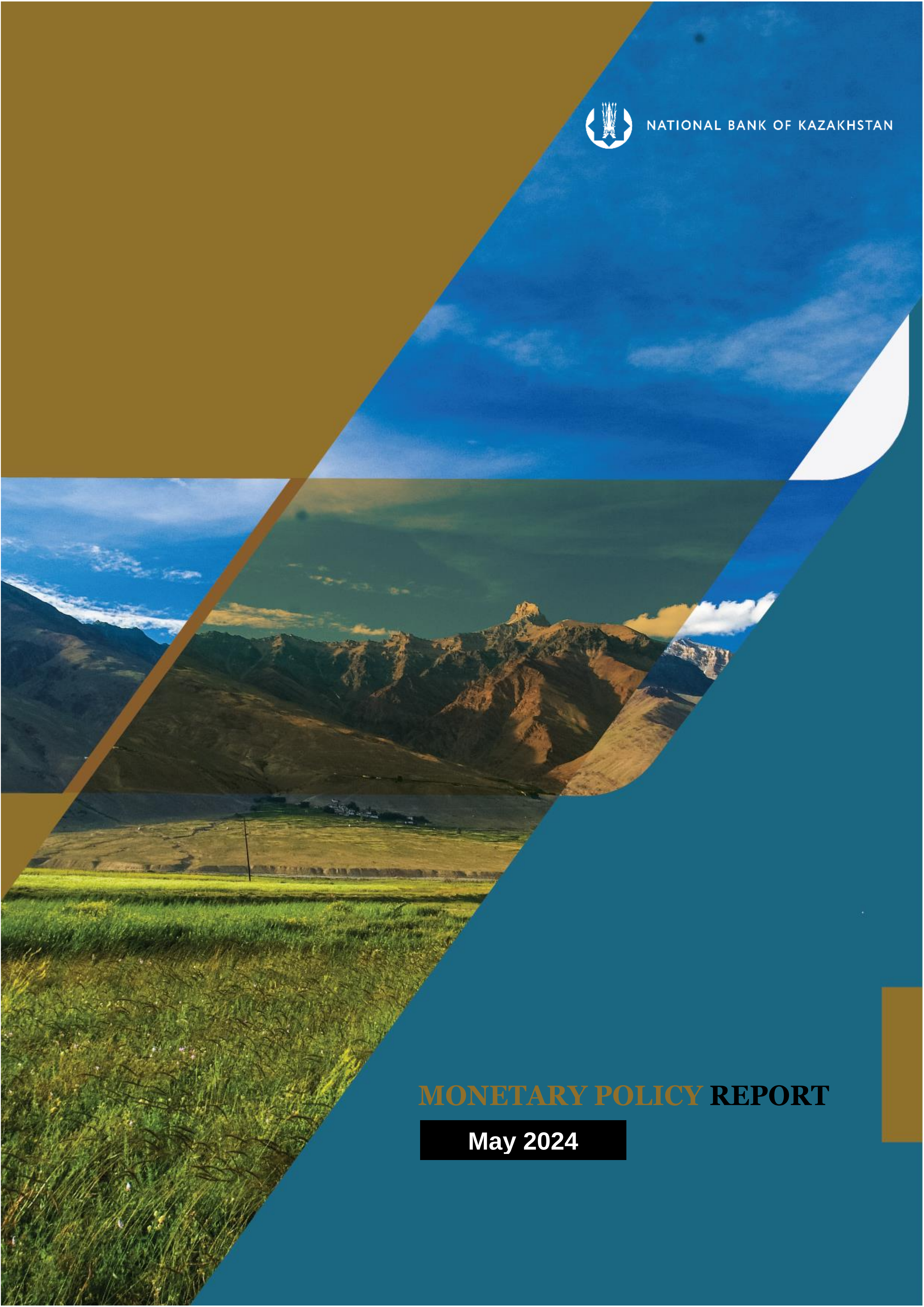


NATIONAL BANK OF KAZAKHSTAN

MONETARY POLICY REPORT

May 2024

CONTENTS

Monetary Policy Report is a quarterly publication of the National Bank, which contains the analysis of key macroeconomic factors affecting inflation as well as the forecast of macroeconomic parameters in the short- and medium-term horizon.

The Report is published in an electronic form on the official Internet resource of the National Bank in the Kazakh, Russian and English languages.

The forecast and analysis of macroeconomic indicators was prepared on the basis of statistical information as at **May 13, 2024**

STATEMENT BY THE GOVERNOR OF THE NATIONAL BANK OF THE REPUBLIC OF KAZAKHSTAN ON THE BASE RATE DATED MAY 31, 2024

The Monetary Policy Committee of the National Bank has decided to reduce the base rate to 14.5%. This decision is based on updated inflation and economic growth forecasts, as well as the results of the analysis of actual data and the balance of risks.

Under current conditions, we continue to observe a decrease in annual inflation in line with forecasts. A positive signal for us is the emerging slowdown in the core part of price growth in March-April of this year. However, at the same time, inflation expectations are rising again, confirming the need to continue disinflationary policy.

Pro-inflationary factors within the economy remain. In addition to high inflation expectations, these include fiscal stimulation, persistently high domestic demand, and ongoing reforms in the housing and utilities sector. The risks to the economy and inflation associated with the abnormal floods were lower than expected.

The external inflationary environment is assessed as neutral in conditions of restrictive monetary policy by central banks and low growth in food prices.

Current monetary conditions will contribute to the further cooling of inflationary processes in the country, aiming to reduce and stabilize inflation at 5% in the medium term.

Next, about the factors of the decision.

FIRST. INFLATION DYNAMICS AND INFLATION EXPECTATIONS.

The slowdown in inflation is occurring in the context of weakening global inflationary pressures, declining food producer prices, and moderately tight monetary policy.

In April, the annual price growth was 8.7%. Food inflation significantly decreased to 6.3%. The growth rate of non-food prices also slowed, amounting to 7.6%. However, the annual inflation of paid services accelerated to 13.5% due to higher regulated tariffs in the housing and utilities sector.

Monthly inflation in April was 0.6%, corresponding to the historical average. With low food price growth, core and seasonally adjusted inflation indicators have been declining for the second consecutive month. It is crucial for us to consolidate this trend.

Inflation expectations increased in April. The expected inflation for the year ahead was 16.1% (14.2% in March). According to respondents, the main reasons for high price growth expectations are changes in food prices amid the flood situation and ongoing housing and utilities price reforms.

Meanwhile, surveys of real sector representatives show more restrained expectations for future inflation. Enterprises expect a slowdown in the growth rates of prices for finished products, raw materials, and materials. Financial market professionals, according to the latest survey, expect inflation to form at 8.5% by the end of this year.

SECOND. TRENDS IN THE DOMESTIC ECONOMY.

According to the short-term economic activity index, Kazakhstan's economy grew by 3.9% in January-April 2024. Business activity growth is supported by both domestic and external demand. All major sectors of the economy are growing at a steady pace.

The fastest-growing sectors are construction, information and communications, and transportation. After a decline in 2023, agricultural production continues to recover.

Aggregate domestic demand remains strong. Demand is supported by moderate real wage growth, increased investment in the non-oil sector of the economy, and increased budget spending. In addition, high volumes of consumer lending continue. This indicates that consumption volumes significantly exceed the growth rates of real incomes of the population.

Investment activity in the non-oil sector is growing (18.4% in January-April this year). This includes manufacturing, electricity supply, construction, transportation, information, and communications.

The Business Activity Index (BAI) has been in positive territory for three consecutive months, both in manufacturing and the services sector. Enterprises positively assess current and future business conditions.

THIRD. EXTERNAL ECONOMIC ENVIRONMENT.

The inflationary background in the external sector is assessed as neutral, due to the continuation of restrictive monetary policy and positive food price dynamics globally.

Despite a slight increase in March and April, global prices for all types of food, except vegetable oils, decreased year-on-year.

Central banks in developed countries maintain high-interest rates, necessary for ensuring a more sustainable slowdown in inflation to target levels.

Annual price growth in the EU slowed to 2.6% in March-April. According to the ECB, monetary conditions are at levels that significantly contribute to the ongoing process of reducing inflation, and policy easing may begin as early as this summer.

In the US, inflation was 3.4% in April. According to the Fed's recent rhetoric, it does not show further progress towards the 2% target. Accordingly, high rates will be maintained for a longer period.

In China, consumer inflation has been rising for three consecutive months amid a gradual recovery in domestic demand. Annual price growth in April was 0.3%.

In Russia, inflation reached 7.8% in April. Prices are still under pressure from increased domestic demand and high inflation expectations. According to the Central Bank of Russia, returning inflation to the target and stabilizing it around 4% requires a prolonged period of tight monetary conditions in the economy.

The oil market shows signs of stabilization, with prices around $82 per barrel. Prices are supported by the extension of oil production cuts by OPEC+ countries until the end of the second quarter, stable production growth in the US, and ongoing military actions in the Middle East.

In the baseline scenario, the price of Brent crude oil is set at an average of $85 per barrel in 2024, with further declines to $80 and $77 per barrel in 2025 and 2026, respectively.

Next, about the forecasts of macroeconomic indicators.

The inflation forecast for this year remains unchanged at 7.5-9.5%. The forecast for 2025 is maintained at 5.5-7.5%. We expect inflation to slow to 5-6% by 2026, as fiscal stimulation decreases and the full effects of moderately tight monetary conditions manifest. We anticipate that core inflation will be below the overall inflation level, forming at 5% in 2025-2026.

We focus on core inflation as it excludes temporary factors such as housing and utilities price reforms and allows a more accurate assessment of the sustainable trends in the general price level.

Moderately tight monetary conditions and further improvements in external price growth and expected budget consolidation will contribute to reducing inflation.

Key risks to the forecast include uncertainty in budget policy parameters, continued regulated price reforms, increased pressure from domestic demand with unanchored inflation expectations, and geopolitical tensions.

The economic growth forecast for Kazakhstan in 2024 remains at 3.5-4.5%. Business activity this year will be driven by domestic demand amid ongoing fiscal stimulation, as evidenced by tax collection dynamics and the actual non-oil budget deficit. For the following years, forecasts have been significantly revised.

We estimate that the postponement of the TCO Future Growth Project to the second half of 2025 will shift the trajectory of export and GDP growth. Accordingly, we expect economic growth of 4.8-5.8% in 2025. In 2026, with the realization of the deferred effect of increased production at TCO, GDP growth will be higher than previously forecasted, at 4.9-5.9%.

Our primary goal is to achieve the 5% inflation target in the medium term. This requires maintaining a moderately tight monetary policy for an extended period, allowing us to consolidate progress in slowing inflation.

The National Bank does not respond to direct price increases resulting from housing and utilities reforms by changing the base rate. However, we will monitor the secondary effects of these reforms and take necessary measures in accordance with our mandate.

Future monetary policy decisions will depend on the alignment of actual inflation with the forecasted trajectory and the risk balance assessment. A stable slowdown in the core part of price growth will create room for further cautious base rate reductions in the second half of 2024.

Chairman of the National Bank of the Republic of Kazakhstan
Timur Suleimenov

PROSPECTS OF ECONOMIC DEVELOPMENT

I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

1.1. Forecast Assumptions

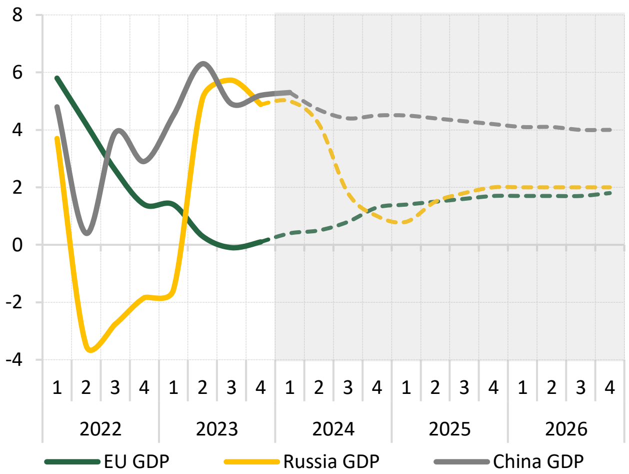
The global economy is expected to continue growing at a moderate pace. A gradual decrease in global inflation is anticipated, but it will remain above target levels this year. An easing of monetary conditions is not expected in the near term.

According to the IMF's baseline scenario[1], global economic growth will remain at 3.2% (y/y) in 2024-2026. Compared to 2023, a slight acceleration in economic activity is expected in developed countries, particularly in the United States. Developing countries are expected to experience a moderate slowdown in growth. According to IMF expectations, global inflation is forecasted to decrease from 6.8% (y/y) in 2023 to 5.9% (y/y) in 2024, with further stabilization at around 4.5% (y/y) in 2025.

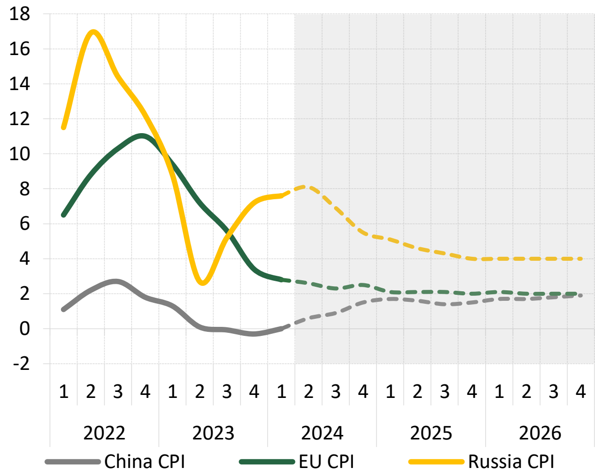
The external demand for Kazakhstan's exported goods may be supported by the expected higher economic growth in Russia. External inflationary pressures will increase slightly in the short term due to the acceleration of inflation in Russia, which may be offset by an increase in trade with China.

During the forecast period, China is expected to experience higher economic growth rates, supported by monetary policy easing. Economic growth in Russia will be supported by high domestic demand. The EU economy, amid tight monetary policy, a weak industrial sector, and external demand, is expected to grow at a slow pace (see Figure 1). In the short term, external inflationary pressures may be intensified by higher-than-previously-anticipated inflation in Russia. Inflation in China is expected to remain below the target of 3.0% throughout the entire forecast horizon. The EU is expected to achieve the target level faster than previously expected (graph 2).

Graph 1. GDP Growth Rates, YoY, %



Graph 2. Inflation, YoY, %



Source: Eurostat, National Bureau of Statistics of China, Rosstat, Consensus Ecs., CB RF, NBK estimate

In many countries, overall inflation has continued to slow down. However, core inflation remains above target levels, leading to the maintenance of high interest rates for a prolonged period.

Compared to the forecast round of "February 2024," external monetary conditions remain tight. It is expected that the US Federal Reserve will maintain a restrictive policy for a longer period. As a

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[1] *World Economic Outlook «Steady but slow: resilience amid divergence», April 2024*

result of slowing inflation, the ECB may consider easing its policy starting as early as this summer. The Central Bank of Russia will maintain a tight monetary policy for a longer duration than previously anticipated.

In the medium term, a gradual decline in oil prices is expected in the face of an excess of oil supply over demand, an expected increase in oil production by non-OPEC+ countries and forecasts of moderate development of the global economy.

