1.7% of GDP (against 1.4%), while non-tax revenues were 7.5% of GDP (against 7.7%). Overall, the state budget revenues increased by 7.4 p.p. of GDP and amounted to 40.4% of GDP (against 33.0% in 1H 2021).

**Budget expenditures exceeded the level of the previous year – 39.0% of GDP against 32.5% – amid an increase in salaries and wages of social workers and higher domestic capital investments** related to the purchase of buildings, machinery and equipment, and replenishment of state stockpiles – 6.3% of GDP against 2.0% a year earlier. Current state budget expenditures also increased, amounting to 29.9% of GDP (against 28.0% a year earlier). Increases in salaries and wages, as well as social benefits resulted in higher labour costs (13.3% of GDP against 12.2%), social benefits (2.3% of GDP against 2.0%), and transfers to the Social Fund and the Mandatory Health Insurance Fund (MHIF) (6.9% of GDP against 6.3%). A deferral of interest payments on external public debt helped reduce the amount of interest expenditures of the state budget (1.6% of GDP against 1.8%).

**Against the background of a substantial increase in tax revenues, the state budget had a surplus of 1.4% of GDP in 1H 2022, against a surplus of 0.5% of GDP a year earlier.** Taking into account the on-lent funds, the budget was executed with a surplus of 0.2% of GDP (compared to the balanced budget in the previous earlier).

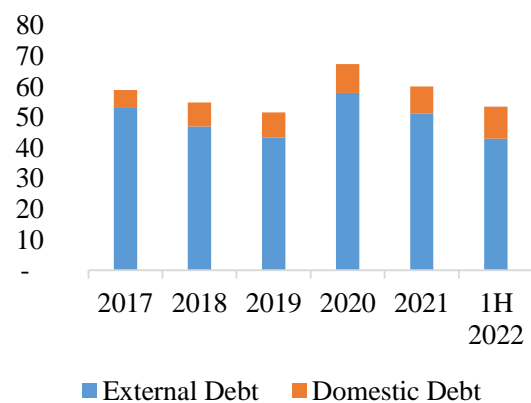
As a result of economic growth and appreciation of the exchange rate, the public debt fell to 53.1% of GDP from 60.4% in 2021 (down by 4.9% in nominal terms).

**Figure 7. State budget (in % of GDP)**



Source: MF KR

**Figure 8. Public debt (in % of GDP)**



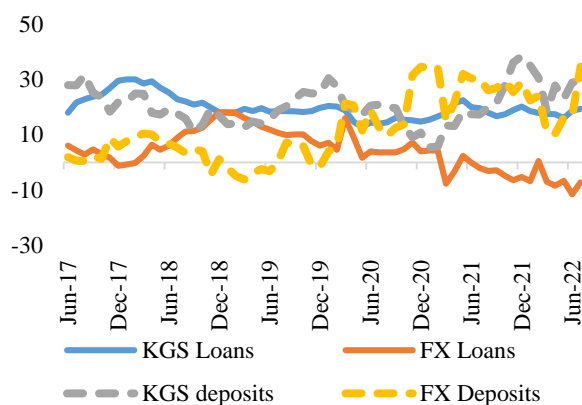
Source: MF KR

**Financial Sector**

**Lower bank lending in foreign currency contributed to a slowdown in the rate of growth of commercial banks' loan portfolio.** Bank lending grew by 9.6% y-o-y in June 2022 (against 13.1% y-o-y a year earlier). The main reason for the slowdown in lending was a drop of foreign currency loans (-11.5% y-o-y against about zero growth a year earlier) due to lower foreign currency loans to industry, construction, mortgage, and other sectors. That was accompanied by a slowdown of the growth of local currency loans from 19.9% last year to 18.7%. The growth was mainly driven by consumer loans (5.9 p.p.), loans to trade enterprises (4.6 p.p.), as well as mortgage loans (3.5 p.p.), and loans to agriculture (2.6 p.p.). The rates of growth of deposits in both local and foreign currencies accelerated compared to the previous year. The growth of both Kyrgyz som (28.8% y-o-y against 17.4% y-o-y) and foreign currency deposits (an increase of 24.4% y-o-y in US dollar terms against 16.9% y-o-y a year earlier) was mainly attributable to an increase in current accounts and term deposits of legal entities.

