



NATIONAL BANK OF KAZAKHSTAN

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The base rate raised to 9.25%

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Almaty

The National Bank of Kazakhstan has made a decision to raise the base rate by 25 b.p to 9.25% per annum.

The actual inflation is formed higher than the expectations and reached 5.5% year-on-year this August. The inflationary pressure, caused by the expanding consumer demand, increased compared to the previous forecast, pushing the inflation to the upper boundary of the target range at the level of 5.7%-5.8% by the end of 2019. In the medium-term forecast horizon, the inflation is anticipated in 2020 to be within target range 4-6% with some slowdown. The economic growth during the 7 months of 2019 exceeded the forecast of the National Bank, reaching 4.2%, which creates an inflationary pressure in the economy.

In order to achieve the announced inflation target, the National Bank will make further decisions on the base rate taking into account the alignment of the actual and forecast inflation to the target range, risk realization originating from the domestic demand, import growth, and developments in the global economy.

The annual inflation was formed at the level of 5.5% in August 2019. Food-stuff goods continue to be the driving force of the inflation, an annual price growth for those accelerated to 9% (5.1% in December 2018). Amid the expanding external demand and contracting domestic supply, the prices of meat, bread products and cereal have increased. The annual price increase for these groups of items amounted to 12.8% and 12.6%, respectively.

The prices of non-food items demonstrate a moderate growth rate of 5.7% in annual terms (6.4% in December 2018). The overall price increase of the entire category is restricted by the falling prices of gasoline (by 5.2% in annual terms) and stable prices of diesel fuel.

The prices for paid services remained on the historically low level of 0.8% in annual terms (4.5% in December 2018). A slowdown of inflation for unregulated services is observed, which is related to the cuts in costs of production amid the falling utility costs and the price of gasoline.

In August of this year inflation expectations of households declined. According to the households' survey, 60% of respondents expect the inflation to remain at the same level or to decrease 12 months ahead. The respondents assess that the inflation in the 12 months horizon will amount to 5.3%.

In the medium-term horizon the annual inflation will be formed within the target range. Nevertheless, in the short run the inflation is expected to rise due to the growing domestic demand, price acceleration of particular food-stuff goods, and exhausting effect of the reduced tariffs for regulated services in the 1st quarter of 2020. All of the above cause the risks for inflation to exceed the upper boundary of the target range.

The expanding domestic demand remains to be the core driver of inflation. The real income growth among the population in January-June reached 5.1%. In the 2nd quarter of 2019 the real wage accelerated to 8.9%. The growth of this indicator was observed in all sectors of the economy. The expansion of the domestic demand is promoted by the extensive fiscal spending on the social support, salaries, along with persisting growth in consumer lending by 24.1% in annual terms in July of this year. A growth 5.4% in retail trade turnover is observed in January-July 2019. In the 1st half of this year the consumer import grew up by 4.8%. The main contribution was observed from the non-food items import, which increased by 7.3%.

The growth of the domestic economic activity remains above the National Bank's expectations. In January-July of this year short-term economic indicator grew up by 4.4%, including the growth in construction by 11.5%, trade by 7.5%, transport by 5.4%, agriculture by 3.5%, manufacturing and mining industries by 3.2% and 2.4%, respectively. This development is fostered by the expanding investment, which increased by 11.3% in January-August 2019. The demand for imported capital goods expanded by 24.9% as a result of implementation of large-scale infrastructure and investment projects (TCO expansion, "Saryarka" gas pipeline, etc.)

According to the National Bank estimates, in 2019 the economic growth in Kazakhstan is projected to reach 3.8%. In the medium-term Kazakhstan's economic growth rate will slow down marginally, but will remain at a relatively high level of 3.5% in 2020. In the short term expanding household consumption and growth of investments will become the main drivers of economic development. Forthcoming economic slowdown will occur as a result of weakening fiscal stimulus effect, as well as lowering dynamics of net export.

Amid the growing consumer and investment demand, the output gap, i.e. the difference between the actual and potential GDP, will be positive in the forecast horizon, signaling the existence of the inflationary pressure.

External sector factors will make a negative impact on the domestic prices. The oil prices had declined this year. Since the beginning of the year the average Brent oil price level stood at 65 US dollars a barrel (72 US dollars a barrel of Brent oil in 2018). An increasing volatility of oil prices is observed in recent months. From the middle of July 2019 world oil

prices started falling due to the weakening demand and high production volumes in the US, which in conjunction led to the growth of the world oil supply.

Since the beginning of this year the FAO Food Price Index rose by 5.1% as a result of consumption growth and anticipated reduced stocks of certain food items. In particular, since the beginning of the year world prices for meat (11%) and bread products (14%) increased substantially. The growth of world prices is not fully compensated by the inflation slowdown in countries-main trade partners of Kazakhstan.

External monetary conditions were easing as a result of interest rate reductions by the central banks, changing rhetoric regarding the future trajectory of interest rates, as well as measures, stimulating the economies.

The external drivers of rising inflation forecast trajectory are the unresolved disputes in trade policy between the world's leading economies, and, as a consequence, intensifying trade wars and slowing global economy, which lowers the demand for Kazakhstan's export.

Raising the base rate will promote the attractiveness of the tenge denominated assets and enable to prevent the upsurge of inflation caused by the rising cost of imports.

Current monetary conditions are assessed as neutral. The level of the base rate in real terms (accounting for the expected inflation by the end of forecast horizon) remains to be within the 3.0-3.5% target benchmark.

The National Bank's further decisions on the base rate will be based on the accordance of the actual and forecast inflation dynamics with the 4-6% target range in 2019-2020, emerging risks coming from the domestic economy and the development in the global economy.

In order to enhance the transparency and improve communication strategy, the National Bank will post the Statement of the Governor about the base rate on the National Bank's official website. In addition, the Inflation Report that contains the detailed analysis of key macroeconomic indicators in the short and medium-term horizon will be posted a week later. During the next two weeks the results of the forecast round, as well as meetings with experts will get a more extensive coverage in the media.

The next decision on the base rate will be announced on October 28, 2019, at 15:00 Nur-Sultan time.

For more information please check The Inflation Report
that will be posted on the National Bank's official website on September 16,2019,
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