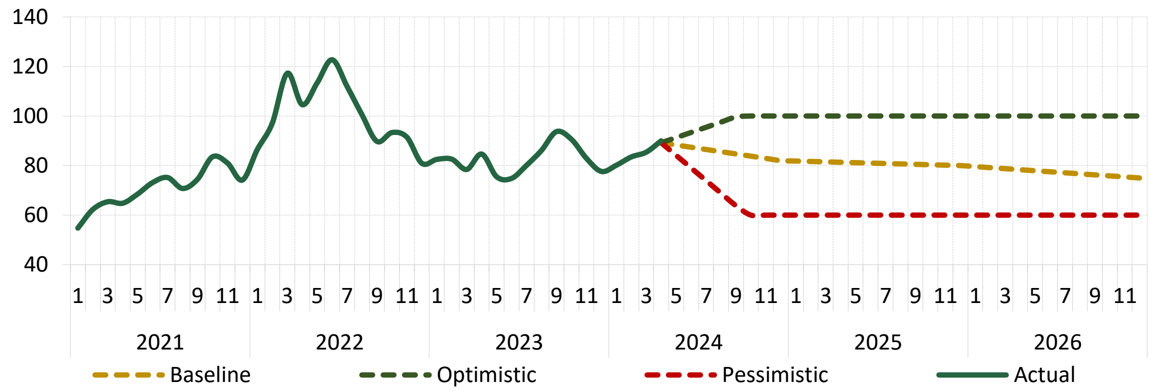
Higher world oil prices, observed since the end of the previous forecast round "February 2024", led to an upward revision of the short-term dynamics of oil prices within the framework of the current forecast round. A decrease in oil supply against the background of the extension of the OPEC+ agreement, as well as the persistence of geopolitical tensions, will help maintain world oil prices at current levels in the short term. Under the baseline scenario, oil prices are expected to stabilize at $85 per barrel on average this year. This will be facilitated by the extension of the agreement on reducing oil production between Saudi Arabia and other OPEC+ countries by 2.2 million barrels until the end of the second quarter of 2024[2]. In the future, oil prices are expected to gradually decrease to $80 per barrel on average in 2025 and to $77.3 per barrel in 2026 due to the expected increase in oil production by non-OPEC+ countries and forecasts of a more moderate development of the global economy.
At the same time, due to the uncertainty of the development of the global economy, in addition to the baseline scenario, alternative scenarios for the dynamics of the world oil price were also considered (Table 1, Graph 3).

Table 1. Forecast Assumptions Regarding the Oil Price*

	2024	2025	2026
Baseline Scenario	**85.0** (80.0)	**80.0** (80.0)	**77.3** (77.0)
Pessimistic Scenario	**74.0** (66.8)	**60.0** (60.0)	**60.0** (60.0)
Optimistic Scenario	**93.0** (91.8)	**100.0** (100.0)	**100.0** (100.0)

Source: NBK computations
** the preceding forecast as part of the "February 2023" forecasting round is shown in the parenthesis*

Graph 3. Scenarios Regarding the Brent Oil Price, US$/BBL



Source: EIA, NBK computations

[2] *https://www.opec.org/opec_web/en/press_room/7305.htm*

1.2. Prospects of economic situation development under the baseline scenario

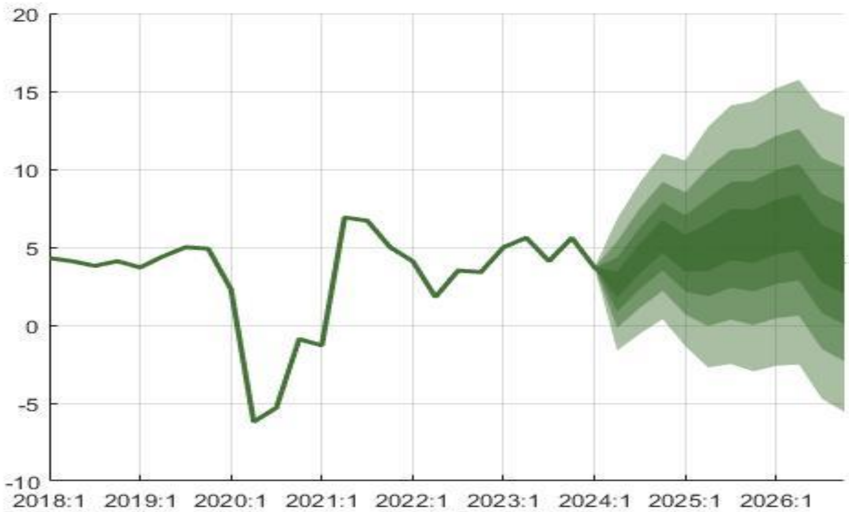
Kazakhstan's GDP growth slowed to 3.7% in the first quarter of 2024. Business activity is expanding in all major sectors of the economy, but weak growth is observed in mining and related investments. GDP growth is projected to be 3.5-4.5% in 2024, 4.8-5.8% in 2025 and 4.9-5.9% in 2026 (Graph 4) (Table 2).

In 2024, domestic demand will be the main source of GDP growth. Household consumption will be supported by the growth of budget expenditures on the social sphere, payments of compensation to flood victims, as well as positive dynamics of wage growth and issuance of consumer loans. Gross capital formation will grow due to the implementation of investment projects in industry, agriculture and other sectors of the economy, due to the modernization of energy and transport infrastructure, as well as due to an increase in the volume of construction works aimed at restoring buildings, structures and residential houses damaged during the spring floods.

Positive dynamics of domestic demand will stimulate the growth of imports, which will have a restraining effect on GDP growth. Positive dynamics of public administration expenditures is also expected, which will be conditioned by the growth of expenditures on salaries of employees and consumption of goods and services. At the same time, exports will show low growth rates due to a slight increase in oil production and grain exports because of a poor harvest in 2023. As a result, **the forecast of economic growth in 2024 is 3.5-4.5%**.

As for economic growth in the following years, it will be **4.8-5.8% and 4.9-5.9% in 2025-2026**, respectively. The decrease in the forecast in 2025 and its increase in 2026 relative to the previous forecast (5.5-6.5% in 2025 and 3.5-4.5% in 2026) is due to the postponement of the implementation of the FGP-WPMP project at TCO from the beginning of 2025 to its second half. In addition to the substantial support to economic growth from the oil sector and the corresponding growth in exports, domestic demand fueled by fiscal stimulus and consumer credit growth will also contribute positively to GDP growth. However, with the planned fiscal consolidation and stabilization of oil production growth, the impact of these factors will weaken, and annual economic growth from the second half of 2026 will tend towards its potential values.

Graph 4. GDP, YoY, %



Source: NBK forecast

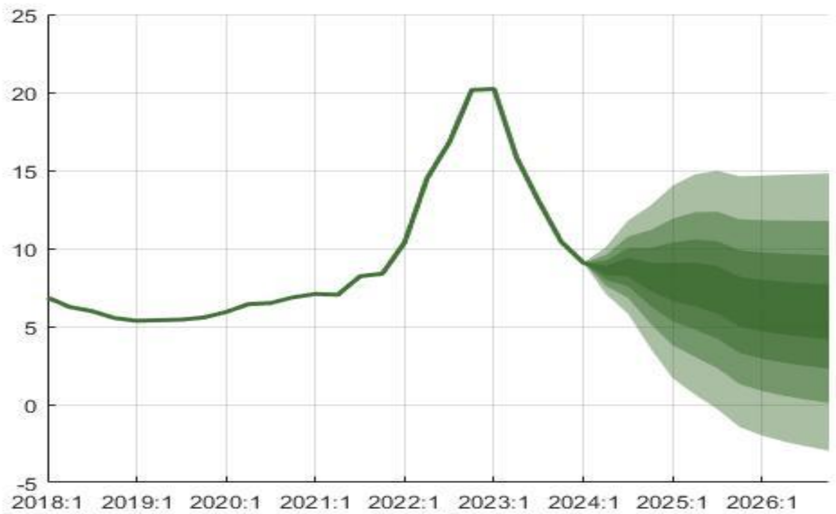
The output gap, defined as the percentage deviation of the actual level of GDP from its potential level, will be in the positive zone during 2024-2025 with a gradual closing by the end of 2026. This is due to the positive dynamics of domestic demand on the back of fiscal stimulus and consumer credit, and exports in 2025-2026 in view of rising oil production. At the same time, in 2026, as the fiscal stimulus is exhausted, the economy will move closer to its potential levels. Thus, the output gap over the forecast horizon will exert mainly pro-inflationary pressures in the economy.

The current dynamics of inflation in the first months of 2024 is developing according to the forecasts of the National Bank. In 2025-2026, inflation will continue to slow down, the assumptions and trajectory of the forecast dynamics have not undergone significant changes. Thus, inflation in 2024 will be 7.5-9.5%, in 2025 – 5.5-7.5%, in 2026 it will approach the target of 5%, forming in the range of 5.0-6.0% (Graph 5) (Table 2).

In 2024, a gradual slowdown in the growth rate of food prices is expected, which will be facilitated by lower prices for producers of food and agricultural products, as well as low growth rates of import prices. At the same time, there are risks of price increases in the food market due to the possible consequences of floods and the likelihood of drought.

The slowdown in inflation will be restrained by pro-inflationary pressures caused by sustained domestic demand for non-food products and market services. The largest price increases are projected in the service sector, largely due to higher tariffs for regulated housing and communal services.

Graph 5. Inflation, YoY, %



Source: NBK Forecast

In 2025-2026 against the background of moderately tight monetary conditions, inflation will continue to slow down and will amount to **5.5-7.5% in 2025 and 5-6% in 2026**. Stabilization of inflation expectations due to moderately tight policy of the NBK, expected reduction of the budget deficit, gradual return of inflation in the countries - trading partners of Kazakhstan to its target values and the general trend of decline in world food prices will contribute to the reduction of inflation in the medium term. At the same time, the growth of tariffs for regulated housing and utility services, positive fiscal impulse, strong consumer lending will prevent a rapid decline in inflation.

Table 2. Projections under the baseline scenario.

	2024	2025	2026
GDP, *YoY, %*	**3.5-4.5** (3.5-4.5)	**4.8-5.8** (5.5-6.5)	**4.9-5.9** (3.5-4.5)
CPI, *Dec. to Dec. of the preceding year, %*	**7.5-9.5** (7.5-9.5)	**5.5-7.5** (5.5-7.5)	**5-6** (5-6)
Brent oil, *in US$/bbl, yearly average*	**85** (80)	**80** (80)	**77** (77)

Source: NBK forecasts

Table 3 (a). Forecasts under the Pessimistic Scenario

	2024	2025	2026
GDP, *YoY, %*	**3-4** (3-4)	**4.3-5.3** (5-6)	**4.9-5.9** (3.5-4.5)
CPI, *Dec. to Dec. of the preceding year, %*	**8-10** (8-10)	**6.5-8.5** (6.5-8.5)	**6-7** (5.5-6.5)
Brent oil, *in US$/bbl, yearly average*	**74**	**60**	**60**

Table 3 (b). Forecasts under the Optimistic Scenario

	2024	2025	2026
GDP, *YoY, %*	**4-5** (4-5)	**5-6** (6-7)	**4.9-5.9** (3,5-4,5)
CPI, *Dec. to Dec. of the preceding year, %*	**7-9** (7-9)	**5-7** (5.0-6.5)	**5-6** (5-6)
Brent oil, *in US$/bbl, yearly average*	**93**	**100**	**100**

Source: NBK forecasts

1.3. Risks in the Medium Term

Compared to the previous forecast round, the aggregate balance of risks is largely unchanged (Graph 6).

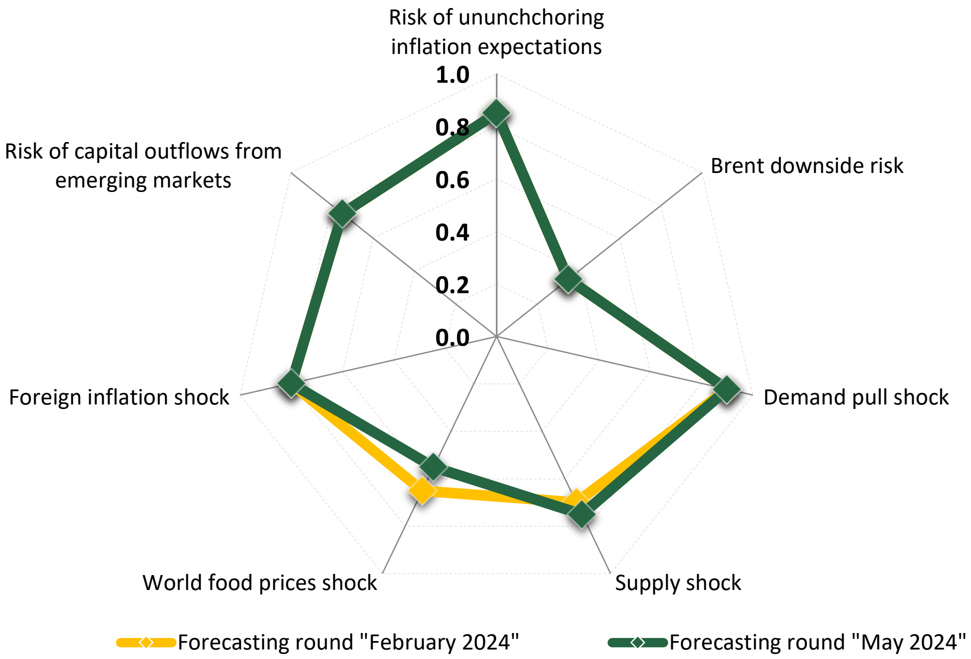
The risk of realization of supply shocks associated with the continuation of reforms in the sphere of regulated prices in Kazakhstan remains high. Given the current collection of taxes to cover state budget expenditures and high non-oil deficit coupled with the need to rebuild the regions affected by the recent floods, the risk of stronger domestic demand fueled by fiscal stimulus is one of the main risks.

The risks of inflation expectations remaining unanchored against the background of their high values and exposure to shocks for certain goods and services (foodstuffs, fuels and lubricants, housing and utilities) remain high as well.

The risk of imports of higher external inflation in the short term also remains, especially from the Russian Federation against the background of high monthly inflation fueled by domestic demand, which exceeds the supply of goods and services. Meanwhile, on the import side of external food prices, despite their expected short-term increase, risks have eased somewhat due to generally downward dynamics and ample global supply. However, risks may intensify in the future against the backdrop of logistical problems in the world due to increased geopolitical tensions and a decline in global harvests on the back of climate change. These external risk factors, together with the effects of an unfavorable harvest in Kazakhstan, could cause food prices to rise more rapidly in the country.

The risk of capital outflows from emerging markets in favor of developed markets remains high. If sustained inflationary pressures persist or even intensify globally, developed market central banks will maintain tight monetary conditions for a longer period of time, which could negatively affect emerging market currencies. In addition, the risk of increased sanctions against trading partner countries remains high.
With regard to GDP, the risks to its forecast are related to uncertainty about oil production levels in the coming years and the parameters of future fiscal policy.