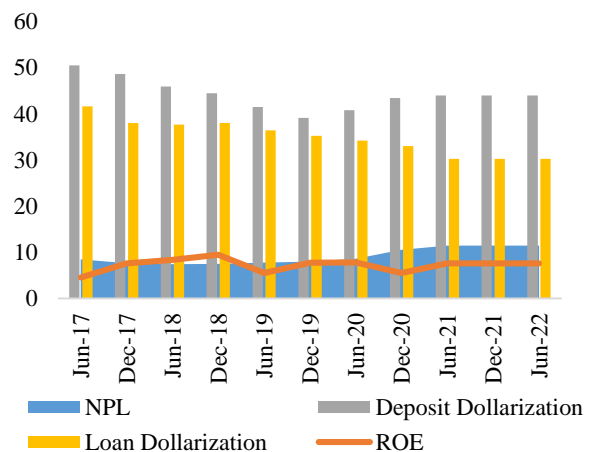
**In 1H 2022, the banking system remained stable, and there was a significant increase in profitability and disproportionate growth of foreign currency deposit liabilities compared to loan assets.** An increase in foreign currency deposits, accompanied by a decrease in lending, resulted in a significant drop of the foreign currency loan to deposit ratio (47.3% in June 2022 against 63.0% a year earlier). Higher demand for foreign currency deposits had an effect on banks' profitability. By June 2022, profitability had increased sharply compared to 2021: the return on capital was 33.3% (against 7.6% a year earlier), and the return on assets was 4.9% (against 1.2% a year earlier). The net profits of the banking sector almost tripled in five months, mainly due to an increase in non-interest operating incomes (up by 448%), predominantly explained by the "card tourism". The capital adequacy ratio was 21.2% in June 2022 (against 20.4% a year earlier), and the share of nonperforming loans (NPL) in total loans was 12.8% (against 11.4% a year earlier). Against the background of the Kyrgyz som appreciation against the US dollar in 2Q 2022, the rate of deposit dollarization was 43.3% as at end-June 2022 (against 44.0% a year earlier). The rate of loan dollarization fell to 24.4% (against 30.2%).

**Figure 9. Bank loans and deposits (in %, y-o-y)**



Source: NB KR

**Figure 10. Banking sector indicators (in %)**



Source: NB KR



## Medium-Term Prospective

**Under the baseline scenario, the economic growth is expected to slow down in 2H 2022, followed by an acceleration in the medium term.** The scenario assumes a decline in gold production in 2H 2022 against the background of last year's high base, which would lead to a slowdown in economic growth to 4.6% for the year as a whole. At the same time, other sectors of the economy would maintain the economic trends during 2022. In the medium term, as the economy adapts to external conditions, while consumption and exports recover, the real GDP would grow by 5.2% in 2024.

**The inflationary pressure would remain relatively high in 2022 as a result of the primary effects of non-monetary factors, but would gradually ease in the medium term, which would be conducive to monetary policy loosening by the NB KR.** This year, the 12-month inflation is expected to be 13.8%, which is much higher than the medium-term target range of the NB KR (5–9%) and is above the target of 12% announced by the NB KR at the beginning of the year. In 2023, the inflation is expected to go down to 9.0% and remain within the medium-term target range in future.

**The balance of payments would not be stable in the medium term in the context of a persistent CA deficit and growing payments related to the external debt.** According to the EFSD Project Unit, the decline in remittances (20.9% in 2022), against the background of imports growing at a faster pace compared to exports, could lead to an expansion of the CA deficit to 12.6% of GDP. The reduction in remittances in the medium term, against the background of export growth (as a result of the gradual resumption of gold exports), would facilitate a gradual reduction of the CA deficit to 4.4% of GDP in 2024. At the same time, in the context of the continued relatively low inflow of foreign direct investment, the CA deficit and growing liabilities related to servicing the external public debt of the NB KR would put pressure on the exchange rate, resulting in lower GIR, at the level of 3.1 months of imports by end-2024.

**Against the background of a considerable improvement of tax collection, the fiscal policy priority is to implement measures to support the economy and households.** Additional revenues from the development of the Kumtor mine, as well as the effects of the economic recovery and the measures taken by the authorities to automate administrative procedures would contribute to an increase of tax revenues to 22.3% of GDP in 2022 (against 20.9% in 2021). The MF KR is implementing the measures to support the economy and households included in the CoM KR programme that results in higher state budget expenditures on salaries to public sector employees, pensions and benefits, and non-financial assets, including measures to support energy sector enterprises. As a result, the state budget deficit in 2022 may increase to 3.1% of GDP against 0.2% in 2021.

**Kyrgyzstan: Key macroeconomic indicators**

	2019	2020	2021	1H 2022	2022	2023	2024
<b><u>National accounts and prices (in %)</u></b>							
Real GDP growth	4.6	-8.4	3.6	6.3	4.6	5.1	5.2
CPI (December, y-o-y)	3.1	9.7	11.2	13.1	11.2	9.0	8.1
<b><u>Money and credit (in %)</u></b>							
Broad money supply growth (y-o-y)	12.8	23.9	19.1	18.6	23.7	17.6	14.1
Policy interest rate	4.25	5.0	8.0	14.0	12.0	8.0	7.0
<b><u>Public finance (in % of GDP)</u></b>							
Budget revenues and grants	27.0	25.3	29.0	40.4	30.1	28.2	28.1
Budget expenditures	27.1	28.6	29.3	39.0	33.2	31.5	29.5
Budget balance	-0.1	-3.3	-0.2	1.4	-3.1	-3.2	-1.5
<b><u>External Sector</u></b>							
Net remittances (in % of GDP)	20.9	24.2	25.7	25.0	20.9	20.0	20.0
Current account (in % of GDP)	-12.1	4.8	-8.6		-12.6	-9.0	-4.4
Net foreign direct investment (in % of GDP)	3.8	-7.5	6.8	3.7	2.2	2.3	2.5
Gross reserves, in months of imports of goods and services	5.1	8.3	6.0	4.1	4.0	3.3	3.1

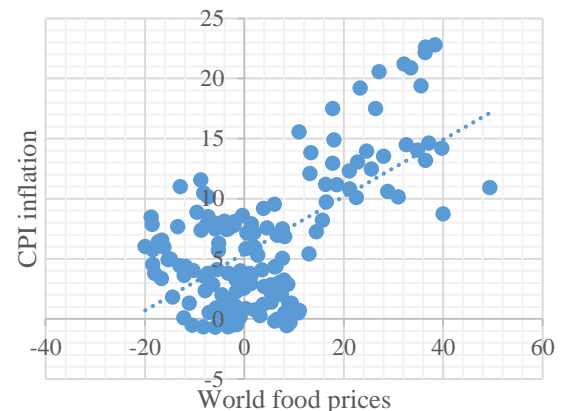
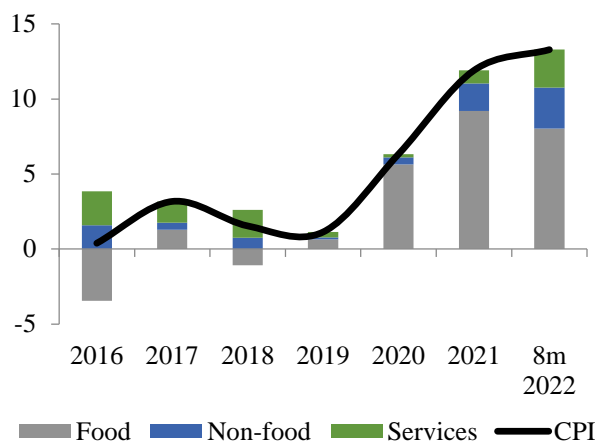
**Source:** NSC KR, NB KR, MF KR

Annex

## Analysis of Factors and Indicators of Inflation in the Kyrgyz Republic

The inflation in Kyrgyzstan is predominantly driven by world food prices. Since food products account for more than half (52% on average for 2010–2021) of the consumer basket, the evolution of food prices largely determines the pattern of inflation. In 2016–2019, the inflation was at its historic lows (1.6%) due to food deflation. The impact of quarantine restrictions, imposed during the COVID-19 pandemic, on food prices contributed to acceleration of inflation in Kyrgyzstan. The inflation rose from 3.2% in January 2020 to 15.6% by August 2022 (Figure A1). A significant part of food is imported, which makes the behaviour of inflation dependent on the evolution of world food prices (Figure A2). According to the NSC KR, the share of imports in the consumption of cereals is about 50%, in that of vegetable oil – 88%, sugar – 65%, fruit and berries – 65%, eggs – 53%, and meat – 32%. World prices for cereals and oilseeds have been rising since end-2019. The growth had a significant impact on food inflation in the Kyrgyz Republic and became one of the key drivers of accelerating price growth, along with the low gross grain and oilseed harvest in the region in 2021.