Graph 6. Risk Map Based on the Expert Judgment



Source: NBK computations

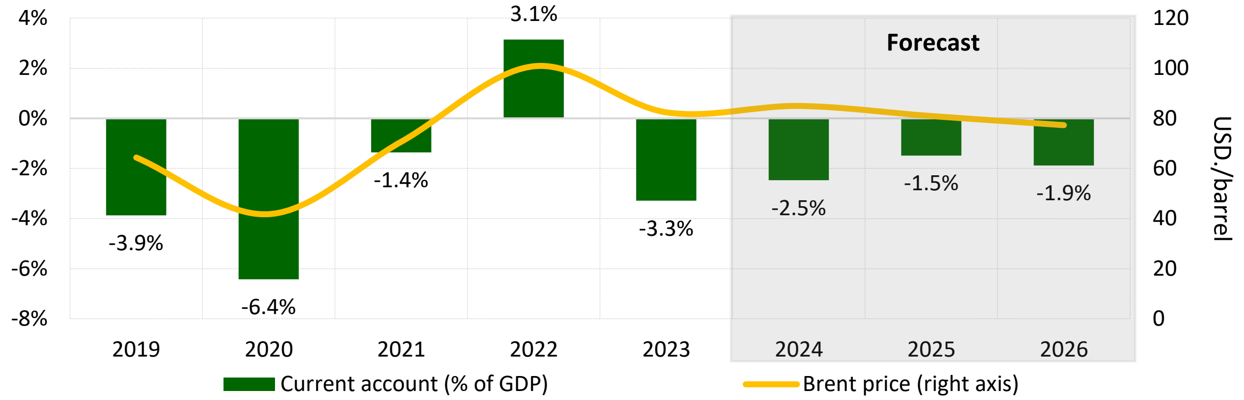
1.4. Forecast of the Current Account of the Balance of Payments

According to the baseline scenario, the current account of the balance of payments will remain in the deficit zone in 2024- 2026. The current account deficit over the next three years will be driven by a gradual projected decline in oil prices and high import volumes.

The projected current account deficit is expected to be at (-)2.5% of GDP in 2024, (-)1.5% of GDP in 2025 and (-)1.9% of GDP in 2026 (Graph 7). The expected dynamics will be determined by the following factors.
Export of goods will continue to depend on oil component. The gradual decline in oil prices to US$77 per barrel in 2026 will be offset by an increase in oil production volumes due to the completion of the TCO's FGP-WPMP project. Non-oil exports will be supported by high projected prices for metals and uranium.
Import of goods will exceed the historical highs observed in 2023, showing moderate growth in the medium term. High volumes of imports will be driven by the insufficiency of domestic production volumes to cover the growing needs of the households and businesses, the high import component in Kazakhstan's production chains, as well as the implementation of government programs and initiatives to support the economy.
The deficit of income balance will remain deep and will continue to follow the dynamics of commodity exports. Despite the decline in oil prices over the forecasting horizon, increased oil production will lead to substantial income payable to foreign direct investors. Accrued interest payable, which reached a historical peak in 2023, will begin to decrease due to the expected reduction in global interest rates in the third quarter of 2024.

The deficit in the balance of services will be maintained due to higher volumes of import of services compared to their exports. Export of services will grow due to the cargo transit through the country and personal travel by non-residents to Kazakhstan. The main driver of growth in import of services will be travel due to a significant increase in the volume of tourist flows abroad.

Graph 7. Current Account of the Balance of Payments



Source: NBK forecast

Box 1. Comparative analysis of the external debt of developing countries

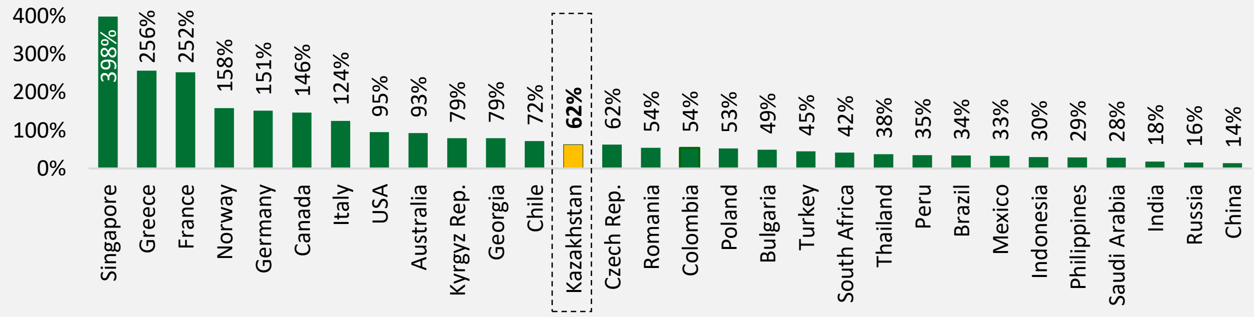
The analysis of external debt (ED) statistics is often accompanied by a negative connotation. However, it is necessary to understand that ED, in addition to direct borrowing, is also a natural consequence of attracting capital from abroad.

At the same time, the optimal level of ED is determined by many factors, including the degree of economic development, macroeconomic stability, investment climate, efficiency and transparency in the expenditure of borrowed funds. There are various metrics for determining the sustainability and optimality of ED. To obtain an objective assessment, it is necessary to consider them together.

One of the most common and simple coefficients is the ratio of **ED to GDP**. The threshold range for this indicator varies from 60% to 100%. At the same time, a high level of the ratio does not always signal financial problems, just as low levels do not guarantee debt sustainability.

For example, at the end of 2023, such developed countries as Singapore (398%), Norway (158%), Germany (151%), Canada (146%), USA (95%) and Australia (93%) have a high ED/GDP ratio (Graph 1). However, this is due to the moderate investment risks given the development of the economic structure, low inflation, currency stability and predictable macroeconomic policy. Conversely, the ED/GDP ratio below the threshold is observed in countries such as Turkey (45%), South Africa (42%), Peru (35%), Brazil (34%), Mexico (33%) and Russia (16%) and may be a consequence of the country's limited attractiveness for investors due to rapid price growth, difficulties in accessing capital markets, sanction risks and other structural problems.

Graph 1. External debt to GDP as of the end of 2023

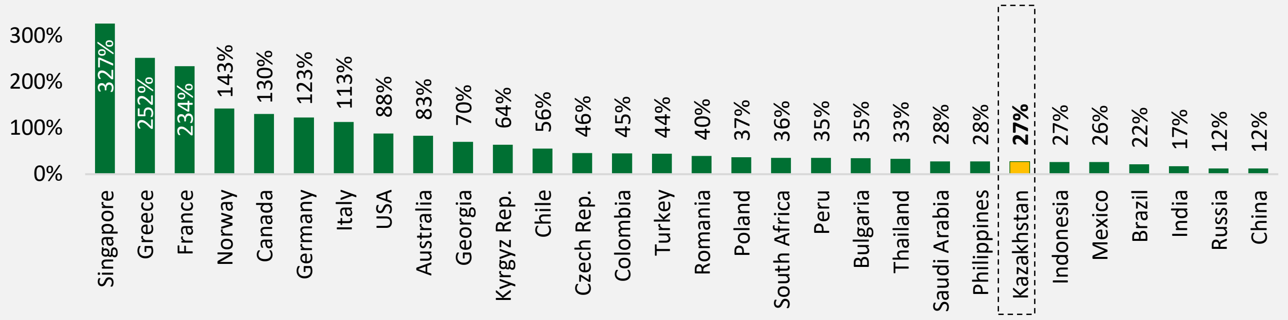


Source: World Bank, IMF, Refinitiv

At the end of 2023, the ED to GDP ratio for Kazakhstan amounted to 62%. However, as for many other developing countries, the most representative indicator of debt sustainability for Kazakhstan is the ratio of **ED excluding intercompany lending (ICL) to GDP**.

ICL is considered the least risky because affiliated direct investors take business risks themselves. In Kazakhstan, about 60% of ED is ICL. Such a significant share is the result of large direct investments in the commodities sector of the economy since the 1990s. As a consequence, at the end of 2023, the ratio excluding ICL to GDP was 27% (Graph 2).

Graph 2. External debt (excluding ICL) to GDP as of the end of 2023

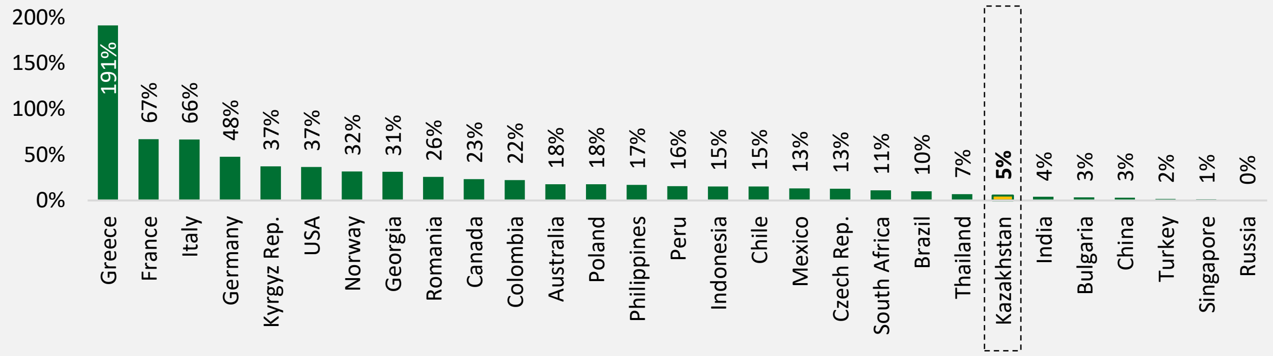


Source: World Bank, IMF, Refinitiv

The significant and viable indicator for assessing the financial stability of the state as a whole is the ratio of **the government sector ED to GDP**. A high value of this indicator may signal the accumulation of imbalances in the economy, the country's vulnerability to external shocks, inefficiency in public financial management and, as a consequence, an increasing risk of default.

Kazakhstan's government sector ED is relatively low compared to other countries and is about 5% (Graph 3). This is lower than the indicators of some developing countries such as Brazil (10%), Saudi Arabia (11%), Mexico (13%), Chile (15%), Colombia (22%), Georgia (31%) and Kyrgyzstan (37%).

Graph 3. The government sector ED to GDP as of the end of 2023



Source: World Bank, IMF, Refinitiv

When assessing the adequacy of government borrowing, the ratio of **the government sector ED to its assets** is also considered. State assets most often include the country's sovereign wealth funds and international reserves. A high value of this indicator points to an insufficient capital buffer to cover sovereign default risk, whereas a low value is an indicator of the state's solvency.

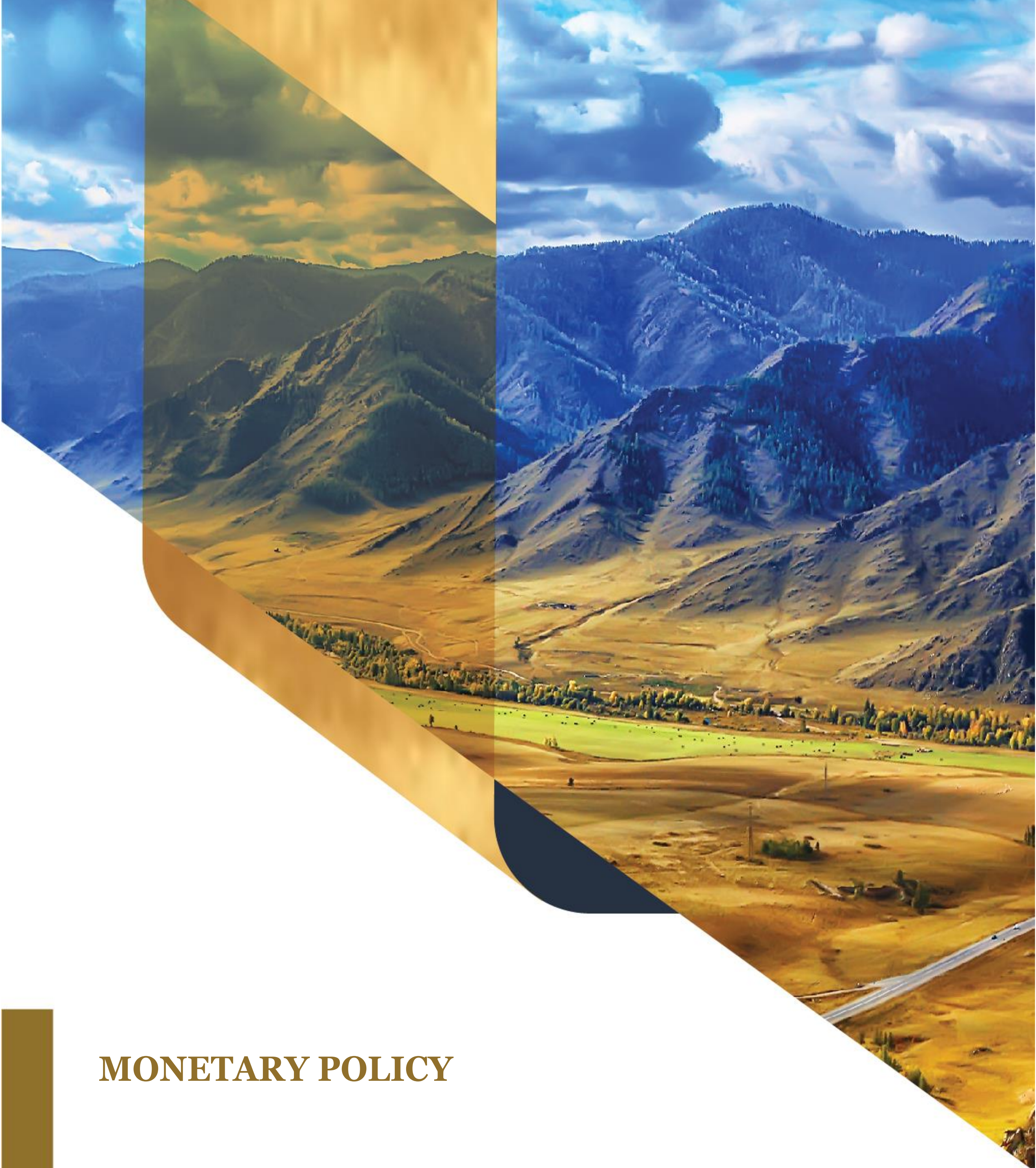
In Kazakhstan, the ratio of the government sector ED to its assets was at a moderate level of 15% in 2023, which is explained by the presence of the NFRK (Graph 4). The value is comparable to Norway (9%), which also has a sovereign oil fund. However, stricter approach to the management and use of sovereign fund resources in Norway makes the ratio optimal for a developed country.

Graph 4. The government sector ED to its assets as of the end of 2023

Source: World Bank, IMF

The total debt of the Government of Kazakhstan amounted to 24.9 tln tenge (20.7% of GDP) at the end of 2023, with 28% allocated to ED. Despite relatively stable indicators, the Government's net financial assets (NFRK assets less the Government's total debt) have been declining recently. For instance, in 2023, the Government's net financial assets amounted to 4.2 tln tenge (3.5% of GDP), compared to 17 tln tenge (32% of GDP) in 2016.

According to the discussed metrics, Kazakhstan’s external debt remains at a relatively acceptable level. However, to ensure economic security and minimize risks of excessive external borrowing, debt management policy should focus not only on quantitative, but also on qualitative parameters. For long-term macroeconomic stability, external borrowing should be spent efficiently, rationally and directed towards prospective projects aimed at economic diversification.



MONETARY POLICY

II. MONETARY POLICY

2.1. Transmission Mechanism of Monetary Policy

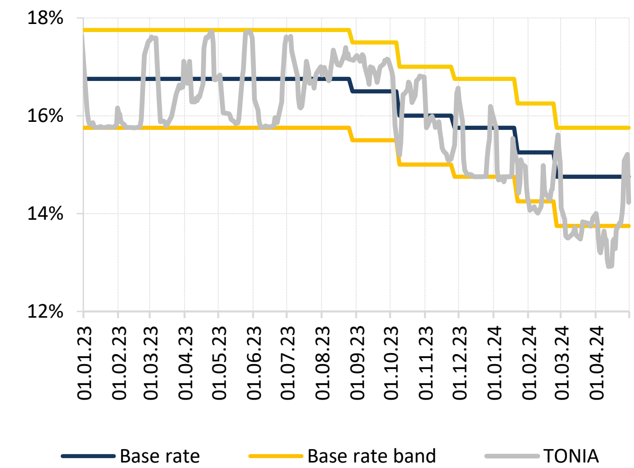
2.1.1. Interest Rate Channel

Monetary conditions continued to be moderately tight amid persistent inflationary risks. A disinflationary impulse is observed through the currency and partially through the interest rate channels. Deposit and loan rates more accurately reflect the signal from the base rate, especially in business lending. The cost of consumer loans remains relatively inelastic to changes in the base rate due to increased availability amid digitalization, high margin consumer lending and preferential mortgage programs. Despite moderately tight monetary policy, there is active business lending growth, and consumption continues to be supported by the expansion of consumer credit.

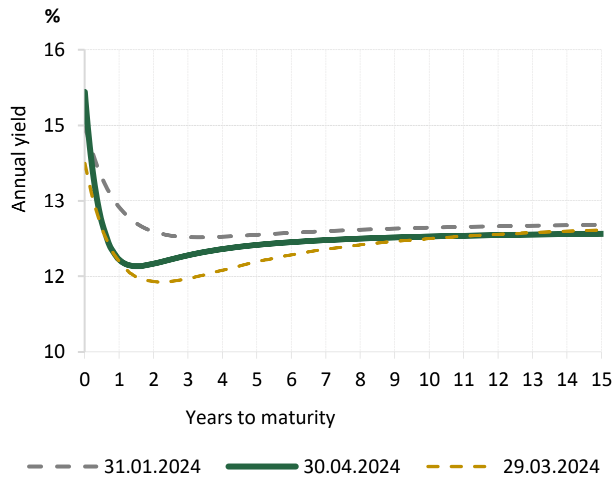
Money market rates are formed below the lower boundary of the National Bank's base rate corridor. Following changes to the NBRK's toolkit, the money market TONIA rate periodically fell outside the base rate corridor (Graph 8). In these conditions, the spread between TONIA and the base rate averaged (-) 0.9 percentage points from February to April this year (February-April 2023 – (-) 0.2 percentage points). The implementation of changes to the toolkit aims for a more market-driven formation of the TONIA rate.

Yields on government securities in the short- and medium-term segments continue to decline, altering the yield curve's shape. Compared to January this year, there was a significant decrease in the yields of government securities with maturities of up to one year. The yield curve for longer-term securities is beginning to take on a standard (normal) shape (Graph 9). In April of this year, compared to March, the curve shifted upward amid the maintenance of the base rate on April 12. Expectations for slower declines in inflation and the base rate are shown in macro surveys. Compared to February, higher expectations for the rate were observed in the surveys conducted in April and May of this year.

Graph 8. Interest Rate Band and TONIA Rate



Graph 9. Risk-Free Yield Curve, %



Source: NBK, KASE

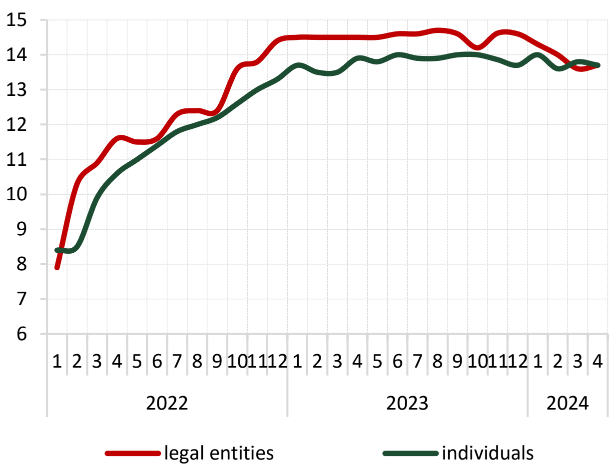
Deposit rates for legal entities decreased following the change in the base rate, while rates for individuals remained almost unchanged. Rates on tenge deposits of legal entities showed a proportional change to the base rate reduction (decrease by 0.9 percentage points since the beginning of this year). Meanwhile, the average yield on retail deposits did not change (Graph 10); however, the dynamics of rates of different maturities were heterogeneous. Rates on medium-term and long-term deposits (from 3 months to 1 year and from 1 year to 5 years), which account for the majority of time deposits (over two-thirds of all attracted deposits of individuals), showed a decrease. In addition to the base rate effect, the rates on retail deposits were influenced by the introduction of a new rate regulation mechanism by the Kazakhstan Deposit Insurance Fund (KDIF)[3], aimed at developing market pricing in the deposit market. According to this mechanism, recommended maximum rates are set only for a certain category of banks most exposed to liquidity risks. At the same time, banks are obliged to pay a systemic risk fee depending on the spread between the bank's rate and the market-weighted average rate.

There is a transmission of changes in the base rate to the cost of business loans. In the first quarter of this year, business loan pricing conditions showed a gradual easing.

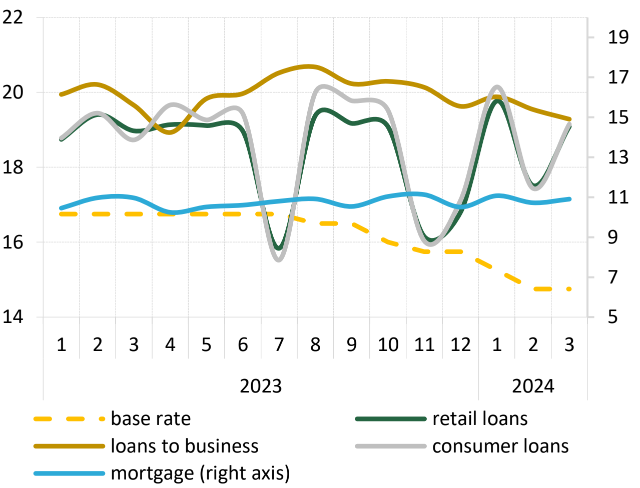
Corporate lending rates. The average weighted rate on business loans in tenge, following the base rate, showed a decrease to 19.3% in March (Graph 11). The easing of lending conditions was mainly observed on loans to medium and large businesses. A survey of banks on lending[4] also confirms the easing of conditions for all business entities due to rate reductions.

Retail lending rates. The high share of installments in the issuance of consumer loans continues to significantly influence the formation of lending rates. This makes them almost inelastic to changes in the base rate - the rate on consumer loans increased from the beginning of the year to 19.2% in March (Graph 11). The mortgage rate did not show significant deviations from the previous level, remaining below the base rate due to the continued high share of preferential programs in the mortgage portfolio of banks.

Graph 10. Deposit Rates in National Currency, %



Graph 11. Lending Rates in National Currency, %



Source: NBK

2.1.2. Credit Channel and Deposits (Wealth Channel)

The credit channel contributed to business activity growth and consumer demand stimulation. In March this year, the banks' loan portfolio maintained high growth rates (by 23.9% yoy) amid accelerated growth in household loans and significant business lending increase (Graph 12).

Household loans, despite maintaining restrictive monetary conditions, continue to grow at high rates, supporting the inflationary impact of consumer demand. The dynamics of mortgage lending, after prolonged growth deceleration, showed signs of recovery in March this year (acceleration to 15.3% y/y) due to the low base effect and the activation of «Otbasy Bank» lending. Growing

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[3] *More information on the KDIF website: https://www.kdif.kz/press-tsentr/press-relizy/s-yanvarya-2024-goda-izmenitsya-regulirovanie-stavok-po-depozitam-fizicheskikh-lits/*
[4] *Bank lending survey for the 1st quarter of 2024: https://nationalbank.kz/en/news/predydushchie-publikacii-opros/rubrics/2213*

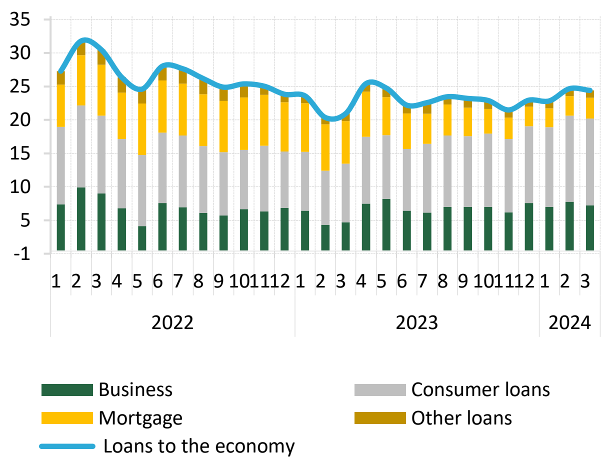
consumer loans (up to 37.9% y/y in March) continue to constrain the disinflationary potential of the base rate amid widespread installments, accelerated digitalization of financial services, and high inflation expectations. At the same time, bank surveys show a decline in demand for auto loans due to the completion of most promotional products, partially subsidized by partner car dealerships.

There is high business lending activity.

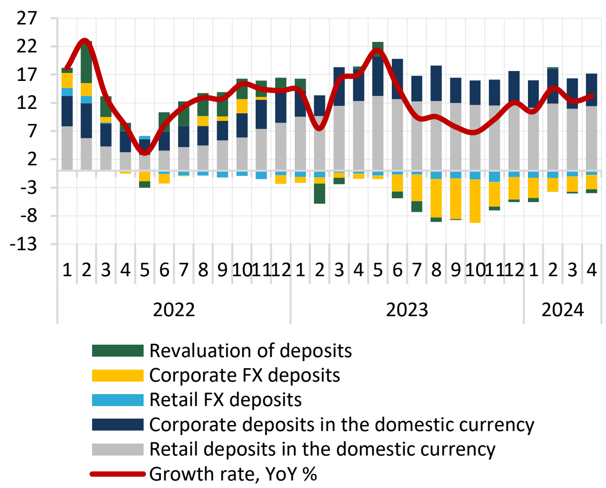
Corporate lending growth remained at a high level (growth of 16.2% y/y in March) due to the expansion of coverage of economic agents with credit products in the context of digitalization, rate reductions, and the resumption of financing within government programs. Overall, positive dynamics were observed in all major sectors of the economy and for all types of business entities. The survey of banks on the credit market showed increased demand for loans from business entities, primarily medium and large businesses.

Increasing savings behavior. Restrictive monetary conditions contributed to the increase in savings of economic agents (deposits in depository organizations) in tenge (Graph 13). The expansion of the tenge deposit base was primarily due to individuals, while deposits from legal entities also showed significant growth. Foreign currency deposits decreased mainly due to the "outflow" of deposits due to low rates.

Graph 12. Loans to the Economy from STBs (portfolio), YoY, %



Graph 13. Resident Deposits in Deposit Organizations, Year-on-Year, %



Source: NBK

Dollarization of deposits continued to decline, reaching historical minimum levels.

The preservation of the downward trend in total dollarization since the beginning of this year was facilitated by its reduction in retail deposits due to the high rate differential between national and foreign currencies, increased confidence in the national currency, and bilateral exchange rate volatility. Dollarization of legal entity deposits in April remained at the level of December 2023.

Box 2. Assessment of the Impact of Lending Volumes on Economic Activity

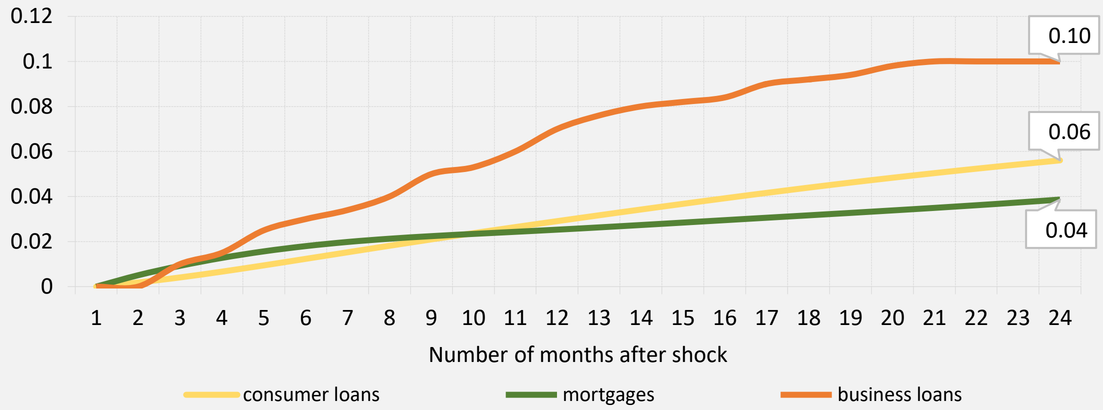
In the context of continuing the analysis of the transmission mechanism (TM) of monetary policy (MP), an assessment was conducted on the impact of lending volumes to businesses and households on economic activity.

In theory, the credit channel is closely linked with the interest rate channel and is one of the main channels in the monetary transmission mechanism in many countries. Low rates stimulate lending volume growth, which contributes to increased investment and consumer demand, ultimately leading to expanded business activity.

For the analysis of TM effectiveness, structural vector autoregression (SVAR) models based on quarterly data from Q3 2009 to Q4 2023 (starting from post-crisis economic development after the global financial crisis) were used. Three models were built for each of the three types of lending: business, mortgage, and consumer. As endogenous variables, the models included volumes of the respective types of lending, their rates, real GDP and the exchange rate of tenge to the US dollar. Brent oil prices were included as an exogenous variable. The inclusion of additional endogenous and exogenous variables in the model was necessary to ensure its structure. Time series were seasonally adjusted (if a formal test indicated seasonality), and strong volatility in the dynamics of indicators was smoothed using the Hodrick-Prescott filter with a unit lambda. The results of the Granger causality test were used as justification for introducing restrictions into the SVAR model. To understand the quantitative assessment of the transmission chain from lending volumes to economic activity, impulse response results were used.

1. Business Lending. Alongside consumer and mortgage lending, the results of the model demonstrate the preservation of moderate positive influence of business lending on real GDP in the short term. Thus, a 1 percentage point increase in business lending leads to a gradual rise in real GDP by 0.10 percentage points within two years after the shock (Graph 1).