Figure A1. Evolution of contributions to inflation      Figure A2. CPI inflation and world food prices



Source: NSC KR

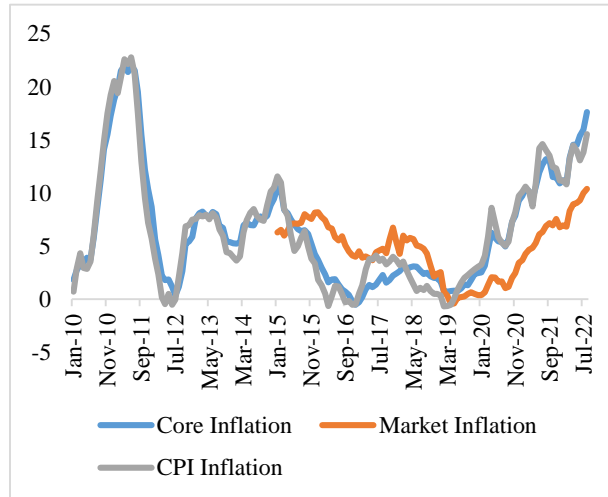
Source: NSC KR, World Bank

In 2022, the continuing growth of food prices was accompanied by an increase in the contribution of prices for non-food goods and services, driven by both domestic monetary factors – higher consumer demand and Kyrgyz som exchange rate depreciation – and disruptions in transport and logistics processes, as well as declining global trade. In addition to the headline inflation (CPI inflation), the NSC KR calculates other indicators that eliminate the influence of non-monetary factors on the evolution of prices in the consumer market (Figure A3).

One of the indicators is the core inflation index, which has been calculated since 2010 and eliminates the impact of seasonal factors and some groups of administratively regulated prices. According to the methodology used by the NSC KR to produce core inflation estimates, the group of food products does not include milk, sugar, fruit, and vegetables, which are most sensitive to seasonal price fluctuations. Some domestically produced products that are subject to excise tax are excluded from the group of goods “Alcoholic beverages and tobacco products”. Non-food goods and services do not include fuels and lubricants, certain types of materials for the maintenance and repair of residential premises, electricity, gas and other types of fuel, passenger transport, telecommunication, and other services, the prices for which are regulated. The indicator is instrumental in assessing stable long-term trends in price fluctuations, while minimising the effects of seasonal fluctuations, supply shocks, and administrative regulation

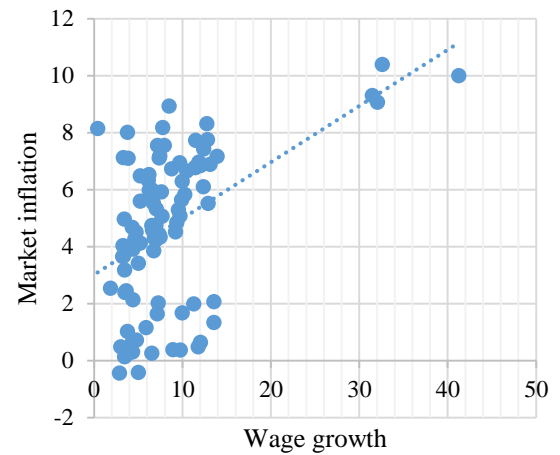
of prices for certain goods. The total share of the goods and services used for the calculation of the core inflation in the CPI is about 70%. Overall, the past evolution of the index is similar to that of the CPI (Figure A3), with the exception of 2017, when the core inflation averaged 1.4% y-o-y and deviated from the CPI trend by 1.8 p.p. due to an increase in excise rates on tobacco products.

**Figure A3. Alternative inflation indices**



Source: NSC KR

**Figure A4. Market inflation and wage growth**



Source: NSC KR

Another indicator is the *market inflation* index (Figure A3), which has been calculated since 2015 and eliminates the impact of food and regulated prices, thus, demonstrating the effects of prices for non-food products and non-administered services. According to the weight structure of the consumer price index, the market inflation covers about 36% of the total consumer basket. Wage growth has a strong impact on the trend of the market inflation (Figure A4). The fiscal stimulus for domestic demand, effected through an increase in public sector salaries and wages starting from April 2022, led to growth of salaries and wages in the formal sector by 32% y-o-y, which contributed to market inflation acceleration from 6.8% in December 2021 to 10.4% in August 2022.

**During the past eight months of this year, the contribution of food inflation to the growth of inflation remained significant (8 p.p.) against the background of a higher contribution of non-food inflation and services (2.7 p.p. and 2.5 p.p., respectively).** However, external factors are expected to generate additional pressure on domestic prices in the KR until the end of 2022. Under these conditions, the NB KR is likely to maintain relatively tight monetary policies.