Graph 1. Accumulated Impulse Responses of Real GDP to a 1 p.p. Shock in Loan Issuance to Households (separately for consumer and mortgage loans) and Businesses



2. Household Loans. In assessing the impact of the bank lending channel, the separate influence of consumer loans and mortgage loans on economic activity was considered.

2.1. Consumer Loans. The impact of consumer loans on real GDP is due to the stimulation of solvent demand for goods and services, which, in turn, activates aggregate demand. The results of the model show a gradual increase in real GDP in response to a positive shock in consumer lending.

According to impulse responses, a 1 percentage point positive shock in consumer lending results in an accumulated increase in real GDP by 0.06 percentage points within two years after the shock (Graph 1).

2.2. Mortgage Lending. The results of the model on the impact of a shock in mortgage lending show a more pronounced short-term effect on real GDP compared to consumer lending, with the impact becoming weaker compared to consumer lending after the realization of the short-term effect. As a result, a 1 percentage point shock in mortgage lending leads to an accumulated increase in real GDP by 0.04 percentage points within two years after the shock (Graph 1).

The results of the assessments showed that an increase in lending to both businesses and households positively affects economic activity through stimulating investments, increasing consumer demand, and ensuring housing availability.

On the one hand, business loans are used by enterprises for further investment, which in the long run improves the production process and promotes its expansion. Loan funds are spent on purchasing materials, necessary equipment, etc., additionally stimulating the development of other related sectors of the economy, and creating a multiplier effect. Consumer lending, in turn, stimulates demand for goods and services, increasing total production and promoting the active development of small businesses. Mortgage lending directly influences the active development of the construction sector, the growth of which creates jobs, activates activities in sectors related to construction, and generates demand for domestic production. Thus, all types of lending through different channels affect the economic activity of the country.

On the other hand, an increase in borrowed funds in the economy additionally boosts demand for imported goods and real estate, limiting the multiplier effect of increased lending volumes on real GDP growth. Part of the borrowed funds is used to meet consumer demand through imports due to the lack of a full production cycle for many goods in Kazakhstan. Demand for housing leads to increased imports of materials for construction activities. Additionally, the active growth of mortgage lending (including due to rates below the market) results in excess demand and overheating in the real estate market, leading to further housing price increases. As a result, this can lead to increased household expenses on debt servicing and subsequent reductions in disposable income and household welfare.

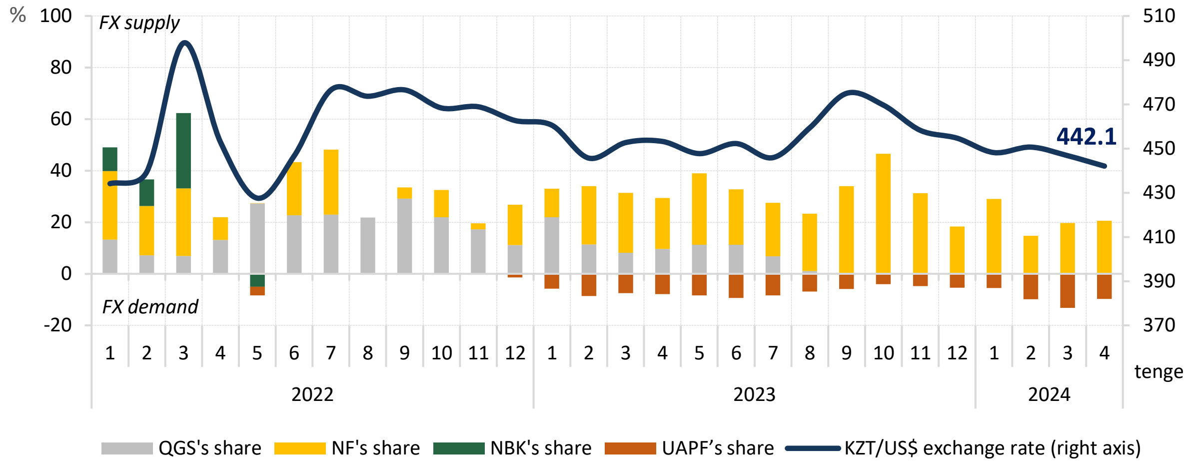
Thus, according to the obtained assessments, a moderate impact of lending volumes on economic growth can be noted. The lack of a "strong" effect is due to the fact that the stimulation of short-term increases in lending volumes is accompanied by subsequent reductions in aggregate demand, rising inflation, reduced housing availability, and increased household expenses on mortgage debt servicing.

2.1.3. Exchange Rate Channel

The exchange rate channel has a restraining effect on inflation.

In January-April 2024, the national currency continued to strengthen against the US dollar by 2.8% amid rising oil prices, currency conversion for transfers to the republican budget, and seasonal decreases in demand for foreign currency in January and February (Graph 14).

Graph 14. Shares of Large Participants in Currency Purchases/ Sales, YoY, %



Source: NBK, KASE

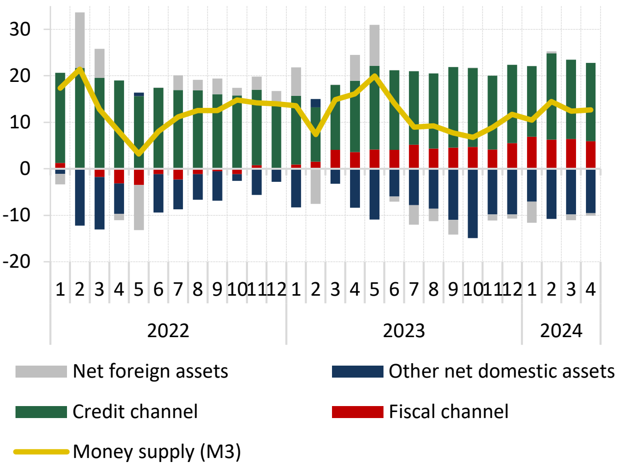
2.2. Money Supply

The tenge money supply continues to grow at high rates due to active lending and budget operations.

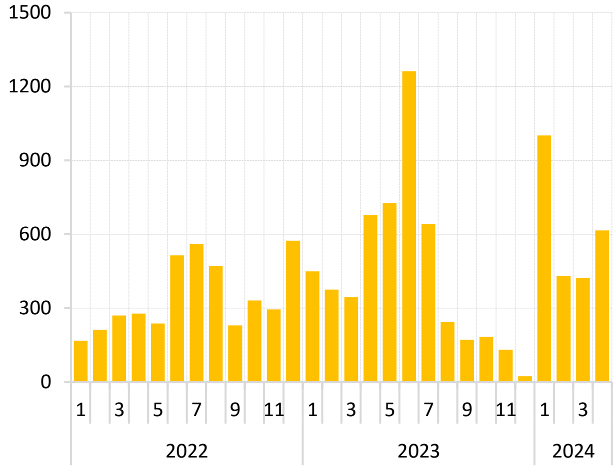
High growth rates of the tenge money supply are maintained (growth of 22.1% y/y in April), while the overall money supply demonstrated more moderate growth (Chart 15).

The expansion of the money supply was mainly provided by lending and significant increases in government borrowing (compared to the previous year) within the framework of budget deficit financing. Thus, the volume of transactions on the primary government securities market in January-April increased year-on-year by 33.6%, with the maximum volume of government securities placement in January of this year, accounting for about 20% of the planned issuance volume for this year. Volumes were more moderate in subsequent months (Chart 16).

Graph 15. Money Supply, Year-on-Year, %



Graph 16. Volume of Transactions on the Primary Government Securities Market, bln tenge



Source: NBK, KASE

MACROECONOMIC CONDITIONS

III. MACROECONOMIC CONDITIONS

3.1. External Sector

Global business activity in manufacturing and services continues to demonstrate resilience to high interest rates and inflation.

Business activity in the services sector continues to expand. In the manufacturing industry, in April 2024, there was a slight slowdown in activity against the background of lower growth rates in new orders, production and employment. An upward impulse is observed in the dynamics of new export orders (see Figure 17). Production in the manufacturing sector continued to decline in the EU. In Russia, despite reaching historical highs, there has been a slowdown in activity in the manufacturing sector. In China business activity has continued to grow at the same pace.

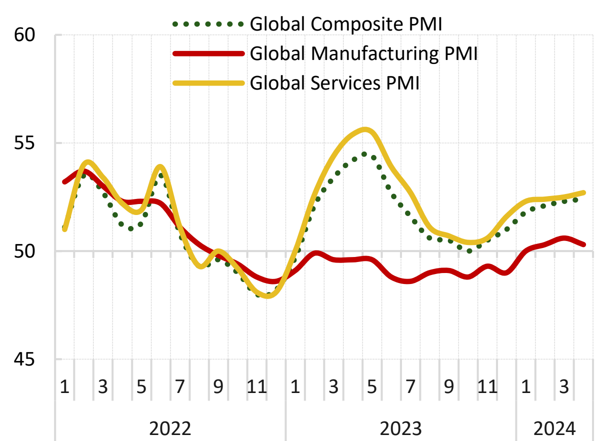
The peak of inflation has been surpassed in many countries. In developed countries services remain the main drivers of price growth, while in developing countries prices tend to rise more uniformly across sectors. Core inflation continues to slow down universally, but it remains above the target.

In March 2024, both in developed and developing countries overall inflation significantly slowed down from the peak levels observed since January 2022. The slowdown is a result of declining energy prices, as well as due to the implementation of tight monetary policy (Figure 18).
In Russia inflation reached 7.7% (y/y) in March 2024, with the highest price growth observed in services and food products. Annual inflation in the EU stood at 2.6%, with services remaining the main drivers of growth. In China weak consumer demand is keeping consumer prices at a low level.

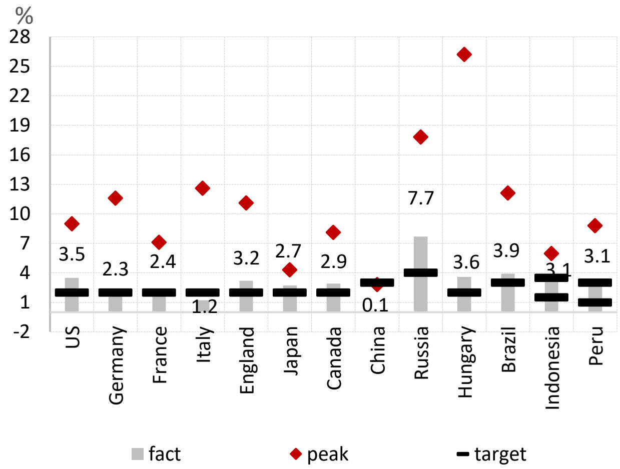
Developed countries are not hastening policy easing, whereas developing countries continue to actively lower rates as inflation approaches or nears target levels.

In April 2024, major central banks around the world kept their rates at consistently high levels. In developing countries policy easing persisted despite the depreciation of their currencies.

Graph 17. Global Business Activity*



Graph 18. Dynamics of inflation by country in March 2024, YoY



Source: PMI by S&P Global, national statistical offices
**The index greater than 50 means the growth of the indicator, less than 50 – its decline, equal to 50 – its invariance*

Since the beginning of 2024, the global oil market has experienced an upward trend. This is largely due to the extension of the agreement by OPEC+ countries to reduce oil production until the end

of the second quarter of this year, coupled with heightened geopolitical tensions in the Middle East.

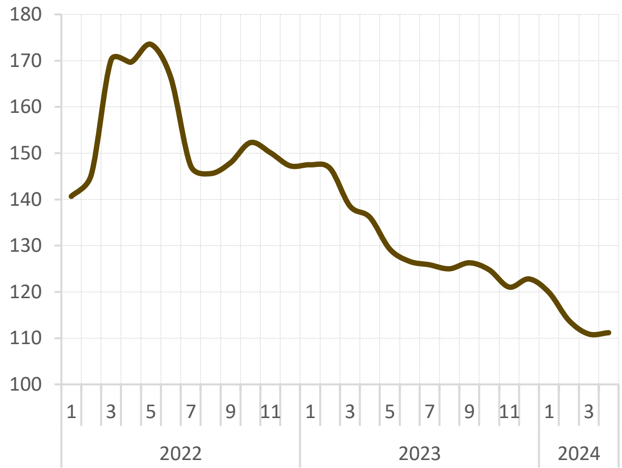
Since the beginning of this year, world prices for Brent crude oil have risen, averaging $90 per barrel in April 2024 (Graph 19). The primary drivers of this price increase include the escalating geopolitical tensions in the Middle East, particularly in the Red Sea region. Additionally, in March 2024, OPEC+ countries extended their agreement for a voluntary reduction in oil production by 2.2 million barrels per day, further boosting Brent oil prices.

Global grain prices declined in the first quarter of 2024 due to a moderate supply of wheat and corn. However, adverse weather conditions in the EU, Russia, and the United States in April led to an increase in world export prices for wheat. Similarly, corn prices rose in April 2024, driven by logistical issues and lower crop expectations in Brazil.

According to the FAO's May report[5], current grain stocks (as of April 2024) are 2.1% higher than last year's levels. Nevertheless, compared to March 2024, grain stocks decreased by 0.5%, primarily due to adverse weather conditions in Russia. Consequently, the FAO cereal index increased by 0.3% m/m in April 2024, despite showing an 18.8% y/y decline (Graph 20).

Graph 19. Dynamics of Brent crude oil prices, $/barrel

Graph 20. FAO Cereal Index, 2014-2016 = 100



Source: EIA, UN FAO

Box 3. Risks of Implementing the "European Green Deal"[6] for Kazakhstan's Economy

The European Union (EU) is one of Kazakhstan's key trading partners. In 2023, EU countries accounted for over 30% of Kazakhstan's total external trade volume and 40.3% of the country's total exports in nominal terms. Mineral products have traditionally dominated Kazakhstan's exports to the EU.

According to data from the Bureau of National Statistics of the Agency for Strategic Planning and Reforms of the Republic of Kazakhstan, in 2023, crude oil and petroleum product exports to the EU amounted to USD 27.7 billion (89% of Kazakhstan's total exports to the EU and 65% of all oil exports). Over the past decade, Kazakhstan's share in the EU's oil imports has steadily increased, except during the post-pandemic period when overall EU oil imports declined. From 2013 to 2022, Kazakhstan's share of EU crude oil imports averaged 7.3% (Graph 1). Notably, Kazakhstan remains a stable trading partner for the EU, supported in part by its logistical infrastructure. A significant portion of oil exports to the EU is transported via the Caspian

[5] *https://www.fao.org/worldfoodsituation/foodpricesindex/ru/*
[6] *The European Green Deal*

Pipeline Consortium (CPC) pipeline. The main recipients of Kazakh oil in the EU are Italy, the Netherlands, and France (Graph 2, Figure 1).

In response to the growing challenges of climate change, the EU developed a Strategy for Decarbonization and Economic Transformation ("European Green Deal") under the European Climate Law, adopted in 2020. To achieve carbon neutrality by 2050, the Strategy plans to implement industrial innovations, revise investment policies in favor of environmentally friendly technologies, and completely phase out the use of hydrocarbons in the energy sector. These measures could impact the development of the global economy by reducing demand for energy resources, thereby posing risks for raw material-exporting countries, including Kazakhstan.

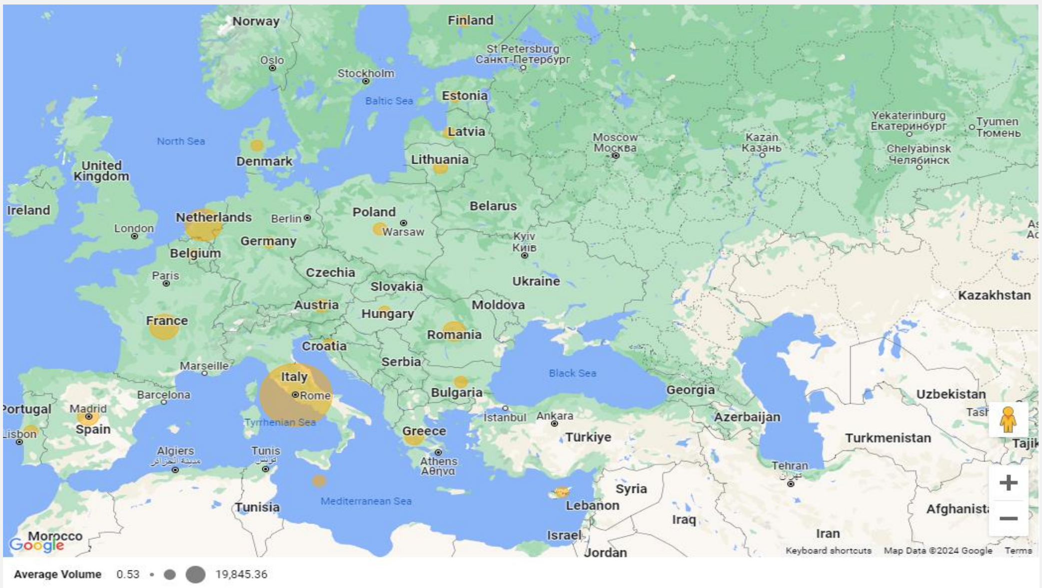
Kazakhstan's economy remains heavily dependent on oil extraction and export. The share of oil revenues in the country's budget averaged over 40% from 2019 to 2023. A decrease in oil and petroleum product sales to the EU due to climate policy changes could reduce Kazakhstan's export revenues and put pressure on the nominal exchange rate if current levels of domestic demand are maintained in the medium to long term. This, in turn, would affect inflation.

Furthermore, changes in the EU's investment strategy could negatively impact investment activity in Kazakhstan. On average, EU countries accounted for 42.6% of gross foreign direct investment in Kazakhstan from 2019 to 2023. The high energy intensity of the production process and the low share of environmentally friendly high value-added goods production in Kazakhstan could reduce the country's investment attractiveness.

In the context of the "European Green Deal," risks to Kazakhstan's economy could materialize in the medium term, not only in the oil sector. Starting from 2026, EU countries plan to introduce cross-border carbon regulation[7] to promote greener industrial production in non-EU countries. The new carbon emissions tax will apply to export products in six industrial sectors (production of ferrous metals and aluminum, cement, fertilizers, hydrogen, and electricity).

These risks necessitate efforts to diversify markets and logistical options for exporting Kazakhstan's products, as well as continued measures to diversify the economic structure to reduce dependence on fluctuations in global prices and demand for raw materials.

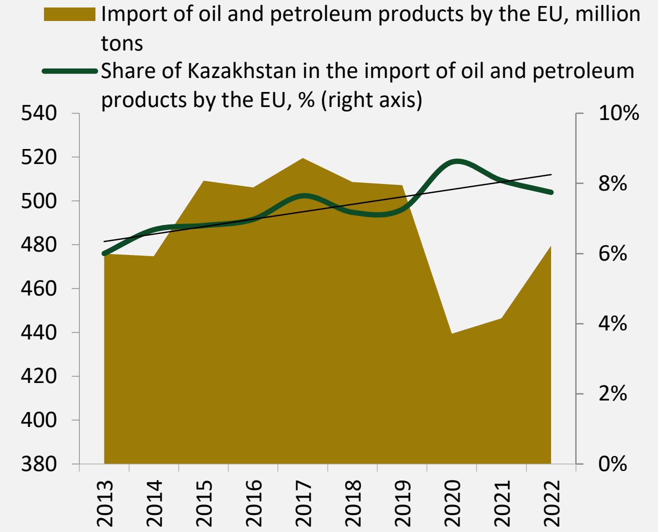
Figure 1. Average Export of Crude Oil and Petroleum Products from Kazakhstan to the EU for 2013-2023, thousand tons



Source: compiled based on data from BNS ASPR

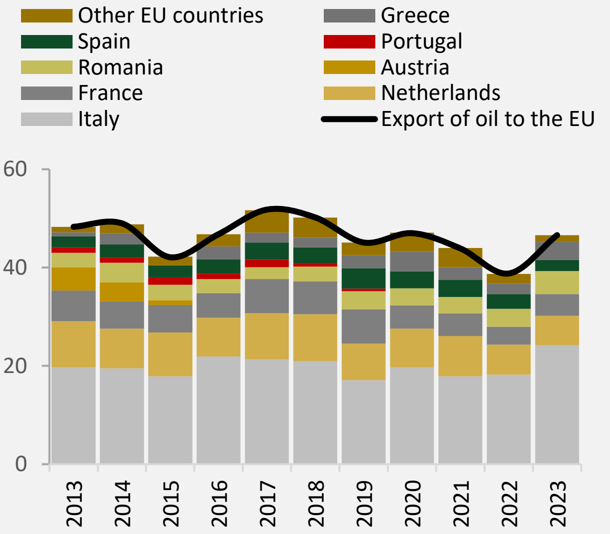
[7] Carbon Border Adjustment Mechanism

Graph 1. Dynamics of Crude Oil and Petroleum Product Imports by EU and Kazakhstan's Share in EU Imports



Source: Eurostat

Graph 2. Dynamics of Crude Oil and Petroleum Product Exports from Kazakhstan to the EU, million tons



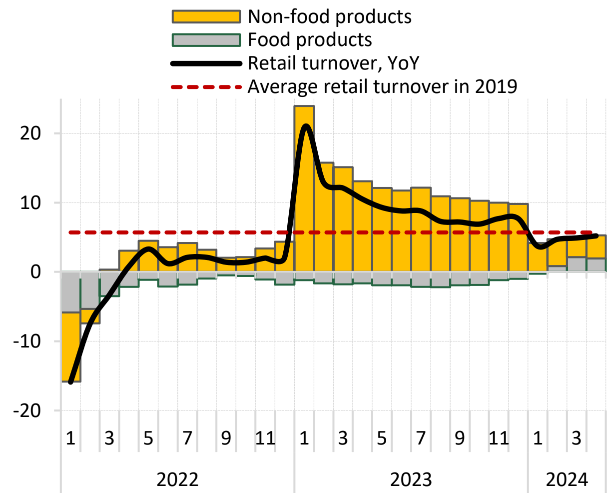
Source: BNS ASPR

3.2. Development of the Domestic Economy

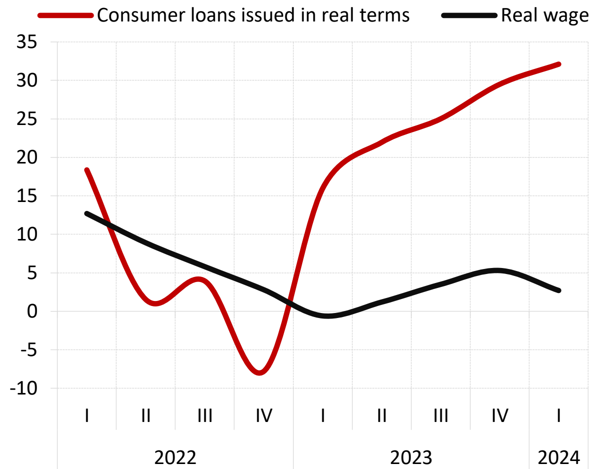
Domestic demand in the economy remains stable. After a sharp increase in 2023, retail turnover growth rates reached pre-pandemic levels in the first quarter of this year.

Retail trade growth in January-April 2024 slowed to 5.2% y/y against the background of a significant slowdown in the volume of sales of non-food products. At the same time, since February of this year, there has been a recovery in retail trade of food products (graph 21).
Consumer demand is supported by the high growth rates of consumer loans and the growth of real wages. Thus, in the first quarter of 2024, real wage growth amounted to 2.7% y/y, consumer lending increased by 32.1% y/y in real terms (graph 22).

Graph 21. Retail turnover, YoY, %



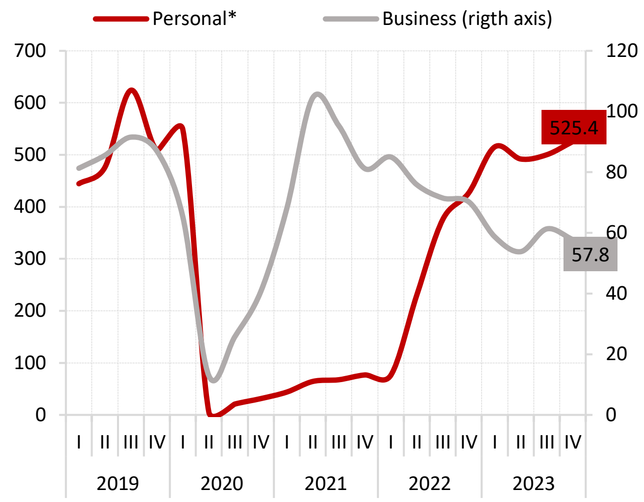
Graph 22. Dynamics of wages and consumer lending, YoY, %



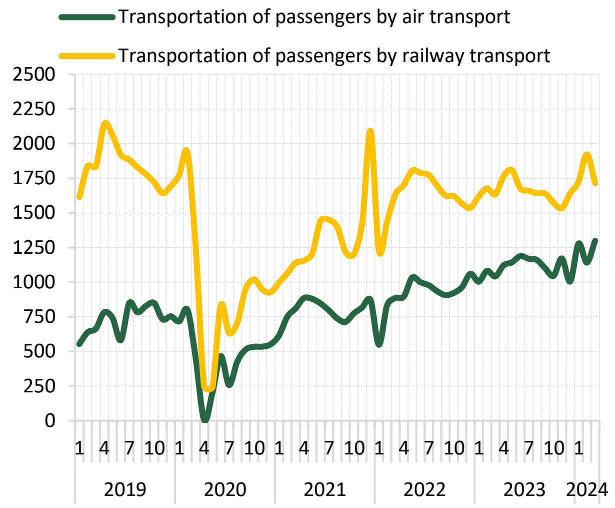
Source: ASPR BNS, NBK calculations

By the end of 2023, there is an increase in exports of services, in particular trips for personal purposes, which may be due to an increase in the flow of tourists to Kazakhstan as a result of easing the visa regime with some countries (graph 23). This also supported consumer demand. The growth in the number of passengers, both by air and by railway transport, continued in the first quarter of 2024, reaching historically maximum number of passengers by air transport (graph 24).

Graph 23. Exports of services (trips), SA, in mln. US Dollars



Graph 24. Number of transported passengers, SA, thsd. people



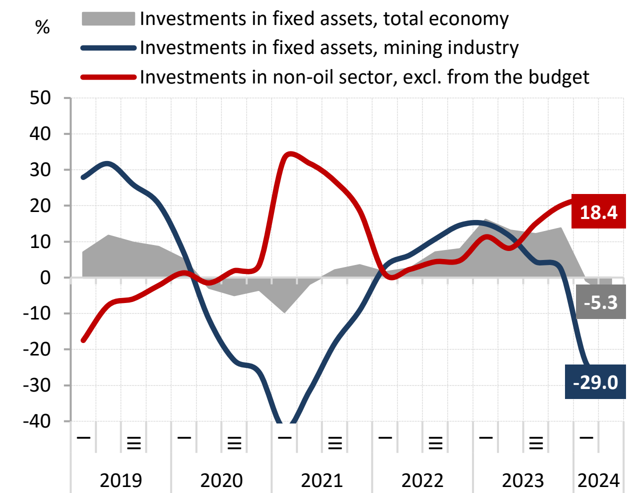
Source: NBK, ASPR BNS

** Personal services include treatment, education and other purposes, including travel*

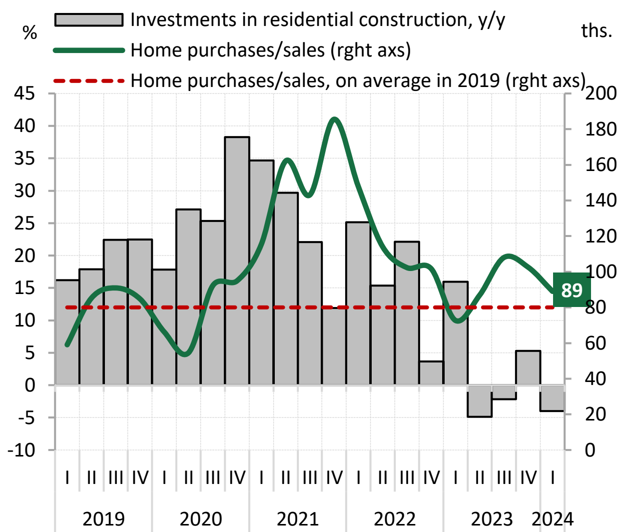
After a significant expansion of investment activity in 2023, there has been a decrease in investment since the beginning of this year, due to a decrease in investment in the mining sector. In the non-oil sector of the economy, the growth of investment activity continued.

In January-April 2024, investments in fixed assets decreased by 5.3% y/y against the background of a decrease in investments in the mining industry as a result of a decrease in the volume of construction work at the Tengiz field (FGP-WPMP). At the same time, investments in the non-oil sector increased, with the exception of investments from the budget (graph 25). High rates of investment growth are observed in transport, manufacturing, supply of electricity, construction, communications, financial and insurance activities, accommodation and food services.

Graph 25. Investments in fixed assets, YoY, % , accumulated total



Graph 26. Investments in Residential Construction and Activity in the Real Estate Market



Source: ASPR BNS, NBK calculations

The structure of the manufacturing industry implements investment projects in the field of oil refining, chemical industry, food production, metallurgy, and mechanical engineering. The increase

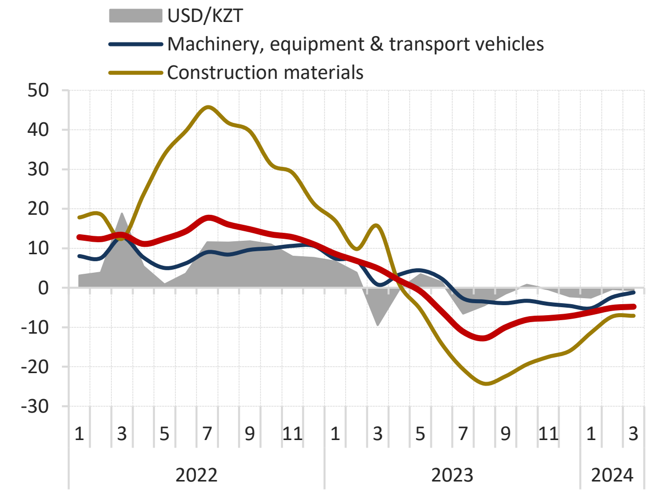
in investments in supply of electricity is due to the continuation of work on the modernization and construction of power station. High investment activity in the transport sector is associated with the repair and construction of railways and highways, the updating of the fleet of wagons, and the construction of airport terminals in some cities. The expansion of investments in fixed assets in the Information and Communication sector is taking place against the background of the implementation of the National Project "Available Internet".
Investments in housing construction decreased in the first quarter of 2024. The population's own funds remain the main source of investment in housing construction, while the share of loans and budget funds remains low. Nevertheless, activity in the housing market (the number of purchase and sale transactions) exceeds the pre-pandemic level (graph 26).

3.3. Production Costs

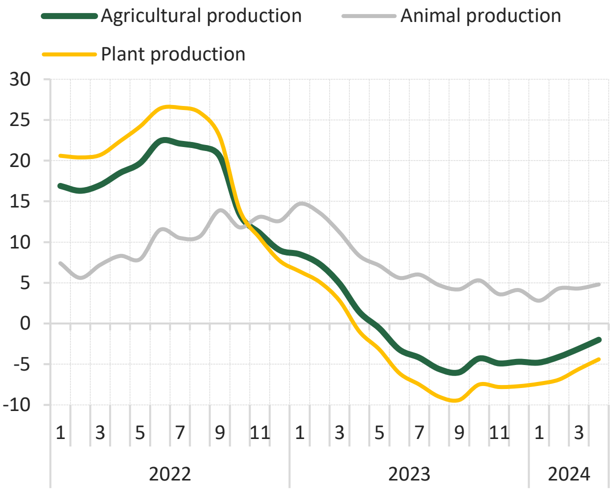
Production costs continue to decline as a result of lower prices for imported products and crop products in annual terms, having a disinflationary effect on the dynamics of consumer prices. At the same time, there is an increase in the cost of storage and warehousing services, as well as utilities, against the background of increased tariffs as part of the implementation of the "Tariff in Exchange for Investment" program.

The decline in import prices continued amid a strengthening tenge exchange rate and slowing global inflation. Import prices for investment and intermediate goods, construction materials and food have decreased, which has a positive effect on domestic production costs. Meanwhile, the rate of contraction is decreasing, which gradually reduces the disinflationary impact on consumer prices from the real sector (Graph 27).
Despite the reduction in grain stocks due to the poor harvest of last year (in the first quarter of 2024, stocks of grain crops decreased by 11.9% y/y, oilseeds – by 24.3% y/y), prices in crop production continued to decline. In April 2024, producer prices for grain crops decreased by 3.0% y/y, oilseeds by 10.5% y/y, and feed crops by 9.1% y/y. Since the end of last year, in some periods there has been a monthly increase in prices for crop products. At the same time, the growth in prices for livestock products accelerated against the backdrop of rising prices for live cattle and poultry (Graph 28).

Graph 27. Import Prices and Nominal Exchange Rate of Tenge to US dollar, %, YoY



Graph 28. Producer Prices in Agriculture, %, YoY



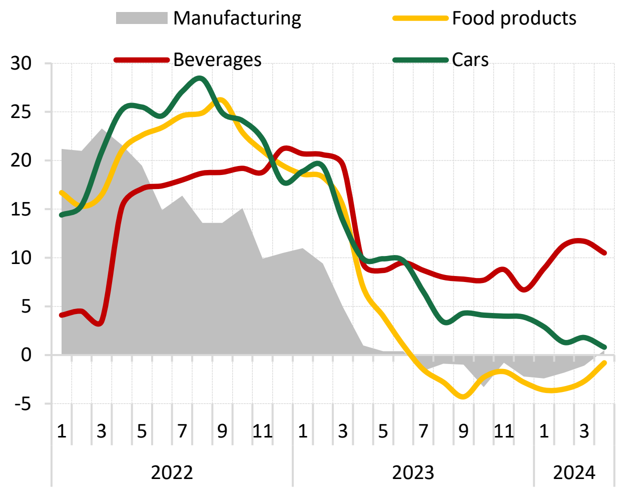
Source: BNS ASPR

Lower prices for raw materials and imported products contributed to lower or slower growth in prices for industrial products. Food producer prices decreased by 0.8% y/y in April of this year. Producer prices for sugar, oils and fats continued to decline, against the backdrop of optimization of the production process as part of the modernization of production facilities. In turn, the production of bakery, pasta and flour products, and confectionery products has become more expensive. Price growth for beverage and automobile producers slowed in April 2024 (Graph 29).

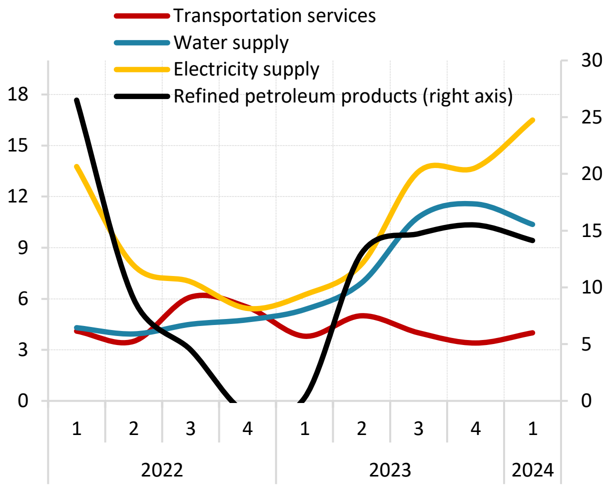
Despite the favorable dynamics of prices for raw materials and supplies, the price of utilities continues to rise, which may put upward pressure on the final cost of manufactured products.

Producer prices for electricity and water supply continued to grow in April of this year, amounting to 17.9% y/y and 10.8% y/y, respectively. The price increase is due to the reform of tariff formation in favor of the modernization of existing thermal communications and water supply networks. Along with this, in the first quarter of 2024 there is an increase in the cost of transport services, including storage and warehousing services. The rise in producer prices for petroleum products continued (Graph 30). The observed rate of growth in prices for storage and warehousing services, including storage of grain, remains high, which also puts additional pressure on production costs.

Graph 29. Producer Prices in the Manufacturing Industry, %, YoY



Graph 30. Manufacturer Prices for Certain Types of Industrial Products and Services, %, YoY



Source: BNS ASPR

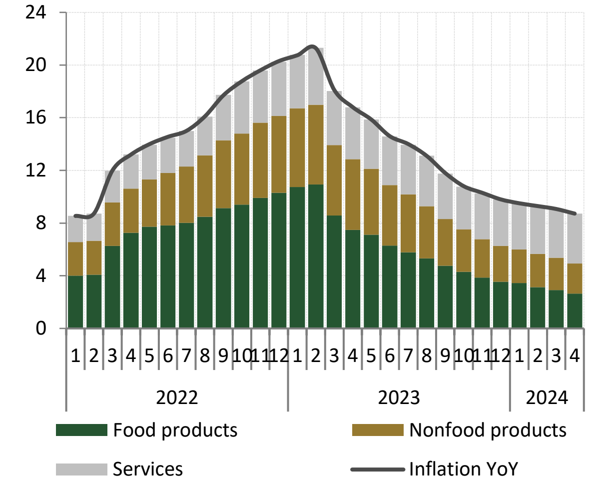
3.4. Inflation

Inflation continued to slowdown, however, pro-inflationary risks associated with the actual and planned increase in tariffs for regulated services remain in the economy. Since the beginning of 2024, the main contribution to inflation has been made by paid services.

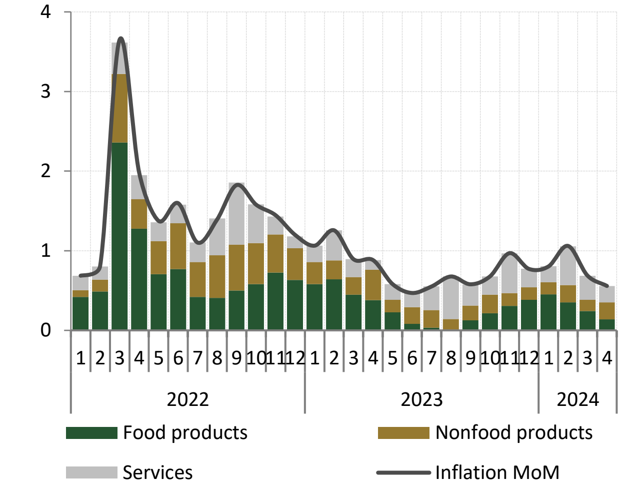
In April 2024, the annual inflation rate slowed to 8.7%. The slowdown occurs against the background of weakening global inflationary pressures and moderately tight monetary conditions. In addition, lower producer prices in manufacturing and agriculture, as well as lower import prices, contributed to the slower growth in consumer prices. In the structure of annual inflation, there is a slowdown in the annual growth rates of prices for all main components of the CPI except for services (Figure 31). The monthly inflation rate slowed to 0.6%, reaching average historical values for April 2017-2021 (Figure 32).

The slowdown in food inflation to 6.3% y/y in April 2024 was due to a decrease in prices for agricultural products and food industry products for Kazakhstani producers. Additionally, this was facilitated by a decrease in import prices for products of plant origin against the background of strengthening of the nominal exchange rate of the tenge. Monthly food inflation slowed to 0.3%, which was due to a decrease in prices for certain vegetables amid an increase in their supply.

Graph 31. Dynamics of YoY inflation and contributions of its main components, % pp.



Graph 32. Dynamics of MoM inflation and contributions of its main components, % pp.



Source: BNS ASPR, NBK calculations

Annual growth in non-food prices also slowed to 7.6% in April 2024. This was facilitated by a decrease in the growth rate of import prices of finished and intermediate goods, which, in turn, led to a decrease in prices for domestic producers of certain non-food products. However, monthly price growth, which slowed in March 2024, accelerated again in April to 0.7%. Upward pressure on prices is exerted by steady demand against the backdrop of a recovery in real wage growth and high growth rates in the issuance of consumer loans.

In April 2024, the service component of inflation accelerated to 13.5% in annual terms. The increase in regulated utility tariffs continues to exert significant pro-inflationary pressure. The accumulated increase in prices for regulated housing and communal services since the beginning of 2024 amounted to 9.9%. In addition, against the backdrop of an increase in the influx of tourists, there is an increase in prices for certain market services, such as catering, hotel services, as well as entertainment and recreation services.

With the food component slowing, estimates of seasonally adjusted and core inflation moved closer to the target inflation rate. At the same time, the growth rates of prices for a significant number of goods and services continue to grow above their historical averages, as well as the target inflation rate.

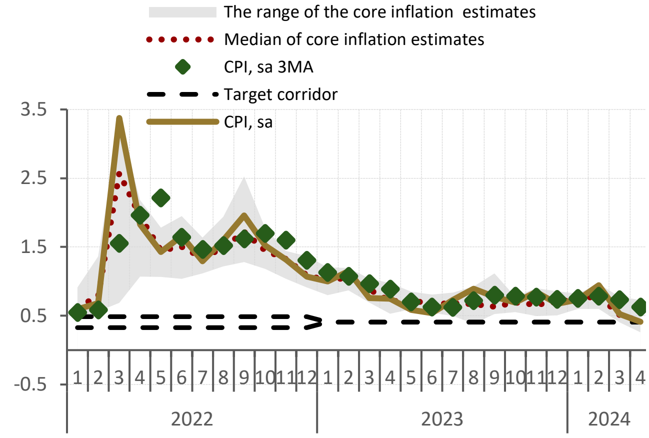
In April 2024, seasonally adjusted three-month smoothed inflation was 0.6%. The three-month smoothed median estimate of seasonally adjusted core inflation was 0.6% (Graph 33).

Despite the general slowdown in core and seasonally adjusted inflation, the rate of price growth for a significant part of goods still significantly exceeds the target value and historical average levels (Figure 34). The slowdown in seasonally adjusted and core inflation was mainly due to lower food price growth, while the non-food and service components of the CPI remain well above target. The annualized value of the seasonally adjusted non-food component was 9.1%, and the service component - 8.8%.

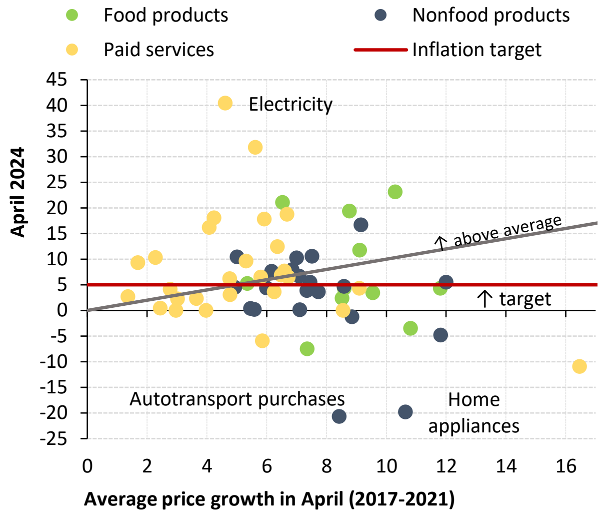
Despite the slowdown in inflation, inflation expectations increased in April 2024.

Inflation expectations of the population remain volatile and sensitive to shocks in certain commodity markets. In April 2024, the median estimate of expected inflation rose to 16.1% after declining since the beginning of the year (Graph 35). A significant share of the population expects prices to rise above the target level in the medium and long term, and 25.1% of respondents expect prices to rise faster than now. The main reasons, according to respondents, include changes in food prices, fuel and lubricants, as well as an increase in wages and pensions.

Graph 33. Seasonally adjusted Consumer Price Index and Core Inflation Estimates, %

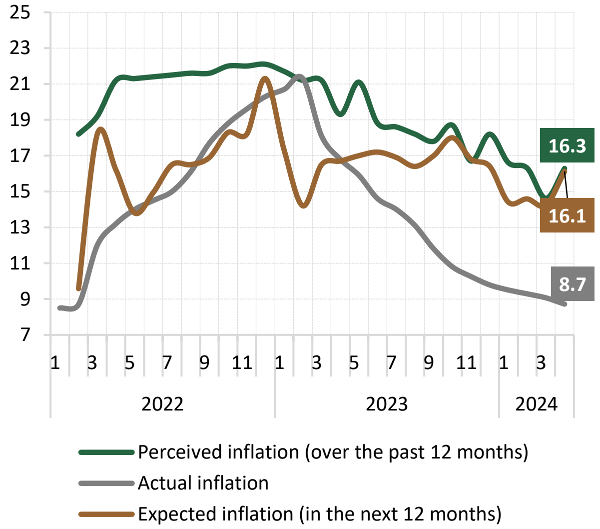


Graph 34. Price growth for various groups of goods, m/m ann. %



Source: BNS ASPR, NBK calculations

Graph 35. Median Estimates of Expected and Perceived Inflation, YoY, %



Source: BNS ASPR, FusionLab: population survey

In April 2024, perceived inflation, after slowing down in previous months, rose again to 16.3%. Despite the slowdown in the food component of inflation, most respondents continue to note a faster increase in food prices. Rising housing and communal services prices are also putting upward pressure on the perception of inflation.

At the same time, in the April responses of respondents, there is a deterioration in assessments of the country's development prospects in the coming year. This is probably due to floods in the regions of Kazakhstan, which have increased the level of uncertainty and expectations of faster price growth.

Box 4. Potential impact of abnormal floods in the regions of Kazakhstan on inflation

Since the beginning of April 2024, most regions of Kazakhstan have been affected by floods. In addition to direct destruction, floods can have a pro-inflationary impact through damage to agriculture. This can manifest itself through damage to infrastructure, decreased soil productivity, the spread of harmful microorganisms and changes in the sowing schedule in certain areas. These risks are especially relevant due to the fact that some of the affected regions – Akmola, Kostanay and North Kazakhstan – account for a large share of wheat production in Kazakhstan (Figure 1).

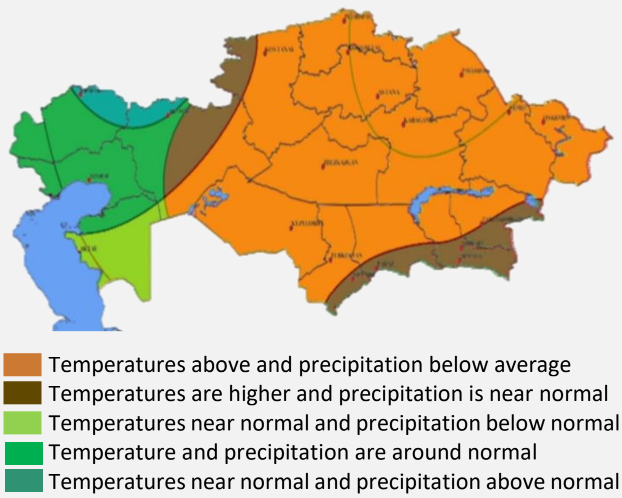
In addition to this, according to the Kazhydromet forecast, unfavorable weather conditions are expected in a number of regions of the country in June this year[8]. Temperatures above normal and precipitation below normal are forecast for most of Kazakhstan. This applies to most grain-producing regions, which creates additional threats to grain harvests and increases pro-inflationary risks (Figure 2).

[8] Seasonal weather forecast for the territory of Kazakhstan for spring and summer 2024 (from April 4)

Figure 1. Map of Floods and grain crop growing areas

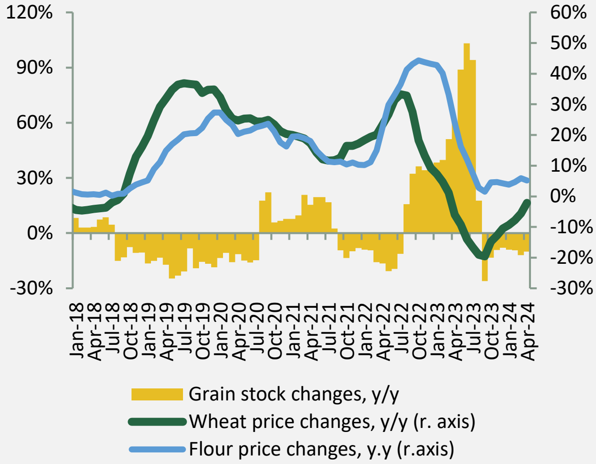
Source: USDA Foreign Agriculture Service, European Civil Protection and Humanitarian Aid Operations

Figure 2. Temperature and precipitation deviations in June 2024



Source: Kazhydromet (April-October forecast 2024.)

Graph 1. Dynamics of changes in grain stocks, prices for wheat and flour



Source: BNS ASPR

It should also be noted that given the results of last year's wheat harvest, the economy may be more vulnerable to the impact of abnormal situations in agriculture. According to BNS data, the gross harvest of grain and legumes in Kazakhstan in 2023 decreased by 22.4% compared to 2022. These trends were also reflected in grain stocks, which in December 2023 were lower than the level of the corresponding period last year by 7.9%, and in April 2024 – by 10.1% (Graph 1).

In 2024, despite the floods, the Ministry of Agriculture announced plans to meet optimal sowing dates and sufficient moisture in the soil[9]. As of May 24, 2024, 45% of the planned areas have been sown. [10]Meanwhile, it is important to take into account all factors for timely adaptation and minimization of potential risks.

[9] Official Information Source of the Prime Minister of the Republic of Kazakhstan
[10] Press center of the Ministry of Agriculture of the Republic of Kazakhstan

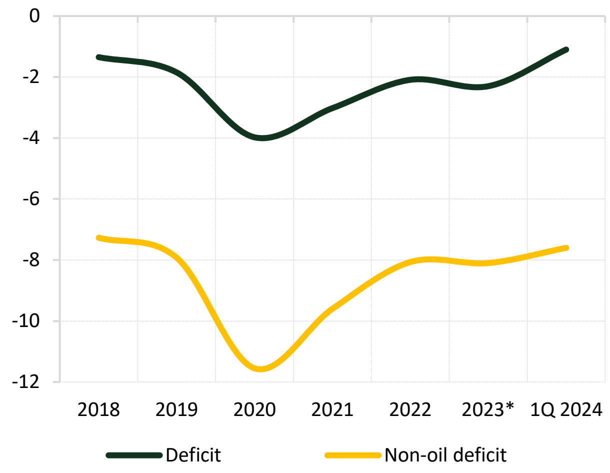
3.5. Fiscal policy

The deviation from the tax collection plan for the republican budget increases the risks of additional fiscal stimulation.

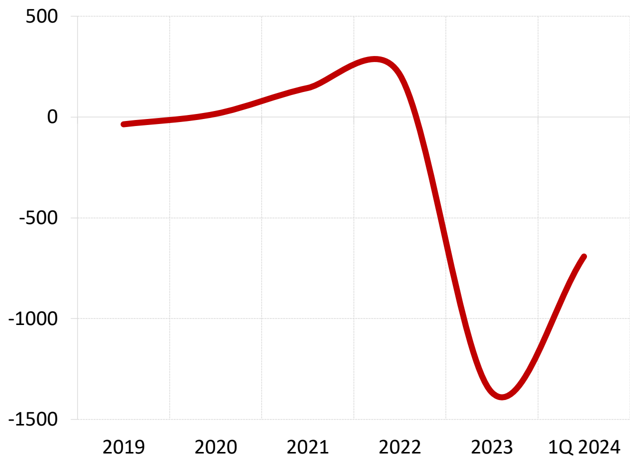
The state budget for the first quarter of 2024 resulted in a deficit of 270 billion tenge (1.1% of GDP), against the backdrop of rising revenues and lower issuance of budget loans, which is 29% lower compared to the same period last year. Both revenues and expenditures grew by 7.6% y/y. Transfers contributed positively to revenue dynamics, increasing by 47.7%. Within the expenditure structure, significant growth was driven by spending on social security and debt servicing. The state budget deficit excluding oil revenues increased to 1.9 trillion tenge (7.6% of GDP) (Graph 36).

In the first quarter of 2024, there was a decrease in tax revenues, particularly in VAT, export customs duties on oil, and corporate income tax from large enterprises, which are allocated to the republican budget. This may be due to advance payments made in the fourth quarter of 2023, as well as a reduction in foreign trade turnover and the strengthening of the tenge against the US dollar. As a result, tax revenue performance in the republican budget for the first quarter of 2024 fell short of the plan, with a deviation of almost 700 billion tenge. It is noteworthy that in 2023, the shortfall in tax revenues for the republican budget amounted to more than 1.3 trillion tenge, which was compensated by the purchase of shares of JSC NC "KazMunayGas" into the National Fund and the payments of dividends of equivalent funds to the Government (Graph 37).

Graph 36. State budget deficit, as % of GDP



Graph 37. Tax performance of the republican budget, billion tenge (+overachievement/-underachievement)



** The purchase of shares of JSC NC "KazMunayGas" in 2023 for the amount of 1.3 trillion tenge was received into the National Fund as dividends in the republican budget, recorded under the article "Non-tax revenues." For analytical purposes, this amount was excluded from the calculation of the non-oil deficit, similar to transfers from the National Fund.*

Source: MF RK, BNS ASPR PK, NBK computations

In the spring of 2024, Kazakhstan experienced unprecedented natural disasters in the form of floods. Funds from the Government's reserve, local executive bodies' budgets, and business contributions will be used to cover compensation for the affected victims. The damage to households and businesses is currently being assessed. Additionally, in 2024, the Government aims to ensure economic growth at the level of 6%. Given the high base from the previous year, achieving this target may require additional fiscal stimulation, which could have an inflationary impact on the economy.

BASIC TERMS AND DEFINITIONS

The base rate is a key monetary policy instrument of the National Bank that allows regulating nominal interbank interest rates in the money market. By establishing the base rate level, the National Bank determines a target value of key interbank money market short-term interest rate to achieve the goal of ensuring the price stability in the medium term.

Gross Fixed Capital Formation is the growth in non-financial assets, which have been used in the process of production for a long time. Gross fixed capital formation includes the following components: a) acquisition, less retirement, of new and existing fixed assets; b) costs for major improvements of tangible produced assets; c) costs for improvement of non-produced tangible assets; d) expenses in connection with the transfer of title for non-incurred costs.

Gross Domestic Product (GDP) is an indicator that reflects the market value of all final goods and services produced during a year in all sectors of the economy within the territory of the country for consumption, exports and saving, irrespective of the national identity of the used production factors.

Reserve Money includes cash issued into circulation by the National Bank, other than cash at the cash departments of the National Bank, transferrable and other deposits of banks, transferrable deposits of non-bank financial organizations and current accounts of government and nongovernment non-financial organizations in the tenge at the National Bank.

Money Supply (M3) is determined on the basis of consolidation of balance sheet accounts of the National Bank and banks. It consists of cash in circulation and transferable and other deposits of non-bank corporate entities – residents and individuals in the national and foreign currency.

Dollarization of the Economy means the situation where a foreign currency (largely – the US dollar) starts to be used for transactions within a country or in certain sectors of its economy, pushing out the national currency from the domestic money turnover, and acting as the means of saving, measure of value and the legal tender.

Inflation is an increase in the overall price level of goods and services. In Kazakhstan, inflation is measured by the consumer price index.

Consumer Price Index is the change over time in the average price level of a fixed basket of goods and services purchased by the population for personal consumption. The consumer basket in Kazakhstan for computation of inflation reflects the structure of household spending and includes goods and services, which have the largest relative share in consumption of the population. The CPI is calculated as the ratio of the cost of a fixed set of goods and services in current prices and its cost in the prices of the preceding (base) period. The index is calculated by the Bureau of National Statistics of the Agency for Strategic Planning and Reforms of the Republic of Kazakhstan.

Inflation Targeting is a monetary policy regime, which is oriented at achieving a target inflation rate.

Reverse Repo is the purchase of a security with the commitment to sell it after a specific period of time and at a specific price. The National Bank conducts reverse repo operations with a view to provide the tenge liquidity to banks against the pledge of securities in accordance with the National Bank's list of collateral. Open Market Operations are regular operations of the National Bank in the form of auctions for liquidity provision or withdrawal in the money market with a view to set interest rates around the base rate.

Standing Facilities refer to monetary policy instruments for adjustment of volumes of liquidity, which resulted from the open market operations. Standing facilities are provided as part of bilateral arrangements where the National Bank is one party to the transaction. Such operations are conducted at the initiative of banks.

Transferrable Deposits refer to all deposits, which: 1) can be converted into cash at face value at any moment in time without any penalties and restrictions; 2) are freely transferable through a check, draft or endorsement orders; and 3) are widely used for making payments. Transferrable deposits represent a part of the narrow money. Other deposits primarily include savings and term deposits that only can be withdrawn on expiration of a certain period of time, or can have different restrictions which make them less convenient for use in the ordinary commercial transactions and, mainly, meet the requirements established for saving vehicles. In addition, other deposits also include non-transferable deposits and deposits denominated in foreign currency.

Potential Output. Reflects the level of output in the economy that can be reached subject to full utilization of inputs and full employment. It reflects the volume of production, which can be manufactured and realized without creating prerequisites for the change in the price growth rates.

Consumer Basket means a sample of goods and services, which characterizes the standard level and the structure of monthly (annual) consumption of an individual or a family. Such sample is used to calculate the minimum subsistence level, based on the cost of the consumer basket in current prices. The consumer basket also serves as a comparative basis for estimated and real consumption levels as well as the basis to determine the purchasing capacity of currencies.

Interest Rate Channel of the Monetary Policy Transmission Mechanism is the transmission mechanism channel, which describes the impact of the central bank on the economy through the interest rate regulation.

Direct Repo is the sale of a security with the commitment to repurchase it after a specific period of time and at a specific price. The National Bank conducts direct repos with a view to withdraw excess liquidity in the tenge.

Free Floating Exchange Rate. According to the IMF's current classification, under the floating exchange rate framework a central bank does not establish any pegs including operating ones for the level or the change in the exchange rate, allowing the exchange rate to be determined by the market factors. In doing so, the central bank reserves the opportunity to periodically influence the domestic foreign exchange market in order to smooth out the volatility of the national currency exchange rate or to prevent its dramatic movements as well as to ensure the financial system stability.

Output Gap is the deviation in GDP expressed as a percentage of a potential output. Expresses the difference between an actual GDP and potential GDP for a certain time interval. Serves as an indicator, which reflects the effectiveness of resources utilized in the country. If an actual output exceeds the potential one (a positive gap), other things remaining equal, the trend of acceleration in the price growth rates would be anticipated because of the overheating of the economy.

Real Exchange Rate refers to a relative price of a commodity produced in two countries: the proportion of commodity exchange between countries. The real exchange rate depends on the nominal rate, on relation between exchange rates of currencies, and prices of goods in the national currencies.

TONIA Rate represents a weighted average interest rate on one-day repo opening transactions made on the stock exchange with government securities in the automatic repo sector.

Monetary Policy Transmission Mechanism is the process, whereby monetary policy instruments influence final macroeconomic indicators such as the economic growth, inflation.

LIST OF KEY ABBREVIATIONS

bp – basis point
BNS ASPR – Bureau of National Statistics of the Agency for Strategic Planning and Reform
GDP – gross domestic product
TEA – types of economic activities
GSs – government securities
EIA – Energy Information Administration
EM – emerging markets
EU – European Union
ECB – European Central Bank
CPI – consumer price index
SRC MF RK – State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan
KASE – Kazakhstan Stock Exchange
KDIF – “Kazakhstan Deposit Insurance Fund” JSC
KSF – “Kazakhstan Sustainability Fund” JSC
NBK – National Bank of the Republic of Kazakhstan
NFRK – National Fund of the Republic of Kazakhstan
OPEC – Organization of Petroleum Exporting Countries
PPE – property, plant and equipment
pp – percentage point
Rosstat – Federal State Statistics Service of the Russian Federation
MAEC – Mangistau Atomic Energy Complex
IMF – International Monetary Fund
MW – minimum wage
bln – billion
mln – million
MNE – Ministry of National Economy of the Republic of Kazakhstan
MF RK – Ministry of Finance of the Republic of Kazakhstan
MED – Ministry of Economic Development of the Russian Federation
FGP/WPMP – Future Growth Project/ Wellhead Pressure Management Project
trln – trillion
thous. – thousand
TCO – Tengizchevroil
CBRF – Central Bank of the Russian Federation
FAO – Food and Agriculture Organization of the United Nations
US Fed – US Federal Reserve System